

I. Economic and social development of the Czech Republic in the second quarter of 2006

(Preliminary figures)

Dynamic economic growth that started last year continued also in Q2 2006, but the rate slightly slowed down in comparison to Q1 2006. Yet the economy of the Czech Republic is still among those with the fastest economic growth within the EU (the growth differential between the CR and the EU25 average was 3.4 percentage points). Total output at constant prices grew slower year-on-year than intermediate consumption (by 7.3% and 7.8% respectively), and gross value added thus increased by only 6.6%. Among CZ-NACE activities, GVA grew most in manufacturing, energy industry and trade. The lower growth rate of GDP (6.2%)¹ than of GVA was affected by different trends of product subsidies and product taxes. On the demand side, economic growth was stimulated in particular by expenditure on gross capital formation (+17.8%, contribution to GDP growth 4.9 percentage points) and expenditure on final consumption (+1.6%, contribution 1.1 p.p.), of which household final consumption (+3.8% and contribution 1.8 p.p.); the contribution of net exports was only 0.2 p.p. Total exports grew at the same rate as total imports (10.2%); exports of services dropped by 4.7%, but imports of services increased by 1.0%. The year-on-year deterioration of terms of trade by 1.5% caused that the trading loss on external market transactions in goods and services was CZK 6.3 billion (last year, however, the loss was even by CZK 0.5 billion higher), which resulted in a lower growth rate of gross domestic income (5.0%) than of GDP.

Total labour productivity (GDP at constant prices per worker²) was up by 5.0% y-o-y in Q2 2006 and its contribution to GDP increase was more than four-fifths. The remaining less than a fifth is attributed to a higher number of workers (+1.1%). Unit labour costs fell.

Gross domestic product (**hereinafter at current prices**), amounting to CZK 815.7 billion, was by CZK 57.7 billion up y-o-y, i.e. +7.6%. Gross disposable national income (CZK 753.3 billion) was by CZK 46.9 billion, i.e. 6.6%, higher y-o-y. As final consumption expenditure increased less (+5.0%), gross national saving grew by 11.6% (from CZK 177.9 billion in Q2 2005 to CZK 198.6 billion in Q2 2006). The rate of gross national saving thus increased by 1.2 p.p. and reached 26.4%. In spite of that, gross national saving was unable to cover the growing expenditure on gross capital formation, which was by CZK 49.1 billion higher. As a result, the deficit of national current transactions with non-residents increased by CZK 18.1 billion.

Key economic characteristics

%

	Q2 2005	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2004 to Q2 2005	Q4 2004 to Q3 2005	Year 2005	Q2 2005 to Q1 2006	Q3 2005 to Q2 2006
GDP, y-o-y change (constant prices)	6.1	5.9	6.9	7.1	6.2	5.1	5.5	6.1	6.5	6.5
Final consumption, y-o-y change (constant prices)	1.9	3.1	1.4	2.8	1.6	0.8	1.4	1.8	2.3	2.2
Gross capital formation, y-o-y change (constant prices)	0.6	1.9	7.3	12.4	17.8	3.8	2.3	2.9	5.3	9.9
Inflation rate, y-o-y, average	1.6	1.9	2.4	2.8	2.9	2.4	2.0	1.9	2.2	2.5
Registered unemployment rate, average	8.8	8.8	8.6	9.0	7.7	9.2	9.0	9.0	8.8	8.6
State budget balance / GDP ratio, % ¹⁾	-0.6	2.9	-10.6	2.1	-1.0	-1.4	-0.9	-1.9	-1.6	-1.7
Current account / GDP ratio, % ¹⁾	-3.9	-4.1	-2.7	0.3	-6.1	-4.2	-2.8	-2.1	-2.6	-3.2
Financial account / GDP ratio, % ¹⁾	13.6	4.0	1.9	0.0	2.6	7.8	6.9	4.6	4.9	2.1
Net exports / GDP ratio, % ¹⁾	2.7	0.8	0.5	3.8	1.6	1.1	1.5	1.9	1.9	1.7

¹⁾ At current prices

Sources: CZSO, Ministry of Finance, Ministry of Labour and Social Affairs, CNB; calculations by CZSO

Industrial production (measured by the industrial production index³) grew by 8.9% in Q2 2006. The decisive influence (9.1 p.p.) on this figure was manufacturing, where the fastest increases were recorded in 'manufacture of transport equipment', 'manufacture of electrical and optical equipment' and 'manufacture of basic metals and fabricated metal products'.

Sales of own goods and services at constant prices rose by 10.0% y-o-y; the share of sales in the ICT sector in total sales at current prices grew by 0.5 p.p. The number of employees in the industry continued increasing, in particular thanks to foreign-controlled enterprises. Labour productivity rose more than average wages, unit wage costs dropped by 2.6%. Book value added (at current prices) was up by 10.1%, i.e. more than in Q2 2005.

¹ The GDP indices and GDP component indices are at average prices of preceding year; the sales indices in individual CZ-NACE activities are at constant prices of 2000, unless otherwise stated.

² According to employment data from the national accounts.

³ Starting with data for January 2006, IPI calculation is governed by a new methodology, which was published in the Press Release of 10 March 2006 (http://www.czso.cz/csu/redakce.nsf/i/zmena_metodiky_indexu_prumyslove_produkce).

Electricity generation decreased by 0.1% y-o-y, while domestic consumption grew by 2.5%. Like in preceding quarters, exports were higher than imports, but the surplus (exports minus imports) was by 11.1% lower. **Natural gas** consumption was down by 3.5% and imports stagnated. As a result, the stock level increased. Imports of **crude petroleum** (in tonnes) were by 12.9% higher than in Q2 2005.

In July 2006, industrial production was up by 11.8 % y-o-y.

The volume of **construction output** grew by 6.2% y-o-y, in enterprises with 20+ employees by 6.9%. Better results were registered also for **construction work carried out by own workers** (construction put in place by enterprises with 20+ employees), which rose by 5.4%.

Sales of own goods and services (predominantly from construction activity) were up by 6.5% y-o-y. The number of employees in construction actually remained at the same level y-o-y. The faster growth of labour productivity than of wages reduced unit wage costs by 0.5%. As to financial data, book value added produced by construction enterprises was higher than in Q2 2005. The growth of production consumption was faster than the growth of output.

The value and number of **construction orders** were up y-o-y, but the average value per order fell. Over two-thirds of orders came from the government sector. The planning and building control authorities granted by 2 thousand **building permits** fewer than in Q2 2005, but the total value was higher.

In **housing construction**, the numbers of started and completed dwellings grew by 22.6% and fell by 14.5%, respectively. This translates into an increase in dwellings under construction of 7.3% y-o-y.

In July 2006, construction output grew by 12.2% y-o-y.

The sales of own goods and services in **agriculture** were down by 3.8% y-o-y at current prices and up by as much as 8.0% at constant prices. The number of employees in holdings of agricultural primary production continued decreasing. As labour productivity rose less than average wages, unit wage costs increased by 12.6%. As to financial data, agriculture reached worse results than a year earlier. Outputs stagnated and production consumption rose, book value added fell by 8.3%. At the end of June 2006, the populations of cattle and poultry were up y-o-y, the population of pigs was down.

According to harvest estimates as at 15 August, the total production of main cereals should be lower by 13.1%, potatoes by roughly a third and sugar beet by 16.7% in comparison to 2005. Better harvest is expected for rape, mainly due to larger sowing areas.

Retail sales, incl. sale, maintenance and repair of motor vehicles and motorcycles and retail of automotive fuel, increased by 6.6% y-o-y at constant prices; sales in retail trade (incl. repair of personal and household goods grew by 6.9%; and sale, maintenance and repair of motor vehicles and motorcycles and retail of automotive fuel was up by 5.0%. The number of employees and workers in **trade total** grew y-o-y, and so did their labour productivity. Book value added (at current prices) in trade was up by 5.3%. Sales in **hotels and restaurants** dropped by 3.0% at constant prices, labour productivity decreased too.

In the framework of **international tourism**, international visitor arrivals in the Czech Republic increased by 2.6% y-o-y (according to the frontier statistics). Czech resident departures were up by 3.3%. Thanks to international clients, demand for collective accommodation establishments increased (higher numbers of guests and overnight stays alike). In particular four- and five-star hotels were successful in having enough clients. On the other hand, the ups and downs of the weather reduced the numbers of guests at camping sites and holiday villages. The active balance of international tourism (as part of the balance of payments) stood at CZK 14.0 billion, which was more than in Q2 2005.

Sales of own goods and services and goods for resale in **transport** were, just like in Q1 2006, lower y-o-y (the same affect of change in organisation). This showed itself in lower labour productivity, whereas the average wage grew in all modes of transport, except for inland water transport. Book value added (at current prices) increased by 4.1%. In rail transport of goods, tonnage carried and outputs were down, compared to Q2 2005; outputs in road transport of goods grew.

Sales in **communications** rose by 3.5%, the dynamics were lower than in 2005. Employment decreased and labour productivity grew slower than wages. Book value added grew by 3.5%.

Financial intermediation (excl. the CNB) reached by nearly a quarter lower gross profit compared to Q2 2005. Only insurance companies raised their profit (to twice as much). Considering the aggregate of financial institutions, the number of employees remained nearly the same and the average wage grew by 3.6%. Employment in insurance companies and pension funds decreased and the average wage rose by more than a quarter.

Sales of **other market services** were up by 2.5% due to the growth of services predominantly to the population by 7.8% (inter alia transfer of several health establishments from the general government sector to the non-financial institutions sector). Employment was up by 7.1% y-o-y; the average monthly nominal wage grew markedly faster than labour productivity. Book value added produced was by 10.0% higher y-o-y. Nearly three-quarters of total sales were made in enterprises with fewer than 100 employees.

Sales^{*)} in chosen CZ-NACE activities

Y-o-y indices (%)

CZ-NACE activity		Q2 2005	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2004 to Q2 2005	Q4 2004 to Q3 2005	Year 2005	Q2 2005 to Q1 2006	Q3 2005 to Q2 2006
Industry (CZ-NACE 10-41)	Current prices	109.4	107.9	107.5	118.4	111.4	111.5	110.2	108.2	110.8	111.3
	Constant prices	105.0	106.5	107.5	118.0	110.0	104.5	104.8	105.1	109.2	110.5
Construction	Current prices	102.0	110.6	108.6	103.7	109.4	103.5	105.7	106.7	106.7	108.7
	Constant prices	99.2	108.0	106.0	101.2	106.5	99.6	102.3	103.7	104.1	106.0
Agriculture	Current prices	106.3	89.5	96.8	98.1	96.2	109.8	102.6	97.8	96.7	94.8
	Constant prices	123.8	98.2	102.8	99.6	92.0	112.8	110.3	108.0	104.7	98.5
Retail trade (CZ-NACE 50, 52)	Current prices	105.2	105.5	103.5	107.9	106.9	104.7	104.9	104.7	104.6	104.9
	Constant prices	105.2	103.9	102.7	107.1	106.2	103.5	104.1	104.1	105.4	105.8
Transport	Current prices	104.5	108.4	109.1	92.6	91.6	107.4	107.0	107.2	103.9	100.5
	Constant prices	101.2	104.3	104.8	90.3	89.7	104.4	103.5	103.5	100.5	97.6
Communications	Current prices	103.7	105.8	103.9	104.2	104.4	103.5	104.0	104.1	104.4	104.6
	Constant prices	109.0	109.3	106.8	103.9	103.5	105.9	107.3	108.1	107.2	105.9
Other market services	Current prices	103.1	108.3	106.9	107.8	107.0	102.8	104.1	105.6	106.5	107.4
	Constant prices	100.2	105.5	104.0	103.9	102.5	99.3	100.9	102.6	103.3	103.9

^{*)} The data on the industry, construction and agriculture refer to sales of own goods and services; the data on other CZ-NACE activities refer to total sales.

The total **economic result** (i.e. gross profit or pre-tax profit) of **non-financial corporations with 100+ employees** was up by 15.2% on Q2 2005 (current prices). Total yields grew by 12.1% and costs by 11.9%. At the same time, return on costs increased and return on equity capital stagnated. The number of loss-making enterprises did not change y-o-y and made up 25.4% of all enterprises. Gross profit rose y-o-y mainly due to 'manufacturing' and 'wholesale and retail trade'. The highest fall in profits was registered in 'agriculture, forestry and hunting'. **Book value added** produced in large corporations was by 10.6% higher y-o-y and grew in all institutional sectors. The stock of total inventories grew by 4.7% y-o-y at the end of Q2 2006. Overcapitalisation, i.e. negative value of equity capital, was observed in a lower number of enterprises than a year earlier. The share of equity capital in the coverage of the balance sum increased to 52.5%, external resources covered the rest. **Foreign-controlled enterprises** raised their book value added by 13.4% and gross profit by 35.6%.

The level of consumer prices in Q2 2006 grew by 2.9% y-o-y. This increase was mainly affected by the growth of prices of natural gas, electricity, heat and hot water, water and sewerage, prices of post and telecommunications, automotive fuel and road transport. Market prices rose by only 0.8%. Prices of goods were up by 2.4% y-o-y and prices of services by 3.8%.

Inflation rate, measured as increase in the average consumer price index for last 12 months over the average for preceding 12 months, stood at 2.5% in June and increased by 0.1 p.p. every month of Q2 2006.

In July and August 2006, consumer prices grew by 2.9% and 3.1% y-o-y, respectively.

Following decreases recorded in previous five quarters, **agricultural producer prices** were up by 4.7%. **Industrial producer prices** rose by 1.3%, growth accelerated in all three months. The overall price level was affected by higher prices of energy resulting from growing prices of crude petroleum in world markets. Lower prices were recorded for 'food, beverages and tobacco products', 'basic metals and fabricated metal products' and transport vehicles. **Construction work prices** grew by 2.8% and **prices of market services** by 3.9%; especially prices of 'business services' and 'post and telecommunication services' rose. **Tangible investment prices** were by 0.9% higher y-o-y.

In July and August 2006, year-on-year, agricultural producer prices rose by 1.4% and 2.4% respectively, construction work prices by 3.1% in both months, industrial producer prices by 2.4% and 2.7% respectively. Prices of market services grew most (by 3.8% and 4.0% respectively).

External trade prices continued their tendency of previous quarters, although the growth of import prices slowed down to 1.3%, and export prices decreased by 2.0%. This trend was still affected by strengthening of the *koruna* against the main foreign currencies and by the growth of import prices of mineral fuels by 2.0%. Compared to Q2 2005, **terms of trade** deteriorated to 96.7% and they were below 100% for the fifth consecutive quarter. **World prices** of industrial raw materials and food measured by the CZSO index grew by 34.8% y-o-y on average in Q2 2006.

The growth rates of exports and imports were higher in comparison to Q2 2005. Exports and imports at current prices rose by 10.2% and 11.3% y-o-y respectively. The surplus of trade balance, which dropped by CZK 3.8 billion y-o-y and reached CZK 9.7 billion, was affected favourably by the high surplus of trade in 'machinery and transport equipment' and negatively by the high deficit of trade in mineral fuels and chemical products. As to the commodity structure, exports were driven by 'machinery and transport equipment', which reported the highest y-o-y growth among all sections of the SITC; imports increased mainly due to mineral fuels, lubricants and related materials. According to the territorial structure, exports to all groups of countries were up (with the exception of developing economies), exports to developed

market economies and European transition economies grew above the average; imports from all groups of countries increased, but the rates of growth varied considerably. Surplus of external trade was concentrated in trade with developed market economies/EU25 and with European transition economies, because the balance of trade with 'other states', CIS countries and developing economies run a deficit, which was by CZK 17.2 billion higher y-o-y.

In July 2006, exports and imports at current prices increased by 14.4% and 14.8% respectively, y-o-y. Trade balance was passive by CZK 1.2 billion.

The current account of the **balance of payments** ended in a deficit of CZK 50.0 billion in Q2 2006; the surplus of transactions in goods and balance of services stood against a deficit of the balance of revenues and current transfers. The financial account of the balance of payments reached a surplus of CZK 20.9 billion, which was markedly less than a year earlier in consequence of the fall in foreign direct investments. Deficit of the current account made up 6.1% and surplus of the financial account 2.6% of the nominal volume of GDP. Foreign exchange reserves decreased by CZK 1.0 billion in Q2 2006 (excluding exchange rate fluctuations), compared to the increase of CZK 83.7 billion in Q2 2005.

Foreign exchange reserves of the CNB reached CZK 681.6 billion at the end of Q2 2006, which would be enough to cover 3.7 months' imports of goods and services.

The average **exchange rate** of the Czech **koruna** strengthened **against the euro** to 28.4 CZK/EUR and **against the US dollar** to 22.6 CZK/USD y-o-y in Q2 2006. The index of nominal effective exchange rate of the *koruna* was by 5.7 p.p. higher y-o-y on average.

The y-o-y growth of **money supply M2** slowed down in Q2 2006, in comparison to Q1. At the end of Q2 2006, M2 relative to the annualised GDP volume was 67.1%, i.e. more than in Q2 2005. Deposits of non-financial corporations affected slower dynamics of money supply, on the other hand the growth of household deposits accelerated. The monetary aggregate **M1** was by 13.7% higher y-o-y in June, money in circulation and overnight deposits grew too. The share of the monetary aggregate M1 in money supply M2 increased to 55% in Q2 2006.

The dynamics of total **deposits** at banks slowed down to 12.2% y-o-y at the end of Q2 2006, *koruna* deposits recorded the same increase. Total **loans** granted to enterprises and households were by 17.7% higher y-o-y in June. In particular long-term loans provided to domestic enterprises were on the increase. The y-o-y dynamics of housing loans remained at a high level.

In Q2 2006 the Czech National Bank kept the basic REPO rate constant at 2.00%. The average **interest rate** on total **deposits** and total **loans** reached 1.15% and 5.57%, respectively, at the end of Q2 2006. The **interest margin** between total rates on loans and total rates on deposits does not tend to fluctuate significantly and reached 4.42 percentage points in June: 5.75 p.p. in the household sector and 3.19 p.p. in the non-financial corporations sector.

The number of workers in the economy of the CR (estimated) increased by 0.7% in comparison to Q2 2005, **the number of employees** in the economy grew by 0.9%. Their average wage was up by 6.8% and reached CZK 18 773.

The number of employees in businesses with **20+ employees** of the business sphere (in financial intermediation irrespective of employment) and in all organisations of the non-business sphere increased by 1.2%. This is mainly attributable to foreign-controlled enterprises, where the increase was over a tenth. The highest decrease in employed persons was apparent in state-owned enterprises. The average monthly gross **nominal wage** of employees grew by 6.9% and stood at CZK 20 036. Consumer prices were up by 2.9% and the average **wage** rose by 3.9% **in real terms**; by 4.1% in the business sphere and by 3.0% in the non-business sphere. The wage differentiation between individual CZ-NACE activities widened (the variation coefficient was up by 1.0 percentage point y-o-y in Q2 2006 and reached 36.1%).

The **registered unemployment rate** was 7.7% on 30 June, i.e. a decrease of 1.2 p.p. against the end of 2005 and 0.9 p.p. year-on-year. There were 541.1 thousand registered job applicants, of which 423 thousand were available unemployed job applicants. The number of unemployed job applicants decreased in all age groups. The number of long-term unemployed persons dropped by 7.8% y-o-y, but their percentage in the total number of the unemployed did not change y-o-y and remained high. The average number of unemployed school-leavers fell by 11.8% y-o-y. The job vacancy rate was 1.9% in Q2 2006. The highest unemployment rates persist in the districts of Most (20.5%), Karviná (17.9%) and Teplice (15.9%).

The registered unemployment rate was 7.9% at the end of both July and August 2006.

Per capita **net money expenditures** at constant prices grew by 7.6% in households of employees and by 6.1% in households of pensioners. The share of indispensable expenditures, i.e. on food, beverages and housing, made up 37.9% of total expenditures in households of employees and 54.7% in households of pensioners. The costs of basic housing grew y-o-y in both groups of households.

In the framework of **social expenditures**, resources paid as pensions rose by 7.2% in nominal terms. As a result of the pensions adjustment as of 1 January 2006, the average old-age pension was CZK 8 163 at the end of Q2 2006, i.e. by 5.7% higher y-o-y. As the cost of living of pensioners was up by 4.1% y-o-y, the average old-age pension grew by 1.5% in real terms.

In the first half of 2006, the **state budget** registered revenues CZK 468.8 billion and expenditures CZK 461.2 billion, which resulted in a surplus of CZK 7.6 billion at the end of June (by CZK 3.9 billion more y-o-y). In relation to nominal GDP, the surplus was 0.5%. Especially excise taxes, VAT and accepted subsidies contributed to the better result of the revenue side of the state budget. In total CZK 110.3 billion was collected for pensions and CZK 140.0 billion was paid as pensions. On the expenditure side, mainly non-investment purchases, non-investment transfers to municipalities and social benefits including pensions were higher. The share of mandatory expenditures in total expenditures grew by 0.5 p.p. in comparison to the first half of 2005.

At the end of July and August 2006, the state budget run a deficit of CZK 0.4 billion and CZK 6.4 billion respectively.

The budgets of **regions, municipalities and voluntary associations of municipalities** received CZK 173.5 billion at the end of the first half of 2006, i.e. 47.7% of the annual budgeted level. **Total expenditures of territorial self-governing units** made up CZK 162.4 billion, i.e. 43.5% of the annual budgeted level. Regions and municipalities reported surplus CZK 3.0 billion and CZK 8.2 billion, respectively.

The **population** of the Czech Republic was 10 268.6 thousand on 30 June 2006, which was by 34.6 thousand more y-o-y. Of a decisive effect was still the active balance of external migration, while also natural increase was positive. By 959 more children was born than in 2005 and deaths decreased by 4 511. The nuptiality level remains low, marriages kept falling. Divorces stagnated.

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Comparison of development in the CR and the EU in Q2 2006: selected harmonised indicators

Harmonised indicator	EU 25	EU 15	Germany	Slovakia	Czech Republic
Gross domestic product (constant prices), y-o-y change in %	2.2	2.0	1.0	6.7	6.2
Harmonised index of consumer prices (HICP)	102.4	102.4	102.1	104.6	102.5
Harmonised unemployment rate in %	8.0	7.2	8.5	14.4	7.3
Industrial production index (working days adjusted) in %	103.5	103.7	110.8	109.9	110.8
Construction output index (working days adjusted) in %	103.1	103.5	105.6	117.4	109.3
Retail sales index (seasonally adjusted) in %	103.4	102.8	101.9	110.7	105.9

Source: Eurostat (20 June 2006), calculations by CZSO