

19th March 2013

Summary

- During the beginning months of 2012 began the decline of the Czech economy, which gradually deepened in the subsequent periods. Gross domestic product (GDP¹) in Q1 year-on-year decreased by 0.4 %, in following quarters the drop became faster (-1.1 % and -1.5 %) and in the last three months, the performance of the Czech economy fell compared to the same period of year 2011 by 1.7 %. Year 2012 was thus for the economy of the Czech Republic the year of recession, GDP decreased by 1.2 %.
- The development of the Czech economy was the most affected by the household final consumption expenditure, which were in the last quarter lower year-on-year by 4.1 %. It was so far the deepest slump of the Czech households consumption. Their expenditure lowered for the whole year by 3.5 % in real terms, also in nominal terms they were lower in each quarter of 2012.
- Starting Q2, when also the performance of the EU economy went down year-on-year, the economic fall in the CR was in comparison to this formation deeper.
- Expenditure of the government sector experienced more favourable development during the year and following mitigating year-on-year drops they already rose in the last quarter. Still, for the whole year they decreased the rate of growth of GDP by 0.2 p. p., gross capital formation by 0.8 p. p. and household final consumption expenditure by 1.8 p.p. Positive contribution to the rate of growth of GDP in 2012 recorded only the result of foreign trade (+1.5 p.p.).
- Quarter-on-quarter development displayed moderation of the decreases noticeable from the second half of the year, mostly for the government consumption, which rose in the last three months compared to the previous period by 1 % and household consumption by 0.9 %. Final consumption expenditure thus evidenced in Q4 already quarter-on-quarter growth by 0.9 %. Capital formation also rose significantly in the last quarter (+4.8 %), however, not due to the influence of investment (-3.8 %).
- Gross value added in industries fell by 1.1 %. Only industry showed growth (+0.6 % with stagnating manufacturing industry) and the section of professional, scientific, technical and administrative activities (+4.9 %).
- External economic relations improved accompanied by high inflow of foreign direct investment and strong trade balance.
- Labour market recorded the growth of employment as well as the rate of unemployment. The cause was most likely also the shifts in types of employment (part-time jobs, contract jobs, helping family members, illicit work). Real wage in the economy fell by 0.9 %, in the non-business sector for already ten quarters in a row.
- Consumer inflation rose by 3.3 % as a result of the growth of prices of food and the cost of housing. The industrial producer as well as market services price dynamics was influenced by the economic slump, adverse effect of the terms of trade grew milder.

¹ Unless stated otherwise, data related to GDP and its components are considered in real terms and adjusted for seasonal and calendar effects.

- The rate of growth of loans markedly weakened. Inflation lead to the household deposit depreciation according to the CZSO calculations in the amount of CZK 38.1 bn crowns.
- State budget deficit shrank to 2.6 % of nominal GDP from 3.7 % in 2011. Anticipated size of the deficit was successfully reached by the binding of expenditures, renewal of the inflows from EU and improved tax receipts in the second half of the year also helped.

Overall Economic Performance

- ***Recession of the Czech economy deepened during the 2012 in year-on-year comparison...*** Economic development in the Czech Republic was in 2012 characterised by the fall of GDP. Starting with the mild year-on-year decrease in the first three months by 0.4 %, it gradually deepened in the subsequent quarters (through -1.1 % and -1.5 % in Q2 and Q3) to -1.7 % in the last quarter of 2012. Prevailing causes of the economic slump can be found mostly in the first three quarters in the weak domestic demand with limited final consumption expenditure, in the last quarter then mostly in the weakened foreign demand.

For the whole year of 2012, the economic performance fell by 1.2 % against the year 2011 (+1.9 %). Fall was mitigated by +1.5 percentage points by the foreign trade, final consumption expenditure and capital formation were on the contrary the rate of growth of GDP decreasing (-2 p.p. and -0.8 p.p. respectively). Most adverse effects came from the limited household consumption expenditure (- 1.8 p.p.).

- ***...but quarter-on-quarter, the fall slowed down beginning Q3*** In the last three months of 2012, the drop of Czech economy was compared to the preceding quarter milder (-0.2 %) in comparison to the quarter-on-quarter decreases during the year (in first three quarters by -0.5 %, -0.6 % and -0.4 %). This slowing down of fall was impacted by the quarter-on-quarter growth of total final consumption expenditure (+0.9 %), both by household (+0.9 %) and government sector (+1 %). Gross capital formation also rose (+4.8 %), but was not driven by the favourable development of investment, which quarter-on-quarter fell by 3.8 % (in Q3 of 2012 only by 1.9 %).

- ***Quarter-on-quarter fall of the CR economy in Q4 milder than in the EU and the euro area*** Also in the European context, the lowered economic performance of the Czech economy, quarter-on-quarter by 0.2 % in the last quarter, was better compared to the EU 27 average (-0.5 %) and euro area (-0.6 %). In spite of this fact, the recession lasting in the CR the whole past year was in the European comparison longer only in Slovenia, Italy and Cyprus, whose economies experienced recession for six quarters. One quarter longer than in the CR the recession lasts also in Spain and the economy of United Kingdom. The longest recession troubles Portugal with nine consecutive quarters of economic fall in a row.

Regarding the comparison of the structure of the growth, markedly worse compared to the EU average were in the CR in the first three quarters quarter-on-quarter falls of the household consumption – e.g. in Q1 by 3.1 %, against the real stagnation in EU (-0.1 %), in Q3 by -1.4 % compared to -0.1 % in the EU. However, in the last three months a turning point occurred in the CR. Households spent on consumption more compared to the preceding quarter by 0.9 %, while in the EU the household consumption decreased (-0.3 %). Notably deeper were in the CR nevertheless against the EU the quarter-on-quarter fall in investment in the last two quarters, the export dynamics fluctuated more and also the quarter-on-quarter decreases of imports were more noticeable given the deeper recession of the Czech economy.

- ***Year-on-year decrease of the Czech economy three to four times deeper in individual quarters of 2012 compared to the fall*** While in the EU economy fell to red numbers from Q2 2012 (-0.3 %) and in the last three months showed year-on-year decrease of the performance by 0.6 %, drops of the Czech economy were in each quarter several times deeper. The main cause was the drop in the Czech household consumption in the first three quarters and also the consumption of the government sector. EU as a whole then recorded in each quarter of 2012 mild additions to the government consumption. It suggests, that countries (especially Germany) tried even in the times of economic downturn not to hurt the economy by weakening the government expenditure.

in the EU

Germany sustained growth in the last quarter of 2012 (+0.4 %) despite gradual decline of the rate of growth of GDP from Q2 2011, as well as Austria (+0.4 %). Apart from the strongest European economy thus in the sample of accessible countries recorded growth also Lithuania (+3 %), Norway (+1.9 %), Sweden (+1.5 %), Switzerland (+1.2 %) and Poland (+1.1 %).

Year-on-year falls for three quarters were recorded in Finland due to the troubles of the biggest business in the country, marked fall then in Slovenia (-2.8 % in the last two quarters) and Italy with more than two percentage falls (-2.7 % in Q4). Further loss of economic performance experienced Spain (-1.9 %). Mild containment of the debt crisis in the euro area thus was not reflected in the mitigation of the European recession.

- ***Decline of household final consumption expenditure deepened throughout the year and in 2012 was one of the deepest in Europe***

Despite the consumer confidence in the Czech economy starting to show a rise from its bottom from the half of the year and given its trend values, the decreases were milder and milder, this fact was not reflected in the development of the household expenditure. On the contrary: every quarter their consumption expenditure year-on-year significantly worsened (-1.7 %, -3.4 %, -3.9 %, to -4.1 % in Q4), in declines, which are unique in the history of the Czech economy.

More intensely lowered their consumption only households in Portugal (year-on-year by more than 5 %) and Italy (by more than 4 %). In the context of the last 15 years, these are in case of the CR, as well as these countries, the deepest declines of the household expenditure across the whole Europe. They are exceeded only by double-digit drops of the household expenditure in the Baltic countries and tenth drops in Romania in crisis year 2009.

- ***More favourable development of the government consumption, weakening of the investment expenditure and the rate of growth of both imports and exports in positive values***

Year-on-year fall of the CR government sector consumption was becoming milder during individual quarters of 2012 (-3.3 %, -1.9 %, -0.4 %). In the last three months was the government consumption against the same period of 2011 by 0.8 % higher. This development is the evidence of loosening of the expenditure restrictions.

The gross capital formation fell notably in Q3 (-9.2 %), in Q4 it stagnated year-on-year (-0.2 %). Investment alone was following mild increases in first two quarters again falling in the second half of the year (-3 % and -5 % year-on-year in Q3 and Q4 2012).

Foreign trade managed to sustain mild year-on-year increases in each quarter (with the exception of the decline of imports of goods in Q3 and decline of exports of services in Q2). However, in total exports of goods and services during the year grew given a mild weakening of its rate of growth (+6.4 %, +4.1 %, +4.3 % to +1.4 % in the last quarter). Surprisingly also the imports dynamics did not weaken into a year-on-year decrease (+3.7 %, +3.1 %, +0.3 % to +1.2 %) in a situation, when the domestic demand weakened. It can be most likely explained by the still good results achieved by exporters from the CR on the foreign markets with a strong interconnection of exports and imports characterizing the Czech economy. On the contrary, in the euro area for the whole 2012 and in the EU except for a stagnation in Q2, the imports were year-on-year lower.

- ***In Q4 net exports, government consumption and inventory increases contributed to the growth of GDP, for the whole 2012 nevertheless only net exports***

From the dynamics of individual GDP components arises also their contribution to the development of economic performance. In Q4 2012 had a favourable effect, the same as in preceding eight quarters, the foreign trade. Net exports added to the GDP rate of growth negligible 0.2 p.p. (such modest contribution was last recorded in Q2 2009). For the first time in eight quarters of a negative influence, the government sector consumption contributed favourably as well (+ 0.2 p.p.). On the contrary, the household consumption lowered the GDP growth rate by 2.1 p.p. and investment also negatively contributed (-1.2 p.p.). In the opposite direction, the increase in inventory in Q4 added to the rate of growth of GDP 1.1 p.p., when in the preceding quarters of 2012 the effect of its change was negative.

For the year 2012, only net exports contributed positively to the rate of growth of GDP (+1.5 p.p.).

Chart 1 Gross domestic product (constant prices, seasonally adjusted, y/y in %)

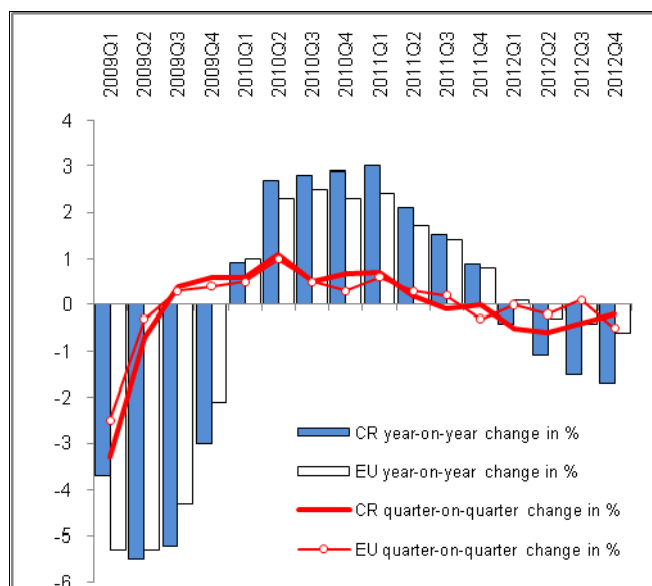


Chart 2 GDP (in current prices, y/y in %) and confidence indicators according to the CZSO Business Cycle Surveys

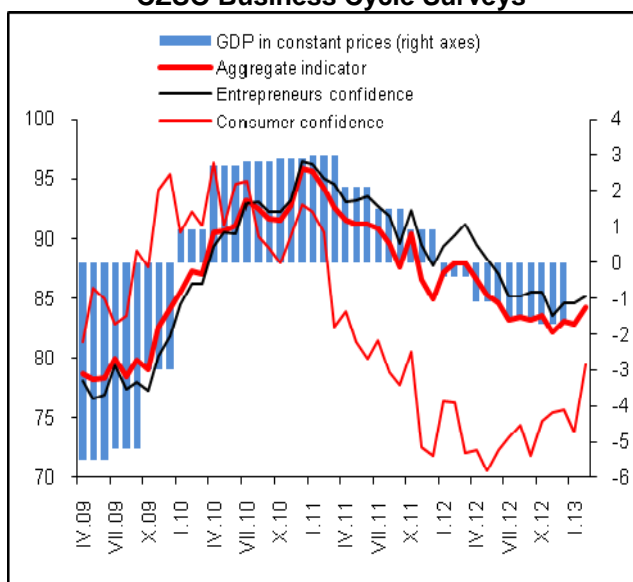


Chart 3 Contributions of expenditure components to the growth of GDP (in p.p.)

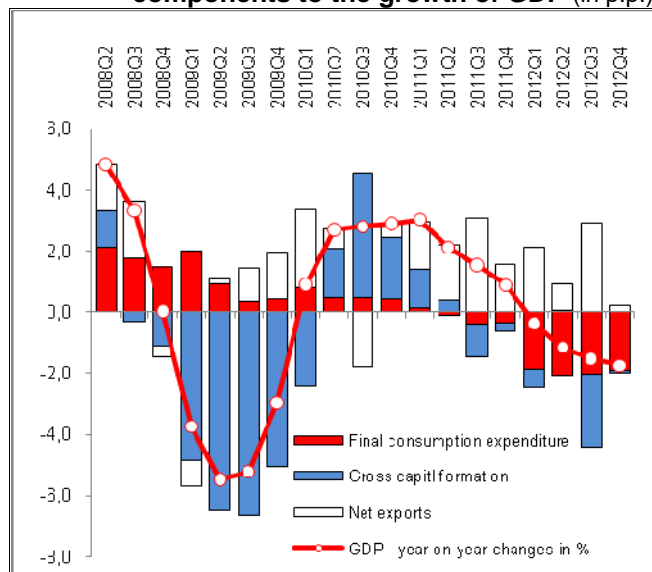
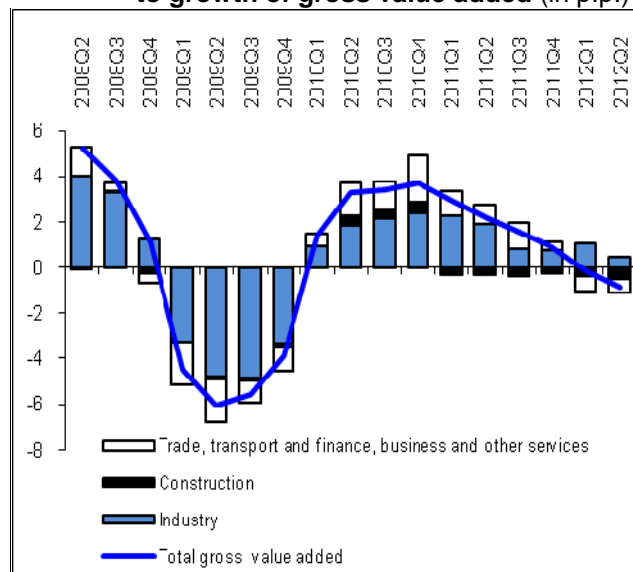


Chart 4 Contributions of industries in relation to growth of gross value added (in p.p.)



Source: CZSO

Industry Performance

• **Visible weakening of the year-on-year dynamics of gross value added in majority of industries during 2012**

The dynamics of real performance of the Czech economy industries, measured by seasonally adjusted volume of gross value added created by them, fell in 2012 based on the preliminary data year-on-year by 1.1 %. If we skip the crisis year 2009 (-5 %), it is an exceptional phenomenon during the past decade. Mild weakening of the rate of growth of created value added lasts given the negligible changes in employment in the economy for almost two years. While in Q1 the value added still stagnated, throughout the year it lowered to -1.5 % in Q3, respectively -1.7 % in the last quarter. Slowing down of its year-on-year dynamics during the year 2012 was visible in

majority of key industries – in industry (mostly manufacturing), construction, real estate activities and also the primary sector.

- **Significant year-on-year drop of value added in agriculture, construction and financial services; stagnation in industry and public services**

Long-time declines also continued in 2012 in agriculture, where the gross value added year-on-year dived by one eighth, which was the effect of worsened climatic conditions a weaker harvest (contrary to the record harvest in 2011), but also more long-term troubles of the animal production. Prolonged problems due to the lack of orders of the private as well as public character are faced also by construction (-6 %). In the most significant industry with respect to volume on the contrary the gross value added in 2012 for the whole year stagnated in real terms, in Q1 it still grew by 3.5 %. At the year's end, however, it with the same intensity declined due to the weakening of the key export-oriented fields. Different from construction, this industry coped with the drop in demand more by the reduction of working hours rather than dismissing of employees. Following the preceding favourable years, last year the gross value added in financial services lowered by one twelfth. Still, it was by one fifth higher compared to the boom year 2007, which is a sign of good long-term situation in the industry (growing employment as well as gross value added). Also other services fared well – mostly professional, scientific, technical and administrative activities (+4.9 %). Real estate industry displayed throughout the year a contrast of worsening value added (compared to 2011 by -1 %) and still strong employment (+6 %). Value added in public services stagnates in the long time period, accompanied opposite from the other services by a long-term reduction of both employment and working hours.

- **In 2011, the motor vehicle industry still managed to slow down the weakening of the year-on-year industrial production dynamics, not anymore in 2012**

Long-time weaker domestic demand in connection with gradually slackening economy of our traditional export destinations had an adverse effect on the production of the whole industry. Its dynamics has been weakening year-on-year already since the beginning of 2011. Despite marked weakening of year-on-year dynamics of industrial production (+11 % in Q1 2011), the whole industry mostly thanks to the strong rates of growth of motor vehicle industry (+15 % at the end of 2011) still kept a mild growth. In the last three months of 2011 the industrial production rose year-on-year by 2.6 %. Relatively favourable situation lasted also in Q1 2012, subsequently was the industrial production year-on-year only weakening (-0.8 % in Q2 and Q3) down to 4 % decline in Q4, which was the deepest since the half of 2009. Worsening tendency was more obvious following the adjustment for calendar days, when the aggregate industrial production after stagnation in Q3 2012 in the consequent quarter year-on-year fell by whole 5 %.

- **Motor vehicle production fell year-on-year at the end of last year below the level of whole industry**

Even though the biggest success within the framework of the whole industry enjoys in the long-term the manufacturers, last year was especially due to the development in Q2 and Q3 more successful the energetics. Less favourable development is in the long-term on the contrary experienced by the mining industry, when last year the production year-on-year fell by 4% and compared to the top of the 2007 boom weakened by one eighth. Gradual weakening of the dynamics of production was during the year 2012 obvious in majority of manufacturing industries, despite the fact, that at the beginning as well as end of the last year the year-on-year growth was still sustained by one third of manufacturing industries. Switch from growth to decreases or even deepening of decreases of production was linked mainly to industries, whose weight on the total production was the largest, i.e. motor vehicle industry, manufacturing of machinery, metallurgy, manufacturing of plastics and rubber. The largest drop was just related to the key industry of motor vehicle production, which still at the beginning of last year generated year-on-year by one eighth higher production and at the end faced already a 5 % drop. Year-on-year dynamics of production in this industry was both in Q3 and Q4 weaker than the performance of the whole industry, which happened for such a long time period since the year 2000 only for the second time (the first case was the period of deep recession between years 2008 and 2009).

- **Long-term mild decrease of production in the food industry;**

On the contrary a strong growth of production is still displayed by the chemical industry (in both Q3 and Q4 of the last year nearly by 10 %), its results are however affected by the bad year 2011, when as one of the few industries experienced the drop in production (similarly to computer manufacturers). The effect of lower

- growth of chemical industry also due to low comparable base*** comparative basis year was in the last past year quarter behind the mild year-on-year growths of production of some “smaller” industries (paper, clothing, textile industry). Thanks to the persistency of household demand, the food industry avoided larger fluctuations in production (Q4 +0.8 %, whole past year -1%), limited decline in production here however lasts already for seven quarters.
- ***Also last year motor vehicle manufacturers contributed the most to the performance of the whole industry*** Following the strong years 2010 and 2011 (+8.6 %, +5.9 %), in 2012, for the third time in the last decade, the industrial production year-on-year weakened (-0.7 %). Significant growth prevailed only in the manufacturing of electrical equipment (+10.2 %) – as the only industrial field featuring continuous year-on-year growth for the past twelve quarters. Chemical industry was also successful as well as the related manufacturing of coke and also the motor vehicle industry, whose growth (+1 %) was however compared to the year-on-year dynamics from the period 2010-2011 (21 % to 23 %) modest. Even then it thanks to its weight contributed last year to the growth of the whole industry (+0.2 p.p., the year before however nearly 4.5 p.p.). The largest contribution however recorded in 2012 the manufacturers of electrical equipment (+0.6 p.p.).
 - ***Deep declines in metallurgical industry and computer manufacturing*** On the contrary due to the sales troubles, the manufacturing of computers (-18.8 %) fell markedly – nearly by one fifth – compared to year 2011. By one tenth lower was also the production of metallurgical factories and iron foundries. Weakening motor vehicle manufacturing negatively affected the production of plastics and rubber (-2.1 %), recession in construction then on the manufacturing of other non-metal mineral products (-4.2 %). Deeper falls did not avoid last year also the manufacturing of furniture (-4 %), wood (-7.9 %), clothing (-5.1 %) or pharmaceutical and typography industry.
 - ***Last year slump of Czech GVA weaker than in the whole EU; better results of our neighbours*** The depth of year-on-year decline of industrial production in 2012 in the CR did not reach the level of the EU (-2.1 %) and was placed near Germany or Hungary (-0.8 %). At other neighbours however the industry grew, mostly in Slovakia (+10 %), which still takes advantage from the completing expansion of the motor vehicle industry. Last year production of the Czech industry was in real terms at the level of year 2007, similarly to Germany. In Austria it was 5 % higher, in Poland then by one fifth and in Slovakia it exceeded the level from before the recession by one quarter.
 - ***At the end of last year 2 % year-on-year fall of industrial companies sales both home and abroad, similar development also for orders*** The rate of growth of sales of industrial companies is closely related to the development of production. Sales from direct exports fare in the long-term better than domestic sales, in Q3 2012 however fell to the lowest level for the past three years (year-on-year +0.5 %) and declined with its rates of growth to the level of domestic sales. Domestic sales include also indirect exports via non-industrial firms. Gradual weakening of sales in industry peaked at the end of last year, when domestic sales as well as sales from direct exports year-on-year fell in consensus by 2 %. Still, for the whole past year the industrial companies received more, especially via the direct exports (+3 %), domestic sales stagnated.
 - ***Sharp worsening of the value of new foreign orders in the motor vehicle manufacturing during the past year*** Gradual weakening of the year-on-year rates of growth during the 2012 affected also the new industrial orders, the total fall in dynamics was however due to the slower development for the domestic orders smaller than during the year 2011. Last year's development of orders copied the situation for sales, in Q4 their value year-on-year weakened by 2 % without larger differences between the domestic and foreign as well as the industry as a total and motor vehicle manufacturing. Parallel drop of both domestic and foreign orders in the whole industry occurred for the first time since the half of the year 2009, for motor vehicles for the first time since the beginning of year 2009. The development of industrial orders for manufacturers of motor vehicles was on the foreign markets at the beginning of last year still promising (Q1 +23 %, Q2 +14 %). On the stable growth of orders on the domestic as well as foreign markets could in the whole past year rely the chemical industry, continuous growth of foreign orders was kept also in the textile and pharmaceutical industry as well as electrical equipment manufacturing and manufacturing of metal constructions.
 - ***The long term*** Not even the development in 2012 did bring any signs of change for the better in the

downturn of building construction as well as civil engineering construction still lasts

construction. Construction production has been in real terms year-on-year falling for fourteen quarters in a row (except for Q1 2011, when the mild growth of production was the result of very low comparative basis of the previous year), last yearly growth was in the industry recorded in 2007. The falls in production were within the year of 2012 relatively evenly dispersed, both in building construction and civil engineering construction (apart from deeper year-on-year fall at the beginning of the year of -18 % due to the adverse climatic conditions). More affected was last year (the weaker with respect to volume) civil engineering construction (-11 %), whose downturn is compared to the building construction (-6.5 %) deeper continuously since the half of 2010. Last parallel year-on-year growth of both building construction and civil engineering dates to the end of Q3 2008 boom. Compared to the period of peak boom (2007), last year the production of the civil engineering construction was in real terms lower by 5 %, for building construction then nearly by one quarter.

• **Deep fall in value of new orders in civil engineering construction also continued last year; the average value of order keeps falling**

Construction companies faced for the whole last year a large shortage of new orders. For the whole year, their value fell² year-on-year nearly by one fifth, to the lowest level since year 2001. Only in the last past year's quarter the value of orders stagnated, as a result of very low comparative basis. In the civil engineering construction the value of new orders fell last year year-on-year nearly by one third, compared to the peak of boom by one fifth. Building construction then the value of new orders in comparison to year 2007 lowered by more than one third, despite the fact, that for the whole last year it stayed at the level of year 2011. Even in the last year continued, if by the lower pace, the decreasing of the size of construction orders. The average value of one new closed order amounted to 3.8 mil crowns (it fell by one third in three years). The trend towards smaller orders in time of recession in the industry confirms also the decline in the average value of one granted building permit, mostly for new construction and non-housing buildings.

• **Total value of all not yet realised public construction orders lowest since 2000**

Also in 2012 the continuous decrease of value of all construction orders continued (year-on-year by 2 %, compared to year 2007 by one quarter). As opposed to the preceding years, the deep reduction of domestic public orders (whose volume arrived at the end of last year to 73 bn crowns and was the lowest since 2000) was last year accompanied also by mild 1 % fall of total volume of private orders (even these were in comparison to the peak boom by one tenth lower). Domestic construction firms managed in the latest years gain orders from abroad (their share in total orders is only one tenth), one half of the stock of all orders still represents the public sector. The lack of large orders takes its tax since the beginning of 2009 in the form of reduction of registered members of employees³ (in companies above 50 employees), whose numbers were year-on-year by 4 % lower, during four years even by 14 %.

• **Record low number of started dwellings, mostly in multi-dwelling buildings**

Last year's number of started dwellings (23.9 thousand) reached the low level of half of 90s and reacts thus to the lowered demand connected to the oversaturated market with a higher number of dwellings completed in times of boom (yearly around 40 thousand) as well as lower number of clients, who do not acquire dwellings for their own housing need. Less dwellings were year-on-year started in all types of buildings except for non-residential buildings and community care service homes (there were started the most dwellings since the year 2007). The number of completed dwellings thus following the deep fall in 2011 last year increased year-on-year by 3 %, still it was the second lowest since the year 2004. To the growth contributed mainly the flats in multi-dwellings buildings (more by one tenth), community care service homes and converted non-residential rooms, the number of flats in family houses stagnated. A one third of flats were completed on the territory of Prague or Central Bohemian region.

• **Last year Czech construction**

The depth of year-on-year fall of construction production in 2012 in the CR slightly exceeded the EU level (-5.3 %) and was comparable to Hungary (-6 %) or Spain.

² Orders are monitored for construction businesses with 50 and more employees.

³ Does not include neither persons working on contract on work and on work activity nor working business owners. Employees of agencies, which are in employment, however not in the construction field are also not included.

production year-on-year below the level of most surrounding countries as well as EU average

Deeper falls were recorded in Slovakia (-12 %) or Netherlands (-9 %). However, other neighbours achieved in construction industry better results (Germany -1.8 %, Poland -0.3 %, Austria +1.5 %). Similarly to the CR, in most countries was more affected the civil engineering construction. Last year's production of domestic construction industry was in real terms by one fifth below the 2007 level, similarly to Slovakia or the whole EU. German construction however produced by one eighth more, Polish by one third. On the contrary, in Hungary the production fell for the last five years by one third and in Slovenia or Spain by more than one half.

• **Weakening demand of households in the long term slows down the retail sales of food**

Last year was in sign of gradual decline of retail sales in real terms and lowering of formerly significant differences between the year-on-year dynamics of its various segments. Retail sales (incl. automotive segment) last year in real terms weakened by 0.9 % following the growth of 1.7 % in the previous year. With the exception of Q1 they were for the remaining part of 2012 slightly decreasing. In line with the consumer confidence indicators in the CR, they are decreasing by a stable rate regardless of the type of shop the sales for food (already six quarters in a row, in Q4 2012 by -1.7 %, for the whole year by -2.4 %). The performance of the whole industry was not much improved even by the more than two years lasting slight growth of sales for non-food products (+0.8 %, stagnating in the last quarter).

• **Stably high year-on-year growth of real sales of internet shops and prolonged troubles of stall sales**

Out of the specialised shops, as a result of marketing strategies and better results in the second half of the year, high growth of sales was sustained by internet and delivery sellers (+9 % for the whole year, preceding two years +12 %). Sales strategies on the contrary started to lose their effect for computer and communication equipment, whose year-on-year growth of sales during the this year's quarters weakened from 16.5 % in Q1 to 3.2 % in H2 (when it even reached a two-year's minimum). On the other hand, in the long-term the shoe and leather industry keeps good results (last year +5.6 %) as well as culture and recreation products, pharmaceutical, health and textile goods, even though the rate of growth of their sales in real terms was compared to 2011 slightly more modest. For a long time suffers the stall sales and retail sales with food, beverages and tobacco products in specialised shops, whose sales in real terms slumped since the beginning of the economic recession in the CR by one fifth.

• **Slowing down of rate of fall for petrol station sales**

Due to the more favourable development through the holiday period (+1.5 %) the year-on-year fall of real sales at petrol stations slowed down last year to -1.6 %, which was the lowest fall for the last four years. It occurred in a situation of long-term fall of sales for repair and maintenance of motor vehicles (-3 %) and ceased two-year growth of their sellers (-1 %).

• **Last year's sales of Czech retail food sellers below the EU level; for non-food products and fuels the opposite**

Mild last year's year-on-year decrease of real sales in retail (excl. automotive segment) ranked the Czech Republic next to its neighbours: Germany and Austria (by -0.2 % to -0.3 %) and near Slovakia and Poland (-1 %) as well as whole EU (-0.8 %). Deeper decreases were recorded in Slovenia and Hungary (-2 %), out of the most developed countries Denmark and Netherlands (by -2.5 to -3 %). The range of EU was from the Baltics and Luxembourg (+6 % to 8 %) to Greece (-12 %). Retail sales of food fell last year in the CR below the EU level (-0.9 %) as well as most surrounding countries: Germany (+0.2 %, Austria +0.8 %), Poland and Hungary (-1 %), the fall was deeper in Slovakia or Slovenia (-5 %). The sales of non-food products and fuels reached last year better results in the CR than in the most of our neighbours or the whole EU.

Stagnating aggregate sales in services shade the notably differentiated development in partial fields

Services similarly to construction has not as yet managed to overcome the year-on-year decreases resulting from crisis in 2009. Also in 2012 they continued in mild year-on-year fall of the sales in real terms (-0.7 %). Administrative and support service activities fared the best, since the worsened situation on the labour market adds to job agencies (+15 %, for the last three years the sales grew by one half), administrative and office activities also grew slightly. Thanks to the connection to industry, the warehousing also achieved good results (+5.7 %), in the long term good results are experienced also by computer and programming activities and creation of programs

and broadcasting, which together with postal and courier activities belonged to the few fields, whose sales last year exceeded in real terms the level from year 2008.

The size of real sales achieved 4 years ago exceeded last year only 5 out of 26 partial fields of services

Wakening tourism helped also by the use of discounts to increase the sales in real terms for accommodation (+4.8 %, similarly to year 2011) following consecutive growths for ten quarters in a row, which also brings profit to travel agencies (+2 %). However, in catering and hospitality the sales decreased (-5 %), they have been consecutively falling already since the beginning of year 2008. Sales for professional, scientific and technical activities fell compared to the end of boom period nearly by one third. Sales for real estate activities achieved similar results (linked also to performance in construction) and also the telecommunication industry, in both cases they weekend in four years in real terms approximately by 15 %. Despite growing arrivals of foreign tourists, the sales of heavily hit air transportation weakened last year by 7 %, since the boom they slumped by one quarter.

Chart 5 Industrial and selected manufacturing fields production (y/y, in %)

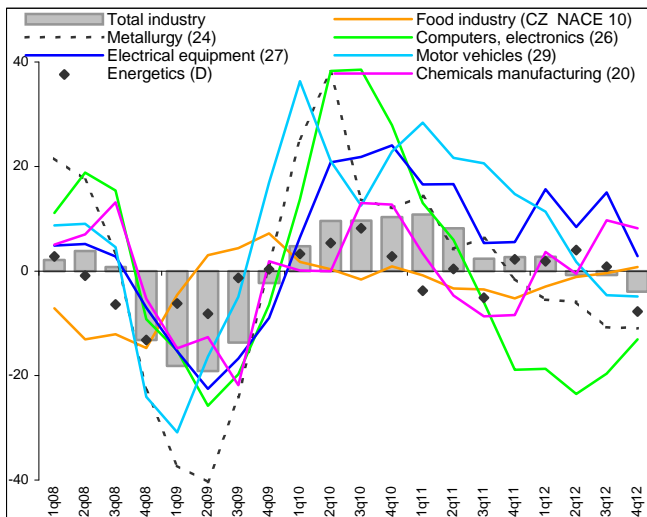


Chart 6 Value of new motor vehicle manufacturing and total industry orders (y/y, in %)

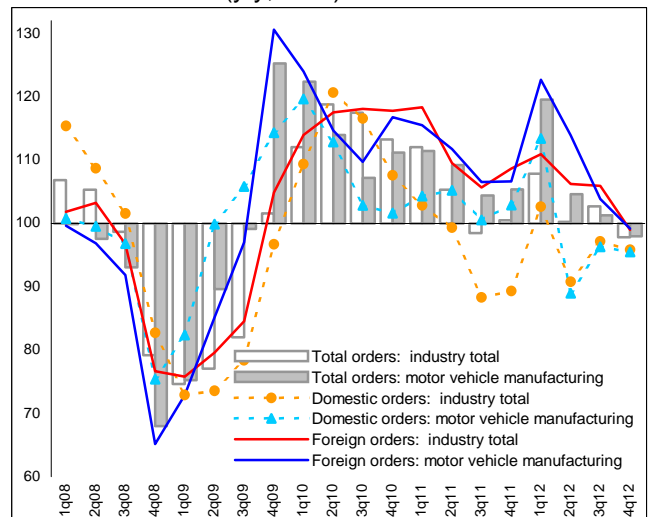


Chart 7 Construction production and value of new orders (y/y, in %)

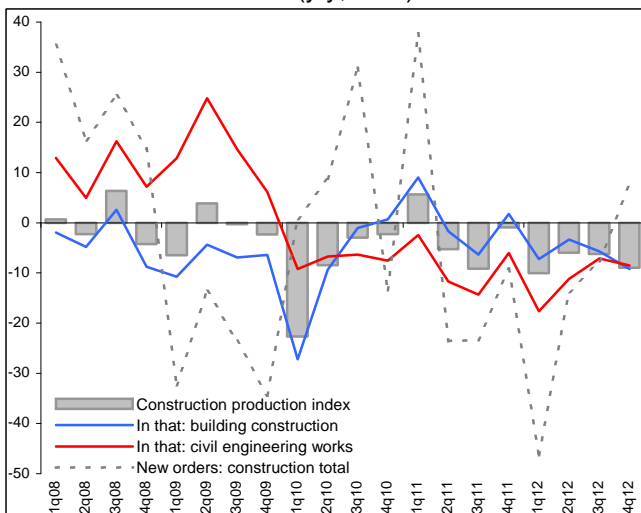
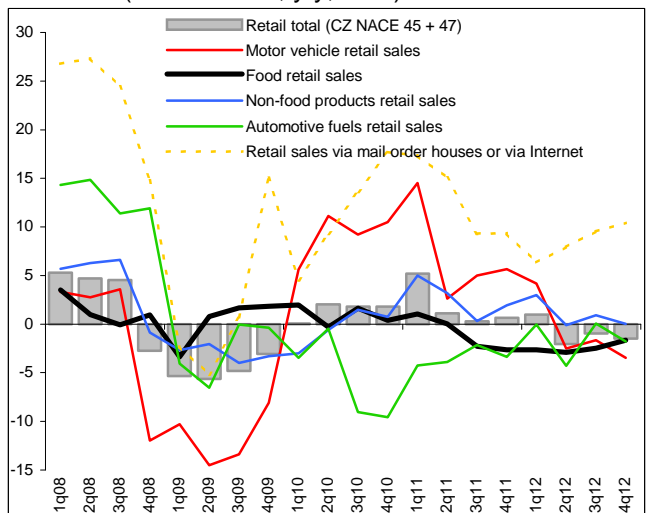


Chart 8 Retail sales incl. automotive segment (in real terms, y/y, in %)



Source: CZSO

External Economic Relations

- **Further improvement of external imbalance of the Czech economy in 2012**

Year 2012 marked further improvement of external economic relations of the Czech Republic. Current account deficit of the balance of payments finished below the boundary of hundred billion (-94 bn crowns) compared to year 2011 (-103.9 bn) and 2010 (-146.6 bn crowns). The cause was mainly in the high positive trade balance, resulting from the higher decrease of the rate of growth of imports of goods (due to economic recession) than the rate of growth of its exports. Financial account surplus (+121.7 bn crowns) was adequate to cover the deficit current account of the balance of payments, whose deficit amounted to 2.4 % of nominal GDP. The result is again better in comparison to year 2011 (2.7 %) and significantly better than in 2010 (3.9 %).

- **Markedly more favourable result of goods trades while worsening of the services balance**

It was the high surplus of the trades in goods balance that caused that the performance was the highest in history, in spite of the result of imports and exports of services (+49.8 bn crowns) year-on-year weekend and arrived at the lowest level since 2006. At the same time the revenues from services were more or less growing. Previous year-on-year losses of income from transportation and tourism (-0.3 bn crowns, resp. -0.2 bn crowns in 2011) in 2012 turned into growth – strengthened not only the transportation revenues (+3.9 bn to 100.8 bn crowns), but also the tourism (+2.1 bn to 137.8 bn crowns). The additional revenues from services (+22.3 bn to total 431.9 bn crowns) was however not adequate to their heightened imports, especially for so called other services and it resulted in worsened balance.

- **Following the improvement in 2011 the income deficit again increased**

Income balance recorded a deficit of 288.7 bn crowns compared to 255.5 bn in 2011, when it improved for the first time. In connection to the influence of foreign direct investors in the CR there were 306,5 bn crowns transferred outside the country, which was by 36.8 bn crowns more than in 2011.

The result of current transfers had an adverse effect on the external relations, with a balance of -1 bn crowns, due to the lower income from abroad (81.7 bn against 85.6 bn crowns in 2011), already for the second year in a row. Effect also had a lower drawing of the European funds – only in Q4 however an improvement occurred in this direction (year-on-year +10.4 bn crowns), following the three quarters of deficit current transfers in the amount of 7.9 bn crowns. Transfers of funds out of the CR in 2012 were year-on-year stagnating (82.6 bn against 82.8 bn crowns in 2011).

- **Domestic direct investment the highest for the last five years**

The inflow of foreign direct investment into the Czech Republic (207.4 bn crowns) was the highest in the last five years. Investors here increased mostly the reinvested profits, but also the equity of their companies by 181.8 bn crowns. In contrast in 2011 there were inflows into the CR of direct investment only in the amount of 41 bn, in that 18.8 bn crowns was directed to reinvested profits and investment into equity. On the contrary Czech firms invested abroad over 26 bn crowns, the most since the year 2009.

- **Trades of portfolio investors strengthened the inflow of funds into the CR...**

It was the strong inflows of direct investment into the CR that resulted in a significant surplus on the financial account of the balance of payments (121.8 bn crowns). The account was also supported by the inflow of funds in the form of portfolio investment (net +42.6 bn crowns) due to the notably strengthened purchases of Czech bonds on the part of foreign portfolio investors (net 71.9 bn crowns).

- **...the development of other investment had however significant adverse effect, mostly short-term foreign operations of commercial banks**

Different from the inflow of direct and portfolio investment into the Czech Republic, the funds of so called other investment went in the opposite direction, in net 110.6 bn crowns. It represented mostly the short-term foreign operations of commercial banks lasting the whole year. At the end they lead to the outflow of funds via active trades in the amount of 41.5 bn crowns, on the passive side then in the amount of 22.5 bn crowns. In total, these operations of commercial banks meant in 2012 an outflow of funds from the CR amounting to 64 bn crowns. Similar development, even though in the smaller range, eventuated also in the year 2009.

Balance of other sectors (apart from the government) meant in the short-term other investment also an outflow of funds from the CR (-22.4 bn crowns), but not as

extensive as in the mentioned operations of commercial banks.

- **Slowing down of exports mostly in the second half of the year; exports to markets outside the EU form already nearly one quarter of the union exports**

Exports from the Czech republic in the national conception rose in 2012 in nominal terms compared to year 2011 by 7.2 % displaying a decreasing trend during the year (+11.6 % in Q1 to +2.5 % in Q4). Given the main destinations, this average rate of growth (also approximately by quarters) was sustained by Czech exporters by the Slovakian market, on the contrary the exports to Germany rose in a year only by 4.6 %, even though in the last quarter it already fell year-on-year. It occurred even for in relation to value much weaker exports to China (from +34 % in Q1 to ending -1.1 %, for the whole year 2012 then by +11.3%). On the other hand, the rates of growth of exports to Russia remained strong, with Czech exports placing to this territory by 31.9 % more goods than in the year 2011 (in Q1 more by one half).

This territorial diversification lead to the growth of exports outside the EU markets (+20.6 %), whose value approximated one quarter of exports to the union. The dynamics of exports to the EU remained in 2012 below average (+4.4 %) given the weakened exports to the euro area (+3.5 %).

- **Slower rate of growth of exports of machinery and transportation vehicles, faster for food and industrial consumption goods; exports of motor vehicles year-on-year slumped in the last quarter**

There were in 2012 exported machinery and transportation vehicles in the value of 1.234 trillion, i.e. 48 % of the aggregate value of exports. Year-on-year increase of 6.5 % (in Q4 only by 0.5 %) was however lower compared to the rate of growth of total exports (+7.2 %). Above average exports was achieved by the exporters of industrial consumption goods (+10.2 %) and other commodities (23.1 %). The exports of food grew strongly (+18.1 %) – in traditionally strong exports of grain in years of favourable harvest - , but also beverages (+15.2 %). Food exports inc. beverages however form only 5 % of the total exports from the CR.

Exports of motor vehicles were hit hard by the weakened mostly western European demand and subsequently also the domestic industrial production – while in Q1 there were year-on-year in total by 17.6 % of motor vehicles exported more, in the last quarter their export was by 2.6 % lower. Year-on-year the exports of motor vehicles increased by 7.1 %.

Chart 9 Long-term development of selected components of the balance of payments (in mil CZK)

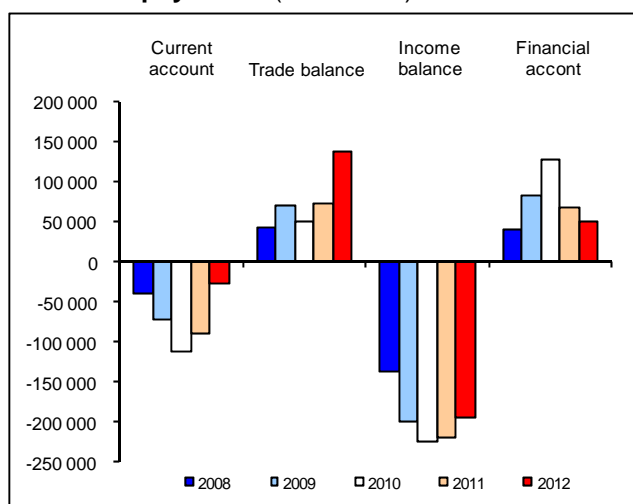
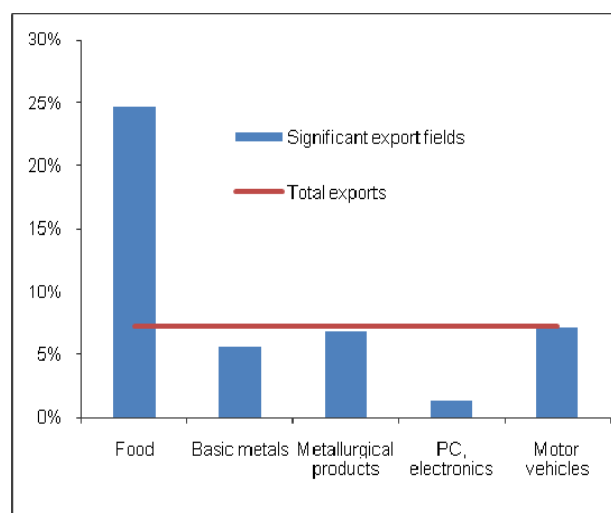


Chart 10 Rate of growth of largest export commodities (2012, y/y, in %)



Source: CNB

Prices

- **After two years again growth of the price level in**

Aggregate price level in the Czech economy expressed by the implicit deflator in 2012 following mild decreases in the previous two years year-on-year grew by 1.3 %. Lowering of GDP was thus in 2012 nearly deeper in constant prices than in current

- the whole economy* prices. Opposed to the year 2011, bringing near the import and export price dynamics weakened the negative effect of the terms of trade. Aggregate price level in the economy was thus more markedly affected by the growing producer prices in industry and agriculture. Consumer inflation was pushed up mostly by the prices of food and housing.
- *Marked slow down of rate of growth of agricultural producers due to the settling of prices of plant production***

Prices of agricultural producers were in 2012 characterised by the opposite direction of development for plant and animal production with the overall gradual settling down of prices of plant production. Prices of agricultural producers thus in total increased for the whole year by 4 % (after nearly 20 % year-on-year growth in the preceding year pushed by the sharp growth of plant production prices), hiding however the imbalanced development within the last year. While in the first half of the year 2012 the prices were staying slightly below the level of the previous year thanks to the lower prices of plant production (affected by the high comparative basis), afterwards they again renewed the strong growth from the previous year. Year-on-year higher were at the end of the year mostly the prices of oleaginous crops by 20 %, grain and potatoes (by 29 %) and vegetable (by 31 %). The development of prices of animal production is compared to the plant production less volatile, last year it added 5 % and grows mildly already eleven quarters in a row. Prices of eggs grew by 55 %, pigs by 17 %, beef by 10 % and poultry by 4.5 %. Only the prices of milk decreased (-6 %). Compared to 2005 the prices in agriculture were higher by one quarter, while the prices of animal products became cheaper in six years by 3 %. For plant production however, the prices were by more than one half higher, with the prices of fruit growing by one quarter, prices of vegetable on the contrary fell by one tenth.
 - *Industrial prices were pressed up for the whole year by high dynamics of prices of coke, oil products and chemicals***

The rate of growth of industrial prices in 2012 from the record growth in the preceding year year-on-year decreased the pace to +2 %. For the whole year, the industry was impacted by the growing prices of coke and refined oil products (+10 %), chemicals and chemical products (+7 %) and also the development in the food segment (+3.5 %), where the manufacturers reacted to the higher prices of primary producers (including milk products, where on the contrary the manufacturers reacted by the reduction of prices due to the effect of decrease of prices of milk producers). Against the year 2011 the year-on-year rate of growth gained pace in water services (+8 %), these prices were increasing also in times of the deepest recession – compared to year 2005 they were higher last year by nearly one half, while in the whole industrial segment they increased only by 17 %. Opposed to this, the economic downturn was last year reflected in the decrease of prices in mining and quarrying and also for manufacturing of computers and electrical and optical equipment.
 - *Tough fight for orders pushes down the prices of construction works despite higher prices for materials***

Prices of construction works last year continued in regular mild decline (-0.6 %), despite growing prices of used construction materials and products (+1.1 %) against +2.8 % in 2011. Prices of construction works fell under high pressure due to the effect of low demand and shortage of large public orders and they have been falling year-on-year for almost three years – weakening of their dynamics however lasts already since the Q2 2008. Against the year 2005 however, the prices of construction works were higher by more than one tenth.
 - *Economic slowdown lead at the end of the year to the deflation development of market services prices***

Prices of market services have been losing dynamics already since the end of the year 2011 and due to the deflation development in the second half of 2012 they recorded a yearly decline of 0.6 %. Last year, lower were especially the prices significant by weight for advertising and market surveys (-3.1 %), architectonic and engineering services (-2.6 %) and also the telecommunication services. Prices for financial services were on the contrary increasing (+2.4 %, without insurance and pension financing). Mildly more expensive were also the services in the area of programming and advising, as well as freight transportation. In seven years the prices in the whole segment of market services increased by nearly one tenth with the highest growth of prices for advertising services and market surveys (by one third), by more than one fifth increased the prices for postal and courier services and programming and advising.

- **Year-on-year rate of consumer prices at the highest level for past four years; high growth of the most weighted components of consumption and significant effect of administrative prices**

In spite of gradual weakening of year-on-year dynamics of consumer prices during the last year the price increase reached for the whole year 2012, according to the average rate of inflation gauged at +3.3 %, the highest level in the past four years. Price development together with the low valorisation of pensions and modest growth of wages in most industries had a common effect on the downturn of consumption behaviour of population. Three most significant components given their weight in the consumer basket have been increasing their prices for the past three years above the level of aggregate consumer inflation and were among other also reflected in the higher increase in the index of cost of living of households of pensioners (it arrived at 4.6 % in 2012). Last year the prices of food experienced the highest growth (+6.6 %, mostly fish, meat, milk products and eggs), also the prices of non-alcoholic beverages were year-on-year higher by one tenth. In the area of housing the total prices of energies rose (+8.6 %) as well as those of other services connected to housing (+8 %). In the long-term the prices of rents grow, which added last year 4.3 % (in Prague 4.1 %), they increased against the year 2005 similarly to prices of energies by two thirds (in Prague by one half). The highest growth featured in 2012 the prices for health (+9.3 %), for the third time in the last five years.
- **Weakening of year-on-year dynamics of consumer prices during the year**

Given the most significant consumption components by weight, the growth of prices continued in 2012 in transportation (+2.8 %), where contrasted the strong growth of fuels (+6 %) and transportation services (+7 %) with the decline in the prices of motor vehicle purchases. Last year also confirmed the long-term fall in the prices of clothing and footwear, household equipment, telecommunication services and partially also the recreation and culture (apart from newspapers, books and holidays with complex services). The largest effect on the aggregate inflation had also last year the housing and food with beverages (2.5 p.p.). One third of aggregate size of inflation was due to the goods and services with administrative prices, which by themselves grew year-on-year by 8.7 %. Saving strategies of households were obvious last year even on the deepening drop of retail sales or transfers to other cheaper providers of services connected to housing.
- **Domestic HICP was kept above the EU level for the whole year by record high growth of prices of food and beverages**

The harmonised index of consumer prices (HICP) remained in the CR above the level of euro area as well as the EU for the whole year 2012. Growth of HICP for food and beverages was last year in the CR the most dynamic in the whole EU. Consumers in the CR however as opposed to those from the EU could profit from the decrease in prices of clothing and footwear and also the housing equipment. The growth of prices of alcoholic beverages and tobacco also fell among the lowest within the EU. Prices for recreation and culture, which includes among other the weakened demand in times or recession, in the EU similarly to the CR last year stagnated, they decreased the most in Bulgaria (-4.6 %), Greece and Ireland, they recorded the highest growth in the so-far facing the crisis well – Germany (2 %).
- **Weakening of HICP dynamics in the second half of year visible in most EU countries**

Weakening rate of growth of consumer prices was typical for the most EU countries, during the year 2012 the year-on-year price growth grew stronger only in Romania (from 2.4 % in H1 to 4.4 % in the second part of the year 2012) and Bulgaria, among other largest economies by a slower pace also in Netherlands and Spain. Last year's weakening of HICP dynamics was recorded also in the most countries of central Europe (Poland the most), Austria remained without changes (2.6 %) and Hungary, which was at front of EU countries for the year 2012 with 5.7 %.
- **Negative effect of terms of trade as a whole weakened...**

Adverse effect of the terms of trade in the foreign trade, typical for the last three years, weakened in the last year. Terms of trade reached the value of 98.8 % and were by 1.3 p.p. more favourable compared to the previous year. Export prices increased the pace of their year-on-year growth to 2.9 % (from +1.7 % in 2011), while the import prices grew by 4.2 % (keeping the dynamics of 2011). For exports, out of the more significant groups the prices rose last year for chemicals (+4.8 %), miscellaneous manufactured articles and food (both +4 %). Imports were dominated by higher prices of food (+6.7 %), chemicals (+3.6 %), machinery as well as transport equipment (+2.7 %) and mostly mineral fuels and grease, whose growth dynamics against the year 2011 weakened by one third, but still it did not stop last year's year-on-year growth of
- **... whether it**

deepened for mineral fuels and grease and ceased its positive effect in foreign trade with food

more than 15 %.

Adverse effect of terms of trade on the result of foreign trade is typical for mineral fuels (last year it deepened to the worse level since 2006), it also worsened after two years of positive effect for food. On the contrary, the improvement occurred for raw materials, whose export prices last year grew by 3.5 %, while import fell year-on-year by 2.5 %.

Chart 11 Consumer prices indices, administrative prices and selected social groups of households (year-on-year development)

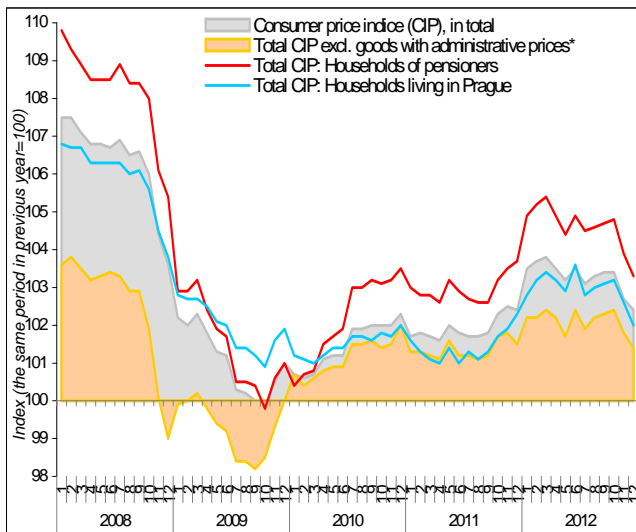


Chart 12 Consumer prices indices (year-on-year development)

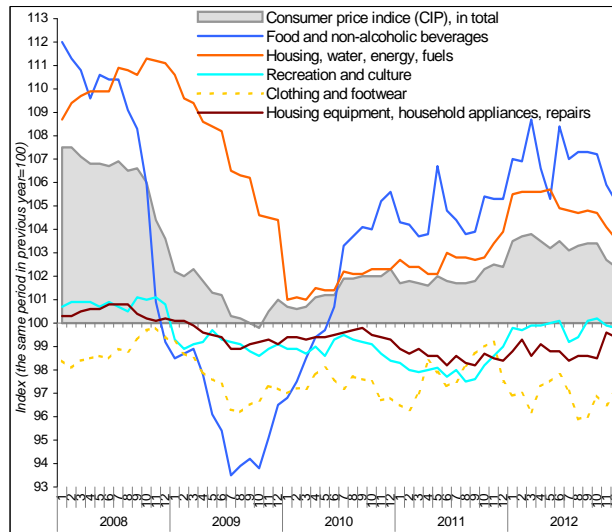


Chart 13 Producer price indices (year-on-year development)

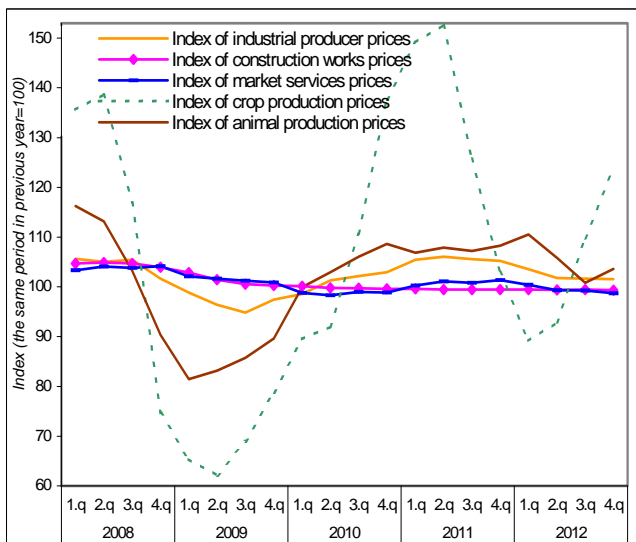
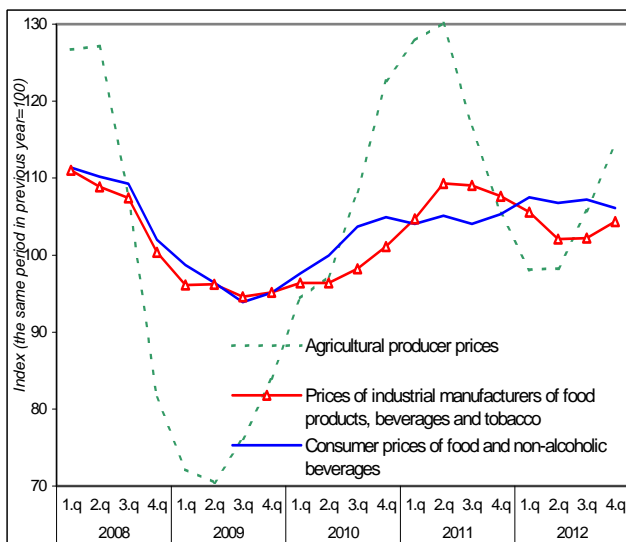


Chart 14 Price indices on various levels of food chain (year-on-year development)



Source: CZSO

Labour Market

• **“Paradoxes” of Czech labour market in 2012**

Situation on the Czech labour market was characterised in the year 2012 by several on the first sight opposing phenomena. In spite of the economy finding itself according the development of GDP in recession, the rate of employment has been continuously growing for already several quarters in a row. Simultaneously, the number of registered persons without a job strongly grows and the rate of

unemployment is increasing. These phenomena can be explained at the micro level of the labour market and are connected to the usage of alternative types of work opportunities compared to those, which are given by an employment relationship or entrepreneurship. Apart from the employment, the atypical development also occurred in Q4 in the sphere of wages.

- **Total employment in 2012 increased and its additions during the year accelerated**

In 2012 there were – according to the data from the national accounts conception – total of 5 091.5 thousand of persons working in the CR, i.e. by 0.39 % more than in 2011, when the employment also rose (+0.26 %) following two years of year-on-year decreases (-1.78 % in 2009 and -1.02 % in 2010). In addition, the growth of total employment accelerated during the year, lead by its improvement in industry (still the numbers of employed were for the whole year 2012 lower). Dynamics of the strongest grouping given the employment, i.e. trade, transportation, accommodation and hospitality was on the contrary throughout the year 2012 weakening.

- **Decreases of employed in industry, agriculture, construction and public services, additions mostly in trade and transportation**

Apart from industries where the number of employed persons in 2012 decreased, i.e. in agriculture (-1 %), industry (-0.3 %), construction (-1.1 %) and public services (governance, defence, education and health and social care) by 0.4 %, in other industries the employment grew. In that the most in activities in the real estate area (+5.8 %), in financial services and insurance services (+4 %) and in total for professional, scientific, technical and administrative activities (+2.1 %).

The most new workers were absorbed by trade (12 thousand), which gives work to more than one quarter of employed in the Czech economy, as well as the industry – here however the job places were disappearing in 2012 (-4.2 thousand of persons). Decreases of job positions in some fields were not as deep as in 2011. E.g. public services, which cut over 31 thousand of job positions in the last four years (in that 16.8 thousand in 2011) recorded in 2012 a loss of 3.6 thousand of employed persons. In construction the number of employed has been falling already for three years in a row (in total -26.9 persons), in that in 2011 over 14.3 thousand of persons and in 2012 further 5.2 thousand of persons.

The working as an employment relationship however as opposed to the total employment has been decreasing for four years in a row. In 2012 however only one thousand of employees left (compared to 17 thousand in 2011 and 89 thousand in 2010), the most in public services (-6.2 thousand), in construction (-6.2 thousand) and manufacturing industry (-5.9 thousand).

- **The number of employees falling year-on-year**

A group of persons without the employee status thus participated on the growth of aggregate employment in the CR economy, composed not only by entrepreneurs (physical persons with Identification Number), but also helping family members, people working on work contracts and working activity contracts and owners of business companies (whose main activity is the work in this company). It can be assumed, that it is this group strengthening the total employment in the CR even in times of economic recession.

In 2012 there were 955.8 thousand of persons working, which was by 21 thousand more than in 2011. In percentage terms, the highest increase was in financial services (+8.3 %), public services (+7.1 %), activities in the real estate area (+6.5 %) and also in so called other activities (+5.9 %), i.e. in total +15.2 thousand of persons.

- **General rate of unemployment increased, it stayed lower compared to the EU and the euro area**

General rate of unemployment according the methodology of the International labour organisation increased during the year 2012 to 7 % of population aged above 15 years, following 6.7 % in 2011 and 7.3 % in 2010. During the year 2012 it grew gradually seasonally adjusted from 6.8 % in Q1 to 7.2 % in Q4. In the EU 27, there were by the end of 2012 10.7 % of people without a job, in the euro area 11.8 %. One digit rate of general unemployment recorded in the EU apart form the CR also 11 another countries (the lowest was in Austria 4.7 %, Luxembourg 5.2 % and Germany 5.3 %). In Greece and Spain, more than one quarter of people were without a job (26.4 % resp. 26.1 %).

- **Historically the highest number of registered persons without a job**

The number of registered persons without a job increased in December 2012 to 545.3 thousand of persons (by the end of February of 2013 then to 593.7 thousand of persons). The rate of registered unemployment at the year's conclusion arrived at 9.4 %. The growth started only in September (8.3 %), till the half of the year the rate of registered unemployment was falling. The number of job vacancies in reality for the whole year stagnated, which indicates that the growing employment can be ascribed in most part to the works done on contracts, helping of family members etc.

- **Reserves in the flexibility of the CR labour market**

The labour market in the CR still displays large reserves, with respect to its flexibility. According to the Eurostat data for year 2011, e.g. the part-time jobs were used by 32 % of employed women in the age of 25-54 caring for one child, in the CR only 11 % women (for females with no children this ratio was 22 % to 4 %).

- **The growth of average nominal wage in Q4 result of tactics of firms in connection to the legislative change...**

The average monthly nominal wage in 2012 increased compared to 2011 by 665 crowns to 25 101 crowns, i.e. by 2.7 %. It grew faster in the business (+2.8 %) than in the non-business sector (+2.2 %). Despite the year-on-year increments of wages decreasing during the first three quarters, in Q4 a significant rise occurred especially in the non-business sector (e.g. in financial services and insurance industry nearly by one quarter). It can be assumed, that this largely atypical development had a connection with the tactics of employers to use the so far favourable legislation for the provision of extraordinary benefits. Similar effect, however, with „the opposite sign“ occurred in year 2008, when in its Q1 the average wage in the business sector grew year-on-year by 11.4 % due to the transfer of benefits, which were paid out standardly in Q4 of the previous year („ceiling“ of paid social insurance for high income employees).

- **...was not expressed in the non-business sector and lead here to the drop of real wage for already ten consecutive quarters**

In the non-business sector this effect did not occur. The drop in the rate of growth of the average nominal wage continued also in Q4 2012.

As a result the decrease of the real wage for year 2012 (-1.1 %) was maintained for the second consecutive year – following the real stagnation in 2010 and continuous declining lasting already ten quarters – and it was deeper than for the real wage in the business sector (-0.5 %). Average wage in the economy thus fell in real terms by 0.6 %, even though in Q4 the above mentioned reasons caused its temporary addition (+0.9 %).

Chart 15 Aggregate employment and number of employees (y/y in %, seasonally adjusted)

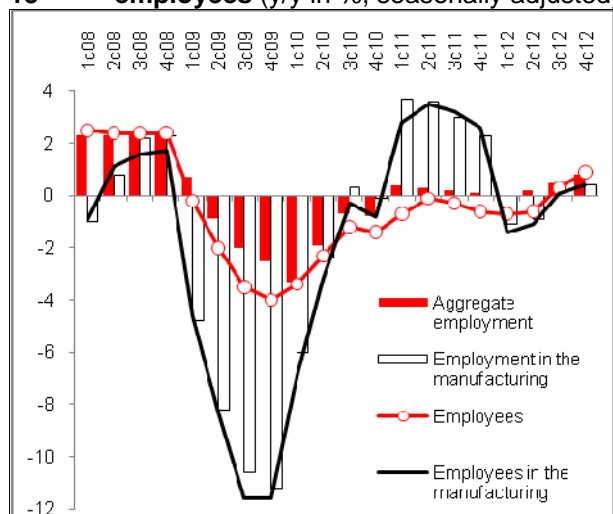


Chart 16 Nominal and real wage (y/y in %, to recalculated numbers, monthly average)

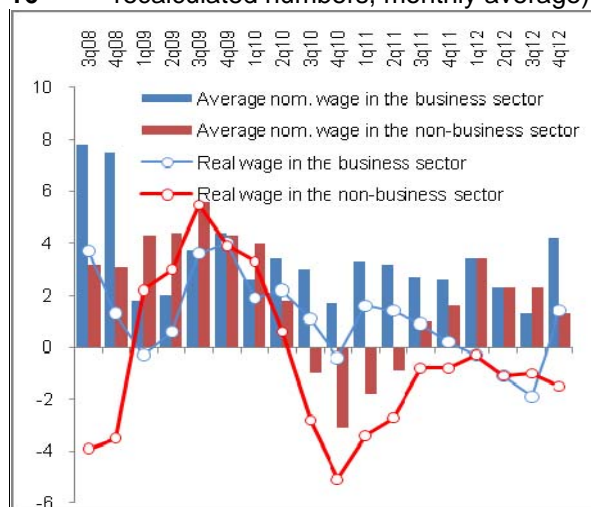


Chart 17 Number of persons without a job (in thousand) and registered rate of unemployment (in %)

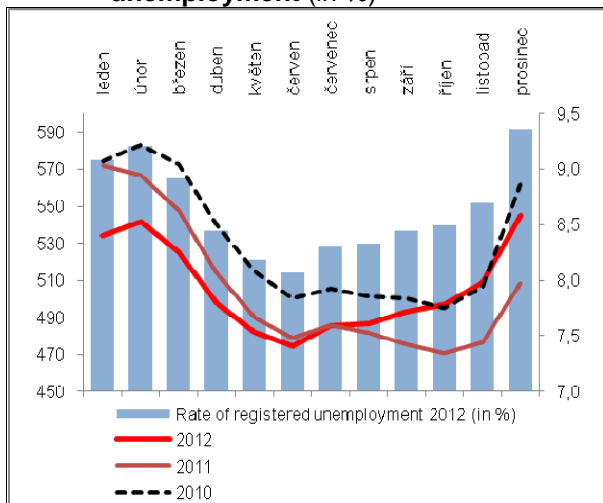
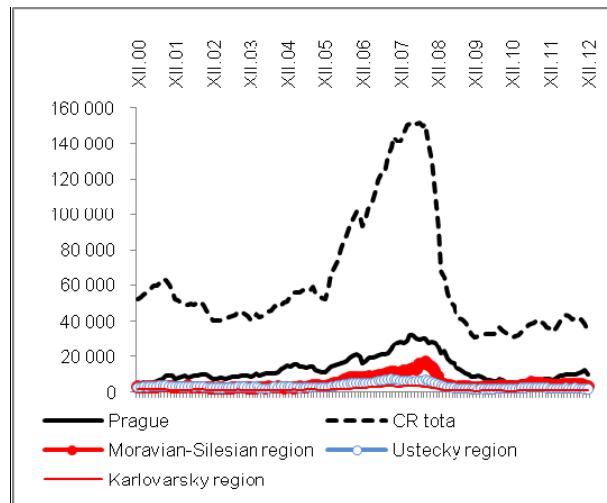


Chart 18 Development of the number of job vacancies (selected regions)



Source: CZSO, MLSA

Monetary Conditions

- High range of depreciation of household and businesses deposits**

Monetary conditions were characterised by practically zero prices of money, which however did not enhance higher loans given the uncertainties for the business sector in anxiety over weak demand, for consumers then the distrust flowing from the worries related to the possible job losses and an adverse development of wages. Due to the development of the inflation rate and low nominal interest rates, the bank deposits of households and businesses were in 2012 depreciated in the amount of 54.3 bn crowns. The central bank tries to support the growth of not only “money for free”, but also the faster growth of money stock (M2 year-on-year +4.5 %) in comparison to the real stagnation of the growth of nominal GDP (+0.1 %). Expansive monetary conditions thus continued.

- Loans grew the slowest for the past ten years**

Shrinking of the loan activity on the side of the business sector and further significant limiting of its dynamics of loans to households lead together with the lowering of net credit of the government sector to the result, that the domestic credit grew in 2012 compared to 2011 only by 1.4 %, i.e. by 34 bn crowns. In the preceding two years their additions amounted to 218 and 116 bn crowns. “Freezing” of credit depicts the uncertain situation in the economy and little optimism especially regarding the investment.

Credit to businesses grew year-on-year only by 0.9 % after +5.1 % in 2011, loans to households by 4 % (the least since year 1998). Together the credit to businesses and households increased year-on-year by 2.6 %, which was the lowest increase since year 2003.

- Decline of the balance of consumer credit**

The balances of consumer credit provided to households have already decreased for the second year (-0.7 %), even though the fall was not that deep as in 2011 (-1.9 %). It is most likely not only the effect of rational behaviour of households with a will not to indebt themselves further this way, but also the stricter assessment of the solvency of clients on the side of banks. Lower indebtedness of households for consumption caused the fall mainly of the consumer nonpurposed-credit (-1.2 %), which form more than three quarters of household consumption debt. On the contrary, the liabilities on credit cards grow (+2.1 %) and somewhat also the debit balances on overdraft accounts, by 0.1 %. The transfer of indebtedness to the sphere outside the official statistics cannot be yet reliably confirmed, however it can be observed from the growth of these most expensive debts.

- **Growth of credit for housing only thanks to mortgages, balances on building savings accounts fell again**

Credit for housing in 2012 further increased (+4.8 %) after 6.1 % in 2011 following the favourable development of prices on the real estate market. It can be presumed, that these loans were applied for mostly highly solvent clients – many of whom were acquiring the real estate for investment purposes - , since the total increase in credit for housing was affected only by mortgages provided (+6.3 %). Balances of loans from building savings societies were year-on-year lower (bridging by 6.8 %, standard credit from building savings by 4.3 %), while these are decreases second year in a row (-17.3 %, resp. -4.3 % in 2011).

- **Growing balances on non-term deposits markedly enhance the size of depreciation of overall client deposits**

In 2012, the aiming of money to nonterm deposits with higher liquidity continued – for households (+8 %) as well as businesses (+12.4 %), with a higher rate of growth compared to 2011 (+7.4 %, resp. +6.5 %). Together the demand deposits grew year-on-year by nearly one tenth (+9.6 %).

It is the concentration of money on the demand deposits that causes, due to the effect of negative real interest rates, its depreciation on a massive scale. In 2012 it took away from households⁴, as a result of higher inflation rate in comparison to the level of nominal interest rates from the size of their non-term deposits – whose balances reached by the end of 2012 1.102 bn crowns – over 26.8 bn crowns. It was more than the sum of depreciation of these deposits for the previous three years together. Further 11.3 bn crowns households lost this way on the term deposits (deposits on maturity and notice period).

Depreciation of deposits of businesses amounted in 2012 a total of 16.2 bn crowns, while the largest share had the depreciation of balances on their current accounts (by 13.6 bn crowns).

- **Crown depreciated**

Crown in 2012 weakened against the main currencies roughly to the level of 2010. The exchange rate against euro was on the yearly average 25.143 CZK/EUR, towards dollar 19.583 CZK/USD. Strong depreciation was obvious especially against dollar (-10.7 %), milder against euro (-2.3 %). The development of the crown exchange rate was probably connected with the worsening of fundamentals of the Czech economy in 2012.

Chart 19 Deposits of businesses and households (y/y in %)

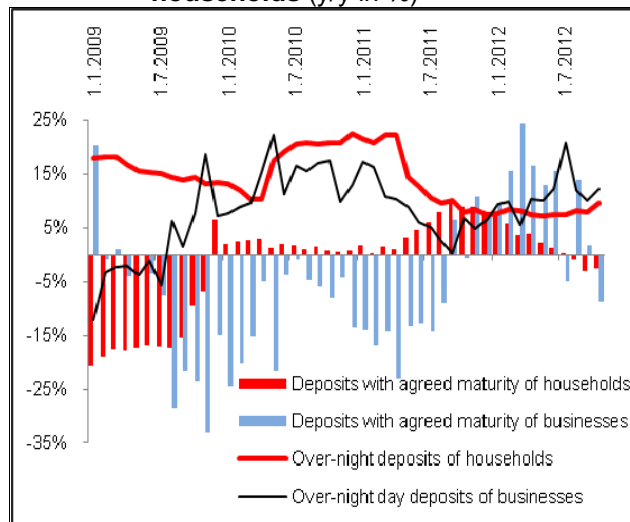
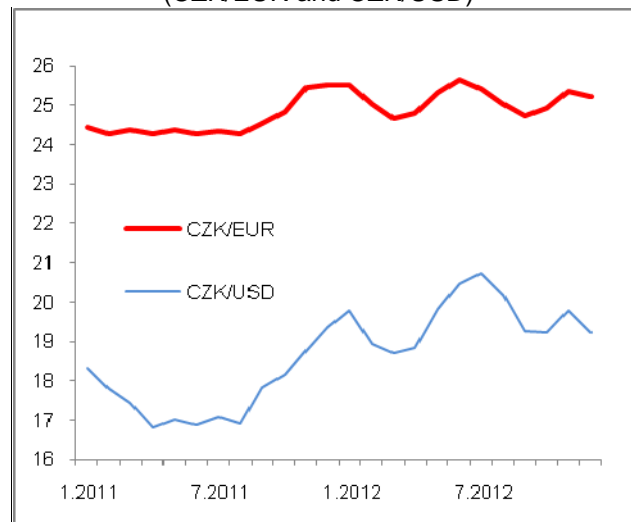


Chart 20 Czech crown exchange rate (CZK/EUR and CZK/USD)



Source: CNB

⁴ Incl. non-profit institutions serving households

State Budget

- *Planned size of state budget deficit achieved thanks to the binding of expenditures; renewal of inflows from EU and improved tax revenues in the second half of year also helped***

State finances finished in 2012 with a deficit in the amount of 101 bn crowns. The deficit was against the anticipated approved budget by 4 bn crowns lower and confirmed the trend towards gradual reduction of the deficit commenced in 2010. The size of last year's deficit was in comparison to the record year 2009 by nearly one half lower, in the twenty year history of independent CR however it was the fifth deepest deficit. The state managed the finances worse in the first half of the last year (deficit - 72 bn crowns). In the remaining part of the year it was possible to tame the finances by the binding of expenditure and renewal of payments for some operational programs from the side of the EU. Year-on-year improved of total balance of the last year given the real stagnation of total expenditure (year-on-year by -0.3 %) ensured the higher revenues of the state budget (+3.8 %), both in tax and non-tax area. Despite year-on-year growth the last year's revenues did not fulfil the budget anticipations by nearly 40 bn crowns and keeping the planned deficit had to be achieved by almost later added saving of current expenditures in the amount of nearly 45 bn crowns. Weak growth of nominal GDP in 2012 highlighted the improvement of state budget deficit to 2.6 % of GDP from 3.7 % in 2011.

- *Non-filled anticipations regarding the indirect tax revenues connected mostly to the decrease of private consumption***

Contributions to year-on-year growth of total revenues came more or less in a balanced manner from higher tax revenues (+22 bn crowns) as well as non-tax and capital revenues (+16.7 bn crowns). The more favourable balance in tax area was positively affected by the improvement of revenues from taxes significant by volume – mostly VAT and taxes on legal person income in the second half of the year. Budget anticipations were thus after all fulfilled for majority of taxes apart from the excise taxes (-2.7 bn crowns) and VAT, with missing nearly 22 bn crowns. Lower revenues for VAT was linked to the longer-term decline of private consumption, which was last year reflected mostly for goods and services in the basic tax rate.

- *Yearly revenues of consumption taxes were helped by the end of the year by the pre-stocking of cigarette sellers***

Even the year-on-year nearly one tenth higher receipts from electricity manufactured in photovoltaic plant were not enough to improve the revenues from consumption taxes, since for the key items the revenues somewhat decreased (tax on mineral oils by 2.5 %) or stagnated for the most part of the year (tax on tobacco products). High prices of fuels in combination with the slowing down of foreign trade growth were reflected in the lower transportation performance. In case of tobacco products, the increase in rate valid from January, did not lead for the most part of the year to a higher revenues also due to the long-term fall of the cigarette consumption. Yearly revenues of this tax (+4.5 %) thus saved the last quarter, with a marked effect of the pre-stocking of producers related to this year's change of the tax rate.

- *Revenues growth of corporate tax due to low base of 2011; worsening of personal income tax reflects the troubles of labour market***

Among the direct taxes the revenues from corporate tax achieved good results (+8.4 %), however it was affected by a very low comparative basis of 2011. Last year's revenues from corporate tax thus stayed nearly one third below the level of the same period of 2008, for personal income tax the revenues were lower by 5 %. Revenues from personal income tax showed last year markedly more modest year-on-year growth (+2.2 %). Revoked tax exemption for the interest revenues on deposits in building savings had a positive impact on budget. On the contrary, the higher discount on tax for families with children had opposite effect. Revenues from personal income tax worsened from year-on-year increase by 6.4 % in Q1 to drop of 0.1 % in the last quarter compared to the same period in 2011.

- *Improvement of drawing of European funds at the end of year***

Growth of budget revenues outside the sphere of taxes (+13.6 %) was influenced mainly by the revenues from the EU budget, which were for the most part of the year suppressed as a result of stopped payments of some operational programs⁵. State received also by nearly one third more on court fees, also lottery payments were higher.

⁵ Especially the renewal of certification for expenditures of the Operational Program Environment and Transportation and subsequent reimbursement lead in the last quarter of 2012 to a marked strengthening of state receipts from the EU budget (+31 bn CZK). Nearly 36% of

- **Nearly 42 % of state expenditures were directed to the social payments; their year-on-year growth by 10 bn crowns went in full to retirees**

Total budget expenditures were year-on-year lower by 0.3 % and given the real stagnation of current expenditures, the capital expenditures (-5 %) put a more intensive mark on the overall results. Current expenditures were most burdened by pensions (+3.8 %). However, other types of social payments brought savings due to the more strict conditions for their allocation: sickness benefits (2.1 bn crowns) as well as the unemployment benefits (1.6 bn crowns). The number of registered job applicants was in 2012 on average by 1.5 % higher year-on-year. Also expenditures on the active policy of employment fell to a two third level of the previous year.

Worsened economic situation lead only to the mitigation of long-term decrease of expenditures on state social support benefits (year-on-year by -1.5 %). More than 50% year-on-year decline of the state contribution to building savings saved this year nearly 5.5 bn crowns to the state, against the year 2005 the contributions were at their one third level. On the contrary, the state contributions to pension insurance grow in the long-term, even though with a slowing pace. For this year their amount (5.7 bn crowns) for the first time in history exceeded the amount of contributions to building savings and reflects the long term change in the state policy in preferring various forms of savings, but also the behaviours of consumers themselves (legislative changes in the pension insurance aided at the end of the year again enliven the interest in this product for small savers). To all social payments were directed last year 41.7 % of state budget expenditures, year-on-year (after the adjustment from the methodical influence) by nearly 10 bn crowns more. This increase went however in full in the benefit of expenditures on pensions (+14 bn crowns), which cut already 79.5 % of all social payment expenditures (last year by 1.5 p.p. less).
- **Gross expenditure on state debt two times higher than in 2006 and formed one half of investment expenditures**

On the wages of its employees the state spent year-on-year by one percent more, due to the marked reduction in the previous year it was an amount comparable to the period six years ago. Non-investment transfers to semi-budgetary organisations, less important in volume, as well as to state funds also rose mildly. Expenditures on state debt also rose (to 57 bn crowns) – year-on-year by 2.5 %, in six years even two times and their size corresponded in year 2012 already to nearly one half of resources the state exerts on all capital expenditures. Outflows to EU budget (39 bn crowns) decreased by 4 % following the previous years of growth.
- **Weakening of revenues from social insurance at the end of the year significantly worsened the pension account deficit to 52 bn crowns**

Balance of pension account, expressed as the difference in budget revenues in the form of social insurance to pensions (year-on-year +1.3 %) and paid out pension payments (+3.8 %) deepened year-on-year nearly by 10 bn crowns. Its size achieved nearly one half of overall balance of state budget and was the deepest in the whole last decade. Marked worsening occurred in the last past year's quarter (for the first three quarters the balance was year-on year worse „only“ by 1.8 bn crowns) by the decrease of receipts (-0.5 %) with the concurrent growth of expenditures (+8 %). Lower revenues from social insurance also reflect the worsened situation on the labour market. The size of paid out pensions was affected by their valorisation (increase in the percentage rate of a pension by 1.6 % from January 2012), partially also the long term mildly growing number of pensioners.
- **The decrease of capital expenditures ceased after the removal of troubles with operational programs**

The capital expenditures continued even last year in their long-term decline. They decreased year-on-year by 5 %, in two years by one eighth. Transfers to State fund of transport infrastructure (in the amount of 28.7 bn crowns) lowered year-on-year by one sixth. The most investment was drawn on the pre-financing of programs financed together with the EU. The slump of investment expenditures grew stronger in summer months, on the contrary following the renewal of some operation programs, in October and November the funds in the amount of 27.5 bn crowns were freed and drawing of the capital expenditures thus got from the beginning of the year nearly to the last year's level.
- **Net positive position of the CR towards the EU last**

Net positive position of the CR towards the EU despite the issues with drawing in 2012 significantly improved to record 73.8 bn crowns (out of last year's 30.8 bn). The received amount (113.7 bn crowns) in 2012 was constituted in 2012 especially by the

this year's receipts from the EU fell into the last three months of the year.

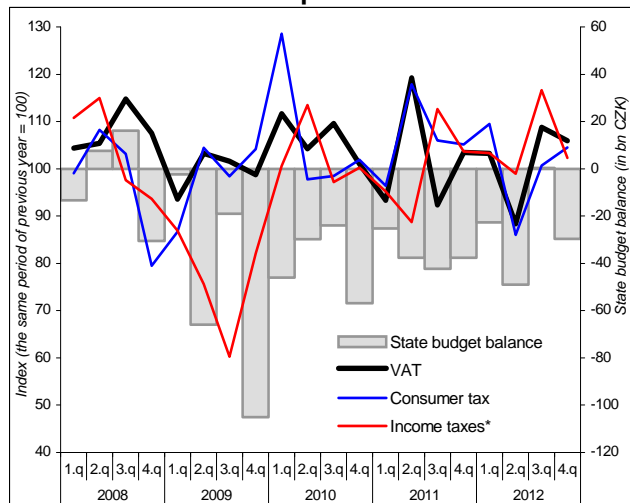
year on the historical maximum, since the accession to EU it arrived at one quarter of trillion crowns

structural actions (Structural funds 44.3 bn and Cohesion fund 37 bn) as well as funds for agriculture (29.7 bn crowns with the highest share of direct payments, i.e. 18.7 bn and money on the rural development in the amount of 10.5 bn crowns). In comparison to the preceding years the Cohesion fund increased significantly its share in the total allocation. For years 2004-2012 the CR paid into the EU budget 301.2 bn crowns and received 551.2 bn crowns. Since the accession to the Union the CR thus so far gained in net a quarter of trillion crowns.

• State budget deficits in the CR belong lately to the more favourable than the EU average; deeper deficits had e.g. Slovakia or Slovenia

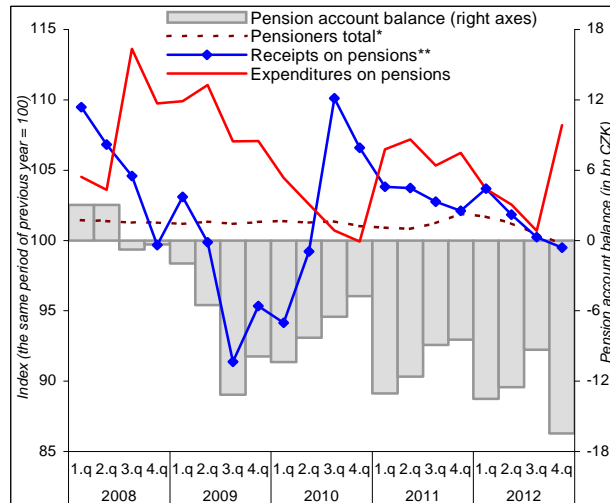
In times of across the world recession (2009 – 2011) the CR with the depth of reached deficits of public budget stood in relation to GDP better (-4.6 %) than countries of the euro area (-5.5 %) or the whole EU (-5.9 %). From the surrounding countries, the better results were achieved by Austria (-3.7 %) and Germany (-2.7 %), considerably worse by Slovenia (-6 %), Poland and Slovakia (both -7%). Balanced public finances in this period sustained only Sweden. Also for the three last year's quarters, the deficit placed the CR (-2.5 %) in the union area among countries better managing their finances, even though the close Poland and Hungary reached according to the preliminary data slightly lower deficits (-2 %). These were traditionally deeper in Slovenia and Slovakia (-4.5 % to -4.7 %) and surprisingly also in Austria (-4.9 %). Euro area countries similarly to the whole EU achieved 4 % deficit, in Greece, Ireland and Spain the deficits deepened even to 10 % of GDP. On the contrary, mild surplus recorded only four economies, mostly on the north of Europe. The government sector deficit reflects apart from the result of the state budget also the results of regional budgets and social security funds.

Chart 21 National tax revenues and state budget balance development



*income taxes of natural or legal persons

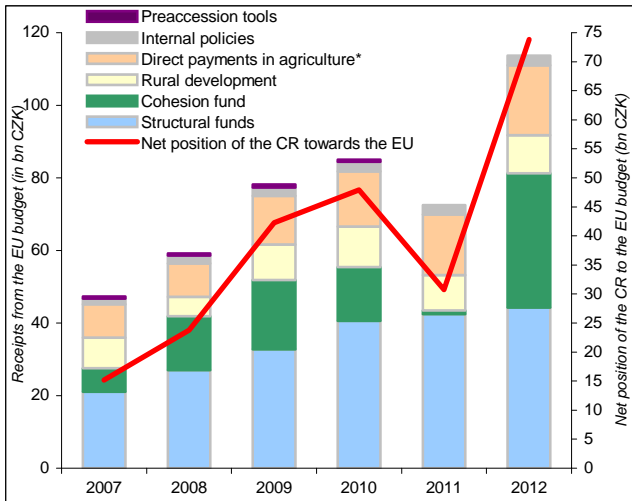
Chart 22 Pension account balance and development of the number of pensioners



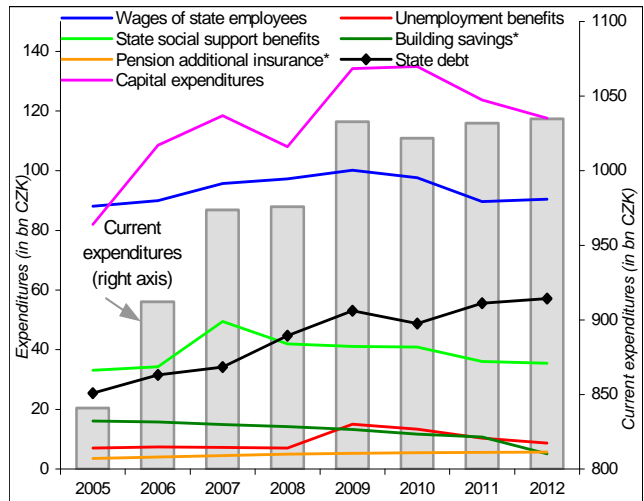
*recipients of pension insurance benefits
** from pension insurance premiums

Chart 23 Receipts of the CR from the EU budget and net position of the CR to the EU budget

Chart 24 Selected types of state budget expenditures in 2005-2012



* incl. veterinary, fishery and market operations



* contributions paid to households from state budget

Source: MF CR

Sources of data for the entire analysis: Czech Statistical Office (CZSO), Czech National Bank (CNB), Ministry of Labour and Social Affairs (MLSA), Ministry of Finance (MF), Eurostat, CZSO's calculations.

Latest information from the CZSO, CNB, MLSA sources given in this report are dated the 7th of March 2013.