INFLATION REPORT / I

2010

CNB CZECH NATIONAL BANK

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In 1998, the Czech National Bank switched to direct inflation targeting. In the inflation targeting regime, the central bank's communication with the public plays a significant role. One of the core elements of this communication is the publishing of quarterly Inflation Reports.

The forecast for inflation at the "monetary policy horizon" (about 12–18 months ahead) is of greatest relevance to the decision-making on the current interest rate settings. Section II of the Inflation Report describes economic and monetary developments in the previous quarter, which represent the starting conditions for the forecast for the Czech economy. Section III describes the forecast for the Czech economy as drawn up by the CNB's Monetary and Statistics Department.

The inflation forecast and the assumptions underlying it are published with the aim of making monetary policy as transparent, comprehensible, predictable and therefore credible as possible. The Czech National Bank is convinced that credible monetary policy effectively influences inflation expectations and minimises the costs of maintaining price stability. Maintaining price stability is the Czech National Bank's primary objective.

The forecast is the key, but not the only, input to the Bank Board's decision-making. At its meetings during the quarter, the Bank Board discusses the current forecast and the balance of risks and uncertainties surrounding it. The arrival of new information since the forecast was drawn up and the possibility of asymmetric assessment of the risks of the forecast and divergent views of some board members on the development of the external environment or the linkages between the various indicators within the Czech economy mean that the Bank Board's final decision need not correspond to the message of the forecast. Information on the Bank Board's discussions at the past two meetings and on the reasons for its monetary policy measures in that period is given in the minutes of the Bank Board meetings at the end of this Inflation Report.

The annex to this Inflation Report is a document analysing the current and expected fulfilment of the Maastricht criteria and the degree of economic alignment of the Czech Republic with the euro area. Based on these analyses, the document recommends that the Czech Republic should not set a target date for euro area entry yet and therefore should not to attempt to enter the ERM II during 2010. The document was drawn up by the Ministry of Finance of the Czech Republic and the Czech National Bank, and was approved by the Government of the Czech Republic on 21 December 2009

This Inflation Report was approved by the CNB Bank Board on 11 February 2010 and contains the information available as of 22 January 2009.

Unless stated otherwise, the sources of the data contained in this Inflation Report are the CZSO or the CNB. All the Inflation Reports published to date are available on the CNB website at http://www.cnb.cz/. Underlying data for the tables and charts in the text of this Inflation Report are published at the same internet address.

Chart I.1 Fulfilment of the inflation target
After dropping below zero in October, inflation increased in the remaining months of 2009 Q4 and approached the lower boundary of the 3% inflation-target tolerance band
(annual percentage changes)

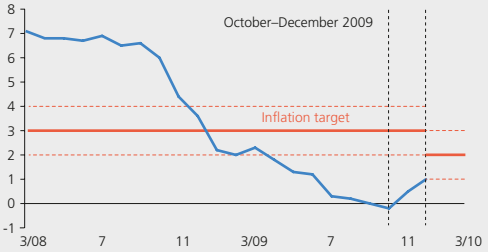


Table I.1 Key macroeconomic indicators
The unemployment rate continues to rise
(annual percentage changes unless otherwise indicated)

	12/08	6/09	7/09	8/09	9/09
Consumer price inflation	3.6	0.0	-0.2	0.5	1.0
Industrial producer price inflation	-0.2	-5.4	-4.6	-2.4	-0.8
Money supply growth (M2)	6.6	4.3	4.1	4.0	-
3M PRIBOR[a)] (in per cent)	3.9	1.9	1.9	1.8	1.6
CZK/EUR exchange rate[a)] (level)	26.11	25.35	25.84	25.83	26.08
CZK/USD exchange rate[a)] (level)	19.48	17.42	17.44	17.32	17.84
State budget balance since January[b)] (CZK bn)	-19.4	-87.3	-138.1	-169.4	-192.4
GDP growth at constant prices[c), d)]	-0.1	-4.1			-
Average nominal wage[c)]	8.1	4.8			-
Unemployment rate[e)] (in per cent)	6.0	8.6	8.5	8.6	9.2

a) average level for the month
b) including SFAOs, end-of-month position
c) figure for the quarter ending with the given month
d) seasonally adjusted
e) registered unemployment (MLSA); end-of-month position

After dropping slightly below zero in October, inflation gradually increased in the remaining months of 2009 Q4. However, it stayed well below the lower boundary of the tolerance band around the 3% inflation target valid until the end of 2009. The year-on-year contraction of the Czech economy moderated in 2009 Q3, and in quarter-on-quarter terms the economy grew by almost 1%. The Bank Board lowered the repo rate by 0.25 percentage point in December. The current forecast expects the decline in economic activity in 2009 to switch to modest growth in Q1, although a more pronounced recovery can be expected only in 2011. Inflation will gradually rise during 2010, getting just above the new inflation target of 2% in the second half of the year as a result of tax changes. At the monetary policy horizon, i.e. in 2011 H1, headline inflation will be close to the inflation target. Consistent with the forecast is stability of short-term interest rates close to current levels in the first half of this year and a gradual rise in rates thereafter. At its meeting in February the Bank Board assessed the risks of the forecast as being balanced and decided unanimously to leave the monetary interest rates unchanged.

The monetary policy decision-making of the CNB Bank Board in 2009 Q4 was based on the inflation forecast published in the previous Inflation Report. At the monetary policy horizon, headline inflation was expected, according to this forecast, to be just above the 2% inflation target, and monetary policy-relevant inflation was expected to gradually approach this target from below. Consistent with the baseline scenario of the forecast and its assumptions was a decline in market interest rates in 2009 followed by a gradual rise this year.

At its November meeting, the Bank Board voted by a slim majority to leave monetary policy interest rates unchanged. The forecast had assumed that rates would come down, but the Bank Board viewed the risks of the baseline forecast scenario as being slightly inflationary. Most emphasis was put on the uncertainty surrounding potential output and the depreciation of the exchange rate at the time the forecast had been prepared, including the possibility of a further depreciation due to uncertainty about domestic economic activity and public finances going forward. At its meeting in December, the Bank Board decided by a narrow majority vote to lower monetary policy rates by 0.25 percentage point, except for the discount rate, which was left unchanged at 0.25%. The two-week repo rate was thus set at 1% with effect from 17 December 2009.

Money market interest rates declined by roughly 0.3 percentage point at all maturities during 2009 Q4. Rates with shorter maturities fell mainly in response to the lowering of monetary policy interest rates in mid-December. Rates with longer maturities started falling before monetary policy rates were lowered and declined further the day after the cut was announced. Market rates were flat in the following period.

The koruna depreciated against the euro in 2009 Q4. At the end of December it was roughly 5% weaker than at the end of September. Against the dollar, the koruna depreciated by around 7% in the same period. During January, the koruna appreciated slightly against the euro. The koruna's exchange rate continued to be affected mainly by external factors and to a lesser extent by the decline in domestic interest rates. Developments in the domestic economy affected the exchange rate only slightly.

An almost 1% quarter-on-quarter rise in GDP in 2009 Q3 confirmed that the contraction phase of the Czech economy had been overcome. GDP continued declining year on year, but at a slower pace than in 2009 H1. This was due mainly to foreign trade, whose negative contribution to GDP growth

virtually disappeared in Q3. In contrast to the previous quarter, the decline in output was almost exclusively a result of falling gross capital formation. Final consumption continued to have a pro-growth effect. Within final consumption, however, the contribution of households continued to weaken while that of government consumption strengthened. Despite improving somewhat, the latest available data on developments in industry and construction are still indicating that the recovery of the Czech economy will be only moderate and gradual.

As expected, the labour market saw continued adverse tendencies. Amid low labour demand, the annual decline in employment deepened further and the unemployment rate increased in 2009 Q3. The number of unemployed persons per vacancy reached a historical high. Average nominal wage growth increased noticeably in Q3, largely because of a lower sickness rate and changes in the employment structure. However, growth in the wage cost-output ratio slowed, owing mainly to falling employment.

Inflation rose in 2009 Q4. After dropping into negative values in October, it gradually increased again in the remaining months of Q4. This increase was mainly due to a sharp rise in fuel prices, which had previously been falling. Actual inflation was 0.3 percentage point higher on average in 2009 Q4 than forecasted in the previous Inflation Report. This difference was due equally to faster-than-expected growth in regulated prices and fuel prices and a more moderate decrease in adjusted inflation excluding fuels.

Section III of this Inflation Report describes the CNB's latest forecast, which takes into account new information obtained since the previous forecast was drawn up. The anti-inflationary effect of import prices compared to the assessment of the previous forecast slightly strengthened owing to greater pass-through of the past appreciation of the exchange rate of the koruna and low inflation abroad. There are no apparent inflation pressures from the domestic economy. From the future perspective, however, the overall macroeconomic conditions are slightly inflationary, mainly because of the expected future return of producers' currently narrow margins to the long-term level.

Headline inflation will rise during 2010 H1, getting just above the CNB's target of 2% in the second half of the year as a result of tax changes. This increase will be due in large measure to the first-round effects of changes to indirect taxes linked with the package of measures adopted to reduce the state budget deficit; their effect will gradually disappear in 2011 H1. At the monetary policy horizon, i.e. in 2011 H1, headline inflation will thus be close to the CNB's inflation target (see Chart I.2).

Monetary-policy relevant inflation, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, on which interest rate decision-making is based, will be below headline inflation from the start of this year owing to the aforementioned increases in indirect taxes. It will thus approach the CNB's target from below over the monetary policy horizon.

The forecast assumes that the contraction of the Czech economy recorded in 2009 will be replaced by modest annual growth in 2010 Q1, although this will slow as the year progresses owing to subdued household consumption, a renewed slowdown in euro area growth and the unwinding of the pro-growth effect of some anti-crisis measures in the Czech Republic and abroad. In 2011, a stronger recovery in external demand will lead to a rise in growth in domestic economic activity (see Chart I.3).

Chart I.2 The headline inflation forecast

Headline inflation will rise, getting just above the CNB's target in 2010 H2 as a result of tax changes

(annual percentage changes)

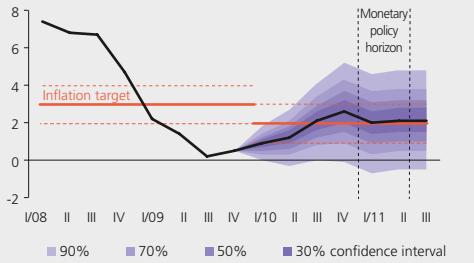


Chart I.3 The GDP growth forecast

Annual GDP growth will turn positive in 2010 Q1

(annual percentage changes; seasonally adjusted)

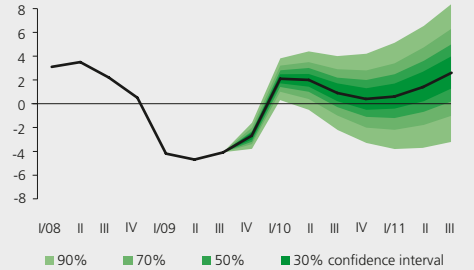


Chart I.4 The interest rate forecast

Consistent with the forecast is stability of short-term interest rates close to current levels in 2010 H1 and a gradual rise in rates thereafter

(3M PRIBOR, %)

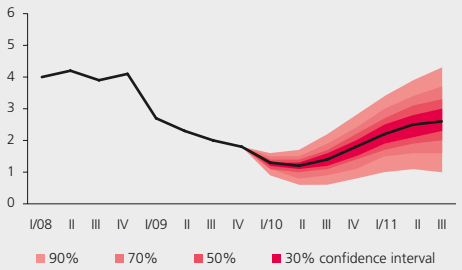
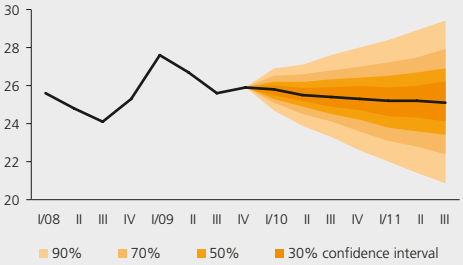


Chart I.5 The exchange rate forecast

The nominal exchange rate of the koruna is gradually appreciating over the forecast horizon

(CZK/EUR)



Consistent with the forecast is stability of short-term interest rates close to current levels in the first half of this year and a gradual rise in rates thereafter (see Chart I.4). The nominal exchange rate of the koruna is gradually appreciating over the forecast horizon, mainly because of a slightly positive interest rate differential and a growing output balance surplus (see Chart I.5).

At its meeting in February, the Bank Board assessed the risks of the forecast as being broadly balanced. Marked asymmetric risks had not been identified, but there is a bidirectional uncertainty regarding nominal wage developments. The Bank Board decided unanimously to leave the monetary interest rates unchanged.

The annex to this Inflation Report is the full version of the *Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area*. This document, which the CNB was involved in preparing, was approved by the Government of the Czech Republic on 21 December 2009. The aim of the document is to inform the Government every year about the current and expected fulfilment of the Maastricht criteria and the degree of alignment of the Czech economy with the euro area economy. The latest assessment resulted in a recommendation not to set a target date for euro area entry yet and therefore not to attempt to enter the ERM II during 2010. The main obstacle is persisting problems in the public finance area.

II.1 THE EXTERNAL ENVIRONMENT

The annual decline in GDP in the USA and the euro area slowed in 2009 Q3 and their GDP rose quarter on quarter. Annual inflation returned to positive values at the end of 2009, mainly because of rising energy prices. The exchange rate of the dollar against the euro depreciated in Q4, but firmed in January 2010 to USD 1.41/EUR. The price of Brent crude oil fluctuated between USD 70 and 80 a barrel in Q4 and January 2010, rising on average by 10% compared to Q3.

The annual decline in US GDP slowed to 2.6% in 2009 Q3 from 3.8% in the previous quarter (see Chart II.1). The decline in consumption and investment eased and net exports improved. In Q3, following four quarters of quarter-on-quarter decline, GDP started rising again (by 0.6%) thanks to growth in all components of domestic demand. A further slowdown in the annual decline and continued quarter-on-quarter growth is expected for Q4, but it is uncertain whether the acceleration will continue. The year-on-year decline in industrial production decreased to 4.7% from 10% in Q3, but the average month-on-month growth fell by almost half (from 0.9% to 0.5%). The goods and services balance worsened by USD 8 billion in October and November relative to the previous quarter. By contrast, production capacity utilisation has been increasing every month since May, and retail turnover recorded year-on-year growth again in November, with its average month-on-month growth going up compared to Q3. The unemployment rate stopped rising during Q4 and was flat at 10% in December. It rose by 2.5 percentage points compared to the previous year. The price of Brent crude oil (see Chart II.2) fluctuated between USD 70 and 80 a barrel in Q4 and January 2010, rising on average by 10% (by USD 7 to USD 75 a barrel) compared to Q3.

Consumer price inflation in the USA (see Chart II.1) returned to growth of 1.9% year on year in November for the first time since February 2009. In December it rose to 2.8%, mainly because of a sharp rise in energy prices. At its meetings in November and December, the Fed left its key interest rate unchanged at 0–0.25% and indicated that it would leave the rate at this level for an extended period. Thanks to the improved functioning of the financial markets, during the first half of 2009 the Fed will limit the individual unconventional monetary policy measures (see Box 1 *Exit strategies from unconventional monetary policy measures planned by selected central banks*) which it put in place during autumn 2008 and spring 2009 with the aim of reducing the impacts of the financial crisis on the US financial system and economy. As from the start of Q4 the exchange rate of the dollar (see Chart II.3) against the euro gradually depreciated to USD 1.51/EUR, but in the first half of December it appreciated rapidly to USD 1.43/EUR. In mid-January, the dollar started to appreciate slightly again to USD 1.41/EUR as a result of reports about the Greek state budget deficit.

The annual decline in GDP in the euro area (see Chart II.4) slowed to 4% in 2009 Q3 from 4.8% in Q2. Apart from steadily growing government consumption, the negative contribution of the other components of domestic demand remained broadly unchanged. By contrast, net exports improved. GDP increased by 0.4% quarter on quarter following five quarters of decline. Growth in inventories and government consumption contributed most to this increase. A further slowdown in the year-on-year contraction of economic activity and continued quarter-on-quarter growth is expected for 2009 Q4. The data available on industrial production, industrial orders and retail turnover for this quarter, however, indicate that the quarter-on-quarter GDP growth rate will not increase.

Chart II.1 GDP and inflation in the USA
The annual decline in US GDP slowed in 2009 Q3 and inflation increased sharply in Q4
(annual percentage changes)

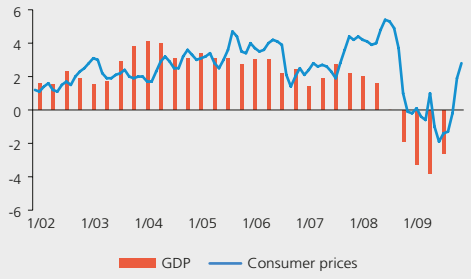


Chart II.2 Brent and Ural crude oil prices
The average price of Brent crude oil rose by 10% in 2009 Q4 and January 2010 compared to the previous quarter
(USD/barrel)

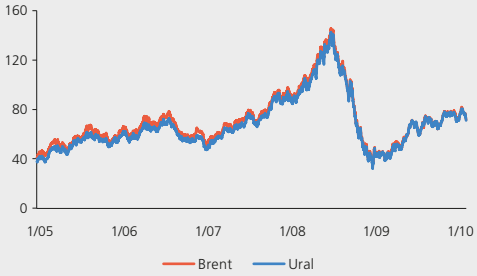


Chart II.3 The dollar-euro exchange rate
The exchange rate of the dollar initially depreciated, reaching USD 1.51/EUR at the end of November, but firmed in January 2010 to USD 1.41/EUR

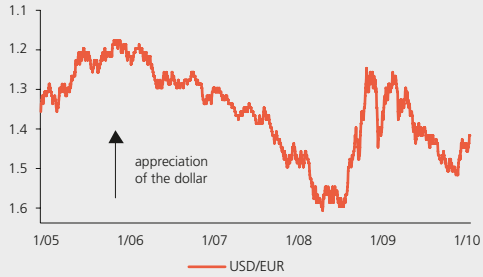
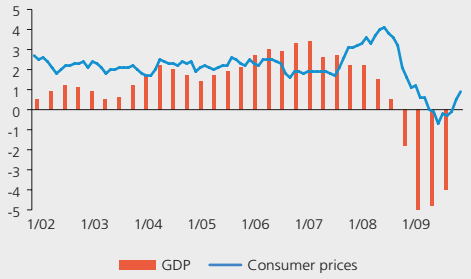
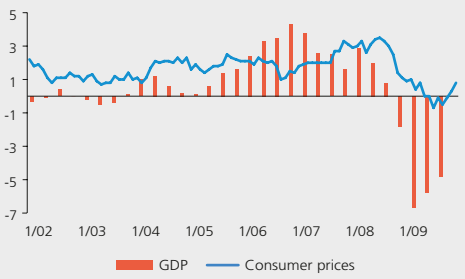


Chart II.4 GDP and inflation in the euro area
The decline in euro area GDP slowed further in 2009 Q3 and inflation rose in Q4
(annual percentage changes)



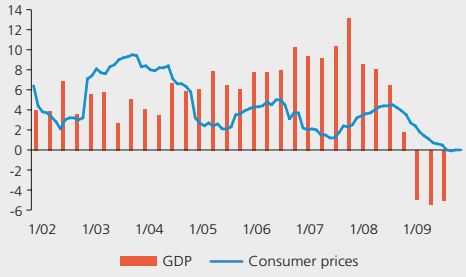
Annual HICP inflation in the euro area (see Chart II.4) turned positive again (0.5%) in November, increasing to 0.9% in December. The inflation was due mainly to rising prices of energy, fuel and some services. The ECB left its key rate unchanged at 1% in January. As a result of an expected weak recovery, rising unemployment and low capacity utilisation, the ECB sees no threat of inflationary pressures over the medium term, and inflation expectations are also firmly anchored in line with its objective. The monetary aggregates also indicate the same conclusion. M3 fell by 0.2% year on year in November as a result of the continuing decline (of 0.7%) in loans provided to the private non-financial sector. At its meeting in December, the Governing Council of the ECB decided to start gradually limiting the unconventional monetary policy measures that it put in place in response to the outbreak of the financial crisis and the problems in the functioning of the money market in October 2008 (see Box 1 *Exit strategies from unconventional monetary policy instruments planned by selected central banks*). According to a European Commission estimate, the average budget deficit in the euro area surged to 6.4% of GDP in 2009 from 2% in the previous year as a result of the economic crisis. The deficits of almost all euro area countries exceeded 3% and the excessive deficit procedure was initiated against 13 countries.

Chart II.5 GDP and inflation in Germany
The contraction in German GDP decreased further in 2009 Q3 and inflation rose in Q4
(annual percentage changes)



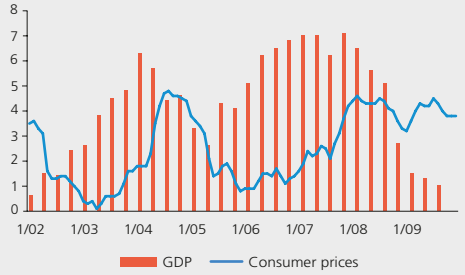
The year-on-year contraction of the German economy (see Chart II.5) eased further to 4.8% in 2009 Q3 from 5.8% in Q2 thanks to a moderation of the fixed investment decline and growth in government consumption and net exports. Despite falling household consumption, quarter-on-quarter GDP growth rose by 0.3 percentage point to 0.7% thanks to growing investment, government consumption and net exports. A further decrease in the year-on-year fall is expected for 2009 Q4. However, the quarter-on-quarter growth is expected to decline or stagnate rather than rise. Industrial production grew by 0.7% month on month in November after shrinking by 1.8% in October. Industrial orders were none too favourable either, and retail turnover fell month on month in November after being flat in October. The unemployment rate increased by 0.2 percentage point to 7.8% in December compared to November; a year earlier the figure had been 7.1%. After four months of decline, the consumer price level (HICP) returned to annual growth of 0.3% in November, rising to 0.8% in December. Price increases were recorded mainly for energy prices and services. A year-on-year decline in food prices had an anti-inflationary effect.

Chart II.6 GDP and inflation in Slovakia
The decline in economic activity in Slovakia slowed further in 2009 Q3 and annual inflation was zero in Q4
(annual percentage changes)



The year-on-year fall in Slovak GDP in 2009 Q3 (see Chart II.6) moderated by 0.4 percentage point to 5% relative to the previous period thanks to a smaller fall in investment and improved net exports. The quarter-on-quarter growth increased to 1.6% from 1.1% in Q2. A further moderation of the year-on-year contraction in economic activity is expected in Q4. However, it is not certain whether economic activity will maintain the rapid quarter-on-quarter rate of growth seen in Q3, given that industrial production was flat month on month in October and retail turnover fell in October and November. Since the end of 2008 the economic crisis in Slovakia has been manifesting itself also in sharp growth in the unemployment rate, which increased by 4.5 percentage points year on year in November 2009 (to 13.6%). Annual inflation has been flat close to zero since September 2009, with growth in services prices and administered prices being offset by a fall in prices of tradable goods.

Chart II.7 GDP and inflation in Poland
GDP growth in Poland slowed further in 2009 Q3 and inflation was flat at 3.8% in Q4
(annual percentage changes)



In Hungary and Poland, the global economic crisis manifested itself in 2009 Q3 in worsening economic activity and a rising unemployment rate. While Poland recorded only a decline in annual GDP growth, Hungary experienced a deepening economic contraction.

Although annual GDP growth in Poland (see Chart II.7) slowed to 1% in 2009 Q3 from 1.3% in Q2, the Polish economy was the only one in the EU to show year-on-year growth in this period (and in all other quarters of 2009). The quarter-on-quarter economic growth rate remained at 0.5% in Q3 thanks to rising government and household consumption and a slowing investment decline. The outlook for Q4 is positive. Year-on-year and quarter-on-quarter growth in industrial production and retail turnover increased in October and November. The unemployment rate rose both month on month (by 0.1 percentage point) and year on year (by 2 percentage points) to 8.8% in November. In December, annual inflation stayed at 3.8% for the third month in a row and was caused mainly by growth in food, energy and transport prices. The Polish central bank left its key monetary policy rate unchanged at 3.5% in Q3 owing to the favourable outlook for inflation and economic activity and a modestly appreciating zloty (see Chart II.9).

The year-on-year fall in the Hungarian economy (see Chart II.8) deepened by a further 0.7 percentage point to 7.9% in 2009 Q3 as a result of a faster decline in all components of domestic demand. The quarter-on-quarter rate of decline in GDP remained high (1.8%), decreasing by only 0.1 percentage point relative to Q2. A favourable change in economic activity is expected in Q4. The annual and quarter-on-quarter decline in GDP is expected to ease, thanks mainly to a strengthening of external demand connected with a recovery in EU countries. Annual inflation (see Chart II.8) rose by 0.2 percentage point to 5.4% in December compared to November, mainly because of rising energy prices. The Hungarian national bank (MNB) lowered its key monetary policy rate in three steps by a total of 1.25 percentage points to 6.25% during the course of Q4. The MNB was able to ease its monetary policy thanks to stabilisation of the exchange rate of the forint (see Chart II.9), low GDP growth and a favourable inflation outlook.

CHART II.8 GDP AND INFLATION IN HUNGARY

The decline in GDP in Hungary deepened further in 2009 Q3 and inflation rose in Q4

(annual percentage changes)

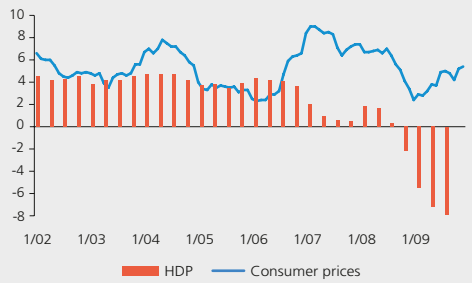
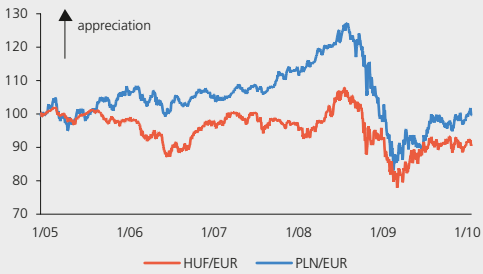


CHART II.9 CENTRAL EUROPEAN CURRENCIES

The Polish zloty strengthened slightly and the Hungarian forint was flat in 2009 Q4 and January 2010

(average for January 2005 = 100)



BOX 1

EXIT STRATEGIES FROM UNCONVENTIONAL MONETARY POLICY MEASURES OF SELECTED CENTRAL BANKS

With conditions in the financial markets and the real economy improving, central banks are considering ending the use of unconventional measures. Their plans to terminate such measures are called "exit strategies". By defining an exit strategy, central banks will specify the steps they will take when it becomes necessary to end the monetary policy easing and when growing inflationary pressures will conversely require tighter monetary policy. In general, the exit strategy should define the sequence and timing of the steps needed to exit markets or discontinue programmes. It should also include estimates of its impacts on the markets. The decision on the timing and speed of withdrawal of unconventional measures is of particular importance. On the one hand, early withdrawal might undermine the nascent economic recovery. On the other hand, a delayed decision on this matter might endanger the medium-term equilibrium of the economy and the financial sector. When taking such steps it is equally important to respect not only monetary policy objectives and the inflation outlook, but also the need to maintain and strengthen financial stability and restore the efficient functioning of the banking sector.

As regards the sequence and combination of steps relating to the termination of the cycle of easy monetary policy, the most likely procedure seems to be one in which liquidity-supporting programmes are first discontinued and monetary policy rates are later raised, paying due regard to the inflation outlook and the state of the real economy. The selection of specific instruments and procedures to absorb the liquidity generated by purchases of financial assets remains open for the time being. A discussion is going on about whether the purchased securities will continued to be held in central banks' balance sheets and liquidity will be absorbed, for example, by conducting reverse repos or issuing central bank bills, or whether the purchased assets will be gradually sold in the markets.

The Federal Reserve System (Fed) plans to discontinue most of its liquidity-providing programmes, lending to financial entities and swap lines on 1 February 2010. After this date, the Term Auction Facility (TAF)[1] and the Term Asset-Backed Securities Loan Facility (TALF)[2], will probably remain in force. Termination of the credit easing, i.e. purchases of mortgage-backed securities and agency bonds, is planned for 2010 Q1. These securities currently account for almost half of the Fed's balance sheet, which has increased considerably in volume as a result of these purchases. To absorb liquidity from the system, the Fed is considering using reverse repos and deposits and, if necessary, selling off part of its debt securities.

The European Central Bank (ECB) has changed the method for calculating the interest rate on its one-year refinancing operation. The rate was originally set at 1%, but the rate in the December auction (the last one) is fixed to the average minimum bid rate on main refinancing operations to be conducted over one year. The rate will thus be set ex post. The ECB has also decided to carry out its last six-month refinancing operation on 31 March 2010 and to discontinue the weekly EUR/CHF swaps with the Swiss central bank on 31 January 2010. Termination of the covered bond purchase programme is planned for the end of June 2010. Roughly half of the planned volume of covered securities has been purchased to date.

The Bank of England (BoE) is continuing to apply quantitative easing through purchases of debt securities, in particular government bonds. The announced volume of asset purchases of GBP 200 billion is now almost fulfilled, so the purchases are likely to be discontinued. The BoE is proposing the following two options for its exit strategy and simultaneous monetary policy tightening when the inflation outlook exceeds the inflation target of 2%: either (i) an increase in the key interest rate combined with the simultaneous sale of purchased assets, or (ii) the issuance of central bank bills to decrease the volume of liquidity without selling financial assets in the BoE's balance sheet.

1 TAF – a facility that allows depository institutions to borrow funds against collateral, with 28-day or 84-day maturity. The declared volume of the facility is set by the Fed and the operations take place on the basis of an auction with a minimum bid rate. This facility is similar in nature to the ECB's usual refinacing facility.

2 TALF – a facility for providing funds to support securitisation by helping interested parties to finance purchases or sales on the asset-backed securities market. Three- or five-year loans are provided against collateral composed of newly issued commercial mortgage-backed securities (to terminate on 30 June 2010) and other securities backed by a broad range of assets (to terminate on 31 March 2010).

The gradual withdrawal of unconventional monetary policy measures by central banks is a positive signal, since it reflects improved conditions in the financial markets and the real economy. However, despite the relative ease of discontinuing most liquidity-providing facilities, there are still question marks hanging over the size and structure of some central banks' balance sheets, which include significant volumes of purchased debt securities of private and public entities with long maturities and various levels of risk.

II.2 THE MONETARY CONDITIONS

Both the interest rate and exchange rate conditions continued to be affected by the global financial and economic crisis in 2009 Q4 and January 2010. Money market interest rates declined in response to the December reduction of the repo rate by the CNB, but rates with longer maturities did not show a clear trend. The exchange rate fluctuated relatively strongly.

II.2.1 Interest rates

The domestic financial market situation in 2009 Q4 remained affected by the global financial and economic crisis. Risk premia (the spread between PRIBOR rates and the 2W repo rate) shrank very slowly and the bid-offer spread on the interbank market was flat. Market liquidity also remained limited.

Interest rates showed mixed developments depending on maturity. Money market interest rates continued to fall gradually. Part of the market and some analysts were expecting the CNB's key rates to be lowered at the November meeting. This expectation did not materialise until December. With effect from 17 December 2009, the 2W repo rate was set at 1.00% and the Lombard rate at 2.00%; the discount rate remained unchanged at 0.25% (see Chart II.10). The market outlook for FRA rates fell immediately after the rate change, but rose gradually in the days that followed. This was probably due to comments made by some Bank Board members on the termination of the monetary policy easing cycle. Long-term IRS interest rates showed a similar trend, responding to the lowering of the CNB's key rates with only a slight decrease and subsequently increasing at all maturities.

PRIBOR interest rates decreased in 2009 by 1.3–2.1 percentage points overall depending on maturity (see Chart II.11). IRS interest rates fell only at the shortest maturities (up to 3Y), whereas the other maturities rose by up to 0.7 percentage point.

The PRIBOR yield curve shifted downwards during 2009 Q4, but its slope remained positive. The spread between the 1Y PRIBOR and the 2W PRIBOR was roughly 0.9 percentage point on average in December 2009. The money market yield curve remained unchanged during January. The IRS yield curve also shifted downwards during Q4, although in January its level increased slightly again at all maturities. The average 5Y–1Y spread was 1.3 percentage points and the 10Y–1Y spread 1.8 percentage points in December 2009.

Short-term interest rate differentials vis-à-vis the main world currencies (PRIBID/CZK – EURIBOR/EUR, or LIBOR/USD) were mostly falling. The main underlying factor was the lowering of the CNB's key rates and the related fall in interest rates at the end of 2009. Nevertheless, the differentials stayed positive (see Chart II.12).

Chart II.10 The CNB's key rates
The CNB lowered the 2W repo rate and Lombard rate in December 2009
(percentages)

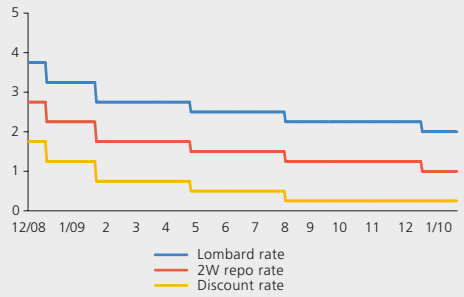


Chart II.11 Market interest rates
Money market interest rates fell
(percentages)

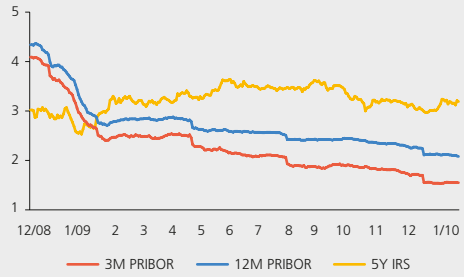


Chart II.12 Interest rate differentials
Interest rate differentials vis-à-vis the euro and the dollar were positive
(percentage points)

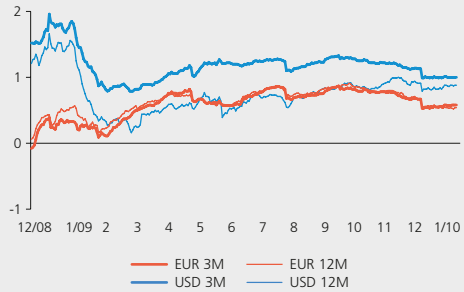


Chart II.13 Government bond yields
Long-term yields rose at the end of 2009
(percentages)

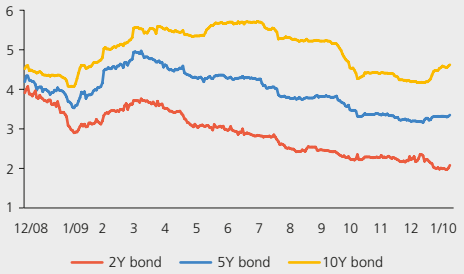


Chart II.14 Ex ante real rates
Ex ante real interest rates on new loans increased slightly
(percentages)

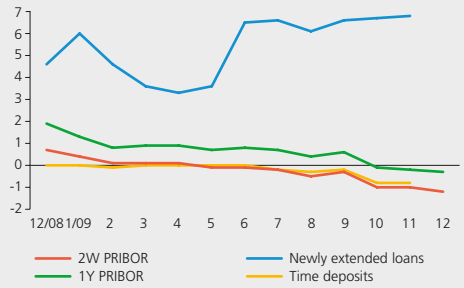
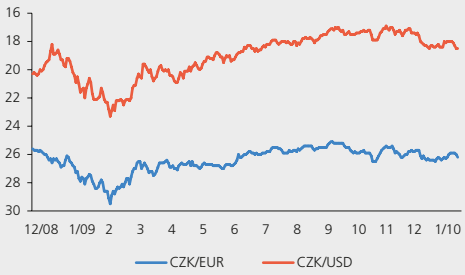


Chart II.15 CZK/EUR and CZK/USD exchange rates
The koruna depreciated slightly year on year against the euro but appreciated against the dollar in 2009 Q4



Four auctions of fixed coupon bonds and one auction of variable interest rate bonds were held on the primary government bond market. The total volume of bonds issued was CZK 28.5 billion. Investors' interest in Czech government bonds gradually weakened in this period. At the end of 2009, amid concerns about the sharp rise in the supply of government bonds, yields on government bonds with longer maturity started rising, thereby increasing the slope of the yield curve (see Chart II.13). Standard & Poor's affirmed the Czech Republic's local currency rating at A+/A-1 and its foreign currency liabilities rating at A/A-1 with a stable outlook. However, the evaluation report states that the main risk to the credit rating is the absence of a political consensus in favour of undertaking deeper fiscal reform.

The increased riskiness of clients from the real economy continued to prevent full transmission of the CNB's key rate cuts to client rates. Nominal interest rates on new loans were 6.9% and rates on new time deposits 1.7% in November. Real interest rates[3] are affected not only by nominal rates, but also by inflation expectations. Consumer price inflation expectations were flat during 2009 Q4, whereas expected industrial producer price inflation decreased slightly. Real rates on new loans were 6.8% in November, while real rates on time deposits were -0.8% (see Chart II.14).

II.2.2 The exchange rate

The average exchange rate of the koruna against the euro was CZK 25.9 in 2009 Q4 (see Chart II.15), which represents a year-on-year depreciation of the koruna of 2.2% (although in December alone the koruna recorded a very slight appreciation of 0.1%). In quarter-on-quarter terms, the koruna weakened by 1.2%. Amid considerable volatility, the koruna's exchange rate depreciated during the quarter from CZK 25.4 to CZK 26.2 to the euro at the end of the quarter. In January, the koruna gradually appreciated by around 30 hellers, and in late January it was fluctuating around CZK 25.9 to the euro.

The koruna's exchange rate was affected mainly by short-term capital movements. The weaker exchange rate of the koruna was also due to changes in the CNB's monetary policy rates (a decrease to the same level as euro rates). The effect of other domestic fundamentals on the exchange rate remained negligible. The important role of monetary policy rates in the exchange rate path is confirmed by comparing the koruna's exchange rate with that of the Polish zloty. Historically, the remuneration on the zloty is higher than that on the Czech koruna. Nevertheless, the koruna has long been appreciating against the zloty. Since mid-2009, owing to a decline in short-term investors' risk aversion, their interest in the zloty has surged (the attractiveness of higher rates coupled with acceptable currency risk) and the zloty has appreciated against the koruna from around CZK 5.9/PLN to the current approximately CZK 6.4/PLN, i.e. by more than 8%.

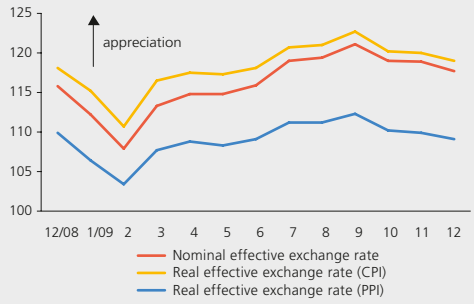
The koruna appreciated against the dollar in 2009 Q4. In year-on-year terms it appreciated by 8.9%, and compared to Q3 by 2.1%. During the quarter itself, however, the koruna tended to depreciate from around CZK 17.5/USD at the start of the quarter to CZK 18.2/USD at the end. The sizeable year-on-year

3 Ex ante real interest rates: nominal interest rates on loans are deflated by the industrial producer price inflation forecasted by the CNB; nominal interest rates on deposits and PRIBOR rates are deflated by the consumer price inflation expected by financial market analysts.

appreciation of the koruna was almost exclusively due to the year-on-year depreciation of the dollar on global financial markets. In January, the exchange rate fluctuated between CZK 17.9/USD and CZK 18.5/USD without showing any signs of a trend.

The nominal effective exchange rate depreciated by 1.1% quarter on quarter in 2009 Q4 (see Chart II.16). However, in year-on-year terms it was 0.4% stronger. This year-on-year strengthening was due mainly to the koruna's appreciation against the dollar. The CPI-deflated real effective exchange rate weakened by 0.4% year on year, indicating thus lower inflation in the Czech Republic than in its major trading partners. The year-on-year depreciation of the PPI-deflated real effective exchange rate was still rather more pronounced (2.3%) as a result of a larger year-on-year fall in producer prices in the Czech Republic than in other countries on average.

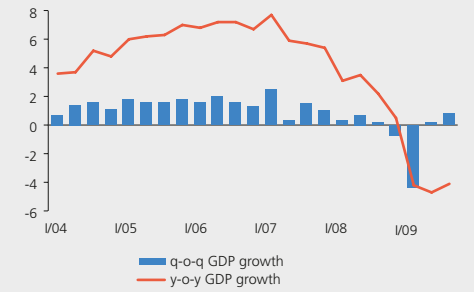
CHART II.16 EFFECTIVE EXCHANGE RATES OF THE KORUNA
The nominal and real effective exchange rates both depreciated in 2009 Q4
(year 2005 = 100)



II.3 DEMAND AND OUTPUT

The year-on-year decline in GDP moderated in 2009 Q3. At 4.1%, it was down by 0.6 percentage points from the previous quarter.[4] *In quarter-on-quarter terms, GDP growth accelerated, reaching 0.8%. This change was mostly due to foreign trade. Net exports recorded a large surplus, which increased slightly in year-on-year comparison. The strong decline in gross capital formation continued, however. The growth rate of final consumption expenditure was the same as in the previous quarter. On the supply side, the unfavourable trends moderated, particularly in manufacturing.*

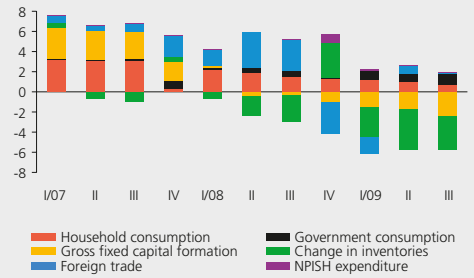
CHART II.17 GROSS DOMESTIC PRODUCT
The year-on-year decline in output moderated in 2009 Q3
(annual and quarterly percentage changes at constant prices; seasonally adjusted data)



II.3.1 Domestic demand

The year-on-year decline in domestic demand deepened only slightly in 2009 Q3. This decline was again mostly due to a marked fall in additions to inventories, albeit to a lesser extent than in Q2 (see Chart II.18). Fixed investment also continued falling in Q3, but unlike in the case of inventories the decline deepened further. Growth in household consumption slowed, whereas growth in government expenditure picked up pace.

CHART II.18 STRUCTURE OF GDP GROWTH
The main contributor to the moderation of the annual GDP decline was foreign trade
(contributions in percentage points)



Final consumption

Amid rising unemployment and declining income, household consumption behaviour was subdued in 2009 Q3. Annual growth in household consumption expenditure slowed further. At 1.3%, it was 0.6 percentage point lower than in Q2 (see Chart II.19). Household expenditure on services and durable goods were already falling year on year and growth in expenditure on non-durable and semi-durable goods was low.

The slowdown in real household consumption growth was due mainly to weaker nominal gross disposable income growth, although this was partially offset by falling inflation.[5] In 2008, gross disposable income had grown at a rate of more than 8%. In 2009 Q1 its growth slowed sharply and in 2009 Q3

4 The assessment of the evolution of GDP expenditure and GDP sources is based on seasonally adjusted data from the CZSO's national accounts.

5 As measured by the household consumption deflator.

Chart II.19 Household consumption expenditure
Real household consumption expenditure growth slowed further in 2009 Q3
(annual percentage changes)

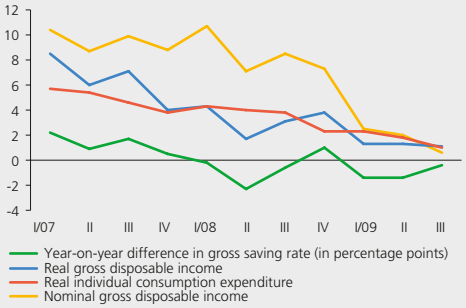


Chart II.20 Disposable income
Nominal disposable income growth decreased below 1%
(annual percentage changes; contributions in percentage points; current prices)

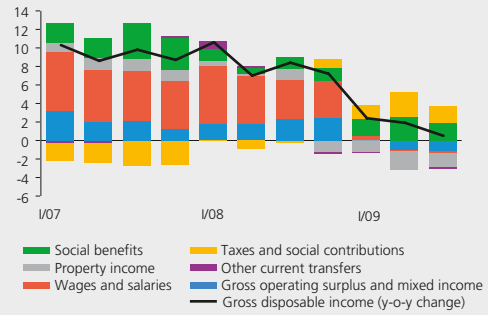


Chart II.21 Consumer confidence
Consumer confidence rose further, but remained low
(2005 average = 100)

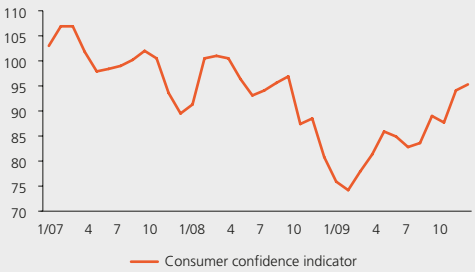
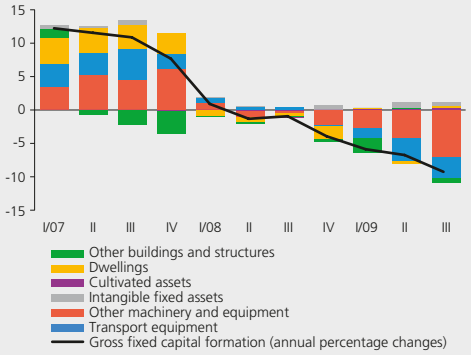


Chart II.22 Fixed capital formation
The downward trend in investment activity continued into 2009 Q3
(annual percentage changes; contributions in percentage points; constant 2000 prices)



it reached only 0.6% (see Chart II.19). In Q3, gross disposable income growth was adversely affected mainly by a fall in net property income and gross operating surplus and mixed income. The decrease in wages and salaries was also relatively large.[6]

The falling household income from these sources clearly reflected the impact of the persisting weak demand on corporations' earnings, which exerted sharp downward pressure on wage costs. This decrease was partly offset by social benefit income, which rose very quickly in the first three quarters of 2009 (by 8.2%, or CZK 10 billion, in 2009 Q3) amid rising unemployment. The fall in social contributions paid and tax payments continued at the same time.[7] The rising social benefits and falling wages mainly reflected the business cycle. The decline in social contributions and taxes on the household current expenditure side was additionally affected by previous legislative changes.

The generally already modest rise in household consumption[8] in 2009 Q3 was also fostered by the more prudent behaviour of households and banks at a time of recession, reflected in a continued slowdown in annual consumer credit growth (see section II.6 *Monetary developments*).

Consumer confidence started to rise gradually from the nine-year low recorded in 2009 Q1, but remained relatively low in both Q3 and Q4. Households were rather less pessimistic about the overall economic situation, their own financial situation and unemployment in the next twelve months, but a decline can be expected in most categories of household consumption expenditure in 2009 Q4. This is evidenced particularly by the latest figures on declining retail sales in November.

General government expenditure on final consumption rose by 5.3% year on year in real terms in 2009 Q3 (and by 6.5% at current prices). As in the previous two quarters, this was largely due to rising expenditure by health insurance companies on health care, while overall state budget expenditure at current prices decreased by 1.1% year on year in 2009 Q3.[9]

Investment

A further deepening of the decline in fixed investment in 2009 Q3 suggested a continuing slowdown in investment activity in the economy. The fall in gross fixed capital formation deepened by 2.6 percentage points compared to 2009 Q2, to 9.6% (see Chart II.22). The main causes of the continuing weak investment demand remain the same as in previous quarters, most notably uncertainties surrounding future domestic and external demand, a more prudent approach of banks to lending and falling formation of corporate own funds. The effects of these factors on investment decision-making continued to be reflected in falling investment in machinery and equipment and transport equipment, as well as in buildings and structures.[10]

6 The annual falls in net property income, gross operating surplus and wage and salaries were CZK 8.4 billion, CZK 5.7 billion and CZK 1.1 billion respectively.

7 These are contributions paid by employees and self-payers. They decreased by CZK 6.5 billion year on year in 2009 Q3, while tax payments declined by CZK 2.9 billion.

8 In 2009 Q3, households' consumption expenditure increased by 0.9% in nominal terms and by 1.3% in real terms.

9 State budget expenditure at current prices recorded marked growth in Q4 and in 2009 as a whole. In addition to dynamic growth in expenditure on unemployment benefits (of 112.1%), the almost 8% rise in expenditure in 2009 as a whole was due to a marked increase in transfers to state funds and expenditure on debt service and pensions (of 8.7%).

Fixed investment declined in most sectors again in 2009 Q3. Table II.1 shows that the decline in total investment was mostly due to investment in the non-financial corporations sector, which accounts for the largest volume of investment. Its annual fall of almost 22% in Q3 was apparent mainly in investment in machinery and equipment and transport equipment. The results of the latest CNB survey suggest that the above factors affecting investment decision-making will continue to have an adverse effect on fixed investment by non-financial corporations going forward.[11] The overall decline in private investment in 2009 Q3 was only partially offset by fast growth in general government investment, which is mostly associated with the development of infrastructure.

Household investment was still being most affected by investment in dwellings, which has been falling since mid-2008 (see Chart II.23). The main reason can be seen in considerable uncertainty among households about future prospects on the labour market and their ability to repay loans. Banks' increased prudence in providing new mortgage loans and households' expectations of a possible decline in residential property prices during the recession also contributed to the continuing fall in investment in dwellings. Its annual decline slowed significantly in Q3 (to -0.3%), but the still falling numbers of housing starts and building permits and also the uncertain labour market prospects are signalling that no major recovery in demand for investment in dwellings can be expected in the near future.

The real annual decline in additions to inventories moderated in 2009 Q3 compared to the previous quarter, but their negative contribution to GDP growth was still significant (see Chart II.18). Their trend so far in 2009 corresponds to the overall decline in economic activity, particularly in industry and export-oriented sectors, and to the tighter lending conditions.

II.3.2 Net external demand

Foreign trade turnover in 2009 Q3 suggested a moderation of the impacts of the financial and economic crisis on the real economy. Its annual fall decreased from the previous double figures to below 10%. As Chart II.24 shows, the decline in both exports and imports moderated. Given the high import intensity of domestic production, imports usually closely follow the path of exports.

The annual decline in exports decreased to less than one half compared to Q2 (by 8.5 percentage points to -7.2%). The decline was still deep, however, pointing to low external demand in respect of almost all major trading partners. The year-on-year depreciation of the koruna only partially dampened the impact of the weak external demand on the corporate sector. At the same time, the annual decline in total imports decreased considerably, to -7.5%. The decline in exports was thus slightly more modest than that in imports.

Table II.1 Fixed investment by sector
Most sectors are recording a real decline in investment
(source: CZSO, CNB calculation)

	IV/08	I/09	II/09	III/09
Annual percentage changes				
Non-financial corporations	-6.4	-10.1	-13.2	-21.7
Households	-10.2	-2.7	-8.7	-2.4
General government	9.3	2.7	17.3	14.3
Financial corporations	4.8	-15.9	-54.9	-10.3
Non-profit institutions serving households	-14.8	-6.0	-0.9	4.5
Share in total fixed investment in per cent				
Non-financial corporations	55.9	54.9	53.5	47.5
Households	19.9	20.5	20.4	23.5
General government	21.7	22.5	24.7	26.7
Financial corporations	2.0	1.6	0.9	1.8
Non-profit institutions serving households	0.5	0.5	0.6	0.6

Chart II.23 Investment in dwellings
The decline in investment in dwellings slowed in 2009 Q3
(annual percentage changes)

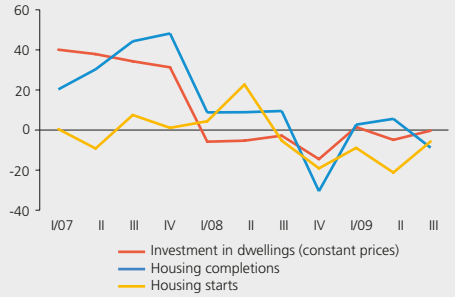
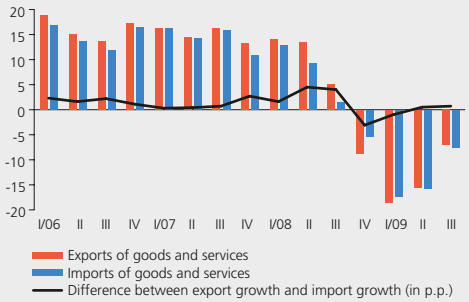


Chart II.24 Exports and imports
The decline in total foreign trade turnover moderated appreciably in 2009 Q3
(annual percentage changes; percentage points; constant prices; seasonally adjusted data)



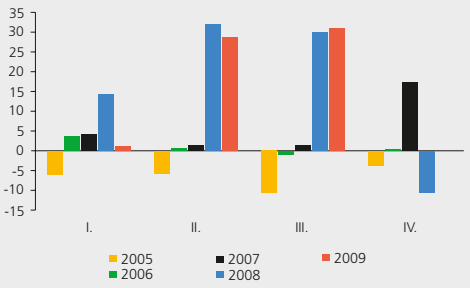
10 Only investment in intangible fixed assets and cultivated assets increased year on year, but its effect on total investment was insignificant.

11 According to the latest CNB survey, uncertainty regarding future demand will limit investment expenditure among 62% of respondents and shortages of own funds among 50% of respondents in the manufacturing sector in the next 12 months. The uncertain demand will curb investment expenditure among 75% of respondents in construction and 72% of respondents in trade.

Chart II.25 Net external demand

The previous adverse trend in net exports was replaced by annual growth in 2009 Q3

(CZK billions; constant 2000 prices; seasonally adjusted data)



In these circumstances, the adverse trend in net exports of goods and services[12] observed in the previous three quarters came to a halt. The net export surplus increased slightly year on year (by CZK 1.1 billion to CZK 31.1 billion; see Chart II.25). Following previous negative values, its contribution to annual GDP growth was thus close to zero (see Chart II.18).

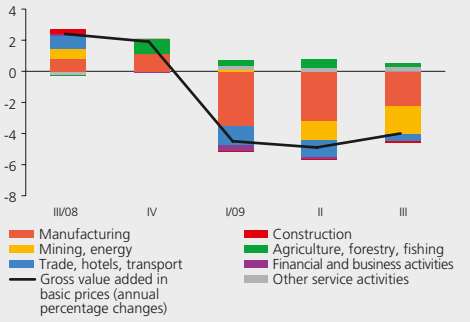
The evolution of net exports was a result of the goods balance. The annual moderation of the fall in goods exports (to -9.9%) was affected by a generally smaller decline in external demand and also by exports of cars thanks to car-scrapping incentives abroad. There was also a slowdown in the annual decline in goods imports as a result of a less pronounced fall in imports for intermediate consumption, associated primarily with production for exports. However, investment imports still showed a sizeable fall, thus reflecting the marked downturn in investment activity.

Both exports and imports of services continued rising year on year in Q3, showing resilience to the impacts of the economic crisis from the point of view of trade turnover, but imports of services grew faster than exports. The rapid growth in total services imports was chiefly due to services provided within multinational corporations.

Chart II.26 Contributions of branches to GDP growth

Manufacturing was the main contributor to the moderation of the decline in value added

(contributions in percentage points; annual percentage changes; selected branches)



II.3.3 Output

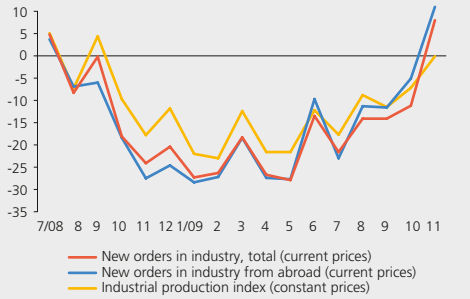
The evolution of value added at basic prices in 2009 Q3 indicated a moderation of the impact of the world economic recession on the Czech economy. The decline in gross value added slowed year on year compared to 2009 H1, reaching 4%[13] (see Chart II.26). In quarter-on-quarter terms, value added continued rising for the second consecutive quarter (to 1% in Q3). The previous adverse trends eased mainly in manufacturing, which had previously been hit hardest by the global financial and economic crisis. Annual value added growth continued only in agriculture and in part of the services sector, but their contribution to GDP was low. Quarterly value added growth was seen mainly in services.

The year-on-year decrease in value added at basic prices was still due mostly to manufacturing, although its negative contribution decreased considerably in Q3 (see Chart II.26). This was largely due to external demand developments, as indicated by a substantial slowdown in the annual decline in real exports of goods compared to 2009 H1 (of around 10 percentage points to roughly 10%) and a moderation of the decline in direct export sales in industry (of almost 5 percentage points) in the same period.[14] The intensity of production capacity utilisation stopped decreasing in Q3, but the fall in employment continued deepening. The negative contribution of the electricity, gas and water supply industry to the decline in total value added was also significant, as the sizeable year-on-year decline in gross value added in this industry gained in strength.

Chart II.27 New orders in industry

The evolution of orders in 2009 Q4 suggests a recovery in industrial production

(annual percentage changes)



The latest available data for November suggest an improvement in sales

12 At 2000 prices, seasonally adjusted.

13 Compared to 2009 Q2, the annual decline in value added slowed by 0.9 percentage point in Q3.

14 Direct export sales (at current prices) showed very mixed trends across the individual branches of manufacturing. In most branches the decline in sales moderated, and only five out of the total of 24 branches saw annual growth in sales. However, sales continued falling in the major export branches.

opportunities in the near future. This is indicated by a November recovery in year-on-year growth in new industrial orders, a moderation of the decline in the industrial production index to almost zero (see Chart II.27) and a modest rise in production capacity utilisation from the lows recorded in 2009 Q2 and Q3 (see Chart II.28). A recovery in orders was recorded in more than half of the branches under review, and particularly in traditional export branches. However, when assessing the renewed growth in orders, account should be taken of the previous year's very low base.

Value added in construction also confirmed a continuing quarterly pick-up in growth in 2009 Q3. The evolution of total construction output was again a result of a combination of falling building construction (-6.6% year on year) and rising civil engineering output (+15.3% year on year), financed primarily from public resources. The persisting decline in building construction output was still largely due to more prudent investment decision-making of corporations and households and a more cautious approach of banks to lending given the uncertain demand outlook.

According to the latest available data, construction output increased by 1.4%[15] year on year in October and by 6.4% in November. Thanks to very favourable weather conditions, the November increase in construction output was a result of not only civil engineering output, but also building construction.

The impact of the crisis on services and trade was noticeably smaller than that on industry, and their negative contribution to the decline in value added was insignificant overall in 2009 Q3 (see Chart II.26). This was partly due to continuing strong growth in value added in financial intermediation and insurance and in some other services, public in particular. The impact of the crisis in the services sector was most apparent in trade and other market services, where was a clear close link with the pronounced fall in output in industry. The low demand was most strongly reflected in value added in trade, whose decrease was still significant (4.9% in Q3). This was mainly due to falling sales of motor vehicles. The CZSO data for November – indicating a still large decline in retail trade turnover – suggest a continuation of these tendencies.

Business confidence in industry, construction, trade and services remained relatively low in 2009 Q3 (see Chart II.30). At the same time, changes and differences were visible in the view of current and future economic developments across the individual industries. Industry has been recording a steady improvement in its assessment of demand and the expected economic situation at both the three- and six-month horizons almost since the start of 2009, whereas the confidence indicators in construction have been decreasing further owing to the unfavourable demand outlook. However, the latest data for December are indicating a modest increase in confidence. Services are also showing some improvement according to the latest CZSO data, while business confidence in trade decreased slightly.

Chart II.28 Capacity utilisation

Production capacity utilisation in industry started to rise

(full capacity utilisation = 100)

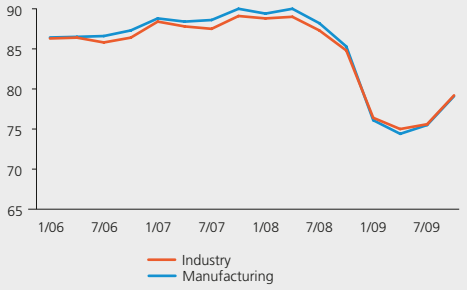


Chart II.29 Barriers to growth in industry

Low demand was still the main barrier to growth in industry

(percentages)

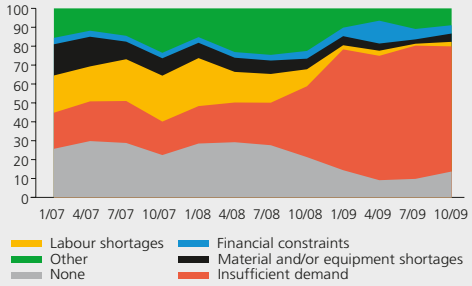
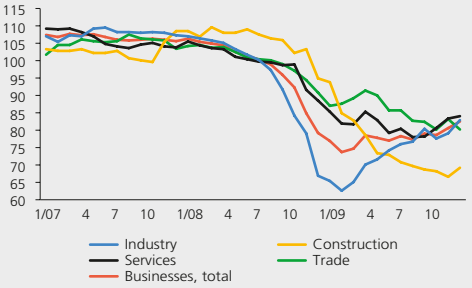


Chart II.30 Confidence indicators

Business confidence is rising in industry and services

(2005 average = 100)



15 Working-day adjusted

BOX 2

UNCERTAINTIES SURROUNDING THE CALCULATION OF POTENTIAL OUTPUT

In an environment of global crisis, the Czech economy saw a shift in the business cycle in 2008 and 2009. The current position in the business cycle is illustrated by the output gap, which is the percentage deviation of real output from potential output, expressing the equilibrium level of output. Like the equilibrium levels of other macroeconomic variables, however, potential output is not observable and measurable. There is thus considerable uncertainty about its level and growth rate, particularly in the present situation, and a whole range of different methods can be used to estimate it.

The first method currently used in the CNB to estimate potential output is based on the Cobb-Douglas production function (in its basic form), which represents the supply side of the economy and expresses the relationship between the volume of inputs (production factors – aggregate productivity, labour and capital) and output (product), with productivity being calculated and subsequently smoothed using the Hodrick-Prescott filter. The advantage of this potential output calculation method is the possibility of analysing the contributions of the individual factors (productivity, labour and capital) to potential output growth. In the CNB, the production function is computed in three variants using different input data.

The second method applied in the CNB to calculate potential output uses a multi-equation model estimated using a recursive algorithm known as the Kalman filter. The advantage of this model is that in addition to data concerning economic activity directly, as measured by GDP, it includes other information, for example regarding the labour market and inflation.

The third, and technically simplest, method used to estimate potential output involves application of the Hodrick-Prescott (HP) filter to the GDP time series. This univariate filter (i.e. using only one time series) is used quite often to filter the trend and cyclical parts of a time series. Its drawback is that it suffers from an end-point bias, particularly if the cycle changes phase. To mitigate this problem, the HP filter calculation is performed at the CNB on the time series including the forecast.

All the above methods for calculating potential output are applied at the CNB to quarterly data from 1997. Their results show that the annual decline in GDP in 2009 was associated with a significant slowdown in the growth rate of potential output (see Chart 1). The Cobb-Douglas production function calculation indicates that the potential output growth rate decreased to 2.1% in 2009 Q3 (the average of the three variants), while the alternative estimates using the Kalman filter and HP filter provide slightly higher values.

At the start of 2009, the corresponding output gap turned negative and stayed there throughout 2009 (see Chart 2). The Cobb-Douglas production function estimate indicates a not-too-wide opening of the output gap to negative values (-2% of potential output) following

Chart 1 (Box) Potential output

Potential output growth slowed in 2009
(annual percentage changes)

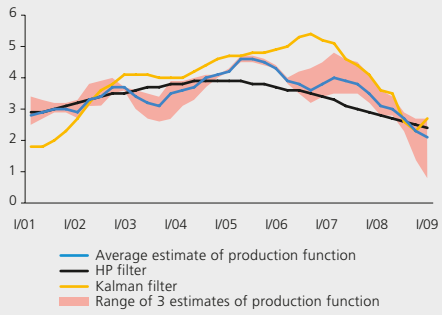
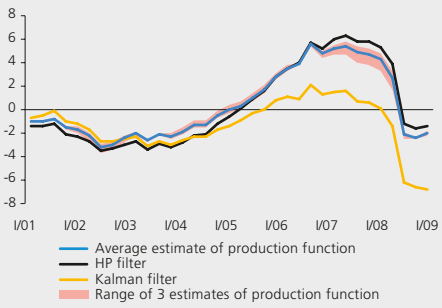


Chart 2 (Box) Output gap

The output gap has opened into negative values, but the range of the estimate is wide
(in % of potential output)



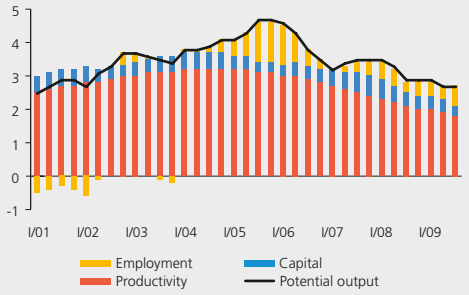
a previous significant overheating of the economy in 2006–2008, whereas the Kalman filter puts the current output gap almost 5 percentage points wider. The range of the individual results thus indicates a high degree of uncertainty.

A look at the contributions of the individual production factors entering one of the variants of the Cobb-Douglas production function reveals that the slowdown in potential output growth is due to slowing growth in all input factors, but mainly in productivity (see Chart 3). The decline in employment has a lagged effect and its negative contributions to potential output growth can thus be expected to appear during 2010.

Chart 3 (Box) Contributions to potential output growth

The slowdown in potential output growth is due mainly to aggregate productivity

(annual percentage changes, contributions in percentage points)



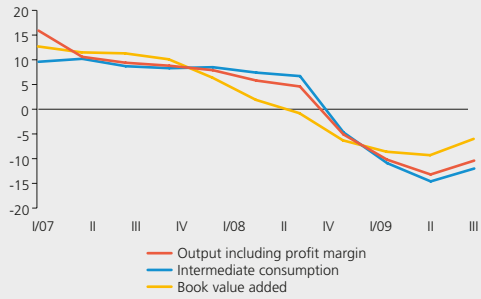
II.3.4 Economic results of non-financial corporations[16]

According to the available data and CNB calculations, the annual decline in the main financial performance indicators monitored in the segment of non-financial corporations with 50 employees or more[17] moderated in 2009 Q3. Along with a moderation of the year-on-year decline in sales, a slowdown was also recorded in the year-on-year decline in output (see Chart II.31). As in the previous two quarters, this was accompanied by a faster decrease in intermediate consumption. Book value added thus decreased more slowly than output and its year-on-year decline was smaller than in the previous quarter. On the basis of the available data it can be estimated that the moderation of the year-on-year decline in gross operating surplus in the monitored set of corporations continued in 2009 Q3.

Chart II.31 Key financial indicators

The year-on-year declines in output and book value added moderated in 2009 Q3

(annual percentage changes)



The material cost-output ratio in Q3 confirmed a continued weakening of cost pressures, which fostered an improvement in value added. This trend was due primarily to falling import prices of energy-producing materials and semi-manufactures, bringing about a reduction in corporations' costs. The annual decline in the material cost-output ratio slowed somewhat in 2009 Q3, to 1.3 percentage points. The decrease in personnel costs was, however, still slower than the decline in output, so the personnel cost-output ratio increased year on year again in Q3 (by 0.8 percentage point). Its growth was, however, noticeably lower than in the previous quarter. This can be viewed as being a consequence of the falling number of employees, as annual average wage growth increased.

Table II.2 Absolute data and performance ratios

The material cost-output ratio fell in 2009 Q3 while the personnel cost-output ratio kept rising modestly

(CZK billions; percentages; annual changes in percentage points and percentages)

	2009 Q3	2008 Q3	Annual percentage changes
Output incl. profit margin (CZK billions)[a]	1,163.3	1,297.9	-10.4
Personnel costs (CZK billions)[a]	192.2	203.7	-5.7
Intermediate consumption (CZK billions)	833.4	946.8	-12.0
Book value added (CZK billions)	329.9	351.0	-6.0
Sales (CZK billions)	1,512.9	1,684.3	-10.2
	percentages	percentages	Annual changes in p.p.
Ratio of personnel costs to value added[a]	58.3	58.0	0.2
Material cost-output ratio[a]	71.6	73.0	-1.3
Personnel cost-output ratio[a]	16.5	15.7	0.8
Ratio of book value added to output[a]	28.4	27.0	1.3

a) CNB calculation

In 2009 Q3, the moderation of the annual decline in output, value added and gross operating surplus was also reflected in the narrower segment of large corporations (with 250 employees or more[18]). Compared to the wider segment of corporations with 50 employees or more, the annual decline in the number of employees and personnel costs was less pronounced in large corporations, where collective agreements probably play a more significant role and where there is greater downward rigidity of wages.

16 The assessment in this section draws partly on calculations based on partial data published by the CZSO. The data are at current prices.

17 The segment of corporations with 50 employees or more consisted of almost 10,000 non-financial corporations at the end of 2009 Q3.

18 The segment of corporations with 250 employees or more consisted of more than 1,800 non-financial corporations at the end of 2009 Q3.

The financial indicators of selected non-financial corporations with the largest asset volumes[19] suggest that the volume of assets and equity decreased slightly in the first three quarters of 2009. Gross debt and the gross debt-to-equity ratio also recorded slight falls. The liquidity of this sector (the ratio of short-term financial assets to short-term liabilities) deteriorated in Q3 in quarter-on-quarter terms, but remained at an acceptable level. This is linked with the generally satisfactory maturity structure of corporate liabilities. Solvency (the ratio of financial assets to financial liabilities) stayed just below 100%. The data on the economic results of the monitored corporations show that return on equity was 2.9% at the end of 2009 Q3.

Chart 1 (Box) Financial assets and GDP

The decline in GDP was accompanied by slowing year-on-year growth in financial assets

(annual percentage changes)

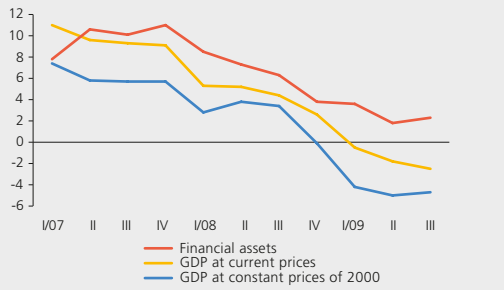
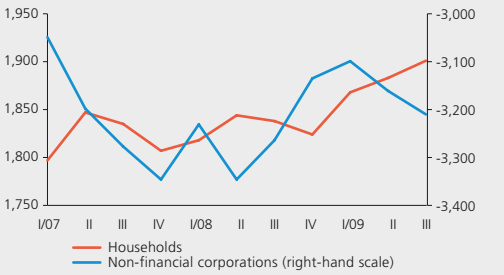


Chart 2 (Box) Net financial assets

Net financial assets of households kept rising, while those of non-financial corporations fell in 2009

(CZK billions)



BOX 3

REVISION OF THE QUARTERLY FINANCIAL ACCOUNTS

Since October 2007, the Czech National Bank has been publishing quarterly financial accounts statistics in order to provide users with information on current financial developments in the economy and on the financial linkages between economic sectors. As these statistics are relatively new, methodological changes have had to be made on an ongoing basis to further refine the statistics and align them with ESA 95. However, it has not been possible to incorporate these changes immediately and completely into past quarters, and the data for some indicators have thus not been fully methodologically comparable over the entire time series published.

For this reason, the CNB has performed an overall revision of the stock data (balance sheets) of the quarterly financial accounts in 2009 H2, thereby ensuring consistency of the data over the entire time series. So far, revised data have been published for the period from 2007 Q1 to 2009 Q3. In October 2010, the time series will be extended back to 2004 Q1. Consistent time series increase the analytical usefulness of the statistics, as they allow better monitoring of financial developments in recent quarters, indicate potential financial risks more precisely and can expand our knowledge of the seriousness of the impacts of the financial crisis on the balance sheets of economic sectors.

The release of the entire revised time series of stock financial accounts in October 2010 will be accompanied by an extension of the published datasets to include counterparty information describing the relations between individual sectors. In addition to balance sheets, the entire time series (from 2004 Q1) of the financial account, i.e. the account that records financial transactions effected in the economy, will be published.

The quarterly financial accounts data are commonly used in many countries to conduct partial analyses in the area of financial (im)balances at the level of economic sectors, to study the wealth effect, to assess

19 Owing to changes made by the CZSO to the publication of data on the balance sheets of non-financial corporations, the evaluation of the financial position of non-financial corporations since 2009 is based on data on the set of around 2,000 corporations with the largest asset volumes. As data for 2008 are not available, it is not possible to make a year-on-year comparison.

debt growth or to monitor the degree of financial intermediation. These data play an essential role mainly in the analysis of sectors for which comprehensive financial data are not available from other statistics (from direct data collection), i.e. for example in the analysis of non-financial corporations and households from the point of view of their financing or the development of their overall financial position.

In addition to sectoral analyses, the quarterly financial accounts can be used in analyses of past macroeconomic developments or short-term macroeconomic projections. Their information value for this type of analysis is shown in Chart 1, illustrating the evolution of economic activity (GDP) and financial assets before and during the current financial and economic crisis. The co-movement of these variables in the Czech Republic in 2007–2009 confirms the general assumption that financial developments are as a rule pro-cyclical in nature and correspond with GDP, even though financial assets, unlike output, were still rising year on year in 2009. Chart 1 shows that their growth stopped slowing in 2009 Q2 and accelerated slightly again in Q3. This was largely due to price effects, particularly renewed growth in stock prices on the capital markets.

A more detailed sectoral view of the total financial position expressed by net financial assets (i.e. financial assets minus liabilities) confirms that the above indicator evolved differently in the household and non-financial corporations sectors, mainly as a result of a different structure of financial assets and liabilities (see Chart 2). The household sector is traditionally a net creditor, whereas the overall financial position of non-financial corporations is that of a debtor. The financial position of households in 2009 indicates a year-on-year improvement (see Chart 3) resulting from a gradual slowdown in the growth rate of liabilities (mainly in the form of loans received) and an only modest annual decline in growth in the value of financial investment; the aforementioned pick-up in stock price growth was also a minor contributing factor. Net financial assets in the non-financial corporations sector remained negative in the medium term at around CZK -3 trillion (see Chart 2). In 2009, they increased. The deterioration was due to a recovery in growth in prices of equity (quoted shares in particular) on the capital market, which account for about 50% of the total liabilities of non-financial corporations, and to only weak growth in the sector's financial assets. These effects completely offset the impact of a sizeable slowdown in growth in loans received in the crisis period.

More detailed information on the overall financial situation and on the current tendencies in the economic sectors is regularly published in the commentary on the quarterly financial accounts. Other ways of using the quarterly financial accounts data for the analysis of individual sectors are given, for example, in a previous analysis *Financing and financial investment of corporations and households* in Box 2 of Inflation Report III/2009.

Chart 3 (Box) Net financial assets of households

Slower growth in new loans fostered a modest improvement in the net positive financial position of households in 2009

(annual percentage changes)

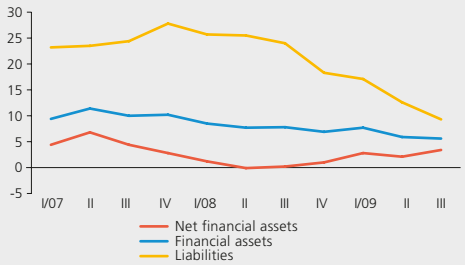


Chart II.32 Labour market indicators
The economic decline was accompanied by falling employment
(annual percentage changes; percentage points)

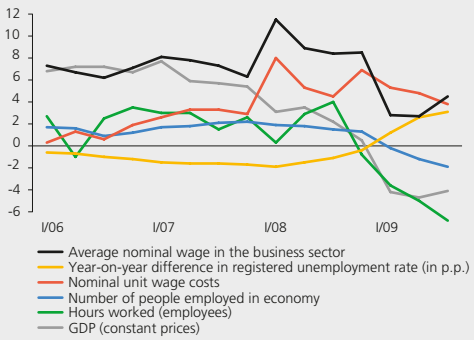


Chart II.33 Employment breakdown by branches
Employment fell most sharply in industry
(contributions in percentage points to annual growth; selected branches)

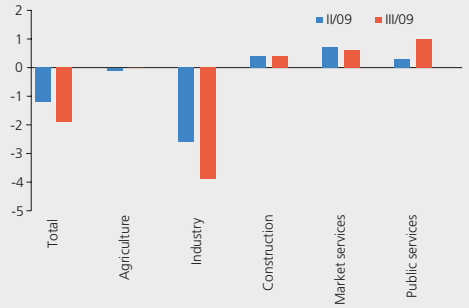


Chart II.34 The Beveridge curve
The rapid fall in the number of vacancies was accompanied by rising unemployment
(seasonally adjusted numbers in thousands)

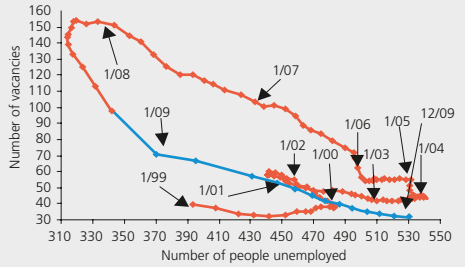
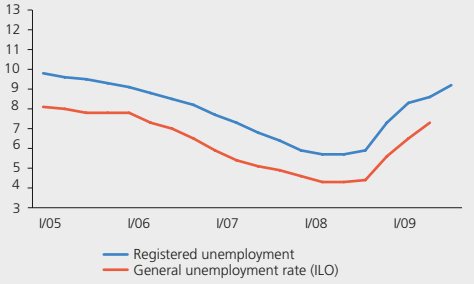


Chart II.35 The unemployment rate
The unemployment rate continues to rise
(percentages; seasonally adjusted data; source: MLSA, CZSO, CNB calculation)



II.4 THE LABOUR MARKET

As expected, 2009 Q3 saw a further deepening of the decline in employment and an increase in both general and registered unemployment. The number of unemployed persons per vacancy reached an all-time high. However, annual average wage growth picked up noticeably after declining sharply at the beginning of the year as a result of falling demand; this pick-up was due largely to a lower sickness rate and a changing employment structure. Nevertheless, annual growth in nominal unit wage costs eased as the volume of wages and salaries continued to decrease year on year amid lower employment and the decline in output moderated.

II.4.1 Employment and unemployment

The continued downturn in economic activity in 2009 Q3 was reflected in a further deepening of the annual decline in employment (to -1.9%; see Chart II.32). This was again due mostly to a declining number of employees[20] (down by 2.8% year on year), whose effect on total employment was partly offset by a concurrent rise in the number of entrepreneurs. This suggests that employees turn to full-time independent business activity if they lose their job.

The further decline in employment was still not commensurate with the more marked changes in economic output. This resulted in a continuing year-on-year fall in productivity (see Chart II.37). As mentioned in the previous Inflation Report, the seemingly insufficiently flexible reaction of corporations to the cyclical decline in output can partly be viewed as a rational defence against costly dismissals and loss of skilled employees. One of the ways of facing this problem is to reduce working hours. In this respect, corporations have introduced many projects leading to reductions in working hours, primarily by reducing overtime work, shortening the working week and adjusting flexible working hours. Their implementation undoubtedly helped to avoid a more pronounced fall in employment, but the future demand situation remains a risk. The impact of these measures on total hours worked is shown in Chart II.32.

The low demand affected output and consequently employment and unemployment in the individual sectors of the national economy with varying intensity. In industry, which was hit hardest by the sales crisis, the fall in employment deepened further in 2009 Q3 (by 197,400 persons to -12.6%).[21] So far, the services sector has been affected by the economic crisis noticeably less than industry. Total employment in services was still rising in 2009 Q3 according to the latest data. This also corresponds to the much weaker value added trend in industry than in services (see section II.3.3 *Output*). However, employment in market services also started to grow slower or decline in Q3. With sales falling, the downward trend in employment can be expected to intensify in the near future. The total decline in employment in Q3 was partly offset by an increase in the number of employees in the non-business sector (especially in health and social care, public administration and defence).

20 Including members of production co-operatives.

21 However, the impact of the crisis on employment in industry was probably stronger. The LFS statistics, based on surveys in flats, capture employment of foreign nationals, most of whom work in industry and construction, with difficulty (as most of them live in lodging houses). A large proportion of them are thus not covered by the survey. The number of registered foreign workers decreased by 17.6% year on year in October.

Persisting unfavourable conditions on the labour market amid weak demand were indicated also by the Beveridge curve, according to which the fall in the number of vacancies accompanied by a rising number of unemployed persons continued into Q3 and Q4 (see Chart II.34). The number of unemployed persons per vacancy reached an all-time high. In these circumstances, the general unemployment rate (LFS) increased by 3 percentage points year on year to 7.3% in Q3.[22] The total registered unemployment rate[23] followed a similar pattern, rising by 3.1 percentage points to 8.7% in the same period and increasing further in Q4 (to 9.2% in December).

II.4.2 Wages and productivity

After a large adjustment of average nominal wages to the unfavourable demand-side developments in 2009 H1, their growth accelerated again in 2009 Q3 (to 4.8% year on year; see Table II.3). At 4.7%, their real growth was only slightly lower as a result of low inflation. This unexpectedly strong rise in average wages in Q3 was recorded in both the non-business and business sectors (5.6% and 4.5% year on year respectively).

According to analyses by the CZSO and the MLSA, average nominal wage growth was affected in 2009 by a lower sickness rate and shifts in the structure of employment, because the economic decline did not have a symmetrical effect on men and women, all age groups and all types of employment contracts, as pointed out in the previous Inflation Report. The recession led to redundancies mainly among employees with lower wages and above-average sickness rates, and this was reflected in average wage growth. Other factors probably also contributed to the lower sickness rate, for example the introduction of a three-day non-eligibility period for sickness benefits, the replacement of sick leave with holiday leave, the economic recession and the fear of loss of employment.

Given the persisting adverse demand conditions, corporations increased wages substantially in exceptional cases only (across-the-board wage growth was recorded in health care and education in 2009 H1).[24] On the other hand, few employers cut their employees' wages, and extraordinary bonuses and benefits were reduced instead. No increases in bonuses were recorded in any category. By contrast, there was a significant annual decline in bonuses in branches hit by the recession.[25] Corporations are trying to cut costs using all available means, including reductions in working hours and overtime. This is reflected, *ceteris paribus*, in a decrease in wages. Many corporations are also moving to part-time work, but this does not affect average wage growth when converted to full-time employment.

However, the significant rise in the average wage was not reflected in a deteriorating wage cost-output ratio. On the contrary, annual growth in nominal unit wage costs, which are an indicator of potential inflation pressures in the wage area, moderated significantly in Q3, falling by 1 percentage point to 3.8% compared to Q2 (see Chart II.38). Total wages and salaries continued

Table II.3 Wages, productivity, unit wage costs

Contrary to expectations, average wage growth accelerated in 2009 Q3

(annual percentage changes)

	IV/08	I/09	II/09	III/09
Average wage in monitored organisations				
nominal	8.1	3.0	3.1	4.8
real	3.2	0.9	1.7	4.7
Average wage in business sector				
nominal	8.5	2.8	2.7	4.5
real	3.6	0.7	1.3	4.4
Average wage in non-business sector				
nominal	6.5	4.3	4.5	5.6
real	1.7	2.2	3.1	5.5
Whole-economy labour productivity	-1.0	-4.1	-3.9	-2.7
Nominal unit wage costs	6.9	5.3	4.8	3.8

Chart II.36 Productivity developments in branches

Productivity decreased in industry and market services, although less so than in the previous quarter

(annual percentage changes; selected branches)

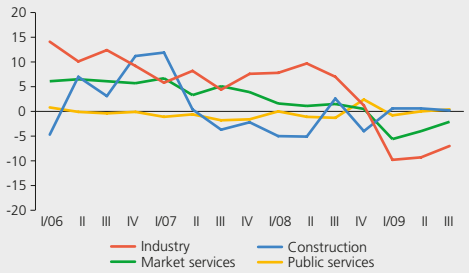
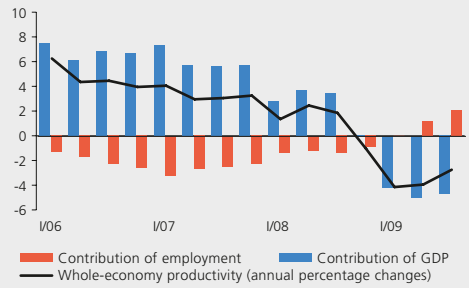


Chart II.37 Whole economy productivity growth

The decline in productivity moderated

(contributions in percentage points; annual percentage changes)



22 Calculated for the age group of 15 years or more.

23 Not adjusted for unavailable job applicants.

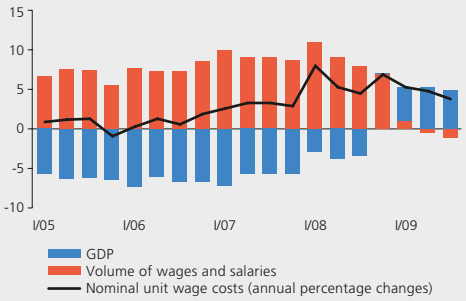
24 According to an analysis by Trexima.

25 According to the Trexima analysis, for example, bonuses fell by 75% in manufacture of transport equipment, 68% in manufacture of machinery and equipment and 77% in manufacture of basic metals.

Chart II.38 Nominal unit wage costs

Nominal unit wage cost growth slowed despite faster average wage growth

(contributions in percentage points; annual percentage changes)



to decline in year-on-year terms[26] owing to the further drop in employment, and the annual decrease in real GDP slowed as a result of a partial improvement in sales conditions.

Growth in the wage cost-output ratio moderated only in industry and market services. In industry, nominal unit wage costs were still being significantly affected by an extraordinary decline in value added in the electricity, gas and water supply industry, and saw the highest growth among the monitored branches (6.5% year on year). Nominal unit wage costs also rose rapidly in non-market services, where strong wage growth was accompanied by only a modest improvement in productivity (see Chart II.36). In market services, by contrast, a significant moderation in wage growth towards zero and an easing of the drop in productivity contributed to an only slight increase in nominal unit wage costs in Q3, not exceeding 1%.

II.5 THE BALANCE OF PAYMENTS

In the first three quarters of 2009, the balance of payments was characterised primarily by a high, although decreasing in year-on-year terms, income deficit as a result of income on non-residents' direct investments and also by a sizeable net inflow of portfolio investment due to the issuing of government and corporate bonds on foreign markets. The output surplus[27] grew in this period thanks to the annual development of the trade balance. The deficit on other investment was due primarily to a net outflow in the corporate sector.

Table II.4 The balance of payments

The current account deficit decreased in 2009 Q1-Q3

(CZK billions)

	I–III/06	I–III/07	I–III/08	I–III/09
A. CURRENT ACCOUNT	-34.8	-73.1	-55.7	-24.9
Trade balance	52.4	93.6	110.0	140.0
Balance of services	36.5	40.6	63.9	43.3
Income balance	-109.5	-184.5	-225.6	-199.3
Current transfers	-14.1	-22.9	-4.0	-8.8
B. CAPITAL ACCOUNT	3.0	6.1	21.6	25.8
C. FINANCIAL ACCOUNT	51.2	80.5	98.0	52.8
Direct investment	65.0	117.3	116.1	2.5
Portfolio investment	-56.6	-69.9	34.7	97.1
Financial derivatives	-1.3	3.3	-8.6	-8.7
Other investment	44.2	29.7	-44.2	-38.1
D. ERRORS AND OMISSIONS	-17.4	-15.9	-25.5	-12.2
E. CHANGE IN RESERVES (- = increase)	-2.1	2.5	-38.3	-41.5

II.5.1 The current account

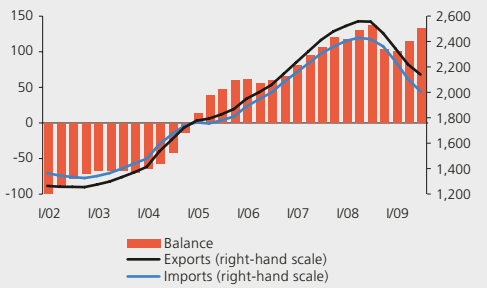
In the first three quarters of 2009, the current account ended in a deficit of CZK 24.9 billion (see Table II.4), or 0.9% of GDP. The deficit shrank by almost CZK 31 billion year on year, owing chiefly to an increase in the trade surplus. A decline in the services surplus acted in the opposite direction.

In 2009 Q1–Q3, the trade balance recorded a surplus of CZK 140 billion, up by CZK 30 billion on a year earlier (see Chart II.39). The increase in the trade surplus was due exclusively to price developments, linked mainly with strongly positive terms of trade for mineral fuels. Roughly one-third of the trade surplus was offset by developments in real terms as a result of a sharp decline in external demand linked with the economic contraction abroad. The decline in external demand was also reflected in a decrease in foreign trade turnover, which fell by almost one-fifth year on year at current prices. The annual decrease in the overall surplus in real terms was slowed considerably by a deep decline in imports for investment and intermediate consumption resulting from the fall in domestic economic activity, particularly in export-oriented engineering sectors. Exports of small cars, connected with car-scrapping incentives in some countries, also helped to moderate the fall in exports and stabilise the overall balance. The foreign trade surplus continued to rise year on year during Q4, growing by almost CZK 36 billion in October and November.

Chart II.39 The trade balance

The annual moving total of the trade surplus increased in 2009 Q3

(CZK billions)



26 By comparison with 2009 Q2, the annual decline deepened only marginally, by 0.5 percentage point to -1% in 2009 Q3.

27 The output balance is the sum of the trade balance and the balance of services.

As regards the commodity structure, the trade balance again showed very mixed trends. Annual growth in the overall surplus was supported mainly by a decline in the deficit on mineral fuels. A decline in the surplus on machinery acted in the opposite direction. From the geographical perspective, the annual growth in the trade surplus was due to a lower trade deficit with non-EU countries, especially Russia because of lower oil prices. Despite strong growth in the trade surplus with Germany, the trade surpluses with most EU countries fell year on year. The overall trade surplus with EU member states therefore decreased, most of all in trade with Romania.

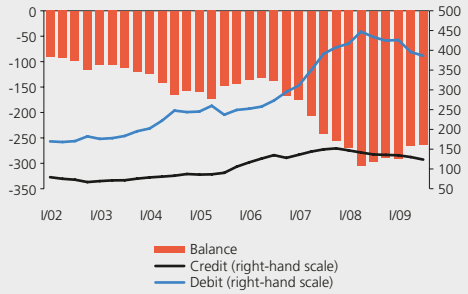
The balance of services ended 2009 Q1–Q3 in a surplus of CZK 43.3 billion, down by almost CZK 21 billion year on year. All three component balances contributed to the decrease in the overall surplus. The most significant factor was a widening of the deficit on other services, due mainly to a deterioration of the balance on miscellaneous business, professional and technical services. The surplus on travel also fell significantly as a result of a decline in credits stemming from the economic crisis abroad.

The income deficit reached CZK 199.3 billion, representing a year-on-year decrease of more than CZK 26 billion (see Chart II.40). The direct investment income deficit, which contains the most important items of the overall balance (dividends paid to non-residents and earnings reinvested in the Czech Republic), was only slightly lower (CZK 191.8 billion) than the overall income deficit. The main reason for the narrowing of the overall deficit was the decline in direct investment income – particularly reinvested earnings – on the debit side of the balance, owing to the downturn in domestic economic activity. A deficit on compensation of employees, which also decreased significantly owing to falling wage expenditure on foreign workers in the Czech Republic, acted in the same direction. This deficit was almost fully offset by a surplus on other investment income, comprising interest on deposits and income on CNB reserves. Portfolio investment also ended in a slight deficit.

Chart II.40 The income balance

The annual moving total of the income deficit decreased slightly in 2009 Q3

(CZK billions)



Current transfers recorded a deficit of CZK 8.8 billion, up by almost CZK 5 billion year on year due to a drop in credits. The determining factor was a rising private transfers deficit, which reached CZK 18.5 billion. However, this was partly offset by a surplus on government transfers. Within this, the balance of transfers between the Czech Republic and the EU budget, recorded on the current account, ended in a surplus of CZK 6.0 billion.

II.5.2 The capital account

The capital account recorded a surplus of CZK 25.8 billion, a slight increase on a year earlier. Its main component was net government revenues from EU funds, which amounted to CZK 18.9 billion. The remainder of the capital account surplus was linked mainly with a surplus on trading in emission allowances.

II.5.3 The financial account

The financial account ended 2009 Q1–Q3 in a surplus of CZK 52.8 billion. This represented a decrease of around one-half in year-on-year terms due to the evolution of direct investment. The largest component of the overall surplus was a portfolio investment surplus, which was, however, partly offset by a net outflow of other investment.

Chart II.41 Direct investment abroad
Direct investment abroad was directed mainly into Turkey and Romania in 2009 Q1–Q3

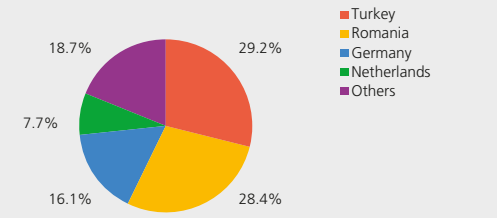


Chart II.42 Portfolio investment
Portfolio investment recorded a net inflow in 2009 Q3
(CZK billions)

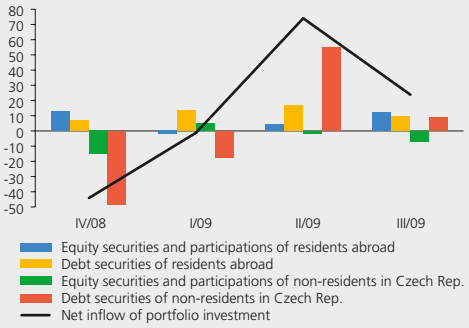
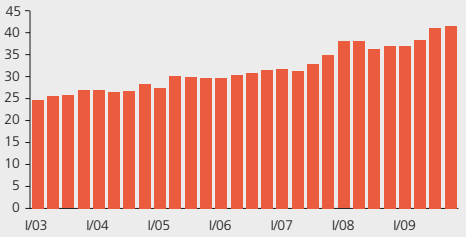


Chart II.43 The CNB's international reserves
The CNB's international reserves increased slightly in dollar terms in 2009 Q4
(USD billions)



The net inflow of direct investment moderated to CZK 2.5 billion. It declined by almost CZK 114 billion year on year due mainly to a decrease in foreign investment in the Czech Republic. However, it was also influenced by rising Czech investment abroad. The inflow of foreign direct investment into the Czech Republic decreased to CZK 56.5 billion as domestic subsidiaries repaid loans from foreign parent companies and foreign parent companies drew loans from their Czech subsidiaries. Its largest component was again reinvested earnings (CZK 85.7 billion). Investment in equity capital was only one-sixth of this figure. Czech direct investment abroad rose by almost CZK 31 billion to CZK 54.1 billion despite the continuing economic contraction abroad. Investment in equity capital was its largest component.

With regard to its branch structure, the foreign capital inflow was channelled primarily into real estate and business services, followed by manufacture of food, beverages and tobacco. The outflow of capital went mainly into the electricity, gas and water supply industry and mining and quarrying. By territory, the biggest foreign capital inflows came from Austria and Luxembourg. Capital outflows abroad went mainly to Turkey and Romania (see Chart II.41).

Portfolio investment ended 2009 Q1–Q3 in a net inflow of CZK 97.1 billion (see Chart II.42), up by more than CZK 62 billion on a year earlier. Issues of government and corporate bonds on foreign markets were the main operations. Adjusted for these issues, non-residents' sales of domestic debt and equity securities would have prevailed on the liabilities side. However, the year-on-year increase in the overall surplus was related to a change in flows on the asset side due to a loss of interest in foreign securities among domestic investors. At the same time, three-quarters of the decline in holdings of foreign securities (totalling CZK 54.1 billion) was due to sales of foreign bonds. This was probably linked with the low level of interest rates and a need for liquidity.

The net outflow of financial derivatives remained broadly unchanged year on year, generating a CZK 8.7 billion decrease in the financial account surplus.

Other investment recorded a net outflow of CZK 38.1 billion in Q1–Q3, which represented a year-on-year decrease. The overall deficit was most affected by a net outflow of CZK 23.1 billion in the corporate sector, due mainly to repayments of financial loans and trade credits provided by non-residents. A net outflow of capital exceeding CZK 20 billion was also recorded in the monetary financial institutions sector. This was related to repayments of short-term deposits and loans abroad. By contrast, the modest net inflow of government sector capital was linked with EIB loans for infrastructure development.

The CNB's international reserves increased relatively strongly in koruna terms in 2009 Q4. At the end of the year they amounted to CZK 762.0 billion, up by CZK 56.0 billion quarter on quarter. This rise was again due mostly to valuation changes. In dollar terms, the reserves rose by only USD 0.4 billion to USD 41.5 billion in the same period (see Chart II.43).

II.6 MONETARY DEVELOPMENTS

Money and credit growth slowed further in 2009 Q3 and Q4. The preference for liquid money persisted, growth in household deposits slowed, but the decline in deposits of non-financial corporations moderated. Loans to non-financial corporations continued to drop as a result of lower demand in the economy and a more cautious approach of banks. The growth rate of loans to households

has been slowing on account of concerns over labour market developments and the related lower willingness of households to borrow. Non-performing loans increased further. Client interest rates on new loans and deposits were flat or falling slightly.

II.6.1 Money

In Q3 and the part of Q4 for which data are available, annual M2 growth slowed, reaching 4% in November (see Chart II.44). This slowdown reflected the still weak economic activity and lower price growth. It was affected by slower growth in domestic loans and a decrease in net external assets. On the other hand, bank financing of the government increased. However, the monthly money supply flows were positive at the close of the period under review.

Within M2, a preference for more liquid forms of money is apparent. Growth in transaction money picked up pace, while the decline in quasi money deepened (see Table II.5). The stronger M1 dynamics reflected the low interest rate level manifesting itself in faster growth in overnight deposits. The increase in these deposits was partly due to shifts away from deposits with agreed maturity of up to two years. The annual decline in currency in circulation was influenced by base effects, i.e. its marked increase following the escalation of the global financial and economic crisis in the same period a year earlier. Within quasi money, deposits with agreed maturity continued to fall relatively rapidly, while deposits redeemable at notice maintained a high growth rate.

Household deposits were again the main contributor to money supply growth, although their growth rate fell to 7.8%. They have been affected by adverse labour market developments in recent months. The annual decrease in deposits of non-financial corporations moderated to 1.7% and deposits of non-monetary financial institutions rose by 12.4%. Monthly household deposit flows were mostly only slightly positive in the period under review. On the other hand, the monthly flows of deposits of non-financial corporations were strongly positive at the close of the period under review, in line with the signs of economic recovery. The ratio of banks' total primary deposits to client loans fell slightly to 128% in November, but remained high.

The average interest rate on new deposits stayed at 1% in the period under review. Following a gradual decline recorded since the beginning of 2009, the rate on new deposits of households has been flat at 1.1% in the last few months. The rate on new deposits of non-financial corporations fell somewhat to 0.6%. In the case of households, the rate on deposits with agreed maturity recorded the most significant decrease from the start of the year (see Chart II.45).

II.6.2 Credit

Annual growth in loans to corporations and households continued to slow, reaching 1.3% in November, the lowest level since 2005 (see Chart II.46). The modest growth rate of loans reflected lower demand in the economy, uncertainty regarding labour market developments and a more cautious approach of banks. Loans to non-financial corporations started to decrease in 2009 H2. Lending growth was visible only for loans to households, but their growth rate also fell significantly. New loans declined year on year, although their rate of decline has moderated in recent months, especially in the case of loans to households (see Chart II.47). Lending growth also continued to slow in other CEE countries. The overall stock of loans in the euro area is now falling.

Chart II.44 M1 and M2

M2 growth slowed further

(annual percentage changes)

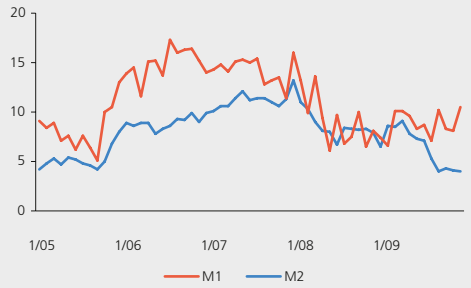


Table II.5 Monetary aggregate structure

The continuing fast growth in transaction money reflected the low interest rate level

(quarterly averages and end-of-month stocks; annual percentage changes)

	II/09	III/09	10/09	11/09	Share in M2, % 11/09
M1	8.9	8.5	8.1	10.5	61.8
Currency in circulation	9.4	6.8	-3.2	-3.8	13.2
Overnight deposits	8.7	9.0	11.8	15.2	48.5
M2-M1 (quasi money)	5.5	-0.9	-1.4	-5.0	38.2
Deposits with agreed maturity	-11.4	-17.8	-15.7	-18.5	20.2
up to two years	-1.4	-14.1	-15.7	-22.4	15.3
Deposits redeemable at notice	41.9	34.0	26.5	19.9	17.5
up to three months	47.3	32.9	21.7	14.2	14.3
Repurchase agreements	-11.4	-26.9	-34.0	-37.8	0.5
M2	7.5	4.6	4.1	4.0	100.0

Chart II.45 Interest rates on deposits

Interest rates on deposits were again flat or falling slightly

(new business; percentages)

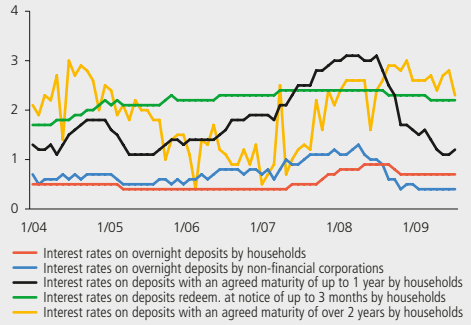


Chart II.46 Loans to non-financial corporations and households

Loans to non-financial corporations have been declining for several months

(stocks, annual percentage changes)

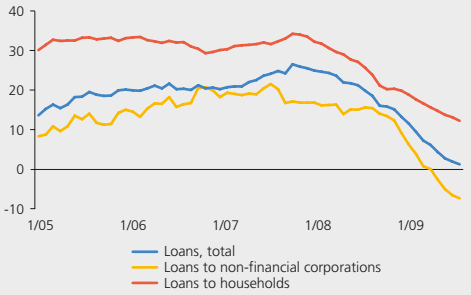


Chart II.47 Newly extended loans

New loans to non-financial corporations and households kept falling

(annual percentage changes)

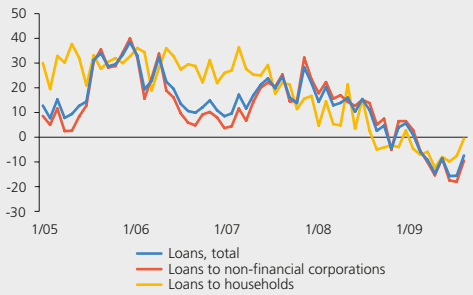


Table II.6 Loan structure

The credit market contraction affected all types of loans

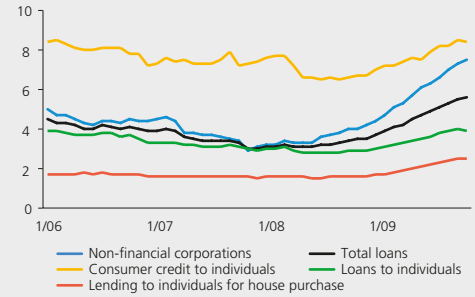
(quarterly averages and end-of-month stocks; annual percentage changes)

	II/09	III/09	10/09	11/09	Share in total loans, % 11/09
Non-financial corporations	3.6	-2.6	-6.5	-7.3	41.8
Loans up to 1 year	-12.8	-20.0	-26.0	-24.9	14.2
Loans over 1 year and up to 5 years	15.2	5.7	2.7	-1.2	9.0
Loans over 5 years	15.7	12.7	10.9	8.8	18.6
Households	17.8	14.7	13.2	12.3	50.8
Consumer credit	17.7	14.4	12.8	11.4	9.7
Loans for house purchase	16.6	13.9	12.2	11.7	35.6
Other loans	26.0	21.4	21.5	18.7	5.5
Non-monetary financial institutions	-2.7	-11.7	-11.8	-11.8	7.4
Total loans	9.4	4.4	2.0	1.3	100.0

Chart II.48 Non-performing loans

Non-performing loan ratios rose most significantly in non-financial corporations

(% of total loans in segment)



Loans to non-financial corporations have been falling for several months now (see Table II.6). The still low demand in the economy is affecting all types of loans. The decline is most visible in short-term loans, owing to their short maturities and strongest link with corporations' financing needs. The volume of loans is declining in most major branches, and especially in manufacturing and in real estate. Loan growth in wholesale and retail trade is virtually zero. Monthly flows of loans to corporations were close to zero. Overdrafts and new loans of up to CZK 30 million declined. By contrast, new large loans recorded annual growth. This was aided by a fall in interest rates, which was most pronounced for large loans. The sluggish loan growth can be expected to persist in 2010 as a result of the expected contraction in investment, although this adverse trend should moderate gradually.

Annual growth in loans to households continued slowing in the period under review, owing to concerns over unemployment and the related lower willingness of households to borrow. However, the monthly flows of loans were positive, thanks mainly to loans for house purchase. In November, new loan business was 0.6% lower than in the same period a year earlier. New consumer credit and loans for house purchase declined, while overdrafts picked up pace. Hypoindex data for December indicate potential signs of recovery in the number and volume of mortgages provided, associated with the turnaround in the business cycle. Supply prices of flats recorded a further year-on-year decline in Q4. Given the persisting economic uncertainty, growth in loans to households can be expected to remain subdued in 2010.

Non-performing loans continued to rise apace, even though their growth rate edged down in November 2009. Non-financial corporations recorded the largest increase in the non-performing loan ratio (7.5%). For households, the ratio of non-performing loans for house purchase was 2.5% and that of non-performing consumer credit 8.4% (see Chart II.48).

In November 2009, client interest rates on new loans mostly remained unchanged from the previous month, with money market interest rates flat or falling slightly and long-term government bond yields decreasing. The interest rate on new loans to non-financial corporations was flat at 4.1%. As regards its components, the rate on overdrafts picked up slightly, while the rates on small and large loans declined. Short and most long rate fixations recorded a moderate decrease. The interest rate on new loans to sole proprietors was 6.5% in May. For most fixations, the rate on new loans for house purchase remained at 5.5%. According to Hypoindex data, the average interest rate on mortgages remained unchanged in December 2009, but there are currently signs of a fall in interest rates for some types of mortgages with selected banks as well as signs of a potential easing of the credit conditions as a result of an expected halt in the economic contraction. The interest rate on consumer credit was flat at 14.5%.

The transmission of the monetary policy rate cuts made during 2009 was mixed across the various types of client rates (see Box 4 *Differences in client interest rates in the Czech Republic and the euro area*).

BOX 4

DIFFERENCES IN CLIENT INTEREST RATES IN THE CZECH REPUBLIC AND THE EURO AREA

In the Czech Republic, the monetary policy rate cuts made during 2009 were most visible in falling rates on loans to non-financial corporations, while rates on housing loans were flat and rates on consumer credit rose modestly (see Charts 1 and 2). Financial market reference rates diverged;[28] money market rates declined while the ten-year government bond yield temporarily rose. In the euro area, by contrast, interest rates have been falling for all types of loans since the end of 2008 in line with the fall in the ECB's key interest rate, money market rates (partly due to unconventional monetary policy) and the ten-year government bond yield (see Charts 3 and 4). This Box looks at the divergent trends in certain client interest rates in the Czech Republic and the euro area and the factors underlying this divergence. The analysis is based on decomposition of the average client interest rate on new loans in the Czech Republic and in the euro area into the contributions of the difference in monetary policy rates, the difference in the range of market and monetary policy interest rates and the difference in the range of client rates and relevant financial market rates expressing the risk premium of the particular segment of the credit market in the particular phase of the business cycle.

The difference in the average client rate on new loans in the Czech Republic and the euro area has increased since the end of 2008. This reflects a slightly smaller decline in the domestic monetary policy rate and money market interest rates (the 3M PRIBOR versus the 3M EURIBOR) in the Czech Republic than in the euro area. The difference in the credit market risk premia is relatively stable on average in the Czech Republic at around 1 percentage point and is at the pre-crisis level. An increase in the difference in client interest rates between the Czech Republic and the euro area was recorded in all segments of the credit market. As regards new loans to non-financial corporations, the increase in the difference in rates was influenced by the aforementioned smaller decline in the monetary policy and short-term market interest rate in the Czech Republic than in the euro area, while the difference in the risk premium for these loans narrowed.

The increase in the difference in interest rates on new loans to households was due to a rise in the ten-year yield on the Czech government bond as against a broadly flat yield in the euro area amid a smaller decline in the monetary policy rate in the Czech Republic than in the euro area. The difference in the risk premium for housing loans also increased.

CHART 1 (BOX)
Monetary policy, market and client interest rates on loans to non-financial corporations and entrepreneurs in the Czech Republic
(new business, percentages)

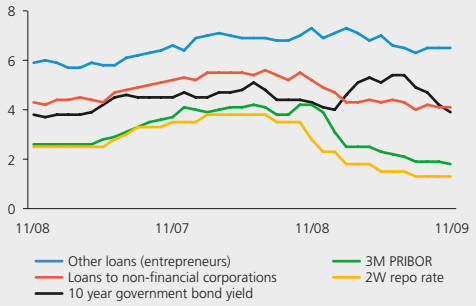


CHART 2 (BOX)
Monetary policy, market and client interest rates on loans to households in the Czech Republic
(new business, percentages)

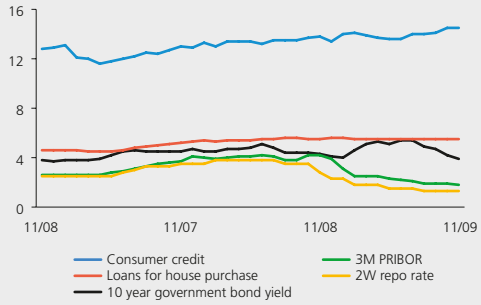
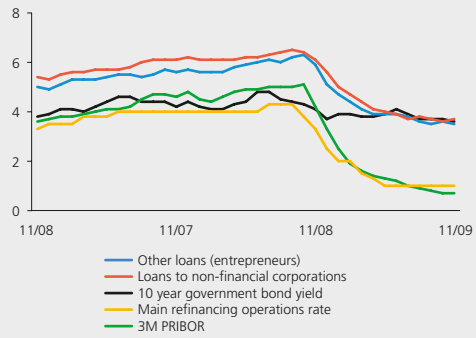
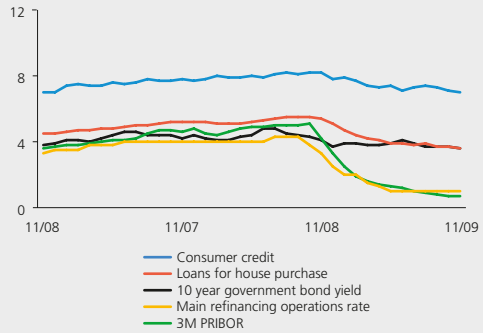


CHART 3 (BOX)
Monetary policy, market and client interest rates on loans to non-financial corporations and entrepreneurs in the euro area
(new business, percentages)



28 For the transmission mechanism to work effectively, it is vital that changes in key CNB interest rates, transmitted by the financial market, influence client rates. According to the CNB's analyses (Box 1 *Transmission of financial market interest rates to client interest rates*, Inflation Report II/2009), in the Czech Republic the 1M PRIBOR and FRA 3*6 rates are most important for short fixations of rates on loans to corporations, while the 3M and 1Y PRIBOR are most important for long fixations of rates on corporate loans. The 1M PRIBOR and the ten-year government bond yield are most important for rates on housing loans.

Chart 4 (Box)
Monetary policy, market and client interest rates on loans to households in the euro area
(new business, percentages)

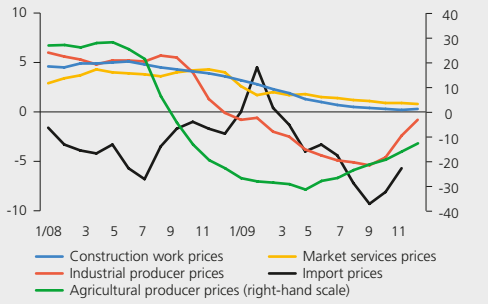


A larger increase in the risk premium for domestic loans was recorded for short-term rates on housing loans, i.e. rates with fixations of up to one year. The risk premium for consumer credit is traditionally high in the Czech Republic compared to the euro area and this difference remained broadly unchanged in the period under review.

As regards interest rates on deposits, the most pronounced transmission to rates in the Czech Republic was recorded for corporate deposits. However, interest rates on household deposits also decreased in 2009. As in the case of loan rates, rates on deposits declined more strongly in the euro area than in the Czech Republic. Here too, though, this primarily reflected a larger decline in monetary policy and market rates. Deposit rates, however, are now more significantly below market rates in the Czech Republic than in the euro area.

All this shows that monetary transmission in the Czech economy experienced some disturbances during the global financial and economic crisis. Overall, however, the monetary policy transmission mechanism remains functional. The risk premia for rates on loans increased, although no more so than in the euro area, with the exception of shorter fixation periods for housing loans. The smaller decline in client interest rates thus reflects a less significant reduction of monetary policy rates, divergence in rates on the interbank market (mainly because of the ECB's use of unconventional instruments) and an increase in ten-year government bond yields in the Czech Republic.

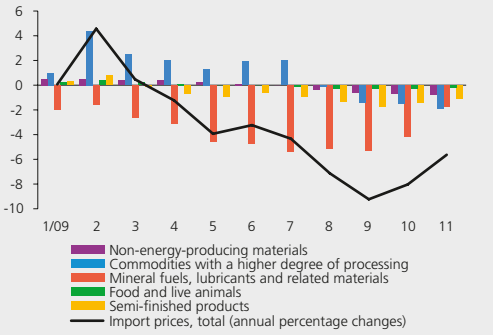
Chart II.49 Import prices and producer prices
The decline in industrial and agricultural producer prices moderated appreciably
(annual percentage changes)



II.7 IMPORT PRICES AND PRODUCER PRICES

In conditions of low global demand, prices declined in all categories included in the import price index. However, the decline in import prices did not deepen further, but instead slowed appreciably. This was due mainly to a strong upswing in oil prices on world markets, which fed through quickly to import prices of energy-producing materials and on to producer prices in the primary oil processing sector. Overall, industrial producer prices continued to show an annual decline, although this was insignificant at the end of 2009. The annual decline in agricultural producer prices moderated substantially, but was still deep. Owing to low domestic demand, growth in prices of construction work and market services slowed further and was very weak.

Chart II.50 Import prices
The decline in import prices weakened in October and November
(annual percentage changes; contributions in percentage points)



II.7.1 Import prices

According to the CZSO's latest data for November, import prices continued to decline year on year for the eighth consecutive month. After deepening to 9.3% in September, the decline weakened gradually in the following two months, reaching 5.7% in November (see Chart II.50).

The considerable moderation of the overall decline in import prices in the first two months of 2009 Q4 was largely due to energy-producing materials (see Chart II.50). The change in trend for import prices of mineral fuels was linked with renewed annual growth in oil prices on world markets, which reached 0.5% in October and as much as 44.7% in November, whereas in September oil prices had declined by more than 30%. Nevertheless, world prices of natural gas, which follow oil prices with a longish lag, recorded a continued

deepening annual decline of around 60% in the first two months of Q4. These contrary movements in world prices of oil and natural gas gave rise to a significant moderation in the annual decline in import prices of mineral fuels. At 15.1%, their decline in November was more than half that recorded in September. The annual appreciation of the koruna-dollar exchange rate only partly offset the impact of prices of energy-producing materials on domestic prices (see Chart II.51).

Import prices of food, chemicals and manufactured goods moved in the same direction. However, the slowdown in the annual decline in import prices of these commodities, consisting mainly of intermediate goods, was far less significant than that recorded for energy-producing materials in October and November. The volatility of import prices of intermediate goods is usually considerably lower than in the case of key commodities, as shown in Table II.7. It is probable that the moderation of the decline in import prices of manufactured goods was due to renewed growth in world prices of metal, which started to feed through to prices of imported intermediate goods.

By contrast, import prices of non-energy-producing materials continued to record a deep annual decline exceeding 20% in October and November. This decline was stronger than in September. Import prices of higher-value-added products also declined more significantly than at the end of 2009 Q3. The fall in import prices of machinery and transport equipment and miscellaneous manufactured articles, which are very sensitive to the exchange rate, was due not only to the slowing annual depreciation of the koruna-euro exchange rate, but also to declining prices of these products abroad as a result of low demand.

Overall, import prices in the first two months of 2009 Q4 signalled an anti-inflationary effect on domestic prices. Falling prices in all import categories, reflecting the slowdown in world economic activity, created conditions for a decline in producers' input costs, producer prices and prices on the consumer market amid still low domestic demand. At the same time, prices of some key commodities on world markets (especially oil and metals) signalled an upturn in growth, probably linked with the expected global economic recovery and other factors.[29] According to the latest data, their impact on import prices was most visible in mineral fuels, whose import prices recorded a rapid moderation of their annual decline due to the sharp rebound in growth in world oil prices.

Chart II.51 Mineral fuels

The sharp upswing in growth of world oil prices markedly affected import prices of mineral fuels

(annual percentage changes)

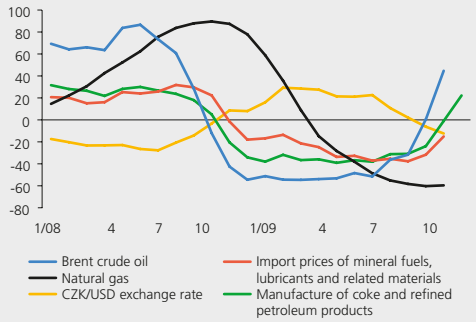


Table II.7 Structure of the import price index

Prices fell year on year in all import categories

(annual percentage changes)

	8/09	9/09	10/09	11/09
IMPORTS, TOTAL	-7.2	-9.3	-8.1	-5.7
of which:				
food and live animals	-5.1	-7.3	-6.3	-4.9
beverages and tobacco	-3.7	0.0	-0.4	-0.7
crude materials inedible. except fuels	-13.7	-20.4	-22.1	-24.3
mineral fuels and related products	-35.4	-37.7	-31.7	-15.1
animal and vegetable oils	-3.8	-7.4	-9.9	-9.7
chemicals and related products	-6.4	-8.1	-7.1	-5.9
manufactured goods classified chiefly by material	-6.1	-7.9	-6.5	-5.1
machinery and transport equipment	1.3	-1.3	-1.7	-2.6
miscellaneous manufactured articles	2.0	0.0	-0.7	-2.0

II.7.2 Producer prices

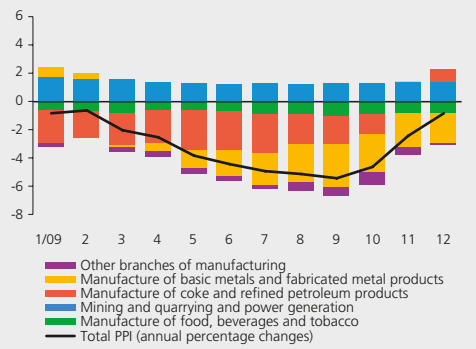
Industrial producer prices

Amid persisting low global and domestic demand and falling prices of most imported inputs, industrial producer prices continued to decline year on year in 2009 Q4. However, a pronounced slowdown in their annual decline to 0.8% in December signalled a change in trend (see Chart II.52). This change was due mainly to an upswing in prices of key commodities on world markets, which started to feed through to prices of producers at the early stages of the production chain.

Chart II.52 Industrial producer prices

The decline in industrial producer prices moderated owing to the upswing in oil price growth

(annual percentage changes; contributions in percentage points)



29 In particular the latest favourable results and outlooks for the Chinese economy for 2010, the evolution of the dollar exchange rate and the forecast for extremely cold weather in late 2009 and early 2010.

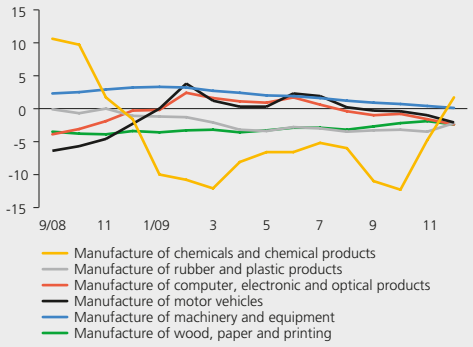
The changes in prices of key raw material inputs were most reflected in producer prices in the manufacture of coke and refined petroleum products. As Chart II.52 shows, the sharp upswing in growth in world oil prices fed through quickly to prices of primary-oil-processing businesses. This was reflected in a pronounced change in growth between September and December 2009 (of more than 50 percentage points to 22.5% year on year). The upturn in growth of world metal prices had yet to significantly affect producer prices in the manufacture of basic metals and fabricated metal products. The annual decline in producer prices in this sector eased by almost 6 percentage points in Q4, but was still very deep (-14.7% in December).

Producer prices in the food industry also saw a slower annual decline in 2009 Q4 (to 4.3% in December). This was broadly consistent with the weaker decline in domestic agricultural producer prices and world food prices. Mostly only gradual changes were visible in prices in other branches of manufacturing that make higher-value-added products. Producer prices in many of these branches recorded an annual decline in 2009 Q4 and their aggregate contribution to the change in industrial producer prices was negative, suggesting a persisting dampening effect of low demand.

Chart II.53 Manufacturing

Prices in the branches of manufacturing mostly fell

(annual percentage changes; selected branches)



The fundamental view of industrial producer price inflation has partly changed since the last Inflation Report. This is due to a pronounced upswing in producer price inflation in the primary oil processing sector, which can be regarded as a potential source of cost pressures in related branches of the economy. However, the duration and intensity of this cost shock is currently associated with considerable uncertainty deriving from the nature of the factors underlying the current upturn in oil price growth. In most other branches of manufacturing, falling or slightly rising producer prices indicated a strong influence of the persisting low domestic demand and their effect was anti-inflationary overall. However, electricity prices continued rising rapidly in year-on-year terms, thus increasing the costs of corporations with electricity-intensive production.

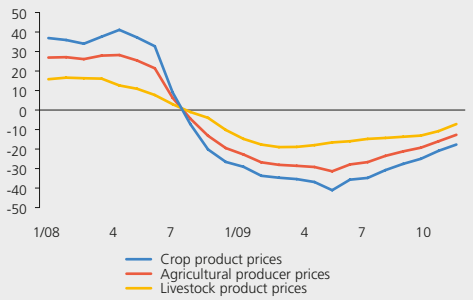
Agricultural producer prices

In 2009 Q4, agricultural producer prices saw a continuing moderation of their deep annual decline which peaked in May (at 31.4%). The decline was only 12.7% in December (see Chart II.54). This path was observed for both crop and livestock product prices. A more pronounced moderation was seen in the decline in crop product prices, which was considerably deeper throughout 2009 than that in livestock product prices (to -17.7% in December). The decline in livestock product prices was roughly half that in crop product prices in December.

Chart II.54 Agricultural producer prices

The deep decline in agricultural producer prices gradually eased in 2009 H2

(annual percentage changes)



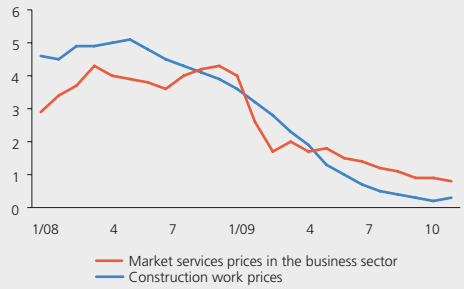
The slow change in the agricultural product price trend in the Czech Republic in 2009 H2 was linked mainly with an upswing in growth in prices on world markets. World prices were affected above all by an expected increase in demand for food products connected with the expected economic recovery worldwide. A worse harvest in the southern hemisphere at the turn of 2010 was a short-term growth factor.

Other producer prices

A continuing trend of slowing annual growth in prices of construction work and market services in the business sector suggested a persisting strong effect of weak domestic demand on prices in these branches in 2009 Q4. As Chart II.55 shows, annual construction work price inflation started to approach zero. In November, it fell to its lowest level since construction work prices started to be monitored in 1995, then in December it edged up to 0.3%. Prices of materials and products consumed in construction continued to show an annual decline, but it moderated to 3.6% in December 2009.

Annual market services price inflation in the business sector also slowed in 2009 Q4 (to 0.8% in December). Underlying this overall low inflation were relatively mixed price movements in individual service categories. The strongest decliners were again prices in freight transport (down by 6.1%), while prices of telecommunication, architectural and engineering services also recorded noticeable annual declines. Prices in most other services increased slightly or decreased. A marked decline in annual price growth was recorded mainly for administrative and office services due to a sharp fall in demand. However, prices of advertising services and research maintained a high growth rate (9.4% in December).

CHART II.55 OTHER PRICE CATEGORIES
Growth in prices of construction work and market services in the business sector fell below 1%
(annual percentage changes)



II.8 INFLATION

The rise in consumer price inflation in 2009 Q4 was due mainly to a pronounced upswing in growth in oil prices on world markets, which fed through quickly to fuel prices. Prices of other components of inflation continued to be significantly dampened by the anti-inflationary effect of low domestic demand. Headline and monetary-policy relevant inflation reached 1% in December and were thus below the lower boundary of the tolerance band around the 3% target valid until the end of 2009.

II.8.1 Current inflation

Annual inflation[30] increased in 2009 Q4. The long-running downward trend in inflation bottomed out in October with a decline to just below zero (-0.2%) and inflation rebounded to positive territory in November (see Chart II.56). At 1% in December, annual inflation was one percentage point higher than in September. The rise in inflation was due most of all to fuel prices, whose annual growth picked up considerably owing to an upswing in oil prices on world markets. The change in the inflation trend in Q4 was also fostered by a slower annual decline in food prices and adjusted inflation excluding fuels. However, their price growth was still being significantly affected by subdued activity in the domestic economy, as confirmed by the CZSO's latest November data on retail turnover in Q4.

Despite increasing in 2009 Q4, inflation fluctuated below the lower boundary of the tolerance band around the 3% target valid until the end of 2009. Compared to the new inflation target of 2% in effect since the beginning of 2010, inflation was at the lower boundary of the tolerance band. The first-round effects of past changes to indirect taxes having unwound, monetary-

CHART II.56 INFLATION
Annual inflation increased in 2009 Q4
(annual percentage changes)

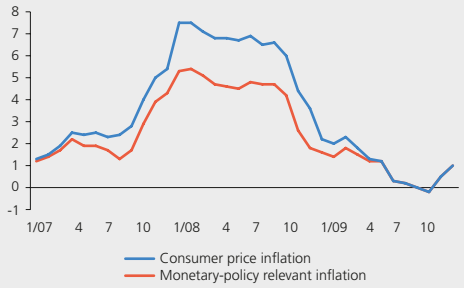
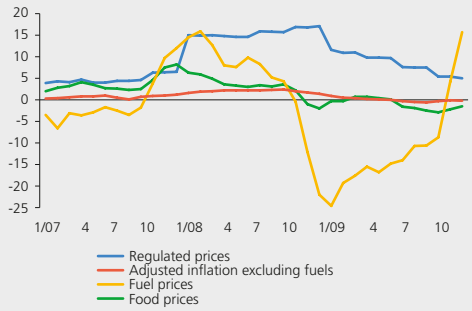


CHART II.57 INFLATION COMPONENTS
The main contributor to the increase in inflation was a rapid rise in fuel prices
(annual percentage changes; excluding indirect tax changes)



30 Measured by annual growth in consumer prices.

Chart II.58 Structure of inflation

The rise in consumer prices in 2009 Q4 was driven by regulated prices and fuel prices

(annual percentage changes; contributions in percentage points)

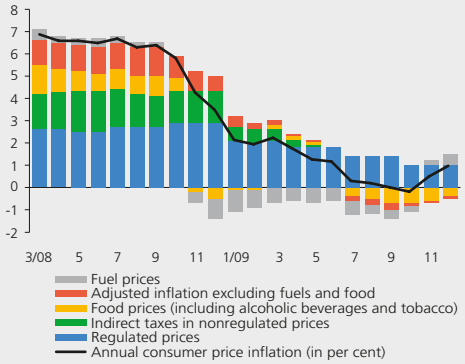


Chart II.59 Food prices

Food prices declined more modestly in 2009 Q4 than in the previous quarter

(annual percentage changes)

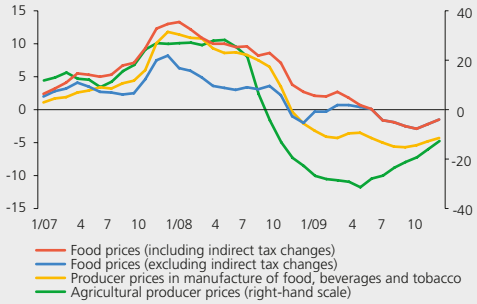
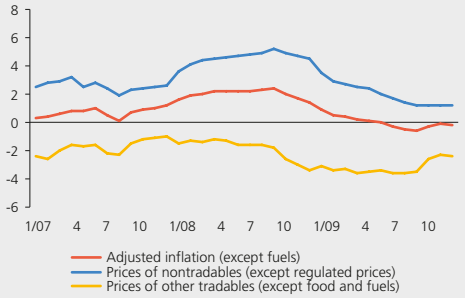


Chart II.60 Adjusted inflation excluding fuels

The decline in adjusted inflation excluding fuels also moderated in 2009 Q4

(annual percentage changes)



policy relevant inflation was the same as headline inflation, so it, too, stood at 1% in year-on-year terms in December.

As Chart II.58 shows, fuel prices and regulated prices recorded positive contributions to annual inflation in 2009 Q4. However, annual growth in regulated prices slowed further in Q4 (by 2.5 percentage points compared to September, to 5% in December). Their still fast current growth continued to be most affected by high growth in regulated rents and electricity prices. Particularly pronounced was the almost 30% annual growth in regulated rents, reflecting faster convergence of regulated rents to their market level. On the other hand, the impact of the fast growing electricity prices (11.4%) and regulated rents on total regulated price inflation was significantly dampened by an annual decline in natural gas prices. The almost 12% decline in natural gas prices in December was also fostered by a further price decrease of 3% in October.

The annual decline in market prices, as measured by net inflation, further moderated in 2009 Q4 and turned into stagnation in December. As Chart II.58 shows, all the main components of net inflation contributed to this moderation. Nonetheless, food prices and adjusted inflation excluding fuels still recorded a slight annual decrease in December amid persisting low domestic demand. However, fuel prices, which declined continuously year on year between October 2008 and October 2009, started to rise again in November and accelerated significantly to growth of 15.7% in December. The change in the fuel price trend during Q4 stemmed from growth in world oil prices and petrol prices on European stock exchanges as expressed in koruna (i.e. including the effect of the dollar-koruna exchange rate). Fuel price inflation was also significantly affected by base effects.

The annual decline in food prices slowed in 2009 Q4 (by 1 percentage point compared to September, to 1.5% in December). This was consistent with the ongoing weakening of the decline in agricultural producer prices (for details, see *Agricultural producer prices*). Import prices of food acted in the same direction. Nevertheless, analyses of inflation in this area continue to show that the response of consumer food prices to the sharp fall in agricultural producer prices was subdued. It is probable that this was again due to still modestly rising demand for food, as indicated by the latest figures for retail sales of food until November 2009.

The year-on-year decline in annual adjusted inflation excluding fuels also slowed in 2009 Q4 (from -0.6% in September to -0.2% in December). This was due to prices of non-food tradable commodities[31], whose annual decline slowed appreciably to 2.4% in December (see Chart II.60). Annual growth in prices of non-tradable commodities, consisting mainly of services, remained at a record low level of 1.2% in 2009 Q4. Their prices thus followed the path of gradually declining household expenditure on services amid slowing household income growth, rising unemployment and uncertain economic growth prospects (see section II.3.1 *Domestic demand*).

The continuing, albeit smaller than in the previous quarter, decline in prices of non-food tradable commodities suggested a strong dampening effect of weak domestic demand on prices in this category. According to the December figures, prices of clothing fell by 2.9% year on year, while prices of household equipment and furnishings decreased by 1%.

31 Excluding fuels.

Turning to the major categories of the consumer basket, prices in the housing category continued to rise fastest (by 4.4% in December), owing mainly to ongoing rent deregulation and growth in electricity prices. Although prices in the transport category grew at almost the same rate, their contribution to the total growth in consumer prices was noticeably smaller than that of the housing category (see Chart II.61). The positive contribution of these and some other categories of the consumer basket was partly offset by falling food prices in December.

By international comparison, consumer prices as measured by the HICP moved in the same direction in the Czech Republic in 2009 Q4 as on average in the EU countries (see Chart II.62). However, the upswing in their growth, due mainly to rising oil prices on world markets, was less pronounced in the Czech Republic. According to Eurostat, the HICP recorded a slight annual increase in the Czech Republic in December (0.5%). In the EU countries it was higher on average, at 1.4%.

II.8.2 Fulfilment of the inflation target

Headline inflation was well below the lower boundary of the tolerance band around the CNB's inflation target in 2009 Q4 (see Chart II.63). This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

In order to assess the effect of monetary policy on the fulfilment of the inflation target one needs to analyse retrospectively the forecasts and the Bank Board's decisions based thereon in the relevant period. As monetary policy is focused on hitting the inflation target at the 12–18 month horizon, the key period for the fulfilment of the inflation target in 2009 Q4 is roughly from April 2008 to December 2008. For the sake of clarity, however, the analysis of the accuracy of the forecasts is limited here to a comparison of the Inflation Report III/2008 forecast with subsequent inflation. This is thus the first time the forecast compiled using the new "g3" core prediction model is being assessed.

This forecast expected headline inflation to remain above the upper boundary of the inflation-target tolerance band until the end of 2008. In addition to a rise in the lower VAT rate as from 1 January 2008 and the harmonisation of consumer and environmental taxes with EU rules, the high inflation was expected to be due to regulated prices and fuel prices. At the start of 2009, inflation was expected to fall quickly to the upper boundary of the tolerance band thanks to the unwinding of the one-off inflation effects that occurred in late 2007 and early 2008, the anti-inflationary effect of the appreciation of the koruna, and a gradual decline in inflation pressures from the domestic economy. The forecast expected headline inflation to be in the lower half of the tolerance band around the 3% inflation target at the end of 2009 (see Chart II.63).

Headline inflation in reality was lower throughout the entire period than had been forecasted, with the deviation gradually increasing. From the start of 2009 onwards, inflation was even below the lower boundary of the tolerance band around the inflation target. The deviation was due to all components of inflation, most of all food and fuel prices, which reflected a substantial decline in world commodity prices. Regulated prices, comprising, for example, regulated rents and energy prices for households, also grew more slowly than forecasted (see Table II.8).

Chart II.61 Consumer basket prices

Prices in the housing and transport categories were the biggest contributors to annual inflation

(December 2009; contributions in percentage points, including changes to indirect taxes)

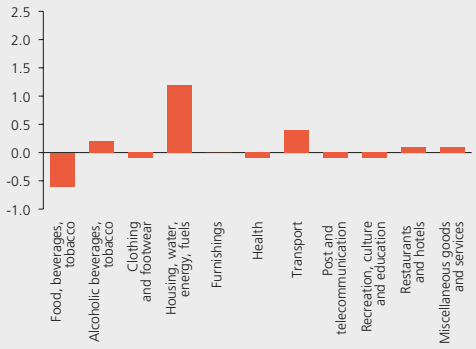


Chart II.62 The HICP in the Czech Republic and the EU

Inflation in the Czech Republic was below the EU average in 2009 Q4

(annual percentage changes)

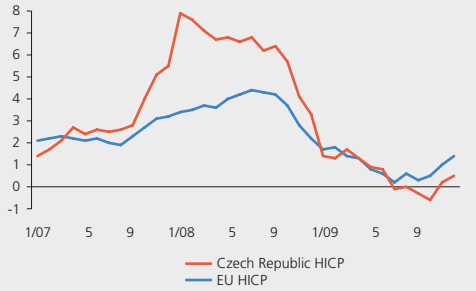


Chart II.63 Forecast versus actual inflation

Inflation was below the IR III/2008 forecast throughout the period

(annual percentage changes)

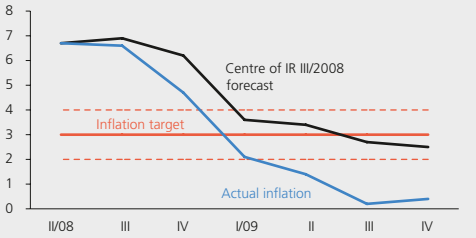


Table II.8 Fulfilment of the inflation forecast

Prices of food contributed the most to the lower inflation

(annual percentage changes; contributions in percentage points)

	IR III/2008 forecast	2009 Q4 outturn	Contribution to total difference[a)]
CONSUMER PRICES	2.5	0.4	-2.1
Breakdown into contributions:			
regulated prices	6.9	5.2	-0.3
first-round impacts of changes to indirect taxes	0.0	0.0	0.0
food prices[b)]	1.5	-2.2	-1.0
fuel prices[b)]	15.4	3.7	-0.4
adjusted inflation excl. fuels[b)]	0.3	-0.2	-0.3

a) owing to rounding, the sum of the contributions need not be equal to the total difference
b) excluding the first-round impacts of changes to indirect taxes

Table II.9 Fulfilment of the external assumptions

External economic developments influenced the domestic economy towards sharply lower economic growth, interest rates and inflation

(annual percentage changes unless otherwise indicated)

		III/08	IV/08	I/09	II/09	III/09	IV/09
GDP in euro area[a), b), c)]	p	1.8	1.6	0.8	1.3	1.5	1.6
	o	2.2	-0.7	-5.7	-5.4	-4.3	-
PPI in euro area[b), c)]	p	6.2	5.3	4.1	2.8	2.6	2.6
	o	8.2	4.2	-0.7	-4.8	-7.6	-5.4
1Y EURIBOR	p	4.3	4.5	4.5	4.3	4.1	4.1
(percentages)	o	4.3	2.6	1.1	0.7	0.4	0.4
USD/EUR exchange rate	p	1.58	1.53	1.52	1.49	1.45	1.43
(levels)	o	1.50	1.32	1.30	1.36	1.43	1.48
Brent crude oil price	p	141.7	146.9	148.3	148.4	148.1	147.7
(USD/barrel)	o	115.9	56.2	45.0	59.3	68.3	74.9

p - prediction, o - outturn
a) at constant prices
b) seasonally adjusted
c) effective indicator as defined in the IR III/2008 forecast

Table II.10 Fulfilment of the forecast for key variables

The forecast had not predicted such a sharp slowdown in real economic activity

		III/08	IV/08	I/09	II/09	III/09	IV/09
3M PRIBOR	p	3.6	3.2	3.3	3.2	3.2	3.4
(percentages)	o	3.9	4.1	2.7	2.3	2.0	1.8
CZK/EUR exchange rate	p	24.4	24.8	24.8	24.6	24.5	24.3
(levels)	o	24.1	25.3	27.6	26.7	25.6	25.9
Real GDP [a)]	p	3.6	2.9	3.1	3.2	3.9	4.2
(annual perc. changes)	o	2.2	0.5	-4.2	-4.7	-4.1	-
Nominal wages [b)]	p	10.1	8.9	7.4	7.9	7.6	6.8
(annual perc. changes)	o	8.4	8.5	2.8	2.7	4.5	-

p - prediction, o - outturn
a) seasonally adjusted
b) in the business sector

In an environment of global financial and economic crisis, external economic factors contributed significantly to the divergence of domestic inflation in the period under review. External demand, inflation, interest rates and oil prices dropped at the end of 2008. All these variables were thus lower than forecasted and therefore acted strongly in the anti-inflationary direction (see Table II.9).

Real interest rates and the exchange rate both differed significantly from the expectations of the forecast in the key period. Real interest rates were tighter over the entire period; there was an increase in the risk premium on the interbank market in 2008 H2, later accompanied by a larger-than-expected decline in inflation. Not even the lowering of the CNB's key interest rates, which started in August 2008 and was gradually reflected in money market rates, offset the effect of the sharply falling inflation. The exchange rate was weaker than forecasted over the entire period, most of all in 2009 H1 (see Table II.10). It thus had an inflationary effect, partially dampening the impacts of the global crisis on the Czech economy.

Based on the CNB's current knowledge of the workings of the Czech economy and its current knowledge of the actual economic situation, the developments since the forecast under review was drawn up can be summed up in the following way. The assumption of a falling inflation path materialised, but the decline was considerably faster and more significant than forecasted. The decline in inflation was due mainly to an unexpected fall in world prices of food and oil at the end of 2008 and the downturn in global demand. Real economic activity was substantially weaker than forecasted in the period under review, due mainly to the fall in external demand resulting from the financial and economic crisis. This was also reflected in lower nominal wage growth. As a result of the overall economic trend, monetary policy rates and later also market interest rates declined more than forecasted in Inflation Report III/2008 (see Table II.10).

In addition to the message of the forecast, an assessment of the risks associated with this forecast is of importance for the Bank Board's decisions on monetary policy rates. At its meetings between April and December 2008 (see the relevant minutes), the Bank Board assessed the risks to inflation at first as being on the upside. This assessment changed gradually to a strong downside risk. Amid unexpected economic developments, the Bank Board's decisions led to tighter-than-forecasted real monetary conditions. This was due mainly to a higher interest rate level in the course of 2008. Although the Board took into account the increase in the 3M PRIBOR – 2W repo spread in 2008 H2 when deciding on the repo rate setting, the actual 3M PRIBOR was higher in this period than implied by the forecasts. Headline inflation was in the lower half of the tolerance band around the inflation target at the start of 2009 and below the lower boundary from April 2009 onwards. In this regard, based on current knowledge, it seems that monetary policy should have been easier. However, the size and strength of the adverse external developments, which significantly affected the decline in inflation to negative values in the short term and led to an increase in the risk premium, were difficult to anticipate.

III.1 SUMMARY OF THE STARTING CONDITIONS

Headline inflation increased in 2009 Q4 but remained below the lower boundary of the tolerance band around the inflation target. The year-on-year contraction in real GDP moderated in 2009 Q3, while in quarter-on-quarter terms economic activity rose for the second consecutive quarter. The decline in employment deepened further and unemployment increased. However, average nominal wage growth accelerated significantly. Import prices are anti-inflationary and their effect is stronger than in the previous forecast as a result of stronger pass-through of the past exchange rate appreciation and low inflation abroad. No domestic inflation pressures are visible. A gradual recovery in the currently narrow profit margins will act towards higher inflation.

In 2009 Q4, headline inflation rebounded from the slightly negative figure recorded in October and started to rise. However, it remained below the lower boundary of the tolerance band around the inflation target of 3% valid until the end of 2009.[32] Monetary-policy relevant inflation, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, developed similarly. Inflation was higher than predicted in the previous forecast, owing both to a smaller-than-expected decline in adjusted inflation excluding fuels and to higher regulated prices and fuel prices.

Economic activity rose quarter on quarter in Q3 and its year-on-year decline moderated to -4.1%. Gross investment was again the main contributor to the annual decline in real GDP, owing to low additions to inventories and falling fixed investment. By contrast, household and government consumption continued to rise. According to the assumptions of the forecast, the year-on-year fall in real activity moderated further to -2.7% in 2009 Q4. In quarter-on-quarter terms, the forecast assumes that economic activity will continue to expand.

The contraction in economic activity is still manifesting itself on the labour market. Total employment continued to fall, but this fall remained slower in year-on-year terms than that in economic activity, implying a continuing decline in labour productivity. At the same time, registered unemployment continued to rise rapidly. The average wage in the business sector recorded rapid growth in Q3, due partly to ongoing changes in the structure of employment and a lower sickness rate.

Based on the above developments, we assess the current nominal cost developments as being anti-inflationary. Import prices are anti-inflationary and their effect is stronger compared to the previous forecast as a result of stronger pass-through of the past exchange rate appreciation and low inflation abroad. No domestic inflation pressures are visible. From the future perspective, however, the overall macroeconomic conditions are slightly inflationary in 2009 Q4. Producers' margins remain narrow, which in turn is creating pressures for a future return of margins to their long-term level, thus supporting the return of inflation to the target at the forecast horizon. However, given the higher-than-expected observed inflation and slower cost growth in 2009 Q4, this factor of future inflation acceleration will be weaker compared to the previous forecast.

32 At the start of 2010, a new inflation target of 2% with a tolerance band of ±1 percentage point takes effect in accordance with a CNB Bank Board decision of March 2007.

III.2 THE FORECAST

Inflation will gradually rise during 2010. Owing to tax changes, it will temporarily increase slightly above the new inflation target of 2% in the second half of the year. Monetary-policy relevant inflation will approach the inflation target from below. From Q1, economic activity will return to moderate year-on-year growth. However, stronger growth will be prevented by weakening household and government consumption and uneven growth in external demand. The forecast expects real GDP to grow by 1.4% in 2010. The nominal exchange rate is predicted to appreciate gradually. Consistent with the forecast is stability of short-term interest rates close to current levels in the first half of this year and a gradual rise in rates thereafter.

III.2.1 Assumptions of the forecast

The forecast is based on the starting conditions summarised in section III.1 and on assumptions regarding the future external economic environment, regulated prices, indirect tax changes and public budgets.

Table III.1 Expected external developments

The forecast assumes an asymmetrical W-shaped recovery in external demand
(quarterly averages)

	I/10	II/10	III/10	IV/10	I/11	II/11	III/11
Brent crude oil prices (USD/barrel)	80.7	82.9	84.7	86.2	87.6	88.7	89.4
GDP in euro area[a)]	2.5	2.0	1.0	0.5	0.9	1.6	2.3
Producer prices in euro area[a)]	-1.9	0.4	1.7	2.2	2.1	1.9	1.6
Consumer prices in euro area[a)]	0.9	1.1	1.4	1.5	1.5	1.7	1.8
USD/EUR exchange rate	1.44	1.47	1.46	1.45	1.43	1.42	1.41
3M EURIBOR (in per cent)	0.7	0.8	1.2	1.6	1.8	2.1	2.4

a) effective indicator; annual percentage changes

Expectations regarding the external environment are one of the key assumptions of the forecast. For this purpose, the CNB has as usual drawn on the publication Consensus Forecasts, which brings together the forecasts of a range of foreign analytical teams, and on market outlooks. The current forecast is based on the January Consensus Forecasts data and the market outlooks effective on the survey date. Effective developments in the euro area are used to proxy for developments in the Czech Republic's major trading partner economies. The CNB forecast uses the outlook for prices of Brent crude oil as an indicator of prices of energy-producing materials. In addition, the outlook for petrol prices on the ARA markets is used in forecasting fuel prices.

The effective GDP in the euro area is expected to rise by 1.5% this year and it will accelerate slightly to 1.9% in 2011, which represents a slight revision of the outlook upwards. The outlook for effective consumer price inflation is almost unchanged, with inflation of 1.2% and 1.7% expected for 2010 and 2011 respectively. Effective producer price inflation for this year has been lowered slightly and is currently expected to be 0.6%; the estimate for 2011 has conversely been increased to 1.8%.

The ECB is maintaining its key monetary policy rate at 1%, and at the same time injecting large volumes of liquidity into the economy. These measures have led to a decline in three-month euro rates to well below the ECB's monetary policy rate. The three-month EURIBOR is thus expected to start rising gradually from its current level of 0.7% to 2.9% at the end of 2011. The path of foreign interest rates has been moved downwards by around 0.5 percentage point compared to the previous forecast. The dollar-euro exchange rate is expected to depreciate slightly at first and then appreciate to USD 1.4/EUR in the longer term. The outlook for oil prices has been moved upwards by roughly 10% along its entire path. The average price of Brent crude oil is expected to rise gradually from the current USD 80 a barrel to USD 90 at the end of 2011. Simultaneously with the crude oil price, the expected petrol price path has been moved upwards to a similar extent.

Domestic regulated prices will slow their annual growth to very low values in Q1 as a result of falling prices of electricity and natural gas. In the remainder of the year, they will gradually pick up to 2.3% year on year in Q4 and account for about 0.5 percentage point of headline inflation. In 2011, regulated

price inflation will continue to rise slightly, mainly because of an upturn in energy prices amid continuing rent deregulation. Annual regulated price inflation will be around 3%, with an impact of about 0.6 percentage point on headline inflation.

The assumptions of the forecast also include the outlook for the first-round effects of indirect tax changes, which are subject to escape clauses. Starting in 2010 Q1, inflation will be affected by the inflationary effects of indirect tax changes which are part of the measures adopted to reduce the state budget deficit. The first-round effects of these changes are estimated at 1.2 percentage points, but the actual impact on inflation is expected to be smaller, at 0.9 percentage point. The only slow recovery in economic activity will prevent full pass-through of the tax changes to prices.

The fiscal deficit is expected to be 5.9% of GDP this year. Its lowering compared to the previous year is a result of a package of adopted measures, some of which have, however, only a temporary effect. In 2011 – if no further austerity measures are adopted – the deficit will therefore grow again to 6.5% of GDP. The 3% reference value of the Maastricht convergence criteria for the public finance deficit will thus be significantly exceeded over the entire forecast horizon. Next year, the rise in the overall deficit will be accompanied by renewed growth in the structural deficit.

III.2.2 The message of the forecast

Annual headline inflation will rise during 2010 H1. Owing to tax changes, it will increase slightly above the inflation target of 2% in the second half of the year. At the monetary policy horizon, i.e. in 2011 H1, headline inflation will be close to the inflation target (see Chart III.1).

Monetary-policy relevant inflation, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, will be below headline inflation from the start of this year (see Chart III.2). It will thus approach the CNB target from below over the monetary policy horizon.

The contribution of regulated prices to headline inflation will be markedly smaller than last year, but remains positive and will increase as the year progresses. The first-round effects of changes to indirect taxes will significantly increase headline inflation in 2010 but will gradually disappear in 2011 H1.[33] The other components of inflation will be affected by pressures stemming from the domestic economy as well as import prices. Adjusted inflation excluding fuels will be negative in year on year terms until the end of this year, but will gradually reach a level of around 2% during 2011. A slow recovery in economic activity will allow only a slow renewal of domestic producers' profit margins and will prevent full pass-through of the increase in indirect taxes to final prices. Food prices will continue to record a year-on-year decline until mid-2010 due to a fall in agricultural producer prices, but will return to growth thereafter. Fuel prices will continuously record modest increases, but their annual growth will be uneven this year due to past fluctuations in prices (see Table III.2).

33 The expected persistence of the effect of tax changes until 2011 is based on the assumption that, as in previous cases, the increase in excise duty on tobacco products will pass through to cigarette prices gradually and with a lag.

Chart III.1 The headline inflation forecast

Headline inflation will rise, getting just above the CNB's target in 2010 H2 as a result of tax changes

(annual percentage changes)

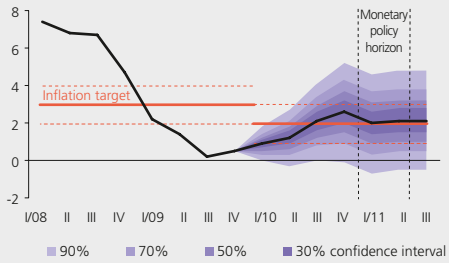


Chart III.2 The monetary-policy relevant inflation forecast

Monetary-policy relevant inflation will approach the CNB target from below over the monetary policy horizon

(annual percentage changes)

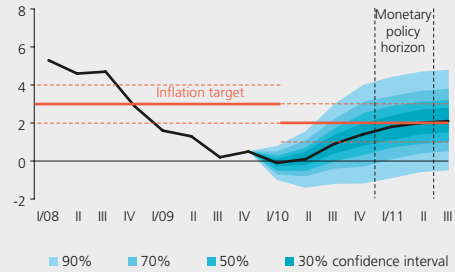


Table III.2 Forecast of key inflation components

The contribution of regulated prices to headline inflation will be much lower compared to the previous year, but will remain positive and gradually increase

(annual percentage changes; quarterly averages)

	I/10	II/10	III/10	IV/10	I/11	II/11	III/11
CONSUMER PRICES	0.9	1.2	2.1	2.6	2.0	2.1	2.1
Regulated prices[a)]	0.9	1.1	1.9	2.3	2.5	2.9	3.0
First-round impacts of indirect tax changes on consumer prices[b)]	1.0	1.1	1.2	1.2	0.2	0.1	0.0
Net inflation[c)]	-0.2	-0.1	0.6	1.0	1.6	1.8	1.9
Prices of food. beverages. tobacco[c)]	-1.9	-0.4	2.0	2.6	2.7	2.4	2.1
Adjusted inflation excl. fuels[c)]	-0.3	-0.5	-0.2	0.0	0.6	1.2	1.5
Fuel prices[c)]	14.8	5.8	2.3	5.6	6.1	6.0	6.2
Monetary-policy relevant inflation[d)]	-0.1	0.1	0.9	1.4	1.8	2.0	2.1

a) including changes to indirect taxes
b) contributions in percentage points
c) excluding changes to indirect taxes
d) headline inflation excluding first-round impacts of changes to indirect taxes

Chart III.3 The interest rate forecast
Consistent with the forecast is stability of short-term interest rates close to current levels in 2010 H1 and a gradual rise in rates thereafter
(3M PRIBOR, percentages)

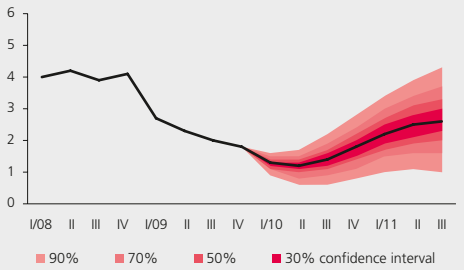


Chart III.4 The exchange rate forecast
The nominal exchange rate of the koruna is gradually appreciating over the forecast horizon
(CZK/EUR)

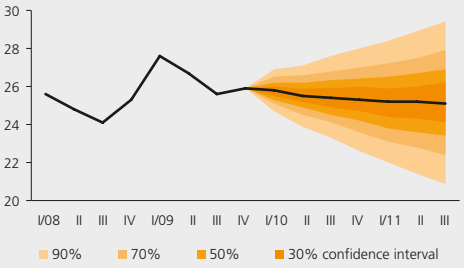


Chart III.5 The GDP growth forecast
Annual GDP growth will turn positive in 2010 Q1
(annual percentage changes; seasonally adjusted)

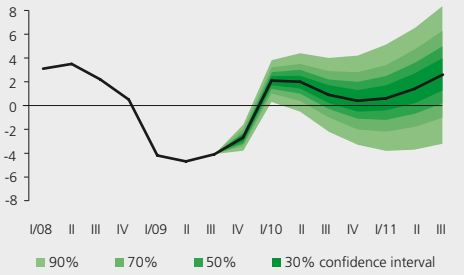


Table III.3 Forecast of key GDP components
The outlook for exports is affected mainly by renewed external demand
(annual percentage changes; seasonally adjusted)

	2009	2010	2011
GROSS DOMESTIC PRODUCT	-3.9	1.4	2.1
Household consumption	1.6	-1.7	-0.1
Government consumption	4.5	2.4	1.0
Gross capital formation	-23.8	-1.5	0.8
Imports of goods and services	-11.9	-0.2	5.0
Exports of goods and services	-10.7	2.7	7.0
Net exports of goods and services (in CZK bn; at constant prices)	97.0	178.9	246.5

Consistent with the forecast is stability of short-term interest rates close to current levels in the first half of this year and a gradual rise in rates thereafter (see Chart III.3). Domestic market interest rates will continue to be influenced by the credit premium, although the latter should gradually fall in line with the assumptions regarding the calming of the financial market situation and developments in the external credit premium. The nominal exchange rate of the koruna is gradually appreciating over the forecast horizon, mainly because of a slightly positive interest rate differential and a growing output balance surplus (see Chart III.4).

Annual GDP growth will turn positive, reaching roughly 2% in 2010 Q1. However, GDP growth will slow again in the remainder of the year owing to subdued household consumption, affected by ongoing adverse labour market developments and the impacts of budget measures. A renewed slowdown in euro area growth and the unwinding of the effect of some anti-crisis measures in the Czech Republic and abroad (car-scrapping incentives) will act in the same direction. In 2011, a stronger recovery in external demand will lead to a rise in growth in domestic economic activity to 2.1% on average (see Chart III.5).

Household consumption will decline year on year in 2010 and 2011 H1 (see Table III.3). The decline in consumption will be affected by the labour market developments described below as well as the effects of the fiscal measures on annual disposable income growth. Household consumption will grow again slightly in 2011 H2 as the labour market situation improves. Real government consumption will grow by 2.4% on average this year and slow to 1.0% in 2011.

The deep year-on-year fall in gross capital formation observed in 2009 will halt this year on average and investment will start to increase slightly in 2011. Inventories in particular will foster growth in total investment at first, whereas fixed investment will remain weak due to persisting unused capacity in the economy. The forecast expects average changes in gross capital formation of -1.5% and 0.8% in 2010 and 2011 respectively.

The outlook for exports is affected mainly by renewed external demand and will thus switch to strongly positive annual growth in 2010 H1. Exports will dip temporarily in 2010 H2 owing to the W-shaped outlook for external demand and the discontinuation of car-scrapping incentives abroad. In 2010 and 2011, the forecast expects average real export growth of roughly 3% and 7% respectively. Imports will respond mainly to import-intensive exports and investment. The decline in household consumption will foster lower imports until mid-2011. Imports will fall slightly on average in 2010 and rise by 5% in 2011.

The labour market will respond to the real economy with the usual lag (see Table III.4). Employment will decline year on year until 2011 H2, while the unemployment rate under ILO methodology will increase, reaching 8.8% on average in 2011. Annual average nominal wage growth in the business sector will remain high in 2010 H1 in the wake of the changes in the structure of employment and will thus reach almost 4% in 2010 as a whole. It will, however, slow markedly in the course of the year. Wage growth will accelerate again in 2011 as economic activity recovers. Wage growth in the non-business sector will be dampened by austerity measures and will slow considerably over the entire forecast horizon.

III.3 FORECASTS BY OTHER ENTITIES

Financial market analysts expect a gradual improvement in some key macroeconomic indicators. The analysts expect growth in GDP in 2010 and an appreciation of the koruna exchange rate and an increase in the CNB's key rates at the one-year horizon. Inflation is expected to stay above the CNB's target at both the one-year and three-year horizon.

In 2009 Q4, inflation expected by financial market analysts[34] was above the 2% inflation target valid from January 2010 at the one-year horizon, while business managers expected inflation to be slightly below this target (see Table III.5). The analysts slightly lowered their forecast in the January survey. Inflation expectations were roughly flat in both sets of respondents at the three-year horizon, remaining above the CNB's inflation target.

The financial market analysts expect GDP to increase in 2010 (see Table III.6), but the unemployment rate to rise further and wage growth to be slower than in 2009. Compared to the value at the end of January 2010, the analysts expect a stronger exchange rate of the koruna at the one-year horizon. All the analysts were expecting the CNB's key rates to remain unchanged at the February CNB Bank Board meeting. The outlook for the CNB's key rates foresees an increase at the one-year horizon compared to the current level.

Compared to the current CNB forecast, the financial market analysts expect slightly higher figures for real GDP growth and inflation at the one-year horizon in 2010. The exchange rate was slightly stronger in the analysts' predictions than in the CNB forecast at the one-year horizon. At the one-year horizon, the analysts' expectations regarding the 2W repo rate were slightly lower than the level implied by the 3M PRIBOR rate path consistent with the CNB forecast described in section III.2, assuming a gradual decline in the credit premium on the interbank market.

The indicator of inflation perceived by households was negative throughout 2009 (see Chart III.6).[35] This means that households on average felt that prices tended not to rise over the last 12 months. The indicator of expected inflation was also negative in 2009 H2. This suggests that the number of respondents who expect prices not to rise over the next 12 months is higher than the number of those who expect prices to stay the same or increase more rapidly than in the past.

Table III.4 Forecast of selected variables
The general unemployment rate will rise further and employment will decline
(annual percentage changes)

	2009	2010	2011
Real gross disposable income of households	0.8	-1.7	0.9
Total employment	-1.4	-1.1	-0.2
Unemployment rate (in per cent)[a]	6.8	8.4	8.8
Labour productivity	-2.8	2.5	2.3
Average nominal wage	3.9	3.3	2.8
Average nominal wage in business sector	3.7	3.9	3.2
Current account deficit (ratio to GDP in per cent)	-0.8	0.7	1.2
M2	6.3	2.5	3.1

a) ILO methodology

Table III.5 Inflation expectations
The inflation expectations of the financial market are above the CNB's target
(annual percentage changes in consumer price index)

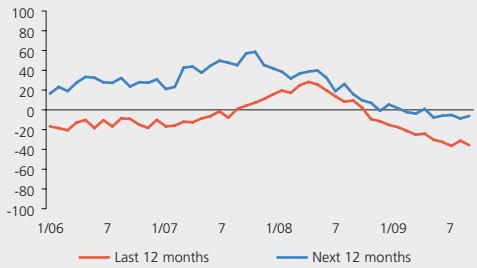
	9/09	10/09	11/09	12/09	1/10
Financial market, 1Y horizon	1.8	2.5	2.5	2.5	2.2
Financial market, 3Y horizon	2.5	2.5	2.5	2.6	2.6
Corporations, 1Y horizon	1.7			1.8	
Corporations, 3Y horizon	2.5			2.6	

Table III.6 Other expected indicators
The financial market now expects GDP to grow in 2010
(at 1Y unless otherwise indicated)

	9/09	10/09	11/09	12/09	1/10
Real GDP in 2009[a]	-4.4	-4.4	-4.3	-4.1	
Real GDP in 2010[a]	1.9	1.6	1.6	1.6	1.7
Nominal wages in 2009[a]	2.7	2.6	2.7	3.2	
Nominal wages in 2010[a]	2.7	1.9	1.7	2.1	2.4
CZK/EUR exchange rate[b]	24.8	25.0	24.9	24.9	24.9
2W repo rate[c]	1.7	1.6	1.7	1.8	1.8
1Y PRIBOR[c]	2.7	2.7	2.6	2.6	2.7

a) year-on-year changes in per cent
b) level
c) in per cent

Chart III.6 Perceived and expected inflation
The inflation expectations of households for next year are low
(Source: European Commission Business and Consumer Survey)



34 The CNB monitors the expectations of financial market analysts regarding key macroeconomic indicators and the inflation expectations of business managers by means of statistical surveys. Tables III.5 and III.6 show the average values from these surveys.

35 The CNB draws on the qualitative assessment of past and future inflation by households collected as part of the European Commission Business and Consumer Survey (see Box 2 in the July 2007 Inflation Report).

ASSESSMENT OF THE FULFILMENT OF THE MAASTRICHT CONVERGENCE CRITERIA AND THE DEGREE OF ECONOMIC ALIGNMENT OF THE CZECH REPUBLIC WITH THE EURO AREA

A joint document of the Ministry of Finance of the Czech Republic and the Czech National Bank approved by the Government of the Czech Republic on 21 December 2009.

The document was prepared before the Lisbon Treaty entered into force, therefore the references to the Treaty correspond to the legal situation before the Lisbon Treaty.

1. SUMMARY AND RECOMMENDATIONS REGARDING THE CZECH REPUBLIC'S PREPAREDNESS FOR JOINING ERM II AND THE EURO AREA

Besides being required to harmonise their legislation with Articles 108 and 109 of the Treaty establishing the European Community and the Statute of the European System of Central Banks, EU Member States are required to achieve a high degree of sustainable convergence in order to join the euro area.

As regards European structures, this is measured by the fulfilment of four convergence criteria: a high degree of price stability, as apparent from the rate of inflation; sustainability of the government financial position, as measured by the government deficit and government debt; exchange rate stability, as measured by movements in the exchange rate within the normal fluctuation margins of the ERM II system for two years without devaluation; and durability of nominal convergence, as reflected in the long-term interest rate level.

The Czech Republic is obliged to take steps to be prepared to join the euro area as soon as possible. However, setting the date for joining the euro area is within the competence of the Member State and depends on its preparedness. Potential non-fulfilment of the convergence criteria has no direct consequences for the Czech Republic. The only exception is the criterion on the sustainability of public finance. If a country fails to meet this criterion it is subject to the excessive deficit procedure, which the Czech Republic was in from spring 2004 to June 2008. The procedure will probably be re-opened against the Czech Republic before the end of 2009.

1.1 Assessment of Fulfilment of the Convergence Criteria

The Czech Republic will be compliant with **the criterion on price stability** at the end of 2009 owing to sharp disinflation caused by the abatement of the mostly one-off inflation factors recorded in the past, and owing to the economic recession. The Czech Republic should see relatively subdued consumer price inflation in 2010–2012. In the medium term, moreover, upward pressures on the price criterion reference value are expected as the global economy recovers. Fulfilment of the price stability criterion should thus not be a major problem for the Czech Republic unless large unforeseeable shocks occur in the reference period.

The reduction of the CNB's inflation target for the national CPI to 2.0%, with a tolerance band of ±1.0 p.p., from 1 January 2010 creates better conditions for fulfilling the criterion. It is desirable, however, that no substantial inflationary changes to indirect taxes or other administrative measures in the consumer

price area hindering the fulfilment of the criterion be made during the reference period for the assessment of this criterion.

The Czech Republic is not compliant with **the criterion on the sustainability of the government financial position** at present, and given the current fiscal policy settings and expected macroeconomic developments it is not likely to fulfil it in the medium term either.

The general government deficit for 2009 is notified at 6.6 % of GDP. The government's fiscal strategy aims to reduce the deficit to 5.3% of GDP in 2010. Unless more measures are adopted, however, it will rise to 5.6% of GDP in 2011 and 5.5% of GDP in 2012 according to the Czech Ministry of Finance's forecast. This is well above the 3% reference value.

The Czech Republic has long been compliant with the government debt-to-GDP ratio criterion. Given its relatively low initial level of government debt, the Czech Republic currently has no problems fulfilling this criterion, although the rate of growth of the debt started rising sharply 2009. A debt of 35.6% of GDP is expected for 2009, i.e. around 5 percentage points higher than in the previous six years, when the debt-to-GDP ratio fluctuated around 30%. Owing to the expected annual government sector deficits, the government debt level will increase sharply in the medium term, reaching almost 45% of GDP in 2012. Another risk going forward is the expected adverse effect of population ageing. Unless the necessary reforms of the pension and health care systems are implemented, a further increase in the debt-to-GDP ratio is to be expected in the long run.

Assessment of the fulfilment of **the criterion on exchange rate stability** will only be possible after the Czech currency joins ERM II and the central rate of the koruna against the euro is set. The koruna has been recording a long-term appreciation trend against the euro and its movements have so far been mostly subdued. The exceptions were the crisis-hit years 2008 and 2009, when the koruna's exchange rate recorded a cumulative (for the previous 24 months) appreciation and depreciation respectively of greater than 15%. Moreover, the second half of 2008 was an exception from previous appreciation trend, as the global crisis changed the sentiment of financial market investors, resulting in a correction of the koruna exchange rate. The size of depreciation between July 2008 and February 2009 indicates potential risks to the fulfilment of the exchange rate criterion. The sharp fluctuations in the exchange rate observed recently thus indicate that the exchange rate stability criterion can be difficult to fulfil in turbulent times. The appropriate timing of ERM II entry, which should be preceded by a calming of the global financial market situation and of investment sentiment towards the region, as well as consolidation of domestic public finances, will thus be of key importance for successful fulfilment of the exchange rate stability criterion going forward. The correct setting of the central rate of the koruna against the euro will also be very important.

The Czech Republic is currently compliant with **the criterion on long-term interest rates** and the forecast for the yields to maturity of 10-year government bonds likewise suggests no problems in this respect in the future.

1.2 Assessment of Economic Alignment Analyses

In previous years, thanks to high economic growth, the Czech economy was gradually catching up with the average economic level of the euro area and was also showing some signs of increasing alignment. However, developments in the past year were strongly affected by the global financial and economic crisis, which led to a sharp economic downturn. As a result of the crisis, the public finance outlook is deteriorating sharply. The interest rate differential and exchange rate volatility have increased and financial market integration has loosened. In 2009, the convergence trend of the domestic price level towards the euro area is likely to be interrupted temporarily and long-term unemployment will probably rise. One positive aspect as regards the flexibility of the Czech economy is a gradual partial improvement in the business environment. Conversely, problems persist in the institutional set-up on the labour market. The economic preparedness for euro adoption in the Czech Republic has worsened markedly from the previous year as a result of the economic crisis.

In the longer term, i.e. since 2003, when the Czech Republic's Euro-area Accession Strategy was adopted, there have been both favourable and unfavourable developments in terms of euro adoption and the flexibility of the Czech economy. Compared to 2003, real and nominal convergence has advanced. Public finance performance improved in 2004–2008, but the fiscal situation will worsen sharply again in 2009 and 2010 owing to the economic slowdown. In addition to cyclical factors, the fiscal deterioration will be due to expected growth in the structural public finance deficit. The correlation of economic activity with the euro area has increased recently, owing mainly to the global financial and economic crisis. Given the global and exceptional character of this shock, the observed increase in correlation does not necessarily signal a long-term change in the Czech economy's alignment with the euro area. Since 2003, there has been no major structural improvement in the labour market either. Except for some positive changes in the business environment, the flexibility of the Czech economy has not increased.

In terms of its current preparedness to adopt the euro, the characteristics of the Czech economy can be divided into four groups.

The first group consists of **economic indicators that speak in favour of the Czech Republic adopting the euro**, which traditionally include the high degree of openness of the Czech economy, its close trade and ownership links with the euro area, and the achievement of long-term convergence of the inflation rate and nominal interest rates, even though the level and volatility of interest rate differentials vis-à-vis the euro area have increased recently.

The second group comprises **areas which, in terms of euro adoption in the Czech Republic, continue to pose a risk of macroeconomic costs, but which have shown signs of improvement in recent years**. The positive developments include fast real economic convergence in the Czech Republic, including further convergence of the price level towards that in the euro area, even though a difference in the price level and in the level of economic development persists and the distance from the euro area price level will increase again in 2009 (probably only temporarily). The correlation of economic activity between the Czech Republic and the euro area has recently increased, although this reflects the recent extreme global developments and is not likely to increase the probability of greater alignment of the business cycle going forward in normal global economic conditions. In terms of labour market flexibility, the positive developments also include an ability to make use of

inflows of foreign labour at times of economic growth and, conversely, to reduce the number of foreign workers during the current economic downturn. Other favourable developments include a halt in growth in overall labour taxation and a rise in the ratio of the minimum wage to the average wage. Nominal wages in the Czech economy have been showing signs of flexibility in the past two years, but in real terms there has been no increase in wage flexibility so far. The business environment is also showing some gradual improvement.

The third group consists of **areas which have recently recorded adverse developments in terms of future euro adoption**. The public finance outlook has deteriorated sharply as a result of the economic slump and the budgetary measures adopted. The overall fiscal deficit will probably exceed 6% in 2009. The structural deficit will increase substantially, partly because of the anti-crisis fiscal measures. Despite measures subsequently adopted to stabilise public budgets, the rapid growth in debt servicing costs that started recently and, unfortunately, the traditionally ignored long-term ageing-related challenges pose a risk to the evolution and sustainability of public finance. A temporarily adverse factor in terms of future euro adoption and prior participation in ERM II is the persisting uncertainty on the financial markets, which – despite a gradual calming of the situation in 2009 – is manifesting itself in continued increased market volatility. In this context, the alignment of the exchange rate of the koruna with the euro and the alignment with the euro area of yields on individual financial market assets have decreased. The economic downturn will also lead to a rise in long-term unemployment next year. The existing structural problems on the labour market were exacerbated by a change in the social benefits area in 2007 which was not fully corrected by the subsequent reform.

The fourth group contains other **areas which are showing problems in terms of the economy's flexibility and ability to adjust to shocks and which, moreover, are not showing any significant improvements**. A persisting problem here is the low or unsuitable skills of the long-term unemployed. The costs of terminating open-ended employment contracts, particularly after a short period of employment, remain very high by international comparison and are contributing to employment inflexibility.

1.3 Conclusions and Recommendations

The state of public finance in the deficit area is the main barrier to the fulfilment of the Maastricht convergence criteria. As the one-off inflationary effects that generated the temporary surge in inflation in 2008 have subsided, there has been a marked fall in inflation in 2009 to values allowing fulfilment of the price stability criterion. This is being aided by the CNB's new inflation target which takes effect in 2010. The criterion on long-term interest rates is being – and very probably will continue to be – fulfilled without any problems. The Czech Republic does not fulfil the exchange rate criterion because it does not participate in ERM II. The increased volatility of the koruna exchange rate in recent years resulting from the global financial crisis is an adverse factor in this respect. Fulfilment of the exchange rate criterion after the country potentially joins ERM II could thus be very difficult under these conditions.

In the area of economic alignment, the preparedness of the Czech Republic for euro adoption has worsened, mainly as a result of the economic crisis. In recent years, the Czech Republic has gradually been catching up with the euro area economic level, but the functioning and flexibility of the Czech economy are not showing any major improvement. Owing to a sharp rise in the public

finance deficit in 2009, eliminating the structural deficit and ensuring long-term public finance sustainability are still a challenge. The past positive trend on the labour market was driven largely by cyclical factors. There has been no great structural improvement and problems persist in the institutional set-up. A gradual partial improvement is taking place in the business environment. The current recession can be viewed as a temporary adverse factor as regards future adoption of the euro, since it is worsening public finance and may generate increased exchange rate variability. The persisting major uncertainty on financial markets is not creating a favourable environment for joining ERM II, since ERM II is potentially vulnerable to changes in financial market sentiment and in short-term capital flows. Any adverse developments during the Czech koruna's stay in this mechanism could generate macroeconomic costs and reduce the Czech economy's alignment with the euro area.

In the current circumstances it is very unlikely that the Czech Republic will be able to fulfil all the Maastricht convergence criteria in the medium term. A general government deficit of above 3% will be the principal barrier to joining the monetary union. Maintaining and further increasing the degree of alignment of the Czech economy with the euro area in the next few years is equally uncertain. **In this situation, therefore, it is impossible to conclude that the Czech Republic has made sufficient progress in laying the groundwork for euro adoption to allow it to set a target date for entry into the euro area. Therefore, in line with the Czech Republic's Updated Euro-area Accession Strategy, the Ministry of Finance and the Czech National Bank recommend that the Czech government should not set the target date for the time being. The recommendation not to set a target date for euro area entry for the time being simultaneously implies a recommendation that the Czech Republic should not attempt to enter ERM II during 2010.**

2 ASSESSMENT OF THE CURRENT AND EXPECTED FULFILMENT OF THE MAASTRICHT CONVERGENCE CRITERIA

The degree of sustainable convergence, which is one of the prerequisites for euro adoption defined in the Treaty establishing the European Community, is assessed according to the Maastricht convergence criteria. These criteria include a criterion on price stability, a criterion on sustainability of the government financial position, a criterion on exchange rate stability and a criterion on long-term interest rates. The criteria are specified in more detail in protocols annexed to the Treaty, namely the Protocol on the Excessive Deficit Procedure and the Protocol on the Convergence Criteria referred to in Article 121 of the Treaty.

2.1 Criterion on Price Stability

BOX 2.1 DEFINITION OF THE CRITERION ON PRICE STABILITY

Treaty provisions

The first indent of Article 121 (1) of the Treaty requires: "the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability".

Article 1 of the Protocol on the Convergence Criteria referred to in Article 121 of the Treaty stipulates that: "the criterion on price stability referred to in the first indent of Article 121 (1) of this Treaty shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1½ percentage points that of, at most, the three best performing Member States in terms of price stability. Inflation shall be measured by means of the consumer price index on a comparable basis, taking into account differences in national definitions."

Application of Treaty provisions in ECB and EC Convergence Reports
With regard to "an average rate of inflation, observed over a period of one year before the examination", the inflation rate is calculated using the increase in the latest available 12-month average of the Harmonised Index of Consumer Prices (HICP) over the previous 12-month average.

The reference value relating to the values of "at most, the three best performing Member States in terms of price stability" is calculated in practice as the unweighted arithmetic average of the rate of inflation in the three countries with the lowest inflation rates, given that these rates are compatible with price stability.

Implementation of the price stability criterion – current practice
Both the Treaty and the Protocol in some areas leave scope for interpretation by the institutions that assess the fulfilment of the criteria. Therefore, when assessing the fulfilment of the criteria one should also take into account the specific way in which these institutions apply the criterion.

As experience from the Convergence Reports published since 2004 has shown, both the Commission and the ECB have in these reports used the three countries with the lowest non-negative inflation, even though they have differed somewhat in their specific interpretations of the phrase "best performing Member States in terms of price stability".

Moreover, the negative verdict for Lithuania[36] in the May 2006 Convergence Reports indicated that a very strict assessment can be expected as regards sustainable fulfilment of the criterion. If the outlook for the coming months foresees inflation rising above the reference value, the conclusion may be that the country is failing to satisfy the criterion in a sustainable manner. A similar signal has been sent out in the relatively strict assessment of the risks to the sustainable fulfilment of this criterion by Slovakia in the ECB Convergence Report 2008, despite the fact that Slovakia ultimately entered the euro area in 2009.

According to the calculation of the reference value for the three countries with the lowest non-negative inflation (see Table 2.1), the Czech Republic did not fulfil this criterion in 2007 and 2008. The main exogenous factors in 2008 were a surge in prices of food and energy (most notably oil) and a wave of administrative

36 Lithuania recorded a rise in inflation between 2004 and 2006. As a result, inflation in Lithuania exceeded the price stability criterion reference value by 0.1 percentage point in the spring 2006 assessment.

measures (an increase in the lower VAT rate from 5% to 9%, the introduction of environmental taxes and health care fees, and further increases in excise duties). 2009 has seen much lower energy and food prices compared to the previous year amid a global crisis which, together with a fall in the domestic economy, is manifesting itself in sharp disinflation. In the past two years, inflation has also been affected by higher exchange rate volatility. The Czech Republic should start to fulfil the price stability criterion again in September 2009.

Table 2.1: Harmonised index of consumer prices
(average for last 12 months vs. average for previous 12 months as of end of period, growth in %)

	2006	2007	2008	8/2009	2009	2010	2011	2012
Average for 3 EU countries with lowest inflation	1.4	1.3	2.6	0.2	0.1	0.7	1.2	1.2
Reference value	2.9	2.8	4.1	1.7	1.6	2.2	2.7	2.7
Czech Republic	2.1	3.0	6.3	2.2	0.6	1.2	1.6	1.8

Sources: Eurostat, European Commission – Economic Forecast (autumn 2009).[37] The forecast for the Czech Republic is taken from the October 2009 Macroeconomic Forecast of the Czech Ministry of Finance.

In 2010–2012, prices in the Czech Republic will still be affected, in addition to standard factors, by a significant contribution of administrative measures to consumer price inflation. However, the Czech Republic should fulfil the price stability criterion in 2010–2012 provided that there are no unexpected one-off shocks. Sustainable fulfilment of this criterion in the future period will be aided by the CNB's new inflation target. It is desirable, however, that no substantial inflationary changes to indirect taxes or other administrative measures in the consumer price area be made during the reference period for the assessment of this criterion (i.e. the ERM II participation period). Such measures would hinder fulfilment of the criterion.

2.2 Criterion on the Sustainability of Public Finance[38]

2.2.1 Government deficit criterion

BOX 2.2: DEFINITION OF THE CRITERION ON THE SUSTAINABILITY OF THE GOVERNMENT FINANCIAL POSITION

Treaty provisions
The second indent of Article 121(1) of the Treaty requires "the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive, as determined in accordance with Article 104 of the Treaty".

Article 2 of the Protocol on the Convergence Criteria referred to in Article 121 of the Treaty stipulates that this criterion "shall mean that at the time of the examination the Member State is not the subject of a Council Decision under Article 104(6) of this Treaty that an excessive deficit exists".

37 Owing to a shift in the deadline for submitting the Convergence Programmes of the individual countries for 2009, and in the light of the current economic situation, where only a modest recovery can be expected in 2011–2012, the reference value of the inflation criterion for 2012 was determined using the same data as for 2011.

38 The criterion on the sustainability of public finance is satisfied only when both components of the fiscal criterion, i.e. the government deficit and government debt, are fulfilled in a sustainable manner.

Article 104 of the Treaty sets out the excessive deficit procedure. According to Article 104 (2) and (3), the European Commission prepares a report if a Member State does not fulfil the requirements for fiscal discipline, in particular if:

1. the ratio of the planned or actual government deficit to GDP exceeds a reference value (defined in the Protocol on the excessive deficit procedure as 3% of GDP), unless:

   – either the ratio has declined substantially and continuously and reached a level that comes close to the reference value, or

   – the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value.

2. the ratio of government debt to GDP exceeds a reference value (defined in the Protocol on the Excessive Deficit Procedure as 60% of GDP), unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

The excessive deficit procedure against the Czech Republic was opened in 2004. On the commencement of the procedure by the ECOFIN Council, the Czech Republic was given a deadline of the end of 2008 to bring its government deficit below 3% of GDP in a credible and sustainable manner. The favourable fiscal result for 2007 led to the abrogation of the procedure in June 2008.

The government deficit criterion is not being fulfilled (see Table 2.2). In addition to the unresolved structural problems of Czech public finance, the government sector is now facing an unprecedented shortfall in tax revenues. This is due to the extraordinarily unfavourable economic situation and to legislative changes approved particularly on the revenue side of the public budgets. These changes were made, among other things, in an effort to soften the impacts of the economic crisis. The current stabilisation measures do not represent a long-term systematic solution for the general government deficit.

Table 2.2: General government balance
(ESA 1995 methodology, in % of GDP)

	2006	2007	2008	2009	2010	2011	2012
Reference value	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Czech Republic	-2.6	-0.7	-2.0	-6.6	-5.3	-5.6	-5.5

Sources: CZSO, Government Deficit and Government Debt Notifications (October 2009), Fiscal Outlook of the Czech Ministry of Finance

The medium-term state budget outlook for 2010–2012 foresees some stabilisation of the general government deficit, but the level of the deficit is unacceptable from the point of view of the sustainability of public finance. Although this shortfall was caused largely by the recession, it will be necessary in future to focus on greater budgetary discipline and the adoption of further measures to reduce the structural deficit, as the high general government deficit recorded each year is contributing fundamentally to the rising government debt-to-GDP ratio. Given the assumption that the Czech Republic will enter the excessive deficit procedure at the end of 2009, it can be expected that the European institutions will exert strong pressure for more consolidation of Czech public finance.

As regards the alignment of the Czech economy with the euro area economy and the sustainability of public finance, it is essential to address the structural problems of public finance. The medium-term budgetary objective for the Czech Republic under the Stability and Growth Pact is to achieve a structural general government deficit of 1% of GDP. The Czech Republic has committed to achieve this objective as soon as possible and by 2012 at the latest (see the 2008 Convergence Programme of the Czech Republic). From the current perspective, however, this objective is not likely to be fulfilled in 2012. The structural deficit is expected to be around 5% of GDP in 2009 with a subsequent decrease to about 3% of GDP in 2010 and a modest deterioration in 2011 and 2012.

The adoption of a law to rectify some property injustices against churches and the potential one-off resolution of environmental obligations could also widen the deficit. The potential impacts on public finance will depend on the exact form of the relevant measures.

2.2.2 Government debt criterion

Given the low initial level of government debt, the Czech Republic has had no problem fulfilling this criterion so far (see Table 2.3). In the past few years, the government debt has stabilised around 30% of GDP, following a substantial increase (due mainly to government guarantees) in 2001–2003. The debt amount is affected to a large extent by the public budget deficit, the largest component of which is the state budget deficit, which is expected to grow sharply as from this year. The overall debt is not high compared to other countries, but it is growing much faster as a result of the crisis. Moreover, the rate of growth of the debt has been slowed considerably in recent years by high privatisation revenues. However, this effect is disappearing as the privatisation process comes to an end. It is therefore clear that the period of comfortable fulfilment of the government debt criterion is ending and that increased attention will have to be paid to the sustainability of fulfilment of this criterion in the future.

Table 2.3: Government debt
(ESA 1995 methodology, in % of GDP)

	2006	2007	2008	2009	2010	2011	2012
Reference value	60.0	60.0	60.0	60.0	60.0	60.0	60.0
Czech Republic	29.6	29.0	30.8	35.6	39.6	42.1	44.3

Sources: CZSO, Government Deficit and Government Debt Notifications (October 2009), Fiscal Outlook of the Czech Ministry of Finance.

Another risk is the adverse effect of population ageing. Unless the necessary reforms are implemented to mitigate the fiscal impacts of population ageing, in particular a pension system reform and health care reform, a further increase in the debt-to-GDP ratio is to be expected in the long term.

2.3 Criterion on Exchange Rate Stability

BOX 2.3: DEFINITION OF THE CRITERION ON EXCHANGE RATE STABILITY

Treaty provisions
The third indent of Article 121 (1) of the Treaty requires: "the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the currency of any other Member State".

Article 3 of the Protocol on the Convergence Criteria referred to in Article 121 (1) of the Treaty stipulates that: "the criterion on participation in the exchange-rate mechanism of the European Monetary System referred to in the third indent of Article 121 (1) of this Treaty shall mean that a Member State has respected the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency's bilateral central rate against any other Member State's currency on its own initiative for the same period."

Application of Treaty provisions in ECB and EC Convergence Reports
The Treaty refers to the criterion of participation in the European exchange-rate mechanism (ERM until December 1998 and ERM II since January 1999).

First, the ECB assesses whether the country has participated in ERM II "for at least the last two years before the examination", as stated in the Treaty.

Second, as regards the definition of "normal fluctuation margins", the ECB recalls the formal opinion that was put forward by the EMI Council in October 1994 and its statements in the November 1995 report entitled "Progress towards Convergence".

The EMI Council's opinion of October 1994 stated that "the wider band has helped to achieve a sustainable degree of exchange rate stability in the ERM", that "the EMI Council considers it advisable to maintain the present arrangements", and that "member countries should continue to aim at avoiding significant exchange rate fluctuations by gearing their policies to the achievement of price stability and the reduction of fiscal deficits, thereby contributing to the fulfilment of the requirements set out in Article 121 (1) of the Treaty and the relevant protocol".

In the November 1995 report entitled "Progress towards Convergence" it was stated that "when the Treaty was conceived, the 'normal fluctuation margins' were ±2.25% around bilateral central parities, whereas a ±6% band was a derogation from the rule. In August 1993 the decision was taken to widen the fluctuation margins to ±15%. The interpretation of the criterion, in particular of the concept of 'normal fluctuation margins' became less straightforward". It was then also proposed that account would need to be taken of "the particular evolution of exchange rates in the European Monetary System (EMS) since 1993 in forming an ex post judgement".

Against this background, in the assessment of exchange rate developments the emphasis is placed on exchange rates being close to the ERM II central rates.

Third, the issue of the presence of "severe tensions" or "strong pressures" on the exchange rate is addressed by examining the degree of deviation of exchange rates from the ERM II central rates against the euro. Other indicators, such as short-term interest rate differentials vis-à-vis the euro area and their evolution, are used as well. The role played by foreign exchange interventions is also considered.

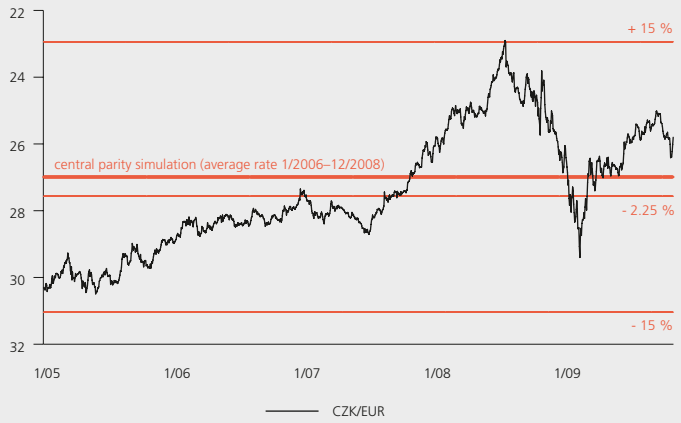
The example of the assessment of sustainability of fulfilment of the exchange rate stability criterion for Slovakia in the 2008 ECB Convergence Report recalls that some European authorities currently tend to take a stricter view in the interpretation of the convergence criteria and their fulfilment.

The admission of an EU Member State into the euro area is conditional on a successful, at least two-year stay of the national currency in ERM II. The Czech currency has not entered this system yet, hence it does not have a fixed central parity vis-à-vis the euro against which exchange rate fluctuations and thus also the fulfilment of this criterion can be monitored. The timing of ERM II entry and the appropriate selection of the central parity will be of key importance for fulfilment of the criterion.

With the aid of a hypothetical CZK/EUR central parity, set on the basis of the average daily rates for 2006–2008 (see Chart 2.1), it is theoretically possible to monitor whether the Czech Republic would have fulfilled the exchange rate stability criterion in the given time period.

The koruna's exchange rate has been recording a long-term appreciation trend. However, this trend was interrupted roughly in the second half of 2008 and in early 2009 by a sizeable depreciation resulting chiefly from deteriorating sentiment about the Central European region. The koruna strengthened again between March and September 2009. The koruna's exchange rate recorded a cumulative (for the previous 24 months) appreciation and depreciation respectively of greater than 15% during 2008 and 2009. A depreciation of 23% between July 2008 and February 2009 indicates potential risks to the fulfilment of the exchange rate criterion.

Chart 2.1: Nominal CZK/EUR exchange rate



Note: In the chart, an upward movement of the exchange rate means an appreciation of the koruna. The hypothetical central parity is simulated by the average exchange rate for 2006–2008.

Sources: CNB, Ministry of Finance calculations. Data up to 5 November 2009.

The minimum length of stay of an EU Member State in ERM II is set by the Treaty at two years. The Czech Republic's September 2003 Euro-area Accession Strategy and its August 2007 update state that the Government and the CNB agree on a stay in ERM II that does not greatly exceed the minimum required period. They also agree that the Czech Republic should enter the ERM II only after conditions have been established which enable it to introduce the euro at the time of the assessment of the exchange rate criterion and then to benefit from its introduction without experiencing any problems.[39]

The sharp fluctuations in the exchange rate observed recently indicate that the exchange rate stability criterion can be difficult to fulfil in turbulent times. The appropriate timing of ERM II entry, which should be preceded by a calming of the global financial market situation and of investment sentiment towards the region, as well as consolidation of domestic public finance, will thus be of key importance for successful fulfilment of the exchange rate stability criterion going forward. The correct setting of the central rate of the koruna against the euro will also be very important.

2.4 Criterion on Long-term Interest Rates

BOX 2.4: DEFINITION OF THE CRITERION ON LONG-TERM INTEREST RATES

Treaty provisions

The fourth indent of Article 121 (1) of the Treaty requires: "the durability of convergence achieved by the Member State and of its participation in the exchange-rate mechanism of the European Monetary System being reflected in the long-term interest-rate levels".

39 For details, see the joint documents of the Czech Government and the CNB: "The Czech Republic's Euro-area Accession Strategy" and "The Czech Republic's Updated Euro-area Accession Strategy" at http://www.mfcr.cz/cps/rde/xchg/mfcr/hs.xsl/eu_acc_stra.html

Article 4 of the Protocol on the Convergence Criteria referred to in Article 121 of the Treaty stipulates that: "the criterion on the convergence of interest rates referred to in the fourth indent of Article 121 (1) of this Treaty shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of, at most, the three best performing Member States in terms of price stability. Interest rates shall be measured on the basis of long-term government bonds or comparable securities, taking into account differences in national definitions".

Application of Treaty provisions in ECB and EC Convergence Reports
With regard to "an average nominal long-term interest rate" observed over "a period of one year before the examination", the long-term average interest rate has been calculated as an arithmetic average over the latest 12 months for which HICP data were available.

The notion of "at most, the three best performing Member States in terms of price stability" which is used for the definition of the reference value has been applied by using the unweighted arithmetic average of the long-term interest rates in the three countries with the lowest non-negative inflation rates. Interest rates have been measured on the basis of harmonised long-term interest rates, which were developed for the purpose of assessing convergence, i.e. the yields to maturity of 10-year convergence government bonds.

Average 10-year government bond yields in the Czech Republic have shown a mostly upward trend in the past few years. However, the Maastricht criterion on long-term interest rates has been fulfilled throughout the period.

Tabule 2.4: Yields to maturity of 10-year government bonds on the secondary market
(average for last 12 months vs. average for previous 12 months as of end of period, growth in %)

	2006	2007	2008	8/2009	2009	2010	2011	2012
Average for 3 EU countries with lowest inflation	4.2	4.4	4.2	4.2	4.1	4.7	5.2	5.2
Reference value	6.2	6.4	6.2	6.2	6.1	6.7	7.2	7.2
Czech Republic	3.8	4.3	4.6	4.7	4.9	4.3	4.3	4.3

Sources: European Commission, Ministry of Finance calculations.

Assuming that risk premia decrease and the spread between Czech and European government bonds closes, the yields to maturity are expected to decline slightly and then stabilise in 2010–2012. The evolution of the convergence criterion[40] in the future indicates a modest rise, mainly thanks to massive fiscal impulses in Western economies, which, despite a global decline in risk premia, are likely to lead to higher demanded yields owing to concerns about fiscal sustainability. Growth in global inflationary pressures connected with the economic and political measures adopted to support the financial sector and demand in the major world economies may act in the same direction. Given the long-term low-inflation nature of the Czech economy, no significant problems are expected in the medium term as regards the fulfilment of the long-term interest rate criterion in the Czech Republic.

40 No forecast for 2009–2012 is available for long-term interest rates for the countries with the lowest non-negative inflation rate, necessary to calculate the criterion. The projection of the reference value is thus based on the assumption that long-term interest rates will move in line with inflation, i.e. real interest rates will not change. The future reference value should therefore be viewed as only tentative.

3. ASSESSMENT OF THE CZECH REPUBLIC'S CURRENT ECONOMIC ALIGNMENT WITH THE EURO AREA

This part summarises the results of a set of analyses directed at assessing the Czech economy's alignment with the euro area over and above the formal criteria, the fulfilment of which is assessed in the previous part. If the Czech economy is to reap the benefits associated with introducing the euro it will need to be able to operate without an independent monetary policy and without the option of exchange rate adjustment vis-à-vis its most important trading partners. This ability will be affected by the similarity of economic developments in the Czech economy with those in the euro area, since the degree of alignment will co-determine the appropriateness of the monetary conditions in the euro area to the current situation in the Czech Republic. The ability to adjust rapidly to economic shocks will also be an important factor. The Czech economy's alignment and its preparedness to adopt the euro can thus be assessed in terms of the long-term economic trends, the medium-term development of economic activity and the structural similarity of the Czech economy to the euro area economy, all of which affect the probability of asymmetric developments and the occurrence of asymmetric shocks, and in terms of the ability of the economy to absorb shocks and adjust flexibly to them.

The analyses are divided into two basic groups according to the type of question they try to answer. The section entitled "Cyclical and Structural Alignment" indicates the size of the risk of economic shocks whose impact on the Czech economy will differ from that on the euro area as a whole ("asymmetric shocks"). The section entitled "Adjustment Mechanisms" answers the question of to what extent the Czech economy is capable of absorbing the impacts of potential asymmetric shocks. The basic theoretical starting point for the underlying analyses is the theory of optimum currency areas. These analyses are aimed at assessing the evolution of the alignment indicators over time and in comparison with selected countries. The countries under comparison either are euro area members already (Austria, Germany, Portugal, Slovakia and Slovenia)[41] or aspire to such membership (Poland and Hungary). The individual studies were prepared using the statistical data and information available in June 2009. Some studies, chiefly in the fiscal policy area, were updated in November 2009. The conclusion as to whether the Czech economy is sufficiently prepared for adopting the single currency cannot be made in absolute terms, but can ensue from the aforementioned comparison with other countries and the assessment of developments over time. In general, it can be expected that the benefits of adopting the euro will grow with greater economic alignment and stronger adjustment mechanisms.

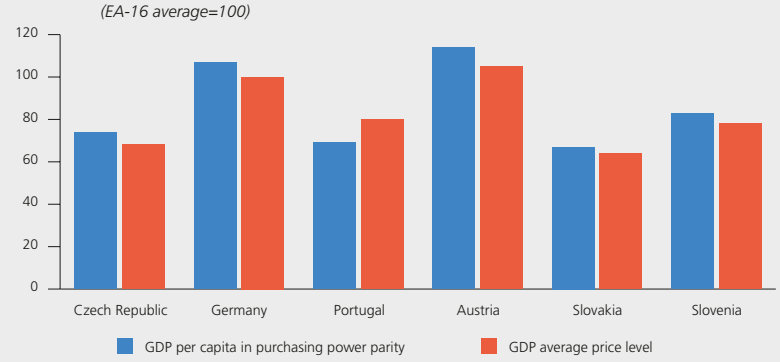
3.1 Cyclical and Structural Alignment

The costs arising from the loss of the Czech Republic's own monetary policy will be particularly pronounced if the Czech economy is not aligned with the euro area economy. The risks arising from the Czech Republic's accession to the euro area will decrease as the degree of alignment increases.

41 The selection of euro area countries included in the comparison comprises countries that are comparable in terms of economic level and countries with which the Czech economy has trading links. The values of the indicators for the euro area are defined at the EA-16 level.

The degree of real economic convergence is an important indicator of the Czech economy's similarity to the euro area. A higher level of such convergence fosters greater similarity of long-run equilibrium development. Indirectly it can also foster a lower likelihood of misalignment in the shorter run. A higher degree of convergence in the economic level prior to ERM II entry and euro adoption should further increase the relative price level, which will decrease potential future pressures for growth of the price level and equilibrium appreciation of the real exchange rate. The process of convergence of the economic and price levels has accelerated over the past six years. In 2008, GDP per capita in the Czech Republic was almost 75% of the euro area average, which represents a slightly higher standard of living than in the least advanced euro area countries (see Chart 3.1). The price level in the Czech Republic increased considerably during 2008 owing to the sharp appreciation of the koruna, but was still below that corresponding to the observed performance of the economy. However, at 68% of the average price level of the euro area, the deviation was smaller than in the past. In 2009, though, due to a weaker exchange rate compared to the previous year, the distance from the euro area price level can be expected to increase again (probably only temporarily). The real exchange rate of the koruna (on an HICP basis) appreciated on average by 4.2% a year between 1998 and 2008, which is a significantly higher pace than in the euro area countries under comparison except Slovakia. Going forward, the equilibrium trend of real appreciation of the koruna against the euro can be expected to continue in line with the real convergence, according to the analyses at a rate of 1.3–3.5% a year. Persistence of this trend following euro area entry will initially engender a corresponding higher rate of inflation in the Czech Republic than that in the euro area and related lower domestic real interest rates (possibly even negative in the case of short-term money market rates). If this situation persists in the long term, there could be a risk of an overheating of the economy associated with adverse consequences for macroeconomic and financial stability.

Chart 3.1: Real economic convergence of selected states towards the euro area in 2008
(EA-16 average=100)

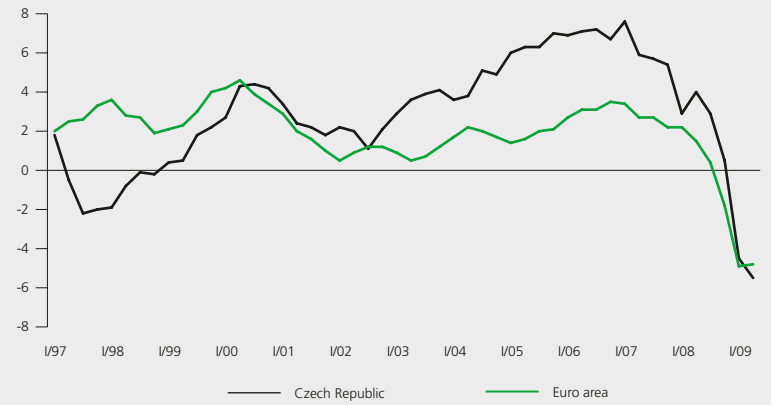


Sources: Eurostat, CNB calculations.

Alignment of economic activity and similarity of economic shocks will help the single monetary policy to have an effective and appropriate effect on the economy in the monetary union. The analyses indicate increased correlation of overall economic activity between the Czech Republic and the euro area recently; the same goes for activity in industry and export activity. According to

the analyses, the Czech Republic's export activity has recently been statistically significantly correlated with euro area exports. Compared to last year's analyses, the correlation of Czech exports to the euro area with euro area GDP has increased as well. Similar developments were identified for most of the countries under review. However, the significant recent rise in the monitored correlations, including the supply shock correlation, should be taken very cautiously, since these indicators have recently been strongly affected by the global economic downturn, which has affected both the Czech economy and the euro area economy (see Chart 3.2). The resulting observed increased correlation is therefore not necessarily a good indicator of future developments.

Chart 3.2: GDP growth in the Czech Republic and the euro area
(in %, year-on-year, seasonally adjusted)



Source: Eurostat. Data as of 5 November 2009.

Increased **drawing on resources from EU structural funds** could be a specific asymmetric factor that might impact on the Czech economy. This could act as a considerable economic stimulus, materialising primarily in increased investment activity. The actual drawdown of funds from EU structural funds and their economic use in the Czech Republic was slow until the end of 2008. However, data on the use of the structural funds for 2009 H1 indicate that the original difficulties with drawings have probably been overcome, so accelerated drawdown of funds for structural operations can be expected in the coming years (from the 2007–2013 allocation). This should be reflected in a rise in the inflow of EU funds. However, the economic stimulus from these flows will depend on the actual use of these funds by final beneficiaries. According to current estimates, only a slight positive economic stimulus from the inflow of EU funds is to be expected. The estimated amounts do not indicate any risk of a strong asymmetric shock.

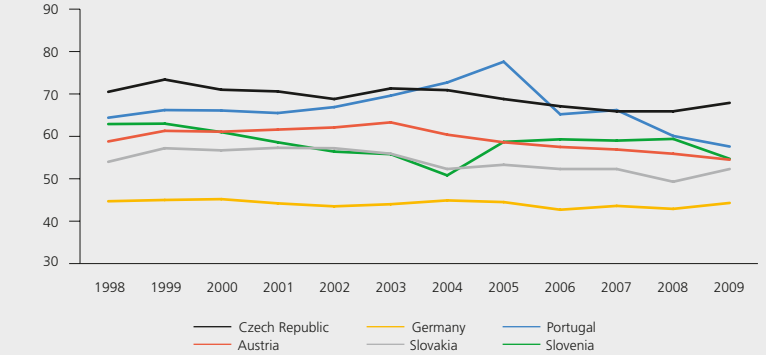
Similarity of the **structure of economic activity** with the euro area should decrease the risk of occurrence of asymmetric economic shocks. In terms of production structure, the Czech economy retains a specific feature in the form of a higher share of industry and a smaller share of certain services in GDP compared to the euro area. Of the other countries under review, Slovakia has a comparable economic structure. The above-average share of the car industry in the total output and value added of the Czech economy compared to the euro area is (as in Germany) a possible source of sector-specific shocks. This has been confirmed by recent developments.

Fast convergence of **nominal interest rates** in the immediate run-up to joining the euro area has acted as an asymmetric shock in some economies in the past. For a country planning to enter the monetary union, earlier gradual convergence is therefore an advantage. The difference between Czech and euro area interest rates was zero or negative for a long time (i.e. between 2002 and 2007). However, a modest positive interest rate differential opened up in mid-2008 and widened further during 2009 owing to the escalation of the global financial crisis, the significant fall in the ECB's key rates and the use of unconventional monetary policy instruments by the ECB. The interest rate differentials for three-month and five-year rates and the rates on ten-year government bonds increased, but remain lower than in Hungary and Poland. The heightened uncertainty and volatility of interest rate differentials also persist.

Another indicator of the possibility of sharing a single currency is long-term co-movement in the **exchange rates** of two currencies against a reference currency. Compared to the other currencies under review, the correlation between the rates of the Czech koruna and the euro against the dollar was relatively high until mid-2008, at about 0.8–0.9. The koruna's rapid appreciation in 2001–2002 and the short period following the outbreak of the financial crisis were the only major exceptions in this respect since 2000. Similar figures were recorded only by Slovakia, whereas Hungary, Poland and Slovenia (before ERM II entry) showed lower correlations. The fall of Lehman Brothers was followed by a deep fall (of several tens of per cent) in the correlations of the currencies of all the non-euro area countries under comparison. The decrease in the alignment of these currencies vis-à-vis the euro was affected by the surge in volatility in global financial markets and did not always reflect fundamentals only. The exchange rate volatility in these countries expected by the markets has recently been falling from the peaks observed in 2008 H2, but is still higher than before 2008.

The Czech economy's strong **trade and ownership links** with the euro area magnify the benefits arising from the elimination of potential fluctuations in the exchange rate. Following Slovakia's entry, the euro area is the partner for approximately 70% of Czech exports (see Chart 3.3), a level comparable to, or even higher than, in the other countries under review. The Czech economy's ownership links with the euro area on the direct investment inflow side are relatively strong and still growing. The Czech economy's strong economic integration with the euro area creates conditions for increasing economic alignment with this area. Another positive aspect from this perspective is the high intensity of intra-industry trade with the euro area, which is only slightly lower than in Austria and Germany.

Chart 3.3: Exports to the euro area as a percentage of in total exports
(in %)



Sources: Eurostat, IMF, CNB calculations.

The analysis of the Czech **financial system**, and, within it, the banking sector, reveals that despite its smaller share in GDP and smaller depth of financial intermediation relative to the average for the euro area and its founding member countries, common features of the effect on the economy usually prevail, particularly in normal economic conditions. Nevertheless, the current global financial crisis and recession have shown that only a sufficiently capitalised banking sector which is independent of external financing and has high balance-sheet liquidity and which in the run-up to euro adoption focuses on the traditional business model of conservative banking intermediation mostly in the domestic currency, is highly resistant to shocks. In this situation, the reaction to asymmetric shocks arriving from global financial markets is much more effective as regards ensuring the functioning and effectiveness of the system. By contrast, banking sectors which were dependent on external funding and which – owing to over-optimistic expectations regarding early euro adoption – recorded large volumes of asset transactions in foreign currencies were hit hard by the negative external shock.

The ratios of client loans to total loans and GDP had been increasing over the past seven years as a result of dynamic growth in lending to households and corporations in the Czech Republic. On the one hand, this trend implied convergence towards the corresponding ratios in the euro area. On the other hand, the historical experience of some countries shows that strong growth in lending and rising household and corporate debt can lead to a higher loan default risk in an adverse economic situation. However, the recent recession-related slowdown in lending in the Czech Republic and greater prudence on the part of both banks and borrowers are suppressing any risk of overleveraging of the real sector.

Given their minimal exposure to toxic and other very risky assets, domestic financial institutions have not been hit significantly by the global financial crisis. However, some of them are exposed to the financial crisis to a limited extent through their investments in foreign bonds, shares, mutual fund units and, in some cases, real estate. However, the fall in the value of their assets due to revaluation has had no fundamental effect on the functioning of the domestic financial system. It is thus reasonable to assume that the indirect effect of the crisis – acting via a worse financial situation of households and corporations and manifesting itself mainly in a probable increase in the loan default rate in the future period – will be dominant.

The structure of the financial assets and liabilities of Czech non-financial corporations and households still differs from that of euro area entities. The difference is particularly visible in a higher share of trade receivables in corporate assets and a higher share of currency and deposits in household assets. However, gradual convergence towards the euro area structure can be observed. The indebtedness of Czech corporations and households is currently significantly lower than in the euro area countries under review. In the past, the effect of money and financial market rates on client rates in the Czech Republic was roughly the same as in the euro area, but the economic crisis has led to slightly greater stickiness of client rates in the Czech Republic. The interest rate sensitivity of new loans to non-financial corporations is similar to that in the euro area. Households have a larger weight of long-term rate fixations in the case of loans for house purchase. The use of the euro in the financial transactions of non-financial corporations is gradually growing, reflecting the Czech economy's openness and foreign trade integration. However, the degree of spontaneous euroisation is still relatively low, although there is a difference between corporations and households. The expansion of foreign currency cash holdings and deposits of households in the Czech

Republic is roughly comparable with the selected Central European countries, but foreign currency borrowing is negligible.

The degree of **integration of the Czech financial markets** (money, foreign exchange, bond and stock) with the euro area markets is similar to that in the new EU Member States under comparison. The integration of government bond and stock markets is also comparable to that of Austria and Portugal. The speed of elimination of shocks on the Czech financial markets had been increasing since 2002, but the speed of adjustment has recently declined somewhat (except on the government bond market) as a result of the global financial crisis. The financial crisis has loosened financial market integration in all the countries under comparison over the last two years. In contrast, the sensitivity of asset prices to global events has been developing unevenly across the individual countries following the outbreak of the financial crisis. In the Czech Republic it has increased somewhat in the foreign exchange and stock markets.

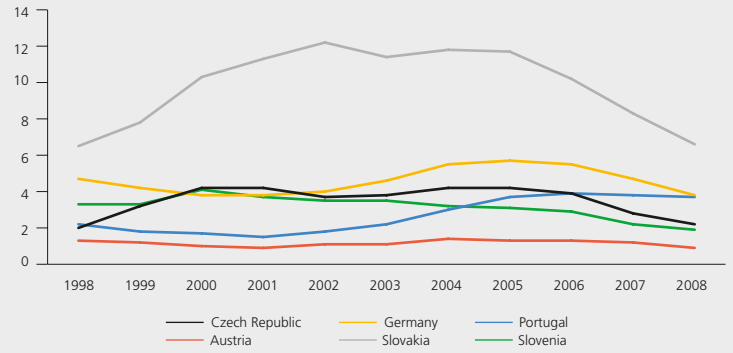
3.2 Adjustment Mechanisms

As regards the **public finances** of the Czech Republic, their ability to stabilise the economy subject to the European fiscal rules will be important. Under the Stability and Growth Pact, the Czech Republic committed itself to steering over the medium term towards a structural government deficit of no more than 1% of GDP by 2012. The closer the structural part of the public budget deficit is to zero, the more room there will be at a time of economic downturn for the functioning of automatic stabilisers and the potential implementation of discretionary measures. After improving in 2007, the structural deficit in the Czech Republic increased again in 2008 owing to measures adopted on the budget revenue side and to faster growth in some expenditures. The evolution of the structural deficit is also very negative in 2009, as a result of anti-crisis and other measures. Although the elimination of adverse structural effects should remain a high priority for the Czech Republic, fulfilment of this target represents a big challenge at present despite measures adopted in autumn 2009 to stabilise the public budgets. Owing the deficit budget outlook, growth in public debt is expected as well. The past downward trend in the ratio of public debt to GDP will thus be interrupted in the Czech Republic. Although the problem of public debt is less serious for the Czech Republic than for most of the countries under comparison, its ratio to GDP is likely to approach 40% as early as 2010. In the context of the current economic slowdown, the rise in mandatory debt service expenditure along with the expected effect of demographic changes on pension system and health care system expenditures poses a risk to the sustainability of public finance.

Wage elasticity can enhance the economy's ability to absorb the shocks to which the single monetary policy cannot respond. The analyses indicate that real wage elasticity in the Czech Republic was low in the past, as in the other countries under comparison. However, nominal wages have been showing signs of flexibility over the last two years. The current crisis is hitting corporations mainly in terms of reducing demand. Around two-thirds of corporations are responding to the crisis by freezing wages. Other ways of cutting labour costs are also being employed, for example a shorter working week. The response of reducing nominal wages is less widespread, but as in the case of wage freezes is more common than before the crisis. Differences in **inflation persistence** in the countries of the monetary union might lead to different impacts of the single monetary policy. Inflation persistence in the Czech Republic is medium-low among the countries under comparison.

The Czech **labour market** situation reflects the impacts of the recent economic downturn. Thanks to the lag with which the current growth in total unemployment is spilling over to long-term unemployment, some improvement (see Chart 3.4) was still observed in some of the 2008 data (as in the other countries under comparison), but a significant rise in long-term unemployment can be expected in 2009 and 2010. The analyses also indicate that the decline in unemployment in the Czech Republic in the previous period was largely cyclical and that structural unemployment is unlikely to have improved markedly.

Chart 3.4: Long-term unemployment rate
(ratio of persons unemployed for more than 1 year to the labour force, in %)



Source: Eurostat.

As in some of the other countries under review, the Czech Republic has persisting relatively large regional differences in the unemployment rate. This is due to regional gaps between the demand for, and supply of, labour and the low regional, occupational and sectoral mobility of the labour force, exacerbated, among other things, by the dominance of owner-occupied housing. It is thus reasonable to expect that the contribution of cross-border mobility of Czech citizens to the adjustment in the event of economic imbalances will be relatively limited, even after the movement of labour between the Czech Republic and all the original EU countries has been fully liberalised by 2011. The dynamic inflow of foreign labour into the Czech Republic visible since 2005 has recently slowed, or the number of foreign workers has already started falling, reflecting the decline in labour demand. This flexible response to economic developments can be regarded as a sign of flexibility of the Czech labour market. On the other hand, the use of foreign labour during the economic boom suggested that some serious problems persisted in this market (in particular low incentives to work among the long-term unemployed with low skills), since foreigners work mainly in low-skilled jobs.

Labour market flexibility is determined to a great extent by the **institutional rules**. The effect of collective bargaining on wage setting is no higher in the Czech Republic than in the current euro area members. The impact of the minimum wage on the flexibility of low wages and on job creation is rather low on average by international comparison. The halt in growth, or slight decline, of the minimum wage as a percentage of the average wage for less-skilled jobs can be regarded as positive, since high minimum wages coupled with high labour taxation could have an adverse effect on demand for less-skilled labour. At the same time, the labour force in the Czech Republic

in 2007 was exposed to the highest tax burden of all the countries under comparison as measured by the implicit tax rate. The 2008 tax reform reduced the tax burden on most households, but for households of individuals without children, labour taxation at the average wage level increased slightly due to "cold progression". The adverse effect of taxation on long-term unemployment and job creation was roughly the same as in Austria, Hungary and Poland, but higher than in Portugal and Slovakia. The financial incentives for the Czech unemployed to accept a job given by the combination of taxes and benefits declined as a result of the 2007 social benefit system reform. Although the 2008 reform halted the adverse trends, it did not deliver a significant reduction of the existing problems. The level of social benefits coupled with the tax burden may diminish efforts to seek or keep a job, particularly in the case of households with children, but unemployment benefits are high by international comparison even for childless individuals. In the area of permanent employment, the degree of job protection is higher than in other countries, whereas the protection of temporary employment and agency employment is relatively low. The costs of dismissing employees in the Czech Republic are independent of the duration of employment and are therefore relatively high by international comparison particularly with regard to short-term contracts. Moreover, the institutional set-up of the labour market in the euro area should be regarded as a relatively soft standard for international comparisons. Low flexibility may present a general risk in particular as regards the entry of young people to the labour market.

In the area of **product market flexibility** the situation is showing a gradual partial improvement. In particular, gradual steps are being taken to simplify the procedures for setting up businesses and carrying on business activities. However, the domestic business environment continues to be more burdened with administrative obstacles than that in most of the countries under comparison, partly because of a current gradual improvement in the business environments in those countries. As in the other countries under comparison, the corporate taxation rate has been declining recently and is currently one of the lower ones, but the overall tax burden on Czech corporations is higher than in Portugal, Hungary, Poland and Slovakia.

Stability and effectiveness of the banking sector is a precondition for the sector to be able to assist in absorbing economic shocks. The banking sector has achieved a high level of efficiency and profitability in the European context, and in past years has created a sufficient capital reserve from its profits. Banks have tightened the availability of loans for reducing the impacts of the deepening recession so as to absorb risks and not endanger the admissible regulatory capital ratios for banking business. By increasing capital out of the previous year's retained earnings, the Czech banking sector achieved a capital adequacy ratio of 13.7%, thereby creating a larger buffer against potential losses. While the governments and central banks of other countries responded to the build-up of losses in the global financial system with numerous measures aimed at bolstering the balance-sheet liquidity and solvency of key institutions, the Czech Republic was not forced to adopt any additional measures to strengthen banking sector solvency. Nonetheless, the slump in economic activity will show up in the Czech financial system in the form of rising credit risk and worsening quality of the banking sector's loan portfolio. Stress test results indicate that even a highly unfavourable macroeconomic scenario should not be negatively reflected in the stability of the banking sector. According to the tests, and also by international standards, the Czech banking sector seems to be resilient to risks and does not require any capital injections implying fiscal costs.

MINUTES OF THE BOARD MEETING ON 16 DECEMBER 2009

Present at the meeting:
Z. Tůma (Governor), M. Hampl (Vice-Governor), M. Singer (Vice-Governor), R. Holman (Chief Executive Director), P. Řežábek (Chief Executive Director), V. Tomšík (Chief Executive Director), E. Zamrazilová (Chief Executive Director)

The meeting opened with a presentation of the eighth situation report assessing the new information and its effect on the fulfilment of the risks of the November macroeconomic forecast. The new situation report assessed the risks in relation to the forecast overall as being moderately inflationary. The main upside risks to inflation were the higher inflation observed in November and the near-term outlook for inflation, as well as a slightly weaker exchange rate. Roughly half of the deviation of actual inflation from the forecast had been due to higher fuel prices, linked with an increased outlook for oil prices, while the other half had been due to higher adjusted inflation excluding fuels. The main downside factor, by contrast, was a change in the external outlook, in particular an assumption of lower foreign market interest rates.

After the presentation of the eighth situation report, the Board discussed the new information and the risks to the fulfilment of the November forecast. Most of the board members agreed that the new information had not convinced them of the need to change their opinion regarding the interest rate settings, despite the persisting high level of risk. Those board members who were in favour of lowering interest rates emphasised the assumption of the forecast in the seventh situation report about the need for lower market rates. The non-reduction of interest rates at the last monetary policy meeting had led to a situation where market interest rates were currently higher than forecasted and had been for some time. The advocates of unchanged interest rates conversely pointed out that, in addition to the arguments for leaving rates unchanged that had been made during the discussion of the forecast in the seventh situation report, the economy was now seeing some upside risks to inflation. It was also mentioned that despite the higher differential between market and reference rates in the Czech Republic, market rates were now at a historical low, and that when rates are so low the economy cannot function in the long term without developing major imbalances. Against this, however, it was said that no risks of imbalances or impacts on financial stability were apparent so far from the available information and analyses.

In the context of the interest rate settings, the Board discussed the size of the market interest rate differential between the Czech Republic and the euro area. The Board agreed that the effective market interest rate differential was larger in reality than suggested by the difference between repo rates. However, the individual board members differed in their interpretation of the monetary policy implications of this differential. On the one hand, it was argued that a reduction of interest rates was desirable since it would allow the interest rate differential to decrease. On the other hand, it was mentioned that the high market interest rate differential reflected certain non-standard monetary policy measures of the ECB, and that given the announced gradual abandonment of these measures it would tend to disappear of its own accord. In addition, it was said that the higher differential reflected the current higher risk premium in the Czech Republic. Against this, some of the board members expressed doubts that the ECB would be willing to abandon these non-standard measures in the foreseeable future.

The Board also spent quite some time discussing the labour market, where, among other things, there had been surprisingly rapid growth in the average wage and a faster decline in employment in the national economy. It was mentioned that part of the deviation of faster-than-forecasted average wage growth was probably due to a change in the employment structure, with low-wage and high-sickness-rate employees being laid off first. Also mentioned was the discrepancy between average wage growth according to

the Czech Statistical Office and growth in the nominal hourly wage according to the Ministry of Labour and Social Affairs, which was substantially lower. Likewise, there was a contradiction between the growth in the average wage and the decline in the total volume of wages in the national economy, even taking into account the year-on-year fall in total employment. The prevailing view was thus that the labour market data were not indicating any major upside risks to inflation overall.

The Board then discussed GDP, which had recorded a lower-than-forecasted year-on-year decline. This deviation had been due mainly to higher-than-expected growth in household consumption and also to higher growth in government consumption. It was said that the household consumption growth was not in line with the aforementioned decline in the volume of wages. Real household consumption growth might have been partly affected by the unexpected fall in the consumption deflator, which was inconsistent with the rising consumer price index and which might be revised retroactively. With regard to the unexpectedly high growth in government consumption, some of the board members mentioned their concerns about easy fiscal policy, which, given the failure to push through the fiscal austerity package, might lead to a further escalation of inflationary pressures. It was also mentioned that the high public finance deficits might keep the risk premium at a higher level. Concern was also expressed about the decline in loans provided to non-financial corporations and about its impacts on investment activity.

In arguing to leave interest rates unchanged, some of the board members mentioned their uncertainty regarding the equilibrium paths specified in the model. In this context, the Board mainly discussed the potential future one-off decline in production capacity, or potential output, which in a situation of inertial aggregate demand would lead to inflationary pressures. Against this, however, it was said that the current evidence tended to suggest persistence of the excess production capacity caused by the fall in demand, which was leading more towards anti-inflationary pressures. It was mentioned that the temporarily lower growth in potential output was already partially reflected in the current forecast and that considerations about a fall in potential output only had an effect beyond the monetary policy horizon. Against this, it was said that the one-off decline in potential output, were it actually to occur, was in fact relevant in the short and medium term.

For some of the board members, the main argument for leaving interest rates unchanged was the forecast assumption of rising interest rates over the next two to three quarters and their unwillingness to make such aggressive monetary policy changes in the opposite direction. In this context, some of the board members repeated their concerns about the limited effectiveness of monetary policy in a situation of very low interest rates. Against this, however, it was said that monetary policy-relevant inflation was approaching the target from below, which did not testify to a significantly aggressive monetary policy response. The proposed interest rate cut was, moreover, lower than assumed by the forecast, and besides that the reduction of the market rate outlook in the euro area would allow domestic rates to be raised much more slowly in 2010 than assumed by the current forecast. The prevailing view was that even if the effectiveness of the interest rate channel of monetary policy transmission was lower, this channel would nonetheless remain operational and should be used as and when necessary. The belief was also expressed that transparent monetary policy should be anticyclical and that the point of monetary policy was to react to economic shocks and not to smooth interest rates. If monetary policy were to miss the right moment for lowering rates, it would mean slower output growth and a larger undershooting of the inflation target.

At the close of the meeting the Board decided by a majority vote to lower the CNB two-week repo rate by 0.25 percentage point to 1.00%, effective 17 December 2009. At the same time it decided to lower the Lombard rate by the same amount, to 2.00%. The discount rate was left unchanged at 0.25%. Four members voted in favour of this decision: Governor Tůma, Vice-Governor Singer, Chief Executive Director Tomšík and Chief Executive Director Zamrazilová. Three members voted for leaving interest rates unchanged: Vice-Governor Hampl, Chief Executive Director Holman and Chief Executive Director Řežábek.

MINUTES OF THE BOARD MEETING ON 4 FEBRUARY 2010

Present at the meeting:
Z. Tůma (Governor), M. Hampl (Vice-Governor), M. Singer (Vice-Governor), R. Holman (Chief Executive Director), P. Řežábek (Chief Executive Director), V. Tomšík (Chief Executive Director)

The meeting opened with a presentation of the first situation report containing the new macroeconomic forecast. Headline inflation had risen in 2009 Q4, but had remained below the lower boundary of the tolerance band around the inflation target. The year-on-year contraction in real GDP had moderated in 2009 Q3, while in quarter-on-quarter terms economic activity had risen for the second consecutive quarter. The decline in employment had deepened further and unemployment had increased. However, average nominal wage growth had accelerated. Import prices were anti-inflationary. According to the forecast, no domestic inflation pressures were currently visible.

The February forecast predicted that inflation would gradually rise during 2010. Owing to tax changes, it would temporarily increase slightly above the inflation target of 2% in the second half of the year. Monetary-policy relevant inflation would approach the target from below. From 2010 Q1, economic activity would return to moderate year-on-year growth. However, stronger growth would be prevented by weakening household and government consumption and uneven growth in external demand. Economic growth was expected to reach 1.4% in 2010 and to speed up slightly to 2.1% in 2011. According to the forecast, the nominal exchange rate would appreciate gradually. Consistent with the forecast was stability of short-term interest rates close to current levels in the first half of this year and a gradual rise in rates thereafter.

In the discussion that followed the presentation of the situation report, the Board agreed that it was appropriate to leave interest rates unchanged. The prevailing view was that the overall balance of risks to the forecast was balanced. An opinion was also expressed emphasising the upside risks to inflation connected with wage growth, although these risks were associated with greater uncertainty for the time being. On the other hand, downside risks to inflation were also mentioned, namely the fall in expected market rates in the euro area and the persisting low economic activity, in respect of which a more robust recovery could be expected only in 2011. Some of the board members stated that the decision-making on monetary policy interest rates was going on in an environment of less uncertainty than in past months.

It was said repeatedly that the domestic economy was slowly rebounding and emerging from recession and that an asymmetrical W-shaped recovery in external demand could be expected. The domestic inflation pressures were currently not very strong, but a gradual build-up of inflation pressures could be expected as the recession faded.

The Board discussed the implications of producers' currently squeezed profit margins for future inflation. It was said that in the longer run margins would probably rise to the usual level and exert pressure on inflation. On the other hand, opinions were expressed that the reactivation of current excess production capacity would not necessarily have inflationary effects. For the same reason, a rapid recovery in investment could not be expected. The discussion also covered the uncertainty surrounding the rate of growth of potential output. The opinion was expressed that the economic crisis had not affected the long-run rate of growth of potential output. It was also said, however, that the rate of growth of potential output assumed by the current forecast was on the optimistic side, even though it had been temporarily reduced relative to the long-run rate on the basis of expert estimates.

The Board then discussed the labour market. It was said that year-on-year average nominal wage growth in the business sector was surprisingly high given the low economic activity. However, it was said that the observed growth to some extent reflected changes in the employment structure due to lay-offs of low-wage and high-sickness-rate employees and that, moreover, the wage growth figures were at variance with the national accounts statistics. It was said that inflation pressures caused by wage growth could be expected not to emerge until 2011.

It was said several times that the fiscal policy outlook would be a major factor as regards the future path of the economy. In this context, it was said repeatedly that the fiscal outlook was associated with considerable uncertainty. It was said that the risk of an increasing general government deficit could be regarded as significant.

The Board discussed the outlook for net exports in relation to the recovery in external economic activity. In this context, mention was made of the considerable uncertainty regarding the goods and services balance data and the corresponding financial flows.

The spread between interbank market interest rates and the monetary policy rate was discussed. The opinion was expressed that the faster-than-forecasted decline in the spread between short-term interest rates and the monetary policy rate might represent an upside risk to inflation going forward. However, opinions were conversely also expressed emphasising the downside risk of the opposite scenario.

At the close of the meeting the Board decided unanimously to leave the two-week repo rate unchanged at 1%. Governor Tůma, Vice-Governor Hampl, Vice-Governor Singer, Chief Executive Director Holman, Chief Executive Director Řežábek and Chief Executive Director Tomšík voted in favour of this decision.

TABLES IN THE TEXT

ARA	Amsterdam–Rotterdam–Antwerp
BCPP	Prague Stock Exchange
BoE	Bank of England
ČMZRB	Czech-Moravian Guarantee and Development Bank
CNB	Czech National Bank
CPI	consumer price index
CZK	Czech koruna
CZSO	Czech Statistical Office
EA-16	euro area
ECB	European Central Bank
ECOFIN	Council of EU ministers
EIB	European Investment Bank
EMI	European Monetary Institute
EMS	European Monetary System
EONIA	Euro Over-Night Index Average
ERM II	Exchange Rate Mechanism
ESA 95	European System of National Accounts
EU	European Union
EUR	euro
Euribor	Euro Interbank Offered Rate
FDI	foreign direct investment
Fed	US central bank
FOMC	Federal Open Market Committee
FRA	forward rate agreement
GBP	pound sterling
GDP	gross domestic product
HICP	Harmonised Index of Consumer Prices
HP filter	Hodrick-Prescott filter
HUF	Hungarian forint
ILO	International Labour Organization
IMF	International Monetary Fund
IRS	interest rate swap
LFS	Labour Force Survey
Libor	London Interbank Offered Rate
M1, M2	monetary aggregates
MLSA	Ministry of Labour and Social Affairs
MNB	Hungarian National Bank
NCG	net credit to government
NDAs	net domestic assets
NEAs	net external assets
NPISHs	non-profit institutions serving households
OMFIs	other monetary financial institutions
OPEC	Organization of the Petroleum Exporting Countries
PLN	Polish zloty
PPI	producer price index
PRIBID	Prague Interbank Bid Rate
PRIBOR	Prague Interbank Offered Rate
(1W, 1M, 1Y)	(one-week, one-month, one-year)
repo rate	repurchase agreement rate
SFAOs	state financial assets operations
SITC	Standard International Trade Classification
TAF	Term Auction Facility
TALF	Term Asset-Backed Securities Loan Facility
USD	US dollar
VAT	value added tax

Price indices used for the evaluation of inflation	(Box)	April 1998
Analysis of the money supply trend	(Box)	July 1999
Revisions to the statistical data on GDP	(Box)	July 1999
Measuring the inflation expectations of the financial market	(Annex)	October 1999
Oil prices and their impact on inflation	(Box)	July 2000
The effect of oil price changes on the balance of trade	(Box)	October 2000
The methodological framework for evaluating wage developments relative to inflation	(Box)	January 2001
The CNB's monetary policy rates	(Box)	April 2001
The setting of the inflation target for 2002–2005	(Annex)	April 2001
Harmonisation of the reserve requirements with European Central Bank standards	(Annex)	April 2001
Escape clauses pertaining to the new inflation target	(Annex)	July 2001
Changes in economic growth forecasts in the eurozone, Germany, the USA and Japan for 2001 and 2002	(Annex)	October 2001
Strategy for dealing with the exchange rate effects of capital inflows from privatisation of state property and from other foreign exchange revenues of the state	(Annex)	January 2002
Assessment of fulfilment of the CNB's net inflation target in December 2001	(Annex)	January 2002
Prediction of external variables	(Box)	April 2002
Estimated capital flows in 2002 and 2003 and their effect on the exchange rate	(Box)	April 2002
The Balassa–Samuelson effect	(Annex)	April 2002
The CNB changes its type of inflation forecast	(Box)	July 2002
An assessment of the effect of the August floods on Czech economic growth	(Box)	October 2002
The financial conditions of the Czech Republic's accession to the EU	(Box)	January 2003
Implications of the unexpectedly slow growth in regulated prices	(Box)	January 2003
The Czech Republic and the euro – Draft accession strategy	(Annex)	January 2003
Fiscal consolidation and its effect on economic growth	(Annex)	January 2003
Price deregulation in the period of transformation of the Czech economy	(Box)	April 2003
Revisions to the March 2003 GDP figures	(Box)	April 2003
Credit to households	(Box)	July 2003
The withdrawal of 10- and 20-heller coins and its possible impact on prices	(Box)	July 2003
Indirect taxes and the inflation forecast	(Box)	July 2003
Changes to the methodology for surveying inflation expectations	(Box)	July 2003
ERM II and the exchange-rate convergence criterion	(Annex)	July 2003
Use of the output gap indicator at the CNB	(Box)	October 2003
Monetary policy in the CNB's macroeconomic forecast	(Box)	October 2003
The Czech Republic's euro-area accession strategy	(Annex)	October 2003
Short-run food price prediction methods	(Box)	January 2004
Monetary conditions	(Box)	April 2004
The CNB's inflation target from January 2006	(Annex)	April 2004
The CNB has fully integrated into the European System of Central Banks	(Annex)	July 2004
The exchange rate in the CNB's forecasting system	(Box)	July 2004
Indicators of households' financial situation	(Box)	October 2004
GDP data revision	(Box)	October 2004
Petrol prices and their impact on inflation in the Czech Republic	(Box)	October 2004
Assessment of the fulfilment of the Maastricht convergence criteria and the degree of alignment of the Czech economy with the euro area	(Annex)	January 2005
The structure of lending	(Box)	January 2005
Uncertainty regarding the evolution of public finances in 2005 and 2006	(Box)	January 2005
Inflation expectations in the CNB's modelling system	(Box)	January 2005
The transmission of external cost shocks into domestic prices in 2003–2005	(Box)	April 2005
The effect of the exchange rate on inflation	(Box)	April 2005
The Czech National Bank's position on the revision of the Stability and Growth Pact	(Annex)	April 2005
The effect of EU accession on prices and inflation expectations	(Box)	July 2005
Foreign trade in the first year after the Czech Republic's accession to the EU	(Box)	July 2005
Financial flows between the Czech Republic and the European Union	(Box)	July 2005
The effect of world energy prices on consumer prices	(Box)	October 2005
The performance of large non-financial corporations 1998–2004	(Box)	October 2005
Potential output in the CNB's forecasting system	(Box)	October 2005
Fiscal policy in the CNB's modelling system	(Box)	January 2006
Assessment of the fulfilment of the Maastricht Convergence criteria and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	January 2006

Implications of household debt for consumption	(Box)	April 2006
Effective indicators of external developments	(Box)	July 2006
Oil and petrol prices in the CNB forecast	(Box)	July 2006
The role of monetary aggregates in the CNB's forecasts	(Box)	October 2006
Assessment of the fulfilment of the Maastricht convergence criteria and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	October 2006
Employment of foreign nationals	(Box)	January 2007
The extension of the core prediction model to include the effect of real wages	(Box)	January 2007
The new consumer basket as from January 2007	(Box)	April 2007
Financing of non-financial corporations	(Box)	April 2007
The application of escape clauses to indirect tax changes	(Box)	April 2007
The CNB's new inflation target and changes in monetary policy communication	(Annex)	April 2007
The relationship between interest rates and the structure of new loans for house purchase	(Box)	July 2007
The CNB's new approach to the monitoring of inflation expectations of households in the Czech Republic	(Box)	July 2007
The causes, course and impacts of the current turmoil in global financial markets	(Box)	October 2007
Household debt by income group in 2006 and its impact on consumption	(Box)	October 2007
The causes of the sharp growth in world prices of cereals	(Box)	October 2007
Fiscal measures and their impact on the economy in 2008	(Box)	October 2007
The Czech Republic's updated euro-area accession strategy	(Annex)	October 2007
Changes in the conduct and communication of monetary policy	(Box)	I/2008
Publication of the forecast-consistent interest rate path and the use of fan charts	(Box)	I/2008
The quarterly financial accounts statistics – New statistics at the CNB	(Box)	I/2008
Changes to the CNB's core prediction model	(Box)	I/2008
Assessment of the fulfilment of the Maastricht convergence criteria and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	I/2008
The new g3 structural model	(Box)	II/2008
Joint agreement between the Czech Government and the Czech National Bank and Updated strategy for dealing with the exchange rate effects of foreign exchange revenues of the state	(Annex)	II/2008
The sectoral and production structure of the g3 model	(Box)	III/2008
The withdrawal of 50-heller coins and its possible impact on prices	(Box)	III/2008
The impact of the still fast growing world prices of energy-producing materials on inflation in the Czech Republic	(Box)	IV/2008
Pricing in the g3 model	(Box)	IV/2008
Publication of a numerical exchange rate forecast	(Box)	I/2009
The exchange rate path in the g3 model	(Box)	I/2009
Assessment of the fulfilment of the Maastricht convergence criteria and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	I/2009
Transmission of financial market interest rates to retail interest rates	(Box)	II/2009
Proxying external developments after Slovakia's entry to the euro area	(Box)	II/2009
Monetary policy in the g3 model	(Box)	II/2009
Analysts' forecasts in financial market inflation expectations questionnaires: A look back at the past ten years	(Box)	II/2009
Unconventional monetary policy of selected central banks	(Box)	III/2009
Financing and financial investment of corporations and households	(Box)	III/2009
The impact of the recession on public finances in the Czech Republic	(Box)	III/2009
Investment in housing during the business cycle	(Box)	IV/2009
The effect of regulated prices and other administrative measures on inflation in 2008–2009 and their expected future development	(Box)	IV/2009
Exit strategies from unconventional monetary policy instruments planned by selected central banks	(Box)	I/2010
Uncertainties surrounding the calculation of potential output	(Box)	I/2010
Revision of the quarterly financial accounts	(Box)	I/2010
Differences in client interest rates in the Czech Republic and the euro area	(Box)	I/2010
Assessment of the fulfilment of the Maastricht convergence criteria and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	I/2010

This glossary explains some terms frequently used in the Inflation Report. A more detailed glossary can be found on the CNB website (www.cnb.cz/en/general/glossary/index.html).

Adjusted inflation excluding fuels: The increase in prices of non-food items of the consumer basket excluding items with regulated prices, indirect tax changes and fuels.

Balance of payments: Records economic transactions with other countries (i.e. between residents and non-residents) over a particular period. The basic structure of the balance of payments includes the current account, the capital and financial accounts and the change in international reserves.

Consensus Forecasts: A regular monthly publication issued by Consensus Economics bringing together the forecasts of hundreds of prominent economists and analytical teams regarding future world developments. The CNB uses these predictions in its macroeconomic forecast when forming assumptions regarding the future development of the external environment.

Current account: Records exports and imports of goods and services, income from capital, investment and labour and unrequited transfers.

Discount rate: A monetary policy rate which as a rule represents the floor for short-term money market interest rates. The CNB applies it to the excess liquidity which banks deposit with the CNB overnight under the deposit facility.

Disinflation: A decline in inflation

Effective euro area indicators: Proxy for the effect of economic activity (effective GDP) and inflation (effective producer prices and consumer prices) in the euro area on the Czech economy. The weights used in the calculation are the shares of the individual euro area economies in the foreign trade turnover of the Czech Republic.

Effective exchange rate: Shows the appreciation (index > 100) or depreciation (index < 100) of the national currency against a basket of selected currencies for a certain time period relative to a base period. The weights applied in the basket are the shares of major trading partners in foreign trade turnover.

Escape clause: Excuses the central bank from its obligation to hit the inflation target. In the flexible inflation targeting regime, it is applied in the event of large shock changes in exogenous factors (particularly supply-side shocks, e.g. indirect tax changes) that are completely or largely outside the purview of central bank monetary policy.

Euro area: The territory of all Member States of the European Union that have adopted the euro as a single currency pursuant to the Treaty Establishing the European Community.

Financial account: Records transactions connected with the creation, liquidation and change in ownership of the financial assets and liabilities of the government, the banking and corporate sectors and other entities vis-à-vis the rest of the world. It consist of direct investment, portfolio investment, other investment and financial derivatives transactions.

Fiscal impulse: Captures the effect of domestic fiscal policy on economic demand.

Food prices: In CNB documents, the term food prices refers to the consolidated category of prices of food and non-alcoholic beverages and prices of alcoholic beverages and tobacco.

Gross domestic product (GDP): The key indicator of economic development. It represents the sum of the value added by all economic sectors. In terms of use it consists of expenditure on final consumption (consumption of households, the government and non-profit institutions), gross capital formation (fixed investment and changes in inventories) and foreign trade (net exports of goods and services).

Inflation: Commonly, inflation is considered to be recurring growth of most prices in the economy. It means a decrease in the real value (i.e. purchasing power) of a given currency relative to the goods and services which consumers buy – if there is inflation in the economy, consumers need ever more currency units of the given country to buy the same basket of goods and services. In practice, inflation is measured by the increment of the consumer price index.

Inflation rate: The increase in the average (basic) consumer price index for the last 12 months relative to the average for the previous 12 months.

Inflation target: The level of consumer price inflation that the CNB endeavours to achieve, set publicly and well in advance.

Lombard rate: A monetary policy interest rate which provides a ceiling for short-term interest rates on the money market. The CNB applies it to the liquidity which it provides to banks overnight under the lending facility.

Monetary aggregates: Represent the amount of money in the economy covered in the monetary survey. According to the national definition, they are calculated from the monetary liabilities of resident monetary financial institutions to other resident sectors in the Czech Republic (households, non-financial corporations and financial institutions excluding the general government). Monetary aggregates differ according to the degree of liquidity of the individual components. The narrow monetary aggregate M1 comprises currency in circulation and overnight deposits. The broad monetary aggregate M2 comprises M1 plus deposits with agreed maturity, deposits redeemable at notice and repurchase agreements.

Monetary conditions: Represent the combined effect of interest rates (the interest rate component of the monetary conditions) and the exchange rate (the exchange rate component) on the economy. These are the key variables through which monetary policy can affect economic activity and, through it, inflation. In a period of easy monetary conditions monetary policy has been set in such a way as to support economic growth. If, conversely, monetary policy suppresses growth, we speak of a period of tight monetary conditions. Finally, in the case of neutral monetary policy settings, the monetary conditions are also termed neutral. The components of the monetary conditions do not necessarily affect the economy in the same direction.

Monetary policy horizon: The time horizon which monetary policy-makers focus on when making decisions and which takes into account the monetary policy transmission lag. This horizon is about 12–18 months ahead.

Monetary policy interest rates: Short-term interest rates associated with monetary policy-making. They comprise the two-week repo rate, the discount rate and the Lombard rate.

Monetary-policy relevant inflation: Inflation to which monetary policy reacts. It is defined as headline inflation adjusted for first-round effects of changes to indirect taxes.

Money market: The part of the financial markets which is used to obtain short-term loans and where debt instruments maturing in less than one year are traded. T-bills are typical securities traded on this market. Within this market the CNB carries out its repo operations.

Net inflation: Consumer price inflation net of regulated prices and adjusted for the first-round effects of changes to indirect taxes. Net inflation consists of food price inflation, fuel price inflation and adjusted inflation excluding fuels. Until the end of 2001, the CNB's inflation targets were set in terms of net inflation. Since 2002, the CNB has targeted headline inflation, using net inflation for analytical purposes only.

Nominal unit labour costs: The labour costs needed to produce a unit of output. Nominal unit labour costs are calculated as the ratio of the nominal volume of wages and salaries to GDP at constant prices.

Real marginal cost gap: Approximation of inflation pressures from the real economy. Marginal costs consist of the costs arising from the increasing volume of production (the "output gap") and wage costs (the "real wage gap"). A positive real marginal cost gap implies an inflationary effect of the real economy and a negative gap implies an anti-inflationary effect.

Regulated prices: A sub-category of the consumer basket consisting of items with price ceilings (set at either central or local level), prices regulated on a cost-plus basis (items whose prices may only reflect economically justified costs and a reasonable profit) and administratively fixed fees. The selection of these items is based on the Price Bulletin of the Czech Ministry of Finance.

Repo rate: The CNB's key monetary policy rate, paid on commercial banks' excess liquidity as withdrawn by the CNB in two-week repo tenders.

Unemployment rate: The ratio of the number of unemployed persons to the total labour force. We distinguish between the general unemployment rate, as determined by the CZSO according to International Labour Organisation methodology, and the registered unemployment rate, as determined by the Ministry of Labour and Social Affairs.

Table 1

KEY MACROECONOMIC INDICATORS												
						years						
		2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
DEMAND AND SUPPLY												
Gross domestic product												
GDP	CZK bn, constant p., seas. adjusted	2,244.9	2,286.0	2,368.4	2,470.8	2,628.5	2,812.2	2,984.6	3,053.3	**2,933.1**	**2,972.6**	**3,034.6**
GDP	%, y-o-y, real terms, seas. adjusted	2.4	1.8	3.6	4.3	6.4	7.0	6.1	2.3	**-3.9**	**1.4**	**2.1**
Household consumption	%, y-o-y, real terms, seas. adjusted	2.4	2.2	5.9	2.8	2.6	5.2	4.8	3.5	**1.6**	**-1.7**	**-0.2**
Government consumption	%, y-o-y, real terms, seas. adjusted	3.6	6.7	7.1	-3.5	2.9	1.2	0.7	1.0	**4.5**	**2.4**	**1.0**
Gross capital formation	%, y-o-y, real terms, seas. adjusted	6.6	4.5	-1.4	8.4	-0.6	10.2	9.3	-3.1	**-23.8**	**-1.5**	**0.8**
Exports of goods and services	%, y-o-y, real terms, seas. adjusted	11.2	2.0	7.2	20.3	11.8	16.2	15.0	5.7	**-10.7**	**2.7**	**7.0**
Imports of goods and services	%, y-o-y, real terms, seas. adjusted	12.7	4.9	8.0	17.5	5.2	14.7	14.2	4.3	**-11.9**	**-0.2**	**5.0**
Net exports	CZK bn, constant p., seas. adjusted	-97.1	-146.4	-170.7	-152.5	-26.1	3.6	24.5	65.8	**97.0**	**178.8**	**248.2**
Coincidence indicators												
Industrial production	%, y-o-y, real terms	7.4	4.1	1.6	10.4	3.9	8.3	10.6	-1.8	-	-	-
Construction output	%, y-o-y, real terms	10.4	3.0	9.3	8.8	5.2	6.0	7.1	0.0	-	-	-
Receipts in retail sales	%, y-o-y, real terms	8.5	1.7	7.3	3.9	8.1	10.9	10.0	2.8	-	-	-
PRICES												
Main price indicators												
Inflation rate	%, end-of-period	4.7	1.8	0.1	2.8	1.9	2.5	2.8	6.3	1.0	-	-
Consumer Price Index	%, y-o-y, average	4.7	1.8	0.1	2.8	1.9	2.5	2.8	6.4	1.1	**1.7**	**2.1**
Regulated prices (16.40%)*	%, y-o-y, average	11.1	5.7	0.6	3.5	5.7	9.3	4.8	15.6	8.4	**1.5**	**2.9**
Net inflation (83.60%)*	%, y-o-y, average	3.3	0.8	0.0	1.8	0.7	0.4	1.7	2.4	-0.9	**0.3**	**1.8**
Food prices (including alcoholic beverages and tobacco) (24.44%)*	%, y-o-y, average	4.6	-0.9	-1.2	2.8	0.0	-0.2	3.8	3.0	-0.9	**0.6**	**2.3**
Adjusted inflation excluding fuels (55.12%)*	%, y-o-y, average	3.0	2.4	0.6	1.2	0.7	0.6	0.7	2.0	0.0	**-0.2**	**1.3**
Fuel prices (4.04%)*	%, y-o-y, average	-4.9	-9.3	1.5	4.5	7.8	3.7	-0.3	4.3	-11.1	**7.1**	**6.0**
Monetary-policy inflation (excluding tax changes)	%, y-o-y, average	4.7	1.8	0.1	2.0	1.8	2.3	2.2	4.4	0.9	**0.6**	**2.0**
GDP deflator	%, y-o-y, seas. adjusted	4.9	2.8	0.9	4.5	-0.3	1.1	3.4	1.8	**2.5**	**-0.3**	**2.7**
Partial price indicators												
Producer prices	%,y-o-y, average	3.0	-0.5	-0.3	5.6	3.1	1.4	4.1	4.5	-3.1	**-0.6**	**1.5**
Agricultural prices	%,y-o-y, average	9.6	-7.5	-4.5	9.6	-9.8	1.3	16.4	10.8	-24.3	**2.9**	**5.2**
Construction work prices	%,y-o-y, average	4.0	2.7	2.2	3.7	3.0	2.9	3.9	4.5	1.3	-	-
Brent crude oil	%, y-o-y, average	-12.7	4.9	17.6	33.6	43.2	21.4	12.3	40.6	-25.9	**40.4**	**6.3**
LABOUR MARKET												
Average monthly wages in monitored organisations	%, y-o-y, nominal terms	8.8	8.0	5.8	6.3	5.0	6.6	7.2	8.3	**3.9**	**3.3**	**2.8**
Average monthly wages in monitored organisations	%, y-o-y, real terms	3.9	6.1	5.7	3.4	3.0	4.0	4.3	1.9	**2.8**	**1.6**	**0.7**
Number of employees	%, y-o-y	0.3	-0.8	-2.0	-0.2	2.2	1.2	1.9	1.7	**-2.2**	**-1.4**	**-0.3**
Nominal unit wage costs	%, y-o-y	6.2	4.6	2.3	1.8	0.6	1.0	3.0	6.1	**3.9**	**-1.2**	**0.5**
Nominal unit wage costs in industry	%, y-o-y	11.0	0.6	3.4	-4.4	-4.1	-5.6	1.0	0.5	-	-	-
Aggregate labour productivity	%, y-o-y	2.5	1.9	3.6	4.1	5.2	4.8	3.4	1.2	**-2.8**	**2.5**	**2.3**
ILO general unemployment rate	%, average	-	-	7.8	8.3	7.9	7.1	5.3	4.4	**6.8**	**8.4**	**8.8**
Registered unemployment rate	%, average	-	-	-	10.0	9.5	8.6	7.0	5.8	**8.3**	**9.8**	**10.2**
PUBLIC FINANCE												
Public finance deficit (ESA95)	CZK bn, current p.	-135.0	-166.8	-170.0	-82.7	-106.6	-84.5	-23.2	-75.6	**-232.9**	**-214.6**	**-248.4**
Public finance deficit / GDP**	%, nominal terms	-5.7	-6.8	-6.6	-2.9	-3.6	-2.6	-0.7	-2.0	**-6.4**	**-5.9**	**-6.5**
Public debt (ESA95)	CZK bn, current p.	584.7	695.0	768.3	847.8	885.4	948.3	1 023.8	1,104.9	**1,330.6**	**1,529.7**	**1,779.2**
Public debt / GDP**	%, nominal terms	24.9	28.2	29.8	30.1	29.7	29.4	29.0	30.0	**36.7**	**41.8**	**46.4**
EXTERNAL RELATIONS												
Current account												
Trade balance	CZK bn, current p.	-116.7	-71.3	-69.8	-13.4	59.4	65.1	120.6	103.2	**180.0**	**200.0**	**240.0**
Trade balance / GDP	%, nominal terms	-5.0	-2.9	-2.7	-0.5	2.0	2.0	3.4	2.8	**5.0**	**5.5**	**6.3**
Balance of services	CZK bn, current p.	58.0	21.9	13.2	16.6	36.9	45.1	49.7	82.0	**55.3**	**60.0**	**65.0**
Current account	CZK bn, current p.	-124.5	-136.4	-160.6	-147.5	-39.8	-77.2	-113.1	-113.9	**-29.9**	**25.0**	**45.0**
Current account / GDP	%, nominal terms	-5.3	-5.5	-6.2	-5.2	-1.3	-2.4	-3.2	-3.1	**-0.8**	**0.7**	**1.2**
Foreign direct investment												
Direct investment	CZK bn, current p.	208.3	270.9	53.5	101.8	279.6	90.3	179.1	150.4	**40.0**	**55.0**	**75.0**
Exchange rates												
CZK/USD	average	38.0	32.7	28.2	25.7	24.0	22.6	20.3	17.1	19.1	**17.5**	**17.8**
CZK/EUR	average	34.1	30.8	31.8	31.9	29.8	28.3	27.8	25.0	26.5	**25.5**	**25.2**
CZK/EUR	%, y-o-y, real (CPI euro area), avg.	-	-	-	0.0	-6.3	-5.1	-2.2	-12.5	5.6	**-3.7**	**-1.1**
CZK/EUR	%, y-o-y, real (PPI euro area), avg.	-	-	-	-3.1	-5.6	-1.3	-3.9	-8.9	4.4	**-2.3**	**-1.1**
Foreign trade prices												
Prices of exports of goods	%, y-o-y, average	0.4	-6.6	0.8	3.6	-1.5	-1.2	1.4	-4.6	**0.2**	**-2.1**	**0.6**
Prices of imports of goods	%, y-o-y, average	-1.5	-8.5	-0.3	1.6	-0.5	0.3	-1.0	-3.3	**-3.6**	**-0.5**	**1.1**
MONEY AND INTEREST RATES												
M2	%, y-o-y, average	11.1	7.0	4.1	7.7	5.3	8.9	11.2	8.4	**6.3**	**2.5**	**3.1**
2W repo rate	%, end-of-period	4.75	2.75	2.00	2.50	2.00	2.50	3.50	2.25	1.00	-	-
3M PRIBOR	%, average	5.2	3.5	2.3	2.3	2.0	2.3	3.1	4.0	2.2	**1.4**	**2.5**

* in brackets are constant weights in actual consumer basket
** CNB calculation
– data are not available / forecasted / released
data in bold = CNB forecast

2007				2008				2009				2010				2011			
QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV
737.1	739.5	750.2	757.9	760.0	765.3	766.6	761.4	728.0	729.2	735.1	**740.8**	**743.3**	**743.4**	**741.9**	**743.9**	**747.9**	**754.1**	**761.4**	**771.2**
7.7	5.9	5.7	5.4	3.1	3.5	2.2	0.5	-4.2	-4.7	-4.1	**-2.7**	**2.1**	**2.0**	**0.9**	**0.4**	**0.6**	**1.4**	**2.6**	**3.7**
5.8	5.4	4.8	3.4	4.5	3.7	3.0	2.6	2.3	1.9	1.3	**0.7**	**-1.1**	**-1.9**	**-1.9**	**-1.6**	**-1.3**	**-0.6**	**0.2**	**0.9**
0.7	-0.6	-1.1	3.8	-0.8	2.3	2.9	-0.4	4.5	4.0	5.3	**4.0**	**3.2**	**3.0**	**1.3**	**2.1**	**1.6**	**1.3**	**0.9**	**0.4**
15.5	10.0	10.1	2.2	-1.8	-8.8	-10.5	9.4	-17.2	-23.5	-23.8	**-30.3**	**-9.6**	**3.6**	**2.7**	**-1.5**	**-0.4**	**0.5**	**1.2**	**1.9**
16.3	14.4	16.2	13.3	14.1	13.4	5.1	-8.7	-18.5	-15.5	-7.0	**-0.4**	**7.3**	**4.9**	**-3.0**	**2.2**	**3.2**	**5.4**	**8.4**	**11.0**
16.3	14.3	15.8	10.9	12.8	9.2	1.4	-5.3	-17.3	-15.7	-7.5	**-6.7**	**1.4**	**2.7**	**-5.1**	**0.7**	**2.0**	**3.9**	**6.1**	**8.0**
4.1	1.5	1.5	17.4	14.2	32.1	30.0	-10.5	1.1	28.6	31.1	**36.2**	**41.9**	**44.5**	**45.1**	**47.3**	**51.6**	**57.8**	**65.1**	**73.7**
13.7	10.8	9.5	8.8	2.1	3.9	0.8	-13.2	-19.1	-18.5	-12.8	-	-	-	-	-	-	-	-	-
28.0	8.2	-0.5	3.4	0.7	-2.3	6.4	-4.2	-11.4	1.0	0.1	-	-	-	-	-	-	-	-	-
12.2	10.4	8.7	9.2	5.4	4.8	4.6	-2.6	-4.0	-4.6	-5.0	-	-	-	-	-	-	-	-	-
2.2	2.1	2.0	2.8	4.3	5.4	6.4	6.3	5.0	3.7	2.1	1.0	-	-	-	-	-	-	-	-
1.6	2.5	2.5	4.8	7.4	6.8	6.6	4.7	2.2	1.4	0.2	0.4	**0.9**	**1.2**	**2.1**	**2.6**	**2.0**	**2.1**	**2.1**	**2.1**
4.1	4.2	4.5	6.4	15.0	14.7	15.8	16.9	11.2	9.8	7.5	5.2	**0.9**	**1.1**	**1.9**	**2.3**	**2.5**	**2.9**	**3.0**	**3.2**
0.9	1.6	1.0	3.1	3.6	2.9	2.9	0.4	-0.6	-0.6	-1.5	-0.7	**-0.2**	**-0.1**	**0.6**	**1.0**	**1.6**	**1.8**	**1.9**	**2.0**
2.6	3.4	2.5	6.8	5.7	3.3	3.4	-0.3	0.0	0.4	-2.0	-2.2	**-1.9**	**-0.4**	**2.0**	**2.6**	**2.7**	**2.4**	**2.1**	**2.1**
0.4	0.9	0.4	1.0	1.8	2.2	2.3	1.7	0.6	0.1	-0.5	-0.2	**-0.3**	**-0.5**	**-0.2**	**0.0**	**0.6**	**1.2**	**1.5**	**1.6**
-4.4	-2.7	-2.6	8.5	14.4	8.5	5.9	-11.5	-20.5	-15.7	-11.8	3.7	**14.8**	**5.8**	**2.3**	**5.6**	**6.1**	**6.0**	**6.2**	**5.5**
1.4	2.0	1.6	3.7	5.3	4.6	4.7	2.9	1.6	1.3	0.2	0.4	**-0.1**	**0.1**	**0.9**	**1.4**	**1.8**	**2.0**	**2.1**	**2.1**
3.2	3.7	3.4	3.3	2.3	1.4	1.1	2.6	3.8	3.4	2.2	**0.4**	**-1.5**	**-1.1**	**0.3**	**1.2**	**2.0**	**2.8**	**3.0**	**2.9**
3.2	4.2	3.9	5.0	5.6	5.1	5.5	1.7	-1.1	-3.6	-5.2	-2.6	**-2.1**	**-0.8**	**0.0**	**0.5**	**1.5**	**1.6**	**1.5**	**1.4**
13.3	11.2	15.0	26.0	26.7	27.2	7.7	-18.5	-27.8	-29.5	-23.8	-16.0	**-6.9**	**-1.6**	**7.6**	**12.6**	**10.2**	**5.6**	**2.1**	**2.9**
3.6	3.8	4.0	4.4	4.7	5.0	4.5	3.9	2.8	1.4	0.5	0.3	-	-	-	-	-	-	-	-
-6.1	-1.5	7.8	49.0	66.5	77.9	54.2	-36.3	-53.4	-51.8	-39.8	41.6	**80.4**	**42.2**	**24.1**	**15.0**	**8.0**	**7.0**	**5.7**	**4.5**
7.8	7.5	7.3	6.5	10.0	7.9	7.5	8.1	3.0	3.1	4.8	**4.7**	**4.3**	**4.0**	**2.8**	**2.0**	**2.1**	**2.5**	**3.0**	**3.6**
6.2	5.0	4.7	1.6	2.4	1.0	0.8	3.2	0.9	1.7	4.7	**4.2**	**3.5**	**2.7**	**0.8**	**-0.6**	**0.2**	**0.3**	**0.8**	**1.4**
1.3	1.8	2.1	2.4	2.1	1.9	1.7	1.2	-0.9	-1.8	-2.8	**-3.4**	**-1.9**	**-1.6**	**-1.1**	**-0.9**	**-0.8**	**-0.5**	**-0.1**	**0.4**
2.6	3.3	3.3	2.9	8.0	5.3	4.5	6.9	5.3	4.8	3.8	**1.9**	**-3.1**	**-2.1**	**-0.2**	**0.6**	**0.7**	**0.4**	**0.2**	**0.3**
1.6	-0.8	3.2	-0.2	3.3	-1.4	-1.1	1.1	8.7	7.7	6.5	-	-	-	-	-	-	-	-	-
4.1	3.0	3.1	3.3	1.4	2.5	1.9	-1.0	-4.1	-3.9	-2.7	**-0.3**	**4.2**	**3.2**	**1.5**	**1.0**	**1.0**	**1.8**	**2.8**	**3.6**
6.0	5.3	5.1	4.8	4.7	4.2	4.3	4.4	5.8	6.3	7.3	**7.8**	**8.3**	**8.2**	**8.5**	**8.5**	**8.9**	**8.6**	**8.9**	**8.7**
8.2	7.0	6.7	6.3	6.3	5.5	5.6	5.8	7.5	8.1	8.7	9.0	**9.9**	**9.5**	**9.9**	**9.9**	**10.4**	**9.9**	**10.3**	**10.0**
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
45.5	27.3	20.8	27.0	42.9	39.6	27.5	-6.8	40.8	53.6	45.6	**40.0**	**56.0**	**54.0**	**52.0**	**38.0**	**60.0**	**62.0**	**63.0**	**55.0**
5.5	3.1	2.3	2.9	4.9	4.2	2.9	-0.7	4.7	5.8	5.0	**4.4**	**6.4**	**5.8**	**5.6**	**4.1**	**6.7**	**6.4**	**6.5**	**5.5**
10.5	16.0	14.1	9.1	22.3	22.1	19.5	18.1	17.4	13.0	12.9	**12.0**	**18.0**	**15.0**	**14.0**	**13.0**	**19.0**	**17.0**	**15.0**	**14.0**
28.3	-50.1	-51.3	-40.0	30.3	-55.9	-30.1	-58.2	23.2	-28.1	-19.9	**-5.0**	**41.0**	**-18.0**	**0.0**	**2.0**	**41.0**	**-13.0**	**2.0**	**15.0**
3.4	-5.6	-5.7	-4.4	3.5	-6.0	-3.2	-6.2	2.7	-3.1	-2.2	**-0.5**	**4.7**	**-1.9**	**0.0**	**0.2**	**4.6**	**-1.3**	**0.2**	**1.5**
36.7	38.5	42.2	61.7	21.5	53.2	41.4	34.3	13.4	-1.8	8.9	-	-	-	-	-	-	-	-	-
21.4	21.0	20.3	18.5	17.1	15.9	16.1	19.3	21.2	19.6	17.9	17.5	**17.8**	**17.4**	**17.4**	**17.5**	**17.6**	**17.7**	**17.8**	**17.9**
28.0	28.3	27.9	26.8	25.5	24.8	24.1	25.4	27.6	26.7	25.6	25.9	**25.8**	**25.5**	**25.4**	**25.3**	**25.2**	**25.2**	**25.2**	**25.2**
-1.2	-0.4	-1.4	-5.7	-12.2	-14.7	-15.9	-7.2	7.4	6.7	6.1	2.1	**-6.6**	**-4.2**	**-1.1**	**-2.8**	**-2.1**	**-1.2**	**-0.7**	**-0.4**
-2.7	-2.9	-3.9	-6.2	-9.9	-11.1	-11.4	-3.0	8.6	6.1	3.4	-0.7	**-6.4**	**-3.1**	**1.1**	**-0.6**	**-1.7**	**-1.1**	**-0.9**	**-0.5**
1.9	2.8	1.9	-1.2	-4.3	-6.2	-6.5	-1.2	5.2	1.3	-2.2	**-3.6**	**-7.3**	**-2.8**	**1.2**	**0.5**	**0.3**	**0.6**	**0.7**	**0.8**
-1.7	-0.4	-0.5	-1.5	-3.0	-4.4	-4.0	-1.6	1.6	-2.9	-7.0	**-6.0**	**-5.6**	**-1.4**	**2.8**	**2.2**	**1.0**	**1.1**	**1.1**	**1.0**
10.5	11.6	11.2	11.7	10.1	7.6	8.3	7.6	8.8	7.5	4.6	**4.2**	**2.0**	**2.0**	**3.1**	**2.9**	**2.0**	**2.2**	**3.4**	**4.9**
2.50	2.75	3.25	3.50	3.75	3.75	3.50	2.25	1.75	1.50	1.25	1.00	-	-	-	-	-	-	-	-
2.6	2.8	3.3	3.8	4.0	4.2	3.9	4.1	2.7	2.3	2.0	1.8	**1.3**	**1.2**	**1.4**	**1.8**	**2.2**	**2.5**	**2.6**	**2.8**

Table 2a

INFLATION DEVELOPMENT												annual percentage changes
2007	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Consumer prices	1.3	1.5	1.9	2.5	2.4	2.5	2.3	2.4	2.8	4.0	5.0	5.4
Regulated prices	3.9	4.3	4.1	4.7	4.0	4.0	4.4	4.4	4.6	6.3	6.4	6.5
(contribution to consumer price inflation)	*0.66*	*0.72*	*0.70*	*0.80*	*0.69*	*0.68*	*0.75*	*0.74*	*0.79*	*1.07*	*1.08*	*1.11*
First-round impacts of changes to indirect taxes on consumer prices (contribution to consumer price inflation)	*0.10*	*0.11*	*0.21*	*0.33*	*0.45*	*0.55*	*0.64*	*1.07*	*1.09*	*1.09*	*1.09*	*1.09*
Net inflation	0.7	0.8	1.3	1.7	1.6	1.5	1.1	0.7	1.2	2.2	3.4	3.8
(contribution to consumer price inflation)	*0.53*	*0.62*	*1.00*	*1.29*	*1.19*	*1.17*	*0.80*	*0.49*	*0.92*	*1.81*	*2.84*	*3.19*
Prices of food, beverages and tobacco	2.0	2.7	3.2	4.1	3.5	2.7	2.6	2.3	2.5	4.6	7.5	8.2
(contribution to consumer price inflation)	*0.48*	*0.67*	*0.78*	*1.01*	*0.85*	*0.67*	*0.64*	*0.56*	*0.63*	*1.17*	*1.90*	*2.09*
Adjusted inflation excluding fuels	*0.3*	*0.4*	*0.6*	*0.8*	*0.8*	*1.0*	*0.5*	*0.1*	*0.7*	*0.9*	*1.0*	*1.2*
(contribution to consumer price inflation)	*0.19*	*0.20*	*0.34*	*0.43*	*0.46*	*0.57*	*0.27*	*0.08*	*0.37*	*0.49*	*0.56*	*0.64*
Fuel prices	*-3.5*	*-6.6*	*-3.1*	*-3.6*	*-2.9*	*-1.7*	*-2.5*	*-3.5*	*-1.8*	*3.8*	*9.7*	*12.0*
(contribution to consumer price inflation)	*-0.14*	*-0.26*	*-0.12*	*-0.15*	*-0.12*	*-0.07*	*-0.11*	*-0.15*	*-0.07*	*0.15*	*0.38*	*0.46*
Monetary-policy relevant inflation	*1.2*	*1.4*	*1.7*	*2.2*	*1.9*	*1.9*	*1.7*	*1.3*	*1.7*	*2.9*	*3.9*	*4.3*
Inflation rate (annual moving average)	2.4	2.3	2.2	2.2	2.1	2.1	2.1	2.0	2.0	2.2	2.5	2.8
2008												
Consumer prices	7.5	7.5	7.1	6.8	6.8	6.7	6.9	6.5	6.6	6.0	4.4	3.6
Regulated prices	15.0	14.9	15.0	14.8	14.6	14.6	15.9	15.8	15.7	16.9	16.8	17.1
(contribution to consumer price inflation)	*2.60*	*2.59*	*2.59*	*2.56*	*2.53*	*2.52*	*2.74*	*2.72*	*2.72*	*2.93*	*2.89*	*2.93*
First-round impacts of changes to indirect taxes on consumer prices (contribution to consumer price inflation)	*2.21*	*2.07*	*2.03*	*2.12*	*2.22*	*2.19*	*2.09*	*1.85*	*1.83*	*1.82*	*1.82*	*1.82*
Net inflation	3.6	3.8	3.4	2.9	2.9	2.9	2.9	2.7	2.9	2.0	0.2	-0.9
(contribution to consumer price inflation)	*3.06*	*3.18*	*2.87*	*2.46*	*2.39*	*2.38*	*2.45*	*2.27*	*2.41*	*1.63*	*0.16*	*-0.71*
Prices of food, beverages and tobacco	6.3	5.9	4.9	3.6	3.3	3.0	3.4	3.1	3.6	2.2	-1.0	-2.0
(contribution to consumer price inflation)	*1.66*	*1.53*	*1.28*	*0.96*	*0.89*	*0.80*	*0.90*	*0.81*	*0.94*	*0.60*	*-0.23*	*-0.53*
Adjusted inflation excluding fuels	*1.6*	*1.9*	*2.0*	*2.2*	*2.2*	*2.2*	*2.2*	*2.3*	*2.4*	*2.0*	*1.7*	*1.4*
(contribution to consumer price inflation)	*0.86*	*1.07*	*1.11*	*1.19*	*1.19*	*1.19*	*1.21*	*1.25*	*1.29*	*1.04*	*0.89*	*0.72*
Fuel prices	*14.5*	*15.9*	*12.7*	*8.0*	*7.6*	*9.8*	*8.3*	*5.2*	*4.3*	*-0.4*	*-12.1*	*-22.0*
(contribution to consumer price inflation)	*0.54*	*0.58*	*0.47*	*0.31*	*0.31*	*0.40*	*0.34*	*0.21*	*0.17*	*-0.02*	*-0.49*	*-0.90*
Monetary-policy relevant inflation	*5.3*	*5.4*	*5.1*	*4.7*	*4.6*	*4.5*	*4.8*	*4.7*	*4.7*	*4.2*	*2.6*	*1.8*
Inflation rate (annual moving average)	3.4	3.9	4.3	4.7	5.0	5.4	5.8	6.1	6.4	6.6	6.5	6.3
2009												
Consumer prices	2.2	2.0	2.3	1.8	1.3	1.2	0.3	0.2	0.0	-0.2	0.5	1.0
Regulated prices	11.6	10.9	11.0	9.8	9.8	9.7	7.6	7.5	7.5	5.4	5.4	5.0
(contribution to consumer price inflation)	*2.14*	*2.02*	*2.05*	*1.83*	*1.82*	*1.80*	*1.42*	*1.41*	*1.40*	*1.03*	*1.03*	*0.96*
First-round impacts of changes to indirect taxes on consumer prices (contribution to consumer price inflation)	*0.60*	*0.60*	*0.50*	*0.28*	*0.07*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	-0.7	-0.7	-0.4	-0.5	-0.7	-0.8	-1.4	-1.4	-1.7	-1.5	-0.6	0.0
(contribution to consumer price inflation)	-0.56	-0.57	-0.33	-0.34	-0.52	-0.62	-1.16	-1.17	-1.36	-1.21	-0.48	0.02
Prices of food, beverages and tobacco	-0.3	-0.3	0.7	0.7	0.4	0.1	-1.6	-1.9	-2.5	-2.9	-2.2	-1.5
(contribution to consumer price inflation)	*-0.06*	*-0.07*	*0.18*	*0.18*	*0.10*	*0.03*	*-0.41*	*-0.48*	*-0.65*	*-0.74*	*-0.57*	*-0.38*
Adjusted inflation excluding fuels	0.9	0.5	0.4	0.2	0.1	0.0	-0.3	-0.5	-0.6	-0.3	-0.1	-0.2
(contribution to consumer price inflation)	*0.49*	*0.25*	*0.18*	*0.09*	*0.06*	*-0.02*	*-0.18*	*-0.26*	*-0.30*	*-0.14*	*-0.06*	*-0.09*
Fuel prices	-24.6	-19.3	-17.6	-15.5	-16.8	-14.8	-14.0	-10.7	-10.6	-8.7	4.2	15.7
(contribution to consumer price inflation)	*-0.98*	*-0.75*	*-0.69*	*-0.61*	*-0.68*	*-0.62*	*-0.58*	*-0.43*	*-0.42*	*-0.33*	*0.15*	*0.48*
Monetary-policy relevant inflation	1.6	1.4	1.8	1.5	1.2	1.2	0.3	0.2	0.0	-0.2	0.5	1.0
Inflation rate (annual moving average)	*5.9*	*5.4*	*5.0*	*4.6*	*4.1*	*3.7*	*3.1*	*2.6*	*2.1*	*1.6*	*1.3*	*1.0*
2010		**forecast**										
Consumer prices	**0.9**	**0.9**	**0.8**									
Regulated prices	**0.6**	**1.1**	**1.0**									
(contribution to consumer price inflation)	***0.12***	***0.21***	***0.19***									
First-round impacts of changes to indirect taxes on consumer prices (contribution to consumer price inflation)	***0.97***	***0.97***	***0.97***									
Net inflation	**-0.1**	**-0.2**	**-0.3**									
(contribution to consumer price inflation)	***-0.10***	***-0.17***	***-0.25***									
Prices of food, beverages and tobacco	**-2.1**	**-1.7**	**-1.9**									
(contribution to consumer price inflation)	***-0.51***	***-0.42***	***-0.47***									
Adjusted inflation excluding fuels	**-0.4**	**-0.3**	**-0.2**									
(contribution to consumer price inflation)	***-0.19***	***-0.15***	***-0.13***									
Fuel prices	**20.3**	**13.2**	**10.9**									
(contribution to consumer price inflation)	***0.59***	***0.41***	***0.34***									
Monetary-policy relevant inflation	**-0.1**	**-0.1**	**-0.2**									
Inflation rate (annual moving average)	***0.9***	***0.8***	***0.7***									

CNB calculation based on CZSO data

Table 2b

INFLATION DEVELOPMENT monthly percentage changes

2007	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Consumer prices	1.0	0.3	0.3	0.7	0.4	0.3	0.4	0.3	-0.3	0.6	0.9	0.5
Regulated prices	3.2	0.6	0.0	0.6	0.3	0.1	0.4	0.1	0.2	0.7	0.0	0.2
(contribution to consumer price inflation)	*0.54*	*0.10*	*0.01*	*0.11*	*0.05*	*0.01*	*0.07*	*0.02*	*0.03*	*0.12*	*0.01*	*0.03*
First-round impacts of changes to indirect taxes on consumer prices (contribution to consumer price inflation)	*0.10*	*0.14*	*0.15*	*0.12*	*0.12*	*0.10*	*0.10*	*0.25*	*0.02*	*0.01*	*0.00*	*0.00*
Net inflation	0.4	0.1	0.2	0.6	0.3	0.2	0.2	0.0	-0.4	0.6	1.1	0.6
(contribution to consumer price inflation)	*0.36*	*0.05*	*0.15*	*0.46*	*0.22*	*0.16*	*0.18*	*0.03*	*-0.35*	*0.49*	*0.87*	*0.47*
Prices of food, beverages and tobacco	1.2	0.2	0.1	1.0	0.0	0.1	-0.3	-0.1	0.1	1.5	2.9	1.2
(contribution to consumer price inflation)	*0.30*	*0.04*	*0.02*	*0.24*	*0.01*	*0.03*	*-0.07*	*-0.03*	*0.03*	*0.39*	*0.73*	*0.31*
Adjusted inflation excluding fuels	0.3	0.2	0.0	0.1	0.1	0.1	0.4	0.1	-0.6	0.2	0.0	0.2
(contribution to consumer price inflation)	*0.14*	*0.11*	*0.01*	*0.05*	*0.04*	*0.07*	*0.22*	*0.07*	*-0.34*	*0.10*	*0.02*	*0.13*
Fuel prices	-2.1	-2.6	3.3	4.3	4.3	1.3	0.8	-0.3	-0.9	-0.1	2.9	0.8
(contribution to consumer price inflation)	*-0.08*	*-0.10*	*0.12*	*0.16*	*0.17*	*0.05*	*0.03*	*-0.01*	*-0.03*	*0.00*	*0.11*	*0.03*
Monetary-policy relevant inflation	0.9	0.1	0.2	0.6	0.3	0.2	0.3	0.1	-0.3	0.6	0.9	0.5
2008												
Consumer prices	3.0	0.3	-0.1	0.4	0.5	0.2	0.5	-0.1	-0.2	0.0	-0.5	-0.3
Regulated prices	11.4	0.5	0.1	0.5	0.1	0.0	1.5	0.1	0.1	1.7	0.0	0.4
(contribution to consumer price inflation)	*1.95*	*0.09*	*0.01*	*0.09*	*0.03*	*0.01*	*0.28*	*0.01*	*0.02*	*0.32*	*0.00*	*0.07*
First-round impacts of changes to indirect taxes on consumer prices (contribution to consumer price inflation)	*1.22*	*0.00*	*0.10*	*0.22*	*0.21*	*0.07*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	0.3	0.2	-0.2	0.1	0.2	0.2	0.3	-0.2	-0.3	-0.3	-0.7	-0.5
(contribution to consumer price inflation)	*0.22*	*0.17*	*-0.14*	*0.06*	*0.14*	*0.15*	*0.25*	*-0.13*	*-0.21*	*-0.26*	*-0.54*	*-0.38*
Prices of food, beverages and tobacco	-0.5	-0.3	-0.8	-0.3	-0.2	-0.2	0.1	-0.4	0.6	0.2	-0.3	0.1
(contribution to consumer price inflation)	*-0.13*	*-0.07*	*-0.21*	*-0.07*	*-0.06*	*-0.06*	*0.04*	*-0.11*	*0.15*	*0.06*	*-0.09*	*0.02*
Adjusted inflation excluding fuels	0.6	0.6	0.1	0.2	0.1	0.1	0.5	0.2	-0.6	-0.3	-0.2	-0.1
(contribution to consumer price inflation)	*0.34*	*0.30*	*0.05*	*0.13*	*0.05*	*0.07*	*0.24*	*0.11*	*-0.29*	*-0.14*	*-0.11*	*-0.04*
Fuel prices	0.1	-1.4	0.4	0.0	3.9	3.3	-0.6	-3.1	-1.7	-4.6	-9.2	-10.5
(contribution to consumer price inflation)	*0.00*	*-0.06*	*0.01*	*0.00*	*0.15*	*0.13*	*-0.03*	*-0.13*	*-0.07*	*-0.18*	*-0.35*	*-0.36*
Monetary-policy relevant inflation	1.8	0.3	-0.2	0.1	0.2	0.2	0.5	-0.1	-0.2	0.0	-0.5	-0.3
2009												
Consumer prices	1.5	0.1	0.2	-0.1	0.0	0.0	-0.4	-0.2	-0.4	-0.2	0.2	0.2
Regulated prices	6.1	-0.2	0.2	-0.6	0.1	0.0	-0.5	0.0	0.1	-0.3	0.0	0.0
(contribution to consumer price inflation)	*1.19*	*-0.03*	*0.04*	*-0.12*	*0.02*	*0.00*	*-0.09*	*0.00*	*0.02*	*-0.05*	*-0.01*	*0.00*
First-round impacts of changes to indirect taxes on consumer prices (contribution to consumer price inflation)	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*	*0.00*
Net inflation	0.4	0.2	0.1	0.1	0.0	0.1	-0.3	-0.2	-0.5	-0.1	0.2	0.1
(contribution to consumer price inflation)	*0.36*	*0.15*	*0.10*	*0.04*	*-0.04*	*0.04*	*-0.30*	*-0.14*	*-0.40*	*-0.10*	*0.19*	*0.12*
Prices of food, beverages and tobacco	1.3	-0.3	0.2	-0.3	-0.5	-0.5	-1.6	-0.7	-0.1	-0.1	0.3	0.8
(contribution to consumer price inflation)	*0.34*	*-0.08*	*0.04*	*-0.07*	*-0.14*	*-0.13*	*-0.40*	*-0.18*	*-0.01*	*-0.04*	*0.09*	*0.21*
Adjusted inflation excluding fuels	0.2	0.1	0.0	0.1	0.0	0.0	0.2	0.1	-0.6	0.0	-0.1	-0.1
(contribution to consumer price inflation)	*0.12*	*0.06*	*-0.02*	*0.03*	*0.02*	*-0.02*	*0.09*	*0.03*	*-0.33*	*0.02*	*-0.03*	*-0.07*
Fuel prices	-3.3	5.6	2.4	2.5	2.3	5.8	0.4	0.5	-1.6	-2.6	3.7	-0.6
(contribution to consumer price inflation)	*-0.10*	*0.17*	*0.08*	*0.08*	*0.08*	*0.19*	*0.01*	*0.02*	*-0.06*	*-0.09*	*0.13*	*-0.02*
Monetary-policy relevant inflation	1.5	0.1	0.2	-0.1	0.0	0.0	-0.4	-0.2	-0.4	-0.2	0.2	0.2
2010		**forecast**										
Consumer prices	**1.4**	**0.1**	**0.0**									
Regulated prices	**1.7**	**0.3**	**0.1**									
(contribution to consumer price inflation)	***0.35***	***0.06***	***0.02***									
First-round impacts of changes to indirect taxes on consumer prices (contribution to consumer price inflation)	***0.97***	***0.00***	***0.00***									
Net inflation	**0.3**	**0.1**	**0.0**									
(contribution to consumer price inflation)	***0.24***	***0.08***	***0.02***									
Prices of food, beverages and tobacco	**0.7**	**0.0**	**0.0**									
(contribution to consumer price inflation)	***0.20***	***0.00***	***0.00***									
Adjusted inflation excluding fuels	**0.0**	**0.2**	**0.0**									
(contribution to consumer price inflation)	***0.02***	***0.10***	***0.01***									
Fuel prices	**0.5**	**-0.6**	**0.4**									
(contribution to consumer price inflation)	***0.02***	***-0.02***	***0.01***									
Monetary-policy relevant inflation	**0.5**	**0.1**	**0.0**									

CNB calculation based on CZSO data

Table 3

CONSUMER PRICES

percentage changes; average for 2005 = 100

Group	Constant 2005 weights in per mille	Months 1	2	3	4	5	6	7	8	9	10	11	12	Average since start of year
Total - 2005	1,000.0	-0.9	-0.7	-0.8	-0.7	-0.5	0.1	0.3	0.3	0.1	0.9	0.7	0.6	0.0
Food and non-alcoholic beverages	162.6	0.8	0.8	0.7	0.5	1.2	1.4	-0.4	-1.3	-1.5	-1.0	-0.8	-0.4	0.0
Alcoholic beverages and tobacco	81.7	0.1	0.3	0.2	-0.2	-0.2	0.0	-0.1	-0.1	-0.2	-0.1	-0.2	-0.1	0.0
Clothing and footwear	52.4	2.4	1.2	1.0	1.3	1.3	1.1	-0.6	-2.0	-1.9	-1.3	-1.1	-1.4	0.0
Housing, water, electricity, gas and other fuels	248.3	-1.0	-0.9	-0.7	-0.9	-0.9	-0.8	-0.4	-0.3	-0.2	2.0	2.0	2.0	0.0
Furnishings, household equipment and routine maintenance of the house	58.1	0.8	0.6	0.5	0.3	0.2	0.0	-0.2	-0.3	-0.5	-0.5	-0.6	-0.7	0.0
Health	17.9	-2.5	-2.0	-1.6	-1.1	0.3	1.1	1.1	1.3	1.8	0.9	0.6	0.6	0.0
Transport	114.1	-4.0	-4.2	-3.8	-1.3	-1.2	-0.4	1.1	1.2	4.9	4.4	2.6	0.5	0.0
Communications	38.7	-7.6	-8.2	-8.2	-8.3	-8.4	5.9	6.2	6.2	5.6	5.6	5.4	5.4	0.0
Recreation and culture	98.6	-1.3	0.1	-1.1	-2.1	-1.7	-1.1	4.1	6.1	-1.1	-0.1	-0.6	-0.7	0.0
Education	6.2	-1.9	-1.2	-1.1	-1.1	-1.1	-1.2	-1.2	-1.2	2.1	2.7	2.7	2.7	0.0
Hotels, cafés and restaurants	58.4	-1.1	-0.6	-0.4	-0.2	-0.2	-0.2	-0.4	-0.4	0.6	0.9	0.9	0.9	0.0
Miscellaneous goods and services	63.0	-0.4	0.1	0.1	0.1	0.0	-0.1	-0.1	-0.1	-0.1	0.0	0.1	0.1	0.0
Total - 2006	1,000.0	2.0	2.1	2.0	2.1	2.6	2.8	3.3	3.5	2.8	2.2	2.2	2.3	2.5
Food and non-alcoholic beverages	162.6	0.4	0.2	0.0	0.2	0.9	2.3	2.0	1.2	1.0	0.3	0.4	1.5	0.9
Alcoholic beverages and tobacco	81.7	0.9	1.1	1.1	0.9	1.3	1.1	1.2	1.2	1.2	1.3	1.5	0.8	1.1
Clothing and footwear	52.4	-3.7	-4.8	-5.1	-4.9	-5.1	-5.6	-7.6	-8.0	-7.6	-6.8	-6.4	-5.9	-6.0
Housing, water, electricity, gas and other fuels	248.3	5.8	6.1	6.1	6.3	6.4	6.5	6.6	6.6	6.6	6.0	6.0	6.0	6.3
Furnishings, household equipment and routine maintenance of the house	58.1	-0.9	-0.9	-1.1	-1.1	-1.2	-1.4	-1.6	-1.6	-1.6	-1.6	-1.4	-1.4	-1.3
Health	17.9	1.7	2.0	2.8	3.1	4.2	4.9	4.9	7.2	7.5	6.9	6.3	6.3	4.8
Transport	114.1	0.2	0.4	0.2	1.7	2.9	2.8	3.6	3.8	2.8	1.0	0.0	-0.2	1.6
Communications	38.7	6.0	4.0	4.0	1.7	7.3	7.3	8.1	8.7	8.5	8.7	8.5	8.5	6.8
Recreation and culture	98.6	0.7	1.8	0.7	0.1	0.4	0.3	5.5	8.1	1.0	0.2	-0.5	-0.3	1.5
Education	6.2	2.6	2.7	2.6	2.6	2.6	2.6	2.6	2.6	5.2	5.2	5.2	5.2	3.5
Hotels, cafés and restaurants	58.4	1.6	1.9	2.0	2.2	2.4	2.5	2.7	2.9	3.1	3.2	3.3	3.5	2.6
Miscellaneous goods and services	63.0	0.9	1.4	1.6	1.8	1.8	1.8	2.1	2.1	2.1	2.2	2.2	2.2	1.9
Total - 2007	1,000.0	3.3	3.6	3.9	4.6	5.0	5.3	5.8	6.1	5.8	6.4	7.4	7.9	5.4
Food and non-alcoholic beverages	162.6	3.1	3.2	3.3	5.0	4.8	5.0	4.5	4.1	4.2	6.6	10.9	12.9	5.6
Alcoholic beverages and tobacco	81.7	2.6	4.6	6.5	7.7	9.7	10.9	12.2	15.8	16.2	16.5	17.4	17.5	11.5
Clothing and footwear	52.4	-7.3	-7.3	-6.8	-5.7	-5.5	-5.6	-7.6	-8.3	-7.5	-6.5	-6.2	-5.9	-6.7
Housing, water, electricity, gas and other fuels	248.3	8.2	8.5	8.6	9.0	9.3	9.5	9.9	10.2	10.6	11.3	11.5	11.7	9.9
Furnishings, household equipment and routine maintenance of the house	58.1	-1.5	-1.6	-1.6	-1.4	-1.3	-1.4	-1.4	-1.5	-1.5	-1.5	-1.4	-1.3	-1.4
Health	17.9	6.6	6.7	6.7	9.7	10.1	9.9	9.3	9.2	9.0	8.7	8.7	8.9	8.6
Transport	114.1	-0.8	-1.6	-0.4	0.9	2.3	2.9	3.2	3.2	2.7	2.8	3.9	4.5	2.0
Communications	38.7	8.1	8.0	7.9	7.7	7.6	7.5	7.5	6.3	5.4	5.3	5.1	4.9	6.8
Recreation and culture	98.6	1.5	2.3	1.4	0.9	0.8	1.1	4.2	5.2	0.7	0.4	-0.5	-0.2	1.5
Education	6.2	5.2	5.3	5.3	5.3	5.3	5.3	5.3	5.3	7.2	7.3	7.3	7.3	6.0
Hotels, cafés and restaurants	58.4	4.0	4.2	4.4	4.7	5.0	5.3	5.6	5.7	6.1	6.3	7.0	7.8	5.5
Miscellaneous goods and services	63.0	2.9	3.6	4.0	4.1	4.1	4.0	4.1	4.0	4.0	4.1	4.3	4.2	4.0
Total - 2008	1,000.0	11.1	11.4	11.3	11.7	12.2	12.4	13.0	12.9	12.7	12.7	12.1	11.8	12.1
Food and non-alcoholic beverages	162.6	15.5	14.9	14.5	15.1	15.9	15.9	15.4	13.6	12.9	12.9	11.9	12.0	14.2
Alcoholic beverages and tobacco	81.7	18.8	19.0	18.3	19.1	19.5	19.7	21.2	23.3	26.7	27.5	28.3	28.4	22.5
Clothing and footwear	52.4	-8.8	-9.1	-8.2	-7.0	-6.8	-6.9	-8.6	-9.4	-8.2	-6.8	-6.4	-6.5	-7.7
Housing, water, electricity, gas and other fuels	248.3	17.5	18.7	19.1	19.8	20.1	20.3	21.8	22.1	22.3	23.9	24.0	24.2	21.2
Furnishings, household equipment and routine maintenance of the house	58.1	-1.2	-1.3	-1.1	-0.8	-0.7	-0.6	-0.6	-0.7	-1.1	-1.3	-1.3	-1.1	-1.0
Health	17.9	42.4	42.2	41.3	41.1	42.0	42.2	43.4	43.7	44.0	43.9	43.7	43.3	42.8
Transport	114.1	6.0	5.5	5.7	5.7	7.1	8.0	7.6	6.3	5.4	2.1	-1.9	-5.2	4.4
Communications	38.7	5.2	5.0	5.0	5.0	4.8	4.7	4.3	4.2	3.0	2.4	1.7	1.1	3.9
Recreation and culture	98.6	2.2	3.2	2.3	1.8	1.5	2.0	4.9	5.7	1.8	1.4	0.6	0.6	2.3
Education	6.2	7.5	7.7	7.7	7.7	7.7	7.8	7.8	7.9	11.1	11.1	11.1	11.1	8.9
Hotels, cafés and restaurants	58.4	10.5	11.5	11.8	12.3	12.7	13.1	13.5	13.5	14.1	14.3	14.3	14.3	13.0
Miscellaneous goods and services	63.0	8.3	8.5	8.6	8.8	8.8	8.9	8.9	9.4	9.3	9.2	9.3	9.1	8.9
Total - 2009	1,000.0	13.5	13.6	13.8	13.7	13.7	13.7	13.3	13.1	12.7	12.5	12.7	12.9	13.3
Food and non-alcoholic beverages	162.6	13.8	13.4	13.2	12.6	11.4	10.6	7.9	6.7	6.3	5.9	6.4	8.1	9.7
Alcoholic beverages and tobacco	81.7	29.4	29.1	30.0	30.2	30.7	30.5	30.4	30.3	30.9	31.2	31.4	30.9	30.4
Clothing and footwear	52.4	-9.5	-10.3	-9.6	-9.0	-9.1	-9.4	-12.0	-12.8	-11.4	-9.8	-8.9	-9.1	-10.1
Housing, water, electricity, gas and other fuels	248.3	30.0	30.1	30.3	30.1	30.2	30.2	29.8	29.9	29.9	29.6	29.6	29.6	29.9
Furnishings, household equipment and routine maintenance of the house	58.1	-1.1	-1.2	-1.2	-1.2	-1.2	-1.2	-1.7	-1.8	-2.0	-2.1	-2.0	-2.0	-1.6
Health	17.9	43.4	40.2	40.6	35.6	36.7	36.8	36.8	36.9	37.4	37.6	37.5	37.6	38.1
Transport	114.1	-5.9	-4.2	-3.6	-2.5	-1.8	0.1	0.2	0.2	-0.5	-1.2	-0.3	-1.0	-1.7
Communications	38.7	0.4	0.9	0.6	0.4	0.2	0.0	-1.8	-1.8	-2.0	-2.2	-2.5	-3.0	-0.9
Recreation and culture	98.6	1.5	2.1	1.4	1.0	1.2	1.3	4.1	4.7	0.6	0.0	-0.5	-0.3	1.4
Education	6.2	11.3	11.3	11.3	11.3	11.3	11.2	11.2	11.2	12.8	12.8	12.8	12.8	11.8
Hotels, cafés and restaurants	58.4	14.7	14.8	15.1	15.3	15.5	15.6	15.7	15.7	16.0	16.0	16.0	16.0	15.5
Miscellaneous goods and services	63.0	10.1	10.7	10.8	11.0	10.9	10.6	11.4	11.6	11.3	11.3	11.4	11.1	11.0

Source: CZSO

Table 4

CONSUMER PRICES - TRADABLES AND NONTRADABLES annual percentage changes

	1	2	3	4	5	6	7	8	9	10	11	12
2003												
Fuel prices	6.1	10.5	11.4	1.9	-0.5	-1.1	-0.6	0.7	-2.5	-2.9	-2.7	-2.0
Other tradables excluding food and fuel prices	-2.3	-2.5	-2.6	-2.7	-2.7	-2.9	-3.0	-3.0	-2.9	-2.7	-2.8	-2.7
Prices of nontradables excluding regulated prices	*4.0*	*4.1*	*3.9*	*3.9*	*3.8*	*3.3*	*2.4*	*2.5*	*2.5*	*2.4*	*2.5*	*2.4*
Prices of non-food commodities excluding regulated prices	1.5	1.7	1.6	1.1	0.9	0.5	0.1	0.2	0.1	0.1	0.1	0.1
Prices of tradables - food	*-4.1*	*-3.8*	*-3.6*	*-3.5*	*-2.8*	*-1.1*	*-0.8*	*-0.8*	*-0.2*	*0.6*	*2.5*	*2.7*
Prices of nontradables - regulated prices	-0.3	-0.8	-0.8	1.4	1.5	1.5	0.4	0.4	0.4	1.2	1.2	1.3
2004												
Fuel prices	1.0	-1.9	-0.3	2.0	11.0	14.2	13.7	12.8	10.5	14.4	13.7	8.9
Other tradables excluding food and fuel prices	-2.6	-2.4	-2.2	-2.3	-2.6	-2.6	-2.6	-2.6	-2.9	-2.9	-2.7	-2.8
Prices of nontradables excluding regulated prices	*3.3*	*3.3*	*3.4*	*3.4*	*5.2*	*5.9*	*5.9*	*5.9*	*6.4*	*6.4*	*6.3*	*6.3*
Prices of non-food commodities excluding regulated prices	0.9	0.8	1.1	1.1	2.5	2.9	3.0	2.9	3.0	3.2	3.1	2.9
Prices of tradables - food	*3.2*	*3.2*	*3.5*	*3.8*	*3.6*	*3.1*	*4.4*	*4.9*	*3.7*	*3.0*	*1.4*	*1.6*
Prices of nontradables - regulated prices	5.0	4.9	4.7	3.1	2.4	2.4	2.4	2.3	2.3	4.4	4.4	4.4
2005												
Fuel prices	-0.4	-0.6	-1.2	6.1	1.1	2.7	8.2	8.3	21.6	16.1	11.4	9.8
Other tradables excluding food and fuel prices	-3.4	-3.6	-3.8	-3.7	-3.4	-3.1	-2.6	-2.6	-2.4	-2.3	-2.3	-2.3
Prices of nontradables excluding regulated prices	*5.2*	*5.2*	*5.0*	*5.0*	*3.5*	*3.1*	*2.6*	*2.6*	*2.6*	*2.4*	*2.3*	*2.2*
Prices of non-food commodities excluding regulated prices	1.6	1.6	1.4	1.8	0.8	0.8	0.8	0.9	1.7	1.3	1.0	0.8
Prices of tradables - food	*0.8*	*1.0*	*0.8*	*0.2*	*0.4*	*0.4*	*-0.4*	*-0.5*	*-0.2*	*0.3*	*0.3*	*-0.5*
Prices of nontradables - regulated prices	2.9	2.9	2.9	3.1	4.0	5.8	6.6	6.8	6.8	9.0	9.0	9.0
2006												
Fuel prices	12.5	13.9	10.9	7.3	10.4	8.3	5.7	6.0	-7.5	-10.8	-8.4	-3.4
Other tradables excluding food and fuel prices	-2.1	-2.1	-2.1	-2.1	-2.1	-2.9	-2.7	-2.6	-2.4	-2.4	-2.3	-2.1
Prices of nontradables excluding regulated prices	*2.6*	*2.5*	*2.4*	*2.4*	*2.5*	*2.2*	*2.4*	*2.6*	*2.5*	*2.4*	*2.4*	*2.5*
Prices of non-food commodities excluding regulated prices	1.2	1.2	1.0	0.9	1.0	0.7	0.8	1.0	0.1	-0.1	0.1	0.5
Prices of tradables - food	*-0.1*	*-0.2*	*-0.3*	*0.1*	*0.3*	*1.0*	*2.1*	*2.2*	*2.2*	*1.3*	*1.3*	*1.6*
Prices of nontradables - regulated prices	11.0	11.0	11.2	11.5	12.4	10.5	9.7	9.8	9.8	4.9	4.8	4.9
2007												
Fuel prices	-3.5	-6.6	-3.1	-3.6	-2.9	-1.7	-2.5	-3.5	-1.8	3.8	9.7	12.0
Other tradables excluding food and fuel prices	-2.4	-2.6	-2.0	-1.6	-1.7	-1.6	-2.2	-2.3	-1.5	-1.2	-1.1	-1.0
Prices of nontradables excluding regulated prices	*2.5*	*2.8*	*2.9*	*3.2*	*2.6*	*2.8*	*2.4*	*1.9*	*2.3*	*2.4*	*2.5*	*2.6*
Prices of non-food commodities excluding regulated prices	0.1	-0.1	0.4	0.6	0.7	1.0	0.4	0.0	0.6	1.1	1.6	1.9
Prices of tradables - food	*2.4*	*3.2*	*4.1*	*5.5*	*5.3*	*5.0*	*5.3*	*6.7*	*7.1*	*9.3*	*12.3*	*13.0*
Prices of nontradables - regulated prices	3.9	4.3	4.1	4.7	4.0	4.0	4.4	4.4	4.6	6.3	6.4	6.5
2008												
Fuel prices	14.5	15.9	12.7	8.0	7.6	9.8	8.3	5.2	4.3	-0.4	-12.1	-22.0
Other tradables excluding food and fuel prices	-1.3	-1.3	-1.4	-1.1	-1.1	-1.4	-1.4	-1.4	-1.6	-2.4	-2.8	-3.2
Prices of nontradables excluding regulated prices	*4.1*	*4.6*	*4.9*	*5.0*	*5.1*	*5.2*	*5.3*	*5.4*	*5.7*	*5.5*	*5.3*	*5.0*
Prices of non-food commodities excluding regulated prices	2.8	3.2	3.1	3.0	3.0	3.1	3.0	2.9	2.9	2.2	1.1	0.0
Prices of tradables - food	*13.3*	*12.2*	*10.9*	*10.0*	*10.0*	*9.5*	*9.6*	*8.2*	*8.6*	*7.1*	*3.8*	*2.7*
Prices of nontradables - regulated prices	15.0	14.9	15.0	14.8	14.6	14.6	15.9	15.8	15.7	16.9	16.8	17.1
2009												
Fuel prices	-24.6	-19.3	-17.6	-15.5	-16.8	-14.8	-14.0	-10.7	-10.6	-8.7	4.2	15.7
Other tradables excluding food and fuel prices	-3.1	-3.4	-3.3	-3.6	-3.5	-3.4	-3.6	-3.6	-3.5	-2.6	-2.3	-2.4
Prices of nontradables excluding regulated prices	*3.5*	*2.9*	*2.7*	*2.5*	*2.4*	*2.0*	*1.7*	*1.4*	*1.2*	*1.2*	*1.2*	*1.2*
Prices of non-food commodities excluding regulated prices	-0.9	-0.9	-0.9	-0.9	-1.1	-1.2	-1.4	-1.2	-1.3	-0.9	0.2	0.7
Prices of tradables - food	*2.1*	*2.0*	*2.7*	*1.8*	*0.7*	*0.1*	*-1.6*	*-1.9*	*-2.5*	*-2.9*	*-2.2*	*-1.5*
Prices of nontradables - regulated prices	11.6	10.9	11.0	9.8	9.8	9.7	7.6	7.5	7.5	5.4	5.4	5.0

CNB calculation based on CZSO data

Table 5

INFLATION EXPECTATIONS OF SELECTED ECONOMIC SECTORS percentage changes

	CPI			
	Financial market		Businesses	
	1Y horizon	3Y horizon	1Y horizon	3Y horizon
1/04	2.9	2.9	-	-
2/04	3.2	2.8	-	-
3/04	3.0	2.8	3.3	3.1
4/04	2.8	2.9	-	-
5/04	2.6	2.9	-	-
6/04	2.7	2.7	3.1	3.0
7/04	2.8	2.6	-	-
8/04	2.8	2.7	-	-
9/04	3.0	2.9	3.1	2.7
10/04	2.8	2.9	-	-
11/04	2.8	2.7	-	-
12/04	2.8	2.8	3.2	2.7
1/05	2.8	2.7	-	-
2/05	2.6	2.7	-	-
3/05	2.6	2.6	2.7	2.8
4/05	2.5	2.5	-	-
5/05	2.4	2.4	-	-
6/05	2.3	2.5	2.7	3.1
7/05	2.4	2.5	-	-
8/05	2.5	2.6	-	-
9/05	2.5	2.5	2.8	2.8
10/05	2.7	2.5	-	-
11/05	2.8	2.6	-	-
12/05	2.6	2.5	2.8	2.9
1/06	2.5	2.4	-	-
2/06	2.5	2.4	-	-
3/06	2.5	2.4	2.7	2.9
4/06	2.6	2.4	-	-
5/06	2.6	2.4	-	-
6/06	2.8	2.4	2.9	3.1
7/06	2.9	2.6	-	-
8/06	3.1	2.7	-	-
9/06	3.2	2.7	3.0	3.2
10/06	3.1	2.7	-	-
11/06	3.4	2.7	-	-
12/06	3.3	2.7	3.0	2.9
1/07	3.1	2.6	-	-
2/07	3.0	2.6	-	-
3/07	3.2	2.5	3.0	3.1
4/07	3.1	2.5	-	-
5/07	3.2	2.5	-	-
6/07	3.2	2.5	3.0	2.9
7/07	3.1	2.5	-	-
8/07	3.6	2.5	-	-
9/07	4.2	2.5	3.6	3.4
10/07	4.3	2.5	-	-
11/07	4.3	2.6	-	-
12/07	4.5	2.7	4.9	3.8
1/08	3.7	2.8	-	-
2/08	3.4	2.6	-	-
3/08	3.2	2.6	4.9	3.7
4/08	3.0	2.6	-	-
5/08	3.1	2.6	-	-
6/08	3.2	2.7	4.9	4.0
7/08	3.1	2.6	-	-
8/08	3.0	2.6	-	-
9/08	2.8	2.6	4.1	3.8
10/08	2.5	2.5	-	-
11/08	2.4	2.5	-	-
12/08	2.2	2.5	2.9	3.0
1/09	2.1	2.4	-	-
2/09	2.0	2.4	-	-
3/09	1.9	2.5	1.9	2.5
4/09	1.9	2.4	-	-
5/09	1.9	2.5	-	-
6/09	1.8	2.5	1.8	2.5
7/09	1.9	2.6	-	-
8/09	2.0	2.7	-	-
9/09	1.8	2.5	1.7	2.5
10/09	2.5	2.5	-	-
11/09	2.5	2.5	-	-
12/09	2.5	2.6	1.8	2.6

Source: CNB statistical survey

Table 6

HARMONISED INDEX OF CONSUMER PRICES

annual percentage changes

	2003	2004	2005	2006	2007	2008	2009
	12	12	12	12	12	12	12
European Union (27 countries)	2.1	2.5	2.3	2.2	3.2	2.2	1.4
European Union (25 countries)	1.9	2.4	2.1	2.2	3.1	2.0	1.3
Belgium	1.7	1.9	2.8	2.1	3.1	2.7	0.3
Bulgaria	5.6	4.0	7.4	6.1	11.6	7.2	1.6
Czech Republic	0.9	2.5	1.9	1.5	5.5	3.3	0.5
Denmark	1.2	0.9	2.2	1.7	2.4	2.4	1.2
Germany	1.0	2.3	2.1	1.4	3.1	1.1	0.8
Estonia	1.2	4.8	3.6	5.1	9.7	7.5	-1.9
Ireland	3.0	2.4	1.9	3.0	3.2	1.3	-2.6
Greece	3.1	3.1	3.5	3.2	3.9	2.2	2.6
Spain	2.7	3.3	3.7	2.7	4.3	1.5	0.9
France	2.4	2.3	1.8	1.7	2.8	1.2	1.0
Italy	2.5	2.4	2.1	2.1	2.8	2.4	1.1
Cyprus	2.2	3.9	1.4	1.5	3.7	1.8	1.6
Latvia	3.5	7.4	7.1	6.8	14.0	10.4	-1.4
Lithuania	-1.3	2.8	3.0	4.5	8.2	8.5	1.2
Luxembourg	2.4	3.5	3.4	2.3	4.3	0.7	2.5
Hungary	5.6	5.5	3.3	6.6	7.4	3.4	5.4
Malta	2.4	1.9	3.4	0.8	3.1	5.0	-0.4
Netherlands	1.6	1.2	2.0	1.7	1.6	1.7	0.7
Austria	1.3	2.5	1.6	1.6	3.5	1.5	1.1
Poland	1.6	4.4	0.8	1.4	4.2	3.3	3.8
Portugal	2.3	2.6	2.5	2.5	2.7	0.8	-0.1
Romania	14.1	9.3	8.7	4.9	6.7	6.4	4.7
Slovenia	4.7	3.3	2.4	3.0	5.7	1.8	2.1
Slovakia	9.4	5.8	3.9	3.7	2.5	3.5	0.0
Finland	1.2	0.1	1.1	1.2	1.9	3.4	1.8
Sweden	1.8	0.9	1.3	1.4	2.5	2.1	2.8
United Kingdom	1.3	1.7	1.9	3.0	2.1	3.1	

Source: Eurostat

Table 7

MONETARY SURVEY							positions at month-ends in CZK billions
	2003	2004	2005	2006	2007	2008	2009
	12	12	12	12	12	12	11
Assets	1,766.1	1,844.1	1,992.1	2,188.7	2,478.3	2,641.1	2,676.4
Net external assets (NEAs)	821.5	863.3	1,076.4	972.6	970.4	975.1	982.1
NEAs of CNB	687.5	634.1	724.7	659.1	633.5	719.9	744.6
NEAs of OMFIs	134.0	229.3	351.7	313.5	336.9	255.2	237.5
Net domestic assets	944.5	980.8	915.8	1,216.0	1,508.0	1,666.1	1,694.3
Domestic loans	1,145.6	1,147.0	1,166.6	1,422.4	1,700.4	1,912.7	2,026.0
Net credit to government (NCG) (including securities)	354.0	257.5	99.1	136.3	72.2	22.9	111.7
NCG to central government (including securities)	408.7	312.4	163.0	206.9	146.1	154.3	232.2
NCG to other government (including securities)	-54.8	-54.9	-64.0	-70.6	-73.9	-131.4	-120.5
Loans to corporations and households (excluding securities)	791.6	889.4	1,067.5	1,286.1	1,628.2	1,889.8	1,914.2
Loans to corporations (excluding securities)	554.1	574.2	649.7	745.5	901.9	1,009.6	942.1
Loans to households (excluding securities)	237.5	315.2	417.8	540.6	726.3	880.2	972.1
Other net items (including securities and capital)	-201.1	-166.2	-250.8	-206.4	-192.4	-246.7	-331.7
Holdings of securities	16.6	18.8	14.4	14.0	26.6	15.6	11.9
Issued securities	-51.6	-74.9	-119.1	-121.8	-159.9	-138.6	-133.0
Liabilities							
Monetary aggregate M2	1,766.1	1,844.1	1,992.1	2,188.7	2,478.3	2,641.1	2,676.4
Monetary aggregate M1	902.8	962.3	1,087.3	1,239.8	1,438.7	1,545.3	1,653.3
Currency in circulation	221.4	236.8	263.8	295.3	324.1	365.5	354.2
Overnight deposits	681.4	725.6	823.5	944.5	1,114.6	1,179.7	1,299.1
Overnight deposits - households	372.1	410.8	456.6	529.3	601.2	708.9	800.3
Overnight deposits - corporations	309.3	314.7	367.0	415.3	513.4	470.8	498.8
M2-M1 (quasi money)	863.3	881.8	904.8	948.9	1,039.7	1,095.9	1,023.1
Deposits with agreed maturity	666.4	675.3	671.4	674.9	709.8	615.9	540.3
Deposits with agreed maturity - households	439.8	458.6	445.1	433.6	429.0	328.7	342.7
Deposits with agreed maturity - corporations	226.6	216.7	226.3	241.3	280.8	287.2	197.6
Deposits redeemable at notice	185.6	198.8	224.1	265.6	315.5	458.0	469.2
Deposits redeemable at notice - households	182.3	194.6	220.6	260.8	311.2	450.0	445.6
Deposits redeemable at notice - corporations	3.2	4.2	3.6	4.8	4.3	8.1	23.6
Repurchase agreements	11.3	7.6	9.3	8.4	14.4	21.9	13.7
Annual percentage changes							
M1	14.6	6.6	13.0	14.0	16.0	7.4	10.5
M2	6.9	4.4	8.0	9.9	13.2	6.6	4.0
Loans to corporations and households	9.3	12.4	20.0	20.5	26.6	16.1	1.3
M2-M1 (deposits)	-0.1	2.1	2.6	4.9	9.6	5.4	-5.0
Annual percentage growth rates							
M1	15.5	8.3	13.1	14.7	16.6	7.4	10.7
M2	8.1	5.8	8.1	10.6	13.8	6.5	4.1
Loans to corporations and households	11.8	15.3	20.8	21.6	27.3	16.0	1.5
M2-M1 (deposits)	1.2	3.3	2.6	5.7	10.2	5.2	-5.1

Table 8

MARKET INTEREST RATES

percentages; monthly averages

A. INTEREST RATES ON INTERBANK DEPOSITS	2003 12	2004 12	2005 12	2006 12	2007 12	2008 12	2009 12
1. Average PRIBOR [1)]							
- 1 day	1.98	2.49	2.00	2.48	3.40	2.32	1.01
- 7 day	2.02	2.51	2.04	2.51	3.58	2.79	1.28
- 14 day	2.03	2.51	2.04	2.51	3.63	2.89	1.32
- 1 month	2.04	2.53	2.05	2.52	3.98	3.61	1.44
- 2 month	2.06	2.55	2.10	2.54	4.02	3.76	1.54
- 3 month	2.08	2.57	2.17	2.56	4.05	3.89	1.64
- 6 month	2.13	2.67	2.33	2.67	4.09	4.01	1.90
- 9 month	2.22	2.76	2.44	2.79	4.15	4.09	2.07
- 12 month	2.30	2.85	2.53	2.89	4.20	4.16	2.20
2. Average PRIBID [1)]							
- 1 day	1.88	2.39	1.90	2.38	3.30	2.09	0.75
- 7 day	1.92	2.41	1.94	2.41	3.48	2.48	1.00
- 14 day	1.93	2.41	1.94	2.41	3.53	2.55	1.02
- 1 month	1.94	2.43	1.95	2.42	3.88	3.23	1.14
- 2 month	1.96	2.45	2.00	2.44	3.92	3.39	1.24
- 3 month	1.98	2.47	2.07	2.46	3.95	3.52	1.33
- 6 month	2.03	2.57	2.23	2.57	3.99	3.65	1.58
- 9 month	2.12	2.66	2.34	2.69	4.05	3.72	1.73
- 12 month	2.20	2.75	2.43	2.79	4.10	3.79	1.87

1) Commercial banks quoting their rates daily on the interbank deposit market

percentages; monthly averages

B. FRA RATES	2003 12	2004 12	2005 12	2006 12	2007 12	2008 12	2009 12
3 * 6	2.23	2.74	2.46	2.71	4.15	3.12	1.64
3 * 9	2.36	2.81	2.57	2.83	4.16	2.98	1.80
6 * 9	2.47	2.85	2.66	2.92	4.15	2.75	1.76
6 * 12	2.64	2.92	2.74	3.02	4.17	2.71	1.90
9 * 12	2.77	2.97	2.79	3.08	4.16	2.58	1.94
9*12 - 3*6 spread	0.55	0.24	0.33	0.37	0.02	-0.55	0.30
6*12 - 3*9 spread	0.28	0.12	0.17	0.19	0.02	-0.27	0.10

percentages; monthly averages

C. IRS RATES	2003 12	2004 12	2005 12	2006 12	2007 12	2008 12	2009 12
1Y	2.41	2.82	2.56	2.86	4.19	3.14	1.77
2Y	2.98	3.06	2.82	3.09	4.20	2.82	2.32
3Y	3.38	3.27	3.00	3.21	4.22	2.84	2.68
4Y	3.69	3.45	3.13	3.31	4.26	2.90	2.92
5Y	3.93	3.62	3.25	3.40	4.30	2.96	3.04
6Y	4.13	3.77	3.33	3.46	4.34	3.01	3.14
7Y	4.29	3.89	3.40	3.52	4.38	3.07	3.23
8Y	4.43	4.00	3.46	3.58	4.42	3.15	3.33
9Y	4.54	4.09	3.52	3.63	4.47	3.24	3.43
10Y	4.64	4.17	3.58	3.68	4.52	3.34	3.52
15Y	4.97	4.40	3.78	3.83	4.71	3.54	3.85
20Y	5.11	4.54	3.88	3.89	4.76	3.43	3.93
5Y - 1Y spread	1.52	0.80	0.69	0.54	0.11	-0.18	1.28
10Y - 1Y spread	2.23	1.35	1.02	0.82	0.33	0.20	1.75

Table 9

NOMINAL AND REAL INTEREST RATES (ex post approach)

percentages

	Nominal rates				Real rates based on CPI				Real rates based on PPI		
	PRIBOR		client rates		PRIBOR		client rates		PRIBOR		new
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits	2W	1Y	client loans
1/04	2.0	2.3	5.5	1.4	-0.3	0.0	3.1	-0.9	0.4	0.7	3.9
2/04	2.0	2.3	5.0	1.4	-0.3	0.0	2.7	-0.9	0.5	0.8	3.5
3/04	2.0	2.3	5.1	1.5	-0.5	-0.2	2.6	-1.0	-0.1	0.2	3.0
4/04	2.0	2.3	5.4	1.5	-0.3	0.0	3.0	-0.8	-1.6	-1.4	1.6
5/04	2.0	2.5	5.4	1.5	-0.7	-0.2	2.6	-1.2	-2.7	-2.3	0.5
6/04	2.1	2.8	5.3	1.6	-0.8	-0.1	2.4	-1.3	-3.9	-3.2	-0.8
7/04	2.3	3.0	5.7	1.7	-0.9	-0.2	2.4	-1.5	-4.7	-4.0	-1.5
8/04	2.3	3.0	6.0	1.7	-1.0	-0.4	2.5	-1.7	-5.3	-4.7	-1.9
9/04	2.5	3.1	5.9	1.8	-0.5	0.1	2.9	-1.2	-5.1	-4.5	-1.9
10/04	2.5	3.0	6.0	1.8	-1.0	-0.4	2.4	-1.6	-5.6	-5.1	-2.4
11/04	2.5	2.9	6.1	1.8	-0.4	0.0	3.1	-1.1	-5.3	-4.9	-2.0
12/04	2.5	2.8	6.1	1.9	-0.3	0.0	3.2	-0.9	-4.8	-4.5	-1.5
1/05	2.5	2.7	6.2	1.8	0.8	1.0	4.4	0.1	-4.4	-4.2	-1.0
2/05	2.3	2.2	6.0	1.7	0.6	0.5	4.2	0.0	-4.5	-4.5	-1.1
3/05	2.2	2.1	5.6	1.7	0.7	0.6	4.1	0.2	-3.9	-4.0	-0.7
4/05	2.0	2.1	5.9	1.6	0.4	0.4	4.2	0.0	-3.4	-3.4	0.2
5/05	1.8	1.8	5.7	1.4	0.5	0.5	4.3	0.1	-2.1	-2.1	1.6
6/05	1.8	1.8	5.3	1.4	0.0	0.0	3.4	-0.4	-0.9	-0.9	2.5
7/05	1.8	1.8	5.3	1.4	0.1	0.1	3.6	-0.3	-0.2	-0.2	3.3
8/05	1.8	1.9	5.3	1.4	0.1	0.2	3.5	-0.3	0.7	0.8	4.1
9/05	1.8	1.9	5.1	1.5	-0.4	-0.3	2.8	-0.7	0.8	0.9	4.1
10/05	1.8	2.2	5.6	1.5	-0.8	-0.4	2.9	-1.1	1.5	1.9	5.3
11/05	2.0	2.6	5.4	1.7	-0.4	0.2	2.9	-0.7	2.0	2.6	5.4
12/05	2.0	2.5	5.5	1.7	-0.2	0.3	3.2	-0.5	2.3	2.8	5.8
1/06	2.0	2.4	5.5	1.7	-0.8	-0.5	2.6	-1.2	1.7	2.1	5.2
2/06	2.0	2.2	5.5	1.7	-0.8	-0.6	2.6	-1.1	1.7	1.9	5.2
3/06	2.0	2.3	5.5	1.7	-0.8	-0.5	2.6	-1.1	1.7	2.0	5.2
4/06	2.0	2.4	5.6	1.7	-0.8	-0.4	2.7	-1.0	1.5	1.9	5.1
5/06	2.0	2.4	5.6	1.7	-1.0	-0.6	2.4	-1.3	0.5	0.9	4.0
6/06	2.0	2.6	5.5	1.7	-0.8	-0.2	2.6	-1.0	0.2	0.7	3.6
7/06	2.0	2.8	5.7	1.7	-0.9	-0.1	2.7	-1.2	-0.1	0.7	3.5
8/06	2.3	2.7	5.8	1.9	-0.8	-0.3	2.7	-1.2	-0.4	0.0	3.1
9/06	2.2	2.9	5.8	1.9	-0.4	0.2	3.0	-0.8	-0.2	0.5	3.3
10/06	2.5	3.1	6.1	2.0	1.2	1.8	4.7	0.7	0.6	1.2	4.1
11/06	2.5	3.0	6.0	2.0	1.0	1.5	4.4	0.5	0.5	1.0	3.9
12/06	2.5	2.9	5.9	2.0	0.8	1.2	4.1	0.3	-0.1	0.3	3.2
1/07	2.5	2.9	6.1	2.1	1.2	1.5	4.8	0.7	-0.3	0.1	3.3
2/07	2.5	2.8	6.1	2.1	1.0	1.3	4.5	0.6	-0.7	-0.4	2.8
3/07	2.5	2.8	6.1	2.1	0.6	0.9	4.1	0.2	-1.0	-0.8	2.4
4/07	2.5	2.9	6.1	2.1	0.0	0.4	3.5	-0.4	-1.1	-0.8	2.3
5/07	2.5	3.2	6.0	2.0	0.1	0.7	3.5	-0.4	-1.6	-0.9	1.8
6/07	2.8	3.4	6.1	2.2	0.3	0.9	3.5	-0.3	-1.7	-1.2	1.4
7/07	2.8	3.6	6.3	2.2	0.5	1.3	3.9	-0.1	-1.2	-0.5	2.1
8/07	3.0	3.7	6.5	2.3	0.6	1.3	4.0	-0.1	-0.7	0.0	2.7
9/07	3.3	3.8	6.5	2.4	0.5	1.0	3.6	-0.4	-0.7	-0.2	2.4
10/07	3.3	3.8	6.7	2.5	-0.7	-0.2	2.5	-1.5	-1.1	-0.5	2.2
11/07	3.3	4.0	6.8	2.5	-1.6	-1.0	1.7	-2.4	-2.0	-1.3	1.4
12/07	3.6	4.2	6.9	2.6	-1.7	-1.1	1.4	-2.7	-1.6	-1.0	1.5
1/08	3.6	4.2	6.8	2.6	-3.7	-3.1	-0.6	-4.6	-2.3	-1.7	0.8
2/08	3.8	4.1	7.2	2.6	-3.5	-3.2	-0.3	-4.6	-1.7	-1.4	1.5
3/08	3.8	4.2	7.2	2.6	-3.1	-2.7	0.1	-4.2	-1.4	-1.0	1.8
4/08	3.8	4.3	7.2	2.7	-2.8	-2.4	0.4	-3.8	-0.9	-0.4	2.4
5/08	3.8	4.3	7.2	2.7	-2.8	-2.4	0.3	-3.9	-1.3	-0.9	1.9
6/08	3.8	4.4	6.9	2.6	-2.7	-2.2	0.2	-3.8	-1.5	-0.9	1.5
7/08	3.8	4.3	7.2	2.7	-2.9	-2.4	0.3	-3.9	-1.4	-0.9	1.9
8/08	3.6	3.9	7.1	2.7	-2.7	-2.4	0.6	-3.6	-2.0	-1.7	1.4
9/08	3.6	3.9	6.9	2.7	-2.8	-2.5	0.2	-3.7	-1.8	-1.5	1.3
10/08	3.8	4.3	7.2	2.7	-2.1	-1.6	1.1	-3.1	-0.1	0.4	3.2
11/08	3.3	4.5	7.1	2.4	-1.1	0.1	2.6	-1.9	2.1	3.2	5.8
12/08	2.9	4.2	6.8	2.2	-0.7	0.5	3.1	-1.3	3.1	4.4	7.0
1/09	2.5	3.5	6.8	2.1	0.3	1.2	4.5	-0.1	3.3	4.3	7.7
2/09	2.1	2.8	6.4	1.9	0.1	0.8	4.3	-0.1	2.7	3.4	7.0
3/09	2.0	2.8	6.4	1.9	-0.3	0.5	4.1	-0.4	4.1	4.9	8.6
4/09	2.0	2.8	6.5	1.9	0.2	1.0	4.7	0.1	4.6	5.5	9.3
5/09	1.8	2.7	6.8	1.9	0.5	1.3	5.4	0.5	5.8	6.7	11.0
6/09	1.7	2.6	6.7	1.8	0.5	1.4	5.4	0.6	6.3	7.3	11.6
7/09	1.7	2.6	6.9	1.7	1.4	2.3	6.6	1.4	6.9	7.9	12.4
8/09	1.5	2.4	6.6	1.7	1.3	2.2	6.4	1.5	7.0	7.9	12.3
9/09	1.5	2.4	6.8	1.6	1.5	2.4	6.8	1.6	7.3	8.3	12.8
10/09	1.5	2.4	6.8	1.6	1.7	2.6	7.0	1.8	6.3	7.3	12.0
11/09	1.4	2.3	6.9	1.7	0.9	1.8	6.3	1.2	3.9	4.8	9.5
12/09	1.3	2.2	-	-	0.3	1.2	-	-	2.1	3.0	-

Note: real rates = nominal rates deflated by annual index (CPI/PPI) in given month.

Table 10

REAL INTEREST RATES (ex ante approach)

percentages

	Real rates expected by financial markets				Real rates expected by businesses			
	PRIBOR		client rates		PRIBOR		client rates	
	2W	1Y	new loans	time deposits	2W	1Y	new loans	time deposits
1/04	-0.9	-0.6	2.5	-1.4	-	-	-	-
2/04	-1.2	-0.8	1.8	-1.7	-	-	-	-
3/04	-1.0	-0.7	2.1	-1.5	-1.2	-1.0	1.8	-1.8
4/04	-0.8	-0.5	2.5	-1.3	-	-	-	-
5/04	-0.6	-0.1	2.7	-1.1	-	-	-	-
6/04	-0.6	0.1	2.6	-1.1	-1.0	-0.3	2.2	-1.5
7/04	-0.5	0.2	2.8	-1.1	-	-	-	-
8/04	-0.5	0.2	3.1	-1.1	-	-	-	-
9/04	-0.5	0.1	2.9	-1.2	-0.6	0.0	2.8	-1.3
10/04	-0.3	0.2	3.1	-1.0	-	-	-	-
11/04	-0.3	0.1	3.2	-1.0	-	-	-	-
12/04	-0.3	0.0	3.2	-0.9	-0.7	-0.3	2.8	-1.3
1/05	-0.3	-0.1	3.3	-0.9	-	-	-	-
2/05	-0.3	-0.3	3.3	-0.8	-	-	-	-
3/05	-0.4	-0.5	2.9	-0.9	-0.5	-0.6	2.8	-1.0
4/05	-0.5	-0.4	3.3	-0.9	-	-	-	-
5/05	-0.6	-0.6	3.2	-0.9	-	-	-	-
6/05	-0.5	-0.5	2.9	-0.8	-0.9	-0.9	2.5	-1.2
7/05	-0.6	-0.6	2.9	-0.9	-	-	-	-
8/05	-0.7	-0.6	2.7	-1.0	-	-	-	-
9/05	-0.7	-0.6	2.5	-1.0	-1.0	-0.9	2.2	-1.3
10/05	-0.9	-0.5	2.8	-1.1	-	-	-	-
11/05	-0.7	-0.2	2.5	-1.1	-	-	-	-
12/05	-0.5	-0.1	2.8	-0.9	-0.8	-0.3	2.6	-1.1
1/06	-0.5	-0.1	3.0	-0.8	-	-	-	-
2/06	-0.5	-0.3	2.9	-0.8	-	-	-	-
3/06	-0.5	-0.2	2.9	-0.8	-0.7	-0.4	2.7	-1.0
4/06	-0.6	-0.2	2.9	-0.9	-	-	-	-
5/06	-0.6	-0.2	2.9	-0.9	-	-	-	-
6/06	-0.8	-0.2	2.6	-1.0	-0.8	-0.3	2.5	-1.1
7/06	-0.9	-0.1	2.7	-1.2	-	-	-	-
8/06	-0.8	-0.3	2.7	-1.2	-	-	-	-
9/06	-0.9	-0.3	2.5	-1.3	-0.8	-0.1	2.7	-1.1
10/06	-0.6	0.0	2.9	-1.1	-	-	-	-
11/06	-0.9	-0.4	2.5	-1.3	-	-	-	-
12/06	-0.8	-0.4	2.5	-1.2	-0.5	-0.1	2.8	-0.9
1/07	-0.6	-0.2	3.0	-1.0	-	-	-	-
2/07	-0.5	-0.2	3.0	-0.9	-	-	-	-
3/07	-0.7	-0.4	2.8	-1.1	-0.4	-0.1	3.0	-0.8
4/07	-0.6	-0.2	2.9	-1.0	-	-	-	-
5/07	-0.7	0.0	2.7	-1.1	-	-	-	-
6/07	-0.4	0.2	2.8	-1.0	-0.3	0.3	3.0	-0.8
7/07	-0.3	0.5	3.1	-0.9	-	-	-	-
8/07	-0.6	0.1	2.8	-1.2	-	-	-	-
9/07	-0.9	-0.4	2.2	-1.7	-0.3	0.2	2.8	-1.2
10/07	-1.0	-0.4	2.3	-1.7	-	-	-	-
11/07	-0.9	-0.3	2.4	-1.8	-	-	-	-
12/07	-0.8	-0.3	2.3	-1.8	-1.2	-0.6	2.0	-2.2
1/08	-0.1	0.4	3.0	-1.1	-	-	-	-
2/08	0.3	0.7	3.6	-0.8	-	-	-	-
3/08	0.6	1.0	3.9	-0.6	-1.0	-0.6	2.2	-2.1
4/08	0.8	1.2	4.1	-0.3	-	-	-	-
5/08	0.7	1.1	3.9	-0.4	-	-	-	-
6/08	0.6	1.2	3.6	-0.5	-1.0	-0.4	2.0	-2.1
7/08	0.7	1.2	4.0	-0.4	-	-	-	-
8/08	0.6	0.9	4.0	-0.3	-	-	-	-
9/08	0.8	1.1	3.9	-0.1	-0.5	-0.2	2.6	-1.4
10/08	1.2	1.7	4.6	0.2	-	-	-	-
11/08	0.9	2.0	4.6	0.0	-	-	-	-
12/08	0.7	1.9	4.5	0.0	0.0	1.3	3.8	-0.6
1/09	0.4	1.3	4.6	0.0	-	-	-	-
2/09	0.1	0.8	4.3	-0.1	-	-	-	-
3/09	0.1	0.9	4.5	0.0	0.1	0.9	4.5	0.0
4/09	0.1	0.9	4.6	0.0	-	-	-	-
5/09	-0.1	0.7	4.8	0.0	-	-	-	-
6/09	-0.1	0.8	4.8	0.0	-0.2	0.7	4.8	0.0
7/09	-0.2	0.7	4.9	-0.2	-	-	-	-
8/09	-0.5	0.4	4.5	-0.3	-	-	-	-
9/09	-0.3	0.6	4.9	-0.2	-0.3	0.7	4.9	-0.1
10/09	-1.0	-0.1	4.2	-0.8	-	-	-	-
11/09	-1.0	-0.2	4.3	-0.8	-	-	-	-
12/09	-1.2	-0.3	-	-	-0.5	0.4	-	-

Note: real rates = nominal rates deflated by inflation expected by selected economic sectors according to the CNB statistical survey.

Table 11

KORUNA INTEREST RATES (stock of business)							percentages
	2003 12	2004 12	2005 12	2006 12	2007 12	2008 12	2009 11
Koruna interest rates on loans provided by banks to residents:							
Households and non-profit institutions serving households (S.14+S.15) - total	8.24	7.96	7.20	6.80	6.63	6.95	7.01
- maturity up to 1 year	11.21	12.82	12.96	13.75	13.96	14.89	16.40
- maturity over 1 year and up to 5 years	10.17	12.40	11.43	11.35	12.46	13.05	12.59
- maturity over 5 years	6.65	6.39	5.96	5.84	5.79	6.18	6.29
for consumption - total	13.83	14.89	13.88	13.59	13.32	13.64	13.90
- maturity up to 1 year	14.26	15.48	16.22	17.31	17.34	18.04	20.09
- maturity over 1 year and up to 5 years	13.86	15.17	14.94	14.67	15.13	15.32	14.73
- maturity over 5 years	13.21	13.45	11.85	11.93	11.65	12.15	12.37
for house purchase - total	6.31	5.93	5.24	4.91	4.89	5.17	5.25
- maturity up to 1 year	6.24	4.48	4.29	5.39	6.56	7.37	7.05
- maturity over 1 year and up to 5 years	7.05	6.57	6.22	6.15	6.19	6.15	5.89
- maturity over 5 years	6.09	5.89	5.19	4.88	4.86	5.16	5.24
other - total	7.80	7.50	7.09	6.87	6.98	7.01	6.55
- maturity up to 1 year	8.49	8.96	9.09	9.52	10.35	10.75	10.41
- maturity over 1 year and up to 5 years	8.02	7.63	7.17	7.74	8.56	9.04	8.21
- maturity over 5 years	7.02	6.58	5.79	5.51	5.70	5.94	5.71
Non-financial corporations (S.11) - total	4.53	4.75	4.20	4.45	5.52	5.40	4.36
- maturity up to 1 year	4.08	4.35	3.84	4.23	5.37	5.06	4.18
- maturity over 1 year and up to 5 years	4.64	4.68	4.18	4.38	5.60	5.67	4.35
- maturity over 5 years	5.14	5.39	4.72	4.74	5.63	5.61	4.50
Koruna interest rates on deposits accepted by banks from residents:							
Households and non-profit institutions serving households (S.14+S.15) - total	1.30	1.41	1.25	1.28	1.41	1.59	1.30
overnight	0.50	0.52	0.40	0.41	0.55	0.91	0.66
with agreed maturity - total	2.02	2.13	1.92	1.96	2.11	2.24	2.00
- with agreed maturity up to 2 years	0.96	1.37	1.03	1.49	2.14	2.24	1.94
- with agreed maturity over 2 years	2.90	2.69	2.50	2.31	2.08	2.26	2.08
redeemable at notice - total	1.26	1.63	1.71	1.97	2.14	2.17	1.96
- redeemable at notice up to 3 months	1.67	2.14	2.27	2.34	2.42	2.33	2.23
- redeemable at notice over 3 months	0.98	1.12	0.81	1.00	1.08	1.02	0.83
Non-financial corporations (S.11) - total	0.85	1.21	0.91	1.18	1.67	1.21	0.68
overnight	0.64	0.68	0.52	0.72	1.06	0.62	0.41
with agreed maturity - total	1.50	2.08	1.64	2.09	3.01	2.29	1.25
- with agreed maturity up to 2 years	1.49	2.05	1.61	2.08	3.02	2.29	1.21
- with agreed maturity over 2 years	3.04	3.12	2.47	2.28	2.62	1.99	2.93
redeemable at notice - total	1.17	1.60	1.14	1.64	1.89	2.54	1.60
- redeemable at notice up to 3 months	1.14	1.49	1.07	1.53	1.79	2.52	1.59
- redeemable at notice over 3 months	1.32	2.26	1.64	2.21	2.93	3.11	2.38

Table 12

BALANCE OF PAYMENTS [1]						in CZK millions
	2004	2005	2006	2007	2008	2009,[2]
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q3
A. Current account	-147,455.7	-39,826.1	-77,193.8	-113,077.2	-113,858.4	-19,930.4
Balance of trade	-13,384.0	59,369.5	65,094.0	120,616.9	103,232.1	45,564.8
exports	1,722,657.4	1,868,585.8	2,144,573.4	2,479,233.8	2,465,400.4	522,070.7
imports	1,736,041.4	1,809,216.3	2,079,479.4	2,358,616.9	2,362,168.3	476,505.9
Services	16,564.4	36,937.1	45,088.4	49,707.1	81,992.7	12,905.3
credit	247,084.8	282,411.4	314,032.3	341,534.3	377,343.7	95,281.9
transport	69,859.0	76,701.5	85,700.7	101,840.5	105,484.8	26,590.6
travel	107,231.8	112,234.4	124,744.2	129,009.3	130,738.2	31,431.4
others	69,994.0	93,475.5	103,587.4	110,684.5	141,120.7	37,259.9
debit	230,520.4	245,474.3	268,943.9	291,827.2	295,351.0	82,376.6
transport	47,571.4	56,254.1	62,140.7	73,128.4	75,288.8	17,518.1
travel	58,398.0	57,777.6	62,174.3	73,486.3	77,518.2	23,070.4
others	124,551.0	131,442.6	144,628.9	145,212.5	142,544.0	41,788.1
Income	-156,637.9	-143,427.6	-166,942.8	-255,652.7	-288,842.3	-66,728.9
credit	87,206.1	105,728.7	127,975.4	151,986.0	135,611.2	27,744.7
debit	243,844.0	249,156.3	294,918.2	407,638.7	424,453.5	94,473.6
Current transfers	6,001.8	7,294.9	-20,433.4	-27,748.5	-10,240.9	-11,671.6
credit	53,050.6	76,655.5	50,197.1	63,337.1	75,240.5	6,217.1
debit	47,048.8	69,360.6	70,630.5	91,085.6	85,481.4	17,888.7
B. Capital account	-14,186.5	4,689.3	8,454.6	19,568.8	31,027.0	5,671.9
credit	5,608.2	5,525.2	14,269.6	21,273.7	46,410.3	6,136.8
debit	19,794.7	835.9	5,815.0	1,704.9	15,383.3	464.9
Total A + B	-161,642.2	-35,136.8	-68,739.2	-93,508.4	-82,831.4	-14,258.5
C. Financial account	177,312.0	154,767.4	92,417.9	125,803.9	151,187.3	34,013.8
Direct investment	101,776.3	279,630.5	90,261.7	179,064.0	150,438.2	-9,134.1
abroad	-26,067.3	449.0	-33,169.6	-32,879.7	-32,358.3	-19,036.5
equity capital and reinvested earnings	-20,260.0	-4,262.8	-33,886.7	-26,412.3	-30,476.9	-13,176.6
other capital	-5,807.3	4,711.8	717.1	-6,467.4	-1,881.4	-5,859.9
in the Czech Republic	127,843.6	279,181.5	123,431.3	211,943.7	182,796.5	9,902.4
equity capital and reinvested earnings	121,482.9	262,471.8	129,598.6	191,531.6	175,677.9	30,676.5
other capital	6,360.7	16,709.7	-6,167.3	20,412.1	7,118.6	-20,774.1
Portfolio investment	53,032.5	-81,243.8	-26,882.5	-57,232.1	-9,145.4	23,955.0
assets	-70,245.2	-82,095.7	-68,383.5	-98,653.0	-4,456.4	21,850.1
equity securities	-36,457.1	-35,342.4	-43,559.2	-65,643.8	-11,103.5	12,052.3
debt securities	-33,788.1	-46,753.3	-24,824.3	-33,009.2	6,647.1	9,797.8
liabilities	123,277.7	851.9	41,501.0	41,420.9	-4,689.0	2,104.9
equity securities	19,558.6	-36,408.9	5,758.0	-5,855.7	-21,302.1	-7,056.8
debt securities	103,719.1	37,260.8	35,743.0	47,276.6	16,613.1	9,161.7
Financial derivatives	-3,208.0	-2,798.6	-6,236.9	1,296.3	-14,000.7	-693.8
assets	-15,565.8	-2,860.9	-10,850.5	-15,700.1	36,031.4	8,839.5
liabilities	12,357.8	62.3	4,613.6	16,996.4	-50,032.1	-9,533.3
Other investment	25,711.2	-40,820.7	35,275.6	2,675.7	23,895.2	19,886.7
assets	-30,507.4	-114,430.6	-31,054.7	-142,189.4	-84,328.2	30,456.4
long-term	20,434.2	-16,338.0	-6,119.2	-45,988.9	-67,660.0	4,160.8
CNB	-184.9	-176.3	-	2.3	-	-
commercial banks	505.0	-24,641.7	-10,715.8	-45,243.7	-69,282.9	3,844.6
government	22,790.7	14,056.5	4,983.6	-691.7	322.8	294.3
other sectors	-2,676.6	-5,576.5	-387.0	-55.8	1,300.1	21.9
short-term	-50,941.6	-98,092.6	-24,935.5	-96,200.5	-16,668.2	26,295.6
commercial banks	-34,248.5	-87,137.0	24,866.4	-88,410.9	27,572.0	27,614.8
government	92.9	9.4	-	-	-	-
other sectors	-16,786.0	-10,965.0	-49,801.9	-7,789.6	-44,240.2	-1,319.2
liabilities	56,218.6	73,609.9	66,330.3	144,865.1	108,223.4	-10,569.7
long-term	36,550.9	49,022.1	68,702.1	30,158.0	34,981.4	3,684.5
CNB	-20.5	-19.1	-18.1	-18.1	-8.6	-
commercial banks	-1,410.8	311.1	12,733.4	28,675.1	18,126.1	5,942.7
government	10,296.1	20,809.1	9,847.3	2,899.1	7,856.3	1,697.5
other sectors	27,686.1	27,921.0	46,139.5	-1,398.1	9,007.6	-3,955.7
short-term	19,667.7	24,587.8	-2,371.8	114,707.1	73,242.0	-14,254.2
CNB	843.7	5,060.1	-4,147.6	-552.8	320.0	179.8
commercial banks	-15,344.5	14,808.8	2,250.5	89,157.0	55,108.6	-8,030.8
government	-	-	-	-	-	-
other sectors	34,168.5	4,718.9	-474.7	26,102.9	17,813.4	-6,403.2
Total A + B + C	15,669.8	119,630.6	23,678.7	32,295.5	68,355.9	19,755.3
D. Net errors and omissions, valuation changes	-8,887.6	-26,779.0	-21,604.3	-16,629.0	-28,244.6	-20,422.2
Total A + B + C + D	6,782.2	92,851.6	2,074.4	15,666.5	40,111.3	-666.9
E. Change in reserves (- increase)	-6,782.2	-92,851.6	-2,074.4	-15,666.5	-40,111.3	666.9

1) Balance of payments structure based on the Balance of Payments Manual (5th edition), IMF 1993
2) Preliminary data

Table 13

INTERNATIONAL INVESTMENT POSITION

in CZK millions

	2004 31 Dec.	2005 31 Dec.	2006 31 Dec.	2007 31 Dec.	2008 31 Dec.	2009,[1] 30 Sep.
Assets	1,549,334.9	1,875,403.8	1,888,248.1	2,118,640.9	2,288,379.8	2,174,814.2
Direct investment abroad	84,087.4	88,772.7	104,743.3	154,700.9	191,775.0	231,345.0
- equity capital	70,664.0	80,061.1	96,748.8	140,239.0	174,825.0	209,820.0
- other capital	13,423.4	8,711.6	7,994.5	14,461.9	16,950.0	21,525.0
Portfolio investment	372,237.6	467,808.5	532,163.4	618,625.4	505,136.7	451,927.0
- equity securities	76,121.3	146,957.6	202,322.0	256,779.1	189,701.2	186,947.4
- debt securities	296,116.3	320,850.9	329,841.4	361,846.3	315,435.5	264,979.6
Financial derivatives	39,695.3	42,556.2	53,406.7	69,525.0	129,950.1	121,807.0
Other investment	417,071.9	549,564.4	541,297.0	644,773.4	745,713.6	663,745.4
long-term	118,432.7	136,314.1	128,334.6	162,633.3	238,066.4	214,672.7
- CNB	600.0	3,184.5	2,993.8	2,848.9	3,174.8	2,909.2
- commercial banks	58,137.8	83,231.1	87,666.2	126,415.4	200,680.0	180,268.2
- government	48,574.9	38,408.5	29,894.6	27,359.0	31,471.6	29,035.3
- other sectors	11,120.0	11,490.0	7,780.0	6,010.0	2,740.0	2,460.0
short-term	298,639.2	413,250.3	412,962.4	482,140.1	507,647.2	449,072.7
- CNB	71.7	71.1	131.3	102.1	84.1	88.0
- commercial banks	184,588.0	273,879.1	233,831.1	310,538.0	295,963.1	244,124.7
of which: gold and foreign exchange	128,119.8	198,042.8	166,588.9	200,780.8	204,178.9	162,438.2
- government	9.5	0.1	-	-	-	-
- other sectors	113,970.0	139,300.0	179,000.0	171,500.0	211,600.0	204,860.0
CNB reserves	636,242.7	726,702.0	656,637.7	631,016.2	715,804.4	705,989.8
- gold	4,253.9	5,526.8	5,690.9	6,431.6	6,933.8	7,123.3
- SDR	118.0	289.8	346.0	363.3	402.4	21,619.0
- reserve position in the IMF	9,137.5	4,447.7	2,324.6	1,521.6	3,128.0	4,190.6
- foreign exchange	610,659.1	716,315.2	648,192.1	618,048.0	695,695.7	632,781.7
- other reserve assets	12,074.2	122.5	84.1	4,651.7	9,644.5	40,275.2
Liabilities	2,374,328.4	2,710,646.3	2,969,225.5	3,533,858.3	3,891,749.8	3,840,766.9
Direct investment in the Czech Republic	1,280,594.8	1,491,564.0	1,666,760.7	2,032,111.2	2,212,577.2	2,261,395.8
- equity capital	1,121,842.3	1,316,101.8	1,497,465.8	1,842,404.2	2,011,862.2	2,111,510.8
- other capital	158,752.5	175,462.2	169,294.9	189,707.0	200,715.0	149,885.0
Portfolio investment	381,019.4	437,806.0	487,994.5	556,342.4	508,094.6	578,234.9
- equity securities	208,872.1	220,495.8	241,594.8	262,518.8	179,775.0	212,324.9
- debt securities	172,147.3	217,310.2	246,399.7	293,823.6	328,319.6	365,910.0
Financial derivatives	31,806.1	31,868.4	36,482.0	54,222.9	144,154.4	103,756.8
Other investment	680,908.1	749,407.9	777,988.3	891,181.8	1,026,923.6	897,379.4
long-term	373,456.4	417,645.7	464,073.2	478,698.3	530,501.0	501,925.9
- CNB	70.2	47.8	27.2	8.8	-	-
- commercial banks	52,020.8	51,639.8	62,263.6	87,448.9	120,767.8	111,590.1
- government	32,065.4	52,322.1	61,686.4	65,875.1	73,497.7	78,520.3
- other sectors	289,300.0	313,636.0	340,096.0	325,365.5	336,235.5	311,815.5
short-term	307,451.7	331,762.2	313,915.1	412,483.5	496,422.6	395,453.5
- CNB	866.5	5,926.5	1,779.0	1,226.2	1,546.4	1,894.1
- commercial banks	185,025.2	201,315.7	193,816.1	272,187.3	332,976.2	251,629.4
- government	-	-	-	-	-	-
- other sectors	121,560.0	124,520.0	118,320.0	139,070.0	161,900.0	141,930.0
Net investment position	-824,993.5	-835,242.5	-1,080,977.4	-1,415,217.4	-1,603,370.0	-1,665,952.7

1) Preliminary data

Table 14

EXTERNAL DEBT

in CZK millions

	2004 31 Dec.	2005 31 Dec.	2006 31 Dec.	2007 31 Dec.	2008 31 Dec.	2009,[1] 30 Sep.
Debt in convertible currencies	1,011,807.9	1,142,180.3	1,193,682.9	1,374,712.4	1,555,958.2	1,413,174.4
of which:						
Long-term	667,327.6	783,533.1	872,113.2	966,893.1	1,056,814.4	1,033,875.7
by debtor						
- CNB	70.2	47.8	27.2	8.8	-	-
- commercial banks	64,346.5	65,418.9	76,426.6	107,852.8	147,006.1	143,277.0
- government	147,729.1	221,003.4	247,019.8	268,669.9	292,278.5	317,118.2
- other sectors	455,181.8	497,063.0	548,639.6	590,361.6	617,529.8	573,480.5
by creditor						
- foreign banks	269,081.3	276,594.3	324,908.9	340,251.2	373,577.8	352,768.2
- government institutions	-	9,636.0	9,555.5	8,686.0	7,249.6	5,748.1
- multilateral institutions	84,862.4	105,187.7	107,043.6	100,897.3	121,655.0	125,652.5
- suppliers and direct investors	143,301.2	170,586.6	179,903.7	220,419.0	219,010.0	182,055.0
- other investors	170,082.7	221,528.5	250,701.5	296,639.6	335,322.0	367,651.9
Short-term	344,480.3	358,647.2	321,569.7	407,819.3	499,143.8	379,298.7
by debtor						
- CNB	866.5	5,926.5	1,779.0	1,226.2	1,546.4	1,894.1
- commercial banks	188,495.9	202,616.9	196,529.5	274,189.3	335,538.1	251,988.5
- government	3,334.6	1,102.4	350.0	5,722.8	2,763.4	2,950.8
- other sectors	151,783.3	149,001.4	122,911.2	126,681.0	159,295.9	122,465.3
by creditor						
- foreign banks	202,372.6	197,820.7	187,186.7	243,132.5	322,095.5	238,475.4
- multilateral institutions	861.3	5,918.8	1,768.2	1,220.3	1,540.8	1,525.1
- suppliers and direct investors	98,611.3	102,235.6	78,391.2	72,188.0	83,045.0	60,770.0
- other investors	42,635.1	52,672.1	54,223.6	91,278.5	92,462.5	78,528.2
Debt in non-convertible currencies	-	-	-	-	-	-
of which:						
- long-term	-	-	-	-	-	-
- short-term	-	-	-	-	-	-
Total external debt	1,011,807.9	1,142,180.3	1,193,682.9	1,374,712.4	1,555,958.2	1,413,174.4
of which:						
- long-term	667,327.6	783,533.1	872,113.2	966,893.1	1,056,814.4	1,033,875.7
- short-term	344,480.3	358,647.2	321,569.7	407,819.3	499,143.8	379,298.7
Total long-term debt	667,327.6	783,533.1	872,113.2	966,893.1	1,056,814.4	1,033,875.7
of which:						
- IMF loans	-	-	-	-	-	-
- liabilities of government sector and guaranteed by government, and liabilities of entities majority owned by state	272,202.1	322,498.4	342,241.9	376,867.5	428,681.9	461,581.0
- liabilities of entities with majority private capital	395,125.5	461,034.7	529,871.3	590,025.6	628,132.5	572,294.7

1) Preliminary data

Table 15

FOREIGN EXCHANGE AND CAPITAL MARKETS

in CZK; foreign exchange market rates

A. NOMINAL RATE	2003 1–12	2004 1–12	2005 1–12	2006 1–12	2007 1–12	2008 1–12	2009 10–12
CZK exchange rate against selected currencies							
- annual/quarterly averages							
1 EUR	31.84	31.90	29.78	28.34	27.76	24.94	25.92
1 USD	28.23	25.70	23.95	22.61	20.31	17.04	17.53
	12	**12**	**12**	**12**	**12**	**12**	**12**
- monthly averages							
1 EUR	32.31	30.65	28.98	27.78	26.30	26.11	26.08
1 USD	26.32	22.87	24.44	21.02	18.04	19.48	17.84
	31 Dec.	**31 Dec.**	**31 Dec.**	**31 Dec.**	**31 Dec.**	**31 Dec.**	**31 Dec.**
- last day of the month							
1 EUR	32.41	30.47	29.01	27.50	26.62	26.93	26.47
1 USD	25.65	22.37	24.59	20.88	18.08	19.35	18.37

B. NOMINAL EFFECTIVE RATE	2003	2004	2005	2006	2007	2008	2009
CZK nominal effective exchange rate (percentages)							
(2005=100)							
weights - foreign trade turnover	93.44	94.07	100.00	105.09	107.78	120.33	116.05
weights - foreign trade turnover SITC 5-8	93.37	93.96	100.00	105.21	107.93	120.50	115.46

Drawing on CZSO statistics on the geographical and commodity structure of foreign trade for 2005, 26 countries which account for around 90% of the Czech Republic's foreign trade were selected. The weights were processed in two alternatives:
Alternative I, used by the IMF, applies to the Czech Republic's entire foreign trade turnover
Alternative II, used by the European Central Bank, applies to only four commodity groups of the Czech Republic's foreign trade

C. REAL EFFECTIVE RATE	2003	2004	2005	2006	2007	2008	2009
CZK real effective exchange rate (percentages)							
(2005=100)							
a) industrial producer prices							
weights - foreign trade turnover	92.57	95.50	100.00	102.22	104.97	114.82	108.95
weights - foreign trade turnover SITC 5-8	92.12	95.20	100.00	102.49	105.41	115.50	109.40
b) consumer prices							
weights - foreign trade turnover	94.44	94.97	100.00	104.73	107.75	123.04	118.23
weights - foreign trade turnover SITC 5-8	93.90	94.60	100.00	105.06	108.29	123.98	118.73

Source: CZSO - consumer prices and industrial producer prices of the Czech Republic
Monthly IMF publication - International Financial Statistics - and the CNB's own calculations

last days of months in points

D. STOCK MARKET INDICES	2003 12	2004 12	2005 12	2006 12	2007 12	2008 12	2009 12
BCPP							
PX	659.1	1,032.0	1,473.0	1,588.9	1,815.1	858.2	1,117.3
PX-GLOB	816.9	1,232.7	1,811.3	1,987.4	2,268.4	1,096.4	1,401.4

On 20 March 2006, the Prague Stock Exchange's PX 50 and PX-D indices were replaced by a single index called the PX. Calculation of both original indices was terminated on Friday, 17 March 2006. The new main PX index carries on from the PX 50 and takes over its history.

Table 16

CNB MONETARY POLICY INSTRUMENTS

rate valid from relevant date

	2W repo rate (%)	Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)	
				Banks	Building societies and ČMZRB
1999					
18 January	8.75	-	-	-	-
28 January	-	-	-	5.00	-
29 January	8.00	-	-	-	-
12 March	7.50	6.00	10.00	-	-
9 April	7.20	-	-	-	-
4 May	6.90	-	-	-	-
25 June	6.50	-	-	-	-
30 July	6.25	-	-	-	-
3 September	6.00	5.50	8.00	-	-
5 October	5.75	-	-	-	-
7 October	-	-	-	2.00	2.00
27 October	5.50	5.00	7.50	-	-
26 November	5.25	-	-	-	-
2000					
		No changes made.			
2001					
23 February	5.00	4.00	6.00	-	-
27 July	5.25	4.25	6.25	-	-
30 November	4.75	3.75	5.75	-	-
2002					
22 January	4.50	3.50	5.50	-	-
1 February	4.25	3.25	5.25	-	-
26 April	3.75	2.75	4.75	-	-
26 July	3.00	2.00	4.00	-	-
1 November	2.75	1.75	3.75	-	-
2003					
31 January	2.50	1.50	3.50	-	-
26 June	2.25	1.25	3.25	-	-
1 August	2.00	1.00	3.00	-	-
2004					
25 June	2.25	1.25	3.25	-	-
27 August	2.50	1.50	3.50	-	-
2005					
28 January	2.25	1.25	3.25	-	-
1 April	2.00	1.00	3.00	-	-
29 April	1.75	0.75	2.75	-	-
31 October	2.00	1.00	3.00	-	-
2006					
28 July	2.25	1.25	3.25	-	-
29 September	2.50	1.50	3.50	-	-
2007					
1 June	2.75	1.75	3.75	-	-
27 July	3.00	2.00	4.00	-	-
31 August	3.25	2.25	4.25	-	-
30 November	3.50	2.50	4.50	-	-
2008					
8 February	3.75	2.75	4.75	-	-
8 August	3.50	2.50	4.50	-	-
7 November	2.75	1.75	3.75	-	-
18 December	2.25	1.25	3.25	-	-
2009					
6 February	1.75	0.75	2.75	-	-
11 May	1.50	0.50	2.50	-	-
7 August	1.25	0.25	2.25	-	-
17 December	1.00	0.25	2.00	-	-

Table 17

MACROECONOMIC AGGREGATES						in CZK millions; annual percentage changes; constant 2000 prices
	2004 Q1–4	2005 Q1–4	2006 Q1–4	2007 Q1–4	2008 Q1–4	2009 Q3
Gross domestic product						
- in CZK millions	2,474,006	2,630,273	2,809,338	2,981,579	3,055,035	742,106
- percentages	4.5	6.3	6.8	6.1	2.5	-4.7
Final consumption						
- in CZK millions	1,834,457	1,882,570	1,956,408	2,027,938	2,084,993	537,865
- percentages	0.9	2.6	3.9	3.7	2.8	2.3
of which:						
Households						
- in CZK millions	1,294,377	1,327,217	1,394,195	1,461,718	1,513,913	390,849
- percentages	2.9	2.5	5.0	4.8	3.6	1.0
Government						
- in CZK millions	526,656	541,825	548,208	551,902	557,239	143,230
- percentages	-3.5	2.9	1.2	0.7	1.0	5.4
Non-profit institutions						
- in CZK millions	14,579	14,629	16,443	18,545	19,530	5,256
- percentages	9.1	0.3	12.4	12.8	5.3	8.7
Gross capital formation						
- in CZK millions	773,916	767,420	841,412	920,201	894,961	173,166
- percentages	9.1	-0.8	9.6	9.4	-2.7	-24.4
of which:						
Fixed capital						
- in CZK millions	716,285	729,043	772,820	856,246	843,694	196,436
- percentages	3.9	1.8	6.0	10.8	-1.5	-9.6
Changes in inventories						
- in CZK millions	54,706	35,654	65,891	60,718	48,055	-24,037
Acquisitions less disposals of valuables						
- in CZK millions	2,925	2,723	2,701	3,237	3,212	767
- percentages	-39.6	-6.9	-0.8	19.8	-0.8	-3.5
Foreign trade						
of which:						
Exports of goods						
- in CZK millions	1,820,657	2,032,500	2,368,967	2,744,170	2,899,855	638,324
- percentages	23.0	11.6	16.6	15.8	5.7	-11.2
Exports of services						
- in CZK millions	226,614	251,989	278,675	305,096	330,299	93,564
- percentages	6.5	11.2	10.6	9.5	8.3	11.9
Imports of goods						
- in CZK millions	1,928,984	2,033,055	2,332,772	2,683,119	2,792,090	601,011
- percentages	18.8	5.4	14.7	15.0	4.1	-11.8
Imports of services						
- in CZK millions	263,438	268,334	297,136	322,186	352,939	105,380
- percentages	11.7	1.9	10.7	8.4	9.5	15.2
Final domestic demand						
- in CZK millions	2,550,742	2,611,613	2,729,228	2,884,184	2,928,687	734,301
- percentages	1.8	2.4	4.5	5.7	1.5	-1.1
Aggregate domestic demand						
- in CZK millions	2,608,373	2,649,990	2,797,820	2,948,139	2,979,954	711,031
- percentages	3.2	1.6	5.6	5.4	1.1	-5.8
Gross domestic product at current prices						
- in CZK millions	2,814,762	2,983,862	3,222,369	3,535,460	3,688,994	912,207
- percentages	9.2	6.0	8.0	9.7	4.3	-2.5

Source: CZSO

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