

CONTENTS

CZECH ECONOMY IN 2007: IS RAPID GROWTH SUSTAINABLE?

1. Summary and Outlook	2
2. External Environment	5
3. External Balance	7
4. Domestic Demand	10
5. Inflation	13
6. Monetary Policy and Exchange Rate	14
7. Labour Market	15

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CZECH ECONOMY IN 2007: IS RAPID GROWTH SUSTAINABLE?

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1. SUMMARY AND CONCLUSIONS

The year 2006 was another one of rapid economic growth in a context of solid macroeconomic stability. The GDP growth in 2006 amounted to 6.1 %, which was the same like in 2005. Economic expansion has remained strongly above the growth rates of developed European economies, demonstrating steady progress in the real convergence process. According to Eurostat, GDP per capita in 2005 was at 74 % of the EU 25 average, and, according to preliminary estimates, that improved by another 2 percentage points in 2006.

The structure of economic growth has notably changed in comparison with 2005, as domestic demand has become the leading growth factor. Investment demand was the main engine of growth, as it rose by 7.3 % year on year, in 2006. At the same time, consumer demand was strengthening from the beginning of the year. After growing by 2.8 % in 2005, it rose by 4.1 % y/y. This acceleration was confirmed in the following quarters, and so full-year growth in consumer demand amounted to 4.6 %. A mix of factors positively influenced consumer demand. The improving

situation on the labour market (as unemployment declined to 7.7 % at the end of 2006) combined with relatively low inflation to produce quite rapid growth in incomes. Meanwhile, credits to households also continued to grow briskly throughout the year, and that further supported consumer demand.

On the other hand, the impact on economic growth of foreign trade in goods and services was lower than in 2005, as the dynamics of exports and imports were very similar to one another. While 2005 had been the first year to achieve a foreign trade surplus, which had totalled CZK 39 bill., the trade surplus improved to just CZK 44 bill. for 2006. Although exports stayed on a solid growth course (14.6 %, y/y), imports rose at almost the same pace (14.2 %, y/y), driven by both high world fuel prices and strong domestic demand. The trade with services had an adverse effect on GDP growth, while the trade with goods affected the GDP growth slightly positively.

As for the supply side, manufacturing industry (with the share of 26 %) witnessed most rapid growth of value added (by 14 %, y/y). Out of services, trade reported most dynamic growth of 10.4 %, y/y, correspondingly to strong consumer demand. Financial services increased by 6.8 %, y/y.

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Table 1: Main Macroeconomic Indicators

		2001	2002	2003	2004	2005	2006	2007F
GDP	%, y/y	2.5	1.9	3.6	4.2	6.1	6.1	5.0
Inflation	%, y/y	4.1	0.6	1.0	2.8	2.2	1.7	2.5
Inflation	%, average	4.7-	1.8	0.1	2.8	1.9	2.5	2.0
Industrial prices	%, y/y	9.6	-0.7	0.9	7.7	-0.3	2.6	3.5
Unemployment rate*	%, eop.	8.9	9.8	10.3	9.5	8.9	7.7	6.5
Industrial production	%, real	6.7	1.9	5.5	9.6	6.7	9.7	9.0
Construction output	%, real	9.6	2.5	8.9	9.7	4.2	6.6	10.0
Retail sales	%, real	4.5	3.0	4.9	2.5	4.0	6.4	6.0
State budget	CZK bill.	-67.7	-45.7	-109.1	-93.7	-56.3	-97.6	-95
Trade balance	CZK bill.	-116.7	-70.8	-69.8	-26.4	38.6	44.4	60
Current account	% of GDP	-5.4	-5.5	-6.2	-6.0	-2.6	-4.2	-4.1
Current account	USD bill.	-3.3	-4.2	-5.7	-6.5	-3.2	-5.9	-6.5
Financial account	% of GDP	7.3	14.1	6.1	6.6	5.2	3.5	3.5
Financial account	USD bill.	4.5	10.6	5.6	7.1	6.5	4.9	5.5
FOREX reserves	USD bill.	14.8	23.7	27.0	28.4	29.5	31.3	32.5
PRIBOR 3M	%, average	5.2	3.6	2.3	2.4	2.0	2.3	2.7
CZK/EUR	average	34.1	30.81	31.84	31.9	29.78	28.34	27.5
CZK/USD	average	38.0	32.74	26.32	25.7	23.95	22.61	21.5

Source: Czech National Bank, Czech Statistical Office, forecasts by Komerční banka

*Note: As of July 2004, the unemployment rate is published according to the new methodology

Acceleration of industrial output above the 10% level appeared already from the beginning of 2006, driven by both foreign and domestic demand. The recovery in the euro zone, particularly in Germany, had a positive impact. The full year growth of industrial output was at 9.7 %. Five manufacturing industries (accounting for approximately one half of total output) played a key role: automotive industry, metal industry, electrotechnics, rubber and plastics, general machinery.

Automotive industry (accounting for approximately 15 % of industrial output) registered most rapid growth of 20.6 %, y/y. An important factor behind the acceleration in industry in 2006 was the improvement in metal industry, which rose by 8.8 %, y/y, in 2006, after a drop of 0.9 %, in 2005.

Generally, the importance of direct export sales increases, as well as the share of foreign controlled companies on total sales and their tendency to export. The effects of massive inflow of foreign direct investments have been strongly felt in the Czech industry. The penetration of firms under foreign control increased further. Foreign controlled industrial companies, which are strongly export oriented, have been the main driver of good machinery export performance and solid growth in industrial output.

The growth in construction accelerated in 2006, growth of output amounting to 6.6 %, y/y. The activities of foreign investors were concentrated on new assembly halls and shopping centres, government stood behind the construction of highways and railroads. Housing registered above average growth in 2006, increasing its share on total construction output to 18.7 %, which is still low within the European context: the share of housing amounts to approximately 40 % of construction output in developed European economies.

The main factors behind growth of housing construction remain the same: booming mortgage market, growth of loans from construction savings (both supported by low interest rates), demographic factors, solid growth of real incomes and expected changes in the VAT rate for housing construction. Mortgage market has kept dynamic growth between 40 and 50 %, y/y, in 2006, with a slowdown observable in Q4 2006.

The accelerating consumer demand was reflected, too, in retail sales. Retail sales

growth registered only minor fluctuations through the year and amounted to 6.4 % in 2006, which was the best result of the past decade. Acceleration in retail trade corresponded well with strengthening of consumer demand, supported by consumer credits. The major drivers have been consumer goods and cars, increasing by 7.7 % and 7.1 %, y/y, respectively. Spending was supported by a shift towards more expensive goods with higher quality, because of increasing living standard.

In 2006, the exports increased by 14.6 %, y/y, the imports rose by 14.4 %, y/y. The trade surplus amounted to CZK 44.4 bill., which was an improvement of CZK 5.8 bill. in comparison with 2005. At the same time, this was the best result in the history of the Czech Republic. The dynamics of foreign trade strongly accelerated in 2006; at the same time, the average growth of imports was almost the same like the growth of exports due to two reasons. Firstly, strong domestic demand provoked the imports and secondly, high world fuel prices pushed up the growth of imports in current prices.

Machinery, fuels and chemistry continued to be the key items for the trade balance. Machinery produced a record-high surplus of CZK 276.9 bill., which was an increase of CZK 64.6 bill. in comparison with 2005. Cars accounted for approximately two thirds of the machinery surplus. Fuels represented the highest burden for the trade balance, producing a deficit of CZK 138.9 bill., followed by chemistry. High world fuel prices hit strongly the trade balance in 2006 and deteriorated the developments of terms of trade.

The trade with EU 25 ended in a surplus of CZK 330.5 bill. (year over year improvement of CZK 58.5 bill.). The highest surpluses were generated in the trade with Germany (CZK 86.9 bill.) and Slovakia (CZK 70.3 bill.). The highest deficits were in trade with China (CZK 118.8 bill.) and Russia (CZK 83.4 bill.). Both these countries registered deterioration of the trade balance. While the deficit with Russia increased only in a small extent (by CZK 12.4 bill.), the deterioration of deficit with China was significant (by CZK 31.9 bill.). While the deterioration of trade with Russia was driven by fuel prices, the growing trade deficit with China was provoked by high domestic demand.

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Inflation continued to be low in the first quarter of 2007. Although in January some regulated prices were increased, as well as some consumption taxes, the y/y inflation was only 1.3 % - and the low trend persists. Czech National Bank therefore decided to change the medium-term inflation target, as of 2010, from 3 % (+1%) to 2 % (+-1%). The bank has stated that Czech Republic has become a low-inflation economy, and monetary policy has to be adapted to this fact (the same applies to inflation expectations, indirectly influenced by monetary policy).

Czech currency continued in appreciation trend during the whole year 2006. The appreciation was interrupted for a short time in July 2006 (as a consequence of an unclear result of parliamentary elections); the appreciation however accelerated in November and December 2006. On average, CZK appreciated by 4.8 % against the EUR and by 5.6 % against the USD, yearly averages amounting to 28.3 CZK/EUR and 22.6 CZK /USD. The appreciation trend stopped in the first quarter of 2007, due to changing sentiment concerning Central European markets (despite good macroeconomic parameters of the Czech economy). The Czech currency started to appreciate both against the EUR and USD at the end of March 2007, and this slight appreciation continued in April.

After the two increases of basic interest rates in the third quarter of 2006 (each time by 25 basis points), the CNB is keeping the repo rate at 2.5 %, the lowest rate among EU-27 and 125 basis points under the refi rate of ECB. Thanks to low inflation and again appreciating currency, the CNB can keep the basic rate at low levels also for the future.

In 2006, labour market registered further decline of the unemployment rate as a consequence of strong economic activity, the year-end unemployment rate amounting to 7.7 %, down from 8.9 %, in December 2005. Strong economic activity strongly promoted the offer of vacancies, which was record high, in 2006. However, there is a structural

mismatch between the offer of vacancies and the qualification structure of the unemployed. This structural mismatch has been connected with the developments of the long-term unemployment. Along with the notable decline in unemployment observed in previous two years, the share of long-term unemployment steadily increases. In the last quarter of 2006, the share of long-term unemployment further increased to 54.5 %. Low qualification and low education – these are the main characteristics of long-term unemployed persons.

Outlook

The quarterly GDP growth data (deceleration from 6.4 %, y/y, in Q1 to 5.8 %, y/y, in Q4) indicated that the peak of the business cycle is most probably over. We expect further gradual moderate slowdown for 2007. Both the consumer and investment demand should register some slowdown. We expect the GDP growth for 2007 roughly around 5 %.

Czech economy continues to be a low-inflation economy, nevertheless there are some risks of upward shift of CPI: first, world oil and raw material prices continue to be at high level, second, the expectations of price increases in 2008 and wage pressures could push inflation up, probably in the second half of 2007. For 2007, we expect end-of-year inflation in the range 2.5 – 3.0 %, and average inflation around 2.0 %.

Solid export performance driven by machinery will continue. However, the increase of machinery surplus will be lower than in 2006, since the production and exports of the car industry are close to the potential and the machinery imports will grow rapidly due to strong investment demand. In the last quarter of 2006, the terms of trade registered an upturn from decline to growth – this will most probably continue and will be helpful for the trade balance. Under the assumption that present increase in oil prices will be only a short-term one, the trade surplus will moderately increase in 2007; the full-year figure will amount to approximately CZK 60 -70 bill.

We expect the current account deficit to reach approximately CZK 150 bill., in 2007. This will represent stagnation of the ratio between the current account deficit and GDP slightly above 4 %. However, increasing stock of FDI combined with their increasing profitability creates some risky space for the

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external balance for the future. The share between reinvestments and dividends will be of high importance – more significant shift to dividends payments would lower the coverage of the current account deficit by non-debt financing.

In 2007, industry will continue to be the main driving force of economic activity. In the course of the year, the demand in the EU countries is expected to remain solid. However, the automotive industry seems to be close to its potential and the metal industry will probably not repeat a good result from 2006. For 2007, we expect growth of industrial output around 9 %.

The construction of infrastructure will continue, new projects of foreign investors are expected (e.g. Hyundai). 2007 will be the year of boom in housing construction before the expected VAT change. Therefore, the mortgage market will represent great challenge this year. In the first two months of 2007, the construction output rose by 31 %, y/y. This record high result will influence the full-year figure. However, these extremely high figures cause high level of uncertainty in the full-year forecast. If the forthcoming months will not bring extremely weak results, the full-year 2007 figure might amount to 10 %.

Good economic prospects accompanied by favourable developments on the labour market and solid growth of wages will support the propensity of the Czech households to spend. In addition, the effect of strong currency will act, making the imported goods cheaper. Consumer loans will continue to support the retail sales. Boom in housing sector has been supporting the retail sales of housing equipment. The full-year 2007 growth of retail sales could thus reach 6 %.

The figures from Q1 confirmed continuing improvement on the labour market driven by strong economic activity. The regular increase

in unemployment in Q3 caused by new school leavers entering the labour market will be only moderate this year due to demographic developments. At the end of 2007, we expect the unemployment rate around 6.5 %. Nevertheless, this decline will be driven only by the decline of short-term unemployment; the share of long-term unemployment will continue to grow due to preserving mismatch between the structure of vacancies and free labour force.

2. EXTERNAL ENVIRONMENT

2.1 World Economy

After three years when average growth of the world economy was just above 5 %, in 2007 it will return to the trend trajectory of 4.5 %. Slower growth should also result in a decrease of world inflation from 3 %, to around 2.5 %.

The economy most severely slowed in 2007 will be the U.S., due in the first place to a feeble housing demand. Weak growth in the U.S. will "spill over" to the economies of Euro area and Japan: in Euro area, it will contribute to growth slowdown; in Japan, prevent growth acceleration. Other factors hindering Euro area growth will be connected with tighter fiscal policies in this area, and with stricter monetary policy of the European Central Bank.

Problem of the Euro area economy is the low potential growth rate – between 2.25 % and 2.50 % - caused by structural problems, and by hesitation of some large countries (France, Italy) to carry out the necessary reforms. Growth in 2006 – 2007 has been around this potential rate. A shift of potential growth to, or above, 3 % can hardly be expected in the short- or medium-time horizon.

In sharp contrast to this is the rapid growth of China and India. In the last years, the government of China tried several times to

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Table 2: World Economic Development, 2005-2007

(GDP growth in %, constant prices)

	2005	2006p	2007f
USA	3.2	3.3	2.1
Japan	1.9	2.2	2.2
China	10.4	10.7	10.5
India	8.3	9.1	8.0
Euro area	1.5	2.7	2.2
Latin America	4.5	5.2	4.5
World	4.7	5.2	4.6

Source: Société Générale, Deutsche Bank, forecast by Komerční banka

slow economic growth down double-digit to one-digit figures, without success. Chinese GDP will in 2007 (and, probably, in 2008) again grow by more than 10 %. Further moderate increase of interest rates and exchange rate can be expected, yet not to an extent sufficient to dampen economic growth.

Rapid Chinese and Indian growth will keep the demand for raw materials (oil, metals) at high levels in the world markets. The basic scenario for oil prices is the interval of USD 60 – 65 per barrel, but a strong volatility around this interval cannot be excluded. Oil prices will also stay at the present high levels, but another fast rise similar to that of 2006 is not likely – which is a good prospect for both world and regional inflation rates.

For the Czech economy, external demand will not pose any significant "downward" risk in 2007. Euro area exports, especially German, will further grow, in spite of the strengthening euro. Further appreciation of koruna against the dollar can, to some extent, dampen the impact of high world commodity prices on domestic producer prices, and on inflation. The basic risks thus lie in possible geo-political events (conflicts in the Middle East, or problems with North Korea), or shocks in the financial markets. However, their probability is not seen as higher than 10 – 15 %.

2.2.4 CE Countries

All four Central-European new EU member countries showed fast economic growth in 2006 - exceeding twice or 2.5 times the average growth in Euro area (see Table 3). Their growth was mainly driven by exports and consumer demand – with the exception of Hungary, where sluggish consumer demand was the main cause of lagging behind the other Visegrad countries. In 2007, the gap between the other three countries and Hungary is expected to widen further.

As to inflation, Poland and Czech Republic were below 2 % in 2006 (1.0 % and 1.7 %,

respectively) – while Slovakia (4.5 %) and Hungary (6.5 %) to a large extent exceeded the Maastricht criterion. In the case of Slovakia who aspires to join the Euro area in 2009, bringing inflation down to the level required by Maastricht criteria is the basic, lasting problem of monetary policy in 2007.

The four countries also vary in the level of market interest rates. On the one side, there is Czech Republic where the 3M PRIBOR has been under the 3M EURIBOR during the last almost two years (Czech Republic in 2006, and in Q1/2007, had the lowest interest rates among all EU-27 countries). The other three countries, in contrast, had interest rates between 7 – 9 % in 2006. That has some consequences in financial markets: in the Czech Republic, the volume of credit in foreign currency has fallen sharply – while for example in Hungary, foreign-currency-denominated credit represents almost 50 % of all credits granted (included mortgages taken by households).

As mentioned above, Slovakia keeps her goal to join the Euro area in 2009. Policies and forecasts of the National Bank of Slovakia give hope that the country can succeed to bring inflation below 3.5 % – and fulfil the last nominal criterion which it so far has been violating. The probability of euro adoption by Slovakia in 2009 can be assessed at 70 %, at least.

The other three countries have so far not announced their intentions officially, as to the timing of euro adoption. Expert evaluation of the situation in individual countries, regarding the fulfilment of Maastricht criteria, especially the deficit of public finance and inflation, leads to the following ranking: Poland and Czech Republic could adopt the euro in 2012–2013, Hungary in 2014–2015.

However, the case of Slovakia points to a serious problem, facing also the other three countries: the requirement to stay in the ERM-II system for the minimum of two years. For all four countries this means – or will mean – a change from free float back to the system of fixed exchange rates, with all

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Table 3: Growth in CE-4 Countries, 2005-2006
(GDP growth in %, constant prices)

	2005	2006p	2007f
Poland	3.5	5.8	5.2
Hungary	4.2	3.9	2.2
Slovakia	6.0	8.2	8.5
Czech Republic	6.1	6.1	5.0

Source: Société Générale, Deutsche Bank, forecast by Komerční banka

disadvantages that a fixed exchange rate has for small, open and catching-up countries. Slovakia entered the ERM-II system in November 2005, that is, more than three years before the expected EMU entry. The reason why Slovakia decided to fix the exchange rate for more than the required two years was political: the central-right government coalition wanted to bind any future government, which would result from the spring-2006 election, to uphold the strategy of euro adoption in 2009. This policy, in the end, proved to be effective.

Yet at the same time the clear disadvantages of staying in the ERM-II system became apparent. The central parity on entering the ERM-II was set at 38.45 SKK/EUR (+15 %, which means that the exchange rate could fluctuate between 32.69 and 44.22 SKK/EUR). Strong inflows of foreign direct investment, plus high GDP and exports growth rates, however pushed the Slovak koruna permanently toward the upper (appreciation) limit of the fluctuation band. A number of interventions by the National Bank of Slovakia failed to help. On March 19, 2007, the NBS (in agreement with the ECB) was forced to revalue the central parity by 8.5 % to 35.44 SKK/EUR. It is clear what this step can mean for Slovak exporters. Yet the problem persists: appreciation pressures continue, and some experts admit that Slovakia will again have to revalue the currency in 2007, or at the start of 2008, to keep it within the required band.

Currencies of the other three countries (zloty, forint and Czech koruna) will face the same danger, as soon as they enter the ERM-II system. The European Commission and ECB refuse to loosen the requirement of a two-year stay in ERM-II system for the new member countries (for example, allowing

them to avoid an official announcement of ERM-II entry, and, instead, examining and testifying ex post their two-year exchange-rate stability within the ± 15 % interval). It follows that for these countries, the only solution is a) shorten the stay in ERM-II to the necessary minimum of 24 months; b) set the central parity carefully on entry – with overvaluation better than undervaluation; c) undertake the change of central parity, if necessary, as a series of smaller steps, rather than one jump – an approach which however would first have to be approved by the ECB.

3. EXTERNAL BALANCE

In 2006, the current account deficit notably increased, confirming thus that a very low deficit in 2005 was a consequence of unique mix of favourable factors unsustainable in the longer run. The deficit of the current account increased to CZK 133.8 bill., up from CZK 77.1 bill. in 2005. Basic indicator of the external balance – the share of current account deficit on GDP increased as well in 2006, amounting to 4.2 % of GDP, after 2.6 % from 2005. The surplus of financial account reached CZK 111.6 bill., with foreign direct investments being the most important part of the inflow of investments.

3.1 Current Account

Table 4 shows that the trade balance was the only item registering year over year improvement, though a very modest one. Balance of services, balance of incomes and transfers deteriorated from a year earlier. Balance of incomes continued to represent the main volume part of the current account as well as the item with highest deficit. In addition, the balance of services deteriorated

Table 4: Balance of Payments, (CZK bill.)

	2003	2004	2005	2006
Current account	-160.6	-167.3	-77.1	-133.7
o.w. Foreign trade	-69.8	-26.4	38.6	44.4
Balance of services	13.2	12.5	20.3	12.5
Balance of incomes	-119.9	-157.8	-155.7	-183.4
Transfers	15.8	4.3	19.7	-7.2
Capital account	-0.1	-14.0	4.9	8.6
Financial account	157.1	183.7	154.8	111.6
o.w. Direct investments	53.5	100.8	279.6	104.3
Portfolio investments.	-35.7	59.4	-81.2	-26.9
Financial der.	3.9	-3.2	-2.8	-6.3
Long-term capital	27.5	57.0	32.7	45.0
Short-term capital	107.9	-31.2	-73.5	-4.5

Source: Czech National Bank

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(surplus of CZK 12.5 bill.) and the transfers turned to the red (CZK -7.2 bill.).

Trade balance registered a surplus of CZK 44.4 bill., in 2006, improving by CZK 5.8 bill. in comparison with 2005. The trade balance thus did not continue in strong improvement which had been observed in 2005. The exports rose by 14.6 %, y/y, the imports increased by 14.4 %, y/y. The growth of exports and the imports was thus almost the same, which was different from 2005, when the growth of exports strongly surpassed the growth of imports. The growth of exports remained very solid; however, the imports grew rapidly as well, particularly by two reasons. Firstly, the prices of fuels were at high levels in the first three quarters of the year; secondly, the imports were pushed up by strong domestic demand.

The activities in foreign trade have been more and more concentrated to three commodity groups: machinery (including cars), fuels and chemistry. Strong export performance of machinery driven by automotive industry has been able to compensate for increasing deficits in fuels and still high deficits in chemistry. The full-year surplus in trade with machinery amounted to record high CZK 276. bill. Approximately two thirds of this surplus belongs to the automotive industry, which accounts for 17 % of total exports. However, the deficits in fuels amounted to record high level of CZK 140 bill., as well. High world prices of fuels represented a heavy burden for the trade balance in particular during the first three quarters of the year. In the last quarter of 2006, the price of oil declined to the levels similar to those of the Q4 2005, therefore the year over year effect of fuel prices on the trade balance weakened.

High fuel prices strongly negatively affected the developments of terms of trade, in the first three quarters of the year. In 2006, the import prices rose by 0.8 %, y/y, driven in particular by the expensive fuels (the import prices of fuels rose by 20 %, y/y, in Q1 – Q3 2006). On the other hand, the export prices fell by 0.8 %, y/y, in 2006. The decline in export prices was caused predominantly by the appreciation of the Czech currency. In addition, the global tendency of increasing competition on the world markets played some role as well. Low-cost exporters as China or India entered the world markets with machinery production. Czech exporters must adapt their prices to be competitive enough on the world markets.

Terms of trade thus deteriorated by 1.6 percentage points in 2006. However, in the course of the year, the situation has been improving; in the first quarter the terms of trade deteriorated by 4.8 percentage points, improving gradually to the increase of terms of trade by 2.1 percentage points in the last quarter. In 2006, the Czech trade balance registered a trade loss due to the developments of terms of trade, amounting approximately to CZK 40 bill. If the export and import prices had remained at 2005 levels, the full-year 2006 trade surplus would have reached approximately CZK 80 bill.

According to the data of ECFIN, Czech economy is one of the most opened ones within the EU: the share of exports of goods and services on GDP amounted to 75 % of GDP which placed the CR to the sixth position in EU 25, in 2006. The main trading partner continued to be the EU, with 85 % of the exports and 70 % of the imports. The trade balance with the EU further improved, in 2006,

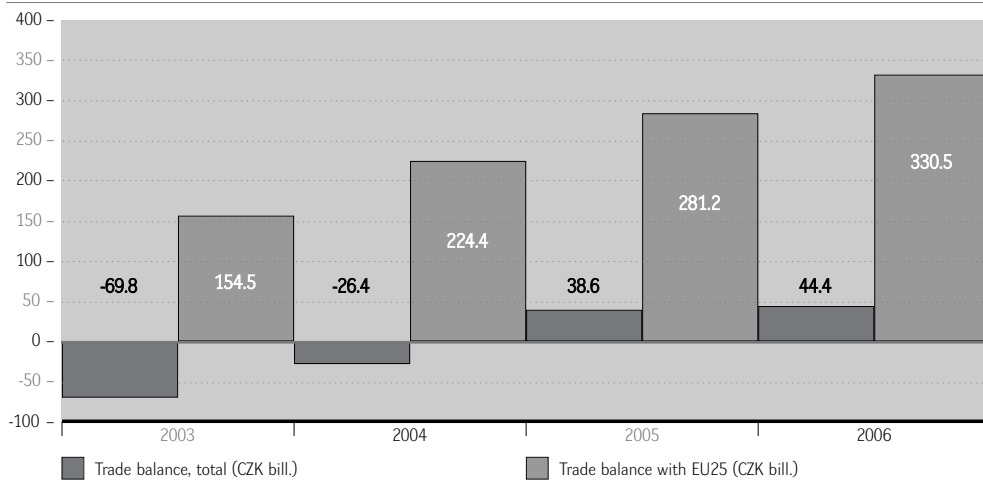
Balance of incomes continued to represent the main volume part of the current account as well as the item with highest deficit.

The full-year surplus in trade with machinery amounted to record high CZK 276. bill. Approximately two thirds of this surplus belongs to the automotive industry, which accounts for 17 % of total exports.

High world prices of fuels represented a heavy burden for the trade balance in particular during the first three quarters of the year.

In 2006, the Czech trade balance registered a trade loss due to the developments of terms of trade, amounting approximately to CZK 40 bill. If the export and import prices had remained at 2005 levels, the full-year 2006 trade surplus would have reached approximately CZK 80 bill.

Figure 1: Trade Balance: Whole World and the EU 25



Source: Czech Statistical Office

with the surplus increasing to CZK 330 bill. The highest surpluses were generated in the trade with Germany (CZK 86.9 bill.) and Slovakia (CZK 70.3 bill.). The highest deficits were produced by China (CZK 118.8 bill.) and Russia (CZK 83.4 bill.). Both these countries registered deterioration of the trade balance. While the deficit with Russia increased only in a small extent (by CZK 12.4 bill.), the deterioration of deficit with China was significant (by CZK 31.9 bill.). Also the reasons behind the deterioration differed: the deterioration of trade with Russia was driven by fuel prices, the growing trade deficit with China was provoked by high domestic demand.

The main source of the current account deficit was again the balance of incomes, with the deficit of CZK 183.4 bill. The balance of incomes deteriorated by CZK 27.7 bill., in 2006, due to increasing penetration of the companies under foreign control in the Czech economy together with their increasing profitability, which pushes up the expenditures of the balance of incomes. The expenditures of the balance of incomes reached record high level of CZK 304.8 bill., increasing by 16.6 %, y/y. The expenditures connected with previous FDI inflow account for CZK 180.3 bill., i. e. 60 % of total expenditures of the balance of incomes.

These expenditures are made by the reinvestments of profits, dividend payments, and interests from FDI loans. The tendency from reinvestments of profits to payments of dividends continued, in 2006. For the first time in history, the volume of dividends (estimated at CZK 89.4 bill.) exceeded the volume of reinvested profits (CZK 82.1 bill.). The volume of profits repatriated from the Czech Republic thus amounted to 2.8 % of GDP.

After separation of the balance of incomes into individual balances (see Table 5), the impact of FDI on the overall deficit is clearly visible. The incomes consist from two main parts: the incomes on compensations of employees and the incomes from investments.

Major part of the deficit of the balance of incomes has been represented by the incomes from the investments, out of which the FDI accounted for major part of the deficit. In 2006, the deficit of incomes from FDI amounted to CZK 171.1 bill. On the other hand, the balances of portfolio investments and other investments were in the black. Compensations of the employees produced a deficit of CZK 35.7 bill.

Balance of services reported a surplus of CZK 12.5 bill., i.e. deteriorated by CZK 7.8 bill: the surpluses in transport (CZK 33.9 bill.) and tourism (CZK 53.1 bill.) are to lower and lower extent able to compensate for the growing deficits of the other services (CZK - 74.5 bill.). Other services include many different kinds of services as telecommunication, insurance, financial, legal, accounting and consulting services, the imports of which have been steadily on the rise. Increasing penetration of the companies under foreign control has been one of the reasons behind rapid growth of imports of these kinds of services. The effect of FDI on the current account has thus been a mixed one: the improvement of the trade balance is accompanied by rapid deterioration of the balance of incomes, as well as some negative effect on the balance of services.

3.2 Financial Account

Financial account reported net inflow of CZK 111.6 bill., main source of incomes being FDI. FDI net inflow amounted to CZK 104.3 bill., in 2006. The total FDI inflow was at CZK 134.7 bill., (USD 6 bill.), approximately one half of the 2005 inflow, while the investments of Czech companies abroad amounted to CZK 30.4 bill. Reinvestments of profits made the main part of FDI inflow (CZK 82.1 bill.). The inflow to basic capital represented approximately one quarter of total inflow (CZK 35.5 bill.), FDI loans amounted to 17.1 bill. The cumulative inflow of FDI up to the end of 2006 thus amounted to approximately CZK 1800 bill. (USD 60 bill.).

The balance of incomes deteriorated by CZK 27.7 bill., in 2006, due to increasing penetration of the companies under foreign control in the Czech economy together with their increasing profitability.

Major part of the deficit of the balance of incomes has been represented by the incomes from the investments, out of which the FDI accounted for major part of the deficit. In 2006, the deficit of incomes from FDI amounted to CZK 171.1 bill.

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Table 5: Balance of Incomes: Individual Balances (CZK bill.)

	1995	2000	2005	2006
Balance of incomes: total	-2.8	-53.0	-155.7	-183.4
<i>Of which:</i>				
Compensation of employees balance	2.3	-12.0	-23.5	-35.7
Investments incomes balance	-5.1	-41.0	-132.2	-147.7
<i>Out of investments:</i>				
Balance of FDI	1.9	-53.6	-147.8	-171.1
Balance of portfolio investments	-5.8	-7.5	6.3	4.3
Balance of other investments	-1.2	20.1	9.3	19.1

Source: Czech National Bank

Portfolio investments reported a net outflow of 26.9 bill. The main cause was strong investment activity of Czech investors abroad, with their purchases of foreign portfolio investments amounting to CZK 68.4 bill. The inflow of portfolio investments to the CR has been steadily quite low. Therefore, the impact of portfolio investments on the balance of incomes is positive and the investment position of the CR in the segment of these investments is positive (in a small surplus of CZK 45 bill.).

Other investments showed net inflow amounting to CZK 40.5 bill. Long-term loans registered net inflow of CZK 45 bill., continuing inflow was due to the Government activities and increasing loans of domestic companies abroad. Short-term money reported net outflow of CZK 4.5 bill., which was partly a consequence of the very low Czech interest rates.

At the end of 2006, foreign indebtedness amounted to CZK 1217 bill., increasing by 6.5 %, y/y. Foreign indebtedness thus amounted 38 % of GDP which is very close to the sensitive level of 40 % of GDP. Nevertheless, the structure of the indebtedness has been favourable with 69 % represented by long-term indebtedness (see Figure 2) and the total indebtedness driven only by the long-term one.

4. DOMESTIC DEMAND

4.1 Industry

Since the beginning of 2006, industry registered the acceleration to double digit growth rates both of output and sales. Growth in industry was supported by the recovery in the eurozone, in particular in Germany as well as by strong domestic demand. The industry thus reported record-high growth since 2001 (i.e. in the period for which the time series in current methodology are available). In 2006, industrial output rose by 9.7 %, industrial sales increased by 10.3 %, y/y.

The output of manufacturing rose by 10.5 %, y/y, driven by five key industries: automotive industry, metal industry, electrotechnics, rubber and plastics, general machinery. These industries account for approximately one half of total industrial output.

The leader of Czech manufacturing continues to be the automotive industry, which accounts for approximately 15 % of industrial output. Automotive industry registered highest growth (out of all the industries), with production increasing by 20.6 %, y/y. This means a slowdown against 2005 (23 %, y/y), nevertheless only a small one. In H1 2006, car industry rose by 26.9 %, y/y.

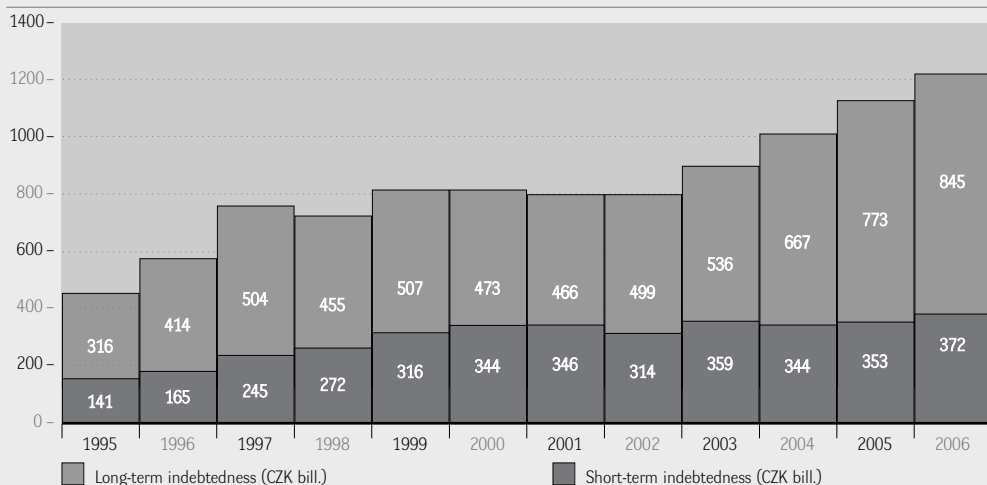
Table 6: The Inflow of FDI to the CR

	1993-97	1998	1999	2000	2001	2002	2003	2004	2005	2006
USD bill.	1.3	3.7	6.3	5.0	5.6	8.4	2.1	5.0	11.7	6.0
CZK bill.	41.3	120.0	218.8	192.4	214.6	277.7	59.3	127.8	279.2	134.7
% of GDP	n.a.	6.0	10.5	8.8	9.1	11.3	2.3	4.6	9.4	4.2

Source: Czech National Bank

FDI net inflow amounted to CZK 104.3 bill., in 2006. Reinvestments of profits made the main part of FDI inflow (CZK 82.1 bill.).

Figure 2: Foreign Indebtedness (CZK bill.)



Source: Czech National Bank

At the end of 2006, foreign indebtedness amounted to CZK 1217 bill., increasing by 6.5 %, y/y. Foreign indebtedness thus amounted 38 % of GDP which is very close to the sensitive level of 40 % of GDP.

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y/y, in H2 a slowdown to 15.1 %, y/y, occurred. This slowdown was caused by the effect of strong statistical bases from H2 2005, due to new capacity of TPCA in Kolín.

Electrotechnics and general machinery reported excellent results in 2006, growing by 16.3 % and 18 %, y/y, respectively. An important factor behind the acceleration in industry in 2006 was the improvement in metal industry, which rose by 8.8 %, y/y, in 2006, after a drop of 0.9 %, in 2005. Metal industry accounts for approximately 15 % of total industrial output. This industry has been strongly sensitive to fluctuations of the global demand for metal production on world markets, in particular on the emerging ones. Rubber and plastics performed well, increasing by 14.6 %, y/y; this industry has been profiting from boom in the automotive industry.

The fastest growing industries show similar features: high propensity to exports and high penetration of foreign controlled companies. The share of export sales on total industrial sales amounted to 48.5 %, in 2006, on average. In the case of car industry the share of export sales exceeds 70 %, in the case of electrotechnics and general machinery the respective share amounts to approximately two thirds.

The share of foreign controlled companies on total sales has been increasing as well as their propensity to export. The share of foreign controlled companies on total sales amounted to 56.3 %, in December 2006 (up from 52.1 %, in December 2005), the share of exports on sales in the segment of foreign controlled companies further increased to 73.9 % (up from 71.1 %, in December 2005). Therefore, the companies under foreign

control account for approximately 90 % of direct export sales, while their share on purely domestic sales is much lower – approximately one quarter.

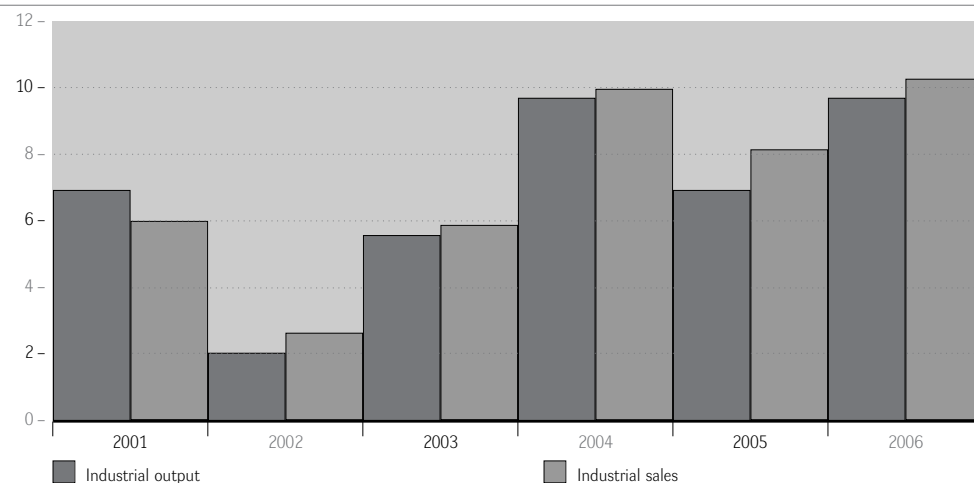
The growth of productivity went along with the growth of output and was highly above the growth of real wages. In 2006, productivity in manufacturing rose by 9.2 %, y/y; real wage increased by 3.4 %, y/y. The decline of unit labour costs enables to keep the competitiveness of Czech industrial exporters on foreign markets even under appreciating currency. Strong CZK has been hitting the exporters and slowing down the exports, however, not to a significant extent.

The developments of the beginning of 2007 indicate very good results driven by solid foreign demand as well as by continuing robust domestic demand. Both January and February have seen double digit growth rates, the cumulative figure amounting to 13 %, y/y. The structure of growth seems to be unchanged with the exception of metal industry which has been reporting sluggish results in recent months.

4.2. Construction

In 2006, the construction output rose by 6.6 %. In the course of the year, the results were strongly affected by weather conditions: first quarter results were adversely influenced by extremely tough winter; on the other hand, last quarter figures were strongly promoted by favourable weather conditions in November and December. Correspondingly, the growth rates in individual quarters notably differed: after stagnation (0.5 %, y/y) in Q1 2006, construction accelerated to 6.2 % and 7.4 %, in

Figure 3: Industrial Output and Industrial Sales (growth rates in %, y/y)



Source: Czech Statistical Office

The fastest growing industries show similar features: high propensity to exports and high penetration of foreign controlled companies.

The companies under foreign control account for approximately 90 % of direct export sales, while their share on purely domestic sales is much lower – approximately one quarter.

Q2 and Q3, respectively. Last quarter registered highest growth of 9.5 %, y/y.

Construction was driven by the activities of foreign investors focused on new assembly halls and shopping centres, government stood behind the construction of highways and railroads. Housing registered above average growth in 2006, increasing its share on total construction output to 18.7 %. However this is still a low figure in the European context: in the old EU countries, the share of housing amounts to approximately 40 %.

Construction of 43.7 thousands of dwellings was started in 2006, i.e. by 8.3 % more year-on-year. 30.2 thousands of dwellings were completed (decline of 8.1 %, y/y). 168.8 thousands of flats were under construction, which was a y/y increase of 8.7 %. Increasing scope of flats under construction has been caused by lack of capacities; the investors also prefer starting to finishing of new projects in the unclear atmosphere before the expected change in VAT (effective as of January 2008).

Long-lasting factors behind growth of housing construction remain the same: developing mortgage market, growth of loans from construction savings (both supported by low interest rates), demographic factor, expected changes in the VAT rate for housing construction. Mortgage market has kept dynamic growth between 40 and 50 %, y/y, in 2006, with some slowdown observed in Q4 2006. In December 2006, the volume of loans on housing amounted to CZK 448.4 bill., out of which mortgages on housing made for CZK 304.8 bill. Total volume of loans on housing thus represented 14 % of GDP, at the end of 2006.

Mild winter was helpful for the construction

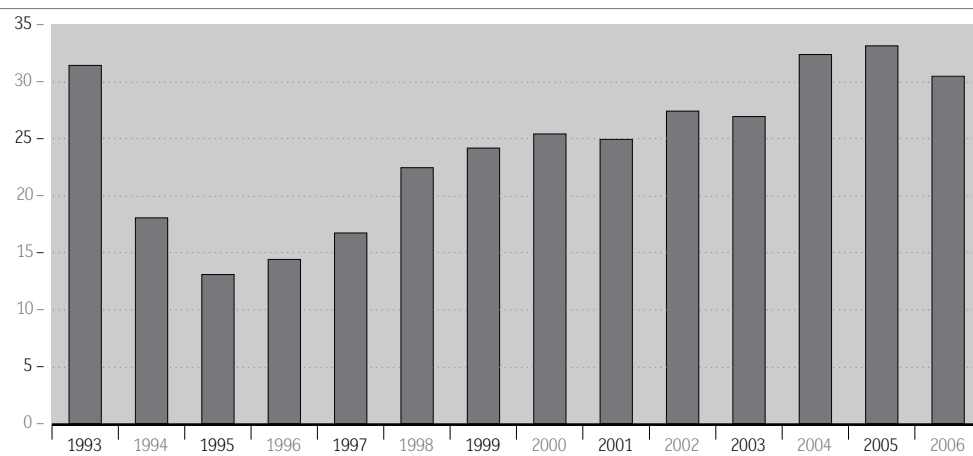
also at the beginning of 2007. In the first two months of 2007, the construction output rose by 31 %, y/y. This record high result will influence the full-year figure. However, these extremely high figures cause high level of uncertainty in the full-year forecast.

4.3 Retail Trade

Along with the acceleration of consumer demand, also the retail sales registered higher growth than a year before. In 2006, retail sales grew by 6.4 %, up from 4.0 %, y/y, in 2005. The dynamics did not register significant fluctuations in the course of the whole year, moving between 6.1 and 6.9 %, y/y, in individual quarters.

Mix of factors influencing consumer demand has been very favourable: strong economic activity, declining unemployment, solid growth of real wages and low inflation. The rapid growth of disposable incomes has been accompanied by increasing propensity to borrowing. At the same time, the range and feasibility of various types of consumer credits has been growing. At the end of 2006, the volume of consumer credits (granted by financial institutions) amounted to CZK 101 bill, with year over year growth rates around 30 % in the course of the year. Credits granted by non-financial institutions play an important role, as well. In addition, some mortgage products offer combined types of credits, with the possibility to finance also housing equipment. According to the statistical surveys, about 20 % of Czech households are currently newly equipping (or changing the equipment) their flats or houses. Similar to housing boom, the demographic factor plays a favourable role in this respect.

Figure 4: Completed Flats (in thousands)



Source: Czech Statistical Office

Long-lasting factors behind growth of housing construction remain the same: developing mortgage market, growth of loans from construction savings, demographic factor, expected changes in the VAT rate for housing construction.

Mix of factors influencing consumer demand has been very favourable: strong economic activity, declining unemployment, solid growth of real wages and low inflation.

The equipment of households was one of the main drivers of rapid growth in retail sales, in 2006, with sales increasing by 11 %, y/y. The most rapidly growing item was the clothing and footwear, with growth of 17.9 %, y/y. Total segment of consumer goods (non-food items) registered full-year growth of 7.7 %, y/y. Food sales grew by 4.8 %, y/y, showing thus the shift to higher growth trajectory, from about 3 % growth observed in previous years. Due to increasing purchasing power, the customers are more and more willing to buy more expensive foods of better quality. This applies for some other kinds of consumer goods (in particular clothing, cosmetics, etc.) as well.

Sales in the automotive segment, which accounts for approximately one third of total volume of retail trade, rose by 6.3 %, y/y, in 2006. Car sales increased by 7.1 %, y/y, and were thus another important driver of overall rapid growth. Car sales accelerated from a year earlier (4.9 %, y/y). Volume of fuel sales increased by 4.8 %, y/y, notably less than sales in current prices, which rose by 7.6 %. Some sensitivity of customers to high petrol prices thus appeared.

The tendency of increasing preferences of customers to big retail chains continued. The growth of sales in this segment was permanently above the overall dynamics. The tendency, observable in previous year, that is growing preferences to discount stores, in comparison with hypermarkets, continued as well. The penetration of foreign controlled companies is very high in the segment of big

retail trade companies (above 100 employees); these multinational retail chains account for 80 % of the market. As a consequence of extremely tough competition on this segment of the market, some big chains already decided to leave the Czech market.

5. INFLATION

5.1 Consumer Prices

In spite of a relatively fast growth of the Czech economy, inflation pressures remained low in 2006 (see Table 7). Despite growing prices of oil and metal products, year-over-year growth of CPI in the first three quarters was slightly below 3 % (i.e. the CNB inflation target). Last quarter of 2006 dramatically changed the inflation picture. Together with some decrease of oil prices, competition in the domestic market kept prices at low levels. The year-over-year inflation was, at the end of 2006, at 1.7 %, visibly under the lower band of CNB inflation target. CNB acknowledged (tacitly) the undershooting of the target and, at the end of January 2007, changed the inflation forecast for December 2007 from 3.2 – 4.6 % to 2.4 – 3.8 %.

Inflation continued to be low in the first quarter of 2007. Although in January some regulated prices were increased, as well as some consumption taxes, the y/y inflation was only 1.3 % - and the low trend persists. Czech National Bank therefore decided to change the medium-term inflation target, as of 2010, from 3 % (+1%) to 2 % (+-1%). (More see below).

Figure 5: Retail Sales and Consumer Demand, (growth rates in %, y/y)



Source: Czech Statistical Office

Figure 6: Retail Sales – Total Sales, Cars, Consumer Goods, 2003- 2006, (growth rates in %, y/y)



Source: Czech Statistical Office

In 2006, consumer goods and cars were the main drivers of acceleration in retail sales.

5.2. Producer Prices

After a sharp fall of producer prices in 2005, the first quarter of 2006 brought their stagnation – and, in the following four quarters, producer price inflation increased (see Table 8). At the end of 2006, PPI stood at 2.6 %, y/y. The average growth of PPI in 2006 amounted to 1.6 %, which was the lowest average growth within previous three years.

In the first quarter of 2007, the increase of PPI continued, for the following reasons:

- oil prices grew again above the level of 60 USD per barrel;
- fast economic growth in China, India and some other countries keeps the demand high for metals and metal products, with resulting high prices;
- increased grain prices push the prices of food products up;
- CZK appreciation against the dollar has stopped, so that the exchange rate could not compensate for increasing import prices.

Nevertheless, PPI growth in the Czech Republic remains under the average of EU-27. In manufacturing, producer price index, due to strong competition, is visibly under the level of the overall PPI growth, acting as an effective constraint of PPI inflation.

6. MONETARY POLICY AND EXCHANGE RATE

Czech koruna continued to appreciate in 2006, both against the EUR and the USD. Appreciation was caused by good macroeconomic data (strong HDP growth, active trade balance, continuing FDI inflows). On average, the Czech currency appreciated by 4.8 % against the EUR and by 5.6 % towards the USD.

The appreciation trend towards euro was registered mainly in the fourth quarter of 2006, while appreciation against the dollar was permanent, being stronger in the second

and fourth quarters of 2006 (see Table 9). As indicated above, the strong Czech currency attenuated the influence of high oil, gas and metal prices on the Czech economy.

In the first quarter of 2007, appreciation of Czech koruna against both the euro and the dollar stopped. The reason can be seen in the prevailing markets sentiment toward most currencies in the region, rather than in fundamentals of the Czech economy (growth continued, inflation was under market expectations, trade balance was further improving) – or in political reasons (Czech Republic, at last, had government approved by the Parliament, after more than six months). However, this market sentiment faded away, and since the second half of March 2007, Czech currency is again appreciating, moderately against the euro, more vigorously against the USD.

Since the second quarter of 2005, the 3M PRIBOR has kept below the level of 3M EURIBOR. The split increased from the original 20 - 30 basis points to 130 basic points in March 2007. The last two years thus represent a period of historically lowest interest rates in the Czech Republic (see Table 10). This situation, together with the highly competitive climate in Czech banking and financial markets, creates a very favourable entrepreneurial climate. Borrowing in foreign currencies fell sharply; Czech firms make use of the situation and take koruna-denominated credits.

After the two increases of basic interest rates in the third quarter of 2006 (each time by 25 basis points), the CNB is keeping the repo rate at 2.5 %, the lowest rate among EU-27 and 100 basis points under the refi rate of ECB. Thanks to low inflation and again appreciating currency, the CNB can keep the basic rate at low levels also in the future.

At its meeting on March 8, 2007, the CNB Bank board approved the CNB's new inflation target as a annual consumer price index

Czech National Bank decided to change the medium-term inflation target, as of 2010, from 3 % (+-1%) to 2 % (+-1%). The bank has stated that the Czech Republic has become a low-inflation economy, and monetary policy has to be adapted to this fact.

Czech koruna continued to appreciate in 2006, both against the EUR and the USD. Appreciation was caused by good macroeconomic data (strong HDP growth, active trade balance, continuing FDI inflows).

Since the second quarter of 2005, the 3M PRIBOR has kept below the level of 3M EURIBOR. The split increased from the original 20 - 30 basis points to 130 basic points in March 2007. The last two years thus represent a period of historically lowest interest rates in the Czech Republic.

Table 7: CPI Inflation, Q1/2006 – Q1/2007

(in %, e.o.p.)

Q1/2006	Q2/2006	Q3/2006	Q4/2006	Q1/2007
2.8	2.8	2.7	1.7	1.9

Source: Czech statistical Office

Table 8: PPI Inflation, Q1/2006 – Q1/2007

(in %, e.o.p.)

Q1/2006	Q2/2006	Q3/2006	Q4/2006	Q1/2007
0.3	1.8	2.4	2.6	3.6

Source: Czech statistical Office

Table 9: Exchange Rates, Q1/2006 – Q1/2007

(monthly averages, e.o.p.)

	Q1/2006	Q2/2006	Q3/2006	Q4/2006	Q1/2007
CZK/EUR	28.65	28.38	28.38	27.78	28.06
CZK/USD	23.83	22.44	22.30	21.02	21.19

Source: Czech National Bank

Table 10: 3M PRIBOR, Q1/2006 – Q1/2007

(monthly averages, e.o.p.)

	Q1/2006	Q2/2006	Q3/2006	Q4/2006	Q1/2007
	2.08	2.16	2.49	2.56	2.56

Source: Czech National Bank

growth of 2 % (with a tolerance band of plus minus 1 %), effective from January 2010. The new target will replace the current target of the Czech National Bank of 3 % (plus minus 1 %) which was announced in March 2004 and took effect in January 2006. The CNB will continue to view its inflation target as a medium-term one which actual inflation may deviate from temporarily as a result of exogenous shocks.

The CNB declared in the explanation of its decision that the Czech economy is a low-inflation economy. The existing trends confirm that the Czech economy is capable of achieving high rates of growth while maintaining a low level of inflation and a moderate trend of appreciation of the nominal exchange rate of the koruna. Prices of tradable commodities are showing downward flexibility thanks to combination of subdued wage growth and high productivity growth in the industry. In this situation it is appropriate - according to CNB - to move the inflation target to a lower level in line with the practice in advanced countries.

The main problem with the new target will be the question whether the inflation expectations of financial market participants (or all economic subjects) are anchored at a low level for a longer period of time. This will be crucial for the success of the monetary policy in the years to come.

7. LABOUR MARKET

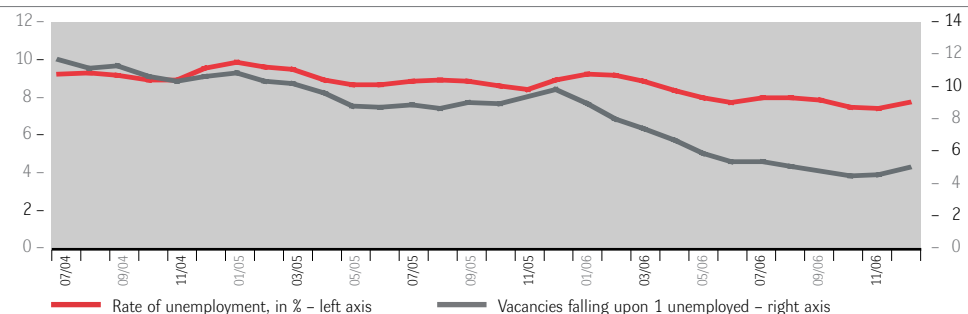
In 2006, the improvement on labour market driven by strong economic activity continued. At the end of 2006, the rate of unemployment amounted to 7.7 %, which was a significant decline from a year earlier (8.9 %). The number of unemployed was strongly below the half-million bar (448.5 thousands) and was by 12 % less, y/y. Strong economic activity accelerated the offer of vacancies, which was record high, in 2006. At the end of the year, there were 93.4 thousands of vacancies and only 5 unemployed fell upon one vacancy (the UV ratio stood at 4.8). However, there is a structural mismatch between the offer of vacancies and the qualification structure of the unemployed. Almost 30 % of unemployed have no (or very low qualification); in this group, there falls approximately 10 unemployed upon one vacancy.

This structural mismatch has been connected with the developments of the long-term unemployment. Along with the notable decline in unemployment observed in previous two years, the share of long-term unemployment steadily increases. In the last quarter of 2006, the share of long-term unemployment further increased to 54.5 %, up from 53.4 %, in Q4 2005. More than one third of the unemployed was jobless longer than two years. Low qualification and low

In 2006, the improvement on labour market driven by strong economic activity continued. At the end of 2006, the rate of unemployment amounted to 7.7 %, which was a significant decline from a year earlier (8.9 %).

The share of long-term unemployment steadily increases. In the last quarter of 2006, the share of long-term unemployment further increased to 54.5 %.

Figure 7: Rate of Unemployment and the UV Ratio



Source: Ministry of Labour and Social Affairs

education – these are the main characteristics of long-term unemployed persons. In the groups of people with lower education, the rate of unemployment is higher as well as the share of long-term unemployment. Both the specific rates of unemployment and the shares of long-term unemployment significantly differ as for the level of education as indicates Table 11.

The unemployed (especially long-term unemployed persons) are not qualified and educated enough to get better paid (and qualified) jobs. At the same time, they are not willing to take low paid jobs due to still generous social system as there is only a minor difference between the amount of social benefits and wages for low qualified jobs. Tendency of increasing long-term unemployment starts to be visible also in the group of people with completed secondary education. The offer of jobs for lower administration staff declines as these activities are gradually less labour intensive. Therefore, also in this segment of the labour

market, the UV ratio is close to 10 people falling upon one vacancy.

Low flexibility caused by inappropriate institutional framework of the Czech labour market is one of the most important factors behinds the unfavourable developments of the long-term unemployment. There are various reasons for the low flexibility, the most important among them being low regional mobility, high direct taxation of wages (in particular in the case of low wages), increasing ratio of the minimal wage to average wage, still high costs on dismissing employees with permanent contract and inadequate regulations for temporary work. It is worth mentioning that minimal wage in the course of 2006 increased by more than 10 %, to CZK 7955. This exceeded hugely the increase of nominal average wage, which amounted to 6.5 %, y/y. For the time being, the analyses made by the Czech National Bank consider the low flexibility of the labour market as one of the most important obstacles to the eurozone entry.

Table 11: Education and Unemployment (Q4 2006)

Education	Rate of Unemployment (in %)	Share of Long-term Unemployment (in %)
Basic	22.5	70.5
Secondary uncompleted	7.2	53.8
Secondary completed	4.4	42.2
University	1.8	40.2
Total	6.6	54.5

Source: Czech Statistical Office

Table 12: The Ratio between Minimal Wage and Average Wage, in %

1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
23.4	22.7	28.4	33.4	34.1	36.3	37.0	37.5	38.2	40.5

Source: Czech National Bank

Table 13: Growth of Nominal and Real Wages (growth rates in %)

	2001	2002	2003	2004	2005	2006
Nominal wages	8.7	7.2	6.8	6.6	5.5	6.5
Real wages	3.8	5.3	6.7	3.7	3.5	3.9

Source: Czech Statistical Office

Low flexibility caused by inappropriate institutional framework of the Czech labour market is one of the most important factors behinds the unfavourable developments of the long-term unemployment.

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