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1. Summary

- The Gross Domestic Product (GDP) increased by 2.3% in 2016. The economic expansion was supported mostly by the growing household final consumption expenditure. Equally, the growth of the positive foreign trade balance surplus, affected by the favourable economic development of the nearest business partners of the CR, played a role. The rate of the economic growth compared to the preceding year slowed down year-on-year. The high comparative basis of the year 2015, when the combination of one-off growth factors not recurring in 2016 manifested, was however the main reason. The investment activity, which featured a negative addition to the GDP growth in 2016 (-0.9 p.p.), was one of these factors.
- The gross value added (GVA) rose by 2.1% in 2016. Manufacturing played the most important role in the growth of the GVA, with its significance for the GVA growth deepening. Real estate activities also prospered and especially the agriculture, forestry and fishing, which enjoyed a strong GVA growth (by 9.5%) due to the contribution of a very good harvest. On the contrary, the performance of construction was slowing down during the year, its addition to the GVA growth in 2016 was negative in the value of -0.3 p.p.
- The Czech Republic attained a marked surplus of the current account of balance of payments in 2016, which resulted mostly from the exceptionally high positive balance of trade in goods and services. The value of exports was record high and reached 3312 CZK bn (even despite the slowdown of the export growth in the second half of the year). Strongly rising exports of motor vehicles were mainly behind this result, comprising 27.8% of exports from the CR.
- The price development was influenced by a drop of oil prices at the turn of the years 2015 and 2016. This was reflected in the consumer prices, with their growth staying below 0.6% in the first three quarters of the year, as well as the industrial producer prices, which were falling throughout the whole year on a year-on-year basis. The development of the food prices, which were notably decreasing in the first three quarters, was also determining for the consumer prices. The food prices were raised in the final quarter and the growth of consumer prices started nearing 2%. The prices of real estate hiked up markedly. The lack of price affordable dwellings together with the territorial mismatch between the supply and demand left its mark in the acceleration of growth of realised prices of older dwellings, which increased by 14.5% year-on-year in Q4 2016. The fall of prices of imported goods eased up and the period of imported deflationary pressures ended.
- Monetary conditions were to a large extent characterized by low interest rates and continuing regime of forex interventions in the CR. Interest rates on deposits kept further decreasing during the year 2016. The outflow of funds continued from the term deposits to the benefit of the current accounts. The volume of credit provided to households rose with the view to low interest rates and easy accessibility. The anticipated changes of rules for the provision of mortgagees fastened the increase of volume of these loans towards the end of the year.
- The labour market situation kept further improving in 2016. The rate of growth of total employment strengthened already a third year in row, reaching 1.8% last year¹. Manufacturing shared in the higher employment by more than 40%, however services were also advancing during the year. Record 5.32 mil persons were employed by the end of the last year. The proportion of businesses, which considered the lack of labour force as an important barrier to growth however also increased. General unemployment rate kept falling throughout the whole year and it arrived at 3.6% in December 2016. The supply of vacancies kept further expanding, professionals and qualified manual workers found employment the best. Favourable financial situation of businesses as well as the rising obstacles when searching for new employees pressed the nominal wages up. These grew by 4.2% last year, the most since the year 2008. Increase of the minimal wage together with the strengthening of earnings in the branches with the predominance of state were projected into 6.0% growth of the wage median in Q4 2016 and contributed thus to the lowering of the wage differentiation of employees. The real average wages grew despite strengthening inflation towards the end of the year by 3.5% for the whole year, i.e. by the highest rate of growth since 2007.
- State budget (SB) reached a positive balance of 61.8 CZK bn. The budget surplus was last achieved in the period of years 1993–1995. Both last year's SB income and expenditure were markedly influenced by irregularities in the drawing on funds from the EU budget. Expenditure of the SB on investment slumped by 52% year-on-year (by one quarter compared to the year 2014) and their share in the total budget expenditure dropped below 7%. The stable growth of the economy was mirrored in the higher collection especially of direct taxes, but also in the pension account deficit, which fell by nearly one half year-on-year. The state debt shrank by 3.6% for the last year (to 1613.4 CZK bn).

¹ Seasonally adjusted data in the national accounts conception.



2. Overall Economic Performance

Gross Domestic Product increased by 2.3% in 2016. The growth slowed down compared to the year 2015, mostly due to the year-on-year fall of the investment activity.

Quarter-on-quarter growth of the GDP was strongest in Q2. Economic growth was supported by exceptionally favourable results in both industry and foreign trade.

Year-on-year pace of the Czech economic growth aligned with the EU average in the second half of the year. The year 2016 was successful for most European countries. Strong growth continued in Slovakia, the German economy expanded by a stable rate of growth.

Growth of the final consumption expenditure of households shared significantly in the GDP growth in 2016. Growth of the trade balance surplus also manifested notably. Gross fixed capital formation lagged behind the year 2015.

The Gross Domestic Product (GDP) increased by 2.3% in 2016². The Czech economy enlarged by a halved pace in 2016 in comparison to the year 2015, when the significant growth was supported by an extraordinary combination of factors, which did not recur in the year 2016. Moderation of the growth dynamics started already in the final quarter of 2015 and the year-on-year additions recorded further fall (3.0%, 2.6%, 1.8%). The year-on-year growth went up somewhat to 1.9% at the end of the year. The year-on-year growth of the gross value added (GVA) corresponded to the GDP and it was decreasing during the year (2.7%, 2.6%, 1.6% and 1.6% in the individual quarters). In total, the GVA rose by 2.1%. The domestic demand (final consumption expenditure of households), whose significance was strengthening for throughout the whole year as well as the growing surplus of the foreign trade balance, which held key meaning for the economic growth especially in the first half of 2016, supported the GDP growth. On the contrary, the investment activity, which stood behind the exceptional results of the year 2015, was subdued the whole last year. A number of indicators signalled a favourable development of the economy.

The quarter-on-quarter dynamics of the GDP growth lagged behind the two preceding years. The quarter-on-quarter additions to the GDP arrived at 0.4% and 0.9%. Notable slowdown manifested in Q3 (0.2%). The growth gained pace to 0.4% at the end of the year. The quarter-on-quarter additions to the GVA amounted to 0.4%, 0.7%, 0.2% and 0.3% in individual quarters.

Year-on-year rate of growth of the economic growth in the Czech Republic moved closer from above to the growth in the EU and they were equal in the second half of the year. Growth of the EU economy quarter-on-quarter fluctuates quite stably around 0.5% in the last three years and the Czech Republic (except for Q2) did not overtake it in 2016. The year 2016 was from the view of the economic development favourable for most of the European countries³. The GDP fell only in Greece year-on-year; other economies experienced at least a mild year-on-year growth. The largest GDP growth was recorded in Romania (4.8%) in 2016, followed by Spain (3.3%). Neighbours of the Czech Republic and its nearest economic partners also prospered. The German economy expanded by 1.8% year-on-year, the Austrian GDP rose by 1.5%. The year-on-year growth decreased its pace somewhat in Slovakia during the year, still the Slovak economy expanded by 3.3% for the year 2016 and ranked among the fastest growing in the EU. The growth of the Polish economy accelerated in the last quarter and increased by 2.9% for the whole year.

The year-on-year GDP growth was driven by the final consumption expenditure of households through the whole last year. Their contribution to the total GDP⁴ growth amounted to +1.1 p.p. and their importance grew in the course of the year. It attained +0.9 p.p. and +1.0 p.p. in the first half of the year and it strengthened to +1.3 p.p. and +1.4 p.p. in Q3 and Q4. On the contrary, the contribution of final consumption expenditure of government institutions, which reached +0.4 p.p. and +0.5 p.p., in the first two quarters weakened to +0.2 in the third quarter and it was zero in the final quarter. The export and import balance contributed more strongly and substantially to the GDP growth than in the preceding year (in total +1.2 p.p.). Its addition even exceeded the above-mentioned household consumption in the first half of the year, when it reached +1.2 p.p. and +2.0 p.p. It lowered to +0.5 p.p. in the third quarter, which was from the view of the foreign trade results less successful and increased to +0.9 p.p. at the end of the year. The positive addition of changes in inventories to the growth strengthened especially in the second half of the year (+0.9 p.p. and +1.0 p.p. in Q3 and Q4). The contribution of the already mentioned investment activity represented by gross fixed capital

² Data regarding the GDP, gross value added and their components are expressed in constant prices and adjusted for seasonal and calendar effects. Data were published on 3rd March 2017 and more precise values will be published on 31st March 2017.

³ Data for Ireland and Luxembourg not available. Data for Slovakia not adjusted for calendar effects.

⁴ Contributions to GDP change excluding the import for final use.

Households acquired durable assets in a larger extent in 2016.	formation was negative (in total -0.9 p.p.).
Favourable economic situation led to the enlarged volume of paid wages, however the real wage growth subdued towards the end of the year.	Growth of the household consumption was 2.9% in 2016 and was driven mainly by the large increase in the category of durable goods (6.2%). The year-on-year growth of expenditure on consumption of these goods slowed down to 3.4% in the final quarter of the year, but it was replaced by a relatively strong year-on-year rise for semi-durable goods (8.4%). In the last quarter of 2016, the growth of expenditure on non-durable goods also accelerated to 3.1%. Expenditure on services grew more notably compared to the preceding years (total year-on-year growth of 2.5%).
Year-on-year growth of government final consumption expenditure slowed down during the year.	The growth of consumption was supported by the positive expectations of consumers as well as the growth of earnings. The increase of the volume of paid out wages fastened compared to the year 2015 and attained 5.5%. The growth was stronger in the first three quarters of the year (6.0%, 5.4% and 5.7%) and it mildly eased up to 5.0% in the final quarter. The increase of the price level manifested especially at the end of the year and the volume of paid out wages declined in the real terms (5.9%, 5.4%, 4.8% and 3.6% in individual quarters) ⁵ . The continuous increase of the minimal wages, which is apparent mostly by rise of 6.2% in branch trade, transportation, accommodation and restaurants, was partially projected into the growth of the volume of paid out salaries and wages. The volume of paid out wages significantly rose also in manufacturing (6.6%). Compared to the previous year, the dynamics fastened in branch information and communication activities (7.6%) or professional, scientific, technical and administrative activities (6.5%), partially also due to the rise of employment. The volume of paid out wages grew less than in the previous year in real estate activities (3.2%). The volume of paid out wages grew by 2.1% accompanied by a simultaneous fall of employment of 0.8% in construction, which experiences a long-term downturn.
Expenditure on gross fixed capital formation decreased year-on-year. It was caused mainly by the slump of investment into other buildings and structures.	Total year-on-year growth of consumption expenditure of government institutions amounted to 1.5%, which was by 0.5 p.p. less compared to the year 2015. The growth was concentrated especially into the first two quarters, when it reached 2.3% and 2.7%. Such high rate of growth was not sustained in the second half of the year. The year-on-year increase arrived at 1.0% in Q3 and the value of final consumption expenditure of government institutions did not differ from the level of the same period of the previous year in the final quarter.
Investment into transport equipment and projects of intellectual property increased.	Expenditure on gross fixed capital formation, which represents the investment activity in the economy, fell by 3.6% in 2016. This decrease is the result of combination of finalisation of drawing on the European funds in the year 2015 and a slow pace of preparation as well as realization of projects for the subsequent programme period. The investment activity was rising still by 1.8% in Q1 year-on-year, but a decline occurred in the three following quarters, which deepened down to -5.0% in Q4. Year-on-year slump was caused especially by the cut of investment into other buildings and structures by 13.4%. This category includes large infrastructure projects often financed by the help of subsidies (investment rose markedly in this area in the previous year). Investments into the ICT, machinery and equipment and weapon systems, which recorded year-on-year decrease of 5.4%, had a similar development.
Foreign trade balance was positive in 2016 and exceeded the preceding year by 67.4 bn.	Aforementioned investment categories present more than one half of the gross fixed capital formation volume, that is why even the strong growth of investment into transport equipment, which followed in the year 2015 and attained 7.2%, did not offset their decrease. Investment into the projects of intellectual property markedly increased (8.1% in 2016, 4.0% in 2015). Investment into dwellings weakened compared to the previous year (2.5% in 2016, 8.4% in 2015).
Foreign trade balance was positive in 2016 and exceeded the preceding year by 67.4 bn.	Surplus of the foreign trade with goods and surplus balance (in current prices) arrived at 347.2 CZK bn in 2016, resulting in excess over the year 2015 of 67.4 bn. Positive balance of the trade with goods reached 248 CZK bn (year-on-year

⁵ Converted into the real expression using the deflator of final consumption expenditure of households.



increase by 43 bn) and 99.3 CZK bn for services (increase of 24.3 bn). The terms of trade had a value of 100.9 for the year 2016. They were positive in the first three quarters of the year, however they fell into negative values (99.8) in the last quarter for the first time since Q2 2015.

Profits from terms of trade were decreasing during the year.

Real gross domestic income (RGDI), which in contrast to the GDP reflects the additional profits or losses from the development of prices in the foreign trade, respectively the profits or losses from the terms of trade, rose by 3.1% in 2016 (before adjustment for seasonal and calendar effects). The RGDI exceeded the GDP growth during the first three quarters, however its dynamics weakened and it lagged by 0.6 p.p. behind the GDP growth in Q4. Profit from the terms of trade was shrinking during the year and a mild loss occurred in the last quarter.

Manufacturing contributed to the overall GVA growth by more than half and it is thus the most significant source of growth.

Manufacturing shared the most on the GDP growth in the year 2016. Even though its gross value added did not increase as much as in the two previous years (4.8%, it was 8.2% in 2015), its additions to the total GVA growth was +1.3 p.p., that is more than one half (similarly to 2015). Manufacturing contributed to the GVA evenly in all quarters of the year. Real estate activities was another branch that grew more markedly (increase by 3.2%), growing slower compared to 2015, nevertheless its additions to the GVA arrived at +0.3 p.p. and it was also stable throughout the year.

The contribution of branch trade, transportation, accommodation and food service reduced year-on-year. The GVA fell notably in construction.

The growth slowed down in branch trade, transportation, accommodation and food service during the year 2016, its contribution to the GVA was +0.7 p.p. in 2015. The mentioned branch still added +0.5 p.p. in Q1 2016, but the additions subsequently shrank to -0.1 p.p. at the end of the year. The total contribution was +0.2 p.p. in 2016. Another branches, which did not sustain the growth from the previous year are information and communication and professional, scientific, technical and administrative activities. Both branches contributed to the GVA increase similarly only by 0.1 p.p. in 2016. The year 2016 was not successful for construction, whose GVA fell by 5.8%. The negative impact on the total growth of the GVA on the part of this branch deepened during the year and it arrived in total at -0.3 p.p.

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

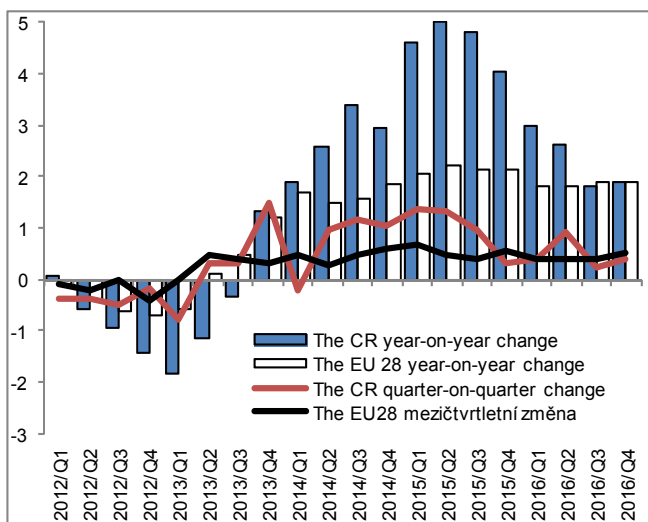


Chart 2 GDP (constant prices, adjusted for seasonal and calendar effects, y/y in %, right axis and confidence indicators (2005=100, left axis)

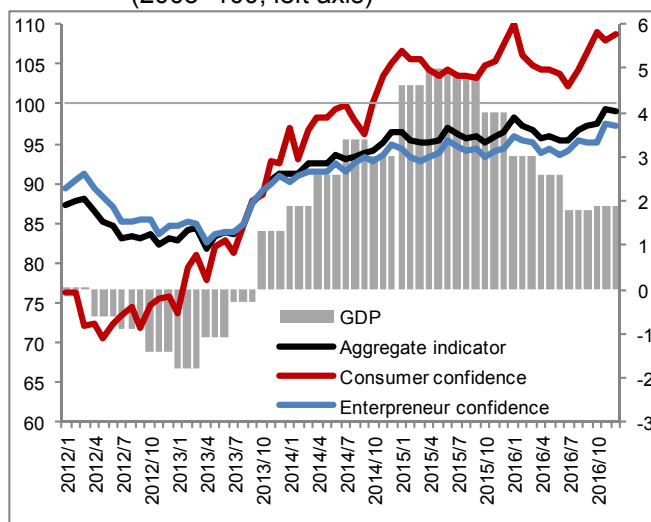
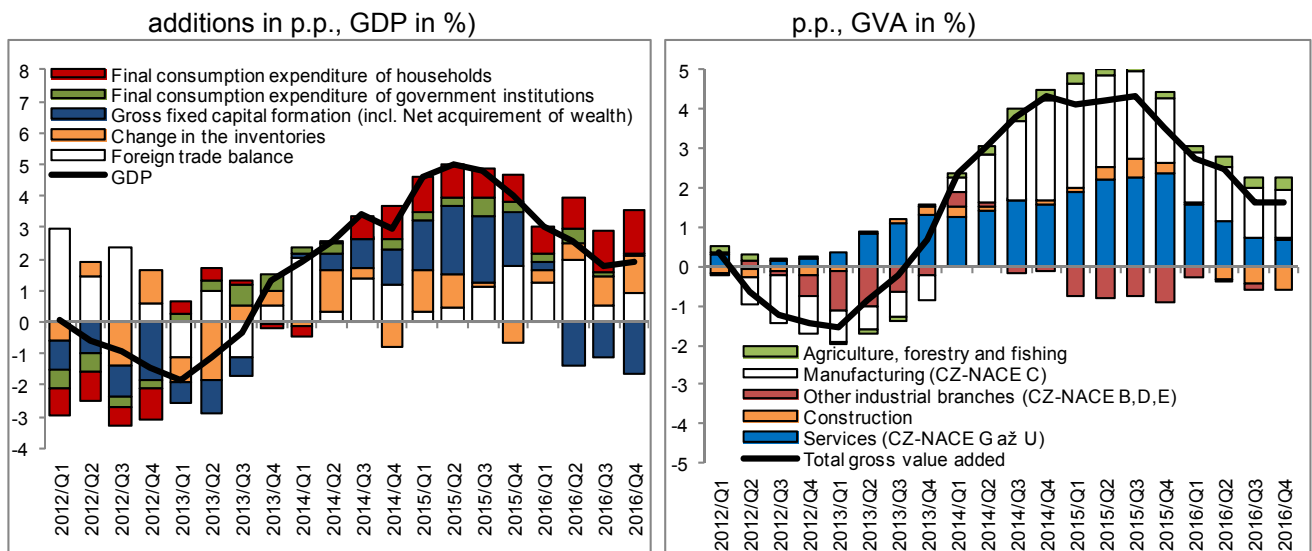


Chart 3 Contributions of expenditure items to GDP change * (constant prices, y/y,

Chart 4 Contributions of branches to change in GVA (constant prices, y/y, additions in



*after exclusion of imports for final use

Source: CZSO, Eurostat

3. Branches Performance

Year-on-year GVA growth eased its pace last year and it was the weakest in total for the last three years.

Slackening of the GVA growth was caused by weaker performance in weight significant groups of service activities and also the deepening of the adverse development in construction during the last year.

Very good harvest led to the highest GVA growth in agriculture, forestry and fishing since 2009, its value added increased by one quarter in the last three years.

Year-on-year growth of the industrial production slowed down due to the high comparative basis during the year 2016, weaker results of key export branches in summer period as well as unplanned restriction of

Performance of all economic branches according to the gross value added (GVA)⁶ was by 2.1% higher compared to 2015. The GVA growth eased its pace due to the influence of a gradual fading away of the extraordinary stimulating factors last year. It was apparent especially in the quarter-on-quarter comparison – gradually in the second half of the year +0.2%, resp. +0.3% (it represented the weakest rates of growth in both cases since Q3 2013, when the Czech economy was slowly recovering from the prolonged recession). Manufacturing managed to hold the key driving role, similarly to most periods of the economic growth. It added 1.3 p.p. to the total last year's growth of the GVA of 2.1%. Its role was even magnified in the second half of the year, when the notable growth of the GVA in the group significant by weight trade, transportation, accommodation and food service evaporated after 2.5 years. Real estate activities and especially agriculture, forestry and fishing on the contrary fully extended their successful previous years. Very good harvest of all basic agricultural crop (for cereals it was even the third highest in the history of the independent CR) contributed to the strong growth of the GVA (by 9.5%). Lowering of the extraordinary sources of public orders suppressed the performance of construction. The GVA was falling quarter-on-quarter in construction already since Q4 2015, it declined in total by 11.3% in the five quarters. The uncertain situation over a long term took its toll in the area of employment. Number of hours worked was by 4.0% lower year-on-year in the second half of the last year. Non-manufacturing industrial branches also faced obstacles. Their negative contribution to the year-on-year GVA growth significantly shrank last year (to -0,1 p.p., -0.8 p.p. a year ago), it was even already positive thanks to the development in energy industry in Q4 2016 (for the first time after nine quarters).

More detailed results of the business statistics also confirm the lasting growth tendencies of the main economic branches. Industry performance⁷ (based on the industrial production index) strengthened by 2.9% in 2016 (resp. 2.3% after adjustment for calendar effects)⁸. Even though the last year's pace declined by approximately one half against the years 2014 and 2015, it still exceeded the dynamics of the whole EU (by 0.9 p.p.). Signals of slowdown in the Czech Republic were apparent already from the lower volume of new orders in the

⁶ Data regarding the GVA are expressed in constant prices and adjusted for seasonal and calendar effects.

⁷ Including branches based on the CZ-NACE: B (Mining and quarrying), C (Manufacturing), D (Energetics).

⁸ The calendar effects influenced production mainly in Q2. That quarter had three working days more compared to the same period in 2015. The difference between adjusted (+2.2%) and not adjusted production (+5.7%) was significant and last recorded in a similar extent in Q3 2008.



production capacities of chemical industry and energetics for most of the year.

second half of year 2015 (in machinery or manufacturing of electrical appliances), resp. their dive in the chemical industry as a result of serious accidents. Volume significant energetics branch (comprising one twelfth of production of the whole industry) also faced cutback in production capacities during majority of the last year. Weaker results in summer months also left its mark on the last year whole industrial production. The production in whole industry declined by nearly 2% in this period and it thus recorded the deepest quarter-on-quarter fall since the end of the year 2012 (even by 4% in key export branch – manufacturing of motor vehicles). However, the last quarter of the past year indicated, that it represented only a one-off fluctuation. The restoration of production capacities in power stations as well as chemical industry enabled the industry to fully breathe again.

The long-term dominant position of the motor vehicle manufacturing within industry was even amplified in 2016.

Manufacturing of motor vehicles traditionally pulled the production of the whole industry. Its dominant position was even magnified compared to the preceding period of the years 2014 and 2015, when it contributed 2.0 p.p. to the year-on-year growth last year (together with the nearest subcontractor branches 2.5 p.p.). It is also evidenced by the fact, that it did not reduce its double-digit growths from the previous years as the only industrial branch (its production expanded by 41% in the last three years, growth in the whole industry arrived at 13%). Rising demand on European as well as Asian markets stimulated production, which was also reflected in the repeated conquest of the record of manufactured motor vehicles in the Czech Republic⁹. Manufacturers of corresponding intermediate products also benefited from this development – especially manufacture of rubber products fared well (however the growth of production was only 0.7% in the manufacture of electrical appliances). Manufacturers of other (mainly rail) transportation equipment also reached similarly modest result last year, the weaker domestic demand stood in the background (compared to the strong year 2015).

Production growth continued in the weight significant manufacture of metal products as well as machinery, manufacturers of computer, electronic and optical products also thrived

Within the other more significant manufacturing activities, the manufacture of metal products recorded an above average growth last year (by 4.5%) and its production overtook the level of the peak year 2007 for the first time¹⁰. Strongly export oriented manufacture of computer, electronic and optical products accelerated its growth as one of the few activities year-on-year (to 5.6% from 2.8% in 2015). In machinery, the higher foreign demand managed to compensate the less favourable development at home and it resulted in higher production (by 1%). Larger diversification of this branch made it more resilient with respect to the fluctuations in demand. The production in machinery thus increased already seventh year in a row and it was by nearly one tenth higher last year compared to the year 2007 (similarly as in the whole industry).

Dynamic growth of production continued among the smaller manufacturing activities in furniture industry, as well as also a mild recovery in the textile industry.

Among the smaller branches, the furniture industry continued thriving, with the production rising by more than one quarter in the last four years (even though it still lagged behind its latest peak from the year 2007-by 6 %). Both the textile and leather industry recorded slightly higher pace than the whole manufacturing (+3.7%) last year. The clothing industry (subdued in the long term) stagnated after its recovery in 2015 (driven by the higher foreign demand) last year, when the increased domestic demand only compensated for the mild year-on-year decline in the foreign demand, holding higher weight. Printing industry achieved a swift growth also due to the lower comparative basis, being traditionally focussed predominantly on the domestic market.

The production was within the more important manufacturing activities falling only in metallurgy, chemical industry and

The chemical industry put the brakes the most on the growth of the whole industry in 2016, since its performance has been restricted due to accident for more than one year¹¹. In spite of a gradual renewal of capacities in the second half of the last year, the year-on-year production was still placed by 7% lower compared to the

⁹ According to the data of the Automotive industry association 1.351 mil motor vehicles were manufactured in the Czech Republic last year, by 8.2% more year-on-year.

¹⁰ One half of manufacturing activities still lagged behind this level in 2016. It included especially the manufacture of clothes and manufacture of leather products or manufacture of beverages (by one quarter in all cases). Among the activities more significant by weight, the same was valid in metallurgy and foundry industry (89% of the production level of year 2007), manufacture of food products (91%) and chemical industry (92%). Manufacturers of motor vehicles surpassed this level already in 2010 and they exceeded it by 81% last year.

¹¹ Production in the chemical industry lowered (by 16% in total) during four quarters (i.e. from Q3 2015 to Q2 2016).

manufacturing of food products.

Impact of unplanned shutdowns on the annual production was deeper in chemical industry than in energetics.

The long-term more favourable development of industrial sales from direct exports over domestic sales continued.

Entrepreneur confidence strengthened in industry at the end of the year and reached the highest values for the last 5.5 years.

The ratio of businesses that face a lack of labour force grows already since the beginning of the year 2015, it accelerated in Q4 and reached the level of the peak years 2007-2008.

Civil engineering construction struggled with the impacts of the very uneven drawing of public investment due to the setup of EU programme periods, lower production of building construction was also affected by the administrative demands of construction proceedings.

year 2015¹². The unplanned shutdowns in energetics did not have such a high impact on this industry, since the production rose by 0.5% for the whole year and at the same time it grew for the first time since the year 2010. On the contrary, the external influence (commodities prices on the world markets) were adversely reflected in mining and quarrying, when the guided slow-down of mining (mostly the black coal) showed in the sharp falls of production (by 9% in 2016, by 27% then in the last five years). The excess of supply of steel on the European markets led to a mild lowering of production in metallurgy and foundry industry (by 0.5%, similarly as in Germany or the whole EU)¹³. The manufacturing of food products (stable branch, oriented mostly on the domestic market), achieved in the CR the weakest result in the past five years in the last year (-2.5%, +1.0% in Germany, +6.4% in Poland). Lowering of the volume of public orders in the civil engineering construction as well as a weaker intensity of the commenced residential construction had an effect on the production of other non-metal mineral products, where the production following the revival in the years 2014 and 2015 stagnated last year.

Trends in the industrial production are closely connected to the development of sales. These grew by 1% in nominal terms compared to the year 2015, since the more favourable development of sales from direct exports (+2.7%) managed to offset the mild slump of the domestic sales (-1.3%). The domestic sales however revived in the last quarter of the past year (+2.3%), when they profited from the year-on-year strengthening both in the chemical industry and energetics.

This year's trends in the value of new orders¹⁴ signal the outlooks of industry. They increased by 5.9% year-on-year in Q4 2016 – the most in the motor vehicle manufacturing (+11.3%), all main branches however indicated favourable tendencies (apart from the manufacturing of electrical appliances). It is also important to stress, that the domestic orders also mildly grew (+1.7%) apart from the foreign demand (+8.1%). The positive mood of entrepreneurs lasted in industry throughout the whole year, in addition it even mildly grew at the end of the year. According to the fresh data (from January 2017), 22% of industrial businesses expected the increase of the production activity in the next three months (similarly as a year ago). 19% of businesses planned to increase employment (13% the year ago). Expectations improved significantly in energetics, negative outlooks deepened in the mining industry. The share of businesses, that consider the lack of labour force as a barrier to growth markedly accelerated in the last quarter of the past year (to 29%) and it already achieved 33% at the beginning of 2017. Still, the inadequate demand remains the main barrier to growth (43%), facing for example the food industry.

Construction production again returned to deeper declines last year after the growth from the years 2014–2015. It decreased by 6.1% compared to the year 2015¹⁵, even by 16% in civil engineering construction (the deepest fall after the year 2000). Effect of high comparative basis (due to the fastened realisation of public orders for infrastructural projects during 2015) and the slow onset of investment in the new programme period were manifested during the whole year. The construction however already extricated from the declines in the quarter-on-quarter expression in the second half of the year, even though only thanks to the building construction so far. The production in whole construction still lagged behind the peak year 2008 by one fifth last year. On the other hand, it was by 0.6% higher (due the influence of the building construction) in comparison to the year 2014 (in which the effect of strengthening completion of drawing of European

¹² The level of production of this branch from the end of the last economic recession (Q1 2013) was exceeded thanks to the strong quarter-on-quarter growth in the last three months of 2016 (+7.9%). The manufacture of paper and paper products was the only manufacturing activity that lagged behind this level also at the end of 2016 (by 4%). From the non-manufacturing activities, it was further the mining and quarrying (by 21%) and energetics (by 3%).

¹³ The position of the branch partially improved also in connection to the introduction of anti-dumping customs duty on the import of pipes from the stainless steel from China to the EU in the second half of the year. The production of metallurgy and foundry industry increased year-on-year in Q4 (by 3.2% in the CR, by 0.9% in the EU).

¹⁴ Industrial orders are monitored only in the selected CZ-NACE sections (13, 14, 17, 20 till 21, 24 till 30), which produce mostly to order, with a longer production cycle and larger stocks of orders.

¹⁵ All data relating to the construction production are adjusted for calendar effects.



subsidies was already partially felt) last year (the decline in civil engineering construction amounted to 1.6%).

Year-on-year fall of the value of new construction orders (lasting five quarters in a row) halted at the end of the year (+10%) exclusively thanks to the building construction, ...

...total stock of orders however stayed the second lowest after the year 2001 at the end of the year.

Balance of entrepreneur confidence in construction fell to a two-year minimum in September 2016 and it still perseveres in the markedly negative range.

Revival of commenced residential construction was only mild in 2016.

Number of completed flats was by more than one third lower compared to the record year 2007.

Sales in services slowed down its growth to 1.2% year-on-year (from 3% in the year before last), ...

...the deeper fall in professional, scientific and technical activities (bound partially to the development in construction –i.e. architectural and engineering activities) and also the mild drop in land and pipe transport stood in the background.

The last year sales in services lagged by nearly 9% behind the level achieved in the peak year 2008 mainly due to the effect of the downturn in professional, scientific and

The differing development of both main fields of construction was apparent to a great extent in new orders last year¹⁶. While those in building construction enlarged by more than one fifth year-on-year (to 86 CZK bn, the highest volume after 2008), they were decreasing for the civil engineering construction for the whole year. Decline of the whole branch was connected to the absence of larger number of more significant structures. The average size of the newly closed domestic order oscillated around 3 mil crowns during the year and it was thus the lowest since Q1 2013. The drop of the total stock of orders (in the form of all so far not realised construction orders) halted after six preceding quarters at the very end of the last year (due to the lower comparative basis, since the completion of public orders was culminating during Q4 2015). Despite this development, the last year's volume of orders was the second lowest since 2001. Another flash indicator – approximate value of granted building permits – gives more favourable impression for construction. It increased by 11.5% compared to the year 2015, in large part due to the swift growth of non-residential buildings (by 39%). On the contrary, the negative balance of confidence indicator in construction kept further deepening especially in the first half of the year and even its end did not bring a turn. The development of confidence was however more favourable in the vast majority of states, which are significant receivers of support from the EU funds in the last year. One third of businesses in the CR (one quarter a year ago) expected a decreasing of construction activity in the next three months in January 2017, one quarter anticipated a decreasing of the employee levels (resp. 18%) and only 3.5% of them expected rise. Slightly above half majority of businesses considered, similarly like a year ago, the inadequate demand to present a barrier of growth (only 11% of businesses stated the lack of employees).

The residential construction did not contribute much to revival of construction despite frequent assumptions of the opposite (growing household incomes, low interest rates) either. Even though the number of commenced flats rose for the third year in a row, it exceeded the long-term minimum from the year 2013 (22.1 thousand) not even by one quarter last year. Especially the frequency of multi-dwelling buildings (5.9 thousand, due to the slump of construction in Prague) and the construction of flats in community care homes was low. The low volume of new construction accompanied by strengthening purchasing power of households was reflected in the accelerated growth of both supply and realised prices of residential real estate not only in Prague.

The sales increased by 1.2% in real terms in the selected services¹⁷ (by 3.0% in 2015). Vast majority of partial branches shared in this growth apart from the professional, scientific and technical activities (-2.3%), whose 3% growth in 2015 was one-off in the long period since the end of the strong boom in the preceding decade. It was partially also associated to the development of the project activities linked to the completion of drawing on the EU funds – mostly the sales in architectural and engineering activities (in 2015: +2.8%, last year -7.3%). On the contrary, the legal and accounting activities or advertising and market research continued in the mild growth. The weight-significant branches of transportation and storage profited from the robustly growing industry as well as the foreign trade only to a limited extent, since its sales enlarged by 1.1% (by 0.4% in 2015). Moderate decrease in land and pipe transport (-0.3%) and postal and courier services (-1.0%) was offset by the more favourable development in warehousing (+3.7%) and also other types of transport. Food service activities and restaurants fared well, with the high increase in the year 2015 (+5.0%) grew even faster to 5.7% in the following year (the fastest pace after the year 2001). Continuing growth of the number of overnight stays of both foreign (+3.8%) and domestic (+7.0%) guests also supported the sales in accommodation (+4.4%). Sales in administrative and support activities were also strengthening by a similar pace,

¹⁶ Statistical surveys cover only orders of construction businesses with 50 and more employees.

¹⁷ Data are not adjusted and do not include trade, financial and insurance activities, scientific research and development and also the public services.

technical activities.

pushed by fast developing job agencies, whose sales more than doubled against the year 2010. Vast majority of other activities within this branch however also thrived. Travel agencies and offices (incl. reservation activities) represented an exception, the reduction of sales continued already for the fourth year in a row in these activities¹⁸.

Favourable conditions prevailed for swift growth of retail sales, sales were driven mostly by the sale of non-food goods.

Increasing disposable income of households, fed by the growth of volume of paid out salaries and wages in the whole economy (+5.5% in 2016, +4.4% the year ago), combined with a very optimistic sentiment of consumers throughout the whole last year led into a swift hike of the retail (+5.1% year-on-year)¹⁹. While the sales growth oscillated around 5.5% in the first three quarters, the pace moderated to 4.2% at the end of the year – primarily as a result of development of sales for food. These grew by 5% in Q1 2016, however already only stagnated towards the end of the year. This development concerned in the first place the non-specialised (mostly large) shops²⁰. Sales for food in specialised shops grew by 2.9% in Q4, by 3.1% for the whole year – i.e. a higher rate of growth compared to the non-specialised sellers of food, which occurred last in the year 2005. Weight-dominant retail segment – sale of non-food goods – grew without any large fluctuations (by 6.3% for the whole year). It was driven especially by the internet sales and further by the sale of goods for culture as well as recreation and goods predominantly for households. The growth of the economy as well as the favourable prices of automotive fuels were reflected in the strong increase of sales at petrol stations, which lasted already eight quarters in a row (by 6.8% for the whole year). Pro-cycle developing sales in trade (inc. repairs and maintenance) of motor vehicles strengthened by 7.6% for the whole year, nevertheless the growth weakened in H2 and it was the weakest since the end of the last recession in Q4 2016 (+4.2%).

Year-on-year growth of food sellers' sales weakened during the year, it diminished completely in Q4 (-0.2%).

Retail sales growth in the CR was the seventh highest among the EU countries last year, it grew faster only in Poland within the neighbouring countries.

Chart 5 Production in industry and selected manufacturing branches
(real, y/y, adjusted for calendar effects, in %)

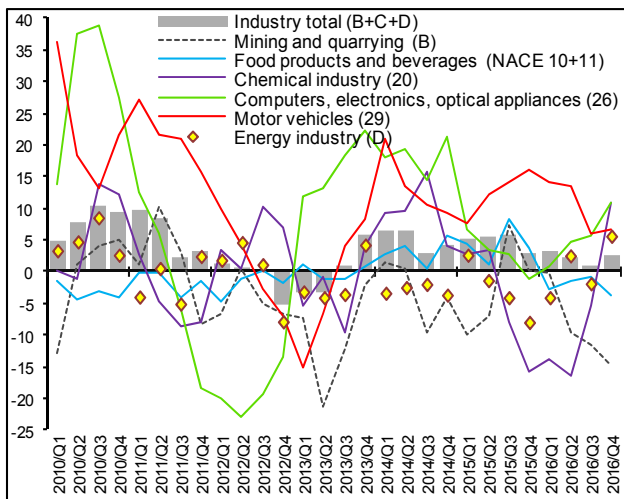


Chart 6 New orders in manufacture of motor vehicles, industry in total (cur.p, y/y in %) and balance of confidence indicator in industry (right axis)

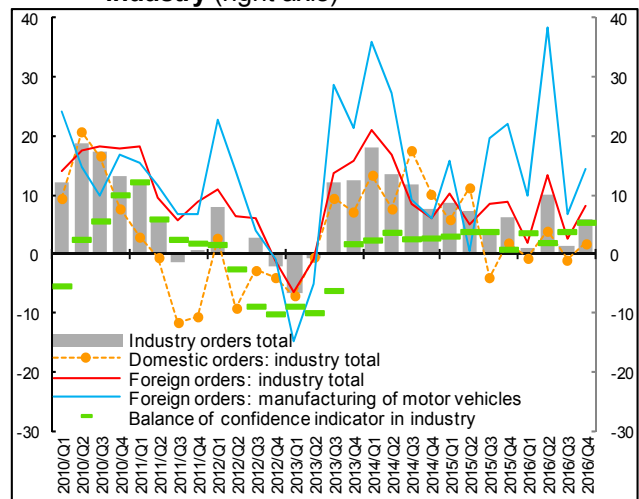


Chart 7 Construction production*, value of new orders (y/y in %) and balance of confidence indicator in construction (right axis)

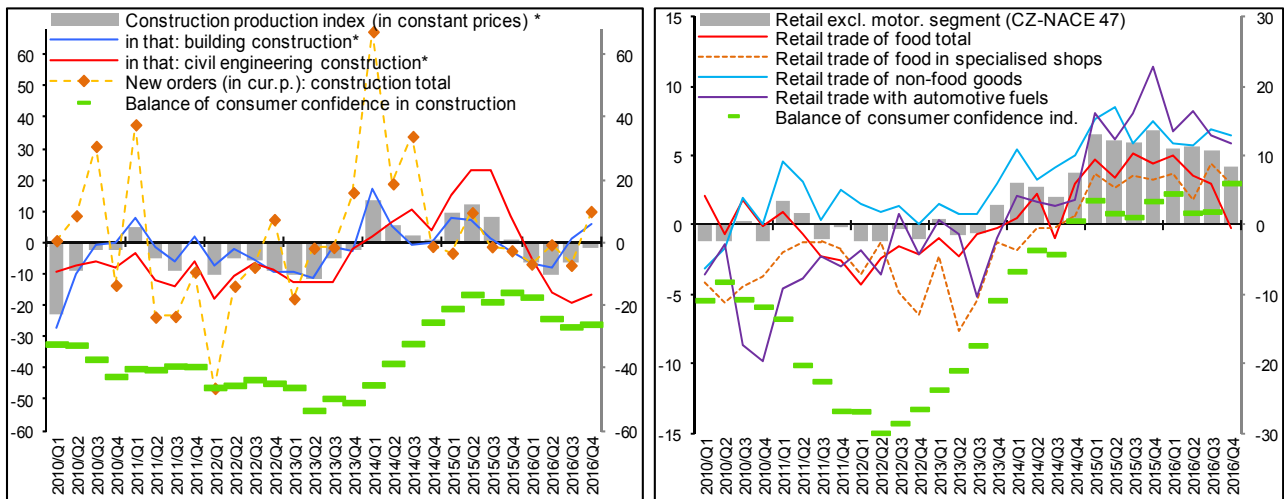
Chart 8 Retail sales* (in real terms, y/y in %), balance of consumer confidence indicator (right axis)

¹⁸ Sales however increased by 4.7% year-on-year in the Q4 2016 itself. It occurred for the first time after sixteen quarters of adverse development. Halting of decline of arrivals of Russian tourists into the Czech Republic in part contributed to this turn. Their numbers fell by 15% year-on-year in the period from Q1 to Q3 2016, however they already rose by 23% in the remaining part of the year.

¹⁹ All data related to retail sales are adjusted for calendar effects in constant prices.

²⁰ A considerable slump of sales for services occurred in these in H2 2016 (comprising however only a marginal share of all sales of sellers of food).





*adjusted for calendar effects

Source: CZSO

4. External Economic Relations

Surplus of the goods and services balance led to the record positive balance on the current account of balance of payments.

The surplus on the current account of balance of payments attained according to the CNB data 52.6 CZK bn in 2016 and exceeded the surplus from the preceding year by 41.4 CZK bn. Extraordinarily high positive balance of goods and services, which was by 85.6 bn higher than in the year 2015 is behind this result. Especially the deficit of secondary incomes worked in the opposite direction, deepening by 27.3 CZK bn compared to the year 2015. Primary income deficit reached 271.8 CZK bn, which is by 16.9 bn more than in 2015. Monetary transfers of funds from the EU and especially their marked decline between the years 2016 and 2015 were reflected in the capital account. Surplus of the capital account reached 53.5 CZK bn for the year 2016 and it lowered by 48.4 bn against the year 2015. For the comparison purposes, the positive balance of the capital account was 32.3 CZK bn in 2014.

Increase of the volume of reserve assets overtook other factors and the financial account ended in surplus despite a marked inflow of foreign investment.

Financial account finished in surplus of 117.7 CZK bn, which is by 58.1 CZK bn less than in 2015. The reserve assets significantly heightened the positive balance, with their volume steadily growing during the year and in total enlarged by 563.5 CZK bn, which is by 212.2 CZK bn more than in the preceding year. The enlargement of foreign exchange reserves markedly influenced the final state of the financial account, because the inflow of direct investment from abroad pushed strongly against the positive balance. A notable outflow of domestic investment abroad manifested during Q2 and Q3 2016, which was concentrated especially into the debt instruments. By contrast, foreign direct investment in the size of 158.8 CZK bn (by 117,3 CZK bn more than in the year 2015) flew into the Czech Republic in the year 2016.

Flow of Czech portfolio investment abroad weakened in 2016. Interest in Czech debt securities on the part of foreign investors continued.

The net inflow of portfolio investment into the CR amounted to 169.5 CZK bn in the year 2016, which is by 5.4 CZK bn more than in the preceding year. The flow of funds shrank on the receivables side (inflow in the size of 191.5 CZK bn, i.e. by 44.9 bn less than in the year 2015). The increase of net portfolio investment is thus the result of a weak flow of the domestic investment abroad. The asset side of the portfolio investment attained the result of 21.9 CZK bn, which is by 50.3 bn less than in the year 2015. Majority of this difference comprises the lowering of shares in the collective investment funds by 31.5 CZK bn. Interest in Czech debt securities persisted. Foreign investors bought in total these instruments in the amount of 181.7 CZK bn (in that bonds of the government institutions formed 121.7 CZK bn).

The value of exports reached record levels in 2016. Still, the export performance lagged behind the year 2015 in the second half of the year.

From the view of the value of exports, the year 2016 was record breaking. Goods in the value of 3 312 CZK bn²¹ were exported from the Czech Republic, which is an increase of 1.5% against the year 2015. The year-on-year rate of growth of exports lowered compared to the preceding two years. The exports increased by 1.8% in the first quarter. The second quarter became the most successful quarter for exporters in the whole year, when the exports grew by 4.2%. However, the high comparative basis of the year 2015 in combination with a temporary limitation of the production capacities of some important exporters played a role in the second half of the year. The exports fell by 0.9% year-on-year in Q3 and its addition arrived only at 0.7% at the end of the year.

The exports to the EU decreased pace in the second half of the year. The exports into the rest of the world on the contrary grew.

Exports into the European Union countries, which comprised 84.0% of the total value of Czech exports, increased by 2.7% year-on-year and by 5.4% in Q1 and Q2. The second half of the year 2016 was not so successful, when the exports into the EU decreased by 1.1% in Q3 and subsequently reached the value of Q4 of the previous year. The year-on-year drop of exports occurred for the first time since Q1 2013 and the marked fall of exports to Slovakia and Great Britain played a major role. Exports to Germany, which formed nearly one third of total exports grew by 0.6% and 4.4% in Q1 and Q2 and it subsequently fell by 0.6% in Q3. At the end of the year, it again rose (+2.2%). On the contrary, exports into the countries outside the EU decreased in the first two quarters and again gained pace in the second half of the year, when they grew by 0.5% and 4.5%.

Motor vehicles remained the most successful and the most significant article of the Czech export throughout the whole year, even though its performance markedly slowed down in the second half of the year. Exports of chemical products managed to revive at the end of the year.

Among the most important goods divisions (based on CZ-CPA classification), the exports of motor vehicles, machinery and equipment fared the best. Exports of motor vehicles increased at first by 10.8% and subsequently by 16.7% in the first two quarters. The high comparative basis of the preceding year left its mark on the slowdown in the second half of the year (+3.0% and +3.8%). Growth of exports of chemical substances and products renewed after seven quarters of year-on-year fall, when the exports grew by 9.2% in Q4. The stagnation persisted in the division computers, electronic and optical appliances and equipment, lasting since Q2 2015. Export of food products dropped by -1.5% and -10.1% year-on-year in Q3 and Q4, it however represents a result of comparison with an above average successful second half of the year 2015. The end of the year 2016 was not very successful for exporters of metalworking products, who did not manage to sustain growth lasting more than three years. Exports fell by 11.4% in this division in Q4 year-on-year.

Imports stagnated. Renewal of the chemical production in the Czech Republic led to higher imports of oil as well as lowering of dependence on imports of foreign chemical products in Q4.

Total imports into the Czech Republic attained the value of 3 145 CZK bn. Imports from the EU grew similarly by 2.7% year-on-year in the first two quarters and they subsequently slowed down and increased only by 0.2% and 0.6% in Q3 and Q4. Imports from Poland had a noticeable share on the growth, increasing by 13.6% and 5.9% year-on-year in the first half of the year. Imports from the Great Britain rose by 11.4% in 2016. Imports from Germany stagnated and grew only by 0.4%. Imports from Slovakia fell by 1.1% in total for the whole year and to Austria by -3.4%. The more than two years lasting slump of the value of imports of oil and natural gas halted with respect to the growing oil prices as well as the renewed production capacities in the chemical industry and associated revival in this branch in Q4 2016 and simultaneously, the imports of chemical substances and products lowered. The value of imports of motor vehicles rose by 12.4% and electrical appliances by 5.6% in 2016. Import of computers and electronic appliances decreased by 5.6% and machinery and equipment by 3.6%.

Foreign trade surplus reached record values, despite mild weakening of the export performances by the end of the year.

Surplus of the foreign trade arrived at 167.0 CZK bn in 2016 and overtook the surplus from the year 2015 by 36.1 bn²². This difference was attained exclusively in the first three quarters. The balance surplus was lower compared to Q4 2015 at the end of the year. The Czech Republic has traditionally a positive surplus of

²¹ Data in the national conception in nominal expression include only trade with goods. The value of exports is captured in FOB prices, i.e. including the costs connected with the transport to the CR boundaries. Import is in CIF prices, i.e. including costs associated with the transposition abroad, up all the way to the CR boundaries. Data are valid as of 9th March 2016.

²² If we included the amount of 16.2 CZK bn following the review of the methodology of capturing the trade with the natural gas, the difference in the balance of years 2015 and 2016 would deepen to 52.3 CZK bn.



the foreign trade with the EU. Surplus of trade with Germany reached 208.4 CZK bn for the whole year and it increased by 14.0 bn year-on-year. The positive balance with France increased (+3.4 CZK bn) and Austria (+6.0 bn). The Czech Republic attained surplus of trade with Slovakia in the amount of 147.8 CZK bn and 95.0 CZK bn with Great Britain, but these two surpluses shrank compared to the year 2015. Deficit of the trade with Poland deepened by 8.9 CZK bn and reached 73.0 bn. The negative balance of trade with the countries outside the EU prevails.

Chart 9 **Current account of Balance of Payments** (cumulation for the year 2016 in CZK bn, FOB/FOB)

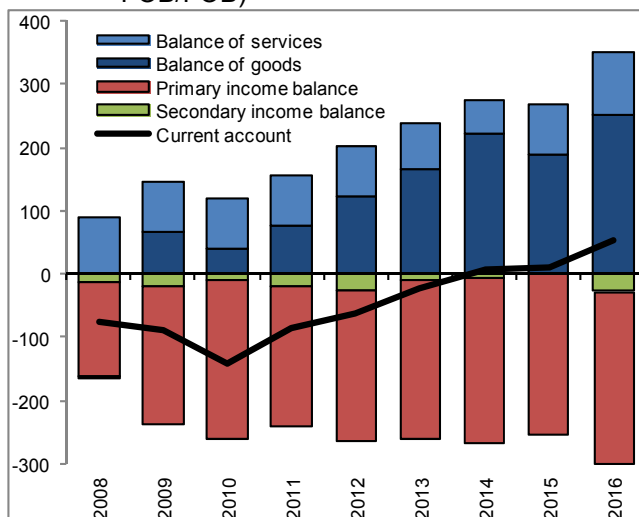
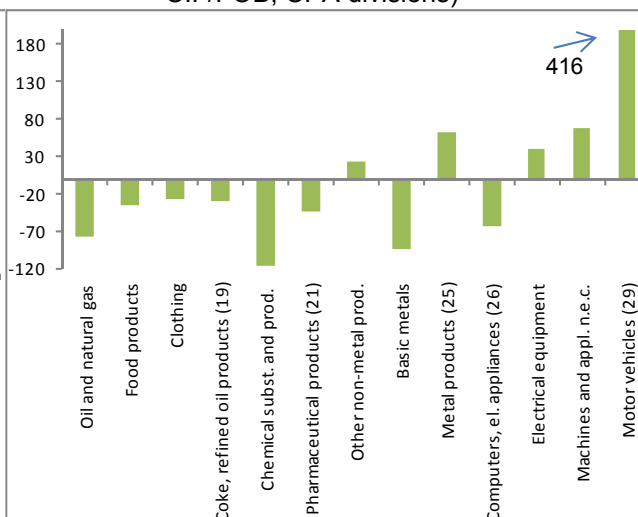


Chart 10 **Balance of foreign trade with goods in national concept in 2016** (in CZK bn, CIF/FOB, CPA divisions)



Source: CZSO, CNB

5. Prices

Total price level increased by 1.1%.

Total price level gauged by the implicit GDP deflator increased by 1.1% in 2016. The impact of final consumption expenditure was growing during the year. The prices of goods and services consumed by households started to rise especially in the second half of the year (0.9% in Q3, 1.4% in Q4).

Development of consumer prices in Q1 to Q3 2016 did not differ from the previous two years. Break occurred in November, when the consumer prices approached the inflation target after nearly three years.

The first three quarters of the year 2016 did not differ much with respect to the consumer price development from the previous two years. The year-on-year growth of prices did not cross 0.5% and remained below the target band of the CNB. A break occurred in November, when the year-on-year price increase crossed the 1% boundary for the first time since December 2013 and hiked up to 1.5%. The growth of consumer prices touched 2% in December and the average price growth thus came to 1.4% in Q4. The inflation rate²³ equalled 0.4% from January to May, it lowered to 0.3% from June to September and it reached 0.4%, 0.5% and 0.7% during October to December.

Negative effect of the oil prices on the consumer prices, apparent especially in the first half of the year, ceased at the end of the year.

The growth of the consumer price index was considerably slowed down by the development of prices of automotive fuels in combination with the drop of the food prices at the beginning of the year. The oil prices started to rise slightly after the deep slump at the turn of the years 2015 and 2016 and their effect on the price level decline weakened during the year. The year-on-year growth of the price index excluding fuel oils and automotive fuels thus exceeded the total price level growth by several tenths of percentage points during the first three quarters of the year. Both indices evened out only in the last quarter and the prices of automotive fuels even mildly contributed to the growth of the total price level in December.

²³ Expressed by the addition to the average consumer price index for the last twelve months against the average of the preceding 12 months.

The fall of prices of food halted after nearly two years, which had a notable effect on the total price level.

Prices of food and non-alcoholic beverages were falling year-on-year since December 2014 (with the exceptions of June 2015). They hold the second highest weight in the consumer price index, it is thus not surprising, that their November and December growth (1.6% and 3.3%) significantly influenced the total price level. Until then, they were reduced by an average year-on-year rate of growth of 1.6%. While the prices of food thus on average reduced the total growth of prices by more than 0.2 p.p. in January till October, they added 0.3 p.p. to the growth in November and even 0.6 p.p. in December. The autumn increase of prices caused especially the raised prices of vegetables and dairy products year-on-year.

Increase of the prices of rent and imputed rent did not show much in the cost of housing and energies thanks to the fall of prices of energies.

Prices of housing, water, energies and heating fuels, which present the most significant items in the consumer basket for the Czech consumers, grew by average year-on-year pace of 0.6% and average month-on-month pace of 0.1% in 2016. It is not surprising with respect to the fast-growing prices of real estate in 2016, that the growth of the imputed rent fastened its pace from the year-on-year increase of 1% in Q1 and Q2 to 2.6% in Q4. Prices of rent accelerated its growth even one quarter sooner. Total growth of prices of housing and energies dampened only the notably falling prices of gas, which exceeded even the mild growth of prices of electricity and heat. Development of costs of transport was in fact identical to the prices of food. Prices of transport were falling by an average year-on-year rate of -2.4% until October and they increased by 1% and 2.5% in November and December.

Rise of realised prices of older dwellings gained pace during the year and reflected thus the excess demand on the market.

Development on the real estate market mirrored the good shape of the economy in 2016 and the positive outlooks of consumers. Increase of real income, low unemployment and positive expectations heightened the demand for real estate. The supply side of the market however did not manage to react in the needed time and the stock of flats shrank very soon. The year-on-year growth of realised prices of older flats reflected this fact, accelerating during the year 2016 and reaching 14.5% in Q4. Realised prices of new flats²⁴ grew by 5.5% quarter-on-quarter at the end of the year and by 9.3% year-on-year (year-on-year growth arrived at 3.8% in Q3). The year-on-year growth of prices of offered flats attained 9.6% already in the last quarter of the year 2015 and it mildly crossed the 10% in the first two quarters of 2016. The growth of supply prices then hovered closely below the 10% level in Q3 and Q4 of the year.

Similarly to the Czech Republic, the EU also experienced a more pronounced change in the price development in the last quarter of the year.

Price development in the Czech Republic fits into the European context. Year-on-year growth of the price level in the European twenty-eight did not digress much from zero during the first two quarters (+0.1% and -0.1%). It reached 0.3% in the third quarter and it definitely moved away from zero in the last quarter of the year, when the prices increased by 0.8% year-on-year. The December inflation even crossed 1% for the first time since September 2013 (it was 1.2%). The prices rose by 0.2% in Slovakia year-on-year in December, which ended the more than two years' period of deflation. A similar turn occurred in Cyprus, despite the deflation reaching two percent in Q2 2016 there. The rate of growth of prices in Germany grew quite steadily, when the price level stagnated in the first half of the year, but it reached 1% growth in the final quarter.

Long term reduction of prices of industrial producers moderated in the second half of the year 2016.

Industrial producer prices were falling year-on-year already since January 2014 and they were falling also during the year 2016. The situation on the world markets with oil as well as the falling prices of raw materials were closely reflected in the development of the index. Combination with the fall of food prices led to a relatively atypical situation, when the growing demand was not followed the increase of prices. However, the pressure, which was put by the oil prices on the industrial producer price index loosened in 2016, and the index started to slightly grow at least in the month-on-month expression. Year-on-year fall shrank in the second half of the year (from 4% and 4.6% in the first two quarters to 3.2% in the third and 1.1% in the final quarter). Raised prices in the division of coke and refined oil products as well as the moderation of the fall of prices of food products assisted this development. Marked drop of the prices in the category of mining and

²⁴ Data surveyed only for Prague.



quarrying prevailed, reflecting a higher supply of materials from China as well as the deflection of developed countries from using solid fossil fuels. Prices of construction works grew by an average year pace of 1.1%. Prices of buildings and engineering structures recorded the same growth.

Industrial producer prices were falling in the EU year-on-year in the first three quarters, but the increase of oil prices manifested towards the end of the year and the development at least partially turned to growth.

EU industrial producer prices featured similar dynamics as in the Czech Republic during the year 2016. Year-on-year changes of prices were negative in the EU-28 in Q1 to Q3 (-3.7%, -3.6% and -1.6%) and they rose by 1.1% in the final quarter. The group of countries where the industrial producer prices again grow year-on-year thus significantly enlarged in Q4. Prices were notably raised in Great Britain (+5.6%), in Belgium (+4.8%) or in Sweden (+3.2%). The Czech Republic still remains among countries, where the industrial producers experience deflation. Only Luxembourg (-6.7%), Slovakia (-2.4%), Latvia (-2.2%) and Croatia (-1.5%) overtook it in the fall.

Agricultural producer prices were falling. The fall of the prices of animal production slowed down during the year.

Prices of agricultural production were falling year-on-year for the whole year. They thus continued in the trend from the previous two years (with the short exception of autumn 2015). In contrast to other monitored price indices, their development did not signal much the change of this trend during the year. Year-on-year declines reached 2.9%, 6.9%, 5.7% and 4% during Q1 till Q4 2016. In total the prices of both plant and animal production were also falling. The prices of plant production increased by 3.9% in Q1 of the year, but they fell by 3.2%, 5.3% and 5.7% in the following quarters of the year. The slump of prices of plant production excluding fruits and vegetables was even higher. On the contrary, the year-on-year fall of the prices of animal production was slowing down during the year. The year-on-year increase of prices of farm animals by 2% and 3.5% in the second half of the year had an effect here. The slowdown of the fall of the prices of milk from 15.9% in Q1 to 6.5% in the last quarter of 2016 as well.

Prices of market services remained at nearly constant level during 2016.

Prices of market services stagnated in 2016 and continued thus in the trend from the previous year. They increased by an average year-on-year rate of growth of 0.1% since the beginning of the year. Prices remained at a constant level in majority of divisions of the classification of market services, still some exceptions occurred. Costs for services in the area of land and pipe transportation were lowering year-on-year during the whole year. Even though their fall reduced from 1.3% in Q1 to 0.5% in Q4 during the year. Prices of advertising services and the market survey recorded already traditional growth (0.2%, 2%, 2.8% and 1% in individual quarters of the year). Prices of postal and courier services, whose growth was strengthening during the year, can also be mentioned (from 2.2% in Q1 to 5.6% similarly in Q3 and Q4 2016).

Prices of exports were falling, but the pace was slowing down.

The prices of exports were falling during the year, but the pace of the year-on-year decrease was slowing down (-4.2%, -4.3%, -2.7% and -1.3% in individual quarters). It was assisted by the development of prices of inedible materials (-13.4%, -12.2%, -7.1% and +1.1%) and mineral fuels (-19.0%, -17.3%, -13.6% and -1.3%). On the contrary, the prices of beverages and tobacco, which grew by a relatively stable pace during the year (1.5%, 2.4%, 2.6%), fell year-on-year in the last quarter (-2.4%).

Import prices, which created the deflation pressures in the Czech economy in Q1 and Q2, ceased their descend.

Prices of imports were falling in all four quarters of 2016 (-5.6%, -6.3%, -3.7% and -0.4%), and they presented a significant source of deflationary pressures in the Czech economy mostly in Q1 and Q2. The decline of prices considerably weakened in the second half of the year and the prices of imports increased for the first time after 18 months year-on-year in December. Prices of beverages and tobacco (+3.3%), food and live animals (+2.8%) and inedible materials (+3.2%) rose more notably in Q4. Prices of imports of mineral fuels and oils considerably fell in first three quarters of the year 2016 (-32.6%, -31.7% and -20.8%), and significantly thus affected the total price level. Their price movement moderated to 1.5% decrease in the last quarter, mainly thanks to the December year-on-year increase of 12.3%.

Terms of trade, which were positive in Q1 to Q3 fell below zero

Terms of trade were positive in the first three quarters of the year (101.5, 102.1 and 101.0), they were affected the most by the positive terms of trade of the mineral

towards the year.

fuels. However, the situation turned in Q4 and the terms of trade arrived at 99.1. Terms of trade of beverages and tobacco (94.3) or food (96.4) worked in the negative direction. The exchange rate of euro was hitting the 27 crown boundary already since the half of the year 2015 and remained the same. The crown still appreciated against euro by 2.2% and 1.3% in Q1 and Q2 2016 year-on-year, but the exchange rate practically did not change towards the previous year in the second half of the year. Exchange rate of crown fluctuated during the year, more significant movement occurred in Q2, when the crown appreciated against this currency by 3.5% and depreciated by 1.4% in Q4. Marked appreciation of crown towards the British pound was reflected unusually strongly in the deflationary pressures.

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

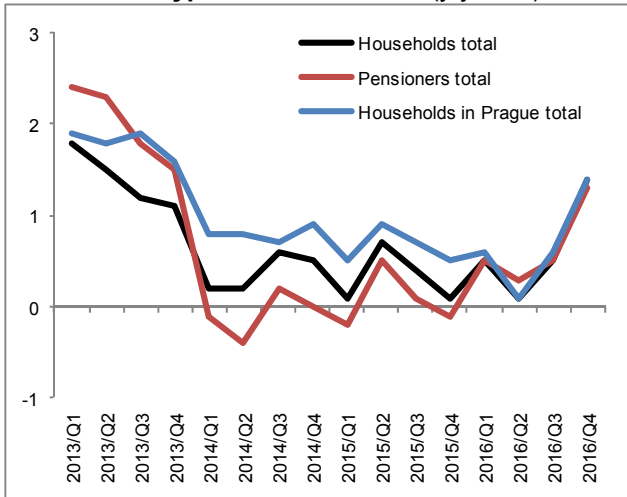


Chart 12 **Prices in selected CPI divisions (y/y in %)**

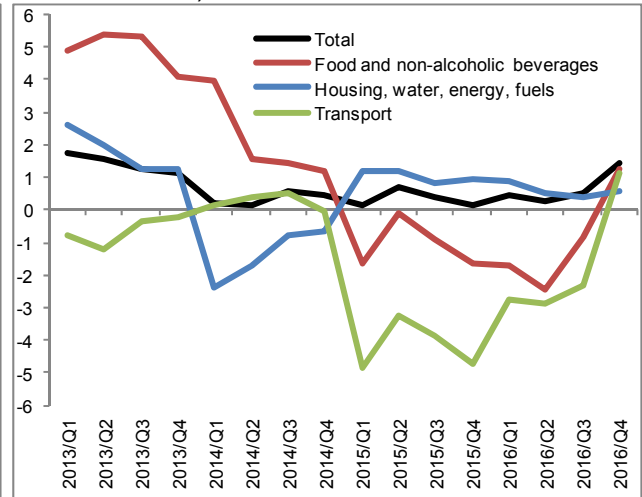


Chart 13 **Deflators (adjusted for seasonal and calendar effects, y/y in %)**

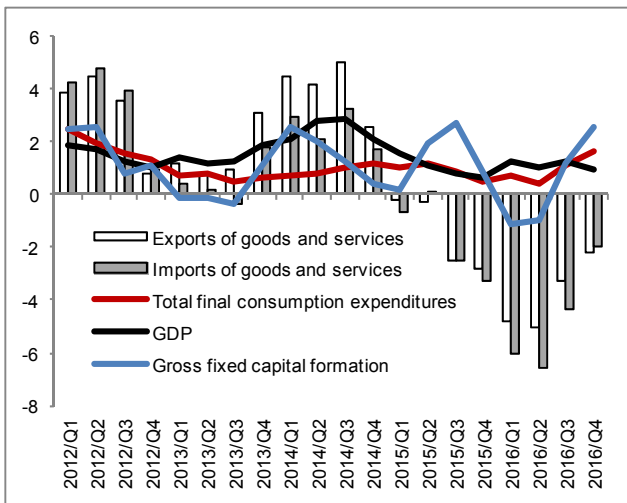
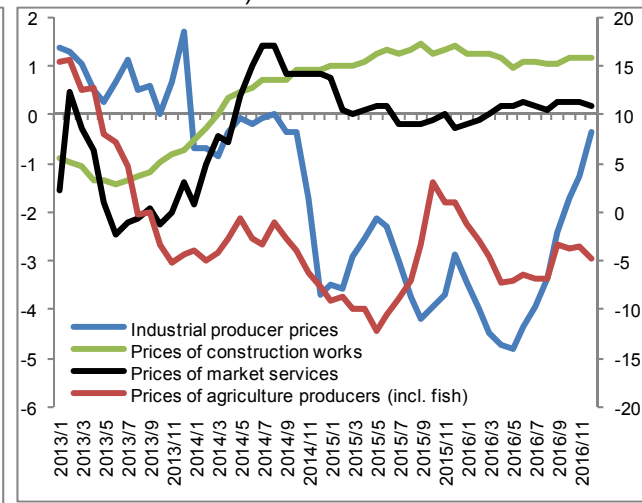


Chart 14 **Producer prices (y/y in %, agricultural producer prices on the right axis, other on left axis)**



Source: CZSO



6. Labour Market

Properly anchored economic growth further improved the situation on the labour market, the year-on-year growth of employment was highest since the year 2008 last year.

Situation on the labour market was further improving in 2016 and it had in many respects similar features to the peak period of the past decade. Continuing economic growth generated new job positions. Total employment²⁵ was further strengthening in the quarter-on-quarter expression during the year (apart from temporary stagnation in Q3). More persons by 1.8% worked last year compared to the year 2015 (pace of the year-on-year growth increased for already third year in a row and was the highest since 2008). Even though the number of workers crossed the boundary of 5.3 mil for the first time in the history of the Czech Republic towards the end of the last year, the share of businesses, that considered the lack of labour force as an important barrier to their growth, also markedly rose at the same time. The businesses tried to cover the needed labour force by hiring foreign workers (mainly from the economically less developed EU countries), engaging growing number of prisoners or groups of economically inactive persons capable of work.

Employment rate (77.0%), but also its differences between males and females in the CR (16.3 p.p.) belonged to the highest among the Union countries.

Employment rate (persons aged 20–64) was according to the LFSS 77.0% in the CR in Q3 2016 (it increased by 1.9 p.p. year-on-year, by nearly double pace compared to the EU). While the employment rate of males came to 85.0% (and was the highest among the Union states already eighth quarter in a row), for females it was “only” 68.7% (the Czech Republic was “pushed” out of the first ten of Union countries not only by the Nordic states, Germany, Austria, but also by the Baltic states).

Manufacturing contributed the most to the year-on-year growth of the total employment already third year in a row, services however also helped noticeably in the last year.

Both employees (with the growth of 1.9%) and self-employed (whose levels expanded by 1% year-on-year, mainly due to the more favourable development in H2)²⁶ participated on the last year’s increase of number of workers in the economy for the first time since 2007 last year. From the view of branches, manufacturing added the most to the growth of total employment already third year in a row absorbed by 40 thousand workers more compared to the year 2015 (similarly to the preceding year). Among services, especially the professional, scientific, technical and administrative activities contributed (+19 thousand persons). Rate of growth of employment increased also in (the group dominant by weight) trade, transportation, accommodation and restaurants, as well as in information and communication (where the levels of workers expanded already a fifth year in a row – by 15% in total). Last year’s 0.7% growth was on the contrary the lowest after the year 2012 in branches with the state dominance – public administration, defence, education, health and social work. Adverse situation continued in construction, which lost nearly 65 thousand positions since the year 2010. The number of employees as well as the self-employed was decreasing in this branch in 2016. Employment dropped in total by more than 8 thousand persons in mining and energetics compared to the year 2008.

Long term adverse development of employment persisted in construction and non-manufacturing industrial activities.

Only branches with higher value added did not create new job positions in 2016. It is thus not particularly surprising, that the more significant labour productivity growth from the years 2014 and 2015 was not repeated last year (GVA related to the hour worked lowered by 0.4% for the whole year). Both lower productivity in construction (by 4.7%) and e.g. also in branch trade, transportation, accommodation and restaurants played a role. Development was on the contrary more favourable in manufacturing (+1.6%), the productivity however grew the most in branch agriculture, forestry and fishing (+6.1%) last year (similarly to the years 2014 and 2015).

Growth of the hourly labour productivity from the years 2014 and 2015 was not repeated any more mainly due to the unfavourable development in construction but also some services last year.

Pace of decrease of the unemployment rate of males slowed down last year, for females it was comparable to the years 2014 and 2015.

General unemployment rate (persons aged 15–64) kept further falling throughout the whole year and it arrived at 3.6²⁷ in December 2016 (4.5% a year ago). While for males it hit its limits given by the structural influences (decreased “only” by 0.6 p.p. year-on-year to 3.1%), for females the reduction was more significant (by 1.3 p.p. similarly to the years 2014 and 2015). Persons that were without a job for more than one year majorly participated on the decrease of unemployment. The number of these persons fell by 35% year-on-year in Q4 and they formed 39% from the total number of

Job applicants being without job for more than one year

²⁵ Unless stated otherwise, all employment data are in the national accounts conception and seasonally adjusted in this chapter.

²⁶ Additional more detailed data of the Labour force sample survey suggest, that the numbers of entrepreneurs without employees were increasing (by 46 thousand year-on-year in Q4) in 2016, while the number of entrepreneurs with employees on the contrary shrank (by 10 thousand).

²⁷ After adjustment for seasonal effects.

had a major effect on the unemployment decrease last year.

General unemployment rate fell in 90% of EU countries in 2016. Large differences between states however did not shrink.

Supply of job vacancies kept further expanding, professionals and qualified manual workers were the most in demand.

Good financial situation of businesses as well as the growing obstacles to find new workers pressed on the increase of wages. They rose by 4.2% last year, the most since the year 2008.

Vast majority of branches recorded a more favourable year-on-year rate of growth of the average wages than in 2015, with the exception of mining and quarrying, construction and also the real estate activities.

Wage median grew more dynamically than the average wage already sixth quarter in a row.

unemployed (the lowest share since Q1 2010). Consequently, this was reflected also in the accelerated fall of the unemployment rate of job applicants with primary education (from 22.8% to 18.7%). The Czech Republic maintains the most favourable position with respect to the total unemployment among the EU states (thanks to the very low unemployment of males or persons with the secondary education). General unemployment rate dropped in 90% of the Union states during the year 2016 (the most in Croatia, Spain and Portugal), large regional differences however persisted. High unemployment in some states strongly hit by the recession in the past decade stagnated (Italy, France), it even grew by 1 p.p. in Cyprus and by contrast it even markedly fell further in many countries with low unemployment rate, e.g. in Hungary (to 4.3%), Poland and Romania (to 5.5%).

Opportunities of unemployed to find job on the labour market kept further widening. Supply of job positions increased via the labour offices (LO) by nearly one third year-on-year, there were 132.5 thousand positions available in December 2016. The ratio was 2.9 applicants per one vacancy (the most favourable December relation since the year 2007). This relation improved in all regions during the year 2016, the most visibly in the Ústecký Region (still there was 5.8 job applicants for one vacancy at the end of the year, together with the Moravskoslezský Region the most in the CR). Less than two applicants per vacancy were assigned in Prague, the Plzeňský and the Pardubický Region. The highest demand from the view of the qualification levels was thus for specialists or professionals (1.8), craft and related trades workers (1.7) and plant machine operators, incl. assemblers (1.2%). The situation of assisting and unskilled workers in elementary occupations also improved year-on-year, despite their share on the total job applicants increasing to nearly 30%.

Continuing growth of the economy, lasting positive outlook in key branches, loose budget policy of the state and last but not least, the growing lack of labour (due to the low and still falling unemployment) pushed the growth of the earnings up. The average gross wage (reflecting the length of employee job contracts) increased by 4.2% last year compared to the year 2015 (nominal growth of wage stayed closely below the 3% in the years 2014 and 2015 at the same time). Year-on-year rates of growth of wages however did not signal an upward trend anymore within the last year (the growth arrived at 4.2% in the Q4 itself). High growth of the number of employees (1.8%) prevented the acceleration of the average wages, with a significant part being concentrated into the branches with the below average level of wages (trade, transportation and storage, real estate activities, administrative and support service activities).

Average wage increased in all branches except for the mining and quarrying (-0.5%) last year, where it was in addition accompanied by a considerable reduction of the number of employees (by 6%). The strongest growth of wages occurred in accommodation and food service activities (+7.2%) pulled for the most part by the growth of the minimal wage (by 1100 crowns). In the absolute expression, the wages of employees in information and communication improved the most (by 1687 crowns), the average wage here crossed the 50 thousand boundary similarly to the financial and insurance activities. In the weight significant manufacturing the growth of wages copied (similarly to the year 2015) the rates of growth in the whole economy, this branch however still intensively hired new workers. Average wages in the branches with a dominant share of the state grew swiftly, however they did not create (apart from the health and social care) new job positions to any significant extent. Higher earnings of the members of the armed forces also contributed to the wage growth (+5.6%) in the public administration, defence and social security. Wages in education displayed weaker dynamics throughout the whole year (+4.1%), the growth however accelerated due to the increase of the wage tariffs to 7.4% in the Q4 itself. More favourable development of the average earnings in the branches with the dominant share of state was reflected in the high growth of the wage median (by 6.0% in Q4, by 6.7% for females). It exceeded the dynamics of the average wages already six quarters in a row, both direct and indirect impacts of the repeated increases of the minimal wages had an effect here. Average real wage grew by 3.5% last year (the most since 2007), it slowed down to 2.8% due to a growing inflation in Q4.



Chart 15 Total number of employed persons and employees (national accounts data, seasonally adj., y/y in %)

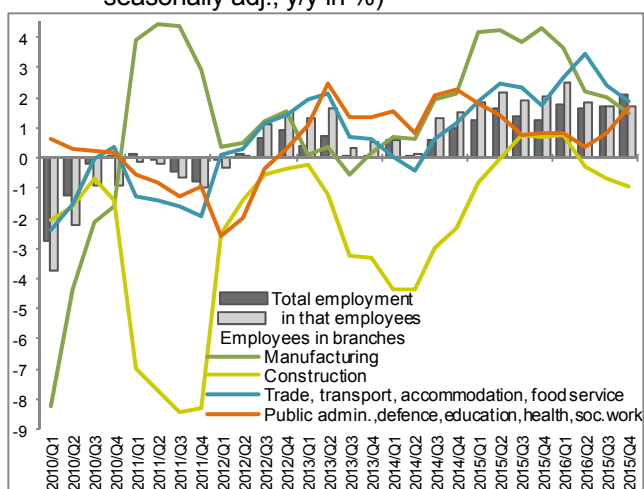
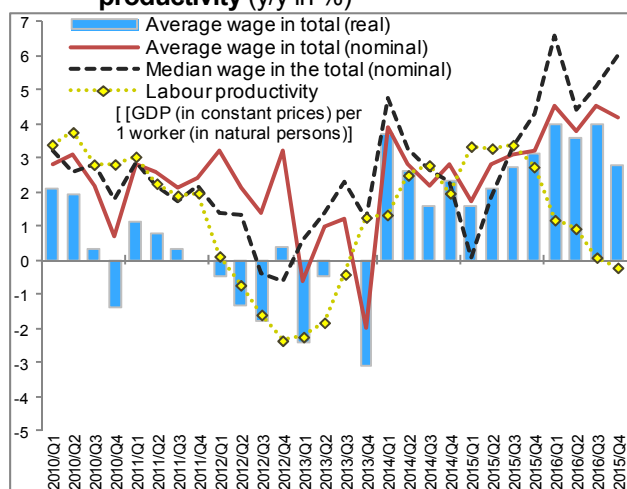


Chart 16 Gross monthly wage of employees (in full-time equivalent, y/y in %) and labour productivity (y/y in %)



Source: CZSO

7. Monetary Conditions

The Czech National Bank continued in loose monetary policy. Sustaining of the exchange rate commitment required active CNB forex interventions on the foreign exchange market. The pressure on the crown appreciation grew by the end of the year.

Growth of the monetary aggregate M3 was relatively high in the first half of the year, nevertheless slowed down at the end of the year.

Interbank interest rates stayed the same during the year. Yields from short-term state bonds fell to record minimums.

The overall setting of the monetary policy did not change during the year 2016. Monetary-policy interest rates remained at a constant level since December 2012. Sustaining of the exchange rate commitment, which the Czech National Bank (CNB) uses as a further instrument of easing the monetary conditions, required a series of transactions on the foreign exchange market. The exchange rate of crown against euro thus held just above the level of 27 crowns for the whole year. The exchange rate of crown against dollar mildly fluctuated during the year. The national currency strengthened from the January average of 24.89 crowns per dollar below the 24 crowns boundary during the first half of the year²⁸. The exchange rate oscillated in the relatively narrow range around the 24.30 crowns per dollar in Q3. The crown depreciated more noticeably only at the end of the year and it reached an average exchange rate of 25.64 crowns per dollar in December.

Growth of the volume of money in the economy²⁹ accelerated during the years 2014 and 2015 and the year-on-year addition remained above 9% in the first half of 2016. This rate of growth dropped to the 8% boundary in the second half of the year and it arrived at 6.5% in December, which returned it to the values of the first half of 2015. The volume of deposits with agreed maturity was decreasing throughout the whole year. Growth of the money stock was thus concentrated into the increase of amount of currency and deposits on current accounts. Monetary aggregate M1, which includes just these two items, comprises 89.4% of the total volume of money in the economy.

Market interest rates remained the same during the year. Three-month interbank rate PRIBOR kept at 0.29% and the one-year PRIBOR was at the level of 0.45% the whole time. The situation on the market with state bonds was different. Yields of medium term bonds (with maturity from 2 to 5 years) got above zero in Q2 2016, but it subsequently fell and oscillated around the value of -0.20% towards the end of the year. Yields of bonds with short-term maturity (up to 2 years) did not climb above zero since July 2015. Similarly to the medium-term bonds, its yields increased in Q2 2016 and reached to -0.04%, it fell down to -0.5% during Q3 and it arrived at historically the lowest value of -0.81% in December 2016. The interest rate on the long-term bonds attained the lowest value in September 2016 and it rose in contrast to the other two types of bonds in Q4 – it was 0.53% in December.

²⁸ The CNB data. Unless stated otherwise, all data in this chapter are taken from the Czech National Bank database ARAD.

²⁹ Measured by the monetary aggregate M3.

Interest rates on deposits were further falling and they tightly touched zero in case of non-financial businesses.

Interest rates on deposits were decreasing throughout the whole year 2016 or remained at a constant level regardless of the type or deposit or client. Household deposits with agreed maturity up to 1 year represented a partial exception and fluctuated between 1.31% and 0.53% and they finished at the same level at the end of the year as in January. Households had the largest volume of funds deposited on one day deposits (77.6% as of 31st December 2016). The average interest rate fell from 0.21% in January to 0.11% in December 2016. The situation was similar for non-financial businesses. The vast majority of their monetary resources (93.9% as of 31st December 2016) is deposited as one day deposits, whose interest rates did not have much room any more for the decrease to zero, since they reached 0.08% in January 2016. Their average rate came to 0.04% in December. Rates on the deposits with agreed maturity for non-financial businesses reached the level of current accounts in December.

The long-term outflow of funds from term deposits continues, with their interests falling below the level of inflation.

The practically zero interest rates led to a notable outflow of funds from term accounts of non-financial businesses. The volume of deposits with agreed maturity lowered by 22.8 bn for 2016, which represents a 32.3% fall. The rates on term deposits of households remained slightly above the level of inflation (until November), but even the private savers deposit still larger proportion of their funds on current accounts. The volume of one day deposits of households increased by 221.5 CZK bn (+14.4%) for 2016.

Rates both on consumer credit and mortgages were falling.

Most of the rates on credit to households were decreasing during the year 2016. The interest rates on consumer credit fell by 1.6 p.p. during the year. The decline manifested mainly for medium and long term fixed rate credit. Interest rates on mortgages were also declining during the year. Rates on medium term fixed rate credit were falling at a stable rate. The most common fixed rate credit with term above 1 year and within 5 years charged on average interest of 2.35% in December 2015 and the rate fell by 0.15 p.p. during the year. The drop of rates for fixed rate credit with term between 5 and 10 years was more pronounced (-0.5 p.p.). The situation on the credit market did not change much for non-financial businesses during the year 2016.

Credit financing for non-financial businesses stayed at the level of the preceding year.

With respect to the favourable conditions, the volume of provided consumer credit was growing. The largest increase eventuated in February till May, when these credits swelled by more than 10% rate of growth year-on-year. The increase moderated in Q3 and settled at 6.3%. The year-on-year additions increased to 8.2% in the last quarter of the year. Mortgages formed the largest part of the total volume of provided credit (66.5% as of 31st December 2016). Their year-on-year growth was more than 8% throughout the whole year 2016, while it gained pace in the last quarter and crossed 9% in November. The new fixed rate mortgages with term between 5 and 10 years accrued the fastest, having the most advantageous interest conditions in 2016.

The volume of provided consumer credit markedly rose in the first half of the year. Growth of the volume of mortgages fastened in the last quarter.

Non-financial businesses voted especially credit financing with long-term maturity. Growth of volume of credit was driven mostly by the increase of credit denominated in foreign currencies.

The volume of credit provided to non-financial businesses grew in the first three quarters of 2016 similarly to the year 2015 and it dropped in the last quarter. It increased from 922 CZK bn to 1001 bn during January till November and it fell to 976 CZK bn during December. The volume of long term credit (with maturity longer than 5 years) grew the fastest. These credits comprise more than 50% of the total volume of credit to non-financial businesses already several years and their share stably grows. The currency composition of credits presents a relatively interesting detail. The credits denominated in foreign currency participated in 22.7% from the total volume at the beginning of the year 2016 and this share arrived at 27.8% as of 31st December 2016. Practically only these credits contributed to the total growth of credit in Q3 and Q4. From the view of the branch structure³⁰, the largest and fastest growing volume of credit was provided to businesses, which operate in the real estate activities. Financial and insurance activities were another branches, where the credits were significantly rising in the last year. On the contrary, the volume of credit provided to businesses in manufacturing stagnated and the volume of credit continued in decline for pro manufacturing and distribution of electricity, gas, heat, air, water and waste water.

³⁰ Based on CZ-NACE classification.



Household debt stably increases and mortgages represented the main contribution in 2016.

Household indebtedness increased by 96 CZK bn since the beginning of 2016 and arrived at 1428 CZK bn as of 31st December 2016. Mortgages comprised the majority of this increase (81.7 bn) and formed 74.2% of the total household debt as of 31st December 2016. The year-on-year increase of their volume fastened during the year from 7.7% in Q1 to 8.5% in Q4. Debt for the consumption purposes grew by a year-on-year pace of 10.1% in the first five months of the year, but the rise slowed down in Q3 and Q4 (2.4% and 4.0%).

Chart 17 **Monetary aggregates and gross domestic product (y/y in %)**

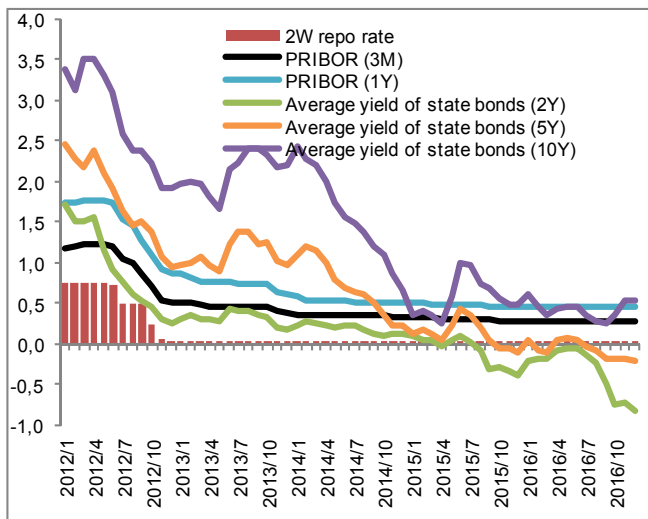
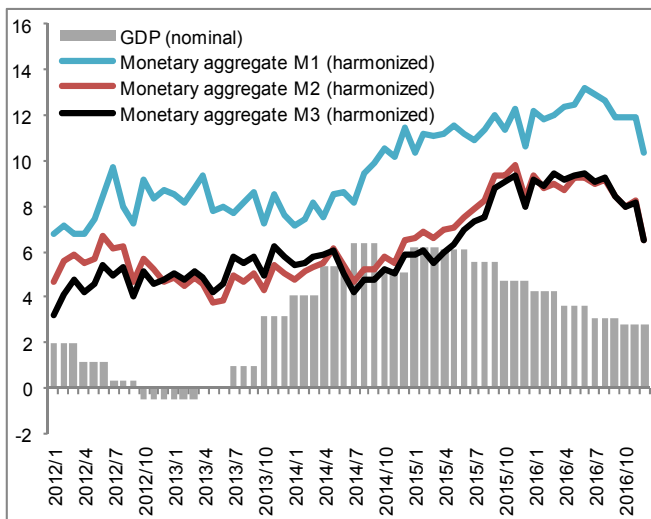


Chart 18 **Market interest rates (in %)**



Source: CZSO, CNB

8. State Budget

The state budget (SB) was driven to the record surplus by the income from the EU (mostly due to strong completion of drawing on funds in the year 2015) accompanied by the effects of continuing economic growth last year.

The state budget (SB) ended according to the cash fulfilment in surplus in the amount of 61.8 CZK bn in 2016 (it was a deficit of 62.8 bn in 2015). The budget surplus was last achieved in the history of the independent CR in the period of the years 1993–1995. The irregularities in the drawing on European funds at the turn of the EU programme periods were majorly reflected in the last year’s result. On the income side (157.8 CZK bn), it presented for the most part funds still bound to the expiring programme period (2007–2013), while among the investment expenditure of the SB (84.7 bn) the lower total readiness of projects on the start of the new programme period had an impact. The continuing expansion of the economy also played a role in the last year SB balance, when all the tax incomes (excluding insurance) strengthened by 7.5%³¹ year-on-year and were by 22.3 CZK bn higher in comparison to the budget anticipations (i.e. the approved budget). The SB balance in relation to the nominal GDP arrived at +1.3% last year and was nearly double compared to the so far record year 1994.

High year-on-year growth of total final consumption expenditure was reflected in the VAT collection.

State wide VAT collection strengthened by 5.4% last year. Even though the year-on-year rate of growth of the collection (of this most significant tax by weight) nearly doubled compared to the preceding year, its last year’s collection – in contrast to all other taxes significant in volume – stayed mildly (by 0.8%) behind the budget anticipations. Higher collection reflected the nominal growth of final consumption expenditure (by 3.5% for households in, by 3.4% for government institutions).

Taxes on tobacco products and taxes on mineral oils both contributed equally to the higher collection of

Income inflow from the consumption taxes to the SB was by 5.2% higher year-on-year. Both stronger collection of taxes on tobacco products (+7%, driven mostly by the increase of the tax rate) and the higher income from the tax on the mineral oils, whose

³¹ State wide collection of tax income (i.e. at the level of all public budgets) increased even by 8.4% compared to year 2015. Tax income of the SB itself were negatively affected by the change of the budget distribution scheme of taxes last year, when the proportion of the SB on the state-wide collection decreased roughly by 1 p.p., both for the VAT and the income taxes of natural persons (ITNP) from dependent activity.

consumption taxes year-on-year.

collection grew by 4.7% year-on-year, were behind this rise. It was caused by the growing consumption of motor gasoline as well as the diesel oil³² stimulated by the favourable prices of automotive fuels (especially in the first half of the year) as well as the long-term growth of demand for transportation with the continuing economic expansion.

Collection of corporate taxes rose the fastest since the peak year 2008, benefited mainly from the strengthening profits of businesses in the years 2014 and 2015.

State wide collection of the corporate taxes continued to grow by a swift pace. It further accelerated to 11.7% in 2016 (from 11.4% in 2015) and it exceeded the budget anticipations by nearly one tenth (14.5 CZK bn). In contrast to other types of taxes, it was not significantly affected by the legislative effects in the last five years and more clearly thus reflected the favourable development of the profit rate of businesses after the year 2013. Despite of this development, the last year's collection of taxes (164.7 bn) still hovered one tenth below its pre-crisis maximum from the year 2008³³.

Collection of ITNP from the dependent activity grew the most since the year 2007 due to a favourable condition of the labour market, the collection of taxes from self-employed natural persons also increased...

Year-on-year rate of growth of the state-wide collection of income taxes of natural persons (ITNP) more than doubled (to 11.7%), primarily due to the tax payments from the dependent activity. Record number of employed persons as well as the continuing reduction of the number of unemployed contributed to this development, as well as the strengthening wage dynamics in most branches³⁴. The collection of income taxes of natural persons (ITNP) based on the tax returns significantly increased in the last year (to nearly 7 bn, the highest collection since the year 2010), which was associated not only with the profitability of the self-employed natural persons but also with the limitation of the size of expense rates. The double-digit growth of the collection of tax from the property acquisition continued last year similarly to the year 2015, indicating the further revival of the real estate market due to the growing disposable income of households as well as the prevailing low interest rates.

...on the contrary, the dynamics for ITNP from capital yields was modest and remained tightly behind the budget anticipations.

Record depth of the fall of total SB expenditure due to year-on-year slump of investment, but a modest growth of current expenditure as well.

Total SB expenditure decreased by 6.0% last year. It represented the deepest year-on-year fall of expenditure in the era of the independent CR. Sharp, however expected slump of investment (by 52% year-on-year) was not compensated by a corresponding growth of the current expenditure – these strengthened by 1.2% (the least in the last four years), when the vast majority of current expenditure (incl. pensions or other social benefits) did not fulfil the budget anticipations.

Share of investment on all SB expenditures dropped below 7% last year, taking into account the extraordinary year 2015 it however fully fits into the long-term development.

Sharp fall of the capital outlays (by 91 CZK bn) was linked to the extraordinarily high basis of the year 2015 and also the anticipated slower drawing of funds on common projects of the CR and the EU on the start of the new programme period³⁵. Mild acceleration of the investment flow towards the end of the last year ensured meeting the whole year amount anticipated by the SB. The proportion of investment on total budget expenditure fell to record 6.9% last year. If we however took into account also the year 2015, then a similar proportion (for whole period of 2015-2016) would not deviate from the long-term level in any way in this two year period³⁶.

Moderate growth of expenditure on pensions combined with the dynamic growth of collection of compulsory insurance led to the lowest pension account deficit in the last eight years.

Full 45% of current expenditure were directed to social benefits last year, the dominant part was traditionally formed by the expenditure on pensions. These also thanks to a one-off February contribution (in the total size of 3.5 CZK bn) strengthened by 1.0% year-on-year. The year-on-year dynamics was however stronger (2.4%) in 2015, since it reflected the higher expenditure in connection to the return to the traditional adjustment scheme of pensions³⁷. Mild increase of the number of pensioners (+0.3%)

³² Total consumption of diesel oil increased by 4.0% from January till November 2016 (in case of motor gasoline by 1.7%). Due to the lowering of support of green and high percentage biofuels in transport (since year 2016) it can be assumed, that part of the consumption transferred to more taxed automotive fuels. Consumer prices of automotive fuels hovered the lowest since the deep recession (2009) in eleven months of the last year.

³³ The sharp year-on-year fall of collection (by more than one third) in the crisis year 2009 was the reason, the lowering of the tax rate from 21% to 19% in the period of years 2010 and 2011 also had an effect to a lesser extent.

³⁴ State-wide collection of ITNP from dependent activity was negatively impacted by the legislative changes – it was especially the further tax deductions on second and further child in the year-on-year comparison. It however represented only a marginal effect with respect to the growth of the economy.

³⁵ 54.3 CZK bn was spent in 2016 on current as well as capital expenditure for common CR and EU programmes (excluding the common agricultural policy) according to the preliminary data (the budget expectation was 70 bn).

³⁶ The share of investment on the SB expenditure was on average 10.2% during the period 2015–2016, similarly to the preceding decade (2005–2014).

³⁷ Starting January 2015, the full adjustment of pensions returned. They again fully reflect with the current adjustment scheme the increase of the consumer prices and further 1/3 of the increase of the real wage.



also manifested in the last year's volume of expenditure on pensions. The number of persons with a permanently shortened old-age pension grew more dynamically, their proportion of all recipients of old age pension crossed 25% for the first time last year. The pension account deficit (difference between incomes and expenditure on pensions from the SB) reached 16.5 CZK bn and it shrank by more than one half compared to the year 2015.

Expenditure on other social benefits (without pensions) were by 2.7% higher year-on-year, mostly due to higher sickness benefits.

Volume of other social benefits (without pensions) was growing more dynamically than the expenditure on pensions themselves last year in contrast to the year 2015. Higher drawing of sickness insurance benefits stood primarily behind this development (by 8.9%), caused by the growth of sickness (in all regions) as well as more intensive drawing of the maternity benefit. Even though the expenditure on sickness benefits grew already fourth year in a row, they were still lower than the volume of collected insurance payments last year (by 2.1 CZK bn, by 5.5 bn in the year 2012). Social care benefits also slightly increased (by 2%). It was a consequence of the across-the-board increase of the contribution to care benefits (since August by 10%), because the material deprivation assistance benefits were by one eighth lower year-on-year (even by 18% for the two years). The volume significant benefits of state social support stagnated (around 37.5 bn, already third year in a row), when the lower volume of paid out child benefits was compensated by slightly higher housing benefits, parental benefits as well as the foster care benefits. Despite significant improvement on the labour market and also the decrease of the number of registered job applicants (by 72 thousand at the end of December year-on-year), the volume of the unemployment benefits reduced only by 0.7% last year (number of persons with the right to claim support fell only by 5.3 thousand at the same time).

Continuing notable fall of the material deprivation benefits evidenced the improving financial situations of households.

Lower drawing of expenditure on non-investment purchases and further reduction of net expenditure on state debt.

Expenditure on wages of state employees similarly to the non-investment transfers to the regional budgets significant in volume (especially to regional education) increased by 5% in 2016, in both cases however it represented lower rates of growth than in the previous year. Budget savings were achieved for non-investment purchases and expenditure on state debt. Net expenditure on state debt dropped last year already for the third year in a row (to 40.7 CZK bn). The improving SB balance (and connected lower borrowing need of the state), as well as the favourable conditions on the markets with government bonds both play a role here.

Total amount of the state debt lowered after three years of stabilisation in the year 2016, both the internal and external indebtedness was reduced.

While the total size of the state debt increased by 21.7 CZK bn during the Q1, the trend turned in the remaining part of the year. The debt lowered by 3.6% for the whole last year (to 1613 CZK bn), the most since the inception of the independent CR. It mirrored the reduction of the inner indebtedness (by 45.8 bn), however the crown value of the external debt was also lower (by 13.8 bn). The external debt comprised 16.7% of the total debt at the end of the year, which represented the lowest proportion since the beginning of the year 2008. Decrease of the total debt was associated with the higher volume of planned repayments concentrated into the second half of the year. The falling borrowing need of the state also had a positive effect. The state tried to make use of the negative interest rates in the year 2016 – 57% of the value of newly issued bonds thus displayed a maturity up to five years and the volume of sales of state bonds with a negative yield reached 145.7 bn. The growth of the volume of Czech bonds held by the foreign investors further fastened. It represented already 424 CZK bn at the end of December 2016, resp. 31.6% of the value of all crown bonds (it was 14.5% two years ago)³⁸.

Value of debt of the whole sector of government institutions lowered quarter-on-quarter already second time in a row, it amounted to 1813 crowns at the end of Q3 2016

Consolidated gross debt of the whole sector of government institutions³⁹ reached the size of 1 813 CZK bn based on the newest CZSO data at the end of Q3 2016 and it arrived at 38.7% in relation to the GDP (it was by 1.9 p.p. higher in the same period of the previous year). The swift growth of the nominal GDP stood behind the year-on-year lowering of the relative level of the debt last year, but the decrease of the absolute size of the debt to a lesser extent as well (by 15.6 CZK bn). The Czech

³⁸ Inflow of the speculative capital in connection with the nearing end of the exchange rate commitment of the CNB at the beginning of 2017 accelerated. Non-residents owned Czech bonds already in the amount of 538.8 CZK bn at the end of January, resp. 38.7% of value of all crown bonds.

³⁹ Debt of the sector of government institutions includes apart from the central government institutions also the budget of the regional governments or health insurance companies. Preliminary data regarding the debt and deficit of the government institutions sector for the whole year 2016 will be published by the CZSO on 4th April 2017 (by Eurostat then on 24th April).

Only three EU states achieved a notably lower indebtedness in relation of debt to the GDP than in the CR.

Republic was the seventh less indebted EU country last year, only Estonia, Luxembourg and Bulgaria recorded significantly lower relative debt at the end Q3. The indebtedness fell in 17 EU states in comparison to Q3 2015 (the most in Ireland from 85.6% to 77.1% of the GDP). From the seven most hit states⁴⁰ only Italy however managed to reduce its indebtedness (by 1.4 p.p.). Out of the largest EU economies, Germany was the most successful in this respect, when it also thanks to the budget surpluses pushed the indebtedness below the 70% boundary (the lowest since Q1 2009).

All subsectors of government institutions achieved more favourable budget balance for the three last year quarters.

Budget of the government institutions ended in the positive balance in the amount of 41.3 CZK bn in the CR for Q1 to Q3 2016 (in the accrual expression)⁴¹. Especially the local government institutions contributed to the more favourable result year-on-year (by 38.4 bn), their high surplus (51.8 bn) was mainly connected with the restriction of the investment activity. Deficit of the central government institutions reduced by nearly one half year-on-year (to 17 bn), health insurance companies achieved a more favourable budget result as well.

Chart 19 State wide collection of tax income (y/y in %) and state budget balance (in CZK bn)

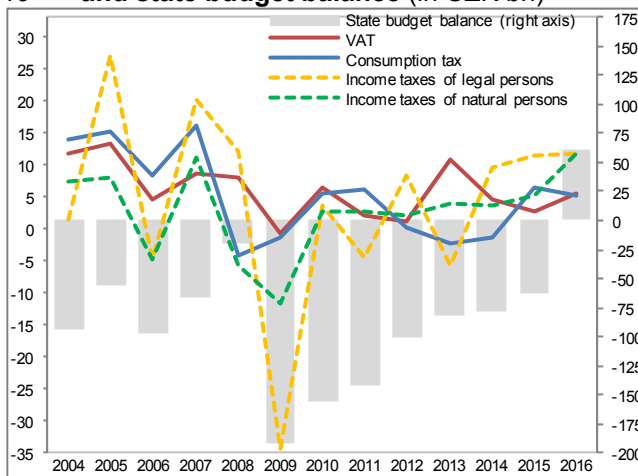
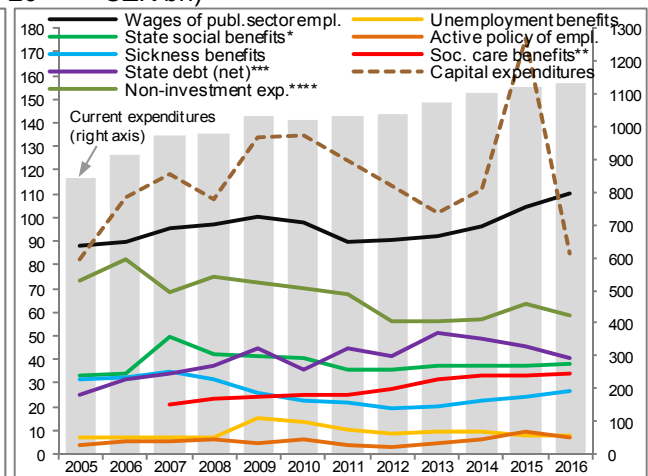


Chart 20 Selected state budget expenditures (in CZK bn)



*including the foster care benefits, ** material deprivation assistance benefits, disability benefits, contribution to care based on Act on State Social Support, *** expenditures also include the income of the chapter State debt
**** excluding interest and other financial costs of state debt

Source: MF CR, MLSA

Chart 21 State debt of the CR according to means of financing (in CZK bn) and share of CZK bonds held by non-residents (in %)

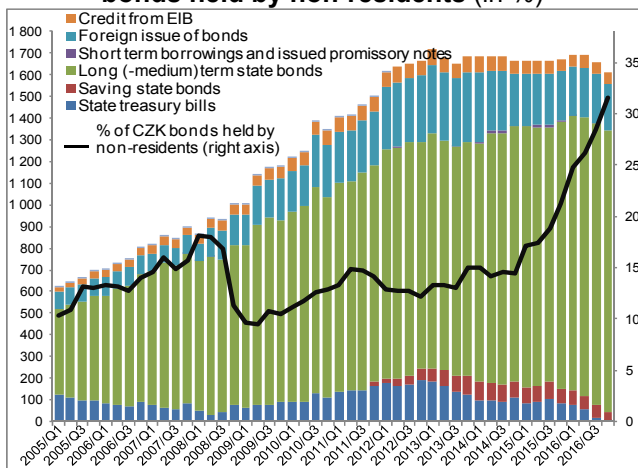
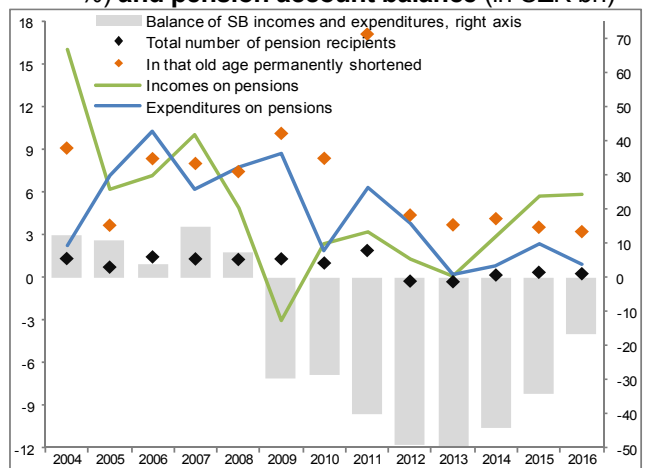


Chart 22 Number of pension recipients, incomes and expenditures on pensions from the SB (y/y in %) and pension account balance (in CZK bn)



Source: MF, CSSA

⁴⁰ States, where the debt of the government institution sector exceeded 95% of GDP last year (Greece, Portugal, Italy, Cyprus, Belgium, Spain and France).

⁴¹ Indicators of the budget balance and the government institutions debt are based on the accrual principle. According to this principle, incomes and expenditures are assigned to the period, to which they are connected by type, i.e. regardless of the period of occurrence of the cash flow (as it is in case of the cash fulfilment).

