

## Summary performance of the economy

- ***The expected slowdown of the economic growth has materialized***

The slight weakening of the Czech Republic's economy, which started back in 2007 after the high growth rate of GDP achieved in 2006, continued this year with a greater slowdown than one year ago. This occurred with shifts of effects influencing the GDP, particularly on the side of resources utilization and at the same time as a result of a shift from industrial production for final consumption to production for investments into tangible assets on the side of resources creation. The main macroeconomic proportions, expressed through development of expense items of GDP in the three quarters of 2008, indicate structural changes, particularly in the proportion between the domestic economy and foreign economic operations. The relation changed between development of the domestic realized demand and the foreign demand, as well as between the domestic and foreign resources for coverage of the aggregate demand. GDP increased during the three quarters of 2008 in real terms by 4.5% year on year.
- ***Strengthening of the Czech Republic's position among EU 27***

Despite the slowdown the Czech economy retained a higher growth than the West European countries, which experienced a significant economic slump and the most recent forecasts for those countries expect a significant weakening of the prosperity or even a recession. The overall economic position of the Czech Republic in respect to EU has apparently improved.
- ***The industry accounts for the biggest contribution to the growth of GVA***

The gross value added (hereinafter GVA) increased year on year in nominal terms by 5.9% and in real terms by 4.8%, while in the 1<sup>st</sup> quarter it was by 4.9%, in the 2<sup>nd</sup> quarter by 4.7% and in the 3<sup>rd</sup> quarter by 4.6%. The changes in the structure of industries contributing to GVA indicated a slight strengthening of the tertiary sphere, particularly the financial and banking services, which was mainly a result of significant price increases. In the first three quarters the biggest GVA growth in real terms occurred in the industry (by 7.6%) and it accounted for more than one half of the overall growth. The GVA decreased in the construction industry (by 3.4%). The labor productivity measured by GVA at constant prices per one worker increased by 2.4% and thus contributed to its growth only with slightly more than one half.
- ***GDP experienced the biggest slowdown in the 3<sup>rd</sup> quarter***

The gross domestic product (hereinafter GDP) increased in real terms by 4.5% year on year, while in the 1<sup>st</sup> quarter it was by 4.7% , in the 2<sup>nd</sup> quarter by 4.5% and in the 3<sup>rd</sup> quarter by 4.3%; GDP experienced the biggest slowdown in the 3<sup>rd</sup> quarter. Also the annual GDP growth rate (annualization) indicates a slowdown of the growth. In terms of value GDP in the first three quarters achieved the year-on-year increase of 162.6 billion CZK, i.e. 6.2%, which means that the implicit deflator was exceptionally low (101.7%). The combination of effects of the physical volume and the overall price level on the increase of the GDP value significantly changed in comparison with the development in 2007; the implicit deflator indicates that the effect of volume was 73% and the effect of prices was 27% (one year ago it was 62% and 38% respectively).
- ***The strongest driving force of the GDP growth was foreign trade***

The net export accounted for the biggest contribution (3.7 p.p.) to the year-on-year increase of GDP in the first three quarters of 2008, while the positive effect of exports (11.6 p.p.) exceeded the negative effect of imports (- 7.9 p.p.). The mentioned contribution of net exports was significantly bigger than one year ago. The GDP growth in the previous year was based on consumer and investment demand, which however strongly decreased this year and their contribution to the GDP growth (0.8 p.p.) was significantly lower than one year ago. The expenses on final consumption increased in real terms by 2.5%, from which consumer expenses by households accounted for 2.9% and contributed to the GDP growth by 1.3 p.p. Meanwhile, its value structure significantly changed; the contribution by the increasing price level was significantly higher than one year ago. The household expenses grew faster than a year ago in nominal terms but in real terms their growth slowed down dramatically. In respect to expenses on consumer goods the consumers most severely cut the expenses on furniture and household furnishing. The structure of expenses on creation of gross capital substantially changed and their growth was significantly slower than a year ago. In real terms they dropped in the first

three quarters by 2.2%, from which the expenses on fixed assets increased by 5.4%. This resulted in a positive effect of 1.4 p.p. of the creation of fixed assets; the biggest growth was experienced by investments in means of transport and other machines and equipment. Creation of inventories had a negative impact of 2.1 p.p. on the GDP growth.

- **Increased coverage of domestic demand by domestic supply**

On the supply side structural changes in the first three quarters of 2008 were slightly greater than those on the demand side, which was a result of a lower year-on-year increase of inventories. The share of domestic realized demand on the total demand was 54.0% and it slightly increased year on year (by 0.6 p.p.) while the share of domestic effective supply on the total supply increased by 1.2 p.p. (to 57.7%), particularly due to the reduced accumulation into inventories. The coverage of domestic demand with domestic supply has slightly increased, as well as coverage of external supply by external demand. The value increase of the total demand and supply was to different degrees affected on both sides by an increase of domestic price level and by reduction of foreign trade prices.

- **Significant increase of domestic effective supply**

The growth of aggregated demand (8.1%) was in real terms slightly higher than the aggregated supply (7.9%) in the first three quarters of 2008 and their growth was significantly more influenced by external economic relationships than by transactions on the domestic market. The domestic realized demand weakened, particularly as a result of the slowed-down growth of real disposable income of households, especially the decrease of real wages in the non-business sphere, and it increased only by 3.3% and contributed to the growth of aggregated demand only by 1.6 p.p. The contribution of external demand growth was 6.5 p.p. The domestic effective supply significantly increased (by 7.1%) and its effect on the aggregated supply reached 3.5 p.p. The contribution of external supply amounted to 4.4 p.p. of the aggregated supply growth.

- **Considerable slowdown of the growth of gross domestic income**

Due to a major devaluation of the Czech national work on foreign markets the gross national income grew only by 2.4% in real terms, i.e. by 2.1 p.p. less than GDP. The loss from unfavorable exchange rate relations amounting to 40.9 billion CZK in the first three quarters of 2008, as compared to the profit from favourable exchange rate relations of 28.5 billion CZK one year ago, caused considerable qualitative year-on-year changes. The development of foreign trade prices also indicates that while export purchasing power in the first three quarters of 2007 increased significantly faster than the growth of import demand for resources produced by exports, in the first three quarters of this year the trend was opposite; the purchasing power of exports grew by 10.3% and the import demand for resources produced by exports increased by 11.0%.

- **GDDI is still behind the GDP growth**

The gross disposable domestic income (hereinafter GDDI) grew in the first three quarters of 2008 less than GDP, which was strongly influenced by the outflow of net primary income abroad. In terms of value, GDP was higher by 9.3% than GDDI, which had a negative impact on the gross national savings and the ratio of funding of capital expenses from domestic sources. The smaller value increase of GDDI (4.2%) than that of GDP (6.2%) with a significantly greater increase of final consumption (8.0%) was not enough to create a sufficient amount of gross domestic savings, which were lower than a year ago. The expenses on creation of gross capital were higher than gross domestic savings by 9.1%, while the percentage of savings decreased by 2.6 p.p. to 25.2% year on year and it was lower than the percentage of investments. The funding of creation of gross capital from external sources increased by 3.2 p.p. to 8.3%.

- **Increase of gross domestic savings in real terms**

GDDI grew by 2.5% in real terms year on year, i.e. less than GDP; however it grew equally as the expenses on final consumption. With regard to a considerable increase of the price level of final consumption and the lower implicit deflator of GDP the real growth of gross domestic savings was 2.6%, which means that with the decrease of creation of gross capital the rate of their financing from external resources decreased in real terms.