

Main Trends Overall

- In the course of past three quarters GDP growth has been getting slightly faster than a year ago.
- In Q3 compared to Q2 growth of industry construction outputs as well as retail sales set back.
- Fast growth of exports has been progressing and it jumped by one fourth in Q3.
- Trends towards decrease of trade balance deficit are being occurred.
- In Q3 growth of consumer prices speeded up, however in November the m-o-m growth in prices stopped and, as a result, prices decreased y-o-y.
- The y-o-y employment dropped in Q3, in comparison to Q2 it increased; on the other hand it hovered in a sector of services.
- In the course of individual quarters wages and salaries fluctuated, the y-o-y growth slowed down both nominally and really; in that account cohesiveness between the development of wages and salaries and labour productivity enforced.
- Within the balance of payments the y-o-y changes of liability of current account have nearly been compensated for assets of both capital and financial accounts. Balance of yields affected most negatively increase in current account deficit.
- Volume expansion of currency aggregate M_2 , mortgage credits, as well as negative interest rates of household deposits increased.
- Economy development that is more rapid than expected has been contributing to the decrease of the state budget deficit.

Overall Economic Performance

- ***The 2004 development continued in high paces of the GDP growth in 2003***

The 2003 GDP growth that was relatively higher (3.7% in real terms) and considerably faster (by 2.2 p. p.) preceded the Czech economy development in 2004. Not only was the growth getting faster in the course of the year, but also paces of growth arrived at 3.6% (during past three quarters) or 4.0% in Q3, respectively. Both total results and the economic performance in 2004 are reflecting these development tendencies. Keeping up the same dynamics under the same economy parameters indicate that the annual gain of physical volume of GDP would be larger in 2004 by 2.5 bln than that in 2003 (at constant prices 1995). Both internal and external economic conditions were favourable in 2004, which indicated the slightly higher paces of growth might be reached than in 2003. Economic results reached in the course of three quarters gave evidence of it, however the Q3 GDP gains were slower than in Q2 (in Q3 were less three days).

- ***Perceptible structural changes – increase in outcomes for GFCF***

Both the y-o-y outcomes structure of GDP and its growth changed positively during three quarters of 2003. Gross fixed capital formation (GFCF) mostly contributed to the GDP increase of basic outcome items. Excellent results of management of non-financial facilities and favourable development in prices at the foreign markets proved to generate profits. Nevertheless primary incomes of enterprises rose quicker than the gross added value, which caused noticeable increase of investment activities. It contributed to a drop in interest rates of credits in Q1 2004, as well. The general government sector contributed to the increase in outcomes for gross capital formation especially with investments credits predetermined for improvement of traffic infrastructure. Increased outcomes for the gross fixed capital formation pointed to the future expansion of economic production performance.

- ***Households' consumption decreased, its gross savings rate lessened***

A considerable increase of inflation rate as well as slightly stunt of growth of primary net incomes of households resulted in more than twofold speedup of the gross fixed capital formation and a sizeable slackened growth of household expenditures. Marginal propensity of households to consume decreased; volume of households expenditures lessened, volume of gross savings and capability of financing abated. On the other hand outlays for gross capital formation in households augmented and rose faster than its gross disposable incomes.

- ***Negative influence of net***

The sizeable y-o-y speedup of both imports and even more exports of goods and services (at current prices as well as in real terms) was a typical feature of external

exports slightly intensified in real terms

economic relations. Share of the net negative exports in GDP lessened (at current prices), which was affected positively by an exchange relations development, on the other hand it was insufficient for decrease of total trade balance deficit at constant prices.

Slightly faster GDP growth during past three quarters 2004 than last year

The y-o-y GDP increased by 3.7% in real terms; in Q3 it was up by 3.6%. It grew faster by 0.1 p. p. or sluggish by 0.4 p. p., respectively than in the equal period of 2003. The seasonally adjusted q-o-q GDP ascended by 0.8% in real terms, but its growth was structured on both demand and supply side other way in this year (in the course of three quarters as well as in Q3) than a year ago. The y-o-y outlays growth for households' expenditures was higher by 1.6 p. p. and growth of outlays for gross fixed capital formation faster by 0.9 p. p. than GDP growth for three quarters 2003; in this year the proportion inverted. During three quarters 2004 the y-o-y households' outcomes swollen by 2.6% in real terms and it grew slower by 1.1 p. p. than GDP. On the contrary outcomes for gross capital formation increased by 9.9% in real terms in the equal period and it enlarged more by 6.2 p. p. than GDP. As a result of this positive shift a gain of gross fixed capital formation influenced the GDP increase 2.3 times more than gain of household consumption expenditures, while a year ago this proportion of two basic expenditure factors comprised 0.5 times. Neither extremely increase of exports of goods and services (for three quarters up by 19.8% in real terms), nor its sizeable speedup prevented the y-o-y increase of negative impact. In spite of both import of goods and services developed sluggish (for three quarters it was up by 18.9% in real terms), at constant prices (absolutely) the proportion of imports to GDP expanded more than the proportion of exports to GDP. Predominating share in imports of goods and services (more than two thirds) was poured into inter-consumption, one seventh of them was allocated in households consumption and the rest was distributed in gross capital formation.

Gross domestic savings increased in spite of it extent of financing from external sources increased

Since Q1 to Q3 2004 GDP arrived at CZK 2053.8 bln at current prices. Its y-o-y gain amounted to CZK 149.3 bln, i. e. 7.8% shared partly growth of total prices (52.5% or 4.1 p. p. respectively), partly increase of the physical volume (47.5% or 3.7 p. p. respectively). Gross disposable domestic product amounted to CZK 1950.5 bln (at current prices) and in the course of three past quarters 2004 it expanded by CZK 113.4 bln, i. e. 6.2% y-o-y. This lower growth compared to GDP was affected partly by a sizeable expansion of primary net incomes of non-residents, partly by a shrinking decrease of net current transfers of non-residents. High growth of gross net domestic savings (10.8%) that amounted to CZK 491.9 bln since Q1 to Q3 2004 was influenced by low increase in final consumption outlays (4.7% that representing the y-o-y deceleration by 1.9 p. p.). Expansion of gross savings was relatively lower than the expansion rate of investments, so almost one sixth of the gross capital formation was funded by external sources. The y-o-y adverse balance of domestic current transactions increased by CZK 12.6 bln and reached amount of CZK 105.3 bln.

Labour productivity – essential issue for GDP growth

The y-o-y aggregate labour productivity rose by 4.0% in the course of past three quarters; in Q3 expanded by 3.6% and stood for an exceptional factor of GDP growth. Number of employees being involved into GDP formation dropped by 0.3% or did not altered at all, respectively. Their fixed assets contributed to the labour productivity; primary incomes rose faster than GDP in real terms, what led to the y-o-y increase of unit labour costs by 1.4% or 1.7%, respectively.

Industry, Construction, Services and Agriculture

Production growth of goods and services speeded up

Production of goods and services in all branches jumped extensively since Q1 to Q3 2004 and paces of growth were substantially higher than a year ago. The sizeable production growth of 7.5% lagged behind much larger growth of inter-consumption. As a result gross added value expanded lesser. Construction outputs hit record level. Agriculture achieved a substantial expansion due to extremely large yields of cereals. On the other hand sales in selected services increased least. Prices fluctuation in individual branches influenced the expansion of nominal volume of production differently – the largest one (almost one half) was monitored in services, the least one (about one fourth) in construction. Changeability of monthly and quarterly paces of growth was remarkable especially in construction; however it was relatively stable in industry. The y-o-y changes in labour forces movement were different in branches; in agriculture a sizeable drop in employment was recorded, in industry it was a slight

decrease in number of employees; on the contrary in construction a massive enlargement of employment was monitored. Labour productivity as a main production factor linked with an increased amount of fixed capital stood for essential affects on production growth. In industry as well as in construction volume of new voided orders outstripped growth of production outputs. Not only shaped it preconditions for further production growth, but also it presented extensive labour supply after realization of sales volume.

- **High growth of industrial production**

In the course of past three quarters 2004 the y-o-y economic performance of industry (measured by an industrial production index) rose by 10.1%, which was up in total sales by 9.9% in real terms. The slowest growth was monitored in Q3, on the contrary in Q2 the three-quarters average was exceeded. This development was positively affected by favourable external conditions, for instance revival of West European economic systems and a huge expansion of export of goods to EU member states, especially within production co-operation. Extension of production and putting into operation new fixed assets were internal conditions made contribution to prosperity of industry. The highest increases in the industrial production were observed in the following industrial groupings: manufacture of intermediate products and durable goods, concurrently a growth of manufacture of energy was below-average, nevertheless seemed to be sufficient. Huge enlargement of machinery by 16.5% affected the economy most. Volume of direct export sales was up by 16.5% in real terms and outstripped the volume of total sales, which issued in a very low growth of domestic sales (only 3.5% in real terms). Moreover, prices of goods at external markets increased paradoxically rather slow then prices of goods provided at the domestic market. So that prices increase by 2.7 p. p. participated in gain of nominal direct exports sales by 19.5%, in gain of domestic sales by 9.2% at current prices it was by 5.6 p. p.

- **Drop in employment in industry slowed down and increase of average wages speeded up**

The y-o-y average number of employees since Q1 to Q3 was down by 0.6% and concurrently in the course of this period of time it was getting slowed down systematically (in Q3 only 0.2%). In processing industry employment increased in August and in September (by 0.3% and 0.6%). Growth of average monthly wages by 7.3% during three quarters (arrived at the same value in Q3) was by 2.0 p. p faster than a year ago. In spite of it total amount of wages and salaries (at current prices) to the amount of total sales in industry furthermore plummeted, so that wages and salaries in industry reduced and primary incomes of enterprises (mainly gross profits) significantly increased. Labour productivity rose faster by 10.6% than last year, on those account unit labour costs decreased by 3.0%, which firmed up competition ability of the Czech industry.

- **Increase of labour supply continued**

A sizeable acceleration of number of new orders (mainly foreign ones) outstripped expansion of total sales in industry (mainly direct export sales); they are giving evidence of a full play for further industrial expansion. Total number of all orders voided at the end of Q3 2004 is manifesting a full amount of labour supply of all industrial facilities for 12.6 months that is substantially more than a year ago.

- **Substantial slowdown of construction outputs in Q3**

In the course of past three quarters the y-o-y enlargement of construction work volume performed according to suppliers' contracts accelerated by 11.4% in real terms; in Q3 it was only by 4.2% (indicated an effect of VAT changes on construction outputs, which shaped Q2 data stated). Construction outputs climbed most in smaller enterprises with 20 – 49 employees in Q3. In the middle-sized enterprises with 50 – 99 employees even dropped in Q3. Despite decelerating of production outputs development in Q3 (by 12.1 p. p.) a volume expansion of construction outputs, which started in Q2 2003, continued in the course of past three quarters and evinced in the infrastructure development. It was entirely domestic investment demand that had an influence on extraordinary development of construction outputs. Increase in growth of construction work was shared with 3.7 p. p. at current prices; 11.7 p. p. was allocated for expansion of physical volume. Construction outputs boosted considerably the GDP growth, faster increase of inputs than outputs alike.

- **Enormous growth of new building construction**

Development of new buildings, reconstruction and modernisation outstripped the growth of work on repairs and maintenance that slowed down y-o-y (almost by 20 p. p.) Development of building construction outputs accelerated and increased more than structural engineering development, which the y-o-y growth was lower. Volume of building constructions increased its growth and enlarged more than volume of

structural engineering that expanded sluggish y-o-y. Increase in growth of construction work performed by own employees falling behind the increase in those according to suppliers' contracts lessened. Balance between construction work taken up as suppliers' work from other companies and those performed as suppliers' work for other companies diminished; nevertheless this sway manifested that smaller companies are performing orders received from larger construction companies.

- ***Speedup of employment increase in Q3***

Construction furthermore endorsed employment; the y-o-y number of employees in enterprises with 20+ employees increased by 3.2% during three quarters; in Q3 it was up by 4.1%, which is manifesting a striking speedup. In this period of time average wages jumped by 6.9% or 5.7%, respectively and its growth (except in Q3) hastened. Labour productivity grew markedly in the first half-year, however its increase by 7.3% (in the course of three quarters) is showing a slight drop of unit wage costs. Volume expansion of nominal wages and salaries was lower going than volume of construction outputs at current prices, so that wages and salaries decreased. Primary incomes of construction enterprises (mainly profits) swelled considerably quicker (by more than 5 p. p.) than total wages and salaries.

- ***Ten months' supplies of construction work***

Mainly in Q3 number of building permits as well as estimation costs of construction outputs decreased and in the process its matter-of-fact structure changed markedly. During past three quarters 2004 the y-o-y estimation costs of new buildings were up by 13.3%, on the other hand those of finished buildings were down by 8.5% at increase in average prices by 3.8% or drop by one tenth, respectively. Number of new voided construction orders increased and its grow accelerated; the y-o-y nominal volume of orders was up by 31.7% during three quarters 2004; in structural engineering (for instance subway and motorways constructions) jumped most. The y-o-y volume of orders at the end of Q3 2004 was higher by more than one third, which represented ten months' supplies that is by 1.6 months more y-o-y. A considerably great volume of construction work has not been performed yet guarantees further expansion of construction outputs.

- ***Unstable coefficient of residential building continuity***

The substantial y-o-y growth of number of completed residential buildings than started ones was a typical feature of a development in residential buildings construction during past three quarters 2004. The q-o-q changes (started residential buildings) oscillated between a growth by 30.2% (in Q2) and a drop by 5.6% (in Q3) y-o-y; the q-o-q changes (finished residential buildings) were up by 25.7% (in Q2) or down by 10.9% (in Q3). The coefficient of residential building continuity fluctuated in the course of past three quarters; in this period for 1 000 finished flats were 1 459 started ones that was less almost by one tenth y-o-y. The y-o-y number 148.6 thousand of partially built flats was by 6.4% higher at the end of Q3, however growth of number of partially built flats slackened. The ratio of the amount of started residential buildings to the amount of partially built residential buildings slightly increased. Range of unfinished flats is relatively large; it can differ in accordance with investments. Not all unfinished flats that are supposed to be used as residential can be converted into non-residential ones. The y-o-y number of building permits for residential buildings during past three quarters slackened, on the contrary the volume of construction work on residential buildings markedly rose. The y-o-y volume of mortgage loans amounted to CZK 137.1 bln expanded by almost one half at the end of Q3 2004; together with building savings surpassed residential building fixed assets.

- ***Growth in retail sales fall behind***

In all branches of services the y-o-y sales volume enlarged by 3.4% in real terms during past three quarters; in Q3 it was only by 1.9%. The highest paces of growth were recorded in transport and post and telecommunication services (7.4% or 4.1%, respectively) that shows acceleration in the course of past three quarters but in Q3 it is representing a deceleration. Retail sales increased least in total (1.8% or 1.2%, respectively), as a result of leaving off sales in motor sports segment, especially drop in sales of selling and servicing of motor vehicles. Large volume of purchases of company cars a year ago were realised a year ago due to possibility of VAT tax rebate. Sales in hotels, restaurants and canteens also dropped due to changes in VAT rate (the y-o-y prices jumped by 7.6% in Q3 2004). Development of the main item of purchase resources and disposable incomes of households, i. e. the development of wages and salaries, could not significantly affect this significant deceleration of growth of retail sales. The y-o-y volume of nominal wages and salaries swelled by 5.5% during three quarters; in Q3 it was up by 6.3% (in real terms by 2.7% or 3.0%, respectively) and outstripped volume of retail sales, that

demonstrates on one hand moderated household consumption, on the other increase of gross savings rate.

Selected branches of services showed fluctuating paces of growth, for instance sales in computer services; the y-o-y sales in other personal services decreased by 4.1% in real terms during three quarters, what is related to changes in consumers' preferences.

- ***Outstanding growth of plant production after a poor crop last year***

In this year an outstanding crop of cereals contributed to the highest y-o-y growth in the history of agriculture, despite dropping of milk and meat production, and its effect on a development of gross added value will be significantly positive. A favourable period of growing season as well as during gathering was the most important factor of outstanding crop. Crop of cereals that was almost by one half larger than in 2003, when agriculture was hit by a poor harvest, affected most the y-o-y growth of plant production, which was up by more than one third. Yields per ha were substantially higher compared to sown fields and shared in exceptionally crop most. Yield of basic cereals amounted to 5.48 t per ha was higher by 1.38 t per ha than an average yield in the course of last eleven years, and was up by 1.03 t per ha than the highest yield in this period. Yields of other cereals also exceeded its level reached in previous years. Market problems with vegetables led to its ploughing in. Plant production outstripped livestock production. Farmers are more focused on plant production, reduced number of herds and cut down on breeding of pigs, which influenced volume of production of both beef and pork meat. In the course of past ten months 2004 the y-o-y production of meat plummeted by 8.4% and drop rate steadily increased. Furthermore farmers embarked on a direct delivery of live animals abroad, where they get higher prices than in the Czech Republic.

- ***Agricultural production growth by 14.2% in real terms***

The y-o-y agriculture production increased by 14.2% in real terms, which show known results of the plant production to date (estimations will not have been changed) and both meat and milk production. Its nominal volume swelled by 25.2%, so that prices of agricultural products increased by 9.6%. It follows that prices increase shared in the agricultural production gain by two fifths.

External Economic Relations

- ***Double-digit growth of exports and imports continued***

While exports grew by 12.8 % year-on-year in Q1, they accelerated up to 31.6 % in Q2 and slowed down somewhat to 27.9 % in Q3. This year's economic recovery in the EU, accession of the CR to the EU accompanied by the lowering of transaction costs and reaping the benefits from foreign direct investment were the main factors contributing to this dynamic growth. The foreign exchange rate ceased to be a supporting factor in Q3 when it for the first time after five consecutive quarters strengthened year-on-year. It reached on average CZK/EUR 31.59 compared to CZK/EUR 32.17 in the same period last year. This year's growth of exports markedly exceeded the export dynamics of the original EU member countries and ended comparable to the export levels of the new EU members.

- ***Trade deficit has shown diminishing tendencies since the accession to EU***

While the trade deficit was in Q2 lower by mere CZK 3.6 bln on a year ago, in Q3 it already decreased by nearly CZK 13.3 bln. September saw the largest September positive balance in the last decade and also this year's second largest positive balance. After the accession to the EU, the rate of growth of exports started taking over the rate of growth of imports. This meant a diversion from a previous pattern, when the acceleration of economic growth used to be accompanied by a parallel growth of trade deficit. Terms of trade represented a supporting element, despite declining excess of the rate of growth of export prices over import prices.

Growing surplus of exports over imports of machinery and transportation vehicles

In September 2004 compared to the same period of the previous year, the surplus of exports over imports in manufacturing industry increased by nearly CZK 6 bln. The growth of export surplus was the result of the growth of positive trade balance of machinery and transportation vehicles. Chemicals and related products, registering long-term worsening of their trade deficit signalling weak competitiveness of domestic products, achieved partial shift towards lowering of their negative trade balance.

- ***Year-on-year change of current account deficit and***

The sum of balances of balance of payments accounts for the three quarters went mildly down (from CZK 2.2 bln in 2003 down to 1.7 in 2004), being adversely affected by the rise of negative current account balance (CZK 12.4 bln) and positively affected

**capital and finance
account surplus
nearly offset each
other**

by notable growth of capital account surplus (CZK 4.0 bln) and slight growth of financial account surplus (CZK 7.9 bln). The rate of coverage of current account deficit by financial account surplus dropped by 4.5 p. p. and the growth of foreign exchange reserves was lower by CZK 4.1 bln year-on-year. The extent of errors and omissions shrank by a mere one half.

• **Highly negative
influence of the
income balance on
the current account**

The current account deficit of CZK 105.3 bln for the three quarters of 2004 was year-on-year higher by CZK 12.4 bln and relative to GDP in current prices worsened by 0.2 p. p. (from -4.9 % to -5.1 %). Year-on-year growth of current account revenues was by 0.5 p. p. higher than the growth of outlays over the three quarters, however it was not enough to decrease the deficit to a larger extent. Mentioned excess growth of revenues over outlays made a favourable impact on the change of the trade balance (2.9 p. p.) and components balances (0.3 p. p.) and a negative one on the change of the income balance (2.3 p. p.) and the balance of current transfers (0.4 p. p.). The most negative effect on the expanded current account deficit had the 2.9 times higher outlays (costs) to revenues (income) and the increase of the income balance deficit by CZK 30.7 bln. The total income balance deficit for the three quarters of 2004 was mostly – more than fourth fifths – caused by investment income. On the other hand the drop in trade deficit by CZK 21.8 bln had a highly positive effect on the change of current account balance.

• **Substantial
change of the
financial account
structure**

Financial account surplus of CZK 103.1 bln for the three quarters of 2004 was higher by CZK 8.0 bln year-on-year and relative to GDP in current prices remained the same (5.0 %). The relatively small increase of the surplus hides extensive and opposing changes of portfolio investment (from outflow of CZK 57.4 bln for the three quarters of 2003 to inflow of CZK 62.7 bln for the same period of 2004) and other investment (from inflow of CZK 61.0 bln to outflow of CZK 52.2 bln). Net inflow of foreign direct investment of CZK 89.8 bln was year-on-year higher by only CZK 0.6 bln. Reinvested profit played considerably bigger role in local foreign investment (from the direct investment account) than equity.

• **The CZK
exchange rate was
strengthening in Q3**

The CZK against EUR exchange rate reached for the three quarters of 2004 on average 32.16, in that 31.59 in Q3, implying year-on-year depreciation of CZK by 2.2 % and appreciation by 1.8 % respectively. In relation to USD the Czech crown appreciated on average for the three quarters by 9.0 % (26.25 CZK/USD) and by 10.6 % in Q3 (25.86 CZK/USD). The CZK exchange rate fluctuated somewhat in relation to both currencies during the ten months; from CZK 32.98 per EUR (March) to CZK 31.48 per EUR (October) and from CZK 27.12 per USD (April) to 25.23 per USD (October). The exchange rate market acting upon the strengthening of the Czech crown in Q3 had an impact on the trade deficit decrease and the financial account surplus increase. CZK strengthening was supported by the realised growth of the Czech economy.

**The CZK real
effective exchange
rate index grew
mainly in Q3**

CZK nominal effective exchange rate index was year-on-year for the three quarters of 2004 lower by 0.5 %, in that higher by 1.9 % in Q3. CZK real effective exchange rate index was in the same period when constructed on the basis of industrial producer prices index higher by 0.9 % and by 5.2 % respectively and on the consumer prices bases lower by 0.9 % and higher by 1.8 % respectively. Both indexes were mostly affected by the relation of CZK to EUR, the dominant currency of foreign trade in goods and by external economic relationships of CR to EU-15 countries. The growing rate of inflation (consumer prices) in the CR as well as the acceleration of the industrial producer prices surfacing in the increased price differentials led in Q3 to a reduced competitiveness of the Czech economy.

Trend of Prices

• **The growth of
consumer prices
speeded up in Q3**

Consumer prices in Q3 2004 year-on-year grew on average by 3.2 %. Compared to the year-on-year increase of 2.6 % in Q2, the growth of consumer prices further accelerated and was the fastest in the last two years. The growth of prices was influenced by traditionally volatile segments of the market, i.e. mainly food and fuel and further telecommunication services, restaurants and accommodation.

• **Predominant
inflationary**

Following the September month-on-month decrease, the consumer prices rose in October year-on-year by 3.5 %, with the dominant source of inflation growth being the

inflationary pressures on the cost side

energy products. Inflationary pressures of the cost kind thus keep prevailing. This is evident from the coinciding growth of prices in all the main price territories, i.e. import prices, producer as well as consumer prices. Growth of prices based on an excess demand over supply eventuates only rarely. In September the month-on-month growth of consumer prices ceased, on a year-on-year basis the prices dropped.

- ***The excess growth of consumer prices in the CR compared to EU is negligible***

Price differential with respect to EU-25 average ranges up to one percentage point, which should not create destabilising pressures on the currency rate. The inflation in the CR is below average compared to new EU members.

- ***Industrial producer prices gained speed***

Industrial producers recorded price hikes in all three quarters this year. On average for the Q3 the prices increased year-on-year by 7.8 %. The sources of growth were especially the prices of metals, which grew by 25 % year-on-year and the prices of oil products – by 45 %. The rate of growth of industrial producer prices ended approximately double to that of EU average in Q3.

Unemployment, Employment and Wages

- ***Employment in Q3 went down year-on-year, but increased on a quarter earlier***

The average number of employed in Q3 compared to Q2 rose by 12.6 thousand persons and signals the ceasing of total employment decrease. The upward phase of the business cycle in the CR and EU thus started to be felt. The year-on-year employment slump in agriculture in industry continued, but in a lesser extent compared to preceding years. Employment in the services sector stagnated, however its individual branches experienced opposing development of the number of employed.

- ***General unemployment rate was rising***

General unemployment rate (ILO) according to the labour force survey came up to 8.2 % and increased by 0.2 p. p. compared to Q3 last year. The number of long-term unemployed also rose and their share tipped over the half of the total number of unemployed (51.4 %). The rate of unemployment continues to correlate with the level of education. University graduates permanently enjoy lower rate of unemployment (2.5 %) as well as persons with full secondary education (5.1 %).

- ***Differences in the nominal and real wage development***

While the growth of nominal wages in Q2 this year slowed down year-on-year from 6.1 % down to 4.2 %, it speeded up again in Q3 up to 7.3 %. Similarly, the growth of real wages slowed down in Q2 from 6.1 % down to 1.6 %, but reversed the course in Q3 and rose to 4 %. Whereas during the year this fluctuation of wages is caused mainly by the swings of the changing part of wages, year-on-year comparison shows evident shift towards faster growth of productivity to the growth of wages, which positively affects the competitiveness of czech products.

Monetary Development

- ***Acceleration of the M_2 growth***

Money stock M_2 reached CZK 1839.7 bln by the end of Q3 2004 and was higher by 8.5 % year-on-year and by 4.2 % compared to the level at the end of 2003. Year-on-year changes of M_2 so far during this year ranged from the growth of 6.5 % (January) to 10.2 % (May) with the total increase of 8.1 % for the three quarters, which constitutes more than doubled growth. The structure of demand for as well as supply of money has changed considerably. Year-on-year growth of M_2 was on the asset side impacted more by the increase of net foreign assets (5.7 p. p.) than net domestic assets (2.8 p. p.) and on the liabilities side more by the increase in transaction money (6.0 p. p.) than quasi money (2.5 p. p.).

- ***Fast growth of mortgages year-on-year***

On the demand side the net foreign assets grew year-on-year faster (11.3 %) than net domestic assets (5.6 %), however their rates of growth fluctuated markedly in individual months. Nominal volume of net foreign assets of CZK 949.9 bln again surpasses the net domestic assets. Whereas the net foreign assets of CNB go slightly down, they rose sharply in other financial institutions. Domestic credit of CZK 1,111.1 bln at the end of Q3 2004 was year-on-year higher by 4.6 % and its increase was crucially influenced (6.7 p. p.) by rapid and acceleratory growth of household credit, which already reached CZK 284.9 bln (by 30th September 2004), which was

year-on-year more by one third. Mortgages growing by more than 1.5 times constitute almost half of these loans. Credit to non-financial businesses of CZK 577.8 bln was year-on-year higher by 7.0 % and contributed to the growth of household credit by 3.5 p. p.; their growth went up in Q3, net credit to government of CZK 248.3 bln was year-on-year lower by one fifth.

- ***Notably faster growth of money to quasi money***

On the supply side the transaction money grew year-on-year much faster (11.7 %) than quasi money (5.2 %). The fastest growing component of transaction money was the one day deposits of non-financial businesses (14.3 %) and currency was the slowest expanding component (8.2 %). Term deposits constituted less than four fifths of quasi money and were higher year-on-year by 6.4 %; business deposits grew the fastest here (9.4 %). Total household deposits at the end of Q3 arrived at CZK 1,055.5 bln and grew year-on-year by 6.8 %; household deposits exceeded household credit by CZK 770.6 bln.

- ***Income velocity of M_2 remained the same***

GDP in current prices for the three quarters of 2004 increased year-on-year by 7.8 %, which increase the money demand as well as supply. Average yearly level of M_2 to annualised GDP remained the same (66.4 %) and indicates, that the income velocity of M_2 stays the same.

- ***Negative interest rates on household deposits of 1.8 % in Q3***

Market nominal interest rates of commercial banks for the three quarters of 2004 were diminishing year-on-year. Interest rates on deposits dropped more than interest rates on credit. Interest rates on deposits of non-financial businesses decreased from 1.153 % in three quarters of 2003 down to 1.098 % in three quarters of 2004 and households recorded relatively larger decrease (from 1.446 % to 1.313 %). Interest rates on credit were considerably higher for households then for non-financial businesses already in 2003 a this differential rose even further in the three quarters of 2004. They shrunk year-on-year from 4.620 % down to 4.429 % for non-financial businesses and from 8.341 % down to 8.134 % for households. Bank interest rate spread was more than doubled for households (6.821 p. p.) in compassion to that for non-financial businesses (3.331 p. p.) and lowered year-on-year only negligibly for households (0.074 p. p.) and for non-financial businesses by 0.136 p. p. Real interest rates on household deposits were negative 1.4 % for the three quarters and already 1.8 % in Q3.

State Budget

- ***Higher than expected economic growth contributes to the decrease of the state deficit and internal imbalance***

Dynamic economic performance of industrial sectors, higher nominal volume of value added as well as GDP and their faster growth than anticipated by the state budget for 2004 constitute the main factors, which contributed to the marked year-on-year growth of budget revenues, as well as to their satisfactory annual fulfilment. The state budget forecasted the year-on-year growth of revenues only slightly faster than the growth of outlays for 2004 (107.8 % against 107.6 %), while in fact for the ten months of 2004 the revenues rose year-on-year by 9.8 % and outlays only by 5.0 %. The deficit of CZK 59.5 bln was thus year-on-year lower by CZK 23.4 bln and only slightly higher (by CZK 1.7 bln) than the half of annual budget deficit. The budget deficit of CZK 40.5 bln for the three quarters of 2004 in relation to nominal volume of GDP ended notably lower compared to the three quarters of 2003 (by 2.2 p. p.).

- ***The non-fulfilment of outlays rather than fulfilment of revenues the cause of lower deficit***

According to the cash fulfilment of the budget deficit by the end of October 2004 the total revenues arrived at CZK 624.8 bln, which represents 82.9 % of the adjusted budget and total outlays of CZK 684.3 bln or 78.7 % of the adjusted budget. The differential of 4.2 p. p. is considerably higher than for the ten months of 2003 (2.9 p. p.). The year-on-year reduction in the budget deficit was the result of faster than expected growth of revenues by two fifths and slower than expected growth of outlays by three fifths.

- ***The share of tax incomes in total revenues lower than aimed for***

Total tax incomes of CZK 582.8 bln were year-on-year higher by 7.5 % and amounted to 81.6 % of the annual budget. The collection of taxes and fees (less social security) was in accordance to the budget plans with respect to its fulfilment as well as year-on-year growth. Given the bigger items, the above average growth was recorded by the VAT incomes, (by 10.1 %, consumption tax (by 14.8 %) a personal

income taxes (by 8.4 %), except for consumption taxes exceeding the budget projections; on the contrary the below average growth eventuated for corporate taxes (by 2.4 %). Collection on social security was year-on-year higher by 7.5 % and amounted to 81.5 % of the annual budget. The major part of total insurance consists of pension insurance (more than four fifths), whose collection was year-on-year higher by 15.7 % and represented 81.0 % of the budget. Non-tax and capital incomes and received grants constitute less than one fifteenth of total incomes and increased by 1.6 times, already exceeding the budget projections. High fulfilment as well as significant growth was achieved mainly due to the compensation payments from the EU budget and the settlement from CSOB for the realised state guarantee for the sale of IPB.

- ***The share of current outlays in total outlays higher than projected***

Total current outlays of CZK 650.6 bln were year-on-year higher by 5.0 % and amounted to 81.0 % of the annual budget. Expenditure on salaries and other payments for work done experienced slow growth as well low fulfilment. The non-investment transfers to public budgets on the regional level already exceeded the assigned amount (CZK 100.7 bln). Social benefits constitute the largest outlay component (CZK 262.8 bln) and their volume increased year-on-year by 3.0 %. Paid out pensions of CZK 192.7 bln were higher by 1.9 % and arrived at 83.0 % of the budget. Capital outlays on the state debt are by one quarter higher on a year ago and remains only 7.1 % for their annual budget fulfilment. Drawing of capital outlays represents slightly over the half of the budget and year-on-year growth of 5.1 %.

- ***Surplus on the so called pension account***

Whereas the balance of social security revenues and outlays is negative in the amount of CZK 24.6 bln, the difference of pension revenues and outlays including administration cost is positive in the amount of CZK 3.5 bln, which is a better result by CZK 23.1 bln on a year ago, however lower than the annual budget projection by CZK 6.7 bln.

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

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

Table 1 Monthly Macroeconomic Indicators

	Months 2003			Months 2004											
	X	XI	XII	I	II	III	IV	V	VI	VII	VIII	IX	X		
Consumer prices, in %, y-o-y	0,4	0,5	1,0	2,3	2,3	2,5	2,3	2,7	2,9	3,2	3,4	3,0	3,5		
Consumer prices, in %, m-o-m	0,1	1,0	0,2	1,8	0,2	0,1	0,0	0,4	0,2	0,4	0,0	-0,8	0,5		
Industrial producer prices, in %, y-o-y	-0,1	0,4	0,2	1,6	1,5	2,1	3,7	4,9	6,2	7,3	8,1	8,0	8,6		
Industrial producer prices, in %, m-o-m	0,6	0,4	0,9	0,8	0,3	0,8	0,8	0,8	1,1	0,8	0,9	0,3	1,1		
Imports of goods, in %, y-o-y	10,9	3,4	20,9	-0,8	12,7	20,4	28,5	30,9	28,9	18,1	26,1	24,3	15,1		
Exports of goods, in %, y-o-y	13,5	1,4	21,6	-0,3	18,8	19,3	26,4	35,3	33,4	24,7	32,9	26,9	16,6		
Trade balance, in CZK billion, Cumulative year to date	-41,5	-49,9	-69,8	0,0	4,2	0,5	-11,8	-9,7	-9,7	-15,7	-17,8	-14,1	-18,3		
Registered unemployment rate ¹⁾	9,92	9,90	10,31	10,84	10,86	10,65	10,20	9,9	9,87	10,15	10,22	10,11	9,88		
Industrial production, in %, y-o-y	5,2	4,8	8,9	3,8	7,1	15,3	10,1	12,7	15,1	11,0	8,7	6,6	8,1		
Construction works, in %, y-o-y, real	12,1	14,3	8,6	15,0	9,9	21,4	62,4	-2,4	-2,9	0,3	9,6	3,5	2,9		

¹⁾ Proportion of unemployed registered with the labour offices to the total labour force in %

Table 2 Selected Quarterly Macroeconomic Indicators

		2003				2004		
		1. Q	2. Q	3. Q	4. Q	1. Q	2. Q	3. Q
Gross Domestic Product	in CZK billion, current prices	601,1	655,8	647,6	646,2	646,3	705,3	702,2
Gross Domestic Product	real % change, y-o-y	3,2	3,7	4,0	4,0	3,5	3,9	3,6
Final Consumption	real % change, y-o-y	4,7	5,1	4,8	4,2	1,9	1,5	-0,3
in that: household consumption	real % change, y-o-y	4,9	5,2	5,5	4,1	3,3	2,5	2,0
Gross Capital Formation	real % change, y-o-y	1,6	4,9	1,4	3,2	10,0	10,6	8,0
in that: fixed	real % change, y-o-y	3,7	3,8	5,8	5,9	9,3	10,5	9,7
Exports of goods and services	real % change, y-o-y	4,9	5,6	9,5	9,3	10,4	26,0	22,7
Imports of goods and services	real % change, y-o-y	5,6	7,4	8,9	9,6	11,3	25,8	19,3
Net exports as % of GDP	in current prices	-0,2	-1,4	-2,4	-4,8	0,4	-0,5	-0,1
Current account as % of GDP	in current prices	-1,3	-5,7	-7,4	-10,0	-2,3	-5,2	-7,7
Financial account as % of GDP	in current prices	5,7	2,9	6,4	10,6	0,5	5,1	9,1

Source: CZSO