

# Meeting with Analysts

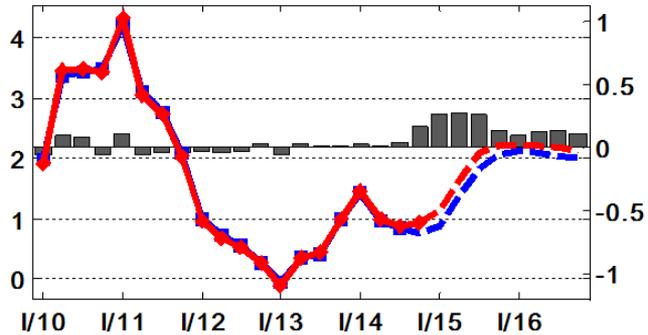
Petr Král

Prague, 11 May, 2015

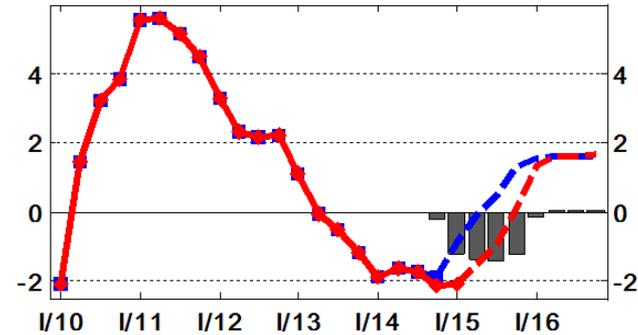
- Assumptions of the forecast
- The new macroeconomic forecast
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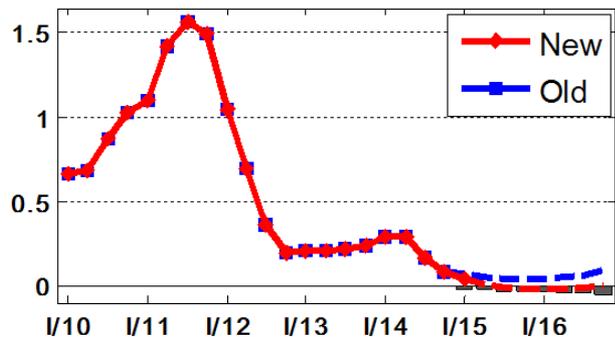
Growth Rate of GDP - Eurozone (y/y, in %)



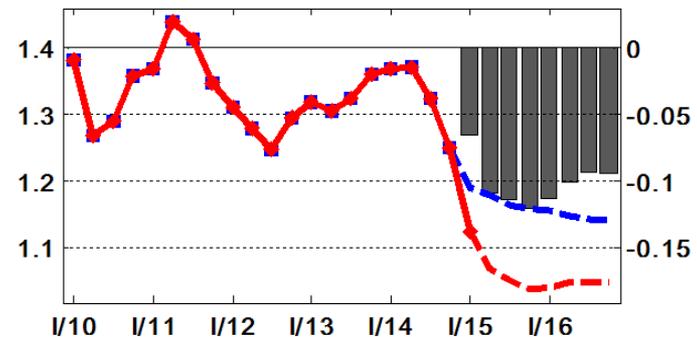
PPI Inflation - Eurozone (y/y, in %)



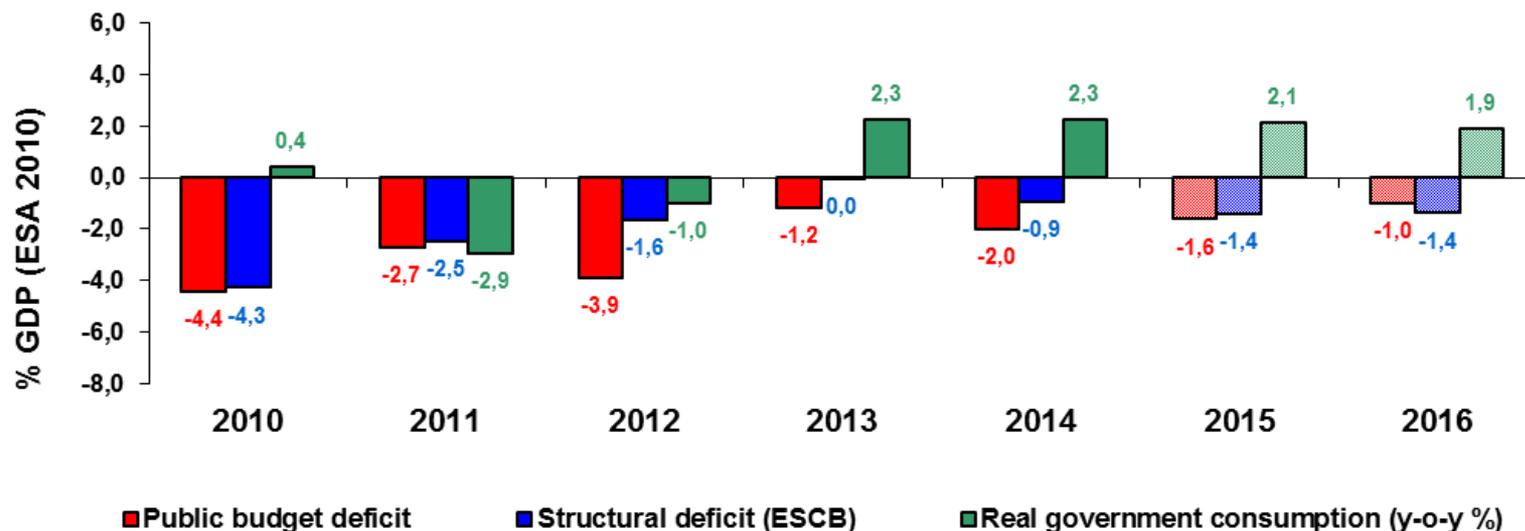
3M EURIBOR



USD/EUR

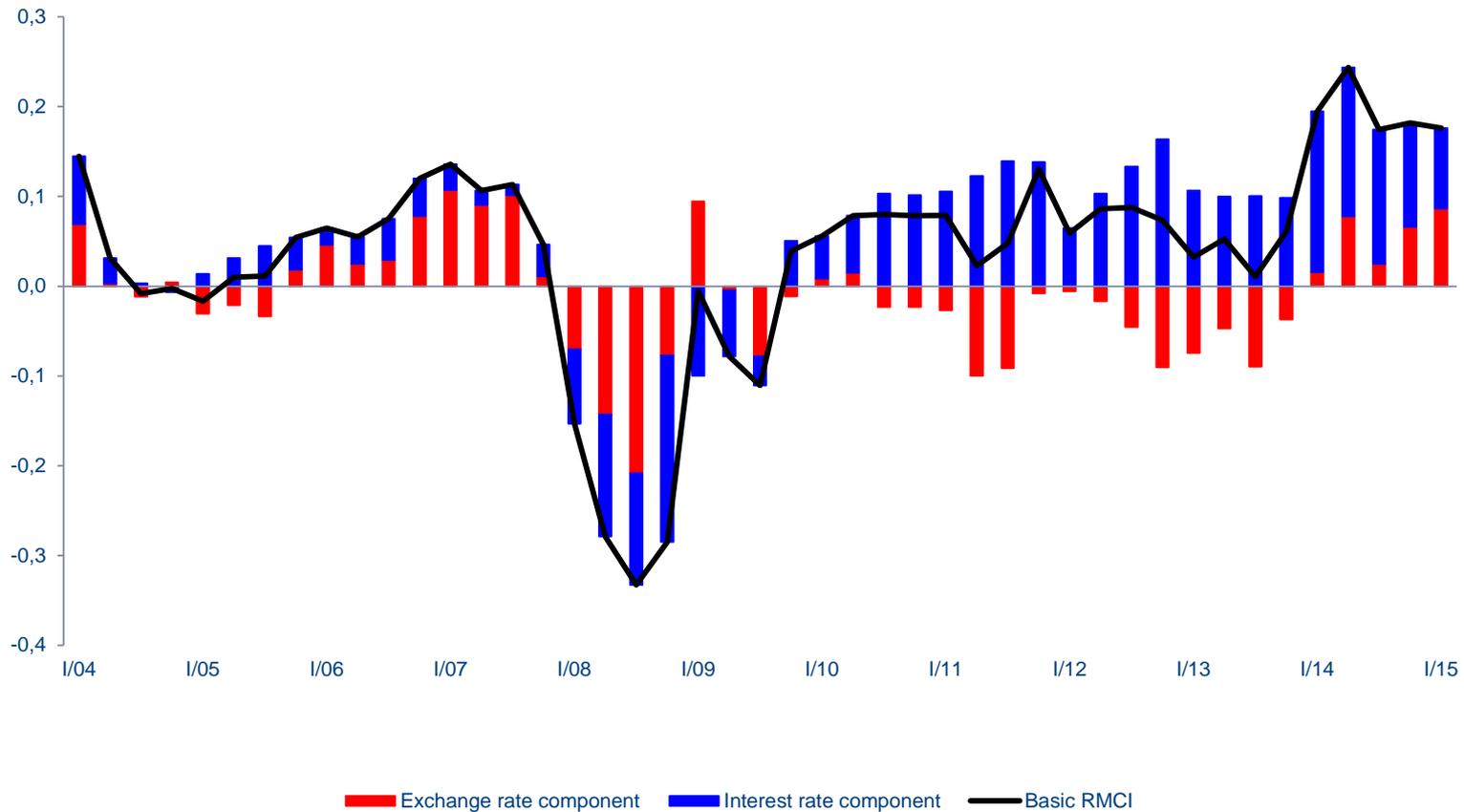


- External demand growth is expected to pick up this year and the next.
- The slump in energy commodity prices coupled with only sluggish economic growth is reflected in currently falling PPI (as well as CPI), which will start rising as from the beginning of the next year.
- 3M EURIBOR and EUR/USD reflect the ECB's easing measures.



- 2014: deficit at 2 % of GDP (inclusion of new institutions + lower revenues from excise tax on tobacco vs. extraordinary revenues from an auction of frequency bands to mobile operators).
- 2015: drop of the deficit to 1.6% of GDP due to economic growth and inspite of 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 % of GDP (continuing economic growth, lower public investment due to the EU funds' cycle).
- Fiscal impulse: +0.3 p.p. in 2014, +0.5 p.p. in 2015 and -0.2 p.p. in 2016.

- The forecast assumes market interest rates to be flat at their current very low level and the exchange rate to be used as a monetary policy instrument until the 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 Q2 takes into account its development in the first half of April. It is expected to be stable in the following quarters at a level that is slightly weaker than the announced asymmetric exchange rate commitment (i.e. CZK 27 to the euro).
- 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.

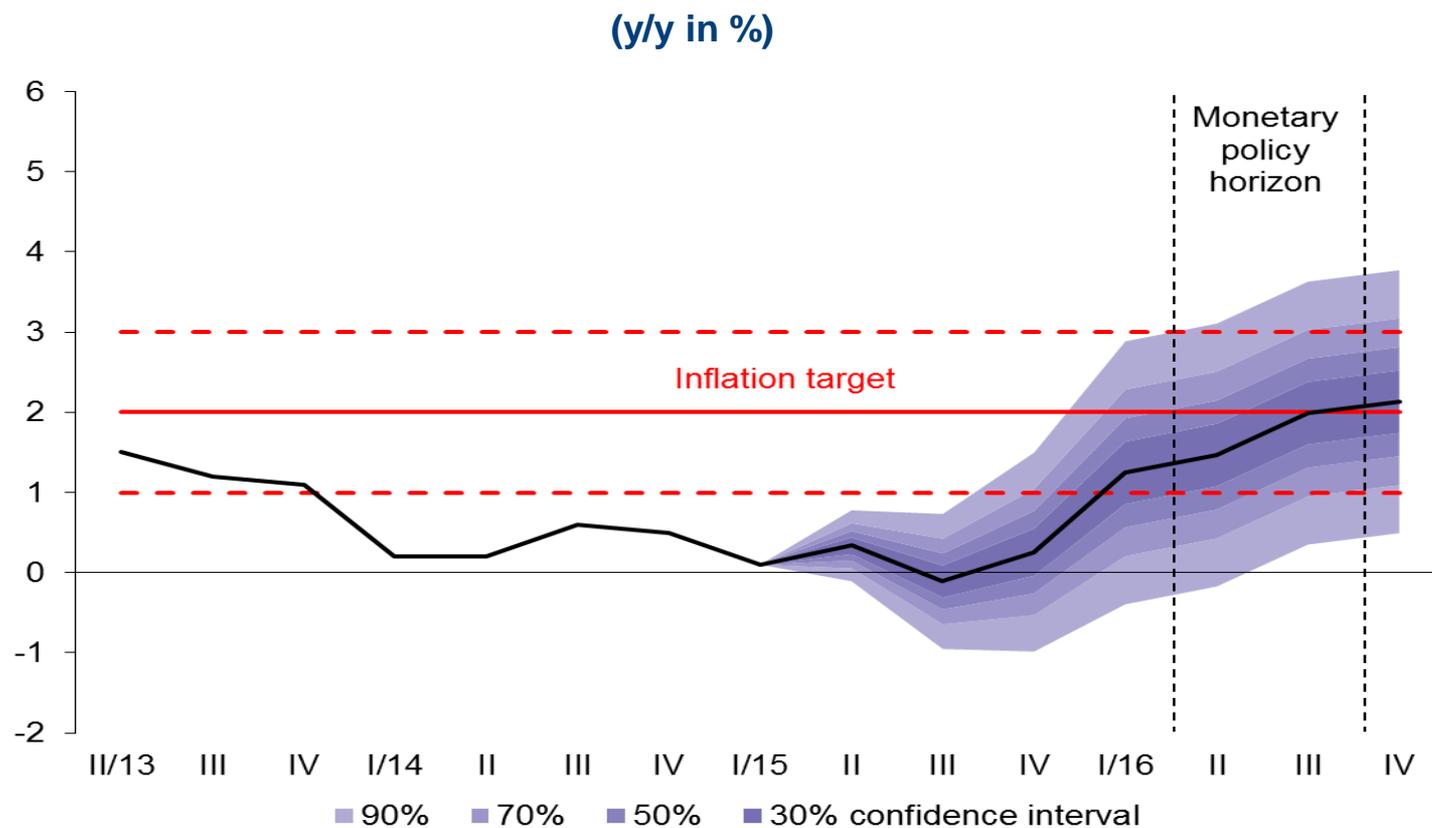


- The monetary conditions have been very accommodative since the end of 2013, albeit rather less so recently as a result of a fall in inflation expectation.

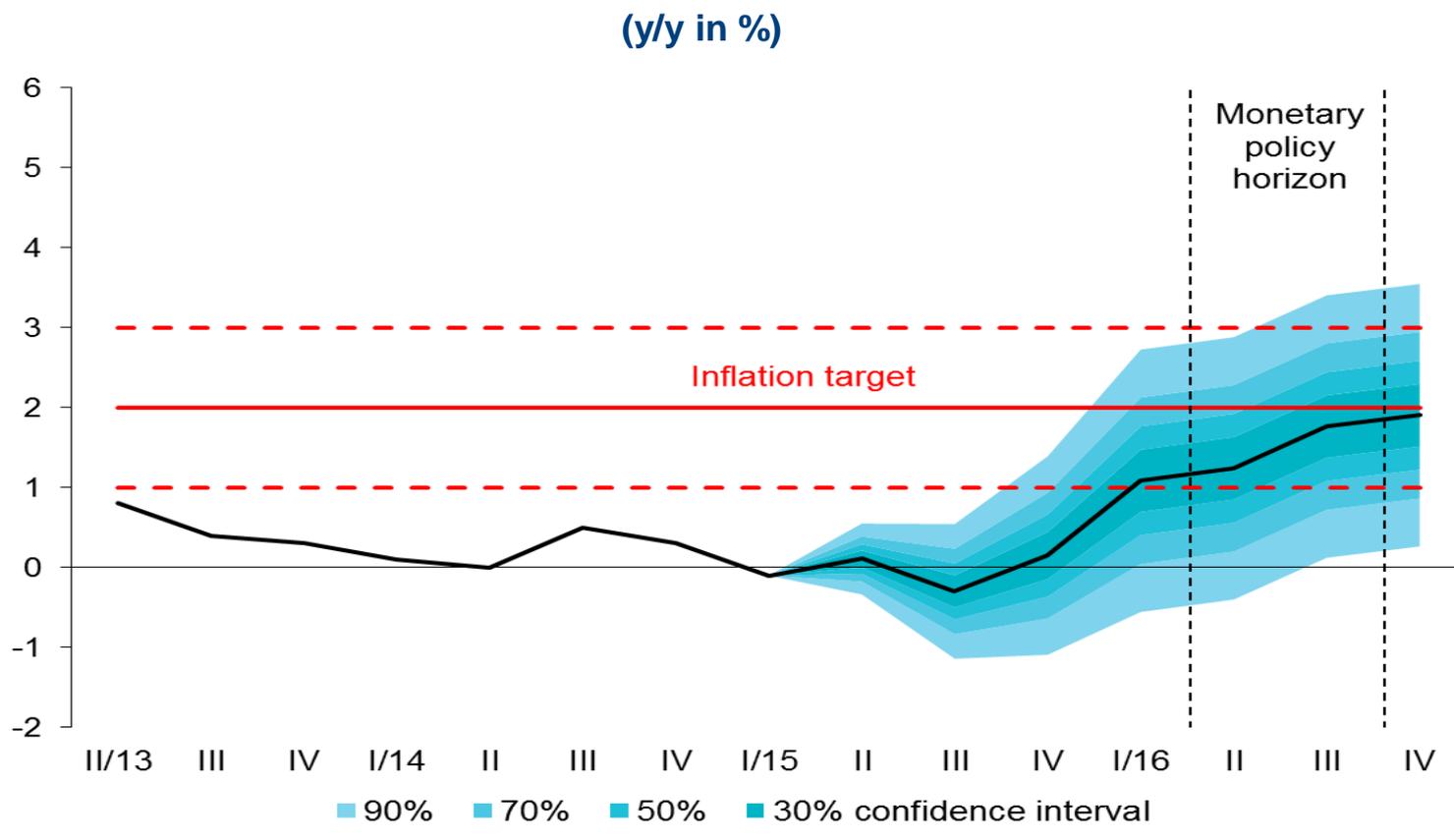
- Assumptions of the forecast
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- Both headline and monetary policy-relevant inflation will stay close to zero in 2015. During 2016, they will return to the CNB's 2% inflation target.
- Import prices will remain anti-inflationary in the near future owing to falling producer prices in the euro area and the recent decline in energy commodity prices. In 2016 this effect will subside, and import prices will be slightly inflationary next year.
- The domestic economy will contribute to price increases over the entire forecast horizon as a result of its continued robust growth and gradual acceleration in wage dynamics.

- Following a temporary slowdown in late 2014, GDP growth will start to pick up this year owing to positive development in both domestic and external demand, fuelled by relaxed monetary conditions, positive supply-side effect of low oil prices and this year also by an increase in government investment. GDP growth will thus reach 2.6% in 2015 and 3.2% in 2016.
- The rising economic activity is manifesting itself in the improvement in the labour market situation. Total employment will rise gradually, while the unemployment rate will continue to decrease.
- Both business and non-business sector will experience a marked wage growth.

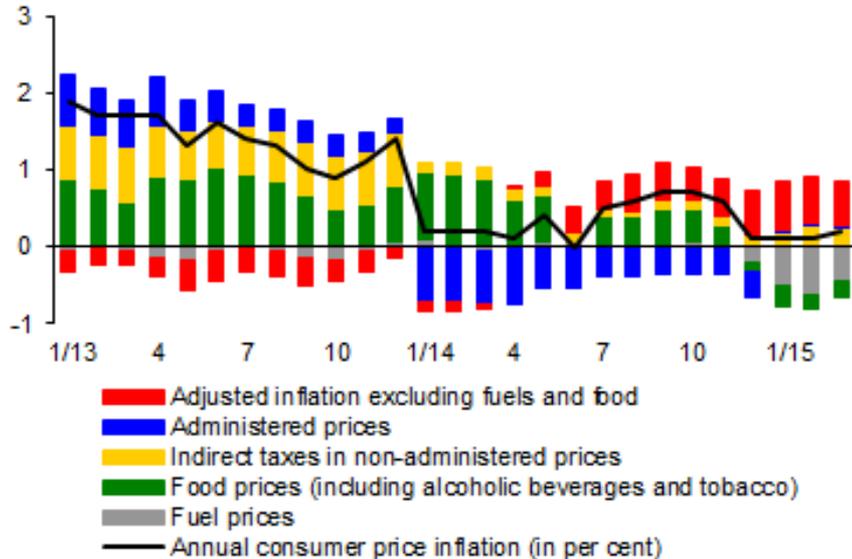


- Headline inflation will be close to zero in 2015, reflecting the recent drop in global energy prices and deflationary tendencies in the euro area.
- It will then rise to the 2% target in 2016, due to unwinding of the imported deflationary pressures and ongoing growth of the domestic economy and wages.

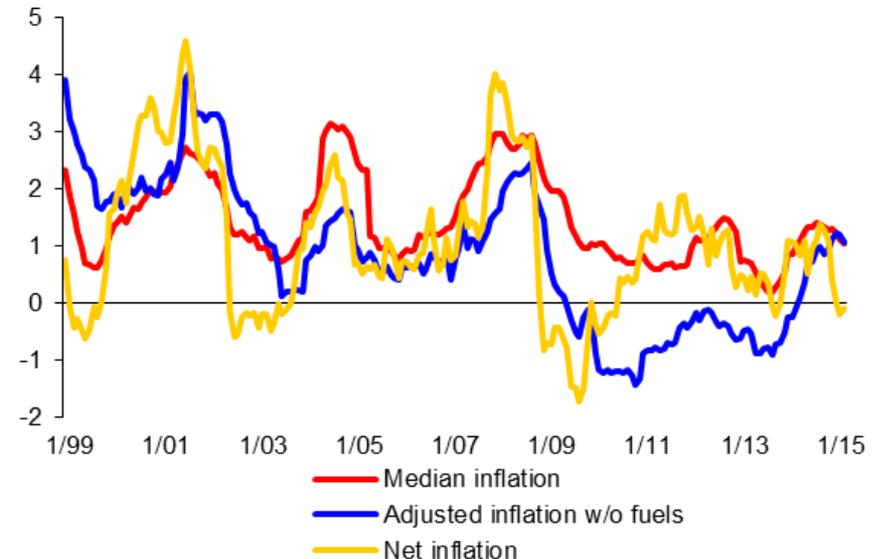


- Monetary policy-relevant inflation will follow a similar yet slightly lower path as headline inflation, reflecting positive first-round effects of changes to indirect taxes (increase in excise duties on tobacco products in both years vs. introduction of second reduced VAT rate in 2015, with total contribution 0.2%).

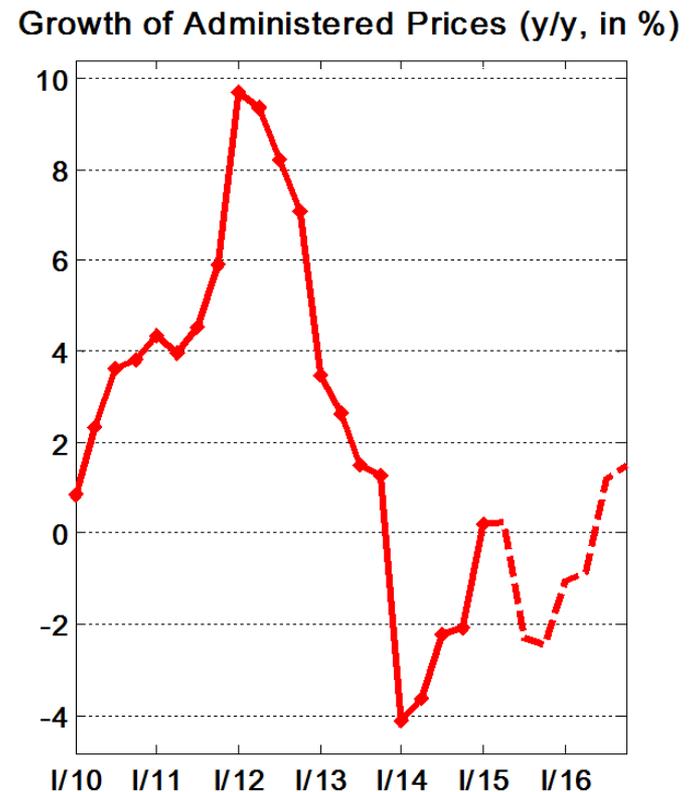
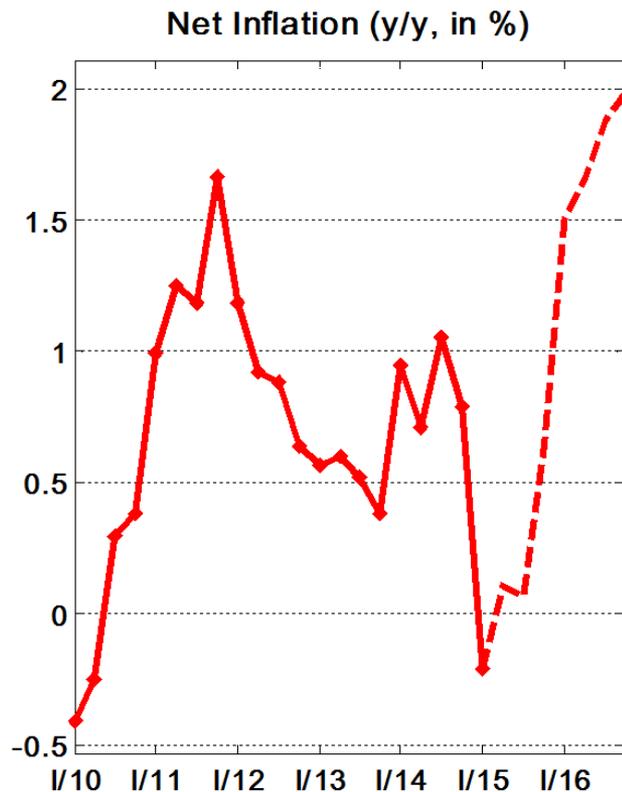
Structure of inflation (in p.p.)



Core inflation and its components (in %)

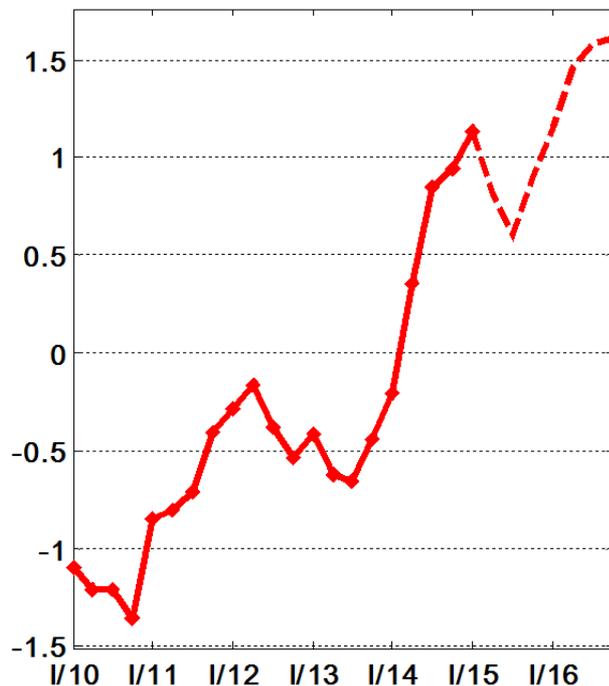


- Headline inflation slightly increased to 0.2% in March. Low levels are driven by a drop in fuel prices and continued fall of food prices.
- On the other hand, core inflation remained distinctly positive. Its previous increase reflected the weakened koruna, the growth in the domestic economy and improved situation on labor market.
- Median inflation bottomed out from its record low in the end of 2013 and remains noticeably positive, owing to direct and indirect effects of the weaker koruna.

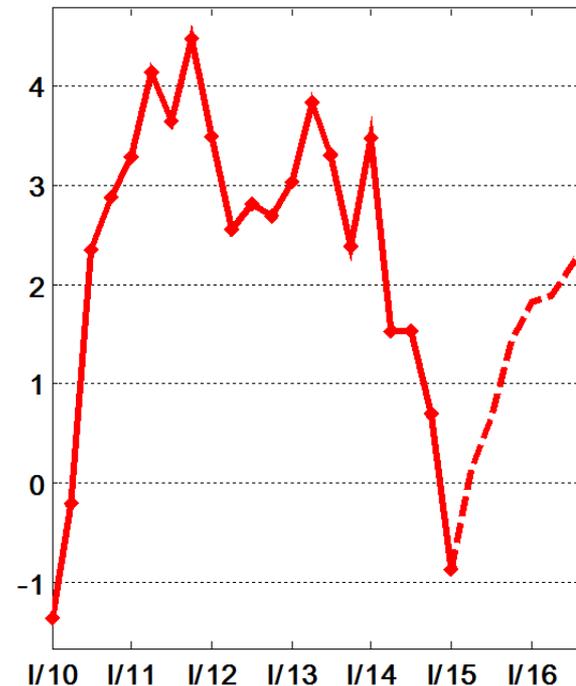


- Net inflation turned negative at the start of 2015 due to a sharp fall in fuel prices and decline in food prices. It will increase again in the rest of 2015 and reach 2% at the end of 2016.
- The administered prices will fall in 2015, with growth resuming only in 2016H2.

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

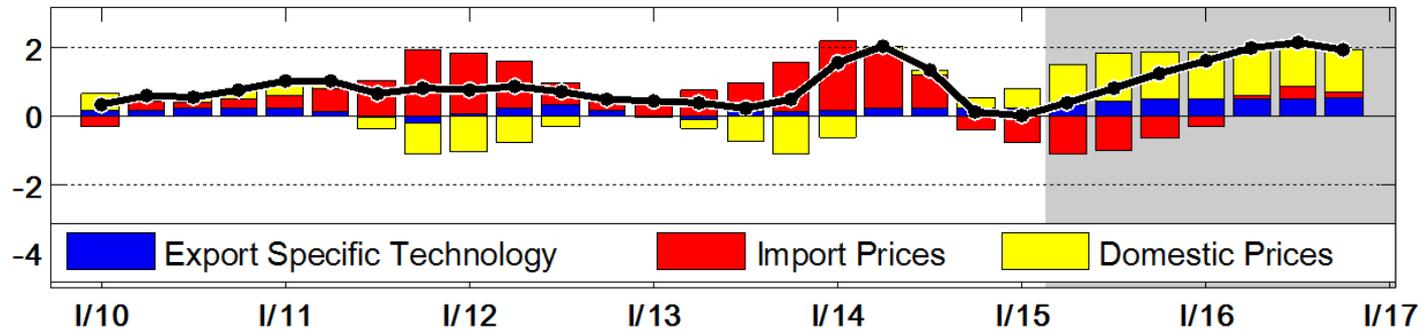


Food Inflation  
(y/y, in %, Excl. Tax Changes)

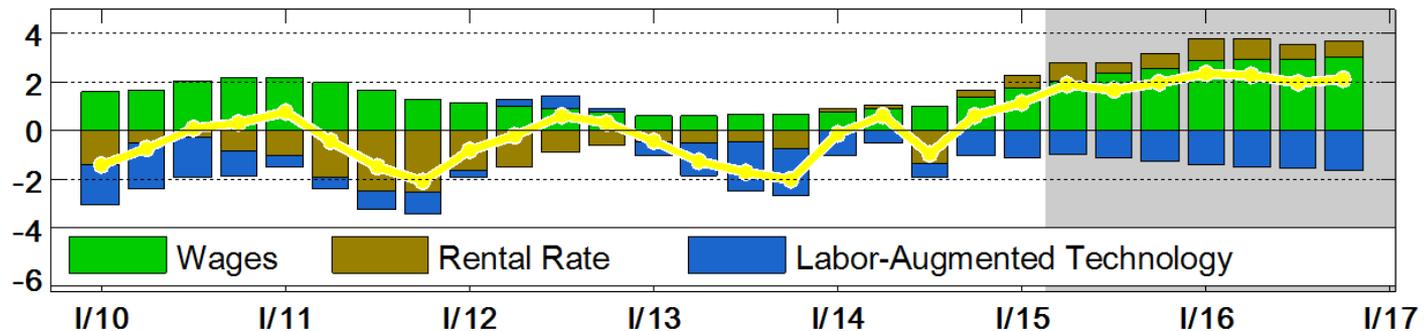


- Core inflation will slow down temporarily as a result of the unwinding of the direct effect of the weakened exchange rate. It will then speed up and reach roughly 1.5% in 2016 H2.
- Growth of food prices will renew only gradually due to continuing fall in the agriculture producer prices.

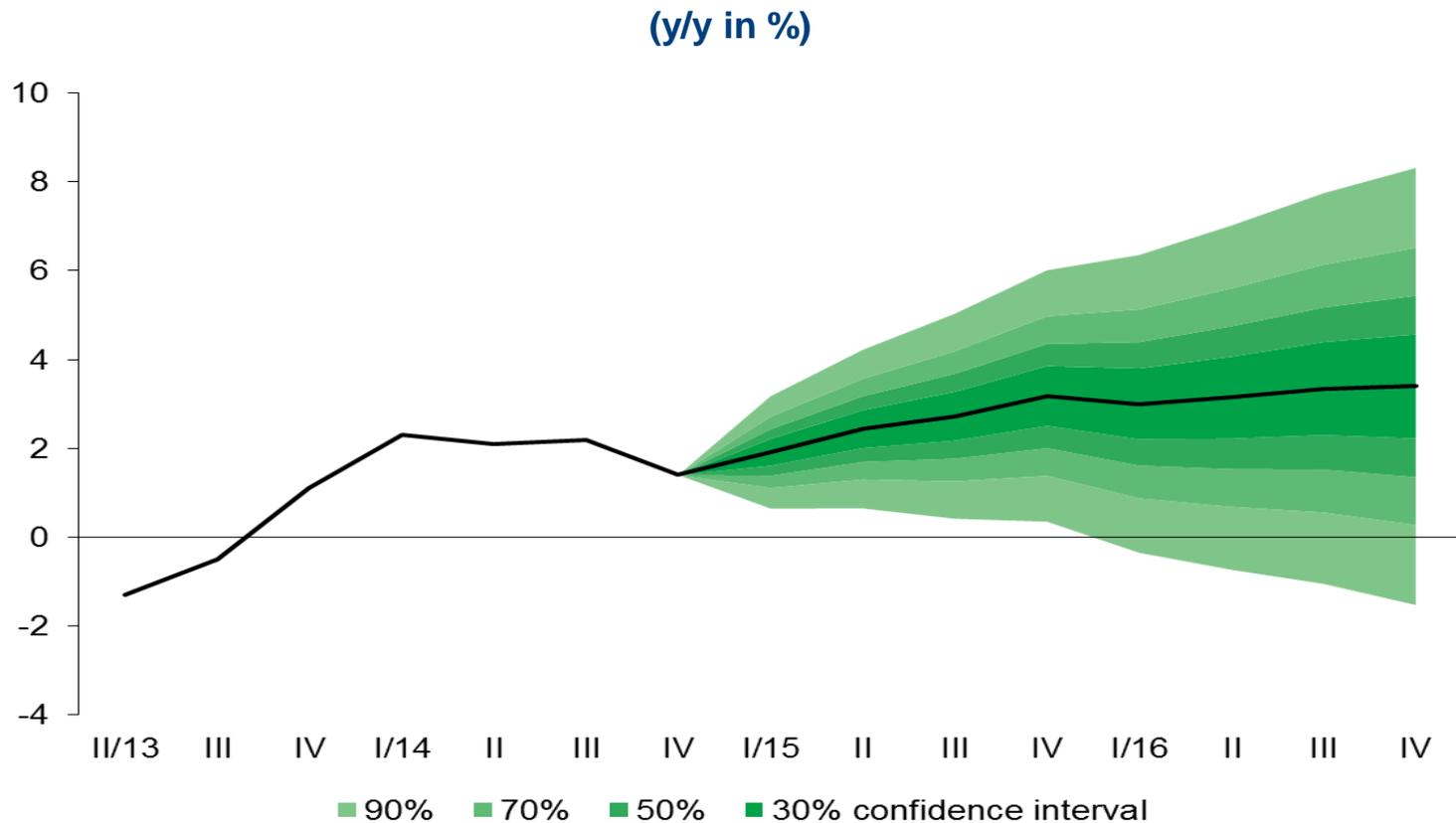
Nominal Marginal Cost in Consumption Sector (q/q, in %, ann.)



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

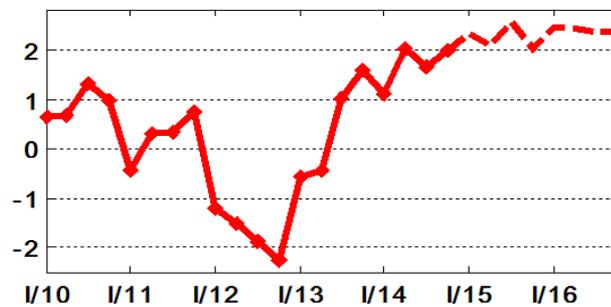


- Growth of prices in the consumption sector will be driven by the strengthening inflationary effect of domestic economy, contribution of import prices being negative until the beginning of 2016.
- Domestic costs will grow mainly due to increasing dynamics of wages.

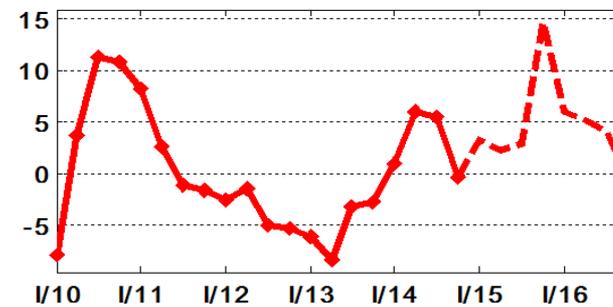


- GDP growth forecast: 2.6% in 2015; 3.2% in 2016.
- The economy will be boosted by an upswing in external demand, easy monetary conditions, low oil prices and in 2015 by expansionary fiscal policy.
- The growth will be supported by almost all components of aggregate demand.

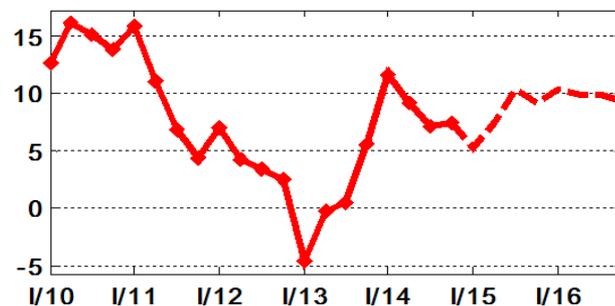
Household Consumption Growth (y/y, in %)



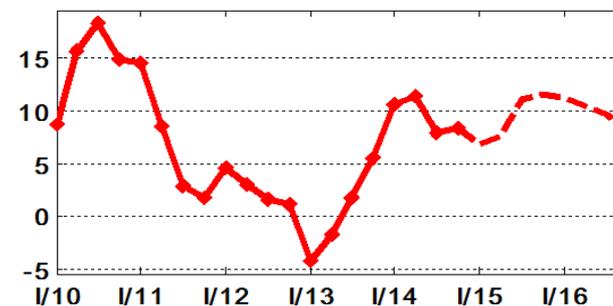
Investments Growth (y/y, in %)



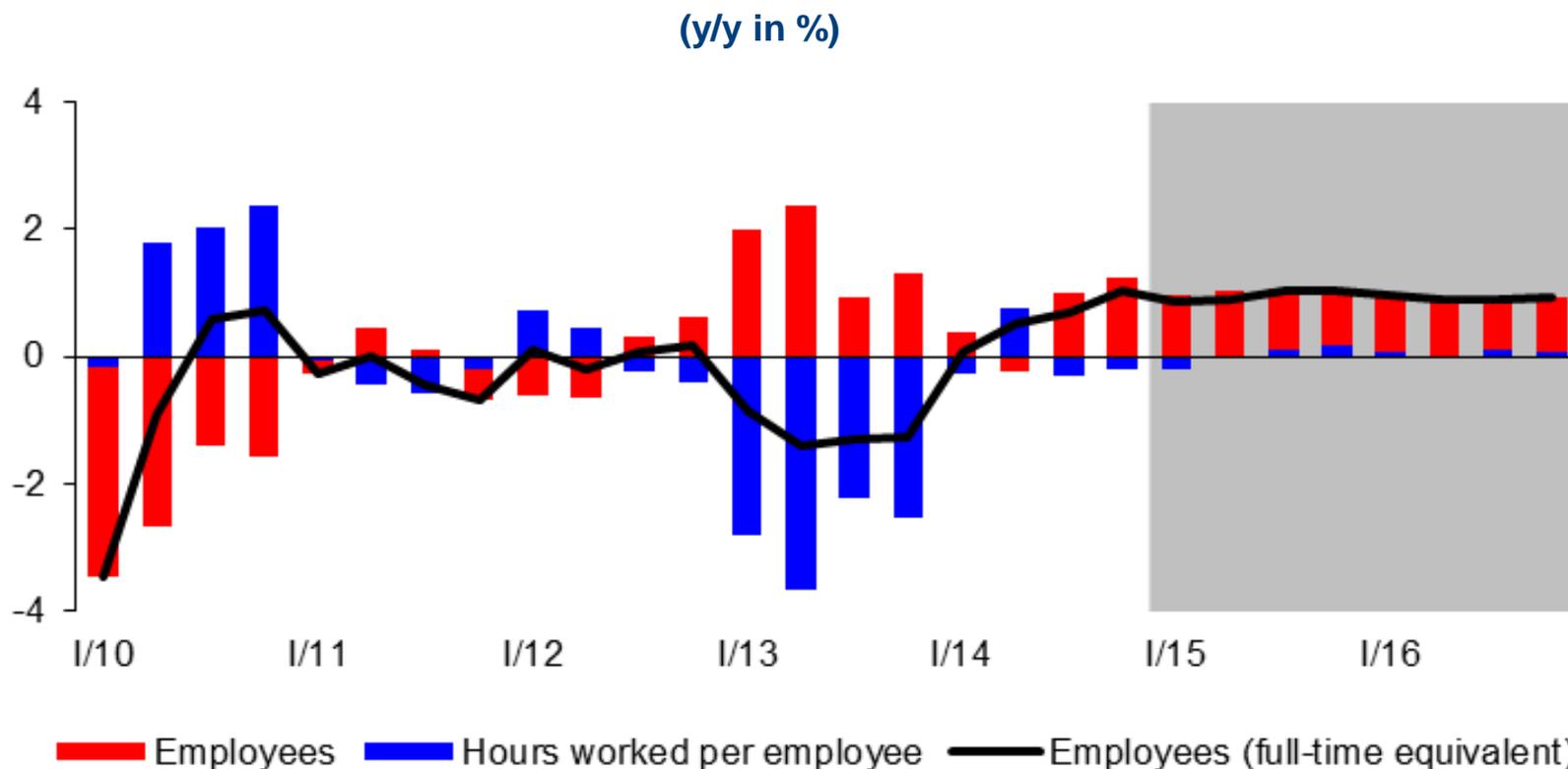
Exports Growth (y/y, in %)



Imports Growth (y/y, in %)

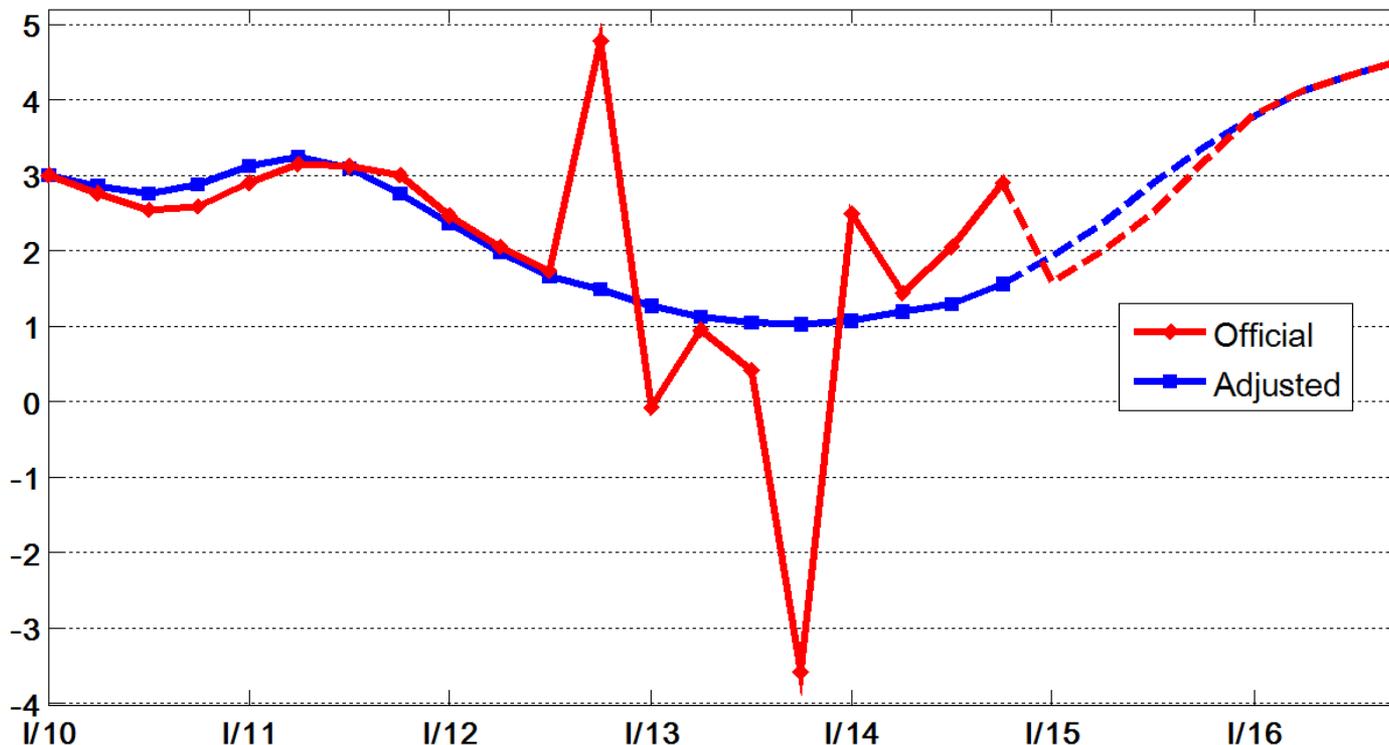


- Household consumption will continue to grow over the following two years.
- The total investments will pick-up driven by expected fixed investment growth partly related to government investments (in 2015 mainly due to EU funds).
- Exports reflect revival of foreign demand, while imports growing domestic demand esp. investments.

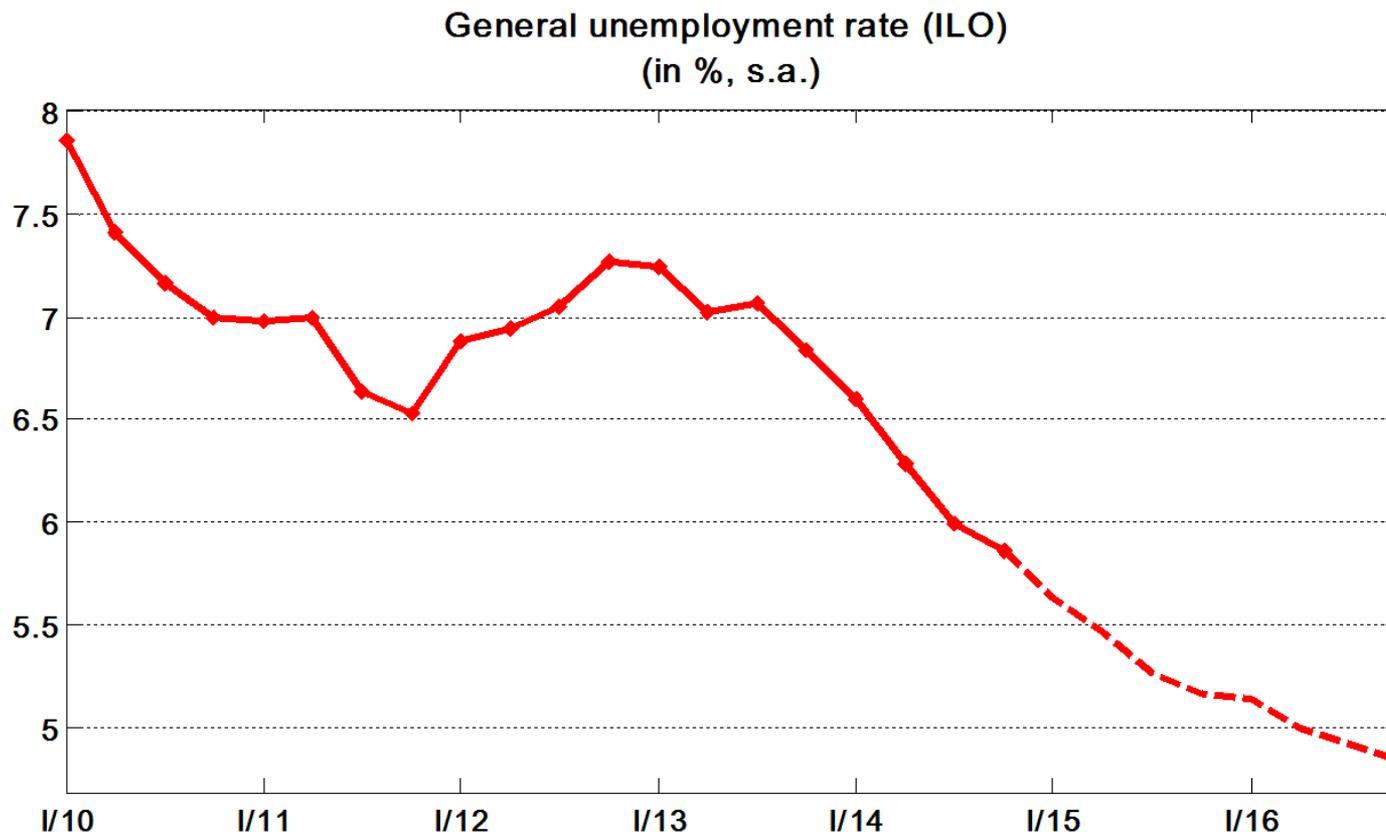


- Employment growth expressed in full-time job equivalent will remain at 1% for both 2015 and 2016.
- This will be fostered mainly by a higher number of employees, while average hours worked are expected to be flat.

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

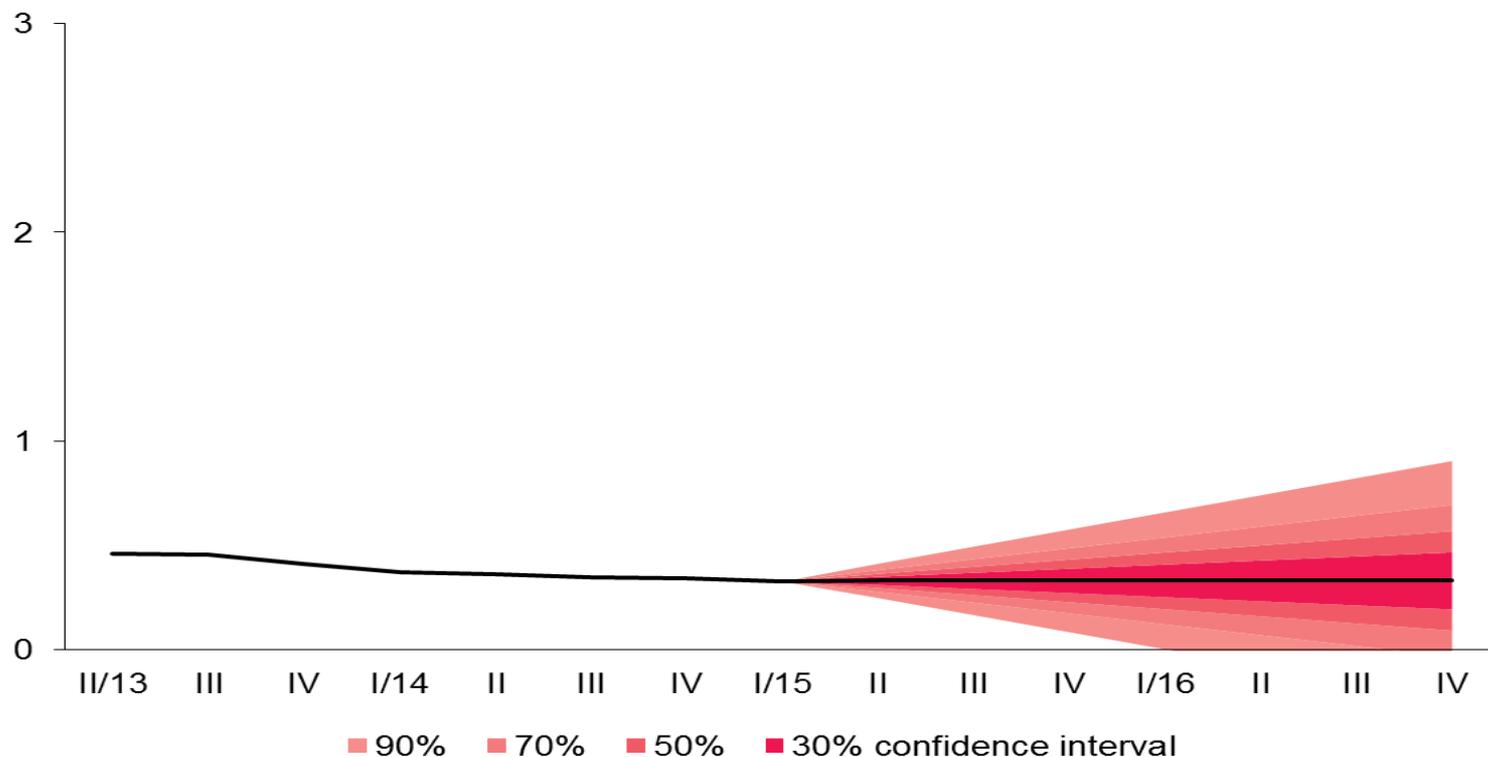


- Wage growth in the business sector will increase to 2.3% for 2015 as a whole and 4.2% in 2016.
- Wages in the non-business sector will rise rapidly, especially this year.



- The general unemployment rate will continue to steadily decline over the entire forecast horizon due to expected growth in employment associated with a gradual pick-up in the economic growth.
- The number of employees but simultaneously the rate of unemployment for Q1 above the forecast.

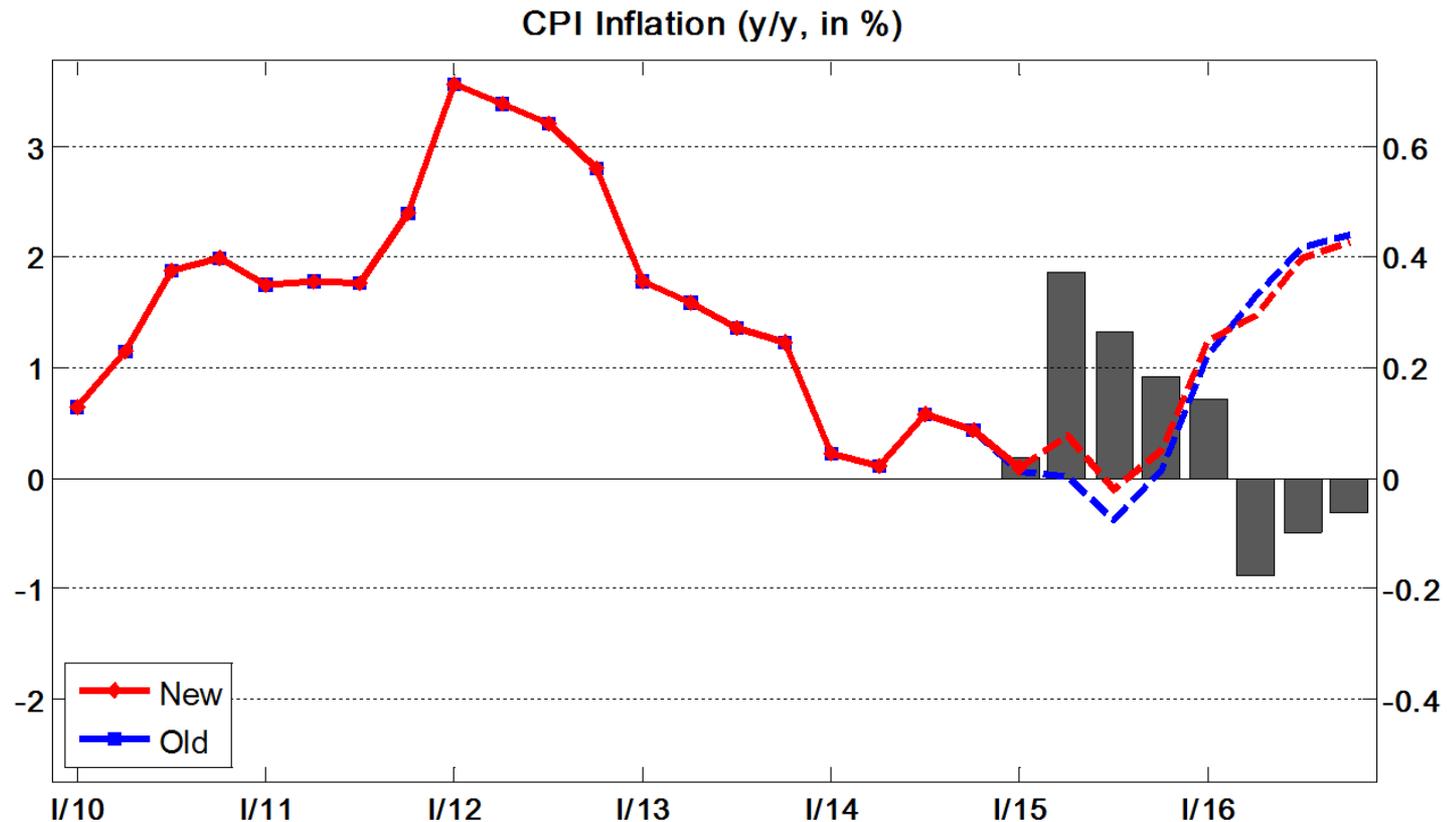
PRIBOR 3M, % p.a.



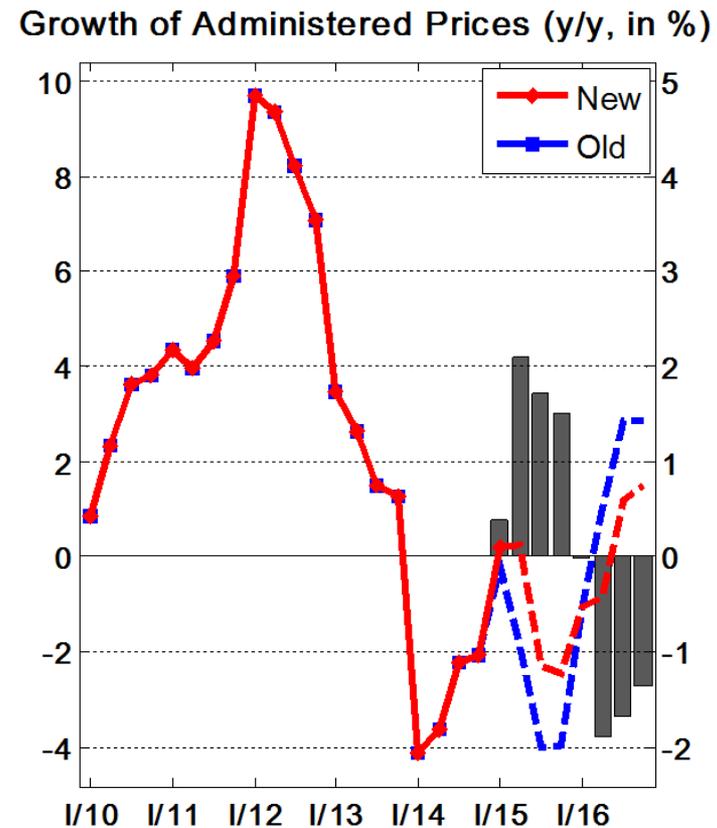
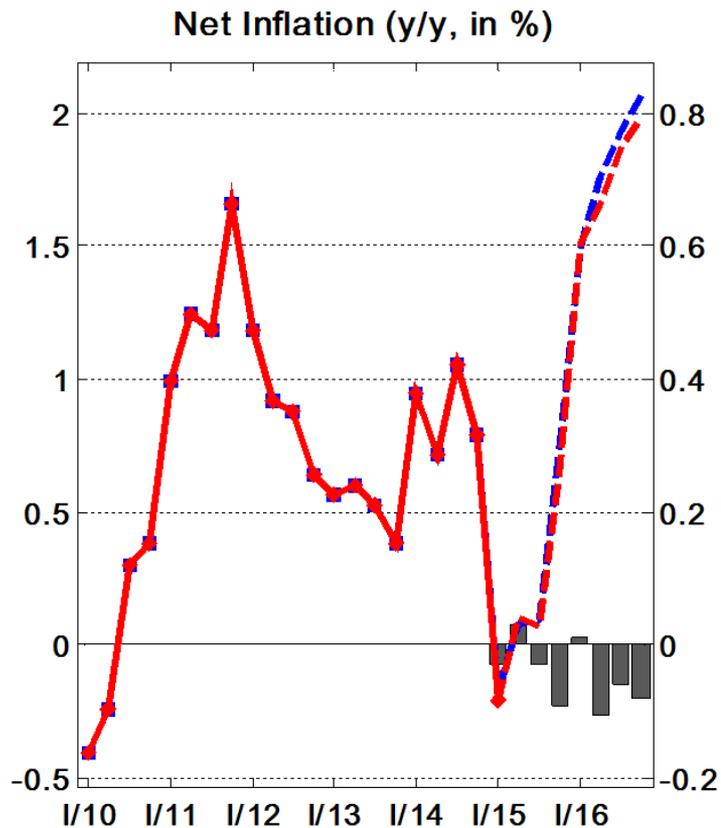
- The forecast expects market interest rates to be flat at their current very low levels until the end of 2016, i.e. over the entire forecast horizon.
- This reflects an assumption that the 2W repo rate will be left at technical zero and the money market premium will remain unchanged in the same period.

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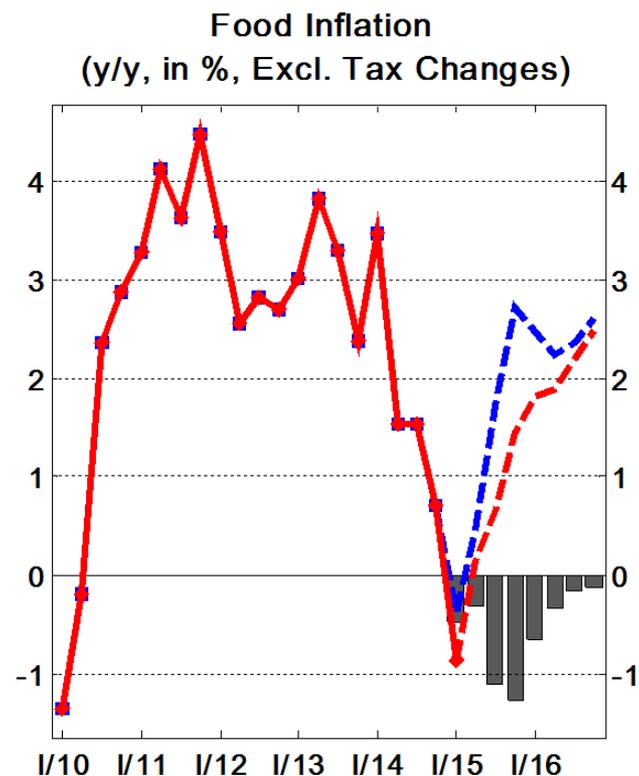
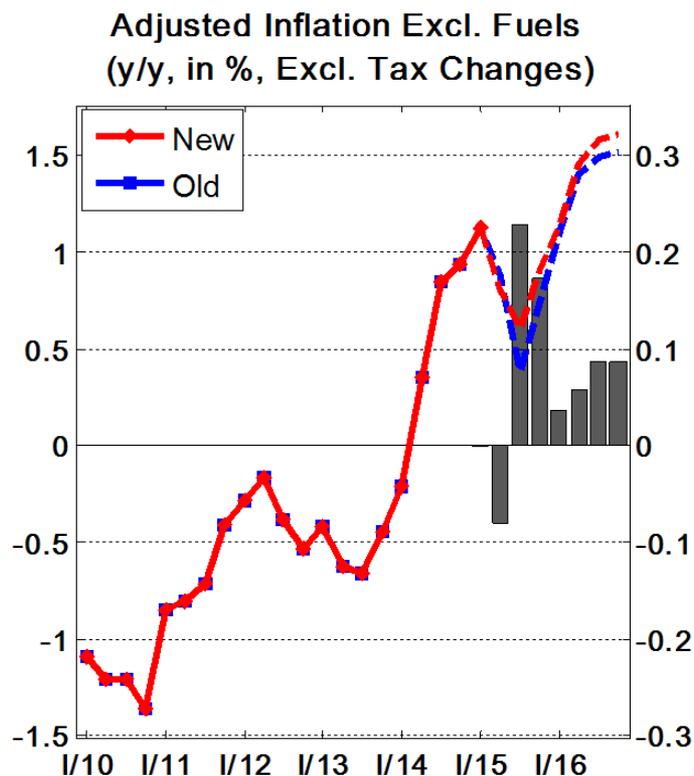
- The forecast for inflation is, compared to the previous forecast, slightly higher in 2015 and negligibly lower in 2016, owing to less pronounced swings in administered prices as well as a slightly lower outlook for net inflation.
- GDP growth forecast has been revised upwards for 2016, mainly as a result of slightly stronger external demand.
- The outlook for nominal wage growth in the business sector for 2015 has shifted lower as a result of slower observed wage growth in 2014. In the next year, however, the forecast expects more sizeable wage growth acceleration.
- The assumption of interest rates stability on current very low levels and use of the exchange rate as a monetary policy instrument until the end of the forecast horizon remains unchanged.



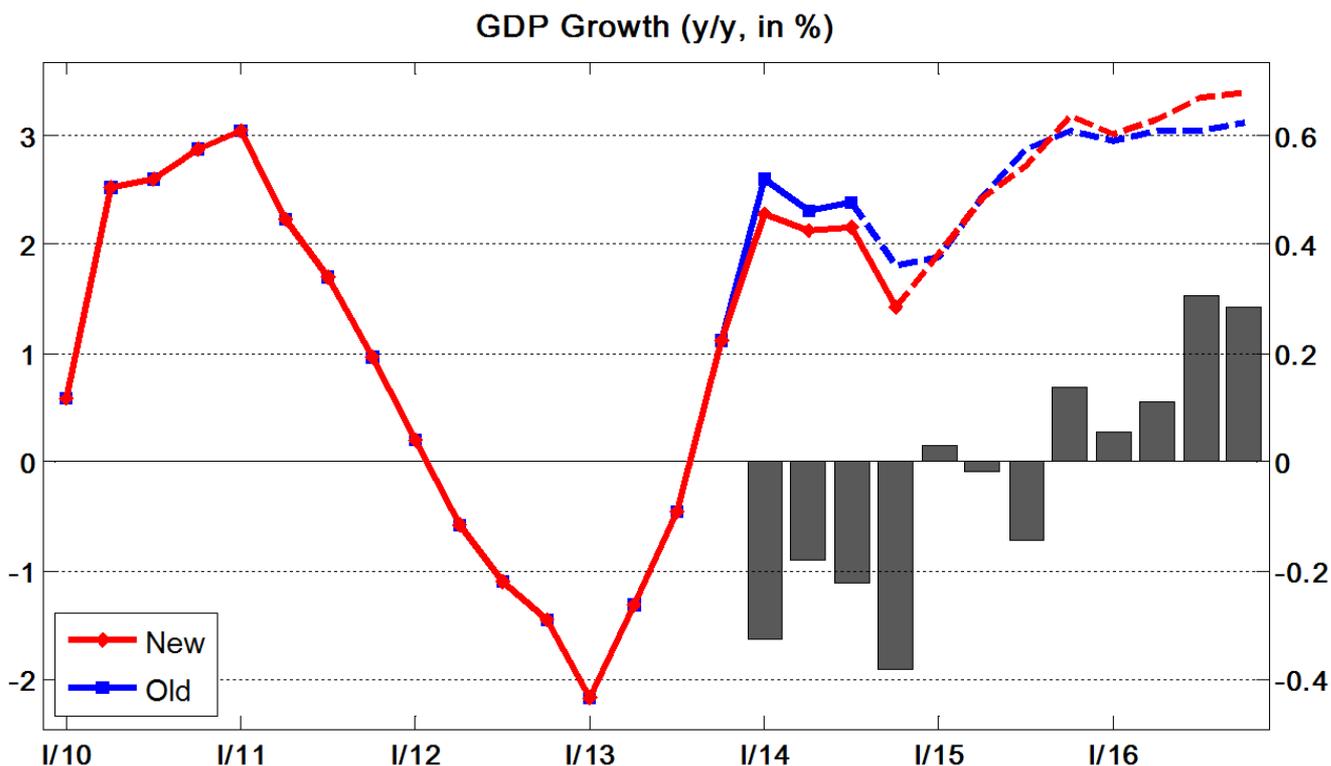
- The forecast for headline inflation is slightly higher in 2015 due to less pronounced decrease in administrative prices partially compensated by lower net inflation.
- Forecast shifts negligibly lower in 2016.



- Net inflation is marginally lower over the entire forecast horizon, reflecting counteracting effects of higher fuel prices and weaker food price growth.
- The outlook for administered prices in 2015 has increased as a response to higher than expected gas prices, while the opposite is true for 2016.



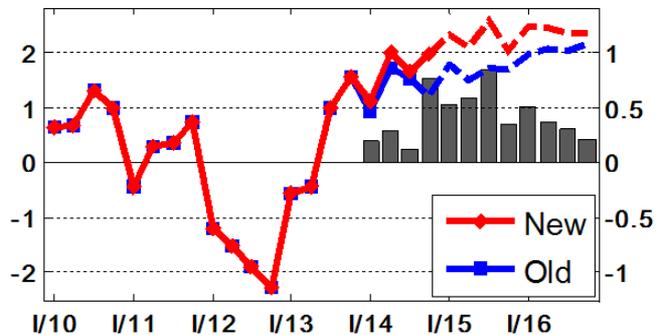
- Slightly higher outlook for core inflation reflects stronger domestic economic and wage growth especially in the second half of the forecast horizon.
- The forecast for food prices is lower on the full forecast horizon due to lower agricultural prices outlook.



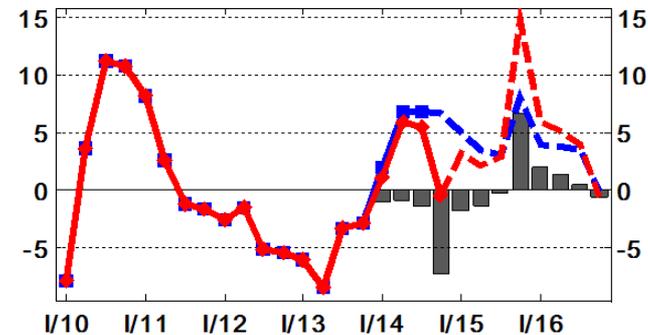
- The GDP growth forecast for 2015 has not visibly changed, however, there are slight differences in the contributions of its components.
- In 2016, forecast shifts up due to slightly stronger external demand leading to a higher contribution of both net exports and gross capital formation.

# Comparison with Previous GDP Forecast (ii)

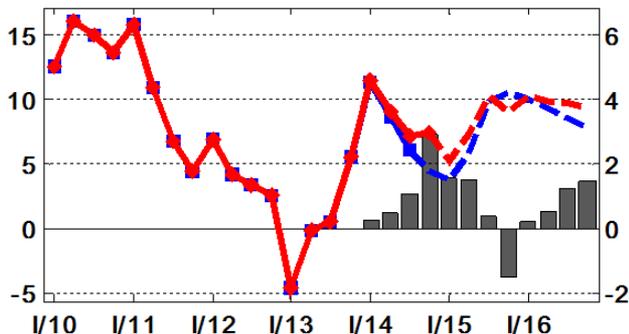
### Household Consumption Growth (y/y, in %)



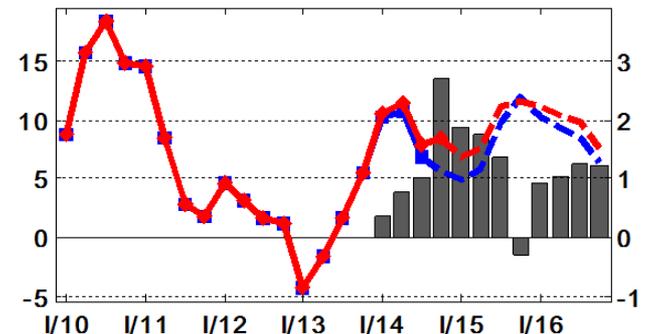
### Investments Growth (y/y, in %)



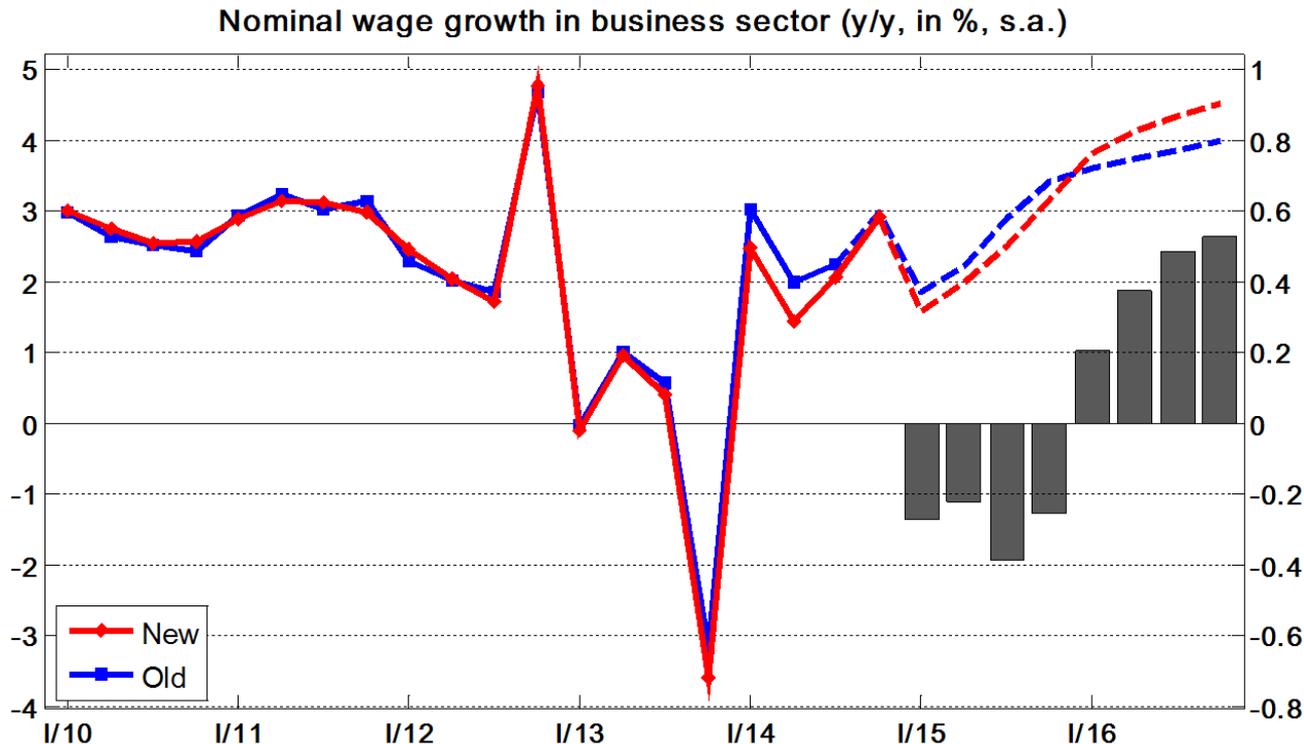
### Exports Growth (y/y, in %)



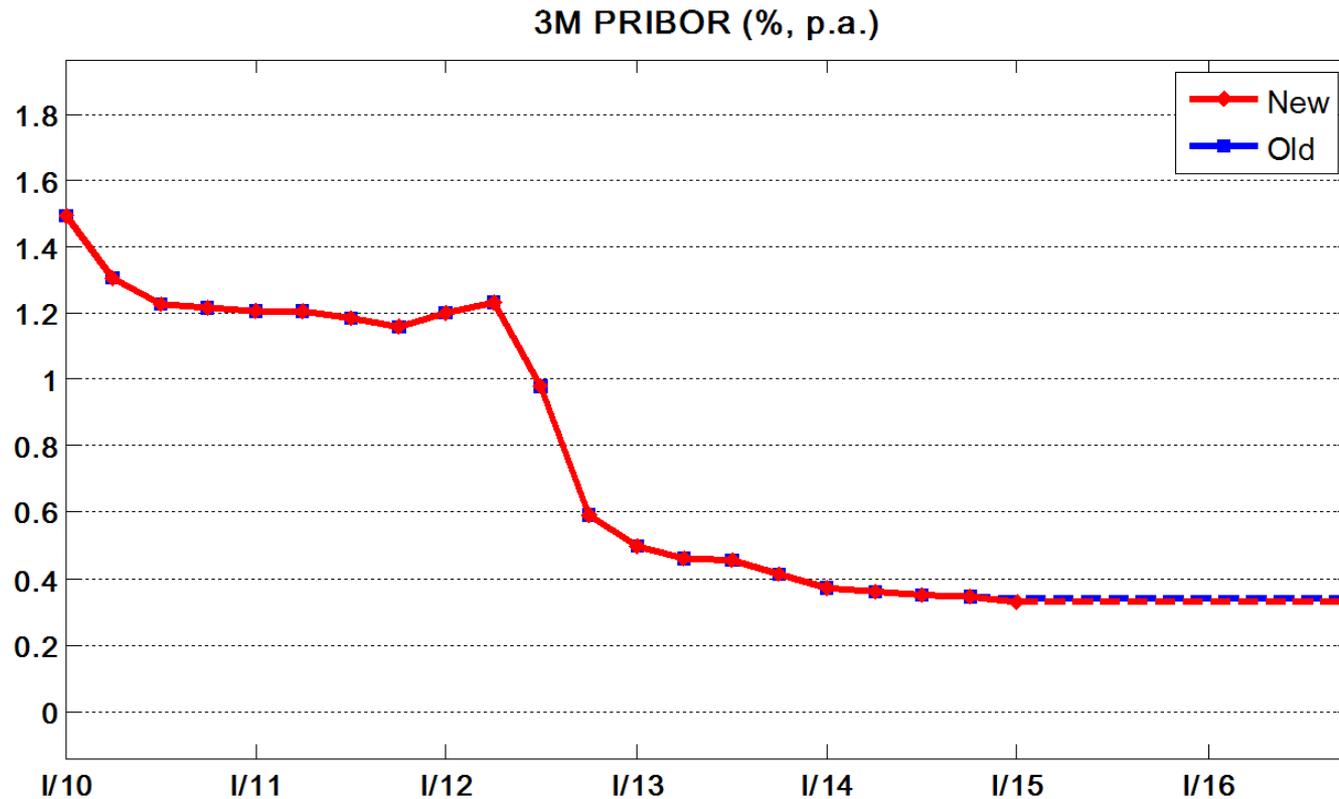
### Imports Growth (y/y, in %)



- Growth in household consumption has been revised upwards due to better starting conditions and more pronounced forecasted revival of wages later on.
- The higher external demand outlook is reflected in an increase in expected export and import growth in the next two years.



- The forecast for average nominal wage growth in the business sector has shifted slightly downwards in 2015, reflecting lower dynamics of wages in 2014.
- On the other hand, wage dynamics is expected to be faster in 2016 due to stronger economic growth and more rapidly declining unemployment.



- No change compared to the previous forecast: 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.

Thank you for your attention!

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