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The Czech Economy Development in 2013

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1. Summary

- Year 2013 marked the Czech economy by a continuing recession – year-on-year fall of GDP¹ by 0.9 % was the same as in year 2012. However, while at that time the final consumption expenditures and to a large extent also investment participated on the fall of GDP, in 2013 already these expenditures in total slightly increased year-on-year, while the fall of investment preserved in the comparable extent. The same depth of GDP fall in both recession years was thus influenced by the achieved result of the foreign trade. It affected the economic development in 2012 favourably, while in 2013 on the contrary contributed to its slow down by the year-on-year worsening of the imports and exports balance from Q1 and Q3.
- During 2013 the performance of the economy gradually improved. Year-on-year falls in the first three quarters mitigated (from -2.2 % via -1.6 % as far as -1 %) and in the last three months of the year the GDP already rose by 1.3 % compared to the same period of 2012. The results of both the first and last quarter were however affected by extraordinary influences on the supply side of the economy, connected to the collection of taxes. The strong quarter-on-quarter growth of GDP by 1.9 %, according to the Eurostat data highest in the EU 28, can also be attributed to this influence to a notable extent. Also for this reason in Q4 a recorded year-on-year growth of the Czech GDP (+1.3 %) was higher than in the EU (+1.1 %).
- In spite of adverse development of real wages the rate of growth of household consumption expenditures improved gradually during the year from the drop in the first half year up to 0.7 % year-on-year in Q4. Compared to the preceding quarter, people expended on consumption by 2.3 bn crowns more (+0.5 %). It contributed from 12 % to the quarter-on-quarter growth of GDP, which was higher by 18.3 bn crowns. Favourable foreign trade balance improved by 6.3 bn crowns added further 35 % to the increase of GDP, however the investment had the highest impact on the achieved quarter-on-quarter improvement of the Czech economy. The investment grew by 10.7 bn crowns in comparison to Q3 – higher amount was last recorded at the beginning of the boom period in 2008 – and thus out of the expenditure items it shared decisively (from 59 %) in the achieved quarter-on-quarter result of the Czech economy growth.
- Promising start of revival, which could be driven by investment, is also indicated by the data related to the lending in the business sector. In the last months of the year the real estate activities recorded notable growth especially of the long-term loans to the non-financial businesses visible roughly from August 2013. The dynamics of loans in foreign currencies for non-financial businesses markedly strengthened against crown loans. Balances of loans to non-financial businesses in total grew by 31.2 bn crowns for the period of August till December 2013, in that by 21.3 bn for long-term loans. Comparable addition of these loans to these businesses in foreign currencies arrived at 33.1 bn crowns, in that long-term 15.5 bn crowns. Unless there is a majority of financial investment, the growth of long-term loans can be a signal of future growth of gross fixed capital formation.
- Industry performance according to the gross value added fell for the whole economy by 0.8 %, year-on-year improvement occurred only in the financial activities thanks to the development in insurance companies and pension funds, further also in the other activities industry. In Q4 however the industry sector significantly strengthened (+3 %). A turn in demand boosted the production in the manufacturing industry in November and December to the rates of growth (+9.7 %, + 8.9 %) from the times of boom in the Czech economy during autumn of year 2007.
- Deflation character of imports – especially energy prices – significantly contributed together with the weak demand effects through the price chain to the lowering of the rate of growth of prices in the whole economy. Prices of imports fell by 0.2 % compared to year 2012, prices in the industry were with respect to its dynamics (0.8 %) the weakest since year 2009. The inflation rate reached 1.4 %, in the last quarter the prices were higher by 1.1 % according to the consumer price index year-on-year. November monetary intervention of the CNB had practically an immediate impact on the growth of prices of goods traded on the domestic market in euros. It affected the prices of the foreign trade more significantly by the increase of the import prices than the export prices, which supported the competitiveness of exporters.
- On the labour market, the intensive utilisation of „non-standard“ forms of employment contracts continued, thus helping the growth of the aggregate employment while simultaneously lowering the number of hours worked. Hourly labour productivity in the economy thus went up, productivity per employed person again decreased. Employees evidenced a mere stagnation of the average nominal wage, real wage fell for a second year in a row (in the non-business sector already four years in a row). Unemployment rate according to the LFSS has been rather stagnating.

¹ Unless stated otherwise, data related to GDP and its components are considered in real terms and adjusted for seasonal and calendar effects.

- External imbalance of the CR economy remained favourable in 2013 featuring the deficit of the current account of the balance of payments in the amount of 1.4 % of the nominal GDP.
- Balances of term deposits were again year-on-year weaker (-2 %), however the decrease was lower compared to year 2012 (-3.8 %). Consumption loans to population from banks again slightly revived after two years.
- Thanks to growing revenues of the state budget accompanied by a weak dynamics of expenditures, the deficit reached the best level since year 2009 and in relation to the nominal GDP it arrived at 2.1 %.

2. Overall Economic Performance

Gross domestic product shrunk by 0.9 % in 2013, it thus contracted for second year in a row. All significant items of demand apart from the final consumption expenditures of government institutions contributed to the fall

Year 2013 was a second recession year in a row. Gross domestic product (GDP) contracted in total by 0.9 %², which was a comparable decrease as in the preceding year. The lowering of performance was similarly to year 2012 a result of the strong pressure of weak demand after gross fixed capital formation, i.e. investment – it contributed to the lower GDP by -0.8 p.p. If in 2012 a slower increase of the stock of inventories occurred in comparison to 2011 in the economy, for the whole year 2013 the inventories in the aggregate fell (due to the slump in Q2) and contributed thus to the contraction of GDP -0.2 p.p. – increase of inventories in the economy renewed again only in the second half of the year. In 2013 the result of foreign trade also contributed to the decrease of GDP (-0.3 p.p.), which occurred last in year 2007 – i.e. on the top of boom resulting from strong domestic demand causing high imports. Opposed to this, in 2013 a negative contribution on the part foreign trade was realised due to the notable fall of exports in Q1 in the year-on-year comparison combined with a relatively strong increase of imports in Q3, most likely allocated into the strengthening of inventories. If also the household consumption negatively contributed to the development of GDP (-0.1 p.p.), the only demand item, which prevented a deeper contraction of GDP in 2013, were the final consumption expenditures of the government institutions (+0.4 p.p.) – in aggregate two years lasting fiscal restriction limiting the consumption of government institutions did not continue in 2013 anymore.

Growth of GDP by 1.9 % in the last quarter of 2013 in the q-on-q comparison was affected mostly by considerable increase of the balance of taxes on products and product subsidies, only then it was caused by real increase of the Czech economy performance

Gross domestic product expanded by 1.9 % in the last quarter of 2013 compared to the previous quarter. Such high rate of growth has not been observed since Q1 2007 (2.3 %). However, if we compare the quarter-on-quarter dynamics of GDP with the increase of gross value added (+0.6 %), it is obvious, that the main share on the significant rate of growth belonged to the notable increase of the balance of taxes on products and product subsidies, only then the growth of actual performance of the domestic economy. Reason behind the increase of the balance can be seen in the announced raising of the consumption tax on tobacco starting at the beginning of year 2014 – the traders with this good thus pre-stocked in the last quarter of 2013 and paid its consumption tax, which consequently led to a significant growth of collected taxes on products.

Contraction of performance of domestic economy halted according to the quarter-on-quarter data in the half of 2013

The effect of uneven collection of taxes on products however had an impact throughout the whole year 2013. If it was possible to attribute the marked contraction of GDP in the quarter-on-quarter comparison by 1.2 % at the beginning of year 2013 in part to the weaker collection of taxes on products (again due to the pre-stocking of tobacco products in the last quarter of year 2012 and thus a higher collection of taxes in this period), the quarter-on-quarter rate of growth in Q2 (+0.3 %) was partially affected by a low comparative basis. Only the following increase in Q3 2013 (similarly by 0.3 %) showed, that the contraction of the Czech economy performance ceased – the gross value added increased for the first time in seven quarters, specifically by 0.2 %. Quarter-on-quarter rate of growth of gross value added from the last quarter of 2013 in the amount of 0.6 % confirmed this turn.

² In real terms, adjusted for seasonal and calendar effects – unless stated otherwise. Contraction of GDP in 2013 according to non-adjusted data also corresponded to 0.9 %, which was compared to year 2012 by 0.1 p.p. a better result.



Quarter-on-quarter growth of GDP in the CR in the last quarter of 2013 was based on accessible data the highest among the EU28 countries

Expansion of GDP in the CR in the last quarter of 2013 – in the quarter-on-quarter comparison – was definitely the highest among the EU28 countries in the view of accessible data. The second place belonged to Sweden (+1.7 %) followed by Lithuania and Slovenia (similarly by +1.2 %). In the whole European Union the GDP expanded by 0.4 %. If at the beginning of year 2013 the GDP in the CR was declining faster compared to the EU28 (by 1.2 %, in the EU28 only by 0.1 %), in Q2 the expansion in the CR was slightly lower (by 0.3 % compared to 0.4 %) and in Q3 the rate of growth already attained similar values. In the year-on-year comparison the GDP in the CR expanded by 1.3 % in the last quarter, i.e. by 0.2 p.p. more than in the EU28. The highest year-on-year rate of growth was recorded in Lithuania (+3.3 %), the deepest contraction occurred in Italy (-0.8 %).

Final consumption expenditures of households did increase already a second quarter in a row in the last quarter of 2013 (in the year-on-year comparison), these numbers were however influenced by very low comparative basis from the second half of the previous year

Final consumption expenditures of households increased by 0.7 % in the year-on-year comparison in the last quarter of 2013. The increase of consumption thus occurred already a second quarter in a row (following a mild increase by 0.3 % from Q3), however this development was to a high extent influenced by a very low comparative basis from the second half of the year 2012. So we cannot most likely talk about the recovery of the household consumption yet and it can be assumed, that it will not happen until the time, when the income situation of households improves. This for now do not confirm neither the latest data regarding the development of real wages (in Q4 2013 the wages in the year-on-year comparison fell by 2.9 % - despite this number being strongly affected by marked bonuses paid out in the last quarter of 2012, in the last eight quarters the real wages were reduced already for the sixth time), nor the data related to the unemployment rate of persons aged 15-64 years, which in Q4 2013 reached still high 6.8 % (which is compared to a two-year average only by 0.2 p.p. less). Only the Business Cycle Surveys thus still speak about the optimism of households-consumers, pointing to the gradual mitigation of no-confidence of consumers in the economy already since the half of 2012.

Final consumption expenditures of government institutions has not dropped any more in 2013 – the volume of government institutions consumption was higher in all individual quarters of year 2013 year-on-year

Throughout the whole year 2013 the final consumption expenditures of government institutions were year-on-year increasing. If in Q1 and Q2 of 2013 these were higher year-on-year by 1.3 % respectively by 1.5 %, in Q3 and Q4 by 2.6 % and 2.1 %. The growth occurred in 2013 after nine quarters lasting fall. The fiscal restrictions on the expenditure side thus stopped, nevertheless from the increase of the year-on-year rate of growth in the second half of the year 2013 for the time being cannot be deducted further easing of consumption – its growth above the 2 % level in both quarters had roots in very low comparative basis in the second half of year 2012.

In the last quarter of 2013 investment expanded by notable 5.1 % in the quarter-on-quarter comparison and their level was comparable with the Q3 of the previous year

In the last quarter of 2013 the volume of new investment in the economy very significantly expanded. If in Q2 2013 the investment fell in the quarter-on-quarter comparison already sixth quarter in a row, only in Q3 it went up by moderate 0.4 %. In Q4 2013 however it increased by high 5.1 %, which was the rate of growth not observed since the beginning of year 2008 (+13 %). The volume of created investment in the last quarter of 2013 was thus higher even in the year-on-year comparison (by 2.7 %) and comparable to the level of investment realised in Q3 2012.

Increase of investment in the year-on-year comparison in the last quarter of 2013 was apparent mostly for machinery and equipment; investment into buildings, constructions and dwelling however still missing in the domestic economy

Increase of investment in the last quarter of 2013 directed especially into machinery and equipment – these investment increased by 6 % year-on-year (the structure of investment in non-adjusted data), when their volume had been falling the whole six preceding quarters. Investment into the transport equipment increased too (by 1.9 %, already third quarter in a row), which benefited also the domestic automobile industry, but also into intangible fixed assets, which is a type of investment, whose accumulated balance is compared to other investment relatively low. On the contrary in the Czech economy there is still missing the investment into buildings and constructions (year-on-year decreasing already eleven quarters in a row) and investment into dwellings, which had not grown already twelve quarters in a row. This consequently lowers the performance of the domestic construction in the long term. From the development of the structure of investment in the last quarter of 2013 it can be assumed, that mostly businesses shared on this growth, most likely expecting the improvement of demand for its production. The increase of investment of businesses is thus consistent with the development of confidence of entrepreneurs in the economy.

The optimism of domestic businesses can be also discern from the gradual increasing of the value of inventories in the economy in the second half of year 2013

The development of inventories in the Czech economy also confirmed the positive expectations of businesses in relation to the future economic development. If in Q1 and Q2 of 2013 a gradual reduction of inventories still eventuated by 1.8 and 10.6 bn crowns in current prices, in Q3 the value of inventories already increased by 4.7 bn crowns and in the last even by 6.6 bn crowns (quarter-on-quarter). Even though the already mentioned pre-stocking of tobacco products also probably contributed to this development, its roots most likely lie in the positive anticipations of the future demand development.

Foreign demand for Czech products revived step by step during year 2013. The result of foreign trade however contributed favourably to the performance of the domestic economy in the quarter-on-quarter comparison only in Q2 and Q4

The result of the foreign trade contributed to the development of GDP favourably in Q4 2013 – the exports expanded compared to the preceding quarter by 1.1 %, imports only by 0.3 %. This development was thus the parallel of the Q2 2013, when the exports rose by 2.6 % and imports by 0.6 %, but it was the opposite of Q3, when the exports increased by 1 % and imports by 3.2 %. From the development of exports, which in quarter-on-quarter comparison enlarged apart from Q1 2013 throughout the whole year, a very gradual recovery of the foreign demand was visible. The growth of demand abroad most likely led to the increase of optimism on the side of businesses, which started to increase their inventories. These were most likely partially satisfied from abroad, which proves the already mentioned notable quarter-on-quarter rate of imports in Q3 (+3.2 %).

All main components of demand with the exception of inventories, which grew in the year-on-year comparison slower, worked in the last quarter of 2013 in the direction of year-on-year growth of GDP

The increase of investment (+0.6 p.p) the most strongly participated on the growth of GDP in the year-on-year comparison by 1.3 % in the last quarter of 2013, contributing negatively for the whole nine preceding quarters. The final consumption expenditures of households, final consumption expenditures of government institutions, but also the result of foreign trade contributed as well to the growth of GDP similarly 0.4 p.p. The change of inventories (-0.5 p.p.) was thus the only component of demand, which worked in the direction of GDP fall. The inventories in the economy did increase in the last quarter of 2013, however their growth was weaker compared to the same period of the previous year.

The industry strongly contributed to the growth of the aggregate gross value added in the economy in the year-on-year comparison by 0.6 % in Q4 2013, increasing its performance by 2.9 %, in that the manufacturing industry itself by 3 %, ...

As already mentioned, the gross value added increased by 0.6 % in Q4 2013 compared to the preceding period and grew already second quarter in a row. It also increased by the same portion in the year-on-year comparison, the growth eventuated for the first time since Q1 2012. Mostly the industry (CZ NACE B-E) contributed to the growth of gross value added in the year-on-year comparison, increasing its performance by 2.9 %, in that the manufacturing industry itself by precise 3 %. It can be assumed, that the growth of the performance of the manufacturing industry was the result of the gradually improving foreign demand during the year in connection with the marked investment activity in Q4 at home.

...on the contrary the gross value added in services as a whole was going down compared to the same period of the previous year already seventh quarter in a row in the last quarter of 2013

The drop of gross value added continued in the year-on-year comparison on the contrary in the group of economic activities trade, transportation, accommodation, restaurants and in information, communication activities (in the last quarter of 2013 similarly by 0.9 %), but also in activities in the real estate area (-2.4 %) or in professional activities (-3.5 %). The gross value added in services as a whole (CZ NACE G-U) fell in the year-on-year comparison for already seventh quarter in a row in Q4 2013 and thus reflected both the weak domestic demand and the saving measures in the public sector. The activities including agriculture, forestry and fishing (-5.7 %) also returned to fall following the year-on-year growth of gross value added in the amount of 1.4 % in Q3 2013.



Chart 1 **GDP (constant prices, adjusted for seasonal and calendar effects, in %)**

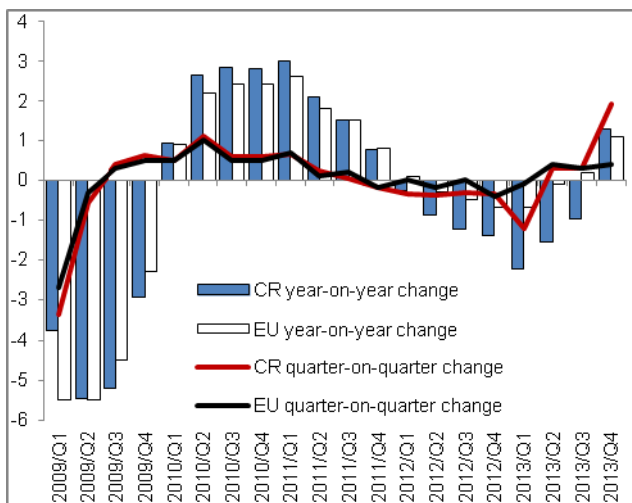
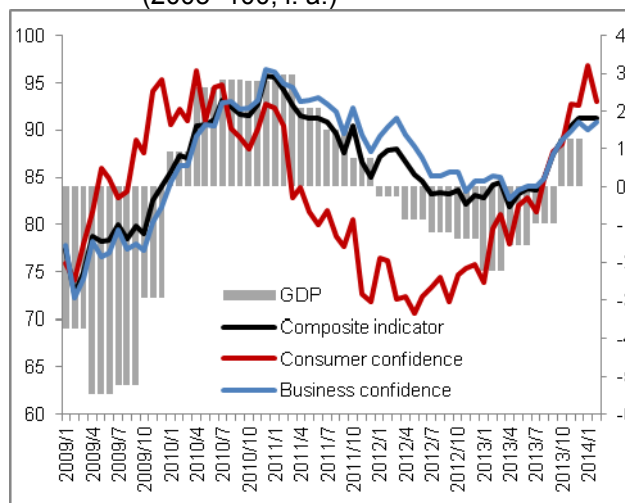


Chart 2 **GDP (constant prices, adjusted for seasonal and calendar effects, y/y in %, r.a.) and confidence indicators (2005=100, l. a.)**



Source: CZSO, Eurostat

Chart 3 **Contributions of expenditure items to GDP change (constant prices, y/y in p.p.)**

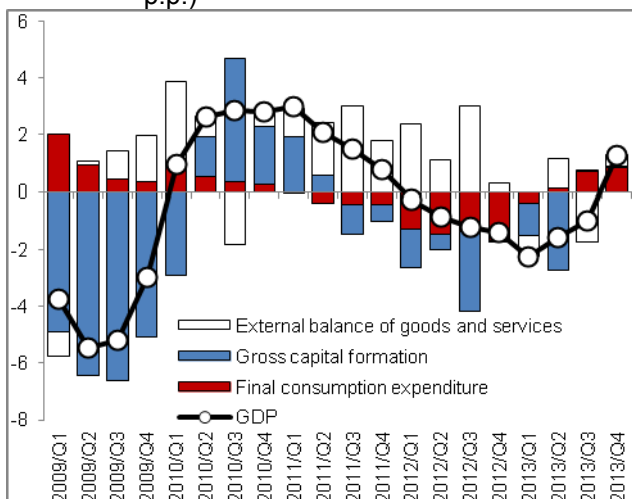
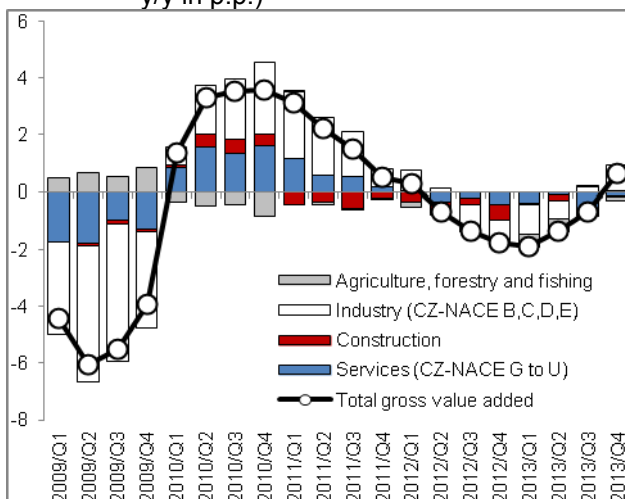


Chart 4 **Contributions of branches to change in gross value added (constant prices, y/y in p.p.)**



Source: CZSO

3. Industry Performance

Depth of the year-on-year drop of GVA for the whole year 2013 comparable to year 2012

Marked recovery of foreign demand of the manufacturing industry led in Q4 2013 to the highest quarter-on-quarter growth of GVA (+3 %) in the economy for the last three years

Year-on-year growth of GVA was in 2013 limited only to the manufacture of transport vehicles and associated industrial activities and also on some segments of the financial sector

Seasonally adjusted size of the gross value added (GVA), reflecting the performance of the industries in the Czech economy, fell in real terms in 2013 (-0.8 %) similarly to the preceding year. The adverse result was affected mostly by the development in the first half of the year, when the inadequate demand curbed performances especially of the investment-oriented industrial activities. In Q3 the quarter-on-quarter growth of the GVA creation renewed after a year and a half, which turned even in the mild year-on-year growth (+0.6 %) in the last quarter after the same duration of time. The manufacturing industry participated by a decisive way on this revival. The growth of GVA however has not been reflected yet in a more significant increase of the hours worked, including the manufacturing industry itself.

Eccentric development of GVA in the financial sector (in 2013 year-on-year by +8 %) is somewhat relativized by a low comparative basis (against the year 2011 the GVA only stagnated) and a low weight of financial and insurance activities in the creation of value added of the whole economy. The manufacturing industry also had a negligible contribution to the year-on-year change of GVA, however for the reason of differentiated development within year 2013. Regardless of good harvest of grain

Long-term fall of GVA continued in agriculture (also due to higher intermediate consumption) and construction (lack of large both public and private orders being at fault)

the value added in the agriculture fell by one tenth, the volume of inputs in this economic activity grew faster than the production. The fall of value added in the agrarian sector is a more long-term phenomenon, for the last four years the GVA decreased in real terms by more than one third. Negative trends also prevail in the construction in the long term, when in 2013 the depths of year-on-year decreases of hours worked (-5.8 %) as well as aggregate employment (-2.5 %) reached four-year lows. Due to the mild recovery of new orders in the civil engineering construction accompanied by favourable climatic conditions at the end of year 2013 the depth of fall of value added was on the contrary mitigated, however still the performance of construction was weaker compared to year 2007 by one tenth in real terms.

Services apart from the financial sector remained free from substantial signs of revival during 2013 due to still tightened final consumption expenditures

The dynamics of value added apart from the value in the financial sector did not differ much within the services sector in 2013, in contrast to the industry there were no noticeable signs of revival during the year. The cluster of economic activities significant by weight - trade, food service activities, accommodation and transportation (with the drop of GVA in the activity by 1.6 %) contributed the most to the year-on-year fall of the total GVA among the services. Contrary to the industry, the employment in the conception of national accounts grew more significantly across the services activities in 2013 (with higher dynamics the positions of the employee nature) supported also by the growth of hours worked (except for trade, transportation, accommodation and food service activities with year-on-year fall of 2.6 %).

Shallow year-on-year drop of GVA contrasted for most services with mild growth of both employment and hours worked

Notably uneven year-on-year development of industrial production within year 2013

Marked change of the dynamics of the industrial performance (according to the index of production) during 2013 was to the major extent affected by the considerable revival of foreign demand especially for transportation vehicles, noticeable already since the beginning of summer. Industrial production (adjusted for calendar effects) similarly being situated nearly 3 % below the last year's level in both Q1 and Q2, expanded in the last quarter (+7.2 %), partially also due to the effect of low year-on-year comparative basis. In the quarter-on-quarter expression, the industry was gaining pace by 2.5 % (in Q3 +2.3 %) towards the end of the year, mild growth was apparent throughout the whole year 2013.

Improvement of year-on-year dynamics of production during 2013 nearly in all manufacturing branches

Revival during 2013 occurred in the form of more favourable year-on-year dynamics of production nearly in all manufacturing activities, mainly in the manufacture of motor vehicles, rubber and plastic products, basic metals, metallurgy or manufacture of other non-metallic mineral products. The exception was formed by manufacturing of food products (with long-time stagnating production), long-time dampened manufacture of leather products and also coke and refined petroleum products (hit by a long-time recession of the mining industry). In the last quarter the production increased year-on-year in $\frac{3}{4}$ of manufacturing branches.

Marked revival of foreign demand for transport vehicles and machinery assisted in the second half of the year to the export-oriented industry of the CR to lift the industrial production in 2013 to a mild growth

Production of the manufacturing industry following the actual stagnation in 2012 returned a year later to a mild growth (year-on-year by +1.5 %), especially thanks to the manufacture of basic metals, motor vehicles and machinery. Deep fall of the foreign demand on the contrary takes its toll on the manufacturers of computer, electronic and optical products, whose production has been falling for already ten quarters in a row (it weakened by one quarter in the last two years). The chemical industry did not in 2013 continue (-2 %) in the successful previous year (+5 %). Real production in the manufacturing industry attained the level of boom from year 2007 in 2013 (exceeded the level however only in one third of manufacturing activities: apart from the manufacture of motor vehicles with some subcontractor branches also in the chemical and pharmaceutical industry), it was lower by one eighth in the energy industry, even by one sixth in mining and quarrying.

The dynamics of industrial production of activities oriented on short-term, long-term consumption or investment (year-on-year +1.3 %) did not differ in total in 2013 opposed to the previous years. The production of activities focused predominantly on the manufacture of intermediate products increased the most (+2.0 %), e.g. manufacture of rubber products, basic metals or electrical appliances. Mild decreases from the previous two years deepened (-4 %) in the branches focused on manufacture of energies in 2013.



In H2 2013 record value of new foreign orders in manufacture of transport vehicles, but also a notable revival of domestic demand in key manufacturing activities

Important point of turn in the demand for industrial products is evident from the sharp growth of nominal value of foreign orders during the year 2013. This value increased year-on-year for motor vehicles as well as other transportation vehicles (manufacture of railway locomotives and rolling stock) by whole one third in the second half of the year and reached the highest rate of growth for the last decade. After five quarters of stagnation the manufacturing of machinery and equipment also fared well (H2 +11 %), as well as the metallic constructions (+17 %), where the foreign demand have grown already 16 months in a row. Branches mentioned above also revived also due to the growth of the domestic demand at the same time (+15 % for manufacturers of motor vehicles), which also proves the strong interconnectedness of subcontractor relations.

Long-term trend of faster dynamics of sales on direct exports continued

In total for 2013 only the manufacturers of computers, electronic and optical appliances faced the falling demand to a larger extent. The long-term growth of new foreign orders compensates the larger fluctuations of the domestic demand in the textile and pharmaceutical industry. The advance of the dynamics of the value of new orders from abroad over the domestic orders represents for the CR industry a long-term phenomenon, which is also apparent from the development of nominal sales. These in 2013 for the direct exports accelerated the year-on-year growth to 5.1 % (from last year's +2.9 %), while the domestic sales fell by 2.3 % (after last year's stagnation).

CR belonged to one third of the EU countries with the fastest growth of industrial production in 2013

Real value of industrial production in the CR was even in spite of a slight growth (+0.7 %) the eight highest in the EU28 in 2013. We can find higher year-on-year dynamics in the newer countries of the Union, next to Romania (+7.3 %) also in Poland (+5.2 %) and Slovakia (+2.4 %), it stagnated in Austria and Germany, weakened by 0.5 % in the whole EU. Compared to year 2007 the industry in Slovakia and Poland strengthened the most (by one quarter, resp. one fifth), it was lower by 3 % in the CR and it stagnated in Germany. It was lower by one tenth in the whole EU, mostly because of South European countries – it fell by one quarter in Italy, nearly by one third in Greece and Spain.

Deep downswings of production also continued in both building construction and civil engineering construction to the lowest level in the last decade in 2013

Adverse tendencies in the construction prevailed as a result of long-term fall of investment activities in the economy also in year 2013. Construction production year-on-year dropped by 6.7 % in real terms (comparable rate of fall as in 2012), without larger differences between (more significant by weight) building construction (-5.6 %) and civil engineering construction (-9.3 %). Yearly development was affected by deep falls of production in H1 (in both quarters it was year-on-year by near one eighth lower). On the contrary in H2 the revival of new orders in the civil engineering construction as well as the favourable climatic conditions helped and the production in the whole construction did not fall quarter-on-quarter anymore.

Gauged year-on-year however, the construction production has been falling already seventeen quarters in a row (if we do not take into account the Q1 2011, when the mild growth of production was the result of very low comparative basis of the preceding year). The whole year growth in production was last recorded in 2007. The current year's performance of construction corresponded to the level in real terms of year 2003, it was lower by 27 % against the boom year (2007) (in building construction), resp. by 14 % (in civil engineering construction).

Lasting low investment activity in the economy pushes the value of new orders to historical lows

The value of new construction orders (for businesses with 50 and more employees) remained practically on the last year's (historically the lowest) level mainly because of continued downturn of building construction in 2013. The new orders in the civil engineering construction did increase year-on-year by one sixth, nevertheless their nominal value was still the third lowest for the last decade. The value of new orders decreased nearly by one half in five years (for building constructions), resp. by near 40 % (for civil engineering constructions). The average value of newly closed order still displays a slow rate of fall (in 2013 it amounted to 3.6 mil crowns) as well as the approximate value of one issued construction permit (mostly for non-housing constructions).

The average size of orders keeps declining, as well as their total stock negatively marked mostly by the lack of large public orders

Lack of new orders towards the end of 2013 transferred also to a low value of all construction orders (141 bn crowns). Notable slump of the value of total public orders (by one tenth) was also accompanied by year-on-year slower downswing (-2.6 %) of private orders. Lower volume of these orders could not be compensated

by a dynamic boost of by weight so far marginal orders from abroad (+58 %), these shared in nearly 17 % on the value of all orders of construction businesses towards the end of 2013. On the contrary, the stock of public construction orders was compared to year 2008 lower by more than one half and their proportion on all orders of construction businesses fell below the 50% boundary for the first time in history.

Number of started dwellings attained after continuous falls the level of middle 90s in 2013

Saturation of the market with dwellings due to intensive housing construction from boom years in combination with the drop of real household incomes is reflected in the current low frequency of both started and completed construction. The number of started dwellings has been declining already sixth year in a row, its size was one half compared to the top of boom (for housing constructions only one third). In 2013 only dwellings in multi-dwelling buildings increased year-on-year (because of extremely low comparative basis) and among regions significantly only dwellings started in Prague (+19 %).

More than third of completed dwellings in the CR is located in Prague and Central Bohemia in the long term

Number of completed dwellings fell by one seventh year-on-year (to 15-year minimum) without significant differences in types of buildings. More than third of completed dwellings was located in Prague and the Central Bohemia in 2013. Protracted lack of orders led to further deepening of the registered number of employees in 2013 („core“ labour force in this economic activity), the construction thus lost in physical persons over 50 thousand employees for five years of continuous decreases.

The depth of construction production slump in the CR in 2013 the fifth highest in the whole EU

The depth of year-on-year slumps of construction production was deeper in the CR compared to the EU28 in the last four years. Against the top of boom the production cut in real terms a whole quarter in the CR, comparably to Slovakia or the whole EU. This level exceeded only in five member countries (in Germany by 5 %, in Poland by 17 %) in 2013.

Mild year-on-year drop of sales in services lasted also during 2013

Sales in selected services³ in the aggregate continued in tendencies of the last four years and mildly weakened in real terms in 2013 (year-on-year by -0.9 %). The growth of sales in transportation and storage already continues for nearly four years (+4.2 %), mostly thanks to the warehousing and support activities for transportation (+7.9 %), however all main types of transportation generated higher sales year-on-year, except for the postal and courier activities (-8.5 %), which fell already for second year. The rate of growth of sales of the most significant activities by weight - land transport and transport via pipelines (similarly to warehousing) was strengthening in connection with the revival in industry and foreign trade during the year 2013.

Recovering industry contributed to higher sales in transportation and storage, foreign tourism to accommodation activities, shifts in the labour market then to job agencies and management consultancy activities

The differentiated development continued in the area of accommodation, restaurants and food service activities, where the sales in real terms for accommodation have been growing for more than four years (+2.1 %), which was the result both of the discount strategies of accommodators and the rising frequency of overnight stays of non-residents. Restaurants and food service activities on the contrary face long-term difficulties, despite the depth of falls of sales in real terms slowing down this year (to -0.8 %) and recorded growth in Q3 for the first time since 2007. However, for the last six years the sales in this branche slumped by 30 %. The growth dynamics of sales of job agencies mildly weakened (+6 %, still in four years the sales were raised by two thirds). The demand for management consultancy activities and telecommunication activities or security and investigative activities increased. The market research and public opinion polling still experience a mild growth. A larger reduction of sales occurred in majority of information and communication activities, real estate activities, architectural and engineering activities, travel agencies and especially advertising activities (year-on-year by one eighth, since the beginning of deep recession by two fifths).

Deep slump of sales in advertising activities, long-term reduction for real estate activities

Since Q2 a mild growth of retail sales renewed due to marked revival in the motoristic segment and internet sales

The development of real retail sales (incl. the motoristic segment) was uneven during the year 2013. A year lasting year-on-year slump in sales halted in Q2, the dynamics of sales growth strengthened for the remaining part of the year up to 3.6 % in Q4 (after adjusting for calendar variations by 4.2 %). The motoristic segment gaining strength contributed to a more favourable result during the year (Q2 +3.6 %, Q4

³ Do not contain the activities of trade, financial and insurance activities, science and research and also the public services.



+10.3 %), both in case of trades and maintenance of motor vehicles. The dynamics was also strengthening for sales of non-food products, which were boosted also due to the pre-stocking (because of fears from price rises) towards the end of the year, mainly in specialised shops with computer and communication equipment and products predominantly for households. On the contrary the mild decrease of sales in businesses predominantly with food has continued for already ten quarters (for the whole year 2013 year-on-year by 1.1 %), the long-term weakening of real sales at petrol stations also lasted (-3 %), not even the mild reduction of prices did improve the results.

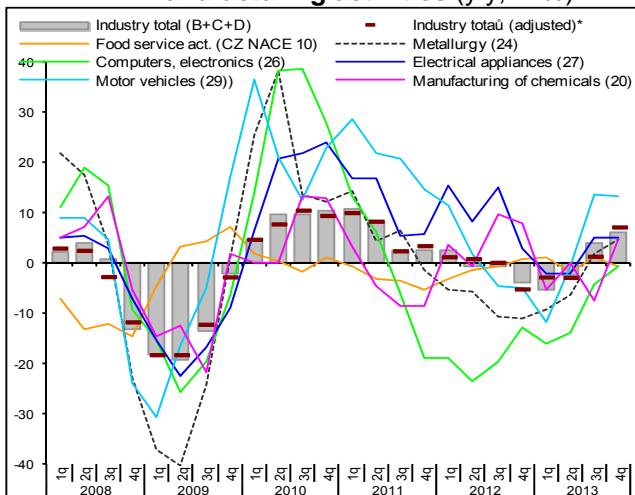
The decreasing retail sales on automotive fuels continued to display stronger rates of fall, in five years the sales were in real terms lower by one sixth

In the whole retail the sales strengthened by 1 % in 2013, stagnating against the year 2011. Internet sellers returned to high rises from times of top of boom (+27 %) during 2013, their sales more than doubled in real terms compared to 2007. Discount strategies assist also the information and communication equipment (+9 %), clothes and footwear (+3 %) in the long term. In other specialized stores the sales stagnated in 2013 (books, paper products, furniture, electrical appliances and electronics, cultural and recreational goods) or slightly weakened (pharmaceutical, medical, cosmetic and chemist articles).

Dynamics of retail sales in the CR (excl. motoristic segment) above the EU level in the long term, mostly for non-food goods, reversely for sellers of automotive fuels

Year-on-year dynamics of CR retail sales in real terms (excl. the motoristic segment) (apart for year 2010) already exceeded the level of the EU28 in the last decade, resp. the original member countries (EU15). In 2013 these sales rose by 0.2 % in the CR (in the whole EU they were reduced by 0.1 %), similarly to most neighbour countries, except for Poland (+4.6 %). They mildly grew among large economies in Great Britain (+1.4 %) and France (+1.2 %), long-term decreases hit the Netherlands (-3.8 %) and states of the South Europe (notably Greece -8.1 %). The CR enjoys even more favourable position towards the whole Union in the area of non-food goods in the long term, on the contrary with the depth of year-on-year falls of sales of automotive fuels (-3 %) in 2013 it strongly stayed behind the EU (-1.2 %) and all neighbours (Germany +3.5 %, Slovakia +3.2 %).

Chart 5 Production in industry and selected manufacturing activities (y/y, in %)



* data adjusted for number of working and calendar days
Source: CZSO

Chart 6 New orders in manufacture of motor vehicles and industry in total (y/y, in %)

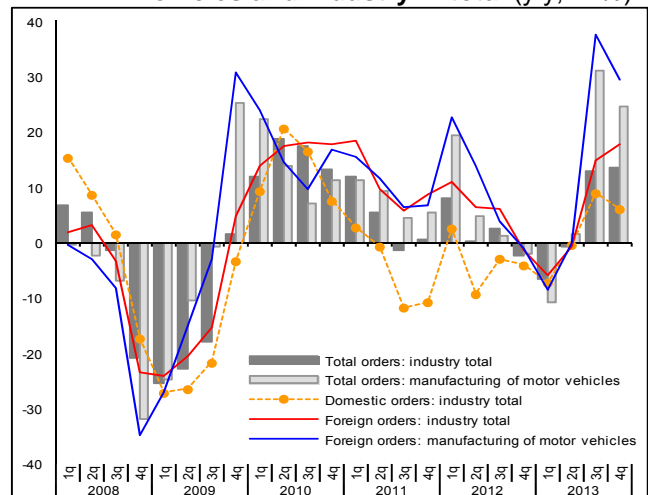
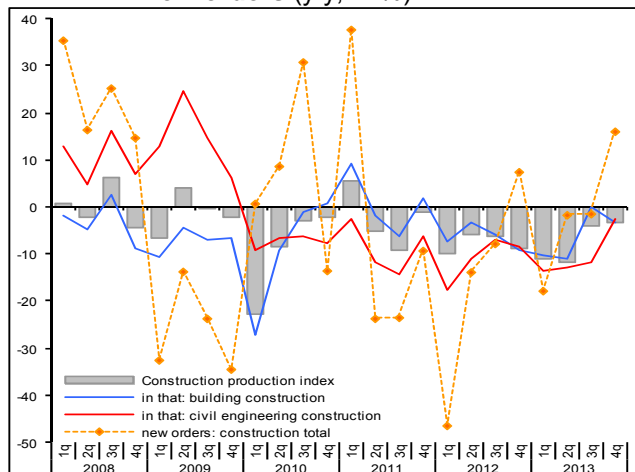
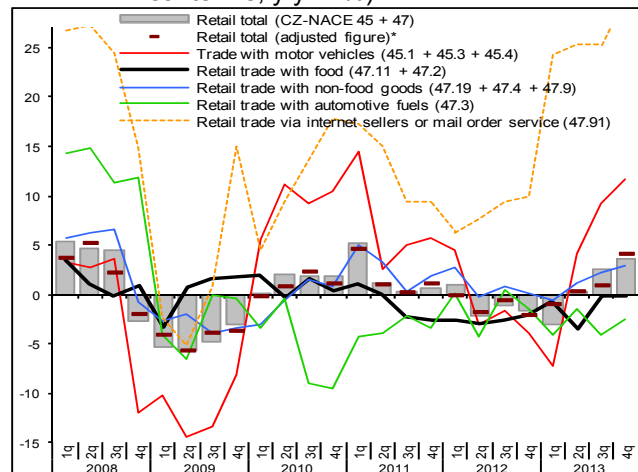


Chart 7 Construction production and value of new orders (y/y, in %)



* data adjusted for number of working and calendar days

Chart 8 Retail sales incl. motoristic segment (in real terms, y/y in %)



Source: CZSO

4. External Economic Relations

External balance did not worsen and remains relatively favourable...

External economic relations based on the deficit of the current account of balance of payments did not virtually change in 2013 – its deficit in the amount of 56 bn crowns was only by 4.7 bn crowns deeper compared to the preceding year. In relation to the nominal GDP, the current account deficit of 1.4 % reached the third lowest in the last nine years and compared to year 2012 (1.3 %) increased only negligibly. It means, that in years of recession and with relatively weak dynamics of prices the CR maintains a favourable level of external balance.

... with comfortable coverage of the current account deficit by marked surpluses of other items of the balance of payments

Current account deficit is comfortably covered by the surpluses of other items of the balance of payments – only the capital account balance itself would suffice to its elimination (+74.6 bn crowns) without the need to consider the high surplus on the financial account (+187.9 bn crowns). Also from this view the external imbalance in the Czech Republic does not present a problem for the economy.

Record trade balance as well as notable improvement of current transfers result improved the current account imbalance...

Current account maintained in practice the same level due to the improved trade balance for the whole year 2013, its surplus rose by 39.4 bn crowns and was (according to imports and exports data in the national conception in FOB prices) in fact the best result for the time of the CR existence. The result of current transfers was the second factor working towards reduction of the current account deficit, improving by 17.8 bn crowns (to 15.4 bn crowns) due to the effect of payments from the EU funds, which had an atypical progress in both 2012 and 2013. Also in case of current transfers, the result is the best for the last nine years.

... on the contrary the income balance and reduced surplus of the trade in services made it worse

Outflow of dividends of companies under foreign control had the highest effect on further deepening of the income balance deficit, which worsened by 52.7 bn (to 312.5 bn crowns). Data for the whole year are not yet available, however the outflow of dividends was year-on-year lower in 2012 (204.1 bn crowns, i.e. by 14.4 bn) despite the profits from the preceding year 2011, where the dividends originated, not yet being hit by the recession.

Except for the worsened income balance, the CR earned less also in the trade in services. Here the balance was worse by 9.3 bn crowns compared to 2012. Lower revenues from transportation and markedly weaker than from exports of other services (revenues from tourism remained approximately the same) participated in the surplus of 53 bn crowns.

Year-on-year lower inflow of foreign direct investment due to the repayments of loans to parent companies

The CR gained foreign direct investment in the amount of 97.7 bn crowns. It was less than in 2012 (156.3 bn), but still the investors here together with the reinvested profits and new capital entrances spent 155.6 bn crowns, the most since year 2007. At the same time however the loans of subsidiaries to parent companies abroad were being repaid, in the highest volume so far annually



recorded (57.9 bn crowns). It was just this transfer, which lowered year-on-year inflow of foreign direct investment into the CR in 2013.

Return of funds into the country in the form of portfolio investment

Inflow of funds into the CR in the form of portfolio investment intensified (net balance 94.9 bn against 54.8 bn crowns in 2012). While the interest of foreign investors in Czech bonds increased – in contrast to their purchases in 2012 – only mildly (+8.3 bn to 92.4 bn crowns) and revived also their interest regarding the Czech shares, domestic entities on the contrary realised profits from sales of their purchased foreign bonds. If they spent net for these bonds in 2012 22.1 bn crowns, in 2013 the funds in this form on the contrary returned back into the CR in the amount of 7.6 bn crowns. Also the appetite of Czech portfolio investors to purchase foreign shares – also with respect to their high prices on capital markets – markedly weakened.

Neither direct nor portfolio investment would in spite of their flows manage such a high level of the financial account surplus, i.e. its jump year-on-year by 113.6 bn crowns in 2013. The item of so called other investment stood behind this development with its balance year-on-year swinging from the deficit of 110.4 bn into the surplus of 58 bn crowns. It occurred due to massive transfers of funds in the sphere of commercial banks.

Strengthening imports from half of 2013 proves the improving demand in the Czech republic economy

With respect to the very favourable result of the CR trade balance, the development of imports – according to the CZSO data in the national conception in the current prices, CIF - showed also together with other characteristics of the production nature during 2013, that the Czech economy started to recover from the second half of the year. The positive year-on-year increases of total imports can be attributed to improved domestic demand also for foreign goods – in July these grew as a whole year-on-year for the first time in seventeen months (+3.7 %) and in December the value of imports was even already higher by 17 %.

Exports of the most significant items gained above average pace in the long term, with the highest year-on-year dynamics then the exports of wood, furniture, medicines and beverages –double-digit December rates of growth influenced similarly to imports by weakened exchange rate of crown

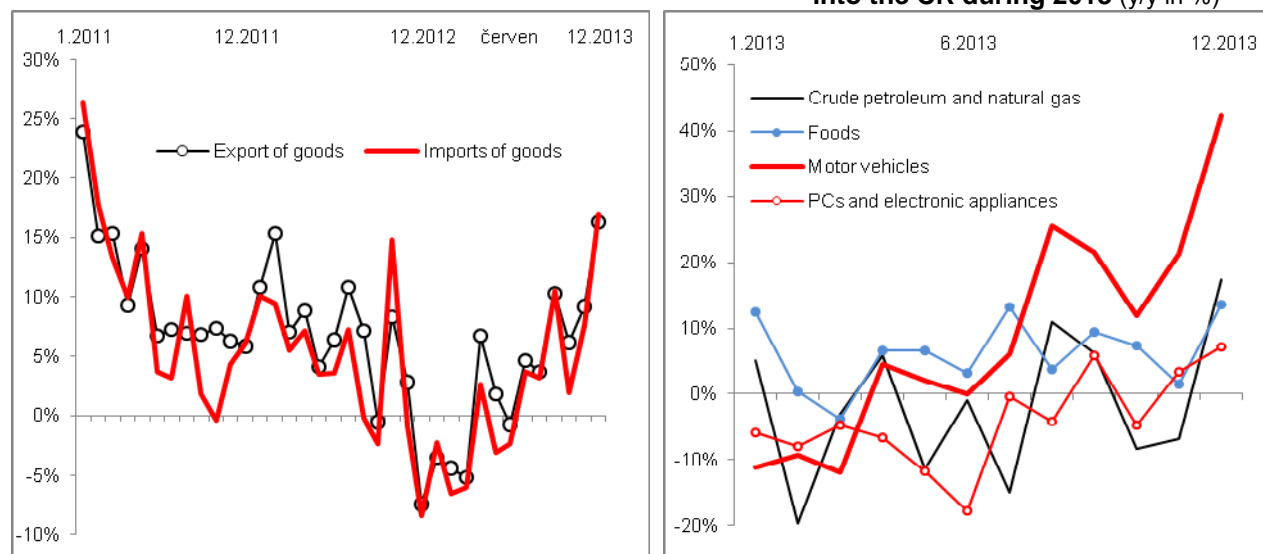
Exports of goods from the CR⁴ following the increasing year-on-year falls in the first three months of 2013 (in March by -5.2 %) started to gain pace and its dynamics significantly accelerated (+16.4 % in December 2013). Regarding the individual products, the exports of „non-machinery“ commodities such as wood (+28 %), furniture (+17 %), hides (+14 %), further then medicines (+13 %) and beverages (12 %) experienced the highest growth. If we consider the exported value, the increments were rather smaller, which follows from the nature of this goods. Among significant export items the CR earned for exports of motor vehicles and their parts according to the data of foreign trade statistics in the national conception by 32 bn crowns more (+5.8 %), for exports of electrical appliances by 15 bn more (+6.8 %) and for exports of other machinery⁵ by 20 bn crowns more (+6 %) in 2013 compared to 2012. Only the exports of energy commodities (black coal -26 %, electricity -22 %, crude petroleum and natural gas (-14 %)) were notably weaker year-on-year, with the falling prices on world markets playing a role. It was also less exported of clothing (-0.4 %), recording media (-11 %), coke and refined petroleum products (-5 %). The third largest by volume item of exports from the CR, concretely computers and electronic appliances (-4 %) was also in negative numbers.

Enlarged dynamics of exports corresponded to the improving demand in the European Union countries, the double-digit growth in December was also affected by the weaker crown (similarly as in case of imports).

⁴ Based on data in the national conception in the current prices, FOB.

⁵ Item of the classification of products (CZ-CPA) „Machinery and equipment n.e.c.“.

Chart 9 Imports and exports of goods (y/y in %) Chart 10 Imports of selected types of goods



Source: CZSO

5. Prices

Year-on-year growth of aggregate price level in the economy – gauged by the implicit GDP deflator – accelerated in Q4 2013

Aggregate price level in the economy gauged by the GDP implicit deflator⁶ increased by 2.2 % in Q4 2013 in comparison to the same period in the preceding year and exceeded thus the rates of growth from the previous quarters (1.8 %, 1.6 % and 1.6 %). Especially the favourable terms of trade, which followed from the growth of export prices by 3.4 %, while the import prices grew only by 1.5 %, participated on the growth of the price level. Price level of the overall consumption expenditures grew by 0.8 %, investment prices (gross fixed capital formation) by 0.6 %.

Costs of living of the average household based on the inflation rate grew in the CR in 2013 the slowest since 2009

Inflation rate was equal to 1.4 % in 2013, the lowest value since 2009 (1 %). Low price growth was given by the weak overall domestic demand in connection to the „import of deflation“ from abroad, which was reflected in lower prices of inputs (materials, semi-finished products, raw materials) and consequently via the production chain transferred into the prices of final products, which did not have in total a high tendency to grow. If in the average Czech household cost of living increased by 1.4 % in 2013, costs of living of households of pensioners rose by slightly higher 2 %. However also for the households of pensioners, the year 2013 represented the lowest increase in prices since 2009 (1.5 %).

Slowing down of year-on-year growth of prices for consumers lasted in the last quarter of 2013 already the seventh quarter in a row. If it was not for the increase of both rates of VAT in January 2013 by 1 percentage point, the year-on-year growth of prices would be in Q4 2013 already nearly zero

Year-on-year growth of prices for consumers was slowing down throughout the whole year 2013. If still in Q1 2013 the prices were year-on-year higher by 1.8 %, the rate of growth gradually weakened via 1.5 % and 1.2 % until final 1.1 % in Q4. The falling year-on-year rate of growth of prices lasted already seven quarters in a row. Such a low increase of prices for consumers in the year-on-year comparison, apparent in the last quarter 2013, has not been observed since the beginning of year 2010 (0.7 %). If it was not for the administrative amendments of the VAT rates at the beginning of year 2013 (both rates were upsized by 1 p.p.), which immediately manifested in January 2013 in the month-on-month rising of prices by 0.8 percentage points (prices grew by total 1.3 % compared to December 2012), the year-on-year increase of prices would be in the last quarter of 2013 already nearly zero.

Slowing down of the price dynamics in the CR was not unique, it occurred across the whole Europe in 2013, some of the European Union countries even faced deflation

Slowing down of rising of prices in the CR in 2013 was not at all an isolated occurrence. According to the internationally comparable harmonised index of consumer prices, the prices in the CR rose against the same period of the preceding year in quarters by 1.7 %, 1.5 %, 1.2 % and 1.1 %. The rate of growth of prices decelerated even faster in the EU28 – from the original 2 % in Q1 2013 via 1.6 % and 1.5 % to final 1 % in the last quarter. Weak demand led to the decline of year-on-year growth of prices across the whole Europe, some of the countries

⁶ Adjusted for seasonal and calendar effects.

even had to face deflation – in Greece the prices were curbed by 2.2 % year-on-year in the last quarter of 2013, in Bulgaria by 1 %, Cyprus by 0.8 % and Latvia by 0.2 %.

During 2013 the year-on-year increase of prices of significant groups of goods in the consumption basket decelerated, prices of transportation were lower throughout the whole year

More than half of consumption expenditures of average household in the CR consists of resources on housing, water, energy and fuels together with food and non-alcoholic beverages and transportation. If still at the beginning of year 2013 the prices of housing, water, energy and fuels were by 2.6 % year-on-year higher, in the last quarter especially due to slowing down of prices of energies only by 1.2 %. The same conclusion was also valid for food and non-alcoholic beverages, whose prices increased by 4.9 % in Q1 - and even though the growth gained pace (as a result of temporarily faster growth of prices of bakery products and vegetables) to 5.4 % and 5.3 % during the year – at the end of the year the prices were only by 4.1 % higher. Prices of expenditures on transport were throughout the whole year 2013 – because of year-on-year lower prices of petroleum on the world markets and cheaper transport vehicles – even in the year-on-year decrease.

Only the expenditures on clothing and footwear and expenditures on recreation and culture worked in the direction of higher inflation, which however could not reverse the trend of decline of year-on-year increases

To these more significant groups add also the gradual slackening of the year-on-year rate of growth of prices for alcoholic beverages and tobacco, expenditures on health, restaurants and accommodation, but also the year-on-year price reduction in the segment of postal services and telecommunications and household equipment, and gradually we come to a conclusion, that the only groups, which pressed on higher inflation during the year 2013, were the prices of clothing and footwear together with recreation and culture, which broke free from the long-term deflation development in Q3. More favourable price development for these goods however could not in any way reverse the trend of gradual deceleration of growth of prices for the consumers, since in the aggregate these two groups formed in total consumer expenditures only roughly one eighth.

Non-zero growth of prices in industry in 2013 due to the January increase of prices in the energy sector and water supplies

Prices in industry in the aggregate rose by 0.8 % in 2013, which corresponded to the lowest price raise since the significant slump in the crisis year 2009. Weak growth of prices in this area was given by the nearly stagnating prices in the manufacturing industry (+0.2 %) - which this way adapted to the overall weak demand – in connection to the deflation development in the segment of mining and quarrying affected by the very low prices of coal on the world market. Only the prices in the energy industry and water supplies pushed in the direction of price raises, which were together already third year in a row adjusted upwards immediately in January.

Weaker exchange rate of crown has not managed to manifest in the prices of industrial producers in Q4 2013 – year-on-year rate of growth of industrial producer prices was only by tenths of percentage point higher in Q4 than in the previous quarters

In Q4 2013 the prices in industry increased compared to the same period of the previous year by 0.8 %, which was only by tenths higher growth compared to the preceding two quarters (0.5 % and 0.7 %). At the same time, the rate of growth of prices in the energy industry and water supplies nearly did not change compared to Q3. The same was also valid for the manufacturing industry, which in the prices of the industry as a whole shares the largest weight. If the weaker crown following the intervention on the part of the central bank the most intensively expressed itself in the boosted growth of prices of transportation vehicles (because of higher price dynamics for motor vehicle parts) – the growth of prices by 1.2 % in Q3, already by 3.5 % in Q4 – in other branches of the manufacturing industry on the contrary eventuated the lowering of rates of growth or deepening of falls, which in the aggregate led to the continuing actual stagnation of the prices of manufacturers. A mildly higher growth of prices in the industry as a whole thus occurred only as a result of lower deflation in mining and quarrying in Q4 2013.

Agricultural producer prices were in the aggregate higher by 4.5 % for the whole year 2013, however, growth-rates weakened very fast in individual quarters (in Q4 in deflation)

Prices of agricultural producers were raised by 4.5 % in 2013, which was slightly higher growth compared to the preceding year (+3.8 %). If still in Q1 2013 the prices were year-on-year higher by 14.4 % and in Q2 by 9.3 %, in Q3 already only by 1.4 % and the disinflationary development transformed into deflation in the last (year-on-year fall of prices by 4.2 %). This occurred due to the year-on-year reduction of prices of vegetable production in the second half of the year – the prices of vegetable production were curbed by 2.6 % in Q3, already by more than one tenth in the last.

Prices in construction fell by 1.1 % in 2013, the most in last four years, when they were

The prices in construction were reduced by 1.1 % in 2013. The price adjustment downwards thus arrived already fourth year in a row, the cut in 2013 was the deepest. If the prices in construction were in the year-on-year comparison lower

continually lowering, ...	by 1 % in Q1 2013, by 1.3 % in Q2 and Q3. In Q4 however the year-on-year fall slowed down to 0.8 % and it is possible to infer from the development of the index, that the trend of falling prices in the construction ceased in the half of year 2013 – the question however remains, whether this occurred as a result of heightened demand for construction in the second half of the year supported by the above-average warm weather in the last quarter or the simple fact, that the long-term reduction of prices in construction hit the limits, signalling the prices of costs, and further potential reduction of prices was not possible any more.
... for the second year the prices of market services were also falling	The decline in prices of market services also continued in 2013 (by 1.5 %). They were cut for the second year in a row (in 2012 cut of 0.6 %) and thus completed the overall picture of unfavourable price development in the production chain in the CR. If the prices of market services were year-on-year lower by 0.5 % in Q1 2013, by 1.7 % in Q2 and even by 2.1 % in Q3. Only in the last quarter of 2013 the prices of market services slightly narrowed the reduction in the year-on-year comparison (to 1.9 %), especially due to the milder deflation in transportation and storage, which could be a signal regarding the end of deepening of reduction of prices resulting from the gentle revival of the domestic resp. foreign trade.
For the first time in three years the domestic economy recorded the improvement of terms of trade in 2013	Prices of exported goods went up in total by 1.2 % for year 2013, which was the weakest raise since year 2010 (-1 %). With respect to the reduction of prices of commodities in the world, a deflation was imported from abroad in 2013(-0.2 %), consequently contributing to the lowering of production costs and in the end to the disinflationary process in the CR. Growth of export prices accompanied by the reduction of import prices led to the improvement of the terms of trade by 1.4 %, which has not been apparent in the CR for whole three preceding years.
Still in Q3 2013 the export prices were in the year-on-year comparison higher only by 0.4 %, the weaker crown however contributed to a notable acceleration to 2.9 %	Central bank intervention (carried out at the beginning of November 2013) contributed to the crown depreciation against euro in the year-on-year comparison by 5.9 % in the last quarter of 2013, which consequently assisted the growth of export prices by 2.9 %, when they still grew only by mere 0.4 % in Q3. Among significant groups of goods on the side of exports the prices of machinery and transportation vehicles increased notably (by 3.7 %) in the last quarter of 2013 (when the year-on-year growth did not overtake the boundary of 2 % in no previous quarter), the prices of exported beverages and tobacco however increased the most (by more than one fifth, when they still grew by 8.8 % in Q3).
Weaker crown cut the deflation in the year-on-year expression on the side of imports in Q4 2013, still a significant improvement of the terms of trade occurred	Weaker crown also assisted the rising of prices of imported goods. In the last quarter of 2013 the import prices increased precisely by one percent in the year-on-year comparison, falling in all the previous quarters of the same year. Still the increase of the year-on-year rate of growth was not as high as on the side of exports – for exports the year-on-year rate of growth rose by 2.5 p.p. in the last quarter, for imports by 1.9 p.p. If the terms of trade thus improved in the year-on-year comparison by 1.2 %, 1.3 % and 1.3 % quarter by quarter in 2013, in the last quarter they increased by 1.9 % and the Czech economy thus expanded the profits from the favourable development of prices in the foreign trade.



Chart 11 Growth of consumer prices for individual types of households (y/y in %)

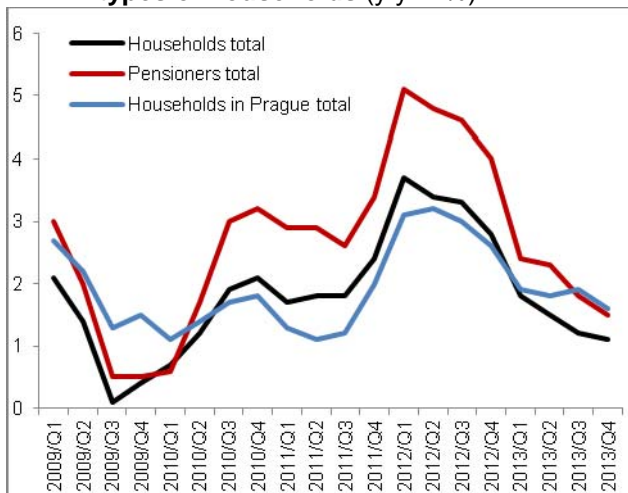
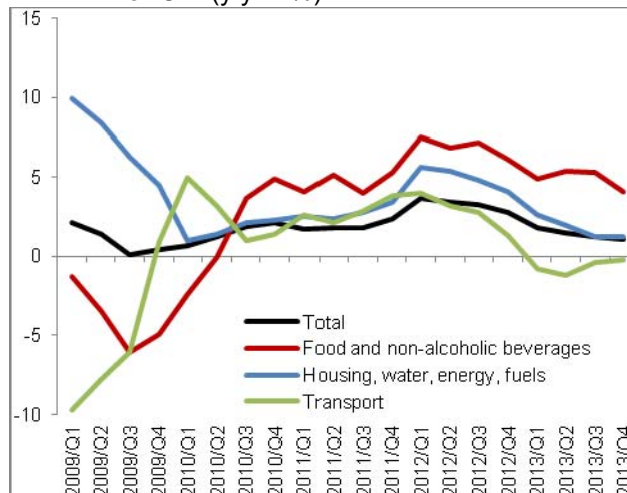


Chart 12 Growth of prices in selected divisions of CPI (y/y in %)



Source: CZSO

Chart 13 Deflators (adjusted for seasonal and calendar effects, y/y in %)

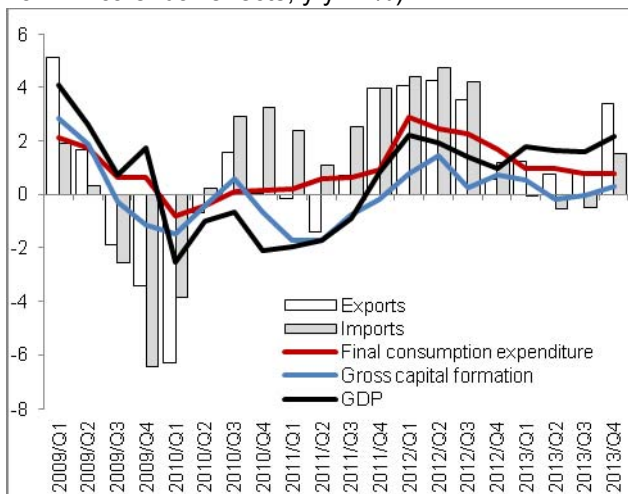
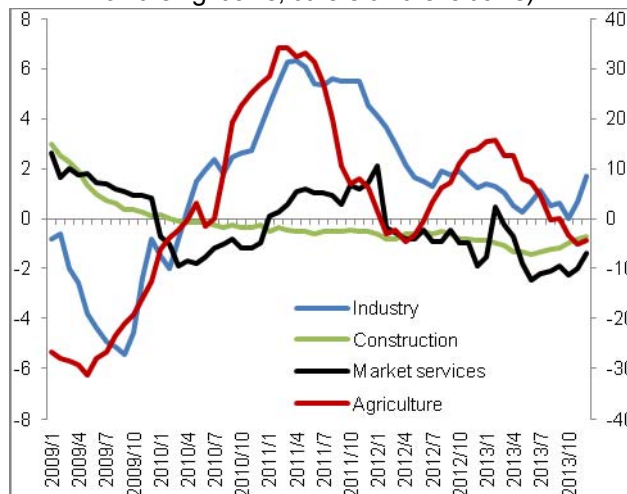


Chart 14 Producer prices (y/y in %, prices in agriculture on the right axis, others on the left axis)



Source: CZSO

6. Labour Market

Aggregate employment highest since 2008, in the second half of the year the rate of growth however did not accelerate any more

Labour market according to the employed persons expanded in 2013 the most in the last five years. Year-on-year addition by 0.9 % was not however even one half compared to the average of the boom period (for years 2005-2008 it added up to 2 %). In the second half of the year based on seasonally adjusted data in the national accounts conception the growth of the aggregate employment did not accelerate any more – the number of persons being employed was on the contrary gradually falling to 5 117.7 thousand persons in the last quarter during the year, which was less than the whole year average (5 124.2 thousand persons). Labour market was thus in this view the third strongest in 2013 in the last nearly two decades.

In 2013 significant addition to employed persons also in the public services, having lost nearly 41 thousand job positions in the previous four years

Compared to year 2012 less persons worked only in agriculture and construction. In the manufacturing industry and the group of services activities (trade, transportation, accommodation and restaurants), where a quarter of persons employed in the CR economy works in both cases, the aggregate employment increased by 1 %, resp. by 0.5 %. On the contrary the economic activities with a relatively low weight on total employment in the economy recorded roughly the triple rate of growth of employed persons (e.g. ICT year-on-year +2.7 %). Also the growth of employment in the public services (+2.5 %) was significant, with the

employment always year-on-year falling in the previous four years (in total there were 40.7 thousand jobs lost in this time period).

Strong dynamics in fixed-term employments...

Following a year-on-year stagnation in the number of employees in 2012, its marked improvement arrived in 2013 (+1.6 %). The dynamics was however – similarly to the aggregate employment – stronger in the first two quarters (+2 %, resp. +2.3 %). The addition to the number of employees was lower than yearly average only in the agriculture and industry.

Wariness of businesses in hiring new employees into the „core numbers“ is however still apparent. According to the data of the Labour Force Sample Survey (LFSS) namely the numbers of fixed-term employees increased during the whole year – in Q3 the proportion of those working in these employments already amounted to more than one tenth (10.2 %) from the total number of employees, in Q4 10 %. While in 2011 the stated ratio was 8.5 % of the overall number of employees, in 2012 it climbed to 8.8 % and in year 2013 the share of fixed-term jobs was already nearing also one tenth (9.6 %) of all employees in the CR economy.

... and in part-time jobs

The part-time jobs also follow a similar development. This form of employment was chosen or needed to be chosen by 5.5 % of employed persons in 2011, in 2012 already 5.8 % and in 2013 the share of persons working part-time arrived at 6.6 % out of total number of employed persons in the CR. The share has been growing continually every quarter since year 2012. Opposed to this, the fixed term jobs feature certain „seasonality“ – every 1st quarter of each year, the proportion of these employees against the preceding quarter mildly falls, it climbs up during the year and in the last quarter again mildly decreases. It can be assumed, that these types of jobs can be significantly utilised in branches of seasonal jobs (agriculture, construction).

Hourly labour productivity grows due to the fall of hours worked in the economy ...

The dynamics of the number of hours worked also corresponds to the logics of increasing share of jobs to other than „standard“ employment contracts – number of people, who boosted the labour market grew faster to the number of aggregate hours worked (in 2013 year-on-year -0.8 %, in Q4 -0.9 % and quarter-on-quarter even -1.6 %). However, it was not valid for the industry sector and most branches of the services sector.

Stagnating number of hours worked has been apparent in the economy for already three years in a row. If we relate the product created (the size of gross value added in the economy) to the number of hours needed to its creation, we gain the growth of hourly labour productivity, while the labour productivity per one worker on the contrary kept falling as a consequence of the rising number of employed persons in both recession years (-0.1 % year-on-year in 2012, -0.6 % in 2013).

... which is not however valid for activities with part-time jobs or fixed-term jobs represented to a lesser extent

Hourly labour productivity rose in the CR economy in 2012 year-on-year by 0.4 %, in 2013 already by 1.1 %. This trend was not however reflected in the manufacturing industry and in total for activities of trade, transportation, restaurants and accommodation services – where together more than half of persons employed in the CR works; further then in the services activities, where the drop of hourly labour productivity either deepened (e.g. in ICT -8.8 % against -2 % in 2012) or newly arose (real estate activities with -2.3 % compared to +2.3 % in 2012).

Unemployment rate did not fall substantially during the year 2013

Based on the monthly data, which beginning the year 2013 the CZSO commenced to record seasonally adjusted, the general unemployment rate (related to the population aged 15-64 years)⁷ given the trend curve slightly lowered, however the actual fall was apparent only in the period February-June (from 7.3 % to 6.7 %). In the second half of the year the labour market from the view of unemployment already only stagnated between 6.9 %-7 % unemployed persons. Female unemployment rate was however even in this period continuously falling (from August 8.5 % to December 8.1 %), which can indicate, that it is just the female labour force which is absorbed on the labour market in the form of fixed-term jobs or part-time jobs more intensively.

⁷ According to the definition of the International Labour Office (ILO).



Market has also absorbed in the so far not seen extent the part of labour force, which previously acted in the group of economically inactive⁸ (rate of economic activity as the share of employed to unemployed of this group age reached in the so far highest level since 1993 in Q4, i.e. 73.3 %). The number of long-term unemployed persons also decreased (year-on-year by 12 thousand to 150.1 thousand persons in Q4). Still, they represent more than two fifths (42.2 %) out of total number of unemployed in the CR economy.

Historically the deepest fall of the average monthly nominal as well as real wage in Q4 2013 ...

The sinking of real wage in the non-business sector lasts already more than four years in a row, two years in the business sector. The real wage in total for the economy fell year-on-year by 1.3 % in 2013, in Q4 itself its lowering was by 2.9 % historically the deepest slump since the commencement of observation. Especially the stagnation of the nominal average monthly wage stood behind the fall of the real wage in the Czech economy (+0.1 % to 25 125 crowns recalculated to average number of registered employees to full time employed). Consumer prices did not grow according to the inflation rate, shrinking the development of the nominal wage to a large extent (+1.4 %) in 2013. Yearly stagnation was influenced by the year-on-year lower nominal wage in the first three months of the year, but especially in Q4, when it fell by 1.8 %. Again it presented the worst wage result in the CR history, with the effect of the comparative basis of extraordinary compensations standing behind it.

Historically for the first time also the average nominal monthly wage of the employees of businesses fell in 2013.

...with respect to a marked impact of year-on-year lower extraordinary bonuses especially in high-income branches

Large extraordinary bonuses in the last quarter of 2012 pushed up at that time year-on-year very significantly the rate of growth of wages in the business sector (nominal +4 %, real +1.2 %), also placing the total result for the CR into positive numbers.

It was this high comparative basis playing a major role in the marked drop of wages in the same period of year 2013, where the extraordinary bonuses were year-on-year lower. This movement in the extraordinary bonuses eventuated especially in branches with high average wages, which were since year 2013 burdened with the so called solidarity tax (7 % for wages exceeding in any month 103 thousand crowns). In the last quarter of 2013 thus in the financial and insurance activities the average nominal wage sank by 18 %, in the energy industry then by 12.6 % - this decreased the nominal wage in the business sector by 646 crowns and in the figure for the whole economy by 464 crowns (in the non-business sector this effect in reality did not occur). Thus for the whole year the average monthly wage remained practically the same in the CR economy (+16 crowns) with a negligible decrease in the business sector (-28 crowns) and increase by 213 crowns in the non-business sphere. However, there works over four fifths of employees in the businesses (in recalculated balances).

Differentiation according to industry – with respect to number of employees, wages did not decrease to most of them

It is important, that in the manufacturing industry, which is key especially for the employment of the key employees, the nominal wages did not fall (+1.3 % for the whole year 2013, +0.9 % in Q4). Considerably worse development in Q4 is suggested also by the fact, that while for the whole year 2013 over 63 % of the total number of employees worked in the industries characterised by growth resp. stagnation of the nominal wage (recalculated to the number of full-time employees), in Q4 it was already only 53 %. Still, this high proportions of persons in industries, where the wages did not fall can indicate, that the impact on the effective demand of households does not have to be fatal. What is however clear is the inflation effect „nibbling away“ from the increments of these wages and deepening the total decrease of the real wage in the CR economy, which was deeper in the business rather than the non-business sector.

⁸ Persons who do not work, do not seek work in an active manner and thus do not comply with the ILO conditions for the unemployed, yet they state they would like to be working. Statistics captures the numbers of these persons aged 15-64 years for the calculation of the ratio „employed/unemployed“ of this age group, i.e. the rate of economic activity.

Chart 15 Aggregate employment and numbers of employees (y/y in %, seasonally adjusted)

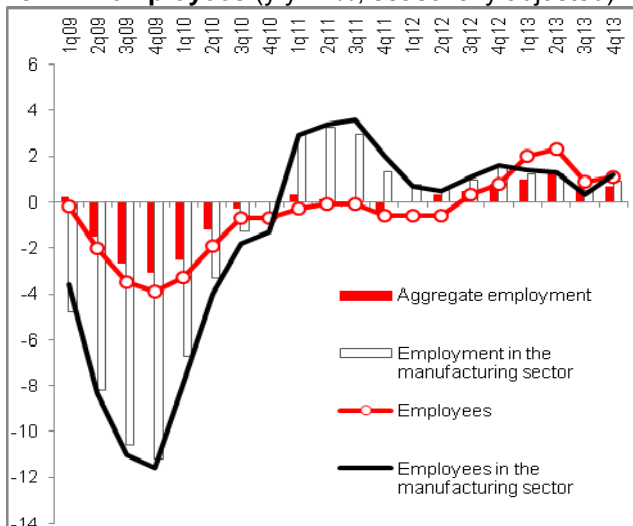


Chart 16 Nominal and real wage (y/y in %, recalculated numbers, monthly average)

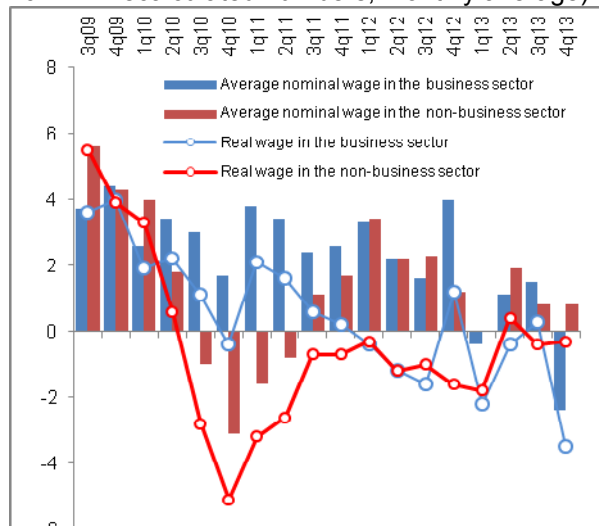


Chart 17 Annual development of wages (y/y in %, average registr. number of employees from seas. adjusted data)

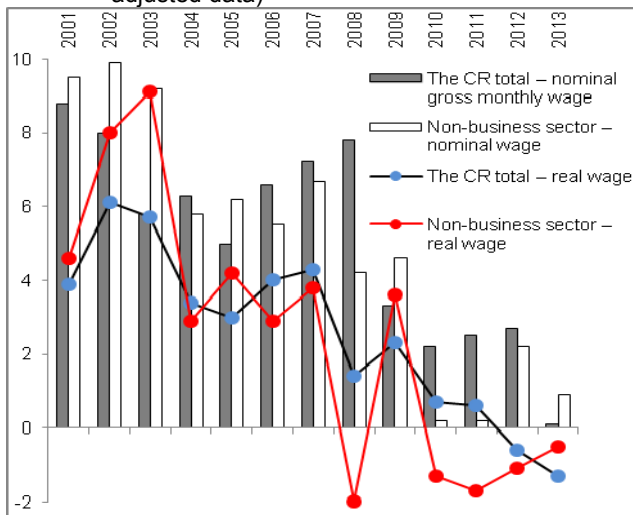
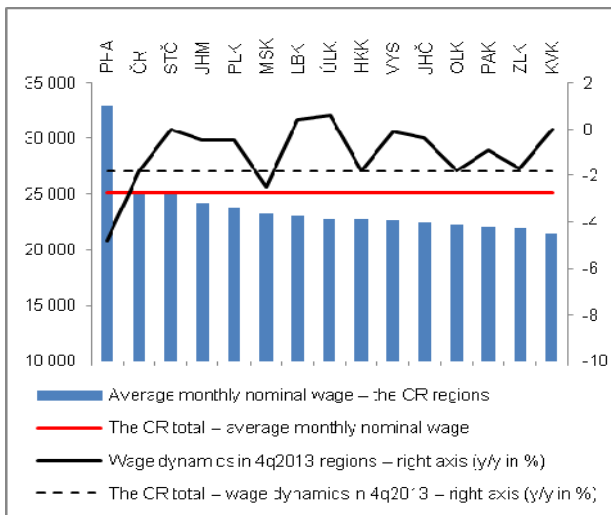


Chart 18 Gross average monthly wage in CZK (2013); wage dynamics in 4q2013 (y/y in %)



Source: CZSO

Note to chart 18:

Regions: Pha=Capital city Prague, STČ=Central Bohemia, JH=South Bohemia, PLK=Pilsen region, KVK=Karlovarský region, ÚLK=Ústecký region, LBK=Liberecký region, HKK=Královéhradecký region, PAK=Pardubický region, VYS=Vysočina region, JHM=South Moravia, OLK=Olomoucký region, ZLK=Zlínský region, MSK=Moravia-Silesian region

7. Monetary Conditions

Monetary intervention of the CNB from November 2013...

The most significant change in the monetary conditions in Q4 as well as throughout the whole year 2013 was the monetary intervention of the Czech National Bank, which to a considerable extent artificially weakened the exchange rate of the Czech crown. This action from the beginning of November had as its primary goal to prevent deflation with all the consequences, which arise from the fall of prices in the economy. Further construction in the form “Strengthening of competitiveness of exporters due to the weak crown - their higher incomes - creation of bigger number of jobs - improvement of growth of wages - increased household consumption (including the awareness of its initial weakening by the inflation impulse flowing from the higher import prices) - possibility of improved investment - long-term income effect in the form of higher growth of GDP” can be given the actual absence of the economic policy understood as an attempt to resolve the two-year recession of the Czech economy.

... - for assessment of

Risks flowing from the fact, that some of the expectations linked to the mentioned



wider impacts on the real economy still a very short time elapsed

construction are not going to be fulfilled, do not show according to the first „post intervention“ data from the real economy for the time being to be fatal. Faster growth of export prices compared to import prices strengthened given the import-export nature of the Czech economy the profits to the export companies. To explain the proven higher investment in the last quarter of 2013 by this fact is however still premature. Within the range of consumer prices, the inflation rate is low, production prices in the industry are following the first impact connected to the weaker crown affected as a whole by the slump of the energy prices. Household consumption stagnated quarter-on-quarter in Q4, wages were affected by extraordinary influences (more in the Chapter on Labour Market).

Expansion of bank loans to non-financial businesses provided in foreign currencies...

Significant turn arrived according to the banking statistics data in the loan dynamics provided to non-financial businesses (residents). Massive lending to businesses especially in foreign currencies is apparent approximately from August 2013 and both the rate and absolute additions to the balances of these loans further sharply increased towards the end of the year.

This commencement of the loan expansion targets mostly loans to businesses in foreign currencies and is dominated by long-term loans. While from August till December 2013 the aggregate balances of loans to businesses expanded on average year-on-year by 2.1 % every month - while in November and December by 4 %, resp 3.8 % -, increments of business loans in foreign currencies were several times higher they enlarged during that time monthly on average by 15.5 %, while in November by 22.5 % and in December even by 28.5 %. The month-on-month boosts in balances of these loans were especially sharp – in November they rose by 27.9 bn crowns compared to October, in that loans in foreign currencies by full 21.1 bn crowns. At the same time, such jump cannot be of course attributed to pure conversion of these foreign-currency loans into crowns due to the depreciation of the currency.

Simultaneously, the bank loans to non-financial businesses in foreign currencies are not with respect to volume in the Czech economy negligible (towards the end of 2013 they amounted to 22.2 % of total loans to non-financial businesses, for medium term loans even 31.6 %), even though the interest differential promotes in theory rather the loans in Czech crowns.

... occurs mostly for long-terms loans and there is hope for the expansion of investment activity

The long-term loans play the largest part in the sharp rise of loans to businesses – they shared 21.3 bn crowns out of total addition to bank loans to non-financial businesses from August till December in the amount of 31.2 bn. Analogous to this out of the additions to the loans in foreign currencies themselves the businesses borrowed from banks for a period longer than five years 15.5 bn crowns.

Since the long-term loans have an investment nature, their high proportion can be considered the start of the Czech economy to the revival of investment activity assuming these massive growths are not caused mostly by the financial investments. With respect to economic activity, majority of these additions to long-term loans belongs mainly to non-financial businesses specialised on the real estate area.

Deposits of households and businesses in total falling for the second year in a row

Deposits in the banking sector on accounts with maturity and accounts with a notice period were in the aggregate number for both households and firms by 2 % lower by the end of year 2013 in comparison to the same period of 2012, when however their year-on-year slump was even deeper (-3.8 %). In years 2011 and 2010 these deposits were still year-on-year increasing. The recession weakened the dynamics of disposable incomes of households, which had the decisive effect on the fall of total deposits – their regular deposits on accounts with maturity fell nearly by one tenth (-9.5 %) by the end of 2013 and thus also weakened the households deposits with a notice period (-1.3 %). People thus partially utilise the previously saved funds for consumption.

The rate of growth of loans to population on housing strengthened, consumption loans after the previous falls of balances went slightly up

In spite of less favourable situation with respect to the household incomes the loans to population were boosted in 2013 more than in 2012 – the balances of mortgages were year-on-year higher by 5.2 % in December 2013 and amounted to 852.1 bn crowns, in that mortgages 746.4 bn crowns (+6.6 %). The long-time falling balances of consumption loans also slightly revived (+0.4 % year-on-year compared to -0.7 %

from the end of 2012) and reached 195.2 bn crowns. It is however obvious, that the segment of loan clients is for both types of loans rather different.

Growing volume of both currency in circulation and property in mutual funds

The volume of currency enlarged year-on-year by 4.3 %, i.e. more than presented addition by the end of year 2012. It suggests, that a significant part of the household purchasing power can lie as ready cash in homes (hoarded money). Regarding the alternatives of household savings to bank deposits and their eventual strengthening to the detriment of these regular deposits, data known at the time of this analysis preparation were limited only to the volume of property in mutual funds. These data show, that households and institutions saved in domestic and foreign mutual funds operating in the CR in total 269.8 bn crowns by the end of year 2013, which was year-on-year by 14.7 % more. This very favourable expansion however does not mean that people and institutions purchased by 34.6 bn crowns more mutual fund shares. It is given mainly by the favourable development on the financial markets, especially the share markets (property in these markets enlarged year-on-year by 27.4 %), which above all enabled such strong increase of property.

Chart 19 **Bank loans to non-financial businesses in foreign currency (y/y, in %)**

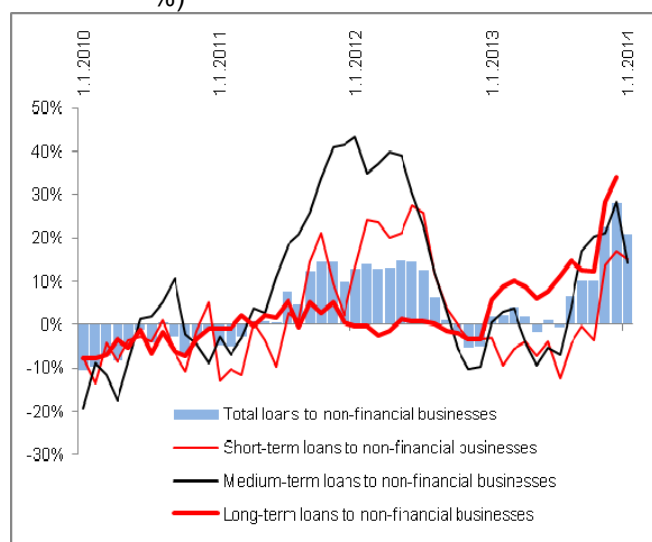
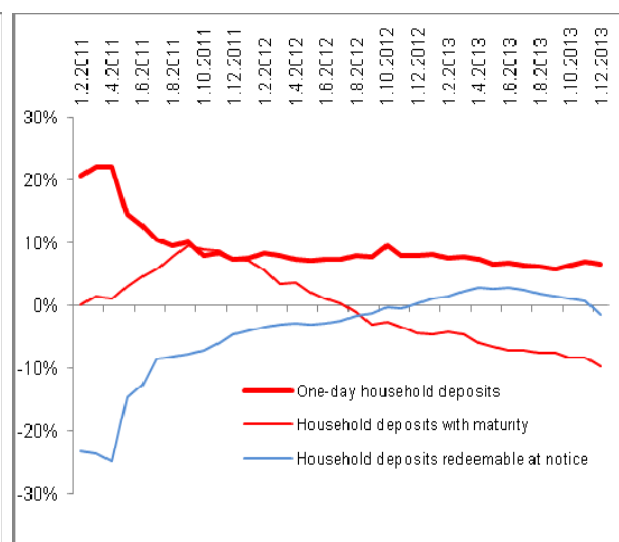


Chart 20 **Household deposits (y/y, in %)**



Source: CNB, own calculations

8. State Budget

Improving state budget deficit already four years in a row

Better result against the approved budget in 2013 ensured by lower than expected drawing of investments on transport constructions and savings on non-investment purchases

State budget revenues were pulled by the dynamic growth of VAT collection and continuing drawing of the European funds

Despite subsiding adverse development of the economy for the most part of the year, the tendencies leading to gradual consolidation of public budgets asserted in the development of state finances. State budget management for 2013 finished (according to cash fulfilment) with the lowest deficit (81.3 bn crowns) since the beginning of deep economic recession and was compared to the anticipations of the approved budget by one fifth lower. Simultaneously, it represented the fourth lowest deficit since the year 2003. The year-on-year milder deficit was the merit of the first half of the year, in the second half itself the deficit reached nearly 50 bn crowns (year-on-year by more than one half higher). The deficit in relation to nominal GDP improved to 2.1 % (year-on-year by 0.5 p.p.) in 2013.

The considerably higher dynamics of the state budget revenues (+3.8 %) ensured year-on-year more favourable result of the deficit given a slower growth of expenditures (year-on-year +1.8 %). Especially the non-tax and capital revenues grew (+31 bn crowns), the effect of normally significant by weight tax revenues⁹ was weaker (+9.5 bn crowns). Tax revenues were pulled mostly by the robust growth of VAT collection (+20.3 bn crowns), marginally also the physical person income tax from the dependent activity – e.g. employees (+2.8 bn crowns) and tax on property

⁹ State budget revenues could have been by 5.9 bn crowns higher, if it was not for the changes in the budget determination of taxes, which from the beginning of year 2013 strengthened the preference of municipal budgets to the detriment of both the region and state budgets.



transfers (+1.2 bn crowns). In all cases the administrative measures played a dominant role¹⁰. On the contrary the effect of economic recovery in the last quarter of 2013 could be partially reflected in the improvement of indirect taxes collection (especially VAT)¹¹, the year-on-year dynamics of direct taxes however did not change much during the year 2013.

Adverse development of the economy in spite of partial legislative measures influenced the consumption tax collection, which year-on-year weakened for all main types of consumption taxes

The collection of consumption taxes was fundamentally impacted for the most part of the year by the weak dynamics of final consumption expenditures, which thus overshadowed the influence of the legislation changes. The effect of the increase of rates for tobacco products, which similarly to last year induced their pre-stocking, in the view of state budget revenues subsided during the year 2013 (in Q1 year-on-year +5.5 bn crowns, for four quarters -0.2 bn crowns). Collection of the tax the most significant by weight on the mineral oils went down year-on-year by 3 % especially due to the long-time falling consumption of petrol, the effect also had the lowering of tax refunds on mineral oils to persons using these oils for the agricultural primary production.

Mild year-on-year growth of PPIT from the dependent activity mostly due to the legislative changes, other direct taxes kept falling as a result of the subsiding recession

Six quarters lasting weakening of the year-on-year dynamics of collection of physical person income tax (from dependent activity) was halted at the beginning of year 2013, when the state-wide collection increased by 5.3 % in 2013. The growth of collection apart from the administrative influences also reflects the situation on the labour market (moderate growth of the number of employees, dampened growth of the average nominal wages). The collection of other income taxes on physical persons, influenced among other things by the economic results of small entrepreneurs or drop of the interest rates on deposits in banks, was however weaker year-on-year. The state-wide collection of corporate taxes (not blurred by any significant changes of legislation) then also weakened year-on-year by similar rate (-6 %), which compared to the top of boom decreased even by a whole third.

State finance budget anticipations in 2013 fulfilled only for in terms of volume key VAT, year-on-year decline of fulfilment for all other significant revenues

In relation to the approved budget the state finances achieved year-on-year higher percentage of fulfilment in 2013 only for the VAT (simultaneously this item as the only significant one met the budget expectations). Lower fulfilment prevailed for all basic types of consumption taxes, for income taxes of both legal and physical persons (despite higher year-on-year collection) and for the absolute majority of other tax incomes.

Year-on-year by one fifth higher budget non-tax and capital revenues due to a more continuous drawing of funds from the EU during 2013

By more than one fifth higher year-on-year non-tax and capital revenues of the state budget were affected mostly by the revenues from the EU budget (+29 bn crowns) as well as payment of 6 bn crowns from the state enterprise "Lesy CR" into the revenues of the Ministry of Agriculture. The anticipated-in-budget year-on-year fall of revenues within the chapter "state debt" (-9 bn crowns) had the opposite effect.

Continuing of long-term drop of investment, growth of current expenditures

Year-on-year growth of state budget expenditures (+21 bn crowns) was completely under the direction of current expenditures (+3 %) in 2013, while the capital expenditures year-on-year continuously decreased already for the third time in a row (against the level reached three years ago they were by one quarter lower). Especially the investment into the transport constructions weakened year-on-year (-11 bn crowns). Expenditures on pensions the most significant by volume stopped (opposed to the anticipated increase in the planned budget) their year-on-year growth (-0.3 %) after more than five years. The size of all social benefits on the contrary in total grew from the start of the year (+1.4 %, on total state expenditures shared similar to last year 41.6 %). It was also assisted by the dissatisfactory situation on the labour market (continuing growth of unemployment, decrease of the real income of majority of population). State social support benefits increased year-on-year by 5 % in 2013, the expenditures on the unemployment benefits and other social benefits then by one tenth (e.g. assistance in material deprivation, disability benefits, contribution to care and sickness benefits). Drawing of all main items of social benefits (apart from pensions) was this year in relation to the approved budget year-on-year higher.

Aggregate amount of expenditures on social benefits year-on-year by 1.4 % higher, as opposed to previous years the expenditures on pensions fell, on the contrary the resources on state social support and other social benefits increased

¹⁰ In case of VAT it was the January increase of both rates by one p.p. in combination with the adopted measures against the tax evasion on VAT (e.g. compulsory deposits and registration duty for traders with automotive fuels), for taxes of physical persons then the cancelling of the element discount for working pensioners and introducing the so-called solidarity surcharge in the amount of 7 % on incomes exceeding the fourfold of the average wage. The collection of tax on transfer of property fully reflected the increase in the tax rate by one p.p. to 4 %.

¹¹ For the first two months of year 2014 the collection of VAT state-wide increased nearly by one fifth (resp. 10.3 bn crowns).

Halting of the year-on-year deepening of the pension account deficit due to the fall of retirees, deficit did not shrink however as collection of insurance lower than expected

Long-term deepening of pension account deficit given the year-on-year comparable weak reduction of incomes (social insurance on pensions) and expenditures (paid out pension benefits) stopped in 2013 (whole year deficit -50 bn crowns). Second quarter of 2013 also terminated the period of more than two years falling dynamics of pension insurance collection, still these incomes were in the aggregate for year 2013 year-on-year weaker by 0.3 %. Both surprisingly slightly falling number of retirees (-0.3 %) and the long-time growing share of recipients with permanently reduced pension affected the size of paid out insurance. Adverse situation on the labour market in 2013 also mirrored in the non-fulfilment (-6 bn crowns) of budget-anticipated collection of insurance.

Since its accession into the EU, the CR has so far gained in „net“ 333 bn crowns, one quarter of this amount only in year 2013 itself

Net positive position of the CR towards the EU budget achieved a record size in 2013, the difference between revenues and payments arrived at 84 bn crowns (year-on-year by +11 bn.). Nearly half of the revenues came from the structural funds. From the view of the CR revenues, the significance of the Cohesion Funds strengthens to the detriment of resources for the Regional Development Fund in the long term. For years 2004-2013 the CR paid to the EU budget 342.8 bn crowns and received from it 676.2 bn crowns.

In 2013 the lowest increment of the state debt since 1996, due to the considerable year-on-year fall of the volume of loans

Total state debt increased by 15.7 bn crowns during the year 2013, the size of the addition in absolute terms was less than one tenth compared to the preceding year. Markedly better result was reached thanks to the considerable drop in the volume of state treasury bills (-75 bn crowns) as well as issue of foreign bonds (-69 bn crowns). Three quarters of the state debt was allotted to the internal debt at the end of 2013 (whose size stagnated year-on-year), the exchange rate influences took care of a mild growth of foreign indebtedness while accompanied by a low volume of both loans and repayments. Given the structure of creditors the weight of financial institutions decreased to the benefit of non-residents and households (which at the end of 2013 held 4.9 % of the CR state debt).

Chart 21 State-wide collection of tax revenues and state budget balance development

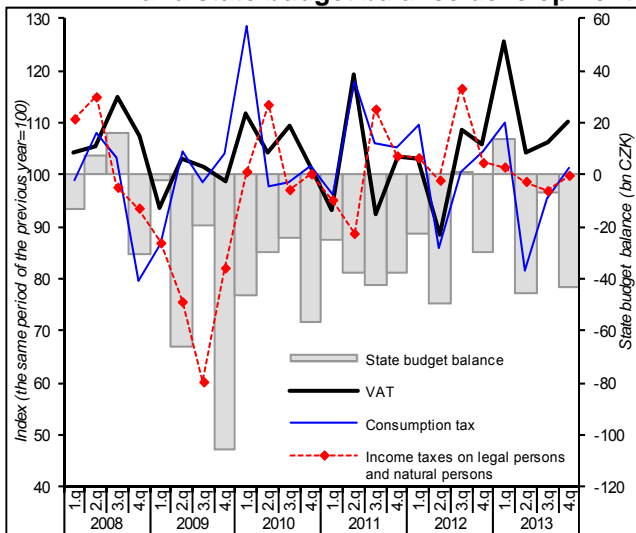


Chart 22 Pension account balance and number of pensioners development

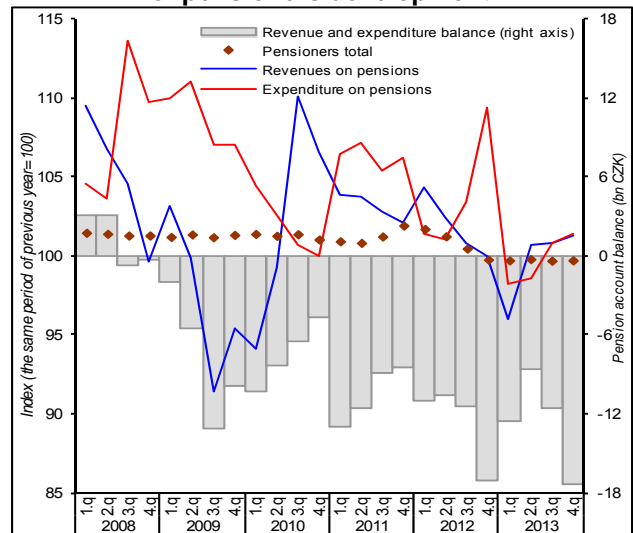


Chart 23 Structure of revenues of the CR from the EU budget and net position of the CR towards the EU budget

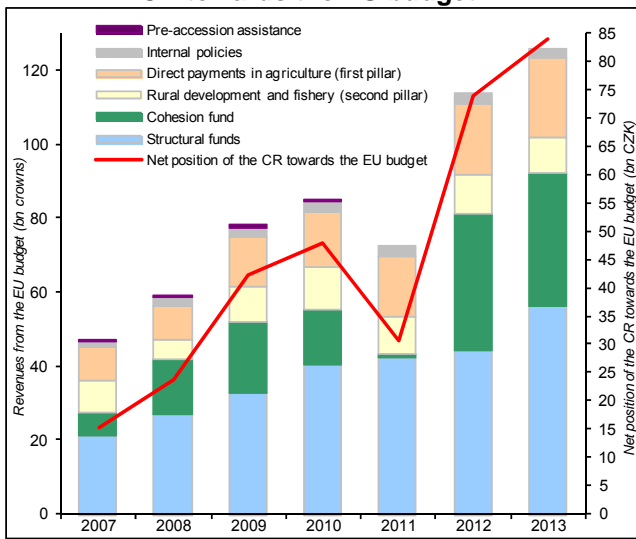
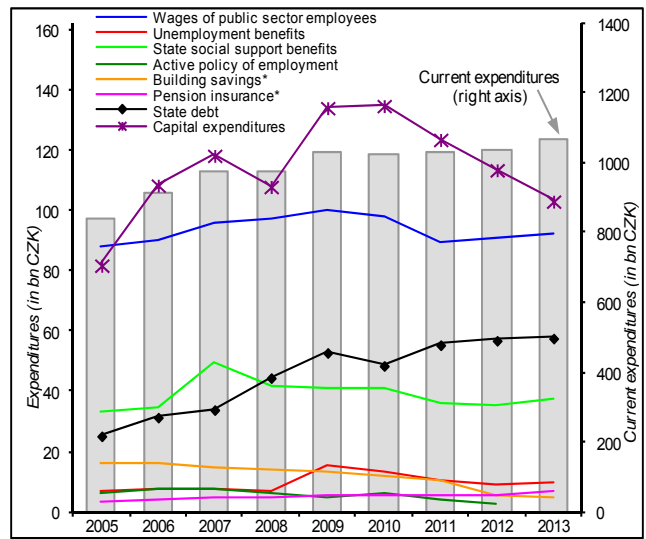


Chart 24 Selected state budget expenditures in years 2005-2013



*state contributions

Source: MF CR

Sources of data in the whole analysis: CZSO, MF CR, CNB, Eurostat, CZSO calculations. Latest information from the CZSO and CNB given in this report has been dated the 12th March 2014.