Meeting with Analysts

Tomáš Holub

Prague, 14 February, 2014

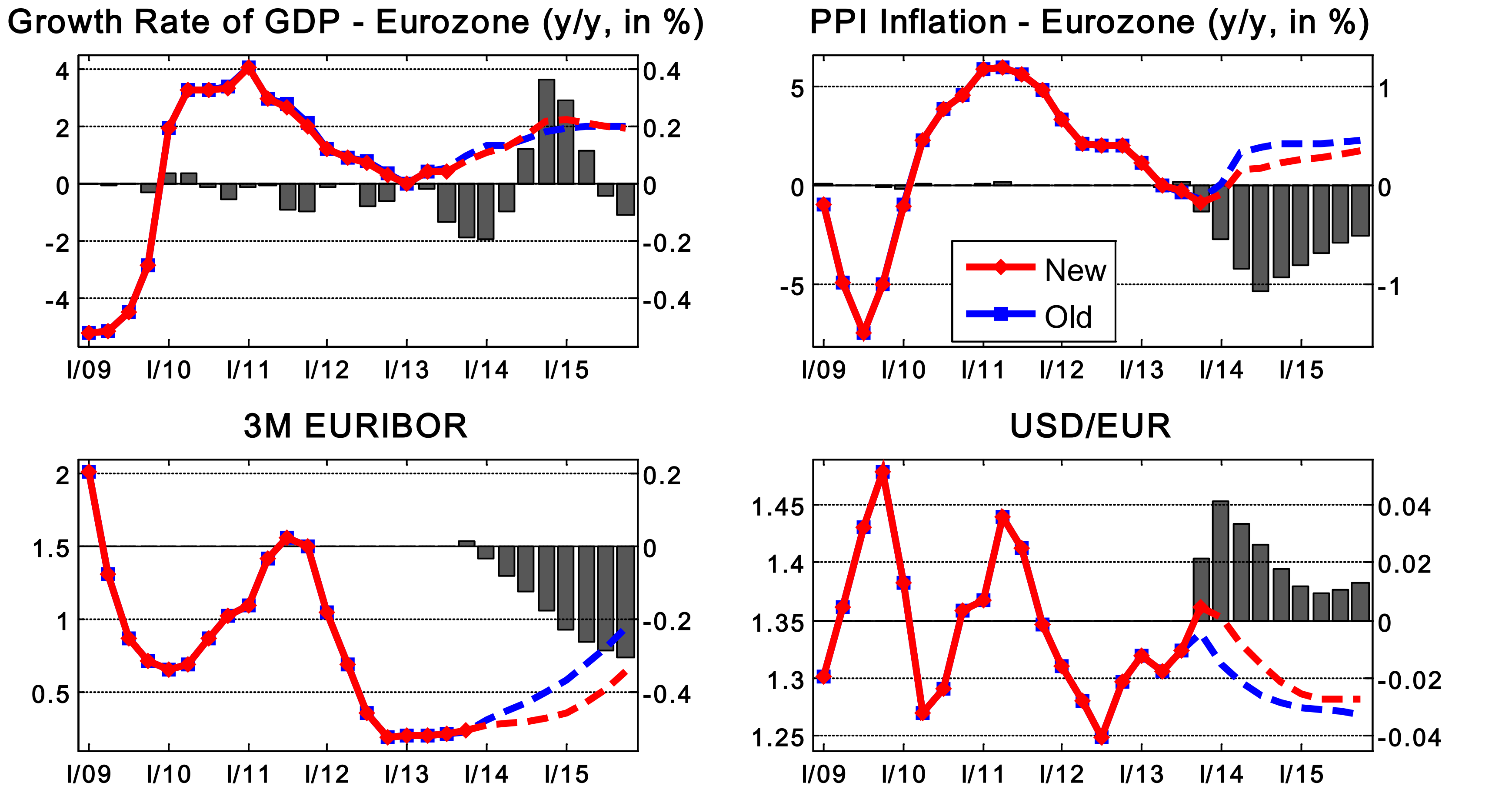
Outline

- Assumptions of the forecast
- The new macroeconomic forecast
- Comparison with the previous forecast (alternative scenario)
- Import intensity of consumption
- Changes in the CNB‘ monetary policy communication

Outline

- Assumptions of the forecast
- The new macroeconomic forecast
- Comparison with the previous forecast (alternative scenario)
- Import intensity of consumption
- Changes in the CNB' monetary policy communication

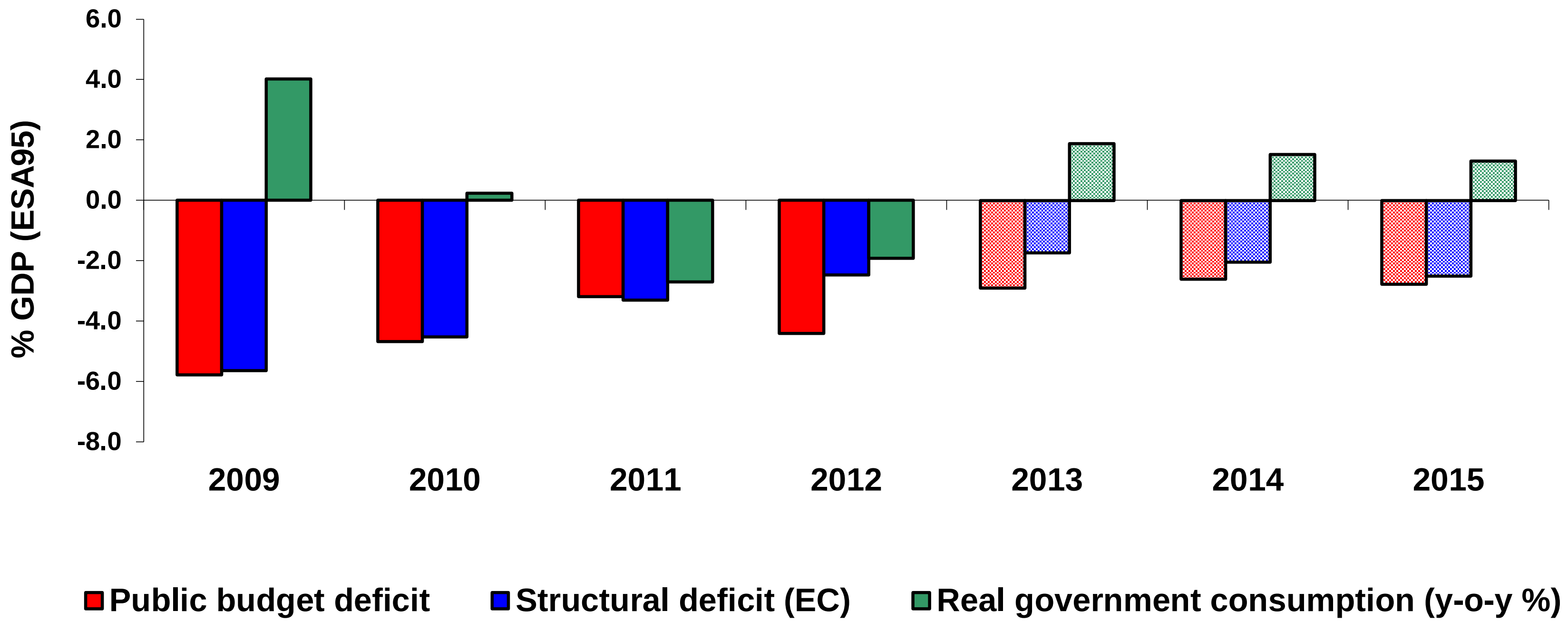
External environment outlook



- The recovery of GDP growth in the effective EA will continue.
- PPI in the EA is currently declining, but will speed up gradually.
- Interest rates in the EA will remain low, euro will gradually depreciate.

Fiscal policy

CNB CZECH NATIONAL BANK



- The deficit has declined below 3% of GDP in 2013 and will stabilize at this level (the structural deficit will increase roughly to the 2012 level).
- Fiscal impulse -0.6 p.p. in 2013, neutral in 2014, and +0.3 p.p. in 2015.
- Real government consumption will continue growing modestly.

- The forecast assumes that market interest rates will be flat at their current very low level (i.e. the sum of ”technically zero“ 2W repo rate and the money market premium) until the start of next year.
- The near term forecast for the exchange rate in 1.Q 2014 is set at 27.3 CZK/EUR.
- Afterwards, the exchange rate is assumed at 27 CZK/EUR (i.e. at the level of the CNB‘s exchange rate commitment) until the beginning of 2015.
- This level of the exchange rate continues to be appropriate, as it delivers the necessary easing of the monetary conditions.

- The exit from the current regime will not imply appreciation of the exchange rate to the level recorded before the CNB started intervening, as the weaker exchange rate of the koruna will in the meantime pass through to the price level and other nominal variables.

Outline

- Assumptions of the forecast
- The new macroeconomic forecast
- Comparison with the previous forecast (alternative scenario)
- Import intensity of consumption
- Changes in the CNB‘ monetary policy communication

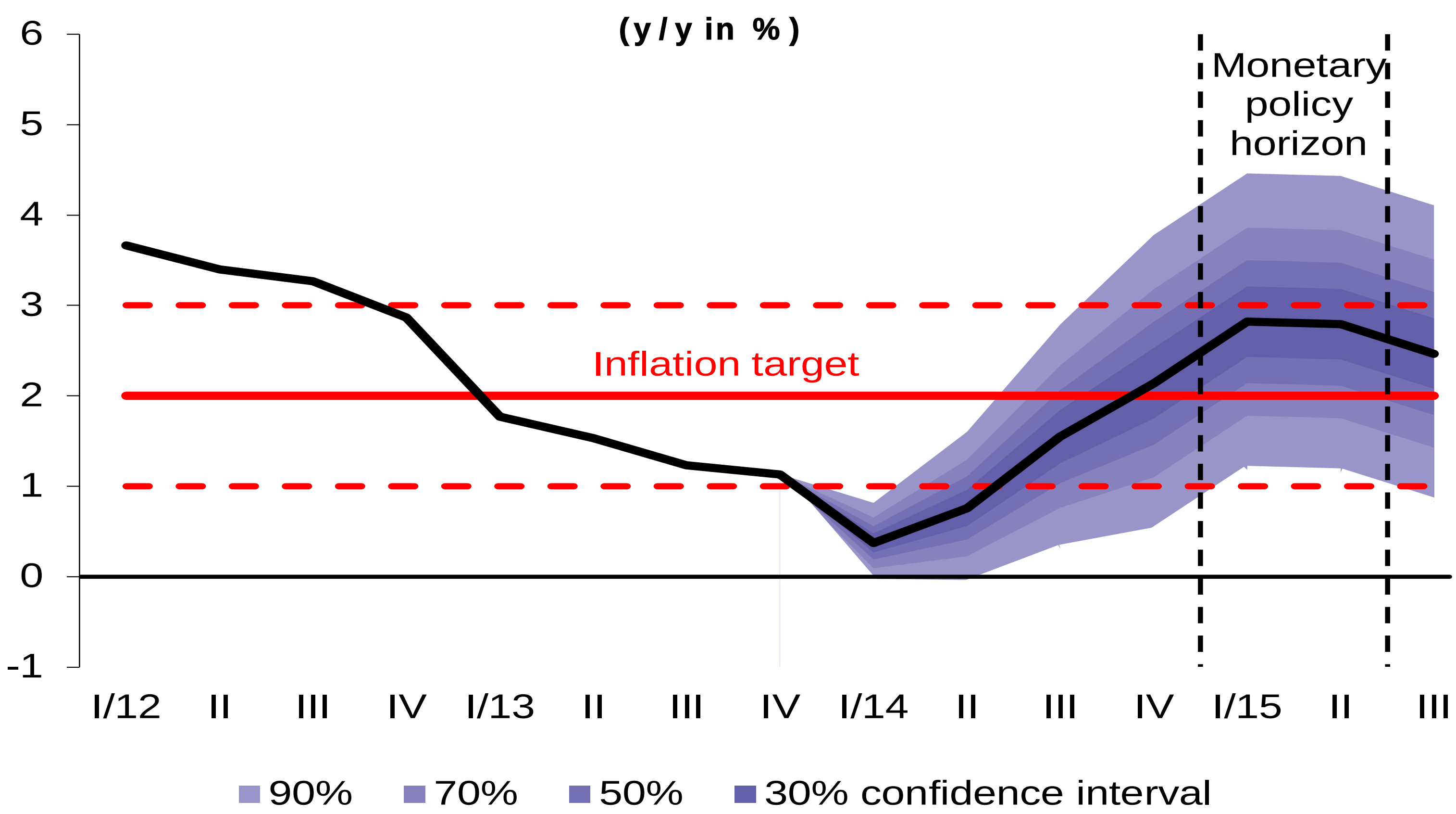
Summary of the Inflation Forecast (i)

- Headline inflation will decrease to low positive levels at the start of this year due to a drop in administered prices and unwinding of the effects of the VAT changes. It will then return to the target at the end of this year, reaching 1.2% on average in 2014.
- Inflation will increase further in early-2015 amid renewed growth in administered prices. It will thus move in the upper half of the tolerance band at the MP horizon, before returning from above to the 2% target.
- Monetary-policy relevant inflation will move in parallel with headline inflation, only at a slightly lower level.
- The accelerating growth of market-determined prices will initially reflect rising import prices connected with the weakening of the koruna. Starting in the second half of this year, consumer price inflation will also be noticeably affected by an economic recovery and faster wage growth.

Summary of the Inflation Forecast (ii)

- Following a decline in the previous two years, the economy will increase by more than 2% this year, supported by growth in external demand and the monetary policy easing executed via the weakening of the koruna. Next year the growth rate will reach 2.8%.
- The recovery of the domestic economy will be reflected on the labour market in 2014 initially in lower use of forced part-time work and in 2015 also in a drop in the unemployment rate. Wage growth in the business sector will increase from the current record lows.
- According to the forecast, the market interest rates will increase in 2015, as the ongoing economic recovery and wage growth will be sufficient to allow monetary policy potentially to return to the conventional regime.

Headline inflation forecast

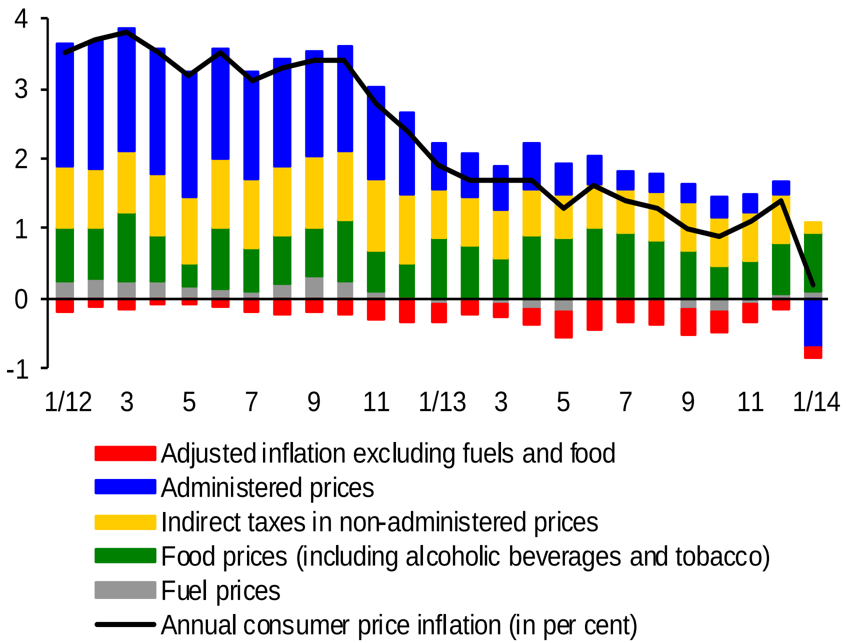


- Inflation will be picking up during 2014 from a very low starting level, but its average rate will still be the second lowest in a decade.
- In 2015, the inflation will temporarily move in the upper half of the tolerance band, allowing a return to the standard MP regime.

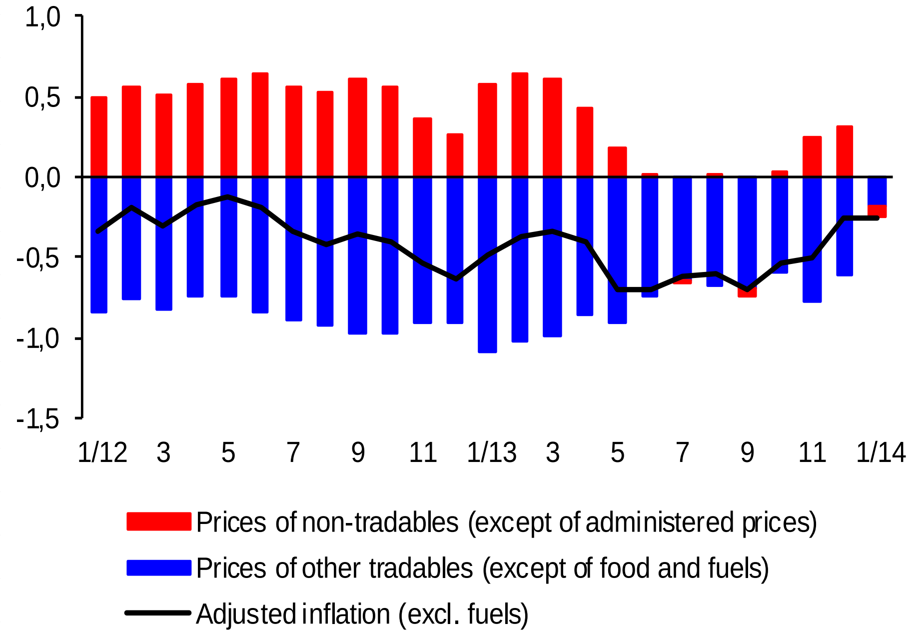
Inflation in January 2014

CNB CZECH NATIONAL BANK

Structure of inflation
(annual percentage changes; contributions in percentage points)

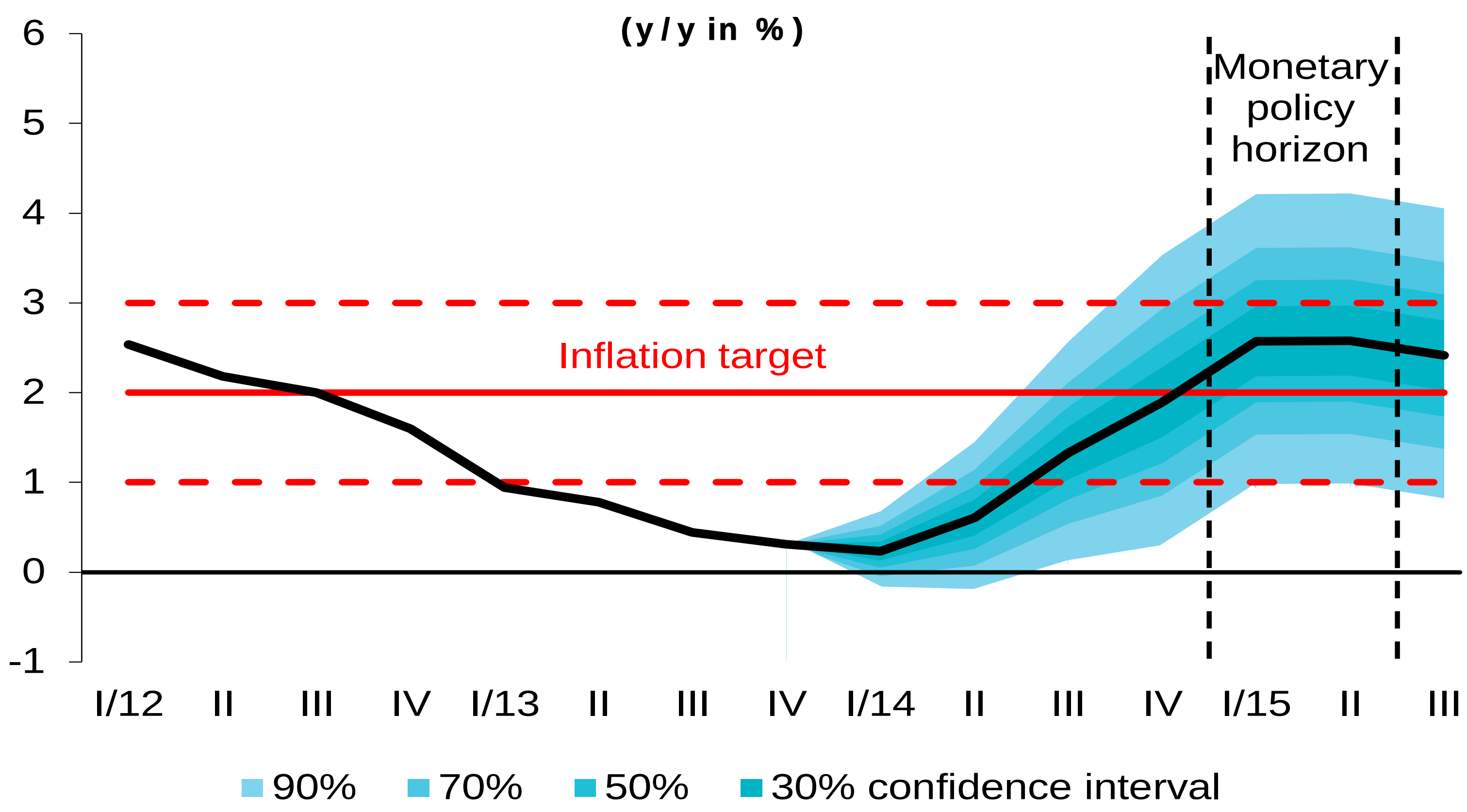


Adjusted inflation excluding fuels
(annual percentage changes; contributions in percentage points)



- Inflation was lower than the forecast by 0.2 p.p., mainly due to lower regulated prices (i.e. not a sign of weaker exchange rate pass-through).
- There was also a slight downward surprise in ”core inflation“ (vs. higher food prices), mainly due to a decline in non-tradable prices, which reflect the anti-inflationary impact of the domestic economy.

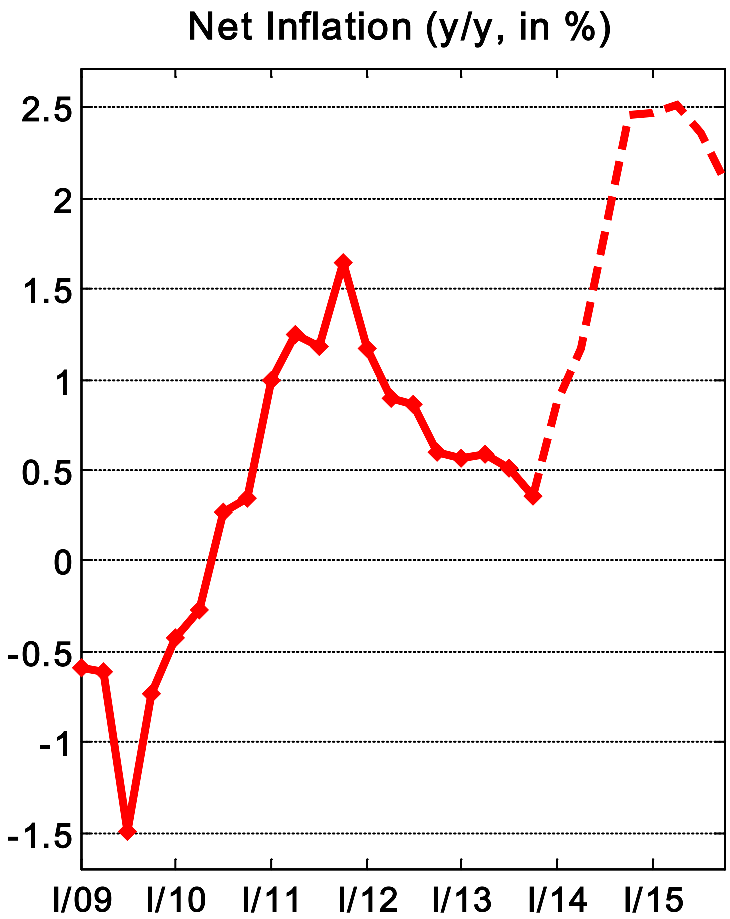
MP-Relevant inflation forecast

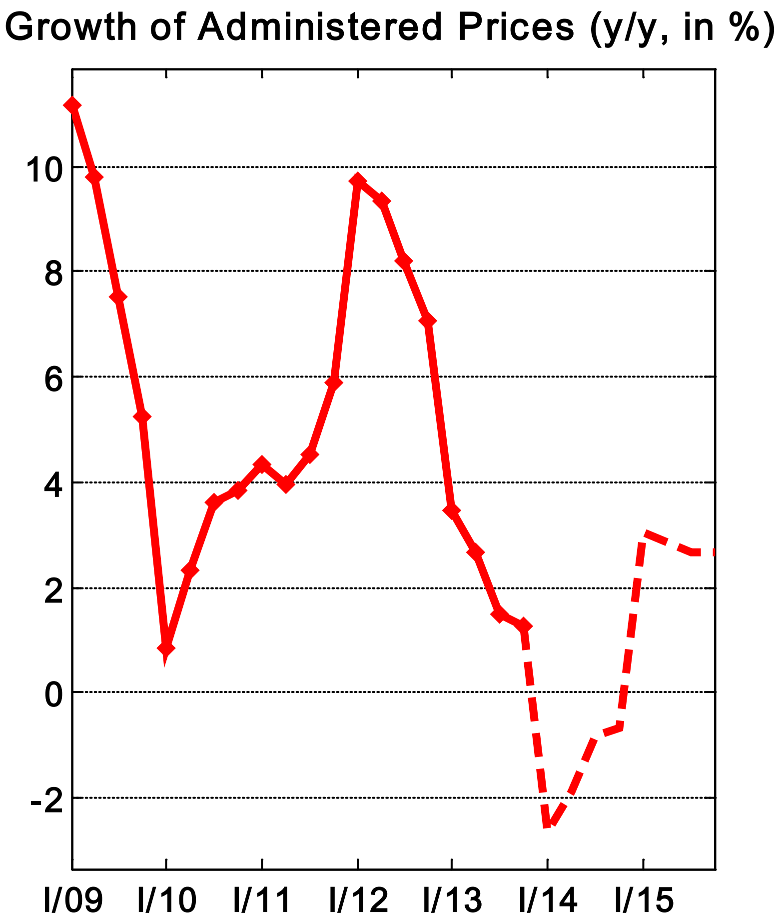


- The monetary policy-relevant inflation will be slightly lower than the headline inflation due to a further harmonisation increase in excise duty on cigarettes in 2014 (with traditionally lagged effect on prices.)

Net Inflation and Administered Prices

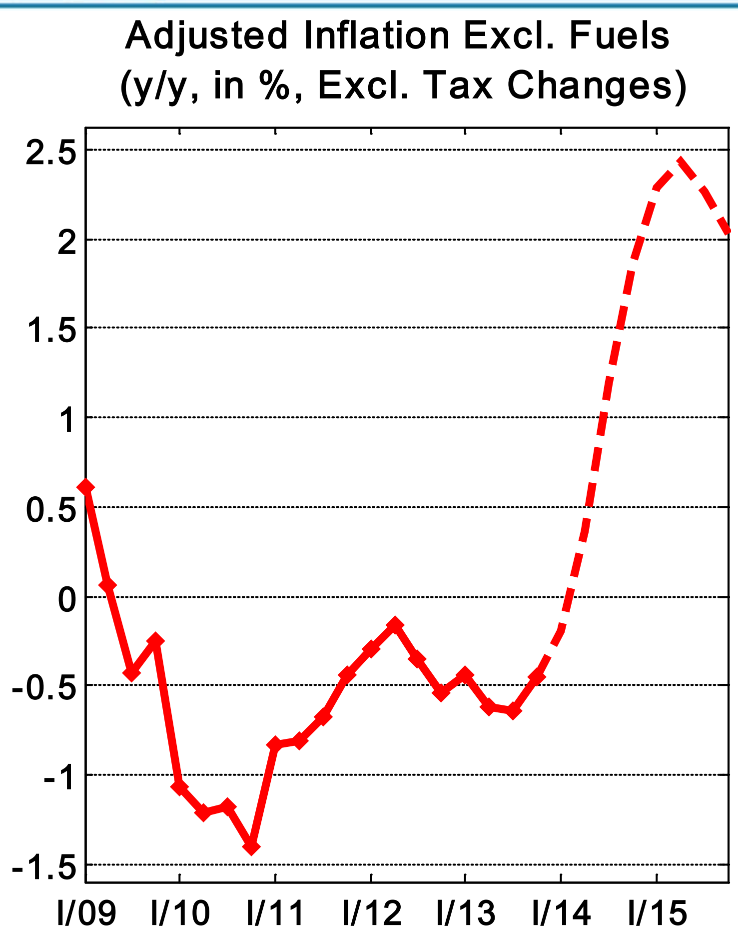
CNB CZECH NATIONAL BANK

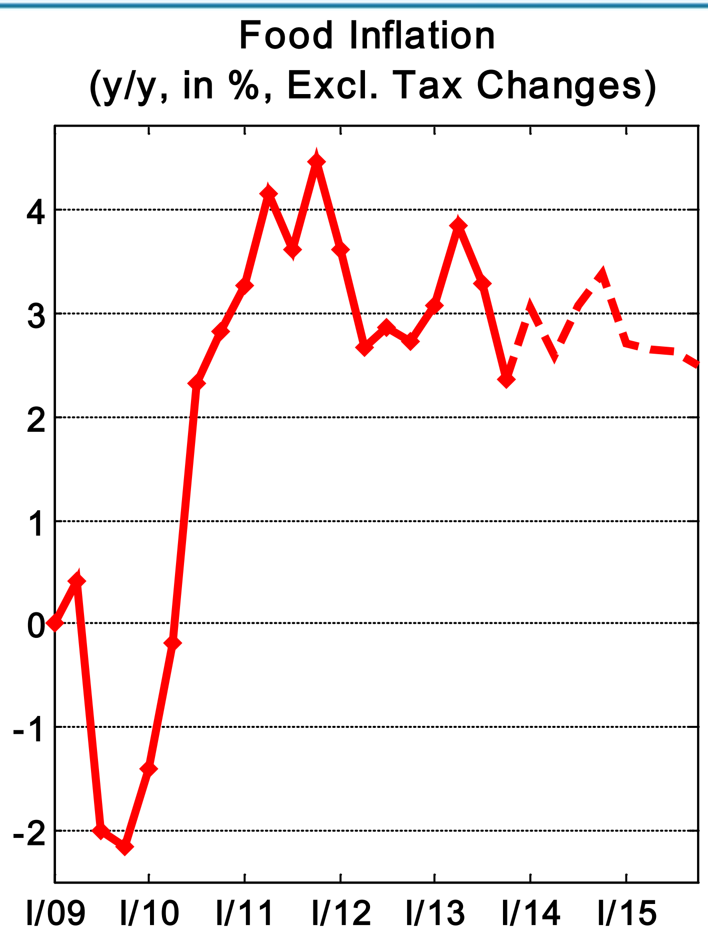




- Net inflation will accelerate from the recent low levels until the turn of 2015, mainly as a result of gradually increasing ”core“ inflation.
- Administered prices will drop in 2014 due to falling energy prices.

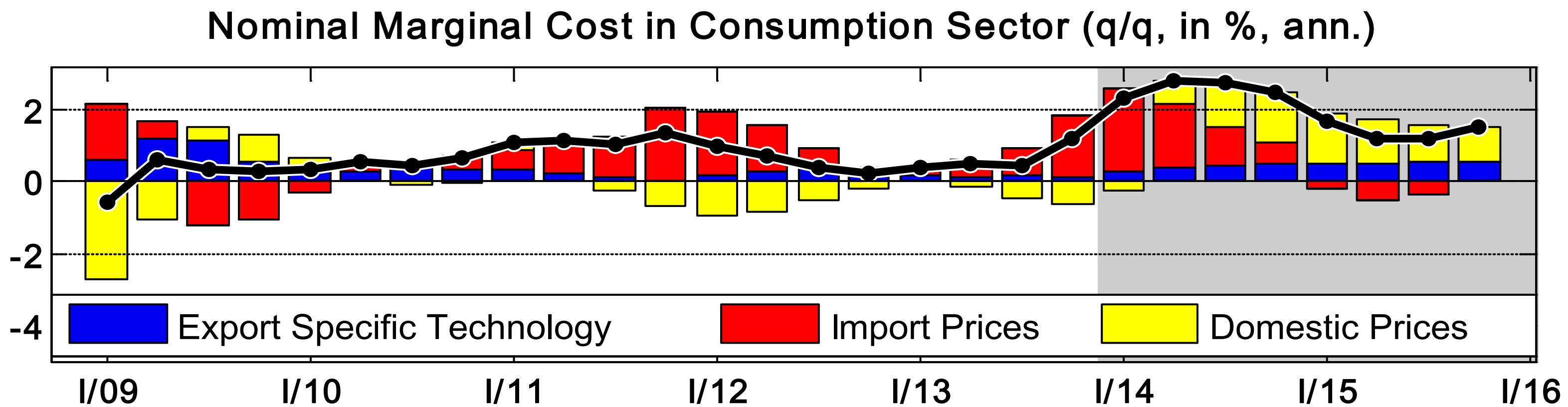
Adjusted Inflation Excluding Fuels; Food Prices

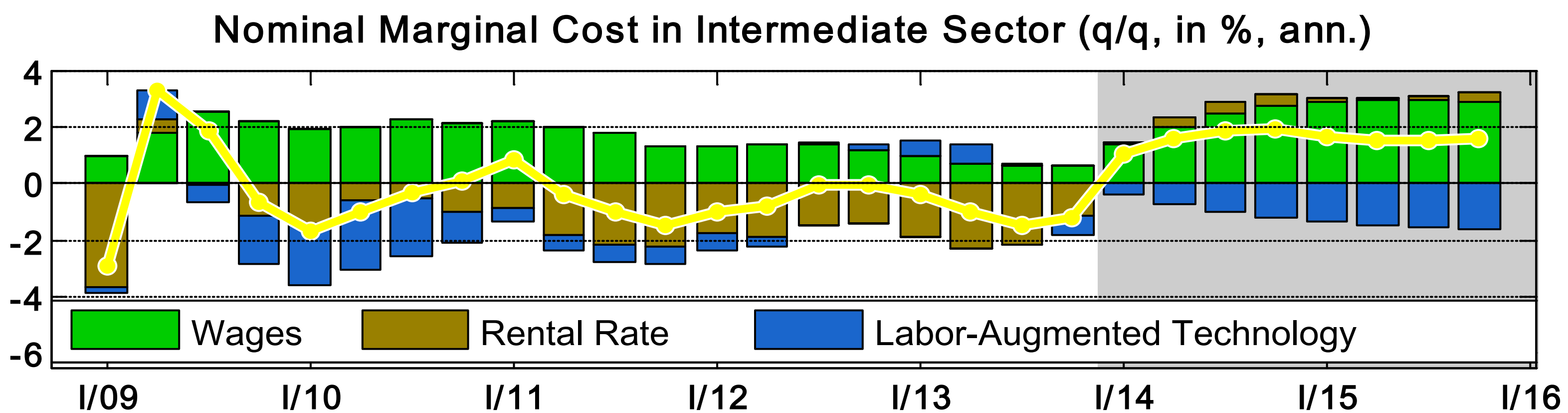




- ”Core“ inflation is still negative, but will shift to the positive territory in 2.Q 2014 and then increase further until the turn of 2015, initially driven by growing import prices and later on also by the economic recovery.
- Food price growth will move around 3%.

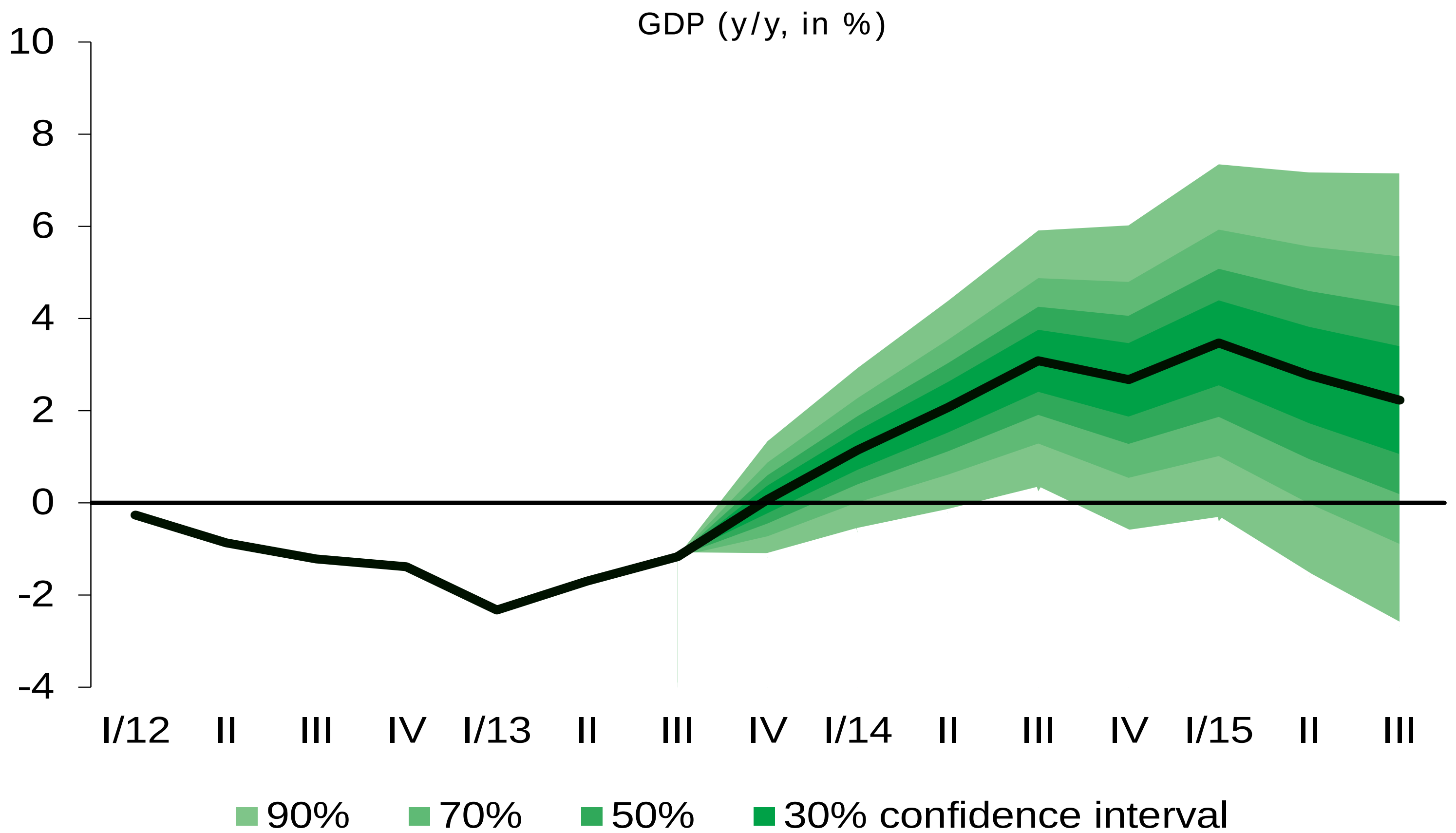
Domestic Costs vs. Import Prices





- Currently, the import prices are contributing to inflation, while the domestic economy is still anti-inflationary.
- In the coming quarters, the impact of import prices will be decreasing, while the accelerating domestic wage growth and economic recovery will start to play the main role in stabilizing inflation close to the target.

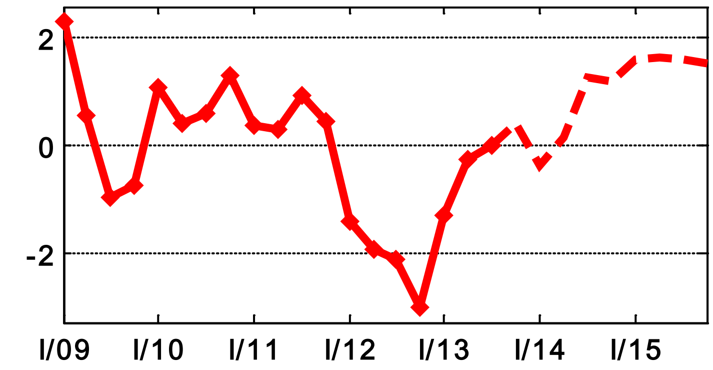
GDP Growth Forecast



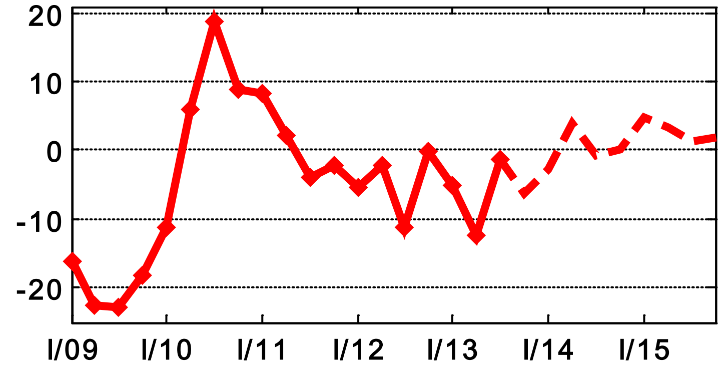
- GDP growth forecast: 2.2% in 2014 and 2.8% in 2015.
- The growth will be supported by a recovery in foreign demand.
- The positive impact of depreciated exchange rate is estimated at around 1 p.p. in 2014 (higher price competitiveness, lower real interest rates).

Forecast of Aggregate Demand

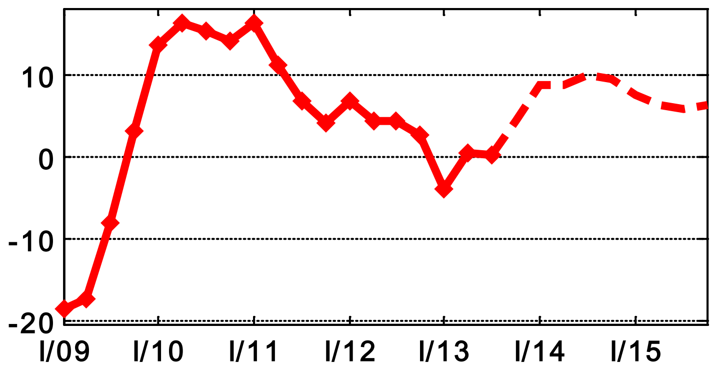
Household Consumption Growth (y/y, in %)



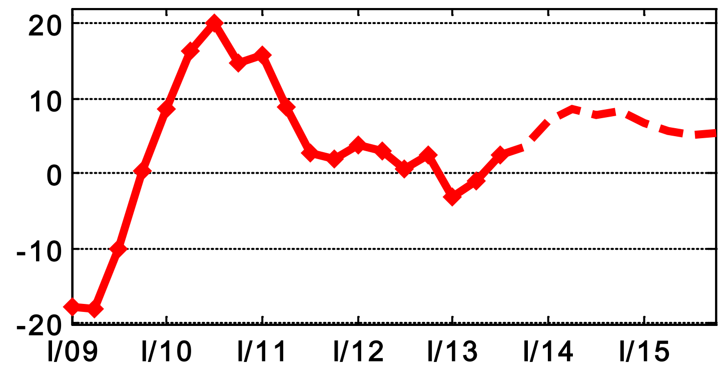
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)

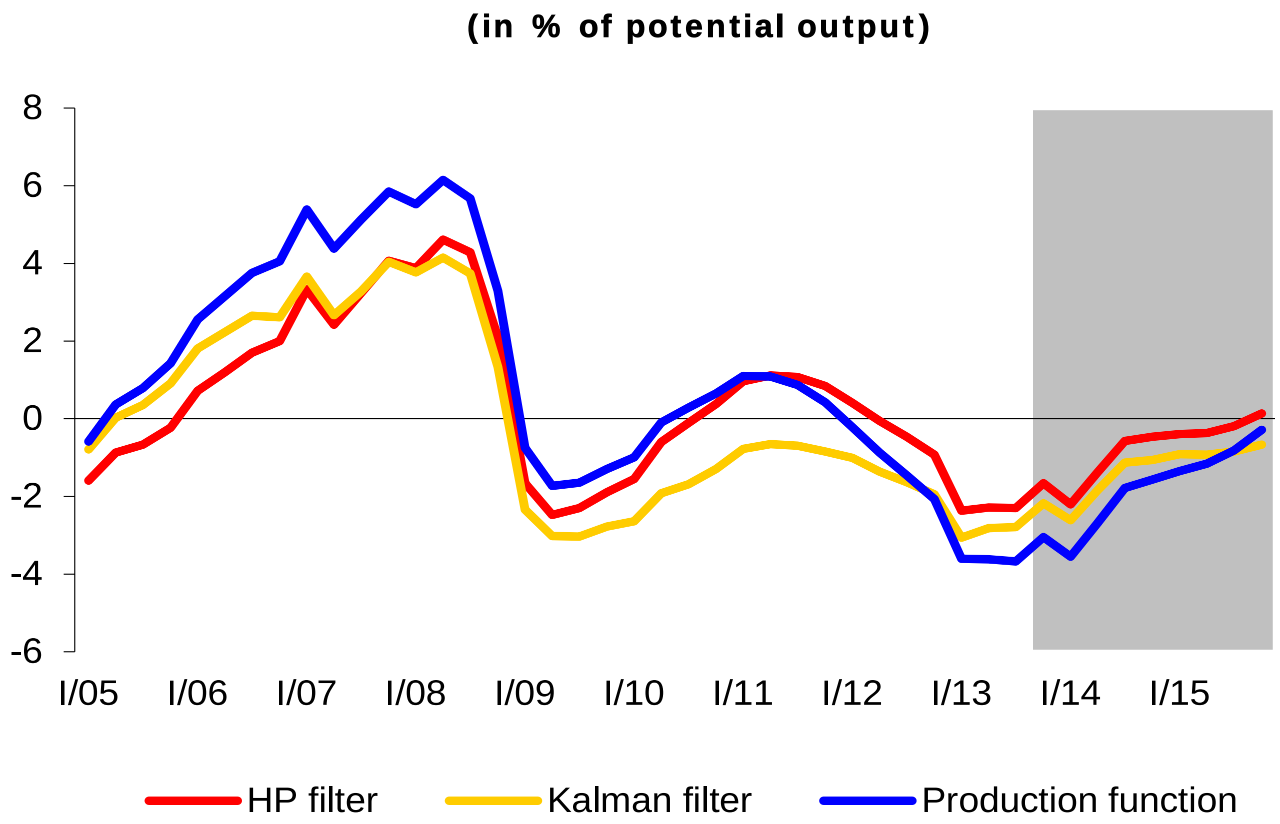


Imports Growth (y/y, in %)



- Household consumption will be gradually recovering.
- Investments will stagnate this year and start growing slightly in 2015.
- The recovery will be led by exports, supported by growing foreign demand and weaker exchange rate.

Output gap

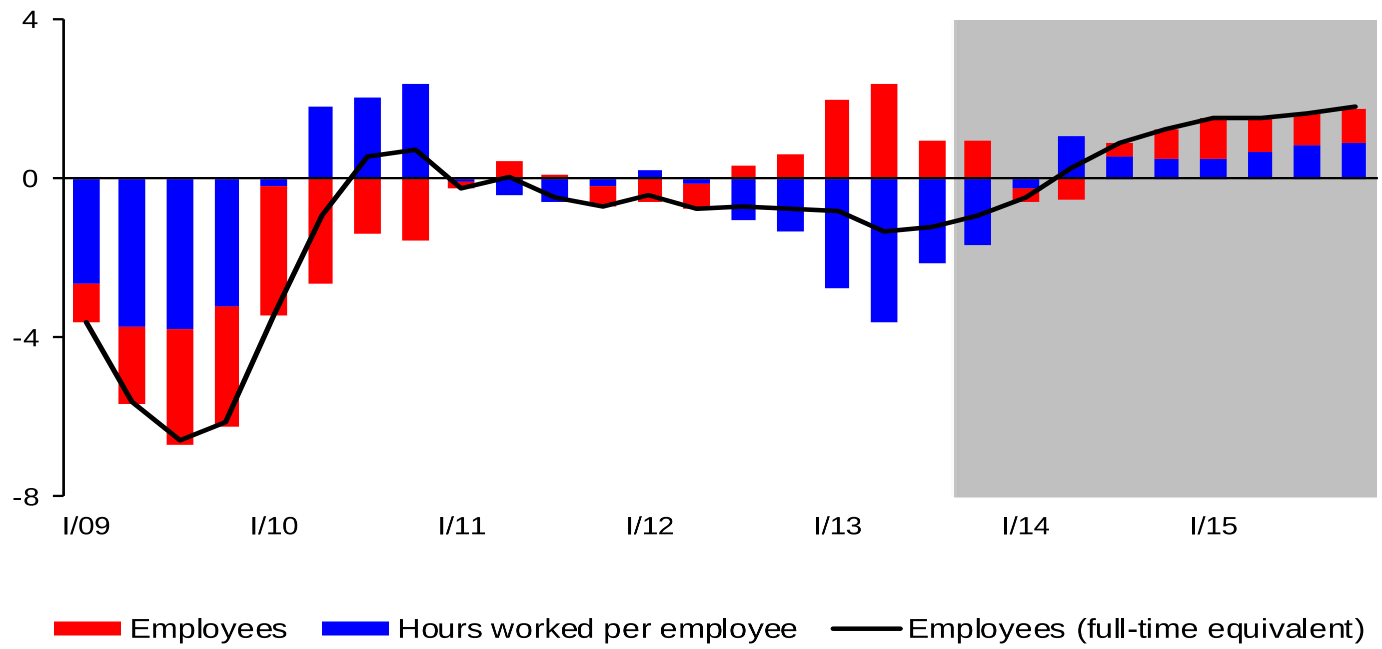


- The output gap remains significantly negative (around 2.5-4.0 %).
- It will start continuously narrowing from 2.Q 2014, but will not close before the end of 2015.

Labour Market Forecast (i)

CNB CZECH NATIONAL BANK

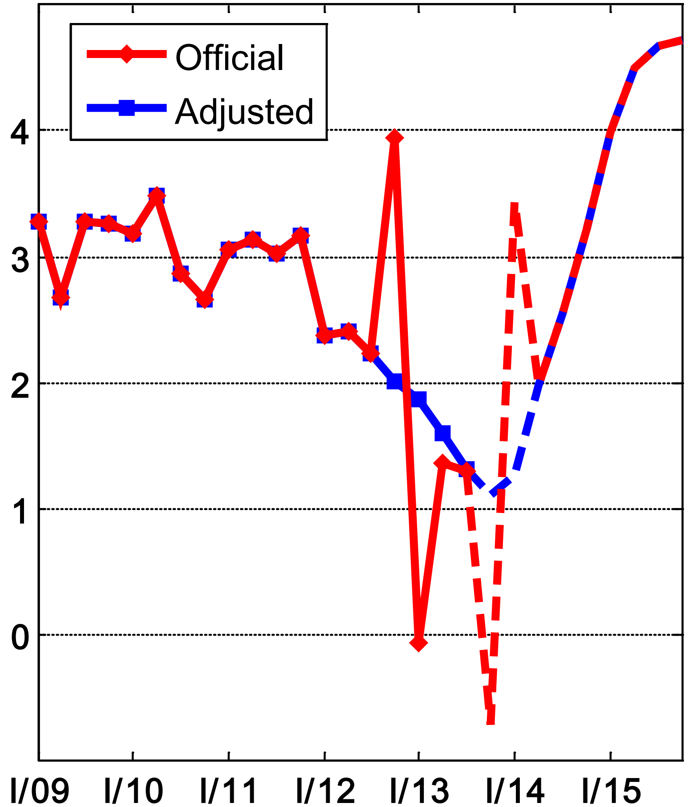
Number of employees (full-time equivalent)
(annual percentage changes; contributions in percentage points)



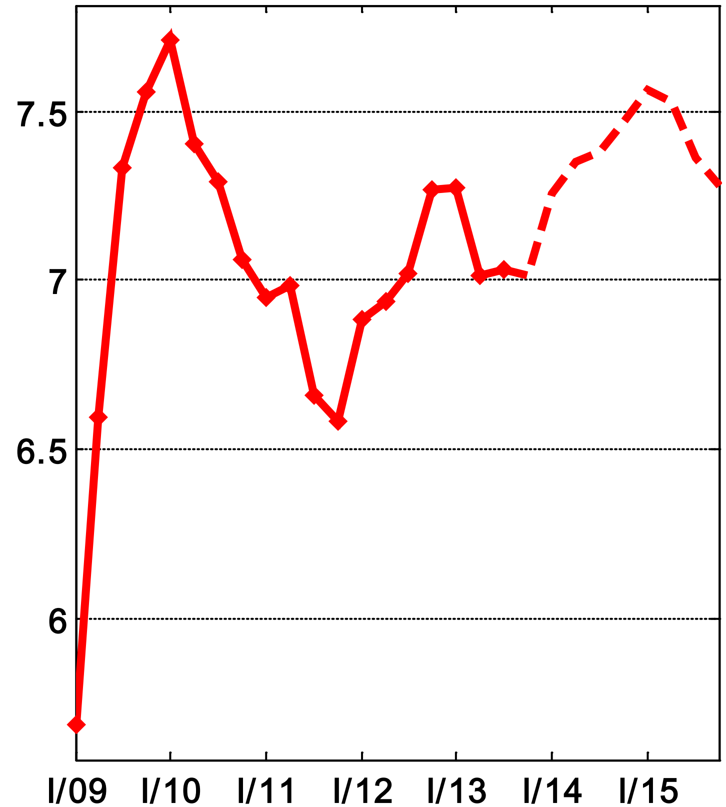
- The number of employees has continued to grow mainly in the services sector, but – taking into account the reduced hours – the full-time equivalent is actually declining.
- The recovery will initially increase the hours worked per employee, and later on lead to resumed employment growth.

Labour Market Forecast (ii)

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

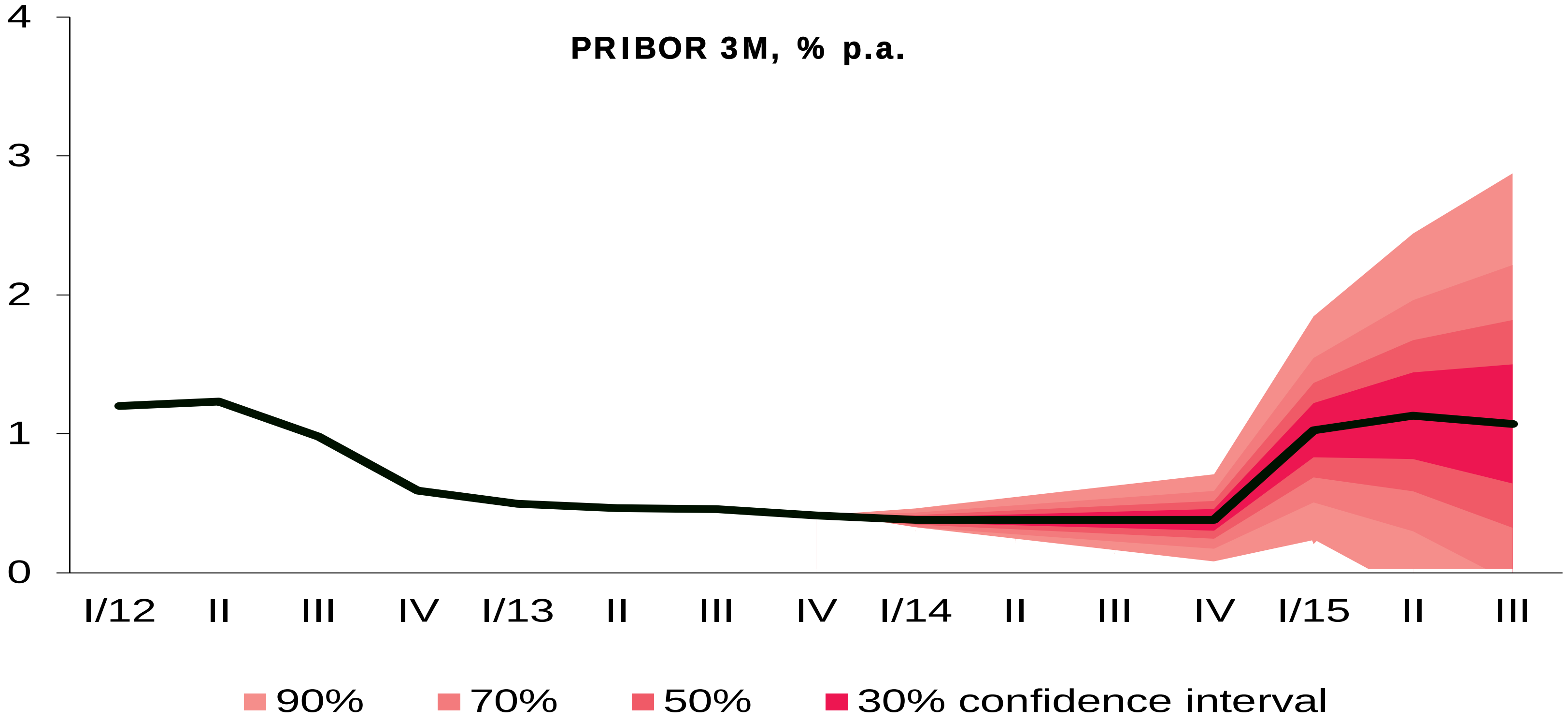


General unemployment rate (ILO)
(in %, s.a.)



- Nominal wage growth is significantly affected by tax optimisation from late 2012. It will recover from currently very low levels. In 2015, there will be an upward effect (0.3 p.p.) of changes in the health insurance.
- The unemployment rate (ILO) will start declining in 2015.

Interest rate path



- The forecast expects market interest rates to be flat at their current very low level until the start of next year.
- According to the forecast, the easier monetary conditions will lead to an economic recovery and wage growth sufficient to allow monetary policy potentially to return to the conventional regime, in which interest rates will again play the main role, at the start of next year.

Outline

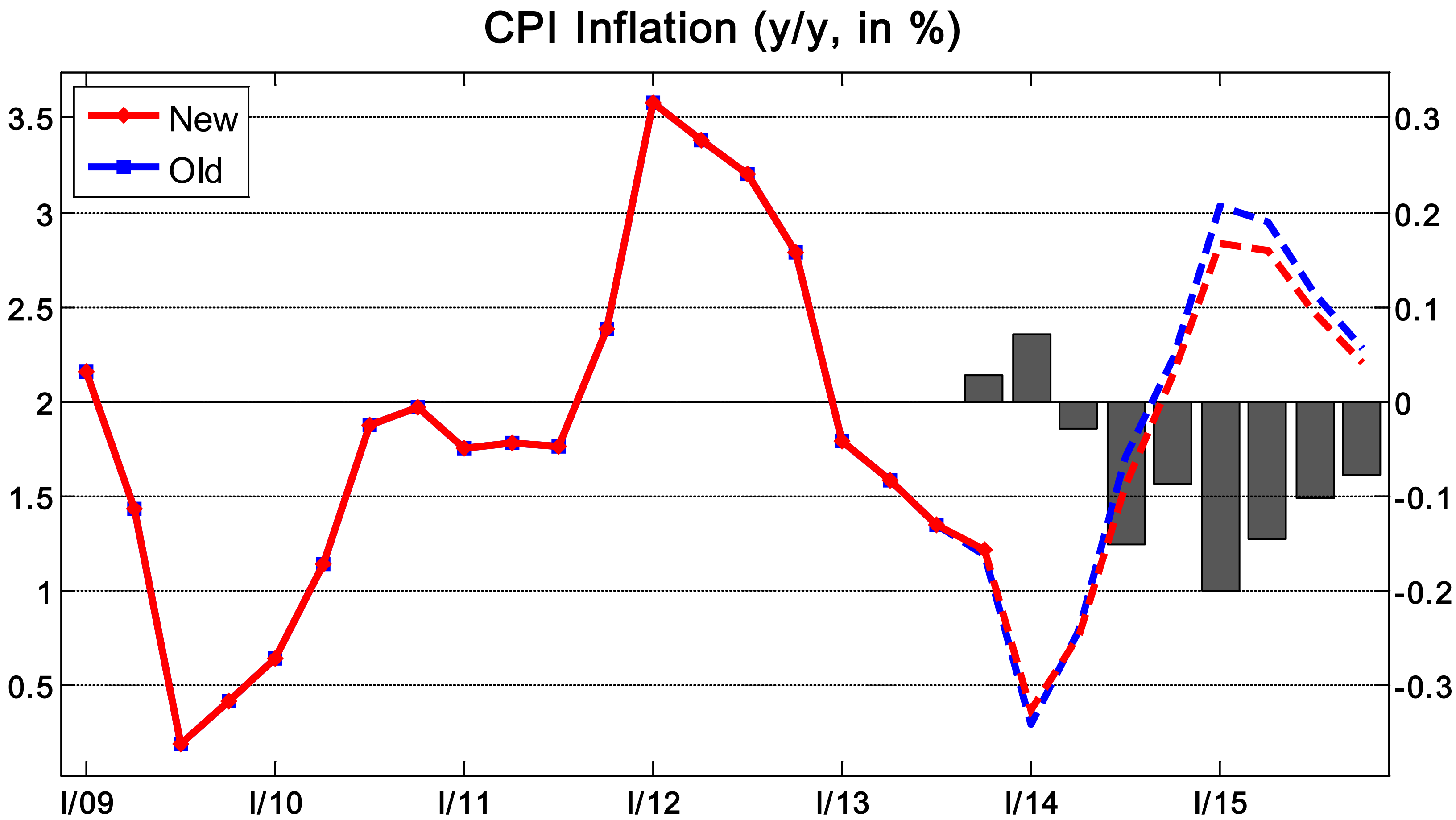
- Assumptions of the forecast
- The new macroeconomic forecast
- Comparison with the previous forecast (alternative scenario)
- Import intensity of consumption
- Changes in the CNB‘ monetary policy communication

Comparison with Previous Forecast (Alternative)

CNB CZECH NATIONAL BANK

- Both headline inflation and monetary-policy relevant inflation have shifted downwards slightly at the monetary policy horizon.
- This year, marginally higher net inflation will be broadly offset by a more pronounced drop in administered prices. In 2015, lower net inflation will dominate, mainly due to lower ”core“ inflation.
- GDP growth has been revised slightly upwards this year and more considerably upwards next year.
- Nominal wage growth will be somewhat higher, the unemployment rate lower.
- After the discontinuation of the use of the exchange rate as a monetary policy instrument, interest rates will probably be slightly lower in 2015 by comparison with the previous forecast, mainly because of a lower outlook for foreign interest rates.

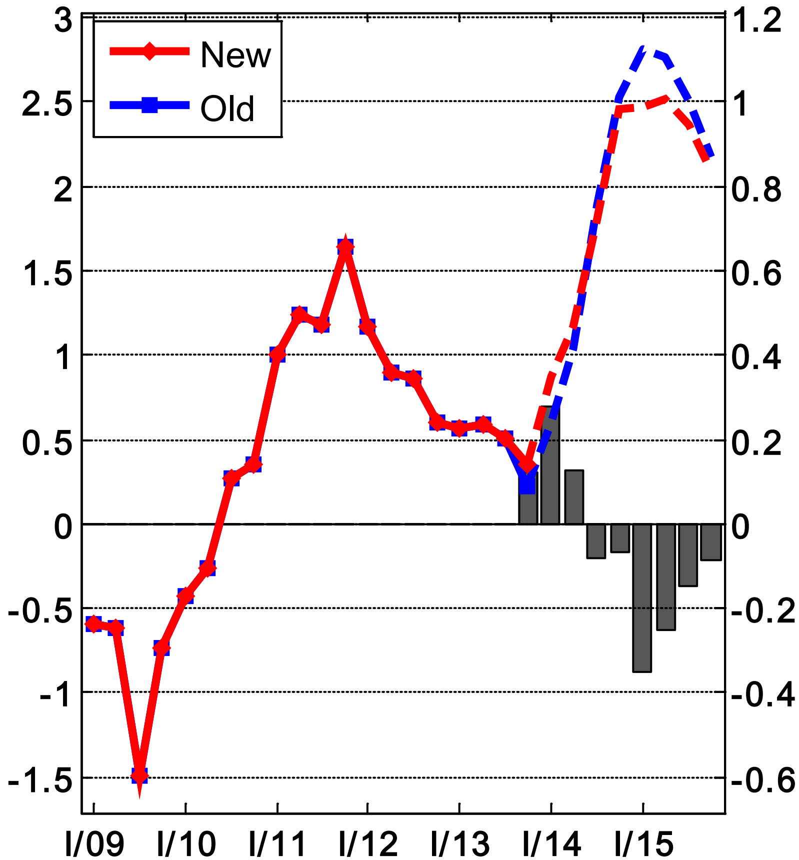
Change in the inflation forecast



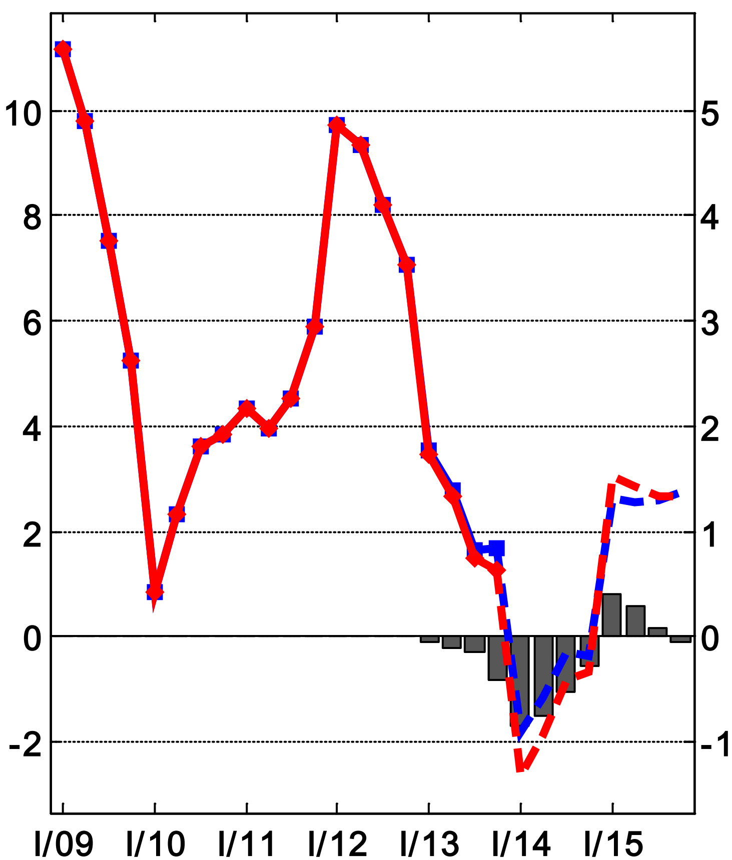
- The inflation forecast has been slightly lowered for the second half of 2014 and for next year.

Comparison with Previous Inflation Forecast (ii)

Net Inflation (y/y, in %)



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

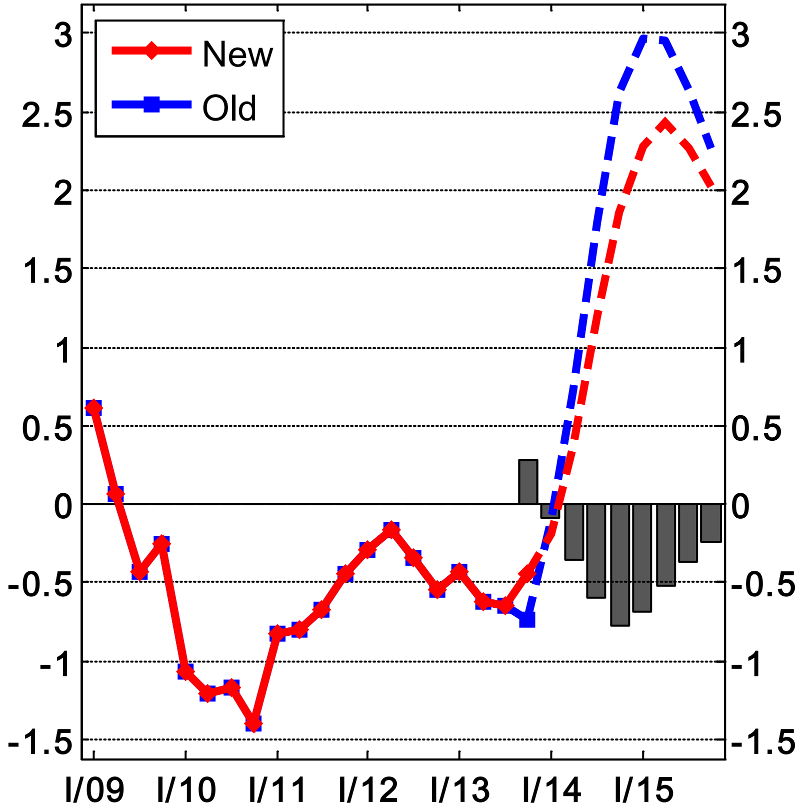


- Net inflation: higher forecast for food price growth this year, partly offset by lower "core" inflation, which will dominate in 2015.
- Administered prices: even more pronounced drop in electricity prices and more muted increase in water supply and sewage prices in 2014.

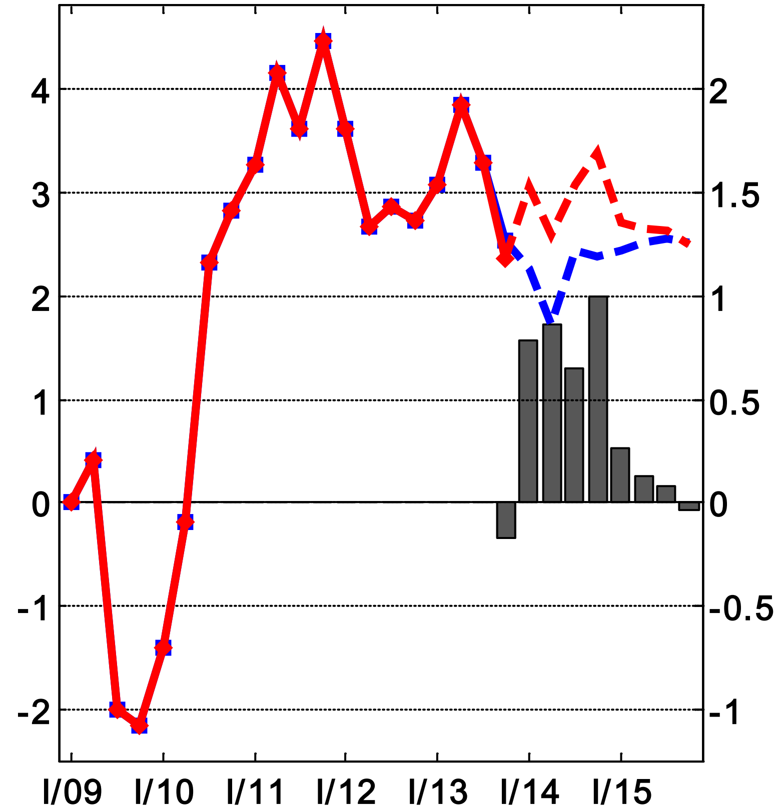
Comparison with Previous Inflation Forecast (iii)

CNB CZECH NATIONAL BANK

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



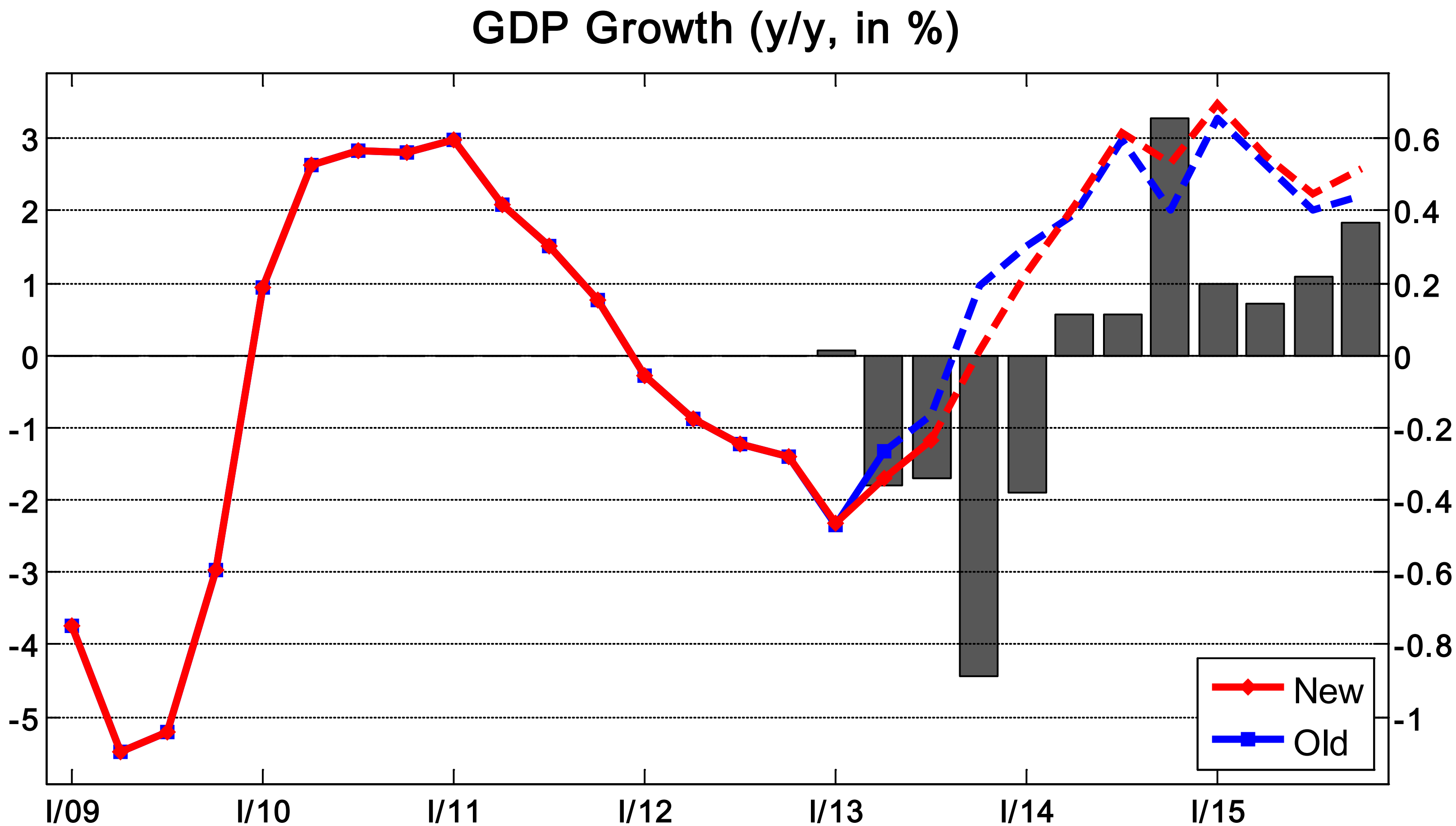
Food Inflation
(y/y, in %, Excl. Tax Changes)



- The lower forecast of adjusted inflation excluding fuels (i.e. "core" inflation) reflects a more gradual recovery of household consumption.
- The higher food price outlook is due to the actual developments in recent months and higher observed import prices.

Comparison with Previous GDP Forecast (i)

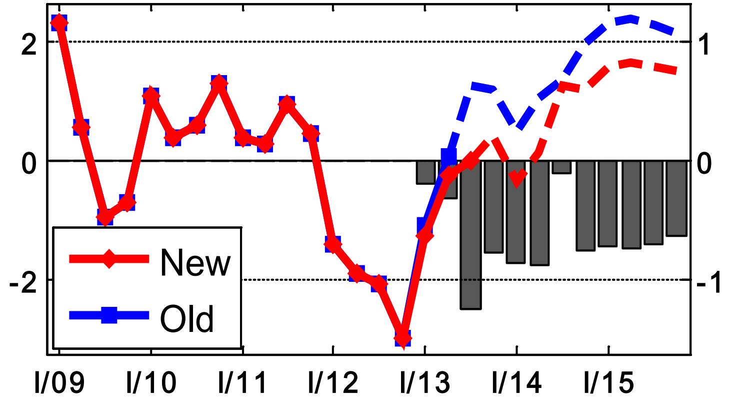
CZECH NATIONAL BANK



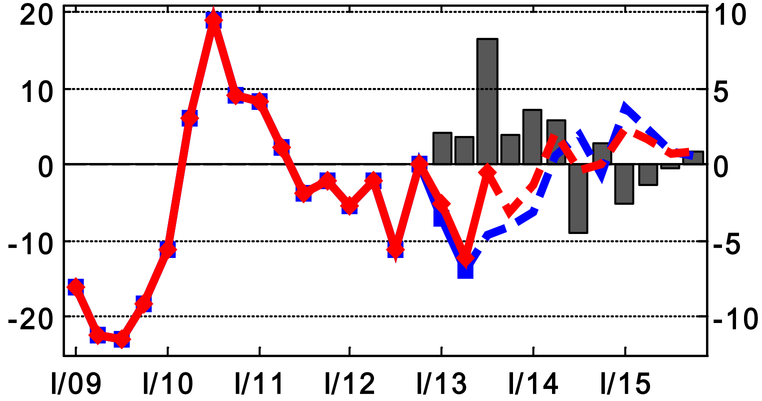
- After a deeper decline last year, the GDP growth will be marginally higher this year and more significantly (by 0.3 p.p.) higher in 2015.
- The upward shift in 2015 reflects slightly higher foreign demand as well as government consumption growth.

Comparison with Previous GDP Forecast (ii)

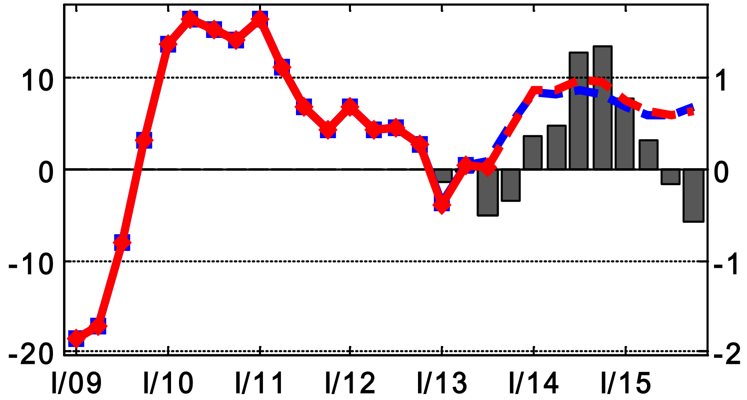
Household Consumption Growth (y/y, in %)



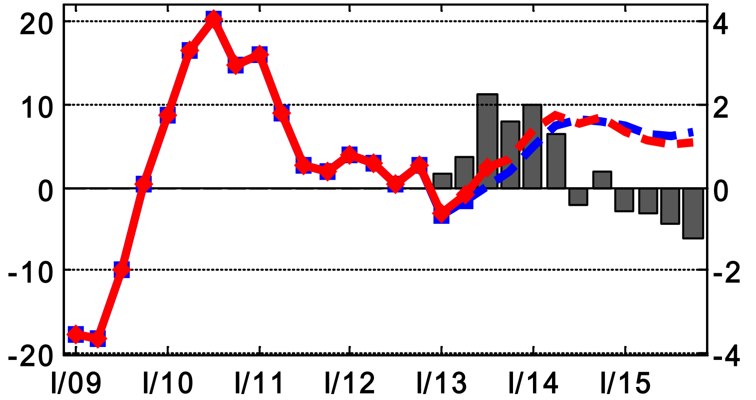
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)

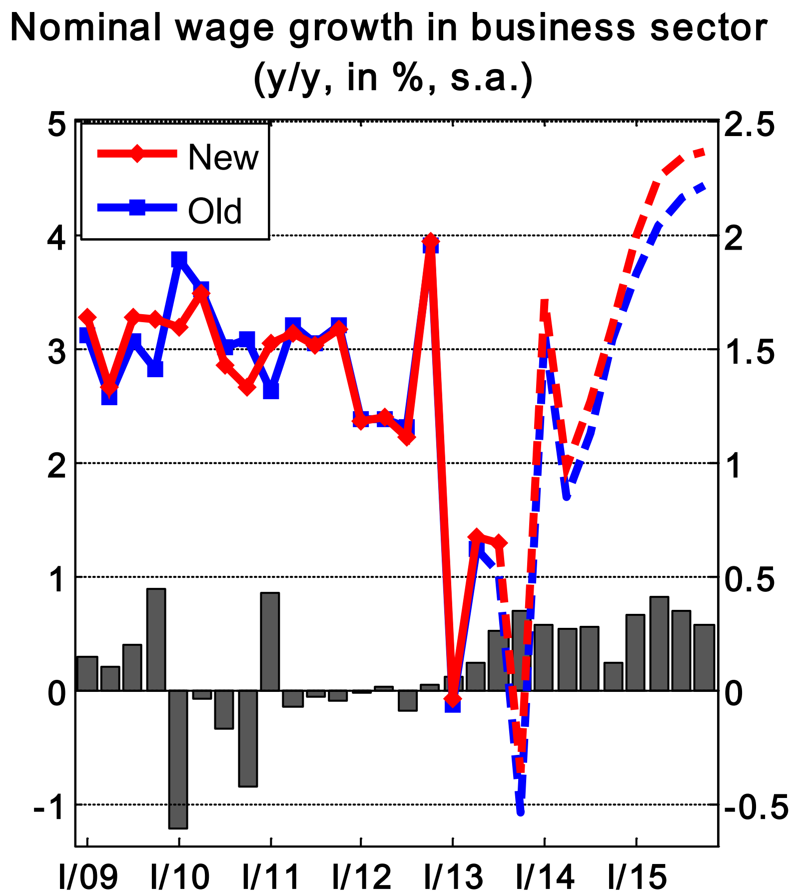


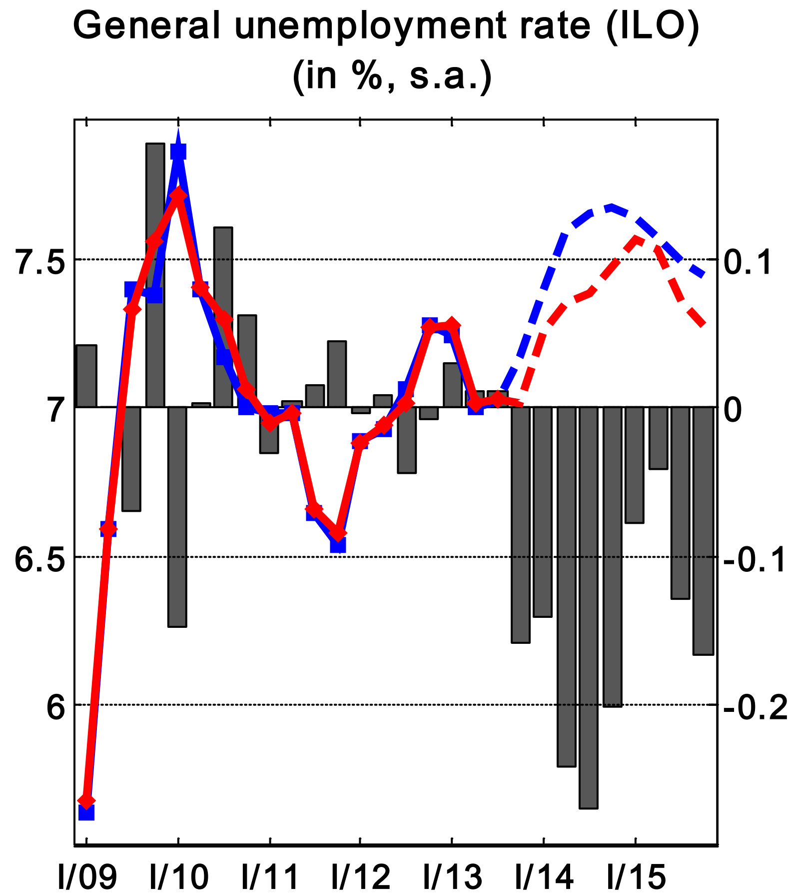
Imports Growth (y/y, in %)



- The more gradual recovery in household consumption reflects weaker observed data in 3.Q 2013.
- The recovery of investments and exports will be slightly faster.

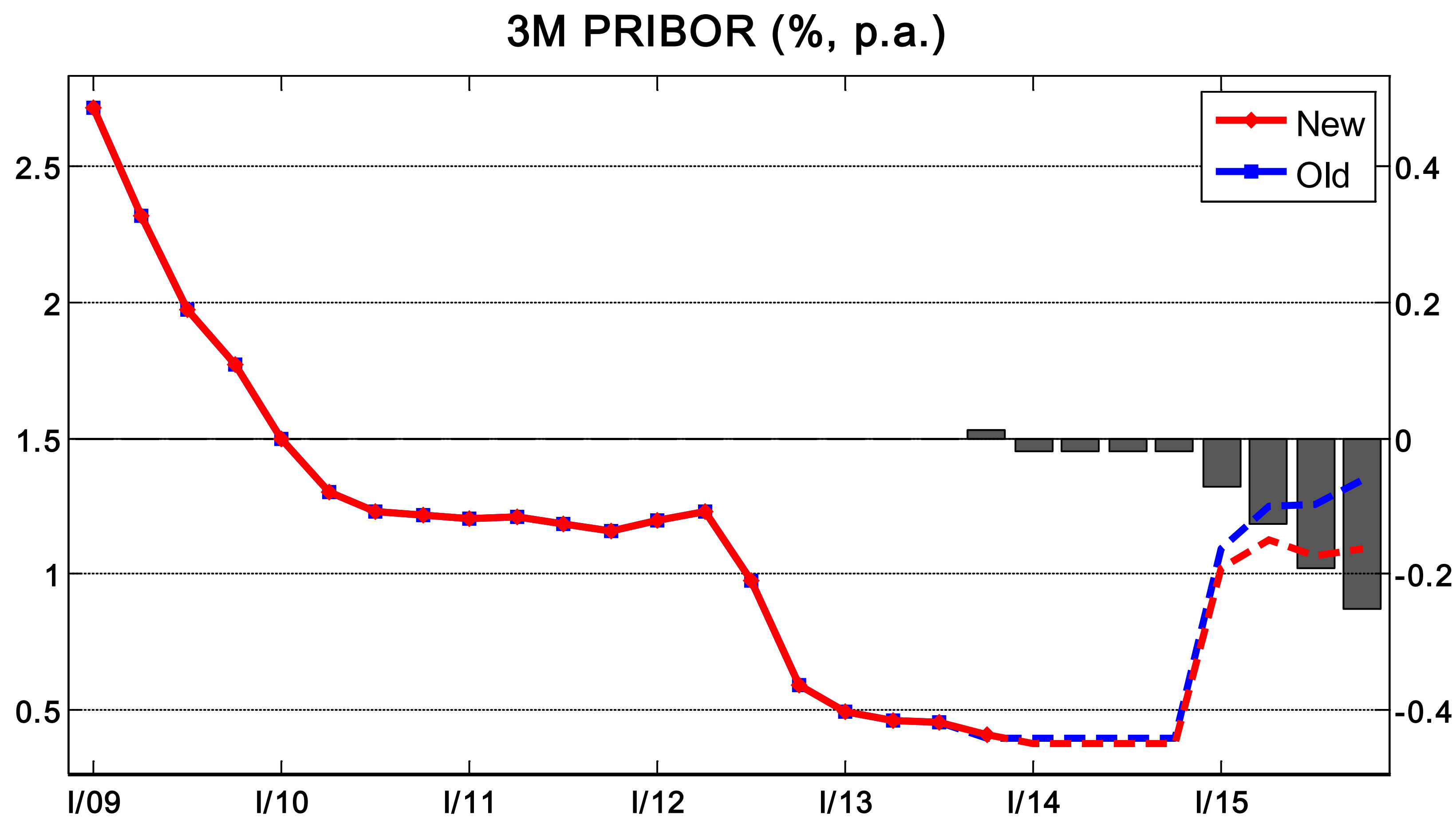
Changes in Labour Market Forecast





- The nominal wage growth data have been revised slightly up, and the forecast is also higher, in 2015 partly due to changes in health insurance.
- The general unemployment rate has recently surprised to the downside (unlike registered unemployment), and the forecast is also lower.

Changes in Interest Rate Forecast



- The interest rate path is marginally lower for 2014 (decreased money market premium) and more significantly lower for 2015 mainly due to a lower outlook of the euro area interest rates.

Outline

- Assumptions of the forecast
- The new macroeconomic forecast
- Comparison with the previous forecast (alternative scenario)
- Import intensity of consumption
- Changes in the CNB‘ monetary policy communication

Import intensity of consumption

Import intensity of product groups and household consumption (in %)

Product class	Weight on the CPI	Import intensity	
		Total	Direct
Food	24,6	35	25
Energy	11,8	48	37
Raw materials without oil	1,6	43	36
Medicines and health care	2,3	50	44
Basic metals	0,0	66	58
Motor vehicles	3,5	41	30
Computers	0,7	81	78
Machinery and equipment	0,3	58	50
Other products and semi-finished products	16,5	56	47
Services	38,8	14	6
Total consumption	100,0	33	24

Effect of a permanent 5% exchange rate depreciation on prices (in %)

Product class	Weight on the CPI	The long-term effect	Direct effect
Food	24,6	1,8	1,2
Energy	11,8	2,4	1,9
Raw materials without oil	1,6	2,1	1,8
Medicines and health care	2,3	2,5	2,2
Basic metals	0,0	3,3	2,9
Motor vehicles	3,5	2,1	1,5
Computers	0,7	4,1	3,9
Machinery and equipment	0,3	2,9	2,5
Other products and semi-finished products	16,5	2,8	2,3
Services	38,8	0,7	0,3
CPI	100,0	1,6	1,2

- The direct import intensity of consumption is around 25 %, including imported inputs it reaches 33 %.
- The simulated impact of a permanent 5% depreciation on prices assumes no change in margins, and does not take into account the second-round effects on the macroeconomic developments.

Outline

CNB CZECH NATIONAL BANK

- Assumptions of the forecast
- The new macroeconomic forecast
- Comparison with the previous forecast (alternative scenario)
- Import intensity of consumption
- Changes in the CNB‘ monetary policy communication

Changes in the monetary policy communication

- Press conference set to normally begin at 14:15, broadcast live on ČT24 and later this year also on the CNB‘s web page

- Statement of the Bank Board on monetary policy presented at the press conference and immediately published on the web in both Czech and English

- New dates of the Meeting with Analysts, typically the day after decision; this year 12 May (Monday), 1 August, 7 November

- Summary of the Inflation Report and the table with Key Macroeconomic Indicators to be published before the meeting

Thank you for your attention!

www.cnb.cz

Tomáš Holub

Monetary and Statistics Department

Tomas.Holub@cnb.cz