# INFLATION REPORT / I

2013

CZECH NATIONAL BANK

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In 1998, the Czech National Bank switched to inflation targeting. In the inflation targeting regime, the central bank's communication with the public plays a significant role. One of the core elements of this communication is the publishing of quarterly Inflation Reports. Section II of the Inflation Report contains a description of the Czech National Bank's new quarterly macroeconomic forecast, and section III presents its assessment of past economic and monetary developments.

The inflation forecast and the assumptions underlying it are published with the aim of making monetary policy as transparent, comprehensible, predictable and therefore credible as possible. The Czech National Bank is convinced that credible monetary policy effectively influences inflation expectations and minimises the costs of maintaining price stability. Maintaining price stability is the Czech National Bank's primary objective.

The forecast for the Czech economy is drawn up by the CNB's Monetary and Statistics Department. The forecast for inflation at the "monetary policy horizon" (about 12–18 months ahead) is of greatest relevance to the decision-making on the current interest rate settings.

The forecast is the key, but not the only, input to the Bank Board's decision-making. At its meetings during the quarter, the Bank Board discusses the current forecast and the balance of risks and uncertainties surrounding it. The arrival of new information since the forecast was drawn up and the possibility of asymmetric assessment of the risks of the forecast and divergent views of some board members on the development of the external environment or the linkages between the various indicators within the Czech economy mean that the Bank Board's final decision need not correspond to the message of the forecast.

This Inflation Report was approved by the CNB Bank Board on 14 February 2013 and contains the information available as of 25 January 2013. Unless stated otherwise, the sources of the data contained in this Inflation Report are the CZSO or the CNB. All the Inflation Reports published to date are available on the CNB website. Underlying data for the tables and charts presented in the text of this Inflation Report, minutes of Bank Board meetings, and time series of selected economic and monetary indicators (available in the ARAD database) are published at the same internet address.

CHART I.1

**FULFILMENT OF THE INFLATION TARGET**

**Headline inflation declined into the upper half of the tolerance band around the CNB's target in 2012 Q4**
(annual percentage changes)

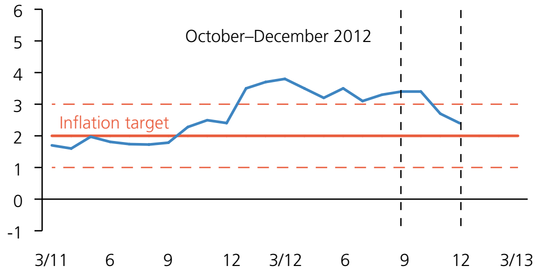



CHART I.2

**HEADLINE INFLATION FORECAST**

**Headline inflation will be close to the CNB's target this year despite tax changes, and will fall below the target at the start of next year**
(annual percentage changes)

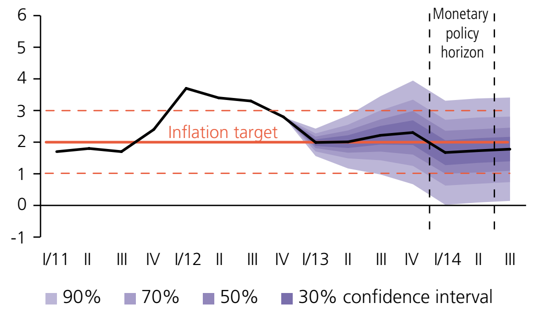
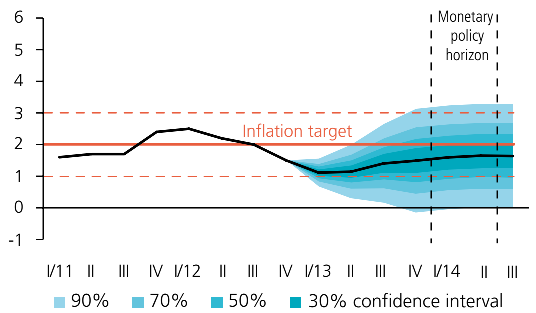



CHART I.3

**MONETARY-POLICY RELEVANT INFLATION FORECAST**

**Monetary-policy relevant inflation will be in the lower half of the tolerance band around the target over the entire horizon, i.e. including at the monetary policy horizon**
(annual percentage changes)




## I. SUMMARY

*The year-on-year decline of the Czech economy deepened further in 2012 Q3, with investment and household consumption making negative contributions. In Q4, headline inflation was in the upper half of the tolerance band and monetary-policy relevant inflation was below the CNB's target. Tax changes, food price growth and gradually falling import price growth are the sources of inflation. By contrast, the domestic economy is dampening inflation. Real economic activity will decrease slightly overall this year owing to subdued domestic demand amid continuing fiscal consolidation. It will recover gradually in the second half of the year, however, thanks to improving external demand. GDP growth will continue to accelerate next year, reaching about 2% for the year as a whole. Headline inflation will be close to the CNB's target this year despite substantial impacts of tax changes, and will fall slightly below the target after these impacts fade away. Monetary-policy relevant inflation will be in the lower half of the tolerance band around the CNB's target until the end of 2014. On the forecast horizon the exchange rate of the koruna against the euro will appreciate very slowly from the level of CZK/EUR 25.5 assumed for 2013 Q1. Consistent with the forecast is a slight decline in market interest rates, followed by a rise in rates as from mid-2014.*

The **Czech economy** contracted by 1.3% year on year in **2012 Q3**, mainly because of lower investment in inventories and household consumption. By contrast, the contribution of net exports to growth in economic activity was positive. The forecast assumes an annual GDP decline of similar magnitude in 2012 Q4.

**In 2012 Q4, headline inflation** declined into the upper half of the tolerance band around the CNB's target (see Chart I.1). Monetary-policy relevant inflation was below the target. Tax changes, food price growth and gradually falling import price growth are the sources of inflation. Negative adjusted inflation excluding fuels still reflects the anti-inflationary effect of the domestic economy.

**Economic growth in the effective euro area**[1] slowed to 0.4% in 2012 Q3 and will continue to slow until the beginning of this year. According to the assumptions of the forecast, growth is expected to reach 0.6% in effective terms, but the euro area as a whole will – as in the previous year – record a modest recession. The market outlook for low 3M EURIBOR rates takes into account expectations of continued easy monetary policy of the ECB amid an only gradual recovery of economic activity in the euro area. This is reflected in an outlook for gradual depreciation of the euro-dollar exchange rate. Oil prices are expected to follow a slightly downward path.

1 The euro area effective indicators proxy for the effect of the euro area on the Czech economy. For more details, see the Glossary.

**According to the forecast, headline inflation** will be close to the CNB's 2% target this year despite an increase in both VAT rates of one percentage point. After the effect of this tax change drops out in early 2014, inflation will fall slightly below the target (see Chart I.2). **Monetary-policy relevant inflation**, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, will be in the lower half of the tolerance band around the CNB's target until the end of 2014, i.e. including at the monetary policy horizon (see Chart I.3). The overall upward pressures on prices in the consumer sector will remain moderate in the next few quarters. The effect of the domestic economy will remain slightly anti-inflationary until mid-2014. The inflationary effect of import prices is weakening, but will persist over the entire forecast horizon owing to stable foreign producer price inflation amid an only slow appreciation of the exchange rate from its currently weakened level. The forecast assumes full pass-through of the above tax increases to prices, whereas the second-round effects on inflation expectations and wages are not expected to be significant. Adjusted inflation excluding fuels will turn slightly positive in the second half of this year and then increase steadily. By contrast, growth in administered prices and food prices will slow. Fuel prices will show a temporary decline.

Consistent with the forecast is a slight decline in market **interest rates**, followed by a rise in rates as from mid-2014 (see Chart I.4). Subdued growth in the domestic economy, due to an only gradual recovery in external demand and restrictive domestic fiscal policy, and a low interest rate level abroad are pushing interest rates downwards over the forecast horizon. At the start of the forecast horizon, these factors are offset by the current exchange rate depreciation and growth in administered prices. The forecast expects the **exchange rate of the koruna** against the euro to appreciate very slowly from its present level of around CZK 25.5 (see Chart I.5). The effect on the exchange rate of a low outlook for foreign interest rates and a falling current account deficit will be largely outweighed by subdued external demand.

Generally weak domestic demand in an environment of continuing fiscal consolidation and only slowly recovering external demand will lead to a 0.3% decline in the **Czech economy** this year (see Chart I.6). Net exports will again be the only component to make a positive contribution to economic growth; the other components will slow it. In 2013 H2, however, economic growth will recover gradually. Next year, the previous years' dampening factors will largely subside and the economy will grow by about 2%. On the **labour market**, the aforementioned economic developments will cause total employment to decrease somewhat and the unemployment rate to increase. Low wage growth in the business sector will reflect the contraction of the Czech economy this year. Wage growth will pick up slightly in 2014 as economic activity recovers more significantly. Wages in the non-business sector will rise at a low rate owing to fiscal consolidation.

CHART I.4

**INTEREST RATE FORECAST**

**Consistent with the forecast is a slight decline in market interest rates, followed by a rise in rates as from mid-2014**
(3M PRIBOR in %)

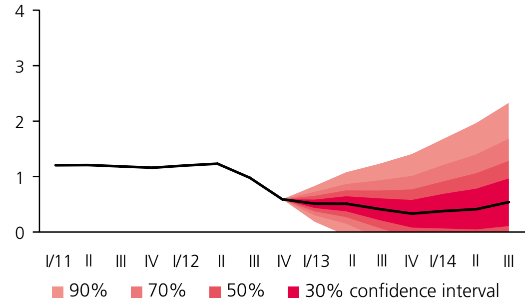



CHART I.5

**EXCHANGE RATE FORECAST**

**The nominal exchange rate will appreciate very slowly from the level of CZK/EUR 25.5 assumed for 2013 Q1**
(CZK/EUR)

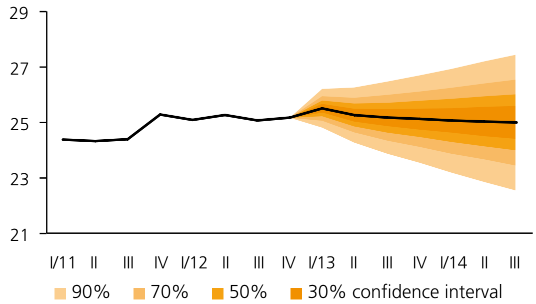
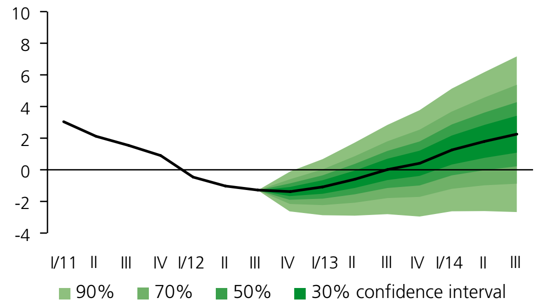



CHART I.6

**GDP GROWTH FORECAST**

**GDP will decline this year overall, but will gradually start to recover**
(annual percentage changes; seasonally adjusted)



At its monetary policy meeting on 6 February 2013, the Bank Board decided unanimously to **leave interest rates unchanged**. The risks of the new forecast were assessed as being balanced overall; uncertainty surrounds the extent and impacts of fiscal consolidation and household behaviour in the areas of consumption and saving.

# II. THE FORECAST, ITS CHANGES AND RISKS

## II.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

*Economic growth in the effective euro area is expected to slow further at the start of this year and recover gradually thereafter. The fading effect of higher commodity prices and subdued economic activity will lead to a slowdown in producer and consumer price inflation. The persisting low outlook for the 3M EURIBOR path takes into account expectations of continued easy monetary policy of the ECB and subdued economic activity in the euro area. The outlook for the dollar-euro exchange rate in the next two years expects the European currency to gradually depreciate to about USD 1.25. The price of Brent crude is expected to follow a slightly falling trend over the entire forecast horizon.*

The outlook for the **effective indicator of euro area GDP** foresees annual growth of 0.6% this year (the euro area as whole will record a continuing recession this year). This is 0.1 percentage point lower than in 2012 (see Chart II.1.1).[2] The fiscal consolidation process in most euro area countries, which was strengthened last year, will thus continue to foster a contraction of economic activity. External demand should trough at a slightly negative annual level in 2013 Q1. Economic activity is expected to rebound in 2013 Q2. A more pronounced recovery from the whole-year perspective is expected in 2014, for which the forecast assumes a 1.7% increase in economic activity in effective terms. Compared to the previous forecast, this means a modest shift towards lower growth over almost the entire horizon. In addition, there is persisting uncertainty about the evolution of the global economy despite the recent calming of the situation on financial markets.

The outlook for the **effective indicator of producer prices in the euro area** reflects the unwinding of the effect of high commodity prices and subdued industrial production (see Chart II.1.2). At 1.8% on average in 2013, it is 0.7 percentage point lower than a year earlier. A renewed modest pick-up in producer price inflation to 2.2% is expected in 2014, together with the onset of a stronger economic recovery.

The subdued economic activity is expected to hinder growth in the **effective indicator of consumer prices in the euro area** (see Chart II.1.3). A lower outlook for prices of food, fuels and other energy items will contribute to this slowdown. By contrast, rising indirect taxes and housing expenses and a weaker exchange rate of the euro will foster higher inflation. Compared to 2012, consumer price inflation is expected to fall this year and the next, from 2.6% to 2.1% on average.

2 The outlooks for euro area GDP, PPI and CPI and the dollar-euro exchange rate are based on the January Consensus Forecasts (CF). The outlooks for the 3M EURIBOR and Brent crude oil are derived from prices of market contracts as of 14 January 2013. The outlook is indicated by the grey areas in the charts. This convention is used throughout this Report.

CHART II.1.1

EFFECTIVE GDP IN EURO AREA

**Economic growth in the euro area is expected to slow further in the near future and start recovering gradually in 2013 Q2**

(annual percentage changes; differences in percentage points – right-hand scale)

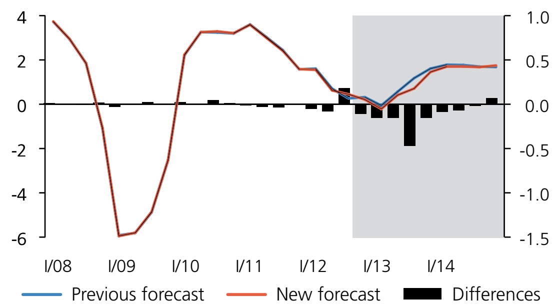



CHART II.1.2

EFFECTIVE PPI IN EURO AREA

**Producer prices will rise at a moderate and stable pace**

(annual percentage changes; differences in percentage points – right-hand scale)

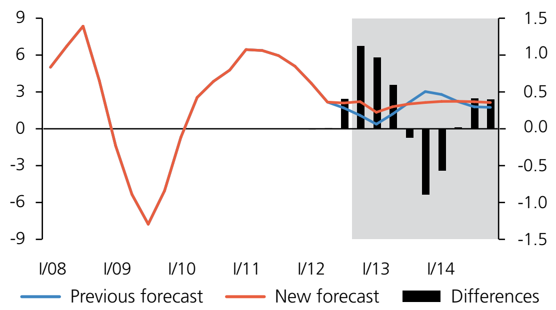



CHART II.1.3

EFFECTIVE CPI IN EURO AREA

**Effective inflation should fluctuate around the 2% level this year and the next**

(annual percentage changes; differences in percentage points – right-hand scale)

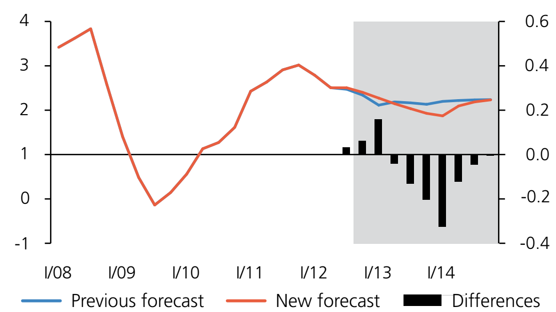


CHART II.1.4

**3M EURIBOR**

**Easy monetary policy of the ECB and subdued economic activity continue to be reflected in a low outlook for interest rates**
(in %; differences in percentage points – right-hand scale)

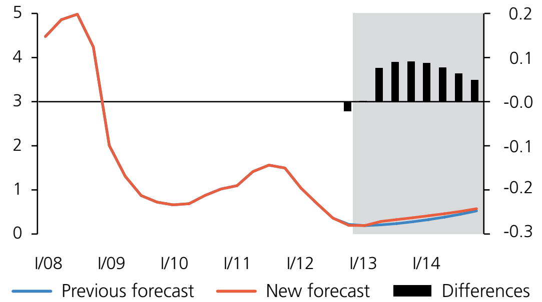



CHART II.1.5

**EURO-DOLLAR EXCHANGE RATE**

**The exchange rate of the euro against the dollar should gradually weaken**
(USD/EUR; differences in % – right-hand scale)

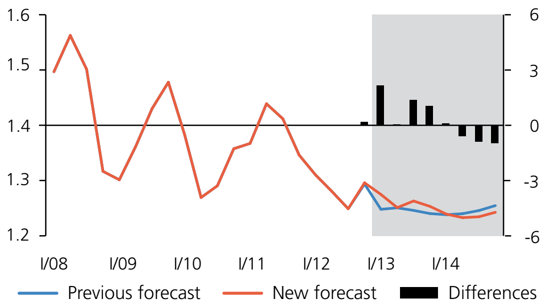
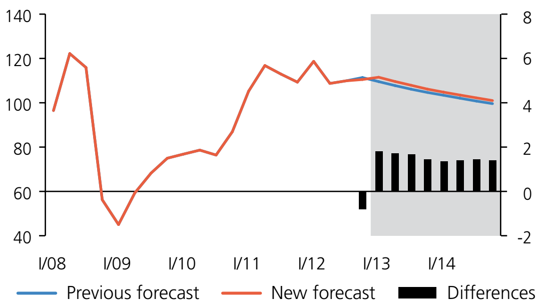



CHART II.1.6

**PRICE OF BRENT CRUDE OIL**

**The market outlook for the price of oil has a slightly falling trend**
(USD/barrel; differences in % – right-hand scale)




The market outlook for **3M EURIBOR rates** for this year and the next remains at very low levels, chiefly due to subdued economic growth and expectations of continued easy monetary policy of the ECB (see Chart II.1.4). Compared to 2012, 3M EURIBOR rates are expected to fall by 0.3 percentage point to 0.3% on average this year. The current level of 0.2% is considered to be the trough of the current cycle by the analysts surveyed in the January CF. They expect the 3M EURIBOR to stay at the same level at the three-month horizon and then record modest growth. This growth will continue into 2014, when the 3M EURIBOR should reach 0.5% on average. Compared to the previous forecast, the market outlook for interest rates is thus about 0.1 percentage point higher over the entire horizon. This reflects a change in ECB communication following the latest monetary meeting on 10 January, earlier repayment of loans from the LTRO programme and rising interbank market transaction volumes.

The outlook for the **euro-dollar exchange rate** still foresees a gradual weakening of the euro, reflecting the different macroeconomic environments in the USA and the euro area. The current data on the US economy suggest a modest recovery, whereas the euro area as whole is in recession. Compared to 2012, this means that the outlook for this year expects the euro to weaken by approximately 2% against the dollar to about USD 1.26 (see Chart II.1.5). The gradual depreciation of the euro should continue in 2014, to USD 1.24 on average.

The path of the **Brent crude oil price** based on market futures is still falling for this year and the next (see Chart II.1.6). In 2013, the price of Brent crude oil should thus decrease by USD 3 on average compared to 2012, to USD 109 a barrel. This is in line with the expectations of analysts surveyed in the January CF, who predict an average price of Brent crude oil of USD 110 a barrel at the 12-month horizon. The average price of Brent crude oil should then fall further to USD 103 a barrel in 2014. Compared to the previous forecast, the whole outlook has thus shifted upwards by 2%, mainly on the back of more favourable data from the US economy and the postponement of the fiscal cliff in the USA, which led to a decline in risk aversion on financial markets and an increase in demand for risky assets, including commodities.

## II.2 THE FORECAST

*Tax changes, food price growth and gradually falling import price growth are currently the sources of inflation. Adjusted inflation excluding fuels remains negative, reflecting the anti-inflationary effect of the domestic economy. Headline inflation will be close to the CNB's 2% target in 2013 despite substantial impacts of tax changes. Monetary-policy relevant inflation will be in the lower half of the tolerance band over the entire horizon, including at the monetary policy horizon. The contribution of import prices will remain inflationary amid stable foreign producer price inflation and an only slow appreciation of the koruna from its current weakened level. The current slightly anti-inflationary effect of cost pressures from the domestic economy will last until mid-2014, as very slowly accelerating wage growth will be supported by renewed growth in productivity and economic activity will remain subdued in the next few quarters. GDP will decline by 0.3% this year, amid restrictive effects of budget consolidation measures and an only gradual recovery of external demand. In 2014, the previous years' dampening factors will largely subside and the economy will grow by approximately 2%. Consistent with the forecast is a slight decline in market interest rates, followed by a rise in rates as from mid-2014.*

Annual **headline inflation** was 2.8% on average in 2012 Q4. Monetary-policy relevant inflation, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, was 1.5% in the same period. Headline inflation will be close to 2% this year. In early 2014, it will decline slightly below the CNB's target, after the first-round effect of the increase in both VAT rates by 1 percentage point drops out (see Chart II.2.1). Monetary-policy relevant inflation will be just above the lower boundary of the tolerance band around the target in early 2013, and will then rise gradually owing to weakening anti-inflationary pressures from the domestic economy amid a marginal increase in the contribution of import prices.

Annual **administered price inflation** continued to slow gradually in 2012 Q4, reaching 7.1% on average. It will moderate noticeably further in the period ahead, mainly because of a reduction in the effect of VAT changes and slower growth in deregulated rents[3] (see Chart II.2.2). The biggest contributor to administered price inflation in 2013 will be an expected increase in heat prices connected with the introduction of the sale of emission allowances for heating plants. The effect of electricity prices will also be significant, with a sudden increase in the contribution of consumers to renewable resources outweighing a decline in prices of electricity generation. Deregulated rents, water supply and sewerage collection charges and gas prices will also rise

3 The last phase of rent deregulation took place in early 2013. This will be reflected in the CZSO's new consumer basket weighting scheme for 2013, where administered prices will no longer include any rental housing items. However, the current forecast has been prepared still on the basis of the 2012 consumer basket weighting scheme, as the new scheme will be published after this forecast has been released.

CHART II.2.1

**HEADLINE INFLATION AND MONETARY-POLICY RELEVANT INFLATION**

**Headline inflation will be close to the 2% level, while monetary-policy relevant inflation will be in the lower half of the tolerance band around the inflation target**

(annual percentage changes)

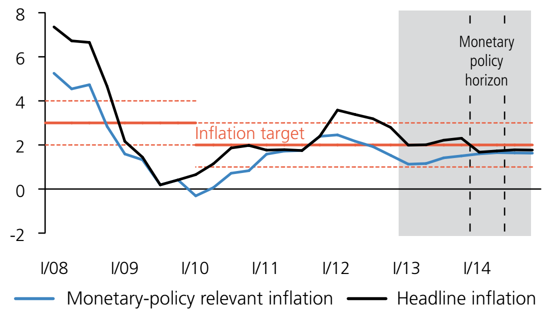



CHART II.2.2

**ADMINISTERED PRICES AND FUEL PRICES**

**Administered price inflation will slow, while fuel prices will fall this year**

(annual percentage changes; fuel prices excluding first-round effects of indirect tax changes)

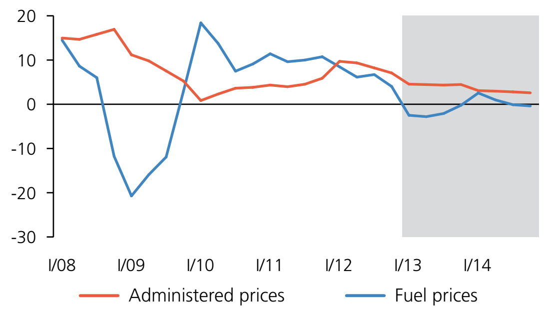


**Table II.2.1**

### FORECAST OF ADMINISTRATIVE EFFECTS

**The growth of administered prices will be due mainly to rising prices of heat and electricity, owing among other things to a VAT increase**
(annual percentage changes; impacts in percentage points)

| | 2012 actual | | 2013 forecast | | 2014 forecast | |
|---|---|---|---|---|---|---|
| Administered prices – total[a)] | 6.2 | 1.16 | 4.3 | 0.81 | 2.6 | 0.48 |
| of which (main changes): | | | | | | |
| regulated rents[b)] | 11.6 | 0.14 | 4.0 | 0.05 | 3.5 | 0.04 |
| electricity | 4.2 | 0.18 | 4.1 | 0.18 | 3.0 | 0.13 |
| natural gas | 4.3 | 0.12 | 3.7 | 0.10 | -1.1 | -0.03 |
| heat | 8.4 | 0.17 | 10.0 | 0.21 | 5.0 | 0.10 |
| healthcare | 8.3 | 0.15 | 2.6 | 0.05 | 2.0 | 0.04 |
| First-round impacts of tax changes in non-administered prices | | 0.99 | | 0.69 | | 0.14 |

a) Including effects of indirect tax changes
b) as from 2013 deregulated rents; this item will no longer be a component of administered prices

**Chart II.2.3**

### NET INFLATION AND ADJUSTED INFLATION EXCLUDING FUELS

**Adjusted inflation excluding fuels will turn positive in 2013 H2**
(annual percentage changes)

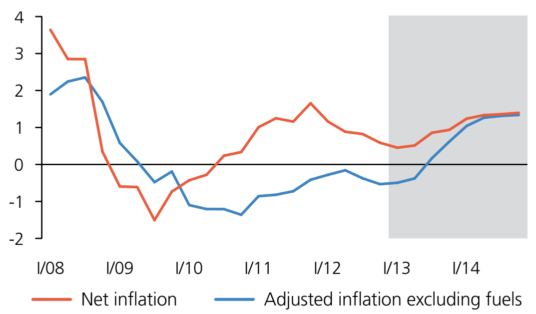
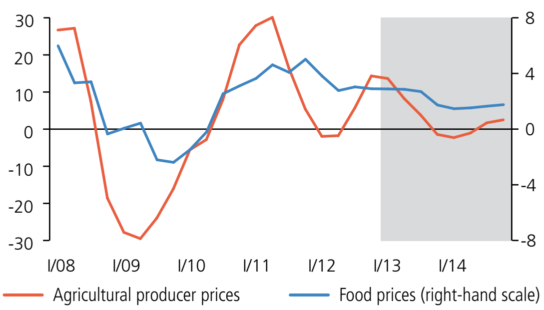



**Chart II.2.4**

### FOOD PRICES AND AGRICULTURAL PRODUCER PRICES

**Food price inflation will slow in late 2013/early 2014 as a result of a decline in agricultural producer prices**
(annual percentage changes)




noticeably owing to an increase in distribution fees and a concurrent reduction of prices on world markets. Administered prices will also be pushed up by an increase in both VAT rates, although its contribution will be smaller than last year. Overall, annual administered price inflation will be just above 4% in 2013 (see Table II.2.1). In 2014 it will drop below 3% as a result of the unwinding of the one-off effect of the VAT increase and an expected decline in natural gas prices for households.

Changes to **indirect taxes** contributed about 1.3 percentage points to annual inflation on average in 2012 Q4. The forecast includes an increase in both VAT rates of one percentage point as of January 2013. The first-round effect of this change will be about 0.7 percentage point. At the same time, excise duties on cigarettes will also see another "harmonisation increase" with a contribution to consumer price inflation of around 0.1 percentage point. An identical change in excise duties on cigarettes is expected in January 2014. The forecast assumes full pass-through of the above changes to the relevant prices, whereas the second-round effects on inflation expectations and wages are still not expected to be significant.

Annual **net inflation** fell to 0.6% in 2012 Q4 (see Chart II.2.3). This decrease was due to reductions in all components of market price inflation. The forecast expects an only slight decline in net inflation in the near term, with weak growth in food prices being slightly outweighed by a switch of fuel prices to an annual decline. The expected shift of adjusted inflation excluding fuels to positive figures in 2013 H2 and its subsequent gradual rise will then foster a gradual increase in net inflation to around 1%; the effects of fuel and food prices will offset each other. In early 2014, food price inflation will go down, amid a modest decline in agricultural producer prices, but higher adjusted inflation excluding fuels and a halt in the fuel price decline will lead to a further rise in net inflation to roughly 1.3%. Net inflation will then stay at this level for the rest of 2014.

Annual **adjusted inflation excluding fuels** turned more negative in 2012 Q4 (see Chart II.2.3), owing to a slowdown in import price growth amid continuing weak domestic demand. The forecast expects the negative adjusted inflation excluding fuels to moderate only slowly in the first half of 2013 and to turn positive only in the second half of the year. This will be fostered by continuing import price growth, reflecting modest growth in prices abroad and only a very slow appreciation of the koruna-euro exchange rate from its current weakened level, and also by a moderation of the anti-inflationary effect of the domestic economy. Adjusted inflation excluding fuels will thus increase to around 0.6% at the end of this year. Thanks to a gradual recovery in domestic demand in 2014, adjusted inflation excluding fuels will then increase further to 1.3%.

Annual **food price inflation** (excluding the first-round effects of tax changes) slowed slightly to 2.7% in 2012 Q4. It will pick up again in the near future, mainly because of rising agricultural producer prices and food import prices, whereas subdued domestic demand will act in the opposite direction in the long term. A marked slowdown in annual food price inflation is expected in late 2013/early 2014, when both agricultural producer prices and food import prices will switch to a year-on-year decline (see Chart II.2.4).

Annual **fuel price inflation** fell significantly in 2012 Q4 as a result of global petrol and oil price developments and a moderating year-on-year depreciation of the koruna-dollar exchange rate. The forecast assumes that fuel prices will switch to a year-on-year decline in early 2013 (see Chart II.2.5). In 2014, fuel price inflation will fluctuate around zero.

**Interest rates** on the Czech money market and rates with maturities longer than one year declined further during 2012 Q4. Consistent with the forecast is a slight decline in market interest rates, followed by a rise in rates as from mid-2014 (see Chart II.2.6). Subdued growth in the domestic economy, due to an only gradual recovery in external demand and restrictive domestic fiscal policy, and a low interest rate level abroad are pushing interest rates downwards over the forecast horizon. At the start of the forecast horizon, these factors are offset by the koruna's current depreciation and a rise in administered prices.

**The koruna** depreciated slightly **against the euro** in 2012 Q4, to CZK 25.2 on average. The short-term forecast for 2013 Q1 assumes a further slight depreciation to an average of CZK 25.5 (see Chart II.2.7). This prediction takes into account the current exchange rate level, which reflects, among other things, the CNB's communication regarding potential interventions in the foreign exchange market. Subdued external demand is another factor shifting the exchange rate path to weaker levels in the first half of 2013. A low outlook for foreign interest rates and improved nominal net exports will act in the opposite direction. The exchange rate will thus appreciate very gradually to CZK 25 against the euro at the end of 2014. In light of the CF outlook for a gradually depreciating euro against the dollar (see section II.1), this implies a slight depreciation of the koruna-dollar exchange rate until the start of 2014.

Quarterly growth in **nominal marginal costs in the consumer goods sector** remained at a relatively low level in 2012 Q4. Inflationary pressures from import prices are weakening (see Chart II.2.8) as the effect of growth in world commodity prices, which outweighs the impacts of the weaker exchange rate of the koruna, gradually subsides. The effect of the domestic economy, approximated by intermediate goods price inflation, is anti-inflationary due to subdued economic activity accompanied by low wage growth. The estimated impact of export-specific technology is linked to the difference in the evolution of prices of tradables and non-tradables (the Balassa-Samuelson effect), which for some time now has been contributing less markedly to inflation than in the pre-crisis period.

CHART II.2.5

**FUEL PRICES AND OIL PRICES**

**The moderately falling outlook for oil prices will result in a decline in fuel prices**
(annual percentage changes)

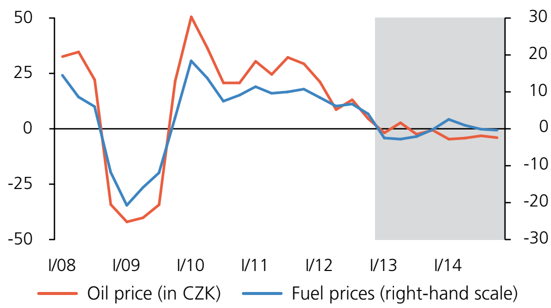



CHART II.2.6

**INTEREST RATE FORECAST**

**Consistent with the forecast is a slight decline in market interest rates, followed by a rise in rates as from mid-2014**
(3M PRIBOR and 3M EURIBOR in %)

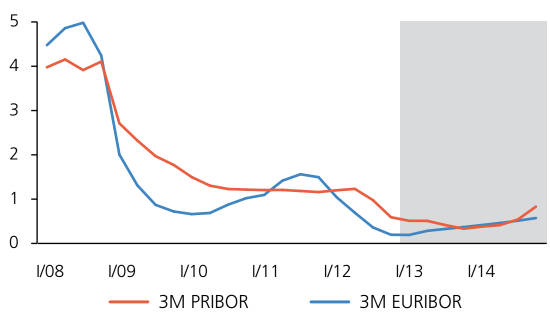



CHART II.2.7

**EXCHANGE RATE FORECAST**

**The exchange rate of the koruna against the euro will appreciate very slowly from the level of CZK/EUR 25.5 assumed for 2013 Q1**
(CZK/EUR and CZK/USD)

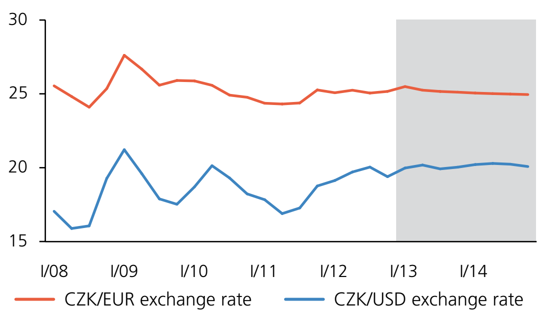


**Chart II.2.8**

**COSTS IN THE CONSUMER SECTOR**

**The overall inflationary pressures in the consumer sector will be moderate in the coming quarters**
(quarterly percentage changes; contributions in percentage points; annualised)

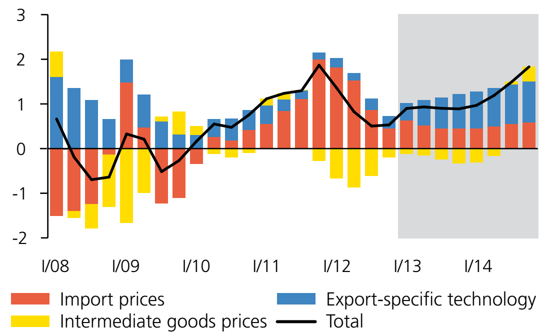



**Chart II.2.9**

**COSTS IN THE INTERMEDIATE GOODS SECTOR**

**Domestic costs will continue to decline moderately over the forecast horizon as a result of low wage growth and subdued economic activity**
(quarterly percentage changes; contributions in percentage points; annualised)

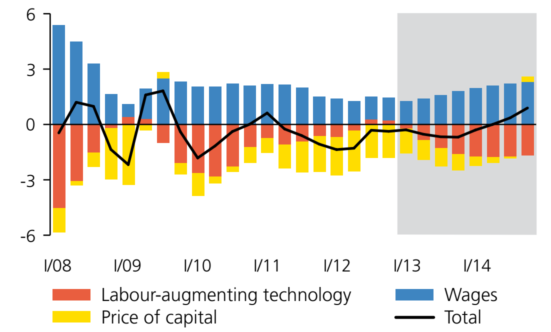
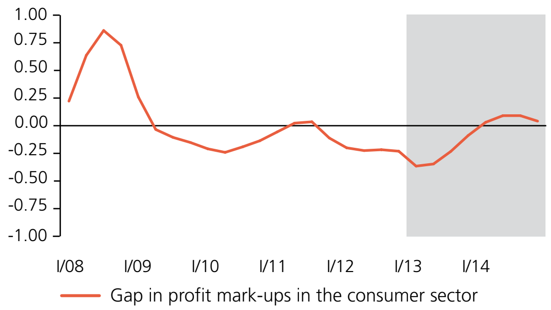



**Chart II.2.10**

**GAP IN PROFIT MARK-UPS IN THE CONSUMER SECTOR**

**The gap in profit mark-ups will close at the start of 2014**
(percentages)




The overall upward pressures on prices in the consumer sector will be moderate in the coming quarters and will record more pronounced growth only in 2014. The slightly inflationary effect of import prices will persist over the entire forecast horizon owing to stable foreign producer price inflation and only slow appreciation of the exchange rate from its currently weakened level. The slight anti-inflationary effect of the domestic economy will persist until mid-2014. The contribution of export-specific technology will gradually increase as economic activity gradually recovers.

**Nominal marginal costs in the intermediate goods sector** continued to edge down in 2012 Q4. Nominal wage growth in the business sector seems to have remained very low and was outweighed by the estimated declining price of capital, which reflects the subdued economic activity and weak investment activity. The contributions of labour-augmenting technology are roughly neutral due to a temporary halt in productivity growth (see Chart II.2.9). Domestic costs will continue to decline moderately until mid-2014. The contribution of the price of capital will stay negative in the next few quarters, changing only at the end of the horizon along with a continuing recovery in economic activity. Moreover, wage growth will remain low and will be offset by gradually recovering growth in labour-augmenting technology.

The estimated gap in **profit mark-ups in the consumer goods sector** stayed negative in 2012 Q4 (see Chart II.2.10), reflecting subdued pass-through of previous cost pressures to final prices amid weak economic activity. The gap in profit mark-ups will turn more negative in 2013 Q1 due to low growth in prices of consumer goods and a weaker exchange rate. The negative gap will close at the start of 2014, when modest price growth will be accompanied by an even more gradual increase in costs. In 2014 the gap in profit mark-ups will be close to zero, with still relatively low inflation being offset by roughly equal growth in costs amid slowly recovering economic activity.

Whole-economy **labour productivity** continued to fall at a rate of around 2% in 2012 Q4. The decline will start to moderate gradually in 2013 Q1 and switch to growth in the second half of 2013. Owing to a gradual recovery in economic activity and a decline in employment, labour productivity growth will pick up to just above 3% in 2014 Q4.

Annual growth in the average nominal **wage in the business sector** was 2% in 2012 Q3 (after seasonal adjustment).[4] The short-term prediction for 2012 Q4 assumes a slight pick-up to 2.3%, due to an assumed time shift in wages in late 2012 and early 2013 caused by tax optimisation related to the abolition of the cap on health insurance and additional taxation of higher income as from 2013. Wage growth

4 Without seasonal adjustment, the average wage increased by 1.3%.

will remain low throughout the year, primarily reflecting subdued economic activity. Wages in the business sector will increase by 1.8% in 2013 and accelerate to 3% in 2014 (see Chart II.2.11).

Continuing consolidation of public budgets will affect the nominal average **wage in the non-business sector**. The forecast expects growth in the average wage to slow to 1.5% in this sector in 2012 Q4. Average wage growth in the non-business sector will increase only marginally (by 0.2%) in 2013, with wages rising in only some professions (government officials and judges) and outside the central level. In 2014, average wage growth in the non-business sector will rise slightly to 1%.

**Real GDP** recorded a year-on-year decline of 1.3% and a quarter-on-quarter decline of 0.3% in 2012 Q3 (see Chart II.2.12). The annual decline was due to most components of domestic demand, most of all to household consumption and changes in inventories, and to a lesser extent also to fixed investment. Government consumption was flat year on year, so net exports were the only component to make a significantly positive contribution to annual GDP growth.

The forecast assumes that **economic activity in 2012 Q4** recorded an annual decline of 1.4% and a quarterly decrease of 0.1% (see Chart II.2.13). Household consumption is expected to record an annual decline of 3.5%. Fixed investment and changes in inventories probably also contributed negatively to GDP growth. Net exports will record a positive, albeit declining contribution to economic activity in year-on-year terms. Real GDP decreased by 1% overall in **2012 as a whole**, with all expenditure components except net exports declining. The fall in real household consumption was due to an increase in the lower VAT rate introduced in January 2012, slowing wage growth and adverse consumer sentiment. Government real consumption decreased because of austerity measures. The decline in investment reflected weak external demand and generally low domestic economic activity. Despite the low growth in external demand, net exports made a positive contribution to growth, partly because of subdued domestic demand in its import-intensive components.

In **2013**, real economic activity will drop by 0.3% amid the contrary effects of highly restrictive domestic fiscal policy and an only gradual recovery in external demand. Household consumption will be dampened by disposable income, affected mainly by low nominal wage growth and fiscal consolidation. A slow recovery in external demand and subdued domestic demand will prevent more pronounced growth in total investment; the only exception will be investment in the government sector, where growth in investment activity funded from domestic resources and EU funds is expected. Government consumption will also make a negative contribution to GDP growth. The contribution of net exports in real terms will remain positive, but will be slightly smaller overall than in 2012 due to only gradual growth in external demand and a fading decline in domestic demand. Favourable terms of trade will also foster a higher volume of net exports in nominal terms.

CHART II.2.11

**AVERAGE NOMINAL WAGE**

**Wage growth will remain low this year, primarily reflecting subdued economic activity**

(annual percentage changes; business sector – seasonally adjusted; non-business sector – seasonally unadjusted)

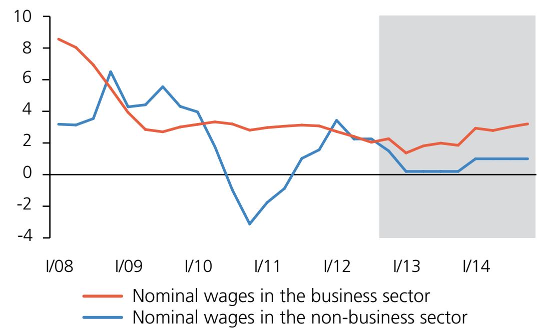



CHART II.2.12

**GDP GROWTH FORECAST**

**GDP will decline slightly this year; economic activity will recover in 2014**

(percentage changes; seasonally adjusted)

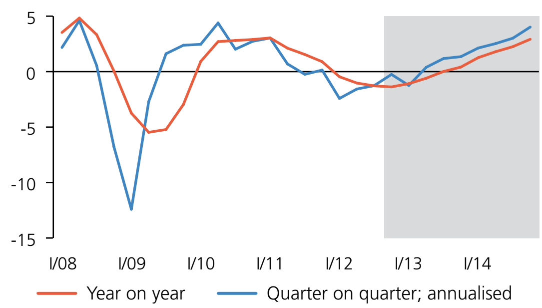



CHART II.2.13

**ANNUAL GDP GROWTH STRUCTURE**

**Only net exports will contribute positively to GDP growth this year, while domestic demand will decrease**

(annual percentage changes; contributions in percentage points; seasonally adjusted)

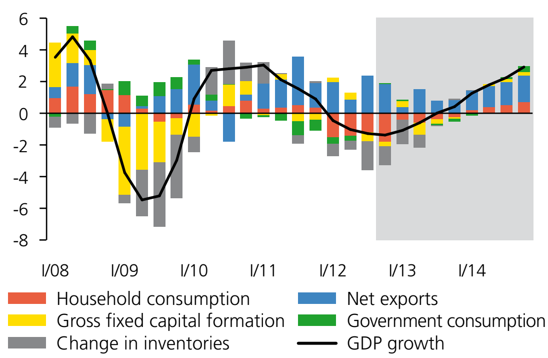


CHART II.2.14

**LABOUR MARKET FORECAST**

**Total employment will mostly fall and the unemployment rate will rise**

(annual percentage changes in employment; general unemployment rate in percentages; seasonally adjusted)

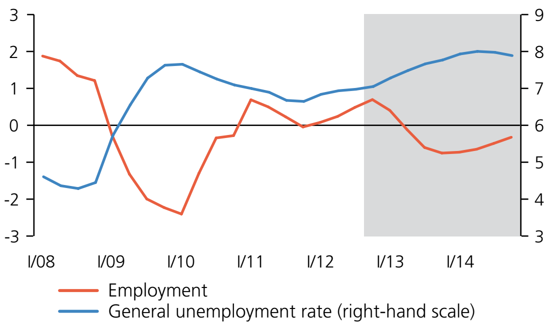



CHART II.2.15

**NUMBER OF EMPLOYEES (FULL-TIME EQUIVALENT)**

**The decline in the number of employees converted into full-time equivalents will start to moderate in 2013 H2**

(annual percentage changes; contributions in percentage points)

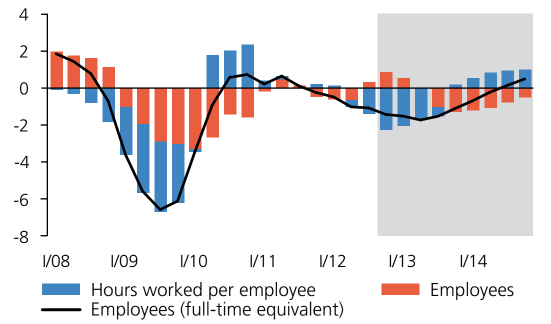
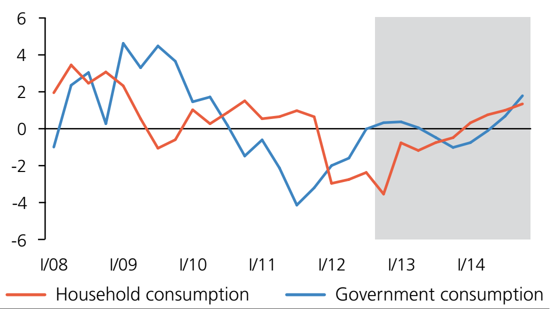



CHART II.2.16

**REAL HOUSEHOLD AND GOVERNMENT CONSUMPTION**

**Household and government consumption will start to grow in 2014**

(annual percentage changes; seasonally adjusted)




GDP will grow by 2.1% in **2014** after the previous years' dampening factors largely subside. The forecast assumes more robust growth in external demand and a significantly less restrictive effect of fiscal policy. The contribution of government consumption to GDP growth will be slightly positive and growth in government investment, which started this year, is expected to continue. Household consumption will start to rise again as a result of accelerating wage growth. Investment will also increase slightly due to a recovery in external demand.

Owing to a continuing contraction of economic activity, the forecast expects **total employment** to record a slight quarter-on-quarter decline in 2012 Q4, and this decline will deepen in the following quarters. The quarter-on-quarter decline in employment will start to moderate gradually in the second half of 2013 and switch to stagnation at the end of 2014. However, total employment will continue to grow in the next two quarters in year-on-year terms, due to the historical data. Subsequently, employment will switch to a decline, which will deepen until the end of this year and then gradually weaken during 2014 (see Chart II.2.14). When converted into full-time equivalents, the observed annual decline in the number of employees will continue until mid-2014 (see Chart II.2.15).

The forecast assumes that the seasonally adjusted **general unemployment rate** edged up to 7.1% in 2012 Q4. The general unemployment rate will gradually rise to 8% in mid-2014 owing to the evolution of economic activity and continued growth in the labour force (see Chart II.2.14). Later, it will fall slightly as a result of a recovery in GDP. The growth in the unemployment rate will also be a result of a limited ability to further reduce the average hours worked per employee (see Chart II.2.15). Their decline in recent quarters dampened growth in unemployment, but they are likely to reach a historical low in 2013 Q1 and this adjustment mechanism will probably be exhausted. A similar trend as for the general unemployment rate can be expected for the seasonally adjusted **proportion of unemployed persons according to the MLSA**,[5] which will rise gradually to 8% due to a continued decline in the population aged 15–64 and a cyclical increase in the number of unemployed persons registered with labour offices. It will remain at this level for almost the whole of 2014.

Real **household consumption** probably declined by 2.9% for 2012 as a whole (see Chart II.2.16). Its decline will be much more moderate this year (-0.8%). Consumption will reflect weak nominal disposable income growth, linked mainly with labour market developments and fiscal consolidation. Subdued consumer demand in the near future is also indicated by the available leading indicators, such as a low

5 The proportion of unemployed persons aged 15–64 compares the number of available job applicants and the population of the same age. This new indicator published by the MLSA replaces the previously published registered unemployment rate as from 1 January 2013.

consumer confidence indicator and a decline in retail sales in 2012 Q4[6] (see section III.3). This will be counteracted by slower inflation, despite a further increase in indirect taxes, together with an assumed decline in the saving rate from its currently elevated level. The growth rate of household consumption will continue to rise in 2014 as a result of a recovery in economic activity and a resulting gradual pick-up in the volume of wages and salaries together with a further decline in inflation.

**Gross nominal disposable income** will decrease by 0.5% this year (see Chart II.2.17). The contribution of its most significant component, i.e. wages and salaries, will be neutral in the near term. Next year, however, its growth rate will start to rise gradually in connection with the gradual economic recovery and the labour market developments described above. Another significant component of disposable income, social benefits, should also record positive contributions over the entire forecast horizon, despite a slower increase in pensions. The contribution of operating surplus and mixed income will start to grow in 2014 thanks to a pronounced economic recovery. Overall, gross disposable income will increase by 2.2% next year.

The forecast assumes a gradual decline in the **household saving rate** from its current level of above 12% to 10.5% at the end of 2014 (see Chart II.2.18).[7] Its profile will mainly reflect subdued growth in disposable income and gradually improving prospects for the economy.

Real **government consumption** (see Chart II.2.16) is declining as a result of government austerity measures, which will continue this year in connection with expenditure cuts. Real government consumption will decline by 0.3% in 2013 as a whole and increase by 0.4% in 2014.

**Gross capital formation** recorded a year-on-year decline of 9.4% in 2012 Q3, due mainly to change in inventories amid a slight decline in gross fixed capital formation. Negative annual growth in gross capital formation should continue until the end of this year, despite a recovery in investment in the government sector connected with renewed implementation of projects co-financed from EU funds.[8] Overall, gross capital formation will fall by 3.2% in 2013. A slight rise in fixed investment is expected at the start of 2014 due to renewed growth in external demand and continued growth in government investment (see Chart II.2.19).

6 In real terms, however, annual growth of retail sales continues to significantly outpace that of household consumption.
7 The revision of the quarterly national accounts from December 2012 resulted in a sharp increase in the saving rate at the start of 2012 (for details see the Box in section II.3). The uncertainty associated with the household saving rate and household consumption is described in two sensitivity scenarios in section II.4.
8 Nevertheless, the latest results of a joint survey conducted by the CNB and the Confederation of Industry of the Czech Republic indicate growth in the positive balance of responses concerning investment activity at both the six-month and the one-year horizons.

CHART II.2.17

## NOMINAL DISPOSABLE INCOME

**Disposable income will decrease slightly in 2013, its growth will re-emerge in 2014 due mainly to wages and salaries**
(annual percentage changes; contributions in percentage points)

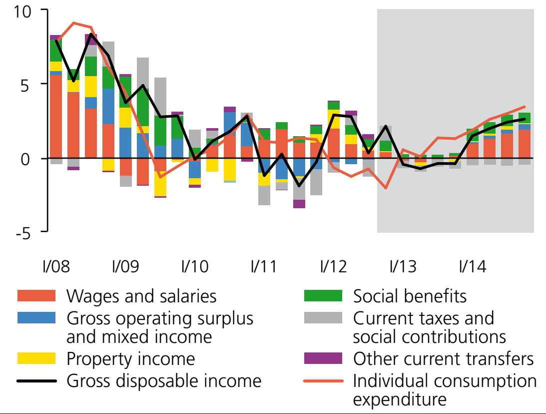



CHART II.2.18

## HOUSEHOLD SAVING RATE

**The saving rate will gradually go down after having increased sharply last year**
(percentages)

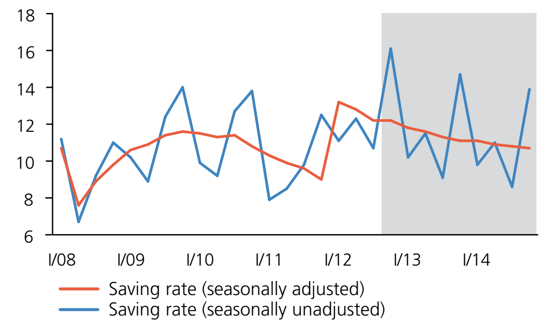



CHART II.2.19

## GROSS CAPITAL FORMATION

**Gross capital formation will be falling until the end of this year**
(annual percentage changes; seasonally adjusted)

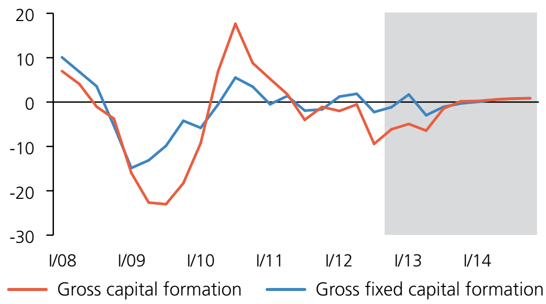


CHART II.2.20

## REAL EXPORTS AND IMPORTS

**Export and import growth will pick up pace in 2013 H2, and the contributions of net exports to GDP growth will subsequently increase again**

(annual percentage changes; annual changes in CZK billions; seasonally adjusted)

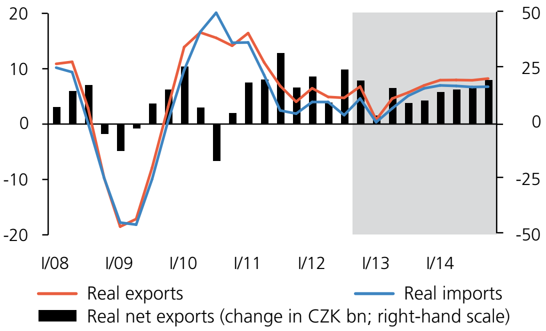



TABLE II.2.2

## FORECASTS OF SELECTED VARIABLES

**Real disposable income will not rise until 2014; labour productivity will start to increase again**

(annual percentage changes unless otherwise indicated)

| | 2011 actual | 2012 exp. outc. | 2013 forec. | 2014 forec. |
|---|---|---|---|---|
| Real gross disposable income of households | -1.3 | 0.2 | -2.1 | 0.3 |
| Total employment | 0.3 | 0.4 | -0.3 | -0.5 |
| Unemployment rate (in per cent) [a] | 6.8 | 6.9 | 7.5 | 7.9 |
| Labour productivity | 1.6 | -1.6 | 0.0 | 2.6 |
| Average nominal wage | 2.4 | 2.3 | 1.5 | 2.6 |
| Average nominal wage in business sector | 2.9 | 2.3 | 1.8 | 3.0 |
| Current account deficit (ratio to GDP in per cent) | -2.8 | -2.0 | -1.3 | -0.9 |
| M2 | 3.7 | 5.7 | 5.2 | 4.1 |

a) ILO methodology, 15–64 years

TABLE II.2.3

## BALANCE OF PAYMENTS FORECAST

**A rising trade surplus will reduce the current account deficit**

(CZK billions)

| | 2011 actual | 2012 exp. outcome | 2013 forec. | 2014 forec. |
|---|---|---|---|---|
| A. CURRENT ACCOUNT | -109.1 | -75.0 | -50.0 | -35.0 |
| Trade balance | 94.0 | 155.0 | 195.0 | 225.0 |
| Balance of services | 66.3 | 50.0 | 55.0 | 60.0 |
| Income balance | -271.9 | -270.0 | -290.0 | -310.0 |
| Current transfers | 2.5 | -10.0 | -10.0 | -10.0 |
| B. CAPITAL ACCOUNT | 14.7 | 56.0 | 80.0 | 78.0 |
| C. FINANCIAL ACCOUNT | 87.8 | 145.0 | 40.0 | 75.0 |
| Direct investment | 75.2 | 120.0 | 25.0 | 100.0 |
| Portfolio investment | 5.8 | 70.0 | 25.0 | 10.0 |
| Financial derivatives | -3.0 | 10.0 | | |
| Other investment [a] | 9.8 | -55.0 | -10.0 | -35.0 |
| D. ERRORS AND OMISSIONS | -10.7 | | | |
| E. CHANGE IN RESERVES (- = increase) | -17.2 | -80.0 | | |

a) preliminary data and forecast excluding operations of banking sector

Year-on-year growth in real **exports of goods and services** slowed in 2012 Q3. The expected slowdown in external demand in late 2012 and early 2013 is reflected in lower forecasted export growth. Export growth will start to accelerate again in 2013 Q2 in line with external demand, reaching 4.5% in 2013 as a whole and 8% in 2014 (see Chart II.2.20).

Real **imports of goods and services** also recorded a decrease in growth (to 1.6%), amid lower growth in exports of goods and services in 2012 Q3. Imports will rise by 3.7% this year as the decline in domestic demand abates. Growth in imports of goods and services will rise further to 6.8% in 2014 due to a recovery in import-intensive exports and marginally also investment.

**Net exports** at constant prices made a positive contribution to annual GDP growth in 2012 Q3 (2.3 percentage points). The forecast expects their positive contribution to decline temporarily in 2013 Q1 in connection with low growth in external demand. Net exports will be the only component to make a positive contribution to GDP growth this year. Moreover, the contribution of net exports will edge up again as external demand recovers in 2014.

The balance of payments forecast expects the **current account** deficit, as recorded in 2011 and 2012, to continue to decrease this year and the next (see Table II.2.3). In relative terms, this means a decline in the deficit from 2% of GDP in 2012 to 1.3% this year and 0.9% next year. The decline in the current account deficit in the coming two years is due to a sizeable increase in the trade surplus and, to a lesser extent, to an improvement in the services balance (the surpluses on transport and tourism will increase slightly). The growing trade surplus in 2013 is associated on the one hand with an assumed year-on-year decline in aggregate domestic demand and a modest decrease in commodity prices on world markets, hindering growth in imports, and on the other hand with a slight increase in external demand, supporting growth in exports. In 2014, an expected improvement in the terms of trade will play a role, in addition to assumed faster growth in external demand than domestic demand. An expected deepening of the income deficit, associated with a slight increase in direct investment earnings in the Czech Republic, will act against a more pronounced decline in the current account deficit in both years. The forecast expects current transfers to remain flat at the 2012 level.

The year-on-year improvement in the **capital account** this year is associated mainly with higher expected drawdown of EU funds and, to a lesser extent, with assumed one-off sales of telecommunication frequencies. In 2014, the forecast assumes drawdown of EU funds approximately at this year's level.

The **financial account** surplus is declining significantly over the forecast horizon compared with previous years. Given the weak demand in Europe and a limited need for new investment due to excess production capacity, the direct investment forecast expects no net inflow of capital, except for a surplus of reinvested earnings in both years. Moreover, the overall direct investment balance will be only slightly positive in 2013 (well below the reinvested earnings balance), owing to one major acquisition by a resident abroad. The lower expected portfolio investment surplus is due mainly to an assumption of a lower volume of bond issues abroad by the government and government-controlled companies in 2013, and also by increased interest among residents in investing abroad due to the economic recovery in 2014.

The future macroeconomic developments described above are reflected in the **government finance outlook** (see Table II.2.4). The fiscal forecast takes into account this year's increases in the two VAT rates of 1 percentage point, to 15% and 21% respectively, other budgetary consolidation measures and the introduction of the second pillar of the pension system.

According to the forecast, the general government deficit increased to 4.9% of GDP in **2012**. The annual increase in the deficit was due mainly to the accounting effect of the adoption of the law relating to property settlement between the state and churches (totalling 1.5% of GDP). However, the deficit would have risen slightly even when adjusted for this effect, owing to weak indirect tax collection in conditions of subdued domestic demand. However, the impact of fiscal policy on real GDP growth was restrictive as a result of budget consolidation measures (especially a rise in the reduced VAT rate of 4 percentage points). The year-on-year increase in general government debt to 45.9% of GDP was caused by the need to finance the government deficit (adjusted for property settlement with churches) and by bond issues on top of the borrowing requirement totalling 1.8% of GDP.

The government deficit should fall to 2.7% of GDP in **2013** owing to consolidation measures of almost 1.3% of GDP. The package of consolidation measures will slow economic growth by about 0.8 percentage point this year. It will affect the economy both through the price effect stemming from the increase in VAT and through lower nominal disposable income, with both factors reducing real household consumption. According to the forecast, real government consumption will also decline this year, while government investment will grow, among other things because of faster drawdown of EU funds. The forecast also foresees a gradually emerging shortfall of around CZK 6 billion in social security revenue in 2013 due to the launch of the second pillar of the pension system.[9]

**Table II.2.4**

**FISCAL FORECAST**

**Continuing fiscal consolidation will lead to significant decline in the ratio of the general government deficit to GDP as from 2013**
(% of nominal GDP)

| | 2011 actual | 2012 exp. outc. | 2013 forec. | 2014 forec. |
|---|---|---|---|---|
| Government revenue | 39.8 | 40.1 | 41.5 | 41.9 |
| Government expenditure | 43.0 | 44.9 | 44.2 | 44.4 |
| of which: interest payments | 1.4 | 1.5 | 1.6 | 1.7 |
| GOVERNMENT BUDGET BALANCE | -3.2 | -4.9 | -2.7 | -2.5 |
| of which: | | | | |
| primary balance a) | -1.9 | -3.4 | -1.1 | -0.8 |
| one-off measures b) | -0.2 | -1.5 | -0.2 | -0.2 |
| ADJUSTED BUDGET BALANCE c) | -3.0 | -3.3 | -2.5 | -2.3 |
| Cyclical component (ESCB method) d) | 0.4 | -0.4 | -0.9 | -0.9 |
| Structural balance (ESCB method) d) | -3.4 | -2.9 | -1.6 | -1.4 |
| Fiscal stance in pp (ESCB method) e) | 1.3 | 0.5 | 1.4 | 0.2 |
| Cyclical component (EC method) d) | 0.2 | -0.4 | -0.8 | -0.3 |
| Structural balance (EC method) d) | -3.2 | -2.9 | -1.8 | -2.0 |
| Fiscal stance in pp (EC method) e) | 1.2 | 0.3 | 1.2 | -0.2 |
| Government debt | 40.8 | 45.9 f) | 48.2 | 49.6 |

a) government budget balance minus interest payments
b) Impact of the pension reform included for economic reasons in 2013 and 2014.
c) adjusted for one-off measures; CNB estimate
d) CNB estimate
e) year-on-year change in structural balance (positive value indicates fiscal restriction, negative value fiscal expansion)
f) Starting 2012 the estimate of government debt comprises issuance of bonds on top of the borrowing requirement amounting to 1.8% of GDP in 2012.

9 This estimate has been reduced by roughly one-half compared to the previous forecast owing to a revision of expected interest in participation in the second pillar. It is broadly in line with participation of persons from the tenth decile of the wage distribution who are younger than 45 years of age. The Ministry of Finance currently estimates approximately the same shortfall in social security revenue linked with the launch of the pension reform.

A further, albeit only modest, decrease in the government deficit (to 2.5% of GDP) is expected in **2014**. This will be caused by the continuing effect of the consolidation measures adopted in 2012 (in particular a smaller increase in pensions), expected stagnation of state employees' salaries and a recovery in economic activity. The forecast expects the impact of the partial transfer of pension savings contributions into the second pillar of the pension system to amount to CZK 8.5 billion in 2014. The effect of fiscal policy on GDP growth in 2014 will be only marginally restrictive, at around 0.1 percentage point.

The general government **structural deficit** was around 3% of GDP in 2012. In connection with the consolidation measures, it is expected to fall below 2% of GDP in 2013 and be broadly flat at that level in 2014 (adjusted for the effect of the pension reform). The expected general government deficit will cause **general government debt** to increase to almost 50% of GDP in 2014. In addition to the expected borrowing requirements of general government owing to persisting public finance deficits, the prediction of this ratio reflects the negative effect of subdued nominal GDP growth and the assumption that the debt reserve will be maintained.

The potential implementation of additional austerity measures is a **risk to the fiscal forecast** towards a lower deficit and a more restrictive effect of fiscal policy in 2014. The value of the fiscal multiplier is also surrounded by uncertainty. It may be higher than usual at this time of sustained domestic fiscal restriction, interest rates at their lowermost limit, weak external demand and persisting uncertainty surrounding developments in the euro area (see the higher fiscal multiplier sensitivity scenario in Inflation Report IV/2012).

## II.3 COMPARISON WITH THE PREVIOUS FORECAST

*The forecasts for headline and monetary-policy relevant inflation are little changed from the previous prediction, with lower net inflation and higher administered price inflation acting in opposite directions. In the near future, the interest rate path has shifted to a slightly higher level, owing mainly to the short-term exchange rate forecast. In 2014, by contrast, it is slightly lower. Compared to the previous forecast, the currently weaker exchange rate gradually moves to a slightly stronger level in the longer term. The GDP forecast for this year has been lowered in connection with weaker growth in domestic and external demand. In 2014, the GDP forecast has been revised slightly upwards. The expected pace of nominal wage growth in the business sector is lower over the entire forecast horizon.*

The forecast for annual **headline inflation** is little changed from the previous forecast (see Chart II.3.1). In 2013, lower net inflation will outweigh higher growth in administered prices and headline inflation will therefore move slightly downwards. In 2014, the effect of higher administered prices will become stronger and headline inflation has therefore been revised marginally upwards. The assumptions regarding indirect tax changes remain the same as in the previous forecast, so the outlook for **monetary-policy relevant inflation** has changed in a similar way to that for headline inflation.

Expected **administered price inflation** is higher over the entire horizon compared to the previous forecast, owing mainly to higher prices of natural gas for households.[10] The outlook for electricity prices and water supply and sewerage collection charges has also increased. These factors are only partly offset by a lower outlook for regulated rent growth.

Compared to the previous forecast, annual **net inflation** has moved significantly downwards (see Chart II.3.2). This is due to lower predictions for adjusted inflation excluding fuels, reflecting developments in 2012 Q4, and in 2013 also to weaker economic activity. A lower fuel price outlook is acting in the same direction. These effects are only partially offset by stronger growth in food prices.

Turning to the **external environment** outlook, by comparison with the assumptions of the previous forecast, the 3M EURIBOR path has increased slightly over the entire horizon. The expected growth rate of external demand is slightly lower in 2013 and unchanged in 2014. The foreign producer price outlook has shifted slightly upwards in both years.

10 The Energy Regulatory Office has completely abandoned the announced reduction in distribution fees.

CHART II.3.1

**CHANGE IN THE HEADLINE INFLATION FORECAST**

**The forecast for headline inflation has been revised downwards slightly this year and upwards next year**
(annual percentage changes; differences in pp – right-hand scale)

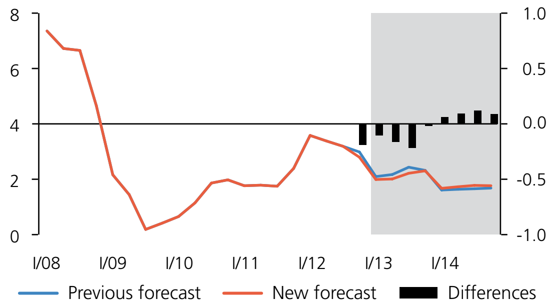



CHART II.3.2

**CHANGE IN THE NET INFLATION FORECAST**

**The forecast for net inflation has moved significantly downwards**
(annual percentage changes; differences in pp – right-hand scale)

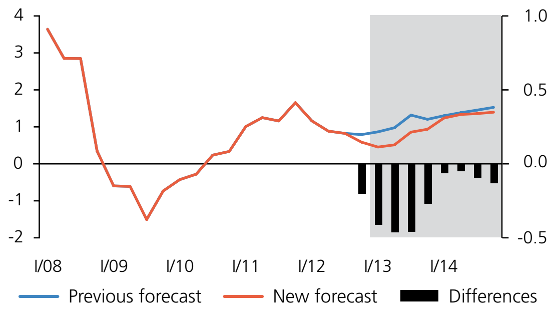



CHART II.3.3

**CHANGE IN THE INTEREST RATE PATH**

**The market interest rate path is slightly higher this year and slightly lower in the longer term**
(3M PRIBOR in %; differences in pp – right-hand scale)

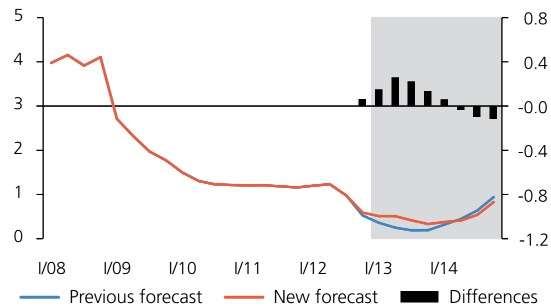


**Chart II.3.4**

**DECOMPOSITION OF CHANGES IN THE INTEREST RATE FORECAST**

**Higher rates are being fostered in 2013 mainly by the current exchange rate level and by administered prices**
(3M PRIBOR; percentage points)

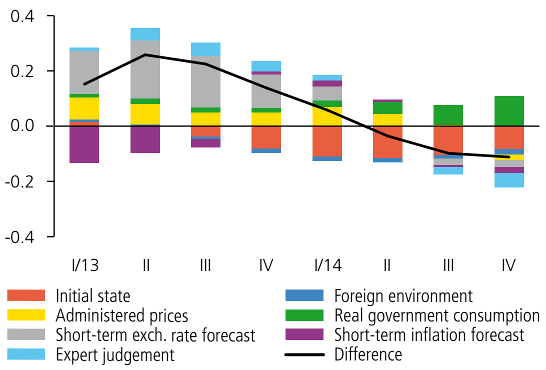



**Chart 1 (Box)**

**REVISIONS OF CONSUMER DEFLATOR**

**The growth rate of the household consumption deflator is significantly lower after the revision**
(annual percentage changes; seasonally adjusted)

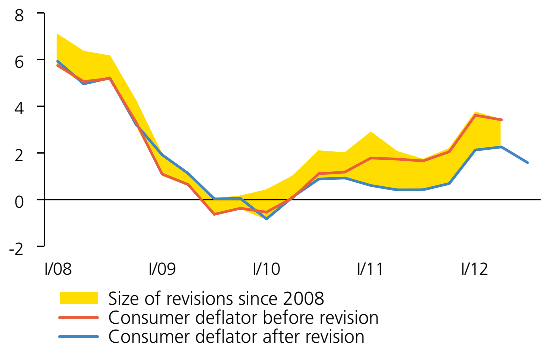
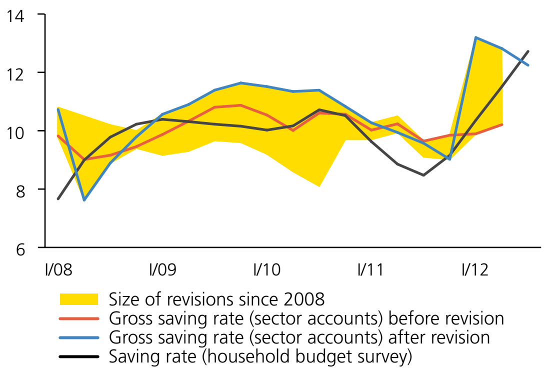



**Chart 2 (Box)**

**REVISIONS OF HOUSEHOLDS' SAVING RATE**

**The saving rate in early 2012 has been revised by around 3 percentage points**
(in % of gross disposable income; seasonally adjusted)




The forecast for domestic market **interest rates** is slightly higher in 2013 compared to the previous forecast; in 2014, by contrast, it is slightly lower (see Chart II.3.3). Lower rates are being fostered by the short-term prediction of net inflation at the start of the forecast horizon and by the initial state in the longer run (see Chart II.3.4). This is due mainly to the lagged impact of the lower wage growth observed in the business sector, weaker economic activity and lower observed inflation. The overall anti-inflationary effect of these factors is more than offset in the next few quarters by the short-term exchange rate prediction and to a lesser extent also by an increase in the outlook for administered prices. The change in the initial state was also due to revisions of the national accounts data; in particular, a marked upward revision of real household consumption is acting towards higher rates (see the Box below). Expert judgement, linked with a slight increase of the investment forecast, is also acting towards slightly higher rates. Changes in the external environment outlook have a neutral effect overall, as somewhat higher foreign rates and foreign producer prices are offset by lower external demand.

**BOX**

**Revision of the quarterly national accounts**

The CZSO published revised quarterly national accounts together with the data for 2012 Q3. The non-seasonally adjusted historical series for GDP and its components have been revised as from 2009 and the seasonally adjusted series have changed over the entire available time series as from 1995. Within the GDP growth structure, household consumption, fixed investment and in 2012 also inventories have increased. This was offset by a lower contribution of net exports. This box focuses on describing the revision of household consumption and investment.

The household consumption deflator has been revised substantially (see Chart 1). Its annual growth rate over the last six quarters has been shifted 1.3 percentage points lower on average. The consumption deflator has therefore deviated downwards from the consumer price index, whereas before the revision the two variables showed similar dynamics. According to the CZSO, 1 percentage point of the 1.3 percentage point difference between the two indicators in 2011 was due to rent reassessment, of which 0.8 percentage point was imputed rent. For the purposes of the consumer price index, imputed rent is derived from prices of construction work and construction material inputs, while the consumption deflator in the annual national accounts is derived from external surveys of supply rents in 140 towns and 114 locations in Prague, Brno and Ostrava; these data are then adjusted using transaction price data from estate agencies.

Real private consumption has been revised upwards by 0.8 percentage point on average in 2009–2011, offset mainly by a lower contribution of net exports. A revision of nominal consumption together with a revision of nominal disposable income (which was affected most of all by changes to current taxes and social benefits) has been consistently incorporated into a revision of the household saving rate. The seasonally adjusted saving rate in early 2012 has been revised sharply upwards by around 3 percentage points (see Chart 2). The uncertainty associated with the evolution of consumption and the household saving rate is described in two sensitivity scenarios in section II.4.

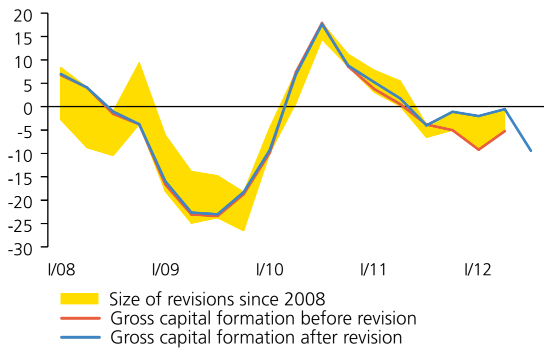
Both components of gross capital formation (change in inventories and fixed investment) have been revised. The revision has increased the annual growth rate of fixed investment by 0.5 percentage point and that of total investment by 0.7 percentage point on average in 2009–2011 (see Chart 3). With regard to the breakdown by kind, the rise in fixed investment is due largely to other machinery and equipment in 2010 and other buildings and structures in 2011. From the sectoral perspective, the biggest contributors were households in 2009 (although their contributions in the next two years are negative), non-financial institutions in 2010 and financial institutions in 2011.

Overall, this revision of the quarterly national accounts has affected the initial state of the forecast in the direction of lower estimated growth in nominal marginal costs in the consumer goods sector and a less negative path of the gap in profit mark-ups.

### Chart 3 (Box)

### REVISIONS OF GROSS CAPITAL FORMATION

**Investment activity is falling at a slower pace after the revision**
(annual percentage changes; seasonally adjusted)

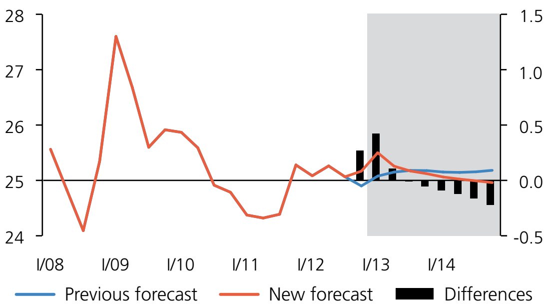



The forecast for the nominal **exchange rate of the koruna against the euro** has been revised to a weaker level at the start of the forecast horizon. The short-term forecast for 2013 Q1 is affected by the current exchange rate, which evidently reflects the unfavourable evolution of the Czech economy and the CNB's communication regarding potential foreign exchange interventions (see Chart II.3.5). From the end of this year, by contrast, the exchange rate shifts towards slightly stronger levels compared to the previous forecast.

### Chart II.3.5

### CHANGE IN THE EXCHANGE RATE FORECAST

**The currently weaker exchange rate moves to slightly stronger levels in the longer term**
(CZK/EUR; differences in CZK – right-hand scale)



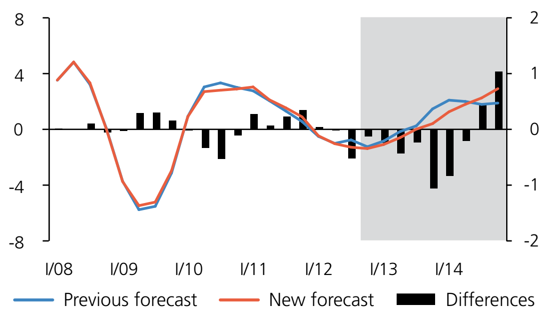

The forecast for annual **GDP** growth is 0.5 percentage point lower for this year (see Chart II.3.6). This is due to a slightly lower outlook for external demand and more subdued household consumption, reflecting developments observed last year and slower wage growth. In 2014, by contrast, the GDP forecast is slightly higher.

The contribution of **net exports** to GDP growth this year will be higher than in the previous prediction, as sharper declines in import-intensive investment and household consumption are fostering lower import growth. In 2014, the contribution of net exports to GDP growth will also be slightly higher than in the previous forecast.

### Chart II.3.6

### CHANGE IN THE GDP FORECAST

**The GDP forecast for 2013 has been revised downwards**
(annual percentage changes; differences in pp – right-hand scale; seasonally adjusted)



The forecast for average **nominal wage** growth in the business sector is lower than in the previous prediction in both 2013 and 2014. The lower predicted wage growth is due to lower wage dynamics in 2012 Q3 and a lower outlook for domestic economic activity owing to a more gradual recovery in external demand. In late 2012 and early 2013, the forecast is now also affected by an expected time shift of part of the volume of wages and salaries due to tax optimisation.

## II.4 ALTERNATIVE SCENARIOS AND SENSITIVITY ANALYSES

*Several uncertainties were identified during the preparation of the forecast. There is persisting uncertainty regarding the evolution of the global economy despite the recent calming of the financial market situation. Household consumption and the household saving rate are also a source of uncertainty. This uncertainty led to the preparation of two sensitivity scenarios. An exchange rate sensitivity scenario was also prepared as usual.*

### II.4.1 Household consumption data uncertainty sensitivity scenario

Simultaneously with the publication of the annual national accounts data, the historical data underwent a significant revision (see the Box in section II.3). The revision brought the path of household consumption closer into line with that of retail sales. However, consumption has continued to fall more strongly than sales in the recent period. This decline in household consumption is reflected in a sharp increase in households' saving rate to a historical high at the start of 2012. At the same time, however, this indicator is also subject to significant data revisions. This sensitivity scenario quantifies the **data risk regarding household consumption and the saving rate** in 2012 with a path of real household consumption that copies the profile of real retail sales.

In the sensitivity scenario, household consumption in 2012 is increased by 2.5 percentage points. This implies an almost 2 percentage point decrease in the saving rate. The higher consumption is offset by a lower path of gross capital formation in the inventories item, such that the published GDP growth path is preserved. The change in the composition of GDP changes the structure of the initial state of the forecast, where the less anti-inflationary effect of household consumption is almost offset by the more anti-inflationary effect of gross capital formation. As in the baseline scenario, the initial state thus has an anti-inflationary effect overall.

To sum up, this sensitivity scenario leads to a slightly weaker exchange rate and slightly higher GDP growth. This is consistent with a **slightly higher interest rate path**. The impacts on the inflation outlook are negligible. The simulation results are shown in the table in the form of deviations from the baseline scenario of the forecast (see Table II.4.1).

TABLE II.4.1

**HOUSEHOLD CONSUMPTION DATA UNCERTAINTY SENSITIVITY SCENARIO**

**The sensitivity scenario implies a significantly lower saving rate and slightly higher interest rates than the baseline scenario**
(deviations from baseline scenario)

| | CPI inflation (in pp) | 3M PRIBOR (in pp) | Household consumption (in pp) | Saving rate (in pp) | Nominal exchange rate (CZK/EUR) |
|---|---|---|---|---|---|
| I/13 | 0.0 | 0.0 | -1.1 | -1.9 | 0.0 |
| II/13 | 0.0 | 0.1 | 1.1 | -2.0 | 0.1 |
| III/13 | 0.0 | 0.1 | 0.3 | -1.9 | 0.2 |
| IV/13 | 0.0 | 0.1 | 0.4 | -1.9 | 0.2 |
| I/14 | 0.0 | 0.1 | 0.0 | -1.8 | 0.2 |
| II/14 | 0.0 | 0.1 | 0.0 | -2.0 | 0.2 |
| III/14 | 0.0 | 0.1 | 0.0 | -1.9 | 0.2 |
| IV/14 | 0.0 | 0.1 | 0.1 | -1.9 | 0.2 |

### II.4.2 Longer-term consumption deferral sensitivity scenario

In addition to data uncertainty, households' low consumption and high saving rate observed in 2012 can be explained by a change in households' behaviour in reaction to uncertainty in the economic environment. The preparation of this sensitivity scenario was motivated by the **risk that households will decide to continue deferring their consumption** and save at a higher rate.

**Table II.4.2**

**LONGER-TERM CONSUMPTION DEFERRAL SENSITIVITY SCENARIO**

**A long period of low consumption would lead to lower interest rates and a weaker exchange rate of the koruna**
(deviations from baseline scenario)

| | CPI inflation (in pp) | 3M PRIBOR (in pp) | Household consumption (in pp) | Saving rate (in pp) | Nominal exchange rate (CZK/EUR) |
|---|---|---|---|---|---|
| I/13 | 0.0 | -0.2 | -0.6 | 0.4 | 0.0 |
| II/13 | 0.0 | -0.3 | -0.9 | 0.6 | 0.3 |
| III/13 | 0.0 | -0.4 | -1.1 | 0.7 | 0.4 |
| IV/13 | -0.1 | -0.4 | -1.1 | 0.8 | 0.4 |
| I/14 | -0.1 | -0.5 | -0.4 | 0.7 | 0.4 |
| II/14 | -0.1 | -0.5 | 0.0 | 0.6 | 0.4 |
| III/14 | -0.1 | -0.5 | 0.3 | 0.5 | 0.3 |
| IV/14 | -0.1 | -0.5 | 0.4 | 0.4 | 0.2 |

**Table II.4.3**

**EXCHANGE RATE SENSITIVITY SCENARIO**

**Exchange rate depreciation leads to temporarily higher inflation and higher GDP growth than in the baseline scenario; interest rates increase**
(deviations from baseline scenario)

| | CPI inflation (in pp) | 3M PRIBOR (in pp) | GDP growth (in pp) | Nominal exchange rate (CZK/EUR) |
|---|---|---|---|---|
| I/13 | 0.0 | 0.0 | 0.2 | 0.8 |
| II/13 | 0.0 | 0.3 | 0.3 | 0.3 |
| III/13 | 0.1 | 0.3 | 0.3 | 0.1 |
| IV/13 | 0.2 | 0.3 | 0.0 | 0.0 |
| I/14 | 0.2 | 0.1 | -0.2 | 0.0 |
| II/14 | 0.1 | 0.0 | -0.3 | 0.1 |
| III/14 | 0.1 | 0.0 | -0.2 | 0.1 |
| IV/14 | 0.0 | 0.0 | -0.1 | 0.1 |

The return of the **household saving rate** to its long-term values is slower in the sensitivity scenario than in the baseline scenario. The related deferral of household consumption is reflected in a larger contraction in economic activity, or more generally in a more anti-inflationary effect of the domestic economy. A weaker exchange rate, affecting import prices, acts in the opposite direction. Consistent with the sensitivity scenario is a larger **decrease in market interest rates** than in the baseline scenario. The simulation results are shown in the table in the form of deviations from the baseline scenario of the forecast (see Table II.4.2).

### II.4.3 Exchange rate sensitivity scenario

The sensitivity scenario quantifies the impacts of a **different exchange rate path**. This standard sensitivity scenario assumes a deviation of the nominal exchange rate of ±3% from the baseline scenario in the first quarter of the forecast. Interest rates in that quarter are the same as in the baseline scenario. The exchange rate is thus CZK 24.7/26.3 to the euro in 2013 Q1, compared to CZK 25.5 in the baseline scenario.

The table shows the results of the depreciation scenario, expressed as deviations from the baseline scenario of the forecast (see Table II.4.3). The scenario of a stronger nominal exchange rate leads to the same results but with the opposite sign.

The exchange rate depreciation improves producers' price competitiveness and, via higher net exports, leads to higher GDP growth compared to the baseline at the start of the forecast horizon. It also results in higher import prices and temporarily stronger inflation pressures. The market interest rate path is therefore higher than in the baseline scenario in the next few quarters. However, GDP growth then slows slightly below the baseline in response to tighter monetary policy and an exchange rate correction. It returns to the baseline scenario at the end of the forecast horizon.

## II.5 FORECASTS BY OTHER ENTITIES

*Analysts' inflation expectations decreased towards the CNB's target of 2%, or just below it, at both the one-year and three-year horizons. The analysts expect a stagnation or only weak growth in GDP this year. All the analysts were expecting stable key rates before the CNB Bank Board meeting in February. The majority of them also expect the koruna to appreciate slightly and the CNB's 2W repo rate as well as market interest rates to be flat in the following 12 months. The market rate outlook one year ahead is slightly falling, broadly in line with the interest rate path consistent with the new CNB forecast over the entire forecast horizon.*

**Inflation expected by financial market analysts** at the one-year horizon edged down in 2012 Q4 and fell more markedly in early 2013 to slightly below the CNB's target. The one-year inflation expectations of business managers were flat at about 0.5 percentage point above the CNB's target of 2% at the end of last year (see Table II.5.1). The analysts' inflation expectations at the three-year horizon decreased to the CNB's target level.

The indicator of **inflation perceived by households** turned slightly positive in early 2012 (see Chart II.5.1). This means that households on average felt that prices rose moderately over the last 12 months. This indicator rose slightly at the end of last year. The indicator of **expected inflation** has long been positive. This suggests that the number of respondents who expect prices to rise more rapidly over the next 12 months is higher than the number of those who expect prices to stay the same or increase more slowly than in the recent past. The indicator of expected inflation also went up slightly on average in 2012 Q4 as a whole.

**Both the FMIE and CF analysts** expect GDP to be flat or to grow only modestly this year following the contraction last year (see Table II.5.1 and Table II.5.2). Next year the economy should expand by almost 2%, and wage growth should also accelerate slightly. Compared to the average koruna exchange rate so far in January 2013, the analysts participating in both the FMIE and the CF expect the exchange rate to be stronger at the one-year horizon (by 2% and 1.3% respectively). Before the CNB Bank Board meeting in February, all twelve FMIE analysts were expecting no changes in key interest rates at this meeting. Most of the analysts also expect rates to remain flat at the current level at the one-year horizon. Their estimates for the 2W repo rate lie in the range of 0.05–0.50%.

**In contrast to the CNB's new forecast**, the analysts do not expect real GDP to decline this year, but next year they expect the economy to grow at a slightly lower pace than predicted by the CNB. Inflation expected at the one-year horizon is slightly above the CNB forecast.

TABLE II.5.1

### EXPECTED INDICATORS OF FMIE AND CORPORATIONS

**The inflation expectations of analysts at the one-year horizon fell slightly below the CNB's target**
(at 1Y; annual percentage changes unless otherwise indicated)

| | 9/12 | 10/12 | 11/12 | 12/12 | 1/13 |
|---|---|---|---|---|---|
| FMIE: | | | | | |
| CPI | 2.5 | 2.4 | 2.5 | 2.3 | 1.8 |
| CPI, 3Y horizon | 2.3 | 2.2 | 2.2 | 2.1 | 2.0 |
| Real GDP in 2012 | -0.9 | -0.8 | -1.0 | -1.0 | |
| Real GDP in 2013 | 1.1 | 0.6 | 0.7 | 0.1 | 0.0 |
| Nominal wages in 2012 | 2.6 | 2.5 | 2.6 | 2.3 | |
| Nominal wages in 2013 | 3.0 | 2.8 | 2.7 | 2.3 | 2.0 |
| CZK/EUR exchange rate (level) | 24.4 | 24.5 | 24.9 | 24.9 | 25.0 |
| 2W repo rate (in per cent) | 0.3 | 0.2 | 0.1 | 0.1 | 0.1 |
| 1Y PRIBOR (in per cent) | 1.3 | 1.2 | 1.0 | 0.9 | 1.0 |
| Corporations: | | | | | |
| CPI | 2.5 | | | 2.5 | |

CHART II.5.1

### PERCEIVED AND EXPECTED INFLATION

**The inflation expectations of households increased slightly on average in 2012 Q4**
(source: European Commission Business and Consumer Survey)

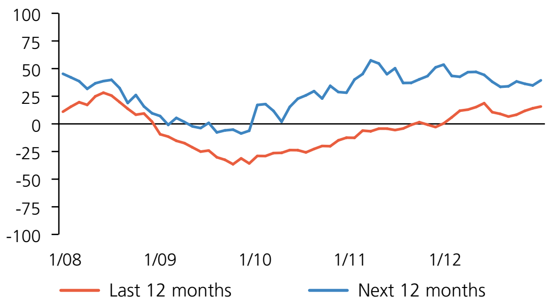



TABLE II.5.2

### CF EXPECTED INDICATORS

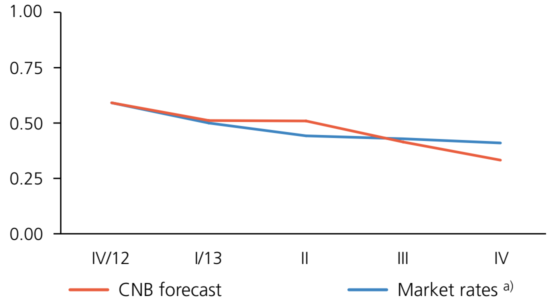
**The CF analysts expect the economy to expand modestly this year after contracting last year**
(at 1Y; annual percentage changes unless otherwise indicated)

| | 9/12 | 10/12 | 11/12 | 12/12 | 1/13 |
|---|---|---|---|---|---|
| Real GDP in 2012 | -0.8 | -0.9 | -1.0 | -1.0 | |
| Real GDP in 2013 | 1.0 | 0.9 | 0.6 | 0.3 | 0.3 |
| Nominal wages in 2012 | 2.6 | 2.6 | 2.5 | 2.4 | |
| Nominal wages in 2013 | 2.8 | 2.8 | 2.5 | 2.4 | 2.2 |
| CZK/EUR exchange rate (level) | 24.9 | 24.7 | 25.0 | 25.1 | 25.2 |
| 3M PRIBOR (in per cent) | 0.8 | 0.7 | 0.5 | 0.5 | 0.5 |

**CHART II.5.2**

**FRA RATES VERSUS THE CNB FORECAST**

**The FRA rate outlook is approximately in line with the rates consistent with the CNB forecast**
(percentages)




a) for 2012 Q4 and 2013 Q1 the 3M PRIBOR and for 2013 Q2–2013 Q4 the average values of the FRA 3*6, 6*9 and 9*12 rates for the last 10 trading days as of 25 January 2013

The exchange rate at the one-year horizon differs little from the CNB forecast. The analysts' expectations regarding the 2W repo rate and market rates at the one-year horizon are only slightly above the 3M PRIBOR path consistent with the new CNB forecast.

Chart II.5.2 provides a **comparison of expected 3M market rates** derived from FRA quotations and the interest rate path consistent with the new CNB forecast. The current market outlook is slightly falling, broadly in line with the interest rate path consistent with the new forecast over the entire forecast horizon.

# III. CURRENT ECONOMIC DEVELOPMENTS

## III.1 INFLATION

*Annual headline CPI inflation was 2.4% in December 2012 and was thus above the CNB's target. At 1.1%, monetary policy-relevant inflation was close to the lower boundary of the tolerance band around the CNB's target. The pronounced fall in annual inflation in 2012 Q4 was due to all its components. Market prices were strongly affected by the anti-inflationary effect of the domestic economy amid falling economic activity as a result of weak domestic demand. A moderation of the inflationary effect of import prices of consumer goods and oil prices also helped to reduce inflation in 2012 Q4.*

### III.1.1 Fulfilment of the inflation target

**Headline inflation** was above the CNB's target in 2012 Q4 (see Chart III.1.1), while monetary-policy relevant inflation was below the target. This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

In order to assess the effect of monetary policy on the fulfilment of the inflation target one needs **to analyse retrospectively the forecasts** and the Bank Board's decisions based thereon in the past. To assess the fulfilment of the inflation target in 2012 Q4, we have to examine above all the period roughly from April 2011 to December 2011 (referred to as the "key period"), as monetary policy is focused on hitting the inflation target at the 12–18 month horizon. For the sake of clarity, the analysis of the accuracy of the forecasts is limited here to a comparison of the Inflation Report III/2011 forecast with subsequent developments.

The **Inflation Report III/2011** forecast expected headline inflation to rise slightly above 3% in 2012 owing to a VAT increase (see Chart III.1.1). Monetary-policy relevant inflation was expected to be close to the 2% inflation target over the entire forecast horizon. In addition to administered prices, this was to be fostered by gradually strengthening pressures from the domestic economy combined with a pick-up in wage growth. However, their impact was to be largely offset by gradual exchange rate appreciation and by the unwinding of the inflationary effect of commodity prices. The forecast assumed a gradual slowdown in food price inflation and – in the longer term – also in fuel price inflation.

Headline **inflation in reality** was roughly in line with the forecast over almost the entire forecast horizon. It deviated from the forecast only slightly downwards in 2012 Q4 – by 0.3 percentage point. This deviation was due to much lower adjusted inflation excluding fuels, which remained negative owing mainly to domestic anti-inflationary

CHART III.1.1

FORECAST VERSUS ACTUAL INFLATION

**Inflation was slightly below the IR III/2011 forecast in 2012 Q4**
(annual percentage changes)

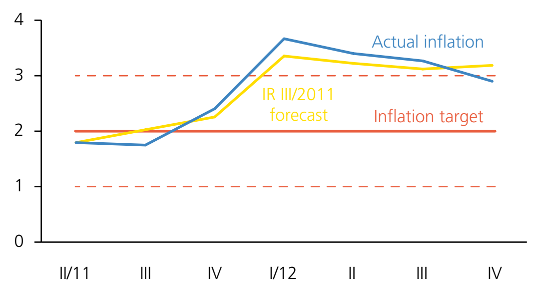


**Table III.1.1**

**FULFILMENT OF THE INFLATION FORECAST**

**Adjusted inflation excluding fuels fostered significantly lower inflation, while the other components were higher than forecasted**

(annual percentage changes; contributions in percentage points)

| | IR III/2011 forecast | 2012 Q4 outturn | Contribution to total difference |
|---|---|---|---|
| CONSUMER PRICES | 3.2 | 2.9 | -0.3 |
| Breakdown into contributions: | | | |
| administered prices | 5.3 | 7.1 | 0.4 |
| first-round impacts of changes to indirect taxes[a)] | 0.9 | 1.0 | 0.1 |
| food prices[b)] | 1.6 | 2.7 | 0.2 |
| fuel prices[b)] | 2.9 | 3.8 | 0.0 |
| adjusted inflation excl. fuels[b)] | 1.5 | -0.5 | -1.0 |

a) impact in non-administered prices on total inflation
b) excluding the first-round effects of changes to indirect taxes

**Table III.1.2**

**FULFILMENT OF THE EXTERNAL ASSUMPTIONS**

**External factors had a roughly neutral effect on domestic inflation**

(annual percentage changes unless otherwise indicated)

| | | III/11 | IV/11 | I/12 | II/12 | III/12 | IV/12 |
|---|---|---|---|---|---|---|---|
| GDP in euro area[a), b), c)] | p | 2.4 | 2.4 | 2.1 | 2.2 | 2.2 | 2.2 |
| | o | 2.4 | 1.6 | 1.6 | 0.6 | 0.4 | - |
| PPI in euro area[b), c)] | p | 4.8 | 3.8 | 1.9 | 1.7 | 2.8 | 3.4 |
| | o | 6.0 | 5.1 | 3.7 | 2.2 | 2.1 | 2.2 |
| 3M EURIBOR | p | 1.6 | 1.8 | 1.9 | 2.0 | 2.0 | 2.1 |
| (percentages) | o | 1.6 | 1.5 | 1.0 | 0.7 | 0.4 | 0.2 |
| USD/EUR exchange rate | p | 1.43 | 1.43 | 1.42 | 1.42 | 1.40 | 1.39 |
| (levels) | o | 1.41 | 1.35 | 1.31 | 1.28 | 1.25 | 1.30 |
| Brent crude oil price | p | 114.7 | 116.5 | 116.5 | 116.2 | 115.9 | 115.4 |
| (USD/barrel) | o | 112.9 | 109.3 | 118.7 | 108.7 | 109.9 | 110.5 |

p – prediction, o – outturn
a) at constant prices
b) seasonally adjusted
c) effective indicator as defined in the IR III/2011 forecast

**Table III.1.3**

**FULFILMENT OF THE FORECAST FOR KEY VARIABLES**

**Observed GDP growth was well below the forecast throughout the period**

| | | III/11 | IV/11 | I/12 | II/12 | III/12 | IV/12 |
|---|---|---|---|---|---|---|---|
| 3M PRIBOR | p | 1.2 | 1.3 | 1.5 | 1.6 | 1.7 | 1.9 |
| (percentages) | o | 1.2 | 1.2 | 1.2 | 1.2 | 1.0 | 0.6 |
| CZK/EUR exchange rate | p | 24.2 | 23.7 | 23.4 | 23.1 | 23.0 | 22.8 |
| (levels) | o | 24.4 | 25.3 | 25.1 | 25.3 | 25.1 | 25.2 |
| Real GDP[a)] | p | 1.7 | 1.5 | 1.1 | 1.6 | 2.6 | 3.3 |
| (annual perc. changes) | o | 1.5 | 0.9 | -0.5 | -1.0 | -1.3 | - |
| Nominal wages[b)] | p | 3.2 | 3.8 | 4.3 | 4.9 | 5.2 | 5.3 |
| (annual perc. changes) | o | 2.7 | 2.6 | 3.4 | 2.3 | 1.3 | - |

p – prediction, o – outturn
a) seasonally adjusted
b) in the business sector

pressures. By contrast, administered prices fostered higher inflation, with natural gas prices and regulated rents showing stronger growth. Food and fuel price inflation was also slightly higher than expected (see Table III.1.1).

**External economic factors** contributed significantly to domestic inflation. External economic activity showed an unexpected strong contraction compared to the forecast (see Table III.1.2). External production prices grew faster than expected for most of the period, but in 2012 H2 their growth slowed and was below the forecast. Foreign interest rates reacted to the worse outlook for economic activity and were well below the expected path. The effect of external developments on domestic inflation was roughly neutral overall.

Domestic **interest rates and the exchange rate** also differed from the forecast. Interest rates remained stable until mid-2012 and then went down. They thus deviated downwards from the forecast, which had assumed that they would gradually increase in late 2011/early 2012. The exchange rate depreciated significantly at the end of 2011, mainly as a result of lower growth in external demand and an escalation of the euro area debt crisis. The koruna remained at weaker levels in 2012 (see Table III.1.3).

Based on the CNB's current knowledge of the workings of the Czech economy and its current knowledge of the actual economic situation, the **developments since the forecast under review was drawn up** can be summed up in the following way. Domestic GDP growth deviated increasingly from the forecast because of a stronger-than-expected decline in external demand growth and subdued domestic demand. The latter was affected by uncertainty associated with continuing domestic fiscal consolidation and the euro area debt crisis. Despite the easier domestic monetary policy and weaker koruna exchange rate, these factors were reflected in an unexpected fall in consumption and investment. The volumes of real exports and imports were much lower as well. Wage growth was also noticeably more subdued than forecasted as a result of the lower economic activity. The comparison of the current data on the GDP growth structure with the forecast is also affected by substantial revisions to the national accounts.[11]

In addition to the forecast, an assessment of the risks associated with this forecast is important for the Bank Board's decisions on **monetary policy rates.** At its meetings in 2011 Q2, the Bank Board assessed the risks to the forecast as being balanced for monetary policy-relevant inflation and on the upside for headline inflation due to the VAT change announced by the government but not yet incorporated into the forecast. In 2011 Q3, the risks to the forecast were assessed as being balanced or slightly on the downside and those relating to

11 See the Box: *Revision of the quarterly national accounts* in section II.3.

interest rates as being skewed towards significantly lower levels. In 2011 Q4, the risks to the forecast were tilted towards interest rate stability in the spirit of the alternative scenario (as compared to a decline in rates in the baseline scenario) or were slightly inflationary, according to the Bank Board. Interest rates remained stable until mid-2012 and then decreased. Headline inflation was above the target in 2012 Q4, primarily because of the increase in the reduced VAT rate, while monetary-policy relevant inflation was slightly below the target. Almost all the identified risks materialised in the key period. From this perspective, based on current knowledge, it seems that the monetary policy pursued between April and December 2011 was roughly appropriate.

### III.1.2 Current inflation

**Annual inflation**[12] decreased significantly in 2012 Q4, falling by 1 percentage point compared to September, to 2.4% in December (see Chart III.1.2). This change was due to all components of inflation (see Chart III.1.3), reflecting weakening external cost pressures and the anti-inflationary effect of the domestic economy.

Turning to the **structure of annual inflation**, inflation continued to be affected in 2012 Q4 mainly by administrative factors, i.e. changes to indirect taxes and administered prices. Their share in overall annual consumer price inflation exceeded 90% in December, as the effect of food price inflation weakened and the decline in adjusted inflation excluding fuels deepened (see Chart III.1.4).

Owing to an increase in the reduced VAT rate and a harmonisation increase in excise duties on cigarettes at the start of last year, changes to **indirect taxes** contributed about 1 percentage point to annual market price inflation in 2012 Q4. The overall first-round effect on inflation including administered prices was roughly 1.3 percentage points. **Monetary-policy relevant inflation**, i.e. inflation adjusted for the first-round effects of indirect taxes, therefore stayed below headline inflation and was 1.1% in December (see Chart III.1.2).

**Administered prices** made the biggest contribution to annual inflation again in 2012 Q4 owing to changes made at the start of last year. However, their annual growth gradually slowed during Q4 (from 8.1% in September to 6.2% in December), mainly as a result of slower annual growth in prices of natural gas for households due to base effects. By contrast, faster growth was recorded for regulated rents, which rose by 11.6% year on year in December. The following text assesses the evolution of the main components of inflation adjusted for the tax changes.

12 Measured by year-on-year growth in consumer prices.

CHART III.1.2

**INFLATION**

**Inflation decreased significantly in 2012 Q4**
(annual percentage changes)

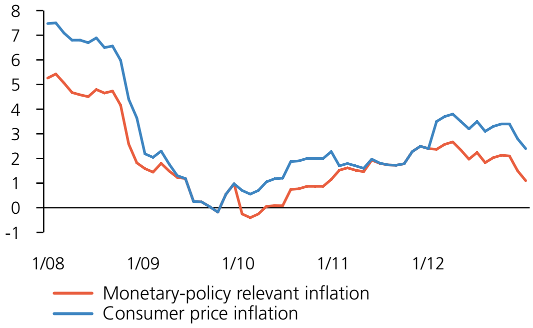



CHART III.1.3

**INFLATION COMPONENTS**

**All the components of inflation contributed to the decrease in inflation**
(annual percentage changes; excluding indirect tax changes)

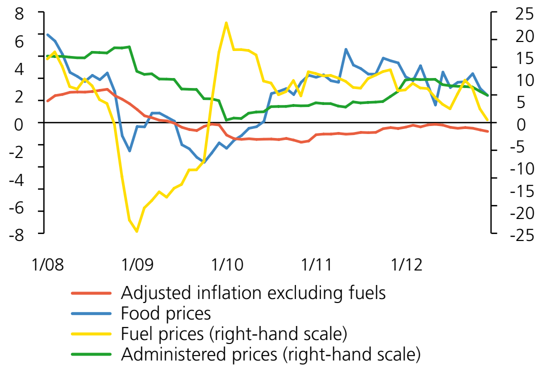



CHART III.1.4

**STRUCTURE OF INFLATION**

**Indirect taxes and administered prices contributed the most to inflation**
(annual percentage changes; contributions in percentage points)

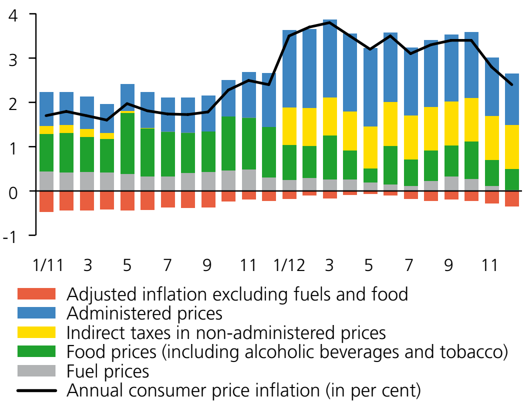


**CHART III.1.5**

**FOOD PRICES**

**Food price inflation went down**
(annual percentage changes)

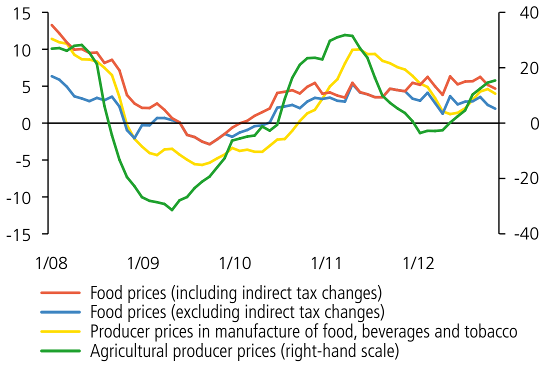
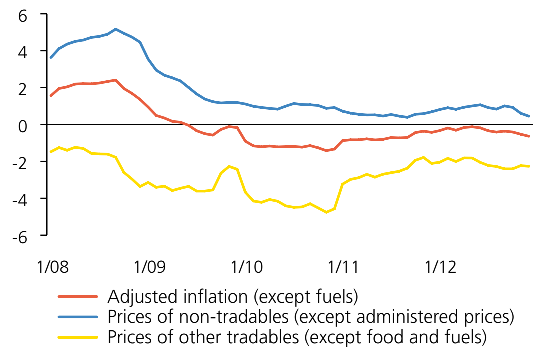



**CHART III.1.6**

**ADJUSTED INFLATION EXCLUDING FUELS**

**Adjusted inflation excluding fuels turned more negative**
(annual percentage changes)




Annual **market price inflation**, as measured by net inflation, also fell significantly in 2012 Q4 (from 1.1% in September to 0.2% in December). This was largely due to a marked fall in fuel price inflation combined with a more modest decline in food price inflation. A shift of adjusted inflation excluding fuels to more negative levels (see Chart III.1.6) acted in the same direction. The by now generally low annual growth in market prices, and in particular a deepening decline in prices within adjusted inflation in 2012 Q4, indicated persisting subdued consumer demand and a generally anti-inflationary effect of the domestic economy. Low inflation was also fostered by only slightly rising, or falling, import prices of final products for the consumer market. A sharp decrease in oil price growth on world markets and in import prices of oil also contributed to low inflation in the period under review.

The slowdown in annual **food price** inflation in 2012 Q4 (from 3% in September to 2% in December; see Chart III.1.5) was due to several factors. Base effects at the end of 2011 were an important factor, as retailers had incorporated the increase in the reduced VAT rate (which took effect on 1 January 2012) into food prices in advance. The decline in food price inflation was also due to weak consumer demand. These factors outweighed the impact of the continuing rise in agricultural producer price inflation and the still quickly rising food import prices.

In 2012 Q4, the effect of low consumer demand was again most apparent in annual **adjusted inflation excluding fuels**, which has been negative since mid-2009. Its further shift towards more negative values in Q4 (from -0.4% in September to -0.6% in December; see Chart III.1.6) primarily reflected a noticeable weakening of annual growth in prices of nontradable commodities, which consist mainly of services. Prices of other tradables excluding food and fuels continued to show a year-on-year decline, which deepened only marginally. Consumer prices of clothing and footwear, household appliances and some other consumer goods thus continued to fall.

Annual **fuel price** inflation recorded the sharpest slowdown in 2012 Q4 (see Chart III.1.3). Fuel prices rose by almost 10% in September, but in December their annual growth was close to zero (0.6%). They were affected above all by the subsiding effect of the annual depreciation of the koruna-dollar rate amid an insignificant year-on-year change in world oil prices.

## III.2 IMPORT PRICES AND PRODUCER PRICES

*Import price inflation slowed in the first two months of 2012 Q4. Lower annual growth was recorded for import prices of energy commodities and products with a high degree of processing. Prices of imported non-energy commodities continued to fall year on year. Industrial producer price inflation moderated slightly in 2012 Q4, mostly due to the unwinding of the surge in oil prices on world markets. By contrast, agricultural producer price inflation rose as a result of an increase in global agricultural prices. Construction work prices continued to fall amid persisting low demand. The decline in market services prices deepened noticeably at the end of 2012.*

### III.2.1 Import prices

The substantial decline in **import price** inflation in September was followed by a further moderation in the first two months of 2012 Q4 (see Chart III.2.1). Annual import price inflation slowed by 1.5 percentage points compared to September, to 1.3% in November. This was mostly due to import prices of energy commodities and products with a high degree of processing (see Chart III.2.2).

The marked slowdown in growth in import **prices of mineral fuels** (from 20.5% in August to 6% in November) was thus one of the main reasons for the further moderation of annual import price inflation. This occurred mostly as a result of the unwinding of the surge in dollar oil prices amid falling natural gas prices on world markets. The koruna-dollar exchange rate (see Chart III.2.3) also fostered lower price growth in this import category at the end of 2012. The year-on-year depreciation of the koruna-dollar rate was not as significant as in previous quarters,[13] and its impact on import price inflation thus decreased gradually. The contribution of import prices of mineral fuels to overall annual import price inflation in November was about half that recorded in September (0.9 percentage point).

Annual growth in import prices of **food** has also been slowing gradually since September. Although it picked up again slightly in November (to 8%), it did not exceed the September level. Growth in agricultural commodity prices on global markets is rising gradually, but the effect of this increase was reduced by exchange rate developments. By contrast, import prices of animal and vegetable oils and chemicals and related products saw a modest pick-up in growth in the first two months of 2012 Q4. The annual decline in prices of **non-energy commodities** observed since May deepened in October and November, probably again because of the unwinding of the effect of the annual depreciation recorded in the first three quarters of 2012. Growth in import prices of **semi-finished products** has been fluctuating around zero in recent months (see Table III.2.1).

13 The year-on-year depreciation of the koruna-dollar rate slowed to 3.7% in Q4.

**CHART III.2.1**

**IMPORT PRICES AND PRODUCER PRICES**

**Import price inflation and industrial producer price inflation moderated, while agricultural producer price inflation went up**

(annual percentage changes)

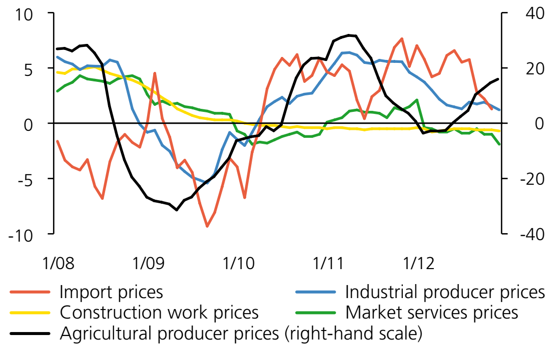



**CHART III.2.2**

**IMPORT PRICES**

**Import price inflation decreased in all the main categories; prices of imported non-energy commodities and semi-finished products fell**

(annual percentage changes; contributions in percentage points)

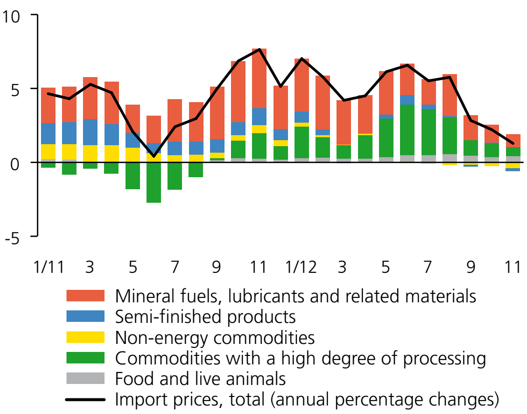



**CHART III.2.3**

**MINERAL FUELS**

**Dollar prices of oil and natural gas are falling; the depreciation of the koruna-dollar exchange rate moderated**

(annual percentage changes)

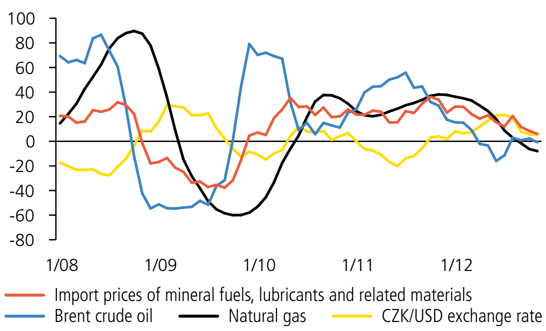


TABLE III.2.1

## STRUCTURE OF IMPORT PRICE INFLATION

**Prices rose in most import categories, and most of all in the case of food, beverages and tobacco**
(annual percentage changes)

| | 8/12 | 9/12 | 10/12 | 11/12 |
|---|---|---|---|---|
| IMPORTS, TOTAL | 5.8 | 2.8 | 2.2 | 1.3 |
| of which: | | | | |
| food and live animals | 10.5 | 8.6 | 6.6 | 8.0 |
| beverages and tobacco | 12.1 | 8.1 | 6.7 | 8.5 |
| crude materials inedible, except fuels | -4.6 | -4.6 | -6.6 | -10.7 |
| mineral fuels and related products | 20.5 | 11.7 | 8.6 | 6.0 |
| animal and vegetable oils | 4.0 | 2.6 | 5.2 | 4.2 |
| chemicals and related products | 3.5 | 2.3 | 3.1 | 2.6 |
| manufactured goods classified chiefly by material | 0.4 | -0.6 | 0.2 | -0.8 |
| machinery and transport equipment | 4.8 | 1.8 | 1.5 | 0.9 |
| miscellaneous manufactured articles | 3.9 | 1.4 | 0.0 | -0.8 |

CHART III.2.4

## INDUSTRIAL PRODUCER PRICES

**Industrial producer price inflation went down slightly in 2012 Q4**
(annual percentage changes; contributions in percentage points)

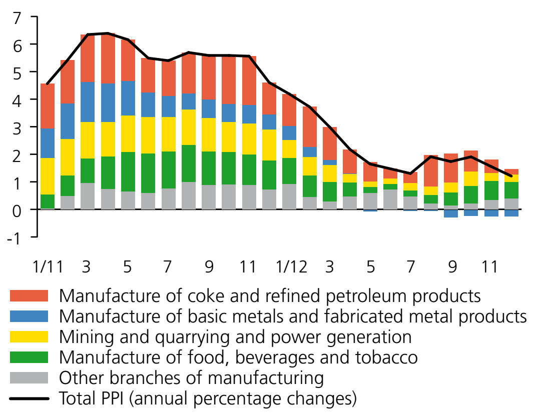
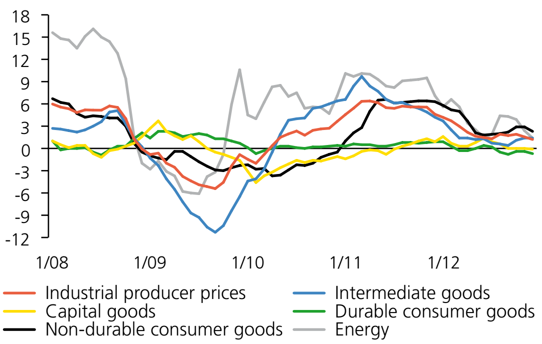



CHART III.2.5

## PRODUCER PRICES BY MAIN INDUSTRIAL GROUPINGS

**Inflation weakened in most of the industrial categories; only intermediate goods and non-durable consumer goods recorded higher growth in prices**
(annual percentage changes)




The growth rate of import prices of **high-value-added commodities**[14] has also been decreasing gradually since September. Whereas in August import prices of some commodities had risen by almost 5%, in November annual growth in import prices of machinery and transport equipment was less than 1% and import prices of miscellaneous manufactured articles were falling (see Table III.2.1). This was due to the aforementioned unwinding of the annual depreciation of the koruna-euro rate and to a decline in inflation abroad.

### III.2.2 Producer prices

***Industrial producer prices***

Annual **industrial producer price** inflation fell slightly in 2012 Q4 (to 1.2% in December). This was due above all to producer prices in the manufacture of coke and refined petroleum products and, to a lesser extent, to producer prices in mining and quarrying and in the electricity, gas and steam supply industry (see Chart III.2.4).

A more detailed analysis of the causes and **structure of industrial producer price inflation** reveals that the gradual slowdown in their growth in 2012 Q4 was mainly due to an unwinding of the strong annual growth in global oil prices. This – coupled with a noticeable moderation of the sharp year-on-year depreciation of the koruna against the dollar – fed through to producer prices in the primary oil processing sector (see Chart III.2.5). Falling prices of imported non-energy inputs and prices in mining and quarrying also fostered a decrease in producers' costs. Rising prices of domestic agricultural inputs, which helped to increase producer price inflation in the food industry, acted in the opposite direction. Annual inflation also went up in other branches of manufacturing, but only in a few sectors.

The stagnation or modest decline in oil prices, combined with a moderation of the annual depreciation of the koruna-dollar exchange rate, led to a marked slowdown in annual producer price inflation in the **manufacture of coke and refined petroleum products** (from 13.3% in September to 2.4% in December). As a result, this industry's contribution to overall annual industrial producer price inflation fell in December compared to September, to one-fifth (see Chart III.2.4). Producer prices in the **manufacture of basic metals and fabricated metal products** have been falling since May 2012. By contrast, producer price inflation in the **food industry** rose to 4.1%, largely because of fast growing prices of inputs of crop origin.

14 This category contains machinery, transport equipment and miscellaneous manufactured articles. Their prices are affected mainly by the koruna-euro exchange rate, which appreciated slightly year on year in November (by 0.3%).

Inflation in the **electricity, gas and steam supply industry** slowed slightly in 2012 Q4 (to 1.4% in December). Prices in mining and quarrying have been falling constantly since April, mainly as a result of a significant decline in coal prices in 2012. Price growth in the water supply and sewerage-related services industry remained high at around 8%.

Annual producer price inflation in the **other branches of manufacturing**, comprising the manufacture of high-value-added products, picked up slightly in 2012 Q4 (see Chart III.2.4). However, this change was due to only a small number of branches, notably chemicals and chemical products, electrical equipment and machinery and equipment. This category was dominated by branches with rising prices, but only two branches recorded stronger price growth.[15] The mostly only slightly rising or falling producer prices thus indicated the impact of low demand on prices in most other branches of manufacturing.

### *Agricultural producer prices*

The rise in agricultural producer price inflation observed since June 2012 continued into 2012 Q4 (see Chart III.2.7). These prices rose by 15.9% year on year in December, whereas in May they had still been falling. This was due to a noticeable upswing in crop product prices, which rose by almost 30% in December, and to renewed growth in prices of livestock products.

The surge in agricultural producer price inflation in 2012 H2 was largely due to adverse weather and resulting weak harvests in major world producers – notably the USA, Australia and Europe. The 2012 harvest in the Czech Republic was also one of the lowest in history, down by about 20% from 2011. In addition, domestic prices were affected for most of 2012 by a weaker exchange rate of the koruna against both the euro and the dollar. Prices of livestock products in 2012 were also affected by the one-off impact of a sudden rise in egg prices due to new veterinary rules in the EU.

### *Other producer prices*

Amid persisting low construction investment demand, **prices of construction work** continued to show a slight annual decline (of 0.7% in December; see Chart III.2.8). By contrast, prices of materials and products consumed in construction showed very modest growth.

The persisting effect of weak domestic demand was also evident in **market services prices** in 2012 Q4. Their annual decline deepened significantly in December (to -1.9%), mostly because of a fall in prices

15 The highest annual growth was recorded by chemicals and chemical products (11.3% in December) and by basic pharmaceutical products (3.9% in December).

**CHART III.2.6**

**PRICES OF METALS AND REFINED PETROLEUM PRODUCTS**

**The sharp slowdown in oil prices fed through to producer prices in the manufacture of coke and refined petroleum products**
(annual percentage changes)

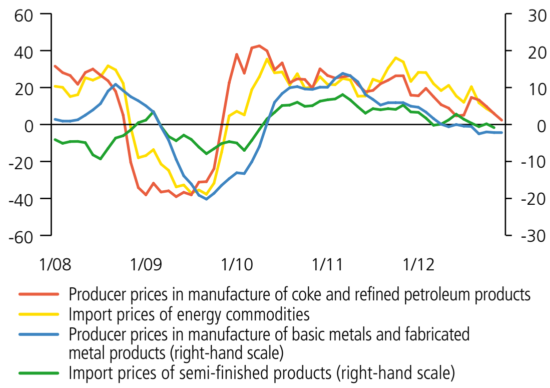



**CHART III.2.7**

**AGRICULTURAL PRODUCER PRICES**

**Agricultural producer price inflation rose further in 2012 Q4**
(annual percentage changes)

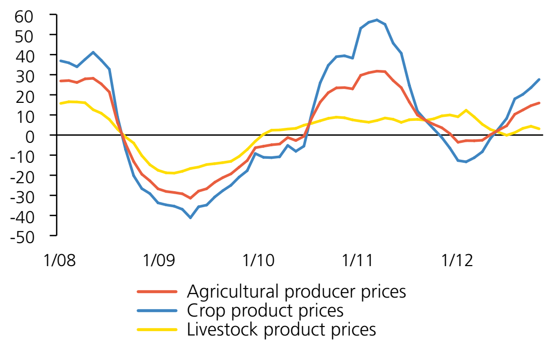
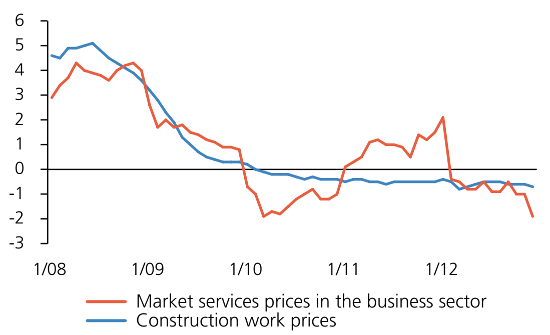



**CHART III.2.8**

**OTHER PRICE CATEGORIES**

**The decline in prices of market services deepened noticeably in December; prices of construction work continued to decline**
(annual percentage changes)



of advertising services and market research (of 13.2% in December). Adjusted for this effect, the decline in market services prices would have been only 0.4%. Prices of architectural and engineering services also continued to fall markedly, mainly due to persisting low demand for investment in buildings and structures. About half of the market services categories recorded falling prices in Q4. The other branches under review saw only modest price growth; only financial services except insurance and pension financing posted more significant price growth (3.7% on average in 2012 Q4).

## III.3 DEMAND AND OUTPUT

*The year-on-year decline in real GDP deepened further in 2012 Q3 (to -1.3%).[16] In quarter-on-quarter terms, GDP declined by 0.3%. The year-on-year decline was due most of all to household consumption and change in inventories. Government consumption was flat in Q3. Amid a persisting lead of export growth over import growth, only net exports had a pro-growth effect. On the supply side, positive contributions to GDP growth came only from some services. In manufacturing, by contrast, value added decreased year on year for the second consecutive quarter. The estimated output gap continued to open into negative values.*

### III.3.1 Domestic demand

The year-on-year decline in **domestic demand** deepened further in 2012 Q3. This was mostly due to inventories, whose negative contribution increased markedly (see Chart III.3.2). The renewed downturn in fixed investment also contributed to a reduction in aggregate domestic demand. By contrast, the decline in household consumption, which is the largest expenditure component of GDP,[17] slowed somewhat. Following a decline in Q3, the effect of government consumption was neutral.

***Final consumption***

**Household consumption** continued to fall year on year in 2012 Q3, but the decline moderated further to -2.4% (see Chart III.3.3). This decline was linked above all with ongoing fiscal consolidation, the stagnating labour market and considerable uncertainty surrounding future economic developments. In 2012 Q3, these factors were reflected in much lower growth rates of nominal and real household income and in the maintenance of an increased propensity of households to save (a phenomenon observed since the start of the year).

Annual growth in **nominal gross disposable income** was very modest in 2012 Q3, reaching just 0.3%. This meant a marked decline of 2.5 percentage points compared to Q2. In addition, the **real purchasing power** of gross disposable income continued to be eroded by annual inflation,[18] albeit to a lesser extent than in 2012 Q2. The effect of inflation gave rise to a renewed decline in real gross disposable income, which reached 1.4% (see Chart III.3.3). However, fall in real consumption expenditure was even more pronounced.

16 The assessment of GDP expenditure and sources is based on seasonally adjusted data from the quarterly national accounts.
17 The share of household consumption in GDP at current prices was around 50% in 2012 Q3.
18 As measured by the household consumption deflator.

CHART III.3.1

**GROSS DOMESTIC PRODUCT**

**The year-on-year decline in GDP deepened in 2012 Q3**
(annual and quarterly percentage changes at constant prices; seasonally adjusted data)

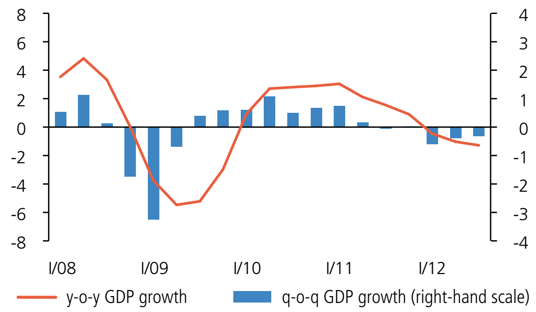



CHART III.3.2

**STRUCTURE OF ANNUAL GDP GROWTH**

**Real GDP growth was driven by net exports in 2012 Q3, while domestic demand decreased**
(contributions in percentage points; seasonally adjusted data)

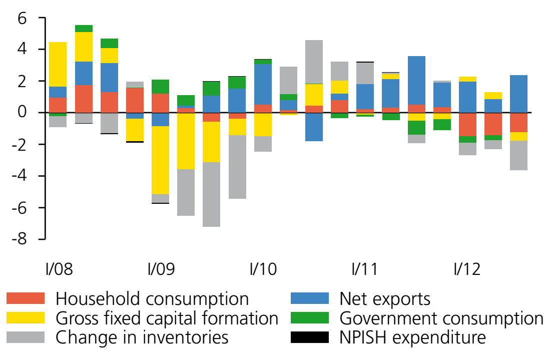



CHART III.3.3

**HOUSEHOLD CONSUMPTION EXPENDITURE**

**Real household expenditure continued to fall**
(annual percentage changes)

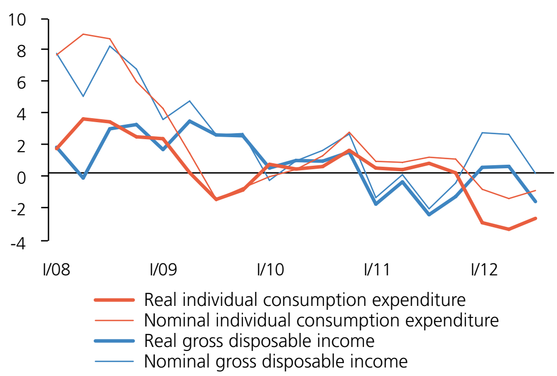


CHART III.3.4

**DISPOSABLE INCOME**

**Nominal gross disposable income increased only slightly**

(annual percentage changes; contributions in percentage points; current prices)

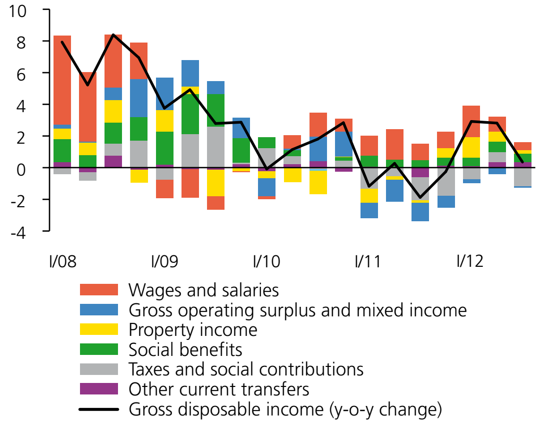
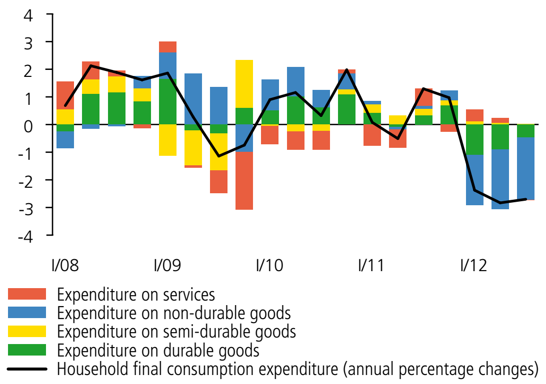



CHART III.3.5

**STRUCTURE OF HOUSEHOLD CONSUMPTION**

**Households are cutting their spending on non-durable goods most of all**

(annual percentage changes; contributions in percentage points; constant prices)




A closer look at the **structure** of nominal gross disposable income shows that the noticeable moderation of its growth rate was chiefly due to slower growth in wages and salaries and property income compared to the previous quarter (see Chart III.3.4). Annual growth in taxes and social contributions paid also weakened households' disposable income growth. The relatively high-weight category of business income (gross operating surplus and mixed income) continued to decline year on year for the seventh consecutive quarter, but this decline was negligible (-0.1%). Consequently, only **social benefits** and income from other transfers made positive contributions to annual disposable income growth at the previous quarter's level.

Although real gross disposable income decreased year on year in 2012 Q3, households continued to create higher financial reserves. The **gross saving rate of households** edged down in Q3 after rising considerably in early 2012 (to 13%),[19] but remained much higher than in previous years (12.8%; see Chart II.2.18). This suggests that households strongly perceived the persisting uncertainty on the labour market and the expected further restrictive fiscal measures. Restrained consumption behaviour of households was also evidenced by weak growth in **consumer credit** (see section III.5.2) and ongoing changes in the material structure of household consumption expenditure. According to the latest CZSO data, households' expenditure on non-durable and durable **consumer goods** decreased again in 2012 Q3. Households also gradually reduced their expenditure on services, which, as a result, was flat in year-on-year comparison (like expenditure on semi-durable goods).

The latest available **leading indicators** did not yet suggest any noticeable change in household consumption. The seasonally adjusted November data on real retail sales including the automotive segment decreased year on year (by 3.1%). This decline led to lower sales of goods in all the monitored segments. The latest results of the CZSO's January 2013 business survey do not indicate any change in the consumption behaviour of households either. The consumer confidence indicator decreased somewhat, remaining close to its historical lows. This primarily reflected households' worsening expectations regarding the overall economic situation and unemployment.

In 2012 Q3, after seven quarters of decline, **government final consumption expenditure** was flat at the level of the same period a year earlier.

19 According to revised, seasonally adjusted national accounts data. See the Box: *Revision of the quarterly national accounts.*

### *Investment*

Investment remained subdued in 2012 Q3 owing to persisting considerable uncertainty among both households and corporations regarding future economic developments and continuing fiscal consolidation (see Chart III.3.6). After rising slightly in 2012 H1, **fixed investment** dropped by 2.3% in Q3.

Most of the monitored sectors contributed to the decline in fixed investment. Investment remained at the level of the same period a year earlier in financial and non-profit institutions only (see Chart III.3.7). A significant change by comparison with the previous trend was a year-on-year decrease in investment in the highest-weight sector of **non-financial corporations** (0.9%)[20] for the first time in two years. This change was probably due to most of the components of investment by non-financial corporations, in particular a deepening year-on-year decline in investment in buildings and structures and falling investment in intangible assets following a period of modest growth. Investment in machinery and equipment was still rising, albeit at a much slower rate than in the previous two quarters. The latest business survey conducted by the CNB and the Confederation of Industry in December signals a gradual improvement in the investment outlook in the non-financial corporations sector.

By contrast, investment in the **household sector** fell by 1.5% year on year in Q3. This was mostly due to investment in dwellings, whose year-on-year decline deepened to 7.2% (see Chart III.3.8). The reasons for the weaker demand for investment in dwellings are the same as in previous quarters, in particular very cautious investment decision-making by households amid uncertain prospects for economic growth and employment. This was also evidenced by slowing growth in new mortgage loans (see section III.5.2). Leading indicators do not yet indicate a recovery in housing demand in the period ahead. The numbers of housing starts continued to fall significantly (by 19.6% year on year), indicating a revision of housing demand estimates by developers given the existing stock of new unsold apartments, the low confidence of households and expectations regarding their future earnings.

The long-term decline in fixed investment in the **government sector**, reflecting the government's austerity measures and problems with the drawdown of EU funds, continued into 2012. In Q3, government fixed investment fell by 0.5% year on year.

The negative contribution of change in **inventories** to GDP growth deepened in 2012 Q3 (to 1.8 percentage points; see Chart III.3.2). According to the latest business survey conducted by the CNB and the Confederation of Industry in December, the positive balance of responses regarding the expected year-on-year evolution of stocks of

20 Investment by non-financial corporations accounts for more than 60% of total fixed investment.

CHART III.3.6

**FIXED CAPITAL FORMATION**

**Investment in buildings was the biggest contributor to the fall in fixed investment**

(annual percentage changes; contributions in percentage points; constant prices)

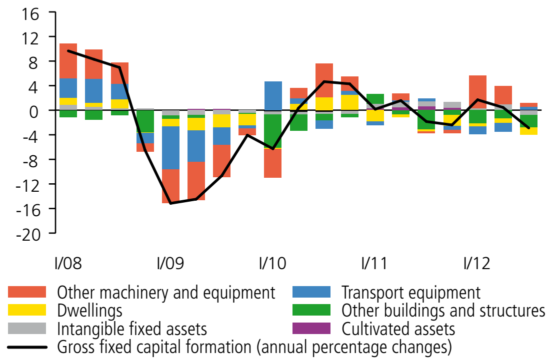



CHART III.3.7

**INVESTMENT BY SECTOR**

**Investment went down in most of the monitored sectors**

(annual percentage changes; contributions in percentage points; constant prices)

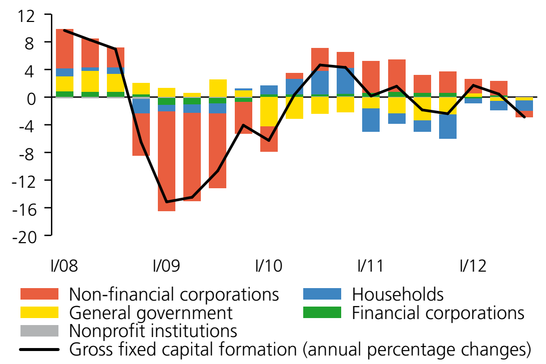



CHART III.3.8

**INVESTMENT IN DWELLINGS**

**The decline in investment in dwellings deepened further**

(annual percentage changes)

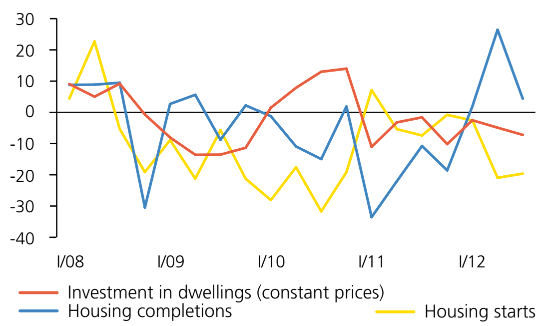


**Chart III.3.9**

**NET EXPORTS**

**Net exports increased significantly year on year in 2012 Q3**
(seasonally adjusted data; constant prices)

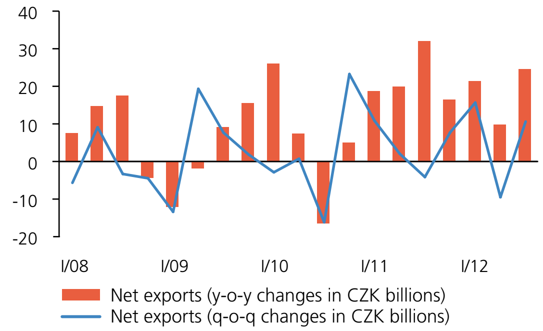



**Chart III.3.10**

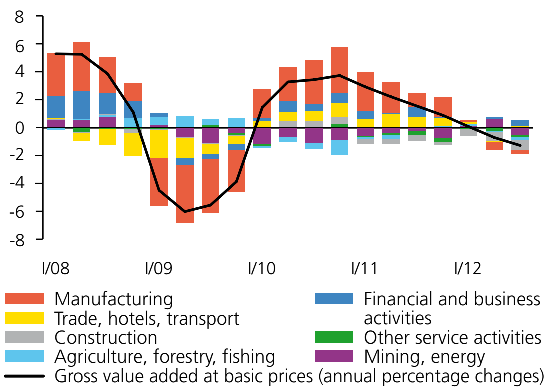
**EXPORTS AND IMPORTS**

**Foreign trade turnover slowed in 2012 Q3, but exports continued to rise faster than imports**
(annual percentage changes; percentage points; constant prices; seasonally adjusted data)


**Chart III.3.11**

**CONTRIBUTIONS OF BRANCHES TO GVA GROWTH**

**Gross value added continued to decline in 2012 Q3**
(contributions in percentage points; annual percentage changes)




inputs and work in progress in 2012 Q3 and Q4 decreased noticeably in the companies surveyed. The balance of responses regarding the expected evolution of stocks of finished products was negative.

### III.3.2 Net external demand

Amid a year-on-year decline in most components of domestic demand, **net exports of goods and services**[21] remained the main pro-growth component of GDP in 2012 Q3 (see Chart III.3.2). Net exports grew for the eighth consecutive quarter in year-on-year terms. In 2012 Q3 alone, the net export surplus was CZK 94.5 billion, up by more than CZK 24 billion on the same period a year earlier. In quarter-on-quarter terms, net exports increased by almost CZK 11 billion (see Chart III.3.9). The year-on-year growth in net exports was again solely due to a trade surplus, as the surplus on services fell for the fourth quarter in a row.

As in the previous six quarters, the year-on-year increase in net exports was due to the lead of export growth over import growth, which rose to 3.1 percentage points (see Chart III.3.10). However, annual growth in total foreign trade turnover slowed further. **Total exports** rose by 4.7%, their growth rate falling only marginally from the previous quarter (by 0.2 percentage point). The dynamics of total exports reflected a further slowdown in external demand growth in the Czech Republic's major trading partner countries, most notably Germany. However, this slowdown manifested itself only in more modest growth in goods exports, while growth in services exports accelerated.

The slowdown of **total imports** was more pronounced than that of exports in 2012 Q3. Their growth rate fell by 2.4 percentage points compared to the previous quarter, to 1.6% (see Chart III.3.10). The main cause lies in a further deepening of the annual decline in total domestic demand, which was reflected in only a marginal increase in goods imports, due mainly to a decline in imports of goods for investment purposes. However, growth in services imports increased compared to the previous quarter, entering double digits for the first time in five quarters thanks to very fast growth in other services.

### III.3.3 Output

The annual decline in **gross value added** at basic prices continued into 2012 Q3, deepening further to -1.3% (see Chart III.3.11). The weakening domestic and external demand continued to affect the output of different branches with different intensity, with a downward trend prevailing. Only some services made positive contributions to annual value added growth.

21 At 2005 prices, seasonally adjusted.

Gross value added in **manufacturing** fell for the second consecutive quarter (by 1.2% in 2012 Q3) and also fell year on year in the other branches of industry.[22] Overall, the contribution of industry to annual growth in gross value added was negative in Q3, amounting to 0.7 percentage point (see Chart III.3.11).

Annual growth in gross value added in industry weakened further (to -2.5%) amid a continuing real decline in **industrial production**, which amounted to -1.1% in Q3 (see Chart III.3.12).[23] Persisting low demand was reflected in the output of most branches of industry, with only some export-oriented branches – electrical equipment, machinery and equipment, and other transport equipment – maintaining production growth. Following a decline, a sizeable double-digit increase was also recorded in the manufacture of coke and refined petroleum products and the manufacture of chemicals, chemical products and man-made fibres. However, output declined year on year in most branches of industry in 2012 Q3.[24] The overall decline in industry was largely due to the manufacture of motor vehicles, trailers and semi-trailers, where output fell year on year for the first time since the crisis year 2009 (by 3.1%).

The effect of low demand on industrial production in 2012 Q3 was indicated both by slowing, and by now fairly low, annual growth in direct export **sales** (at current prices) and by subdued growth in domestic services[25] following a decline.

According to seasonally adjusted data, industrial production decreased again in the first two months of 2012 Q4 (see Chart III.3.12). Consistent with these are the January results of the CZSO's business survey, according to which the effect of insufficient demand as a **barrier to growth in industry** increased further and **production capacity utilisation** decreased. The high year-on-year volatility in **new industrial orders** around zero also does not currently indicate any major improvement in the conditions for growth in industrial production going forward (see Chart III.3.14).

Only **services and trade** made a positive contribution to total annual growth in gross value added in Q3 (0.4 percentage point in 2012 Q3). Growth in this sector was fostered mainly by rapidly rising value added in the real estate area (of 6.7% year on year), while value added in financial intermediation and insurance has been declining noticeably since 2011 Q4. According to the CZSO's latest November data, the across-the-board decline in retail sales does not currently indicate that wholesale and retail trade will make any noticeable contribution to value added growth in the last quarter of 2012.

22 The mining and quarrying and energy supply sectors.
23 According to seasonally adjusted data.
24 Output fell in around three-quarters of the branches monitored.
25 Domestic sales also include indirect exports through non-industrial corporations.

CHART III.3.12

## INDUSTRIAL PRODUCTION

**The seasonally adjusted volume of industrial production is decreasing**
(basic index; year 2005 = 100)

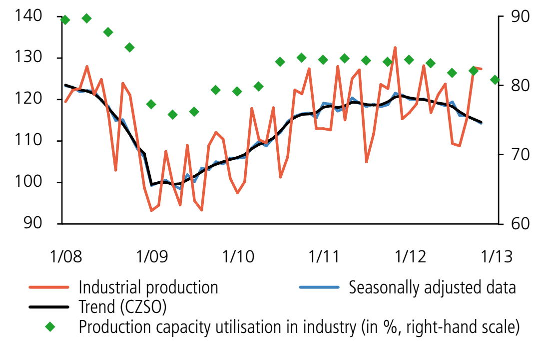



CHART III.3.13

## BARRIERS TO GROWTH IN INDUSTRY

**The effect of insufficient demand as a barrier to growth in industrial production continued to increase**
(percentages)

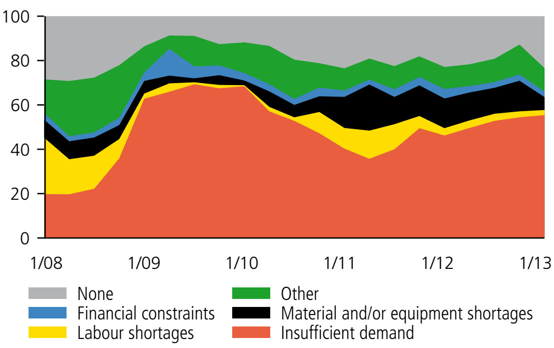



CHART III.3.14

## NEW ORDERS IN INDUSTRY

**Growth in new industrial orders is fluctuating around zero**
(annual percentage changes)

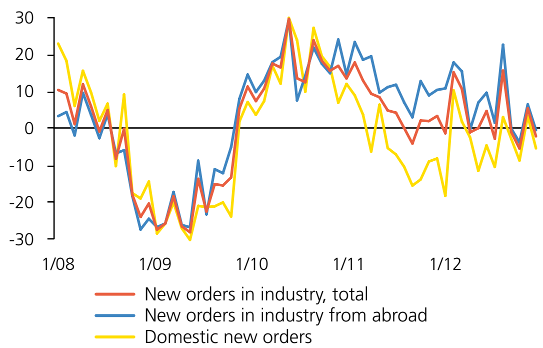


CHART III.3.15

**CONFIDENCE INDICATORS**

**Business confidence decreased compared to 2012 Q3**
(2005 average = 100; source: CZSO)

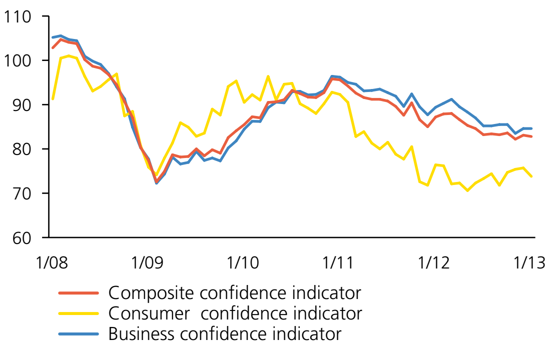



CHART III.3.16

**ECONOMIC SENTIMENT**

**Economic sentiment both in the Czech Republic and in Germany and the EU improved at the close of 2012**
(long-term average = 100; seasonally adjusted data; source: Eurostat)

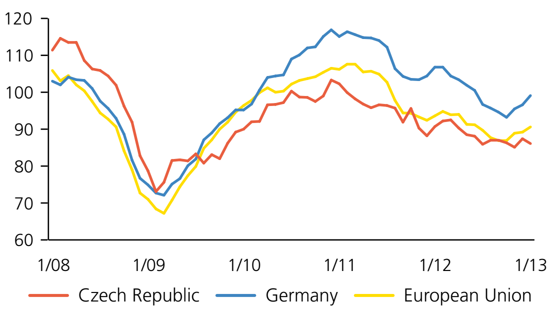
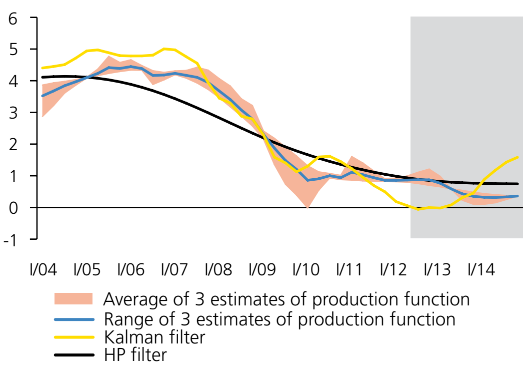



CHART III.3.17

**POTENTIAL OUTPUT**

**The rate of growth of potential output remained unchanged in 2012 Q3 according to the production function calculation**
(annual percentage changes)




**Construction** again saw a double-digit annual decline in gross value added in 2012 Q3 (of 10%) and its negative contribution to the annual decrease in total gross value added was equal to that of industry (0.7 percentage point; see Chart III.3.11). This outcome was due to a continuing double-digit annual contraction in civil engineering output and a more modest decline in building construction output. No improvement in this sector is indicated by the latest November data on the number of building permits issued, which recorded an annual decline of 14.1%. Pessimistic expectations thus prevail in construction, as reflected in a reduction in the number of employees.

The CZSO's business survey shows that the **overall confidence indicator** in 2012 Q4 was broadly unchanged overall (see Chart III.3.15), as a decrease in business confidence was offset by a slight improvement in consumer confidence. In January 2013, however, the overall confidence indicator fell slightly, mainly because of a renewed decrease in consumer confidence. An international comparison reveals that economic sentiment in Germany and the EU as a whole worsened throughout 2012, except at the end of the year (see Chart III.3.16). However, situation changed in November and December, when economic sentiment in these countries improved considerably. At the end of 2012 Q3, economic sentiment in the Czech Republic moved closer to the EU average, but at the end of the year it fell back below this average, despite showing some improvement. In January 2013, the difference between them widened again.

### III.3.4 Potential output and estimate of the cyclical position of the economy

The slowdown in the annual growth rate of potential output halted in 2012 Q3, but the output gap continued to open into negative values. According to the **Cobb-Douglas production function** calculation,[26] the growth rate of potential output has recently stabilised at 0.9%[27] (see Chart III.3.17). The output gap opened further to -1.7%[20] of potential output (see Chart III.3.18). This method suggests a further slowdown in growth in potential output at the forecast horizon. The related output gap should continue to open into negative values until mid-2013 and then start to decrease gradually. However, the output gap will not close until the final quarter of 2014.

The breakdown of the **contributions of the individual factors** entering the baseline production function reveals that the gradual stabilisation of potential output growth was due to both an

26 The production function is computed in three ways using different input data. While the first (baseline) variant uses equilibrium employment, the second variant uses total employment. The third variant differs from the baseline variant by using slightly different coefficients $\alpha$ (the labour-to-GDP ratio). Coefficient $\lambda$ = 10,000 is used to filter productivity in the HP filter. The estimates of future potential output and the output gap are based on the CNB's macroeconomic forecast. The inclusion of the forecast helps to reduce the deviation of the HP filter at the end of the data sample.

27 Average of the three calculations.

unwinding of the negative contribution of equilibrium employment and a gradual stabilisation of the growth rate of the contribution of aggregate productivity. However, the estimate indicates an increase in the negative contribution of employment from mid-2014 onwards. By contrast, the contribution of capital remained stable and will not change significantly at the forecast horizon (see Chart III.3.19).

An alternative estimate using the **HP filter**[28] indicates the same growth rate of the output gap (0.9% in 2012 Q3) as the calculation using the production function. The output gap is similar under both methods until mid-2013, but the HP filter suggests slower closure of the output gap in the second half of 2013 and in 2014. The **Kalman filter**, calculated using data including the forecast, indicates slightly negative growth in potential output in 2012 Q3 (0.1%), which, after stagnating in late 2012 and early 2013, increases over the forecast horizon. Compared to the Cobb-Douglas production function calculation, the Kalman filter indicates a greater opening of the output gap into negative values and slower closure after a stagnation in 2013. The persisting dispersion of the results of the individual methods thus indicates the degree of uncertainty surrounding the estimates of the current cyclical position of the economy.

CHART III.3.18

**OUTPUT GAP**

**The output gap opened further into negative values in 2012 Q3**
(in % of potential output)

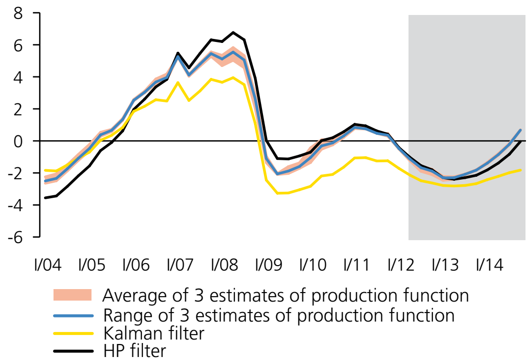
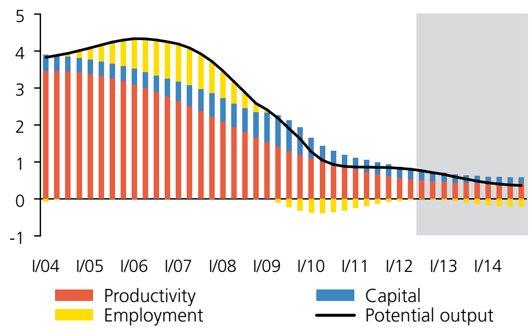



CHART III.3.19

**CONTRIBUTIONS TO POTENTIAL OUTPUT GROWTH**

**The contribution of aggregate productivity will continue to be the main factor of potential output growth**
(baseline production function; annual percentage changes)




28 The estimate using the HP filter also used coefficient $\lambda$ = 10,000.

CHART III.4.1

**LABOUR MARKET INDICATORS**

**The number of hours worked fell in 2012 Q3, while average nominal wage growth slowed**
(annual percentage changes)

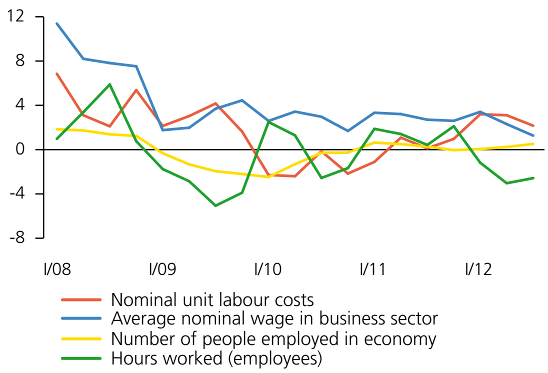



CHART III.4.2

**EMPLOYMENT BREAKDOWN BY BRANCHES**

**The slight growth in employment was driven by non-market services**
(contributions in percentage points to annual change; selected branches; source: LFS)

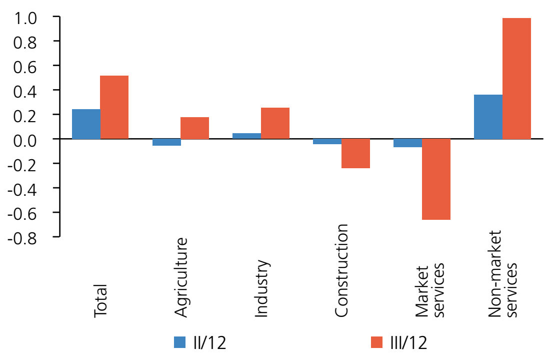
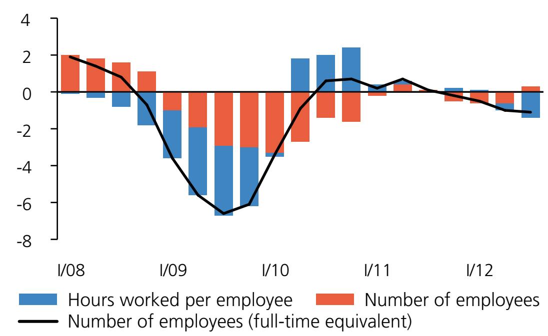



CHART III.4.3

**NUMBER OF EMPLOYEES (FULL-TIME EQUIVALENT)**

**The number of employees converted into full-time equivalents decreased in 2012 Q3**
(contributions in percentage points; annual percentage changes)




## III.4 THE LABOUR MARKET

*The labour market continued to be affected by weakening economic activity in 2012 Q3. Total employment and the number of employees increased modestly, but the number of employees continued to decline when converted into full-time equivalents. The general unemployment rate recorded an annual increase amid higher growth in the labour force than in employment. Adjusted for seasonal effects, it was broadly flat in quarter-on-quarter terms, while the registered unemployment rate increased in both 2012 Q3 and Q4. Amid persisting low demand for work, annual growth in the average nominal wage in the business sector slowed noticeably, contributing to a lower growth rate of the total volume of wages and salaries in the economy and to lower growth of unit labour costs. The decline in whole-economy labour productivity did not deepen any further.*

### III.4.1 Employment and unemployment

Annual growth in total **employment**[29] picked up further in 2013 Q3 (to 0.5%; see Chart III.4.1). Adjusted for seasonal effects, employment rose by 0.3% in quarter-on-quarter terms. As regards its structure, the pick-up in annual growth in total employment was due to the category of employees,[30] whose previous three-quarter decline switched back to modest growth (of 0.3%). By contrast, growth in the number of entrepreneurs moderated (to 1.4%)[31] and was concentrated in a relatively small range of activities.[32] This growth related solely to entrepreneurs with no employees, as the number of entrepreneurs with employees continued to decline year on year.

Adjustment of the labour market to the subdued economic activity is apparent when one looks at the number of hours worked and the **number of employees** converted into full-time equivalents. A continuing decline in **hours worked** (of 2.6% year on year; see Chart III.4.1) and a fall in the number of employees converted into full-time equivalents (of 1.1%; see Chart III.4.3) indicated that in some branches employers increased their employee numbers, but generally shortened employees' working hours in an environment of weakening economic activity. This approach can be viewed as an expression of prudence by employers amid persisting considerable uncertainty about future demand and, at the same time, as a way of cutting labour costs amid lower demand.

In **industry**, employment growth rose only slightly in 2013 Q3 and stayed below 1%. The number of employees rose only in manufacturing. However, a fall in the converted number of employees

29 Employment according to the LFS.
30 Including members of production cooperatives.
31 In absolute terms, their annual growth was only slightly higher than in the category of employees (12,700 versus 12,600 persons).
32 Wholesale, retail trade and repair of motor vehicles in particular.

in industry (of 0.7% year on year) simultaneously indicated cuts in working hours in this sector. According to the latest available data (for the first two months of 2012 Q4), the unconverted number of employees in industry also fell year on year (by 0.5% in October and 0.7% in November).[33]

Across the individual sectors, employment recorded the largest increase in **non-market services**, where a moderation of the annual decline in employment in public administration and defence was accompanied by a sizeable increase in employment in the other branches (education in particular). Cuts in working hours were made in this sector as well, as evidenced by a flat converted number of employees in education and a fall in such number in health and social care in year-on-year terms. The annual decline in employment in **market services** was stronger than in the previous quarter, due mainly to developments in trade, transport and storage and hotels and restaurants. The decline in employment also deepened in **construction**, where the effect of low demand for construction work persisted. Employment in agriculture increased for the first time in a long time (see Chart III.4.2).

**The general unemployment rate**[34] increased year on year in 2012 Q3, amid faster growth in the labour force than in employment. Adjusted for seasonal effects, it was broadly flat at 7% in quarter-on-quarter terms. In the same period, the **total registered unemployment rate** (MLSA) rose by 0.2 percentage point to 8.6% in year-on-year terms and also by 0.2 percentage point to 9% in quarter-on-quarter terms.[35] The registered unemployment rate continued to rise in 2012 Q4 (to 9.3%, see Chart III.4.4).

**The Beveridge curve**[36] moved gradually in the easterly direction during 2012 Q4, as the number of unemployed people increased while the number of vacancies fell only slightly (see Chart III.4.5). The Beveridge curve thus indicated a continued deterioration in the labour market situation during the final months of 2012.

### III.4.2 Wages and productivity

Amid persisting low labour demand, annual growth in the **average nominal wage**[37] slowed significantly further (to 1.4%) in 2012 Q3. With annual inflation falling only slightly, the decline in the **average real wage** deepened further to 1.8%. The further significant slowdown in average annual nominal wage growth was due to wages in the business sector (see Table III.4.1).

33 Corporations with 50 employees or more, excluding agency workers.
34 In the 15–64 age category. Measured by the ILO methodology according to the LFS.
35 Seasonally adjusted data are used for the quarter-on-quarter figures.
36 The Beveridge curve has been affected by legislative changes in effect since 1 January 2012. Since that date, corporations have not been obliged to report the number of vacancies to labour offices.
37 The average gross wage converted into full-time equivalents.

CHART III.4.4

**UNEMPLOYMENT RATE**

**The registered unemployment rate went up in 2012 Q3 and Q4**
(percentages; seasonally adjusted data; source: MLSA, CZSO)


CHART III.4.5

**BEVERIDGE CURVE**

**The number of vacancies was flat in 2012 Q3 and Q4**
(seasonally adjusted numbers in thousands)

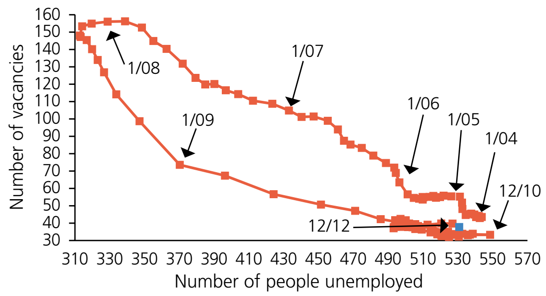



TABLE III.4.1

**WAGES, PRODUCTIVITY, UNIT LABOUR COSTS**

**Average nominal wage growth moderated noticeably in 2012 Q3, while the decline in whole-economy labour productivity stayed close to 2%**
(annual percentage changes)

| | IV/11 | I/12 | II/12 | III/12 |
|---|---|---|---|---|
| Average wage in Czech Republic | | | | |
| nominal | 2.4 | 3.4 | 2.3 | 1.4 |
| real | 0.0 | -0.3 | -1.1 | -1.8 |
| Average wage in business sector | | | | |
| nominal | 2.6 | 3.4 | 2.3 | 1.3 |
| real | 0.2 | -0.4 | -1.1 | -1.9 |
| Average wage in non-business sector | | | | |
| nominal | 1.6 | 3.4 | 2.3 | 2.3 |
| real | -0.8 | -0.3 | -1.1 | -1.0 |
| Whole-economy labour productivity | 0.5 | -0.3 | -1.9 | -1.8 |
| Nominal unit labour costs | 1.0 | 3.2 | 3.1 | 2.2 |

CHART III.4.6

WHOLE-ECONOMY PRODUCTIVITY

**Productivity fell in all the monitored sectors**
(annual percentage changes)

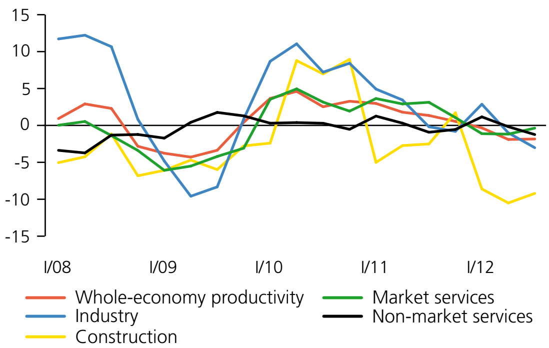
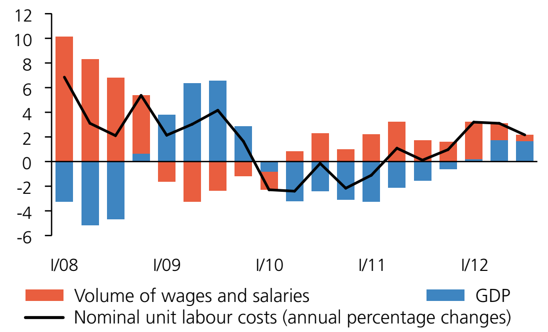



CHART III.4.7

UNIT LABOUR COSTS

**Annual growth in nominal unit labour costs slowed markedly**
(contributions in percentage points; annual percentage changes)




The slowdown in average annual nominal wage growth in the **business sector** in 2012 Q3 (to 1.3%) was due mainly to a sharp decrease in wage growth in manufacturing, reflecting the weakening demand. The annual decline in wages in professional, scientific and technical activities was also significant. In most other branches of the business sector the average nominal wage continued to rise, but the rates of growth were very mixed. The decline in the average wage in the non-business sector deepened further in real terms to -1.9%.

The average nominal wage in the **non-business sector** continued to rise at the same annual rate as in 2012 Q2 (2.3%). This stagnation concealed slower wage growth in public administration and defence (to 0.8%), which was fully offset by faster average wage growth in education. The real decline in the average wage in the non-business sector observed in the previous quarter moderated somewhat thanks to a slight fall in annual inflation (see Table III.4.1).

With the real GDP decline stagnating and employment rising only slightly, the annual decline in **whole-economy productivity**[38] was almost unchanged in 2012 Q3 at close to 2% (see Chart III.4.6). As in the previous quarter, productivity declined year on year in all the monitored sectors. The construction industry recorded the largest fall in productivity, although this decline was more moderate than in the previous quarter. Productivity in manufacturing also decreased to a lesser extent than in 2012 Q2.

In these circumstances, growth in **unit labour costs**[39] slowed year on year in 2012 Q3 (by 0.9 percentage point compared to 2012 Q2, to 2.2%; see Chart III.4.7). This sizeable decline in the growth rate of unit labour costs was due to an annual decrease in growth in the volume of wages and salaries (from 1.4% in 2012 Q2 to 0.6%), as the real decline in output in 2012 Q3 stayed at the previous quarter's level.

Both service sectors contributed to the slower growth rate of unit labour costs in 2012 Q3. However, the growth rate of unit labour costs in industry increased further (to 4.9% year on year), as slower growth in wages and salaries was accompanied by a significantly deeper decline in gross value added. Growth in unit labour costs in manufacturing was 1 percentage point lower than that in industry as a whole.

38 Productivity is calculated on the basis of non-seasonally adjusted data.
39 Nominal unit labour costs are calculated on the basis of non-seasonally adjusted data.

## III.5 FINANCIAL AND MONETARY DEVELOPMENTS

*Money aggregate growth slowed in 2012 Q4. In conditions of low interest rates, continued uncertainty and subdued economic activity, an increased preference for holding highly liquid money persists. The growth rate of loans to the private sector declined further. This occurred amid a tightening of credit standards and of some conditions for approving corporate loans by banks. Following repo rate cuts in September and November and a subsequent fall in market rates, client interest rates declined, except for the average rate on consumer credit, which increased further. Non-financial corporations' performance indicators improved slightly. The creation of net financial assets in the household sector has recorded a significant pick-up in recent quarters. Asking prices of apartments kept falling year on year, albeit more slowly than in the previous period.*

### III.5.1 Money

Money growth remains subdued. Following fairly volatile developments, the annual growth rate of **M2** slowed to 4.8% in November (see Chart III.5.1). Given the annual decline in nominal GDP, the velocity of money slowed further at the end of 2012. The annual rate of growth of M3 also fell to 5.4% and is around 1 percentage point above the euro area average.

Money growth continued to be driven by **highly liquid money**. The annual growth rate of M1 remained just above 8% (see Chart III.5.1). This reflected growth in overnight deposits due to economic agents' increased preference for holding liquid assets in conditions of low interest rates and economic contraction. The spread between interest rates on short-term time and overnight deposits of households increased, but remains relatively low in the longer run (see Chart III.5.2).

Turning to the **sector structure** of money, households remained the principal contributor to money growth. The annual rate of growth of these deposits fluctuated around 4% (see Chart III.5.3). Growth in deposits of non-financial corporations amounted to 7.4% in November. This was reflected in a further increase in the acid-test ratio of corporations. The growth rate of deposits of non-monetary financial institutions slowed to 7.7%.

Turning to the **sources of creation of money**, a rise in net external assets was more than offset by a gradual decline in growth in loans to both the private and government sectors. The growth in net external assets was associated mainly with growth in external assets of banks.[40] The growth rate of loans provided by domestic banks to

40 Purchases of debt securities by domestic banks abroad increased by about 14% year on year. By contrast, growth in loans and deposits by domestic banks abroad moderated to around 5% after having increased since the middle of last year.

CHART III.5.1

MONETARY AGGREGATES

**The annual growth rate of the broad monetary aggregates slowed**
(annual percentage rates of growth)

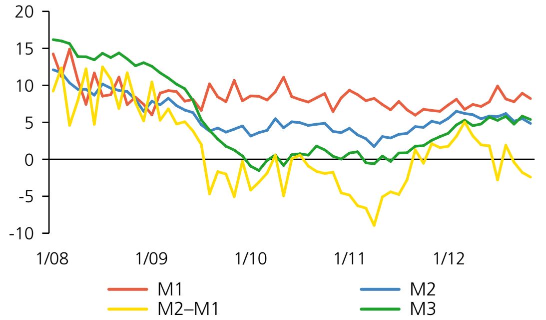



CHART III.5.2

MAIN COMPONENTS OF M2 AND INTEREST RATE SPREAD

**The growth in overnight deposits continued to reflect an increased preference for liquidity in conditions of very low interest rates and economic recession**
(annual flows in CZK billions; spreads in percentage points)

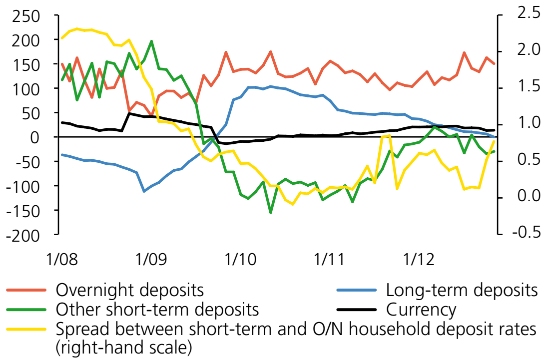



CHART III.5.3

DEPOSIT STRUCTURE OF M2

**Growth in household deposits continued to fluctuate around 4%**
(annual percentage rates of growth)

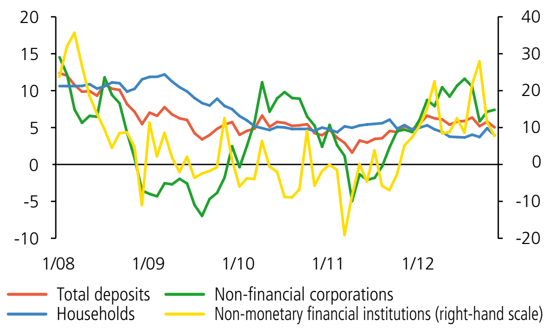


**Table III.5.1**

**CHANGES IN BANKS' CREDIT CONDITIONS**

**Banks' credit standards were tightened for corporate loans and eased for loans to households for house purchase**
(net percentages; positive value = tightening standards/conditions, demand growth; negative value = easing standards/conditions, demand decrease)

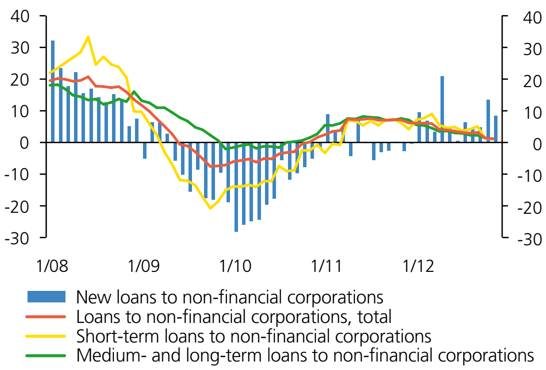
| | Supply | | | Demand |
|---|---|---|---|---|
| | | Credit terms and conditions: of which | | |
| | Credit standards | Average margin for loans | Banks' margin on riskier loans | Demand for loans |
| Loans to non-financial corporations | | | | |
| II/12 | 14 | 6 | 23 | 7 |
| III/12[a] | 20 (18) | 18 | 21 | -5 (6) |
| IV/12[b] | 37 (19) | 8 | 1 | 17 (-6) |
| I/13[c] | (22) | | | (-21) |
| Loans for house purchase | | | | |
| II/12 | -25 | -34 | 13 | 8 |
| III/12[a] | 8 (10) | 41 | 17 | -41 (21) |
| IV/12[b] | -28 (-44) | -30 | 17 | 21 (24) |
| I/13[c] | (-7) | | | (-19) |
| Consumer credit | | | | |
| II/12 | 10 | -29 | -15 | 26 |
| III/12[a] | 0 (0) | 0 | 6 | 24 (-29) |
| IV/12[b] | 0 (0) | 0 | 7 | 51 (7) |
| I/13[c] | (2) | | | (9) |

Note: Net percentages are calculated as the difference between the percentage share of loans provided by banks reporting that standards/conditions have been tightened (or demand increased) and the percentage share of loans provided by banks reporting that standards/conditions have been eased (or demand decreased). The individual responses are thus weighted by the volumes of loans of a given type.
a) Banks' expectations reported in the II/12 survey given in parentheses.
b) Banks' expectations reported in the III/12 survey given in parentheses.
c) Banks' expectations reported in the IV/12 survey given in parentheses.

**Chart III.5.4**

**LOANS TO NON-FINANCIAL CORPORATIONS**

**Growth in loans to non-financial corporations slowed, but the rate of growth of new loans increased at the end of last year**
(annual percentage rates of growth; annual percentage changes)




foreign non-financial corporations slowed further to around 10% in November after having increased to around 30–40% in late 2011 and early 2012.

### III.5.2 Credit

The annual growth rate of MFI **loans to the private sector** declined further in 2012 Q4, reaching 2.9% in November.[41] This reflected slower growth in loans to non-financial corporations and households and a decline in loans to non-monetary financial institutions. The lower growth in loans was due to still relatively weak demand for credit, although according to banks this demand increased slightly in 2012 Q4 (see Table III.5.1). A tightening of credit standards on corporate loans and of some of the conditions for approving them also had an effect. This tightening stemmed from an adverse outlook for some sectors and for overall economic activity. The conditions for approving loans reflected this mainly through increased collateral requirements and stricter assessment of loan size.

The annual growth rate of **loans to non-financial corporations in the Czech Republic** slowed to 1.1% (see Chart III.5.4). Growth in long-term loans for financing fixed investment and in short-term loans for financing working capital remained lower. The volume of loans declined in most major sectors (industry, energy, trade and construction) or was almost unchanged (property development). On the other hand, the growth rate of new large corporate loans increased. The slightly higher demand of corporations for loans was due mainly to mergers and acquisitions and manifested itself in long-term loans to large corporations. By contrast, lower fixed investment financing needs had a negative effect on credit demand, the effect of financing working capital was neutral.

According to a business survey conducted by the CNB and the Confederation of Industry, the **availability of corporate loans** is assessed as very good in more than 30% of the firms surveyed and as normal in 50% of firms. However, firms expect it to worsen slightly in the coming twelve months. Banks are expecting credit standards to tighten further and demand for loans to decline again in 2013 Q1.

MFI **lending to households** remained subdued. The annual growth rate of such loans slowed further in 2012 Q4, reaching 4.7% in November (see Chart III.5.5).

The annual growth rate of **loans for house purchase** decreased to 5.9% as a result of a gradual slowdown in growth in mortgage loans to 6.3% and a decline in building society loans of 3.8%. New mortgages

41 By contrast, loans continued to decline by around 1% year on year for the euro area on average (although lending remains highly heterogeneous across euro area countries). This was due to demand factors and, in some euro area countries, also to supply factors.

rose in 2012 Q4 in line with slightly higher than expected demand, but their growth rate is subdued in the longer term (following a decline at the start of the financial crisis and a subsequent slight recovery due, among other things, to refinancing of old mortgages and expected tax changes). This is consistent with the more moderate growth in the number of new mortgages reported by Hypoindex (see Chart III.5.5). All this is going on in an environment of low consumer confidence, an expected decline in demand for loans and higher non-housing-related consumer spending by households. In a situation of growing competition, banks responded by easing their credit standards.

The annual growth rate of bank **consumer credit** slightly edged up to 1.4% in November. This reflected a slowing decline in consumer non-purpose credit and renewed weak growth in debit balances on the current account. Loans from non-banks (i.e. leasing and hire-purchase companies), which are used primarily to fund consumer spending, declined at a rate of around 5% for the third consecutive quarter.

Following a gradual increase, total **household debt** remained broadly unchanged in 2012 Q3, amounting to 57% of gross disposable income. The ratio of household debt to GDP was around 32%. As a result of a decline in interest rates, households' interest burden fell slightly. However, all three indicators increased in the longer term (see Chart III.5.6).

### III.5.3 Interest rates

***Monetary policy interest rates***

The monetary policy decision-making of the CNB Bank Board in 2012 Q4 was based on the macroeconomic forecast published in the previous Inflation Report. Consistent with this forecast and its assumptions was a decline in market interest rates, followed by a rise in rates as from 2014. At the November Bank Board meeting, the risks to the previous forecast were assessed as being broadly balanced. Accordingly, the Bank Board decided by a majority vote to lower the CNB two-week repo rate by 0.20 percentage point, the discount rate by 0.05 percentage point and the Lombard rate by 0.50 percentage point. The two-week repo rate and the discount rate were thus set at 0.05% and the Lombard rate at 0.25% with effect from 2 November 2012. The CNB Bank Board also decided to suspend the programme of sales of part of the investment income on international reserves, as a conflict cannot be ruled out between such operations and monetary policy implementation at a time when monetary policy interest rates are at technical zero. At its meeting in December the Bank Board assessed the risks of the forecast as being slightly anti-inflationary and **key interest rates** were left unchanged (see Chart III.5.7).

CHART III.5.5

**LOANS TO HOUSEHOLDS**

**Growth in loans to households decreased; the rate of growth of new mortgages is subdued despite a slight increase in demand**
(annual percentage rates of growth; annual percentage changes)

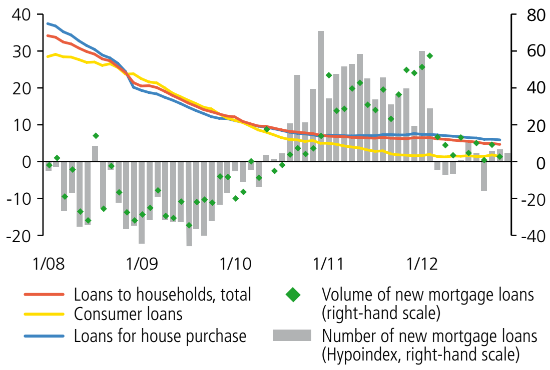



CHART III.5.6

**HOUSEHOLD DEBT**

**Household debt in relation to gross disposable income was almost unchanged in 2012 Q3**
(percentage ratios to gross disposable income)

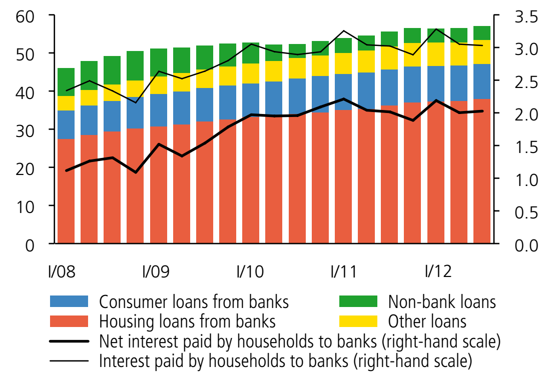
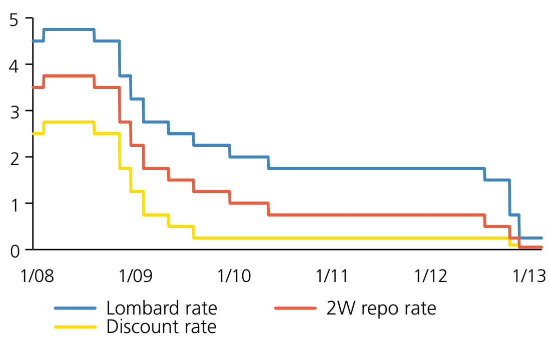



CHART III.5.7

**CNB KEY RATES**

**The CNB lowered key interest rates to "technical zero" in November 2012**
(percentages)



At its monetary policy meeting on 6 February 2013, the Bank Board decided unanimously to **leave interest rates unchanged**. The risks of the new forecast were assessed as being balanced overall; uncertainty surrounds the extent and impacts of fiscal consolidation and household behaviour in the areas of consumption and saving.

CHART III.5.8

MARKET INTEREST RATES

**Interest rates with shorter and longer maturities decreased**
(percentages)

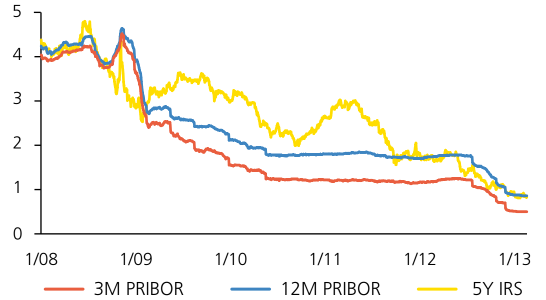
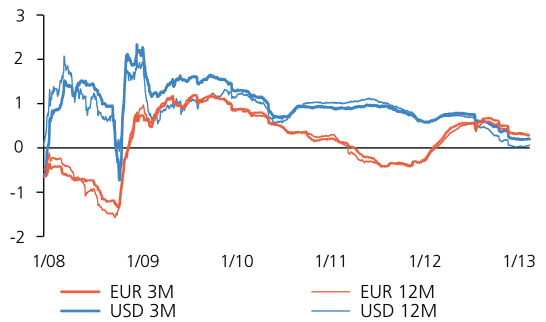



CHART III.5.9

INTEREST RATE DIFFERENTIALS

**Interest rate differentials decreased vis-à-vis the euro and the dollar**
(percentage points)




***Financial market interest rates***

**Money market interest rates** declined further to new historical lows in 2012 Q4. This was due to the above-mentioned easing of monetary policy by the CNB at the start of November.[42] PRIBOR interest rates responded with an immediate decline of 0.10–0.15 percentage point at individual maturities and also edged down in the following days. Overall, PRIBOR rates have decreased by around 0.2–0.3 percentage point since the beginning of October (see Chart III.5.8). After the reduction in monetary policy interest rates, **FRA derivative rates** also recorded a one-off decline of 0.15–0.20 percentage point, but moved slightly upwards in the following days. The market outlook for 3M rates according to end-January FRA quotations is slightly declining. It is roughly in line with the interest rate path consistent with the new forecast over the entire horizon (see section II).

**Interest rates with longer maturities** also fell to historical lows. IRS yields at maturities of up to 6Y and government bond yields at maturities of up to 4Y were below 1%. In addition to easy monetary policy and published data confirming a downturn in domestic demand, domestic medium and long-term rates reflected external factors. The downward trend in rates abroad has slowed in recent months. These rates were broadly flat at low levels at the start of 2013. A slight increase at some maturities reflected the announced repayment of ECB loans drawn by financial institutions within the LTRO programme (see section II.1).

The average **3M PRIBOR** was 0.6% in 2012 Q4, i.e. slightly higher than expected by the previous forecast. Money market interest rates continued to be influenced by the credit premium. This premium, as measured by the spread between the 3M PRIBOR and the 2W repo rate, was unchanged, averaging around 0.5 percentage point in 2012 Q4.

42 The repo rate and the discount rate were reduced to the same level (technical zero). Banks have therefore been making less use of sterilisation repo operations since this decision. The volumes of 2W repo operations have thus been significantly lower than the declared limit volumes, whereas take-up of the overnight deposit facility by banks has increased significantly. The amount of liquidity provided has remained zero.

The positively sloped **PRIBOR yield curve** shifted to a lower level in 2012 Q4 after the repo rate was lowered in September. A similar shift was observed in November following the reduction of monetary policy rates. The spread between the 1Y PRIBOR and the 2W PRIBOR fell slightly to 0.6 percentage point. The **IRS yield curve** also shifted to a lower level in 2012 Q4 and its slope remained positive. In December, the average 5Y–1Y spread was 0.4 percentage point and the 10Y–1Y spread 1.0 percentage points. The IRS yield curve was broadly flat in January 2013.

Short-term **interest rate differentials** vis-à-vis the two main world currencies (PRIBOR/CZK–EURIBOR/EUR, or LIBOR/USD) reflected the lowering of key rates in the Czech Republic and developments on foreign financial markets. With rates abroad declining only slightly, the differentials vis-à-vis euro and dollar rates decreased (see Chart III.5.9). The 3M PRIBOR–3M EURIBOR interest rate differential was 0.4 percentage point on average in 2012 Q4. On 25 January, it was 0.3 percentage point.

Seven auctions of fixed coupon bonds and five auctions of variable coupon bonds have been held on the primary **government bond market** since the start of October. The total volume of bonds issued was CZK 36.9 billion. Demand exceeded supply in all the auctions – strongly so in some cases; the bid-to-cover ratio was 2.2 on average. This means that the Ministry of Finance still had no problems subscribing government bonds in the primary market even in an environment of increased risk aversion and, moreover, with historically low yields (for example, the yield on the five-year bond was 1.5% and that on the nine-year bond was 1.9%). The Ministry of Finance also issued a third issue of state saving bonds totalling CZK 30 billion. In addition to koruna bonds, EUR 750 million in ten-year eurobonds were issued at the start of October. The government bond yield curve shifted downwards at the end of 2012, among other things as a result of the foreign bond market situation, while its positive slope remained approximately unchanged (see Chart III.5.10).

***Client interest rates***

**Interest rates on corporate loans and loans for house purchase** decreased further. This reflected a decline in market interest rates due to the lowering of the CNB repo rate in September and November 2012.[43]

43 In the euro area, declines were mainly recorded by long-term rates on loans for house purchase and on corporate loans (rates on these loans range between 2% and 3%). The rate on consumer credit is fluctuating around 7%.

**CHART III.5.10**

**GOVERNMENT BOND YIELD CURVE**

**The government bond yield curve shifted downwards**
(percentages)

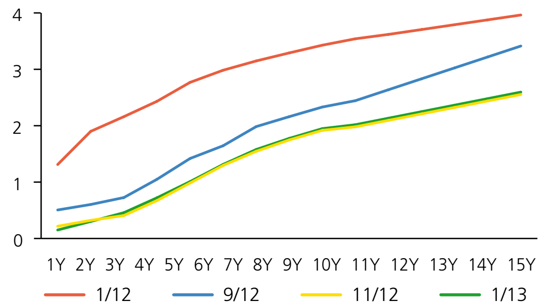



**CHART III.5.11**

**INTEREST RATES ON LOANS TO CORPORATIONS**

**The interest rate on corporate loans continued to fall on average**
(new business; percentages)

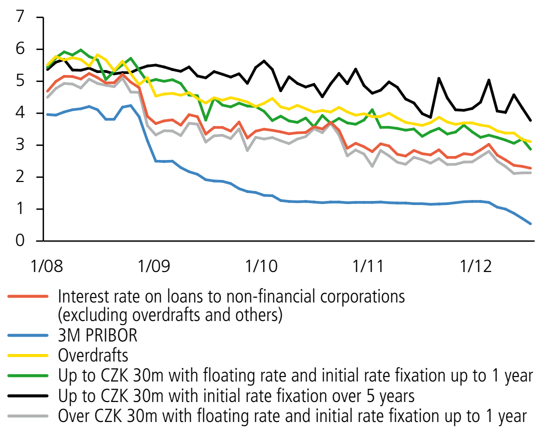


CHART III.5.12

### INTEREST RATES ON LOANS FOR HOUSE PURCHASE

**Rates on loans for house purchase decreased for all fixations except those of over 10 years**
(new business; percentages)

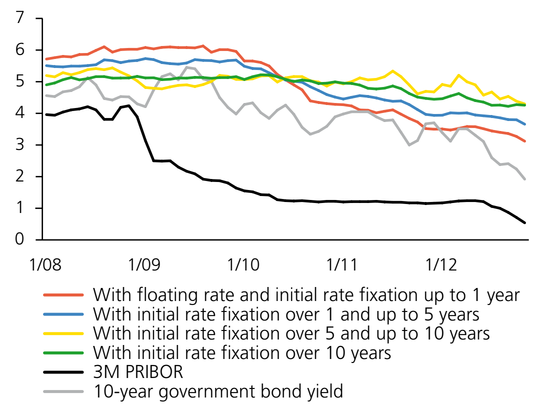



CHART III.5.13

### CLIENT AND MARKET INTEREST RATE SPREADS

**Risk premiums, as expressed by the spread between client and market rates, increased in most segments of the credit market**
(percentage points)

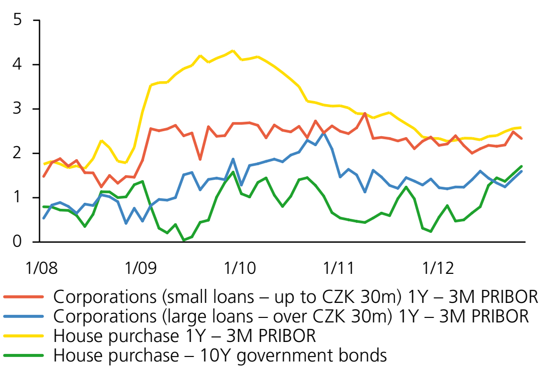
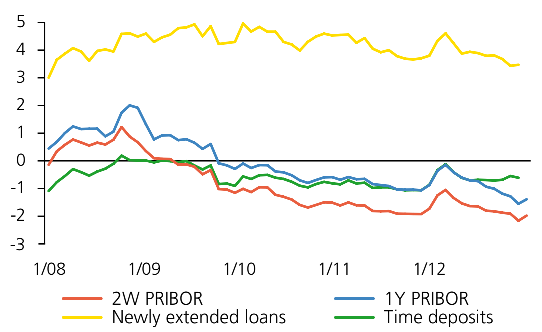



CHART III.5.14

### EX ANTE REAL RATES

**Ex ante real interest rates on new loans fell slightly, while rates on deposits were flat**
(percentages)




The **average interest rate on loans to non-financial corporations** has dropped by a further 0.1 percentage point since September, to 2.3% (see Chart III.5.11). The rate on loans of up to CZK 30 million, which mainly reflects the borrowing costs of small corporations, fell by 0.3 percentage point to 3%. The rate on large loans remained at 2.1%. With the 3M PRIBOR falling by 0.3 percentage point, the spread between the short-term rate on large loans and this market rate increased (see Chart III.5.13).

The **interest rate on loans for house purchase** for households also continued to decline in the period under review, falling by 0.2 percentage point to 3.6%. Rates with all fixations declined except for the rate with the longest fixation (over ten years), which remained flat (see Chart III.5.12). The proportion of new loans with floating rates or rates fixed for up to one year remained just below 30%. Loans with fixations of over one year and up to five years accounted for the largest share (51%). The spread between short-term client and market rates, expressing the risk premium, widened (see Chart III.5.13). The spread between the average rate on loans for house purchase and the long-term financial market rate increased significantly on account of a continuing fall in long-term government bond yields. According to Hypoindex, the decline in interest rates on new mortgages continued into December 2012.

By contrast, the **interest rate on consumer credit** increased by 0.6 percentage point since September, to 14.7%. The gradual increase in the interest rate on such credit reflected an estimate of growth in future client risk due to the economic recession and rising unemployment. In line with the rise in interest rates, the loan default rate went up by 1 percentage point to around 12% in 2012. The rate on overdrafts and revolving loans reached 14.5% and the rate on credit card debt was just below 24%. Rates on consumer credit with longer fixations went up, while the short-term rate declined.

The **interest rate on deposits** remains low (0.9%). As regards its structure, the rate on deposits with agreed maturity for households increased to 1.5% at the end of 2012. The rates on deposits redeemable at notice and on overnight deposits remained at 2% and 0.7% respectively. On the other hand, the analogous rates on corporate deposits mostly gradually declined, reaching 0.3% for overnight deposits and deposits with agreed maturity. The average rate on household deposits was 1% and that on corporate deposits was 0.4%.

**Real client interest rates**[44] showed no major changes in 2012 Q4. Real rates on new loans were 3.5% in November, while real rates on time deposits were -0.6% (see Chart III.5.14).

44 Ex ante real interest rates: nominal interest rates are deflated by the consumer price inflation expected by financial market analysts.

### III.5.4 The exchange rate

The average **exchange rate of the koruna against the euro** was CZK 25.2 in 2012 Q4. This represents a year-on-year appreciation of 0.4% and a quarter-on-quarter depreciation of 0.4% (see Chart III.5.15). The koruna thus oscillated ±4% around CZK 25 to the euro for the tenth consecutive quarter. The koruna generally appreciated against non-European currencies and depreciated very slightly against European currencies in the period under review. During January, it weakened to about CZK 25.6 to the euro.

The exchange rate **movements in 2012 Q4** were due mainly to growing financial market optimism about the survival of the euro area in more or less its current form. This optimism was fostered by the ECB's actions and by a gradual restoration of macroeconomic balances (external rather than fiscal, however) in Southern European countries, which resulted in European currencies appreciating vis-à-vis the rest of the world. However, the Czech koruna did not follow this trend, as the CNB's comments that it was considering foreign exchange interventions caused the koruna to weaken by roughly 1% at the end of the quarter. During January, adverse information on the economic situation in the Czech Republic (industry, unemployment and retail sales) and CNB communications accelerated the depreciation of the koruna against European currencies.

The average **exchange rate of the koruna against the dollar** was CZK 19.4 in 2012 Q4. This represents a year-on-year depreciation of 3.4% and a quarter-on-quarter appreciation of 3.2%. During the quarter, the exchange rate fluctuated in a range of CZK/USD 19–20. At the end of 2012 it was at the lower boundary of this range, reflecting a weakening of the dollar on world markets at the year-end over financial market concerns about the activation of automatic budget stabilisers (a fall from the fiscal cliff). The dollar appreciated in early January after the automatic cuts were postponed and taxes were increased. Financial market expectations regarding future developments in Europe were another factor affecting the exchange rate of the dollar especially against European currencies. A calming of the situation in the euro area led to the aforementioned strengthening of European currencies against most currencies, including the dollar. In the first third of January 2013, the koruna and other European currencies thus weakened somewhat vis-à-vis the dollar.

CHART III.5.15

**CZK/EUR AND CZK/USD EXCHANGE RATES**

**The koruna appreciated very slightly against the euro and depreciated against the dollar in 2012 Q4**

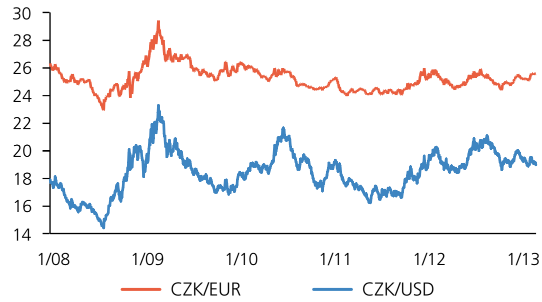


**CHART III.5.16**

**KEY FINANCIAL INDICATORS**

**The main financial indicators improved slightly in 2012 Q3**
(annual percentage changes)

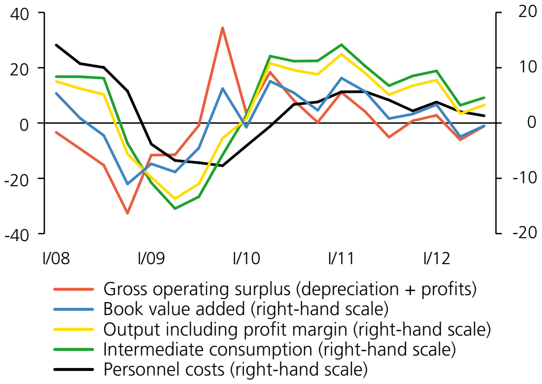



**TABLE III.5.2**

**PERFORMANCE INDICATORS OF CORPORATIONS**

**Growth in the material cost-output ratio and personnel cost-output ratio decreased somewhat**

| | 2011 Q3 | 2012 Q3 | Annual percentage changes |
|---|---|---|---|
| Output incl. profit margin (CZK billions)a) | 1,338.0 | 1,381.3 | 3.2 |
| Personnel costs (CZK billions) | 200.0 | 202.6 | 1.3 |
| Intermediate consumption (CZK billions) | 987.0 | 1,032.1 | 4.6 |
| Book value added (CZK billions) | 351.0 | 349.1 | -0.5 |
| Sales (CZK billions) | 1,739.6 | 1,803.6 | 3.7 |
| | **Percentages** | **Percentages** | **Annual changes in pp** |
| Ratio of personnel costs to value addeda) | 57.0 | 58.0 | 1.0 |
| Material cost-output ratioa) | 73.8 | 74.7 | 0.9 |
| Personnel cost-output ratioa) | 14.9 | 14.7 | -0.2 |
| Ratio of book value added to outputa) | 26.2 | 25.3 | -0.9 |

a) CNB calculation

### III.5.5 Economic results of non-financial corporations

In the monitored segment of **non-financial corporations with 50 employees or more**,[45] the growth rates of the main monitored indicators improved slightly in 2012 Q3. Annual growth in sales and output picked up pace, but was still accompanied by faster growth in intermediate consumption, reflected in a slight decline in book value added in Q3 (see Chart III.5.16). The gross operating surplus recorded an annual decline (of 1.1%), also due to continued growth in personnel costs. However, the declines in book value added and gross operating surplus were smaller than a quarter earlier.

With intermediate consumption rising faster than output, the **material cost-output ratio**[46] increased by 0.9 percentage point year on year in 2012 Q3 (see Table III.5.2). Its growth was only slightly lower than in the previous quarter. The continuing growth in the material cost-output ratio of non-financial corporations was due mainly to rapid growth in import prices of energy commodities, whose impact on the material cost-output ratio was most apparent in the electricity, gas, heat and air-conditioned air supply industry.

By contrast, the **personnel cost-output ratio**[47] fell slightly in 2012 Q3 (see Table III.5.2). This was due to a pick-up in output growth and a continuing slowdown in growth in personnel costs. Annual growth in personnel costs moderated amid a decline in the number of employees and slower growth in the average wage compared to the previous quarter.

Data for the narrower **segment of large corporations** (with 250 employees or more[48]) indicate similar trends in the main financial indicators in 2012 Q3 as in the larger segment of corporations. As in the previous quarter, faster growth was recorded for output and intermediate consumption as well as for total sales compared to the wider segment of corporations. The decline in gross operating surplus was smaller than in the previous quarter.

45 The segment of corporations with 50 employees or more consisted of more than 9,300 non-financial corporations at the end of 2012 Q3.
46 The material cost-output ratio defined as the ratio of intermediate consumption to output.
47 The personnel cost-output ratio defined as the ratio of personnel costs to output.
48 The segment of corporations with 250 employees or more consisted of more than 1,700 non-financial corporations at the end of 2012 Q3.

### III.5.6 Financial position of corporations and households

The **financial liabilities of non-financial corporations** rose slightly year on year in 2012 Q3 (see Chart III.5.17). This rise was due to loans and issued bonds, while the negative contributions of quoted shares and other accounts payable decreased. As regards the **assets** of non-financial corporations, the share of liquid financial assets in the form of currency and deposits is growing. The total net financial position of corporations has long been negative and currently stands at -95% of GDP.

The main trends in the balance-sheet structure are reflected in the financial indicators. The acid-test ratio of corporations edged up further in 2012 Q3. The ratio of market-based financing rose slightly owing to renewed bond issuance. Corporate solvency continued to fall gradually and was roughly at the level observed in 2009.

**Households** are net creditors in the national economy. Their net financial assets have risen quite significantly as a percentage of GDP in recent quarters (and stood at 67% of GDP in 2012 Q3, up by almost 5 percentage points year on year). The net creditor position of households has been influenced in recent quarters by the creation of financial assets in the form of currency, deposits, saving bonds and life insurance and pension fund reserves. Other financial assets of households increased mainly because of methodological changes in reporting by sole proprietors[49]. Households' financial liabilities are still rising moderately, but their growth is slower than that of financial assets.

In recent quarters, annual growth in the net financial assets of households has been around 8% of the annual gross disposable income of households (see Chart III.5.18). The marked acceleration in the creation of net financial assets by households as measured by this indicator is thus qualitatively consistent with the surge in the saving rate recorded in the national accounts.

### III.5.7 The property market

According to CZSO data, **asking prices of older apartments** in Prague were again the only price category to show year-on-year growth in 2012 Q4. Their growth accelerated to 9.7%, the highest level since the end of 2008, when the price bubble peaked (see Chart III.5.19; in quarter-on-quarter terms, prices rose by 0.8%). According to alternative data sources (e.g. the Institute for Regional Information), by contrast, asking prices in the rest of the Czech Republic and in Prague continued to fall year on year, albeit at a slightly slower pace

49 The last four quarterly observations for the "Others" item, comprising other financial receivables of households, were affected by a methodological change consisting in the CZSO switching to a new primary data source in the form of tax returns.

CHART III.5.17

**FINANCIAL LIABILITIES OF NON-FINANCIAL CORPORATIONS**

**The financial liabilities of corporations increased slightly year on year in 2012 Q3**

(annual percentage changes; contributions in percentage points)

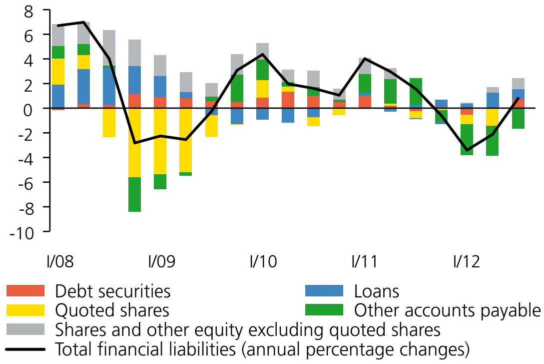



CHART III.5.18

**STRUCTURE OF HOUSEHOLD FINANCIAL ASSETS**

**The financial assets of households are still growing quite quickly despite slowing slightly in 2012 Q3**

(contributions in percentage points; annual percentage changes and percentage ratios)

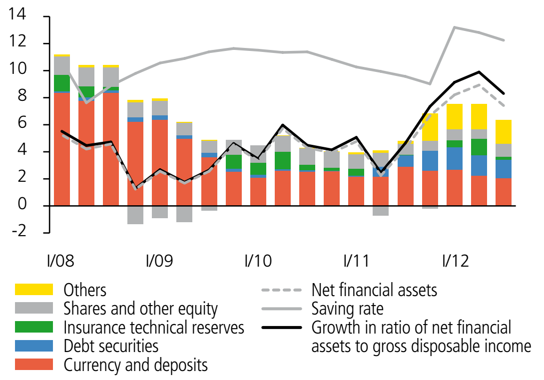



CHART III.5.19

**TRANSACTION AND ASKING PRICES OF APARTMENTS**

**Asking prices of apartments in Prague showed stronger year-on-year growth in 2012 Q4, but alternative price indicators do not confirm a recovery**

(annual percentage changes; source: CZSO, Institute for Regional Information)

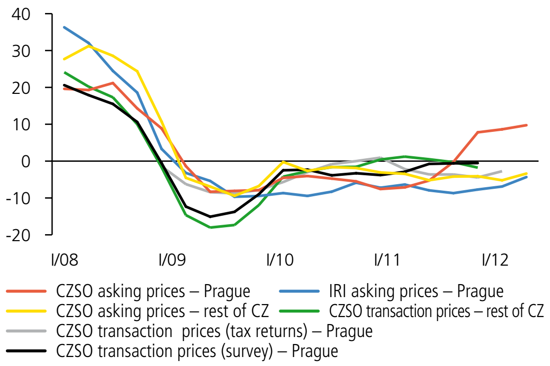
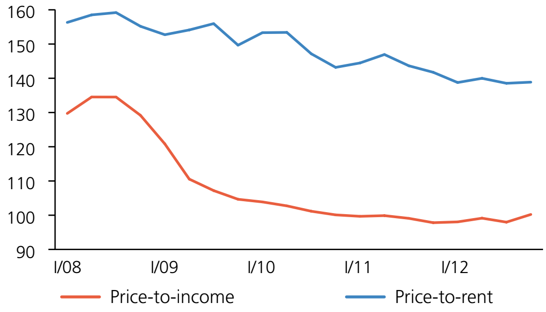


CHART III.5.20

APARTMENT PRICE SUSTAINABILITY INDICATORS

**The property price sustainability indicators rose slightly, but remain close to historical lows**

(2000–2007 average = 100; source: CZSO, Institute for Regional Information)




(down from -5.2% to -3.4% for prices outside Prague and from -6.9% to -4.3% for prices in Prague according to the IRI). Therefore, the relatively strong rise in asking prices in Prague according to the CZSO can be considered a statistical anomaly.

Data on **transaction prices** published by the CZSO do not confirm any significant recovery in apartment prices. As regards prices based on tax returns, the end-2011 data have been revised down by 1.5% in Prague and by 0.6% in the rest of the Czech Republic. In addition, a new estimate for 2012 H1 has been published indicating year-on-year price declines of 0.5% in Prague and 1.8% outside Prague at the end of 2012 Q2 (see Chart III.5.19). An alternative index of transaction prices obtained on the basis of a CZSO survey in estate agencies showed year-on-year declines of 2.7% and 7.3% for older apartments in Prague and outside Prague respectively and of 2.6% for prices of new apartments in Prague in 2012 Q3. Overall, therefore, the growth rates of the indices are consistent with the worse macroeconomic environment, labour market situation and demographic trends, despite some moderation of the year-on-year declines.

The continuing downturn, especially on the demand side of the property market, is confirmed by the **number of property market transactions.** The number of proceedings on entry of ownership rights in the cadastre fell further at the close of the year. In 2012 as a whole, the number of entries dropped by 1.8% year on year (and by a sizeable 10.9% for the sub-category of houses and apartments). In 2012 Q4 it edged up year on year (by 0.1%), but for houses and apartments it fell by 2.2%. By contrast, demand for new apartments in development projects in Prague rose quite sharply. According to Ekospol data, the number of apartments sold was up by 16.2% year on year in 2012, thanks mainly to a rapid rise in Q4 (of 48.8% year on year). The increase in new apartment sales can be explained by a relatively sizeable drop in apartment prices, especially in some areas, uncertainty with regard to future VAT changes (frontloading) and a further fall in mortgage rates, which, together with higher rental returns, opens up the possibility of investment property purchases.

After having declined, the property price sustainability indicators rose slightly in 2012 Q4. The **price-to-income ratio** rose by 2.3% quarter on quarter (and 2.5% year on year), while the **price-to-rent ratio** increased by 0.2% quarter on quarter (but fell by 2% year on year; see Chart III.5.20). However, the price-to-income ratio was affected by possible overestimation of the price used for the calculation (the price for Q4 was calculated using CZSO asking prices, whose reported increase in Prague was debatable – see above). Despite having increased, both indices are close to their lowest levels since 2007 and implied no risk of property price overvaluation. The property price outlook for 2013 is unchanged (flat or slightly falling).

## III.6 BALANCE OF PAYMENTS

*In the first three quarters of 2012, the balance of payments was characterised as usual by a high income deficit, due mainly to dividends from direct investment paid to non-residents. However, its effect on the current account was largely offset by a goods and services surplus resulting from a rising trade surplus. The financial account surplus was driven mainly by a net inflow of direct investment, primarily in the form of earnings reinvested in the Czech Republic, as well as by a surplus on portfolio investment. However, these net inflows were largely offset by a net outflow of other investment, due chiefly to a decrease in the short-term external liabilities of Czech monetary financial institutions.*

### III.6.1 The current account

The **current account** recorded a deficit of CZK 47.9 billion in 2012 Q1–Q3. In year-on-year terms, the deficit fell by almost CZK 44 billion. The decline in the overall deficit was related mainly to the trade balance and to a lesser extent also to the income balance (see Chart III.6.1). The annual moving ratio of the current account deficit to GDP fell for the fifth consecutive quarter, to 1.7%.

The **trade surplus** for 2012 Q1–Q3 rose by almost CZK 51 billion year on year to CZK 121.5 billion. The increase in the trade surplus was due to developments in real terms, which were partly offset, however, by the price effect stemming from a negative year-on-year change in the terms of trade. The significant slowdown in external demand visible since Q2 was reflected in a marked moderation of export growth. However, its nominal annual growth rate for Q1–Q3 reached almost 8%. Amid a constantly high import intensity of exports and a deepening decline in total domestic demand, the nominal growth rate of imports, which exceeded 5% for Q1–Q3, also followed a downward trend. The falling nominal growth in foreign trade turnover was partly dampened by a year-on-year depreciation of the koruna, especially against the US dollar. Turning to the commodity structure, growth in the machinery and transport equipment surplus was the biggest contributor to the increase in the overall surplus (see Chart III.6.2). The year-on-year rise in the trade surplus continued during 2012 Q4, but moderated significantly (to less than CZK 1 billion for October to November).

In 2012 Q1–Q3, the **services surplus** fell by almost CZK 13 billion year on year to CZK 40.5 billion (see Chart III.6.3). The overall surplus was due mainly to travel and to a lesser extent to transport. Their surpluses increased in year-on-year terms owing to faster growth in credits than in debits, driven mainly by private travel and road transport. By contrast, other services recorded a deficit stemming mainly from a merchanting deficit. At the same time, a year-on-year switch of other services from surplus to deficit led to a decrease in the overall services surplus.

CHART III.6.1

**CURRENT ACCOUNT**

**The current account deficit decreased in 2012 Q3, owing to a rise in the trade surplus**

(annual moving totals in CZK billions)

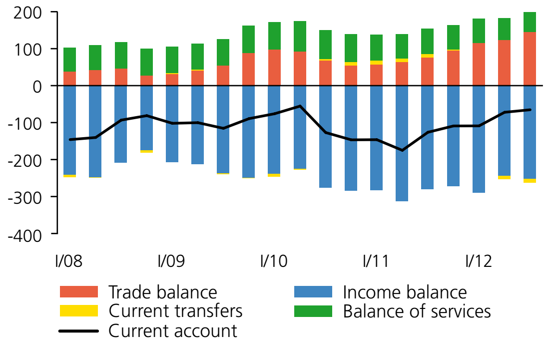



CHART III.6.2

**TRADE BALANCE**

**The year-on-year change in the trade balance was affected most strongly in 2012 Q1–Q3 by growth in the machinery surplus**

(accumulation since start of year in CZK billions; change of ownership principle)

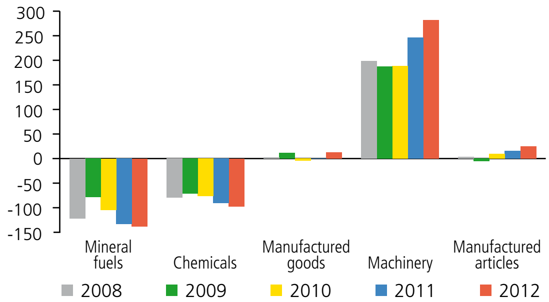



CHART III.6.3

**BALANCE OF SERVICES**

**Travel and transport contributed to the services surplus in 2012 Q1–Q3**

(CZK billions)

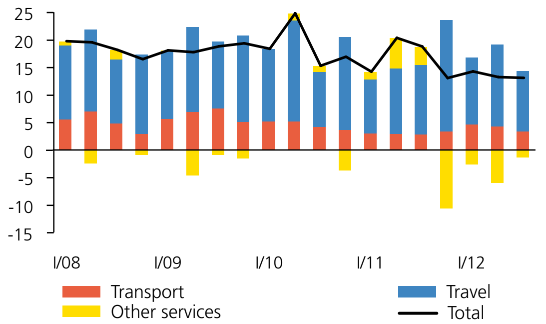


CHART III.6.4

**INCOME BALANCE**

**Within the income balance, the direct investment income deficit decreased in particular in 2012 Q1–Q3**
(accumulation since start of year in CZK billions)

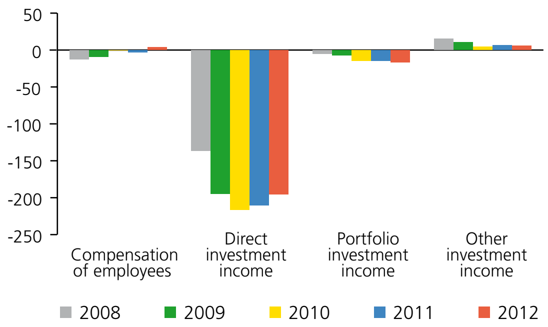



CHART III.6.5

**FINANCIAL ACCOUNT**

**The financial account surplus increased in 2012 Q3, owing mainly to a rise in the net inflow of direct investment**
(annual moving totals in CZK billions)

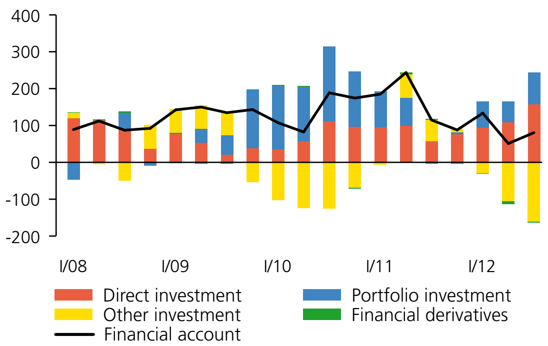
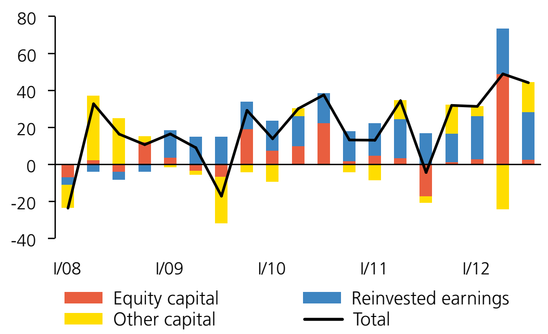



CHART III.6.6

**DIRECT INVESTMENT**

**A net inflow of equity capital and reinvested earnings contributed to the direct investment surplus in 2012 Q1–Q3**
(CZK billions)




In contrast to the goods and services surplus, the **income balance** ended in a deficit of CZK 202 billion. However, the deficit was down by almost CZK 20 billion year on year. The direct investment income deficit (of CZK 195.1 billion) was again the largest component of the overall balance (see Chart III.6.4). It was linked mainly with income in the form of dividends paid to non-residents and estimated reinvested earnings in the Czech Republic. The year-on-year moderation of the overall deficit was also due above all to a lower direct investment income deficit resulting from lower dividend payments. The decrease in the overall deficit was also fostered by compensation of employees, which shifted from slight deficit to surplus in year-on-year terms owing to higher credits.

**Current transfers** recorded a deficit of CZK 7.9 billion in 2012 Q1–Q3, falling by CZK 14 billion year on year. Private transfers, which ended in a deficit of CZK 14.4 billion, were the largest contributor to the balance. Almost one-half of the deficit was offset by a surplus on government transfers stemming from a surplus on transfers of funds between the Czech Republic and the EU. The switch of current transfers from surplus to deficit was linked above all with lower credits and higher government transfers to the EU budget, which led to a drop in the net inflow recorded on the current account of almost CZK 12 billion.

### III.6.2 The capital account

The **capital account** ended in a surplus of CZK 7 billion in 2012 Q1–Q3, double the level of a year earlier. The overall surplus was due mainly to net transfers of CZK 6.5 billion from the EU budget. Only a very modest surplus was recorded on trading in emission allowances. The increase in the overall surplus was also linked with a rise in capital transfer credits vis-à-vis EU institutions.

### III.6.3 The financial account

The **financial account** ended 2012 Q1–Q3 in a surplus of CZK 60.5 billion (see Chart III.6.5), due mainly to net inflows of direct investment and portfolio investment. However, these net inflows were largely offset by a net outflow of other investment.

**Direct investment** recorded a surplus of CZK 124.6 billion in Q1–Q3 (see Chart III.6.6), up by more than CZK 80 billion year on year owing to a higher inflow of investment into the Czech Republic. The overall inflow of foreign direct investment exceeded CZK 145 billion and was linked mainly with estimated reinvested earnings (CZK 88.5 billion). As a result of a significant operation between affiliates connected with a change in ownership, higher investment in equity was also recorded. This was the biggest contributor to the rise in the overall surplus. Reinvested earnings were also the largest component of direct investment by domestic corporations abroad. With regard to industries, the foreign capital inflow (i.e. excluding reinvestment) was channelled primarily into transport and storage. The outflow of capital abroad went mainly into the electricity, gas and heat supply sector.

**Portfolio investment** recorded a net inflow of CZK 68.6 billion in Q1–Q3 (see Chart III.6.7). Issues of government and corporate bonds on foreign markets were the most significant operations. Government and corporate bond issuance abroad was also the biggest contributor to the annual change in portfolio investment flows, which reached CZK 81 billion. Non-residents' holdings of domestic koruna bonds, and marginally also shares, also increased. On the liabilities side, the overall inflow of portfolio investment exceeded CZK 84 billion. Purchases also dominated domestic investors' transactions in foreign securities. However, they were associated solely with an increase in bond holdings, whereas sales slightly outweighed purchases in the case of shares.

Settlement of **financial derivatives** recorded a net inflow of CZK 6.6 billion in 2012 Q1–Q3, representing a slight year-on-year increase.

By contrast, **other investment** saw a high net outflow of funds totalling CZK 139.4 billion. This was due chiefly to a net outflow of CZK 83.5 billion in the monetary financial institutions sector, linked above all with the repayment of short-term non-resident deposits in the Czech Republic and with a rise in short-term deposits and loans abroad. A net outflow of capital (of over CZK 54 billion) was also recorded in the corporate sector. It was associated mainly with export credits to non-residents and repayment of loans. Other investment in the government sector also ended in a small deficit stemming from repayment of foreign loans from the EIB. The marked year-on-year change in other investment flows was due mainly to a change in the short-term position of monetary financial institutions.

The **CNB's international reserves** totalled CZK 852.9 billion at the end of 2012 Q4, representing a quarter-on-quarter increase of CZK 69 billion. The increase was due chiefly to a surplus on transactions executed for CNB clients, especially high government income from the EU in October. In dollar terms, the reserves rose by USD 4.2 billion to USD 44.8 billion in the same period (see Chart III.6.8). The CNB's international reserves covered 41.5% of all external debt liabilities of domestic entities at the end of 2012 Q3.

CHART III.6.7

**PORTFOLIO INVESTMENT**

**Portfolio investment recorded a net inflow in 2012 Q1–Q3, owing mainly to issuance of bonds abroad**
(CZK billions)

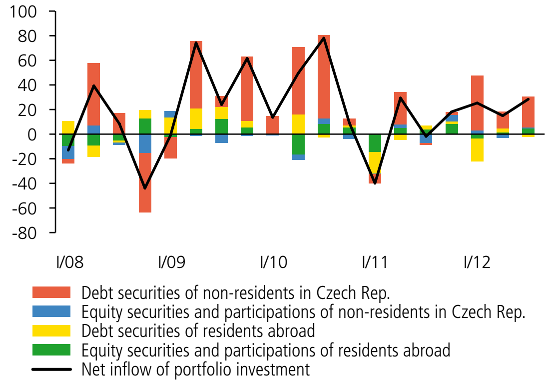
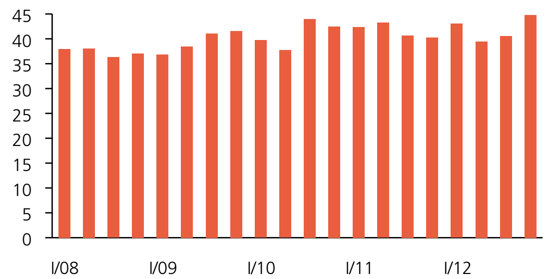



CHART III.6.8

**CNB INTERNATIONAL RESERVES**

**The CNB's international reserves increased in 2012 Q4 compared to the previous quarter**
(USD billions, end of quarter)



## III.7 THE EXTERNAL ENVIRONMENT

*While GDP growth in the USA accelerated in 2012 Q3, the decline of the euro area economy continued and is expected to have deepened further in Q4. A moderation of the year-on-year decline in euro area economic activity is expected for 2013. Euro area inflation decreased in 2012 Q4 and a further decrease is expected this year. In the USA, inflation should remain at the 2012 Q4 average in 2013. In the euro area the ECB and politicians are focusing mainly on mitigating the financial crisis and boosting financial market confidence, whereas the Fed is attempting to stimulate the economy – which is still not creating enough jobs – with continuing bond purchases and low interest rates. These measures generated improved sentiment and lower risk aversion on the markets. This was reflected, among other things, by appreciation of the euro against the dollar and other currencies. Prices have stabilised on commodity markets.*

### III.7.1 The euro area

The slight quarterly **decline in euro area GDP** continued into 2012 Q3 (-0.1%). After weakening in Q2, household consumption stabilised. The decrease in investment slowed and the contribution of net exports was positive. By contrast, a drop in inventories acted against an improvement in GDP growth. The annual economic decline deepened slightly to 0.6% in Q3, mainly as a result of a larger decrease in investment and household consumption (see Chart III.7.1).

The **January CF** expects the quarter-on-quarter economic decline to deepen in 2012 Q4. This is also indicated by data on industrial production and retail sales in October and November. Unemployment also increased, rising by 0.2 percentage point on average in this period compared to Q3. In November, it rose by 1.2 percentage points year on year to 11.8%. The January CF expects a decrease in GDP of 0.4% in 2012 as a whole and a more moderate decrease of 0.1% in 2013. The ECB's December prediction expects a decline of 0.3% (see Chart III.7.2).

**Euro area inflation** was unchanged at 2.2% in December (see Chart III.7.3). Stronger growth in prices of food, tobacco and services was offset by slower growth in energy prices. The January CF expects inflation to slow further in 2013. Average consumer price inflation is expected to fall from last year's 2.5% to 1.9%. In 2014, average inflation is expected to decrease further to 1.7%. Other institutions present similar outlooks.

On 10 January 2013, the ECB **Governing Council** decided unanimously to leave the ECB's key interest rate unchanged at 0.75%. The Council expects that inflation will continue to fall below 2% this year and does not see any risk of inflationary pressures over the policy-relevant horizon. This view is supported by weak M3 growth in November (3.8%) and a decline in loans to the private sector of 0.5%.

CHART III.7.1

**GDP IN EURO AREA**

**The decline in GDP deepened in 2012 Q3 due to investment and household consumption**

(annual percentage changes; contributions in percentage points; seasonally adjusted; source: Datastream)

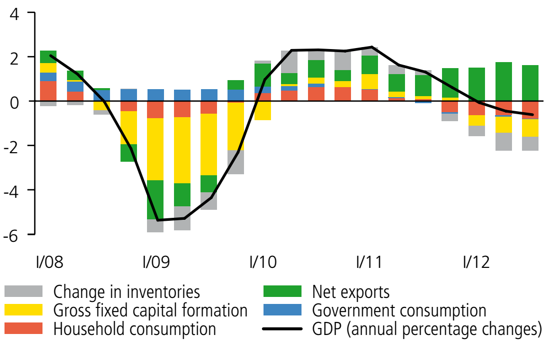
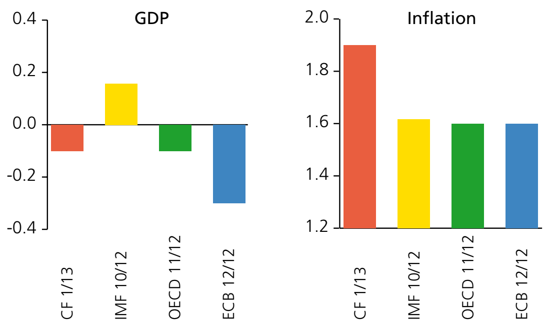



CHART III.7.2

**GDP AND INFLATION OUTLOOKS FOR EURO AREA FOR 2013**

**Euro area GDP should decrease slightly in 2013, while inflation should fall below 2%**

(annual percentage changes; source: CF, IMF, OECD, ECB)




Note: Horizontal axis shows most recent forecast data in format "Source month/year of publication". Midpoint of range for ECB.

At the **Eurogroup meeting of ministers of finance** on 26 November, another tranche of around EUR 44 billion was disbursed to Greece. Other supporting measures were adopted, including an extension of the maturities of Greece's loans, a lowering of the interest rate charged on those loans and the approval of a buy-back of bonds at roughly one-third of their nominal value. On 28 November, the European Commission approved the restructuring of four Spanish banks and aid totalling EUR 37 billion. In mid-December, an EU summit approved the establishment of euro area banking supervision as the cornerstone of the planned banking union. The ECB is to perform supervision of the 150–200 largest banks as from January 2014.

**German GDP growth** slowed slightly year on year to 0.9% in 2012 Q3 (see Chart III.7.4), reaching 0.2% in quarter-on-quarter terms. As regards its individual components, net exports and government consumption were the biggest contributors to annual GDP growth, while household consumption was broadly flat year on year. By contrast, declines in gross capital formation and inventories, stemming from persisting uncertainty and the resulting deferral of investment by German corporations, made negative contributions. According to preliminary estimates, the growth rate of German GDP in 2012 as a whole should reach 0.7%, implying an annual decrease of 0.5% in 2012 Q4. This is also indicated by worse data from industry indicating a further deepening of the annual decline in industrial production in October and November 2012. The PMI leading indicator in industry was only slightly above 46 on average in 2012 Q4 and January 2013, pointing to prevailing negative sentiment.

By contrast, the January value of the ZEW economic sentiment indicator appears to be a favourable signal: the indicator turned positive in December and rose sharply in January to its highest level in two and a half years. The Ifo index of business expectations also increased further in January. The German labour market saw relatively favourable developments, with the unemployment rate rising only slightly to 6.7% in December 2012. Private consumption should thus continue to contribute positively to economic growth in 2013. The January CF outlook for 2013 expects German GDP to grow by 0.7%. The IMF estimate is more optimistic at 0.9%, whereas the Bundesbank expects growth of only 0.4%.

Annual **consumer price inflation in Germany** accelerated slightly in December compared to the previous month, reaching 2.1% (see Chart III.7.5). Inflation excluding energy and food prices stood at 1.6%. Both the January CF and the IMF expect consumer price inflation to slow slightly to 1.9% in 2013 from 2% in 2012. Annual producer price inflation has been subdued since June 2012, reaching only 1.5% in December. At the close of 2012, annual M3 growth slowed from an almost four-year high in October to 5.8% in December.

The quarterly **growth rate of the Slovak economy** remained unchanged at 0.6% in 2012 Q3. A smaller decline in fixed investment and faster growth in government consumption were offset by lower positive net

CHART III.7.3

**INFLATION AND PRODUCER PRICES IN EURO AREA**

**Consumer price inflation was flat at 2.2% in December 2012**
(annual percentage changes; source: Datastream)

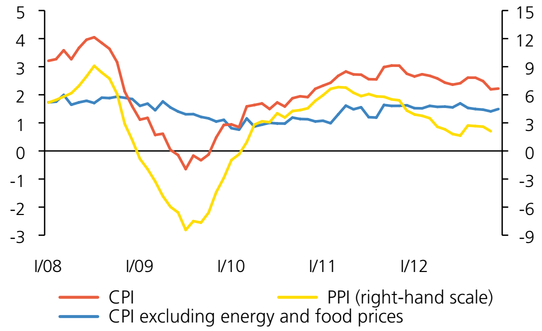



CHART III.7.4

**GDP IN GERMANY**

**Net exports were again the biggest contributor to GDP growth in 2012 Q3**
(annual percentage changes; contributions in percentage points; seasonally adjusted; source: Datastream)

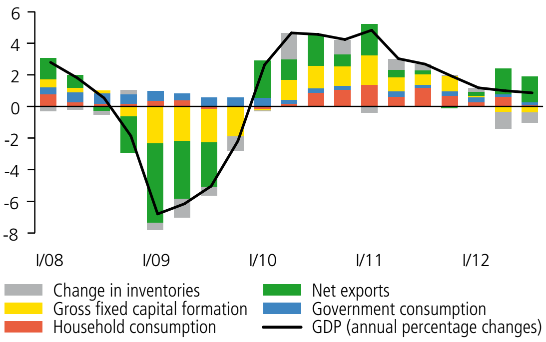



CHART III.7.5

**INFLATION AND PRODUCER PRICES IN GERMANY**

**Consumer price inflation increased slightly in December 2012**
(annual percentage changes; source: Datastream)

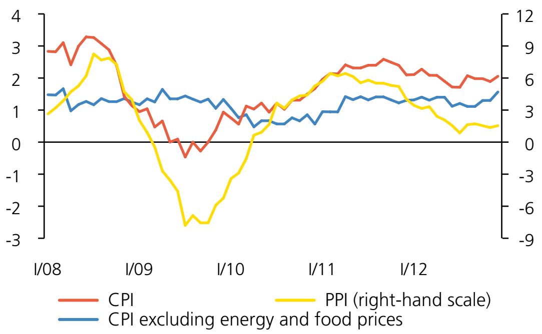


**CHART III.7.6**

**GDP IN USA**

**The upswing in GDP growth in 2012 Q3 was due mainly to household consumption and investment**

(annual percentage changes; contributions in percentage points; seasonally adjusted; source: Datastream)

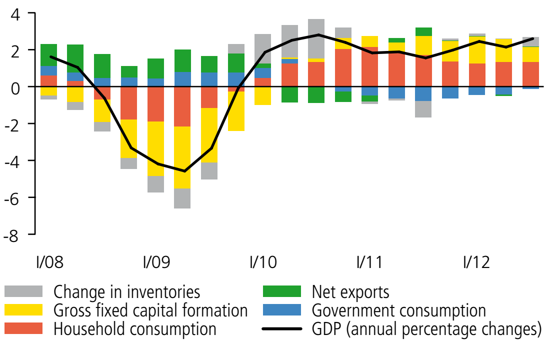
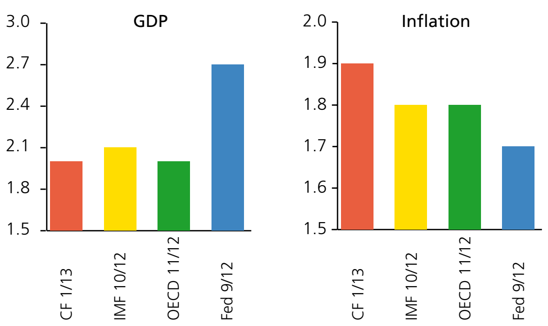



**CHART III.7.7**

**GDP AND INFLATION OUTLOOKS FOR USA FOR 2013**

**GDP growth should stay above 2% and inflation below 2%**

(annual percentage changes; source: CF, IMF, OECD, Fed)



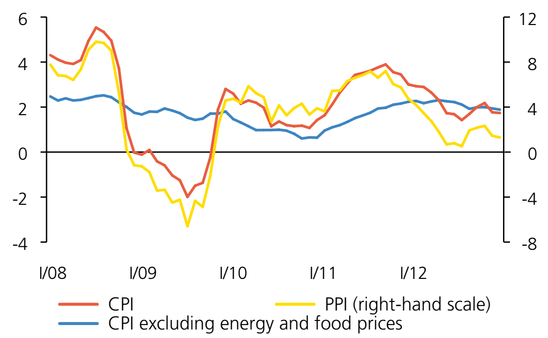

Note: Horizontal axis shows most recent forecast data in format "Source month/ year of publication". Midpoint of range for Fed.

**CHART III.7.8**

**INFLATION AND PRODUCER PRICES IN USA**

**Inflation decreased slightly towards the end of 2012**

(annual percentage changes; source: Datastream)




exports. The annual economic growth rate slowed by 0.1 percentage point to 2.5% in Q3. According to the January CF, GDP growth is expected to be 2.3% in 2012 and slow to 1.5% this year. Thereafter, growth should rebound to 2.7% in 2014. **Inflation in Slovakia** weakened somewhat to 3.4% in December. For 2012 as a whole it averaged 3.6%. CF expects inflation to fall to 2.7% over the next two years.

### III.7.2 The United States

Annualised quarterly **GDP growth in the USA** accelerated to 3.1% in 2012 Q3 from 1.3% a quarter earlier (see Chart III.7.6). Investment recorded the fastest growth, rising by 6.4% in annualised terms. Government consumption rose by 3.8%. As usual, private consumption, which increased by 1.9%, was the biggest contributor to the growth (1.1 percentage points).

Industrial production, which grew by 3.1% month on month in annualised terms (2.3% year on year), is also indicating gradual growth. The PMI index in industry also suggests an improvement, staying above 50 for the second consecutive month. This is the threshold separating a perceived improvement from a perceived deterioration in the situation. Retail sales maintained their growth momentum at the close of 2012, while the consumer confidence indices fell in December as a result of the protracted debate about the fiscal cliff. The labour market recorded no major changes. The unemployment rate is falling only slowly and is fluctuating just below 8%, as the economy is still not creating enough new jobs.

The most closely watched event at the turn of the year was the political debate aimed at averting a fall from the fiscal cliff. At the last minute, US politicians agreed on measures that for the time being will prevent significant cuts in government expenditure and sharp increases in taxes.[50] However, the crucial issue of the debt ceiling, which the US economy will hit sometime around mid-February unless an agreement to increase it is reached, was deferred. Despite the uncertainty associated with the fiscal situation in the USA, the January CF increased the **US GDP growth estimate** for 2013 to 2.0% (see Chart III.7.7).

Annual **growth in consumer prices** slowed to 1.7% in December and average inflation in 2012 stood at 2.1%. Core inflation has been fluctuating just below 2% for several months now (see Chart III.7.8). The decrease in inflation is due chiefly to slowing energy price growth. CF expects consumer prices to go up by 1.9% in 2013. Growth in the industrial producer price index fell to 1.3% in November after hitting a seven-month high of 2.3% in October. Annual M2 growth moderated slightly to 8.3% in November 2012.

50 According to the Congressional Budget Office (CBO), a failure to agree would have caused the US economy to contract by 0.5%.

At its meeting on 12 December 2012 the **FOMC decided** that instead of the Twist programme it would continue to purchase mortgage-backed securities at a pace of USD 40 billion a month and additionally purchase Treasury securities at a pace of USD 45 billion a month. It also decided to keep interest rates between 0.0% and 0.25% until the unemployment rate falls below 6.5% or inflation exceeds 2.5%. However, the Fed (in line with CF) expects inflation to stay below its 2% objective over the medium term. Longer-term inflation expectations are well anchored.

### III.7.3 The exchange rate of the euro against the dollar and other major currencies

The **euro appreciated against major world currencies** at the close of 2012 as the situation in the euro area gradually calmed (see Chart III.7.9). Further reforms were implemented in Greece and the situation surrounding the Spanish banking sector also calmed. ECB operations also contributed significantly to the easing of tensions on financial markets. On the other hand, the fact that the economic slowdown had by now spread to the entire euro area counteracted these factors. The dollar was negatively affected at the end of the year by the replacement of Operation Twist with outright purchases of bonds and by the lengthy negotiations on the fiscal cliff. These factors outweighed the new macroeconomic data from the USA, which look better than those in the euro area.

The dollar appreciated against the Japanese yen after the announcement of new radical steps to support domestic growth by the Japanese government. As expected, the Bank of Japan increased its asset purchase programme by around 10% in December, to JPY 101 trillion. A further increase was announced in January 2013, when the Japanese central bank also adopted an inflation target of 2%, thereby creating room for more radical application of unconventional instruments. As a result, the euro strengthened by more than 13% against the yen between 1 October and the end of 2012. Its appreciation against the dollar and the pound in the same period was much smaller (roughly 2%).

In the **first half of January 2013**, the euro continued to strengthen moderately against major currencies. At its January meeting, the ECB Governing Council decided unanimously to leave interest rates unchanged, thereby dampening speculation about further monetary policy easing. Purchases of bonds issued by the European rescue fund ESM into Japan's international reserves were also announced.

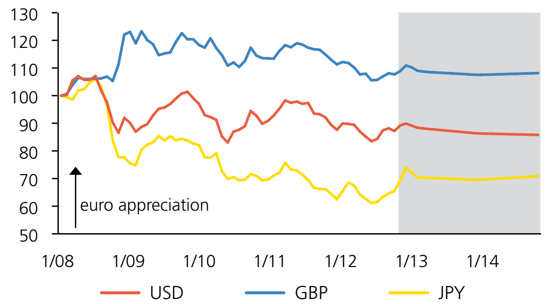
The **January CF** expects the euro to depreciate slightly against the dollar to USD 1.25 at the one-year horizon. The current appreciation trend of the euro against world currencies is regarded as temporary, as the effect of the current euro area recession should become dominant

**Chart III.7.9**

**EURO EXCHANGE RATE AGAINST MAJOR CURRENCIES**

**The euro appreciated against the major world currencies in the final quarter of 2012**

(January 2008 = 100; source: Datastream, outlook from CF)



in the months ahead. A slight appreciation against the Japanese yen is expected in 2014. The outlook vis-à-vis the British pound remains virtually flat at the current level, as the prospects for the British economy are not very optimistic either. The latest data show that the UK slipped back into recession in 2012 Q4.

### III.7.4 Prices of oil and other commodities

The **price of Brent crude oil** fell by about USD 5 a barrel in mid-October 2012 and since then has been fluctuating around USD 110 a barrel with relatively little volatility (see Chart III.7.10). The price shifted to a lower level as concerns regarding global economic growth outweighed the risk of supply disruptions as a result of the political unrest in the Middle East. Although the seven-month rise in commercial oil stocks in OECD countries came to a halt in October and a seasonal downward trend was recorded in the rest of the year, stocks were still around 1% above the five-year average in the last four months of 2012. Commercial stocks fluctuated around 59 days of future consumption throughout 2012. Market supply and demand is therefore roughly balanced and OPEC is not currently planning any changes to its extraction limits.

The **market price outlook** is falling, as no major tensions are expected on the oil market going forward. The price of a barrel of Brent crude oil should therefore decline from the current level of around USD 110 to USD 105 at the end of 2013 and USD 100 at the end of 2014, in line with the US EIA forecast. By contrast, the January CF, which now includes Brent instead of WTI crude oil in its survey, expects the price to stagnate at USD 110 a barrel at the one-year horizon. The expected annual decrease in oil prices in koruna terms is negligible, as the strengthening dollar exchange rate offsets the falling dollar prices of oil (see Chart III.7.11).

In its January report, the IEA increased its **oil demand growth forecast** in response to both stronger demand at the end of last year and expectations of higher consumption in China. Oil consumption should reach 90.8 million barrels a day in 2013, up by roughly 1% on a year earlier. However, the increase in demand should be more than covered by a rise in extraction outside OPEC (especially North America). The launch of new OPEC investments will therefore increase the cartel's reserve capacity.

The **spread between Brent and WTI** returned above USD 20 a barrel in late 2012. WTI is continuing to lose its position as the global benchmark. Commodity indices are responding by increasing the weight of Brent at the expense of WTI. However, the capacity of the Seaway pipeline, which transports WTI oil from the US inland to the Gulf Coast, is to increase from 150,000 to 400,000 barrels a day in mid-January 2013, which should narrow the price spread between the two types of oil.

**CHART III.7.10**

**OIL AND NATURAL GAS PRICES IN USD**

**The price of Brent crude oil stabilised close to USD 110 a barrel during 2012 Q4, but the outlook expects it to fall gradually**

(oil in USD/barrel; gas in USD/1,000 m³ – right-hand scale; source: IMF, Bloomberg)

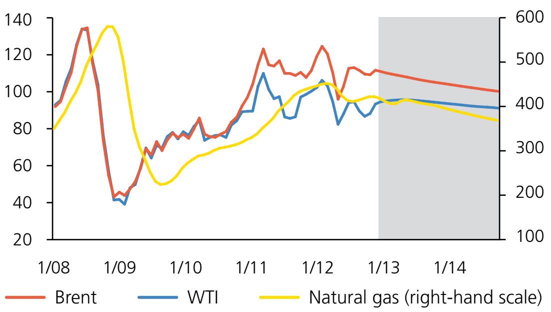
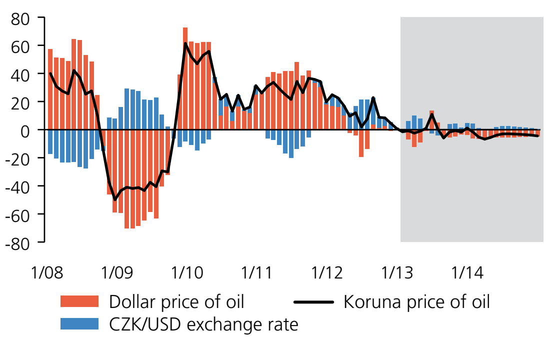



**CHART III.7.11**

**DECOMPOSITION OF KORUNA OIL PRICE GROWTH**

**The koruna price of oil was broadly flat in year-on-year terms in 2012 Q4**

(Brent crude oil in CZK/litre – annual percentage changes; contributions of dollar price of Brent crude oil and CZK/USD exchange rate in percentage points; source: Bloomberg, CNB calculation)



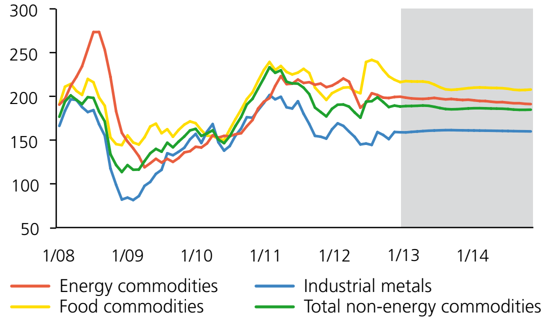
The **overall index of energy commodities** has been virtually flat since September 2012 (see Chart III.7.12). The forecast is only slightly falling, as the expected decline in prices of oil and natural gas is partly offset by a rising outlook for coal prices.

The **non-energy commodity index** has also calmed since November 2012. However, its components showed mixed developments. The food commodity index has been falling gradually since September, thanks mainly to more favourable expectations regarding future harvests (the index has declined by 10.5% from the peak observed in August 2012). By contrast, the industrial metals index reached its lowest level since July 2010 in August 2012 and has since risen by 10% amid considerable fluctuations on hopes that the Chinese economy has reached the bottom of its cycle. The food commodity forecast expects a further slight decline in prices in 2013 H2. Despite recent growth, the outlook for metal prices is flat over the entire forecast horizon, as the fundamentals on this market have yet to show any improvement.

CHART III.7.12

**COMMODITY PRICES**

**Prices of food commodities fell sharply in 2012 Q4, while prices of industrial metals rose**
(year 2005 = 100; source: Bloomberg)




Note: The structure of the non-energy commodity indices corresponds to the composition of the Economist's commodity indices; the energy commodity index consists of Brent crude oil (0.4), coal (0.4) and natural gas (0.2).

| | |
|---|---|
| CBO | Congressional Budget Office |
| CF | Consensus Forecasts |
| CNB | Czech National Bank |
| CPI | consumer price index |
| CZK | Czech koruna |
| CZSO | Czech Statistical Office |
| ECB | European Central Bank |
| EIA | Energy Information Administration |
| EIB | European Investment Bank |
| ESCB | European System of Central Banks |
| ESM | European Stability Mechanism |
| EU | European Union |
| EUR | euro |
| EURIBOR | Euro Interbank Offered Rate |
| FDI | foreign direct investment |
| Fed | US central bank |
| FMIE | Financial Market Inflation Expectations |
| FOMC | Federal Open Market Committee |
| FRA | forward rate agreement |
| GBP | pound sterling |
| GDP | gross domestic product |
| GVA | gross value added |
| HP filter | Hodrick-Prescott filter |
| IEA | International Energy Agency |
| Ifo | Ifo Institute Business Climate Index |
| ILO | International Labour Organization |
| IMF | International Monetary Fund |
| IRI | Institute for Regional Information |
| IRS | interest rate swap |
| JPY | Japanese yen |
| LFS | Labour Force Survey |
| LIBOR | London Interbank Offered Rate |
| LTROs | long-term refinancing operations |
| M1, M2, M3 | monetary aggregates |
| MLSA | Ministry of Labour and Social Affairs |
| OECD | Organisation for Economic Co-operation and Development |
| OPEC | Organization of the Petroleum Exporting Countries |
| PMI | Purchasing Managers Index |
| pp | percentage points |
| PPI | producer price index |
| PRIBOR | Prague Interbank Offered Rate |
| (1W, 1M, 1Y) | (one-week, one-month, one-year) |
| repo rate | repurchase agreement rate |
| USD | US dollar |
| VAT | value added tax |
| WTI | West Texas Intermediate |
| ZEW | The Centre for European Economic Research in Mannheim (Zentrum für Europäische Wirtschaftsforschung) |

| | | |
|---|---|---|
| **Forecasts for general government debt and debt service, and sensitivity analyses** | (Box) | I/2011 |
| **Price-setting behaviour in the Czech Republic (micro data evidence) in relation to the pricing mechanism in the g3 forecasting model** | (Box) | II/2011 |
| **The relationship between the Brent crude oil price and the dollar exchange rate** | (Box) | II/2011 |
| **The impacts of changes to VAT rates on the budget and inflation and their components in 2012 and 2013** | (Box) | III/2011 |
| **Labour market developments during the economic recession and the subsequent recovery** | (Box) | III/2011 |
| **The debt situation in Italy** | (Box) | III/2011 |
| **Publication of the Graph of Risks to the Inflation Projection (GRIP)** | (Annex) | III/2011 |
| **Pension system reform** | (Box) | IV/2011 |
| **The credit rating of the Czech Republic** | (Box) | IV/2011 |
| **Germany – the Czech Republic's main trading partner** | (Box) | IV/2011 |
| **The pass-through of VAT to food prices at the end of 2011** | (Box) | I/2012 |
| **Extraordinary revision of the quarterly national accounts** | (Box) | I/2012 |
| **An analysis of the impacts of fiscal measures in the Czech Republic in 2001–2011** | (Box) | I/2012 |
| **Revision of the consumer basket** | (Box) | II/2012 |
| **Factors affecting retail fuel prices** | (Box) | II/2012 |
| **The Bank Lending Survey** | (Box) | III/2012 |
| **The CZK/USD exchange rate at a time of uncertainty** | (Box) | III/2012 |
| **Easy monetary policy and commodity prices** | (Box) | III/2012 |
| **The household saving rate** | (Box) | IV/2012 |
| **Consumption and money savings by household income group** | (Box) | IV/2012 |
| **The share of reinvested earnings in total FDI income** | (Box) | IV/2012 |
| **Revision of the quarterly national accounts** | (Box) | I/2013 |

This glossary explains some terms frequently used in the Inflation Report. A more detailed glossary can be found on the CNB website (www.cnb.cz/en/general/glossary/index.html).

**Adjusted inflation excluding fuels:** The increase in prices of non-food items of the consumer basket excluding items with administered prices, indirect tax changes and fuels.

**Administered prices:** A sub-category of the consumer basket consisting of items with price ceilings (set at either central or local level), prices regulated on a cost-plus basis (items whose prices may only reflect economically justified costs and a reasonable profit) and administratively fixed fees. The selection of these items is based on the Price Bulletin of the Czech Ministry of Finance.

**Balance of payments:** Records economic transactions with other countries (i.e. between residents and non-residents) over a particular period. The basic structure of the balance of payments includes the current account, the capital and financial accounts and the change in CNB international reserves.

**Bid-to-cover ratio:** The ratio of total demand to demand coverage in primary auctions of medium-term and long-term government bonds.

**Consensus Forecasts:** A regular monthly publication issued by Consensus Economics bringing together the forecasts of hundreds of prominent economists and analytical teams regarding future world developments. The CNB uses these predictions in its macroeconomic forecast when forming assumptions regarding the future development of the external environment.

**Covered bond:** A bond collateralised (backed) by long-term assets, usually mortgage loans or public sector loans. The issuers are mostly banks and the issuance of covered bonds is subject to strict legislative rules. Compared to standard bonds, this type of bond has lower credit risk thanks to higher coverage (known as dual recourse), which gives the covered bond holder a preferential claim on the issuer's receivables underlying the mortgage loans or public sector loans and likewise a claim on the issuer. If the issuer defaults, the holder therefore has a preferential right to the assets backing the covered bond.

**Current account:** Records exports and imports of goods and services, income from capital, investment and labour and unrequited transfers.

**Cyclical component of the general government balance:** Expresses the effect of the business cycle on the general government fiscal balance.

**Discount rate:** A monetary policy rate which as a rule represents the floor for short-term money market interest rates. The CNB applies it to the excess liquidity which banks deposit with the CNB overnight under the deposit facility.

**Disinflation:** A decline in inflation.

**Effective euro area indicators:** Proxy for the effect of economic activity (effective GDP) and inflation (effective producer prices and consumer prices) in the euro area on the Czech economy. The weights used in the calculation are the shares of the individual euro area economies in the foreign trade turnover of the Czech Republic.

**Effective exchange rate:** Shows the appreciation (index > 100) or depreciation (index < 100) of the national currency against a basket of selected currencies for a certain time period relative to a base period. The weights applied in the basket are the shares of major trading partners in foreign trade turnover.

**Escape clause:** Excuses the central bank from its obligation to hit the inflation target. In the flexible inflation targeting regime, it is applied in the event of large shock changes in exogenous factors (particularly supply-side shocks, e.g. indirect tax changes) that are completely or largely outside the purview of central bank monetary policy.

**Euro area:** The territory of all Member States of the European Union that have adopted the euro as a single currency pursuant to the Treaty Establishing the European Community.

**Financial account:** Records transactions connected with the creation, liquidation and change in ownership of the financial assets and liabilities of the government, the banking and corporate sectors and other entities vis-à-vis the rest of the world. It consist of direct investment, portfolio investment, other investment and financial derivatives transactions.

**Fiscal stance:** The annual change in the general government structural balance (in percentage points). A positive figure indicates fiscal restriction and a negative figure indicates fiscal expansion.

**Food prices:** In CNB documents, the term food prices refers to the consolidated category of prices of food and non-alcoholic beverages and prices of alcoholic beverages and tobacco.

**General government balance:** Revenues minus expenditures of the general government sector. A negative government balance is called a general government deficit and a positive government balance is called a general government surplus.

**General government primary balance:** The general government balance net of interest payments (i.e. debt service).

**General government structural balance:** The cyclically adjusted general government balance adjusted for extraordinary one-off operations. It captures the structural configuration of fiscal policy.

**Goods and services balance:** The sum of the trade balance and the services balance.

**Gross Domestic Product (GDP):** The key indicator of economic development. It represents the sum of the value added by all economic sectors. In terms of use it consists of expenditure on final consumption (consumption of households, the government and non-profit institutions), gross capital formation (fixed investment and changes in inventories) and foreign trade (net exports of goods and services).

**Inflation:** Commonly, inflation is considered to be recurring growth of most prices in the economy. It means a decrease in the real value (i.e. purchasing power) of a given currency relative to the goods and services which consumers buy – if there is inflation in the economy, consumers need ever more currency units of the given country to buy the same basket of goods and services. In practice, inflation is measured by the increment of the consumer price index.

**Inflation pressures:** Proxied in the CNB's modelling system by the real marginal cost gap in the consumer goods sector. Total inflation pressures are divided into domestic inflation pressures (in the intermediate goods sector) and imported inflation pressures (in the import price sector).

**Inflation rate:** The increase in the average (basic) consumer price index for the last 12 months relative to the average for the previous 12 months.

**Inflation target:** The level of consumer price inflation that the CNB endeavours to achieve, set publicly and well in advance.

**Lombard rate:** A monetary policy interest rate which provides a ceiling for short-term interest rates on the money market. The CNB applies it to the liquidity which it provides to banks overnight under the lending facility.

**Monetary aggregates:** Represent the amount of money in the economy covered in the monetary survey. According to the national definition, they are calculated from the monetary liabilities of resident monetary financial institutions to other resident sectors in the Czech Republic (households, non-financial corporations and financial institutions excluding the general government). Monetary aggregates differ according to the degree of liquidity of the individual components. The narrow monetary aggregate M1 comprises currency in circulation and overnight deposits. The broad monetary aggregate M2 comprises M1 plus total deposits with agreed maturity and redeemable at notice and repurchase agreements. The broad monetary aggregate M3 (harmonised with EU standards) comprises currency in circulation, overnight deposits, deposits with agreed maturity of up to two years, deposits redeemable at notice of up to three months, repurchase agreements, money market fund shares/units and issued debt securities with maturity of up to two years.

**Monetary conditions:** Represent the combined effect of interest rates (the interest rate component of the monetary conditions) and the exchange rate (the exchange rate component) on the economy. These are the key variables through which monetary policy can affect economic activity and, through it, inflation. Interest rates and the exchange rate do not necessarily affect the economy in the same direction.

**Monetary policy horizon:** The time horizon which monetary policy-makers focus on when making decisions and which takes into account the monetary policy transmission lag. This horizon is about 12–18 months ahead.

**Monetary policy interest rates:** Short-term interest rates associated with monetary policy-making. They comprise the two-week repo rate, the discount rate and the Lombard rate.

**Monetary-policy relevant inflation:** Inflation to which monetary policy reacts. It is defined as headline inflation adjusted for the first-round effects of changes to indirect taxes.

**Money market:** The part of the financial markets which is used to obtain short-term loans and where debt instruments maturing in less than one year are traded. T-bills are typical securities traded on this market. Within this market the CNB carries out its repo operations.

**Net inflation:** Consumer price inflation net of administered prices and adjusted for the first-round effects of changes to indirect taxes. Net inflation consists of food price inflation, fuel price inflation and adjusted inflation excluding fuels. Until the end of 2001, the CNB's inflation targets were set in terms of net inflation. Since 2002, the CNB has targeted headline inflation, using net inflation for analytical purposes only.

**Nominal costs in the consumption sector:** These comprise output prices in the intermediate goods sector and import sector, as final consumption goods are produced using inputs from these sectors. They also include "export-specific technology", which approximates the productivity differential between the tradables sector and the non-tradables sector and its price effect, known as an analogy to the Balassa-Samuelson effect.

**Nominal costs in the intermediate goods sector:** Co-determined by prices of production factors, i.e. labour costs and the price of capital. In addition to these components, they are determined by "labour-augmenting technology". This technology can be understood as a concept similar to total factor productivity, e.g. in the Cobb-Douglas production function.

**Nominal unit labour costs:** The labour costs needed to produce a unit of output. Nominal unit labour costs are calculated as the ratio of the nominal volume of wages and salaries to GDP at constant prices.

**Price-to-income ratio:** The ratio of the price of an apartment (68 $m^2$) to the sum of the annual wage in a given region over the last four quarters. Higher values of this indicator usually mean that apartments are overpriced.

**Price-to-rent ratio:** Indicator of sustainability of apartment prices, calculated as the ratio of the price of the apartment to the annual rent. The price-to-rent ratio is the inverse of the rent return. Higher values of this indicator usually mean that apartments are overpriced.

**Producers' margins:** The inverse of producers' real marginal costs in the relevant sector. Growth in producers' nominal costs without corresponding growth in the price of production causes a decline in the profit margin, i.e. an increase in real marginal costs. If prices in the sector were perfectly flexible, the price at any given moment would comprise a constant margin over marginal nominal costs. In the consumer sector, a gap in profit mark-ups represents a deviation from the long-term margin level.

**Property asking prices:** Property sale asking prices in estate agencies. Asking prices should be higher than transaction prices. Property asking prices in the Czech Republic are published, for example, by the CZSO and the Institute for Regional Information (IRI).

**Property transaction prices:** Prices based on Ministry of Finance statistics from property transfer tax returns and published by the CZSO. These prices are the closest to actual market prices in terms of methodology, but are published with a time delay.

**Repo rate:** The CNB's key monetary policy rate, paid on commercial banks' excess liquidity as withdrawn by the CNB in two-week repo tenders.

**Technological growth:** The situation where the volume of production rises without an increase in the production factors of labour or capital. Growth in technology thus causes the real volume of production to rise given a constant price of production, or the output price to fall relative to input prices given a constant real volume of production.

**Unemployment rate:** The ratio of the number of unemployed persons to the total labour force. We distinguish between the general unemployment rate, as determined by the CZSO according to International Labour Organisation methodology, and the registered unemployment rate, as determined by the Ministry of Labour and Social Affairs.

## KEY MACROECONOMIC INDICATORS

| | | years | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
| **DEMAND AND SUPPLY** | | | | | | | | | | | | |
| *Gross domestic product* | | | | | | | | | | | | |
| GDP | CZK bn, constant p., seas. adjusted | 2,914.5 | 3,113.5 | 3,338.4 | 3,529.4 | 3,632.1 | 3,473.9 | 3,554.9 | 3,622.2 | **3,584.6** | **3,573.3** | **3,646.8** |
| GDP | %, y-o-y, real terms, seas. adjusted | 4.6 | 6.8 | 7.2 | 5.7 | 2.9 | -4.4 | 2.3 | 1.9 | **-1.0** | **-0.3** | **2.1** |
| Household consumption | %, y-o-y, real terms, seas. adjusted | 3.0 | 3.0 | 4.4 | 4.1 | 2.9 | 0.3 | 0.9 | 0.7 | **-2.9** | **-0.8** | **0.9** |
| Government consumption | %, y-o-y, real terms, seas. adjusted | -3.3 | 1.6 | -0.6 | 0.4 | 1.2 | 4.0 | 0.5 | -2.5 | **-0.8** | **-0.3** | **0.4** |
| Gross capital formation | %, y-o-y, real terms, seas. adjusted | 6.4 | 4.5 | 10.6 | 15.5 | 1.5 | -20.0 | 5.5 | 0.3 | **-4.6** | **-3.2** | **0.6** |
| Exports of goods and,services | %, y-o-y, real terms, seas. adjusted | 13.1 | 11.9 | 14.3 | 11.2 | 3.5 | -10.5 | 15.0 | 9.4 | **5.7** | **4.5** | **8.0** |
| Imports of goods and,services | %, y-o-y, real terms, seas. adjusted | 9.5 | 6.1 | 11.2 | 12.8 | 2.3 | -11.7 | 15.3 | 6.7 | **3.5** | **3.7** | **6.8** |
| Net exports | CZK bn, constant p. of 2005, seas. adjusted | -17.3 | 84.8 | 156.3 | 139.3 | 174.7 | 185.3 | 207.1 | 294.1 | **369.2** | **409.1** | **475.8** |
| *Coincidence indicators* | | | | | | | | | | | | |
| Industrial production | %, y-o-y, real terms | 10.4 | 3.9 | 8.3 | 10.6 | -1.8 | -13.6 | 10.3 | 6.5 | - | - | - |
| Construction output | %, y-o-y, real terms | 8.8 | 5.2 | 6.0 | 7.1 | 0.0 | -0.9 | -7.1 | -3.5 | - | - | - |
| Receipts in retail sales | %, y-o-y, real terms | 3.8 | 8.1 | 10.8 | 10.0 | 2.7 | -4.7 | 1.3 | 1.8 | - | - | - |
| **PRICES** | | | | | | | | | | | | |
| *Main price indicators* | | | | | | | | | | | | |
| Inflation rate | %, end-of-period | 2.8 | 1.9 | 2.5 | 2.8 | 6.3 | 1.0 | 1.5 | 1.9 | 3.3 | - | - |
| Consumer Price Index | %, y-o-y, average | 2.8 | 1.9 | 2.5 | 2.8 | 6.4 | 1.1 | 1.5 | 1.9 | 3.3 | **2.1** | **1.7** |
| Regulated prices (18.70%)* | %, y-o-y, average | 3.5 | 5.7 | 9.3 | 4.8 | 15.6 | 8.4 | 2.6 | 4.7 | 8.6 | **4.4** | **2.9** |
| Net inflation (81.30%)* | %, y-o-y, average | 1.8 | 0.7 | 0.4 | 1.7 | 2.4 | -0.9 | 0.0 | 1.3 | 1.0 | **0.7** | **1.3** |
| Food prices (including alcoholic beverages and,tobacco) (24.58%)* | %, y-o-y, average | 2.8 | 0.0 | -0.2 | 3.8 | 3.0 | -0.9 | 0.9 | 3.9 | 2.9 | **2.5** | **1.6** |
| Adjusted inflation excluding fuels (53.32%)* | %, y-o-y, average | 1.2 | 0.7 | 0.6 | 0.7 | 2.0 | 0.0 | -1.2 | -0.7 | -0.3 | **0.0** | **1.2** |
| Fuel prices (3.39%)* | %, y-o-y, average | 4.5 | 7.8 | 3.7 | -0.3 | 4.3 | -11.1 | 11.8 | 9.9 | 6.0 | **-1.9** | **0.8** |
| Monetary-policy inflation (excluding tax changes) | %, y-o-y, average | 2.0 | 1.8 | 2.3 | 2.2 | 4.4 | 0.9 | 0.4 | 1.9 | 2.1 | **1.3** | **1.6** |
| GDP deflator | %, y-o-y, seas. adjusted | 4.0 | -0.3 | 0.5 | 3.3 | 1.9 | 2.3 | -1.4 | -0.8 | **1.0** | **1.2** | **0.5** |
| *Partial price indicators* | | | | | | | | | | | | |
| Producer prices | %, y-o-y, average | 5.5 | 3.1 | 1.5 | 4.1 | 4.5 | -3.1 | 1.2 | 5.6 | 2.1 | **1.1** | **1.6** |
| Agricultural prices | %, y-o-y, average | 9.6 | -9.8 | 1.3 | 16.4 | 10.8 | -24.3 | 5.6 | 20.0 | 4.1 | **6.1** | **0.2** |
| Construction work prices | %, y-o-y, average | 3.7 | 3.0 | 2.9 | 3.9 | 4.5 | 1.3 | -0.2 | -0.5 | -0.6 | - | - |
| Brent crude oil | %, y-o-y, average | 32.7 | 42.1 | 18.6 | 12.6 | 34.3 | -36.6 | 28.7 | 39.5 | 0.8 | **-2.8** | **-5.4** |
| **LABOUR MARKET** | | | | | | | | | | | | |
| Average monthly wage | %, y-o-y, nominal terms | 6.3 | 5.0 | 6.6 | 7.2 | 7.8 | 3.3 | 2.2 | 2.4 | **2.3** | **1.5** | **2.6** |
| Average monthly wage | %, y-o-y, real terms | 3.4 | 3.0 | 4.0 | 4.3 | 1.4 | 2.3 | 0.7 | 0.5 | **-1.0** | **-0.6** | **0.9** |
| Number of employees | %, y-o-y | -0.2 | 2.0 | 1.1 | 1.8 | 1.6 | -2.2 | -2.2 | 0.0 | **0.0** | **-0.5** | **-0.9** |
| Unit labour costs | %, y-o-y | 3.7 | 0.6 | 0.2 | 2.4 | 4.3 | 2.6 | -1.8 | 0.3 | **2.7** | **0.9** | **-0.3** |
| Unit labour costs in industry | %, y-o-y | 1.2 | -7.2 | -7.2 | 2.4 | -3.3 | 5.4 | -6.3 | 1.3 | - | - | - |
| Aggregate labour productivity | %, y-o-y | 5.1 | 4.6 | 5.6 | 3.5 | 0.8 | -2.8 | 3.5 | 1.6 | **-1.6** | **0.0** | **2.6** |
| ILO general unemployment rate | %, average, age 15–64 | 8.4 | 8.0 | 7.2 | 5.4 | 4.4 | 6.7 | 7.4 | 6.8 | **6.9** | **7.5** | **7.9** |
| Share of unemployed | %, average | - | 6.6 | 6.1 | 4.9 | 4.1 | 6.2 | 7.0 | 6.7 | 6.8 | **7.6** | **8.0** |
| **PUBLIC FINANCE** | | | | | | | | | | | | |
| Public finance deficit (ESA95) | CZK bn, current p. | -82.9 | -101.1 | -79.2 | -26.7 | -85.0 | -217.7 | -180.7 | -124.8 | **-186.8** | **-103.5** | **-99.8** |
| Public finance deficit / GDP** | %, nominal terms | -2.8 | -3.2 | -2.4 | -0.7 | -2.2 | -5.8 | -4.8 | -3.2 | **-4.9** | **-2.7** | **-2.5** |
| Public debt (ESA95) | CZK bn, current p. | 847.8 | 885.4 | 948.1 | 1,023.4 | 1,104.3 | 1,285.6 | 1,436.6 | 1,567.9 | **1,760.5** | **1,866.3** | **1,967.7** |
| Public debt / GDP** | %, nominal terms | 28.9 | 28.4 | 28.3 | 27.9 | 28.7 | 34.2 | 37.8 | 40.8 | **45.9** | **48.2** | **49.6** |
| **EXTERNAL RELATIONS** | | | | | | | | | | | | |
| *Current account* | | | | | | | | | | | | |
| Trade balance | CZK bn, current p. | -13.4 | 48.6 | 59.3 | 46.9 | 25.7 | 87.3 | 53.8 | 94.0 | **155.5** | **195.0** | **225.0** |
| Trade balance / GDP | %, nominal terms | -0.5 | 1.6 | 1.8 | 1.3 | 0.7 | 2.3 | 1.4 | 2.4 | **4.1** | **5.0** | **5.7** |
| Balance of services | CZK bn, current p. | 16.6 | 37.9 | 49.0 | 59.2 | 73.9 | 73.9 | 75.3 | 66.3 | **49.5** | **55.0** | **60.0** |
| Current account | CZK bn, current p. | -147.5 | -30.9 | -67.1 | -156.9 | -81.3 | -89.3 | -146.6 | -109.1 | **-74.9** | **-50.0** | **-35.0** |
| Current account / GDP | %, nominal terms | -5.0 | -1.0 | -2.0 | -4.3 | -2.1 | -2.4 | -3.9 | -2.8 | **-2.0** | **-1.3** | **-0.9** |
| *Foreign direct investment* | | | | | | | | | | | | |
| Direct investment | CZK bn, current p. | 101.8 | 279.6 | 90.3 | 179.1 | 36.3 | 37.7 | 95.0 | 75.2 | **120.0** | **25.0** | **100.0** |
| *Exchange rates* | | | | | | | | | | | | |
| CZK/USD | average | 25.7 | 24.0 | 22.6 | 20.3 | 17.1 | 19.1 | 19.1 | 17.7 | 19.6 | **20.0** | **20.2** |
| CZK/EUR | average | 31.9 | 29.8 | 28.3 | 27.8 | 25.0 | 26.5 | 25.3 | 24.6 | 25.1 | **25.3** | **25.0** |
| CZK/EUR | %, y-o-y, real (CPI euro area), avg. | 0.0 | -6.3 | -5.1 | -2.2 | -12.5 | 5.4 | -4.6 | -1.9 | 1.5 | **0.6** | **-0.5** |
| CZK/EUR | %, y-o-y, real (PPI euro area), avg. | -2.9 | -5.6 | -1.5 | -3.7 | -8.7 | 4.1 | -3.1 | -2.4 | 2.6 | **0.9** | **-0.4** |
| *Foreign trade prices* | | | | | | | | | | | | |
| Prices of exports of goods | %, y-o-y, average | 3.6 | -1.5 | -1.2 | 1.3 | -4.6 | 0.2 | -1.0 | 1.7 | **2.9** | **1.6** | **1.3** |
| Prices of imports of goods | %, y-o-y, average | 1.6 | -0.5 | 0.2 | -1.0 | -3.3 | -3.5 | 2.0 | 4.3 | **4.3** | **1.1** | **0.3** |
| **MONEY AND INTEREST RATES** | | | | | | | | | | | | |
| M2 | %, y-o-y, average | 8.8 | 5.9 | 9.5 | 11.6 | 9.5 | 5.7 | 4.4 | 3.7 | **5.7** | **5.2** | **4.1** |
| 2W repo rate | %, end-of-period | 2.50 | 2.00 | 2.50 | 3.50 | 2.25 | 1.00 | 0.75 | 0.75 | 0.05 | - | - |
| 3M PRIBOR | %, average | 2.4 | 2.0 | 2.3 | 3.1 | 4.0 | 2.2 | 1.3 | 1.2 | 1.0 | **0.4** | **0.5** |

* in brackets are constant weights in actual consumer basket
** CNB calculation
– data are not available / forecasted / released
data in bold = CNB forecast

| 2010 | | | | 2011 | | | | 2012 | | | | 2013 | | | | 2014 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| QI | QII | QIII | QIV | QI | QII | QIII | QIV | QI | QII | QIII | QIV | QI | QII | QIII | QIV | QI | QII | QIII | QIV |
| | | | | | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | | | | | |
| 877.9 | 887.3 | 891.8 | 897.8 | 904.6 | 906.1 | 905.6 | 905.9 | 900.4 | 896.8 | 894.0 | **893.4** | **890.6** | **891.5** | **894.1** | **897.1** | **901.8** | **907.5** | **914.2** | **923.3** |
| 0.9 | 2.7 | 2.8 | 2.9 | 3.0 | 2.1 | 1.5 | 0.9 | -0.5 | -1.0 | -1.3 | **-1.4** | **-1.1** | **-0.6** | **0.0** | **0.4** | **1.3** | **1.8** | **2.3** | **2.9** |
| 1.0 | 0.3 | 0.9 | 1.6 | 0.4 | 0.6 | 1.0 | 0.6 | -3.0 | -2.8 | -2.4 | **-3.5** | **-0.8** | **-1.2** | **-0.8** | **-0.5** | **0.3** | **0.8** | **1.0** | **1.3** |
| 1.5 | 1.7 | 0.2 | -1.5 | -0.6 | -2.1 | -4.1 | -3.2 | -2.0 | -1.6 | 0.0 | **0.3** | **0.4** | **0.1** | **-0.5** | **-1.0** | **-0.8** | **-0.1** | **0.7** | **1.8** |
| -9.3 | 6.9 | 17.6 | 8.8 | 5.2 | 1.7 | -4.0 | -1.1 | -2.0 | -0.5 | -9.4 | **-6.1** | **-4.9** | **-6.4** | **-1.5** | **0.2** | **0.2** | **0.6** | **0.7** | **0.8** |
| 13.9 | 16.6 | 15.6 | 14.2 | 16.4 | 11.1 | 6.9 | 4.0 | 6.5 | 4.9 | 4.7 | **6.8** | **0.8** | **4.6** | **5.7** | **7.0** | **7.9** | **8.0** | **7.9** | **8.2** |
| 9.7 | 16.6 | 20.1 | 14.7 | 14.7 | 8.8 | 2.5 | 1.9 | 4.0 | 4.0 | 1.6 | **4.6** | **0.3** | **2.8** | **5.1** | **6.5** | **7.0** | **6.9** | **6.7** | **6.8** |
| 53.5 | 54.2 | 38.0 | 61.3 | 72.1 | 74.2 | 70.0 | 77.7 | 93.4 | 83.9 | 94.5 | **97.4** | **97.2** | **100.1** | **104.0** | **107.9** | **111.5** | **115.7** | **121.1** | **127.6** |
| | | | | | | | | | | | | | | | | | | | |
| 6.9 | 11.5 | 10.7 | 11.8 | 12.1 | 8.7 | 3.2 | 2.4 | 2.9 | -1.5 | -2.0 | - | - | - | - | - | - | - | - | - |
| -22.7 | -8.3 | -2.8 | -2.1 | 5.9 | -5.2 | -9.0 | -0.8 | -9.4 | -4.9 | -4.9 | - | - | - | - | - | - | - | - | - |
| -0.2 | 2.1 | 1.6 | 1.5 | 5.3 | 1.1 | 0.5 | 0.9 | 1.2 | -2.4 | -1.0 | - | - | - | - | - | - | - | - | - |
| | | | | | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | | | | | |
| 0.7 | 0.6 | 1.1 | 1.5 | 1.7 | 1.9 | 1.8 | 1.9 | 2.4 | 2.7 | 3.2 | 3.3 | - | - | - | - | - | - | - | - |
| 0.7 | 1.1 | 1.9 | 2.1 | 1.7 | 1.8 | 1.7 | 2.4 | 3.7 | 3.4 | 3.3 | 2.8 | **2.0** | **2.0** | **2.2** | **2.3** | **1.7** | **1.7** | **1.8** | **1.8** |
| 0.8 | 2.3 | 3.6 | 3.8 | 4.4 | 4.0 | 4.5 | 5.9 | 9.7 | 9.4 | 8.2 | 7.1 | **4.5** | **4.4** | **4.3** | **4.5** | **3.1** | **3.0** | **2.8** | **2.6** |
| -0.5 | -0.3 | 0.3 | 0.4 | 1.0 | 1.2 | 1.2 | 1.7 | 1.3 | 1.0 | 0.9 | 0.6 | **0.5** | **0.5** | **0.9** | **0.9** | **1.2** | **1.3** | **1.4** | **1.4** |
| | | | | | | | | | | | | | | | | | | | |
| -1.4 | -0.2 | 2.3 | 2.8 | 3.2 | 4.1 | 3.6 | 4.5 | 3.5 | 2.5 | 2.8 | 2.7 | **2.9** | **2.9** | **2.7** | **1.7** | **1.5** | **1.5** | **1.6** | **1.8** |
| | | | | | | | | | | | | | | | | | | | |
| -1.1 | -1.2 | -1.2 | -1.3 | -0.8 | -0.8 | -0.7 | -0.4 | -0.3 | -0.2 | -0.4 | -0.5 | **-0.5** | **-0.4** | **0.2** | **0.6** | **1.0** | **1.3** | **1.3** | **1.3** |
| 18.1 | 13.3 | 7.0 | 8.7 | 10.8 | 9.1 | 9.5 | 10.2 | 8.0 | 5.8 | 6.4 | 3.8 | **-2.5** | **-2.8** | **-2.1** | **-0.2** | **2.5** | **1.0** | **-0.1** | **-0.4** |
| -0.3 | 0.1 | 0.8 | 1.0 | 1.6 | 1.7 | 1.7 | 2.4 | 2.5 | 2.2 | 2.0 | 1.5 | **1.1** | **1.2** | **1.4** | **1.5** | **1.6** | **1.6** | **1.6** | **1.6** |
| -2.3 | -0.8 | -0.5 | -1.9 | -1.8 | -1.5 | -0.8 | 1.0 | 1.6 | 1.4 | 0.9 | **0.2** | **1.7** | **1.1** | **1.1** | **1.0** | **-0.3** | **0.5** | **0.8** | **1.0** |
| | | | | | | | | | | | | | | | | | | | |
| -1.4 | 1.3 | 2.2 | 3.0 | 5.4 | 6.0 | 5.6 | 5.2 | 3.6 | 1.8 | 1.6 | 1.6 | **0.8** | **1.0** | **1.4** | **1.4** | **1.6** | **1.6** | **1.7** | **1.6** |
| -5.6 | -2.8 | 8.2 | 22.7 | 27.9 | 30.1 | 16.6 | 5.4 | -1.9 | -1.8 | 5.8 | 14.3 | **13.7** | **8.2** | **3.8** | **-1.4** | **-2.3** | **-1.1** | **1.7** | **2.5** |
| 0.0 | -0.2 | -0.3 | -0.4 | -0.4 | -0.5 | -0.5 | -0.5 | -0.6 | -0.6 | -0.5 | -0.6 | - | - | - | - | - | - | - | - |
| 70.5 | 35.9 | 11.9 | 15.8 | 36.7 | 49.0 | 48.0 | 26.2 | 13.2 | -7.2 | -2.5 | 1.1 | **-5.7** | **1.6** | **-1.7** | **-3.9** | **-6.1** | **-5.6** | **-5.2** | **-4.9** |
| 2.8 | 3.1 | 2.2 | 0.7 | 2.4 | 2.4 | 2.4 | 2.4 | 3.4 | 2.3 | 1.4 | **2.1** | **1.2** | **1.5** | **1.7** | **1.6** | **2.6** | **2.5** | **2.7** | **2.8** |
| 2.1 | 1.9 | 0.3 | -1.4 | 0.7 | 0.6 | 0.6 | 0.0 | -0.3 | -1.1 | -1.8 | **-0.7** | **-0.8** | **-0.5** | **-0.5** | **-0.7** | **0.9** | **0.7** | **0.9** | **1.0** |
| -3.3 | -2.7 | -1.4 | -1.6 | -0.2 | 0.4 | 0.1 | -0.5 | -0.6 | -0.6 | 0.3 | **0.9** | **0.5** | **0.0** | **-1.0** | **-1.3** | **-1.2** | **-1.1** | **-0.8** | **-0.5** |
| -2.3 | -2.4 | -0.1 | -2.2 | -1.1 | 1.1 | 0.1 | 1.0 | 3.2 | 3.1 | 2.2 | **2.4** | **1.8** | **1.4** | **0.6** | **-0.2** | **0.1** | **-0.4** | **-0.4** | **-0.6** |
| -8.0 | -8.3 | -4.6 | -4.6 | -1.6 | 1.2 | 2.9 | 2.7 | 2.6 | 4.5 | 4.9 | - | - | - | - | - | - | - | - | - |
| 3.7 | 4.6 | 2.5 | 3.3 | 3.0 | 1.8 | 1.3 | 0.5 | -0.3 | -1.9 | -1.8 | **-2.1** | **-1.5** | **-0.5** | **0.6** | **1.2** | **2.0** | **2.5** | **2.8** | **3.3** |
| 8.2 | 7.2 | 7.1 | 7.0 | 7.3 | 6.8 | 6.6 | 6.5 | 7.2 | 6.8 | 7.0 | **6.8** | **7.5** | **7.3** | **7.6** | **7.5** | **8.2** | **7.8** | **7.9** | **7.7** |
| 7.6 | 6.8 | 6.6 | 6.9 | 7.4 | 6.5 | 6.4 | 6.4 | 7.1 | 6.5 | 6.6 | 7.0 | **7.9** | **7.3** | **7.5** | **7.8** | **8.6** | **7.8** | **7.7** | **7.8** |
| | | | | | | | | | | | | | | | | | | | |
| - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| | | | | | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | | | | | |
| 31.0 | 22.9 | -4.5 | 4.4 | 33.7 | 29.3 | 7.9 | 23.2 | 53.8 | 37.4 | 30.2 | **34.0** | **58.0** | **51.0** | **40.0** | **46.0** | **63.0** | **58.0** | **48.0** | **56.0** |
| 3.5 | 2.4 | -0.5 | 0.4 | 3.8 | 3.0 | 0.8 | 2.3 | 6.0 | 3.9 | 3.1 | **3.4** | **6.4** | **5.3** | **4.1** | **4.5** | **6.9** | **5.8** | **4.8** | **5.3** |
| 18.3 | 24.8 | 15.3 | 16.9 | 14.2 | 20.3 | 18.8 | 13.0 | 14.2 | 13.2 | 13.1 | **9.0** | **15.0** | **15.0** | **14.0** | **11.0** | **16.0** | **16.0** | **16.0** | **12.0** |
| 22.3 | -28.1 | -106.4 | -34.5 | 22.7 | -56.8 | -57.6 | -17.4 | 22.9 | -20.1 | -50.7 | **-27.0** | **28.0** | **-13.0** | **-49.0** | **-16.0** | **31.0** | **-12.0** | **-47.0** | **-7.0** |
| 2.5 | -2.9 | -11.0 | -3.5 | 2.6 | -5.9 | -5.9 | -1.7 | 2.5 | -2.1 | -5.3 | **-2.7** | **3.1** | **-1.3** | **-5.0** | **-1.6** | **3.4** | **-1.2** | **-4.7** | **-0.7** |
| | | | | | | | | | | | | | | | | | | | |
| 13.9 | 30.2 | 37.6 | 13.3 | 13.1 | 34.5 | -4.3 | 32.0 | 17.3 | 17.6 | - | - | - | - | - | - | - | - | - | - |
| | | | | | | | | | | | | | | | | | | | |
| 18.7 | 20.1 | 19.3 | 18.2 | 17.8 | 16.9 | 17.3 | 18.8 | 19.1 | 19.7 | 20.0 | 19.4 | **20.0** | **20.2** | **20.0** | **20.1** | **20.3** | **20.3** | **20.3** | **20.1** |
| 25.9 | 25.6 | 24.9 | 24.8 | 24.4 | 24.3 | 24.4 | 25.3 | 25.1 | 25.3 | 25.1 | 25.2 | **25.5** | **25.3** | **25.2** | **25.2** | **25.1** | **25.1** | **25.0** | **25.0** |
| -6.3 | -4.1 | -3.2 | -4.8 | -5.2 | -4.1 | -1.0 | 2.6 | 2.0 | 2.9 | 2.0 | -0.8 | **1.9** | **0.3** | **0.4** | **-0.3** | **-1.2** | **-0.5** | **-0.3** | **-0.2** |
| -5.6 | -2.9 | -1.0 | -2.7 | -4.9 | -4.6 | -1.8 | 1.9 | 3.0 | 4.3 | 3.2 | -0.2 | **1.8** | **0.5** | **0.8** | **0.6** | **-1.0** | **-0.3** | **-0.2** | **-0.2** |
| | | | | | | | | | | | | | | | | | | | |
| -6.5 | -0.3 | 2.2 | 1.0 | 0.8 | -0.1 | 1.6 | 4.6 | 4.0 | 3.9 | 3.3 | **0.5** | **1.7** | **1.1** | **1.7** | **2.0** | **1.0** | **1.2** | **1.4** | **1.5** |
| -4.4 | 2.5 | 5.8 | 4.7 | 4.7 | 2.4 | 3.5 | 6.5 | 5.7 | 5.7 | 4.7 | **1.2** | **1.3** | **0.8** | **1.1** | **1.4** | **0.2** | **0.1** | **0.4** | **0.4** |
| | | | | | | | | | | | | | | | | | | | |
| 3.6 | 4.9 | 4.8 | 4.1 | 3.4 | 2.6 | 3.8 | 4.8 | 6.1 | 5.8 | 5.7 | **5.0** | **6.1** | **5.3** | **4.6** | **4.7** | **3.0** | **4.1** | **4.5** | **4.6** |
| 1.00 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.50 | 0.50 | 0.05 | - | - | - | - | - | - | - | - |
| 1.5 | 1.3 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.0 | 0.6 | **0.5** | **0.5** | **0.4** | **0.3** | **0.4** | **0.4** | **0.5** | **0.8** |

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