

THE CZECH ECONOMY DEVELOPMENT IN THE FIRST HALF OF 2015

Summary data on the Czech Republic

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1. Summary

- Robust economic growth from the first three months of 2015 further accelerated according to the gross domestic product (GDP)¹ in Q2. Loose fiscal and monetary policy contributing to the improvement on the labour market, i.e. a fast drop of the unemployment rate and rising incomes, but also the strengthened investment activity, favourable result of foreign trade and continuing positive expectations on the side of households and firms upturned the performance of the Czech economy more than in Q1. The GDP growth increased from +4.0 % to +4.4 % in a year-on-year comparison and the domestic economy thus expanded in total by 4.2 % for the whole half-year. The growth was non-inflationary and – with respect to the state finances and external relations development – also balanced.
- All key demand items contributed to the high growth of the Czech economy in Q2, mostly however the final consumption expenditure of households and gross fixed capital formation (further only investment) which added similarly +1.5 p. p.² Contribution of change in inventories shrank to +0.7 p. p., the impact of final consumption expenditure of government did not change in comparison with Q1 (+0.5 p. p.). Result of the foreign trade also worked towards the growth of the Czech economy (+0.3 p. p.), for the first time after two quarters.
- The GDP increased by 1.0 % compared to Q1 2015, being driven mostly by investment (+3.5 %). This rate of growth was nevertheless significantly influenced by extraordinary factors (drawing on EU funds at the end of the program period, exceptional profits of companies mostly from year 2014). Total final consumption expenditure rose by 0.6 %.
- Performance according to the growth of gross value added (+3.8 % year-on-year in Q2), which was based on the available data the highest in the European Union, was to the largest extent with respect to dynamics affected by manufacturing (+7.0 %). Its contribution to the growth of the gross value added in the economy amounted to +1.8 p. p., the same as in case of services more significant by weight. The continuing favourable development in construction, following a long-time downturn, was also positively reflected in the performance of the Czech economy (+0.2 p. p.). Branches encompassing agriculture, forestry and fishing added +0.1 p. p., non-manufacturing industrial branches were mildly slowing down the growth on the contrary (-0.1 p. p.). Branches were also faring well in view of the business statistics. Retail sales rose in real terms year-on-year by 6 % for the half-year 2015, those for goods other than food by 7.6 %. Sales in services rose by 2.9 %, given that they increased only by 1.9 % in the same time period of 2014. Their growth was blanket (with the exception of the real estate activities, where the sales dropped by 0.2 %).
- The marked GDP growth did not cause the misalignment the Czech economy from the external balance. Record half-yearly surplus of the current account of the balance of payments in the amount of 95.8 bn crowns was influenced above all by a weaker outflow of dividends. The improvement in balance of secondary income together with large surplus on the capital account (83.3 bn crowns mostly thanks to the EU money) contributed positively, as well. In the result of it, surplus on current account, with surplus on the capital account together, were able to compensate in the large extent the deep deficit of the financial account. Opposed to the preceding years, the stagnating balance of goods and services did not strengthen surplus on current account.
- Total price level in the economy rose by 0.7 % year-on-year in Q2 2015, i.e. less than in Q1 (+1.3 %). Mostly the development of prices in foreign trade played a role in the deceleration of its growth (terms of trade were negative for the first time after nine quarters). Deflation of industrial producer prices weakened from -3.3 % to -2.3 %, growth of consumer prices mildly paced up (from +0.1 % to +0.7 %).
- Favourable development of the real economy was reflected on the labour market as well. General unemployment rate (for age category 15-64 years) arrived only at 5.1 % in June, despite still reaching 5.9 % in January. Number of job vacancies rose up to 97 thousand by the end of the half-year, even though the total employment (in the national accounts conception) strengthened in both quarters year-

¹ The data regarding the GDP and its components expressed in real terms and adjusted for seasonal and calendar effects, unless stated otherwise. The same applies for the gross value added.

² Contributions to GDP change not excluding the imports for final use.



on-year (+1.1 %, +1.4 %). Growth of the average nominal wage increased its pace to +3.4 % in Q2, the real wage rose by 2.7 %.

- Money supply rose faster than the nominal GDP (+5.8 % against +5.2 %) in the Czech economy year-on-year by the end of H1. However, its growth was not driven by the credit expansion to such extent as in the preceding long and strong boom of the Czech economy, though the rate of growth of credit to businesses and households went mildly up. Good financial condition of businesses and households enabled realization of financial operations, respectively financing of investment, largely from their own resources.
- State budget ended based on the cash fulfilment with a surplus in the amount of 22.6 bn crowns in H1, which represented 1.0 % of the nominal GDP. Completion of drawing of financial resources from the EU funds significantly contributed to the record positive balance, since the tax collection of the so called „large“ taxes (VAT, consumption tax) fell year-on-year.

2. Overall Economic Performance

The Czech economy prospered. Year-on-year growth of both GDP and gross value added accelerated in Q2 2015, quarter-on-quarter rates of growth remained large

Economy of the CR not only continued in the very good result from the beginning of the year in Q2 2015, but it even accelerated.³ Year-on-year dynamics of the gross domestic product (GDP) expanded from +4.0 % to +4.4 %, the growth of gross value added increased as well (from +3.4 % to +3.8 %). The quarter-on-quarter rates of growth also proved, that the Czech economy was in a good shape. Despite their size shrank (in case of GDP from +2.4 % to +1.0 %, in the concept of the gross value added from +1.2 % to +0.9 %), these rates remained robust and above-average in the context of the development in the last years.

Quarter-on-quarter dynamics of GDP already reflected the actual development of the Czech economy. Year-on-year change of GDP was still however affected by the low comparative basis associated with the increase of the consumption tax on cigarettes from the beginning of year 2014

Expansion of the CR economy was overrated from the view of year-on-year dynamics of GDP in Q2 2015, similarly to Q1 (the difference between the year-on-year GDP growth and gross value added growth in both Q1 and Q2 2015 amounted to 0.6 p. p. in favour of the GDP). „Discrepancy“ in the quarter-on-quarter growth of GDP and gross value added however decreased already (from 1.3 p. p. in Q1 to mere one tenth of the percentage point in Q2). It thus showed, that while the year-on-year growth of GDP was still influenced by the low comparative basis associated with the increase of the consumption tax on cigarettes from the beginning of year 2014 (pre-stocking with these products led to a higher collection of consumption tax at the end of 2013, in 2014 – when the traders drew on the pre-stocking – the collection fell), the quarter-on-quarter dynamics of GDP already reflected the real development of the Czech economy.

The GDP expanded year-on-year by 4.2 % in total for the whole H1, the fastest since the 2nd half of 2007

The GDP expanded by 4.2 % in the year-on-year comparison in total for the whole H1 2015, the Czech economy recorded faster rate of growth last in the second part of year 2007 (+5.3 %). When compared to the 2nd half-year of the last year, GDP increased by 3.2 %. It represented the largest growth between two subsequent half-years since the first six month of the year 2006 (+4.1 %).

Domestic growth was solid also within the context of the EU countries. The real convergence of the Czech economy thus likely continued

Economy of the CR thrived and comparison with the development in the individual EU countries proved this fact as well. While the year-on-year GDP growth in the Czech republic was, based on the available data, the third highest among the Union countries in Q1 and the increase of the gross value added also, its position further improved in Q2. Viewed by the GDP change, the domestic economy was placed on the second position; from the point of view of the gross value added, it was even on the first place.

Up-to-date data suggest that the last year's real convergence of the CR to the average level of the Union countries was not a one-off phenomenon. It can be concluded, that it continued.

³ The data regarding the GDP and its components expressed in real terms and adjusted for seasonal and calendar effects, unless stated otherwise. The same applies for the gross value added.

<p>Especially the final consumption expenditure of households and investment participated on the GDP growth in Q2 2015 (year-on-year), ...</p>	<p>Not only all four key items of the domestic demand – as at the beginning of the year – but also the result of the foreign trade with goods and services participated on the year-on-year GDP growth in Q2 2015.⁴ Contribution of investment (gross fixed capital formation) expanded from +0.8 p. p. in Q1 to +1.5 p. p. in Q2, final consumption expenditure of households also participated on the growth by a strengthened force (+1.4 p. p., +1.5 p. p.). The contribution of final consumption expenditure of government remained at the level of first three months (+0.5 p. p.), the contribution of the change in inventories shrank, however, from the extraordinary +1.9 p. p. to +0.7 p. p. The foreign trade result in real terms, which slowed down the GDP growth for the two preceding quarters, already shared positively on the enhanced performance of the Czech economy (+0.3 p. p.).</p>
<p>...if we however exclude the imports for final use from the total volume of imports, then this way modified result of the foreign trade was the „driver“</p>	<p>If we exclude the imports for final use from the total volume of imports into the CR, whose dynamics has nothing to do with the Czech economy development at all, then the contributions to the year-on-year GDP growth logically change. Investment, whose increase was for a large part saturated by imported products, participated on it only by +1.1 p. p. in this concept in Q2, the contribution of final consumption expenditure of households even reached only +1.0 p. p. Final consumption expenditure of government contributed to the growth of the Czech economy by only a slightly weaker force than in the classical concept (+0.4 p. p.), the contribution of the change in inventories was even the same (+0.7 p. p.). Balance of exports and imports, where imports are lowered by imports for final use, participated on the GDP growth by +1.3 p. p.</p>
<p>Final consumption expenditure of households rose in total for the whole H1 2015 by 3.0 % year-on-year, ...</p>	<p>The final consumption expenditure of households rose in total for the whole H1 2015 by 3.0 % year-on-year, the fastest since the second half of year 2007. The development in Q2 – when the household expenditure expanded by 3.1 % year-on-year – participated to a larger extent on this result than the development in Q1, when it was higher by 2.8 %.</p>
<p>...thanks both to the expanding household income and still high confidence in the economy</p>	<p>The willingness of households to spend was favourably affected by two key factors in the first half of the year. Raised incomes – as suggested by the increasing real average wage and rising employment – were the first one, still high confidence in the Czech economy was the second one (consumer confidence indicator was on a lower lever at the end of Q2 2015 compared to the end of Q1, nevertheless it still remained higher in the year-on-year comparison).</p>
<p>Households expended more especially on durable goods year-on-year in the first half of the year</p>	<p>The breakdown of final consumption expenditure of households according to durability shows, that the households strengthened especially the purchases of durable goods in the first half of 2015.⁵ They purchased more on these by 9.0 % compared to the previous year in Q1, by 8.7 % more in Q2. However, they also expended more for semi-durable goods (+3.8 %, +5.7 %) and non-durable goods (+2.3 %, +2.7 %). Expenditure on services, which is significant in weight, also grew, but rather only modestly (+1.4 %, +1.8 %).</p>
<p>Fiscal policy still loose</p>	<p>The fiscal policy remained expansionary and it showed not only in a stronger investment activity of government, but also in the relatively stable growth rates of final consumption expenditure. While the final consumption expenditure of government was higher year-on-year by 2.7 % in the last quarter of 2014, this expenditure exceeded the last year's level by 2.6 % and 2.5 % in Q1 and Q2 of this year.</p>
<p>Investment rose by 5.9 % year-on-year in Q2 2015, ...</p>	<p>Investment was one of the two main sources of growth of the Czech economy in Q2 2015. It increased by 5.9 % in the year-on-year comparison, the most dynamically since the beginning of year 2008. The origin of this growth was lying mainly in the large increment to investment between Q1 and Q2 (+3.5 %), not in the low comparative basis.</p>

⁴ Contributions to GDP change not excluding the imports for final use.

⁵ The data presented are in the so called domestic concept, which captures the outlays of residents and non-residents on the territory of the CR. Data are not adjusted for seasonal and calendar effects.



...however the increase represented for most part a result of extraordinary influences. While on the side of government it was the completion of drawing of the resources from the EU funds, it was an extraordinarily high growth of profits in case of non-financial corporations in the last year

Even though the data related to the investment in the individual institutional sectors are not yet available, breakdown of investment by type of capital suggests, that especially the government and non-financial corporations stood behind the very large year-on-year jump of investment in Q2 2015. While the government tried to complete the drawing of the allocated resources from the European Union funds, non-financial corporations reached extraordinarily high profits in the last year and started to utilize them to an increased extent for investment purposes.

Investment into buildings and structures rose by 13.2 % year-on-year in Q2,⁶ the most in the available time series from year 1997. Growth of investment into transport equipment shrank in comparison to the beginning of the year (however it remained robust, +10.4 %), growth of investment into the ICT, machinery and equipment on the contrary accelerated (from +1.0 % in Q1 to +2.5 %). Intellectual property products experienced less investment compared to the preceding year (-1.5 %), similarly to Q1 and two previous years. Growing household income together with still prevailing low interest rates of mortgages kept favourably affecting the investment into dwellings (year-on-year +3.4 %).

Change in inventories still positive. Its structure has not changed much either (stock of material and unfinished production grew)

The value of inventory stock enlarged in nominal terms by 14.2 bn crowns during Q1 2015 and because their value dropped by 7.9 bn in the same period last year, the inventories became the main driver of the Czech economy growth. The value of inventories kept further growing in Q2 2015 (their value enlarged by 11.9 bn crowns), however since the change in inventories was positive also already in the last year's Q2 (+5.8 bn), its growth effect significantly weakened.

Year-on-year growth of exports of goods and services from the CR further slowed down

The economic growth of the euro area countries slowly gained strength, however it was not reflected in the dynamics of domestic exports of goods and services abroad. On the contrary, the growth of Czech exports continually weakened. While the exports was still higher by 11.7 % in Q1 2014 year-on-year (based on the data of national accounts), it was „only“ by 7.0 % in Q2 of this year. Still, it is possible to perceive the result of the increment to exports from the CR as favourable in Q2, since for example the exports from Germany rose „only“ by 6.4 %.

The foreign trade surplus higher in Q2 2015 year-on-year (+2.0 bn crowns in nominal terms) thanks to „services“

Surplus of the foreign trade with goods and services in nominal terms enlarged year-on-year by 2.0 bn crowns in Q2 2015. The source of this growth was surprisingly not the trade with goods (the surplus in goods shrank by 4.1 bn), but the trade with services (+6.1 bn). As the data of the balance of payments show, the increase of the surplus of trade with services occurred mostly due to the improvement of the financial services balance and balance of services connected to transport. Balance of travel services worsened, despite the fact, that large sport events were held in the CR.

From the view of the supply side, the economic growth was spread out quite evenly

The manufacturing (+1.8 p. p.) participated from a large part on the growth of the gross value added in Q2 2015 (+3.8 % year-on-year), however, the services significant by volume also participated on the growth of GVA to a similar extent. Here all monitored branches shared in the increase of the performance of the Czech economy, nevertheless especially trade, transportation, accommodation and food service (+0.5 p. p.) and professional, scientific, technical and administrative activities (+0.4 p. p.). Construction – whose performance was favourably affected mostly by large demand for construction activities on the part of public contracting authorities – shared in the growth of the gross value added by +0.2 p. p., agriculture, forestry and fishing by +0.1 p. p. The economic growth was being „dampened“ only by a fall in the segment consisting of mining and quarrying, energetics, water supply (-0.1 p. p.).

⁶ Breakdown of investment by type of capital. Data are not adjusted for seasonal and calendar effects.

Chart 1 GDP (constant prices, adjusted for seasonal and calendar effects, in %)

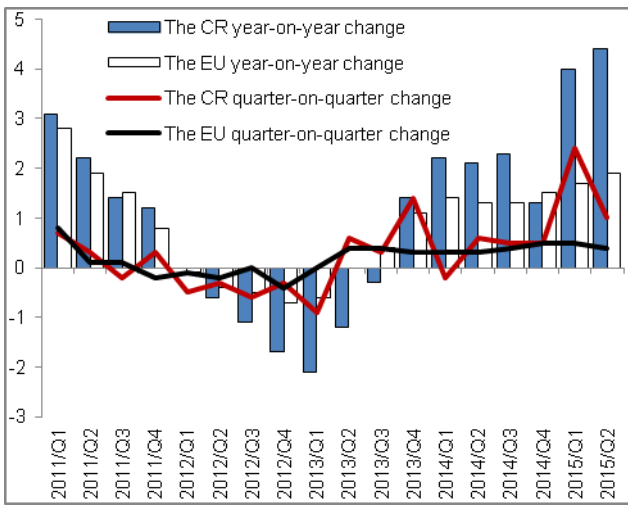
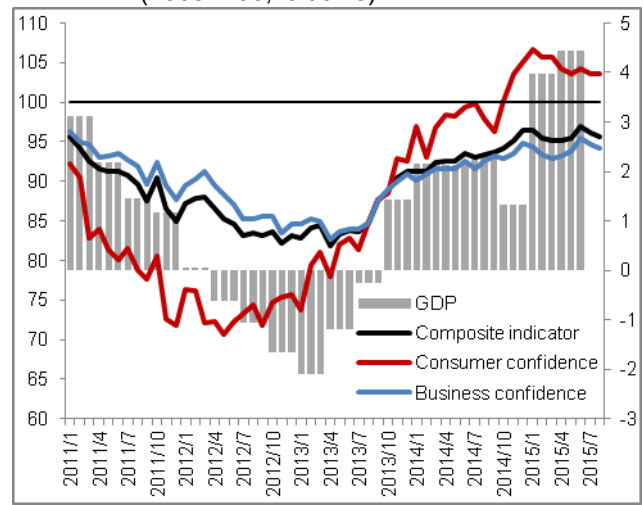
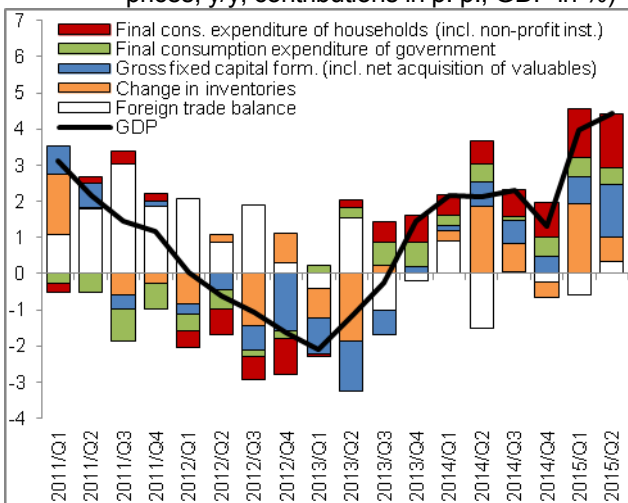


Chart 2 GDP (constant prices, adjusted for seasonal and calendar effects, y/y in %, right axis) and confidence indicators (2005=100, left axis)



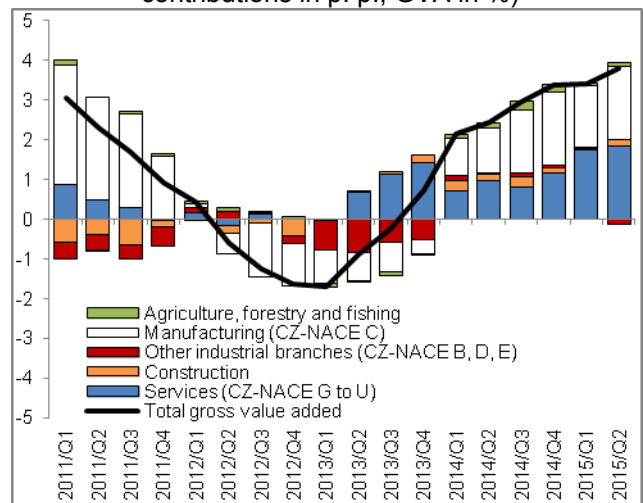
Source: CZSO, Eurostat

Chart 3 Contributions of expenditure components to GDP change* (constant prices, y/y, contributions in p. p., GDP in %)



*contributions to GDP change not excluding the imports for final use

Chart 4 Contributions of branches to GVA change (constant prices, y/y, contributions in p. p., GVA in %)



Source: CZSO

3. Branches Performance

The GVA dynamics accelerated to the highest level since the boom year-on-year

Especially the manufacturing industry keeps driving the growth of the value added in the CR, the branch grouping trade, transportation, accommodation and food service than in the whole EU

The renewal of confidence in the economy as well as the relentless inflow of orders in

It was confirmed during the first half of 2015, that the recovery of the Czech economy has still more solid foundations. Seasonally adjusted gross value added (GVA) continued in the quarter-on-quarter growth for already the ninth time in a row. The year-on-year GVA dynamics was continuously accelerating since the half of year 2013. While the GVA increased similarly by 3.4 % by the end of last year and in Q1 this year, it grew already by 3.8 % in Q2 2015 (the fastest growth since the first half of year 2008). The strengthening manufacturing (it contributed to the value added in the whole economy by a similar addition – nearly one half in both this year's quarters) as well as the even spreading of the year-on-year growth of GVA within other branches (all ten main groupings of economic activities recorded favourable development in both this year's quarters, which did not occur even in times of boom) stood behind the current acceleration of the GVA dynamics.

The value added was strengthening by 6.4 % year-on-year in the predominantly export oriented manufacturing in the whole H1 (even by +7 % in Q2), and rose (similarly to the previous year) by nearly double pace compared to the whole



key branches led to the fastest growth of number of persons employed in the whole economy after year 2008 in the first half of the year

economy. The prevailing high both domestic and foreign demand is gradually reflected in the number of employees (+2.7 % in both Q1 and 2 year-on-year), when the businesses apparently started to transfer the agency workers (which covered the fluctuations in demand in „uncertain times“) among their primary employees to a larger extent.

Protracted fall of employees halted in construction in Q1, the decline of self-employed on the contrary deepened

The construction also fared well, even though the dynamics of its GVA was compared to the last year's sharp recovery one-half in H1 2015 (+1.8 %). The year-on-year fall of the number of employees halted for the first time since the end of 2009 (in the national accounts conception), the number of their hours worked (+2.5 %) grew the most in the last five years in Q2.

The highest growth of both GVA and employment in the branch grouping trade, transportation, accommodation and food service in the last five resp. six years

The branches agriculture, forestry and fishing also followed in a successful last year, which was reflected also in a mild increase of employment (it concerned workers outside the employee segment unlike the majority of other branches). The branches of trade, transportation, accommodation and food service contributed the most to the growth of total GVA in the tertiary sector thanks to its weight as well as gradually strengthening dynamics (+2.8 % in H1), benefiting from the favourable sentiment of consumers as well as growing arrivals of both domestic and foreign guests. The long-term growing professional, scientific, technical and administrative activities fared the best among services, due to the enduring demand for agency workers, but also the recent upsurge in some specialised activities (architectural and engineering activities). The financial sector also recorded more than 5% growth of GVA in H1, however the growing cost pressures left its mark on declining number of employees in the last two years. The value added increased much more modestly in the public services (+2 %), still it presented the highest rate of growth following year 2008. The slowly growing employment, as well as across-the-board raising of wage tariffs at the end of 2014, were a factor.

High demand for information and communication activities as well as professional, scientific, technical and administrative activities prevails

Industry, whose production overtook the pre-crisis level already at the end of the last year, keeps the last year's high rates of growth also during the year 2015 so far

Industry performance⁷ (based on the industrial production index in real terms) fully followed the previous successful year, it strengthened by 5 % year-on-year in H1. It keeps stable high rates of growth thanks to the dominant manufacturing, which benefits especially from the so far strong domestic as well as foreign demand for transport equipment and its components.

Recovery also in the vast majority of smaller branches after several years, on the contrary continuing long-term downturn of mining activities

All branches within industry almost achieved year-on-year higher production this year. It was also valid for some smaller, more downturn branches in the long-term. It was mainly the manufacture of wearing apparel, with near 9 % growth experiencing the highest growth in the last ten years in H1, and also the manufacture of leather products, which achieved long-term growth record already in the last quarter of 2014. The revival of manufacture of textiles or furniture lasts already for nearly two years. Production accelerated in the manufacture of paper and paper products (+ 9 %) in H1, which attained (with double digit growth of foreign orders) the highest dynamics of production in the uninterrupted ten year time series. The production was falling only in the printing or wood industry this year and especially in the mining and quarrying (year-on-year by -7 %, by nearly one quarter in seven years), mainly due to the effect of long-term reduction of the black coal mining.

The manufacturing of motor vehicles contributed to the year-on-year growth of the whole industry by nearly one third, together with the closest associated economic activities by more than one half

The manufacturing of motor vehicles still remains the most significant contributor to the year-on-year growth of the entire industry, even though its dominant role weakened somewhat in comparison to the last year (it was responsible for the production growth from roughly one third in H1 2015). Main individual sub-contractor fields also contributed similarly one eighth – manufacture of rubber and plastic products as well as the manufacture of electrical equipment. The contribution of significant by weight manufacture of machinery was also important despite relatively mild growth (+3.9 %). The metallurgy and also the chemical industry recorded even more modest dynamics of production, which was held

⁷ Including CZ-NACE branches: B (Mining and quarrying), C (Manufacturing), D (Energy industry).

back by a lack of orders, especially domestic orders. The markedly pro-cycle oriented branch of manufacturing of computer, electronic and optical products keeps growing faster than most manufacturing activities, which also still benefits from a large stock of orders from the last year.

The value of new orders was still higher year-on-year despite stronger last year basis, the manufacturers of railway vehicles had the highest dynamics of new orders especially thanks to domestic orders in H1

The continuing year-on-year growth of foreign orders (+9.8 % and +4.8 % in Q1 and Q2 resp.) illustrates the favourable short-term outlook of industry, the demand decreased (within the more significant economic branches) only in metallurgy and also in the chemical industry. The mildly positive sentiment of entrepreneurs in industry prevails (the balances of confidence indicators were below the level of turn of years 2010 and 2011 in August 2015, however they were stable positive for more than twenty months in a row). Nearly 58 % of industrial businesses (based on seasonally adjusted data) stated insufficient demand as a barrier to growth at the beginning of year 2014, one year and half later already only 49 %. At the same time, the share of businesses mildly increases, which are blocked in further growth by a lack of labour force. The mild drop of new foreign orders for manufacturers of motor vehicles (-0.3 % in Q2, following 15% growth in Q1) could bring up questions regarding the sustainability of high rates of growth of the industrial production. Nevertheless, the most up-to-date July data do not support this hypothesis (+11 %, against strong last year's basis). The favourable development of both foreign and domestic demand is reflected in the strengthening growth rates of employment as well as wages in the whole industry (number of employees fell year-on-year only in energy industry, mining and wood processing branches in Q2).

The CR belongs to countries with the highest industrial production growth in the EU in the long-term, mostly due to the branches producing capital goods

The industry in the CR, similarly to most Central European countries, overtakes with its growth rates the euro area as well as the whole EU in the long term. It grew the most in Ireland in H1 2015 (+17 %), then only Hungary, Slovenia and Malta (+5 to +7 %) mildly exceeded the dynamics in the CR. The branches focussed on the production of products of investment nature (capital goods) strengthened the most in the EU (+2.4 %) similarly to the CR (+7.5 %). Eleven EU countries exceeded the level of industrial production from H1 2008 so far – Ireland (by one third) and also Austria and Belgium next to the majority of the converging economies (incl. the CR). While the production stagnated in Germany, Italy, Spain, Greece but also Finland reached in real terms only three quarters of the boom level this year.

Abundant construction production despite last year's high basis

Construction capitalizes not only from the overall recovery of the economy and above average winter periods (with respect to the temperature) in the last two years, but mostly from the acceleration of the public investment into the transport infrastructure. Construction production was accelerating year-on-year this year (from +7.7 % in Q1 to straight +10 % in Q2). The construction reached the second best result for the entire half-year since the beginning of year 2007. The civil engineering participated the most on this result, when it reached the best dynamics of production since the half of year 2009 in Q1 and subsequently also in Q2. The building construction, dominant by the weight share, was thus slightly overshadowed (it strengthened by 5 % in H1), being blocked in a larger expansion also by the so far modest upsurge of the residential construction. The construction production however remains in Q2 one eighth below the level on the same period in 2008 despite the recent recovery.

Production of civil engineering construction added nearly 24 % year-on-year in Q2, fuelled by the pressure to complete constructions in connection to the finishing EU program period

Total stock of so far not realised orders again lower (following six quarterly growths) year-on-year in Q2 2015

Construction benefited mostly from the large stock of last year's new orders for the civil engineering constructions in H1 (in the value of 117 bn crowns, the highest after year 2008). New orders of the construction businesses (with 50 and more employees) were higher only by 2.8 % year-on-year this year, thanks only to the building construction (+11 %), they already somewhat decreased for the civil engineering constructions. This led together with the effect of intensive realization of large volume of last year's orders to the drop of the value of all not yet realised orders (year-on-year by -7.7 %) already at the end of Q2 2015. The total stock of public sector orders also decreased after five quarters (-1.4 %), deeper reduction occurred for the private domestic demand (-5.3 %), as well as the stock of work from abroad (which managed to partially compensate the fall of the domestic orders at the turn of years 2012 and 2013). The average value of one new closed order



stagnated year-on-year (it arrived at 4 mil crowns in H1 2015). The approximate value of one granted building permit slightly decreased, it was nevertheless higher for modifications to completed buildings (3.2 mil crowns, 2.4 mil crowns 2 years ago), where the effect of larger projects funded from the EU played a role.

Improvement of business cycle indicators in construction, stabilization of employment

The overall balance of entrepreneur confidence in construction keeps improving already since the end of 2013 (and was the highest in Q2 2015 since the beginning of 2009). Negative short-term expectations decreased for demand as well as construction activity against August 2014, simultaneously the positive anticipations improved for the employment, especially for large businesses (a quarter of businesses with more than one thousand employees expects the growth of the number of employees in the next three months, none of these businesses in August 2014). The stabilization of employment thus appeared in construction in 2015 after six adverse years, when the average registered number of employees was reduced only negligibly (in the order of per mils year-on-year). Registered number of employees shrank by 60 thousand in total for the last seven years. Still 59 % of businesses in the CR (41 % in the whole EU) considered the insufficient demand as a barrier to higher production in August 2015, but more than three quarters a year ago. The share of businesses, which are prevented in growth by inadequate labour force, increased to 8.5 % during June 2015, which was the most since 2008.

Mild recovery of commenced as well as finished residential buildings

Current trends of the residential market occur in the context of the growing purchasing power as well as predominating positive mood of households, improving labour market, turn in the historically low interest rates of the mortgages, gradual growth of the prices of dwellings both in Prague and other regions, but also the persisting high number of vacant flats built in times of boom. The number of commenced dwellings in H1 (12.9 thousand) increased by 7 % year-on-year (by one sixth against the extremely low value in H1 2013). The growth appeared in all types of buildings except for the additional extensions of s to family houses, which there were commenced the least since half of the nineties. 42 % of commenced dwellings were located in Prague or the Central Bohemia region, the highest share since 2005. The number of finished dwellings „bounced from the bottom“ (+11 % year-on -year), nearly exclusively thanks to the multi-dwelling buildings , which there were completed the most in the last five years (within H1) this year.

There were nearly 30 % less finished dwellings this year against H1 2008, 40 % less than of the commenced dwellings (by more than one half even for the multi-dwelling buildings)

Sales in services accelerated their dynamics (given the simultaneous fall of prices), they grew the most in the last seven years year-on-year

The recovery took effect with a certain delay in services due to their notable internal diversity. Sales in selected services⁸ recorded key turn only at the beginning of 2015. While they still slightly weakened year-on-year in the last quarter of the last year (by -0.7 %), the rate of growth of sales sharply accelerated at the beginning of this year (to +3 %, the most since the end of 2007), the sales kept a similar rate of growth also in the following quarter (Q2). Significant recovery of services occurred uncharacteristically with simultaneous fall of prices, mainly in the air transport or warehousing (as a result of deep decrease of prices of oil on the world markets), but also in the telecommunications (where the fall of prices is a longer-term phenomenon) and also for the job agencies (here though the prices were growing noticeably in the previous two years).

Especially the architectural and engineering activities were pulling the professional, scientific and technical branch up

Sales stagnated in transportation and warehousing, the branches which react quite flexibly to the economic cycle in the conditions of the CR, in real terms in H1 2015. The land transport and transport via pipelines, significant by weight, (+4.1 %) managed to compensate the lower sales in the air transport (-2.1 %) and especially the warehousing (-4.8 %), whose development was significantly affected by high year-on-year basis. The professional, scientific and technical activities markedly contributed to the turn in services, where the sales increased for the first time after eleven quarters at the beginning of the year and added 3.6 % for the whole H1 (the most since 2007). Especially the activities of the development of building projects fared well on the wave of the strong growth in construction. Sales of

The sport as well as cultural events assisted the record results of accommodation and food service in Q2

⁸ Do not include the branches of trade, finance and insurance, science and research and also the public services.

administrative and support service activities (+6.3 %) were traditionally pulled by the job agencies (+ 19.3 %, continuous growth for 21 quarters in a row), travel agencies carried on in the long-term downturn (-6.6 %), with part of customers being also possibly discouraged from their services by the raised prices of foreign vacations. On the contrary, the sales of the accommodation grew already twenty quarters in a row, accelerating year-on-year by one tenth in Q2. Food and beverage service activities also experienced record sales in the same period (+5.2 %, the most since Q4 2005). Information and communication activities also achieved the fastest growth since the boom in H1 (+5.1 %).

Retail sales (excl. motoristic segment) increased year-on-year the most in the last seven years

The renewal of the economic growth slowly followed by the gradual improvement on the labour market (with the impact on the disposable income of the households) was reflected in the consumer confidence indicator (it was placed the highest since March 2007 at the beginning of year 2015). The growth of the retail sales (CZ-NACE 47) gained speed to 6.4 % at the beginning of the year (it was +3.5 % in the last quarter of 2014), it also kept a strong year-on-year dynamics in Q2 (+5.7 %). It represented the fifth highest value in both cases in the EU, Poland (+8.1 %) reached the best results in H1, Hungary or Ireland was placed around the CR level, the United Kingdom were near (+4.5 %), the sales grew more modestly in Germany (+2.7 %) or Slovakia (+1 %). Sales of maintenance and repair of motor vehicle (CZ-NACE 45) reacted faster to the economic recovery, it grew by one eighth in H1 (similarly to the last year). The most significant by weight sale of non-food goods (+8.1 % in Q2) pulled the whole retail itself (CZ-NACE 47), where the drop of prices assisted especially to the sellers of computer and communication equipment (+8.2 %) in the long-term. The sales however climbed up in all other specialized stores, especially for cultural and recreational goods (from +7.3 % in Q1 to +13.1 % in Q2). Growth of sales for food products was despite the more „modest“ dynamics (by +3.4 % in H1) also the highest in the „post-crisis“ period (and similarly to the year 2014 also higher compared to the EU). The sellers of food in specialised shops also managed to maintain this pace of the sales dynamics apart from the previous years. Sales of petrol stations accelerated since the last year's December, they increased by nearly 8% year-on-year for H1. Especially the very favourable price development of the automotive fuels stimulated the higher demand (also in the context of the neighbouring countries).

Higher sales for goods in specialised shops in all main ranges of products

Growth of sales for food products was the fifth highest in the whole EU in the CR⁹ in H1, the sixth highest for non-food goods, the ninth highest for the automotive fuels

Chart 5 Production in industry and selected manufacturing branches (real terms, y/y, in %)

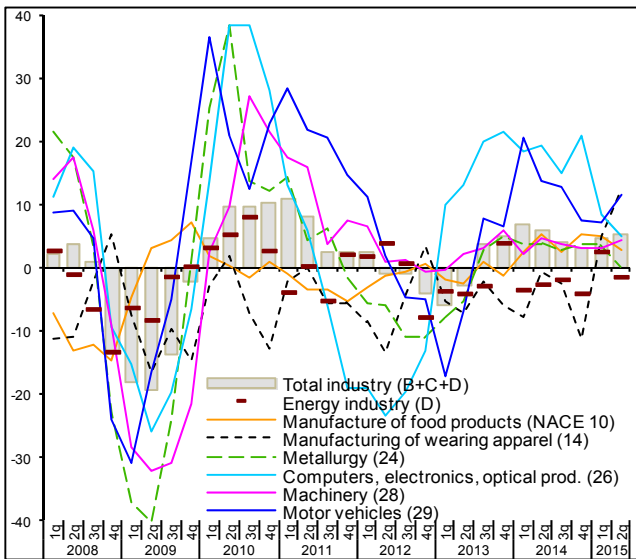
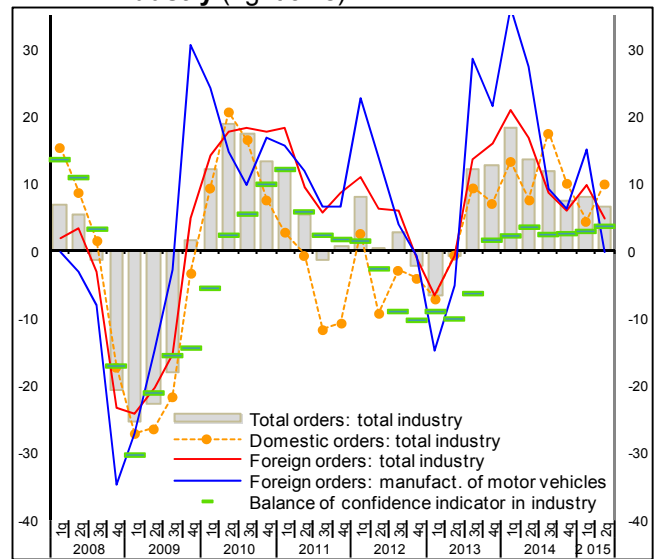


Chart 6 New orders in manufacture of motor vehicles, industry in total (c.p., y/y, in %) and balance of confidence indicator in industry (right axis)



Source: CZSO

⁹ Adjusted for calendar effects.



Chart 7 Construction production, value of new orders (y/y, in %) and balance of confidence indicator in construction (right axis)

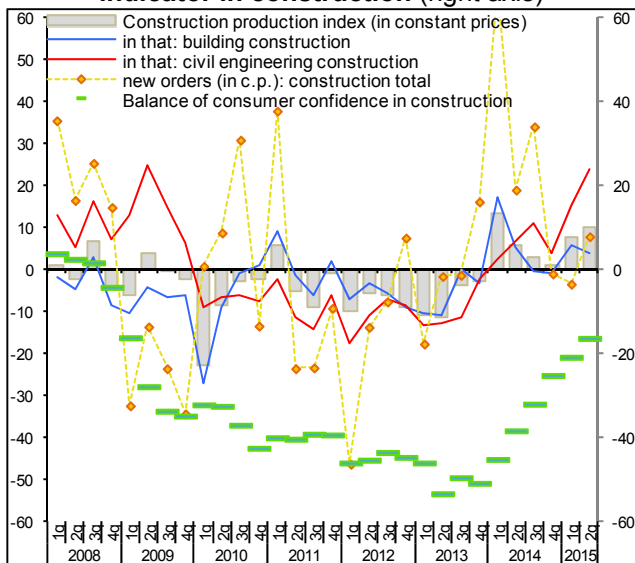
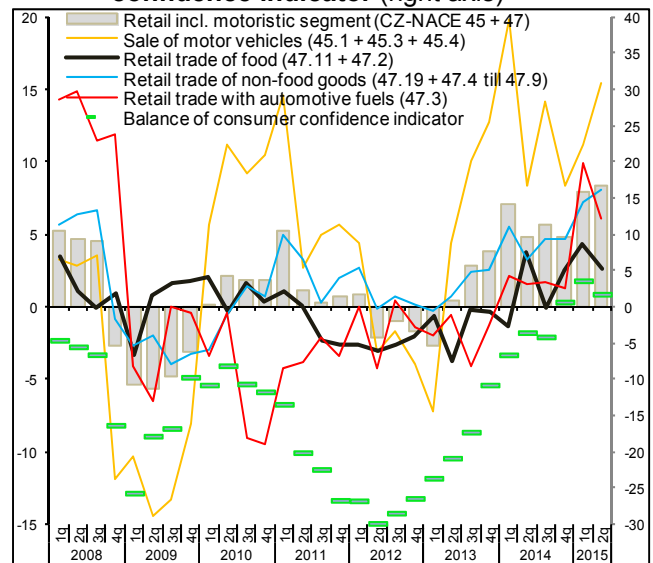


Chart 8 Retail sales including motoristic segment* (in real terms, y/y in %), balance of consumer confidence indicator (right axis)



*Motoristic segment includes trade repair and motor vehicle maintenance

Source: CZSO

4. External Economic Relations

Further improvement of external balance by both the record surplus on the current account of the balance of payments and mutual inclusion of surpluses and deficits in their further components

Strong growth of the Czech economy was accompanied by further improvement in its external balance in the first two quarters of 2015. Therefore, half yearly result of external economic relations was marked by record surplus on the current account of the balance of payments in the amount of 95.8 bn crowns, which represented 4.4 % of the nominal GDP and 1.5 % in the annualised formulation. The deep deficit on the financial account caused especially by the growth of foreign exchange reserves thus could be „financed“ together with the surplus on the capital account.

Q2 itself historically for the first time with a surplus of the current account due to lower outflow of the primary incomes, ...

The half-yearly incomes of the current account exceeded its outlays already for the fourth year in a row, however the surplus was recorded for the first time in Q2 itself (3.1 bn crowns). This is usually deficit mainly due to the outflow of the primary incomes (mainly dividends) apparent especially in the second quarters (following the decisions of the shareholders meetings of companies under foreign control). This however occurred to a considerably lesser extent based on the data towards the end of June 2015, when the net outflow of the primary income (-96.7 bn crowns) was only on the roughly three quarters of the comparable level of 2014. In addition, given the actual preservation of the surplus in trade with goods and services in the year-on-year comparison (182 bn crowns, when the services balance of 39.8 bn remained in reality at the level of the average half-yearly surplus of the previous five years) and significant improvement of the balance of the secondary income (mostly thanks to the development in Q1, the half-yearly surplus arrived at 10.6 bn against -2.8 bn crowns of the comparable period of 2014), the excess of revenues of the current account of the balance of payments over its outlays reached in total the historically best half-yearly result.

... when it flew out in dividends from the CR less than in the same period of 2014, reinvestment of earnings were however also slightly lower

Outflow of primary income in net expression in total balances of interests, dividends and reinvestment of earnings amounted to 140.1 bn crowns for H1, which was slightly better result compared to the same period of 2014 (155.9 bn crowns), but worse compared to the yearly average of the preceding five years (128.7 bn crowns). The lower outflow of dividends into the parent countries of the foreign investors stood behind this positive year-on-year change, however they also left here fewer reinvestment of earnings year-on-year (50 bn crowns).

Notable deficit of the financial account

Strong inflow of funds from the European Union budget strengthened the positive balance on the capital account of the balance of payments to record 83.3 bn crowns, so the surplus amounted to 179.2 bn crowns together with the result of the current account. This level overtook the significant outflow of funds, recorded on the financial account of the balance of payments (-174.6 bn) only very mildly.

... was influenced not only by net outflow of funds from the CR both for direct, portfolio as well as other investment, but mostly by marked strengthening of the foreign exchange reserves

Adverse development in Q2 – both foreign investors in the CR and domestic entities abroad „withdrew“ their direct investment – led into the net outflow of direct investment from the CR for the half-year (1.7 bn crowns). The entire financial account registered markedly higher deficit result in the noted amount of -174.6 bn crowns together with the net outflow of the portfolio investment (48.6 bn) and also other investment (1.3 bn), however especially due to a considerable growth of the foreign exchange reserves (119.3 bn crowns). (Foreign exchange reserves are incorporated into the financial account newly based on the 6th Edition of the Balance of Payments and International Investment Position Manual, BPM6, they were accounted for separately in the preceding version).

The growth pace of both imports and exports slowed down also due to the effect of the comparative basis; the share of the four strongest product items (i.e. cars and their parts, PCs and electronics, electrical appliances and other machinery and equipment) on total exports from the CR further rose to 52.2 %...

The rate of growth of exports from the CR slowed down to +7.4 % year-on-year based on data on foreign trade with goods in the national conception. It was more than double with +15.4 % in the same period of 2014, but it was also affected by a weak comparative basis (its effect but in the opposite direction also worked in H1 2015). The export of vehicles and their parts participated in two fifths on the addition to exports by 115.6 bn crowns. It also enhanced its proportion in the structure of the total exports from the CR to nearly one quarter (24.2 % against 23 % in the same period 2014). It was caused by strong pace of export of vehicles and their parts in H1 2015 (+12.9 %) even though growth was notably lower than in the comparable period of the previous year (+27.6 %). Nevertheless, this export dynamics of vehicles was the strongest of the four main product groups which represent more than one half of the Czech exports.

Exports of other strongest export products grew by a pace lower than average – exports of computer and electronics grew by 7.2 % to 154 bn., electrical appliances by 6.4 % to 138 bn and other machinery and equipment by 3.5 % to 179 bn crowns. These four product items together with the exports of vehicles and their parts in the amount of 408 bn crowns thus expanded their share on the total exports from the CR to 52.2 % from 51.5 % recorded in half of 2014.

„The rest“ of the Czech exports thus weakened with respect to its share, even though the exports of 12 out of 40 product items increased by the rate of growth higher than average (more significantly e.g. paper products, other transportation vehicles and products of other manufacturing industry). On the contrary, the exports of value significant chemical products (-2.1 %), but also medicine (-0.8 %) or textiles (-1.5 %) were lower year-on-year.

The imports of oil and gas lowered the dynamics of imports due to the fall of their prices on the world markets, similarly in case of some other commodities...

The somewhat faster rate of growth of imports (+7.6 %) compared to exports (+7.4 %) completes the picture of the relative strong domestic demand. Due to the impact of the year-on-year fall of prices of oil on the world commodity markets, the value of its imports together with the imports of the natural gas fell by nearly one fifth (-19.8 % i.e. by 18 bn crowns). The same reason also contributed to the weakening of the value of imports of other commodities (ore -32 %, coal -3 % or wood -9 %, whose import is however, with respect to the import value, less significant).

... however imports of the largest product items grew above the average

Main import items are similar concerning the weight to the main export items due to the effect of the import-export oriented nature of the Czech economy. Their imports into the CR grew by the above average pace year-on-year, which was valid especially for vehicles and their parts (+14 %). These four product items, i.e. cars and their parts, PCs and electronics, electrical appliances and other machinery have represented together 42.4 % of the total imports into the CR in H1 2015, while 39.7 % in the same period of the preceding year. Increase in this share also proves the current boom phase of the business cycle in the Czech Republic.



Nominal surplus of the trade balance above the hundred billion mark, its improvement however the lowest in the previous five years

Excess of exports over imports overtook the hundred billion threshold in the national conception¹⁰ for the first time in H1 2015 (102.6 bn crowns). Nevertheless, the improvement of the trade balance (+4.3 bn crowns year-on-year) was the weakest H1 result in the previous five years (the trade balance had been growing during mentioned periods on average by 16.6 bn crowns yearly since 2011). This is also the reason, why the income balance contributed to the current account of the balance of payments surplus only negligibly in H1 2015.

Exports into the EU and euro area led to the strengthening of these territories with respect to the share in total exports, non-European markets were „losing“

Exports increased by 8.4 % into the main target destinations from the CR year-on-year in H1, i.e. identically in the case of the EU 28, to the euro area, Germany and Poland. This development further increased the Czech exports proportion to the EU market by 0.7 p. p. to 83.9 % and to the euro area market by 0.6 p. p. to 65.1 % compared to the same period of 2014.

Destinations of the Czech exports which standing outside the EU, participated by 16 % on total exports against 16.8 % in the H1 2014. The main reason was that exports to Russian Federation fell significantly by 32.6 %, i.e. by nearly 17 bn crowns due to effect of sanctions imposed by EU countries and also due to shrinking of the Russian economy.

Alike, the exports from the CR into Austria has fell (-2.7 %). The slowdown of the Chinese economy did not reflect in the dynamics of the exports from the CR as yet (+15.3 %) given the still low volumes of trades. In H1 2015, their amount 18.2 bn crowns represented only 1.1 % of total exports from the CR. Wider diversification of the Czech exports especially in the direction of the eastern markets thus does not eventuate for now. One of the significant reasons is that the changes in the pace of growth can be seen on global level, especially that economic growth in the developed countries accelerates compared to its weakening in big emerging markets.

Chart 9 **Total exports and imports of goods** (y/y in %, 6M moving averages; national conception; current prices FOB/ CIF)

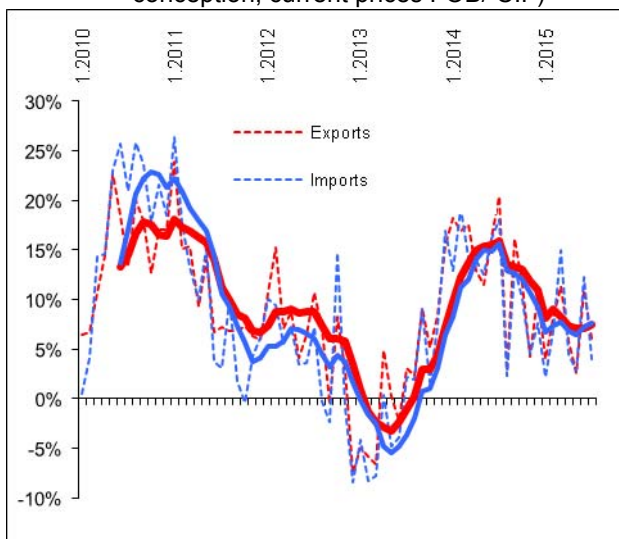
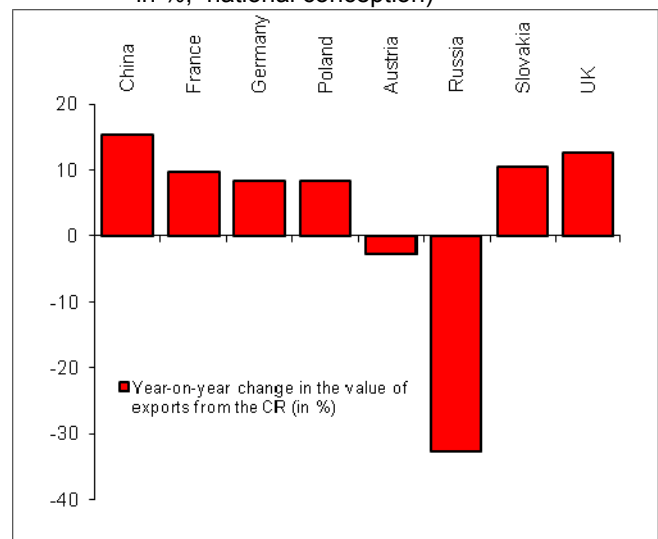


Chart 10 **Year-on-year change in the value of exports into selected countries** (half 2015, in %, national conception)



Source: CZSO, own calculations

¹⁰ Balance of goods according to the CZ-CPA (Classification of Products) in the national conception. Exports in FOB prices, imports in CIF prices.

5. Prices

Year-on-year growth of the total price level in the economy further slowed down in Q2 2015

The total price level went up according to the implicit GDP deflator by 0.7 % in the economy year-on-year in Q2 2015.¹¹ It rose not only less than in Q1 (+1.3 %), but also the slowest since Q3 2011 (when it decreased by 0.1 %). In the context of individual GDP components, the prices of investment (gross fixed capital formation) rose by 1.6 % year-on-year, prices of goods and services – purchased by the government – went up by 1.2 %. Prices of products bought by the households grew only mildly (+0.4 %). While the terms of trade in the foreign trade with services reached positive values (100.4 %) similarly to the previous quarter and worked in the direction of growth of the total price level, the terms of trade in the foreign trade with goods were negative for the first time in the last two and a half years (99.7 %) and slowed down its growth.

The inflation rate, expressed by the year-on-year change in the consumer price index, increased from +0.1 % in Q1 2015 to +0.7 % in Q2. The inflation trend however still remains uncertain

The year-on-year growth of the consumer price index, which was moving only slightly above the zero level at the beginning of this year, accelerated in further months and moved away from the „dangerous zone of deflation“. If the prices for consumers grew only by 0.1 % year-on-year in Q1 2015, they were already higher by 0.7 % in Q2. The inflation trend however still remains uncertain, as shown by the latest available data regarding the development of the index from the holiday months. The year-on-year growth of consumer prices again fell – to +0.5 % in July and to +0.3 % in August. The threat of deflation, hovering above the Czech economy especially at the beginning of the year, thus was not yet averted.

It can be assumed, that the price of oil is the main risk for the further inflation development – the barrel of Brent oil was traded on average for 64.1 US dollars in May of this year, however its price fell to 46.6 dollars in August

The price of oil on the world commodity markets can be considered the main risk, connected to the further development of inflation in the CR. While the barrel of the Brent oil was traded on average for 64.1 US dollars in May 2015 and its price was lower by 41.5 % in the year-on-year comparison, its price reached only 46.6 dollars already in August and it was lower by 54.2 % compared to the same month of year 2014. The deepening fall of the prices of the animal and animal products (striking the prices of food via the production chain) also presents a risk for inflationary development as well as the continuing deflation in the manufacturing in the euro area (which has an indirect effect on the inflation in the Czech Republic, that is via the prices of imports).

Change in the development of prices of vegetables and fruits, increase of the consumption tax on cigarettes and temporary growth of the price of oil. These were the three key factors standing behind the higher year-on-year growth of prices for consumers in Q2

The higher inflation rate in Q2 2015 compared to Q1 of this year was determined by three key factors. Firstly, the development of prices of vegetables and fruits changed. If the vegetables were cheaper year-on-year on average by 10.5 % and fruits by 6.4 % in the first three months of the year, the prices of vegetables were already raised (+6.0 %) in Q2 as well as the prices of fruits (+4.2 %). Secondly, the consumption tax on cigarettes was increased as of 1. 12. 2014. As the stocks of cigarettes with older tax stamps were sold out (they were allowed to be sold only till the end of February) and replaced by new ones, the price of cigarettes was growing (the item „tobacco“ was more expensive by 5.5 % in Q1 2015 in the year-on-year comparison, but already by 8.8 % in Q2). Thirdly, a temporary turn occurred in the development of the prices of oil in the first half of the year. It started to rise (price of one barrel of the Brent oil rose from the January 47.8 US dollars to May 64.1 dollars) and it was reflected in the mitigation of the year-on-year fall of price of operation of personal transport equipment from -10.2 % to -7.1 % (the expenditures for fuels are represented in these expenditures from more than seven tenths).

More favourable dynamics of the consumer prices not only in the CR in Q2, but also in further twenty two countries of the Union

The year-on-year change of HICP increased in the CR from zero in Q1 2015 to +0.7 % in Q2. It represented a significant shift in the context of the European Union countries, however not an unusual shift. Apart from the CR, twenty two countries registered more favourable dynamics of the consumer prices in Q2 2015 compared to the beginning of the year, the euro area as well as the European Union as a whole even broke out of the deflation. It can be assumed, however,

¹¹ Adjusted for seasonal and calendar effects.



that it was only a temporary affair, since the turn in the development of price of oil participated on this more favourable development of prices similarly to the CR. And this turn, as already mentioned, did not last long.

Price of rentals for housing grew only gradually

The low rise of consumer prices in the CR was accompanied by a relatively weak increase of the prices of rentals for housing. It is logical, since the dynamics of the consumer prices is often incorporated in the rental contracts as a reference quantity, used to adjust the size of rent. The price of rentals for housing went up by 1.0 % year-on-year in Q1 2015 and by 1.2 % in Q2.

Year-on-year fall of industrial producer prices continued also in Q2 2015. Even though the deflation deepened in trend, ...

The deflation in industry lasted already one year and a half in Q2 2015. It even deepened with respect to trend. While the depth of the year-on-year fall of the industrial producer prices was always contained within one percentage in the first three quarters of year 2014, it regularly overtook this boundary in the last quarter of 2014 and in Q1 and Q2 of this year. The cause was obvious, the lower prices of oil were reflected in the prices of industrial producers.

...it mitigated between Q1 and Q2

Despite the trend deepening of the industrial producer deflation, a change for the better was apparent between Q1 and Q2 2015. If the industrial producer prices were falling by 3.3 % in the year-on-year comparison in Q1 of this year, the depth of the fall shrank by a percentage point to -2.3 % in Q2. It represented mostly the consequence of the temporary turn in the development of the price of oil, which mitigated the deflation in the segment of producers of coke and refined petroleum products and in case of producers of chemicals and chemical products. The development of prices of producers of beverages also negligibly participated on the smaller deflation of the industrial producers (prices shifted from deflation into growth).

Decline of the growth of prices of transport equipment producers since the end of the last year was the consequence of fading away of the effect of crown depreciation towards the euro

Depreciation of crown against the euro, which occurred at the end of 2013 (the crown was losing towards the euro due to the forex intervention of the Czech National Bank on average 5.9 % year-on-year in the last quarter of 2013), significantly increased the dynamics of the prices of producers of transport equipment (these products are traded in euros to a large extent, thus the change of the exchange rate of crown against the euro has on prices – denominated in crowns – a marked impact). By the end of 2014, when the effects of a weaker crown faded away, the growth of prices of producers of transport equipment logically shrank. This year's price dynamics is thus weak. Prices of producers of transport equipment rose by only 0.7 % year-on-year in Q1, they even fell by 0.1 % in Q2.

Surplus of milk on the market pressured its prices down. While they were lower by 10.5 % in the year-on-year comparison in Q1, it was already by 16.6 % in Q2

Prices of agricultural producers kept falling, they were lower roughly by one tenth year-on-year in both Q1 and Q2 (-9.3 %; -10.9 %). Especially the crop products were bought out for lower prices on a year before (-11.0 %; -11.6 %), the acceleration of the price drops was however apparent mostly for the animal and animal products (from -7.6 % to -10.3 %). It was the consequence of the surplus of milk in Europe, which reflected the restrictions on import of agricultural products and food in the Russian Federation, however it also cannot be ruled out, that the lifting of milk quotas also contributed to the surplus of milk on the market (lifting of milk quotas came into effect at the beginning of April 2015).

The growth of prices of construction works accelerated due to the high demand for construction activities on the part of public contractors

The strengthening demand for construction activities – especially on the part of the public sector, which tried to complete the drawing of financial resources from the European Union funds – was reflected in the insufficient capacities of construction businesses and in pressures on the growth of prices. If the prices of construction works rose by 0.5 % year-on-year in total for the entire last year, their growth increased its pace to +1.0 % in Q1 2015 and even to +1.3 % in Q2. The development of prices according to the type of construction work also proved, that the prices were pushed up mostly by higher demand of public contractors. While the prices of buildings rose by 0.9 % and 1.1 % in Q1 and Q2, the prices of engineering works increased by 1.1 % and 1.4 % (especially the prices of so called rail tracks increased among the engineering works).

Growth of prices of market services producers shrank

Disinflation continued in case of producers of market services, in spite of the fact, that the year-on-year growth of prices decreased only mildly between Q1 and

to +0.2 % year-on-year in Q2 2015

Q2 (from +0.3 % to +0.2 %). Prices of land transport services and transport services via pipelines fell by 1.8 % in Q2, other significant segments ascribed a moderate price increase (architectural and engineering services; computer programming, consultancy and related services; telecommunication services). With respect to the relatively little significant by weight – however „intensively monitored“ – employment services (services of job agencies), the price fall deepened from -2.9 % in Q1 to -7.3 % in Q2 in this segment. Anyhow it suggested itself, that this price development was a result of a favourable situation of Czech businesses reflecting in the transfer of agency employees among primary employees, the data of business statistics did not support this. Sales of job agencies increased in real terms by roughly one fifth year-on-year in Q2.

Prices of imports of goods, which fell by 1.5 % year-on-year in Q1 2015, already stagnated in Q2, ...

Prices of imports of goods were lower by 1.5 % in the year-on-year comparison in Q1 2015, however they already stagnated in Q2. Higher price growth, shift from deflation into growth, a milder deflation alternatively was apparent without exception in all division of SITC (Standard International Trade Classification), especially however in case of mineral fuels. If the prices of imports of mineral fuels were still lower by 25,0 % year-on-year in Q1, the prices of these commodities were losing 19.5 % against the same period of the previous year in Q2. If we take into account, that the exchange rate of crown against the US dollar was weaker on average by 22.5 % year-on-year in Q1 and on average by 23.8 % in Q2, it is obvious, that the moderation of fall of import prices of the mineral fuels can be mostly attributed to the movements in the price of oil.

...the deflation on the side of exports however persisted...

Reduction of prices persisted on the side of exports of goods and its depth also remained the same. The prices were lower by half a percentage year-on-year in both Q1 and Q2. Manufactured goods classified chiefly by material (-0.6 %) and chemicals (-1.5 %) were exported abroad for prices below the level of the last year in Q2 2015, among the commodities less significant by volume then also for example the mineral fuels, food and live animals or crude materials. Prices of the most significant goods on the side of exports, that is machinery and transport equipment (they form more than one half of total exports of goods from the CR in the long-term), increased mildly (+0.6 %).

... and terms of trade were negative for the first time after nine quarters

Fall of prices of exports of goods in connection to the stagnation of import prices, occurring in Q2, resulted in negative terms of trade (99.5 %). They fell into the negative numbers for the first time in the last two and a half years.

Chart 11 Consumer prices of individual types of households (y/y in %)

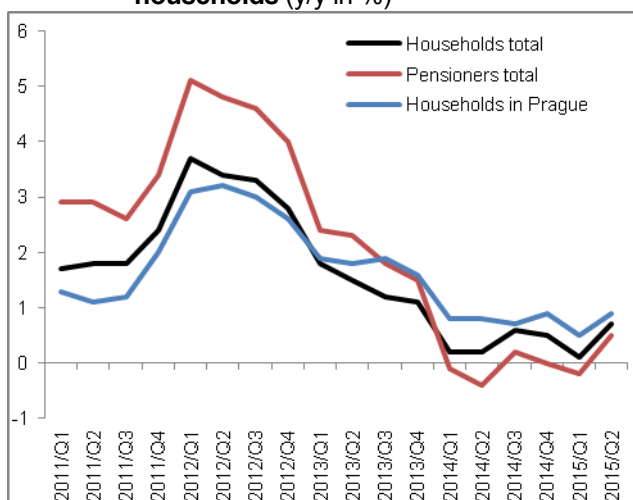
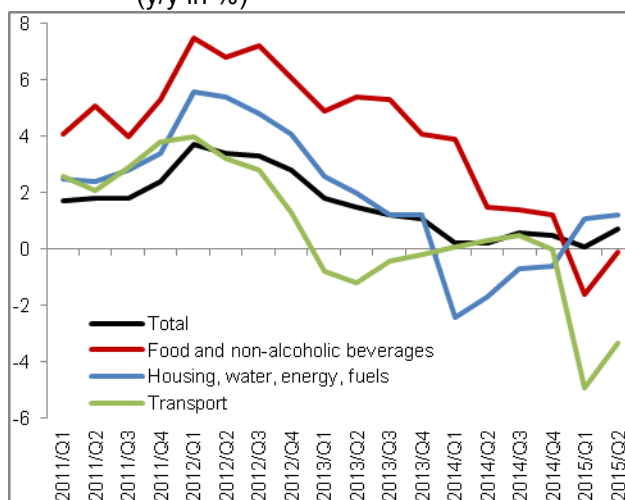


Chart 12 Prices in selected CPI divisions (y/y in %)



Source: CZSO



Chart 13 **Deflators** (adjusted for seasonal and calendar effects, y/y in %)

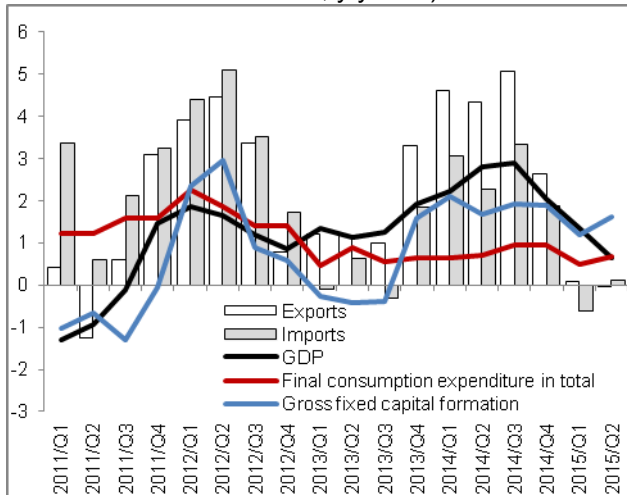
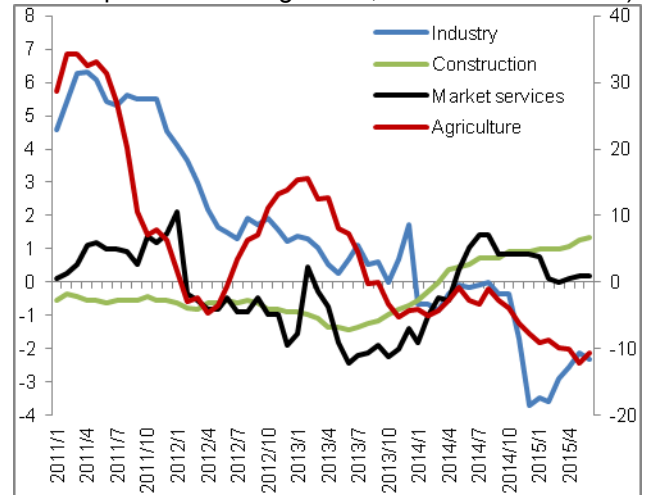


Chart 14 **Producer prices** (y/y in %, agricultural prices on the right axis, other on the left axis)



Source: CZSO

6. Labour Market

Favourable development of the Czech economy spills also to the labour market

Current trends on the labour market fully correspond to the development of the real economy. Total employment went up in the year-on-year comparison in both quarters of 2015, the numbers of vacant positions also increased. Number of persons seeking employment as well as their share in the total labour force was decreasing. Nominal growth of wages, which was only modest in the last year and at the beginning of year 2015 and did not develop in line with the expectations, already accelerated in Q2.

Total employment increased already by 1.4 % year-on-year in Q2 2015, ...

Total employment¹² rose by 1.3 % year-on-year in total for the entire H1 of this year and thus it increased the fastest since the 2nd half of the pre-crisis year 2008 (+2.2 %). Additionally it is apparent, that its increments are continually expanding. If the number of employed persons was practically the same in Q2 2014 as in the same period of the previous year, it was already higher by 1.1 % year-on-year in Q1 2015 and even by 1.4 % in Q2.

... especially due to the increase of number of employed in trade, transportation, accommodation and food service, in the manufacturing and in branches with the prevalence of the public sector

The increase of employment mingled nearly throughout the entire economy, except for only the financial and insurance activities (which registered by 0.2 thousand workers less on a year ago in Q2 2015), industrial branches apart from the manufacturing (-0.6 thousand) and „traditionally“ already the construction (where the number of employed persons lowered by 9.3 thousand). The two largest branches of the Czech economy (from the view of the number of employed persons) absorbed the most people, that is trade, transportation, accommodation and food service (+29.2 thousand) and the manufacturing (+27.2 thousand). The employment also significantly rose in the group of branches with the predominance of the public sector (public administration, education, health and social work; +10.3 thousand persons).

Continuing higher growth of the number of employees compared to the growth of total employment suggested, that the number of self-employed persons also decreased in Q2 2015

Favourable development of the Czech economy was not reflected only in the growth of the total employment that is in the growth of the number of persons, who have a job. This development also altered its structure. While the number of employees grew, the number of self-employed (i.e. persons, who worked so called for themselves) was declining. These tendencies – whose origin had been most probably lying partially in the transfer of workers from the „svarc system“ back among the classical employees, but partially also in the effort of self-employed to shift into the more certain employee positions – were pointed by

¹² Unless stated otherwise, the data are the national accounts data adjusted for seasonal effects.

the „discrepancy“ between the year-on-year growth of the number of employees and total employment. This discrepancy was apparent already for four quarters and it had rather a tendency to expand. If the increase of number of employees was higher than the growth of the total employment by 0.4 p. p. and 0.3 p. p. in Q3 and Q4 2014, this defined „discrepancy“ already amounted to 0.7 p. p. and 0.6 p. p. in Q1 and Q2 2015.

Hour labour productivity had been growing in the year-on-year comparison already seven quarters in a row

The growth of the economy occurred practically with a stable number of hours worked in the last quarter of 2014 and in Q1 2015 (gross value added rose by 3.4 % year-on-year in both quarters, total number of hours worked however nearly did not change). The acceleration of the economy in Q2, when the gross value added grew by 3.8 %, however already demanded a larger time resources (total number of hours worked rose by 2.2 %). If the hour labour productivity (gross value added related to the total number of hours worked) thus increased by very high 3.4 % year-on-year in Q4 2014 and even by 3.6 % in Q1 2015 (that was the strongest growth since the second part of 2010), its dynamics slowed down to +1.5 % in Q2.

Number of vacancies similar to the beginning of deep recession

New positions were being created fast and employers did not keep up with filling these by suitable candidates. The number of vacancies was thus growing – there were already 97.0 thousand vacant positions based on the data of the Ministry of Labour and Social Affairs (MLSA) as of the last June 2015, i.e. roughly by 20 thousand more than at the end of Q1 2015. Their number was the highest since November 2008.

Further lowering of the number of unemployed persons will likely be difficult with respect to the differing structure of the supply of labour force compared with the demand structure

Differing structure of the job applicants compared to the structure of the vacant positions suggested, that the supply did not match the demand on the labour market. While there were for example 12.8 times more job applicants for administrative positions than vacancies at the end of June (calculated from the MLSA data), the number of applicants for qualified jobs in agriculture, forestry and fishing exceeded the relevant job vacancies 7.5 times and the numbers of applicants for assistant and unskilled jobs 7.0 times. These persons thus founded employment only with difficulties. On the contrary, a low excess of persons searching employment as workmen and servicemen (2.7 times more compared to the relevant job vacancies) or operation of machines and equipment or a mechanician (2.1 times) can signal a high demand for these employees on the part of businesses and their difficulties to find suitable workers.

General unemployment rate lower on a year ago in June 2015. Improvement realised mainly for females

General unemployment rate for persons aged 15-64 years, based on the Labour Force Sample Survey (LFSS) and seasonally adjusted, lowered from 5.9 % in January to 5.1 % in June 2015. June share of unemployed in total labour force was lower by 1.1 p. p. year-on-year and suggested, that the number of persons seeking employment fell down by 55.8 thousand. Regarding males, in their case the general unemployment rate amounted to 4.2 % in June and it was lower by 0.9 p. p. year-on-year. In case of females it still remained by roughly 2 p. p. higher (6.2 %), however it fell more than for males year-on-year (-1.4 p. p.).

Situation on the labour market in the CR more favourable compared to the vast majority of the EU countries in Q2

The general unemployment rate in the CR had been low in comparison to the EU countries already for a long time, the position of the domestic economy nevertheless improved even further in this respect during H1 2015. While 5.9 % of labour force aged 15-74 years were seeking employment in the CR in January and it represented the fifth best result among the Union countries, this proportion fell to 5.3 % in April and it was the second best within the whole 28 countries. The CR kept a second position till the end of the quarter, only Germany registered a lower proportion of unemployed on the total labour force in these months.

Year-on-year growth of the average wage increased to +3.4 % in nominal terms in Q2...

Average gross monthly wage per full-time equivalent employee, which was raised only by 2.3 % in nominal terms in year-on-year comparison in total for the entire year 2014 and similarly in Q1 of this year, already started to grow more dynamically in Q2 (+3.4 %). It is apparent from more detailed data, that the average wage significantly increased for employees in accommodation and food service activities (+6.1 %) and in construction (+5.1 %), the earnings however notably increased –



due to the growth of wages of public employees at the end of 2014 – also for example in the public administration and defence (+5.6 %) and in the human health and social work activities (+5.0 %). The fact, that the wage median (+4.3 % year-on-year) grew faster than the average wage, was a positive aspect of the wage development in Q2. It suggested, that the earnings increased especially for employees with relatively low level of wages and thus can be assumed, that it was connected mostly with the increase of the minimal wage.

...and was also reflected in faster growth of the purchasing power of employees

Nominal growth of the average wage year-on-year was already quite strong in Q2 2015 and even a higher inflation rate did not prevent a faster growth of the purchasing power of employees in comparison to Q1. While the real average wage increased by 2.2 % then, it increased by 2.7 % in Q2.

Chart 15 Number of employed persons and employees (national accounts data, seasonally adjusted, y/y in %)

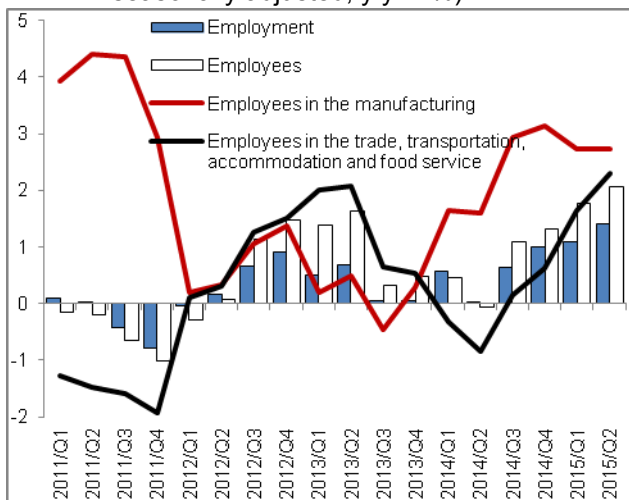
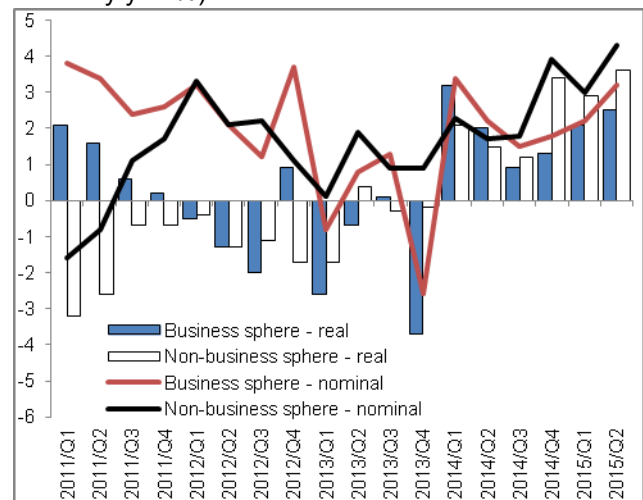


Chart 16 Average gross monthly wage, nominal and real (per full-time equivalent employee, y/y in %)



Source: CZSO

7. Monetary Conditions

The expansiveness of both monetary and fiscal policy affected significantly the growth of the Czech economy in H1 2015

The money supply rose in the Czech economy towards the end of June 2015 the most in the last three years. The M2 aggregate reached 3 461.2 bn crowns, which was by 5.8 % more compared to the same period of 2014. The addition to money supply was thus slightly higher than the nominal year-on-year addition to the nominal GDP (+5.2 %), which meant in this view, opposite from the same period of 2014, a mild expansivity of the monetary conditions. The growth of the monetary supply strengthened more markedly in Q2, the M2 aggregate increased by 3.9 % in the same period of 2014.

Both monetary and budget policy thus in combination with the fiscal expansivity contributed to the significant growth of the Czech economy in H1.

Large increase of non-term deposits of businesses was enabled by high growth of their profits even with considerable strengthening of their investment into the fixed assets...

Businesses further accumulate „cash“, if we contemplate with a certain simplification the financial balances on their current accounts this way. 102 bn crowns were added to these overnight deposits of business against June 2014, which is the highest year-on-year addition since the start of monitoring (2002). It shows the significant and growing reserve for financing of the fixed investment, but also the size of the operating capital. Only near 14 bn crowns diminished on the term deposits (deposits with maturity and deposits with redeemable at notice) of businesses, which means that the notable addition on current accounts was created by their large profits. These increased by nearly one tenth based on data for Q1 year-on-year (+9.8 %), i.e. less than in each quarter of year 2014 with a whole year addition of strong 12.4 %, however significantly more in comparison to the stagnation in 2013 (+0.4 %).

. ... and confirm the potential for wage increases in the private sector

The room for increases of wages for employees of firms as well as financing of investment from their own resources is thus large. It represents in this sense a potential for the growth of the economy not only via the household consumption, but also the investment activity.

People increased their non-term deposits – second largest year-on-year addition since the start of monitoring in 2002...

The household deposits followed development in a similar spirit as in case of businesses – the deposits on the giro accounts were higher by 148.3 bn crowns at the end of June 2015 compared to the same period of the previous year (the second highest year-on-year addition since the start of monitoring), while the decrease of funds on the term deposits was also very strong. People withdrew nearly 65 bn crowns from the term deposits and deposits with redeemable at notice compared to June 2014, which again represented the highest year-on-year decrease in the time series since 2002 based on the half-yearly data in year-on-year comparisons.

. ... and also alternatives of money deposits given the low interest rates on deposits

These proportions prove the lack of attractiveness of bank interest rates for clients flowing from the level of basic interest rates in the economy, but partially also the possible tilt of households to alternative forms of saving, as suggested by the development of their property in mutual funds or resources on the accounts of supplementary pensions. Direct investment into securities on the capital markets (especially foreign) could also attract the investors from the ranks of households, enabling yields high above the level of other assets – e.g. the Dow Jones Index increased by 26.4 % on the New York Stock Exchange at the end of June and the DAX Index by 10.5 % on the Frankfurt Stock Exchange, taking into account the movement of the crown foreign exchange, which rendered such investments even more lucrative.

Growing purchasing power as a significant factor of the household deposit increase

The growth of the purchasing power of households also impacted the significant addition to household bank deposits (in total for both term and non-terms deposits by 83.4 bn crowns year-on-year) apart from the causes of the financially-investment nature. It was induced by the improvement on the labour market and growth of incomes. The average nominal wage was raised by 2.9 % based on the half-yearly data year-on-year, real wage by 2.5 %, but the median wage of males even by +5.6 % in Q2 due to the structure of their employment oriented to a notable extent on the manufacturing, which grew dynamically.

The relatively low need for external sources of funding still prevails – dynamics of corporate loans increased its pace only mildly from +3.9 % to +5.8 % year-on-year towards the end of June 2015

The total deposits of businesses hiked up roughly the same as the total household deposits year-on-year in H1 (by 88.1 bn crowns, which was the second largest addition since the beginning of monitoring in 2002). This development logically limited the need for external resources. The dynamics of loans offered to businesses did accelerate somewhat (+5.8 % year-on-year against +3.9 % by the end of June 2014), however it still remains relatively low – e.g. when compared with year 2008, when the economy grew in nominal expression by 4.8 %, the financing of firms on the part of banks was markedly more intensive (the loans to businesses increased by 16.7 % and by nearly one fifth in the first half-year).

The additions to the mortgages of households strengthen already since the half of year 2013, the fastest in the last three years year-on-year by the end of June 2015 – on the contrary, the growth of consumption credit was affected only by the organisational change in the financial institutions sector

Marked year-on-year increase of consumption credit to households was affected by organizational change¹³ causing their increase by 18 bn crowns. Without this change, the provided consumption credit to population including the debit balances on the current accounts would be based on the banking statistics again lower year-on-year. People likely use their resources deposits with banks for the purchases of durable goods. Total balances of consumption credit (210.3 bn crowns at the end of June 2015) represent only 17 % of the total size of banking credit provided to the population.

On the contrary, the housing loans to population increased by 59.1 bn (+6.8 %) to 930.2 bn crowns year-on-year. The reason was the strong addition of provided

¹³ Merger of the foreign bank branch with the non-bank entity (falling into the category Financial assets intermediaries – other lending) affected the data in the bank and monetary statistics as of 30.6.2015. The balance sum of banks increased one-off by 20 bn crowns, consumer credit to population including the debit balances on the current accounts rose by 18 bn crowns, in that receivables on the credit cards by 8 bn crowns. At the same time, the credit provided to other financial intermediaries decreased by 8.5 bn crowns.



mortgages (+57.7 bn, i.e. +7.5 %, to 826.1 bn crowns). People were motivated the most by the very low price of funds the banks provided these loans for. Positive expectations associated with the economic development also had their impact and also the improving condition of the household budgets. Balances of building saving loans were however nearly by one billion lower, which confirms the decisive effect of low interest rates of mortgages on the growth of total loans of Czech households for housing.

Margins of commercial banks remain high

Low interest rates of banks on new deposit trades were again lower year-on-year at the end of June 2015, both for businesses and for households. Interests on deposits with maturity for households were the exception (+0.39 p. p. to 1.57 % p.a.), still people reduced the balances on these deposits by 28.6 bn crowns against the end of June 2014. Bank margins remain despite relatively weak credit expansion still at high levels – interest rates on provided bank loans added up to 12.57 p. a. in new trades on consumption loans and rates from deposits, in maturities roughly corresponding to these loaned funds, oscillated between 1.4 % till 1.57 % p.a. Banks determined interest on the deposited funds on current accounts of households by the rate of 0.12 % p.a. and to businesses 0.11 % p. a. in June 2015.

Chart 17 Credit dynamics (y/y in %)

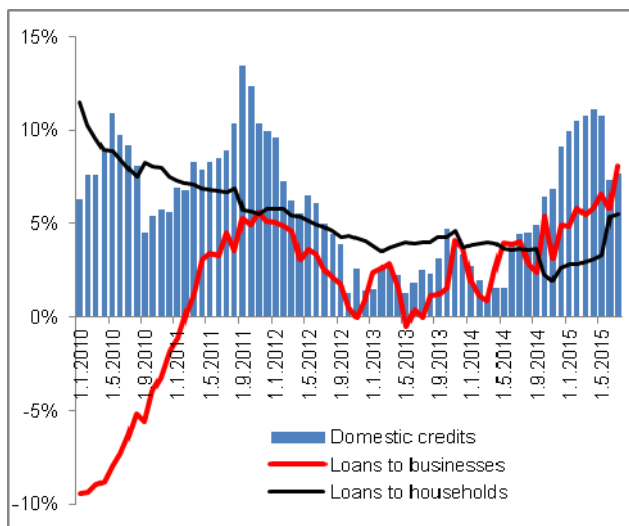
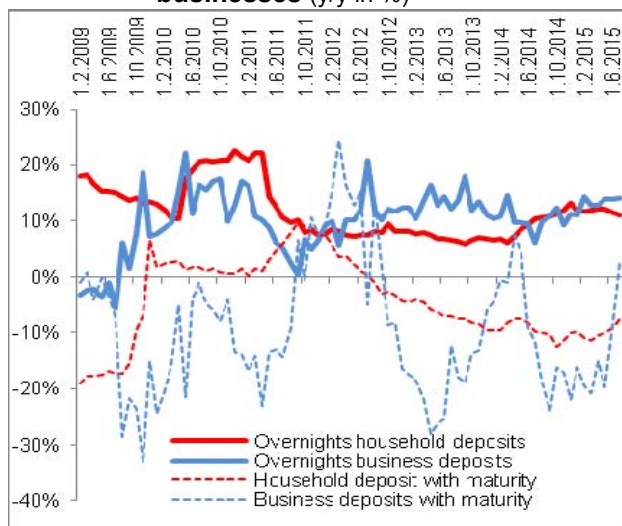


Chart 18 Deposits of households and businesses (y/y in %)



Source: CNB

8. State Budget

The surplus of the state budget was the highest since the formation of the CR in H1

The results of the state budget were affected mostly by the strengthening economic growth during the first half of 2015, gradual shift from the former restrictive measures, as well as the intensive drawing of funds from the EU budget. State budget (SB) achieved (based on cash fulfilment) the surplus of 22.6 bn crowns, which represented the best half-yearly result in the history of the independent CR. SB balance (forming the key item of surplus or deficit of the government institutions sector) amounted to +1.0 % in relation to nominal GDP in H1 (+0.1 % last year).

Acceleration of drawing on the EU funds – state budget gained by nearly 50 bn crowns more year-on-year in H1

Non-tax revenues¹⁴ held a key position in the record SB balance thanks to the completion of drawing of funds from the EU at the end of the programme period. The size of revenues from the EU exceeded the level anticipated by the SB for the whole year 2015 already during June. The CR in total acquired 150.5 bn crowns from the EU in H1 (nearly double year-on-year) and at the same time it represented 19 % of all „Union“ revenues gained from year 2007. Mostly the

¹⁴ Non-tax revenues were increased by some extraordinary revenues in the last year (especially the auction of frequency bands for high speed mobile network for 8.5 bn crowns).

revenues from the structural funds significantly accelerated (to 96 bn crowns, from 35 bn crowns in H1 2014). Total net position of the CR towards the EU budget thus arrived at record 126.8 bn crowns in H1 and 537.1 bn crowns then since the beginning of year 2004.

State wide collection of VAT was continuously higher year-on-year since March 2015, total final consumption expenditure in the economy increased by 3.5 % in nominal terms in H1

The swift economic growth was more and more visibly reflected in the collection of tax revenues during the year, even for the indirect taxes, whose year-on-year dynamics was blurred by the non-standard high last year's basis¹⁵. State-wide collection of the dominant VAT still lagged by 7.5 bn crowns behind the last year's result for the whole H1, however it recorded a continuous year-on-year growth already since March (and it almost reached the last year's level for the first eight months of 2015). The falling prices of automotive fuels as well as introduction of the second lowered VAT rate (books, medicaments) also influenced the VAT collection.

Collection of all consumption taxes still by 4 % lower year-on-year in H1 (due to the lower collection for tobacco products), however already 4 % higher at the end of August

The state acquired by 4 % more on the tax on mineral oils (the key item of the consumption taxes). Favourable prices of the automotive fuels stimulated demand (incl. foreign carriers), the expanding economy also contributed to the development of transportation, the repeated introduction of tax reliefs had on the contrary a negative effect (so called green fuel). The impact of last year's pre-stocking on the collection of taxes on tobacco products overshadowed the effect of the repeated increase of rates for a long time (the collection weakened by 13 bn crowns for Q1 2015, by 4 bn crowns for H1, it was by nearly 2 bn crowns higher again by the end of August).

Collection of the corporate tax higher year-on-year already sixth quarter in a row, higher collection of income taxes from employees was prevented by the spread of tax reliefs

The improved financial situation of businesses was also reflected in the state-wide collection of corporate income taxes, whose strong growth dynamics from the last year was sustained also in this year's H1 (+8.4 %). The collection of individual income taxes on wages and salaries (ITNP) on the contrary increased only modestly (+1 %), when the effect of higher employment as well as gradual acceleration of growth of wages was partially hampered by the legislative measures (increase of the concession on the second and further child, „kindergarten fee“, basic concession of working pensioners). Tax reliefs also reduced the collection of tax of unincorporated individuals in H1, which was by 2 bn crowns weaker year-on-year. State wide collection of corporate taxes was compared to its boom (H1 2008) lower by one sixth this year, collection of taxes from employees however increased by one seventh compared to the same period.

Lower fulfilment prevailed among the significant items of tax revenues against the budget anticipations only for VAT at the end of August

Dynamics of the SB outlays growth fastened

Total SB outlays increased by 5.2 % in H1 following their stagnation in the previous three years, the most after year 2009. Investment participated on this result in nearly two thirds, current outlays then to a lesser extent (+11.4 bn crowns). Social benefits, the key component of outlays, rose by a more modest pace year-on-year (+2.7 %). Social benefits cut straight 40 % out of all SB outlays (40.9 % a year ago). More than three quarters of social benefits were directed for pensions, influenced by a restoration of a former adjustment scheme, partially also by the intergenerational change of pensioners (their numbers stagnate for the last three years). Even though the growth of outlays on pensions (by 3.1 % year-on-year) was the highest this year after year 2012, deficit of the pension account balance (the difference between revenues and outlays on pensions from the SB) kept further falling (to 13 bn crowns) thanks to the dynamic growth of the retirement contributions (+4.8 %, the highest in the last seven years within H1).

Economic growth is fully reflected in higher collection of insurance on pensions, pension account deficit was the most favourable this year since H1 2009

The dynamics of social benefits outlays (apart from pensions) slows down since 2013, only the sickness benefits rise more significantly

The growth of sickness benefits (11 %) was reflected in the higher outlays on other social benefits (+1.2 %), due to the repeated payment of sickness benefits already from the 15th day as well as the growth of incapacity for work. Social care benefits also grew but considerably less (+1 %) as a result of higher contributions on care as well as benefits for the persons with disabilities (on the contrary, the

¹⁵ The last year's higher collection of consumer tax on tobacco products was linked to the intensive pre-stocking of traders at the end of year 2013 for the reason of subsequent increase of rates. As of 1.12.2014, another increase of the consumer tax rates occurred for the tobacco products, but was supplemented also by the regulation of the pre-stocking. Higher VAT basis was associated with the temporary deferring of payment of the part of excessive deductions at the beginning of year 2014 (in the amount of 8.4 bn crowns) for the non-settled VAT payers.



supplementary payments for housing growing strongly in the past fell mildly year-on-year in H1). Less was directed to the state social support (when only the contributions for housing, maternity grant and benefits for foster parents grew) and the unemployment benefits (-12 %).

Outlays on state employees' wages overtook the level from years 2009-2010 for the first time

Retreat from the former restrictive measures was also reflected in higher non-capital transfers to the local budgets by one eighth year-on-year (e.g. teacher salaries or contribution on the state governance performance in municipalities) as well as the growth of outlays on wages of the state employees (by 9.9 %, partially also due to the preparation for the new civil service act). The SB saved on the outlays on the state debt similarly to the last year (-3 bn crowns) or payments to the EU budget.

Intensive completion of drawings from the EU funds catapulted the size of SB investment to the level from the first half of years 2008-2010

Continuous fall of the capital outlays halted after four years (within H1), when the investment grew by strong 55 % year-on-year. Full 85 % of outlays consisted of cofinancing projects with the EU (mostly into the transportation infrastructure, entrepreneurship and innovation, environment and also within the framework of the Regional operational programme). The SB investment apart from the cofinancing of projects with the EU played with respect to their volume as well as the year-on-year dynamics a marginal role. The total investment presented 8.7 % of the SB outlays in H1 2015, they moved close to the level from the first half of years 2008-2010 in the absolute amount.

The stabilization of the size of the state debt in process already for nearly two years, the state borrowing needs focus on the domestic market

The stabilisation of the state debt, whose size has been practically stagnating for nearly two years, continued also in H1. It amounted to 1 663 bn crowns towards the end of Q2, featuring minimal movement regarding both the external and internal debt since the beginning of the year. The total debt decreased by 20.3 bn crowns year-on-year. The significant reduction of the external debt contributed to this result (-13.8 %), when the state preferred to realise its new borrowings on the domestic market, internal indebtedness on the contrary increased by 2 %. External debt shared in the total state debt by near 17.8 % (the least since the beginning of year 2008).

Chart 19 State-wide collection of tax revenues (y/y, in %) and state budget balance (in bn crowns, data for individual half-years)

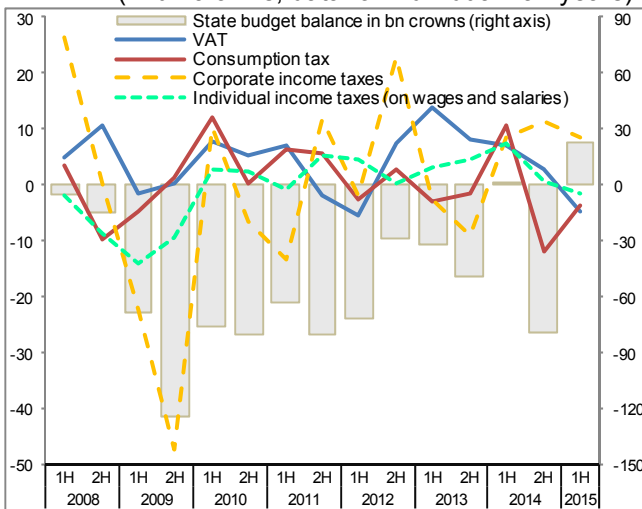
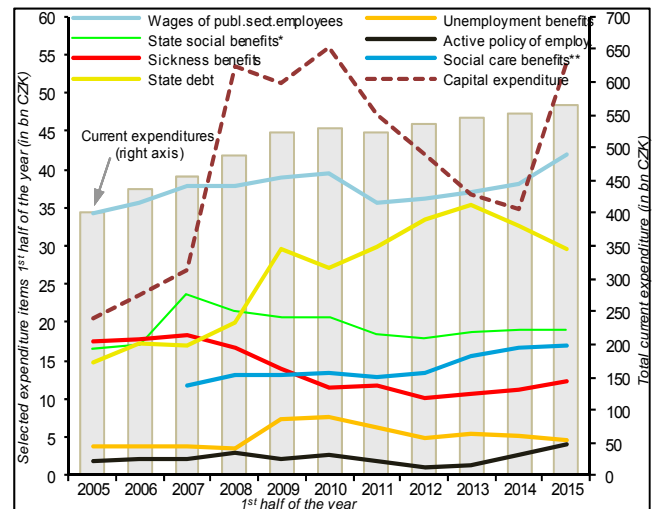


Chart 20 Selected state budget expenditures (1st half-year, in bn crowns)



*incl. foster care benefits
 **material deprivation assistance benefits, disability benefits, contribution to care based on Act on State Social Support
 Source: MF CR

Sources of data in the whole analysis: CZSO, MF CR, CNB, CSSA, MLSA, Eurostat, CZSO calculations. Latest information from the CZSO and CNB given in this report has been dated the 15th September 2015.