

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

(Preliminary figures)

The growth of the Czech economy continued in Q4 2006. On the supply side it was boosted especially by 'manufacturing', but above-the-average rates were registered also for 'construction' and 'wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods'. **Gross value added** (GVA) reached CZK 756.0 billion (current prices) in Q4 2006 and increased by 6.1% y-o-y (constant prices). As increase of taxes on products (+4.2%) was lower than increase of subsidies on products (+11.8%), GDP grew less than GVA.

The **value of GDP** reached CZK 839.4 billion (current prices) and GDP growth was 5.8% y-o-y<sup>1</sup> (constant prices). GDP was unfavourably affected by net export figures where the balance of services deteriorated more than the balance of goods. On the other hand, GDP growth was predominantly due to final consumption expenditure (contribution 3.4 p.p.), of which the effect of household consumption expenditure was 2.7 p.p. Gross capital formation contributed to the GDP growth with 2.8 p.p., of which the effect of gross fixed capital formation was 1.9 p.p.

**Total labour productivity** (GDP at constant prices per worker<sup>2</sup>) was up by 3.8% y-o-y in Q4 2006 and contributed with two-thirds to GDP growth (the remaining third was due to higher employment). The number of workers rose by 1.9% and unit labour costs fell.

The real increase of 10.9% y-o-y in **aggregate demand** in Q4 2006 was substantially more affected by growth of domestic aggregate demand than by growth of external demand (2.8 times more). The increase of **aggregate supply** of 11.2% was 3.4 times more affected by external supply than by domestic supply. **Domestic aggregate demand** rose by 5.4% and its growth was faster than in Q4 2005, while the increase of **domestic effective supply** of 4.8% was slower than in Q4 2005 due to higher stock formation.

Incomes, expenditures and capital transactions developed less favourably than in Q4 2005. Of the most negative effect were net primary incomes and net current transfers. As a result, the growth of **gross disposable national income** (GDNI) was markedly lower than GDP. The growth of expenditures on final consumption being higher than the growth of GDNI led to a decrease in gross national saving. The rate of saving dropped from 23.0% in Q4 2005 to 21.5%; this had an adverse effect on the financing of gross capital formation which had to be funded from external resources. The passive balance of national current transfers with non-residents was many times higher than the balance of saving.

In the **household sector**, growth of current expenditures (8.2%) was faster than growth of current incomes (6.5%), all at current prices. The increase in current incomes was most affected by increase in compensation of employees by 6.5%, and the fastest growth was recorded for property incomes (by 16.2%). **Gross disposable income of households** stood at CZK 426.5 billion and grew by 5.6% y-o-y; gross saving was substantially less than in Q4 2005. The rate of gross household saving dropped by 1.0 p.p. y-o-y to 5.6%.

## Key economic indicators

	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Year 2005	Q2 2005 to Q1 2006	Q3 2005 to Q2 2006	Q4 2005 to Q3 2006	Year 2006
GDP, y-o-y change (constant prices)	6.7	6.4	6.2	5.9	5.8	6.1	6.3	6.3	6.3	6.1
Final consumption, y-o-y change (constant prices)	2.0	3.6	2.3	2.5	4.6	2.3	2.9	2.9	2.6	3.2
Gross capital formation, y-o-y change (constant prices)	4.8	7.4	16.7	13.0	11.1	1.6	3.0	7.5	10.7	12.2
Inflation rate, y-o-y, average	2.4	2.8	2.9	2.9	1.5	1.9	2.2	2.5	2.8	2.5
Registered unemployment rate, average	8.6	9.0	7.7	7.8	7.5	9.0	8.8	8.6	8.4	8.1
State budget balance / GDP ratio, % <sup>1)</sup>	-10.6	2.1	-1.0	-0.8	-11.8	-1.9	-1.6	-1.7	-2.6	-3.0
Current account / GDP ratio, % <sup>1)</sup>	-2.9	-0.9	-5.7	-5.4	-6.0	-2.6	-2.8	-3.1	-3.4	-4.2
Financial account / GDP ratio, % <sup>1)</sup>	3.1	-1.4	3.7	5.8	5.3	5.2	5.3	2.8	2.9	3.5
Net exports / GDP ratio, % <sup>1)</sup>	0.5	3.6	1.3	1.4	0.9	1.9	1.9	1.0	1.7	1.8

<sup>1)</sup> 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 index) grew by 7.8% y-o-y in Q4 2006. A decisive contribution (7.7 p.p.) to this figure was made by 'manufacturing', where the fastest increases were recorded in 'manufacture of transport equipment', 'manufacture of electrical and optical equipment' and 'manufacture of machinery and equipment'.

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

<sup>2</sup> According to employment data from the national accounts.

**Sales** of own goods and services rose by 15.1% y-o-y; the share of sales in the ICT sector in sales in total manufacturing at current prices grew by 0.9 p.p. y-o-y. 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 6.7%. Book value added (current prices) was up by 12.3%, i.e. considerably more than in Q4 2005.

**Electricity** generation grew by 2.4% y-o-y, being up in all types of power stations except for nuclear ones. Domestic consumption decreased by 1.5%, of which in households by 4.0%. Like in preceding quarters, exports were higher than imports, and the surplus of exports over imports was by 733 GWh higher y-o-y. Whereas imports of **natural gas** grew y-o-y, domestic consumption dropped by 15.5%. As a result, gas reserves decreased. Imports of **crude petroleum** (in tonnes) decreased in comparison to Q4 2005 and reserves of crude petroleum on 31 December 2006 were almost by a fifth higher than at the end of 2005.

*In January 2006, industrial production was up by 9.8 % y-o-y and real sales by 11.0%.*

**Construction output** grew by 9.5% y-o-y, in enterprises with 20+ employees by 9.0%. Construction work abroad almost doubled, but its share was insignificant. On the other hand, the growth of **construction work carried out by own workers** in enterprises with 20+ employees slowed down to 6.9%.

**Sales** of own goods and services (predominantly from construction activity) were up by significant 17.7% y-o-y. The number of persons employed in construction increased by 0.3% y-o-y. Faster growth of labour productivity than growth of average wages reduced unit wage costs by 0.8%. As to financial data, book value added at current prices produced by construction enterprises was almost by a third higher than in Q4 2005. Growth of production consumption was slower than growth of outputs.

The number and value of **construction orders** increased y-o-y, order books were full for almost the next 10 months. Roughly two-thirds of orders came from the government sector. The planning and building control authorities granted about the same number of **building permits** as in Q4 2005, but their value was more than a fifth higher.

In **housing construction**, the number of dwellings started grew faster (+13.7%) than the number of dwellings completed (+1.3%). This resulted in an increase in dwellings under construction of 8.7% y-o-y.

*In January 2007, construction output grew by 29.2% y-o-y.*

The sales of own goods and services in **agriculture** were down by 3.3% y-o-y (by 1.0% at current prices). The decrease of the number of employees in holdings of agricultural primary production accelerated in the course of the year, in Q4 2006 the number was by 3.6% lower compared to Q4 2005. As labour productivity dropped and average wages grew, unit wage costs increased by 7.8%. As to financial data, the results of agriculture were worse than in Q4 2005. While output stagnated, production consumption rose; book value added fell by 3.7%.

Compared to 2005, the total production of cereals dropped by 16.6% and the total sowing area was by almost 5% smaller. The harvest of potatoes was down by 27.6% and sowing areas were by 6.5% smaller. The harvest of sugar beet decreased by more than 10%. The harvest of rape increased due to a larger sowing area and also due to a higher yield per hectare.

**Retail sales** (incl. repair of personal and household goods) increased by 6.2% y-o-y (constant prices) and in **sale, maintenance and repair of motor vehicles and motorcycles and retail of automotive fuel** by 7.4%. The growth of labour productivity in retail sales was faster than in 'sale, maintenance and repair of motor vehicles and motorcycles and retail of automotive fuel'. Book value added (current prices) in trade grew by 10.4%. Sales in **hotels and restaurants** dropped by 0.5% (constant prices); labour productivity decreased too.

*In January 2007, retail sales, incl. 'sale, maintenance and repair of motor vehicles and motorcycles and retail of automotive fuel', increased by 7.7% y-o-y.*

In **international tourism**, guests at collective tourist accommodation establishments recorded an upward trend and so did the overnight stays. Overnight stays per guest increased only among non-residents. In particular five-star hotels were successful in having clients. According to the frontier statistics on international visitor arrivals in the Czech Republic, the number of visitors decreased by 0.5% y-o-y. Czech resident departures increased by 2.9%. The active balance of tourism (as part of the balance of payments) stood at CZK 12.9 billion, which was down year-o-year.

Due to a change in organisation, the data on transport are not comparable between years. Subject to that, sales of own goods and services and goods for resale in **transport** were, like in previous quarters, lower than in Q4 2005. This had an impact on labour productivity which dropped in all activities that are comparable y-o-y, except for 'supporting and auxiliary transport activities', whereas the average wage grew in all modes of transport except for 'inland water transport'. Book value added (current prices) increased by 3.0% owing to higher increase of production consumption than of outputs. In rail transport of goods, the tonnage carried decreased y-o-y due to a significant fall of inland transport. The outputs dropped insignificantly. In road transport of goods, the tonnage carried increased and outputs grew considerably (almost by a third).

Sales in **communications** rose by 4.4% which is the highest figure among all quarters of 2006. Employment decreased and labour productivity grew faster than average wage. Book value added grew by 2.8% (current prices) due to faster growth of production consumption than of outputs.

**Financial intermediation** (excl. the CNB) reached a markedly higher gross profit; except for leasing companies, the profit increased in all groups of institutions. An all time high profit was recorded in investment companies and funds (rise by a factor of 7.5) and in insurance companies (rise by a factor of more than 3). The number of employees in 'financial intermediation' increased by 0.9% while the average wage grew by 7.4% and reached nearly CZK 40 thousand.

Sales in **other market services** were up by 4.6%, which was the highest growth among all quarters of the year. The highest sale increases were maintained by enterprises engaged in 'renting of machinery and equipment without operator' 'computer and related activities' and 'sewage and refuse disposal'. Among services provided predominantly to the population, sales in all service activities grew except for 'other service activities' (NACE 93). Employment in other market services was up by 6.5% y-o-y; the average monthly nominal wage grew markedly faster than labour productivity. Book value added produced was by 10.9% higher y-o-y. Nearly three-quarters of total sales were made in enterprises with fewer than 100 employees, but their sales decreased. The fastest sale increase was recorded for the medium-sized enterprises with 100-250 employees.

#### Sales\*) in selected CZ-NACE activities

Y-o-y indices in per cent

CZ-NACE activity		Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Year 2005	Q2 2005 to Q1 2006	Q3 2005 to Q2 2006	Q4 2005 to Q3 2006	Year 2006
Industry	Current prices	107.5	122.9	113.3	115.8	117.7	108.2	111.9	112.9	114.7	117.3
	Constant prices	107.5	122.5	111.8	113.0	115.1	105.1	110.3	112.1	113.6	115.5
Construction	Current prices	108.6	103.7	109.4	111.7	121.5	106.7	106.7	108.7	109.1	113.0
	Constant prices	106.0	101.2	106.5	108.3	117.7	103.7	104.1	106.0	106.1	109.8
Agriculture	Current prices	96.8	98.0	95.6	99.8	99.0	97.8	96.7	94.6	97.6	98.3
	Constant prices	102.8	99.5	91.4	97.2	96.7	108.0	104.6	98.4	98.1	96.3
Retail trade (CZ-NACE 50, 52)	Current prices	103.5	107.6	106.6	106.3	105.6	104.7	105.3	105.7	105.9	106.5
	Constant prices	102.6	106.8	105.9	106.3	106.6	104.1	104.5	104.7	105.3	106.4
Transport	Current prices	109.1	91.7	90.2	92.7	95.1	107.2	103.7	99.9	95.8	92.5
	Constant prices	104.8	89.5	88.3	91.2	95.6	103.5	100.3	97.1	93.5	91.3
Communications	Current prices	103.9	104.9	104.3	103.2	104.5	104.1	104.4	104.6	103.9	104.1
	Constant prices	106.8	104.8	103.4	102.7	104.4	108.1	107.3	105.9	104.3	103.7
Other market services	Current prices	106.9	107.8	108.2	107.5	108.9	105.6	106.4	107.8	107.6	108.2
	Constant prices	104.0	104.3	104.3	103.3	104.6	102.6	103.4	104.5	104.0	104.2

\*) 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** grew sizeably by 32.6% against Q4 2005 (current prices). Total yields increased by 15.5% and costs by 14.7%. At the same time, return on costs and return on equity capital grew. The number of loss-making enterprises decreased y-o-y and made up 37.0% of all enterprises. In the industry, gross profit grew y-o-y mainly due to 'electricity, gas and water supply', 'manufacture of basic metals and fabricated metal products' and 'mining and quarrying'. Outside the industry, the growth was contributed to by 'wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods' and 'construction'. **Book value added** produced in large corporations was by 13.4% higher y-o-y and grew in all institutional subsectors, most in foreign-controlled enterprises. Total inventories grew by 10.4% y-o-y at the end of 2006. Overcapitalisation, i.e. negative value of equity capital, was observed in the same number of enterprises as a year earlier, the volume of overcapitalisation dropped. The share of equity capital in the coverage of the balance sum decreased to 52.5%, the rest was covered by external resources. **Foreign-controlled enterprises** raised their book value added by 22.5% and gross profit by 34.2% y-o-y.

The level of consumer prices in Q4 2006 grew by 1.5% y-o-y, which was markedly less than in the previous quarters. This increase was mainly affected by the growth of prices of housing (by 1.1 p.p.; prices of electricity and heat grew and gas prices stagnated). Market prices rose by only 0.8%, regulated prices by 3.5%. Prices of goods were up by 0.6% and prices of services by 3.0%.

**Inflation rate**, measured as increase in the average index of consumer prices for last 12 months over the average for preceding 12 months, stood at 2.5% in December and decreased by 0.1 p.p. each month of Q4 2006.

*In January and February 2007, consumer prices grew by only 1.3% and 1.5% y-o-y, respectively.*

**Prices of agricultural producers** were up by 2.4% y-o-y. Crop product prices and animal product prices showed contrary trends. **Prices of industrial producers** rose by 2.2% (in 2006 by 1.6%). The growth of the overall price level was affected mainly by price increases in 'electrical energy, gas, steam and water', 'basic metals and fabricated metal products' and 'chemicals, chemical products and man-made fibres'. Lower prices were registered for 'coke, refined petroleum products and nuclear fuel' and also for 'transport equipment'. **Construction work prices** grew by 3.2% and **prices of market services** by 3.5%; especially prices of 'real estate, renting and business activities' rose. **Prices of tangible investments** were by 1.0% higher y-o-y.

*In January and February 2007, year-on-year, agricultural producer prices grew by 11.8% and 13.0% respectively, construction work prices by 3.2% in either month, industrial producer prices by 2.8% and 3.2% respectively. The smallest growth was recorded for prices of market services provided to the business sphere (by 2.0% and 1.5% respectively).*

**Prices of external trade** in goods were characterised by the increase of export prices and decrease of import prices (+0.5% and -1.6% respectively). Compared to Q4 2005, **terms of trade** improved and reached 102.1%; after six successive quarters they were for the first time above 100%. **World prices** of industrial raw materials and food measured by the CZSO index grew by 14.5% y-o-y on average in Q4 2006 and their growth slowed down.

Exports and imports at current prices rose by 17.0% and 16.0% y-o-y respectively. The trade balance surplus, which grew by CZK 5.4 billion y-o-y and reached CZK 6.6 billion, was affected favourably by a high trade surplus in machinery and transport equipment and lower trade deficit in mineral fuels. As to the commodity structure of external trade, increases in exports and imports were driven by machinery and transport equipment, whose y-o-y growth of exports by 20.7% was the highest among all sections of the SITC; the same applies to imports with an increase of 21.3%. In external trade by group of countries, exports to all groups of countries were up, exports to CIS countries, other states and European transition economies grew above the average; imports from other states and European transition economies rose at above-the-average rates. The surplus of external trade was concentrated in trade with developed market economies/EU25 and with European transition economies. The balance of trade with other states, CIS countries and developing economies was passive.

*In January 2007, exports and imports at current prices increased by 13.8% and 15.5% respectively, y-o-y. The trade balance was active by CZK 11.0 billion.*

The current account of the **balance of payments** ended in a deficit of CZK 50.4 billion in Q4 2006; the surplus of balance of services and transactions in goods was counteracted by deficits of the balance of revenues and current transfers. The financial account of the balance of payments reached a surplus of CZK 44.6 billion, which was more y-o-y mainly due to lower outward flows of net portfolio investments. Foreign exchange reserves hardly changed in Q4 2006 (unaffected by changing rate of exchange).

**Foreign exchange reserves of the CNB** reached CZK 656.6 billion at the end of 2006, which would be enough to cover 3.3 months' imports of goods and services.

The average **exchange rate** of the Czech **koruna** strengthened **against the euro** to 28.05 CZK/EUR and **against the US dollar** to 21.8 CZK/USD in Q4 2006, all y-o-y.

The y-o-y growth of **money supply M2** was higher than nominal growth of GDP at the end of 2006. Money supply M2 relative to the annualised volume of GDP was 61.9%, which was more than in Q4 2005. The acceleration of dynamics of money supply was contributed to by increased loans provided to enterprises and households; of a positive effect was also the growth of net government loan. The monetary aggregate **M1** was by 14% higher y-o-y in December; overnight deposits and money in circulation grew too. The share of monetary aggregate M1 in monetary aggregate M2 increased to 56.7% in Q4 2006.

Dynamics of total **deposits** at banks made up 9.4% y-o-y at the end of Q4 2006, **koruna** deposits recorded an increase of 9.3%. Total **loans** granted in December grew by 19.9% y-o-y (of which loans in CZK by 19.1% and loans in foreign currency by 25.6%). Loans to non-financial corporations grew faster. The y-o-y dynamics of housing loans remained at a high level.

In Q4 2006 the Czech National Bank left its basic rates unchanged, the limit 2T repo rate was fixed at 2.5%. The average **interest rate** on total **deposits** and total **loans** reached 1.25% and 5.86%, respectively, at the end of 2006. The **interest margin** between total rates on loans and total rates on deposits does not tend to fluctuate significantly and reached 4.4 p.p. in December: 5.5 p.p. in the household sector and 3.3 p.p. in the non-financial corporations sector.

The number of the only (main) job holders measured by the Labour Force Sample Survey reached 4.861,7 thousand in Q4 2006, which was by 58.0 thousand more y-o-y. The proportion of entrepreneurs increased. The rate of employment went up by 0.4 p.p. to 55.3%, whilst the participation rate dropped by 0.4 p.p. to 59.1%.

The number of workers in the economy of the CR (estimate) increased by 1.1% in comparison with Q4 2005, the registered number of employees in the economy reached 4 061.7 thousand. Their average wage was up by 6.3% and made up CZK 20 673. Nearly 250.8 thousand foreign nationals were employed in the Czech Republic at the end of 2006, of which 65.7 thousand were entrepreneurs.

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 1.9%. This is mainly attributable to foreign-controlled enterprises, where the increase was over a tenth. Decrease in employed persons continued in state-owned enterprises and in cooperatives. The average monthly gross nominal wage of employees grew by 6.2% and stood at CZK 21 952. Consumer prices were up by 1.5% and the average wage rose by 4.6% in real terms (the highest growth in 2006): by 5.1% in the business sphere and by 2.9% in the non-business sphere. The wage differentiation among individual CZ-NACE activities widened (the variation coefficient increased by 0.9 percentage points y-o-y in Q4 2006 and reached 34.3%).

The **registered unemployment rate** was 7.7% on 31 December, i.e. a decrease of 1.2 p.p. y-o-y. There were 448.5 thousand registered job applicants, of which 421.3 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 13.1% y-o-y; their percentage in the total number of the unemployed hardly changed y-o-y and remained high. The average number of unemployed school-leavers fell by 13.9% y-o-y compared with Q4 2005. The job vacancy rate was 2.3%. The highest unemployment rates persist in the districts of Most (19.5%), Karviná (16.9%) and Teplice (15.7%). The registered unemployment rate was 7.9% at the end of January and 7.7% at the end of February.

Per capita **net monthly money expenditures** reached CZK 10 193 in households of employees and CZK 8 905 in households of pensioners; they increased by 8.9 % and by only 3.1% respectively in real terms. The share of indispensable expenditures, i.e. expenditures on food, beverages and housing, decreased in both types of household: in households of employees to 36.6% and in households of pensioners to 52.6% of their total expenditures.

Total expenditures on **social security** increased by 5.6% y-o-y in Q4 2006 and their share in GDP was 10.3%. The fastest growth was registered for amounts paid as pensions (by 6.6%). As a result of the pensions adjustment as of 1 January 2006, the average old-age pension amounted to CZK 8 187 at the end of 2006, which was by 5.7% more y-o-y. As the cost of living of pensioners was up by 2.3% y-o-y in Q4 2006, the average old-age pension grew by 3.3% in real terms.

In the year 2006 the **state budget** recorded revenues CZK 923.1 billion and expenditures CZK 1 020.6 billion, which resulted in a deficit of CZK 97.6 billion at the end of 2006. The balance of the state budget deteriorated by CZK 41.2 billion, the deficit in relation to nominal GDP was more than 3%. Especially lower revenues from taxes on incomes of legal persons (due to a decrease in the rate of taxation) and taxes on incomes of the self-employed affected the revenue side of the state budget. Consumer taxes produced less than expected. The swift growth of expenditures is mainly attributable to higher pension expenditures and capital expenditures. The pension account showed a surplus of almost CZK 4 billion.

*The state budget reached a surplus of CZK 5.0 billion at the end of January, and a deficit of CZK 6.7 billion at the end of February.*

The **population** of the Czech Republic was 10 287 189 at the end of 2006, which was by 36.1 thousand more y-o-y. Of a decisive effect was still the active balance of external migration, while also annual natural increase has been positive for the first time since 1994. There were by 3 620 births more and by 3 497 deaths fewer y-o-y. In spite of a higher number of marriages, the nuptiality level remains low; the average age at the first marriage increased to 31.0 years for men and to 28.4 years for women. Divorces stagnated at a high level.

At the end of 2006, 2 480 481 businesses were registered in the **Business Register**, of which almost three-quarters were private entrepreneurs incl. self-employed farmers. The remaining part was legal entities, especially business companies and partnerships. The proportion of foreign-controlled companies in the number of legal entities keeps growing, being 27.1% in 2006. It is estimated that 50-55% of businesses registered in the Business Register are active in the long term.

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#### Comparison of development in the CR and the EU in Q4 2006: selected harmonised indicators

Harmonised indicator	EU25	Euro area	Germany	Slovakia	Czech Republic
Gross domestic product (constant prices), y-o-y change in %	3.4	3.2	3.5	9.6	5.8
Harmonised index of consumer prices (HICP)	2.0	1.8	1.3	3.5	1.1
Harmonised unemployment rate in % (Eurostat prediction)	7.5	7.4	7.2	12.0	6.8
Industrial production index (working days adjusted) in %	3.7	3.6	5.0	9.9	7.7
Construction output index (working days adjusted) in %	2.6	6.4	9.4	14.7	8.8
Retail sales index (seasonally adjusted) in %	3.4	2.6	1.2	11.2	6.8

Source: Eurostat (20 March 2007), calculations by CZSO