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1. Summary

- The CR economy continued in the successful development of the last quarters also in Q2 2016. The gross domestic product (further also “GDP”¹) as well as the gross value added (further also “GVA”) increased by 0.9% in the quarter-on-quarter comparison, which represents the acceleration of 0.4 p.p. for both indicators compared to Q1 (from +0.4%). In the view of the whole first half-year of 2016, the GDP increased by 2.8% year-on-year.
- The high comparative basis of the year 2015 had an effect in case of the year-on-year rate of growth, again as in Q1. The year-on-year growth of GDP arrived at 2.6% and GVA 2.7%. The economy was driven by the extraordinarily successful foreign trade and the stable household consumption. On the contrary, investment which significantly supported the growth in 2015, impacted the GDP growth negatively. The Czech economy grew faster compared to the EU28 in Q2 – by 0.8 p.p. year-on-year and by 0.5 p.p. quarter-on-quarter. The EU growth was 1.8% year-on-year and 0.4% quarter-on-quarter.
- The continuing year-on-year growth of the household consumption, which reached 2.2% in Q2, was supported by the growing average wage, record employment and also the persisting high consumer confidence. In the view of the quarter-on-quarter development, the household consumption stayed at the level of the Q1 (it grew by 0.1 p.p. compared to this quarter). In case of investment, the slump of the investment subsidies already fully manifested in contrast to Q1, which led especially to the fall of investment into other buildings and structures (compared to the exceptionally high year 2015, when a finalisation of drawing of funds occurred for the European funds of the programming period 2007–2014). Investment fell by 4.4% year-on-year and by 4.1% quarter-on-quarter. The foreign trade balance reached record level in Q2 as well as in the whole H1 2016 (+94.2 CZK bn).
- The good condition especially of the manufacturing (GVA increased by 4.8 % in Q2) was apparent in the growth of the economy on the supply side. Services also prospered. On the contrary, the construction faced a falling demand mainly after the investment into other buildings and structures and dropped by 5.5% year-on-year.
- The surplus of the current account of the balance of payments increased by 44.7 CZK bn year-on-year in H1 2016 and attained the level of 107 CZK bn. For the most part, the growing surplus on the income balance stands behind the improvement as well as the weaker outflow of the primary income (especially in the form of dividends), which fell by 20 CZK bn year-on-year. The demand of foreign investors for Czech government bonds went up significantly year-on-year. The purchases rose from the last year's 39 CZK bn to current 114.2 CZK bn.
- The price level gauged by the implicit GDP deflator rose by 0.8% year-on-year in Q2, mostly due to the positive terms of trade. The growth of the consumer prices was approaching stagnation (+0.2%). The deflation development further deepened in industry and agriculture. A price stagnation persisted in the business support service activities and prices slowed down its weak growth in the construction. The deflation pressures leaked into the Czech economy via the foreign trade prices. Prices of the housing real estate were however accelerating their growth dynamics in the environment of the record low interest rates on mortgages, which affected mostly the current flats sold among households.
- The monetary conditions remained loose also in June 2016. A fast growth of the harmonised monetary aggregate M3 occurred (by 9.7% year-on-year). The volume of one-day deposits enlarged by 340 CZK bn year-on-year and currency by 41 bn. So called quasi-money decreased by 80 CZK bn in Q2 and by 52 CZK bn in Q1. The credit to households increased by 6.4% in Q2 (82 CZK bn) and loans to businesses by 11% (112 CZK bn).
- The labour market still enjoyed a favourable development. The rate of growth of employment gained pace markedly in H1 (to 1.7% year-on-year), mostly thanks to manufacturing. The number of employed reached a historical maximum (5.26 mil persons). Unemployment kept shrinking further, if already by a slower pace. The position on labour market improved especially for the qualified manual workers. The qualification mismatch between the unemployed persons and vacancies and the subsequent long-term unemployment remains a big difficulty on the labour market. The low unemployment accompanied by a

¹ Data related to the GDP, gross value added and their components are expressed in constant prices and adjusted for seasonal and calendar effects. Data were published on 2nd September 2016 and accuracy improvement on 30th September 2016.



growing lack of labour force pressures on the growth of wages. The average wages grew in real terms by 3.8% in H1, which presented the highest growth since the end of the year 2009.

- The state budget reached a surplus in H1 (40.6 CZK bn), which was the best result in the history of the independent CR. The irregularities in the drawing of the funds from the EU budget, but also the strengthened collection (especially of the direct taxes) connected to the brisk growth of the economy were reflected considerably in the result of the state budget.

2. Overall Economic Performance

The growth of the economy of the Czech Republic continued also in Q2 2016, in addition it even mildly accelerated compared to Q1. Both GDP and GVA increased by 0.9% year-on-year...

The stable economic growth of the Czech economy from the last years continued also in Q2 2016.² It is evidenced by the development of the gross domestic product (GDP) as well as the gross value added (GVA). Both GDP and GVA increased by 0.9% in comparison to Q1. This development signals mild growth acceleration, since the quarter-on-quarter growth of GDP and GVA fluctuated around 0.4% in Q1. It is apparent, that despite of the subsiding of the exceptional factors supporting the economic growth in the last year (finalisation of drawing of resources from the European funds or the marked drop of the prices of oil), the economic situation remains favourable and above-average in the context of the latest years.

... and the performance of the economy increased according to these indicators by 2.6% and 2.7% compared to the same quarter of the year 2015

The GDP was higher by 2.6% and GVA by 2.7% in comparison to the same quarter of the preceding year. The dynamics of the GDP growth mildly decreased in Q2 compared to Q1 (GDP grew by 3.0%), nevertheless it was caused especially by the higher comparative basis of Q2 2015. The last year's significant economic growth peaked just in Q2 and thus the year-on-year comparison of the year 2016 is also affected by this development.

The GDP increased by 2.8% year-on-year in total for the whole H1

The view of the whole H1 2016 confirms that the Czech economy flourished. The performance of the economy gauged by GDP increased by 1.0% compared to H2 2015 and by 2.8% in comparison to the first six months of the year 2015. If we omit the extraordinary last year, it still represented the highest rate of growth since year 2008.

The economy of the CR keeps expanding faster than the European Union both in the year-on-year and quarter-on-quarter comparison

The year-on-year growth of the GDP in the CR remains despite its slow-down still stronger compared to the European Union. The domestic economy grows faster practically since stepping out of recession in 2013. Its dynamics was by 0.8 p.p. higher compared to the EU28 in Q2 of this year, since the growth of the EU28 arrived at 1.8%. The Czech economy was faster also from the view of the quarter-on-quarter rate of growth, specifically by 0.5 p.p. (given the growth of the EU28 economy by 0.4 p.p.).

Only the Great Britain keeps growing by the above-average pace among the three largest economies of the EU

Based on the available data for the individual countries of the EU, the GDP grew the fastest in Romania, Slovakia³ and Spain year-on-year in Q2 2016. The Czech Republic ranked the eighth. The Great Britain grew the fastest (+2.2%) among the largest EU28 economies. Romania and Hungary grew the fastest quarter-on-quarter, the Czech Republic together with Poland and Slovakia shared the third place.

A foreign trade was the main source of the year-on-year growth of the Czech economy in Q2 2016

Similarly to Q1, the three pillars which supported the growth most in the last year were reduced to two. Only the household consumption and foreign demand participated on the year-on-year growth of the CR economy. The domestic demand was driven only by the final consumption expenditure of households in Q2 2016, fuelled by the good situation on the labour market, and the government expenditure. Rising foreign demand, resp. the surplus of the foreign trade were

²Unless stated otherwise, data related to the GDP and its components are expressed in real terms and adjusted for seasonal and calendar effects. The same is also valid for the gross value added. The GDP time series in the period of Q1 2014 has been seasonally adjusted by using a new model. This model takes into account a change of the seasonal behaviour of GDP after 2013, associated with the newly more even collection of taxes on products, especially tobacco products.

³Data for Ireland and Luxembourg are not available. Dynamics for Slovakia not adjusted for calendar effects.

the most significant factors behind the economic growth in Q2.⁴ The household consumption more significant by weight contributed to the GDP growth of 2.6% by 0.8 p.p., consumption of the government institutions added 0.5 p.p. And the foreign trade 2.5 p.p. On the contrary, the cooling down of the total investment activity (gross fixed capital formation) induced especially by the drop of investment of the government institutions sector was reflected in the negative effect of this demand component on GDP (-1.1 p.p.). The increasing household consumption was partially satiated by the rising imports, nonetheless it stimulated the domestic production rather than imports.

The year-on-year growth of the household consumption was still significant in spite of the strong last year

The continuing year-on-year growth of the household consumption, which reached 2.2% in Q2, was supported by the rising average wage, record employment and of course also the persisting high consumer confidence. It can be stated based on the quarter-on-quarter development, that the household consumption remains stable at the relatively high level of Q1. It did rise compared to this quarter, but only by 0.1 p.p. The final consumption expenditure of households was in total for the whole H1 2016 by 2.4% higher year-on-year. The development in Q1 participated on this result to a higher extent, since the household consumption expenditure rose by 2.7% year-on-year in this quarter. The willingness of households to spend was favourably influenced by the rising real average wage and rising employment in first half of the year. The total volume of paid out wages and salaries⁵ was by 5.7% higher in nominal terms in Q2, in real terms then⁶ it was by 5.3% higher. The trend from Q1 that the beginning of the year 2016 represents the strongest raise of the wage resources since Q3 2008, in real terms even since the beginning of the year 2007, is thus validated. The year-on-year increase of the wage resources moved around 5.7% for the whole H1.

Year-on-year dynamics of the final consumption expenditure of government institutions approximately on the level of the last year, similarly as in Q1

Final consumption expenditure of government institutions including the expenditure on the individual consumption (benefiting exclusively households) and the collective consumption (benefiting all sectors) increased by 2.8% year-on-year in Q2 of this year – similarly to the preceding quarter. The quarter-on-quarter growth was somewhat faster compared to Q1, specifically 0.8%. The picture of the development for the whole half-year is very similar. The government consumption increased by 2.8% year-on-year in the first six months and by 0.8% compared to the second half of the year 2015.

The quarter-on-quarter slump of investment considerably strengthened. Investment was falling not only year-on-year, but also quarter-on-quarter

The impulse in the form of completion of drawing on the European funds from the programming period 2007–2014 was reflected in the growing year-on-year dynamics of investment, reaching the value of 9.1%, during the whole last year. Investment increased also quarter-on-quarter in all periods in 2015, even though in a decelerating fashion. Thus it can be stated, that the high investment activity persisted during the whole year. The quarter-on-quarter slump eventuated in Q1 2016, even though the formation of investment was still higher (by 2.6%) when compared to the beginning of the year 2015. In Q2 the fall of investment activities was evident both in quarter-on-quarter and year-on-year expression. The overall development was to a large extent affected by the drop of investment into other buildings and structures, resp. high comparative basis of the year 2015. Fixed capital formation was by 4.4% lower year-on-year, it fell by 4.1% quarter-on-quarter.

The low investment into other buildings and structures, whose growth was supported by the funds from the programme period 2007 – 2014 in the last year, was the main cause behind the fall of the total volume of investment

The type classification of gross fixed capital formation (not adjusted for seasonal and calendar effects) reveals that only the investment into housing (2.5%), reflecting the low cost of financing of the residential real estate on credit, and investment into the transportation equipment (6.6%), associated with the renewal and expansion of the company car park increased in year-on-year comparison in Q2 of this year. The purchases of the groups most significant by weight ICT, other machinery and equipment were mildly decreasing, which could be partially associated with the fact, that not only other buildings and structures, but also

⁴ Contributions to the GDP change after exclusion of imports for final use.

⁵ Not adjusted for seasonal and calendar effects.

⁶ Wages expressed in real terms using the deflators of final consumption expenditure of households.



other assets were linked to the end of the programming period in the last year. Investment into other buildings and structures, which was significantly supported by the investment subsidies from the EU funds, fell by 18.4% in the year-on-year comparison.

Higher year-on-year growth of exports (5.7%) over imports (3.1%) together with the positive terms of trade led to a high surplus in the foreign trade

From the view of the foreign trade, the Czech economy was very successful in Q2. The foreign trade balance in the current prices (94.2 CZK bn) was higher by 34.2 CZK bn year-on-year in Q2. Both the trade with goods as well as the trade with services participated on the record foreign trade balance. The growth of exports noticeably exceeded the growth of imports in both cases. Exports, which rose by 5.7% in real terms year-on-year, were driven especially by the trade with the transport equipment in goods and by the land transport or information and communication activities in services. The growth of imports by 3.1% was supported significantly by the sub-supplies for the motor vehicles and the production of electrical appliances and equipment. In the view of the whole H1, the foreign trade surplus also reached a record level. The gain of the foreign trade for the Czech economy in the form of a positive balance has never been so large in the history of the CR, as at the beginning of this year. The positive terms of trade also affected the foreign trade favourably, since the prices of imports kept decreasing faster year-on-year than the prices of exports. Nevertheless, this phenomenon has already started to change quarter-on-quarter and the prices of imports were falling slower compared to prices of exports especially for the reason of the quarter-on-quarter growth of the prices of oil.

Real gross domestic income rose by 4.3%

Real gross domestic income (RGDI), which unlike the GDP takes into consideration the additional profits or losses from the development of prices in the foreign trade, resp. profits or losses from the terms of trade, increased by 4.3% year-on-year in Q2 2016 (not adjusted for seasonal or calendar effects).

Manufacturing mostly participated on the year-on-year growth of the economy on the supply side in Q2 2016, services also participated significantly,...

On the supply side, the majority of the main branches participated on the year-on-year growth of the economy in Q2, similarly to Q1. Manufacturing sustained its dominant position, with the gross value added growing by 4.8% and contributing to the total growth 1.3 p.p. Most branches thrived from the view of dynamics within the services sector. The grouping trade, transportation, accommodation and food service activities increased by 2.5%, financial and insurance activities by 3.8%, professional, scientific, technical and administrative activities by 3.4% and activities in the area of real estate by 2.1%. Agriculture, forestry and fishing expanded by 5.6%.

... construction however sank in comparison from the exceptional year 2015

Lower investment into other buildings and structures compared to the last year, which was boosted by the extraordinary finalisation of drawing of funds from the programming period 2007 to 2014, was reflected in the notable year-on-year as well as quarter-on-quarter fall of the gross value added of construction (by -5.5%, resp. 5.7% in Q2).

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

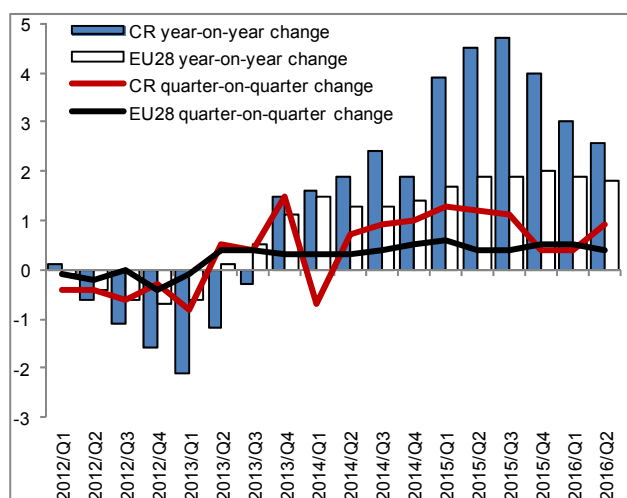
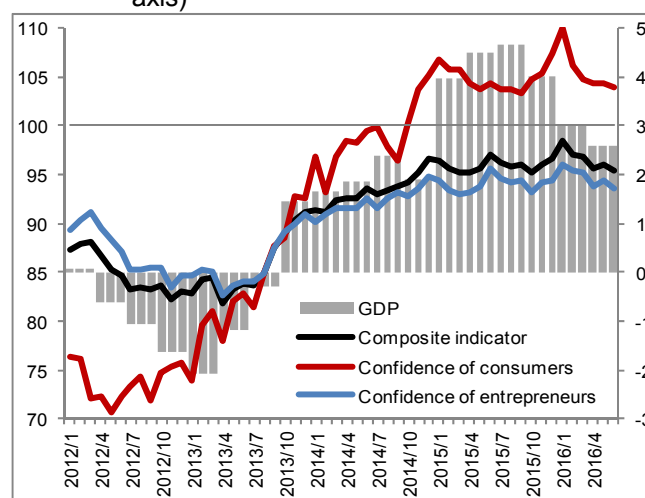
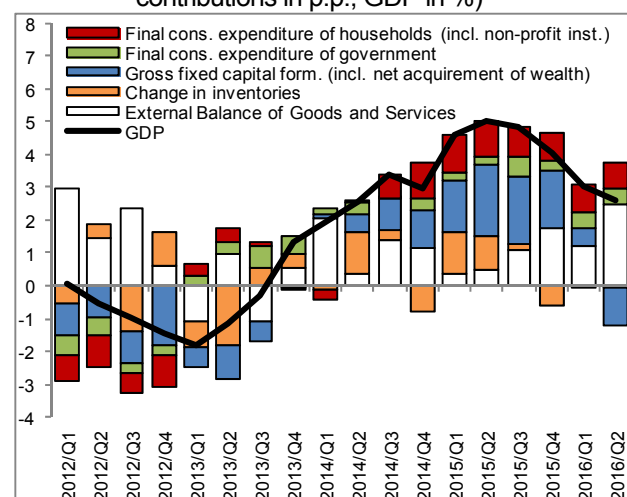


Chart 2 GDP (constant prices, adjusted for seasonal and calendar effects, y/y in %, right axis) and confidence indicators (2005=100, left axis)



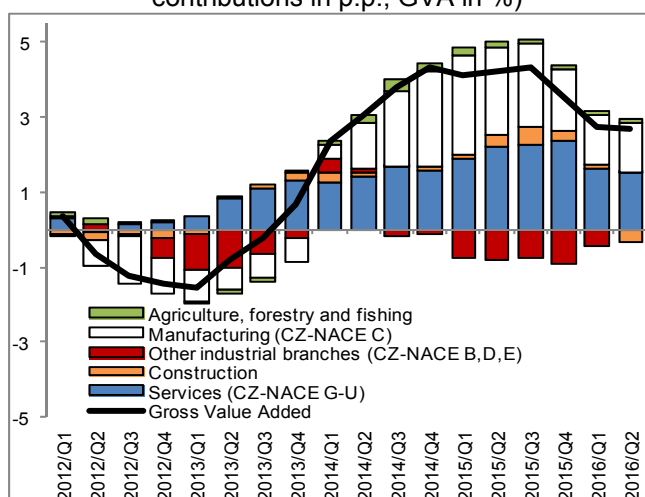
Source: CZSO, Eurostat

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



* Contributions to GDP change after exclusion of imports for final use.

Chart 4 Contributions of branches to change in GVA (constant prices, y/y, contributions in p.p., GVA in %)



Source: CZSO

3. Branches Performance

Rate of growth of gross value added (GVA) slowed down year-on-year in comparison to the extraordinary year 2015, the quarter-on-quarter growth however continued and it was even enhanced in Q2 itself

Manufacturing sustained a dominant position thanks to strong foreign demand,

Performance of all branches of economy, captured by the gross value added in these branches (GVA)⁷, expanded by 2.7% year-on-year – by the same pace both in Q1 and Q2 of this year. These rates represented milder paces compared to the strong last year's growth (always exceeding 4% in all first three quarters) in connection to a gradual dissipation of the extraordinary growth factors. The GVA growth slowed down already towards the end of the last year (to 0.3% – as compared to previous quarter). The development during the H1 2016 however gradually signalled a sign of a positive turn, since the GVA increased by a notable 0.9% in Q2 (the quarter-on-quarter growth of GVA was evident already a thirteenth quarter in a row).

Manufacturing traditionally contributed the most to the growth of the total value added. It shared from one half on (the more favourable) year-on-year result of all

⁷ Data related to the GVA expressed in constant prices and adjusted for seasonal and calendar effects.

without this industry, the GVA would grow by only a halved rate in the whole economy

branches this year (it has held a similarly dominant role since the half of 2014). The GVA was (against the exceptionally high last year's basis) by 4.8% higher in manufacturing in both this year's quarters, overtaking markedly the dynamics of most other branches. A strong demand (in traditional export branches) became evident in a higher employment⁸ (which grew slightly above 3% this year similarly to the last year's H1, by a double pace in comparison to the whole economy in both cases). The businesses tried to cover the growth of new orders also by a more intensive utilisation of the existing labour force. The number of hours worked increased against the last year's level by the unprecedented 6.1% in H1.

Good harvest of basic cereals and oil plants also contributed to the higher value added in agriculture this year

Agriculture, forestry and fishing also thrived, driven especially by the plant production. The good harvest of basic cereals and oil plants made a major impact here this year. GVA in the whole branch strengthened by 5.1% in H1 year-on-year and recorded a growth for a third year in a row.

Value added was falling in construction already a third time in a row (quarter-on-quarter), the branch faced a lack of more significant public orders after the dissipation of the "doping effect" of the European subsidies

Construction was the only more significant branch, which did not contribute to the growth of value added this year. The GVA decreased in the quarter-on-quarter comparison already at the end of the last year, the slumps deepened – down to -4.7% in Q2 2016 (which was also reflected in the year-on-year comparison, where the GVA fell for the first time after twelve months) since then. The relatively favourable development in the intermediate consumption prevented an even weaker result, since the production itself underwent in comparison to the GVA deeper declines in construction. The performance in construction adversely affected the area of employment.

Tertiary sector contributed to the higher GVA year-on-year 1.6 p.p. this year, the branch presenting a significant weight trade, transportation, accommodation and food service assisted by a whole one third to this contribution

Value added increased by 2.6% in the whole services sector year-on-year in H1 (the growth amounted to 3.6% in the same period of the last year). The rates of growth were on the whole quite equal within the main branches of services. Only the professional, scientific, technical and administrative activities deviated somewhat, when it reached 3.5% growth of the GVA despite the year-on-year decline of production (since the intermediate consumption in this branch was falling by even a higher rate). The financial and insurance activities also reached more than 3% increase of GVA and thus indicated, that the last year's fall of GVA (accompanied by a more substantial reduction of employment) was only a temporary fluctuation⁹. Information and communication activities are also developing in the long-term, which is reflected in the above average creation of new job positions (not only for employees) in the last four years.

The GVA was strengthening a bit more modestly in the branches with a significant weight proportion with the state domination¹⁰ (+1.9%) this year. The low growth of the volume of paid out wages stood behind this occurrence in the educational system. The branch trade, transportation, accommodation and food service activities could have capitalised on the positive consumer sentiment (supported by a large growth of both employment and real wages), on the growth of demand for freight transport, as well as more frequent arrivals of both domestic and foreign guests. Its this year's results were near to the growth rates of both GVA and employment in the whole economy.

Year-on-year dynamics of the industrial production was significantly influenced by higher number of working days in Q2

The performance of industry (gauged by the index of industrial production)¹¹ strengthened by 4.3% year-on-year in H1 (resp. 2.9% after adjustment for calendar effects). Calendar effects impacted especially the production in Q2, which had compared to the same period of the last year by three working days more this year. The difference between the adjusted (+2.3%) and non-adjusted production (+5.7%) was significant and lastly seen in such extent in Q3 2008. The higher last year's basis, when the industrial production successfully headed for 5% rates of growth, also had an effect. More essentially, the quarter-on-quarter rates of growth have not indicated a more notable slowdown of growth so far.

⁸ Unless stated otherwise, data are in the conception of the national accounts adjusted for seasonal effects.

⁹ It is also evident from the fact, that this year's value added in financial and insurance activities was by one quarter higher in comparison to the H1 of the boom year 2008. Only agriculture, forestry and fishing also reached a similar result within the ten main branches of economy. On the contrary, constructions still lagged 5 % behind this mark. The growth of GVA totalled 7.3 % in the whole economy in the last eight years.

¹⁰ Consists of branches: public administration and defence; education; health and social work.

¹¹ Including branches according to CZ-NACE: B (Mining and quarrying), C (Manufacturing), D (Energy).

Production stagnation in the energy industry, as well as the long-term slump in the mining and quarrying continued in the first half of 2016

Manufacturing exclusively contributed to the higher industrial production year-on-year (growth of the branch itself attained 5.4%). Energy production, which still struggled with the impacts of the long-term unplanned shutdowns of production facilities in fact stagnated (similarly to last year's H1). Controlled reduction of the currently little profitable mining of black coal manifested in the production of the whole mining industry – it was reduced by nearly one tenth against the level from the first three months of 2016 in Q2. The production slumped by 31% in the coal mining in the last five years (resp. against the H1 2011), which corresponded to the context of the EU countries.¹²

Year-on-year growth of both production and sales reached double digit values in the motor vehicle manufacturing...

Manufacturing of motor vehicles (comprising nearly one quarter of production of the whole industry) increased by 16% year-on-year in H1 2016, already by 53% since the end of the last recession (Q1 2013)¹³. Sales (in current prices) were by 13% higher year-on-year, both the domestic as well as those from the direct exports. The physical number of manufactured personal motor vehicles also attained a record value.¹⁴ The manufacturers of other (especially rail) transport vehicles also recorded an above average rate of production (+5.4%), mostly due to the rising the domestic demand. The main support activities of the motor vehicle industry did not fully take up in the successful last year (e.g. the year-on-year growth slackened to 2.7% in the manufacturing of electrical equipment and the sales from both exports and the domestic market even slightly decreased).

...the long-term dominant position of this branch within industry was even enhanced this year, the industrial production would grow by 3 p.p. less without it

On the contrary, the development of production in the proportionally strong branches of manufacture of basic metals (+7.2%) and machinery (+2.3%) remained stable. The manufacturers of furniture (their production increased by one fifth in three years) or printing (benefiting from the higher domestic demand) prospered out of the smaller branches. The mild revival continued for the long-term subdued clothing industry. Production in the textile industry already neared the level of H1 of the boom year 2008 (one half of manufacturing activities still has not reached this “mark”).

Among more significant manufacturing activities, the production was declining only in metallurgy (due to the surplus of steel on the European markets), chemical industry (caused by breakdowns of the production facilities) and for the first time after eight quarters also in the food industry

Despite the overall favourable development, manufacturing activities still existed, that were facing obstacles. Shutdowns of some operations have been limiting the production capacities in the chemical industry for already one year, its production slumped by one seventh this year. It presented (together with wood industry holding a smaller weight) the only manufacturing activity, whose production has not overtaken the level of its production from the beginning of the year 2013 (the trough of the last economic recession). Production also fell in metallurgy and foundry industry this year. Even the majority of significant European manufacturers have been confronted with the negative consequences of the excess supply of steel on the European markets in the recent months. The mild growth of production halted in the (volume significant) food industry for the first time after eight quarters. Even a shallow year-on-year reduction (by 2.2%) signified in this stable (mostly on the domestic market oriented branch) the worse result since the end of the year 2011.

Significant acceleration of the rate of growth of new orders in motor vehicle manufacturing in Q2, however the dynamics was weak in other branches (machinery), alternatively the value of orders was even falling (chemical industry, metallurgy)

The development of new orders indicates a positive short-term outlook for the industry. The rate of growth of their value considerably slackened at the beginning of the year (to 0.9% year-on-year, i.e. the slowest pace since the end of recession), however it tightly breached the 10% boundary in Q2. Manufacturing of motor vehicles contributed in a decisive way (the growth arrived at 11% in Q1, 30% in Q2).

A mildly positive entrepreneur sentiment prevailed in industry during H1. Seasonally adjusted balances of business confidence indicator have kept attaining stable

¹² The decline was 34 % in the whole EU, 42 % in Germany, 22 % in Poland in the last five years. Spain and the Great Britain recorded even deeper downfalls of production. The decline was related mainly to the black coal production (by nearly 60 % in the EU15), the reductions were milder for the brown coal (by 8 %).

¹³ It represented the fifth highest rate of growth within the assessed EU countries (without Slovakia, Slovenia). Only Hungary achieved a better result among the countries, that are significant producers of motor vehicles (56 %). The production was higher only by 12 % in the main manufacturing country - Germany, by 23 % in the whole EU.

¹⁴ Based on the data from the Automotive Industry Association, nearly 720 thous. personal vehicles were manufactured in the CR during the first six months of this year, by one eighth more year-on-year. Producers of other types of motor vehicles also thrived.



Industrial businesses experience the lack of labour force as a growth barrier more and more frequently since the half of the year 2015

values for already two and a half years. 22% of industrial businesses anticipated a growth of the production activity in the upcoming three months in August 2016, 16% for employment. The values were mildly higher in both cases compared to August 2015. On the contrary, the share of businesses, that consider the lack of labour force as a barrier to growth, notably quickened. It was already 19% of companies at the beginning of Q3 2016, but only 8% the year ago.

The dynamics of both employment and wages slightly strengthened. The average registered number of employees enlarged (based on statistics of businesses) in industrial businesses in the CR by 2.7% year-on-year at the beginning of the year, in that by more than 6.5% in the manufacture of motor vehicles. Metallurgy, mining and energy reduced the number of job positions. Average wages (in connection to the shift of the minimal wage boundary) were raised relatively the most in branches with low level of earnings (clothing, leatherworking, wood industry, furniture industry), but despite the cut of capacities also in the chemical industry.

Decline of public expenditure on transport structures, but also the slow development of housing construction impacted negatively on the construction production

Construction production again returned to deeper year-on-year drops this year following the strong growth from the preceding two years¹⁵. It fell by 7.7% in the first three months of the year, the fall even deepened to 12.2% in Q2. The performance in construction in quarter-on-quarter expression has been declining continuously already four quarters in a row. Both the civil engineering construction (-13.2%) and the more weight significant building construction (-9.4%) lagged behind the last year's level in H1 of this year. While the result of the civil engineering construction was (with the view to the intensive realisation of the transport constructions bound to the EU programming period finishing last year) expected to a large extent, the deep decline of the building construction was a surprise finding.

Performance of construction was situated on the level of two years ago, however it was still by one quarter lower compared to H1 2008

Value of new orders stagnated year-on-year already four quarters in a row

Total stock of work (at the end of Q2) in the form of all not yet completed construction orders reduced by one tenth year-on-year (to 147 CZK bn) exclusively due to the impact of the domestic public orders (-18.4%). The value of new orders (in construction businesses with 50 and more employees) fell by 4% year-on-year in H1, which resulted from the one sixth lower orders for the engineering constructions. Higher inflow of new orders in the building construction represented a positive signal in Q2 (+28%). Their value for the whole H1 was (within this time period) the highest in the last five years. Nonetheless, the whole industry lacks larger constructions this year. The average value of newly closed order fell below 3 CZK mil in H1 (it oscillated around 4 CZK mil in years 2014 and 2015). According to another leading indicator – building permits – the prospects of construction were somewhat more favourable. The approximate value of one granted building permit increased to 3.7 CZK in Q2 (from 3.2 mil recorded in Q1 2016) and simultaneously it was the highest since Q3 2012.

Construction has been lacking larger projects so far this year, average value of new closed order fell below 3 CZK mil – to the lowest level in last twelve quarters

Lower frequency of construction of housing flats in Prague this year slashed the number of all commenced flats in the CR to the third lowest value after year 2000

The number of all commenced flats fell by 3.4% year-on-year in H1 – together with years 2013 and 2014 it ranked among the lowest in this millennium. The construction of flats in residential buildings slumped considerably – as a result of a situation in Prague, where there was only 522 flats commenced this way. Partially, it can be caused by the heightened activity in Prague in H1 of the last year, when this number (2614) on the contrary belonged to the highest in the long-term context in the capital. The number of completed flats increased by 4.1% in the CR, especially due to the higher construction of family houses.

Negative balance of confidence of businesses in construction farther deepened

The confidence of businesses in construction worsened during H1. Seasonally adjusted balance of the business confidence in construction, positioned in the negative zone in the long-term, fell lower during this year and its July value was the lowest in the last 21 months. The construction businesses state as a barrier to growth more frequently the inadequate demand (53% based on seasonally adjusted data in January, 61% in May). In August, 17% of construction businesses (23% a year ago) anticipated a growth of the production activity in the three upcoming months, for employment 11% (resp. 16%).

Number of registered employees continued declining, construction lost more than 60 thous. employee job positions in the last eight years

¹⁵ All data related to the construction production are adjusted for calendar effects.

Growth of sales notably slackened in services compared to the last year

Sales fell for the first time after twelve quarters in the land and pipe transportation year-on-year at the beginning of the year

Sales of travel agencies and tour operators slumped by 23% in total in the last four years, in contrast they strengthened by 60% to the job agencies

Total sales in the services sector have not exceeded the level of the peak of the cycle yet, they were still by 7.1% lower compared to H1 2008

Year-on-year growth of the retail sales (adjusted for calendar effects) have oscillated around 6% already six quarters in a row

Among the specialised shops the sales increased the most for the products for cultural and recreational goods as well as for the products predominantly for household in H1

Favourable prices of automotive fuels are mirrored in growing sales at petrol stations

Year-on-year growth of the retail sales in the CR was the highest among the central European countries in H1

Sales in selected services¹⁶ grew by 1.1% in H1 (only by 0.1% following the adjustment for the number of working days). The slowdown of the sales growth compared to the whole year 2015 (+3%) followed especially from the professional, scientific and technical activities, whose last year's also 3% yearly growth presented only an extraordinary deviation in the whole period since the boom. They fell by 4.1% in this year's first half, mostly due to the architectural and engineering activities (as a consequence of a higher number of semi-finished not yet billed orders). Sales were however declining throughout the whole division, apart from the legal and accounting activities.

Transportation and storage also recorded a mild growth (+1.3%), especially thanks to the storage, since the sales in the weight dominant land and pipe transport (given the high last year's basis) slightly lowered. Administrative and support service activities continued in the last successful year also this year (4.9%), driven by the fast developing job agencies. Nevertheless, all activities throughout the whole division fared well, apart from the activities of travel agencies and offices. Sales were growing fast (similarly to the last year) in food service activities and restaurants in H1 (+4.6%). Sales in accommodation mildly lowered in Q2 year-on-year (for the first time since Q2 2010). A high tourism in the CR in spring last year was affected by the organisation of a significant sport event.

Retail sales (without the motoristic segment) grew by 6.7% in H1 (by 5.6% after adjustment for calendar effects). They were reflecting the growing incomes of households associated with their still improving position on the labour market. Simultaneously, the optimistic consumer confidence was strengthening. The seasonally adjusted balance of confidence attained the highest value in the history of monitoring at the beginning of the year (+7.5 points), it was staying in the positive values even in the following months.

The sale of non-food goods traditionally contributed the most to the growth of the whole retail (with sales growth of 7%, resp. 5.8% after adjustment). The sales of food, beverages and tobacco products also expanded by a strong pace (by 5.4%, resp. 4.2%). Among the specialised shops of the non-food goods, the sales increased the most for the products for cultural and recreational goods in H1 (by 7.7% year-on-year), by a similar pace then also for the products predominantly for household (including e.g. electrical appliances, electronics, furniture, carpets, textile). All other segments of the specialised sales could also profit from the higher sales, including the shops with the computer and communication equipment (1.4%), which belonged traditionally to the most dynamic in the preceding years.

Retail sales of the automotive fuels strengthened by nearly one tenth in H1. Demand was stimulated by a low prices of fuels (favourable when compared with the neighbouring states as well), partially also by the higher transportation requirements connected to the growth of the economy and expanding foreign trade.

Retail sales¹⁷ grew by double pace in the CR as opposed to the EU (+2.7%), the fastest from the countries of central Europe. Romania recorded a double digit growth, the year-on-year. On the contrary, decline occurred only in Belgium (-2.4%) and Greece (-3.7%). The growth rates of sales from the sale of food as well as automotive fuels placed the Czech Republic similarly to the sixth best position in EU, in case of non-food goods outside the first ten (mainly the majority of newer member states of the EU achieved a stronger growth – including Slovenia, Poland or Hungary).

¹⁶ Do not include either trade, financial and insurance activities, science and research or public services.

¹⁷ Includes retail without the motorist segment, data are adjusted for calendar effects.



Chart 5 **Production in industry and selected manufacturing branches (real, y/y, adjusted for calendar effects, in %)**

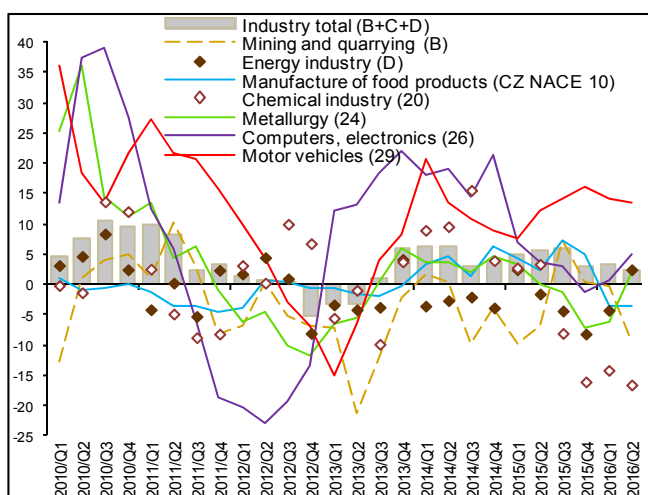


Chart 6 **New orders in manufacture of motor vehicles, industry in total (current prices., y/y in %) and balance of confidence indicator in industry (right axis)**

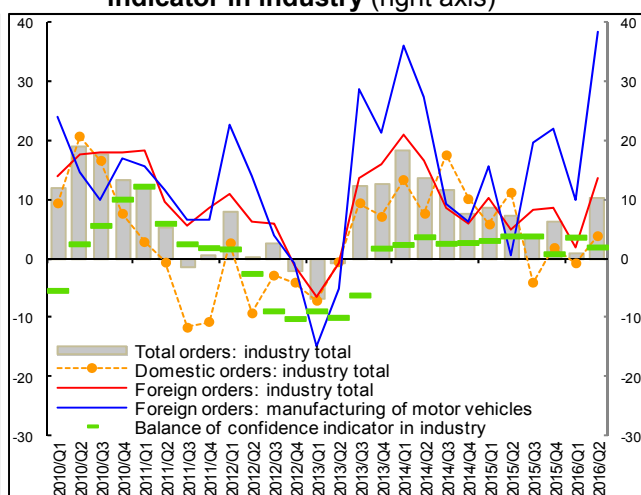
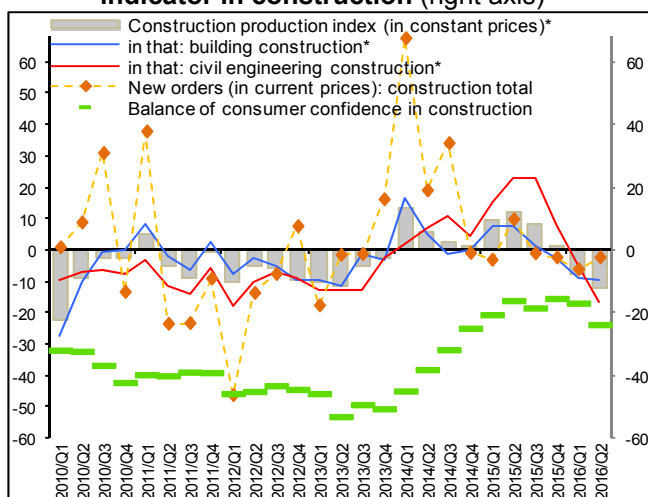
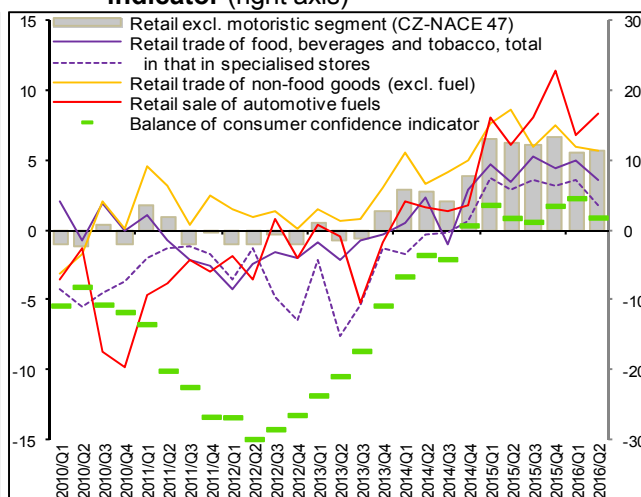


Chart 7 **Construction production*, value of new orders (y/y in %) and balance of confidence indicator in construction (right axis)**



*adjusted for calendar effects

Chart 8 **Retail sales incl. motorist segment* (real, y/y in %), balance of consumer confidence indicator (right axis)**



Source: CZSO

4. External Economic Relations

Surplus of the current account of the balance of payments arrived at 107 CZK bn in H1 2016...

Balance of the current account of the balance of payments reaches a surplus in Q1 regularly since the year 2005 and the same situation occurred also in January to July. The surplus reached an amount of 107 CZK bn for the first half-year. Surplus of the capital account fell by 44 bn to 39 CZK bn year-on-year at the end of the first half-year, as a result of a shrinking volume of resources drawn from the EU funds. The financial account recorded an inflow of financial resources in the amount of 32.8 CZK bn in the second quarter, which reduced the outflow of the first quarter (109.1 CZK bn) to 76.3 CZK bn at the end of the first half-year. Investments of the foreign investors into the domestic government bonds stand behind this development.

... thanks to the year-on-year growth of the goods and services balance and lowering of the primary income deficits

Surplus of the current account expanded in the year-on-year comparison by 44.7 CZK bn in H1 of this year. The surplus of the goods and services balance year-on-year by nearly 40 CZK bn shared to the largest extent on its improvement. A weaker outflow of income from the direct investment caused the reduction of the negative balance in the component of primary incomes to -99 CZK bn from the last year's -120 CZK bn. In contrast, the secondary income account experienced a

Especially the growing reserve activity linked to the intervention regime of the CNB was the source of the financial account deficit	worsening of the balance (-4.7 bn) by 16 CZK bn in comparison to the half-year of 2015.
Interest of the foreign investors in the domestic government bonds is growing – they purchased these in the amount of 114.2 CZK bn during the first three months of this year	Inflow of the direct investment into the Czech economy increased its pace year-on-year from 9.7 bn to 67 CZK bn in H1 2016. While the domestic investors lowered the value of their foreign direct investment (further also “FDI”) by 1 bn, 66 CZK bn flew into the Czech economy from abroad in the form of FDI. Debt securities also recorded a marked year-on-year increase (from 17 bn to 133.6 CZK bn). The main source of the financial account deficit, i.e. the outflow of funds abroad, was the development in the component of the reserve assets especially due to the continuing interventions of the CNB. Net transactions with reserve assets arrived at 220 CZK bn in H1, which represents a year-on-year increase of nearly 100 CZK bn.
Year-on-year rate of growth of exports declined to 3.1% in H1 2016 from 4.9% in the same period of 2015	Inflow of portfolio investment in the amount of 140.9 CZK bn eventuated during H1 2016. It markedly contrasted with the portfolio investment of the residents abroad (19.5 CZK bn). Massive purchases of the government bonds kept occurring, the foreign institutions invested 114.2 CZK bn, i.e. much more than in the same period of 2015 (39.4 CZK bn). The demand of foreign investors flows for once from the good position of the Czech government bonds (i.e. relatively lower level of government indebtedness, lower credit risk of the CR), but also the anticipated future appreciation of Koruna after the completion of the exchange rate interventions of the CNB. High demand and expectations of investors simultaneously manifested in the development of yields of the government bonds, when the investors especially with the bonds with maturity within two years accepted even a negative yield (-0.05%). Low yields however prevailed also for bonds with a remaining maturity up to 5 years (0.05%) and 10 years (0.45%). As a result of this development, the share of possession of government bonds by non-residents increased by nearly 9 p.p. (to 26.12%).
Motor vehicles and metal products recorded the highest year-on-year additions to exports	Based on the data related to the foreign trade with goods in the national conception, a mild revival of exports to 4.3% occurred in Q2 2016 following a lowered addition in Q1, which increased by 1.8% in comparison to the same period of the preceding year. Subsequently the rate of growth of exports of the Czech economy slowed down year-on-year to 3.1% in H1 2016 from 4.9% in H1 2015. Exports grew by 15.4% in H1 2014. Exports grew in nominal terms by 50.5 CZK bn year-on-year in H1 2016 (by 14.8 bn in Q1 a by 35.7 CZK bn in Q2), which was by 26.1 CZK bn less compared to the same period of the preceding year.
Rate of growth of exports into the EU countries slowed down	The highest year-on-year addition to exports (by 53.8 CZK bn) was recorded for motor vehicles in the first two quarters, which have a dominant position in the commodity structure of the Czech exports in the long-term. Their share on the total Czech exports rose by 2.4 p.p. to 27.3% year-on-year in H1. Exports of motor vehicles rose by above average 13.2% in the given period, similarly as in H1 2015. Among other commodities with a strong representation on the Czech exports, metal products (by 14.3 CZK bn) and machinery and equipment (by 8.2 CZK bn) registered the highest year-on-year additions. On the contrary, the largest decrease was apparent for exports of basic metals (by 14.3 CZK bn), oil and natural gas (by 9.9 CZK bn) and chemicals and chemical products (by 8.0 CZK bn).
	The rate of growth of exports into the EU countries slowed down to 4.2% in the first six months of the year 2016 from 5.6% in the same period of the preceding year. The reason is the slower growing exports to Germany (increase by 2.6% compared to 4.9%), France, Great Britain or Slovakia, but also the deepening fall of exports to Poland. Exports into the three most important export destinations of the Czech Republic, involving Germany, Slovakia and Poland, reached 827.6 CZK bn in H1 of this year. In the year-on-year comparison, the exports into these countries grew by 2.8%. The proportion of exports into Germany, Slovakia and Poland on the total exports lowered to 48.1% in H1 2016 from 48.2% in H1 2015. The value of goods bound for the countries outside the Europe twenty-eight fell by 2.4% year-on-year (6.4 CZK bn). In that exports to Russia, hit by restrictions and recession of local economy, plunged by 14.6%. Exports to China declined by 5.1%.



Growth of exports into the CZ markedly slowed down in H1 2016

Higher year-on-year growth of imports against exports, characteristic for H1 2015 (by 5.9% compared to 4.9%) was substituted by a marked slowdown in H1 2016, when the imports grew only by 0.4%. Mostly the imports of motor vehicles (by 26.3 CZK bn year-on-year) and metalworking products (by 12.2 CZK bn) were higher year-on-year. The imports of oil and natural gas (by 33.9 CZK bn), computers, electronic and optical appliances (by 15.9 CZK bn) and basic metals (by 15.5 CZK bn) lowered. Imports from the EU grew by 2.5% year-on-year (26.9 CZK bn). The relative addition to imports from Germany and Poland slowed down, imports from Slovenia and Austria decreased. Imports from the countries outside the EU were lower by 4.7% (22.7 CZK bn), mostly affected by the plunge of imports from Russia (by more than 20 CZK bn year-on-year).

Trade balance surplus nearly the same in Q1 and Q2 2016

Trade balance of the foreign trade with goods in the national conception ended in surplus of 133.5 CZK bn in H1 2016, which was by 44.8 CZK bn higher year-on-year. The balance contributed to the positive final value by nearly the same share in Q1 and Q2 2016.

Lower negative balance of trade with oil and natural gas

In the view of the Classifications of Products (CZ-CPA), the slump of the trade deficit with oil and natural gas (by 24.0 CZK bn) and the traditional growth of the trade surplus with the motor vehicles (by 27.5 CZK bn) had a favourable impact on the total balance. Deficit in the trade with the chemicals and chemical products deepened by 16.1 CZK bn in comparison to the last year, the surplus of the balance of trade with machinery and equipment on the contrary increased by 14.9 CZK bn and the trade with the metalworking products grew slightly by 2.1 CZK bn.

Trade balance improved due to the lowering of the deficit with the countries outside the EU year-on-year

The higher positive foreign trade balance compared to the last year was affected by lowering of the foreign trade deficit with the countries outside the EU by 16.3 CZK bn to 199.7 CZK bn.. At the same time the deficit reduced nearly by 15 CZK bn in trade with Russia, further then with Azerbaijan and Kazakhstan (by 4.5 bn and 4.8 CZK bn). Half-yearly surplus of the CR trade with the Union states recorded an increase of 30.6 CZK bn to 344.1 CZK bn despite the increase of the passive balance with Poland by 11.9 CZK bn. Constant positive balance with Germany rose by 10.9 CZK bn and attained the value of 115.2 CZK bn. The active balance with the neighbouring Slovakia improved by 11.2 CZK bn

Chart 9 **Current account of balance of payments** (in CZK bn)

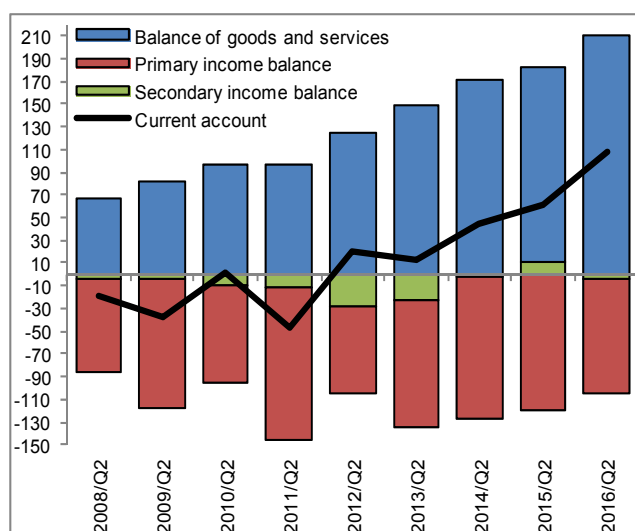
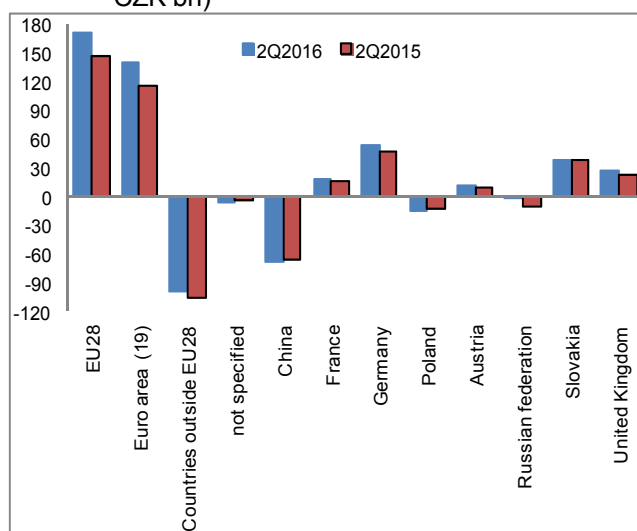


Chart 10 **Balance of foreign trade with goods in national conception in Q2 2016 (y-y in CZK bn)**



Source: CZSO, CNB

5. Prices

Price level increased only by 0.8% in the year-on-year comparison in Q2 2016

The price level based on the implicit GDP deflator¹⁸ increased by 0.8% year-on-year in Q2 2016, which was less than the value for the previous quarter (+1.3%). Prices of goods and services consumed by households practically stagnated year-on-year in both quarters of 2016 (the same values of +0.1%). The growth of prices of products purchased by the government institutions (+1.6%) was mildly higher in Q2 2016 year-on-year. On the contrary, the prices of investment (resp. gross fixed capital formation) stagnated year-on-year in the same period. The terms of trade in the foreign trade were thus the only more significant contribution to the growth of the implicit deflator, reached the same value of 101.4% in both quarters so far in 2016, especially thanks to the terms of trade with goods, where there was a value of 101.5% reached in Q2 2016.

Year-on-year growth of consumer prices remained weak also in Q2 2016, ...

Consumer prices increased by mere 0.2% in the year-on-year comparison in Q2 2016, which was even less than 0.5% in the preceding quarter. Their year-on-year dynamics thus have not overtaken the 1% boundary already ten quarters and it remained below the goal set by the CNB at the level of 2% even fourteenth quarter. Changes in Q2 2016 were reflected in the mild slowdown of the year-on-year growth of the market prices to 0.3% (from 0.4% in Q1 2016) and regulated prices to 0.2% (from 0.7% in Q1 2016). The inflation rate expressed as the addition to the average consumer price index for the last twelve months against the previous twelve months was equal to 0.4% from January to May and it lowered to 0.3% from June to August.

...when the price of oil was the lowest since the beginning of the year 2004 on the world market and deflation of manufacturers in the euro area and falling prices of agricultural producers also contributed to the dampened development in the CR

The low prices of oil are among the sources of the lasting indistinctive growth of consumer prices in the Czech Republic. Barrel of the Brent oil was traded on the world markets in Q2 2016 on average for 45.5 American dollars, which was by 26.2% less compared to the same quarter of the year 2015. Price of oil, which is seasonal, was lower in each of the first seven months of the year 2016, than was its lowest value attained in the given month since year 2004. Expressed in CZK given the year-on-year mild appreciation of the exchange rate of Koruna against dollar in Q2 2016, the prices of Brent oil were by 28.7% lower (by 37.5% in the first quarter of 2016). Deflationary tendencies linked to the low prices of oil in manufacturing in the euro area and the long-term decline of agricultural producer prices projected via the production chain into the prices of food as well also contributed to the dampened price development in the domestic economy for the whole H1.

Excluding food and non-alcoholic beverages, the year-on-year dynamics of consumer prices would be by 0.4 p.p. stronger

Prices of food and non-alcoholic beverages exerted a significant effect on the lowering of the composite consumer price index in the CR in H1 2016 (-0.2 p.p.), which deepened to -0.4 p.p. in Q2. The year-on-year growth of the composite index excluding prices of food and non-alcoholic beverages attained 0.8% in Q2. Low prices of oil were projected into the transport price index, which pushed down the composite index by 0.3 p.p. in both quarters of 2016. Division alcoholic beverages and tobacco with the positive contribution to the total in the amount of 0.3 p.p. in Q1 and 0.4 p.p. in Q2 2016 was the only division, which had a bit more significant effect on the growth of the composite index.

Only prices of alcoholic beverages and tobacco shared more significantly on the consumer prices growth

Prices in the division food and non-alcoholic beverages were falling year-on-year in all quarters of the year 2015 and this development also continued in 2016. The most substantial drop occurred in the group milk, cheeses, eggs, which arrived at 10.4% in Q2. In that prices of milk fell by 14.0% and cheeses by 10.3%. Also the majority of other basic food continued experiencing a year-on-year fall of prices in Q2 (e.g. bread by 1.7%, flour by 16.6%, meat by 2.0%, butter by 9.8% and sugar by 10.2%). On the contrary, the vegetable price index recorded a growth, which slowed down to 4.9% in Q2 from 16.9% in Q1. Prices of fuels have been decreasing continuously year-on-year since December 2014 and their fall hit the furthest value -17.6% in November 2015. It already moderated to -12.5% in Q1 2016 and to -12.3% in Q2. Prices of alcoholic beverages were by 4.3% higher in

¹⁸ Deflator is not adjusted for seasonal and calendar effects.



Q2 (by 3.2% in Q1 2016) and prices of tobacco products by 4.4% (by 3.8% in Q1), while the increase of the consumer tax since January 2016 manifested in the growth of the cigarette prices. The price growth slowed down by 4.7% in the division housing due to the year-on-year fall of the natural gas prices (fall of 0.5% in Q1). Prices of electricity were similarly higher by 1.2% in both quarters. Prices of water and sewer rates increased by 1.6%, resp. 5.3% (by 0.5% resp. 3.3% in Q1). Net rental prices were raised by 1.3% and heating by 1.0%. A more significant year-on-year growth was also registered for the prices of footwear (by 5.4%) and prices of recreation with complex services (by 3.2%) in Q2 2016).

Year-on-year development of both the offered and realised prices of flats is strong. It signals, that the growth of real estate prices gains pace in the CR

Lasting low interest rates on mortgages, low unemployment rate, continuing growth of the average wage and high consumer confidence are the cause of the accelerating growth of prices of housing real estate. Indicative offer prices of flats increased by 10.2% year-on-year in Q1 2016 and by 10.3% in Q2. It represented the strongest growth of prices since the end of 2008. The offer prices were increasing more substantially in Prague as opposed to regions outside the capital approximately till the half of the year 2015, the price development is already similar since Q3. The year-on-year development of the realised prices of flats also signals a long-term tendency of the accelerated growth. Prices of older flats increased by 5.8% in Prague in Q1, by 7.4% in Q2 and even by 10.0%, resp. 9.6% in the regions outside the capital city. Realised prices of new flats, which are monitored only for Prague, were by 3.7% higher year-on-year in Q1 and by 3.8% in Q2 2016.

Romania, Bulgaria and Cyprus recorded a more substantial deflation among the European Union countries in H1

The prices in the Czech Republic increased by 0.1% according to the harmonised index of consumer prices in Q2 2016 compared to the same period of the last year (by 0.4% in the preceding quarter). 12 countries of the twenty-eight EU countries faced deflation in Q1, even 15 in Q2. The Czech Republic thus remained in the first third of countries according to the size of the annual inflation rate in both quarters, still it moved into the negative numbers (-0.1%) in June 2016 for one month. The inflation rate in the euro area was lower than in the CR (0.0% in Q1 and -0.1% in Q2 2016).

Prices of industrial producers have been falling in the CR in the year-on-year comparison for already ten quarters. Intensity of their decline kept growing in the first half of 2016

Apart from the low prices of oil, the deepening year-on-year price decreases in energy and mining and quarrying started to become substantially evident in the prices of industrial producers since the beginning of this year. Prices in manufacturing fell by 4.0%, resp. by 4.8% in the first two quarters. Except for the significant drop of the prices in the division coke and refined petroleum products, the prices of chemicals and chemical products were lower year-on-year in Q2 (by 11.2%), prices of metals and metalworking products (by 5.3%) and prices of food products, beverages and tobacco (by 3.1%). Supplies of electricity, gas, steam and air conditioning were lower by 4.1% year-on-year in both quarters and prices in mining and quarrying fell by 6.4% in Q1 and by 7.1% in Q2. In case of mining and quarrying, it presented a similarly deep slump of prices as in the crisis year 2009. Prices of water, its treatment and supply, which grow regularly and permanently, increased by 0.5% year-on-year in Q1 and by 1.6% in Q2.

Prices in manufacturing fall in the whole EU28

Falling prices of manufacturers present a characteristic feature practically for the whole European Union. The deflationary development in this part of economy spread into all countries of the European economic unit during the years 2013 to 2015, and it kept further deepening in the first half of 2016. Prices in manufacturing fell year-on-year on average by 3.7% both in the euro area and in the EU28 in the first three months of this year. By 3.6% in the Union in Q2, in that by 3.8% in the euro area.

Surplus of production of pigs and milk drives the prices of these commodities in Europe down in the long-term

Agricultural prices again started to fall following a mild year-on-year growth of prices of agricultural producers (including fish) towards the end of the last year, which occurred for the first time after eight quarters. They dropped by 2.9% in Q1 2016 and already by 6.9% in the subsequent three months. Prices of plant production held a positive year-on-year pace of 3.9% at first, however they fell by 3.2% in Q2. Prices of animal production were lower by 9.5% in comparison to the same period of the previous year in Q1, and even by 11.3% in Q2. Mainly the lower prices of milk (by 19.4%) and slaughter pigs (by 8.5%) had the most

significant effect. The average price of one litre of milk dropped to 7.30 CZK in Q1 and even to 6.56 CZK in Q2. Compared to the average price of the year 2014 (9.50 CZK), it was thus by 30.9% lower.

Growth of prices of construction works slows down and simultaneously the costs of construction production keep decreasing

Prices of construction works extended the year-on-year growth from year 2015 in Q1 of this year and increased by 1.3%. The pace already started to slacken somewhat in Q2 and the year-on-year growth attained a value of 1.1%. Prices of residential buildings increased (by 1.0%) in Q2, prices of non-residential buildings (by 1.1%) and engineering works (by 1.1%). Similarly to the last year, the lowering of costs of the construction production occurred simultaneously with the growth of the construction works (by 1.4% in the first quarter of 2016, by 1.0% in Q2, in the prices of material inputs by 1.4% in Q1 2016 and even by 2.0% in Q2).

Prices of market services for the business sector stagnate in the long-term

Prices of market services go through the stagnation in the business sector already since the beginning of the year 2015. They fell by 0.1% year-on-year against the same period of the previous year in Q1 2016 and stagnated in Q2 (excluding the very seasonal prices of advertising services). Prices were higher for postal and courier services (by 3.7%), for advertising services and market research (by 2.0%) and for architectural and engineering services (by 1.7% however by 3.3% in Q1) in Q2. The prices for non-life insurance lowered (by 4.4%), for services in the area of rental and operative leasing (by 2.0%) and in the land transport (by 0.8%) due to the decrease of the rail freight transport by 9.1%.

Year-on-year exchange rate development of the Czech Koruna worked in the first half of 2016 in the direction of decreasing prices of foreign trade

The Czech Koruna appreciated against euro by 2.2% year-on-year in Q1 2016, by 1.3% in the second. It remained on average at the same level against the American dollar in Q1, however the Koruna strengthened by 3.6% in Q2. The exchange rate development thus contributed to the significant import of the deflation trends into the Czech economy.

Prices of exports of goods were lower by 4.3%, ...

Prices of exports of goods fell by 4.2% year-on-year in Q1 2016, by 4.3% in Q2, the most noticeably since the first three months of the year 2010. Among the more significant groups, the prices of mineral fuels (by 17.3%, even by 19% in Q1), other raw materials (by 12.2%), semi-finished products (by 5.5%) and machinery and transport vehicles (by 2.5%) were falling the most in Q2. Especially the prices of beverages and tobacco (by 2.4%) recorded growth.

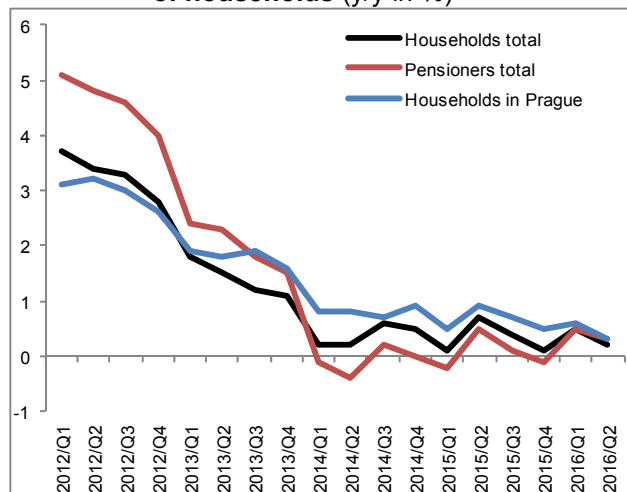
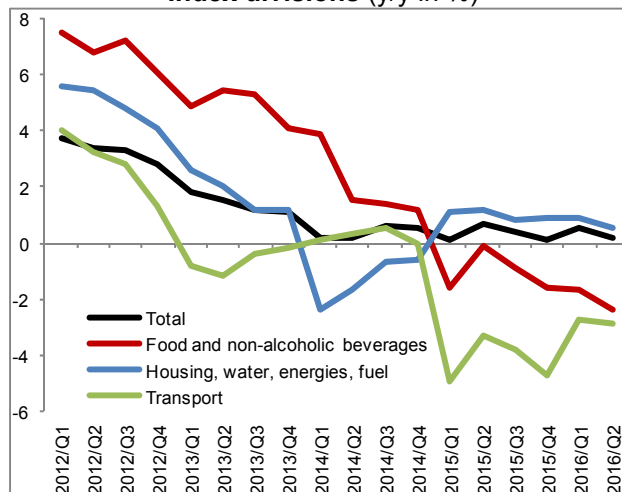
... import prices slumped even by 6.3%. It presented the strongest price fall in the last six years in the first case, six and a half years in the second

Prices of imports of goods slumped by 5.6% based on the data from the first three months of the year 2016 compared to the same period of the last year, even by 6.3% in the subsequent second quarter. It presented the deepest slump of import prices since Q3 2009. Mineral fuels (their prices sank by nearly one third year-on-year in both quarters) and also all other commodities classified according to the SITC nomenclature (apart from animal and plant oils in Q1) were imported for lower prices into the Czech Republic. The decrease of the year-on-year index of prices of machinery and transport vehicles also significantly contributed to the slump of the year-on-year import price index in Q2.

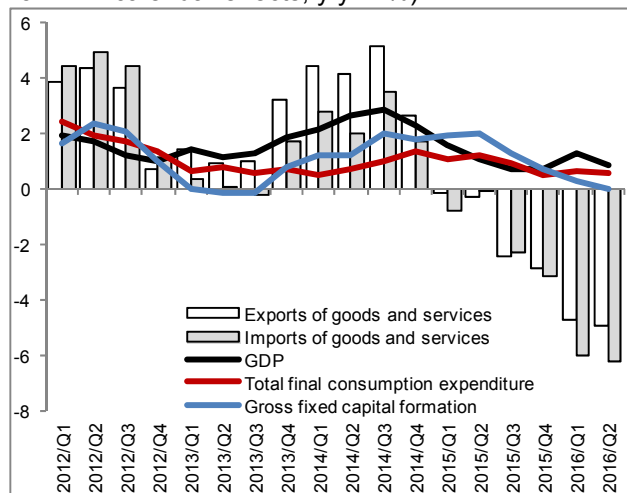
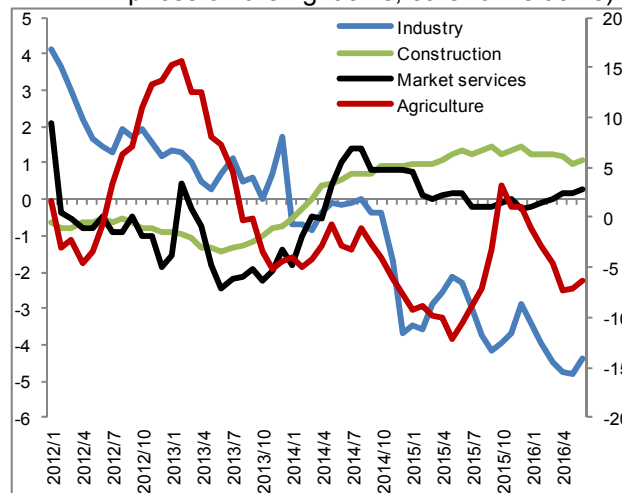
Terms of trade in the foreign trade with goods remained positive in the first half of the year 2016

Stronger year-on-year reduction of prices of imported goods compared to the lowering of the export prices was reflected in the positive terms of trade. These attained the value of 101.5% in Q1, increased to 102.1% in the second and moved in the positive band already a third quarter in a row. The trade with the mineral fuels especially affected the positive terms of trade. In case of year-on-year stable exchange rate of the Czech Koruna, the terms of trade would be slightly higher (101.8%) in Q1, the year-on-year exchange rate changes did not impact the size of the terms of trade in Q2 (102.1%).



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

Chart 12 Prices in selected Consumer Price Index divisions (y/y in %)


Source: CZSO

Chart 13 Deflators (not adjusted for seasonal and calendar effects, y/y in %)

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


Source: CZSO

6. Labour Market

Favourable tendencies further prevailed on the labour market during the year 2016

Favourable development prevailed on the labour market also in year 2016. The rate of growth of employment accelerated considerably, the highest number of persons in history held a job, especially thanks to manufacturing. Unemployment was further reduced, if already by a slower pace, the chance of good employment heightened especially to qualified manual workers. The qualification mismatch between unemployed persons and job vacancies and the associated long-term unemployment remains the weak point on the labour market. Low unemployment rate accompanied by a growing lack of labour force pushes the wages up. Average wages grew in real terms the most since year 2009.

Employment accelerated during H1, 5.26 mil persons held a job, the most in the history of the CR

The creation of new job positions has been one of the most important features of the steadily expanding economy. Rate of growth of employment¹⁹ markedly accelerated at the beginning of the year, to 1.7% in total for the whole half-year. The number of workers was the highest in history in Q2 2016 (5.26 mil.). Quantities of employed are also affected by the generational shifts on the labour market and increasing of the retirement age. Representation of older persons

¹⁹ Unless stated otherwise, data are in the conception of the national accounts and adjusted for seasonal effects in this chapter.

Employment rate in the CR ranks among the highest (mostly thanks to males) in the EU	gradually grows on the labour market. The employment rate of persons aged 15–64 years exceeded 71%, it was higher only in five EU countries (the Czech Republic held primacy within the frame of the newer Union members). Branch specialisation of the Czech economy is also reflected in the high employment rate of males (78.5%), only Netherlands achieved higher values in the Union this year.
Manufacturing caused one half of the growth of total employment in H1, similarly also to the two preceding years	Higher employment this year, similarly to the whole time period since the end of recession, is mostly the credit of manufacturing. 3.2% more persons were working in manufacturing year-on-year. The growth of employment had a practically an all covering nature. The most significant by weight grouping of activities – trade, transportation, accommodation and restaurants thrived similarly to the last year, with 20 thousand persons more finding employment in this grouping year-on-year. The dynamics of creation of new job positions accelerated in professional, scientific, technical and administrative activities (to 4.4%). Information and communication activities, where the total employment strengthened the most since the end of recession (Q2 2013) also prospered. On the contrary, the quantities of employees in total increased by the slowest pace in the public administration, education, defence, health and social work in the last four years. The stagnation of employment in education was especially apparent here.
Employment in services was growing nearly across the whole spectrum, the dynamics however still stayed different in individual branches	
After the dissipation of the interim stimulus linked to the European subsidies, the employment again returned to decreases in construction	Construction again started to lose employees after the last year's stagnation this year, 1.4% against the H1 of the last year. Mining companies are also still faced with a notable reduction of job positions (by one quarter between years 2008 and 2015), on the contrary the employment declined only slightly in other branches of the primary sector and energy.
Year-on-year fall of the number of self-employed (mainly the small entrepreneurs) halted after eight quarters	Structural changes on the labour market expressed by a varying development of the number of employees and self-employed continued. While there was by 2.2% more of employee positions, 1% of self-employed diminished (their year-on-year reduction ceased in Q2 itself, however only data in the second half of the year will show, to what extent it is a signal of longer-term tendencies). The fact remains, that the number of employees has been showing more favourable growth rates compared to self-employed continuously already since half of 2012.
The number of hours worked grew year-on-year against the total employment by more than a doubled pace...	The labour productivity kept growing despite the high employment dynamics. The gross value added (GVA) per 1 worker was by 1% higher year-on-year (by 2.6% for the whole year 2015). GVA in relation to an hour worked lowered at the beginning of the year for the first time after nine quarters (down to -2.3% in Q2), almost in all significant branches. The unusually high growth of the number of hours worked had an effect here (by 3.1% in Q1, by 5.1% in Q2), which can be connected to the fact, that companies react to the present lack of qualified workers by a more intensive utilisation of the existing labour force. The hourly productivity was by 5% higher in the whole economy this year compared to H1 of the boom year 2008, by one fifth in manufacturing, it grew significantly also in the agricultural and financial sector.
... hourly labour productivity fell in the whole economy for the first time in nine quarters	
Supply of vacancies was continuously growing, LO registered 134 thousand of these positions at the end of June, the most since September 2008	Labour offices (LO) offered 134 thousand vacancies (by nearly 40% more year-on-year) at the end of Q2, the number of positions thus slowly approached the historical maximum from April 2008 (152 thousand). 31 thousand positions were added compared to the beginning of the year in 2016, however, this addition was mildly higher in the same period of the last year. Positively, new job positions were created in a higher extent also in the economically less developed or structurally stricken regions. Among other things, a marked improvement in the ratio of the registered applicants and vacancies ²⁰ is evident. A substantial qualification mismatch however still persists between the offered vacancies and the registered applicants for employment. Applicants in the group “operating of machine and equipment, assembler” (continuously since spring 2014) could find a job the most easily, there was only 1.2 applicants per one vacancy at the end of June 2016. Craftsmen and servicemen also enjoyed a very good prospects (1.6 applicants per
Job applicants from qualified manual professions had a higher chance for employment (via the LO) over lawmakers, managers and specialists	

²⁰ This ratio decreased from 19.6 (June 2015) for instance in Bruntalsko to 7.6 (one year later). Similarly also in Mostecko (from 12.9 to 6.4) or the Ústí nad Labem region (from 18.7 to 11.7). Only eleven regions had more than 5 applicants per one vacancy this year in June, on the contrary it was less than 1.5 in fourteen regions (all applicants could have been theoretically satisfied in Pardubicko, Rokycansko and Rychnovsko).



vacancy), the position of non-qualified and assistant works improved markedly in the last year, they had a twice as high chance for employment compared to office workers (within their qualification class).

Together with Germany and Malta, the Czech Republic belonged to countries with the lowest unemployment rate at the end of H1, for males the CR holds the best position continuously already since April 2014

Unemployment rate kept further falling, however, gradually it most likely met its limits. The proof is the weakening dynamics of the fall of the general unemployment rate (aged 15–64 years, adjusted for seasonal effects) – it decreased only by 0.2 p.p. between January and June 2016 (to 4.2%). The unemployment rate dropped in all education groups, the most for persons with the secondary education without the school leaving certificate, incl. apprentices (4.2% in Q2, 5.7% a year before), on the contrary a high unemployment (within all EU countries) persists in the relative less numerous group of persons with primary education (20.9%, it decreased only by 5.2% since the end of recession).

Growth of average wages accelerated to 4.2% in H1, it represented the highest pace within H1 since 2008, when however the strong nominal growth was depreciated by high inflation

Favourable economic development (mirrored also in the profitability of companies, but also in the continuing growth of orders in key branches) together with low and still falling unemployment rate accompanied by still more intensively articulated lack of employees (which has not been saturated even by foreign workers yet) push together on the wage growth. Business sphere is also affected by the repeated increase of the wage tariffs in the public sector and more intensive activity of unions at the collective bargaining. The gradual rising of the minimal wage also has an effect in a part of the wage spectrum in businesses. Year-on-year growth of the average wages (to recalculated numbers of employees - FTE) amounted to 4.2% in H1 and was the highest since the end of the year 2009 (when nevertheless the wage growth was accompanied by a considerable reduction especially of the low qualified and less paid job positions). Employees in the “low income” branches – accommodation, restaurants and food service activities (+6.9%), cultural, amusement and recreation activities (+5.8%) and in administrative support services activities (+5.5%) improved their position relatively the most. Among the best paid branches, the financial and insurance activities kept the primacy, also thanks to the paid out high extraordinary bonuses in Q2. The wage growth copied the rates attained in the whole economy in manufacturing both in Q1 and Q2.

Average wages were raised the most in the Ústecký region and Vysočina region (similarly by 4.6%), volume of paid out wages grew the most year-on-year in the Central Bohemia (also due to the dynamic growth of employment in industry)

Low inflationary environment accentuated the acceleration effect of the growth of wages

Wage differentiation mildly narrowed. The growth of the wage median clearly exceeded the dynamics of average wages already four quarters in a row. Low inflation rate and accelerating growth of the average wage positively impacted the development of the purchasing power of the employee earnings. The dynamics of real wages fastened to 3.8% in H1, i.e. the highest year-on-year rate of growth since the end of 2009.

Chart 15 **Number of employed persons and employees (national accounts data, seasonally adjusted, y/y in %)**

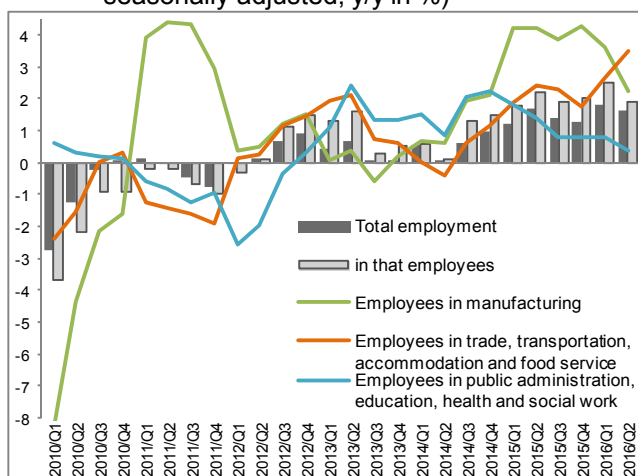
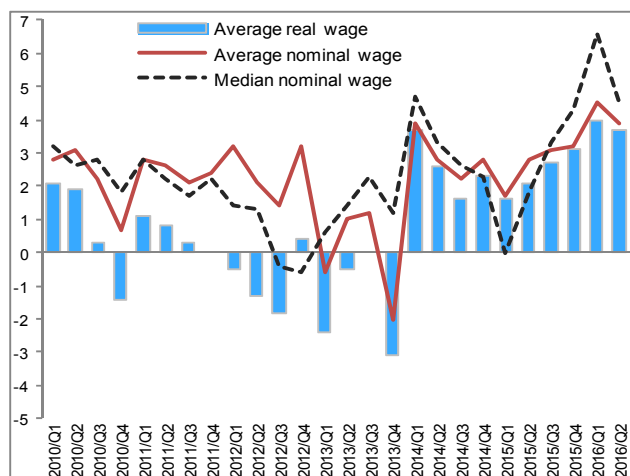


Chart 16 **Gross monthly wage in nominal and real terms (per employee, in FTE, y/y in %)**



Source: CZSO

7. Monetary Conditions

Monetary policy remained still loose in the first half-year, the exchange rate of Koruna against euro slightly appreciated year-on-year in relation to both euro and dollar

Loose monetary policy of the CR was still prevailing in the first half year, stimulating both the economic growth of the local economy and the price growth. 2W repo rate as well as the discount rate (0.05%) also remained unchanged in the second quarter and the Lombard rate also did not change (0.25%). The exchange rate of Koruna against euro is regulated by the CNB commitment since November 2013. Exchange rate of Koruna against the American dollar fluctuates around CZK 25 to one dollar since the beginning of the last year; it fell to CZK 23.945 to one dollar in Q2 2016. The Koruna was against euro stronger by 1.2% in the year-on-year comparison in Q2 2016 and remained at the same level as in Q1 2016 (close to the boundary of CZK 27 to euro). The money stock expressed by the harmonised monetary aggregate M3 increased by 9.7% year-on-year in June 2016.

Mostly the one day deposits affected the growth of the money stock year-on-year

Money stock (M3) reached the size of 3 708 CZK bn by the end of Q2 2016. The year-on-year growth of 380.8 CZK bn was induced by the increase of the volume of the most liquid money – one-day deposits (by 305 CZK bn) and currency (by 41 CZK bn).. Their highest share on the money stock (M3) is also the evidence, arriving at 88.2% in Q2 2016. On the contrary, the deposits with maturity within two years nearly continuously fall in the environment of low interest rates since September 2012 (by 35.5 CZK bn compared to Q2 2015), similarly to notice deposits up to three months, which declined by 32.6 bn. The less liquid money include repo operations, securities in funds of the financial market and bonds with maturity up to two years, which comprise less than 1% of the money stock. These increased from 10 CZK bn in June 2015 to 17 bn in June 2016.

Long-term preference for liquidity prevails

Long-term rise of the preference for liquidity on the part of depositors (enhanced by the low interest rates on deposits with agreed maturity and deposits redeemable at notice) is apparent mainly for households and non-financial businesses (with the fact that deposits of these sectors comprised 84% of the resident deposits in Q2). One-day household deposits increased by 13.3% year-on-year and deposits of non-financial businesses by 9.6%.

Average yields of government bonds remain record low, even negative in some cases

Market interest rates still remain at the record low levels in the Czech Republic. Rates on the interbank market reflect nearly zero basic monetary-political rates of the CNB. Discount rate, which is projected into the interest calculation for deposits of commercial banks, has still remained 0.05% since the end of 2012, similarly to the repo rate. Lombard rate from the provided credit to commercial banks also remains at the same level (0.25%). The average yield on the ten-year government bonds is below 0.5% since November 2015; it amounted to 0.45% in June 2016. With respect to the state bonds with a remaining maturity of 2 years, their “yields” have been negative since July 2015 (-0.05% in June 2016 compared to 0.11% in June 2015). All PRIBOR interest rates stay basically at the same level in the second quarter of 2016, specifically since October 2015, with one-day PRIBOR showing the relatively lowest rate (0.13%) and 9month PRIBOR relatively the highest rate (0.41% since February 2016).

Savers face historically the lowest interest rates on their deposits

Development on the financial markets also transmits into the low level of interest rates – deposit rates and credit rates. Interest rates on the newly contracted one-day deposits of household and non-profit institutions serving households (NPISH) have been falling in the long-term and amounted to 0.15% in June 2016 as the lowest in the history (compared to 0.19% in June 2015). The non-financial businesses also attained a record low yields on their “new” one-day deposits (0.06%, compared to 0.12% in June 2015). Rates on the term deposits (deposits with maturity and at notice) also in total move around the low levels. Even though the interest rates from the term deposits of households and NPISH also permanently fall, their level is higher in comparison to the rates for the non-financial businesses. They amounted to 1.27% on the deposits with an agreed maturity for households and NPISH in the second quarter of this year (compared to 1.57% in the same period of 2015) and 1.11% for deposits redeemable at notice (against 1.4%); interest rates on deposits with an agreed maturity added to



0.08% for non-financial businesses (against 0.24%) and 0.47% for notice deposits (against 0.7%).

Record low interest rates are also on mortgages and consumption

Interest rates on mortgages and consumption provided to households and NPISH show (with a certain small fluctuations) a permanent decrease since the year 2012. Interest rates on credit on consumption lowered to 10.7% in June 2016 in comparison to June 2015 (12.6%) and rates on purchase of the housing real estate decreased from 2.51% to 2.25% in the same time period. Interest rates on credit provided to the non-financial businesses (excluding overdraft, revolving credit, liabilities and credit cards) oscillate around 2% and increased to 2.12% in Q2 2016 from 1.92% in Q2 2015.

Record interest of households in mortgages

The interest of households in a credit financing prevailed also in the second quarter. It was evident consequently in the increase of the total level of credit, which arrived at 1 358.6 CZK bn towards the end of the second quarter of 2016. Thus they increased by 6.4% year-on-year. In that credit in the national currency amounted to 1 356 CZK bn (they increased also by 6.4% year-on-year). The population devotes the stated credit resources mainly to housing, which share comprises nearly three quarters of total credit of households (73.9%). Simultaneously, the improved economic status of households due to the increasing economic performance is evident here to a certain extent, specifically in the development of credit in default. Credit of households for housing in default decreased by 16.5% year-on-year to 22.9 CZK bn. Consumption credit and mortgages also registered a drop of credit in default.

Drawing of credit by non-financial businesses grows

Drawing of credit funds increases also for the non-financial businesses. They received credit in the amount of 966.6 CZK bn in June 2016 (including the credit denominated in foreign currency), i.e. by 6.6% compared to June 2015. A certain oscillations are evident in credit provided to public non-financial businesses (which share in the credit to non-financial businesses by 2.7%).

Total debt of households grows, by 82 CZK bn year-on-year, especially thanks to mortgages

Total household debt reached 1 369 CZK bn in June 2016 and increased by 82 bn compared to the same month of the previous year. Mainly the credit for housing, which increased by 79 CZK bn year-on-year participated on the growth of debt similarly to Q1.

Chart 17 Monetary aggregates and gross domestic product (y/y in %)

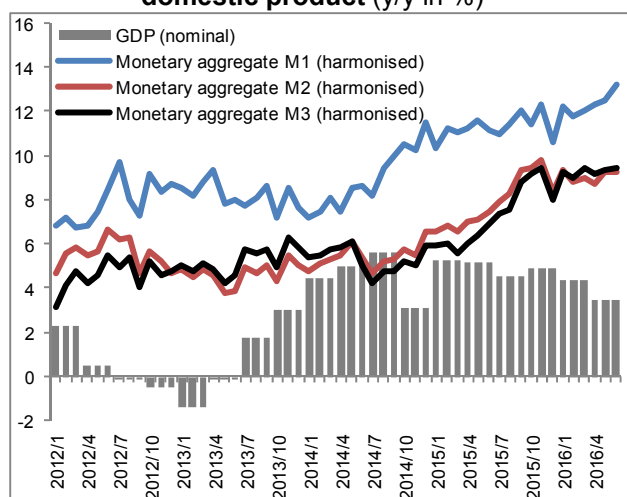
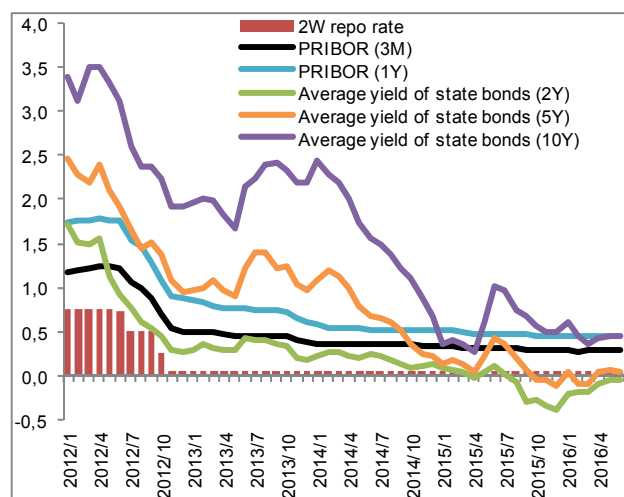


Chart 18 Market interest rates (in %)



Source: CZSO, CNB

8. State Budget

Continuing swift growth of the economy in combination with the effects of irregular drawing on the European funds led to the so far record size of the SB surplus,...

...which arrived at 1.8% in relation to the GDP

High year-on-year growth of final consumption expenditure in the economy as well as the more intensive control measures aimed at the tax collection were reflected in the GVA collection

The rise of the tax rates on the tobacco products stood behind the higher collection of consumption tax since the beginning of the year

The growth rate of collection of corporate taxes year-on-year has been hitting double digit numbers for already nine quarters

Taxes from income of employees from grew by the highest rate since the year 2007 in H1

The irregularities in drawing of funds from the EU budget were essentially reflected in the results of the state budget (SB) during the year 2016. While the revenues (in cash fulfilment) were still significantly strengthened by the finishing financial flows linked to the recently completed programme period, capital expenditure on the common CR and EU projects considerably muted due to the overall low readiness of larger projects on the start of a new programme period this year. Beside these effects, the economic growth have been mirrored mainly in the revenue side of the budget more and more visibly several quarters in a row, especially via the growing collection of direct taxes.

The state budget surplus nearly doubled year-on-year in H1 2016 (to 40.6 CZK bn).²¹ At the same time it was the best result (of this time period of the year) in the history of the CR itself. The SB balance in relation to the nominal GDP also reached a record level of +1.8% (+1.0% on a year ago). Total revenues of the SB²² (+2.3%) grew exclusively thanks to the tax revenues incl. insurance (higher by 35.9 CZK bn in total) in H1.

State wide collection of the tax most significant by weight – GVA – increased by 6% (by 4.4% at the SB level). It mirrored the stable growth rates of final consumption expenditure, both for households (2.7% nominally in H1) and government institutions (4.3%). The VAT was also affected by the more intensive control measures for tax collection, which were aimed especially at the unentitled claims and excessive VAT deductions.

The SB gained by nearly 8% more from the consumption taxes compared to H1 of the last year. This was mainly due to the growing tax collection on the tobacco products (+14.6%) supported by the increase of the tax rate.. The rate of growth of collection of this tax was not affected by a marked pre-stocking any more unlike in the previous years. The collection of weight dominant tax on the mineral oils strengthened by 4.8%. Favourable prices of automotive fuels as well as growth of demand for transportation stimulated by the economic growth contributed to a higher consumption.

Among the direct taxes, the corporate taxes achieved the highest state wide collection in the absolute terms this year. They were by nearly one eighth higher for the first half-year, since they capitalised mostly from the fast growing profits of businesses in the preceding two years. However, their collection was still by 7% lower in comparison to the current peak in the boom year 2008 this year (in contrast, the collection of income taxes of natural persons from dependent activity exceeded their pre-crisis peak already by one fifth).

State wide collection of income taxes of natural person (ITNP) from dependent activity strengthened by high 10.7%, the year-on-year growth arrived even at 13.3% in Q2 2016 itself. It fully reflected favourable situation on the labour market (i.e. growth of the average wages as well as the record number of employees). Both the development of the economy and the legislative changes²³ supported the collection of ITNP paid based on the tax return – the result was by 3.7 CZK bn year-on-year more favourable (after allowing for the regular refund) at the end of the half-year. The total collection advanced for the first time in the last six years into the positive values. On the contrary, the collection of ITNP from capital yields increased only very negligibly year-on-year for now. As for the other taxes, the SB

²¹ The SB surplus doubled at the end of August compared to the data towards the end of H1 (to 81.2 CZK bn). Next to the mildly strengthening tax revenues, mainly the irregularities in the drawing on European funds contributed to this result. Transfers from the EU budget (as a consequence of exceptionally intensive last year finalisation of drawing) exceeded 140 CZK bn (they were even by 2.2 % higher year-on-year), at the same time the decline of capital expenditure kept deepening (down to 40 %, resp. 31 CZK bn).

²² SB revenues are adversely impacted by the change in the budget allocation of taxes in 2016, which lowers the share of the SB on the state-wide collection approximately by 1 p.p., both for the VAT and income tax of natural persons from the dependent activity.

²³ It was related to setting a ceiling to the expenditure flat rate for the self-employed persons (60 % and 80 %) to the size of 2 CZK mil. On the contrary, the increase of the tax deduction for the second and further child, kindergarten fees or the reintroduction of discounts to working retirees affected the collection somewhat negatively (these changes have been effective since 2015, however as a result of the maturity of the payment of the tax, they impact its collection only in 2016).



	gained a more significant resources from the real estate tax, whose swift growth (+1.1 CZK bn, similarly to the last year) proved the revival of the real estate market.
SB revenues from the EU weakened by one seventh year-on-year, but exceeded the whole-year amount anticipated by the budget already during May	The SB gained 115.5 CZK bn on the revenues from the EU in H1 (the overwhelming majority still bound to the previous programme period). Even though their size decreased year-on-year (by 14%), it already exceeded the amount anticipated by the annual budget by more than 20 CZK bn. Total net position of the CR towards the EU budget amounted to 66.6 CZK bn. It reached approximately only half of the record last year's level. Nevertheless, it was by 10 CZK bn higher against H1 2014. Mostly the lower inflow of finances from the structural funds stood behind the year-on-year weaker result this year (by nearly two thirds), on the contrary the direct payments into agriculture were falling more mildly – by less than one quarter.
Capital expenditure sank sharply (in line with the budget anticipations) year-on-year, their volume was the third lowest after year 2007	Total SB outlays fell by 0.5%. It was only the second year-on-year decline within the first half-year after year 2000. However, in contrast to year 2011, decline of this year occurred in the period of a stable economic growth and was as well anticipated by the budget. It was caused by the slump of investment, whose size attained 39.1 CZK bn and approached the level from years 2012–2013, when the public expenditure was strongly affected by the restrictive measures. Two thirds of this year's investment was related to the common programmes of the CR and the EU, they were however still connected to the programme period 2007–13 in the vast majority. The reason was a lower overall readiness of larger (transport) projects at the beginning of new programme period. ²⁴ Total investment has shared in the total state expenditure by 6.4% so far.
Allocation of the SB investment aimed at the development projects in the new programme period stays very low for now	
Expenditure on pensions grew the fastest in the last five years, however thanks to a strong growth of the collection of insurance (+5.2%) the pension account deficit kept shrinking	Rate of growth of current SB expenditure (2.1%) had similar pace as recorded in the last five years. The social benefits were traditionally instrumental in the higher expenditure (by 10 CZK bn year-on-year). More than three quarters were directed to pensions, which grew by 4.8%, the fastest in the last five years. The effect of the one-time February allowance (1 200 CZK) beyond the standard pension adjustment (valid again since January 2015) and partially also the growing number of retirees (+0.7%, after three years of stagnation) were in play here. The pension account deficit (the difference between the revenues and expenditure on pensions from the SB) amounted to 11.2 CZK bn in H1 and was again more favourable year-on-year, already the fifth time in a row.
Expenditure on other social benefits has been rising already a fourth year in a row, mainly due to the impact of the sickness benefits and partially also the social care benefits (for long-term seriously sick)...	The stated expended 57.6 CZK bn for other social benefits (i.e. excluding pensions), by 1.9% more year-on-year. The economic growth had a differentiated effect, it was overshadowed by legislative changes for some types of benefits. Further, the paid out unemployment benefits were reduced (-3%), but by a much slower rate than on a previous year, since the number of recipients of this benefit stagnated, in contrast to all registered job applicants (-15%). On the contrary, the year-on-year decline deepened for the material deprivation benefits (from last year's -4.7% to -11.6%). The state social support benefits (significant from the point of view of volume) stagnated. The long-term growth of the social care benefits and mainly the sickness benefits (by 9.2%) continued. This was due to the legislative measures (reintroduced sickness payments already from the 15 th day), the growth of incapacity to work as well as higher drawing of the maternity benefits. Even though the expenditure on sickness benefits reached a maximum after H1 2009 this year, they were still by 750 CZK mil lower than the volume of the collected insurance.
...on the contrary the fall of expenditure on the material deprivation benefits deepened	
Fall of net expenditure on the state debt halted after two years, their size (23.8 CZK bn) was still the third lowest since H1 2008	Expenditure on the wages of state employees was expanding (despite the growth of employment and wage tariffs) by slight 3.2%. A high last year basis, possibly in part reflecting also the expenditure associated with the preparation of the new Service act (which brings new rules for public administration employees), stood behind the milder growth. Non-investment transfers to the regional budgets, which

²⁴ Situation has not changed much during the vacation period either. All capital expenditure of the SB reached 46.5 CZK bn in the first eight months of 2016. Only 8.4 CZK bn were bound to the EU new programme period (resp. 16.2 bn after calculating also the current expenditure).

are significant by volume, strengthened by 3.7%, mostly representing the funds for the regional education system. State saved somewhat only on the payments to the EU budget (4.5 CZK bn).

Stabilization of the size of the total state debt continued, lasted already 13 quarters in a row

Net expenditure on the state debt (i.e. after calculation the revenues of the state debt chapter) did not fall any more in contrast to the previous two years. The size of the total state debt amounted to 1 691.3 CZK bn at the end of H1, it strengthened by 1.7% year-on-year (its size did not grow any more during the Q2 itself). Higher borrowing activity of the state given the favourable situation on the financial markets and the spreading of the planned repayments of bonds within the year were reflected in the mild growth of the debt. The volume of Czech bonds held by foreign investors gained pace. Non-residents held already by 367 CZK bn at the end of June, resp. 26% of the value of all bonds denominated in Czech Koruna.

Relative size of debt of the government institutions sector was falling exclusively thanks to the strong growth of GDP

Consolidated gross debt of the whole sector of government institutions (including also the local budgets or the social security funds) reached according to the up-to-date data of the CZSO the size 1 857.9 CZK bn at the end of Q1 2016²⁵ and it amounted to 40.4% in relation to GDP (it was by 1.5 p.p. higher in the same period of the preceding year). The reduction of the relative level of debt was exclusively the result of the growth of the nominal GDP, since the absolute level of indebtedness increased (by 22.5 CZK bn).

The Czech Republic was the eight least indebted country in the EU at the beginning of the year 2016, the declining trend of relative indebtedness was apparent already since Q2 2015 in the EU

Budget of the government institutions reached a mild deficit of 8.1 CZK bn in Q1 2016 (in the accrual expression)²⁶, when the surplus of the local government institutions did not manage to compensate the deeper deficit of the central government institutions. The proportion of the total government sector debt to GDP was the eighth lowest within the EU (Denmark, Sweden, Lithuania or Romania were in a similar position) in the Czech Republic (at the end of Q1 2016). Relative debt lowered in half of the EU states compared to the last year's Q1, however by a faster pace only in Ireland, which nevertheless recorded a double indebtedness compared to the Czech Republic at the beginning of the year 2016. Very high indebtedness rate prevailed in Greece (176% of GDP). It was mildly expanding also in the economically stagnating Finland in the last two years.

Chart 19 State-wide collections of tax revenues (y/y in %) and state budget balance (in CZK bn)

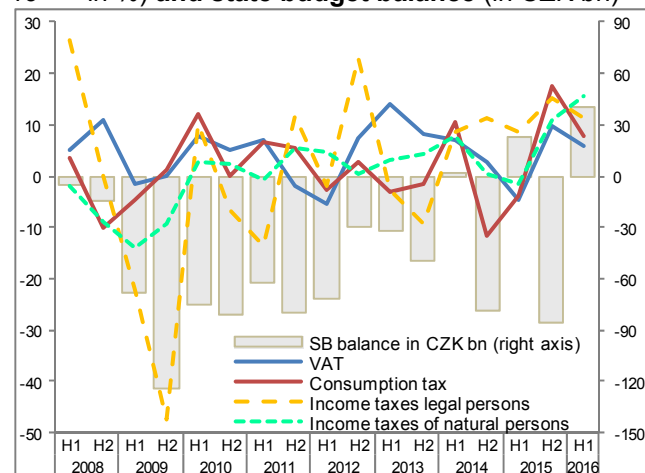
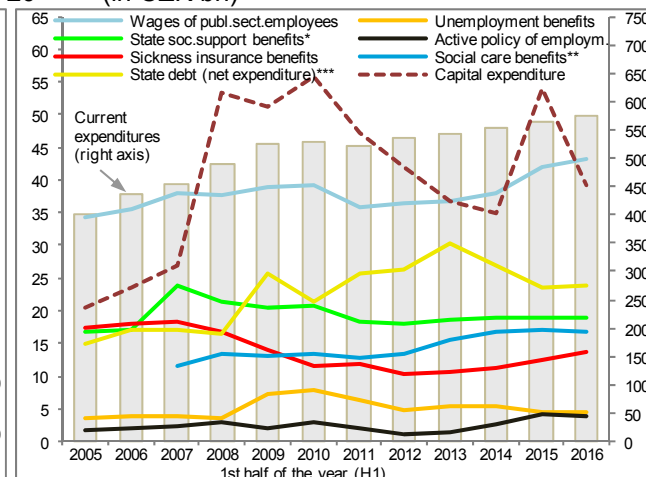


Chart 20 Selected state budget expenditures (in CZK bn)



** including the foster care benefits

** material deprivation assistance benefits, disability benefits, contribution to care based on Act on State Social Support.

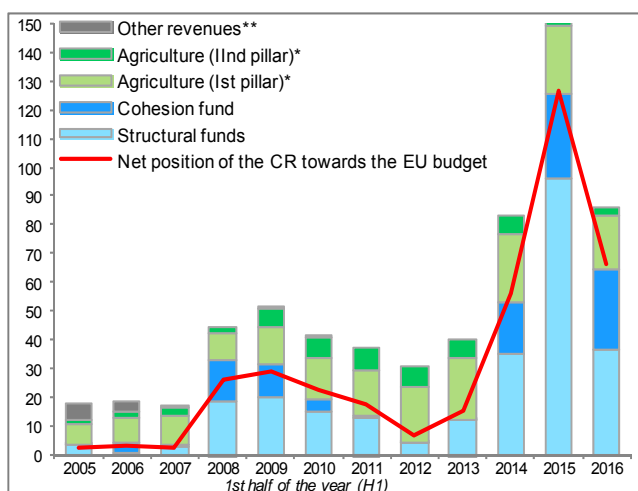
*** expenditure calculations also include the revenues in chapter on State Debt

Source: MF CR, MLSA

²⁵ Preliminary data regarding the debt and deficit of the government institutions sector for Q2 will be published by the CZSO on 3rd October 2016, by Eurostat then on 24th October.

²⁶ Indicators of the budget balance and government institutions debt are based on the accrual principle required by the methodology ESA2010 and Manual on Government Deficit and Debt. According to the accrual principle, the revenues and expenditure are assigned to the period, to which they relate by type, i.e. regardless of the period of the actual realisation of the cash flow (as in the case of cash fulfilment).

Chart 21 Structure of the CR revenues from the EU budget, total net position (in CZK bn)

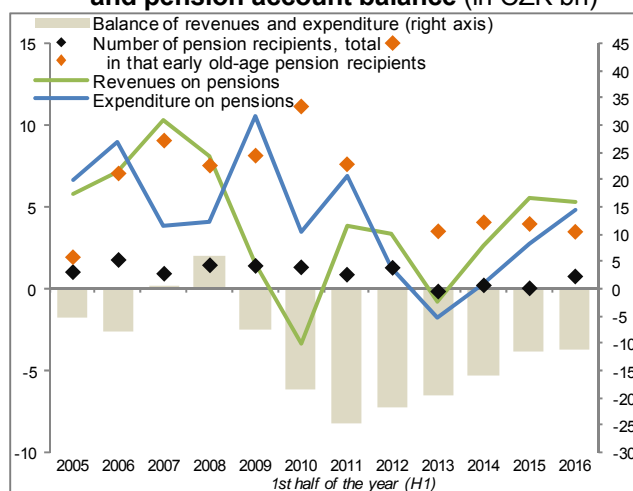


* Ist pillar includes funds for direct payments, market measures and vet. measures, IInd pillar resources for development of rural areas and fishing.

** Pre-accession tools, internal policies, compensation payments.

Source: MF, CSSA

Chart 22 Number of pension recipients, revenues and expenditure on pensions from SB (y/y, in %) and pension account balance (in CZK bn)



Sources of data in the whole analysis: CZSO, MF CR, CNB, MLSA, CSSA, Eurostat, CZSO calculations. Latest information provided in this report has been dated the 14th September 2016.