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Česká národní banka
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ČESKA NÁRODNÍ BANKA



ANNUAL REPORT 2003

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CONTENTS

GOVERNOR'S FOREWORD 4

I. MANAGEMENT AND ORGANISATION 7

THE BANK BOARD 9

EXECUTIVE DIRECTORS OF DEPARTMENTS 10

EXECUTIVE DIRECTORS OF BRANCHES 10

ORGANISATIONAL CHART 11

II. THE CNB'S OBJECTIVES AND TASKS AND THEIR FULFILMENT 13

MONETARY POLICY AND ECONOMIC DEVELOPMENTS 14

FINANCIAL MARKET OPERATIONS 16

ECONOMIC RESEARCH 18

THE BANKING SECTOR, ITS STABILITY AND REGULATION 20

CURRENCY IN CIRCULATION AND THE PAYMENT SYSTEM 22

THE CNB AS THE BANK OF THE STATE 25

STATISTICS 26

EUROPEAN AND INTERNATIONAL CO-OPERATION,
FOREIGN TECHNICAL ASSISTANCE 27

THE CNB AS AN ADMINISTRATIVE BODY 29

TECHNOLOGY AND SECURITY 29

III. THE CNB AND THE PUBLIC 31

EXTERNAL COMMUNICATIONS 32

PROVISION OF INFORMATION IN COMPLIANCE
WITH ACT NO. 106/1999 COLL., ON FREEDOM OF INFORMATION 33

EXHIBITION 33

SPECIAL LIBRARY 34

CONGRESS CENTRE 34

IV. THE CNB AND ITS PEOPLE 37

V. FINANCIAL REPORT 41



The Czech National Bank's Annual Report has undergone several changes intended to promote a better understanding of the central bank's work. The report contains new information providing a deeper insight into the central bank as an institution, and, in addition to describing the CNB's technical work and its activities arising under the Act on the CNB, gives a better idea of its "human" dimension.

The primary objective of the CNB is to maintain price stability. Like numerous other central banks, the CNB fulfils this objective by targeting inflation. The inflation target in 2003 took the form of a band gradually descending to annual consumer price inflation of approximately 2.5%–4.5%. As is clear from the figures for 2003, actual inflation was well below target: in December it stood at 1%, while in the preceding months it was substantially lower even than that.

Analyses revealed that the extraordinarily low inflation was due not to the CNB's monetary policy, but mainly to a combination of several unusual and difficult-to-predict factors. The effects of the significant appreciation of the Czech koruna against the euro dissipated, being replaced during 2003 by a sharp depreciation of the U.S. dollar associated with a decline in prices of imported raw materials.

External demand pressures were attenuated by slow economic growth in the EU member states, while Germany, our main trading partner, experienced an economic stagnation. The political situation in the Czech Republic hindered adjustments to regulated rents, so the effect of regulated prices on inflation did not reach the expected figures. The CNB Bank Board assessed the situation on an ongoing basis, deciding in the first half of the year to lower the key monetary policy interest rate three times.

In 2003, the benefits of the restructuring of the banking system became evident. Banks concentrated on enhancing their competitiveness, offering a wider range of products and generally broadening their activities. They focused intensively on lending to households, taking advantage of the space created by low interest rates and households' favourable income situation. In a climate of stable growth of the Czech economy, banks are thus succeeding in making profits to bolster their stability despite growing competition in the financial intermediation sector as a whole. However, the closure of Union Bank for reasons similar to those underlying the failures of small banks in the past – uncontrolled expansion and insufficiently prudent business – reminded us of past times.



In the Czech Republic, in line with global trends, financial services – provided until recently by specialised institutions in quite discrete segments of the financial market – are becoming increasingly interconnected. Associated with this trend is an effort to gradually integrate the regulatory and supervisory bodies of the state. Plans are afoot for supervision of credit unions to be taken over by the Czech National Bank and regulation of insurance companies and pension funds to be transferred to the Czech Securities Commission.

In the operational area, the CNB not only endeavours to fulfil its legally defined tasks, but also pays attention to cost effectiveness. This ensures among other things that the growing demands associated mainly with integration into European structures can be met with the current number of employees. The rise in salaries at the CNB last year was lower than the earnings growth indices in the banking sector and in the national economy overall. However, operating costs represent a very small proportion of the CNB's bottom line, and so, despite efforts to be efficient, the CNB again made a loss in 2003, this time of CZK 18,173 million. The reasons are similar to those in the past, the majority of the costs being due to exchange rate losses. This time the loss was particularly exacerbated by the koruna's appreciation

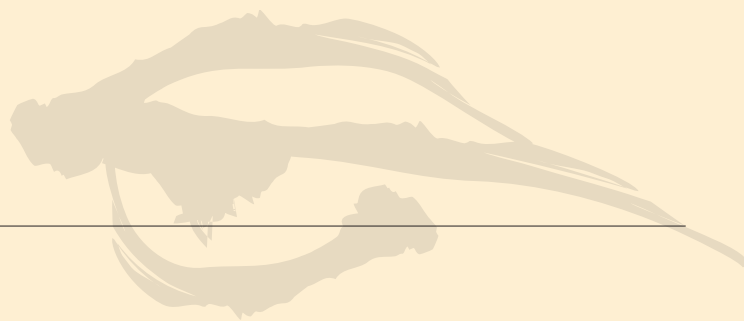
against the dollar: the koruna value of the dollar reserves fell by 14% over the year.

In 2003, the system and legislative changes enabling the Czech Republic to become a member of the European Union were essentially completed. The relevant authorities and institutions must now shift their focus to an even more important issue: how to stand up economically within the EU and how to prove the nation's readiness for future acceptance of the single European currency. These questions moved to the centre of the Czech National Bank's attention last year. Accession to the EU and the CNB's related acceptance into the European System of Central Banks will further strengthen this priority.

Zdeněk Tůma
Governor

I. MANAGEMENT AND ORGANISATION





MOTTO:

PROFESSIONALISM, TRANSPARENCY AND EFFICIENCY

In 2001, the Czech National Bank published a conceptual document “Challenges for the Czech National Bank in the Years Ahead”. The purpose of this document was to encapsulate the CNB’s view on the right outlook and functioning of the central bank in a nation intent on joining the European Union in the foreseeable future and hence committed to accepting the single European currency at some future point. The “Challenges” became a starting point for changes to the CNB’s management structure and system and the staffing of its individual departments. The new Organisational Statute that took effect on 1 January 2002 defined the Bank Board’s collective decision-making powers in more detail, strengthened the responsibilities of the basic management elements (departments), reduced the number of organisational units and put greater emphasis on research work. The posts of executive directors of all departments were filled on the basis of selection procedures. In line with a decision of the Bank Board, the organisational units prepared medium-term plans of activity and an Economic Research Programme, all of which were discussed by the Bank Board. The approval of these plans made it possible to inform the public in more detail about the objectives and measures being implemented by the CNB.

The CNB has a two-tier management system. The Bank Board makes fundamental decisions relating to monetary policy, the development of core activities and the management and institutional development of the bank. Responsibility for implementing the Bank Board’s decisions in the day-to-day running of the bank is delegated to the executive directors of departments and branches, who report to the Bank Board. The members of the Bank Board supervise the departments assigned to them.

THE BANK BOARD

The Bank Board is the supreme governing body of the CNB. It has seven members: the Governor (who chairs the Board), two Vice-Governors and four Chief Executive Directors. The Bank Board takes decisions by a simple majority of the votes cast. The Board sets monetary policy and the instruments for implementing this policy and decides on the fundamental monetary policy measures and transactions of the CNB. It approves key measures arising from the supervision of the banking sector and rules on appeals in administrative proceedings. It sets the CNB’s overall development strategy, decides the bank’s organisational structure, and appoints and dismisses senior officers of the CNB. The Bank Board also approves the CNB’s budget and budgetary rules, and defines the types, amounts and uses of the CNB’s funds.

Twice a year, the Governor submits a report on monetary developments to the Chamber of Deputies (the lower house) of the Czech Parliament for review; likewise a financial report

is submitted after the end of the calendar year. Under the Act on the CNB, the CNB is also obliged to inform the public directly about monetary developments at least once every three months. The CNB also has an information duty to the Government and to the state institutions it works with. The CNB Bank Board is careful to ensure that the information it provides on monetary policy and the bank’s activities is not limited in scope to that required by law. In practice, the amount and frequency of the information it issues is substantially higher. The CNB employs various forms of communication, including presentations by Bank Board members and other senior officers in the media and at various professional and social events.

EXECUTIVE DIRECTORS OF DEPARTMENTS

The executive directors of the CNB’s departments and branches are responsible – subject to the CNB’s overall strategy, approved medium-term plans and annual programmes – for effective performance of the activities falling within their areas of competence as set out in the Organisational Statute. These include in particular: management activities (including those of a methodological nature), preparing documents of fundamental significance and presenting them at Bank Board meetings, performing the tasks set by the Bank Board, and setting targets for the staff under them. They also perform the employer’s rights and duties under labour law in respect of their juniors, and propose appointments and dismissals of senior employees in the department. They are responsible for co-operation with other units of the bank and with domestic and foreign partner institutions.

EXECUTIVE DIRECTORS OF BRANCHES

The executive directors of the CNB’s branches manage the regional branches in:

- Prague, for Prague and the Central Bohemian region,
- České Budějovice, for the South Bohemian and Highlands regions,
- Plzeň, for the Plzeň and Karlovy Vary regions,
- Ústí nad Labem, for the Ústí and Liberec regions,
- Hradec Králové, for the Hradec Králové and Pardubice regions,
- Brno, for the South Moravian and Zlín regions,
- Ostrava, for the Olomouc and Moravian-Silesian regions.

The CNB’s branches are responsible mainly for managing money reserves, maintaining accounts of the state budget and other CNB clients, making payments, and operating safe deposit boxes. They also assist in administrative proceedings, perform foreign exchange inspections, process foreign exchange statistics in the region and collect regional data for business surveys.

THE BANK BOARD



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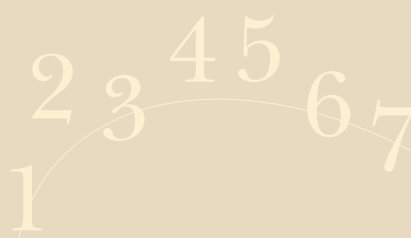
1. Jan Frait
2. Michaela Erbenová
3. Oldřich Dědek
4. Zdeněk Tůma
5. Luděk Niedermayer
6. Pavel Ráchocha
7. Pavel Štěpánek

EXECUTIVE DIRECTORS OF DEPARTMENTS AND EXECUTIVE DIRECTORS OF BRANCHES



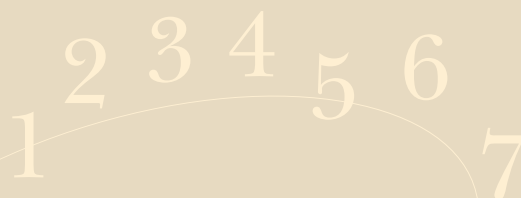
EXECUTIVE DIRECTORS OF DEPARTMENTS:

1. Tomáš Kvapil,
2. Miloš Hrdý,
3. Tomáš Hládek,
4. Jan Schmidt,
5. Zdeněk Virius,
6. Marian Mayer,
7. Jana Báčová



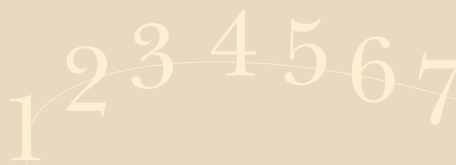
EXECUTIVE DIRECTORS OF DEPARTMENTS:

1. Miroslav Hrnčič,
2. Vladimír Kolman,
3. Věra Mašindová,
4. Jan Hampl,
5. Vladimír Krejča,
6. Ota Kaftan,
7. Aleš Čapek

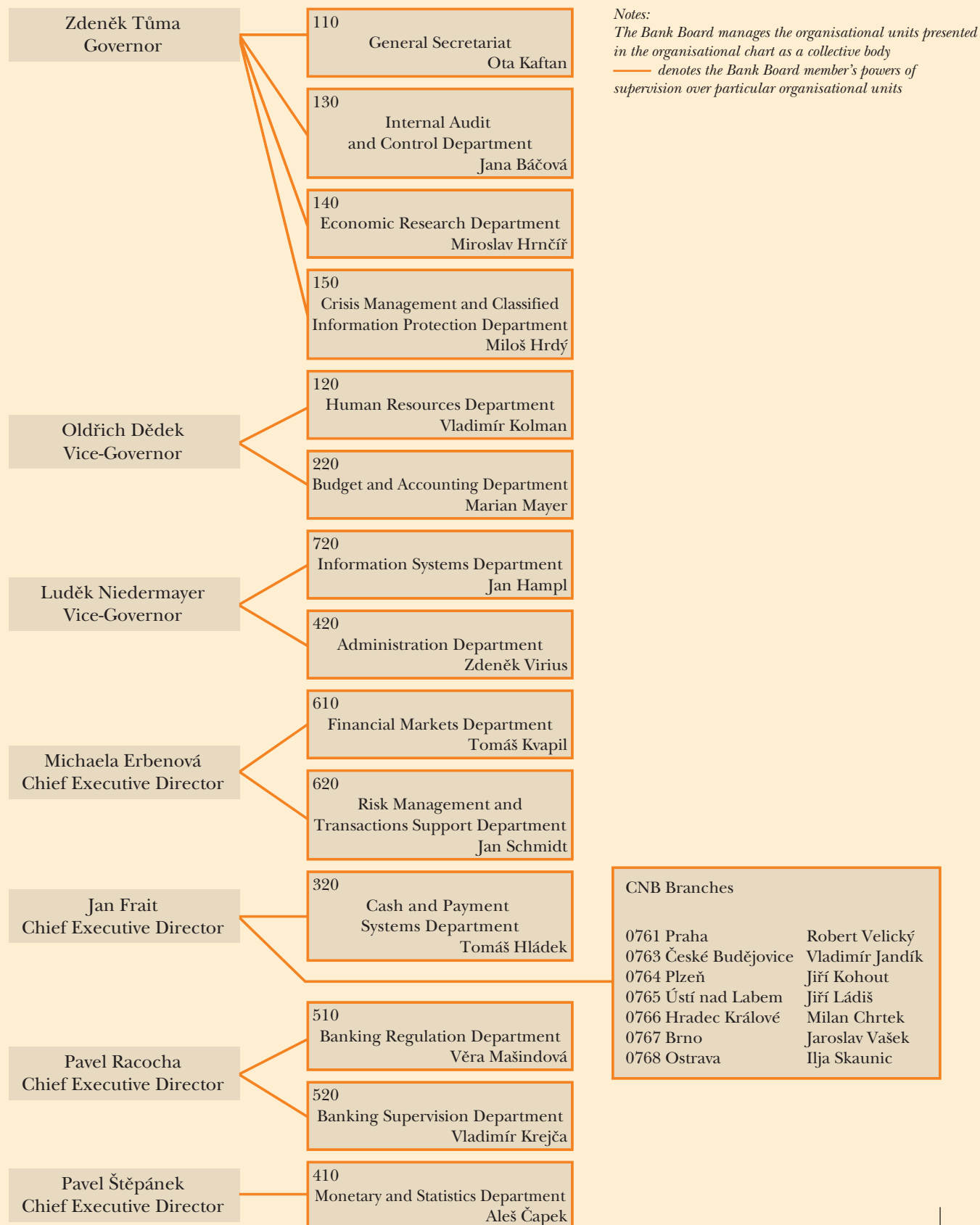


EXECUTIVE DIRECTORS OF BRANCHES:

1. Jiří Ládiš (Ústí nad Labem)
2. Vladimír Jandík (České Budějovice)
3. Ilja Skaunic (Ostrava)
4. Robert Velický (Praha)
5. Milan Chrtek (Hradec Králové)
6. Jiří Kohout (Plzeň)
7. Jaroslav Vašek (Brno)



ORGANISATIONAL CHART



Notes:

The Bank Board manages the organisational units presented in the organisational chart as a collective body

— denotes the Bank Board member's powers of supervision over particular organisational units

II. THE CNB'S OBJECTIVES AND TASKS AND THEIR FULFILMENT

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“... The primary objective of the Czech National Bank shall be to maintain price stability. Without prejudice to its primary objective, the Czech National Bank shall support the general economic policies of the Government leading to sustainable economic growth. The Czech National Bank shall act in accordance with the principle of an open market economy.

(2) In accordance with its primary objective, the Czech National Bank shall:

- a) set monetary policy;
- b) issue banknotes and coins;
- c) manage the circulation of currency, administer payments and clearing between banks, promote smooth and efficient operation thereof, and contribute to the safety, soundness and efficiency of payment systems and to the development thereof;
- d) supervise the activities of banks, foreign bank branches and any consolidated groups that contain a bank having its registered address in the Czech Republic, and see to the sound operation and purposeful development of the banking system in the Czech Republic;
- e) carry on other activities ...”

Article 2 of Act No. 6/1993 Coll.,
on the Czech National Bank, as amended



MONETARY POLICY AND ECONOMIC DEVELOPMENTS

The CNB's primary monetary policy objective is to maintain price stability, in other words to ensure that domestic inflation is low, that it is stable (i.e. that it does not suffer from excessive fluctuations), and, if it does change significantly (due to factors which either cannot be influenced, or it is not desirable to influence, with monetary policy), that such a change is foreseeable by economic agents.

To this end, the bank employs a system of “inflation targeting”, which involves:

- setting an inflation target for a particular period,
- producing inflation forecasts for the period when the bank's monetary policy instruments will have greatest effect, and
- making adjustments to these instruments, i.e. raising or lowering intervention interest rates if the inflation forecast indicates that inflation is diverging from the target.

This monetary policy structure, which is intelligible to the public and binding on the CNB, can itself help foster foreseeable, low and stable inflation.

The inflation target for 2002–2005 was set in 2001 in the form of a continuous band descending evenly from 3%–5% in January 2002 to 2%–4% in December 2005.

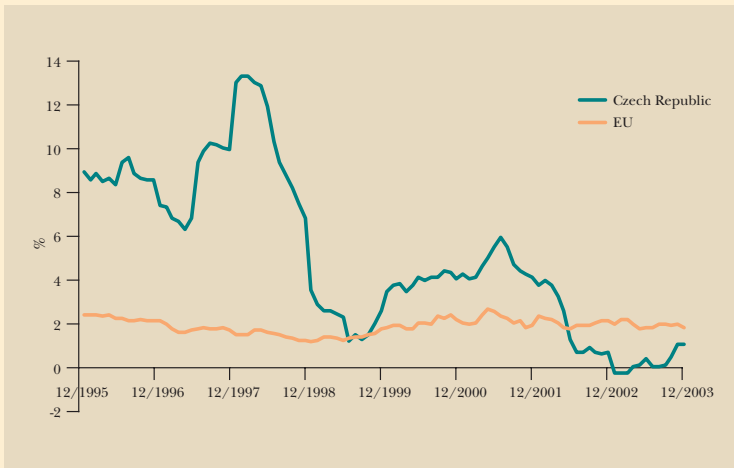
Inflation was very low in the course of 2003, fluctuating below the target band.

Fulfilment of the inflation target



In the first quarter, consumer prices recorded a year-on-year fall for the first time in Czech history. In the months that followed, annual inflation fluctuated around zero, rising only in the final quarter of 2003. For the first time ever, consumer price inflation in the Czech Republic was below the level in the EU countries throughout 2003.

Inflation in the Czech Republic and the EU countries

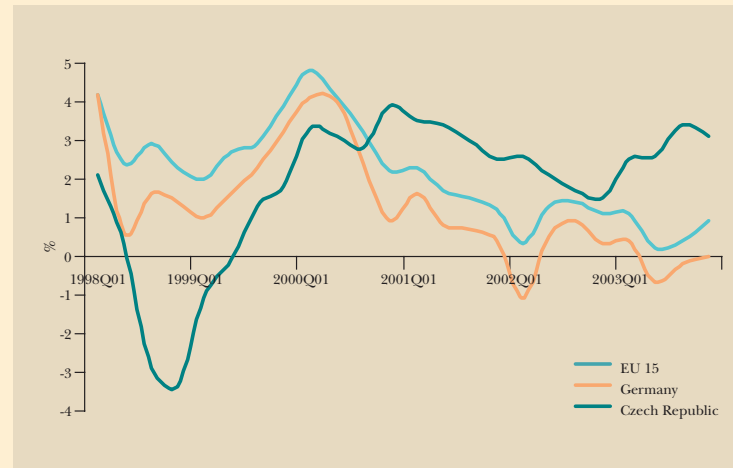


The Czech economy entered 2003 with inflation already below the set target. However, external inflationary factors combined with a pick-up in domestic growth were expected to take inflation back inside the target band. During 2003, the domestic economy did indeed record faster growth, driven chiefly by consumer demand. This reflected growth in households' disposable income and, given declining interest rates, their increasing willingness to use credit for purchases and investment.

But the expectations regarding external factors failed to materialise. In particular, foreign demand was weaker, inflation abroad lower and the koruna's exchange rate against both the euro and the dollar stronger than expected, and agricultural producer prices fell. Other contributing factors included lower-than-expected growth in regulated prices and less expansive fiscal policy. Despite the pick-up in economic growth, the demand-pull inflationary pressures were simultaneously depressed by the fact that the economy was operating below its potential and the retail market environment was strongly competitive. This accentuated even further the effect of the divergence of external factors on actual inflation. Had the forecasts captured the external factors as they subsequently developed, monetary policy could probably have been easier, or could have been eased more quickly, and the "undershooting" of the inflation target might therefore have been less marked. However, apart from its positive effect of increasing GDP growth by several tenths of a percentage point, an easier monetary policy might, under the circumstances, have led to the emergence of imbalances in various parts of the economy.

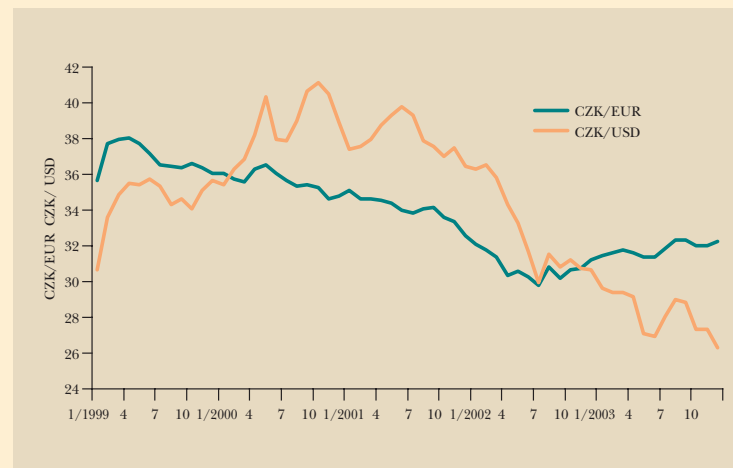
The low inflation and interest rates last year bolstered economic growth. Concerns of a continuing and deepening decline in the price level proved to be unfounded.

GDP growth



The evolution of the exchange rate fostered not only lower inflation, but also greater price stability than in past years. The nominal exchange rate of the koruna depreciated only moderately and slowly against the euro and continued appreciating against the dollar.

Nominal exchange rate of the koruna against the euro and dollar



The favourable effect of the koruna-euro exchange rate on the balance of trade was largely offset by an upturn in imports from the dollar area, hence the trade deficit remained virtually unchanged from the previous year. Conversely, the current account deficit increased by comparison with the previous year, mainly because of a wider income deficit, reflecting rising foreign direct investment earnings. A lower surplus on the services balance, caused by declining demand for services abroad due to the world economic slowdown, also contributed. The volume of direct investment, including privatisations, was



II. THE CNB'S OBJECTIVES AND TASKS AND THEIR FULFILMENT

significantly lower than a year earlier, while financial flows on the foreign exchange market were more balanced.

The inflation forecasts in 2003 (drawn up progressively for the period of 2004–2005 H1) indicated that inflationary pressures were under control, which allowed further cuts in interest rates. Inflation expectations developed in line with these forecasts and were resistant to a transitory decline in inflation to zero. A broad consensus on flat CNB interest rates until 2004 H2 gradually formed.

During the first seven months of last year, the CNB Bank Board lowered monetary policy interest rates a total of three times, from 2.75% to 2%. Unlike in the previous year, the CNB did not intervene in the foreign exchange market, hence the koruna's exchange rate was unaffected by any such interventions.

Over the course of the first half of the year, the risk of deviations from the original forecasts (continuing appreciation of the koruna-dollar exchange rate, a decline in prices of Ural crude oil and persisting subdued economic growth and inflation abroad) became ever more prevalent and the inflation forecasts for 2004 started to indicate that, adjusted for the primary effects of the expected tax adjustments (bolstering inflation), inflation would be within the target band. The inflation forecast was downscaled sharply in July. According to this forecast, inflation would not return to the target band until May 2004 and would fluctuate thereafter just below centre of the band.

The main reason for the changed inflation outlook was a shifting of the expected changes to indirect taxes to 2004 combined with the evolution of external inflation factors and the impact of expected lower foreign demand on the output gap (a prolonging of the period during which the economy would be operating below its potential). In the remainder of the year there were no further significant changes in the inflation forecast and monetary policy interest rates remained unchanged.

An upward deviation in the inflation forecast in April and subsequent downward corrections in July and October were chiefly due to uncertainties regarding the timing of the changes to indirect taxes and their direct and secondary impacts.

More details can be found in the quarterly Inflation Reports at http://www.cnb.cz/en/mp_zpinflace.php.

Priorities for developing the analytical system and enhancing modelling and forecasting techniques and conceptual monetary policy considerations in the long-term outlook

As in the previous year, the CNB's specialised departments focused their attention on further increasing the reliability of

the macroeconomic forecast (improving the model infrastructure and consolidating the forecasting process) and, within it, the inflation forecast, on which decision-making on interest rate changes is based. Constant emphasis is put on explaining monetary policy to the public, something that is of key importance for influencing inflation expectations effectively.

In 2003, analytical work started on preparing the new, post-2005 inflation target, which was announced in spring 2004.

A major step from the monetary policy point of view in the medium term was the elaboration and announcement of the CNB's position regarding future participation in the ERM II and the completion and publication of a joint document of the Czech Government and the CNB on the Czech Republic's euro-area accession strategy.

FINANCIAL MARKET OPERATIONS

The CNB implements monetary policy by means of its instruments and operations on the financial markets. By setting monetary policy interest rates and executing transactions on the money market the CNB affects the interest rates that are created there and then transmitted to the entire economy. Through foreign exchange market transactions (sales or purchases of foreign currencies for Czech korunas) the bank can affect the exchange rate. The outcome of these transactions simultaneously generates a change in the level of the international reserves. The present amount of the reserve holdings is a result of monetary policymaking and of a government decree under which privatisation proceeds were converted. The CNB's objective in managing the Czech Republic's international reserves is to achieve safe returns while maintaining the potential to intervene.

Money market instruments and operations

The main monetary policy interest rate is the two-week repo rate. A further two rates, the discount rate and the Lombard rate, are directly linked to it. By deciding on the settings of these interest rates the CNB Bank Board determines its monetary policy stance, and by executing asset operations on the money market (with instruments remunerated at this rate) the Board affects liquidity and the short end of the money market yield curve. The instruments employed by the CNB and the European Central Bank are now closely harmonised.

Operative (daily) decision-making regarding the central bank's money market operations is based on a daily supply/demand forecast for commercial bank reserves. The purpose of these operations is to balance the (predicted) supply and demand so that the liquidity of the banking sector is at the optimal level for compliance with the reserve requirement and hence causes no long-term divergence of short-term money market interest rates from the level defined by the current two-week repo rate.



In 2003, the main instrument for managing short-term interest rates was again the two-week repo, supplemented as in previous years with two “automatic” facilities. Under the “marginal lending facility” the CNB stands ready to lend banks funds overnight. The interest rate applied to this facility is the Lombard rate, which is currently 1 percentage point higher than the two-week repo rate. The Lombard rate thus provides a ceiling for short-term interest rates. The CNB requires such loans to be collateralised with eligible securities. To ensure the smooth running of the payment system at CNB Clearing, the CNB gives banks the option of drawing collateralised intraday credit (the intraday credit facility). No interest is charged on intraday credit and there is automatic spillover into the marginal lending facility in the event of non-repayment at the end of the day.

On the other hand, banks make use of the “deposit facility”, i.e. the option of making overnight deposits with the CNB at the discount rate, which is currently 1 percentage point lower than the two-week repo rate. The discount rate thus provides a floor for short-term interest rates. No collateral is provided against these funds. The use of both facilities is limited by a minimum volume, which was set at CZK 10 million last year. Other “fine-tuning operations” (repos and reverse repos under market conditions), executed on an ad hoc basis, are used only rarely.

The reserve requirement is 2% of banks’ primary liabilities against non-banks. Averaging of daily reserve holdings over the maintenance period is permitted. Reserve holdings are remunerated at the two-week repo rate. Only those reserve holdings which on average do not exceed the required reserves are remunerated. Two changes were made last year:

- the length of the maintenance period remained one month, but its start was shifted to the first Thursday of the month and its end to the Wednesday before the first Thursday of the following month;

- banks’ balances for the reserve requirement calculation now also include their balances on cash deposit and transfer accounts maintained at the CNB. This change has enabled banks to make better use of balances on these accounts and has reduced the uncertainty of the excess liquidity forecasts.

The money market operations last year again proceeded smoothly. The average volume of sterilised liquidity increased, but the CNB’s sterilisation costs decreased.

The volume of excess liquidity absorbed in monetary operations averaged CZK 490 billion in 2003, an increase of around 22% on the previous year. By comparison with 2002, therefore, the average amount of liquidity absorbed rose by approximately CZK 68 billion. Excluding extraordinary effects, however, there was a gradual fall in excess liquidity in the course of 2003. Interest paid to banks as a result of monetary operations totalled around CZK 11.37 billion in 2003.

Management of international reserves

The main objectives in managing international reserves are:

- to provide for the foreign exchange obligations of the CNB and the state, i.e. to maintain the potential to intervene on the foreign exchange market (by selling foreign currencies for Czech korunas) at any given moment,
- to achieve maximum and stable returns by investing the reserves at low risk.

The principal operations and instruments that may be used in managing the international reserves are determined by the Bank Board. The strategy is defined by setting the currency and interest rate allocation of the reserves and stipulating rules for credit and operational risk management and rules for portfolio management. Two separate departments at the CNB – the Risk Management and Transactions Support Department and the Financial Markets Department – ensure mutually independent execution and control of reserves management.

The reserve currencies are the US dollar and the euro. Since mid-2003, the dollar portion of the reserves has been maintained at the level of the twelve-month average of the monetary base. Once a month the current required size of the dollar portfolio is calculated and, if the deviation limit is exceeded by 2%, the size of the dollar portfolio is adjusted by the necessary amount. At the end of 2003 the international reserves were allocated as follows: 63.73% EUR, 34.18% USD and 2.09% SDR and gold. One portfolio is defined in each of the reserve currencies. Foreign exchange risk may not be accepted when managing the portfolios. Parameters defining interest rate risk – portfolio duration in particular – are also set separately for each portfolio. The duration set in 2003 was based on the requirement that the portfolio should not record a loss in any twelve-month period. At the beginning of last year, the duration was set at 2.23 of a year for the euro portfolio and 1.37 of a year for the dollar

II. THE CNB'S OBJECTIVES AND TASKS AND THEIR FULFILMENT

portfolio. In addition to historical data, the methodology for determining the duration takes into account the situation on the financial markets. Consequently (given the general decline in interest rates), the portfolio duration was shortened during the year. At the year end, it stood at 1.7 of a year for the euro portfolio and 0.86 of a year for the dollar portfolio.

Another parameter – the credit risk of the investment – arises from the selection of issuers of financial instruments and the selection of business partners for reserves management transactions. The sole eligible issuers are the governments and central banks of OECD countries, some governmental and multilateral organisations from these countries (e.g. the World Bank), and selected banks from these countries. The most important criterion for including an institution among the eligible issuers is its rating. The same applies to the selection of business partners, which can also include certain investment banks. The CNB's international reserves are invested in high-quality, liquid instruments. Moreover, maximum maturity is limited to 15 years for government bonds and 6 months for claims on banks.

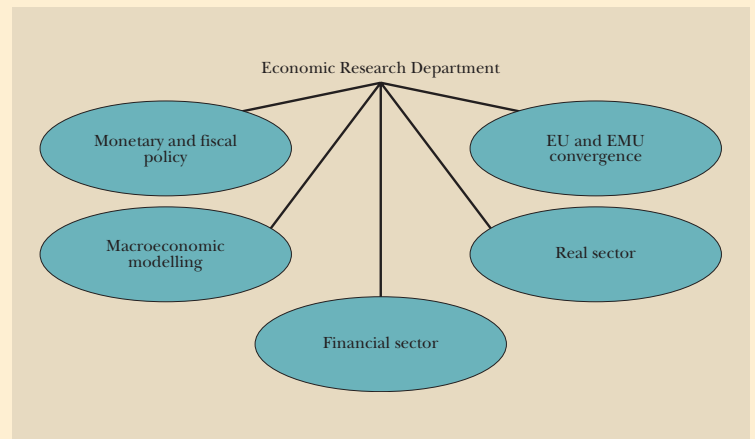
The parameters described above are reflected in reference portfolios ("benchmarks") representing the bank's neutral policy for the investment of international reserves. These portfolios are defined by the Risk Management and Transaction Support Department, i.e. by a department that is not itself involved in trading. This department also supervises compliance with the set rules and limits.

Portfolio managers invest the international reserves in particular instruments in compliance with the principles of the CNB's reserve management policy and subject to investment opportunities and developments on the financial markets. The rate of return on the reserves portfolios is measured both in absolute terms and relative to the benchmark portfolios. Measuring the rate of return relative to benchmark portfolios indicates how successfully this strategy was implemented.

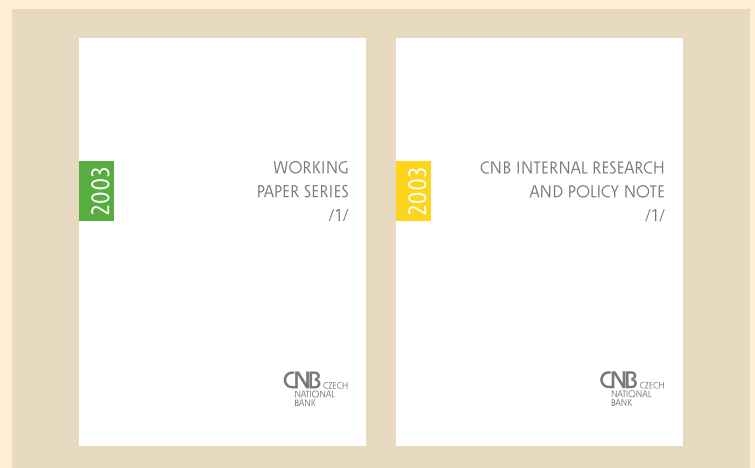
The international reserves totalled EUR 21.3 billion at the end of the year, a decline of EUR 1.3 billion from the beginning of the year. In dollar terms, the reserves rose by USD 3.3 billion to USD 27 billion. This was due mainly to appreciation of the euro against the dollar. The decline in the reserves was also attributable to repayments of Czech government liabilities running to several hundred million euro. The total net return on the reserves was CZK 24,971 million, a decline of approximately 8% by comparison with 2002. This decline was associated with falling interest rates in the euro area and the USA.

The overall rate of return on the international reserves in 2003 (i.e. the weighted average of the rates of return on the individual portfolios) was 2.86% (compared to 4.33% in 2002). The relative rate of return (i.e. the difference between the rate of return on the actual portfolio and that on the benchmark) was 0.14% for the euro portfolio (0.10% in 2002) and 0.10% for the dollar portfolio (0.15% in 2002).

ECONOMIC RESEARCH



The primary aim of the CNB's research work is to help the CNB meet its long-term strategic goals and to foster an international standard of analytical and forecasting activity in each specialised division. The economic research conducted at the CNB is planned and co-ordinated by the Economic Research Department (ERD)



From the formulation of research priorities through to the assessment of each particular project, the Economic Research Department works with the members of the Bank Board, their advisers and, especially during the implementation of research activities, with the specialised divisions of the CNB. The Research Advisory Committee, which advises the Bank Board on matters of research planning and assessment, has special status in guiding the research work. Made up of international and domestic experts and chaired by the CNB Governor, it convenes usually once or twice a year to evaluate the economic research programme for the period ahead and to assess the results of completed projects. Its meetings are usually followed by meetings of the Bank Board, which is responsible for the final assessment and appraisal of the research work.

CNB WORKING PAPERS SERIES

12/2003	Tibor Hlédik	Modelling the second-round effects of supply-side shocks on inflation
11/2003	Luboš Komárek Zdeněk Čech Roman Horváth	ERM II membership – the view of the accession countries
10/2003	Luboš Komárek Zdeněk Čech Roman Horváth	Optimum currency area indices – how close is the Czech Republic to the eurozone?
9/2003	Alexis Derviz Narcisa Kadlčáková Lucie Kobzová	Credit risk, systemic uncertainties and economic capital requirements for an artificial bank loan portfolio
8/2003	Tomáš Holub Martin Čihák	Price convergence: What can the Balassa–Samuelson model tell us?
7/2003	Vladimír Bezděk Kamil Dybczak Aleš Krejdl	Czech fiscal policy: Introductory analysis
6/2003	Alexis Derviz	FOREX microstructure, invisible price determinants, and the central bank's understanding of exchange rate formation
5/2003	Aleš Bulíř	Some exchange rates are more stable than others: Short-run evidence from transition countries
4/2003	Alexis Derviz	Components of the Czech koruna risk premium in a multiple-dealer FX market
3/2003	Vladimír Benáček Ladislav Prokop Jan Á. Víšek	Determining factors of the Czech foreign trade balance: Structural issues in trade creation
2/2003	Martin Čihák Tomáš Holub	Price convergence to the EU: What do the 1999 ICP data tell us?
1/2003	Kamil Galuščák Daniel Můnich	Microfoundations of the wage inflation in the Czech Republic

CNB INTERNAL RESEARCH AND POLICYNOTES

2/2003	Kateřina Šmídková	Targeting inflation under uncertainty: Policy makers' perspective
1/2003	Michal Škořepa Viktor Kotlán	Inflation targeting: To forecast or to simulate?

CNB SEMINARS 2003

Juergen von Hagen	Fiscal sustainability in EMU. From the Stability and Growth Pact to a Stability Council for EMU
William R White	Monetary and financial stability: How to find reinforcing anchors?
Nouriel Roubini	Sovereign debt restructuring

II. THE CNB'S OBJECTIVES AND TASKS AND THEIR FULFILMENT

When elaborating the selected projects, the research staff (CNB employees and external experts) collaborate with the Economic Research Department via a co-ordinator (an ERD employee) for each of the five economic research areas shown in the preceding figure. The results of the research take the form of refereed papers. The review process is usually public. The committee of referees is made up of CNB specialists plus one Czech expert and one foreign expert who are not CNB staff members. Successfully refereed projects are published in the "CNB Working Papers Series". Those whose content is more closely linked to internal decision-making processes are published as "CNB International Research and Policy Notes".

The Economic Research Department has close ties with prominent international research institutions (the Centre for Economic Policy Research and the European Economic Association) and the research departments of other central banks. Another of its key activities is the organising of international conferences and lectures by leading world economists jointly with domestic institutions such as the Czech Economic Society and the Prague University of Economics.

The Economic Research Department puts great emphasis on making the CNB's research output available to economists on the CNB's website. The site contains further details on the ERD's current research priorities together with the full versions of all refereed CNB research papers (<http://www.cnb.cz/en/vyz.php>). Another electronic source of information is the regular Czech National Bank Economic Research Bulletin.

THE BANKING SECTOR, ITS STABILITY AND REGULATION

Banking supervision, as performed by the CNB, comprises two fundamental, interrelated powers: regulatory and supervisory. Within its regulatory capacity, the CNB is responsible for ensuring that the laws and regulations governing the banking sector include rules and conditions to help prevent failings in the activities of individual banks, and that during the preparation of these rules both domestic and foreign experience is fully exploited. Supervisory activity is focused on checking banks' competence to engage in banking activities and compliance with the relevant terms and conditions, rules and laws. Linked to this supervisory activity is the power to stipulate remedial measures and to impose sanctions on those banks which do not comply with these measures.

The expertise that the CNB has acquired through implementing monetary policy, together with the information and experience obtained in conducting banking supervision, makes the CNB a suitable place for assessing the financial sector's stability, its likely development and its weak points. This is an advantage when orienting supervisory activities or adjusting the regulatory framework in areas where problems might arise. At the same time, information on the financial sector's stability

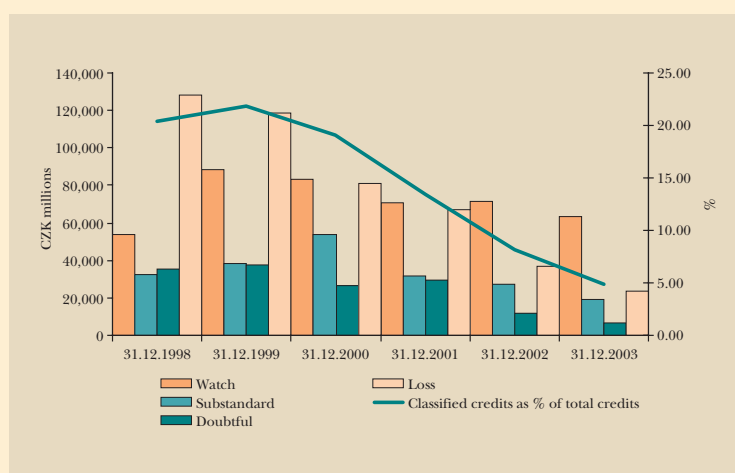
and its resistance to various shocks constitute important information on which to base monetary and economic policies.

In 2003, the number of banks fell to 35. Banking licences were revoked for Union banka and Plzeňská banka, which are now in bankruptcy proceedings. Due to their small share of the sector, the impact on the financial system was minimal. The banking sector is stable, its resistance has increased, and financial results have improved. However, lending to the economy increased only modestly and was predominantly geared to the household sector.

The equity capital of the banking sector is consistently high. Capital adequacy has reached 14.5% and all banks have met the regulatory requirement of 8%. Foreign owners account for 85% of the sector's capital and directly or indirectly control 97% of total assets. The majority of owners are banks from EU countries.

In 2003, the quality of loans continued to increase thanks to an improvement in risk management, the transfer of bad credits outside the banking sector, and the focus on the lower-risk segment of households. Non-performing credits fell to approximately CZK 50 billion, i.e. to 4.9% of total credits, an amount comparable to the EU average. The coverage of classified credits by provisions and high-quality collateral is sufficient.

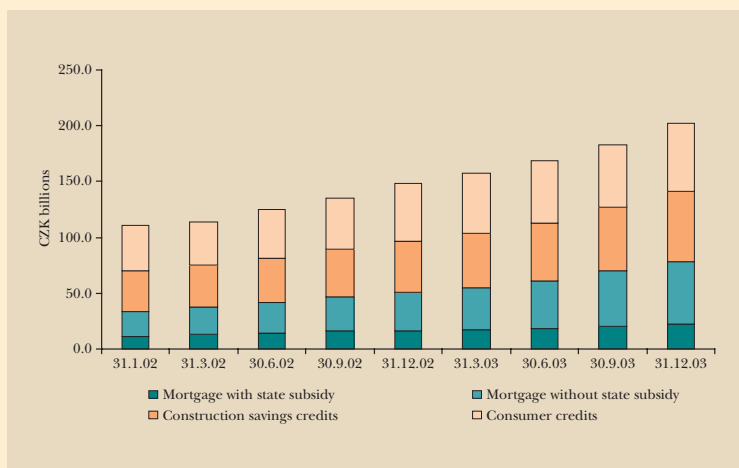
Quality of credit portfolio



The low level of exchange rate risk follows from the banking sector's low level of involvement in foreign currency operations and from the balanced foreign exchange position.

The assets of the banking sector amounted to CZK 2,528 billion and the share of credits rose to 39.4% due to the growth in loans to households, which went up by more than 34%.

Credits to households



A sufficient volume of funds and limited effective demand for loans from other sectors resulted in growth in other assets. Quick assets continued to grow, reaching 35.9% of total assets. The volume of funds deposited with other banks went on decreasing: it declined by approximately 24% year-on-year.

The derivatives market rebounded after a year's hiatus. Most active in this field were foreign bank branches, where the volume of such transactions was 2.8 times the value of their assets. Banks focused almost exclusively on transactions in currency and interest rate instruments, which accounted for 70.6% and 29.3% respectively. As in past years, the proportion of transactions involving interest rate instruments increased, whereas those involving currency instruments declined.

Client deposits grew more slowly in 2003 than the previous year. Such deposits amounted to CZK 1,659 billion, accounting for almost 66% of total assets. Low interest rates had an impact on their structure. Demand deposits grew at a faster pace, whereas time deposits declined in absolute terms.

The banking sector achieved positive financial results for the fourth year running. Net profit was CZK 30.1 billion and that from financial activities CZK 90.2 billion. These results are only slightly lower than in 2002. This was due mainly to low interest rates and competition, which led to a reduction in the interest rate spread. In contrast, profit from fees and commissions rose by 11.9% to CZK 26.3 billion, due to the new policy of banks in this area. A further reduction by 563 in the number of employees in the banking sector did not significantly affect administrative costs, which saw a slight increase. The net profit was attributable mainly to the reduced need to create reserves and provisions (only CZK 0.7 billion) associated with the improving quality of assets.

Detailed information on the development of the banking sector over the past year is published in the CNB's regular annual publication *Banking Supervision*. Continuous updates to this information are available at the CNB website: www.cnb.cz/en/bd/publikace_rz.php.

What's new in regulation

The legislation governing banking activity hardly changed at all last year. Act No. 423/2003 Coll., principally changing the rules for providing state support to those saving money in building-society accounts, was the only act to be passed last year.

In September, the CNB issued Czech National Bank Provision No.1, on the Internal Control System of a Bank for the Area of Money Laundering Prevention.

In December, an amendment to Czech National Bank Provision No.5, stipulating Rules for the Assessment of Financial Receivables and the Creation of Provisions and Reserves, and Rules for the Acquisition of Certain Types of Assets, was adopted. This was aimed at removing some of the restrictions on the acquisition of assets from persons having a qualifying holding in the bank or from persons over which a person having a qualifying holding in the bank exercises control.

Throughout the year, a provision regarding a bank's internal control system, including its risk-management system, was in preparation. This, Czech National Bank Provision No. 2 (promulgated in the CNB Bulletin on 16 February 2004), summarises both risk-management requirements already dealt with and those elements hitherto lacking (operational risk, information technology, internal auditing).

CNB Provision No. 1 (promulgated in the CNB Bulletin on 12 January 2004), stipulating the minimum requirements for information disclosure by banks, was amended in December. The main reason for this was the adoption of certain provisions of the now obsolete Ministry of Finance measure on individual financial statements, and the setting of certain requirements for disclosing information on capital adequacy.

The Central Register of Credits

Following the commencement of activities at the end of 2002, the Central Register of Credits started regular operation in 2003. Providing the opportunity to share relevant information on credit commitments and debt repayments, the register has ranked among the most important instruments contributing to better credit-risk management in the banking sector. Information on the credit commitments of individual entrepreneurs and legal entities is available to all banks operating in the Czech Republic. The CNB, as the operator and guarantor of the register, is planning to further enhance its information functions.

II. THE CNB'S OBJECTIVES AND TASKS AND THEIR FULFILMENT

The Agreement on Co-operation with the Ministry of Finance and the Securities Commission

The institutions supervising the financial market have been working together since 1998, when they signed a tripartite co-operation agreement. The new agreement, from February 2003, creates the preconditions for co-ordinating the supervision of consolidated groups, the mutual exchange of information on individual sectors, and the alignment of regulatory and supervisory rules. The newly established Committee on the Coordination of the Supervision of the Financial Market began working on a project for integrating supervisory institutions, enforcing international accounting standards for all regulated entities, and unifying disclosure requirements; it also discussed related issues. The Committee agreed to gradually integrate the four existing supervisory institutions into one by the time the Czech Republic joins EMU. During the first phase, i.e. until 30 June 2005, the supervision of banks and the supervision of credit unions will be integrated under the Czech National Bank, and as of 31 December 2006 state surveillance of the capital market and state surveillance of insurance and contributory pension schemes will be integrated under the Securities Commission.

The New Basel Capital Accord (Basel 2)

Throughout 2003, work continued on preparations for implementing the Accord and the relevant European directive (the RBCD), and activities relating to the joint project of the Czech Banking Association, the CNB and the Chamber of Auditors intensified. With other banks, the CNB took part in working through the Quantitative Impact Study (QIS 3) prepared by the Basel Committee for Banking Supervision. The objective was to test the impact of the new rules on banks and the banking sector. Details of the work's progress and the CNB's approach to the implementation of the Accord are regularly published at www.cnb.cz/en/bd_bdindex.php, and information on the activities of the joint project can be found at www.czech-ba.cz/basel2

International co-operation and European integration

Activity in this area has been proceeding in several directions. One is the signing of memoranda of understanding on banking supervision with regulators in those countries where the parent companies or headquarters of banks and branches operating in the Czech Republic are registered. In the last year, memoranda of understanding were signed with Belgium and Germany, and negotiations with Italian and Dutch regulators continued, the result of which (i.e. the signing of memoranda of understanding) can be expected in 2004.

Supervisory activities in figures

- In the course of 2003, 18 inspections were carried out at 15 banks and foreign bank branches; 2 were comprehensive inspections and 16 partial inspections directed at selected areas of banking risk.

- 19 information-gathering visits were made in order to acquire sufficient data.
- Remedial measures were imposed on 18 banks.
- 23 administrative decisions were issued in the area of licences and permits.
- The re-licensing of banks and foreign bank branches in compliance with the provisions of the harmonisation amendment to Act No. 121/2002 Coll., on Banks, was a key activity. Banks initiated administrative proceedings for the extension of licences and the acquisition of holdings by new shareholders.
- There were 2 proceedings on revoking a licence and imposing fines.
- 124 decisions approving the appointment of external auditors, shareholder structure prior to general meetings, the inclusion of subordinated debt in a bank's capital, types of consolidated group, and internal models for market risk measurement, etc., were issued.
- Opinions on nominees for managerial posts in banks were delivered in 21 cases.

CURRENCY IN CIRCULATION AND THE PAYMENT SYSTEM



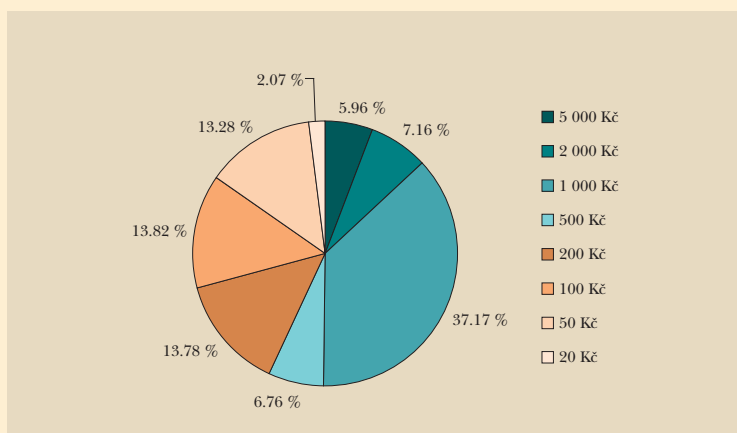
The management of money circulation is one of the traditional activities of the central bank. As technology progresses, the importance of electronic payment systems and clearing systems based on computer technology is increasing and the use of electronic payment instruments is expanding rapidly. At the same time the demands for reliable, efficient and secure systems are also increasing. Overseeing desirable development in these areas has become the domain of central banks in modern times. Although much less efficient, the tradition of cash payment is yielding to this trend only very slowly, hence the provision of cash-related services to the public and banks remains an important central bank activity.

By law the CNB has executive and legislative responsibilities in both these areas. In the currency area it is responsible for putting sufficient volumes of coins and banknotes into circulation and for the quality of those coins

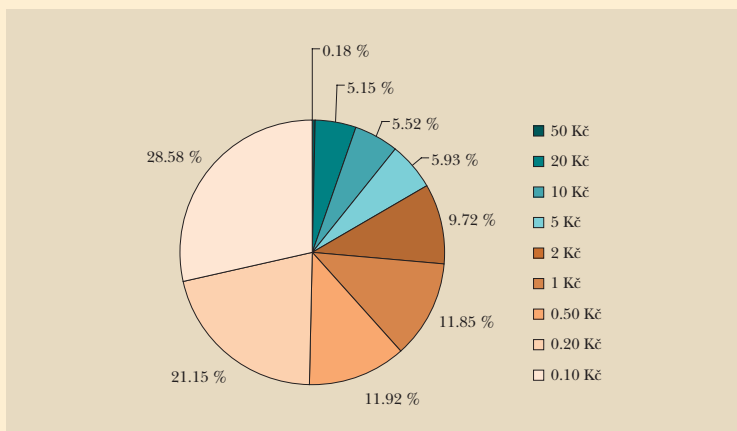
and banknotes (from the aesthetic perspective and with regard to the acceptable degree of wear and tear and resistance to counterfeiting and imitation). In the area of non-cash payments, the CNB directly operates, in addition to its own clearing system, the nation's interbank clearing system and the register of short-term securities, and it is charged with supervising payments and settlements in the Czech Republic. Its legislative responsibility consists in preparing legal rules and implementing measures for both these areas.

With respect to the long-term trend, 2003 brought no major changes in the volume of circulating currency. The value of money in circulation increased by 10%, to CZK 248.4 billion. Favourable changes occurred, however, in the currency structure, as some banks started putting banknotes of higher denominations into circulation through their ATMs. Relatively low growth in the number of circulating banknotes meant that the quantity of banknotes accepted from circulation and processed by the CNB's branches in 2003 rose by a mere 1%.

Structure of banknotes in circulation (number of notes)



Structure of coins in circulation (number of coins)



A very positive development as regards rationalising cash operations and cutting costs was that the 10-heller and 20-heller coins ceased to be legal tender. These coins were no longer fulfilling the function of circulating currency, as they were failing to return from circulation to the bank and it was necessary to constantly produce new coins for circulation purposes. The production prices of both coins were, however, higher than their face value. The CNB and the other banks were having to spend large amounts on transportation and handling. The withdrawal of these coins also made it possible to terminate cash operations with commercial banks at the CNB's branches in České Budějovice and Ústí nad Labem.

Cash movement between commercial banks and the CNB was also rationalised thanks to the establishment of a "consolidated" account at CNB headquarters, through which banks can now deposit and withdraw cash. This change allows banks to better manage balances on the cash deposit and withdrawal account and at the same time offers more room for asset management, since the account balances are now included in the required reserves.

Counterfeiting was more frequent than in 2002, although the police detected a greater number of cases. In 2003, a total of 10,829 counterfeit and altered banknotes and coins and 162 imitations were seized in the Czech Republic. A survey of seized counterfeit and altered money is given in the table. This was the first year-on-year increase since 1999, as between 1999 and 2002 the number had been constantly decreasing.

The value of the seized counterfeit and altered banknotes and coins totalled CZK 17,920,728. In the course of 2003, the CNB's legal-tender testing room dealt with 85 non-standard cases of damaged money (flood-damaged, fire-damaged, decayed, mouldy, disintegrated, mouse-nibbled, etc.), for which compensation amounting to CZK 1,636,450 was paid out.

	Seized from circulation	Seized by the police	Total
CZK	4,384	2,982	7,366
USD	693	490	1,183
EUR	457	46	503
DEM	38	0	38
ITL	15	0	15
Other	110	9	119
Coins	64	0	64
Altered	1,540	1	1,541
Total	7,301	3,528	10,829

II. THE CNB'S OBJECTIVES AND TASKS AND THEIR FULFILMENT

Commemorative coins

The CNB issued four silver commemorative 200 Kč coins in 2003: in February to mark the 150th anniversary of the birth of Jaroslav Vrchlický (poet); in March to mark the 150th anniversary of the birth of Josef Thomayer (physician and writer); in June to mark the 100th anniversary of the first electrified railway from Tábor to Bechyně; and in November to mark the 100th anniversary of the foundation of the Skiers' Union in the Kingdom of Bohemia.



Two more gold 2000 Kč coins from the cycle *Ten Centuries of Architecture* were issued in April and September: the Late Renaissance – house gables in Slavonice, and the Baroque – Buchlovice castle.

Seven public tenders were called during the year for the design of commemorative coins: five for silver coins, two for gold coins and one for a special bimetallic coin to mark the Czech Republic's accession to the European Union. The CNB Bank Board approved all the designs from these tenders recommended by the Commission for the Evaluation of Designs for Czech Banknotes and Coins.

The non-cash payment system run by the Czech National Bank underwent further innovations and improvements in 2003.

What is CERTIS?

CERTIS (Czech Express Real Time Interbank Gross Settlement System) is the interbank payment system operated by the CNB. It handles all domestic interbank transfers (in Czech koruna), checking in real time whether banks have sufficient coverage for these transfers.

CERTIS in figures: In 2003, CERTIS processed a total of 317.7 million transactions (transfers), totalling more than CZK 97 trillion. This means 1.2 million transactions a day on average, with daily turnovers averaging CZK 384.7 billion. The system recorded its daily maximum on 16 November 2003, when it handled more than 3.5 million transactions. On 29 December 2003, transactions totalling almost CZK 568 billion were processed.

Changes to CERTIS in 2003: Work was completed on separating transaction processing into two streams: fast and slow, allowing settlement of priority interbank transfers (express payments) on the same accounting day. In addition, adjustments were made to the pricing policy, consisting in the introduction of bulk discounts for participants depending on the number of items transferred.

What is SKD?

The CNB is responsible by law for administering and operating the Short-Term Bond System (SKD). This system is used for issuing and registering all book-entry securities with maturities of up to one year, and for settling trades in these securities. It comprises T-bills, CNB bills and bonds issued by the Czech Consolidation Agency.

SKD in figures: In 2003, the system handled more than 17,000 transactions, representing transfers of securities worth more than CZK 39 trillion.

Changes to SKD in 2003: Stabilisation of the new version of SKD launched in December 2002 continued. The system not only executes sales of securities, but also allows segregation of repo operations and sell and buy operations as well as realisation of collateral and exchanges of securities. Furthermore, it allows direct, automated and very flexible provision and repayment of the intraday credit extended to banks by the CNB within CERTIS, including increases and decreases thereof, at any time during the accounting day according to banks' instructions and needs. The system is highly secure, with electronic authentication of participants and the option of digital signature and encryption of transmitted data. In 2003, SKD underwent an assessment with respect to the ECB's standards for settlement systems. SKD was evaluated as fully compliant in most respects.

What is ABO?

The CNB is responsible by law for maintaining and administering the accounts of state organisational units and organisations connected to the state budget. This it does through the ABO (Automated Banking Operations) system. In addition, the ABO system is used to keep books on the central bank's own funds. Using data obtained from the ABO system, the CNB provides the Ministry of Finance with source materials for the state budget accounts.

ABO in figures: The ABO system processes more than 200,000 items a day on average (and on peak days more than 400,000 items). Average daily turnover exceeds CZK 1 trillion.

Changes to ABO: Data-processing in a new version of ABO was launched in October 2003. The new version, which is more secure, introduced real-time processing, simplified and automated the existing procedures and increased the settlement speed.

Legislation, licensing procedures and co-operation with the European Central Bank

Further to the adoption of the Payment System Act, the CNB prepared a decree stipulating the manner of execution of payments between banks, settlement on accounts with banks, and technical procedures of banks for corrective clearing. The aim of this draft was to enact in Czech law certain standards and important principles for the conduct of banks within the payment system. The decree took effect on 1 March 2004, save for some provisions postponed to 1 September 2004 because of the need for software modifications in banks.

The CNB was involved in preparing an amendment to Act No. 229/2002 Coll., on the Financial Arbiter. This extends the Arbiter's powers in respect of out-of-court settlement of disputes arising during the execution of transfers and the issuance and use of electronic payment instruments.

Under the Payment System Act, the CNB issues prior consent to entities other than banks to the issuing of electronic money instruments on the basis of an application in administrative proceedings. One such prior consent was granted in 2003, two other cases are being dealt with, and a further increase in the number of applications can be expected in the near future.

CNB representatives are involved in the ECB's working groups for the payment system area. These working groups are currently dealing primarily with payment instruments, securities, TARGET system development and collection of statistical information.

THE CNB AS THE BANK OF THE STATE

Central banks are usually characterised as the banks of banks, as they have long provided guaranteed credit to other banks. This original central bank function has seen major changes over the years. The range of services provided to banks has gradually widened and new functions have been added. In many countries, central banks act as organisers of payment relations, operators of payment systems and supervisors of the banking sector.

The CNB not only fulfils the above roles, but also functions as the bank of the state. This, too, is one of the central bank's traditional duties, but it has become narrower in content than in the past. Today, central banks do not lend to the state; indeed, an ever increasing number of central banks are prohibited by law from doing so in any form. In the modern age, being the bank of the state above all means making use of the central bank's expertise (the knowledge and experience of its staff) and infrastructure (its settlement systems and branch network), which as a rule generates cost savings and lower expenditure for the state. The CNB maintains the state budget accounts for the state, sells government bonds and provides associated services, including the registration of short-term government bonds.

The CNB maintains the accounts of state organisational units connected to the state budget, revenue and customs offices (tax

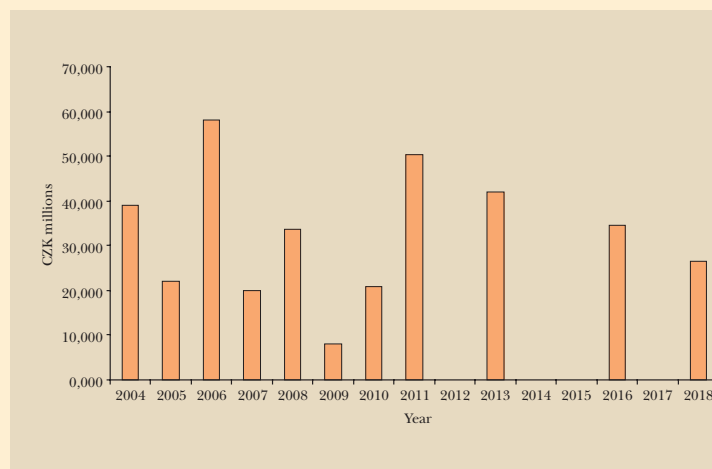
revenues), the Czech Social Security Administration (health insurance and pension contributions, pension payments), labour offices (employment policy), subsidised organisations, state funds, and business entities that receive subsidies from the state budget. The CNB is also responsible for the payment of state social benefits. The CNB provides the Ministry of Finance on a daily basis with detailed information on state budget revenues and expenditure broken down by type and state budget chapter, and on other treasury funds. It pools the funds of the National Fund of the European Communities on euro accounts and facilitates their use in both euro and koruna. For the Ministry of Finance the CNB also maintains the government debt financing accounts, treasury liquidity management accounts and state financial asset management accounts. Under the Act on Budgetary Rules, the CNB also maintains accounts for the registration and use of National Fund money.

Number and structure of accounts maintained as of 31 December 2003

Treasury accounts	24,484
Extra-budgetary accounts of state organisational bodies	2,917
Subsidised organisations' accounts	972
State funds accounts	148
National Fund accounts	297
Total	28,818

The Czech National Bank also assists in the management of the Czech Republic's national debt. When carrying out transactions it follows the orders and strategy of the Ministry of Finance, which last year aimed to extend the average maturity of the national debt.

The volume of due government bond issues in individual years



II. THE CNB'S OBJECTIVES AND TASKS AND THEIR FULFILMENT

In line with the strategy adopted, the volume of medium-term and long-term bonds increased by CZK 58 billion, while the volume of T-bill issues rose by just CZK 8 billion. In 2003, the CNB organised 36 T-bill auctions for the Ministry of Finance. These bills had maturities ranging from 3 months to 1 year and totalled CZK 447 billion. Of this volume, bills with a face value of CZK 333 billion were purchased by direct participants in the auctions and the remainder (amounting to CZK 114 billion) were purchased by the issuer and placed in its portfolio. The bills were sold by Dutch auction. At the close of 2003, the outstanding volume of T-bills held by investors was CZK 161 billion. The investors at T-bill auctions were particularly interested in bills with short maturities, for which the excess demand was highest. Turning to medium-and long-term government bonds, a total of 15 auctions took place in 2003, with a total nominal value of CZK 146 billion. Here too, demand exceeded supply in most cases, although the excess decreased during the year. Three bond issues, with a nominal value of CZK 28 billion, were duly redeemed. The technique of reopening existing issues continued to be applied. This again helped to increase the liquidity of the secondary market. The way in which the auctions are planned and organised is geared towards improving predictability and providing better information to market participants. This was fostered by regular informative meetings between CNB and Ministry of Finance representatives and the direct participants in government bond auctions.

STATISTICS

The CNB is the sole institution in the Czech Republic responsible for the methodology, collection and processing of data for the monetary and financial statistics (for the purposes of monetary policy and bank and financial system monitoring as well as for the needs of international institutions, financial markets, research and the public). The CNB also compiles the balance of payments of the state, including associated statements on the international investment position, external debt, international reserves and other related indicators.



Monetary and financial statistics

The monetary and financial statistics comprise the monetary statistics, banking statistics and the rapidly developing financial market statistics. The driving factor for their current development is harmonisation with European Central Bank standards in connection with the Czech Republic's entry into the EU and later the EMU. The CNB maintains a list of monetary and financial institutions, which it updates regularly and publishes on its website: http://www.cnb.cz/en/stat_mb_list.php.

The monetary statistics consist chiefly of the balance-sheet statistics of monetary and financial institutions, which are used among other things for compiling the consolidated balance sheet and calculating monetary aggregates and their counterparts. In addition to end-of-period balances, however, they monitor transaction (flow) data related to the period under review and year-on-year growth rates. Furthermore, they include statistics on bank interest rates vis-à-vis households and non-financial corporations. In this area, the Czech Republic is at a level comparable with the euro area countries. One very important area is the banking financial stability statistics, although these have yet to take definitive shape. The CNB has drafted their initial, preliminary form. The financial market statistics are also only in their infancy. EU enlargement has given this area a new impulse. Monitoring of bond markets and interest rates on long-term bonds has been commenced for the fourth Maastricht convergence criterion. The results of this statistical survey were published in a European Central Bank document *Bond markets and long-term interest rates in EU accession countries*.

Balance of payments statistics

The priority in this area is to introduce the methodological standards required by the European Union, which lay greater emphasis on detail, particularly as regards geographical breakdown. Since January 2003, the basic balance of payments items have been published on a monthly basis. Geographical cross-sections of the current account and a more detailed sectoral and geographical breakdown of foreign direct investment etc. have been published monthly for three years now.

CNB statistics on the Internet

All statistical outputs are disclosed on the CNB website (http://www.cnb.cz/en/stat_pb.php). Further information on selected indicators, including meta-data, is issued under the IMF Special Data Dissemination Standard (SDDS), whose webpage for the Czech Republic as a whole is also available on the CNB website and is updated on a daily basis. More detailed aggregated data in time series are published in the ARAD database system. In addition to the statistics collected by the CNB, the CNB website contains exchange rates (daily rates,

averages and various calculations of the koruna's effective exchange rate), relevant statistical publications, specimen statements for compilers, laws and regulations relating to the balance of payments statistics, and key documents issued by international institutions in this area.

EUROPEAN AND INTERNATIONAL CO-OPERATION, FOREIGN TECHNICAL ASSISTANCE

The CNB's status entails numerous duties connected with the Czech Republic's involvement in the European economic and political integration process. The CNB Act has itself already gone through this process. In its last amendment, the status of the CNB as the only monetary institution in the state, and its independence of the Government, were fully harmonised with the principles applied in the European Union. This also makes it possible for the CNB to become a member of the European System of Central Banks upon the Czech Republic's accession to the EU in May 2004, and hence is an important step for joining the Economic and Monetary Union and introducing the single currency in the Czech Republic in the future. Although we are not talking here about the near future, this prospect needs to be taken into consideration very seriously in at least three respects:

- *when drafting monetary strategy in the years ahead*
- *when planning the long-term development of the bank's activities, and*
- *with regard to personnel preparedness, i.e. to be an equal partner and an active representative of the state in European monetary institutions.*



The CNB's state of preparedness for joining European institutions can be assessed as very good. Work on harmonising the legislation that must be in effect as from accession was virtually completed last year. A co-ordinating body for EU issues was set up in the CNB. The bank was also involved in the Czech Republic's co-ordinating institutions, in particular the EU Committee established by the Government and headed by the Secretary of State for European Affairs at the Ministry of Foreign Affairs.

The nature of the CNB's co-operation with the ECB changed substantially, becoming regular and systematic at all levels. Since April 2003, when the accession agreement was signed in Athens, CNB representatives have been invited to the meetings of EU bodies and institutions as observers. This allows them to follow the negotiations and take part in the debates on the materials submitted. The CNB has observer status in 12 committees of the European System of Central Banks and in various working groups. In addition, CNB employees attend meetings of advisory bodies to the Council of the European Union and the European Commission. The CNB Governor, together with the governors of the other nine central banks of the acceding countries, regularly attends the meetings of the ECB's General Council.



By comparison with the dynamic development of its relations with the ECB, the CNB's level of involvement in the bodies of the Council of the European Union and the European Commission is lower, but no less significant. The CNB Governor is invited as an observer to attend the enlarged meetings of the council of economics and finance ministers (ECOFIN). In 2003, CNB representatives attended meetings of the Economic and Financial Committee and the Banking Advisory Committee, which fulfil advisory functions for the Council of the European Union and the European Commission in the areas of economic policy and financial services. During 2003, representatives of the CNB and the Ministry of Finance were also involved in the work of an economic and financial subcommittee for issues of co-ordination of EU member states' policy towards the IMF.

The CNB during 2003 promoted public awareness of the functioning of the European Union and its institutions. Besides issuing standard printed outputs (an information brochure *The European Union and the Czech National Bank*) it made use of its website, which has a special page of links to all its EU-related activities. The CNB's website should remain a primary source of EU information for the Czech public in the future.



II. THE CNB'S OBJECTIVES AND TASKS AND THEIR FULFILMENT

The International Monetary Fund and World Bank Group

In mid-2003, a consultation took place with an IMF mission, which positively assessed the monetary and exchange rate policy of the CNB. In the fiscal area, the intention to reduce the general government deficit to 4% of GDP by 2006, and to do so by means of austerity measures and institutional changes, met with a positive response. A joint IMF and WB project also assessed the measures applied to combat money laundering and the financing of terrorism. In this area the Czech Republic is compliant with most of the recommended international standards.

The Bank for International Settlements (BIS)

In 2003, the Governor of the CNB again attended the regular working meetings of central bank governors organised by the BIS. At these meetings, topical issues relating to world economic and monetary developments are discussed. The close co-operation between the CNB and the BIS also continued in the Basel Committee on Banking Supervision, in the Central Bank Governance Steering Group and in the co-ordination of foreign technical assistance. A seminar on credit risk management and securitisation organised jointly by the CNB, the BIS and the Financial Stability Institute in September 2003 in Prague also generated much interest.

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

CNB representatives took part in the activities of key OECD committees, which during the year addressed topical global economic issues, in particular the impacts of geo-political uncertainties on the recovery of the world economy; the worsening fiscal position of some OECD countries; and the preparation of an analytical project dealing with structural reforms. The CNB was also involved in the preparation of an economic survey of the Czech Republic, discussed in January 2003. Of particular importance is the favourable assessment of macroeconomic developments and the OECD's positive comments on the CNB's monetary policy. A follow-up press conference in Prague attended by representatives of the relevant government departments and the CNB and OECD experts informed the business community and the public in more detail about the evaluation of the Czech Republic and the OECD's recommendations. The CNB also helped to organise a seminar on liberalisation of capital movements organised by the OECD for non-member states in May 2003 in Istanbul.

The European Bank for Reconstruction and Development (EBRD)

Every two years, the EBRD prepares and approves a strategy for each country in which it invests. The new strategy for the Czech Republic for 2004–2005 was approved at the end of 2003. In the financial sector it focuses on co-operation with local banks in the development of innovative financial products, on different forms

of financing of small and medium-sized enterprises, and on providing support for non-banking financial institutions. During 2003, the EBRD signed four projects in the Czech Republic and three projects in individual regions worth EUR 82 million in total. The EBRD's total investment in the Czech Republic since its launch up to the end of 2003 amounted to EUR 1 billion and involved 45 projects. The EBRD had also financed 32 technical assistance projects, worth EUR 5.4 million.

Foreign technical assistance

In 2003, the CNB continued providing technical assistance, an activity it launched in 2002. The main element of the plan for 2003 was a programme of seminars intended primarily for central bank employees from the countries of the former Soviet Union and southern Balkans and Central and Eastern European countries. Seven seminars were held last year, covering monetary policy, banking and preparation for EU accession, during which a total of 123 foreign experts visited the CNB. In addition to seminars, plans were made for bilateral co-operation in the form of consultations (mostly held at the CNB, but sometimes at the recipient's bank). Also, thirteen projects, attended by 42 experts, were realised at the CNB based upon the specific requirements of the recipients. Experts from the central banks of Albania, Azerbaijan, Indonesia, Kyrgyzstan, Macedonia, Poland, Romania, the Russian Federation, Serbia, Ukraine and Vietnam attended bilateral consultations. Missions of CNB experts – organised either by international organisations or directly by the CNB – took place in the National Bank of Ukraine and the National Bank of Slovakia. The aim of these missions was to pass on the CNB's experience of constructing a forecasting system. The CNB became sought after as a systematic provider of assistance in the form of seminars and highly specialised consultations. This activity is valued not only by seminar and consultation participants themselves, but also by the BIS in Basel, which monitors the technical assistance provided by central banks.



THE CNB AS AN ADMINISTRATIVE BODY

The Czech National Bank has the powers of an administrative body in the following areas:

- *banking supervision,*
- *interbank payments and clearing,*
- *foreign exchange.*

(The CNB's activities as an administrative body in the first two areas are covered in the sections "The banking sector, its stability and regulation" and "Currency in circulation and the payment system" of this Report.)

offences were associated with breaches of the conditions for foreign exchange trading (in particular failure to make correct deductions for foreign currency sales and purchases, and failure to fulfil the reporting duty). However, the foreign exchange supervision priority is, and will continue to be, the combating of unauthorised business. Five rulings relating to unlicensed foreign exchange trading were issued, with fines exceeding CZK 10 million imposed. Both the number of rulings and the volume of fines imposed was higher in 2003 than in previous years, reflecting the CNB's increasing resolve in this area.

CNB branches and headquarters	No. of forex licence applications submitted	No. of applications granted	No. of forex licences, total
Prague	24	24	86
České Budějovice	4	4	27
Plzeň	12	12	30
Ústí nad Labem	11	11	35
Hradec Králové	1	1	13
Ostrava	10	7	28
Brno	8	8	30
Headquarters	8	8	65
Total	78	75	314

In the foreign exchange area, the CNB issues foreign exchange licences for certain types of foreign exchange transactions and oversees compliance with the foreign exchange regulations by means of foreign exchange inspections. If these regulations are contravened, it is authorised to impose penalties.

In 2003, the CNB granted 75 foreign exchange licences for trading in foreign exchange, roughly the same number as in 2002.

In 2003, the CNB started to centralise its administrative proceedings. This process includes a proposal to transfer responsibility for imposing fines for foreign exchange offences from branches to CNB headquarters. Responsibility for processing licence applications and conducting inspections remains with the branches. This means that the execution of foreign exchange inspections has been segregated – both organisationally and personally – from the administrative proceedings, in accordance with the law. At the same time it has facilitated the creation of an integrated register of foreign exchange offenders, which is an important tool for assessing persistent offending in this area. These changes will increase the effectiveness of the activities performed and improve discipline in foreign exchange trading.

In 2003, the CNB issued 34 final and conclusive rulings on foreign exchange offences and imposed fines amounting to CZK 11 million. These fines constitute revenues to the state budget. Most of the

TECHNOLOGY AND SECURITY

Computing and communication systems

The activities of a central bank are today unthinkable without the support of information technology and information systems. The Czech National Bank's computer network has gradually developed into a complex system of interconnected technologies and applications. The bank's results depend on the quality (technological level), reliability (stable functioning) and security (protection of information and restriction of access to it) of these technologies.

The main elements of the CNB's information system are the internal and external communication infrastructure, and the high-performance client workstations and application and database servers. These are supported by on-line back-ups at remote sites, by the centralisation of computing, disk and back-up capacities, and by a central back-up and archiving system. The CNB's system environment is made up of 1,500 client workstations, 80 workstations, 650 network printers, 65 servers on the Intel platform, 20 Unix servers, and central disk systems with a capacity of 1.4 TB. The monthly volume of back-up data amounts to 22 TB and the daily volume may be up to 1 TB.

The CNB has installed 84 applications of varying scale and importance. These include information systems supporting basic bank activities (monetary policy, statistics and reporting, banking



II. THE CNB'S OBJECTIVES AND TASKS AND THEIR FULFILMENT

supervision, banking transactions, payment systems, and currency in circulation) and systems supporting the bank's operation. Of special importance are those systems whose functioning affects the banking sector as a whole and the financial performance of the State: the interbank payment system, the system for treasury payments, the Central Register of Credits, and the system for registering and settling short-term bonds.

The CNB's information systems communicate with external systems through the exchange of data files, and this interconnectedness is gradually increasing. Data are exchanged on a daily basis with the Ministry of Finance and the General Customs Office, and on a monthly or quarterly basis with the Czech Statistical Office and the Securities Commission. The CNB also provides data from its system to institutions outside the Czech Republic: to the Slovak National Bank (data on cross-border payments) and the European Central Bank (statistical data).

The security policy is based on ISO 17799:2000 and has been adapted to conditions within the CNB. Great attention is paid to the security of external communication, particularly with respect to connections to branches, commercial banks and the ECB, and to the use of internet services. Antivirus protection, an ever-current problem, is ensured by three degrees of protection using seven independent virus or dangerous-code detectors. New technologies employing electronic signatures and the encryption of sensitive data are increasingly common.

The CNB and the crisis management system

The concentration of huge volumes of financial operations using the latest computing technologies makes the CNB an important and at the same time highly sensitive place, and the smooth functioning of the banking and financial sectors in the Czech Republic depends on it. The disruption of just one of its functions would lead to immense economic damage. The crisis-management system is therefore an inherent part of the CNB's functioning. The system is being built and maintained to eliminate or minimise potential risks. It also consists of measures and procedures to be applied in the case of undesirable events. It is connected to the national system, in terms of both personnel and function. The Governor attends meetings of the National Security Council and CNB representatives participate in its working committees – the Civil Emergency Planning Committee, the Defence Planning Committee and the Committee for Foreign Security Policy Co-ordination. The Civil Emergency Planning Committee deals with the protection of crucial infrastructure in the Czech Republic. The CNB here fulfils the role of legal guarantor and co-ordinator of emergency plans in the banking sector.

Act No. 240/2000 Coll., on crisis management, places an obligation on the CNB to prepare an emergency plan for the area of monetary policy and the banking sector. This involves safeguarding all key activities on which essential CNB functions depend (e.g. the informational and technological bases of processes). In constructing and maintaining the crisis management system, there has been an effort to make use of available foreign experience. A system of back-up workstations forms an important part of preparations for crisis situations. Underlying the concept for this system is the attempt to utilise existing capacities as much and as effectively as possible. For this reason, it makes use of the existing CNB branch network, supplemented with a new integrating module – the back-up centre, which is being constructed as part of the renovation and enlargement of the existing archive building in Prague 5 – Zličín.

III. THE CNB AND THE PUBLIC





EXTERNAL COMMUNICATIONS

In its external communications, the Czech National Bank is maximally open and transparent. Indeed, communications form one of the principal pillars of the bank's efforts to meet its primary objective, as stipulated by law. The CNB affects the inflation expectations of market participants and, at the same time, the behaviour of consumers. We can say without exaggeration that the creation of a stable, low-inflation environment can scarcely be imagined without strict adherence to regulations clearly stipulated as part of the bank's information policy. The path taken by the CNB in this area is in line with current trends in countries with advanced banking systems and long traditions of monetary policymaking.

In terms of improving communication, the most important event in 2003 was the launching of the new version of the bank's website. Navigation was substantially improved and simplified by creating three search windows for the CNB's most important target groups. The website's users are now able to obtain either specialist or general information. The third window is intended for the media. The web pages have quickly become the bank's dominant means of communication, as attested by the large number of visitors – several thousand a day. The priorities of the CNB website are to provide high-quality information to serve the needs of the main target groups and to reinforce the bank's status as a reliable and rapid source of information.

The CNB does not neglect other forms of communication. In 2003, it dealt with more than 300 letters from the public. It answers dozens of telephone queries daily. The bank also issues regular publications – the *Annual Report* and the *Banking Supervision Report* once a year, and the *Inflation Report* on a quarterly basis. All these publications are available at the CNB website and the printed versions can be obtained free of charge at the CNB's special library.

One of last year's most talked-about topics was the withdrawal of 10- and 20-heller coins from circulation. For the Communications Division, this meant preparing an extensive information campaign. Thanks to the openness and timeliness of the information provided and the strong arguments put forward against artificially retaining low-denomination coins in circulation, the change took place in a calm atmosphere.

The year 2003 also marked the 10th anniversary of the founding of the Czech National Bank. To celebrate this milestone, the CNB issued a brochure, *The CNB, 1993–2003*, held several important specialist conferences, and organised a second open day for the general public. As two years ago, interest in visiting the normally inaccessible premises of the bank was immense. The CNB's employees showed visitors around the bank and gave them the benefit of their wide expertise. The open day again served its purpose of acquainting the public with the Czech National Bank's activities.



In view of the Czech Republic's imminent entry into the EU – and the CNB's imminent entry into the European System of Central Banks – the CNB provided the public with detailed information about all aspects of this important step and the CNB's role in the process. The main topic dealt with by the CNB was the Czech Republic's preparations for joining the euro area, including the setting of a horizon for adopting the euro and the creation of the single banking area.



The Czech National Bank is also aware of its responsibilities in the field of education, which stem from its position as the central monetary authority. For this reason, it has begun work on projects aimed at increasing the general awareness of fundamental economic relationships and the role of the CNB in the economy. In addition to the extensive publishing activity of the bank and its representatives, the CNB has started to work with the world-wide non-profit educational organisation *Junior Achievement* on preparing a long-term project aimed at teenagers and addressing topics related to

central banking and finance. The CNB's experts have prepared a substantial portion of a course entitled "The Foundations of the National Economy" and have been involved in training the teachers taking this project to schools.

PROVISION OF INFORMATION IN COMPLIANCE WITH ACT NO. 106/1999 COLL., ON FREEDOM OF INFORMATION (hereinafter referred to as the "Act")

The Czech National Bank's procedure for fulfilling the tasks ensuing from the Act, particularly in dealing with applications for information in compliance with it, is internally regulated by Czech National Bank Directive No. 55 of 13 December 2002, stipulating the principles and procedure for dealing with applications for information.

Under the Act, the CNB provides information to applicants on the basis of applications or by way of public disclosure.

Information provided in 2003 on the basis of applications:

Number of applications for information under the Act:	one
Number of appeals against decisions:	none
Transcript of relevant parts of each court judgement:	none
Results of sanction proceedings for non-compliance with the law:	none

Other information relating to the application of the Act: The CNB provides the information referred to in Article 2(2) of the Act in cases where it makes decisions on the rights, legally protected interests or obligations of natural persons or legal entities in the area of public administration. The CNB has this legal obligation in respect of the administrative proceedings it conducts pursuant to the Act on the CNB, the Act on Banks and the Foreign Exchange Act. The CNB provides information on specific administrative proceedings where such proceedings have been closed by a final and conclusive decision.

Most written, e-mail and telephone applications for information go beyond the framework of the Act. In 2003, the CNB answered 304 written and 1,721 e-mail enquiries from the public.

Information provided by way of public disclosure:

The CNB discloses the information referred to in Articles 5(1) and 5(2) of the Act on notice boards at its headquarters and branches, in locations accessible to the public during working hours, and also on its website, www.cnb.cz.

EXHIBITION



A permanent exhibition entitled "People and Money" has been opened to the public in the CNB headquarters. The exhibition illustrates the history and the present of the economy and the evolution of money within the Czech lands since the middle of the tenth century. It has been set up in the former strong-room, which has been preserved in its original state as far as possible and still includes the original eight-tonne strong-room door, whose remarkable construction and beauty arouse both respect and admiration.

Visitors are invited to watch short video presentations acquainting them with the history and mission of the central bank, and also to see the building in which the CNB is located at present. In its 65 showcases, the exhibition provides an overview of the evolution of monetary policy and means of payment against the background of the historical development of the Czech state. In addition to reading the interesting and informative texts, visitors can see historical banknotes and coins, as well as objects and documents relating to finance and to the CNB's activity. On display are some unique designs for banknotes and coins, detailed information on





III. THE CNB AND THE PUBLIC

security elements on current banknotes, and part of the gold reserves: a tonne of gold in the form of 80 gold bars.

Visitors also have the opportunity to use touch screens enabling access to vast quantities of detailed information on the notes and coins exhibited and other interesting facts about the domestic and world economy and banking.

The appeal of the CNB exhibition is attested to by the extraordinary interest from the public. Almost 32,000 people have visited the exhibition since its opening, many of whom have been pupils at elementary and secondary schools (more than 430 school groups have visited).

The exhibition is open to the public from Tuesday to Friday at two-hour intervals for groups of up to 34 people. Tours start at 9:00 a.m., 11:00 a.m. and 1:30 p.m. There is an additional tour at 4:00 p.m. on Thursdays for working people and others who cannot visit the exhibition during the day. One tour ends when the following one begins. The last tour ends at 4:00 p.m. (or at 5:45 p.m. on Thursdays). Booking is recommended. A special infoline has been set up for this purpose: 224 412 626. More details are available at the CNB website: www.cnb.cz/en/exp.php.

SPECIAL LIBRARY



The CNB's special library has been in existence since 1926. It is open to the CNB's employees and to professionals in the sphere of finance and banking. The highly specialised collection allows visitors to obtain information not available anywhere else in the Czech Republic.

The collection comprises literature on economics (in particular banking), of course, but also on law, computer technology, politics and history. Encyclopaedias, language textbooks and biographies are also available. A collection of current books and periodicals is

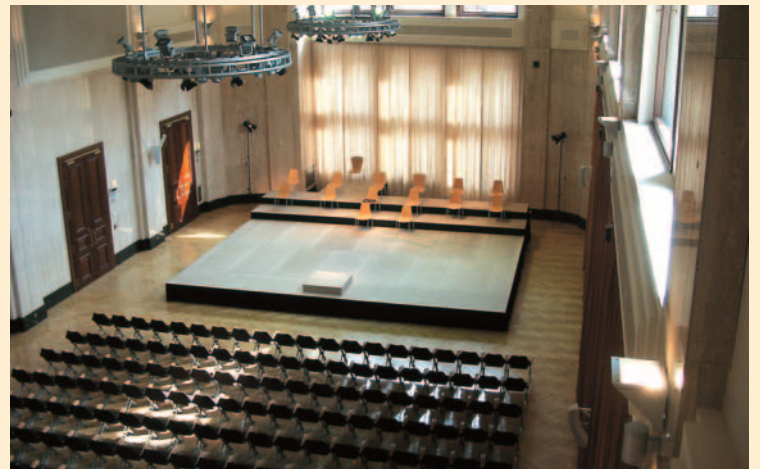
deposited in the reading-room and is freely accessible to all users. Overall, the library maintains and provides access to more than 42,000 books and research reports and 1,500 periodicals and items of grey literature. The predominant languages are Czech and English. The library acquires about 2,500 books and research reports and about 9,000 periodicals and grey literature items annually. In 2003, access was provided to a number of electronic information sources and visitors are now able to use them directly from the reading-room.

The library is open to the public on working days from 9:00 a.m. to 2:00 p.m. In addition to the basic lending services (outside loans and the provision of reference materials for use in-house), the library staff provides advisory and reference services (information on the catalogue and on other information sources and library collections and how to make use of them), and bibliographic and research services. Last year, an electronic reading-room was put into operation, allowing users to search for information from all available sources. Through the library's website, www.cnb.cz/en/knihovna.php, people can obtain information from the online catalogue (<http://sd.ruk.cuni.cz/tinweb/cnbanka/k6>). They can reserve the books they need or extend the borrowing period, etc. by e-mailing lib@cnb.cz.

The expansion of the library's collection and services has met with a favourable response from the public. A total of 13,170 visitors borrowed 15,886 publications in 2003

CONGRESS CENTRE

The Czech National Bank's Congress Centre is located in the neo-Renaissance palace of the former Commodity Exchange. The building was renovated by the CNB under the strict supervision of the Office for the Preservation of Historical Monuments. As well as the Congress Centre, it houses a special library open to the public, the CNB training complex (which includes language and computer classrooms), and catering facilities.



The Congress Centre is used for both domestic and international specialist conferences, seminars, educational projects, social events and press conferences, and is available for use to other institutions besides the CNB.



In 2003, there were a number of events devoted to the tenth anniversary of the founding of the Czech Republic and to the economic aspects of the Czech Republic's entry into the European Union. These included an international conference in April attended by the governors of the central banks of the accession countries; another international conference in June of representatives of European mints, marking the tenth



anniversary of the establishing of the Czech currency; an exhibition of photographs, *The Making of the Euro*, organised in co-operation with the European Central Bank; and a gala evening in August. Other events were focused on acquainting economists with the latest knowledge and trends in the areas of monetary policy, regulation and financial-market surveillance. The three-day European Banking and Financial Forum, which

took place at the Congress Centre and involved the participation of President Václav Klaus and a number of important foreign guests, has already become something of a tradition.

The Congress Centre, however, does not solely serve economic specialists; it is also a venue for important civic events. As part of Forum 2000, the Centre hosted the ceremony for the Hanno R. Ellenbogen Citizenship Award, attended by Václav Havel and Madeleine Albright. Through its concert series Cycle of the Nations, the Prague Chamber Philharmonic Orchestra under Ilja Šmíd presented groundbreaking concerts of classical music, which acquainted people with young soloists, conductors and composers from Switzerland, Slovenia, Spain and Italy. Concerts of the Prague Spring and Young Prague international music festivals and the Prague Chamber Music Festival are also performed here regularly.



Another emerging tradition is the exhibitions of photographs in the foyer of the Congress Centre acquainting CNB employees and guests with the work of young photographers and trends in contemporary Czech photography.



IV. THE CNB AND ITS PEOPLE

IV. THE CNB AND ITS PEOPLE

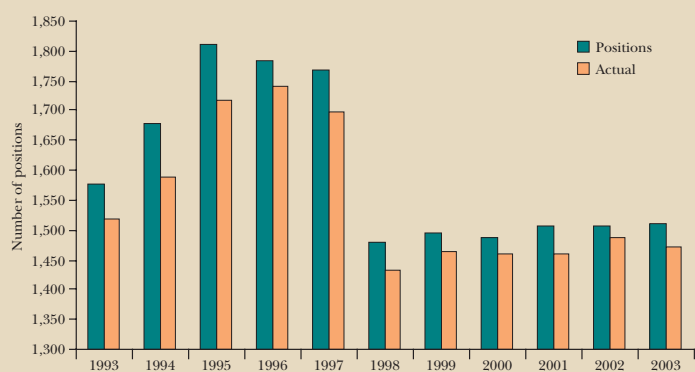
The basis of the CNB's success is human capital, which needs to be further improved:

...The human resources area is of key significance, since successful fulfilment of the challenges in the period ahead will depend on the quality, knowledge and motivation of each member of staff. Up until now, personnel work has focused on acquiring people with the required qualifications in areas of central banking in the market economy. It has also been necessary to stabilise central bank staffing in the competitive environment of the developing commercial banking sector. The target for the future is to develop the professionalism of CNB staff members and motivate them to cope with a qualitatively different period of CNB operation...

CHALLENGES FOR THE CZECH NATIONAL BANK IN THE YEARS AHEAD

At the end of 2003, the CNB had 1,472 employees, fewer than at the time of its establishment in 1993. Since the reorganisation in 1998, however, the number of positions has stabilised.

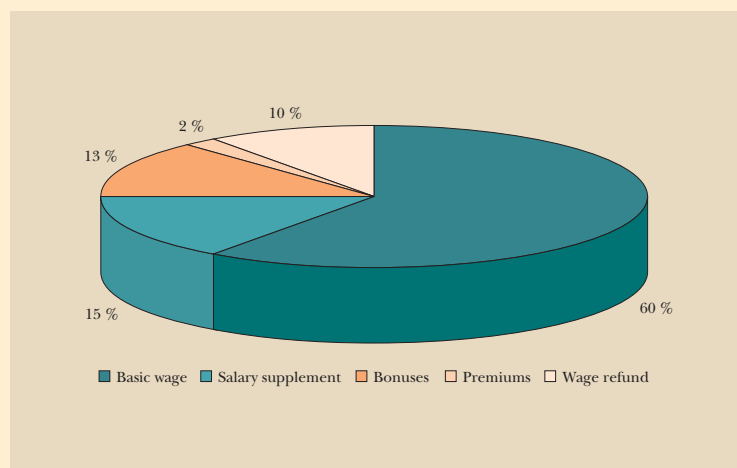
Number of positions
and actual number of CNB employees



In 2002, a total of 100 new employees were taken on and 73 people terminated their employment. In 2003, the respective figures were 67 and 72, of whom 10 retired. The recruitment of new employees generally takes the form of headhunting and written job applications, or of directly approaching selected students in their final years at university, and to a lesser extent of job advertisements, tenders and selection procedures. Employment is preceded by a demanding interview with the applicant, verifying his or her professional qualifications and personal attributes.

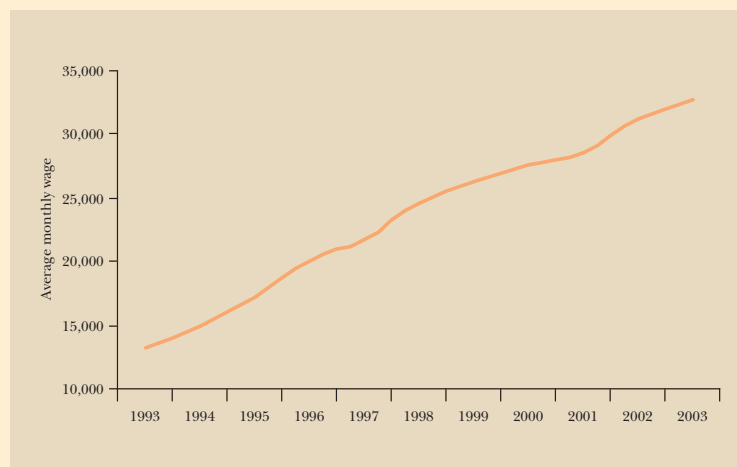
The main component of the CNB's salary system is the basic wage, which is based on a sliding scale. Another component is the salary supplement, amounting to 25% of the basic wage, which is intended to compensate CNB employees in part for the increased duties and limits imposed on them by the Labour Code. Employees may obtain bonuses for work results.

Share of wage components in total volume of wages paid



Employee expenses totalled CZK 823 million in 2003, up by 5.0% on a year earlier. A total of CZK 581 million was paid on salaries, i.e. 4.5% more than in 2002. The average monthly nominal wage was CZK 32,786. The average annual wage increase was 4.7%.

Average monthly wage of CNB employees



The salaries of Bank Board members were as follows:

	gross CZK	net CZK
Governor	3,590,670	2,203,238
Vice-Governors (2)	5,781,379	3,550,921
Other BB members (4)	9,567,449	5,952,264

Statutory insurance payments amounted to CZK 206 million. Other social contributions (e.g. health insurance for foreign travel, compensation for job-related injuries) totalled CZK 5 million. Spending on employee training reached CZK 31 million (up by CZK 4 million compared with 2002). The increase in training costs was associated with EU entry.

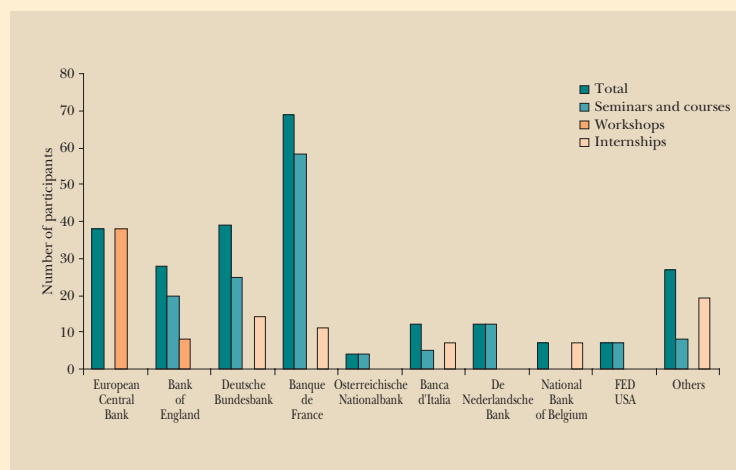
Staff training is one of the priorities of personnel work. As part of the bank's internal training activities, management and systematic training was organised for 204 employees, specialist banking courses for 1,164 and computer courses for 159; other, smaller-scale training activities took place as well. A total of 659 employees (including at branches) attended long-term language courses and 173 took part in intensive language courses. In 2003, e-learning pilot projects were launched in the areas of language study, computer technology, EU issues and the training of CNB lecturers.

Training projects organised in co-operation with foreign central banks or international financial and banking institutions are adjudged to have been highly beneficial. Of increasing significance have been seminars and courses, and in particular consultations and internships, at partner central banks, allowing CNB employees the opportunity to obtain information and share experience of the latest developments. Foreign training ventures were attended by 251 people.



The European Central Bank is a very important partner of the CNB, as are the central banks of the other accession countries. As part of ongoing intensive co-operation, fifteen CNB employees completed long-term internships (of 2–11 months) at the ECB. These internships are intended to provide CNB employees with the opportunity to familiarise themselves with the activities of the ECB divisions concerned and to establish closer working contacts.

Co-operation with foreign central banks





V. FINANCIAL REPORT

REPORT OF INDEPENDENT AUDITORS



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REPORT OF INDEPENDENT AUDITORS

TO THE BANK COUNCIL OF THE CZECH NATIONAL BANK

We have examined whether the financial information presented in the section V. Financial report in the Annual report (hereinafter "the Report") of the Czech National Bank (hereinafter "the CNB") for the year ended 31 December 2003, which does not form part of the audited financial statements of the CNB, is consistent with the audited financial statements as at 31 December 2003. In our opinion, the financial information included in the Report is consistent with the accounting records of the CNB maintained in support of the audited financial statements in all material respects.

Our audit report on the financial statements as at 31 December 2003 and for the year then ended which do not form part of the accompanying Report was as follows:

"We have audited the accompanying balance sheet of the Czech National Bank (hereinafter "the CNB") as at 31 December 2003, the related statement of income and notes for the year then ended (hereinafter the "financial statements"). The financial statements and underlying accounting records are the responsibility of the management of the CNB. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion the accompanying financial statements give a true and fair view, in all material respects, of the assets, liabilities and equity of the CNB as at 31 December 2003, and the results of its operations for the year then ended in accordance with the Act on Accounting and other relevant legislation of the Czech Republic."

24 March 2004

PriceWaterhouseCoopers Audit, s.r.o.
represented by

Paul Cunningham
Partner

Petr Kříž
Auditor, Licence No. 1140

PriceWaterhouseCoopers Audit, s.r.o., is registered in the Commercial Register with the Municipal Court in Prague, part C, section No 3637, and in the Register of Audit Companies with the Chamber of Auditors of the Czech Republic under Licence No 21.

INCOME STATEMENT AND BALANCE SHEET

in CZK millions

INCOME STATEMENT		31. 12. 2003	31. 12. 2002	31. 12. 2001
1.	Interest income and similar income	19,192	22,104	28,106
1.1.	Interest from fixed income securities	16,530	16,717	22,381
1.2.	Other	2,662	5,387	5,725
2.	Interest expense and similar expense	12,598	17,032	17,092
2.1.	Interest from fixed income securities	-	-	-
2.2.	Other	12,598	17,032	17,092
3.	Income from securities with variable income	43	40	43
4.	Fee and commission income	447	510	555
5.	Fee and commission expense	41	49	53
6.	Loss from financial operations	(- 23,232)	(- 13,864)	(- 37,745)
7.	Other income	120	444	454
7.1.	Income from money issue	23	20	17
7.2.	Other	97	424	437
8.	Administration expenses	2,042	2,015	2,002
8.1.	Personnel expenses	785	751	675
8.1.1.	Wages and salaries	579	554	499
8.1.2.	Social and health security	206	197	176
8.2.	Other operating expenses	1,257	1,264	1,327
9.	Other expenses	655	1,119	1,776
9.1.	Expenses for issuing bank notes and coinage	285	371	309
9.2.	Other	370	748	1,467
10.	Charge for specific and general provisions for loans and guarantees	33	5 876	325
11.	Release of specific and general provisions	576	5,997	1,245
12.	Charge for other specific and general provisions	10	23	38
13.	Release of other specific and general provisions	60	184	-
14.	Ordinary loss	(- 18,173)	(- 10,699)	(- 28,628)
15.	Extraordinary income	-	22,521	-
16.	Extraordinary expenses	-	21,290	-
17.	Extraordinary profit	-	1,231	-
18.	Loss for the period	(- 18,173)	(- 9,468)	(- 28,628)

The notes to the financial statements are available on the CNB website, on the attached CD-ROM and from the CNB's Budget and Accounting Department, Na Příkopě 28, Praha 1

V. FINANCIAL REPORT

in CZK millions

ASSETS		31. 12. 2003	31. 12. 2002	31. 12. 2001
1.	Gold	833	833	837
2.	Receivables from International Monetary Fund	32,193	35,319	39,800
3.	Receivables from foreign countries including securities	677,158	707,238	528,619
3.1.	Deposits at foreign banks	76,414	90,539	117,446
3.2.	Loans provided to foreign banks	-	20,350	14,384
3.3.	Securities	600,654	596,300	396,740
3.4.	Other receivables against foreign countries	90	49	49
4.	Receivables from domestic banks	96	115	793
5.	Receivables from clients	37,467	39,820	48,263
6.	Fixed assets	6,739	7,197	7,769
6.1.	Tangible fixed assets	6,582	6,918	7,419
6.2.	Intangible fixed assets	157	279	350
7.	Other assets	7,346	3,669	1,419
7.1.	Prepayments and accrued income	34	16	388
7.2.	Other	7,312	3,653	1,031
TOTAL ASSETS		761,832	794,191	627,500

LIABILITIES		31. 12. 2003	31. 12. 2002	31. 12. 2001
1.	Currency in circulation	247,361	224,402	205,861
2.	Liabilities to International Monetary Fund	19,790	27,869	34,033
3.	Liabilities to foreign countries	3,089	4,735	14,743
3.1.	Loans from foreign banks	2,665	4,289	14,275
3.2.	Other liabilities to foreign countries	424	446	468
4.	Liabilities to domestic banks	470,311	488,233	309,247
4.1.	Bank monetary reserves	21,237	28,359	30,273
4.2.	Repo operations	439,609	455,419	264,847
4.3.	Other liabilities	9,465	4,455	14,127
5.	Deposits from clients	29,249	35,937	27,916
6.	Domestic treasury bills issued	-	-	-
7.	Liabilities to the state	45,708	49,968	57,737
8.	Reserves	5,881	6,210	11,935
9.	Share capital	1,400	1,400	1,400
10.	Funds	8,109	8,156	8,198
11.	Accumulated losses from previous periods	(- 53,780)	(- 44,531)	(- 15,903)
12.	Loss for the accounting period	(- 18,173)	(- 9,468)	(- 28,628)
13.	Other liabilities	2 887	1 280	961
13.1.	Accruals and deferred income	-	8	186
13.2.	Other	2,887	1,272	775
TOTAL LIABILITIES		761,832	794,191	627,500

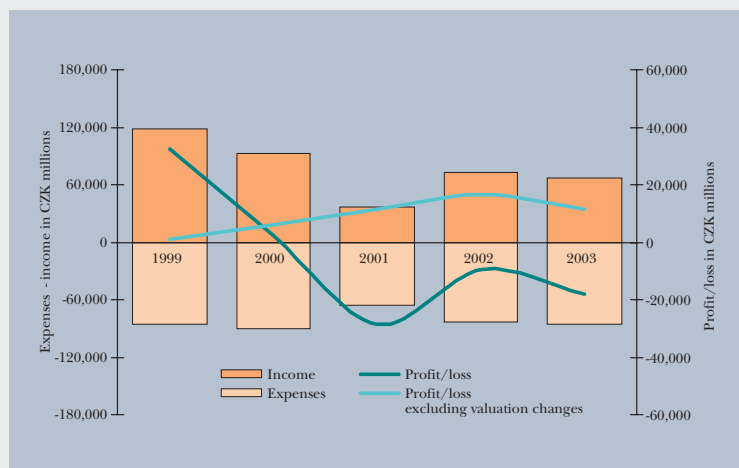
in CZK millions

OFF BALANCE SHEET		31. 12. 2003	31. 12. 2002	31. 12. 2001
1.	Guarantees issued	170,440	199,962	103,787
2.	Receivables from spot, term and option transactions	122,293	101,673	10,867
3.	Liabilities from spot, term and option transactions	118,516	101,453	10,861
4.	Guarantees received	180,500	182,500	62,340

With income of CZK 67,189 million and expenses of CZK 85,362 million, the Czech National Bank made a loss of CZK 18,173 million.

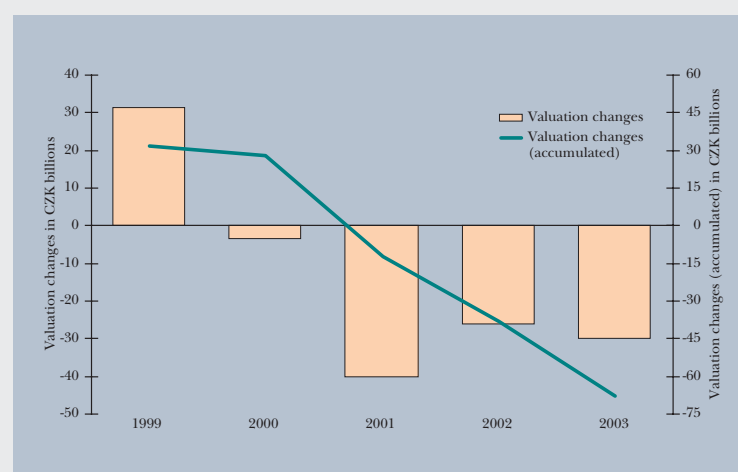
In terms of the CNB's performance, the year 2003 was largely similar to 2002. Easier monetary policy resulted in lower sterilisation costs. Due to interest rate trends on foreign markets and reduced foreign exchange reserves, income from these reserves fell. As in previous years, in 2003 there was a fairly high degree of volatility in exchange rates, due to which the bank incurred exchange rate losses, which were the main cause of its negative financial results.

The CNB's performance 1999–2003



The volume of foreign exchange assets and liabilities and the exchange rate at the end of the previous year were the crucial factors in determining the level of valuation changes. Due to interest rate trends and the volume of the CNB's foreign exchange assets and liabilities at the end of 2003, the CNB recorded a total exchange rate loss of CZK 29,766 million. The exchange rate loss incurred with dollar assets was offset by one third by the exchange rate income from euro-denominated assets.

Valuation changes 1999–2003



Expenses linked to the banking sector consolidation had a marginal impact on the CNB's financial results in comparison to other operational areas. The overwhelming majority of expenses had been incurred in previous years. A proportion of the potential expenses is covered by a CZK 22.5 billion state guarantee issued by the Czech government in 1997. Since this amount does not cover the total expenses of the consolidation programme, the CNB has set aside reserves and provisions up to the level of total potential expenses.

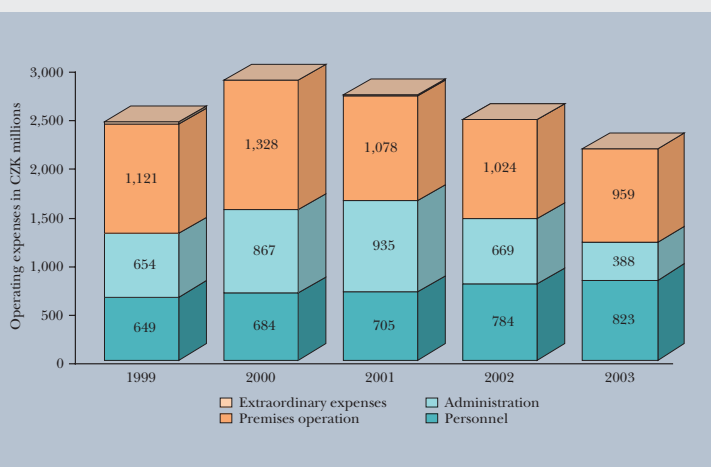
In the area of issue and currency management, the CNB ended 2003 with a loss of CZK 263 million. The bank spent CZK 284 million on the preparation and supply of banknotes from the State Securities Printer in Prague (Státní tiskárny cenin Praha) and coins from the Czech Mint (Bižuterie Česká Mincovna). The liquidation of small coins with nominal values of CZK 0.10 and CZK 0.20, which ceased to be legal tender at the end of October 2003, required expenses totalling CZK 2 million. Income linked to the sale of numismatic material amounted to CZK 23 million.

In the area of operations, the CNB showed a loss of CZK 2,071 million, up by CZK 18 million on the



previous year. Expenses decreased again over the past year: CZK 792 million was spent on wages and salaries and on social and health insurance (up by 4.6% on a year earlier), CZK 175 million on property-maintenance costs (up by 2.9%), CZK 137 million on contracted services (down by 1.4%), and CZK 90 million on value added tax. Depreciation changes amounted to CZK 700 million. The remaining portion of expenses included those on telecommunications, communications services, travel, transportation, energy, printed forms, office supplies and other sundries. Income in the area of operations was down as well: sales of materials and tangible assets, rent, and fines and penalties totalled CZK 99 million. In 2003, operating expenses represented 2.5% of the CNB's total expenses.

Operating expenses 1999–2003



In 2003, a total of CZK 288 million was spent on asset acquisition, i.e. around 13% more than in 2002. This increase was mostly due to higher expenditure on acquiring tangible assets and lower expenditure on materials for stock and intangible assets. Expenses on tangible assets were 77% higher than in 2002, and were chiefly on the acquisition of technology for cash keeping, handling and processing, computers and security equipment. Expenses on the acquisition of materials for stock were down by about 26% compared to 2002 and those on intangible assets fell by about 66%.

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2003

**REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS**

YEAR ENDED 31 DECEMBER 2003

CNB CZECH
NATIONAL
BANK

REPORT OF INDEPENDENT AUDITORS

TO THE BANK COUNCIL OF THE CZECH NATIONAL BANK

We have examined whether the financial information presented in the section V. Financial report in the Annual report (hereinafter "the Report") of the Czech National Bank (hereinafter "the CNB") for the year ended 31 December 2003, which does not form part of the audited financial statements of the CNB, is consistent with the audited financial statements as at 31 December 2003. In our opinion, the financial information included in the Report is consistent with the accounting records of the CNB maintained in support of the audited financial statements in all material respects.

Our audit report on the financial statements as at 31 December 2003 and for the year then ended which do not form part of the accompanying Report was as follows:

"We have audited the accompanying balance sheet of the Czech National Bank (hereinafter "the CNB") as at 31 December 2003, the related statement of income and notes for the year then ended (hereinafter the "financial statements"). The financial statements and underlying accounting records are the responsibility of the management of the CNB. Our responsibility is to express an opinion on these financial statements based on our audit.

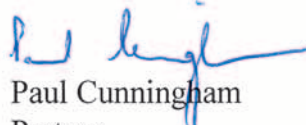
We conducted our audit in accordance with the Act on Auditors and Auditing Standards of the Chamber of Auditors of the Czech Republic. Those auditing standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement.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

In our opinion the accompanying financial statements give a true and fair view, in all material respects, of the assets, liabilities and equity of the CNB as at 31 December 2003, and the results of its operations for the year then ended in accordance with the Act on Accounting and other relevant legislation of the Czech Republic."

24 March 2004



PricewaterhouseCoopers Audit, s.r.o.
represented by


Paul Cunningham
Partner


Petr Kříž
Auditor, Licence No. 1140

CNB BALANCE SHEET, INCOME STATEMENT AND AUDITORS' REPORT

ASSETS

in CZK millions

Item no.	Item	31. 12. 2003	31. 12. 2002	31. 12. 2001
1.	Gold	833	833	837
2.	Receivables from International Monetary Fund	32,193	35,319	39,800
3.	Receivables from foreign countries including securities	677,158	707,238	528,619
3.1.	Deposits at foreign banks	76,414	90,539	117,446
3.2.	Loans provided to foreign banks	-	20,350	14,384
3.3.	Securities	600,654	596,300	396,740
3.4.	Other receivables against foreign countries	90	49	49
4.	Receivables from domestic banks	96	115	793
5.	Receivables from clients	37,467	39,820	48,263
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7.1.	Prepayments and accrued income	34	16	388
7.2.	Other	7,312	3,653	1,031
	TOTAL ASSETS	761,832	794,191	627,500

LIABILITIES

in CZK millions

Item no.	Item	31. 12. 2003	31. 12. 2002	31. 12. 2001
1.	Currency in circulation	247,361	224,402	205,861
2.	Liabilities to International Monetary Fund	19,790	27,869	34,033
3.	Liabilities to foreign countries	3,089	4,735	14,743
3.1.	Loans from foreign banks	2,665	4,289	14,275
3.2.	Other liabilities to foreign countries	424	446	468
4.	Liabilities to domestic banks	470,311	488,233	309,247
4.1.	Bank monetary reserves	21,237	28,359	30,273
4.2.	Repo operations	439,609	455,419	264,847
4.3.	Other liabilities	9,465	4,455	14,127
5.	Deposits from clients	29,249	35,937	27,916
6.	Domestic treasury bills issued	-	-	-
7.	Liabilities to the state	45,708	49,968	57,737
8.	Reserves	5,881	6,210	11,935
9.	Share capital	1,400	1,400	1,400
10.	Funds	8,109	8,156	8,198
11.	Accumulated losses from previous periods	(- 53,780)	(- 44,531)	(- 15,903)
12.	Loss for the accounting period	(- 18,173)	(- 9,468)	(- 28,628)
13.	Other liabilities	2 887	1 280	961
13.1.	Accruals and deferred income	-	8	186
13.2.	Other	2,887	1,272	775
	TOTAL LIABILITIES	761,832	794,191	627,500

OFF BALANCE SHEET

in CZK millions

Item no.	Item	31. 12. 2003	31. 12. 2002	31. 12. 2001
1.	Guarantees issued	170,440	199,962	103,787
2.	Receivables from spot, term and option transactions	122,293	101,673	10,867
3.	Liabilities from spot, term and option transactions	118,516	101,453	10,861
4.	Guarantees received	180,500	182,500	62,340

INCOME STATEMENT

in CZK millions

Item no.	Item	31. 12. 2003	31. 12. 2002	31. 12. 2001
1.	Interest income and similar income	19,192	22,104	28,106
1.1.	Interest from fixed income securities	16,530	16,717	22,381
1.2.	Other	2,662	5,387	5,725
2.	Interest expense and similar expense	12,598	17,032	17,092
2.1.	Interest from fixed income securities	-	-	-
2.2.	Other	12,598	17,032	17,092
3.	Income from securities with variable income	43	40	43
4.	Fee and commission income	447	510	555
5.	Fee and commission expense	41	49	53
6.	Loss from financial operations	(- 23,232)	(- 13,864)	(- 37,745)
7.	Other income	120	444	454
7.1.	Income from money issue	23	20	17
7.2.	Other	97	424	437
8.	Administration expenses	2,042	2,015	2,002
8.1.	Personnel expenses	785	751	675
8.1.1.	Wages and salaries	579	554	499
8.1.2.	Social and health security	206	197	176
8.2.	Other operating expenses	1,257	1,264	1,327
9.	Other expenses	655	1,119	1,776
9.1.	Expenses for issuing bank notes and coinage	285	371	309
9.2.	Other	370	748	1,467
10.	Charge for specific and general provisions for loans and guarantees	33	5 876	325
11.	Release of specific and general provisions	576	5,997	1,245
12.	Charge for other specific and general provisions	10	23	38
13.	Release of other specific and general provisions	60	184	-
14.	Ordinary loss	(- 18,173)	(- 10,699)	(- 28,628)
15.	Extraordinary income	-	22,521	-
16.	Extraordinary expenses	-	21,290	-
17.	Extraordinary profit	-	1,231	-
18.	Loss for the period	(- 18,173)	(- 9,468)	(- 28,628)

The notes to the financial statements are available on the CNB website, on the attached CD-ROM and from the CNB's Budget and Accounting Department, Na Příkopě 28, Praha 1

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

1 GENERAL INFORMATION

The Czech National Bank (hereinafter the “Bank” or the “CNB”) is the central bank of the Czech Republic (hereinafter the “CR”). The Bank was established on 1 January 1993 following the dissolution of the State Bank of Czechoslovakia to form the Czech National Bank and the National Bank of Slovakia. The Bank was established on the basis of Act No. 6/1993 Col. as amended, The Czech National Bank Act. The Bank is a legal entity governed by public law and is not registered in the Commercial Register. The Bank operates from its headquarters in Prague and from seven branches around the CR (Prague, České Budějovice, Plzeň, Ústí nad Labem, Hradec Králové, Brno and Ostrava).

The primary objective of the Bank is to maintain price stability. Without prejudice to its primary objective, the Bank also aims to support the general economic policies of the Government leading to sustainable economic growth. The Bank acts in accordance with the principle of an open market economy.

In accordance with its primary objective, the Bank sets the monetary rules, issues bank notes and coins, manages the money supply and clearing for interbank settlements, maintains the interbank settlement systems to ensure its fluency and efficiency, supervises the activities of banks and branches of foreign banks and sees to the safe functioning and development of the banking system in the CR. The Bank also performs other activities as defined by the CNB Act and by other legislation.

When pursuing its objectives, the Bank cooperates with the central banks of other countries, the authorities supervising the banks and financial markets of other countries, and with international financial organizations and international organizations involved in the supervision of banks and financial markets.

When carrying out its business, the Bank is independent of any instruction given by the President of the CR, the Czech Parliament, the Czech Government and administrative or other authorities and its relationship to the Chamber of Deputies of the Czech Parliament is defined by the law. The Bank and the Government communicate with each other about the principles and measures of monetary and general economic policy.

The highest-ranking management body of the Bank is the Bank Council of the CNB. The Bank Council has seven members. The members include the governor of the Bank, two vice-governors of the Bank, and four other Bank Council members. The members of the Bank Council are appointed and recalled by the President of the CR. The members of the Bank Council are appointed for a period of six years. The Bank Council sets the monetary rules and instruments for their implementation and decides about the primary monetary-political measures of the Bank.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

1 GENERAL INFORMATION (continued)

The members of the Bank Council as at 31 December 2003, 2002 and 2001 were as follows (including information regarding the end of their term):

Mr. Zdeněk Tůma	Governor	Until 12 February 2005
Mr. Oldřich Dědek	Vice-Governor	Until 12 February 2005
Mr. Luděk Niedermayer	Vice-Governor	Until 26 February 2008
Mrs. Michaela Erbenová	member	Until 30 November 2006
Mr. Jan Frait	member	Until 30 November 2006
Mr. Pavel Racoča	member	Until 12 February 2005
Mr. Pavel Štěpánek	member	Until 12 February 2005

The statutory representative of the Bank is the Governor. In the event of the Governor's absence the Vice-Governor is appointed by him to represent the Bank.

The Bank uses its income to cover necessary operational costs of its operations. The Bank's profit, if any, is allocated to its reserve fund and other funds created from profit, and for other uses within the Bank's budget. Any remaining profit is transferred to the state budget. Accumulated losses are expected to be covered by future profits, however this depends on a number of factors, the outcome of which is not certain. The Bank Council is monitoring the situation, so that appropriate action, consistent with the Bank's statutory objectives, can be taken should this be necessary.

The CNB submits its annual report on its operations to the Czech Parliament within three months after the calendar year end.

2 ACCOUNTING POLICIES

(a) Basis of preparation

The accounting records are prepared in compliance with the Act on accounting (Act No. 563/1991 Col. as amended) and the Chart of accounts, accounting rules for banks and other financial institutions and decrees issued by the Ministry of Finance of the CR. The financial statements are prepared in compliance with the Act on accounting under the historical cost convention as modified by the revaluation of financial instruments held for trading and available-for-sale to fair values. The financial statements are prepared according to principles of presentation and disclosure determined by the management of the CNB to be appropriate bearing in mind the needs and requirements for the reporting of a central bank. The financial statements are rounded to millions of Czech Crowns (hereinafter "CZK") unless otherwise stated. The Bank does not prepare consolidated financial statements because the Bank has no investments in subsidiary and associated undertakings.

2 ACCOUNTING POLICIES (continued)

(b) Foreign currencies

Transactions in foreign currencies are translated to CZK at the foreign exchange (hereinafter "FX") rate effective at the transaction date. Assets and liabilities, including all unsettled committed spot or term purchases and sales of foreign currencies, are translated to CZK at the exchange rate effective at the balance sheet date. All resulting realised and unrealised foreign exchange gains and losses are recognised in the income statement in the net profit or loss from financial operations.

(c) Gold and other precious metals

Gold and other precious metals are valued at historic cost. Deposits and securities denominated and payable in gold, that the CNB intends to hold to maturity, are included in the gold balance and valued at historical cost. The related interest income is accrued and included in the gold balance.

(d) Securities

The Bank classified all its fixed income securities as available-for-sale securities. Since 2002, shares, other than investments in subsidiary or associated undertakings are included in other assets. Comparative financial information has been reclassified.

Securities transactions are recorded on a settlement date basis.

Foreign securities are purchased in relation to foreign currency reserves administration in accordance with predefined rules. They consist of money market and capital market securities.

Treasury bills and other discounted securities are originally recorded at cost, which is further increased by related accrued interest income (amortised cost). They are subsequently re-measured to their fair value on a quarterly basis.

Bonds are valued at cost, which is further increased by related accrued coupon interest income (amortised cost). The difference between the purchase price and the nominal value of bonds is amortised to interest income. Re-measurement of bonds to their fair value is performed on a monthly basis.

Transaction costs are not included in cost of purchased securities.

2 ACCOUNTING POLICIES (continued)

(d) Securities (continued)

The fair value of a security is determined as the market value quoted by a relevant stock exchange or other active public market. In other cases the fair value is estimated by:

- the share of the investee's equity for equities, in the absence of any other measure the historical cost less impairment;
- the risk adjusted net present value for debt securities and notes.

Changes in the fair values of securities are included in profit (loss) from financial operations.

Dividends received are included in income from securities with variable income.

Disposals of securities are valued at weighted average cost of the amortised costs.

The Bank does not have any investments in subsidiary or associated undertakings.

(e) Securities financing arrangements

Securities borrowed or purchased under agreements to resell (reverse repo agreements) are not recognised on the balance sheet. Securities lent or sold under agreements to repurchase (repo agreements) are retained in their original portfolio. The underlying cashflows are recorded as received or provided loans and borrowings respectively on a settlement date basis.

(f) Currency in circulation

Notes and coins in circulation represent the liability of the Bank from the issue of currency. Since 1 January 2002 the amount of currency in issue is decreased by the cash in hand denominated in CZK. Comparative financial information has been reclassified.

(g) Membership quota at the International Monetary Fund

The membership quota at the International Monetary Fund (hereinafter the "IMF") is denominated in Special Drawing Rights (hereinafter the "SDR") and is translated to CZK at the rate advised by the IMF on a yearly basis.

2 ACCOUNTING POLICIES (continued)

(h) Issued securities

The amount of treasury bills issued by the Bank is presented in the balance sheet after offsetting against treasury bills repurchased by the Bank. The Bank repurchases the whole issued amount of treasury bills and uses the treasury bills as a collateral in repo operations with domestic banks.

(i) Derivative financial instruments

Derivative financial instruments including foreign exchange contracts, futures, currency and interest rate swaps and other derivative financial instruments are initially recognised on balance sheet at cost and subsequently are re-measured at their fair value or market value (futures). Fair values approximate the market value through a calculation of foreign exchange differences and accruals of the difference between spot and forward rate. All derivatives are presented in other assets or in other liabilities when their fair value is positive or negative respectively. The Bank does not apply hedge accounting. Changes in the fair value of derivatives are included in loss from financial operations.

(j) Interest income and expense

Interest income and expense are accrued using a linear yield method. Accrued interest is recorded together with the underlying assets and liabilities.

Income on non-performing loans is also accrued and included in the related loan balance at the due date. Such amounts are considered in estimating the specific provisions for non-performing loans. Interest income also includes interest earned on securities. Penalty interest income recognition is suspended in case of a debtor's default and excluded from interest income until received.

Interest expense includes interest expense from loans and deposits received.

(k) Fee and commission income

Fee income from the maintenance of current accounts and other activities is accrued. One off fees are recognised immediately in the income statement.

2 ACCOUNTING POLICIES (continued)

(l) Specific provisions and reserves

Reserves are created when the Bank has a present obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

When creating reserves for issued guarantees related to the consolidation of the banking sector, the guarantee issued by the Czech Government that covers the related risks was taken into consideration (see also Note 29). The received and issued guarantees related to the consolidation of the banking sector are recorded in the off balance sheet of the CNB.

The amount of specific provisions for loans and other assets at risk is based on appraisals of these assets at the balance sheet date. When creating specific provisions for assets at risk related to the consolidation of the banking sector, the guarantees issued by the Czech Government that covers these assets were taken into consideration (see also Note 29). A specific credit risk provision for loan impairment is established to provide for the credit losses as soon as the recovery of an exposure is identified as threatened.

Specific provisions adjust the book value of individual assets at risk. Reserves for off balance sheet exposures and reserves for standard loans are included in liabilities.

When a loan is deemed to be not collectable, it is written off and the related provision for impairment is released. Subsequent recoveries are credited to the income statement if previously written off.

(m) Tangible and intangible fixed assets

Tangible and intangible fixed assets are recorded at cost, which, with the exception of vehicles, excludes value added tax (hereinafter "VAT").

Tangible fixed assets are depreciated by applying the straight-line basis of depreciation over the estimated useful lives. Intangible fixed assets are amortised over four years unless their usage is limited by contract; in such cases the intangible fixed assets are amortised over the shorter of the contractual period or five years. Low value tangible fixed assets with a unit cost of more than CZK 2,000 and less than or equal to CZK 40,000 and low value intangible fixed assets with a unit cost less than or equal to CZK 60,000 are treated as fixed assets and are fully depreciated / amortised upon the inception of use. Land, art and art collections are not depreciated.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

2 ACCOUNTING POLICIES (continued)

(m) Tangible and intangible fixed assets (continued)

Tangible and intangible fixed assets are depreciated as follows:

Buildings and constructions	30 years
Furniture and fittings	6 years
Motor vehicles	4 years
Office equipment and computers	4 years
Software	4 years

In case of a change in the annual depreciation or amortisation rate or classification or valuation of the property, the depreciation charge is modified in the month of the change; depreciation or amortisation charged before that date is not adjusted.

Repairs and maintenance expenditures are charged to expenses as incurred. Improvement expenditures exceeding CZK 40,000 per unit in one year are included in the costs of the property.

(n) Value added tax

The Bank is registered for VAT. In accordance with the VAT Act, the CNB claims the full amount of input VAT in respect of received taxable supplies used to effect taxable supplies liable to VAT or to generate income or proceeds from output which is not taxable (for example the production of Czech coins and notes for circulation and support of the information system for the credit register maintained by the CNB according to the Banking Act no. 21/1992 as amended).

(o) Income tax and profit transfer to the state budget

The Bank is exempt from income tax in accordance with Paragraph 17, Article 2 of the Act No. 586/92 Col. on Income Taxes as amended. As a result the Bank does not account for current and deferred tax. The income of the Bank is used to cover necessary operating expenses. Profit after allocations to funds and other budgeted usage is transferred to the state budget.

2 ACCOUNTING POLICIES (continued)

(p) Pensions and social fund

The Bank does not administer its own pension fund but operates defined contribution schemes for its employees administrated by commercial pension funds. Regular contributions are made to the state budget to fund the national pension plan.

The CNB creates a social fund to finance the social needs of its employees and employees' programme. In compliance with the Czech accounting requirements the allocation to the social fund is not recognised in the income statement but as a transfer between funds. Similarly, the usage of the social fund is not recognised in the income statement but as a decrease of the fund.

(q) Cash flow statement

As the Bank is the central bank of the CR, the management of the Bank is of the opinion that inclusion of a cash flow statement would not provide further significant information to the users of these financial statements.

(r) Extraordinary items and changes in accounting policy

Since 1 January 2002, extraordinary items include one-off effects of events outside the scope of the Bank's activities. Comparative financial information has been reclassified.

Since 1 January 2003, the effects of changes in accounting policies are recognised in the equity.

The CNB's investments in the Bank for International Settlement (hereinafter the "BIS") were denominated in Gold francs until 30 March 2003. Under Czech accounting rules, all equity investments which are denominated in foreign currency have to be retranslated at the year end exchange rate. The revaluation of the shares for the foreign currency impact was not possible previously, as the foreign exchange rate for Gold francs was not quoted. As of 1 April 2003, the BIS shares are denominated in SDR and the CNB re-measured the shares using the current foreign exchange rate.

The impact of the re-measurement of CZK 219 million was recognised in the equity (Note 16) and decreased the Accumulated losses from previous periods.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

2 ACCOUNTING POLICIES (continued)

(r) Extraordinary items and changes in accounting policy (continued)

As at 1 January 2002 the CNB re-measured available-for-sale securities at fair value and released the provision to available-for-sale securities to extraordinary income. Any resulting difference is presented as extraordinary income or expense. Comparative financial information has not been reclassified in compliance with the accounting principles.

In 2002, the difference between the purchase price and the nominal value of bonds became material and therefore the Bank started amortisation of the difference.

The changes in accounting policies affected the income statement for the year 2002 as follows:

	<u>2002</u> CZK million
Effects of changes in accounting policies included in extraordinary items:	
Release of provisions to securities and re-measurement of securities at fair value	22,521
Re-measurement of securities at fair value	<u>(21,290)</u>
	<u>1,231</u>

Changes in disclosure of assets and liabilities in 2002 are described in Notes 2(d) and 2(f).

(s) Subsequent events

The effects of events, which occurred between the balance sheet date and the date of signing the financial statements, are reflected in the financial statements in the case that these events provide further evidence of conditions, which existed at the balance sheet date.

Where significant events occur subsequent to the balance sheet date but prior to signing of the financial statements that are indicative of conditions which arose subsequent to the balance sheet date, the effects of these events are disclosed, but are not themselves reflected in the financial statements.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

3 GOLD

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Gold in total	<u>833</u>	<u>833</u>	<u>837</u>

The gold as at 31 December 2003 includes a gold bond issued by the International bank for Reconstruction and Development with maturity on 15 December 2007, in the book value of CZK 283 million (2002 and 2001: nil). The nominal value of the purchased bond was 150,115 oz of gold and the market value of this gold as at 31 December 2003 was CZK 1,626 million.

The total market value of gold as at 31 December 2003 was CZK 4,784 million (31 December 2002: CZK 4,654 million, 31 December 2001: CZK 4,470 million).

4 RECEIVABLES AND PAYABLES WITH THE IMF

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Membership quota at IMF	20,028	28,006	34,064
Deposits in IMF	<u>12,165</u>	<u>7,313</u>	<u>5,736</u>
Total receivables from IMF	<u>32,193</u>	<u>35,319</u>	<u>39,800</u>
Liability to IMF	19,653	27,761	33,925
Current account IMF	<u>137</u>	<u>108</u>	<u>108</u>
Total payables to IMF	<u>19,790</u>	<u>27,869</u>	<u>34,033</u>

Membership quota at IMF is denominated in SDR and financed by bills of exchange payable on request issued by the Czech Government and co-accepted by the CNB.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

5 RECEIVABLES FROM FOREIGN COUNTRIES INCLUDING SECURITIES

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Current accounts with banks	678	825	555
Deposits	<u>75,736</u>	<u>89,714</u>	<u>116,891</u>
Total deposits at foreign banks	76,414	90,539	117,446
Total loans provided to foreign banks	-	20,350	14,384
Treasury bills and other discounted securities	217,879	226,667	79,083
Bonds and other coupon securities	382,775	369,633	319,230
Provision when market value lower than accrued cost (Note 17)	___*	___*	_(1,573)
Total securities	600,654	596,300	396,740
Cash in foreign currencies	90	49	37
Other receivables from abroad	___-	___-	___12
Total other receivables from foreign countries	90	49	49
Total receivables from foreign countries including securities	<u>677,158</u>	<u>707,238</u>	<u>528,619</u>

5 RECEIVABLES FROM FOREIGN COUNTRIES INCLUDING SECURITIES (continued)

Loans provided to foreign banks

Loans provided to foreign banks consist only of reverse repo operations. Securities used in reverse repo operations include state treasury bills, other short-term treasury bills and government and other coupon bonds. Their market value does not materially differ from the carrying value of the agreements.

The CNB had no reverse repo operations as at 31 December 2003. Reverse repo operations at 31 December 2002 include foreign bonds purchased from counter parties of CZK 20,344 million (31 December 2001: CZK 14,384 million). The maturity of these operations was less than 60 days.

Geographic sector risk concentrations within receivables from foreign countries, excluding securities (Assets Balance sheet lines 3.1., 3.2., 3.4.)

	31 December 2003		31 December 2002		31 December 2001	
	CZK million	%	CZK million	%	CZK million	%
Euro zone	35,110	46	55,219	50	88,433	67
Great Britain	40,637	53	42,618	38	42,871	33
Other European countries	99	-	846	1	49	-
USA	653	1	812	1	522	-
Japan	2	-	11,438	10	1	-
Other countries	3	-	5	-	3	-
	<u>76,504</u>	<u>100</u>	<u>110,938</u>	<u>100</u>	<u>131,879</u>	<u>100</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

5 RECEIVABLES FROM FOREIGN COUNTRIES INCLUDING SECURITIES (continued)

Treasury bills and other discounted securities (Assets Balance sheet line 3.3.)

Treasury bills and other discounted securities can be analysed as follows:

	Fair value 31 December <u>2003</u> CZK million	Fair value 31 December <u>2002</u> CZK million	Accrued cost 31 December <u>2001</u> CZK million	Fair value 31 December <u>2001</u> CZK million
Treasury bills	114,913	107,452	32,793	32,805
Other discounted securities	<u>102,966</u>	<u>119,215</u>	<u>46,290</u>	<u>46,289</u>
			79,083	
Provision against securities			<u>(6)</u>	
Total treasury bills and other discounted securities	<u>217,879</u>	<u>226,667</u>	<u>79,077</u>	<u>79,094</u>

Geographic sector risk concentrations within treasury bills and other discounted securities

	<u>31 December 2003</u>		<u>31 December 2002</u>		<u>31 December 2001</u>	
	CZK million	%	CZK million	%	CZK million	%
Euro zone	13,714	6	90,662	40	39,137	50
Great Britain	2,694	1	3,285	2	-	-
Switzerland	30,128	14	27,451	12	18,516	23
USA	60,671	28	9,291	4	10,798	14
Japan	99,570	46	79,762	35	-	-
Other countries	<u>11,102</u>	<u>5</u>	<u>16,216</u>	<u>7</u>	<u>10,632</u>	<u>13</u>
	<u>217,879</u>	<u>100</u>	<u>226,667</u>	<u>100</u>	<u>79,083</u>	<u>100</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

5 RECEIVABLES FROM FOREIGN COUNTRIES INCLUDING SECURITIES (continued)

Bonds and other coupon securities (Assets Balance sheet line 3.3.)

Bonds and other coupon securities can be analysed as follows:

	Fair value 31 December <u>2003</u> CZK million	Fair value 31 December <u>2002</u> CZK million	Cost 31 December <u>2001</u> CZK million	Fair value 31 December <u>2001</u> CZK million
State bonds	175,459	300,462	257,676	256,930
Other foreign bonds	198,902	61,028	43,584	43,916
Bonds managed by external manager	-	-	11,695	11,758
Accrued interest from bonds	<u>8,414</u>	<u>8,143</u>	<u>6,275</u>	<u>6,275</u>
			319,230	
Provision against securities			<u>(1,567)</u>	
Bonds and other coupon securities	<u>382,775</u>	<u>369,633</u>	<u>317,663</u>	<u>318,879</u>

Bonds and other securities with fixed income reported as trading securities as at 31 December 2003, 2002 and 2001 include solely fixed income securities.

Geographic sector risk concentrations within bonds and other coupon securities

	<u>31 December 2003</u>		<u>31 December 2002</u>		<u>31 December 2001</u>	
	CZK million	%	CZK million	%	CZK million	%
Euro zone	266,327	70	285,654	78	255,387	80
Great Britain	11,815	3	8,488	2	-	-
USA	104,633	27	74,278	20	62,697	20
Other countries	-	-	<u>1,213</u>	-	<u>1,146</u>	-
	<u>382,775</u>	<u>100</u>	<u>369,633</u>	<u>100</u>	<u>319,230</u>	<u>100</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

6 RECEIVABLES FROM DOMESTIC BANKS

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Non-performing loans	14	14	14
Loans provided from European Investment Bank (the "EIB") funds (Note 11)	96	115	133
Other receivables	-	-	<u>660</u>
	110	129	807
Specific provisions against receivables from domestic banks (Note 17)	<u>(14)</u>	<u>(14)</u>	<u>(14)</u>
	<u>96</u>	<u>115</u>	<u>793</u>

Non-performing loans

Non-performing loans represent loans after maturity and loans that show violated contract terms in other respects or which indicate a worsening financial situation of the debtor.

7 DUE FROM CLIENTS

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Standard loans	5,218	5,723	14,109
Redistribution loans	9,623	10,610	11,651
Classified loans	<u>31,727</u>	<u>32,876</u>	<u>26,658</u>
	46,568	49,209	52,418
Specific provisions for classified loans (Note 17)	<u>(9,101)</u>	<u>(9,389)</u>	<u>(4,155)</u>
	<u>37,467</u>	<u>39,820</u>	<u>48,263</u>

7 DUE FROM CLIENTS (continued)**Redistribution loans**

Long-term redistribution loans were provided to Konsolidační banka Praha, s.p.ú. (now Česká konsolidační agentura) in 1990 and 1991. A redistribution loan, under special conditions, was provided to fund the co-operative housing scheme. It is repayable by annual installments based on payments received from clients and its final maturity has not been specified.

Classified loans

Classified loans are categorised into four categories (watch, substandard, doubtful, loss) in accordance with the definitions issued by the Bank that are binding to commercial banks in the CR. They consist of total outstanding principal and accrued interest receivable, and are overdue or show other defaults in contractual terms or financial performance.

	31 December 2003		31 December 2002		31 December 2001	
	Accounting value CZK million	Fair value CZK million	Accounting value CZK million	Fair value CZK million	Accounting value CZK million	Fair value CZK million
Doubtful	-	-	2	1	4	3
Loss	<u>31,727</u>	<u>22,626</u>	<u>32,874</u>	<u>23,486</u>	<u>26,654</u>	<u>22,500</u>
Classified loans brutto	31,727		32,876		26,658	
Specific provisions	<u>(9,101)</u>		<u>(9,389)</u>		<u>(4,155)</u>	
Net book value	<u>22,626</u>	<u>22,626</u>	<u>23,487</u>	<u>23,487</u>	<u>22,503</u>	<u>22,503</u>

The net book value and fair value of classified loans reflect the guarantee received from the Czech Government (Note 29).

Classified loans include a portfolio of receivables against Agrobanka Praha, a.s., v likvidaci in the total gross amount of CZK 5,674 million. In 2002 a specific provision of CZK 5,548 million was created against these receivables and the reserve for exposure to Česká finanční, s.r.o. (hereinafter the "CF") (Notes 17 and 29) was decreased by the same amount.

Except for specific provisions for classified loans the Bank created a reserve for standard loans of CZK 348 million as at 31 December 2003, 2002 and 2001. The reserve must be utilised or written back to income in compliance with Czech accounting rules for banks by 31 December 2005.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

8 TANGIBLE AND INTANGIBLE FIXED ASSETS**Tangible fixed assets**

	31 December <u>2001</u> CZK million	31 December <u>2002</u> CZK million	<u>Additions</u> CZK million	<u>Disposals</u> CZK million	31 December <u>2003</u> CZK million
<u>Cost</u>					
Land	202	174	2	-	176
Buildings	7,081	7,040	14	(18)	7,036
Technical equipment	2,554	2 526	190	(164)	2,552
Equipment	355	349	15	(23)	341
Other	447	442	9	(6)	445
Advances for fixed asset acquisitions	<u>74</u>	<u>43</u>	<u>300</u>	<u>(303)</u>	<u>40</u>
Total cost	<u>10,713</u>	<u>10,574</u>	<u>530</u>	<u>(514)</u>	<u>10,590</u>
<u>Accumulated depreciation</u>					
Buildings	(817)	(1,044)	(253)	18	(1,279)
Technical equipment	(1,830)	(1,941)	(270)	164	(2,047)
Equipment	(235)	(264)	(30)	23	(271)
Other	<u>(412)</u>	<u>(407)</u>	<u>(9)</u>	<u>5</u>	<u>(411)</u>
Total accumulated depreciation	<u>(3,294)</u>	<u>(3,656)</u>	<u>(562)</u>	<u>210</u>	<u>(4,008)</u>
Net book amount	<u>7,419</u>	<u>6,918</u>			<u>6,582</u>

The original cost of low value tangible fixed assets that have been fully depreciated when put into use in 2003 is CZK 9.0 million (2002: CZK 4.9 million, 2001: CZK 15.0 million).

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

8 TANGIBLE AND INTANGIBLE FIXED ASSETS (continued)**Intangible fixed assets**

	31 December 2001 CZK million	31 December 2002 CZK million	Additions CZK million	Disposals CZK million	31 December 2003 CZK million
<u>Cost</u>					
Software	1,026	1,089	82	-	1,171
Other intangible assets	2	2	-	-	2
Advances for intangible assets acquisitions	39	58	29	(81)	6
Total cost	1,067	1,149	111	(81)	1,179
<u>Accumulated amortisation</u>					
Software	(715)	(868)	(152)	-	(1,020)
Other intangible assets	(2)	(2)	-	-	(2)
Total accumulated amortisation	(717)	(870)	(152)	=	(1,022)
Net book amount	350	279			157

The original cost of low value intangible fixed assets that has been fully amortised when put into use in 2003 is CZK 0.9 million (2002: 1.4 million, 2001: CZK 1.0 million).

The Bank did not provide any fixed tangible or intangible assets as collateral and does not hold any fixed assets under finance lease contracts.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

9 OTHER ASSETS

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Prepayments	34	16	16
Accrued income	-	-	372
Advances in relation to the Indemnity letter (Note 29)	2,785	2,773	478
Other advances in relation to the consolidation of the banking sector (Note 29)	1,496	1,520	1,928
Other foreign financial assets	253	50	50
Other domestic financial assets	-	-	19,717
Other precious metals	21	11	18
Positive fair value of foreign currency forwards	4,122	653	-
Other	<u>647</u>	<u>634</u>	<u>338</u>
	9,358	5,657	22,917
Specific provisions to advances and other assets (Note 17)	<u>(2,012)</u>	<u>(1,988)</u>	<u>(21,498)</u>
Total other assets	<u>7,346</u>	<u>3,669</u>	<u>1,419</u>

The CNB's investments in BIS and SWIFT are disclosed in other foreign financial assets. The shares of BIS and SWIFT are non-tradable and their holding results from the participation of the CNB in these institutions. In 2003, the accounting value of the shares of BIS increased due to the revaluation of shares upon re-denomination of these shares into SDR (Note 2 (r) and 16).

Within other domestic financial assets the Bank disclosed its share in GE Capital Bank, a.s. with a fair value estimated to be approximately nil in 2002 and 2001. In 2001, this share was disclosed at cost of CZK 19,717 million together with a provision of the same amount. The share was sold in 2003.

Within other domestic financial assets as at 31 December 2003 and 2002, the Bank disclosed its shares in Agrobanka Praha, a.s. v likvidaci, Kreditní banka Plzeň, a.s. – v likvidaci and BH CAPITAL, a.s., transferred free of charge from Československá obchodní banka, a.s. (hereinafter “CSOB”) to the CNB, in compliance with the Agreement and Indemnity Letter (hereinafter the “Indemnity Letter”) in 2002 (Note 29). In the opinion of the representatives of the Bank the fair value of these shares is approximately nil.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

10 CURRENCY IN CIRCULATION

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Notes in circulation	242,102	219,360	201,793
Coins in circulation	6,338	6,114	5,782
Cash in hand denominated in CZK	<u>(1,079)</u>	<u>(1,072)</u>	<u>(1,714)</u>
Total currency in circulation	<u>247,361</u>	<u>224,402</u>	<u>205,861</u>

11 LIABILITIES TO FOREIGN COUNTRIES

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Repo operations	2,569	4,174	14,141
Loans from the EIB	<u>96</u>	<u>115</u>	<u>134</u>
Total loans from foreign countries	2,665	4,289	14,275
Other liabilities to foreign countries	<u>424</u>	<u>446</u>	<u>468</u>
Total liabilities to foreign countries	<u>3,089</u>	<u>4,735</u>	<u>14,743</u>

Loans from the EIB

From the loans received from the EIB, the Bank granted loans in foreign currencies to commercial banks in the CR (Note 6). Loans were received and provided in the same amount, have the same maturity date and are not secured. The CNB earns a margin on these loans.

Repo operations

State treasury bills and state bonds secure loans granted from repo operations. Their market value does not materially differ from the carrying value of the operations.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

11 LIABILITIES TO FOREIGN COUNTRIES (continued)

Geographic sector risk concentrations within liabilities to foreign countries:

	<u>31 December 2003</u>		<u>31 December 2002</u>		<u>31 December 2001</u>	
	CZK million	%	CZK million	%	CZK million	%
Euro zone	2,684	87	4,325	91	3,461	23
Other European countries	4	-	8	-	5	-
USA	<u>401</u>	<u>13</u>	<u>402</u>	<u>9</u>	<u>11,277</u>	<u>77</u>
	<u>3,089</u>	<u>100</u>	<u>4,735</u>	<u>100</u>	<u>14,743</u>	<u>100</u>

12 DUE TO DOMESTIC BANKS

	<u>31 December 2003</u>	<u>31 December 2002</u>	<u>31 December 2001</u>
	CZK million	CZK million	CZK million
Monetary reserves from banks	21,237	28,359	30,273
Repo operations	439,609	455,419	264,847
Other liabilities to domestic banks	<u>9,465</u>	<u>4,455</u>	<u>14,127</u>
Total liabilities to domestic banks	<u>470,311</u>	<u>488,233</u>	<u>309,247</u>

Monetary reserves from banks

Obligatory minimum reserves represent deposits of the banks in the CR held at the CNB. The CNB pays interest equal to the CZK two-week repo interest rate on these deposits. Obligatory minimum reserves are defined as 2% of deposits with maturity less than two years.

Repo operations

Repo operations as at 31 December 2003 include CZK 439,609 million (31 December 2002: CZK 455,419 million, 31 December 2001: CZK 264,847 million) of loans received from banks in the CR. Repurchased treasury bills of the Bank guarantee these loans. Their market value does not materially differ from the carrying value of the operations.

Other liabilities to domestic banks

Other liabilities to domestic banks represent deposits used for interbank money transfers.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

13 CLIENT DEPOSITS

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Current accounts	9,836	8,990	9,730
Term deposits	2,020	11,083	2,046
Deposits of local government bodies	13,699	12,025	11,092
Other deposits	<u>3,694</u>	<u>3,839</u>	<u>5,048</u>
Total client deposits	<u>29,249</u>	<u>35,937</u>	<u>27,916</u>

14 DOMESTIC SECURITIES ISSUED

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
CNB treasury bills	700,000	700,000	400,000
CNB treasury bills repurchased:			
- held in the treasury bills portfolio	(267,867)	(250,582)	(136,826)
- in repo operations	(432,133)	(449,418)	(263,175)
- in reverse repo operations	___-	___-	___1
	<u>___-</u>	<u>___-</u>	<u>___-</u>

The treasury bills were issued at zero discount.

15 LIABILITIES TO THE STATE

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
State funds' accounts	23,182	23,111	12,033
State assets denominated in CZK	19,025	25,011	24,435
State assets denominated in foreign currency	<u>3,501</u>	<u>1,846</u>	<u>21,269</u>
Total liabilities to the state	<u>45,708</u>	<u>49,968</u>	<u>57,737</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

16 EQUITY

Changes of equity during 2003, 2002 and 2001 were as follows:

	Share capital CZK million	Funds CZK million	Accumulated losses CZK million	Profit / (loss) for the year CZK million	Equity CZK million
Balance at 1 January 2001	1,400	8,202	(18,392)	2,524	(6,266)
Transfer of profit from 2000 to accumulated losses	-	-	2,489	(2,489)	-
Usage of social fund	-	(39)	-	-	(39)
Allocation to social fund from profit	-	35	-	(35)	-
Loss for the year 2001	-	-	-	(28,628)	(28,628)
Balance at 31 December 2001	1,400	8,198	(15,903)	(28,628)	(34,933)
Transfer of accumulated losses	-	-	(28,628)	28,628	-
Usage of social fund	-	(42)	-	-	(42)
Loss for the year 2002	-	-	-	(9,468)	(9,468)
Balance at 31 December 2002	1,400	8,156	(44,531)	(9,468)	(44,443)
Transfer of accumulated losses	-	-	(9,468)	9,468	-
Revaluation of BIS shares (Note 2 (r))	-	-	219	-	219
Decrease of valuation fund upon sale of fixed assets acquired free of charge	-	(2)	-	-	(2)
Usage of social fund	-	(45)	-	-	(45)
Loss for the year 2003	-	-	-	(18,173)	(18,173)
Balance at 31 December 2003	<u>1,400</u>	<u>8,109</u>	<u>(53,780)</u>	<u>(18,173)</u>	<u>(62,444)</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

16 EQUITY (continued)

Funds

The major part of funds is represented by the General reserve fund of CZK 7,773 million existing in all reporting periods, which can be used to cover accumulated losses, increase share capital or for any other purpose approved by Bank Council of the CNB and Special reserve fund.

The Social fund of CZK 3 million as at 31 December 2003 (31 December 2002: CZK 6 million and 31 December 2001: CZK 8 million) is used for coverage of the social needs of employees and employees' programme of the CNB. Allocations to the Social fund are performed each year from the profit of the prior year. If the CNB achieved a loss in the prior year, the allocation to the Social fund is made from the Special reserve fund.

17 RESERVES, SPECIFIC PROVISIONS AND WRITE OFFS

The Bank created specific provisions and reserves for assets at risk:

Specific provisions	31 December ____ 2003 CZK million	31 December ____ 2002 CZK million	31 December ____ 2001 CZK million
Non-performing loans due from domestic banks (Note 6)	14	14	14
Classified loans to clients (Note 7)	9,101	9,389	4,155
Foreign securities (Note 5)	-	-	1,573
Domestic securities (Note 9)	-	-	19,717
Other (Note 9)	<u>2,012</u>	<u>1,988</u>	<u>1,781</u>
Total specific provisions	<u>11,127</u>	<u>11,391</u>	<u>27,240</u>
Reserves			
Standard loans (Note 7)	348	348	348
Guarantee for CF (Note 29)	4,770	4,916	10,587
Guarantees for the consolidation of the banking sector (Note 19 and 29)	467	598	582
Other guarantees (Note 19)	<u>296</u>	<u>348</u>	<u>418</u>
Total reserves	<u>5,881</u>	<u>6,210</u>	<u>11,935</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

17 RESERVES, SPECIFIC PROVISIONS AND WRITE OFFS (continued)

Write-offs and recovery of amounts written off previously

The CNB wrote off receivables of CZK 75 million in 2003 (2002: CZK 11 million, 2001: CZK 128 million) and did not receive any payments on debts that had been previously written off in 2003, 2002 and 2001.

Specific provisions

The movements in the specific provisions can be analysed as follows:

	Amounts due from banks and from foreign countries CZK million	Classified loans CZK million	Securities CZK million	Other CZK million	Total CZK million
At 1 January 2001	14	4,680	20,823	1,477	26,994
Addition	-	18	1,190	305	1,513
FX difference	-	-	(84)	-	(84)
Usage	-	(543)	(639)	(1)	(1,183)
At 31 December 2001	14	4,155	21,290	1,781	27,240
Addition	-	5,560	-	312	5,872
Change in accounting policy (Note 2 (r))	-	-	(21,290)	-	(21,290)
Usage	-	(326)	-	(105)	(431)
At 31 December 2002	14	9,389	-	1,988	11,391
Addition	-	9	-	27	36
Usage	-	(297)	-	(3)	(300)
At 31 December 2003	<u>14</u>	<u>9,101</u>	<u>-</u>	<u>2,012</u>	<u>11,127</u>

The 2001 creation and usage of specific provisions for securities were presented as profit or loss from financial operations (Note 21).

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

17 RESERVES, SPECIFIC PROVISIONS AND WRITE OFFS (continued)

Reserves

The movements in reserves can be analysed as follows:

	<u>Standard loans</u> CZK million	<u>Consolidation</u> CZK million	<u>Other</u> <u>guarantees</u> CZK million	<u>Total</u> CZK million
At 1 January 2001	348	11,421	828	12,597
Addition	-	28	11	39
Usage	-	(280)	(421)	(701)
At 31 December 2001	348	11,169	418	11,935
Addition	-	16	9	25
Usage	-	(5,671)	(79)	(5,750)
At 31 December 2002	348	5,514	348	6,210
Addition	-	-	7	7
Usage	-	(277)	(59)	(336)
At 31 December 2003	<u>348</u>	<u>5,237</u>	<u>296</u>	<u>5,881</u>

18 OTHER LIABILITIES

	31 December <u>2003</u> CZK million	31 December <u>2002</u> CZK million	31 December <u>2001</u> CZK million
Accruals and deferred income	-	8	186
Negative fair value of foreign currency forwards	586	844	-
Advance received in relation to the State guarantee (Note 29)	2,000	-	-
Other liabilities	<u>301</u>	<u>428</u>	<u>775</u>
Total other liabilities	<u>2,887</u>	<u>1,280</u>	<u>961</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

19 CONTINGENCIES AND COMMITMENTS

Issued guarantees	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Clients	330	426	514
CF (Note 29)	4,770	4,916	10,587
Consolidation of the banking sector (Note 29)	<u>165,340</u>	<u>194,620</u>	<u>92,686</u>
Total issued guarantees	<u>170,440</u>	<u>199,962</u>	<u>103,787</u>
Received guarantees			
From the Czech Government for impaired assets taken over by the Bank within the Consolidation Programme (Note 29)	22,500	22,500	22,500
From the Ministry of Finance in relation to the Indemnity Letter (Note 29)	<u>158,000</u>	<u>160,000</u>	<u>39,840</u>
Total guarantees received	<u>180,500</u>	<u>182,500</u>	<u>62,340</u>

The issued guarantees for the consolidation of the banking sector include primarily the Indemnity Letter and the Guarantee for deposits of IPB (Note 29).

The identified need for reserves for expected losses (Note 17) on the issued guarantees was as follows:

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Guarantees for clients	296	348	418
Guarantee for CF (Note 29)	4,770	4,916	10,587
Guarantees for the Consolidation of the banking sector (Note 29)	<u>467</u>	<u>598</u>	<u>582</u>
	<u>5,533</u>	<u>5,862</u>	<u>11,587</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

19 CONTINGENCIES AND COMMITMENTS (continued)

Receivables and payables from unsettled transactions with securities

	31 December <u>2003</u> CZK million	31 December <u>2002</u> CZK million	31 December <u>2001</u> CZK million
Receivables from unsettled transactions with securities	31,835	51,490	11,851
Payables from unsettled transactions with securities	<u>30,130</u>	<u>46,164</u>	<u>9,493</u>
Net position	<u>1,705</u>	<u>5,326</u>	<u>2,358</u>

All receivables and payables from unsettled transactions with securities matured in January of the following year.

Legal suits

The Bank is participating in a legal suit against Union banka, a.s. “v likvidaci” relating to compensation for an alleged claim of approximately CZK 1,800 million resulting from a transaction performed by the CNB during the consolidation of the Czech banking sector. Based on the Bank’s own opinion resulting from cooperation with an external law firm and the result of arbitration, the management of the CNB does not consider it to be probable that any compensation will have to be paid by the CNB and therefore has not created any reserve for such compensation.

Investment commitments

The Bank has not entered into any contracts for the purchase of tangible and intangible fixed assets as at 31 December 2003, 2002 and 2001.

Assets held in custody

The Bank has not received any assets from third parties to be held in custody in 2003, 2002 and 2001.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

20 INTEREST MARGIN

	<u>2003</u> CZK million	<u>2002</u> CZK million	<u>2001</u> CZK million
Interest income and similar income	19,192	22,104	28,106
Interest expense and similar expense	<u>(12,598)</u>	<u>(17,032)</u>	<u>(17,092)</u>
Interest margin	<u>6,594</u>	<u>5,072</u>	<u>11,014</u>

Interest income and similar income

	<u>2003</u> CZK million	<u>2002</u> CZK million	<u>2001</u> CZK million
Repurchased treasury bills issued by the Bank	-	-	53
Treasury bills and other discounted securities	2,602	3,134	3,952
Coupon bonds	<u>13,928</u>	<u>13,583</u>	<u>18,376</u>
Total interest from securities with fixed income	<u>16,530</u>	<u>16,717</u>	<u>22,381</u>
Inter-bank deposits	2,165	4,320	4,250
Receivables from the clients	384	956	1,450
Other	<u>113</u>	<u>111</u>	<u>25</u>
Total other interest income	<u>2,662</u>	<u>5,387</u>	<u>5,725</u>
Total interest income and similar income	<u>19,192</u>	<u>22,104</u>	<u>28,106</u>

Based on the estimate of the Bank's management, in 2003 total income included CZK 1 million from interest income on classified loans (2002: CZK 7 million, 2001: CZK 14 million). Unpaid interest is accrued and is taken into account when calculating the amount of specific provisions.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

20 INTEREST MARGIN (continued)

Interest expense and similar expense

	___ 2003 CZK million	___ 2002 CZK million	___ 2001 CZK million
Liabilities to state	143	391	429
Liabilities to banks	12,320	16,081	16,348
Liabilities to clients	___ 135	___ 560	___ 315
Total interest expense and similar expense	<u>12,598</u>	<u>17,032</u>	<u>17,092</u>

21 LOSS FROM FINANCIAL OPERATIONS

Loss from financial operations can be analysed as follows:

	___ 2003 CZK million	___ 2002 CZK million	___ 2001 CZK million
Profit from sale of securities	5,910	2,097	3,927
Loss from sale of securities	(3,297)	(1,762)	(2,117)
Foreign exchange losses	(29,715)	(26,170)	(40,113)
Other income	1,387	7,342	1,101
Result on swap transactions (Note 24)	5,096	-	-
Other interest	(307)	(197)	8
Decrease in fair value of securities	(18,451)	(1,469)	-
Increase in fair value of securities	16,145	6,295	-
Addition to specific provisions for securities (Note 17)	-	-	(1,190)
Usage of specific provisions for securities (Note 17)	___ -	___ -	___ 639
	<u>(23,232)</u>	<u>(13,864)</u>	<u>(37,745)</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

22 ADMINISTRATION EXPENSES

The administration expenses can be analysed as follows:

	<u>2003</u> CZK million	<u>2002</u> CZK million	<u>2001</u> CZK million
Wages and salaries	579	554	499
Social security and health insurance	<u>206</u>	<u>197</u>	<u>176</u>
Total personnel costs	<u>785</u>	<u>751</u>	<u>675</u>
Depreciation of tangible fixed assets	547	556	604
Amortisation of intangible fixed assets	152	152	175
Rent	14	12	16
Other	<u>544</u>	<u>544</u>	<u>532</u>
Total other administration expenses	<u>1,257</u>	<u>1,264</u>	<u>1,327</u>
Total administration expenses	<u>2,042</u>	<u>2,015</u>	<u>2,002</u>

Staff statistics

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Average number of employees	1,477	1,479	1,455
From which: Number of members of the Bank Council	7	7	7

23 OTHER OPERATING EXPENSES AND EXTRAORDINARY EXPENSES

Other operating expenses

	<u>2003</u> CZK million	<u>2002</u> CZK million	<u>2001</u> CZK million
Cost of transfer of the share in the CF (Note 29)	-	-	13
Settlement of CF losses (Note 29)	172	565	864
Expenses for issuing bank notes and coins	285	371	309
Other expenses and damages	<u>198</u>	<u>183</u>	<u>590</u>
Other expenses in total	<u>655</u>	<u>1,119</u>	<u>1,776</u>

Due to a change in accounting policy (Note 2 (r)), other damages and extraordinary expenses of CZK 11 million in 2001 were included in other operating expenses.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

**23 OTHER OPERATING EXPENSES AND EXTRAORDINARY EXPENSES
(continued)**

Extraordinary expenses and incomes

	<u>2003</u> CZK million	<u>2002</u> CZK million	<u>2001</u> CZK million
Extraordinary expenses	=	<u>21,290</u>	=
Extraordinary incomes	=	<u>22,521</u>	=

Extraordinary expense and income in 2002 result from the change in accounting policy for the re-measurement of securities to fair value (Note 2 (r)).

24 FINANCIAL RISKS

Liquidity risk

The Bank monitors and manages the structure and duration of its foreign currency reserves in compliance with the mission of the Bank. The table in Note 25 analyses assets and liabilities of the Bank into relevant maturity bands based on the remaining period at the balance sheet date to the contractual maturity date.

Interest rate risk

The Bank takes on exposure resulting from fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Changes in interest rates result in a change in market value of securities held in the portfolio of the Bank. Rules for investing foreign currency reserves are targeted to limit the significant risk of a change in interest rates. The table in Note 26 summarises the Bank's exposure to interest rate risks. Included in the table are the Bank's interest bearing assets and liabilities at carrying amounts, categorized by the earlier of contractual, repricing or maturity dates.

Currency risk

The Bank takes on exposure resulting from fluctuations in prevailing foreign currency exchange rates on its financial position and cash flows. The structure of foreign currency reserves is targeted to limit the significant risk of a movement in mutual foreign exchange rates of single currencies. The CNB cannot reduce the risk of the strengthening of the Czech currency against foreign currencies, as it is responsible for the administration of the foreign exchange reserves. The table in Note 27 summarises the Bank's exposure to the currency risk. Included in the table are the Bank's foreign currency denominated assets and liabilities at carrying amounts, categorized by currency.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

24 FINANCIAL RISKS (continued)

Credit risk

The Bank manages the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower or groups of borrowers and to geographical segments. Such risks are monitored on a revolving basis and are subject to an annual or more frequent review. Geographical concentrations of assets and liabilities are stated in Note 28.

Spot transactions and derivative financial instruments

The receivables and payables from spot, term and option transactions can be analysed as follows:

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Receivables			
- from futures transactions	3,964	-	-
- from unsettled spot transactions	-	1,355	2,877
- from forward transactions	103,348	91,420	5
- from option transactions	<u>14,981</u>	<u>8,898</u>	<u>7,985</u>
	<u>122,293</u>	<u>101,673</u>	<u>10,867</u>
Payables			
- from futures transactions	3,964	-	-
- from unsettled spot transactions	-	1,359	2,871
- from forward transactions	99,571	91,196	5
- from option transactions	<u>14,981</u>	<u>8,898</u>	<u>7,985</u>
	<u>118,516</u>	<u>101,453</u>	<u>10,861</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

24 FINANCIAL RISKS (continued)

Spot transactions and derivative financial instruments (continued)

The Bank has outstanding currency forwards at the balance sheet date hedging the movement of foreign exchange rates:

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Off balance sheet receivables from forward transactions	103,348	91,420	5
Off balance sheet payables from forward transactions	99,571	91,196	5
Positive fair value (Note 9)	4,122	653	-
Negative fair value (Note 18)	586	844	-

The nominal or notional amounts reported in off balance sheet provide a basis for volume comparison with instruments recognised on the balance sheet but do not indicate the Bank's exposure to credit risk.

Despite the fact that these foreign currency forwards provide efficient financial hedging of the Bank's position from a foreign exchange reserves administration point of view, they do not fulfill the criteria for hedge accounting required by the Czech accounting rules, so that they are treated as trading derivatives. Gains and losses from the change of the fair value of these foreign currency forwards are recorded in the loss from financial operations (Note 21).

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

25 LIQUIDITY RISK

As at 31 December 2003	Up to <u>1 month</u>	1-3 <u>months</u>	3-12 <u>months</u>	1-5 <u>years</u>	Over <u>5 years</u>	Un- <u>specified</u>	<u>Total</u>
	CZK m	CZK m	CZK m	CZK m	CZK m	CZK m	CZK m
Assets							
Gold	550	-	-	283	-	-	833
Receivables from IMF	-	-	-	-	-	32,193	32,193
Treasury bills and other discounted securities	66,328	68,570	82,981	-	-	-	217,879
Bonds and other coupon securities	23,326	13,705	88,486	174,671	82,587	-	382,775
Deposits, loans and other receivables from foreign countries	69,108	7,396	-	-	-	-	76,504
Receivables from domestic banks	-	12	12	72	-	-	96
Receivables from clients	22,783	-	5,061	-	-	9,623	37,467
Fixed assets	-	-	-	-	-	6,739	6,739
Other assets	<u>7,059</u>	<u>-</u>	<u>34</u>	<u>-</u>	<u>-</u>	<u>253</u>	<u>7,346</u>
Total assets	<u>189,154</u>	<u>89,683</u>	<u>176,574</u>	<u>175,026</u>	<u>82,587</u>	<u>48,808</u>	<u>761,832</u>
Liabilities and equity							
Currency in circulation	-	-	-	-	-	247,361	247,361
Liabilities to IMF	-	-	-	-	-	19,790	19,790
Liabilities to foreign countries	2,993	12	12	72	-	-	3,089
Liabilities to domestic banks	470,311	-	-	-	-	-	470,311
Deposits from clients	28,622	-	342	285	-	-	29,249
Liabilities to the state	45,708	-	-	-	-	-	45,708
Reserves	-	-	-	-	-	5,881	5,881
Equity	-	-	-	-	-	(62,444)	(62,444)
Other liabilities	<u>2,887</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,887</u>
Total liabilities and equity	<u>550,521</u>	<u>12</u>	<u>354</u>	<u>357</u>	<u>-</u>	<u>210,588</u>	<u>761,832</u>
Net liquidity gap	<u>(361,367)</u>	<u>89,671</u>	<u>176,220</u>	<u>174,669</u>	<u>82,587</u>	<u>(161,780)</u>	<u>-</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

25 LIQUIDITY RISK (continued)

As at 31 December 2002	Up to <u>1 month</u>	1-3 <u>months</u>	3-12 <u>months</u>	1-5 <u>years</u>	Over <u>5 years</u>	Un- <u>specified</u>	<u>Total</u>
	CZK m	CZK m	CZK m	CZK m	CZK m	CZK m	CZK m
Total assets	164,117	150,490	86,573	330,268	9,567	53,176	794,191
Total liabilities	<u>574,631</u>	<u>4,497</u>	<u>627</u>	<u>398</u>	<u>-</u>	<u>214,038</u>	<u>794,191</u>
Net liquidity gap	<u>(410,514)</u>	<u>145,993</u>	<u>85,946</u>	<u>329,870</u>	<u>9,567</u>	<u>(160,862)</u>	<u>-</u>
As at 31 December 2001							
Total assets	168,615	41,520	123,919	232,035	1,619	59,792	627,500
Total liabilities	<u>403,488</u>	<u>12</u>	<u>1,917</u>	<u>5,174</u>	<u>13</u>	<u>216,896</u>	<u>627,500</u>
Net liquidity gap	<u>(234,873)</u>	<u>41,508</u>	<u>122,002</u>	<u>226,861</u>	<u>1,606</u>	<u>(157,104)</u>	<u>-</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

26 INTEREST RATE RISK

As at 31 December 2003	Up to <u>1 month</u>	1-3 <u>months</u>	3-12 <u>months</u>	1-5 <u>years</u>	Over <u>5 years</u>	Un- <u>specified</u>	<u>Total</u>
	CZK m	CZK m	CZK m	CZK m	CZK m	CZK m	CZK m
Assets							
Gold	-	-	-	-	-	833	833
Receivables from IMF	-	-	-	-	-	32,193	32,193
Treasury bills and other discounted securities	66,328	68,570	82,981	-	-	-	217,879
Bonds and other coupon securities	20,650	12,806	86,626	178,021	84,672	-	382,775
Deposits, loans and other receivables from foreign countries	69,108	7,396	-	-	-	-	76,504
Receivables from domestic banks	-	12	12	72	-	-	96
Receivables from clients	22,783	-	5,061	-	-	9,623	37,467
Fixed assets	-	-	-	-	-	6,739	6,739
Other assets	<u>7,093</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>253</u>	<u>7,346</u>
Total assets	<u>185,962</u>	<u>88,784</u>	<u>174,680</u>	<u>178,093</u>	<u>84,672</u>	<u>49,641</u>	<u>761,832</u>
Liabilities and equity							
Currency in circulation	-	-	-	-	-	247,361	247,361
Liabilities to IMF	-	-	-	-	-	19,790	19,790
Liabilities to foreign countries	2,993	12	12	72	-	-	3,089
Liabilities to domestic banks	470,311	-	-	-	-	-	470,311
Deposits from clients	29,249	-	-	-	-	-	29,249
Liabilities to the state	45,708	-	-	-	-	-	45,708
Reserves	-	-	-	-	-	5,881	5,881
Equity	-	-	-	-	-	(62,444)	(62,444)
Other liabilities	<u>2,887</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,887</u>
Total liabilities and equity	<u>551,148</u>	<u>12</u>	<u>12</u>	<u>72</u>	<u>-</u>	<u>210,588</u>	<u>761,832</u>
Net interest sensitivity gap	<u>(365,186)</u>	<u>88,772</u>	<u>174,668</u>	<u>178,021</u>	<u>84,672</u>	<u>(160,947)</u>	<u>-</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

26 INTEREST RATE RISK (continued)

As at 31 December 2002	Up to <u>1 month</u>	1-3 <u>months</u>	3-12 <u>months</u>	1-5 <u>years</u>	Over <u>5 years</u>	Un- <u>specified</u>	<u>Total</u>
	CZK m	CZK m	CZK m	CZK m	CZK m	CZK m	CZK m
Total assets	163,635	150,672	87,128	329,180	9,567	54,009	794,191
Total liabilities	<u>575,288</u>	<u>4,497</u>	<u>278</u>	<u>90</u>	<u>-</u>	<u>214,038</u>	<u>794,191</u>
Net interest sensitivity gap	<u>(411,653)</u>	<u>146,175</u>	<u>86,850</u>	<u>329,090</u>	<u>9,567</u>	<u>(160,029)</u>	<u>-</u>
As at 31 December 2001							
Total assets	173,782	54,159	119,640	219,277	13	60,629	627,500
Total liabilities	<u>405,720</u>	<u>12</u>	<u>12</u>	<u>4,847</u>	<u>13</u>	<u>216,896</u>	<u>627,500</u>
Net interest sensitivity gap	<u>(231,938)</u>	<u>54,147</u>	<u>119,628</u>	<u>214,430</u>	<u>-</u>	<u>(156,267)</u>	<u>-</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

27 CURRENCY RISK

As at 31 December 2003	<u>CZK</u>	<u>EUR</u>	<u>USD</u>	<u>JPY</u>	<u>Other</u>	<u>Total</u>
	CZK m	CZK m	CZK m	CZK m	CZK m	CZK m
Assets						
Gold	-	-	-	-	833	833
Receivables from IMF	19,790	-	-	-	12,403	32,193
Treasury bills and other discounted securities	-	25,185	93,124	99,570	-	217,879
Bonds and other coupon securities	-	279,271	101,816	-	1,688	382,775
Deposits, loans and other receivables from foreign countries	-	57,593	18,803	2	106	76,504
Receivables from domestic banks	-	96	-	-	-	96
Receivables from clients	37,467	-	-	-	-	37,467
Fixed assets	6,729	-	-	-	10	6,739
Other assets	6,966	117	10	-	253	7,346
Total assets	<u>70,952</u>	<u>362,262</u>	<u>213,753</u>	<u>99,572</u>	<u>15,293</u>	<u>761,832</u>
Liabilities and equity						
Currency in circulation	247,361	-	-	-	-	247,361
Liabilities to IMF	19,790	-	-	-	-	19,790
Liabilities to foreign countries	424	96	2,569	-	-	3,089
Liabilities to domestic banks	470,311	-	-	-	-	470,311
Deposits from clients	27,832	1,366	51	-	-	29,249
Liabilities to the state	42,207	3,501	-	-	-	45,708
Reserves	5,881	-	-	-	-	5,881
Equity	(62,444)	-	-	-	-	(62,444)
Other liabilities	2,886	-	1	-	-	2,887
Total liabilities and equity	<u>754,248</u>	<u>4,963</u>	<u>2,621</u>	<u>-</u>	<u>-</u>	<u>761,832</u>
Net assets / (liabilities)	<u>(683,296)</u>	<u>357,299</u>	<u>211,132</u>	<u>99,572</u>	<u>15,293</u>	<u>-</u>
Net off-balance sheet assets	<u>-</u>	<u>79,904</u>	<u>23,444</u>	<u>(99,571)</u>	<u>-</u>	<u>3,777</u>
Net foreign exchange position	<u>(683,296)</u>	<u>437,203</u>	<u>234,576</u>	<u>1</u>	<u>15,293</u>	<u>3,777</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

27 CURRENCY RISK (continued)

As at 31 December 2002	<u>CZK</u>	<u>EUR</u>	<u>USD</u>	<u>JPY</u>	<u>Other</u>	<u>Total</u>
	CZK m	CZK m	CZK m	CZK m	CZK m	CZK m
Total assets	78,401	456,323	159,855	91,199	8,413	794,191
Total liabilities	<u>777,597</u>	<u>16,497</u>	<u>96</u>	<u>-</u>	<u>1</u>	<u>794,191</u>
Net assets / (liabilities)	(699,196)	439,826	159 759	91,199	8,412	-
Net off-balance sheet assets	<u>-</u>	<u>67,934</u>	<u>23,482</u>	<u>(91,196)</u>	<u>-</u>	<u>220</u>
Net foreign exchange position	<u>(699,196)</u>	<u>507,760</u>	<u>183,241</u>	<u>3</u>	<u>8,412</u>	<u>220</u>
As at 31 December 2001						
Total assets	91,712	363,581	164,402	1	7,804	627,500
Total liabilities	<u>590,423</u>	<u>6,617</u>	<u>30,459</u>	<u>-</u>	<u>1</u>	<u>627,500</u>
Net assets / (liabilities)	(498,711)	356,964	133,943	1	7,803	-
Net off-balance sheet assets	<u>0</u>	<u>561</u>	<u>(537)</u>	<u>0</u>	<u>(18)</u>	<u>6</u>
Net foreign exchange position	<u>(498,711)</u>	<u>357,525</u>	<u>133,406</u>	<u>1</u>	<u>7,785</u>	<u>6</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

28 CREDIT RISK AND CONCENTRATION OF LIABILITIES

Geographical concentrations of assets

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Czech Republic	52,573	51,683	59,031
Germany	146,522	123,883	83,298
France	48,981	46,568	82,318
Italy	66,577	140,758	111,309
Other Euro zone countries	53,071	120,326	104,711
Switzerland	30,134	27,456	18,516
Great Britain	55,146	54,391	42,871
Other European countries	1	2,005	99
Canada and USA	198,151	119,700	113,565
Japan	99,572	91,200	1
Other countries	<u>11,104</u>	<u>16,221</u>	<u>11,781</u>
	<u>761,832</u>	<u>794,191</u>	<u>627,500</u>

Geographical concentrations of liabilities

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Czech Republic	738,953	761,587	578,724
Euro zone countries	2,684	4,325	3,461
Other European countries	4	8	5
Canada and USA	<u>20,191</u>	<u>28,271</u>	<u>45,310</u>
	<u>761,832</u>	<u>794,191</u>	<u>627,500</u>

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

29 CONSOLIDATION OF THE BANKING SECTOR

Consolidation of the banking sector

Pursuant to its role in supporting and maintaining the stability of the banking sector and monitoring the security of client's deposits in CR the CNB took over certain assets and liabilities or guaranteed certain liabilities of various commercial banks. The Czech Government issued a guarantee of CZK 22,500 million in favour of the Bank (hereinafter the "Guarantee") to cover the exposure of the Bank arising as a consequence of these activities. The Guarantee was issued on 19 March 1997 and is valid for ten years from that date. CNB has fully provided for the estimated losses resulting from the consolidation of the banking sector not covered by the Guarantee.

The assets taken over and specific provisions and reserves created as at 31 December 2003, 2002 and 2001 can be summarised as follows:

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Receivables from banks	26,971	27,175	27,480
Purchased receivables of banks	223	308	308
Guarantees and commitments	<u>467</u>	<u>598</u>	<u>582</u>
	27,661	28,081	28,370
Specific provisions (Note 17)	(4,694)	(4,983)	(5,288)
Reserves (Note 17)	<u>(467)</u>	<u>(598)</u>	<u>(582)</u>
Total net book value covered by the Guarantee	<u>22,500</u>	<u>22,500</u>	<u>22,500</u>

29 CONSOLIDATION OF THE BANKING SECTOR (continued)

Česká finanční, s.r.o.

CF was 100% acquired by the Bank in 1997 as a special purpose vehicle to administer the banking industry Stabilisation and Consolidation programmes which focused on small and middle sized banks. Further to the resolution of the Czech Government number 1162 dated 8 November 1999, by which the Czech Government approved the restructuring of certain transformation institutions, CNB sold its 100% ownership interest in CF for an agreed price of CZK 1 to Konsolidační Banka Praha, s.p.ú., now Česká Konsolidační Agentura (hereinafter the "CKA") in June 2000. The CNB has undertaken to cover all CF losses resulting from the Consolidation Programme and concluded an agreement with CF on the settlement of operating costs and losses from assumed assets incurred in relation to the implementation of the Consolidation Programme, which would exceed the share capital of CF and therefore could not be offset against the CF share capital of CZK 13,833 million. The CNB increased the share capital in CF in 1997 and 1998.

The Consolidation programme involved transfers of certain doubtful assets of certain banks taking part in this programme to CF. CF purchased these assets from the CNB and other banks without any further claims. The aim of this programme was to regain financial stability and the programme was started in 1997. CF ceded the portfolio of three receivables against Agrobanka Praha, a.s., v likvidaci included in the Consolidation Programme back to CNB in 2002. The unaudited net book value of the Consolidation programme assets administered by CF (net of provisions created by CF but reflecting the guarantee received from the CNB) was CZK 5,090 million as at 31 December 2003 (audited amount as at 31 December 2002: CZK 5,631 million and audited amount as at 31 December 2001: CZK 26,304 million).

In compliance with this agreement concluded by the CNB and CF, the relevant part of the operating costs of CF will be settled on a quarterly basis by the CNB. The agreement also specifies CF's reporting duties to the CNB on a regular basis and the mechanism whereby the CNB retains a certain level of control over CF activities relating to the Consolidation Programme.

29 CONSOLIDATION OF THE BANKING SECTOR (continued)**Česká finanční, s.r.o. (continued)**

The calculation of the reserve can be summarised as follows:

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Provided loans	5,060	5,542	14,026
Less expected recoverability of			
- receivables in Consolidation programme	(170)	(510)	(3,334)
- securities in Consolidation programme	(120)	(116)	(105)
Created reserves (Note 17)	<u>4,770</u>	<u>4,916</u>	<u>10,587</u>

Investiční a poštovní banka, a.s.

In June 2000 CNB declared forced administration in Investiční a poštovní banka, a.s. (hereinafter "IPB"). On 16 June 2000 CNB issued a guarantee for deposits (hereinafter the "Guarantee for Deposits") covering all commitments resulting from deposits received by IPB and from bonds issued by IPB including accrued interest as at 16 June 2000. Liabilities with a fixed maturity date were guaranteed until the maturity date and liabilities without a fixed maturity date were guaranteed until June 2003.

The Guarantee for Deposits is regularly updated in the CNB off balance sheet based on an assessment of the liabilities covered by the Guarantee for Deposits performed by CSOB. The balance of the Guarantee for Deposits in the off balance sheet of the CNB as at 31 December 2003 was CZK 3,651 million (31 December 2002: CZK 32,780 million, 31 December 2001: CZK 48,707 million).

The forced administrator of IPB concluded with CSOB a contract about the sale of the business on 19 June 2000 and based on this agreement CSOB took over assets and liabilities of IPB. On 19 June 2000 the CNB and CSOB concluded the Indemnity Letter in which the CNB irrevocably and unconditionally undertook to pay to CSOB certain losses and it indemnifies CSOB for certain costs related to the transaction.

29 CONSOLIDATION OF THE BANKING SECTOR (continued)**Investiční a poštovní banka, a.s. (continued)**

On 23 June 2000 the Czech Government issued a Government guarantee in which it undertook that it will refund certain losses incurred by the CNB in connection with CSOB indemnification based on the Indemnity Letter (hereinafter the “State Guarantee”). The State guarantee covers losses incurred by the CNB resulting from indemnification of CSOB’s losses (damages) arising from unrecorded liabilities relating to IPB that were transferred to CSOB.

During 2001 the CNB granted advances to CSOB relating to the Indemnity letter of CZK 478 million relating to compensations paid by CSOB resulting from liabilities unrecorded in the IPB accounting records. The CNB paid out further advance payments in the total amount of CZK 2,200 million and EUR 3 million in 2002 and an advance payment of USD 391 thousands in 2003. These advance payments are not provided for, since they are considered by the CNB to be covered by the State Guarantee. In 2003, the CNB received an advance payment relating to the State Guarantee in the amount of CZK 2,000 million.

CSOB regularly lists and quantifies the items, which according to the CSOB opinion may be covered by the Indemnity Letter and may result in potential compensations by the CNB. The final outcome of claims under the Indemnity Letter or claims under the Indemnity Letter that are not covered by the State Guarantee cannot be currently determined. On 6 November 2002, the CNB obtained an unilateral obligatory declaration from CSOB according to which all claims for compensations under the Indemnity letter from the CNB will be made by CSOB and will be settled by the CNB by 31 December 2016 and the maximum amount of the compensation is CZK 160,000 million. Based on this declaration, the CNB expects that the maximum compensation from the State Guarantee would be in the same amount.

The amounts covered under the Indemnity letter, advances paid to CSOB, advances received and the State Guarantee can be analysed as follows:

	<u>31 December 2003</u> CZK million	<u>31 December 2002</u> CZK million	<u>31 December 2001</u> CZK million
Potential claims under the Indemnity Letter	157,215	157,227	39,362
Advances paid to CSOB	2,785	2,773	478
Advances received from the State Guarantee	<u>(2,000)</u>	—	—
Available State Guarantee	<u>158,000</u>	<u>160,000</u>	<u>39,840</u>

29 CONSOLIDATION OF THE BANKING SECTOR (continued)**Investiční a poštovní banka, a.s. (continued)**

The CNB has not created a provision for these claims as no claims not covered by the State Guarantee have been raised so far and the CNB is currently not able to assess reliably the expected outcome of legal proceedings or the amount of damages, if any, which may be incurred by CSOB and then claimed from the CNB.

In case CSOB will ask CNB to settle any claim under the Indemnity Letter, based on the agreement CNB should make the related payment within the five working days after the receipt of the CSOB request. The payment calendar related to the State Guarantee is as follows:

<u>Amount claimed by the CNB</u>	<u>Maturity</u>
Below or equal to CZK 2 billion	in the same calendar year
Greater than CZK 2 billion and less than or equal to CZK 5 billion	CZK 2 billion in the same calendar year, the rest in the following calendar year
Over CZK 5 billion	CZK 2 billion in the same calendar year, CZK 3 billion in the following calendar year, the rest in the third calendar year after the request of the CNB

30 RELATED PARTY TRANSACTIONS

Related parties are defined as follows:

- Members of the Banking Council, senior management and their relatives;
- Corporates in which members of the Banking Council, senior management hold at least 10% shareholding;
- Subsidiaries;
- CF.

Related party transactions, including transactions with the management and employees of the CNB arose under the same conditions and interest rates as for unrelated parties under the same terms. In the opinion of the management of the Bank, a common interest rate was used in all cases and the deposits do not have different liquidity risk or other unfavourable features.

CZECH NATIONAL BANK

NOTES TO FINANCIAL STATEMENTS

AS AT 31 DECEMBER 2003 AND FOR THE YEAR THEN ENDED

30 RELATED PARTY TRANSACTIONS

The objectives and basic activities of the CF are described in Note 29. Transactions were entered into with the CF when performing the Bank's role in stabilisation of the banking sector. Loans were provided on arm's length interest rate terms.

31 SUBSEQUENT EVENTS

The CNB's management is not aware of any subsequent events that would have a material impact on the financial statements.

CZECH NATIONAL BANK

**REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS**

YEAR ENDED 31 DECEMBER 200