2. Economic and Monetary Development in the CR

2.1. Trend of Prices

- ***Long term decline in the growth of consumer prices***

Long-term price development features a decreasing year-on-year rate of growth of consumer prices. In the course of the transformational recession of 1990-1993 consumer prices grew on average by 23.2 %. In the 1994-1996 expansion, inflation reached an average rate of growth of 9.3 % p.a. A further slowdown of consumer prices down to 7.1 % occurred in the economic dip of 1997-1999. Subsequently, consumer prices grew in 1999-2003 on average only by 2.5 % p.a. Exceptionally low growth of inflation of 0.1% was attained in 2003.

- ***Continuous changes in the structure of inflationary factors***

Relevant factors affecting the price movement included in particular monetary and exchange rate developments, changes of regulated prices and some taxes, the development of wages and labour productivity relation and price changes in the external economic environment. Their impacts on the price development varied in each period. The stated factors explain the causes of inflation movements through the changes in the supply side of the economy. These usually take form of so called supply shocks, influencing the costs for businesses.

- ***Price movement was chiefly affected by the monetary development***

In the recessionary periods, i.e. in the transformational downturn and then in 1997-1999 period, the impact of restrictive monetary policy and the dampened economic activity reacting on the suppressed domestic demand had notable anti-inflationary effect. Different factors and mechanisms were curbing the growth of inflation in the expansionary phase of the business cycle. It was particularly the exchange rate development, which was dominated by the appreciation of *koruna* with a positive anti-inflationary effect through the low rate of growth or declining import prices. Growth of domestic demand was for a high part ensured by imports and led consequently to a deflationary development, which peaked in 2003, when deflationary pressures prevailed in a number of months. These arose as a concurrence of effects of exchange rate development, excess supply in the agricultural markets, deepening competition in the retail market and minimal growth of prices in the regulated markets.

Table 3 Inflation, Money Stock and GDP Development

year-on-year % change

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Ø1994-2003
Consumer prices	10,0	9,1	8,8	8,5	10,7	2,1	3,9	4,7	1,8	0,1	6,0
Money stock (M_2)	20,7	20,3	9,1	10,8	5,4	7,7	5,6	13,0	3,2	4,2	10,0
GDP (current p.)	15,8	16,8	13,5	7,1	9,5	3,4	4,3	9,6	4,6	5,6	9,0

Source: CZSO

Regarding the development of inflation, two notable departures from trend manifested; specifically in 1999, when the growth of inflation slowed down by 8.6 p. p. and in 2003, when the slowdown represented only 1.7 p. p., however the level of inflation was positioned practically around zero, which was not anticipated. Main cause can be in both cases attributed to strong fluctuations in the money stock in preceding years. In 1998 the growth of money stock dropped by 5.4 p. p., in 2002 even by 9.8 p. p. This swing was in the following years projected with a certain lag into the swing of consumer prices.

Concerning the development of money stock and nominal GDP relationship, in six out of ten years in question, the money stock was leading, signaling loosening of the monetary policy. Opposite tendencies, i.e. tightening monetary policy was observed in years 1996, 1999, 2002 and 2003.

- ***Deflationary process prevailed in 2001-2003 despite relatively high incomes of population***

Development of proportions between the population incomes and consumer prices displayed closer link in the recessionary years, i.e. in the 1997-1999 period, when 1 % growth of nominal incomes was accompanied by 1 % growth of inflation. On the contrary, in the 2000-2003 period, the growth of nominal incomes of 1 % accompanied increase in prices of 0.4 %. In spite of the fact, that in the 2001-2003 period average nominal wages grew relatively fast (7.1 %), deflationary process took place at the same time. Inflation slowed down from 4.7 % in 2001 down to 0.1 % in 2003. It is then obvious that price movement was not affected by the demand effect but only by the economy's supply side effect.