I. Economic and social development in the Czech Republic in the second quarter of 2007

(Preliminary figures)

Fast growth of the Czech economy continued in Q2 2007. Among resources the **gross value added (GVA)** of manufacturing industry increased markedly and among uses household expenditures on final consumption. The structure of resources and especially uses in the economy showed significant changes and so did the effects of individual items of expenditures on GDP. GVA and GDP increased, y-o-y, in real terms identically by 6.0%[1], seasonally adjusted, q-o-q, by 1.4% and 0.7%, respectively.

Among resources the biggest contribution to the GVA growth came from manufacturing industry (3.5 p.p.) which increased by 10.5%, y-o-y. A significant increase showed GVA in wholesale and retail trade; repair of motor vehicles (by 14.2 %) and enterprise services (by 11.3 %). The GVA drop was recorded in agriculture (by 13.0%) and especially in electricity, gas and water supply (by 39.8%). Among uses the most significant contribution to the growth of GDP came from household expenditure on consumption (3.0 p.p.), important was also the contribution of stock formation (1.9 p.p.). The gross fixed capital formation was contributed to by the growth of expenditures (0.1 p.p.) and also by net exports (0.3 p.p.). Only general government showed a negative effect on the GDP growth due to lower expenditures.

Labour productivity measured as a ratio of the GVA volume to total employment increased by 4.4% and contributed by nearly ¾ to the GVA growth. The growth of **persons employed** (in compliance with national accounts data) by 1,6 % owed to the remaining ¼ contribution. At the average wage growth by 6.3% unit wage cost increased.

Fluctuation of domestic and especially external trade price levels showed mostly favourable effect on the economy in Q2. The growth of output prices (by 102,7 %) advancing prices of intermediate goods (102,1 %) resulted into a considerable raise of **aggregate price level** measured by GVA (103,8 %) and GDP (103,9 %) and showing positive impact on some businesses. At the level of national economy the growth of export (101,0 %) and drop of import prices (99,1 %) resulted into the trade surplus coming from favourable terms of trade (CZK 9,3 billion) which consequently resulted into the gross domestic income growth by 7.6% in real terms.

A marked growth of gross capital formation funded extensively from external sources (16.0%) owing mainly to the increased outflow of net primary income and transfers to non-residents (CZK 84.5 billion compared to CZK 58.0 billion in Q2 2006) showed a negative effect on the economy. **Gross national saving rate** (27,4 %) and **gross investment rate** (32.7 %) increased (as a result of high increases of the GDP values and gross disposable income) while the difference between them grows.

Basic economic characteristics

in %

	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2. 2007	Q3 05 to Q2 06	Q4 05 to Q3 06	year 2006	Q2 06 to Q1 07	Q3 06 to Q2 07
GDP, y-o-y change (constant prices)	6.5	6.3	6.1	6.4	6.0	6.6	6.6	6.4	6.3	6.2
Final consumption, y-o-y change (constant prices)	2.7	2.4	4.6	4.9	3.9	3.1	2.9	3.4	3.6	4.0
Gross capital formation, y-o-y change (constant prices)	15.0	13.8	10.2	11.1	10.3	6.3	9.5	11.7	12.5	11.3
Inflation rate, y-o-y, average	2.9	2.9	1.5	1.5	2.4	2.5	2.8	2.5	2.2	2.1
Registered unemployment rate, average	8.2	7.9	7.5	7.7	6.7	8.6	8.4	8.1	7.8	7.4
State budget balance / GDP ratio, %[1/]	-1.0	-0.8	-11.8	1.4	-1.1	-1.7	-2.6	-3.0	-3.1	-3.1
Current account / GDP ratio, %[1)]	-4.0	-4.8	-5.4	1.8	-4.8	-2.0	-2.3	-3.1	-3.1	-3.4
Financial account / GDP ratio, %[1)]	3.7	5.8	5.3	-0.1	1.8	2.8	2.9	3.5	3.7	3.2
Net exports / GDP ratio, %[1)]	3.1	2.6	2.2	6.6	4.6	2.9	3.1	3.2	3.6	4.0

[1)] at current prices

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

The y-o-y growth of **industrial production** (measured by the industrial production index) reached 9.1% of which the contribution of manufacturing industry made 8.9 p.p. Within the manufacturing industry the highest contribution was attributed to the manufacture of transport equipment and manufacture of electrical and optical equipment, manufacture of rubber and plastic products and manufacture of machinery and equipment.

Sales from own products and services increased y-o-y by 4.0 %, contribution of sales in ICT sectors to the sales in total in manufacturing at current prices increased y-o-y by 0.1 p.p. The **number of employees** in industry grew mainly thanks to foreign controlled enterprises. Average wage increased by 7.0 %. **Book value added** (at current prices) increased by 10.3%.

[1] Indices of GDP and its components are calculated at average prices of the previous year. Sales indices in individual industries are at constant prices of 2000, unless otherwise stated.

Electricity generation grew, y-o-y, by 6.0% and the total growth was designed for export. Domestic consumption remained the same as in the previous year, an increased consumption of big enterprises was offset by lower consumption of small consumers and households. **Natural gas** consumption dropped by 13.6 % and so did its imports. Import of **crude petroleum** (in tonnes) was 4.2% up compared with Q2 2006.

In July industrial production increased, y-o-y, by 11.5 %.

Construction output compared with Q2 2006 increased by 3.5 %, in enterprises with 20+ employees by 3.1 %. The growth was markedly lower compared with Q1 when the construction work was affected by mild winter. **Construction work carried out by own workers** (construction put in place by enterprises with 20+ employees) increased by 6.3%.

Sales of own goods and services (predominantly from construction activity) were up by 4.8%, y-o-y. The number of persons employed in construction increased by only 0.2% and their productivity was 3.3% up. Faster growth of average wage (in nominal terms by 7.6%) increased the unit wage costs by 4.2%. As to financial data, book value added at current prices produced by construction enterprises was significantly higher compared with Q2 2006.

The number and value of **construction orders** represented order books for almost 8 months by the end of June. The planning and building control authorities granted by 5.5 thousand building permits less than a year ago**,** and their estimated value was 14.4% down.

In **housing construction**, the total number of started dwellings was by 9.2% down compared with Q2 2006, the number of completed ones increased by 30.3%. This resulted in an increase in dwellings under construction of 7.8%.

In July 2007, construction output dropped by 1.7%, y-o-y.

The sales of own goods and services in **agriculture** were down by 0.4% y-o-y; at current prices. The decrease of the number of employees in holdings of agricultural primary production continued to decline. As labour productivity dropped by 1.4%, average wages increased by 6.8%. Production consumption dropped faster than output and the book value added increased by 3.7%. Numbers of cattle and pigs decreased while numbers of poultry increased. Sales of animals for slaughter increased, too.

Compared to 15 August 2007, the estimated total production of basic cereals was 6 362 thousand tones, the total of potatoes was estimated at 752 thousand and of industrial sugar beet 2 549 thousand tons (CZSO estimates). Estimated harvest of basic cereals and potatoes is in total higher compared to 2006 by 10.3% and 8.6%, respectively. Harvest of industrial sugar beet is estimated to drop by 18.8% and harvest of rape is expected to be 17.2% up compared to the previous year.

Retail sales, (incl. sale, maintenance and repair of motor vehicles and motorcycles and retail of automotive fuel) increased y-o-y by 7.5%, in real terms, in retail sales (incl. repair of personal and household goods) by 7.0% and in sale, maintenance and repair of motor vehicles and motorcycles and retail of automotive fuel by 8.3%. The number of employees in trade increased, y-o-y, faster than the number of workers. Book value added (current prices) in trade grew by 4.0%.

In **international tourism**, the total of 3.4 million guests stayed at collective tourist accommodation establishments which is by 2.3% up compared to 2006. Both the number of resident and non-resident guests increased. As a rule, Prague recorded the highest visiting rate. The growth of number of overnight stays decelerated and the average duration of overnight stays thus dropped. Four-star hotels and tourist campsites were the most successful in having clients. Visitors coming from Russian Federation recorded a dramatic increase and so did the number of their overnight stays. The active balance of tourism (as part of the balance of payments) stood at CZK 15.5 billion, which was 7.5% up.

A 10.2% growth of sales of own goods and services and goods for resale in **transport** was contributed to by all transport sectors, almost three quarters of the increase was due to auxiliary and miscellaneous activities. The number of employees in transports rose by 1.6%. Labour productivity in transport (adjusted by working company owners and assisting household members) grew faster than average wage. Book value added at current prices increased by 16.1% when outputs grew faster than production consumption.

Sales in **communications** rose by 3.7%. Employment decreased and labour productivity grew faster than average wage. Book value added grew by 1.7%.

Financial intermediation (excl. the CNB) reached, compared with Q2 2006, higher gross profit (83.3% up). Profit of insurance companies and pension funds more than doubled and that of non-banking financial institutions was three times higher. This corresponded with the average wage growth, in the sector wages increased by more than one tenth in total and reached its record value, i.e. almost CZK 43 thousand.

Sales in **other market services** were up by 4.2% owing to the growth in inter-company services. Sales in services provided predominantly to the population grew by 50% slower, the fastest growth was recorded in education. Employment in the sector rose, y-o-y, by 6.5%. Labour productivity decreased and average wage grew by 7.5%. Book value added produced was by 7.7% higher, y-o-y. Almost three quarters of total sales ware made in enterprises with fewer than 100 employees.

Sales*) in selected CZ-NACE activities

Y-o-y indices in %

CZ-NACE activity		Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 2007	Q3 2005 to Q2 2006	Q4 2005 to Q3 2006	2006	Q2 2006 to Q1 2007	Q3 2006 to Q2 2007
Industry	Current prices	113.5	116.1	117.9	107.3	108.4	113.0	114.9	117.6	113.6	112.2
	Constant prices	112.1	113.3	115.4	104.0	104.0	112.2	113.8	115.7	111.0	108.9
Construction	Current prices	109.4	111.7	121.5	130.8	108.6	108.7	109.1	113.0	117.6	116.7
	Constant prices	106.5	108.3	117.7	126.4	104.8	106.0	106.1	109.8	114.0	113.0
Agriculture	Current prices	95.6	99.8	99.0	98.2	99.6	94.6	97.6	98.3	98.3	99.2
	Constant prices	91.4	97.2	96.7	87.7	92.0	98.4	98.1	96.3	93.9	94.1
Retail trade (CZ-NACE 50, 52)	Current prices	106.7	106.3	105.8	108.8	107.6	105.9	106.4	106.6	106.8	107.1
	Constant prices	106.0	106.3	106.8	109.4	107.5	104.9	105.7	106.5	107.1	107.5
Transport	Current prices	90.6	93.3	95.6	114.2	112.3	99.9	96.0	93.0	97.4	102.8
	Constant prices	88.6	91.7	96.0	112.5	110.2	96.9	93.6	91.6	96.1	101.4
Communications	Current prices	104.0	101.1	104.7	105.1	104.1	104.7	103.4	103.5	103.7	103.8
	Constant prices	103.1	100.8	104.6	104.7	103.7	106.1	103.9	103.0	103.3	103.4
Other market services	Current prices	107.4	106.1	107.8	106.4	107.5	110.3	108.4	107.1	107.0	107.0
	Constant prices	103.6	101.9	103.6	103.1	104.2	107.3	104.9	103.2	103.1	103.2

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

The level of consumer prices in Q2 grew by 2.4% y-o-y, which was by 0.9% more than in Q1. This increase was mainly affected by growth of regulated prices by 7.2%, the biggest increase was recorded mainly for tobacco products and amounts paid by patients for drugs prescribed by doctor and net rentals, heat and water supply. Market prices rose by only 1.6%. Prices of goods were up by 2.1% and prices of services by 3.1%.

Inflation rate, measured as increase in the average index of consumer prices for last 12 months over the average for preceding 12 months, stood at 2.1% in June which means deceleration of inflation compared with March 2007 by 0.1 p.p.

Consumer prices grew by 2.3% in July and 2.4% in August, y-o-y.

Prices of agricultural producers were up by 10.9% and continued to increase by two-digit growth rate for the second quarter in a row. This was due to an intensive growth of prices for crops which were, for example, in crops and potatoes by a third higher compared with the last year. **Prices of industrial producers** rose by 4.2% which was the biggest increase recorded for the last nine quarters. Rising were especially prices in basic metals a fabricated metal products, in electricity, gas and water and in food products. **Construction work prices** grew by 3.9% and **prices of market services** by 1.7%; especially prices of inland road freight transport and business services and so did prices of real estate and renting activities.

In July and August 2007, year-on-year, agricultural producer prices grew by 11.3 % and 15.6% respectively, construction work prices by 3.6% in both months, industrial producer prices by 4.1% and 3.7% respectively. The smallest growth was recorded for prices of market services for the entrepreneurs (by 0.8% and 1.0% respectively).

Development of prices of external trade followed in Q2 the trends of the previous quarter, import prices decreased, y-o-y, by 0.4% while export prices increased by 2.8%. This trend was affected by lower strengthening of the Czech crown and on the other hand, by the drop of mineral fuels prices (in import by 4.0%). Over Q2, **terms of trade** reached 103.2 on average and showed positive value for the third quarter in a row. **World prices** of industrial raw materials and food measured by the CZSO index grew by only 1.0% y-o-y on average in Q2 2007.

Exports and imports at current prices rose by 16.3% and 14.2% y-o-y, respectively (at constant prices by 13.8% and 14.7%[2], respectively). Trade balance surplus in the amount of CZK 20.3 billion improved compared with Q2 by CZK 12.4 billion and favourable terms resulted into trade surplus in the amount of CZK 16.2 billion. Contribution of machinery and transport equipment was traditionally high (surplus increased by CZK 10.6 billion) and trade deficit in crude materials, inedible and mineral fuels fell by CZK 9.5 billion. Trade in manufactured goods classified chiefly by material and materials developed conversely (balance deteriorated by CZK 5.0 billion) and so did the trade in chemical materials and products (deficit increased by CZK 3.6 billion). As to the territorial structure of external trade, an increase in trade surplus was recorded with the EU27 states while the trade deficit with countries outside the EU increased. Contribution of HT items to imports and exports dropped while the deficit fell to CZK 8.6 billion.

In July 2007 exports and imports at current prices increased by 20.7% and 18.7% respectively, y-o-y. The trade balance in July was passive and showed the deficit in the amount of CZK 0.7 billion for the first time this year.

[2] Deflators are calculated using export price indices and import price indices by 67 groups of the SITC, Rev. 4, two-digit level.

The current account of the **balance of payments** ended in a deficit of CZK 43.0 billion in Q2 2007; the surplus of transactions in goods and balance of services stood against the balance of revenues deficit and current transfers. Compared with Q2 2006 the surplus of transactions in goods was by CZK 13.8 billion higher and the surplus of the balance of services by CZK 2.1 billion. The balance of payments financial account reached a surplus of CZK 16.1 billion except for direct investment and financial derivatives the outflow of capital was recorded for all other items of the financial account. The balance of other investment where the decisive factor is the position of commercial banks against foreign banks deteriorated. The current account deficit made 4.8% and financial account surplus 1.8% of nominal volume of GDP. Foreign exchange reserves in Q2 were lower by CZK 8.5 billion.

Foreign exchange reserves of the CNB reached CZK 665.2 billion at the end of Q2, which would be enough to cover 3.2 months' imports of goods and services.

The average **exchange rate** of the Czech ***koruna*** strengthened **against the euro** to 28.3 CZK/EUR and **against the US dollar** to 21.0 CZK/USD y-o-y in Q2. The index of nominal effective CZK exchange rate (2005 = 100) reached in Q2 104.7% and weakened, y-o-y, by 0.2 p.p. The index of real effective exchange rate of CZK (in industrial producers´ prices) strengthened, y-o-y, from 101.8% to 103.5% and signalises the trend of decreasing of international competitiveness of the CR.

The y-o-y growth of **money supply M2** accelerated in Q2 due to low interest rate and economic growth. While in March 2007 the growth of money supply was 10.6%, in June it was 11.2%. The growth responded especially to the increased loans provided to corporations and households. The drive of monetary supply growth was the monetary aggregate M1 in which the demand for transaction money increased. Quasi-money recorded slower growth. The share of monetary aggregate M1 in monetary aggregate M2 stood at 56.9% in June.

Total **loans** provided to corporations, households, government and non-residents increased in July by 23.3%, y-o-y. The development was backed especially by low level of interest rates (which increased in June) and robust growth of economy. Loans provided to non-financial corporations and households grew (by 19.2% and 31.5%, respectively) while the growth rate for corporations slowed down moderately. Housing loans increased, y-o-y, by 33.6% and consumer credits by 27.0%. Development of loans provided to households corresponded with the real estate market development.

Dynamics of total **deposits** at banks increased at the end of Q2 2007 to 12.0%, y-o-y. of which *koruna* deposits recorded an increase of 11.2% and foreign exchange deposits by nearly one fifth. Higher dynamics of foreign exchange deposits reflected mainly the external trade turnover. Household deposits and deposits of financial non-monetary corporations grew faster (by 16.6% and 20.6, respectively).

In Q2 the Czech National Bank increased its basic repo rate to 2.75%. The average **interest rate** on total **deposits** and total **loans** reached 1.29% at the end of Q2 and made 5.72% of the total amount of **loans.** The **interest margin** between total rates on loans and total rates on deposits does not tend to fluctuate significantly and reached 4.4 percentage points in the beginning of the year, 5.36 p.p. in the household sector and 3.36 p.p. in the sector of non-financial corporations.

At 30 June 2007 the population of the Czech Republic was 10 325.9 **inhabitants,** i.e. by 59.3 thousand more than a year earlier. The population growth was mainly due to active balance of foreign migration, the growth by natural population change was significantly lower. In Q1 the number of live-born children exceeded the number of deaths and natural population increase was 4.5 thousand persons. 56.0 thousand children were born which was by 3.7 thousand more than a year earlier. Over one third of children were born out of wedlock. The number of marriages remained the same as in the first half of 2006, the marriage rate remained low.

As the unemployment rate according to ILO data dropped rapidly and the employment rate grew more slowly the economic activity rate decreased in Q2 2007 (58.7%) dropped compared with to Q2 2006 by 0.5 p.p.

The **number of employees** in enterprises **with 20+ employees** of business sphere (in financial intermediation irrespective of employment) and in all organisations of non-business sphere increased by 1.0%. The average monthly gross **nominal wage** of employees grew by 7.4% and stood at CZK 21 462. Consumer prices were up by 2.4% and the average **wage** rose by 4.9% **at constant prices,** by 5.3% in business sphere and by 3.4% in non-business sphere. The wage differentiation among individual CZ-NACE activities widened (the variation coefficient was up by 2.3 percentage points y-o-y in Q2 and reached 37.2%).

The number of workers in the economy of the CR (estimate) increased by 1.6% in comparison with Q2 2006, the registered number of employees in the economy increased by 1.4% and their average wage was up by 7.2% and accounted for CZK 20 107. At the end of Q2 209.3 thousand foreign nationals were employed in the Czech Republic.

The **registered unemployment rate** was 6.3% on 30 June, i.e. a decrease of 1.4 p.p., y-o-y. There were 370.8 thousand registered job applicants, i.e. by 80 thousand less than a year earlier of which 346.8 thousand were available unemployed job applicants. The number of long-term unemployed persons dropped by 19.3% y-o-y; their percentage in the total number remained high and over the quarter oscillated around 41%. The average number of unemployed school-leavers fell by a quarter compared with Q2 2006. The job vacancy rate was 2.7% in Q2. The highest unemployment rates persist in the districts of Most (17.4%), Karviná (15.0%) and Teplice (13.0%).

The registered unemployment rate at the end of July and August was the same for both months, i.e. 6.4%.

Per capita **net money expenditures** at constant prices increased in households of employees by nearly one fifth due purchases and reconstructions of dwellings and houses, in households of pensioners it remained unchanged. The share of indispensable expenditures, i.e. expenditures on food, beverages and housing, made in households of employees 36.6% and in households of pensioners 53.1% of their total expenditure. Both shares were lower than a year earlier. Housing expenditure (excl. current maintenance and repair of dwelling) were the same as in Q2 2006 in both groups of households. Growth of rentals, consumption of electricity and other services was offset by savings in expenditures on gas and heat.

Total expenditures on **social security** increased compared to Q2 2006 by 12.3.% of which expenditures on state social security benefits by 46.2% (especially-due to the increase of birth grants and parental benefits) on social care benefits by 41% and on pensions by 8.0%. As a result of the pensions adjustment as of 1 January 2007, the average **old-age pension** amounted to CZK 9 058 in June and compared to June 2006 was 6.9% up. As the cost of living of pensioners was up by 3.0% y-o-y in Q4 2006, the average old-age pension grew by 3.8% in real terms.

In Q1 and Q2, the **state budget** recorded **revenues** CZK 483.3 billion and **expenditures** CZK 482.0 billion (expenditures grew faster than revenues), at the end of June the state budget recorded a surplus of CZK 1.3 billion (by CZK 6.4 billion less than a year earlier). The surplus in relation to nominal GDP made 0.1% and compared to Q1 and Q2 2006 narrowed. Among revenues the excise tax income decreased and so did the tax on income of legal entities and non-taxable and capital income and received transfers. The state budget could count on the growth of natural person income tax, income from social security insurance and value added tax. The state budget revenues from the EU increased by CZK 1.6 billion.

Among uses, slower growth of current expenditures accelerated capital expenditures. In terms of current expenditures the fastest growth was recorded for state social support benefits and non-investment transfers to public budgets on territorial level. Mandatory expenditures increased by 2.1% and their share in total expenditures decreased.

The biggest share in income and expenditures of budgets of territorial self-governing units is attributed to municipalities and voluntary unions of municipalities (approximately two thirds), then districts (one third) and intangible is the share of regional councils of cohesions. All mentioned groups showed a surplus at 30 June, the highest surplus was recorded for municipalities and voluntary unions of municipalities..

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Comparison of development in the CR and the EU in Q2 2007: selected harmonised indicators

Harmonised indicator	EU25	EU15	Germany	Slovakia	Czech Republic
Gross domestic product (constant prices), y-o-y change in %	2.5	2.5	2.5	9.4	6.0
Harmonised index of consumer prices (HICP)	102.2	101.9	102.0	101.7	102.6
Harmonised unemployment rate in %	6.8	6.7	6.6	10.7	5.6
Industrial production index (working days adjusted) in %	102.7	102.7	105.7	114.7	108.9
Construction output index (working days adjusted) in %	103.4	102.7	97.4	106.8	103.2
Retail sales index (seasonally adjusted) in %	107.5	102.1	99.0	109.1	108.4

Source: Eurostat (20 September 2007); calculations by CZSO