

Meeting with Analysts

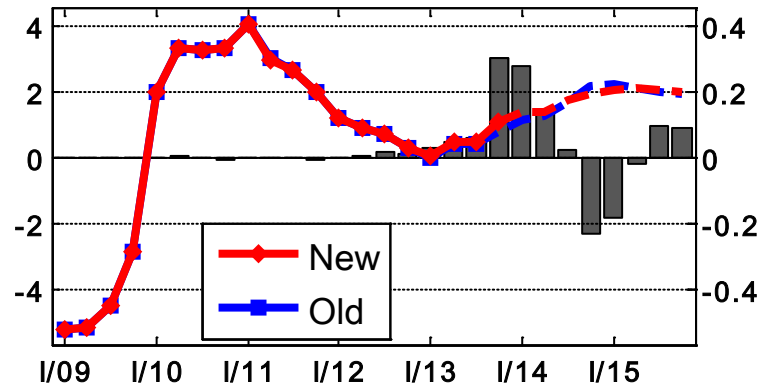
Tibor Hlédik

Prague, 12 May, 2014

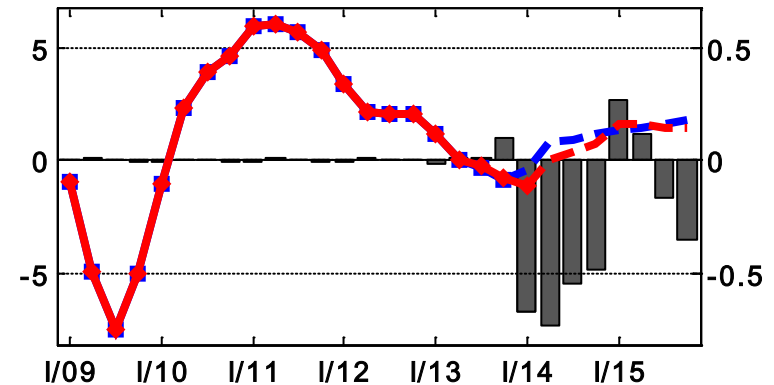
- Assumptions of the forecast
- The new macroeconomic forecast
- Comparison with the previous forecast

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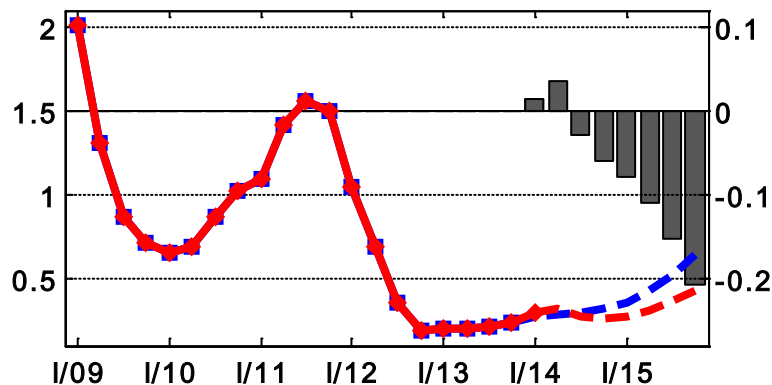
Growth Rate of GDP - Eurozone (y/y, in %)



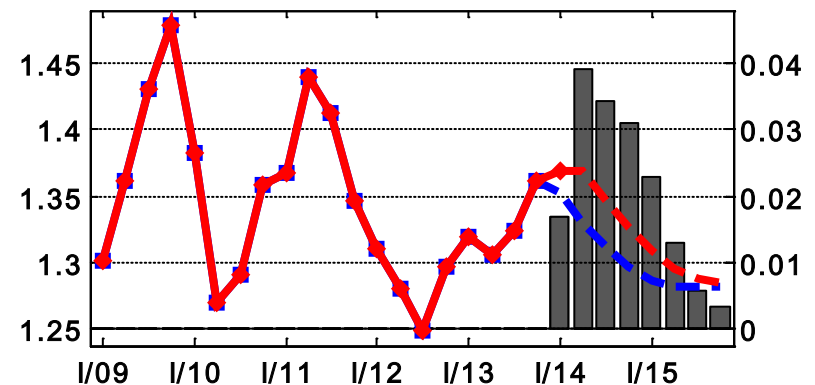
PPI Inflation - Eurozone (y/y, in %)



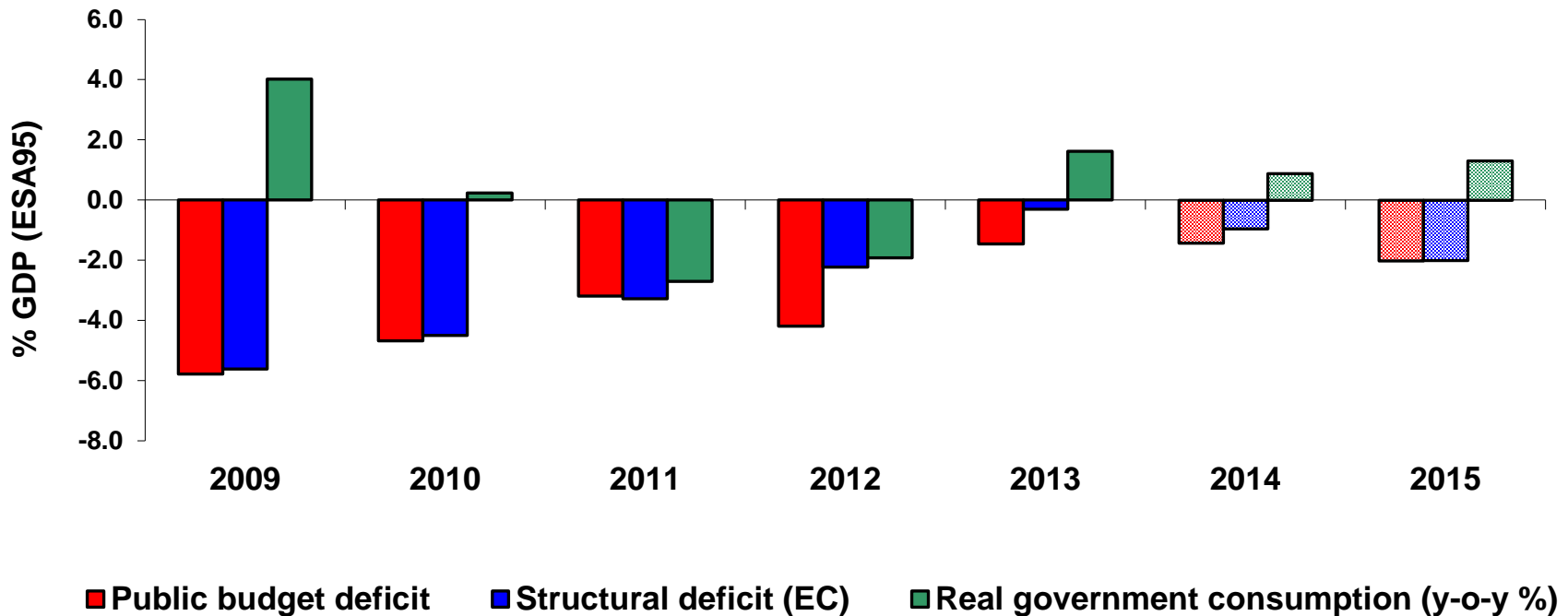
3M EURIBOR



USD/EUR



- The recovery of GDP growth in the effective EA will continue.
- PPI in the EA is currently falling, but it will return to subdued growth.
- Interest rates in the EA will remain low, the euro will gradually depreciate.



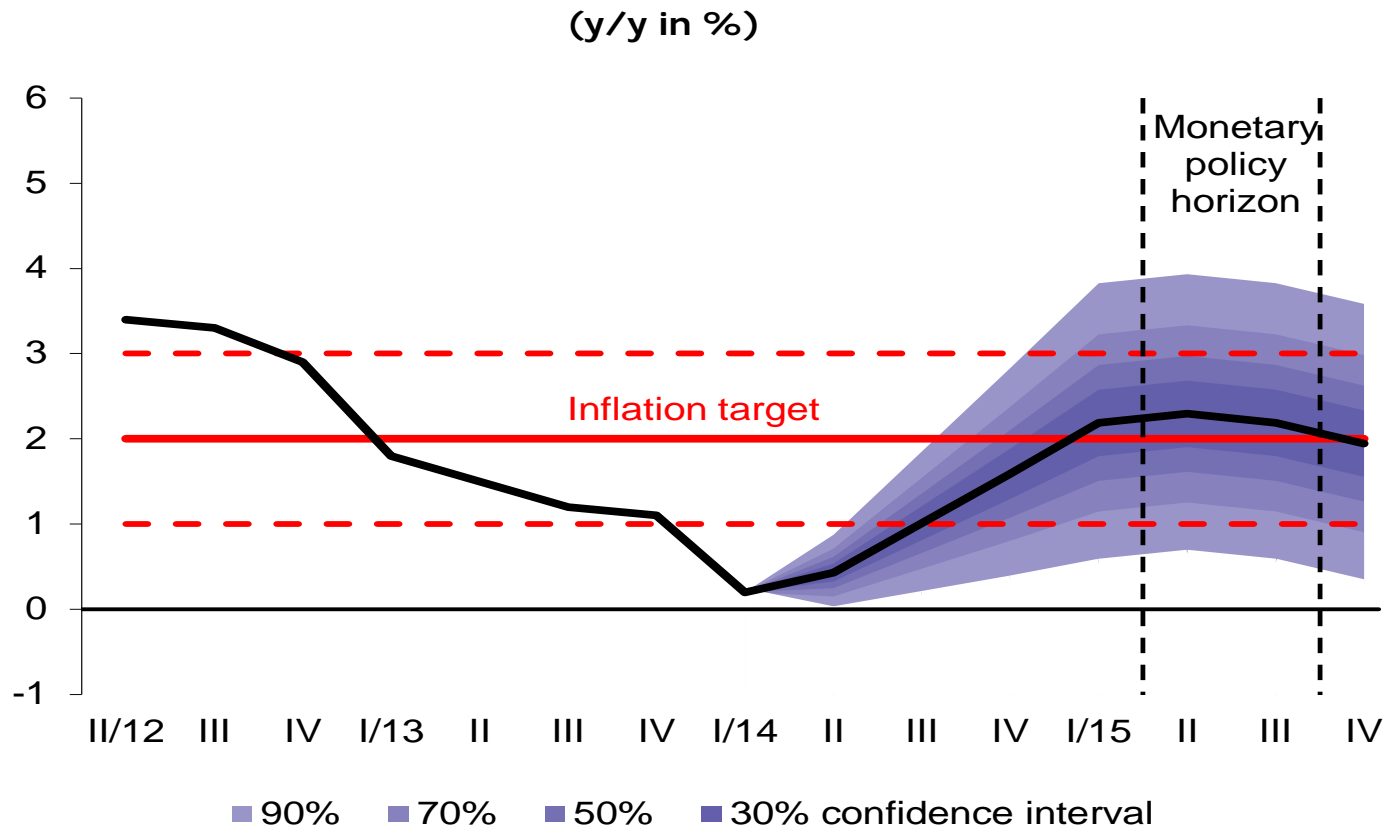
- The public deficit has declined to 1.5% of GDP in 2013 and will stay close to this level this year. Changes in direct taxes, social insurance contributions and strong public investment activity will lead to an increase of public deficit to 2% of GDP in 2015.
- Fiscal impulse -1.0 p.p. in 2013, +0.2 p.p in 2014, and +0.8 p.p. in 2015.
- Real government consumption will continue growing modestly.

- The forecast assumes that market interest rates will be flat at their current very low level (i.e. the sum of "technically zero" 2W repo rate and the money market premium) until the start of next year.
- The near term forecast for the exchange rate in 2.Q 2014 is set at 27.3 CZK/EUR.
- Afterwards, the exchange rate is assumed at 27 CZK/EUR (i.e. at the level of the CNB's exchange rate commitment) until the beginning of 2015.
- This level of the exchange rate continues to be appropriate, as it delivers the necessary monetary easing.
- At the forecast horizon, the return to conventional monetary policy will not imply appreciation of the exchange rate to the level recorded before the CNB started intervening.

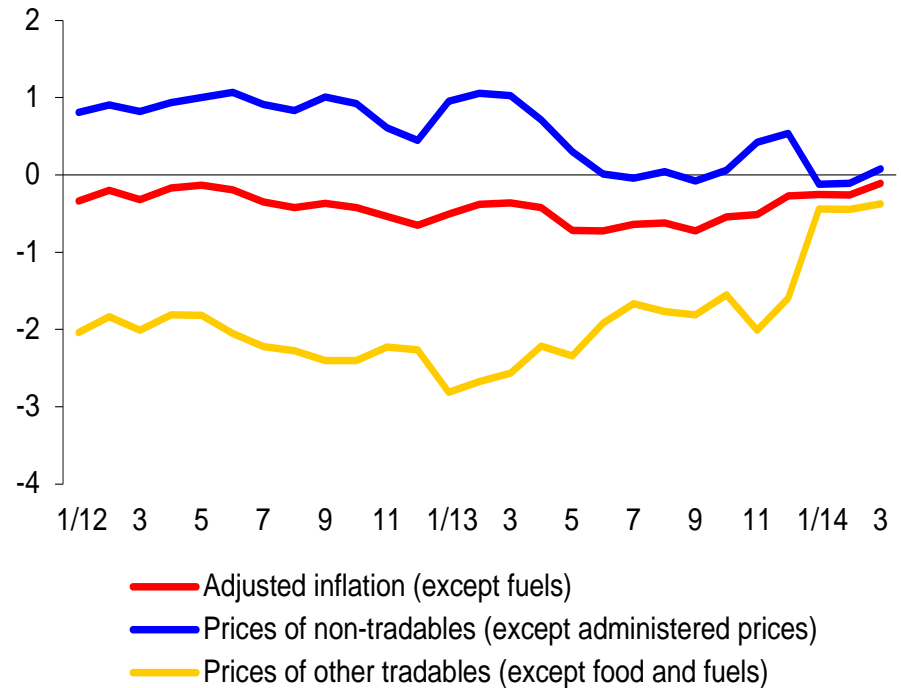
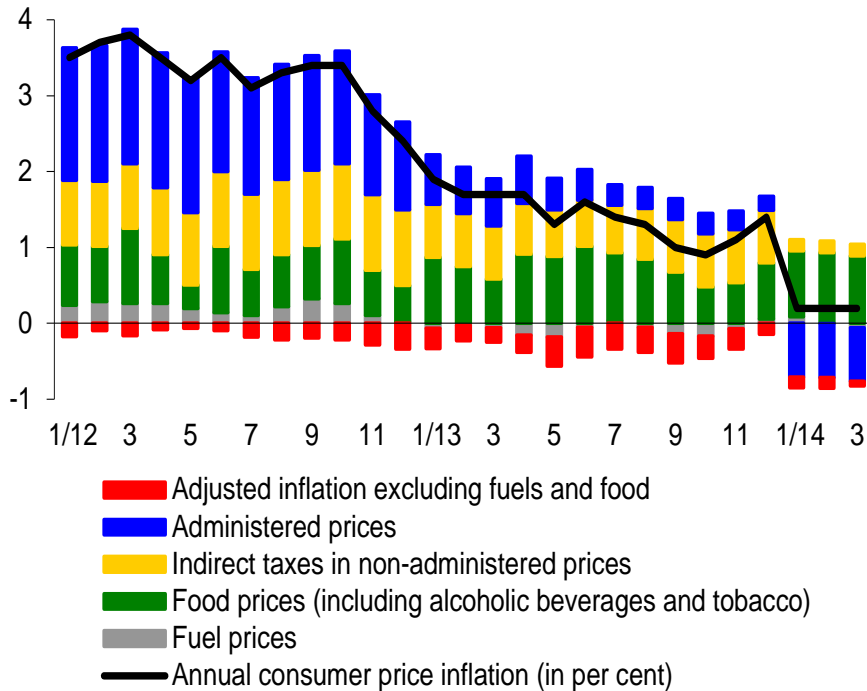
- Assumptions of the forecast
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- The forecast expects headline inflation to increase this year from its current low but positive level. Headline inflation will get just above the target at the start of next year. In the second half of 2015 it will return to the 2% target, where it will stabilise.
- Monetary-policy relevant inflation will return towards the target at the end of this year and stay very close to the target next year.
- The weaker koruna, without which inflation would have been deep in negative territory at the start of this year, will continue to affect inflation through import prices. However, this effect will gradually fade from the second quarter of this year onwards. Starting in the second half of this year, consumer price inflation will also be strongly affected by continuing growth of the domestic economy and a recovery in wages.

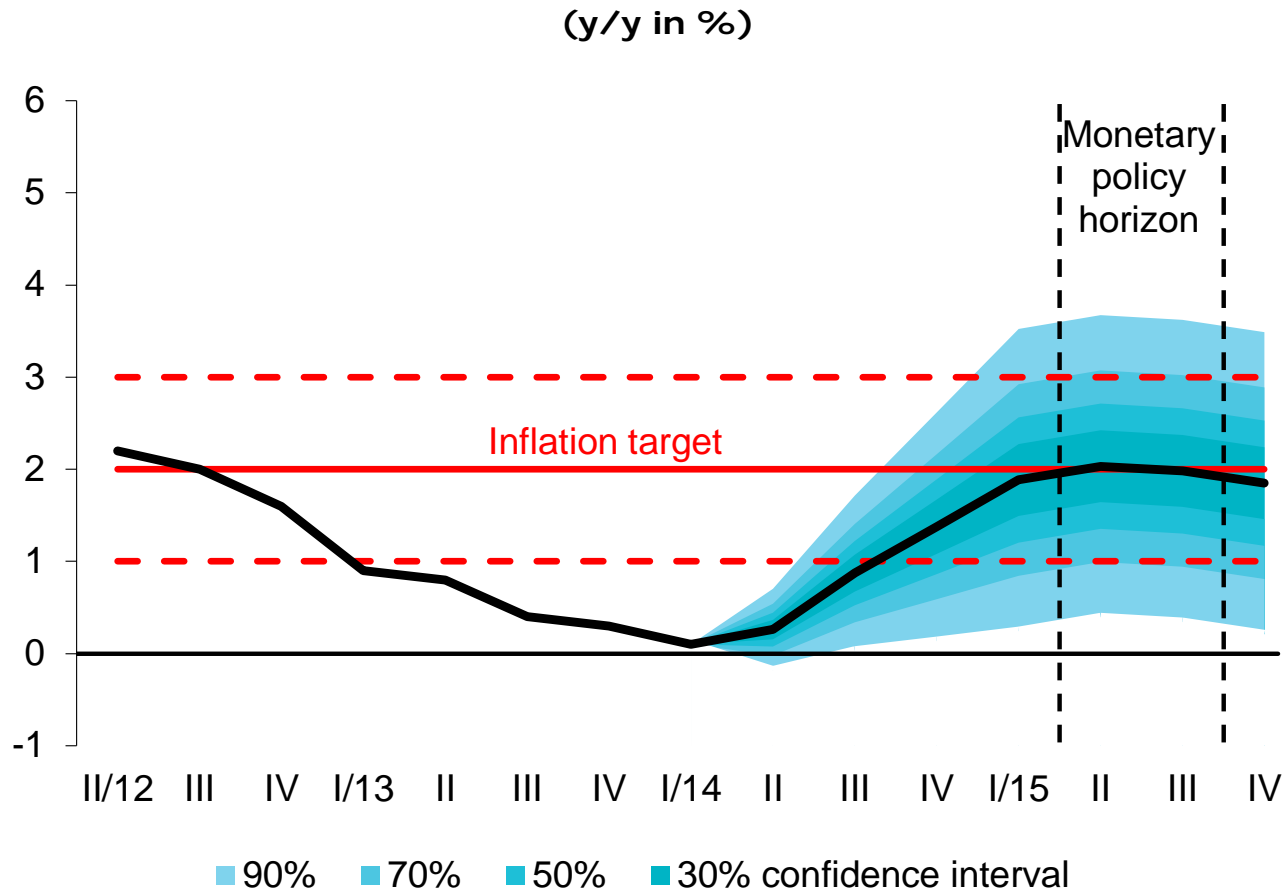
- Following a decline in the previous two years, the economy will increase by 2.6% this year, supported by growth in external demand, the monetary policy easing delivered through the weakening of the exchange rate and slightly positive fiscal stimulus. The economic activity will be even more boosted by fiscal policy in 2015, leading to 3.3% growth of GDP.
- The recovery of the domestic economy will become more visible on the labour market from the 3Q 2014, when employment (expressed in full time equivalent) switches to positive growth, reaching 1.3% y-o-y at the end of 2015. Wage growth in the business sector will recover from the significant drop witnessed in the 4Q 2013 and accelerate further on the forecast horizon reflecting the ongoing economic recovery.
- The forecast assumes market interest rates to be flat at their current very low level until the start of next year, followed by a gradual rise in market rates into 2015 by about 0.6 percentage point.



- As expected, inflation dropped to a very low level in the 1.Q 2014. It will be gradually moving towards the target in the rest of the year.
- At the start of 2015, headline inflation will slightly exceed the target, to which it will then return in the second half of the year.

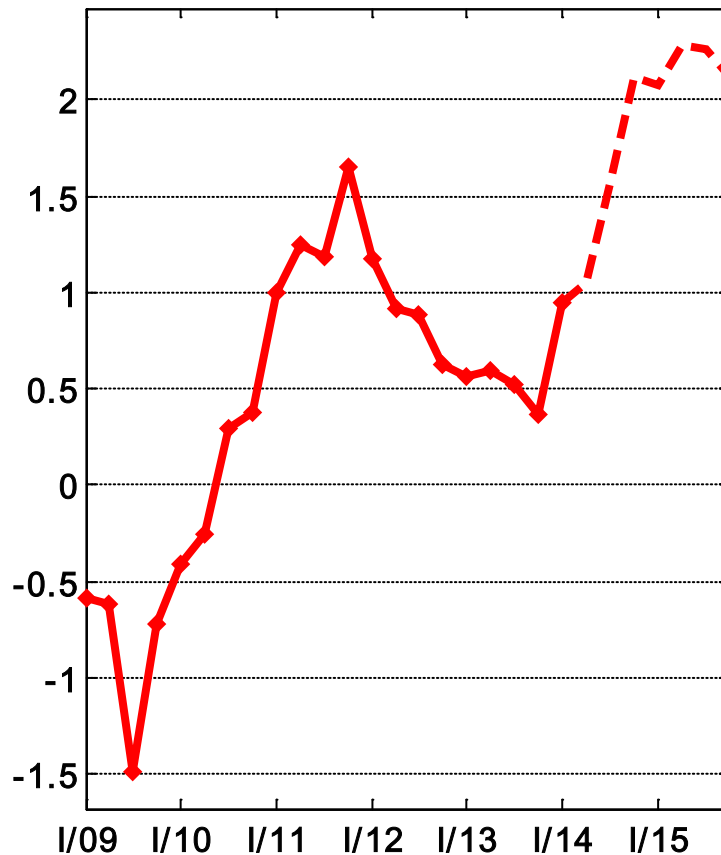


- Inflation was lower than the forecast by 0.2 p.p., mainly due to lower administered prices (i.e. not a sign of weaker exchange rate pass-through).
- There was also a slight downward surprise in "core inflation" (vs. higher food prices), mainly due to non-tradable prices, which reflect the anti-inflationary impact of the domestic economy.

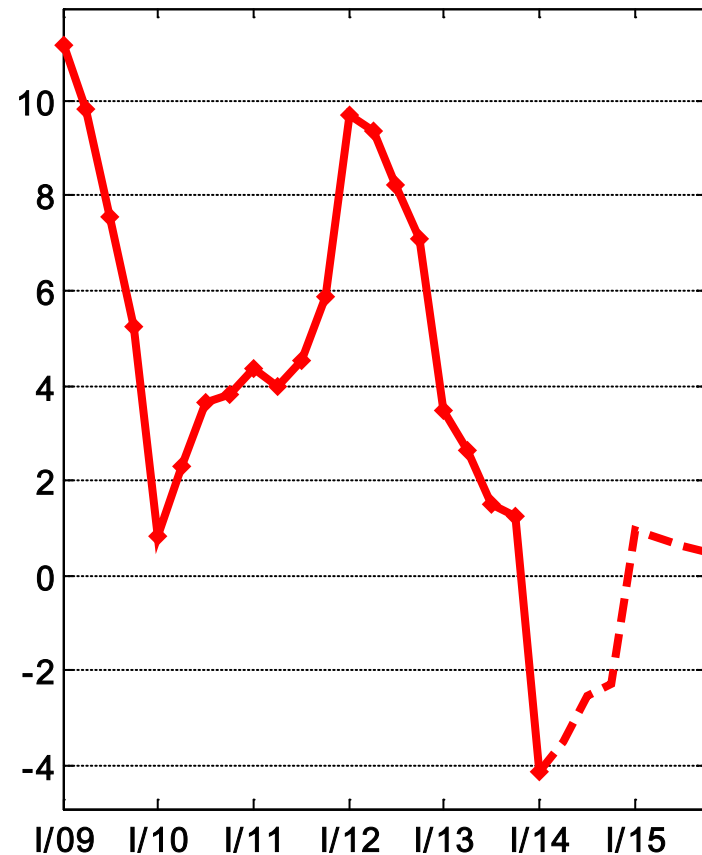


- Monetary policy-relevant inflation will be very close to the inflation target on the MP horizon.
- It will be slightly lower than the headline inflation due to further harmonisation increases in excise duty on cigarettes in 2014.

Net Inflation (y/y, in %)

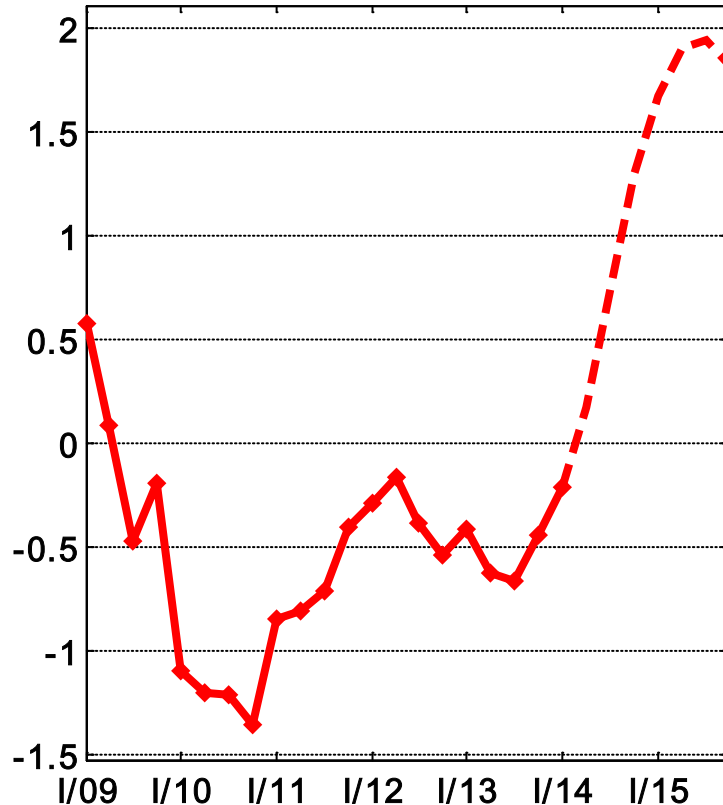


Growth of Administered Prices (y/y, in %)

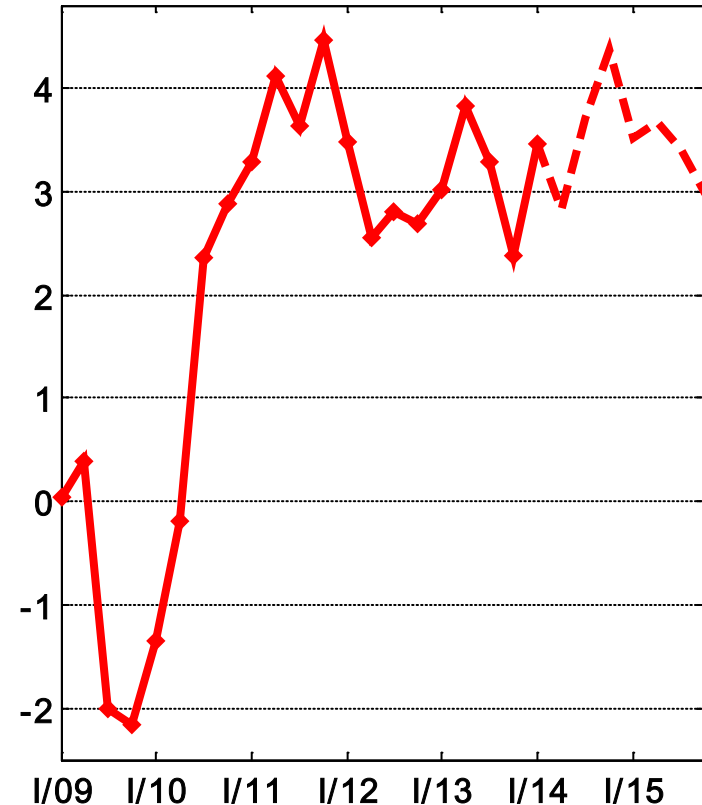


- Net inflation will continue to accelerate until mid-2015, mainly as a result of higher import prices and improving economic activity.
- The fall of administered prices will gradually diminish during 2014 due to weakening antiinflationary effect of the y-o-y decrease of gas prices.

Adjusted Inflation Excl. Fuels
(y/y, in %, Excl. Tax Changes)

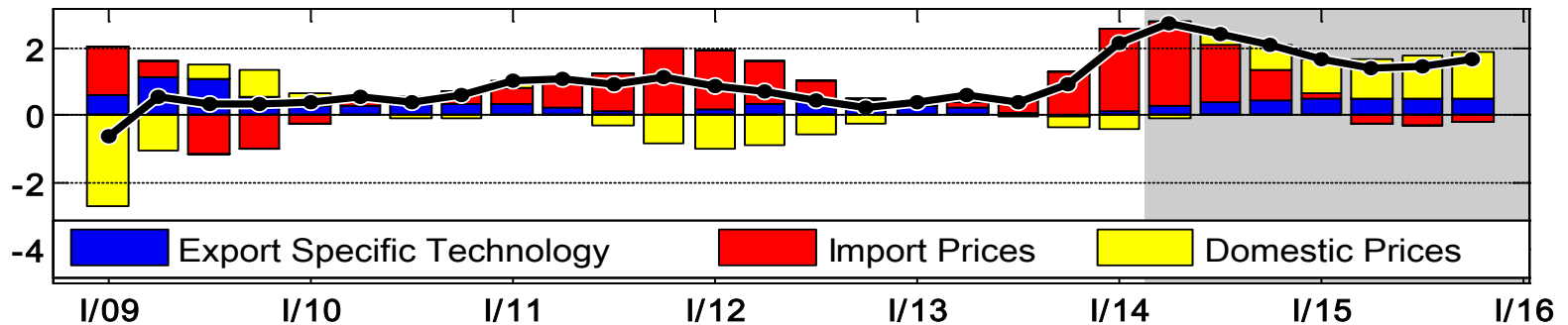


Food Inflation
(y/y, in %, Excl. Tax Changes)

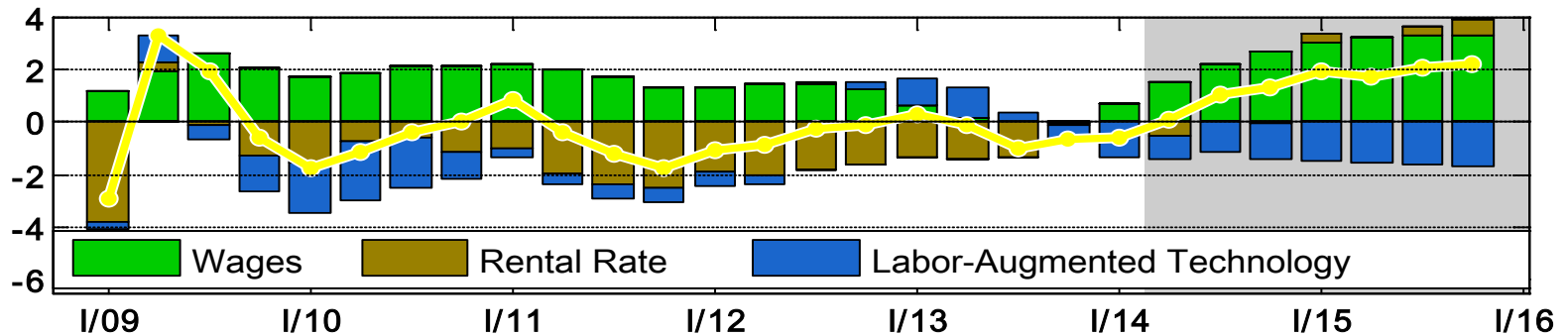


- "Core" inflation was still negative in the 1Q 2014. It is expected to switch to a positive value in the next quarter and then increase further until mid-2015. Initially driven by growing import prices, later on by economic recovery.
- Food price growth: around 3-4 % (exchange rate, agricultural commodities).¹⁴

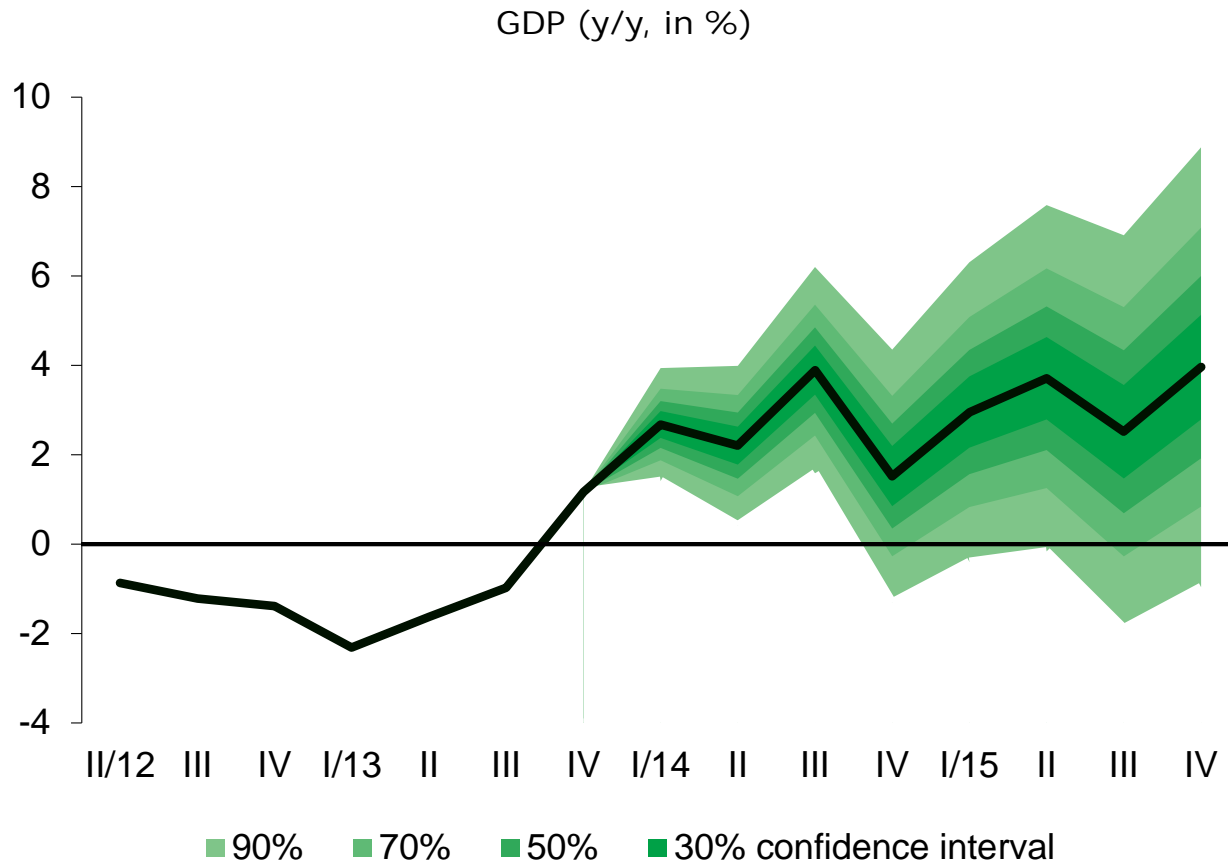
Nominal Marginal Cost in Consumption Sector (q/q, in %, ann.)



Nominal Marginal Cost in Intermediate Sector (q/q, in %, ann.)

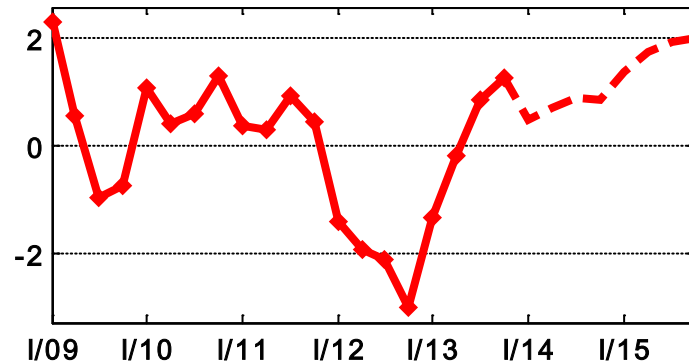


- Currently import prices are keeping consumer price inflation in a positive territory, while the domestic economy is still anti-inflationary.
- In the coming quarters, the impact of import prices will be gradually decreasing, while the accelerating wage growth and economic recovery will start to play the main role in stabilizing inflation close to the target.

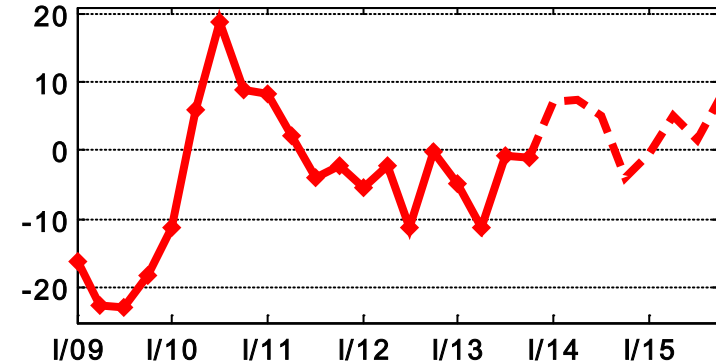


- GDP growth forecast: 2.6% in 2014 and 3.3% in 2015.
- The economic recovery in 2014 will be supported by growing foreign demand, relaxed monetary conditions and partially also by fiscal policy. The acceleration of economic growth in 2015 will be boosted by a significant fiscal impulse, contributing to both consumption and investment.

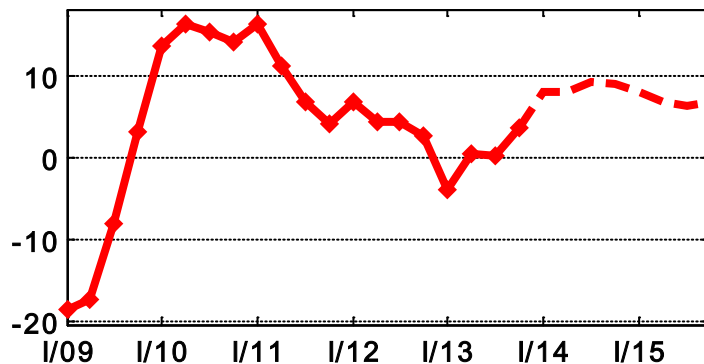
Household Consumption Growth (y/y, in %)



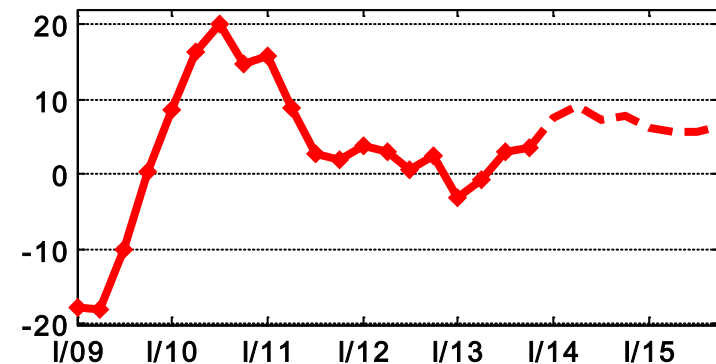
Investments Growth (y/y, in %)



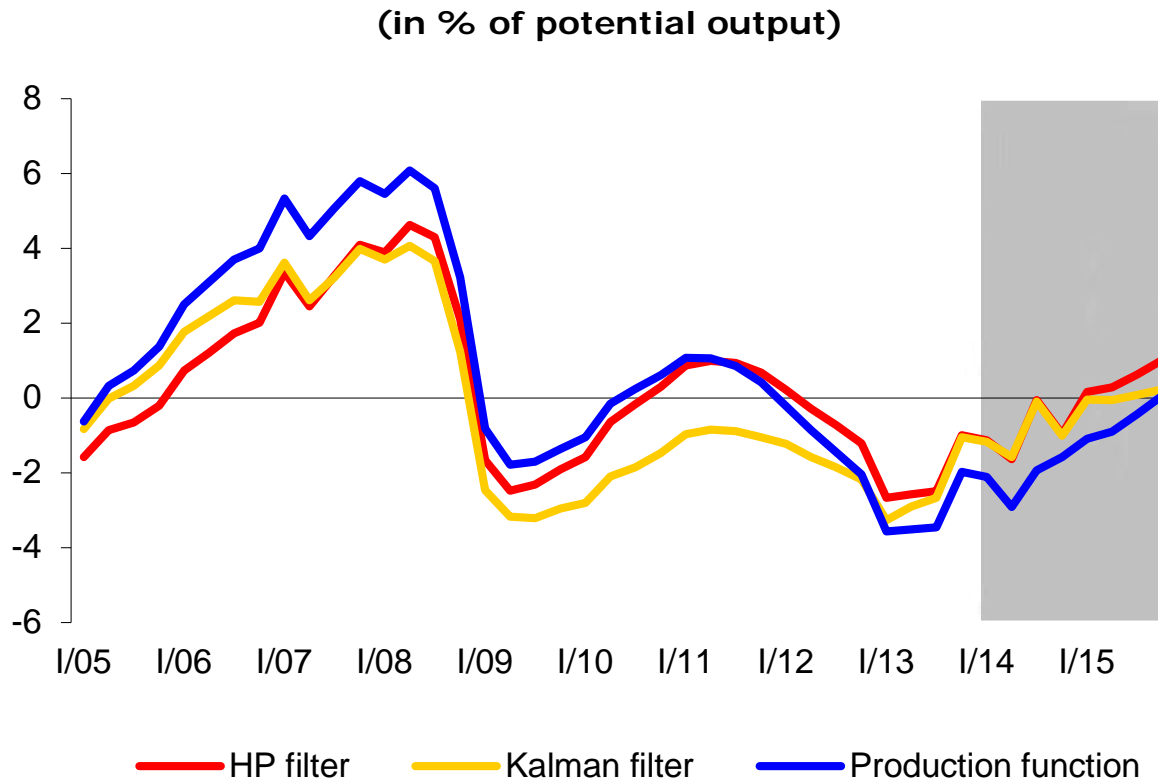
Exports Growth (y/y, in %)



Imports Growth (y/y, in %)

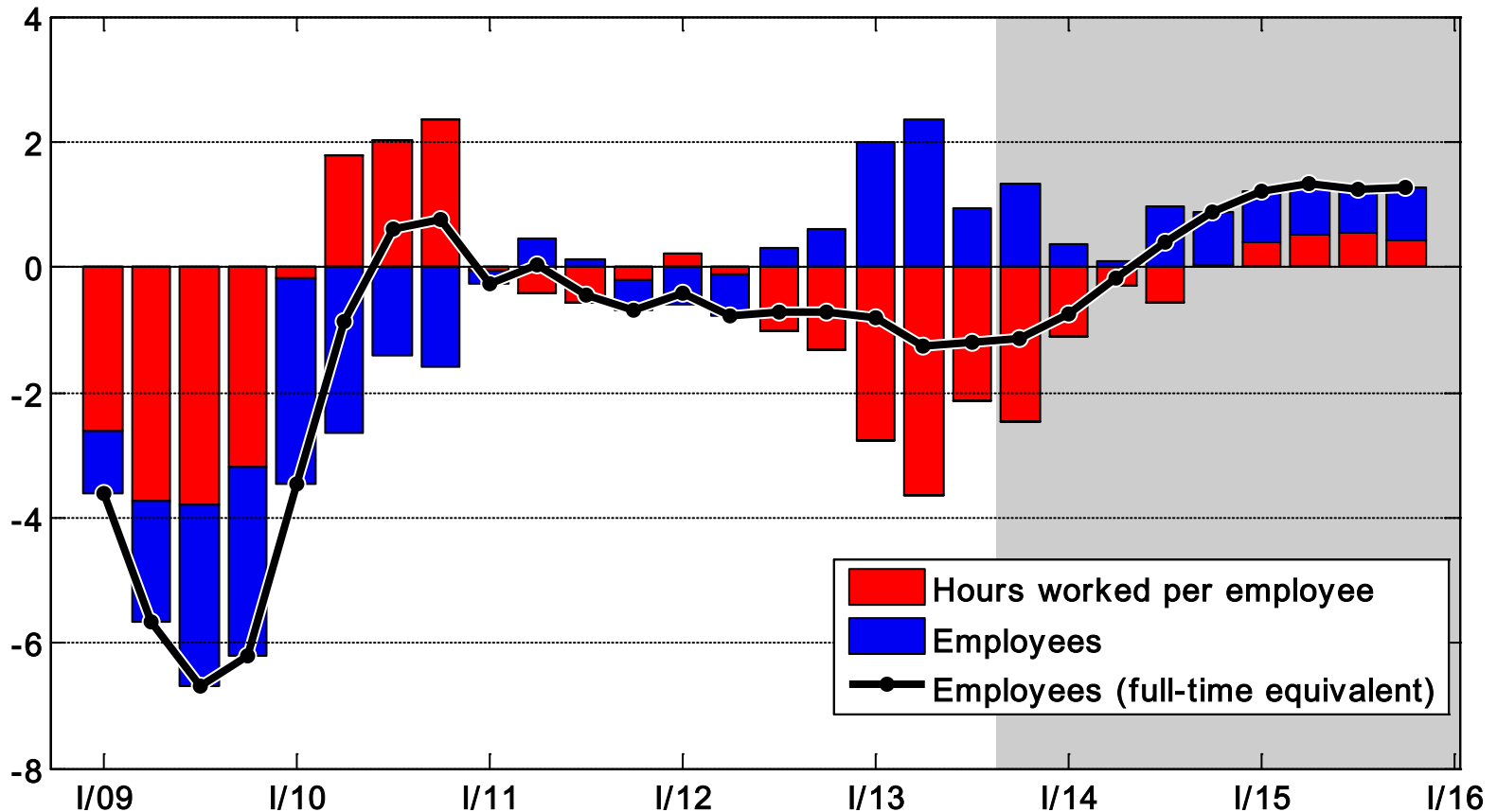


- Household consumption will be gradually recovering.
- Investments growth will be influenced by frontloading of cigarettes and strong revival of public investment, mainly in 2015.
- Exports: growing foreign demand and in 2014 also weak exchange rate.



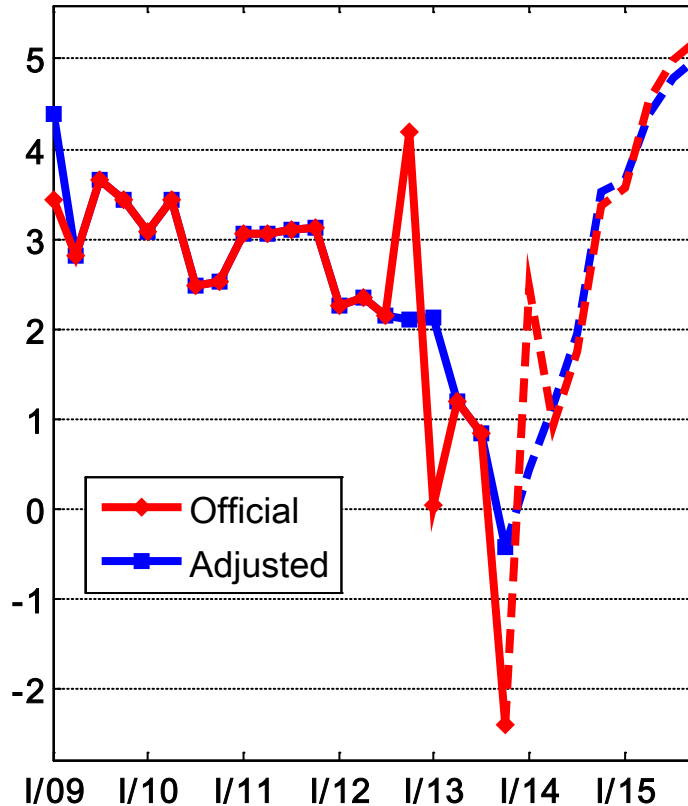
- The output gap remained negative in the last quarter of 2013, despite the significantly higher pick-up of GDP than expected.
- All methods, however, imply that it will close by the end of 2015.

Employees - full time equivalent (y/y, in %, s.a.)

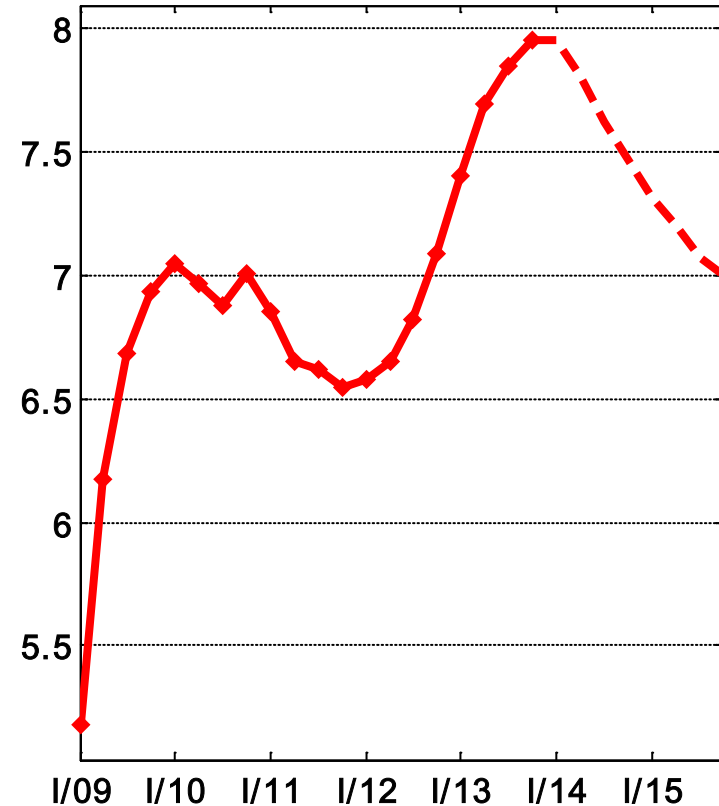


- The y-o-y growth of employment will continue from the second half of this year, picking up more strongly in 2015. The average hours worked per employee will also start increasing. The employment expressed in full-time equivalent will thus start growing from the end of 2014.

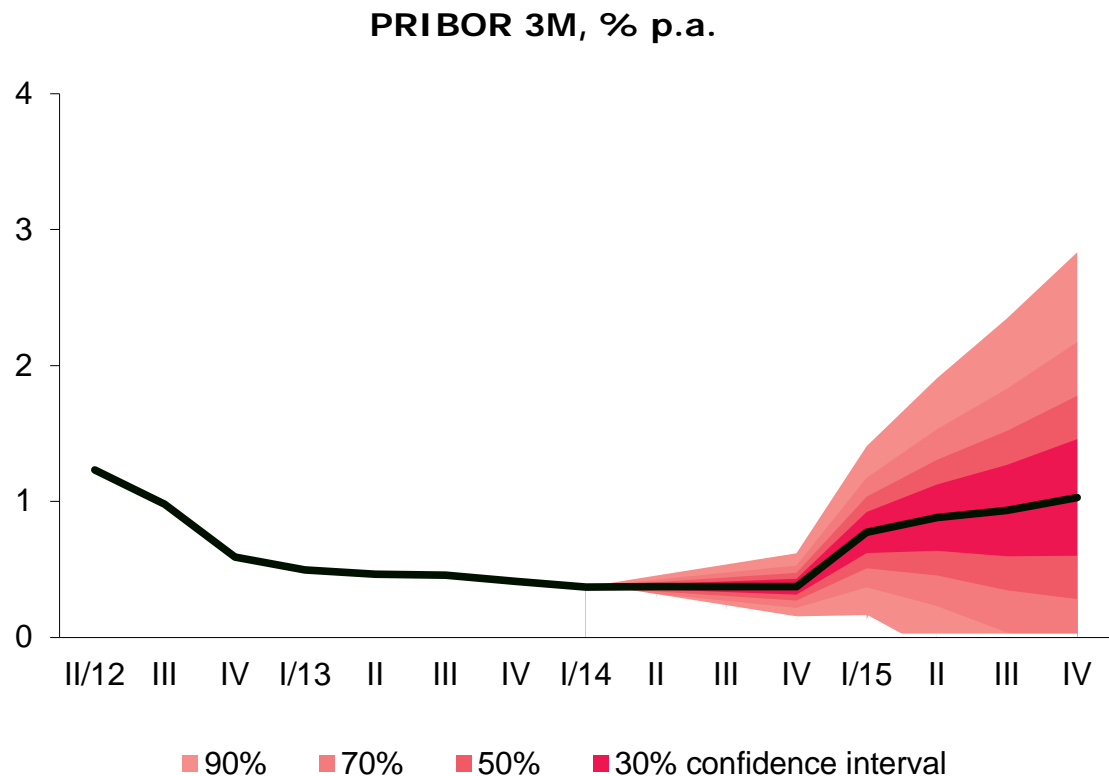
Nominal wage growth in business sector
(y/y, in %, s.a.)



Share of unemployed persons
(in %, s.a.)



- Nominal wage growth is significantly affected by tax optimization from late 2012. It will swiftly recover from its deep fall in 4Q 2013. In 2015, there will be an upward effect (0.3 p.p.) of changes in the health insurance.
- The share of unemployed persons will be declining on the forecast horizon.²⁰

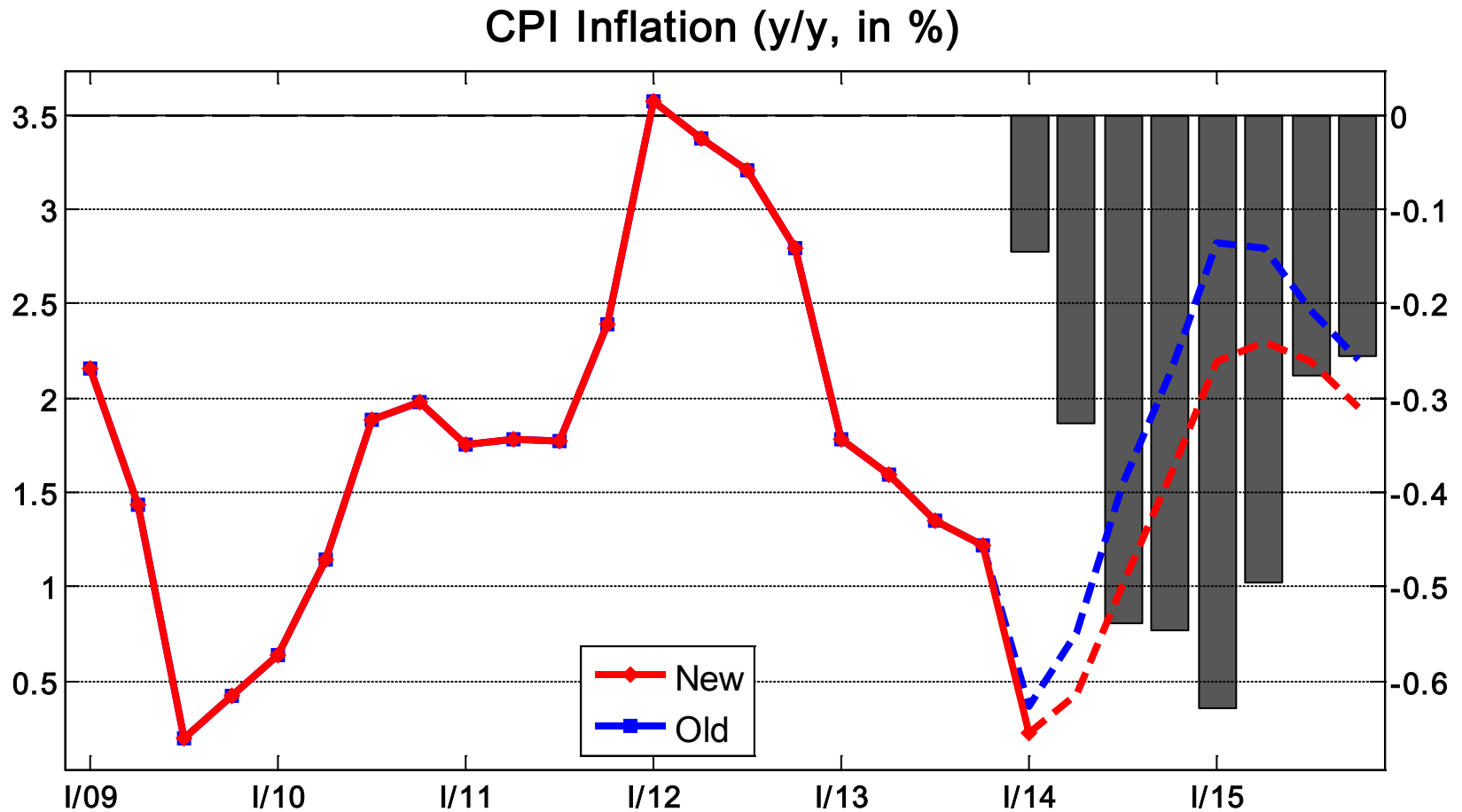


- The forecast assumes market interest rates to be flat at their current very low level until the start of next year, followed by a gradual rise in market rates into 2015 by about 0.6 percentage point.

- Assumptions of the forecast
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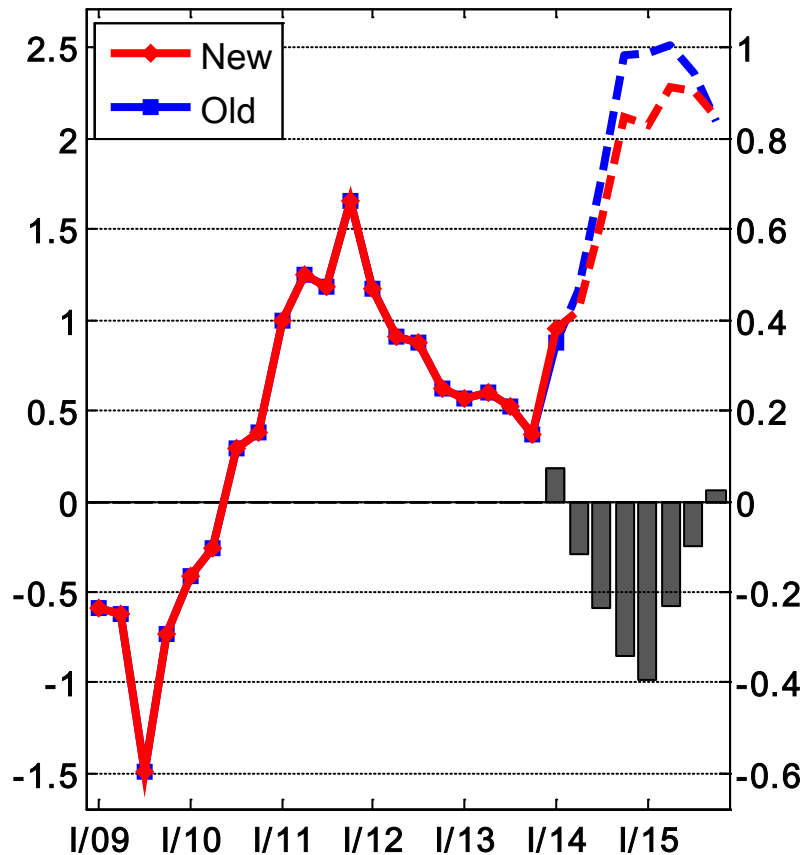
- Both headline and monetary-policy relevant inflation are lower than in the previous forecast owing to a lower outlook for administered price and a lower prediction for net inflation.
- Lower net inflation will be accompanied by deeper fall of administered prices this year and by their less significant increase in 2015. The lower outlook of net inflation reflects a downward revision of core inflation partly offset by a higher forecast of food price growth.
- GDP growth has been revised upwards for both 2014-15. The main factor behind the revision of growth in 2015 is higher fiscal stimulus.

- Nominal wage growth will be somewhat lower this year, the share of unemployed persons is revised downwards on the whole forecast horizon.
- After the discontinuation of the use of the exchange rate as a monetary policy instrument the interest rate path in the prediction is lower, mainly reflecting a lower outlook for foreign interest rates and prices in 2015, as well as a lower outlook for domestic administered prices and net inflation.

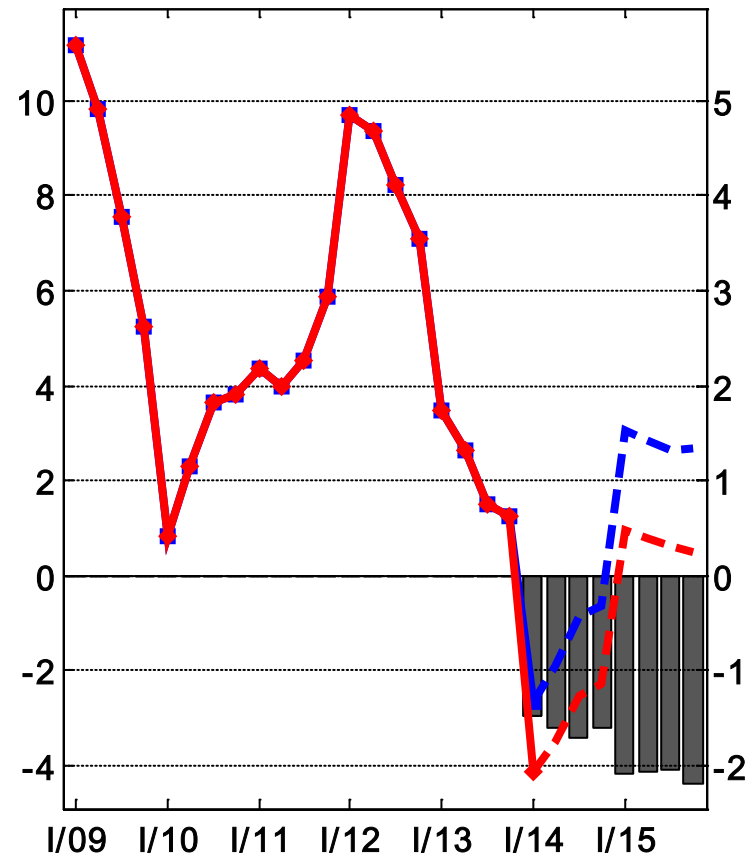


- The inflation forecast has been lowered for the whole forecast horizon.

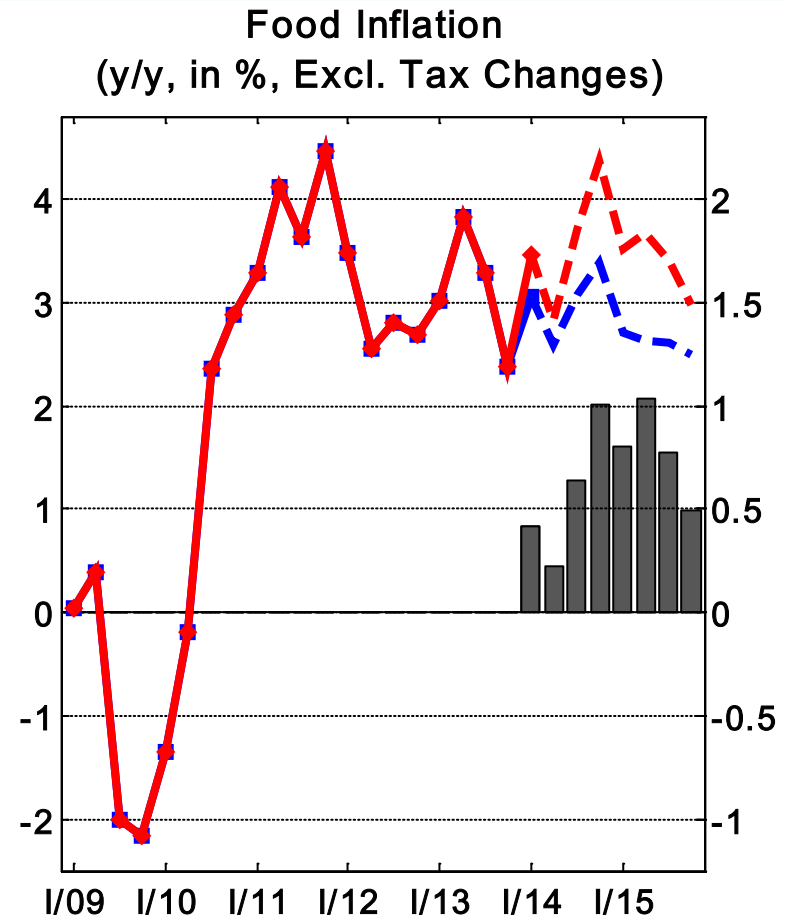
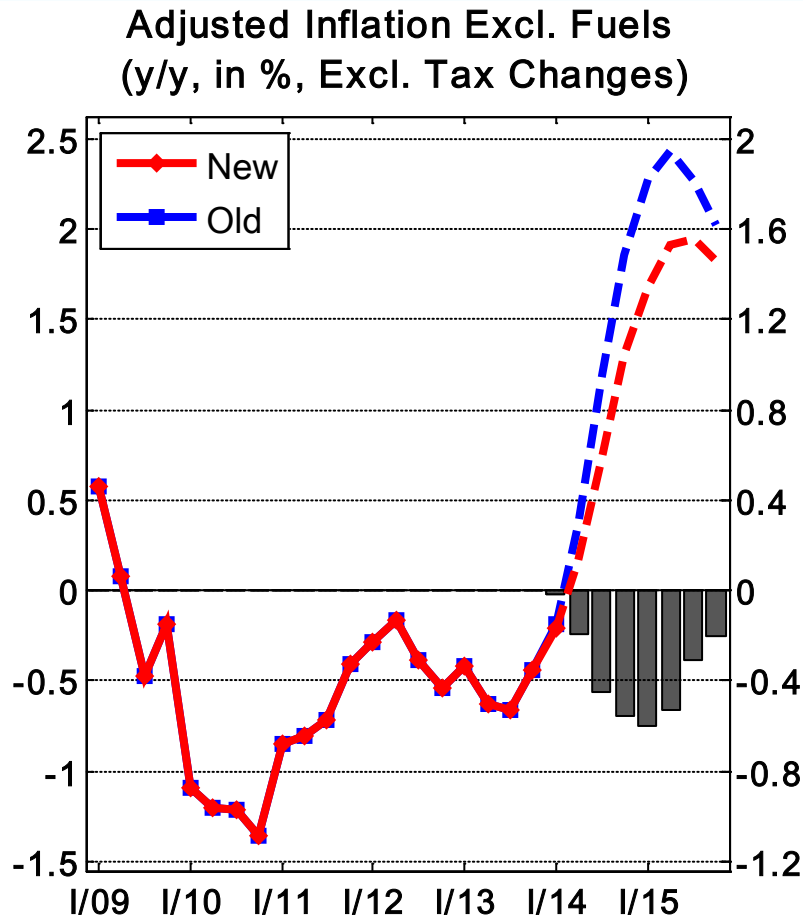
Net Inflation (y/y, in %)



Growth of Administered Prices (y/y, in %)

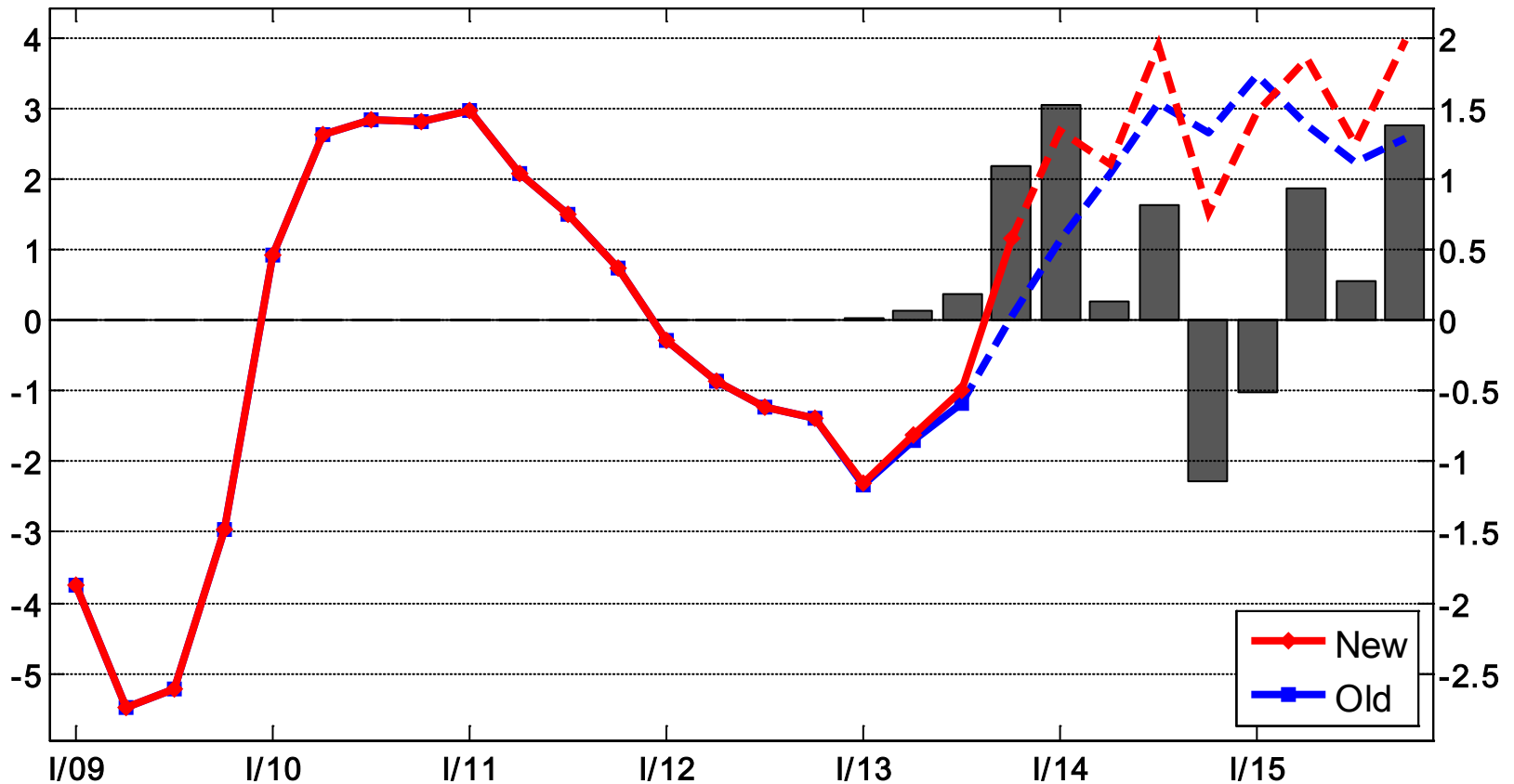


- Net inflation: lower forecast of "core" inflation and fuel prices, partly offset by higher food price growth.
- Administered prices: deeper fall in prices of health services, lower price growth of heating and gas; in 2015 downward revision of energy prices.



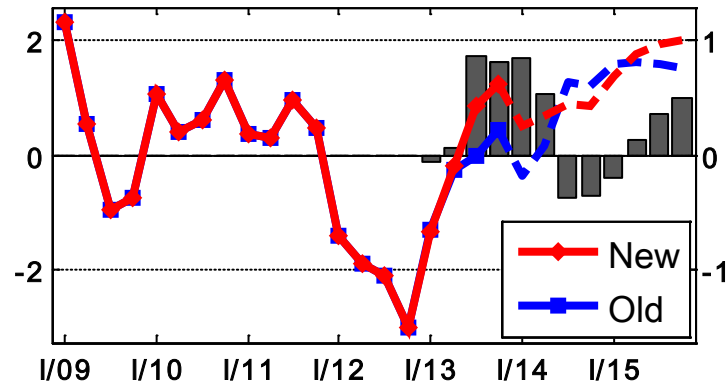
- The lower forecast of adjusted inflation excluding fuels (i.e. "core" inflation) reflects a more gradual recovery of wage growth paired with higher productivity growth.
- The revised food price outlook is a result of higher expected growth of agricultural commodity prices on world markets.

GDP Growth (y/y, in %)

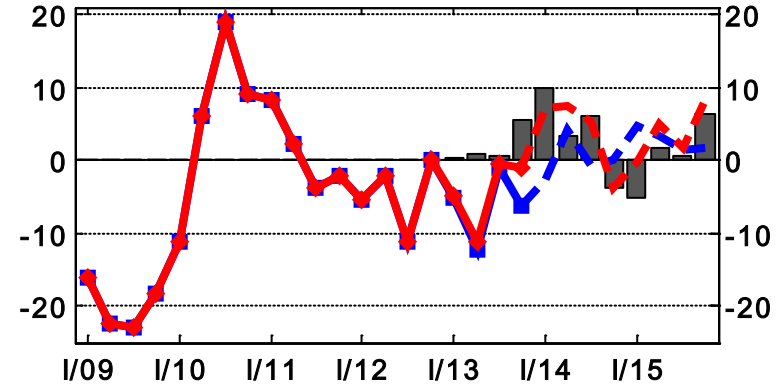


- Expected GDP growth has been revised upwards in both 2014 and 2015, mainly as a result of expected higher investment activity in both the private and government sectors and more expansionary fiscal policy overall.

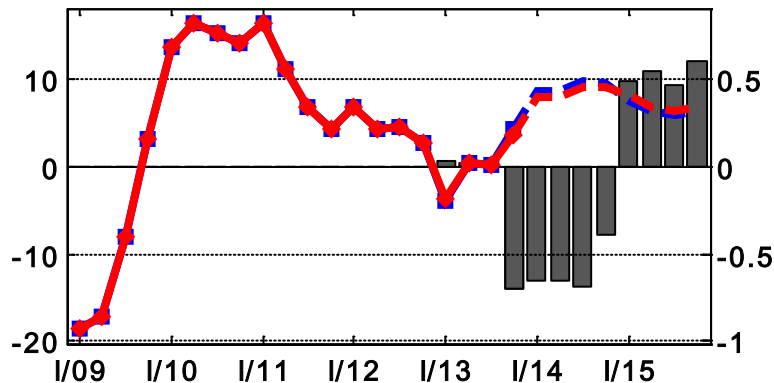
Household Consumption Growth (y/y, in %)



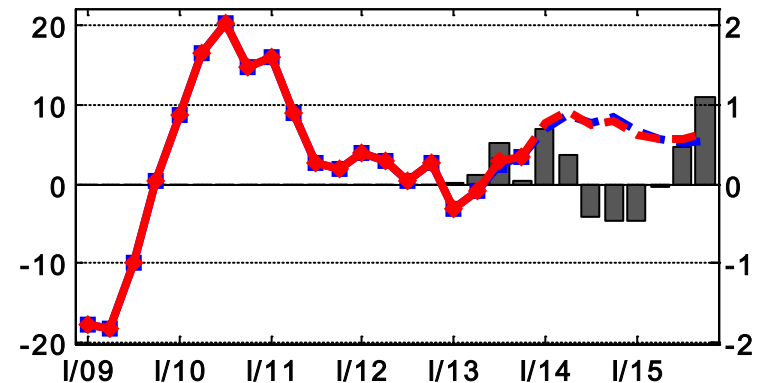
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)

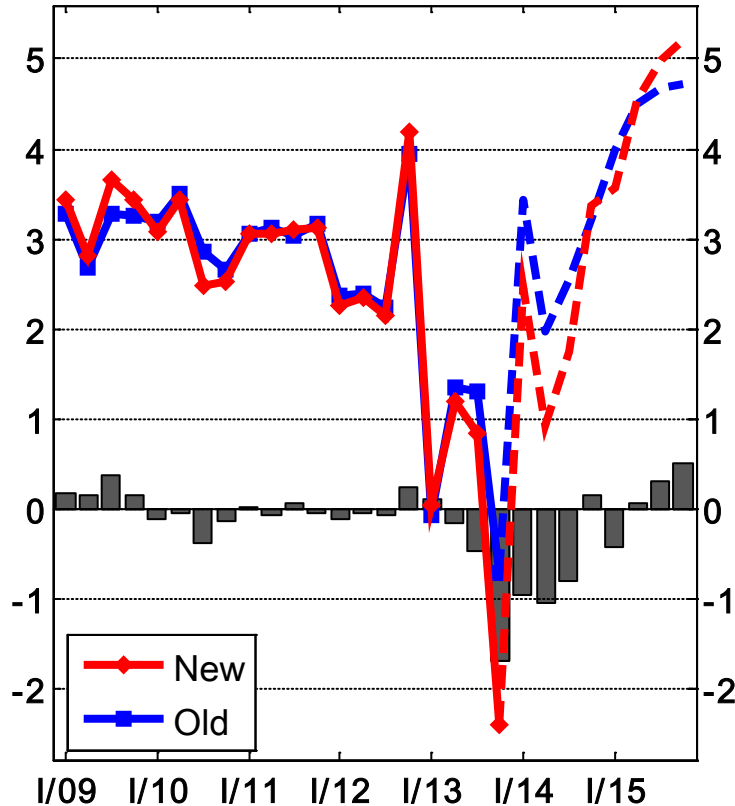


Imports Growth (y/y, in %)

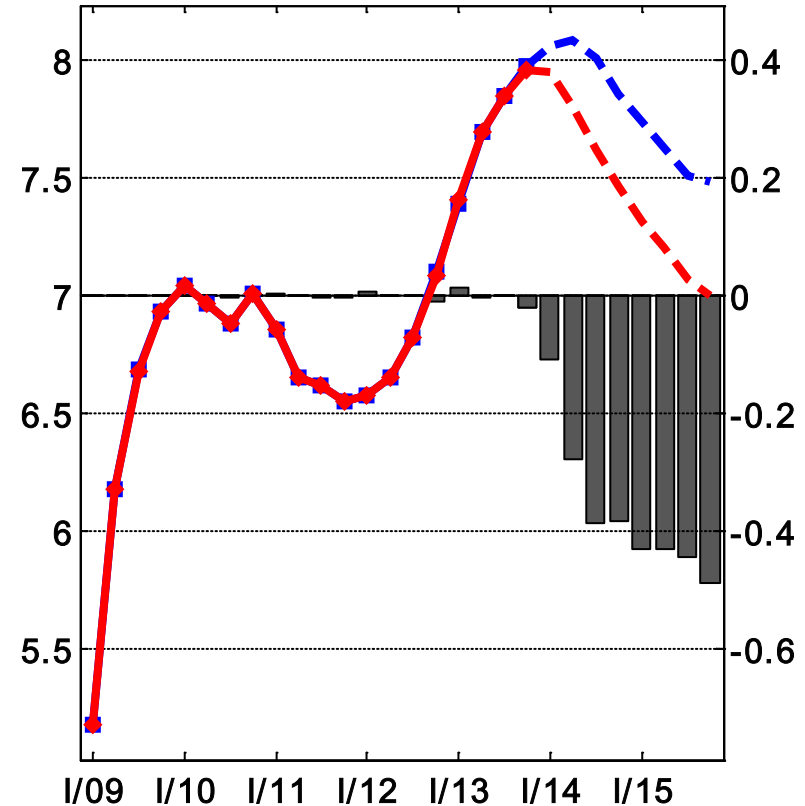


- GDP growth is more than in the previous forecast driven by household consumption and investment.
- Slightly less significant contribution of net exports to GDP growth.

Nominal wage growth in business sector
(y/y, in %, s.a.)

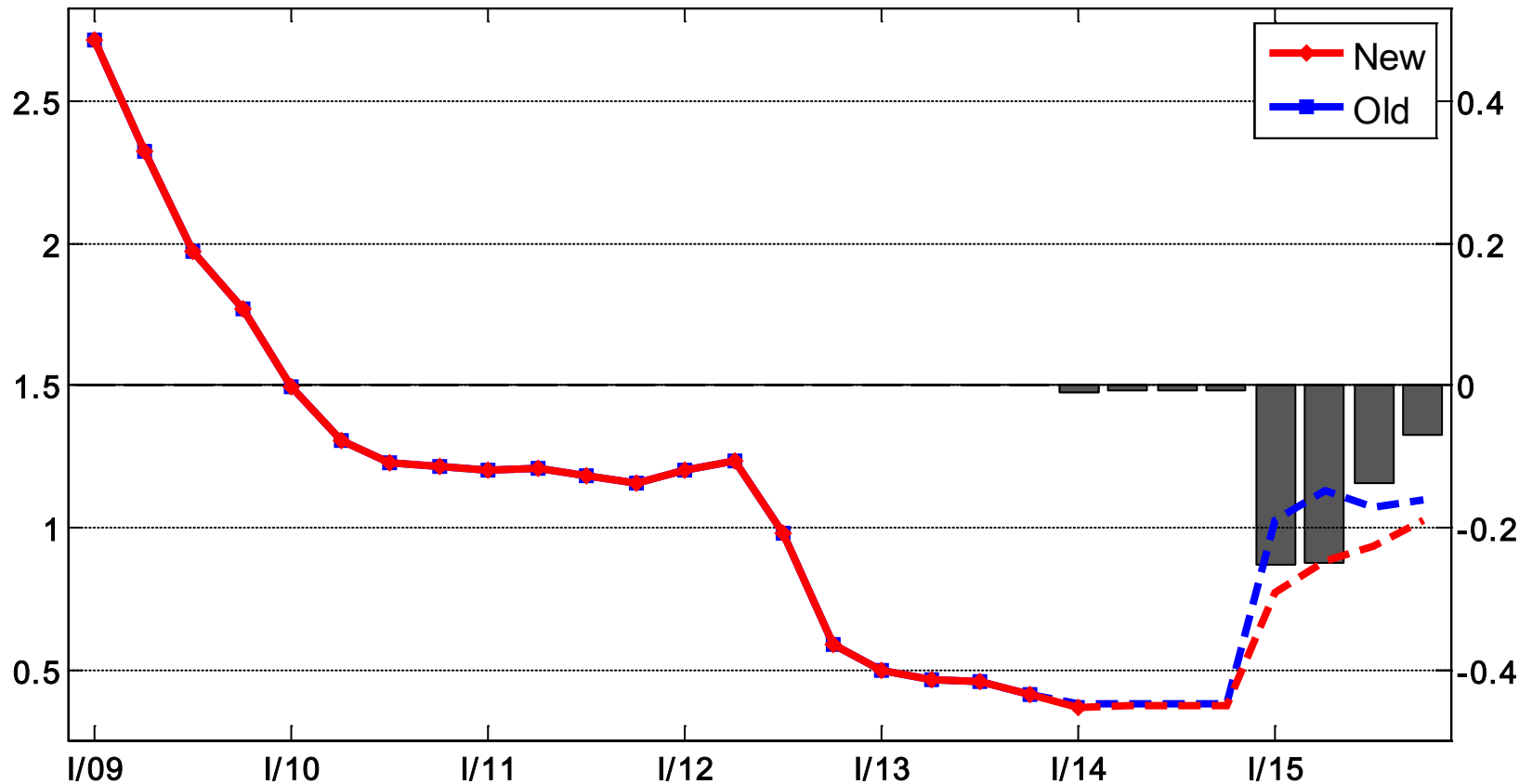


Share of unemployed persons
(in %, s.a.)



- The outlook for wage growth has been revised downward due to a deep fall of y-o-y wage growth in the 4Q 2013.
- The share of unemployed persons will fall faster than in the old forecast due to its more significant decrease recently and improved economic outlook.

3M PRIBOR (% , p.a.)



- The interest rate path consistent with the forecast is unchanged for 2014. Interest rates for 2015 are mainly reflecting a lower outlook for foreign interest rates and prices in 2015, as well as a lower outlook for domestic administered prices and net inflation.

Thank you for your attention!

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