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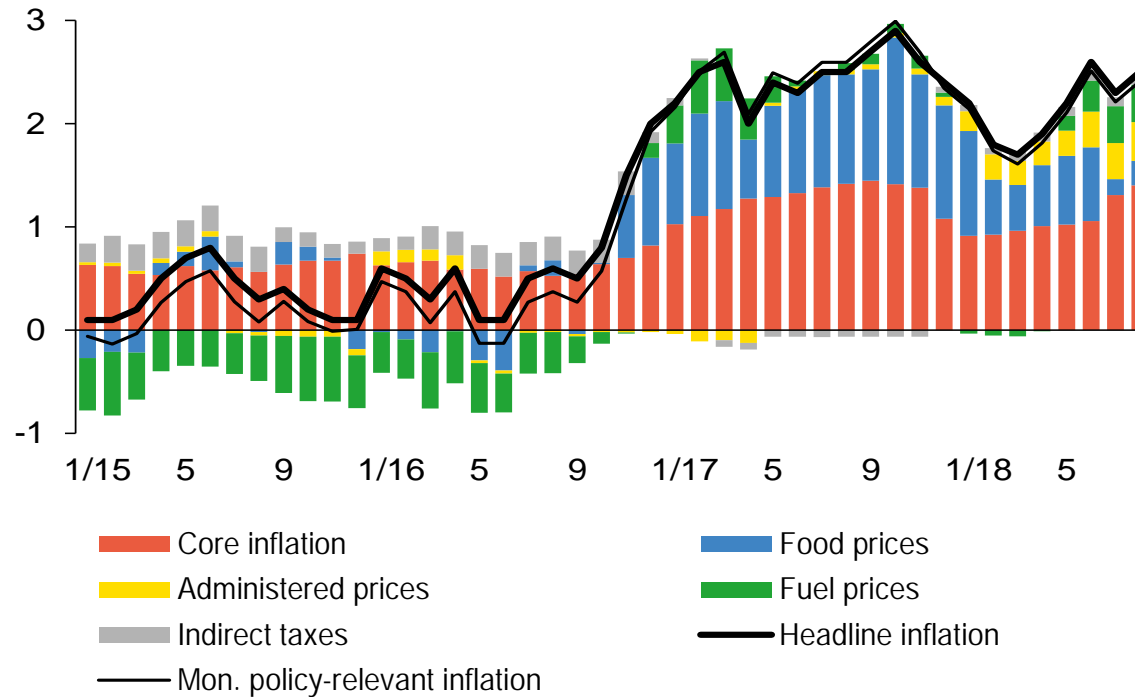
Czech National Bank

Citi Macro Forum and JPMorgan Investor Seminar

IMF/WB Annual Meetings, Nusa Dua, Indonesia

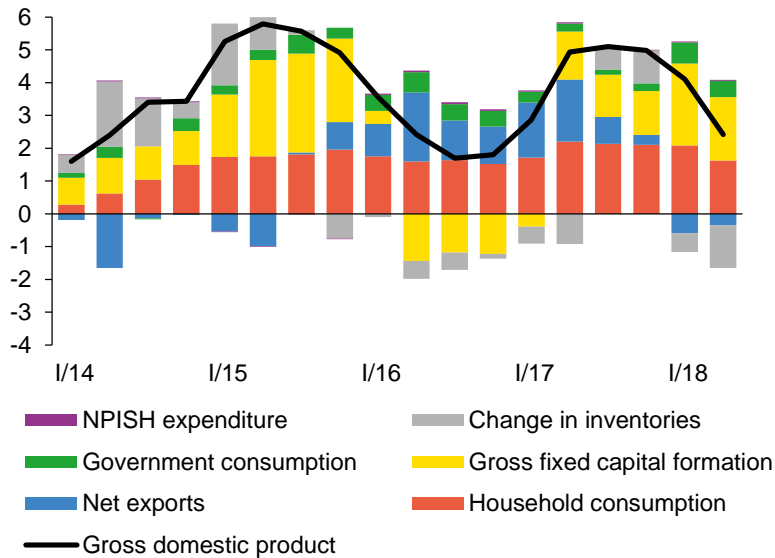
11–12 October 2018

Structure of consumer price inflation
(annual percentage changes; contributions in p.p.)

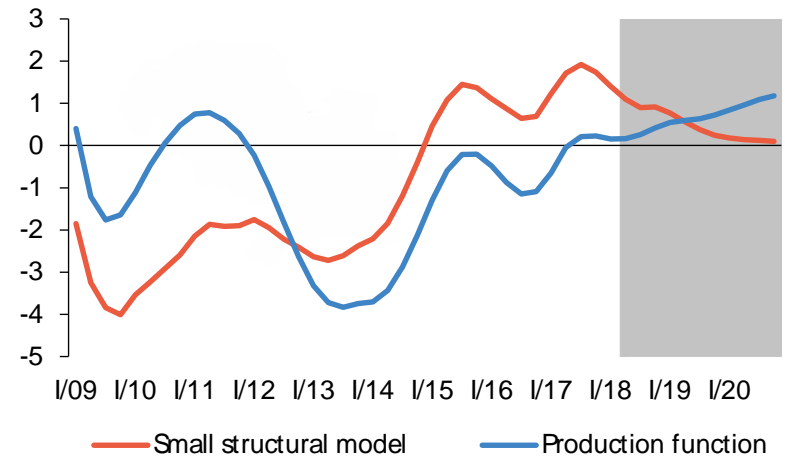


- Inflation has accelerated gradually in recent months.
- A substantial increase in inflation was recorded due mainly to higher growth in prices of fuels, food and electricity. Simultaneously, consumer prices continued to be affected by strong domestic demand.
- Core inflation also went up slightly on the back of rising growth in non-tradables prices.

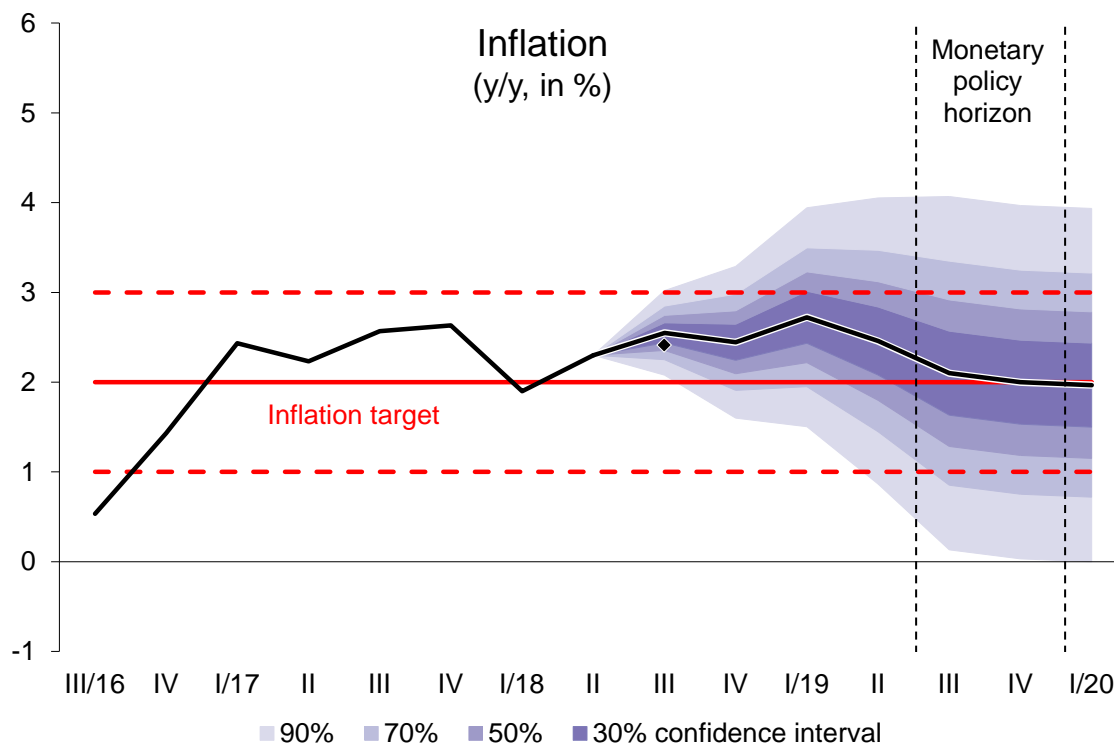
GDP growth and its structure
(annual percentage changes; contributions in p.p., s.a.)



Output gap
(in % of potential output)

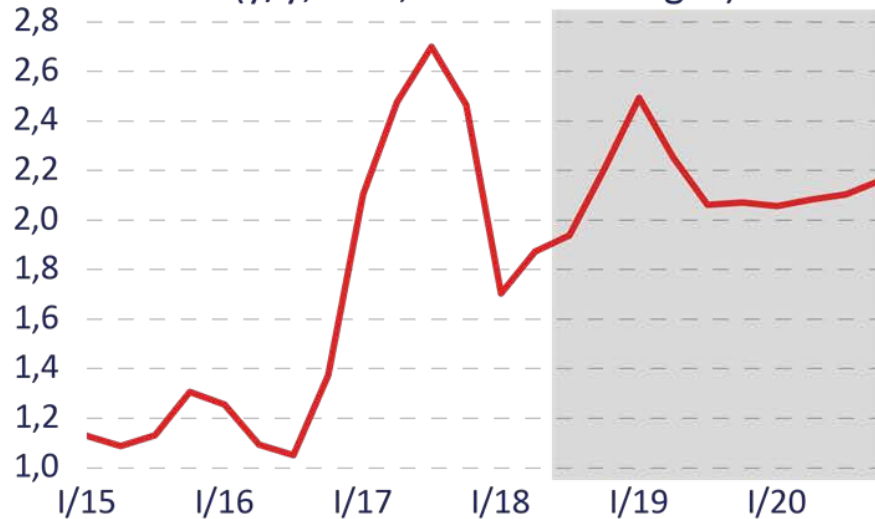


- The Czech economy is operating above its potential, but it is slowing down. Household consumption remains a stable basis for GDP growth, reflecting strong income growth and overall optimism. Growth is also being significantly aided by an increase in investment. Investment coupled with insignificant growth in exports led to a negative contribution of net exports.
- Favourable trends are observed in most sectors. The positive situation is reflected in still high business confidence, even though strong growth in personnel costs is reducing corporate profits. Labour shortages are an increasing barrier to growth. ³



- Inflation will stay in the upper half of the tolerance band until mid-2019 and return to the target at the monetary policy horizon. The tight labour market will generate strong inflation pressures. Later on, overall inflation pressures will start to ease gradually owing to continued growth in interest rates, renewed appreciation of the koruna and slower wage growth.
- August inflation (2.5%) was just below the forecast. Markedly slower growth in food prices was to a large extent compensated by faster growth in core inflation.

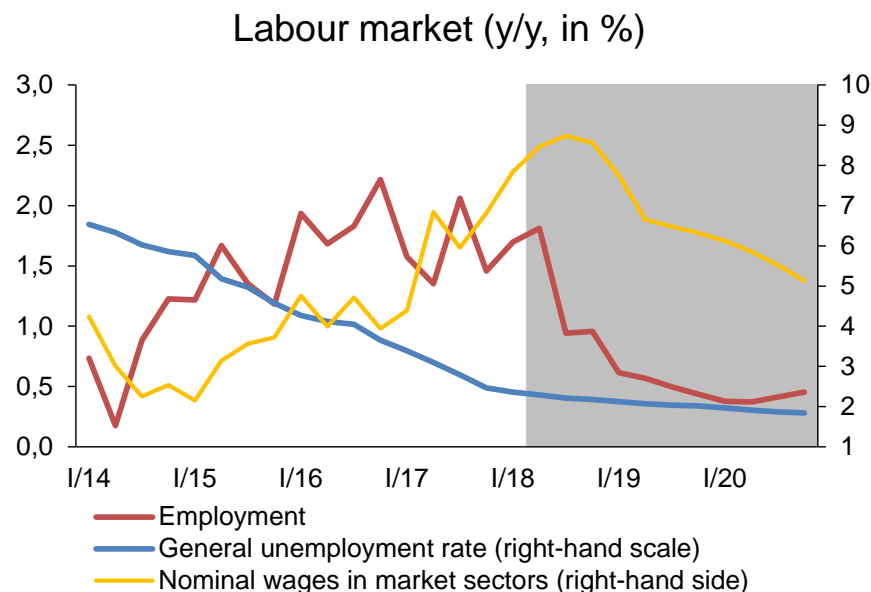
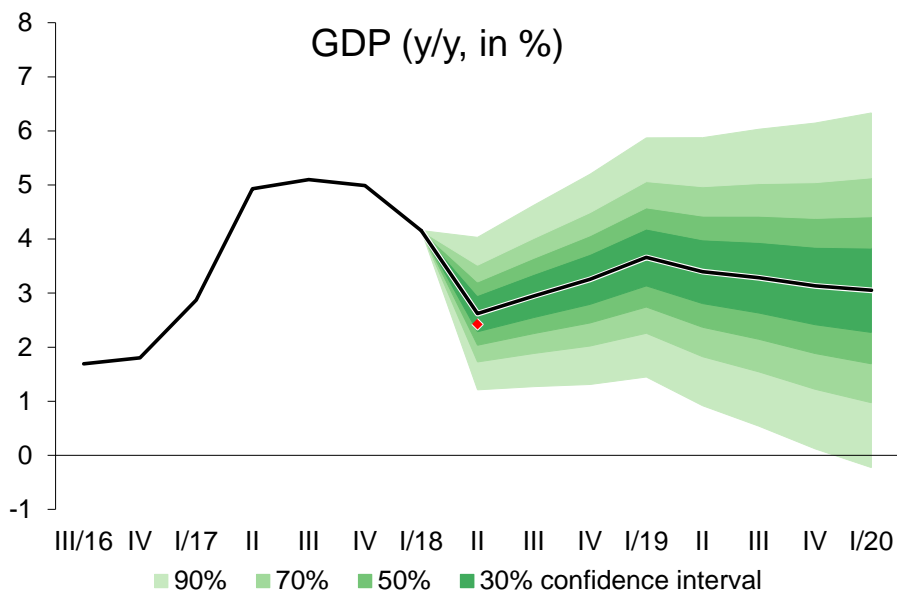
Core inflation excl. fuels
(y/y, in %, excl. tax changes)



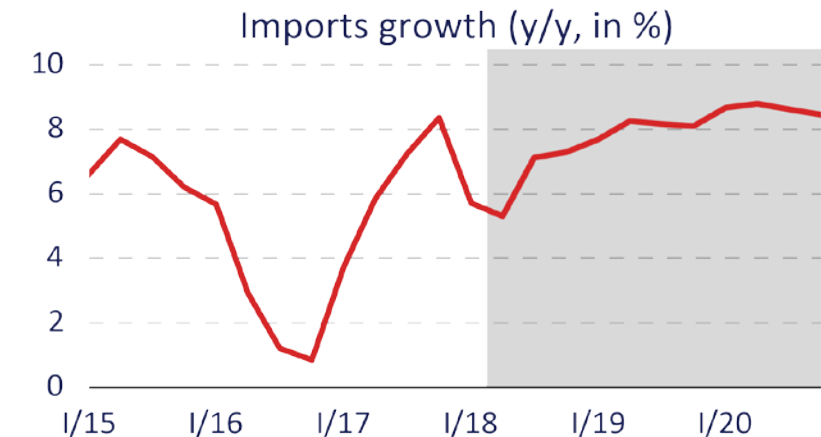
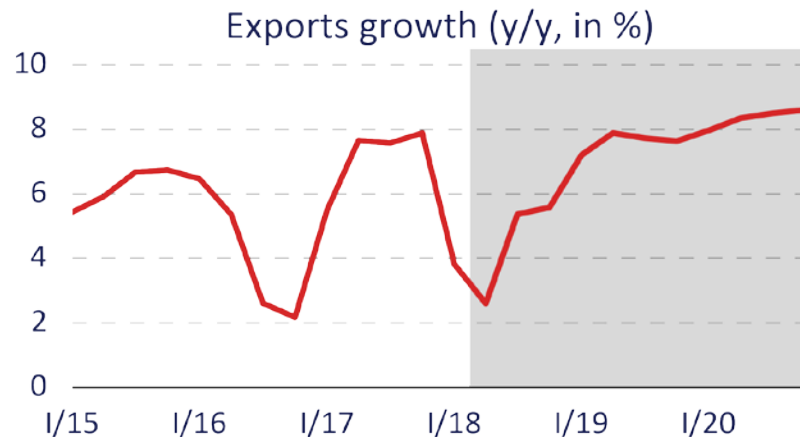
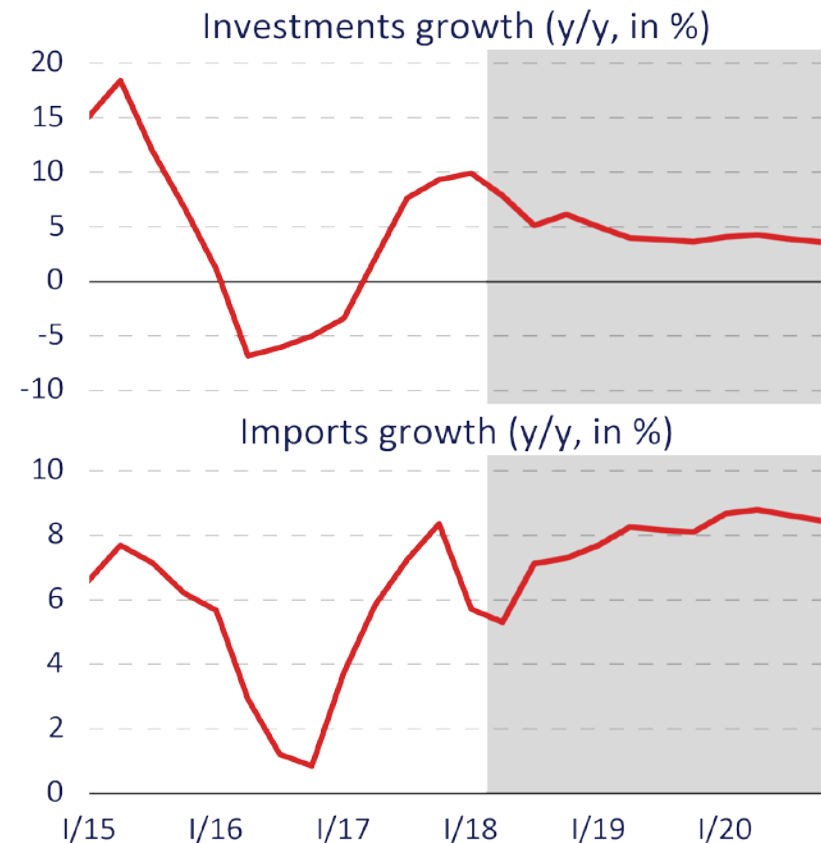
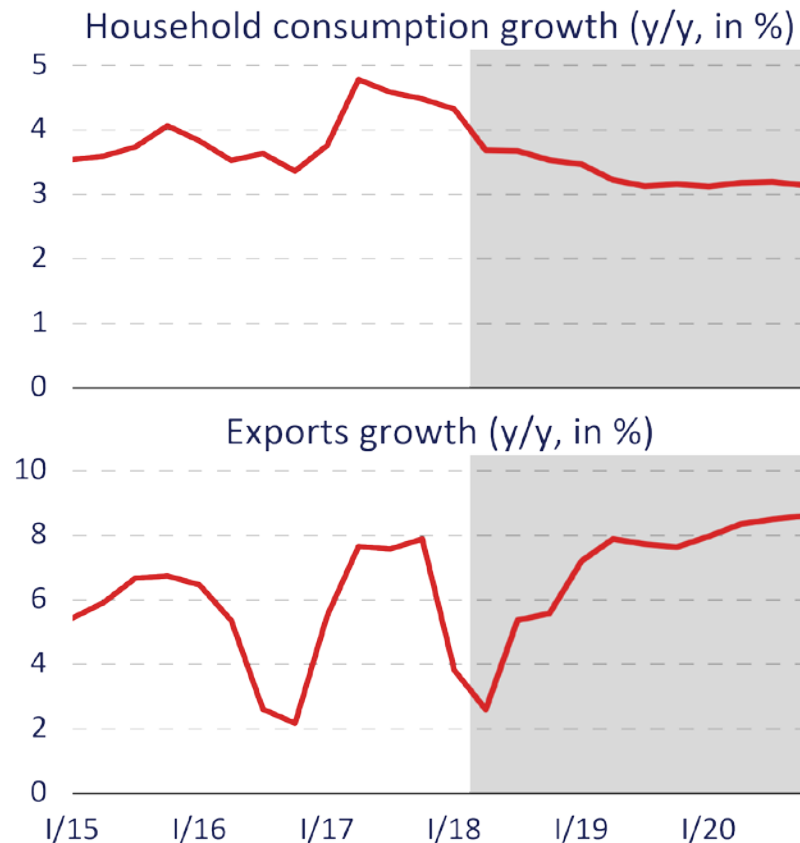
Growth of food prices
(y/y, in %, excl. tax changes)



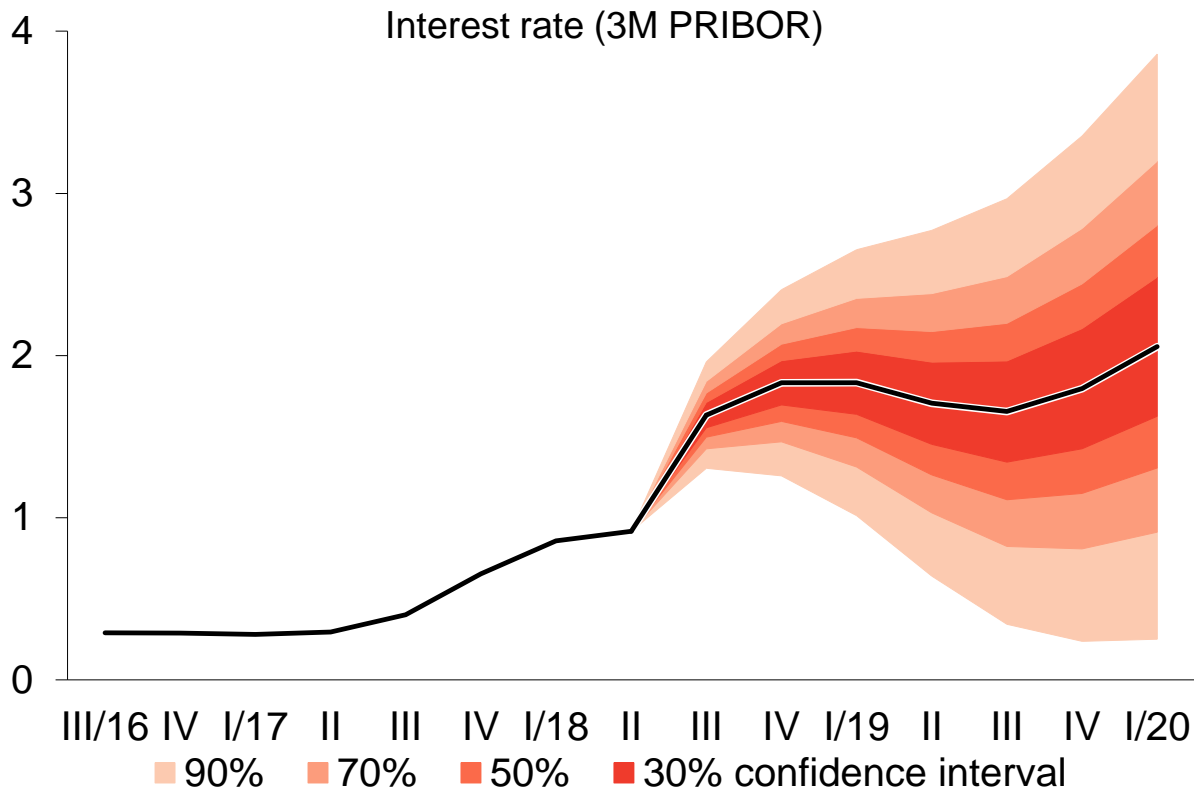
- Core inflation will accelerate further to 2.5% in 2019 Q1 due to an increase in import prices resulting mainly from the previous koruna depreciation coupled with rising foreign PPI in the effective euro area. At the same time, strong inflation pressures from the domestic economy will drive up prices in the non-tradables sector.
- Food price inflation will moderate this year and recover slightly again in 2019 in connection with the outlook for agricultural commodity prices.



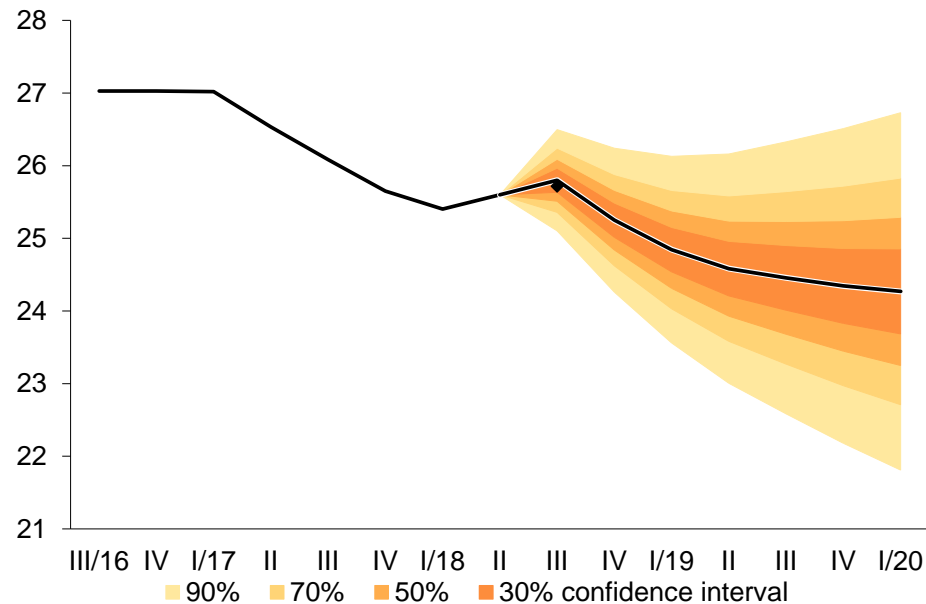
- The growth of the Czech economy will slow, but will remain above 3% on average. It slowed to 2.4% in Q2 (2.4%), which was only slightly below the forecast. Monthly indicators suggest further solid economic growth in Q3.
- The economy will be driven mainly by robust growth in household consumption, continuing investment activity, moderately expansionary domestic fiscal policy and briskly rising foreign demand.
- Total employment will rise at a substantially slower pace, while the decline in the unemployment rate will moderate. The exhausted labour market has led to accelerated nominal wage growth (8.6% in Q2).



- Household consumption growth will remain robust, reflecting continued rapid growth in total disposable income and optimism of consumers.
- Investment growth will be driven by both private and government investment (EU funds).
- The contribution of net exports to GDP growth will be negative this year due mainly to a short-lived slowdown in export growth.



- Consistent with the forecast is a continued rise in interest rates towards their long-run neutral level.
- The rise in interest rates is a reaction both to domestic inflation pressures and to the previous depreciation of the koruna.



- After weakening temporarily, the koruna will return to an appreciation trend.
- Renewed appreciation of the koruna will be driven by:
 - a distinctly positive interest rate differential vis-à-vis the euro area,
 - fading effects of asset purchases by the ECB,
 - real convergence of the Czech economy connected with growth in labour efficiency.
- In the following period, the appreciation will slow in connection with the start of monetary policy normalisation by the ECB.

- At its September monetary policy meeting, the CNB Bank Board decided to increase the two-week repo rate by 25 basis points to 1.50% (after hiking the rate by 25 basis points to 1.25% in early August).
 - At the same time, it increased the Lombard rate by 25 basis points to 2.50% and the discount rate by 25 basis points to 0.50%.
 - Six members voted in favour of this decision and one member voted for leaving interest rates unchanged.
- The Bank Board assessed the risks to the current inflation forecast at the monetary policy horizon as being balanced and the individual risks as being insignificant.
- However, there is still general uncertainty stemming from the growth in protectionist measures in global trade and from Brexit-related events.

Thank you for your attention



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