

# Meeting with Analysts

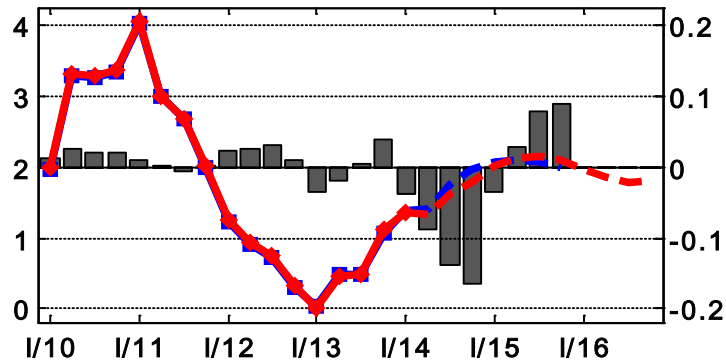
Petr Král

Prague, 1 August, 2014

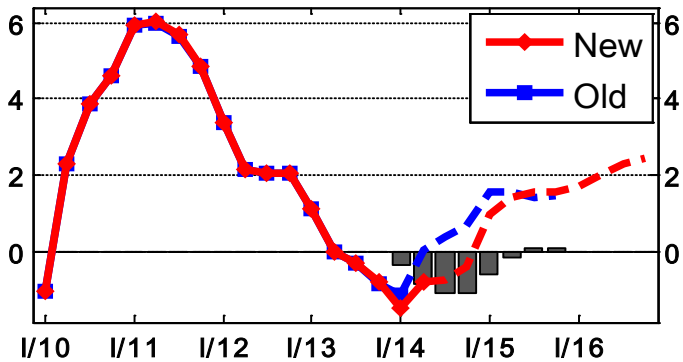
- Assumptions of the forecast
- The new macroeconomic forecast
- Comparison with the previous forecast

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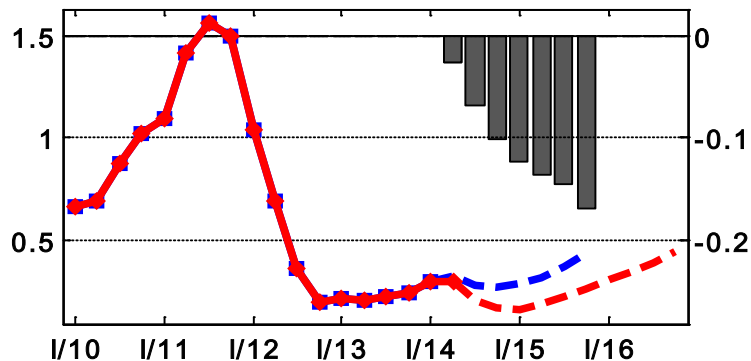
Growth Rate of GDP - Eurozone (y/y, in %)



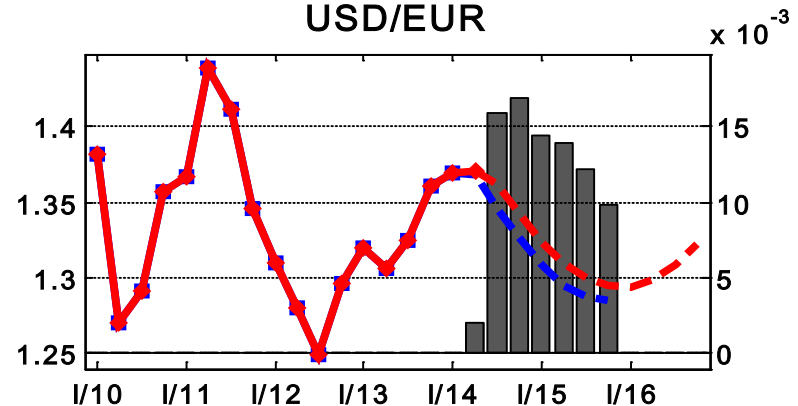
PPI Inflation - Eurozone (y/y, in %)



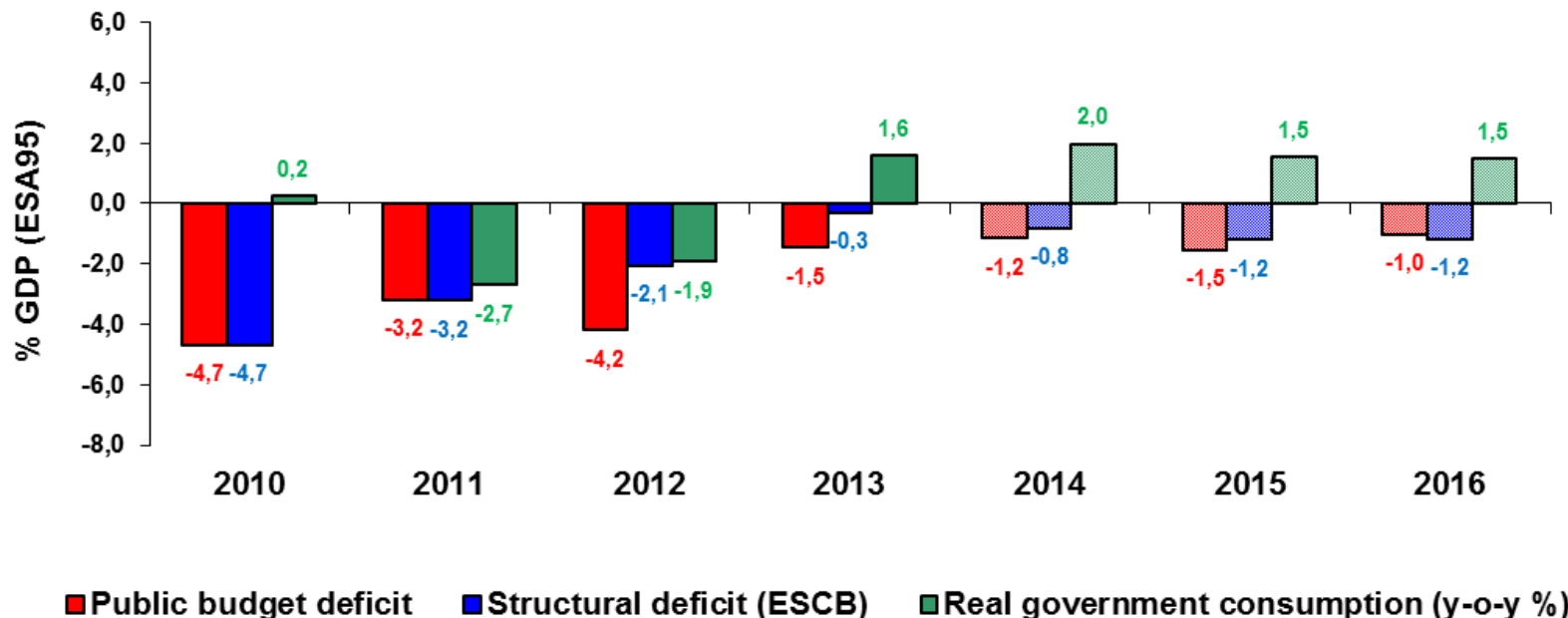
3M EURIBOR



USD/EUR



- GDP growth in the effective EA will further accelerate both in 2014 and 2015.
- Current fall of PPI in EA reflects subdued economic activity in past few years, low commodity prices and previous appreciation of EUR against USD.
- Interest rates in the EA will be low over the whole forecast horizon.
- Euro will gradually depreciate from its current relatively strong level.



- Despite rapid growth of public investment, the government deficit will decline to 1.2% of GDP in 2014 due mainly to increasing tax revenues corresponding to swift economic growth. In 2015, strong public investment (esp. EU funds), changes in VAT and social transfers, and growing pensions will lead to an increase of public deficit to 1.5% of GDP despite continuing economic growth. The deficit will decline to 1% of GDP in 2016.
- Fiscal impulse: +0.2 p.p. in 2014, +0.5 p.p. in 2015 and -0.2 p.p. in 2016.

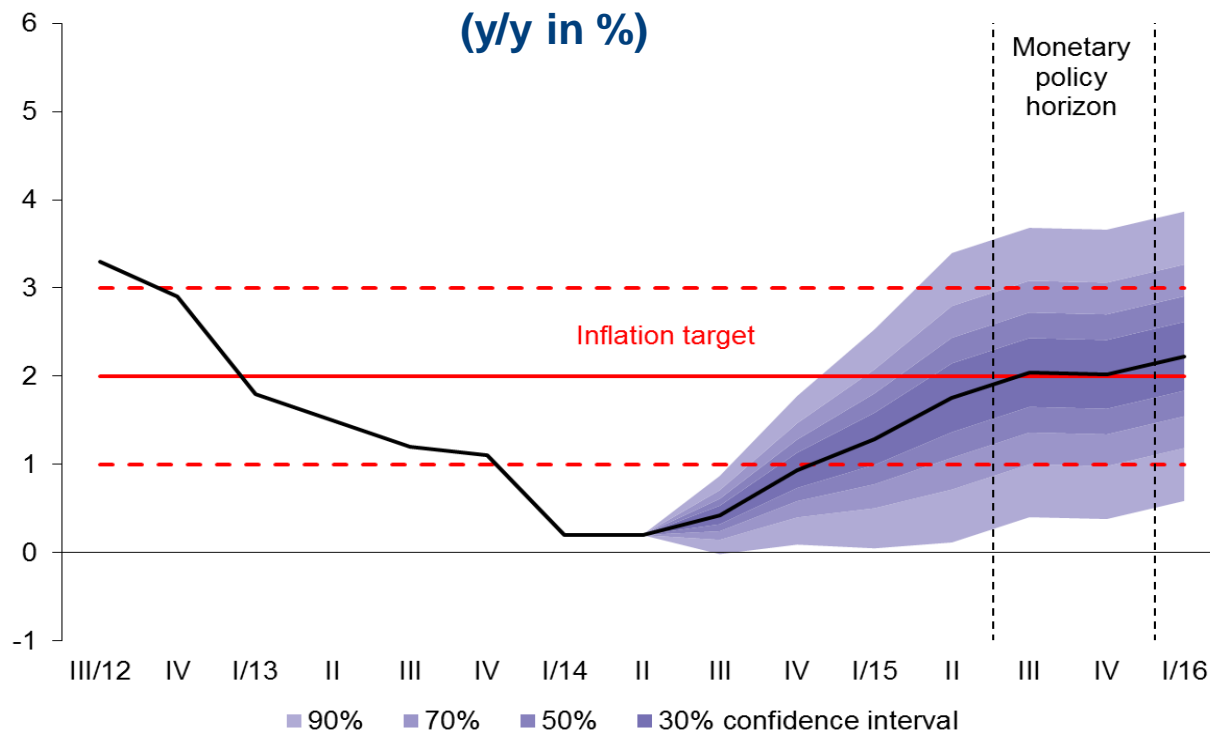
- The exchange rate of the koruna against the euro stayed close to CZK 27.4 in 2014 Q2. Given its low observed volatility, the forecast expects the exchange rate to remain at this level in the next few quarters, slightly weaker than the announced asymmetric exchange rate commitment (i.e. CZK 27 to the euro).
- The forecast expects market interest rates to be flat at their current very low level and the koruna exchange rate to be used as an instrument for easing monetary policy until 2015 Q3.
- The return to conventional monetary policy will not imply appreciation of the exchange rate to the level recorded before the CNB started intervening, as the weaker exchange rate of koruna will in the meantime pass through to the price level and other nominal variables.

- Assumptions of the forecast
- The new macroeconomic forecast
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- Headline inflation will go up from its current very low level and will reach the CNB's 2% target in 2015 H2, i.e. at the monetary policy horizon, where it will remain also in 2016.
- Monetary-policy relevant inflation will be slightly lower than headline inflation and will thus be just below the target at the monetary policy horizon.
- Inflationary effect of import prices will fade this year as a result of subdued growth of foreign PPI and stable nominal exchange rate.
- In contrast, domestic economy will start generating marked inflationary pressures due mainly to rapid nominal wage growth in the business sector.

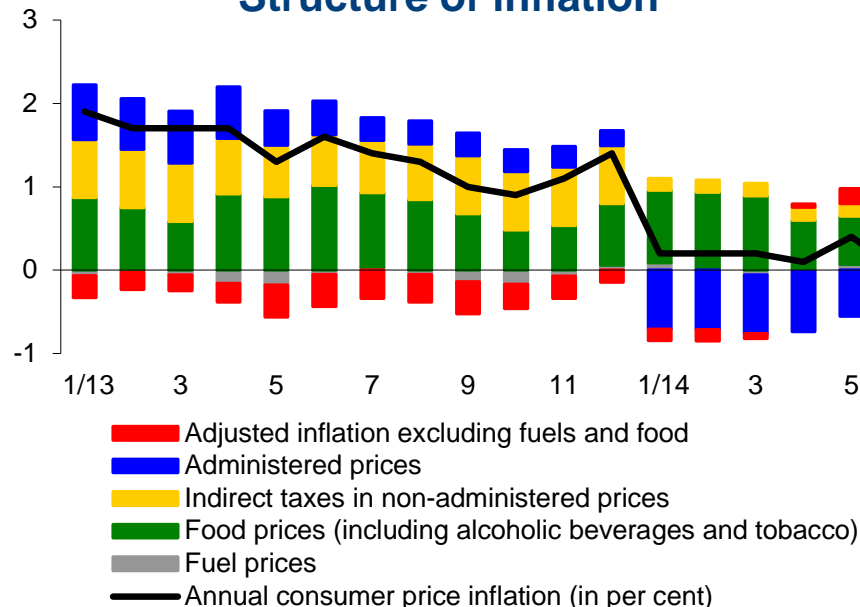


- Following its decline in the last year, GDP will grow by almost 3% this year, owing to accelerating external demand and easy domestic monetary conditions via weaker exchange rate and low interest rates, as well as increased government investment. The growth rates will be similar in the next two years.
- The increasing economic activity will be positively reflected also in the labor market. The wage growth will accelerate, together with the growth of employment expressed in full-time job equivalent.

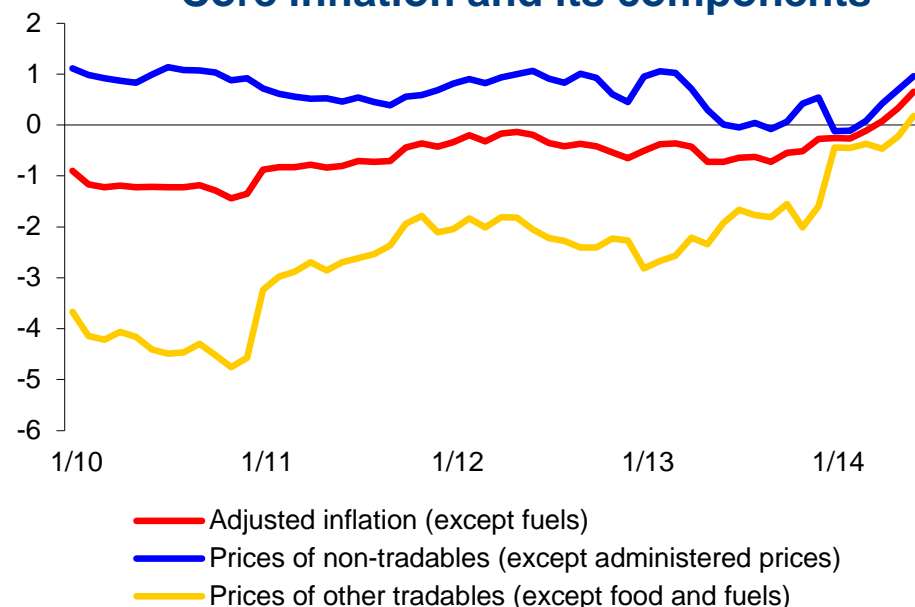


- Inflation remained at a very low level in the 2.Q 2014. It will gradually move up starting the third quarter of this year.
- In summer of 2015, headline inflation will reach the target and will remain there throughout the rest of the forecasting horizon.

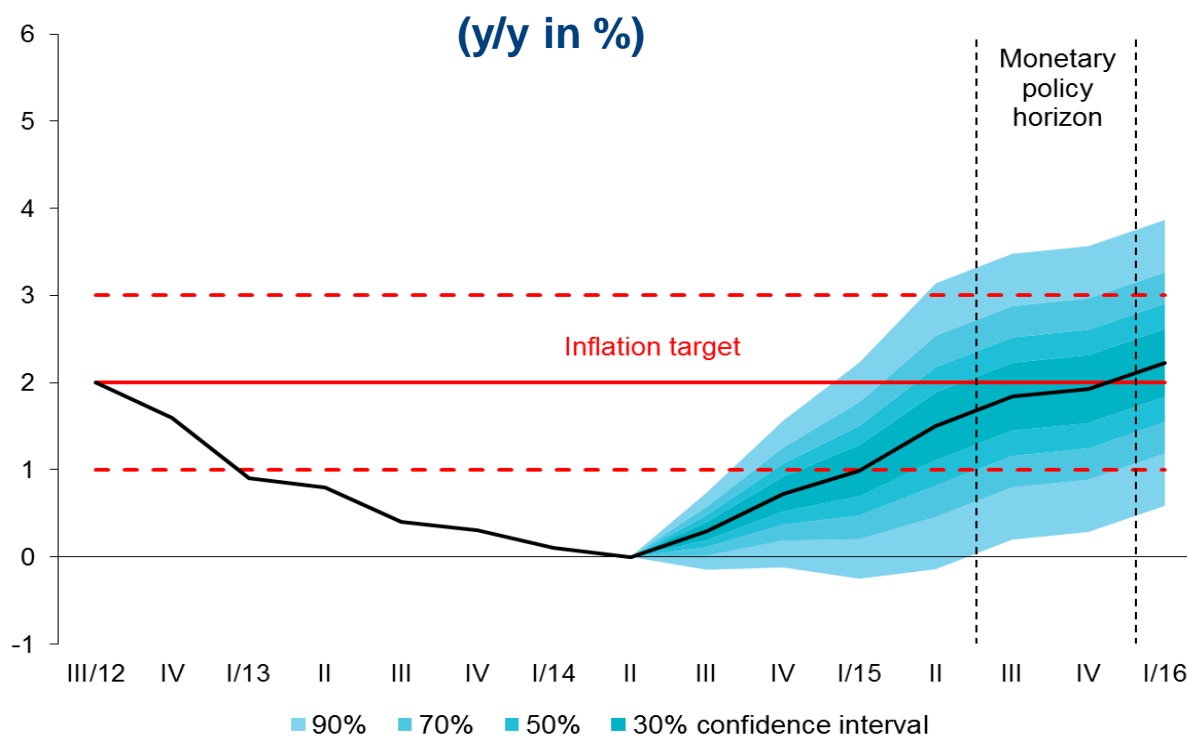
## Structure of inflation



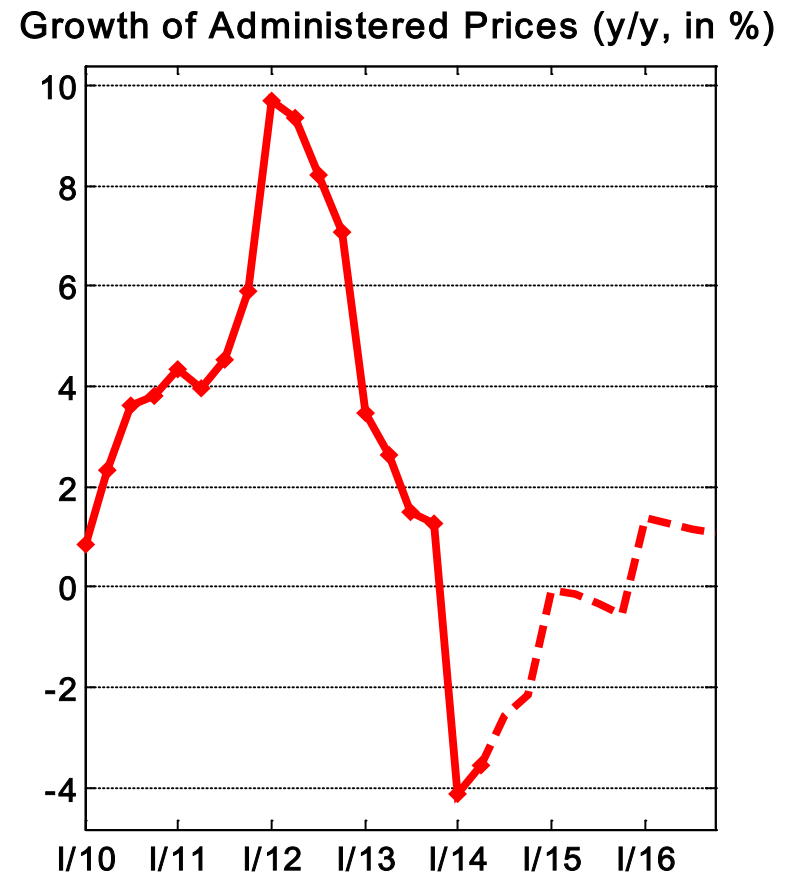
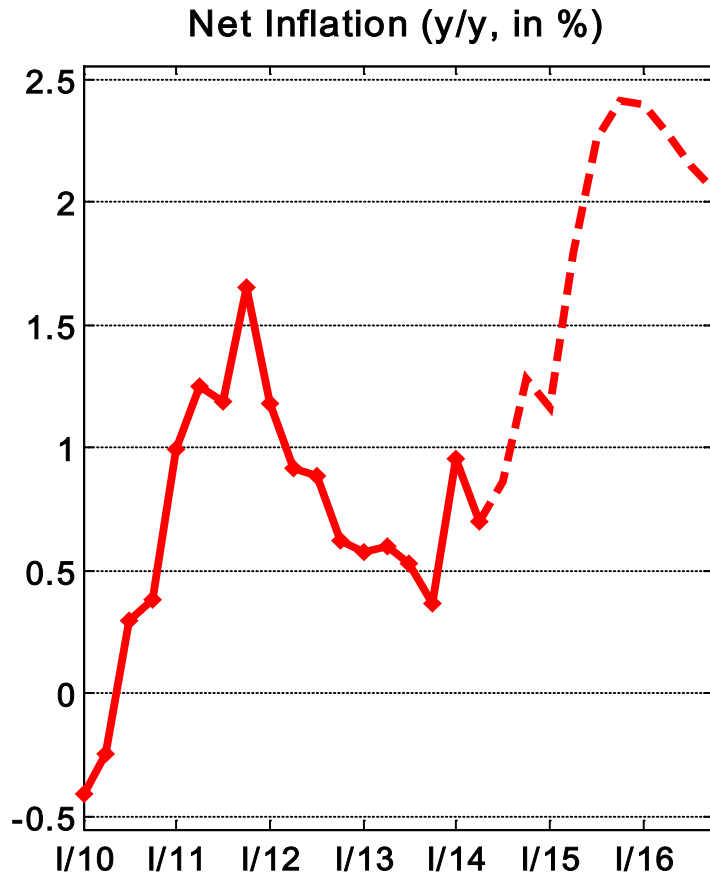
## Core inflation and its components



- Very low inflation has been caused by a decline in administered prices together with unexpectedly rapidly subsiding food price increases.
- On the other hand, for the first time in 5 years “core inflation” turned positive reflecting an increase in prices of both tradables (after 13 years) and non-tradables items.
- The main factor driving the increase in the core inflation was the depreciation of the exchange rate (its pass-through in line with our expectations) and fading out of domestic anti-inflationary pressures (more quickly than expected).



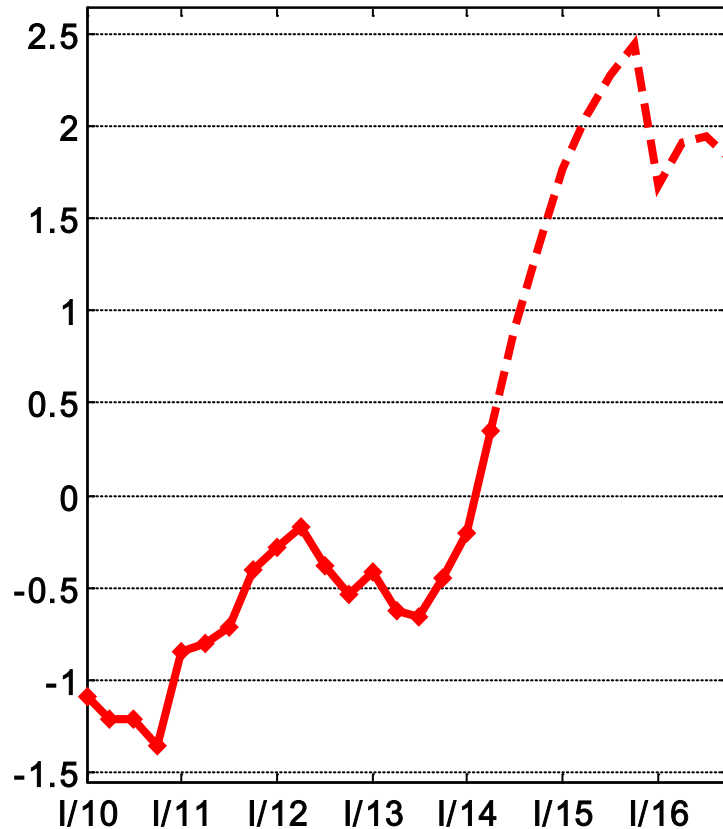
- Monetary policy-relevant inflation will follow the same profile as headline inflation and will be just below the inflation target at the MP horizon.
- Indirect taxation changes: increase in excise duties on cigarettes (+0.31 p.p.) and introduction of a second reduced VAT rate at 10% (-0.07 p.p., in 2015).



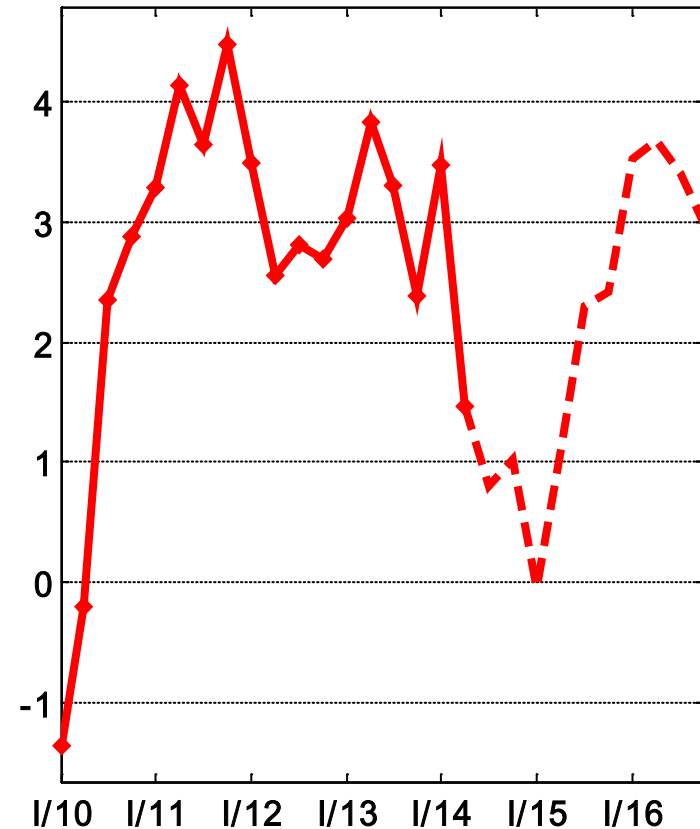
- Net inflation will be picking up until the end of 2015, as a result of recent import price increases, accelerated economic growth and improved labor market situation.
- Administered prices will decrease by 0.3% in 2015, due to lower energy prices and abolition of most co-payments in health care.

# Adjusted Inflation Excluding Fuels; Food Prices

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

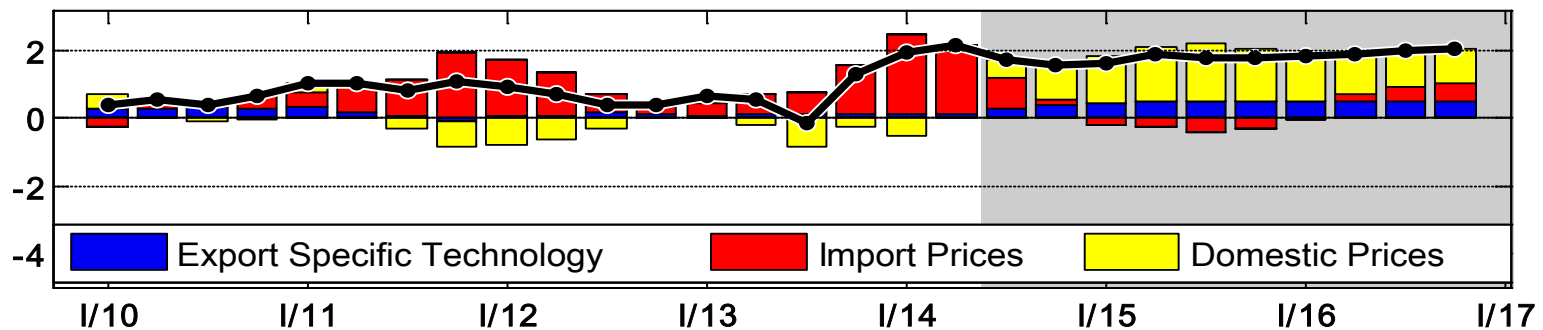


Food Inflation  
(y/y, in %, Excl. Tax Changes)

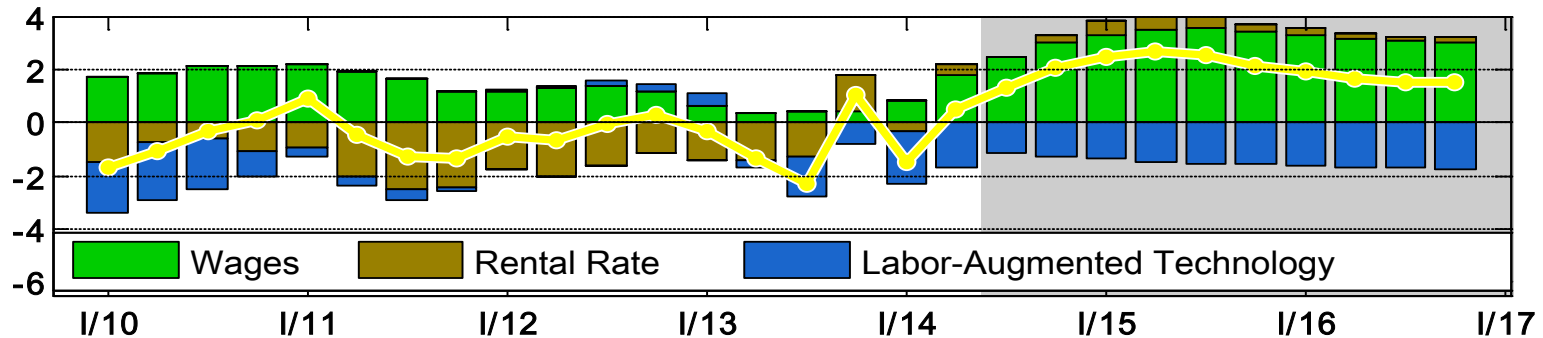


- Core inflation will continue to increase until the end of 2015 in an environment of pronounced economic recovery and renewed wage growth.
- Food prices will increase only modestly during 2014, followed by their pick-up boosted by import prices of food and lagged effects of higher agricultural prices.

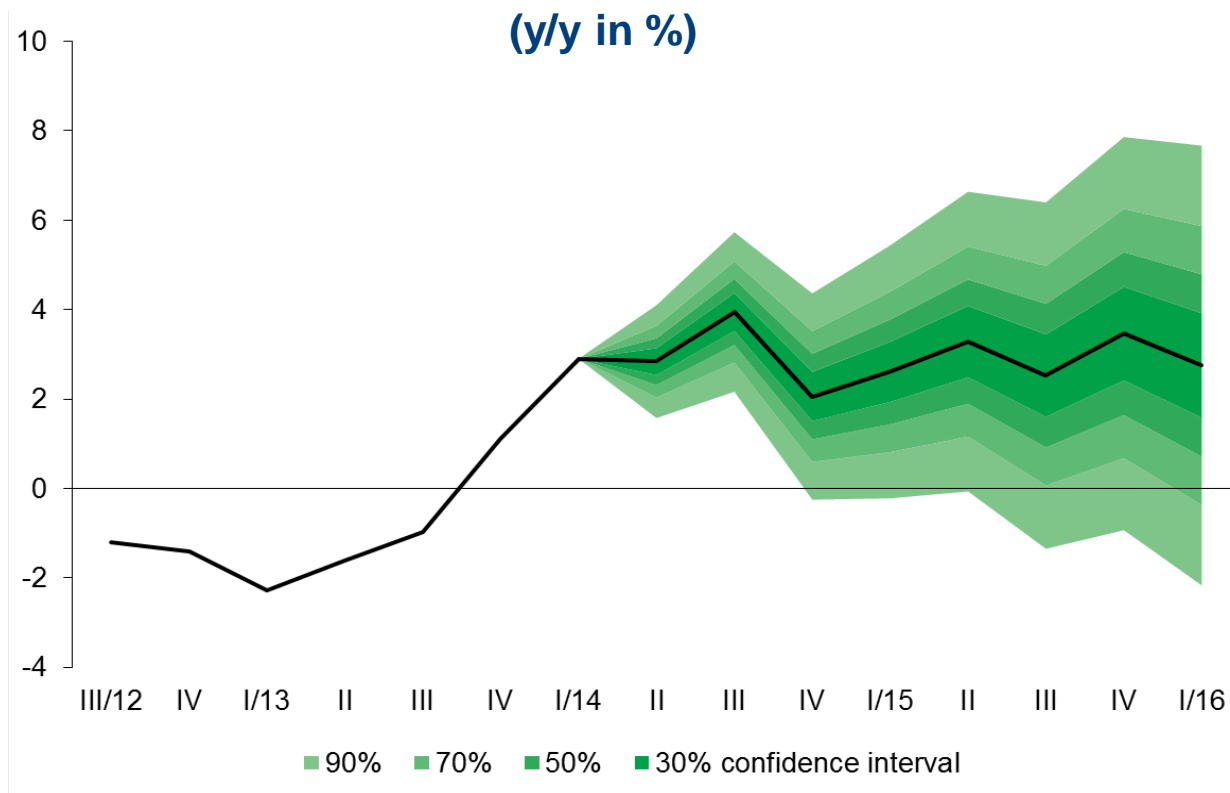
Nominal Marginal Cost in Consumption Sector (q/q, in %, ann.)



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



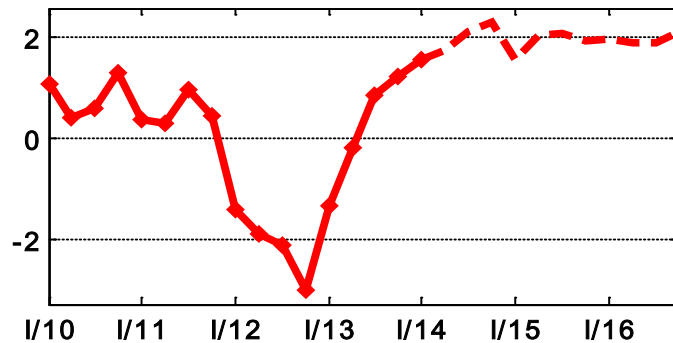
- Domestic inflationary pressures will be building up in coming quarters, reflecting pronounced revival of both domestic and foreign demand.
- Current inflationary effects of import prices will be fading away as a result of subdued growth of foreign PPI and stable nominal exchange rate.
- Increasing wages and costs of capital will be driving the growth of marginal costs in the intermediate sector partly offset by curbing effects of productivity gains.



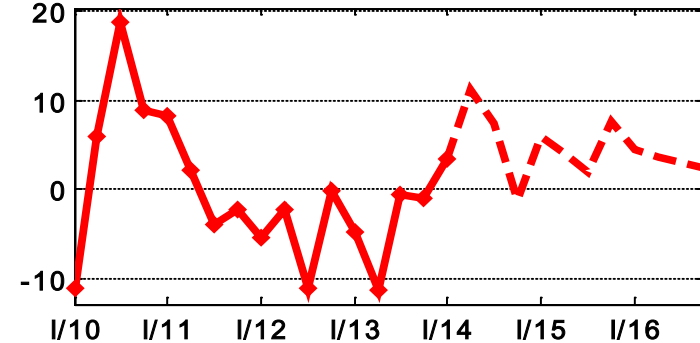
- GDP growth forecast: roughly 3% a year over 2014-2016.
- Swift economic growth will be supported by growing foreign demand, relaxed domestic monetary conditions and increased government investment.
- Volatility of quarterly y-o-y figures mainly as a result of frontloading of cigarettes.



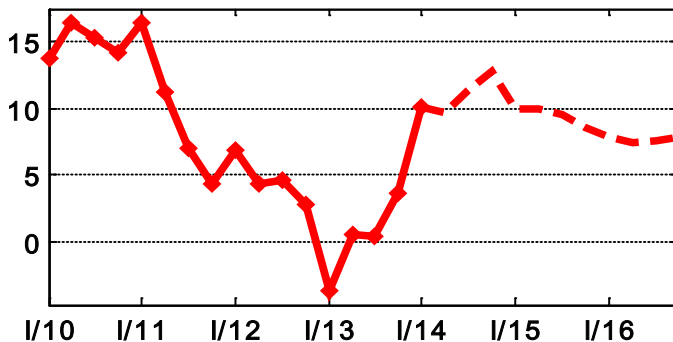
### Household Consumption Growth (y/y, in %)



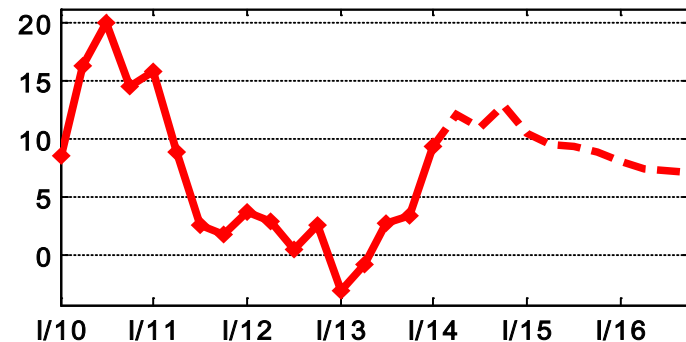
### Investments Growth (y/y, in %)



### Exports Growth (y/y, in %)

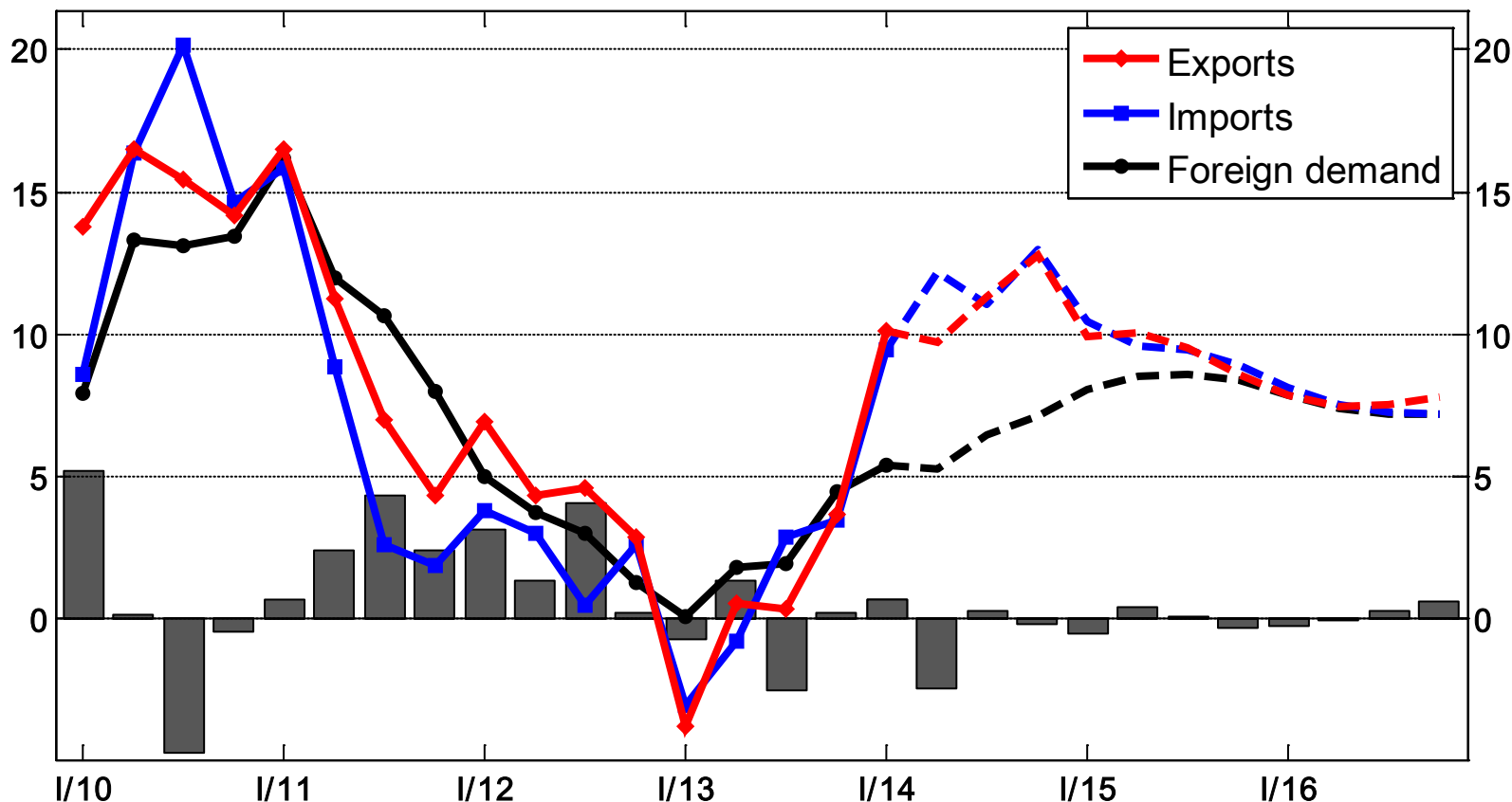


### Imports Growth (y/y, in %)

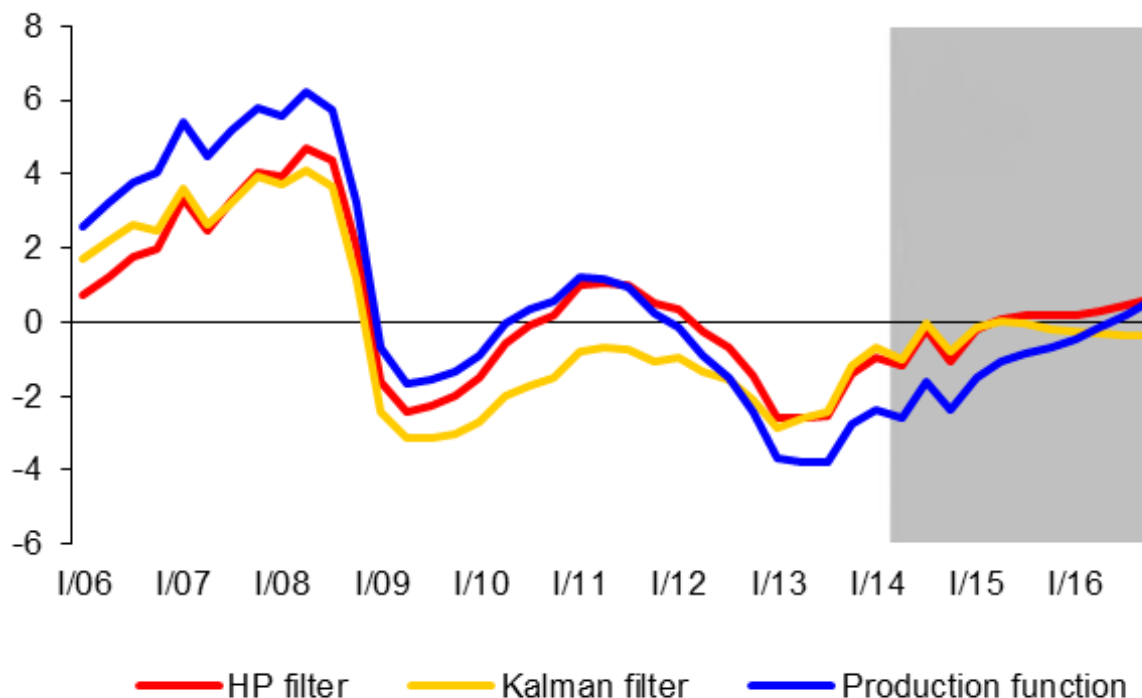


- Household consumption will be growing at a robust pace of approximately 2% on the whole forecast horizon.
- Investment recovery will be influenced by strong growth of public investment financed from both domestic and EU sources (+ frontloading of cigarettes).
- Robust but slightly decelerating growth of both exports and imports in 2015-2016.

Foreign trade (y/y, in %)

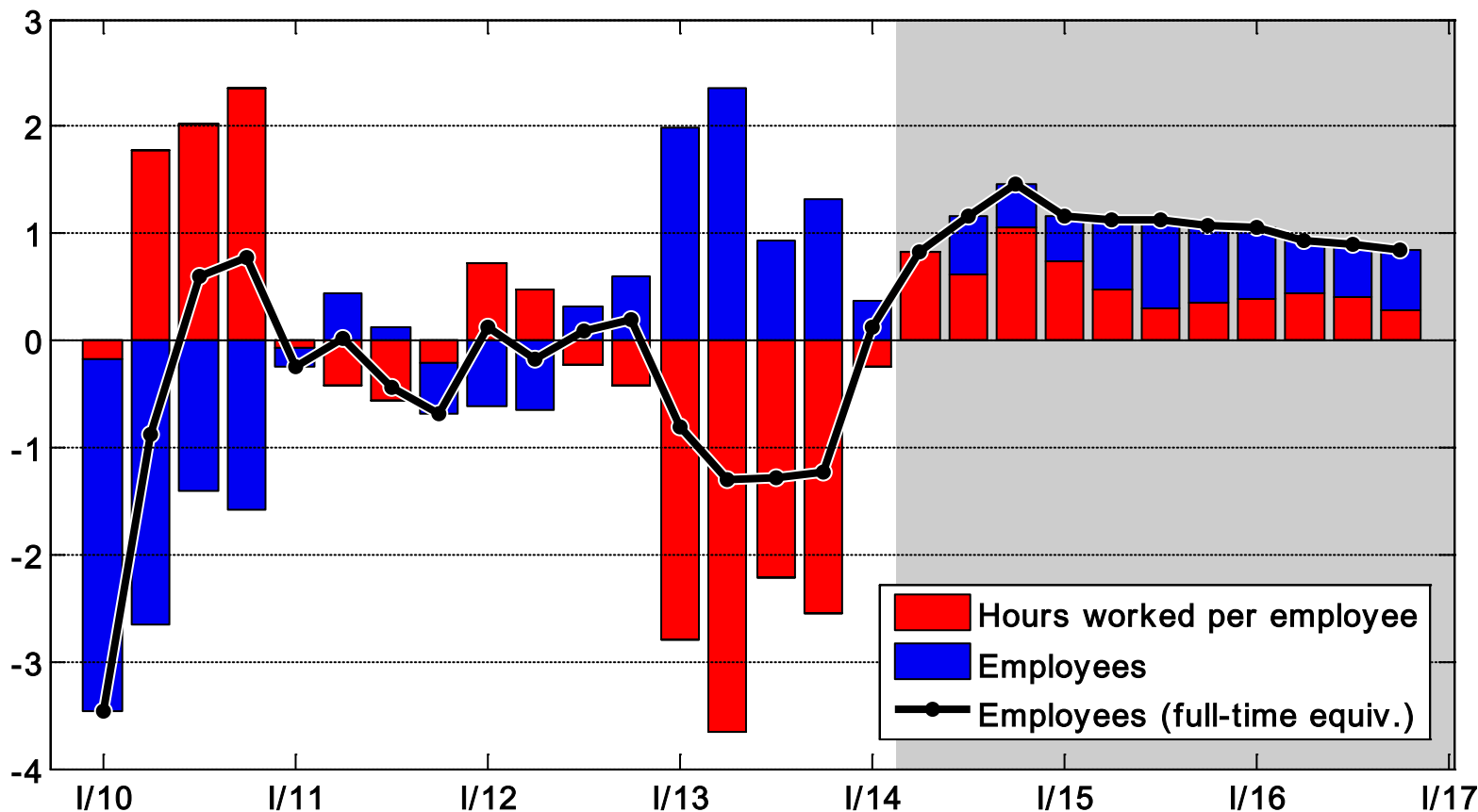


- The pace of export growth significantly exceeds the growth of foreign demand, mainly as a result of depreciated real exchange rate (improved price competitiveness). This positive real exchange rate effect on export growth dynamics will evaporate over the forecast horizon.
- Imports will follow the dynamics of exports, as well as growing domestic demand. 18



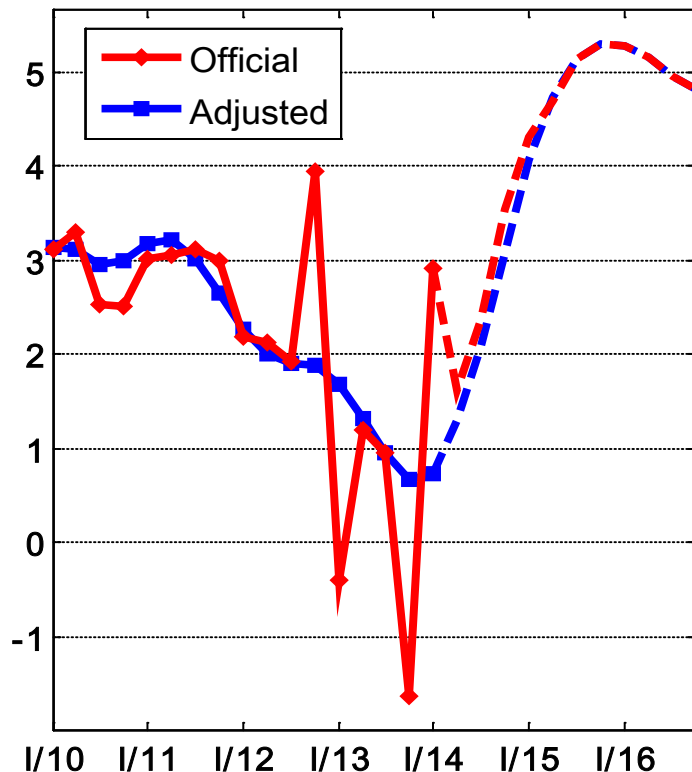
- Output gap narrowed but remained negative in the first quarter of 2014, as implied by all estimation methods.
- All methods imply that the output gap will get closed at the forecast horizon.
- Potential GDP growth will accelerate somewhat from its current level of 1-1.5%.

Employees - full time equivalent (y/y, in %, s.a.)

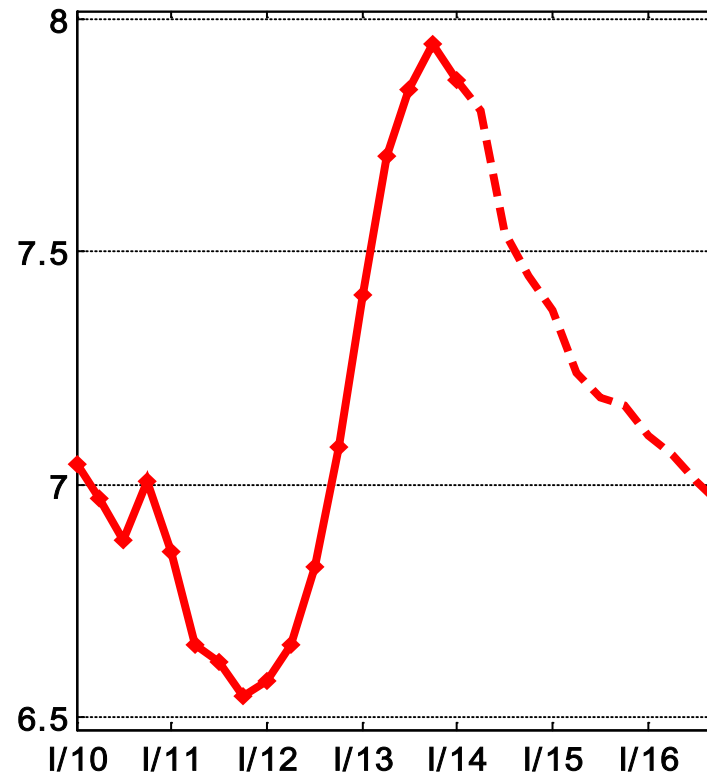


- Employment growth expressed in full-time job equivalent turned positive in 1.Q 2014. Further acceleration in the rest of this year will be primarily a result of increases in hours worked per employee amid continued gradual growth in the number of employees.

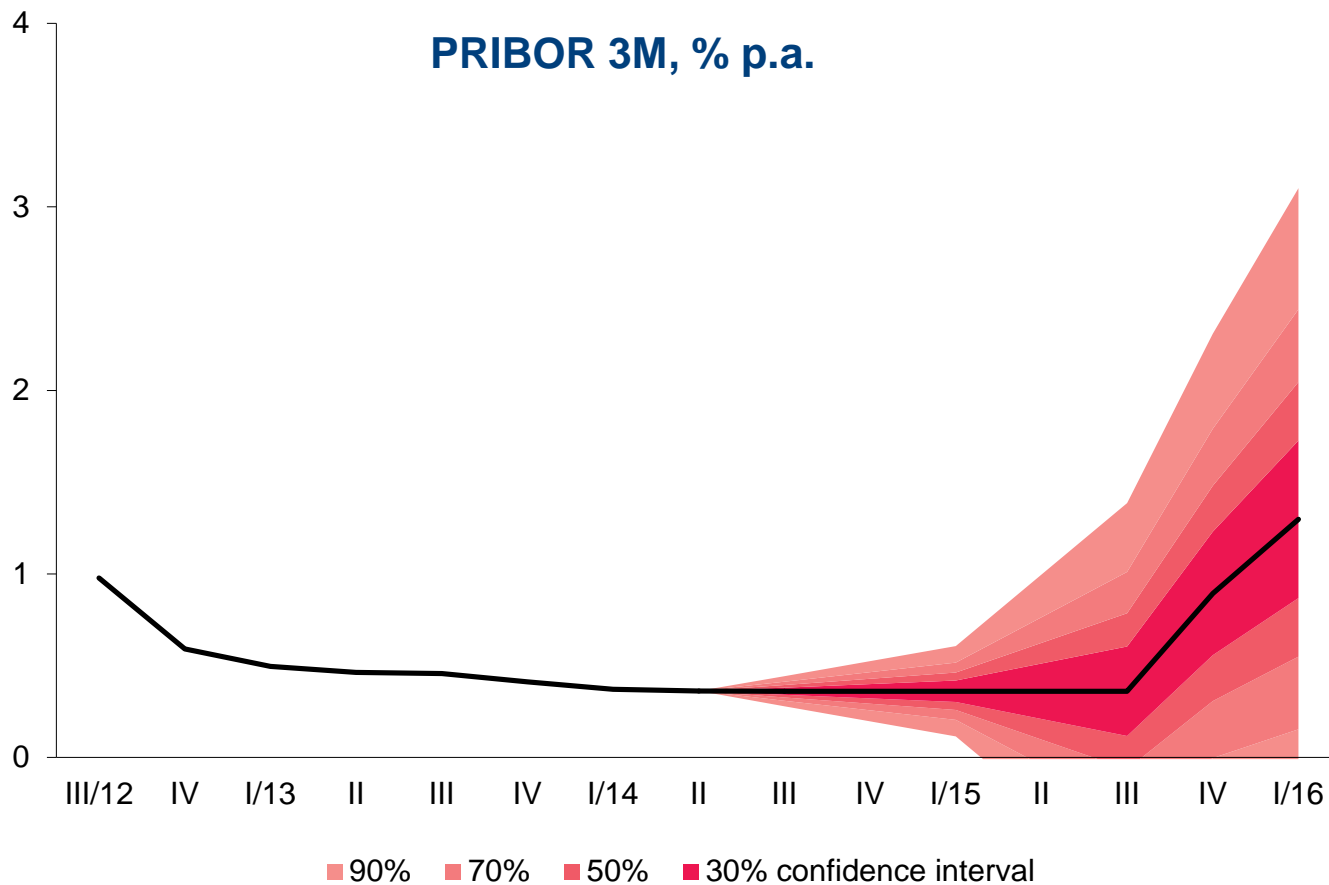
Nominal wage growth in business sector  
(y/y, in %, s.a.)



Share of unemployed persons  
(in %, s.a.)



- Nominal wage growth in business sector has until recently been significantly affected by tax optimization from late 2012. Starting the second half of 2014 the growth will steadily accelerate due to pronounced growth of economic activity.
- Share of unemployed persons will continue to decline over the forecast horizon.

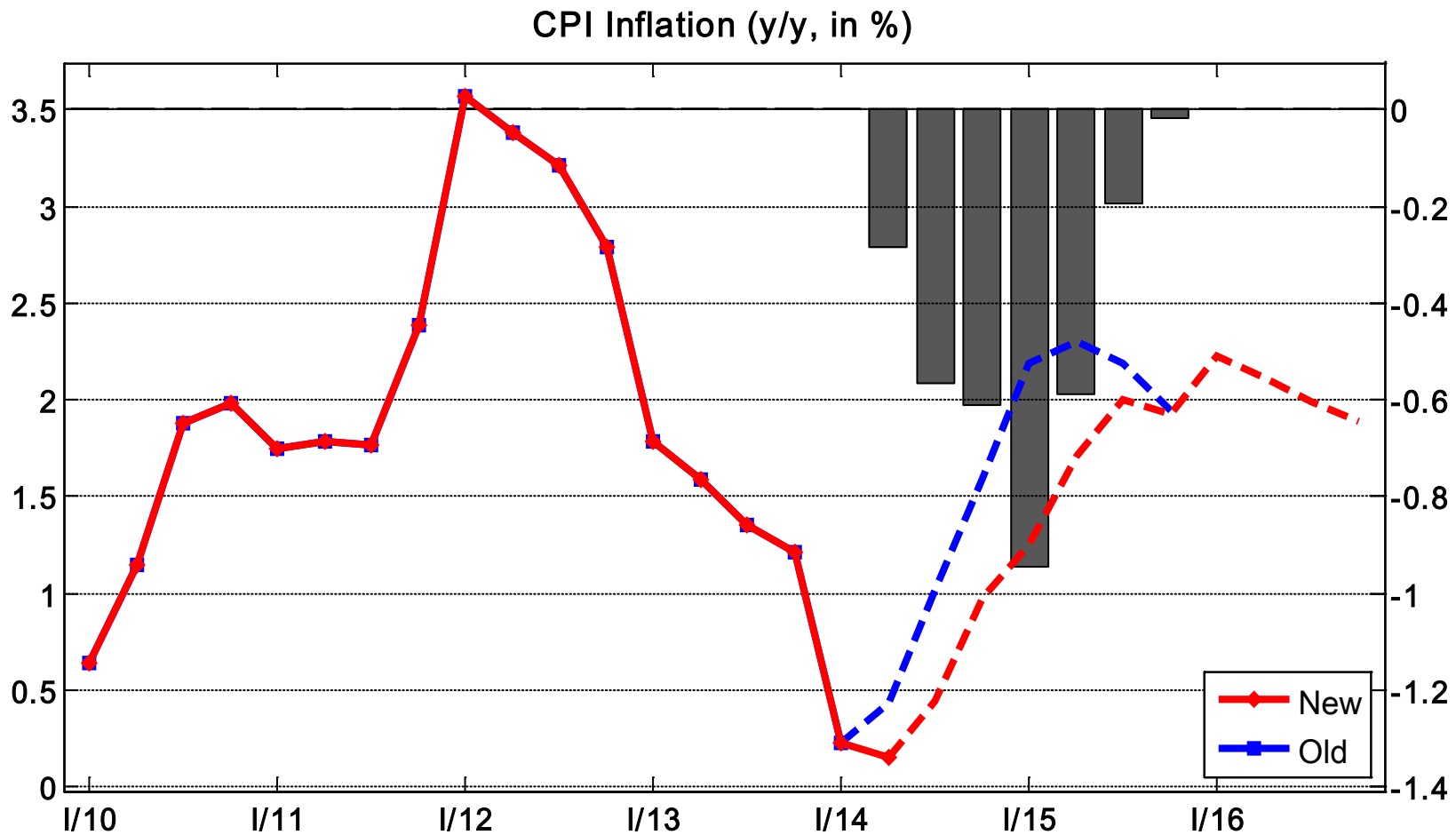


- The forecast assumes the use of exchange rate as a monetary policy instrument until the third quarter of 2015.
- Market interest rates are supposed to be flat at their current very low level until the third quarter of 2015, followed by an increase in market rates by about 0.5 percentage point in the rest of 2015 and their further growth in 2016.

- Assumptions of the forecast
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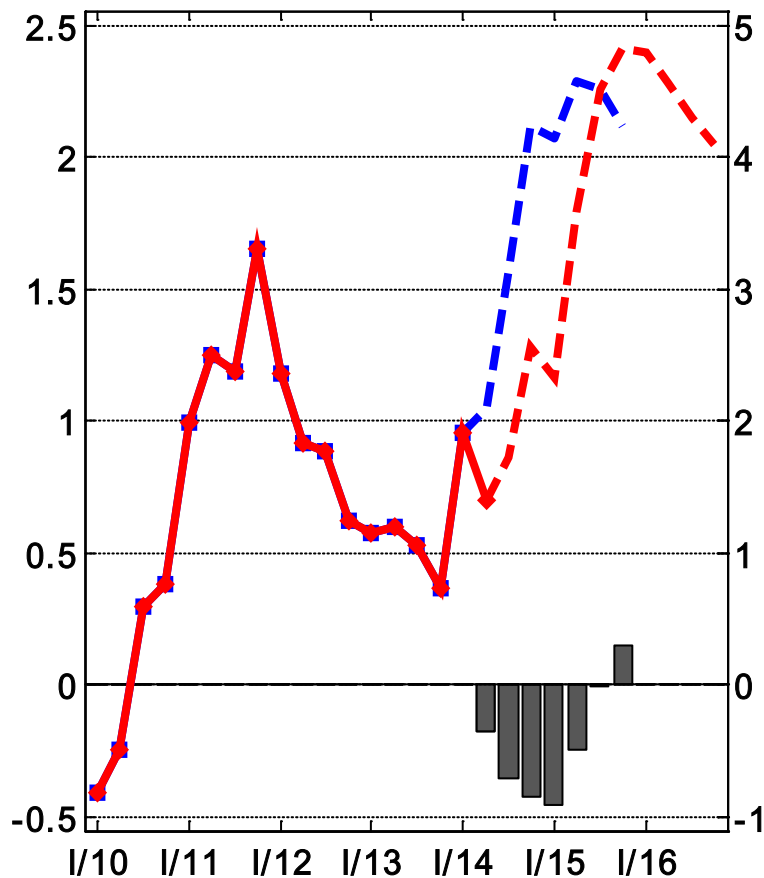
- Outlook for headline as well as monetary policy-relevant inflation shifted downwards compared to previous forecast owing to a lower outlook for both administered prices and net inflation.
- GDP growth has been revised upwards in 2014 as a result of faster recovery of investments and higher consumption. On the other hand, in 2015 GDP will grow at a slower pace compared to previous forecast due to somewhat less (but still) expansionary impact of fiscal policy than in previous assumptions.
- Outlook for nominal wages growth is higher, reflecting the more pronounced growth of wages in the beginning of this year and better prospect for domestic economic activity.
- Decreased trajectory of interest rates mainly reflects more anti-inflationary external environment, lower domestic administered prices, and corresponding shift of assumed exit from the current monetary policy regime to more distant future.



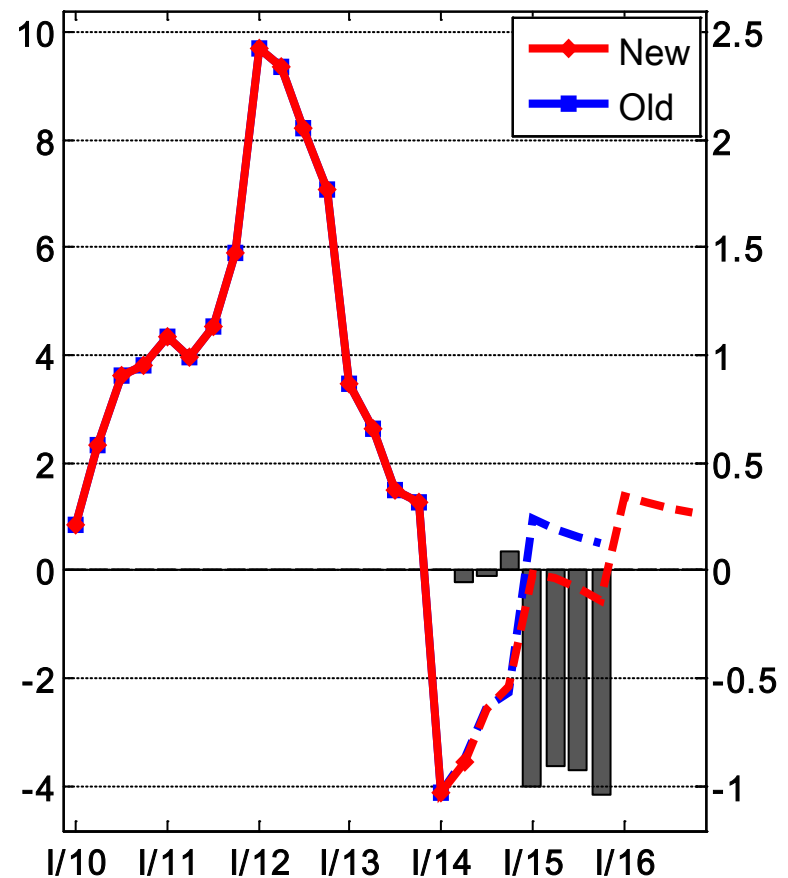


- The inflation forecast significantly lowered until the mid 2015.
- Similar shift in the outlook for monetary-policy relevant inflation.

## Net Inflation (y/y, in %)

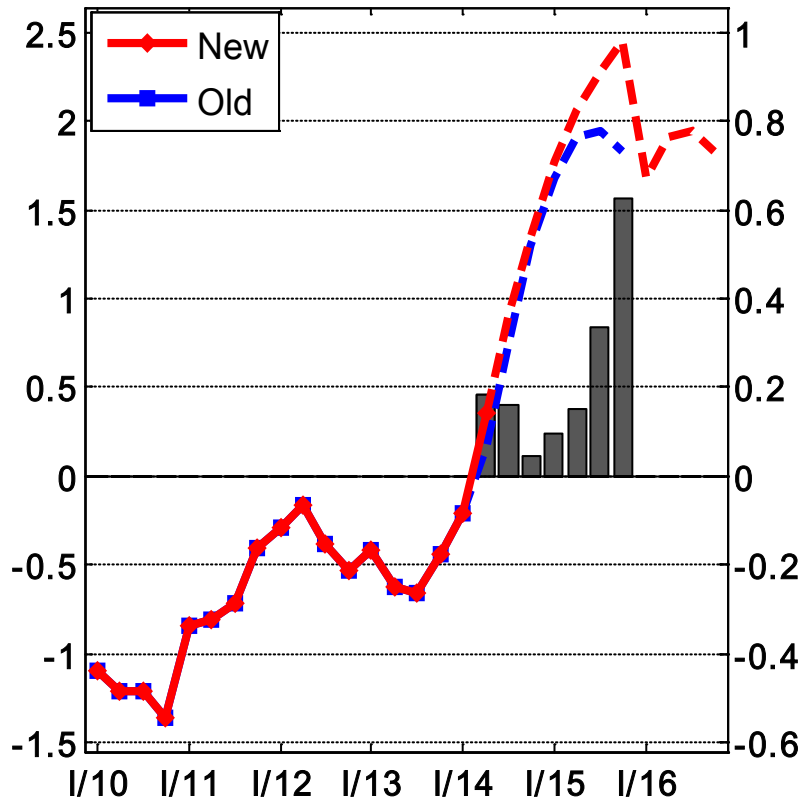


## Growth of Administered Prices (y/y, in %)

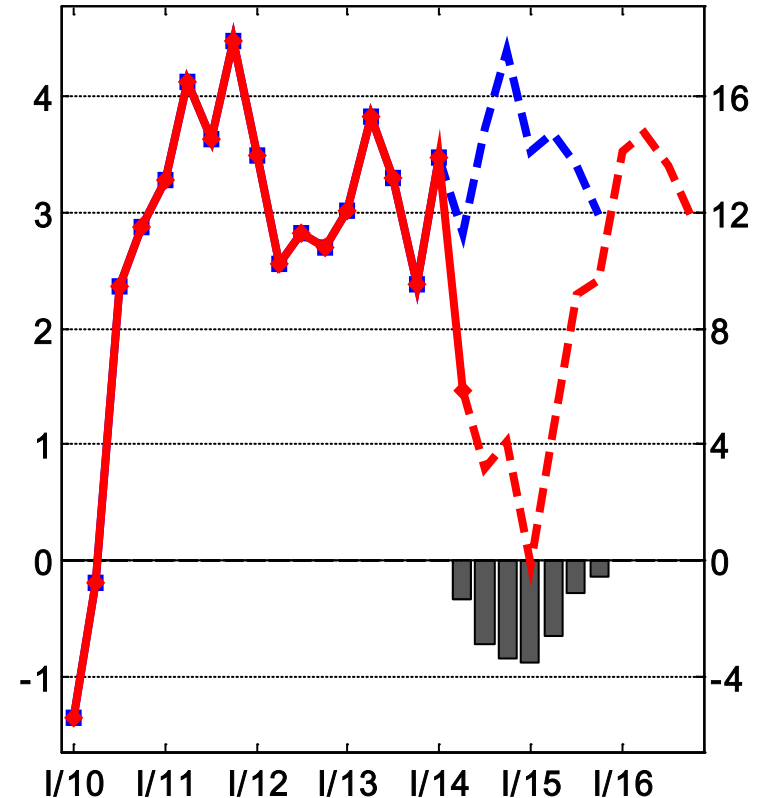


- Net inflation down: strong downward shift of foreign PPI, lower than expected food price growth.
- Administered prices: negligible differences in 2014, in 2015 downward revision reflecting the planned abolition of most health care co-payments.

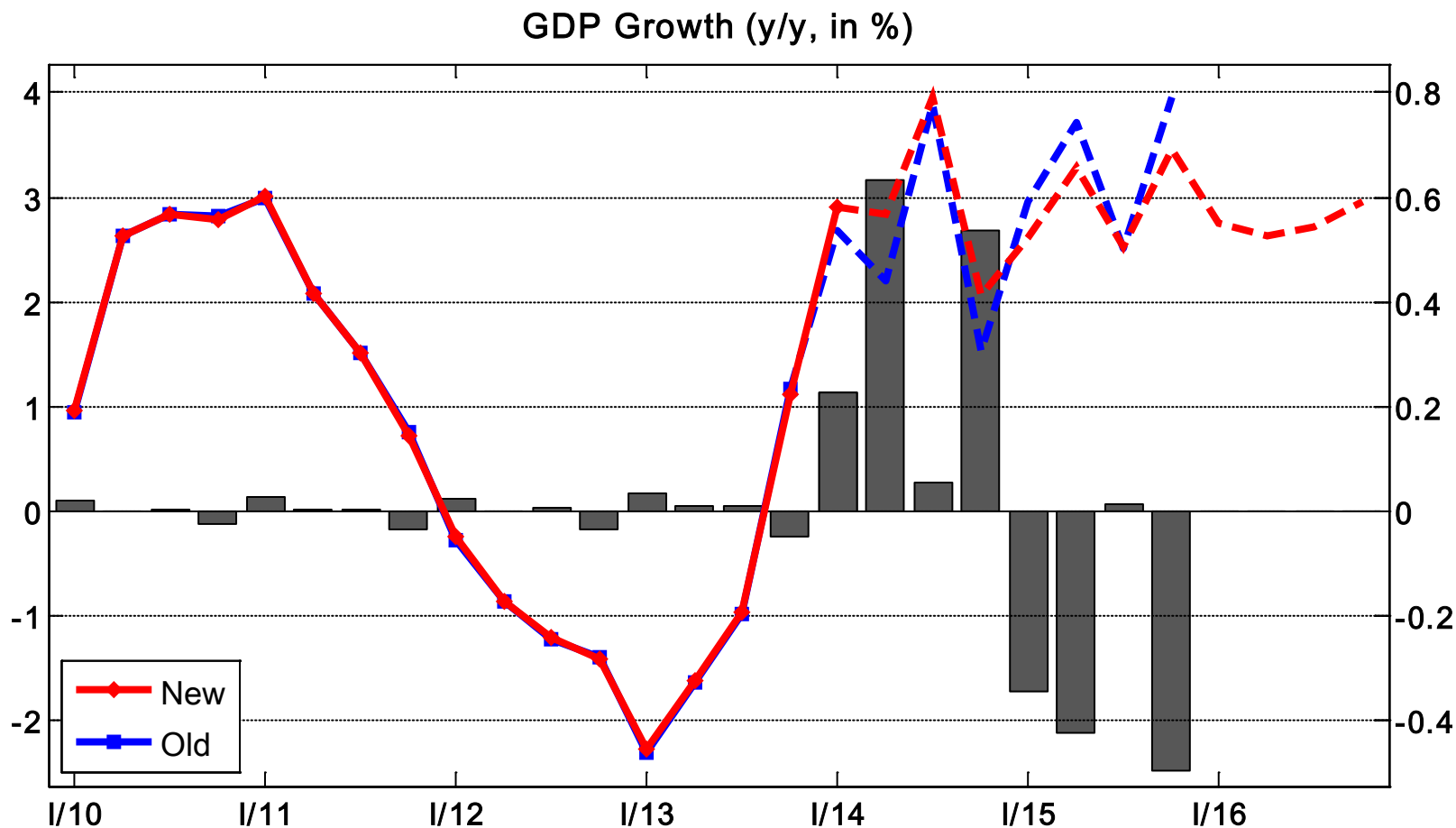
**Adjusted Inflation Excl. Fuels**  
(y/y, in %, Excl. Tax Changes)



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



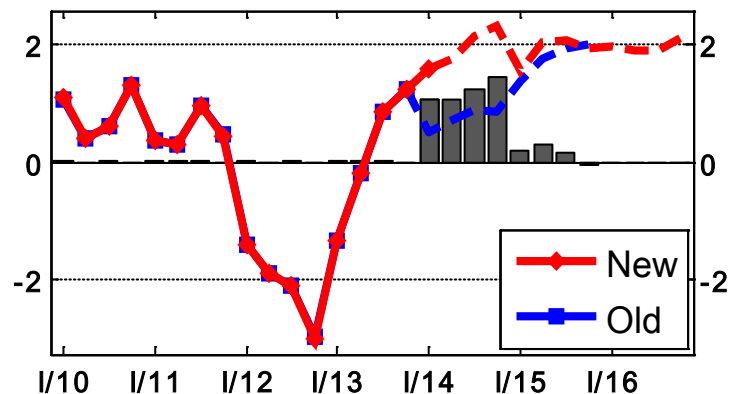
- Higher forecast of "core" inflation due to faster economic and wage growth and weaker exchange rate.
- The food price outlook is lower reflecting the surprise in observed data for 2.Q 2014 and downward revision of the outlook for agricultural prices.



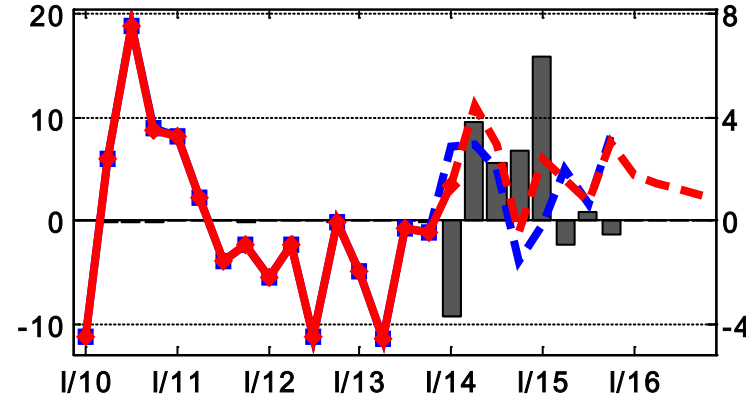
- GDP forecast has been revised upwards in 2014, mainly as a result of higher expected investment activity and household consumption.
- Slight downward revision in GDP growth in 2015 (less expansionary fiscal policy).

# Comparison with Previous GDP Forecast (ii)

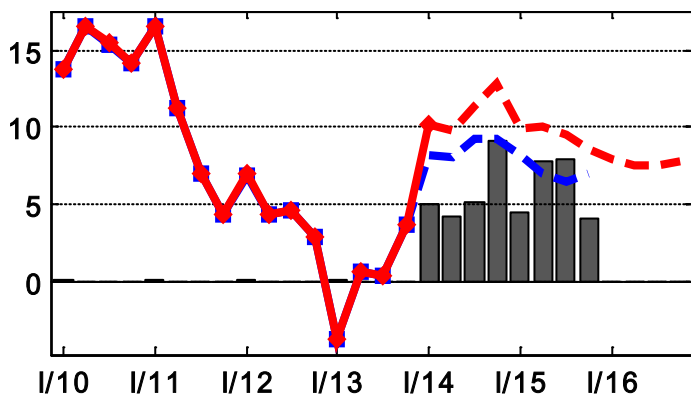
### Household Consumption Growth (y/y, in %)



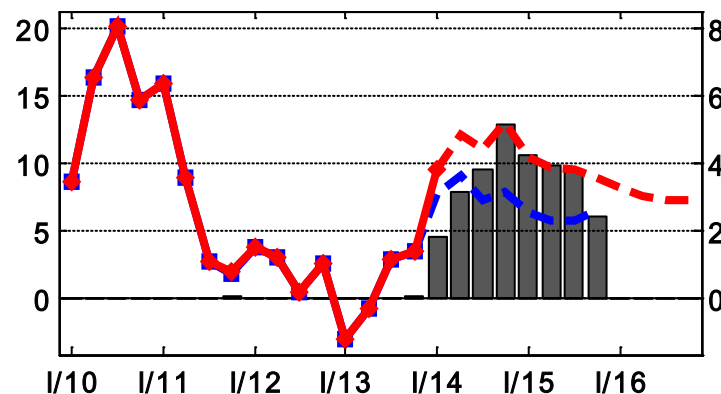
### Investments Growth (y/y, in %)



### Exports Growth (y/y, in %)

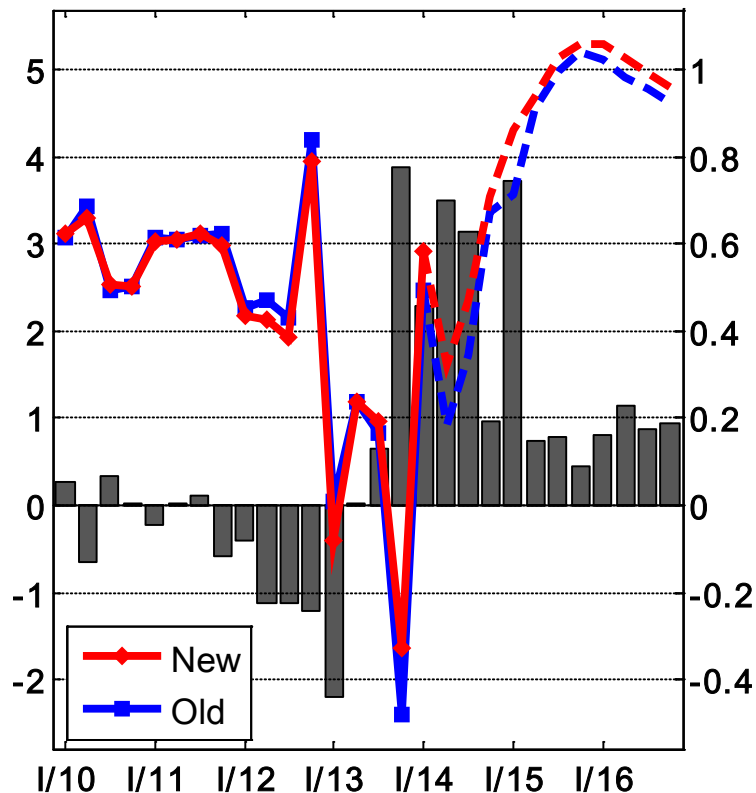


### Imports Growth (y/y, in %)

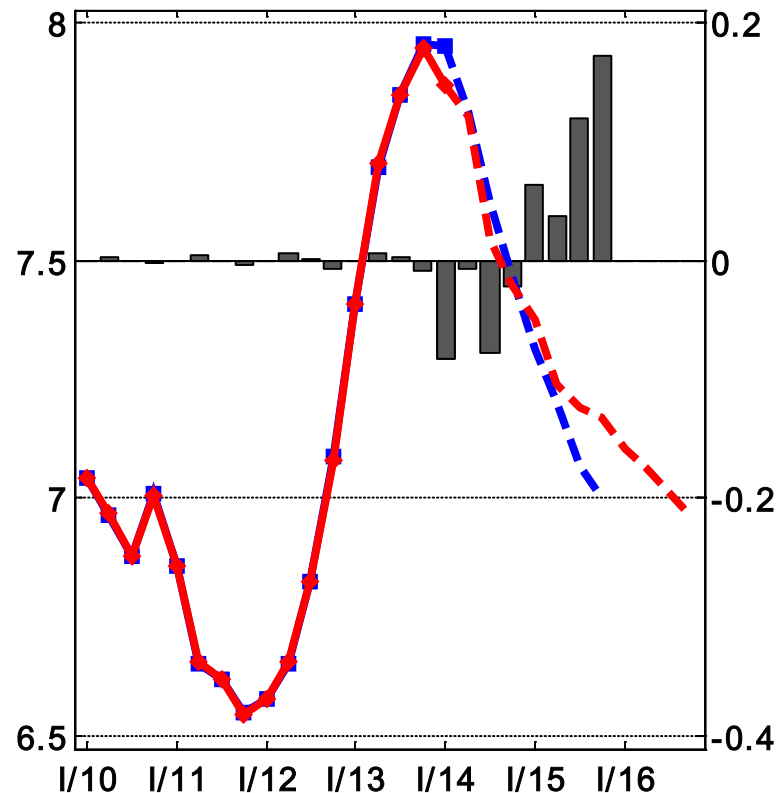


- Stronger consumption growth due to higher growth in wages together with higher investments (revised upwards in the private sector).
- Slightly smaller contribution of net exports to GDP growth (higher growth of exports vs. higher domestic demand for imported goods).

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

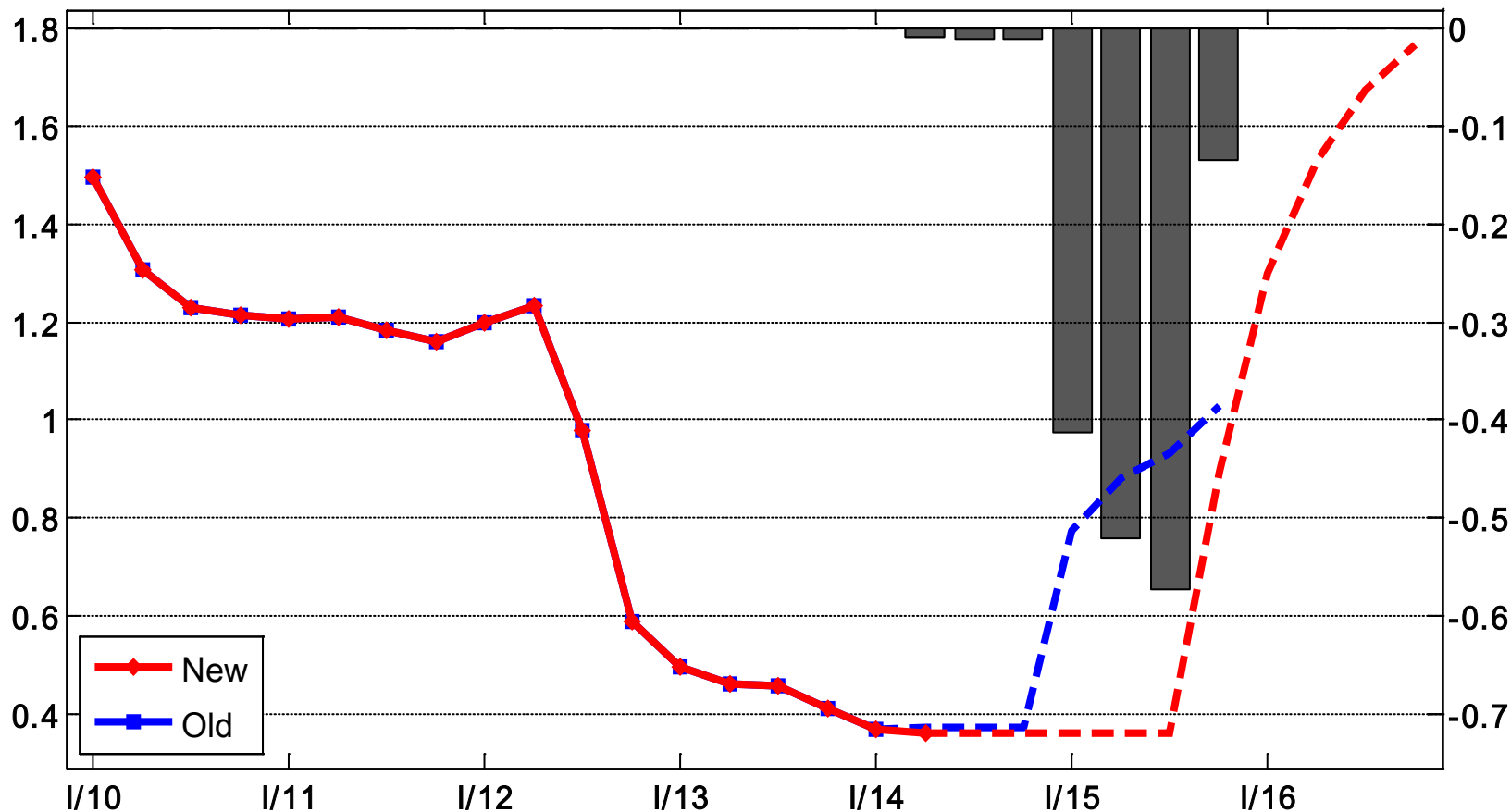


Share of unemployed persons  
(in %, s.a.)



- The wage growth outlook has been revised slightly upwards for 2014 due to higher current observed values and faster economic growth.
- In the short term, the share of unemployed persons will decline a bit more quickly due to better economic outlook.

3M PRIBOR (% , p.a.)



- Interest rate path consistent with the forecast shifted downwards for 2015 due to later assumed discontinuation of the use of the exchange rate as a monetary policy instrument. The shift is given by lower outlook for both foreign PPI and interest rates, as well as domestic regulated prices.

Thank you for your attention!

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