

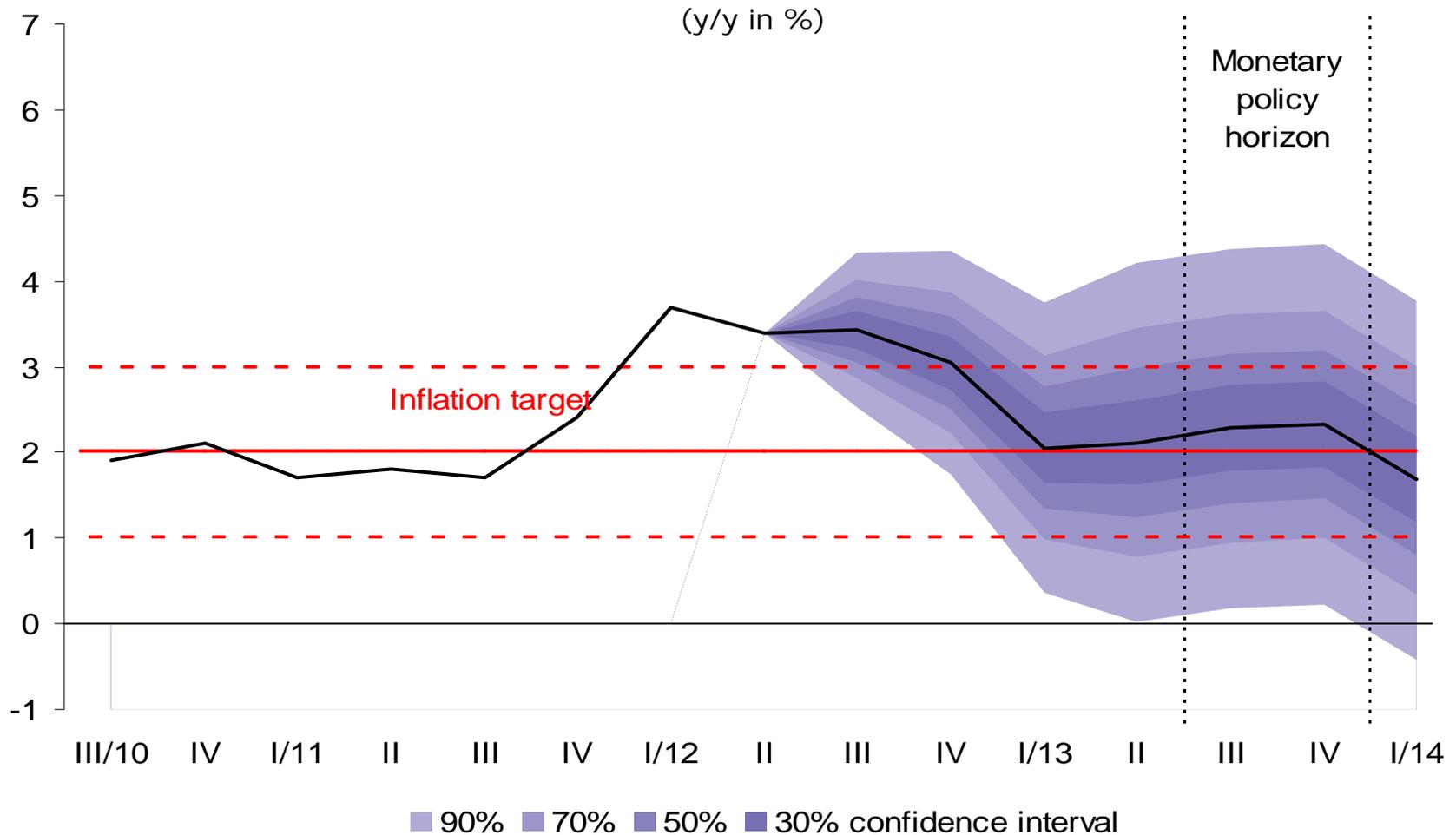
Meeting with Analysts

Tibor Hlédik

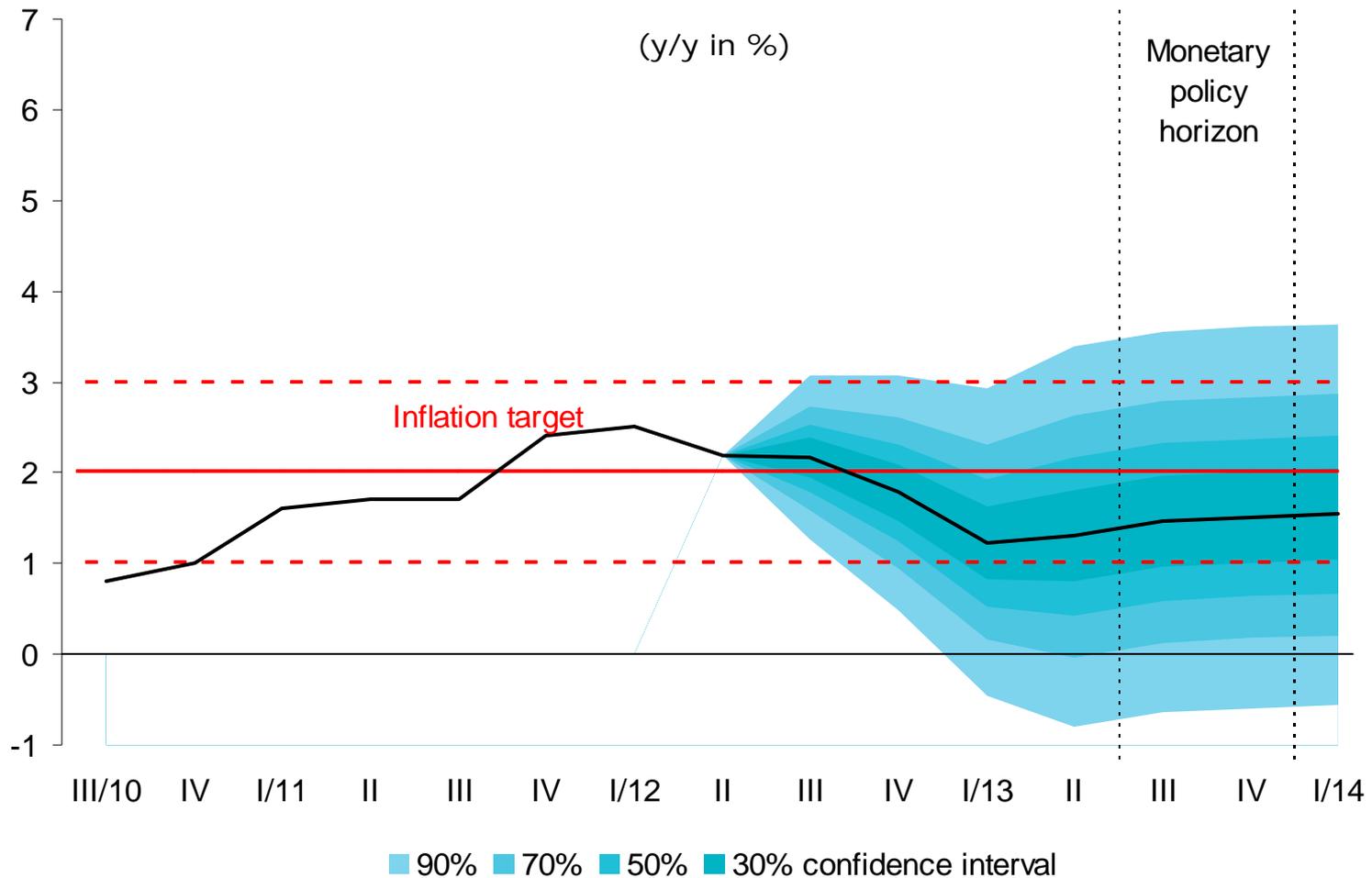
Prague, 10 August, 2012

- Headline inflation will get close the inflation target at the turn of 2013, during 2013 it will be slightly above target due to tax changes.
- MP-relevant inflation will fall below target at the end of 2012 and stay there during the coming two years.
- Administered-, fuel- and food price growth will gradually slow down. Adjusted inflation excl. fuels is expected to turn to a positive growth in the rest of this year and will increase further during 2013.
- There will be a significant slowdown of GDP growth in the effective euro area this year, 2013 should bring a gradual recovery. Foreign interest rates will remain at very low levels.

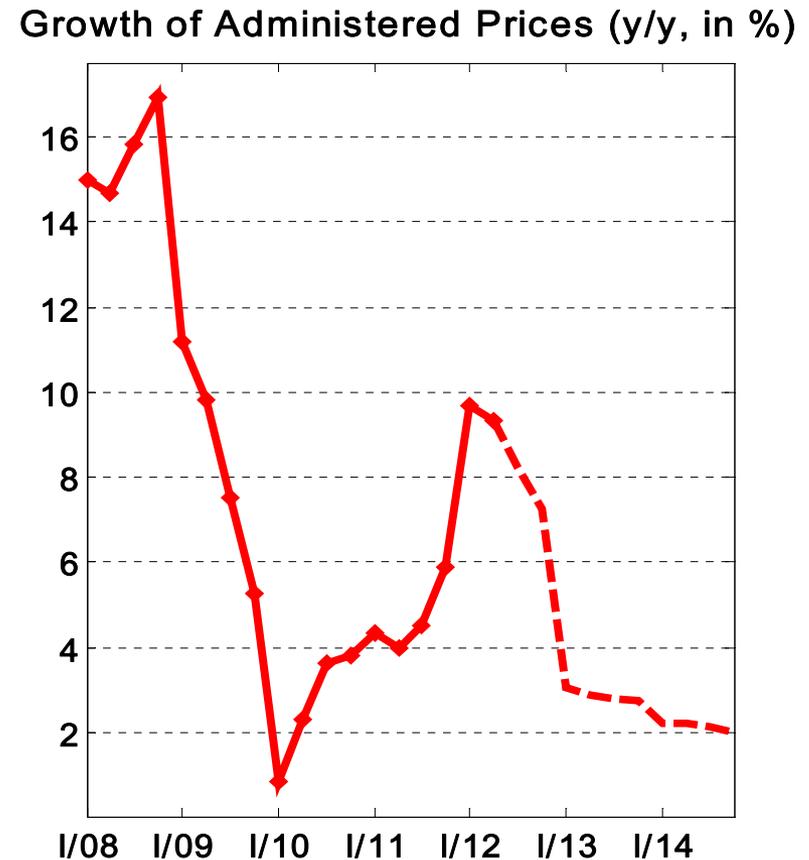
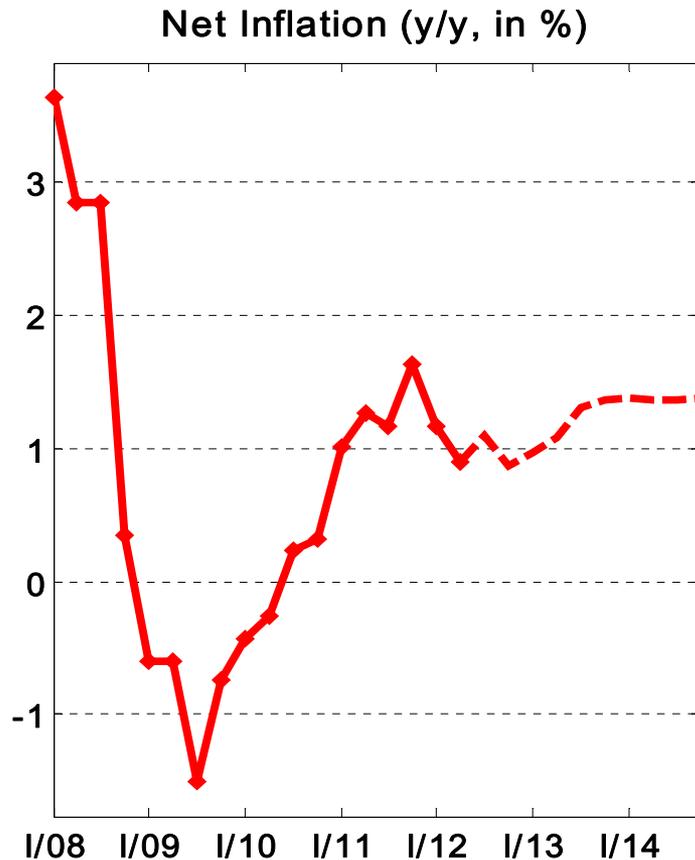
- The anti-inflationary pressures in the Czech economy will disappear at the beginning of 2013, domestic price pressures, however, will not emerge.
- The nominal exchange rate will be gradually appreciating from the currently somewhat depreciated levels. Inflationary pressures, stemming from currently high import prices, will moderate.
- The Czech economic growth will be negative (-0.9 %) this year. In 2013 there will be a slight economic recovery, curbed by fiscal consolidation.
- Consistent with the forecast is a decline in market interest rates in the next few quarters, followed by a rise in rates in 2014.



- Inflation will stay close to the current level in 2012 (VAT, commodities).
- In 2013, inflation will remain slightly above the inflation target, mainly due to VAT changes.

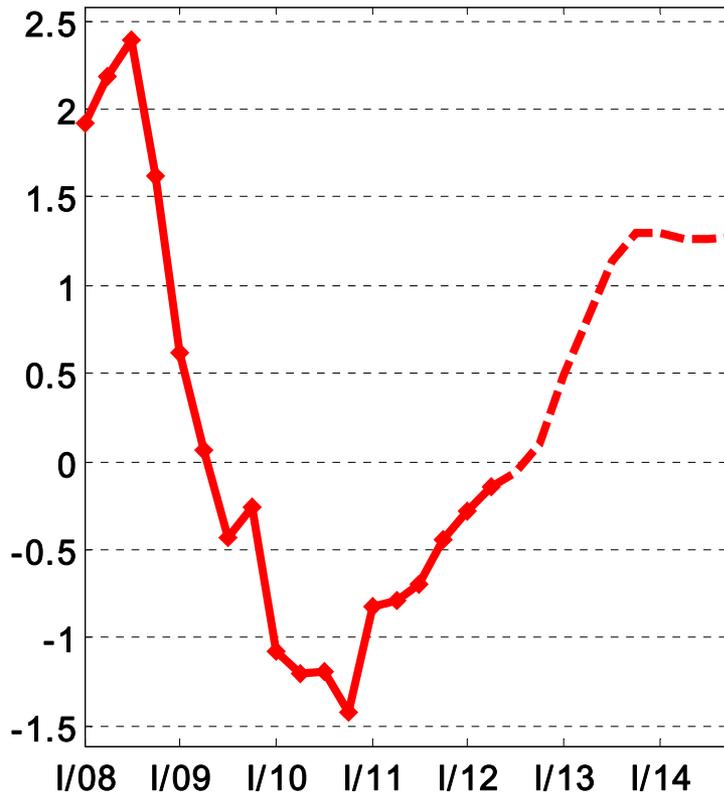


- MP-relevant inflation will be in the lower half of the target's tolerance band from late-2012 due to diminishing import price pressures as well as non-existent domestic price pressures.

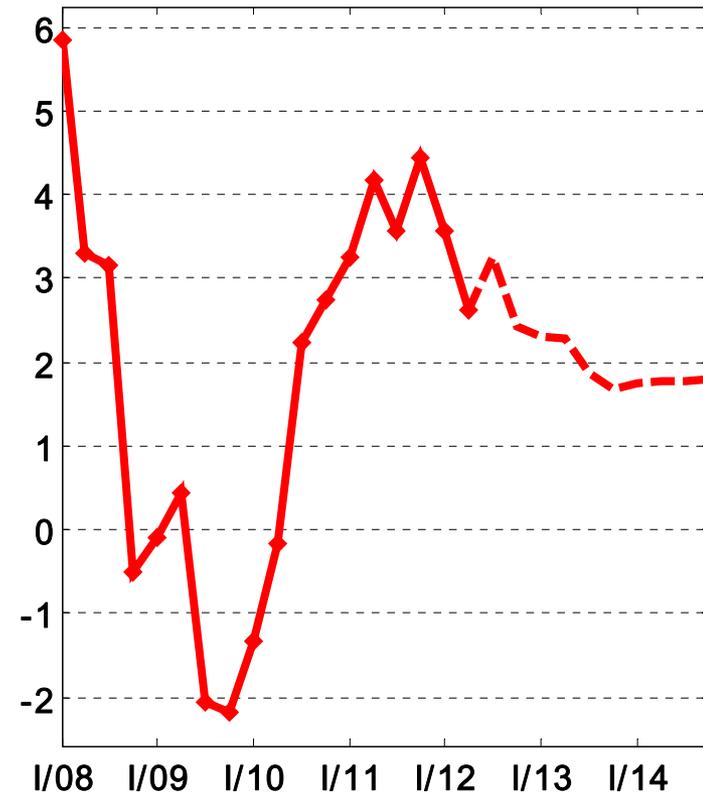


- Net inflation will be broadly stable this year. The speed-up of adjusted inflation excl. fuels will be offset by the slow-down of food prices.
- Growth of administered prices has reached its peak, and will slow down mainly at the beginning of 2013.

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

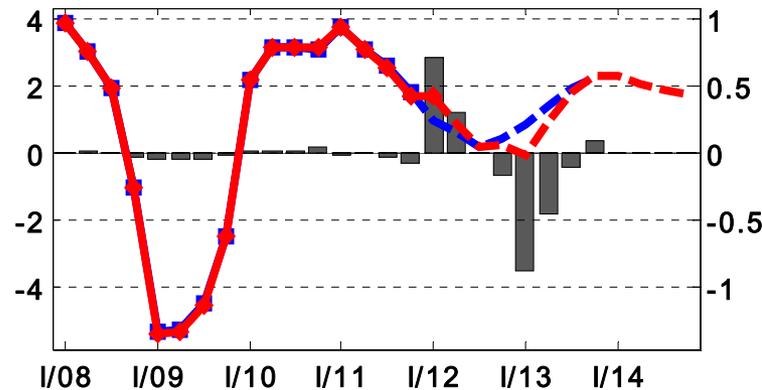


Food Inflation
(y/y, in %, Excl. Tax Changes)

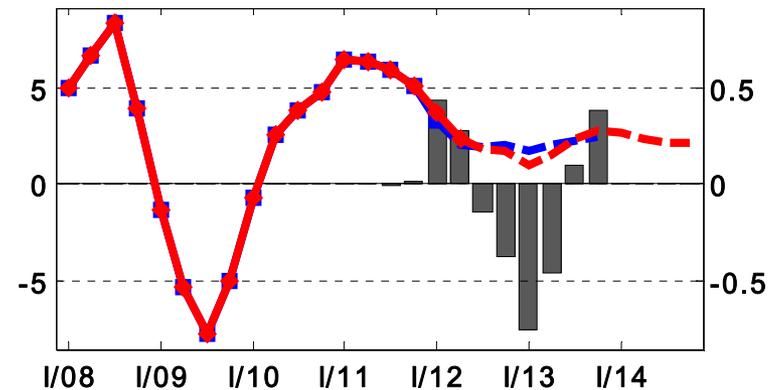


- Core inflation will turn positive in the rest of this year. In 2013, it will increase further to approx. 1,3 %.
- Food prices are expected to slow down from 4Q 2012 due to the y/y fall in agricultural producer prices observed at the beginning of this year.

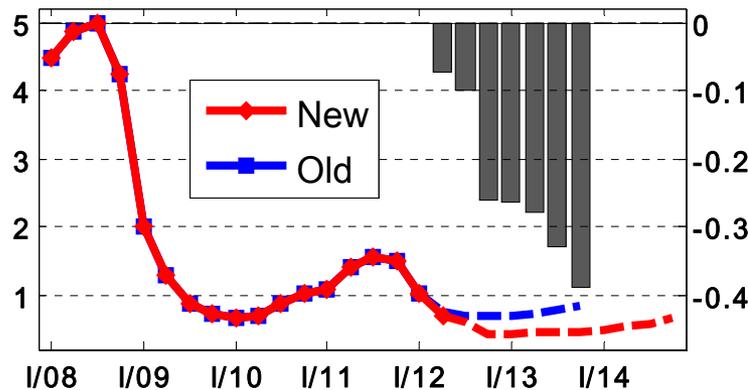
Growth Rate of GDP - Eurozone (y/y, in %)



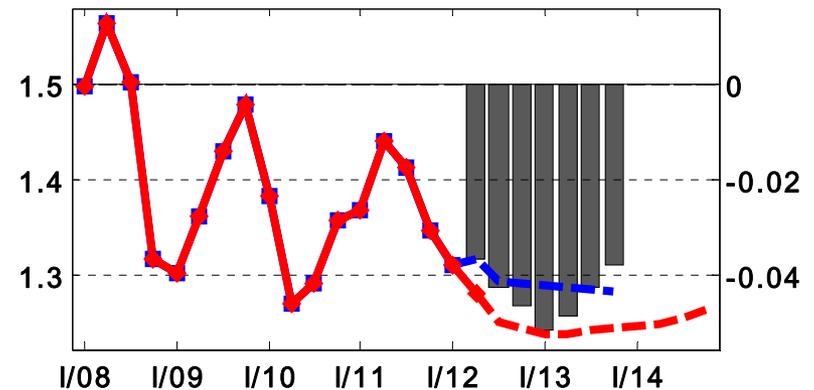
PPI Inflation - Eurozone (y/y, in %)



3M EURIBOR

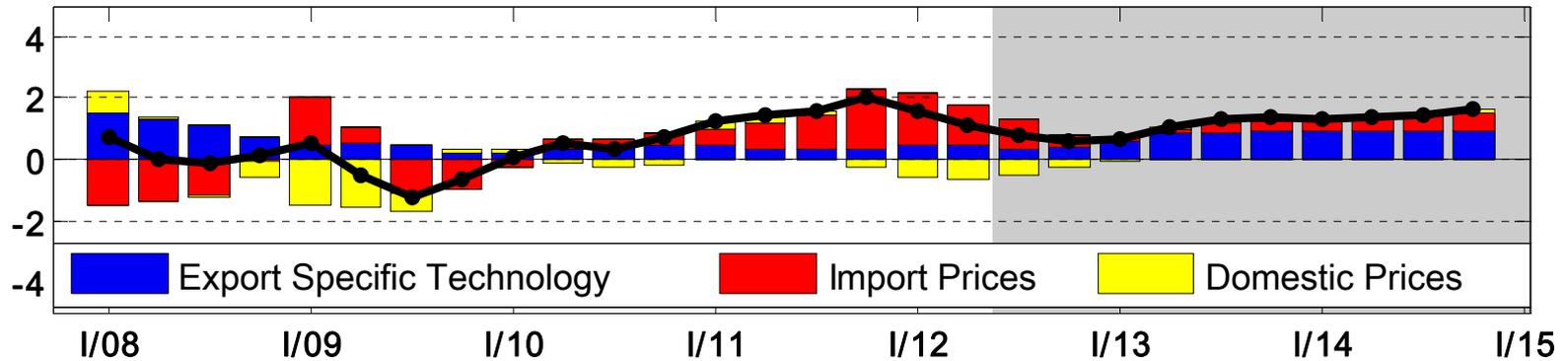


USD/EUR

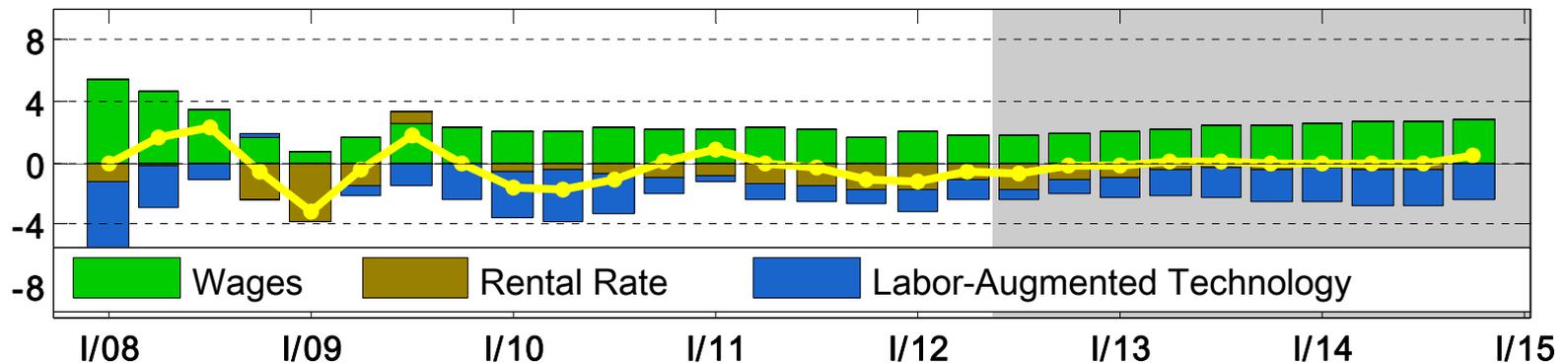


- Deeper slowdown in foreign GDP growth at the beginning of 2013.
- 3M EURIBOR is revised downwards on the whole forecast horizon.
- PPI growth expected to slow down due to commodities. Falling oil prices are partially compensated by weaker EUR against the USD.

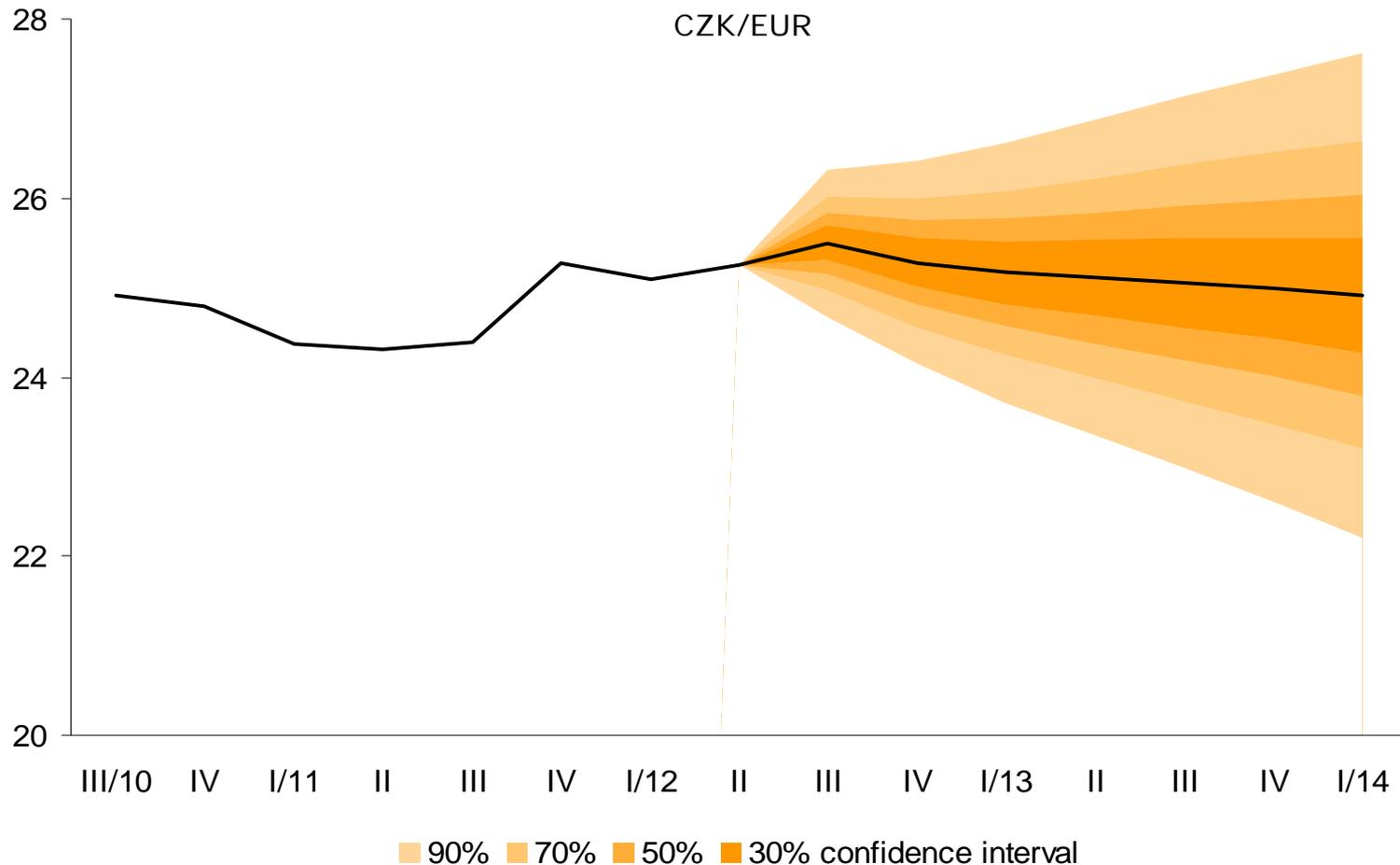
Nominal Marginal Cost in Consumption Sector (q/q, in %, ann.)



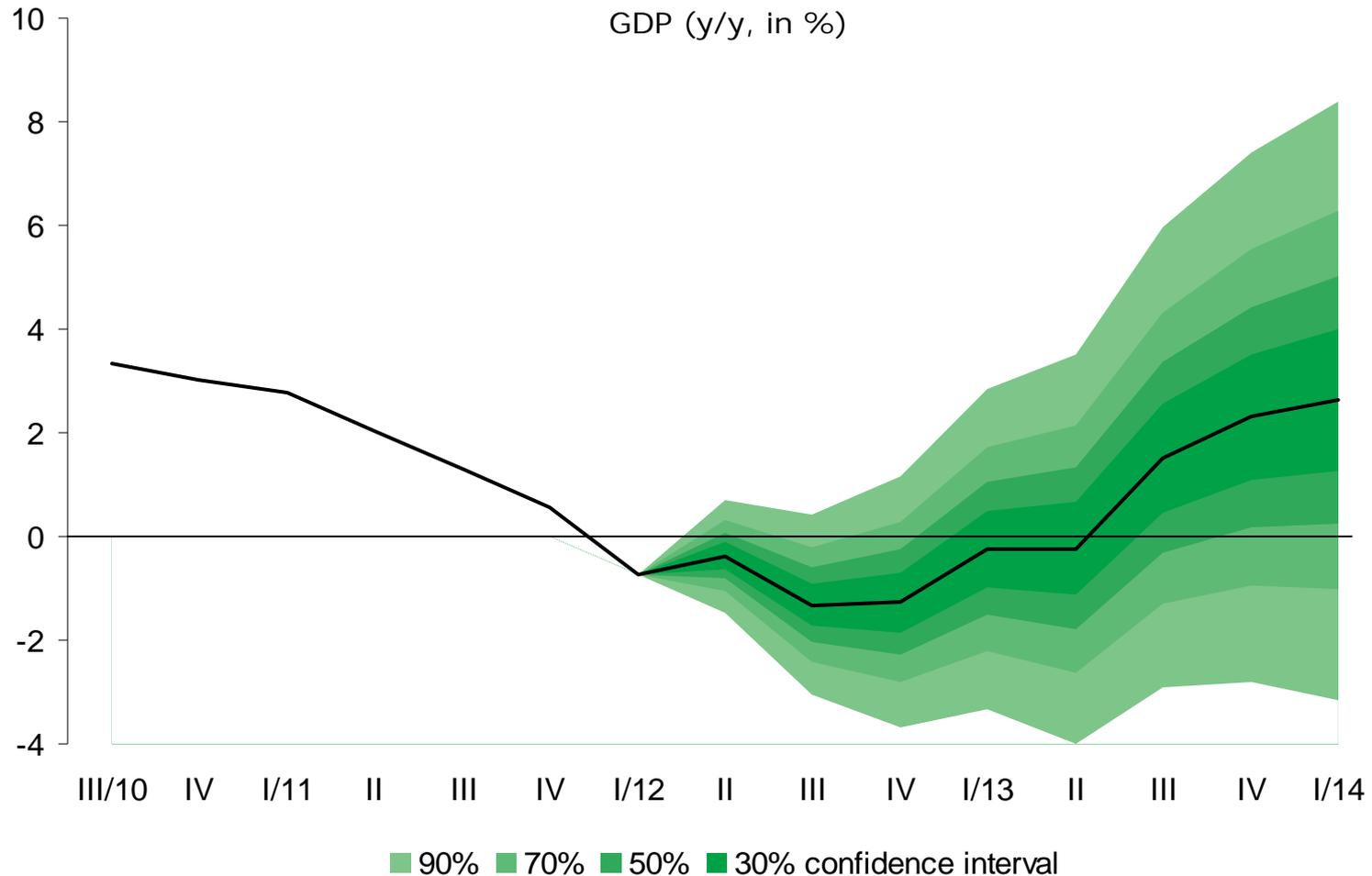
Nominal Marginal Cost in Intermediate Sector (q/q, in %, ann.)



- Inflationary pressures, caused by import prices, will moderate.
- Domestic inflation pressures are currently anti-inflationary due to low demand (incl. investment) and relatively subdued wage growth. No visible wage pressures are emerging on the forecast horizon.

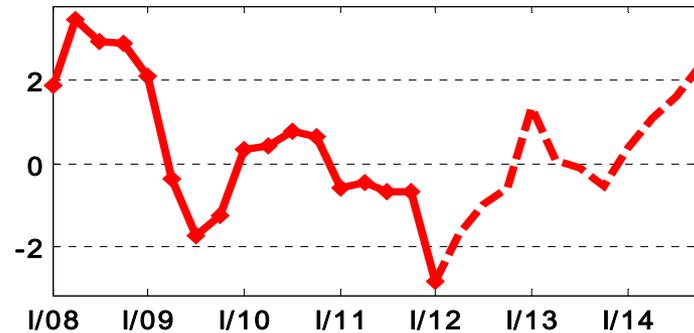


- Near-term forecast for 2012 Q3: CZK/EUR 25.5 (increased uncertainty due to deepening debt crises in the euro area)
- The exchange rate will appreciate gradually as net exports will improve on the forecast horizon (low DD, improving exports and ToT).

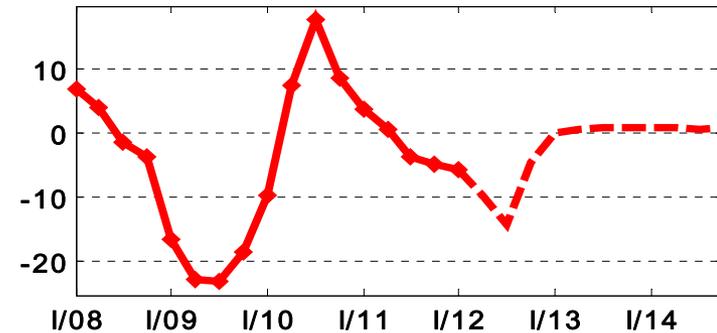


- GDP growth forecast: -0.9 % for 2012, 0.8% in 2013 and 2.5 in 2014.
- This year the only positive contribution comes from net exports, in 2013 fiscal consolidation will curb economic growths.

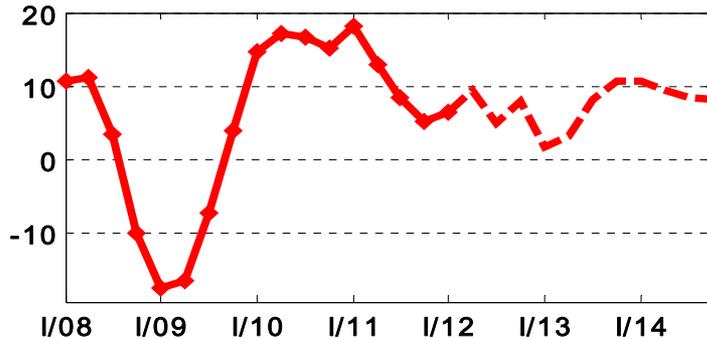
Household Consumption Growth (y/y, in %)



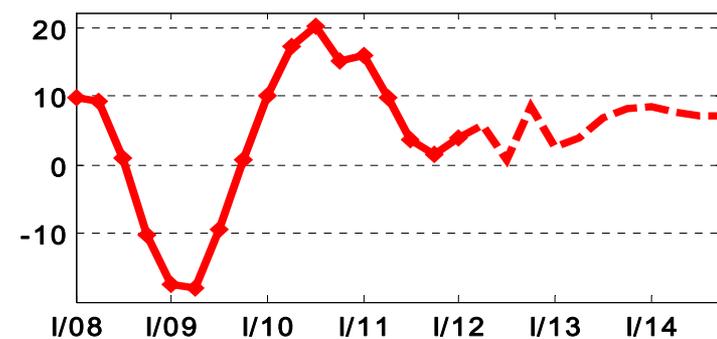
Investments Growth (y/y, in %)



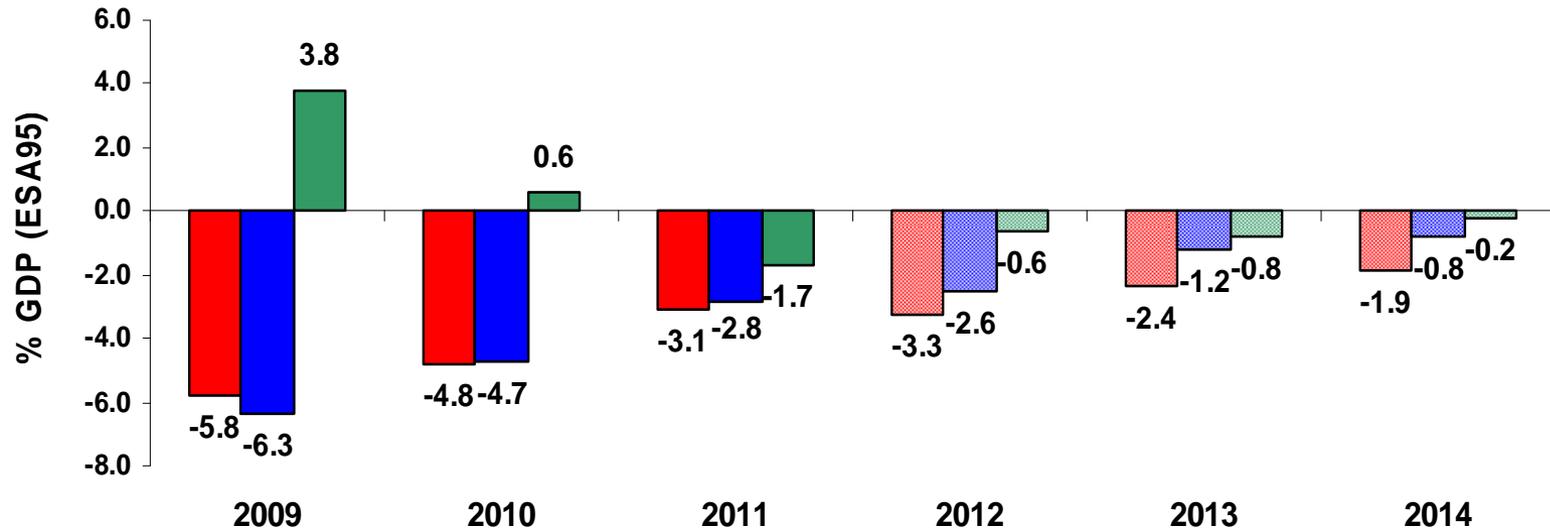
Exports Growth (y/y, in %)



Imports Growth (y/y, in %)



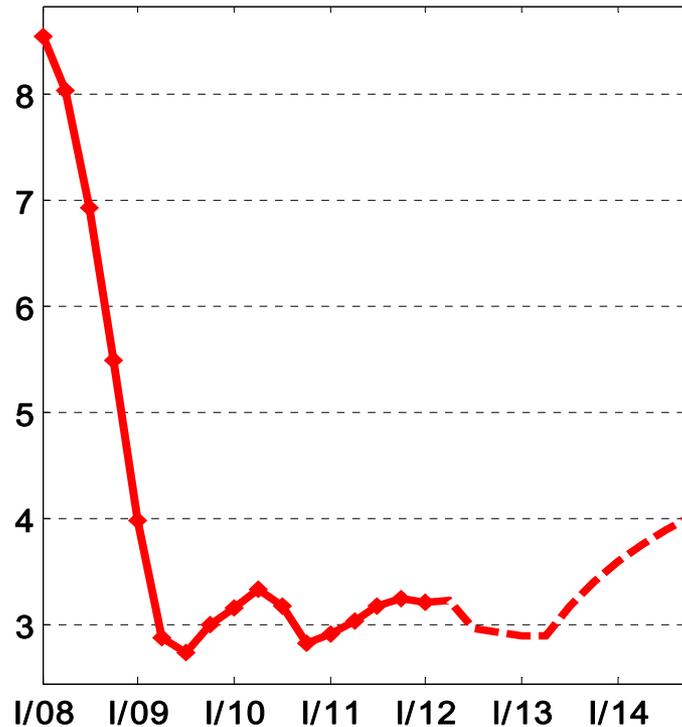
- Private consumption growth will fall this year due to weak real disposable income growth and negative sentiment.
- Low investment reflects weak 1Q, low foreign demand and weak overall activity on the forecast horizon. Net exports will have a positive contribution.



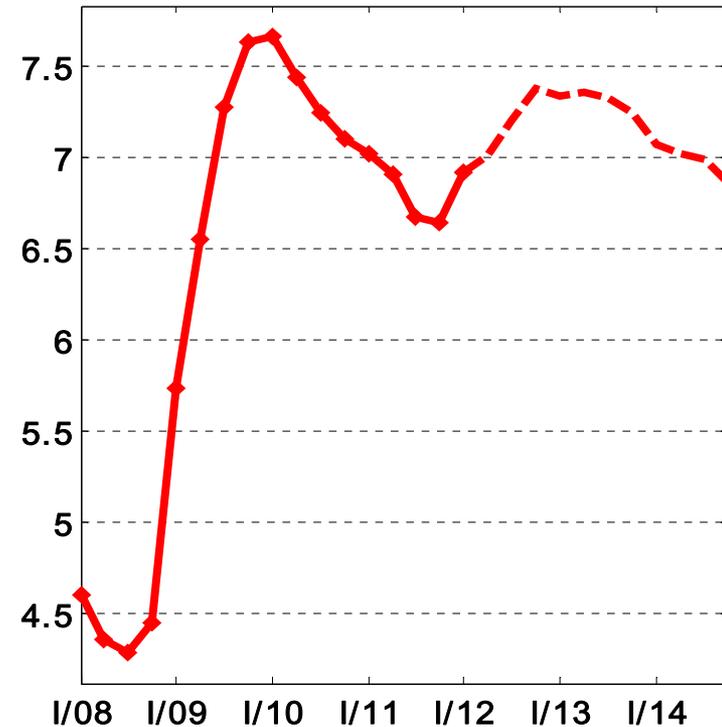
■ Public budget deficit ■ Structural deficit (ESCB) ■ Real government consumption (y-o-y %)

- This year we assume a slight increase of the deficit due to cyclical deterioration of the Czech economy
- The baseline forecast assumes the increase of both VAT rates by one p.p. in 2013. It also includes other fiscal consolidation measures approved in April 2012 (the alternative scenario of the last baseline)
- In 2014 the deficit will decline further to less than 2 % of GDP.

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



General unemployment rate (ILO)
(in %, s.a.)



- Nominal wage growth (after the adjustment of one-off effects) remains relatively low and in the 2H 2012 is expected to slow down. Wage growth will start increasing during 2013 due to gradually reviving external demand.
- The unemployment rate (ILO) will increase slightly due to a moderate decline in employment. Recovery on the labour market only in 2014.

Official wage growth as of 1Q 2012: **3.6 %**

Of which:

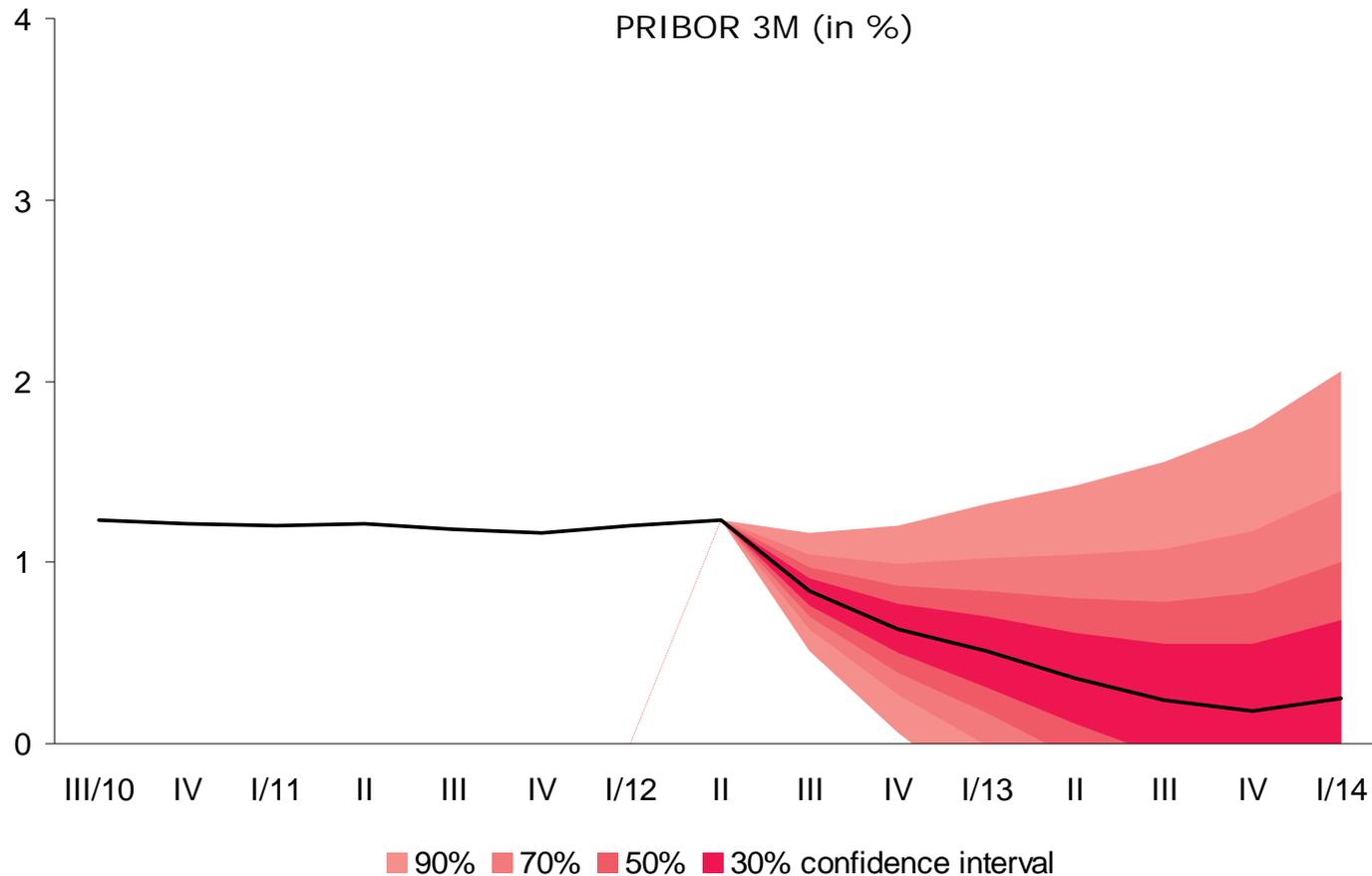
1.2 p.p. one-time bonuses (esp. car industry)

0.3 p.p. increased share of paid leave instead of sickness leave

0.2 p.p. lay-offs in low-income jobs

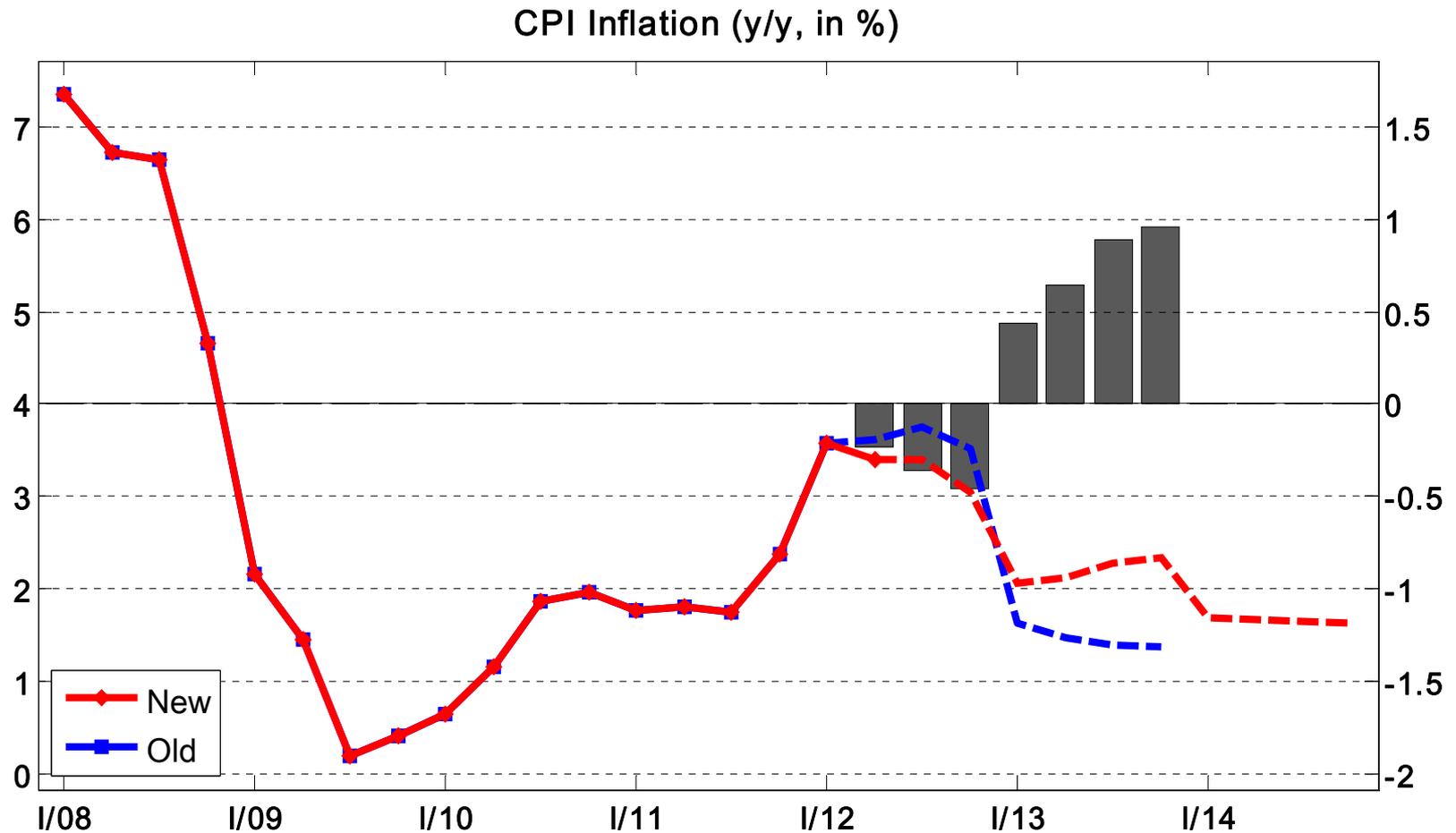
1.9 p.p. fundamental (tariff) growth

Considered wage growth: **3.2 %**



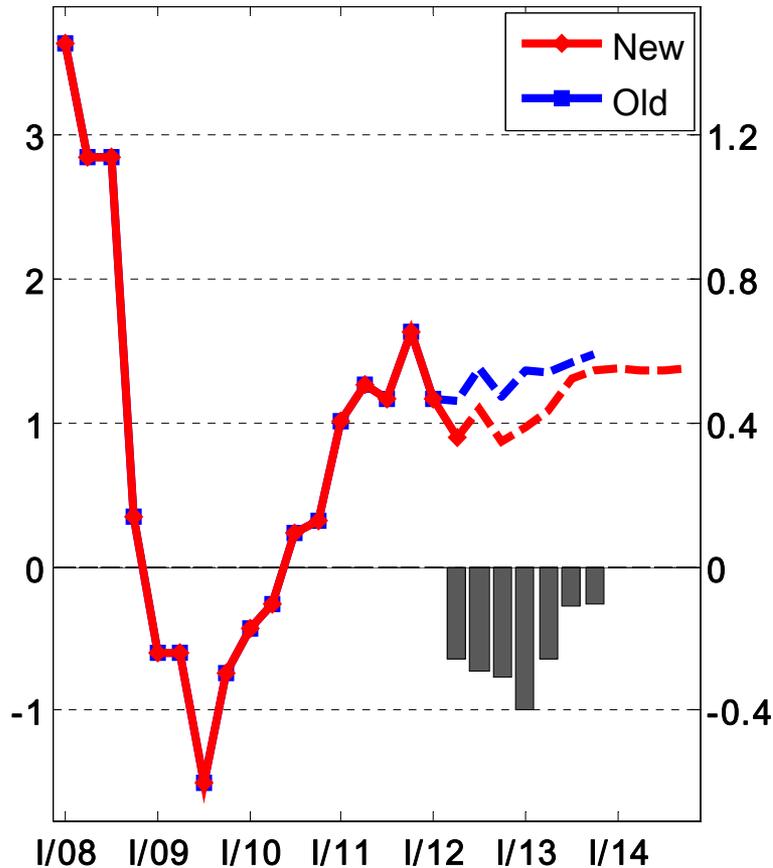
- Consistent with the forecast is a decline in market interest rates in the next few quarters, followed by a rise in rates in 2014.
- Factors: subdued domestic economy incl. a deep fall in consumption, curbing effect of a fiscal consolidation and low foreign interest rates.

- The forecast of headline inflation was decreased for this year. In 2013 it is higher due to indirect tax increases.
- Net- and regulated price inflation were revised down. In the net inflation basket, food prices were revised upwards, while adjusted inflation will be lower.
- The exchange rate is weaker on the whole forecast horizon.
- The forecast of negative economic growth for 2012 fully reflects the negative consumption and investment figures. Fiscal consolidation and lower foreign demand will slow down the recovery in 2013.
- Nominal wage growth is slightly higher for the near term, but lower for 2013.
- The interest rate path is lower for the whole forecast horizon, the downward shift is growing over time.

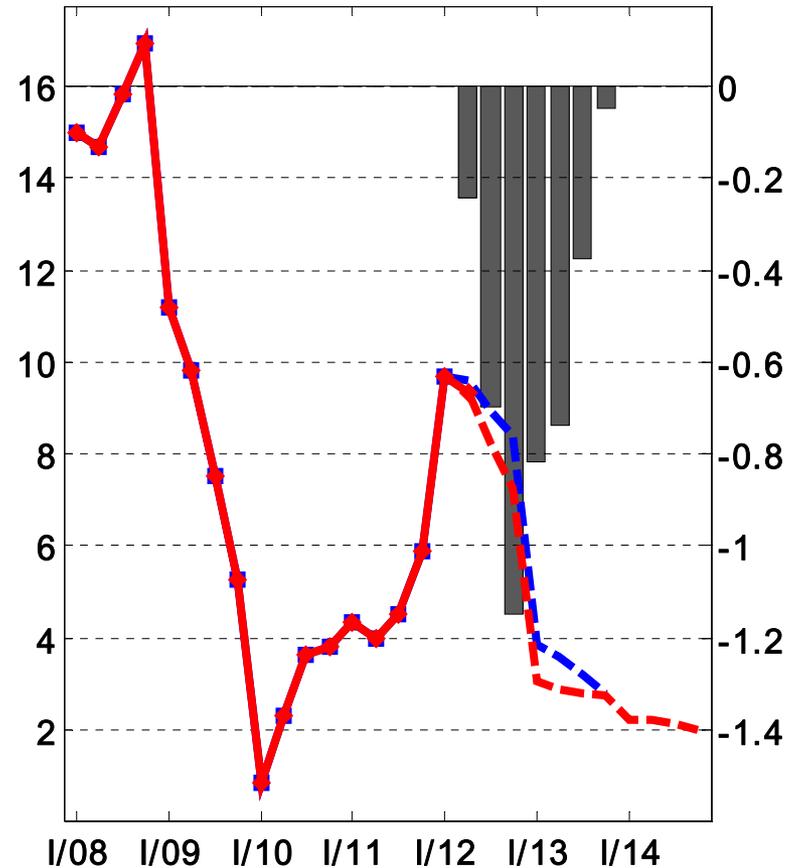


- The forecast of headline inflation is lower all over 2012, but due to VAT increases it is considerably increased for 2013.

Net Inflation (y/y, in %)

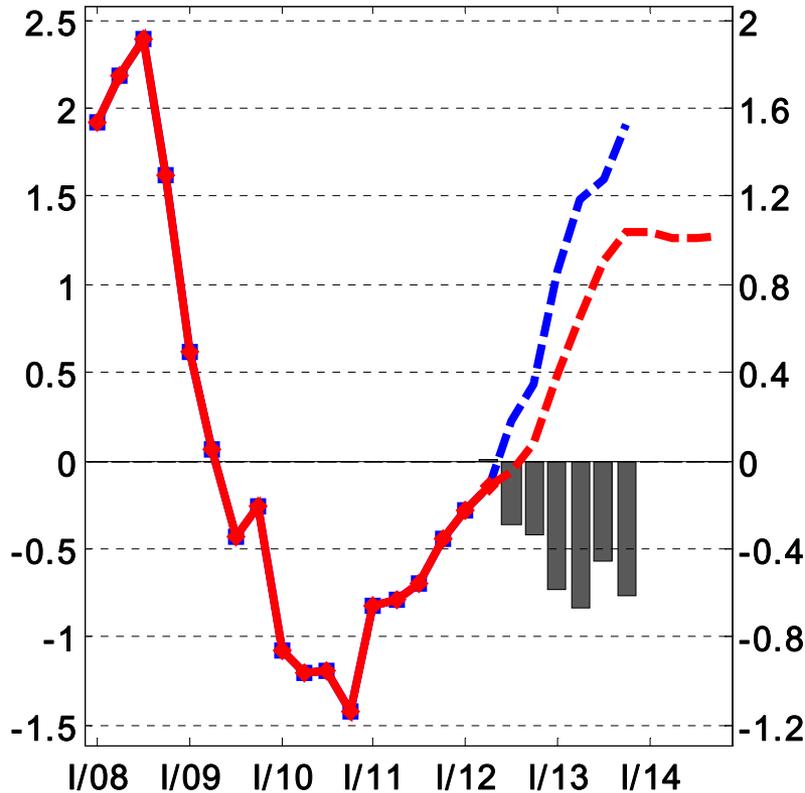


Growth of Administered Prices (y/y, in %)

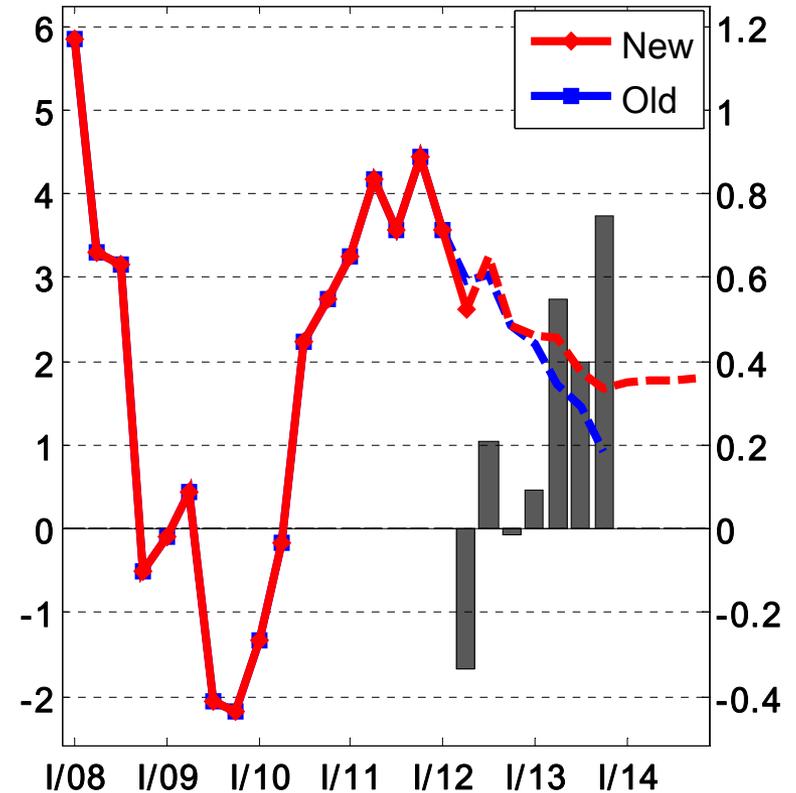


- Net inflation: lower fuel prices (oil), less pronounced fundamental price pressures (more anti-inflationary domestic economy, weaker B-S effect).
- Administered prices: lower gas prices mitigated by weaker USD, positive primary effect of VAT increases.

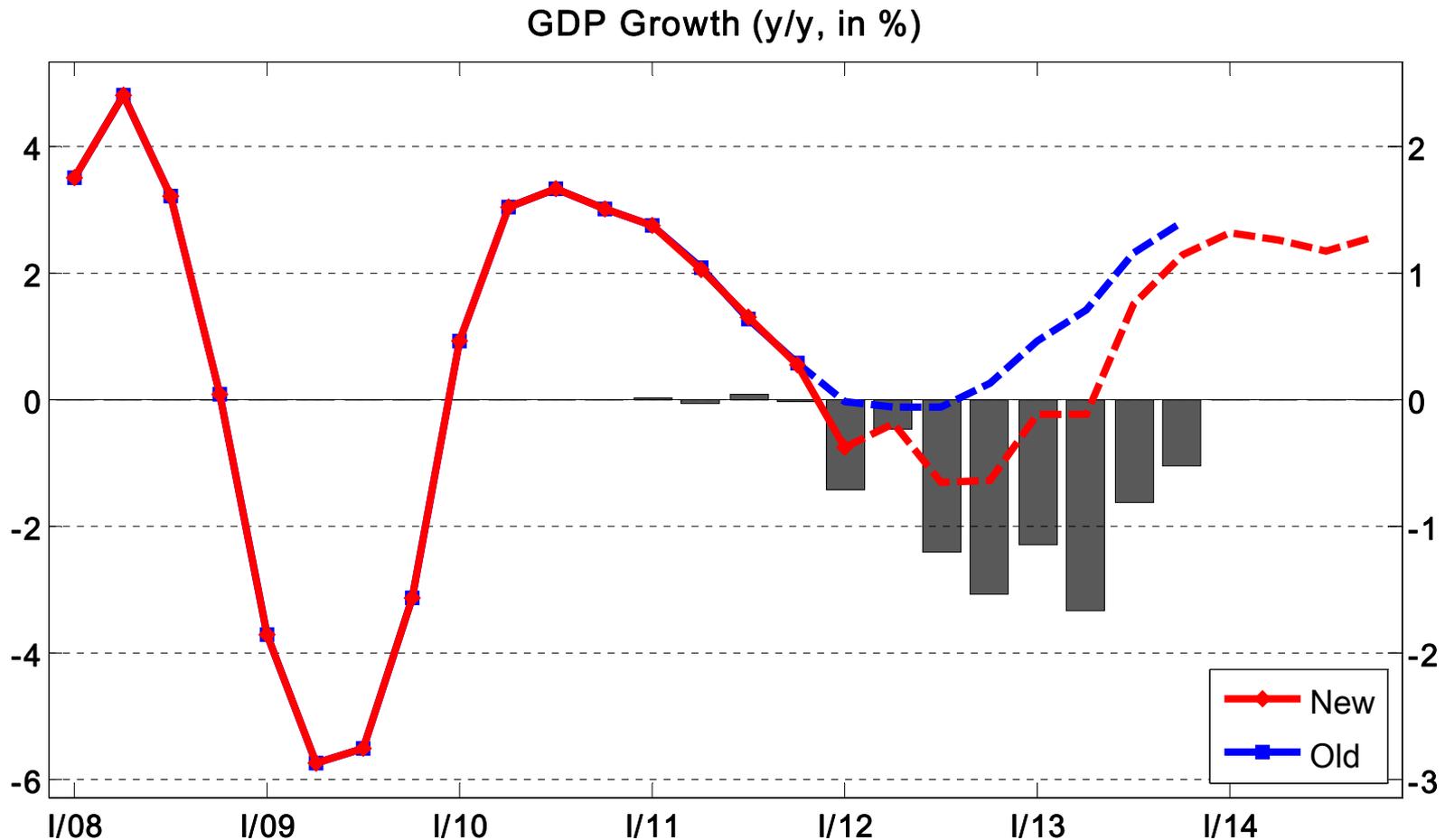
Adjusted Inflation Excl. Fuels
(y/y, in %, Excl. Tax Changes)



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

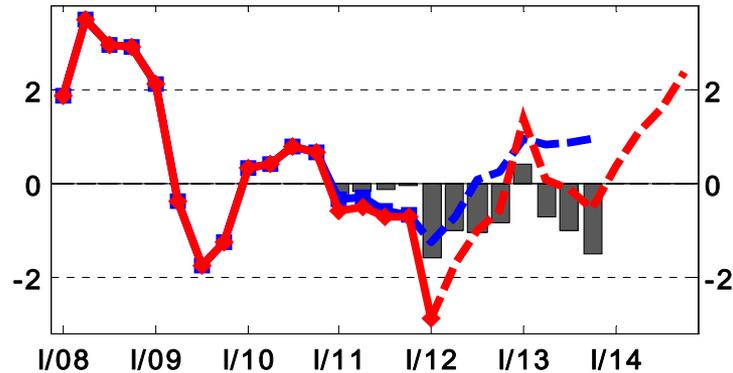


- The lower forecast of adjusted inflation reflects more anti-inflationary domestic economy, only partly offset by weaker exchange rate.
- The forecast of food price inflation was increased due to the higher outlook for agricultural commodity prices.

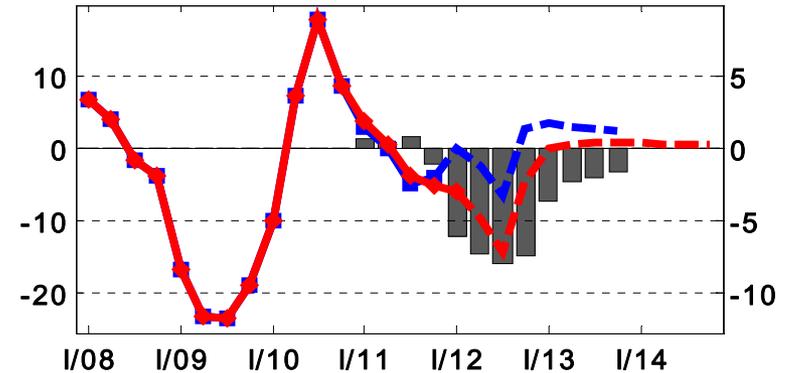


- The overall GDP forecast is gloomier due to very weak 1Q 2012 (with some correction upward in the 2Q), continuing fiscal consolidation measures and changes in foreign outlook.

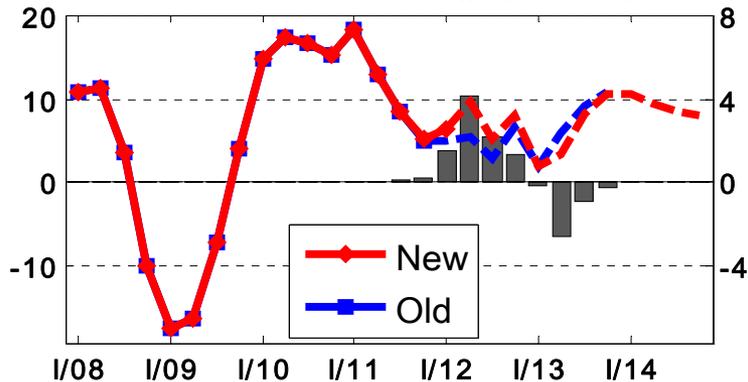
Household Consumption Growth (y/y, in %)



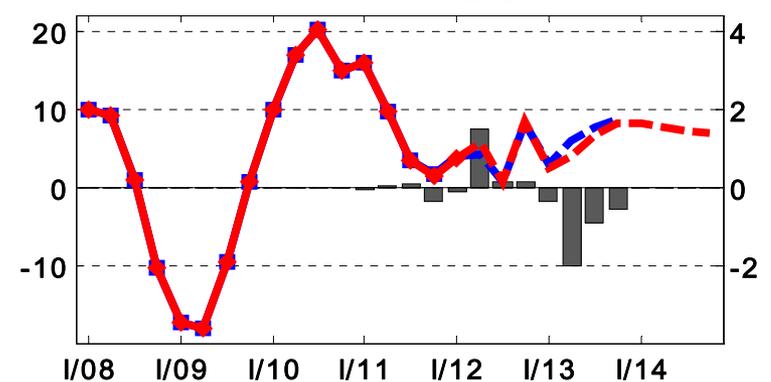
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)

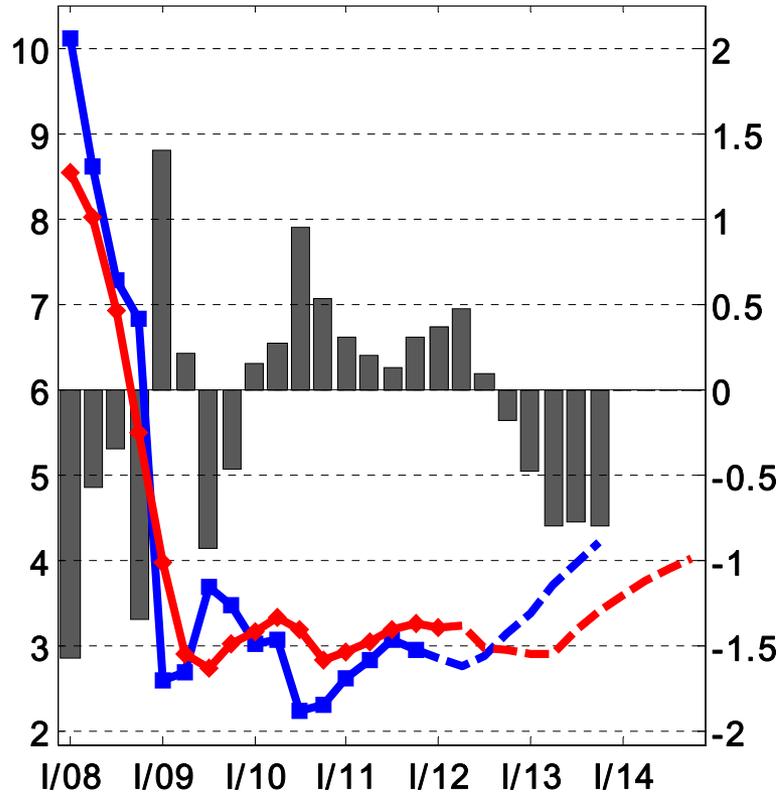


Imports Growth (y/y, in %)

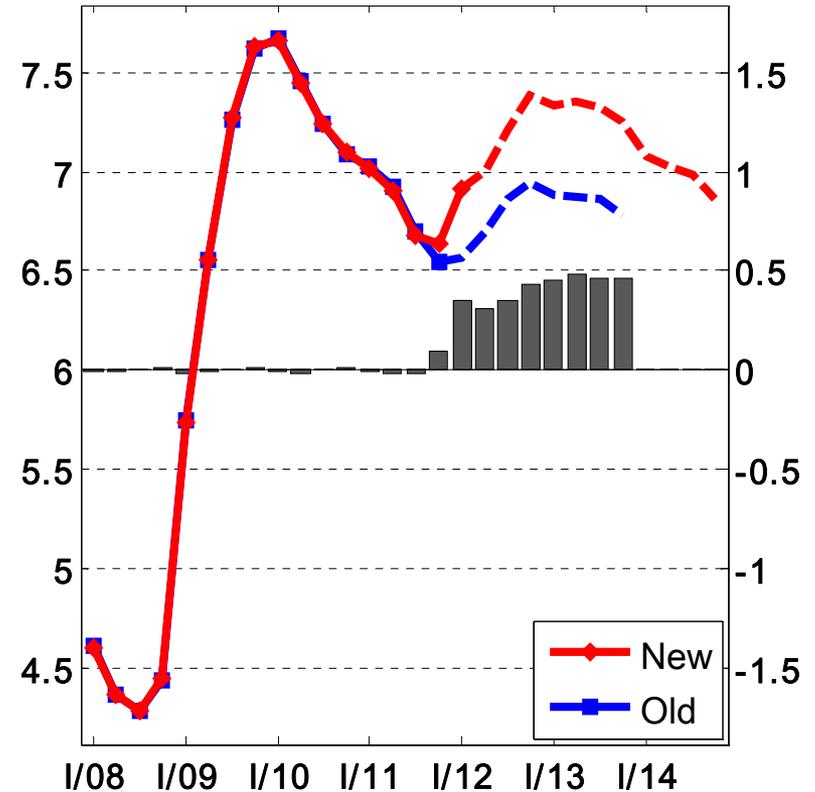


- Lower than expected household consumption (weak 1Q + fiscal consolidation) and investment activity reflecting low foreign demand.
- More significant improvements in exports compared with imports: improving net exports.

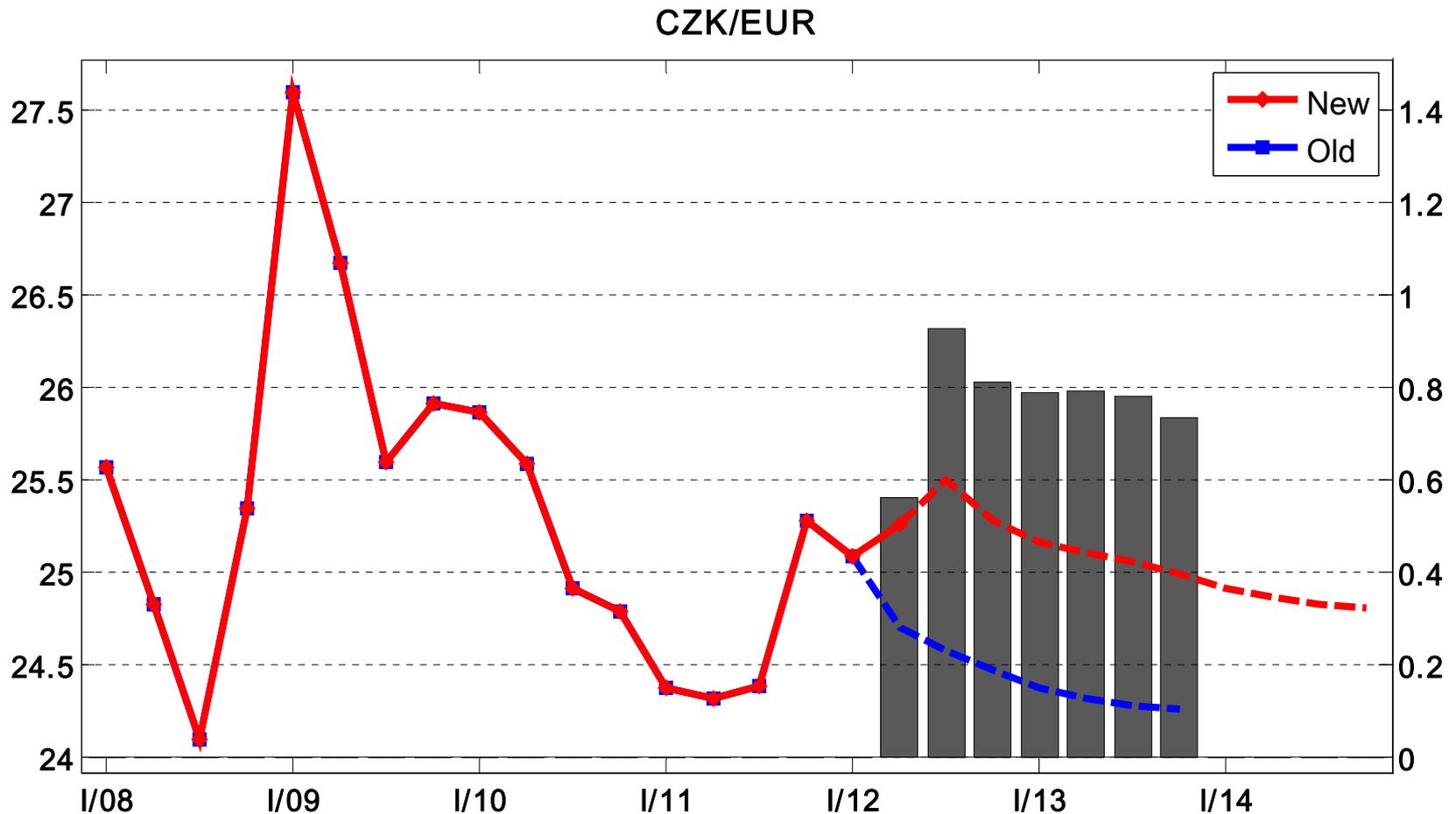
Nominal wage growth in business sector
(y/y, in %, s.a.)



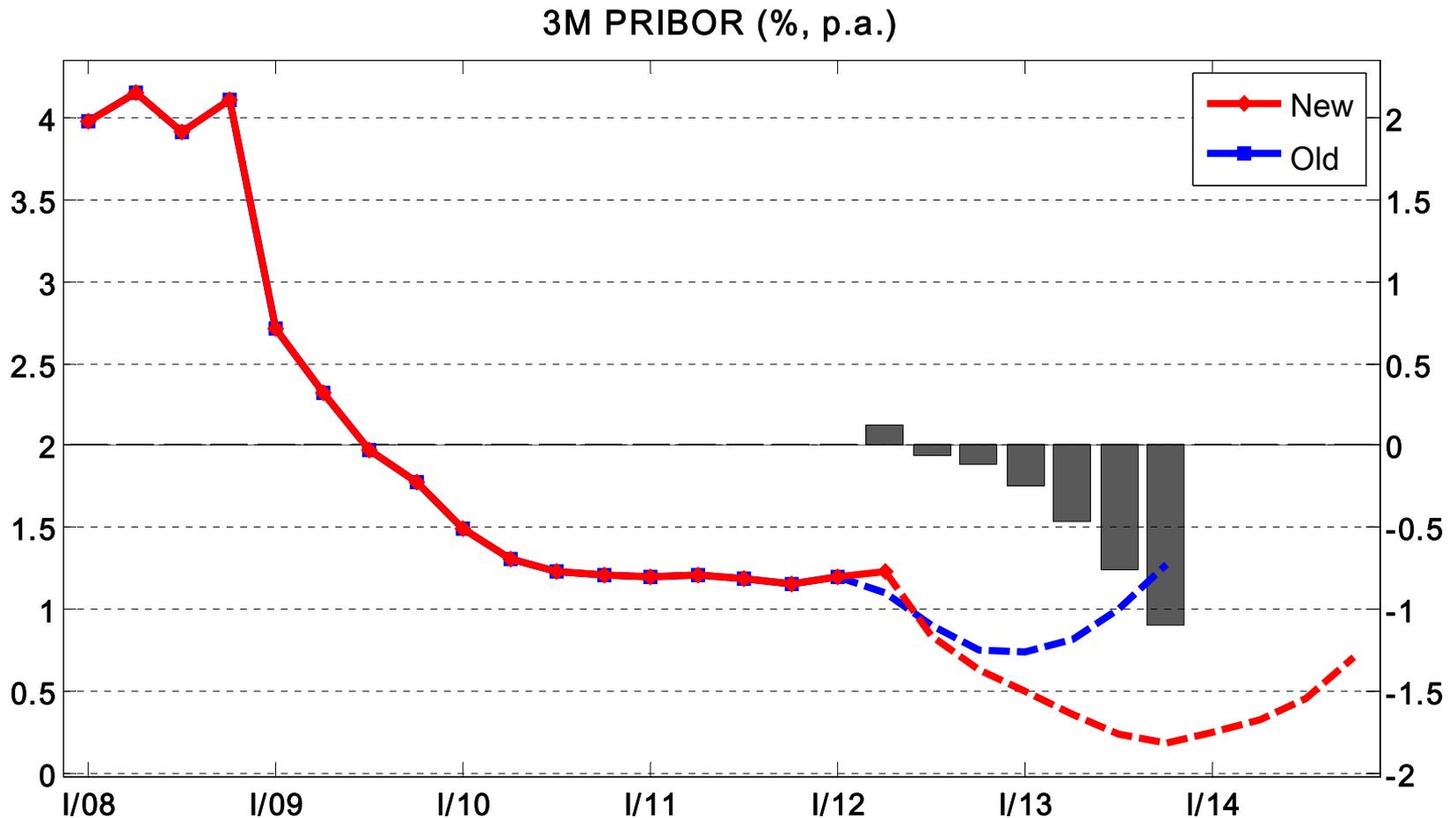
General unemployment rate (ILO)
(in %, s.a.)



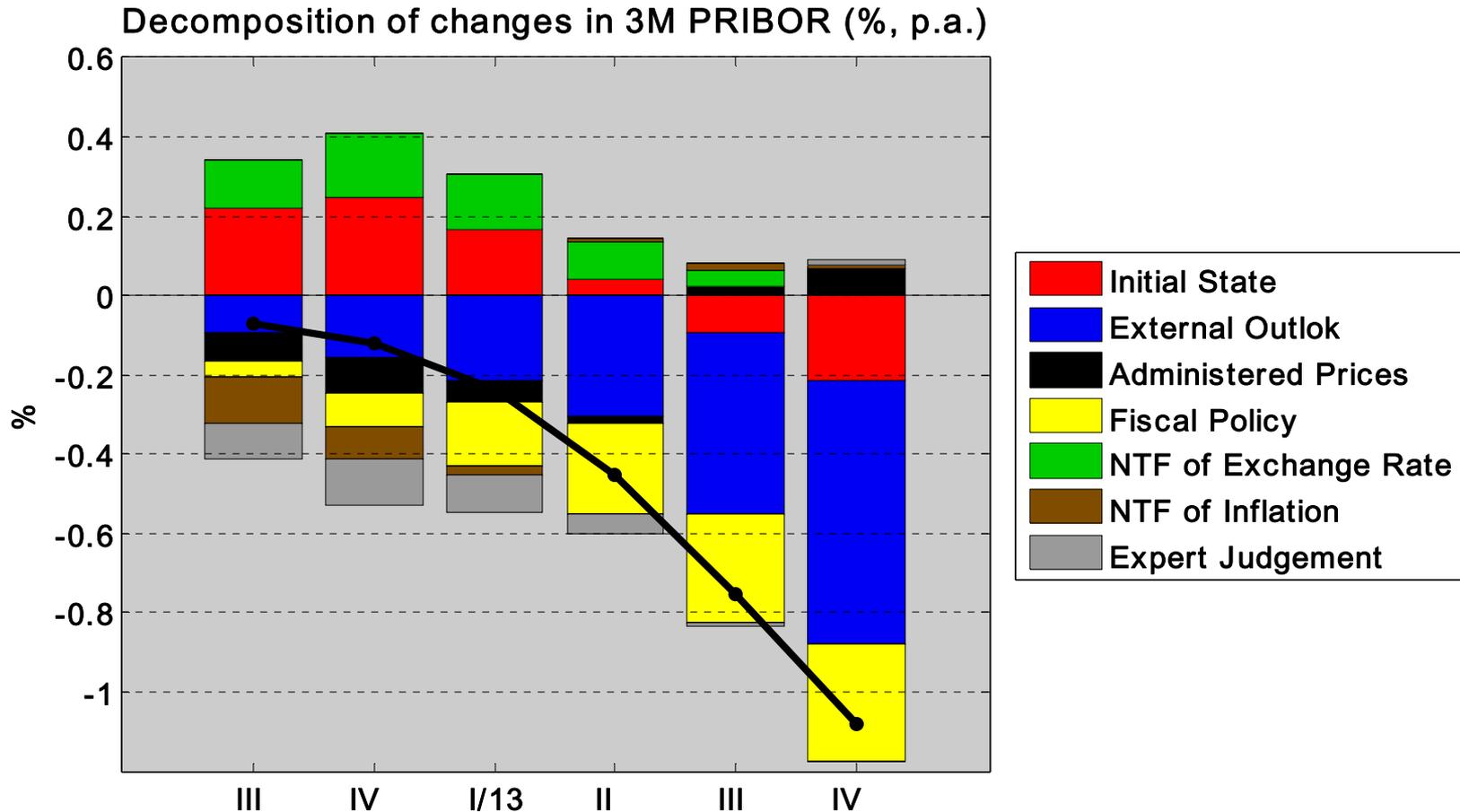
- Slightly higher growth of nominal wages reflects faster wage growth in the industry in early-2012. Lower wage dynamics in 2013 is given by weaker foreign and domestic economic activity.
- Forecast of the unemployment rate reflects lower economic growth.



- The considerably weaker exchange rate forecast is a result of a depreciation in 2Q 2012 and weaker near-term forecast assuming a negative effect of the deepening euro area debt crises on the CZK.

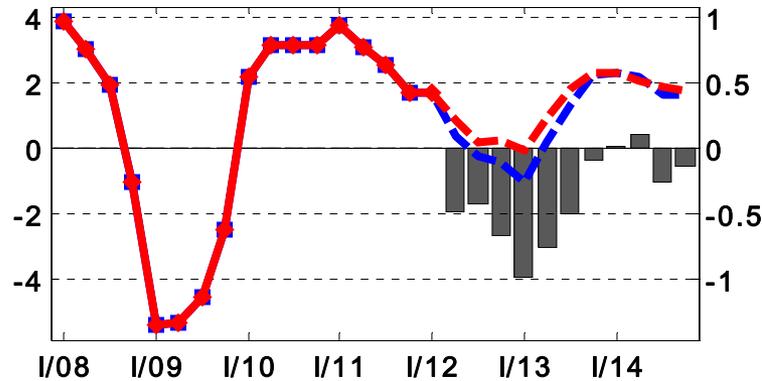


- The interest rate path has been revised downward on the whole forecast horizon. The fall in interest rates is more significant in 2013, gradual increase is expected only at the beginning of 2014.

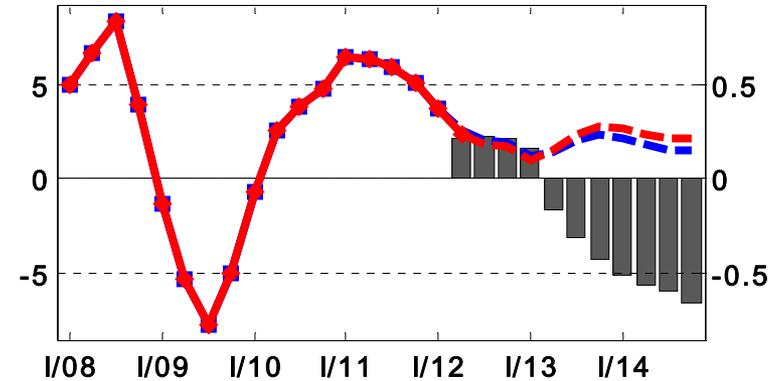


- The most significant factors behind the downside pressures on short term interest rates are low foreign interest rates and fiscal consolidation. Slightly higher wages on initial conditions and weaker CZK are somewhat compensating for these downward effects.

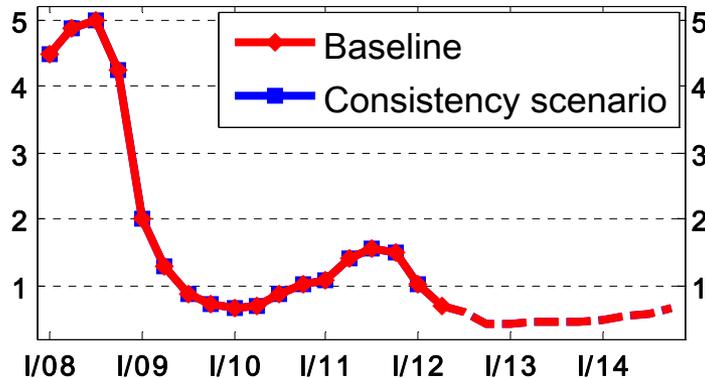
Growth Rate of GDP - Eurozone (y/y, in %)



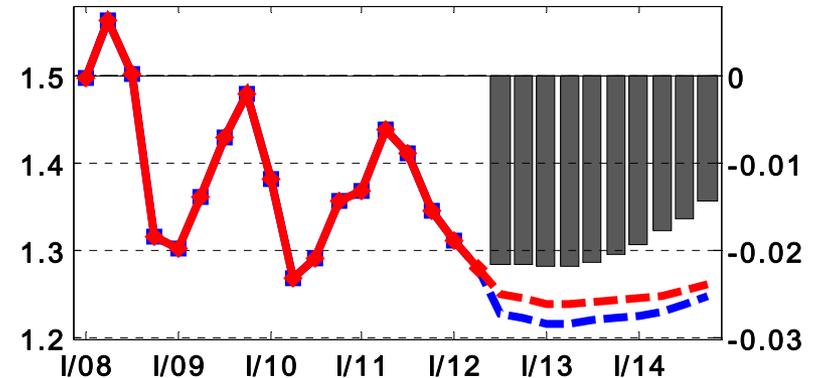
PPI Inflation - Eurozone (y/y, in %)



3M EURIBOR

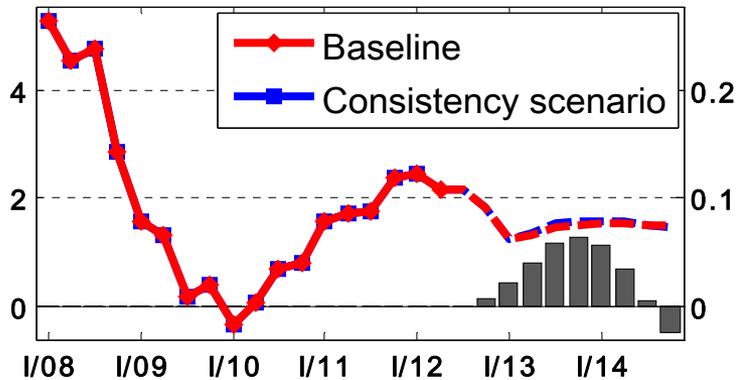


USD/EUR

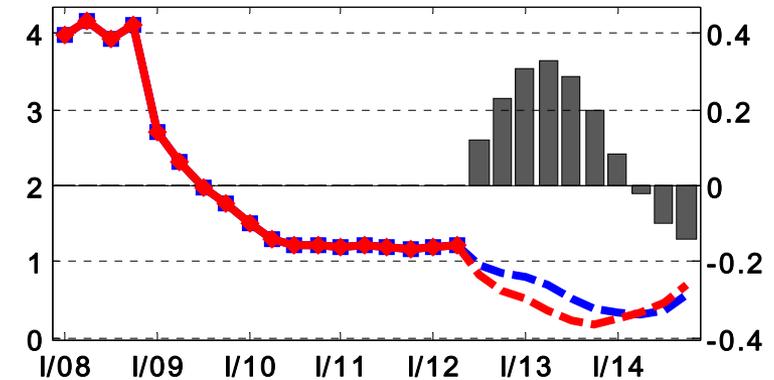


- Simulating lower economic growth in the euro area (by approx. 0.5 %) that would justify the currently prevailing low interest rate outlook in NIGEM.
- Weaker EUR/USD and declining PPI from the beginning of 2013. Small drop in oil prices as a reaction to falling European demand.

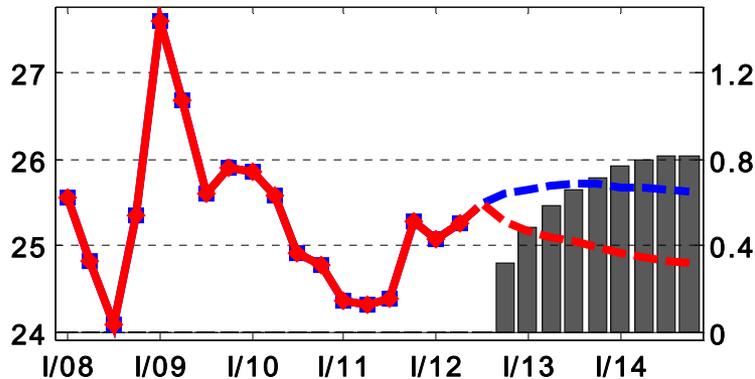
MP inflation (y/y, in %)



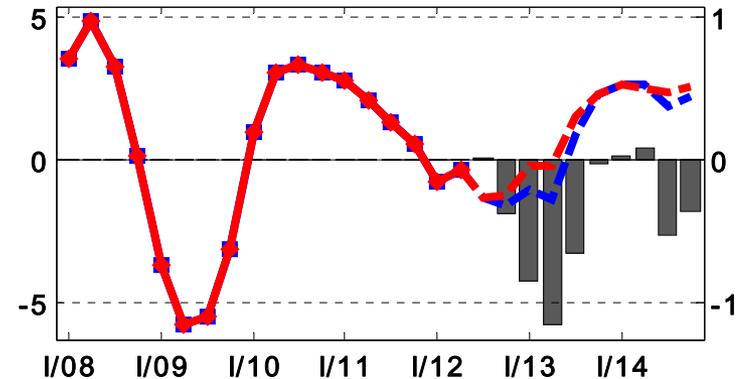
3M PRIBOR (in %, p.a.)



Exchange rate CZK/EUR



GDP Growth (y/y, in %)



- Weaker foreign demand is consistent with lower net exports and more depreciated exchange rate (NFA channel). The exchange rate pushes prices and interest rates up slightly more than the slower domestic growth does in the opposite direction.

Thank you for your attention

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