

External Economic Relations

- **Favourable development of the balance of payments accounts**

The sum of balances of three main balance of payments accounts (current, capital, financial) changed from CZK 0.5 bln deficit in H1 2004, in that from CZK 7.6 bln surplus in Q2 to CZK 80.9 bln surplus in H1 2005 (CZK 72.1 bln in Q2). Increase in the financial account assets and decrease in the current account liabilities had nearly the same impact on this considerable half-year change. Nevertheless, current account deficit to financial account surplus ratio changed dramatically year-on-year, from 102.8 % in H1 2004 to 13.6 % in H1 2005.

- **Marked decrease in the current account deficit – result of the trade balance surplus**

Current account deficit CZK 12.3 bln in H1 2005 was year-on-year lower by CZK 39.3 bln, as a result of faster growth of revenues to outlays. In relation to GDP, the stated deficit represented 0.9 %, i.e. by 2.9 p. p. less on a year ago. Decrease in the deficit was positively affected mostly by the trade balance (5.2 p. p.), followed loosely by the current transfers balance (1.1 p.p.); negative effect (2.0 p. p.) came from the income balance. Trade balance surplus CZK 42.0 bln reflected faster growth of exports to imports of goods, even though their growth slowed down notably. Looking at the subject structure, the crucial positive factor in the year-on-year improvement of the trade balance was the change in the export/import balance of machinery and equipment by marked CZK 44.1 bln and market products assorted by material by CZK 9.7 bln. Trade in chemicals and related products also contributed positively with CZK 9.3 bln. On the other hand, negative effect came from the change of export/import balance of mineral fuels, grease and related materials CZK 15.7 bln. Regarding the territorial structure, the positive balance in trade with industrial countries improved by CZK 42.1 bln and with developing countries by CZK 10.9 bln. Opposite effect had the increase in trade deficit with the Commonwealth of Independent States by CZK 9.7 bln. Low surplus of services balance CZK 8.4 bln was favourably influenced by transport and negatively by other services, with marked excess of outlays over revenues (1.9 times). Income balance deficit of CZK 77.9 bln was by CZK 22.6 bln higher than in H1 2004, with the growth of costs of 36.8 % surpassing the growth of incomes by 6.5 p. p. Acceleration of the dividends paid out to foreign investors played a role in the deficits increase. Balance of current transfers surplus of CZK 15.1 bln and its increase by CZK 11.0 bln, which recorded the repayment of Slovak Republic to CSOB bank, contributed markedly to the drop in current account deficit.

- **Highly positive effect of net inflow of FDI on the financial account**

Financial account surplus CZK 90.4 bln in H1 2005 was year-on-year larger by CZK 40.2 bln, while the rate of growth of liabilities (65.8 %) was higher than that of assets (55.3 %). Ratio of this surplus to GDP 6.3 % was by 2.6 % higher on a year ago. Surplus grew mostly due to the net inflow of foreign direct investment and their year-on-year increase of CZK 112.3 bln. This result was to a large extent affected by a privatisation of state property to the hands of foreign investors (sale of the share in Czech Telecom and Unipetrol). Net outflow of portfolio investment of CZK 20.5 bln meant a great shift in comparison to the large inflow in the previous year (64.0 bln), negatively affecting the financial account development. This was largely caused by a heightened demand of domestic investors for foreign securities. Other investment ended in negative balance of CZK 56.6 bln, CZK 17.3 b lower on a previous year.

- **Fast growth of CNB foreign exchange reserves**

Shift in the CNB foreign exchange reserves of CZK 86.9 bln in the course of H1 2005 (their increase after the elimination of exchange rate effects) was considerably larger compared to the previous year (by CZK 81.2 bln). Relative to GDP, the reserves reached 6.1 %, i.e. by 5.7 p. p. more than in H1 2004. This enormous growth is the consequence of above mentioned privatisation and incomes from investing foreign exchange reserves.

- **Appreciation of CZK halted in Q2**

Average nominal exchange rate of CZK against EUR 30.07 and 23.41 against USD in H1 2005 recorded different development in relation to both currencies. *Koruna* appreciated year-on-year in H1 2005 against EUR by 7.9 % and against USD by 12.9

%, in that less in Q2 (by 6.3 % and 11.2 % respectively). In Q2 CZK somewhat depreciated quarter-on-quarter against EUR (by 0.4 %) and slightly more against USD (by 4.3 %). Following a tendency to slowdown its appreciation against USD, CZK started to depreciate in May and it depreciated by 3.6 % by June. Nominal effective exchange rate index of CZK (NEER) was in H1 2005 year-on-year higher by 7.1 %, in that in Q2 by 5.9 %, which points to a relatively large impact of other currencies than euro and dollar on the Czech national currency appreciation. Real effective exchange rate index of CZK (REER) was in the same period higher by 8.0 % and 5.4 % respectively based on the changes in the industrial producer prices and by 6.0 % and 4.8 % resp. on the basis of consumer price changes. Year-on-year development of this index in H1 signals potential lowering of Czech economy competitiveness. In Q2 quarter-on-quarter, the NEER index was lower by 0.6 % and the REER index by 2.2 %, signalling slight improvement in competitiveness.