

External economic relations

- **Historically biggest deficit of the balance of payment current account for Q2 2007 had a negative impact on its semi-annual deficit**

The balance of payment current account deficit in Q1 and Q2 2007 almost doubled compared with the same period of 2006. This was due to stronger outflow of money in the balance of revenues for Q2 caused by a huge wave of dividends transferred by foreign owners of local companies to their home countries in the amount of CZK 43.5 billion (for the respective Q2 only) which sum exceeded the volume of re-invested profit (CZK 33.7 billion) – this phenomenon appeared in 2006 for the first time. The Czech balance of payment current account deficit showed the worst result for the remaining quarters.

Current account deficit for Q1 and Q2 increased, y-o-y, by CZK 13.4 billion up to CZK 28.3 billion mostly due to the balance of revenues (CZK -112.4 billion). It resulted – despite fast growth of economy – into slight deterioration of external imbalance. Unfavourable impact of the balance of revenues (-112.4 billion) was not reversed either by notable improvement of performance balance – external trade at FOB prices was better, y-o-y, by CZK 26.5 billion (CZK +71.6 billion), balance of services by 4.7 billion (CZK +23.1 billion). The value of current transfers was, compared with the period of 2006, four times lower (CZK -10.8 billion) and showed negative influence on current account. Surplus of performance balance increased from 4.1 % of GDP to 5.5 % GDP.

Key impact of the balance of revenues on deterioration of external imbalance measured by the current account deficit is obvious from the revenue payment - over Q1 and Q2 a record amount of CZK 185.5 flowed out from our country which is by CZK 50.4 billion more than a year ago.

- **Surplus on financial account narrowed while balances of direct and portfolio investment improved**

Should the financial account surplus (CZK +15. billion) cover the current account deficit in Q1 and Q2 it should have been almost double (from foreign-exchange reserves the amount of CZK 7.7 billion was drawn in Q1 and Q2). Its reduction which takes place, according to semi-annual data, in the last two years, was not, however, caused in Q1 and Q2 2007 by deterioration of balance of direct or portfolio investment – their development was in both cases favourable. In contrast, the item Miscellaneous Investment comprising contractors' and bank accounts, deposits and ownership interests in international non-monetary organisations, showed important international deterioration (by CZK 60.8 billion down to -31.9 billion) and had a decisive impact on narrowing of surplus on financial account. Outflow of capital from the country owed mainly to short-term investments made by commercial banks (CZK -73.1 billion against +27.1 billion in Q1 and Q2 2006).

Inflow of direct foreign investment for Q1 and Q2 2007 (CZK 68.1 billion) was higher compared to the same period in 2006 (CZK 52.8 billion). Investment made by Czech companies in abroad were, however, y-o-y, lower (CZK 10.2 billion compared to 18.3 billion for Q1 and Q2 2006). Unfavourable balance of portfolio investment (CZK -5.6 billion) improved for almost the same foreign securities purchase made by residents like in Q1 and Q2 2006 given, however, more marked reduction of their liabilities.

- **Export of goods increased faster compared with imports**

Exports grew faster than imports (+1.5 p.p.) not only thanks to robust economic growth of big developing economies – to which the Czech Republic exported with above-average dynamics but also due to started up growth of the EU economy. A significant improvement of trade balance¹ with Slovakia (CZK + 13.7 billion) and Germany (CZK +8.4 billion) was entirely set off by widening of deficit with China (CZK -22.1 billion). Strong contribution was continuously attributed to exports of road transport vehicles showing a surplus of CZK 105.7 billion despite its y-o-y decline. Trade balance in the CR for the period from January to June showed each month positive figures which was not an uncommon phenomenon. External trade was favourably affected by terms of trade, more markedly than in Q1 (with the value of 103.7) compared to Q2 (103.2) and also by y-o-y drop of crude petroleum prices (-4.5 %).

¹ Imports in FOB prices, imports in CIF prices.

- **Price competitiveness of the Czech economy recorded a moderate decrease**

Real effective exchange rate index of CZK (REER) in Q1 and Q2 increased, y-o-y, indicating the decrease of international competitiveness of the Czech economy in cost area. This fact is recorded by REER (quarterly, deflated by GDP deflator with 2005=base period) weighted both by external trade turnover and by main commodities trade turnover (SITC groups 5-8). Compared with base period = 2005, REEF also signalises a trend of weakening of international price competitiveness of the Czech economy which is a logical phenomenon because the CR moves from the "low-cost economy" group to "medium income" countries of the EU measured by GDP per head in purchase power parity.