

THE CZECH ECONOMY DEVELOPMENT

1st Half of 2018

Summary Data on the Czech Republic

Prague, 22th October 2018

Publication Code: 320194-18

Reference No.: CSU-03092/2018-01

Yearly Publication Number: 1

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Sources of data in the whole analysis: CZSO, MF CR, CNB, MLSA, CSSA, Eurostat, CZSO calculations.
Latest information provided in this report has been dated the 14th September 2018.

1. Summary

- The year-on-year rate of growth of the Gross Domestic Product (GDP) slowed down to 2.4% in Q2¹. The high level of the growth of expenditure on individual GDP components did not hold up any more. Both final consumption expenditure and investment activity grew strongly, even though slower compared to the previous year. Change in the inventory stock had however an adverse effect. The foreign trade balance impacted positively, but considerably less compared to the preceding year. Quarterly addition to GDP reached 0.7%. From the year-on-year perspective, the Czech Republic ranked tightly above the EU average, which arrived at 2.2%.
- The Gross Value Added (GVA) increased year-on-year by 2.4% in Q2. In quarter-on-quarter terms, the GVA rose by 0.5% and it mildly exceeded the pace of the EU as well as the neighbouring Germany. The role of manufacturing, which supported the growth of the GVA in the CR in the past year, weakened this time. Contribution of the services sector played a key role. This sector was supported by demand in areas associated with the expansion (transport, warehousing) as well as the still growing household consumption. Both information and communication and the financial sector also prospered. Construction experienced a marked turnaround, its year-on-year GVA growth of 5.3% presented the best half-yearly result since year 2007.
- The value of export of goods slightly increased (0.3%) in H1 2018 compared to the same period of the preceding year. The export of motor vehicles however hindered the growth, since it decreased. Other branches on the contrary flourished. Especially export of computers, optical and electronic equipment attained exceptional results, IT increased year-on-year by 21.9 CZK bn. The value of imports rose by 1.5%. This development resulted in the drop of the balance surplus by 19.4 CZK bn to 105.7 bn.
- Growth of the consumer prices remained above the 2% level in Q2. The dynamics of food prices, which considerably influenced the price level in the previous year, further moderated. The prices of housing and energies thus had the largest impact on the price growth. They were raised by 2.6% in Q2. It was the consequence of the increase of rents and imputed rent on the one hand, however the prices of energies, which again started to grow this year following a nearly two-year period of fall, also had an effect. Mainly the prices of oil then affected the turn in the dynamics of the producer prices, which rose by 1.5% in Q2. Acceleration of the producer prices dynamics also involved the EU countries, which were affected by the global shift in the oil prices as well.
- Tension continued on the labour market also in H1 2018. Demand for labour force did not decline and the available sources of labour force were not adequate to saturate it, which presented a barrier to growth for businesses across the economic branches. The number of employed reached a new maximum of 5.44 mil² in Q2, which is mostly the result of strengthening economic participation. The general unemployment rate did not lower too much further any more in the 1st half year. The number of vacancies in contrast accelerated, which created a situation, when the number of vacancies exceeded the number of unemployed job applicants. The pressure on the labour market resulted in year-on-year growth of the average nominal wage by 8.6% both in Q1 and 2. Real purchasing power of wages rose by 6.4% in H1, which was the best result in the last 15 years.
- Rising of the monetary policy-relevant interest rates continued in the area of the monetary development. They then directly affected the increase of the interbank interest rates, however the impact on the client rates was not significant. Interest rates remained technically zero on the current accounts and mild shifts were observed only for some types of deposits with maturity. Interest rates on consumer credit to households were falling and mortgage rates experienced stagnation in Q2.
- The state budget (SB) ended in mild deficit of 5.9 CZK bn in the first half of this year. It represented the first deficit within this time frame in the last five years. Continuing economic growth was reflected in the year-on-year increase of the state-wide tax revenues (incl. insurance) by 7.9%. Total SB expenditures however grew

¹ Data regarding the GDP, gross value added and their components are expressed in constant prices and adjusted for seasonal and calendar effects.

² Employment data are in the national accounts conception adjusted for seasonal effects.



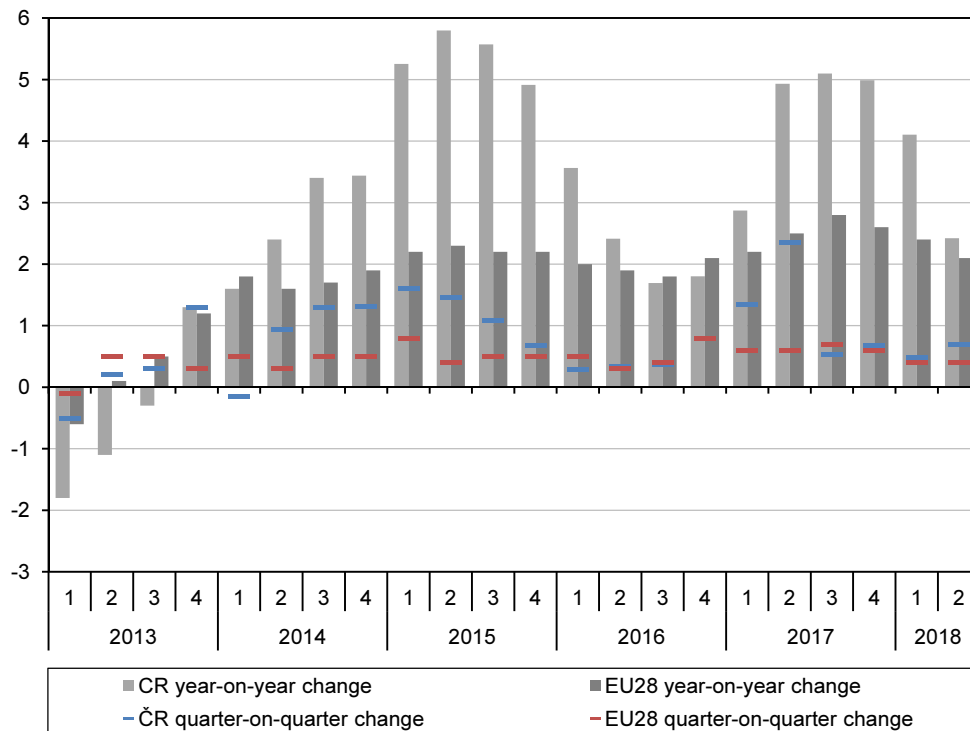
faster (10.2%), especially under the pressure of rising wage costs and larger expenditures on pensions. At the same time the capital outlays also grew, since the drawing on funds from the EU budget gained pace. Despite this, the proportion of investment on total SB expenditures arrived at only 4.8% in H1. It was the second lowest share in the last 14 years. Half-yearly balance of the pension account finished in surplus for the first time in the last ten years.

2. Overall Economic Performance

Year-on-year dynamics of the GDP growth markedly slowed down in Q2.

Fast rate of growth of the economic expansion, which was characteristic for the Czech economy in the past year, was not sustained in the 1st half of year 2018. Moderate slowdown was apparent already in Q1, when the growth of the Gross domestic product (GDP) reached 4.1%³. The year-on-year addition of Q2 2018 definitely confirmed this development. It amounted to 2.4%, which is the lowest value since the end of year 2016. Consumption as well as the investment expenditures had a favourable effect on the GDP growth, similar to the foreign trade balance. The adverse influence of the change of the inventory stock however had a large impact. Quarter-on-quarter dynamics of the GDP has been relatively stable in the recent quarters. Following the exceptionally large quarterly additions in H1 2017, whose impulse subsequently transferred into a notable year-on-year rate of growth, the dynamics returned to a lower level. The GDP thus expanded by 0.7% in Q2 compared to Q1. Year-on-year growth of the Gross value added (GVA) copied the GDP in Q2, when it reached 4.2%. Quarter-on-quarter addition to GVA on the contrary lagged somewhat behind (0.5%). Manufacturing kept its significant role regarding the GVA growth, however the contribution of services dominated the dynamics this time.

Chart 1 GDP (volume indices adjusted for seasonal and calendar effects, in %)



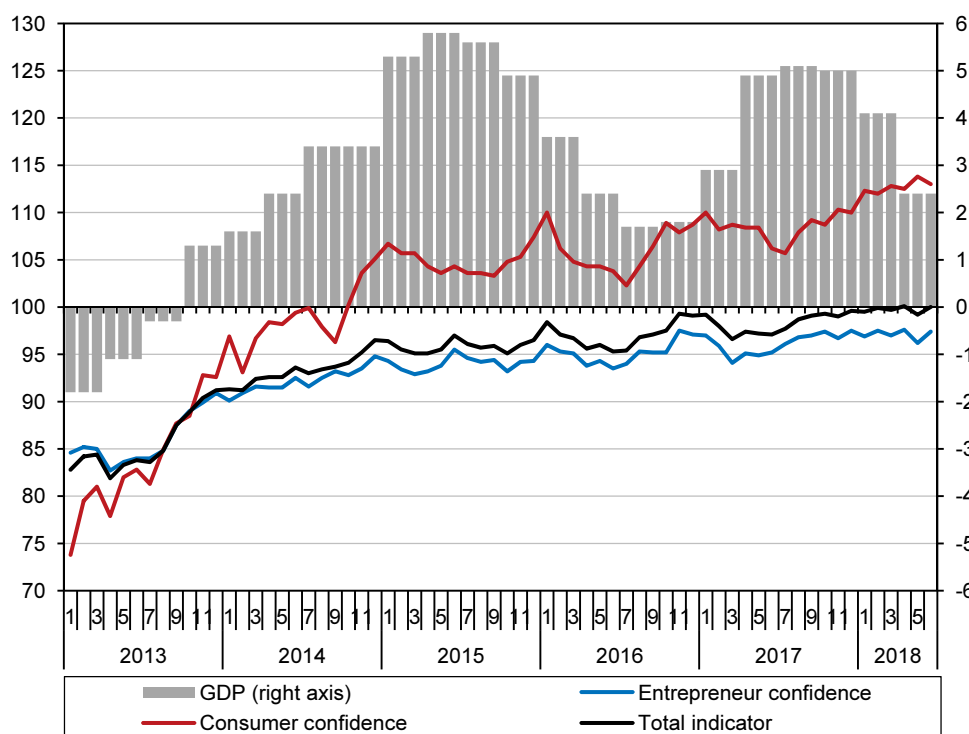
Source: CZSO, Eurostat

³The development of the GDP, gross value added and their components is expressed with the help of the volume indices (i.e. adjusted for changes in prices) and adjusted for seasonal and calendar effects. Data were published on 31.8.2018 and the revised data will be published on 2. 10. 2018.

European Union also recorded a smaller slowdown.

Year-on-year dynamics of the GDP growth also slightly slowed down in the European Union. Total addition arrived at 2.1%⁴ and it moderated for the majority of the EU countries. The economies of Malta (5.7%), Poland (5.0%) and Hungary (4.6%) attained the highest year-on-year additions. This trio of countries also experienced the highest year-on-year increase of the household consumption, Hungary and Malta ranked among the first three countries with the highest addition to the investment activity. Denmark (GDP addition 0.6%), Italy (1.2%) and Great Britain (1.3%) ended on the opposite side of the comparison. Quarter-on-quarter rate of growth of GDP preserved the value from the preceding quarter (0.4%) in the EU. Malta reached the highest quarter-on-quarter addition (1.9%) and this impulse lifted it to the top also in the year-on-year perspective. The GDP grew quarter-on-quarter similarly by 1.4% in Estonia and Romania.

Chart 2 GDP (volume indices, adjusted for seasonal and calendar effects, year-on-year in %, right axis) and confidence indicators (2005 = 100, left axis)



Source: CZSO

Expenditures on the domestic consumption grew by a relatively fast pace, even though slower compared to the past year.

Year-on-year growth of the total final consumption expenditure slowed down to 3.3% in Q2, which simultaneously signified a reduction in the contribution of consumption to total GDP growth to 1.8 p.p.⁵ High comparative basis of the last year affected the final rate of growth. The quarter-on-quarter dynamics however also declined considerably compared to Q1 (1.2% and 0.5% in Q1 and 2). Both household consumption and consumption of government institutions observed a slowdown. Household expenditures increased year-on-year by 3.5% in Q2 (the least since the end of year 2016) and contributed to the total GDP growth by 1.3 p.p. quarter-on-quarter addition was 0.7%. View of the consumption development in terms of durability⁶ shows that with the exception of semi-durables (6.8%) all segments experienced a mild slowdown of the year-on-year dynamics. Expenditures on non-durables (3.3%) as well as services (3.4%) however managed to maintain a

⁴ Data for Ireland and Luxembourg not available. Slovakian data are not adjusted for calendar effects.

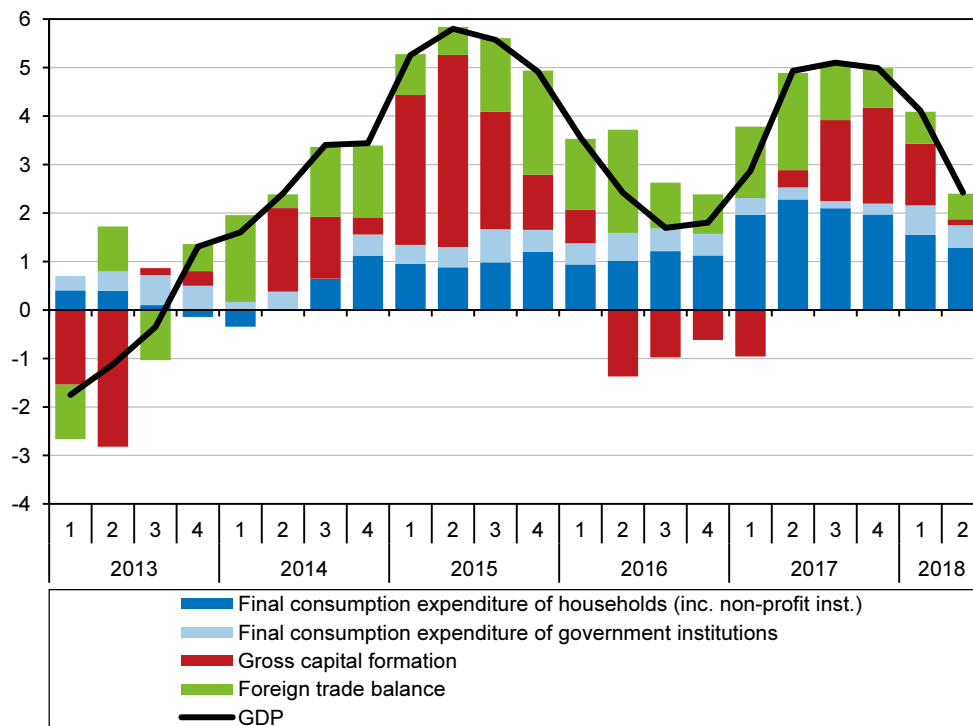
⁵ Additions to the GDP change after exclusion of imports for final use.

⁶ Data regarding the household consumption based on the durability of goods are not seasonally adjusted.



relatively strong pace. After the extraordinarily strong both quarter-on-quarter and year-on-year addition in Q1, the growth rate of consumption expenditures of government dropped. The year-on-year rate of growth thus fell to 2.6% in Q2 and the consumption here rose to 0.2% quarter-on-quarter.

Chart 3 Contributions of expenditure items to real GDP change* (volume indices, year-on-year growth, contributions in p.p., GDP in %)



Source: CZSO
*after exclusion of imports for final use

Volume of paid out wages and salaries again increased by more than 10%. Also, thanks to the moderate growth of prices, the increase is for the most part projected into real incomes.

Moderation of the economic growth has not been reflected in the development of the volume of wages and salaries so far. It increased by 10.2% in total year-on-year in Q2, which is only by 0.3 p.p. less compared to the preceding quarter. Real increase of the wage resources reached 7.4%⁷, so it slightly fell compared to the previous period, however it still represents significantly large value. Growth of total employment⁸ attained 1.9% in year-on-year expression and 0.6% quarter-on-quarter. The majority of the increase of the paid-out wage resources was thus reflected in the rise of the average wage. Manufacturing as a branch with the highest number of employees influences the total wage dynamics from a large part. The employment expanded by 2.1% here in Q2, which was also mirrored in the large increase of the volume of wages and salaries by 9.1%. The most notable addition to the volume of wages and salaries occurred in branches with the predominance of the public sector⁹ (13.6%). The raised tariffs together with increase of the employed persons by 2.7% stood behind this development. Real estate activities, where the increase of total 2.8% also assisted the resulting rate of growth accomplished the same year-on-year dynamics of wages and salaries in Q2. Information and communication succeeded in reaching the highest growth of employment (4.6%). In spite of 11.1% increase of the volume of wages and salaries, the average wage grew here slower compared to the rest of the economy. However, it is a branch with the second highest average wage in the economy, where

⁷ Converted into the real expression using the deflator of final consumption expenditure of households.
⁸ In the national accounts conception, seasonally adjusted.
⁹ Public administration and defence, education, health and social care.

the comparatively high absolute increase is the result of the lower relative growth. Employment slump occurred in construction despite revival of this activity (-0.7%). Final increase of the volume of wages was also the lowest in the whole economy (7.1%).

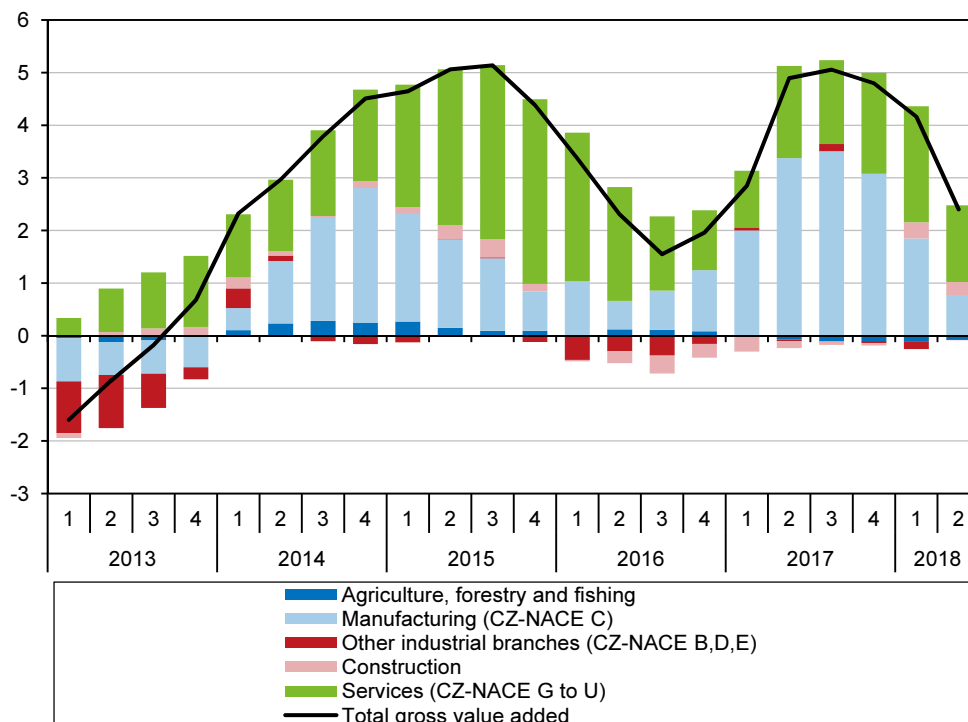
Investment activity does not ease up. Both investments into infrastructure as well as housing participated to a larger extent.

High year-on-year pace of the gross capital formation expenditure, which significantly supported the total economic growth in the past periods slumped notably to the value of 2.4%. The reason is mainly the change in the inventory stock, whose markedly negative effect even overtook the 7.8% increase of investment into the fixed capital. Final contribution of gross capital formation to the GDP growth was only 0.1 p.p., even though the investment activity itself added 1.4 p.p. Type classification of investment activity¹⁰ showed, that high year-on-year growth of investment into housing continued in Q2 (13.0%). This increase indirectly signals the still high investment activity of households. Moderate slowdown occurred for investment into the ICT and other machines and equipment (7.9%). In contrast the investment expenditure on transport equipment followed in the high rate of growth of Q1 and further accelerated to 13.9%. Investment into other buildings and structures was not much hindered even by the high basis of the same period of the last year and it grew by 10.7%.

Surplus of the foreign trade balance shrank.

Total surplus of the trade with goods and services amounted to 185.4 CZK bn¹¹ in the first half year and it lowered by 6.8 bn year-on-year. The drop was equally spread between the individual quarters. The surplus was 93.2 CZK bn in Q2 and it decreased by 3.7 bn year-on-year. The fall of the surplus was again related only to the trade with goods (-6.0 CZK bn), for services a year-on-year increase of 2.3 bn eventuated. The terms of trade mildly fell in Q2 and reached 100.3%.

Chart 4 Contributions of branches to real change in GVA (volume indices, year-on-year contributions in p.p., GVA in %)



Source: CZSO

¹⁰ Data regarding the type classification of gross fixed capital formation are not seasonally adjusted.

¹¹ According to the methodology of quarterly national accounts (import and export in CIF/FOB prices).



Services affected the GVA growth the most.

Manufacturing dominated the development of the gross value added in 2017, followed by the services sector supported by the growth of the domestic consumption. Nevertheless, the year-on-year GVA growth markedly slowed down to 2.8% in manufacturing in Q2 2018 (7.0% in Q1) and the addition to the total GVA also shrank (0.8 p.p., the least since Q3 2016). Total contribution of services attained 1.5 p.p. in Q2. Trade, transportation, accommodation and food service added the most (0.7 p.p.), with the GVA growing by 3.4% (however it slowed down compared to Q1). Lower level of the year-on-year growth was common to the majority of the services branches. Information and communication (4.6%, addition 0.2 p.p.) maintained a fast growth pace. Professional, scientific, technical and administrative activities (GVA growth 2.9%) and branches with the predominance of public sector (here the GVA growth slightly increased to 1.6%) accomplished the same addition to the GVA growth. In contrast to the rest of the economy, the GVA growth did not slacken much in construction (5.0%), which was also illustrated by the addition in the amount of 0.3 p.p.

3. Branches Performance

Quarter-on-quarter growth of the gross value added (GVA) in the economy was the weakest in the last seven quarters.

Gross value added (GVA)¹² expressing the total performance of all branches of the economy signalled a slowdown. The quarter-on-quarter growth of GVA moderated already for the second time in row in Q2. Its attained pace (+0.5%) was simultaneously the weakest in the last seven quarters. Still, the Czech economy features higher growth than the EU (+0.4%) or the neighbouring Germany (+0.3%). Easing of the pace was apparent also in the year-on-year comparison in the CR (+4.2% in Q1, +2.4% in Q2). It cannot be omitted, that the economy thrived exceptionally in the first half of the last year, when all significant resources were activated both on supply and demand side.

Services ensured more than half of the GVA growth in H1. Performance of industry perceptibly slackened, construction substantially revived.

Core of the GVA growth shifted from manufacturing to the tertiary sector. Performance of services rose by 3.0% year-on-year in H1 and it contributed 1.8 p.p. to the increase of the total value added. Information and communication and also the financial sector prospered – these are also dynamic branches in the long term in both cases. The growth rate year-on-year more than doubled (to 4.5%) in the weight-dominant grouping of trade, transportation, accommodation and food service. On the contrary the real estate activities as well as the significant segment of services with the predominance of the public sector continued to experience (similarly to the last year) a negligible growth. Manufacturing deducted more than one half from the last year's pace, still the value added rose by nearly 5% here, i.e. more briskly compared to the total economy. Construction enjoyed a notable positive turn, when the year-on-year GVA growth of 5.3% presented the best half-yearly result since year 2007. In contrast the mild last year's drop of performance in agriculture, forestry and fishing deepened this year (to -3.9%).

Year-on-year growth of the industrial production diminished to 2.3%, quarter-on-quarter development however sent a more positive signal.

Business statistics also confirm the loosening of the rate of growth of industry. Industrial production index¹³ went up by 3.2%¹⁴ year-on-year in H1 (even only by 2.3% in Q2 itself). The fact, that following a weaker entry into this year (+0.2%) the quarter-on-quarter rate of growth of production increased in Q2 (to +1.1%) can draw a more favourable sign. Not only manufacturing, but also energetics or mining and quarrying contributed to this result.

¹² Data regarding the GVA are expressed in constant prices and adjusted for seasonal and calendar effects.

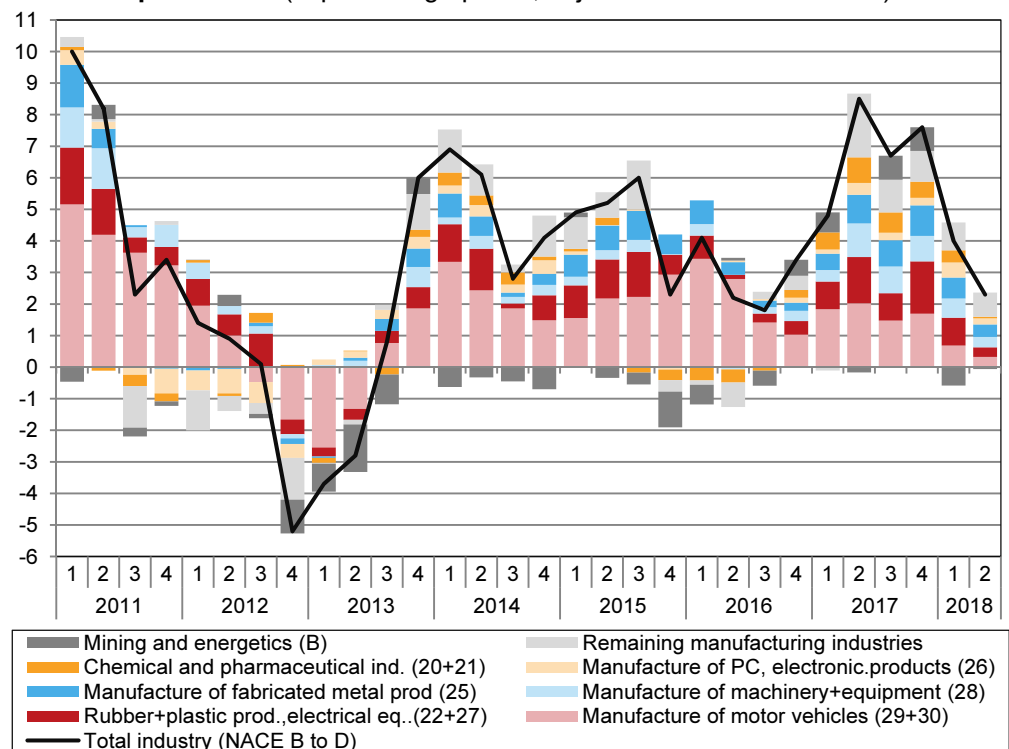
¹³ Included branches: Mining and quarrying, Manufacturing, Energetics. All year-on-year rates of growth of output (at the level of CZ-NACE sections as well as divisions) are adjusted for calendar effects. Quarter-on-quarter rates are then also seasonally adjusted.

¹⁴ There was one working day less in H1 2018 compared to the same period of year 2017. Not adjusted for this effect, the year-on-year growth was only 2.4%.

Production in motor vehicle industry as well as manufacture of rubber and plastic products ended in the weakest rates of growth since the end of recession in Q2....

Short-term slowdown of growth of industry is not in the current expansion phase by far an isolated occurrence. During both years 2014 and 2016, when the similar situations also happened, the key branch manufacturing of motor vehicles held its substantial pro-growth role. However, the current slowdown is connected from a large part just to this branch. While the year-on-year growth of production of manufacturers of motor vehicles oscillated around 10% in 2016, it fell below 3% at the beginning of this year and shrank to 1.5% in Q2 (the weakest rate of growth since the end of the last recession). New orders also provided signs of unsustainability of the high production dynamics in this branch, with their volume stagnating already since Q2 2017. Manufacture of rubber and plastic products also experienced similar development in the last months. In contrast another branch linked to the manufacture of motor vehicles – manufacture of electrical equipment – had success this year similar to the last year (growth between 7 and 8% in H1).

Chart 5 Contributions of sub-branches to the year-on-year change of the total industrial production (in percentage points, adjusted for calendar effects)



Source: CZSO

... manufacture of electrical equipment as well as production of computers and optical products continued to thrive.

Manufacturers of motor vehicles together with the nearest associated branches thus participated on the growth of the industrial production in nearly one third this year. Markedly export oriented manufacture of computers and electronic and optical products became the most dynamic industrial branch, the output increased by 10.8% in H1 (by nearly one quarter in two years). Weight significant branches machinery and manufacture of metal products also prospered. Manufacturers of other non-metal mineral products benefited from the strong domestic demand for building materials already second year in a row. Position of metallurgy and foundry industry, similarly to manufacture of other (mainly rail) transport vehicles improved compared to the last year. The strong growth impulse connected to the end of the forced shutdown on the contrary faded away in the chemical industry (still the production here grew by nearly 5% this year). The majority of smaller manufacturing branches also kept getting ascribed positive results (manufacture of wearing apparel, wood products as well as furniture).

Position of metallurgy and foundry industry or mining industry improved Most smaller industrial branches kept doing well.

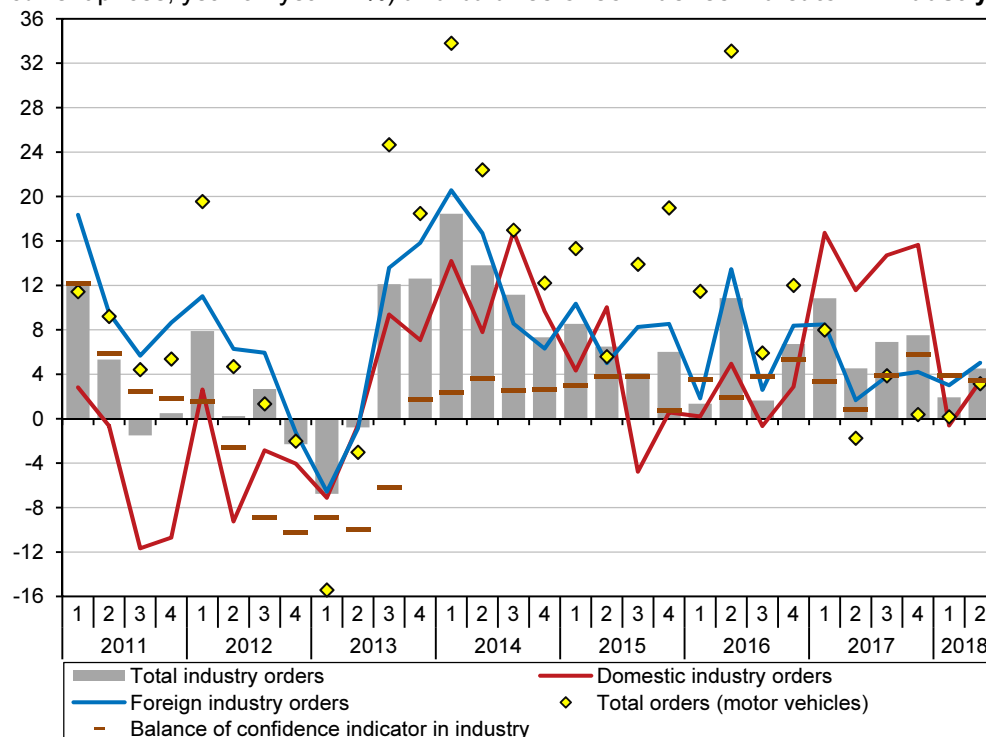


The manufacture of leather goods, whose performance sank deep this year following a short-term recovery in years 2016 as well as 2017 (-25%)¹⁵ represented the exception. Among non-manufacturing activities, the position of the mining industry improved. It was thanks to the higher demand for building materials (stone, sand), but newly also halting of the production fall in the weight dominant mining of brown coal. This year's drop of output in energetics (-2.5%) was associated with the mild winter temperatures as well as the short-term fluctuations of the production in the nuclear power plants.

Growth of sales of industrial businesses almost ceased. They increased the most in metallurgy and foundry industry.

Growth of the nominal sales of industrial businesses halted this year. They stagnated year-on-year in Q1 and increased by moderate 2.1% in the following quarter. While the domestic sales of businesses grew faster than the sales from the direct export for the whole last year, their growths practically aligned in Q2. Sales grew the most – by one tenth – in metallurgy and foundry industry in H1, by half-pace then in manufacture of metal products, wood industry and also in other manufacturing activities (which include e.g. sport equipment, toys, musical instruments or bijouterie). Domestic sales as well as sales from direct export of manufacturers of motor vehicles mildly fell (by 2.5% in total). This year's development of new orders suggested sound outlook for the industrial businesses. Even though they increased only by just under 2%, the pace already fastened to 4.5% in Q2 and the newest data confirm this trend¹⁶. Metallurgy and foundry industry and also manufacture of metal products signalled the highest demand. Three quarters of the monitored branches had at least a moderate growth of orders.

Chart 6 New orders in manufacture of motor vehicles, in industry in total (in current prices, year-on-year in %) and balance of confidence indicator in industry



Source: CZSO

Balance of the confidence indicator in industry was mildly falling this year, however it still remained in

The development of the seasonally adjusted balance of the confidence indicator (according to the evaluation of the managers of industrial businesses) also corresponded with the slowing growth of the performance indicator in industry. It was mildly falling

¹⁵ Together with the repair of machines and equipment however these were the only manufacturing branches, whose production fell year-on-year in this year's H1.

¹⁶ The year-on-year growth of orders exceeded 11% in this year's July (both domestic and foreign demand reached double digit rate of growth). Value of orders also considerably increased in the manufacture of motor vehicles (+8%).

the positive band. Lack of employees still remains the main barrier to growth in industry. Role of the inadequate demand was the weakest since the end of the expansion phase of the past decade.

during the year 2018 and hit its lowest value in the last thirteen months in July. Still it remained in the positive band (+2.3 p. b.). The lack of employees presents the main barrier to growth in industry¹⁷ already since the half of the last year. 44% of businesses cited this barrier at the beginning of Q3 2018 – the most in the history of monitoring. Inadequate demand limited 32% businesses, which was the least since the expansion phase of the last decade. Current utilisation of production capacities in industry exceeded 86% (the highest value after year 2009). Short-term expectation of the development of employment stayed at the beginning of Q3 comparable to the same period of the last year. Share of businesses anticipating increase of employment was in comparison to businesses planning reduction by 8 p.p. higher.

Rate of growth of registered employees was not slowing down

Registered number of employees according to the business statistics expanded by 1.6% year-on-year in H1. Rate of growth was not slowing down significantly compared to year 2017. The motor vehicle industry contributed to the higher number of employees (+20 thousand) by nearly one third. Energetics however added relatively the highest number of persons (+6.7%), chemical and pharmaceutical industries also acquired more than 5% increase. Growth of average wages in industry did not accelerate significantly in contrast to other branches this year. It ranged between 7 and 9% in the majority of industrial branches. Notable differences however prevailed in the reached level of wages. It was 2.7 times higher in energetics than in the manufacture of wearing apparel (with the gross monthly wage just below 17 thousand CZK).

Construction output increased by nearly 9% in H1. Civil engineering construction experienced a positive turn. Next to favourable weather, the accelerated drawing of funds from the EU budget also had an effect.

Construction significantly revived in H1. While the output¹⁸ in the weight dominant segment building construction already grew for the whole last year, the decisive turnaround in the civil engineering construction occurred only with the arrival of this year (output strengthened here year-on-year by nearly 7% in Q1). The output of the whole construction went up by 8.9% in H1, which was from nearly 90% due to the building construction. The output level from year 2015 was exceeded for the first time in Q2 (local maximum in Q2), when the whole branch received a striking impulse resulting from the completion of drawing on resources from the European funds towards the end of the programme period. Nevertheless, the construction still lagged by approximately one sixth behind in comparison with the absolute maximum from the expansion year 2008 (Q1).

Residential construction mildly revived. Number of commenced flats increased in the vast majority of regions. It however considerably lagged behind the total addition to population in Prague.

Next to the favourable weather the accelerated drawing of resources from the EU funds was also reflected in this year's performance in construction. The recovery of the residential construction also had a positive effect. Construction of 16.6 thousand flats commenced in H1 in the CZ. Their number was by one tenth higher year-on-year.¹⁹ More flats were commenced in all types of structures with the exception of pension homes, where however the low intensity of construction already prevails for longer than the whole decade. Construction in the Central Bohemia region and Vysocina region contributed the most to the higher number of flats. Commenced flats however increased in number in the overwhelming majority of regions (apart from Pilsen and Olomouc regions). Even though the construction was growing in Prague already second year in a row²⁰, the number of commenced flats (1.8 thousand) markedly lagged behind the total addition to population (6.6 thousand) in H1. Growing tension on the residential market is reflected in the sharp hike of the realised prices of new flats in the capital city.

¹⁷ According to the Eurostat seasonally adjusted data. Businesses could have also included more types of barriers simultaneously. 24% of industrial businesses considered the inadequate demand to depict the barrier for their growth, 20% then the lack of employees at the beginning of Q3 2018 in the whole EU.

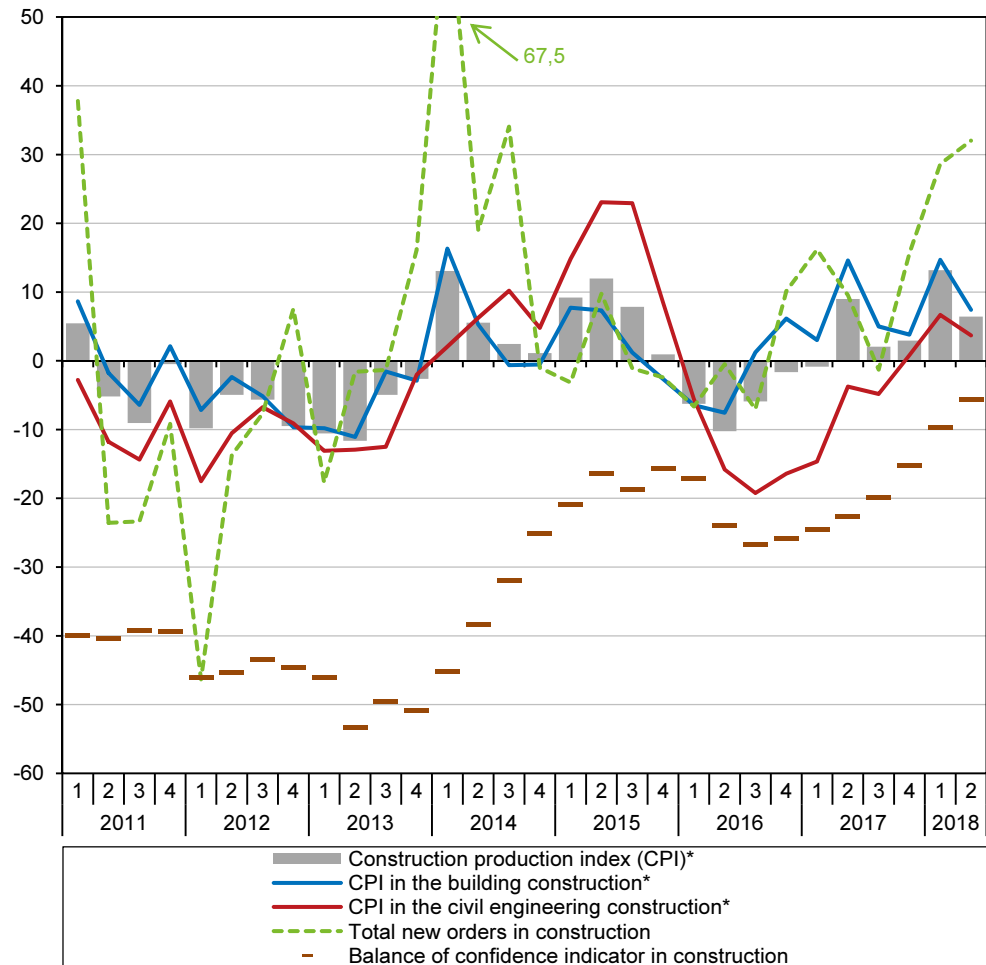
¹⁸ All year-on-year data related to the construction output are adjusted for calendar effects, quarter-on-quarter rates of growth then also for the seasonal effects.

¹⁹ The number of commenced flats moved just below 11 thousand in H1 2013, when the recession was subsiding in the whole economy as well as the construction itself. It was double in the same expansion period of year 2008.

²⁰ The frequency of commenced flats sank to the lowest value since half of the 90s (1037) in the capital in H1 2016.



Chart 7 Construction output, value of new orders (year-on-year in %) and balance of confidence indicator in construction



Source: CZSO

Inflow of new orders notably accelerated – both in building construction and civil engineering construction.

Performance of construction businesses is more and more limited by the lack of workers.

Rise of the value of new domestic construction orders²¹, which was apparent for the most part of the last year this year accelerated. It was year-on-year higher by 26.5% in the building construction, by 34.0% then in the civil engineering construction. It also benefited the construction businesses, that gradually also the realisations of larger projects started up. It is also proved by the increase of the average value of the newly closed order (to 4.3 CZK mil, year-on-year addition by more than 1 mil). Development of orders could have featured even higher dynamics, if it was not for the fact, that many construction businesses are currently situated on the limit of their production capabilities. The lack of both non-qualified workers and technical and expert employees or specialists contribute to this situation. Already more than 30% of construction businesses (only 18% one year earlier) considered the lack of employees to present a barrier of growth already at the beginning of Q3 2018. In parallel, the influence of inadequate demand was falling considerably. While in October 2017, 51% of businesses stated it as a barrier to growth, it was already only 35% this year in July. The development of seasonally adjusted balance of confidence indicator corresponded to these data. Its value climbed up the highest in the last ten years (-2.0 points) this year in August.

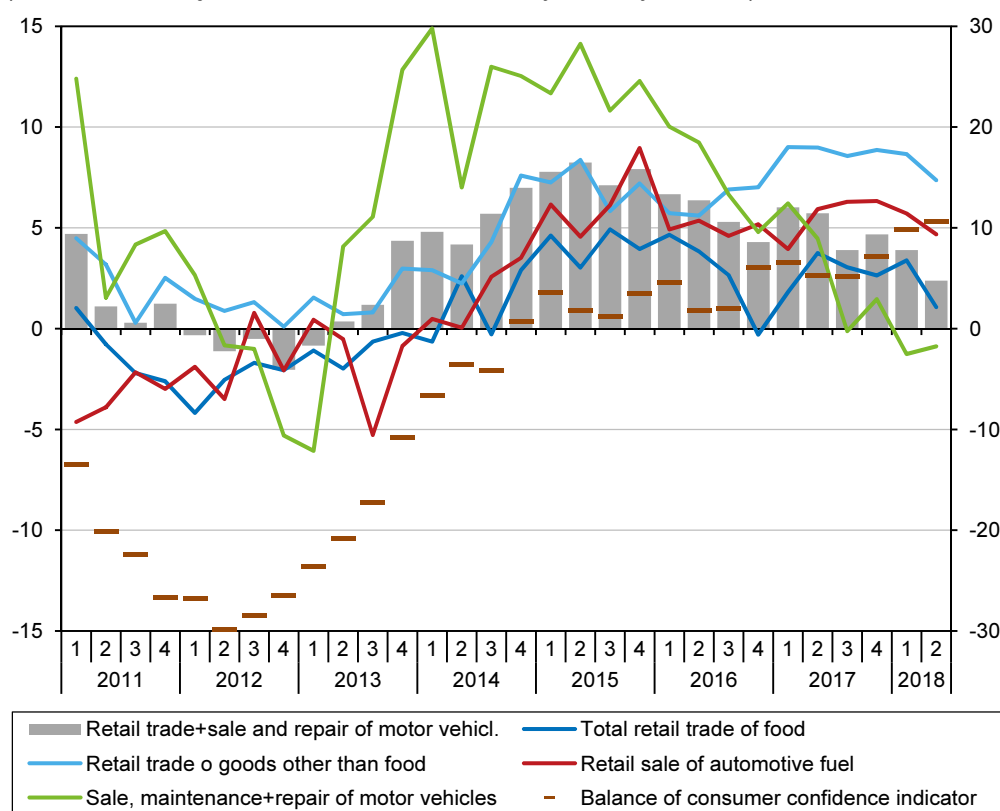
²¹ Covers only businesses with 50 employees and more.

Sales in selected services continued growing swiftly for more than one year. It was mainly thanks to transportation and warehousing activities.

Tertiary sector of the economy also fared well this year. Sales in selected services²² continued in brisk growth for more than one year. Despite the high last year basis²³ they increased by 3.6%²⁴ in H1. Positive fact was that despite a considerable variedness of the whole services segment, a vast majority of its partial branches recorded growth this year. Among the main branches, only real estate activities deviated, here however the slight fall of performance (-0.9%) was not immediately connected to the whole situation on the real estate market.

Total growth of sales in services was – similarly to the whole last year – essentially affected by the dynamic development in transportation and warehousing. Role of this branch was even more highlighted this year, it contributed to the growth of services by nearly one half in H1. Information and communication also secured a more significant contribution, other services branches contributed more marginally.

Chart 8 Sales for retail trade and sale and repair of motor vehicles
(in real terms, adjusted for the calendar effect, year-on-year in %)



Source: CZSO

Dynamic growth in transportation and warehousing was interlinked with the favourable development of industry, trade as well as the record size of employment.

Sales in transportation and warehousing increased by 5.8% in H1 (the fastest pace since the end of 2013). Performance was rising in both the passenger and freight transport by road. Sales fastened to 9.5% in storage. The whole branch benefited from the favourable condition of industry as well as trade. Record number of employed also supported the growing mobility. Performance in the long-term dynamic branch information and communication gained pace (5.1%, 4.5% the year ago). Effect of activities in the IT area (computer programming, computer facilities management activities) were of importance

²²Excluding trade, financial and insurance activities, science, research and public services. All data for services are in constant prices, year-on-year data are adjusted for calendar effects, quarter-on-quarter data are adjusted for seasonal effects (including the effect of the number of working days).

²³ The year-on-year growth of sales in services accelerated in H1 2017, when it reached 5.7% (the highest rate of growth since the end of year 2007).

²⁴ Without adjustment for the differing number of working days, the growth was 3.3%.



Rate of growth of sales markedly slowed down in activities associated with tourism and also in administrative and support service activities.

here, however all branch divisions (except for motion picture and musical industry) recorded higher performance this year. Sales increased only by 1.4% in the branch accommodation, food service and restaurants this year. The effect of the high comparative basis²⁵ was relevant here together with the impact of the legislative changes associated with the tax collection. In the substantially heterogeneous branch professional, scientific and technical activities, mild growth continued for the architectural and engineering activities (+1.2%) in connection to the revival in construction. Photographic, design and translation activities as well as market research and public opinion polling also prospered. Sales for the advertising activities on the contrary decreased. Notable slowdown in the administrative and support service activities (from last year's 9.8% to 3.0%) was influenced especially by the development in the employment placement agencies, where the weaker real growth of sales was connected to the price factors²⁶. Travel agencies also did well (+5.0%). Rental and leasing activities also continued in a similar pace of the long-term growth (where demand was growing for example for the construction machinery).

Retail sales reflected the very optimistic sentiment of consumers.

Brisk growth of the household income (fed by the favourable constellation on the labour market) accompanied by the record consumer confidence created very positive conditions for the retail segment. Retail sales²⁷ were further strengthening at the beginning of the year and rose year-on-year by 6.3% in Q1 2018 (the strongest following Q3 2007). Both the year-on-year and quarter-on-quarter rates of growth slightly fell in the subsequent quarter. Retail sellers received by 5.3% more this year compared to the first half of the last year. The Czech Republic thus ranked seventh among the EU countries. Retail grows traditionally the most dynamically in the countries of Central and Eastern Europe in the last quarters.

Swift growth of sales for non-food goods persisted.

The sale of non-food goods traditionally contributed the most to the growth of retail trade, its pace overtook the 7% boundary already for the seven quarter in a row. Among specialised stores, especially the retail sale of computer and communication equipment and also household equipment²⁸ thrived in H1. The dynamic growth of retail sale via internet and via mail order houses continued also in the Czech Republic similarly to the majority of the EU countries (by one fifth year-on-year). On the contrary the growth of sales for food goods slightly slowed down (to 2.2%). In contrast the retail sellers of automotive fuels maintained a swift growth (5.2%), additionally despite the fact, that the development of prices was from the view of consumers less favourable compared to last year in the first half of the motorist season. Sales for motor vehicles and their repairs dived by more than 1% year-on-year also due to the high last year basis this year and thus recorded the weakest half-yearly result since the end of year 2012.

²⁵ It was also apparent in the in-kind indicators. Number of overnight stays of guests in the collective accommodation establishments increased year-on-year already only by 2.2% in the CR in Q2 2018. Even though the growth was extraordinary 12.7% in the same period of the last year.

²⁶ It was the consequence of the minimum wage increases. In current prices, the double-digit year-on-year growth of sales of the agencies continued.

²⁷ Data do not include the motorist segment. Data related to retail are expressed in constant prices and adjusted for calendar effects.

²⁸ Includes retail with hardware goods, paints, glass, other household DIY articles, textiles, carpets, floor and wall coverings, electrical household appliances, electronical equipment, furniture or lighting equipment.

4. External Relations

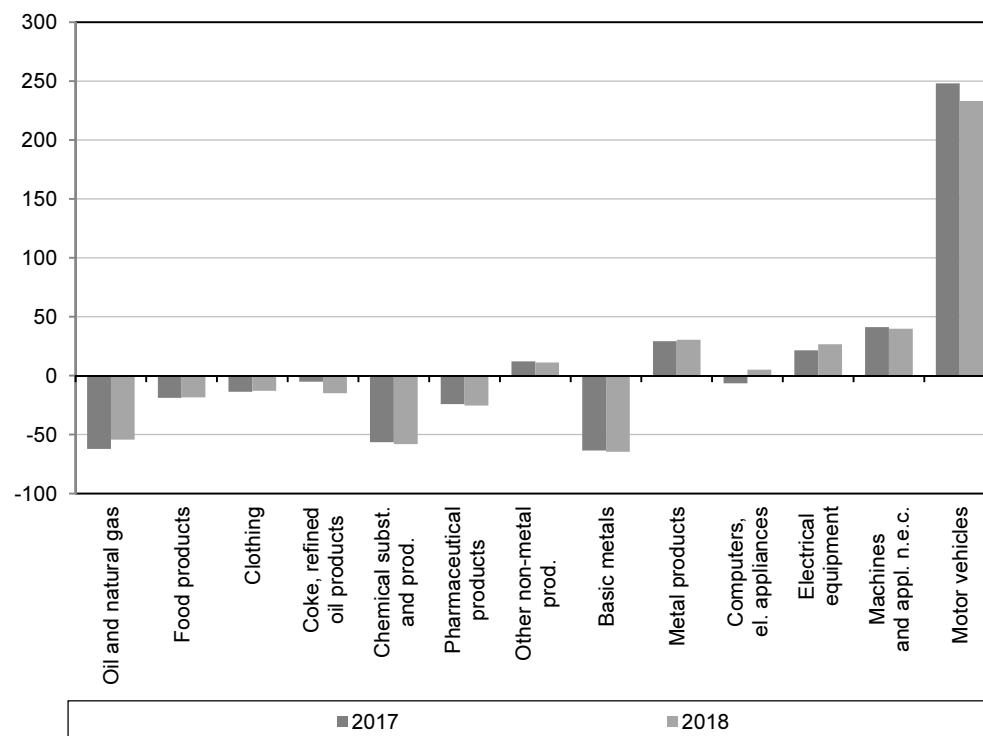
Value of exports went up in H1.	Total value of goods exported reached 1 821.0 CZK bn ²⁹ in H1 2018. That is by 6.3 bn (0.3%) more in comparison to the same period of the last year. Result from Q1, which was considerably impacted by the record exports in 2017 (year-on-year slump amounted to 10.3 CZK bn) especially hindered the year-on-year increase. The year-on-year appreciation of koruna could have influenced the value of exports in current prices as well. The value of exported goods went up by 16.5 CZK bn (1.8%) in Q2 2018.
Exports to Germany fell after a long time.	Given the view of the territorial classification of exports, certain stagnation is observed partially caused by the high basis from the last year. Value of exports into the EU countries thus increased by 11.2 CZK bn in H1 2018, which is much less compared to 98.5 bn in the same period of the last year. Year-on-year fall of exports into Germany arose for the first time since H1 2013 (–3.0 CZK bn, –0.5%). The value of exports to Slovakia fell further (–3.5 CZK bn, –2.2%) as well as to the Great Britain (–5.2 CZK bn, –5.8%). In contrast the trend of large increases of exports to Netherlands continued, this time it was +6.9 CZK bn (12.0%). Exports of goods to Poland climbed up only slightly (2.0 CZK bn, 1.8%), Austria (1.0 bn, 1.3%) and France (2.7 bn, 2.9%). The value of exports into countries outside the EU decreased year-on-year by 5.0 CZK bn (1.7%) in H1.
Value of exports of motor vehicles fell. Other producers managed to maintain growth.	Motor vehicles represented the product, which played a key role in the drop of the value of export in H1. Value of their export decreased year-on-year by 22.7 CZK bn (4.3%) in this period and it was falling both in Q1 and Q2. Other manufacturers recorded rather easing of the growth than slumps, only the decrease for food products by 2.9 CZK bn (5.3%) and rubber and plastic products by 2.3 bn (2.3%) depicted more notable exceptions. The export of machinery and equipment slightly increased (4.2 CZK bn, 2.1%), also the electrical appliances (6.3 CZK bn, 4.2%) or metal products (2.1 bn, 1.9%). Computers, electronic and optical products recorded a significant increase of export by 21.9 CZK bn (13.2%) in H1.
Value of export increased, partially also due to raised prices of some materials.	Value of imported goods arrived at 1 715.2 CZK bn in H1. The year-on-year increase was 25.7 CZK bn (1.5%). Complete majority of the stated addition fell in Q2 (23.5 CZK bn, 2.8%). Prices of imported materials affected the result similarly to the previous periods. It is the case of coke and refined oil products, where the value of imports rose by 8.7 CZK bn (36.2%) year-on-year. The value of imported machinery and equipment increased (5.5 CZK bn, 3.4%), but also the value of other transportation equipment (7.4 CZK bn, 35.7%), which from the view of total volume constituted a small part formerly. On the contrary, the import of motor vehicles dropped by 7.8 CZK bn (2.7%). The value of imported oil and natural gas reduced by 7.2 CZK bn, which is in opposition to the growing prices of these commodities. Among other things the pre-stocking also had an effect in H1, thanks to which it was not necessary to import the same volume of gas as in the preceding year. From the territorial point of view, especially the EU countries stood behind the increase of the total import (+19.9 CZK bn), other destinations recorded a milder increase of 6.4 bn.
Surplus of the balance of trade with goods decreased....	Total surplus of the balance of foreign trade with goods achieved 105.7 CZK bn in H1. This is by 19.4 bn less compared to the same period of the last year. Majority of this decrease arose already in Q1, in Q2 the surplus was year-on-year lower by 6.9 CZK bn. The surplus narrowed for the EU states (–8.7 CZK bn) and it happened for trade with the

²⁹ Statistical data of the foreign trade in the national conception in the nominal terms including only the trade with goods. The value of exports is captured in the FOB prices, i.e. including the costs connected with the transport to the CR boundaries. Import depicted lower in this chapter is in CIF prices, i.e. including costs associated with the transportation abroad, up all the way to the CR boundaries. Data valid as of 6. 9. 2018.



majority of the significant partners (Germany –6.6 bn, Slovakia –3.8 bn, Great Britain – 3.5 bn, etc.). Netherlands where the CR exports more lately, which also supported the increase of the surplus by 6.7 CZK bn, presented the exception.

Chart 9 Balance of foreign trade* in foreign trade statistics (accumulation H1, in CZK bn, selected divisions of the CZ-CPA classification)



Source: CZSO
*In the national conception

... from the large part due to the motor vehicles.

Reduction of the balance surplus was from the large part caused by the motor vehicles, where the positive balance shrank year-on-year for the first time since year 2013 (–14.9 CZK bn). Deepening of the deficit occurred for coke and refined oil products (–9.9 bn). On the contrary, the deficit of the balance moderated by 7.8 CZK bn for oil and natural gas. Computers, electronic and optical products worked against the total deficit, when moving from the usual deficit into the surplus of 5.0 CZK bn (deficit reduced by 11.4 CZK bn). Electrical appliances recorded increase of the surplus (+5.1 CZK bn).

Current account of the balance of payments showed atypical development in Q2.

The current account of the balance of payments accomplished a surplus in H1 according to the CNB data, nevertheless the surplus shrank by 25.1 CZK bn year-on-year. Especially the result from Q2, when the current account finished in surplus this time, was surprising. Surprising because the large outflow of the primary income abroad did not eventuate (specifically the income from investments) as is typical for this quarter. Traditionally thus the positive balance of trade with goods and services worked in the direction of the surplus. Capital account, which usually ends in surplus, descended into deficit in Q2 (for the first time since year 2006).

Financial account ended in surplus in H1.

Financial account surplus decreased by 95.3 CZK bn year-on-year in H1. The net inflow of direct investment fell markedly (by 33.1 CZK bn) in comparison to the same period of the last year, which can be however explained by the extraordinary period around the termination of forex interventions. Net outflow occurred for portfolio investment in H1 – since the volume of debt securities held by foreign owners decreased by 162.7 CZK bn in Q2.

5. Prices

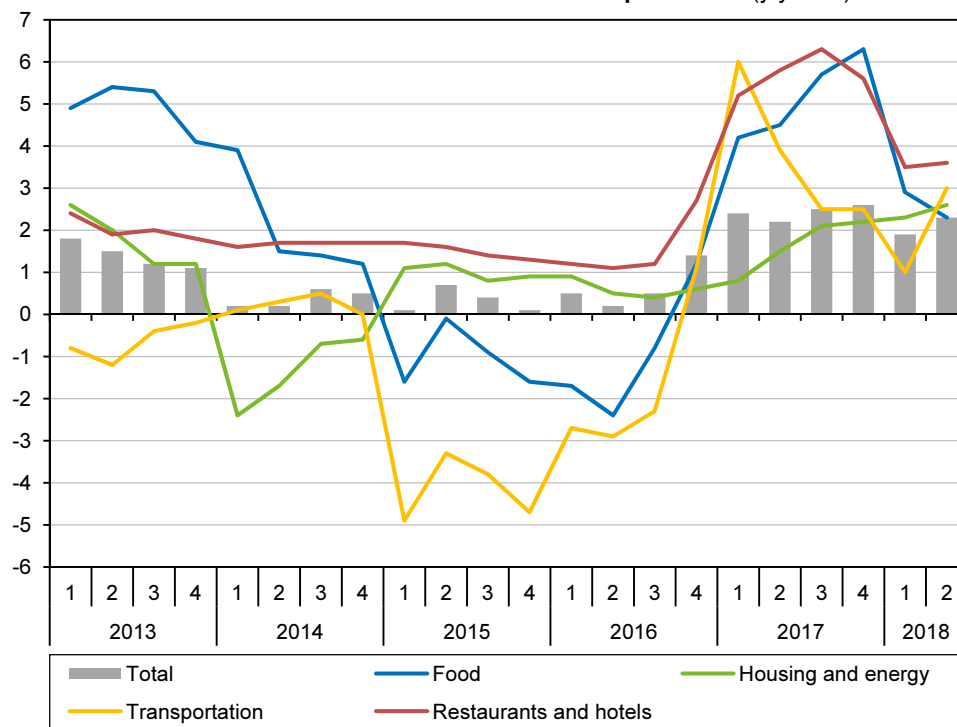
Total price level increased.

Total year-on-year growth of the total price level gauged by the GDP deflator attained 2.3% in Q2. It was affected by the relatively strong growth of prices of consumer goods (3.6%). Even though the price level of the household consumption was raised by 2.6%, for government institutions by 5.9%. Capital goods experienced stagnation (-0.5%). Terms of trade had only a mild positive effect (100.3%).

Consumer price growth accelerated in Q2 2018.

The rate of growth of the consumer prices returned above the 2% boundary after the slump in the preceding quarter in Q2 2018. In total, the prices were raised by 2.3% year-on-year in Q2 and the dynamics featured upward trend in the individual months. For the whole H1, the consumer prices rose by 2.1% year-on-year. The effect of the prices of housing, water and energies, which added the most to the total increase in prices (by 0.6 p.p.) again strengthened in Q2. Rate of price growth of food and non-alcoholic beverages does not reach the level of the last year any more, still the division supported the total growth 0.5 p.p. Alcoholic beverages and tobacco and transportation contributed identically 0.3 p.p.

Chart 10 Prices in the selected divisions of the consumer price index (y/y in %)



Source: CZSO

Cost of housing and energies had the largest impact on the total growth of prices.

Acceleration of the prices of housing and energies did not ease up. Their year-on-year addition reached 2.6% in Q2 (the most since Q1 2013). Apart from the prices of rent on flats, which grew by 0.6 p.p. faster compared to the previous quarter (2.9%), the prices of energies also confirmed the rising trends (from 1.1% to 1.7% in Q2). Growth of the imputed rents did not accelerate any more, the high rate of growth however remained (3.8%). More than plunging growth the high comparative basis of the last year has an effect, the average month-on-month addition arrived at 0.5% in Q2.

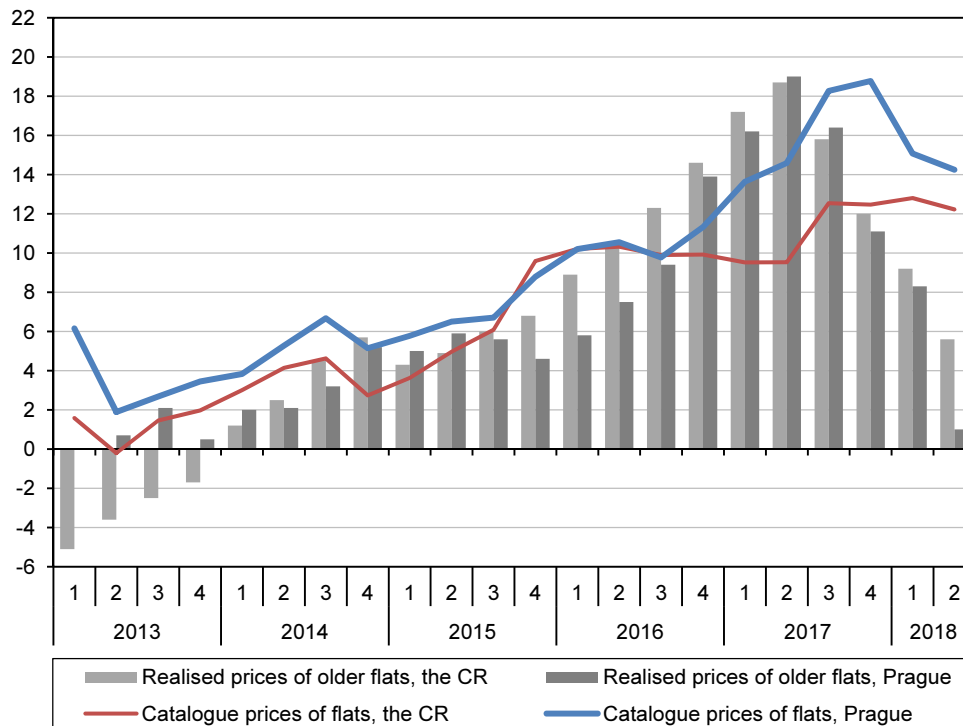
Dynamics of the prices of flats was further slowing down.

Even though the prices of housing accelerated in the consumer price index, the dynamics of the prices of flats individually went down. Prices of completed sales of older flats rose by 5.6% year-on-year in Q2, which is the least since Q2 2015. The



dynamics dived even deeper in Prague. Year-on-year addition was 1.0% in Q2, quarter-on-quarter the prices decreased by 1.6%. It is however necessary to point out, that the segment of older flats is considered. For new flats (index is gauged only in Prague), the year-on-year dynamics of the realised prices accelerated year-on-year to 14.8% in Q2. Year-on-year growth of the supply prices of flats mildly slowed down, still it however stayed above the 12% boundary for the whole CR.

Chart 11 Prices of real estate (year-on-year change, in %)



Source: CZSO

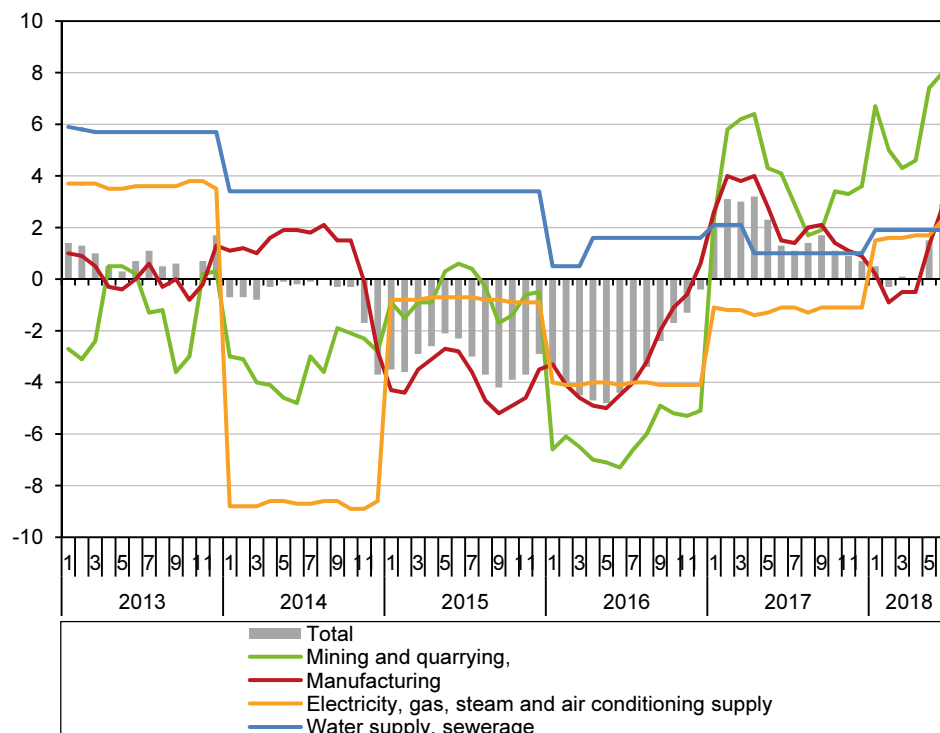
Prices of food and non-alcoholic beverages also experienced the acceleration of dynamics.

Year-on-year increase of the prices of food and non-alcoholic beverages reached 2.3% in Q2. This is slower rate of growth compared to Q1, the reason is however especially the high comparative basis of the preceding year. Following the weak April result, the growth of prices accelerated (month-on-month additions arrived at 1.0% in May and 0.5% in June). Milk, cheese and eggs contributed the most to the year-on-year growth of prices of food, with prices rising by 5.8% in Q2. Year-on-year rate of growth of prices of oils and fats (8.1%) and fruit (5.5%) was also considerable. Prices of alcoholic beverages and tobacco increased by 3.6%. The year-on-year increase of the prices of transportation (3.0%) accelerated due to the growing prices of fuels in Q2. Prices of operating the motor vehicle itself increased by 4.4%, prices of purchases of motor vehicles and other transport equipment kept the pace from the previous quarter (2.5%).

After the weak growth at the beginning of the year, consumer prices again increased pace in the EU.

Year-on-year addition to the consumer price index reached 1.8% in the European Union in Q2 and it gained pace compared to the preceding quarter. Transportation costs portrayed the key factor for the strengthening of the price growth, prices of food and non-alcoholic beverages or housing and energies also experienced a moderate acceleration. Prices of alcoholic beverages also grew relatively fast. Consumer prices grew the fastest in Romania (4.5%), Estonia (3.3%) and Slovakia (2.9%). Prices reached less than 1% addition in Ireland (0.4%), Greece (0.7%), Cyprus (0.8%) and Denmark (0.9%).

Chart 12 Prices of main groups of industrial producers (year-on-year change, in %, based on CZ-CPA classification)



Source: CZSO

Increase of the oil prices played a key role for the industrial producer prices.

Industrial producer prices experienced a year-on-year fall for a short time in Q1 (total quarterly addition then arrived at 0.1%). They however started rising significantly since May and consequently the resulting year-on-year addition for the whole Q2 attained 1.5%. The year-on-year rate of growth of the producer prices in manufacturing accelerated (1.2%). Prices of coke and refined oil products played the main role in the acceleration, these prices were influenced by the increase of prices of oil on the world markets, basic metals and metal products also soundly contributed to the price growth (year-on-year growth by 2.4%). Prices of wood, paper and print went up (2.3%) and furniture (2.0%). Prices of transportation equipment then had anti-inflationary effect, when they fell by 2.3% year-on-year in Q2. The acceleration also touched prices of mining and quarrying (6.7%) and electricity, steam and air conditioning supply (1.9%). Prices of water and sewerage services maintained the pace from the preceding quarter (1.9%).

Development of the oil price on the world markets was also reflected in the prices of the EU producers.

Given the fact, that the movement of oil prices represents a global factor affecting the producer prices, acceleration of the year-on-year rate of growth of this index also affected the majority of the European Union countries. Total year-on-year addition to the producer prices was 3.5% in the EU in Q2. Acceleration again related to the prices of manufacturing products and considerably also for mining and quarrying. The producer prices were raised the most in the Great Britain in Q2 (6.7%, mainly because of mining and quarrying) and by similar pace in Belgium and Estonia (6.4%, acceleration was recorded for the manufacturing products in Belgium, for the prices of electricity, gas, steam and air conditioning supply in Estonia). Year-on-year fall of the producer prices was observed in Ireland (-2.4%) and Luxembourg (-1.4%). Prices were raised only by 0.5% in Malta.

Prices of market services were influenced by the overall economic situation. Prices of job agencies for

Prices of market services maintain their pace 1.7% already three quarters in a row. Economic expansion from the preceding year supported the growth of prices of transportation and warehousing. Their year-on-year rate of growth now moderated



instance went up markedly.

(for land and pipe transportation to 0.6%), for prices of warehousing and support activities for transportation year-on-year drop even occurred of 2.1%. Prices fastened for postal and courier activities (5.3%) in Q2. Prices of insurance and pension funding also went up (4.1%), further then the prices of the real estate activities (2.9%). Prices of the services of employment placement agencies reached the highest increase (15.8%), thus reflecting the current situation on the labour market to a considerable extent.

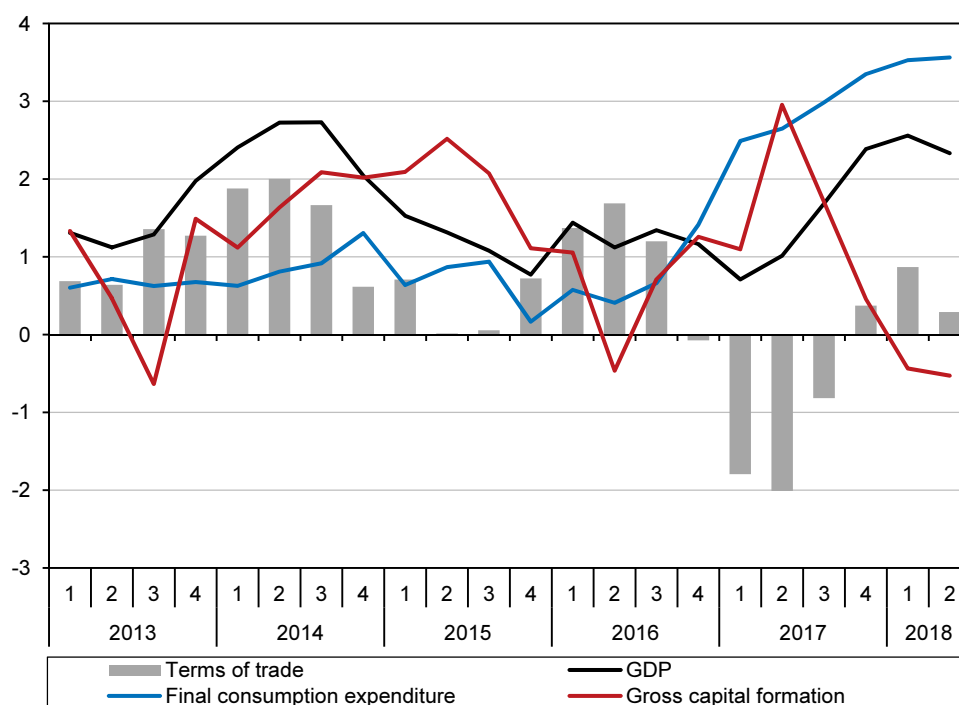
Agricultural producer prices fell by 3.4% following five quarters of year-on-year growth.

Agricultural producer price index started falling quarter-on-quarter already in Q1, year-on-year addition however remained positive at that time. First year-on-year slump since the end of year 2016 eventuated in Q2 (-3.4%). Prices of both plant and animal production were falling. Prices of plant production decreased by 3.3% year-on-year. Reason was the fall of prices of industrial crop by 14.4%. Mostly oil plants, specifically the decrease of prices of seeds of the oilseed rape by 2.2%, exerted a dominant influence. Prices of potatoes also were of importance, lower year-on-year by 6.7%. Weight dominant cereals persisted with the year-on-year growth (2.3%) so far, prices of the key wheat were raised by 1.0%. Prices of animal production fell by 3.5% year-on-year in Q2. Here the heightened drop of the prices of livestock mostly manifested (-8.7%). The fall of the prices of weight most significant slaughter pigs (-19.8%) deepened. Lowering of prices of poultry also continued (-1.2%), where the fall of prices of chicken did not continue further (0.4%), the indicator was however impacted by other poultry (-7.8%). Year-on-year growth of the prices of animal products markedly slowed down in Q2 (0.8%). After double-digit additions of the last year, prices sank for milk (1.5%) and eggs (-6.2%).

Effect of foreign exchange rate on prices weakened.

Prices of export decreased by 3.0% year-on-year in H1. While the slump reached 4.4% in Q1, the dynamics mitigated to -1.6% in Q2. The influence of the koruna foreign exchange also significantly reduced, whose appreciation pushed the prices of the foreign trade notably down since April of the last year. Prices of import fell by 4.2% in H1 and similarly to export, the slump was milder in Q2 (2.4%). The resulting terms of trade were thus positive - 101.3% in the whole half-year and 100.8% in Q2.

Chart 13 Deflators (adjusted for seasonal and calendar effects, y/y in %)



Source: CZSO

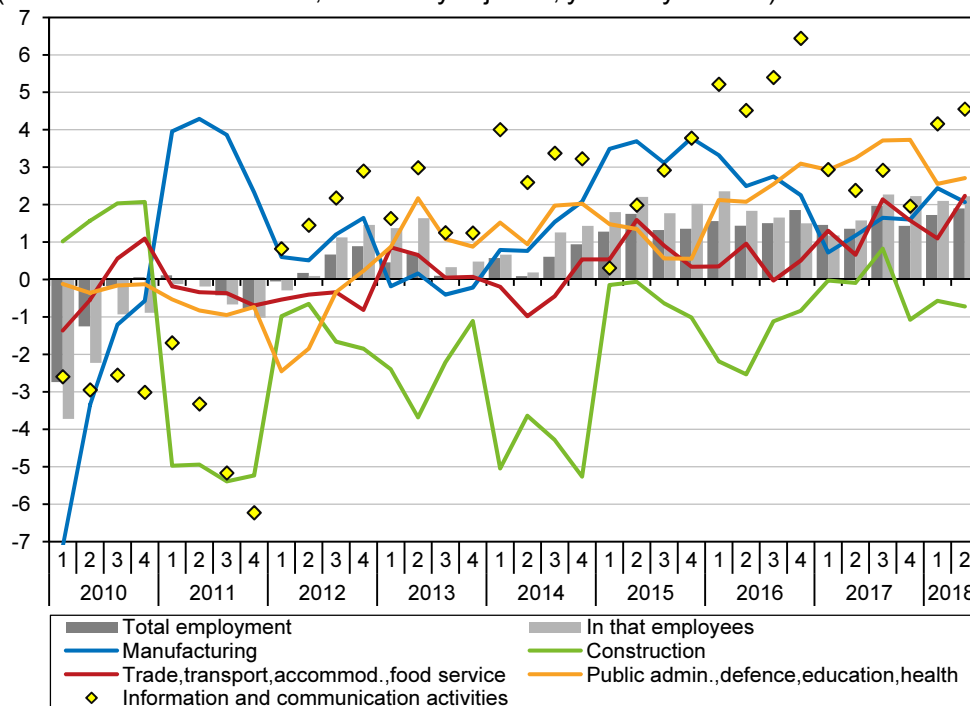
6. Labour Market

Excess robust demand for labour force is the main source of the rising tension on the labour market in the last quarters.

Despite shrinking reserves of potential labour force, the rate of growth of employment was not losing strength.

Labour market was characterised by a growing tension stemming from the unmet robust demand for labour force in the Czech Republic in the first half of year 2018. Proportion of businesses experiencing the current lack of available labour force as a barrier to their growth was expanding in all the main branches of the economy. In case of industry it represented the main growth barrier (already since the half of the last year), in other branches (e.g. construction) the situation was already strongly nearing this state at the beginning of the summer period. Despite shrinking reserves of the disposable labour force (primarily from the ranks of the unemployed), the rate of growth of employment was still not losing strength. Number of workers³⁰ grew by 0.6% quarter-on-quarter in Q2 and thus repeated the result of the first quarter of the year. Growth rate was in both cases slightly higher compared to the EU. Growth of employment neared the 2% boundary in the year-on-year comparison. Physical number of workers in this country set the new maximum in the history of the CR (5.44 mil). To a large extent, persons in one's declining years stood behind this phenomenon, whose employment activity was affected by the lengthening age limit for the retirement. Labour market also with the assistance of the heightened supply of part-time work contracts³¹ absorbed also the numerically strong years of birth of economically inactive persons. The decrease of the unemployment still had a significant effect, even though the role of this factor weakened³². On the contrary, the significance of the labour force from abroad kept further growing³³.

Chart 14 Number of employed in selected branches and total number of employees
(based on national accounts, seasonally adjusted, year-on-year in %)



Source: CZSO (national accounts)

³⁰ Unless stated otherwise, data on employment are given in the national accounts conception adjusted for seasonal effects in this chapter.

³¹ The number of employed working part time increased by 20 thousand year-on-year in Q2 2018. The persons aged 65 and more and also persons in the group aged 25-29 comprised the overwhelming majority of those who contributed. Still the CR belonged among one quarter of states with the lowest proportion of persons in the productive age working part time within the EU.

³² According to the newest so far not seasonally adjusted data from the Labour Force Sample Survey (LFSS) related to the flows on the labour market, 31 thousand persons transferred from unemployed into employed between Q4 2017 and Q1 2018 (nearly 40 thousand the year ago). On the contrary, 44 thousand persons headed from the economically inactive group to employed (similarly to the beginning of year 2017).

³³ Based on the preliminary data of the demographic statistics, the number of immigrated into the CR increased by more than one third in H1 2018. Positive balance of international migration (17.7 thousand) was highest in the last nine years in this period of the year.



Employment rate of those aged 15 to 64 years was already nearing the 75% boundary.

Given the fact, that the frequency of population aged 15 to 64 years continuously falls in the CR after year 2008, the growing number of employed was driven by the effect of the strengthening participation. Employment rate of aged 15 to 64 years increased by 1.4 p.p. year-on-year and it already aimed at the 75% boundary in Q2, which brought the CR closer to the first five EU countries with the highest employment rate. Swifter growth of employment of females rather than males continued³⁴. Employment rate increased year-on-year in all age groups (apart from persons up to 25 years of age).

Solely only employees contributed to the year-on-year growth of employment this year.

In contrast to the first half of the last year, this year's growth of employment in the economy was driven nearly solely by persons with the employment status. Number of self-employed stagnated³⁵, since their moderate growth in manufacturing, real estate activities or a grouping trade, transportation, accommodation and food service activities was offset by the year-on-year decrease in other branches of services, in construction and in the primary sector.

Services secured more than two thirds of the addition from all branches.

From the view of branches, the tertiary sector contributed the most (+67 thousand) to the growth of the total employment (+96 thousand year-on-year) in H1 2018, i.e. similarly to the two preceding years. All branches of services were expanding their levels of workers, only financial and insurance activities stagnated (employment in this branch mildly oscillated already six years in a row). Information and communication were the most successful (+4.4%) and real estate activities (+3.3%). Weight significant branch trade, transportation, accommodation and food service activities was also hiring workers (+1.7%). Branches with the dominance of the public institutions added the most to the growth of the services sector (+2.6%), employment was strengthening here in education as well as activities connected to the state security.

Despite obstacles with hiring of workers, employment grew in manufacturing. Job positions kept dwindling in construction as well as mining industry.

Outside the area of services, strong demand for labour sources prevailed also in manufacturing. Despite the difficulties with filling the vacant job positions, the employment grew by 2.3% here. Reduction of employment in non-manufacturing industrial fields halted this year. Slower reduction of job position in mining and quarrying with the simultaneous growth of employment in energetics as well as the area of water and waste management contributed to this result. On the contrary, number of employees slightly lowered in branch agriculture, forestry and fishing similarly to construction. Given the minimal changes in the employee segment, the lower number of self-employed was decisive factor in both cases.

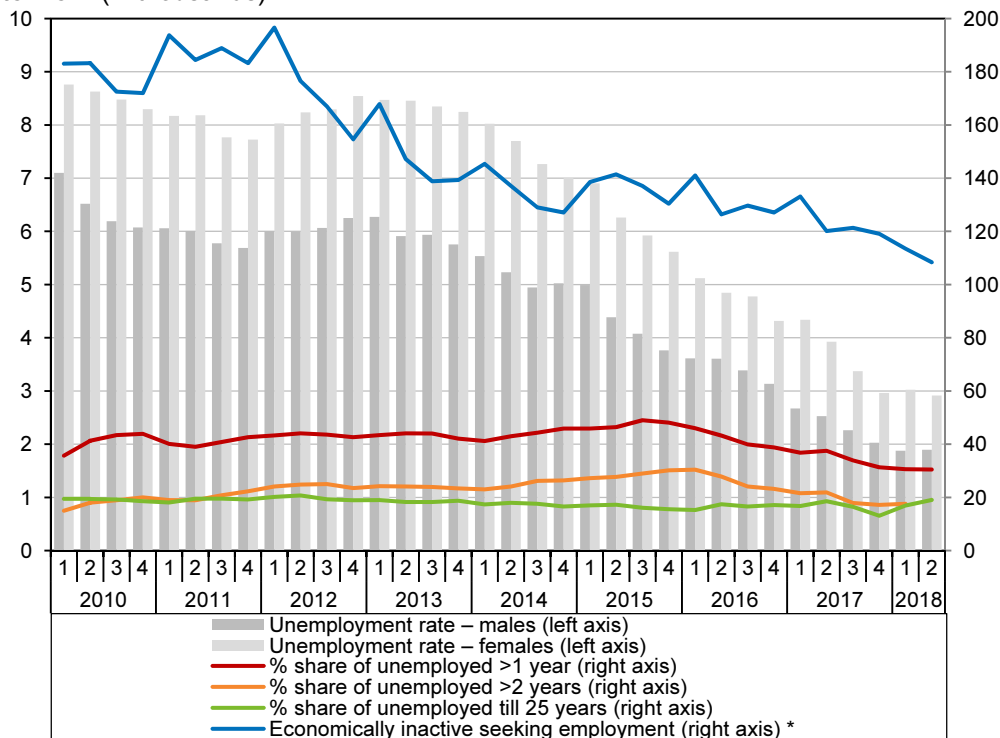
General unemployment rate fell only negligibly during the first half of the year. The number of long-term unemployed however kept shrinking.

LFSS data suggest that the general unemployment rate (the lowest in the history of the independent CR) moved already close to its bottom in the 1st half of 2018. Based on the seasonally adjusted data, the number of unemployed decreased only by 3 thousand between Q1 and 2 (similar result was also achieved in the first three months of the year). 2.9% of economically active females, resp. 2.0% of males aged 15 to 64 years were without a job in June. Year-on-year the unemployment rate was falling for females twice as fast as for males (where there is the potential of further reduction of unemployment apparently already very limited). Lower number of unemployed was from the vast extent the result of lower frequency of persons, who were out of job for more than one year (it lowered by 24 thousand to 36 thousand) in Q2. Their share in the total number of unemployed fell to 30% (the lowest since year 2009) and it was nearly by one third weaker than in the whole EU.

³⁴ Based on the LFSS data, the employment rate for males was 81.8% (by 1.1 p.p. higher year-on-year), for females 67.6% (by 0.7 p.p.) in Q2 2018.

³⁵ LFSS data suggest that the number of entrepreneurs with employees as well as the numerically larger group of entrepreneurs without employees stagnated this year.

Chart 15 General unemployment rate of males and females, share of selected groups of persons on all unemployed (in %) and economically inactive wanting to work (in thousands) *



Note: all data related to unemployment are seasonally adjusted.
 *Persons who are not part of the labour force, are not actively seeking employment (and thus do not meet the conditions of ILO for unemployed), however state that they would like to work.
 Source: CZSO (LFSS – Labour Force Sample Survey)

Number of economically inactive seeking job reached its minimum for the whole period of monitoring.

This development however also leads to the situation in the CR, that still more often persons with minimal or obsolete work experience break through among the long-term unemployed³⁶. Strong absorption capability of the labour market is also evident from the drop of the number of economically inactive persons, who are not part of the labour force, do not actively seek employment, however they state, that they would like to work. Their number was 108 thousand in Q2, the least in the history of monitoring. Only just below one third of them was however able to quickly enter the employment, often these are persons who have specific demands on the job contracts.

Supply of vacancies on the LO set the new records from the view of both the size and dynamics.

Supply of vacant job positions via the labour offices (LO) overtook for the first time in history of their functioning the 300 thousand boundary during June. Month-on-month addition also accomplished a record (18.3 thousand), it was partially also affected by the favourable weather. Despite seasonal factors, the month-on-month supply of vacancies expands continuously since the end of year 2016. The addition to vacancies was however from the view of demands on qualification as well as region considerably varied³⁷. The disproportion between the structure of the supplied vacancies and registered job applicants thus deepened. From the macro view however a positive development prevailed, since starting this year's April the total number of vacancies already exceeded the frequency of job applicants. Nearly two thirds of districts of the CR were in a similar situation at the end of June³⁸. Manual workers had the highest chance

Mostly positions with low demands on qualification accrued. Disproportion between vacancies and job applicants thus deepened.

³⁶ Nearly 30% of all long-term unemployed were without a job for more than four years in Q1 2018.

³⁷ 81% of the total increase of vacancies between this year's and last year's June (118 thousand) belonged to positions, where the maximum primary education was adequate, on the contrary only 2.5% positions required tertiary education. Total supply of vacancies expanded the most in regions with the below average unemployment – only Prague, Central Bohemia region, Plzen and Pardubice regions created in sum two thirds of the vacancy increase in the whole republic.

³⁸ LO registered more than 2.5 applicant per 1 vacancy already in only four districts at the end of this year's June - Karvina (5.8), Most (4.1), Ústí nad Labem (4.0) and Jeseník (3.4).



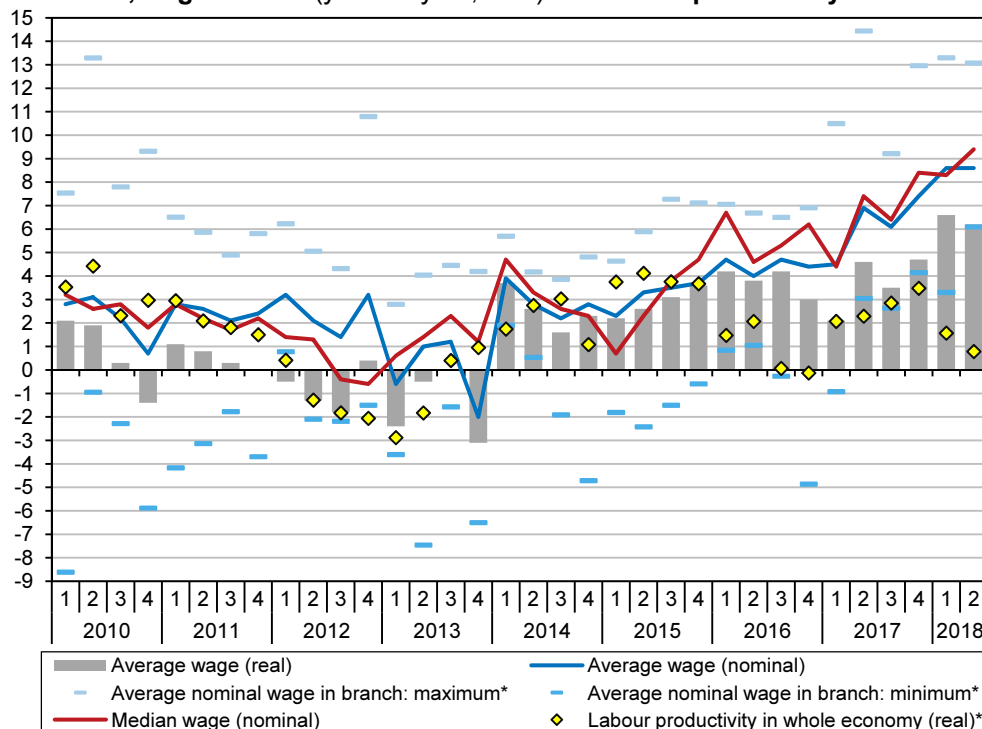
of securing employment regardless of their qualification (machine operators, craftsmen and repairmen or supporting staff), resp. persons with primary education and apprentices. On the contrary for persons with secondary education with the school leaving certificate and university degree registered at LO, the levels of unemployed still exceeded the vacant positions supplied to them.

The CR further kept its special position among the EU states with respect to the unemployment rate as well as the number of job vacancies.

Rate of job vacancies increased year-on-year by one half and it equalled 5.4 %³⁹ in Q2. The Czech Republic was with a significant lead (ahead of Belgium and Germany) dominating all EU countries⁴⁰. The CR holds a front position also in relation to the unemployment rate – and in addition for nearly three years already. Unemployment was reducing across all Union countries. Compared to Q2 2017, it fell the most in Cyprus (by 3.3 p.p. year-on-year) and Croatia (2.4 p.p.), which are nevertheless still the most hit economies (within the framework of states, that acceded to the EU after year 2000). Among the larger states, Spain recorded a bigger shift (from 17.2% to 15.3%), in the opposite direction unemployment in Italy and France fell only a little (by 0.4 p.p.). From the largest economies, both Germany (3.5%) and Great Britain (4.0%) kept the favourable position. Unemployment rate in the whole EU was (similarly to the CR) by 0.8 p.p. lower year-on-year and amounted to 6.8%. For the first time it equalled its minimum from year 2008. In countries of the current euro area, it still remained by whole 1 p.p. above the minimum from the previous expansion period (7.2%). In some countries with a positive situation or development of the total unemployment structural difficulties persist, for example with long-term unemployment (Slovakia, Bulgaria, Belgium) or participation of young people in the labour market (Croatia, Portugal).

Unemployment fell year-on-year in all states of the Union, many of them however keep experiencing structural issues.

Chart 16 Average gross monthly wage, span of its rate of growth across branches*, wage median (year-on-year, in %) and labour productivity**



*Branches with relatively highest, resp. lowest year-on-year rate of growth of the average wage. Branches energetics as well as financial and insurance activities were not included in the whole period (2010-2018) due to the non-standard development at the turn of years 2012 and 2013, resp. 2013 and 2014.
 ** Share of seasonally non-adjusted GDP and employment (in the national accounts conception)
 Source: CZSO

³⁹ It is the proportion of vacancies on the total number of positions (both vacant and occupied). Branch Agriculture, forestry and fishing is not included.
⁴⁰ Comparison does not include Denmark, France, Italy and Malta, where the data are not available in the long term.

Rate of growth of the average nominal wages kept expanding further and hit the ten-year maximum.

Rate of growth of the average nominal wage was further increasing. It was similarly 8.6% in both Q1 and 2 according to the business statistics and it was the highest in the last ten years⁴¹. Factors standing behind the wage dynamization remain the same in the last quarters (good economic results of businesses, prevailing positive expectations in key branches of the economy, strengthening lack of available employees and from this springing competitive pressure, regular increases of the minimal wage impacting also the size of the guaranteed wage). While in the previous three years, the strong growth of the average earnings in branches with very low wage level represented the typical feature of the development, this year the strong wage dynamics in branches with the predominant public sector presence showed of paramount importance.

Wage growth accelerated in all branches with the predominant public sector. In contrast it grew only slightly faster in manufacturing compared to last year.

Arts, entertainment and recreational activities (with the wage growth of 13.2% in H1) prove, that both above mentioned tendencies partially intersect. Rate of growth of wages accelerated the most in education (12.4%, 4.9% a year ago). Outside the public services other branches of services followed with a larger margin, where the relatively weaker growth of average earnings (typically between 6 and 8%) was usually accompanied by a swift growth of employment. Growth of average wages fastened only mildly in manufacturing (to 7.8% from last year's 6.5%), the volume of paid out wages lagged behind the pace in the whole economy for the first time in the last six years. On the contrary in the smallest branch division – mining and quarrying – it increased for the first time in five years (thanks to the high rate of growth of the average wages 9.4%). Even though the growth of earnings in financial and insurance activities lagged behind the pace in the whole economy already the fourth year in a row, still it represented the branch with the highest level of average gross monthly wages (57 thousand, 3.1times more than in accommodation, food service and restaurants). Wage differentiation between branches or regions mildly shrank. Median wage increased by 9.6% year-on-year in Q2 (for females even by 10.1%). Lead of the growth of the median wage before the pace of the average wage prevails with small fluctuations already three years. As a positive fact, the purchasing power of wages strongly increased. It was by 6.4% higher year-on-year for the whole half-year and achieved the best result in the last 15 years.

Relative wage differences between branches or regions mildly shrank.

7. Monetary Conditions

Increase of the monetary policy-relevant rates continued.

One year passed since the termination of the forex intervention in Q2 2018. Gradual transition to the standard conception of the monetary policy continued and increase of the monetary policy-relevant rates as of 28.6. was the reaction to the acceleration of inflation and possible overheating of the economy. Two-week repo rate was raised by 0.25 p.p. to 1.00% and the Lombard rate by 0.50 p.p. to 2.00%. Koruna foreign exchange against euro commenced at the level of approximately 25.30⁴² CZK per euro in Q2. It however gradually depreciated since April and tightly exceeded 26 CZK towards the end of June.

Repo operations gained more significant role in the money stock compared to the past.

Growth of the amount of money in the economy slowed down this year when compared to the last year's double digit rate of growth. The volume of currency and one day deposits, which dominated the dynamics of the money stock in the last years expanded markedly slower. On the other hand, marked increase of the deposits with agreed maturity up to 2 years can be observed starting the beginning of the year. Their volume grew by 30.5% in the first six months. Repo operations started to play a relatively significant role in H1, their volume consisted of 2.9% of

⁴¹ Volume of paid out wages (also reflecting the development of the number of employees) was by 10.8% higher this year compared to H1 2017. Within first half of the year, it was the highest nominal growth in the whole comparable time series (starting year 2000).

⁴² Foreign Exchange rates announced by the CNB data in working days. Unless stated otherwise, all data in this chapter were taken over from the ARAD database of the Czech National Bank.



the total money stock towards the end of June (129.6 CZK bn). This item grew by 44.1 CZK bn from January till June of this year.

Monetary policy-relevant rates and bond yields went also up.

Gradual growth of the monetary policy-relevant rates pushed up also the interest rates on the interbank market. The three-month PRIBOR rate reacted by rising to 0.9% already in February, the shift of the repo rate then provided further impulse and in June it jumped to 0.93% (it is the average influenced only by the last two June days, July value of 1.18% provides a better picture). All interbank rates portrayed a similar dynamic in H1. State bond yields also rose regardless of the maturity. Short term bonds increased their interest rates by 0.7 p.p. to 0.89% since the end of the last year, medium term ones recorded increase of 0.73 p.p. to 1.41% and bonds with the long-term maturity depicted the lowest shift from – 0.64 p.p. to 2.14%.

Changes on the interbank market however were not reflected in the development on the client accounts, especially the current accounts.

Growth of the interbank rates was not reflected in any notable extent into the environment on the client accounts. The average interest on the current accounts of households amounted to 0.05% in H1, which can be considered the level of technically zero and did not basically change in the last two years. The interest rates on the current accounts of non-financial businesses followed a similar development. Different situation is in case of deposits with agreed maturity. Their interest rates were raised in comparison to the level from the last year at the beginning of year 2018, afterwards however the interest rather stagnated. Practically zero interest on the one day deposits led to the decrease of the volume of deposited funds of non-financial businesses. It was 36.4 CZK bn for the whole H1. On the contrary the volume of deposits with agreed maturity expanded by 18.0 CZK bn since January till June. Households directed their funds more to the one-day deposits – their volume expanded by 103.9 bn.

Consumer credit for households became cheaper.

Two opposing factors exerted influence upon the interest rates on the credit for households. Interest rates on consumer credit continued in the falling trend in the first half of the year and the average interest was 8.53% in Q2. On the other side, the interest rates on mortgages mildly grew since the beginning of the year. Average interest maintained at the level of 2.62% in Q2. The volume of provided consumer credit expanded by 9.4 CZK bn from January till June, which is more than in the same period of the last year. In contrast the volume of mortgages increased less in H1 compared to the last year (44.5 CZK bn). Number of new contracts arrived at 93.1 thousand in H1. That is by 8.1% less than in the last year. Total household indebtedness reached 1 651.5 CZK bn towards the end of June and it expanded by 53.6 bn since the beginning of the year. The debt incurred on housing still had the most impact, its year-on-year growth however slightly slowed down this year compared to the last year. On the contrary the debt for consumption grew stronger.

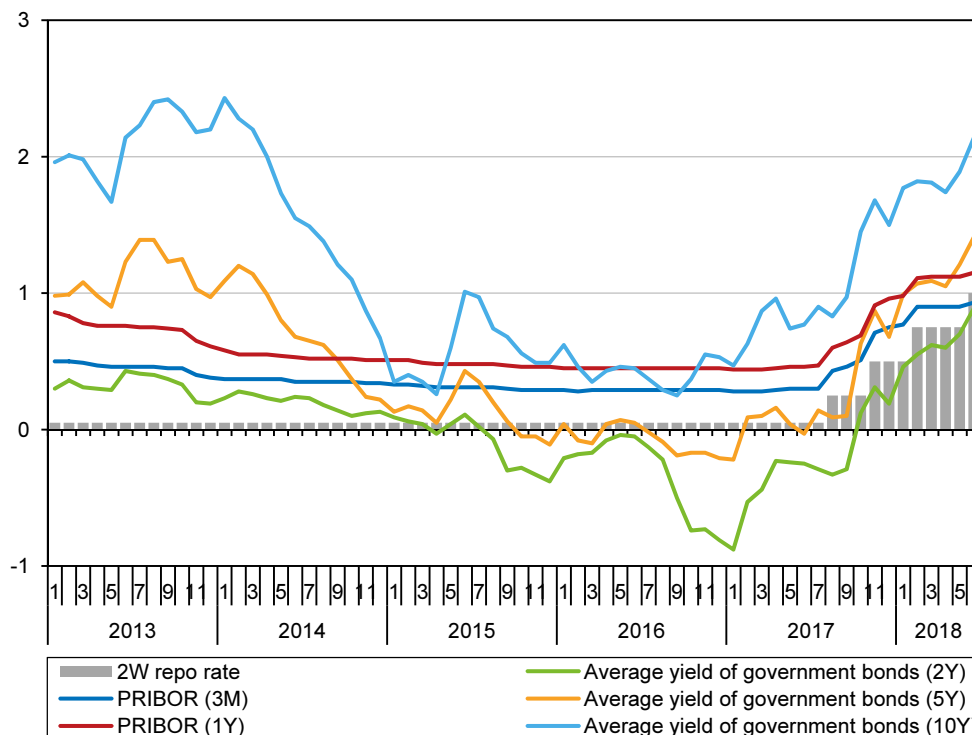
Interest rates on credit to businesses did not grow much so far.

The interest rates on credit for businesses rather fluctuated in H1. From January till April, it was possible to observe mild growth tendencies, however the rates were falling in the subsequent months. Growth trend was apparent for credit up to 7.5 CZK mil for the entire period. From January till the end of June, the shift of the average interest up by 0.35 p.p. to 3.67% occurred. Described dynamics of the total growth of the interest rates was evident for the credit of larger volumes, the most significantly then for those above 30 CZK mil. Their average interest moved around 2.33% at the end of June. In total, the volume of credit and liabilities of non-financial businesses increased by 43.0 CZK bn (4.2%) from January till June. Especially the medium-term credit increased. Their volume grew by 19.8 bn (10.0%) from January till June. The increase of the volume and liabilities denominated in foreign currency was also more pronounced. It increased in total by 20.7 bn (6.9%) in H1. The growth of volume of individual maturities of credit in foreign currency was then relatively balanced.

Development of credit in individual branches mirrored the overall economic development.

Dynamics of the development of credit according to the individual branches to considerable extent reflected the overall economic development. The expansion of credit for financial and insurance activities (62.4 bn, 24.0% from January till June) was the most significant. Marked revival launched the growth of the volume of credit in construction (7.7 CZK bn, 17.7%). The volume of credit rose by 18.4 CZK bn in manufacturing (7.0%). The heightened demands of the accelerating economy on the branch transportation and warehousing showed already in the past year. The volume of credit also notably increased in this branch in H1 2018 (2.8 CZK bn, 5.9%). Their volume on the contrary sank in the supply and distribution of electricity, gas, heat and air by 14.4 CZK bn (-10.3%) in H1. Long term slump of the volume of credit in mining and quarrying also continued (-3.2 bn, -28.5%).

Chart 17 Market interest rates (in %)



Source: CNB

8. State Budget

State budget balance dived thanks to the weaker balance in Q2 into a mild deficit. Half yearly balance was the weakest in the last five years.

The state budget (SB)⁴³ finished with mild deficit in the amount of 5.9 CZK bn⁴⁴ in the first half of this year. The budget balance sank into the deficits within the frame of this part of the year for the first time in the last five years. Traditionally it was caused by the weaker balance of the budget during Q2, since the SB achieved surplus (16.3 bn) for the first three months of the year. In spite of slowing down, the economic growth as well as the significantly uneven drawing of resources from the European funds (even though it bounced this year in a smaller extent compared to the previous four years) had the key effect on the budget of the state⁴⁵. Acceleration of the current SB outlays also had an effect, when they rose by 8.4% already, the strongest year-on-year pace in

⁴³ Unless stated otherwise, all data related to the state budget are sourced from the data of the Ministry of Finance on the cash fulfilment.

⁴⁴ Some irregular transfers were also impacting the size of the balance. It was especially this year's expenditure on the replenishment of the EGAP insurance funds (4.3 bn) and last year's transfer of 5.8 CZK bn from the privatization accounts to cover the pension account deficit (SB did not perform this receipt this year).

⁴⁵ According to the calculations of the MF CR, the SB balance adjusted on both income and expenditure side for the resources on programmes from the EU budget and Financial mechanisms (EEA and the Norway Grants, Swiss – Czech Cooperation Programme) arrived at -28.8 CZK bn in H1 2018 (-13.2 bn the year before).

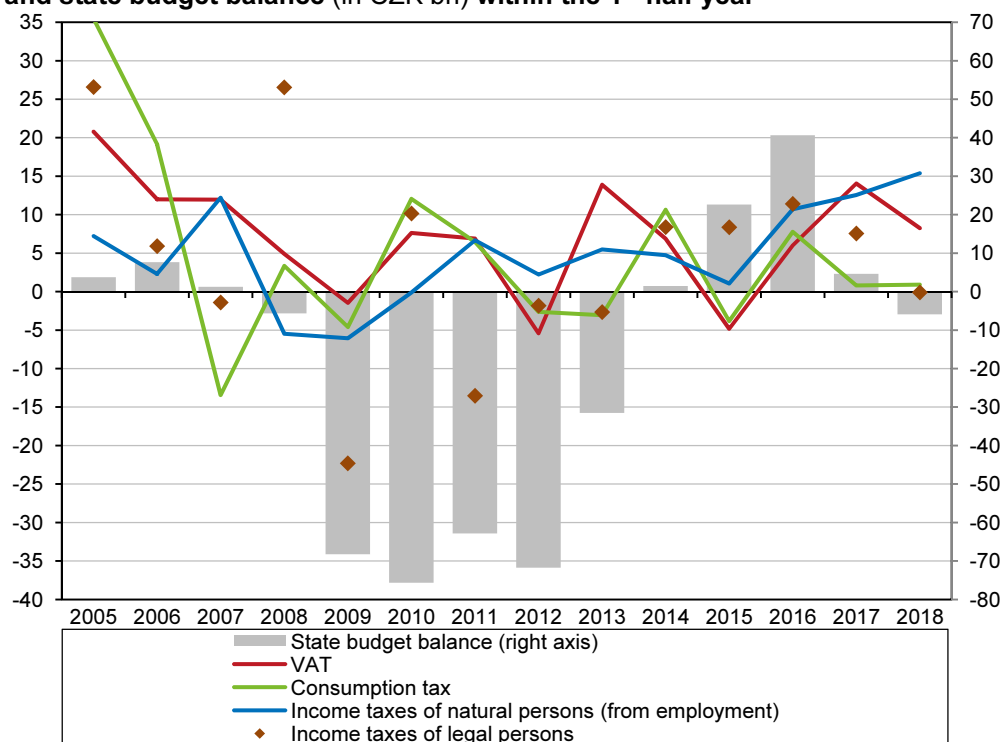


the last twelve years. The SB balance, comprising the key component of the deficit or surplus of the budget of the government institutions sector, amounted in relation to the nominal GDP to -0.2% in H1.

Rate of growth of the state-wide collection of all tax receipts slowed down this year compared to strong years 2016 as well as 2017.

Higher collection of taxes, but in contrast to the last year also the growth of the non-tax revenues driven by the more intensive inflow of the resources from the EU contributed to the strengthening of the half-yearly receipts of the SB (by 8.5% year-on-year). It did not present the consequence of the accelerated drawing of European funds in the preceding months, but the finishing payments related to the already completed programme period⁴⁶. State wide collection of tax receipts documenting the effect of the condition of the economy as well as the efficiency of the collection of taxes, strengthened year-on-year (excl. insurance) by 6.2% (however it exceeded the 9% boundary in the first half of both years 2016 and 2017). The high last year basis contained the effect of not only the culminating expansion, but likely also the impact of the control measures introduced on the side of the tax collection. Higher collection of taxes was driven mainly by the collection of value added tax (VAT) and the income tax of natural persons from employment this year.

Chart 18: State wide collection of selected tax incomes (year-on-year in %) and state budget balance (in CZK bn) within the 1st half year



Source: MF CR

Following the gradual evaporation of the exceptional growth factors, the development of the VAT collection again

State wide collection of the volume dominant tax (VAT) increased by 8.2% (at the level of the SB only by 4.9%)⁴⁷. It considerably relaxed the pace from the record observed in H1 2017 (14.2%). The effect of the non-standardly high basis⁴⁸ however gradually evaporated during Q2 2018 and the dynamics of the VAT collection more notably moved

⁴⁶ It concerns the collection in the amount of nearly 20 CZK bn in the first two months of the year, which was the part of the final payments related to the programme period of 2007–2013. Without this extraordinary payment, the volume of resources received from the EU budget (incl. FM) would be on the contrary by 1 CZK bn lower year-on-year for the whole H1 2018.

⁴⁷ Change of the budget appropriations of taxes came into force in January 2018, which decreased the proportion of the state budget on the statewide VAT collection from 69.68% to 67.5% to the benefit of the share of municipalities.

⁴⁸ It was mainly the introduction of the control reports and electronic registration of sales – especially its second wave (effective since April 2017 for retail, wholesale). The VAT collection thus already in April 2018 collided with the higher comparative basis and its year-on-year growth halted after sixteen months (-2.6%). The VAT growth renewed in the subsequent months, however at weaker rates than at the beginning of year 2018.

started to move closer to the development of final consumption expenditure.

Collection of key components of the consumption tax stayed thanks to the effect of contradictory factors without significant changes.

Collection of the corporate tax slowed down to the lowest rate of growth since the end of the last recession.

Development on the labour market was favourably mirrored in the collection of ITNP from employment. It rose by record 15.4% year-on-year.

Growth of the total SB outlays accelerated to a ten-year maximum this year. Current expenditures as well as the faster drawing of resources from the EU budget stood behind it...

closer to the development of the final consumption expenditure of households or government institutions. Total growth of the collection of consumption taxes remained tightly below 1% this year (similarly to last year's H1). Moderate growth of the collection of weight dominant consumption tax on mineral oils (by 1.8%) was offset by smaller, but anticipated by the budget loss of income from taxes on tobacco products (-1.1%)⁴⁹. Administrative and price factors⁵⁰ prevented a more robust growth of the collection of tax on mineral oils (in connection with the effect of the favourable economic development on the rising mobility also supported by the warm weather). While the present this year's collection of the key components of the consumption tax reproduces the budget anticipations, it lags behind it somewhat for the VAT.

Volume of the collected corporate tax stagnated year-on-year in H1. Signs of the slowing down, connected to the lower profitability of businesses especially due to the rising wage costs were apparent already during the last year. Since the yearly payment of the tax from the largest payers is evident not only in June, but also in July, it is more suitable to compare the cumulation for the first seven months in the year. In this case, the year-on-year increase of the collection arrived at 2.6% (closer to the budget anticipated dynamics). However, simultaneously it was the weakest in the last five years (resp. since the end of the last recession).

State-wide collection of the income tax of natural persons (ITNP) from employment further strengthened. While it grew by 12.6% in the first half of the last year, it was already by 15.4% this year (year-on-year rates of growth were the same in both quarters of this year). Similar rate of growth occurred last time in Q2 of the expansion year 2007. The current collection dynamics contains not only the impact of the record number of employed and the accelerating average wages (due to the market factors also the increase of the minimum wage), but also the state tax policy (increased support for the families with children). Collection of ITNP from self-employment (paid by the payers) remained positive at the end of the half year already third year in a row (+0.7 CZK bn this year). At the same time however, it was lower by one half year-on-year⁵¹. The collection lied below the level of the last year also in Q1 (before the yearly income tax return). Despite longer term growth of the economy as well as the mild increase of the number of entrepreneurs, the collection of this tax stays behind the budget anticipation for now. ITNP collection stemming from the capital yields was by nearly one eighth higher year-on-year (although the collection was mildly falling year-on-year in the last year), the positive impact on the SB was nevertheless due to the low weight of this tax practically negligible.

Rate of year-on-year growth of the total SB expenditure markedly accelerated in H1 (to 10.2%, only 2.5% the year ago) and arrived at the ten-year maximum in this period. Expenditure was strengthening also during the year 2018 (+8.7% in Q1, +11.5% in Q2). Half-yearly growth of the total expenditure was driven primarily by the current outlays, investment however also contributed from one fifth. The decline of investment thus halted after two years. Their this year's volume (33 CZK bn) exceeded the last year's reality by nearly 13 bn (only by 5.5 bn in Q1 itself). The more up-to-date August

⁴⁹ Mild fall of the collection of this tax is possibly associated with the adoption of the Act on health protection from the harmful effects of drugs (in force since June 2017). Its impact on the limitation of the consumption of cigarettes or shift of consumption to alternative products – e.g. the electronic cigarettes – is so far more significant in budget than the impact of the repeated increase of the rates on tobacco products (in force since January 2018).

⁵⁰ It is so called green fuel enabling the refund of this tax in the area of animal primary production. This deduction is already fully manifesting this year (contrary to last year). Rising prices could have also partially negatively affected the consumption of petrol and diesel fuel. While the consumer prices of fuels were falling in the first half of year 2017, the situation was the opposite this year. The average July price of the diesel fuel (32.4 CZK/l) was the highest since July 2015, price of the petrol Natural 95 (33.1 CZK/l) even since December 2014.

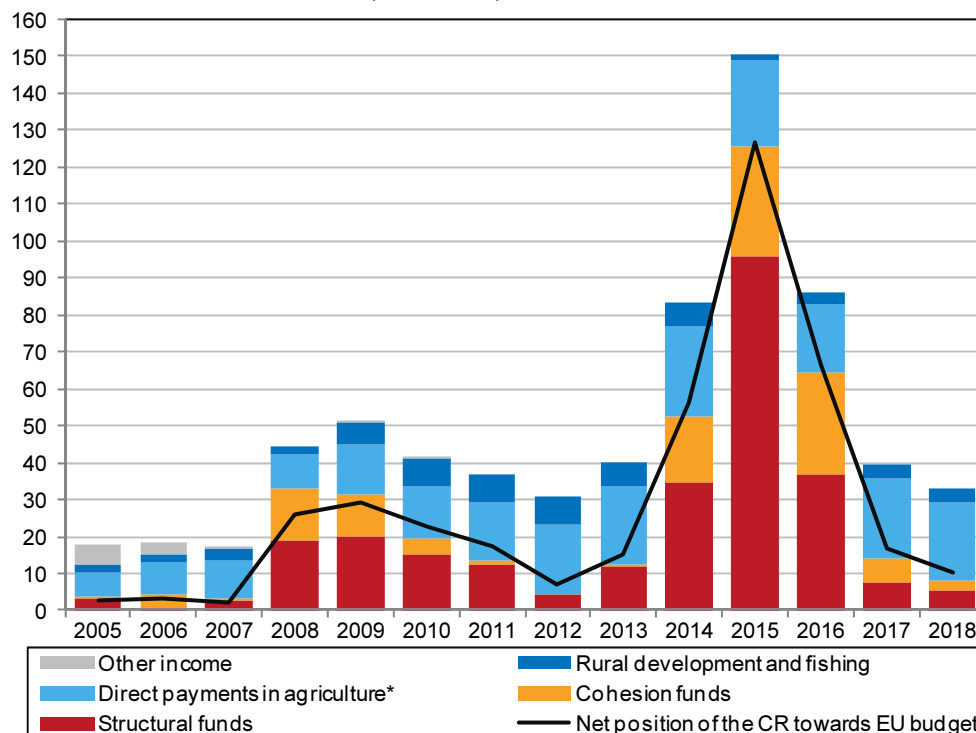
⁵¹ With respect to the relatively low volume of this tax, its year-on-year comparison is very susceptible to the changes in the possibilities of the tax deductions (rebates on the second spouse and tax benefits on dependent children).



... very low drawing of investment from the SB exclusively on the national projects however persisted.

statistics⁵² proves the gradual acceleration of the investment activity of the state. Expenditure on the common programmes of the CR and the EU stood behind this recovery (with the volume of 22.9 bn these were by 13.2 CZK bn higher year-on-year). Despite partial improvement the half-yearly drawing of all SB investment amounted to only 36% of the annual budget amount (expectation). The so far very low drawing of funds for exclusively national projects becomes evident (not related to the EU)⁵³. Proportion of investment on total SB expenditure was 4.8% in H1. Even though it was year-on-year by nearly one third higher, it presented at the same time the second lowest share in the last fourteen years. The proportion of investment aimed for the 10% boundary in the expansion year 2008.

Chart 19: Structure of the CR income from the EU budget and net position of the CR towards EU within H1 (in CZK bn)



* Includes also the market operations and veterinary measures.

Source: MF CR

Size of the net position of the CR towards the EU weakened by one third year-on-year due to the slow onset of drawing in the area of structural and cohesion policy.

Total net position of the CR towards the EU also provides the evidence for the slower onset of the drawing of funds from the EU budget in the first third of the programme period. Positive balance of the CR reduced year-on-year by more than one third and amounted to 10.4 CZK bn for the whole H1. Given the comparable volume of half-yearly payments into the EU budget (just below 23 bn), the lower balance resulted exclusively from the weaker receipts. These decreased by one sixth (to 32.9 CZK bn)⁵⁴. The structure of receipts suggests, that the flows related to the structural funds and the cohesion fund caused the slower drawing. Payments in the area of the common agricultural policy are on the contrary free from large fluctuations in the past years.

⁵² The volume of capital outlays of the SB reached already 48.4 CZK bn for the eight months (it was higher by 14.1 bn year-on-year). Nearly two thirds of this amount was directed to the financing of the common CR and EU programmes this year (including the common agricultural policy).

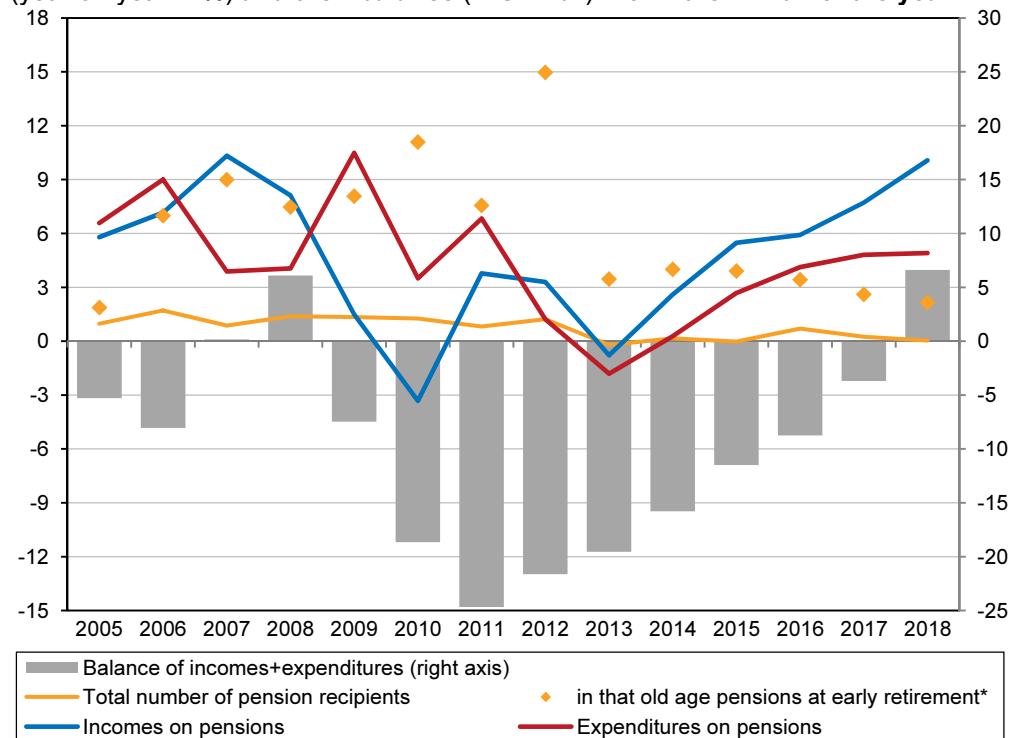
⁵³ Only 10 CZK bn from the annual anticipated amount (based on the approved SB) 54 bn was drawn on these purposes in this year's H1.

⁵⁴ Year-on-year decrease of the total incomes of the CR from the EU is not in contradiction with the above statement regarding this year's partial progress in the drawing of resources from the EU budget. Investment expenditure of the SB on the common CR and EU projects express the volume of all pre-financed funds. These will be only later with a certain lag evident in the total relationship of the CR towards the EU budget (on the income side, in the form of retrospectively refunded resources).

Acceleration of the current SB outlays was for the large part connected to the increase of the wage resources for the public sector employees.

Growth of the current SB outlays was gaining pace already second year in a row. While these outlays were mostly driven by the higher social benefits in the last year's H1 (primarily pensions), non-investment transfers to regional budgets (+15.9 bn., resp. growth by 18.6%)⁵⁵ participated the most on their year-on-year growth this year (+51.4 CZK bn). Expenditure on wages in the central bodies of the state administration increased by one seventh, nearly by double digit pace year-on-year. Higher expenditure was associated primarily with the increase of the wage tariffs.

Chart 20: Pension recipients, income and expenditure on pensions from the SB (year-on-year in %) and their balance (in CZK bn) within the 1st half of the year



* Old age pension income awarded before the pension age is reached and reduced for the earliness for the whole time period of the drawing the benefit. Source: MF CR, CSSA

Expenditures on pensions grew nearly by 5%. Number of persons receiving the pension income stagnated. Rise of the number of recipients of the permanently shortened pension further weakened.

Expenditure on social benefits, comprising more than two fifths of the current SB expenditure, increased by 13 CZK bn (by 0.5 bn less on a year ago) year-on-year in H1 2018. More than three quarters of resources on social benefits were directed on pensions, the state exerted by 4.9% more on them. Given the stagnation of the number of persons receiving pension (2.89 mil), the setting of the pension adjustment was completely determinative for the development of the expenditures⁵⁶. The average monthly size of the old age pension (solo) according to the CSSA amounted to 13 633 CZK for males and 11 247 CZK for females in this year's Q2. The fact that despite the lengthening of the retirement age, the relative addition of persons with the permanently reduced pension (due to early retirement) weakens already third year in a row, is a positive factor. Given the strengthening universal lack of workers, the chances of employment also for seniors increases and for some of them the possibility of extra earnings becomes attractive as well⁵⁷. Favourable situation on the labour market stimulated the growth of the collection of insurance on pensions. Its

⁵⁵ Subsidies on the direct costs of primary and secondary schools (growth of 10.4 CZK bn) and transfers to municipalities and regions according to the Social Services Act (+5.5 CZK bn). Year-on-year increase was related mostly to the increase of the wage resources.

⁵⁶ Starting January 2018, the basic pension assessment was raised by 150 CZK and the percentage assessment by 3.5% (i.e. on average by 475 CZK monthly).

⁵⁷ CZSO data from the household surveys also indirectly prove this. Employment rate of persons aged 65 to 69 years equalled 13.6% in Q1 2018. It increased by precisely 2 p.p. year-on-year, even by 4.6 p.p. in the last four years.

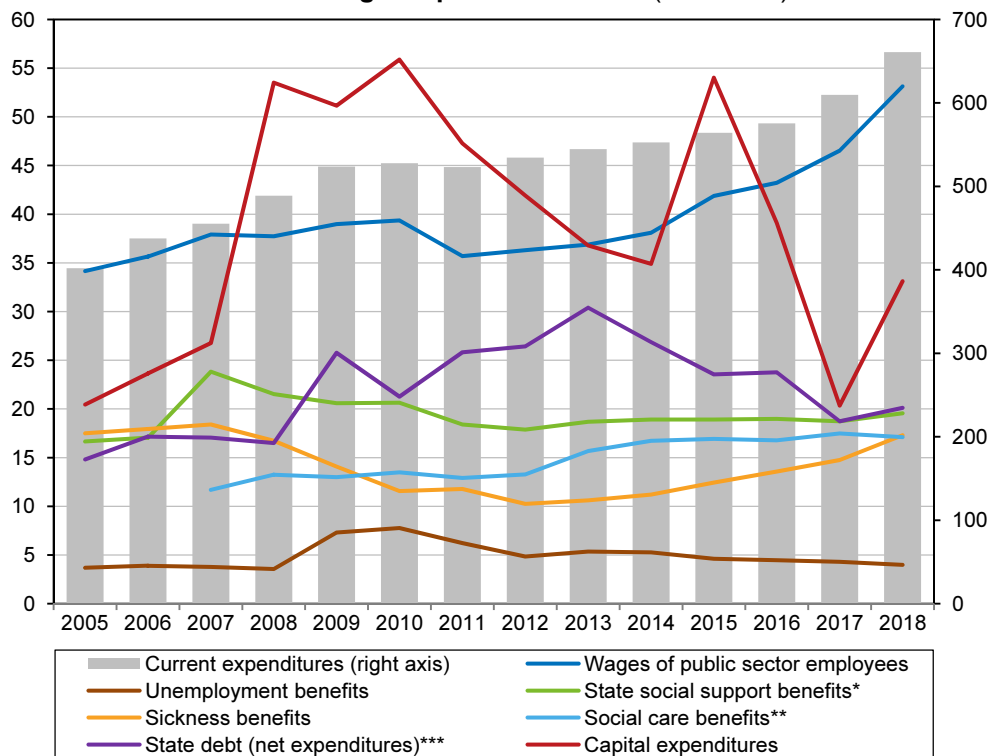


year-on-year rate of growth climbed already above 10% this year and neared the so far record dynamics from year 2007. Balance of the pension account⁵⁸ thus ended in surplus (just below 7 CZK bn) for the first time in the last ten years. State received by 23.5 CZK bn more year-on-year and at the same time it formed the most significant component, which contributed to the growth of the total SB revenues this year.

Growth of expenditure on non-pension social benefits accelerated especially due to higher drawing of the sickness benefits.

The SB expended 62 CZK bn on the other social benefits (apart from pensions) in H1 (by 4.8% more year-on-year, by 2.8% the year ago). If the dynamics of other social benefits was weaker compared to pensions in the preceding three years, their pace practically aligned this year. The sickness benefits contributed the most to the growth of the expenditures on the non-pension social benefits this year (similarly to the previous three years), whose rate of growth doubled (to 17.4%) compared to last year. It was connected to the continuing growth of the temporary work incapacity as well as the higher average daily sickness benefits (derived from the level of earnings in the previous months). Drawing of the maternity benefits (due to the higher birth rate) as well as this year's introduction of new benefits (long-term care benefits, father post-natal care) had much smaller effect. SB further expended more also on some benefits of the social care – for health disabilities as well as the care benefits (for persons on long-term sickness leave).

Chart 21: Selected state budget expenditures in H1 (in CZK bn)



* Also includes the Foster care benefits ** Includes Material deprivation assistance benefits, Benefits for people with disabilities, Care benefits (based on Act on State Social Support) ***Net outlays also include receipts of the chapter State debt.
Source: MF CR

Slump of the volume of paid out material deprivation benefits deepened. The size of other benefits paid out in connection to the

The impact of the economic growth on the incomes of households was becoming more evident in the other types of the benefits. Savings were accomplished this year in unemployment benefits (7.4% year-on-year)⁵⁹ as well as the material deprivation benefits (28%, even 50% for four years). The SB spent in total by nearly one tenth less on the state social support benefits, that are paid out in connection to the household income

⁵⁸ It is expressed as the difference between revenues and expenditure on the pensions from the SB (based on preliminary data).
⁵⁹ 66 thousand unemployed registered with the LO claimed the unemployment benefits in June 2018 (by one eighth less year-on-year). It comprised just fewer than 30% of all job applicants. The average monthly size of the unemployment support was 7 382 CZK.

<p>household incomes also decreased.</p>	<p>(child allowance, allowance for living). On the other hand, the volume of weight significant parent benefits (+8.1%) expanded, the so far relatively marginal foster care benefits also received by one fifth more year-on-year.</p>
<p>Reduction of net expenditure on state debt did not continue this year any more. The nominal size of debt remained despite partial fluctuations stable.</p>	<p>Decrease of the net expenditures on the state debt (commenced after year 2013) ceased this year. Expenditures in this area crossed 20 CZK bn in H1 (7% rise year-on-year)⁶⁰. The state debt amounted to 1 713.5 CZK bn at the end of June and it fell by 4.2% against the higher last year basis⁶¹. The absolute size of the debt stagnated in comparison to the preceding quarter. State further utilised the favourable conditions in part of the money market and was selling the treasury bills maturing still during this year in the larger extent. Borrowing need of the state continued to be focused exclusively on the domestic market. While the internal debt was thus growing, the CZK value of the external debt sank year-on-year by more than one quarter. The external debt shared on the total indebtedness of the state already by less than one eighth (lower share was last recorded at the end of year 2004). The composition of debt holders also changes. Approximately three quarters of the year lasting outflow of the speculative capital, manifesting in the fall of the volume of debt held by the non-residents, stopped at the beginning of his year's spring period (simultaneously with the exchange rate appreciation of koruna). Since then, the proportion of such held debt slightly grows. In the long term on the contrary, the proportion of the state debt held by the household sector shrinks.</p>
<p>Fall of the proportion of non-residents among the holders of the state debt halted in Q2.</p>	<p>Approximately three quarters of the year lasting outflow of the speculative capital, manifesting in the fall of the volume of debt held by the non-residents, stopped at the beginning of his year's spring period (simultaneously with the exchange rate appreciation of koruna). Since then, the proportion of such held debt slightly grows. In the long term on the contrary, the proportion of the state debt held by the household sector shrinks.</p>
<p>Despite mild worsening the CR belonged into the group of five least indebted economies within the EU also this year.</p>	<p>Debt of the whole sector of government institutions⁶² reached based on the current CZSO data the size 1 832.4 CZK bn at the end of Q1 2018⁶³. Nominal size of the debt fell year-on-year (by 4.1%), however it nearly did not change compared to period 2014 to 2015. Next to central government institutions, the local government institutions also participated on the reduction of the absolute size of the debt. This year's rate of indebtedness (35.8% of GDP) ranked the CR among the five best positioned EU countries. Only Estonia, Bulgaria and Luxembourg enjoy markedly more favourable position than the CR in the long-term. Even though the year-on-year decrease of the indebtedness rate prevails in the whole EU for nearly three years, its rate of growth does not rise much (it was -1.7 p.p. on average for the whole period). Nevertheless, the positive factor was, that all members of the Union (except for Greece) at least slightly reduced their indebtedness this year. The fact that only Germany and Malta find themselves in improved position this year compared to the indebtedness rate achieved ten years ago, provides the evidence of a very slow progress. Less than one half of the euro area member states featured indebtedness below the level of the Maastricht debt criterion (60% of GDP) according to data from Q1. Apart from Netherlands, it depicted mostly only the small economies.</p>
<p>Rate of indebtedness was reduced nearly in all Union states year-on-year.</p>	<p>Debt of the whole sector of government institutions⁶² reached based on the current CZSO data the size 1 832.4 CZK bn at the end of Q1 2018⁶³. Nominal size of the debt fell year-on-year (by 4.1%), however it nearly did not change compared to period 2014 to 2015. Next to central government institutions, the local government institutions also participated on the reduction of the absolute size of the debt. This year's rate of indebtedness (35.8% of GDP) ranked the CR among the five best positioned EU countries. Only Estonia, Bulgaria and Luxembourg enjoy markedly more favourable position than the CR in the long-term. Even though the year-on-year decrease of the indebtedness rate prevails in the whole EU for nearly three years, its rate of growth does not rise much (it was -1.7 p.p. on average for the whole period). Nevertheless, the positive factor was, that all members of the Union (except for Greece) at least slightly reduced their indebtedness this year. The fact that only Germany and Malta find themselves in improved position this year compared to the indebtedness rate achieved ten years ago, provides the evidence of a very slow progress. Less than one half of the euro area member states featured indebtedness below the level of the Maastricht debt criterion (60% of GDP) according to data from Q1. Apart from Netherlands, it depicted mostly only the small economies.</p>
<p>Government institution sector continued with budget surplus. Results of the municipal and regional budgets contributed the most.</p>	<p>Sector of the government institutions in the CR recorded surplus of 8.6 CZK bn (in the methodology of the national accounting), resp. 0.7% of the GDP (1.7% of GDP after seasonal adjustment) for Q1 2018. Local government institutions contributed the most to the year-on-year expansion of the surplus (by 5.4 bn). Budgets of the health insurance companies were also more positive. On the contrary, the deficit of the central government institutions slightly deepened (nearly by 16 CZK bn).</p>

⁶⁰ Balance of the budget chapter 396 – State debt. Expenditures on the debt repayment are affected not only by the borrowing need of the state, but also the situation on the bond markets. The average yields of the domestic state bonds relentlessly grow since the half of the last year.

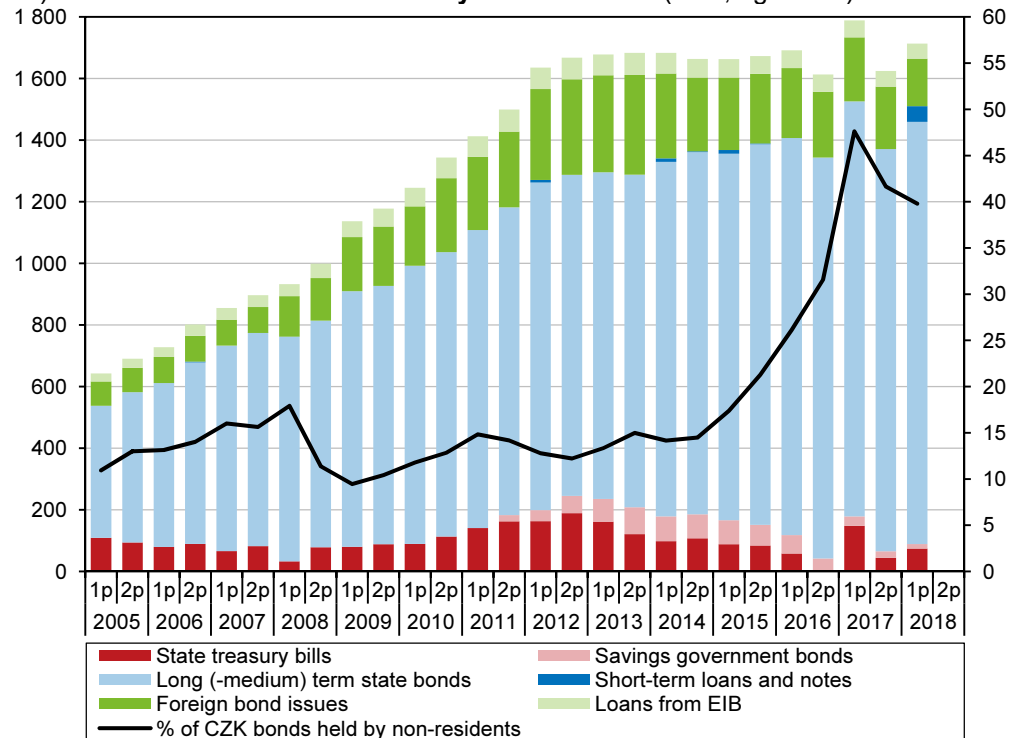
⁶¹ The debt hiked to 1 789 CZK bn in Q1 2017 and recorded the fastest quarter-on-quarter growth since year 2010 (+11%). This short term increase was connected to the specific situation on the bond market due to the expectations tied to the termination of the forex interventions.

⁶² Apart from the state budget takes into account also the budget of other central government institutions and also the municipalities and health insurance companies.

⁶³ The CZSO will publish the preliminary data regarding the debt and deficit of the government institutions sector for Q2 2018 on 3rd October 2018, Eurostat then on 23rd October 2018.



Chart 22: Structure of the CR state debt (balance at the end of half-year, in CZK bn) and share of CZK bonds held by non-residents (in %, right axis)



Source: MF CR