

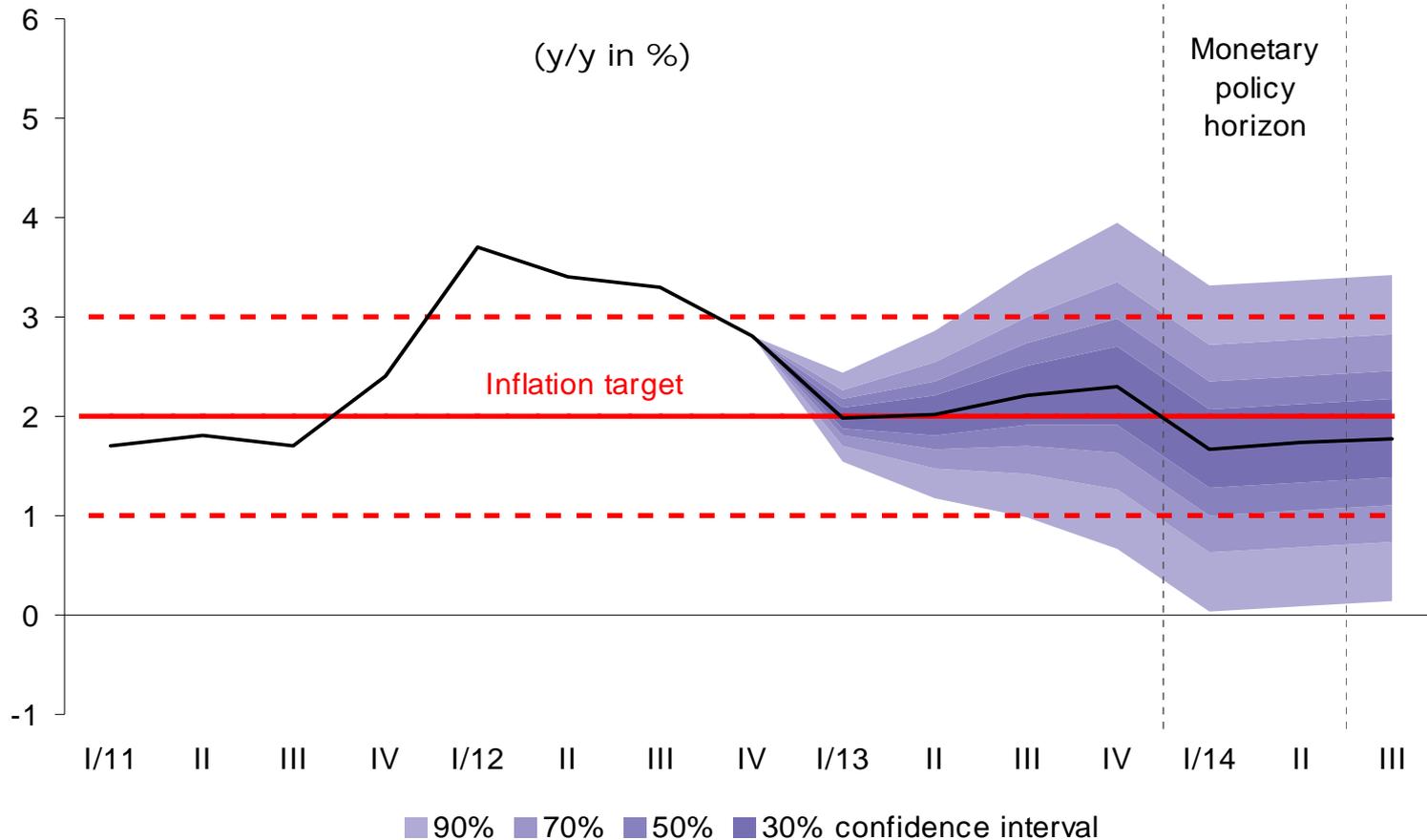
Meeting with Analysts

Petr Král

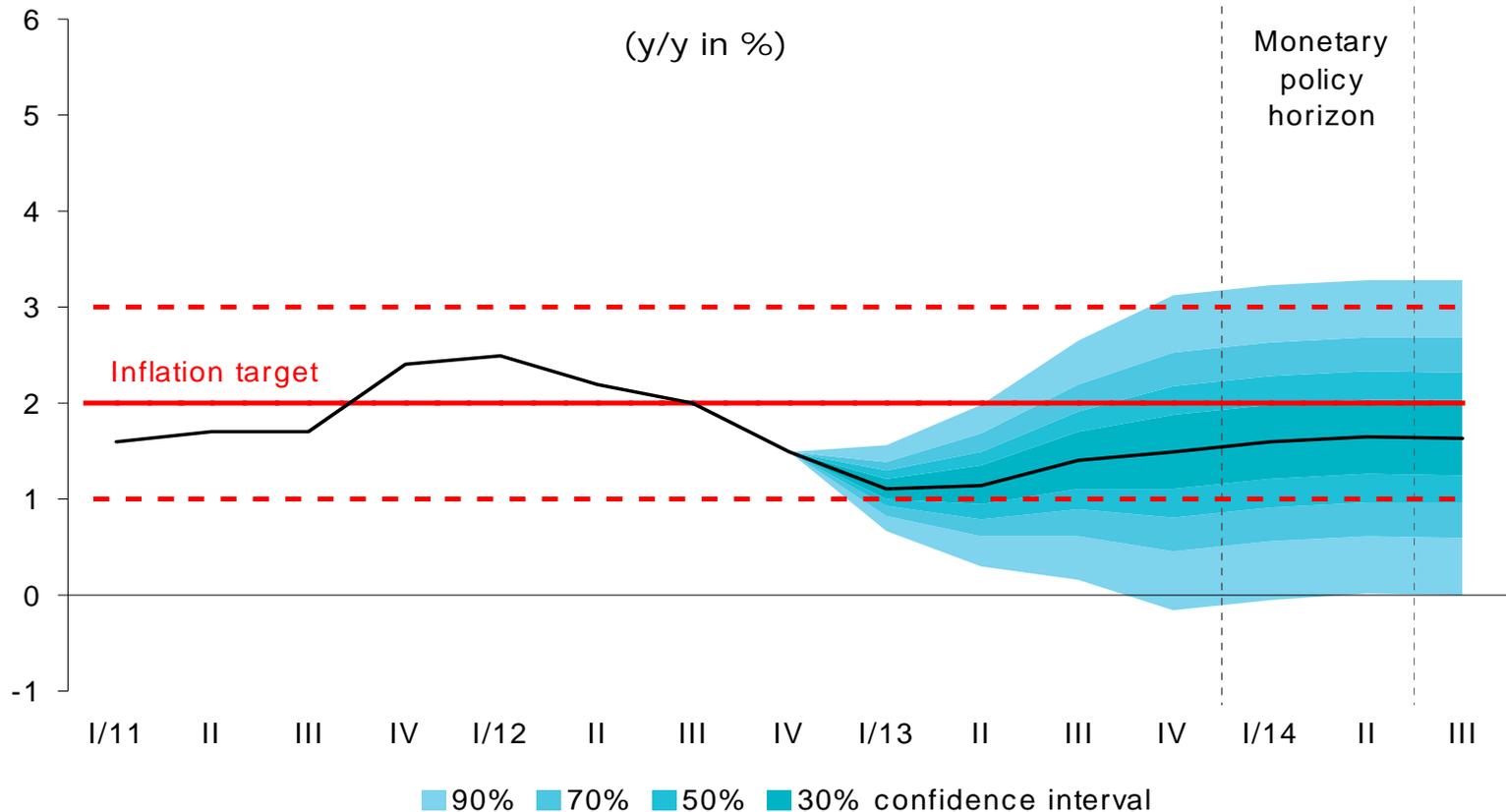
Prague, 15 February, 2013

- Headline inflation will stay close to the CNB's target in 2013 despite the tax changes, and will fall slightly below the target after the tax effects subside.
- MP-relevant inflation will stay in the lower half of the tolerance band until the end of 2014.
- The recovery of GDP in the effective euro area will be gradual. Prices are expected to grow only moderately and foreign interest rates will remain at low levels.
- Overall inflationary pressures in the following quarters will be mild, stemming from muted growth of import prices, with anti-inflationary pressures from domestic economy prevailing until mid-2014.

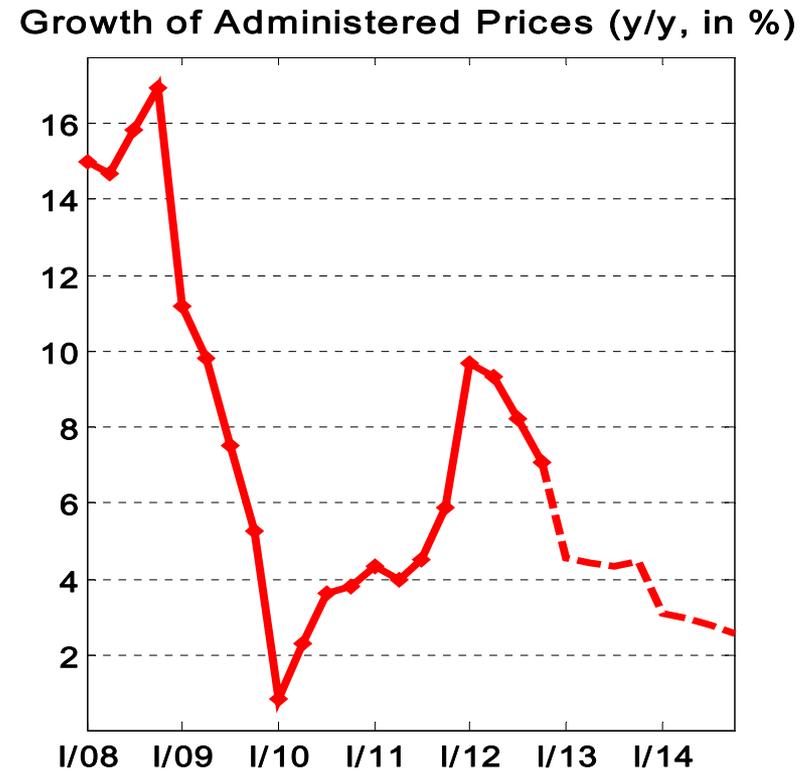
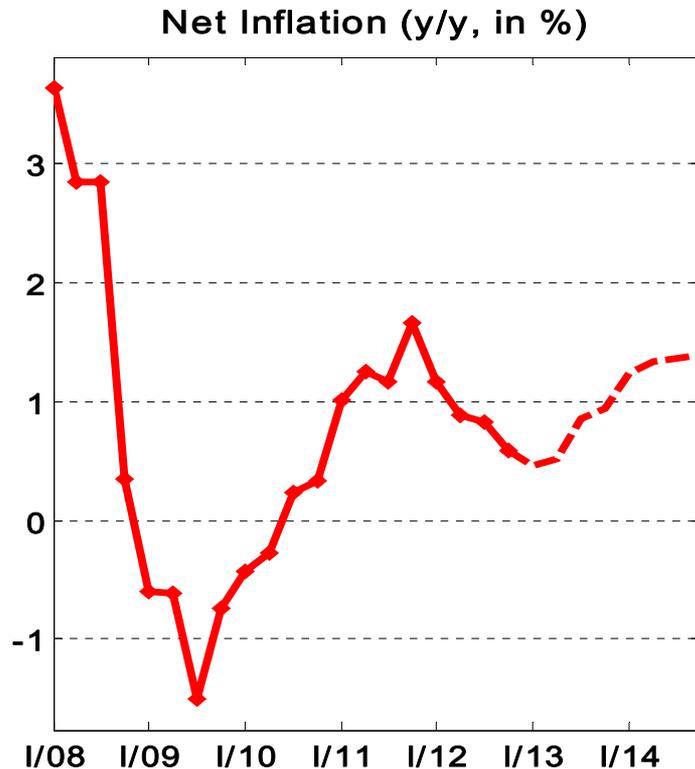
- During 2H 2013, hints of economic growth recovery are expected, yet in aggregate Czech economy will slightly decline this year. In 2014, the GDP growth will reach approximately 2%.
- Nominal wages will remain moderate owing to subdued economy.
- The nominal exchange rate CZK/EUR will modestly appreciate from 25.50 CZK/EUR expected for 2013 Q1.
- Consistent with the forecast is a slight decline in market interest rates, followed by their rise as from mid-2014.



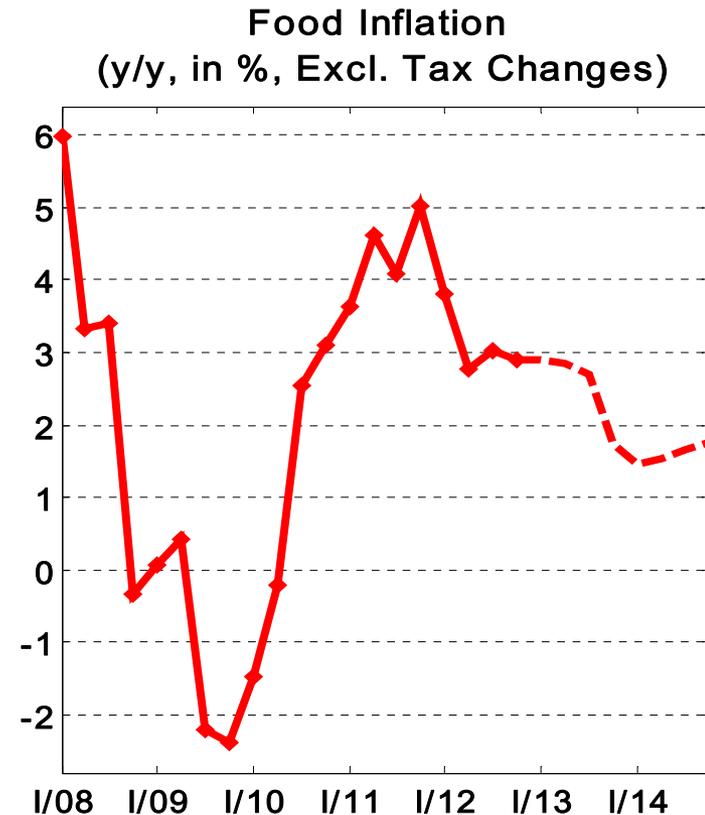
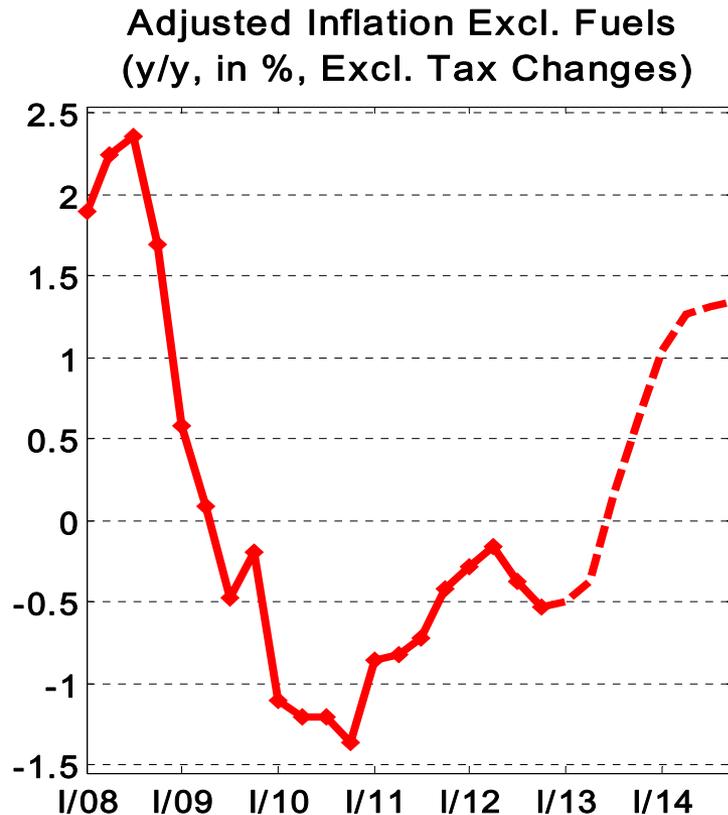
- In the beginning of 2013, inflation will decline to the target and remain near this level throughout the rest of the year.
- In 2014, inflation will decline slightly below the target.



- MP-relevant inflation will stay in the lower half of the tolerance band throughout the entire outlook (incl. the MP horizon).
- The forecast assumes full pass-through of tax increases to prices, the second-round effects on inflation expectations and wages are not expected to be significant.

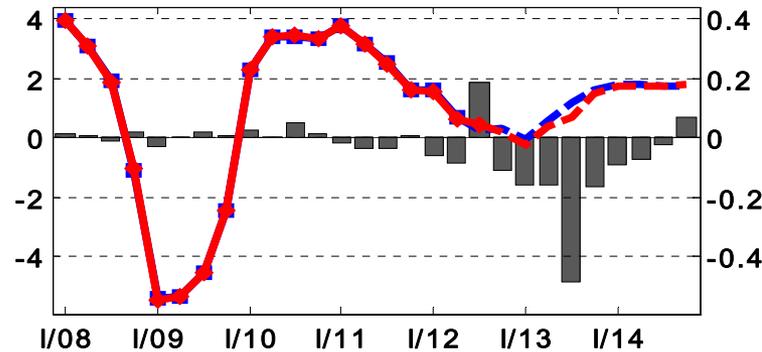


- Net inflation will be broadly stable in the near future and will only gradually rise thereafter.
- Growth of administered prices (including effects of tax changes) will be still positive owing to increasing prices of heating (emission permits), electricity (photovoltaic) and natural gas (distribution fees). Growth dynamics will, however, slow down.

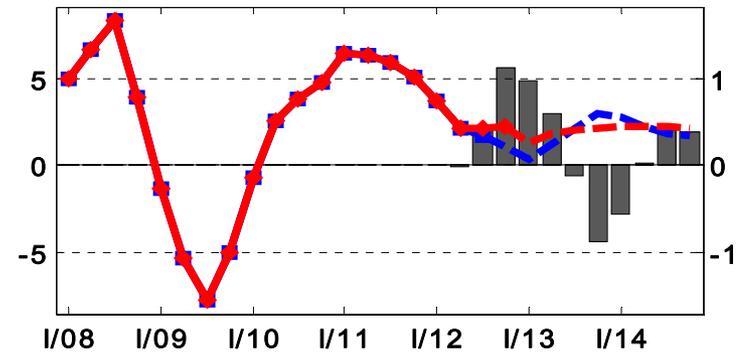


- "Core" inflation will turn positive in 2H 2013 and after that it will slowly increase further due to gradually evaporating anti-inflationary pressures from domestic economy and modest growth in import prices.
- Food price growth will slow down at the turn of 2013/2014, fuel prices will temporarily decline (in y-o-y comparison).

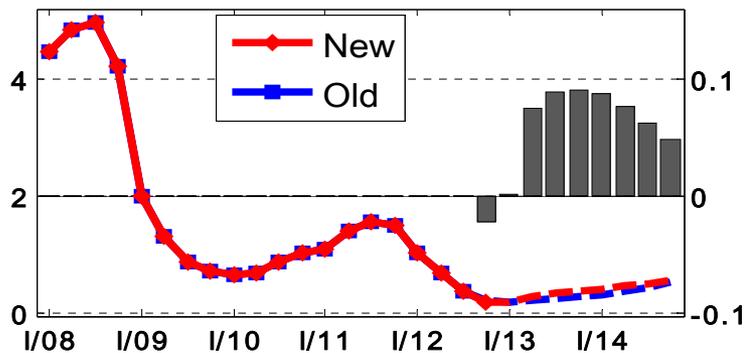
Growth Rate of GDP - Eurozone (y/y, in %)



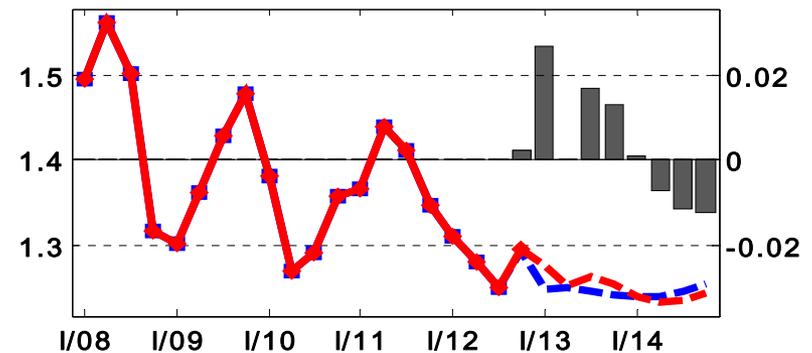
PPI Inflation - Eurozone (y/y, in %)



3M EURIBOR

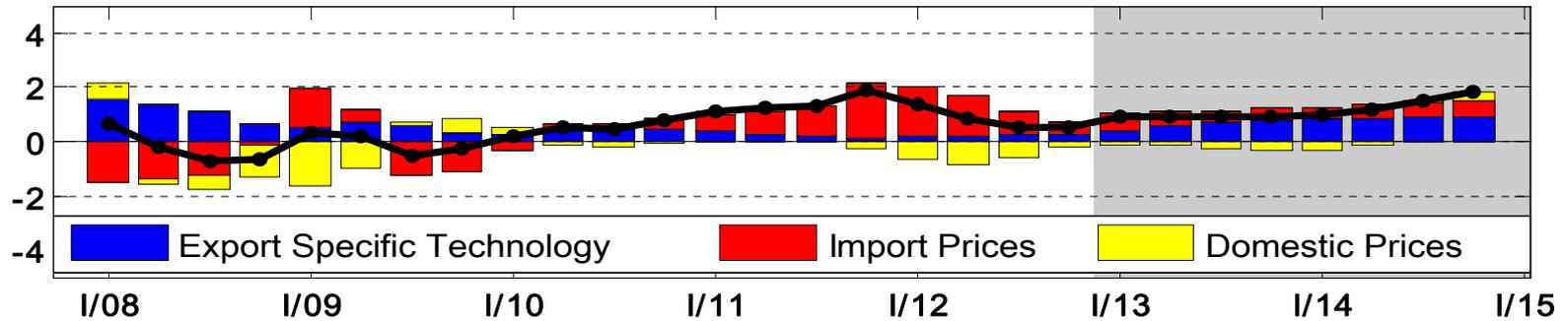


USD/EUR

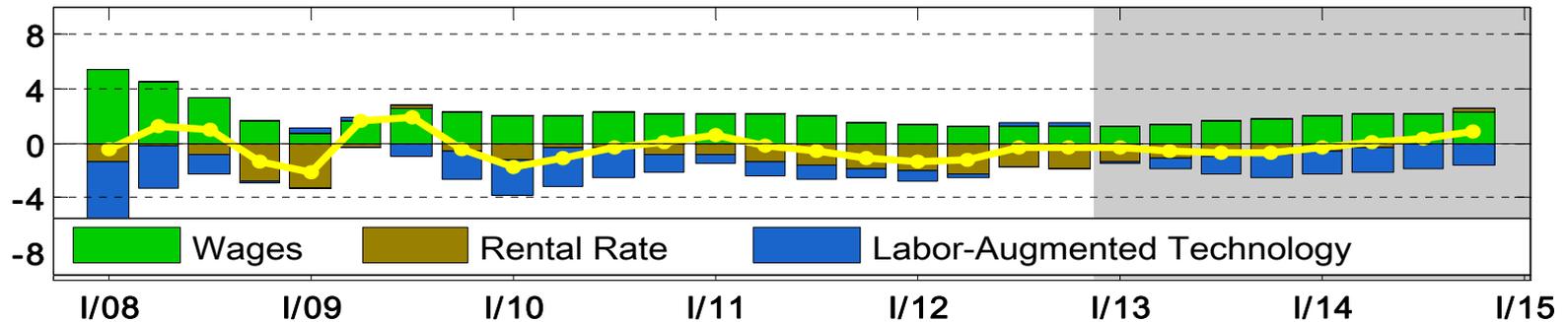


- The recovery of euro area GDP growth in 2013 will be only gradual.
- 3M EURIBOR will stay at very low levels on the whole forecast horizon.
- PPI growth in euro area is expected to be low and stable, oil prices will slightly decline, the euro will gradually depreciate against the USD.

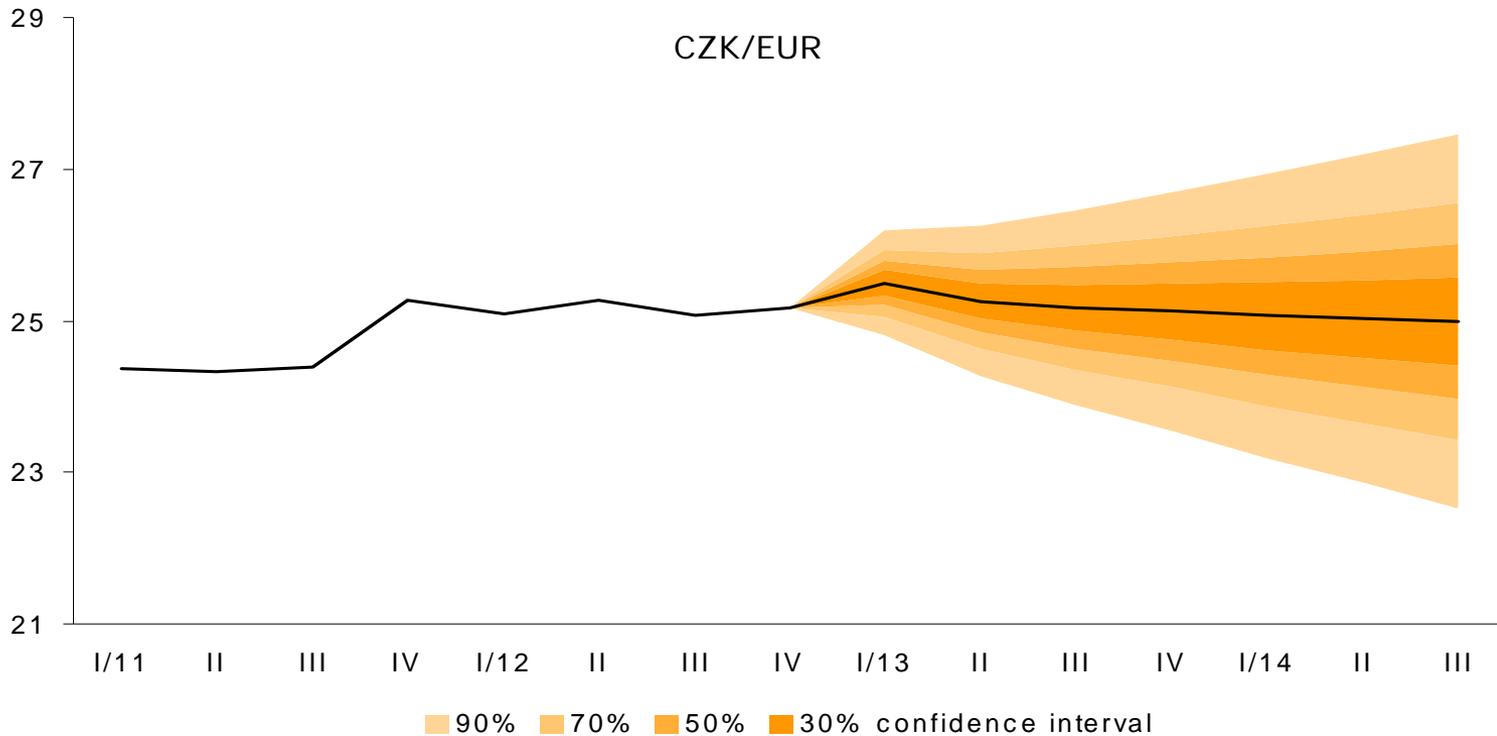
Nominal Marginal Cost in Consumption Sector (q/q, in %, ann.)



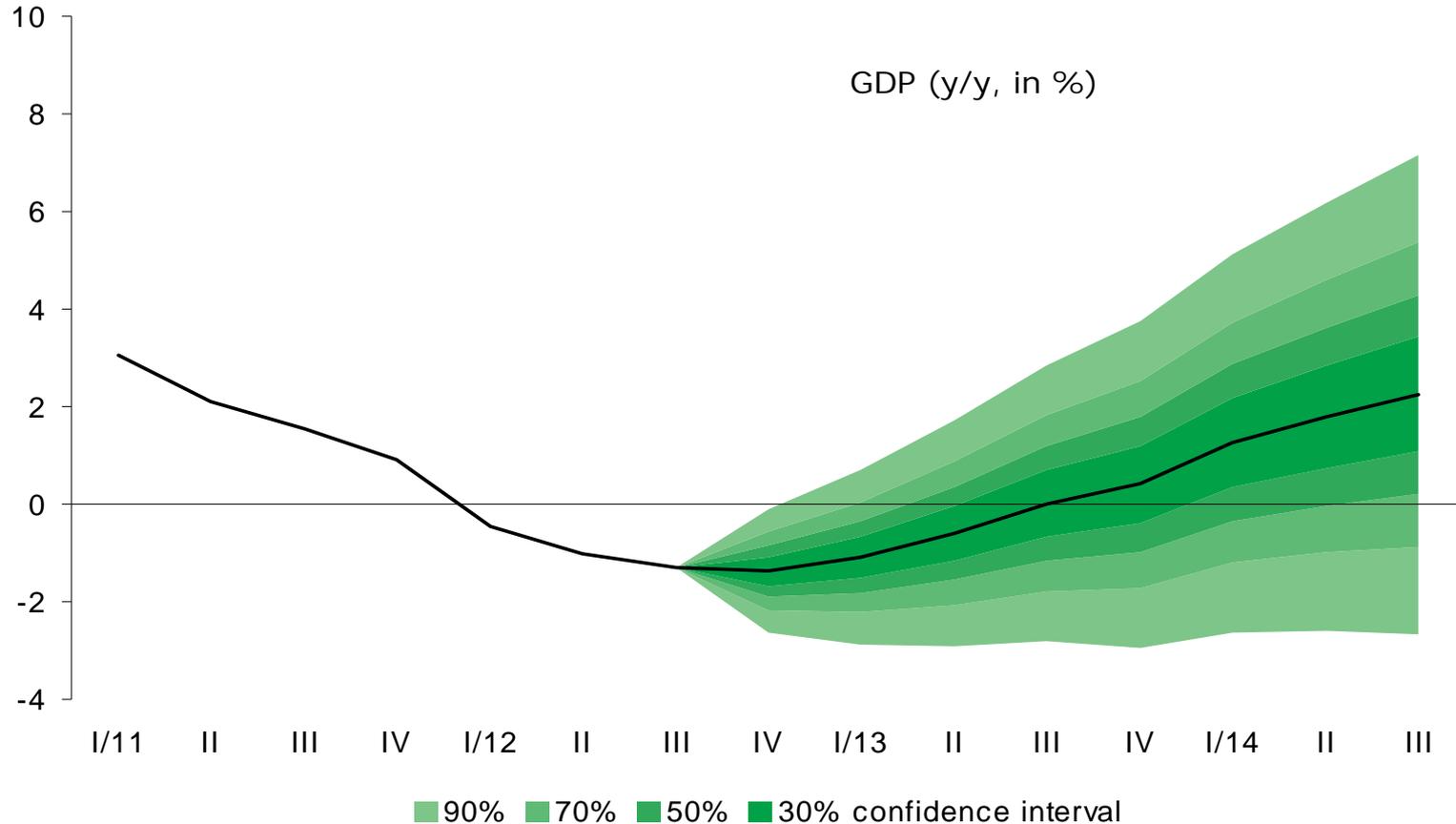
Nominal Marginal Cost in Intermediate Sector (q/q, in %, ann.)



- Muted growth of import prices owing to stable foreign producer price inflation and only slow appreciation of the exchange rate, anti-inflationary domestic economy and increasing export specific technology effects.
- Cost pressures will continue to be slightly anti-inflationary due to low economic activity, subdued wage growth and productivity gains.

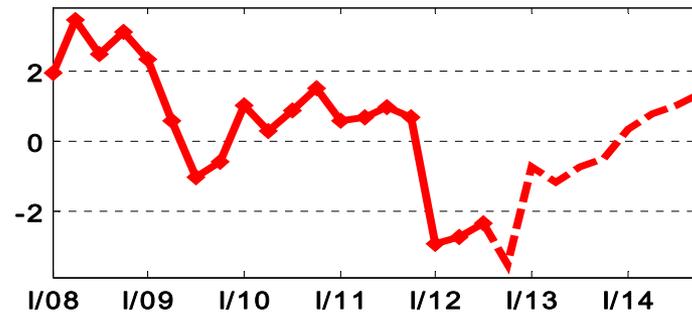


- Near-term forecast for 1Q 2013 is 25.50 CZK/EUR. It reflects current low economic activity and CNB's communication on possible FX interventions.
- The forecast predicts very gradual appreciation to the level of 25 CZK/EUR, implied by low euro-area interest rates and small improvement in nominal net export amid subdued foreign demand.

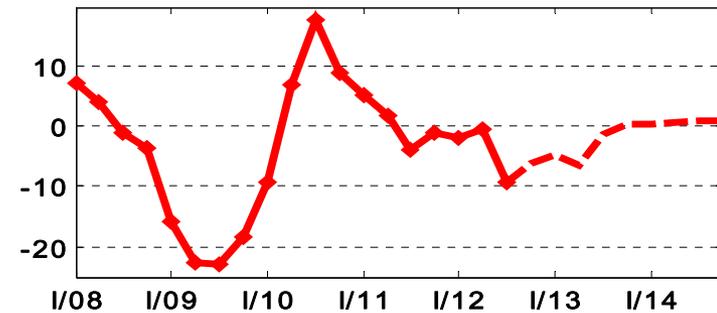


- GDP growth forecast: -0.3% in 2013 and 2.1% in 2014.
- In 2013, significantly restrictive fiscal policy will curb economic growth, whilst the foreign demand will recover only gradually. In 2014, these curbing factors will disappear.

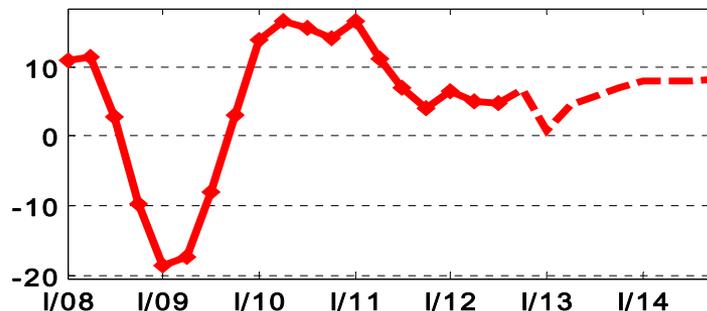
Household Consumption Growth (y/y, in %)



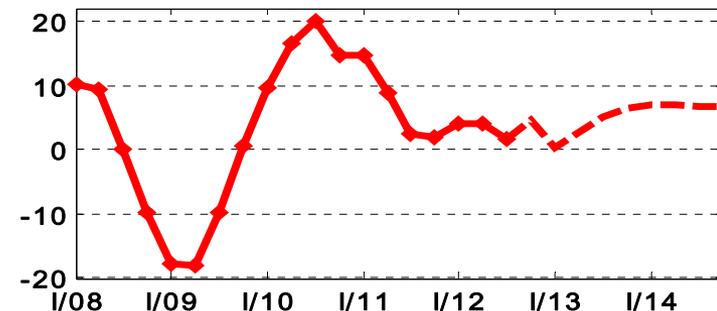
Investments Growth (y/y, in %)



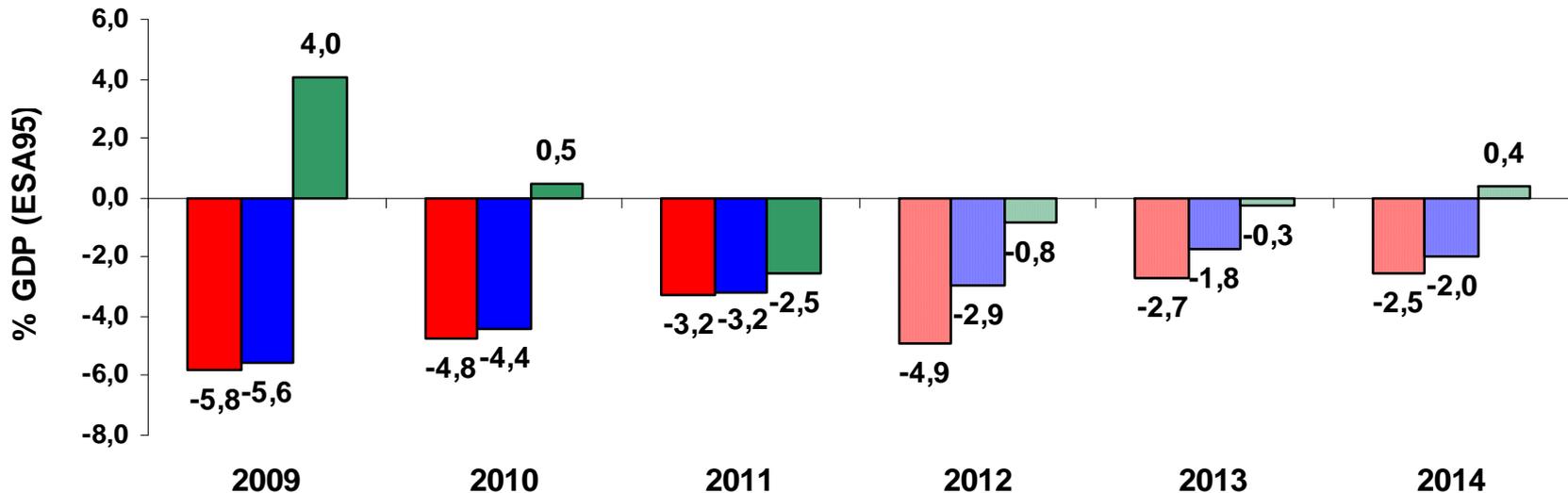
Exports Growth (y/y, in %)



Imports Growth (y/y, in %)



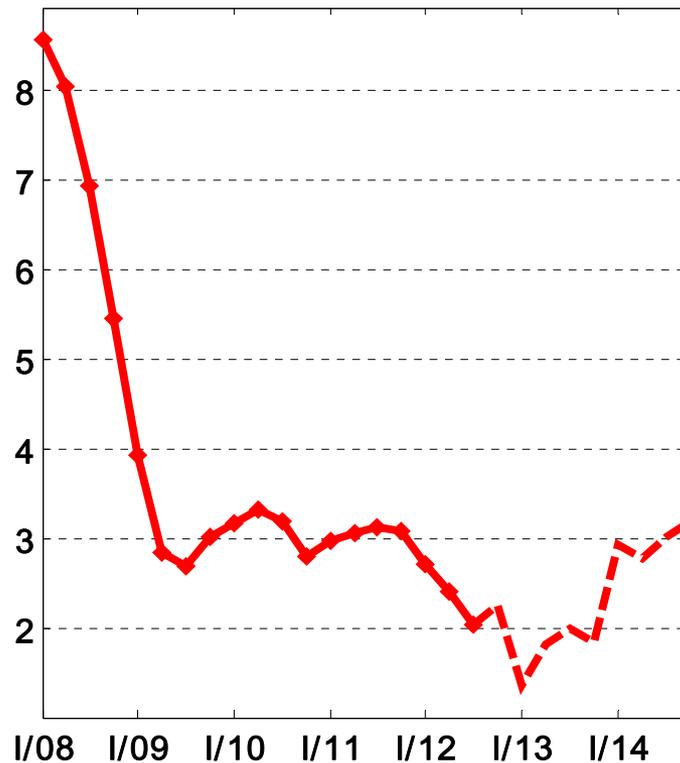
- Decline in household consumption and investment will continue this year, growth of these components will turn positive in 2014.
- The positive contribution of net exports (but smaller than up to now) will continue in both years.



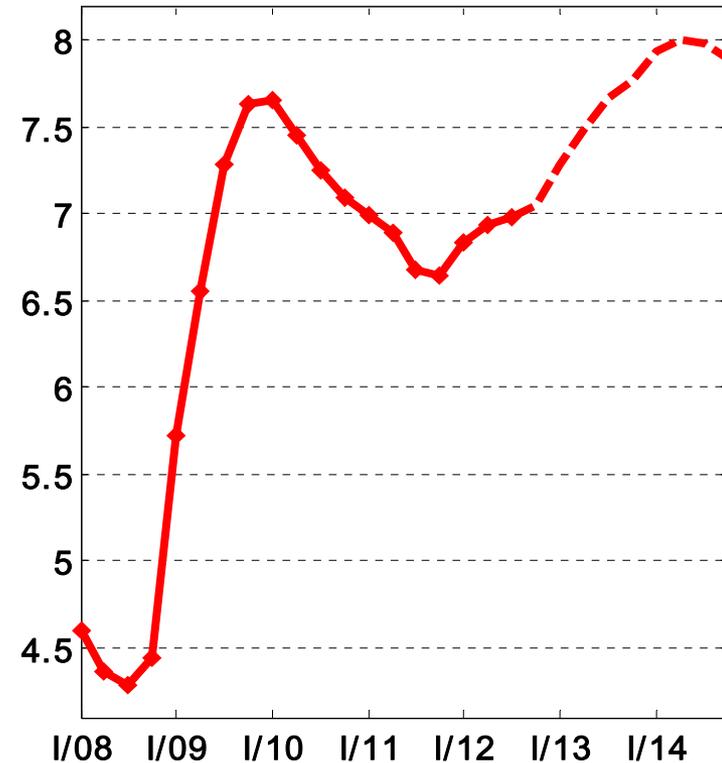
■ Public budget deficit ■ Structural deficit (EC) ■ Real government consumption (y-o-y %)

- Both total and structural budget deficit will decrease significantly in 2013 and 2014 owing to budgetary consolidation measures and renewed GDP growth.
- Real government consumption will decline slightly in 2013; in 2014 it will rise in the similarly negligible magnitude.

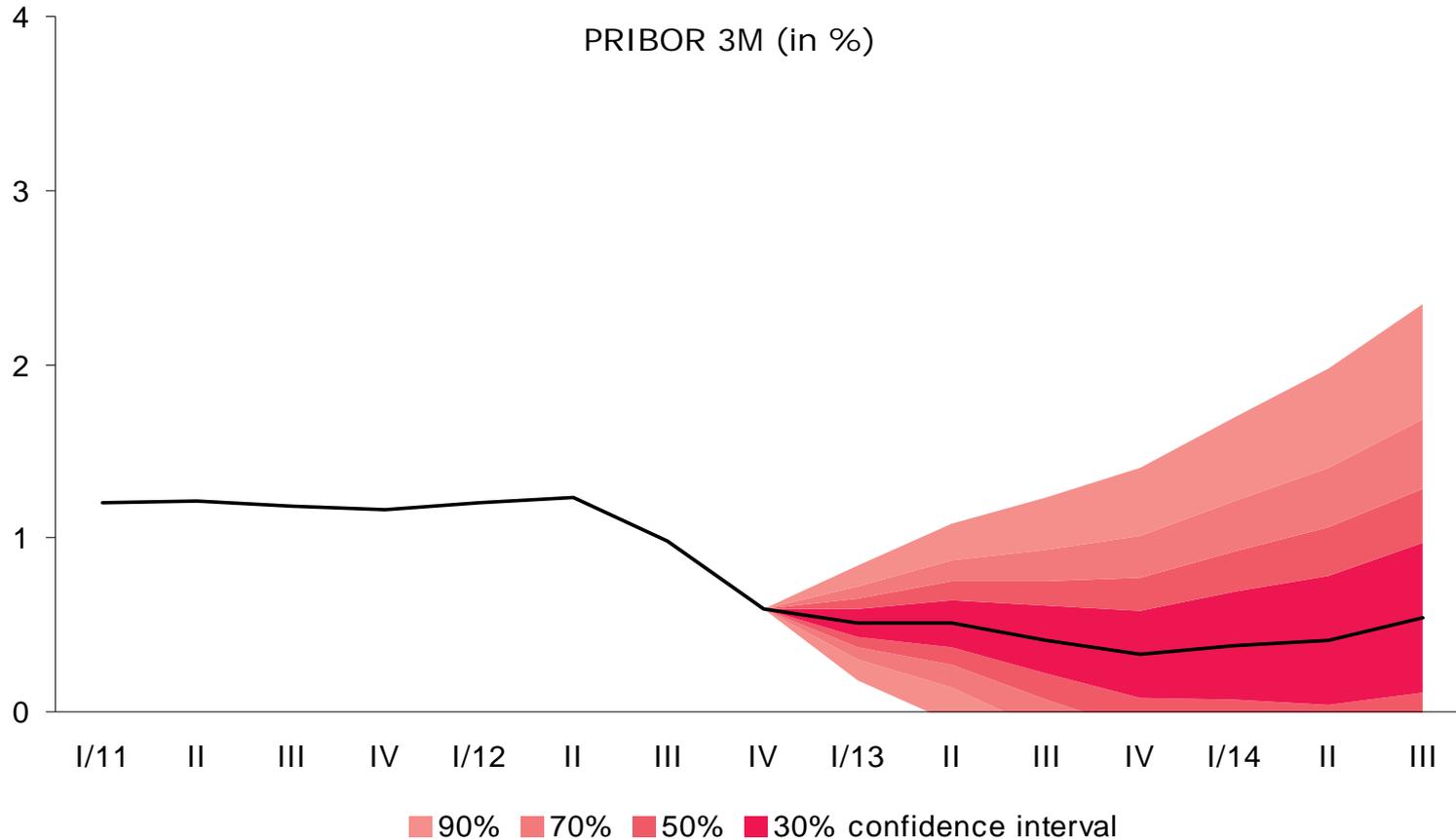
Nominal wage growth in business sector
(y/y, in %, s.a.)



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



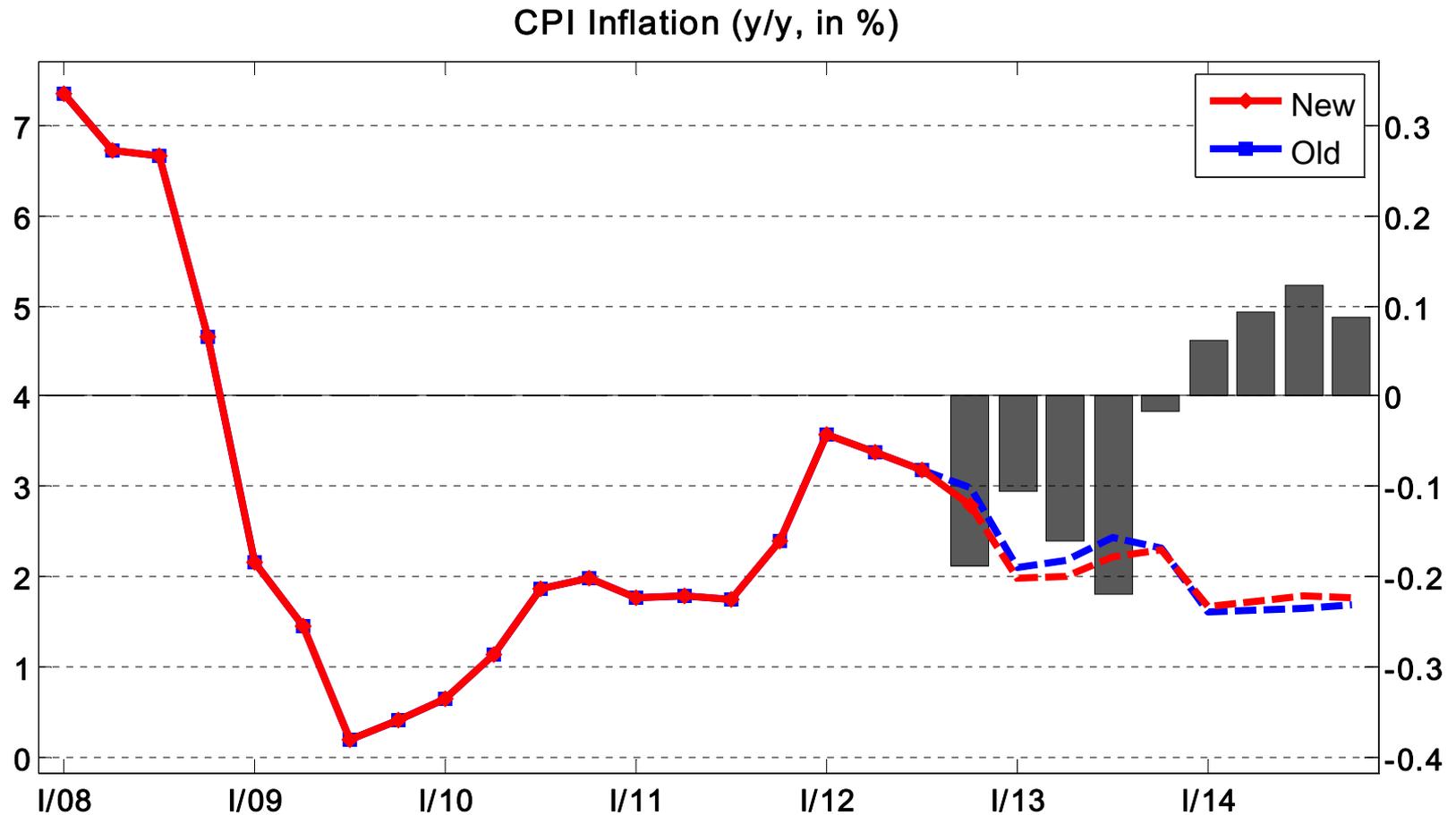
- Slow growth of nominal wages will reflect the subdued economic activity (time shift 2012/2013 caused by tax optimization). In 2014, wage dynamics will increase. Contained wage growth in public sector in both years.
- The unemployment rate (ILO) will rise up to 8% . FTJE decline will cont.



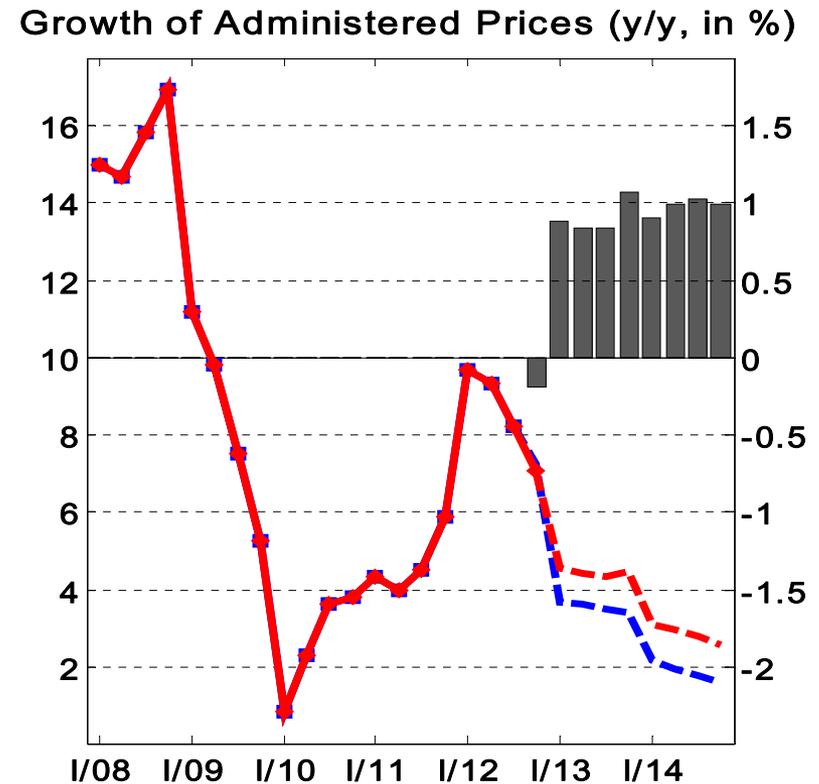
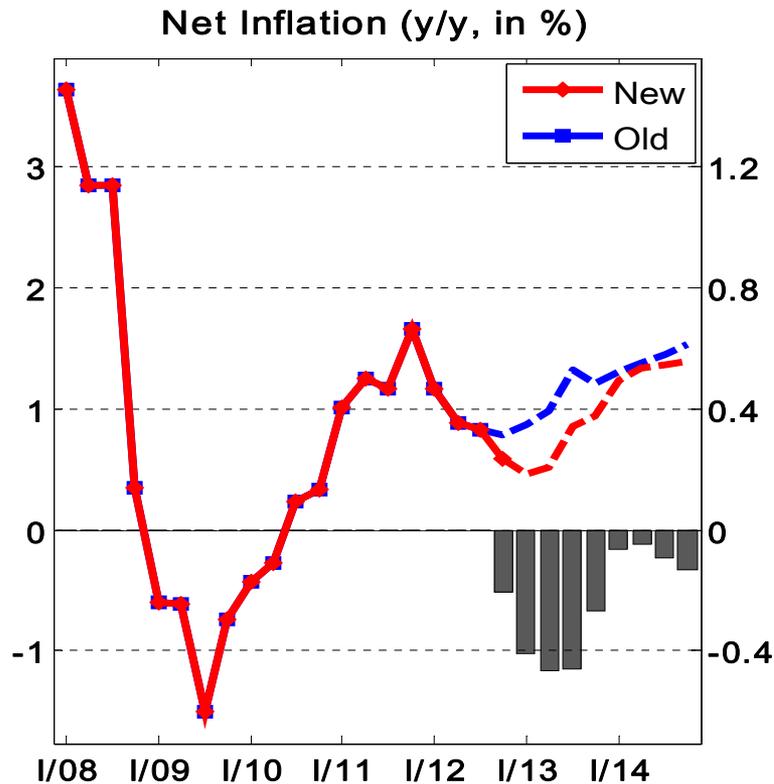
- Consistent with the forecast is a slight decline in market interest rates, followed by their rise as from Q2 2014.

- The forecast for headline and monetary-policy relevant inflation only little changed compared to the previous one.
- Higher forecast of administered prices for this year more than compensated by lower net inflation.
- The forecasts of adjusted inflation without fuels as well as of fuel prices revised downwards in both years, while forecast of food prices revised upwards in 2013 only.
- The exchange rate forecast weaker in the shorter-term and stronger in the longer term.
- The GDP forecast lowered for this year, whereas shifted slightly higher in the longer term.
- Nominal wage growth lowered for the entire horizon.
- The path of market interest rate slightly higher in 2013, while revised slightly downwards starting 2Q 2014.

Comparison with Previous Inflation Forecast (i)

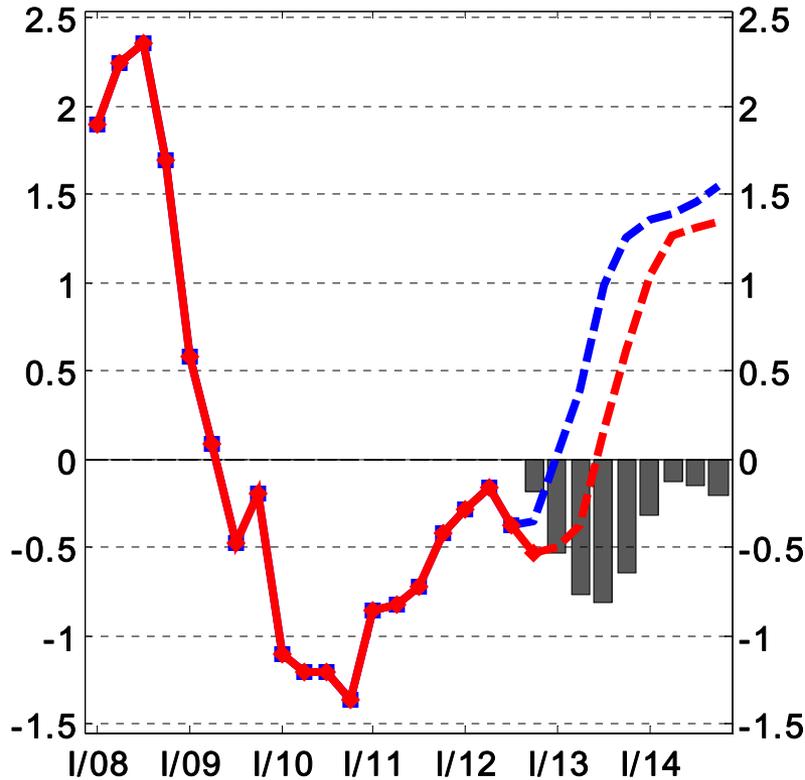


- The forecast of headline (as well as MP-relevant) inflation revised slightly downwards in 2013, and slightly upwards in 2014.

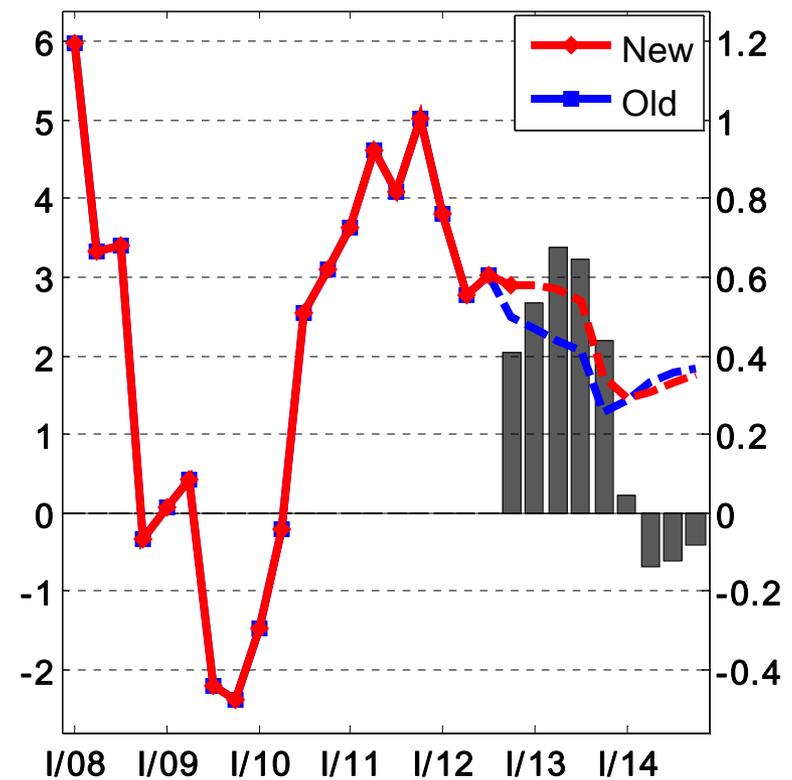


- Net inflation: reflects more subdued economic activity, lower observed values of inflation in 4Q 2012 and decreased near-term forecast.
- Administered prices: increased forecast for prices of natural gas, electricity, water and sewerage charges.

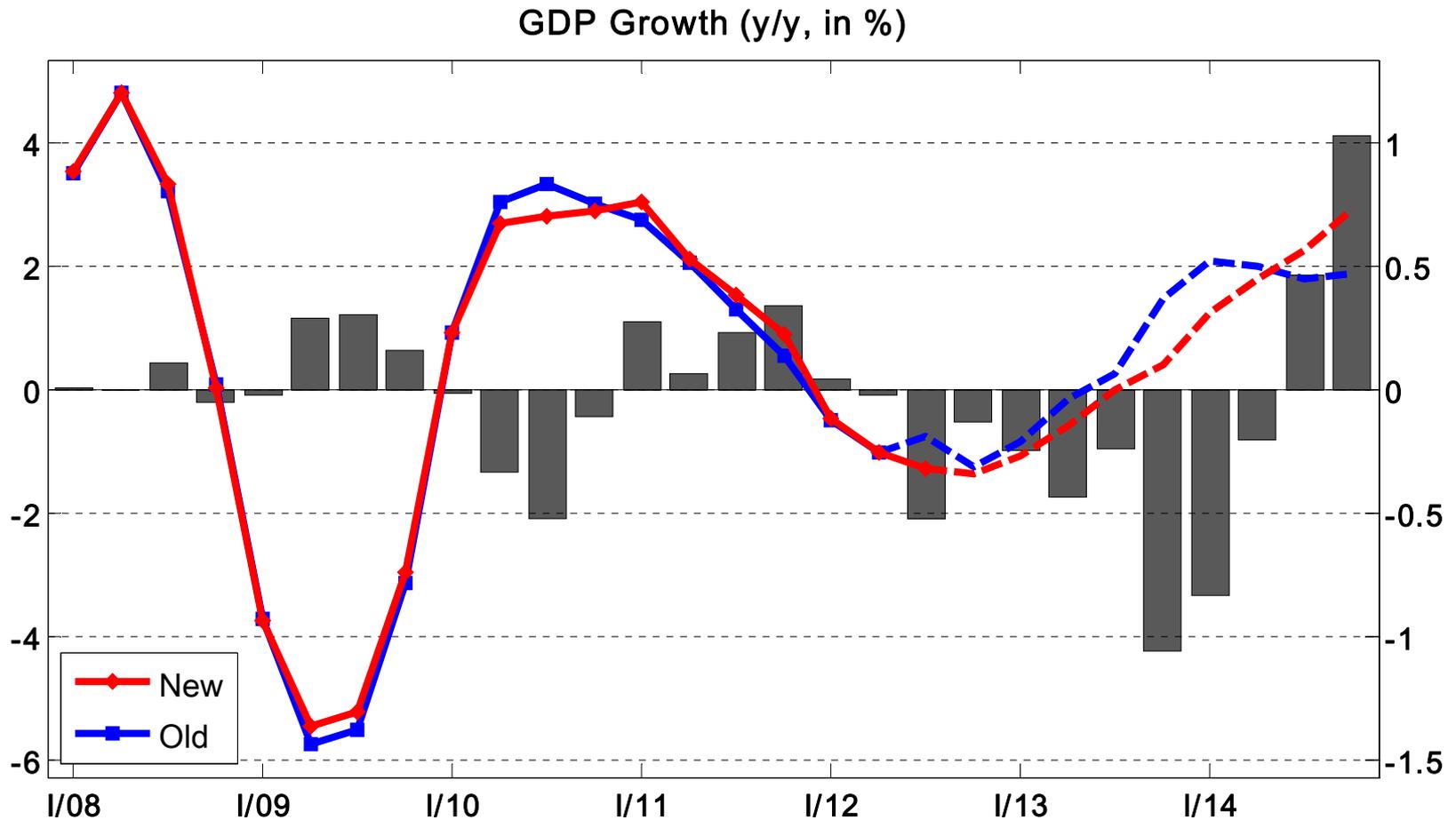
Adjusted Inflation Excl. Fuels
(y/y, in %, Excl. Tax Changes)



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



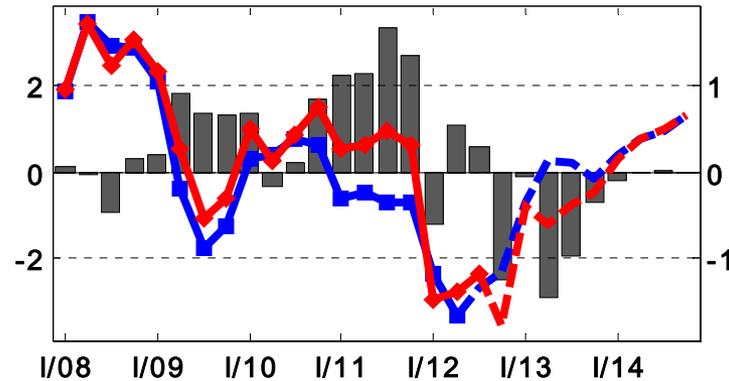
- The lowered forecast of adjusted inflation without fuels reflects more depressed economy whereas weaker exchange rate has opposite effect.
- Food prices forecast higher due to developments of both world and domestic agricultural commodities' prices.



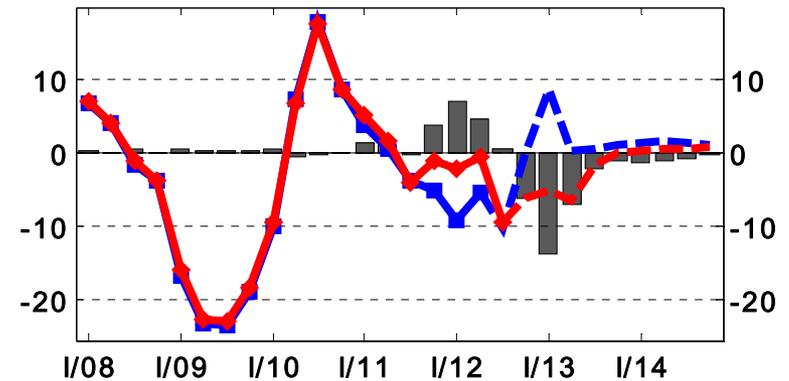
- The GDP forecast for this year downgraded owing to a slightly lowered outlook for foreign demand and more subdued domestic household consumption. For 2014, GDP outlook increased.

Comparison with Previous GDP Forecast (ii)

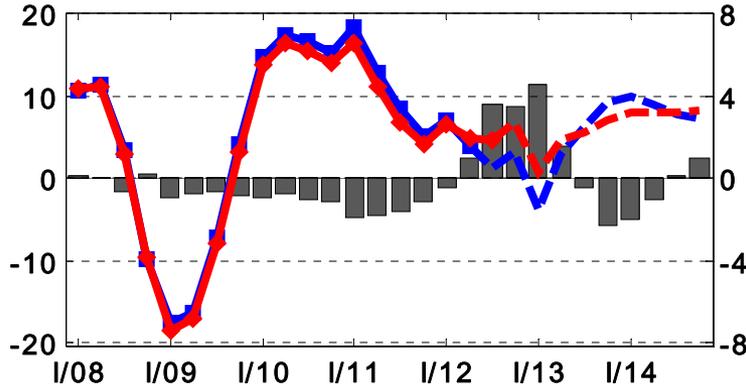
Household Consumption Growth (y/y, in %)



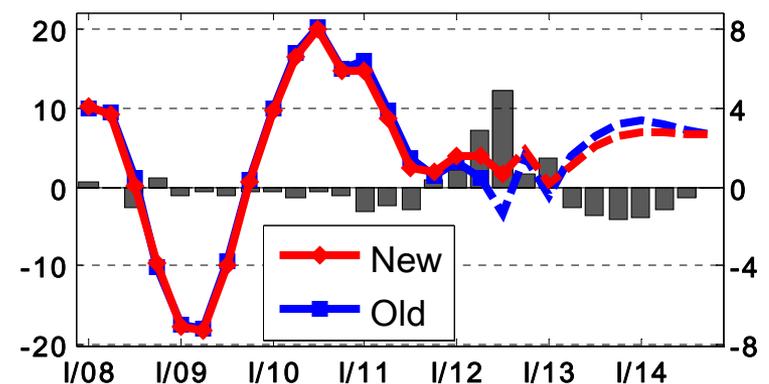
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)

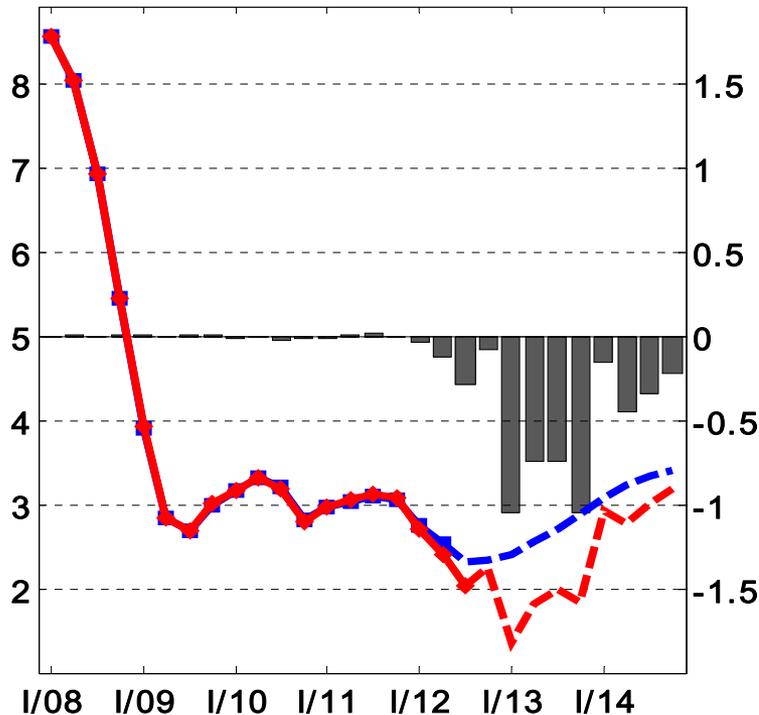


Imports Growth (y/y, in %)

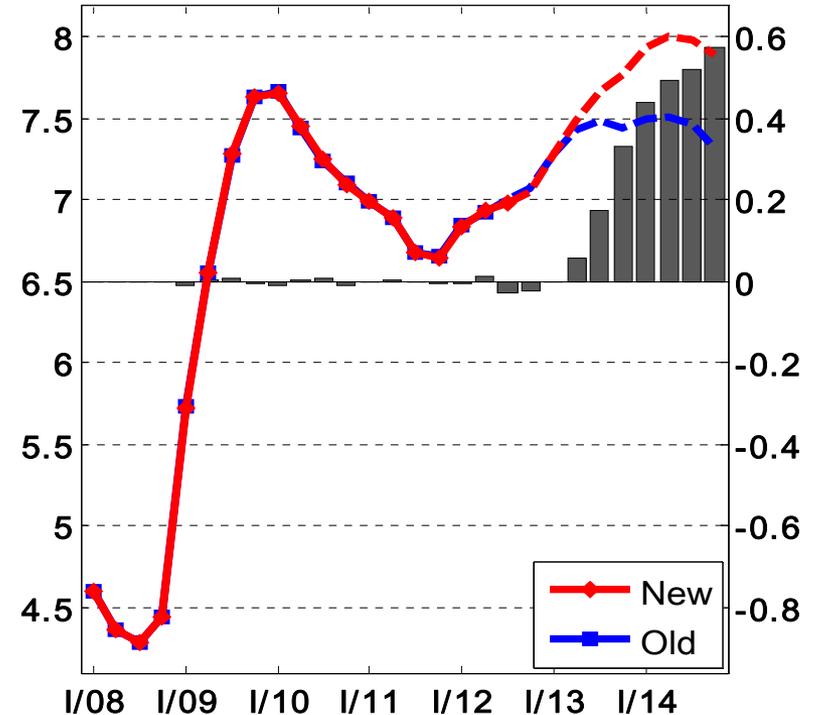


- Lowered household consumption and investment forecasts for 2013.
- Contributions of net exports to GDP dynamics revised upwards (with lowered outlook for export and import) due to more dampened domestic demand forecast and despite lowered foreign demand outlook.

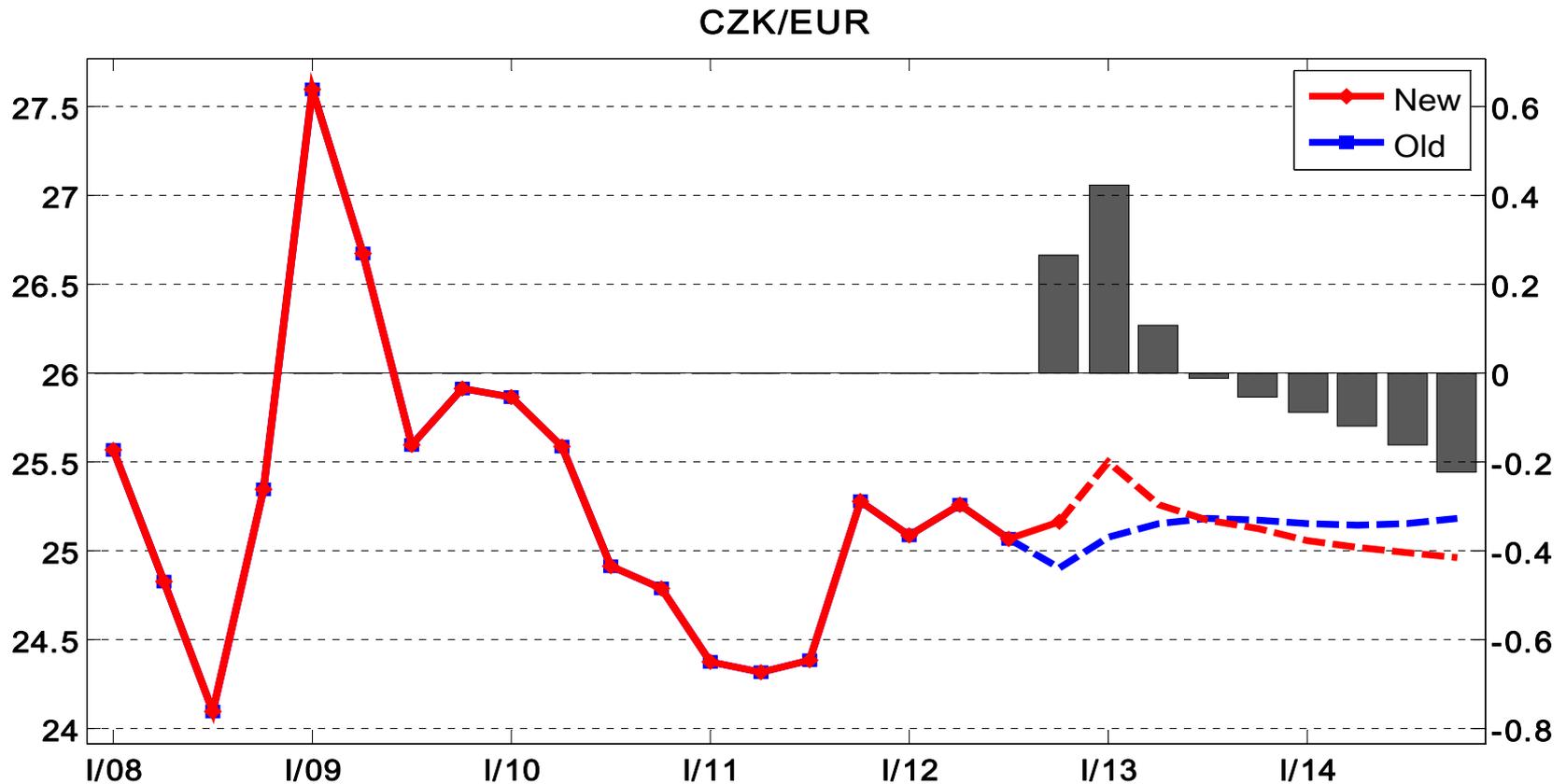
Nominal wage growth in business sector
(y/y, in %, s.a.)



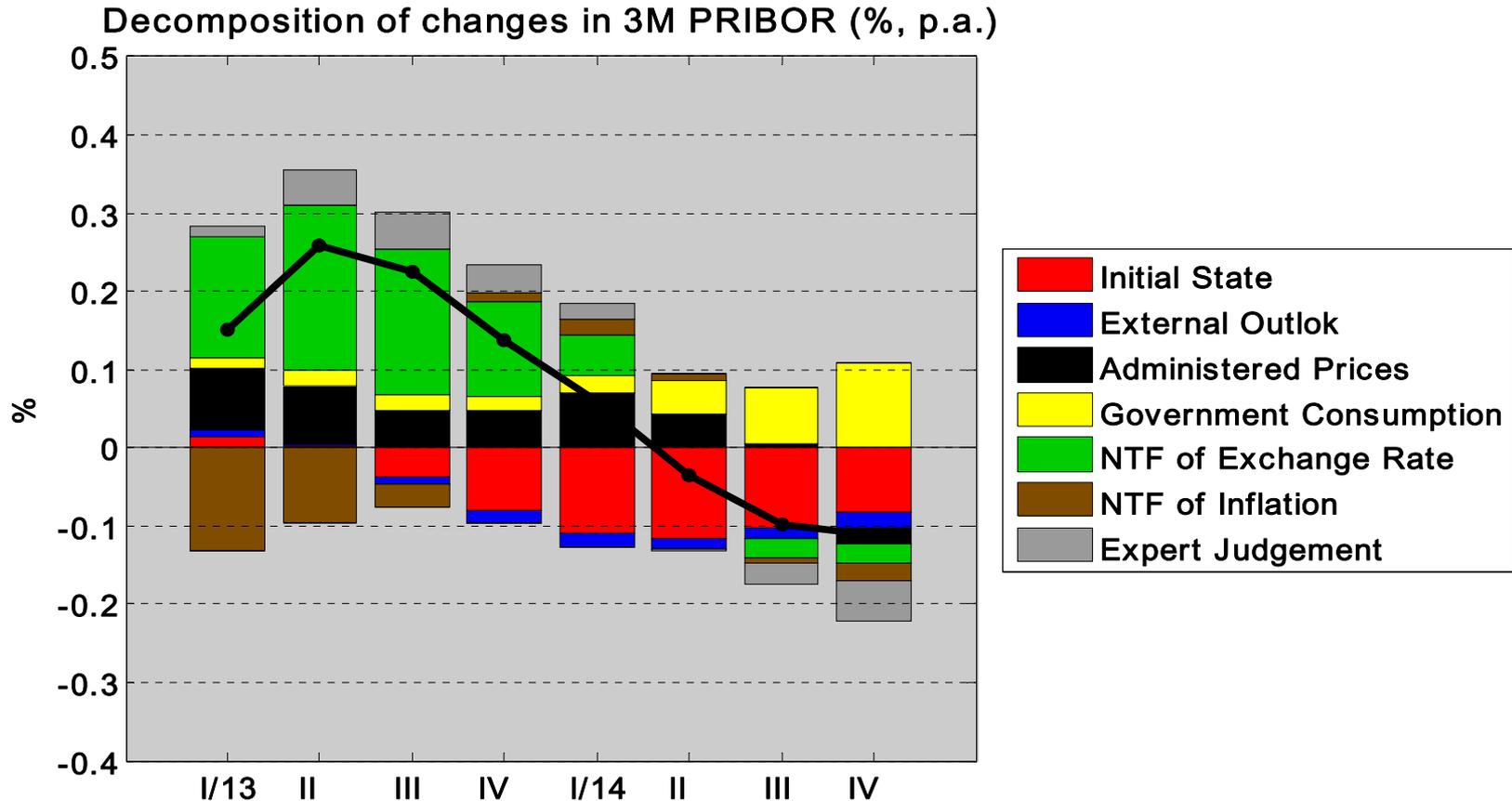
General unemployment rate (ILO)
(in %, s.a.)



- The lowered nominal wage growth in business sector is related to more suppressed domestic economy. Unemployment shifted progressively upwards.
- Forecast includes the effect of tax optimization at the turn of 2012/2013.



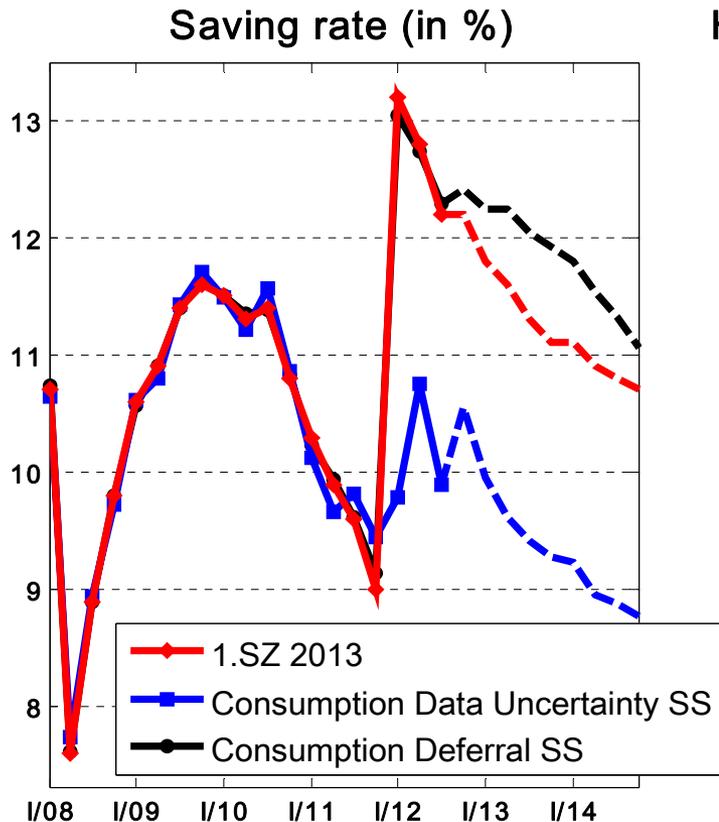
- Weaker near term outlook for exchange rate reflects the CNB's communication on possible FX interventions in combination with more anti-inflationary developments in the economy in late 2012.
- Later on, the exchange rate forecast shifted slightly towards stronger levels. ²³



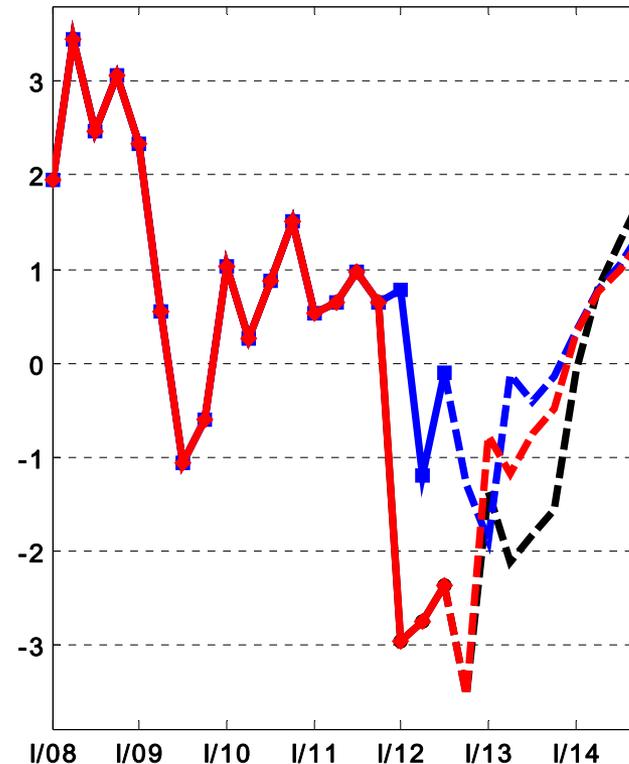
- Weaker short-term outlook for exchange rate together with higher forecast of regulated prices in 2013 more than compensate more anti-inflationary developments of domestic economy (more pronounced economic recession as initial state, and lowered near-term forecast of inflation).

- At the close of the meeting on 6 February 2013, the Board decided to leave all policy interest rates unchanged. All seven members voted in favour of this decision.
- Risks of the forecast evaluated as balanced.
- Two sources of uncertainty identified:
 - Uncertainty regarding the development of consumption and saving's rate of households (2 sensitivity scenarios)
 - Uncertainty concerning the extent and impacts of fiscal consolidation

Two Sensitivity Scenarios (i)



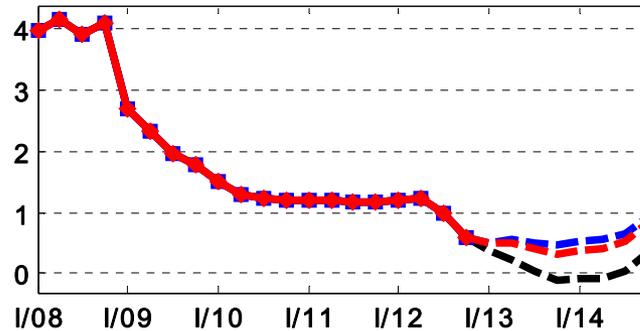
Household consumption growth (y/y, in %)



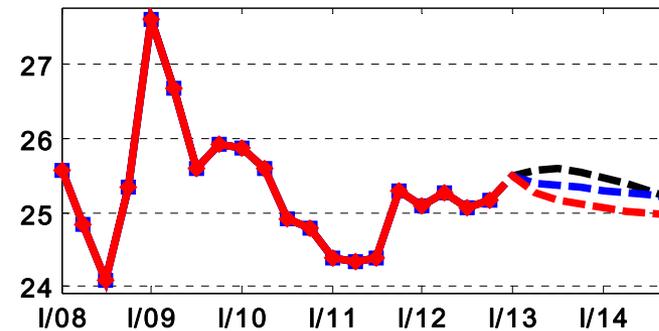
- First scenario quantifies the possibility of revision of household consumption data to levels corresponding to the development of retail sales, and thus lower saving rate (data uncertainty).
- Second scenario analyses the situation in which households continue to defer their consumption and thus save at higher rate (cons. deferral).

Two Sensitivity Scenarios (ii)

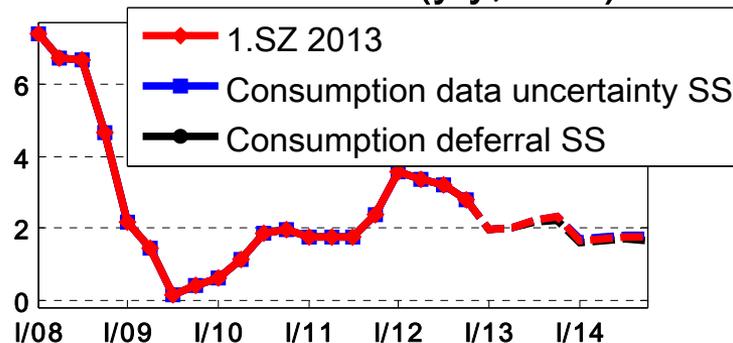
Pribor 3M (in % p.a.)



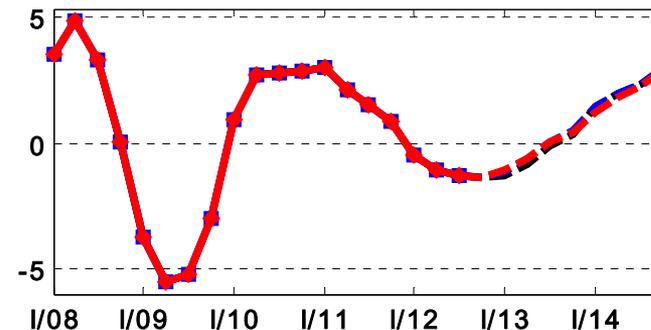
Exchange rate (CZK/EUR)



Headline inflation (y/y, in %)



GDP growth rate (y/y, in %)



- Consumption deferral implies a more pronounced need for easing monetary conditions (lower interest rates and weaker exchange rate than in the baseline scenario). Data uncertainty scenario implies insignificantly higher nominal interest rates compared to the baseline.
- GDP and inflation influenced negligibly in both scenarios.

Thank you for your attention!

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