

Meeting with Analysts

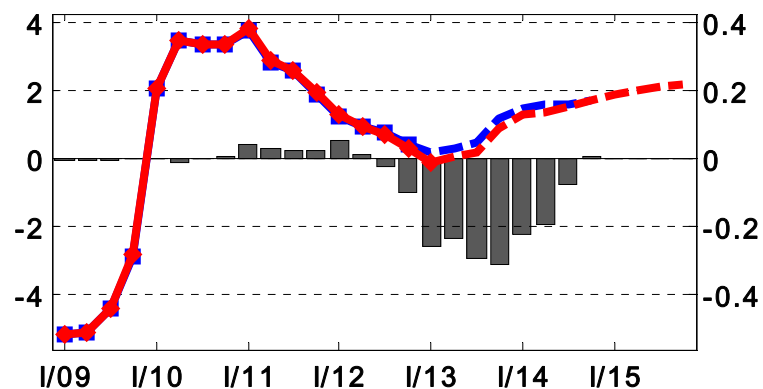
Tibor Hlédik

Prague, 9 August, 2013

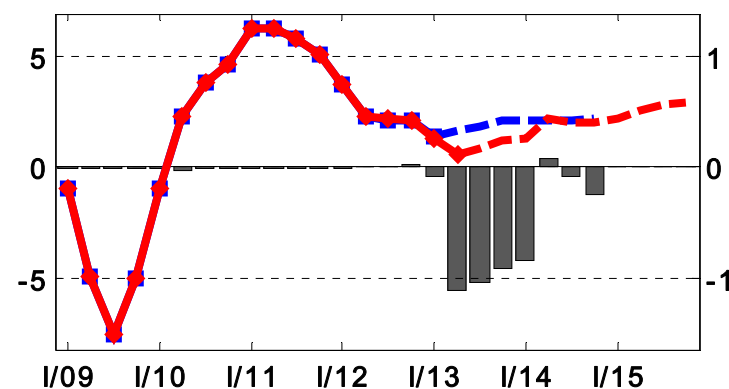
- The recovery of GDP in the effective euro area is postponed again and it is expected to be only gradual. Prices will grow only moderately and foreign interest rates will remain at low levels until 2015.
- Domestic fiscal policy will remain restrictive in 2013, but will turn to neutral in 2014.
- Headline inflation will stay below the CNB's 2% target this year, MP-relevant inflation below the lower boundary of the target's tolerance band. During 2014-2015 they will gradually return to the target.
- Currently suppressed inflationary pressures will pick up gradually. The effect of depreciated exchange rate on import prices will initially add to inflation pressures, that will be followed by a slowly fading anti-inflationary impact of the domestic economy.

- The Czech economy will decline by 1.5% this year, mainly due to its significant drop in the 1Q. In 2014, the GDP will grow by slightly more than 2 %, in 2015 it will accelerate further.
- Nominal wage growth will remain very moderate (but volatile due to the effects of tax optimisation) owing to the subdued economy.
- The exchange rate of the koruna against the euro has weakened and will appreciate only very slowly over the forecast horizon.
- Consistent with the forecast is a decline in market interest rates to zero, followed by a noticeable rise in rates only in 2015.

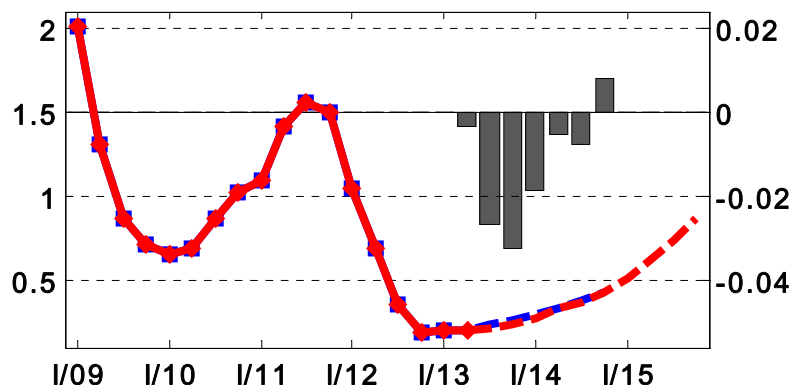
Growth Rate of GDP - Eurozone (y/y, in %)



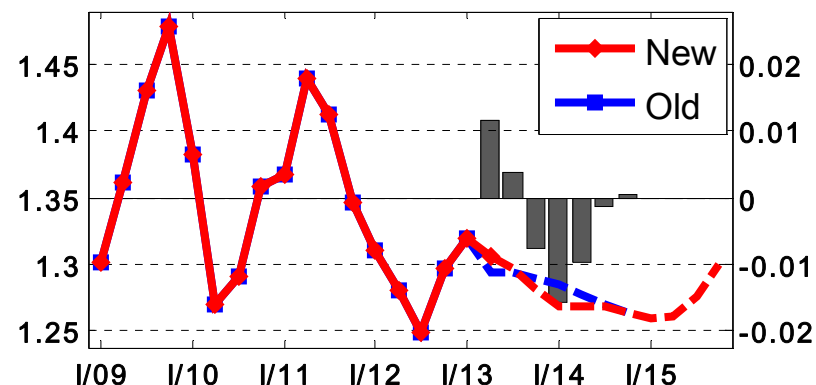
PPI Inflation - Eurozone (y/y, in %)



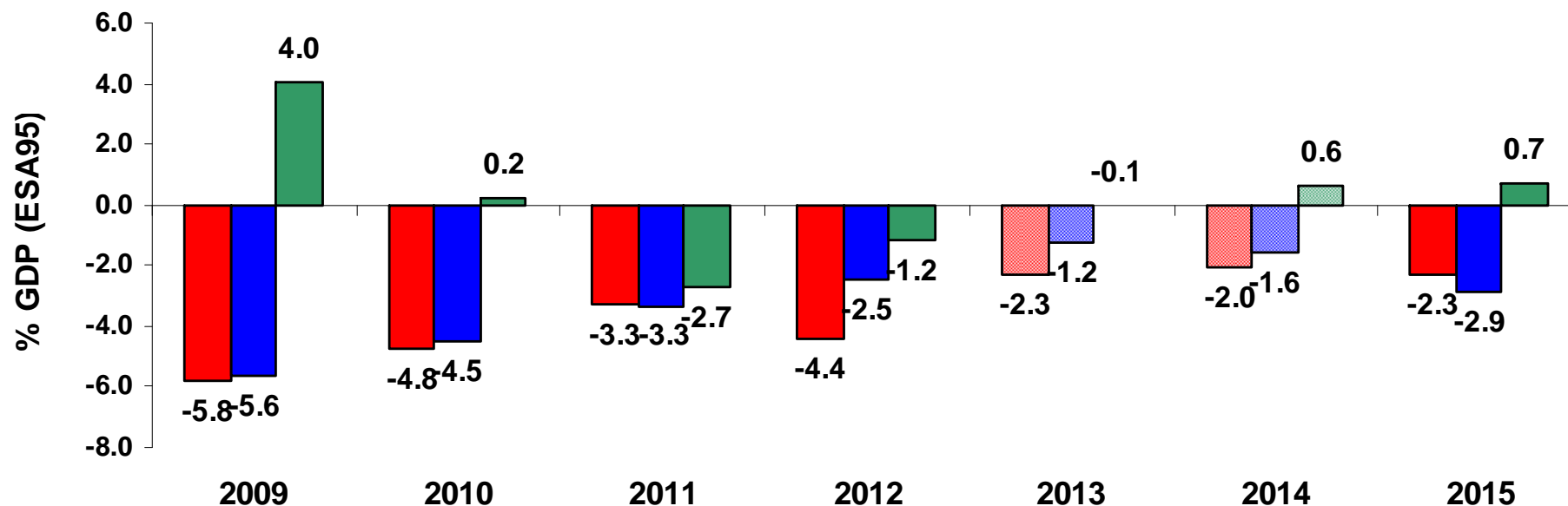
3M EURIBOR



USD/EUR



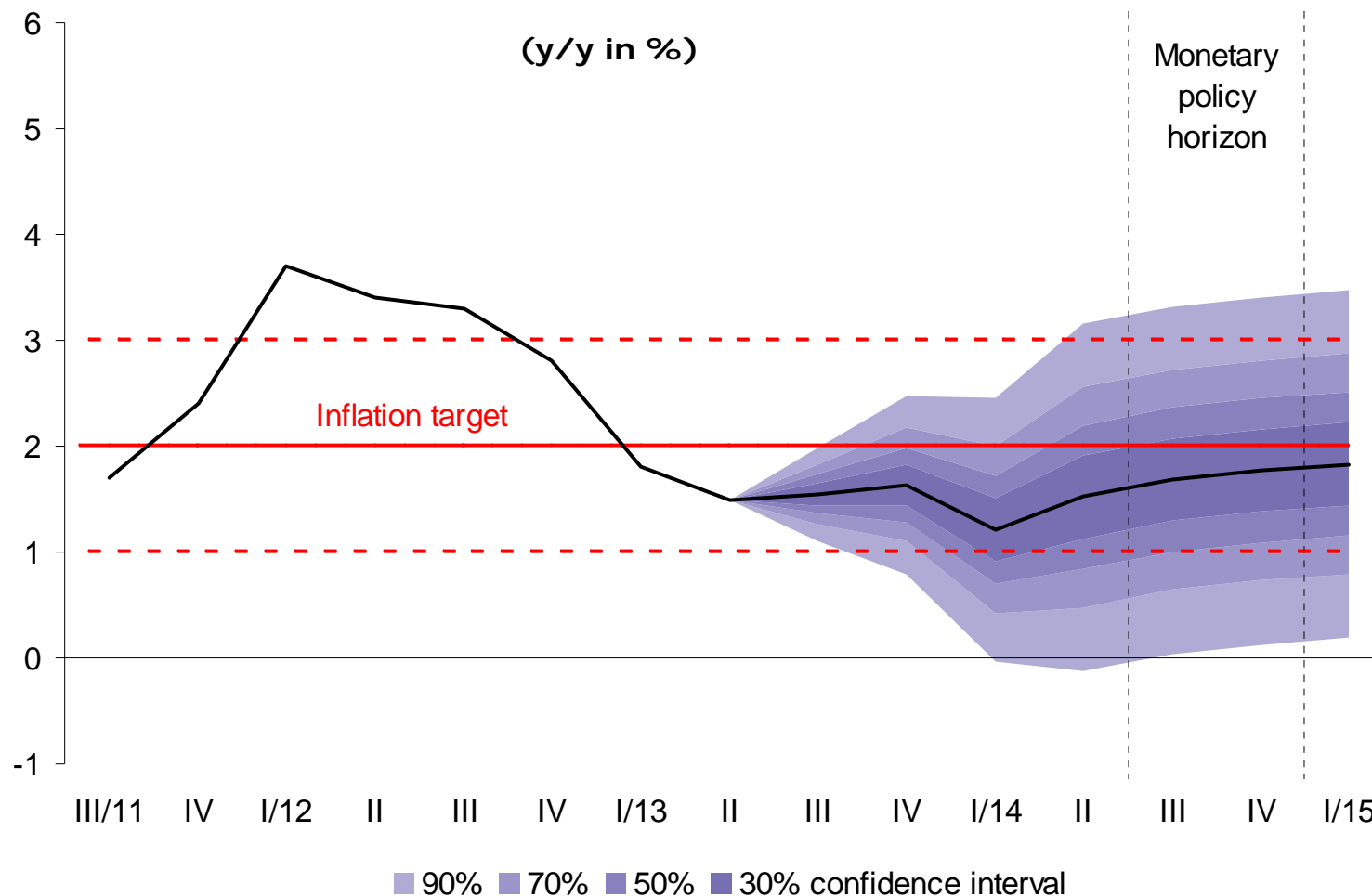
- The recovery of euro area GDP growth is slightly postponed again (CF).
- Price growth, both in terms of CPI and PPI, is subdued.
- The very low level of 3M EURIBOR is prolonged to 2015.



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

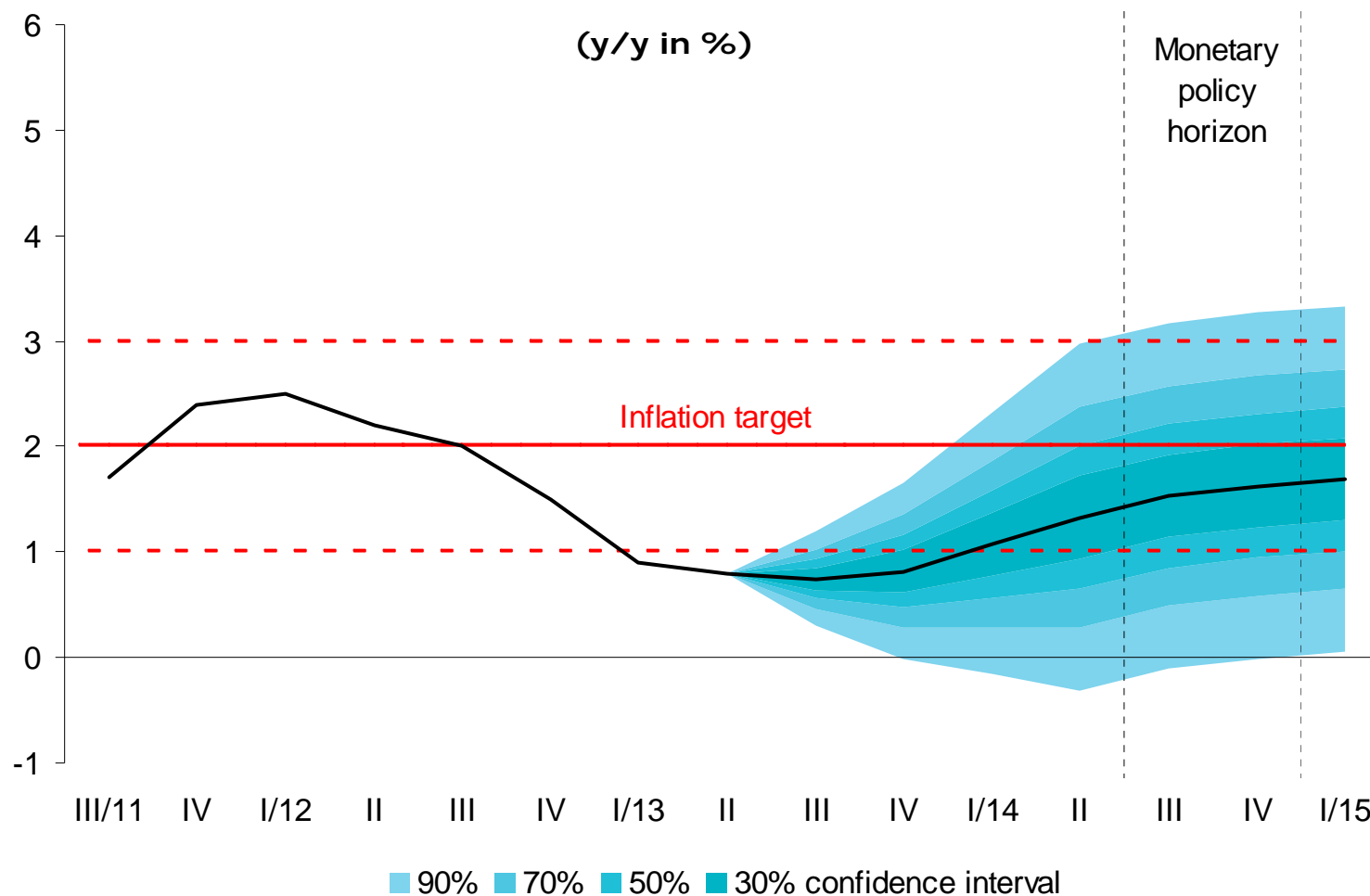
- Both headline and structural deficits will fall significantly in 2013 due to the already realized fiscal consolidation program.
- Fiscal impulse in 2013: -0.6 p.p. 2014: neutral 2015: +0.3 p.p.
- Real government consumption will grow slightly, starting from 2014.

Headline Inflation Forecast



- Headline inflation will remain below the target on the whole forecast horizon, in spite of significant indirect tax changes this year.
- As these tax effects fade away in January 2014, inflation will decline further, and then gradually return to the target.

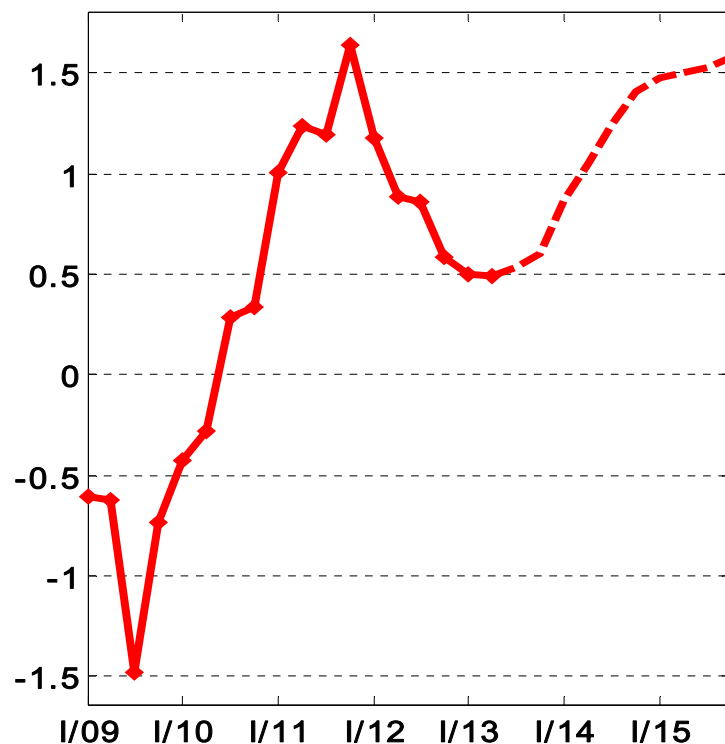
MP-Relevant Inflation Forecast



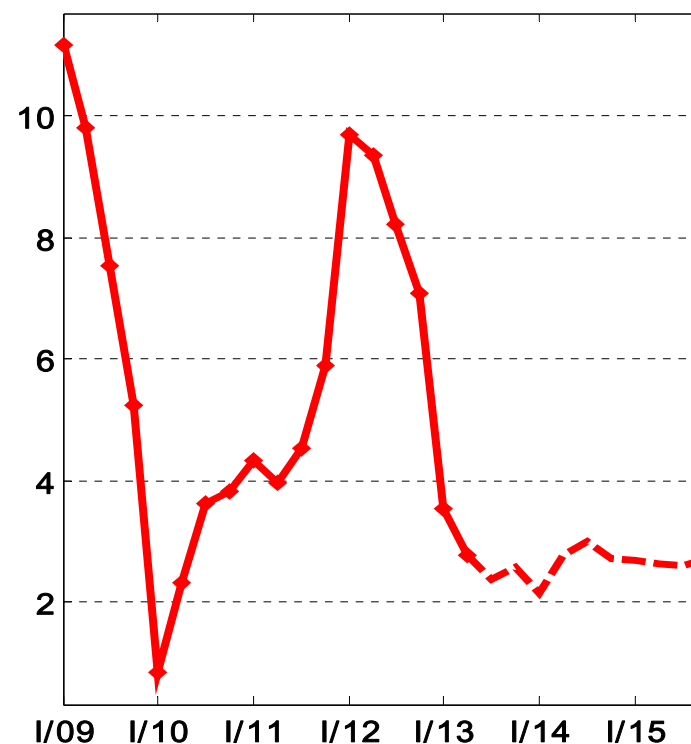
- Monetary-policy relevant inflation will remain below the lower boundary of the tolerance band this year and it will gradually move towards the inflation target on the monetary policy horizon.

Net Inflation and Administered Prices

Net Inflation (y/y, in %)

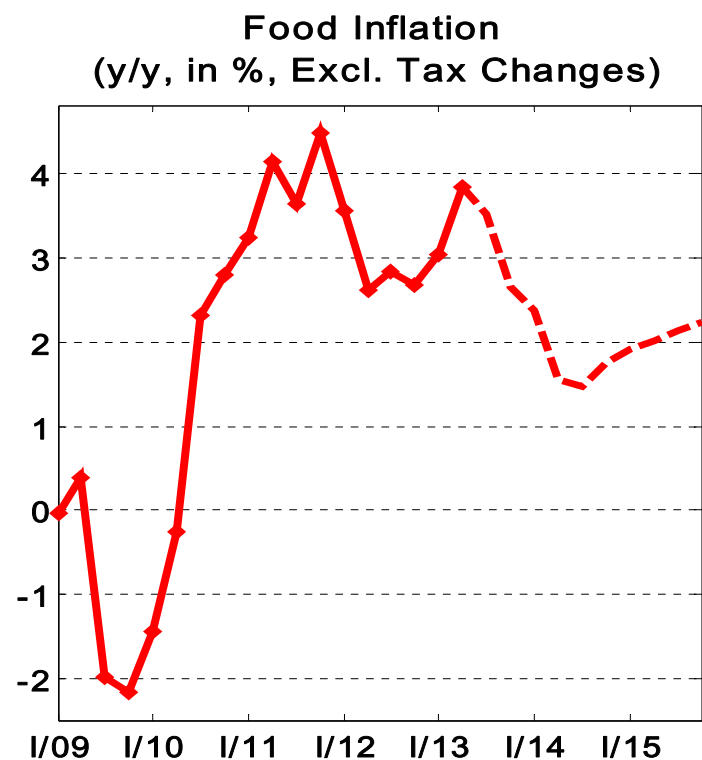
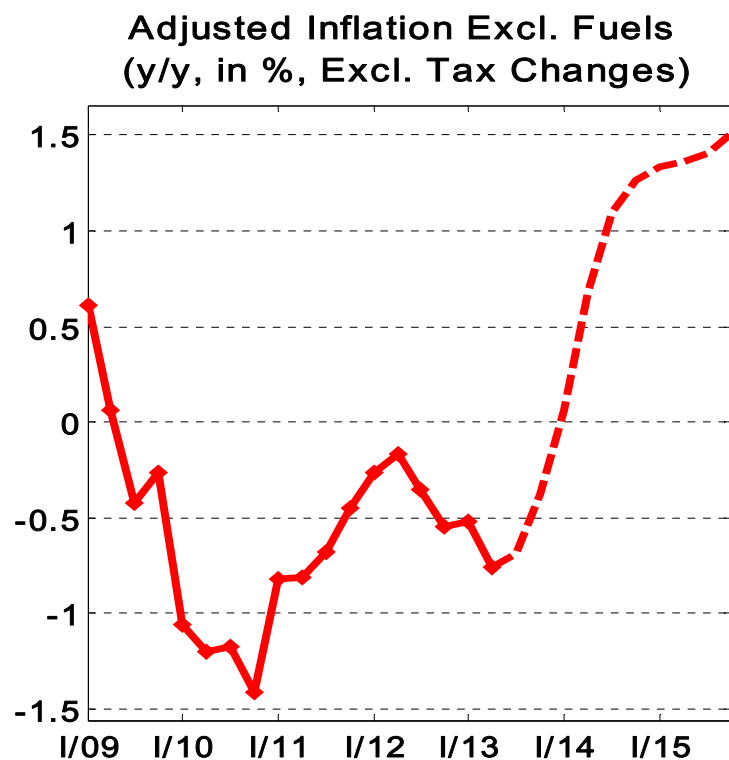


Growth of Administered Prices (y/y, in %)



- Net inflation reflects subdued economic activity and low observed values for the 2Q 2013. In the short-run lower adjusted inflation will dominate over the higher growth of food prices.
- The growth of administered prices will remain below 3 %. The fall of gas prices (4.5 %) this year mitigates price growth in this segment.

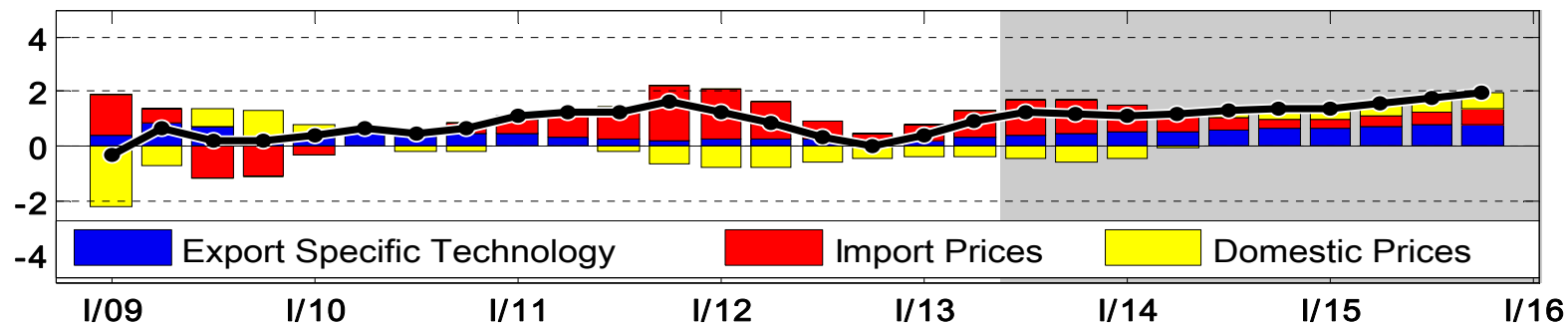
Adjusted Inflation Excluding Fuels and Food



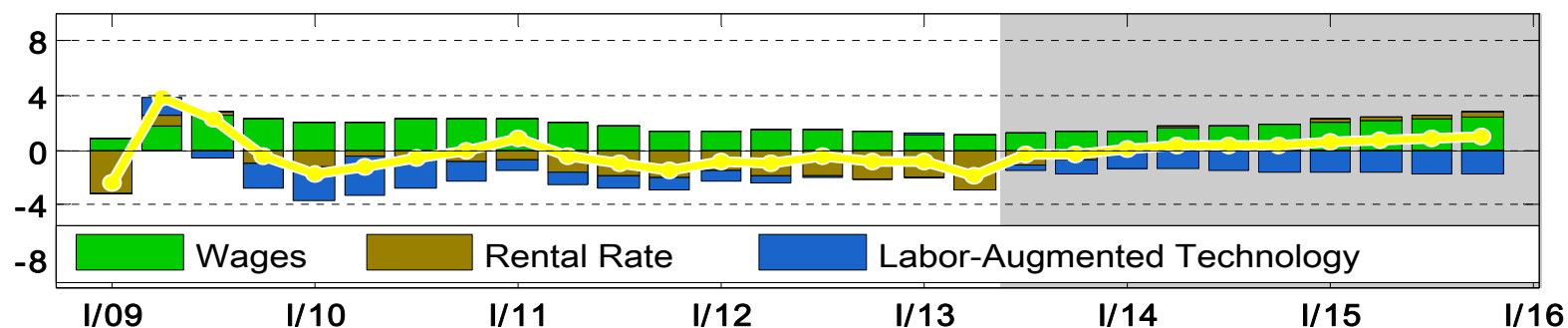
- Adjusted inflation excl. fuels reflects suppressed domestic demand and a fall in mobile tariff prices. The switch to positive price growth is expected in 1Q 2014, followed by gradual increases afterwards.
- Higher observed food price growth in spite the fall in agricultural prices. Significant fall in food price inflation (below 2 %) is expected in 2014.

Domestic Costs vs. Import Prices

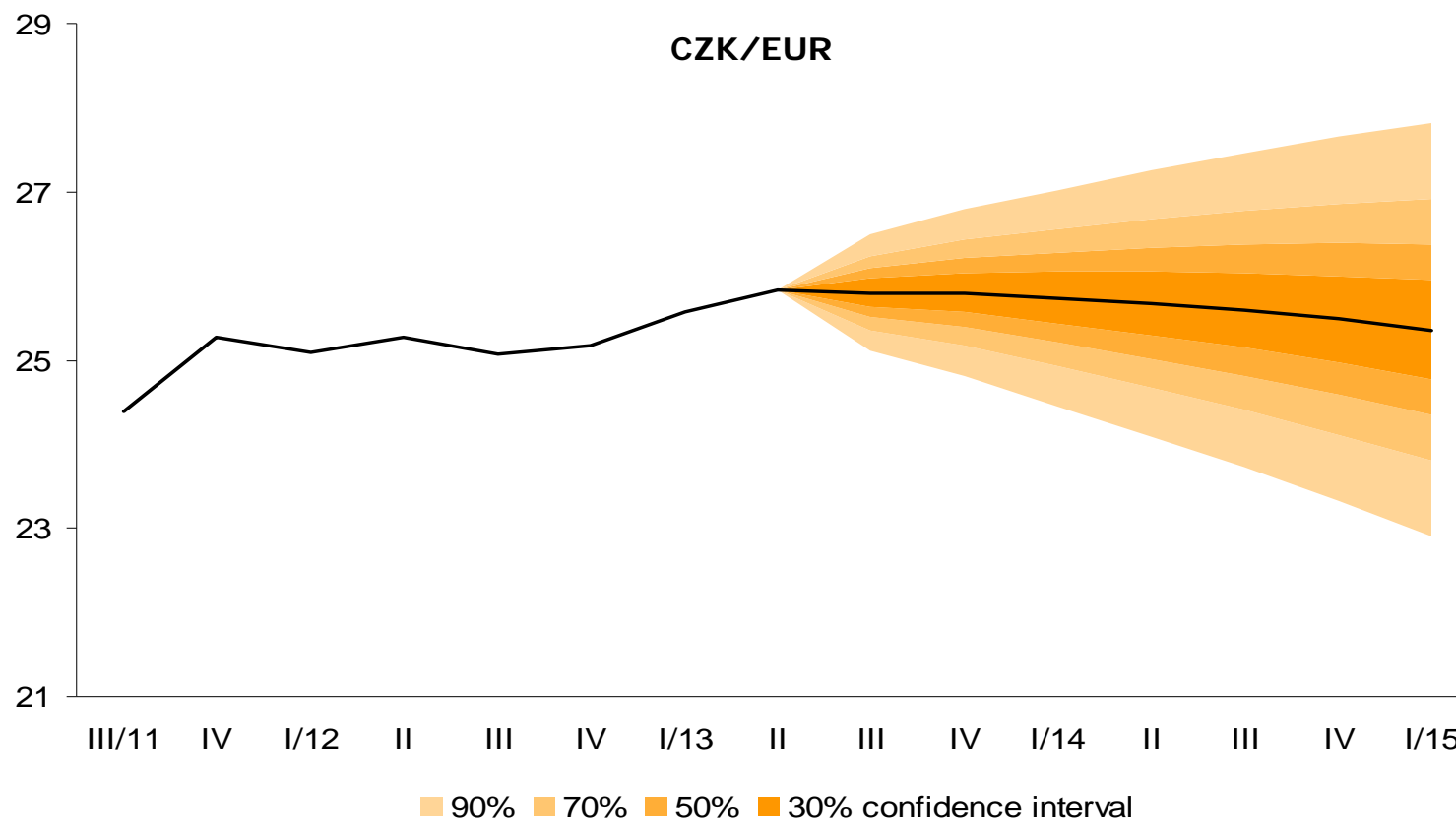
Nominal Marginal Cost in Consumption Sector (q/q, in %, ann.)



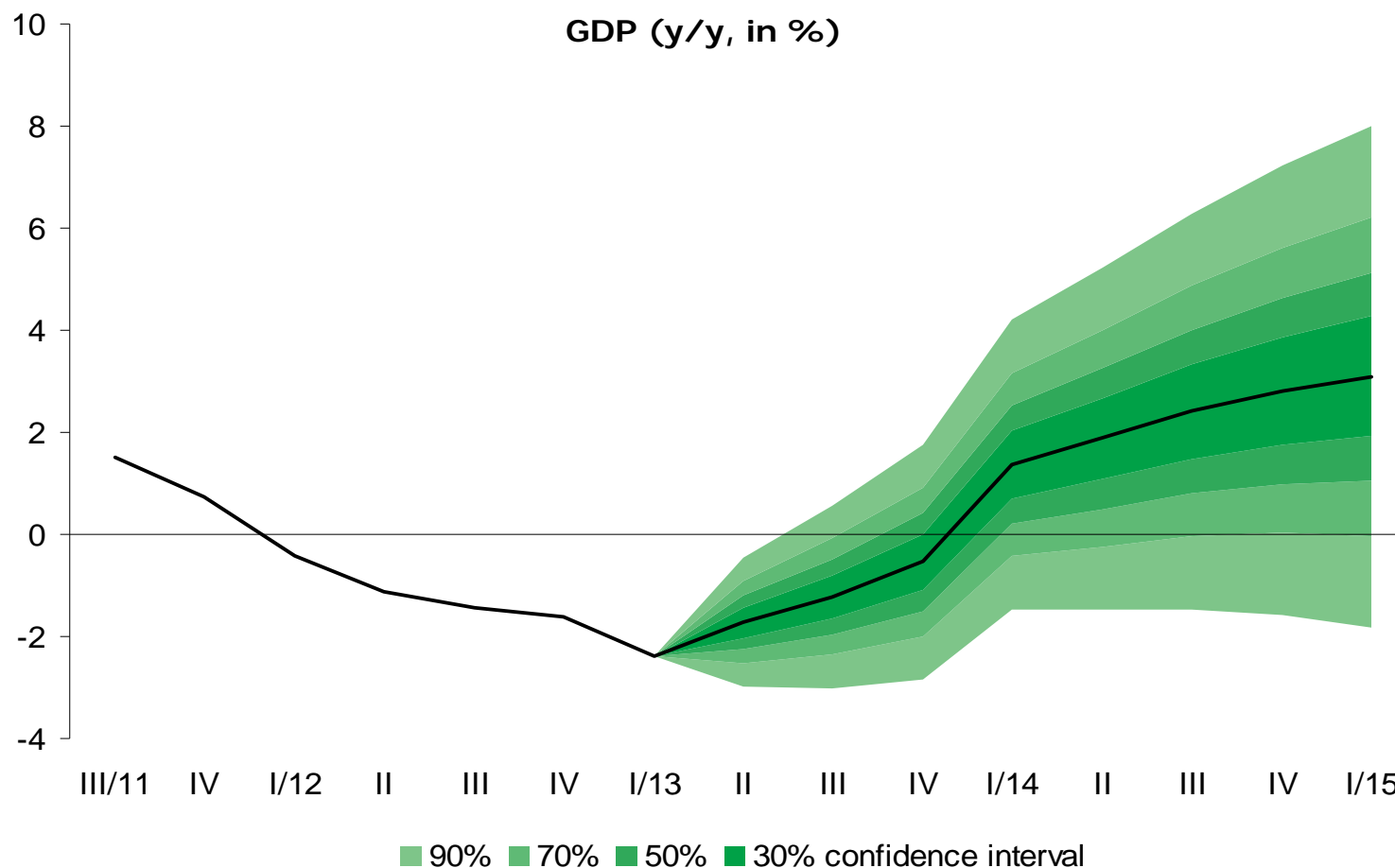
Nominal Marginal Cost in Intermediate Sector (q/q, in %, ann.)



- Domestic price developments will reflect suppressed domestic economic activity in 2013. Import prices will add to inflationary pressures (gradual transmission of the depreciated exchange rate, only partially balanced by the slowdown of the dynamics of foreign PPI).
- Low domestic wage growth and negative contribution of the price of capital are the main determinants of recent domestic price development.



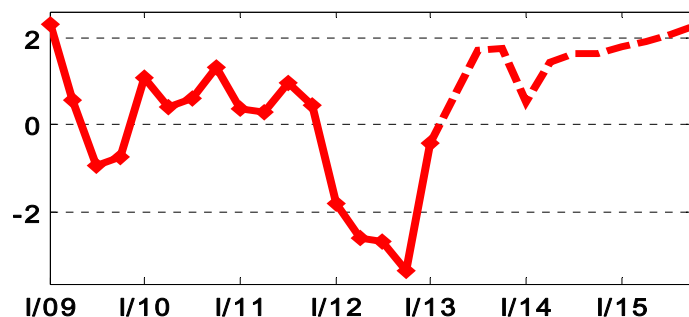
- The NTF for 2013 Q3 is CZK/EUR 25.80, reflecting weak economic fundamentals and the CNB's communication of possible FX interventions.
- Only very gradual appreciation of the exchange rate on the forecast horizon (low foreign interest rates, gradually improving net exports).



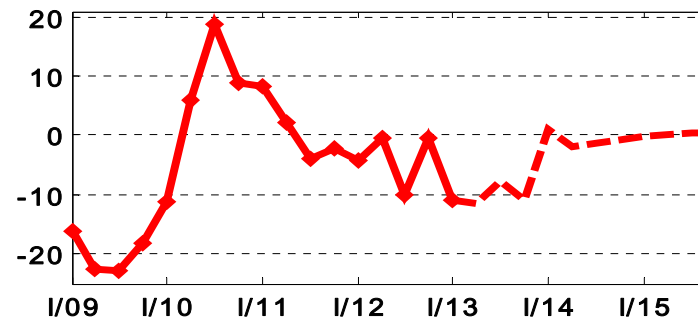
- GDP growth forecast: -1.5% in 2013, 2.1% in 2014 and 3.3% in 2015.
- In 2013, fiscal policy will still curb economic growth (impact estimated at -0.6 p.p.), foreign demand will recover only gradually. In 2014 and 2015, these curbing factors will disappear.

Forecast of Aggregate Demand

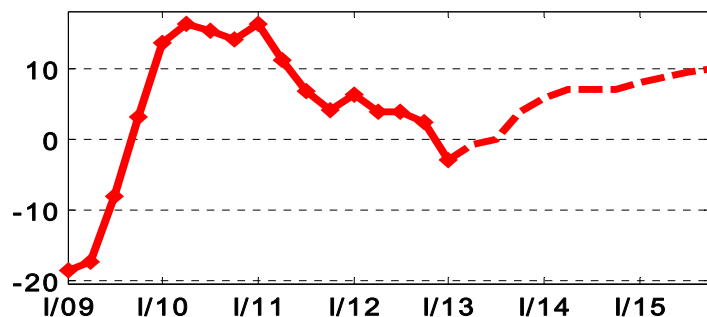
Household Consumption Growth (y/y, in %)



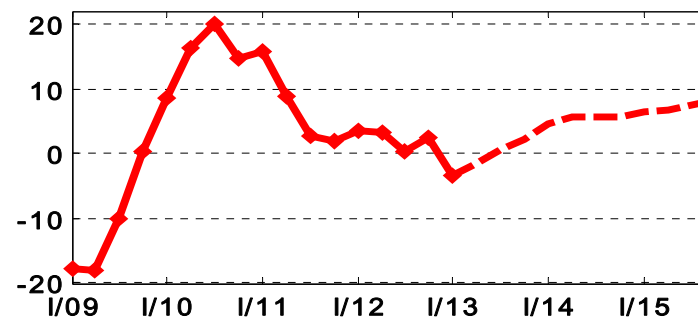
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)



Imports Growth (y/y, in %)

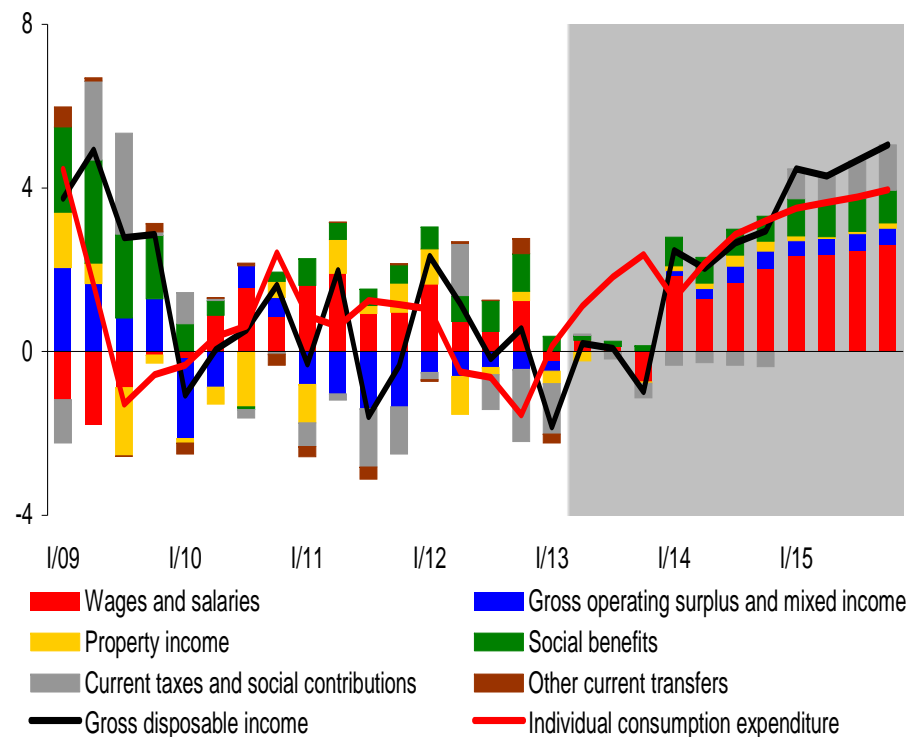


- A slight growth of household consumption already in 2013 accompanied by a fall in households' saving rate. Gradual revival of exports and imports from currently low levels (since the end of 2013 a growing positive contribution of net exports to growth).
- Deep fall in investment this year (the effect of the 1Q), very gradual recovery afterwards.

Household Consumption and Savings

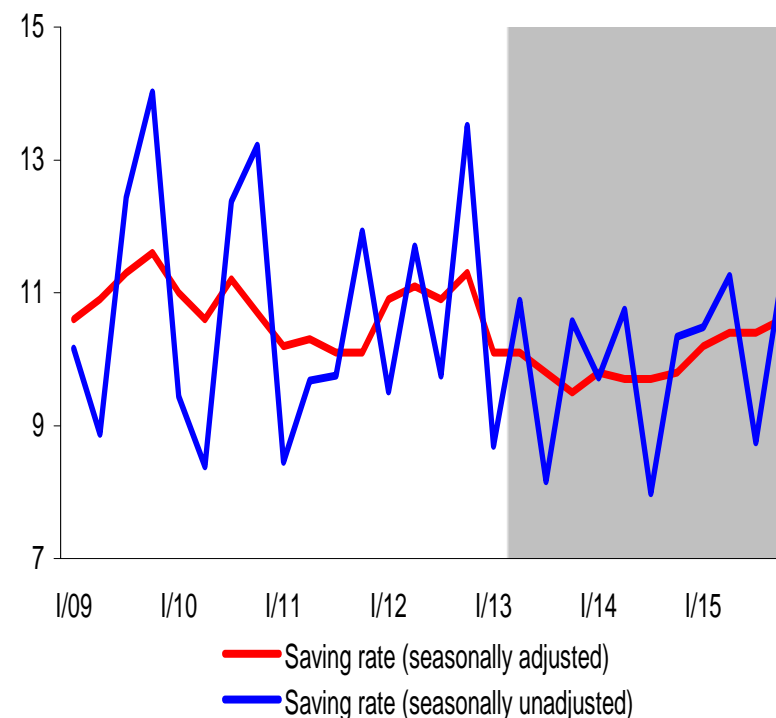
Nominal disposable income

(annual percentage changes; contributions in percentage points)



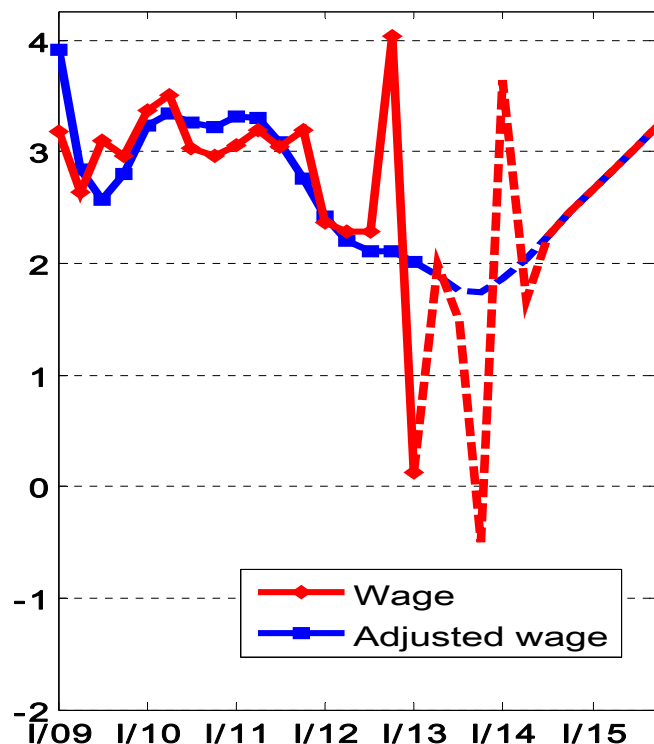
Household saving rate

(percentages)

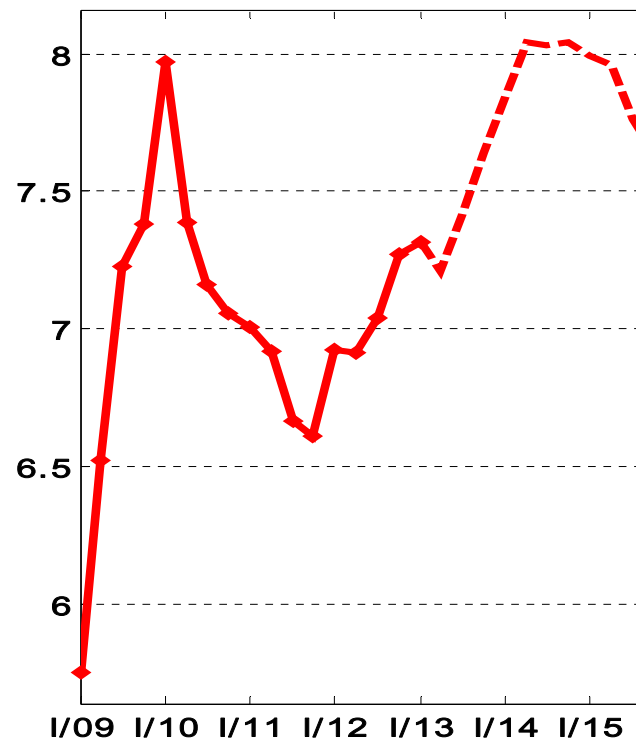


- Nominal disposable income will be slightly declining this year, but it will start to grow in 2014 due to the pick up in nominal wage growth.
- The saving rate will fluctuate around 10 %, some noticeable increase is expected only in 2015.

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

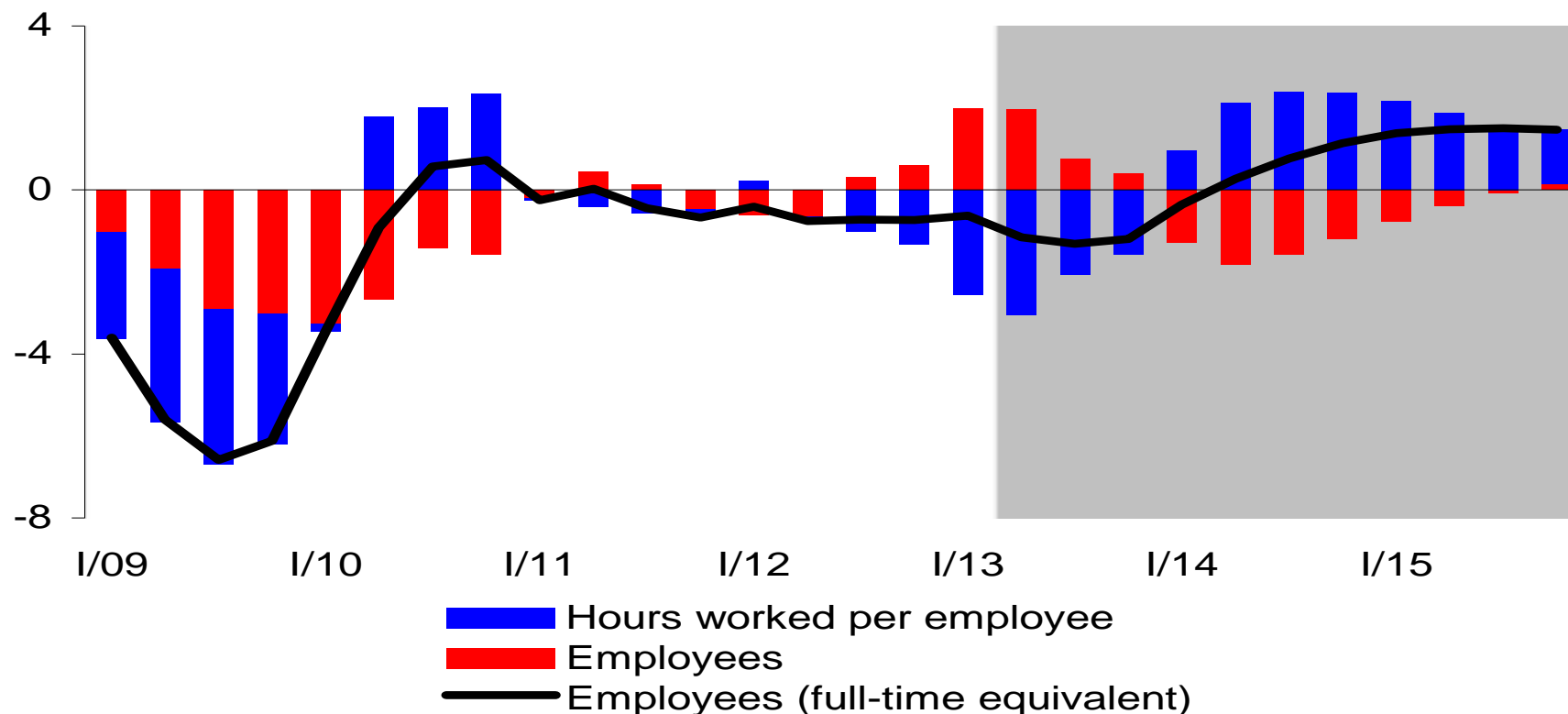


General unemployment rate (ILO)
(in %, s.a.)

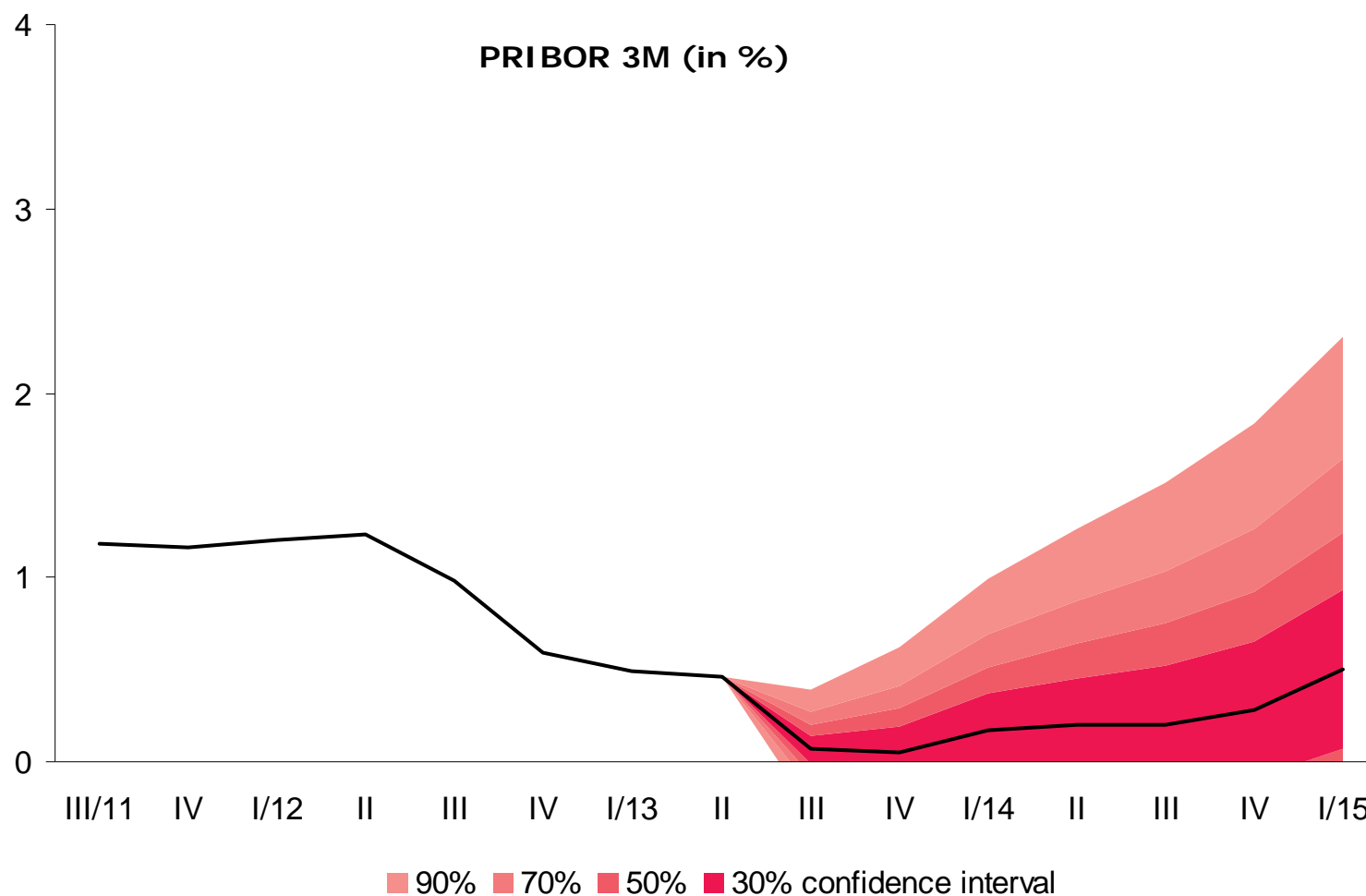


- Wage growth will be slow this year, but volatile due to the effects of tax optimization. It will be gradually increasing in 2014.
- The unemployment rate (ILO) will continue to rise towards 8%.

Number of employees (full-time equivalent) (annual percentage changes; contributions in percentage points)



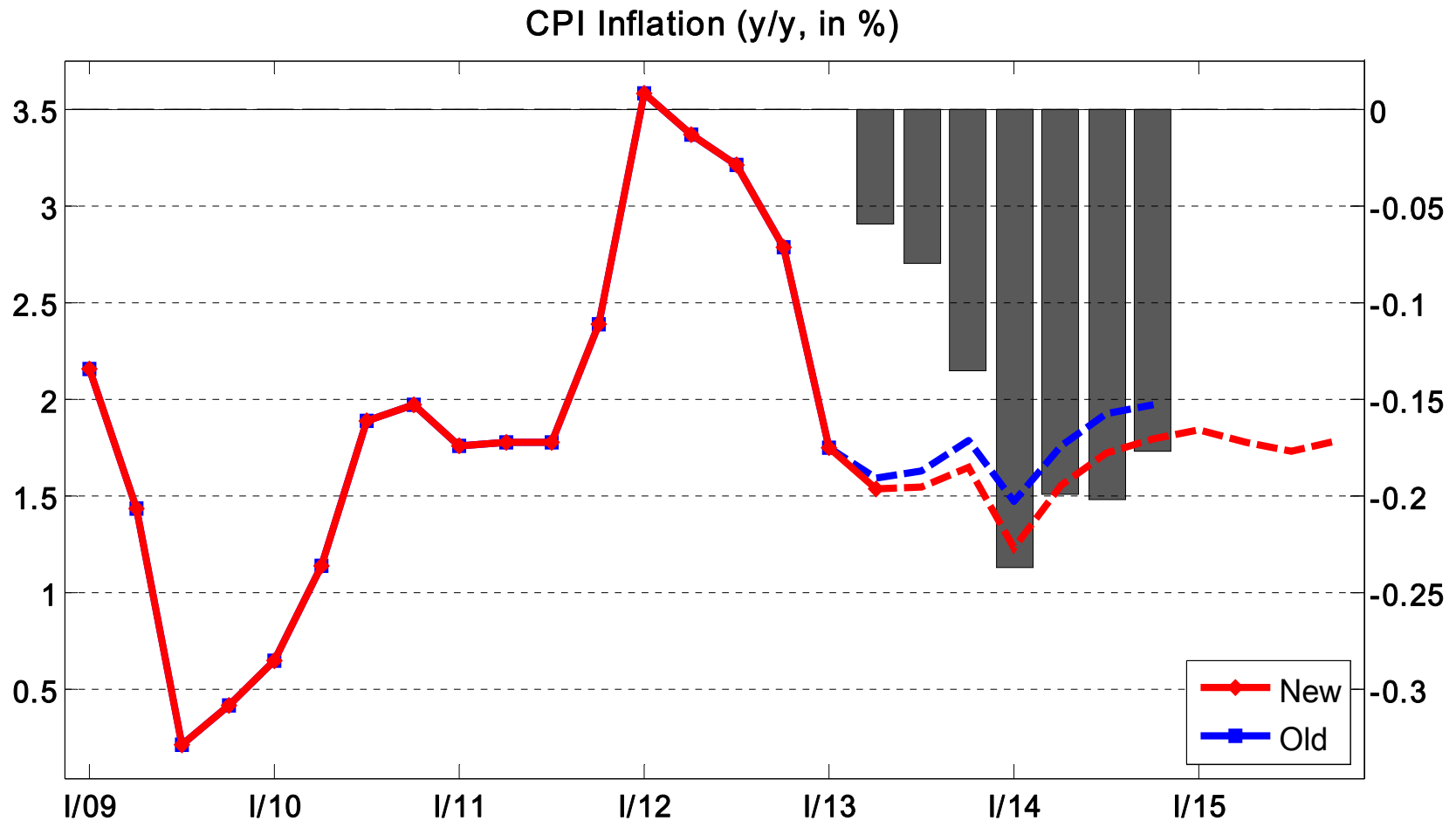
- Employment measured in full-time equivalents will start to grow since mid-2014, reflecting the revival in economic activity.



- Consistent with the forecast is a decline in market interest rates to zero, followed by a noticeable rise in rates only in 2015.

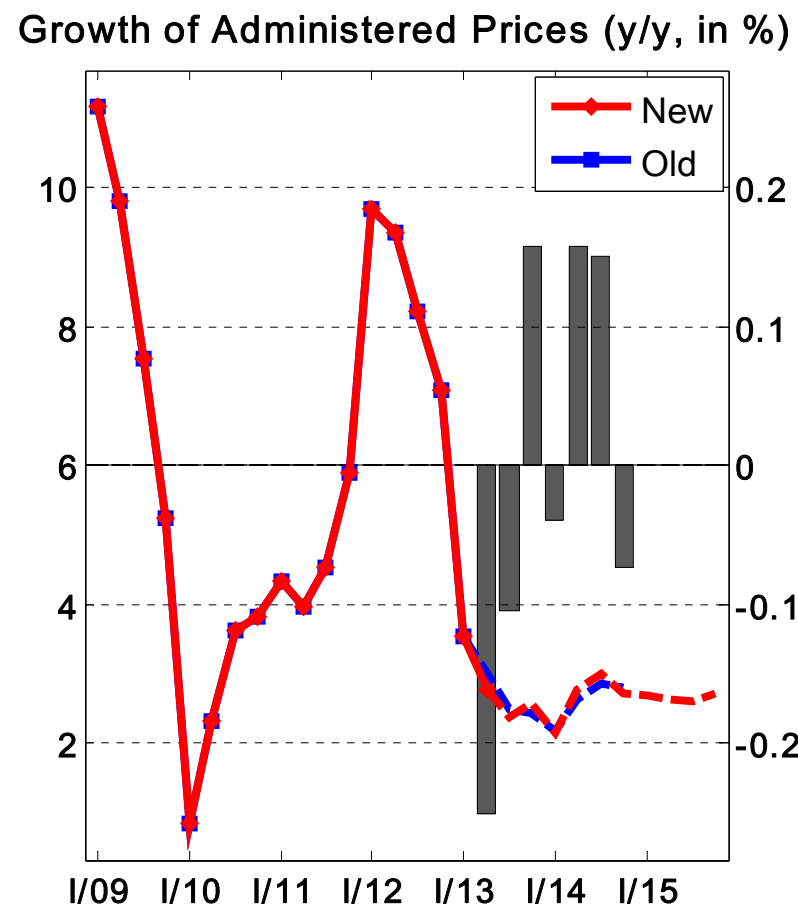
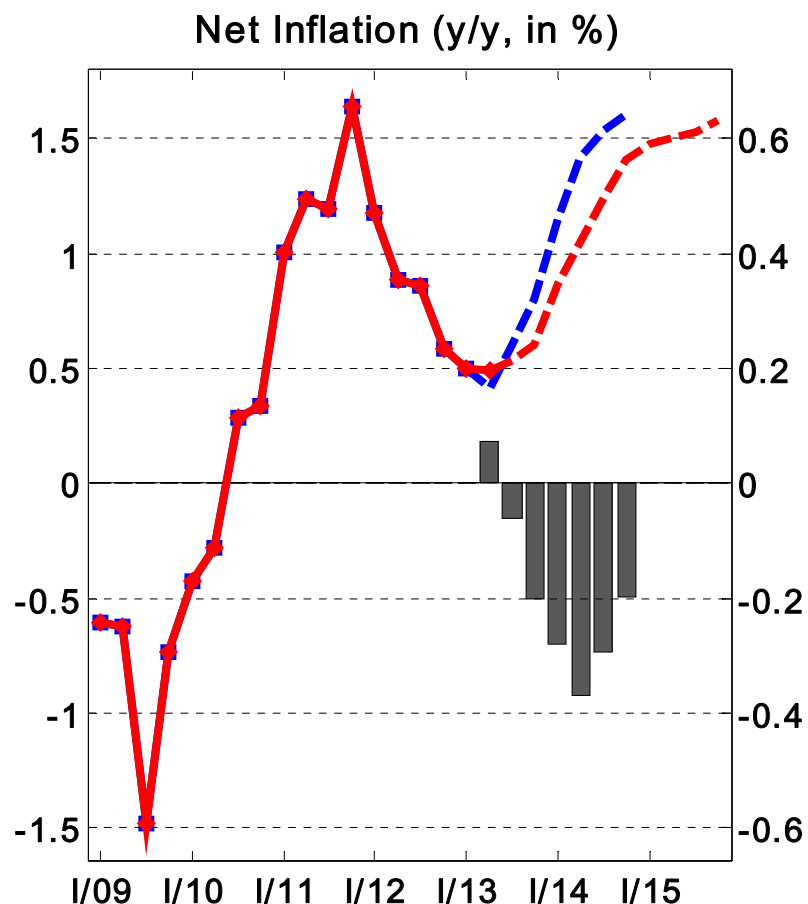
- The forecasts for headline and monetary-policy relevant inflation were decreased on the whole forecast horizon.
- Lower forecast of net inflation, the outlook of administered prices is changed only marginally. The forecasts of food prices is revised upwards, while core inflation outlook is changed in the opposite direction.
- The exchange rate is expected to be weaker on the whole horizon.
- The GDP outlook has been lowered for this year, while it has been revised slightly upwards in 2014.
- Nominal wage growth has been lowered due to less favorable economic outlook compared with the previous forecast.
- The path of market interest rate is lower due to the near-term inflation forecast, subdued economic activity and prolonging the horizon of low foreign interest rates.

Comparison with Previous Inflation Forecast (i)



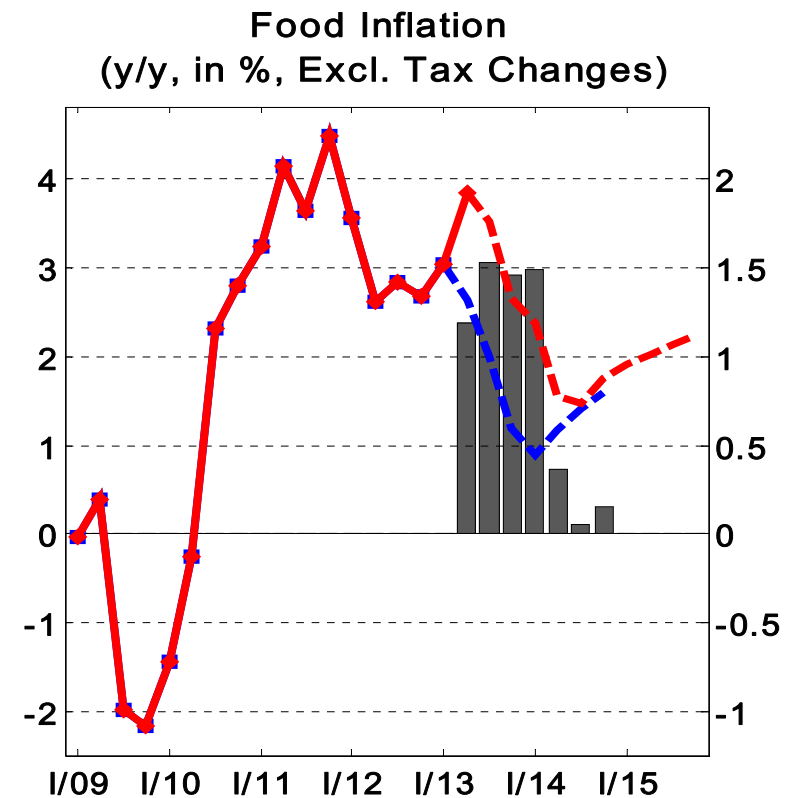
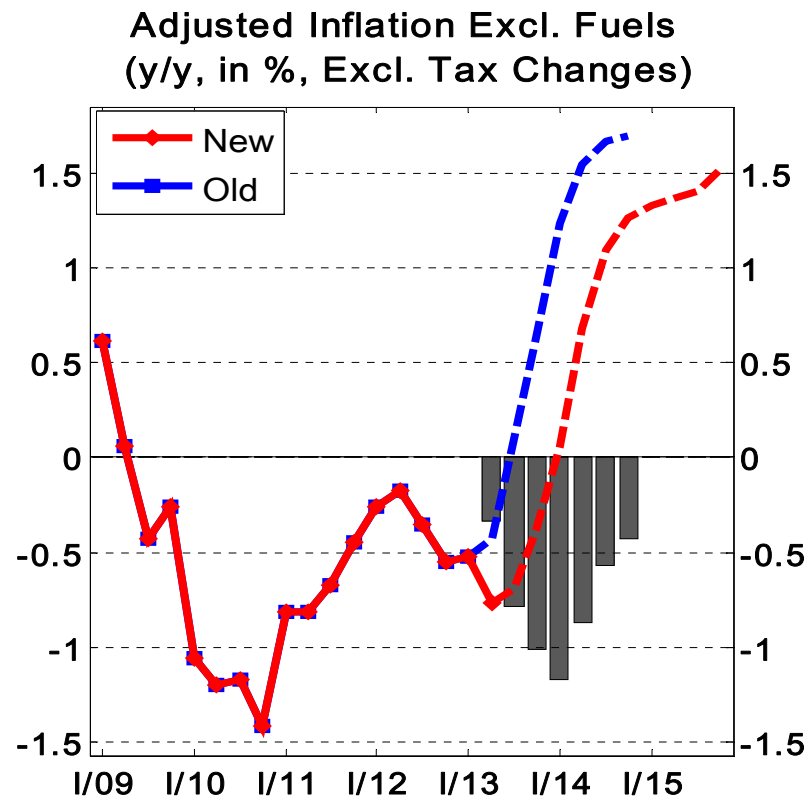
- The forecasts for headline and monetary-policy relevant inflation were decreased on the whole forecast horizon.

Comparison with Previous Inflation Forecast (ii)



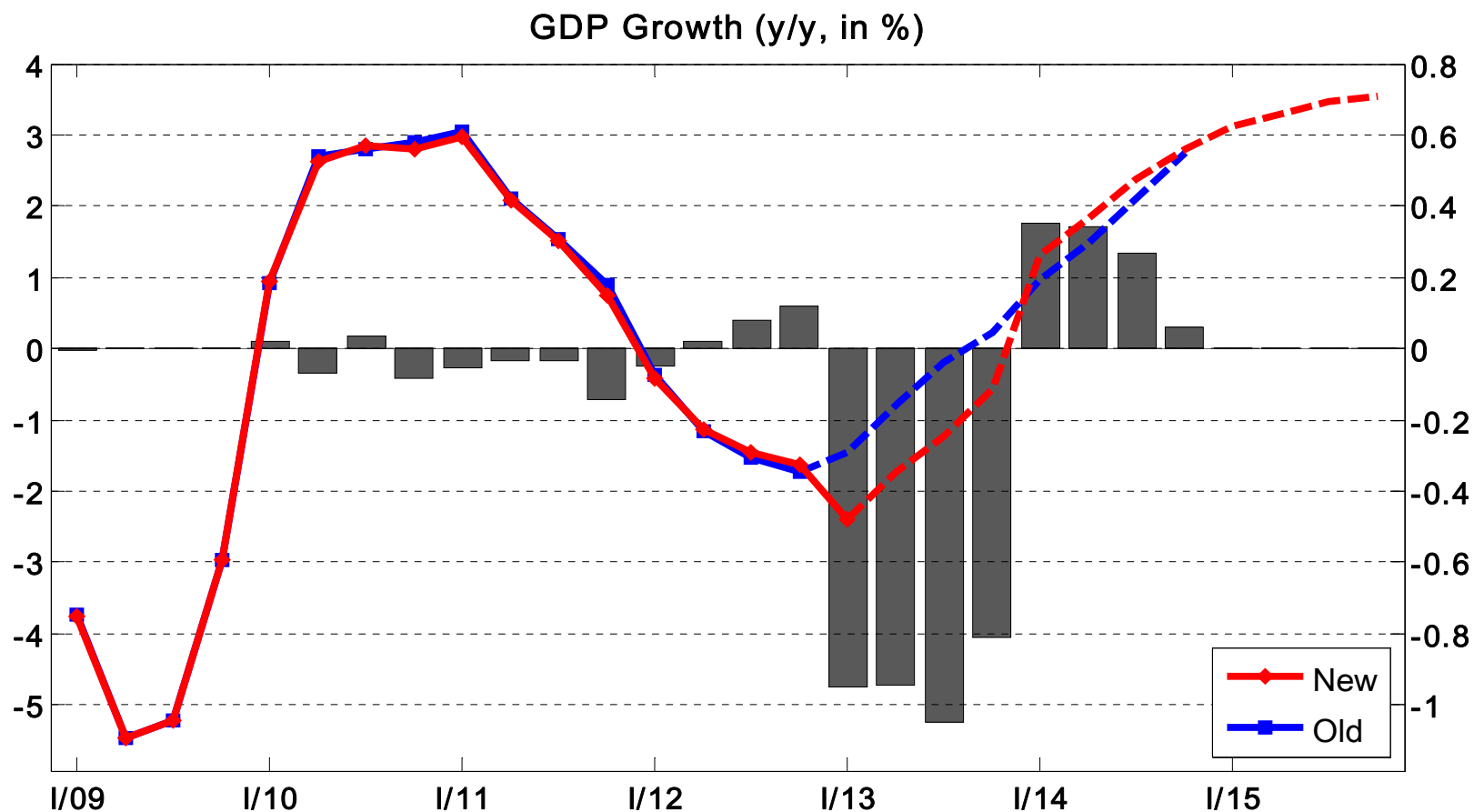
- Net inflation: lower NTF and more subdued economic activity.
- Administered prices: similar outlook as in the previous forecast.

Comparison with Previous Inflation Forecast (iii)



- A significantly lower core inflation reflects a more anti-inflationary stance of the domestic economy as well as the fall in prices of telecommunication services (mobile tariffs).
- Current food price growth is higher than in the previous forecast, despite the fall in agricultural prices.

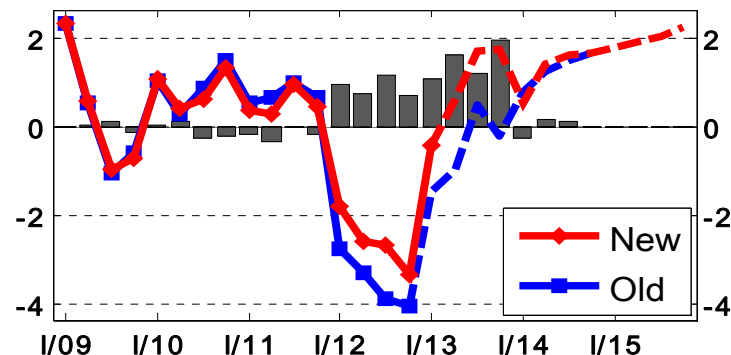
Comparison with Previous GDP Forecast (i)



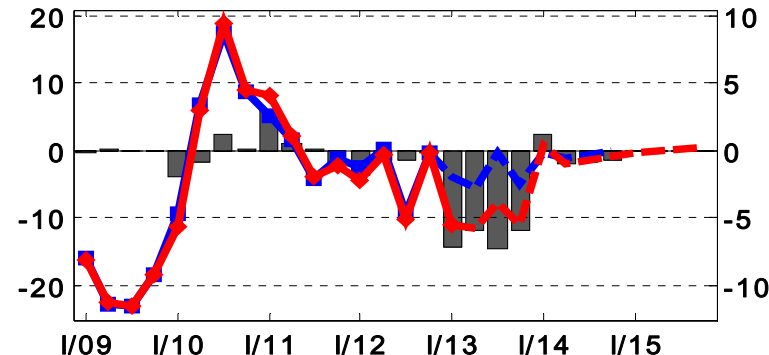
- The downward revision of the GDP forecast is due mainly to the significant fall of GDP in the 1Q 2013. In 2014 the upward base effect in 1Q 2013 dominates over the impact of the more gradual pick up in foreign demand.

Comparison with Previous GDP Forecast (ii)

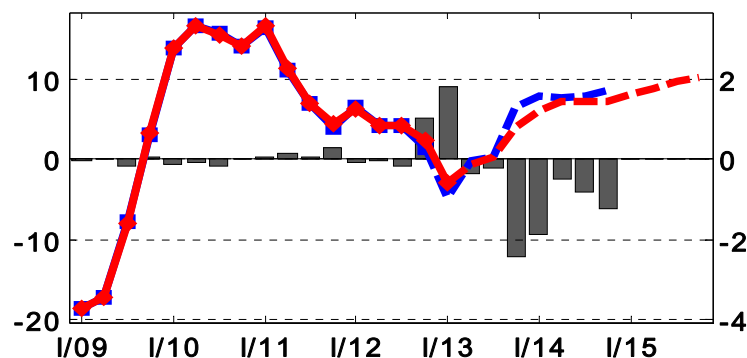
Household Consumption Growth (y/y, in %)



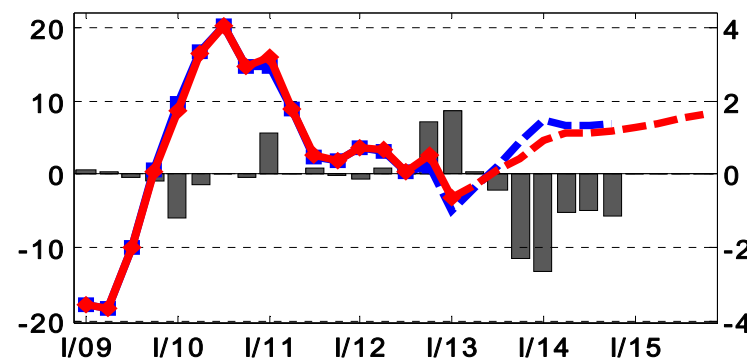
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)



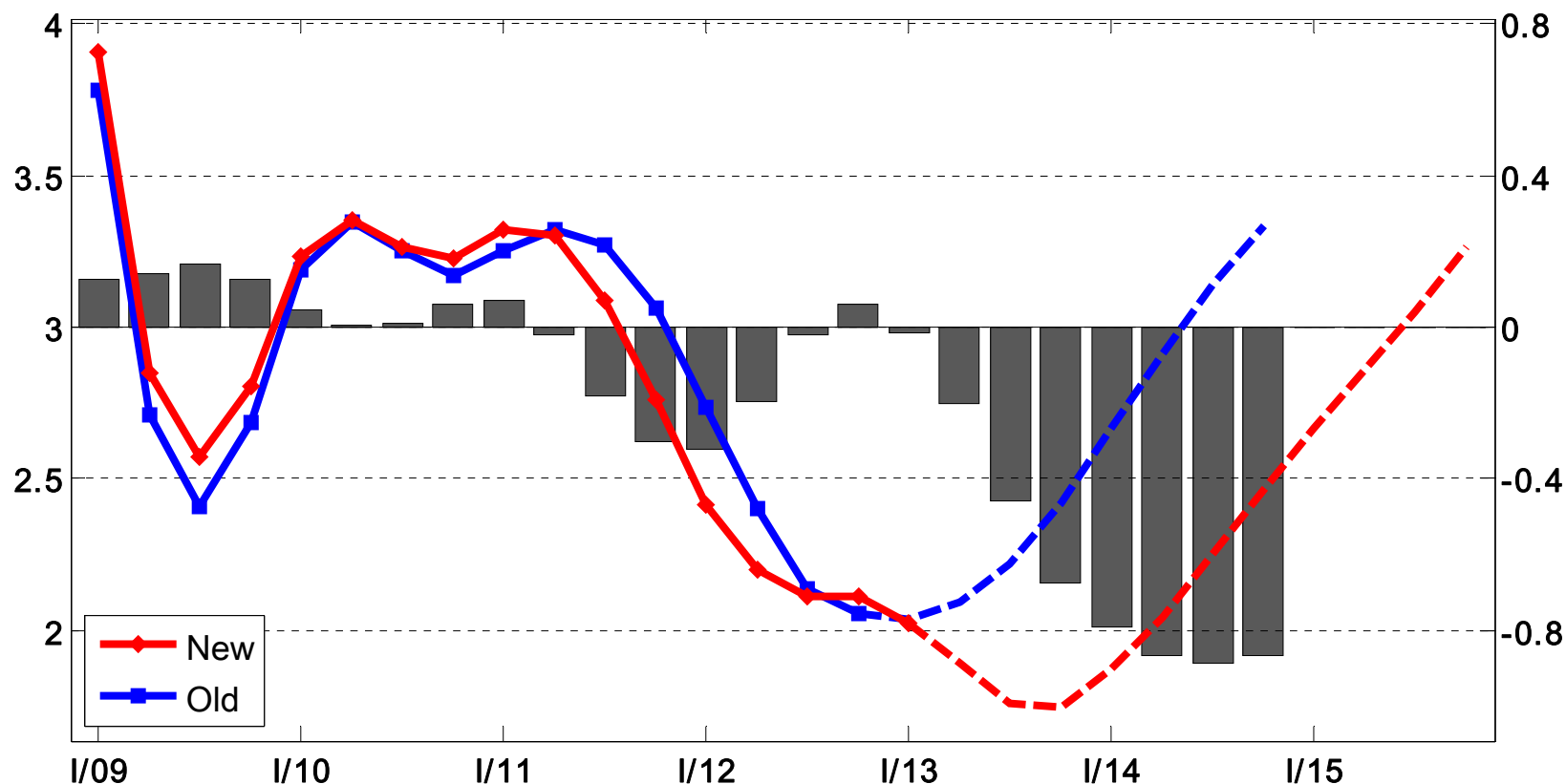
Imports Growth (y/y, in %)



- The higher outlook for household consumption in 2013 is counterbalanced by the fall in investment, specifically by inventories.
- The pick up in exports and imports is more gradual compared with the previous forecast.

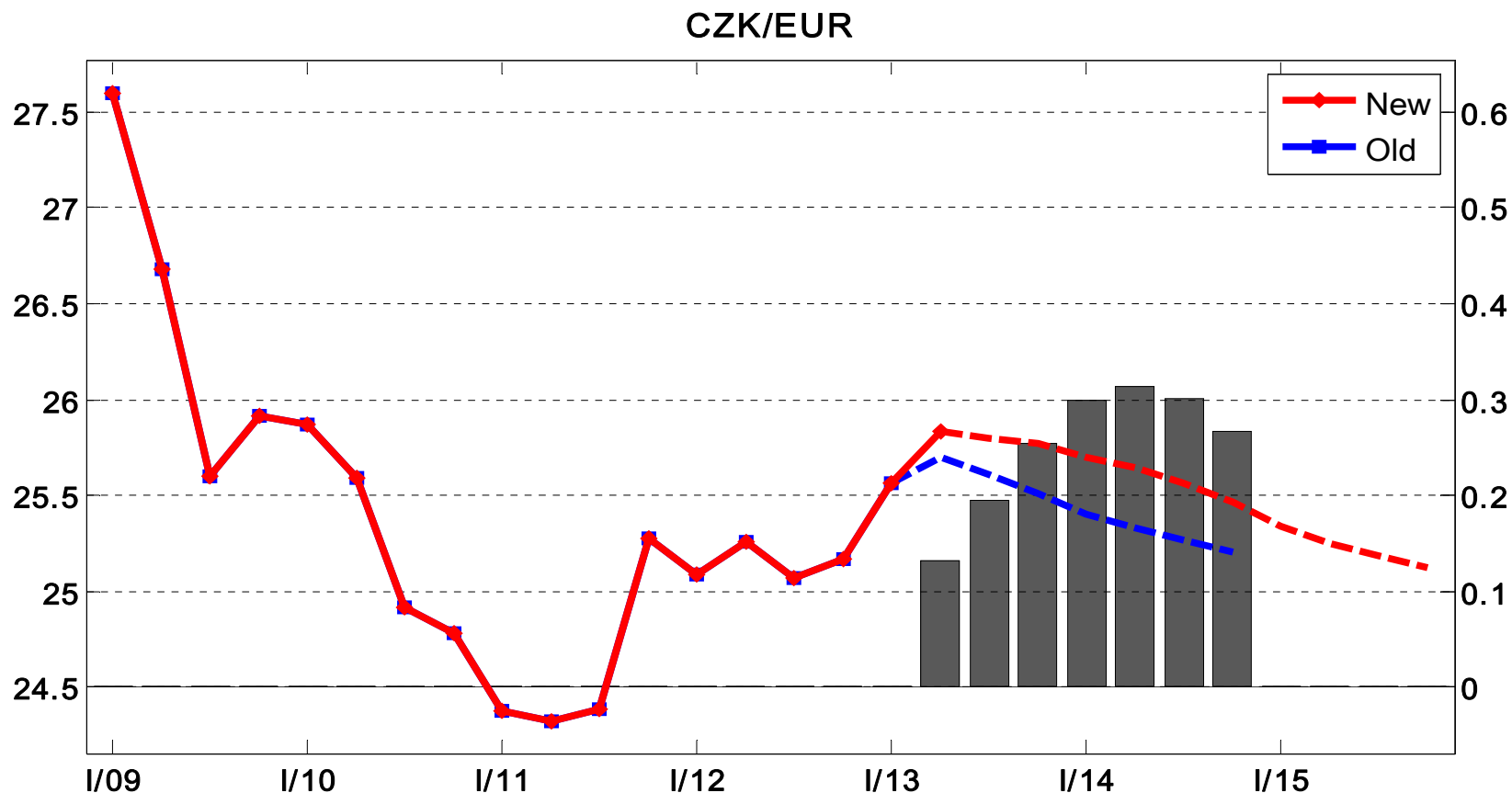
Changes in Labour Market Forecast

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



- The nominal wage growth is shifted downward due to revised economic outlook and lower price pressures compared with the previous forecast.

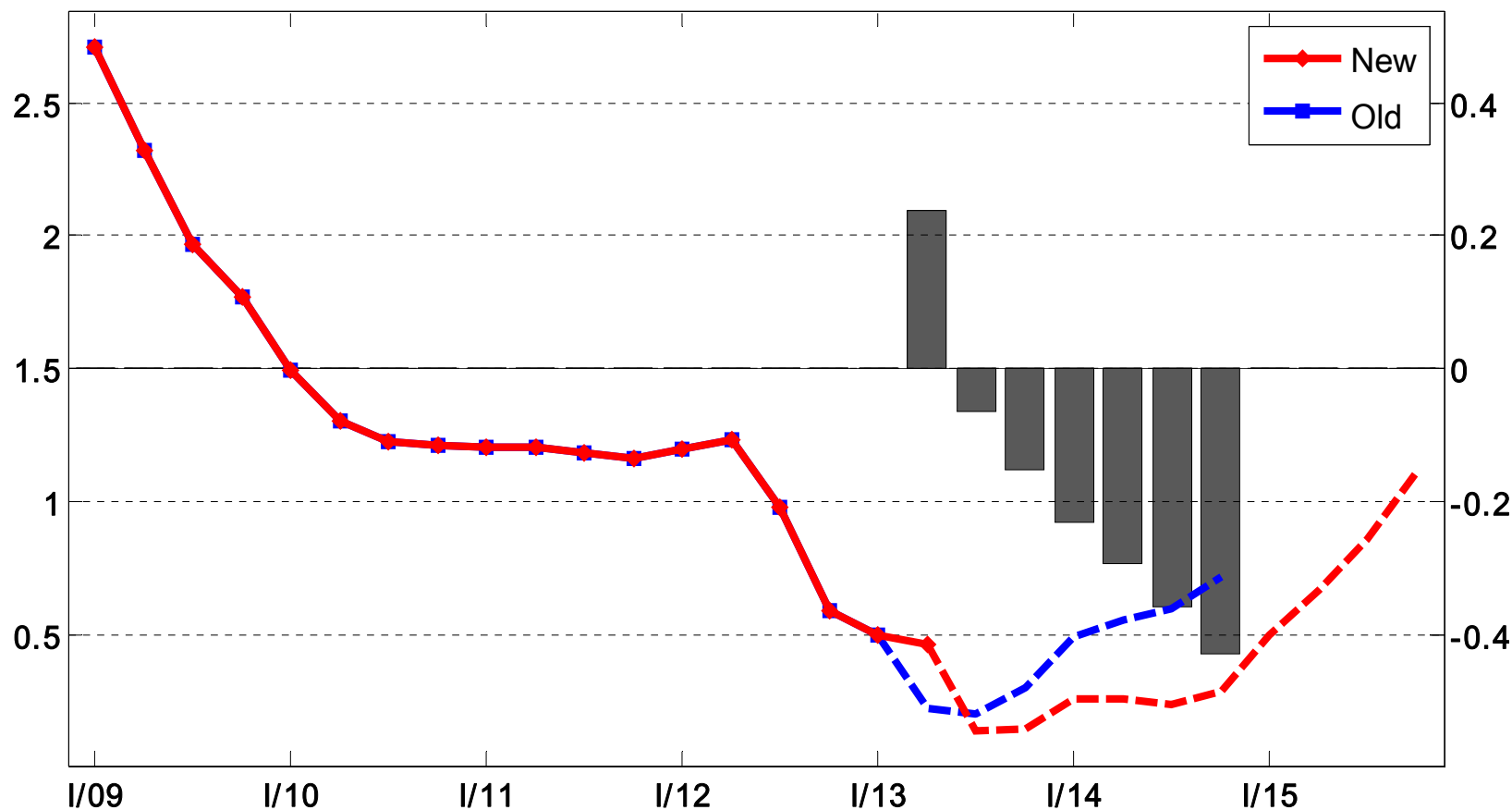
Changes in Exchange Rate Forecast



- The forecast is consistent with a weaker exchange rate on the whole horizon: near-term forecast, less favorable outlook for nominal net exports (weaker foreign demand) and more gradual pick-up in real equilibrium exchange rate appreciation (B-S effect).

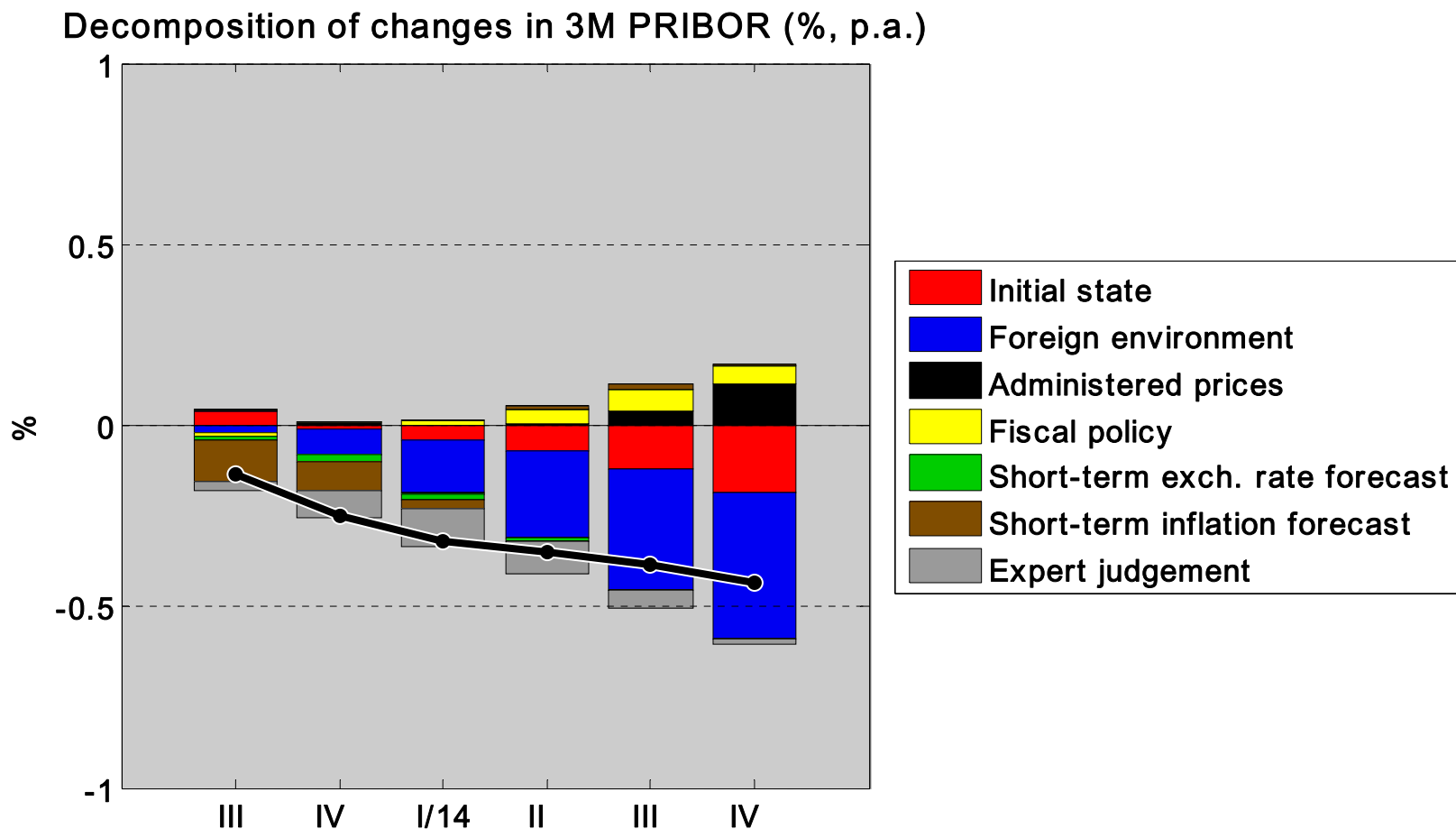
Changes in Interest Rate Forecast

3M PRIBOR (% , p.a.)



- The interest rate trajectory, compared with the previous forecast, is lower, at the end of 2014 by more than 0.4 p.p.

Interest Rate Forecast Change Decomposition



- The interest rates are revised downward due to the near term forecast of inflation, depressed domestic economy, low level of 3M EURIBOR that has been prolonged to 2015 and expert judgments (B-S effect).

Thank you for your attention!

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