

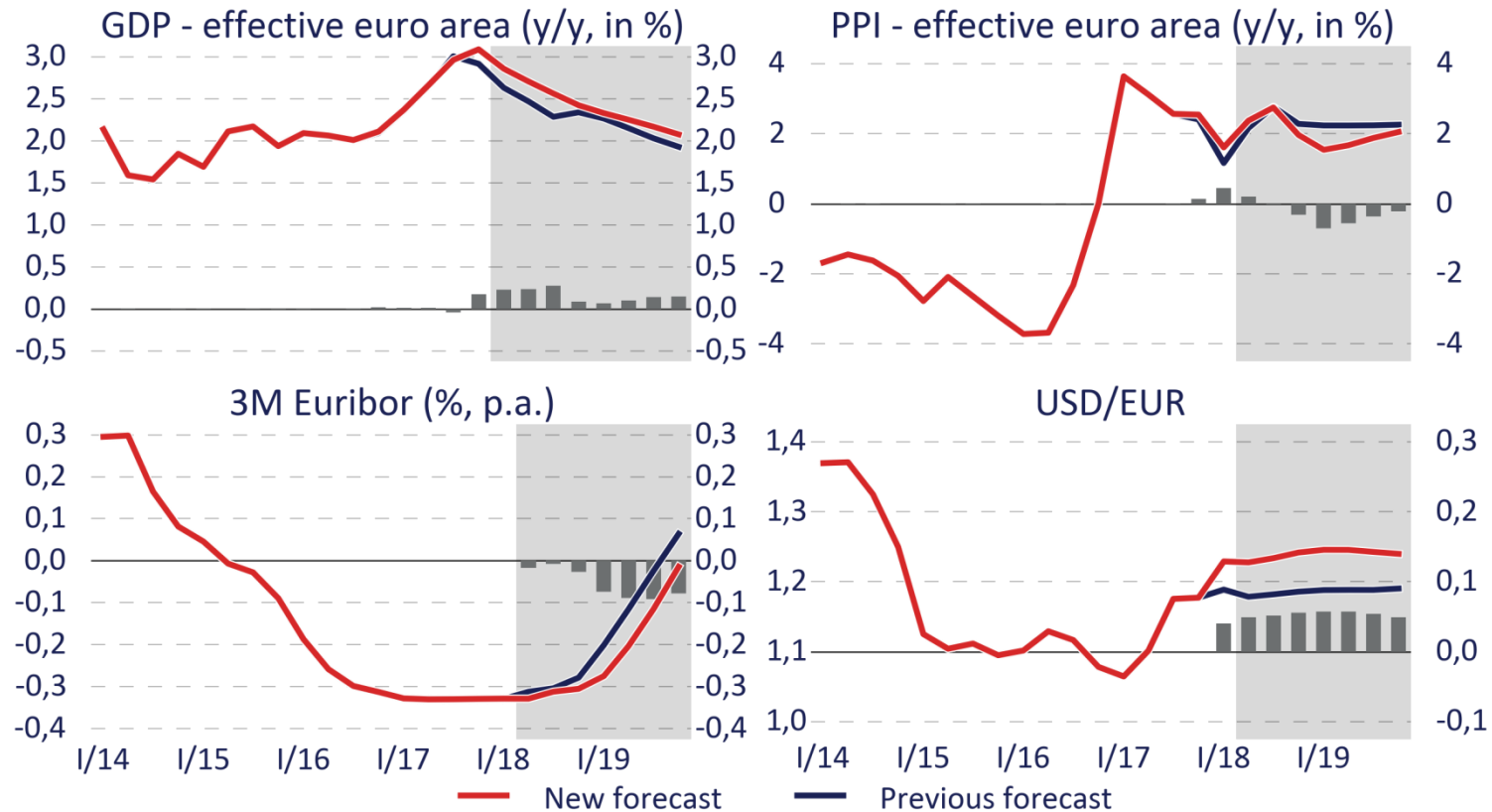
Meeting with Analysts

Petr Král

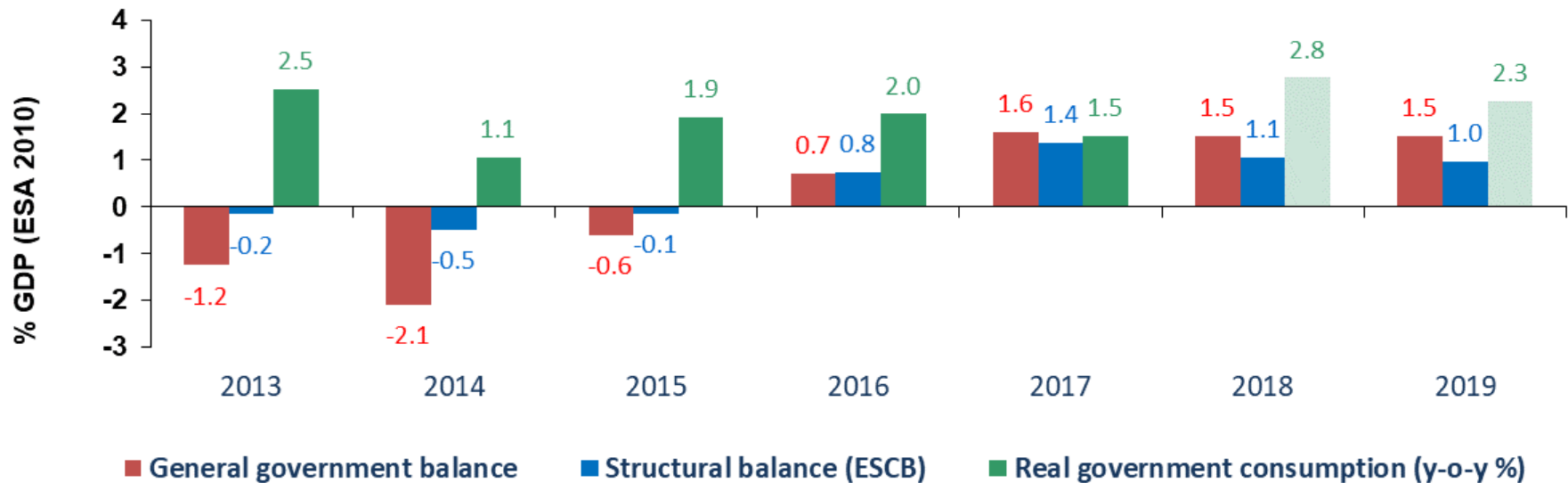
Prague, 4 May 2018

1. Assumptions of the forecast
2. The new macroeconomic forecast
3. Comparison with the previous forecast
4. Sensitivity scenarios

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- GDP growth in the effective eurozone will remain robust and is revised upwards.
- Producer price dynamics will fluctuate around 2%.
- Continued easy monetary policy of the ECB keeps the outlook for 3M EURIBOR in the negative territory until the end of 2019.
- The USD/EUR outlook is above 1.20.



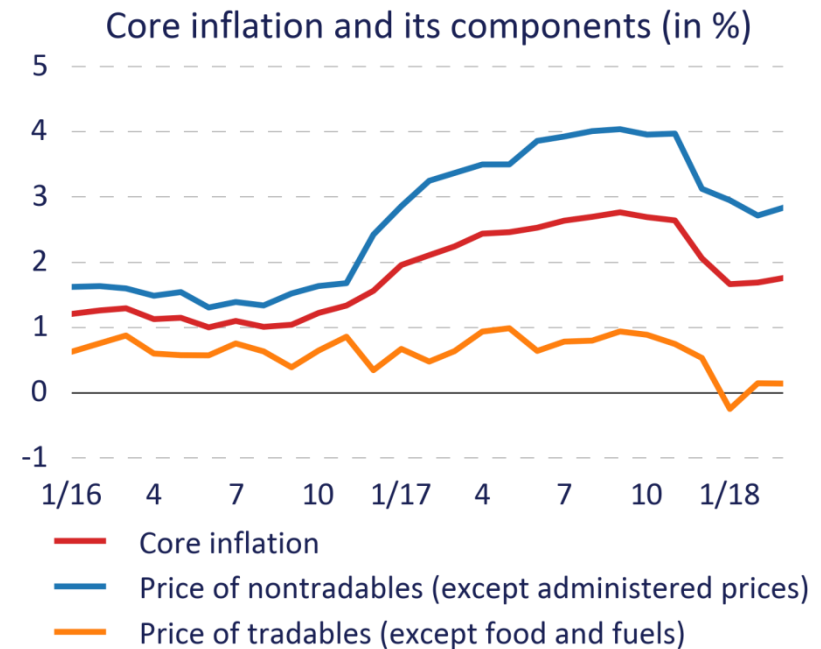
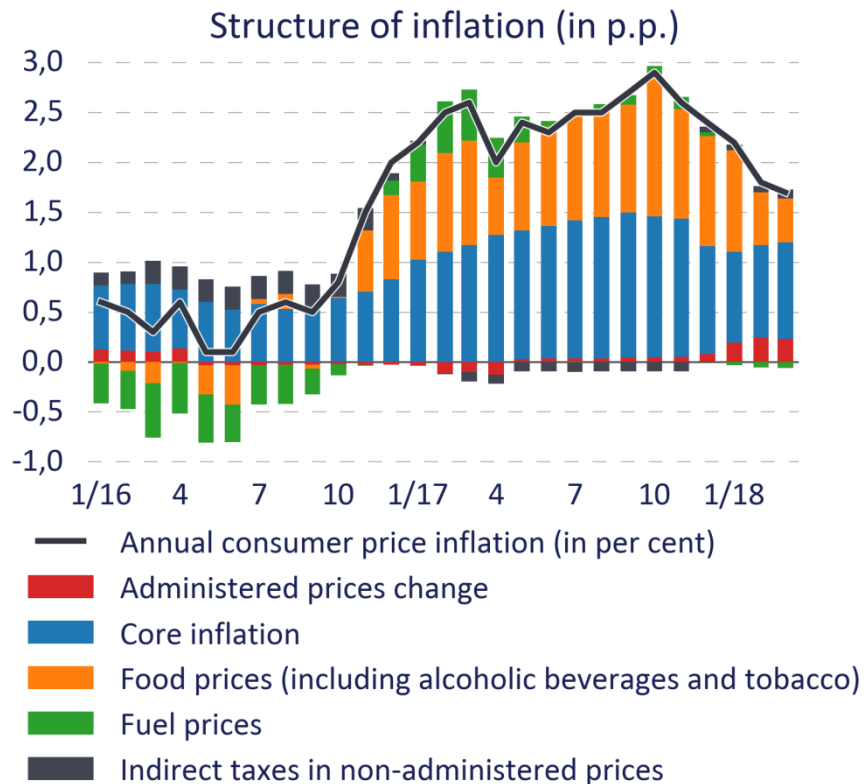
- The increasing government budget surpluses primarily reflect growth in tax revenues due to continued economic growth and policy measures.
- The government surplus will reach 1.5% GDP both in this and the next year. This will be associated with persistent structural surpluses.
- The real government consumption will grow by 2.8% in 2018 (and by only slightly less in 2019).

Contributions to GDP growth in percentage points	2016	2017	2018	2019
	actual	actual	forecast	forecast
Fiscal impulse	-1.1	0.2	0.4	0.3
of which impact through:				
private consumption	0.0	0.2	0.3	0.1
private investment	-0.1	-0.1	0.0	0.0
government investment, domestic	-0.2	0.0	0.1	0.0
government investment, EU funded	-0.7	0.1	0.1	0.1

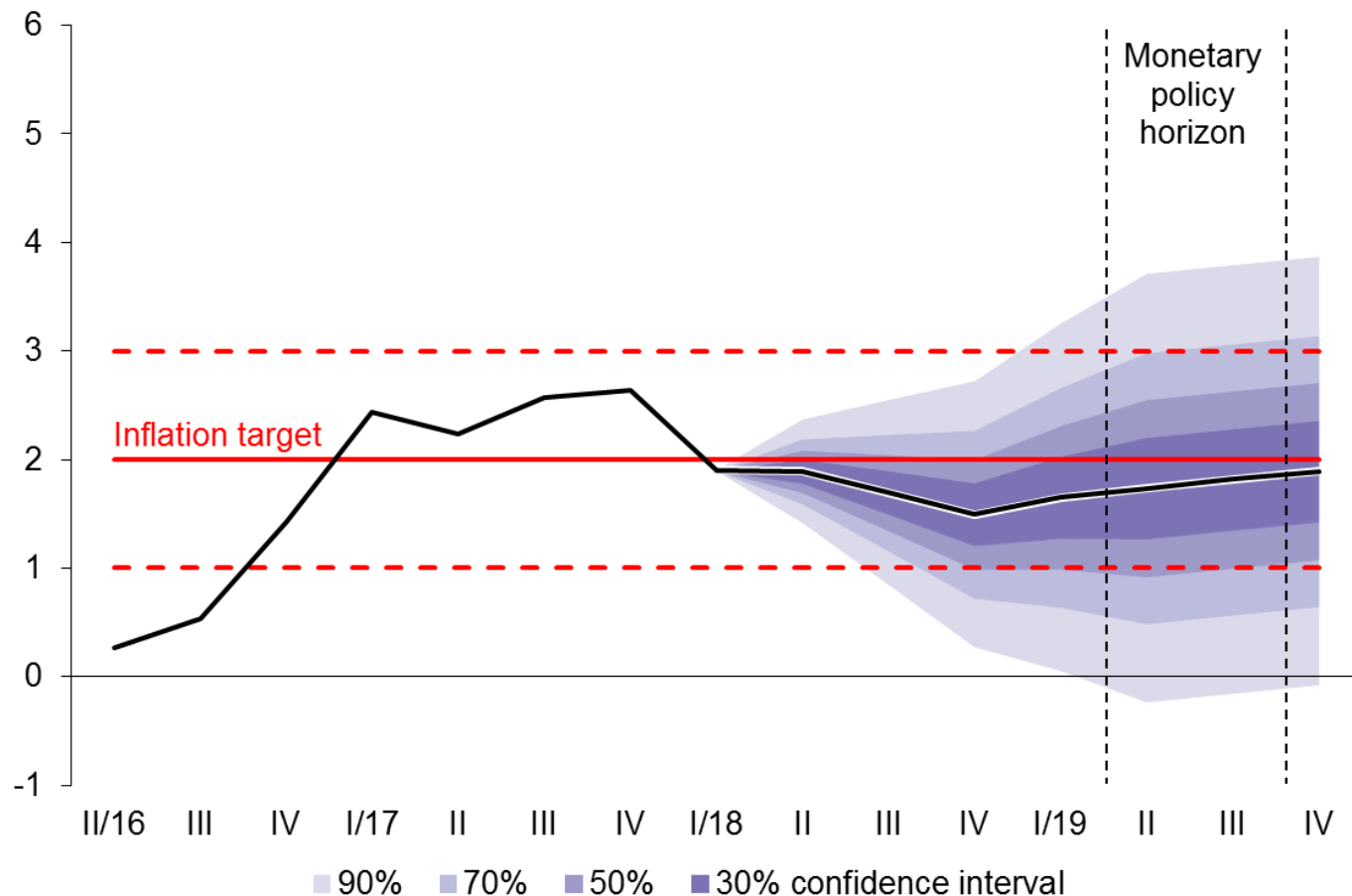
- Fiscal policy will remain expansionary both this year and the next.
- The fiscal expansion in this year will relate mainly to measures supporting household consumption, including buoyant wage growth in the government sector, and to recovery in government investment.
- In 2019, on the other hand, it will stem from the marked increase of old-age pensions and continuous growth of government investment

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- Inflation will be moderately below the 2% target this year and will return very close to the target at the monetary policy horizon.
- GDP growth will slow down from the last year's rates, it will, however, still markedly exceed 3% throughout the years 2018-2019.
- The increase in domestic economic activity will be driven mainly by robust growth in household consumption and fixed investment, amid continuous growth of foreign demand.
- Growing labour demand will, in combination with the lack of available workforce, result in continuing robust wage dynamics.
- The exchange rate will appreciate further due to a positive interest rate differential, and long-term real convergence.
- Consistent with the forecast is broad stability of market interest rates initially, followed by further growth in rates from late 2018/early 2019.

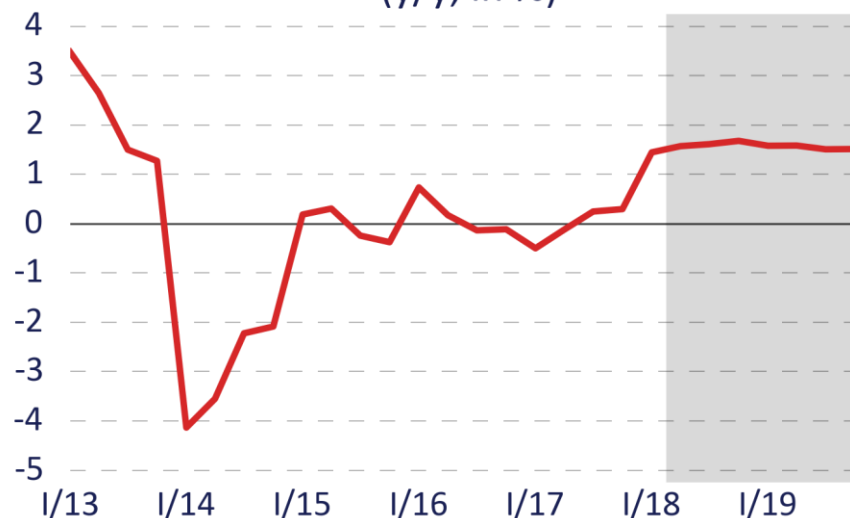


- Slowdown in the growth of consumer prices has been driven by a markedly lower growth in food prices and decline in core inflation.
- Core inflation declined in the beginning of the year owing to slower growth in the prices of nontradables, including fading out of one-off effects from 2016/2017 and slowing dynamics of imputed rents, and due to a decline in import prices affecting the prices of tradables.



- Inflation will be moderately below the 2% target this year and will return very close to the target at the monetary policy horizon.
- MP-relevant inflation will differ only marginally from headline inflation.

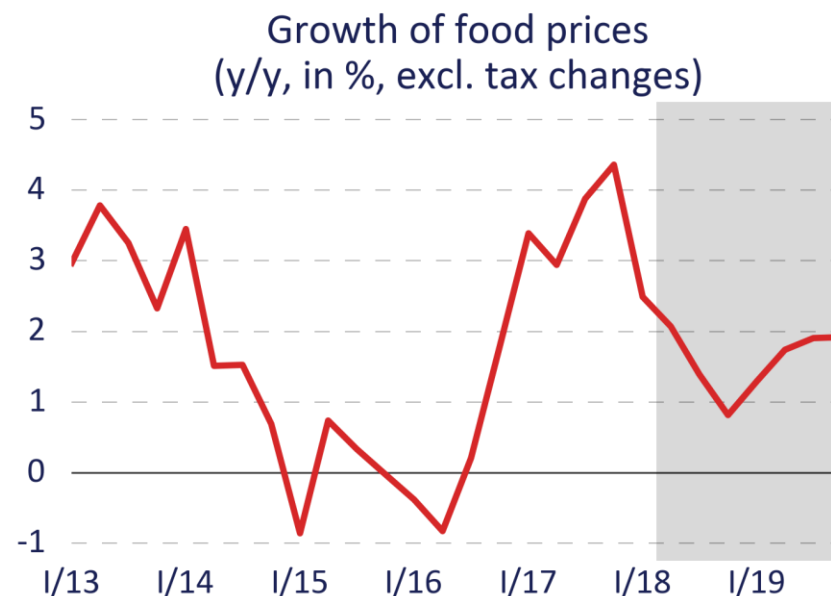
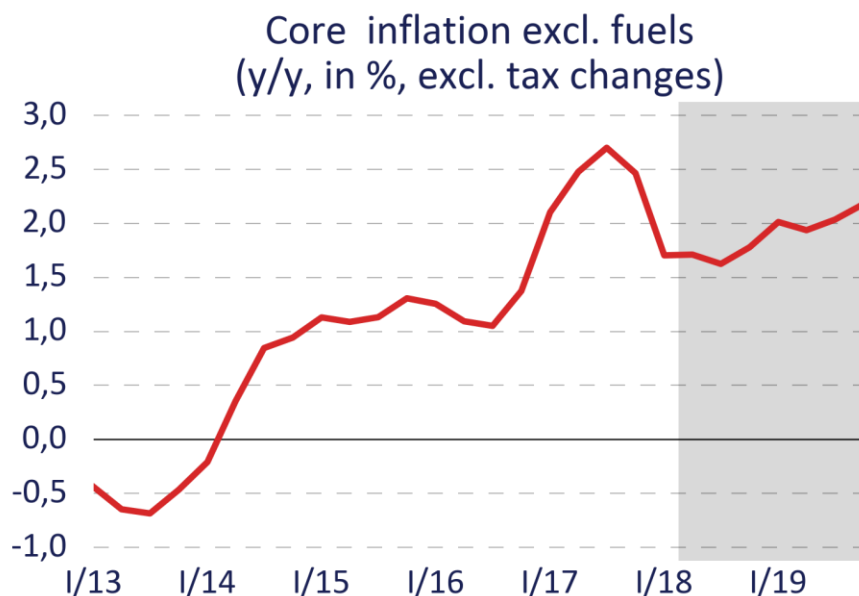
Growth of administered prices
(y/y, in %)



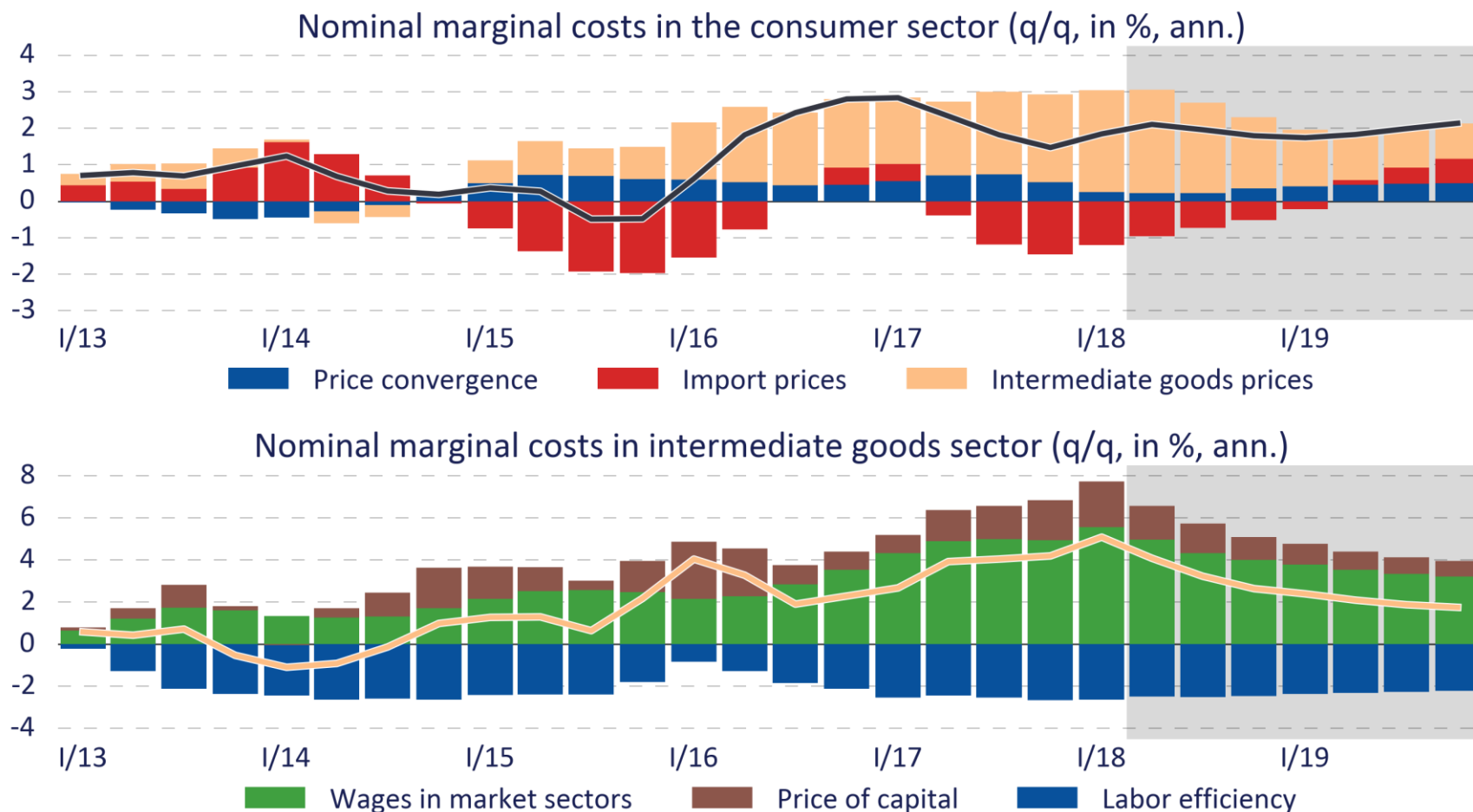
Growth of fuel prices
(y/y, in %, excl. tax changes)



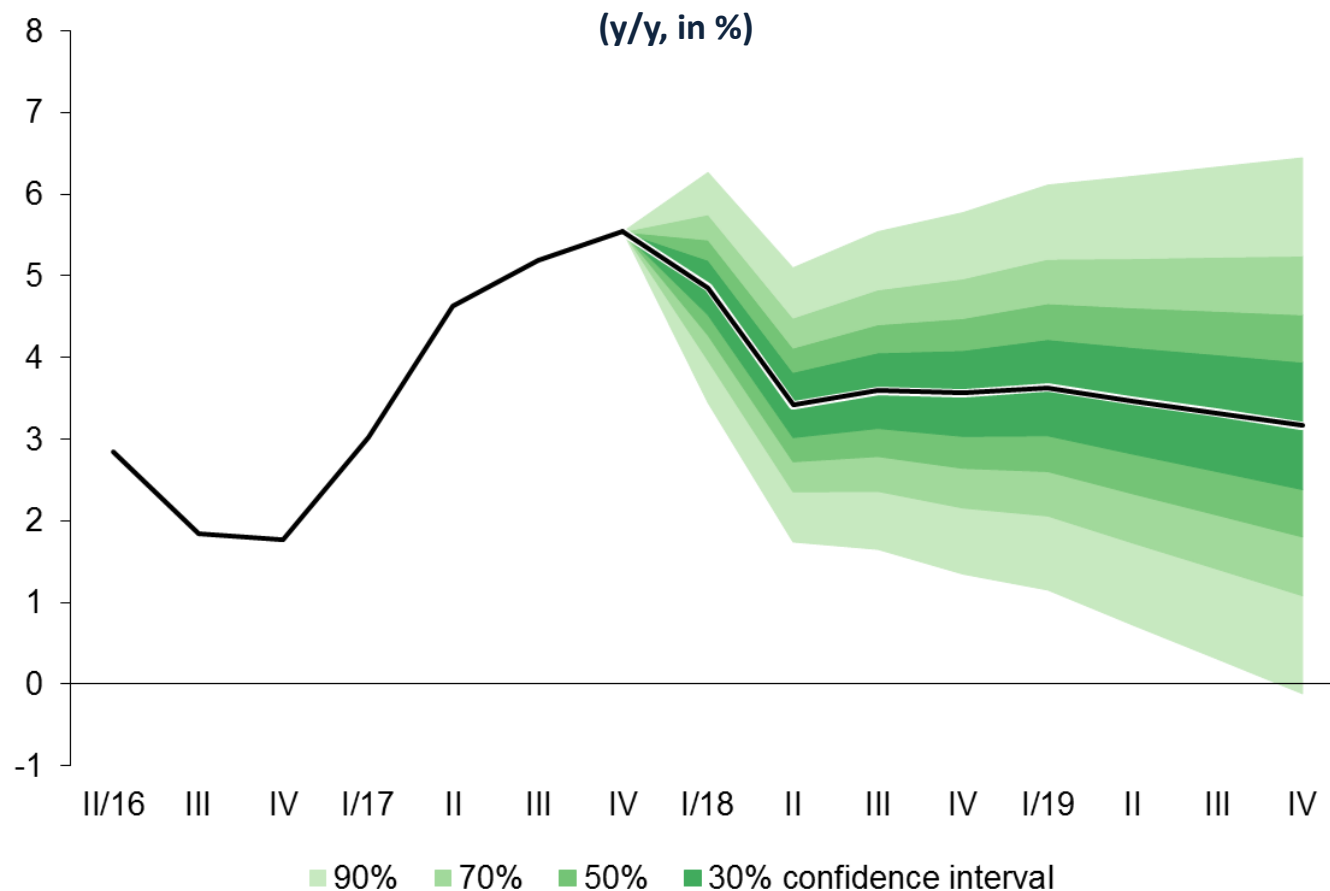
- Administered prices will continue rising this year, owing mainly to an increase in electricity prices. These are partly counteracted by a negative contribution of gas prices, and, in the first half of 2018, also heat prices.
- In 2019, administered price will slow somewhat due to more muted increases of electricity price.
- Fuel prices will see a short renewal in growth this year, but will decline in 2019, in line with the developments of world price of fuels.



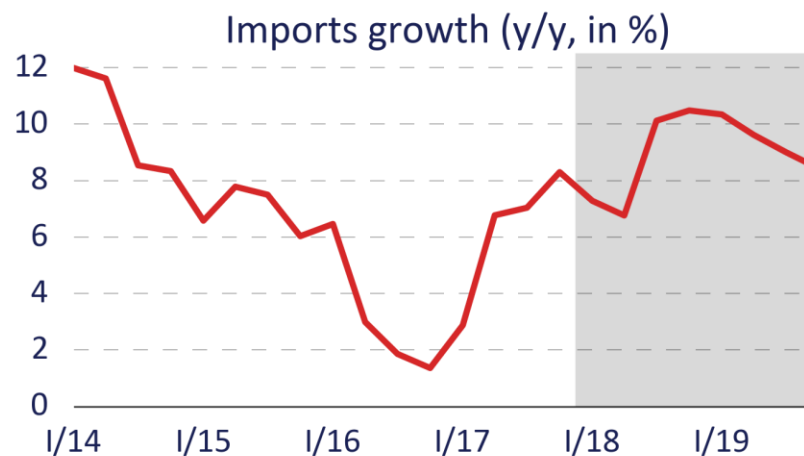
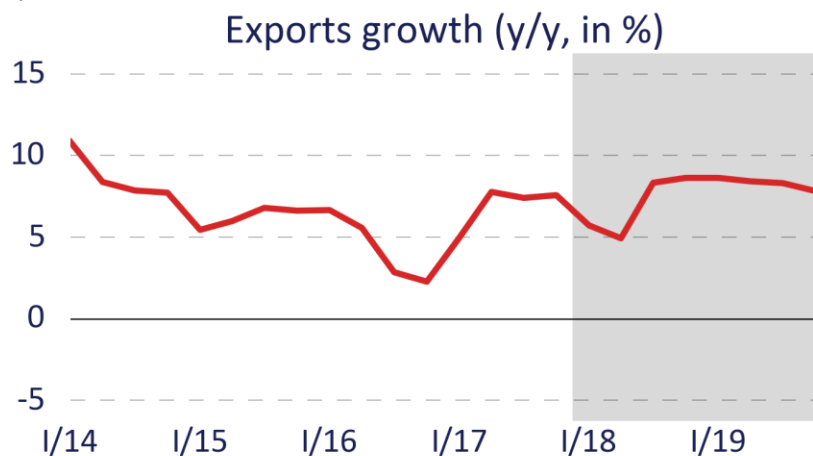
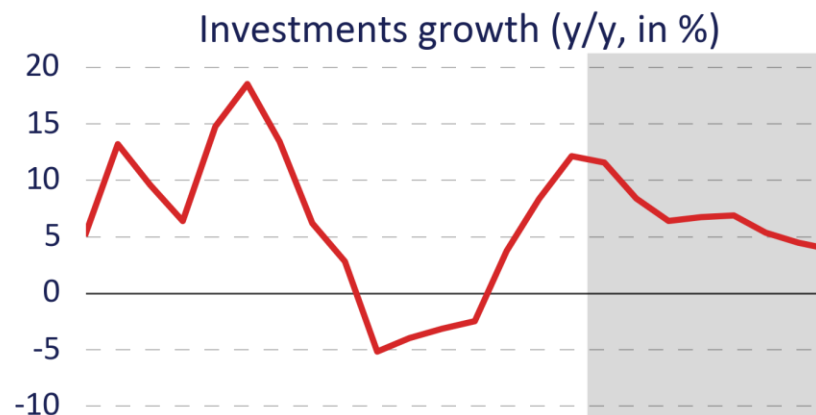
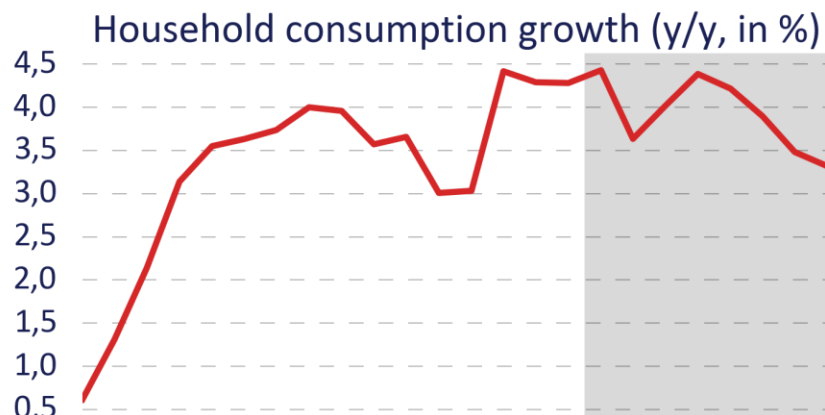
- Slow down in the core inflation in the previous quarter can be attributed to unwinding of one-off factors and appreciation of the koruna. These anti-inflationary factors will be partly offset by the impact of rising domestic demand and wages, resulting in stable core inflation in the short run.
- During 2019, core inflation will start to rise gradually back towards 2%, reflecting renewed growth in import prices.
- Food price growth will slacken owing to a slowdown in the growth of agricultural commodity prices. Its growth will revive in 2019 owing to agricultural commodities outlook and only gradual appreciation of exchange rate.



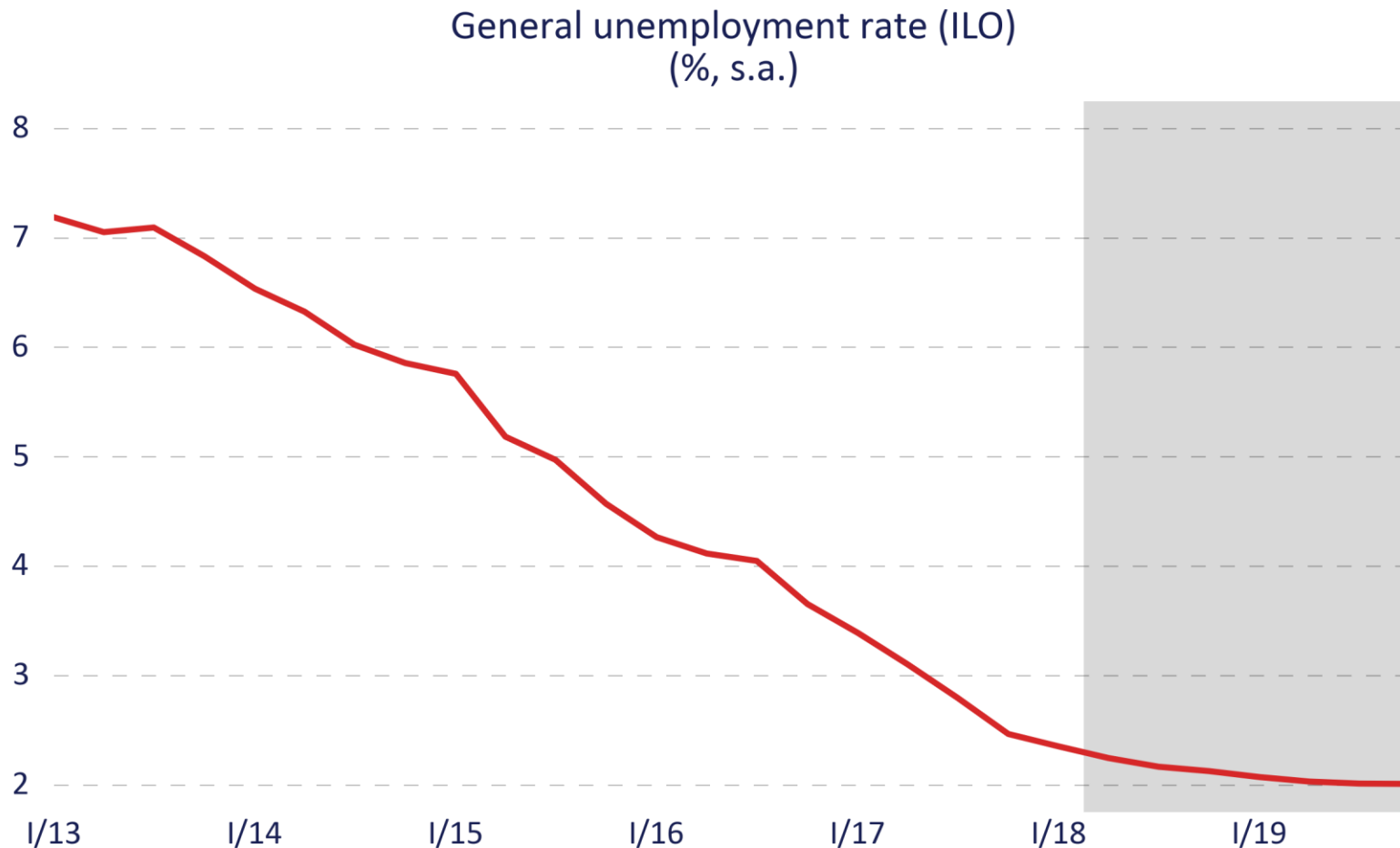
- Overall inflation pressures in consumer sector will remain strong. The dissipation of the anti-inflationary effect of import prices will be counteracted by gradual lowering of domestic inflation pressures due to expected deceleration of nominal wage growth in parallel with continued growth in labour efficiency.



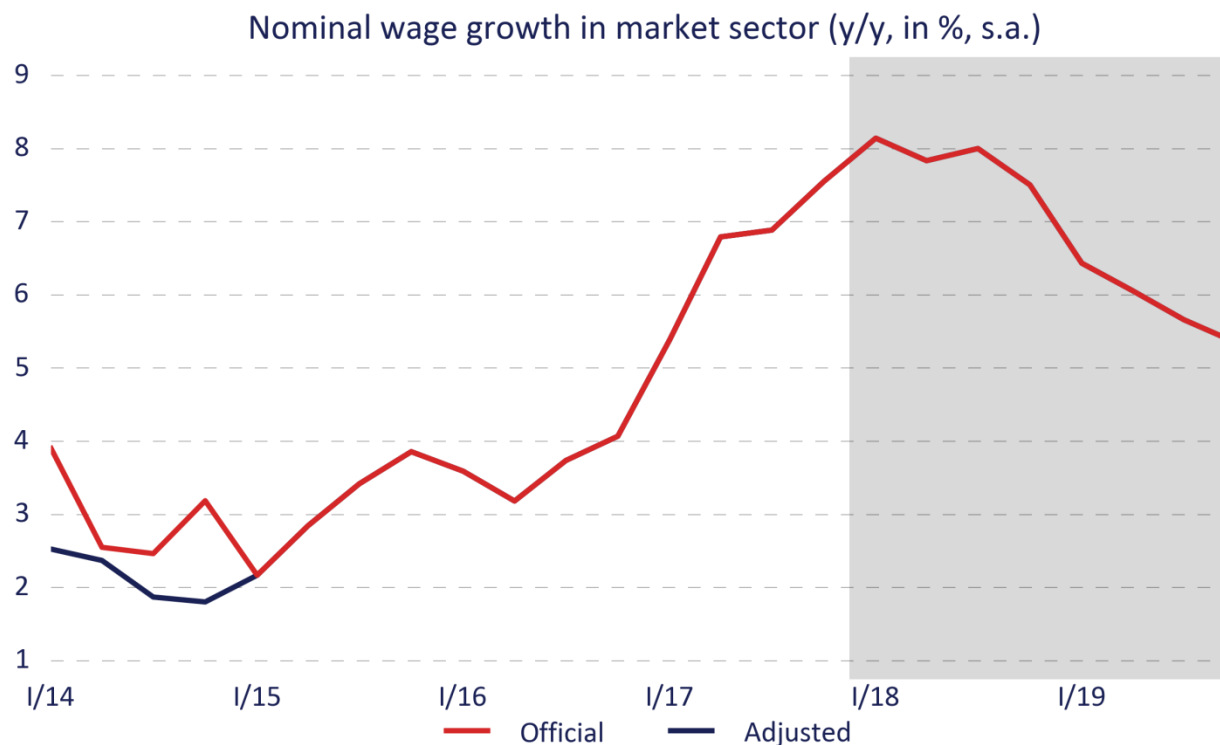
- GDP growth will slow down from the last year's high growth, yet it will markedly exceed 3% both in this and upcoming year. The dynamics of GDP will be fuelled by robust growth of household consumption as well as fixed investment.
- On the other hand, contribution of net exports to GDP growth will be negative in 2018 (stronger CZK, higher imports).



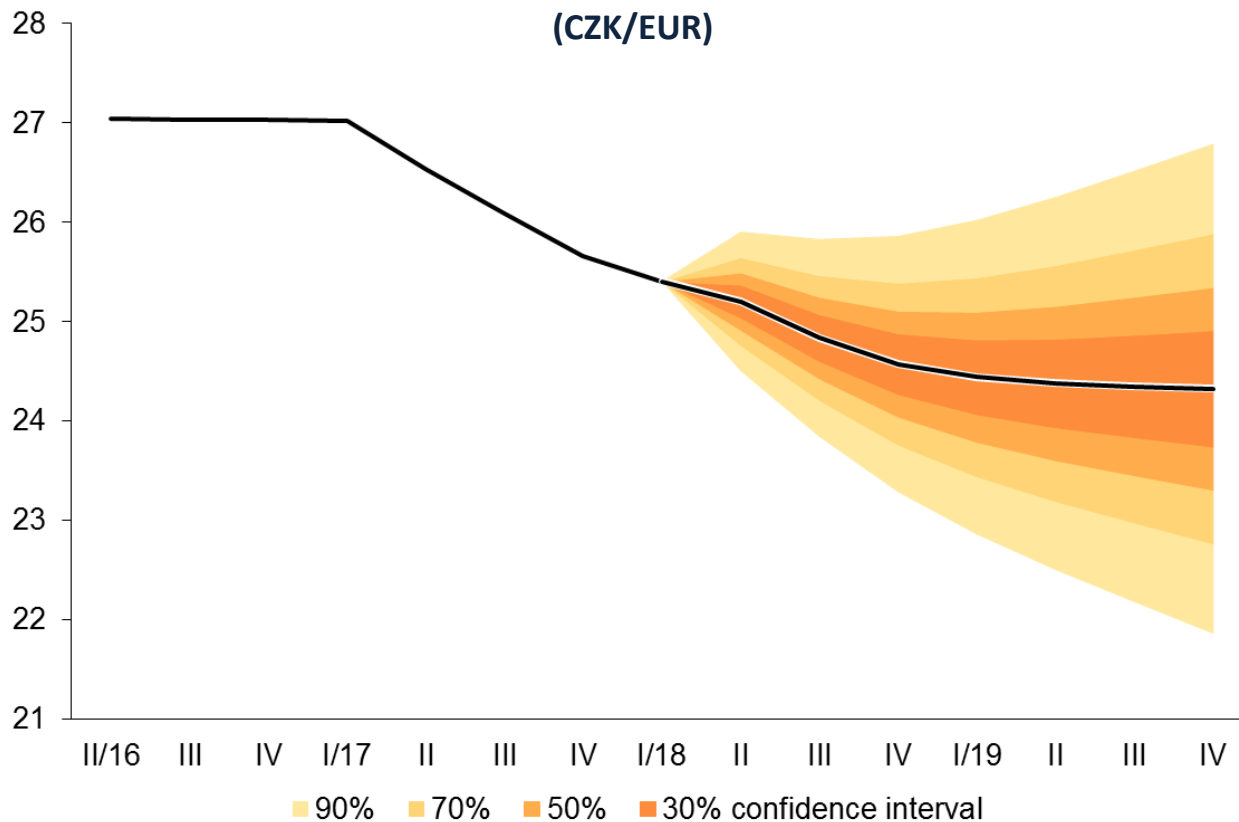
- The strong household consumption growth will reflect a rapid rise in wages and salaries and other income.
- Growth in gross capital formation will accelerate further owing to a stronger growth in government investment amid a continued rise in private investment.
- Both export and import dynamics will slow down only temporarily.



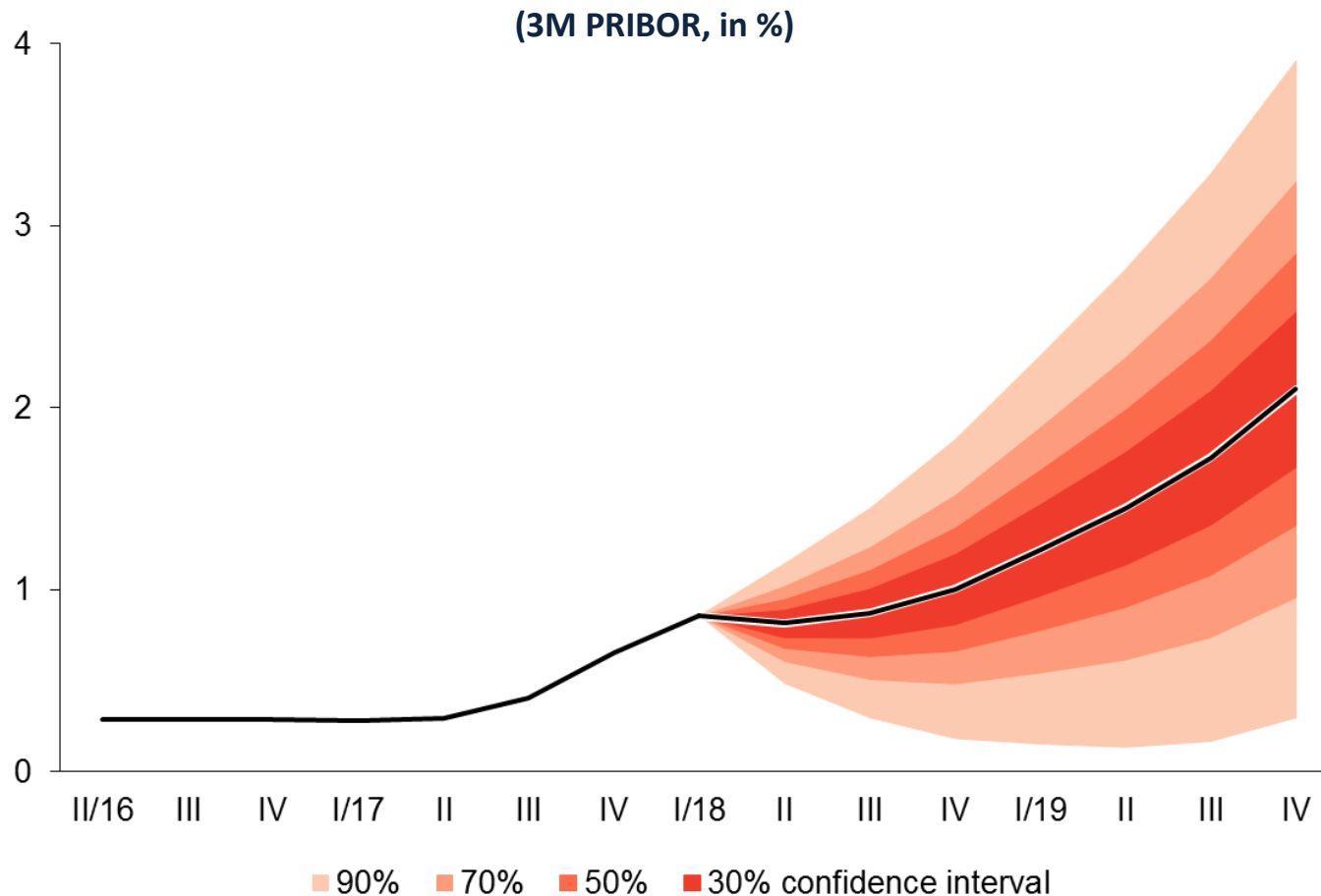
- Employment rate dynamics will slow down due to the lack of available work force.
- The decline in the unemployment rate will almost come to a halt.



- The tightness in the labour market has kept wage growth in market sectors at a high level. The forecast incorporates stronger wage growth in 2018 H2, partly persisting into 2019. However, the ensuing inflationary effect is dampened by an expert increase in labour efficiency growth in line with the current high growth in private investment.
- Afterwards, the wage growth will gradually slow down, owing to more restricted monetary conditions and pressure on the price competitiveness of firms.



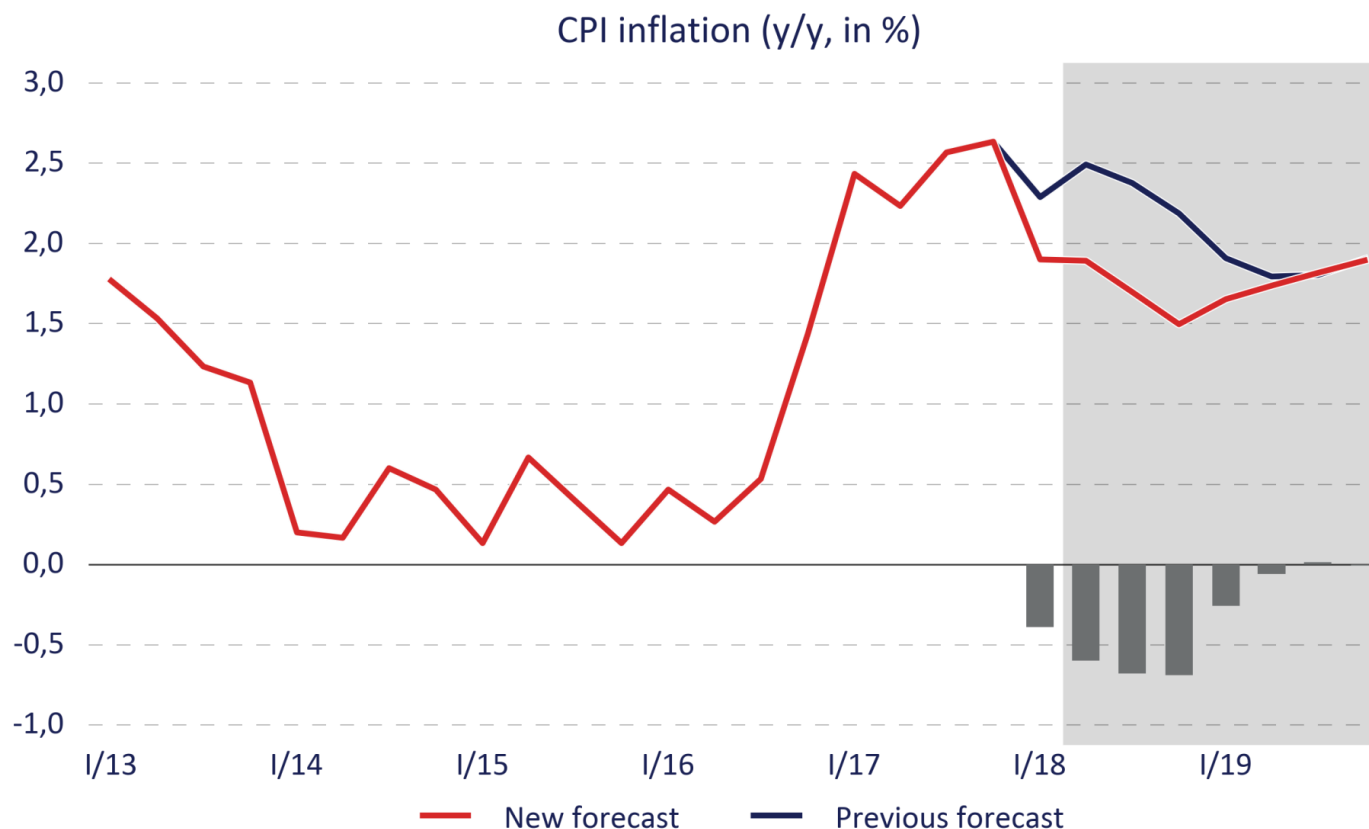
- According to the forecast, the koruna will appreciate further, especially this year, primarily due to a positive interest rate differential, and long-term real convergence to the euro area.
- In 2019, the koruna will appreciate much more modestly, due to gradually slowing growth in external demand and ECB's expected return to conventional monetary policy.



- Consistent with the forecast is broad stability of market interest rates initially, followed by further growth in rates from late 2018/early 2019.
- Continued very accommodative monetary policy of the ECB will remain the main barrier to a faster increase in domestic interest rates.

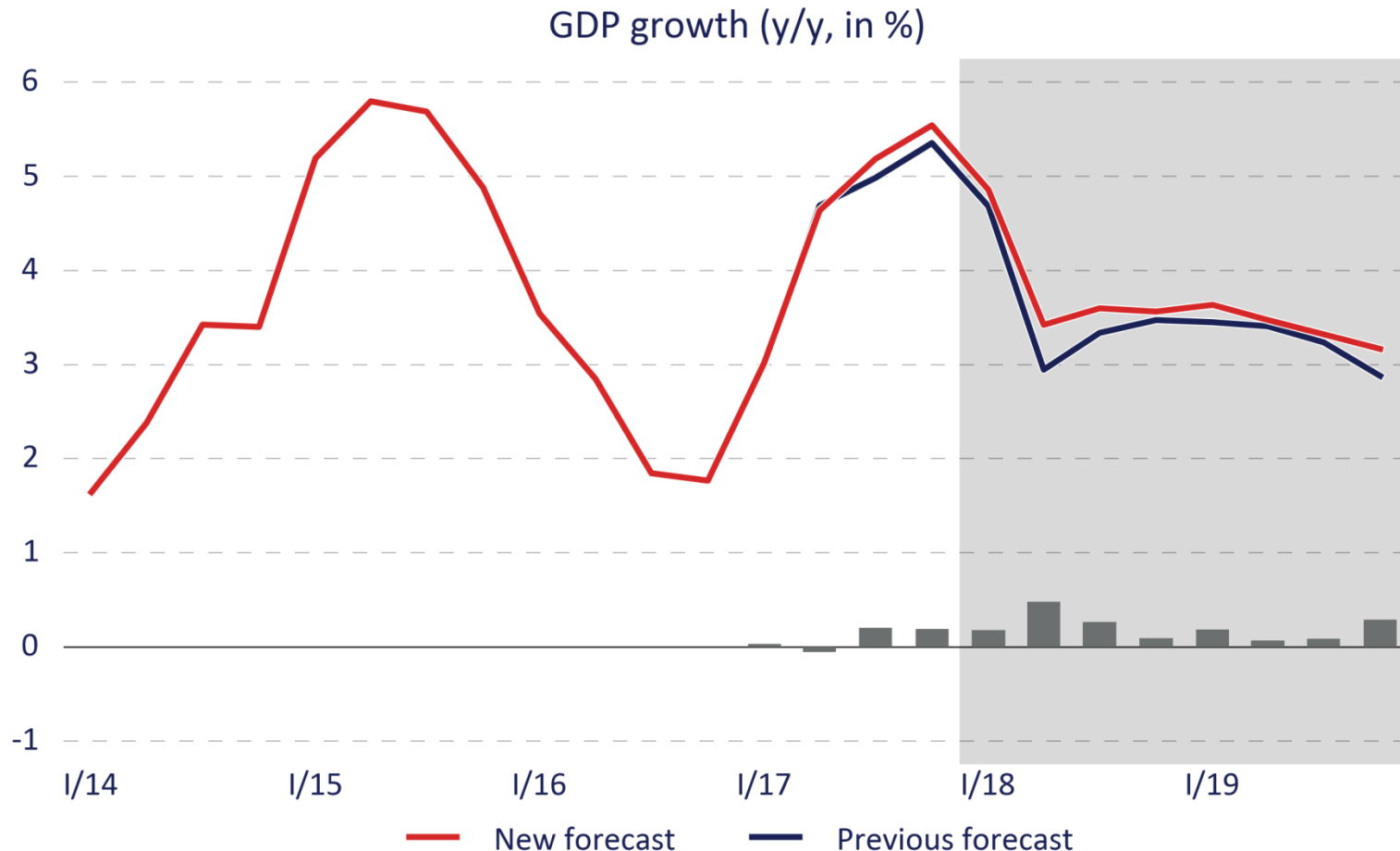
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- The new inflation forecast for this year has been shifted downward despite moderately higher overall inflation pressures.
- Forecasts of GDP growth have been slightly increased for both 2018 and 2019.
- Wage growth will be markedly higher compared to the previous forecast. However, its inflationary effect will be largely offset by faster growth in labour efficiency.
- The forecast of exchange rate of the koruna against the euro will be slightly weaker in the second quarter, but it will appreciate a bit more in the long run compared to the previous forecast.
- The forecast of market interest rate trajectory has not been changed markedly.

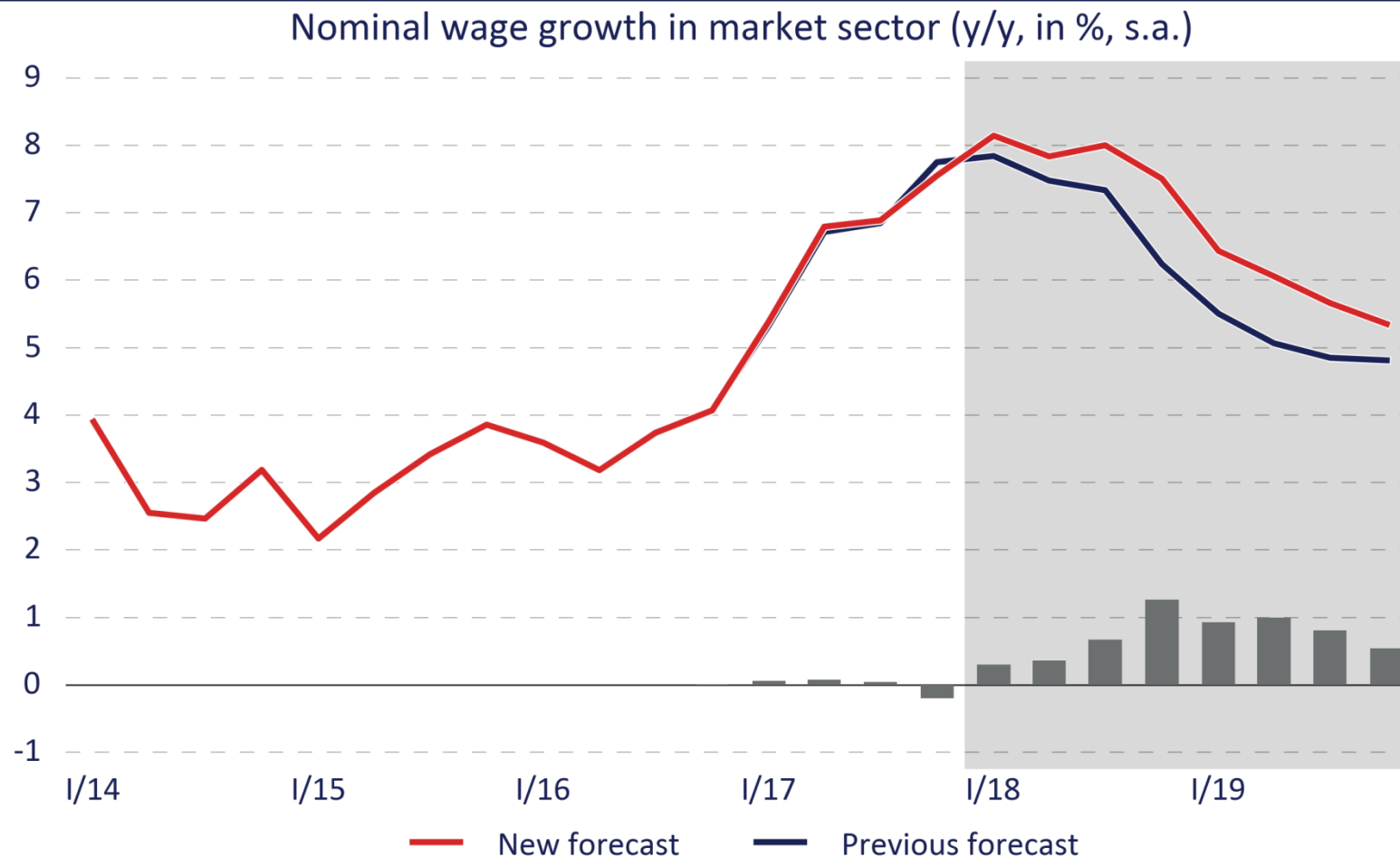


- The headline inflation forecast for this year has been shifted downwards due to lower observed values in the beginning of this year and lowered outlook for regulated prices.
- At the monetary policy horizon, the forecast remains almost unchanged as an expected lower growth of import prices will be offset by a faster growth of domestic demand and wages.

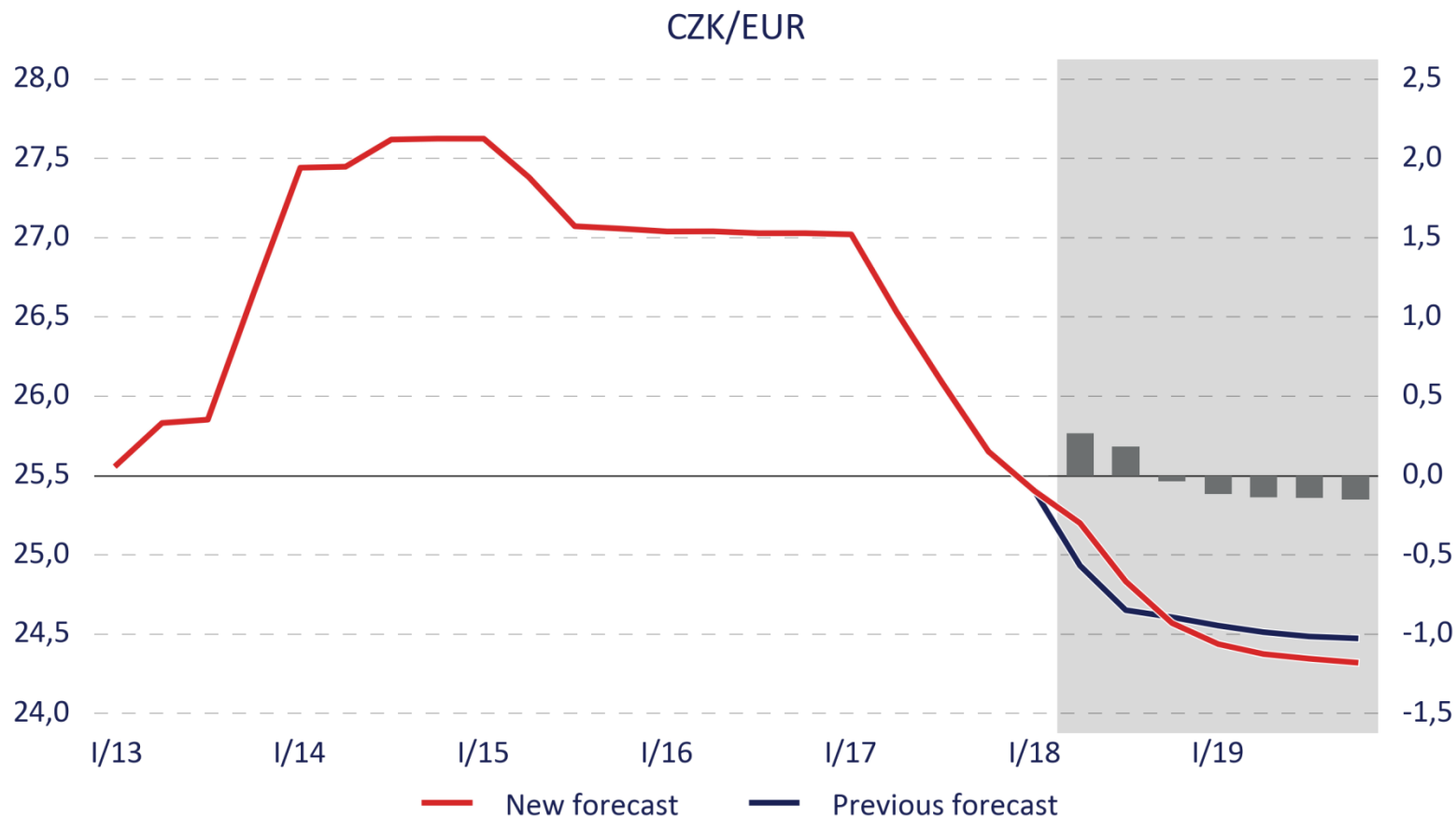
Comparison: GDP Forecast



- Faster growth in external demand and a stronger government consumption will foster slightly higher economic growth this year.
- In the 2019, new forecast assumes stronger fiscal impulse and faster growth of private investment, partly offset by lower contribution of net exports.

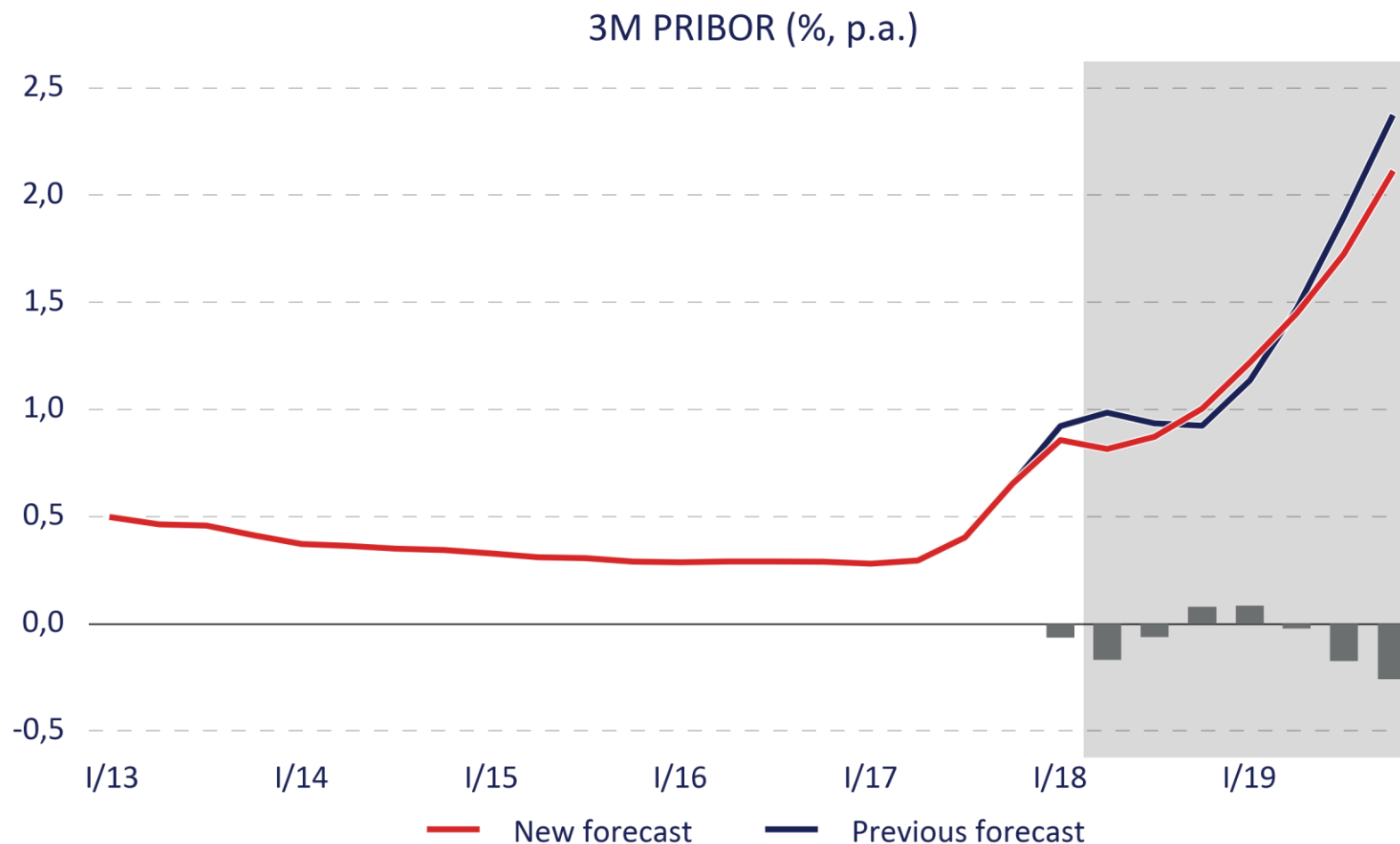


- Considerably higher wage growth outlook for 2018 and 2019 takes into account observed higher tightness of labour market due to more robust economic growth, higher external demand outlook as well as expert judgement introducing faster wage and labour efficiency growth.



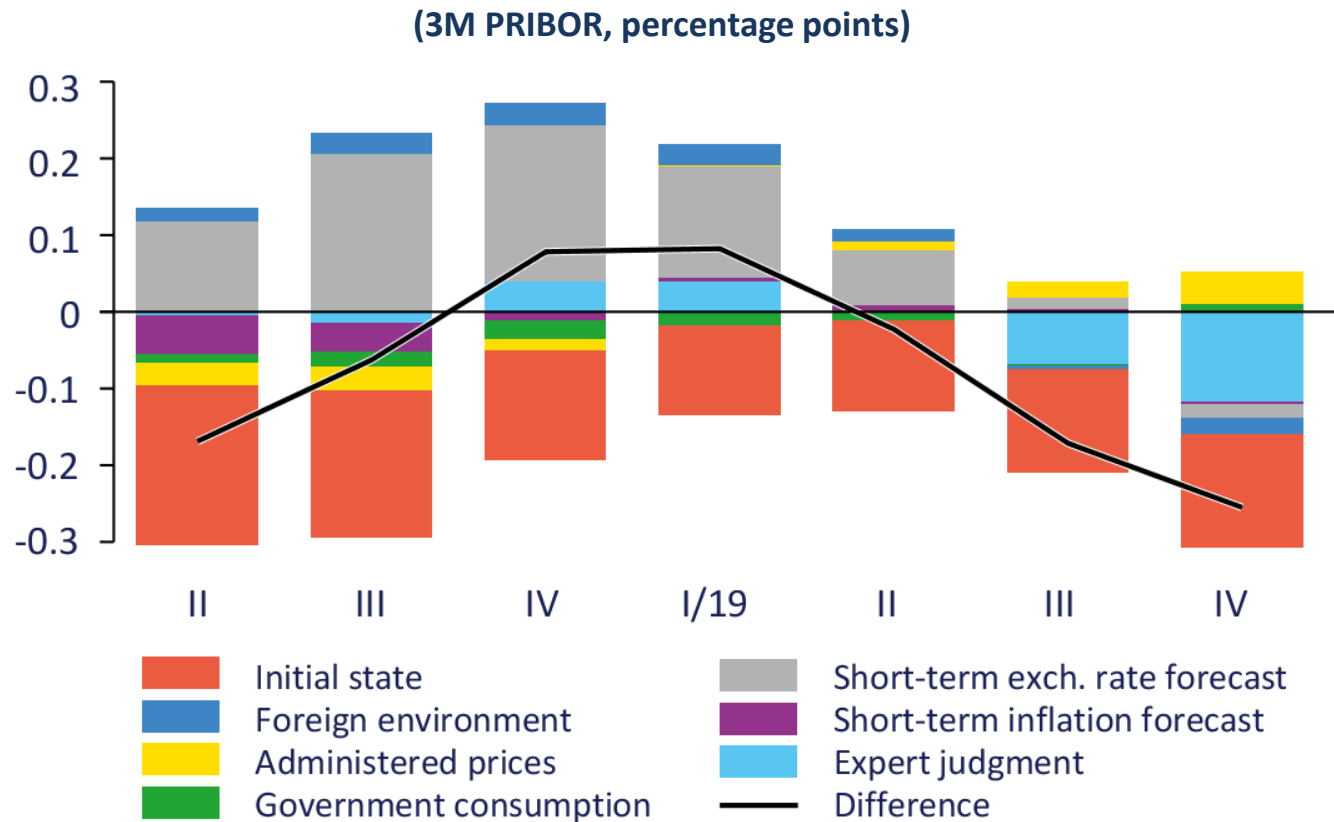
- Weaker exchange rate outlook in the short run reflects current market developments.
- In the long run, faster appreciation will be fostered by more robust domestic and foreign economic activity, higher labour efficiency growth, and looser ECB monetary policy in 2019.

Comparison: Interest Rate Forecast



- The path of market interest rates has not changed significantly.

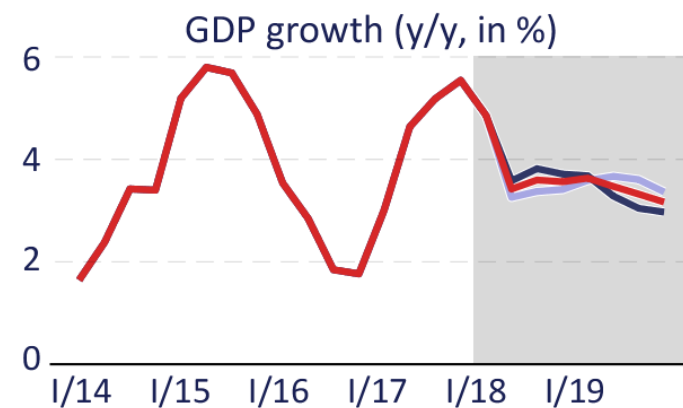
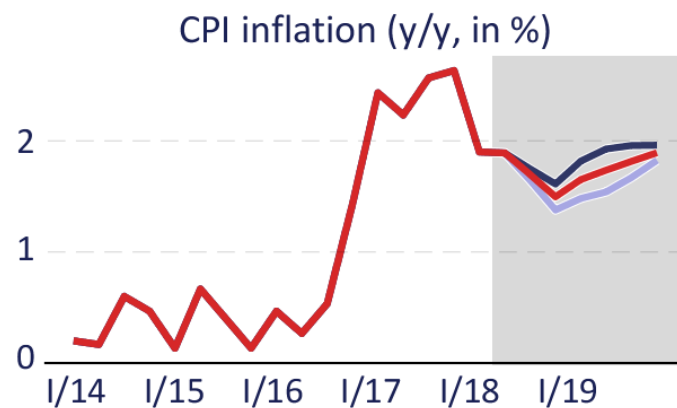
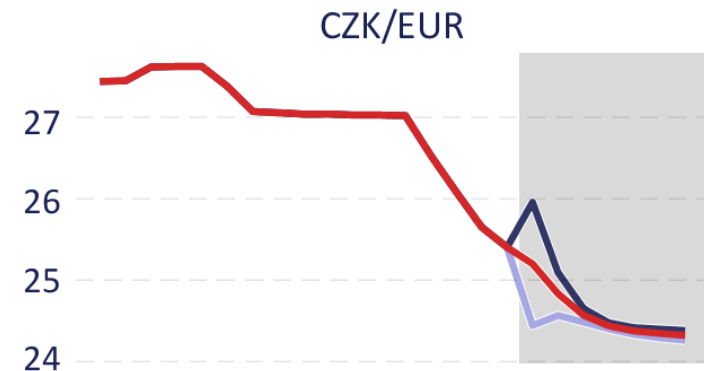
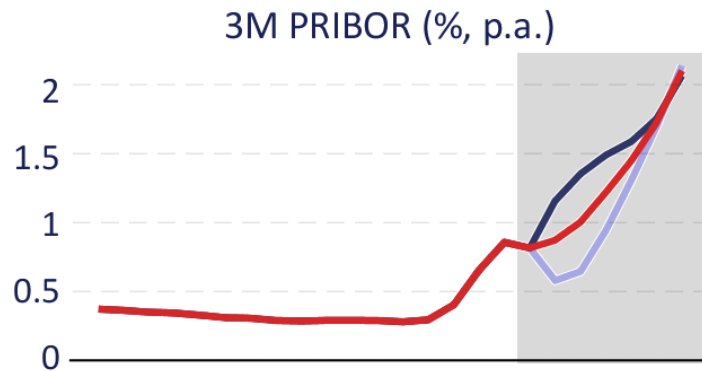
Decomposition of Changes in the Interest Rate Forecast



- Initial downward shift is due to anti-inflationary effect of initial conditions, mainly lower observed inflation values.
- Against it goes weaker short run exchange rate outlook, and expert judgements that reflect longer-lasting wage growth amid higher labour efficiency growth.

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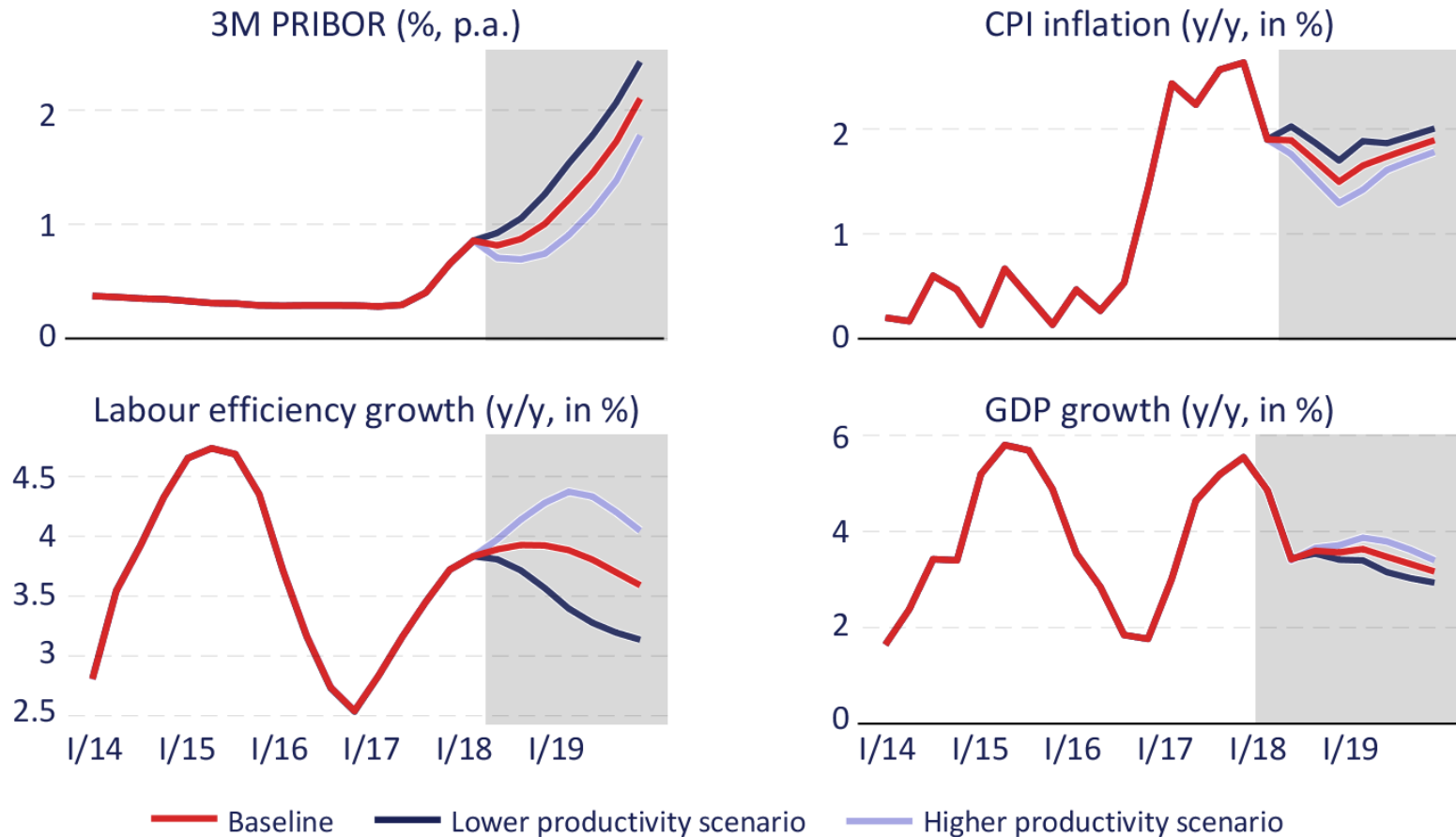
Sensitivity Scenario – Exchange Rate



— Baseline — Sensitivity scenario (+3%) — Sensitivity scenario (-3%)

- The temporarily weaker/stronger exchange rate in the sensitivity scenario leads to a higher/lower interest rate path compared to the forecast.

Sensitivity Scenario – Labour Efficiency



- Scenario, in which current forecast of wage dynamics is accompanied by lower/higher labour efficiency growth, implies slightly higher/lower inflation, resulting in higher/lower trajectory of interest rates and consistently lower/higher GDP growth outlook.

Thank you for your attention!

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