

Meeting with Analysts

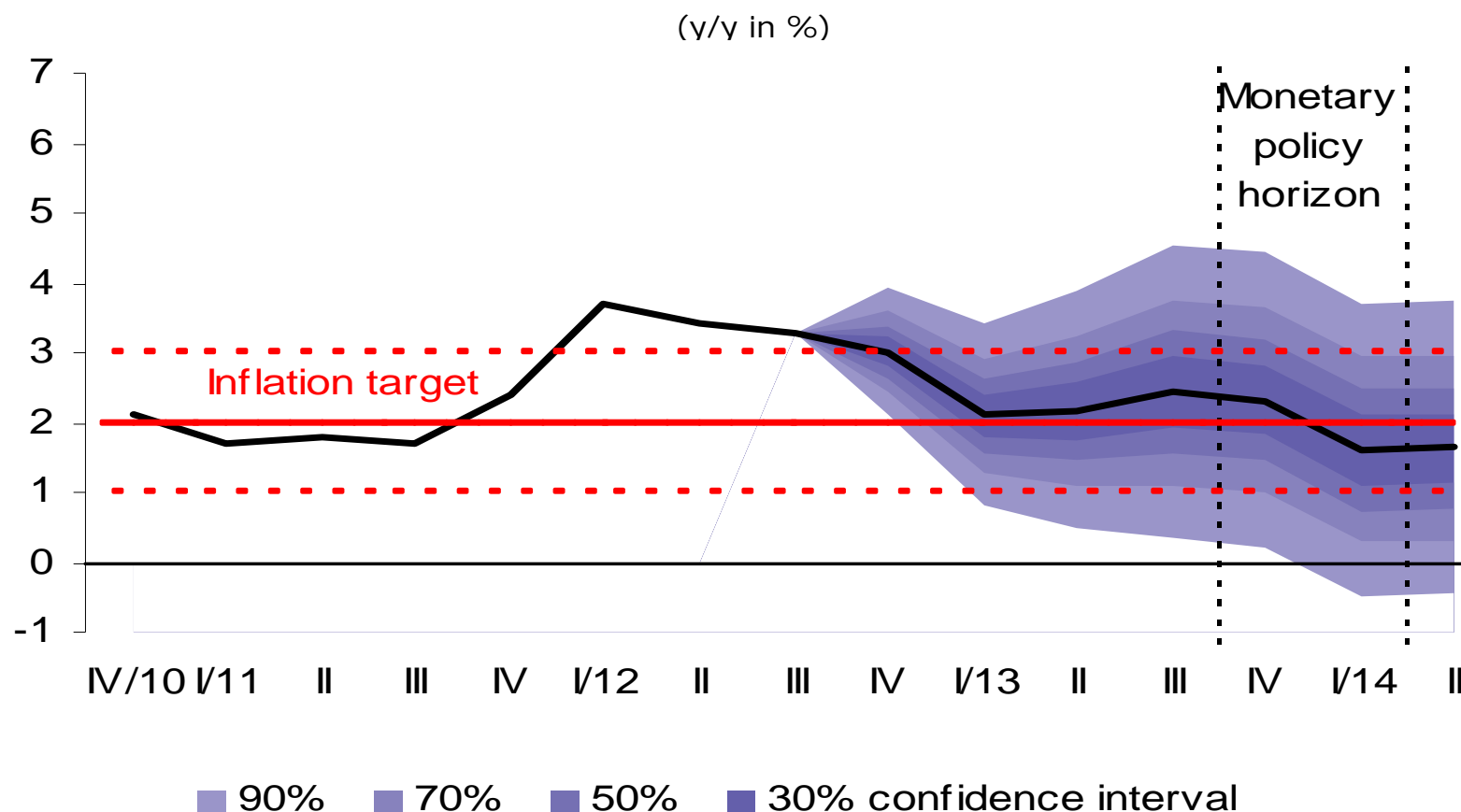
Tomáš Holub

Prague, 9 November, 2012

- Headline inflation will be slightly above the CNB's target in 2013 owing to tax changes, and will fall below the target after this tax effect drops out.
- MP-relevant inflation will fall below the target at the end of 2012 and stay there during the coming two years.
- The growth of administered, food and fuel prices will slow down. Adjusted inflation excl. fuels is expected to turn positive in the first quarter of 2013, and to gradually increase thereafter.
- 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.

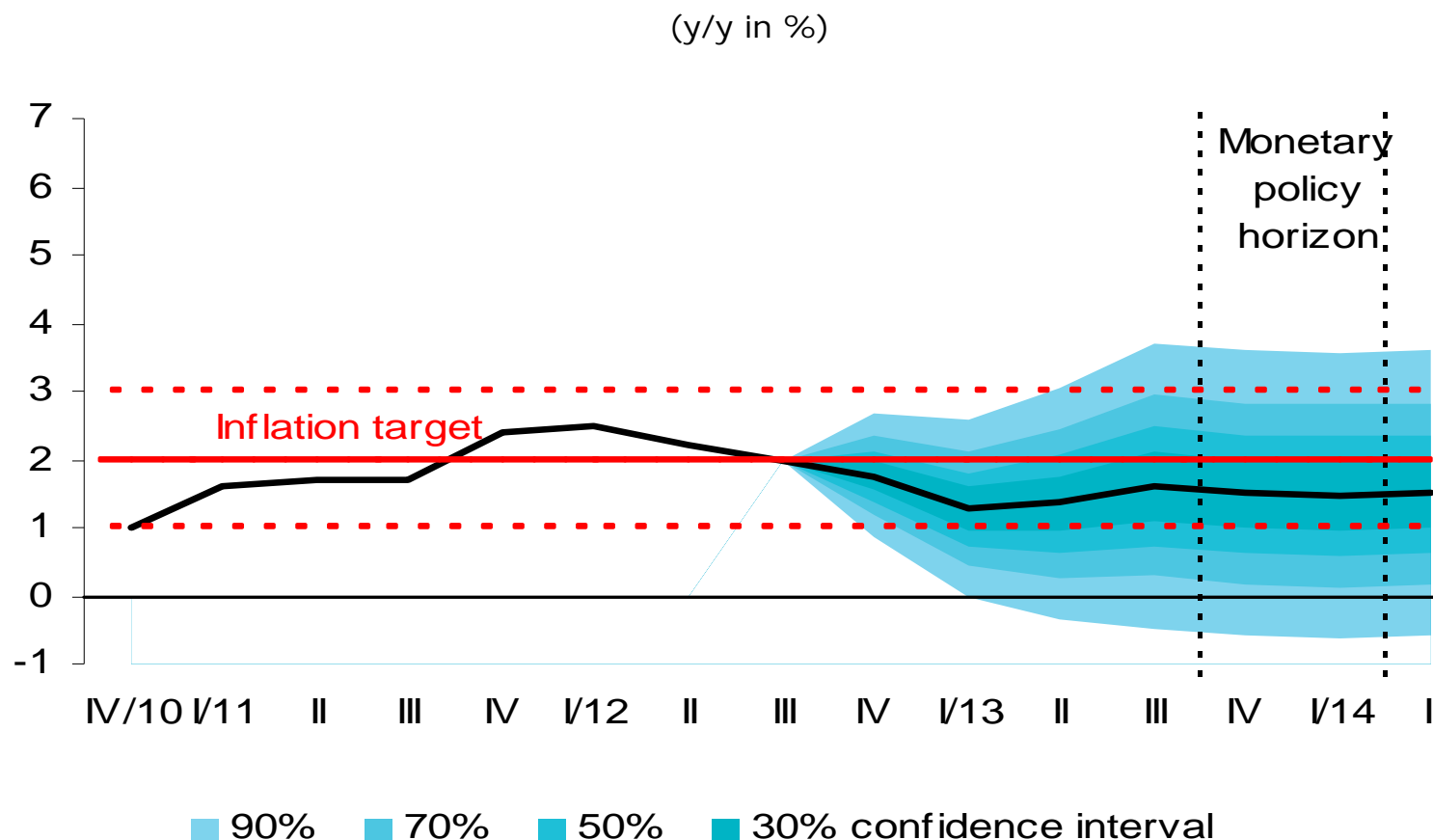
- The overall inflationary pressures will continue to ease in the near future as the domestic price pressures will not be significant and inflationary pressures from import prices will temporarily subside.
- The nominal exchange rate will be broadly stable.
- The Czech economic growth will be negative (-0.9 %) this year. In 2013 there will be a slight economic recovery, curbed by fiscal consolidation. In 2014, the GDP growth will reach almost 2%.
- Consistent with the forecast is a decline in market interest rates, followed by a rise in rates in 2014.

Headline Inflation Forecast



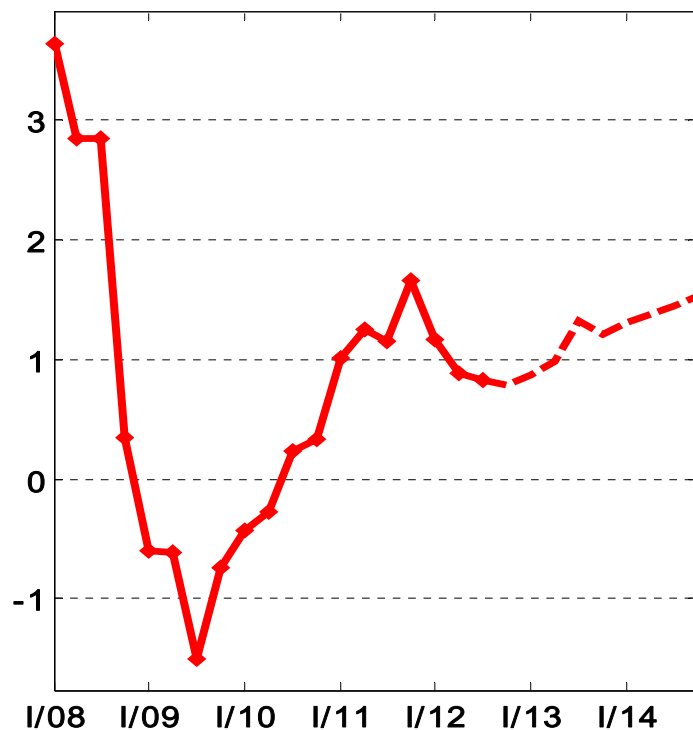
- In 2013, inflation will remain slightly above the inflation target, mainly due to the assumed VAT changes.
- In 2014, inflation will decline below the target.

MP-Relevant Inflation Forecast

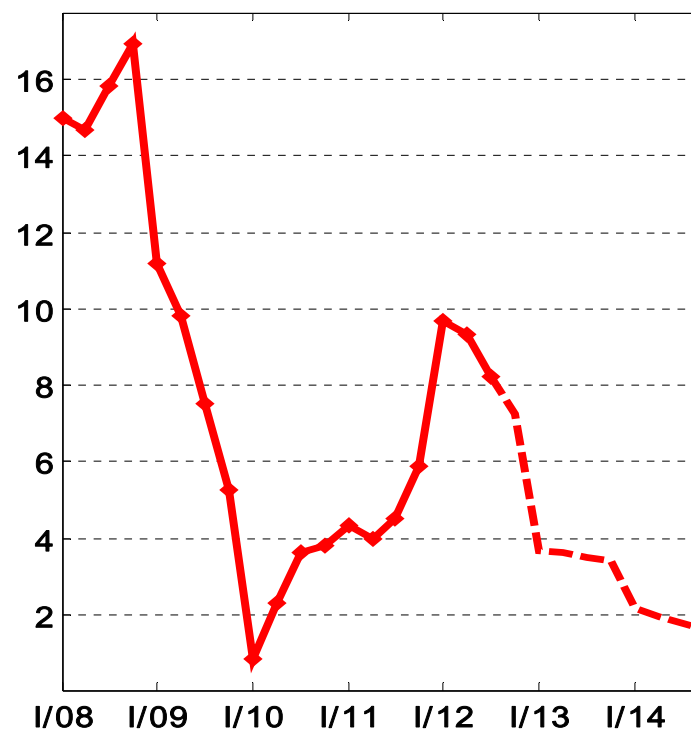


- MP-relevant inflation will be in the lower half of the tolerance band around the CNB's target over the entire forecasts horizon due to evaporating import price pressures as well as non-existent domestic price pressures.

Net Inflation (y/y, in %)

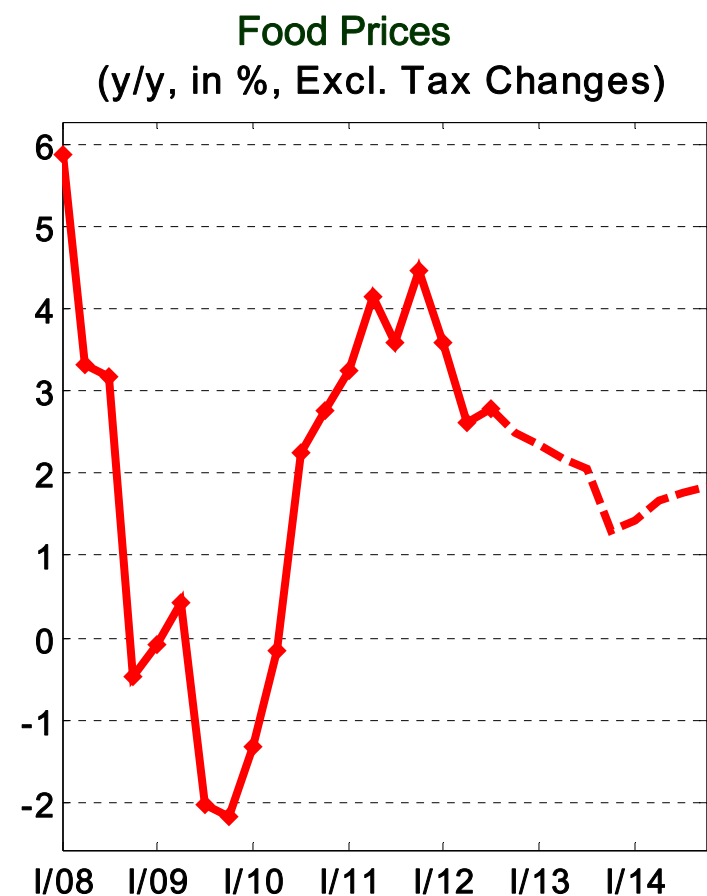
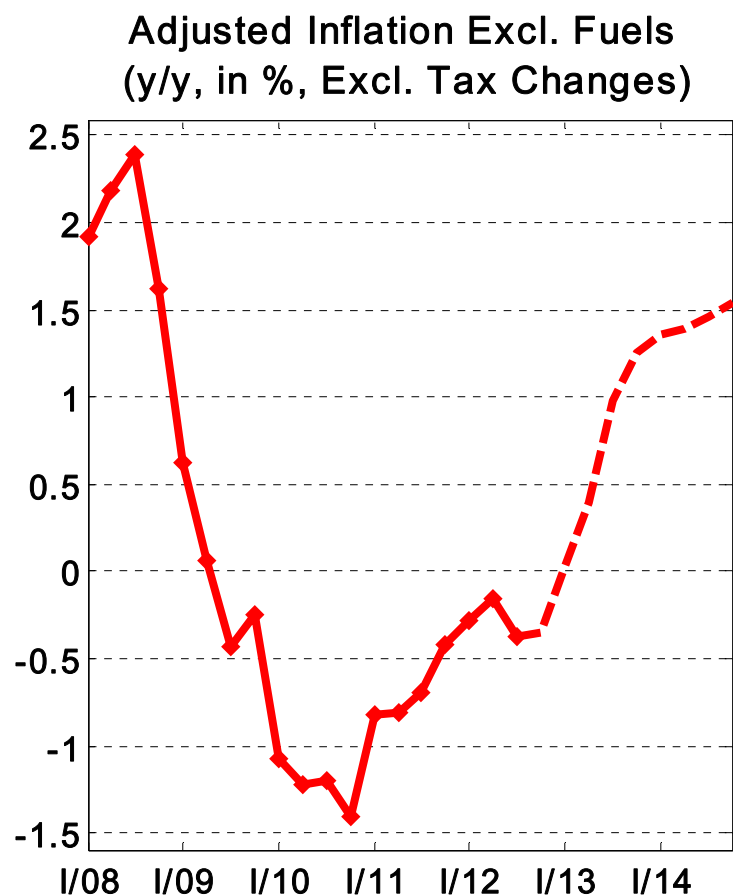


Growth of Administered Prices (y/y, in %)



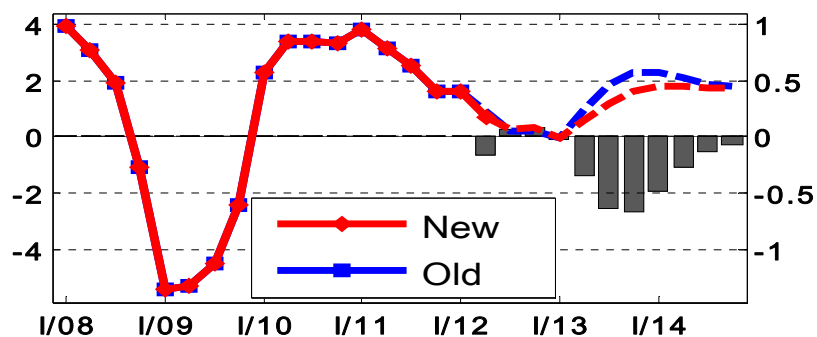
- Net inflation will be broadly stable in the near future. The shift of adjusted inflation excl. fuels towards zero and its subsequent increase will be offset by weakening growth in fuel and food prices.
- Growth of administered prices will slow down mainly at the beginning of 2013 (lower growth of regulated rents, gas and healthcare prices).

Adjusted Inflation Excluding Fuels; Food Prices

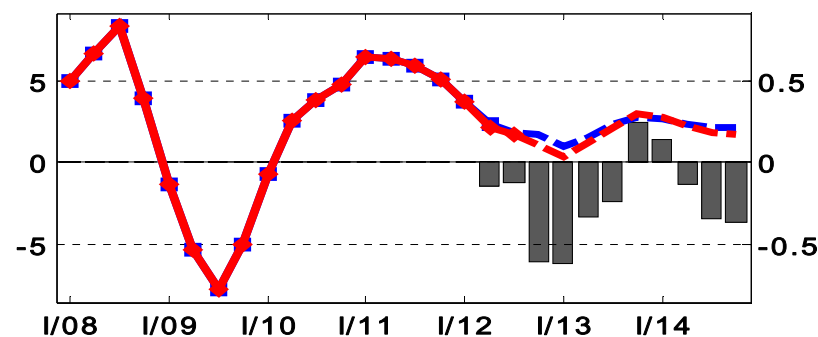


- "Core" inflation will increase gradually due to a less anti-inflationary impact of domestic economy and later on resumed growth in import prices.
- Food price growth will slow slightly in the near future, mainly because of base effects and subdued domestic demand.

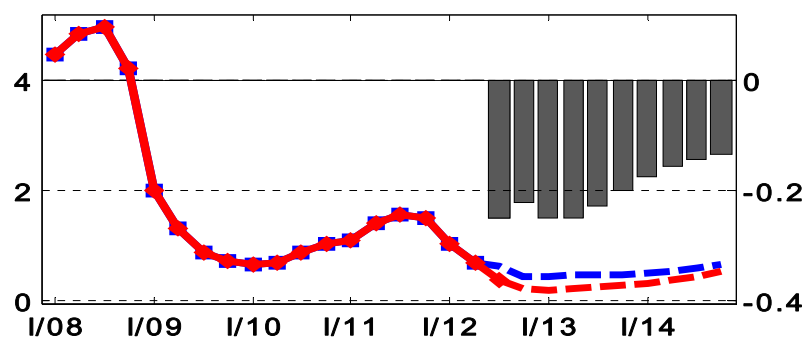
Growth Rate of GDP - Eurozone (y/y, in %)



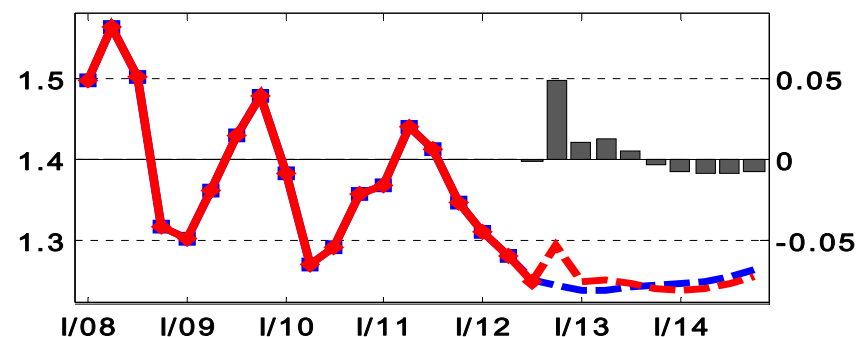
PPI Inflation - Eurozone (y/y, in %)



3M EURIBOR



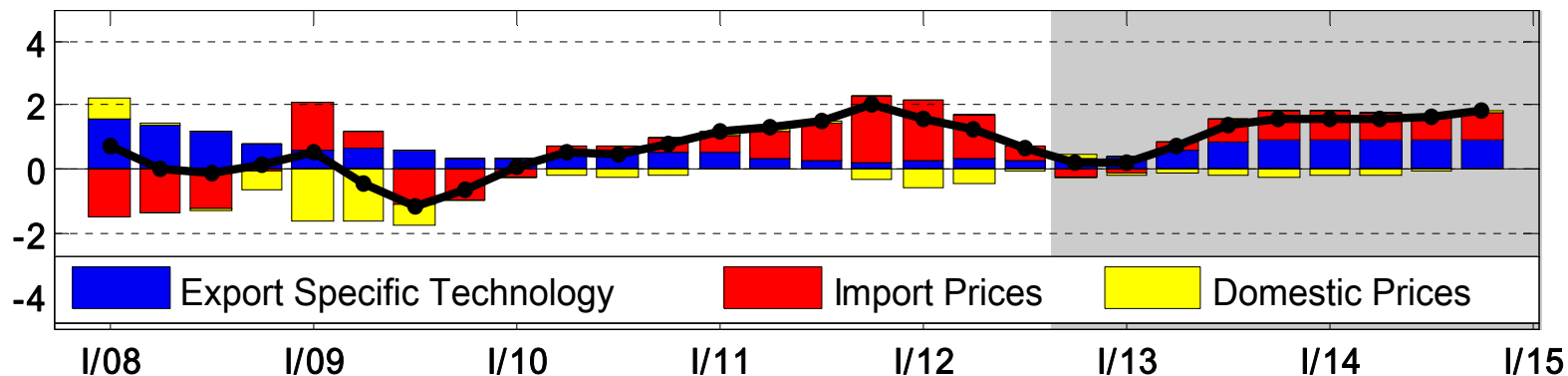
USD/EUR



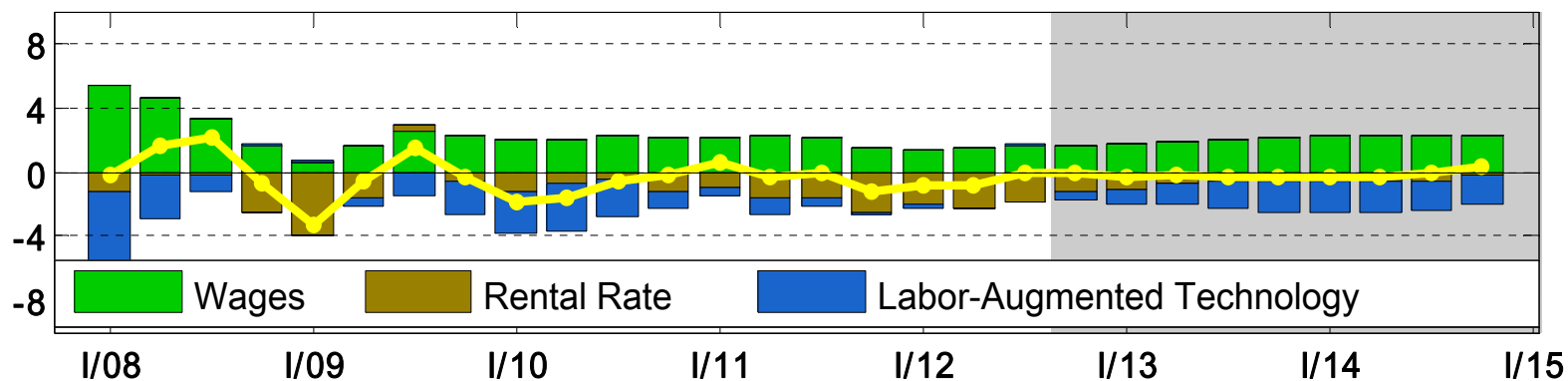
- The recovery of foreign GDP growth in 2013 will be only gradual.
- 3M EURIBOR will stay at very low levels on the whole forecast horizon.
- PPI growth is expected to slow down due to commodities. The USD/EUR exchange rate is expected to return to around 1.25.

Domestic Costs vs. Import Prices

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

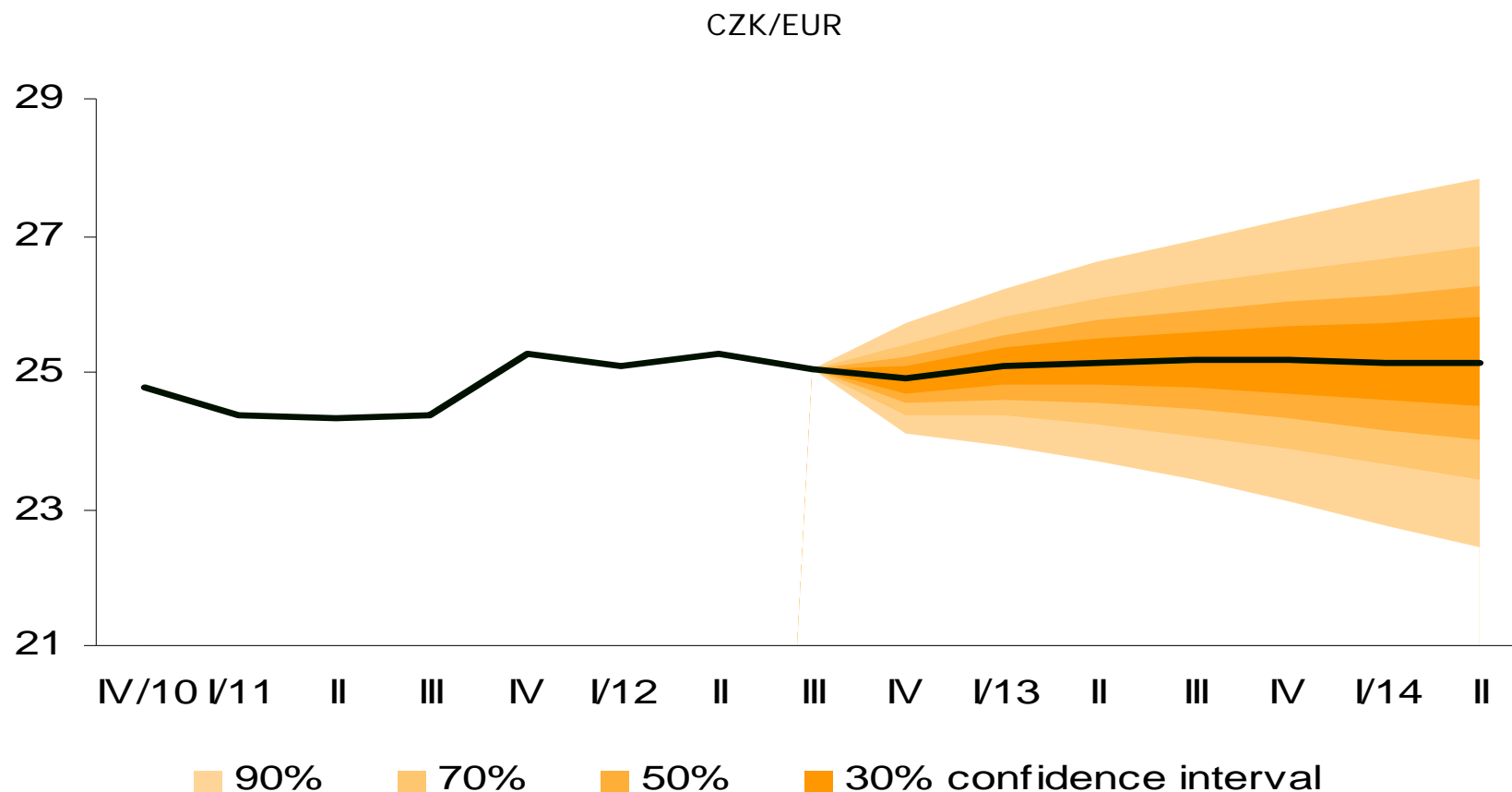


Nominal Marginal Cost in Intermediate Sector (q/q, in %, ann.)



- Inflationary pressures, caused by import prices, will subside temporarily at the turn of 2013.
- The cost pressures from the domestic economy are currently roughly neutral and are not expected to emerge over the forecast horizon.

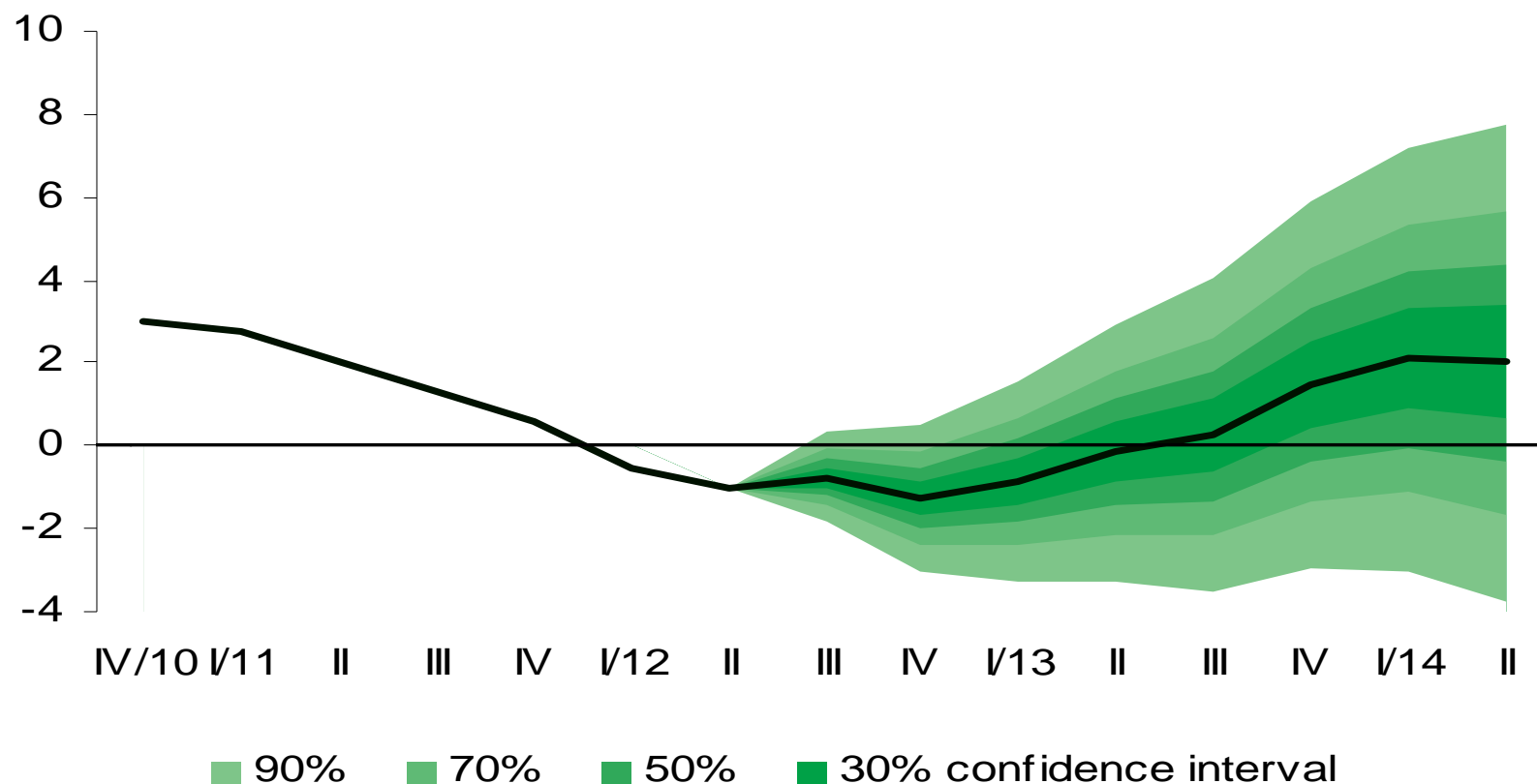
Exchange Rate Forecast



- Near-term forecast for 2012 Q3: CZK/EUR 24.9 (current calming of the debt crises in the euro area).
- The outlook is broadly stable as from the start of 2013 (subdued external demand and an assumed weak productivity growth vs. the low outlook for foreign interest rates and improved nominal net exports).

GDP Growth Forecast

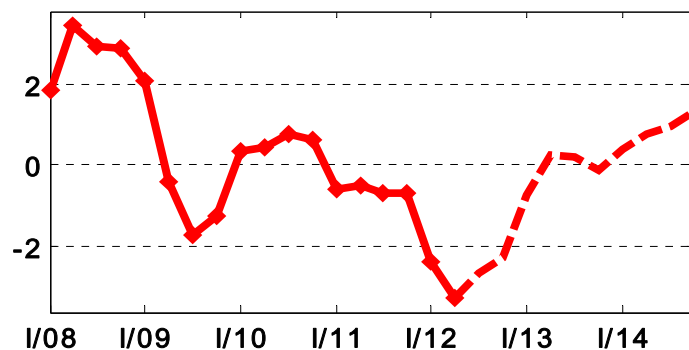
GDP (y/y, in %)



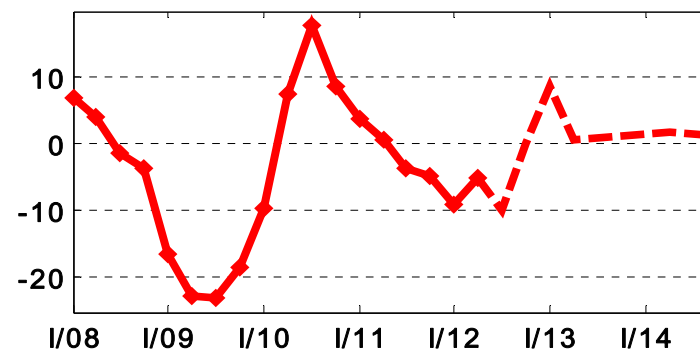
- GDP growth forecast: -0.9% for 2012, 0.2% in 2013 and 1.9% in 2014.
- This year, the only positive contribution comes from net exports, as the domestic demand falls. In 2013, fiscal consolidation will curb economic growth, whilst the foreign demand will recover gradually .

Forecast of Aggregate Demand

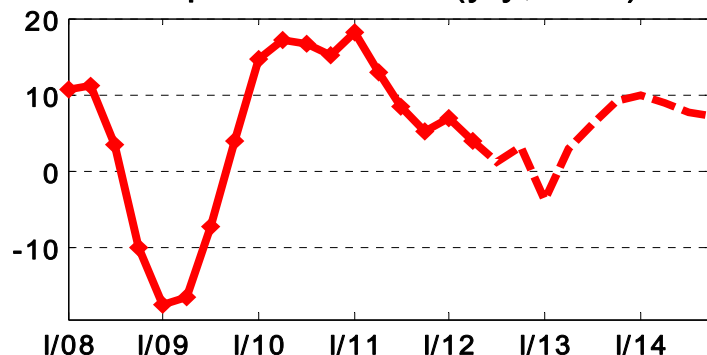
Household Consumption Growth (y/y, in %)



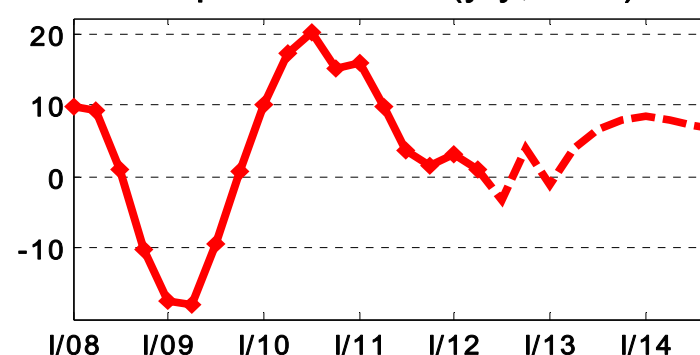
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)



Imports Growth (y/y, in %)

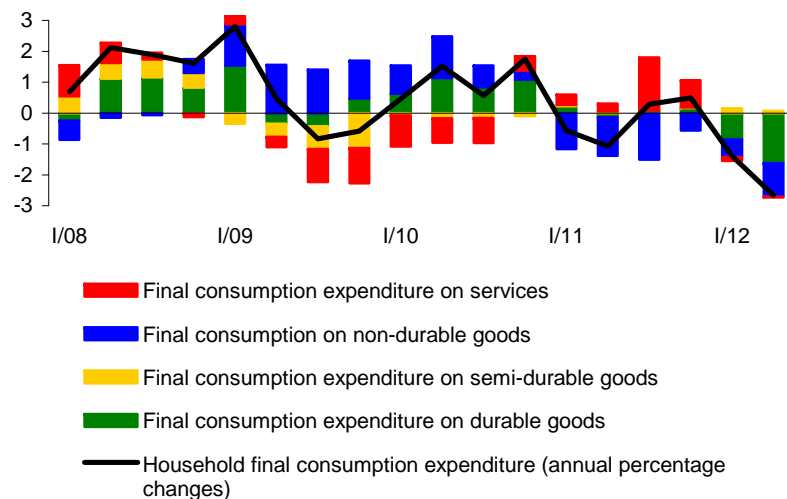


- Private consumption growth will fall this year due to weak real disposable income growth and negative consumer sentiment.
- Negative annual growth of investment until the end of this year.
- The positive contributions of net exports will fade away temporarily in late 2012 and early 2013, but will increase again subsequently.

Household Consumption and Savings Rate

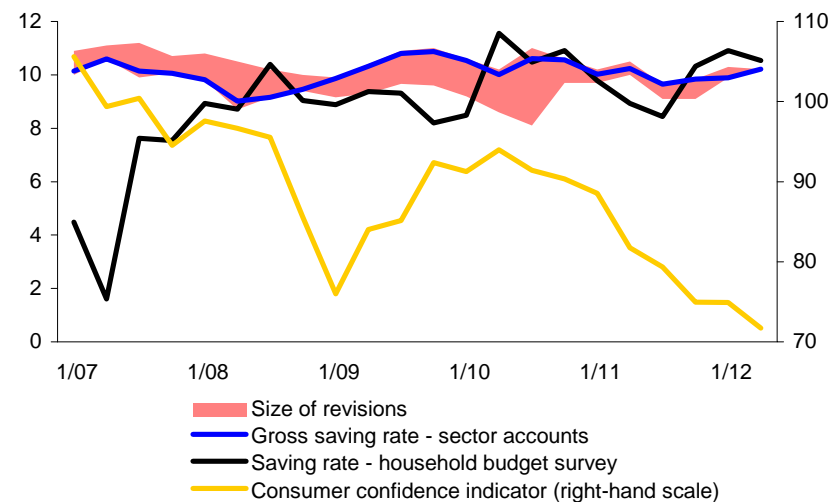
Structure of household consumption

(annual percentage changes; contributions in p.p.s; constant prices)



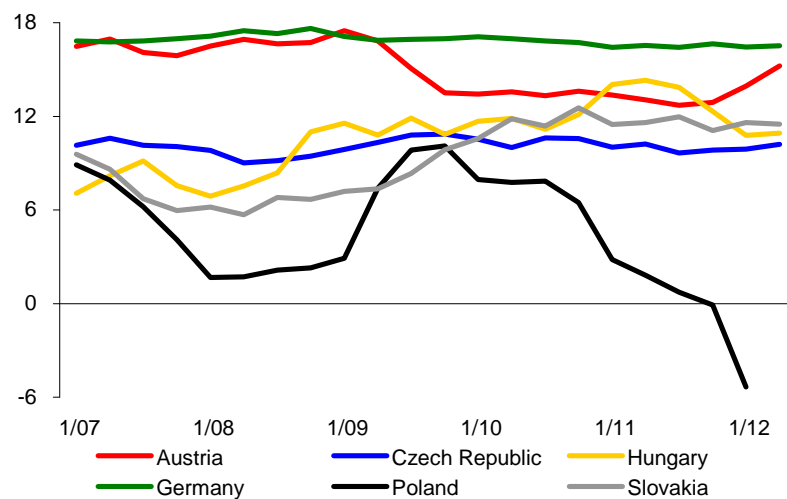
Savings ratio and its past revisions

(in % of gross disposable income)



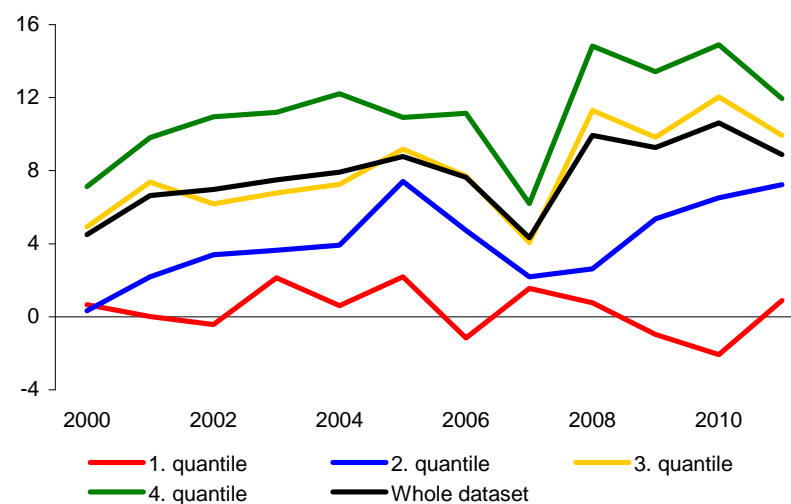
International comparison of savings ratio

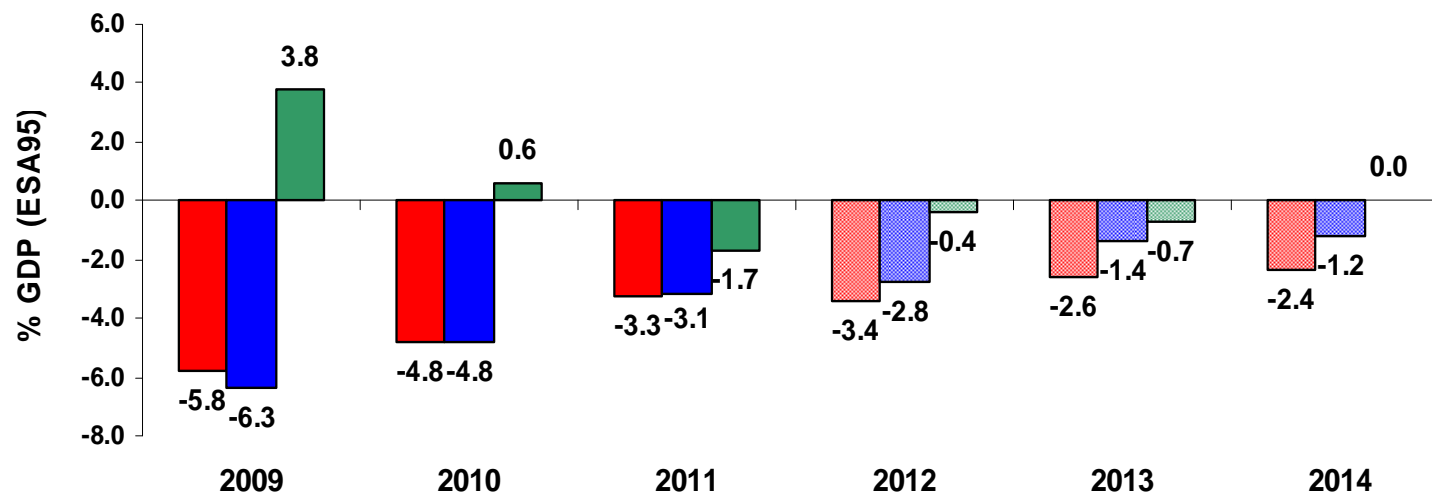
(in % of gross disposable income; source: Eurostat, s.a.)



Savings ratio by income quartile

(in % of net income)

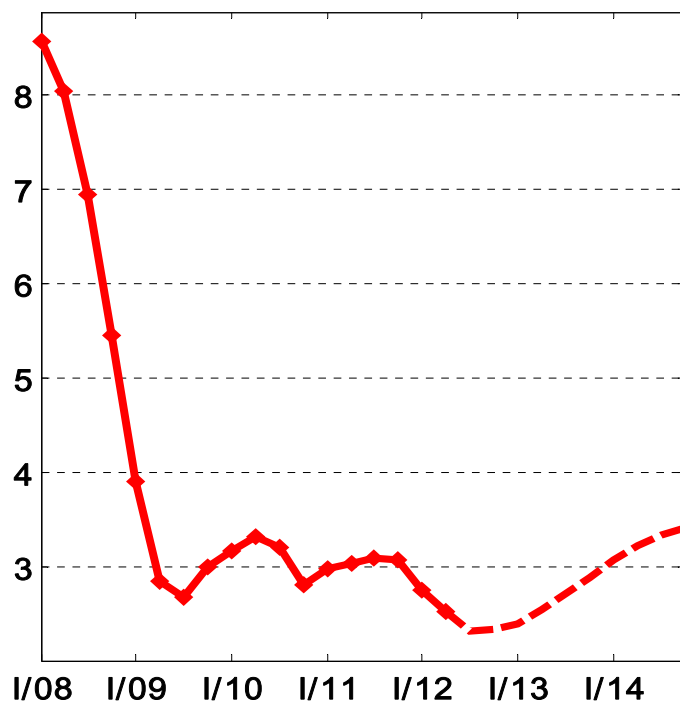




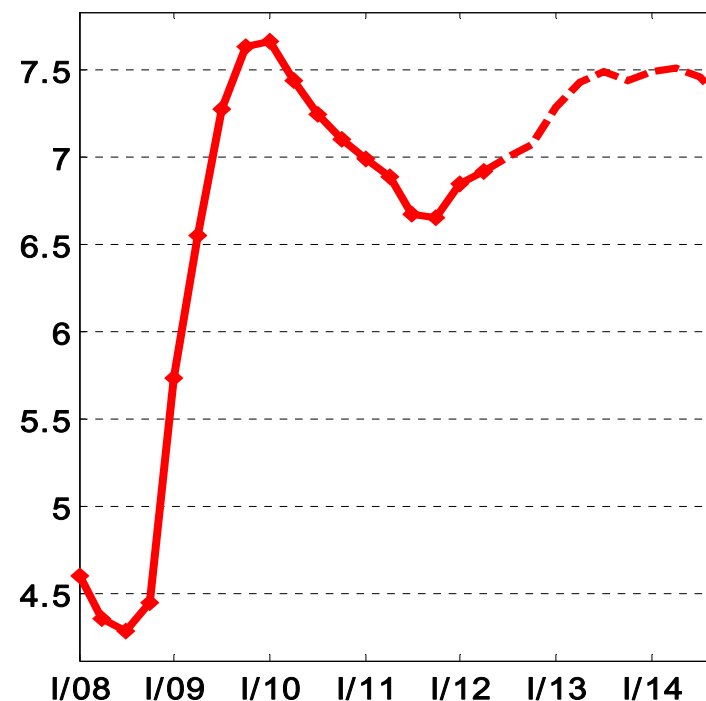
■ Public budget deficit ■ Structural deficit (ESCB) ■ Real government consumption (y-o-y %)

- 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 1 p.p. in 2013. It also includes the other fiscal consolidation measures proposed by the government.
- In 2013 and 2014 the deficit will decline to less than 3 % of GDP.

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

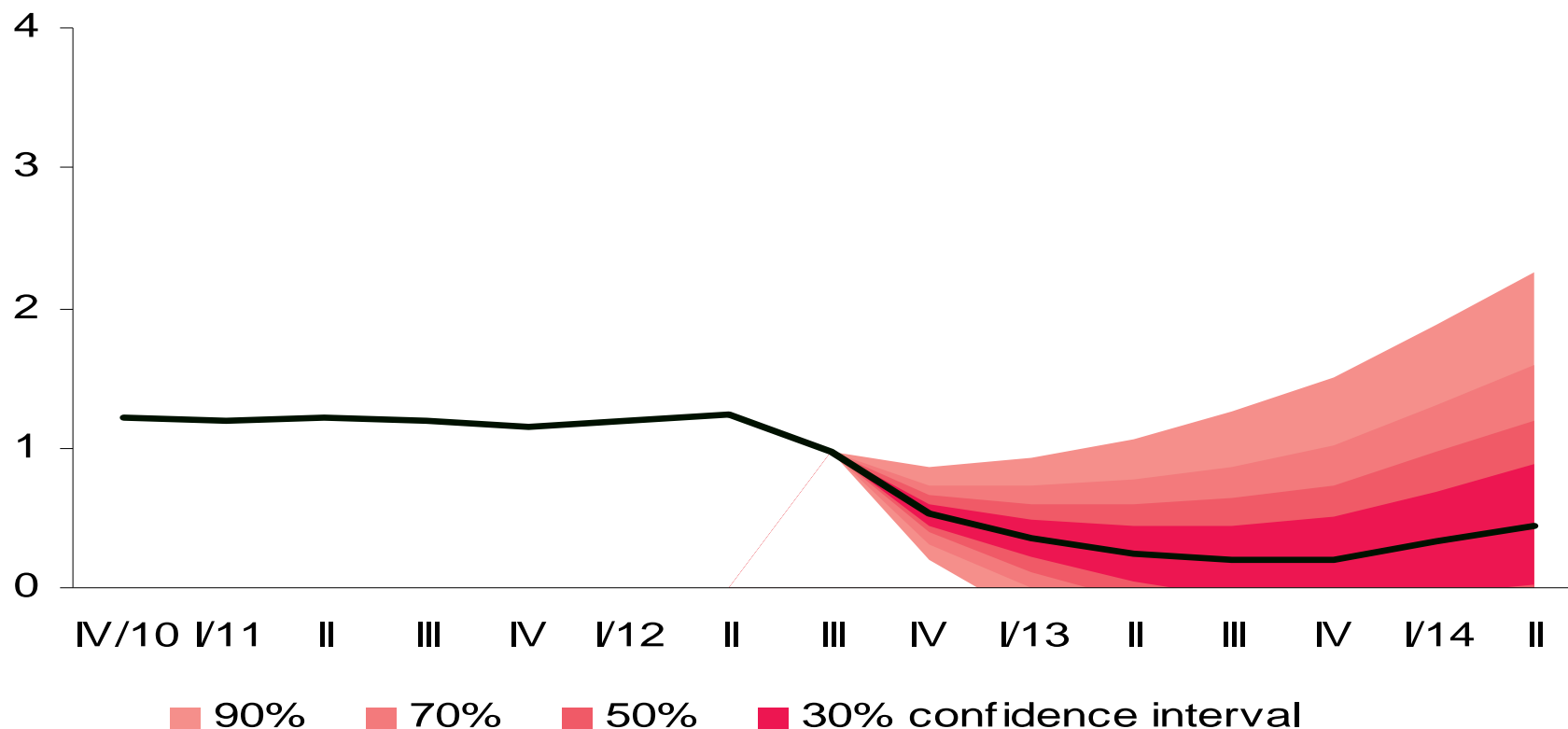


General unemployment rate (ILO)
(in %, s.a.)



- Nominal wage growth remains relatively low. Wage growth will start increasing gradually in 2013 due to a moderate revival of the economy.
- The unemployment rate (ILO) will gradually rise to 7.5% in 2013 Q3 owing to the evolution of economic activity, and stay broadly flat until late 2014.

PRIBOR 3M (in %)

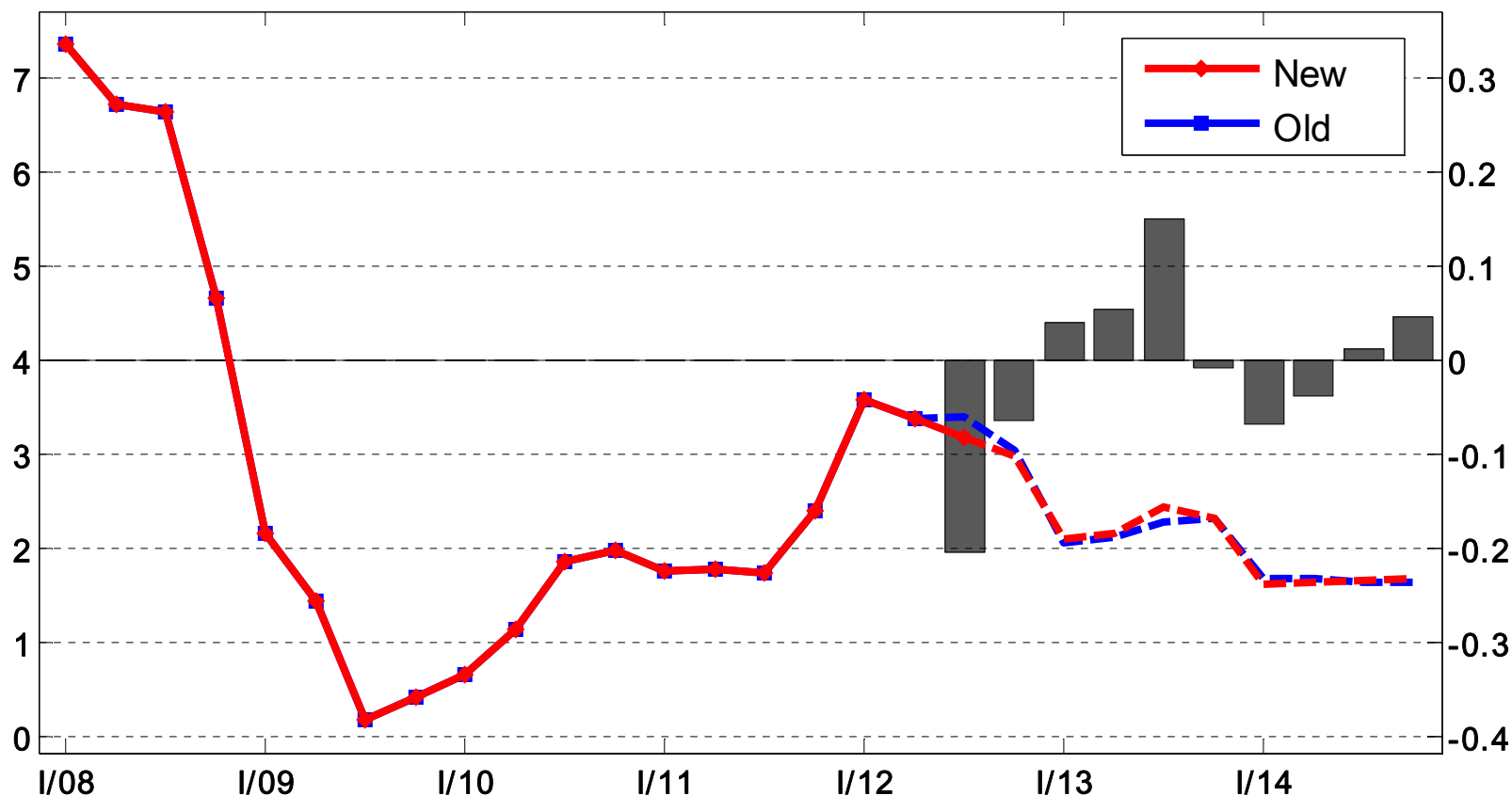


- Consistent with the forecast is a decline in market interest rates, followed by a rise in rates in 2014.
- Factors: subdued domestic economy incl. a deep fall in consumption, effects of the fiscal consolidation and low foreign interest rates.

- The forecasts for headline and monetary-policy relevant inflation almost unchanged from the previous prediction.
- Net inflation forecast has shifted slightly lower in both 2012 and 2013 due to lower predictions for adjusted inflation excluding fuels and food price inflation.
- Regulated price inflation will be higher owing mainly to a rise in the outlook for heat prices.
- The exchange rate forecast is weaker in the longer-term.
- The GDP forecast for the next two years is revised downwards owing chiefly to a smaller contribution of net exports.
- Nominal wage growth is lower over the entire horizon.
- The market interest rate path is marginally lower in the near future and slightly higher in the longer term.

Comparison with Previous Inflation Forecast (i)

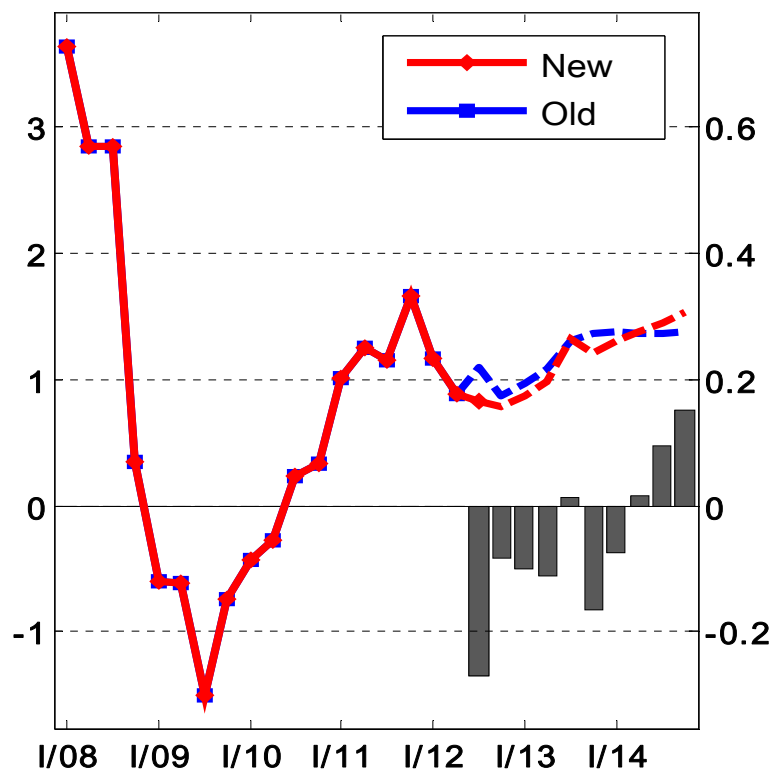
CPI Inflation (y/y, in %)



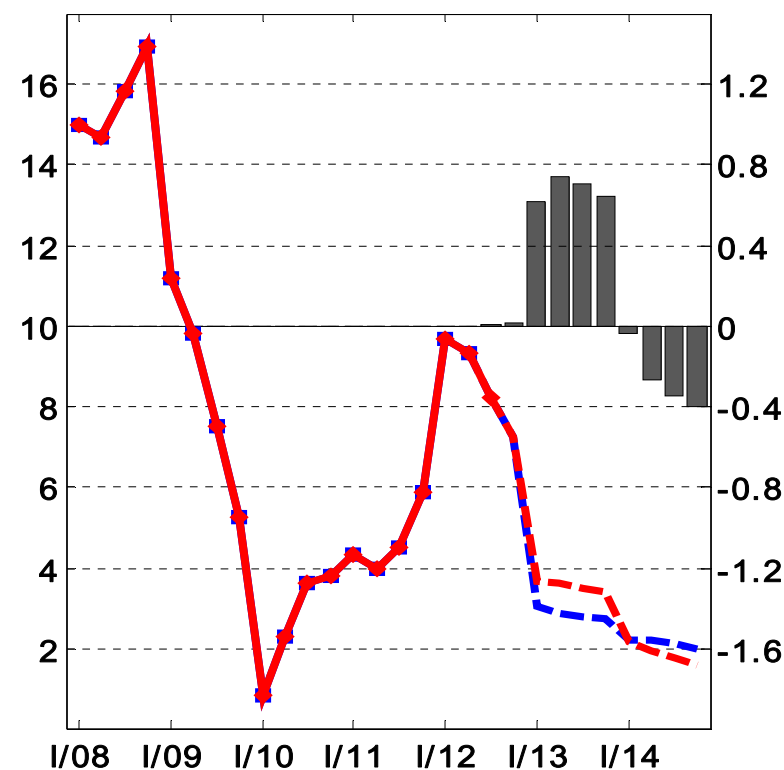
- The forecast of headline inflation has changed very little from the previous prediction.
- Assumptions regarding indirect taxes are unchanged from the previous forecast (but the uncertainty has increased).

Comparison with Previous Inflation Forecast (ii)

Net Inflation (y/y, in %)

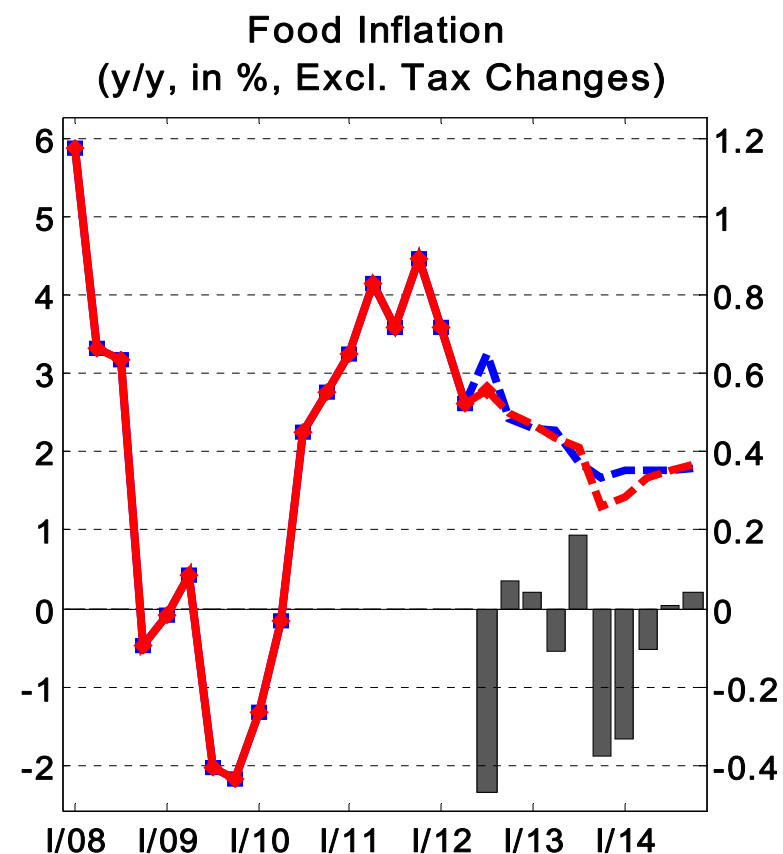
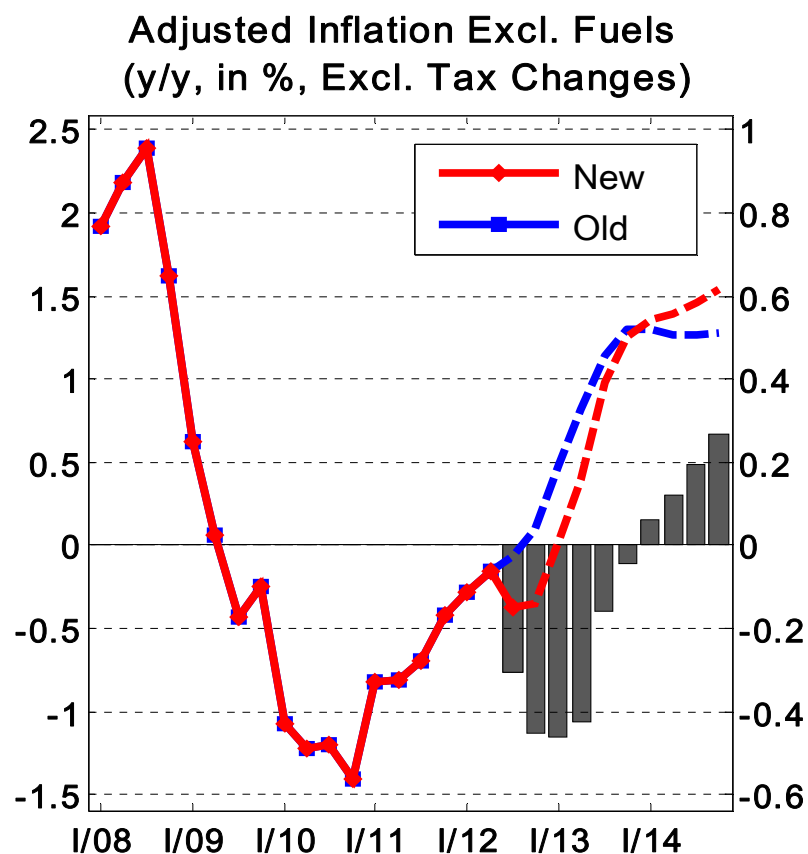


Growth of Administered Prices (y/y, in %)



- Net inflation: lower forecast for adjusted inflation excluding fuels and food price growth, partially offset by higher growth in fuel prices.
- Administered prices: higher heat prices in 2013, lower natural gas prices for households in 2014.

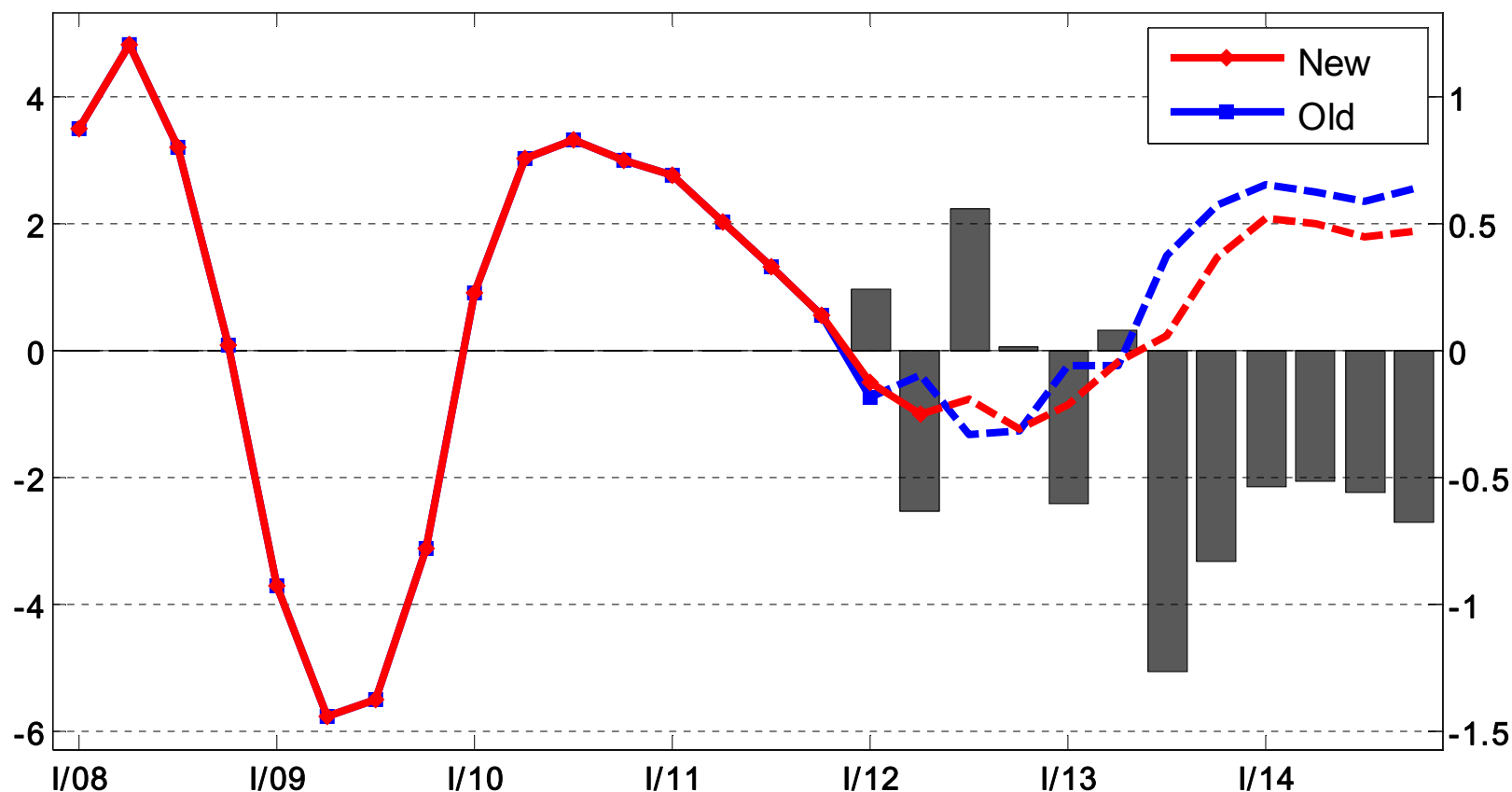
Comparison with Previous Inflation Forecast (iii)



- The lower forecast of adjusted- and food price inflation reflects developments in 2012 Q3, and in 2013 also to weaker economic activity.

Comparison with Previous GDP Forecast (i)

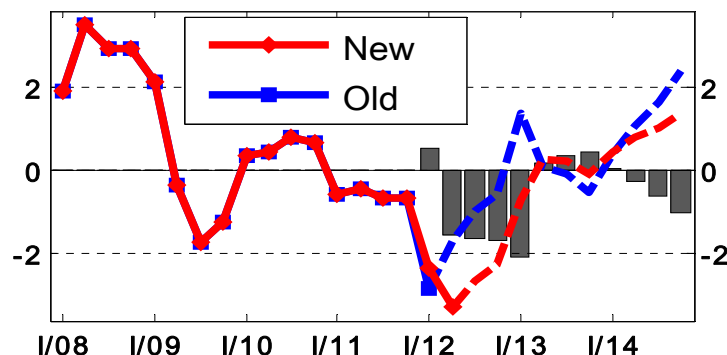
GDP Growth (y/y, in %)



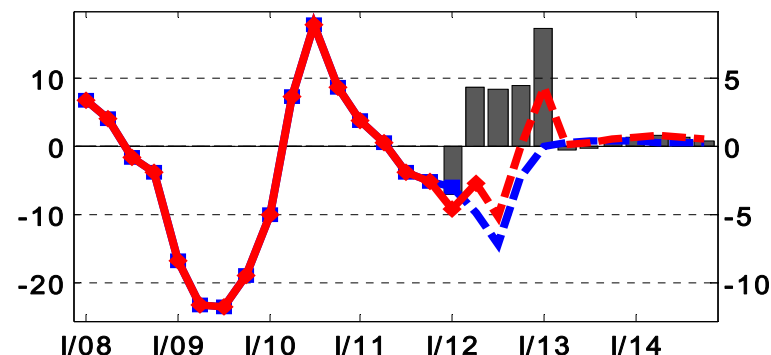
- The overall GDP forecast is virtually unchanged for this year.
- The GDP forecast for next year is revised downwards owing chiefly to a smaller contribution of net exports (more gradual recovery of foreign demand) and to slightly weaker household consumption.

Comparison with Previous GDP Forecast (ii)

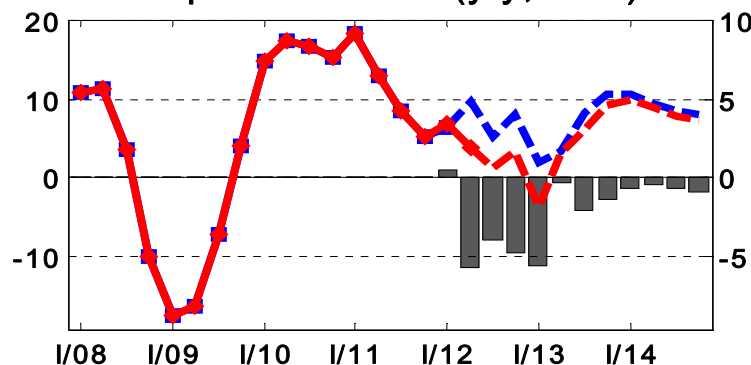
Household Consumption Growth (y/y, in %)



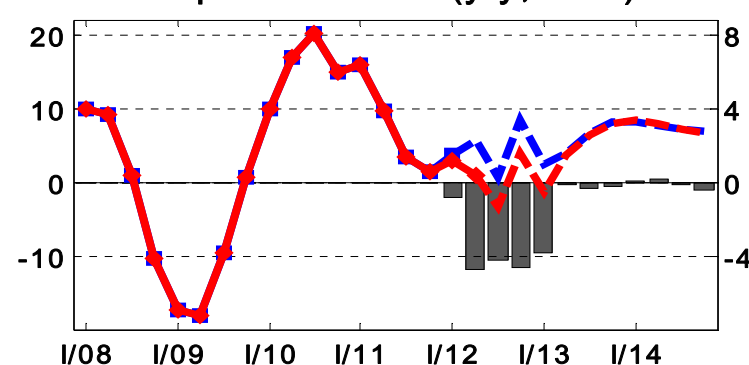
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)



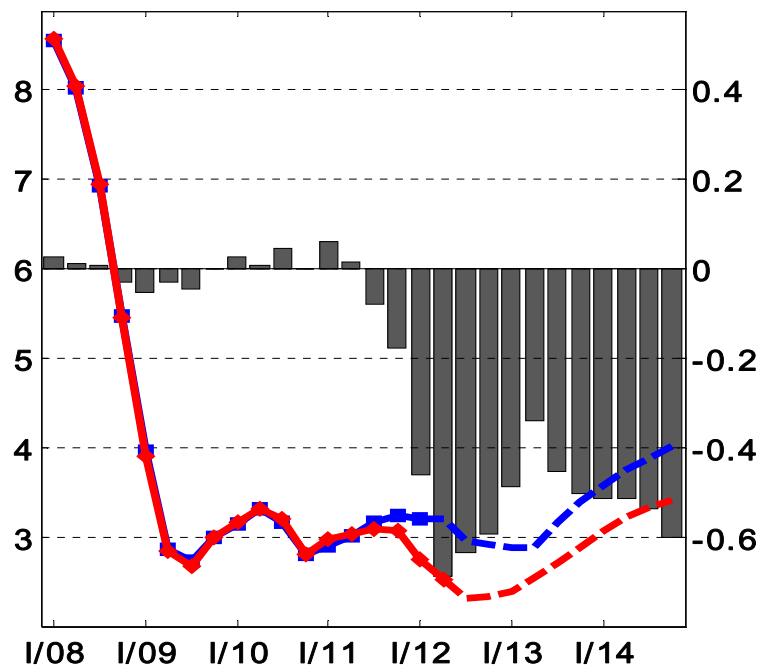
Imports Growth (y/y, in %)



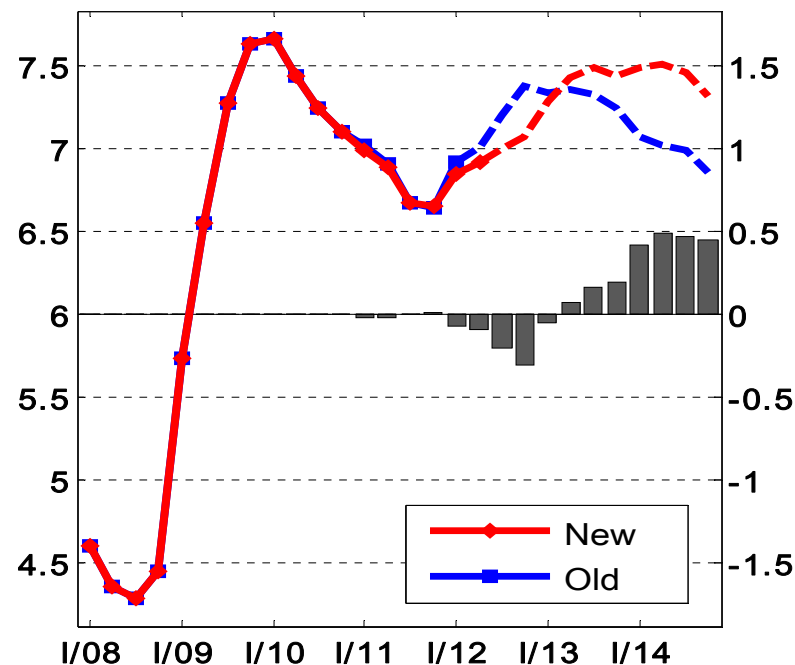
- Sharper decline in household consumption in 2012. Higher investment (strong q/q growth in 2012 Q2 and gradual replenishment of inventories).
- Lower export growth forecast due to weaker external demand. Import growth revised down to a lesser extent due to stronger investment activity, implying smaller contribution of net exports to GDP growth.

Changes in Labour Market Forecast

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

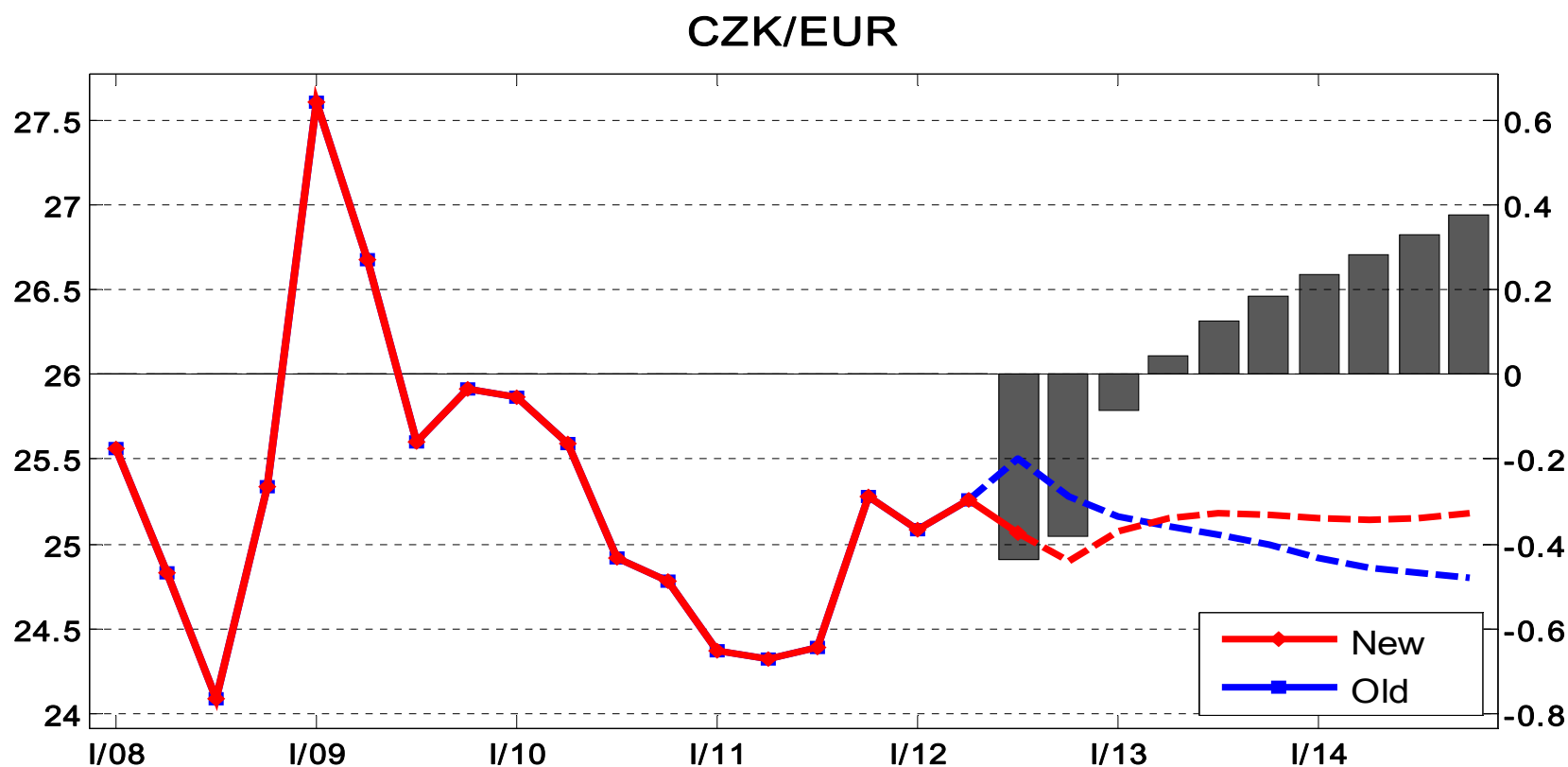


General unemployment rate (ILO)
(in %, s.a.)



- The nominal wage growth is lower: in 2012 due to the weak current wage growth and a revision of past data, and in 2013-2014 due to lower outlook for economic activity (incl. assumed slower productivity growth).
- Forecast of the unemployment rate in 2012 is lower due to observed data. Higher unemployment in the longer term due to lower economic growth.

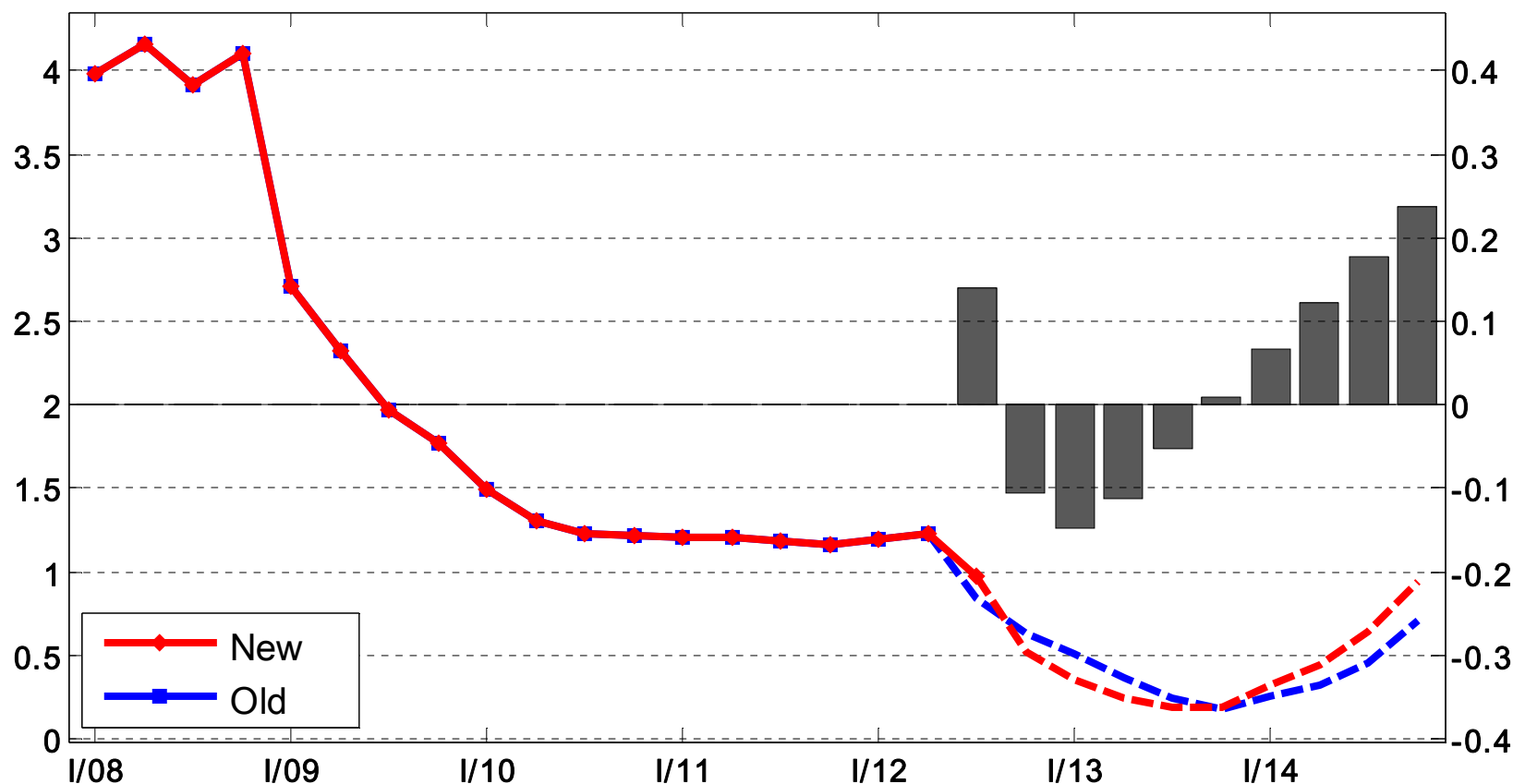
Changes in Exchange Rate Forecast



- Stronger exchange rate at the start of the forecasting horizon reflects current market developments.
- From 2013 Q2, the exchange rate is revised to weaker levels mainly due to lower demand in the effective euro area.

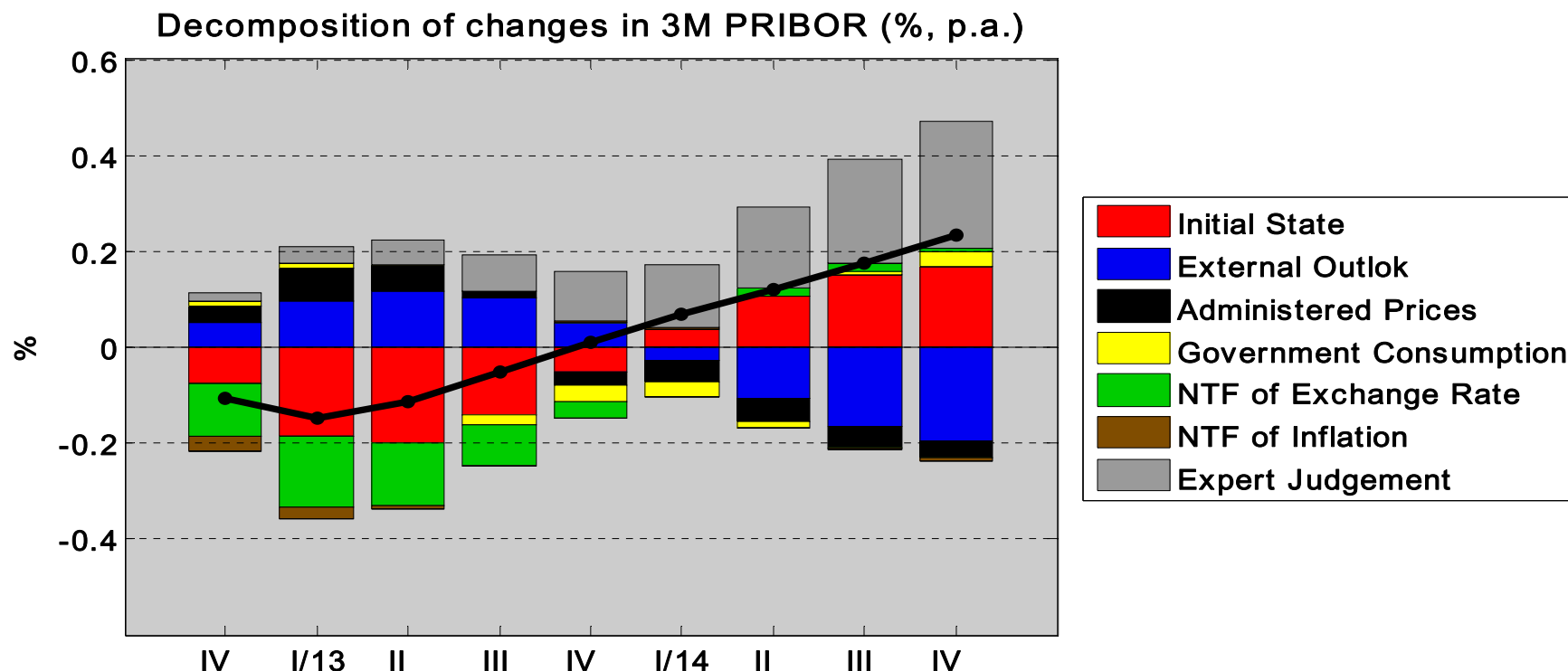
Changes in Interest Rate Forecast

3M PRIBOR (% , p.a.)



- The interest rate path is has changed only little from the previous forecast – initially to the downside and in 2014 to the upside.

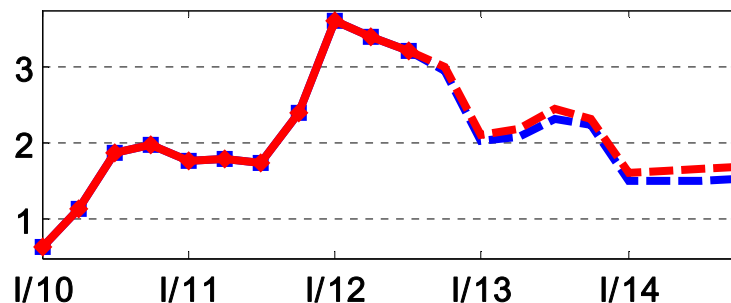
Interest Rate Forecast Change Decomposition



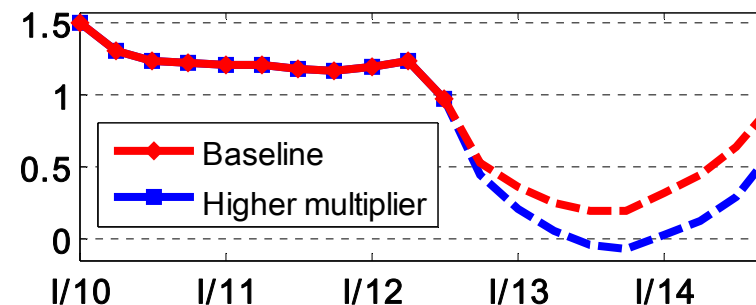
- The initial state and the short-term exchange rate forecast are pushing at slightly lower interest rates at the start of the forecast horizon.
- The external outlook is acting towards modestly higher rates until the end of 2013 (mainly via pressures on weaker exchange rate).
- Expert judgments are associated with a more gradual recovery of productivity growth assumed at the longer end of the forecast horizon.

Higher Fiscal Multiplier Scenario (0.6→1)

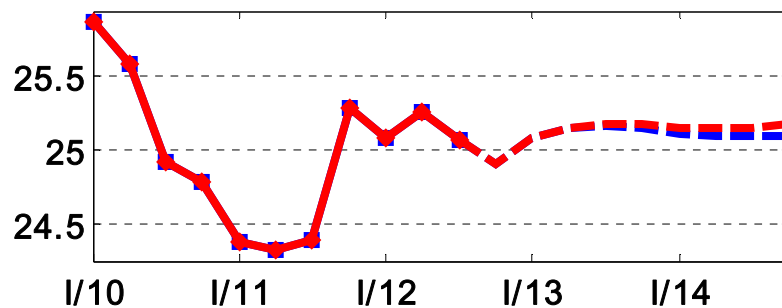
CPI inflation (y/y, in %)



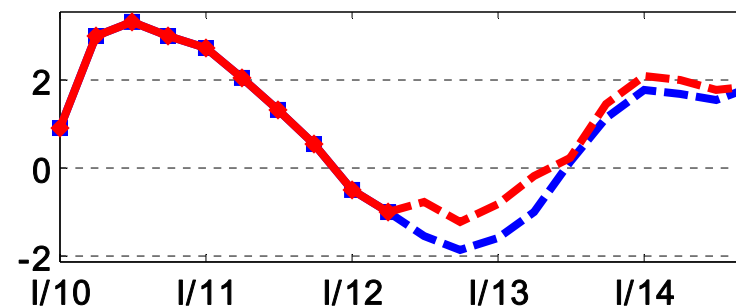
3M PRIBOR (in %, p.a.)



Exchange rate CZK/EUR



GDP growth (y/y, in %)



- Risk of higher fiscal multiplier owing to sustained, procyclical and mostly revenue-driven fiscal consolidation in a recession.
- Stronger restrictive effect of consolidation measures affects negatively household consumption, which leads to lower inflation and to (hypothetically) lower interest rates.

- At the close of the meeting on 1 November 2012, the Board decided to lower the two-week repo rate by 0.20 percentage point to 0.05%.
- At the same time it decided to lower the Lombard rate by 0.50 percentage point to 0.25% and to lower the discount rate by 0.05 percentage point to 0.05%.
- Five members voted in favour of this decision, and two members voted for leaving interest rates unchanged.
- The rates will remain at this level over a longer horizon until inflation pressures increase significantly.
- The Board also decided to suspend the programme of sales of part of the CNB's investment income on international reserves. This decision was motivated by the fact that a conflict cannot be ruled out between these operations and monetary policy implementation in a situation where monetary policy interest rates are technically at zero.

Thank you for your attention

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