

14th September 2012

Summary

- In the first half of 2012, global economic growth slowed. In particular, the manufacturing industry was responsible for the lost pace of global GDP. The European economy is not in recession but in Q2 2012 reported a year on year and quarter on quarter drop (more significant in the euro area than in the EU-27). The economy of the Czech Republic was affected by this by a slowdown of its current export pace, while imports suffered from weak domestic demand. In the fourth consecutive quarter, net exports have been the single positive contributor to the growth of the Czech economy, while final consumption expenditures and gross capital formation have decreased its performance.
- At the half year mark, the performance of the Czech Republic sank and in Q2 was decreasing three times faster than the EU economy. In Q2, the slump of domestic demand was two times deeper than the EU-27 average, while in Q1 it was four times deeper.
- In the first half of 2012, the GDP¹ of the Czech Republic decreased year on year by 0.8%, deepening the drop by 1% in Q2 against the year on year drop by 0.5% in Q1. In a quarter on quarter comparison, GDP was 0.2% lower than in Q1, in which extraordinary effects were responsible for the drop by 0.6%. The developments in Q2 were practically worse for all GDP expenditure items than they had been in Q1, with the exception of a more moderate drop in gross capital formation and an increase in the services imported. A significant quarter on quarter increase of investment was also affected by the comparative base.
- At the half year mark, the performance of industries based on gross value added stagnated, but in Q2 it recorded a drop of 0.3%. The manufacturing industry fared best in the first half of the year despite the fact that its increase by 5.7% in a year on year comparison (+10.5%) only reached half the value. Against the same period of 2011 (-5%) the half year slump in the construction industry (-9.9%) deepened. Apart from finance and the insurance industry, only public services where gross added value continued to grow and information and telecommunications activities which managed to dampen the previous drop, similar to the above-mentioned industry of financial services, were more successful in Q2 than in Q1.
- Employment in Q2 according to national accounting statistics posted growth due to an increase in entrepreneurs, while the number of employees decreased. The general level of unemployment remained in a year on year comparison at 6.8%, there were more job vacancies and their number exceeded 40,000. Real wages in business and non-business sectors sank by 0.7% at the half year mark.
- At the half year mark, the external economic relationships of the Czech Republic improved dramatically. The current account of balance of payments posted a surplus as a result of lower outflow of dividends and increased surplus of trade balance for which weak imports were responsible. The inflow of direct investment was slightly lower in a year on year comparison. In Q2, the drop in the dynamics of export and import of goods deepened once again.
- Consumer prices continued to grow for the whole first half of the year faster than in the EU, driven by food prices, particularly in Q1. In Q2, their year on year growth recorded a moderate slowdown.

¹ Unless stated otherwise, the data on GDP and its components are given in real terms and adjusted for seasonal and calendar effects, including comparisons with the EU.

- The pace of loans provided to households posted yet another slowdown; after two quarters of increased growth, the dynamics of loans provided to companies once again decreased. Enterprises stocked up cash and deposits on current accounts, while increases of household deposits grew weaker.
- In a year on year comparison, the half year deficit of the state budget was deeper as result of the year on year drop of the most volume-relevant taxes, the collection of whose improved in the summer months.

Overall performance of the economy

- ***In the first half of the year, GDP recorded a year on year fall by 0.75% with a more dramatic drop in Q2 by 1%*** In the first half of 2012, the volume of goods and services produced in the Czech Republic was 0.75% lower than in the same period of 2011. This resulted from a deeper year on year drop from 0.5% in Q1 2012 to 1% in Q2. The year on year drop in Q2 against the year on year development in Q1 was recorded by practically all components of the GDP expenditure side², with the exception of gross capital formation and import of services. For the first time since the last quarter of 2009, the gross value added posted a slump in the Czech economy. The negative tendencies thus deepened.
- ***The loss of Czech economic performance was in the y-o-y comparison significantly deeper (-1%) than in the EU-27 (-0.3%)...*** The year on year drop of GDP in Q2 was also recorded by Europe, for the first time since the last quarter of 2009. The debt-related problems of the euro area led to a deeper fall of its GDP (-0.5%) than with the GDP of the EU-27 (-0.3%). The economies of six EU countries posted an even deeper slump than the Czech Republic: Portugal (-3.3%), Italy (-2.5%), and also Slovenia (-2.2%) and Hungary (-1.1%). Norway (+4.8%) and Slovakia (+3%) were the fastest growing economies. German GDP rose by 1%.

The European economic problems are augmented by budgetary issues, as the economy of the USA grew in Q2 by 2.3% in a year on year comparison and the GDP of Japan, still stimulated by recovery impulses after the natural disaster, by 3.6%.
- ***... q-o-q drops seen in Q2 stand at almost half of the EU countries*** With regard to the short-term trajectory, more and more EU-27 countries are sinking deeper into problems. Of the total of 21 states that have already provided data concerning GDP to Eurostat, 11 reported a quarter on quarter drop, nine of these a drop deeper than the Czech Republic – apart from southern countries struck by the debt crisis, these were also countries with mono-product orientation such as Finland (-1.1%) with fluctuating growth and slumps since the crisis, Slovenia (-1%) with problems since the beginning of 2011 and EU-15 states like Belgium, Denmark and the United Kingdom (identically at -0.5%). In Q2, the most effective performance was shown in a quarter on quarter comparison by Sweden (1.4%) and Slovakia (+0.7%). Germany, defying the unfavourable development in external demand, increased its GDP by 0.3% against Q1.
- ***Other countries in recession together with the Czech Republic*** Despite the fact that neither the EU-27 nor euro area are in technical recession as a whole due to the quarter on quarter stagnation in Q1, based on the data available such a recession was, together with the Czech Republic, recorded by states such as Italy, Spain, Portugal, Slovenia, Hungary and the United Kingdom. However, the reasons behind the recession are varied – apart from serious debt problems of southern countries, the crisis was caused e.g. by the poor performance of the service sector (Great Britain) or a strong effort to solve imbalances (Hungary with fiscal consolidation – in the ranking of the EU-27 states, this country had the highest relative government surplus).
- ***Data at the half year mark were influenced by worse*** The drop was particularly due to the influence of lower final consumption expenditure and its impact on the GDP of the Czech Republic. For the first half of 2012, these expenditures recorded a real drop of 2.2%. Households reduced their

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development in Q2

consumption by 2.9% and the government sector by 0.7%. As a result of the diminution of inventories, the gross capital formation was year-on-year significantly lower at the half year mark of 2012 (-7.9% after +2.1% in the same period of 2011), but it was not the case for investment as such – the gross fixed capital formation increased by 0.8% (-0.2% at the half year mark of 2011), due to the stagnation in Q2. Therefore, these investment represented one of two components of GDP expenditures whose development in Q2 did not worsen the overall development for the first half of 2012.

Exports for the first half of the year grew in real terms by 5.4% with a slower pace of the export of services (+3.2%) than the export of goods (+5.8%). Imports, suffering from weak domestic demand, grew by only 2.1% against first half year of 2011 as a result of a significant loss of the pace of the import of goods (+1.5%) with a growth of the import of services by 6.1%. (Together with investment, the import of services was the second expenditure component where the year on year development in Q2 did not post worse results than Q1.)

However, the lost pace concerning the exchange of goods and services with foreign countries is massive, as for the first half of 2011 exports from the Czech Republic rose year on year in real terms by 15.6% and imports by 12.8%. Due to the position of net exports, as the only contributor to GDP growth for several consecutive quarters, this situation poses a risk to the economic development of the Czech Republic should yet another drop in foreign demand occur.

In the European context, exports from the Czech Republic grew faster than exports from the EU-27, but in Q2 the pace slowed, while there was an increase in the EU. There was a similar situation with imports, which saw a recovery in Q2 in the EU, while their dynamics in the Czech Republic continued to decline.

- **Only foreign trade contributed to GDP growth in the fourth consecutive quarter**

There have been no changes in the character of the contribution of each of the expenditure components in relation to GDP. In Q2, GDP was pulled down for the sixth consecutive quarter by increasingly lower consumption expenditure, which reduced dynamics by 1.9 p.p., while in Q1 it was reduced by only 1.3 p.p. – again GDP growth slowed under lower consumption of both households (-1.7 p.p. against -1.2 p.p. in Q1), and the government (-0.2 p.p. against -0.1 p.p.). Also a strong positive contribution of foreign trade was reduced to +2.1 p.p. in comparison with +3 p.p. in Q1. However, it remained the only expenditure component that worked towards the growth of GDP (already in four consecutive quarters). The gross capital formation affected growth negatively in Q2 (-1.3 p.p.), but not with such force as in Q1 (-2.2 p.p.). The gross fixed capital formation as such has not contributed to the slowdown of the GDP pace – in Q2 its influence was neutral, while it supported GDP growth in Q1 (+0.4 p.p.).

The reduced expenditure of households worked towards the decrease of GDP also in the EU-27, but with less intensity than in the Czech Republic (-0.3 p.p.). As opposed to Czech GDP, government consumption increased the growth of GDP in the EU (+0.1 p.p.), as well as net exports (+1.2 p.p.). However, the development of inventories and investment in the EU-27 had a negative influence (-0.9 p.p. and -0.4 p.p. respectively).

- **The slump in household final consumption expenditure was the second deepest in the EU after Portugal**

Both positive and negative contributions to GDP growth were determined by the dynamics of its components. The slump of household final consumption expenditure (-3.3%) in the Czech Republic in Q2 was in a year on year comparison the second deepest in the EU after Portugal (-5.9%). The highest rate was reported by households in the poorer countries of the EU (Bulgaria, Romania, Lithuania), but also in Germany (+1.5%).

The drop in demand of Czech households was apparent in year on year terms as early as the beginning of 2011. However, in the first two quarters of 2012 the drop further deepened. Quarter on quarter, household expenditure fell less significantly in Q2 2012 (-1.1% against -1.8% in Q1). Despite this, the drop was the third deepest in the EU after Finland and Cyprus, where the drops were sudden and did not follow

the trend as in case of the Czech Republic.

- ***In EU-27, government expenditures rose by 0.4% in y-o-y comparison, in the Czech Republic, the cuts increased the drop to y-o-y -0.9%***

Also savings in government consumption expenditure increased and in Q2 2012 these expenditure was 0.9% lower in a year on year comparison (in Q1 by 0.5%, while in the same periods of 2011 the Czech government sector consumed in a year on year comparison 1.3% less and 0.4% less respectively). The cuts were apparent even compared to Q1 (-1.1%, while household consumption decreased quarter on quarter by the same rate).

In Europe, however, government expenditure rose in a year on year comparison by 0.4% in the EU-27 in Q1 and Q2 2012, driven by their growth in large economies (Germany +1.1%, France 1.3%). According to available data from Eurostat, government expenditure dropped in all 12 countries of the EU in a year on year comparison, and quarter on quarter in nine countries. In the Czech Republic, the intensity of cuts in government expenditure in Q2 was in a quarter of quarter comparison the third most intensive after Slovenia and Slovakia. Year on year, 10 countries made more severe cuts in government expenditures than the Czech Republic. According to data from 2011, the debt of Czech government is the seventh lowest in the EU.

- ***Strong q-o-q growth of investment, y-o-y stagnation***

The strong quarter on quarter increase of investment in Q2 2012 (+7%) was very positive, although it might have been affected by the comparative base (a sharp drop by 8% in Q1). Moreover, second quarters report certain periodicity with strongest quarter on quarter increases from the entire year. This was the case of the last two years (in 2011 even with quarter on quarter growth by 8.7% in Q2) and also in 2003–2005. It is the extreme of Q2 2011 that explains how investment in the Czech Republic in a year on year comparison in the same period of 2012 only stagnated.

Despite complaints that restrictions in the Czech economy are very strong and do not give adequate room for investment, in this regard the situation in Europe is much worse – the volume of investment has been on the decline for two consecutive quarters (in the EU-27 in Q2 y-o-y by 2%, in the euro area by 3%). Cyprus and Portugal with double digit slumps followed by Spain and Slovenia are among five countries with the most dramatic drops in investment for several consecutive quarters. Double digit growth is recorded by the Baltic states and Romania.

- ***Half year stagnation of gross value added following the decline in Q2; a better result was recorded only by three industries with low weighting***

Gross value added in the first half of the year against the same period in 2011 posted real stagnation (+0.04%), while in Q1 2011 it grew year on year by 2.2%. The manufacturing industry recorded the best results (+5.7%). However, in the same period in 2011, this increase was almost two times this figure (+10.5%). Concerning the resources generated, the results were largely worse against results from the first half of 2011. The results were only better with regard to activities connected with real properties, in aggregate for industry under the heading “Professional, scientific, technical and administrative activities” and also concerning activities under the so-called other services. On the whole, these industries form only 15% of the volume of gross value added in the Czech economy.

The most dramatic year on year slump was recorded by the construction industry in the first half of 2012 (-9.9%), which meant that the drop for the same period in 2011 (-5%) deepened again. Surprisingly enough, the gross value added reported in the finance industry and the insurance industry (-5.1% against +4.4% in the first half of 2011) was lower. As a result, the significant drop from Q1 2012 surfaced (-7.9%), and could have been alleviated only partially in Q2 (-2%). The finance and insurance industries thus were among the last two activities that were more successful in Q2 than in Q1, by either higher gross value added reported, together with public services (public administration, defence, education, health and social care), or by alleviation of the previous drop (information and telecommunication activities).

Despite the decrease in the gross value added in Q2 (-0.3%) and its half year stagnation, its development was more favourable than that of GDP. In EU-27 the year on year drop of gross value added was more moderate (-0.2%), while in the euro area (-0.3%) it was equal with the Czech Republic.

- **Real domestic income grew slower than GDP, y-o-y trading losses lower**

The Czech Republic posted half year profit from foreign trade generated by favourable development of prices in 2009 for the last time. Since then, the development of exchange rates has yielded only a loss standing at CZK 22.1 billion at the half year of 2012. Against the half year calculations for 2011 and 2010, this loss was lower, for which lower flows of goods in the first half of 2012 compared to the previous years could be responsible. Real gross domestic income in Q1 and Q2 posted year on year drops, even more significantly than in comparable periods in 2011. A deeper slump also occurred in comparison with the pace of GDP in real terms.

Chart No. 1 Gross domestic product (in real terms, adjusted for seasonal and calendar effects, change in %)

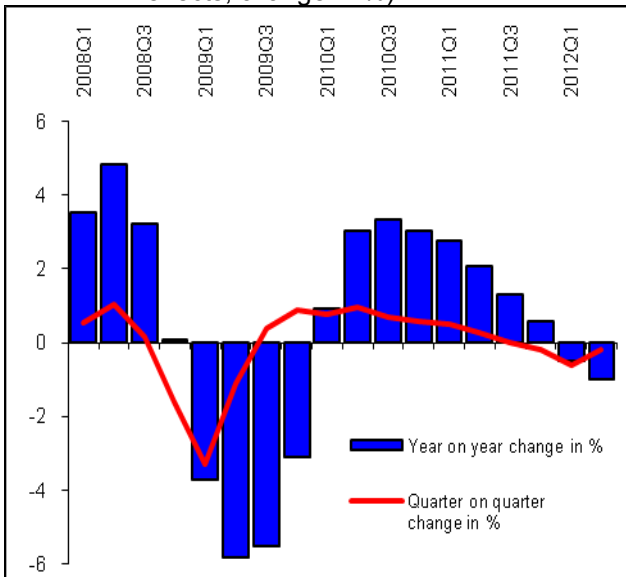


Chart No. 2 GDP (y/y in %) and confidence indicators by Business Cycle Survey of CZSO

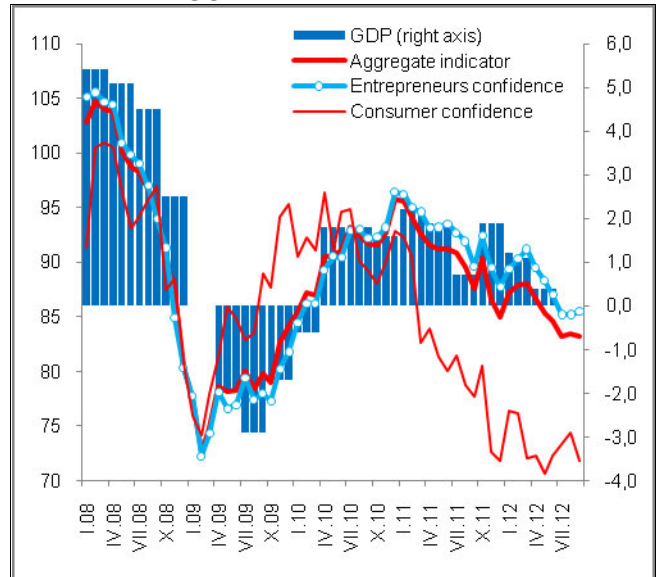


Chart No. 3 Contribution of expenditure items in GDP growth (in c.p.)

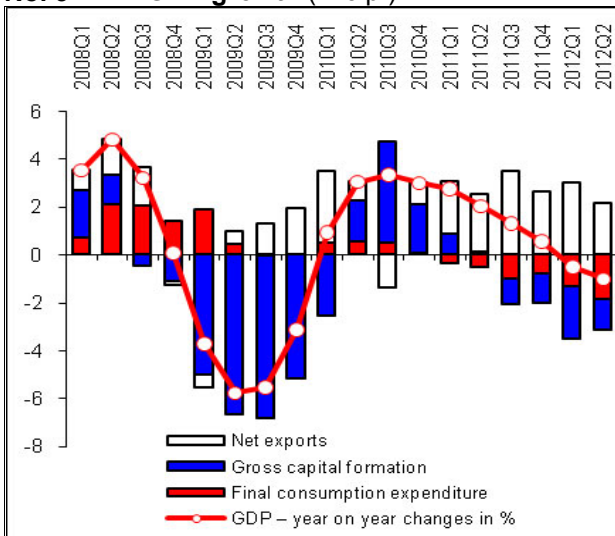
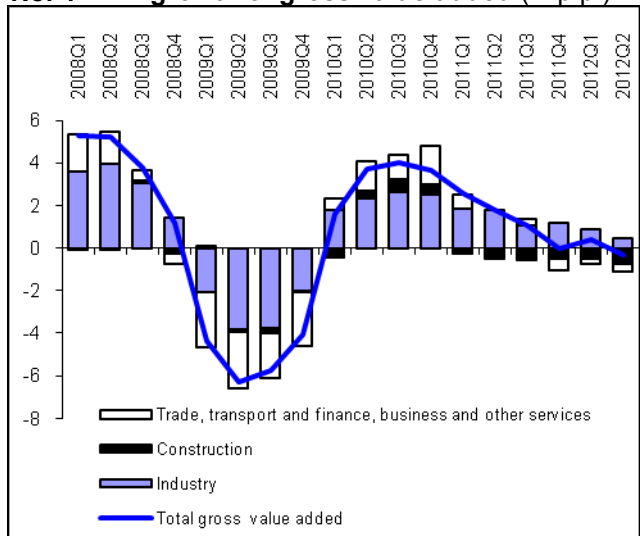


Chart No. 4 Contribution of industries in relation to growth of gross value added (in p.p.)



Source: CZSO

Industry performance

- ***Decrease in year-on-year dynamics of gross value added continued in all sectors also during 2012***

The performance of all sectors of the Czech Republic economy measured by gross value added in Q2 2012 recorded a year on year decrease according to preliminary data (-0.3%). This happened for the first time since 2009, while a moderate slowdown of the pace has lasted for almost 2 years together with the overall stagnation of employment in the economy. The slowdown of year on year dynamics of gross value added was between Q1 and Q2 2012 apparent in all major industries with the exception of the finance and insurance industries (with variable development and the effect of the high comparative base of Q1 from previous year applied) and public services industry (with unchanged dynamics).
- ***The manufacturing industry, despite growth slowdown, is still key to GVA dynamics; however, in Q2 it did not manage to avert a year on year drop of GVA in economy***

Due to its weight (25 %) and year on year dynamics (+4.8% in Q2 2012), the manufacturing industry remains a traditional generator of gross value added in the economy, in spite of a gradual slowdown of the dynamics. In 2010, and even in the first half of 2011, it achieved an increase of more than 10%, while in Q1 of this year it still recorded 6.5%. In Q2, the manufacturing industry was driven by the production of machinery and equipment and manufacturing of electrical equipment, but the food industry, production of rubber and plastic products and production of transport vehicles did not reach the same level as last year. The manufacturing industry did generate the growth of value added in times of long-term stagnating employment and a lower number of hours worked (in Q2 year on year by as much as 4.4%). Also professional, scientific, technical, and administrative activities and also the real estate activities achieved a moderate growth of gross value added (2–3%) after the last year drop, which was supported by better use of the workforce.
- ***Deeper drop of added value in construction industry and telecommunications***

The construction industry (-12%) and information and telecommunication activities (-7%) proved in Q2 long-term tendencies, as the value added has been in real terms on decline in these sectors for six or seven consecutive quarters, and it is lower than the level from the beginning of 2008 by as much as one eighth. Even the primary sector generated year on year lower value added with long-term decreasing employment in Q2 2012 (-4%); contributing to a drop in the whole economy (as a result of its low weight) three times less than trade, transport, and the hospitality industry in which the value added dropped only by 1%.
- ***Long-term moderate weakening of the growth dynamics across all manufacturing industries resulted in Q2 2012 in a 1.5% drop of industry; 2–3% growth was maintained by the manufacturing of motor vehicles and some related industries with production designated for investment***

The dynamics of the growth of industry measured by the production index has been weakening year on year since the beginning of 2011. This trend was also confirmed by Q2 2012 with a year on year drop of 1.5% (after 3% growth in the previous quarter)³. The decrease was recorded for the first time since the last quarter of 2010. Moderate year on year 2–3% growth of production was retained by four manufacturing industries (nine in the previous quarter). These were manufacturing of electrical equipment, machinery and motor vehicles. On the other hand, the sectors of the clothing industry, manufacture of computer, electronic and optical equipment, repair of machinery and the pharmaceutical industry were confronted with a 10–15% decline in production. The year on year pace has slowed in comparison to Q1 and Q2 2012 in almost all manufacturing industries (except for the production of means of transport and the food industry); it also recorded a decline against the same period in 2011. The most dramatic growth reduction was seen in the manufacturing of motor vehicles (manufacturing in the first half of 2011 grew by one quarter) and related industries – electrical equipment and also plastic and rubber products that posted a year on year decline in Q2 2012 by 4%. Worse results can be seen with some industries where the majority of products have an investment character – production and repair of machinery but also manufacturing of computers, electrical and optical equipment, where the year on year growth of production by 35% (Q2 2010) was two years later replaced by a 15% drop.
- ***Stagnation of industrial***

The growth of industrial production designated for investment slowed year on year in Q2 to +0.7% (+8% in Q1), and remained positive only thanks to moderately growing

³ The tendency of moderate year on year weakening of production is notable this year even after adjustment for the effect of a different number of working days (from +1.5% in Q1 to +0.2% in Q2).

production designated for investment

production of motor vehicles and machinery. The production for short-term and long-term consumption recorded a moderate downturn (by 4.5% and 2% respectively). Against Q2 2008 the production for long term consumption was one third lower (particularly the furniture industry and other equipment for households), but production for investment has improved by one tenth in real terms, mainly thanks to the manufacturing of an sport vehicles. In Q2, the production of the industry was positioned in real terms 3.5 % below the level reached 4 years ago. The production in the energy sector, as a result of more favourable development in this year's Q2, was lower by 2% in real terms.

- **New industrial orders abroad, despite slowdown of dynamics, grew by 6% in Q2, and both the automotive and chemical industries fared well**

The pace of sales of industrial companies is closely related to the development of production. A moderate advantage of the growth of sales over dynamics of production has already existed for 2 years, and therefore the sales managed to maintain year on year growth in Q2 (+0.7%). In the long run, the sales from direct export have done better (in Q2 +2.3%) than domestic sales (-0.9%). The insignificant year on year growth was maintained by the value of new contracts across the whole industry in Q2 (+0.5%), despite the fact that a notable slowdown occurred here during 2012 (in Q1 +8%).⁴ The disproportion between the dynamics at home (in Q2 -9%) and abroad (+6%) was larger for orders than for domestic sales and sales from direct export. The value of new orders grew year on year in Q2 only in the automotive (+8.5%, in the previous quarter by 22%), chemical (+5%, and +24%) and textile industries. Apart from these sectors, the foreign jobs were also stimulated by the manufacturing of electrical equipment, and the demand for pharmaceutical products was also higher compared to local demand.

- **The long-term downturn in construction production continued, but year on year decreases were more moderate against Q1**

The long-term negative development in the construction industry has not been reversed in Q2 2012 despite the fact that year on year declines in building production did not reach the dramatic figures from Q1. The building construction even reached the level of the previous year. Civil engineering, having less volume-related weighting, the real production of which has been dropping for ten consecutive quarters, recorded a 15% drop. The last more significant year on year increase was posted by the construction building industry (with concurrent growth of building construction and civil engineering) in Q3 2008. As opposed to the boom period, production is one sixth lower, with no significant differences between building construction and civil engineering construction.

- **Slump of civil engineering, low drop in the value of public orders and a trend towards smaller orders; the value of new local orders concluded was the lowest in the past decade**

The value of new construction orders concluded domestically in Q1 and Q2 (27 billion and 35 billion respectively) was among the lowest in the past decade. In Q2, the value of orders was in a year on year comparison lower by one fifth (for civil engineering by one third) and compared to the period of economic boom almost by half. The average value of newly concluded orders was CZK 3.5 million in Q2 and has decreased by one third over the last two years. The trend towards smaller contracts during recession is confirmed in the same period by the decline in the average value per building permit issued (from CZK 4 to 2.8 million), apparent mostly with the new housing projects and non-residential buildings. The total number of contracts representing the stock of construction works that have not been carried out in a total value of CZK 146 billion dropped in Q2 year on year by one sixth. For the slump of demand, particularly civil engineering, one can point particularly to civil engineering, to a dramatic decline in the value of public orders (against the period of prosperity by more than 40%) and in the last two years, orders from abroad. The permanent year on year decrease of the average registered number of employees has continued for the fourth consecutive year⁵, which stood at -4% in Q2 against the same period four years ago when it was lower by one seventh.

- **The record low number of flats**

The low number of flats started in the first half of 2012 (12.5 thousand) is on the level of the middle 1990s and reflects the current low demand connected with the

⁴ As yet, the highest year on year growth with regard to industrial orders occurred in July 2012 (+16%), when there was concurrent growth of value of orders both at home (+4%) and abroad (+23%).

⁵ In building enterprises with 50 employees or more. The total employment in the building industry (including small enterprises) according to the statistics of national accounting in Q2 2012 stagnated year on year, and against the end of the period of prosperity it dropped by 1.5%.

started in the first half of the year recalled the situation of the middle 1990s

saturation of the market by a higher number of flats completed in the times of boom (annually at around forty thousand) and by the lower number of persons who do not purchase flats for their own housing needs. In Q2 2012 the number of flats started dropped year on year by one fifth, and continued to fall in comparison with the previous quarter, which happened for the first time in this millennium. Fewer flats were started year on year in all types of buildings, except for non-residential buildings. The number of completed flats for the first half of the year increased by one eighth, but it was still the lowest since 2006. Flats in housing buildings were responsible for growth (by one third), but the number of completed flats in family houses has not changed.

• A drop in retail sales for the first time in recent years with the negative influence of the sale of food and the sales of motor vehicles

As a result of long-term weakening of consumer demand, retail sales (including the motor segment) recorded a year on year drop for the first time in the last two years (-2.4%) in Q2 2012. The lower number of working days was partly behind a significant slowdown against Q1 (+1.2%), but retail sales have been on the decline for the first half of this year (-0.7%), while in the same period of the previous year they maintained 3% real growth. In line with consumer confidence indicators, sales of foodstuffs (already for five consecutive quarters, the last time at 2.9%) have been falling irrespective of the type of shop. The performance of the entire industry could not be improved even by stagnating sales for non-food items that interrupted growth after seven consecutive quarters. Among specialised shops, computer and communication equipment were able to retain growth through sales, followed by shops with clothing, shoes and leather goods, particularly internet vendors and mail order services (+7%). In Q2, the long-term drop of real sales at petrol stations continued as a result of falling consumption in Q2; against the same period four years ago, the sales were 14% lower. After nine months of growth, sales of the motor vehicles decreased in real terms as well (-4%).

• Year on year slowdown of services across all main industries

The sales in the service industry (adjusted for the number of working days), after the year on year growth in Q1 (+0.6%), again dropped (-1.1%). The slowdown during 2012 occurred across all major sectors. Higher sales were in real terms maintained in a year on year comparison only by administrative and supporting activities (+2.6%), where employment agencies (+14%) and partially travel agencies recorded stable good results. As a result of the increasing number of visits by local and foreign guests, the accommodation segment, transport and warehousing services posted growth.

Chart No. 5 Industrial production index and its selected manufacturing industries
(in real terms, y/y, in %)

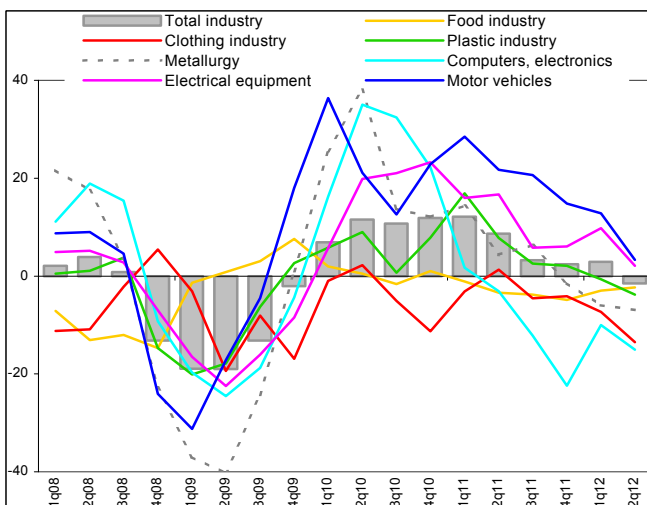
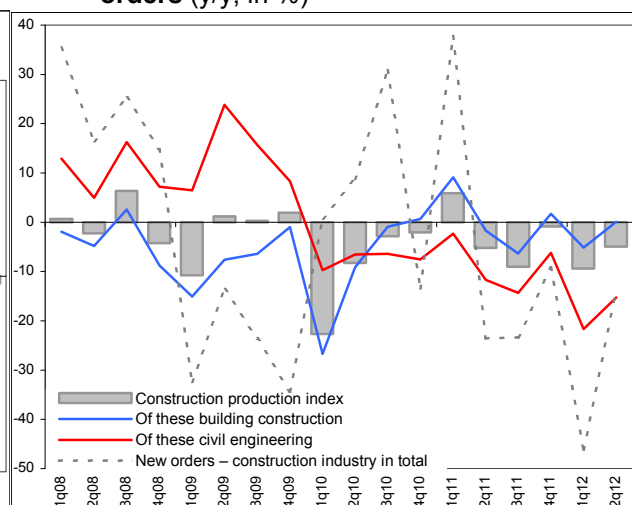


Chart No. 6 Real construction production index in the construction industry and its major fields and nominal value of new construction orders
(y/y, in %)



Note.: building contracts only for enterprises with more than 50 employees

Chart No. 7 Retail sales, including motor segment (in real terms, y/y, in %)

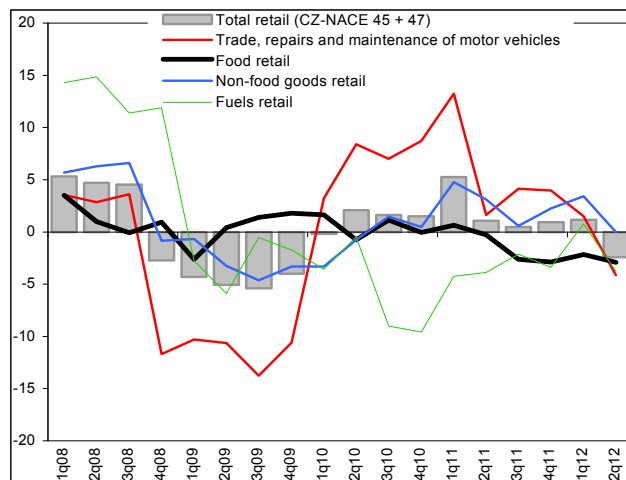
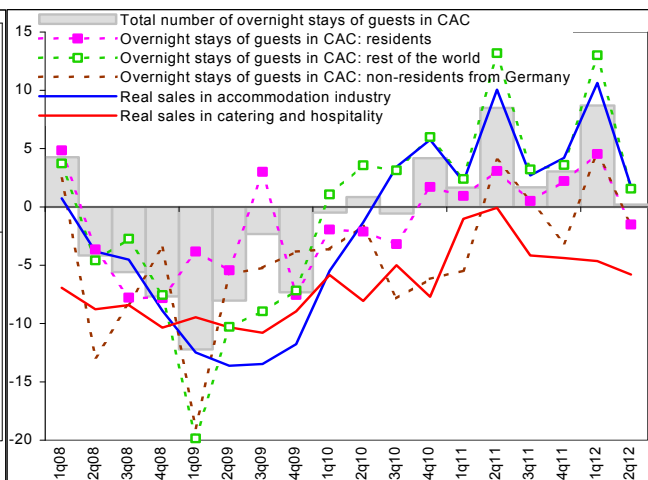


Chart No. 8 Overnight stays of guests in collective accommodation facilities and real sales in accom., lodging and hospitality (y/y, in %)



CAC = guests in an collective accommodation facility

Source: CZSO

External economic relations

- **Half year surplus on the current account for the first time since 2006**

In 2011, the half year results of the balance of payments current account recorded for the first time since 2006 a surplus for this period – the balance as a result of a low deficit in Q2 (-6.6 billion CZK) remained positive in the amount of CZK 16.3 billion. Also the financial account recorded a surplus, and therefore the external economic relationships of the Czech Republic in aggregate have seen a positive development in this period. The surplus of the current account represented 0.9% of nominal GDP (in the first half of 2011 the deficit stood at 1.8% GDP).

- **Strong trade balance and more positive income balance ...**

Despite the worsening of the balance of services and current transfers balance, it has not influenced the very positive result of the current account of the balance of payments. The output related balance – as a result of a strong trade balance – was CZK 30 billion better than in the same period in 2010 and 2011. However, this time, the balance of income have shaped less negatively with a deficit of CZK 32 billion less than in the first half of 2011. The outflow of income from the Czech Republic in Q2 was the lowest since 2006, also in net terms (as a result of the paid dividend Q2 is usually the strongest with regard to repatriated profits and in the last eight years, only 2010 was an exception). Q2 2012 thus influenced even the half year result with the outflow of yields in the amount of CZK 164 billion, representing in net terms CZK 108 billion (in the first half of 2011 it represented the outflow of CZK 188 billion and 140 billion respectively).

- **... and easily eliminated the worsening of balance of services and current transfers**

The result of current transfers was worse by almost CZK 12 billion than in the half year of 2011 due to lower payments from European funds. The surplus of the balance of services declined year on year by CZK 8.5 billion to 26 billion. Despite the fact that the income from transport services and tourism rose year on year more significantly than in the same period in 2011, they were not sufficient to cover the slump regarding other services. These grew year on year only by CZK 0.4 billion, while this figure stood at the half year mark of 2011 at 8.5 billion.

The growth of transport expenditure was year on year significantly lower, as well as in active tourism, for which economic recession may be responsible. The half year worsening of the balance of services was caused, however, by a sharp surge in expenses for all other services by CZK 17.1 billion against a mere +2.8 billion in the same period of 2011. According to the available data for Q1, significant growths were recorded by costs for hedging and particularly the component “Profitable operations and other services” connected with goods. Advertising expenditure declined.

- **Another slowdown in import and export of goods**

The weakening pace of imports given by lower domestic demand for imported goods was responsible for an increased surplus of the trade balance – against the first half of 2011 by CZK 38 billion. The value of exports of goods exceeded the value of imports by CZK 101.4 billion, with a single digit growth rate which was last notable in Q1 2010. The slowdown of foreign trade has deepened in Q2 (with exports at +6.8%, and imports at +4%) when their dynamics worsened already in Q1 (exports +11.1%, imports +8.2%).

- **In Q2, particularly exports of cyclical industries weakened significantly**

Exports of machinery and transport vehicles contributed to total exports⁶ in the first half by 49.3% (against the same period of 2011 the share increased by 0.4 p.p.). In Q2, this share slightly decreased as opposed to imports, where the share of machinery and transport vehicles in total imports rose in Q2 and at the half year mark represented 35.6% of total imports in the Czech Republic. The half year balance has worsened year on year only with regard to trading with mineral fuels, chemical products and commodities of the SITC classification group 9 (not classified).

Exports of foodstuffs (+19% against the half year of 2011), mineral fuels (+16%) and beverages and tobacco (+13%) recorded the fastest growth, in all cases much more significantly than their imports. However, a full four fifths of exports from the Czech Republic are permanently reserved for exports of machinery and transport vehicles, industrial consumer goods and the component “Marketable goods classified according to material”.

The export of production of cyclical character recorded a significant drop, particularly in Q2 when exports of cars posted a year on year increase by 9.2%, but in Q1 by 17.3%. An even more significant drop in the pace, by approximately two thirds, was recorded by metallurgy – exports of metals grew in Q1 2012 in a year on year comparison by 12.2%, but in Q2 only by 4.3% (similar to exports of metal-working products from +12.8% to 4.6%). Apart from weak domestic demand influencing the dynamics of imports, the worsened foreign demand was reflected into the slowdown of the pace of exports.

- **Reduction of financial account surplus caused by transactions of commercial banks under “Other investment”**

The surplus on the financial account of the balance of payments in the amount of CZK 14.2 billion achieved in comparison with the same period in 2011 (CZK 58.5 billion) only 25% of last year’s figure. At the same time, the inflow of direct foreign investment in the Czech Republic did not record any significant drop (CZK 59.8 billion against 64.4 billion in the half year of 2011). Net portfolio investment have even shown significant progress when foreign financial investors purchased four times more bonds than a year ago and cash outflow from the country in investment of domestic portfolio investors was lower. However, as opposed to bonds, there was mutually less activity with regard to stock transactions. On the whole, portfolio investment reported an inflow of cash into the country in the amount of CZK 40.3 billion, while at the half year mark of 2011, the aggregate result posted an outflow of portfolio investment from the Czech Republic (CZK -10.5 billion).

The year on year decrease in the surplus on financial account was therefore caused by the “Other investment” item, particularly by commercial banks. In particular, their short term active transactions under this item ensured the inflow of cash into the country at the half year mark of 2011 (CZK 70 billion), but at the half year mark of 2012 they resulted in their outflow in the amount of CZK 50 billion. This outflow occurred mostly in Q1 (CZK -44 billion).

- **According to half-year averages the Czech koruna weakened**

On average, the exchange rate of CZK towards major currencies weakened in the first half of the year by 3.25% to an average CZK/EUR 25.20 and by 8.12% to an average CZK/USD 19.34. At the same time, a steady strengthening of the Czech currency was apparent from January to April, then the currency weakened, and more significantly in case of CZK/USD. The Czech koruna may have possibly responded to worsening fundamentals in the Czech economy.

⁶ National approach (under the principle of the change in ownership), exports in FOB prices, imports in CIF prices.

Chart No. 9 Change in the balance of current account components (in million CZK, the first half of 2011 and 2012)

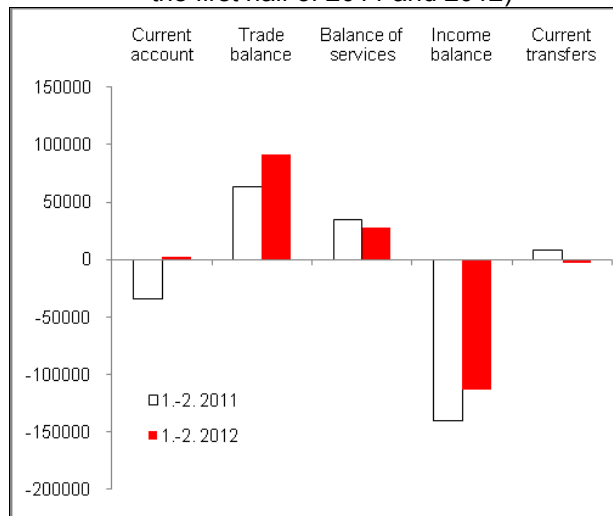
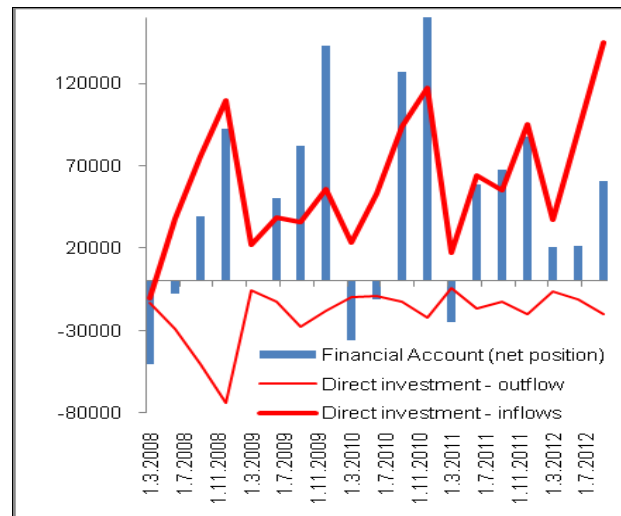


Chart No. 10 Financial Account (FDO, in million CZK)



Source: ČNB

Prices

- **Varied development of prices**

The development of producer prices was a varied one. The prices of industrial producers were rising, while the prices of agricultural producers were falling. The deflation was apparent in the prices of construction works and market services as well. The price development thus corresponded to some cycles of individual industries and to price development on global markets. The increase of consumer price has recorded a moderate slowdown.

- **Prices of agricultural producers recorded a further decrease**

In Q2 2012, the prices of agricultural producers recorded a year on year decrease by 1.7%. Therefore, the trend from Q1 2012 continued. The prices of vegetable products were again in a year on year comparison lower, this time by 7% (in Q1 they were lower by 11%), and their weight was responsible for the drop in the total prices of agricultural producers. The prices of animal products have again posted a year on year increase for nine consecutive quarters (+5.8% against 10.6% in Q1). In particular, the lower price of potatoes that recorded a year on year drop by 42.3%, was responsible for the decrease in the price of vegetable products. The price of cereals and fruits have also decreased by 7.3% and 4.3% respectively. Not even higher prices of vegetables by 11.5% could stop the slump in prices of vegetable products. The growth of prices of animal products was affected by the increase of egg prices by 79.7%, and pigs by 15.8% and cattle by 9.3%.

- **Slowdown of growth of prices of industrial producers**

The growth of prices of industrial producers slowed. In Q2, prices recorded a year on year increase by a mere 1.8% (in Q1, the year on year increase was 3.6%). Despite the fact that the prices were well above average, the prices of coke and refined oil products slowed their increase (+8.1% against 16.7% in Q1). On the other hand, the prices of chemical substances and products recorded an increase well above the average (+6.4%, in Q1 by 3.7%). The same applies to food products, beverages and tobacco (+2.1%, in Q1 by 5.6%). The trend of year on year growth of the prices of the above-mentioned three groups of industrial products can be seen as long lasting. The year on year increase of the prices in the field of water supplies and waste water treatment services was also well above the average (+8.1%).

A significant year on year drop in prices was recorded in the mining and extraction industry (-5.1%), which may affect the decrease in prices of energy and construction materials. In the manufacturing industry, the prices of wood, paper and print producers (-0.6%), general metals and metalworking products (-0.2%) and electrical

equipment (-0.5%) fell.

- **Deflation of prices of construction works and market services**

Based on estimates, in Q2 2012 the prices of construction works recorded a year on year drop by 0.6%, while the price of materials and products used in construction industry rose by 1.6%. When comparing prices of construction works between Q2 and Q1, a drop by 0.2% was noted, while the prices of materials and products used in the building industry grew by 1.1%.

In Q2 2012, the prices of market services dropped by 0.7%. Prices for advertising services and market research were again lower by 3.4% (In Q1 2012 the year on year increase stood at 5.3%, and cyclical changes in this segment can be seen again). In a year on year comparison, also some architectonic and engineering services and related technical consulting recorded lower prices by 2.7%, followed by services in the field of real properties by 0.8% and telecommunication services by 0.5%. Higher prices were also recorded by freight traffic by 0.9% and financial services, except for insurance and pension financing, by 1.5%.

- **The growth rate of consumer prices recorded a moderate drop, which was mainly influenced by foodstuffs**

The growth of consumer prices slowed down moderately in Q2. In a year on year comparison, consumer prices rose by 3.4%, which was less than in the previous quarter by 0.3 percentage points. The year on year increase of the average harmonised consumer price index (HICP) remained for the Czech Republic (+3.8%) in June 2012 for six consecutive months higher than the figure for the EU-27 (+2.5%). Individual items of the consumer basket saw a different development. In particular, prices in the section concerning food and non-alcoholic beverages, health and transport were responsible for a moderate slowdown of the price increase. On the other hand, the items concerning accommodation and catering, other merchandise and services recorded a moderate increase. In the section "food and non-alcoholic beverages" the increase of prices for bakery products and cereals, oils and fats, sugar and coffee slowed down, which was influenced by a sharp increase of prices in Q2 2011. For instance, the price of bread was in a year on year comparison higher by 6.9%, while it rose by 17.5% in Q1. The slowdown of prices in the transport industry may particularly be attributed to a low year on year increase of fuel prices.

The year on year growth of market prices recorded a moderate slowdown to 2.1% (in Q1 2.3%), while the growth of regulated prices slowed by 9.5% (in Q1 9.8%).

- **Terms of trade in negative values for ten consecutive quarters**

In Q2 2012, terms of trade posted a year on year moderate decrease to 98.3% (a drop by 0.1 percentage point against Q1), and for ten consecutive quarters they have remained at negative values. In Q2, export prices recorded a year on year increase by 3.9% (a drop by 0.1 percentage point against Q1). The export prices of chemical substances (year on year by 6.2%), and industrial consumer goods (by 4.9%) posted a significant increase. There was a significant drop in export prices of mineral fuels (by 5.4%). The most significant year on year increase was recorded by the import prices of mineral fuels (by 18.3%) and chemical substances (4.8%). The import prices have not decreased in any of the groups.

Chart No. 11 Production prices in agriculture (y/y in %)

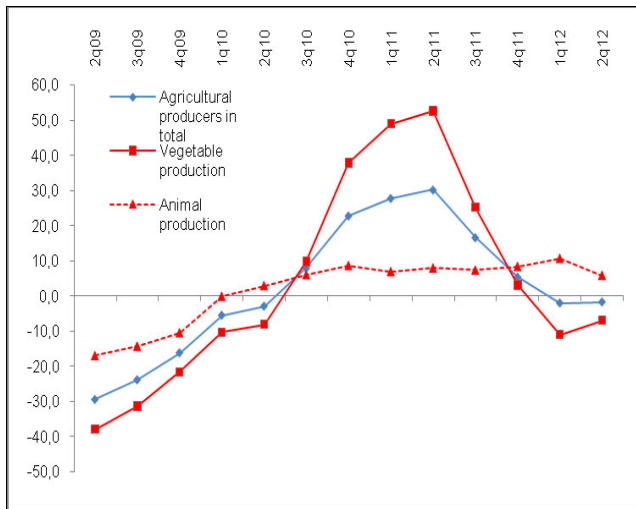
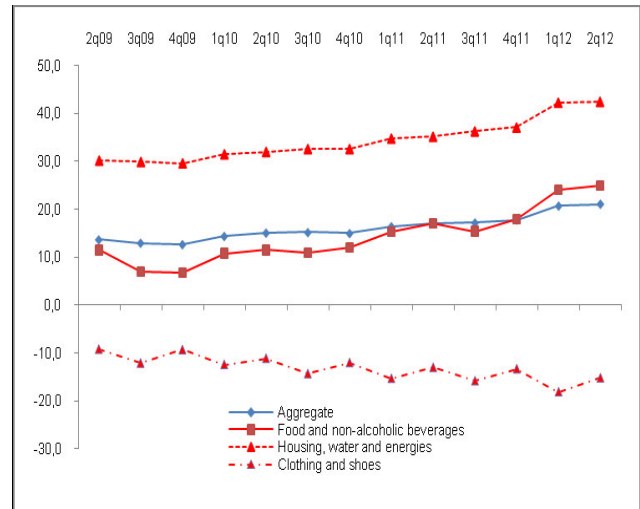


Chart No. 12 Consumer prices (2005=100)



Source: CZSO

Labour market

- **Total employment recorded a year on year increase for the sixth consecutive time**

In Q2 2012, the situation on the labour market was slightly better than in Q1. New job vacancies emerged and there was an increase in total employment. The employment, as shown in the national accounts and adjusted by seasonal fluctuations, rose after two quarters of decline to the level reached in Q3 2011.

The total employment in the Czech economy, based on national accounts, rose in Q2 year on year by 13.6 thousands of persons (+0.3%), against Q1 2012, but the number of employees grew even more significantly – by 17.7 thousands of persons (+0.3%). In a year on year comparison, this was already the sixth consecutive quarter, in which an increase of total employment was recorded, which is influenced by the low comparative base in 2010.

The industries of trade, transport, accommodation and hospitality contributed in the year on year on growth of total employment by almost 39% (+15.3 thousands of persons). A higher number of employees in a year on year comparison were hired by industries of activities in the field of real properties (+8.9 thousand persons), professional, scientific and other activities (+7.2 thousands of persons) and the finance and insurance industries (+5.5 thousands of persons). Higher decreases of employed persons in a year on year comparison were recorded by public administration and defence, education and social care (-13.4 thousand of persons) and the manufacturing industry (-9.8 thousands persons).

- **Total employment rose as a result of the increase of entrepreneurs**

An increase of entrepreneurs is responsible for the improvement of total employment in a year on year comparison adjusted by seasonal fluctuations. Their number increased year on year by 35.4 thousands of persons, that is by 3.8%. From individual sectors, the highest increases of entrepreneurs were recorded in a year on year comparison in trade, transport, accommodation and hospitality (+12.3 thousands of persons) and in the construction industry (+8.2 thousands of persons). Only in information and communication activities (-1 thousand of persons) and the agriculture, forestry and fishing industries (-0.7 thousands of persons) did the numbers of entrepreneurs drop. The number of employees in a year on year comparison decreased in Q2 2012 by 21.8 thousand persons, i.e. by 0.5%. There has been a decrease in the number of employees in public administration and defence, the health sector, education and social care for the fifth consecutive quarter. In a year on year comparison, this decrease stood at 15.5 thousands of persons. The year on year drop in the number of employees in the manufacturing industry (-10.1 thousand of persons) and in the building industry (-8.6 thousands of persons) are also apparent.

• **Moderate improvement of unemployment: more vacancies**

The general rate of unemployment⁷ (in the age group of 15–64) reached in Q2 2012 a value of 6.8% and has not changed in a year on year comparison. However, against Q1 it dropped by 0.4 percentage points. In absolute terms, there were 350.9 thousands of unemployed persons in the Czech Republic in Q2, which in a year on year comparison was 0.5 thousands of persons less and in quarter on quarter comparison 18.3 thousands persons less. Therefore, a typical seasonality was reflected in the unemployment. The share of long-term unemployment from the total number of the unemployed already reached 44.3%. The rate of registered unemployment established at labour offices reached a value of 8.4% in Q2.

In Q2, the number of vacancies increased in a year on year comparison by 4.4 thousand to 42.8 thousand and the quarter on quarter increase was 2.6 thousand positions. Naturally, there are the discrepancy between the qualification of candidates and the required expertise for vacancies.

• **Decrease of real wages**

In the first half of the year, the average wage reached CZK 24,341. In a year on year comparison this represented an increase of CZK 657 (+2.8%). Due to the fact that consumer prices increased for the given period by 3.5%, there was a decrease in real wages by 0.7%. When looking only at the results for Q2, it must be noted that the nominal average wage increased year on year by 2.3%, which, in comparison with the increase of consumer prices by 3.4% in the monitored period, meant a decrease of real wages by 1.1%. In both the business and non-business spheres, the year on year development was equal in Q2 – in nominal terms, the wage increased by 2.3%, and in real terms, it dropped by 1.1%, which was influenced by administrative transfer of units between both spheres. As bonuses were paid in Q2 to a greater extent, the nominal average wage grew against Q1 by 2.4%.

Chart No. 13 Total employment and number of employees (y/y in %)

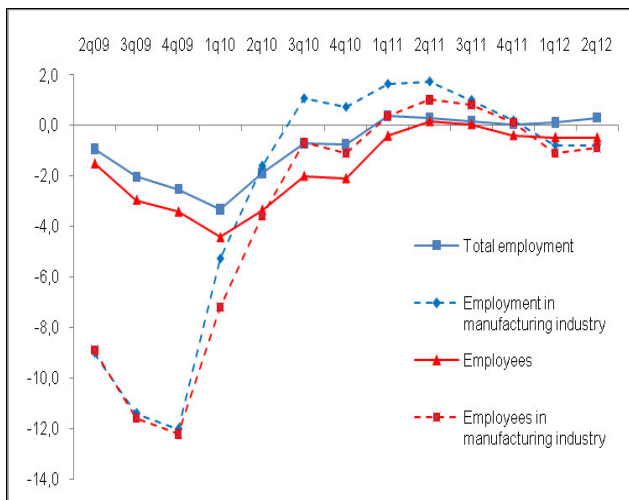
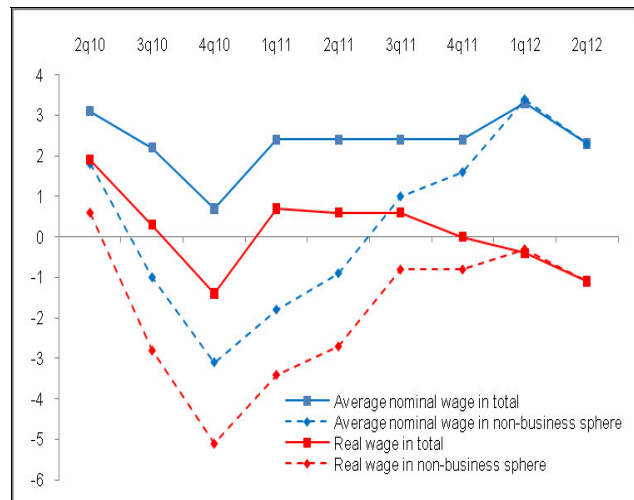


Chart No. 14 Nominal and real wages (y/y in %, recalculated values)



Source: CZSO

Monetary conditions

• **Monetary conditions stimulate expansion, but no recovery occurred**

The level of recession of the Czech economy is evidenced by a significant drop in the rate of loans provided to businesses and households. Even the historically lowest basic interest rates cannot help the economy to recover. The money stock increased by 6.3%, while the half year nominal GDP at current prices grew only by 0.7%. Therefore, the monetary conditions work towards expansion, and are not a restrictive

⁷ According to the definition of the International Labour Organisation (uniform for the EU member states), persons who did not hold in the reference period any job, have not worked a single hour for wage or remuneration and have sought actively a job that they would be able to take on in two weeks at the latest, are considered to be unemployed. The definition of unemployed persons under ILO, who are established by a selective survey of the workforce (LFSS) in CZSO, is different from the definition of a job candidate registered at labour offices of the Ministry of Labour and Social Affairs.

recovery occurred factor.

- **Money stock in the economy exceeded the threshold of CZK 3 trillion**

The growth of the money stock is influenced by the high increase of deposits of businesses on their current accounts with a constant – although lower when compared to businesses – year on year rate of household deposits. The dynamics of loans provided to businesses and households has weakened. Therefore, the money stock in April 2012 exceeded the threshold of 3 trillion for the first time and at the end of June (CZK 3029.6 billion), it was year on year CZK 184.7 billion higher. For this growth, an increase of one-day deposits is responsible for 75% (+139.5 billion), while the increase in other deposits (with maturity and notice period) contributed only by one eighth (CZK +23 billion).

- **Accumulating uncertainty leads businesses to rapid accumulation of short-term liquidity on their current accounts ...**

Businesses withhold cash and are not investing, which in turn raises balances on their current accounts. Despite the fact that in 2011 the slump of business deposits with notice period was viewed as dramatic – from CZK 28.2 billion to 1.7 billion, which almost annulled their balances – against the total amount of deposits of businesses and households that reached CZK 916 billion back then, it was a marginal drop. In the half year of 2012 these deposits stood at the margin of interest of businesses (CZK 2.9 billion). On the contrary, business deposits with maturity recorded a year on year increase by 15.5% (CZK +31 billion). However, their balances in fact remained on the level from June 2010, as in the half year of 2011 there was a drop of CZK 29 billion. (The movement is highly volatile. In June 2012, a year on year decrease by 5% occurred again.)

General uncertainty is thus cumulating in the cash that has not been invested by companies on their overnight deposits. At the half year mark, their balances rose year on year by 12.1% (in July already by 21%, that is, by CZK +107 billion when such strong growth was recorded in May 2010 for the last time). At the same time, corporate profits, according to the data available for Q1, were in a year on year comparison higher than after the stagnation in 2011 and their gross value added recorded only a slower increase. The same situation occurred in Q2 when the gross value added even dropped. The accumulation of cash and short-term liquidity has its own logic.

- **...with still lower increase of deposits of households**

On the contrary, the willingness and ability of people to deposit money was significantly dampened. Despite the fact that the balances of their overnight deposits (giro accounts) with monetary-financial institutions rose in a year on year comparison by 7.4%, the deposits with maturity increased only by 1.1% and there was a steady decline with regard to deposits with notice period (-2.8%), but not so significant as in the same period in 2011 (-12.6%). In July, the deposits of households with notice period increased only by 0.3%, recording the lowest growth since November 2009.

The significant reduction of the growth of household deposits can be evidenced by the comparison of absolute data against the same period in the previous year – while based on balances from June 2011, people increased their deposits on overnight deposits in a year on year comparison by CZK 117 billion, until June 2012 it was only by CZK 77 billion. A similar significant drop in increase was apparent with regard to deposits with maturity (from CZK +16 billion to +4 billion). However, despite drawing cash from accounts with notice period, it was significantly less in a year on year comparison (-10 billion) than in the same period of 2011 (CZK -49 billion). Given the fact that their final consumptions expenditures continue to weaken, that declining increase of household deposits can be seen as an unfavourable factor in their financial situation related to significant reduction of disposable income. According to data for Q1 2012, people set aside 9.2% of their gross disposable income in the form of gross savings against 11.7% in Q4 2011.

- **Loans on the decline**

The lending rate of companies is on the decline depending on the slump of their activity. The recovered growth of lending – which appeared after permanent drops after the crisis as late as Q1 2011 and which had been on a moderate increase until Q3 – slowed its pace again. In the half year, the loans provided to companies were in a year on year comparison higher only by 3.3% than in Q1 (+4.6%) and towards the end of 2011 (+5.1%).

For households, the year on year slump of the loans provided is longstanding. In June 2012, it dropped below the 5% threshold (+4.9%) for the first time. The debts of households towards banks (1133 billion) were in the half year of 2012 higher by CZK 170 billion than the debt of businesses (CZK 965 billion).

• The rate of loans provided to households or housing has started to decline again since Q2

Since April 2012, the dynamics of loans for housing started to decline again (to year on year +5.9% towards the end of the first half of the year). A moderate growth increase thus lasted only one quarter. In addition, the rate of mortgage loans decreased, and bridging loans have been on a steady decline since October 2010, as well as ordinary loans from building savings since June 2011. It can be said that clients with less creditworthiness are no longer willing to take loans for housing, and these make up the greatest part of clients of building savings institutions, using them to finance their housing needs.

Since 2011, consumer credits have been on a steady decline – by 1.7% based on the data at the end of June – with less use of non-special-purpose consumer credit (-4.9%, in the half year of 2011 only -1.1%). Their ratio share in relation to loans for housing is changing as well – in June 2011 these were 3.8 times higher than consumer credit, but in June 2012 already 4.1 times higher.

• Drop in interest rates with new loans for housing, stronger with deposits for households with longer maturity

Margins of banks in new transactions with clients have been influenced by the movement of rates. A downward movement was seen with loans for housing (from 4.42% to 3.91%). However, rates for consumer credit increased (from 13.97% to 14.10%), and business loans grew on price as well (from 3.00% to 3.03%). The price of one-day deposits of households forming the highest share of the money deposited, was increased by a mere 0.01 per mil to 0.715%, while rates for deposits of households with maturity over 2 years even recorded a significant drop (from 2.27% to 1.23%).

• Net domestic assets increased only moderately, net foreign assets more significantly

The significant decrease of the growth of net domestic assets, +1% in a year on year comparison against +12.9% in the same period in 2011, was affected by lost dynamics of domestic loans (despite the fact that net loans to the government sector increased year on year by one fifth). Their growth was also decreased by the development of other net “non-credit” items (including securities and capital). On the contrary, the balance of financial liabilities and liabilities of monetary-financial institutions in the Czech Republic towards the rest of the world increased by 18.3% (predominantly influenced by the growth of foreign assets of banks).

Chart No. 15 Deposits (in million CZK)

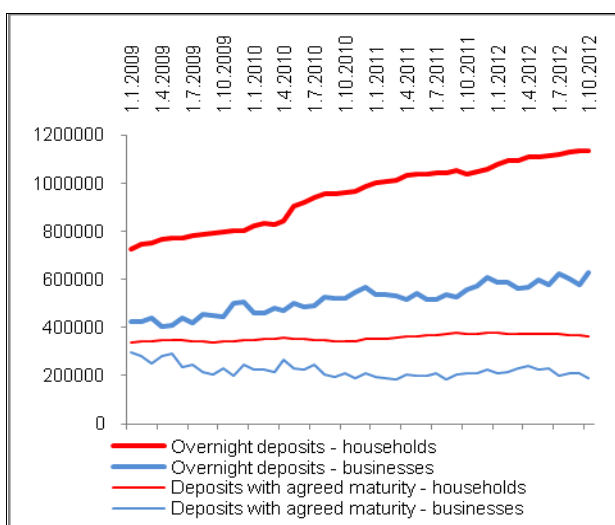
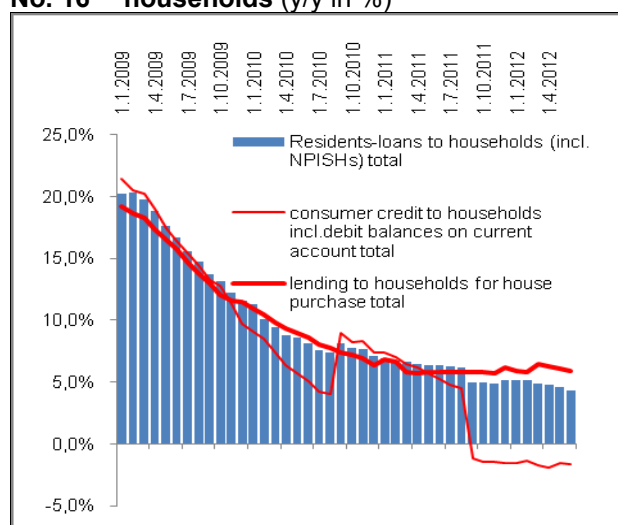


Chart No. 16 Dynamics of loans provided to households (y/y in %)



Source: CNB

State Budget

- **Significant state budget deficit, similar to that in the preceding three years**

In the first half of 2012 the state budget posted a deficit of CZK 71.7 billion, a year on year increase of almost CZK 9 billion. This result must be placed in the context of the economic downturn (the half-year deficits in 2009 to 11 varied between CZK 63 and 76 billion). A year on year comparison is to some extent made more difficult because of the differing timing of the advance payments for regional schools (CZK 10 billion to the detriment of 2012), and partly also the time shift in payments for gift tax for the consideration-free acquisition of emissions permits.⁸ The deficit was reached through a slight year on year fall in total revenues (-0.6%) and a concurrent rise in expenditure (+1%).

- **Revenues from the three most significant taxes fell year on year by 3% in the first half...**

Tax revenues without premiums were primarily behind the year on year fall in state budget revenues, falling in total by 2.6% (CZK 7 billion). This fall was larger than the growth in the economy's overall performance (GDP at current prices grew by 0.5% in the first half of the year). The state budget collected less mainly in the components with higher weighting, namely VAT (-2.6%), in spite of legislative amendments to its benefit (increasing the lower VAT rate, a change in the budget tax allocation). Falling household consumption was also reflected in lower consumer tax revenue (-2.6%), while a larger fall was prevented by a higher tax rate on tobacco products and increasing revenue from the "solar tax". Corporate tax revenue remained 3% under its 2011 level, and was almost one-third lower than in the same period in 2008. On the other hand, income tax revenue from natural persons grew year on year in spite of a slight fall in the number of employees (-0.7%). The cancellation of the tax break on income from interest on building savings deposits had a positive influence on revenue from this tax.

- **...but improved VAT and corporate tax collection in the summer months**

The collection of some significant taxes improved in July and August. Corporate tax was CZK 5 billion higher year on year in this period and in total since the start of the year has exceeded last year's level by CZK 3.5 billion (7.5%). This year's holidays also brought CZK 4.5 billion more in VAT year on year, meaning that since the start of the year the state budget has received 1.6% more. (However, the nationwide collection of VAT was still 1.3% lower year on year, partly due to lowered collection from goods and services at the base rate.) On the other hand, there was no improvement in the collection of consumer taxes in the summer months, and the year on year fall in collection was 1.6% in the first eight months of this year. The collection of indirect taxes corresponds to the fall in household consumption.

- **Year-on-year fall in revenues from the EU continued**

Income from the EU was primarily behind the fall in budget revenue outside the tax sphere (-1.6%), as in the first half of 2012 this fell year on year by 9% (or CZK 4 billion). In the second quarter drawing increased compared to the start of the year (the year on year fall in the first quarter of 2012 was 20%), but it was not possible to close the deficit in drawing even during the holiday period. Over the first eight months of this year, income from the EU came to only 47% of the approved budget.

- **Reductions in the majority of social benefits with the exception of pensions continued**

The total expenditure of the state budget after reductions resulting from the economising measures in the previous year (CZK -13 billion in the first half) returned to a year on year growth (of CZK 6 billion) in the first half of 2012. The current budget expenditure was CZK 12.5 billion higher year on year, while this larger deficit was primarily the result of the earlier payment of advance payments for regional schools (almost CZK 10 billion to the detriment of 2012). Current expenditure was most impacted by pensions (3.1% higher year on year in the first half of 2012). However, the state made savings on other types of social benefits: sickness benefits (CZK 1.5 billion), state social support (CZK 0.5 billion) and support for the unemployed (CZK 1.4 billion). The number of registered job seekers fell by 4% on average in the first half year on year. Expenditure on the active employment policy as well as the state contribution towards building savings also fell to half of last year's level. In the first half the state spent CZK 36 billion (year on year +1.7%) in salaries for its

⁸ More comparable (in methodological terms) and thus more objective would be a comparison of the deficits in the January to July period. In 2012 the state recorded a deficit of CZK 51.7 billion, a year on year fall of CZK 9.4 billion.

employees, while this amount was comparable with that six years ago thanks to significant reductions in the preceding year. State debt expenditure (CZK 33 billion) grew year on year by one-eighth, and by one-half over the past five years. Contributions to the EU budget also grew by almost CZK 5 billion year on year.

• **The net position vis-à-vis the EU weakened year-on-year due to reduced revenues from structural funds**

The net position vis-à-vis the EU budget reached CZK +6.9 billion in the first half of 2012, a year on year fall of CZK 10.5 billion. This drop was the result of lower revenues from structural funds and the Cohesion Fund (a fall to CZK 4.5 billion from last year's CZK 13.4 billion) influenced by the cessation of the payment of the majority of operational programmes. However, year on year revenues from the Common Agricultural Policy were CZK 3 billion higher, almost three-quarters of which were accounted for by direct payments, and the balance directed towards rural development.

• **An increase in the deficit on the pension account was prevented by an almost 3% growth in premium collections**

The pension account balance, expressed as the difference between budget revenues in the form of social security designated for pensions (increased by 2.7% year on year) and pension benefits paid out (+3.1%), slightly worsened in the first half (by CZK 1.3 billion). The increased collections were partly due to an expansion of the obligation to pay premiums (e.g. to include agreements to complete jobs). The height of pension payments was similarly influenced by their valorisation (the increase in the percentage pension assessment by 1.6% since January 2012), as well as the long-term slight growth in the number of pension recipients. The deficit on the pension account reached in the first half (CZK -26 billion) is the highest since 2000.

• **Planned reduction in capital expenditure reduced the state budget deficit**

In the first half of 2012 capital expenditure continued its long-term fall, falling year on year by one-eighth, and by one-fifth over the past four years. Investment transfers to the State Transport Infrastructure Fund (CZK 7.8 billion) fell year on year by almost one-half. The downturn in investment expenditure increased during the holiday period. Over the eight months of this year investment fell year on year by CZK 12 billion and thus significantly contributed, unlike current expenditure, to slowing the growth in the state budget deficit.

Chart No. 17 Nationwide collection of tax revenues and the development of the state budget balance

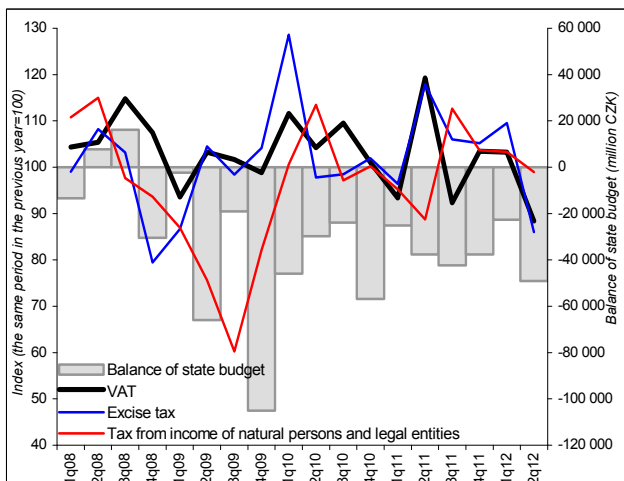


Chart No. 18 Balance on the pension account and the development of the number of pension recipients

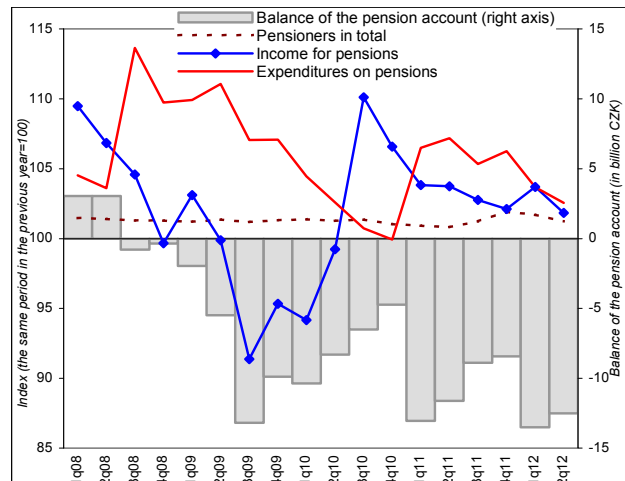
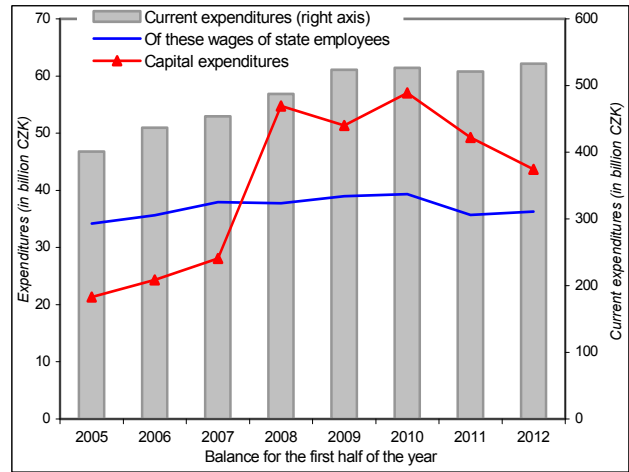
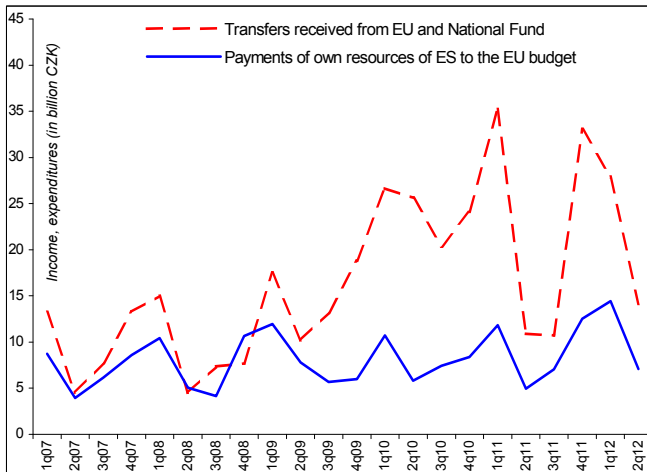


Chart No. 19 CR revenues and expenditure in relation to the EU

Chart No. 20 State budget regular and capital expenditure in the first half of the years 2005 to 2012



Source : MF

Sources of data: CZSO, MF ČR, CNB, Eurostat, CZSO calculations.

The most recent information from the CZSO, CNB and the MLSA given in this report is from 8 September 2012.