I. Economic and social development of the Czech Republic in the third quarter of 2006

(Preliminary figures)

The growth of the Czech economy continued also in Q3 2006, albeit at a slightly lower rate. The growth was supported especially by manufacturing on the supply side and by gross capital formation expenditure on the demand side. **Gross value added** (GVA) reached CZK 728.1 billion (current prices) in Q3 2006 and increased by 6.1% y-o-y (constant prices). This growth was mainly due to manufacturing (contribution 3.9 percentage points) where GVA rose sizeably (+13.9%). GVA achieved in other CZ-NACE activities varied considerably in comparison to the average increase; the span of GVA growth rates among CZ-NACE activities was wide (29.5 p.p.). A small increase in product taxes (2.5%), in spite of lower product subsidies (3.5%), led up to lower growth of GDP than of GVA.

The **value of GDP** was CZK 813.1 billion (current prices) and GDP growth 5.8% y-o-y[1] (constant prices). The GDP increase was mainly affected by expenditures on gross capital formation (contribution 3.6 p.p.), of which the effects of growing fixed capital formation and inventories were the same (both 1.8 p.p.). Expenditures on final consumption increased by only 2.0% and their contribution to GDP growth was 1.5 p.p. Expenditures on household consumption grew by 4.0% and contributed with 2.0 p.p. to GDP growth. The effect of net exports was a mere 0.7 p.p.

Total labour productivity (GDP at constant prices per worker[2]) was up by 4.2% y-o-y in Q3 2006 and contributed with three-fourths to GDP growth (the remaining fourth was made up total employment). The number of employees rose by 1.4% and the value of their wages and salaries was higher by 7.0%, i.e. the average wage was up by 5.5%. The ratio of compensation of employees to GDP value reached 41.9%, which was by 0.5 p.p. less y-o-y. Gross operating surplus and mixed income in relation to GDP was 47.8%. Unit labour costs fell.

The real increase of 7.1% in **aggregate demand** in Q3 2006 is attributable to growth of domestic aggregate demand (contribution 1.9 p.p.), which grew by 3.4%, and to growth of external demand (contribution 5.2 p.p.). **Aggregate supply** rose by 7.0% and growth of external supply had the decisive effect on this rise.

Gross national saving (GNS) CZK 179.5 billion was by CZK 7.3 billion higher y-o-y (+4.2%), yet it was insufficient for the financing of gross capital formation. The saving grew slower than GDP and faster than the value of gross disposable national income (GDNI). A highly negative effect on GDNI increasing less than GDP (by 3.4 p.p.) had net primary incomes flowing out of the country; they grew by CZK 24.9 billion. The balance of current transfer expenditures and incomes deteriorated as well (by CZK 2.3 billion). Due to a substantially higher growth of expenditures on gross capital formation than GNS, the balance of national current transfers with non-residents increased considerably. The rate of financing expenditures on GFCF from external sources thus grew markedly (from 13.9% to 22.4%). The rate of saving stagnated (24.0% in Q3 2005 and 23.9% in Q3 2006), and so did the rate of investment (25-1% in both Q3 2005 and Q3 2006). Higher growth of investment rate than growth saving rate kept on y-o-y.

In the **household sector,** growth of current expenditures (7.1%) was faster than growth of current incomes (5.2%). The increase in current incomes was predominantly affected by increase in compensation of employees by 6.3%, and the increase in current expenditures by increase in social contributions by 7.5%. **Gross disposable income of households** stood at CZK 405.5 billion and grew by 4.4% y-o-y; when it was spent on consumption expenditure and taking account of changes in the share of households in pension fund reserves, gross saving reached CZK 8.2 billion, which was substantially less that a year earlier. The rate of gross household saving (2.0%) markedly dropped y-o-y (by 2.1 p.p.). The reduced ability of financing resulted in a situation where household incomes from loans were higher than all households' assets.

Key economic indicators

Per cent

	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2004 to Q3 2005	Year 2005	Q2 2005 to Q1 2006	Q3 2005 to Q2 2006	Q4 2005 to Q3 2006
GDP, y-o-y change (constant prices)	6.0	6.7	6.4	6.0	5.8	5.6	6.1	6.3	6.3	6.2
Final consumption, y-o-y change (constant prices)	3.6	2.0	3.4	2.3	2.0	1.7	2.3	2.8	2.8	2.4
Gross capital formation, y-o-y change (constant prices)	0.5	4.8	7.6	16.2	13.6	1.6	1.6	3.0	7.4	10.8
Inflation rate, y-o-y, average	1.9	2.4	2.8	2.9	2.9	2.0	1.9	2.2	2.5	2.8
Registered unemployment rate, average	8.8	8.6	9.0	7.7	7.8	9.0	9.0	8.8	8.6	8.4
State budget balance / GDP ratio, %[1)]	2.9	-10.6	2.1	-1.0	-0.8	-0.9	-1.9	-1.6	-1.7	-2.6
Current account / GDP ratio, %[1)]	-4.1	-2.7	0.3	-6.3	-6.0	-2.8	-2.1	-2.6	-3.3	-3.8
Financial account / GDP ratio, %[1)]	4.0	1.9	-0.3	4.1	5.6	6.9	4.6	4.8	2.5	2.9
Net exports / GDP ratio, %[1)]	0.8	0.5	3.7	1.4	1.4	1.5	1.9	1.9	1.6	1.7

[1)] At current prices

Sources: CZSO, Ministry of Finance, Ministry of Labour and Social Affairs, CNB; calculations by CZSO

[1] The GDP indices and GDP component indices are at average prices of previous year; the sales indices in individual CZ-NACE activities are at constant prices of 2000, unless otherwise stated.

[2] According to employment data from the national accounts.

Industrial production (measured by the industrial production index) grew by 8.1% y-o-y in Q3 2006. Decisive contribution (7.6 p.p.) to this figure was made by manufacturing where the fastest increases were recorded in 'manufacture of transport equipment', 'manufacture of electrical and optical equipment' and 'manufacture of basic metals and fabricated metal products'.

Sales of own goods and services rose by 11.8% y-o-y; the share of sales in the ICT sector in sales in total manufacturing at current prices grew by 0.5 p.p. y-o-y. The number of employees in the industry continued increasing, in particular thanks to foreign-controlled enterprises. Labour productivity rose more than average wages, unit wage costs dropped by 4.9%. Book value added (current prices) was up by 13.8%, i.e. considerably more than in Q3 2005.

Electricity generation grew by 0.5% y-o-y, being up in all types of power stations. Domestic consumption increased by 4.5%, of which in households fell by 0.5%. Like in preceding quarters, exports were higher than imports, and surplus of exports over imports was by 7.4% higher. Whereas imports of **natural gas** grew, domestic consumption was lower by 6.4%. As a result, the stock of gas increased. Imports of **crude petroleum** (in tonnes) remained at the same level as in Q3 2005.

In October 2006, industrial production was up by 12.8 % y-o-y and real sales by 13.7%.

Construction output grew by 7.4% y-o-y; the same increase was recorded in enterprises with 20+ employees. Construction work abroad grew by more than half, but its share was insignificant. Better results were registered also for **construction work carried out by own workers** (construction put in place by enterprises with 20+ employees), which rose by 8.6%.

Sales of own goods and services (predominantly from construction activity) were up by 8.3% y-o-y. The number of persons employed in construction remained actually at the same level as in Q3 2005. Faster growth of labour productivity than growth of average wages reduced unit wage costs by 0.5%. As to financial data, book value added at current prices produced by construction enterprises was higher than in Q3 2005. Growth of production consumption was faster than growth of output.

The number and value of **construction orders** were up y-o-y, order books were full for the next 10 months. Over two-thirds of orders came from the government sector. The planning and building control authorities granted fewer **building permits** than in Q3 2005, but their value was by nearly a tenth higher.

In **housing construction**, the numbers of started and completed dwellings fell by 4.7% and 28.6%, respectively. This resulted in an increase in dwellings under construction of 8.3% y-o-y.

In October 2006, construction output grew by 7.1% y-o-y.

The sales of own goods and services in **agriculture** were down by 2.0% y-o-y; at current prices they remained at the same level y-o-y. The number of employees in holdings of agricultural primary production continued decreasing. As labour productivity dropped and average wages grew, unit wage costs increased by 5.7%. As to financial data, agriculture reached worse results than a year earlier. Output stagnated and production consumption rose, book value added fell by 6.7%.

According to final **harvest forecast** on 15 October, the total production of cereals should be down by 10.9%, potatoes down by more than a quarter lower and sugar beet down by 16.9% in comparison to the average of the preceding five years. Better harvest is expected for rape, mainly due to larger sowing areas.

According to the first estimate, **real agricultural output** in 2006 will be by 4.1% lower than in 2005. Crop production and animal production is expected to drop by 7.6% and 0.1%, respectively. The share of intermediate consumption will be higher and the volume of gross value added will fell by 10.5%.

Retail sales, incl. sale, maintenance and repair of motor vehicles and motorcycles and retail of automotive fuel, increased by 6.2% y-o-y at constant prices; sales in retail trade (incl. repair of personal and household goods) grew by 6.0%; and sale, maintenance and repair of motor vehicles and motorcycles and retail of automotive fuel was up by 6.6%. The number of employees and workers in **trade total** grew y-o-y, and so did their labour productivity. Book value added (current prices) in trade grew sizeably (by 12.0%). Sales in **hotels and restaurants** dropped by 0.3% at constant prices, labour productivity decreased too.

In October, retail sales, incl. sale, maintenance and repair of motor vehicles and motorcycles and retail of automotive fuel, increased by 8.6% y-o-y

According to the frontier statistics on **international tourism**, international visitor arrivals in the Czech Republic decreased by 3.4% y-o-y. Czech resident departures dropped by 0.7%. Thanks to domestic clients, demand for collective accommodation establishments increased (the number of guests was the highest in the period of last six years, and overnight stays grew). In particular five-star hotels were successful in having clients. The active balance of tourism (as part of the balance of payments) stood at CZK 13.1 billion, which was down on Q3 2005.

Due to a change in organisation, the data on transport are not comparable y-o-y. Sales of own goods and services and goods for resale in **transport** were, like in preceding quarters, lower than a year earlier. This showed itself in lower labour productivity, whereas the average wage grew in all modes of transport except for inland water transport. Book value added (current prices) increased by 6.2% owing to lower increase of production consumption than of outputs. In rail transport of goods, the tonnage carried increased very slightly and outputs grew, compared to Q3 2005; the tonnage carried and outputs in road transport of goods dropped and grew considerably, respectively.

Sales in **communications** rose by 2.7% in Q3 2006, which is the lowest figure since the start of the year. Employment decreased and labour productivity grew. Book value added grew by 4.0% (current prices).

Financial intermediation (excl. the CNB) reached a moderately higher gross profit, which was exclusively due to a high growth of profits achieved in insurance companies. The profit in other groups fell, most in pension funds and financial leasing companies. The number of employees in the aggregate of financial institutions stabilised and the average wage grew by 6.7%, reaching CZK 36 694.

Sales in **other market services** were up by 2.3%, which is the lowest growth since the start of the year. The highest increases were registered in enterprises engaged in 'renting of machinery and equipment without operator and of personal and household goods', 'computer and related activities' and 'sewage and refuse disposal, sanitation and similar activities'. Among services provided predominantly to the population, only sales in health grew (inter alia due to the transfer of several health establishments from the general government sector to the non-financial institutions sector). Employment in other market services was up by 7.5% y-o-y; the average monthly nominal wage grew markedly faster than labour productivity. Book value added produced was by 6.1% higher y-o-y. Nearly three-quarters of total sales were made in enterprises with fewer than 100 employees, but the fastest increase in sales was recorded for the largest enterprises, where security agencies, spas and hospitals belong.

Sales*) in selected CZ-NACE activities

Y-o-y indices in per cent

CZ-NACE activity		Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2004 to Q3 2005	Year 2005	Q2 2005 to Q1 2006	Q3 2005 to Q2 2006	Q4 2005 to Q3 2006
Industry (CZ-NACE 10-41)	Current prices	107.9	107.5	122.8	113.1	114.6	110.2	108.2	111.9	112.8	114.4
	Constant prices	106.5	107.5	122.5	111.7	111.8	104.8	105.1	110.3	112.0	113.2
Construction	Current prices	110.6	108.6	103.7	109.4	111.7	105.7	106.7	106.7	108.7	109.1
	Constant prices	108.0	106.0	101.2	106.5	108.3	102.3	103.7	104.1	106.0	106.1
Agriculture	Current prices	89.5	96.8	98.0	96.1	100.6	102.6	97.8	96.7	94.7	97.9
	Constant prices	98.2	102.8	99.5	91.8	98.0	110.3	108.0	104.6	98.4	98.4
Retail trade (CZ-NACE 50, 52)	Current prices	105.5	103.5	107.7	106.6	106.1	104.9	104.7	105.4	105.7	105.9
	Constant prices	103.8	102.6	106.9	105.9	106.2	104.1	104.1	104.5	104.7	105.3
Transport	Current prices	108.4	109.1	91.7	90.2	92.5	107.0	107.2	103.7	99.9	95.8
	Constant prices	104.3	104.8	89.5	88.3	91.0	103.5	103.5	100.3	97.0	93.5
Communications	Current prices	105.8	103.9	104.3	104.4	103.2	104.0	104.1	104.4	104.6	103.9
	Constant prices	109.3	106.8	104.0	103.4	102.7	107.3	108.1	107.3	105.9	104.2
Other market services	Current prices	108.3	106.9	107.8	108.2	106.6	104.1	105.6	106.4	107.8	107.4
	Constant prices	105.5	104.0	104.3	104.4	102.3	100.9	102.6	103.4	104.5	103.8

*) The data on the industry, construction and agriculture refer to sales of own goods and services; the data on other CZ-NACE activities refer to total sales.

The total **economic result** (i.e. gross profit or pre-tax profit) **of non-financial corporations with 100+ employees** grew sizeably by 28.6% against Q3 2005 (current prices). Total yields increased by 12.3% and costs by 11.5%. At the same time, return on costs and return on equity capital grew. The number of loss-making enterprises decreased y-o-y and made up 32.1% of all enterprises. Gross profit rose y-o-y mainly due to 'manufacturing'. The highest profit decreases were observed in 'agriculture, forestry and hunting' and in 'mining and quarrying'. **Book value added** produced in large corporations was by 14.0% higher y-o-y and grew in all institutional sub-sectors, most in national public corporations. The stock of total inventories grew by 9.0% y-o-y at the end of Q3 2006. Overcapitalisation, i.e. negative value of equity capital, was observed in a lower number of enterprises than a year earlier. The share of equity capital in the coverage of the balance sum decreased to 52.1%, external resources covered the rest. **Foreign-controlled enterprises** raised their book value added by 18.2% and gross profit by 46.0%.

The level of consumer prices in Q3 2006 grew by 2.9% y-o-y, like in the preceding quarter. This increase was mainly affected by growth of prices of natural gas, electricity, heat and hot water, accommodation services, and newly prices of food and non-alcoholic beverages. Above-the-average increases were recorded also for health and education, which are insignificant in terms of weight. Market prices rose by only 1.4%. Prices of goods were up by 2.6% and prices of services by 3.5%.

Inflation rate, measured as increase in the average index of consumer prices for last 12 months over the average for preceding 12 months, stood at 2.8% in September and increased by 0.1 p.p. each month of Q3 2006.

In October and November 2006, consumer prices grew by only 1.3% and 1.5% y-o-y, respectively.

Prices of agricultural producers were up by 2.6% y-o-y. **Prices of industrial producers** rose by 2.5% (+0.3% in Q1 2006 and +1.3% in Q2 2006). The overall price level was affected by increase in prices of energy, coke and refined petroleum products, chemical products and man-made fibres in excess of 7%. Lower prices were registered for food, beverages and tobacco products and transport vehicles. **Construction work prices** grew by 3.2% and **prices of market services** by 3.7%; especially prices of business services and prices of real estate and renting activities rose. **Prices of tangible investments** were by 1.0% higher y-o-y.

In October and November 2006, year-on-year, agricultural producer prices grew by 1.9% and 1.3% respectively, construction work prices by 3.2% and 3.1% respectively, industrial producer prices by 1.9% and 2.0% respectively. Prices of market services grew most (by 3.2% and 3.4% respectively).

Prices of external trade in goods were characterised by similar increases of import and export prices (by 0.5% and 0.2% respectively). Compared to Q3 2005, **terms of trade** deteriorated to 99.7% and Q3 2006 was the sixth successive quarter in which they were below 100%. **World prices** of industrial raw materials and food measured by the CZSO index grew by 23.6% y-o-y on average in Q3 2006 and their growth slowed down.

In October terms of trade reached 101.5% y-o-y.

Exports and imports at current prices rose by 12.3% and 11.2% y-o-y respectively. Trade balance surplus, which grew by CZK 5.0 billion y-o-y and reached CZK 5.1 billion, was affected favourably by a high trade surplus in machinery and transport equipment and negatively by a high trade deficit in mineral fuels and chemical products. As to the commodity structure of external trade, increase in exports was driven by machinery and transport equipment, whose y-o-y growth of exports by 15.7% was the highest among all sections of the SITC; imports increased mainly due to mineral fuels, lubricants and related materials, and manufactured goods classified chiefly by material. In external trade by group of countries, exports to all groups of countries were up (with the exception of developing economies), exports to developed market economies and CIS countries grew above the average; imports from ‘other states’, European transition economies and CIS countries rose at above-the-average rates. The surplus of external trade was concentrated in trade with developed market economies/EU25 and with European transition economies, because the balance of trade with ‘other states’, CIS countries and developing economies was passive.

In October 2006 exports and imports at current prices increased by 19.8% and 19.2% respectively, y-o-y. The trade balance was active by CZK 4.4 billion.

The current account of the **balance of payments** ended in a deficit of CZK 48.4 billion in Q3 2006; the surplus of transactions in goods and balance of services stood against a deficit of the balance of revenues and current transfers. The financial account of the balance of payments reached a surplus of CZK 45.9 billion, which was more than a year earlier mainly due to lower outward flows of net portfolio investments. Deficit of the current account made up 6.0% and surplus of the financial account 5.6% relative to GDP value. Foreign exchange reserves increased by CZK 2.5 billion in Q3 2006 (adjusted for exchange rate fluctuations) compared to the increase of CZK 2.7 billion in Q3 2005.

Foreign exchange reserves of the CNB reached CZK 688.4 billion at the end of Q3 2006, which would be enough to cover 3.7 months’ imports of goods and services.

The average **exchange rate** of the Czech ***koruna*** strengthened **against the euro** to 28.3 CZK/EUR and **against the US dollar** to 22.2 CZK/USD y-o-y in Q3 2006. The index of nominal effective exchange rate of the *koruna* was by 6.1 p.p. up on average in Q3 2006.

The y-o-y growth of **money supply M2** was higher than nominal growth of GDP at the end of Q3 2006. Money supply M2 relative to the annualised volume of GDP was 66.6%, which was more than in Q3 2005. Deposits of households and non-financial corporations contributed to the acceleration of money supply dynamics. The monetary aggregate **M1** was by 16.3% higher y-o-y in September; overnight deposits and money in circulation grew too. The share of monetary aggregate M1 in monetary aggregate M2 increased to 56.4% in Q3 2006.

In comparison to Q2 2006, dynamics of total **deposits** at banks slowed down to 10.6% y-o-y at the end of Q3 2006, *koruna* deposits recorded an increase of 11.3%. Total **loans** granted in September grew by 17.4% y-o-y. Loans to households maintain a high rate of growth, loans to non-financial corporations grew fast too, and so did the net loan to government since August. The y-o-y dynamics of housing loans remained at a high level.

In Q3 2006 the Czech National Bank raised twice its basic rates, the limit 2T repo rate was fixed at 2.5% on 29 September. The average **interest rate** on total **deposits** and total **loans** reached 1.2% and 5.6%, respectively, at the end of Q3 2006. The **interest margin** between total rates on loans and total rates on deposits does not tend to fluctuate significantly and reached 4.4 percentage points in September - 5.6 p.p. in the household sector and 3.2 p.p. in the non-financial corporations sector.

The number of workers in the economy of the CR (estimate) increased by 0.8% in comparison with Q3 2005, the number of employees in the economy grew by 1.0%. Their average wage was up by 6.1% and reached CZK 18 677. Nearly 178 thousand foreign nationals were employed in the Czech Republic at the end of Q3 2006, which was by 34.5 thousand more y-o-y.

The **number of employees** in businesses **with 20+ employees** of the business sphere (in financial intermediation irrespective of employment) and in all organisations of the non-business sphere increased by 1.3%. This is mainly attributable to foreign-controlled enterprises, where the increase was nearly a tenth. Decrease in employed persons continued in state-owned enterprises and in cooperatives. The average monthly gross **nominal wage** of employees grew by 6.1% and stood at CZK 19 968. Consumer prices were up by 2.9% and the average **wage** rose by 3.1% **in real terms** - by 3.2% in the business sphere and by 2.4% in the non-business sphere. The wage differentiation among individual CZ-NACE activities widened (the variation coefficient was up by 1.9 percentage points y-o-y in Q3 2006 and reached 35.1%).

The **registered unemployment rate** was 7.8% on 30 September, i.e. a decrease of 1.0 p.p. y-o-y. There were 454.2 thousand registered job applicants, of which 427.3 thousand were available unemployed job applicants. The number of unemployed job applicants decreased in all age groups. The number of long-term unemployed persons dropped by 10.1% y-o-y; their percentage in the total number of the unemployed hardly changed y-o-y and remained high. The average number of unemployed school-leavers fell by 12.3% y-o-y. The job vacancy rate was 2.2% in Q3 2006. The highest unemployment rates persist in the districts of Most (20.3%), Karviná (17.8%) and Teplice (15.6%).

The registered unemployment rate was 7.4% at the end of October and 7.3% at the end of November.

Per capita **net money expenditures** at constant prices grew by 13.8% in households of employees and by only 2.3% in households of pensioners. The share of indispensable expenditures, i.e. expenditures on food, beverages and housing, made up 38.1% (y-o-y stagnation) of total expenditures in households of employees and 55.0% (y-o-y growth) in households of pensioners.

Total expenditures on **social security** increased by 6.4% y-o-y in Q3 2006 and their share in GDP was 10.5%. The fastest growth was registered for resources paid as pensions (by 6.9%). As a result of the pensions adjustment as of 1 January 2006, the average old-age pension amounted to CZK 8 176 at the end of Q3 2006, i.e. by 5.8% more y-o-y. As the cost of living of pensioners was up by 4.1% y-o-y in Q3 2006, the average old-age pension grew by 1.6% in real terms.

In Q1-Q3 2006, the **state budget** recorded revenues CZK 673.5 billion and expenditures CZK 672.0 billion, which resulted in a surplus of CZK 1.5 billion at the end of September. The performance of the state budget deteriorated by CZK 24.3 billion, the surplus in relation to nominal GDP was a mere 0.1%. Especially lower revenues from taxes on incomes of legal persons (lower rate of taxation) and taxes on incomes of the self-employed affected the revenue side of the state budget. A low percentage of the annual budgeted level was registered for excise taxes. The swift growth of expenditures is mainly attributable to higher pension expenditures, capital expenditures, transfers to the funds of social security and health insurance (advance payments to the General Health Insurance Company) and non-investment transfers to the budgets of regions, municipalities and voluntary associations of municipalities.

At the end of October and November, the state budget ran a deficit of CZK 12.7 billion and CZK 30.9 billion respectively.

The **population** of the Czech Republic was 10 281.0 thousand on 30 September 2006, which was by 35.5 thousand more y-o-y. Of a decisive effect was still the active balance of external migration, while also natural increase for Q1-Q3 2006 was positive. By 1 574 more children were born than a year earlier and deaths decreased by 4 301. In spite of a higher number of marriages, the nuptiality level remains low. Divorces stagnated at a high level.

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Comparison of development in the CR and the EU in Q3 2006: selected harmonised indicators

Harmonised indicator	EU25	EU15	Germany	Slovakia	Czech Republic
Gross domestic product (constant prices), y-o-y change in %	2.1	2.0	2.3	9.8	5.8
Harmonised index of consumer prices (HICP)	102.2	102.2	101.6	104.8	102.4
Harmonised unemployment rate in %	7.8	7.2	8.5	12.7	7.0
Industrial production index (working days adjusted) in %	103.8	104.0	106.2	111.3	108.6
Construction output index (working days adjusted) in %	103.9	103.9	106.6	118.0	107.8
Retail sales index (seasonally adjusted) in %	103.7	103.2	101.1	110.9	106.0

Source: Eurostat (20 December 2006), calculations by CZSO