Gross Domestic Product, Demand and Supply

- ***Impact of international transactions on structural changes***

The first half 2005 GDP development can be characterised by increasing paces of gain, concurrently having been attended by considerable structural shifts on both demand and supply side. Changes in interrelation between the total exports growth and total imports growth (however it stunted) fall into the most significant ones nevertheless such a positive effect of net exports on GDP has not been recorded in the Czech economy yet. A significant growth of exports gained an advance before imports relating to moderation of the impact of final consumption expenditures on GDP. At the same time on the demand side of economy imports strengthened against domestic demand, on the supply side of economy domestic supply strengthened more than imports. Volume of domestic effective resources was already larger than the domestic realised demand. Share of GDP in resources being at disposal to cover total final expenditures increased; share of gross domestic final expenditures in total final outlays decreased. The lower growth of final expenditures than gross disposable domestic income resulted in this rapid enlargement of gross domestic savings volume leading to a drop of negative balance of current national transactions. Delay of total prices level growth caused by worsening of exchange relations is linked to changes in external economic relations.

- ***GDP growth accelerated by 0.6 p. p. in the first half 2005***

After the GDP growth renewal in 1999 its volume enlarged in average by 2.8% in real terms per year (in the course of preceding six years, by 2004 as against 1998). The year – on – year climbing GDP increase (from 1.2% in 1999 to 4.4% in 2004) continued growing by accelerated paces by 4.9% in first half 2005 in real terms; in Q2 by 5.1%, i. e. by 0.6 p. p. more on a year before. During past four quarters (Q3 2004 to Q2 2005) compared to preceding four quarters GDP gained by 4.8% in real terms and its growth accelerated by 0.8 p. p. The seasonally adjusted GDP volume was in Q2 2005 larger by 1.3% quarter – to quarter in real terms. So the year – on – year rate of GDP growth in Q2 2005 by 1.2% in EU – 15 states was substantially lower than in the CR; the growth differential amplified furthermore, which resulted in strengthening of international economic position of the CR.

- ***Predominating effect of net exports on GDP***

The foreign trade balance in the first half 2005 was exceptionally favourable; total surplus in relation to current prices GDP reached 3.6 % and was much higher on a year before. Despite worsening exchange relations the purchase power of total exports enhanced more than demands of imports on resources produced by exports. In terms of real comparison net exports (5.0 p. p.) had a most positive influence on GDP development, when the total year – on – year exports increased by 11.9% and its positive effect (8.4 p. p.) moderated negative impact of imports (3.4 p. p.) raised by 4.7% in real terms. Growth of final consumption expenditures by 0.9% had a slightly affirmative impact (0.7 p. p.); increase of household consumption expenditures by 1.9% affected only by 0.9 p. p. Growth rate of household consumption was lower on a year before (by 0.5 p. p.) and marginal consumption tendency dropped. In terms or real comparison the total formation of gross capital was lower by 2.7% affecting negatively by 0.8 p. p.; gross fixed capital formation (GFCP) was by 2.6% higher affecting positively by 0.7 p. p. The GFCP growth considerably slowed down (by 5.0 p. p.), a worsening of investment climate and a moderate saturation of the market by fixed material assets came through. The GDP development was adversely affected by the fall in supplies production by 1.5 p. p. Purchases of clothing, shoes, furniture, audio and video recorders and means of transport representing household consumption expenditures swelled most. Expenditures for accommodations services, hotels and restaurants reduced. Economic precautions in budgeted outlays resulted in drop in final outlays of general government by 1.1%. From point of view of gross fixed capital formation segmentation outlays for other machinery and equipment jumped substantially faster (5.2%), mainly means of transport (15.6%) than those for buildings and constructions.

- ***Effect of branches on GDP growth***

In terms of real comparison basic price gross added value (GAV) in the first half 2005 enlarged by 5.1%, i. e. by 0.2 p. p. faster than GDP, what was also contributed by slackened growth in products subsidies. Market services (sales, servicing of motor vehicles and consumer goods jumped by 23.7%), finance, banking and insurance services (went up by 12.9%) most affected increase of GDP. Electricity, gas and water production and supply (up by 10.3%) most favourably affected the GAV growth in industry by 2.4%. The GAV in processing industry increased by 1.7%.

- ***Domestic supply surpassed domestic demand***

The year – on – year aggregate demand and aggregate supply rose by 5.8% in real terms in the first half year 2005 and its growth slowed down. Domestic realised demand rose only by 1.4%; 0.8 p. p. positively influenced the total; external demand influenced it by remaining 5.0 p. p. Domestic effective supply increased by 6.5 % as a result of lower supplies formation; its growth also accelerated having a positive influence 3.8 p. p. on aggregate supply; remaining 2.0 p. p. were apportioned to external supply. In real terms domestic supply surpassed domestic demand by 5.1% as a result of GDP growth. Cover of domestic demand by external supply increased, however less on a year before; concurrently cover of aggregate demand by domestic supply rose.

- ***Considerable fall in financing GCF from external resources***

Current price gross disposable national income (GDNI) in the first half 2005 was lower and increased slower than current price GDP year – on – year. The difference in growth rates of both GDNI by 5.0 % and GDP by 5.7 % was caused by an adverse influence of net primary incomes, as net current transfers had a favourable effect. Final consumption expenditures increased less (by 3.4%) than GDNI, so volume of gross national savings enlarged by 9.6%. Rate of gross savings 27.3% was by 1.2 p. p. higher as against the first half 2004; investment rate sank from 30.0% to 28.1%. An adverse balance of national current transactions amounted on CZK 11.6 bln was much lower on a year before (by CZK 39.0 bln), hence rate of outlays financing for gross capital formation (GCF) from external resources dropped from 10.0 p. p. to only 3.0% year – on – year. Domestic resources of GCF arrived at 97.0%.

- ***Labour productivity added to GDP growth***

The year – on – year total labour productivity increased in the first half 2005 by 4.1% and added effectively to GDP growth by 84.2%. The remaining 15.8% contributed to rise of employment. Salaries and wages rose faster and outstripped labour productivity; as a result unit wage costs increased by 1.0%.

Performance in main branches

- ***Differential slowdown of production growth in main branches***

The total growth of production performance in main branches (based on monthly indicators) after expressive enhancement last year in the first half 2005 markedly abated, in the process the year – on – year changes in individual sectors, or sales in branches, respectively, were different from point of view of time and matter-of-fact. In Q2 as against Q1 the year – on – year performance growth in industry, construction, retail, agriculture was higher; that in market service lower. The growth slowdown as well as favourable or adverse effect of seasonal factors on development differed in branches. The Q2 production growth and total sales in industry decelerated more as against Q1, however rise of domestic sales was lower in Q1. Drop in construction was more distinct in Q1 than in Q2, as a result of the year – on – year negative change of gain paces in new constructions and civil engineering. Growth in market services performance especially in Q2 slackened, on the other hand retail sales rate speeded up mainly in Q1. Performance in transport, especially its Q1 growth deceleration and a fall in Q2 had an adverse effect on the development of market services as a whole. Production of meat slashed mainly in Q1; concurrently an average slaughter weight of fat stock went down.

- ***Favourable effect of seasonal factors in Q1***

In the first half 2005 the year – on – year economic performance in industry (measured by industrial production index IPI) jumped by 4.2%, what represented volume of total sales enlarged by 7.0% in real terms, however the growth slackened by 6.6 p. p., or 4.2 p. p. respectively. In Q2 it went faster than in Q1 (4.5%, or 8.0% respectively), but fluctuated in the course of individual months, as a result of opposed changes across braches and products. The first half 2005 span between the highest and the lowest paces of gain reached 7.1 p. p. or 9.3 p. p. respectively. Seasonal factors had much favourable influence on IPI in Q1 than in Q2.

- ***Negative effect of external conditions***

Reasons for the growth slowdown in industry were as follows: worsening of external economic conditions especially fall in prosperity at the world steel and iron markets, increase of world prices some of imported commodities, stiff competition, especially price competition at the textile and clothing industry. As a result domestic production went down. External demand sizeably attenuated, therefore effect of direct export sales on total sales increase slackened, however hereafter it had been predominating.

- ***Industrial production as crucial factor***

Among main industrial groupings (sharing 64.2%of total) the year – on – year manufacturing of intermediate products grew very fast (7.4%), on the other hand lower increase in investment goods (1.7%) were recorded in the first half 2005; it had been reflected in the development of usage of economic resources. Manufacturing of machinery (whose weight is being reached more than two fifths) went up by 5.3% affecting the total growth in industry almost by one quarter.

- ***Growth of foreign demand weakened***

Growth of direct export sales by 10.9% influenced most sales in industry (by 5.4 p. p. up), however it represents sizeably deceleration. Remaining 1.6 p. p. influenced increase of domestic sales by 3.1%, but its year – on – growth slowed down least. Development of direct export sales characterised extremely great differences among monthly gain paces (range 19.3 p. p. at current prices), as well as differences in growth of total sales (from – 15.2 p. p. in January to 11.8 p. p. in April). Processing industry contributed to the total sales growth most (6.5 p. p.) and direct export sales (11.0 p. p.), although manufacturing and supply of electricity, gas and water (8.4%)rose exceptionally and concurrently direct export sales dropped (by 25.9%). Total reduction of sales of mining minerals (by 5.8%) was affected by domestic use as direct exports increased considerably (by 18.5%).

- ***Foreign enterprises pulling***

In the first half 2005 foreign controlled enterprises had an effect on growth of total sales in industry, as its year – on – year total sales arrived at 13.4% in real terms,

production

direct export sales to 13.6%. In remaining industrial enterprises (public, private, domestic) and households total sales dropped moderately (by 0.7%), direct export sales increased only by 3.7%.

- ***Demands of sales on salaries and wages decreased***

Labour productivity in industry improved by 6.4% in the first half 2005 and contributed to sales increase by more than nine tenths; the rest was allotted the number of employees increase by 0.5%. As a result unit wage costs sunk by 2.1%. Volume of primary incomes of industrial enterprises (profits) expanded substantially faster than primary incomes economically active persons (employees). The total nominal volume of paid out wages and salaries enlarged by 4.7% at concurrent growth of total sales in industry by 8.8% at current prices, thus the proportion of total wages and salaries volume to total sales volume diminished from 9.8% in the first half 2004 to 9.4% in the first half 2005. The substantial difference in wages and sales development (19.1 p. p.) was recorded in manufacturing and supply of electricity, natural gas and water (sales increase by 15.8% at current prices; drop in wages by 3.3%).

- ***Volume of domestic orders shrank***

The year – on – year total nominal volume of new orders in selected branches was larger by 7.0% in the first half 2005; volume of foreign orders was up by 12.0%, that of domestic orders was down by 1.7%. The ratio of foreign orders to direct export sales (1.035) and that of domestic orders to domestic sales (0.899); there are being demonstrated potential possibilities to enlarge volume of sales from abroad; despite the fact advanced growth of labour supplies decelerated its realisation.

- ***Construction remained under the first half 2004 level***

The total construction output remained in the first half 2005 by 1.2% under the level of the equal period of last year in real terms; volume of construction work according to suppliers' contracts ("S") in enterprises with 20+ employees dropped by 0.5% and production in small enterprises (with 0-19 employees) plummeted by 2.5%. Such an attenuation of construction prosperity hit first of all smaller enterprises (up to 49 employees) than middle-sized and larger ones; furthermore volume of reconstructions and maintenance of building constructions lessened by 16.6% and civil engineering enterprises production dropped by 2.1%. A mild growth of construction work "S" was recorded in new constructions, reconstructions and modernisations (by 1.9%), as well as in civil engineering enterprises (by 2.2%). There were extensive differences between a huge growth of construction work in the first half 2004 and its shrinking (stagnation) in the first half 2005 there; in terms of new constructions in Q1 and reconstructions and civil engineering in Q2. Volume of construction work performed by own employees ("ZSV") increased by 5.3% in real terms; in comparison to the drop in construction work "S" it means balance of construction work accepted within a framework of subcontract from other enterprises and construction work performed as subcontract for other enterprises jumped.

- ***Favourable effect of seasonal factors in Q2***

In connection with pre-invoicing and invoicing of construction work (as a result of VAT taxes transfer) and an extremely high growth of construction output last year extraordinary wide span of gain paces occurred in the first half 2005, therefore the difference between the monthly maximum and minimum arrived at 55.5 p. p. Also seasonally adjusted construction output data demonstrate extensive year – on – year and month–on–month differences; the first half 2005 month – on – month differences swung from 3.1 p. p. to – 1.0 p. p.; in the process the average change 0.65% was only negligible higher on a year before. The month – on – month average change of trend 0.55% in the first half 2005 was substantially lower. In Q1 seasonal factors had moderately unfavourably impact on growth of construction work, but in Q2 those affected very positively.

- ***Trust indicators in construction worsened***

After four years of uninterrupted growth in construction was even very high in 2004, in the first half 2005 slowed down, however it is not related to a high comparative basis and reached level of construction work last year only. Increase of nominal volume of domestic orders, especially in infrastructure halted in Q2. Trust indicators in construction gradually worsened since January to June, its the first half 2005 average balance especially in Q2 was substantially lower.

- ***Demands of wages on construction work increased***

Labour productivity in construction enterprises (with 20+ employees) in the first half 2005 decreased by 4.4%; the difference was 17.4 p. p. as against last year. Number of job opportunities as well as employees in construction rose by 4.1% compared to the last year. An average monthly wage increased by 3.5% resulting in jump of unit wage costs by 8.3%. The total year – on – year paid out nominal volume of wages was larger by 7.7%, its share in construction work "S" swelled by 0.6 p. p. at current prices (from 13.8% in the first half 2004 to 14.4% in the first half 2005).

- ***Less permissions but with greater value of constructions issued***

During the first half 2005 planning and building control authorities permitted 64.9 thousand dwellings to be constructed; the approximate value of newly permitted dwellings reached CZK157.3 bln was by 8.7% less, or 11.5% more, respectively year – on – year. It is corresponding to the growth in construction work prices picking up speed that results in sizeable increase of average costs per a construction. Costs for changes of finished constructions increased much more than those for new constructions and non-residential buildings than housings. Share of estimate value of permitted dwellings in total value rather decreased, as a result of diminished growth of building savings and taking out home loans.

- ***Substantial decrease of new orders volume***

The year – on – year nominal volume of new orders in amount of CZK 105.0 bln in the first half 2005 was lower by 18.5%. An average extent of an order amounted to CZK 2.7 bln was substantially lesser on a previous year. The proportion of orders closed within the state sector to the total amount of new ones (40.7%) and furthermore had been getting down. The year – on – year ratio of new concluded orders to the volume of construction work reached 93.8% and markedly sunk. By the end of the first half 2005 the total volume of domestic orders attained CZK 206.4 bln was larger by 7.7% compared to the equal period of the last year; in spite of this trend slowed down, its volume (supplies) will be sufficient for more than nine months of construction work.

- ***Housing construction slackened paces of growth***

Housing construction considerably slackened paces of growth particularly in Q2, which is partly in relation to excess of supply over demand on the market. The first half 2005 number of newly constructed housings (17.7 thousand) was lower by 8.7% on a year before, in Q2 sunk by 19.4%. The year – on – year number of finished flats (12.5 thousand) was by 3.9% higher (by 1.3%, respectively). Its higher ratio to number of flats where construction already started (70.8%) which is by 8.4 p. p. more on a year before manifests noticeable change of housing construction coefficient. By the end of the first half 2005 the year – on – year number of partially built housings 152.1 thousand was by 3.9% higher (the difference of 1 043 housings between review and statistical survey came about as many housings were converted into non-residential spaces in the course of the year). The ratio of finished housings to partially built ones changed imperceptibly.

- ***Growth and acceleration in retail***

In terms of real comparison the year – on – year volume of sales enlarged by 2.8% in selected branches providing market services; faster growth had been recorded in Q1 (3.1%) as against Q2 (2.6%), when striking deceleration (as a result of fall in transport performance) was occurred. Total retail sales increased relatively most in Q1 (by 3.5%), in Q2 by 3.7%; concurrently its year – on – year growth accelerated by 1.5 p. p. in Q1, in Q2 by 0.9 p. p. This increase was unfavourably influenced by the unpropitious situation in hotels and restaurants, where the trend of ebbed performance since 2nd half 2004 continued. In the first half 2005 the year – on – year volume of sales was by 6.7% lower in real terms; in Q2 by 7.4%; and in hotels and restaurants even by 8.1% lower. Not only unfavourable weather and fall in tourism, but also VAT taxes transfer (increase in VAT taxes for hotels and restaurants) were crucial reasons household savings rate went up. The year – on – year volume of retail sales (excluded hotels and restaurants) swelled by 4.3% in the first half 2005 in real terms, and in Q2 by 4.7%, which was noticeable acceleration influenced mainly by sale and servicing motor vehicles (8.0% in Q2). Volume of sales in transport dropped (by 1.3%, or 2.3%, respectively), as a result of fall in performance of other supporting activities provided with transport, travel agencies and offices. Despite sales in post and telecommunication services increased sizeably, drop in performances of postal services accelerated.

- ***Fall in domestic production of meat compensated by imports***

In agriculture in total 208.1 thousand t slaughter meat (excluded poultry) was produced in the first half 2005, which was by 17.3% less on a year before. Production of beef and veal meat went down most, by 22.0%; the plummet of pork meat production by 16.2% had the most adverse effect on fall in total meat production (by 12.9 p.p.) has been partly compensated by imports. This situation is related to accession of the CR to the EU. Exports of living animal abroad increased, so number of herds and flocks went down.

- ***Plenteous harvest is expected***

Based on estimations of yield of the crop and agricultural production to August 15th it is expected volume of plant production will be by more than one tenth lower in 2005 as a result of both lesser-sown area and yield per hectare as against last year. Despite this fact a plenteous harvest is expected. Volume of cereals will lessen by 14.0%, sugar beet by 10.9%, colza by 17.1%. Total volume of potatoes is expected to enlarge by 14.4%.