CZECH
NATIONAL
BANK

ANNUAL

REPORT

1998

CONTENTS:

Foreword

Most assessments of the Czech economy for 1998 tend to emphasise its negative aspects. Economic performance declined, unemployment rose at a fast pace, and households' real incomes fell. The poor financial situation, indebtedness and insolvency of many firms also hit the banking sector hard. However, such situations do not arise overnight: they always have their long-term causes. Last year's economic difficulties can be viewed above all as a consequence of the previous slowdown in necessary reforms and the deferring of essential institutional and structural changes.

However, 1998 did have its positive features. After several years, the imbalance in basic whole-economy relations started to be corrected. Domestic demand and supply, productivity and wages were harmonised, the trade and current account deficits narrowed sharply and the rapid increase in external gross indebtedness was halted. These developments stemmed from prudent macroeconomic policy – the lessons had been learned from the exchange rate crisis in 1997 and from the identification of the causes which preceded it. The Czech currency did not fall victim to the exchange rate crises which occurred in many other regions. On the contrary, its exchange rate strengthened, which, among other things, brought about a multi-billion-crown loss in the central bank's performance.

The Czech National Bank applied an inflation targeting strategy for the first time in 1998. The reasons for this have been explained many times; now that the CNB has abandoned the fixed exchange rate regime, the inflation target plays the role of nominal anchor for the overall financial system and represents a platform for transparent monetary policy and a wide social consensus in economic stability. As is known, a sharp disinflation occurred last year, and at the end of the year price indices were moving at exceptionally low levels. This unexpected trend was partly due to a profound decline in consumer demand connected with growing unemployment and social incertitude. However, the predominant cause has to be seen in external factors, namely the fall in prices of raw materials and food on global markets, which had a major impact on the Czech economy. Once this impact has been absorbed, inflation is expected to return to its earlier-predicted trajectory.

In view of the low-inflationary environment and the economic situation in the Czech Republic, the CNB radically lowered interest rates and the minimum reserve requirement for banks. However, this cannot go on so far as to lead to a repeat of the situation which brought about the monetary crisis in 1997. Experience from past years confirms clearly that growth founded on rapid expansion in domestic demand can only be of a short-term nature and is connected with a widening of external deficits, pressure for a weakening of the exchange rate and higher inflation. Therefore, the CNB's target is to create conditions for balanced and sustainable growth. However, this is a long-term process which must tied to essential structural and institutional changes. Whether and when the desired turnaround occurs in the Czech economy depends solely on the success of these changes.

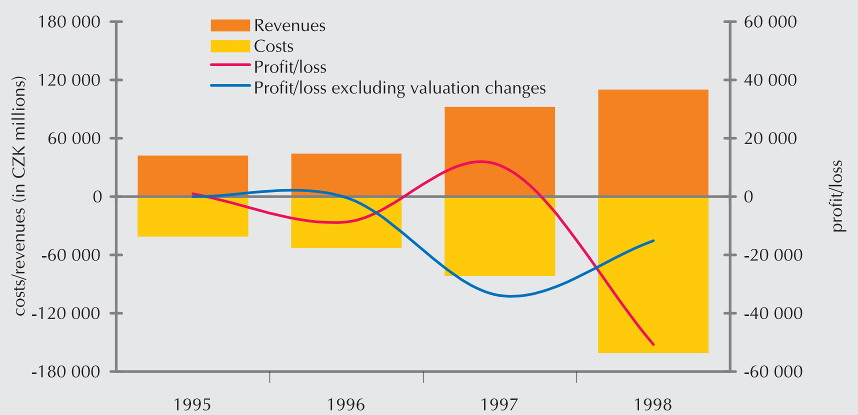
Josef Tošovský
Governor

I. CNB PERFORMANCE REPORT

The Czech National Bank's performance in 1998 reflects the combined effects of its monetary policy measures, the creation of reserves and provisions by virtue of its involvement in the consolidation programme for the banking sector, and, above all, the koruna's appreciation. The bank ended the January–December 1998 period with a loss of CZK 50.7 billion, with expenses of CZK 160.4 billion and income of CZK 109.7 billion.

The above loss was mainly due to a reduction in the koruna value of the CNB's international reserves. It also resulted from the relatively high sterilisation costs generated, among other things, by the lowering of the minimum reserve requirement by 2 percentage points with effect from the end of July 1998, which led to a rise in the free liquidity of banks. Another item strongly affecting the bank's results was the creation of reserves and provisions in connection with the programme of banking sector consolidation. The above cost factors were partly offset by income from international reserves and from the sale of gold. The following chart shows the CNB's performance in 1995–1998.

Chart I.1 CNB performance in 1995-1998



During 1998 the koruna appreciated by 13% against the US dollar, 7% against the Deutsche Mark and 2% against the Japanese yen. Owing to this nominal appreciation, the koruna value of the CNB's international reserves (which were worth USD 12.6 billion as of 31 December 1998) was lower than at the beginning of the year; in accounting terms, this was recorded as valuation changes. Given the extent of the international reserves and the floating exchange rate regime, the consequences of exchange rate fluctuations (which in 1998 caused the CNB to lose CZK 35.6 billion) are a very volatile component of the CNB's performance. In 1997, their impact was positive (CZK 44.7 billion), and thanks to the current koruna depreciation they could give rise to a sizeable profit in 1999. Given the current excess of foreign exchange assets over liabilities, exchange rate movements will continue to strongly influence the CNB's profit and loss account in future years as well. However, this indicator will not reveal the true level of the bank's economic efficiency.

In 1998, the Czech National Bank sterilised the free liquidity of banks exclusively through repo operations. This liquidity increased thanks to the lowering of the minimum reserve requirement and also to an inflow of foreign, and often short-term, capital. During 1998, a total of CZK 134 billion was sterilised on average, up 60% from 1997. The costs of repo operations amounted to CZK 20.4 billion.

The CNB is bearing the costs and losses associated with the banking sector consolidation programme. The costs in 1998 were generated mainly by the need to create reserves and provisions (CZK 26.1 billion) both for the assets and guarantees recorded in the CNB's books and for the losses suffered by

Česká finanční, s.r.o. (since 1 March 1997 a wholly-owned subsidiary of the CNB), which manages most of the assets within the consolidation programme. The overall costs of the consolidation programme are expected to reach CZK 87.3 billion, of which CZK 60.6 billion is covered by reserves and provisions (with a total of CZK 34.5 billion created in previous years) and CZK 8.8 billion is realised loss (the difference between the nominal and sale price of receivables and securities sold to Česká finanční, s.r.o. in 1997, write-offs of claims on banks and payment of financial compensation in connection with the support of integration processes). The remaining CZK 17.9 billion is covered by a state guarantee worth CZK 22.5 billion issued to the CNB by the Czech Government in compliance with Decree No. 51 of 22 January 1997. It should also be noted that the creation of reserves and provisions is based on the estimated return on assets, taking into account prudential principles. The actually realised loss may thus be lower.

The net income from management of the CNB's international reserves (excluding the influence of valuation changes) totalled CZK 14.6 billion, up CZK 842 million compared with 1997. This was due to an increase in the volume of the reserves (from USD 9.8 billion at the end of 1997 to USD 12.6 billion at the end of 1998) and to a higher rate of return on them (the weighted average return on foreign exchange portfolios stood at 4.39% p.a., up by 0.55 percentage points).

In March and April 1998, the Czech National Bank sold 55.78 tonnes of gold for a total of CZK 16.4 billion (at USD 327 per troy ounce and USD 320 per troy ounce respectively). The decision to sell was taken because of the diminishing importance of gold as a reserve asset, the drop in gold prices in the long run and the low yields arising from holding it.

The CNB's income was also affected by the dissolution of provisions and reserves worth CZK 31.6 billion connected mainly with the restructuring of receivables within the consolidation programme. (This restructuring meant at the same time a rise in expenses due to the creation of reserves and provisions.)

In the operating area, the CNB ended 1998 with a 3.1% higher loss than in 1997. Operating costs accounted for 1.4% of overall expenses, while operating income accounted for 0.1% of total income. Operating costs were up by 1.4%, or about CZK 30 million, against 1997. This growth is the lowest in the last three years. Personnel costs (wages and social and health insurance) totalled CZK 614 million, write-off expenses CZK 571 million, rents for operating premises CZK 386 million, and VAT CZK 120 million (VAT paid at entry is reflected in expenses, as the CNB cannot apply for a deduction owing to the volume of its financial activities).

In 1998, the CNB simplified its organisational structure. As a result, the number of managers was reduced by more than 40% and the number of jobs by 277 (ie by more than 15%).

Investment totalled CZK 15.118 billion and had the following structure.

Capital investment stood at CZK 13.333 billion and was directed at increasing the initial capital of Česká finanční s.r.o. in connection with financing the purchase of receivables within the banking sector consolidation programme.

Construction investment totalled CZK 1.523 billion in 1998, ie about 1% less than in 1997. Most of these funds were channelled into the reconstruction of the CNB's headquarters[x)]. About CZK 43 million was spent on finishing the reconstruction of the branch office in Brno. This means that the entire network of CNB branches has been completed and put into operation. The CNB's branches are located in Plzeň, České Budějovice, Ústí nad Labem, Hradec Králové, Brno and Ostrava. (The reconstruction of

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x) In 1997, the CNB commenced the reconstruction and modernisation of its headquarters in Prague 1. This project, involving an area of more than 9,630 m^2 and an enclosed space exceeding 300,000 m^3, was started because many of the structures and technological systems of the Banking Palace (built in 1935-1942) and the Corn Exchange (1893-1895) had reached the end of their physical life span, had been seriously damaged by external physical processes, or did not meet the present requirements. The aim of this general reconstruction is to repair the buildings, build the necessary functions of the central bank and improve the operating functionality and technological level and security of clearing and dealing operations, cash and safes administration and information systems. The project is being carried out (in difficult conditions at the edge of the Prague Monuments Area) by a major supplier chosen in a public tender. It should be completed in the second half of 1999. The sum allocated for this investment project from the start of the preparatory work to the end of 1998 was CZK 2.932 billion (of which CZK 1.474 billion in 1998).

the Prague branch is taking place as part of the reconstruction of the CNB's headquarters.) The branches mainly provide premises for the custody and management of cash reserves and for other CNB activities, in particular the maintaining of the accounts of budgetary organisations, state funds and state financial assets and liabilities.

Non-construction investment amounted to CZK 332 million, which is about 38% less than in 1997. Much of this amount was used to finance projects and to buy application software from suppliers (CZK 137 million). The remaining part was spent mostly on computer hardware and system software, local and long-distance data communication equipment, office furniture and equipment, and cash handling equipment.

CZECH NATIONAL BANK
BALANCE SHEET AS AT 31 DECEMBER 1998

in millions CZK

No.	ASSETS	Line	Current accounting period			Previous
			Gross	Adjustments	Net	accounting
a	b	c	1	2	3	4
1.	**Gold**	1	**541.08**	**-**	**541.08**	**3,921.79**
2.	**Receivables from International Monetary Fund**	2	**26,319.92**	**-**	**26,319.92**	**24,962.55**
2.1.	in foreign currency	3	0.01	-	0.01	0.01
2.2.	in CZK	4	26,319.91	-	26,319.91	24,962.54
3.	**Receivables from abroad**	5	**402,674.95**	**262.76**	**402,412.19**	**364,195.45**
3.1.	in foreign currency	6	402,674.95	262.76	402,412.19	364,195.45
3.1.1.	deposits with foreign banks	7	16,427.11	-	16,427.11	60,391.97
3.1.2.	loans provided to foreign banks	8	16,356.39	-	16,356.39	60,148.38
3.1.3.	securities	9	343,733.49	262.76	343,470.73	217,495.89
3.1.4.	other receivables from abroad	10	26,157.96	-	26,157.96	26,159.21
3.2.	in CZK	11	-	-	-	-
4.	**Receivables from domestic banks**	12	**53,836.35**	**13.90**	**53,822.45**	**78,367.52**
4.1.	receivables from refinancing	13	-		-	7,766.58
4.2.	other receivables from domestic banks	14	53,836.35	13.90	53,822.45	70,600.94
5.	**Receivables from clients**	15	**32,672.92**	**3,559.65**	**29,113.27**	**18,978.97**
6.	**Domestic securities and shares**	16	**36,895.39**	**19,717.50**	**17,177.89**	**3,845.03**
	included therein: shares and other financial investments	17	17,177.88	-	17,177.88	3,844.88
7.	**Current result of state budget**	18	**-**	**-**	**-**	**-**
8.	**Other receivables from state budget**	19	**-**	**-**	**-**	**-**
9.	**Cash**	20	**868.71**		**868.71**	**2,035.03**
10.	**Other assets**	21	**14,052.20**	**2,251.11**	**11,801.09**	**8,777.02**
10.1.	tangible assets	22	8,437.30	1,969.21	6,468.09	5,299.21
10.2.	intangible assets	23	670.11	278.22	391.89	344.48
10.3.	deferred expenses and accrued revenue	24	574.99	-	574.99	1,038.81
10.4.	others	25	4,369.80	3.68	4,366.12	2,094.52
	TOTAL ASSETS	26	**567,861.52**	**25,804.92**	**542,056.60**	**505,083.36**

CZECH NATIONAL BANK
BALANCE SHEET AS AT 31 DECEMBER 1998 (continued)

in millions CZK

No.	LIABILITIES	Line	Current accounting period	Previous accounting period
a	b	c	5	6
1.	**Currency in circulation**	27	**146,059.74**	**139,145.56**
2.	**Liabilities to International Monetary Fund**	28	**26,319.91**	**24,962.54**
2.1.	in foreign currency	29	-	-
2.2.	in CZK	30	26,319.91	24,962.54
3.	**Liabilities to abroad including securities**	31	**11,382.72**	**24,112.52**
3.1.	in foreign currency	32	10,952.13	23,699.44
3.1.1.	loans taken from abroad	33	1,883.28	14,339.33
3.1.2.	bond issues	34	9,068.85	9,360.05
3.1.3.	other liabilities to abroad in foreign currency	35	-	0.06
3.2.	in CZK	36	430.59	413.08
4.	**Liabilities to domestic banks**	37	**275,927.47**	**205,119.12**
4.1.	bank monetary reserve	38	86,605.68	89,829.51
4.2.	other liabilities	39	189,321.79	115,289.61
5.	**Deposits from clients**	40	**31,811.84**	**40,828.26**
6.	**Domestic securities issued**	41	**-**	**-**
7.	**Current result of state budget**	42	**-**	**-**
8.	**Other liabilities to state budget**	43	**28,370.49**	**26,825.21**
9.	**Reserves**	44	**54,369.66**	**27,501.38**
10.	**Share capital**	45	**1,400.00**	**1,400.00**
11.	**Funds**	46	**8,234.12**	**6,185.65**
12.	**Retained profits / (accumulated losses)**	47	**-**	**(8,653.84)**
13.	**Profit / (loss) for accounting period**	48	**(50,740.07)**	**10,744.57**
14.	Other liabilities	49	8,920.72	6,912.39
14.1.	deferred revenue and accrued expenses	50	1,060.94	1,096.74
14.2.	others	51	7,859.78	5,815.65
	included therein: settlement accounts of local authorities resources	52	4,840.83	3,896.71
	TOTAL LIABILITIES	53	**542,056.60**	**505,083.36**

CZECH NATIONAL BANK
OFF-BALANCE SHEET AS AT 31 DECEMBER 1998

in millions CZK

No.		Line	Current period	Prior period
a	b	c	7	8
1.	**Contingent liabilities**	54	**79,423.34**	**75,960.65**
1.1.	accepted bills of exchange and endorsed bills	55	-	790.22
1.2.	issued guarantees	56	79,423.34	75,170.43
1.3.	obligation from collaterals	57	-	-
2.	**Other irrevocable liabilities**	58	**-**	**-**
3.	**Receivables from spot, term and option operations**	59	**75,006.05**	**64,708.87**
4.	**Liabilities from spot, term and option operations**	60	**77,379.21**	**66,084.62**
5.	**Guarantees received**	61	**52,100.28**	**22,500.00**

Note:

In the 1998 data, CNB-bills are recorded as CNB-bills in REPO operations and in the inventory in accordance with international accounting standards. The data for 1997 have been adjusted accordingly (assets: lines 16 and 21, liabilities: line 41).

The annex to the profit and loss account is available from the Office of the CNB at the CNB 's headquarters, DAREX, Václavské nám. 11, Praha 1.

CZECH NATIONAL BANK
PROFIT AND LOSS FOR PERIOD ENDED 31 DECEMBER 1998

in millions CZK

No.	ITEM	Line	Current period	Prior period
a	b	c	1	2
1.	**Interest income**	1	**57,449.86**	**40,908.81**
1.1.	interest from securities with fixed income	2	37,883.70	21,309.49
1.2.	other	3	19,566.16	19,599.32
2.	**Interest expense**	4	**55,881.11**	**34,065.42**
2.1.	interest from securities with fixed income	5	27,461.59	15,693.84
2.2.	other	6	28,419.52	18,371.58
3.	**Income from securities with variable income**	7	**-**	**36.55**
3.1.	income from shares	8	-	36.55
3.2.	income from shares in subsidiaries	9	-	-
3.3.	income from shares in associates	10	-	-
3.4.	income from shares in affiliates	11	-	-
4.	**Income from fees and charges**	12	**512.65**	**551.78**
5.	**Expenses from fees and charges**	13	**52.25**	**100.65**
6.	**Profit / (loss) from financial operations**	14	**(41,301.87)**	**39,610.73**
7.	**Other income**	15	**68.05**	**95.31**
7.1.	income from money issue	16	19.84	19.43
7.2.	other	17	48.21	75.88
8.	**Administration expenses**	18	**2,073.33**	**1,962.98**
8.1.	personnel expenses	19	613.58	608.32
8.1.1.	wages and salaries	20	441.32	443.61
8.1.2.	social security	21	131.19	124.11
8.1.3.	health insurance	22	41.07	40.60
8.2.	other operating expenses	23	1,459.75	1,354.66
9.	**Charge to specific and general provisions for tangible and intangible assets**	24	-	-
9.1.	charge to general provisions for tangible assets	25	-	-
9.2.	charge to specific provisions for tangible assets	26	-	-
9.3.	charge to specific provisions for intangible assets	27	-	-
10.	Release of specific and general provisions for tangible and intangible assets	28	-	-
10.1.	release of general provisions for tangible assets	29	-	-
10.2.	release of specific provisions for tangible assets	30	-	-
10.3.	release of specific provisions for intangible assets	31	-	-
11.	**Other expenses**	32	**436.08**	**5,766.56**
11.1.	expenses for issuing bank notes and coinage	33	296.44	366.28
11.2.	other	34	139.64	5,400.28
12.	**Charge to specific and general provisions for loans and guarantees**	35	**13,739.40**	**20,864.44**
13.	**Release of specific and general provisions for loans and guarantees**	36	**31,597.52**	**922.68**
14.	**Charge to specific and general provisions for investments and other financial investments**	37	**-**	**-**
15.	**Release of specific and general provisions for investments and other financial investments**	38	**-**	**-**
16.	**Charge to other specific and general provisions**	39	**27,052.73**	**8,626.30**
17.	**Release of other specific and general provisions**	40	**183.00**	**-**
18.	**Tax on results from ordinary activities**	41	**-**	**-**
19.	**Ordinary profit / (loss) after taxation**	42	**-**	**-**
20.	**Extraordinary income**	43	**3.33**	**14.24**
21.	**Extraordinary expenses**	44	**17.71**	**9.18**
22.	**Tax on extraordinary result**	45	**-**	**-**
23.	**Extraordinary profit / (loss) after taxation**	46	**-**	**-**
24.	**Profit / (loss) for accounting period**	47	**(50,740.07)**	**10,744.57**

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REPORT OF INDEPENDENT AUDITORS

TO THE BANKING BOARD OF THE CZECH NATIONAL BANK

We have audited the accompanying balance sheet of the Czech National Bank ("ČNB") as at 31 December 1998, the related income statement and notes for the year then ended. These financial statements and underlying accounting records are the responsibility of the management of ČNB. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the Auditing Standards of the Chamber of Auditors of the Czech Republic and International Standards on Auditing. Those auditing standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the accompanying financial statements present fairly, in all material respects, the assets, liabilities and equity of ČNB as at 31 December 1998, and the results of its operations for the year then ended in accordance with the Act on Accounting and other relevant accounting legislation of the Czech Republic.

Without qualifying our opinion, we draw attention to the matters described in the following paragraphs.

As set down in Note 10 f of the Notes to the Financial Statements, ČNB's assets include CZK 26,122 million of receivables from Národní banka Slovenska resulting from the separation of the assets and liabilities of the former Státní banka československá and from the losses resulting from the split of the federal currency. The ultimate collection of this receivable depends on the result of on-going negotiations between both parties. At present, it is not possible to evaluate the outcome.

PRICEWATERHOUSECOOPERS

REPORT OF INDEPENDENT AUDITORS (continued)

As set down in Note 25 of the Notes to the Financial Statements, the Government has issued a guarantee to ČNB to cover potential losses on ultimate realisation of assets amounting to CZK 22,500 million which were acquired from certain commercial banks to provide stability to the banking sector. This guarantee was signed on 19 March 1997 and lasts for ten years from that date. ČNB is required to make provisions for these potential losses during the life of this guarantee in order to limit any final settlement arising from the guarantee. These provisions will be created only when sufficient income to cover the provisions is earned. However, it is not possible to ascertain the amount of provisions ČNB will create.

10 March 1999

PricewaterhouseCoopers

PricewaterhouseCoopers Audit, s.r.o.
Registered Auditing Company
Licence No. 21

František Linhart
Auditor
Licence No. 150

II. ORGANISATIONAL CHANGES WITHIN THE CNB IN 1998

In 1998 the Czech National Bank comprehensively rationalised its organisational structure in order to simplify the system, establish more flexible links in internal management and generally increase the effectiveness of the CNB's activities.

The system of management was simplified both vertically and horizontally, creating conditions for an overall "downsizing". Six special-purpose organisational units were abolished: the Central Branch Office, Payment Systems, Technical and Administration Services, Banking Security Services, Branch Office 701, the Institute of Economics and all agencies at the CNB's branch offices. The activities carried out by these units were rationalised and either transferred to other units or terminated. The new arrangements eliminated duplication of activities, established a link between methodological and executive activities, and assigned the main bank functions and technological, economic and administrational activities within the top management of the bank. The internal organisational structure of individual sections was further flattened.

The functional restructuring was accompanied by a personnel restructuring, with a substantial reduction in the number of jobs in the new organisational units and sections. In total, the number of posts was cut by 277, or 15.8%. The number of managers was reduced by 42%.

The CNB's new organisational structure was approved by the Bank Board on 10 February 1998 and came into effect on 1 June 1998. The Organisational Manual continues to be the principal cross-sectional intra-bank norm, fulfilling at the same time the role of statute of the central bank.

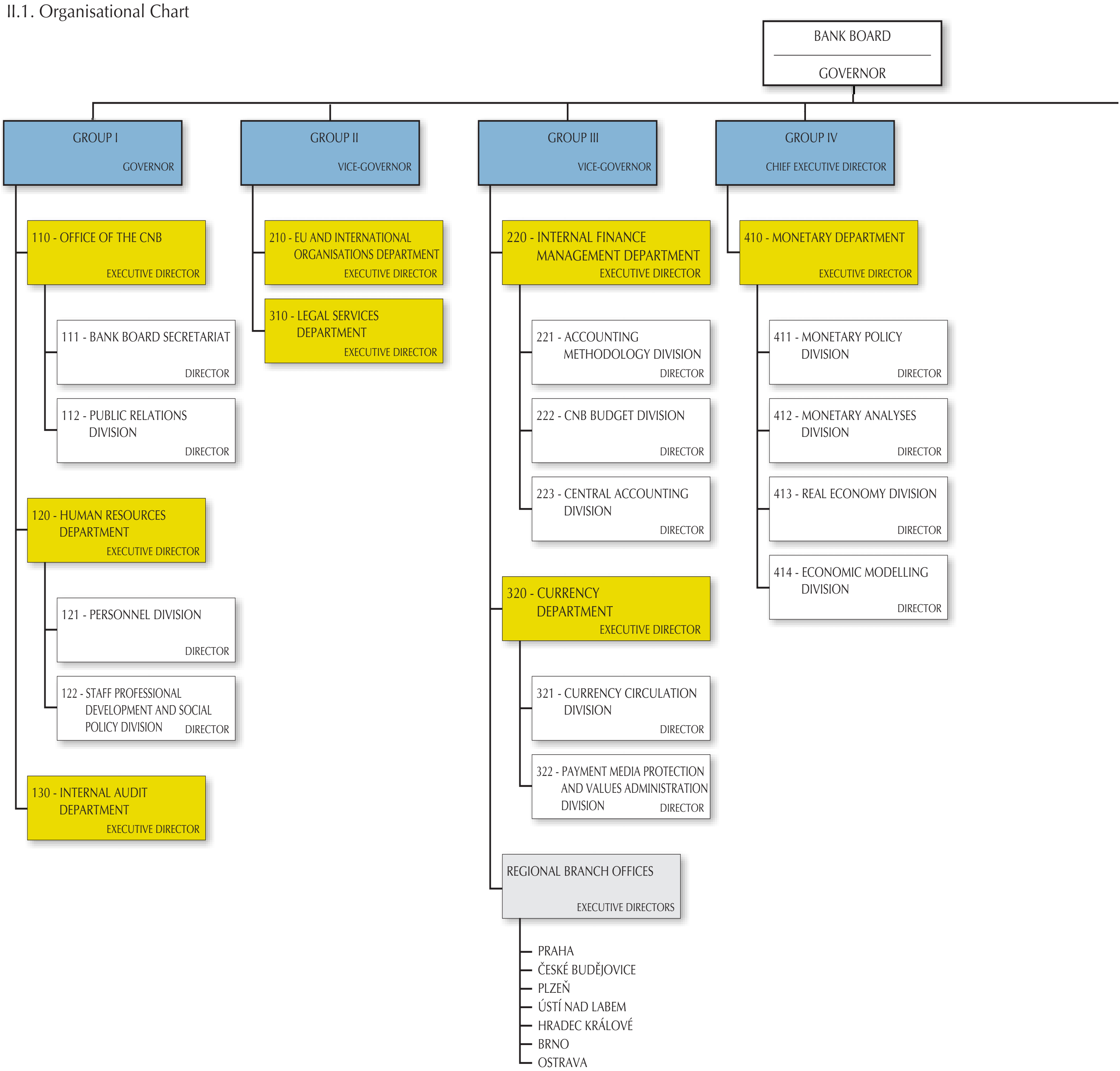
The new organisational structure of the CNB consists of its headquarters in Prague and branch offices ("organisational units"). The organisational units are further divided into organisational sections, which comprise groups, departments and divisions at headquarters and divisions in branches. Within the above sections, managers can set up subdivisions according to their needs. In the banking supervision department, the subdivisions are called inspection teams owing to the specific nature of their activities. The functions of subdivisions are determined by the managers who set them up.

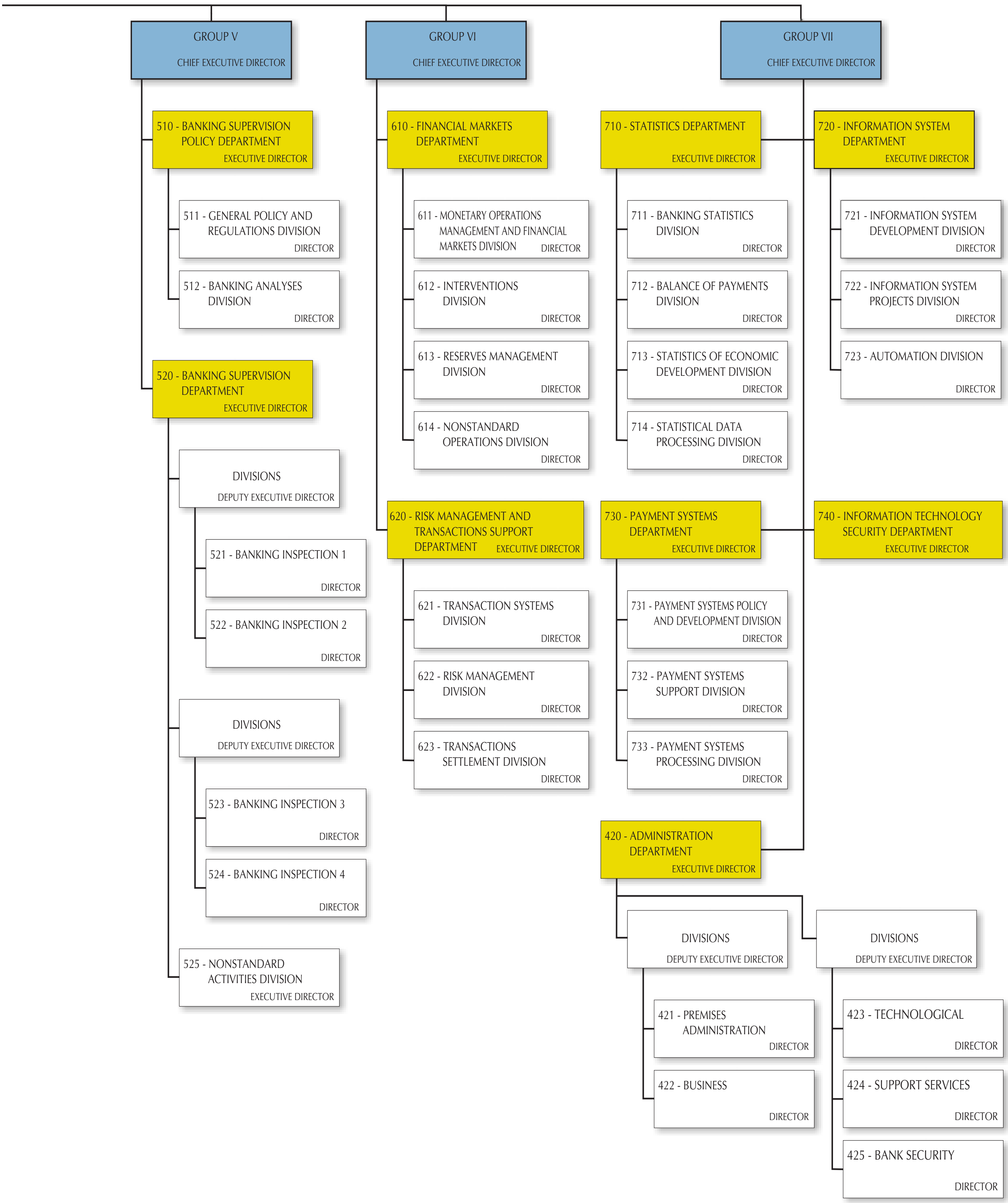
The Governor of the CNB manages the bank's headquarters. The basic management element at headquarters is the department, which ensures the management of individual areas of activity, both methodological and executive.

The CNB's branches, located in Prague, České Budějovice, Plzeň, Ústí nad Labem, Hradec Králové, Brno and Ostrava, are managed by the CNB Vice-Governor in charge of Group III. The branches are fully executive organisational units and have taken over a major part of the operational activities of the central bank. These include maintenance of the state budget accounts and issuing activities (the administration and distribution of banknotes and coins). No less important is their role in conducting surveys in their respective regions, providing foreign exchange control and processing foreign exchange statistics.

The CNB organisational chart given below shows the present structure of the bank's top management following the appointment of four new Bank Board members in February 1999.

II.1. Organisational Chart




GROUP V
CHIEF EXECUTIVE DIRECTOR
510 - BANKING SUPERVISION POLICY DEPARTMENT
EXECUTIVE DIRECTOR
511 - GENERAL POLICY AND REGULATIONS DIVISION
DIRECTOR
512 - BANKING ANALYSES DIVISION
DIRECTOR
520 - BANKING SUPERVISION DEPARTMENT
EXECUTIVE DIRECTOR
DIVISIONS
DEPUTY EXECUTIVE DIRECTOR
521 - BANKING INSPECTION 1
DIRECTOR
522 - BANKING INSPECTION 2
DIRECTOR
DIVISIONS
DEPUTY EXECUTIVE DIRECTOR
523 - BANKING INSPECTION 3
DIRECTOR
524 - BANKING INSPECTION 4
DIRECTOR
525 - NONSTANDARD ACTIVITIES DIVISION
EXECUTIVE DIRECTOR
GROUP VI
CHIEF EXECUTIVE DIRECTOR
610 - FINANCIAL MARKETS DEPARTMENT
EXECUTIVE DIRECTOR
611 - MONETARY OPERATIONS MANAGEMENT AND FINANCIAL MARKETS DIVISION
DIRECTOR
612 - INTERVENTIONS DIVISION
DIRECTOR
613 - RESERVES MANAGEMENT DIVISION
DIRECTOR
614 - NONSTANDARD OPERATIONS DIVISION
DIRECTOR
620 - RISK MANAGEMENT AND TRANSACTIONS SUPPORT DEPARTMENT
EXECUTIVE DIRECTOR
621 - TRANSACTION SYSTEMS DIVISION
DIRECTOR
622 - RISK MANAGEMENT DIVISION
DIRECTOR
623 - TRANSACTIONS SETTLEMENT DIVISION
DIRECTOR
GROUP VII
CHIEF EXECUTIVE DIRECTOR
710 - STATISTICS DEPARTMENT
EXECUTIVE DIRECTOR
711 - BANKING STATISTICS DIVISION
DIRECTOR
712 - BALANCE OF PAYMENTS DIVISION
DIRECTOR
713 - STATISTICS OF ECONOMIC DEVELOPMENT DIVISION
DIRECTOR
714 - STATISTICAL DATA PROCESSING DIVISION
DIRECTOR
720 - INFORMATION SYSTEM DEPARTMENT
EXECUTIVE DIRECTOR
721 - INFORMATION SYSTEM DEVELOPMENT DIVISION
DIRECTOR
722 - INFORMATION SYSTEM PROJECTS DIVISION
DIRECTOR
723 - AUTOMATION DIVISION
DIRECTOR
730 - PAYMENT SYSTEMS DEPARTMENT
EXECUTIVE DIRECTOR
731 - PAYMENT SYSTEMS POLICY AND DEVELOPMENT DIVISION
DIRECTOR
732 - PAYMENT SYSTEMS SUPPORT DIVISION
DIRECTOR
733 - PAYMENT SYSTEMS PROCESSING DIVISION
DIRECTOR
740 - INFORMATION TECHNOLOGY SECURITY DEPARTMENT
EXECUTIVE DIRECTOR
420 - ADMINISTRATION DEPARTMENT
EXECUTIVE DIRECTOR
DIVISIONS
DEPUTY EXECUTIVE DIRECTOR
421 - PREMISES ADMINISTRATION
DIRECTOR
422 - BUSINESS
DIRECTOR
DIVISIONS
DEPUTY EXECUTIVE DIRECTOR
423 - TECHNOLOGICAL
DIRECTOR
424 - SUPPORT SERVICES
DIRECTOR
425 - BANK SECURITY
DIRECTOR

III. MONETARY POLICY AND MONETARY DEVELOPMENTS

III.1 Summary

In 1998, several fundamental changes occurred in the main macroeconomic trends in the Czech economy. There was a positive turnaround in inflation, which fell sharply in 1998 H2. The reduction in the external imbalance led to a narrowing of the current account deficit. On the other hand, GDP continued to fall, unemployment rose throughout the year, and the economy went into recession. Economic developments were affected by a combination of internal and external factors. The world economy in 1998 was characterised by gradually slowing economic growth, disinflationary tendencies in most countries, falling prices in global markets of raw materials, energy and commodities, and by considerable volatility in financial markets. These processes strongly affected the macroeconomic and price developments in the Czech economy.

The year 1998 also saw a turnaround for monetary policy. The Czech National Bank became the first central bank in a transition economy to switch from money supply targeting to direct inflation targeting. Such targeting is not based only on the monitoring of a single intermediate target in the form of money supply, but on a comprehensive multi-criteria evaluation of all the factors affecting inflation.

The dominant economic trend in the Czech Republic in 1998 was the substantial fall in inflation. Consumer prices rose by 6.8% in 1998 overall. Net inflation, monitored for the needs of the inflation target, stood at 1.7% in the same period. This was primarily the result of exogenous factors (global prices and the exchange rate), specific developments on the food market, and the demand contraction. The extraordinary and unexpected evolution of prices on the domestic market was brought about by the pricing policies of retail chains and by subsidised food imports from EU countries, which resulted in a 1.2% year-on-year drop in food prices.

In 1998, GDP declined by 2.7% compared with the previous year. This was due to the sharp fall in domestic demand, which was only partly offset by the lower trade deficit. All the components of domestic demand contributed to the decline, particularly household demand and investment demand. On the supply side, output fell in construction, agriculture and the service sector. The only exception was industrial production, which rose 1.6%. But even here, the slowing pace of growth in the first three quarters changed into a sizeable year-on-year decline in Q4.

The economic decline fed through into a rapid rise in unemployment, especially in 1998 H2. Whereas at the end of December 1997 the unemployment rate was 5.2%, at the end of December 1998 it was running at 7.5%. Despite the relatively large increase in unemployment, labour productivity dropped, as GDP fell more quickly than employment.

The external deficits of the Czech economy narrowed in 1998. Compared with 1997, the current account deficit decreased by CZK 68 billion (67%), from 6.2% of GDP to 1.9%. This improvement was largely due to a lower trade deficit and a higher surplus on the balance of services. The growth of both exports and imports substantially decelerated in individual quarters. This was caused by the ever more difficult sales opportunities for Czech goods on foreign markets owing to weakening foreign demand, a considerable depreciation of the koruna, and receding household and corporate sector demand for imports.

Monetary aggregates in 1998 reflected the declining pace of economic activity. As in 1997, the growth in M1, characterising the transactions demand for money, was negative in year-on-year terms. M2 and L posted falling year-on-year growth. M2 was up 5.2% year-on-year in December 1998, against 10.1% in December 1997. The main reason for the declining or negative growth of monetary aggregates was the low lending activity of commercial banks, although the fact that the state budget was running a surplus for most of the year also played a role. Whereas at the end of December 1997 the volume of credits provided by banks to businesses and households was up by 9.4% year-on-year, in the same period of 1998 it was down by 2.7%. The reduction in credit supply was caused mainly by the increased prudence of banks in granting new credits and also by high nominal and real interest rates.

Financial market developments can be divided into two phases. Up to mid-1998, interest rates were falling only slowly from their high 1997 levels. More rapid rate cuts were prevented by the high inflation, continuing inflationary pressures and risks associated with the financial crises in Asia, Russia and Brazil. In H2, falling inflation, and in particular the favourable inflation forecast, made it possible for the CNB to start steadily lowering its key interest rates. The 2W repo rate was lowered in seven steps by a total of 5.5 percentage points, from 15% in July 1997 to 9.5% at the end of 1998. The Lombard rate was cut from 19% to 12.5% and the discount rate from 13% to 7.5% in the same period. Market interest rates experienced substantial falls as well.

Within the new strategy of inflation targeting, the CNB's monetary policy in 1998 focused on a process of disinflation determined by short-term and medium-term inflation targets. The short-term target was net inflation of 6% ± 0.5 percentage points at the end of 1998. The medium-term target was set at 4.5% ± 1 percentage point for the end of 2000.

At the beginning of 1998, monetary policy decisions were being made in an environment of inflationary pressures and considerable uncertainty about future inflation developments. However, disinflationary trends started to emerge in the second half of the year. Thanks in particular to factors lying outside the direct reach of monetary policy, year-on-year net inflation dropped below the level of the short-term inflation target in December 1998.

The state budget, which ran a surplus for most of the year, ended in a deficit of CZK 29.3 billion. The revenues side developed broadly in line with the budgeted amounts, although the economic decline led to a fall in collection of indirect taxes; this, however, was offset by higher revenues from other taxes. The budget deficit was mostly due to extraordinary expenditures (notably the settlement of Konsolidační banka's loss, the payment of state guarantees to Česká spořitelna, pension valorisations) and higher expenditures on government consumption in connection with the early elections and realised state guarantees. The implementation of strict income and wage policies led to a year-on-year decline in the real financial incomes of households and in real wage incomes in particular. Nevertheless, average real wages increased in year-on-year terms in 1998 Q4 owing to the inertia of nominal wage development under the conditions of rapidly falling inflation and receding employment.

The declining performance of the Czech economy, accompanied by rising unemployment, is not simply a consequence of the restrictive macroeconomic policies in 1997 and 1998, but above all reflects the slow restructuring of the microeconomy and the accumulation of unresolved and deferred legislative and institutional problems. Although some of the trends in the Czech macroeconomy in 1998 were not positive, they were inevitable for renewal of balanced and sustainable growth. The elimination, or moderation, of such imbalances is a necessary precondition for initiating economic growth, and the developments in 1998 contributed significantly to this.

III.2 The world economy

In the world economy, 1998 was characterised by a slowdown in economic growth, disinflationary trends in most countries, a sizeable drop in prices of basic commodities, and increased volatility in global financial markets. The inflation rate in advanced countries reached a 50-year low in 1998. The rapid fall in inflation was largely due to a positive cost shock (falling commodity prices)[1] and the gradual contraction of global demand, which picked up in the second half of the year. These processes affected macroeconomic developments in the Czech Republic through several different channels and were very significant owing to the considerable openness of the domestic economy. Global commodity prices helped to accelerate disinflation and correct the external deficit. The slowing global economic expansion, coupled with the decline in domestic demand, had a negative impact on GDP in the Czech

1 The positive cost shock in the form of falling commodity prices was reinforced by the favourable anti-inflationary environment, devaluations in the countries hit by the currency crisis, technological innovations, and the development of communications technology and the Internet, which led to stronger competition.

Republic. The third channel was the evolution of the koruna's exchange rate. In 1998, the koruna showed a strong inclination towards appreciation, largely because of the wide interest rate differential. At the same time, the greater volatility in global financial markets affected the koruna's exchange rate to a lesser extent than in 1997 thanks to an improvement in some Czech economic fundamentals.

The beginning of 1998 was influenced by the aftermath of the crisis in South-East and East Asia in mid-1997. The sharp decline in economic growth in this region had several consequences for global economic developments. Firstly, it contributed to the overall slowdown in the world economy. The United States and France were the only major economies not to be hit by decelerating economic growth; China experienced an only slight slowdown. Secondly, the contraction of demand for raw materials on the part of South-East Asian countries, which are major importers, reinforced the downward trend in global commodity prices, which had already started to be felt prior to the outbreak of the crisis. Thirdly, the crisis and subsequent devaluation of the currencies of South-East Asian countries contributed significantly to a worldwide strengthening of competitive pressures and to record-low increases in price indices.

The monetary developments in Asia substantially increased the prudence of foreign investors vis-à-vis the emerging markets and heightened the significance of macroeconomic fundamentals in decision-making about capital allocation. This showed up in weaker net capital inflow to these countries. In addition, the fall in global prices had an adverse effect on the foreign exchange incomes of major exporters of raw materials. At the beginning of 1998 H2, the currency crisis hit Russia. This was felt in most countries of the former Soviet Union because of their close economic ties. At the year-end, Brazil's long-term latent problems came to a head with a massive outflow of short-term capital and an attack on the Brazilian real. Prior to this, there had also been some exchange rate corrections in a number of smaller Latin American countries.

The most advanced countries displayed relatively strong resistance to the crises in the emerging markets. The only exception was Japan, where the regional crisis compounded the economic problems resulting from its structural and institutional difficulties. Economic growth in the USA (3.9% in 1998) and in Europe (except for Q4) was fairly robust, confirming that the initial concerns about the effects of the crises on these economies had not been borne out. Concerned about a slowdown in economic growth – and assisted by the favourable inflation developments – the central banks of the USA, Japan and EU countries lowered their interest rates substantially. Notwithstanding the decline in nominal interest rates in 1998, however, investment opportunities in the USA and EU were an important alternative for the speculative capital exiting the risky emerging markets.

Owing to the considerable openness of the Czech economy, the fall in global commodity prices fed through strongly into domestic prices. According to CNB estimates, the influence of these external factors (including the koruna's exchange rate) on the reduction in net inflation was between 2 and 3 percentage points. While the decline in import prices was quite significant, exports (where items with higher value added predominate) were not affected so strongly. Thanks to the commodity structure of the Czech Republic's foreign trade (where there is a substantially higher proportion of raw materials and foodstuffs in overall exports than in imports), the drop in the prices of these commodities on world markets had a positive impact on the balance of trade. This was the major factor in the CZK 70 billion improvement in the trade balance.

In 1998 H1, domestic exports saw robust growth. The effects of the Asian crisis on real GDP in the Czech Republic were negligible because of the low level of trade with this region.

In the second half of the year, export growth started to weaken sharply. This was the result, in addition to the appreciation of the koruna, of a substantial worsening of export conditions in the crisis-hit countries of the former Soviet Union. Before the crisis, these countries accounted for about 5% of overall Czech exports. The year-on-year decreases in the value of monthly exports to this region reached as high as 70% in H1. The slowdown in exports was also aggravated by economic problems in Slovakia, the Czech Republic's second largest trading partner. Slovakia's exchange rate problems peaked at the end of 1998, when the central bank was forced to abandon the koruna's fluctuation band. At the same time the currency depreciated by 10%. Owing to the domestic demand contraction in Slovakia, the year-on-year decreases in Czech exports to that country gradually became larger. In December 1998, the year-on-year decline reached approximately 15%.

In 1997, Slovakia accounted for 12.9% of Czech exports. In 1998 this ratio was down to 10.6%. In 1998 H2, the Czech Republic's other major trading partners – Germany, Austria, Poland and Italy – started to experience a slowdown in growth, which resulted in a slower rise in exports to these countries.

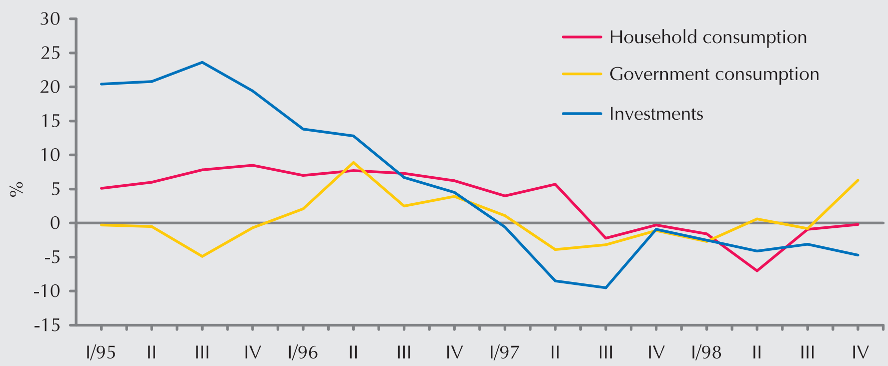
The increased prudence on the part of foreign investors was apparent mainly in the periods of local exchange rate crisis through increased volatility of the koruna. Despite the gradual, albeit significant, cuts in interest rates in 1998 H2, the koruna inclined towards appreciation for most of the year. The appreciation pressures did not diminish even after relatively major CNB interventions (amounting to almost USD 2 billion). This was due to the still high interest rate differential, the substantial improvement in some Czech economic fundamentals (the narrowing of the current account deficit, the fall in inflation) and the stronger inflow of non-debt capital (direct investment in particular).

III.3 The Czech economy

III.3.1 Demand

The downward trend in domestic demand[2], which started in 1997 H2, continued throughout 1998. The decline was bigger than in the previous year: in 1997 overall demand in absolute terms moved slightly below the 1996 level, whereas in 1998 the absolute year-on-year decline was CZK 44.2 billion. The final year-on-year contraction in domestic demand was 2.8 percentage points (to -3.2%), with contributions particularly from household demand and investment demand. Domestic effective demand[3] receded more slowly than overall domestic demand (-2.1% year-on-year, against -1.2% in 1997).

Chart III.3.1 Components of domestic demand
(y-o-y growth in %, 1994 constant prices



The continuing domestic demand contraction in 1998 was the result of:

- economic policies aimed at gradually reducing external and internal imbalance;
- other factors reflecting the behaviour of commercial banks, businesses and households in the current economic situation (when GDP was expected to grow slowly and the unemployment rate was expected to rise). The gradual lowering of interest rates by the CNB in 1998 H2 failed to prompt an

2 Domestic demand including change in inventories

3 Domestic demand excluding change in inventories

expansion of domestic demand because of the time lag in its effect and in particular because of the increased prudence of commercial banks in providing credits. The availability of credits and therefore also the investment demand of the corporate sector were, despite the lower interest rates, adversely affected by the worsening financial position of businesses[4], incomplete restructuring (particularly in the area of ownership) and uncertainty about future economic developments. In addition to falling household incomes (Table III.3.4), the low consumer demand was attributable to a relatively high household propensity to save and the increasing unemployment rate.

At the same time, the acceleration of export growth following the koruna's depreciation in 1997, the enlargement of production capacities through new investment (primarily in businesses with foreign ownership manufacturing higher-value-added products) and the shifting of part of domestic production to foreign markets partially offset the influence of the domestic demand contraction on domestic output.

The favourable conditions on foreign markets in 1998 H1 made for high year-on-year growth in exports of goods and services[5] and a subsequent acceleration of aggregate demand[6] growth (of 4.2% year-on-year in 1998 H1). However, in 1998 H2 the worse sales conditions coupled with the koruna appreciation substantially weakened the favourable trends in exports and aggregate demand (2.3% for 1998 as a whole). The slowdown in exports interrupted the positive trend of a gradual narrowing of the external deficit.

In 1998 H1, exports substantially outpaced imports and the external deficit, measured by negative net exports[7], dropped by CZK 18.9 billion, which means that in relative terms the share of negative net exports in GDP fell by 3 percentage points to 6.8%. In H2, export growth slowed more quickly than import growth. This, coupled with the ongoing relatively high import propensity of GDP, led to a renewed moderate deterioration in the above measures of the external deficit. Nevertheless, in year-on-year comparison, the share of negative net exports in GDP decreased by 0.6 percentage points in 1998 to 8% (in constant prices). The relatively high import propensity of GDP (81.3%) was associated mainly with the development of cross-border production co-operation, the investment structure and a change in the structure of consumption of primary energies (the replacement of solid fuels with imported gas and oil).

Table II.3.1 Real output and demand growth rate (in % y-o-y, 1994 constant prices)

	1995	1996	1997	1998	I/1998	II/1998	III/1998	IV/1998
GROSS DOMESTIC PRODUCT	6.4	3.9	1.0	-2.7	-0.9	-2.4	-2.9	-4.1
AGGREGATE DEMAND (domestic demand and exports)	11.9	7.4	3.3	2.3	6.8	2.0	1.2	-0.2
DOMESTIC DEMAND	9.8	8.5	-0.4	-3.2	-4.5	-4.3	-2.8	-1.4
DOMESTIC EFFECTIVE DEMAND 1)	9.1	7.0	-1.2	-2.1	-2.1	-4.6	-1.5	-0.6
of which:								
Household consumption	6.9	7.0	1.6	-2.4	-1.6	-7.0	-0.9	-0.2
Government consumption 2)	-1.2	4.3	-1.8	1.1	-2.7	0.6	-0.8	6.3
Gross fixed capital formation	21.0	8.7	-4.9	-3.7	-2.5	-4.1	-3.1	-4.7
EXPORTS OF GOODS AND SERVICES	16.1	5.4	10.2	11.5	27.4	12.3	8.1	1.7
IMPORTS OF GOODS AND SERVICES	22.0	12.9	6.7	9.0	17.3	7.9	7.1	5.1

1) Domestic demand excluding change in inventories
2) Including non-profit institutions

4 The worsening financial situation of businesses was documented by a marked decline in their deposits with banks compared with a year earlier, increasing insolvency, high indebtedness, etc.

5 GDP methodology in constant prices

6 Aggregate demand = domestic demand + exports of goods and services

7 Net exports = balance of exports and imports of goods and services

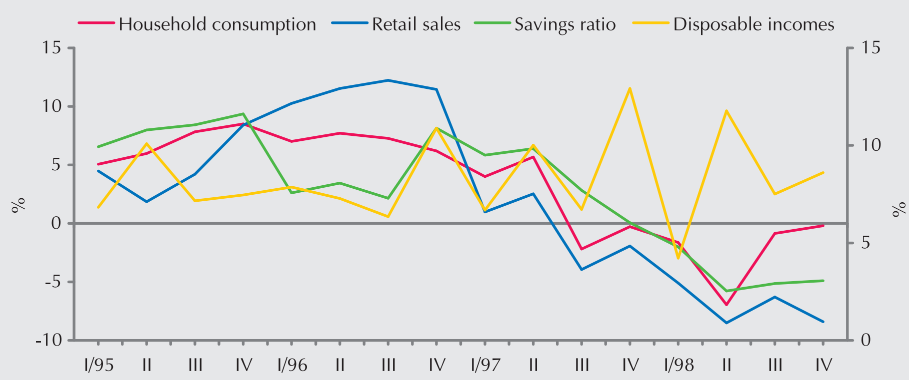
III.3.1.1 Household consumption

The year-on-year downward trend in household consumption seen since 1997 H2 continued – with differing intensity in individual quarters – throughout 1998. The overall 1998 decrease was 2.4%.

The falling household consumption was due largely to the real fall in total household incomes (Table III.3.4). This was apparent in all the basic components of household consumption, especially wage incomes. Another contributing factor was the substitution of wages with social benefits associated with the increasing unemployment rate. Moreover, expectations of low economic growth and a further rise in unemployment led to households maintaining a relatively high savings ratio, despite some deviations during the year.

The persisting interest of households in saving was confirmed by the results of surveys conducted by institutions focusing on research into the overall consumer climate and household savings. According to a survey carried out at the end of 1998[8], the proportion of regularly and irregularly saving households was much higher than in the previous survey (October 1998), with 65% of households saving regularly or irregularly, primarily to create financial reserves.

Chart III.3.2 Real consumption, retail sales, disposable incomes and savings ratio [9/]



With incomes falling and housing expenses[10] rising, household consumption saw some structural changes as well, reflected in declining interest in purchases of durables and household services. Only food consumption remained at the 1997 level (sales of foodstuffs were up 1% year-on-year). The change in the structure of effective demand contributed to an interruption in the long-term upward trend in the import propensity of households.

III.3.1.2 Investment

The fall in investment demand (= gross fixed capital formation) was the fastest of all the components of domestic demand, but was more moderate than in the previous year (decreasing by 1.2 percentage points to -3.7%). The rate of investment[11] also remained very high in 1998 (32.8% in constant prices).

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8 Ecoma plus, February 1999

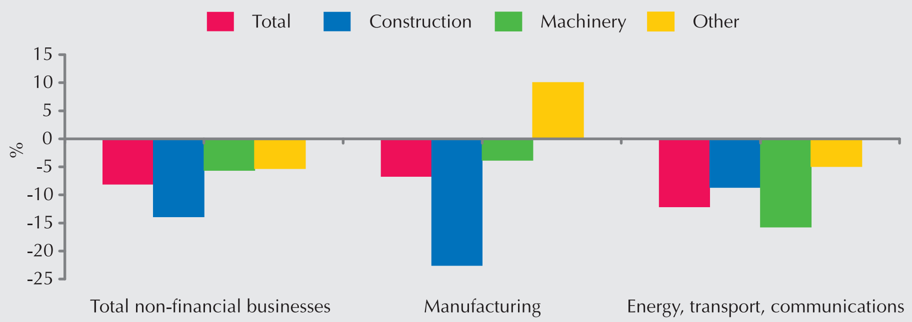
9 Savings ratio (CNB methodology) = change in net financial assets/disposable income; financial assets = koruna and foreign currency deposits + cash + securities + change in technical reserves for life insurance and supplementary pension insurance; financial liabilities = koruna and foreign currency loans

10 Rents, electricity prices, etc.

11 Rate of investment = gross fixed capital formation/GDP in constant prices

Despite the year-on-year decline, the investment structure in 1998 saw some significant new trends. These included above all the ongoing investment decline in those areas that had experienced an investment boom in previous years, notably infrastructure (-12% year-on-year for energy, transport and communications) and the financial sector (-22% year-on-year). The downturn in manufacturing investment was rather larger compared with that in overall capital investment (-6.7% year-on-year). However, some branches producing highly sophisticated products recorded a substantial increase in investment demand during the year. Investment in engineering and electrical engineering increased slightly year-on-year (by 1.8%), causing their share in manufacturing investment to rise by 2.6 percentage points to 30.4%.

Chart III.3.3 Changes in capital investment of non-financial businesses in 1998 (y-o-y)
(1997 = 100)



Investment growth in the non-financial sector was registered only in firms under foreign control (up by 29% year-on-year in current prices). By contrast, investment in public and domestic private firms decreased. This reflected the better results of firms under foreign control as well as other firms' problems in obtaining necessary funds (for the various reasons mentioned at the beginning of this chapter). The desirable inflow of foreign direct investment into the Czech Republic – a significant factor of fixed investment financing – continued into 1998. These investments were, however, directed mostly into the trade sector and financial institutions. Foreign direct investment in the manufacturing sector accounted for 34% of the overall FDI inflow.

III.3.1.3 Government consumption

As in 1997, government consumption was on the decline until Q3 (falling by almost 1% for the first three quarters of 1998)[12]. The downward trend was interrupted only in Q2 by a moderate rise (0.6% year-on-year) related to the early parliamentary elections. Savings were achieved despite the increased expenditure within government consumption ensuing from a number of new measures (eg a rise of more than CZK 4 billion in state payments into the public health insurance system for non-earners). At the year-end, the trend reversed because of a significant increase in several government expenditures (growth of 6.3% in Q4), and for 1998 as a whole, government consumption increased by 1.1%. The Q4 increase in spending was associated particularly with higher insurance company payments and non-investment expenditures on materials, services, repairs and maintenance in centrally governed budgetary organisations.

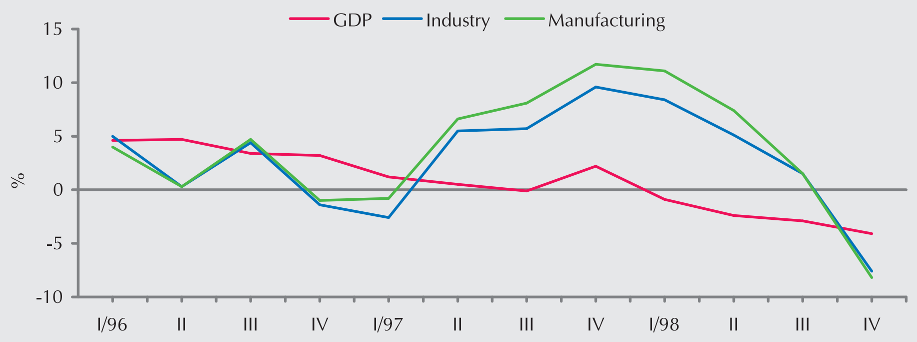
III.3.2 Production

In 1998, the gradual deceleration of economic growth seen since 1996 changed into a decline. During 1998, the year-on-year GDP decline worsened to -2.7% for the whole year (Chart III.3.4). The increasing rate of decline had several causes, in particular the incomplete restructuring of the economy,

12/ Including non-profit organisations

including ownership relations (ineffective corporate governance etc.). The GDP trend confirms that the extensive investments of previous years have not had the required effect with respect to the structure of completed investment projects[13]. In 1998, GDP proved fairly sensitive to the changes in external demand, which partially offset the impact of the domestic demand contraction on domestic output.

Chart III.3.4 GDP, industrial production and manufacturing output
(y-o-y growth, constant prices)



The individual economic sectors saw mixed development in 1998. The main contributions to the GDP decline came from the service sector (including retail) and construction. Rises in value added were recorded only in a few industries and branches.

Following favourable developments at the beginning of 1998, the pace of output growth in industrial production gradually decelerated during the year, changing into decline in Q4. This resulted in substantially lower year-on-year growth in 1998 (1.6%) compared with 1997 (4.5%). The slowdown in output in the second half of the year was attributable to the sizeable fall in external demand combined with the ongoing domestic demand contraction. The rate of year-on-year decline was influenced to a certain extent by the high comparison base from the previous year. As in previous years, developments differed both within individual industries and between organisations by type of ownership.

Output rose by 2.5% in the manufacturing sector, but fell in the raw materials (-5.7%) and energy (-1.5%) industries. The best results were achieved in foreign-owned organisations, where the foreign capital, combined with know-how and organisational and managerial skills, enabled competitive products to be manufactured and, in particular, sold (especially for export).

In construction, which is overwhelmingly dependent on domestic demand, the unfavourable trend seen since 1997 worsened further in 1998 (-7% year-on-year). Except for the first two months (which benefited from a low comparison base, milder winter, and greater number of working hours), the previous year's level was not achieved in any month. New constructions, reconstructions and modernisations fell the most (-8.5%). The construction sector was also hit by increased protection of the building market in neighbouring countries (Germany in particular), resulting in a major downturn in exports of construction work (of almost 25%). Demand increased only for repairs and maintenance (up 3%, accounting for 16% of total construction output) in connection with flood-damage repairs. Construction firms, like industrial companies, responded to the declining demand by reducing their workforces.

The downward trend continued also in agriculture, although with less intensity. Gross agricultural production dropped by 1.3% in 1998, according to CSO estimates. The decline in cattle breeding

13 In previous years, a large proportion of the investment was channelled into infrastructure, the environment and the financial sector

continued, and the harvest of staple crops was also lower than in 1997. Since 1989, agricultural production has fallen by 30%, with crop production down by 21.5% and livestock production by 36.3%.

Within the service sector, individual segments saw mixed development. Services dependent mainly on effective household demand registered the biggest decrease in 1998, with retail (down by 6.5 percentage points to -7.2%), catering (-7.5%) and other services (of a prevailingly personal nature: -10.6%) hit the hardest. The declining economic activity of the business sector led to a decrease in services dependent on demand from this sector. However, their decline was more moderate (eg services mainly for businesses fell by only 2.4%). As in 1997, the upward trend continued in communications services, largely thanks to the expansion of the mobile telephone network and the Internet (10.4%).

III.3.3 The labour market

Against the background of a real decline in most income indicators and constant unemployment growth, the labour market in 1998 saw internally inconsistent development. The first serious problem was the gradual reversal of the quarterly year-on-year decreases in average real wages, notwithstanding the constant worsening of other economic indicators. The second disturbing feature was that although the growth in the unemployment rate was relatively high in 1997, it did not result in a rise in labour productivity, despite the steep GDP decline. The labour market therefore showed ever more distinct features of an inflexibility or inability to react adequately to adverse trends in the real economy. In view of these developments, it seems clear that the restrictive macroeconomic policies were not strong enough to force businesses to implement more sensible wage and employment policies respecting a desirable relationship between growth in labour costs and productivity.

III.3.3.1 Wages and financial incomes

Table III.3.2 Basic data on wages *y-o-y change in %*

		I/96	II/96	III/96	IV/96	1996	I/97	II/97	III/97	IV/97	1997	I/98	II/98	III/98	IV/98	1998
AVERAGE WAGE IN THE CR	(nominal)	17.4	21.0	16.5	17.1	18.0	13.7	13.0	12.4	8.4	11.9	10.9	7.0	9.2	10.1	9.3
	(real)	7.9	11.6	6.6	7.8	8.4	6.1	6.0	2.3	-1.5	3.1	-2.1	-5.0	-0.3	2.4	-1.3
of which:																
Non-business sector	(nominal)	15.0	33.0	15.3	18.5	20.6	12.2	11.1	10.2	-6.6	5.8	5.0	-6.2	3.0	15.1	3.9
	(real)	5.7	22.6	5.5	9.1	10.8	4.6	4.2	0.3	-15.2	-2.5	-7.4	-16.7	-5.9	7.1	-6.1
Business sector	(nominal)	18.2	17.1	17.0	16.6	17.1	14.1	13.6	13.0	13.0	13.6	12.6	11.1	10.9	8.9	10.9
	(real)	8.7	7.9	7.0	7.3	7.6	6.4	6.6	2.8	2.6	4.7	-0.6	-1.4	1.2	1.3	0.2
of which:																
private organisations	(nominal) 1/	.	.	.	.	.	.	.	11.6	11.9	12.7	11.3	9.2	9.0	6.6	8.9
	(real)	.	.	.	.	.	.	.	1.6	1.7	3.9	-1.8	-3.1	-0.5	-0.8	-1.6
state organisations	(nominal) 2/	.	.	.	.	.	.	.	15.5	15.6	15.9	11.8	10.2	12.4	11.3	11.4
	(real)	.	.	.	.	.	.	.	5.1	5.0	6.8	-1.4	-2.3	2.6	3.6	0.7
international organisations	(nominal) 3/	.	.	.	.	.	.	.	14.7	13.5	14.4	14.1	17.3	12.1	12.1	14.1
	(real)	.	.	.	.	.	.	.	4.4	3.0	5.4	0.7	4.1	2.4	4.3	3.1

1/ Including domestic (legal and natural) entities without state interest
2/ Including domestic (legal and natural) entities with 100 % state interest
3/ Including entities with domestic and foreign capital
Source: CSO

The 0.2% rise in real wages in the business sector in 1998 indicates that the contribution of wages to renewing the internal balance was exhausted during the year. Real unit wage costs, and consequently also wage costs per unit product, increased in both industry and construction. From the above facts, it follows that the real increase in the price of labour was not accompanied by a corresponding rise in labour productivity in key segments of the business sector. The steepest growth in real wages was registered in state-owned entities in the business sector.

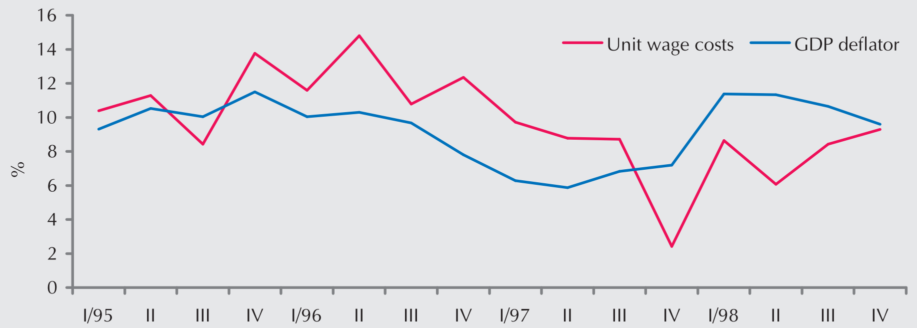
Table III.3.3 Wage, price and productivity indicators *y-o-y change in %*

	I/96	II/96	III/96	IV/96	1996	I/97	II/97	III/97	IV/97	1997	I/98	II/98	III/98	IV/98	1998
Unit wage costs (nominal wage incomes/GDP in constant prices)	11.6	14.8	10.8	12.4	12.4	9.7	8.8	8.7	2.4	7.2	8.6	6.1	8.4	9.3	8.1
GDP deflator	10.0	10.3	9.7	7.8	9.4	6.3	5.9	6.8	7.2	6.6	11.4	11.3	10.6	9.6	10.7
Real unit wage costs (unit wage costs/GDP deflator)	1.4	4.1	1.0	4.2	2.8	3.2	2.7	1.8	-4.5	0.5	-2.5	-4.7	-2.0	-0.3	-2.3
Whole economy labour productivity	2.6	3.6	1.6	3.1	2.7	1.4	0.8	1.0	3.6	1.7	0.6	-0.7	-0.8	-1.9	-0.8

Source: CSO, CNB calculation

The decrease in average real wages in 1998 in the economy as a whole was attributable exclusively to wage restraint in the non-business sector. Wage incomes (both nominal and real) grew at a lower rate than average wages, which can be explained by falling employment. The effects of both the above factors concealed the disturbing wage developments in the business sector. As a result, wages at the macroeconomic level remained within economically acceptable limits in 1998 as a whole and did not accelerate the wage-cost inflationary processes. This statement is supported by the fact that real unit wage costs in the whole economy dropped in absolute terms against 1997. On the other hand, the relatively significant acceleration of nominal unit wage costs against 1997 is worrying, as it casts some doubt on the satisfactory development of this indicator in real terms.

Chart III.3.5 Nominal unit wage costs and GDP deflator (y-o-y)



The trend for overall household incomes in 1998 mirrored that for wage incomes: the real year-on-year quarterly declines peaked in Q2 and then the downward trend started to moderate. This again confirms the hypothesis about the growing insensitivity of wage and overall income aggregates to developments in the real economy in 1998: whereas CPI growth decelerated throughout last year, household incomes and wage incomes showed accelerated growth in 1998 Q4.

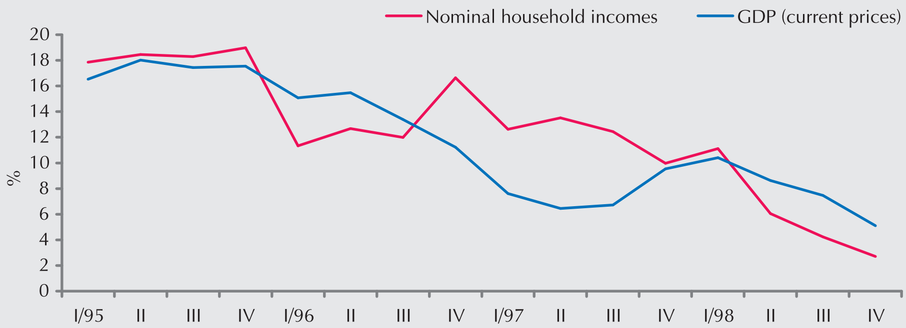
Table III.3.4 Basic data on household incomes *y-o-y change in %*

		I/96	II/96	III/96	IV/96	1996	I/97	II/97	III/97	IV/97	1997	I/98	II/98	III/98	IV/98	1998
HOUSEHOLD FINANCIAL INCOMES	(nominal)	11.3	12.7	12.0	16.6	13.3	12.6	13.5	12.4	10.0	12.1	11.1	6.1	4.2	2.7	5.8
	(real)	2.3	3.9	2.5	7.4	4.1	5.1	6.5	2.3	-0.1	3.3	-1.9	-5.9	-4.8	-4.5	-4.4
of which:																
Incomes from wages	(nominal)	16.7	20.2	14.5	15.9	16.8	11.1	9.4	8.6	4.6	8.2	7.7	3.5	5.3	4.8	5.2
	(real)	7.3	10.8	4.8	6.7	7.4	3.6	2.6	-1.1	-5.0	-0.3	-5.0	-8.2	-3.9	-2.5	-4.9
Social incomes	(nominal)	13.3	21.2	12.0	18.4	16.2	13.8	10.1	14.2	14.7	13.2	11.2	8.2	12.9	4.5	9.1
Other incomes	(nominal)	1.0	-4.5	8.0	17.0	5.5	14.8	24.6	17.9	17.6	18.7	17.6	9.5	-2.0	-2.0	4.8

Source: CNB statistics

Overall, the financial incomes of households grew more slowly than nominal GDP last year, leading to a redistribution of overall disposable incomes slightly to the detriment of households. The fact that 1998 as a whole did not see any demand inflationary pressures generated by household incomes ought not to be overestimated, as it is clear that during 1998 the disproportion between the growth rates of both the above variables, and consequently also the room for inflationary neutral development of incomes, gradually narrowed.

Chart III.3.6 Relative income position of households



III.3.3.2 Employment and unemployment

In 1998, overall employment fell by 1.2% compared with a year earlier, ie by more than 50,000 persons. The disequilibrium between supply and demand for labour widened not only at the aggregate level, but also in the regional, professional and skill structure of the economically active population.

Table III.3.5 Basic data on employment and unemployment

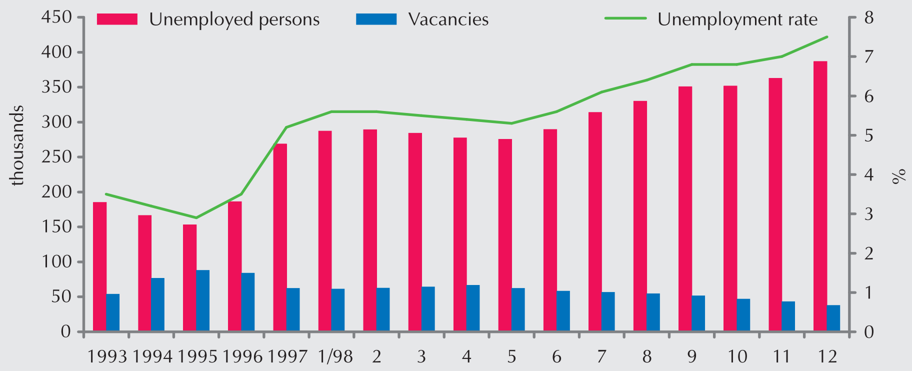
	1995	1996	1997	1998	Quarters of 1997				Quarters of 1998			
					I/97	II/97	III/97	IV/97	I/98	II/98	III/98	IV/98
No. of persons employed in whole economy (average)												
Y-o-y change in %	2.6	0.6	-1.0	-1,4*/	-0.2	-0.3	-1.4	-1.4	-1.3	-1.4	-1.3	-1.1
Natural persons - number (in thousands)	5011	5044	4922	4855*/	4959	4967	4894	4908	4897	4899	4831	4851
Number of unemployed [1)]												
Natural persons - number (in thousands)	153.0	186.3	268.9	386.9	199.6	202.6	247.6	268.9	284.1	289.5	350.7	386.9
Unemployment rate	2.9	3.5	5.2	7.5	3.9	4.0	4.8	5.2	5.5	5.6	6.8	7.5
Number of job applicants per vacancy [1)]	1.7	2.2	4.3	10.3	2.3	2.5	3.4	4.3	4.4	5.0	6.8	10.3

1) as of end of period

The disproportion between aggregate supply and demand for work was reflected in an ever higher number of job applicants per vacancy: 10.3 persons in December 1998, against 4.3 in December 1997.

The seasonal unemployment trend in 1998 was similar to that in 1997, but at a higher level. At the end of December 1998, the unemployment rate stood at 7.5% and the number of unemployed persons was 386,900. The unemployment rate was highest in districts of North Bohemia and North Moravia, where there were considerable falls in employment (particularly in mining). Disabled people, school and university graduates, young people and women (especially those with small children) were hardest hit, accounting for 80% of the total number of unemployed persons in 1998.

Chart III.3.7 Unemployment



III.3.4 Prices

III.3.4.1 Consumer prices

In 1998, the CPI developed differently than in previous years. CPI inflation slowed sharply year-on-year (by 3.2 percentage points against the end of 1997) as a result of favourable cost and demand inflation factors. At the beginning of 1998, consumer prices rose substantially, owing to higher growth in regulated prices, the rise in indirect taxes and, in part, because of net inflation (up to 13.4% year-on-year). From April onwards, however, the rise gradually slowed, to 6.8% at the year-end. Net inflation fell substantially (by 5.1 percentage points to 1.7% at the end of 1998), and regulated prices also recorded lower year-on-year growth. The generally favourable CPI trend was achieved despite the strong negative influence of the increase in indirect taxes.

Chart III.3.8 Structure of CPI inflation (y-o-y)

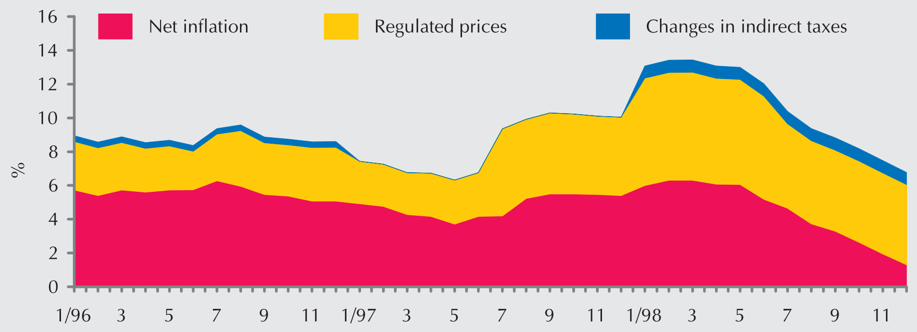
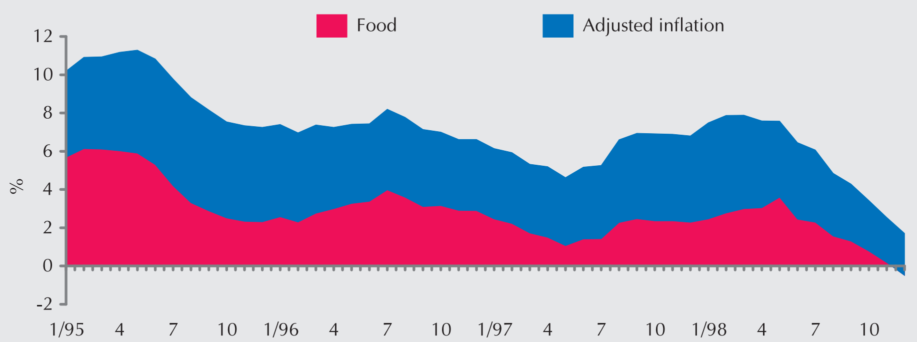


Table III.3.6 Basic data on consumer prices (y-o-y in %)

	3/98		6/98		7/98		8/98		9/98		10/98		11/98		12/98	
CPI INFLATION (y-o-y)	13.4		12.0		10.4		9.4		8.8		8.2		7.5		6.8	
of which:		contribution		contribution		contribution		contribution		contribution		contribution		contribution		contribution
Regulated prices	30.8	*6.38*	29.7	*6.11*	21.1	*5.00*	20.9	*4.91*	20.4	*4.79*	20.6	*4.81*	20.5	*4.78*	20.4	*4.73*
Influence of indirect taxes on unreg. prices		*0.73*		*0.73*		*0.73*		*0.73*		*0.73*		*0.73*		*0.73*		*0.73*
Net inflation	7.9	*6.32*	6.5	*5.19*	6.1	*4.66*	4.9	*3.73*	4.3	*3.30*	3.4	*2.64*	2.6	*1.96*	1.7	*1.32*
of which:																
- food prices	7.2	*2.40*	5.8	*1.96*	5.4	*1.75*	3.8	*1.21*	3.1	*1.00*	1.9	*0.60*	0.4	*0.14*	-1.2	*-0.38*
- adjusted inflation	8.4	*3.92*	6.9	*3.22*	6.6	*2.91*	5.6	*2.53*	5.1	*2.30*	4.5	*2.04*	4.0	*1.82*	3.7	*1.70*
INFLATION RATE (annual moving average)	10.0		11.5		11.6		11.5		11.4		11.2		11.0		10.7	

The relatively fast reduction in net inflation[14] during 1998 was due to both internal and external factors of a demand as well as cost nature. Net inflation was affected in particular by favourable global prices of raw materials and food, the koruna's appreciation and the ongoing contraction of domestic effective demand. The strong competition between retail chains, which fed through mainly into food prices, also helped to reduce the level of year-on-year net inflation.

Chart III.3.9 Structure of net inflation (y-o-y)



14 Net inflation = CPI adjusted for regulated prices and further adjusted for the effect of administrative measures (eg increases in indirect taxes and abolition of subsidies). Within the net inflation index, the food price index and the adjusted inflation index are monitored and analysed separately.

Food prices experienced extraordinary development, deviating in 1998 H2 from the typical seasonal trends. The constant month-on-month decline was largely the result of strong price pressure from subsidised agricultural products (primarily pork from EU countries) and a sizeable drop in tropical fruit prices, combined with the low domestic demand and the aforementioned competition between retail chains. Thanks to these factors, food prices (adjusted for the influence of indirect taxes) fell by 1.2% year-on-year as of the end of 1998, whereas in 1997 they rose by 5.6%

Adjusted inflation[15] also slowed (by 3.9 percentage points to 3.7% at the end of 1998 adjusted for the influence of the increase in indirect taxes), thanks mainly to falling world oil prices, the koruna's exchange rate and the domestic demand decline. The drop in oil prices not only pushed down consumer prices of petrol and diesel, but also led to slower price growth in the transport area and to a decline in costs for businesses of all types. The koruna's appreciation lowered the prices of direct imports of consumer goods as well as sub-deliveries for industrial businesses, which in turn, via a slower rise in industrial producer prices, had a favourable effect on consumer prices.

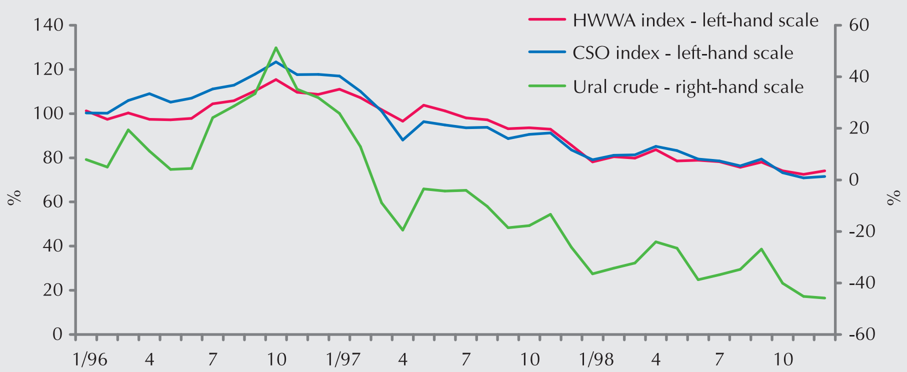
CPI inflation in 1998 was influenced to a large extent by regulated prices and other administrative interventions (the rise in indirect taxes and cuts in subsidies for school canteens). These accounted for 80% of year-on-year CPI inflation in 1998 (with regulated prices contributing 4.7 percentage points and other administrative interventions 0.7 percentage points).

The main contributions to regulated price inflation came from prices of electricity (up by 44%), heating (22%), rents (24%), gas (44%) and mandatory insurance of motor vehicles (60%). Overall, however, the year-on-year rise in regulated prices was lower than in 1997.

III.3.4.2 Global prices of raw materials, import prices

Global prices of raw materials, which are imported into the Czech Republic in substantial volumes, were exceptionally favourable with respect to their impact on domestic prices. The positive tendencies visible in the HWWA index in 1997 (a year-on-year decline of 1.7%) further strengthened in 1998. The HWWA index displayed a sharp downward trend throughout year, falling by 22.3% year-on-year; the largest drop occurred in Q4 (26.4%). Within the index, the biggest decline was registered for energy raw materials (down by 29%). The average price of Ural crude in 1998 was USD 11.85 per barrel, down 35% from 1997. In December 1998 it fell to as low as USD 9.32 per barrel. Global prices of raw materials and foodstuffs reflected the ongoing excess of supply over demand (due mainly to the worldwide weakening of demand caused primarily by the economic developments in Asia).

Chart III.3.10 HWWA index, CSO index and y-o-y changes in prices of Ural crude



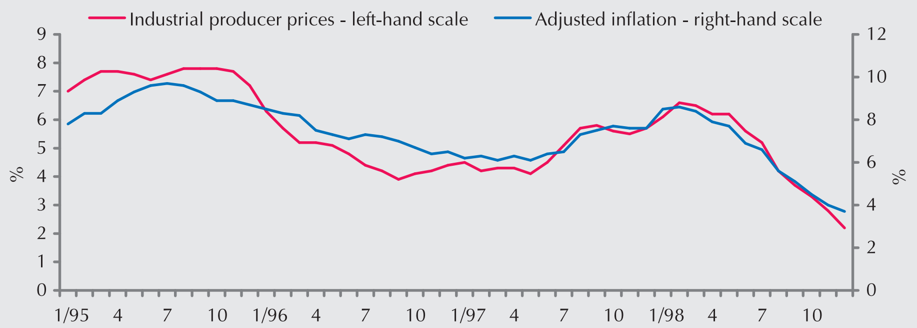
15 Adjusted inflation includes non-food prices excluding regulated prices

In 1998, import prices monitored with the CSO selection index fell by 2.7% year-on-year, compared with a rise of 5.1% a year earlier. During 1998 H1, growth in import prices slowed and from June 1998 changed into a gradual year-on-year decline (of as much as 10.1% in December 1998). This extremely positive development was the result of the ongoing fall in raw materials prices on global markets and the considerable appreciation of the koruna.

III.3.4.3 Producer prices

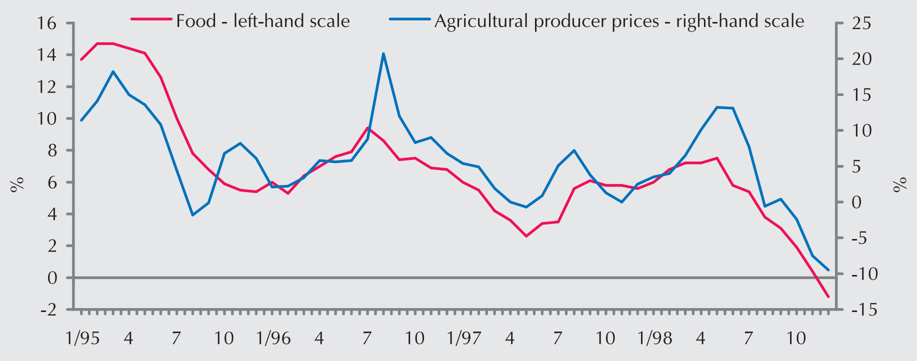
Although average year-on-year industrial producer price inflation in 1998 was the same as in 1997 (4.9%), the trend differed during the year. Unlike in 1997, there was a tendency towards a slowdown in growth. This trend picked up in Q3 and Q4 (largely because of lower year-on-year price increases in the manufacturing sector), resulting in an extraordinarily low inflation outturn at the end of 1998 (2.2% in December against 5.7% in December 1997).

Chart III.3.11 Industrial producer prices and adjusted inflation (y-o-y)



Construction work prices remained relatively high in 1998, but were lower on average compared with the previous year (down by 1.9 percentage points to 9.4%)[16] owing to lower growth in 1998 H2. At the end of 1998, year-on-year construction work inflation stood at 7.0%, or 4.9 percentage points less than at the end of 1997. The main factors in the continuing relatively high growth in this area were the interest costs associated with the relatively high indebtedness of construction firms combined with the steady rise in prices of a number of inputs in the industry and the ongoing wage growth. However, the impact of the above factors gradually unwound because of the overall reduction in domestic demand.

Chart III.3.12 Agricultural producer prices and food prices
(y-o-y growth)



16 ie average year-on-year price growth

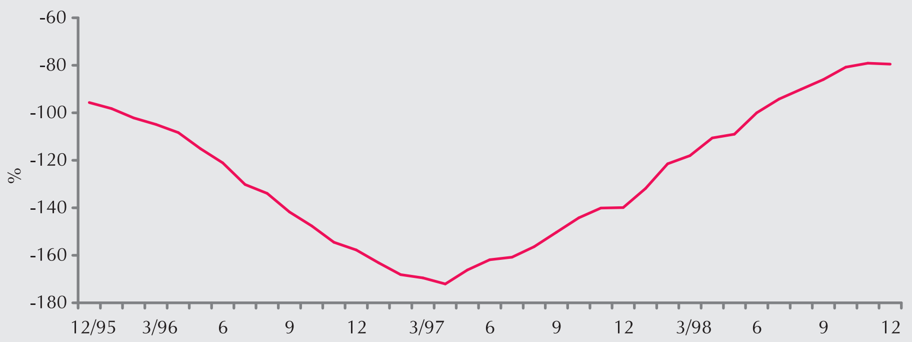
Agricultural producer prices saw very uneven development during 1998. The relatively fast increase in H1 (due in part to a low comparison base from the previous year) came to an end in H2 and later changed into a fairly significant decline (-9.5% year-on-year in December). This was the result of substantially lower prices for grain and livestock products. The fall in livestock prices was largely due to imports of subsidised pork from EU countries.

III.4 Balance of payments

III.4.1 The current account

The positive tendencies seen in the current account in 1997 H2 continued into 1998. In comparison with 1997, external influences played a greater role. At the close of 1998, the current account deficit stood at CZK 33.8 billion, down 67% compared with a year earlier. This decline also led to a significant improvement of relative indicators: against 1997, the current account deficit fell from 6.2% of GDP to 1.9%.

Chart III.4.1 Balance of trade (12-month moving aggregate)



The improvement in the current account balance was largely due to a fall in the trade deficit and an increase in the balance of services surplus. Compared with 1997, the trade deficit narrowed by CZK 60.7 billion to CZK 83.3 billion, and the balance of services surplus rose by CZK 4.8 billion to CZK 60.7 billion, mainly because of a decline in expenditure in the transport area. Unrequited transfers also continued to be in surplus, rising moderately to CZK 13 billion. The income deficit remained roughly at the 1997 level (CZK 24.2 billion).

The 43% year-on-year drop in the trade deficit was due to a 17.7% increase in exports accompanied by a 7.9% rise in imports. Import and export growth slowed substantially in the individual quarters. In 1998 Q1, exports rose by 45% and imports by 23.5% year-on-year, whereas in Q4 exports increased by only 0.3% and imports fell by 2.4%.

The gradual slowdown in export growth had two causes:

- the ever more difficult sales opportunities for Czech goods in foreign markets because of weakening external demand (the slowdown in economic growth in Western European countries, especially Germany, the economic problems in Slovakia, the Russian crisis)
- (in the second half of the year) the significant year-on-year appreciation of the koruna's exchange rate.

Medium-size and small firms without foreign ownership were hardest hit.

The lower import growth was associated mostly with a reduction in imports for intermediate consumption. This was due to the generally low competitiveness of Czech firms and weaker external and internal demand for their production, and also to a fall in the value of raw material imports resulting from the significant reduction in raw materials prices. The import slowdown was also attributable to the weakening household demand, which was reflected directly in imports of consumer goods.

The trade balance was ever more strongly affected during 1998 by the favourable terms of trade. The improvement in the terms of trade accounted for 91% of the year-on-year reduction in the trade deficit in 1998. In the second half of the year, it even outweighed the unfavourable effect of the excess physical volume of imports over that of exports. Had the terms of trade not considerably improved in this period, the trade deficit would have widened.

The territorial structure of exports – especially in the second half of 1998 – saw very mixed development. Whereas exports to advanced market economies rose by 24.8% year-on-year (despite concerns of a slowdown in their economic growth), exports to European transition economies, including the CIS, experienced year-on-year growth of only 4.8% (largely because of a sharp decline in Q4 of 20.5%, or CZK 12.9 billion; exports to Russia shrank in this period by 61.6%, or CZK 5 billion).

Germany, Slovakia and Austria – the three largest importers of Czech goods – accounted for 55.4% of total Czech exports. These nations' imports from the Czech Republic in individual months moderated year-on-year in line with total exports. Exports to Germany grew faster year-on-year in individual quarters than overall exports. Exports to Slovakia shrank by 2.9% because of a sharp fall in 1998 Q4. In the case of Germany and Austria, despite the overall moderation of export growth to these countries, exports of machinery and equipment (trade group 7) increased at a very rapid pace. By contrast, the decline in exports to Slovakia was generated by a significant reduction in group 7 exports.

A very positive tendency in 1998 was the year-on-year rise in exports of products with higher value added. Machinery and electrotechnical commodities accounted for 49% of total exports, up 4 percentage points year-on-year. In contrast, the share of exports of foodstuffs, raw materials and semi-manufactures was down by 2.6 percentage points year-on-year to 16.8% of total exports. Imports of low-value-added commodities dropped by 2.1 percentage points year-on-year, while imports of high-value-added commodities rose by a modest 1.6 percentage points. This was largely due to the very low prices of raw materials on world markets; for example, imports of oil recorded a year-on-year fall of 1.5% in physical terms while declining by 31% in value terms.

In terms of use, imports for intermediate consumption retained the highest share[17] (55.8%), followed by investment imports (24.8%). Imports for personal consumption accounted for 19.4% of the total. Imports for investment rose the fastest (up 10.8% year-on-year), mainly thanks to imports of power generating machinery and equipment and other transport equipment. Without these items, investment imports would have grown by only 1.6%. However, investment imports for the manufacturing sector increased at a relatively fast pace (up 9.6% year-on-year). Imports for personal consumption rose by just 0.6% in 1998, representing a significant slowing element.

III.4.2 The capital account

In 1998, the capital account, including transfers of a capital nature of non-produced, non-financial tangible assets and intangible rights, showed a moderate surplus of CZK 0.1 billion.

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17 The high share of these imports results from the high import propensity of GDP, which ensues mainly from the development of production collaboration (particularly in businesses with foreign ownership).

Table III.4.1. Capital account (CZK billions)

	1993	1994	1995	1996	1997	1998
Capital account	-16.2	0.0	0.2	0.0	0.3	0.1

Note: The figure of CZK -16.2 billion given for 1993 represents the transfer between the Czech Republic and Slovak Republic of shares from the first wave of voucher privatisation.

III.4.3 The financial account

The *financial account* in 1998 was affected by the significant worsening of the investment climate in the world economy, the subdued domestic demand, and, in the second half of the year, by the considerable fall in interest rates in the Czech Republic. The generally more prudent stance of investors was also influenced in the Czech Republic by a negative assessment of the economic transformation process and by the complicated situation in the banking sector. Capital flows did not experience any major structural changes. The share of direct investment in net capital inflow rose significantly to 95%, while long-term debt capital saw an outflow. The portfolio investment surplus remained at a similar level to 1997 because of low share prices and the efforts of domestic investment funds to sell off controlling stakes in selected businesses with good prospects. In 1998, the financial account posted a CZK 84.9 billion surplus, up CZK 50.6 billion from 1997.

Table III.4.2. Financial account (CZK billions)

	1993	1994	1995	1996	1997	1998
Financial account	88.2	97.0	218.3	116.6	34.3	84.9
- direct investment	16.4	21.5	67.0	37.7	40.5	80.2
- portfolio investment	46.7	24.6	36.2	19.7	34.4	32.7
- other long-term investment	23.5	31.9	89.3	84.4	12.9	-29.3
- other short-term investment	1.6	19.0	25.8	-25.2	-53.5	1.3

In 1998, the net inflow of *foreign direct investment* amounted to CZK 80.2 billion, almost double the 1997 figure. This was attributable to the implementation at both government and regional level of a policy of active support for foreign investment (ie the system of investment incentives adopted by the Government in April 1998). The inflow of direct investment from abroad stood at CZK 81.9 billion, an increase of CZK 40.6 billion against 1997. Most of the investment was channelled into industry (37.6%), trade, services and real estate activities (28.5%), finance and insurance (18.6%) and transport and communications (11.6%). Investment in industry went mainly into engineering, the food industry and electrical engineering. The largest investment came from the Netherlands (24.0%), Germany (21.2%), Great Britain (13.3%) and the USA (10.2%). Direct investment by domestic entities abroad continued to be of minor significance, amounting to only CZK 1.7 billion.

The total cumulative volume of foreign direct investment in the Czech Republic between 1 January 1990 and 31 December 1998 was CZK 375.5 billion (USD 120 billion). Of this, 16.5% went into transport and communications, 14.3% into trade, services and real estate activities, 11.8% into finance and insurance and 9.8% into transport equipment. The biggest investors in the Czech Republic were Germany (26.5%), the Netherlands (16.6%) and the USA (12.4%).

Portfolio investment in 1998 was affected by the increased distrust on the part of foreign investors in developing markets in general. In the Czech Republic, this was heightened by the unfavourable economic situation of many businesses and banks. This fed through into a decline in share prices and a very volatile portfolio investment balance during the year. The fall in prices of domestic shares and a shortage of funds led to domestic investment funds selling off their stakes in promising businesses in the communications, services and power sectors – areas in which foreign investors remain generally interested. This showed up in growth in the portfolio investment surplus (particularly in the second half of the year), which reached CZK 32.7 billion, down just CZK 1.7 billion compared with a year earlier.

On the domestic capital market, purchases of securities exceeded sales by non-residents by CZK 28.8 billion. For equity securities the difference was CZK 34.8 billion. By contrast, for debt securities, sales outstripped purchases by CZK 6.0 billion because of increased sales of short-term bonds, particularly T-bills.

At the end of 1998, koruna-denominated portfolio investment stood at CZK 127.6 billion (USD 4.3 billion). Most of this went into transport and communications (37.6%, up 12.5 percentage points from 1997), followed by services (21%, up 17 percentage points). The biggest investors were Great Britain, the USA, Slovakia and Germany.

In 1998 Q4, there was one bond issue (Aero Vodochody, USD 200 million) on foreign markets. As of 31 December 1998 the value of outstanding resident-issued bonds denominated in foreign currencies was CZK 38.5 billion (USD 1.3 billion).

In Q3 and Q4, domestic investors started to show increased interest in foreign securities. In 1998, purchases of these outstripped sales by CZK 2.6 billion, and residents' foreign securities holdings reached CZK 37.5 billion (USD 1.3 billion).

Within *other investment*, there was a capital outflow of CZK 28.0 billion in 1998. This trend reflected low long-term borrowing by commercial banks, which in previous years was the main channel of foreign capital inflow. This was associated both with the more prudent policy of Czech banks in providing loans, which were characterised by an increased exchange rate risk, and with the rise in the price of credit for Czech entities due to the poorer quality of banking portfolios and lower ratings. The only major loan was drawn by Komerční banka to finance the Government's programme for infrastructure renewal. Other loans by major banks mainly took the form of subordinated debt. Borrowing by businesses directly abroad also slowed. Long-term investment inflow started to be outpaced by repayments of these investments, causing a modest net outflow of such funds. The total net decline in long-term credits stood at CZK 29.3 billion.

Short-term investment displayed significant volatility in 1998. Short-term bank liabilities fell substantially in the first half of the year, but started rising again in the second half, documenting the commercial banks' orientation towards wider use of short-term financing. At the same time, the koruna assets of commercial banks vis-à-vis non-residents increased. Short-term investment flows were basically balanced for the full year, posting a surplus of CZK 1.3 billion.

III.4.4 International reserves

In 1998, the CNB's international reserves (especially in dollar terms) experienced a fundamental turnaround in the downward trend seen during 1996 and 1997. During 1998, the reserves rose by CZK 38.4 billion. However, in dollar terms they increased much more substantially, rising by USD 2.8 billion because of exchange rate movements. Several factors acted simultaneously on the level of the reserves, as described below.

The CNB intervened on the foreign exchange market to moderate the appreciation pressures generated by the foreign capital inflow. As a result, the CNB's foreign exchange reserves increased by CZK 62.8 billion.

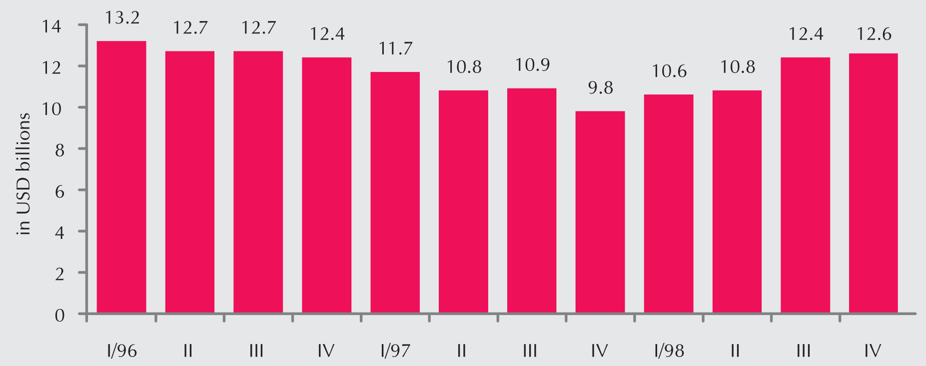
Government and government institution liabilities fallen due, including interest, stood at USD 373.7 million. These involved repayments of the liabilities of the former central foreign exchange resource (liabilities originating prior to the liberalisation of the foreign exchange regime in 1991), G24 countries' loans dating from the start of 1990s, and EBRD loans.

The reserves rose at an unusually high rate during 1998 because of a change in their structure, in particular a lower share of gold (whose value in the reserves is not given at the market price) and an increased proportion of assets in freely convertible currencies. The total value of gold sold was USD 539.4 million.

The value of the reserves was significantly affected during the year by exchange-rate movements. In 1998, the koruna appreciated against the US dollar by approximately 16.0% (1998-end against 1997-end) and the dollar weakened against the Deutsche Mark by about 7%. (International reserves are usually given in dollars; however, in the case of the Czech Republic, approximately two thirds of the reserves were denominated in Deutsche Marks).

At the end of 1998, international reserves totalled USD 12.6 billion, or approximately CZK 376.9 billion.

Chart III.4.2. CNB international reserves



III.5 Public finances

The fiscal policy for 1998 was based on a medium-term strategy whose main targets were to maintain a stable economic environment by:

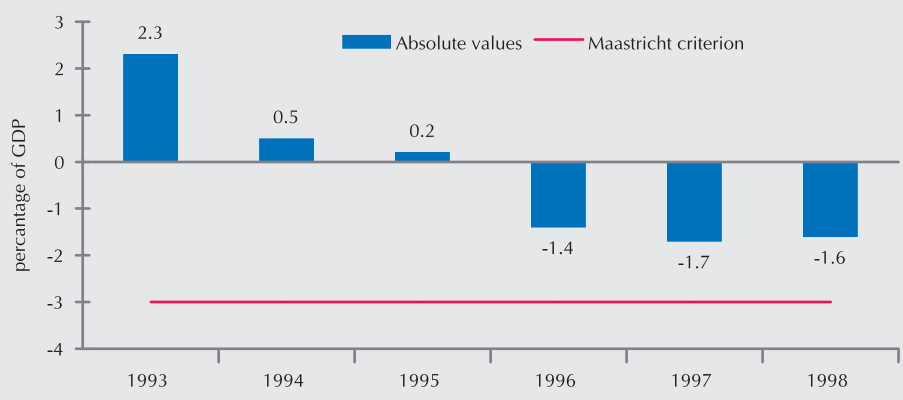
- creating surplus public budgets,
- restricting government consumption and limiting wage growth,
- lowering the share of redistribution through the budget,
- applying maximum pressure for economy, and
- supporting selected priorities (transport infrastructure, science and research, defence).

As early as in its preparatory phase, the state budget for 1998 was affected by a number of factors, notably the macroeconomic developments in 1997 – which led to restrictive economic measures – and the financial consequences of the floods in July 1997. The stabilisation and pro-growth measures of the government "packages" introduced were intended to accelerate the budgetary process, improve business and export conditions, tighten the legislative framework, and standardise and increase the transparency of the financial markets. To balance the budget for 1998, resources were sought in selective non-mandatory expenditure savings; on the revenues side, consumer taxes, administrative fees and motorway fees were increased.

According to forecasts, the public budgets[18] were to have seen a deficit of approximately CZK 17 billion (about 0.9% of GDP) in 1998. This consisted mainly of an expected local budget deficit of around CZK 9.0 billion and a state financial assets deficit of CZK 5.4 billion. A year-on-year decline of 2.5 percentage points was reckoned with in the share of public budget expenditures in GDP. This was necessary for achieving a ratio of 37.5% at the close of 1998, which is comparable with that of other OECD countries. The ratio actually achieved was 38.5%, which is still a positive result considering the accompanying aspects of budget development. The public budgets ended 1998 with a deficit of CZK 28.7 billion, or 1.6% of GDP. The original budget approved by Parliament was therefore not met; however, the indicative Maastricht criteria limit of 3% of GDP was not exceeded. The public budget performance in recent years is shown in the following chart:

18 ie the state budget, local budgets, state financial assets, state funds, the NPF, the Land Fund, health insurance companies

Chart III.5.1 Ratio of public budgets deficit/surplus to GDP



Although the 1998 state budget was prepared under non-standard conditions, it was set as balanced, with revenues and expenditures of CZK 536.6 billion; GDP growth of 2.2% and inflation of 9.0% were assumed.

As early as in the first half of 1998 it became apparent that the reduction in the external deficits was being accompanied by a fall in economic output. The reduced domestic demand and simultaneous slowdown in wage growth fed through into revenues. The budget surplus posted for the period up to November 1998 was only temporary, owing to significantly slower drawing on expenditures. Subsequent extraordinary expenditures approved by the Lower House enabled the financing of extraordinary elections, an increase in health insurance for people insured by the state, and the July valorisation of pensions. The requirements for extraordinary budgetary expenditures led to the “budget measures” in September 1998, by which the originally approved balanced budget was changed to a deficit of CZK 11 billion. This change also became the starting point for the Government’s draft state budget for 1999 and the criterion for assessing the final account for 1998. A whole range of other extraordinary requirements increasing the deficit risk were added to the items mentioned above, most of which turned out to be real.

The revenues side of the state budget reflected the economic decline, in the presence of the usual seasonal fluctuations. The lower demand showed up directly in lower indirect tax revenues. However, the fall (of around CZK 9 billion for VAT and CZK 6 billion for consumer taxes) was offset by significantly higher collection of corporate income tax (the settlement of the lower advances due to flood-related tax relief in 1997) and partly also of natural person income tax (withholding taxes). In short, the revenues side developed broadly in line with budget forecasts and did not affect the final budget deficit.

The expenditures side of the state budget, which was predetermined by the Government’s “package restrictions” in 1997, was additionally burdened by originally unplanned expenditures, the major part of which were not drawn until December 1998. These extraordinary expenditures consisted mainly of transfer payments (pension valorisation, higher payments of health insurance for state employees and the non-productive population, the payment of a state guarantee to Česká spořitelna, the settlement of Konsolidační banka’s loss for 1997, financial compensation of banks), and partly represented higher expenditure on government consumption (the extraordinary elections, the covering of valuation changes, state guarantees realised). The originally posted state budget deficit for 1998 (CZK 26.3 billion), which was generated by these extraordinary expenditures, was further adjusted during the supplementary period for final investment invoices and wages of budgetary organisations to a final amount of CZK 29.3 billion.

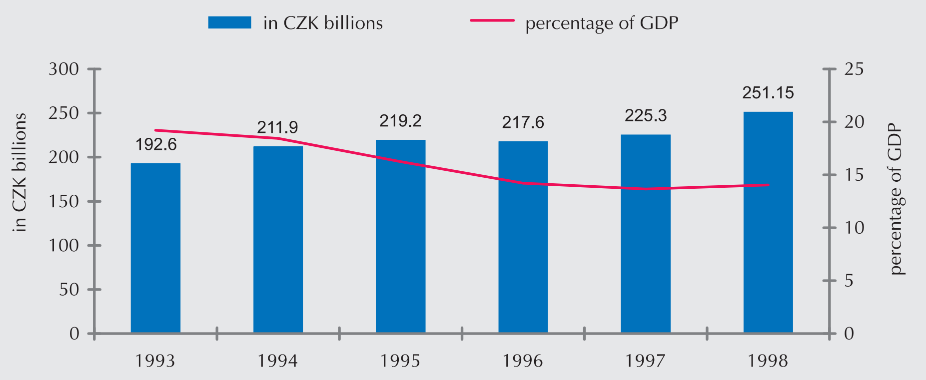
The ongoing poor payment discipline of taxpayers, which is showing up in the level of delinquent tax, is a negative feature accompanying the deteriorating economic situation of the business sector. Delinquent tax totalled around CZK 82 billion at the end of 1998, of which “new” taxes accounted for CZK 70.2 billion. However, the acceleration of growth in delinquent tax is also the result of improved inspection by the tax authorities. Although the level of delinquent tax is comparable with that in advanced EU countries, the acceleration of growth (which in 1998 was CZK 15.6 billion, against CZK 8.76 billion in 1997) is a warning sign. The poor results of businesses and their high credit burden can be considered the primary causes of the deterioration in payment discipline.

In view of the unfavourable developments in 1997, the 1998 budget for regional authorities was drafted with a deficit of CZK 9.0 billion. However, during 1998 municipalities and district authorities used their funds very prudently, which was reflected favourably not only in the results posted during the year, but also in the final local budgets surplus. The full-year surplus of CZK 1.5 billion was generated mainly by an improvement in the revenues (especially tax revenues) shared with the state budget (corporate income tax accounted for 20% and wage-earners' income tax for 64%). In absolute terms, the budgetary projection for corporate income tax was surpassed by CZK 6.5 billion and that for capital incomes by approximately CZK 7.3 billion.

The public budget results can be viewed as the basic element influencing net credit to the government sector[19]. According to preliminary results, net government indebtedness was up CZK 13.8 billion against the base (compared with a rise of CZK 12.2 billion in 1997). This increase was due to the financing of the state budget deficit (of CZK 29.3 billion) by the banking sector in the amount of CZK 13.2 billion, and by the repayment of a foreign loan provided for balance of payments support in the amount of CZK 7.2 billion. Other items of net credit to government reduced the level of indebtedness through their growing deposits with the banking system. The significant growth of state securities held by the domestic non-bank sector (CZK 28.9 billion, of which CZK 16.1 billion for financing the state budget deficit) testifies to the attractiveness of these products.

The Czech Republic's public debt comprises the indebtedness at the level of the state, the municipal budgets, state funds, health insurance companies and the National Property Fund. As of 31 December 1998, the total public debt amounted to approximately CZK 251.2 billion, or around 14% of GDP (an increase of CZK 26 billion, or 0.4 percentage points, against 1997). From the point of view of meeting the Maastricht criteria (60% of GDP), the level of public debt is well below the indicative condition for the Czech Republic's accession to EMU. The most important segment of public indebtedness is the state debt, which directly reflects the state budget deficit (CZK 29.3 billion in 1998). Local budget indebtedness was flat in the assessed period of 1998; within its structure, the decline in credit volume was balanced by an increase in municipal bonds. The fall in the NPF's indebtedness was generated by the repayment of bonds in February 1998 and the decline in health insurance company indebtedness through the partial repayment of credits. The significant increase in the indebtedness of state funds (CZK 3.1 billion) was caused by the acceptance of a credit in the State Fund for Market Regulation. The following chart[20] depicts public debt in the 1993–1998 period.

Chart III.5.2 Public debt in the Czech Republic



19 This includes the net position with the banking sector of the central bank, municipal budgets, state funds, the NPF and health insurance companies.

20 The data do not include the so-called "hidden state debt".

During 1998, the share of domestic debt in the total public debt continued to rise, increasing by 9.3 percentage points, while the foreign item fell by a corresponding amount. The tendency towards an increasing volume of public debt being financed with government securities, specifically with medium-term bonds (totalling approximately CZK 12 billion), also continued. The growth in the T-bill volume was proportional to the amount needed to finance the 1998 state budget deficit.

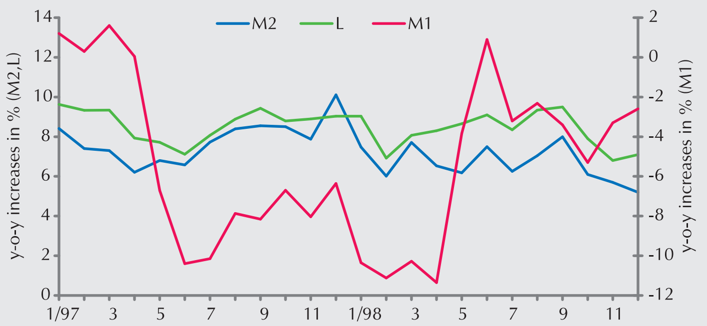
III.6 Monetary developments

III.6.1 Monetary aggregates

Monetary aggregates (M2, L) saw a decline in year-on-year growth. As in 1997, M1 showed a negative year-on-year increase. This trend reflected the lower level of demand for money related to the economic decline and lower growth in the price level.

The year-on-year increases in M2 moved between 5.2% and 8%, although during the year they showed a moderate downward tendency. Average nominal year-on-year M2 growth for the 12 months was 6.6%. In real terms (adjusted for the GDP deflator), the average M2 year-on-year increase was negative at -4.1%.

Chart III.6.1 Monetary aggregates M1, M2 and L



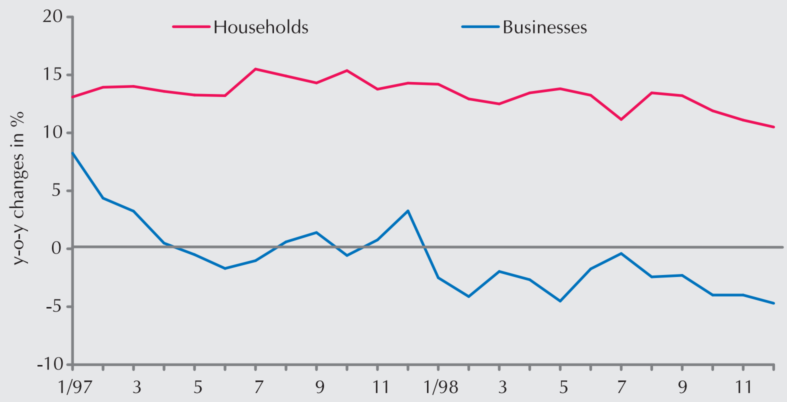
Definition of monetary aggregates
M1 = currency in circulation + demand deposits
M2 = M1 + quasi money
L = M2 + T-bills + CNB bills in portfolios of domestic non-bank entities

The gradual decline in year-on-year M2 and L growth and the negative year-on-year increases in M1 were largely due to lending to businesses and households and to the state budget running a surplus for most of the year (with the exception of December). The absolute increase in the money supply was strongly influenced by the net foreign assets of the banking sector. The growth in these assets reflected the capital inflow on the financial account accompanied by the rise in the CNB's international reserves.

In 1998, growth of M2 and L continued to outpace that of M1 (which represents highly liquid money). The negative year-on-year increases in M1 testify to low demand for liquid money. This is a result of declining economic output and savings growth in favour of time deposits. Balances on current accounts were minimised, which led to a rise in the share of currency in circulation in M1 (29.4% at the end of 1998, against 26.8% in December 1997).

The *M2 sector structure* indicates that the downward trend in year-on-year money supply growth affected the money balances held by businesses and households. Both economic sectors showed a slight tendency towards a decline in year-on-year growth. However, the year-on-year money supply increases of businesses were negative and were broadly in line with the low money supply through bank lending.

Chart III.6.2 M2 by sector



In 1998, the *money supply time structure* saw a decline in demand deposits and a rise in time deposits. The share of currency in circulation and foreign currency deposits remained virtually unchanged (with the share of foreign currency deposits in M2 even falling modestly). This was associated with the attempt by individual economic entities to earn higher appreciation on their savings in view of the relatively high level of both nominal and real interest rates on time deposits compared with demand deposits.

Table III.6.1. Structure of money supply in %

	12/1997	3/1998	6/1998	9/1998	12/1998
Currency in circulation	9.8	9.8	9.9	9.7	9.9
Demand deposits	26.7	23.3	23.3	22.5	23.9
Time deposits	52.1	55.6	54.9	56.1	52.7
CDs, deposit bills of exchange + other bonds	0.0	0.3	0.4	0.8	2.4
Foreign currency deposits	11.4	11.0	11.5	10.9	11.1
Total M2	100.0	100.0	100.0	100.0	100.0

The significant increase in certificates of deposit, bills of exchange and other bonds at the close of the year (December) can be viewed as a one-off deviation.

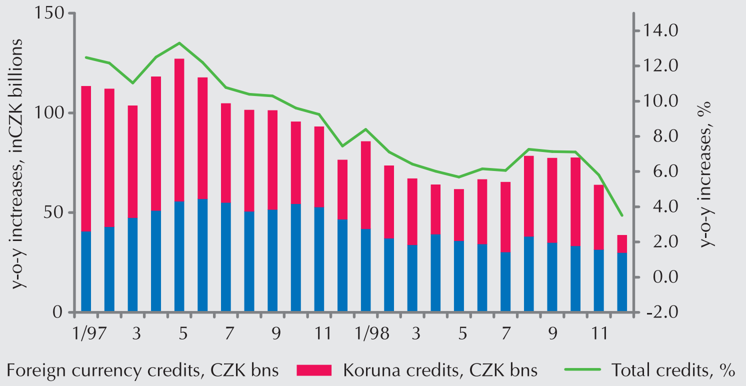
III.6.2 Credit supply

In 1998, credit to businesses and households fell significantly in year-on-year terms because of the relatively high level of both nominal and real interest rates, which curbed credit demand. Also, measures introduced by the CNB's Banking Supervision Department forced banks to assess credit risks in a standardised manner and hence to curtail credit supply. In 1998 H2, the first factor was to a large extent eliminated as interest rates gradually declined. The second factor involves standard requirements, and so an easing of this cannot be expected. A third significant factor for credit supply is the situation at the microeconomic level. The insufficient level of own funds in the corporate sector, the credit burden dating both from the 1990s and from the pre-1990 period, and the generally low productivity of Czech businesses and hence their inability to guarantee repayment of commitments are causing a curtailment of bank lending.

Lending to businesses and households fell from a relative year-on-year increase of 9.4% at the end of 1997 to -2.7% a year later. However, these figures are affected by a range of factors that do not generate a real increase or decline in credit supply, notably credit write-offs, exchange rate influences, the exclusion of banks from the banking system after their licences have been revoked, etc. To assess monetary developments, credit supply must be adjusted for these influences. However, the adjusted credit supply also fell, from 7.5% at the end of 1997 to 3.5% at the end of 1998. Besides the real reduction in credit growth, the decline also includes special operations to restructure the credit portfolio of a selected group of banks.

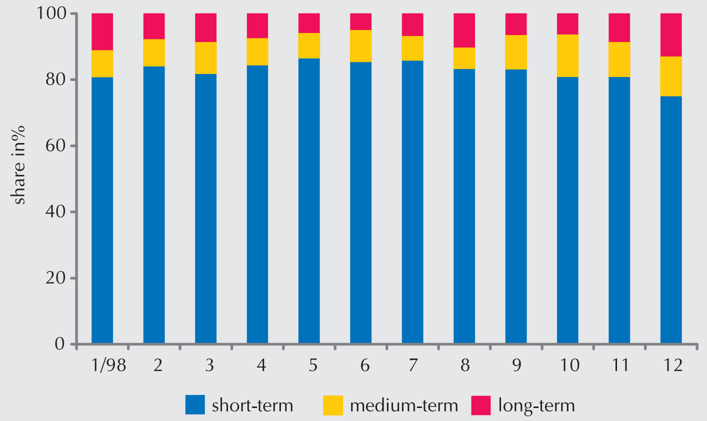
The fall in the year-on-year growth of credit to businesses and households was affected above all by koruna lending, which increased by approximately CZK 9 billion in absolute terms in the period under review. Foreign currency credits rose by CZK 30 billion. Owing to the high level of interest rates on newly granted credits, most of the credits were drawn in foreign currency. The total increase in credit was CZK 39 billion, against CZK 76 billion a year earlier.

Chart II.6.3 Adjusted credits (koruna and foreign currency)



In 1998, there were no major changes in the *time structure of credits*; short-term credits continued to predominate.

Chart III.6.4 Time structure of new koruna credits in %



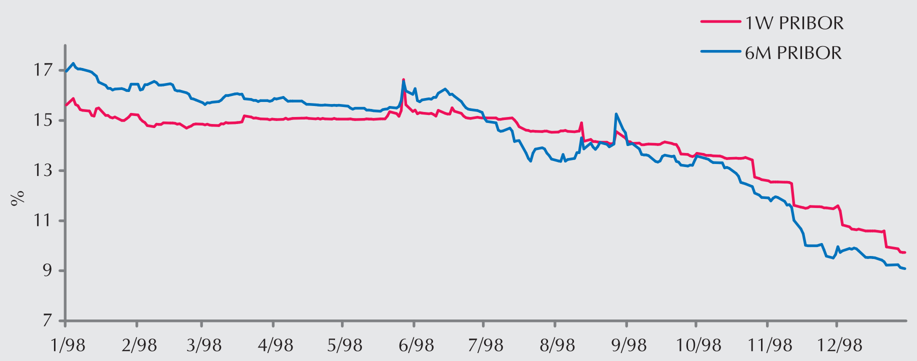
As for the *allocation of credits by purpose*, operating credits accounted for the biggest share at the end of 1998 (one half of all credits). Their share stagnated at the previous year's level. The share of investment credits – the second largest item (one third of all credits) – rose moderately (by 0.9 percentage points). Mortgage and consumer credits as well as credits for securities purchases rose in absolute terms and had an increased share in total credits.

III.7 Financial markets

III.7.1 The money market

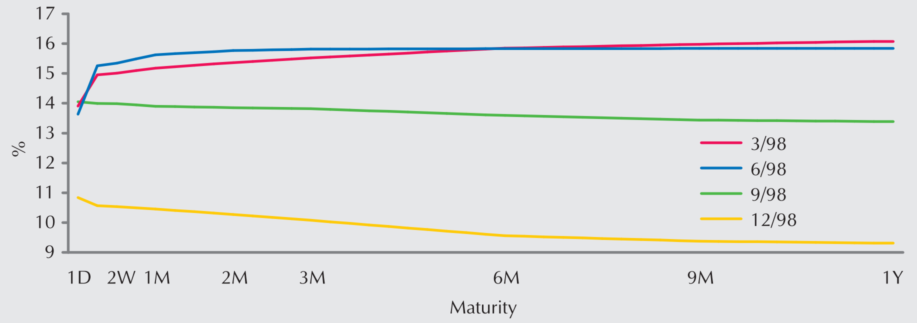
At the beginning of the year, short-term interest rates on the money market gradually declined from their high level of the end of the previous year. In 1997, the Czech market went through several periods of exchange rate turbulence associated with rising interest rates. The slow decline in rates in 1998 continued until mid-May; a faster rate of decline was prevented by the relatively high inflation (around 13%), which started falling in June. However, in the middle of the year the fall in interest rates was interrupted by the Russian financial crisis and nervousness related to the early parliamentary elections. After the situation had calmed, a further crisis erupted on the Russian financial markets which gradually spread to both the emerging and advanced markets. The Czech market was affected by this turbulence for only a short time and interest rates continued falling, helped by favourable inflation and the generally calm situation on other financial markets. These circumstances enabled the central bank to gradually cut its key interest rates. The CNB's basic rate (the repo rate) was cut in seven phases by a total of 5.5 percentage points. At the end of 1998, the repo rate stood at 9.5%, the Lombard rate was down to 12.5% and the discount rate down to 7.5%.

Chart III.7.1 1W and 6M PRIBOR rates



These changes fed through into PRIBOR rates. The average 1W PRIBOR was 15.3% in January, 14.0% in September and 10.6% in December. Longer maturities experienced a more significant decline. The yield curve shifted downwards and its slope changed in the mid-year from positive to negative. This indicated increasing expectations by financial market participants of a future decline in inflation and interest rates.

Chart III.7.2 Yield curve for PRIBOR rates

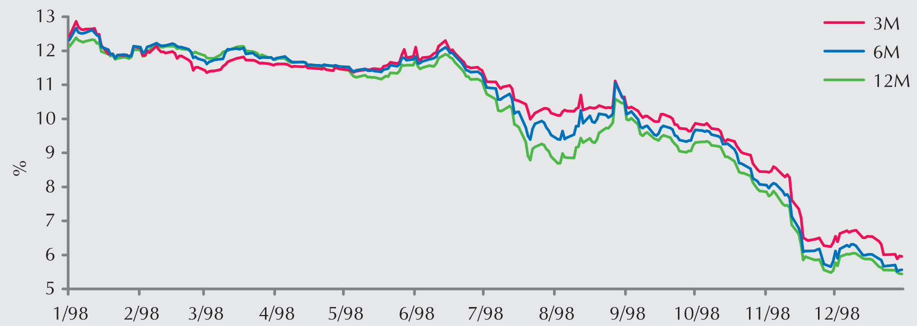


The derivatives market (FRA rates) mirrored PRIBOR rates. However, because of its greater sensitivity it was more volatile. This showed up particularly during the Russian financial crisis and in the last quarter of the year in a higher rate of decline in connection with expectations of interest rate cuts (favourable inflation but unfavourable other macroeconomic indicators).

The short-term bond market comprises mainly T-bills. Thirty seven primary auctions of T-bills with one-year maturity took place. The decline in gross T-bill yields mirrored the interest rate fall in other money market segments. These rates were moving around 16%–17% at the beginning of the year, but fell to below 9% at the end of the year. All auctions saw demand overhang, so the resulting gross yields were below the announced limit yields. The CNB also issues CNB bills, but includes these in its own portfolio and uses them subsequently as collateral for repo operations with commercial banks.

In view of the relative long-term stability of foreign interest rates, the interest rate differential mainly mirrored movements of domestic interest rates. In European countries, interest rates were unified at 3% in connection with the launch of EMU. Key rates in the USA also fell, particularly at the close of the year. However, the downward trend on the interbank domestic deposit market was much more marked and so the interest rate differential dropped. Nevertheless, non-residents continued to be interested in investing in koruna assets. Whereas in H1 the PRIBID/CZK-LIBOR/DEM interest rate differential moved around 12%, at the end of the year it stood at 6% at 3M maturities, 5%–6% at 6M maturities and 5.4% at 1Y maturities.

Chart III.7.3 Interest rate differential PRIBID/CZK - LIBOR/DEM



III.7.2 The interbank foreign exchange market

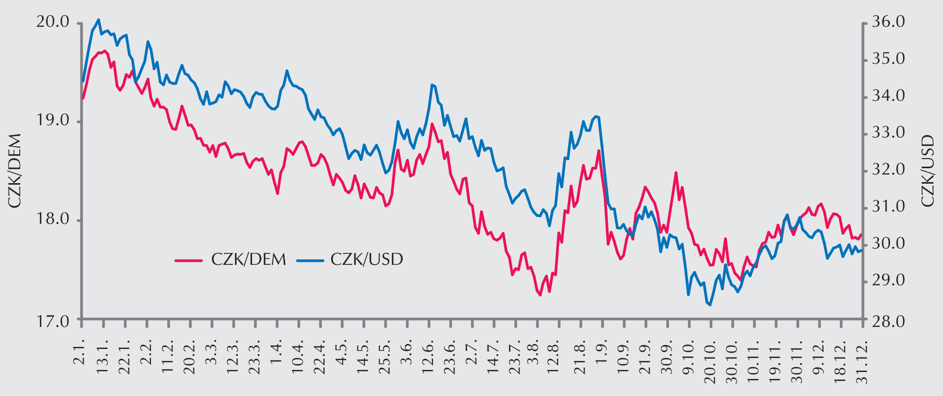
The koruna's nominal exchange rate against the Deutsche Mark showed an appreciation tendency throughout 1998. This is particularly clear from the first five months of last year, when there was a significant appreciation trend and only small deviations. This can be attributed mostly to the interest rate differential, which vis-à-vis both the Deutsche Mark and the dollar in this appreciation period was constantly above the level of the previous few years. In the subsequent period (characterised by a decline in the CNB's key interest rates), the effect of the interest rate differential on the koruna appreciation gradually diminished.

The appreciation tendency was interrupted several times by depreciation fluctuations. The first occurred at the turn of May and June, when the Asian financial crisis peaked, and lasted approximately until the end of June. The second depreciation phase (linked to the Russian financial crisis) started in late August and ended at the beginning of September. In the first half of September, when the first responses of world markets to the freeing of the rouble exchange rate had unwound, the koruna started strengthening again. In the second half of September, international investors realised that the Russian developments reflected persistent difficulties in the world financial system. The resultant nervousness spread to central European countries, including the Czech Republic, and the koruna weakened again. These depreciations of the exchange rate demonstrate its sensitivity to the external environment. The rapid unwinding of these fluctuations indicates a certain shift in foreign investors' approach to the Czech financial market and an assessment of it as qualitatively different from the post-Soviet environment and non-European emerging markets.

These deviations from the appreciation trend happened during the period of higher volatility in the koruna exchange rate, ie between the end of May and October. One reason for the increased volatility, besides the above-mentioned turbulence on the emerging financial markets, may have been uncertainty about the domestic political scene and related uncertainty regarding future economic policy.

The last two months of the year (before the launch of the euro) saw a decline in the interest rates of both the euro "core" countries (Germany, Benelux, France) and the "peripheral" countries. The key domestic money market interest rates (the repo, discount and Lombard rates) also saw a substantial decrease. These two processes resulted first in a slight koruna depreciation, lasting until mid-December, and then a modest appreciation. In general, however, this was a period of relative exchange rate stability (low volatility).

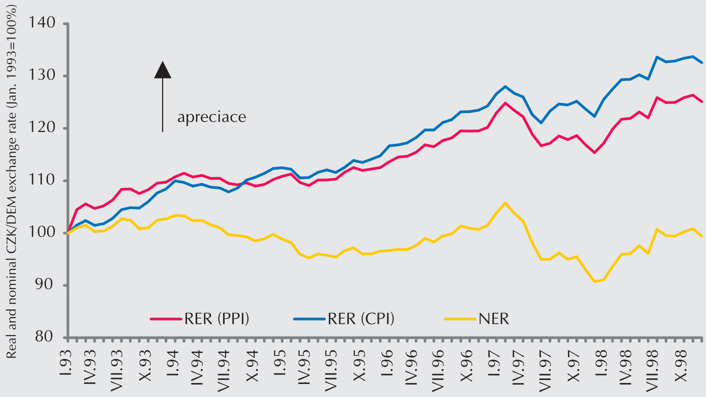
Chart III.7.4 Nominal CZK/DEM and CZK/USD exchange rates - 1998 daily rates



In general, the koruna was more volatile against the dollar than against European currencies. The Deutsche Mark strengthened against the US dollar in H2, probably because of expectations associated with the euro launch, or possibly owing to the military conflict in Iraq, ie factors with no links to the Czech economy. Nevertheless, this weakening of the dollar was the formal cause of the strengthening of the CZK/USD exchange rate in September, October and December.

The koruna's real exchange rate appreciated steadily until the last five months of the year. This strengthening was generated both by an appreciation of the CZK/DEM nominal rate and by the higher inflation in the Czech Republic compared with Germany. However, from H2, inflation in the Czech Republic fell significantly, which together with a slight decline in inflation in other EU countries meant that the nominal exchange rate became the most important factor for movements in the real exchange rate. The relative stability of the nominal exchange rate was thus reflected in real exchange rate stability.

Chart III.7.5 Monthly averages of nominal and real CZK/DEM exchange rates in 1993-1998



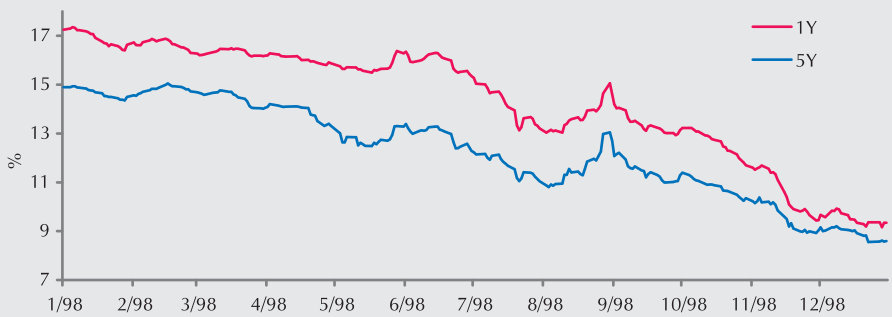
Note: Because of harmonisation with international statistics, the graph has been adjusted so that appreciation expresses growth in the exchange rate.

From this chart it is apparent that the nominal fluctuation in the CZK/DEM ratio are, with no major changes, visible also on the real exchange rate curves based on both the CPI and the PPI. The last five months of 1998 in particular saw a stabilisation of both the nominal and real exchange rates.

III.7.3 The capital market

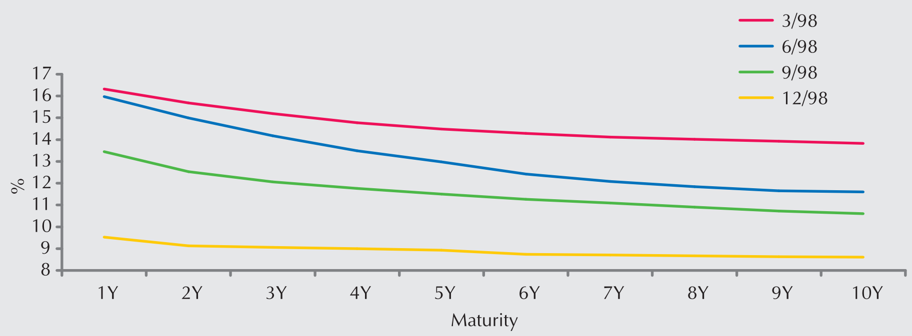
Long-term interest rates (IRS, yields on the bond market), like money market interest rates, were for the most part falling throughout year owing to expectations of a favourable inflation rate and CNB interest rate cuts (especially in H2). The two short periods when the crises on the Russian financial market (at the turn of May and June, and in August) negatively affected interest rates were the exception. The total decline was 7.9 percentage points at 1Y maturities and 6.3 percentage points at 5Y maturities.

Chart III.7.6 1Y and 5Y IRS interest rates



IRS yield curve slopes were negative throughout year, although they gradually moderated as the expectations of lower inflation and a reduction in key koruna rates were borne out.

Chart III.7.7 Yield curve for IRS rates

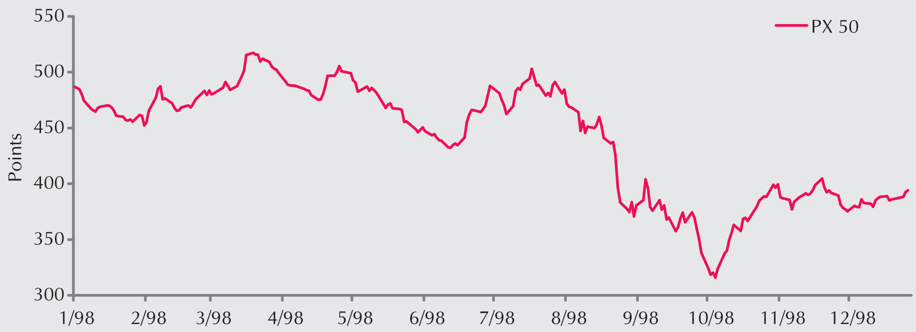


The bond market experienced similar development in terms of both yield levels and yield curve slopes (for government taxed bonds and corporate bonds). Four issues took place on the primary government bond market (2Y and 5Y maturities, total volume CZK 20 billion). Apart from the first two issues in February (when the negative influence of the 1997 crisis was still unwinding and interest rates were relatively high), investor interest in the remaining auctions was fairly strong. The average yields achieved in the auctions declined very fast owing to high demand for government bonds and the general trend in the interest rate level. Eleven issues (totalling CZK 27 billion) took place on the primary corporate bond market, and there were four issues of mortgage certificates (totalling CZK 2.2 billion).

The stock market was strongly affected by events abroad. In H2 in particular, prices reflected the global upheaval on world financial markets caused by the Russian financial crisis and associated with the decline in investor interest in developing markets. However, at the same time, long-term factors (the situation on the capital market, the overall economic situation) and the poor results of individual businesses and banks were also apparent. These factors gave rise to relatively high price volatility during the year. At the beginning of the year, the main stock exchange index, the PX-50, gradually weakened. Later, this trend changed and shares started growing (the index peaked at 517.3 points on 23 March). In H2, share prices were hit by the Russian financial crisis and for the most part fell. This crisis and subsequently also the bankruptcy of one of the major hedge funds led to turbulence on world stock markets. It also caused investors to exit developing markets and head for those of advanced countries, and to shift from stock markets to safer government bond markets. The unfavourable economic developments in the Czech Republic and the poor results of individual firms fed through to the Czech stock market, particularly in H2. The biggest fallers were bank shares because of serious economic problems related to bad credit portfolios, the necessity of creating reserves, and to losses from trading in Russia. Share prices rebounded slightly at the end of the year.

In year-on-year comparison, all the monitored share indices lost: the official PX-50 index 20.4%, the global PX Glob index 20.2% and the RM-System PK-30 index 13.7%. Growth was recorded only in a number of sector indices (agriculture, investment funds and transport and communications). The poor state of the stock market is also shown by the trading volume, which was down 29.9% against a year earlier to CZK 169.2 billion. Only 42% of the trading took place on the central market. For comparison, bonds worth CZK 687.6 billion were traded on the PSE, almost 100% of them through direct trades. At the close of the year, the market capitalisation of the stock market was CZK 401.1 billion, that of the participation certificate market CZK 15.1 billion and that of the bond market CZK 198.1 billion. From the point of view of the market's price-setting function, the launch of PSE trading in the SPAD system (the "System for the Support of the Stock and Bond Market"), which uses market makers, was of great significance. SPAD started up on 25 May with several of the most liquid shares, and according to the results of trading it is substantially strengthening the role of the central market (more than 90% of central market trading is executed through this system).

Chart III.7.8 PX 50 Index



III.8 Monetary policy

III.8.1 Direct inflation targeting

In December 1997, the CNB Bank Board decided to change monetary policy strategy and, starting 1998, switched to direct inflation targeting. This did not signify a change in its long-term target – price stability – but only in the manner of monetary policy implementation. There were several reasons for the step.

One of the most important reasons was the loss of the nominal anchor provided from the very beginning of transformation by exchange rate stability. This loss resulted from the exchange rate turbulence in May 1997, during which the CNB switched over to a managed floating regime.

Another reason was the limited possibility of monetary policy achieving price stability through intermediate (money supply) targets. The unstable function of demand for money and the ensuing not entirely clear relation between money supply in the economy and inflation posed a serious complication for the use of money supply targeting as an intermediary target of monetary policy. In an environment of major financial innovations and a liberalised capital account, both linkages – between prices and money supply and between money supply and the instruments of the central bank – were weakened.

The multi-criteria approach typical of the strategy of direct inflation targeting seemed at the end of 1997 to be the most appropriate monetary policy regime. This approach uses a system of indicators of future inflation, within the framework of which the money supply continues to occupy an important place. The conditional inflation projection plays a pivotal role in decision-making regarding monetary policy measures. If the conditional inflation projection signals that, at the given monetary policy setting and assuming the fulfilment of certain prerequisites regarding future relevant factors, future inflation will differ from the inflation target, the central bank will adopt monetary policy measures to control the deviation. In view of the time lags in the transmission mechanism, the central bank must respond in sufficient time to ensure that the desired inflation change takes place at the time when the meeting of the inflation target is being assessed. However, the short-run inflation trend should never be so volatile as to prevent the meeting of medium-term targets.

One of the virtues of direct inflation targeting is that it incorporates a nominal anchor which is clear to economic entities, ie the inflation target. The changeover to this strategy is expected to affect inflation expectations favourably and to reduce the costs of the disinflationary process. The announcement of explicit inflation targets, along with a more precise setting of the pace of the disinflationary process, should help raise the transparency and credibility of monetary policy.

The inflation targets are announced in the form of the newly constructed net inflation index (CPIx)[21] because of the unfinished price liberalisation process and because of tax harmonisation with the European Union. The full use of the benefits of inflation targeting is currently being prevented by the big discrepancy between net inflation and overall inflation (measured using the CPI). The latter reflects growth in overall living costs and is therefore more important and clearer to economic entities and more effective as regards shaping inflation expectations. The precondition for replacing net inflation with the CPI is the elaboration of a programme of long-term changes to overall inflation.

Within the framework of the decision to change monetary policy strategy and to switch to direct inflation targeting, the CNB in December 1997 announced a medium-term inflation target for the year 2000. The year-on-year CPIx value for the end of 2000 was set at 4.5% ± 1 percentage point. Announcing the inflation target sufficiently in advance (given the time lags of monetary policy transmission mechanisms) is a necessary precondition for meeting the target using central bank instruments. To anchor inflation expectations, the CNB announced, in addition to the medium-term target, a short-term target for the end of 1998: year-on-year CPIx inflation of 6% ± 0.5 percentage points. However, these decisions were taken in a period of strong inflationary expectations, which were confirmed when the year-on-year net inflation index reached 7.9% in February and March.

Following the experience with the unprecedented price developments in 1998, the CNB has made some changes to the operational framework of direct inflation targeting. A set of exceptions have been defined whose action lies either completely or largely outside the reach of monetary policy measures. These are clauses explaining when and why the central bank does not have to respond immediately through its monetary policy to supply shocks whose impact on prices causes a temporary deviation from the inflation target. Neutralising these would above all be too costly in terms of increased output volatility. The CNB has defined these exogenous and unpredictable factors as:

- substantial deviations of global prices of raw materials, energy sources and other commodities from the prediction;
- major deviations of the exchange rate that are not connected with domestic economic fundamentals and domestic monetary policy;
- marked changes in the conditions for agricultural production with an impact on agricultural producer prices;
- natural disasters or similar extraordinary events with cost and demand impacts on prices.

These factors correspond to those of most other central banks using the inflation targeting strategy.

The short-term inflation target of 4.5% ± 0.5 percentage points for 1999 announced by the CNB in November 1998 is consistent with the medium-term disinflationary trajectory set in December 1997 and targeted for the end of 2000. In 1999, owing to less favourable external inflation factors (in comparison with 1998), the CNB expects a modest inflation rise, which will represent a return to the long-term disinflationary trajectory.

III.8.2. Monetary policy measures in 1998

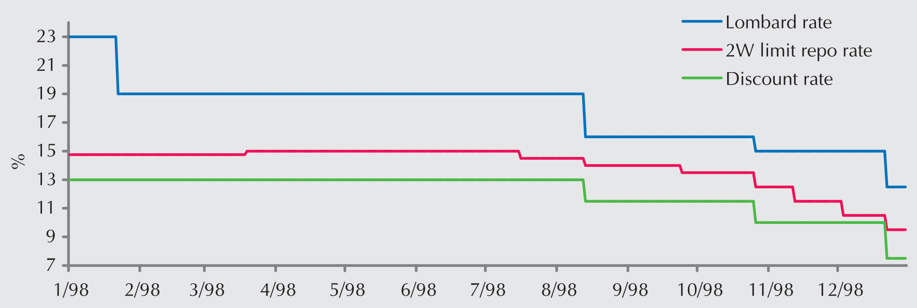
In 1998, monetary policy was conducted in conditions of great uncertainty about the evolution of both the external and internal factors affecting inflation. Most of them were to a large extent out of the direct reach of the central bank. The difficulties with predicting external inflation factors fed through into increasing uncertainty regarding the conditional inflation projections. Individual monetary policy decisions were affected significantly by changes in the economic and political climate in both the global and domestic economies.

From the point of view of the frequency and extent of changes in nominal interest rates, 1998 can be divided into two periods. The *first period*, between January and mid-July, was characterised by stability of the CNB's key interest rates at a relatively high level (Chart III.8.1). These rates reflected an attempt

21 CPIx = CPI excluding regulated price items and adjusted for the effects of other administrative measures (changes in indirect taxes, abolition of subsidies). Within the net inflation index, there are two important sub-indices that are monitored and analysed separately: the food price index and the adjusted inflation index (CPIx excluding food prices). In the consumer basket, CPIx items have a constant weight of 81.86% (663 price items out of the total of 754), regulated prices 18.32%, food 32.71% and items for the adjusted inflation calculation 48.98%.

to confront inflationary pressures and to renew the disinflationary process within the framework of the overall macroeconomic stabilisation.

Chart III.8.1 CNB key rates



In the first few months of 1998, inflation was adversely affected mainly by cost-push inflationary factors. The main factors in the growing inflationary pressure were the nominal depreciation of the exchange rate at the end of 1997, regulated price adjustments, the increase in VAT and excise taxes on selected commodities, and the rise in prices of selected foodstuffs. Though the rise in price indices in January was much higher than expected, the Bank Board did not consider the inflation target for the end of 1998 to be jeopardised. The Board expected the month-on-month inflation rate in February to return to the usual levels, thereby quickly offsetting the January cost-push inflation shock. However, an analysis of the February inflation showed that the absorption of price shocks was slower than originally expected. The public sector's influence on economic developments (local budget deficits), the sustainability of favourable wage developments (particularly in the non-public sector), and the exchange rate trend were viewed as significant future inflation risk factors. In the same period, the conditional inflation projections were signalling that net inflation would be higher than the target. In view of the risks for future development, and particularly given the possibility of adjusting unfavourable inflation expectations, the CNB Bank Board decided to increase the 2W repo rate from 14.75% to 15% as of 20 March 1998.

From April onwards, inflation developed much more favourably. Both net inflation and CPI inflation slowed. Year-on-year net inflation fell from 7.9% in March to 6.5% in June, while year-on-year CPI inflation dropped from 13.4% to 12%. The falling inflation resulted from the combined effects of restrictive monetary, fiscal and income policies and from the extraordinarily favourable evolution of most cost factors, some of which can be considered purely exogenous. The favourable cost factors were associated with the koruna's exchange rate, the trend in commodity prices on world markets, the relation between growth of real wages and productivity, and with industrial producer prices.

Notwithstanding the undoubtedly positive price indices in Q2, certain risks persisted and so the CNB did not cut its key interest rates until mid-July. This was largely because of the relatively short period of favourable disinflation and the only slow unwinding of the above-mentioned uncertainties about the disinflationary process in the future. Moreover, the favourable inflation signals appeared at a time when inflation measured by the 12-month moving average of the CPI was at a five-year high. The CNB's interpretation of these risk factors was such that the conditional inflation projection was left unchanged. However, the bank was aware of the fact that the incipient disinflationary process was the result of exceptionally favourable exogenous factors. Although some of these uncertainties receded in June, attention was focused on the negative impacts of the situation on world financial markets. These are of great significance given the openness of the Czech economy. The volatility in Russian financial markets and the uncertainty associated with the early parliamentary elections in the Czech Republic were also important factors which curtailed the lowering of the CNB's key interest rates.

The *second period*, between mid-July and the end of 1998, was quite different from the point of view of monetary policy. In this period, the CNB gradually cut its key interest rates in line with the accelerating disinflationary process and the fast decline in the conditional inflation projections for the end of 1998 and for 1999 H1. The manoeuvre to lower interest rates was divided into several steps to minimise the risk of shocks on the financial markets. Also, the Bank Board decided, in line with the medium-term plan to lower the minimum reserve requirement (MRR), to cut the MRR from 9.5% to 7.5%, effective 30 July 1998. At the end of 1998, it decided to cut the MRR again, from 7.5% to 5%, effective 28 January 1999.

Inflation continued falling throughout the second period. In December, all inflation indicators (except for the inflation rate) were at their lowest since the beginning of the year. The year-on-year CPI growth rate dropped from 12% in June to 6.8% in December, and the year-on-year net inflation index fell from 6.5% to 1.7%.

In December, year-on-year net inflation was 3.8 percentage points below the lower limit of the short-term inflation target. This decline was due to the exceptionally favourable strong anti-inflationary pressures on both the demand and supply sides. The failure to meet the short-term orientation target in 1998 was attributable mainly to external factors that were partly or completely beyond the reach of the central bank's monetary policy.

The CNB views the prices of raw materials and food and the exchange rate level as the most significant external factors in the failure to meet the inflation target. In January 1998, the CNB forecast a gradual depreciation of the koruna to as low as CZK 19.70/DEM at the end of the year. This forecast was not borne out, as the exchange rate appreciated during 1998. In view of the substantial influence of the exchange rate on inflation, this represented faster-than-expected disinflation. The profound fall in raw materials prices was another important supply factor. The approximately 40% year-on-year fall in the price of oil is worth particular mention. The decline in food prices also contributed to the fall in net inflation. This was attributable to generally low agricultural product prices on world markets (a 20% fall in the HWWA selection index year-on-year), imports of heavily subsidised agricultural products from the EU, and, last but not least, to the ongoing competition among retail chains for shares of the domestic market. The CNB estimates that external factors affected net inflation by 2–3 percentage points in 1998. In other words, had the intensity of the effects of external factors remained at the February level in H2, net inflation would have been somewhere between 3.7% and 4.7% in December 1998.

The restrictive macroeconomic measures also had a major effect, particularly on domestic demand and wage and price developments. These measures mainly concerned the strongly restrictive fiscal and income measures of the two "government packages" adopted in April and May 1997 and the tightening of monetary policy from mid-1996 onwards. In 1998, the restrictions were bolstered by the high prudence of banks in providing credits. This fed through into monetary developments in the form of slower money supply growth.

Throughout most of 1998, the favourable monetary development was one of the factors accelerating the disinflationary process. Rapid growth in nominal wages was curbed by the tight financial situation of most firms, the ongoing restructuring and the growing competitiveness on the labour market, which worsened the position of employees during wage bargaining. However, in 1998 Q3 the decline in real wages slowed, and in Q4 wages even started to show real growth. This was due to the inertia in nominal wage growth and falling inflation.

The decline in CNB interest rates in 1998 H2 was further influenced by the fall in interest rates in advanced countries, the developments in the risk premium of the Czech economy and the turnaround in inflation expectations. Their influence passed through into a lowering of the conditional inflation projection. In 1998 H2, the inflation projections for 1999 were of particular significance for monetary policy. At the end of 1998, the CNB forecast year-on-year CPI inflation of between -0.1% and 1.5% in 1999 H1 and between 2.5% and 5.5% for the end of 1999.

A retrospective assessment of the monetary policy measures taken during 1998 might give rise to objections that the process of cutting interest rates could have been started earlier and could have been more intensive. However, monetary policy reacts to expected developments, which always implies a great degree of uncertainty. In spring 1998, neither the CNB's inflation forecasts nor those of domestic and foreign institutions presaged the steep fall in inflationary pressures which followed. Notwithstanding the certain difficulties which monetary policy undoubtedly had to confront, it can be said that in 1998 a major step forward was taken toward the ultimate long-term objective of the disinflationary strategy, ie to achieve price stability comparable with that in EU countries.

III.9 The views of the IMF and the EU on the CNB's monetary policy

The International Monetary Fund evaluated developments in the Czech Republic twice in 1998, in April and November. The monetary policy and its impacts on the Czech economy were assessed as part of this.

The IMF Mission in April 1998 gave a positive assessment of the progress achieved in decreasing the external deficit. According to the Mission, this progress was based on tight macroeconomic policy, increasing cost competitiveness, the ongoing microeconomic restructuring (driven in particular by foreign direct investment) and the improving external conditions. The situation on the foreign exchange market had improved significantly in comparison with the situation following the exchange rate turbulence in May 1997. According to the Mission, the higher inflation rate in January and February testified to deteriorating inflationary expectations; however, in March the situation had improved. Modest signs of a revival of economic activity had appeared. The Mission considered the main internal risks to be the fragility of the banking and corporate sectors, the threat of strong wage growth, potential fiscal problems and uncertainty related to the elections in mid-1998.

The IMF Mission stated that monetary policy had played a key role in moderating macroeconomic disequilibria and in stabilising conditions on the foreign exchange market. It recommended that the tight monetary policy be continued, particularly in view of the need to keep the exchange rate within limits which will jeopardise neither the inflation targets nor the current account balance. The Mission pointed to the stagnation of credit expansion since mid-1997 and recommended that the financial situation of the banking and corporate sectors be monitored continuously. The steps taken by the CNB in the area of banking supervision reorganisation and the ongoing pressure on banks to create adequate reserves to cover credit and market risks and strengthen payment discipline were welcomed. It was recommended that the central bank develop further legislative initiatives in these areas. The need was also stressed for continuing co-operation with the Government to complete the privatisation of banks and promote economic restructuring.

The IMF Mission in November 1998 again emphasised that the consequences of the May 1997 exchange rate crisis had been dealt with successfully. It praised the fact that the Czech Republic had been affected to only a small extent by the further turbulence on world financial markets, thanks to its prudent macroeconomic policy. The current account deficit had fallen sharply and net inflation had dropped to 3.5%. However, the economy at the same time had slipped into recession. Unemployment had surged and household consumption had declined. Investment had fallen owing to cuts in government investment, the financial weakness of many unrestructured firms, high real interest rates and the credit crunch.

The Mission stated that in conditions where economic development had differed substantially from past expectations, the CNB had quite correctly eased monetary policy and cut interest rates in several steps. However, the economic revival would proceed at a slow pace. The lower interest rates had brought practically no credit expansion as yet owing to the situation in domestic banks, which had made efforts to consolidate their financial positions. Nevertheless, the decline in interest rates had been important for improving the financial situation of businesses. The Mission said that the main economic policy task was an investment- and export-led revival of the economy which at the same time would not jeopardise the external balance or the results achieved in lowering the inflation rate. The inflation target for the year 2000 was assessed as reasonable. A further easing of monetary and fiscal policies should be accompanied by a curbing of nominal wage growth in the corporate sector in 1999. Otherwise, the room for further interest rate cuts would be narrowed and economic competitiveness would be threatened.

The IMF Mission stated that the decline in the trade deficit had been achieved largely thanks to cyclical factors and the worldwide slump in raw materials prices. Without a sustained increase in exports and a redirection of domestic demand towards goods from domestic sources, growth in domestic demand could again jeopardise the external balance. In connection with this, the Mission recommended that the further lowering of interest rates in 1999 H1 be tied to the results of wage bargaining. It also commented on the setting of further inflation targets for the post-2000 period, when, along with the needs of EU convergence, the processes of structural change and the adjustment of relative prices which will take place at that time should also be taken into consideration.

As for the situation in the banking sector, the IMF Mission said that the highest possible priority should be given to the privatisation of banks. It recommended that an acceleration of this process be considered. Any delay in the banks' privatisation would extend the credit crunch period, and, moreover, the banks could lose their shares on the market and the financially stronger part of their clients. It was necessary to strengthen the position of creditors, and of great importance were the steps being taken towards improving the regulatory structure of the capital market and weakening the ownership links between banks, investment funds and businesses. The Mission viewed this as a way to accelerate structural reforms in the corporate sector and improve the conditions for future growth while keeping the inflation rate down.

The European Union assessed the CNB's activities mainly from the point of view of the Czech Republic's preparations for EU accession. On 4 November 1998, in accordance with a decision made at the Luxembourg summit, the European Commission issued its first Regular Report assessing the progress of countries applying for membership. The report assessed the progress made by all applicants in general, and in individual countries in detail.

In the general part of the Report, the Czech Republic was listed among the countries which can realistically be expected to become EMU members in the medium term. With regard to its capacity to withstand competitive pressures and market forces within the Union, the Czech Republic was ranked only behind Hungary and Poland. The need for further structural reforms, in particular a weakening of the ownership links between enterprises and banks, was pointed out. The increased capacity in banking and financial supervision was assessed positively. Criticism was expressed over the slow progress in the legislative area, including the adaptation of the CNB's legal position so that in future it can become part of the European System of Central Banks.

The detailed report on the Czech Republic assessed the macroeconomic situation in the Czech Republic in 1998 as difficult, amid a fall in real GDP, growth in unemployment and a decline in real incomes. However, the report welcomed the growth in exports, the narrowing of the country's external deficits and the return towards a downward inflation trend, to which the CNB's strict anti-inflationary policy has contributed significantly. The European Commission assessed positively the CNB's willingness and ability to apply unpopular measures if the need arises. It stated that the favourable inflation trend allowed monetary policy to be eased in 1998 H2. According to the report, it would be desirable to improve the co-ordination between monetary and fiscal policy in a manner that would not weaken the central bank's independence (eg as part of the drafting of a medium-term economic strategy).

The report identified as a serious problem of the Czech economy the weakness of the financial system and its inability to efficiently channel savings into productive investment. It pointed to the high proportion of classified credits, and stressed the need to complete the privatisation of banks and to continue with structural reforms to strengthen financial discipline. Increasing the transparency of the capital market is of great importance. The report assessed positively the amendments to the Act on Banks, the strengthening of the role of banking supervision, and the restricting of links between banks and businesses and between the commercial and investment divisions of banks. The report stated that the legislative measures adopted in these areas constituted a step towards alignment with EU legislation. The CNB's measures regarding commercial banks, notably the more stringent credit classification and provisioning rules, were also welcomed. Nevertheless, the report drew attention to ongoing shortcomings in the enforcement of laws and regulations and in implementing the measures adopted.

As for the preparations for EMU participation, the report stated that the Czech Republic had made only little progress in this area. Significant problems remained in the financial sector, especially in banking (the high proportion of classified credits and unfinished privatisation). The Act on the CNB would have to be made fully compatible with EU rules. Certain gaps also remained in the banking legislation and in the area of free movement of capital.

According to the European Commission Report, even though the Czech Republic is a country with a functioning market economy, further structural reforms are needed to improve its capacity to cope with competitive pressures within the European Union in the medium run.

MACROECONOMIC AGGREGATES

in CZK billions, y-o-y change in %, 1994 constant prices

	1994 Q1 - 4	1995 Q1 - 4	1996 Q1 - 4	1997 Q1 - 4	1998 Q1 - 4
GROSS DOMESTIC PRODUCT					
- CZK billions	1148.6	1221.6	1269.4	1281.8	1247.7
- %	.	6.4	3.9	1.0	-2.7
FINAL CONSUMPTION					
- CZK billions	827.0	861.8	915.4	921.2	908.2
- %	.	4.2	6.2	0.6	-1.4
of which					
Households					
- CZK billions	564.0	603.1	645.5	656.1	640.2
- %	.	6.9	7.0	1.6	-2.4
Government					
- CZK billions	255.5	250.3	260.6	255.0	257.6
- %	.	-2.0	4.1	-2.1	1.0
Non-profit institutions					
- CZK billions	7.5	8.4	9.3	10.1	10.4
- %	.	12.0	10.7	8.6	3.0
GROSS CAPITAL FORMATION					
- CZK billions	346.1	426.1	481.5	470.7	439.5
- %	.	23.1	13.0	-2.2	-6.6
of which					
Fixed capital					
- CZK billions	339.9	411.2	446.8	425.1	409.2
- %	.	21.0	8.7	-4.9	-3.7
Inventories and reserves					
- CZK billions	6.2	14.9	34.7	45.6	30.3
TRADE BALANCE					
- CZK billions	-24.5	-66.3	-127.5	-110.1	-100.0
of which					
Exports					
- CZK billions	608.0	705.6	743.9	819.9	914.1
- %		16.1	5.4	10.2	11.5
Imports					
- CZK billions	632.5	771.9	871.4	930.0	1014.1
- %		22.0	12.9	6.7	9.0
DOMESTIC EFFECTIVE DEMAND					
- CZK billions	1166.9	1273.0	1362.2	1346.3	1317.4
- %	.	9.1	7.0	-1.2	-2.1
AGGREGATE EFFECTIVE DEMAND					
- CZK billions	1774.9	1978.6	2106.1	2166.2	2231.5
- %	.	11.5	6.4	2.9	3.0
GROSS DOMESTIC PRODUCT IN CURRENT PRICES					
- CZK billions	1148.6	1348.7	1532.6	1649.5	1776.7
- %	.	17.4	13.6	7.6	7.7
PRICE DEFLATOR					
- %	.	10.4	9.4	6.6	10.7

Source: CSO

RATIOS OF KEY INDICATORS TO GDP

ratio in %

	1993	1994	1995	1996	1997	1998
State budget balance	0.1	0.9	0.5	-0.1	-1.0	-1.6
Public budgets balance	2.3	0.5	0.2	-1.4	-1.7	-1.6
Public debt	19.2	18.4	16.3	14.2	13.7	14.1
Indebtedness in convertible currencies	25.4	26.1	32.6	37.2	44.8	40.4
Trade balance 1)	-0.4	-3.1	-7.1	-10.3	-8.4	-4.5
Current account balance	1.3	-2.0	-2.7	-7.6	-6.2	-1.9
M2	70.3	73.6	75.1	72.2	73.8	72.1

Note: ratio = indicator / GDP in current prices
1) Source: CSO

PRODUCTION

in CZK billions, y-o-y change in %

	1993	1994	1995	1996	1997	1998
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4
INDUSTRY						
TOTAL PRODUCTION OF GOODS 1)	-5.3	2.1	8.7	6.4	.	.
TOTAL INDUSTRIAL PRODUCTION 2)	.	.	.	2.0	4.5	1.6
CONSTRUCTION						
TOTAL CONSTRUCTION OUTPUT 3) 4)	-7.5	7.5	8.5	5.3	-3.9	-7.0
AGRICULTURE						
TOTAL GROSS PRODUCTION 5)						
- CZK billions	83.1	78.1	82.0	80.9	76.8	75.9
- %	-2.3	-6.0	5.0	-1.4	-5.1	-1.3
of which						
Crop production						
- CZK billions	37.4	34.7	35.7	36.4	35.1	35.1
- %	4.6	-7.2	2.9	2.1	-3.6	0.0
Livestock production						
- CZK billions	45.7	43.4	46.3	44.5	41.7	40.8
- %	-7.3	-4.9	6.7	-4.0	-6.3	-2.3

1) Constant prices as of 1 January 1989; since 1997 not monitored
2) Since 1996 the Index of Industrial Production based on statistics for production of selected products
3) Natural entities registered and not registered in the companies register included
4) Constant prices
5) 1989 constant prices

Source: CSO

THE LABOUR MARKET

A. HOUSEHOLD CURRENT INCOMES AND EXPENDITURES — y-o-y change in %

	1993	1994	1995	1996	1997	1998
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4
Current incomes				13.4	10.6	7.3
of which:						
- compensation of employees				16.9	7.9	4.8
- mixed income				3.5	15.0	14.0
- property income				-0.9	20.4	19.3
- social benefits				16.2	13.9	9.9
- other current transfers				15.3	7.7	-8.4
Current expenditures				13.0	11.4	6.8
of which:						
- property income				-16.6	-0.8	-0.6
- current taxes on income and wealth				13.4	10.0	8.5
- social contributions				15.2	10.7	5.4
- other current transfers				18.1	24.1	14.1
Disposable income				13.6	10.2	7.6
Changes in net share of households						
in pension fund reserves				60.6	-4.2	-17.6
Expenditures on individual consumption				15.6	9.7	7.3
Savings				3.6	12.3	7.7
Household savings ratio				12.7	13.0	13.0
(savings/disposable income - ratio in %)						

B. AVERAGE WAGES — y-o-y change in %

	1993	1994	1995	1996	1997	1998
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4
Total nominal wage	25.3	18.5	18.5	18.4	10.5	9.3
Business sector	.	18.2	19.2	17.7	11.7	10.9
Non-business sector	.	19.8	17.0	20.7	5.8	3.9
Total real wage	3.7	7.7	8.7	8.8	1.9	-1.3
Business sector	.	7.4	9.2	8.2	2.9	0.2
Non-business sector	.	8.9	7.3	10.9	-2.5	-6.1

C. UNEMPLOYMENT — as of end of period

	1993	1994	1995	1996	1997	1998
	12	12	12	12	12	12
Registered job applicants (thousands)	185.2	166.5	153.0	186.3	268.9	386.9
Unemployment rate in %	3.5	3.2	2.9	3.5	5.2	7.5

Source: CSO

PRICES

change in %

	1993		1994		1995		1996		1997		1998	
	12	average	12	average	12	average	12	average	12	average	12	average
CONSUMER PRICES												
a) previous month = 100	0.8	1.4	0.4	0.8	0.5	0.6	0.5	0.7	0.5	0.8	-0.2	0.5
b) same period of last year = 100	18.2	20.8	9.7	10.0	7.9	9.1	8.6	8.8	10.0	8.5	6.8	10.7
c) 1994 average = 100	.	.	.	0.0	12.5	9.1	22.2	18.8	34.4	28.8	43.5	42.6
d) December 1993 = 100	0.0	-4.3	9.7	5.2	18.4	14.8	28.6	25.0	41.5	35.5	51.0	50.0
e) moving average	20.8	x	10.0	x	9.1	x	8.8	x	8.5	x	10.7	x
INDUSTRIAL PRODUCER PRICES												
a) previous month = 100	-0.1	0.9	0.3	0.5	-0.2	0.6	0.0	0.4	0.2	0.5	-0.4	0.2
b) same period of last year = 100	11.4	13.1	5.6	5.3	7.2	7.6	4.4	4.8	5.7	4.9	2.2	4.9
c) 1994 average = 100	.	.	2.0	0.0	9.4	7.6	14.1	12.7	20.6	18.2	23.3	24.0
d) December 1993 = 100	0.0	-1.8	6.9	4.8	14.6	12.7	19.6	18.1	26.4	23.9	29.2	29.9
e) moving average	13.1	x	5.3	x	7.6	x	4.8	x	4.9	x	4.9	x
CONSTRUCTION WORK PRICES												
a) previous month = 100	1.1	2.0	0.1	0.8	0.1	1.0	0.5	0.9	0.7	0.9	0.2	0.6
b) same period of last year = 100	27.4	25.9	9.7	13.9	12.3	10.6	11.2	11.3	11.9	11.3	7.0	9.4
c) 1994 average = 100	.	.	2.9	0.0	15.2	10.6	28.0	23.1	43.3	36.8	53.3	49.7
d) December 1993 = 100	0.0	-6.4	11.0	7.9	24.6	19.6	38.5	33.1	55.0	48.1	65.9	62.0
e) moving average	25.9	x	13.9	x	10.6	x	11.3	x	11.3	x	9.4	x
AGRICULTURAL PRODUCER PRICES												
b) same period of last year = 100	4.3	8.4	10.1	4.7	6.1	7.6	6.8	8.3	2.5	2.9	-9.5	2.3
e) moving average	8.4	x	4.7	x	7.6	x	8.3	x	2.9	x	2.3	x
of which												
crop products												
b) same period of last year = 100	8.3	14.4	-4.0	-4.4	15.6	7.1	12.8	16.7	-4.3	3.3	-10.9	-5.4
e) moving average	14.4	x	-4.4	x	7.1	x	16.7	x	3.3	x	-5.4	x
livestock products												
b) same period of last year = 100	2.8	4.3	15.8	11.5	2.8	8.1	4.4	5.1	2.8	2.1	-8.1	5.9
e) moving average	4.3	x	11.5	x	8.1	x	5.1	x	2.1	x	5.9	x
MARKET SERVICES PRICES												
a) previous month = 100	.	.	.	.	.	.	-0.3	0.4	1.8	0.8	-4.2	-0.4
b) same period of last year = 100	.	.	.	.	.	.	5.5	6.2	11.2	9.2	-4.9	6.0
c) 1994 average = 100	.	.	.	.	.	.	17.9	16.3	31.2	26.8	24.8	34.5
d) December 1993 = 100	.	.	.	.	.	.	19.6	17.9	33.0	28.5	26.5	36.5
e) moving average	.	.	.	.	.	.	6.2	x	9.2	x	6.0	x

a) average = average monthly rate in the year
b,c,d) average = average from the start of the year
e) average of the indices for the last 12 months against the average for the previous 12 months

Source: CSO

Table 6

CONSUMER PRICES

increase in %, December 1993 = 100

Group	1993 constant weights in per mille	months												Average from start of year
		1	2	3	4	5	6	7	8	9	10	11	12	
Total - 1991	1000.0	-37.5	-33.6	-30.9	-29.2	-27.8	-26.2	-26.8	-27.1	-27.2	-27.3	-26.1	-25.2	-28.7
Total - 1992	1000.0	-24.1	-23.5	-23.0	-22.6	-22.3	-21.6	-21.0	-21.0	-19.9	-18.5	-16.5	-15.8	-20.8
Total - 1993	1000.0	-8.1	-6.7	-6.2	-5.7	-5.4	-4.5	-4.2	-4.1	-3.1	-2.2	-1.5	0.0	-4.3
Total - 1994	1000.0	2.0	2.4	2.6	3.0	3.4	4.7	5.0	5.7	7.1	8.2	9.0	9.7	5.2
Total - 1995	1000.0	11.2	12.1	12.4	13.5	14.0	15.2	15.2	15.2	16.3	17.0	17.8	18.4	14.8
Food, beverages, tobacco	327.1	13.7	15.1	15.1	15.5	15.8	16.8	14.0	13.3	14.7	15.7	16.9	18.1	15.4
Clothing	90.9	9.6	10.8	12.1	13.1	14.2	14.8	15.2	15.6	17.0	19.1	20.2	21.0	15.2
Housing	143.7	17.1	18.1	18.2	18.5	18.6	21.7	26.1	26.3	28.3	28.6	28.9	29.0	23.3
Household equipment	77.2	4.9	5.8	6.4	7.1	7.5	7.8	8.0	8.4	8.9	9.4	9.9	10.2	7.9
Health care	44.2	2.5	2.5	2.5	2.6	3.5	4.4	5.1	5.6	5.8	6.7	6.8	6.9	4.6
Transport	104.8	6.4	6.8	7.2	9.5	9.8	10.3	10.6	10.7	11.5	11.7	12.2	12.2	9.9
Leisure activities	97.5	7.5	8.1	8.4	10.4	11.3	13.2	15.0	15.4	14.3	14.2	15.4	16.2	12.4
Education	16.9	25.0	25.5	25.8	27.1	27.4	27.9	28.0	28.1	35.5	36.0	36.3	36.3	29.9
Catering and accommodation	47.2	15.4	16.0	16.5	17.2	18.2	18.9	19.5	20.0	20.3	20.7	20.8	21.2	18.7
Other goods and services	50.5	5.7	6.5	6.9	12.1	12.6	13.1	13.6	14.1	14.8	15.4	16.0	16.2	12.3
Total - 1996	1000.0	21.1	21.7	22.4	23.2	23.9	24.8	26.0	26.2	26.6	27.2	27.9	28.6	25.0
Food, beverages, tobacco	327.1	21.7	22.4	23.7	24.8	25.8	27.2	26.0	24.2	24.4	25.6	26.2	27.4	24.9
Clothing	90.9	21.8	22.7	23.5	24.6	25.9	27.1	27.7	28.1	29.2	30.7	31.9	32.7	27.2
Housing	143.7	30.8	31.3	31.6	31.9	31.9	31.9	40.7	45.2	45.7	46.0	46.3	46.4	38.3
Household equipment	77.2	10.6	11.2	11.7	12.2	12.3	12.6	12.9	13.1	13.4	13.6	13.9	14.1	12.6
Health care	44.2	7.1	7.2	7.3	7.3	7.5	7.5	7.4	7.7	8.2	8.6	8.9	9.2	7.8
Transport	104.8	15.4	15.6	16.0	16.6	17.3	18.8	19.1	19.2	19.3	19.7	21.2	21.6	18.3
Leisure activities	97.5	17.3	17.9	18.2	18.0	18.7	20.0	22.3	22.7	21.4	20.5	20.6	21.4	19.9
Education	16.9	73.2	74.7	75.6	76.1	76.3	77.2	77.3	77.3	84.3	84.9	87.7	88.0	79.4
Catering and accommodation	47.2	22.4	23.1	23.5	23.7	24.3	25.0	25.7	26.2	27.1	28.2	28.7	29.0	25.6
Other goods and services	50.5	17.3	17.8	18.3	21.6	22.0	22.3	22.6	22.9	23.2	23.6	24.3	24.9	21.7
Total - 1997	1000.0	30.1	30.5	30.7	31.5	31.7	33.2	37.8	38.8	39.6	40.2	40.8	41.5	35.5
Food, beverages, tobacco	327.1	29.0	29.0	28.9	29.3	29.1	31.6	30.4	31.2	32.0	32.9	33.6	34.5	31.0
Clothing	90.9	33.1	33.6	34.3	35.7	37.0	38.2	38.5	38.8	39.9	42.3	43.7	44.7	38.3
Housing	143.7	48.3	48.9	49.1	49.7	49.7	49.8	78.1	78.6	79.1	79.4	79.7	79.9	64.2
Household equipment	77.2	14.4	15.3	16.1	16.5	16.9	18.3	18.9	19.5	20.7	21.5	22.2	22.9	18.6
Health care	44.2	9.6	9.8	9.8	11.4	12.9	13.9	14.8	15.0	15.3	15.4	15.8	16.3	13.3
Transport	104.8	26.0	26.3	26.3	26.6	26.6	28.1	28.0	31.8	33.0	32.7	32.5	32.8	29.2
Leisure activities	97.5	22.2	23.1	22.9	23.5	23.7	25.7	33.1	33.7	32.2	31.7	32.4	33.2	28.1
Education	16.9	91.9	92.8	93.1	93.3	93.4	94.0	94.1	94.1	104.5	105.4	105.8	105.9	97.3
Catering and accommodation	47.2	29.5	30.3	30.7	31.3	31.5	32.8	34.2	35.1	36.6	37.5	38.1	38.4	33.8
Other goods and services	50.5	25.5	26.4	27.0	31.5	31.9	32.5	33.3	34.0	35.0	35.9	36.8	37.1	32.2
Total - 1998	1000.0	47.1	48.0	48.2	48.7	48.8	49.2	52.1	51.8	51.9	51.7	51.3	51.0	50.0
Food, beverages, tobacco	327.1	38.0	39.1	39.4	39.9	40.0	40.6	38.7	37.5	37.4	36.7	35.4	34.2	38.1
Clothing	90.9	44.5	44.6	45.1	46.3	46.7	47.2	47.3	47.1	47.6	48.4	49.0	49.2	46.9
Housing	143.7	100.7	102.1	102.6	102.9	103.0	103.1	124.1	124.5	125.3	125.9	125.9	126.0	113.8
Household equipment	77.2	23.5	24.6	24.9	25.5	25.7	26.0	26.3	26.5	26.7	26.5	26.3	26.6	25.8
Health care	44.2	17.0	17.4	17.6	17.7	17.9	18.2	18.5	18.7	18.8	18.9	18.9	18.9	18.2
Transport	104.8	40.9	40.9	39.8	39.2	38.7	38.0	39.2	38.7	38.6	38.3	38.0	37.5	39.0
Leisure activities	97.5	34.8	35.8	35.2	34.7	35.0	36.9	40.0	40.0	37.7	36.6	36.8	38.1	36.8
Education	16.9	120.4	122.6	123.9	125.4	125.5	126.2	126.6	126.6	135.3	136.0	136.1	136.2	128.4
Catering and accommodation	47.2	41.4	43.7	44.8	45.2	45.6	46.0	46.5	46.9	47.2	47.4	47.3	47.4	45.8
Other goods and services	50.5	38.0	38.9	38.9	41.9	42.2	42.7	42.9	43.2	43.8	43.9	44.0	44.1	42.0

Source: CSO

NET INFLATION

change in %

	months											
	1	2	3	4	5	6	7	8	9	10	11	12
1995												
a) previous month = 100	1.2	1.0	0.3	0.7	0.5	0.8	-0.6	-0.1	0.9	0.7	0.8	0.7
b) same period of previous year = 100	10.2	10.9	10.9	11.2	11.3	10.8	9.8	8.8	8.2	7.5	7.3	7.3
c) December of previous year = 100	1.2	2.3	2.6	3.3	3.8	4.7	4.0	4.0	4.9	5.7	6.6	7.3
1996												
a) previous month = 100	1.4	0.6	0.7	0.6	0.6	0.8	0.1	-0.4	0.3	0.6	0.5	0.7
b) same period of previous year = 100	7.4	7.0	7.4	7.3	7.4	7.4	8.2	7.8	7.1	7.0	6.6	6.6
c) December of previous year = 100	1.4	2.0	2.7	3.3	4.0	4.8	4.9	4.5	4.8	5.4	5.9	6.6
1997												
a) previous month = 100	0.8	0.3	0.1	0.5	0.1	1.4	0.2	0.8	0.6	0.6	0.5	0.6
b) same period of previous year = 100	6.1	5.9	5.3	5.2	4.6	5.2	5.3	6.6	6.9	6.9	6.9	6.8
c) December of previous year = 100	0.8	1.2	1.3	1.8	1.9	3.3	3.5	4.4	5.1	5.7	6.2	6.8
1998												
a) previous month = 100	1.5	0.7	0.1	0.2	0.1	0.4	-0.2	-0.3	0.1	-0.3	-0.3	-0.3
b) same period of previous year = 100	7.5	7.9	7.9	7.6	7.6	6.5	6.1	4.9	4.3	3.4	2.6	1.7
c) December of previous year = 100	1.5	2.2	2.3	2.5	2.6	3.0	2.8	2.5	2.6	2.4	2.0	1.7

Source: CSO

CONSUMER PRICES - TRADABLES AND NONTRADABLES

y-o-y change in %

	Constant weight in consumer basket in %	1994	1995	1996	1997	1998
		12	12	12	12	12
1. Food, beverages, tobacco	32.7	12.0	5.4	7.9	5.6	-0.3
tradables	32.7	12.0	5.4	7.9	5.6	-0.3
nontradables	.	.	.	.	.	.
2. Clothing	9.1	9.2	10.9	9.6	9.1	3.1
tradables	8.8	9.2	10.7	9.6	9.0	2.9
nontradables	0.3	9.0	16.6	9.7	12.3	7.5
3. Housing	14.4	14.1	13.0	13.5	22.9	25.6
tradables	1.1	10.5	9.7	9.4	37.1	18.0
nontradables	13.3	14.4	13.3	13.8	21.7	26.1
4. Household equipment	7.7	4.3	5.6	3.6	7.7	3.0
tradables	7.2	4.1	5.3	3.2	7.5	2.4
nontradables	0.5	6.4	9.1	9.0	10.3	9.4
5. Health care	4.4	2.4	4.3	2.2	6.5	2.3
tradables	.	.	.	.	.	2.6
nontradables	4.4	2.4	4.3	2.2	6.5	2.3
6. Transport	10.5	5.5	6.4	8.3	9.2	3.6
tradables	7.5	3.0	3.0	6.2	6.2	-4.4
nontradables	3.0	11.5	14.5	13.4	16.6	17.2
7. Leisure activities	9.8	5.7	9.9	4.5	9.7	3.7
tradables	6.4	3.5	5.9	2.3	4.5	1.2
nontradables	3.4	12.0	21.3	11.0	19.8	7.0
8. Education	1.7	23.7	10.2	37.9	9.5	14.7
tradables	.	.	.	.	.	.
nontradables	1.7	23.7	10.2	37.9	9.5	14.7
9. Catering and accommodation	4.7	12.9	7.3	6.5	7.3	6.5
tradables	0.1	3.1	21.3	9.9	17.7	12.4
nontradables	4.6	13.2	6.9	6.4	7.0	6.3
10. Other goods and services	5.1	5.5	10.1	7.5	9.7	5.1
tradables	3.2	5.9	5.8	5.0	7.1	1.5
nontradables	1.9	4.7	17.4	11.7	14.3	10.0
Total household consumer prices	100.0	9.7	7.9	8.6	10.0	6.8
tradables	67.3	8.7	6.0	6.7	7.1	0.7
nontradables	32.7	11.9	11.9	12.5	15.9	16.9
Tradables - food	32.7	12.0	5.4	7.9	5.6	-0.3
Tradables - other	34.6	5.6	6.5	5.7	8.3	1.6
Nontradables - regulated	18.3	9.0	9.7	11.2	19.7	20.7
Nontradable - other	14.4	14.2	12.3	8.9	9.3	11.1

BALANCE OF PAYMENTS 1)

in CZK millions

	1993	1994	1995	1996	1997	1998 2)
A. CURRENT ACCOUNT	13 286.7	-22 643.2	-36 331.3	-116 510.6	-101 856.2	-33 756.0
Balance of trade 3)	-15 313.0	-39 750.9	-97 598.6	-159 538.6	-144 025.9	-83 275.8
- exports	414 833.0	458 436.6	569 549.1	588 791.5	722 501.0	850 530.0
- imports	430 146.0	498 187.5	667 147.7	748 330.1	866 526.9	933 805.8
Services	29 465.2	14 052.8	48 881.2	52 198.9	55 935.0	60 738.1
Credit	137 691.2	148 404.0	178 270.4	222 030.4	227 193.6	238 979.4
- transport	36 186.6	35 757.9	38 757.4	36 209.6	41 661.6	43 430.5
- travel	45 437.4	64 170.3	76 301.3	110 620.0	115 700.0	120 000.0
- other services	56 067.2	48 475.8	63 211.7	75 200.8	69 832.0	75 548.9
Debit	108 226.0	134 351.2	129 389.2	169 831.5	171 258.6	178 241.3
- transport	21 402.1	24 542.4	21 208.9	18 983.3	19 973.6	19 643.0
- travel	15 368.3	45 605.6	43 330.3	80 170.0	75 500.0	60 300.0
- other services	71 455.6	64 203.2	64 850.0	70 678.2	75 785.0	98 298.3
Income	-3 424.7	-580.8	-2 804.0	-19 611.0	-25 102.4	-24 213.1
Credit	15 952.0	22 713.2	31 696.1	31 765.9	44 696.0	47 908.4
Debit	19 376.7	23 294.0	34 500.1	51 376.9	69 798.4	72 121.5
Current transfers	2 559.2	3 635.7	15 190.1	10 440.1	11 337.1	12 994.8
Credit	7 024.5	8 523.3	17 631.6	16 752.7	27 402.5	24 952.7
Debit	4 465.3	4 887.6	2 441.5	6 312.6	16 065.4	11 957.9
B. CAPITAL ACCOUNT	-16 175.0	-	179.1	15.6	315.9	66.8
Credit	5 976.0	-	307.8	28.1	493.0	454.4
Debit	22 151.0	-	128.7	12.5	177.1	387.6
Total A + B	-2 888.3	-22 643.2	-36 152.2	-116 495.0	-101 540.3	-33 689.2
C. FINANCIAL ACCOUNT	88 184.7	97 019.7	218 288.5	116 632.5	34 319.1	84 888.2
Direct investment	16 421.8	21 551.1	67 021.2	37 674.8	40 451.4	80 172.5
- abroad	-2 628.6	-3 443.3	-971.6	-1 100.0	-800.0	-1 175.0
- in the Czech Republic	19 050.4	24 994.4	67 992.8	38 774.8	41 251.4	81 947.5
Portfolio investment	46 658.5	24 595.9	36 144.4	19 692.5	34 438.9	32 681.4
Assets	-6 686.9	-1 327.1	-8 565.6	-1 291.1	-6 006.8	-2 581.9
- equity securities	-6 686.9	-1 327.1	-8 565.6	-1 291.1	19.9	2 402.7
- debt securities					-6 026.7	-4 984.6
Liabilities	53 345.4	25 923.0	44 710.0	20 983.6	40 445.7	35 263.3
- equity securities	32 569.8	14 369.8	32 761.7	16 340.9	13 783.7	34 846.2
- debt securities	20 775.6	11 553.2	11 948.3	4 642.7	26 662.0	417.1
Other investment	25 104.4	50 872.7	115 122.9	59 265.2	-40 571.2	-27 965.7
Assets	-83 911.4	-69 582.4	-66 050.8	-64 646.8	-142 725.1	-50 786.1
Long-term	13 340.8	12 046.4	1 384.4	-10 769.8	-11 117.6	-24 866.5
- CNB						
- commercial banks	-1 431.5	-31.7	-3 353.6	-14 168.2	-11 907.4	-26 952.8
- government	8 323.3	8 175.1	3 335.0	1 286.4	519.8	630.3
- other sectors	6 449.0	3 903.0	1 403.0	2 112.0	270.0	1 456.0
Short-term	-97 252.2	-81 628.8	-67 435.2	-53 877.0	-131 607.5	-25 919.6
- CNB						
- commercial banks	2 163.0	-4 289.4	-2 446.2	-48 976.0	-122 038.5	-21 641.6
- government	-97 397.2	-76 040.4	-60 179.4	.	.	.
- other sectors	-2 018.0	-1 299.0	-4 809.6	-4 901.0	-9 569.0	-4 278.0
Liabilities	109 015.8	120 455.1	181 173.7	123 912.0	102 153.9	22 820.4
Long-term	10 131.9	19 865.1	87 965.8	95 193.1	24 047.6	-4 385.0
- CNB	1 297.3	-31 712.7	997.8		-368.0	-216.4
- commercial banks	-2 116.6	11 189.6	60 359.6	46 733.5	-14 875.5	-14 399.2
- government	-3 421.5	-5 249.5	-12 047.3	-7 132.6	-11 581.9	-11 765.4
- other sectors	14 372.7	45 637.7	38 655.7	55 592.2	50 873.0	21 996.0
Short-term	98 883.9	100 590.0	93 207.9	28 718.9	78 106.3	27 205.4
- CNB	1 670.5	-1 634.7	77.1	-59.6	-9.9	-6.0
- commercial banks	2 481.8	14 016.0	27 636.1	30 574.9	67 383.7	24 445.9
- government	91 895.5	86 555.8	56 262.2	-899.6	-69.5	-216.5
- other sectors	2 836.1	1 652.9	9 232.5	-896.8	10 802.0	2 982.0
Total A + B + C	85 296.4	74 376.5	182 136.3	137.5	-67 221.2	51 199.0
D. NET ERRORS AND OMISSIONS, VALUATION CHANGES	3 019.8	-6 121.9	15 779.4	-22 612.6	11 181.2	11 416.0
Total A + B + C + D	88 316.2	68 254.6	197 915.7	-22 475.1	-56 040.0	62 615.0
E. CHANGE IN RESERVES (- increase)	-88 316.2	-68 254.6	-197 915.7	22 475.1	56 040.0	-62 615.0

1) Balance of payments structure based on the IMF Balance of Payments Manual (5th edition, 1993)
2) Preliminary data
3) Based on data published by the CSO - in accordance with customs statistics methodology effective from 1 January 1996; 1993 and 1994 data were taken from the CSO publication "Czech Foreign Trade 1993-1995" (December 1997)

INTERNATIONAL INVESTMENT POSITION

in CZK millions

	1993 1 Jan.	1993 31 Dec.	1994 31 Dec.	1995 31 Dec.	1996 31 Dec.	1997 31 Dec.	1998 31 Dec.1)
ASSETS	406 103.0	536 388.7	572 874.1	780 693.0	835 989.8	1 030 191.5	1 083 211.8
Direct investment abroad	2 634.0	5 432.9	8 426.9	9 190.1	13 609.2	18 989.4	19 738.5
- initial capital 2)	2 634.0	5 432.9	8 426.9	9 190.1	13 609.2	18 385.1	19 134.2
- other capital 3)	.	.	.	.	.	604.3	604.3
Portfolio investment	226.0	8 258.0	12 138.0	20 076.9	37 511.2	35 738.9	37 506.0
- equity securities	226.0	7 911.1	9 370.5	18 422.0	20 450.3	14 442.0	15 049.1
- debt securities	.	346.9	2 767.5	1 654.9	17 060.9	21 296.9	22 456.9
Other investment	378 895.6	406 717.6	377 187.3	378 388.3	444 985.4	636 938.5	649 284.3
Long-term	232 823.7	249 198.8	229 026.4	214 430.3	234 849.6	293 037.3	283 054.5
- CNB	23 102.5	24 572.5	24 573.3	26 172.3	26 122.8	26 122.4	26 122.4
- commercial banks 4)	365.9	1 852.3	1 763.0	5 116.6	25 181.3	37 088.8	64 041.6
- government 5) 6)	167 429.3	186 968.0	174 784.1	157 950.4	160 949.7	203 922.8	174 825.0
- other sectors	41 926.0	35 806.0	27 906.0	25 191.0	22 595.8	25 903.3	18 065.5
Short-term	146 071.9	157 518.8	148 160.9	163 958.0	210 135.8	343 901.2	366 229.8
- CNB	4.7	4.7	4.7	4.7	4.7	0.1	0.1
- commercial banks 4)	82 456.2	83 133.2	80 820.2	87 176.3	128 481.1	250 670.9	272 219.5
of which: gold + foreign currency 7) 8)	79 040.1	70 727.5	71 232.8	76 126.9	95 432.8	172 301.6	175 753.2
- government	.	5 501.9	.	.	.	.	.
- other sectors	63 611.0	68 879.0	67 336.0	76 777.0	81 650.0	93 230.2	94 010.2
CNB reserves	24 347.4	115 980.2	175 121.9	373 037.7	339 884.0	338 524.7	376 683.0
- gold 7)	2 488.2	2 466.4	2 309.3	2 234.6	2 290.3	1 521.9	369.1
- SDR	852.5	247.3	.	4.7	.	.	.
- foreign currency	21 006.7	113 266.5	172 812.6	370 798.4	337 593.7	337 002.8	376 313.9
LIABILITIES	307 887.2	423 237.7	507 337.9	723 101.9	906 073.2	1 138 248.1	1 206 768.9
Direct investment in the Czech Republic	83 488.7	102 539.1	127 533.5	195 526.3	234 301.1	319 820.3	401 767.8
- initial capital 2)	83 488.7	102 539.1	127 533.5	195 526.3	234 301.1	284 674.7	366 622.2
- other capital 3)	.	.	.	.	.	35 145.6	35 145.6
Portfolio investment	4 812.9	58 583.9	81 617.5	124 933.6	144 807.4	169 032.7	166 128.1
- equity securities	75.0	32 985.2	37 335.6	70 280.4	92 867.8	104 862.3	113 247.2
- debt securities	4 737.9	25 598.7	44 281.9	54 653.2	51 939.6	64 170.4	52 880.9
Other investment	219 585.6	262 114.7	298 186.9	402 642.0	526 964.7	649 395.1	638 873.0
Long-term	158 430.0	192 426.3	207 289.7	279 388.9	374 814.7	426 270.1	392 110.4
- CNB	31 109.9	33 697.4	1 695.7	2 491.5	2 272.7	2 188.3	1 883.3
- commercial banks 4)	14 491.1	16 175.5	26 040.1	90 299.3	143 454.2	143 120.2	124 286.3
- government 5)	70 771.0	82 295.1	76 533.9	53 200.2	44 003.7	38 001.1	23 993.3
- other sectors	42 058.0	60 258.3	103 020.0	133 397.9	185 084.1	242 960.5	241 947.5
Short-term	61 155.6	69 688.4	90 897.2	123 253.1	152 150.0	223 125.0	246 762.6
- CNB	8.2	4 581.0	37.9	115.0	55.3	45.5	39.5
- commercial banks 4)	19 527.4	22 249.3	41 339.9	69 502.9	101 543.5	168 927.1	193 373.0
- government 5)	.	.	5 013.4	1 104.1	314.8	287.5	103.2
- other sectors	41 620.0	42 858.1	44 506.0	52 531.1	50 236.4	53 864.9	53 246.9
NET INVESTMENT POSITION	98 215.8	113 151.0	65 536.2	57 591.1	-70 083.4	-108 056.6	-123 557.1

1) Preliminary data

2) Data on initial capital updated to include holdings in associated companies; since 31 December 1997, initial capital has included also reinvested profits

3) Starting with the position on 31 December 1997, part of the credits stemming from credit relations between direct investors and companies have been transferred from other investment (other sectors) to direct investment (other capital)

4) In connection with the introduction of CZK convertibility (1 October 1995), koruna assets and liabilities vis-à-vis non-residents are included in the bank position. (Non-resident CZK deposits are included in commercial bank short-term liabilities as of 31 December 1994)

5) During January 1993, part of the receivables and payables in convertible and non-convertible currencies were transferred from the CSOB position to the Ministry of Finance; in column 1 January 1993 these amounts are included in the government position; the receivable vis-à-vis CIS in the data as of 1 January 1993 is expressed as the balance of accounts in XTR and USD, while in later periods the accounts are held in terms of turnover

6) Including foreign exchange shares in international non-monetary organisations (The World Bank, EBRD, IBEC, IIB)

7) Gold worth USD 42.22 per Troy ounce

8) Foreign exchange - convertible currencies

EXTERNAL INDEBTEDNESS

in CZK millions

	1993 1 Jan.	1993 31 Dec.	1994 31 Dec.	1995 31 Dec.	1996 31 Dec.	1997 31 Dec.	1998 31 Dec.1)
INDEBTEDNESS IN CONVERTIBLE CURRENCIES	204 674.7	254 488.1	299 960.7	440 229.3	569 723.6	739 563.0	717 902.8
of which:							
Long-term	152 695.1	194 525.0	218 944.5	306 034.4	405 143.6	495 058.5	461 697.1
by debtor							
- CNB	35 399.8	58 836.1	22 845.3	22 268.0	11 178.4	11 548.4	10 952.2
- commercial banks 2)	14 491.1	16 175.5	27 620.1	95 433.3	150 780.1	158 503.7	133 376.5
- government	61 147.2	59 477.1	61 763.4	52 101.7	46 738.6	42 877.1	33 132.0
- other sectors	41 657.0	60 036.3	106 715.7	136 231.4	196 446.5	282 129.3	284 236.4
by creditor 3)							
- foreign banks	62 121.2	82 849.8	124 224.8	218 310.9	300 910.4	360 725.6	324 035.8
- government institutions	6 685.9	7 346.8	7 482.1	7 039.1	6 631.8	7 269.4	4 409.6
- multilateral institutions	50 127.1	52 891.7	19 889.7	18 987.2	17 645.5	13 894.1	7 222.4
- suppliers and direct investors	29 023.0	25 838.0	32 601.0	24 567.0	27 116.0	46 465.5	54 327.5
- other investors	4 737.9	25 598.7	34 746.9	37 130.2	52 839.9	66 703.9	71 701.8
Short-term	51 979.6	59 963.1	81 016.2	134 194.9	164 580.0	244 504.5	256 205.7
by debtor							
- CNB	7.9	4 581.0	37.9	115.0	55.3	45.5	39.5
- commercial banks 2)	17 819.7	21 117.0	32 610.3	71 911.8	106 852.6	170 147.0	193 373.0
- government	.	.	9 535.0	15 114.0	2 786.0	8 164.0	22.0
- other sectors	34 152.0	34 265.1	38 833.0	47 054.1	54 886.1	66 148.0	62 771.2
by creditor 3)							
- foreign banks	11 402.7	22 256.0	28 467.5	58 874.2	85 424.0	142 463.2	171 504.1
- suppliers and direct investors	33 069.0	29 664.0	34 132.0	41 986.4	45 914.0	57 831.1	56 313.1
- other investors	7 507.9	8 043.1	18 416.7	33 334.3	33 242.0	44 210.2	28 388.5
INDEBTEDNESS IN NON-CONVERTIBLE CURRENCIES 4)	19 648.8	33 225.3	42 508.1	17 065.9	9 180.7	9 148.1	8 996.7
of which:							
- long-term	10 472.8	23 500.0	23 092.1	10 484.7	8 865.9	8 860.6	8 893.5
- short-term	9 176.0	9 725.3	19 416.0	6 581.2	314.8	287.5	103.2
TOTAL EXTERNAL INDEBTEDNESS	224 323.5	287 713.4	342 468.8	457 295.2	578 904.3	748 711.1	726 899.5
of which:							
- long-term	163 167.9	218 025.0	242 036.6	316 519.1	414 009.5	503 919.1	470 590.6
- short-term	61 155.6	69 688.4	100 432.2	140 776.1	164 894.8	244 792.0	256 308.9

1) Preliminary data

2) As of 31 December 1995 short-term and as of 31 December 1996 also long-term koruna liabilities vis-à-vis non-residents are included in commercial bank liabilities in convertible currencies, while in data as of 31 December 1994 funds in non-resident koruna accounts are included in short-term liabilities in non-convertible currencies and vis-à-vis the Slovak Republic (methodological change connected with introduction of CZK convertibility from 1 October 1995)

3) As of 31 December 1997 the breakdown of indebtedness by creditor is adjusted for the updated credit position under direct investment

4) Indebtedness vis-à-vis the Slovak Republic: in 1993-1995 in non-convertible currencies; from 1996 the unsettled balance of mutual accounts after termination of clearing is given in non-convertible currencies; other liabilities vis-à-vis the Slovak Republic are included in convertible currencies in compliance with Ministry of Finance Provision No. 282/70 490/95 of 22 December 1995

PUBLIC FINANCES

in CZK billions

	1993 1-12	1994 1-12	1995 1-12	1996 1-12	1997 1-12	1998 1-12
STATE BUDGET						
TOTAL REVENUES	358.0	390.5	440.0	482.8	509.0	537.4
Tax revenues	330.2	360.1	409.7	457.4	478.4	509.6
Income tax	71.9	70.2	72.7	78.3	74.8	87.4
Social security insurance	106.0	130.0	154.3	174.3	191.0	203.9
Property tax	0.8	2.1	3.2	3.9	5.0	6.3
Domestic taxes on goods and services	111.8	136.4	155.4	174.8	186.3	191.5
- VAT	70.4	85.8	94.8	109.3	117.6	119.4
- Excise taxes	37.1	46.4	56.7	61.2	64.2	67.8
Foreign trade taxes	15.2	17.4	17.4	19.7	14.9	13.6
Other tax revenues	24.4	4.1	6.7	6.4	6.4	6.9
Non-tax revenues	27.8	30.4	30.3	25.4	30.5	27.7
Corporate and property revenues	14.7	12.8	7.3	8.5	8.5	7.3
Fees, fines and penalties and other non-tax revenues	4.0	8.2	16.7	10.4	13.8	13.8
Government credit repayments	9.0	9.4	6.3	6.5	8.2	6.7
TOTAL EXPENDITURES	356.9	380.1	432.7	484.4	524.7	566.7
Current expenditures	324.6	346.7	388.6	427.3	474.1	516.2
Expenditures on goods and services	125.6	121.2	109.8	123.5	126.7	143.0
Debit interest	13.7	.	2.6	14.0	17.6	18.5
Subsidies and current transfers	180.3	218.3	268.7	285.7	326.2	349.6
Subsidies	42.8	49.3	77.1	84.5	92.5	105.5
- to businesses	29.3	27.0	27.8	27.3	33.2	44.9
- to subsidised organisations	13.5	22.3	49.3	57.3	59.3	60.6
Transfers	137.4	169.1	191.5	201.1	233.7	244.0
- to local budgets	17.0	29.3	33.3	16.8	24.7	17.9
- to households	116.6	136.9	155.6	181.0	206.0	222.8
- abroad						
Government credits	5.0	7.2	7.6	4.1	3.6	5.1
Capital expenditures	32.3	33.3	44.1	57.1	50.6	50.5
Investment expenditures to budgetary organisations	19.0	19.7	21.5	24.9	16.4	16.5
Capital transfers	13.3	13.6	22.7	32.1	34.2	34.0
to businesses	5.0	3.7	5.5	4.6	5.6	6.4
to subsidised organisations	8.4	9.9	17.2	27.5	28.6	27.6
BALANCE						
Public budgets	23.3	5.5	2.9	-21.9	-27.8	-28.7
state budget	1.1	10.4	7.2	-1.6	-15.7	-29.3
local budget	0.9	-1.1	-3.2	-9.4	-4.8	1.5
state financial assets	1.5	1.0	-2.7	-2.3	-2.5	2.4
state funds	0.1	0.4	0.0	1.1	1.7	0.9
Land Fund	1.3	1.1	1.2	0.6	-1.6	0.1
National Property Fund	13.4	-5.4	4.0	-5.9	-4.5	-5.1
health insurance companies	5.0	-0.9	-3.6	-4.4	-0.4	0.8

MONETARY SURVEY

position at month-end in CZK billions

		1993	1994	1995	1996	1997	1998
		12	12	12	12	12	12
Total assets		720.4	870.4	1039.6	1120.5	1217.6	1280.8
Net foreign assets		115.7	194.4	311.4	281.9	338.5	410.0
- assets		213.6	275.8	493.2	538.0	670.7	746.1
- liabilities		97.9	81.4	181.8	256.1	332.2	336.1
Net domestic assets		604.7	676.0	728.2	838.6	879.1	870.8
Domestic credits		713.9	817.5	929.5	1029.7	1137.7	1121.8
Net credit to the government sector		18.4	5.1	10.1	12.6	24.8	38.6
- net credit to government		35.1	23.1	25.4	28.5	37.9	47.9
- net credit to NPF		-16.7	-18.0	-15.3	-15.9	-13.1	-9.3
Client credits of commercial banks and CNB		695.5	812.4	919.4	1017.1	1112.9	1083.2
CZK credits		669.6	768.9	822.3	888.6	912.6	869.6
- businesses		576.8	661.1	720.5	785.1	808.2	765.6
- households		92.8	107.8	101.8	103.5	104.4	104.0
Foreign currency credits		25.9	43.5	97.1	128.5	200.3	213.6
- businesses		.	.	.	.	194.3	210.1
- households		.	.	.	.	6.0	3.5
Other net items		-109.2	-141.5	-201.3	-191.1	-258.6	-251.0
Liabilities							
M2	2)	720.4	870.4	1039.6	1120.5	1217.6	1280.8
M1	1)	359.9	421.8	453.3	475.3	445.1	433.4
Currency in circulation		59.8	84.0	104.3	118.9	119.3	127.2
CZK demand deposits		300.1	337.8	349.0	356.4	325.8	306.2
- households		109.3	131.5	148.8	155.7	153.2	144.0
- businesses		185.1	201.1	195.6	195.6	168.2	158.9
- insurance companies		5.7	5.2	4.6	5.1	4.4	3.3
Quasi money		360.5	448.6	586.3	645.2	772.5	847.4
CZK time deposits		303.1	387.8	498.8	559.5	634.0	674.7
- households		206.8	244.7	306.5	366.0	474.4	550.8
- businesses		60.0	102.9	150.2	172.7	133.9	91.8
- insurance companies		36.3	40.2	42.1	20.8	25.7	32.1
CDs, deposit bills of exchange and other bonds	6)	.	.	.	.	.	30.2
Foreign currency deposits		57.4	60.8	87.5	85.7	138.5	142.5
- households		45.7	42.2	35.8	40.1	68.8	73.6
- businesses		11.7	18.6	51.7	45.6	69.7	68.9
Monetary aggregate L	3)	704.6	845.5	1019.0	1138.9	1241.8	1329.9
Y-o-y changes in %:							
M1		17.5	17.2	7.5	4.9	-6.4	-2.6
M2	5)	19.8	19.9	19.8	9.2	10.1	5.2
L		19.8	20.0	20.5	11.8	9.0	7.1
Client credits of commercial banks and CNB		19.1	16.8	13.2	10.6	9.4	-2.7
Client deposits with banks	4)	21.8	19.1	21.8	7.1	9.7	2.3

1) M1 = currency in circulation + CZK demand deposits
2) M2 = M1 + quasi money
3) L = M2 + T-bills + CNB bills in portfolios of domestic non-bank entities
4) CZK deposits + foreign currency deposits
5) Adjusted for float in 1993 and 1994, short-term operations of several banks in 1994 and for SPT Telecom deposit with CNB in 1995 and 1996
6) Because of changes in statistical reporting, deposit bills of exchange, CDs and other bonds are excluded from CZK deposits from January 1998

CREDIT SUPPLY

	1993	1994	1995	1996	1997	1998
	12	12	12	12	12	12
Non-adjusted credits						
Total credits, CZK and foreign currency						
absolute volumes in CZK billions	695.5	812.4	919.4	1017.1	1112.9	1083.2
y-o-y changes in %	19.1	16.8	13.2	10.6	9.4	-2.7
CZK credits						
absolute volumes in CZK billions	669.6	768.9	822.3	888.6	912.6	869.6
y-o-y changes in %	17.9	14.8	6.9	8.1	2.7	-4.7
Foreign currency credits						
absolute volumes in CZK billions	25.9	43.5	97.1	128.5	200.3	213.6
y-o-y changes in %	57.0	68.0	123.2	32.3	55.9	6.6
Adjusted credits 1)						
Total credits, CZK and foreign currency						
absolute volumes in CZK billions	696.2	807.6	906.1	1014.9	1101.9	1140.5
y-o-y changes in %	19.2	16.0	12.2	12.0	7.5	3.5
CZK credits						
absolute volumes in CZK billions	670.2	763.9	808.8	882.6	922.9	931.5
y-o-y changes in %	18.1	14.0	5.9	9.1	3.3	0.9
Foreign currency credits						
absolute volumes in CZK billions	26.0	43.7	97.3	132.3	179.0	209.0
y-o-y changes in %	57.6	68.1	122.7	36.0	35.3	16.8

1) Credit supply adjusted for exchange rate effects, write-offs, interest capitalisation and banks with licences revoked

CREDIT BREAKDOWN BY TIME, SECTOR AND TYPE

share in total in %

	1993	1994	1995	1996	1997	1998
	12	12	12	12	12	12
Time structure						
Total CZK and foreign currency credits	100.0	100.0	100.0	100.0	100.0	100.0
short-term	41.8	40.5	41.9	43.5	42.0	41.0
medium-term	28.3	30.2	29.1	25.7	24.8	22.5
long-term	29.9	29.3	29.0	30.8	33.2	36.5
Sector structure						
Total CZK and foreign currency credits	100.0	100.0	100.0	100.0	100.0	100.0
Businesses	93.3	94.3	88.9	89.8	90.2	90.1
Households	6.7	5.7	11.1	10.2	9.8	9.9
Type structure						
Total CZK and foreign currency credits	100.0	100.0	100.0	100.0	100.0	100.0
Operating	50.4	47.5	51.5	50.9	52.9	52.9
Investment (incl.general housing construction)	33.9	33.6	33.2	32.4	31.3	32.2
Mortgage	0.4	0.1	0.1	1.0	1.6	2.2
Consumer	0.6	0.7	0.8	0.7	0.6	1.7
For privatisation	5.4	5.0	3.8	3.0	2.0	1.4
For temporary fund shortage	9.1	12.5	9.6	9.2	10.5	8.2
For securities purchase	0.2	0.6	1.0	2.8	1.1	1.4

Note
1) Until 1996 only CZK credits excluding classified credits, and since 1997 total credits
(foreign currency credits broken down by sector not available up to 1996)

INTEREST RATES ON INTERBANK DEPOSITS

%

	1993	1994	1995	1996	1997	1998
	12	12	12	12	12	12
1. AVERAGE PRIBOR RATE 1)						
- 1D	5.47	10.75	10.83	12.44	12.55	10.84
- 7D	5.90	12.28	11.17	12.61	16.64	10.56
- 14D	6.14	12.38	11.20	12.61	16.77	10.54
- 1M	6.68	12.55	11.01	12.63	17.49	10.46
- 2M	7.34	12.61	10.97	12.62	17.54	10.27
- 3M	8.00	12.65	10.93	12.67	17.50	10.08
- 6M	9.21	12.65	10.89	12.55	17.41	9.56
- 9M	10.69	12.65	10.89	12.25	17.39	9.38
- 12M	11.90	12.66	10.90	12.23	17.36	9.31
2. AVERAGE PRIBID RATE 1)						
- 1D	4.51	10.01	10.52	12.19	10.75	10.48
- 7D	4.92	11.48	10.82	12.35	15.37	10.30
- 14D	5.16	11.55	10.84	12.36	15.45	10.27
- 1M	5.68	11.72	10.63	12.35	16.26	10.18
- 2M	6.34	11.76	10.59	12.34	16.33	9.99
- 3M	7.00	11.80	10.53	12.39	16.35	9.79
- 6M	8.21	11.81	10.48	12.26	16.31	9.26
- 9M	9.56	11.82	10.47	11.96	16.27	9.08
- 12M	10.89	11.83	10.48	11.94	16.23	9.02

1) Commercial banks quoting their rates daily on the interbank deposit market

FRA RATES

monthly averages in %

	1997				1998			
	3	6	9	12	3	6	9	12
3 * 6	11.82	14.60	14.53	16.70	15.62	15.38	13.16	9.02
3 * 9	11.52	14.22	14.53	16.70	15.80	15.39	13.02	8.99
6 * 9	11.00	13.32	14.02	16.03	15.43	14.81	12.46	8.79
6 * 12	10.97	13.13	13.97	16.01	15.52	14.82	12.37	8.79
9 * 12	10.57	12.63	13.52	15.47	15.09	14.34	11.94	8.62
12 * 24	10.44	12.16	13.00	15.28	14.95	13.78	11.45	9.03
9*12 - 3*6 spread	-1.25	-1.97	-1.01	-1.23	-0.53	-1.04	-1.23	-0.40
6*12 - 3*9 spread	-0.55	-1.09	-0.55	-0.69	-0.28	-0.57	-0.65	0.20
offer - bid spread (3*6)	0.10	0.21	0.21	0.21	0.16	0.12	0.16	0.19
offer - bid spread (12*24)	0.17	0.36	0.35	0.30	0.19	0.12	0.18	0.58

IRS RATES

monthly averages in %

	1997				1998			
	3	6	9	12	3	6	9	12
1Y	11.89	18.07	14.92	17.54	16.32	15.97	13.44	9.52
2Y	11.17	15.34	13.94	16.58	15.69	15.00	12.53	9.13
3Y	11.05	14.34	13.26	15.93	15.20	14.17	12.07	9.06
4Y	11.01	13.79	12.84	15.54	14.78	13.49	11.76	8.99
5Y	10.98	13.28	12.50	15.25	14.49	12.98	11.51	8.93
6Y	10.97	12.81	12.28	15.19	14.28	12.43	11.26	8.73
7Y	10.91	12.64	12.09	14.88	14.11	12.08	11.09	8.71
8Y	10.94	12.47	12.03	14.90	14.01	11.85	10.90	8.67
9Y	10.90	12.31	11.92	14.29	13.93	11.65	10.72	8.63
10Y	10.88	12.20	11.81	14.24	13.83	11.60	10.61	8.61
2Y - 1Y spread	-0.72	-2.73	-0.98	-0.97	-0.64	-0.97	-0.91	-0.39
5Y - 1Y spread	-0.91	-4.78	-2.42	-2.30	-1.83	-2.99	-1.94	-0.60
10Y - 1Y spread	-1.01	-5.87	-3.11	-3.30	-2.50	-4.37	-2.84	-0.92
offer - bid spread (1Y)	0.12	0.38	0.13	0.23	0.13	0.11	0.13	0.25
offer - bid spread (2Y)	0.12	0.54	0.19	0.30	0.18	0.16	0.19	0.28
offer - bid spread (5Y)	0.17	0.60	0.24	0.37	0.17	0.19	0.20	0.31
offer - bid spread (10Y)	0.35	0.76	0.29	0.46	0.35	0.29	0.28	0.20

COMMERCIAL BANK INTEREST RATES

%

	1993	1994	1995	1996	1997	1998
	12	12	12	12	12	12
Newly drawn credits						
in CZK	14.6	13.7	13.1	13.6	16.5	11.9
- short-term	14.0	13.3	12.9	13.6	16.5	11.7
- medium-term	16.7	14.8	14.2	14.3	17.0	13.4
- long-term	14.5	14.2	13.3	12.5	16.0	11.7
in foreign currency	-	-	-	-	5.9	5.4
- short-term	-	-	-	-	5.9	5.3
- medium-term	-	-	-	-	5.6	5.9
- long-term	-	-	-	-	6.1	5.6
Credits						
in CZK	14.1	12.8	12.7	12.5	13.9	10.5
- short-term	15.6	12.7	12.5	12.4	14.1	10.6
- medium-term	15.9	14.5	14.2	13.5	14.6	10.7
- long-term	10.4	11.2	11.5	11.8	13.0	10.3
in foreign currency	-	-	-	-	6.1	6.4
- short-term	-	-	-	-	5.6	6.9
- medium-term	-	-	-	-	5.9	5.6
- long-term	-	-	-	-	6.7	6
Deposits						
in CZK	7.0	6.9	6.9	6.7	8.0	6.7
- demand	2.3	2.6	2.8	2.5	2.1	1.9
- time	11.0	10.6	10.0	9.2	10.9	8.7
- short-term	9.6	9.6	9.7	9.3	11.6	9.2
- medium-term	11.8	11.5	10.7	9.8	12.2	10.9
- long-term	13.7	11.3	8.8	6.2	5.2	4.2
in foreign currency	-	-	-	-	2.7	2.3
- demand	-	-	-	-	1.1	1.1
- time	-	-	-	-	3.7	3.2
- short-term	-	-	-	-	3.4	3.1
- medium-term	-	-	-	-	5.0	3.3
- long-term	-	-	-	-	5.5	3.5

EXCHANGE RATE

A. NOMINAL RATE

CZK, exchange rate fixing

	1993	1994	1995	1996	1997	1998
	1-12	1-12	1-12	1-12	1-12	1-12
CZK exchange rate against selected currencies						
1 GBP	43.78	44.03	41.89	42.33	51.95	53.45
1 FRF	5.15	5.19	5.32	5.31	5.43	5.47
1000 ITL	18.56	17.85	16.30	17.59	18.61	18.57
100 JPY	26.32	28.15	28.34	24.99	26.29	24.71
1 CAD	22.61	21.09	19.34	19.90	22.91	21.83
1 NLG	15.70	15.82	16.53	16.11	16.25	16.26
1 ATS	2.51	2.52	2.63	2.57	2.60	2.61
1 DEM	17.64	17.75	18.52	18.06	18.28	18.33
1 CHF	19.74	21.06	22.45	22.02	21.85	22.25
1 USD	29.16	28.78	26.55	27.14	31.71	32.27
100 SKK	.	.	89.49	88.57	94.18	91.61
	12	**12**	**12**	**12**	**12**	**12**
1 GBP	44.37	43.99	41.00	45.48	57.72	50.20
1 FRF	5.09	5.21	5.37	5.21	5.84	5.38
1000 ITL	17.63	17.28	16.71	17.89	19.94	18.18
100 JPY	27.12	28.18	26.21	24.05	26.87	25.55
1 CAD	22.34	20.34	19.47	20.10	24.37	19.51
1 NLG	15.54	16.02	16.52	15.71	17.35	15.97
1 ATS	2.48	2.55	2.63	2.51	2.78	2.56
1 DEM	17.41	17.94	18.50	17.63	19.55	18.00
1 CHF	20.30	21.21	22.89	20.64	24.16	22.10
1 USD	29.76	28.22	26.66	27.34	34.73	30.06
100 SKK	.	.	89.76	86.42	100.58	83.04

B. REAL RATE

	1993	1994	1995	1996	1997	1998
	12	12	12	12	12	12
Index of real CZK/DEM rate (January 1993 = 100)						
a) consumer prices	108.43	112.33	114.76	124.27	122.30	132.59
b) industrial producer prices	109.73	110.22	112.53	120.17	115.35	125.11

Real rate: nominal rate adjusted for inflation differential (ratio of producer or consumer price levels between CR and Germany)
(Index > 100: koruna strengthened vs 1993 base)

CAPITAL MARKET

A. SHARE MARKET INDICES

last day of the month in points

	1997				1998			
	3	6	9	12	3	6	9	12
PX-50	558	489	536	495	505	467	360	394
PX-GLOB	670	592	652	599	615	568	460	478
PK-30	748	649	740	664	698	656	521	564

B. BOND MARKET

monthly averages in %

	1997				1998			
	3	6	9	12	3	6	9	12
TAXED GOVERNMENT BOND YIELDS								
Maturity in years								
1Y	.	.	.	.	.	14.51	12.81	8.88
2Y	.	14.35	13.65	16.23	14.95	14.39	12.55	8.77
3Y	.	13.84	13.30	15.67	14.64	13.58	11.98	8.57
4Y	.	14.72	12.94	15.10	14.38	13.13	11.59	8.52
5Y	.	12.97	12.63	14.85	14.41	13.03	11.51	8.64
6Y	.	12.88	12.39	14.84	14.43	.	.	.

C. TRADE VOLUMES

in CZK millions

	1997				1998			
	3	6	9	12	3	6	9	12
PSE								
Total trade volume	51 225	73 413	48 545	63 249	52 525	88 271	87 771	92 553
of which								
a) automated system	2 358	1 125	1 589	1 368	1 718	6 210	11 892	6 772
b) outright and block trades	48 867	72 288	46 956	61 881	50 807	82 061	75 879	85 781
RM-SYSTEM								
Total trade and transfer volume	10 517	5 239	13 662	36 870	17 562	22 163	11 271	20 837
of which								
a) running auction	692	392	742	547	1 036	643	552	491
b) outright and block trades	9 814	4 841	12 915	36 290	16 520	21 425	10 715	20 334
c) transfers with declared price	10	6	4	33	6	95	4	12
SC								
Total volume of charged transfers	100 019	125 576	93 634	150 980	138 738	153 081	159 095	141 892

CNB MONETARY POLICY INSTRUMENTS

	Repo rate (%)		Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)	
	1 week	**2 week**			**banks**	**building societies and ČMZRB**
1995						
1 January	-	-	8.5	11.5	-	-
26 June	-	-	9.5	12.5	-	-
3 August	-	-			8.5	**4.0**
8 December	11.25	11.30				
1996						
29 March	11.50	11.50				
29 April	11.60	11.60				
9 May	11.80	11.80				
21 June	12.40	12.40	10.5	14.0		
1 August					11.5	
1997						
8 May					9.5	
16 May	12.90			50.0		
19 May	45.00					
23 May	75.00					
27 May			13.0			
2 June	45.00					
4 June		39.00				
6 June	39.00					
11 June	31.00	29.00				
13 June	29.00					
18 June	25.00	25.00				
20 June	22.00	22.00				
23 June	20.00	20.00				
24 June	18.50	18.50				
27 June				23.0		
30 June	18.20	18.20				
1 July	17.90	17.90				
7 July	17.00	17.00				
8 July	16.50	16.50				
9 July	16.20	16.20				
15 July	16.00					
16 July		16.00				
22 July	15.70	15.70				
23 July	15.20	15.40				
24 July		15.20				
28 July	14.90	14.90				
1 August		14.70				
4 August	14.50	14.50				
31 October		14.80				
1 December	19.00	18.50				
2 December	18.50	18.00				
3 December	17.75	17.50				
4 December	17.00	16.75				
9 December	15.50	15.50				
10 December		15.00				
11 December	**15.00**					
17 December		14.75				
1998						
23 January				19.0		
20 March		15.00				
17 July		14.50				
30 July					**7.5**	
14 August		14.00	11.5	16.0		
25 September		13.50				
27 October		12.50	10.0	15.0		
13 November		11.50				
4 December		10.50				
23 December		**9.50**	**7.5**	**12.5**		

IV. BANKING SUPERVISION AND THE BANKING SECTOR

The main goal of CNB banking supervision is to help create a stable and competitive banking sector resulting from a dynamic balance between bank regulation and supervision, market discipline and high-quality management of individual banks. This goal was defined in the document: "A conception for the further development of banking supervision" adopted by the CNB Board at the beginning of 1998.

One of the ways to achieve the above goal is to further improve the regulatory framework for the banking sector and gradually harmonise it with the prudential rules in force in EU countries. This is a basic prerequisite for the future integration of the Czech Republic into this European structure. Another aspect of the development of both the methodology and actual implementation of banking supervision is the effort to achieve conformity with the Core Principles for Effective Banking Supervision, which the Czech National Bank officially signed up to in September 1998 at an international conference in Sydney. The 25 internationally acknowledged core principles for effective banking supervision have been further divided into a number of sub-principles. The Czech Republic meets 65% of the sub-principles in full and 15% in part, with 20% yet to be fulfilled. The updating of the present prudential rules and the preparation of new ones are among the current banking sector problems which need to be addressed.

In 1998, two amendments to the Act on Banks came into effect: the first on 6 February and the second on 1 September. These amendments:

- limit the links of banks with the corporate sector by preventing them from exercising control over non-financial institutions, and set limits on qualifying holdings in non-financial institutions to 15% (in individual cases) and 60% (for the sum of all qualifying holdings) of a bank's capital,
- limit the personal involvement of bank representatives in other legal entities,
- require the creation of "Chinese walls" between investment and commercial banking,
- extend the information obligation of banks towards the public,
- stipulate the obligation to apply for prior consent from the CNB when acquiring ownership interests in a bank of higher than 10%, 20%, 33% and 50%,
- broaden the set of sanctions against banks and shareholders,
- extend the system of deposit insurance to legal entities and increase the maximum amount of deposit repayment to CZK 400,000 (or 90% of the insured deposit).

These amendments to the banking law required a change in some of the existing prudential rules as well as the creation of new rules. In the area of licensing policy and acquisitions of holdings in existing banks, the CNB Provision stipulating the essentials for a banking licence application has been amended. Also, a new Decree has been issued stipulating the essentials for an application for prior consent from the Czech National Bank to acquire voting shares in a bank and the essentials of notification about decreasing a holding of voting shares in a bank. The two documents are closely interlinked and include a list of the information which future bank shareholders are obliged to submit to the CNB for assessment prior to acquiring a stake in a bank.

A major step along the path towards improving the transparency of the banking sector and market discipline is the new CNB Provision No. 2 of 29 June 1998 on the minimum requirements for disclosure of information by banks and foreign bank branches. The aim of this Provision is to make basic data on banks and foreign bank branches available to the public. This disclosure should help better inform a wide spectrum of the population – ie bank clients – and assist them in choosing the right financial institution. Under this Provision, banks are obliged to release information for example about the members of the board of directors and supervisory board and other persons in managerial positions, the organisational chart of the bank, information on shareholders with holdings exceeding 10%, selected data from the balance sheet and profit and loss account, data on classified credits, the bank's capital and capital adequacy, indicators of the bank's efficiency, etc.

In 1998, the CNB Banking Supervision Department took steps to ensure Year 2000 compliance of the banking sector. In this context, CNB Provision No. 6 of 29 December 1998 was issued, which stipulates the requirements for safeguarding the operations of banks and foreign bank branches with respect to the Year 2000 risk. Under this Provision, banks and foreign bank branches must:

- minimise the Year 2000 risk by ensuring that their automated systems are resistant to the changeover from the year 1999 to the year 2000,
- draw up a strategy to minimise the Year 2000 risk and secure the necessary human, technological and financial resources to implement it,
- prepare an emergency plan in case any automated systems, despite all the measures taken, prove not to be Year 2000 compliant, in case there is increased demand for cash by clients, and in case there are disruptions in the functioning of telecommunications or other components of the infrastructure,
- by 31 March 1999, implement and verify Year 2000 compliance of their automated systems,
- by 30 June 1999 inform the public in an appropriate way (eg in a press advertisement or on the Internet) that their automated systems are Year 2000 compliant.

In addition, the Banking Supervision Department is using part of its capacity to carry out on-site examinations in banks directed at this issue, and is co-operating with other domestic and international institutions, etc.

An amendment to the CNB Provision stipulating the principles of classification of claims on credits and creation of provisions for such claims was necessitated by problems associated with exercising liens on real estate because of imperfect general legislation in this area. Because of legal problems and the increased risk linked with the devaluation of pledged real estate, it was decided to require additional provisioning for loss loans collateralised by real estate that are more than 1 year past due. This requirement will be fulfilled gradually by the year 2000, in accordance with strictly set provisioning criteria.

The obligation to assess a bank’s Year 2000 readiness has been added to the requirements of the bank performance report – which is verified by external auditors – as part of the assessment of risk management.

In 1998, attention was focused on preparing new regulations meeting the principles of capital adequacy based on market risk and consolidated banking supervision, in compliance with the “Core Principles” and EU directives.

The purpose of the CNB Provision on capital adequacy incorporating market risk, which will replace the existing provision on capital adequacy, is to ensure that banks have sufficient capital with respect to both credit risk and market risks (interest rate risk, currency risk, share risk, commodity risk).

This Provision

- obliges banks to divide their balance sheets into banking and trading portfolios and to re-price on a daily basis all items of the trading portfolio and currency and commodity positions of the banking portfolio in market prices,
- stipulates the amount of capital necessary to cover each individual risk,
- defines the overall minimum capital requirement of a bank as the sum of capital requirements with respect to credit risk, credit exposure and market risk,
- defines the capital adequacy ratio of a bank, setting it at 8% at minimum.

The aim of the Provision stipulating the conditions for supervision on a consolidated basis is to ensure an integrated approach to evaluating the financial strength of banking groups. The Provision sets rules for the composition of the consolidated unit and methods for the consolidation of accounting statements, and defines capital adequacy and credit exposure on a consolidated basis and the limits for groups headed by banks.

Both provisions have been provided to all banks for checking. The final wording should be approved at the end of 1999 H1. The Provision on capital adequacy will enter into force on 1 January 2000 and the Provision on consolidated banking supervision in mid-1999.

The gradual establishment of financial groups and the close links between financial institutions has demanded closer co-operation with other regulators on the financial market. These regulators are the Securities Commission, established in 1998, which is responsible for capital market supervision, and the Ministry of Finance, which is responsible for overseeing insurance companies and pension funds. On 1 July 1998, the CNB and the above-mentioned institutions signed an agreement on co-operation in banking and financial market supervision. In particular, this concerns exchange of information (including in the licensing area), co-operation in control activities and consultations on methodology and other issues.

The wide involvement of foreign bank subsidiaries and branches in the Czech banking market has necessitated bilateral co-operation with foreign banking supervisors. In addition, CNB banking supervisors co-operate closely with international institutions, especially BIS in Basle, the World Bank and US regulators. This co-operation predominantly takes the form of consultations on improving the methods of effective banking supervision. Intense co-operation is continuing with banking supervisors in Central and Eastern European countries, which share the same problems of supervision in not fully developed market conditions.

The approved “Conception for the further development of banking supervision” focuses on strengthening control activities directly in banks (general controls, informative visits), gradually adding “dynamic” aspects to the current “static” assessment of banks and standardising assessment procedures, and on adopting remedial measures as part of the off-site surveillance of banks.

Comprehensive manuals are being drawn up for both analytical and examination activities with the aim of unifying and standardising the methods for applying bank assessment indicators and control procedures. These include a unified structure for the output protocols from on-site examinations. In 1998, work started on the building of a comprehensive information system for banking supervision. This should enable rapid and effective access to the database created from the extensive set of data provided by banks. The CNB’s supervisory activities during 1998 involved 7 general examinations and 30 informative visits.

A positive tendency is the gradual improvement in the quality of bank management. This reflects not only the experience acquired in the banking business by banks themselves, but also the ever increasing influence of banking supervision on banks’ activities through regulation and active monitoring. On the other hand, the banking sector is being adversely affected by the current unfavourable state of the economy, ineffective legislation in the commercial court area (enforcing liens, the effectiveness of the Act on Bankruptcy and Settlement, the slow resolution of commercial lawsuits, etc.), the unfinished restructuring and privatisation in both the corporate and the banking sector, the slow progress in developing other forms of financing of the corporate sector (the capital market), etc.

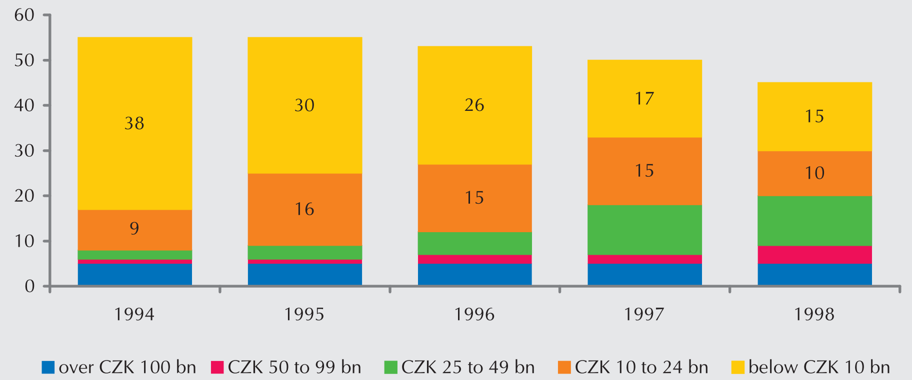
Although 63 banking licences have been granted since 1989, only 45 banks were operating at the end of 1998 (of which 13 were foreign banks and 10 foreign bank branches). Three banks have been dissolved through direct merger with other banks, one did not commence operation, seven are in liquidation and seven are undergoing bankruptcy proceedings. No banks were under conservatorship at the end of 1998.

The reduction of five in the number of banks operating in the Czech banking market in 1998 was the result of foreign bank mergers (Bank Austria and Creditanstalt, HYPO Bank and Vereinsbank) and the completion of the small-bank consolidation programme (termination of conservatorship and subsequent revocation of three banks’ licences). One bank is continuing to operate following the termination of conservatorship and an out-of-court settlement. In 1998, one new banking licence was granted – to GE Capital Bank, which bought the major part of Agrobanka’s banking activities.

The stabilisation programme which six small banks signed up to in 1997 continued in 1998. Under the programme, Česká finanční s.r.o. (which was set up for this purpose) has purchased these banks' poor-quality receivables for a period of seven years. During this time, the banks are obliged to create reserves sufficient to cover the repurchase of those receivables that are not repaid by debtors when the programme comes to an end. The banks are subject to stricter oversight during this period and are required to meet exactly all the conditions of the programme, particularly with respect to capital, management, increased effectiveness and efficiency, etc. In the course of the year it became clear that not all the banks were able to meet these conditions. Two banks were excluded from the programme and their licences were revoked. Two others left the programme at the end of 1998/beginning of 1999 because the major part of their activities had been taken over by other banks.

The five large banks account for the majority of banking activities: 66% of the banking sector's total assets, 74% of total credits and 73% of overall primary deposits. Although the large banks continue to predominate, their share is gradually diminishing. The main gainers are foreign banks and foreign bank branches, which currently manage one quarter of the banking sector's total assets. A group of medium-sized banks, with total assets of CZK 50–100 billion, is gradually being established. On the other hand, the number of banks with total assets of less than CZK 10 billion is falling. This concentration is the result of mergers and banking sector consolidation, under which a number of small banks have ceased to operate.

Chart IV.1 Banking sector structure
number of banks by total assets



1998 brought a number of changes in trend for the main indicators of bank activities. As of 31 December 1998, the total assets of the banking sector stood at CZK 2,437.4 billion, or 8.5% more than a year earlier. This growth rate was about half that seen in 1997, largely because of weak lending activity; the volume of gross credits in 1998 rose by only 3.4% to CZK 1,135.4 billion. This trend is particularly visible in the groups of large and small banks, which registered an absolute decline in gross credits (partly because of a higher level of write-offs and valuation changes, although the above trend is apparent even when adjusted for these effects). Growth in credit volume was stronger for other groups, but even here the individual groups saw lower growth than in previous years.

Main banking sector indicators *(for banks with valid licences as of 31 December 1998)*

in CZK billions

	31 Dec. 1995	31 Dec. 1996	31 Dec. 1997	31 Dec. 1998
Total assets	1 711.1	1 910.8	2 247.4	2 437.9
Credits (net)	772.3	878.5	1 000.3	1 018.4
Quick assets 1)	340.9	293.4	368.9	521.3
Securities in bank portfolios (net) 2)	163.4	187.4	189.9	190.9
Client deposits	848.8	952.9	1 108.5	1 205.3
Bank deposits	362.6	447.4	509.7	505.2

1) cash, deposits and credits with the CNB, current accounts with banks, CNB-bills and T-bills

2) securities in trading and investment portfolios, CNB-bills and T-bills excluded

The slowdown in the growth of primary deposits was not so marked; the overall volume of client deposits was up by 8.7% against the end of 1997, amounting to CZK 1,205.3 billion. The volume of interbank deposits remained at roughly the same level as in 1997.

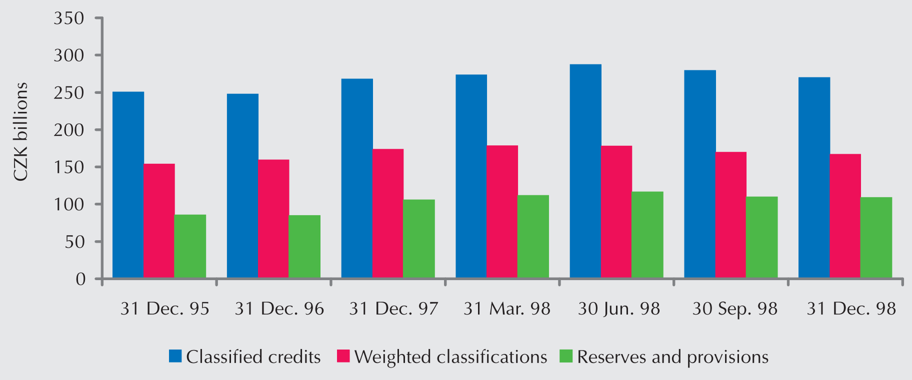
The subdued lending activity was largely due to increased prudence in granting new credits. The unfavourable economic position of the corporate sector – the main recipient of credits – led to a substantial reduction in the number of potential creditworthy clients. This situation is being further exacerbated by the legislative problems in the area of lien enforcement, bankruptcies, etc.

For this reason, banks located their free funds mainly in quick assets, which totalled CZK 521.3 billion as of 31 December 1998, up 41.3% against the end of 1997. The share of quick assets in total assets increased by 5 points to 21.4%. Developments on the capital market meant that the volume of securities held by banks (excluding T-bills and other bills) did not expand. These amounted to CZK 209.4 billion as of 31 December 1998, only 1.5% more than at the end of 1997.

Foreign banks, foreign bank branches and, to some extent, large banks are substantially expanding their activities in the derivatives area. The overall volume of receivables from futures and options operations as of 31 December 1998 was CZK 1,517.5 billion, a 76.1% increase against the end of 1997. The share of these activities in total assets jumped from 40.8% as of 31 December 1997 to 66.5% as of 31 December 1998.

The increased prudence of banks in lending stems from the high credit risk associated with the economic position of clients. The overall volume of classified credits (excluding Konsolidační banka and the Slovak Collection Unit) was CZK 270.0 billion as of 31 December 1998, up 0.7% against the end of 1997. The relatively low rise was to a large extent attributable to write-offs of loss receivables against provisions and to a transfer of selected Česká spořitelna receivables to Konsolidační banka. The share of classified credits in total credits was 27.1%, 0.2 points more than at the end of 1997. This increase was due to a certain extent to the stagnation in the volume of standard credits linked with the subdued lending activity.

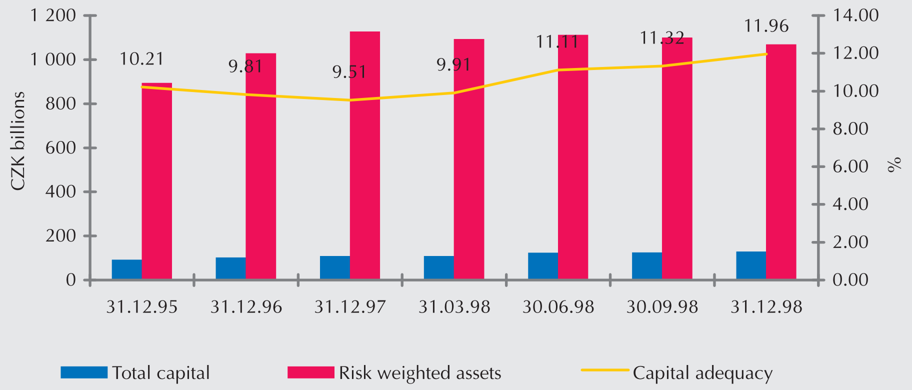
Chart IV.2 Classified credits
(excluding Konsolidační banka and credit to the Slovak Collection Unit)



The weighted classification (which reflects the risk-weighted structure of classified loans) fell by CZK 6.5 billion to CZK 167.1 billion against the end of 1997. To cover this, banks have set aside reserves and provisions worth CZK 109.1 billion, representing about 65% of the volume of the weighted classification. The remaining part is covered by collateral, which in volume exceeds the weighted classification by roughly CZK 12 billion.

The high interest rates which persisted throughout most of 1998 fed through into an 8.3% rise in interest earnings to CZK 58.6 billion. In contrast, earnings from securities operations amounted to CZK 8.2 billion in 1998, down by 40.6% compared with the previous year. Earnings from foreign exchange transactions rose by 1.6% to CZK 13 billion. In 1998, the overall profit from banking activities was CZK 96.3 billion, or 4.4% of average total assets. Banks used this profit to cover their operating costs, which were equal to 52.3% of the profit volume. As in 1997, net earnings were hit hardest by loan loss provisioning, which, together with write-offs of loss receivables, was higher than the profit from banking activities. For this reason, the banking sector (excluding Konsolidační banka) suffered a loss of CZK 8.5 billion, largely because of losses in the large and small banks; other groups posted a net profit in 1998.

Chart IV.3 Capital adequacy
(excluding Konsolidační banka)



The consistent pressure for strengthening the capital of the banking sector (excluding Konsolidační banka) was reflected in a 2.5 point rise in capital adequacy to 12% as of 31 December 1998. This was generated in particular by a CZK 10 billion increase in initial capital to CZK 70.6 billion and by a greater volume of subordinated debt in large banks (up by CZK 17.2 billion in 1998). Risk-weighted assets, down by 5.2% because of the lower lending activity of banks, also had a positive effect, since banks put their free funds into quick assets with low risk weights. The share of risk-weighted assets in total assets dropped from 54.1% as of 31 December 1997 to 48.7% as of 31 December 1998.

Operating costs per employee fell against the previous year, partly because of the ongoing decline in the number of bank units and employees. General operating costs rose to CZK 50.4 billion (up 16.6% from 1997), representing 2.3% of the average total assets of the banking sector. General operating costs per employee increased from CZK 827,000 in 1997 to CZK 963,000 in 1998, ie by 16.4% (compared with 19.5% in 1997).

Note: All figures are for banks with valid banking licences, except for Universal banka, which did not provide the necessary statements after its licence was revoked at the beginning of 1999. The data for 1998 are unaudited.

I. Banking sector assets and liabilities

(for banks with valid banking licences as of 31 Dec. 1998, branches abroad included)

	31 Dec.	31 Dec.	31 Dec.	1998			
	1995	1996	1997	31 Mar.	30 Jun.	30 Sep.	31 Dec.
	Assets in CZK millions						
Cash	20 893	25 583	27 256	24 781	27 814	25 172	27 169
Deposits and credits with CNB	156 412	136 128	193 780	216 957	243 821	286 759	268 897
of which minimum reserve requirement	69 334	107 884	88 078	95 686	97 244	90 052	87 583
Deposits and credits with banks	305 443	386 638	487 702	405 569	498 574	467 100	498 958
of which: current accounts	11 234	19 512	18 937	12 349	24 535	18 439	18 169
time deposits	165 774	275 712	394 519	320 722	402 010	380 212	392 223
credits granted	128 435	91 415	74 246	72 498	72 029	68 448	88 566
T-bills	33 308	49 399	38 964	34 334	39 312	29 862	52 872
CNB-bills	119 009	62 750	94 470	100 349	113 598	163 130	161 100
Credits granted	772 335	878 533	1 000 294	990 919	1 029 680	1 027 863	1 018 439
of which: to clients	767 912	874 386	985 468	972 141	1 006 315	1 005 613	993 027
to state and local authorities	4 423	4 146	14 827	18 777	23 366	22 249	25 412
Tradable securities	142 450	167 422	98 742	103 202	101 906	96 190	97 978
of which: bonds	120 319	131 771	84 972	90 624	92 450	84 772	87 613
equity securities	20 576	33 528	10 052	8 787	6 157	6 361	4 663
Participating interests of banks (investment)	20 951	19 980	91 197	93 738	94 822	98 865	92 880
Tangible and intangible assets	50 852	58 745	62 942	62 522	80 086	80 713	79 622
Other assets	89 423	125 607	152 030	147 209	142 932	152 959	140 001
Total assets	1 711 075	1 910 785	2 247 377	2 179 580	2 372 546	2 428 611	2 437 915
	Liabilities in CZK millions						
Funds from CNB	70 894	67 509	73 929	59 204	78 454	61 081	52 843
Deposits and credits from banks	362 567	447 359	509 705	454 863	513 921	485 318	505 153
of which: current accounts	14 737	16 754	19 552	16 209	21 640	17 630	12 202
time deposits	230 445	317 441	366 693	313 097	368 096	334 269	343 906
credits received	117 385	113 163	123 461	125 557	124 185	133 419	149 046
Deposits and credits received	848 824	952 877	1 108 537	1 075 361	1 144 181	1 161 363	1 205 323
of which: from clients	797 081	919 494	1 076 915	1 041 054	1 105 255	1 121 628	1 169 422
state and local authorities	33 507	28 823	30 105	33 040	36 805	38 594	33 703
deposit certificates	18 236	4 560	1 517	1 267	2 120	1 141	2 199
Bond issues	48 850	62 940	92 724	96 421	98 843	93 435	92 588
Reserves	40 448	35 874	40 297	34 997	43 877	43 515	41 661
Reserve funds	57 361	63 673	72 350	71 666	74 094	74 031	73 959
Capital funds	15 176	18 703	19 449	19 368	13 672	33 401	34 017
Initial capital	53 511	58 378	66 829	71 972	74 858	76 688	76 882
Retained earnings	1 848	1 853	1 332	11 136	3 513	2 983	2 110
Current year profit	11 763	14 445	11 185	4 602	9 323	12 114	11 507
Other liabilities	199 834	187 175	251 042	279 991	317 809	384 682	341 873
Total liabilities	1 711 075	1 910 785	2 247 377	2 179 580	2 372 546	2 428 611	2 437 915

II. Banking sector revenues and costs

(for banks with valid banking licences as of 31 Dec. 1998, branches abroad included and Konsolidační banka excluded)

	31 Dec. 1995	31 Dec. 1996	31 Dec. 1997	1998 31 Mar.	1998 30 Jun.	1998 30 Sep.	1998 31 Dec.
	In absolute terms (CZK millions)						
Interest earned	113 808	132 785	173 081	50 607	102 598	160 047	210 910
Interest paid	73 327	92 473	123 813	36 339	73 246	115 214	152 285
Interest yield	40 481	40 313	49 268	14 268	29 352	44 833	58 625
Fees and commissions earned	9 551	12 167	13 348	3 354	7 025	10 582	14 641
Fees and commissions paid	1 043	1 426	1 614	282	624	974	1 458
Fee and commission profit	8 509	10 742	11 735	3 071	6 400	9 608	13 183
Interest yield including fee and commission profit	48 990	51 054	61 002	17 339	35 752	54 441	71 808
Securities revenues	5 747	11 638	13 713	1 780	4 754	7 266	8 152
Foreign exchange operations revenues	6 971	6 258	12 852	3 535	7 216	10 577	13 001
Other banking operations revenues	1 524	1 346	1 366	750	1 520	2 444	3 368
Banking activity profit	63 233	70 295	88 932	23 404	49 242	74 727	96 330
General operating costs	31 145	37 708	43 234	10 075	22 063	33 448	50 431
Creation of reserves and provisions (net)	14 282	3 167	30 028	5 748	11 329	8 528	11 932
Other operating revenues (costs)	-6 901	-19 135	-18 862	-3 898	-15 597	-30 528	-41 458
Gross operating profit	10 904	10 285	-3 191	3 683	252	2 224	-7 492
Extraordinary revenues (costs)	469	252	707	17	58	144	1 882
Pre-tax gross profit	11 373	10 537	-2 485	3 700	310	2 368	-5 610
Taxes	1 677	445	1 082	677	951	1 604	2 974
Net profit	9 697	10 092	-3 567	3 024	-641	764	-8 584
	In relative terms (%)						
Banking activity profit/assets	4.65	4.19	4.55	4.54	4.71	4.57	4.42
Gross profit/assets	0.84	0.63	-0.13	0.72	0.03	0.14	-0.26
Net profit/assets	0.71	0.60	-0.18	0.59	-0.06	0.05	-0.39
Net profit/core capital	22.02	19.61	-6.34	19.51	-1.99	1.52	-12.78
Total interest revenues/interest earning assets	11.29	10.83	11.95	12.83	12.83	12.86	12.74
Total interest costs/interest bearing liabilities	6.85	6.99	8.13	9.22	9.27	9.49	9.41
Interest rate spread	4.44	3.83	3.83	3.62	3.56	3.37	3.33
Net interest margin	4.01	3.05	3.21	3.08	2.98	2.63	2.60
Number of bank positions	2 691	2 721	2 110	2 060	2 242	2 228	2 220
Number of employees in banking sector	52 246	54 461	52 250	51 469	53 959	53 203	52 388
	Per employee (CZK thousands)						
total assets	30 391	32 884	40 331	39 890	41 234	42 728	43 581
profit from banking activity	1 210	1 291	1 702	1 819	1 825	1 873	1 839
net profit	186	185	-68	235	-24	19	-164
operating costs	596	692	827	783	818	838	963

1) Data annualised for individual quarters of 1998

III. Selected indicators of prudential operation of the banking sector

(for banks with valid banking licences as of 31 Dec. 1998, including bank branches abroad and excluding Konsolidační banka)

	31 Dec. 1995	31 Dec. 1996	31 Dec. 1997	1998 31 Mar.	1998 30 Jun.	1998 30 Sep.	1998 31 Dec.
	Capital adequacy [1]						
Core capital in CZK millions	83 222	93 380	96 978	101 540	103 593	105 912	100 755
Total capital in CZK millions	91 248	100 790	107 207	108 276	123 464	124 371	127 662
Total assets in CZK millions 2)	1 580 036	1 758 756	2 083 841	2 007 643	2 137 072	2 192 955	2 192 852
Risk-weighted assets in CZK millions	893 652	1 027 162	1 126 787	1 092 431	1 110 833	1 098 500	1 067 541
Share of risk-weighted assets in total assets in %	56.56	58.40	54.07	54.41	51.98	50.09	48.68
Capital adequacy in %	10.21	9.81	9.51	9.91	11.11	11.32	11.96
	Credit portfolio quality [3]						
Classified credits in CZK millions	250 504	247 942	268 175	273 418	287 336	279 714	269 957
in % of total credit volume	33.40	28.58	26.91	27.49	28.55	27.81	27.05
Weighted classification in CZK millions	154 122	159 475	173 615	178 570	178 221	169 953	167 141
in % of total credit volume	20.55	18.38	17.42	17.95	17.71	16.90	16.75
Classified credits adjusted for collateral in CZK millions	128 794	121 177	143 770	157 766	168 772	158 589	152 480
in % of total credit volume	17.17	13.97	14.43	15.86	16.77	15.77	15.28
Weighted classification adjusted for collateral in CZK millions	87 910	81 691	94 755	106 365	108 022	98 117	95 738
in % of total credit volume	11.72	9.42	9.51	10.69	10.73	9.76	9.59
Reserves and provisions in CZK millions	85 696	84 786	105 696	111 559	116 369	109 858	109 055
Surplus (+) or shortfall (-) of reserves and provisions in CZK millions	-2 214	3 095	10 941	5 194	8 347	11 742	13 317
in % of total credit volume	-0.30	0.36	1.10	0.52	0.83	1.17	1.33
	Liquidity						
Quick assets in CZK millions [4]	329 445	288 446	360 623	381 604	432 743	510 292	516 677
in % of total asset volume	20.75	16.11	20.14	18.59	19.45	22.45	22.63
in % of total primary funds volume	39.12	30.38	32.68	35.65	38.04	44.20	43.00
Cumulative net balance sheet position up to 1 month in % of total assets [5]	-0.99	-4.63	-3.37	-2.76	-3.20	-2.15	-5.18
Cumulative net balance sheet position up to 3 months in % of total assets [5]	0.95	-1.76	-2.10	-2.87	-2.92	-0.36	-3.16

1) foreign bank branches excluded
2) credit equivalent of off-balance sheet assets included
3) classified credits granted to clients, administrative authorities and banks
4) cash, deposits with CNB, current accounts with other banks, T-bills and other bills
5) after deducting 80% of demand deposits

V. CALENDAR OF EVENTS

Survey of important events affecting economic and monetary developments in the Czech Republic in 1998

2 January	President V. Havel appoints the new Government of Premier Josef Tošovský
18 January	An agreement is concluded between the Czech Government and Nomura International on the basic terms of the sale of the state holding in IPB; NPF and Nomura representatives initial the draft wording of the agreement on 21 January
20 January	V. Havel is re-elected President of the Czech Republic
23 January	The CNB Board cuts the Lombard rate from 23% to 19%
28 January	J. Tošovský's Government wins a vote of confidence in the Lower House of Parliament
2 February	V. Havel takes the vow laid down by the Constitution and officially assumes the office of President of the Czech Republic for the next five years
6 February	The "small amendment" to the Act on Banks enters into force
20 February	President Václav Havel accepts the resignation of Environment Minister J. Skalický
26 February	The Lower House of Parliament passes a constitutional law shortening its electoral term; the Senate passes it on 19 March
27 February	President Václav Havel appoints Martin Bursík Environment Minister
20 March	The CNB Board increases the two-week repo rate from 14.75% to 15%
31 March	The Czech Republic commences official negotiations on European Union membership
15 April	An extraordinary session of the Lower House approves the Czech Republic's entry into NATO. The Senate expresses its approval on 30 April
6 May	The CNB Board decides to revoke the banking licence of COOP banka, a.s.
22 May	The Lower House of Parliament calls on the Government to suspend deregulation until an analysis of all the economic and social effects is completed and effective regulation of network monopolies is introduced
19–20 June	Early elections to the Lower House of Parliament take place
22 June	The sale of the sound part of Agrobanka, a. s. to GE Capital Bank is completed with the signing of the final documents

24 June	The Government closes the stabilisation programme for small and medium-sized banks declared in 1996
1 July	The CNB, the Securities Commission and the Ministry of Finance sign an agreement on co-operation in banking supervision and state oversight in the capital market area
9 July	M. Zeman and V. Klaus sign an opposition agreement between the ČSSD (the Czech Social Democratic Party) and the ODS (the Civic Democratic Party)
17 July	The CNB Board lowers its two-week repo rate from 15% to 14.5%
	President Václav Havel appoints Miloš Zeman Premier of the Czech Republic
	Václav Klaus is elected Chairman of the Lower House of Parliament
22 July	Josef Tošovský is appointed CNB Governor for a 6-year term
	President Václav Havel appoints the Government of Premier Miloš Zeman
30 July	The CNB Board lowers the minimum reserve requirement from 9.5% to 7.5%
14 August	The CNB Board cuts the discount rate from 13% to 11.5%, the Lombard rate from 19% to 16% and the two-week repo rate from 14.5% to 14%
19 August	The ČSSD Government wins a vote of confidence in the Lower House of Parliament
1 September	The "large amendment" to the Act on Banks enters into force
16 September	The Thomson BankWatch agency downgrades the Czech Republic's long-term foreign currency debt rating from BBB+ to BBB
25 September	The CNB Board cuts the two-week repo rate from 14% to 13.5%
22 October	The Czech Republic obtains its first rating from the Duff and Phelps agency: A-
24 October	The CNB Board decision to revoke the banking licence of Pragobanka, a.s. comes into legal effect
27 October	The CNB Board cuts the discount rate from 11.5% to 10%, the Lombard rate from 16% to 15% and the two-week repo rate from 13.5% to 12.5%
5 November	Standard and Poor's downgrades its long-term foreign currency issuer credit rating on the Czech Republic from A to A-
13 November	CNB Board cuts the two-week repo rate from 12.5% to 11.5%
13–14 November	Elections to municipal authorities and the first round of elections to one third of the Senate take place

20–21 November	The second round of the Senate elections is held
25 November	The Lower House approves the State Budget Bill for 1999 in its first reading and passes it on for the second reading
28 November	The CNB Board sets the short-term inflation target for net inflation at the end of 1999 at 4.5% ± 0.5 percentage points
4 December	The CNB Board cuts the two-week repo rate from 11.5% to 10.5%
17 December	The CNB Board decides to lower the minimum reserve requirement from 7.5% to 5%, effective 28 January 1999
	The CNB Board decides to revoke the banking licence of Universal banka, a.s.
23 December	The CNB Board cuts the Lombard rate from 15% to 12.5%, the discount rate from 10.5% to 7.5% and the two-week repo rate from 10.5% to 9.5%

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