

Meeting with Analysts

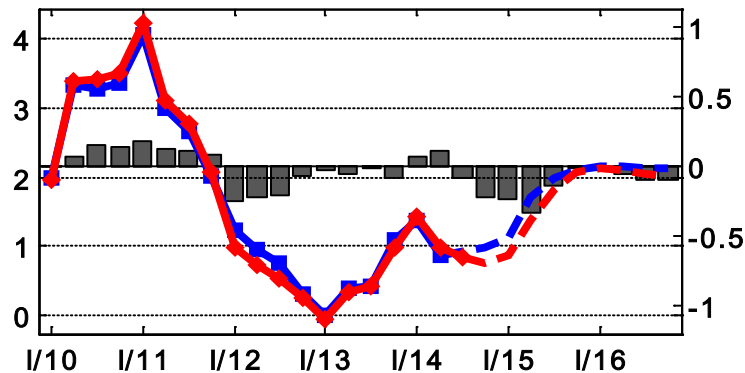
Tomáš Holub

Prague, 6 February, 2015

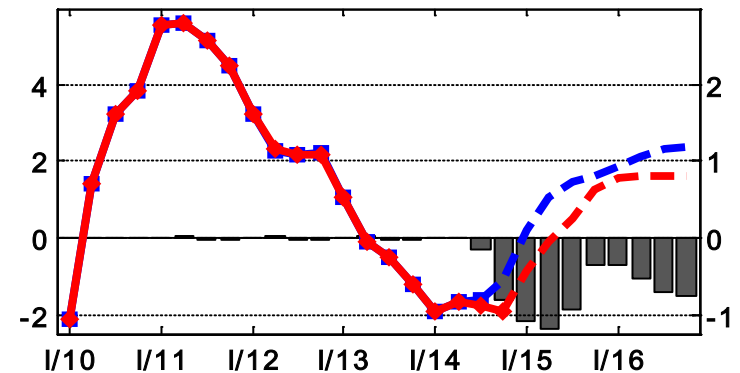
- Assumptions of the forecast
- The new macroeconomic forecast
- Comparison with the previous forecast
- Assessing the impacts of low oil prices

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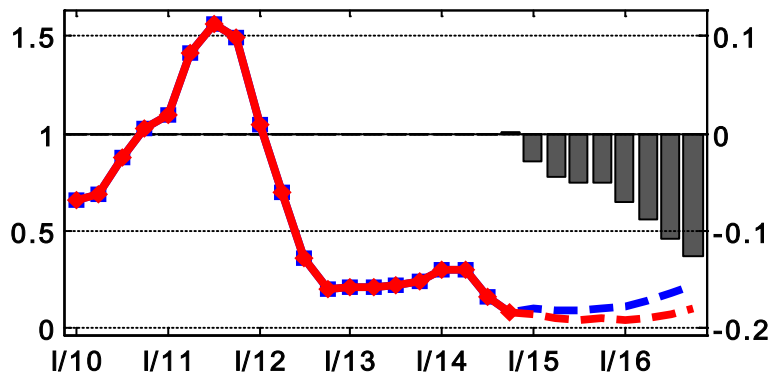
Growth Rate of GDP - Eurozone (y/y, in %)



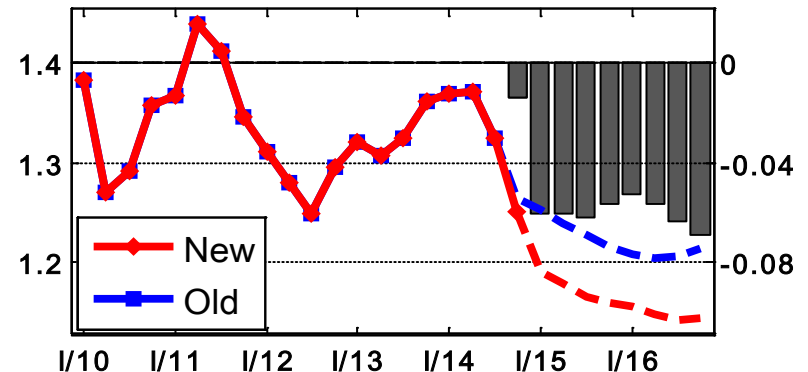
PPI Inflation - Eurozone (y/y, in %)



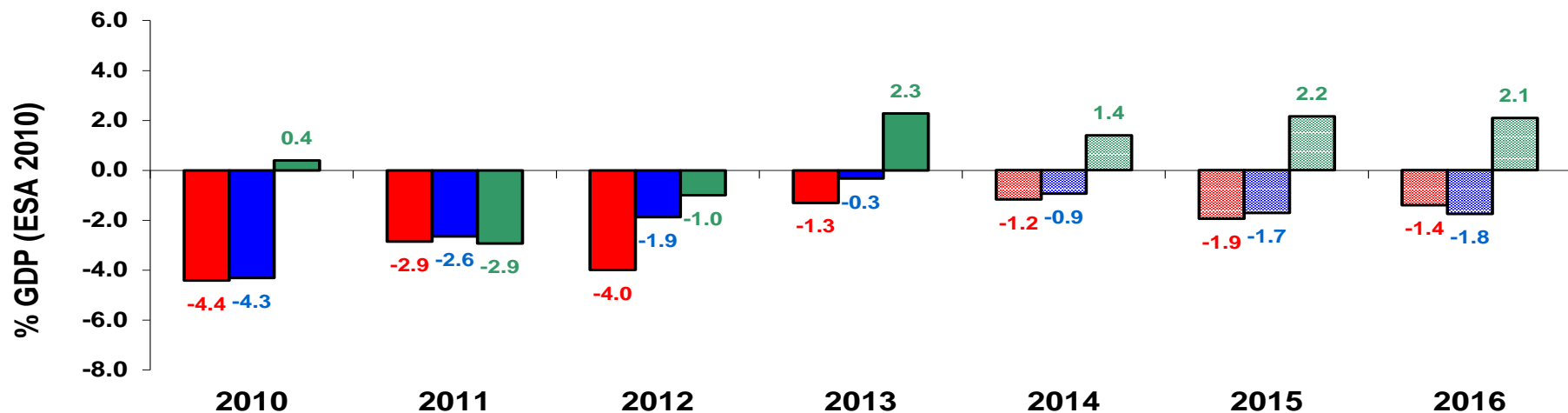
3M EURIBOR



USD/EUR



- External demand growth is expected to pick up this year and the next.
- The slump in energy commodity prices coupled with only sluggish growth in economic activity is reflected in currently falling industrial producer prices (as well as CPI), which will not start rising until the second half of this year.
- 3M EURIBOR and EUR/USD reflect the ECB's easing measures.



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

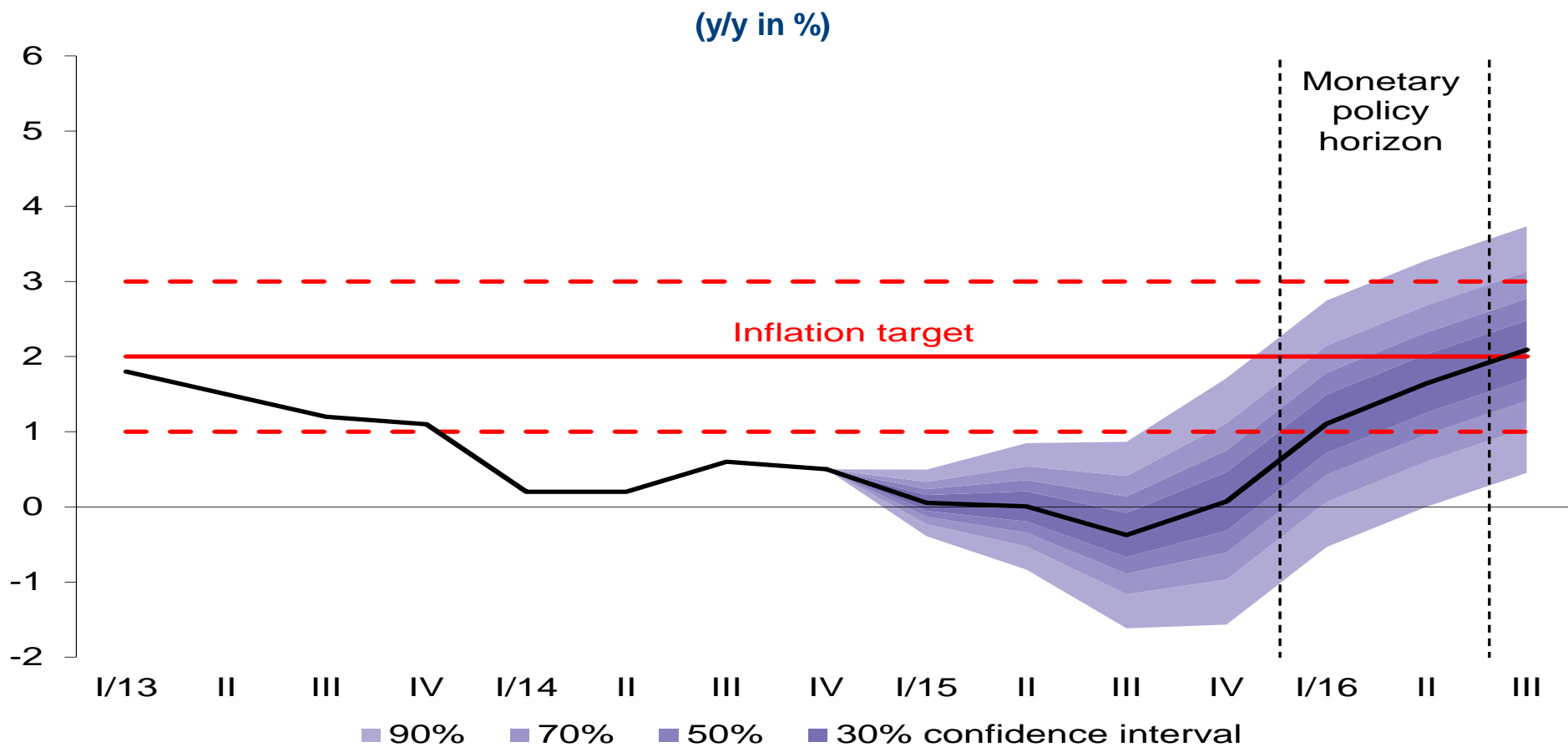
- **2014:** deficit broadly stable at 1.2 % of GDP (revival of public investment and current spending vs. growing economic activity and extraordinary revenues from an auction of frequency bands to mobile operators).
- **2015:** increase of the deficit to 1.9 % of GDP (abolition of health care fees, a new 10 % reduced VAT rate, growing pensions, increase in public wages, culminating public investment financed by both EU funds and domestic sources, etc.).
- **2016:** decline of the deficit to 1.4 % of GDP (continuing economic growth, lower public investment due to the EU funds' cycle).
- **Fiscal impulse:** +0.2 p.p. in 2014, +0.5 p.p. in 2015 and -0.3 p.p. in 2016.

- The forecast expects market interest rates to be flat at their current very low level until end of 2016, i.e. over the entire forecast horizon.
- The short-term forecast for the exchange rate of the koruna against the euro in 2015 Q1 takes into account its depreciation in the first half of January. It is expected to be stable in the following quarters at a similar level to that observed last year, slightly weaker than the announced asymmetric exchange rate commitment (i.e. CZK 27 to the euro). The forecast expects the exchange rate to be used as a monetary policy instrument until the end of 2016, i.e. over the entire forecast horizon.
- The return to conventional monetary policy will not result in the exchange rate appreciating to the level recorded before the CNB started intervening, as the weaker exchange rate of the koruna has in the meantime been passing through to the price level and other nominal variables.

- Assumptions of the forecast
- The new macroeconomic forecast
- Comparison with the previous forecast
- Assessing the impacts of low oil prices

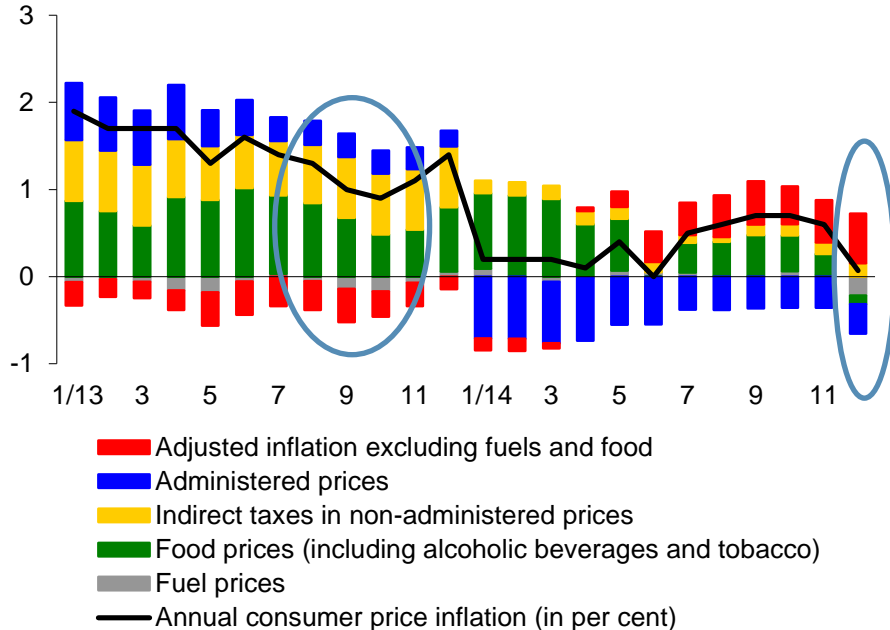
- Both headline and monetary policy-relevant inflation will be at zero or slightly negative levels in 2015. In 2016, they will rise to the CNB's 2% target as the year-on-year fall in oil prices and the deflationary tendencies in the euro area dissipate, while the domestic economy will have an ongoing upward effect on the price level.
- The overall upward pressures on consumer prices will almost disappear in the near term, as a decline in producer prices in the euro area coupled with a fall in global prices of energy commodities will result in a substantial decrease in costs stemming from import prices. The anti-inflationary effect of import prices will subside at the start of 2016.
- By contrast, continued growth in domestic economic activity and gradually accelerating wage growth will foster higher prices over the entire forecast horizon.

- Accelerating external demand, low oil prices, easy domestic monetary conditions via the weakened koruna and exceptionally low interest rates, and expansionary fiscal policy will lead to GDP growth of 2.6% in 2015. Economic growth will accelerate to 3% next year despite falling government investment, thanks mainly to a further pick-up in external demand growth.
- The rising economic activity is manifesting itself in the labour market in growth in the number of employees converted into full-time equivalents. This growth will continue over the forecast horizon. The unemployment rate will continue to decrease gradually. Wage growth in the business sector will increase, and the same will apply to wages in the non-business sector this year.

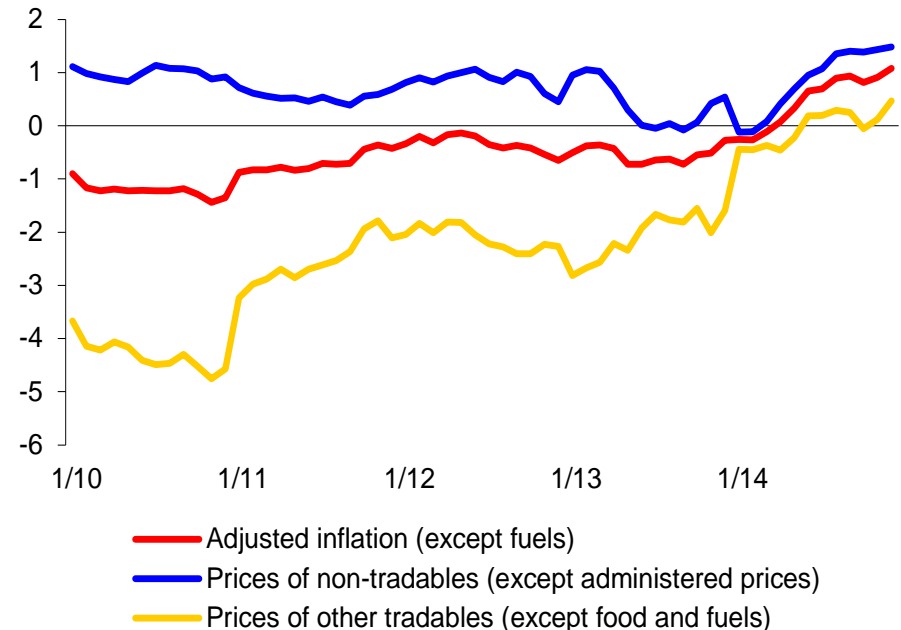


- Headline inflation will be at zero or slightly negative levels in 2015, reflecting the sharp fall in global energy prices and deflationary tendencies in the euro area.
- It will then rise to the 2% target in 2016, due to unwinding of the imported deflationary pressures and ongoing growth of the domestic economy and wages.

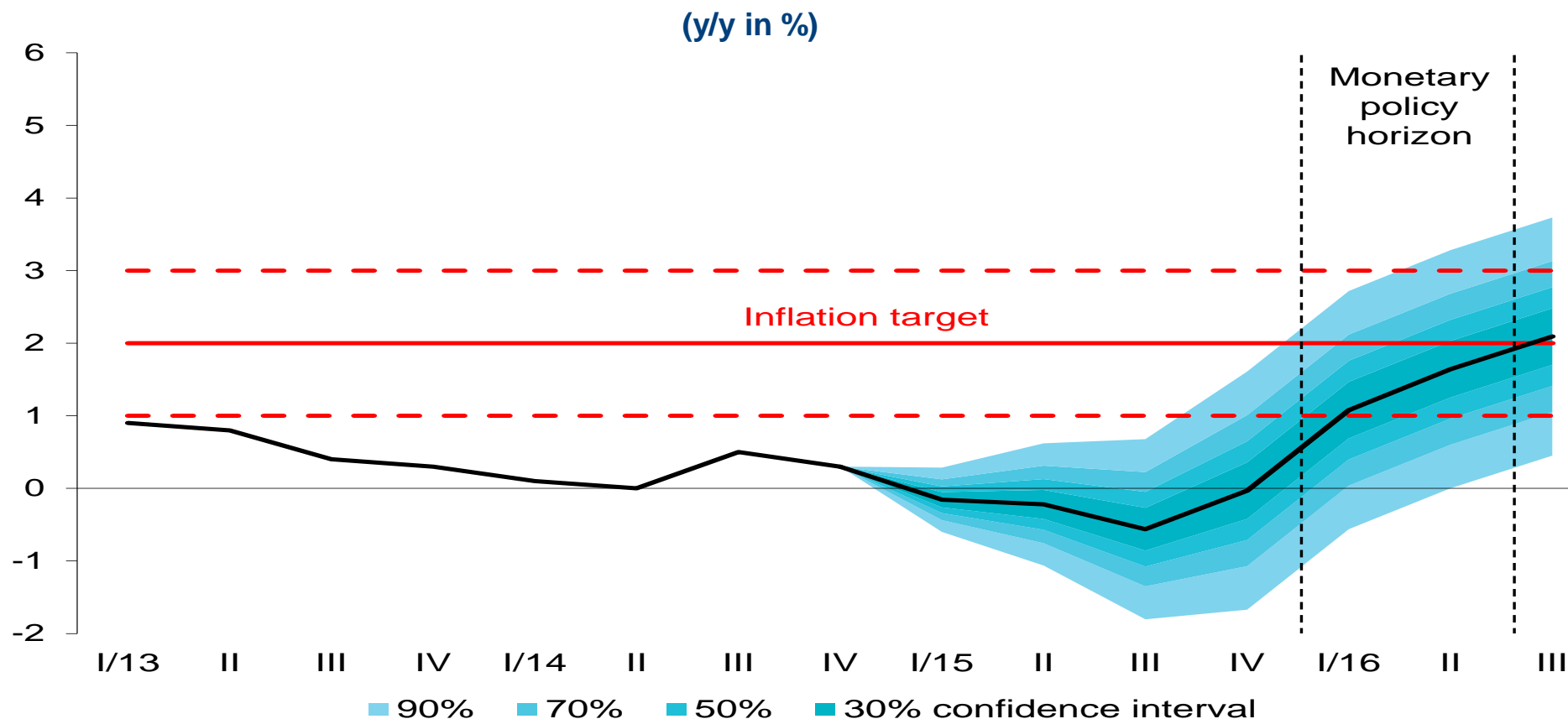
Structure of inflation (in p.p.)



Core inflation and its components (in %)

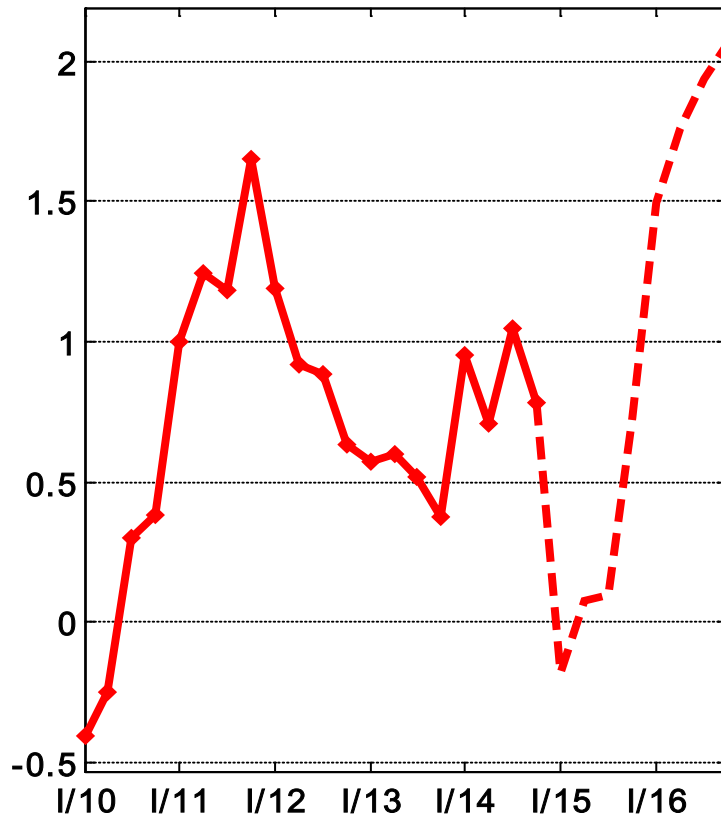


- Headline inflation decreased to 0.1% in December. Administered prices continued falling year on year and fuel and food prices also started to decrease.
- On the other hand, adjusted inflation excluding fuels rose slightly, supported by both its components. Its increase has been reflecting the weakened koruna, the growth in the domestic economy and wage growth.
- The structure of inflation is thus much different from late 2013.

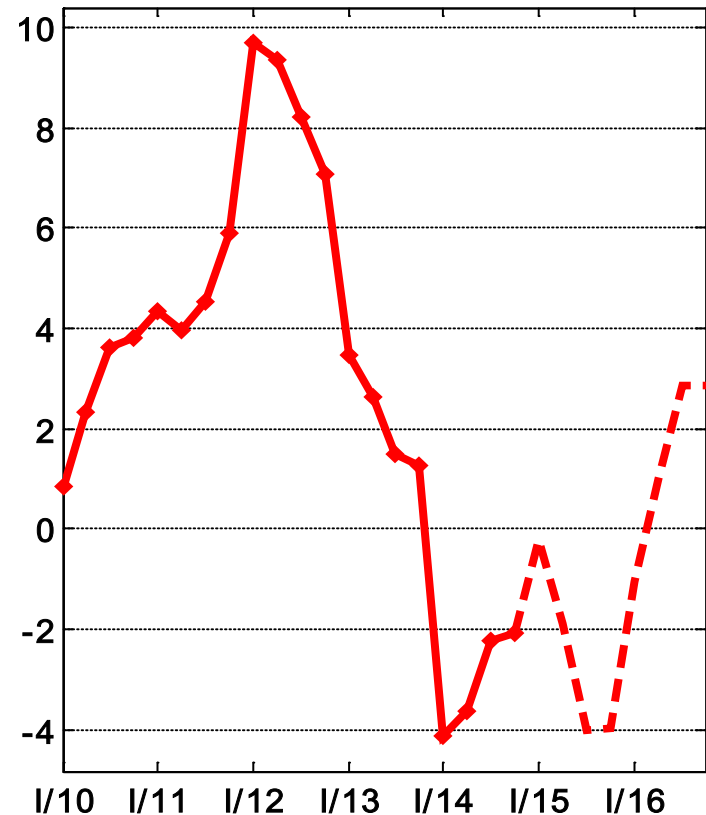


- Monetary policy-relevant inflation will follow a similar path to headline inflation, although until the end of 2015 it will be slightly lower, i.e. negative, owing to positive first-round effects of changes to indirect taxes.
- In 2016 it will be the same as headline inflation, i.e. it will rise to the 2% target at the end of the monetary policy horizon.

Net Inflation (y/y, in %)



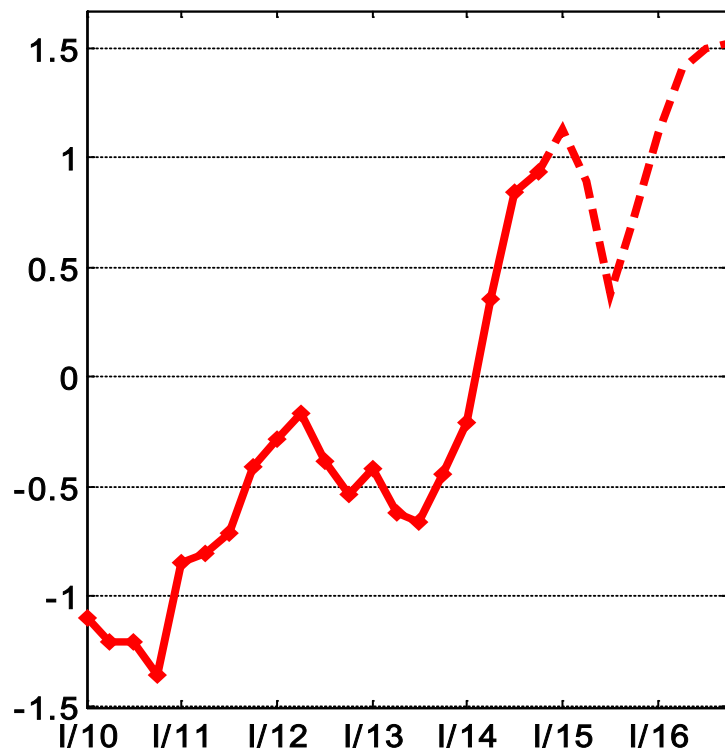
Growth of Administered Prices (y/y, in %)



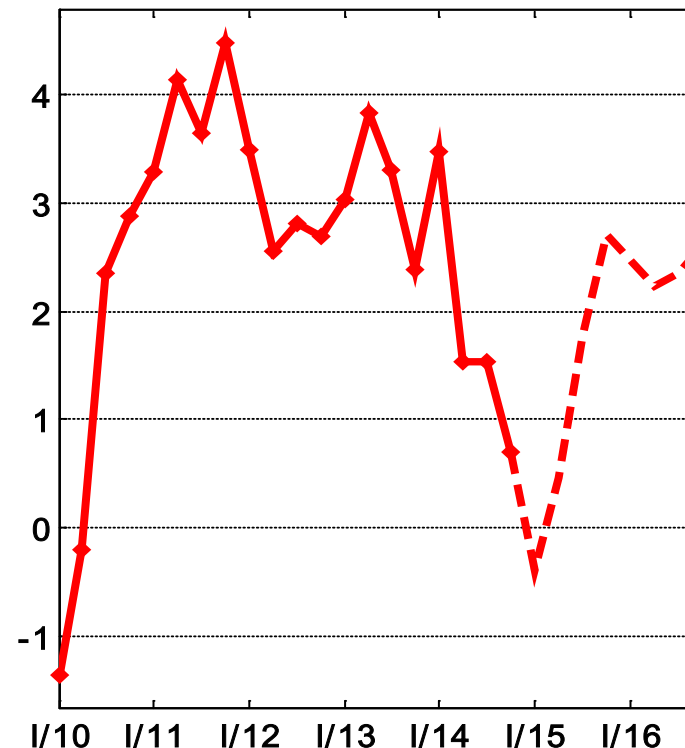
- Net inflation will turn negative at the start of 2015 due to a sharp fall in fuel prices and a temporary decline in food prices. It will increase again in the rest of 2015 and will stand at about 2% in 2016 H2.
- The decline in administered prices will almost halt temporarily at the start of 2015, but will then accelerate again owing to an expected fall in prices of natural gas.

Adjusted Inflation Excluding Fuels and Food

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

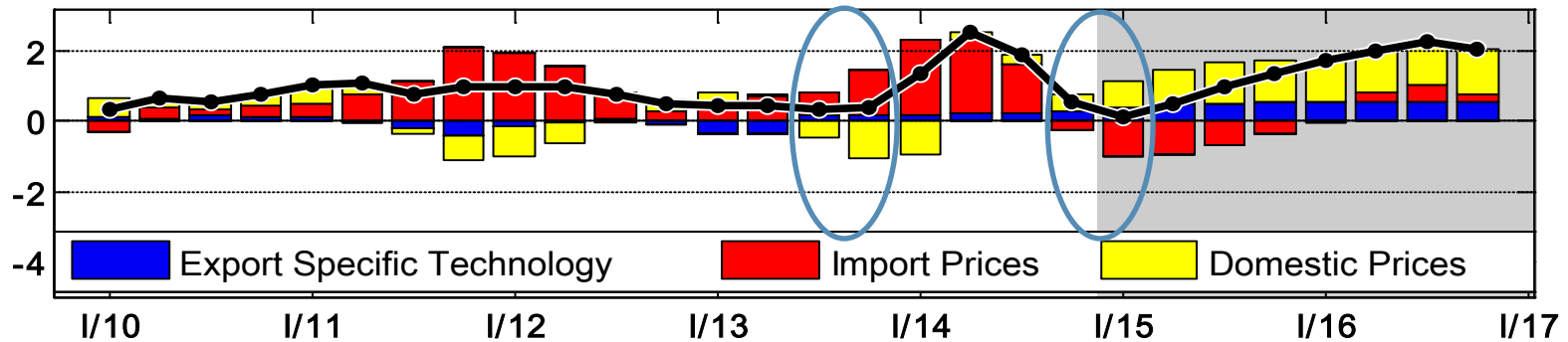


Food Inflation
(y/y, in %, Excl. Tax Changes)

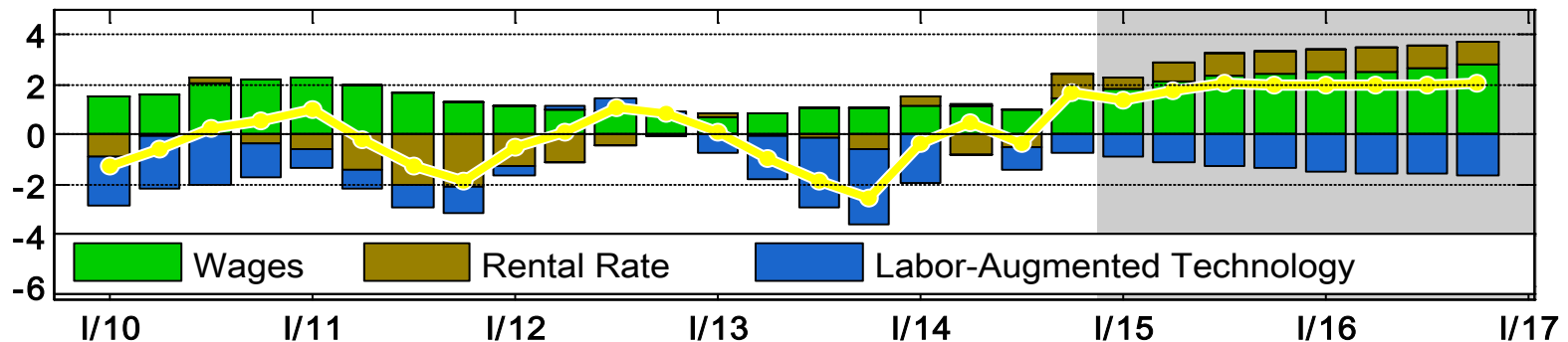


- Core inflation will decrease temporarily as a result of the unwinding of the direct effect of the weakened exchange rate and still very subdued inflation abroad. It will then speed up and reach roughly 1.5% in 2016 H2.
- Food prices are expected to decrease temporarily at the beginning of 2015, reflecting a longer-lasting fall in agricultural producer prices.

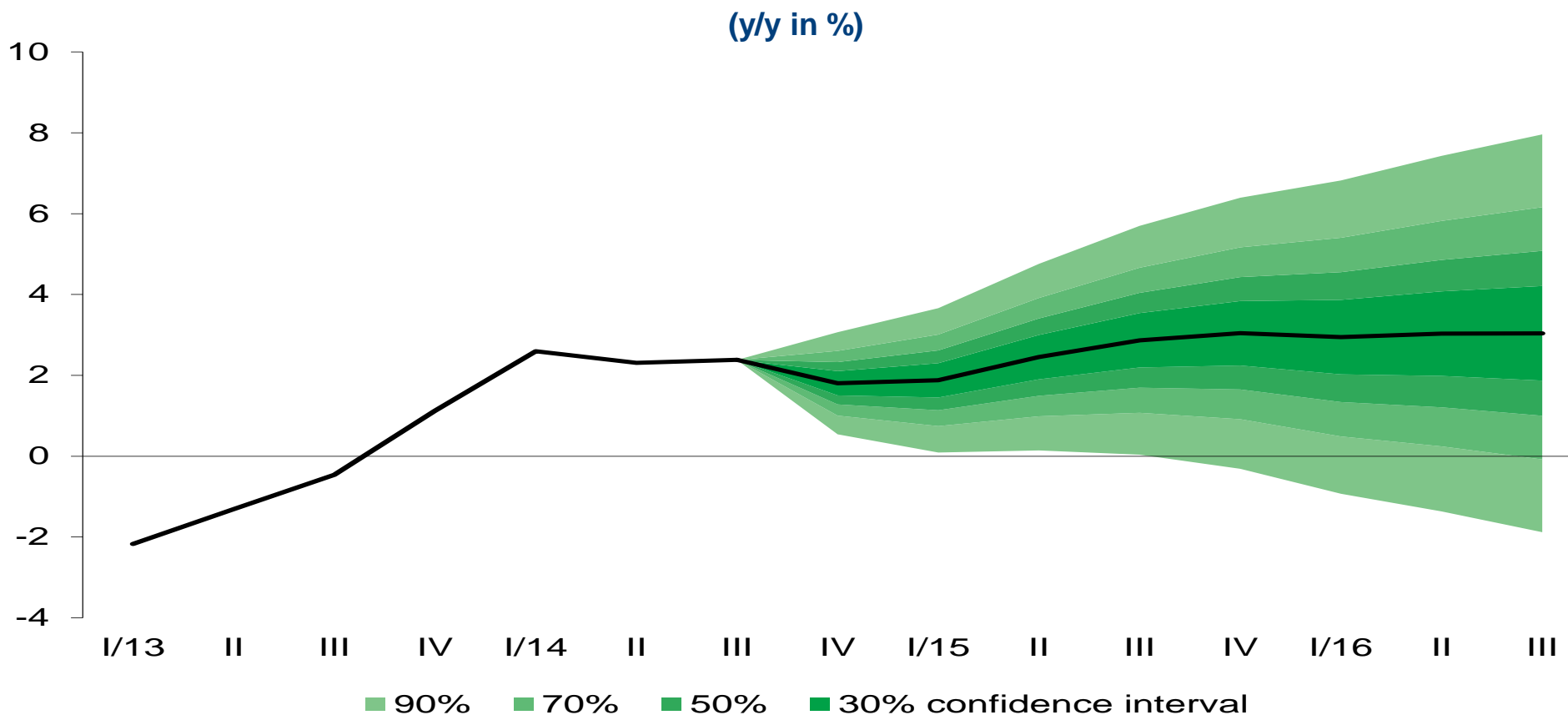
Nominal Marginal Cost in Consumption Sector (q/q, in %, ann.)



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

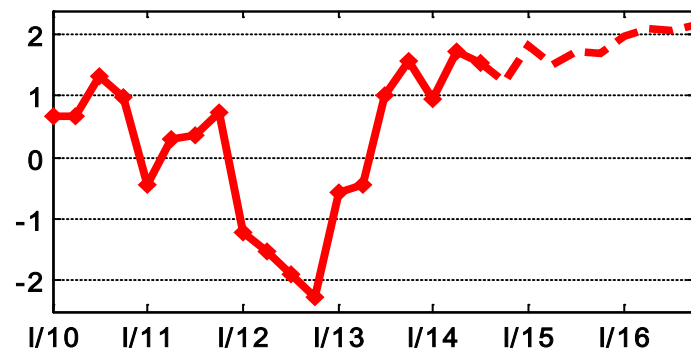


- In 2015, very low foreign producer price inflation coupled with a fall in global prices of energy commodities will result in a substantial decrease in costs stemming from import prices. This effect will fade away in 2016.
- Domestic developments will be raising costs, reflecting gradually accelerating wage growth and continued growth in economic activity.

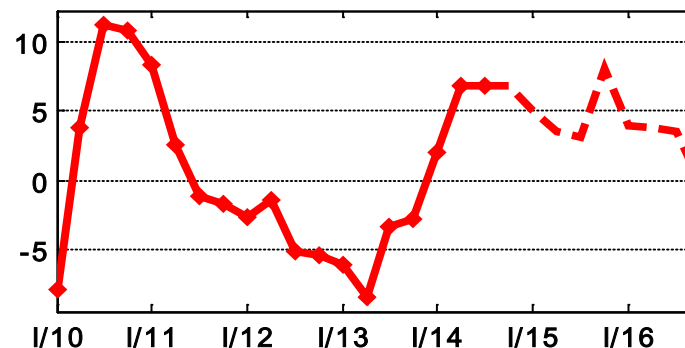


- GDP growth forecast: 2.3% in 2014; 2.6% in 2015; 3.0% in 2016.
- The economy will be boosted by an upswing in external demand, still easy monetary conditions, low oil prices and more expansionary fiscal policy in 2015.
- The growth will be supported by almost all components of aggregate demand.

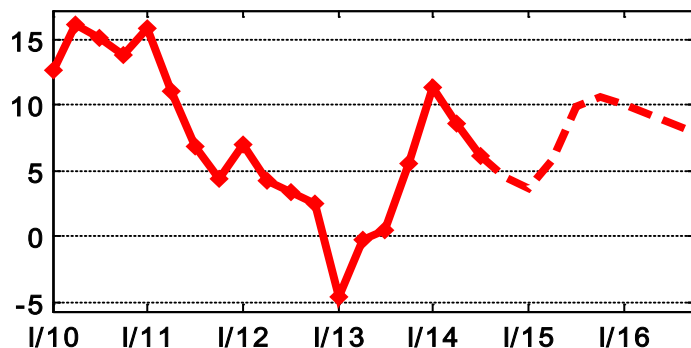
Household Consumption Growth (y/y, in %)



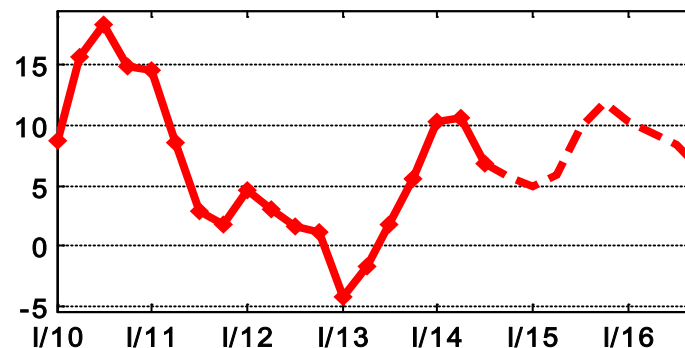
Investments Growth (y/y, in %)



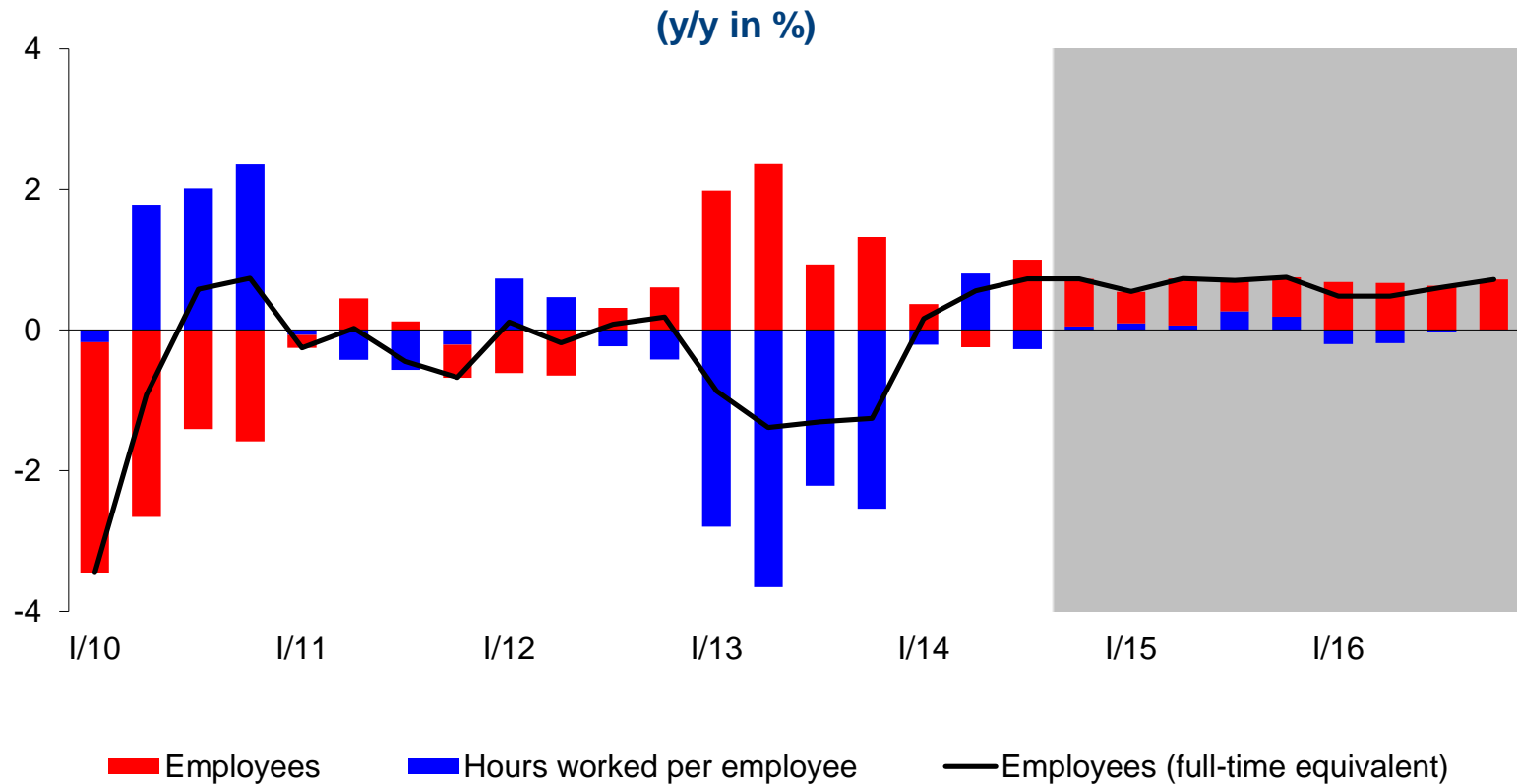
Exports Growth (y/y, in %)



Imports Growth (y/y, in %)

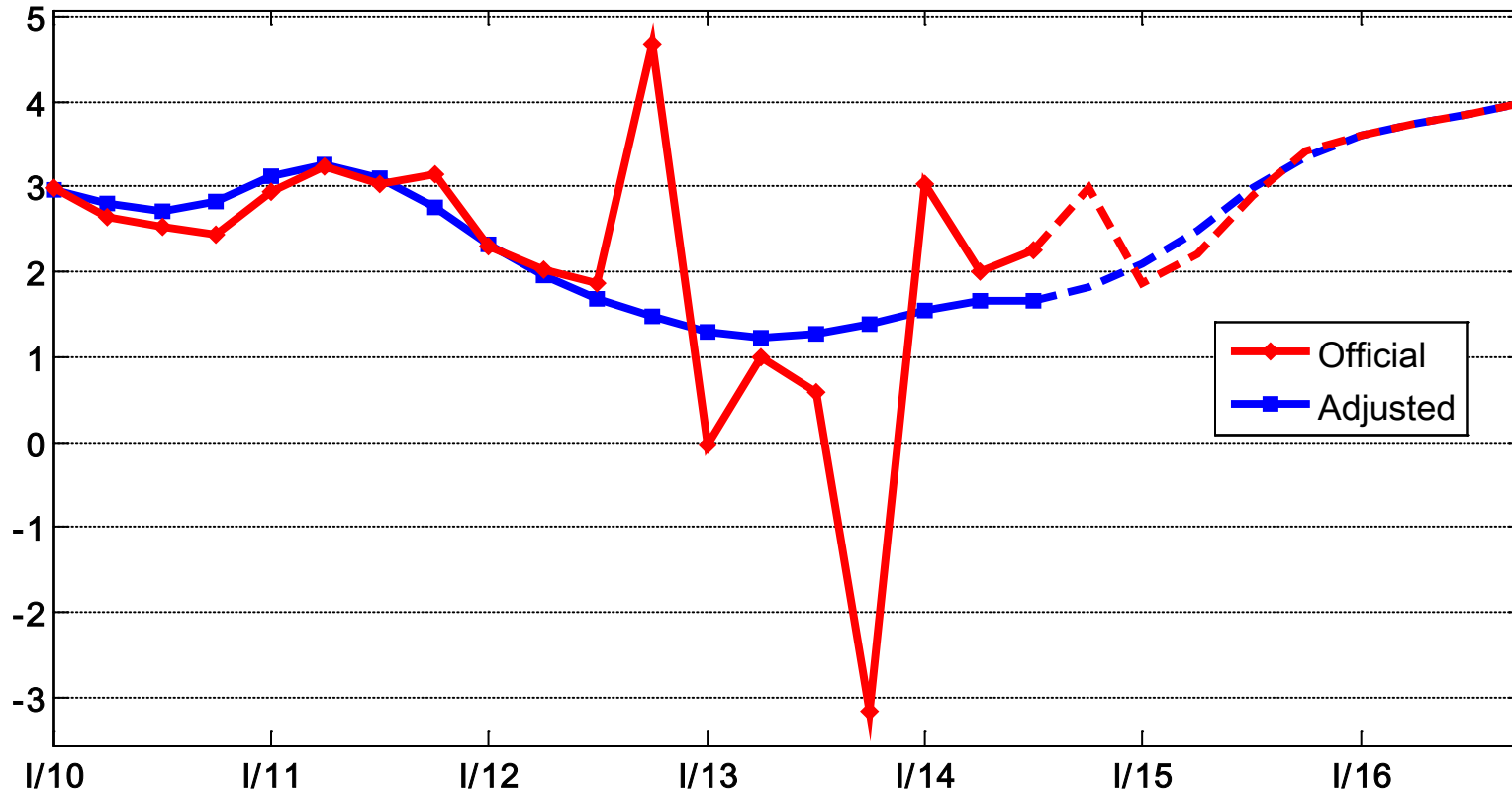


- Household consumption growth will increase over the following two years.
- Investment will continue growing in the private sector, and in 2015 also in the public sector thanks to the drawdown of EU funds.
- Exports and imports will copy the recent slowdown and subsequent acceleration in foreign demand.



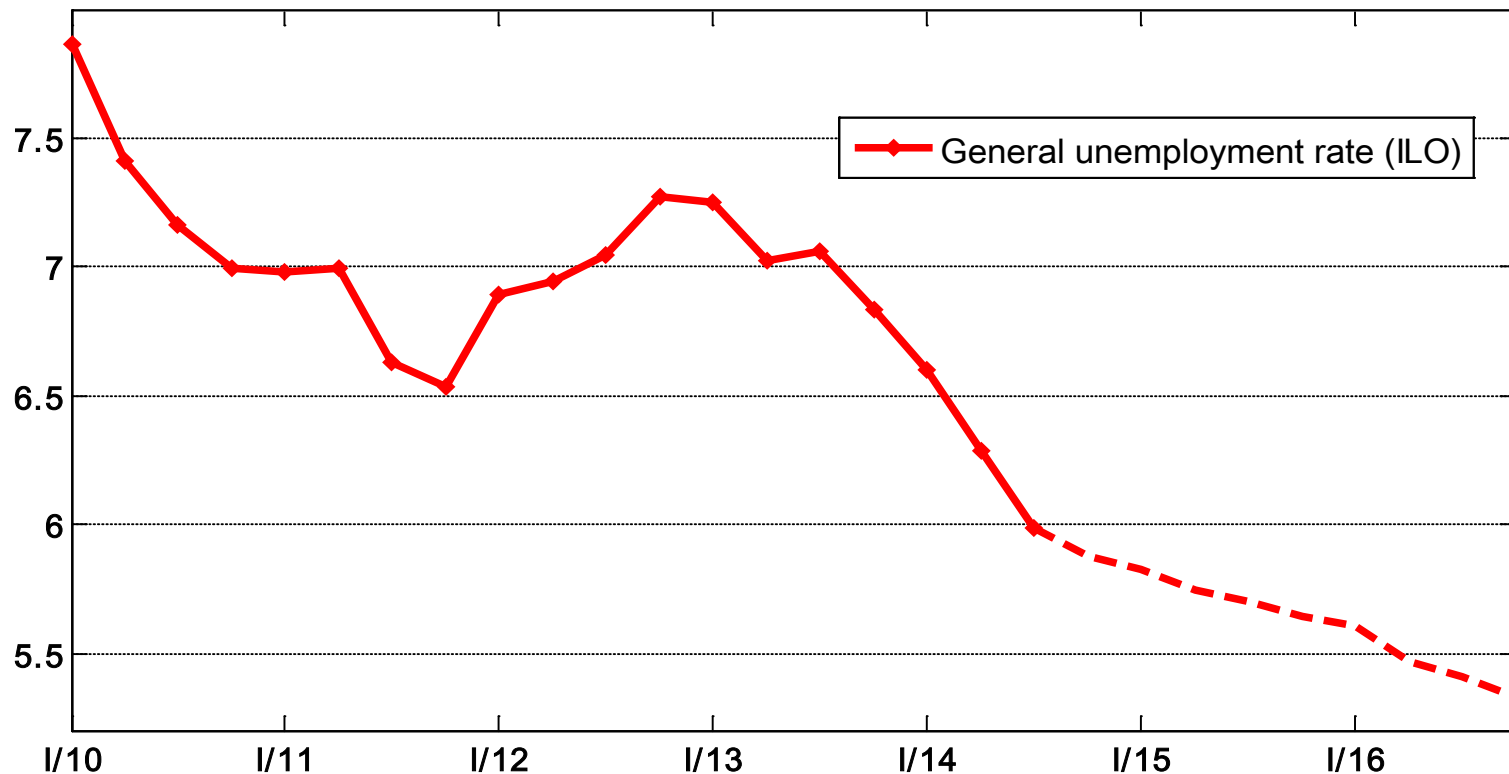
- Employment growth expressed in full-time job equivalent turned positive in 2014. The growth will continue also this year and the next.
- This will be fostered mainly by a higher number of employees, while average hours worked are expected to be flat.

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



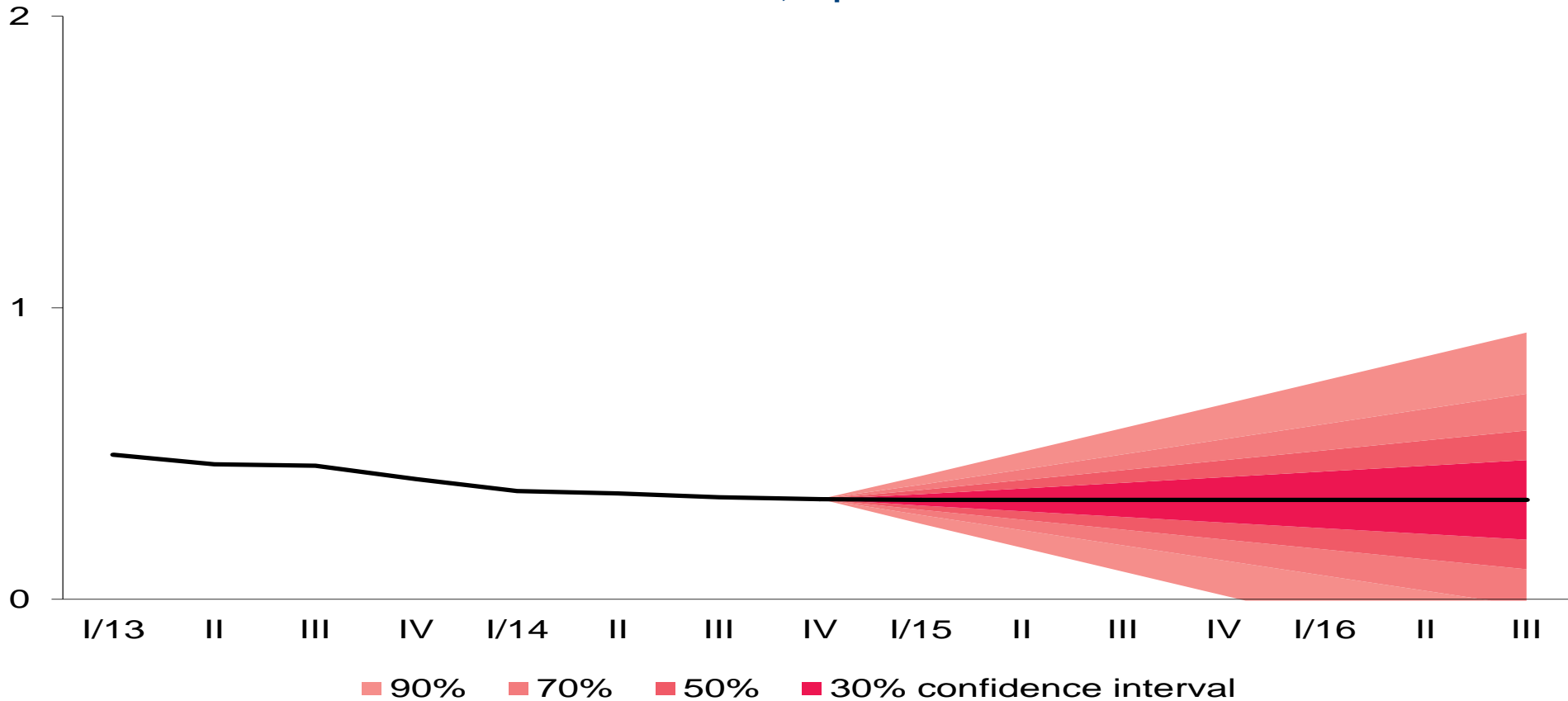
- Wage growth has remained relatively low in 2014, after adjustment for tax optimisation effects.
- It should gradually increase on the back of accelerating growth in domestic economic activity and a return of inflation to the target in 2016.

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



- The general unemployment rate will gradually decline this year and the next, due mainly to expected growth in employment associated with a gradual pick-up in the economic growth.

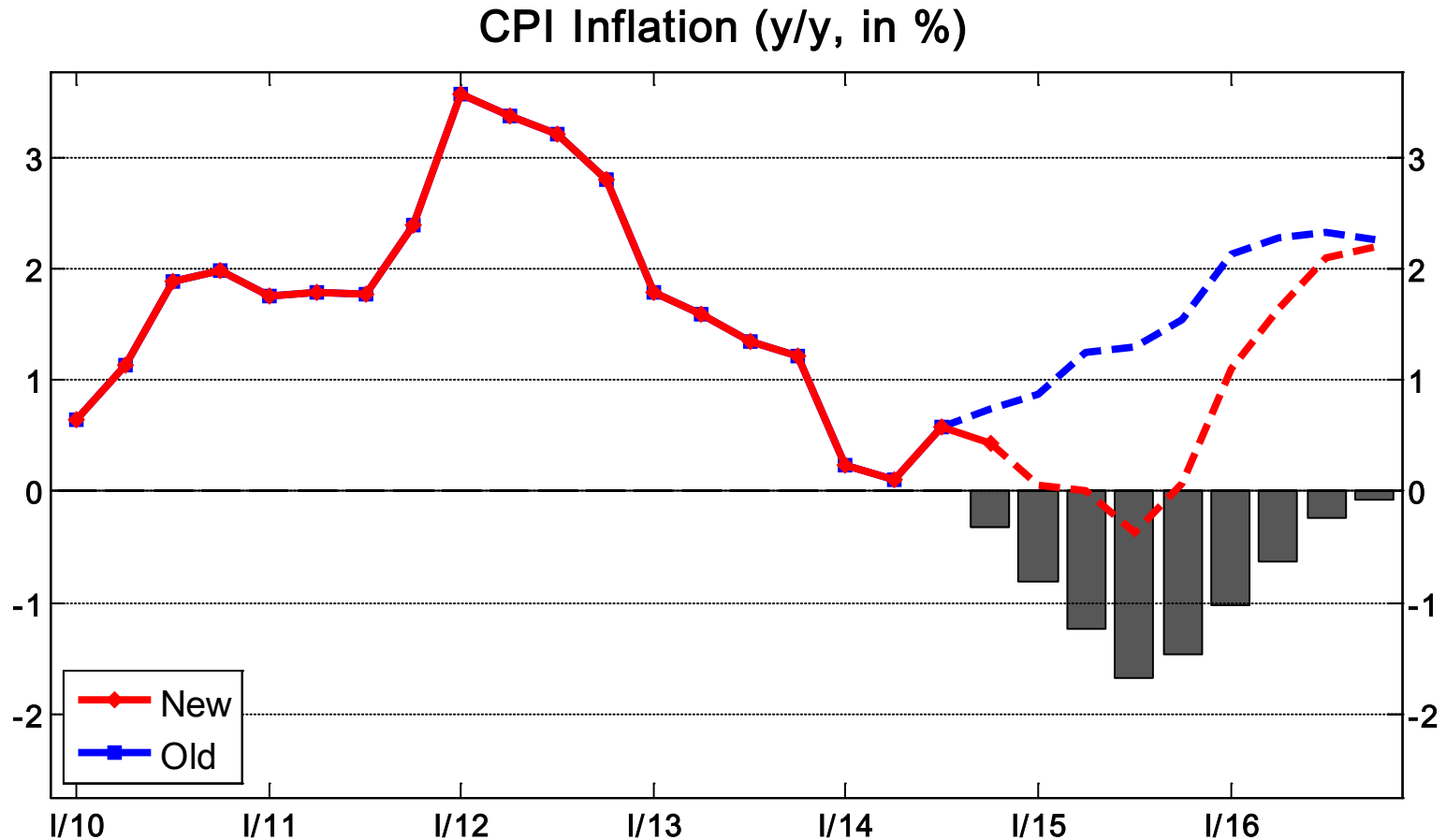
PRIBOR 3M, % p.a.



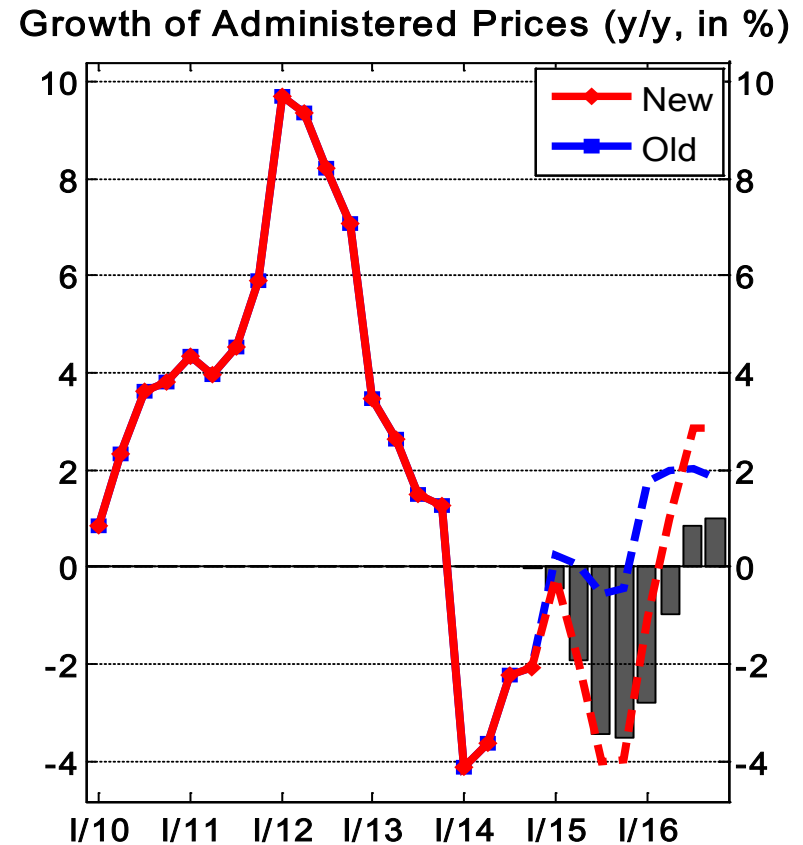
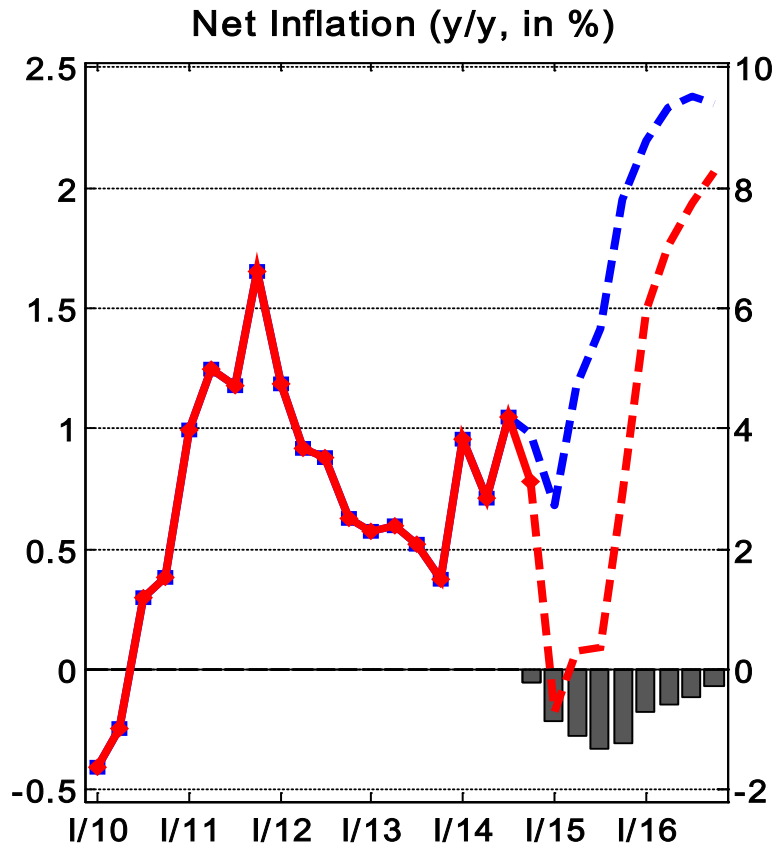
- The forecast expects market interest rates to be flat at their current very low level until the end of 2016, i.e. over the entire forecast horizon.
- This reflects an assumption that the 2W repo rate will be left at technical zero and the money market premium will remain unchanged in the same period.

- Assumptions of the forecast
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- The forecast for inflation is considerably lower than in the previous prediction over the entire horizon, owing to a sharp decrease in administered prices and a lower outlook for net inflation.
- Despite lower external demand, GDP growth forecast has been revised slightly upwards, mainly as a result of significantly lower oil prices.
- The prediction for nominal wage growth in the business sector has shifted much lower as a result of slower observed wage growth in 2014 and considerably more subdued consumer price inflation.
- The interest rate path mainly reflects a more anti-inflationary effect of the external environment and a related extension of the expected use of the exchange rate as a monetary policy instrument until the end of the forecast horizon.

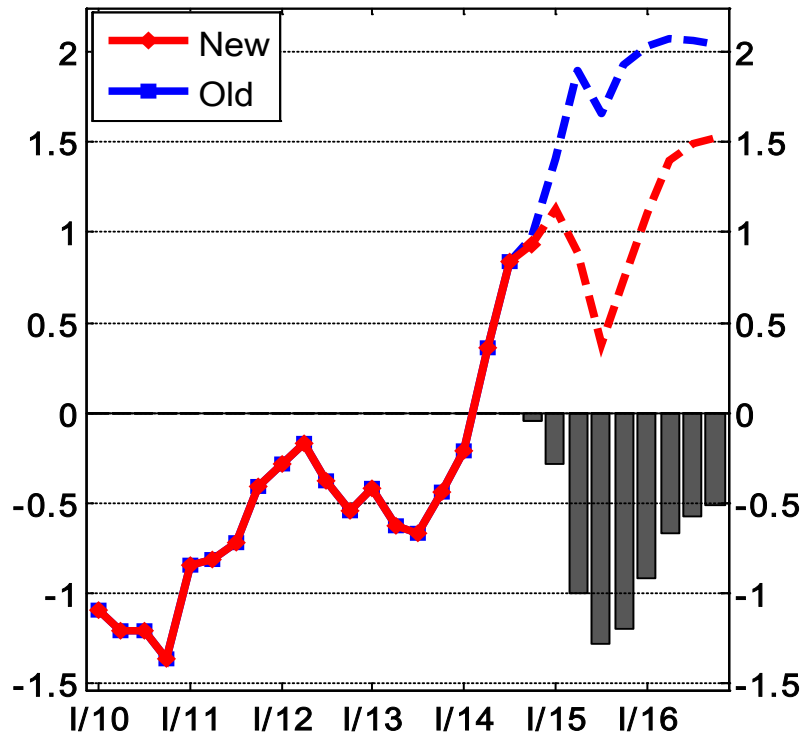


- The forecast for annual headline inflation is considerably lower than in the previous forecast until late 2016. This is due to a significantly lower outlook for administered prices (especially in 2015) and net inflation.

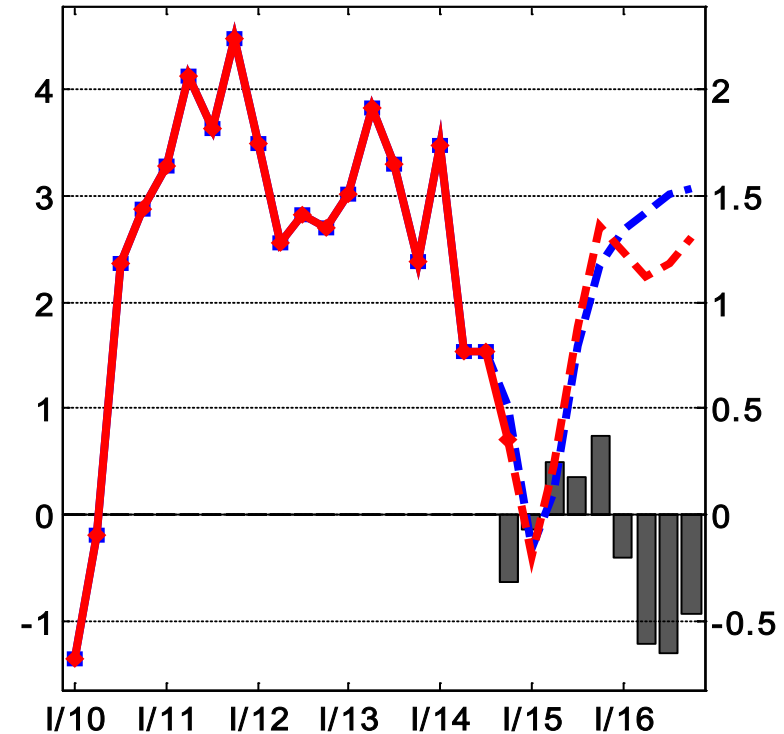


- Net inflation is lower over the entire forecast horizon, reflecting a drop in fuel prices, as well as lower "core" inflation.
- The outlook for administered prices has decreased considerably, owing chiefly to an unexpected fall in energy commodity prices.

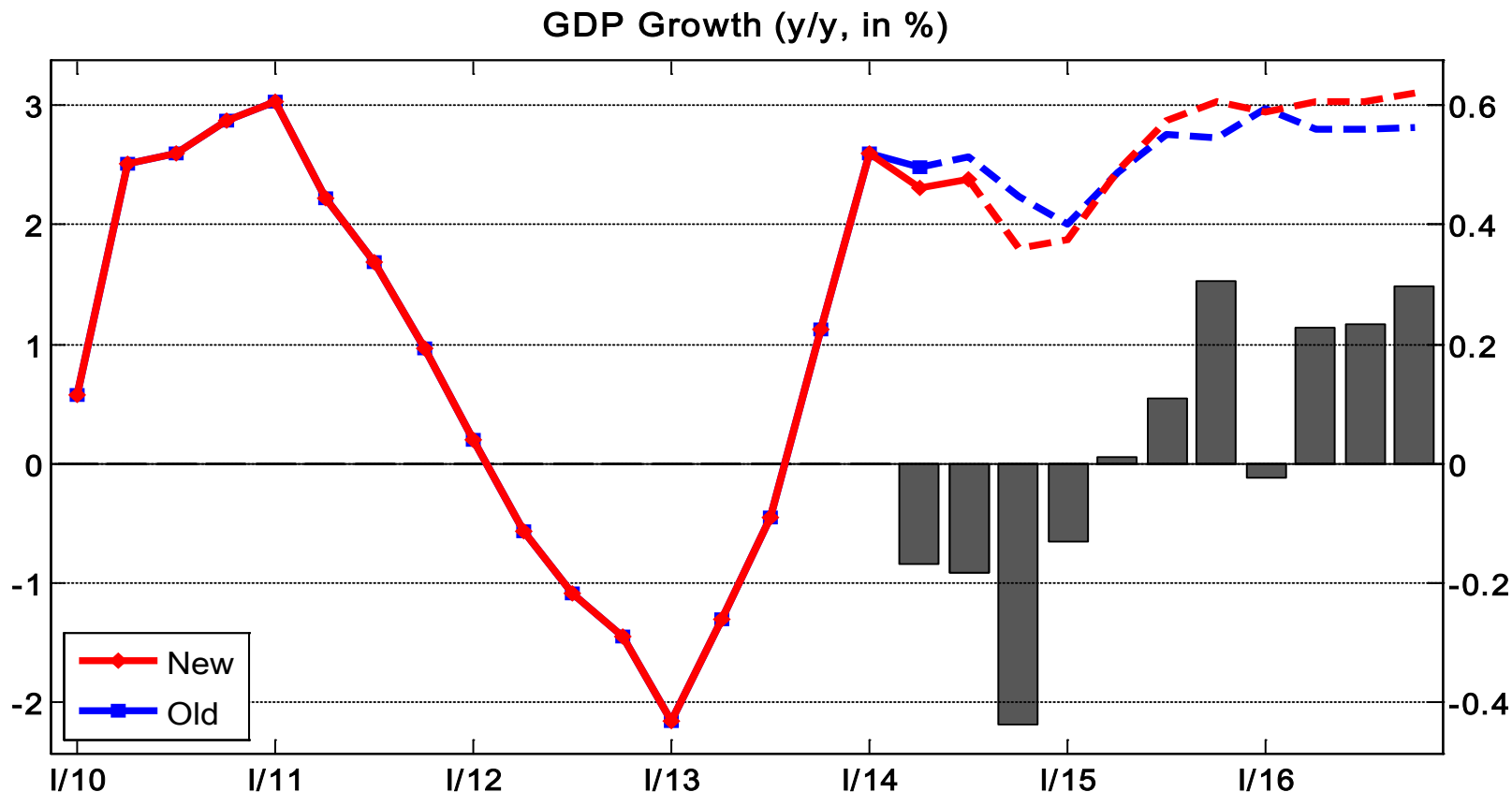
Adjusted Inflation Excl. Fuels
(y/y, in %, Excl. Tax Changes)



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

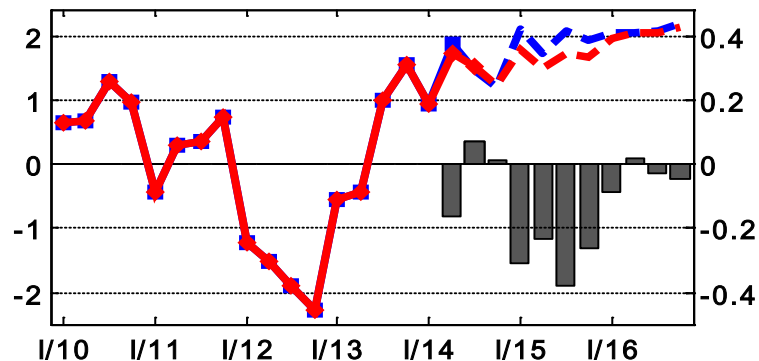


- Lower core inflation forecast reflects stronger anti-inflationary pressures from the external environment, the more subdued domestic wage growth observed in 2014 and lower inflation expectations.
- The forecast for food prices has not changed significantly.

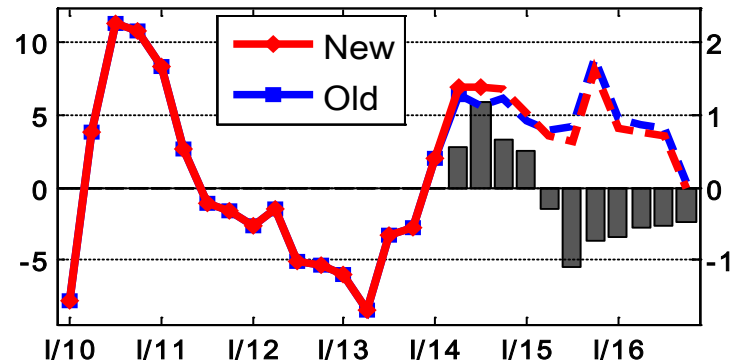


- The GDP growth forecast is marginally higher despite an assumption of weaker external demand and slower observed growth in 2014.
- The main reason is a positive supply shock resulting from significantly lower oil prices, together with an extension of the forecasted period for which the exchange rate will be used as a monetary policy instrument.

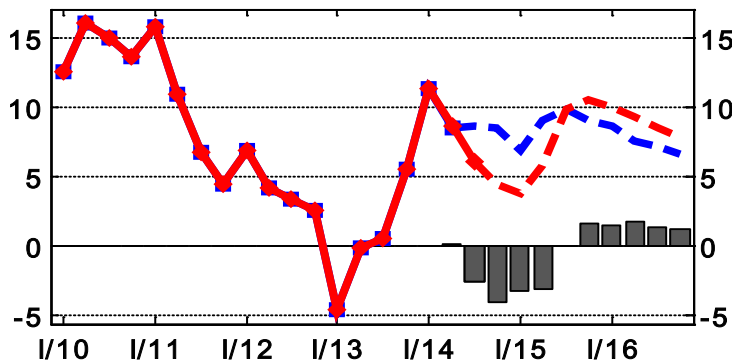
Household Consumption Growth (y/y, in %)



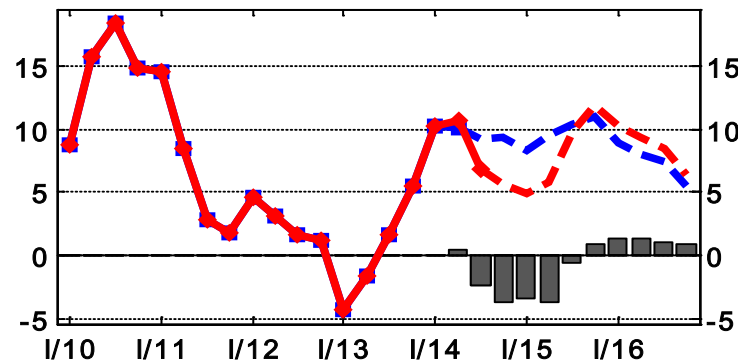
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)

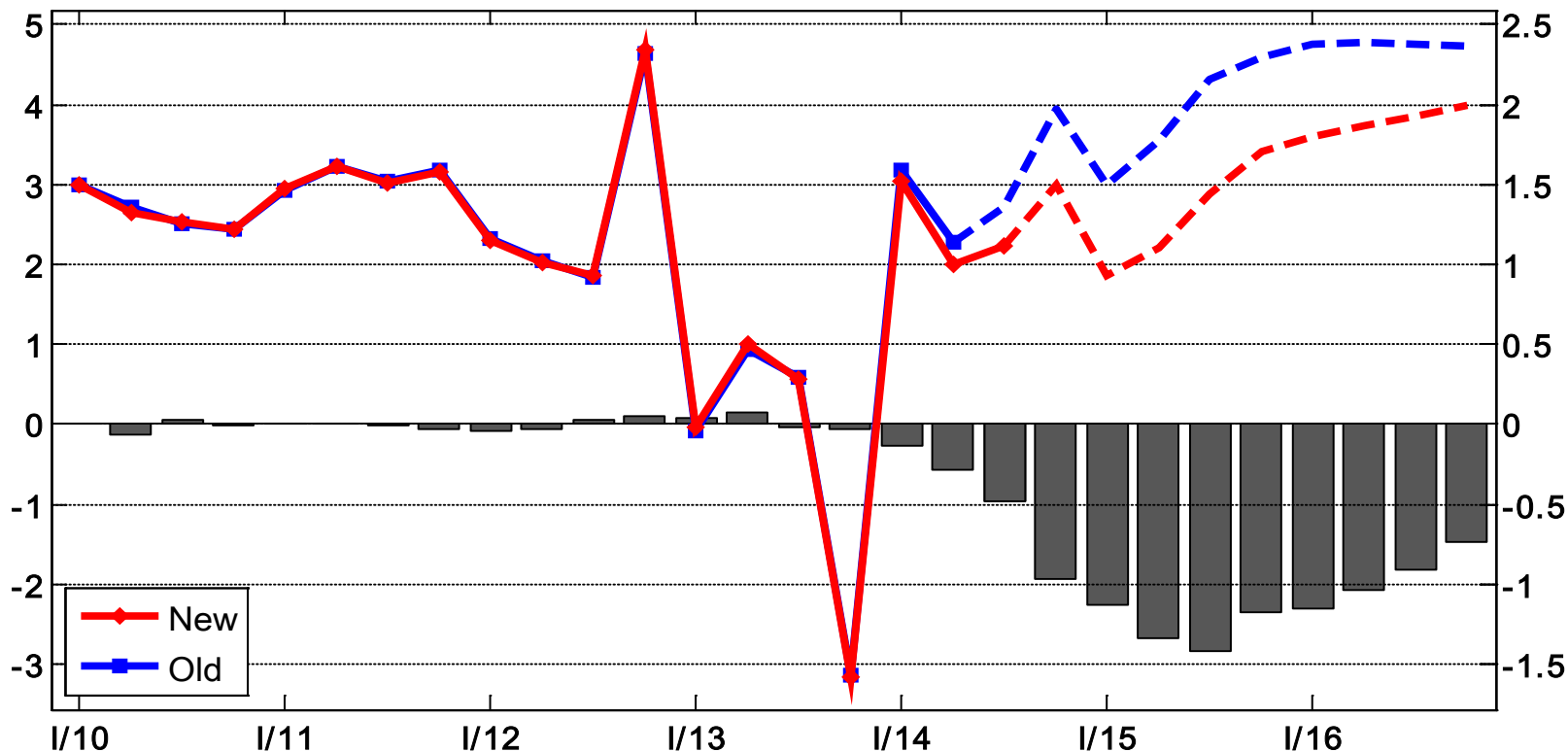


Imports Growth (y/y, in %)

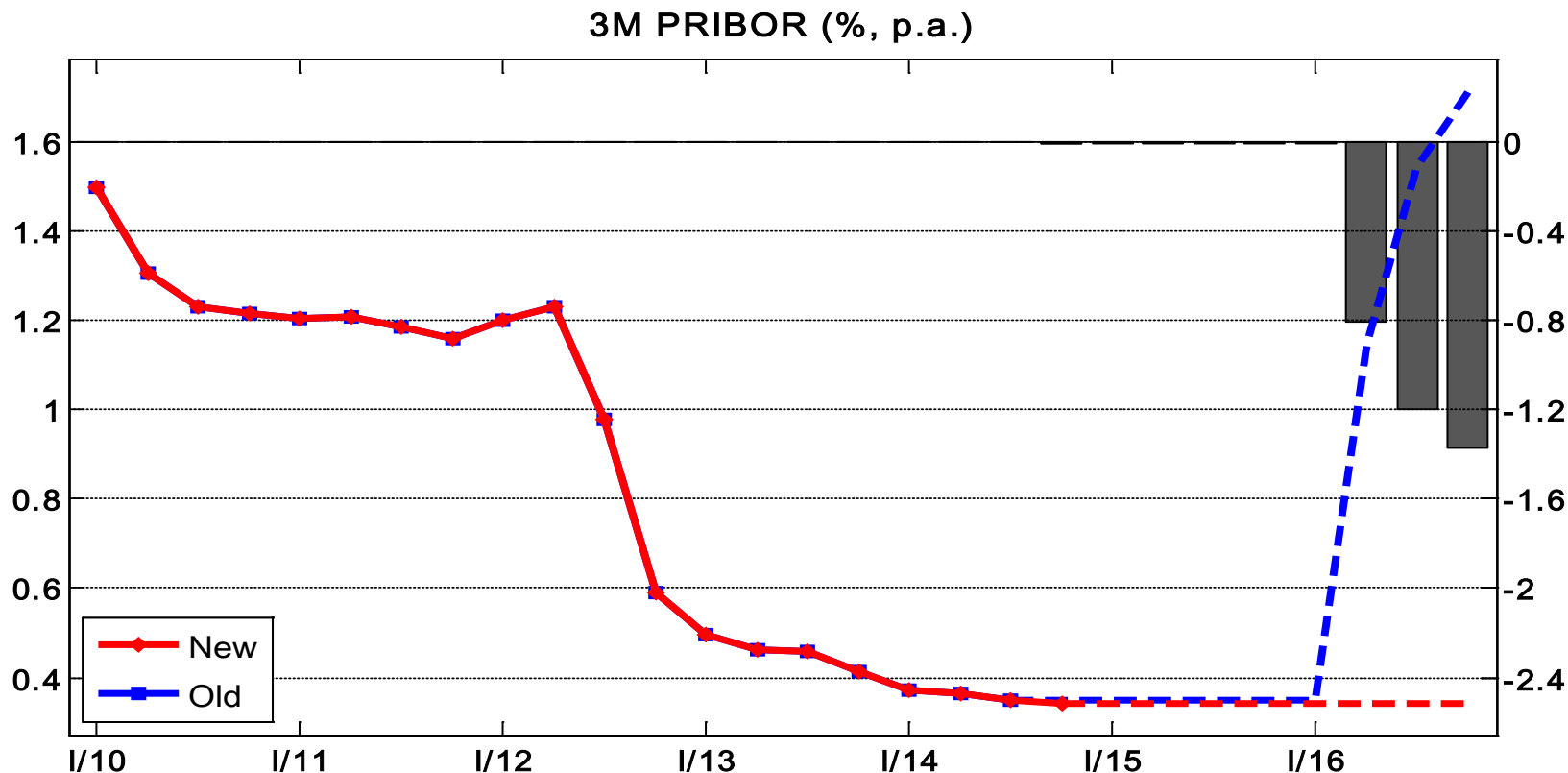


- Growth in consumption and investment has been revised down. Thanks to the favourable effect of oil prices, however, the revision is smaller than would be in line with the observed developments in wages and fixed investment in 2014 H2.
- The lower external demand outlook is reflected in a decrease in expected export and import growth in the next few quarters.

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



- The forecast for average nominal wage growth in the business sector has shifted considerably downwards over the entire forecast horizon.
- This mainly reflects more gradual wage growth and slower growth of the Czech economy in 2014, as well as lower observed and future inflation.



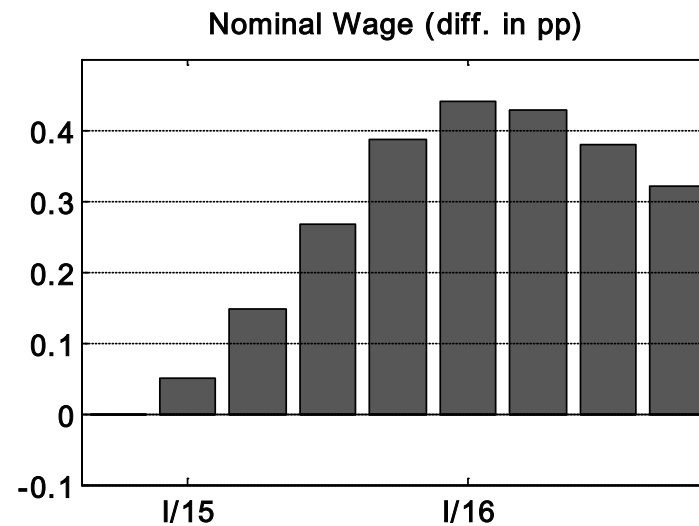
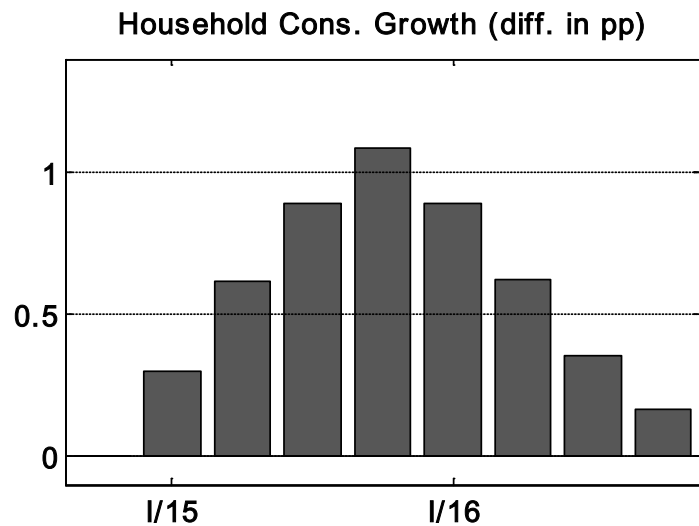
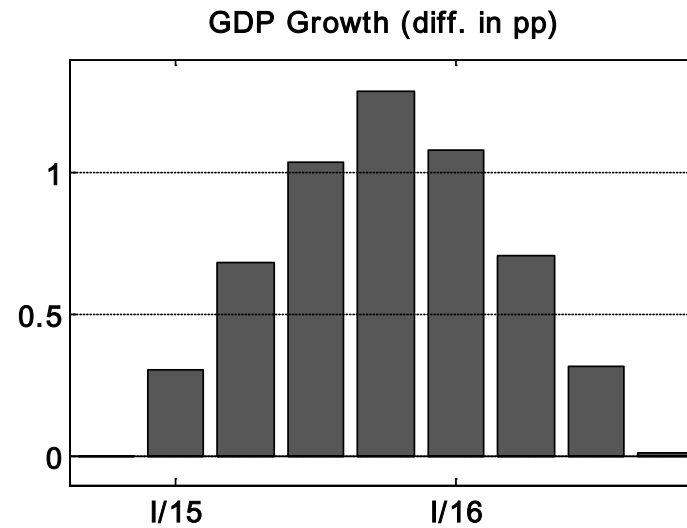
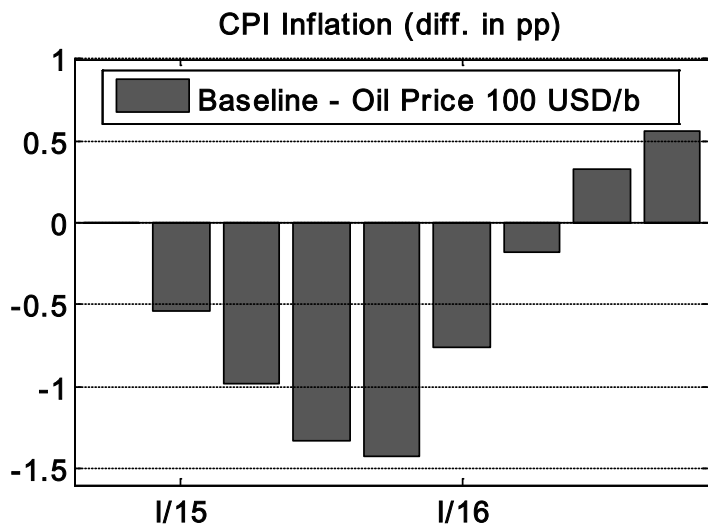
- The new forecast expects the exchange rate to be used as a monetary policy instrument – and interest rates at technical zero – over its entire horizon, whereas the previous forecast assumed it would be used only until 2016 Q1.
- The need for lengthier easy monetary conditions is due mainly to a lower outlook for foreign producer prices, the drop in oil prices and less inflationary domestic developments (especially slower wage growth).

- Assumptions of the forecast
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- **Assessing the impacts of low oil prices**

	Inflation (pp)	Real GDP (pp)	Real consumption (pp)	Oil price (USD/barrel)
I/15	-0,5	0,3	0,2	-50,7
II/15	-0,9	0,6	0,5	-47,3
III/15	-1,2	0,9	0,8	-44,3
IV/15	-1,3	1,2	1,1	-42,1
I/16	-0,6	1,0	1,0	-40,1
II/16	-0,1	0,7	0,8	-38,2
III/16	0,4	0,3	0,5	-36,5
IV/16	0,6	0,1	0,3	-35,2

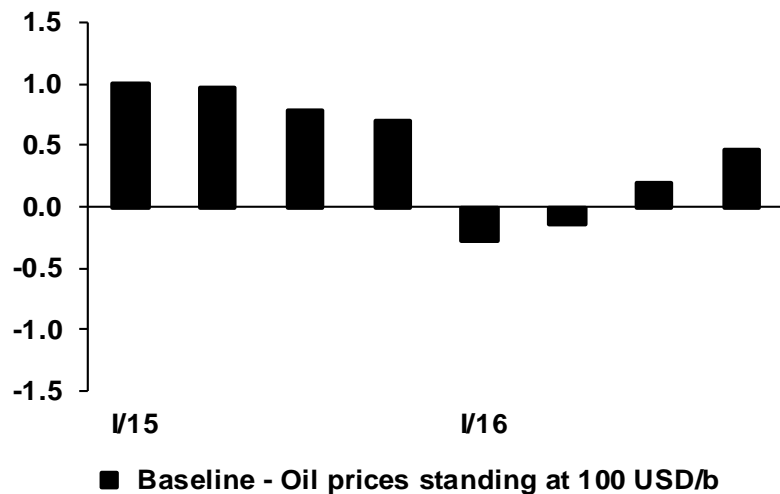
- The assessment is done compared to a hypothetical scenario of oil prices standing at USD 100 a barrel, using an extended version of the g3 model.
- It confirms that the oil price shock is a positive supply-side shock, lowering inflation and boosting economic growth considerably.
- This holds even at the ZLB, provided that expectations remain well anchored.

Impact of Continuing Low Oil Prices (ii)

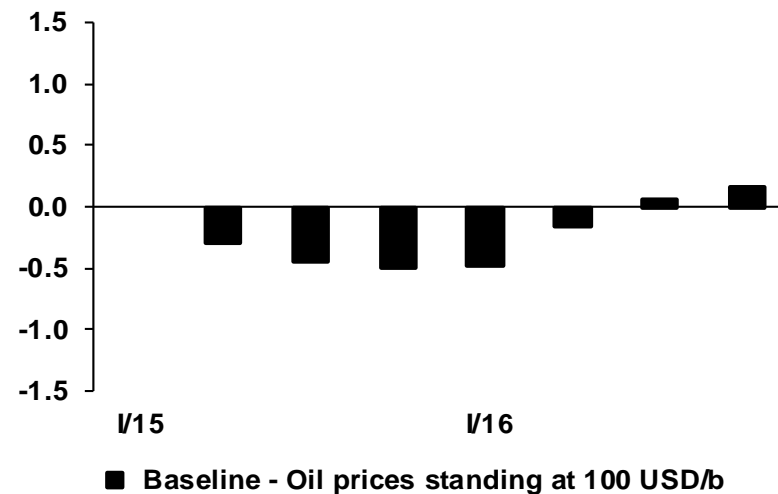


Impact of Continuing Low Oil Prices (iii)

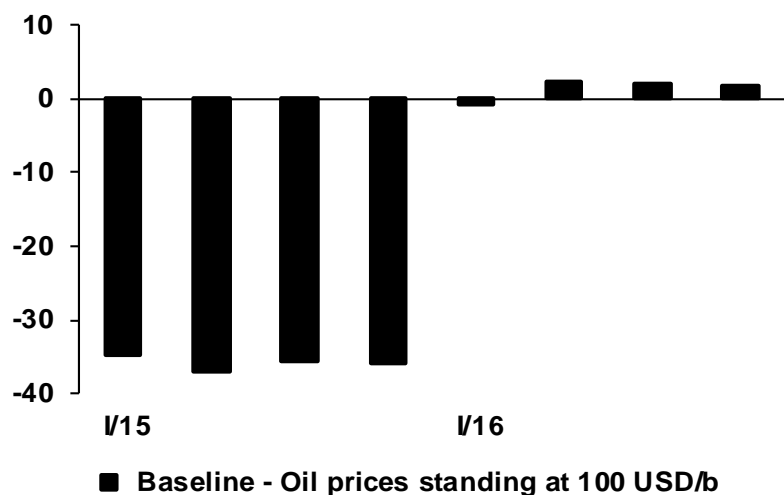
Core infl. ex fuels ex food (differences in pp)



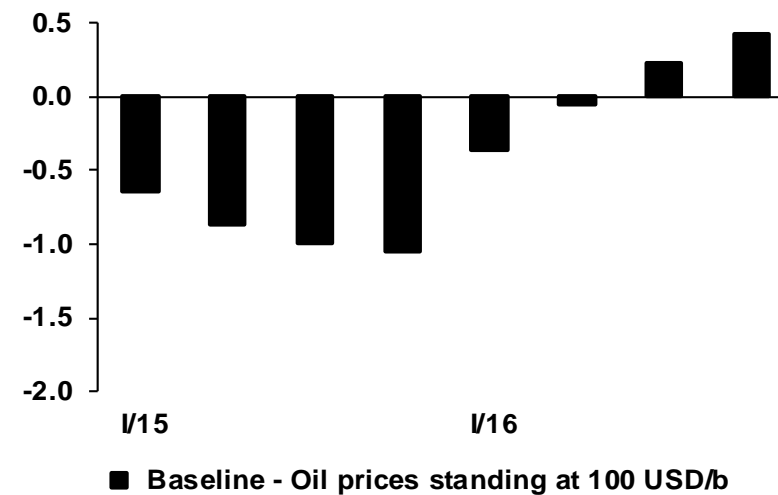
Food price inflation (differences in pp)



Fuel prices inflation (differences in pp)



Net inflation (differences in pp)



Thank you for your attention!

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