# CHAPTER 3. HOUSING FINANCE IN CZECH REPUBLIC
by

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1. Macroeconomic Characteristics[1]

Current Czech macroeconomic developments can be characterized as favourable. A rise in economic growth dynamics can be observed (to 4.1% in the second quarter of 2004 in year-on-year terms), driven by a higher investment activity and, recently, also by a leap in the economy's export performance. Growth acceleration is of both structural and cyclical character. Pace of potential product growth is increasing mainly thanks to robust growth of total factor productivity, closing, at the same time, a negative output gap. Since early 2004, year-on-year growth of consumer prices has been accelerating (to 3.5% in October 2004). It reflects impacts of administrative measures (especially harmonization in excise taxes and VAT), growth of food prices and increasing commodity prices on the world markets. Fall in employment still persists (by 0.8% in the second quarter of 2004 in year-on-year terms) and so dynamic economic growth is generated exclusively by rising labour productivity. Rate of seasonally adjusted registered unemployment peaked in March 2004, stagnating or slightly falling since then. External balance expressed by means of current account deficit to GDP ratio is worsening slightly (-6.4% at the end of the first half of 2004). It results from ongoing deepening of balance-of-income deficit; on the other hand, trade balance has been improving in spite of high oil prices.
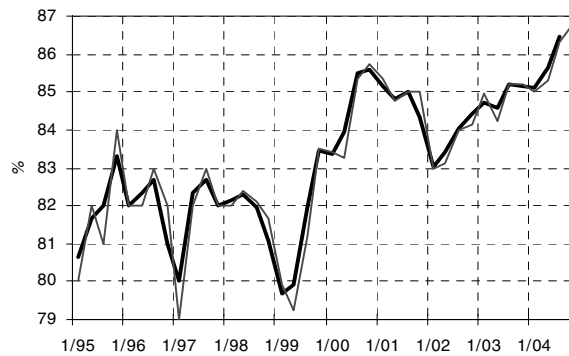
Output Gap

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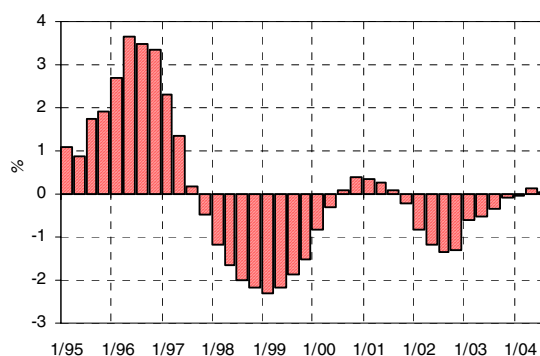
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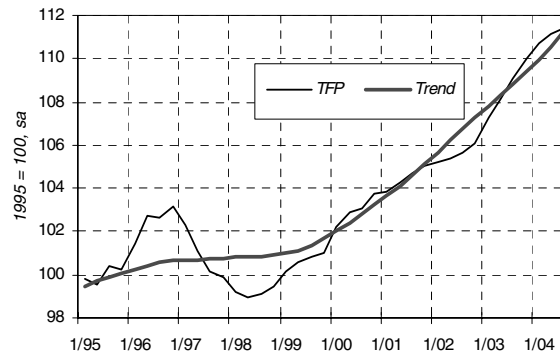
Potential Product Growth
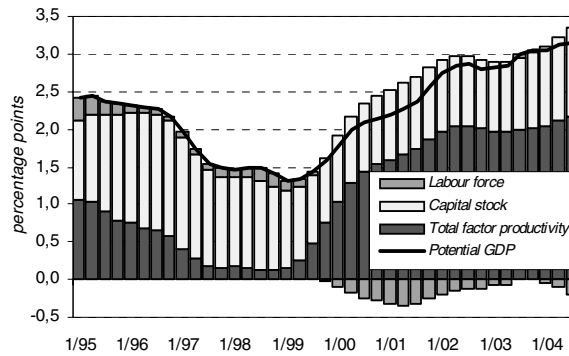
Utilisation of Capacities in Industry

Total Factor Productivity

Negative output gap closed in the beginning of 2004 due to dynamic growth and the economy is now more or less at its potential level. In this stage of cycle, it is reasonable to boost the economy by policies oriented at increasing the growth of economic potential by means of steps on the supply side. A gradual acceleration of year-on-year growth of potential product from 2% in 2000 to some 3.1% in the third quarter of 2004 is a positive phenomenon. A robust growth trend of total factor productivity by some 2% a year is the main factor of this acceleration. It results from an improved functioning of the business sphere especially as regards the foreign-controlled businesses and financial system stability. On the other hand, there are still reserves in some parameters of institutional environment (such as poor enforceability of law or existing barriers to market entry/exit).

High dynamics of gross fixed capital formation contributes to an increase in the economy's capitalization as by means of improved infrastructure as through high-quality and competitive production units able to win recognition on the world markets. Functioning of the labour market can turn risk for acceleration of growth of potential product. Falling participation rate (share of labour force in the working age population) prevents the economy from making use of the still growing number of population in the age that allows them to be economically active.

Monetary policy of the Czech National Bank is conducted under inflation targeting regime. The target band for year-on-year increase of consumer price index (CPI) falls evenly from the level of 3 to 5 % in January 2002 to 2 to 4 % in December 2005. The CNB also announced inflation target for a period starting from January 2006 as a 3% year-on-year increase in CPI with maximum tolerance of +1 percentage point in either direction from this target. The target will apply until the Czech Republic joins the euro area. This CNB's stable monetary policy is an assumption for meeting the convergence inflation criterion and it creates a space for positive inflation differential against EU countries toward which the CZ economic level should converge, and corresponds to long-term expectations of financial markets. The forecast is based on an assumption of stability or moderate increasing of policy rates in 2005, followed with transmission in inter-bank and market rates. The CNB would be thus able to respond to domestic and Europe's recovery and to further assumed increases in Fed's rates and expected growth of ECB policy rates.

Deficit tendencies of the general government have been persisting in recent years. Their size cannot be explained by means of the current stage of the economic cycle. Deficits occur in spite of using one-off receipts, while growth dynamics of government debt accelerates. Structure of the expenditure side is encumbered with high share of social mandatory expenditures, which are not fully covered by revenues from social security and employment policy contributions. Besides the transformation-related costs, the general government bears the expenses related to improvement of infrastructure level and costs on convergence of policies, legal and institutional frameworks and environmental standards to those of the EU. Existence of structural deficiencies can be seen from development of public finance balance – general government deficits are not of cyclical character. Expenses are only partially allocated in areas that would generate positive multiplication effects in the long run. With regard to the above-mentioned negative development in public finances the political representation has come to an agreement on the need to reform them. Concept of the general government reform, produced by the Ministry of Finance, was approved by the government resolution from June 2004. The reform is implemented as a package of measures on both revenue and expenditure sides of the general government, focusing on the spending side. It is targeted at reaching a permanent reduction of fiscal deficits. The government set a fiscal target of 4 per cent government-sector/GDP ratio for 2006 and a downward trajectory of the deficit.

The marketable state debt of the Czech Republic (T-bills, domestic T-bonds and eurobonds outstanding) reached the nominal value of CZK 571.38 bln by the end of 2004. The share of short-term marketable debt (i.e. debt payable up to one year) dropped to 25.82%. At the same time, the share of T-bills in the marketable debt dropped to 21.97%. Modified duration of marketable debt reached 4.08 years including derivative operations; realized derivatives not included, this criterion would be lower by 209 days (i.e. cca 0.6 years).

The total state debt had a nominal value of CZK 592.9 bln.

The short-term state debt dropped to the level of 25.02% (while the share of T-bills in the total debt dropped to 21.17%). The active management of debt portfolio made possible to achieve the bottom level of announced medium-term target for short-term debt in accordance with the MF Issuance

Strategy for 2004 from December 9, 2003. It means that the refinancing risk of the debt portfolio has been significantly reduced as a result of the issuance policy.

The total share of the fixed-rate short-term state debt and of variable-rate state debt made 26.95% including the effect of interest rate derivatives (the interest rate re-fixing). The share of variable-rate state debt has grown to 3.5% because of further drawing of non-marketable loans from the European Investment Bank.

The modified duration of state debt including derivative operations reached 3.95 years. Its increase in the fourth quarter was caused by reduction of the amount of T-bills outstanding by CZK 21 billion and by the significant downward shift of the yield curve. Ministry of Finance hit the yearly duration target band 3.3 - 4.3 years (see the MF Issuance Strategy for 2004 from 9 December 2003). In comparison with previous years, the debt portfolio is much better insulated against interest-rate shocks.

Average life of state debt - the new strategic benchmark from 2005.

The Ministry of Finance announced for the first time the target of 5.5 to 6.5 years for the average time to maturity of state debt (average life) that should be achieved by the end of 2005 (see the Financing and Debt Management Strategy for 2005). It is another measure used for refinancing risk management. Its increase implies lower risk.

Key instruments to ensure cuts in fiscal deficit and reach the mentioned target consist in imposition of binding medium-term expenditure frameworks, which will limit the state budget's and state funds' spending within the horizon of three years and make it possible to get control over development of spending. Expenditure ceilings and rules based on medium-term decision-making will result in improved specification of spending priorities and thus also better efficiency of budget allocation. These changes have been taken into account in an amendment to the organic budget law, effective from September 2004.

Developments of the main macroeconomic indicators of the Czech economy and their forecasts are summed up as follows:

Main Macroeconomic Indicators

		2000	2001	2002	2003	2004 Estimate	2005 Forecast	2004 Previous Forecast	2005 Previous Forecast
Gross domestic product	increase in %, const.pr.	3,9	2,6	1,5	3,7	3,8	3,8	3,8	3,6
Consumption of households	increase in %, const.pr.	2,9	2,6	2,8	4,9	2,5	2,8	3,6	3,4
Consumption of government	increase in %, const.pr.	0,2	3,8	4,5	4,2	-2,2	3,1	-1,2	-0,2
Gross fixed capital formation	increase in %, const.pr.	4,9	5,4	3,4	4,8	9,4	7,5	9,3	7,0
GDP deflator	increase in per cent	1,4	4,9	2,8	1,9	4,1	3,0	4,0	3,1
Average inflation rate	per cent	3,9	4,7	1,8	0,1	2,8	2,8	2,9	3,3
Employment (LFS)	increase in per cent	-0,7	0,4	(0,8)	-0,7	-0,7	-0,2	-1,0	-0,3
Reg. unemployment rate (MoL)	average in per cent	9,0	8,5	9,2	9,9	10,2	10,1	10,3	10,3
Wage bill	increase in %, curr.pr.	2,6	6,9	8,5	5,6	4,8	6,3	5,3	6,2
Current account / GDP	per cent	-4,9	-5,4	-5,6	-6,2	-5,8	-5,9	-6,0	-5,7

(Data on growth of employment for 2002 are given in brackets due to methodology change in Labour Force Survey.)

For seven consecutive quarters, the Czech economy's growth has been exceeding three per cent limit. At the same time, the Czech economy has been gradually catching up with the neighbouring advanced countries. In the third quarter of 2004 the Czech economy slowed a little. Quarter-to-quarter growth of seasonally adjusted GDP slowed from 1.0% in the second quarter to 0.8% in the third quarter according to CSO estimates. Growth continued to be pulled by investment and goods exports. Pace of growth of household consumption slackened.

In short-term outlook, positive effects of the Czech Republic joining the EU will be seen. Both a high dynamic of investment and vigorous growth of exports and imports are expected. At the same time, pace of growth of household consumption should stabilize. Due to economical behaviour, government consumption should have downward tendency with purchase of supersonics for the Czech army having one-off effects in the second and third quarters. This item will be seen in the same period in imports of goods and thus will have no effect on GDP growth. Year-on-year increase of GDP in constant prices reached 3.6% (compared with estimate of 3.9% in October forecast) in the third quarter. For 2005 growth of GDP is expected to keep slightly above the pace of growth of potential product. For both years 2004 and 2005 year-on-year increase of GDP is estimated at 3.8% (unchanged in 2004; 3.6% in 2005). Year-on-year growth of expenditures on final consumption of households slowed to 2.1% (3.4%) in the third quarter of 2004. Household spending was driven mainly by development of real wages. At the same time, low interest rates boosted tendencies to buy own housing, withdrawing part of the household disposable incomes. Final consumption of households is estimated to have increased by 2.5% (3.6%) in 2004. In 2005 growth of household consumption should accelerate to 2.8% (3.4%).

Government consumption fell by 5.5% (fall by 1.0%) in the third quarter of 2004. Year-on-year fall for 2004 is estimated at 2.2% (fall by 1.2%). Public finance reform is expected to lead to economical behaviour of government institutions in terms of both employment and purchase of goods and services. Nevertheless, due to the mentioned purchase of supersonics, government consumption is expected to grow 3.1% (fall by 0.2%) in 2005. Volume of gross fixed capital formation grew in the third quarter of 2004 in year-on-year terms by as much as 9.7% (8.0%). Total increase in 2004 is estimated at 9.4% (9.3%). In the years to come, high pace of growth is expected to keep up mainly due to inflow of foreign direct investments and improving financial situation of the business sphere. At the same time, foreign owners in the CR are assumed to reinvest a substantial part of profits. An increase by 7.5% (7.0%) is predicted for 2005. Certain risks for maintenance of positive development of economic output are seen in public finance whose equilibrium should be ensured by reform. Price development of oil or possibly also metals is another risk.

Prices of goods and services

After more than two years of relative stability, consumer price levels have started growing slightly again in 2004. Average rate of inflation reached 2.8% (2.9%) in 2004. December year-on-year increase was also 2.8% (3.4%) with administrative price measures contributing by 1.7 p.p. (unchanged). The change in trend was caused by many cost-related factors. An impact of increases in indirect taxation and harmonization tax adjustments connected with EU accession was an accelerating factor of consumer price growth in early 2004. Contribution of administrative measures to year-on-year price growth was higher in 2004 than in 2003 by 1.4 p.p. in total. Also price movements on the world and domestic commodity markets of raw materials and products had a significant impact.

Growth of prices of domestic agriculture producers, initiated as soon as in 2003, reflected with some delay in growth of some foodstuff prices still over the third quarter of 2004. Growth of prices on world oil and metal commodity markets generated cost pressure on growth of industrial producer prices practically all the year round. Impact of growth of dollar oil prices (on average USD 38.3 per barrel of Brent oil in 2004, which is 32.8% more than in 2003) outweighed, in the end, impact of the exchange rate of the Czech crown against the dollar (an average year-on-year appreciation by 9.8%), reflecting in growth of fuel and transport prices. With influence of harmonization adjustments from the previous year abating, no acceleration of year-on-year price growth and increase in average rate of inflation is expected in 2005. Average rate of inflation is estimated within an interval centred at 2.8% (3.3%) with contribution of administrative price measures at 0.9 p.p. (0.8 p.p.).

In the following years, impact of administrative measures will be less important depending on time of validity of exceptions agreed on under the accession negotiations with the EU and gradual completion of liberalization of prices on energy markets. Implicit GDP deflator should grow by 3.7% (3.5%) in 2004 and some 3.2% (3.3%) in 2005.

Labour market and households

Dynamic economic growth, exceeding three per cent level since early 2003, has not resulted in an improvement of labour market situation so far. Up to now, it has been accompanied by year-on-year fall in employment and growth of unemployment. In the third quarter of 2004 it was for the first time when seasonally adjusted data showed a very moderate decline in unemployment and growth of total employment. We believe however that this development reflects – with a certain delay –a shift in the economy's cyclical position while structural problems still persist, which is documented on ongoing fall in rate of participation and growth of number of economically non-active people.

Employment

Employment is estimated to have fallen by 0.7% (1.0%) in 2004. Ongoing year-on-year decline in employment (0.2% in the third quarter) with dynamic economic growth stems from two principal causes2. First, businesses prefer high-quality minimum employment and struggle for further growth of productivity and, second, some segments of population are passive and difficult to be employed. Due to an increase in not only minimum wage but also in subsistence level from 1 January 2005, no change in behaviour of risk categories can be expected without taking supplementary measures.

Ongoing shrinkage of employment in manufacturing industry and reduction in number of employees in public administration, army forces and education had the most substantial impact on fall in employment. Biggest increases were observed in transport and storing, and education. In the third quarter a moderate increase of employees was seen while number of members of production cooperatives and entrepreneurs continued falling. Although shrinkage of workforce in essence stopped in the third quarter, number of persons in productive age was still growing and rate of economic activity thus further decreased.

Fall in employment is expected to slow to 0.2% (0.3%) in 2005.

Unemployment[3]

Rate of registered unemployment reached on average 10.2% (10.3%) in 2004 with a December value of 10.3% (10.4%). Seasonally adjusted data reached historic maximum of 10.4% in March 2004 while subsequent decline stopped at 10.0% in October. Our forecast is therefore cautious. Changes in registered unemployment were affected as by employment developments as by administrative measures – in particular, programmes of active employment policy (AEP, mainly intensified assistance to school-leavers and persons endangered with loss of working habits) and an amendment to the Employment Act. Number and share of the long-term unemployed is still growing in year-on-year terms. However, due to AEP measures (in particular in the most problem regions), an overall tendency toward fall in their number can be seen in the second half. Nevertheless their increase especially in the age category of 20 – 29 years still warns. Number of the registered unemployed is expected to fall slightly in 2005. Effects of economic growth and AEP should outweigh the structural deficiencies of the labour market. However, it will be necessary to pay maximum attention to adjustment of social benefit system aimed at boosting motivation to work to the utmost degree. Regional differences in rate of unemployment should persist due mainly to qualification discrepancy in supply and demand for labour force in problem regions. Due to differentiated support of creating new jobs and employment

offices' active approach, differences should not nevertheless increase. Consequently, a slight fall of rate of unemployment to a December value of 10.2% (unchanged) is expected in 2005 with an average value of 10.1% (10.3%).

Households[4] (National accounts methodology)

Growth of average wages in the business sphere is in principle continuous in dependence of the firms' economic situation. However, changes in a structure of salaries and marked cuts in extra items in the budgetary sphere resulted in considerable fluctuations of the average wage in the non-business sphere during the year. Slowdown in wage bill growth within the national accounts reflects ongoing reduction of number of employees affecting also higher salary categories in 2004. Social benefit bill grew more slowly in year-on-year terms, due mainly to lower indexation of pensions in spite of resumed growth of disability and early retirements. Health insurance benefits have fallen significantly in year-on-year terms. It is mainly low interests on deposits that motivate households to higher consumption. Under recalculated data, gross saving rate goes on falling in year-on-year terms. Nominal increase in wage and salary bill for 2004 probably reached 4.8% (5.3%) and it is estimated at 6.3% (6.2%) for 2005. Growth of social benefit bill for 2004 and 2005 is estimated at 3.7% (4.2%) and 5.5% (6.0%), respectively.

Savings and investments

Since mid-1998 a monotonous fall of ratio of gross national savings to GDP could be observed from nearly 27% to 21.1% in 2003. This unfavourable phenomenon stopped in 2004 due to increased formation of savings in government sector and non-financial institutions. As regards share of individual sectors in current account deficit (considering the difference between savings and investments), efforts to stop worsening of the government sector financial balance were successful thanks to the general government measures. The current high dynamics of investment in the non-financial sector should abate in the next period and bring no risk in terms of external imbalance.

Demographic trends[5]

In terms of workforce resources, the current demographic structure is obviously the most favourable over the entire history backed up with demographic data. Under the Czech Statistical Office´s projection, share of population in the age group of 20-59 should reach the record level in 2005. This category includes numerically strong age groups born immediately after the World War II as well as strong generations of the seventies and eighties. On the other hand, numbers of young people are falling and numbers of 60-plus seniors are increasing. From the dynamic point of view, we witness a beginning of population-ageing process. Share of young-age categories will go on reducing. It results from the past and present extremely low birth rates related not only with a change in lifestyle but also with a very poor availability of housing for young families. On the other hand, number and share of seniors in population will grow thanks to demographic structure and extending average life expectancy. Unfavourable development can be partly mediated by international migration with the Czech Republic becoming the target country. Demography represents a risk for the economy's developments in the medium and long run.

To mediate the unfavourable effects of population ageing, parametric reform measures have been adopted. Preferential treatment of early retirements and disadvantaged treatment of delayed retirements were eliminated. Up to 2013, gradual extension of minimum retirement age is ensured. Under public finance reform, further changes were made – abolition of the temporarily reduced early retirements, indexation of pensions only to the extent set by the law etc. However, since late 2003 the number of old-age pensioners (especially in the early retirement category) has been increasing again.

Due to population ageing, deficit tendencies on the pension account will be deepening in the traditional pay-as-you-go system in the future. That's why a common commission of experts and representatives of parliamentary parties has been established to propose a rational and politically feasible solution of the pension reform.

Interest rates

In August 2004, the Czech National Bank set its policy rates as follows: 2T repo rate at 2.50%, discount rate at 1.50% and Lombard rate at 3.50%. In 2004 a gradual increase in inflation was seen, based mainly on tax changes, growth of world commodity prices and recovery of domestic, European and world economies. Similar rate of inflation, albeit without marked administrative interventions, is expected also in 2005. Yield curve of PRIBOR rates moved again to higher level after the past change in policy rates but fell a little in late 2004 and the difference between the longest and shortest rates reduced. Its positive slope along the whole curve thus persists signalling expectations of further increases in policy rates by financial markets but much more sedate than in the previous period. An average rate of PRIBOR 3M is estimated at 2.4% (unchanged) in 2004 and at 2.8% (2.7%) in 2005. Yield to maturity of 10-year governments bonds for convergence purposes[6], which is substantially influenced by the extent of state bond issues including eurobond issues, but mainly by bond trading on foreign markets, is estimated at 4.8% (unchanged) in 2004 and at 4.5% (5.3%, i.e. return to the last but one estimate). In the forecast period, client interest rates[7] will grow with certain time delay depending on potential increase in CNB policy rates and subsequent growth of inter-bank market rates. Average rates of demand deposits and one-day deposits of non-financial sectors are assumed to have reached 0.6% in 2004 and to reach the same level in 2005 (forecast lowered). Rates of fixed-maturity deposits reached on average some 2.0% over 2004 and will grow slightly in 2005, reaching 2.3%. Interest rates of loans to non-financial sector should reach 6.0% in 2004 and 6.2% (6.5%) in 2005.These are estimates under the new methodology and rate of uncertainty is a product of only a short-term experience.

Monitoring of Other Institutions' Forecasts

The Czech Ministry of Finance monitors macroeconomic forecasts of other institutions, engaged in forecasting of future developments of the Czech economy. Forecasts of 14 institutions are continuously monitored from publicly available data sources. Of these, 8 institutions are domestic (CNB, domestic banks and branches of foreign banks, investment companies) and others are foreign (European Commission, OECD, IMF, the Economist panel, foreign banks). The forecasts are summed up in the following table:

Consensual Forecast

|		*December 2004*			*January 2005*
		min.	*max.*	*consensus*	*forecast MoF*
Gross domestic product (2004)	*%, const.pr.*	3,3	4,4	3,8	3,8
Gross domestic product (2005)	*%, const.pr.*	3,4	4,5	4,0	3,8
Average inflation rate (2005)	*%*	2,4	3,2	2,8	2,8
Unemployment rate (2005)	*%, end of year*	9,3	10,0	9,7	10,2
Current account / GDP (2004)	*%*	-6,5	-5,4	-6,0	-5,8
Current account / GDP (2005)	*%*	-6,7	-4,0	-5,5	-5,9

Forecasts of GDP growth are in tune: 2005 should not bring any worsening compared with 2004. More than one third of institutions allows for the same values for both years while others provide for a very slight growth of dynamics.

Forecasts of average rate of inflation for 2005 are interestingly inconsistent. Czech institutions but one expects a moderate fall by some 0.2 p.p. compared with the previous year while foreign institutions expect, similarly as the MoF, stable inflation. Forecasts of rate of registered unemployment for 2005 agree that the situation will be more favourable than in the previous year. However, the MoF is by 0.5 p.p. more pessimistic than the consensus, which stems from the fact that the MoF forecast takes into account the December result, which was worse than expectations of other monitored institutions. As regards ratio of the current account of balance of payments to GDP for 2004 and 2005, an agreement prevails (exclusive of two institutions) that this indicator should improve by approximately 0.5 percentage points. By contrast, the MoF expects a slight worsening in 2005. But it is not quite clear to what extent the individual institutions have taken into account the expected import of military aircraft in 2005, significant in macroeconomic terms, which will worsen current account balance by some 0.6 p.p. of GDP.

Forecasts of GDP growth in c.p. for 2004
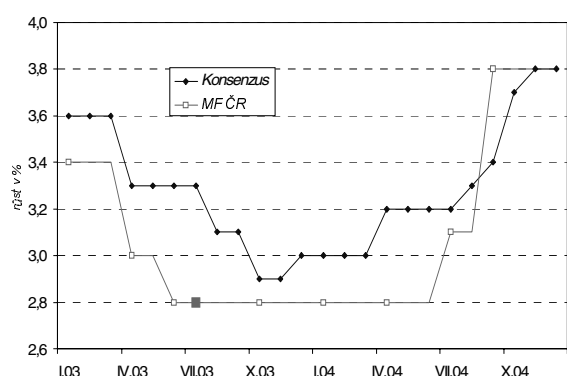
Forecasts of inflation rate. for 2004
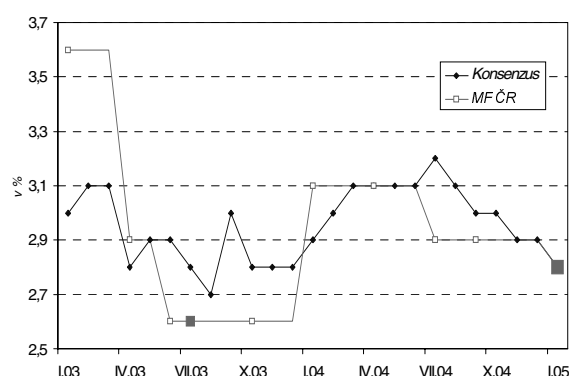
(Note : Periods on axis x express forecast releases. Highlighted symbol in the MoF forecast from June 2003 indicates the period of cut-off date in preparation of the Macroeconomic Framework of the 2004 State Budget. Besides, in the graph of inflation rate forecasts a final outcome, which was released in January 2005, is highlighted.)

2. Supply and Demand of Housing

At the central level, housing policy is in the jurisdiction of the Ministry for Regional Development. Some specific aspects of the housing policy are in the jurisdiction of the Ministry of Finance (regulation of rent and prices of heat, electric power, water, etc.) and the Ministry for Labour and Social Affairs (social allowances). The central government plays a key role through the establishing of the general legal and economic framework for housing. At the local level, housing is in the jurisdiction of individual municipalities (the Czech Republic has over six thousand municipalities); however, their role has not been defined in an unequivocal manner.

The Government's role is based on the notion that the state's role in the area of housing is using legal and economic instruments to create a situation where people are able to secure adequate housing, either by their own means or with the state's assistance. Such a model conforms fully to the market-oriented approach to housing used in all European Union Member States, and it allows people to exercise the right to housing which the Czech Republic has agreed to ensure under various international agreements. Thus, the basic objective of the state's housing policy is creating conditions under which every household is able to secure adequate housing corresponding to its needs and financial situation. Efforts are concentrated especially on improving the financial accessibility of

housing, increasing the availability of housing, and improving the quality of housing stock. Other plans the Government has in respect of housing include eliminating economic and legislative barriers which hinder the functioning of the market, improving the existing system of legal and economic intervention instruments with the aim of increasing their effectiveness and efficiency, emphasizing the role of private funds in the housing sector, reducing the role of the state, and increasing the responsibility of individual households for securing adequate housing.

While private individuals own 86% of permanently inhabited buildings, municipalities and the state are the proprietor of only approximately 5% and cooperatives of about 3% of such buildings. Private individuals own 97% of permanently inhabited family homes. Municipalities and the state owned in 2001 an important number of permanently occupied housing stock (approximately 29%). Private individuals own some 15% of permanently occupied housing stock. Most buildings are made of bricks and profilated bricks (60.8% of all permanently occupied buildings) as well as stone and brick (26.5%). However, wall panels are used in 34% of permanently inhabited buildings. Only 1.4% of permanently occupied buildings have no running water, and 25.8% have no district or central heating.

Construction of new housing takes place mainly in the sector of privately-owned dwellings, that is privately-owned family homes and condominiums in apartment buildings. The volume of construction of rental housing is relatively low; this form of housing is developed only by municipalities which construct rental housing with the state's support consisting of direct investment subsidies. There is almost no construction of cooperative housing. Revitalization of this sector is expected after the introduction of measures consisting of subsidies targeting construction of cooperative housing which were prepared by the Ministry for Regional Development and approved by the Government in October 2004.

Construction of privately-owned housing mostly relies on mortgage financing, construction savings plans, and loans. The volume of construction activity differs from region to region. The highest number of new houses are built in Prague, its vicinity, and areas characterized by an abundance of employment opportunities, high incomes, etc. In dynamically developing regions (Prague and some other cities), construction of new housing is fully comparable to the extent of construction activity in EU countries. As the purchasing power of the population increases, so does the price of new housing. In the past two years, the price of condominiums and family homes has increased in expectation of the fact that real estate prices would grow after the Czech Republic joins the European Union. However, the prices stopped increasing already in 2004, and the prices of some older dwellings, especially those in prefabricated-panel buildings, decreased considerably.

One problematic area is a relatively low volume of constructed rental housing (insufficient in respect of the needs of low- and middle-income households). Rental housing is built almost exclusively with government subsidies, since the private sector is not interested in this area, mainly due to the fact that rental housing entails a long period of return on investment in contrast to privately-owned dwellings. A negative role is also played by long-term rent control measures and unbalanced distribution of the rights enjoyed by landlords and tenants. Measures of support can be divided into two basic groups according to the financing method. The first group relies on special-purpose investment subsidies for construction of rental housing by municipalities and buildings where social services are provided; this form of support is not directly tied to financing from other sources. The second group includes support in the form of interest subsidies, loans, and repayable contributions, and it is directly related to loan financing. The second group also includes construction savings plans in cases where people use a construction savings loan or combine the use of construction savings with another type of loan.

New housing construction
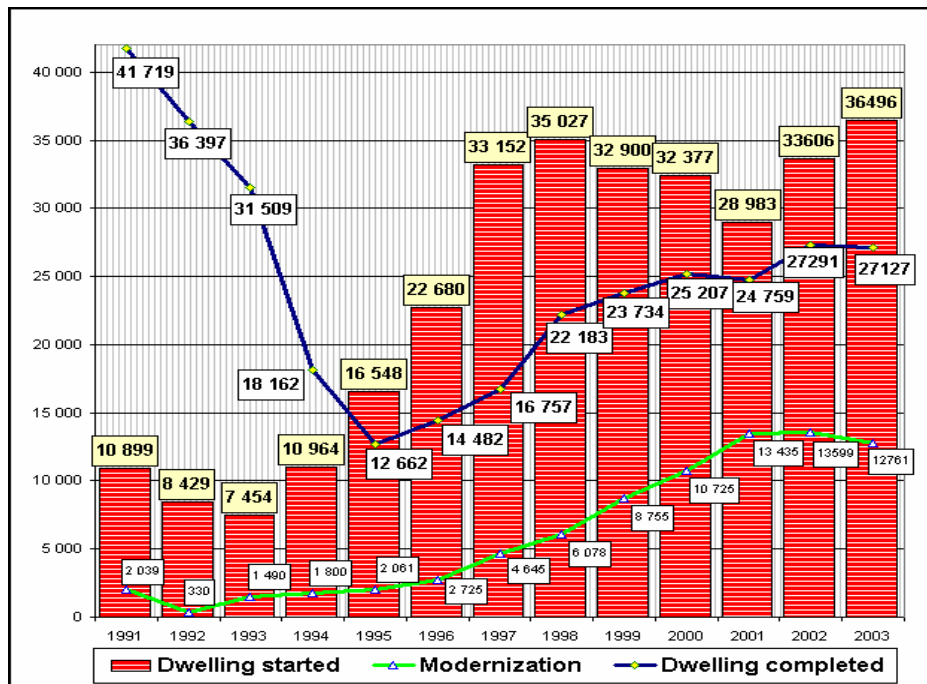
Assessing the effectiveness and efficiency of programs intended to support construction of new housing up to 2002 was very difficult, if not impossible. The main reason was the fact that instruments of support, as they were conceived, did not meet the usual requirements for program-based financing, preventing evaluation of their benefits. The problems which programmes aimed to resolve were not identified in an unequivocal manner, and individual programs did not have a clearly defined objective. In many cases, the target group at which support was aimed was not identified. In addition, programs lacked transparent and measurable criteria for assessing their economic and objective effectiveness. This approach resulted in a situation where assistance was almost always disbursed based on demand and not on clearly defined needs. These conditions understandably resulted in a high demand for subsidies. Effective allocation of public funds, however, should not rely on such indefinite parameters. For this reason, programmes changed fundamentally in 2003, their target groups were defined in a clear manner, and their use was made conditional on setting exact technical and financial parameters. The goal was to ensure as economical use of public funds as possible.

The above shortcomings of measures intended to support housing constructions were the product of the environment in which they were created and applied. Due to the fact that the transformation process has not been completed, the Czech economy is not functioning entirely as an established market economy. Individual market parameters (such as price) do not yet fulfil their economic role and do not provide sufficient information that would allow making effective decisions on the market. For example, the fact that the information function of rent (regulated in almost one third of housing stock through a maximum price) is reduced to an accounting category is detrimental to the effectiveness of expenditure programmess, regardless of how specifically the conditions for disbursement of assistance are conceived.

A social housing sector in the form usual in a number of Western European countries does not exist in the Czech Republic. Privatization, i.e. sale of dwellings to individuals/existing tenants, has been used with regard to municipal housing stock, formerly state-owned, which has been transferred to municipalities gratuitously at the beginning of 1990s. Deciding to privatize buildings and determining

for what price they are sold is in the jurisdiction of the elected representatives of individual municipalities. There is no "right to buy," and dwellings are usually sold for a low price, taking into account the fact that maintenance has been neglected in most buildings. The privatization process also applies to the cooperative sector where it encompasses cooperative dwellings built with state assistance in past decades. Considering the fact that the users of these cooperative dwellings have had to repay construction loans as part of rental payments, dwellings of this type are transferred without payment. In both cases, housing is privatized in accordance with the Act on Ownership of Dwellings (ownership of condominiums).

Overall, approximately CZK 25 billion is paid annually from the state budget and the budget of the State Housing Development Fund, a sum that corresponds to more than 1% of GDP. Combined with indirect subsidies, i.e. tax deductions and exemptions, state support translates to some 1.5% of the GDP. Public support includes expenditures of municipalities, especially funds spent on construction of rental housing and repairs of housing stock.

Housing expenditures burden households in an increasing manner. This trend is the result of deregulation and an unbalanced development of prices; a role has also been played by the decreasing of the average household size. Compared to 2003, household housing expenditures grew in 2004, affecting especially senior citizens and low-income households. An important part of housing expenditures is the cost of energy; for example, for households living in rental accommodation, energy-related expenses account for more than a half of all housing expenditures. In 2004, the proportion of housing expenditures and total net cash household expenditures totalled 18.4% in average households, 25.4% in household of senior citizens, and 23.7% in low-income households with children. Housing expenditures of these households totalled 17.2%, 25.3%, and 24.2%, respectively, of their net income. The proportion of housing expenditures paid by households inhabiting rental dwellings is slightly higher—20.2% for average households, 26.8% for households of senior citizens, and 28.9% for low-income households with children. In like manner, housing expenditures of these households totalled 19.4%, 28.9%, and 30% of their net income, respectively.

The development of housing construction costs in recent years and a regional comparison are shown in enclosed tables and graphs. The acquisition price of new dwellings range between some CZK 17,000 to 28,000 per square meter of efficient area of a dwelling. The acquisition price per one square meter of efficient area of a dwelling differs considerably, especially depending on the number of floors and structure of dwellings (and the corresponding cost of technical installations and facilities). Prices on the market differ substantially depending on the local supply and demand. For example, the price of an older dwelling in a large-panel prefabricated (30 years old) panel building in Prague totals approximately CZK 1,300,000, while the same apartment costs as little as CZK 160,000 in cities affected by high unemployment, low purchasing power, and low demand.

Housing stock structure

| | housing stock total | | of which | | | | | |
| | | | family houses | | apartment buildings | | others | |
	abs.	in %	abs.	in %	abs.	in %	abs.	in %
Buildings total	1 969 568	100,0	1 732 519	100,0	196 430	100,0	40 619	100,0
permanently inhabited	1 630 705	82,8	1 407 248	81,2	194 826	99,2	28 631	70,5
uninhabited	338 863	17,2	325 271	18,8	1 604	0,8	11 988	29,5
in uninhabited buildings-dwellings	353 296	x	331 708	x	9 000	x	12 588	x
Permanently inhabited buildings	1 630 705	100,0	1 407 248	100,0	194 826	100,0	28 631	100,0
Owner								
private natural person	1 397 923	85,7	1 362 175	96,8	28 703	14,7	7 045	24,6
municipality, state	79 066	4,8	12 335	0,9	55 506	28,5	11 225	39,2
housing cooperative	41 808	2,6	2 900	0,2	38 908	20,0	-	-
another	103 613	6,4	24 461	1,7	70 849	36,4	8 303	29,0
Period of construction								
1899 and earlier	135 218	8,3	118 141	8,4	12 161	6,2	4 916	17,2
1900 - 1945	446 041	27,4	398 460	28,3	40 226	20,6	7 355	25,7
1946 - 1970	354 229	21,7	285 860	20,3	64 389	33,0	3 980	13,9
1971 - 1990	500 795	30,7	431 592	30,7	64 303	33,0	4 900	17,1
1991 and later	171 092	10,5	154 936	11,0	11 448	5,9	4 708	16,4
Material of supporting walls								
bricks, breeze blocks	991 080	60,8	875 362	62,2	102 551	52,6	13 167	46,0
stone and bricks	432 181	26,5	400 149	28,4	22 257	11,4	9 775	34,1
wall panels	79 867	4,9	12 695	0,9	65 457	33,6	1 715	6,0
others	113 088	6,9	107 745	7,7	3 677	1,9	1 666	5,8
Water main								
in the house	1 594 743	97,8	1 373 784	97,6	194 598	99,9	26 361	92,1
outside the house	2 514	0,2	2 460	0,2	14	0,0	40	0,1
without a water main	22 271	1,4	21 936	1,6	73	0,0	262	0,9
Central heating								
remote or block boiler source	98 473	6,0	9 360	0,7	85 482	43,9	3 631	12,7
boiler room in the house	1 093 700	67,1	1 047 022	74,4	32 243	16,5	14 435	50,4
without distance and boiler	420 416	25,8	336 245	23,9	75 899	39,0	8 272	28,9

3. Housing Finance Market

Thanks to competition pressures from mortgage banks and low interest rates, mortgages are becoming a commonplace method of financing construction of family homes and condominiums. As to the value of monthly mortgage instalments paid by households and the overall volume of repaid funds, the most important factor are long-term interest rates on mortgages. Even though the base commercial interest rates have been declining steadily in the past two years, the number of households able to obtain a mortgage is limited, chiefly due to the high cost of new housing. Another restricting factor is the unwillingness of households to assume long-term debt. Nonetheless, the importance of this factor is decreasing, as the volume of loans is increasing overall—Czech families are less and less afraid of living on credit, and acquisition of items of long-term consumption is becoming a normal part of life, similarly as in Western countries. The credit standing of an applicant for a mortgage is usually considered sufficient if the applicant's family is left with a 1.8-2 times the subsistence minimum after mortgage instalments are subtracted from the household income—this sum corresponds to a net monthly income of CZK 20-30,000, depending on the household size. In this regard, debtor registries are becoming increasingly important; they register debtors and their credit habits, including payment of telephone bills, utility bills, etc.

Mortgage finance and housing saving schemes[8]

Both mortgage finance and housing savings schemes were introduced in the Czech Republic relative early, in the first half of 1990s. Following the decrease in nominal interest rates in the second half of

1990s and adjusting them by inflation and state subsidies (interest subsidy and tax relief on interest from housing loans) the sharp development in loan financing of home purchases has been expected at the end of 1990s and beginning of new century. However, though new loan products became more popular their use in practice developed much more gradually and slowly than it was previously expected.

The effectiveness and efficiency of housing savings schemes started to be questioned already several years ago but due to the gap in data no profound evaluation of the system has been done till now. According to the estimates of the Association of Housing Saving Banks, only about 30% of clients take the loan when they finish the saving part of the scheme. It is necessary to stress the fact that if a client does not ask for the additional loan at the end of the saving period he/she can use savings for different purposes, i.e., also other than housing. However, they do not loose the right for generous state premiums distributed on their saving accounts each year. Housing purpose is asked only when the loan is extended. There is thus guarantee that only 30% of clients of banks will use the state subsidy for housing and there is no information about the rest of them to check for efficiency of the whole system.

In co-operation with the private company Ronney&Benett, the special questionnaire survey New housing 2003 has been conducted by the Institute of Sociology on the sample of respondents buying new dwellings in Prague in 2003 (N = 138). Two development projects have been selected, one being labelled as „standard" and one as „luxurious" in relation to their location, size and quality of furnishment. As the result figures shows, the majority of respondents financed purchases of their new homes from several distinctive resources (82.5%) and only 17.5% of respondents exclusively from one source (mainly own savings). The ranking of financial sources to purchase new homes according to their share on total values of new dwellings was still dominated by own savings (38.5% of dwelling value in average), followed by mortgage loans (32.8% of dwelling value), housing savings (including loans from housing saving schemes, 8.9% of dwelling value) and gifts from relatives (8.8% of dwelling value). More than 55% of costs were still covered from own savings or family financial help and only one third of costs were, in average, covered by mortgage loans. Moreover, housing savings did not form the substantial part in the total sum at all, which is, in context of high state subsidy expenditures, at least unbalanced. However, these were flats relatively very expansive and in the most expensive town of the country. The share of housing savings on total sum of financial sources used for the dwelling purchase may be more substantial when buying older dwellings and, especially, in regions with relatively low average house prices (region of the North Bohemia).

There was another very interesting finding from this survey. The financing of purchase through own savings or family help is more characteristic for dwellings sold from luxurious project than those from standard project. This is also the reason why the average share of mortgage loan on total sum of finance used for purchases of dwellings from luxurious project is much lower than the same share in case of standard project (28.4% versus 42.5%). The same applies when we look at simple frequentations, i.e., the number of respondents taking the mortgage loan with no regard to its amount. Only 46% of respondents from luxurious project used mortgage loan at all while this was more than 65% of respondents from a standard development project. As respondents buying the properties from luxurious development project are of higher income the hypothesis occurred that the correlation between income and probability of taking the mortgage loan is not a linear one. However, it was confirmed that there is statistically significant linear relation between income and using of mortgage finance and the only factor influencing the divergence is higher family help in case of luxurious flats. This finding just shows that even when quite expensive dwellings are bought the mortgage loans are not more present as primal financial source than in case of less expensive dwellings and, in fact, the opposite may be true. This is mainly caused by an inherited inter-generation family help cultural

pattern and the mortgage loan may still be perceived as the last alternative used only when family help is not available.

There is a statistically significant relationship between the use of mortgage loan and future mobility aspirations. Those who used the mortgage loans for current purchases (both from luxurious and standard development projects) wanted statistically less to move from this new flat and/or use another mortgage loan for future purchases than those who did not use it. Among potential clients of mortgage industry in the future are thus especially those who do not have any mortgage loan now. This may be quite important though the interpretation of this fact cannot be confirmed by an additional data analysis. However, we think that this situation is mainly caused by the constraints present in the mortgage finance system.

In the questionnaire survey Housing Attitudes 2001 conducted on national representative sample of respondents in 2001 (N = 3,564) the Institute of Sociology asked respondents about the past and future mobility as well as about the financial sources used to cover the purchase price and transaction costs. Among those, who have moved since 1995 till 2001 to home-ownership from different tenures (n = 469) only 6.9% mentioned mortgage loan as the primary source to finance the costs of purchase and 19% mentioned the housing savings schemes. More than 36% of respondents selected own savings as the main source and 21% as family help (financial help or heritage). For those intending to move during the next three years to owner-occupied dwelling with no regard to current tenure (2001-2004, n = 232) the figures for market-based housing finance are more optimistic but still remain relatively low when compared with some other European countries: 14% of those intending to move mentioned the mortgage loan and 31% housing savings as the primary source while the role of own savings decreased to 20% and family help (gifts and heritage) to 13%. However, it is necessary to mention, that the survey did not ask about the potential loan volumes that could remain relatively low. As demonstrated by results from the survey New Housing 2003, 52% of buyers took the mortgage loan but these covered, on average, only 33% of a value of dwelling. The conclusion may be drawn that though there was not very common use of market-based housing finance in the second part of 1990s and beginning of a new century, there are good prospects for these finance products in the future. However, even in the future the development will be probably again rather gradual then sharp. When we look at the real interest rates on mortgage loans offered by mortgage lenders adjusted for subsidy and inflation we must definitely conclude that though „it goes well it goes very very slowly." This is conclusion relatively known from other transitional countries too.

It is often stated that mortgage loans are not affordable for major part of population. According to the Housing Attitudes 2001 survey, slightly more than 4% of respondents had had a mortgage loan in the past or had the mortgage loan in 2001. Another 8% of respondents would like to use it in the future and almost 78% do not think they will use it anytime in the future. The reply to this question is naturally very strongly correlated with the household income.

Mortgage loans in total (as of June, 2004)

| Loans for:	Private individuals		Enterprises		Municipalities		Total	
	Total number of loans	Total principal (CZK thousand)	Total number of loans	Total principal (CZK thousand)	Total number of loans	Total principal (CZK thousand)	Total number of loans	Total principal (CZK thousand)
to 31.12.2000	29 560	28 963 045	1 978	26 330 447	372	3 130 608	31 910	58 424 101
from January to March 2001	2 656	2 788 436	70	895 710	41	387 600	2 767	4 071 746
to 31.3.2001	32 216	31 751 481	2 048	27 226 157	413	3 518 208	34 677	62 495 847
from January to June 2001	5 774	6 032 421	180	2 797 232	75	643 687	6 029	9 473 340
to 30.6.2001	35 334	34 995 466	2 158	29 127 679	447	3 774 295	37 939	67 897 441
from January to September 2001	10 271	10 610 934	358	7 538 730	93	846 071	10 722	18 995 735
to 30.9.2001	39 831	39 573 979	2 336	33 869 177	465	3 976 679	42 632	77 419 835
from January to December 2001	14 250	14 728 423	457	8 922 337	130	1 159 589	14 837	24 810 349
to 31.12.2001	43 810	43 691 468	2 435	35 252 784	502	4 290 197	46 747	83 234 450
from January to March 2002	4 064	4 431 033	80	443 243	28	326 640	4 172	5 200 915
to 31.3.2002	47 874	48 122 501	2 515	35 696 027	530	4 616 837	50 919	88 435 365
from January to June 2002	9 322	10 010 300	201	3 170 838	54	711 897	9 577	13 893 036
to 30.6.2002	53 132	53 701 768	2 636	38 423 622	556	5 002 094	56 324	97 127 486
from January to September 2002	14 795	15 766 142	303	4 582 225	87	1 014 822	15 185	21 363 189
to 30.9.2002	58 605	59 457 610	2 738	39 835 009	589	5 305 019	61 932	104 597 639
from January to December 2002	21 002	22 532 310	430	6 543 409	113	1 234 448	21 545	30 310 167
to 31.12.2002	64 812	66 223 778	2 865	41 796 193	615	5 524 645	68 292	113 544 616
from January to March 2003	6 318	6 990 597	141	1 287 009	17	338 273	6 476	8 615 879
to 31.3.2003	71 130	73 214 375	3 006	43 083 202	632	5 862 918	74 768	122 160 495
from January to June 2003	13 688	15 509 927	298	5 006 119	32	524 248	14 018	21 040 294
to 30.6.2003	78 500	81 733 705	3 163	46 802 312	647	6 048 893	82 310	134 584 910
from January to September 2003	22 476	25 799 295	452	7 550 099	49	665 688	22 977	34 015 082
to 30.9.2003	87 288	92 023 073	3 317	49 346 292	664	6 190 333	91 269	147 559 698
from January to December 2003	31 478	36 212 394	626	10 580 917	61	803 636	32 165	47 596 947
to 31.12.2003	96 290	102 436 172	3 491	52 377 110	676	6 328 281	100 457	161 141 563
from January to March 2004	8 826	10 779 150	132	2 619 915	16	157 886	8 974	13 556 951
to 31.3.2004	105 116	113 215 322	3 623	54 997 025	692	6 486 167	109 431	174 698 514
from January to June 2004	20 699	25 625 597	326	8 389 146	37	510 128	21 062	34 524 871
to 30.6.2004	116 989	128 061 769	3 817	60 766 256	713	6 838 409	121 519	195 666 434

(Source: Ministry for Regional Development)

The respondents were also asked whether the mortgage loans are affordable for them and their family: while we expected that those who have already used it or currently use it would reply that a loan is affordable for them, we posed this question only to those respondents who selected other alternatives. Surprisingly, only 37% of those who would like to use the mortgage loan in the future stated that it is affordable for them and, similarly, these were only 10% of those who do not think they will use it anytime in the future. By a subjective perception there were thus only 15% of respondents for which the mortgage loan seemed to be affordable in 2001. Though more "objective" measurement of affordability (by, for example, using bonity criteria of dominant lenders and comparing them with reported household income) would give us a more optimistic picture, the subjective perception is very important as it reflects the real attitudes of population towards this particular financial product. Such a reflection may include the adversity to long-term credit repayment commitment, lack of information about the mortgage financing and, of course, unwillingness to pay high share of income on housing costs and, due to that, reduce the consumption of other goods because of housing expenditures.

Another often mentioned reason is a specific cultural pattern based on family help expectations and an averse to long-term lending. The significance of family help expectations has been already confirmed by above mentioned figures and the averse to long-term lending may be clear when we look at the development in using of different market-based housing finance products. We might see from prospective financing of home purchase in the future that housing savings became more popular as primal source for acquiring of a new home than mortgage loans. The reason may be that the loan from housing saving bank is often only partial and presuppose some proceedings savings. Therefore, the

final credit due is not so high (also repayment period and repayment amount for typical loan from housing savings scheme is relatively low). If the loan amount was not high, the bank would not ask for mortgaging the property and buyers may perceive it as a more safe option because they do not risk loosing their house in the future. Though there was no special research on risk averse or mortgage financing perception among Czech population, it is highly probable that large part of population are still very afraid of long-term credit commitment and do not want to take a risk of loosing their homes in the future. Finally, rent regulation is very often stated as one of the reason why people prefer to use the „privileged" rental tenure than move to home-ownership and use market-based housing finance for this purpose. The rent regulation in the Czech Republic is relatively flat and deeply social unjust as described fully by many experts.

Housing savings
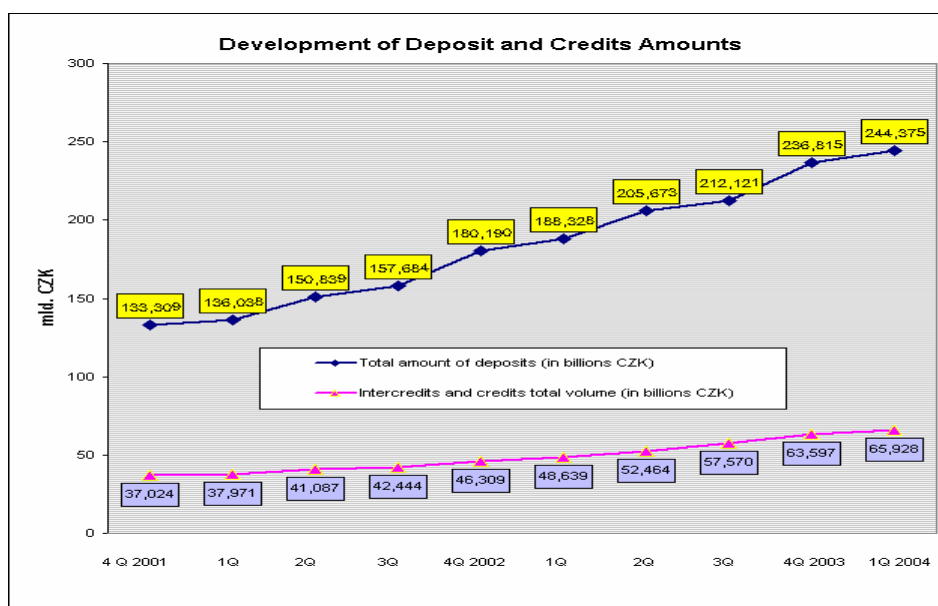
(Source: Association of Housing Savings Banks)

State subsidies to housing savings schemes and amount of housing loans from scheme (for all savings banks, in billions CZK)
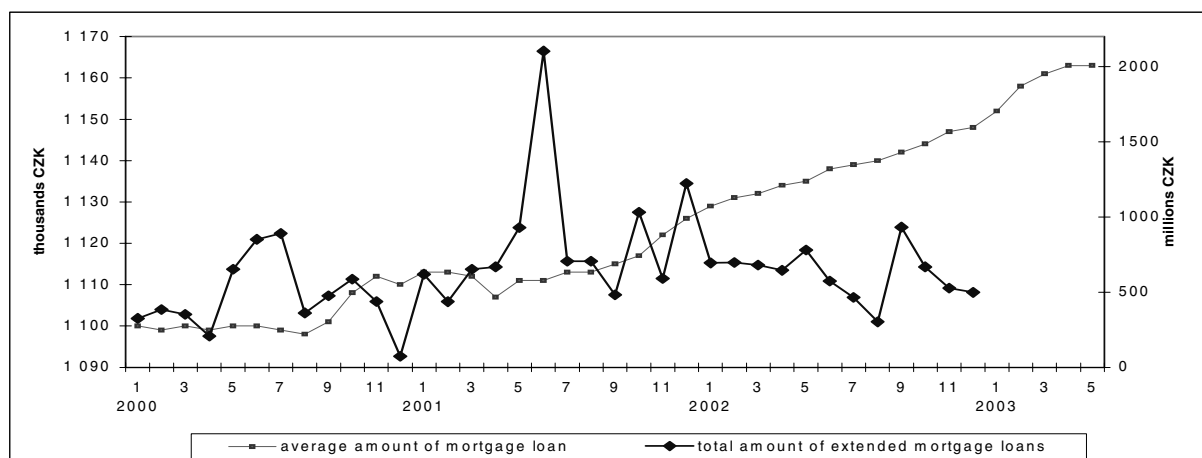
(Source: Czech Banking Association)

Average amount of mortgage loan with state support for physical persons (in thousands CZK) and total amount of extended mortgage credits with state support (in millions CZK) 2000 – 2003
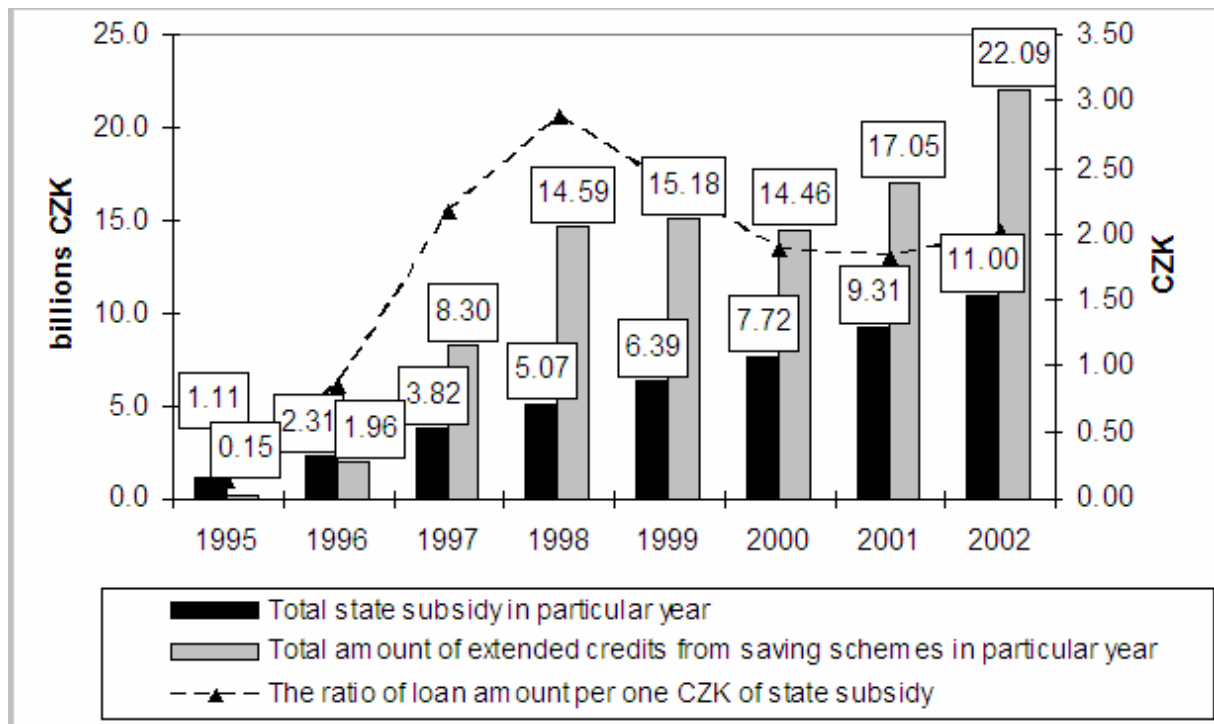
(Source: Association of Housing Savings Banks, own calculations.)
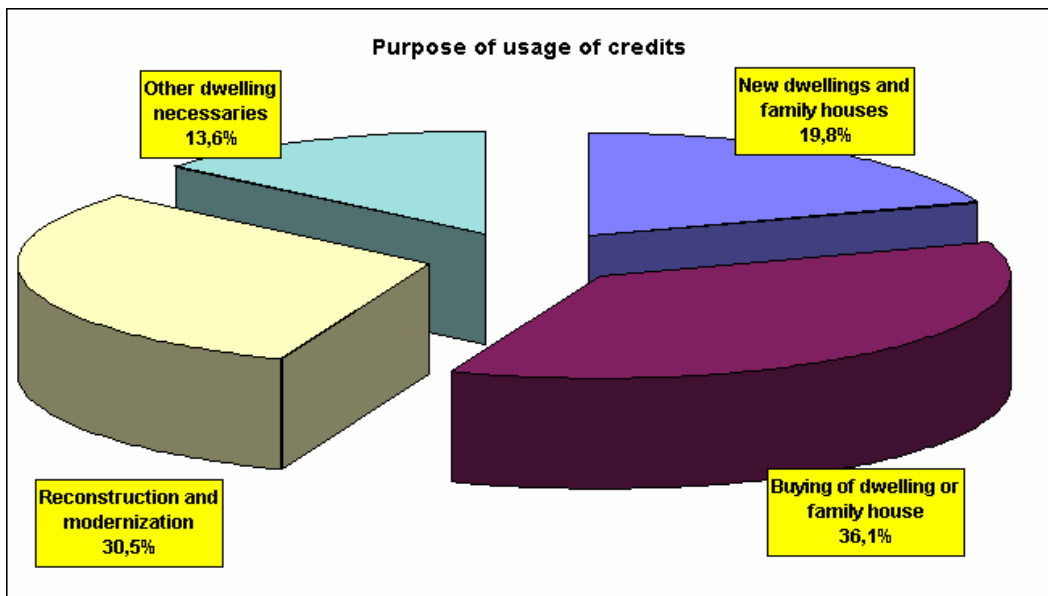
(Source: Czech Banking Association, Ministry for Regional Development)

4. Housing Policy

In March 2005, a new Housing Policy Concept was approved by the Government as a strategic governmental document with the mid-term period by the year 2010. The housing policy is affected by an underway reform of public finances and the resulting pressures to reduce mandatory expenditures. Housing expenditures are delimited by a mid-term framework of expenses which will apply to the budgets of both the Ministry for Regional Development and the State Housing Development Fund (the latter was created in the year 2000 and functions as another source of public funds in the area of housing in addition to the state budget). This measure will result in the consolidation of the ensemble of support instrument and elimination of fluctuations due to the setting of budget expenditures on a year-to-year basis. Disbursement of public funds will include regular assessment of the effectiveness, efficiency, and economic feasibility of individual expense programs.

At the beginning of 2003, two new programs intended to stimulate development of social rental housing were introduced. The first concerns so-called supported housing which is focused on disadvantaged and vulnerable individuals who face specified housing problems. The other targets households with average and below-average incomes. Both programs allow municipalities to build new rental housing for the specific target group of needy families; however, their social function will be temporarily weakened because both housing types will be unable to compete with rental housing where regulated rent is below cost.

It means that social housing leased for cost (non-profit) rent, which is common in advanced European countries, can be fully developed only after a certain transitional period. Only then, it will be possible to eliminate the exemption concerning application of the reduced VAT rate on all housing construction, and the reduced rate will be used only for social purposes, as is usual throughout the European Union. The temporary application of the reduced VAT rate (by the end of 2007) on housing construction is therefore part of the overall strategy of rectifying prices on the housing market.

The second transitional period, which the Czech Republic has negotiated with the European Union at the request of the Ministry for Regional Development, concerns acquisition of housing for secondary residential purposes. Since older real estate is less expensive in the Czech Republic than in neighboring countries, the transitional period is intended to prevent speculative acquisition of housing stock and land—taking advantage of the disproportionate costs—and ensure that such real estate is permanently used for the purpose for which it is intended. By the May 2009, foreigners will not be able to acquire real estate unless they establish residence or have long-term employment in the Czech Republic.

The sector of privately owned housing accounts for approximately 47% of housing stock. Home ownership is developing in a more dynamic manner than other sectors. Development of home ownership is supported by the state and includes construction of new housing, transfers of cooperative housing to private owners, and privatization of municipal housing by sale to existing tenants. Taking into account the income of most households, acquisition of a privately owned dwelling is very costly; however, due to the unresolved situation in the rental sector, even individuals with average and lower income are being forced to use this option. The objective of the government's support for home ownership is to improve its financial accessibility to potential users. The basic instrument of support are income tax deductions. Direct assistance consisting of interest subsidies and state soft loans is currently available to people below 36 years of age.

The existing cooperative sector, which mostly consists of buildings owned by former construction cooperatives, accounts for some 17% of housing stock and in the vast majority of cases functions with no considerable problems. Taking into account the legal ramifications of transferring membership

right and duties, membership in a housing cooperative is very similar to home ownership. At present, construction of cooperative housing is very low. Nonetheless, the government has approved a law based on which construction of cooperative housing will be stimulated through subsidies and low-interest loans starting in 2005.
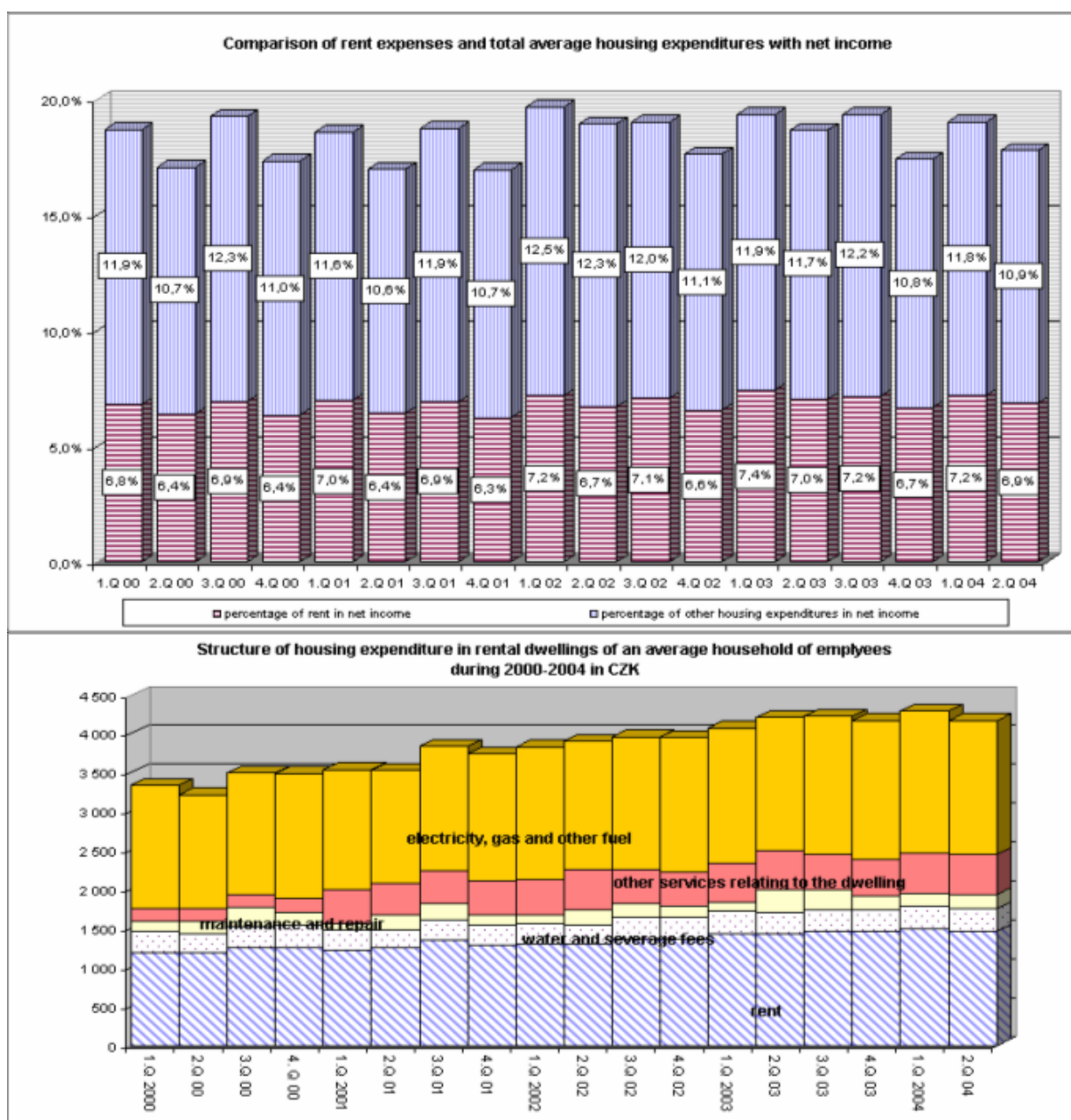
The sector which consists of privately owned rental housing accounts for only about 12% of housing stock. Its functioning is negatively affected by rent control measures and civil-law provisions pertaining to lease of dwellings. Save for exceptions, no construction is taking place in this sector, mostly because tenants enjoy strong legal protection and potential developers see greater opportunities in building privately owned dwellings where the return on invested funds is much faster. In the future, this sector is expected to provide housing mainly for people seeking a short-term solution to their housing situation or those who require high-quality accommodation with matching services. The functioning of this model will depend mainly on the selected rental policies. But, no law on rent regulation has been approved by the Parliament yet.

The sector of municipal rental housing accounts for some 17% of the housing market. Like in the preceding case, its functioning is also negatively affected by rent control measures and civil-law provisions pertaining to lease of dwellings. The role of this sector is unclear; depending on the strategy of individual municipalities and their rental policies, municipal housing is used for both social and entirely commercial purposes. Future development of this sector will depend on the selected rental policy and the success of creating a non-profit rental sector.

Matching the supply and demand on the housing market is one of the fundamental objectives of the housing policy. The increasing of supply is stimulated especially through subsidies for construction of rental housing offered to municipalities. In like manner, measures supporting repair and modernization of housing stock contribute to the increasing of supply of dwellings. As to demand, support includes mainly targeted social allowance, subsidized interest on mortgage loans, low-interest loans for acquisition of a privately-owned dwelling, and income tax deductions relating to the use of mortgage loans and similar financing methods.

State housing support (in million CZK)

	1996	1997	1998	1999	2000	2001	2002	2003	2004
	Reality	Reality	Reality	Reality	Reality	Reality	Reality	Reality	Approved budget
Subsidies for repair of housing stock (defects of prefab panel buildings)	123	240	240	420	533	218,5	283,5	286,599	220
Regeneration of panel building settlements	x	x	x	x	x	150	79,8	0	100
Subsidies for construction of new rental housing and technical infrastructure owened by municipalities	2 180	2 698	2 891	3 381	2 884	2 011	542,2	795,181	784,604
Subsidies for construction of supported housing	x	x	x	x	x	x	x	x	190
Subsidies to municipalities for repair and renovation of housing stock	275	240	300	300	300	0	0	0	0
Subsidies for construction of buildings with social services	700	600	670	471	578	575,7	584,2	46	0
Subsidies for replacement of lead plumbing	x	x	x	x	x	x	x	x	12,456
Aid for elimination of damage caused by floods, incl. hailstorm in 1999	x	1 207	368	227	27	0	1 532,9	1 609,337	0
from which subsidies to housing stock							35,2	53,640	
Interest-free government loan	x	270	796	1 450	329	0	0	0	0
Subsidies for mortgage loans	1	34	132	201	307	432,5	517,8	563,250	430
Ministry for Regional Development - total	**3 279**	**5 289**	**5 397**	**6 450**	**4 958**	**3 387,7**	**3 540,3**	**3 300,367**	**1 737,060**
SHDF - Rental housing and technical infrastructure	x	x	x	x	761	3 000		3 468	1493
SHDF - Construction of rented housing with community care services	x	x	x	x	0	960			
SHDF - construction of rental housing and rental housing with community care services for municipalities caused by floods								105,5	
SHDF - Program PANEL - Support to repairs of apartment buildings built by prefabricated slab technology	x	x	x	x				57,5	600
SHDF - Credits to municipalities and citizen on construction or acquisition of flats	x	x	x	x				225	600
SHDF - Credits to municipalities for repairing and modernization of flats	x	x	x	x				323	400
SHDF - other	x	x	x	x	0	125		24,2	170
State Housing Development Fund - total	**x**	**x**	**x**	**x**	**761**	**4 085**	**3 358,6**	**4 203,2**	**3 263**
Construction savings plans subsidies	2 309	3 817	5 068	6 393	7 719	9 313	11 059	13 261	15 200
Financing of comprehensive housing construction	50	35	x	x	x	x	x	x	x
Subsidies for housing construction by individuals and cooperatives	50	x	x	x	x	x	x	x	x
Material damage to banks	2 473	4 800	3 553	1 411	1 414	1 630	1 143	737	684
Ministry of Finance - total	**4 882**	**8 652**	**8 621**	**7 804**	**9 133**	**10 943**	**12 202**	**13 998**	**15 884**
Housing allowance	677	813	1 367	2 084	2 518	2 698	3 028	2 835	
Separate benefits:									
Heat subsidy (paid from 1 July 1997 to 30 June 2000)	x	67	277	236	106	0	0	0	
Rental subsidy (paid from 1 July 1997 to 31 December 2000)	x	49	163	127	73	6	0	0	
Social allowances earmarked for housing **Ministry of Labor and Social Affairs - total**	**677**	**929**	**1 807**	**2 447**	**2 697**	**2 704**	**3 028**	**2 835**	
MRD+SHDF+MF+MLSA	**8 838**	**14 870**	**15 825**	**16 701**	**17 549**	**21 120**	**22 129**	**24 337**	**20 884**
GDP (CZK billion), in 2004 - forecast	.	.	1 962,5	2 041,4	2 150,1	2 315,3	2 414,7	2 532,4	2 707
Percentage of GDP (in %)			**0,81**	**0,82**	**0,82**	**0,91**	**0,92**	**0,96**	**0,77**

Comparison of rent expenses and total average housing expenditures with net income

☐ percentage of rent in net income ☐ percentage of other housing expenditures in net income

Structure of housing expenditure in rental dwellings of an average household of emplyees during 2000-2004 in CZK

5. Future Development

Up to now, low inflation has been the main reason for low interest rates. Any increases of interest rates will depend chiefly on how economic problems are dealt with by foreign countries, the expected renewal of economic growth, and development of the inflation rate.

The prices of domestic real estate are expected to decline since the expectation factor ceased to exist after the Czech Republic joined the European Union. In the subsequent period, real estate prices are expected to stabilize; however, regional differences will become more pronounced.

It can be expected that developments relating to prices (increased VAT rate, real estate prices, possibly elimination of rent control) will result in higher housing-related expenditures paid by households. However, the impact of joining the European Union on housing is lessened thanks to temporary

exemptions negotiated by the Czech government which allow applying the reduced VAT rate on housing construction and restricting acquisition of real estate for secondary residential purposes by foreigners.

The anticipated development of the unemployment rate (approximately 10%) stems from economic pressures to increase work productivity which are likely to result in layoffs of workers who do not meet growing qualification demands.

There will be a further increase of the differences between people's income which is relatively low at present in comparison with Western European countries. This trend—which will be the result of an increasing number of jobs in positions with high qualification requirements and social allowances which will increase at a slower rate than earnings—will accelerate the process of social differentiation in the area of housing. As a result, disadvantaged groups of people may be driven outside the scope of the supporting instruments of the housing policy, a trend that will be accompanied by the deepening of their social and spatial segregation.

Although the Czech Republic does not have a shortage of housing on a national scale, the situation in individual regions and municipalities differs considerably. In general, in regions and municipalities where a sufficient number of employment opportunities exist, the demand for housing exceeds supply. The result is a higher cost of housing, which is inaccessible for lower-income households. Meeting the housing needs of such households is difficult. This situation exists especially in Prague, other large cities, and their vicinity, i.e. localities which offer ample employment opportunities. The opposite situation can be found in northern parts of the country which suffer from high unemployment due to structural changes. Demand for housing and housing prices are very low in such localities. This situation shows that there is a disparity between the availability of employment opportunities on the labour market and supply of housing.

In the mid-term, the current trends are expected to intensify, i.e. the differences in the income and housing needs of various groups of the population will continue to increase. The disparity between regions and individual municipalities will most likely gradually deepen, a trend that may be slowed down or stopped by a policy targeting development of affected regions, in particular measures aimed at increasing employment.

During the transitional period following the Czech Republic's accession to the European Union, which has been negotiated to last until 2007, housing-related construction work will remain subject to the reduced value added tax rate (at present 5%). As a result, construction of new housing as well as repair and modernization of housing stock will be less expensive then construction of commercial or production facilities. The fact that the reduced VAT rate will continue to apply to housing construction for a temporary period was therefore mainly due to social reasons, since increasing the value added tax would cause a sharp escalation of the cost of construction of new housing, reducing the accessibility of new and repairs of existing housing stock. During the transitional period, the real household income is expected to grow as a result of economic recovery thanks to which increasing the VAT after the end of the transitional period should not have an overly negative social impact. Nonetheless, construction work relating to social housing will continue to be subject to the reduced VAT rate even after the end of the transitional period.

As the economy grows, real incomes are expected to increase and the accessibility of housing will improve. Some of the negative consequences of the existing forms of rent control include an impossible-to-meet demand for rental housing in "regulated dwellings" which is due to the low amount of regulated rent and disproportionately high rents in dwellings released from rent control. In some Czech cities, contractual rent is several times higher than rent subject to regulatory measures is.

The unsurprising result of this "shortage" of housing is a large black market which will be eliminated only after the price deformations are gradually rectified. The situation concerning uneven rents has an overall negative impact on distribution of housing. Due to the facts described above, the correlation between household income and the housing type has been weakened. As a result, municipal housing stock, which is leased for regulated rent in most cases, is occupied by people from all income brackets, as opposed to being rented to low- and middle-income households, a practice which is customary in European Union Member States. Different prices in the rental sector provide ample space for black market activities which concern several thousands rental dwellings where tenants who pay regulated rent sublet their dwellings illicitly to other people—especially young families—depriving the government of several billion Czech crowns every year. Only after the deformations are rectified and the presently artificially divided rental market is unified, it will be possible to develop additional instruments of support, similar to those used by governments of advanced countries to control the situation in the housing sector. This applies especially to support for housing forms of social nature.

NOTES

1   Source: Ministry of Finance

2   Also effect of way of making surveys, which is however difficult to quantify, could be discussed as a contribution to fall in employment, especially after EU accession. Labour Force Survey covers only persons living in selected flats, i.e. does not cover collective lodging facilities. As a result, many foreign nationals legally working in the Czech Republic may not be included.

3   Over 2004, the Ministry of Labour and Social Affairs introduced a new methodology of calculation of registered unemployment rate. The forecast is based on time series under the original approach. New way of calculation does not change the economic substance of phenomenon or system of welfare benefit granting and as such will have no fundamental impact on the social transfer bill implied by the forecast of unemployment.

4   Statistics of the household sector was similarly as data on economic output influenced by harmonization of quarterly data with preliminary national accounts for 2003. The revision resulted in an increase of growth rate of nominal disposable income from 3.1% to 3.4%, household consumption from 4.2% to 5.1%, and lowering of savings rate from 9.0% to 8.5%. In first-half data for 2004, cuts in pace of growth of disposable income by some 1.5 p.p. (especially in the wage bill) with maintained dynamics of consumption also resulted in savings rate cut.

5   Based on the CSO demographic projection from late 2003.

6   The CNB harmonized the methodology of monitoring long-term interest rates so as to correspond to their reporting when meeting the respective Maastricht criterion.

7   Since January 2004, the CNB introduced a new methodology of monitoring the harmonized interest rates of monetary financial institutions against the clients under the ECB's binding instruction. A retrospective reconstruction of some data starts with January 2001. For the needs of analysis and follow-up forecast of client interest rates form the total volume of credits and deposits of non-financial sectors, our own calculation based on the CNB data was made. That's why an interruption can be seen in the following tables and graphs indicating the change in methodology.

8   Source: Martin Lux, Institute of Sociology of the Academy of Science, 2004

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