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Main Trends in General

The GDP y-o-y growth in the Czech Republic rose by 3.1% in Q1, thereby the Czech Republic has surpassed considerably while in the euro area GDP increased only by 0.6% q-o-q and by 1.3% y-o-y.

The predominant GDP sources are construction and industrial production on the supply side of economy; gross fixed capital formation (by 9.5% up) and household consumption (by 3.9% up) are on the demand side of economy.

In Q1 2004 growth rate of both exports and imports of external trade speeded up and arrived at double-digit figure. Exports rose by 12.1% y-o-y, whilst imports by 11.1%. Adverse balance of external trade decreased by CZK 3 bln in Q1 2004; in April the deficit rose again. Course of external trade was positively affected by favourable trends in exchange relations reaching 102.6.

In January consumer prices jumped by 2.3%, then during next couple of months stableness have been gradually enforced, so that swings to positive inflation differential to the EU countries occurred, where inflation did not exceed 2%. In import prices as well as in industrial production prices steep progression in prices of both petrol and metals carried through.

Unemployment growth rate in January and in February was substituted for seasonal fall in the course of next months. In May registered unemployment rate dropped to 9.9%, which was by 0.6 p.p. more than in the equivalent period of the last year. Suspension of labour forces absorption in sector of services was a typical attribute of this development. The unemployment rate in EU countries has hovered around 9%.

Ratio of current account deficit of balance of payment to GDP increased to 2.6%. Faster growth of expenses compared to incomes caused considerable deepening of deficit to CZK 19.2 bln. Common account deficit was not covered by surplus of financial account arriving to CZK 3.5 bln only.

Monetary development showed dilatory growth of the money stock (6.6%) compared to development of the nominal GDP (7.4%). The boost of consumer accounts as well as high margins between deposit and credit interest rates were distinctive characteristics.

Overall Economic Performance

- ***GDP continued rising*** Enlargement of GDP was apparent more in Q1 than its middle-term trend did or its average gain rate for previous eighteen quarters, respectively. Noticeable structural changes occurred. The radical change in comparison to the previous development is that the main contributors to the GDP enlargement were expenditures for gross fixed capital formatting, as the growth of final consumption expenditure of households slowed down. Negative affect of net exports strengthened notably as a result of constantly diminishing surplus of balance of services. Increase in labour productivity entirely hastened the GDP growth, because number of labour forces set lower.
- ***International position of the CR consolidated*** GDP of the CR outstripped nominally as well as really other EU-15 countries; positive growth potential is indicating consolidation of the economic position of the CR; in relation towards the accessing countries the growth differential was negative.
- ***Intense affect of external economic sector*** Enforcement of external economic sector evinced by positive impact on development of both aggregate supply and demand, reflected not only increasing range of negative net exports, but also changes in income structure, outlays and capital transactions.

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Lower growth of gross disposable domestic product than GDP caused mainly by accelerating of growth of non-residents net primary income, as well as considerably faster outlays for gross capital formation than gross domestic savings, resulted partly sizeable expansion of negative balance of non-resident current transactions, partly in net shrinkage of financial assets. Financing of gross domestic capital production with external sources has arisen.

- ***GDP growth by really 3.1% affected most increase in fixed capital production***

In Q1 2004 GDP reached CZK 637.9 bln in current purchase prices and increased really by 3.1% y-o-y. Increase in outlays for gross capital formation contributed twice to GDP growth than increase in final consumption expenditures. Expenses for gross fixed capital production accelerated and enlarged most; it augmented by 9.5% really supplying the GDP growth by 2.3 p.p. Investments in buildings and constructions became substantially faster than those in machinery and equipment. Rise of final consumption expenditures slowed down appreciably; however their y-o-y really expansion by 3.9% affected GDP growth by 1.9 p.p. Expansion of household consumption has been endorsed on one hand by increase in its disposable gross incomes, on the other hand by dissaving of consumer credits. Extent of household savings increased, because population perceives sensitively an unemployment growth as well as inflation rate considerably. Production of supplies put in to GDP growth as well (1.0 p.p.), so that only the general government sector (as one of expenditures items) affected its development negatively; volume of those expenditures really dropped by 1.6%, which supports corrective actions of the government. Significant major acceleration as well as faster growth of total imports than total exports having partly negative effect (with 7.0 p.p.) and partly positive effect (with 5.3 p.p.), leading to increase in range of negative effect of net exports on GDP development. Rapid fall in balance in favour of incomes as well as outlays for services (mainly increase in imports of other services) was causal factor in proportion to GDP. Cover of total imports with total exports decreased significantly, as well.

- ***Increased affect of domestic supply than demand***

The Q1 2004 nominal volume of both aggregated supply and demand reached CZK 1 046.4 bln in current prices, increasing really by 5.7% really y-o-y. Increase in domestic realised demand by 3.9% and external demand by 8.3% contributed to the growth of aggregated demand by 2.4 p.p., or 3.3 p.p. respectively. Domestic effective supply rose moderately (2.1%) than domestic demand and participated in increase of prices by 1.3 p.p. Enlargement of external supply (11.3%) apportioned the remainder 4.4 p. p, resulted in decrease of cover of domestic demand with domestic supply and increase of domestic demand cover with external sources.

- ***Faster growth of final domestic expenditures than GDP***

In Q1 2004 resources at disposal for total final expenditures achieved CZK 1 064.5 bln and rose really by 6.2% y-o-y. Total imports (4.3 p.p.) contributed to their growth much more than GDP (1.9 p.p.). Growth of both total exports by 3.3 p.p. and total gross final domestic expenditures by 2.9 p.p. affected increase in total final expenditures by 2.9 p.p. Hence expansion of final expenditures affected use of disposable resources more than GDP influenced their production increase. Cover of gross domestic final expenditures with GDP dropped really by 1.7%.

- ***Substantial increase in rate of capital financing from external sources***

Gross disposable domestic revenue CZK 620.3 bln was lower by CZK 17.6 bln than GDP (in current prices); it rose by 5.6% y-o-y, i.e. lower than GDP (growth 7.3%). This difference in rates was brought about by common negative influence of net primary revenues and net current transfers (the y-o-y increase in adverse balance by CZK 10.6 bln). Final consumption expenditures rose slightly to a lesser extent than gross disposable domestic revenue, so that nominal volume of gross domestic savings of CZK 163.3 bln was by 5.9% higher y-o-y. Rate of savings rather improved, but on the other hand rate of investments jumped. Shortage of domestic savings caused financing of gross capital production from external sources increased by 4.9% in Q1 2003 to 9.3% in Q1 2004.

- ***Labour productivity gained GDP growth***

In Q1 2004 total labour productivity rose by 3.9% y-o-y; as the only issue (among other production factors) put in to GDP gain. Primary incomes per capita rose faster, which led to increase in unit labour costs.

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Industry, Construction and Selected Services

- ***Growth of production hit records in main branches***

In Q1 2004 the Czech economy was growing steeply which proofs development of the total production in three main branches (industry, construction and selected market services) with more than 7% of the y-o-y gain as well as extremely growth acceleration. Increase in labour productivity developing favourably in relation to average wages level achieved considerably increase in production of the above mentioned branches, leading to diminution of unit wage costs. Strong rise in industrial production did not constitute additional job opportunities, on the contrary the y-o-y employment dropped (but less than the last year); production hit record in construction leading to arise of number of job possibilities, especially rate of number of employees hastened. Improved production in industry and construction outstripped on one hand new voided contracts, on the other hand generation and further widening of labour sources. Contributors to accelerated growth of production were partly faster movement of prices in industry, construction outputs as well as prices of exported goods.

- ***Substantial growth of industrial production differentiated by branches***

In this year industrial growth followed up results achieved in 2003 and even surpassed preliminary expectations. Economic performance of industry measured by an industrial production index as well as by sales in industry was higher by 9.0% or in real terms by 9.1% in Q1 2004, which demonstrated higher dynamics of growth by 2.7 p.p. or 2.4 p.p. respectively. This development comprises sharp growth dissimilarities during couple of months (3.8% in January, 15.3% in March), as well as deep changes in structure of goods and branches. Production of durable goods (with low share of 3.1% in the production) arrived at the maximum growth of 26.0%; then production of intermediate products achieved 15.2% (with a substantial share of 40.7% in the production), which is reflecting an increasing share of intermediate goods production in the Czech industry. In production of energy inconsiderable increases appeared. Volume of manufacturing industry production was higher compared to the growth in the total production (by 0.9 p.p.); in manufacturing of metals, metallurgy and metalworking industry (22.2%), then in production of electrical and optical appliances (14.4%) extremely gains were recorded. Machinery production as well as maintenance of machinery and equipment diminished (by 1.8%), production of textiles and clothing reduced by 0.5%. Sales in industry spanned in the course of months (2.4% in January, 15.7% in March). Mainly processing industry, as well as external demand provided increases in sales.

- ***External demand contributed most to growth of industrial production***

Direct export sales arose by 13.7% really in Q1 2004 (by 21.6% in March). It documents an extraordinary export achievement of the Czech industry was getting faster despite the sluggish revival in the euro zone. Purchasing power of the direct exports of the Czech industry became stronger and its y-o-y growth speeded up. On the contrary absorption capacity of exports for resources produced by exports were substantially lower than the purchasing power growth and slowed down. Increase in domestic income (production for domestic use) was much slower (in real terms 5.1%) in comparison to increases in direct export sales however the growth differential shrank. Total sales in foreign-controlled enterprises jumped (by 12.3% really), and moreover its outstripping expansion (compared to total sales growth) accelerated. Consequently slacking sales growth of remained enterprises gradually went up in contrast to increases in total sales (by 5.5% in real terms); nevertheless the y-o-y increase in total sales was higher.

- ***Labour productivity as crucial indicator of industrial production growth by decrease of number of employees***

Labour productivity in industry arose with remarkable pace (by 10.8% y-o-y), its growth rate intensified; however it put in increases in sales less than a year before, because lowering of unemployment rate diminished (-2.4% in Q1 2003 and -1.6% in Q1 2004). Significant increase in average wages than the labour productivity, such that unit wage costs gradually abated by 2.0%; their fall moderated by 2.3 p.p. at the same time share of wages in total sales in industry (in current prices) shrank, such that primary incomes (for instance revenues) rose faster than sales.

- **Number of new voided purchase orders rise faster than production**

Positive development in new voided purchase orders whose the y-o-y nominal volume expanded by 15.7% in Q1 2004 and accelerated by 10.4 p.p. (i.e. much more than sales in industry) establishing favourable pre-requisites for further rise in industrial production. Volume of new voided purchase orders abroad (18.4%) expanded faster by the sluggish accelerating of growth (9.2 p.p.) than the total volume of all orders. The relation factor between total volume of purchasing orders and total sales than those between purchasing orders abroad and direct exports sales. Nominal volume of new voided purchase orders, especially in the production of other transportation facilities and equipment expanded by 68.7%; as well as volume of purchasing orders abroad in the production of healthcare, optical and precision apparatus and timers. Outstripping growth of new voided purchasing orders than growth of sales, favourable development in state of affairs of purchasing orders, putting some new production plants into operation in coincidence with the influx of new investors underpinned potential resources of the production and further cutting down of employment pace.
- **Industrial production continued growing**

Industrial production continued growing notably fast likewise in April, arriving at 10% y-o-y. Manufacturing of intermediate products increased most (by 15.2%), manufacturing of energy reduced by 0.5%. The essential contributors to the growth were manufacturing of metals, metallurgical and metalworking industry, manufacturing of electrical appliances and chemical products; on the other hand manufacturing of machinery, electricity, gas and water reduced. The y-o-y sales in industry lifted by 8.4% in real terms, the growth layout was broadly the industrial production alike. Mean surpassing were Direct exports sales increasing by 9.8% and total sales in foreign-controlled enterprises achieving 11.4%. Fall of number of employees in industrial plants (1.3%) persisted, in coincidence with the rise of both labour productivity and average wages by 9.8% and 6.9% eventuated shrink of unit wage costs by 2.6%. During the period of four months (January through April 2004) the y-o-y industrial production improved by 9.3%, total sales in industry increased by 8.5% in real terms. Reducing of employment by 1.6% resulted in jump in labour productivity by 10.2% and drop in unit wage costs by 1.9%.
- **Extremely fast grow of construction work**

Construction output can be characterised by boom of production, which contributed especially construction work in accordance with supplier contracts ("S"). In Q1 2004 amount of them (involving estimation) was up by 16.2% really y-o-y; such a quarterly swing has not been observing in the autonomous Czech Republic yet. Production in smaller enterprises (less than 20 employees) arose considerably (by 17.0%) than in those with 20+ employees (15.9%). Production in larger enterprises with 300 – 399 employees increased by substantial 36.1%, production in enterprises with 20 – 99 employees rose by 8.0% only.
- **Boom in new construction work**

Development in construction work showed differences among enterprises as well as types of work; in Q1 2004 the y-o-y volume of work on new construction outputs, reconstructions and modernizations enlarged by 17.8%, accelerating their growth by 20.1 p.p., however in Q1 2004 the y-o-y volume of work on reconstruction and maintenance dwindled really by 7.3%; as a result of the boom in Q1 2003. In the equivalent time period volume of construction work within building construction enterprises enlarged by 17.1% and civil engineering construction by 8.7%; this acceleration seemed to be 18.3 p.p. or "only" 4.5 p.p., respectively.
- **Unambiguous effects of realization of construction work**

This fast growth of construction work supplied not only substantial changes made to VAT, i.e. switches of the construction outputs to higher VAT rate (except construction of dwellings), but also progress in the planners projects (for business and administrative aims), finalisation of work on many big constructions intended for traffic infrastructure, business centres and foreign investors, as well as extension of volume of work on dwellings construction.
- **Increase in number of employees as well as labour productivity**

The Q1 2004 boom in construction work was put into life by the substantial increase of partly labour productivity (by 13.2%) and partly acceleration of growth (by 15.2 p.p.) measured by means of volume "S". Increase in number of job opportunities in construction resulted in increase in number of employees in enterprises with 20+ employees by 2.5%, partly in their average monthly wages by 8.5%, which led to fall

productivity	of unit wage costs by 4.2%; comparing to the Q1 2003 growth it represents a plunge by 11.1 p.p. Almost two thirds of the total number of employees in construction enterprises are manual workers; whose number increased by 1.8%, i.e. lessened by 0.7 p.p. than the total number did.
<ul style="list-style-type: none"> Increased number of construction permits 	In Q1 2004 the building offices granted 29 258 of building permits, which is by 17.2% more y-o-y, however informative price of permitted buildings of CZK 62.9 bln diminished minimally. Nevertheless volume of dwellings constitutes almost 30% of the above-mentioned amount and even increases in their orientation worth eventuated favourable situation at the mortgage market (significant increase in number of mortgage loans) and building savings.
<ul style="list-style-type: none"> Inventories of construction work have increased, their growth is getting slow down 	Construction enterprises with 20+ employees oriented predominantly on building construction, civil engineering and preparative work assigned 15.7 thousand of contracts at the end of Q1 2004. At the end of Q1 2004 construction orders comprised inventories (not realised construction work) in total amount of CZK 173.4 bln, however their y-o-y growth by 12.8% to a great extent moderated. In Q1 2004 volume of new contracts was representing sum of CZK 48.6 bln, which was by 10.2% more than the last year, but their growth slowed down as well, so that whilst pace of construction work speeded up, increase of number of new contracts plunged. Despite there is an adequate amount of construction output inventories can be carried out at any time horizon; almost three quarters of them are comprising those are time limited (have to be completed during one year) purchase orders.
<ul style="list-style-type: none"> Extremely fast growth in construction outputs 	In April construction output came into enormous prosperity; the real y-o-y growth hit 62.4%. Pre-invoiced construction works (supplier contracts with the lower VAT tax) eventuated diminished growth in construction work realized by their own employees. Both data on employment increase (by 2.9%) and growth in average wages (by 8.25%) do not demonstrate any extreme shifts in trends. From January to April 2004 the y-o-y construction output enlarged really by 31.6%. Employment rose by 2.3% that is why at the increase of labour productivity by 28.6% and growth in average wages by 28.6% hence unit labour costs abated by 15.6%.
<ul style="list-style-type: none"> Fall in sales of cars resulted in slowdown of growth in retail sales 	<p>In Q1 2004 the branches of selected market services (retail, hotels and restaurants, transportation and communication and other services) volume of sales expanded really by 5.6% and consequently their growth speeded up by 3.8 p.p.</p> <p>The greatest volume of sales included transport (by 9.1% up) hotels and restaurants (by 8.4% up), where the substantial speed up (by 12.5 p.p. up) was registered. The unexpected diminishing increase in retail sales (only 1.4%) influenced abatement in the growth (by 1.8 p.p. down). In the course of individual months level of retail sales were evolving diversely - fall by 1.5% in January was exchanged for the growth by 3.1% in March. The lower q-o-q growth in retail sales negatively fluctuated sales, servicing and maintenance of motor vehicles (drop by 5.2% in real terms), with swaying pace of growth in the course of the months, on the contrary volume of sales of automotive fuels enlarged by 4.5% in Q1 2004 in real terms. In retail (excluded motor sports segment) sales rose by 2.8% really in Q1 2004, sales of food were by 2.6% up (with relatively stable pace per month), sales in non-food products were by 3.0% up (with fluctuating pace). Total factor and the y-o-y factors of accelerating or decelerating are reflecting considerable variability, as well as a length of span between a maximum and minimum value.</p>
<ul style="list-style-type: none"> Sluggish growth in average wages in comparison to labour productivity growth 	Number of employees in enterprises providing selected market services changed slightly in Q1 2004; their average monthly wages increased by 5.8%. Total sales at constant prices (sales per employee) increased by 5.4%, therefore unit wage costs grew moderately (by 0.4%). In individual branches of selected market services the labour productivity of employees, as well as their average wages and unit wage costs fluctuated dissimilarly.

External Economic Relations

The growth of exports and imports of goods has speeded up

In Q1 2004 exports accelerated and increased year-on-year by 12.1 %, imports rose by 11.1 %. Exports increased relative to all major territories, although to a varying extent. Exports into European transition economies and CIS experienced above-average growth (18.1 %). Semi-finished products and manufactured consumer goods boasted the highest growth of exports. Export performance was favourably affected by terms of trade and the revival of trade in the European Union.

• Trade deficit in Q1 2004 shrunk only to expand again in April

Negative balance of foreign trade in Q1 2004 fell by CZK 3 bln. Diverse development was recorded in individual months. After a mild deficit in January the trade balance ended positive in February (coverage of imports by exports of 103.0 %) and negative in March and April, with the April deficit being more pronounced (CZK -10.8 bln). This result was influenced by repeated faster growth of imports to exports mainly as a consequence of the growth of trade deficit with China, Japan, Russia and Korea. With respect to the commodity structure the exports of investment facilities went up markedly. The significant April escalation of exports and imports (year-on-year by 24.7 % and 25.7 % respectively) could have been impacted by anticipated changes in customs tariffs and administrative requirements of the foreign trade being in effect from May 2004.

Growth of supply and demand for foreign exchange

Nominal volume of generated supply and demand for foreign exchange of CZK 474.5 bln in Q1 2004 meant a year-on-year increase of 7.5 %. In relation to GDP in current prices it represented 74.4 %, which was 0.2 p. p. more compared to Q1 2003. The structure of total foreign exchange supply and demand changed considerably. On the supply side, the effect of exports of goods and services heightened and the effect of imports of capital as well as transfers weakened. On the demand side, the impact of imports of goods and services as well as exports of income strengthened and the impact of exports of capital and increase in foreign exchange reserves lowered.

• New negative phenomenon – deficit of balance of payments deficit

Sum of the balances of balance of payments accounts switched year-on-year from the surplus of CZK 26.4 bln in Q1 2003 to deficit of CZK 13.2 bln in Q1 2004, which was to a much greater extent caused by the drop in the financial account surplus (by CZK 30.9 bln) rather than an increase in the current account deficit (by CZK 8.7 bln). The coverage of the current account deficit by the financial account surplus fell dramatically year-on-year; the ratio of financial account surplus to current account deficit in Q1 2003 presented 4.29 multiple and in Q1 2004 decreased to low 0.21 multiple. Foreign exchange reserves were used to finance current account deficit.

• Current account deficit has more than doubled

Current account deficit of CZK 16.7 bln in Q1 2004 was year-on-year higher by CZK 8.7 bln. Relative to nominal volume of GDP, this deficit constituted 2.6 %, i.e. by 1.2 p. p. more than in Q1 2003. The deficit swelled as a result of faster growth of outlays (11.6 %) in comparison to the growth of receipts (9.7 %); while the final outcome was most adversely affected by slashed receipts on the current transfers balance by more than a half as a consequence of cut down foreign aid from the EU funds and due to various forms of transfers to households. Subsequently, the surplus plummeted year-on-year by CZK 7.8 bln. Year-on-year, the balance of incomes climbed by CZK 2.8 bln (growth of reinvested profit and reduction in the paid out dividends from direct and portfolio investment) and the balance of services surplus diminished by CZK 1.4 bln (notably higher growth of outlays over receipts, specifically the growth of domestic demand for the purchase of other services from abroad). And thus only the trade balance had a favourable effect on the progress of the current account of balance of payments deficit.

• Financial account surplus has shrunk to a mere one tenth

Financial account surplus of CZK 3.6 bln in Q1 2004 dropped year-on-year by CZK 30.9 bln. It constituted 0.6 % in proportion to nominal volume of GDP, by 5.2 p. p. less than in Q1 2003. The financial account asset volume fell year-on-year to such an extent that it reached less than one twentieth of Q1 2003 assets and the volume of liabilities more than halved year-on-year. Given the fact, that the net inflow of foreign direct investment was in Q1 2004 year-on-year larger by CZK 2.9 bln (CZK 31.1 bln)

and the net inflow of portfolio investment even by substantial CZK 58.3 bln (CZK 25.6 bln), such a sharp decrease in the financial account surplus could have been caused only by a net outflow of other investment (CZK 51.8 bln), which compared to the net inflow in Q1 2003 entailed year-on-year change of CZK 92.4 bln. In Q1 2004 foreign direct investment arrived at CZK 31.5 bln, equity holding a share of CZK 11.1 bln and reinvested profit CZK 17.7 bln and with regards to the portfolio investment net purchase of domestic shares reached CZK 22.0 bln. Extensive outflow of capital within the other investment group mostly impacted the banking sector, which greatly curtailed the level of short term deposits received from foreign banks and clients (reduction of short term liabilities by CZK 66.7 bln).

- **Lower growth of CNB foreign exchange reserves year-on-year**

Foreign exchange reserves of CNB excluding the effect of exchange rate differentials in Q1 2004 climbed by CZK 6.9 bln mainly owing to revenues from foreign deposits, nevertheless this was by CZK 5.4 bln less on a year earlier. Relative to GDP the change in foreign reserves of CNB came to 1.1 %, implying 1.0 p. p. decline when matched against Q1 2003.

Official foreign exchange reserves of CNB EUR 22,076 mil diminished year-on-year by 2.8 % (whilst the crown depreciated by 3.7 %). In proportion to nominal annualised volume of GDP the level of foreign exchange reserves marked 28.7 %, by 1.1 p. p. less compared to the previous year. During Q1 2004 was the development of foreign exchange reserves apart from exchange rate differentials determined only by the change in capital and interest revenues. CNB did not intervene on the exchange rate market within this period.

- **Large fluctuations of CZK against EUR exchange rate**

CZK against EUR rate of exchange in Q1 2004 on average amounted to 32.85 and year-on-year Czech crown weakened due to the effects of market forces by 3.7 %, which most likely influenced the increase of the balance of payments current account deficit and the sizeable decline of the balance of payments financial account surplus. The CZK against EUR exchange rate fluctuated considerably in the course of Q1 2004. At the beginning of the year the crown was depreciating, however it started strengthening towards the end of January and kept this trend thanks to the favourable results of foreign trade. In April it attained the level of 32.51 CZK/EUR. The CZK against USD rate of exchange on average in Q1 2004 totalled 26.28 and year-on-year Czech crown appreciated by 12.2 %; USD kept weakening on the world markets. The CZK against USD exchange rate also fluctuated during Q1 2004, especially as a consequence of CZK/EUR development.

Nominal effective exchange rate index of CZK was in Q1 2004 lower by 1.9 % year-on-year; this depreciation of CZK was most adversely affected by the relation of Czech crown to euro, with euro being the major currency of choice of the foreign trade. Real effective exchange rate index of CZK was in Q1 2004 lower year-on-year by 2.2 % when constructed based on industrial products prices and by 2.5 % when constructed based on consumer prices. In the course of Q1 2004 the mutual relationship of the two indices became closer (the differential went down to 0.3 p. p.) and attests to the growing effect of inflation in the CR, which represents a change in direction compared to the annual 2003 development.

Trend of Prices

- **Strong January hike in consumer prices has been replaced by stabilization**

Exceptionally low growth of consumer prices formed a specific characteristic of the economic development in 2003. In the first months of 2004 the anticipated growth of consumer prices took place. In January consumer prices stepped up by 2.3 % on a year earlier. January year-on-year growth of consumer prices was by one half affected by the changes in regulated prices and GDP. February and April featured the same year-on-year rate of growth of consumer prices such as January, i.e. 2.3 %. In May the growth of consumer prices accelerated to 2.7 %. The turn for a positive inflation differential versus the EU proved true, with the inflation in the EU staying below the 2 % level.

Growth of import

Import and export prices advanced year-on-year in all three months of Q1 2004, on

and export prices as a source of a spiral growth of prices in successive price ranges

average by 0.7 % and 0.9 % respectively, evaluated against Q4 2003 identically by 1.0 p. p. The exchange rate development played a significant role in this development, when the Czech crown ceased to appreciate somewhat against the dollar and on the other hand the depreciation of crown against the euro intensified. Mineral fuels experienced the largest divergence from the previous development, with declines turning into increases and differences compared to Q4 amounting to 3.9 p. p. (imports) and 4.1 p. p. (exports). Terms of trade have in the first three months of 2004 progressed highly favourably compared to a year ago and their average value was 102.6 %. This development was positively impacted by the export performance as well as the profitability of the business sector. Terms of trade in the category of machinery and transport facilities of 102,8 had the greatest effect on the positive value of total terms of trade.

• Steep rise of oil and mineral prices

The industrial producer prices in Q1 went up by 1.7 %, yet in April jumped up to 3.7 %. The growth of prices of primary metals was rather significant, with an average growth of 3.7 % in Q1 and March growth of 5.6 %. Steep rise of mineral and oil prices was precipitated by an increased demand in Asia, mainly in China, but the build up of geopolitical tensions and speculative motives had an important role to play as well.

Unemployment, Employment and Wages

• The rise in unemployment in January and February gave way to seasonal decline in the following months

February saw the highest registered unemployment rate (10.9%). Due to seasonal effects the unemployment rate fell in the following months. In May the unemployment rate was down by 0.3 p.p. to 9.9%, though some 0.6 p.p. higher compared with the same period in 2003. The number of the unemployed declined to 520,000, representing an increase of 23,000 on a year earlier. The mismatch between supply of and demand for labour has not changed, with the number of job applicants per job vacancy remaining the same in both years (11.7).

• The slowdown in the capacity of the service sector to absorb labour force

The unemployment development was characterized by a long-term trend manifested by shrinking labour force, an increase in the number of entrepreneurs without employees, and a drop in the number of workers in agriculture and industry. Employment in the primary sector fell below the mark of 200,000 people in 2004's Q1 with the secondary sector having shed off 40,900 people y-o-y. The service sector also witnessed job losses, a phenomenon not seen until then. Gains in employment were sustained in transportation, real estate and entrepreneurial activities, while employment dipped in the educational sector.

• The growth rate of nominal as well as real wages continues to soar

Representing an increase on the previous two quarters when growth hit 6.3 and 6.9%, the average monthly salary edged up to 8.8% in 2004's Q1. This was brought about by a number of factors. Firstly, the adjustment of wage tariffs in the non-business sector, a quantum jump of 9.7%, contributed to faster growth in average wages. And secondly, rapid growth in nominal wages in the business sector was shaped by dynamic output and profit development. Average real wage growth reached 6.4% in 2004's Q1 (with the average growth in 2003 being 6.7%), marking an above-average value when compared with the medium-term development trend.

Monetary Development

• The pace of M_2 growth quickened

Monetary stock as measured by M_2 amounted to CZK 1,756 billion at the end of 2004's Q1; although it had declined somewhat in the course of the period concerned, monetary stock was considerably higher year-on-year (by CZK 134.2 billion), having seen its growth quicken following the previous slowdown. Since Q1 2003 M_2 has been growing faster, with the growth of net domestic assets exclusively contributing on the side of type of money issue and on the side of type of money in circulation it was mainly the increase in the level of transaction money.

• Pronounced change in the assets and

The change in the composition of M_2 on both the supply and demand side of monetary balance was substantial. Net foreign assets (CZK 904.8 billion at 2004's Q1) declined slightly as a result of reduction in liabilities by a close to one tenth.

liabilities composition.

Reaching CZK 793.9 billion at the end of 2004's Q1, faster growth of commercial banks' and CNB's customers credit was a major impetus to a significant increase in net domestic assets. Having dipped throughout 2003's Q1 assets edged up somewhat only to see their growth fasten considerably towards the end of 2003 and at the beginning of 2004. The ratio of foreign assets to net domestic assets was significantly lower year-on-year. Rather high rates of growth of transaction money from the previous year slowed down somewhat in Q1 2004 and their year-on-year increase of 15.7 % (CZK 791.2 bln at the end of Q1 2004) was determined primarily by the growth of non-term deposits. The level of non-transaction (quasi) money (CZK 964.8 bln) was higher after the preceding notable decline; nevertheless the volume of term deposits plunged even further, even though considerably less than a year ago. The ratio of transaction money to non-transaction money was larger by more than one tenth year-on-year.

- **Faster growth of GDP than M_2**

Average annual level of M_2 during the Q2 2003 - Q1 2004 period in comparison to the Q2 2002 - Q1 2003 period went up by 2.0 p. p. less than the level at the end of the period. In relation to annualised volume of GDP in current purchasing prices, the average annual stock of M_2 advanced year-on-year from 66.2 % to 66.6 %, implying the slow down in the income velocity of money. Average annual level of non-transaction money grew year-on-year much faster than the stock of M_2 ; income velocity of M_1 plumped significantly, as a result of willingness especially of households to hoard more money and longer.

- **Excess of deposits over loans is lower**

Large excess of total deposits level over the level of client loans of commercial banks and CNB declined slightly year-on-year. The downward movement of loan indebtedness halted, mainly as a consequence of faster growth of deposits over loans in the non-financial businesses sector.

- **Banks profit more from households than from non-financial firms**

Reference interest rates during Q1 2004 remained the same. The level of market interest rates of commercial banks recorded year-on-year decrease. The reduction of interest rates took place under the circumstances of expanding money stock and an acceleration of its year-on-year growth. Interest yields of banks, i.e. interests paid by households for loans were in Q1 2004 higher 1.9 times compared to interests paid by non-financial firms (8.243 % and 4.307 % respectively), while on a year earlier, the household interest rates were cut down only by 3.5 % and the interest rates of non-financial firms by 12.9 %. Expense interest rates of banks, i.e. interests from household deposits were also higher than interests received by non-financial businesses, however only 1.2 times (1.292 % and 1.040 % respectively); while on a year earlier, these interest rates were slashed down by 18.0 % for households and by 20.1 % for non-financial firms.

The differential between the rate of return of the provision of credit and the costs of received deposits, i.e. the interest spread in Q1 2004 of 6.951 p. p. with respect to households practically has not changed, while that with respect to non-financial firms 3.267 p. p. has fell by 10.3 %.

State Budget

- **Faster growth of receipts over outlays of the state budget**

Fiscal policy had in Q1 2004 from the year-on-year perspective slightly restrictive character. According to the cash fulfilment of the state budget, receipts went up year-on-year markedly faster than outlays, while the growth of receipts accelerated and the growth of outlays considerably slowed down. Overall positive outcome of these monetary flows was remarkable year-on-year reduction of the budget deficit (by CZK 24.02 bln). In relation to nominal volume of GDP for Q1 2004 the deficit (CZK 7.82 bln) constitutes 1.2 %, which entails year-on-year decline of 4.2 p. p. Lower, year-on-year deficit was the result of higher growth of receipts (by CZK 28.44 bln) and substantially lower growth of outlays (by CUL 4.42 bln). From the standpoint of the approved 2004 state budget, this was achieved for the most part by fulfilment of the planned receipts and non-fulfilment of planned outlays contributed only negligibly. Greater fulfilment of planned annual receipts (24.8 %) in contrast to planned outlays (22.4 %) was distributed into those items, that are linked to the stronger economic

performance in Q1 2004 compared to Q1 2003.

- **Substantial year-on-year growth of tax receipts**

Out of total state budget receipts of CZK 186.8 bln in Q1 2004, tax receipts represent the sum of CZK 173.3 bln, a year-on-year increase of 15.6 %. Their nonfulfilment of yearly budget (24.3 %) was adversely affected above all by income taxes, profit taxes and capital income taxes (23.2 %) and social security taxes and contribution to state policy of unemployment (24.0 %), which hold a large share in total receipts (59.8 %). Relatively good fulfilment was attained with respect to the receipts from domestic goods and services taxes (25.5 %) with 29.7 % share in total receipts. Non-tax and capital receipts and received subsidies of CZK 13.5 bln were marked by sizeable year-on-year growth and were met on 34.1 %.

- **Year-on-year decrease of social benefits**

Given total state budget outlays of CZK 194.6 bln in Q1 2004, current outlays of CZK 188.2 bln climbed year-on-year by 3.8 %, having fulfilled the annual budget on 23.4 %. Capital expenditures were considerably lower than in Q1 2003. Out of current outlays particularly the non-investment transfers to social and health insurance funds were drawn greatly (33.4 %), recording mild year-on-year growth. Social benefits of CZK 77.0 bln were lower by 1.6 % year-on-year and their drawing on the annual budget (24.6 %) was also curtailed when matched against Q1 2003. Social incomes had the biggest impact on this development. Investment purchases and connected expenditures, whose volume sagged year-on-year by more than one fifth played the biggest part in the year-on-year decrease of the capital outlays.

State debt of CZK 537.9 bln at the end of Q1 2004 was year-on-year 1.25 times higher. In proportion to annualised nominal volume of GDP the debt level reached 20.9 %, which was by 3.3 p. p. more on a year earlier.

Data sources: CZSO, MF CR, CNB, MLSA: calculations CZSO.

Latest data used in this report are from 10 June 2004. The analysis is based on monthly statistical data.

Table 1 Monthly Macroeconomic Indicators

	Months in 2003									Months in 2004			
	IV	V	VI	VII	VIII	IX	X	XI	XII	I	II	III	IV
Consumer prices ¹⁾ , in %	-0.1	0.0	0.3	-0.1	-0.1	0.0	0.4	1.0	1.0	2.3	2.3	2.5	2.3
Consumer prices ²⁾ , in %	0.2	0.0	0.0	0.1	-0.2	-0.5	0.1	0.5	0.2	1.8	0.2	0.1	0.0
Producer prices ¹⁾ , in %	-0.7	-0.8	-0.9	-0.6	-0.4	0.0	-0.1	0.4	0.2	1.6	1.5	2.1	3.7
Producer prices ²⁾ , in %	-0.8	-0.3	-0.2	-0.2	0.1	0.4	0.6	0.4	0.9	0.8	0.3	0.8	0.8
Imports of goods ¹⁾ , in %	11.6	-0.1	10.1	15.0	13.8	5.8	10.9	3.4	20.9	-0.8	12.9	20.5	25.7
Exports of goods ¹⁾ , in %	4.8	8.5	8.9	13.8	12.4	9.6	13.5	1.4	21.7	-0.6	18.5	18.7	24.7
Trade balance, in CZK billion, cumulative year to date	-11.8	-14.0	-17.4	-29.2	-36.1	-35.7	-41.1	-49.5	-69.4	-0.3	3.3	-0.9	-11.7
Registered unemployment rate ³⁾	9.63	9.44	9.52	9.88	9.97	10.05	9.92	9.90	10.31	10.84	10.86	10.65	10.20
Industrial production ¹⁾ , in %	5.6	3.2	6.2	4.8	8.0	5.2	5.2	4.8	8.9	3.8	7.1	15.3	10.1
Construction works ¹⁾ , real % change	3.3	-0.9	12.1	15.9	18.7	14.5	12.1	13.9	8.6	15.0	9.9	21.4	62.4

¹⁾ Change on previous year

²⁾ Change on previous month

³⁾ Proportion of unemployed registered with the labour offices to the total labour force in %

Table 2 Selected Quarterly Macroeconomic Indicators

		2003				2004
		Q1	Q2	Q3	Q4	Q1
Gross domestic product	In CZK billion, in current prices	594.4	656.4	636.8	644.8	637.9
Gross domestic product	Real % change, y-o-y	2.8	2.9	3.4	3.3	3.1
Final consumption	Real % change, y-o-y	4.4	4.7	3.9	3.3	2.1
Of which: household consumption	Real % change, y-o-y	5.1	5.2	5.6	3.8	3.9
Gross capital formation	Real % change, y-o-y	2.7	6.1	4.7	9.5	12.7
Of which: fixed capital formation	Real % change, y-o-y	6.2	6.3	8.3	8.5	9.5
Export of services and goods	Real % change, y-o-y	4.1	4.2	7.8	6.8	8.3
Import of services and goods	Real % change, y-o-y	5.6	7.4	8.7	9.6	11.3
Net export as % of GDP	In current prices	-0.2	-1.4	-2.4	-4.7	0.1
Current account as % of GDP	In current prices	-1.4	-5.6	-7.5	-10.0	-2.6
Financial account as % of GDP	In current prices	5.8	2.9	6.5	10.7	0.6