



ANNUAL REPORT 2000

CNB CZECH
NATIONAL
BANK



CONTENTS



CONTENTS

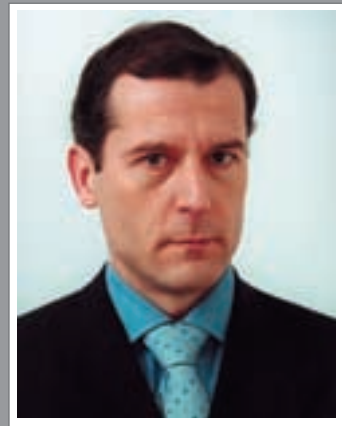
COMMEMORATIVE SILVER COIN ISSUED
to mark the 650th anniversary of the foundation
of the monastery Na Slovanech-Emauzy
DESIGNER: SCULPTOR JIŘÍ HARCUBA



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GOVERNOR'S FOREWORD

GOVERNOR'S FOREWORD



ZDENĚK TŮMA
Governor

The year 2000 brought a marked turnaround in the Czech economy. Economic growth picked up – more considerably than originally expected – and positive trends were visible in other areas, too. Real wages grew fairly briskly but remained in line with productivity, unemployment fell, and massive inflow of foreign capital created a promising climate for further development and for a definitive overcoming of our negative legacy. The Government and Parliament stepped up the process of aligning Czech legislation with European law. The evaluation of the Czech Republic by EU bodies and foreign analysts was consequently more positive than before. I would also like to mention the very good impression left by the Annual Meetings of the International Monetary Fund and the World Bank Group in Prague.

The Czech National Bank regards maintaining low and stable inflation as its chief contribution to the overall improvement in the Czech economy in 2000. We succeeded in mitigating the adverse effects of the external environment and in maintaining favourable inflation expectations, and above all we demonstrated that economic recovery and sustainable growth are compatible with low inflation. CNB policy was able to build on the previous disinflationary process and to keep interest rates – set in a recession phase – unchanged all year long. The koruna's exchange rate against the euro was very stable throughout the year, with a moderate appreciation trend, and its fluctuations vis-a-vis the US dollar reflected the similar movements shown by the single European currency.

Of course, we cannot overlook certain problems. The economy had to face a steep rise in prices of energy raw materials and a consequent deterioration in the balance of trade. Notwithstanding sizeable privatisation proceeds, developments in the public finance area are giving rise to more debt. The restructuring of those segments of the economy not benefiting from foreign capital inflow is proceeding slowly and in some regions is generating serious social problems. More consistent regulation, inspection and oversight have exposed the consequences of previous underestimation of the transformation's institutional framework and the irresponsible entrepreneurial activities and sometimes even criminal practices in businesses and banks.

This has been particularly visible in the events around Investiční a Poštovní banka. IPB's management and shareholders allowed the bank to get into a hopeless state during a comparatively short period. Poor-quality loans and loss-making transactions jeopardised deposits worth three hundred billion korunas. The danger arose that the movement of funds on hundreds of thousands of accounts of companies and individuals would be frozen, paralysing a large part of the economy. The more new information comes to light about the true situation at the former IPB, the stronger is our conviction that conservatorship and rapid sale were, despite being costly, the inevitable and ultimately cheapest solution in the circumstances. This signified the completion of the stabilisation process in the banking sector, which is now entering a new phase of development in much better condition than ever in the recent past.

The Czech National Bank ended the year 2000 with a profit of CZK 2.5 billion, thanks mainly to interest rate developments on the financial markets, which favourably affected income on international reserves. These funds will be used chiefly to cover past losses – dating in particular from 1998 – linked with appreciation of the koruna.

Despite its marked successes in fulfilling its basic role, the CNB was last year the subject of frequent criticism, political disputes and discussions. These accompanied the process of approval of legislative changes to the central bank's status and later the restructuring of the Bank Board. I believe that the controversial provisions of the amended act will soon be corrected and that the emotions generated in the course of nominating the Governor, Vice-Governor and new Bank Board members have already subsided. One only has to realise that repeated, often artificial, generation of unrest in the activities around the central monetary institution is damaging not only to the quality of its work, but also to the Czech Republic as a whole. I regard the present proper co-operation and stabler climate as a good starting point for achieving the Czech National Bank's long-term strategic objectives, namely of maintaining price stability and – in connection with the Czech Republic's accession to the European Union – of joining the European System of Central Banks.



ZDENĚK TŮMA
Governor

I. MANAGEMENT AND ORGANISATION

I. MANAGEMENT AND ORGANISATION



JAN FRAIT
Chief Executive Director

PAVEL ŠTĚPÁNEK
Chief Executive Director

OLDRICH DĚDEK
Vice-Governor

MICHAELA ERBENOVÁ
Chief Executive Director

ZDENĚK TŮMA
Governor

PAVEL RACOCHA
Chief Executive Director

LUDĚK NIEDERMAYER
Vice-Governor

I.1 THE BANK BOARD

A major change occurred in the top management of the CNB last year with the resignations of Governor Josef Tošovský and Chief Executive Director Miroslav Hrnčíř on 30 November. With effect from 1 December 2000, the President of the Czech Republic appointed Zdeněk Tůma as Governor of the CNB and Luděk Niedermayer as Vice-Governor, and named Michaela Erbenová and Jan Frait as new members of the Bank Board and Chief Executive Directors. These personnel changes also gave rise to changes in the areas of competence of the members of the Bank Board.

The composition of the CNB Bank Board following these changes is as follows:

GOVERNOR: *Zdeněk Tůma*
VICE-GOVERNOR: *Oldřich Dědek*
VICE-GOVERNOR: *Luděk Niedermayer*
CHIEF EXECUTIVE DIRECTOR: *Michaela Erbenová*
CHIEF EXECUTIVE DIRECTOR: *Jan Frait*
CHIEF EXECUTIVE DIRECTOR: *Pavel Racocha*
CHIEF EXECUTIVE DIRECTOR: *Pavel Štěpánek*

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GOVERNOR ZDENĚK TŮMA

Born on 19 October 1960 in České Budějovice. Zdeněk Tůma graduated from the Faculty of Trade at the University of Economics, Prague, and worked there after completing his studies. In 1986 he joined the Institute for Forecasting of the Czechoslovak Academy of Sciences as a postgraduate researcher. In 1993-1995 he was an adviser to the Minister of Industry and Trade, and from 1995 he was Chief Economist at Patria Finance. From 1 June 1998 until joining the CNB at the beginning of 1999 he held the post of Executive Director of the European Bank for Reconstruction and Development, representing the Czech Republic, Slovakia, Hungary and Croatia on the Board of Directors. At the same time in 1990-1998, he lectured on macroeconomics at the Faculty of Social Sciences at Charles University. He is a member of the Board of Trustees at the University of Economics, Prague, a member of the Graduation Council at the Centre for Economic Research and Graduate Education (CERGE) at Charles University, President of the Czech Economics Society and Editor in Chief of the economic journal *Finance a úvěr* (Finance and Credit). He has undertaken study programmes in Great Britain (London School of Economics, University of Cambridge), the Netherlands (Tinbergen Institute) and the USA (George Mason University). He publishes articles on monetary policy and macroeconomics in the daily press and in professional journals. On 13 February 1999, he was made a CNB Vice-Governor and a member of the CNB Bank Board. He was appointed Governor of the CNB on 1 December 2000.

VICE-GOVERNOR OLDŘICH DĚDEK

Born on 26 November 1953 in Chlumec nad Cidlinou. Oldřich Dědek graduated in agricultural economics from the University of Economics, Prague. After completing his studies in 1978, he was employed by the Economic Institute of the Czechoslovak Academy of Sciences, where he worked as a researcher specialising in economic policy. In 1992, he joined the State Bank of Czechoslovakia as Deputy Director of the Institute of Economics, and in 1996 he was appointed an adviser to the CNB Governor. He was formerly a member of the Scientific Council of the Faculty of Social Sciences at Charles University in Prague, where he lectures on financial market issues. He is currently a member of the Administrative Board of Charles University. He is

a member of the Board of Directors of the Czech Economics Society. He has participated in internships and study programmes in Great Britain (London School of Economics, University of Warwick) and the USA (International Monetary Fund, Federal Reserve Bank of Kansas City). He translated the *Macmillan Dictionary of Modern Economics* and is the author of the *Concise English-Czech Dictionary of Economic Terms and Abbreviations*. He also publishes articles on monetary and economic policy issues in the daily press and in professional journals. As an adviser to the Prime Minister of the Czech Republic in the first half of 1998 he headed the team of authors who prepared the document *Economic Strategy of Joining the European Union: Starting Points and Directions*. Since 13 February 1999, he has been a CNB Vice-Governor and a member of the CNB Bank Board.

VICE-GOVERNOR LUDĚK NIEDERMAYER

Born on 13 March 1966 in Brno. Luděk Niedermayer graduated in operational research and systems theory from UJEP Brno (now Masaryk University) in 1989 and worked there for a short time researching the theory of structures. In 1991 he joined the State Bank of Czechoslovakia, where he completed a course on asset and liability management organised by the World Bank. In January 1996 he became an Executive Director of the CNB, responsible for foreign exchange reserves administration and money market operations. He has undertaken numerous study programmes and internships in well-known financial institutions in the areas of the capital market (e.g. Swiss Bank Corporation, Salomon Brothers and Morgan Stanley); derivatives trading and risk management (e.g. Bankers Trust, New York Institute of Finance and J. P. Morgan); monetary policy and the central bank (e.g. FED N.Y., IMF, BIS and Bank of England) and other issues. He focuses on financial markets and instruments, risk management and derivatives trading as a conference participant, in lectures at professional courses and in his publishing activities. On 27 February 1996, he was made a CNB Chief Executive Director and a member of the CNB Bank Board. He was appointed a Vice-Governor of the CNB on 1 December 2000.

CHIEF EXECUTIVE DIRECTOR MICHAELA ERBENOVÁ

Born on 24 August 1968 in Prague. Michaela Erbenová graduated in mathematical methods in economics from Moscow State University in 1990 and obtained a Ph.D. in economics from CERGE (Centre for Economic Research and Graduate Education) at Charles University in Prague in 1997. During her postgraduate studies, she undertook study internships at the Tinbergen Institute, University of Amsterdam, the Netherlands, and at Princeton University, USA, (1993) and a research internship at the Harvard Institute for International Development, Harvard University, USA, (1995), where she worked as a research assistant to Prof. Jeffrey Sachs. In 1994-1995 she worked as a Consultant at the Directorate for Education, Employment, Labour and Social Relations at the OECD in Paris. After a brief teaching assignment at CERGE, she worked as an Adviser to the Prime Minister of the Czech Republic, Václav Klaus (1996-1997) and as Head of the Group of Advisers to the Minister of Finance, Ivan Pilip (1997-1998). From November 1998 onwards, she held various managerial posts at Komerční banka, the last being Director of its Investor Relations Division. Since 1997 she has lectured at the Institute of Economic Studies at the Faculty of Social Sciences, Charles University. She was appointed a member of the CNB Bank Board on 1 December 2000.

CHIEF EXECUTIVE DIRECTOR JAN FRAIT

Born on 28 November 1965 in Slavičín. Jan Frait graduated in 1988 from the Faculty of Economics at the Technical University of Ostrava (VŠB-TU) and completed his doctoral studies there in 1995. The same year, he was awarded the prize of "Young Economist of the Year" by the Czech Economics Society. In 1998, he qualified at the faculty as an Associate Professor in Economics. From 1990 onwards he worked in the Department of Economics of the Faculty of Economics at VŠB-TU, becoming Sub-Dean for Science and Research in May 1999. Since 1999 he has been a member of the faculty's Scientific Council and since 2000 he has also been a member of the Scientific Council of VŠB-TU. He publishes primarily in professional journals. He is an Associate Editor of the economic journal *Finance a úvěr* (Finance and Credit) and a member of the Board of Editors of *Ekonomická revue* (Economic Review). He is a member of the National Board of Directors and Executive Committee of the Czech Economics Society, and Executive Secretary of the Society's Ostrava branch. He is also a member of the Centre for Euro-Asian Studies at the University of Reading in the UK and its Representative for the Czech Republic. He has undertaken study programmes at Keele University (1992), University of Reading (1996) and Liverpool John Moores University (1997, 1998 and 2000) in the UK and a traineeship at GOTA Bank in Sweden (1991). He was appointed a member of the CNB Bank Board on 1 December 2000.

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CHIEF EXECUTIVE DIRECTOR PAVEL RACOCHA

Born on 23 March 1962 in Plzeň. Pavel Racoča graduated from the Faculty of Management at the University of Economics, Prague, and completed an eighteen-month study programme at Columbia University in New York. In the second half of the 1980s, he worked in the housing co-operative system. In 1991, he joined the State Bank of Czechoslovakia, where he worked in the banking supervision area, successively holding the posts of specialist, section head and deputy director. From 1998 he worked as Executive Director of Banking Supervision at the CNB. He has participated in a number of internships in the USA, Germany, France, Japan and elsewhere, focusing on banking, risk management and banking supervision issues. In 1996-97, he worked as a consultant at the World Bank in Washington in the area of financial sector development in emerging economies. He is a member of the Core Principles Liaison Group of the Basle Committee on Banking Supervision at the Bank for International Settlements in Basle, which is engaged in developing core principles for effective banking supervision. In 2000 he was Chairman of the Group of Banking Supervisors from Central and Eastern Europe. He is a member of the steering committee for the privatisation of banks, an advisory body to the Czech Ministry of Finance. He lectures at seminars and conferences on banking in the Czech Republic and abroad. Since 13 February 1999, he has been a CNB Chief Executive Director and a member of the CNB Bank Board.

CHIEF EXECUTIVE DIRECTOR PAVEL ŠTĚPÁNEK

Born on 5 September 1956 in Prague. Pavel Štěpánek graduated in finance from the University of Economics, Prague. After completing his studies in 1979, he stayed on there as an assistant lecturer. In 1981, he was employed as a specialist by the Ministry of Finance, where he successively held various posts in the Study-Research Centre, the Public Finance Section and the Financial Policy Department. In 1998, he was appointed Deputy Finance Minister responsible for financial policy, international relations, the capital market and bank privatisation. In the second half of 1998 he became an adviser to the General Director of Česká spořitelna. In 1993-1998, he was

a member of the Presidium of the National Property Fund and was also engaged for a short time on the Supervisory Board of Poštovní banka. He has participated in IMF study programmes abroad, focusing on taxes and public finance. He lectures on financial policy at the University of Economics, Prague, and publishes articles in the daily press and in professional journals. Since 13 February 1999, he has been a CNB Chief Executive Director and a member of the CNB Bank Board.

I.2 ORGANISATION

Following the general restructuring implemented over the previous two years, the CNB's organisational structure was further partially rationalised in 2000.

The CNB consists of a headquarters in Prague and branches in Prague, České Budějovice, Plzeň, Ústí nad Labem, Hradec Králové, Brno and Ostrava. These organisational units are further divided into organisational sections – groups, departments and divisions at headquarters, and divisions at branches.

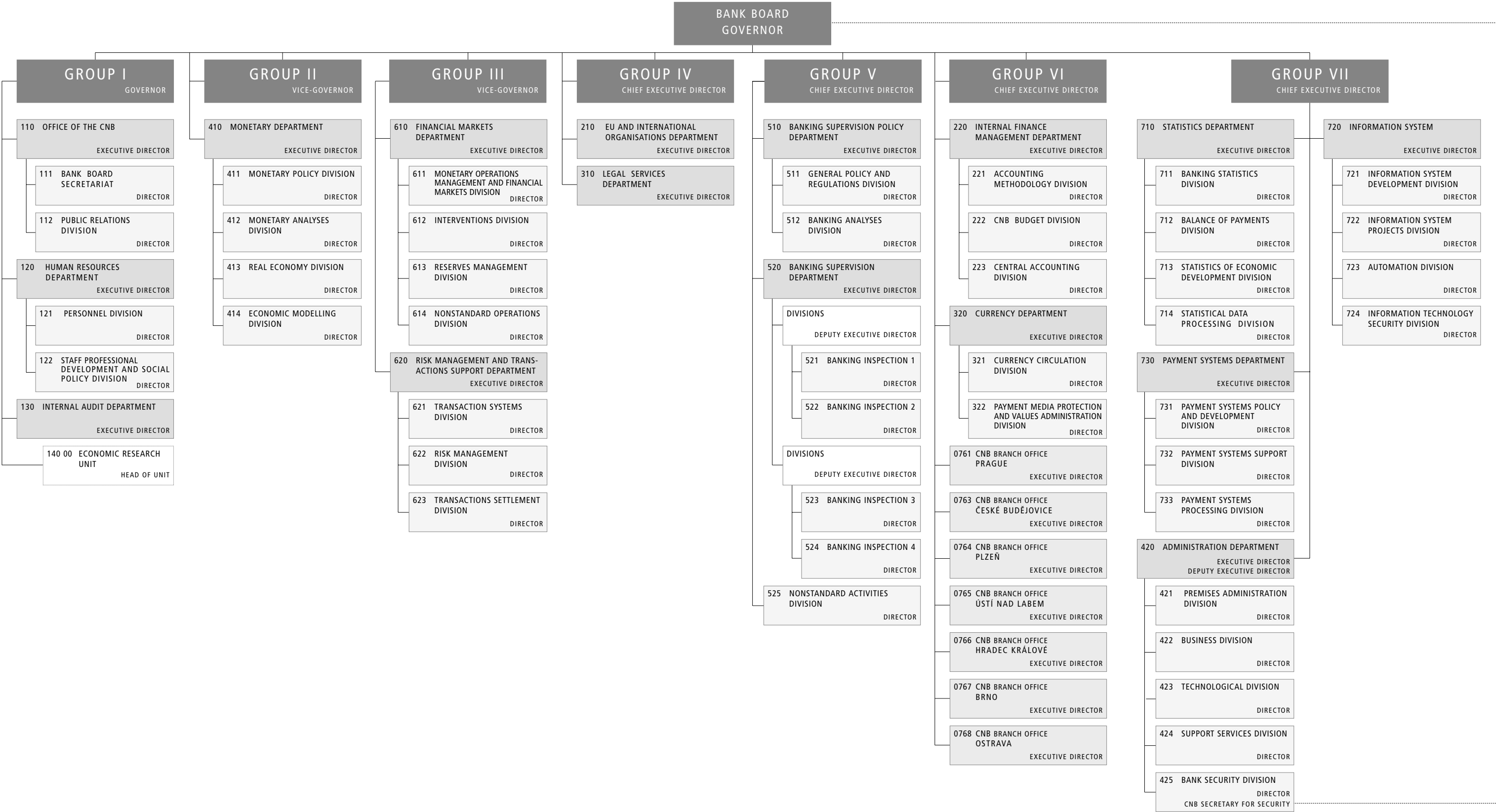
The departments at headquarters are the basic management element at the CNB.

In 2000, several changes were made to the CNB's Organisational Manual. The main change was connected with the appointment of the new members of the Bank Board and the need for a new division of responsibilities among the members with respect to the management of the individual groups and branches of the bank. Also, the descriptions of the functions and activities of the departments were partially modified, with several issues regarding areas of competence being resolved.

The adoption of the amendment to the CNB Act, No. 6/1993 Coll., had a considerable impact on the status of the CNB. The areas of competence of the bank relating to the Freedom of Information Act, No. 106/1999 Coll., to dealing with the complaints, reports and requests of citizens and legal entities, and to its activities ensuing from the Ombudsman Act, No. 349/1999 Coll., were all defined more clearly.

ORGANISATIONAL CHART

ORGANISATIONAL CHART



ORIENTATION AND RESPONSIBILITIES OF THE ORGANISATIONAL SECTIONS OF THE CNB'S HEADQUARTERS AND BRANCHES AS SET FORTH IN THE ORGANISATIONAL MANUAL

HEADQUARTERS

110 OFFICE OF THE CNB

Responsible for secretarial services for the Governor and the Bank Board and its individual members, including organisational and advisory activities; for CNB foreign and internal protocol; for informing CNB management about important events and information; and for the CNB's communications with the public, the media and its own staff.

120 HUMAN RESOURCES DEPARTMENT

Responsible for human resources management; for labour-legislation and wage administration, including income tax; for processing wages and keeping records in the wage area; for the professional and social development of staff; and for co-ordinating the preparation of the CNB's organisational structure and Organisational Manual and managing changes to them.

130 INTERNAL AUDIT DEPARTMENT

Responsible for internal auditing activity and for setting the principles for inspection activities at the CNB. Carries out internal auditing and inspections at the CNB.

210 EUROPEAN UNION AND INTERNATIONAL ORGANISATIONS DEPARTMENT

Responsible for overall co-ordination of CNB relations with the European Union and its institutions, including integration into European structures and relations with international economic and financial institutions and foreign banks; and for drafting conceptual plans for these relations.

220 INTERNAL FINANCE MANAGEMENT DEPARTMENT

Responsible for CNB accounting; for the CNB budget in compliance with Article 47 of Act No. 442/2000 Coll.; for controlling; and for the CNB's financial relations with the state budget.

310 LEGAL SERVICES DEPARTMENT

Responsible for the area of legislation and law at the CNB; for compliance of CNB regulations with other legal regulations; and for the gradual harmonisation of CNB legislation with that of the European Union.

320 CURRENCY DEPARTMENT

Responsible for preparing the issuance of new banknotes and coins; for regulating cash in circulation; for managing the reserves of Czech money, gold, precious metals and commemorative silver coins; and for protecting Czech money against counterfeiting.

410 MONETARY DEPARTMENT

Responsible for drafting monetary policy proposals, comprehensive analyses and forecasts of monetary and economic developments, and proposals for the co-ordination of monetary policy and government economic policy; for analysing the inflation trend and the relationship between aggregate supply and demand; and for analysing and forecasting macroeconomic phenomena using economic models.

420 ADMINISTRATION DEPARTMENT

Responsible for all administrative activities of the CNB, including security.

510 BANKING SUPERVISION POLICY DEPARTMENT

Responsible for setting the regulations for banking sector development; for banking supervision procedures; for comprehensive analyses of the Czech banking sector; and for the central register of credits in the Czech Republic.

520 BANKING SUPERVISION DEPARTMENT

Responsible for comprehensive performance of banking supervision and for implementing banking supervision policy in the Czech Republic.

610 FINANCIAL MARKETS DEPARTMENT

Responsible for implementing monetary policy and regulating the monetary policy operational target; for CNB interventions on the money and foreign exchange markets; for managing CNB international reserves; for acting as agent of the Czech Government in administering government debt; and for providing and administering credits to banks and non-standard CNB clients.

620 RISK MANAGEMENT AND TRANSACTIONS SUPPORT DEPARTMENT

Responsible for managing CNB asset and liability risks; for developing and administering banking transaction information systems; and for comprehensive settlement of CNB transactions on domestic and foreign markets.

710 STATISTICS DEPARTMENT

Responsible for collection and accurate and comprehensive processing of monetary, banking and economic statistical data; for compiling and evaluating the balance of payments; and for administering and developing statistical data systems.

720 INFORMATION SYSTEM DEPARTMENT

Responsible for developing information systems, information technology and communications at the CNB and for their security and protection (excluding the interbank payment information system, the accounting and payments system, the short-term bond market system, collection and processing of the statistical data of the banking information system, the banking transactions information system and the wireless telecommunication systems for non-data communication); and for co-ordinating and integrating the management of IT and IS development projects at the CNB.

730 PAYMENT SYSTEMS DEPARTMENT

Responsible for managing the non-cash payment system; for developing and running the CNB's automated accounting and payment system (ABO2) and interbank settlement system (clearing); and for the conception, methodology, development and operation of the short-term bond market system (TKD).

CNB BRANCHES

Responsible for managing money reserves and maintaining the accounts of the state budget and other branch clients; for making payments; for the financial accounting of the branch; for carrying out foreign exchange inspections and compiling foreign exchange statistics in the region; for conducting business surveys; for labour-law and social administration; and for administrative activities at the branch.

II. FINANCIAL REPORT



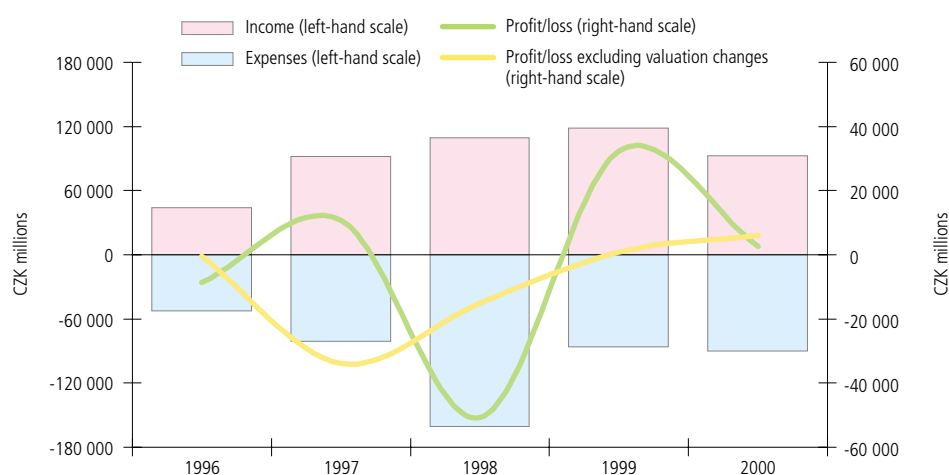


II. FINANCIAL REPORT

COMMEMORATIVE SILVER COIN ISSUED
to mark the 200th anniversary
of the birth of Jean-Baptiste Gaspard Deburau
DESIGNER: SCULPTOR JIŘÍ HARCUBA

The Czech National Bank made a profit of CZK 2,524 million for 2000, income being CZK 92,394 million and expenses CZK 89,870 million. The 2000 result was affected chiefly by profits made in the international reserves management area. Compared with previous years, the return on the CNB's foreign exchange assets increased significantly thanks to favourable developments on foreign markets. This enabled the bank to cover all its sterilisation expenses, exchange rate losses and operating expenses.

CHART II.1 CNB PERFORMANCE 1996 - 2000



Net income on international reserves was CZK 22,340 million (excluding provisions for foreign currency securities amounting to CZK 1,755 million), an increase of CZK 7 billion compared with 1999. This was largely due to income from international reserves management. The weighted average return on the foreign exchange portfolio was 5.07% p.a., which is 2.07 percentage points higher than in 1999 thanks to the trend on world markets. Expressed in US dollars, the CNB's international reserves rose from USD 12.9 billion at end-1999 to USD 13.1 billion at end-2000.

In 2000, as in 1999, domestic banks made use of CNB-bill repo operations. This type of operation is used for managing liquidity on the money market. Owing to the systemic liquidity surplus in the Czech banking sector, repo tenders are currently used exclusively for absorbing liquidity. The CNB accepts surplus liquidity from banks and in return transfers eligible securities to them as collateral. The two parties agree to reverse the transaction at maturity, when the CNB as borrower repays the principal of the loan plus interest and the creditor bank returns the collateral to the CNB. In addition to repo tenders, the banking sector made use of the deposit facility (introduced on 1 December 1998). This allows commercial banks to automatically deposit their surplus liquidity overnight with the CNB at the discount rate. Interest expenses from repo operations and the deposit facility brought a net loss of CZK 13,991 million.

In 2000, an average of CZK 264 billion was sterilised in the form of repo operations, an increase of around 35% on a year earlier (due to the lowering of the minimum reserve requirement and to CNB interventions on the foreign exchange market). Conversely, overall sterilisation costs declined owing to the difference in interest rates between 1999 and 2000. The limit two-week repo rate remained at 5.25% p.a. throughout 2000. The other monetary policy instruments were also held at their end-1999 levels (the discount rate at 5% p.a., the Lombard rate at 7.5% p.a. and the reserve requirement on primary deposits at 2%).

Overall valuation changes were negative at CZK 3,524 million. As a percentage of profit, they were significantly lower than in previous years. Given the extent of foreign exchange assets and liabilities and the floating exchange rate regime, the movement of reserve currency exchange rates against the koruna is a very volatile feature of the bank's performance. Given the current structure of the CNB's balance sheet, where foreign exchange assets significantly exceed liabilities (the CNB has an open foreign exchange position), exchange rate movements may significantly affect the CNB's accounting profit in future years.

Further to the international agreement closing the separation of the assets of the Czech and Slovak Federal Republic and to the Government Decree of 22 November 1999, the CNB in May 2000 transferred receivables against the National Bank of Slovakia with a nominal value of CZK 25,810 million to the Czech Republic, represented by the Czech Ministry of Finance, for the agreed price of one Czech koruna. The resulting losses were met out of provisions created for this purpose at the end of 1999.

In connection with the Government Decree of 8 November 1999, in which the Czech Government gave its consent to the restructuring of certain transformation institutions, the CNB on 30 June 2000 sold its 100% (CZK 15,814 million) stake in Česká finanční to Konsolidační banka for the agreed price of one Czech koruna. The CNB also undertook to cover all Česká finanční's losses ensuing from the consolidation programme recorded as of the date of transfer of the stake.

To cover the risk of losses ensuing from the consolidation of the banking sector, the Czech Government issued a guarantee of CZK 22,500 million on 19 March 1997 for a period of ten years.

The Czech National Bank issued an irrevocable guarantee for creditors of Investiční a Poštovní banka (IPB) for the commitments ensuing from the deposits accepted and bonds issued by this bank, including interest, recorded in its accounting books as of 16 June 2000. This guarantee is gradually shrinking owing to the decrease in individual deposits with IPB. Consequently, the commitment recorded in the off balance sheet at the close of the year was reduced to CZK 54,200 million, which conforms to the appraisal of the guarantee at the year-end conducted by Československá obchodní banka (ČSOB).

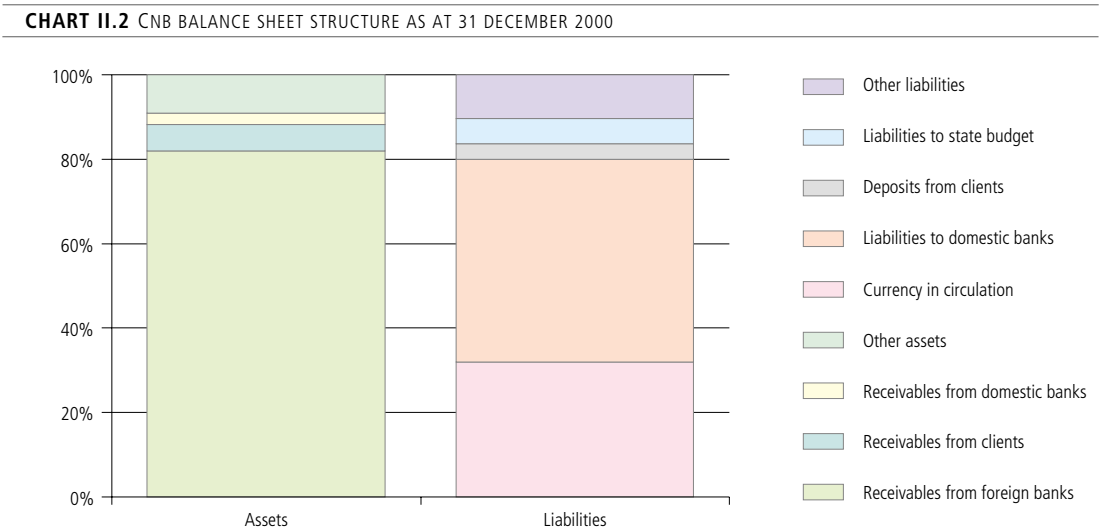
On 19 June 2000, the CNB issued an "Agreement and Promise of Indemnity" undertaking to cover certain ČSOB losses and to compensate it for certain claims relating to the takeover of IPB. Further to this, on 23 June 2000 the Czech Government issued a state guarantee in which it pledged to meet some of the losses incurred by the CNB as a result of compensating ČSOB under the Agreement and Promise of Indemnity. The state guarantee covers only those losses which the CNB

may incur as a result of compensating ČSOB for losses ensuing from any commitments not recorded in IPB's accounts.

As of 31 December 2000, ČSOB had declared and quantified individual cases potentially covered by the Agreement and Promise of Indemnity. Since these were all cases to which the state guarantee applies, the CNB recorded the guarantee issued and the associated guarantee accepted in the same amount (CZK 7,945 million) in its off balance sheet as of 31 December 2000.

The CNB had reserves and provisions of CZK 39,591 million as of 31 December (CZK 12,597 million in reserves and CZK 26,994 million in provisions). Compared with end-1999, the net decrease in reserves was CZK 21,005 million and the net decrease in provisions CZK 28,258 million. The fall in reserves and provisions was associated primarily with the transfer of the CNB's 100% stake in Česká finanční to Konsolidační banka. The costs incurred by the CNB from the transfer of the stake were covered by releasing a reserve of CZK 21.8 billion. Furthermore, a provision of CZK 25,810 million was released in connection with the transfer to the Czech Republic of the receivables against the National Bank of Slovakia resulting from the splitting of the balance sheet of the former State Bank of Czechoslovakia and the dividing of the federal currency.

The CNB had total assets of approximately CZK 616 billion as of 31 December 2000. As in 1999, the most significant items on the liabilities side were liabilities to domestic banks and currency in circulation, accounting for 80% of the total. On the assets side, receivables from abroad (predominantly CNB international reserves) had the biggest share (approximately 82%, up by 5% on a year earlier). The structure of individual assets and liabilities and their share of the CNB's total assets is shown in the following chart.

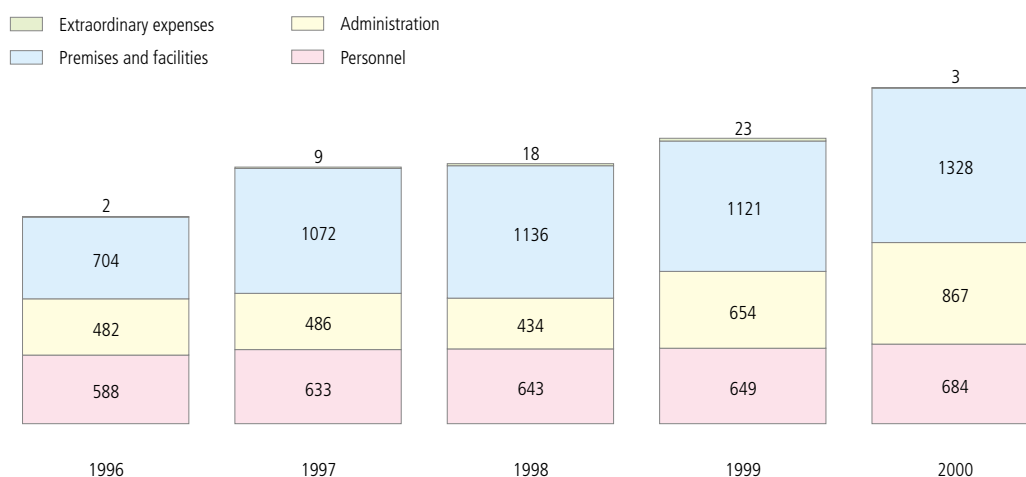


In the area of issuance and management of currency in circulation, the CNB spent CZK 274 million, or CZK 62 million less than in 1999. The overwhelming majority of the expenditure (CZK 297 million) was related to the supply of new banknotes and

coins. Around CZK 5 million was paid out for management of currency in circulation through Komerční banka's branches. The income related chiefly to the sale of gold coins (CZK 20 million) and numismatic material (CZK 8 million).

In the area of operations (including VAT and expenses for co-financing IMF/World Bank Group Annual Meetings) the CNB made a net loss of CZK 2,768 million, up by CZK 362 million (15%) on a year earlier. This increase was associated with the aforementioned IMF/WBG meetings in Prague, which cost the CNB a total of CZK 350 million. Excluding this extraordinary cost, the operations area as a whole saw a similar trend to the previous year. The only differences were in the volume of certain expenses resulting from the completion of the reconstruction of the CNB's headquarters. Transferral of assets into use increased depreciation, whereas moving headquarters staff back to the original building reduced rent. In 2000, operating expenses represented 3.2% of the CNB's total expenses and operating income 0.1% of its total income. By purpose, CZK 684 million was spent on staff (of which CZK 666 million on wages, including social and health insurance, and CZK 18 million on training), approximately CZK 121 million on rental of operational premises, CZK 151 million on value added tax (VAT paid at input showed up in expenses in 2000, since the CNB, given the volume of its financial activities, could not deduct VAT) and CZK 92 million on computer maintenance and servicing. Depreciation and amortisation totalled CZK 975 million. The operating expenses also included fuel and energy consumption, repairs and maintenance of property, contracted services (consulting, auditing, software support, etc.), telecommunication charges, travel expenses, materials, office supplies and printed forms. Extraordinary expenses in the operations area amounted to CZK 3 million. Income in this area (particularly fines and penalties received, sales of materials and tangible assets, and rent received) totalled CZK 114 million.

CHART II.3 OPERATING EXPENSES 1996 - 2000 (CZK MILLIONS)



In 2000, CZK 745 million was drawn for asset acquisition, i.e. approximately 68% less than in 1999. This decrease was due largely to the final phase of the reconstruction of the CNB's headquarters in central Prague and the associated payment schedule. Of this total, CZK 516 million was drawn for acquisition of tangible assets, CZK 43 million for acquisition of inventories and CZK 186 million for acquisition of intangible assets.

The largest part of the spending on acquisition of tangible assets – CZK 283 million – went on buildings, constructions and land. Most of this amount was channelled into the reconstruction of the CNB's headquarters. The construction work was completed in 2000, although with some defects and outstanding work which were gradually rectified and finished off. The inspection permit for the last part of reconstructed premises took effect on 31 January 2000.

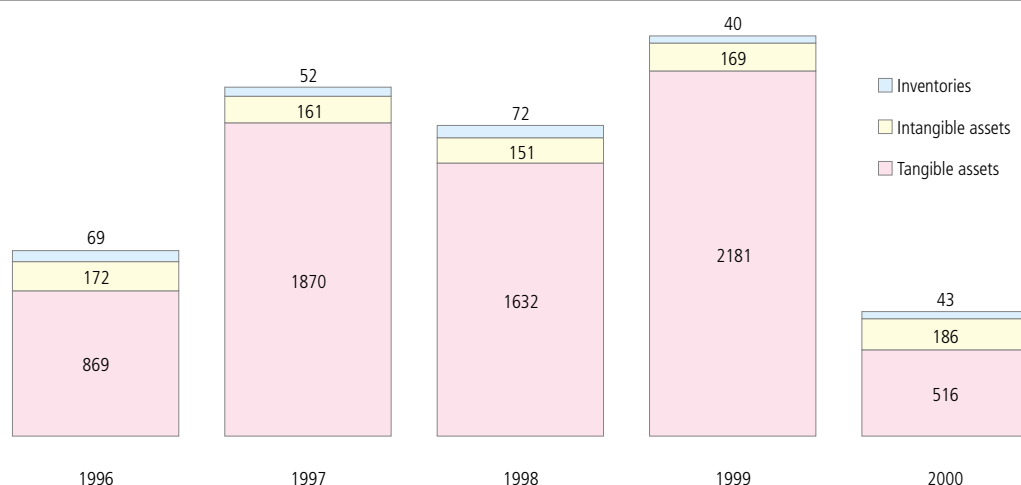
A total of CZK 185 million was spent on computer hardware, another very significant area of expenditure on acquisition of tangible assets. This was mostly invested in standard hardware (in particular the purchase of disk arrays common to the NT and Unix servers). CZK 11 million was spent on equipment for safekeeping, handling and processing of cash, CZK 9 million on security equipment, CZK 9 million on vehicles, CZK 7 million on interior furnishings, CZK 6 million on office equipment and consumer electronics, CZK 4 million on communication equipment and CZK 2 million on other tangible assets.

The funds for acquisition of inventories were spent on items divided into six areas for budgeting purposes. The most significant area was purchases of packing materials for banknotes and coins, totalling CZK 13 million. Another CZK 9 million was spent on office supplies, CZK 7 million on spare parts, CZK 4 million on printed forms, CZK 4 million on maintenance materials and CZK 6 million on other materials.

The expenses for acquisition of intangible assets were channelled solely into the purchase of software. CZK 63 million was spent on software for the payment system (purchase of system software licences for the CNB's clearing centre), CZK 34 million on software for on-line data transfer to the CNB's clearing centre, CZK 24 million on software for remote data backup on disks and CZK 15 million on enhancing input data controls.

The following chart gives the CNB's asset acquisition expenses between 1996 and 2000. It does not show specific capital investments (e.g. the increase in Česká finanční's capital), as these involve participating interests relating to the consolidation of the banking sector.

CHART II.4 ASSET ACQUISITION EXPENSES 1996 - 2000 (CZK MILLIONS)



The CNB's profit for 2000 was used to cover past losses (to the maximum possible extent) and to replenish the social fund (in the amount agreed upon in the collective agreement for 2001). Although covering the 1998 loss has been given priority status in the distribution process, an accumulated loss of CZK 15,904 million will remain uncovered in the balance sheet. This will be met out of future profits.

CNB BALANCE SHEET, PROFIT AND LOSS ACCOUNT AND AUDITORS' REPORT

ASSETS

in CZK millions

Item no.	Item	Current accounting period			Previous accounting period
		Gross	Adjustments	Net	
1.	Gold	841	0	841	840
2.	Receivables from International Monetary Fund	42 802	0	42 802	39 405
3.	Receivables from foreign banks, including trading securities	506 457	1 106	505 351	478 224
3.1.	Deposits at foreign banks	92 805	0	92 805	75 751
3.2.	Credits granted to foreign banks	14 240	0	14 240	7 659
3.3.	Trading securities	399 352	1 106	398 246	394 772
3.4.	Other receivables against foreign countries	60	0	60	42
4.	Receivables from domestic banks	17 385	14	17 371	30 739
5.	Receivables from clients	42 422	4 680	37 742	39 949
6.	Domestic securities and shares	19 728	19 717	11	15 825
7.	Current result of state budget	0	0	0	0
8.	Other receivables against state budget	0	0	0	0
9.	Cash in CZK	1 898	0	1 898	1 063
10.	Fixed assets	11 837	3 508	8 329	8 614
10.1.	Tangible fixed assets	10 841	2 964	7 877	8 167
10.2.	Intangible fixed assets	996	544	452	447
11.	Other assets	3 149	1 477	1 672	7 516
11.1.	Deferred revenue and accrued expenses	431	0	431	686
11.2.	Others	2 718	1 477	1 241	6 830
	ASSETS TOTAL	646 519	30 502	616 017	622 175

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LIABILITIES

in CZK millions

Item no.	Item	Current accounting period	Previous accounting period
1.	Currency in circulation	197 000	183 939
2.	Liabilities to International Monetary Fund	42 399	39 405
3.	Liabilities to foreign banks, including securities	13 829	30 545
3.1.	Loans taken from abroad	13 415	17 798
3.2.	Debt securities in issue	0	12 331
3.3.	Other liabilities abroad	414	416
4.	Liabilities to domestic banks	295 871	275 884
4.1.	Bank monetary reserves	26 575	26 279
4.2.	Other liabilities	269 296	249 605
5.	Deposits from clients	21 573	33 123
6.	Domestic T-bills issued	0	0
7.	Current result of state budget	0	0
8.	Other liabilities to state budget	36 574	27 069
9.	Reserves	12 597	33 602
10.	Share capital	1 400	1 400
11.	Funds	8 202	8 203
12.	Retained profits (accumulated losses) from previous periods	-18 393	-50 740
13.	Profit (loss) for accounting period	2 524	32 378
14.	Other liabilities	2 441	7 367
14.1.	Deferred revenue and accrued expenses	346	1 075
14.2.	Others	2 095	6 292
	LIABILITIES TOTAL	616 017	622 175

OFF BALANCE SHEET

in CZK millions

Item no.	Item	Current accounting period	Previous accounting period
1.	Contingent liabilities	78 740	37 631
1.1.	Accepted bills of exchange and endorsed bills	0	0
1.2.	Guarantees issued	78 740	37 631
1.3.	Obligations from collateral	0	0
2.	Other irrevocable liabilities	0	0
3.	Receivables from spot, term and option operations	13 694	42 639
4.	Liabilities from spot, term and option operations	13 269	42 496
5.	Guarantees received	30 445	22 500

PROFIT AND LOSS ACCOUNT

in CZK millions

Item no.	Item	Accounting period	
		Current	Previous
1.	Interest income and similar income	28 825	33 361
1.1.	Interest from securities bearing fixed income	21 696	25 578
1.2.	Other	7 129	7 783
2.	Interest expenses and similar expenses	17 249	28 923
2.1.	Interest from securities bearing fixed income	495	10 522
2.2.	Other	16 754	18 401
3.	Income from securities with variable income	41	39
3.1.	Income from shares	41	39
3.2.	Income from shares in subsidiaries and associates	0	0
4.	Income from fees and charges	450	542
5.	Expenses from fees and charges	81	49
6.	Profit (loss) from financial operations	-5 074	25 666
7.	Other income	116	16 217
7.1.	Income from money issuance	8	21
7.2.	Other	108	16 196
8.	Administration expenses	2 355	2 295
8.1.	Personnel expenses	666	624
8.1.1.	Wages and salaries	484	454
8.1.2.	Social and health insurance	182	170
8.2.	Other operating expenses	1 689	1 671
9.	Charge for specific and general provisions for tangible and intangible assets	0	0
10.	Release of specific and general provisions for tangible and intangible assets	0	0
11.	Other expenses	49 865	3 949
11.1.	Expenses for issuing bank notes and coinage	297	351
11.2.	Other	49 568	3 598
12.	Charge for specific and general provisions for loans and guarantees	1 351	32 667
13.	Release of specific and general provisions for loans and guarantees	33 008	8 814
14.	Charge for specific and general provisions for shares and other financial investments	0	0
15.	Release of specific and general provisions for shares and other financial investments	15 814	0
16.	Charge for other specific and general provisions	33	1 440
17.	Release of other specific and general provisions	1	17 035
18.	Ordinary profit (loss) after taxation	2 247	32 351
19.	Extraordinary income	280	53
20.	Extraordinary expenses	3	26
21.	Extraordinary profit (loss) after taxation	277	27
22.	Profit (loss) for accounting period	2 524	32 378

The notes to the financial statements are available from the Office of the CNB, Na Příkopě 28, Praha 1, and on the CNB's website

ENGLISH TRANSLATION

REPORT OF INDEPENDENT AUDITORS

TO THE BANKING BOARD OF THE CZECH NATIONAL BANK

We have audited the accompanying balance sheet of Czech National Bank (hereinafter the "CNB") as at 31 December 2000, the related income statement and notes for the year then ended (hereinafter "financial statements"). The financial statements and underlying accounting records are the responsibility of the management of CNB. Our responsibility is to express an opinion on these financial statements based on our audit.

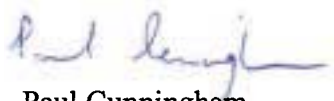
We conducted our audit in accordance with the Act on Auditors and Auditing Standards of the Chamber of Auditors of the Czech Republic. Those auditing standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. 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 CNB as at 31 December 2000, and the results of its operations for the year then ended in accordance with the Act on Accounting and other relevant legislation of the Czech Republic.

27 March 2001



PricewaterhouseCoopers Audit, s.r.o.
represented by



Paul Cunningham
Partner



Zdeněk Mojžíšek
Auditor, Licence No. 1813

III. EU INTEGRATION AND RELATIONS WITH INTERNATIONAL FINANCIAL INSTITUTIONS



COMMEMORATIVE SILVER COIN ISSUED
to mark the 100th anniversary
of the birth of Karel Svoboda
DESIGNER: SCULPTOR VLADIMÍR OPPL

III. EU INTEGRATION AND RELATIONS WITH INTERNATIONAL FINANCIAL INSTITUTIONS



III.1 EU INTEGRATION

The main events of the integration process in 2000

From the foreign policy perspective, the main event of the integration process in 2000 was the EU summit in Nice in December. The most important point on the summit agenda for the candidate countries was the issue of enlargement and reform of European institutions. For the first time, specific ideas on the representation of the accession countries within individual EU bodies were heard. In its protocol on enlargement, the EU indicated that it considers 2004 to be a feasible time scale for accepting new members. The exact dates and scope of the enlargement will be determined later on, most probably during 2001.

Closely linked to the possible 2004 accession date is the preparatory work on the Pre-accession Economic Programmes (PEPs), which is proceeding in parallel in each candidate country and which should, upon accession, facilitate smooth integration into the convergence programmes that monitor fulfilment of the criteria for adopting the single currency. In the Czech Republic, these preparations follow on from the *Joint Assessment of the Economic Policy Priorities of the Czech Republic* signed by the Czech Government and the European Commission. CNB representatives took part in both the drafting of and final discussions on this document.

Within the PEPs, the CNB is helping to draw up a medium-term macroeconomic framework, which among other things covers monetary and exchange rate policy and, separately, the inflation area, and also to prepare structural reforms in the banking sector area. It should be emphasised that the purpose of this programme is not to monitor fulfilment of the Maastricht nominal convergence criteria, but to monitor the progress on and quality of fiscal reform and the stability and long-term sustainability of public finances in the candidate countries in compliance with current EU procedures.

An important document in which the European Commission regularly assesses the preparedness of each of the candidate countries for EU membership is the *Regular Report on Progress towards Accession*. In November 2000, the Commission issued its third Regular Report on the Czech Republic. The general tone of this report was more positive than in 1999, with the accelerating process of legislative harmonisation receiving particular praise. However, the Commission stated that despite considerable progress at the start of the transformation process, the pace of structural and institutional change had been sluggish and the level of economic growth had been low relative to the EU average.

In the banking area, the Commission describes the well-known problems of the Czech banking sector. It regards the high level of classified credits and the incomplete privatisation of banks as the biggest problems in Czech banking at present. It also takes note of the status of harmonisation of the Act on the CNB with the EC Treaty and with the Statute of the European System of Central Banks and the European Central Bank. The Report states that as regards central bank independence, the amendments to the Act on the CNB are incompatible with the Treaty.

Pre-accession strategy

Each year, the European Commission evaluates the Czech Republic's progress in preparing for EU membership according to its fulfilment of the Accession Partnership priorities. On the basis of these priorities, and in response to the problem areas

identified by the Commission in its Regular Report, the CNB then prepares the monetary policy, monetary and balance of payments statistics and banking areas of the *National Programme for the Adoption of the Acquis*.

The CNB met most of the priorities of the 2000 National Programme in the banking area during the period under review. However, owing to the non-adoption of a key amendment to the Act on Banks by the Lower House of the Czech Parliament (the Chamber of Deputies), the foreseen dates of effect of the Act and related banking supervision regulations have shifted to 2002.

In the monetary policy area, the top priority in the 2000 National Programme was the adoption of the "harmonisation amendment" to the Act on the CNB. The amendment, which entered into force on 1 January 2001, aligned numerous provisions of the previous CNB Act with European legislation (e.g. the primary objective of the CNB, increased independence, a ban on financing public institutions from CNB funds, removal of non-market institutions, pre-requisites for joining the European System of Central Banks). It nevertheless also introduced provisions which are incompatible with the Czech constitution and with the European legislation and which curb the central bank's independence (consultation and agreement between the CNB and the Government regarding the inflation target, a split CNB budget, and approval of the operating and investment sections of this budget by the Chamber of Deputies).

Accession negotiations

The accession negotiations have so far shown that the Czech Republic does not consider adoption of the EC banking and monetary policy regulations as of the accession date to be problematic and that it is ready to align fully its own regulations in these areas by that date (in the monetary area to the extent applying to countries having a derogation on the adoption of the euro).

As in previous years, the regular meetings of the Europe Agreement bodies – the Association Committee (6-7 June 2000 in Prague) and its subcommittees – took place. The subcommittee for economic, financial and monetary affairs met on 23-24 May 2000 in Brussels. A large part of these meetings was devoted to the latest economic developments in the Czech Republic and to the legislative and institutional preparations for membership.

Particular praise was given to the efforts of the Government and the CNB to tailor their economic and monetary policy towards meeting the Copenhagen criteria for membership of the EU.

Relations with the European Central Bank

The year 2000 saw a further strengthening of the ties between the CNB and the ECB, which upon accession to the EU will become the CNB's main partner in the Czech Republic's integration into European structures.

In December 2000, the second "Seminar on the Accession Process" was held in Vienna, bringing together the senior representatives of the Eurosystem and the governors and vice-governors of the central banks of the EU accession countries. Whereas the first such meeting in Helsinki in 1999 had concentrated on the adoption

and implementation of the *acquis communautaire*, financial stability in the accession countries and macroeconomic issues linked with future accession to the EU and entry into ERM II, the Vienna discussions focused on the following three issues:

- price dynamics in accession countries and the role of economic policy;
- the role of central banks in the accession process;
- co-operation between the Eurosystem and the accession countries' central banks.

In addition to these high-level meetings, co-operation is going on at a working level between individual specialised sections of the CNB and ECB.

A significant event in the relations between the CNB and ECB in 2000 was the drafting by ECB experts of two legal opinions on the amendment to the Act on the CNB. The ECB focused on the arguments in favour of setting price stability as the primary objective of the CNB and on the necessity of enacting the principle of institutional, personal, material and financial independence of the central bank.

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Phare

The Czech banking sector drew funds from the following Phare budgets in 2000:

- *the 1997 budget* – EUR 0.5 million (approximately CZK 19 million)

In 2000, the CNB's Phare Project Implementation Unit (PIU) completed an extensive training programme for commercial banks and their clients entitled "Preparation and Awareness Scheme of the Czech Banking and Financial Sectors for Accession to the European Union".

- *the 1998 budget* – EUR 0.75 million (approximately CZK 28 million)

On the basis of the Accession Partnership and the National Programme, the European Commission agreed to provide the CNB with funding of EUR 0.5 million for technical assistance in the form of "twinning" in the banking supervision area.

The main aim of twinning is to prepare the institution of the candidate country – in this case the CNB's banking supervisory authority – for functioning within the EU in procedural and executive terms. On the basis of an agreement signed on 19 November 1999 by all the parties involved, this project is being implemented by experts from the German Ministry of Finance and the National Bank of Greece. The project ends on 19 October 2001.

In co-operation with the Banking Institute and the Banking Association's Commission for European Integration, the PIU also prepared a training programme on the implementation of European banking standards in the Czech banking sector. This EUR 2 million (approximately CZK 71 million) project is being implemented from the 2000 budget by experts from the Phare framework contractor DFC London.

The European Commission also agreed to fund a EUR 2 million project to strengthen credit risk management methodology in commercial banks. A detailed project specification and an international tender process under Phare rules are being prepared.

Foreign technical assistance provided by the Czech National Bank

In 2000, the Czech National Bank continued to provide technical assistance to Central and Eastern European countries. This was covered from a special-purpose fund and took the form of seminars, working group meetings and consultations.

Among the most significant events were the 13th conference of banking supervisors from Central and Eastern Europe and the international "Monetary Policy" seminar organised in co-operation with the Joint Vienna Institute.

III.2 RELATIONS WITH INTERNATIONAL FINANCIAL INSTITUTIONS

The International Monetary Fund (IMF)

On 26-28 September 2000, the 55th Annual Meetings of the Boards of Governors of the International Monetary Fund and World Bank Groups (IMF/WBG) took place in Prague. The central theme of the meetings, which were attended by delegates from 182 nations, was "making globalisation work for the benefit of all". At the close of the meetings, high-level IMF/WBG representatives praised the organisation of the event and the care and attention devoted to the participants.

During March and April 2000, the Article IV Consultation took place. The IMF's representatives stated that, after the long and deep recession, signs of recovery were emerging and that macroeconomic policies should remain supportive. These conclusions were confirmed during the October Staff Visit. The mission said that the strengthening recovery would allow consolidation of public finances and that the restructuring of the banking and corporate sectors should continue to be pursued with vigour.

At the turn of December, the first stage of a detailed examination of the entire Czech financial sector took place with the assistance of experts from the IMF and World Bank Group. This programme (the Financial Sector Assessment Programme) aims to assess the Czech Republic's observance of international standards and codes in the financial area and to identify the financial sector's strengths and weaknesses and its vulnerability to shocks.

The World Bank

The activities in 2000 concentrated on the continuing assistance from the World Bank in analysing several problem areas of the Czech economy. In this connection, a World Bank study *Transformation of Banks and Enterprises* was officially presented in November and work was commenced on analysing the Czech Republic's public budget expenditures.

The European Bank for Reconstruction and Development (EBRD)

During 2000, the EBRD signed contracts to finance three projects in the Czech Republic worth EUR 64.0 million overall – an SME finance facility extended to Česká

spořitelna, an equity investment in telecommunications company Český mobil and a participating interest in the Harpen (Germany) investment fund.

The EBRD also provided technical assistance, primarily in the legislative area, but also for individual projects. As at the end of 2000, it had approved contracts for financing 34 projects in the Czech Republic, with a total investment of EUR 695 million, and 30 technical co-operation projects totalling EUR 5.4 million.

The Bank for International Settlements (BIS)

The Governor of the CNB attends the regular working meetings of central bank governors organised by the BIS. At these meetings, topical issues relating to world economic and monetary developments are discussed. The close co-operation between the CNB and the BIS continued, particularly within the Basle Committee on Banking Supervision, in the Central Bank Governance Steering Group and in the area of co-ordination of foreign technical assistance.

The Organisation for Economic Co-operation and Development (OECD)

The Czech Republic completed its fifth year of membership of the OECD in 2000. The OECD's working bodies prepared and discussed numerous studies and reviews of the policies applied in the Czech Republic. These included an economic survey, an energy policy review, an investment review, an in-depth assessment of regulatory mechanisms in the Czech Republic, an environmental performance review and a report on fulfilment of the accession requirements in the area of capital movements and investment.

In 2000, the OECD Secretariat and relevant Czech bodies (primarily the CNB, the Ministry of Finance and the Ministry of Industry and Trade) also prepared a *Foreign Direct Investment Review of the Czech Republic*, which will be published in the first half of 2001. The document assesses the investment climate in the Czech Republic following four years' membership of the OECD and analyses the impact of FDI inflows on the structural and macroeconomic development of the Czech economy.

The OECD's overall operational framework was affected in the period under review by the expansion of the organisation to include Slovakia, which met the membership requirements and became the 30th member. Active support for the completion of Slovakia's accession process – at both a political and working level – was one of the top foreign policy priorities of the Czech Government and received the full backing of the CNB.

IV. MONETARY POLICY AND MONETARY DEVELOPMENTS



IV. MONETARY POLICY AND MONETARY DEVELOPMENTS



COMMEMORATIVE SILVER COIN ISSUED
to mark the 700th anniversary of Wenceslas II's
currency reform and the commencement
of mintage of the Prague groschen
DESIGNER: SCULPTOR JIRÍ VĚNEČEK

IV.1 SUMMARY

The turnaround towards economic growth recorded in 1999 H2 continued into 2000, confirming a lasting change in the Czech economy. This growth is founded on gradual structural changes on the supply side and a recovery for most items on the demand side. The economy faced external cost pressure in 2000 from a rise in energy raw material prices, exacerbated by the koruna's exchange rate against the dollar. Nevertheless, internal macroeconomic stability was successfully maintained. The growth in import prices associated with the cost shock was reflected more strongly in the external imbalance.

The 3.1% GDP growth in 2000 resulted from rises in all items of domestic demand except for government demand. Particularly significant was the renewed growth in investment activity, which underpinned the ongoing process of economic restructuring. The upturn in investment activity also signalled positive expectations regarding future macroeconomic developments. The progress made in restructuring the economy was confirmed by growth in sophisticated production with high value added, supported to a large extent by foreign direct investment. The development of such production helped to sustain a high growth rate of exports. On the other hand, though, it led to growth in imports for intermediate consumption, which, along with rising investment imports linked with the upturn in investment demand, meant that the foreign sector overall counteracted GDP growth in 2000.

The CNB conducted monetary policy under a regime of inflation targeting for the third year. The policy objective was stable price and macroeconomic development as a prerequisite for sustainable economic growth. In its monetary policy decision-making, the CNB weighed up the possible inflationary risks associated with a further pick-up in economic growth, and the intensity and duration of the external cost shock and its secondary impacts in a climate of renewed economic growth. These risks were also perceived by economic agents and were reflected during the year in the financial market indicators. However, analyses indicated generally stabilised price developments in 2000 H2 and signalled that fulfilment of the inflation target for 2001 was not in jeopardy. At the end of 2000, the inflation forecasts for 2001 were on course for the lower half of the target range. Against this background, the CNB viewed its interest rates as appropriate and left them unchanged in 2000. In Q1, the CNB intervened on the foreign exchange market to prevent major fluctuations of the koruna's exchange rate resulting from the strong inflow of FDI capital.

The end-2000 net inflation target was set at the beginning of 1998 during the switch to inflation targeting. This was a medium-term target reflecting the medium-term objectives of monetary policy. In 2000 H1, owing to the external cost shock and in a climate of economic recovery, the price indices edged up. In H2, however, inflation stabilised with moderate volatility. Annual consumer price inflation was around 4% and net inflation around 3%. These outturns meant that net inflation was on course for the target. Notwithstanding the external cost shock and the economic recovery, low inflation was successfully maintained.

The economic developments in 2000 confirmed that the growth of the Czech economy was based on firmer foundations resulting from the restructuring process, reinforced to a large extent by foreign direct investment. The massive investment inflow in 2000 created the preconditions for a continuation of this trend into 2001.

1 Net external demand (net exports) = exports of goods and services - imports of goods and services at constant 1995 prices

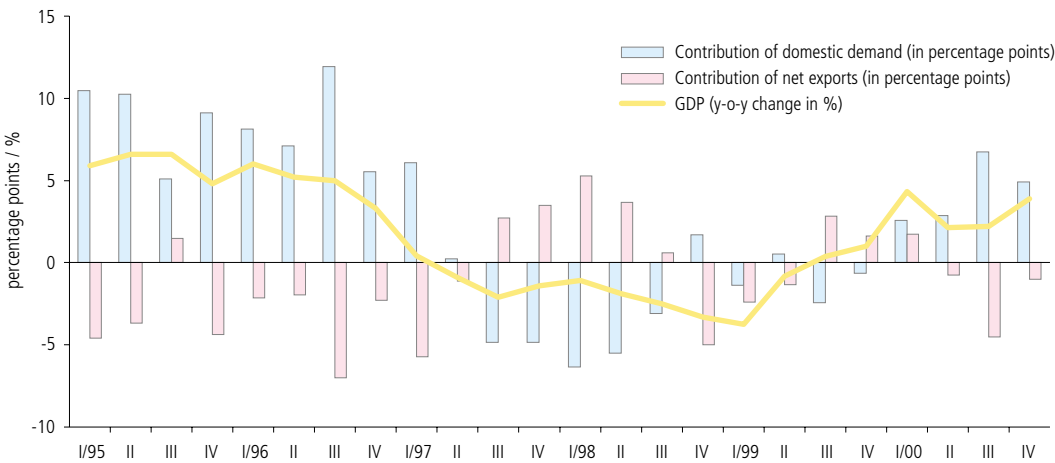
The macroeconomic and monetary outlook simultaneously indicates that the economic growth should proceed in a stabilised macroeconomic environment. The expected moderate growth in domestic demand, the easing of external cost pressures, the wage and productivity trend and the persisting strongly competitive environment on the consumer market are creating conditions for sustained low inflation in 2001.

IV.2 THE CZECH ECONOMY

Demand and output

With respect to demand, the chief contributors to the 3.1% year-on-year GDP growth in 2000 were growth in gross capital formation and continuing growth in household consumer spending. External demand was also favourable in 2000, but the contribution of net external demand¹ to GDP growth was negative owing to rapid growth in imports.

CHART IV.1 CONTRIBUTION OF DOMESTIC DEMAND AND NET EXPORTS TO Y-O-Y CHANGE IN GDP



Investment demand

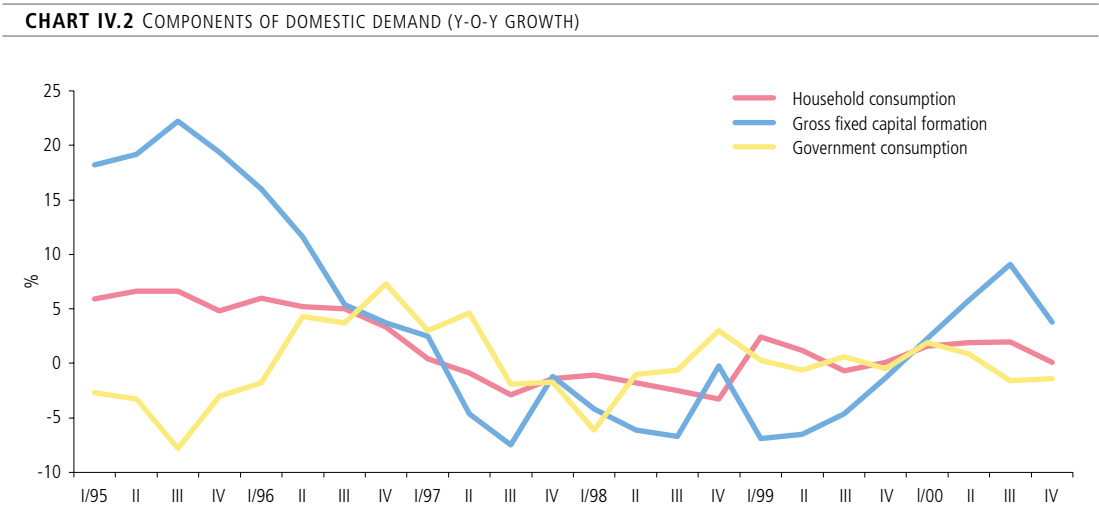
The 5.2% year-on-year growth in gross fixed capital formation in 2000, which followed three years of decline, reflected positive expectations of domestic and external demand due to the recovery of the Czech economy and economic growth in Western Europe. The pick-up in investment demand was also fostered by measures to promote foreign direct investment, which generated a strong inflow of foreign capital into the Czech economy, substituting for the decline in domestic investment credits. In the non-financial corporations sector, a generally favourable trend in companies' own funds contributed to the rise in investment demand.

Investment in tangible goods by non-financial corporations, which accounted for 69.5% of the total investment in 2000, saw the fastest year-on-year growth (6%). Buoyant investment activity was particularly visible for large foreign-controlled firms with the necessary financial backing and good sales opportunities on foreign

markets. Growth in tangible goods investment by the household and government sectors was very modest, and investment by financial corporations recorded a considerable year-on-year decline. As for investment in new tangible goods, investment in machinery and equipment increased, while construction investment decreased slightly. In manufacturing, the share of investment in mechanical and electrical engineering continued to rise in 2000 (by 11.1 percentage points to 42.5%).

Consumer demand

The continuing recovery in household consumption during the course of 2000 generated year-on-year growth of 1.4%, a somewhat higher outturn than in 1999. With real disposable incomes of households remaining flat, the increased consumer spending was financed through reduced saving and greater use of debt forms of financing. The less restrained approach of households towards drawing on loans than in the previous period testified to the confidence of both households and credit institutions in sustained economic growth and thus in ensuring repayment of credits granted. The higher consumer spending was channelled chiefly into durable goods, fostered by the expanding supply of new products and services associated with technological innovations (particularly in the telecommunications sector).



Government demand

Spending on final government consumption in 2000 was much the same as in the previous year. As in 1999, government consumption recorded a modest year-on-year decrease (of 0.2%). This was due to Ministry of Finance austerity measures, which focused primarily on reining back on non-mandatory expenditures such as wages and salaries and non-investment transfers to subsidised and similar organisations.

Net external demand

Growth in both exports and imports remained buoyant throughout 2000². However the lead of export growth over import growth was narrower than in 1999. This led to a widening of negative net exports, whose contribution to the year-on-year change in GDP, in contrast to the previous year, was consequently negative. The

² Exports of goods and services increased by 18.8% and imports of goods and services by 18.7% at constant prices in 2000.

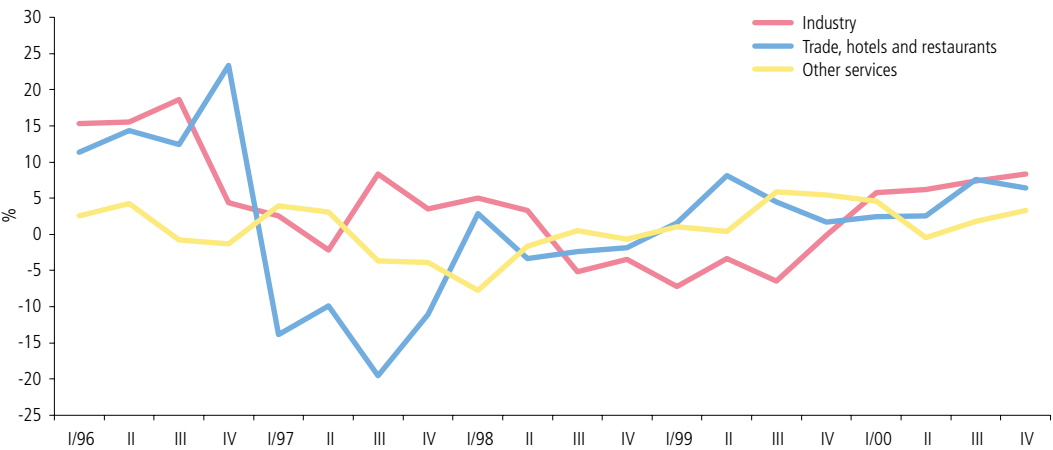
strong import growth in 2000 was associated chiefly with the continuing development of international production collaborations (leading to rising imports for intermediate consumption) and the growing import investment demand. The propensity to import increased further, and negative net exports as a share of GDP rose by 1 percentage point compared with 1999 to 7.8%.

Gross domestic product

The continuing economic recovery in 2000 was also confirmed by structural developments on the supply side of the economy. Particularly significant was the renewal of relatively strong growth in gross value added in industry (of 6.9%), which confirmed the restructuring process in the economy and the favourable sales conditions, especially abroad. Sophisticated production with high value added made a major contribution to gross value added³ in industry. The development of such production was associated largely with foreign capital inflow. The financial performance and productivity indicators testified to the positive effects of the restructuring and rationalisation of manufacturing processes. Nevertheless, the restructuring process cannot be considered complete.

3 In particular: manufacture of transport equipment, electric and optical equipment, machinery and equipment n.e.c., and rubber and plastic products.

CHART IV.3 GDP IN INDUSTRY AND SERVICES (Y-O-Y CHANGES AT CONSTANT 1995 PRICES)



Industry made the biggest contribution to the GDP growth in 2000, accounting for almost three quarters of the year-on-year change at basic prices. The services sector contributed to a lesser extent, but nevertheless maintained its roughly 50% share of output. Gross value added was higher than a year earlier in the following sectors: wholesale and retail trade, repairs, hotels and restaurants, transport and communications and commercial services. Value added continued to fall in construction and other services, although with less intensity than in the previous year.

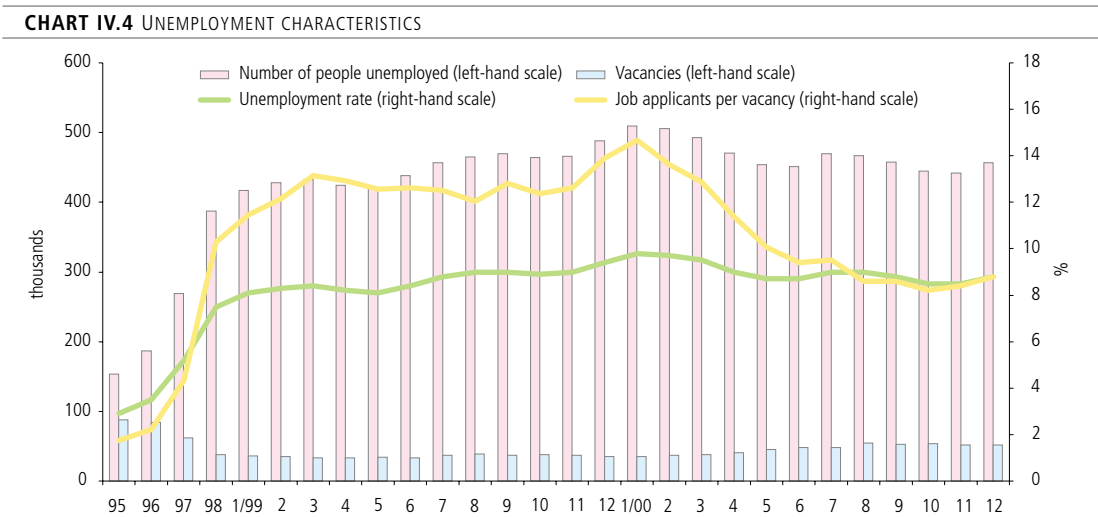
The labour market

Employment and unemployment

The imbalance between demand for and supply of labour eased during the course of 2000. In 1999, the decline in employment had intensified and the unemployment rate had increased in all areas of the national economy, whereas in 2000 the main labour market indicators signalled changes in trend.

The improving situation on the labour market was evidenced in particular by a gradual slowdown in the year-on-year decline in employment, a halt in the growth of the number people unemployed, an increase in the number of vacancies (particularly in export-oriented industries) and finally a downward trend in the unemployment rate following previous long-term growth. Compared with end-1999, the unemployment rate fell during 2000 by 0.6 percentage points to 8.8%. The change in labour market trends was due to several factors, most notably the inflow of foreign direct investment, the continuing economic recovery and the various forms of the Government’s active employment policy.⁴ However, this did not lead to a significant easing of the regional, skills and occupational imbalances on the labour market, which are the main reason for the relatively high share of long-term unemployed people in the total number unemployed.

4 The easing of the unemployment rate in 2000 Q3 and Q4 was also attributable to a decline in the number of secondary school leavers thanks to the one-year extension of compulsory school attendance.



Wages and financial incomes

With the unemployment rate remaining relatively high and the economy below its potential output, the moderate recovery in labour demand has not significantly affected wages as yet. On the contrary, during the course of 2000 wages were affected predominantly by factors leading to a slackening of their growth, in particular the gradual implementation of rationalised wage and employment policies in the business sector and administrative measures in the non-business sector. In these circumstances, year-on-year growth in average nominal and real wages slowed further (by 1.6 and 3.4 percentage points respectively) compared with the previous year, with the change being more marked in the non-business sector. The concurrent

pick-up in labour productivity growth, reflecting the ongoing restructuring of the economy and the economic recovery phase, helped to prevent the build-up of inflationary potential.

TABLE IV.1 BASIC DATA ON WAGES		(year-on-year change in %)				
		1996	1997	1998	1999	2000
Average wage in monitored organisations						
	nominal	18.0	11.9	9.4	8.2	6.6
	real	8.4	3.1	-1.3	6.0	2.6
Whole-economy labour productivity ¹⁾		4.9	-0.1	0.7	2.2	4.6
Unit wage costs						
	nominal ²⁾	12.3	12.0	8.6	5.9	2.0
	real ³⁾	3.4	4.5	-1.5	3.1	0.9
GDP deflator		8.6	7.2	10.2	2.7	1.1

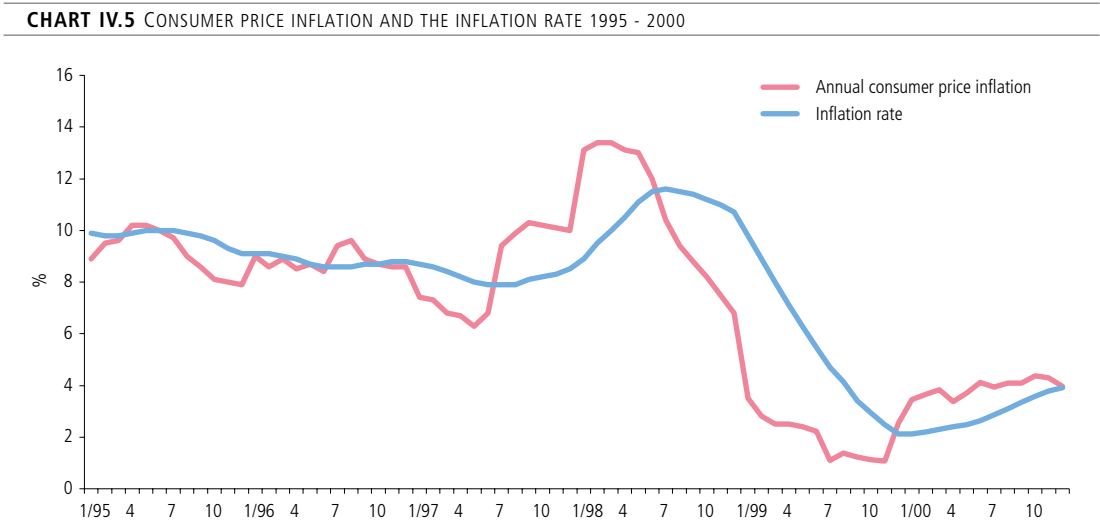
1) GDP at constant prices/employment in the national economy
2) Nominal wages and salaries/GDP at constant prices
3) Nominal unit wage costs deflated by the GDP deflator
Source: CSO; CNB calculation

The favourable trend in wage costs per unit of output was confirmed in numerous sectors, in particular industry, where nominal and real unit wage costs fell in year-on-year terms in 2000. Moreover, analyses of household consumption – based on the trend in households’ total incomes – signalled no build-up of inflationary impulses from the demand side.

Prices

The upward trend in annual consumer price inflation apparent since 1999 Q4 continued into 2000 H1. However, this rise halted at the beginning of Q3 and consumer price inflation stabilised at around 4% in the remainder of 2000. Inflation was generally higher in 2000 than in 1999, when it had reached its lowest level since the start of the transformation period. In these circumstances, the average inflation rate⁵ showed an upward trend throughout 2000.

5 The inflation rate expressed as the increase in the average consumer price index for the last 12 months relative to the average for the previous 12 months.



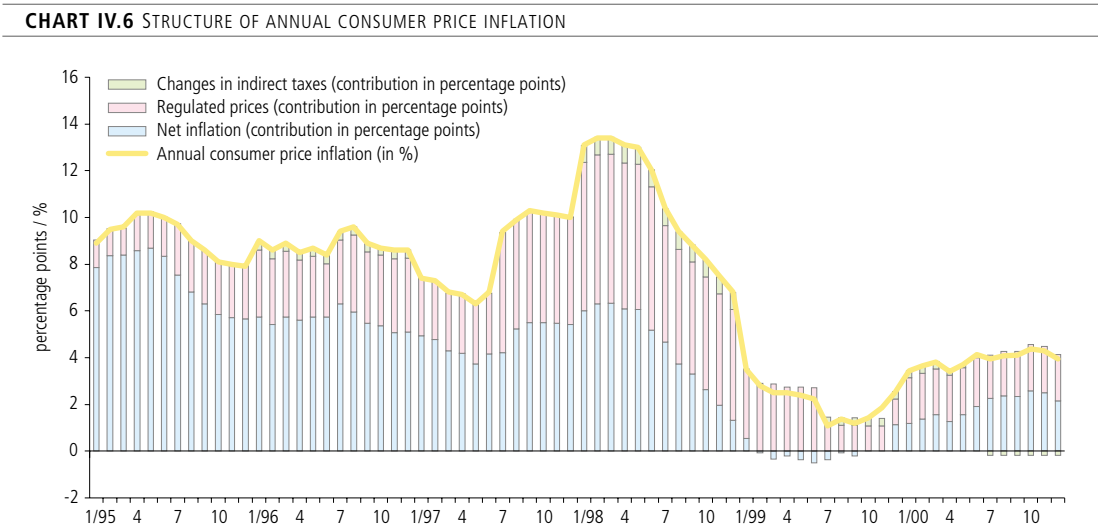
In 2000, prices were affected chiefly by cost factors. The moderate growth in domestic demand and the strong competition on the retail market created no room for demand-pull inflationary impulses.

The pick-up in inflation in 2000 H1 was due to external cost pressures (reflecting in particular the rise in world oil prices) and to the year-on-year weakening of the koruna’s exchange rate against the dollar. However, annual growth in oil prices slowed in H2, helping to halt the rise in inflation. The stabilisation of prices in this period was also fostered by favourable macroeconomic conditions – most notably the aforementioned moderate growth in domestic demand and strong competition on the retail market, favourable wage-cost inflation indicators and the nominal and real appreciation of the koruna’s exchange rate against the euro. These factors mitigated the rising domestic cost pressures exerted on consumer prices by agricultural primary producers in H2, pressures which were bolstered by temporary excess demand for certain key products resulting from the exhausting of duty-free import quotas.

The pass-through of these factors into individual price groups was mixed. The rise in world oil prices chiefly affected net inflation in the adjusted inflation segment⁶, largely via changes in fuel prices. Although year-on-year oil price growth slowed in 2000 H2, the annual net inflation outturns did not fall, but stayed around 3%. This was due to the concurrent upturn in food price inflation linked with the aforementioned rising pressures from domestic agricultural primary producers.

The impact of the high oil prices on the other components of net inflation via prices of fuel and other oil products was insignificant given the macroeconomic environment in 2000. Secondary transmission of external cost pressures into prices was prevented by the situation on the demand side and by the strong competition on the consumer market.

6 Net inflation is defined as the consumer price index adjusted for regulated prices and for the effect of other administrative measures (e.g. increases in indirect taxes and abolition of subsidies). Within net inflation, prices of food and non-food items, i.e. adjusted inflation, are monitored and analysed separately.



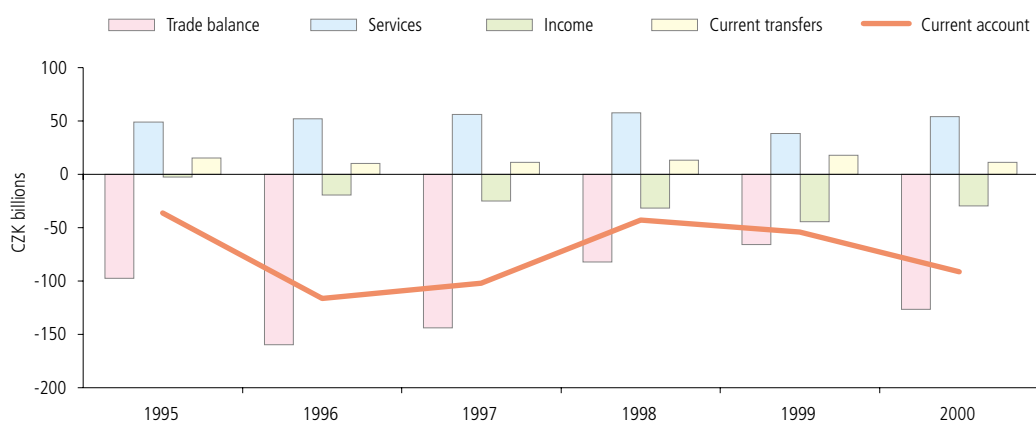
In 2000, as in the previous year, the annual consumer price inflation outturns were strongly affected by changes in prices of regulated items, which accounted for almost half the year-on-year rise in consumer prices in December 2000.

IV.3 THE BALANCE OF PAYMENTS

The current account

The current account deficit widened significantly in 2000 (by 69% compared with 1999 to CZK 91.4 billion), mainly because of a considerable worsening of the trade deficit and partly owing to a decline in the surplus on current transfers. An increase in the services surplus and a fall in the income deficit only partly offset these unfavourable effects. Given the relatively modest recovery in economic growth, the substantial rise in the current account deficit led to a 1.8 percentage point increase in the deficit as a percentage of GDP compared with 1999 to -4.8%.

CHART IV.7 CURRENT ACCOUNT STRUCTURE 1995 - 2000



⁷ The following data are based on balance of payments calculations using monthly statistical statements.

The almost two-fold year-on-year increase in the trade deficit⁷ (to CZK 126.8 billion) resulted from import growth exceeding export growth by almost 5 percentage points. Although growth in exports picked up considerably (to 23.3%), imports grew faster (by 28.2%). The buoyant growth rate of imports was due to several factors. In addition to the principal factor of strong growth in prices of imported energy raw materials (oil and natural gas) brought about by the price developments on world markets and by the depreciation of the koruna's exchange rate against the dollar, imports were affected by rapid growth in investment imports (of 29.8%). The growth in imports was also attributable to increasing demand from industrial businesses for imports for intermediate consumption (up by 33.9%) due to the integration of the Czech economy into international production structures, including development of inward processing.

The export growth was due principally to favourable external demand, the expansion of production collaborations with other countries and the launch of new export-oriented capacities. The contrary effect from the slight appreciation of the koruna's exchange rate against the euro was not very significant. The export structure confirmed a continuation of positive tendencies, characterised by a rise in exports of mechanical and electrical engineering products as a percentage of total exports (to 52.1%) and, geographically, by strengthening growth of exports to developed market economies (to 23.6%). In addition, exports to European transition economies and the CIS were renewed (21.1%).

The financial account

The financial account showed a surplus of around CZK 130 billion (6.8% of GDP) in 2000, which meant a year-on-year increase in capital inflow into the Czech economy of more than 20%. Foreign direct investment again accounted for the lion's share of the inflow (CZK 173 billion), but was lower in volume than a year earlier. Despite this, the FDI-to-GDP ratio was relatively high (9%). The business sector, too, contributed to the foreign capital inflow into the Czech Republic by drawing credits from abroad.

As in the previous year, the total inflow of foreign capital into the Czech Republic was offset by outflow of capital in the form of portfolio investment. This was chiefly due to investment by residents in securities abroad (totalling almost CZK 90 billion), with interest in shares and in bonds approximately equal. The outflow of portfolio investment was partly offset by purchase of domestic shares by non-residents. Other capital flows were of little significance and had virtually no effect on the financial account.

The CNB's international reserves rose by CZK 31.6 billion in 2000 compared with end-1999 to CZK 494 billion (USD 13.1 billion). This was due to interest income on international reserves and to foreign exchange interventions.

IV.4 PUBLIC FINANCES

In 2000, as in the previous year, fiscal policy was focused on promoting economic growth. In keeping with this objective, budget spending on transport infrastructure and housing was strengthened and a new legislative framework of special-purpose funds was established for these areas. The growth in these expenditures and rising mandatory expenditures were the main reasons for the drawing up of an unbalanced state budget. The public budgets were also compiled as deficit (CZK 76.6 billion, i.e. 4% of GDP).⁸

⁸ IMF methodology - the "GFS" (Government Finance Statistics), in which the balance of public budgets is adjusted for privatisation revenues and subsidies to transformation institutions.

The public budgets performed more favourably in reality than had been envisaged (by CZK 11.2 billion), which reduced the deficit to 3.4% of GDP. The smaller deficit was achieved thanks largely to the deferring of the settlement of Konsolidační banka's loss for 1999 and to better-than-expected local budget results. Conversely, the state budget and National Property Fund deficit was CZK 13.2 billion larger than envisaged.

⁹ The partial repayment of foreign loans for balance of payments support accepted at the start of the 1990s helped to reduce the state debt. A decline in debt was also recorded for state funds and the NPF.

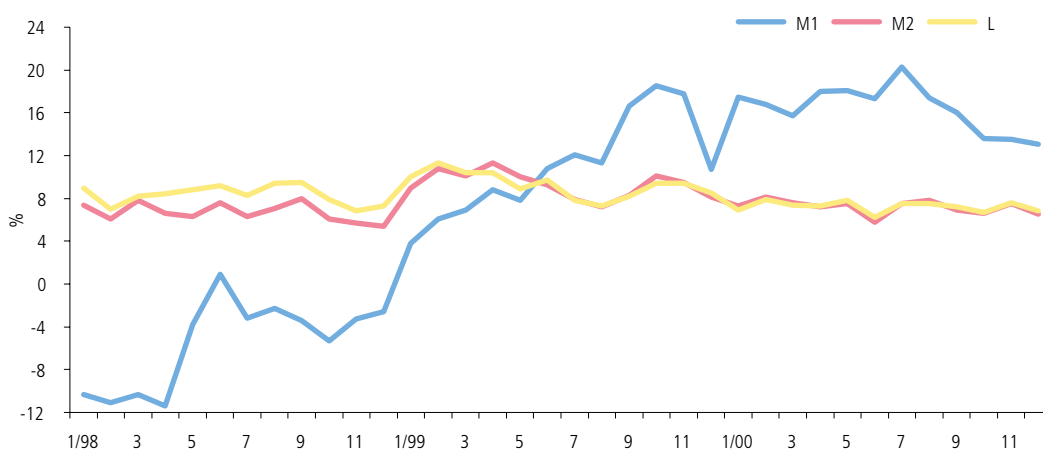
Compared with 1999, the consolidated public debt of the Czech Republic increased by a further CZK 56.6 billion in 2000 to CZK 331.2 billion. Nevertheless, as a percentage of GDP (17.3%) it remained far below the Maastricht criterion of 60%. The rise in public debt was associated mainly with growing state debt, which in 2000 resulted from the financing of the state budget deficit with T-bills and the settlement of Konsolidační banka's loss for 1998. Although indebtedness decreased in some areas of public finance in 2000,⁹ this was not sufficient to offset the growing debt in the aforementioned areas.

IV.5 MONETARY DEVELOPMENTS

Monetary aggregates

The inflow of money into the economy slowed in 2000. Year-on-year growth in the broader monetary aggregate M2 declined by 1.6 percentage points compared with 1999 to 6.5% and growth of L eased by 1.7 percentage points to 6.8%. The slowdown in money supply growth in the economy was associated primarily with the stagnation in lending to businesses and households and with the widening trade deficit.

CHART IV.8 MONETARY AGGREGATES M1, M2 AND L



The structural M2 developments – a brisk pick-up in demand for liquid money and declining interest in time deposits – were due largely to the low interest rates on time deposits. Unlike in 1999, when the rise in the volume of liquid money included in M1 was attributable mainly to currency in circulation, the pick-up in M1 growth in 2000 was associated largely with growth in demand deposits. Although the growth rate of M1 gradually declined from August 2000 onwards, it remained at almost double the level of the broader aggregates M2 and L during the remainder of the year. These tendencies were associated to a large extent with changes in the sector structure of the money supply, with faster money supply growth being recorded in the corporate sector than for households during 2000.

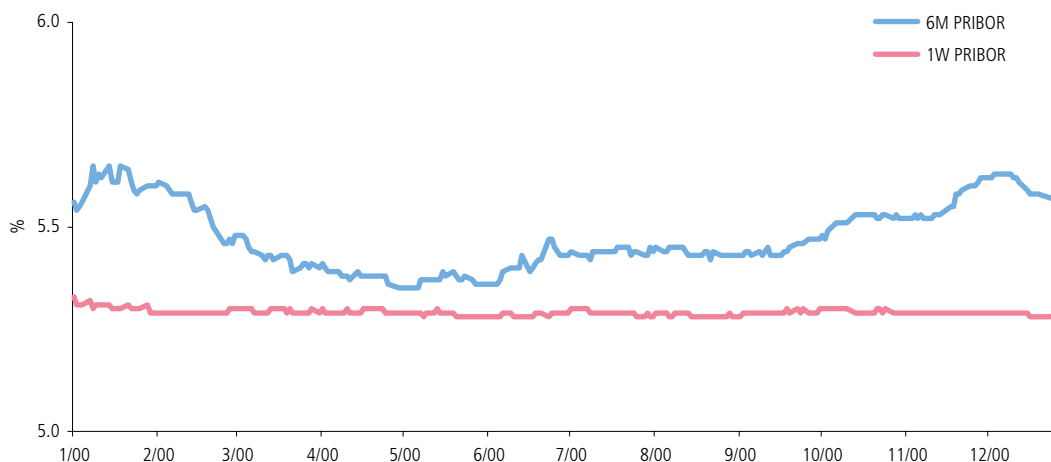
IV.6 FINANCIAL MARKETS

The money market

Short-term interest rates on the money market were fairly stable. The partial changes recorded only involved rates with longer maturities and were in the order of just tenths of a percentage point. This trend was linked chiefly with the unchanged settings of the CNB's key rates. Temporary rises in PRIBOR rates were recorded at the end of June and at the turn of December, in the first case due to nervousness on the financial market associated with the imposition of conservatorship at IPB and in the latter case as a response to expectations of faster growth in the economy and inflation. The yield curve was upward sloping throughout 2000.

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CHART IV.9 1W AND 6M PRIBOR



The interest rate derivatives market (FRA rates) and the short-term bond market developed in line with PRIBOR rates. During the course of the year, there were 46 primary auctions of T-bills with one-year maturity. At the close of the year, the outstanding volume of T-bills was CZK 163 billion. As in other money market segments, gross T-bill yields remained stable (at 5.3%-5.9%). Almost all auctions saw demand overhang, so the resulting gross yields were below the announced limit yields. The CNB also issued its own bills into its own portfolio and used them subsequently in repo operations with commercial banks.

Given the relative stability of interest rates on the domestic interbank market, the interest rate differential largely reflected the movements of foreign rates. The USA and the eurozone experienced a period of rising key rates, which helped to narrow the interest rate differential. The differential increased only at the end of 2000 following a rise in domestic interest rates. At the beginning of the year, the interest rate differential vis-à-vis the euro had been around 2 percentage points. At the end of the year it stood at 0.4-1.0 percentage points depending on maturity. The interest rate differential vis-à-vis the dollar was negative throughout the year.

Client interest rates responded in part to the money market interest rates. Interest rates on newly granted credits fell by 1.3 percentage points to 6.8% during the year. Rates on time deposits saw a similar trend, falling by 0.8 percentage points to 3.9%.

The capital market

Long-term rates (IRS rates and yields on the bond market) were also fairly stable, but were more volatile than the rates on the money market. One of the main reasons for this is their greater sensitivity to economic and inflation expectations, which were changing during the course of the year. Interest rates also responded to the growing state debt, the situation on the oil and dollar markets and the situation around IPB. These factors acted temporarily and with mixed intensity. Compared with end-1999, long-term interest rates were almost unchanged in 2000. The yield curve was upward sloping in its shorter part and flat from the middle part.

The trend was similar on the secondary bond market. There were 12 issues with a total volume of CZK 51 billion on the primary government market, with strong investor interest in all auctions. In 2000, government bonds with maturities of 7 and 10 years were issued for the first time. The outstanding volume of government bonds was CZK 117 billion at end-2000 (compared with CZK 77 billion in 1999). On the primary corporate bond market, there were 14 issues totalling CZK 33.2 billion and 3 issues of mortgage certificates amounting to CZK 4.6 billion.

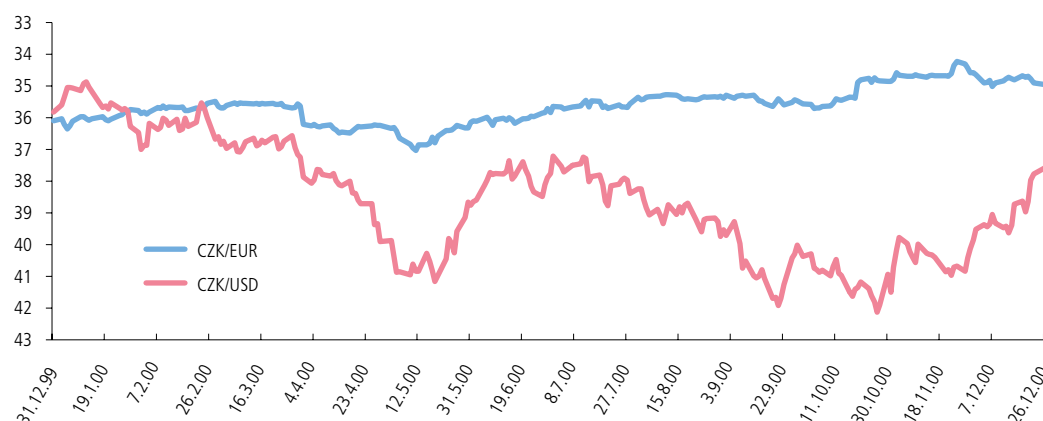
Developments on the stock market were strongly dependent on events on foreign markets. Stock prices also responded to news about the privatisation of key domestic companies. Prices surged at the beginning of the year, but started to fall back at the end of March. This decline – with occasional corrections – lasted until the end of the year. All the monitored share indices were down from a year earlier. The official PX 50 index lost 2.3%.

The foreign exchange market

The koruna's nominal exchange rate against the euro exhibited an overall appreciation tendency in 2000. This gradual strengthening was interrupted at end-Q1 by the CNB's foreign exchange interventions to prevent excessive appreciation of the koruna, which could have had an adverse effect on the real economy. In Q3 and Q4, the koruna's exchange rate against the euro showed a renewed moderate appreciation, associated primarily with the inflow of capital into the Czech Republic, chiefly in the form of foreign direct investment. The koruna's appreciation was also linked to the weakening of the euro's rate against the dollar.

The high volatility of the koruna's exchange rate against the dollar reflected the movements in the euro's rate against the dollar.

CHART IV.10 NOMINAL CZK/EUR AND CZK/USD RATES



The koruna's real effective exchange rates – based on consumer prices and on producer prices – were both affected predominantly by nominal exchange rates and less by relative prices between the Czech Republic and its major trading partners. Both the real exchange rate indices firmed by around 3% overall.

IV.7 MONETARY POLICY

In 2000, the CNB conducted monetary policy under a regime of inflation targeting for the third year. Monetary policy decision-making within this regime was based on comparing the conditional inflation forecast with the relevant inflation target, taking into account the medium-term macroeconomic outlook and its risks.¹⁰ As in the previous year, monetary policy was aimed at price and macroeconomic stabilisation. An important new feature was closer co-operation with the Government in setting the net inflation target for 2001.

¹⁰ The medium-term inflation target was set at end-1997 during the switch to the inflation targeting regime. A more detailed assessment of the first phase of inflation targeting (1997-2000) is contained in the January 2001 Inflation Report.

The starting point for monetary policy in 2000 was the fact that the economy was going through a phase of recovery and that a further pick-up in growth could be expected. In addition to uncertainties regarding the extent of future economic growth, no less important from the point of view of the inflation forecasts and monetary policy decisions was the assessment of the duration and intensity of the external cost shock on prices. Also important for decision-making was the assessment of numerous other potential inflationary impulses (the situation on the labour market, etc.). The gradual release of figures on GDP, oil prices, developments within individual price groups and other information during the year affected the perceptions of the possible pick-up in individual inflationary pressures. All this was reflected in the conditional inflation forecasts and in the decisions regarding the settings of monetary instruments.

The trend in certain economic indicators (industrial output growth in particular) at the start of 2000 signalled that the economic recovery might be faster than originally expected. The gradual recovery of domestic demand in 2000 Q1 was confirmed by the GDP figures. In Q2 and Q3, however, the GDP growth slowed and indicated an only slight recovery. Given the simultaneous rise in oil prices on world markets, the

risk of the primary effects of the cost shock spilling over into secondary price groups mounted. In 2000 H2, the year-on-year growth in world oil prices slowed, but oil prices (in USD/barrel) remained relatively high. The risk of secondary effects on prices therefore persisted. However, the real effect on consumer prices at that time was not considerable. Moreover, the CNB's analyses in Q4 suggested that the likelihood of external cost pressures having secondary impacts on prices would decline, owing to the combined effects of the oil price stabilisation, the continuing but still subdued growth in domestic demand, the highly competitive environment and rising productivity. This assumption was reinforced by inflationary expectations, which signalled that economic agents perceived the external cost shock as temporary.

Against this background, the CNB left its key interest rates and minimum reserve requirement unchanged during 2000. Only in 2000 Q1 did the CNB respond, via interventions on the foreign exchange market, to the strong appreciation trend in the koruna's exchange rate associated with foreign capital inflow. In addition, by agreement between the CNB and the Czech Government, a special privatisation account was established to limit the appreciation effects of one-off inflow of foreign capital. Subsequent developments confirmed a relatively stable macroeconomic trend and intensifying characteristics of a low-inflation economy.

Net inflation stabilised in 2000 H2. The conditional forecasts suggested a relatively low level of net inflation in 2001, too, on course for the lower half of the inflation target range. However, at the medium-term horizon the unbalanced trend in the public finance area continues to pose a threat to macroeconomic stability.

Table 1

MACROECONOMIC AGGREGATES

in CZK billions, y-o-y change in %, constant 1995 prices

	1994	1995	1996	1997	1998	1999	2000
	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4	Q1 - 4
GROSS DOMESTIC PRODUCT							
- in CZK billions	1303.6	1381.1	1447.7	1432.8	1401.3	1390.6	1433.8
- in %	2.2	5.9	4.8	-1.0	-2.2	-0.8	3.1
FINAL CONSUMPTION							
- in CZK billions	949.9	976.8	1035.1	1051.4	1028.5	1032.2	1041.8
- in %	4.8	2.8	6.0	1.6	-2.2	0.4	0.9
of which:							
Households							
- in CZK billions	654.2	692.1	740.1	753.6	731.4	736.3	746.4
- in %	5.6	5.8	6.9	1.8	-2.9	0.7	1.4
Government							
- in CZK billions	287.2	275.1	284.8	287.1	284.4	284.2	283.7
- in %	3.1	-4.2	3.5	0.8	-0.9	-0.1	-0.2
Non-profit institutions							
- in CZK billions	8.5	9.6	10.2	10.7	12.7	11.7	11.7
- in %	.	12.9	6.3	4.9	18.7	-7.9	0.0
GROSS CAPITAL FORMATION - TOTAL							
- in CZK billions	384.2	470.0	525.4	494.5	470.4	452.7	503.5
- in %	18.5	22.3	11.8	-5.9	-4.9	-3.8	11.2
of which:							
Fixed capital							
- in CZK billions	369.2	442.4	478.5	464.7	446.4	426.9	449.0
- in %	9.1	19.8	8.2	-2.9	-3.9	-4.4	5.2
Inventories and reserves							
- in CZK billions	15.0	27.6	46.9	29.8	24.0	25.8	54.5
TRADE BALANCE							
- in CZK billions	-30.5	-65.7	-112.8	-113.1	-97.6	-94.3	-111.5
of which:							
Exports of goods and services							
- in CZK billions	635.0	740.8	809.2	875.0	968.9	1015.0	1205.4
- in %	1.7	16.7	9.2	8.1	10.7	4.8	18.8
Imports of goods and services							
- in CZK billions	665.5	806.5	922.0	988.1	1066.5	1109.3	1316.9
- in %	14.7	21.2	14.3	7.2	7.9	4.0	18.7
DOMESTIC DEMAND (excl. change in inventories)							
- in CZK billions	1319.1	1419.2	1513.6	1516.1	1474.9	1459.1	1490.8
- in %	5.9	7.6	6.7	0.2	-2.7	-1.1	2.2
AGGREGATE DEMAND (excl. change in inventories)							
- in CZK billions	1954.1	2160.0	2322.8	2391.1	2443.8	2474.1	2696.2
- in %	4.5	10.5	7.5	2.9	2.2	1.2	9.0
GROSS DOMESTIC PRODUCT AT CURRENT PRICES							
- in CZK billions	1182.8	1381.1	1572.3	1668.8	1798.3	1833.0	1910.6
- in %	15.9	16.8	13.8	6.1	7.8	1.9	4.2
PRICE DEFLATOR							
- in %	13.4	10.2	8.6	7.2	10.2	2.7	1.1

Source: CSO

Table 2

BALANCE OF PAYMENTS ¹⁾

in CZK millions

	1993	1994	1995	1996	1997	1998	1999	2000 2)
A. CURRENT ACCOUNT	13 286.7	-22 643.2	-36 331.3	-116 510.6	-101 856.2	-43 101.0	-54 221.4	-91 428.1
Balance of trade 3)	-15 313.0	-39 750.9	-97 598.6	-159 538.6	-144 025.9	-82 394.8	-65 830.8	-126 783.0
- exports	414 833.0	458 436.6	569 549.1	588 791.5	722 501.0	850 308.0	908 756.0	1 120 427.0
- imports	430 146.0	498 187.5	667 147.7	748 330.1	866 526.9	932 702.8	974 586.8	1 247 210.0
Services	29 465.2	14 052.8	48 881.2	52 198.9	55 935.0	57 854.7	38 119.3	53 861.9
Credit	137 691.2	148 404.0	178 270.4	222 030.4	227 193.6	241 801.2	239 709.0	279 574.2
- transport	36 186.6	35 757.9	38 757.4	36 209.6	41 661.6	44 829.3	53 520.3	53 732.7
- travel	45 437.4	64 170.3	76 301.3	110 620.0	115 700.0	120 000.0	105 000.0	110 700.0
- others	56 067.2	48 475.8	63 211.7	75 200.8	69 832.0	76 971.9	81 188.7	115 141.5
Debit	108 226.0	134 351.2	129 389.2	169 831.5	171 258.6	183 946.5	201 589.7	225 712.3
- transport	21 402.1	24 542.4	21 208.9	18 983.3	19 973.6	22 794.0	27 071.4	27 787.1
- travel	15 368.3	45 605.6	43 330.3	80 170.0	75 500.0	60 300.0	51 000.0	48 500.0
- others	71 455.6	64 203.2	64 850.0	70 678.2	75 785.0	100 852.5	123 518.3	149 425.2
Income	-3 424.7	-580.8	-2 804.0	-19 611.0	-25 102.4	-31 708.0	-44 187.6	-29 495.1
Credit	15 952.0	22 713.2	31 696.1	31 765.9	44 696.0	45 945.4	56 867.3	70 639.4
Debit	19 376.7	23 294.0	34 500.1	51 376.9	69 798.4	77 653.4	101 054.9	100 134.5
Current transfers	2 559.2	3 635.7	15 190.1	10 440.1	11 337.1	13 147.1	17 677.7	10 988.1
Credit	7 024.5	8 523.3	17 631.6	16 752.7	27 402.5	25 387.9	37 184.4	27 604.6
Debit	4 465.3	4 887.6	2 441.5	6 312.6	16 065.4	12 240.8	19 506.7	16 616.5
B. CAPITAL ACCOUNT	-16 175.0	-	179.1	15.6	315.9	65.8	-73.2	-195.3
Credit	5 976.0	-	307.8	28.1	493.0	454.6	637.3	224.9
Debit	22 151.0	-	128.7	12.5	177.1	388.8	710.5	420.2
Total A + B	-2 888.3	-22 643.2	-36 152.2	-116 495.0	-101 540.3	-43 035.2	-54 294.6	-91 623.4
C. FINANCIAL ACCOUNT	88 184.7	97 019.7	218 288.5	113 582.5	34 319.1	94 324.5	106 564.4	129 632.2
Direct investment	16 421.8	21 551.1	67 021.2	34 624.8	40 451.4	115 866.3	215 703.9	172 768.1
- abroad	-2 628.6	-3 443.3	-971.6	-4 150.0	-800.0	-4 102.2	-3 107.6	-4 557.6
- in the Czech Republic	19 050.4	24 994.4	67 992.8	38 774.8	41 251.4	119 968.5	218 811.5	177 325.7
Portfolio investment	46 658.5	24 595.9	36 144.4	19 692.5	34 438.9	34 508.2	-48 268.9	-68 172.9
Assets	-6 686.9	-1 327.1	-8 565.6	-1 291.1	-6 006.8	-755.1	-65 608.0	-86 631.8
- equity securities	-6 686.9	-1 327.1	-8 565.6	-1 291.1	19.9	3 855.7	-48 965.2	-44 181.0
- debt securities	.	.	.	.	-6 026.7	-4 610.8	-16 642.8	-42 450.8
Liabilities	53 345.4	25 923.0	44 710.0	20 983.6	40 445.7	35 263.3	17 339.1	18 458.9
- equity securities	32 569.8	14 369.8	32 761.7	16 340.9	13 783.7	34 846.2	4 394.2	23 810.9
- debt securities	20 775.6	11 553.2	11 948.3	4 642.7	26 662.0	417.1	12 944.9	-5 352.0
Financial derivatives	.	.	.	.	.	.	.	-1 817.9
- assets	.	.	.	.	.	.	.	-4 916.7
- liabilities	.	.	.	.	.	.	.	3 098.8
Other investment	25 104.4	50 872.7	115 122.9	59 265.2	-40 571.2	-56 050.0	-60 870.6	26 854.9
Assets	-83 911.4	-69 582.4	-66 050.8	-64 646.8	-142 725.1	-46 628.7	-91 273.9	35 832.1
Long-term	13 340.8	12 046.4	1 384.4	-10 769.8	-11 117.6	-24 280.2	-23 884.0	21 322.2
- CNB	.	.	.	.	.	.	.	.
- commercial banks	-1 431.5	-31.7	-3 353.6	-14 168.2	-11 907.4	-26 952.8	-25 858.5	14 362.2
- government	8 323.3	8 175.1	3 335.0	1 286.4	519.8	630.3	977.5	2 937.0
- other sectors	6 449.0	3 903.0	1 403.0	2 112.0	270.0	2 042.3	997.0	4 023.0
Short-term	-97 252.2	-81 628.8	-67 435.2	-53 877.0	-131 607.5	-22 348.5	-67 389.9	14 509.9
- CNB	.	.	.	.	.	.	.	.
- commercial banks	2 163.0	-4 289.4	-2 446.2	-48 976.0	-122 038.5	-21 641.6	-63 804.7	22 001.9
- 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	-706.9	-3 585.2	-7 492.0
Liabilities	109 015.8	120 455.1	181 173.7	123 912.0	102 153.9	-9 421.3	30 403.3	-8 977.2
Long-term	10 131.9	19 865.1	87 965.8	95 193.1	24 047.6	-39 840.7	-1 286.1	-26 212.5
- CNB	1 297.3	-31 712.7	997.8	.	-368.0	-216.4	-2 083.5	-22.8
- commercial banks	-2 116.6	11 189.6	60 359.6	46 733.5	-14 875.5	-14 399.2	-7 109.5	-31 523.7
- government	-3 421.5	-5 249.5	-12 047.3	-7 132.6	-11 581.9	-11 765.4	-6 384.3	-1 837.6
- other sectors	14 372.7	45 637.7	38 655.7	55 592.2	50 873.0	-13 459.7	14 291.2	7 171.6
Short-term	98 883.9	100 590.0	93 207.9	28 718.9	78 106.3	30 419.4	31 689.4	17 235.3
- CNB	1 670.5	-1 634.7	77.1	-59.6	-9.9	-6.0	84.9	-17.0
- commercial banks	2 481.8	14 016.0	27 636.1	30 574.9	67 383.7	24 445.9	36 615.6	-3 812.5
- government	91 895.5	86 555.8	56 262.2	-899.6	-69.5	-216.5	-103.2	.
- other sectors	2 836.1	1 652.9	9 232.5	-896.8	10 802.0	6 196.0	-4 907.9	21 064.8
Total A + B + C	85 296.4	74 376.5	182 136.3	-2 912.5	-67 221.2	51 289.3	52 269.8	38 008.8
D. NET ERRORS AND OMISSIONS, VALUATION CHANGES	3 019.8	-6 121.9	15 779.4	-19 562.6	11 181.2	11 325.7	4 866.9	-6 416.0
Total A + B + C + D	88 316.2	68 254.6	197 915.7	-22 475.1	-56 040.0	62 615.0	57 136.7	31 592.8
E. CHANGE IN RESERVES (- increase)	-88 316.2	-68 254.6	-197 915.7	22 475.1	56 040.0	-62 615.0	-57 136.7	-31 592.8

¹⁾ Balance of payments structure based on the Balance of Payments Manual (5th edition), IMF 1993²⁾ Preliminary data³⁾ 1993-1998 - in accordance with methodology for customs statistics in force since 1 January 1996

1999 and 2000 - in accordance with revised methodology for customs statistics in force since 1 July 2000

Table 3

MONETARY SURVEY

position at month-end in CZK billions

	1993 12	1994 12	1995 12	1996 12	1997 12	1998 12	1999 12	2000 12
Total assets	720.4	870.4	1039.6	1125.3	1219.8	1285.2	1389.2	1479.5
Net foreign assets	115.7	194.4	311.4	281.9	338.5	425.3	570.4	684.8
- assets	213.6	275.8	493.2	538.0	670.7	761.4	940.2	992.2
- liabilities	97.9	81.4	181.8	256.1	332.2	336.1	369.8	307.4
Net domestic assets	604.7	676.0	728.2	843.4	881.3	859.9	818.8	794.7
Domestic credits	713.9	817.5	929.5	1029.7	1137.7	1109.9	1095.8	1116.2
Net credit to the government sector	18.4	5.1	10.1	12.6	24.8	36.1	63.4	117.4
- net credit to government	35.1	23.1	25.4	28.5	37.9	45.4	73.6	116.3
- net credit to NPF	-16.7	-18.0	-15.3	-15.9	-13.1	-9.3	-10.2	1.1
Client credits of commercial banks and CNB	695.5	812.4	919.4	1017.1	1112.9	1073.8	1032.4	998.8
CZK credits	669.6	768.9	822.3	888.6	912.6	860.0	838.5	838.3
- businesses	576.8	661.1	720.5	785.1	808.2	756.3	729.6	717.8
- households	92.8	107.8	101.8	103.5	104.4	103.7	108.9	120.5
Foreign currency credits	25.9	43.5	97.1	128.5	200.3	213.8	193.9	160.5
- businesses	.	.	.	.	194.3	210.3	190.5	158.5
- households	.	.	.	.	6.0	3.5	3.4	2.0
Other net items	-109.2	-141.5	-201.3	-186.3	-256.4	-250.0	-277.0	-321.5
Liabilities								
M2 2)	720.4	870.4	1039.6	1125.3	1219.8	1285.2	1389.2	1479.5
M1 1)	359.9	421.8	453.3	475.3	445.1	433.4	479.8	542.5
Currency in circulation	59.8	84.0	104.3	118.9	119.3	127.2	157.9	171.8
CZK demand deposits	300.1	337.8	349.0	356.4	325.8	306.2	321.9	370.7
- households	109.3	131.5	148.8	155.7	153.2	144.0	162.6	195.0
- businesses	185.1	201.1	195.6	195.6	168.2	158.9	156.4	172.9
- insurance companies	5.7	5.2	4.6	5.1	4.4	3.3	2.9	2.8
Quasi money	360.5	448.6	586.3	650.0	774.7	851.8	909.4	937.0
CZK time deposits	303.1	387.8	498.8	564.3	636.2	679.1	661.4	656.5
- households	206.8	244.7	306.5	366.0	474.4	550.8	537.5	549.8
- businesses	60.0	102.9	150.2	177.5	136.1	96.2	87.3	90.4
- insurance companies	36.3	40.2	42.1	20.8	25.7	32.1	36.6	16.3
Certificates of deposit, deposit bills of exchange and other bonds 6)	.	.	.	.	.	30.2	100.1	123.0
Foreign currency deposits	57.4	60.8	87.5	85.7	138.5	142.5	147.9	157.5
- households	45.7	42.2	35.8	40.1	68.8	73.6	80.8	83.7
- businesses	11.7	18.6	51.7	45.6	69.7	68.9	67.1	73.8
Money aggregate L 3)	704.6	845.5	1019.0	1143.7	1244.0	1334.3	1448.2	1546.3
Year-on-year changes in %								
M1	17.5	17.2	7.5	4.9	-6.4	-2.6	10.7	13.1
M2 5)	19.8	19.9	19.8	9.7	9.8	5.4	8.1	6.5
L	19.8	20.0	20.5	12.2	8.8	7.3	8.5	6.8
Client credits of commercial banks and CNB	19.1	16.8	13.2	10.6	9.4	-3.5	-3.9	-3.3
Client deposits with banks 4)	21.8	19.1	21.8	7.6	9.4	2.5	0.3	4.7

1) M1 = Currency in circulation + CZK demand deposits

2) M2 = M1 + quasi money

3) L = M2 + T-bills and CNB bills in the portfolios of domestic non-banks

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 onwards

CNB MONETARY POLICY INSTRUMENTS

	2W repo rate (%)	Discount rate (%)	Lombard rate (%)	Minimum reserve requirement for primary deposits (%)		
				banks	building societies and CMZRB	
As of 1 January 26 June 3 August 8 December	1995					
	-	8.5	11.5	-	-	
	-	9.5	12.5	-	-	
	-			8.5	4.0	
	11.30					
29 March 29 April 9 May 21 June 1 August	1996					
	11.50					
	11.60					
	11.80					
	12.40	10.5	14.0	11.5		
8 May 16 May 27 May 4 June 11 June 18 June 20 June 23 June 24 June 27 June 30 June 1 July 7 July 8 July 9 July 16 July 22 July 23 July 24 July 28 July 1 August 4 August 31 October 1 December 2 December 3 December 4 December 9 December 10 December 17 December	1997					
				9.5		
		13.0	50.0			
	39.00					
	29.00					
	25.00					
	22.00					
	20.00					
	18.50					
			23.0			
	18.20					
	17.90					
	17.00					
	16.50					
	16.20					
	16.00					
	15.70					
	15.40					
	15.20					
	14.90					
	14.70					
	14.50					
	14.80					
	18.50					
	18.00					
	17.50					
	16.75					
	15.50					
	15.00					
	14.75					
	23 January 20 March 17 July 30 July 14 August 25 September 27 October 13 November 4 December 23 December	1998				
				19.0		
15.00						
14.50				7.5		
14.00		11.5	16.0			
13.50						
12.50		10.0	15.0			
11.50						
10.50						
9.50	7.5	12.5				
18 January 28 January 29 January 12 March 9 April 4 May 25 June 30 July 3 September 5 October 7 October 27 October 26 November	1999					
	8.75			5.0		
	8.00					
	7.50	6.0	10.0			
	7.20					
	6.90					
	6.50					
	6.25					
	6.00	5.5	8.0			
	5.75					
				2.0	2.0	
	5.50	5.0	7.5			
	5.25					

Note: No changes were made to the parameters of the above monetary policy instruments in 2000

V. CNB OPEN MARKET OPERATIONS AND MANAGEMENT OF INTERNATIONAL RESERVES





V. CNB OPEN MARKET OPERATIONS AND MANAGEMENT OF INTERNATIONAL RESERVES

COMMEMORATIVE SILVER COIN ISSUED
to mark the 200th anniversary
of the birth of František Palacký

DESIGNER: SCULPTOR VLADIMÍR OPPL

1798
1998

P

The CNB conducts monetary policy through its financial market operations in accordance with Act No. 6/1993 Coll. on the Czech National Bank.

Decision-making

The CNB Bank Board sets three key interest rates: the discount rate, the Lombard rate and the main monetary policy rate announced by the CNB – the two-week repo rate.

A reserves supply/demand forecast is compiled daily in the morning for the day and for the next four days in order to determine the CNB's operations on the money market for the day. The purpose of such operations is to withdraw excess funds from the market equal to the difference between the expected supply of and demand for reserves.

The reserve supply forecast is composed of:

a) autonomous liquidity factors:

- external sector figures (changes in international reserves resulting from purchases/sales of foreign exchange by the CNB, e.g. due to interventions),
- the government sector (revenues vs. expenditure of the state budget; changes in state financial assets and liabilities and in other items of the government's position with the central bank),
- intended T-bill and CNB-bill operations on the secondary market for the purposes of liquidity management on the Ministry of Finance accounts,
- settlements of primary auctions and of maturing issues of government securities,
- currency in circulation (regular monthly pattern),
- other net assets;

b) monetary policy liquidity factors:

- maturity of automatic facilities (lending facility, deposit facility),
- maturity of repos.

The reserve demand forecast is composed of:

- the reserve requirement + excess reserves corresponding to the desirable level of short-term interest rates on the interbank money market,
- a calculation of the difference between the real amount of reserves for the elapsed period (from the beginning of the current reserve requirement cycle) and the average target demand for reserves for the remaining number of days till the end of the two-week reserve requirement cycle.

CNB instruments

The instruments used by the CNB to conduct monetary policy are fully harmonised with those of the ECB.

Main instruments – the two-week repo rate and the three-month repo rate. The two-week repo rate was set by the CNB Bank Board, whereas the three-month repo rate was taken from the rate at which Czech koruna deposits were traded on the interbank market. The CNB used repo operations to maintain short-term interest rates at the desired level by withdrawing excess liquidity (unlike the ECB, for example, which supplies liquidity). Two-week repo tenders were announced daily and settled

with same-day value. Three-month repo tenders were announced weekly on Tuesdays and settled with spot value.

Automatic facilities – a marginal overnight lending facility and a marginal overnight borrowing facility. The marginal lending rate (the Lombard rate) and the marginal borrowing rate (the discount rate) formed the corridor for the two-week repo rate and short-term money market rates. Under the end-of-day automatic lending facility, the CNB lent to banks on their request any amount of Czech koruna overnight on a collateralised basis. Under the deposit facility, banks had the option of depositing overnight funds with the CNB without collateral

Fine-tuning operations – individual money market (deposit, repo), foreign exchange market and securities market operations at market rates and conditions. Such operations were rarely used.

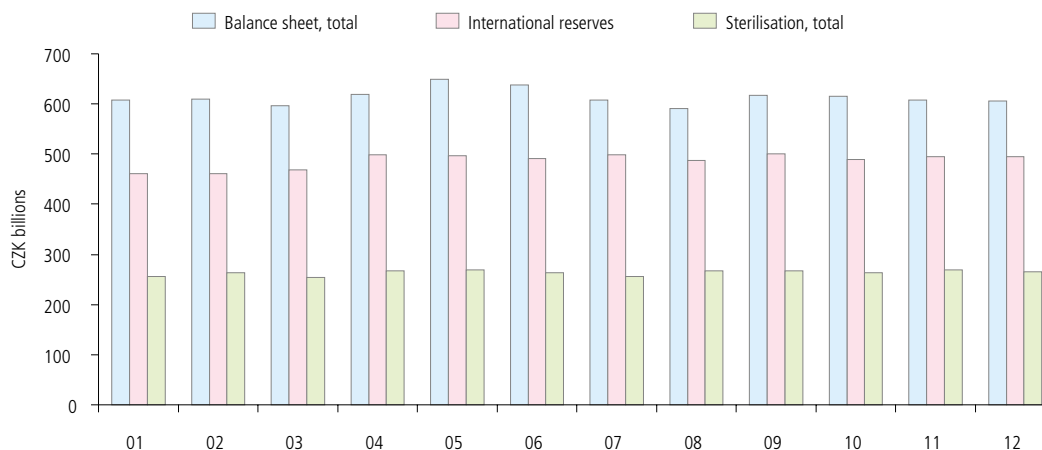
Structural operations – the CNB issued its own bills which it used as eligible collateral for open market operations (both repos and the end-of-day facility) and which banks used to secure intraday credit. The CNB bills were settled in the TKD system.

In 1999, the reserve requirement had been gradually lowered from 7.5% to 2%. This could potentially have endangered the smooth functioning of the interbank payment system at the CNB's Clearing Centre, so the CNB introduced a collateralised intraday credit facility. No interest was charged on intraday credit and there was automatic spillover into the marginal lending facility in the event of non-repayment.

The final CNB instrument was the minimum reserve requirement. In 2000, the reserve requirement was 2% of primary deposits with five-year maturity, non-remunerated, and averaging was permitted. The maintenance period was 14 days, ending every other Wednesday.

Management of the CNB's international reserves

Management of international reserves is one of the CNB's most important activities. International reserves form a major part of the CNB's balance sheet. At end-2000 they totalled EUR 14.1 billion (USD 13.1 billion and CZK 494.8 billion). Income from these reserves was one of the CNB's most substantial revenues. Chart V.1 compares the CNB's balance sheet with the size of its international reserves. The chart also shows the volume of sterilisation (expenditure on monetary transactions forms the largest part of the CNB's expenses).

CHART V.1 CNB BALANCE SHEET

The principles for international reserves management

The international reserves are invested in high-quality liquid assets (government or agency bonds, receivables from selected banks, etc.). The maximum investment maturity is 10 years for government bonds and 3-6 months for banking assets. In 2000, the volume of reserves entrusted to institutional asset management companies increased slightly (from 1% to approximately 2.5% of the total). These portfolios serve primarily for verifying certain new methods that the CNB is considering including among its own instruments and for comparing the CNB's own reserves management with that of an external independent manager. The external portfolios are governed by the same rules for measuring performance as the internal portfolios. The international reserves managed internally are administered in several portfolios by reserve currency, currently the euro and the US dollar. The currency structure of the international reserves changed during 2000 and stood at 72.8% euros and 27.2% dollars at end-2000. This ratio was set on the basis of several factors, primarily investment diversification (driven by the efforts to achieve as stable a return as possible) and the nature of the domestic foreign exchange market, where the most important currency is the euro. Currency risk may not be accepted in portfolio management.

The aforementioned portfolios are managed separately against defined reference portfolios ("benchmarks") which reflect the CNB's neutral investment strategy. The actual rate of return on the portfolios is compared on a daily basis with the theoretical rate of return on the benchmark, thereby measuring the success of individual portfolio managers. In setting the benchmark parameters, the most important aspect was to define a benchmark which would not allow the portfolio to make a loss in any three-month period. Historical data on the financial markets served as the basis. The main parameter used by the CNB to measure the size of the interest rate risk is duration, which was set at three quarters of a year on the basis of the above analyses. The maximum maturity of the investments used in the management of the international reserves did not exceed 9 years.

Another important aspect of international reserves management is credit risk. The CNB essentially invests only in financial instruments issued either by selected banks

or by the governments or government agencies of certain countries. All issuers must be from OECD countries, and the main criterion for selection is their rating. In addition, part of the reserves are also invested in collateralised operations (i.e. repo and reverse repo operations). Chart V.2 gives an overview of investment from the point of view of credit risk. The chart clearly shows that a large part of the investment was channelled into bonds issued by governments and international institutions.

CHART V.2 CREDIT ALLOCATION (IN %)



Rate of return on international reserves management

As mentioned above, the rate of return on the international reserves is measured both in absolute terms and relative to benchmark portfolios.

The rate of return on the individual euro and dollar portfolios, less external flows, is the most suitable indicator for measuring the absolute return on the international reserves. For aggregation, these returns are weighted by the relative size of the portfolios. In 2000, the return was 4.35% for the euro portfolio and 7.05% for the dollar portfolio, which was in line with interest rate developments on the respective markets. The weighted return on total international reserves was 5.07%. The relative rate of return on international reserves is measured as the difference between the rate of return on the actual portfolio and that on the benchmark portfolio. This return was 0.14% above benchmark for the euro portfolio and 0.12% above benchmark for the dollar portfolio.

VI. THE BANKING SECTOR AND BANKING SUPERVISION



VI. THE BANKING SECTOR AND BANKING SUPERVISION



COMMEMORATIVE SILVER COIN ISSUED
to mark the 200th anniversary of the Czech Christmas
Mass by composer Jakub Jan Ryba
DESIGNER: SCULPTOR LADISLAV KOZÁK

In 2000, the banking sector was affected primarily by the nascent economic recovery, the continuing privatisation of major banks and by the resolving of the situation in Investiční a Poštovní banka. The first two factors helped to enhance the stability of the banking sector, as borne out by a number of positive trends, particularly in the areas of bank capital and loan portfolio quality. Some improvement was also registered in the institutional framework, chiefly in the laws regulating the position of creditors. However, the practical effects may be visible only in the longer term. The banking supervisory activities in 2000 focused primarily on further harmonising the legislative base and banking regulations with EC legislation and on aligning procedures and methods with practices applied in advanced countries.

VI.1 THE BANKING SECTOR

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As of 31 December 2000, there were 40 banks and foreign bank branches operating in the Czech Republic, a decrease of two compared with the end of 1999 due to the integration of Erste Bank Sparkassen into Česká spořitelna and to the decision of Banka Haná to terminate its banking operations. During June 2000, Investiční a Poštovní banka (IPB) fell into an acute liquidity crisis – brought on chiefly by a sharp and extensive decline in its primary deposits – and found itself in serious solvency difficulties. Because of the unwillingness of the bank's management to propose and promote effective measures to overcome this crisis and deal with its causes and of shareholders to adopt and implement them, coupled with the bank's systemic importance for banking sector stability, the CNB decided to impose conservatorship upon IPB on 16 June 2000. After evaluating the overall condition of the bank's finances and acquiring prior consent from the Czech National Bank, the conservator concluded an agreement to sell IPB's business to Československá obchodní banka.

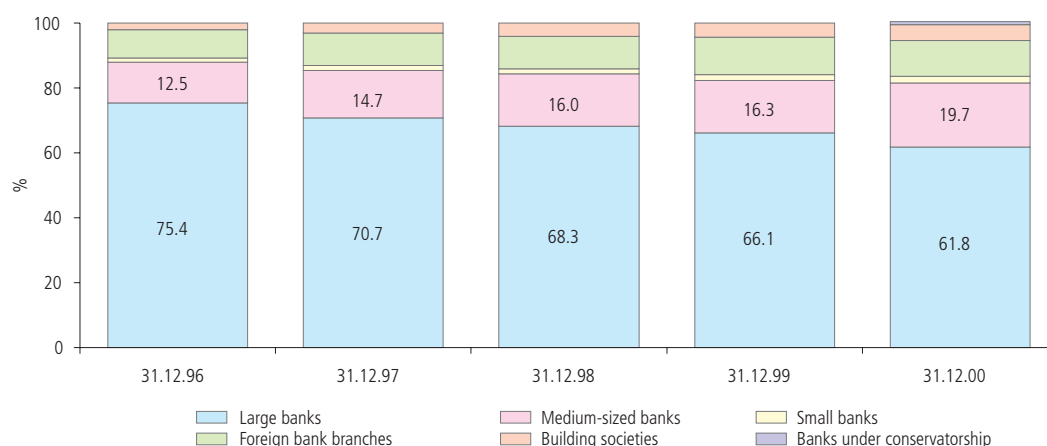
The bank privatisation process continued into 2000 with the sale of Česká spořitelna to Austria's Erste Bank Sparkassen. The privatisation of Komerční banka was started and is expected to be completed during the course of 2001.

The continuing privatisation process has affected the ownership structure of the banking sector with respect to the share of foreign capital. As of 31 December, 16 banks out of the total of 40 were predominantly foreign-owned and 10 were foreign bank branches, 9 banks were controlled by Czech entities and 5 had controlling state (including municipal) interests. Foreign capital accounted for 54.5% of the total equity volume (excluding foreign bank branches). As of the same date, foreign-controlled banks and foreign bank branches managed 65.8% of the total assets of the banking sector. Once the privatisation of Komerční banka is completed, this share will be almost 90%.

One of the important trends in the banking sector is towards greater concentration, which is giving rise to a strong group of medium-sized banks. This process is being fostered on the one hand by the increasing activity of these banks and on the other hand by mergers resulting from the activities of parent banks or from the privatisation of large banks. The average bank size in the Czech Republic was CZK 68.0 billion as of 31 December, which is CZK 8.1 billion more than in 1999 and CZK 15.1 billion more than in 1998. The share of medium-sized banks in the total assets of the banking sector was 3.3 points higher than a year earlier at 19.7%. Against this, the share of large banks decreased in the same period by 4.3 points to 61.8%.

CHART VI. 1 TOTAL ASSETS OF THE BANKING SECTOR BY BANK GROUP

(banks with licences as of 31 December 2000)



The total assets of the banking sector as of 31 December 2000 were 8.2% higher than a year earlier at CZK 2,719.1 billion. Lending is still the dominant activity of banks in the Czech Republic. Gross credits (i.e. prior to provisioning) amounted to CZK 1,073.3 billion as of 31 December, or 39.5% of total assets. The 1.1% decrease in the total volume of gross credits from 1999 was largely due to lower lending activity by some banks. This stems from their greater prudence in providing new credits on account of the high level of credit risk still present in the Czech economy. The decrease in lending activity occurred mainly in the group of large banks; other groups, particularly foreign banks and foreign bank branches, are still showing credit growth.

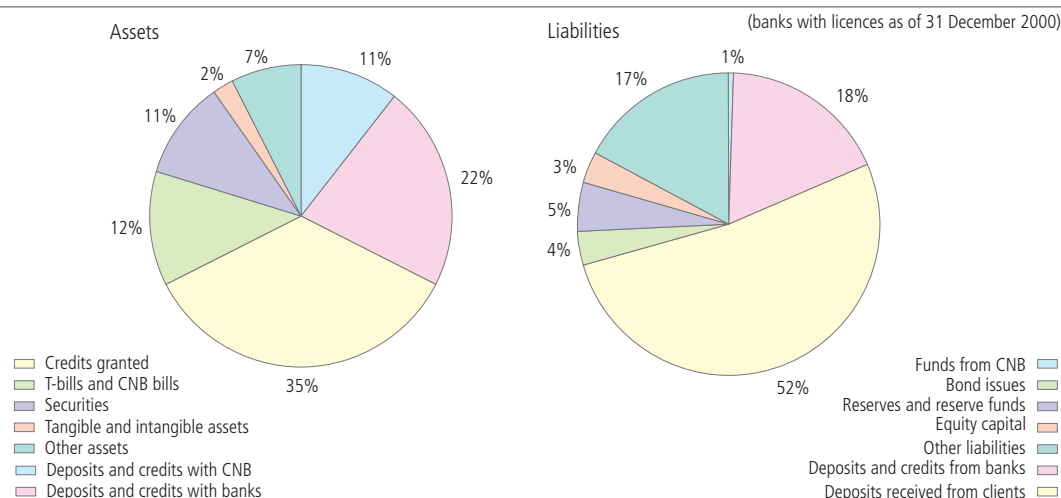
Loan portfolio quality continues to be the banking sector's main problem. As of 31 December, the classified credits of the banking sector, excluding Konsolidáční banka and banks under conservatorship, totalled CZK 254.7 billion, i.e. 29.5% of the total volume of credits granted. Compared with end-1999 this is a fall in volume of 12.5%. However, the decrease is due to the transfer of credits from large banks to Konsolidáční banka and its subsidiaries and to the accounting of the net value of credits in the sale of IPB to ČSOB. Some real growth in classified credits is being recorded in certain large banks, but for other banks in the sector the volume is generally flat or declining.

Loss credits and watch credits account for most of the total volume of classified credits, with shares of 35.0% and 33.1% respectively. The share of loss credits is gradually diminishing (down by 6.6 points compared with end-1999 and 15.5 points compared with end-1998), whereas the share of watch credits is steadily increasing (up by 1.4 and 10.3 points respectively). The high share of watch credits with a low degree of credit risk reflects the increased prudence of banks. The falling share of loss credits is chiefly attributable to cleanup of bank portfolios ahead of privatisation.

The overall volume of provisions and reserves for covering loan portfolio losses reached CZK 76.6 billion as of 31 December 2000, i.e. 65.2% of the overall weighted classification, which is the sum of the risk volumes of the individual types of classified credits (watch 5%, substandard 10%, doubtful 50% and loss 100%).

The remainder of the weighted classification is covered by selected collateral, which exceeds the total value of the weighted classification by roughly CZK 15 billion.

CHART VI.2 ASSETS AND LIABILITIES STRUCTURE OF THE BANKING SECTOR AS OF 31 DECEMBER 2000



The lack of eligible demand for credits led banks to increase the volume of their quick assets (deposits and credits from banks, T-bills and CNB bills, current accounts with banks and cash). These amounted to CZK 675.6 billion as of 31 December 2000, or 24.9% of total assets. The volume of quick assets is growing constantly (up by 9.7% compared with the same period a year earlier), as is their share of assets (up by 0.4 points). The volume of deposits with other banks reached CZK 591.5 billion as of 31 December 2000, a rise of 3.3% on a year earlier. The overall volume of securities (excluding T-bills and CNB bills) in bank portfolios was CZK 288.6 billion as of 31 December 2000, 33% higher than in the same period of 1999. The volume of securities is rising mainly in large banks and building societies.

Client deposits are the major source for banking activities and stood at CZK 1,408.2 billion at end-2000. Compared with the same period a year earlier they were 7.1% higher, which represents a 2-point lower growth rate than in 1999. Client deposits account for roughly 50% of the total assets of the banking sector. Interbank market funds stood at CZK 488.2 billion as of 31 December 2000, down by 0.8% from end-1999 owing to the reduced need for fund replenishment resulting from the limited lending activity. Banks are engaging ever more in derivatives operations, the nominal value of which reached CZK 2,197.2 billion as of 31 December 2000, up by 27% on a year earlier. These operations represented 80.8% of total assets, 12.0 points higher than at end-1999.

Profit from banking activities (excluding Konsolidační banka) reached CZK 80.1 billion as of 31 December 2000, just 88.7% of the 1999 figure. The fall in profit from banking activities is due to a drop in interest income and ensues primarily from the lower overall level of interest rates. Banks spent CZK 52.6 billion on operating costs in 2000, i.e. 3% more than in 1999. They are paying great attention to operating costs, reflected chiefly in optimisation of branch networks and workforce reductions. As of 31 December 2000, the banks recorded an overall net profit of CZK 15 billion.

The capital adequacy indicator comprehensively expresses the strength of the banking sector by rating banks' capital in relation to the structure and degree of risk of their assets. Since April 2000, capital adequacy has incorporated both credit risk

and market risk. The capital adequacy of the banking sector (excluding Konsolidační banka) was 14.9% as of 31 December 2000, up by 1.3 points on a year earlier. As of the same date all banks met the 8% minimum limit, with capital adequacy of less than 10% being registered in just one bank and less than 12% in only six banks of the total of 30.

VI.2 BANKING SUPERVISION

The banking supervisory activities in 2000 focused on further aligning the regulatory framework with EC legislation and on developing the procedures and methods for off-site surveillance and on-site examinations so that they comply as far as possible with the international practices expressed in the *Core Principles for Effective Banking Supervision* prepared by the Basle Committee on Banking Supervision at the BIS.

Methodological activity

During 2000, the CNB's supervisory activities in the methodological area concentrated on finishing work on the amendment to the Act on Banks, in order to complete the harmonisation of the legislative base with EC banking directives. This involved in particular: expanding consolidated supervision to include financial and mixed-activity holding companies; supplementing certain requirements in the licensing area; increasing the limit for compensation from the Deposit Insurance Fund to EUR 15,000 / EUR 20,000 upon EU accession and expanding the insurance to include foreign currency deposits; a unified banking licence regulation as of the date of accession; and the launch of a register of credits at the CNB. The Czech Parliament, however, failed to pass the draft amendment at the end of 2000 and will debate it again during the course of 2001.

The *Provision on Capital Adequacy Incorporating Credit and Market Risks* approved in 1999 took effect in April 2000. For banks, this regulation meant above all a further qualitative shift in risk measurement and management. In addition to regulating capital coverage of credit and market risk, it sets credit exposure limits and limits for open foreign exchange positions. Prior to this Provision's entry into force, informative visits were carried out at the main banks aimed at verifying the banks' readiness to implement the organisational, methodological and technical aspects of the Provision. An amended provision taking on board some of the banks' suggestions was issued in 2000. This resolves a number of the technical aspects of calculating capital requirements.

In 2000, attention was also devoted to preparing internal procedures and rules regulating supervisory activities in banks. The elaboration of internal manuals regulating the procedures for issuing new licences and changing existing licences, the approval of changes in holdings in banks, and the procedures for banks and foreign bank branches in the period between licence issuance and commencing activities all significantly helped to improve and rationalise the supervisor's activities in this area. The CNB banking supervisory authority worked with the Ministry of Finance to prepare an amendment to the Act on Accounting intended to tighten and define more precisely the requirements for the keeping, scope and conclusiveness of accounts, and to prepare an amendment to the regulation stipulating the chart of accounts for banks. The latter includes in particular new rules for setting the real value of securities, making it possible to repeal *CNB Provision No. 5/1999 of the CNB*

Bulletin, on Principles for Covering Losses from Depreciation of Securities and Ownership Interests through Provisions on 1 January 2001.

Practical conduct of banking supervision

In the area of practical conduct of banking supervision, the CNB supervisory authority focused primarily on strengthening its on-site inspections (in-depth inspections and informative visits) and on standardising its procedures for evaluating the financial position of banks and for adopting remedial measures against banks as part of its off-site surveillance.

In conformity with its legal powers, the banking supervisory authority issued a total of 21 administrative decisions in 2000 (chiefly concerning changes in banking licences, acquisition of holdings, sale of a business or part thereof, imposition of conservatorship and banking licence revocation). It also issued 114 other decisions outside the framework of administrative proceedings (opinions on auditors proposed for individual banks; approval of shareholder structure prior to general meetings; consent to the inclusion of subordinated debt in a bank's capital; and approval of consolidated bank units). The banking supervisory authority issued 32 opinions on persons nominated for management positions in banks based on assessment of relevant documents and, in most cases, by conducting interviews. Standard remedial measures were applied in 12 banks, most of them requiring the removal of shortcomings in the bank's activities.

Eleven on-site examinations were carried out, nine of which were in-depth and two were partial. These inspections concentrate ever more on evaluating the quality of risk management and internal control systems. Thirty informative visits took place in 2000, focusing chiefly on strategy and financial results, partial inspections of loan portfolios, functionality of control mechanisms, fulfilment of remedial measures, preparation of on-site examinations, etc. Likewise, discussions were held with senior bank management, in the case of problems on a regular basis.

International co-operation

As in previous years, the international co-operation of the CNB banking supervisory authority focused on bilateral contacts with the banking supervisors of countries having branches or subsidiaries in the Czech Republic and vice versa, the aim being to forge closer ties in order to harmonise the Czech legislative base and banking supervision procedures with European legislation and international practice. These efforts are directed at drafting and later on – after the amendment to the Act on Banks enters into force – signing Memoranda of Understanding with all partners. Such contacts have so far taken place on an informal level, except in the case of the Slovak Republic, with which a co-operation agreement has already been signed.

An important form of international co-operation is the participation of CNB supervisors in Basle Committee working groups involved in further improving the core principles for banking supervision, in developing a new concept of capital adequacy, in enhancing transparency in banking, etc.

As part of the harmonisation of regulations and supervisory methods and procedures with EU practices, the Czech Republic joined the EU's Institution Building Programme ("twinning") at the end of 1999. This roughly two-year project encompasses banking supervision and insurance and its basic objective is to help adjust the main areas of

the Czech financial sector to EU legal standards and to increase the sector's comprehensiveness, efficiency and compliance with EU requirements. In the banking area, the project covers market risk management, supervision on a consolidated basis, setting of individual capital requirements based on the risk profile of the bank, financial position analysis, general on-site inspection methods and specific procedures (manuals) for individual areas, including information technology. On behalf of the EU, this project is being implemented by the German Federal Ministry of Finance and the German banking supervisory authority in co-operation with the National Bank of Greece.

At the end of 2000, the CNB also joined the IMF/World Bank Financial Sector Assessment Programme (FSAP). This project is aimed at overall evaluation of the strength and stability of the Czech financial sector, of which the banking sector is a part. In the first phase, the joint IMF/WB mission concentrated on assessing the conformity of current legislation and banking supervisory practices with the *Core Principles for Effective Banking Supervision*. The main objective of the programme is to define those areas which need to be further aligned with European law and international standards, in other words those areas which represent weak points for the long-term stability of individual banks and the banking sector as a whole.

Co-operation with regulators in the Czech Republic

The development of supervision on a consolidated basis places greater demands on the co-operation between the individual regulators of financial market participants. In the Czech Republic this means co-operation between the CNB, which is responsible for regulating the banking sector, the Ministry of Finance, which regulates the activities of insurance companies and pension funds, and the Securities Commission, which is responsible for supervising securities traders. This co-operation is based on a trilateral co-operation agreement signed in 1998. In practical terms, it primarily takes the form of sharing of information on regulated entities (e.g. licensing procedures, new shareholders, remedial measures and audits). To enhance this co-operation, the CNB has initiated the formation of working groups on the following topics: consolidated supervision, conduct of supervision, disclosure of data and licensing. These groups are intended to promote mutual understanding of the existing rules applied in other regulated areas, standardisation of these rules and co-operation in the oversight of regulated entities and members of consolidated groups.

Central register of credits

The Czech banking sector at present has significant exposure to credit risk, i.e. the risk of non-repayment of credits extended. One of the ways of reducing credit risk, applied in numerous countries, is to set up a central register of credits. For this reason, the CNB decided in May 2000 to create and operate a Central Register of Business Credits to promote the stability of the banking sector. The register under preparation is based on mandatory participation of all banks and foreign bank branches operating in the Czech Republic. It will facilitate sharing of information on overall loan involvement, including off balance sheet receivables and the extent of default credits granted to legal entities and entrepreneurs among banks and foreign bank branches. The project should help improve credit risk management in banks and supplement the commercial activities in the area of natural person credit registers. The central register of credits should start operation in 2001 Q4 providing all the necessary legislative conditions proposed in the amendment to the Act on Banks are met.

I. Banking sector assets and liabilities

(for banks with valid licences as of 31 December 2000, branches abroad included)

(for banks with valid licences as of 31 December 2000, branches abroad included)

	31 Dec.1997	31 Dec.1998	31 Dec.1999	2000			
				31 Mar.	30 Jun.	30 Sep.	31 Dec.
	Assets in CZK millions						
Cash	26 060	26 397	36 903	27 852	29 877	30 730	34 782
Deposits and credits with CNB	187 338	265 998	274 204	291 897	290 907	298 759	289 676
of which required reserves	84 984	85 739	28 019	29 134	29 559	30 336	28 442
Deposits and credits with banks	480 202	492 213	572 856	584 606	564 925	641 787	591 546
of which: current accounts	18 592	18 055	23 206	8 390	14 009	24 986	7 954
time deposits	389 369	386 705	407 313	394 742	390 243	458 053	416 444
credits granted	72 241	87 453	142 337	181 474	160 673	158 749	167 148
T-bills	38 434	52 925	80 532	85 373	76 138	81 280	97 543
CNB bills	90 008	158 770	201 900	236 300	240 593	244 135	234 374
Credits granted	990 447	1 000 111	943 881	951 294	948 029	962 626	952 738
of which: to clients	969 853	972 366	910 714	914 294	905 940	906 345	886 689
to state and local authorities	20 594	27 745	33 167	37 000	42 090	56 280	66 049
Trading securities	95 935	95 152	75 336	69 599	43 223	41 066	92 736
of which: bonds	86 475	91 320	72 409	61 609	38 227	32 589	38 466
equity securities	9 461	3 832	2 927	7 990	4 995	8 476	54 270
Long-term financial investments	90 830	92 759	122 221	150 752	187 332	191 999	197 387
Tangible and intangible assets	60 802	62 309	62 782	62 037	61 681	61 536	60 625
Other assets	112 758	102 620	142 606	140 729	141 396	159 229	167 668
Total assets	2 172 815	2 349 254	2 513 221	2 600 438	2 584 102	2 713 146	2 719 074
	Liabilities in CZK millions						
Funds from CNB	73 807	52 843	33 764	17 920	19 310	16 549	18 342
Deposits and credits from banks	507 525	504 005	492 039	512 122	476 457	536 591	488 213
of which: current accounts	19 548	12 196	10 017	13 966	11 710	16 806	7 717
time deposits	365 786	341 946	303 586	283 599	260 336	332 453	308 450
credits received	122 191	149 863	178 436	214 557	204 411	187 331	172 046
Deposits received	1 099 580	1 205 317	1 314 557	1 332 201	1 325 675	1 365 549	1 408 183
of which: from clients	1 047 916	1 148 550	1 256 719	1 265 195	1 261 530	1 303 754	1 355 125
from state and local authorities	50 318	54 803	54 597	63 129	60 569	58 934	50 828
deposit certificates	1 346	1 964	3 242	3 877	3 576	2 861	2 231
Bond issues	92 024	92 588	98 495	99 812	93 440	100 605	102 094
Reserves	39 487	40 416	45 326	48 478	51 767	53 163	64 786
Reserve funds	72 255	73 931	67 105	67 496	60 319	60 401	60 260
Capital funds	19 369	33 967	12 958	13 023	7 242	7 384	17 893
Equity capital	61 117	69 754	86 914	89 665	90 330	89 756	89 111
Other liabilities	207 651	276 433	362 063	419 722	459 562	483 148	470 191
Total liabilities	2 172 815	2 349 254	2 513 221	2 600 438	2 584 102	2 713 146	2 719 074
	Off balance sheet assets in CZK millions						
Total off balance sheet assets	1 192 389	1 888 839	2 069 465	2 468 145	2 560 805	2 685 722	2 825 960
of which: receivables from futures, forwards and swaps	830 983	1 385 187	1 644 587	1 717 264	1 890 763	1 883 888	2 115 996
receivables from options operations	30 932	84 508	85 578	108 901	104 962	102 668	81 200

II. Banking sector income and expenses

(for banks with valid licences as of 31 December 2000, branches abroad included and Konsolidační banka excluded)

	31 Dec.1997	31 Dec.1998	31 Dec.1999	2000			
				31 Mar.	30 Jun.	30 Sep.	31 Dec.
	In absolute terms (CZK millions)						
Interest income	169 400	206 711	153 550	33 451	66 713	99 944	132 387
Interest expenses	129 458	141 316	96 858	20 733	40 641	60 371	79 008
Interest profit	39 942	65 395	56 692	12 718	26 071	39 573	53 380
Income from fees and charges	13 170	16 949	19 959	5 154	10 712	16 080	22 853
Expenses from fees and charges	1 576	4 130	5 320	1 295	2 860	3 825	5 625
Profit from fees and charges	11 594	12 819	14 639	3 859	7 853	12 255	17 229
Interest profit including fees and charges	51 537	78 214	71 331	16 577	33 924	51 828	70 608
Profit from securities	21 835	3 105	5 735	1 007	-674	-1 022	-583
Profit from foreign exchange operations	12 600	10 784	10 080	2 968	4 507	7 910	10 437
Profit from derivatives operations	x	1 593	1 773	-748	657	-257	-1 226
Profit from other financial operations	1 203	2 813	1 351	314	471	595	867
Profit from banking activity	87 175	96 510	90 271	20 118	38 886	59 053	80 104
General operating expenses	41 786	47 520	51 067	11 453	24 988	37 629	52 586
Creation of reserves and provisions (net)	28 359	14 067	87	-13 583	-42 104	-39 556	-37 501
Other operating income (expenses)	-18 009	-42 048	-46 304	-16 912	-22 894	-25 052	-27 163
Gross operating profit	-979	-7 126	-7 187	5 336	33 108	35 928	37 855
Extraordinary income (expenses)	689	2 967	2 700	-746	-26 654	-25 506	-24 998
Pre-tax gross profit	-289	-4 158	-4 487	4 590	6 454	10 423	12 857
Taxes	1 077	3 072	1 085	2 104	2 287	2 993	-2 099
Net profit	-1 367	-7 231	-5 572	2 486	4 167	7 429	14 956
	In relative terms (%) 1)						
Profit from banking activity/assets	4.58	4.55	3.90	3.43	3.30	3.31	3.33
Net profit/assets	(0.07)	(0.39)	(0.24)	0.42	0.35	0.42	0.62
Net profit/core capital	(1.20)	(5.74)	(4.32)	7.54	6.61	7.82	11.89
Total interest income/interest earning assets	11.82	11.71	7.81	6.84	6.86	6.84	6.73
Total interest expenses/interest bearing liabilities	8.04	8.17	5.17	4.44	4.37	4.30	4.17
Interest rate spread	3.79	3.53	2.63	2.40	2.49	2.54	2.56
Number of banking locations	1 942	2 106	2 005	1 972	1 906	1 924	1 821
Number of banking sector employees	50 233	51 079	48 924	48 700	48 162	45 632	44 932
	Per employee (CZK thousands)						
total assets	40 672	43 231	47 369	48 777	48 840	54 402	55 892
profit from banking activity	1 735	1 889	1 845	1 652	1 615	1 725	1 783
net profit	-27	-142	-114	204	173	217	333
operating expenses	832	926	1 044	941	1 038	1 099	1 170

1) Data annualised for individual quarters of 2000

III. Selected prudential indicators for the banking sector

(for banks with valid licences as of 31 December 2000, branches abroad included and Konsolidační banka excluded)

	31 Dec.1997	31 Dec.1998	31 Dec.1999	2000			
				31 Mar.	30 Jun.	30 Sep.	31 Dec.
	Capital adequacy 1)						
Capital in CZK millions	105 892	126 047	133 155	136 944	122 898	126 725	124 379
Capital requirements for banking portfolio in CZK millions	x	x	x	x	55 345	56 700	62 245
Capital requirements for trading portfolio in CZK millions	x	x	x	x	3 962	3 936	4 783
Capital adequacy in %	9.66	12.10	13.59	14.02	16.58	16.72	14.85
	Credit portfolio quality 2)						
Classified credits in CZK millions	261 225	258 004	291 061	246 147	243 927	243 302	254 705
of which: watch	60 519	58 721	92 124	89 683	88 368	84 292	84 171
substandard	26 261	33 427	39 379	32 556	36 787	36 788	55 263
doubtful	28 579	35 538	38 433	31 894	32 367	33 387	26 205
loss	145 866	130 318	121 125	92 014	86 406	88 835	89 066
Classified credits as % of total credits	26.70	26.45	32.15	28.55	28.48	28.07	29.47
Weighted classification in CZK millions	168 434	157 708	152 823	118 685	114 353	117 099	117 426
Weighted classification as % of total credits	17.21	16.17	16.88	13.76	13.35	13.51	13.59
Weighted classification adjusted for collateral in CZK millions	91 609	88 779	98 817	81 369	52 674	52 604	61 094
Reserves and provisions in CZK millions	102 892	107 995	103 783	93 180	91 260	93 713	76 573
Surplus (+) or shortfall (-) of reserves, provisions and collateral in CZK millions	11 283	19 216	4 966	11 811	38 586	41 109	15 479
Coverage of weighted classification by reserves and provisions in %	61.09	68.48	67.91	78.51	79.81	80.03	65.21
	Liquidity						
Quick assets in CZK millions 3)	347 648	510 616	611 116	636 531	640 677	653 707	669 155
Quick assets as % of total assets	17.02	23.12	26.37	26.80	27.43	26.51	26.82
Quick assets as % of total client deposits	31.77	42.50	46.65	48.26	48.86	48.34	47.92
Cumulative net balance sheet position, including off balance sheet, up to 3 months as % of total assets 4)	0.59	-1.44	-2.27	-2.14	-4.52	-1.21	-5.45

1) foreign bank branches excluded

2) classified credits granted to clients, administrative authorities and banks

3) cash, deposits with CNB, current accounts with other banks, T-bills and other bills

4) after deducting 80% of demand deposits

Note: All figures are for banks with valid banking licences as of 31 December 2000. The 2000 figures are unaudited, so data published later may differ.

VII. BANKNOTES AND COINS, MANAGEMENT OF GOLD RESERVES



VII. BANKNOTES AND COINS, MANAGEMENT OF GOLD RESERVES

COMMEMORATIVE SILVER COIN ISSUED
to mark the 650th anniversary of the foundation
of Charles University in Prague

DESIGNER: SCULPTOR MAJKA WICHNEROVÁ



Currency in circulation

By comparison with 1999, the value of currency in circulation increased by 7% (CZK 13.1 billion). From June onwards, however, the trend differed from previous years owing to the imposition of conservatorship at IPB, one of the nation's largest banks. During one week, currency in circulation surged by CZK 27.9 billion (from CZK 183.9 billion to 211.8 billion). Compared with the same date a year earlier it increased by CZK 46.7 billion, i.e. about 28%. In the remainder of the year the situation gradually calmed and by the end of the year the level had dropped to CZK 197 billion.

The currency structure changed significantly after Česká spořitelna, the largest ATM operator in the Czech Republic, changed the denominations in its machines, replacing the 100 Kč and 500 Kč denominations with 200 Kč and 1000 Kč notes. The biggest difference was recorded for the 500 Kč note, the share of which in total currency in circulation fell in koruna terms from 9.8% to 4.9%. The share of the 100 Kč note saw a moderate decline (from 2.2% to 1.9%), while that of the 1000 Kč note increased from 40.9% to 44.9% and of the 200 Kč note from 2.7% to 3.4%.

CHART VII.1 STRUCTURE OF CURRENCY IN CIRCULATION (IN CZK)

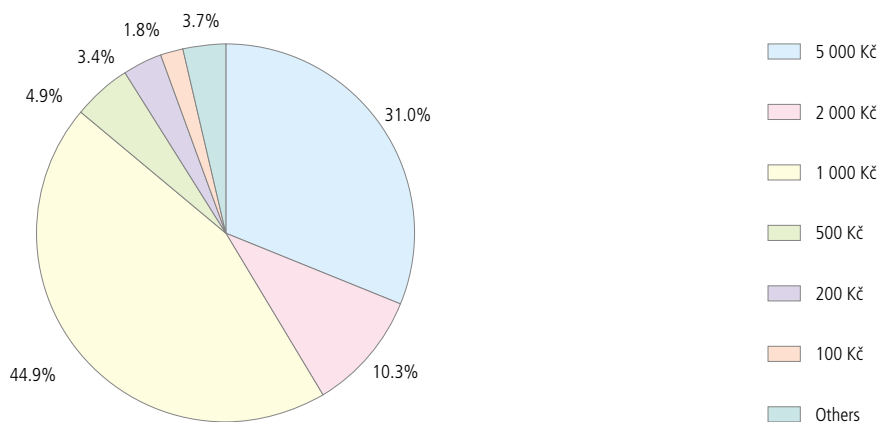


CHART VII.2 STRUCTURE OF BANKNOTES IN CIRCULATION (NUMBER OF NOTES)

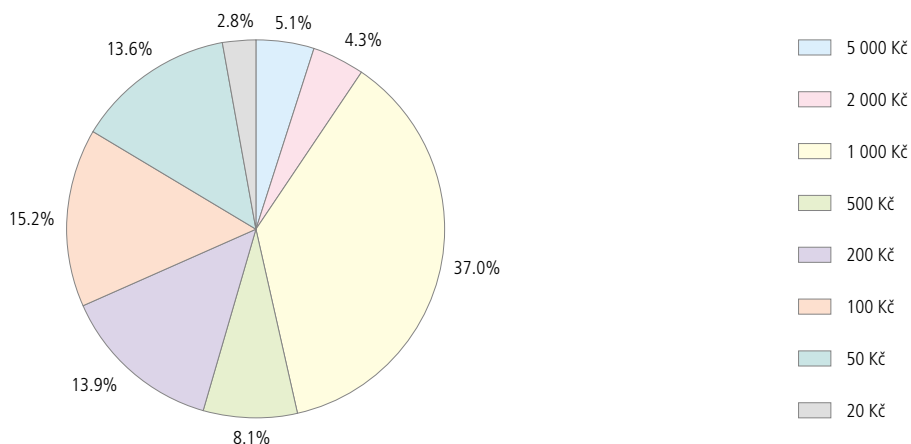
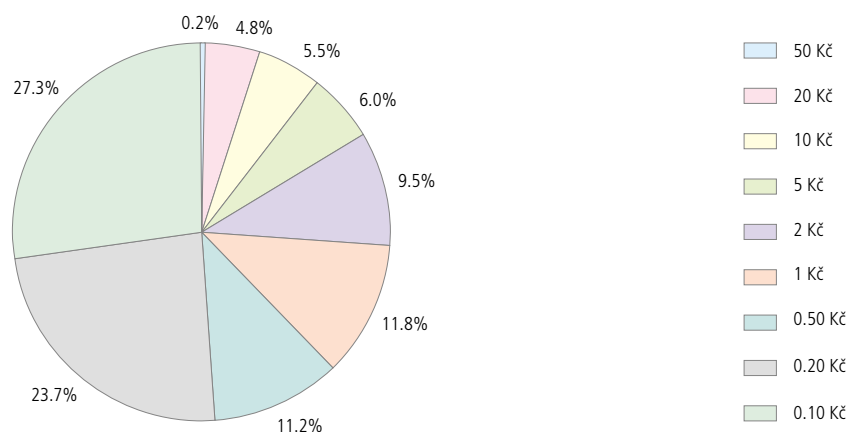


CHART VII.3 STRUCTURE OF COINS IN CIRCULATION (NUMBER OF COINS)



Issuing activity

On 12 January 2000, the CNB put into circulation Year 2000 versions of the 10 Kč and 20 Kč coins with a turn-of-the-millennium motif on the reverse side. No new banknote versions were issued.

In 2000, five silver commemorative 200 Kč coins were issued, marking:

- the 100th anniversary of the birth of Vítězslav Nezval (17 May)
- the 700th anniversary of the currency reform by Václav II and the commencement of minting of the Prager groschen (21 June)
- the International Monetary Fund and World Bank Group Meetings in Prague (13 September)
- the 150th anniversary of the birth and 100th anniversary of the death of the composer Zdeněk Fibich (4 October)
- the start of the new millennium (29 November).

All commemorative coins were minted in both normal and proof quality. No gold commemorative coins were issued in 2000.

The silver commemorative coins issued by the former State Bank of Czechoslovakia, the last remaining legal tender of the single Czechoslovak currency, ceased to be valid on 30 June. The exchange period was set at one calendar year at commercial banks and a further five years at the CNB.

The completion of the reconstruction of the CNB's Na Příkopě building and the commencement of full operation of its Prague branch led to a substantial change in the take-over of newly produced banknotes and coins from the State Printing Office and their subsequent distribution. These activities were transferred in full from a special unit of the Currency Department at CNB headquarters to the Prague branch. In the special unit the checking of new banknotes had been carried out manually, whereas in the Prague branch banknote processing and checking is fully automated using up-to-date ACCS5641 machines.

Counterfeits

In 2000, a total of 9,526 counterfeit and altered banknotes and coins and 524,947 imitations were seized in the Czech Republic.

TABLE VII.1 NUMBERS OF NOTES/COINS SEIZED

COUNTERFEIT CURRENCY	FROM CIRCULATION	BY THE POLICE	TOTAL
CZK	1363	3652	5015
USD	2123	235	2358
DEM	185	36	221
ITL	1430	44	1474
OTHERS	125	9	134
CZK COINS	206	0	206
FOREIGN COINS	20	0	20
ALTERED CZK	22	0	22
ALTERED FOREIGN	76	0	76
TOTAL	5550	3976	9526

The value of the seized counterfeit and altered money was CZK 31,803,727.

To better protect the public against counterfeit banknotes of higher denominations, it was decided in 2000 to withdraw the 1993 versions of the 1000 Kč and 5000 Kč banknotes, i.e. the banknotes counterfeited most frequently. Although these notes will cease to be legal tender on 30 June 2001, a decree terminating their validity was issued before the end of 2000 to inform the public sufficiently in advance and to acquaint them with the differences between the version being withdrawn and the version that will remain valid. For the same reasons, a press conference was held in December 2000 to launch an information campaign on this topic.

Management of gold and other precious metal reserves

On 17 May 2000, the remainder of the gold from the reserves of the former State Bank of Czechoslovakia (fine weight 4,124,623,254 grams) was handed over to the National Bank of Slovakia. This left just under 14 tonnes of gold in the CNB's reserves as of 31 December 2000. However, its composition was significantly different. At the end of 1999 the proportions of gold in coin and bar form had been roughly equal, whereas at the end of 2000 this ratio had swung markedly towards gold in coin form, which was about five times more prevalent. This change in composition is closely linked with the handover to the National Bank of Slovakia, which had asked for most of the gold (4 tonnes) in bar form.

VIII. THE PAYMENT SYSTEM



VIII. THE PAYMENT SYSTEM



COMMEMORATIVE SILVER COIN ISSUED
to mark the 100th anniversary
of the birth of Vítězslav Nezval
DESIGNER: SCULPTOR LADISLAV KOZÁK

1900
2000
LK

Successful transition to the year 2000

Like many other institutions using computers, the CNB had to prepare all its automated systems for smooth transition to the year 2000. The management of the CNB also decided to create a legal framework to be used for resolving potential Year 2000 problems both at the central bank and within individual commercial banks. At the end of 1999, a Decree No. 248/1999 Coll., on non-settlement days on 31 December 1999 and 3 January 2000, was issued. We are happy to report that all central bank systems, including payment systems, passed this challenging test successfully.

Co-operation with international institutions

The Czech National Bank carefully monitors activities in the area of domestic and international interbank settlement of payments and securities. Given the Czech Republic's endeavours to join the European Union and, later on, the European Monetary Union, the CNB co-operates primarily with the European Central Bank, which pays great attention to the payment system area.

Another group of questions that have become relevant thanks to modern technology relates to securities settlement systems. At the joint initiative of the Bank for International Settlements and the International Organisation of Securities Commissions, a Task Force on Securities Settlement Systems was established to develop recommendations for such systems. A CNB representative was invited to participate directly in this task force, which comprises experts from 18 countries. The report produced by the task force has been submitted to all central banks and securities commissions for public comments.

Interbank payment system

The interbank payment system ensures transfers of all interbank transactions in the Czech Republic, irrespective of amount or whether the payment is initiated by the bank itself or by its client. The system also verifies whether the banks have sufficient funds with the central bank to cover them. Uncovered transfers are suspended by the system. If the bank does not secure sufficient liquidity by the end of the accounting day, the system returns the transactions to the payer's bank.

In 2000 the CNB again did its utmost to ensure continuous, uninterrupted and safe running of the system, being aware that a collapse of the system would impact on the entire national economy. The central bank has completed a project to introduce a new data protection standard in the area of interbank clearing. The results of this project have been presented to all banks operating in the Czech Republic. The new security system is expected to go live during 2001.

The second project completed by the CNB in 2000 in the area of interbank clearing technology was that of real-time data transfers. Here, too, banks will be acquainted with the requirements arising from this new system. The first banks are expected to use it during the course of 2001 once the necessary testing has been completed.

As regards interbank clearing, the number of items going through the system continued to see steady growth in 2000. A daily average of 905,000 transactions, worth CZK 385 billion, were processed in 2000. A historical daily high of 2,240,240

items was achieved in mid-April, while in mid-March, more than CZK 621 billion was transferred in a single day. In the year as a whole, the system ensured problem-free settlement of 225,628,000 transactions worth CZK 96.1 trillion.

TABLE VIII.1 THE INTERBANK PAYMENT SYSTEM - NUMBER OF ITEMS AND TURNOVERS IN 2000

MONTH	NO. OF ITEMS PER MONTH (IN MILLIONS)	TURNOVERS PER MONTH (IN CZK TRILLIONS)
January	16.9	7.542
February	17.4	8.529
March	18.2	9.005
April	18.0	7.424
May	19.5	8.355
June	19.0	8.881
July	18.2	7.230
August	18.5	8.419
September	18.1	7.171
October	20.1	8.250
November	20.1	7.674
December	21.6	7.650

The short-term bond market system (TKD system)

The CNB is responsible by law for operating the short-term bond register, i.e. the register of bonds with maturities up to one year. To support the market in these bonds, the central bank operates the "TKD system", to which most of the banks operating in the Czech Republic are connected on-line. Treasury bills (instruments used for adjusting short-term imbalances between state budget revenues and expenditures) and CNB bills (instruments used for managing liquidity on the interbank market) are registered in the system. In 2000, the system registered securities worth around CZK 250 billion on average. In a typical month, the system sees transfers of securities exceeding CZK 1.9 billion.

The year 2000 saw a stabilisation in the volume of "intraday" credits, i.e. collateralised credits extended by the Czech National Bank in the form of short-term securities. The average daily volume was about CZK 30 billion. These funds facilitate very smooth operation of the interbank settlement system.

The TKD system has been running in its present form since 1995. Although the basic principles of the system are up-to-date (the system ensures real-time transfers of securities on the delivery-versus-payment principle), the possibilities offered by modern information technology and the functional requirements of the system have changed in many respects. The Czech National Bank has therefore launched a new project to raise the level of all functions of the system and to enhance its capacity and security.

The CNB's accounting and payment system (ABO system)

For historical reasons and in compliance with the Act on the Czech National Bank and the new Act No. 218/2000 Coll. on Budget Rules, the central bank also maintains and administers all the accounts of the state budget. This it does through the ABO (Automated Banking Operations) system. In addition, the ABO system is used to keep books on the central bank's own funds (e.g. foreign exchange reserves,

the required reserves of banks, and cash payments, in other words all its assets and liabilities).

Consequently, the ABO system processes sizeable volumes of data – more than 100,000 items a day on average (and on peak days more than 220,000). Daily turnover exceeds CZK 1 trillion (and on peak days double this amount). The nature of the items – taxes, social payments, pensions, public sector wages and so on – clearly demonstrates the ABO system's importance.

The Czech National Bank is keenly aware that the ABO system as a whole must run smoothly, both at the CNB's headquarters and in its branches. The "ABO2" project – aimed at increasing the speed of accounting and payments (the objective being real-time accounting) and their security and functionality – continued into 2000.

IX. PROVISION OF INFORMATION
IN COMPLIANCE WITH ACT N° 106/1999 COLL.,
ON FREEDOM OF INFORMATION



IX. PROVISION OF INFORMATION IN COMPLIANCE WITH ACT N° 106/1999 COLL., ON FREEDOM OF INFORMATION

COMMEMORATIVE SILVER COIN ISSUED
to mark the 1000th anniversary
of St. Adalbert's death

DESIGNER: SCULPTOR LADISLAV KOZÁK



The CNB's procedures for performing the tasks ensuing from Act No. 106/1999 Coll. on Freedom of Information (hereinafter the "Act") are defined by internal directives stipulating the principles and procedures for dealing with applications for information.

By law, the CNB provides information to applicants on the basis of their applications or by way of public disclosure.

A) Information provided in 2000 on the basis of applications:

1. Number of applications for information submitted in compliance with the Act:
In 2000, the CNB received and dealt with one written application for information in compliance with the Act. This application concerned information about the CNB decision in the matter of dismissal of an appeal against the CNB decision to impose conservatorship on Investiční a Poštovní banka.
2. Number of appeals submitted against decisions:
None.
3. Transcript of the relevant parts of each court judgement:
None.
4. Results of sanction proceedings for non-observance of the Act:
None.
5. Other information relating to application of the Act:
 - The CNB provides information pursuant to Article 2(2) of the Act in cases where it makes decisions on the rights, legally protected interests or obligations of natural persons or legal entities in the area of public administration. The CNB has this legal obligation only in respect of the administrative proceedings which it conducts pursuant to the Act on the CNB, the Act on Banks and the Foreign Exchange Act. The CNB provides information on specific proceedings only if they are terminated by a legitimate decision subsequent to the entry into force of the Act, i.e. after 1 January 2000. As regards the scope of information provided in connection with specific administrative proceedings to someone other than the parties to the said proceedings, this is limited to the information given in the decision.
 - Most written and telephone applications for information go beyond the framework of the Act. In 2000, the CNB answered 575 such written questions.

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B) Information provided by way of public disclosure:

The CNB releases the information pursuant to Articles 5(1) and 5(2) of the Act on notice boards at its headquarters and branches in locations accessible to the public during working hours and also on its website http://www.cnb.cz/en/_o_cnb/co_je_cnb.htm under the title "Information on the Czech National Bank" in the following wording:

1. The Czech National Bank (hereinafter referred to as the "CNB") is the central bank of the Czech Republic.
2. The CNB was established by Act of the Czech National Council No. 6/1993 Coll., on the Czech National Bank, and carries on its activities in compliance with that law and with Act No. 21/1992 Coll., on Banks, with Act No. 219/1995 Coll., the Foreign Exchange Act, and with other legal regulations.
3. The primary objective of the CNB is to maintain price stability.

4. The CNB is obliged to submit to the Chamber of Deputies at least twice a year for review a report on monetary developments. It is also obliged to submit, within three months of the end of the calendar year, an annual financial report to the Chamber of Deputies for review.
5. The CNB is obliged to inform the public on monetary developments at least once every three months.
6. The supreme governing body of the CNB is the Bank Board, consisting of seven members appointed by the President of the Republic for a term of six years. The members of the Bank Board are the Governor, two Vice-Governors and four other senior officers of the CNB. The Bank Board sets monetary policy and the instruments for implementing that policy, and decides upon the fundamental monetary policy measures of the CNB and on other fundamental measures.
7. The CNB consists of a headquarters broken down into departments, each headed by an Executive Director, and branches in Prague, České Budějovice, Plzeň, Ústí nad Labem, Hradec Králové, Brno and Ostrava, each also headed by an Executive Director. The departments at its headquarters are organised into seven groups, each headed by a Bank Board member.
8. The CNB is a mandatory entity within the meaning of Article 2 of the Act. In cases where it makes decisions as an administrative authority in administrative proceedings, it provides information on the proceedings concerned only if they are terminated by a legitimate decision subsequent to the entry into force of the Act.
9. Applicants for information should submit applications pursuant to Articles 13, 14(1) and 14(2) of the Act to the mail room at the CNB's headquarters at Na Příkopě 28, Prague 1, or to the mail room of the relevant branch. At these locations it is also possible to file a complaint, submit a proposal, suggestion or query, or make any other submission.
10. Decisions on applications pursuant to the Act are delivered to the addressee only.
11. Applications are normally dealt with within 15 days of their receipt by the CNB. The CNB's procedure for dealing with such applications, the particulars of the decision and the possibilities for filing an appeal are provided for in Articles 14(3), 15 and 16 of the Act.
12. The CNB acts and makes decisions pursuant to Act No. 6/1993 Coll., on the Czech National Bank, as amended by Act No. 60/1993 Coll., Act No. 15/1998 Coll., and Act No. 442/2000 Coll., pursuant to Act No. 21/1992 Coll., on Banks, as amended, and pursuant to Act No. 219/1995 Coll., the Foreign Exchange Act. These laws are available for inspection at the CNB Special Library in Prague and at the secretariat of the Executive Director at each CNB branch.
13. The Act and the Annual Report published each year as part of the Annual Report of the CNB pursuant to Article 18 of the Act constitute part of this Information.
14. The CNB provides information pursuant to the Act free of charge.

X. FOREIGN EXCHANGE LICENSING



X. FOREIGN EXCHANGE LICENSING



COMMEMORATIVE SILVER COIN ISSUED
to mark the 800th anniversary of the coronation
of the Czech King Přemysl I Otakar
DESIGNER: SCULPTOR JIŘÍ VENEČEK

The Ministry of Finance and the Czech National Bank are responsible for public administration in accordance with the Foreign Exchange Act. The Ministry of Finance exercises powers in the foreign exchange area vis-à-vis ministries and other administrative bodies, local authorities, budgetary organisations and state funds and vis-à-vis all entities in the area of credits extended or received by the Czech Republic. The Czech National Bank exercises all other foreign exchange powers vis-à-vis other residents and non-residents.

The CNB's legal powers therefore authorise it to intervene in private law, i.e. to interfere in the private relationships between natural persons and legal entities. The Foreign Exchange Act, in force since October 1995, which introduced convertibility of the Czech koruna, represented a big step forward in liberalising the international monetary and financial relations of private entities. Nonetheless, it left the state with the right to regulate certain contractual relationships between residents and non-residents. At the same time, though, it empowered the Government to gradually relax its foreign exchange restrictions in keeping with the development of a market economy. At the initiative of the Ministry of Finance and the Czech National Bank, the Government gradually abolished the licence requirement for providing credits abroad, for carrying on foreign securities and financial derivatives operations, for using hedging instruments in favour of non-residents, for making investments other than direct investment abroad, etc. Ultimately, the right of the state to interfere in the opening and maintaining of accounts abroad by residents was abolished as well. With this, the CNB's powers to license residents' foreign exchange activities were fully terminated as of 1 January 2001.

However, the mandatory reporting obligation has been preserved. This requires residents to report certain information stipulated by law regarding specific foreign exchange operations and flows. This obligation is of continuing importance, as it allows the CNB to obtain a statistical overview of money and capital flows for compiling, forecasting and monitoring the foreign exchange balance of payments.

Trade in foreign exchange assets is still regulated by licences issued by the Czech National Bank. By law, the CNB, when issuing foreign exchange licences, takes into account the foreign exchange situation. Since this is currently favourable, it chiefly considers the technical, organisational and financial preconditions of the applicants and the expertise and integrity of the persons who are to trade in such assets.

In 2000, the CNB issued 107 foreign exchange licences to legal entities, most of them being licences for foreign securities trading (47). A total of 33 licences were issued for other trading in foreign exchange assets, 25 for providing financial services, 1 for financial derivatives trading and 1 to an investment fund.

A total of 156 foreign exchange licences were issued in 1998 and 63 in 1999. The number of applications for foreign exchange licences is expected to decline, since the market is partly saturated. Another reason is that foreign exchange licences for securities trading have been transferred to the Act on Securities area and will be incorporated into the permits for securities traders.

The present legal situation, which allows state interference only in foreign exchange trading carried on as a business, makes it possible for the CNB to step up its foreign exchange inspections. This will increase public confidence that foreign exchange transactions are performed by persons with due authorisation conducting their business in a professional, fair and reliable manner.

CALENDAR OF EVENTS 2000

12 January	<i>The CNB puts new 10 Kč and 20 Kč coins into circulation</i>
13 January	<i>The Bank Board decides that the CNB will publish the data on the Czech Republic's external economic relations in euros as well as in korunas as from 1 February 2000</i>
14 January	<i>The copper time capsule is returned to the restored Genius and the Lion statue on the roof of the CNB; the capsule will be opened again in around 50 years; CNB representatives added two sets of coins (with motifs depicting Prague and the Czech Republic's entry into NATO), a set of current banknotes, a commemorative certificate, photographs and press cuttings relating to the reconstruction of the CNB building, and photographs of the CNB Bank Board members</i>
27 January	<i>The CNB raises its net inflation forecast for end-2000 to 2.5%-4.1%</i>
9 February	<i>The Government approves the "harmonisation amendment" to the Act on the CNB</i>
23 February	<i>The Chamber of Deputies passes the amendment to the Act on the CNB for second reading and instructs the Budget Committee to discuss it</i>
23 March	<i>The Budget Committee suspends debate on the amendment to the Act on the CNB</i>
30 March	<i>The CNB intervenes to weaken the koruna's exchange rate</i>
31 March	<i>The CNB shows a profit of CZK 32.4 billion for 1999 by Czech accounting standards; the CNB's Financial Report is submitted to Parliament</i>
25 April	<i>The CNB announces a net inflation target of 2.0%-4.0% for 2001</i>
27 April	<i>The CNB lowers its net inflation forecast for end-2000 to 2.2%-3.5%</i>
4 May	<i>The Budget Committee gives its backing to the amendment to the Act on the CNB complete with a large number of proposed revisions; CNB representatives express their disagreement with the changes</i>
4 May	<i>The Budget Committee gives its approval to the CNB's Financial Report for 1999</i>

9 May	<i>The IMF calls on Parliament to "exercise its wise discretion and come to a conclusion that puts the CNB on a par with global and EU standards" in its efforts to amend the Act on the CNB</i>
25 May	<i>The Chamber of Deputies postpones the debate on the amendment to the Act on the CNB until its July session</i>
25 May	<i>The CNB Bank Board decides to start work on establishing a Central Register of Business Credits</i>
5 June	<i>CNB Governor Josef Tošovský confirms his candidature for the post of Vice President of the EBRD</i>
12 June	<i>The Ministry of Finance and the CNB confirm officially that they are holding talks with IPB's main shareholder Nomura on the situation at the bank</i>
16 June	<i>The CNB imposes conservatorship at IPB</i>
18 June	<i>Proceedings are initiated to revoke IPB's banking licence</i>
19 June	<i>IPB's assets and liabilities are sold to Československá obchodní banka</i>
30 June	<i>The CNB receives an appeal filed by IPB's Board of Directors against the decision to impose conservatorship</i>
14 July	<i>The Chamber of Deputies passes the amendment to the Act on the CNB</i>
27 July	<i>The CNB lowers its net inflation forecast for end-2000 to 2.1%-2.9%</i>
27 July	<i>Ramiro Cibrián, Head of the EC Delegation to the Czech Republic, states that some parts of the proposed amendment to the Act on the CNB might limit the central bank's independence</i>
4 August	<i>The Senate rejects the amendment to the Act on the CNB</i>
23 August	<i>The Government approves an amendment to the Constitution removing the definition of the primary objective of the CNB, which is at odds with EU law</i>
25 August	<i>The CNB announces that the 1993 version of the 5000 Kč and 1000 Kč banknotes will cease to be legal tender as from 1 July 2000</i>

26-28 September	<i>The IMF/WBG meetings take place in Prague accompanied by disturbances in the city's streets initiated by anti-globalisation protestors, mainly from abroad</i>
5 October	<i>CNB Governor Josef Tošovský withdraws his candidature for the post of Vice President of the EBRD</i>
20 October	<i>The Chamber of Deputies passes for second reading the Government amendment to the Constitution, the main aim of which is to strike out from the Constitution the CNB's primary objective (defined as maintenance of currency stability)</i>
26 October	<i>The CNB raises its net inflation forecast for end-2000 to 3.3%-3.8%</i>
27 October	<i>The Chamber of Deputies overturns the Senate's veto and approves the amendment to the Act on the CNB in its original wording</i>
30 October	<i>President Václav Havel refuses to sign the amendment to the Act on the CNB and returns it to the Chamber of Deputies</i>
31 October	<i>CNB Governor Josef Tošovský hands in his resignation as of 30 November 2000; it is accepted by President Václav Havel; Miroslav Hrnčíř steps down as Bank Board member as of the same date</i>
10 November	<i>The CNB's decision to stop the proceedings to revoke the banking licence of IP banka (the former Investiční a Poštovní banka) takes effect</i>
13 November	<i>President Václav Havel opens discussions on replenishing the CNB Bank Board</i>
14 November	<i>The CNB's decision to reject the appeal against imposition of conservatorship at IB banka (the former IPB) on 16 June 2000 takes effect</i>
24 November	<i>President Václav Havel announces that Vice Governor Zdeněk Tůma is to be appointed as new CNB Governor and that Michaela Erbenová and Jan Frait are to be made new Bank Board members</i>
29 November	<i>President Václav Havel appoints Zdeněk Tůma as new CNB Governor with effect from 1 December 2000. Luděk Niedermayer is appointed as new Vice Governor, and Michaela Erbenová and Jan Frait become Bank Board members</i>

<i>1 December</i>	<i>Former CNB Governor Josef Tošovský becomes Chairman of the Financial Stability Institute at the Bank for International Settlements</i>
<i>7 December</i>	<i>The Chamber of Deputies overturns the President's veto and passes the amendment to the Act on the CNB</i>
<i>18 December</i>	<i>The Government asks the Constitutional Court to rule whether the President's appointment of the CNB Governor is valid without the countersignature of the Prime Minister</i>
<i>21 December</i>	<i>The CNB lowers its net inflation forecast for end-2001 to 2.0%-3.7%</i>
<i>22 December</i>	<i>President Václav Havel files a petition at the Constitutional Court to have several passages struck from the amendment to the Act on the CNB</i>

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