INFLATION REPORT / I

2014

CNB CZECH NATIONAL BANK

INFLATION REPORT / I

CNB CZECH NATIONAL BANK

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 Bank Board's final decision may not correspond to the message of the forecast due to arrival of new information since the forecast was drawn up and to 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.

This Inflation Report was approved by the CNB Bank Board on 13 February 2014 and contains the information available as of 24 January 2014. 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.

I. SUMMARY

The year-on-year decline of the Czech economy slowed in 2013 Q3. In 2013 Q4, headline inflation was on average in the lower half of the tolerance band around the target and monetary-policy relevant inflation was well below its lower boundary. The domestic economy remains anti-inflationary, whereas the weakened exchange rate of the koruna is acting in the opposite direction. Real economic activity will emerge from its decline this year. GDP will grow by 2.2% thanks to a recovery in external demand and to the easing of the monetary conditions executed through the koruna's exchange rate. The growth will then pick up further in 2015. Both headline and monetary-policy relevant inflation will decrease to very low levels at the start of 2014. Inflation will then return to the CNB's target by the end of the year, aided significantly by the weaker exchange rate. At the monetary policy horizon, inflation will be in the upper half of the tolerance band. Average inflation will be 1.2% this year and 2.6% in 2015. The forecast assumes market interest rates to be flat at their current very low level and the exchange rate to stay at CZK 27 to the euro until the start of next year. This exchange rate level continues to deliver the necessary easing of the monetary conditions.

The **Czech economy** contracted by 1.2% year on year **in 2013 Q3**, owing to a decrease in net exports and a continued fall in gross fixed capital formation. The contributions of the other components of demand were zero or slightly positive. In quarter-on-quarter terms, GDP rose slightly for the second quarter in a row, but the output gap remained strongly negative. The forecast assumes a slight annual increase in GDP and accelerating quarterly GDP growth in 2013 Q4.

In 2013 Q4, headline inflation was on average in the lower half of the tolerance band around the CNB's target (see Chart I.1) and monetary-policy relevant inflation was well below its lower boundary. Negative adjusted inflation excluding fuels continued to reflect the strongly anti-inflationary effect of the domestic economy, whereas the weaker exchange rate of the koruna started to act in the opposite direction via import prices.

Economic activity in the effective euro area rose slightly in 2013 H2. According to the assumptions of the forecast, growth is expected to reach 1.5% in effective terms this year and pick up further in 2015. Inflation remains very subdued owing to falling commodity prices amid only a gradual recovery of economic activity. Industrial producer prices in the euro area are falling year on year, and in some countries the same goes for consumer prices. According to the assumptions of the forecast, however, prices in the euro area will increase at a gradually rising pace. The low outlook for 3M EURIBOR market rates takes into account the ECB's still easy current and expected monetary policy. The euro-dollar exchange rate has recently appreciated, but the outlook is for depreciation. Oil prices are expected to fall gradually over the forecast horizon.

Chart I.1

FULFILMENT OF THE INFLATION TARGET

Headline inflation was well below the CNB's target in 2013 Q4
(year on year in %)

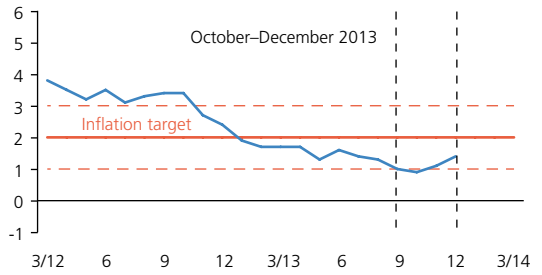
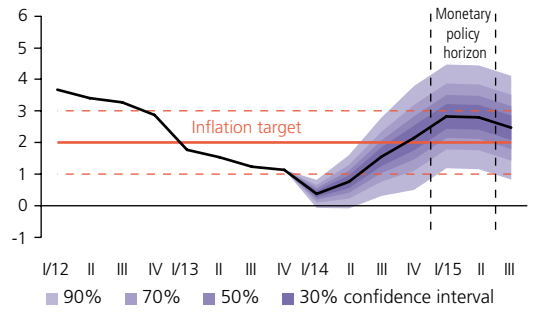


Chart I.2

HEADLINE INFLATION FORECAST

Headline inflation will decrease significantly at the start of 2014 and then fluctuate within the upper half of the tolerance band at the monetary policy horizon
(year on year in %)



According to the forecast, headline inflation will decrease to very low levels at the start of 2014 after the effect of the VAT change drops out and amid falling administered prices. However, the threat of deflation has probably been averted thanks to the easing of the monetary conditions executed through the exchange rate of the koruna. Inflation will rise into the upper half of the tolerance band around the target at the monetary policy horizon. It will then slow down in 2015 H2 and approach the 2% target from above (see Chart I.2). **Monetary-policy relevant inflation**, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, will follow a similar path to headline inflation, but at a slightly lower level (see Chart I.3). The overall upward pressures on consumer prices will increase rapidly in the near future owing to import prices, which, despite very low foreign producer price inflation, will be affected by the weaker koruna exchange rate. Their inflationary impact will gradually weaken, however, and in 2015 import prices will slow inflation slightly. The current anti-inflationary effect of the domestic economy will dissipate by mid-2014. Inflation will then be affected by a recovery in domestic economy and an upswing in wage growth. Adjusted inflation excluding fuels will turn slightly positive in 2014 Q2 and rise further until early 2015 on the back of recovering domestic economic activity. Food and fuel prices will rise modestly over the forecast horizon. Administered prices will decline this year.

The forecast assumes market **interest rates** to be flat at their current very low level until the start of 2015 (see Chart I.4), reflecting the 2W repo rate being left at technical zero and an unchanged money market premium. Market rates are forecasted to increase by about 0.7 percentage point in 2015. The **exchange rate of the koruna** against the euro weakened to above CZK 27 at the end of 2013 after the CNB decided in November to start using the exchange rate as an instrument for easing monetary policy. The forecast assumes the exchange rate to return to the CZK 27 level, which continues to be sufficient to avert the threat of deflation and facilitate a faster economic recovery and a faster return of inflation to the CNB's target. According to the forecast, the exchange rate should stay at this level as long as easy monetary conditions are needed, i.e. until early 2015. During this period, domestic inflationary pressures should be sufficiently renewed thanks to an economic recovery and rising wages, allowing for a return to conventional monetary policy at the start of 2015. However, this return will not imply appreciation of the exchange rate to the level recorded before the CNB started intervening, as the weaker exchange rate of the koruna will in the meantime pass through to the price level and other nominal variables.

Last year's contraction of the **Czech economy** will be followed by a reversal this year (see Chart I.5). A recovery in external demand and the easing of the monetary conditions executed through the weaker exchange rate of the koruna, coupled with a roughly neutral effect of fiscal policy, will lead to GDP growth of 2.2%. The weakening of the exchange rate will account for about 1 percentage point of this growth, owing to increased price competitiveness of Czech products

CHART I.3

MONETARY-POLICY RELEVANT INFLATION FORECAST

Monetary-policy relevant inflation will return to the CNB's target at the end of 2014 and then fluctuate within the upper half of the tolerance band at the monetary policy horizon
(year on year in %)

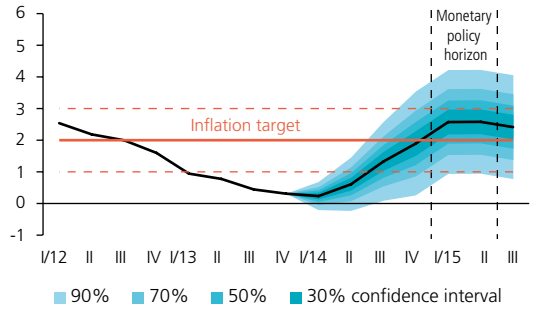


CHART I.4

INTEREST RATE FORECAST

The forecast assumes market interest rates to be flat at their current very low level until the start of 2015
(3M PRIBOR in %)

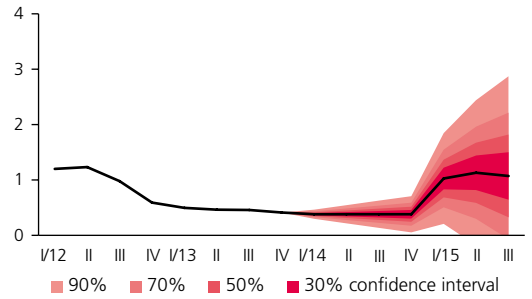
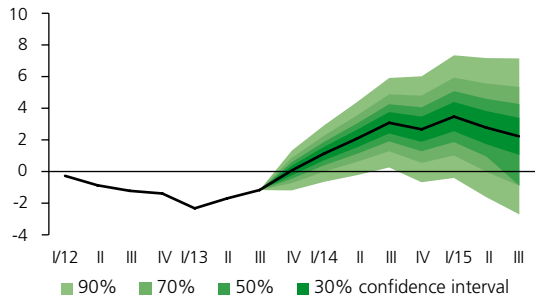


CHART I.5

GDP GROWTH FORECAST

GDP will return to growth at the start of this year thanks to a recovery in external demand and to the easing of the monetary conditions executed through the exchange rate of the koruna
(annual percentage changes; seasonally adjusted)



and lower real interest rates. In 2015, GDP growth will pick up further to 2.8%. In 2014, the economic recovery will – with the usual lag – affect the **labour market**, which will see renewed growth in the number of employees converted into full-time equivalents. However, the unemployment rate will continue to rise owing to persisting growth in the labour force, and will not start coming down until 2015 H2. Wage growth in the business sector will increase from its current low levels. Wages in the non-business sector will rise at a rather lower rate.

At its monetary policy meeting on 6 February 2014, the Bank Board of the Czech National Bank decided unanimously to keep interest rates unchanged, i.e. at technical zero. The Board also decided to continue **using the exchange rate as an additional instrument for easing the monetary conditions** and confirmed the CNB's commitment to intervene on the foreign exchange market if needed to weaken the koruna so that the exchange rate of the koruna against the euro is kept close to CZK 27 to the euro. The nature of this exchange rate commitment is unchanged. The Bank Board continues to view the level of the exchange rate commitment as appropriate, as it delivers the necessary easing of the monetary conditions. The Bank Board foresees this exchange rate commitment being maintained at least until the start of 2015.

II. THE FORECAST, ITS CHANGES AND RISKS

II.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

Economic growth in the effective euro area will gradually pick up this year and the next. The current fall in producer prices and their insignificant rise over the forecast horizon reflect an only gradual recovery of economic activity and lower industrial commodity prices. As regards consumer prices, declining energy prices are acting in the same direction. The low outlook for 3M EURIBOR rates takes into account the ECB's accommodative current and expected monetary policy in the face of the above subdued price developments. In the longer run, the euro is expected to depreciate gradually against the dollar from a stronger initial level. The outlook for the Brent crude oil price continues to expect a gradual decline.

The outlook for the **effective indicator of euro area GDP** foresees a pick-up in economic growth to 1.5% this year. This is 1.1 percentage points higher than in 2013 (see Chart II.1.1).[1] The expected growth in the effective indicator is driven mainly by the German and Slovak economies, which simultaneously account for the largest share of Czech exports. A further acceleration of economic activity in the euro area to 2% is then expected in 2015. Compared to the previous forecast, the outlook is broadly unchanged from the whole-year perspective this year and is slightly higher in 2015. The still unresolved debt problems of a number of euro area countries and the situation in the financial sector remain risks.

The **effective indicator of producer prices in the euro area** is currently falling (see Chart II.1.2), owing to still subdued economic activity and to low prices of industrial commodities. As the economy recovers, its growth is expected to return to slightly positive values and to increase by 0.6% for the year as a whole on average. In 2015, producer price inflation is expected to strengthen to 1.5% on average. This means much lower levels over the entire horizon than in the previous forecast.

The low outlook for the **effective indicator of consumer prices in the euro area** (see Chart II.1.3) at the shorter end of the forecast mainly reflects continuing subdued demand accompanied by a substantial decline in energy prices. In 2014, however, inflation will rise gradually towards 2%, reaching 1.5% on average. Next year, as the decline in energy prices subsides and growth in economic activity increases, consumer price inflation is expected to reach almost 2%. This represents a downward shift compared to the previous forecast in both years, with the shift being significant in 2014.

1 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 13 January 2014. The outlook is indicated by the grey areas in the charts. This convention is used throughout this Report. The differences between the previous and new forecast in the past are due, in addition to revisions, to an update of the weights of individual countries in Czech exports.

CHART II.1.1

EFFECTIVE GDP IN THE EURO AREA

External demand growth should gradually accelerate this year and the next

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

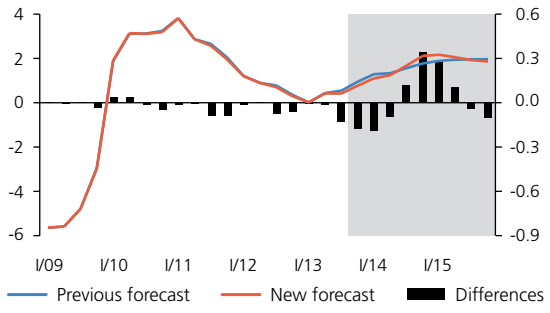


CHART II.1.2

EFFECTIVE PPI IN THE EURO AREA

The subdued producer price inflation this year and the next primarily reflects low outlooks for industrial commodity prices

(year on year in %; differences in percentage points – right-hand scale; seasonally adjusted)

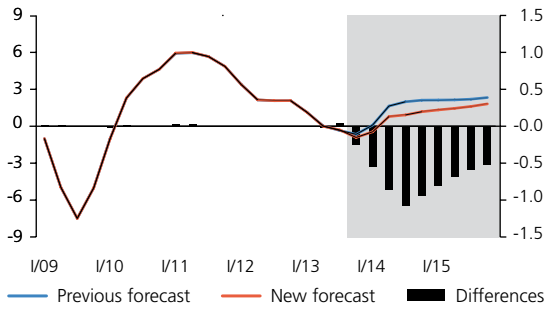


CHART II.1.3

EFFECTIVE CPI IN THE EURO AREA

Effective inflation is currently very low and is below 2% over the entire forecast horizon

(year on year in %; differences in percentage points – right-hand scale; seasonally adjusted)

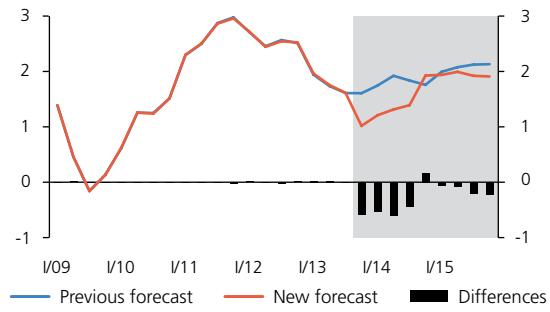


CHART II.1.4

3M EURIBOR

The decrease in the ECB's main refinancing rate and the modest expected growth in prices are reflected in a low outlook for interest rates
(in %; differences in percentage points – right-hand scale)

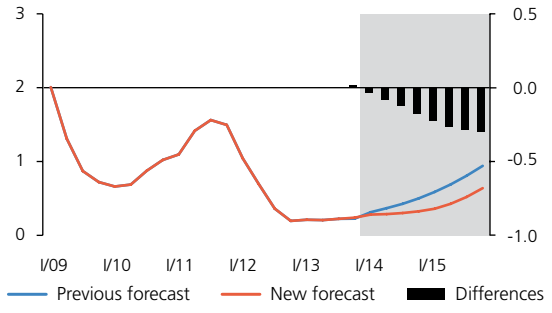


CHART II.1.5

EURO-DOLLAR EXCHANGE RATE

A gradual weakening of the euro against the dollar from a stronger current level is predicted over the entire forecast horizon
(USD/EUR; differences in % – right-hand scale)

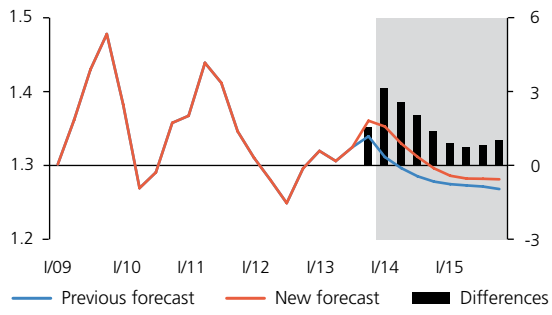
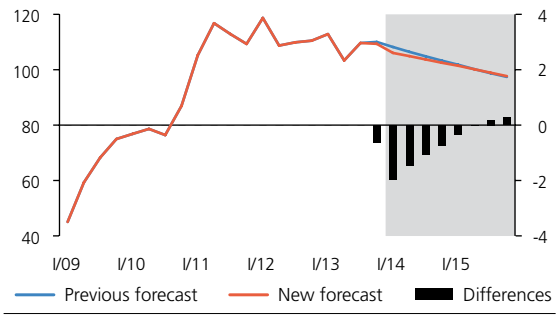


CHART II.1.6

PRICE OF BRENT CRUDE OIL

The market outlook for the crude oil price expects a gradual decline over the entire forecast horizon
(USD/barrel; differences in % – right-hand scale)



The low market outlook for **3M EURIBOR rates** over the entire forecast horizon reflects expectations of continued accommodative ECB monetary policy, which in turn reflects deflation risks at the shorter horizon and the absence of major inflationary pressures in the medium term. The market outlook expects the 3M EURIBOR to average 0.3% this year and 0.5% in 2015 (see Chart II.1.4). Compared to the previous forecast, this means a shift towards lower levels. The market has thus taken into account the decrease in the ECB's main refinancing rate from 0.5% to 0.25% (on 7 November) and the communication of the option of even easier monetary policy going forward. The market outlook for interest rates is about 0.1 percentage point higher over the entire forecast horizon than the expectations of the analysts surveyed in the January CF. Most analysts expect the ECB's main refinancing rate to stay at the current level of 0.25% at least until the end of 2014.

The outlook for the **euro-dollar exchange rate** still foresees a trend of weakening of the euro over the entire forecast horizon (see Chart II.1.5). The outlook for a weakening euro reflects expectations of solid growth of the US economy and tapering of the quantitative easing programme in the USA, whereas the ECB is ready to ease monetary policy further if needed. The euro-dollar exchange rate is thus expected to be USD 1.32 on average this year. The euro depreciation trend should continue into 2015, when the euro-dollar exchange rate is expected to average USD 1.28. Compared with the previous forecast, this means an upward shift over the entire outlook due to a stronger initial level of the euro.

The outlook for the **Brent crude oil price** based on market futures continues to expect a falling path over the entire forecast horizon (see Chart II.1.6). The expected evolution of oil prices is affected by economic factors (growth in the oil supply coupled with only slowly accelerating global growth, and the tapering of quantitative easing in the USA) and geopolitical factors (the situation in the Middle East and North Africa). The oil price is expected to fall from its current level of roughly USD 106 a barrel to about USD 98 a barrel at the end of 2015. The current market outlook thus remains almost unchanged from the previous forecast. The analysts surveyed in the January CF predict a slower downward trend over the 12-month horizon compared to the market outlook, i.e. Brent crude oil USD 4 a barrel higher at the start of 2015.

II.2 THE FORECAST

Annual headline inflation dropped slightly on average in 2013 Q4. The forecast expects it to decline by another one percentage point at the start of 2014, with a modest rise in net inflation being outweighed by a sizeable fall in administered prices and an unwinding of the first-round effects of the VAT changes made last year. Owing to rising import prices, inflation will then rise and both headline and monetary-policy relevant inflation will return to the CNB's 2% target at the end of 2014. In early 2015, inflation will rise further amid renewed growth in administered prices and will move into the upper half of the tolerance band at the monetary policy horizon. It will then return to the target from above. The inflationary effect of import prices reflects depreciation of the koruna amid subdued producer price inflation abroad. The domestic economy will start to contribute to price growth in mid-2014, primarily because of a recovery in wage growth. The economy will grow by 2.2% this year, after last year's GDP decline, thanks to a recovery in external demand and the easing of the monetary conditions executed through the koruna's exchange rate. In 2015, GDP growth will pick up further to 2.8%. The economic recovery will start to have a favourable effect on the labour market. The forecast assumes market interest rates to be flat at their current very low level and the exchange rate to stay at CZK 27 to the euro until the start of next year. This exchange rate level continues to deliver the necessary easing of the monetary conditions.

Annual **headline inflation** dropped slightly to 1.1% on average in 2013 Q4, staying just above the lower boundary of the tolerance band around the CNB's target. However, the December data (1.4%) reflected the effect of the exchange rate weakening, which was about 0.2 percentage point. According to the forecast, headline inflation will dive by about one percentage point at the start of 2014, mainly due to the unwinding of the effect of the VAT changes made in January 2013 and to an expected fall in administered prices. Headline inflation will thus diverge even further from the CNB's target, reaching very low levels (see Chart II.2.1), although the threat of deflation has probably been averted thanks to the easing of the monetary conditions. Inflation will return to the target at the end of 2014 thanks to a pick-up in all market components of inflation and to a slower decline in administered prices. The increase in the market components of inflation will initially stem mainly from accelerating growth in import prices connected with the weakening of the exchange rate. Starting in the second half of this year, however, consumer price inflation will also be strongly affected by a domestic economic recovery and rising wages. Amid renewed annual growth in administered prices, headline inflation will temporarily approach the upper boundary of the tolerance band around the target at the start of next year. It will then slow again in 2015 H2 and approach the 2% target from above. Average inflation will thus be 1.2% this year (the second lowest figure in the last ten years) and 2.6% in 2015.

CHART II.2.1

HEADLINE INFLATION AND MONETARY-POLICY RELEVANT INFLATION

Both headline and monetary-policy relevant inflation will fall to very low levels at the start of 2014 and then increase into the upper half of the tolerance band at the monetary policy horizon
(year on year in %)

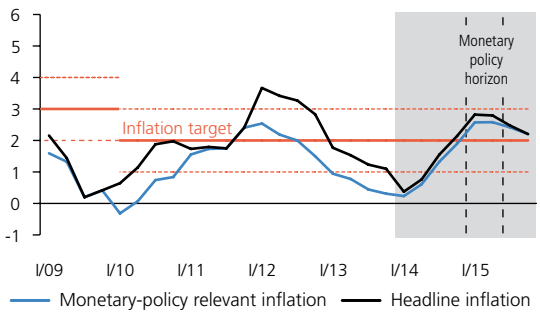


CHART II.2.2

ADMINISTERED PRICES AND FUEL PRICES

Administered prices will fall this year, while fuel prices will rise slightly
(annual percentage changes; fuel prices excluding first-round effects of indirect tax changes)

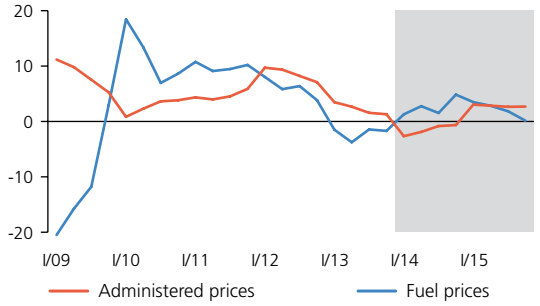


TABLE II.2.1

FORECAST OF ADMINISTRATIVE EFFECTS

The fall in administered prices in 2014 will be due to a sharp decline in electricity prices
(annual percentage changes; impacts in percentage points)

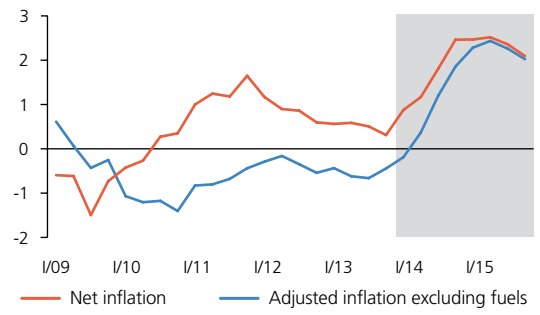
	2013 actual		2014 forecast		2015 forecast	
Administered prices – total[a)]	1.0	0.17	-0.6	-0.10	2.7	0.47
of which (main changes):						
electricity	2.7	0.12	-10.2	-0.45	3.5	0.15
natural gas	-7.0	-0.20	2.4	0.07	-0.5	-0.02
heat	3.8	0.08	3.5	0.07	5.0	0.10
water	6.6	0.06	3.5	0.03	6.0	0.06
health care	0.2	0.00	3.0	0.05	2.0	0.04
First-round impacts of tax changes in non-administered prices		0.70		0.25		0.00

a) Including effects of indirect tax changes

CHART II.2.3

NET INFLATION AND ADJUSTED INFLATION EXCLUDING FUELS

Market price inflation will rise quite quickly owing to the weakened exchange rate and recovering economic activity
(year on year in %)



Monetary-policy relevant inflation, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, was 0.3% on average in 2013 Q4, remaining well below the lower boundary of the tolerance band around the target. Over the forecast horizon it will follow a similar path to headline inflation, although at a slightly lower level owing to the first-round effects of changes to indirect taxes.

The contribution of changes to **indirect taxes** to non-administered prices averaged 0.7 percentage point in 2013 Q4. The first-round effect on annual headline inflation was 0.8 percentage point. This was a result of an increase in both VAT rates of one percentage point in January 2013 and a "harmonisation increase" in excise duty on cigarettes. The forecast assumes another harmonisation increase in excise duty on cigarettes in 2014. Its effect on headline inflation is estimated at about 0.25 percentage point.[2] Because of the usual frontloading of cigarettes, the forecast expects later pass-through of the above tax change to consumer prices. As in past years, this pass-through is assumed to be full. No changes to indirect taxes are yet foreseen by the forecast for 2015.

Annual **administered price inflation** fell to 1.3% on average in 2013 Q4 (including the effect of the VAT increase; see Chart II.2.2). This was chiefly due to slowing price growth in health care together with falling growth in electricity prices, as one of the major distributors (PRE) lowered prices for final customers back in December. Administered prices will drop by 2.7% year on year at the start of 2014. This sharp fall will stem mostly from a large decline in prices of electricity for households, including a drop in electricity generation prices, a decrease in households' contribution to support for renewable sources and a reduction in distribution fees. Year-on-year growth in water supply and sewerage collection charges and heat prices will decrease as well. Prices of gas for households will continue to show a significant year-on-year decline, which will deepen slightly at the start of the year. The decline in administered prices will start to slow gradually in 2014 Q2 owing to base effects and to the effect of renewed growth in prices of gas for households in the second half of the year. This is linked with an expected slowdown in the fall in global gas prices and a weaker koruna-dollar exchange rate. In early 2015, administered price inflation will return to positive, although relatively low, year-on-year levels (see Table II.2.1).

Annual **net inflation** fell slightly to 0.3% on average in 2013 Q4, as adjusted inflation excluding fuels turned less negative (see Chart II.2.3). At the end of the year, net inflation was already being

2 The Czech Republic is obliged to comply with a specific minimum excise duty requirement of EUR 90 per 1,000 cigarettes with effect from 1 January 2014. According to the directive, the requirement must be met on the basis of the koruna-euro exchange rate as of the first working day of October 2013. Because the koruna-euro rate is weaker than when the legislation was adopted in 2012, the Ministry of Finance has proposed a higher increase in excise duty on tobacco products. The legislation has not yet been adopted, but the forecast expects it to take effect in 2014 H1.

affected by the weaker exchange rate of the koruna. In December it stood at 0.8%. The forecast expects a further modest increase in net inflation in January this year, with annual fuel price inflation rising further due to the weaker koruna and the year-on-year decline in prices in the segment of adjusted inflation excluding fuels slowing down. The latter will turn positive in 2014 Q2, and its subsequent gradual rise will be reflected in net inflation, which will reach around 2.5% at the end of this year. Net inflation will stay close to that level at the start of 2015 and will then fall back slightly.

Annual adjusted inflation excluding fuels turned less negative in 2013 Q4, thanks partly to base effects. However, it continued to reflect the anti-inflationary effect of the domestic economy in the form of weak consumer demand and low wage growth. Adjusted inflation excluding fuels will approach zero in the near future and then turn positive (see Chart II.2.3). This shift will stem mainly from rising growth in import prices connected with the weakening of the exchange rate. In an environment of renewed inflation pressures from the domestic economy, adjusted inflation excluding fuels will then gradually increase to 2.4% in mid-2015. It will slow slightly at the end of 2015.

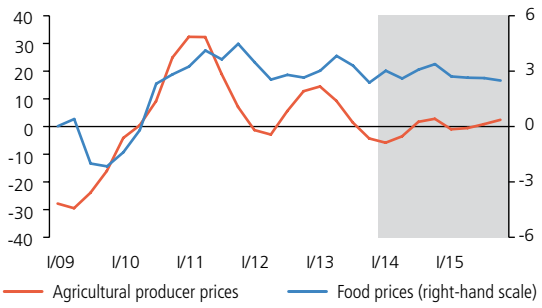
Annual **food price inflation** (excluding the first round effect of tax changes) fell on average in 2013 Q4. However, an upswing in growth connected with the weakening of the exchange rate of the koruna was already visible in December. Annual food price inflation will remain close to 3% in 2014 Q1, among other things as a result of faster growth in prices of imported food commodities (see the Box below for the import intensity of consumption including food). Food prices will pick up slightly further in 2014 H2 as a result of renewed growth in agricultural producer prices (see Chart II.2.4) and a recovery in the domestic economy. Growth in prices of imported food and domestic prices in agriculture will slow significantly in 2015. Growth in consumer prices of food will subsequently slow to 2.6% on average, despite a continued economic recovery.

CHART II.2.4

FOOD PRICES AND AGRICULTURAL PRODUCER PRICES

Food prices will rise at a rate of around 3%, while the current decline in agricultural producer prices will fade away during 2014

(annual percentage changes)



BOX

Effects of the weakened exchange rate on consumer prices (input-output analysis)

This box quantifies the cost impacts of the weakened exchange rate of the koruna on prices following the CNB's decision to use the exchange rate as a monetary policy instrument. The CZSO's symmetric input-output tables were used to this end. These tables enable us to analyse nominal flows among economic sectors, the structure of value added and the components of final use during a single year.[3] Among other things, they

3 The CZSO usually publishes symmetric input-output tables at a five-year frequency. The currently available data are for 2010.

TABLE 1 (BOX)

IMPORT INTENSITY OF PRODUCT GROUPS AND HOUSEHOLD CONSUMPTION

The most import-intensive items are computers and basic metals, but their weight in the consumer basket is negligible; the opposite is true for services
(in %)

Product class	Weight in the CPI	Import intensity	
		Total	Direct
Food	24.6	35	25
Energy	11.8	48	37
Raw materials excluding oil	1.6	43	36
Medicines and health care	2.3	50	44
Basic metals	0.0	66	58
Motor vehicles	3.5	41	30
Computers	0.7	81	78
Machinery and equipment	0.3	58	50
Other products and semi-finished products	16.5	56	47
Services	38.8	14	6
Total consumption	100.0	33	24

TABLE 2 (BOX)

EFFECT OF A PERMANENT 5% WEAKENING OF THE EXCHANGE RATE ON PRODUCT PRICES AND THE CPI

The weaker exchange rate has a larger effect on products with low weights in the consumer basket
(in %)

Product class	Weight in the CPI	Long-term effect	Direct effect
Food	24.6	1.8	1.2
Energy	11.8	2.4	1.9
Raw materials excluding oil	1.6	2.1	1.8
Medicines and health care	2.3	2.5	2.2
Basic metals	0.0	3.3	2.9
Motor vehicles	3.5	2.1	1.5
Computers	0.7	4.1	3.9
Machinery and equipment	0.3	2.9	2.5
Other products and semi-finished products	16.5	2.8	2.3
Services	38.8	0.7	0.3
CPI	100.0	1.6	1.2

can be used to quantify the import intensity of individual GDP expenditure components and of each sector or product considered, broken down by CZ-CPA[4] categories.

For example, according to these data, a quarter of all foods (see Table 1) are imported directly. However, imported inputs are further used in domestic food production. The overall import intensity of food is thus higher than one-third (35%). The most import-intensive items are computers, metals, machinery and equipment, and medicines, but their aggregate weight in the consumer basket is small. By contrast, services have a very low import intensity, but have the greatest weight in the consumer basket. Overall, the direct import intensity of household consumption is around one-quarter and its total import intensity is around one-third.

The cost effect of the weakened exchange rate on prices of individual product classes can be assessed using the estimated import intensities. The impact of a permanent 5% weakening of the koruna assuming 100% pass-through to product prices is quantified in Table 2. For example, food prices should rise by 1.2% directly and by 1.8% in the longer term as a result of such an exchange rate weakening. Both the direct and long-term effects for services amount to less than 1%. The total long-term effect of the weakened exchange rate on the consumer price index is estimated at 1.6%.[5]

These results only partially estimate the pass-through of the exchange rate to prices. On the one hand, retailers may in practice slow the rise in prices over a one-year period by compressing their mark-ups, so the pass-through of higher import prices into consumer prices may not be complete. On the other hand, the estimate does not take into account the impacts of the weakened exchange rate on economic activity, wages and so on, which also affect prices in the longer term. These effects on mark-ups and macroeconomic growth are identified comprehensively in CNB forecasts. The November and December 2013 inflation figures suggest that the effect of the weakened exchange rate on most price categories is broadly in line with the assumptions.

The annual decline in **fuel prices** deepened slightly on average in 2013 Q4, despite fuel prices showing renewed annual growth in December owing to the weakening of the koruna-dollar exchange

4 Statistical classification of products by activity.
5 The import intensity of household consumption (Table 1) and the pass-through to the consumer price index (Table 2) are computed using recalculated CPI weights corresponding to the CZ-CPA product breakdown. For this reason, the weights considered are different from official weights of the consumer basket.

rate. Growth in fuel prices will pick up in the next few quarters due to the weaker exchange rate in spite of muted annual growth in global prices of crude oil and petrol. In 2015, fuel price growth will slow noticeably in conditions of a year-on-year fall in oil and petrol prices on world markets (see Chart II.2.5).

Interest rates on the domestic money market fell slightly in 2013 Q4 due to an increase in excess koruna liquidity after the CNB's interventions in the foreign exchange market. The forecast assumes market interest rates to be flat at their current very low level until the start of 2015, reflecting the 2W repo rate being left at technical zero and an unchanged money market premium. Market rates are forecasted to increase by about 0.7 percentage point in 2015 (see Chart II.2.6).

After the CNB decided in November to start using the exchange rate as an instrument for easing monetary policy, **the koruna** depreciated to CZK 27.7 **against the euro**. The average level for 2013 Q4 thus shifted to CZK 26.7 to the euro. The short-term forecast for 2014 Q1 assumes an exchange rate of CZK 27.3 to the euro. This level corresponds to the current average exchange rate and to the assumed subsequent return of the rate to CZK 27 to the euro, which, according to the analyses, is still sufficient to avert the threat of deflation and facilitate a faster economic recovery and a faster return of inflation to the CNB's target. According to the forecast, the exchange rate should stay at this level as long as easy monetary conditions are needed, i.e. until early 2015. During this period, domestic inflationary pressures should be sufficiently renewed thanks to an economic recovery and rising wages, allowing for a return to conventional monetary policy at the start of 2015. However, this return will not imply appreciation of the exchange rate to the level recorded before the CNB started intervening, as the weaker exchange rate of the koruna will in the meantime pass through to the price level and other nominal variables. Given the CF outlook for a gradually depreciating euro against the dollar (see section II.1), this implies depreciation of the koruna-dollar rate this year.

Quarterly growth in **nominal marginal costs in the consumer goods sector** picked up in 2013 Q4 from very low levels in the previous period (see Chart II.2.7). This pick-up was due to an increase in the contribution of import prices connected with the weakening of the koruna exchange rate at the end of 2013. By contrast, the effect of the domestic economy, approximated by intermediate goods price inflation, remains anti-inflationary owing to a continuing subdued economic activity and very low nominal wage growth in the business sector. The estimated impact on inflation of growth in export-specific technology, linked to different productivity growth in the areas of tradables and non-tradables (the Balassa-Samuelson effect), has been less marked than in the pre-crisis period for some time now. The overall upward pressures on consumer prices will gradually build over the forecast horizon. Despite very low foreign producer price inflation, import prices will continue to foster higher costs in

CHART II.2.5

FUEL PRICES AND OIL PRICES

Fuel prices will rise slightly in spite of muted annual growth in crude oil prices
(annual percentage changes)

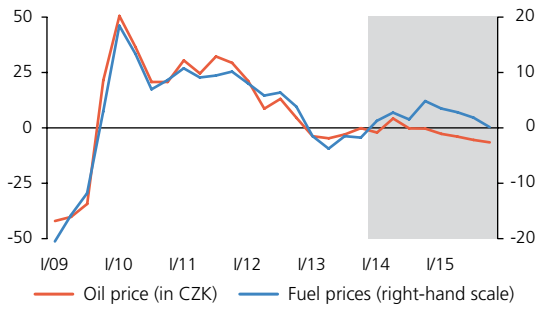


CHART II.2.6

INTEREST RATE FORECAST

The forecast assumes market interest rates to be flat at their current very low level until the start of 2015
(percentages)

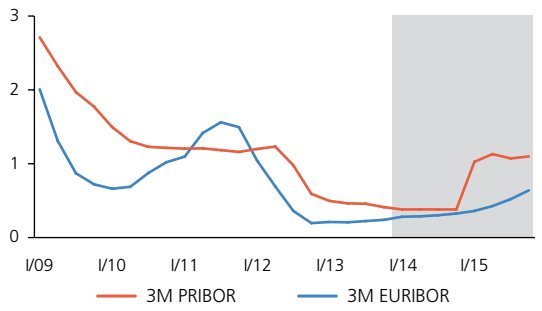


CHART II.2.7

COSTS IN THE CONSUMER SECTOR

The overall inflationary pressures in the consumer sector will increase, initially due to import prices and later also to the domestic economy
(quarterly percentage changes; contributions in percentage points; annualised)

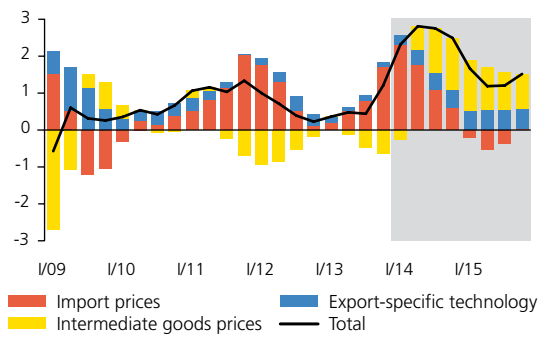


CHART II.2.8

COSTS IN THE INTERMEDIATE GOODS SECTOR

Domestic costs will rise mainly due to accelerating wage growth

(quarterly percentage changes; contributions in percentage points; annualised)

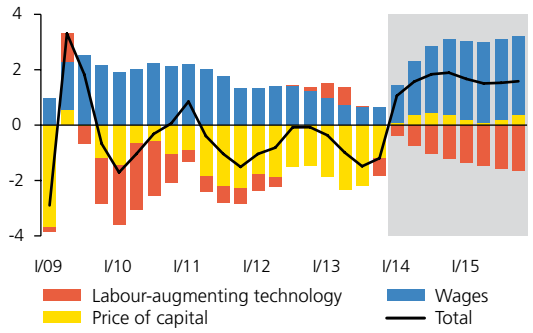


CHART II.2.9

GAP IN PROFIT MARK-UPS IN THE CONSUMER SECTOR

The gap in profit mark-ups will be negative until the middle of next year

(percentages)

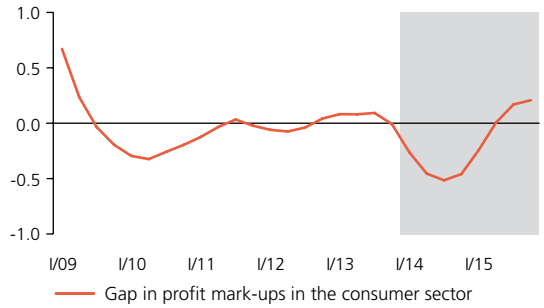
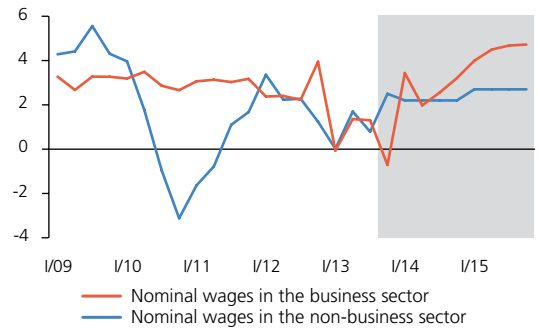


CHART II.2.10

AVERAGE NOMINAL WAGE

Wage growth will pick up noticeably from its current low levels as economic activity recovers

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



the consumer sector due to the stable weakened exchange rate of the koruna. This effect will be strongest in early 2014. After the exit from the regime of using the exchange rate as an instrument for easing monetary policy – in early 2015 according to the assumptions of the forecast – import prices will temporarily turn slightly anti-inflationary, even though foreign producer prices will rise. The anti-inflationary effect of the domestic economy will dissipate by mid-2014 and the domestic economy will then foster price growth as a result of an assumed upswing in wage growth and a recovery in economic activity. The contribution of export-specific technology will also increase as the economy recovers.

Nominal marginal costs in the intermediate goods sector continued to decline in 2013 Q4. Nominal wage growth in the business sector remained very low (adjusted for the one-off effect of tax optimisation) and was thus outweighed by the still declining price of capital, which reflects the subdued economic activity and weak investment activity (see Chart II.2.8). Domestic nominal costs will begin to rise again relatively quickly in early 2014 due to accelerating wage growth, which will be fostered by a gradual recovery in external demand and a weaker exchange rate. However, the cost pressures stemming from nominal wage growth will be partly offset by faster productivity growth. The price of capital will also make a slightly positive contribution to the increase in costs as from the start of 2014, due to the recovery in economic activity and the weaker exchange rate of the koruna.

The estimated gap in **profit mark-ups in the consumer goods sector** was broadly neutral in 2013 Q4, with mark-ups reflecting the increase in costs resulting from the weaker exchange rate (see Chart II.2.9). The gap in profit mark-ups will turn negative at the start of the forecast horizon, since costs will grow faster than prices given the weaker exchange rate. The second half of the year will see a gradual equalisation of profit mark-ups in an environment of recovering economic activity. The gap in profit mark-ups will turn positive in mid-2015.

The year-on-year decline in whole-economy **labour productivity** moderated further in 2013 Q4. Labour productivity growth will turn positive at the start of this year and will gradually rise to around 3% in the second half of the year. Next year it will slow to 2%. With employment staying flat in 2014 and rising only slightly in 2015, the path of labour productivity will be influenced mainly by the profile of economic activity.

The average nominal **wage in the business sector** recorded a year-on-year increase of 1.4% in 2013 Q3. Wage growth adjusted for fluctuations due to tax optimisation will remain close to this level until 2014 Q1. After adjustment for tax optimisation, the wage in the business sector increased by just 0.4% in 2013 as a whole. Wage growth will increase noticeably to 2.8% on average in 2014 and 4.5% in 2015 as economic activity continues to recover this year (see

Chart II.2.10). Gross wages will be partly affected by a change in health insurance contributions next year, as 2 percentage points of the health insurance rate previously paid by employers will be paid by employees. As regards this change, the forecast expects a partial increase in gross wages of 0.3% of the average gross nominal wage in 2015 H1. Nevertheless, the size of this effect is subject to uncertainty.

Growth in the nominal **wage in the non-business sector** slowed to 0.8% in 2013 Q3. According to the forecast, wage growth accelerated again to 2.5% in 2013 Q4. The average wage in this sector will increase by 2.2% this year and pick up to 2.7% in 2015 on the back of higher nominal GDP growth.

Real GDP in 2013 Q3 recorded a year-on-year decline of 1.2% and a quarter-on-quarter increase of 0.2% (see Chart II.2.11). The annual decline was fostered by net exports and gross fixed capital formation, while the positive contribution of changes in inventories and government consumption acted in the opposite direction (see Chart II.2.12). The forecast assumes that **economic activity in 2013 Q4** rose by 0.1% year on year and 0.9% quarter on quarter. The sharp year-on-year fall in gross capital formation continued. By contrast, household consumption is expected to increase slightly. Net exports and government consumption also probably made a positive contribution to annual growth in economic activity. Frontloading of cigarettes ahead of the increase in excise duty in 2014 also had a significant effect. **Real economic activity in 2013** recorded an overall decrease of 1.3%, government consumption being the only component to make a positive contribution.

GDP will grow by 2.2%[6] **in 2014** as the economic recovery fosters an easing of the monetary conditions through a weaker koruna exchange rate (whose effect amounts to around 1 percentage point) and as the previous years' dampening factors subside. The forecast assumes more robust growth in external demand and a broadly neutral effect of fiscal policy. The contribution of government consumption to GDP growth will be slightly positive and growth in government investment is expected to rebound. Household consumption will rise more significantly on the back of moderately accelerating wage growth and low inflation. Gross capital formation will be broadly flat. As a result of a recovery in external demand and the weaker exchange rate, net exports will contribute positively to GDP growth, but will be partly dampened by a gradual recovery in import-intensive domestic demand.

CHART II.2.11

GDP GROWTH FORECAST

GDP will return to growth this year
(percentage changes; seasonally adjusted)

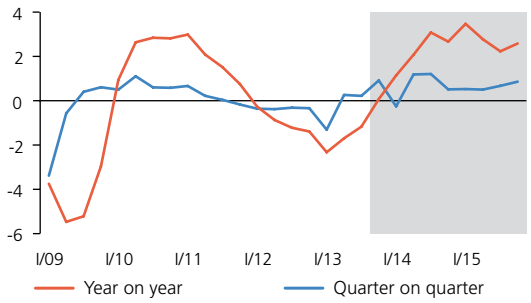
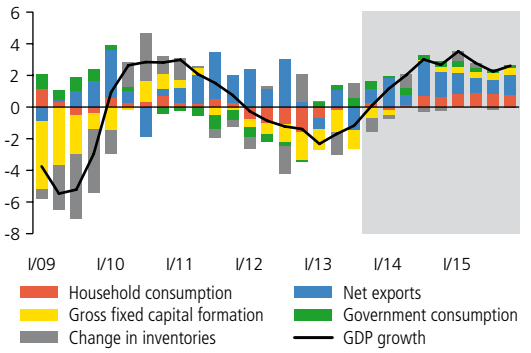


CHART II.2.12

ANNUAL GDP GROWTH STRUCTURE

All components of demand will contribute positively to GDP growth over the forecast horizon
(annual percentage changes; contributions in percentage points; seasonally adjusted)



6 GDP growth will be significantly affected by cigarette frontloading by producers at the end of 2013 owing to the increase in excise duty on cigarettes. Net of this effect, GDP growth would be around 2.5% in both 2014 and 2015.

CHART II.2.13

NUMBER OF EMPLOYEES (FULL-TIME EQUIVALENT)

The converted number of employees will start to rise in 2014 Q2 as the economy recovers
(annual percentage changes; contributions in percentage points)

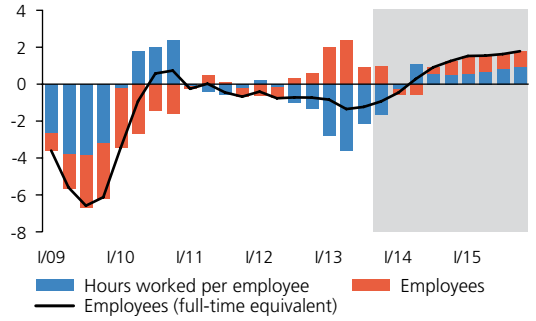


CHART II.2.14

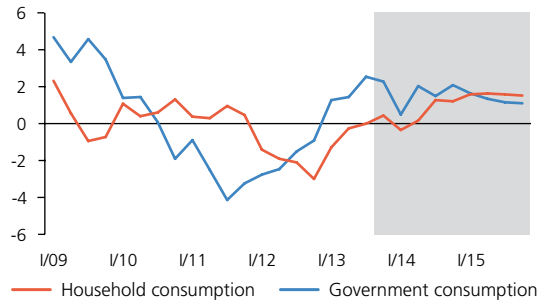
LABOUR MARKET FORECAST

Annual growth in total employment will fall and the unemployment rate will rise slightly further
(annual percentage changes in employment; general unemployment rate in percentages; seasonally adjusted)

CHART II.2.15

REAL HOUSEHOLD AND GOVERNMENT CONSUMPTION

Household consumption and government consumption will rise gradually over the forecast horizon
(annual percentage changes; seasonally adjusted)



GDP growth will reach 2.8% **in 2015**, boosted by a more pronounced recovery in domestic demand. In addition to household consumption, gross capital formation will make a positive contribution. Thanks to a continuing recovery abroad the contribution of net exports will also be positive despite continued growth in imports of consumer goods and intermediate goods for production of export goods.

The observed annual decline in the **number of employees converted into full-time equivalents** will gradually moderate in the coming quarters (see Chart II.2.13). Following a recovery in economic activity, the converted number of employees will start to rise again in 2014 Q2 and its growth rate will be close to 2% at the end of 2015. **Total employment** will rise in year-on-year terms until 2014 Q1, albeit at a considerably slower pace than in the previous year (see Chart II.2.14). After recording a decline in 2014 Q2, partly due to base effects, it will flatten out. Total employment will start growing more significantly during 2015 as a result of a recovery in economic activity.

The forecast assumes that the seasonally adjusted **general unemployment rate** was flat at 7% in 2013 Q4. Persisting growth in the labour force will exert slight upward pressure on the general unemployment rate over the forecast horizon, causing it to rise to around 7.5% in 2015 H1. A gradual increase in employment – linked with an economic recovery fostered by growth in external demand and the easing of monetary policy – will act in the opposite direction. This factor will prevail at the longer end of the forecast and the general unemployment rate will start to go down gradually (see Chart II.2.14). Over the next few quarters, a continuing increase can also be expected for the seasonally adjusted **share of unemployed persons according to the MLSA**, which will rise to just above 8% owing to a further cyclical increase in the number of job applicants registered with labour offices and a steady decrease in the population aged 15–64. However, the share of unemployed persons will start to decline gradually in 2014 H2 as the economy recovers.

Real **household consumption** was flat in year-on-year terms in 2013 Q3 (see Chart II.2.15). The forecast assumes that growth in consumption recovered in 2013 Q4 owing, among other things, to the weakening of the koruna exchange rate and related increased purchases of durable goods. A rise in consumer demand is also suggested by the available leading indicators, especially retail sales in November 2013 (see section III.3). The consumer confidence indicator also increased further in late 2013 and early 2014. However, household consumption declined by 0.3% in 2013 as a whole. Although household consumption will slow temporarily at the start of this year, since a partial correction of the higher purchases observed at the end of 2013 is expected, it will be supported in the coming quarters by growth in the real volume of wages and salaries. Household consumption will thus pick up gradually as economic activity recovers and the effects of fiscal consolidation unwind. A decline in real interest rates will also foster higher household consumption.

Gross nominal disposable income decreased by 0.9% in nominal terms in 2013 as a whole, mainly because of a slight decline in the volume of wages and salaries. Its low and volatile annual growth rate during the year was strongly affected by the tax optimisation observed in late 2012 and early 2013 (see Chart II.2.16). The annual growth rate of wages and salaries will pick up markedly at the start of the year, first as a result of the fading effect of tax optimisation, and from mid-2014 onwards also due to a recovery in the labour market. According to the expectations of the forecast, social benefits will record positive, albeit gradually shrinking, contributions over the forecast horizon. Overall, nominal gross disposable income will rise by 2.8% this year and pick up to 4.5% in 2015.

According to the forecast, the seasonally adjusted **household saving rate** continued to decline moderately at the end of 2013 (see Chart II.2.17). The saving rate will return slightly above 10% at the start of this year owing to quicker growth in wages and salaries and a short-term weakening of annual growth in nominal household consumption. It will remain at a similar level over the entire forecast horizon.

As assumed in the forecast, real **government consumption** increased by 1.9% last year. It will maintain slightly lower growth in 2014 and 2015 (see Chart II.2.15). These developments will be driven on the one hand by increasing growth in nominal government consumption, linked with an easing of the hitherto restrictive fiscal policy, and on the other hand by a rise in the growth rate of its deflator from the current low levels.

The year-on-year decline in **gross capital formation** slowed significantly in 2013 Q3, almost exclusively due to strong replenishment of inventories. The forecast expects the year-on-year decline in fixed investment to moderate gradually and fixed investment to turn positive in 2014 H2 as domestic and external demand recovers and real interest rates fall. The recovery in investment growth will also be aided by sufficient credit financing from the Czech banking sector. The growth rate of overall gross capital formation will be significantly affected again by frontloading by cigarette producers in late 2013 and early 2014 due to a further increase in excise duty on tobacco products as of 1 January 2014. After falling by 6.3% in 2013, gross capital formation will be broadly flat this year (see Chart II.2.18). It will rise by 2.7% in 2015, owing primarily to fixed investment.

Real **exports of goods and services** were again very muted in 2013 Q3. However, the forecast expects a sizeable recovery in annual export growth in 2013 Q4, driven by favourable developments in foreign orders in industry (see Chart II.2.19) connected with the recovery in external demand. However, exports of goods and services will rise only marginally overall for 2013 as a whole. Stronger export growth will be observed in 2014, when exports will rise at a pace of around 9% given accelerating growth in external demand and the expected favourable effect of the weaker koruna. In 2015, the growth rate will slow to 6.6%.

CHART II.2.16

NOMINAL DISPOSABLE INCOME

Disposable income growth will gradually accelerate this year and the next thanks mainly to growth in wages and salaries
(annual percentage changes; contributions in percentage points)

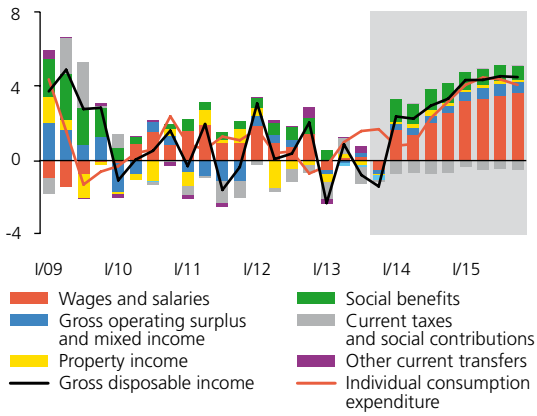


CHART II.2.17

HOUSEHOLD SAVING RATE

The saving rate will fluctuate just above the 10% level over the forecast horizon
(percentages)

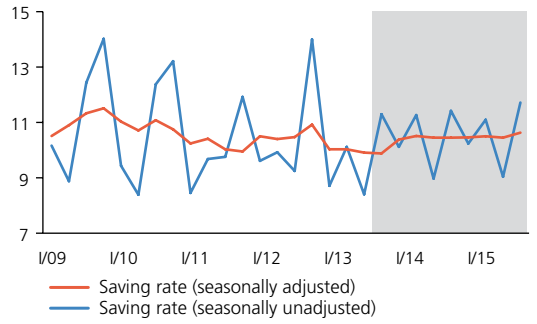


CHART II.2.18

GROSS CAPITAL FORMATION

Gross capital formation will be broadly flat this year and return to growth in 2015
(annual percentage changes; seasonally adjusted)

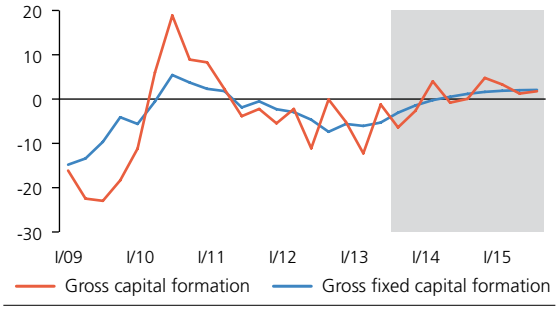


CHART II.2.19

REAL EXPORTS AND IMPORTS

Export and import growth will pick up pace as foreign and domestic demand recovers, aided in 2014 by the weakened exchange rate
(annual percentage changes; annual changes in CZK billions; seasonally adjusted)

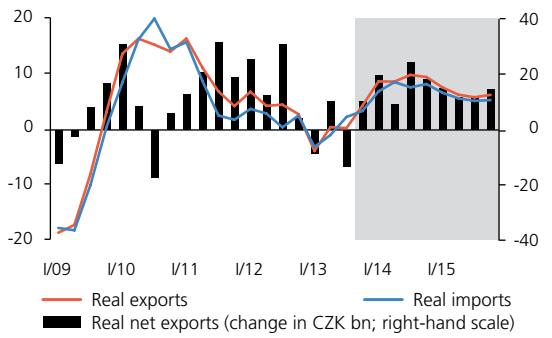


TABLE II.2.2

FORECASTS OF SELECTED VARIABLES

Real disposable income will rise as wage growth picks up, and labour productivity will also start to increase
(annual percentage changes unless otherwise indicated)

	2012 actual	2013 exp. outc.	2014 forec.	2015 forec.
Real gross disposable income of households	-1.3	-2.2	1.5	1.8
Total employment	0.4	0.9	0.0	0.2
Unemployment rate (in per cent)[a)]	7.0	7.1	7.4	7.4
Labour productivity	-1.4	-2.1	2.3	2.5
Average nominal wage	2.7	0.5	2.7	4.2
Average nominal wage in business sector	2.8	0.3	2.8	4.5
Current account balance (ratio to GDP in per cent)	-2.4	-1.0	0.5	0.5
M2	5.6	4.4	4.4	4.6

a) ILO methodology, 15–64 years

TABLE II.2.3

BALANCE OF PAYMENTS FORECAST

The current account should show a modest surplus as from 2014
(CZK billions)

	2012 actual	2013 exp. outcome	2014 forec.	2015 forec.
A. CURRENT ACCOUNT	-94.0	-40.0	20.0	20.0
Trade balance	145.8	195.0	245.0	260.0
Balance of services	49.8	50.0	55.0	60.0
Income balance	-288.7	-300.0	-320.0	-340.0
Current transfers	-1.0	15.0	40.0	40.0
B. CAPITAL ACCOUNT	51.7	75.0	60.0	60.0
C. FINANCIAL ACCOUNT [a)]	121.8	73.0	0.0	60.0
Direct investment	181.1	25.0	40.0	75.0
Portfolio investment	42.6	98.0	0.0	5.0
Financial derivatives	8.6			
Other investment	-110.6	-50.0	-40.0	-20.0
D. ERRORS AND OMISSIONS	1.0			
E. CHANGE IN RESERVES (- = increase)	-80.5			

a) forecast and expected outcome excluding operations of banking sector and financial derivatives

Real **imports of goods and services** switched to year-on-year growth in 2013 Q3. However, this was due mainly to strong replenishment of import-intensive inventories. According to the forecast, imports rose by 0.4% in 2013 as a whole. Growth in imports of goods and services will rise to 7.9% in 2014 and 5.8% in 2015 on the back of accelerating export growth, a high import intensity of exports and a slowing downturn in domestic demand. This rise, however, will be counteracted – where possible – by substitution of imported goods by domestic goods due to the increased price competitiveness of Czech producers.

Net exports at constant prices made a sizeable negative contribution to annual GDP growth in 2013 Q3 (-1.4 percentage point). This, however, was largely due to a one-off increase in imports linked with replenishment of inventories from very low levels. Over the entire forecast horizon, by contrast, the contribution of net exports to annual GDP growth will be positive, reaching 1.2 percentage point in 2014 and 0.8 percentage point in 2015.

The balance of payments forecast expects the **current account** to continue to improve (see Table II.2.3). In relative terms, this means a shift from a deficit of 1% of GDP in 2013 to a surplus of 0.5% of GDP this year and the next. In 2014, this will be due to a continuing increase in the goods and services surplus (in particular the trade surplus) and the current transfers balance. The rise in the goods and services balance will be associated with faster growth in external demand than in domestic demand, a weaker koruna and a slight drop in commodity prices on world markets. In 2015, the higher surplus will be due chiefly to external demand growth. A rising income deficit, linked in both 2014 and 2015 mainly with higher earnings of non-residents on foreign investment in the Czech Republic and in 2015 also with a growing deficit on interest income, will affect the current account balance in the opposite direction. Current transfers should reach record-high surpluses owing to much higher expected drawdown of EU funds compared to previous years.

The forecasted **capital account** surplus is due solely to drawdown of EU funds.[7] The year-on-year drop in the surplus compared to 2013 is caused by the unwinding of the effect of a large one-off financial transaction executed last year.

The net inflow of **direct investment** will rise slightly in 2014 compared to last year, owing to weaker interest of residents in investing abroad, lower disinvestment by non-residents and a lower outflow in the form of loans to parent companies. In 2015, the interest of non-residents in domestic investment should increase in a context of accelerating economic growth in the European and Czech economies.

7 The 50% year-on-year increase in the net drawdown of EU funds in 2014 reflects efforts to minimise non-drawdown of these funds in connection with the end of the 2007–2013 programme period.

The forecast assumes that investment will still primarily take the form of reinvested earnings, which will record an increasing net surplus. Another reason for a stronger direct investment balance should be a further gradual decline in the outflow of other capital to foreign parent companies. As regards **portfolio investment**, a significant year-on-year decrease in the positive balance towards zero is expected this year, linked chiefly with the government's intention to issue new euro-denominated bonds in lower volumes than the euro bonds maturing this year. To a lesser extent, lower foreign funding of investment by government-controlled corporations and renewed interest of residents in investing abroad due to the economic recovery will also be observed. No major change in the balance is forecasted for 2015, with rising external government debt being largely offset by stronger interest of residents in investing abroad.

The future macroeconomic developments described above and the current fiscal policy settings are reflected in the **government finance** outlook for 2013–2015 (see Table II.2.4).

According to current assumptions, the government deficit fell to 2.9% of GDP in **2013**. The annual fall in the government deficit is mainly due to the unwinding of the effect of the financial settlement with churches, which led to a one-off widening of the general government deficit in 2012 under ESA 95 methodology, and to the impact of consolidation measures. Their contribution to economic activity was negative overall, at about -0.6 percentage point. According to information on public budget performance, tax revenues were generally lower than in the alternative scenario of the previous forecast.[8] Nominal government consumption growth accelerated, with both compensation of general government employees and intermediate consumption recovering. Government investment continued to fall, but at a more moderate pace. The decrease in investment was a result of both a still subdued domestic component and lower implementation of projects co-financed from EU funds. The effects of the launch of the second pillar of the pension system were very low. The decline in the general government deficit below 3% of GDP in 2013 should enable the Excessive Deficit Procedure (EDP) to be ended on time.

A decrease in the government deficit to 2.6% of GDP is expected in **2014**, owing mainly to renewed growth in economic activity. The decrease in deficit will also be due to CZK 8.5 billion in revenues from an auction of frequency bands to mobile operators. The forecast takes into account the continuing effect of the consolidation measures adopted in 2012 (for example, a smaller increase in pensions) and the harmonisation changes made to indirect taxes, but their restrictive impact on economic growth will be offset by a significant recovery in government investment connected with the implementation of

8 In particular, excise duty and corporate income tax revenues were lower than assumed in the previous forecast, according to the available information.

Table II.2.4

FISCAL FORECAST

Fiscal consolidation will end in 2013 and fiscal policy will start to be broadly neutral or slightly loose in 2014
(% of nominal GDP)

	2012 actual	2013 exp. outcome	2014 forec.	2015 forec.
Government revenue	40.1	40.7	41.3	41.3
Government expenditure	44.5	43.6	43.9	44.1
of which: interest payments	1.5	1.5	1.6	1.7
GOVERNMENT BUDGET BALANCE	-4.4	-2.9	-2.6	-2.8
of which:				
primary balance [a)]	-2.9	-1.4	-1.0	-1.1
one-off measures [b)]	-1.5	0.0	0.2	0.0
ADJUSTED BUDGET BALANCE [c)]	-2.9	-2.9	-2.8	-2.8
Cyclical component (ESCB method) [d)]	-0.4	-0.9	-0.7	-0.4
Structural balance (ESCB method) [d)]	-2.5	-2.0	-2.1	-2.3
Fiscal stance in pp (ESCB method) [e)]	0.8	0.5	-0.1	-0.2
Cyclical component (EC method) [d)]	-0.4	-1.2	-0.8	-0.3
Structural balance (EC method) [d)]	-2.5	-1.7	-2.0	-2.5
Fiscal stance in pp (EC method) [e)]	0.8	0.7	-0.3	-0.5
Government debt	46.2	47.5	48.5	49.3

a) government budget balance minus interest payments
b) 2012: impact of property settlement between state and churches. 2013–2015: impacts of pension reform. 2014: impact of auction of mobile frequencies.
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)

projects co-financed from EU funds and by continued wage growth in the government sector. In 2014, therefore, the overall effect of discretionary fiscal policy measures on economic activity will be approximately neutral.

The general government deficit can be expected to edge up to 2.8% in **2015**. This is because a tax reform[9] that will result in a considerable decline in direct tax revenue (of almost 0.6% of GDP) takes effect under the applicable legislation in 2015. The tax reform will therefore offset the positive impact of relatively robust economic growth on tax revenues. In addition, the ratio of the deficit to GDP will be increased by the unwinding of the effect of revenues from the sale of frequency bands. Fiscal policy will be slightly expansionary in 2015, making a positive contribution to economic activity of around 0.3 percentage point. As the tax reform also includes a reduction in contributions paid by employers, the slightly expansionary fiscal policy will affect both household consumption and private sector investment.

In connection with the consolidation measures, the **structural deficit** is expected to fall to 2% of GDP in 2013 but start gradually rising again in 2014.[10] The wider structural deficit coupled with the expected economic recovery will imply divergence from the medium-term objective of a general government structural deficit of 1% of GDP.

The expected evolution of the general government deficit will cause **general government debt** to increase gradually to 49.3% of GDP in 2015. In addition to the expected borrowing requirements of general government owing to persisting public finance deficits, and in addition to the positive effect of the recovery in nominal GDP growth, the prediction of this ratio reflects the release of the debt reserve created in the past, which reduces the level of debt.

A weaker recovery in general government investment activity (a more significant one than the previously considered incomplete drawdown of EU funds) is a **risk to the fiscal forecast** towards lower deficits and a more restrictive effect of fiscal policy. The direction of the new government's fiscal policy is also a source of uncertainty.

9 The reform consists mainly of changes to indirect taxes and social security contributions, a lower VAT registration threshold and higher limits for tax deductions on gifts.

10 The structural deficit is adjusted for the impact of the business cycle and extraordinary one-off operations, which in 2014 include revenues from an auction of frequency bands to mobile operators.

II.3 COMPARISON WITH THE PREVIOUS FORECAST

The forecasts for headline and monetary-policy relevant inflation for 2014 are little changed from the previous prediction,[11] with a lower outlook for administered price inflation being offset by slightly higher net inflation. The inflation forecast for 2015 is revised slightly downwards. GDP growth has been revised slightly upwards in both 2014 and 2015. This is due in 2014 to a higher outlook for investment and government consumption, and in 2015 also to a higher contribution of net exports. The expected growth rate of nominal wages in the business sector has shifted slightly upwards as a result of revisions and assumed changes in the payment of health insurance in 2015. After the discontinuation of the use of the exchange rate as a monetary policy instrument the interest rate path in the prediction is lower, mainly reflecting a lower outlook for foreign interest rates.

The forecast for annual **headline inflation** is little changed for 2014 and slightly lower for 2015 (see Chart II.3.1). The similar evolution of headline inflation in 2014 as in the previous forecast is due to a lower outlook for administered prices offsetting a slightly higher net inflation forecast reflecting stronger growth in import prices. Lower annual growth in consumer demand is dampening growth in net inflation with a lag as from 2014 H2. The assumptions regarding the impacts of changes to indirect taxes are unchanged, so the outlook for **monetary-policy relevant inflation** has changed in the same way as that for headline inflation.

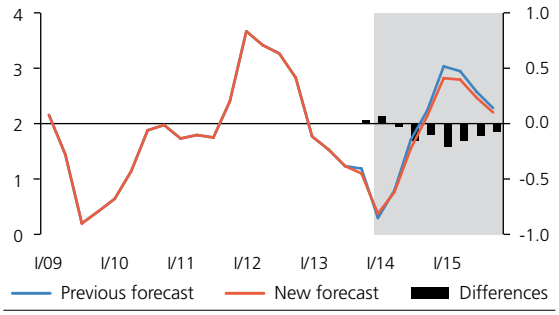
The expected annual decline in **administered prices** in 2014 is deeper than in the previous forecast, mainly because of a sharper assumed decrease in electricity prices[12] and a smaller increase in water supply and sewerage collection charges. Lower observed price growth in transport, health care and education is also acting towards lower annual administered price inflation. By contrast, the renewed administered price growth in 2015 is somewhat stronger than in the previous forecast owing to stronger growth in gas prices for households. According to the forecast, these prices will reflect the observed weakening of the koruna-dollar exchange rate with a lag.[13] Next year, prices of gas for households will also follow the assumed weaker decline in world prices of natural gas amid less pronounced year-on-year appreciation of the koruna-dollar exchange rate.

CHART II.3.1

CHANGE IN THE HEADLINE INFLATION FORECAST

The forecast for headline inflation has been revised to a slightly lower level

(year on year in %; differences in pp – right-hand scale)



11 For the purposes of this Report, the previous forecast means the alternative scenario of using the exchange rate as a monetary policy instrument contained in Inflation Report IV/2013. As a result of the Bank Board's decision of 7 November 2013 to start using the exchange rate, this alternative scenario has become the most likely description of expected future economic developments.

12 The electricity price outlook fully incorporates a decrease in administered distribution fees based on a pricing decision of the Energy Regulatory Office of 27 November 2013.

13 Counteracting the weaker koruna-dollar exchange rate will be a decrease in administered prices for gas distribution based on a decision of the Energy Regulatory Office of 27 November 2013.

CHART II.3.2

CHANGE IN THE NET INFLATION FORECAST

The forecast for net inflation is slightly higher at the start of 2014 but lower as from the middle of this year
(year on year in %; differences in pp – right-hand scale)

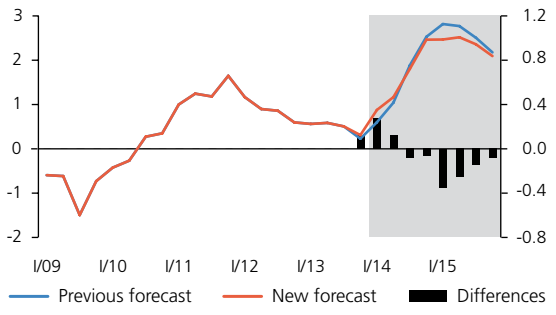


CHART II.3.3

CHANGE IN THE INTEREST RATE PATH

The market interest rate path is slightly lower in 2015 owing to a lower outlook for foreign interest rates
(3M PRIBOR in %; differences in pp – right-hand scale)

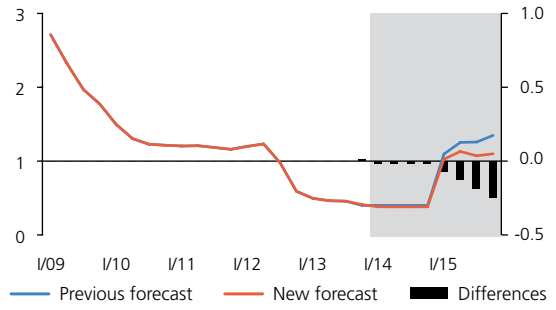
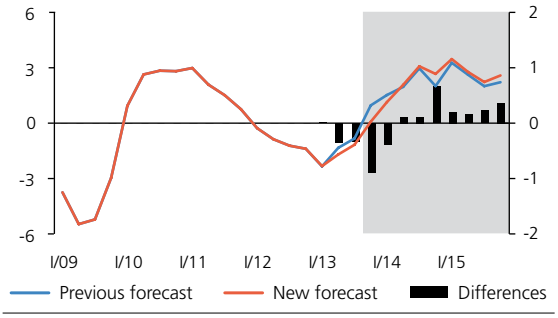


CHART II.3.4

CHANGE IN THE GDP FORECAST

The GDP growth forecast is slightly higher both this year and the next
(annual percentage changes; differences in pp – right-hand scale; seasonally adjusted)



Compared to the previous forecast, the forecast for annual **net inflation** until mid-2014 has moved slightly higher (see Chart II.3.2). As regards its components, adjusted inflation excluding fuels and food prices will record faster growth in view of the rising dynamics of import prices, which are already reflecting the weakened exchange rate. At the same time, a revision of the household consumption forecast is acting towards lower net inflation as from the second half of 2014.

Turning to the outlook for the **external environment**, expected growth in foreign producer prices has been lowered considerably compared to the assumptions of the previous forecast, partly reflecting lower outlooks for commodity prices on world markets. The 3M EURIBOR outlook is also considerably lower. The outlook for external demand growth has been revised slightly downwards at the shorter end of the forecast horizon and slightly upwards at the longer end.

The forecast for domestic market **interest rates** has shifted marginally lower as a result of a decline in the interest rate premium following the launch of foreign exchange interventions. The lower growth in the 3M PRIBOR from the start of 2015 onwards is due to a lower rate outlook abroad (see Chart II.3.3).

The national accounts data for 2013 Q3 point to a deeper decline in **GDP** in 2013. By comparison with the previous forecast, the estimate for last year is 0.4 percentage point lower (see Chart II.3.4). This is due to a lower outcome for household consumption and net exports in 2013 Q3. Government consumption growth has been revised in the opposite direction, and the drop in investment was also lower than expected as a result of an unexpected rise in inventories. GDP growth in 2014 is forecasted to be slightly higher. The structure of economic growth has also changed, with gross capital formation and government consumption contributing more to the recovery and household consumption contributing less (owing to weaker data for 2013 Q3). The GDP growth forecast for 2015 is 0.3 percentage point higher, mainly as a result of stronger export growth, which will be driven by a more marked recovery in external demand.

The contribution of **net exports** to GDP growth in 2013 was lower compared to the previous forecast, primarily reflecting new data and slightly lower growth in external demand. The effect of lower exports and higher imports stemming from the most recent observed data is partly offset in the forecast in 2013 Q4, as a rising number of foreign orders in industry suggests a faster recovery in the export sector. The contribution of net exports to GDP growth in 2014 will be lower than in the previous prediction, whereas at the longer end of the forecast net exports will be supported by stronger external demand growth.

The forecast for average **nominal wage** growth in the business sector has increased slightly compared to the previous forecast. The very subdued wage growth in the past has been revised slightly upwards. In 2015, moreover, the 0.3 percentage point impact of the change in the payment of health insurance on gross wage growth is considered, unlike in the previous forecast.

Table II.4.1

EXPECTED INDICATORS OF FMIE AND CORPORATIONS

The inflation expectations of analysts at the one-year horizon rose slightly above the CNB's target in early 2014
(at 1Y; annual percentage changes unless otherwise indicated)

	9/13	10/13	11/13	12/13	1/14
FMIE:					
CPI	1.7	1.4	1.7	1.7	2.3
CPI, 3Y horizon	2.1	2.1	2.1	2.1	2.1
Real GDP in 2013	-0.9	-0.9	-1.1	-1.3	
Real GDP in 2014	1.8	1.8	1.9	1.9	1.9
Nominal wages in 2013	0.8	0.7	0.7	0.8	
Nominal wages in 2014	2.5	2.5	2.4	2.3	2.2
CZK/EUR exchange rate (level)	25.1	25.1	26.8	26.9	26.9
2W repo rate (in per cent)	0.1	0.1	0.1	0.1	0.1
1Y PRIBOR (in per cent)	0.9	0.9	0.7	0.7	0.7
Corporations:					
CPI	2.1			2.1	

Chart II.4.1

PERCEIVED AND EXPECTED INFLATION

The inflation expectations of households increased slightly at the end of 2013
(source: European Commission Business and Consumer Survey)

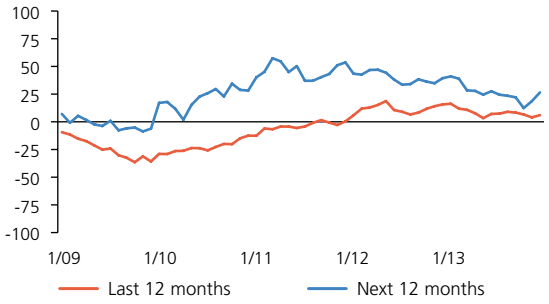


Table II.4.2

CF EXPECTED INDICATORS

The CF analysts expect the economy to return to growth following the decline in GDP last year
(at 1Y; annual percentage changes unless otherwise indicated)

	9/13	10/13	11/13	12/13	1/14
Real GDP in 2013	-1.0	-1.0	-1.1	-1.3	
Real GDP in 2014	1.8	1.8	1.8	1.8	1.9
Nominal wages in 2013	0.8	0.9	1.0	0.9	
Nominal wages in 2014	2.6	2.7	2.6	2.4	2.3
CZK/EUR exchange rate (level)	25.4	25.4	25.8	26.8	26.9
3M PRIBOR (in per cent)	0.5	0.5	0.5	0.4	0.5

II.4 FORECASTS BY OTHER ENTITIES

Analysts' inflation expectations were slightly above the CNB's target at both the one-year and three-year horizons at the start of this year. The indicator of inflation expected by households increased slightly. The analysts expect the economy to return to growth and wage growth to accelerate this year. According to the analysts, the exchange rate of the koruna should appreciate to CZK 26.9 to the euro at the one-year horizon. All the analysts were expecting stable key rates before the CNB Bank Board meeting in February and over the next twelve months. The market rate outlook one year ahead also indicates expectations of broad stability and is roughly 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 was below the CNB's target throughout 2013 and rose slightly above the target in early 2014. The inflation expectations of business managers were stable just above the CNB's target of 2% (see Table II.4.1). The inflation expected by analysts at the three-year horizon was also very close to the target.

The indicator of **inflation perceived by households** has been slightly positive since late 2011 (see Chart II.4.1). This means that households on average felt that prices rose moderately over the last 12 months. The indicator of **expected inflation** is also positive. Its gradual downward trend halted in the last two months of 2013 (i.e. after the CNB's announcement that it had started using the exchange rate as an instrument for easing monetary policy) and the indicator increased slightly. This suggests that the number of respondents who expect prices to rise more rapidly over the next 12 months is slightly higher than the number of those who expect prices to stay the same or increase more slowly than in the recent past.

Both the FMIE and CF analysts expect GDP to grow by almost 2% this year following its contraction last year (see Table II.4.1 and Table II.4.2). Next year the economy should accelerate further and wage growth should also rise from its current very subdued levels. The analysts expect the koruna to appreciate to just below CZK 27 to the euro at the one-year horizon. Before the CNB Bank Board meeting in February, all thirteen FMIE analysts were expecting no changes in key interest rates at this meeting. All the analysts also expect the 2W repo rate to be stable at 0.05% at the one-year horizon.

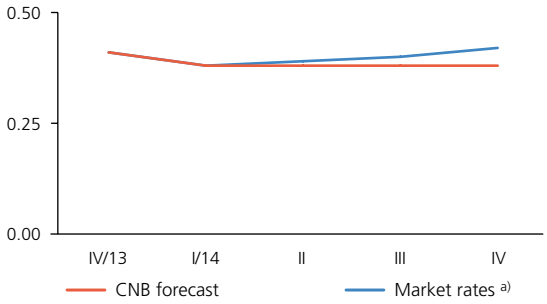
Overall, the analysts expect lower real GDP growth both this year and the next **compared to the CNB's new forecast**. Inflation expected by the analysts at the one-year horizon is lower than in the CNB forecast. The analysts' expectations regarding the 2W repo rate and market rates are broadly in line with the 3M PRIBOR path consistent with the CNB forecast until the end of this year.

Chart II.4.2 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 for 3M rates implies expected broad stability at least until the end of this year. This is roughly in line with the prevailing expectations of monetary policy interest rates being left at technical zero and with the current money market premium. Over the entire horizon the market outlook is close to the interest rate path consistent with the new CNB forecast, which takes into account the use of the exchange rate as an instrument for easing monetary policy.

CHART II.4.2

FRA RATES VERSUS THE CNB FORECAST

The interest rate outlook derived from FRA quotations is approximately in line with rates consistent with the CNB forecast
(percentages)



a) for 2013 Q4 and 2014 Q1 the 3M PRIBOR and for 2014 Q2–2014 Q4 the average values of the FRA 3*6, 6*9 and 9*12 rates for the last 10 trading days as of 24 January 2014

III. CURRENT ECONOMIC DEVELOPMENTS

III.1 INFLATION

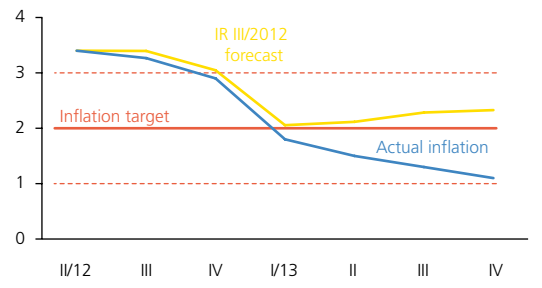
Annual headline inflation was 1.4% in December 2013 and was thus in the lower half of the tolerance band around the CNB's inflation target. At 0.6%, monetary-policy relevant inflation was below the lower boundary of this tolerance band. The increase in headline annual inflation in Q4 was due to all market components of inflation and was linked mainly with the weakening of the koruna after the CNB Bank Board decided to start using the exchange rate as an instrument to further ease the monetary conditions. Nonetheless, in an environment of a continuing anti-inflationary effect of the domestic economy, market price inflation was low. Declining import prices of energy and non-energy commodities also contributed to the generally low inflation in 2013 Q4.

III.1.1 Fulfilment of the inflation target

Chart III.1.1

FORECAST VERSUS ACTUAL INFLATION

Inflation was well below the IR III/2012 forecast in 2013 Q4
(year on year in %)



In 2013 Q4, **headline inflation** was on average just above the lower boundary of the tolerance band around the CNB's target (see Chart III.1.1), while monetary-policy relevant inflation was well below this boundary. 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 2013 Q4, we have to examine above all the period roughly from April to December 2012 (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/2012 forecast with subsequent developments.

The **Inflation Report III/2012 forecast** expected headline inflation to fall from above 3% to the CNB's target in late 2012/early 2013. Headline inflation was expected to be just above the inflation target in 2013 owing to an increase in both VAT rates (see Chart III.1.1). Monetary-policy relevant inflation was expected to fall into the lower half of the tolerance band around the CNB's target at the end of 2012 and to stay there for the whole of 2013. The inflationary effect of import prices was expected to decrease at the start of the forecast due to falling inflation abroad. The anti-inflationary effect of the domestic economy was expected to fade in early 2013, but no pronounced upward pressures on prices in the domestic economy were expected until the end of the forecast horizon. The forecast predicted that falling inflation would also be fostered by slower growth in administered prices, food prices and fuel prices.

Headline **inflation in reality** was below the forecast over the entire period, and the deviation increased gradually in 2013. The 1.2 percentage point deviation of actual inflation from the forecast in 2013 Q4 was due mainly to persisting negative adjusted inflation excluding fuels. Administered price inflation and fuel price inflation were also lower than forecasted. Faster growing food prices only slightly offset these negative deviations (see Table III.1.1).

External economic factors contributed significantly to domestic inflation. The recovery in external economic activity at first grew faster than forecasted, but, starting in 2013, rose more slowly than expected (see Table III.1.2). External production prices also initially rose somewhat faster than expected, but from the start of 2013 onwards their growth was well below the forecast. Foreign interest rates reacted to the escalation of the European debt crisis and the worse outlook for economic activity and were below the expected path. Only oil prices were higher than assumed in the forecast. The effect of external developments on domestic inflation was thus slightly anti-inflationary overall.

Domestic **interest rates and the exchange rate** also differed from the forecast. Market interest rates declined in response to a reduction in the CNB's rates, but in 2013 H2 they were affected by the zero lower bound on interest rates. The exchange rate was broadly stable in 2012. In 2013, it was lower than predicted, owing – among other things – to CNB communication[14] and subdued external demand (see Table III.1.3). In 2013 Q4, the koruna exchange rate was clearly affected by the CNB's decision to start using the exchange rate to further ease the monetary conditions.

Based on the CNB's current knowledge, the **developments since the forecast under review was drawn up** can be summed up in the following way. Domestic GDP growth was much lower owing to lower external demand growth and a sharp contraction in domestic demand in reaction to the uncertainty surrounding future developments, with a significant negative contribution of domestic fiscal consolidation in 2012 and 2013. The evolution of real household consumption reflected negative consumer sentiment and a decline in real disposable income, owing mainly to an increase in indirect taxes and weak wage growth. Investment growth was also lower than forecasted in reaction to the weak domestic and external demand and uncertain outlooks. Export and import volumes also lagged behind the assumptions of the forecast. The comparison of the current data on the GDP growth structure with the forecast is also affected by substantial revisions to the national accounts.

14 At its September 2012 meeting, the Bank Board had agreed that if it was necessary to use monetary policy tools other than interest rates it would probably use the exchange rate. In November 2012, the Bank Board decided to lower interest rates to technical zero and also to suspend the programme of sales of part of the investment income on international reserves, as a potential conflict could not be ruled out between such operations and monetary policy implementation at a time when monetary policy interest rates were at technical zero.

Table III.1.1

FULFILMENT OF THE INFLATION FORECAST

The deviation of inflation from the forecast was due mainly to adjusted inflation excluding fuels
(annual percentage changes; contributions in percentage points)

	IR III/2012 forecast	2013 Q4 outturn	Contribution to total difference[c)]
CONSUMER PRICES	2.3	1.1	-1.2
Breakdown into contributions:			
administered prices	2.8	1.3	-0.3
first-round impacts of changes to indirect taxes[a)]	0.7	0.7	0.0
food prices[b)]	1.7	2.3	0.2
fuel prices[b)]	0.3	-1.7	-0.1
adjusted inflation excl. fuels[b)]	1.3	-0.4	-0.9

a) impact in non-administered prices on total inflation
b) excluding the first-round effects of changes to indirect taxes
c) Owing to rounding, the total difference may not be equal.

Table III.1.2

FULFILMENT OF THE EXTERNAL ASSUMPTIONS

External factors had a slight downward effect on domestic inflation overall
(annual percentage changes unless otherwise indicated)

		III/12	IV/12	I/13	II/13	III/13	IV/13
GDP in euro area[a), b), c)]	p	0.2	0.2	0.0	0.9	1.8	2.2
	o	0.7	0.3	0.0	0.4	0.4	-
PPI in euro area[b), c)]	p	1.8	1.7	1.0	1.5	2.4	2.8
	o	2.1	2.1	1.1	0.0	-0.3	-
3M EURIBOR	p	0.6	0.4	0.4	0.5	0.5	0.5
(percentages)	o	0.4	0.2	0.2	0.2	0.2	0.2
USD/EUR exchange rate	p	1.25	1.25	1.24	1.24	1.24	1.24
(levels)	o	1.25	1.30	1.32	1.31	1.32	1.36
Brent crude oil price	p	99.0	97.0	96.9	96.6	96.3	95.8
(USD/barrel)	o	109.9	110.5	112.9	103.3	109.7	109.4

p – prediction, o – outturn
a) at constant prices
b) seasonally adjusted
c) IR III/2012 outlook for effective indicator

Table III.1.3

FULFILMENT OF THE FORECAST FOR KEY VARIABLES

Observed GDP growth was well below the forecast over almost the entire period

		III/12	IV/12	I/13	II/13	III/13	IV/13
3M PRIBOR	p	0.8	0.6	0.5	0.4	0.2	0.2
(percentages)	o	1.0	0.6	0.5	0.5	0.5	0.4
CZK/EUR exchange rate	p	25.5	25.3	25.2	25.1	25.1	25.0
(levels)	o	25.1	25.2	25.6	25.8	25.9	26.7
Real GDP[a)]	p	-1.3	-1.3	-0.2	-0.2	1.5	2.3
(annual perc. changes)	o	-1.2	-1.4	-2.3	-1.7	-1.2	-
Nominal wages[b)]	p	3.0	2.9	2.9	2.9	3.2	3.4
(annual perc. changes)	o	1.6	4.0	-0.4	1.1	1.4	-

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

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** and other monetary policy instruments. At the 2012 Q2 meetings, the risks to the forecast were assessed as being inflationary for headline inflation, or skewed towards the alternative scenario (which expected lower monetary-policy relevant inflation and interest rates than the baseline scenario). At its June meeting the CNB Board lowered the 2W repo rate by 0.25 percentage point. In 2012 Q3, the risks to the forecast were assessed as being balanced or on the downside; the 2W repo rate was lowered by 0.25 percentage point at the September meeting. In 2012 Q4, the Bank Board assessed the risks to the inflation forecast as being balanced or slightly on the downside. At its November meeting, it lowered the 2W repo rate by 0.20 percentage point to technical zero.

Overall, monetary policy in the key period can be assessed as follows. Market interest rates declined in response to the CNB's rate cuts. Headline inflation was on average just above the lower boundary of the tolerance band around the CNB's target in 2013 Q4 despite strong impacts of tax changes, while monetary-policy relevant inflation was well below this boundary. Most of the identified risks materialised in the key period, with anti-inflationary risks prevailing overall. The domestic anti-inflationary risks were partly offset by a weaker koruna affected by CNB communication, which thus fostered an easing of the monetary conditions. However, based on current knowledge, it still seems that the monetary policy pursued between April and December 2012 should have been substantially easier.

III.1.2 Current inflation

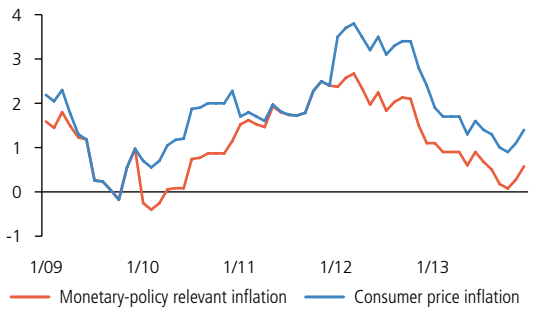
Annual inflation[15] increased in 2013 Q4. At 1.4% in December, it was 0.4 percentage point higher than in September (see Chart III.1.2). However, a continuing downward trend in inflation was still apparent at the start of Q4, with inflation falling below 1% in October. The pick-up in annual inflation in November and December was due, in addition to base effects, to the weakening of the exchange rate, which was reflected in all market components of inflation, while administered price inflation slowed (see Chart III.1.3).

In these circumstances, the share of market prices in the **structure of annual inflation** increased noticeably – especially in December – from roughly zero in October. This rise was primarily due to annual adjusted inflation excluding fuels turning less negative (see Chart III.1.4). However, the contribution of administrative effects to inflation, i.e. the impacts of changes to indirect taxes and administered prices, remained larger than that of market prices at the end of 2013.

CHART III.1.2

INFLATION

Inflation increased in 2013 Q4
(year on year in %)



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

Owing to an increase in both VAT rates by one percentage point and a rise in excise duty on tobacco products at the start of 2013, **indirect taxes** contributed about 0.7 percentage point to annual market price inflation at the end of 2013. The overall first-round effect of tax changes on inflation including administered prices was roughly 0.8 percentage point.

Monetary-policy relevant inflation, i.e. inflation adjusted for the first-round effects of all the changes to indirect taxes, was just 0.1% in October and increased to 0.6% in the following two months (see Chart III.1.2). It was thus again well below the lower boundary of the tolerance band around the CNB's target and was much lower than headline inflation.

Annual **administered price inflation** slowed further at the end of 2013 (from 1.5% in September to 1% in December, including the effect of VAT changes; see Chart III.1.3). This was mainly due to a slowdown in prices of electricity, education and administered health care items. Annual growth in administered price inflation continued to be due mainly to electricity and heat prices, whose contribution, however, was fully offset by a continued decline in prices of natural gas for households. The overall rise in administered prices in the period under review was also fostered by rising water supply and sewerage collection charges, waste collection charges and transport prices. The following text assesses the evolution of the main components of market price inflation adjusted for the tax changes.

Annual **market price inflation**, as measured by net inflation, surged in late 2013 (to 0.8% in December) from zero in October. The rise in net inflation was a result of adjusted inflation excluding fuels turning less negative together with a rise in food price inflation and renewed annual fuel price inflation, linked among other things with the year-on-year exchange rate weakening. Nonetheless, market price inflation was still low, mainly reflecting the persisting sharp downturn in the domestic economy, including slow wage growth in the business sector. The low market price inflation was also due to falling import prices of energy and non-energy commodities.

These anti-inflationary factors were reflected mainly in annual **adjusted inflation excluding fuels**, which has long been negative (see Chart III.1.5). In 2013 Q4, it shifted towards zero (-0.3% in December). This was due mainly to renewed annual growth in prices of **other non-tradable commodities**[16] (to 0.5%), where stronger annual growth in rents and a slower decline in prices of telecommunication services were apparent. A slight moderation of the annual decline in prices of **other tradable commodities** excluding food and fuels (to -1.6%), which are more strongly affected by the exchange rate and foreign prices, acted in the same direction. This segment saw a considerably slower annual decline in prices of transport equipment.

16 This segment consists mainly of services.

CHART III.1.3

INFLATION COMPONENTS

All components of market prices contributed to the increase in inflation in 2013 Q4

(annual percentage changes; excluding indirect tax changes except for administered prices)

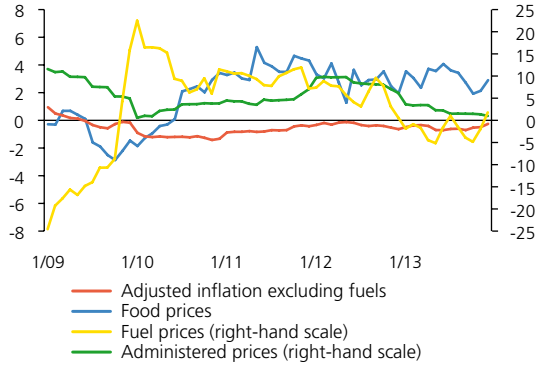


CHART III.1.4

STRUCTURE OF INFLATION

Although the contribution of market prices to inflation increased, the contribution of administrative effects remained larger

(annual percentage changes; contributions in percentage points)

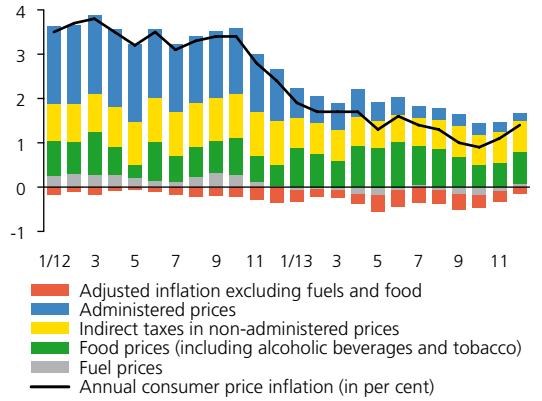


CHART III.1.5

ADJUSTED INFLATION EXCLUDING FUELS

Adjusted inflation excluding fuels turned less negative in 2013 Q4

(annual percentage changes)

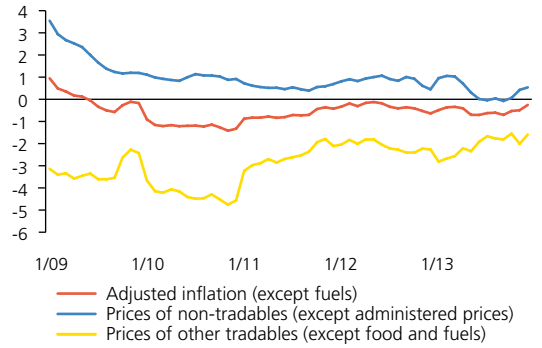
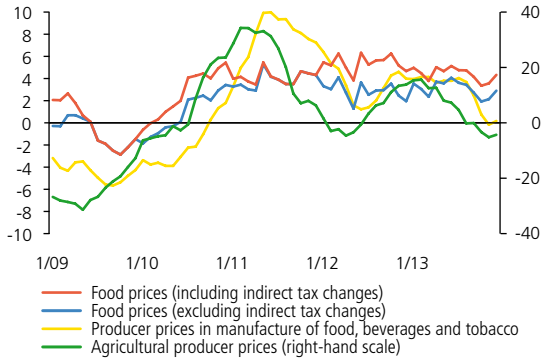


CHART III.1.6

FOOD PRICES

Food price inflation accelerated in 2013 Q4
(annual percentage changes)



As before, **food prices** showed the fastest growth in 2013 Q4. Their annual growth rate rose to 2.9%[17] in December (i.e. by 0.2 percentage point compared to September and by 1 percentage point compared to October). In December, the biggest increases were recorded for growth in retail prices of vegetables and dairy products. In addition to the evolution of food commodity prices on foreign markets, consumer prices of food were affected by the weaker exchange rate. In December, the weaker exchange rate was also reflected in a slowing annual decline in domestic agricultural producer prices and a modest renewal of price growth in the food industry (see Chart III.1.6).

Fuel prices saw renewed annual growth in December (of 1.8%) as a result of a slowing year-on-year fall in global petrol prices (and renewed growth in global oil prices) amid a weakening of the koruna-dollar rate.

17 Including the effect of indirect taxes, food prices rose by 4.3% year on year in December.

III.2 IMPORT PRICES AND PRODUCER PRICES

The renewed annual growth in import prices in November 2013, affected by the weakening of the exchange rate, was reflected most of all in prices of imported semi-finished products and commodities with a high degree of processing. A noticeable moderation of the year-on-year decline in prices of imported energy and non-energy commodities also contributed significantly to the turnaround in import prices. Growth in industrial producer prices was renewed as well. Agricultural producer prices fell year on year as a result of sizeable declines in prices of commodities of vegetable origin. The year-on-year decline in construction work prices and prices of market services in the business sector continued amid persisting low domestic demand.

III.2.1 Import prices

Import prices continued to fall quite quickly year on year in October 2013. In November, however, they were noticeably affected by the exchange rate weakening and rose by 1% year on year (see Chart III.2.1). This change in trend was chiefly due to faster growth in import prices of commodities with a high degree of processing and a renewed increase in import prices of semi-finished products.

Import prices of **mineral fuels** continued to decline year on year in the first two months of 2013 Q4, following the trend observed since the start of 2013 (see Chart III.2.2). Their evolution continued to be determined above all by falling global prices of major energy commodities – crude oil and natural gas. The year-on-year decline in oil and gas prices on world markets was in single figures in October and November, with the fall in natural gas prices being more pronounced (see Chart III.2.3).[18] The growth rate of import prices of mineral fuels was also affected by the change in the koruna-dollar exchange rate, which fluctuated around zero year on year in the period under review.[19] The November weakening of the koruna-dollar exchange rate helped to moderate the annual decline in import prices of mineral fuels (to -5.2%). Their negative contribution to overall annual import price inflation thus decreased by almost one-half in November compared to October, to -0.9 percentage point.

The relatively fast pass-through of the weakening of the koruna exchange rate to import prices was also visible in other import categories. The year-on-year decline in import prices of **non-energy commodities**, which have been falling for more than a year now, slowed significantly in November (from -6.1% in October to -1.2% in November). However, the contribution of these prices to annual import

18 The annual decline in global oil prices was -1.9% in October and -1.5% in November. Natural gas prices fell by 4.9% and 5.4% respectively year on year in the same period.

19 The koruna-dollar exchange rate appreciated by 2.0% year on year in October and weakened by 0.9% in November.

CHART III.2.1

IMPORT PRICES AND PRODUCER PRICES

Import prices and industrial producer prices saw renewed growth in 2013 Q4, while producer prices in other sectors fell
(annual percentage changes)

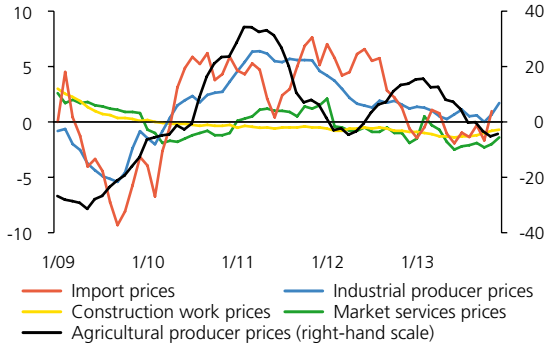


CHART III.2.2

IMPORT PRICES

Commodities with a high degree of processing and semi-finished products contributed the most to the renewed growth in import prices
(annual percentage changes; contributions in percentage points)

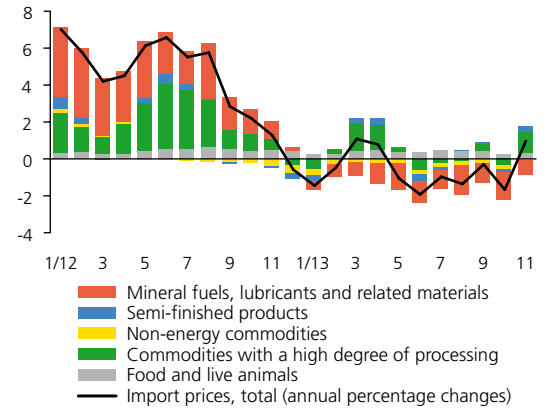


CHART III.2.3

MINERAL FUELS

Prices of imported mineral fuels and lubricants went down in October and November mainly because of falling global prices of natural gas
(annual percentage changes)

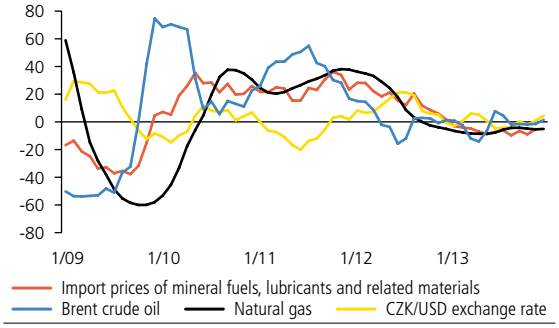


TABLE III.2.1

STRUCTURE OF IMPORT PRICE INFLATION

Import prices of crude materials went down, while import prices of food and miscellaneous manufactured articles went up
(annual percentage changes)

	8/13	9/13	10/13	11/13
IMPORTS, TOTAL	-1.4	-0.3	-1.7	1.0
of which:				
food and live animals	7.0	6.2	4.1	4.0
beverages and tobacco	9.2	8.8	7.5	8.6
crude materials inedible, except fuels	-7.2	-6.4	-6.1	-1.2
mineral fuels and related products	-9.7	-6.6	-9.0	-5.2
animal and vegetable oils	-10.8	-10.9	-14.4	-14.2
chemicals and related products	-1.1	-0.6	-2.2	-0.8
manufactured goods classified chiefly by material	0.1	0.4	-1.1	1.9
machinery and transport equipment	-0.3	0.8	-0.6	2.5
miscellaneous manufactured articles	1.3	1.8	1.3	3.3

CHART III.2.4

INDUSTRIAL PRODUCER PRICES

Industrial producer price inflation accelerated again
(annual percentage changes; contributions in percentage points)

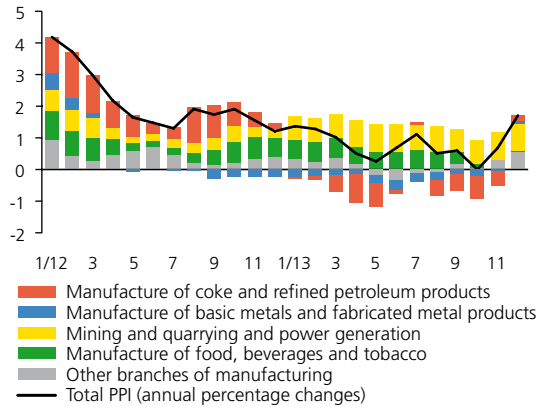
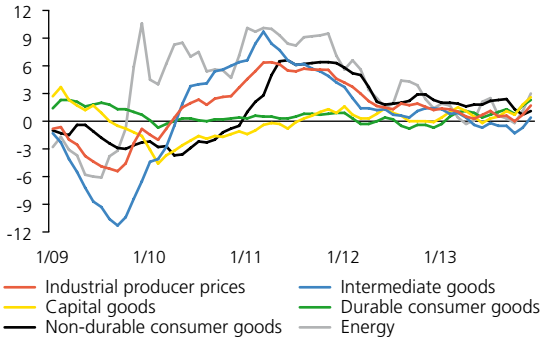


CHART III.2.5

PRODUCER PRICES BY MAIN INDUSTRIAL GROUPINGS

Prices in all subcategories recorded renewed growth or accelerated slightly at the end of 2013 Q4
(annual percentage changes)



price inflation was negligible due to their low weight. The year-on-year decline in import prices of **chemicals** also slowed in November (see Table III.2.1). Import prices of **semi-finished products**, which had been fluctuating around zero in previous months and fell by more than 1% year on year in October, rose again in November (by 1.9%). Only growth in import prices of **food and live animals** remained at 4% in November, after slowing to that level in October. This rise was due mainly to higher foreign prices of meat and vegetables and partly also nuts and cocoa. By contrast, prices of cereals and oil plants decreased on global markets. Semi-finished products and food each contributed 0.3 percentage point to annual import price inflation in December.

However, the biggest contribution to import price inflation came from **higher-value-added products** (1.1 percentage points). Prices of machinery and transport equipment showed the largest acceleration in this category in November. Prices of miscellaneous manufactured articles rose significantly year on year as well (see Table III.2.1). These imported commodities were also affected by the November weakening of the koruna-euro exchange rate.[20]

III.2.2 Producer prices

Industrial producer prices

The slowdown in annual **industrial producer price inflation** in 2013 H2 to zero in October was replaced by renewed growth, which reached 1.7% in December (see Chart III.2.4). This still muted growth was mostly due to electricity, gas and steam prices and producer prices of high-value-added products. Producer prices in the other branches of industry were rising slightly or falling and their effect on industrial producer price inflation was insignificant.

The **structure of industrial producer price inflation** (and import price inflation) also shows that the low growth rates were still due to a continuing decline in global prices of energy commodities. However, its impact on producer prices in the primary oil processing sector was appreciably offset at the end of 2013 by the exchange rate weakening. A similar trend was seen in the primary metal processing sector, which also recorded renewed modest price growth at the end of 2013. The effect of the weaker exchange rate on producer prices was also apparent in other branches of manufacturing, where there was clearly a close link with international production collaborations and with rising prices of parts and accessories for motor vehicles, which are mostly traded in the euro. However, prices in these sectors were also still affected by the generally subdued demand. Rising domestic prices of energy (electricity) and water-related services also had an inflationary effect (see Chart III.2.5). Declining prices of

20 The koruna-euro exchange rate depreciated by 2.9% year on year in October and by 6.2% in November.

agricultural inputs, which helped to slow producer price inflation in the food industry, acted in the opposite direction. This was partly offset, however, by still relatively rapid growth in prices of imported food.

The modestly falling global oil prices were reflected in a continued annual decline in producer prices in the **manufacture of coke and refined petroleum products** in the first two months of 2013 Q4. In December, amid renewed modest growth in global oil prices and year-on-year depreciation of the koruna-dollar exchange rate, producer prices in this sector rose again after an extended period of decline (by 2%; see Chart III.2.6). As a result, this industry's contribution to annual industrial producer price inflation rose to 0.2 percentage point in December. Renewed growth in producer prices in the **manufacture of basic metals and fabricated metal products** (to 1.1% in December) was probably linked with the faster year-on-year growth in import prices of semi-finished products in November. By contrast, producer price inflation in the **food industry** was slower on average in 2013 Q4 than in the previous quarter, mainly because of the now falling prices of domestic agricultural products of crop origin (by contrast, prices of livestock products increased).

Steady inflation was recorded throughout 2013 in the **electricity, gas, steam and air-conditioned air industries**, where producer prices rose by 3.5% in December. Prices in the water supply and sewerage-related services industry have also been showing more or less stable annual growth of just below 6% since the start of 2013.[21] Prices in **mining and quarrying**, which had mostly been decreasing[22] since the start of 2012, switched to modest annual growth in November and December.

Inflation in the **other branches of manufacturing**, comprising the manufacture of high-value-added products, rose gradually in 2013 Q4 (see Chart III.2.4). Higher price growth was recorded in almost all branches of manufacturing, most of all in transport equipment and computer, electronic and optical equipment. This largely reflected the weakening of the koruna. Producer prices in the manufacture of chemicals and pharmaceutical products continued falling, however.

Agricultural producer prices

The gradual slowdown in annual **agricultural producer price inflation** from about 15% at the start of 2013 culminated in a year-on-year decline in the second half of the year, reaching -4.3% in December (see Chart III.2.7). This switch from high growth to sizeable decline was due to significant changes in the evolution of crop product prices during 2013. At the start of 2013, annual growth in crop prices had reached 30%. Its subsequent fast slowdown culminated in an annual decline in August, which deepened further to -11.5% in

CHART III.2.6

PRICES OF METALS AND REFINED PETROLEUM PRODUCTS

Producer prices of coke and refined petroleum products and of basic metals and fabricated metal products saw renewed growth in December
(annual percentage changes)

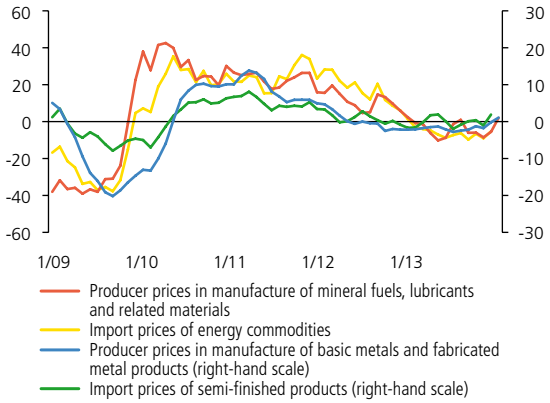
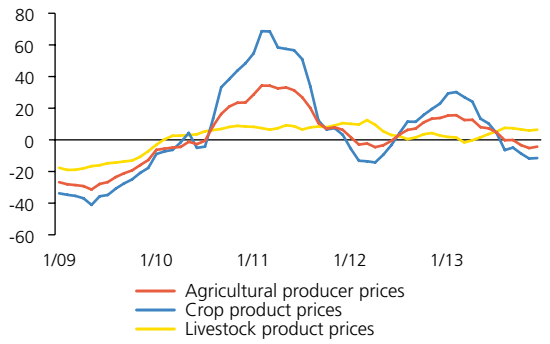


CHART III.2.7

AGRICULTURAL PRODUCER PRICES

The decline in agricultural producer prices deepened further in 2013 Q4
(annual percentage changes)



21 Price agreements in these industries are usually signed for one year.
22 Except for a short episode from April to June 2013, when prices went up slightly.

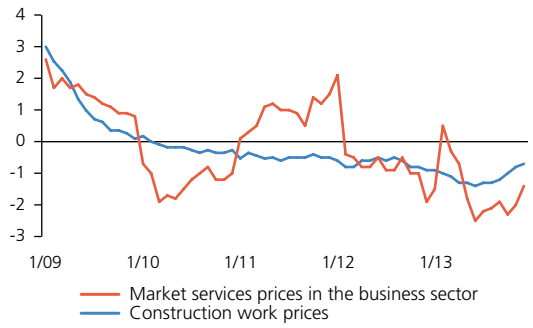
December. Livestock product prices followed a different path, as their year-on-year growth fluctuated around zero in 2013 H1 and rose to over 7% in 2013 H2. In December, the annual rate of growth slowed somewhat to 6.4%.

The **main cause** of the significant changes in crop product prices during 2013 (a slowdown in growth and a subsequent decrease) was last year's harvest, especially that of the highest-weight (in the Czech Republic) categories of cereals and oil plants. From the long-term perspective, their harvest was above average in 2013 both in the Czech Republic and globally, in contrast to the very weak harvest in 2012. Against that, domestic prices were affected in 2013 H2 by the weakening of the koruna against both the euro and the dollar and also by rising prices of some livestock products (most notably milk).

CHART III.2.8

OTHER PRICE CATEGORIES

Prices of construction work and prices of market services continued to decline
(annual percentage changes)



Other producer prices

Amid persisting low construction investment demand, **prices of construction work** in 2013 Q4 continued to follow the annual decline observed since 2010 (see Chart III.2.8). However, this decline moderated partially compared to the previous quarter (to -0.7% in December). After seven months of decline, prices of materials and products consumed in construction showed weak annual growth in November and December.

The annual decline in **prices of market services** for the business sector moderated in 2013 Q4 (to -1.4% in December; see Chart III.2.8). The biggest price declines were recorded for telecommunication services, storage and road and pipeline transport. However, more than half of the branches under review showed modest price growth on the whole. The largest price rises in December were recorded by postal and courier services and by advertising services and market research. Annual growth in prices exceeded 8% in both these categories.

III.3 DEMAND AND OUTPUT

The year-on-year decline in real GDP moderated to -1.2% in 2013 Q3, with economic activity rising slightly in quarter-on-quarter terms for the second quarter in a row. The year-on-year GDP decline was due to fixed investment, which has long been falling, and newly also net imports. By contrast, a marked change in inventories and government consumption contributed positively to economic growth. On the supply side, positive contributions to GDP growth came only from some services. In manufacturing, by contrast, gross value added continued falling year on year. The output gap remained strongly negative.

III.3.1 Domestic demand

The long-running year-on-year decline in **domestic demand** changed into weak growth in 2013 Q3. This was mainly due to changes in inventories (see Chart III.3.2). The contribution of government consumption, whose modest year-on-year growth rose further, was much lower. Domestic demand was also favourably affected in this period by household consumption switching from year-on-year decline to stagnation. Fixed investment continued falling, albeit more slowly than in the previous quarter.

Final consumption

The decline in **household final consumption expenditure** observed since the start of the previous year was replaced by year-on-year stagnation in 2013 Q3.[23] The previous adverse trend in household consumption came to an end, although real gross disposable income decreased again year on year. Household confidence, as measured by the consumer confidence indicator, meanwhile increased further.

Annual growth in **nominal gross disposable income**, which is the main source of financing of households' consumption expenditure, has been fluctuating around zero since 2010. In 2013 Q3, it switched back from the previous quarter's growth to a modest decline. Its **real purchasing power**[24] decreased by 1.9% (see Chart III.3.3).

The **structure** of nominal gross disposable income shows that the contribution of wages and salaries, which are the largest component of households' gross disposable income in terms of volume, remained very modest in 2013 Q3 (0.2 percentage point; see Chart III.3.4), due to weak average wage growth[25] and a falling number of employees converted into full-time equivalents. The relatively high-weight business income (gross operating surplus plus mixed income) showed similar developments. Income from social benefits decreased

23 According to seasonally adjusted data. However, a modest annual increase was recorded according to seasonally unadjusted data (see Chart III.3.3).
24 As measured by the household consumption deflator.
25 See section III.4 *The labour market*.

CHART III.3.1

GROSS DOMESTIC PRODUCT

The year-on-year decline in real GDP moderated in 2013 Q3
(annual and quarterly percentage changes at constant prices; seasonally adjusted data)

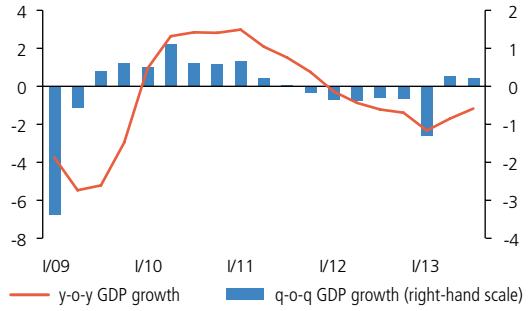


CHART III.3.2

STRUCTURE OF ANNUAL GDP GROWTH

Fixed investment and net exports contributed to the year-on-year decline in GDP, while the contribution of inventories was positive
(contributions in percentage points; seasonally adjusted data)

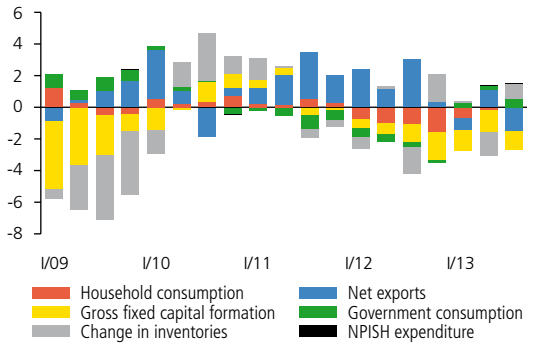


CHART III.3.3

HOUSEHOLD CONSUMPTION EXPENDITURE

Real household expenditure turned positive in year-on-year terms, but real disposable income declined
(annual percentage changes)

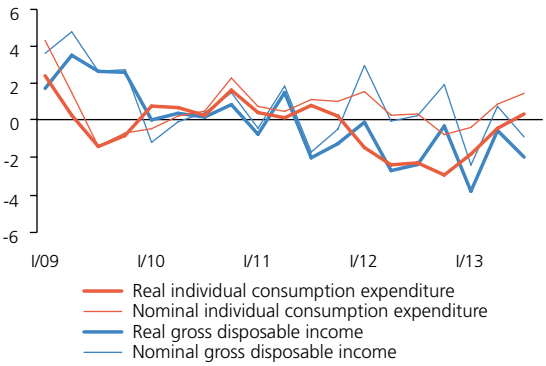


CHART III.3.4

DISPOSABLE INCOME

Nominal gross disposable income growth turned negative in 2013 Q3

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

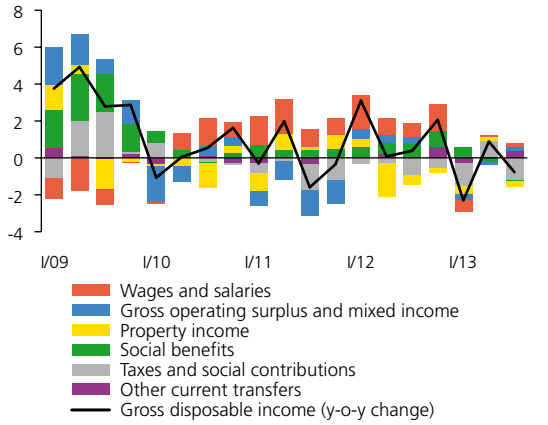


CHART III.3.5

STRUCTURE OF HOUSEHOLD CONSUMPTION

Spending on non-durable goods and services declined, while expenditure on semi-durable and durable goods increased slightly

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

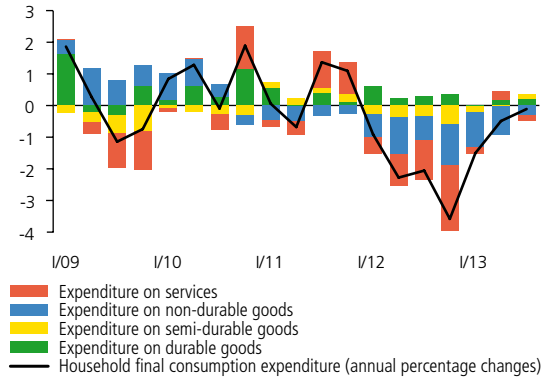
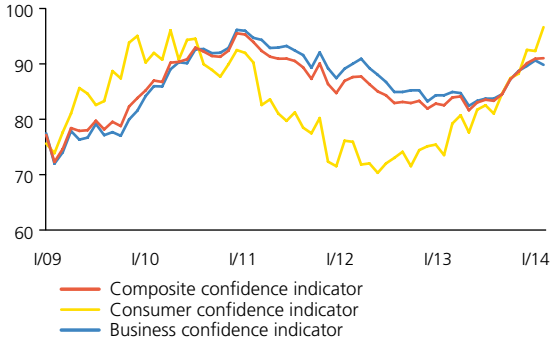


CHART III.3.6

CONFIDENCE INDICATORS

Consumer confidence increased further

(2005 average = 100; source: CZSO)



for the second quarter in a row. Households' gross disposable income was reduced even more strongly by falling property income and by payments of taxes and social contributions.

With nominal gross disposable income falling and households' consumption expenditure rising in year-on-year terms, the **saving rate** fell below 10% in 2013 Q3 (see Chart II.2.17). Households' interest in financing their consumption by means of credit again failed to increase in 2013 Q3 because of persisting uncertainty on the labour market. Consumer credit growth remained low (around 2%).

Households' consumption behaviour in the period under review was also characterised by changes in the **structure of household consumption expenditure**. As in previous quarters, households' spending on non-durable consumer goods (consisting mainly of current expenditure on food, energy and pharmaceutical products and on running a car) decreased year on year in 2013 Q3 (see Chart III.3.5). Households' expenditure on services also decreased again in Q3. However, the year-on-year decline in these two key expenditure items, accounting for about 80% of households' consumption expenditure, was by now only modest (-0.8% and -0.4% respectively in 2013 Q3). On the other hand, households did spend on semi-durable and durable goods, although the year-on-year growth rates did not exceed 3% in 2013 Q3.

According to the latest available **leading indicators**, retail sales improved in October and November. Retail sales rose overall in year-on-year terms,[26] accelerating particularly significantly in November. About two-thirds of this growth was concentrated in the automotive segment, which also comprises sales to companies. Sales in the non-motor-vehicle segment decreased year on year in October, but seasonally adjusted sales rose markedly in November, thanks mainly to a rise in sales of non-food products. This increase was probably partly due to the weakening of the koruna implemented by the CNB. The consumer confidence indicator increased further (see Chart III.3.6), but is still below the pre-crisis level.

The annual growth in real **government final consumption expenditure** observed in 2013 Q1 and Q2 picked up further to 2.5% in Q3.

Investment

Investment remained subdued in 2013 Q3 amid low economic activity and uncertainty among corporations and households regarding future economic developments (see Chart III.3.7). According to the CZSO's seasonally adjusted data, **fixed investment** has been falling for two years in year-on-year terms, but the intensity of the decline eased in 2013 Q3 (to -5.3%).[27]

26 According to seasonally adjusted data.
27 According to seasonally adjusted data. According to seasonally unadjusted data, on which Chart III.3.7 and Chart III.3.8 are based, the decline was 3.2%.

A slowing decline in investment was observed in most economic sectors. The financial institutions sector was alone in recording further growth in investment, but its positive contribution to year-on-year fixed investment growth was minimal. The moderation of the decline in fixed investment in 2013 Q3 was mostly due to the **non-financial corporations sector**,[28] which accounts for about 60% of total investment. The sizeable reduction in this sector's negative contribution to the overall year-on-year change in fixed investment in 2013 Q3 (to -1.2 percentage points, from -3.1 percentage points in 2013 Q2; see Chart III.3.7) was linked mainly with a smaller decrease in investment in machinery and equipment and transport equipment, while investment in buildings and structures fell roughly at the same pace as in Q2 (see Chart III.3.8).

According to the latest **business survey** conducted by the CNB and the Confederation of Industry in December 2013, businesses perceive uncertainty regarding future demand and low returns on investment to be the biggest factors constraining investment growth. A decreasing negative weighted balance of the responses concerning expected investment activity at the six-month and one-year horizons indicates a gradual improvement in businesses' view of investment.

The year-on-year decline in fixed investment in the **household sector** also slowed noticeably in 2013 Q3 (from -10.1% in Q2 to -5.9%).[29] This was partly due to investment in dwellings, whose year-on-year decline slowed again (see Chart III.3.9). Uncertain prospects for economic growth and unemployment were again the main cause of the persisting weak household demand for investment in dwellings despite favourable financing conditions. However, developers showed gradually rising interest in new investment in housing, as indicated by the first year-on-year increase in the number of housing starts recorded in more than two years. A stronger recovery on the housing market is still conditional on improvements in the labour market situation and in household income.

Investment in the **government sector** also declined more moderately in 2013 Q3. Nonetheless, its year-on-year decline remained deep (-7.2%) and its contribution to the total decline in fixed investment was relatively large, even though government sector investment accounts for less than one-fifth of total investment. The overall decline in the investment activity of the government, affected by austerity measures and problems with the implementation of projects co-financed from EU funds, had a strong effect on investment in buildings and structures, which fell by almost 10% year on year in 2013 Q3 (see Chart III.3.8).

28 The year-on-year decline in fixed investment in this sector moderated from -4.9% in 2013 Q2 to -1.9% in 2013 Q3.

29 As a result, its negative contribution to annual fixed investment growth shrank from 1.9 percentage points in 2013 Q2 to 1.2 percentage points in 2013 Q3.

Chart III.3.7

INVESTMENT BY SECTOR

Investment continued to go down in most of the monitored sectors, but the decline slowed

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

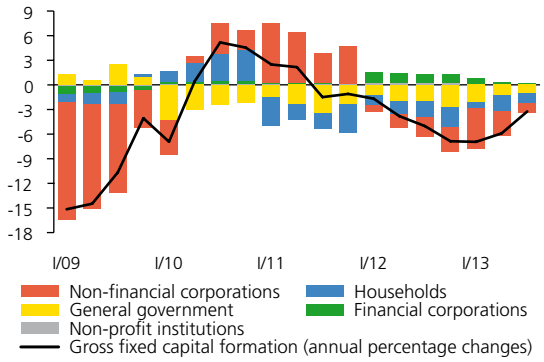


Chart III.3.8

FIXED CAPITAL FORMATION

The decline in fixed investment was due mainly to investment in buildings and structures

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

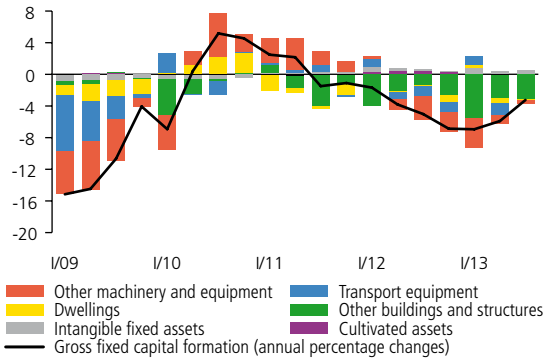
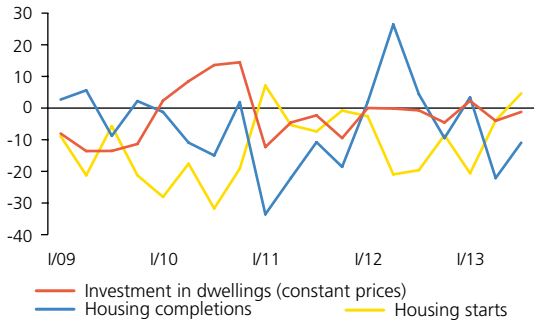


Chart III.3.9

INVESTMENT IN DWELLINGS

The number of housing starts increased year on year for the first time in more than two years

(annual percentage changes)



The biggest change on the expenditure side of GDP in 2013 Q3 was a switch of the contribution of **changes in inventories** to annual GDP growth from negative to positive (from -1.5 percentage points in 2013 Q2 to 0.9 percentage point; see Chart III.3.2). In absolute terms, this meant that inventories rose by more than CZK 16 billion (at current prices) from their unusually low levels in previous quarters. This situation may be linked with the recovery in orders and production in industry over the last two quarters.

III.3.2 Net external demand

After having risen year on year in 2013 Q2, **net exports of goods and services**[30] decreased again in Q3. The net export surplus decreased by more than CZK 13 billion year on year. In quarter-on-quarter terms, the decline was only slightly smaller (more than CZK 11 billion; see Chart III.3.10). The renewed decline in net exports was mainly due to the balance of services, as its surplus fell for the third quarter in a row. However, it was also due to a decrease in the trade surplus, which had been rising in the previous quarter. In these circumstances, the contribution of net exports to GDP growth was negative again in 2013 Q3 (-1.4 percentage points), unlike in the previous quarter, when it had been positive.

The year-on-year decline in net exports in 2013 Q3 was a result of a renewed lead of import growth over export growth (of 2 percentage points). In Q2, the relationship had been the opposite (see Chart III.3.11). **Total exports** rose only slightly (by 0.3% year on year), while their growth slowed by 0.2 percentage point compared to the previous quarter. The negligible increase in total exports was linked with continuing slight growth in external demand in the Czech Republic's major trading partner countries. The increase in total exports was due solely to growth in exports of goods (of 1.8%), whereas exports of services decreased, thereby contributing significantly to the slowdown in total export growth.

Total imports saw a larger change in growth. After two quarters of year-on-year decline, imports rose by 2.3% in 2013 Q3. Compared to the previous quarter, this meant an increase of 3.2 percentage points. This marked change was probably due to an increase in inventories associated with the renewed growth in orders and industrial production (see above) and to a weak recovery in final demand, which was reflected in an increase in imports of commodities for intermediate and final consumption. However, imports for investment purposes fell year on year as a result of the persisting decline in investment activity in the domestic economy. Falling imports of services also helped to reduce growth in total imports. **Total trade turnover** thus increased again in 2013 Q3 after two quarters of year-on-year decline, although mostly thanks to rising imports.

CHART III.3.10

NET EXPORTS

Net exports decreased again in 2013 Q3
(seasonally adjusted data; constant prices)

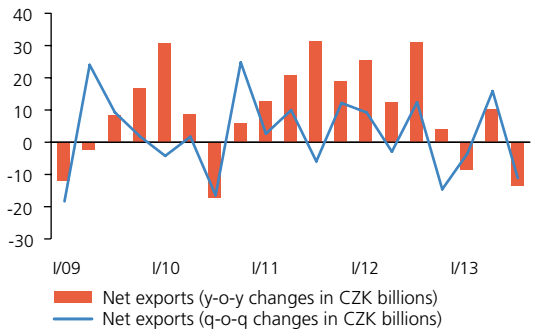
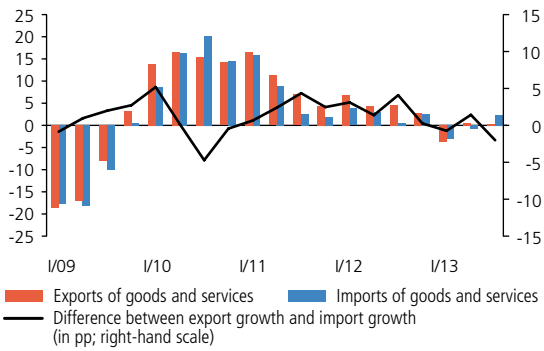


CHART III.3.11

EXPORTS AND IMPORTS

Foreign trade turnover saw renewed growth in 2013 Q3, but imports outpaced exports
(annual percentage changes; percentage points; constant prices; seasonally adjusted data)



30 At 2005 prices, seasonally adjusted.

III.3.3 Output

The year-on-year decline in **gross value added** at basic prices slowed further in 2013 Q3 (to -1.1%). In quarter-on-quarter terms, however, value added decreased by 0.4%. The weak domestic and external demand continued to affect the output of different branches with different intensity, but a trend towards a slowing decline predominated (see Chart III.3.12). Only a few services made positive contributions to the year-on-year evolution of gross value added.

The continuing moderation of the year-on-year decline in gross value added was mostly due to **industry**, whose negative contribution fell to -0.5 percentage point in 2013 Q3. This was mainly due to the low-weight **mining and energy supply sectors**, where the year-on-year decline in gross value added slowed significantly compared to the previous quarter (to -5.6%). By contrast, the decline in value added in manufacturing deepened slightly again (to -1.1%).

Although gross value added in industry still fell overall in 2013 Q3 (by 1.5% year on year), the data on real **industrial production** (see Chart III.3.13)[31] in 2013 Q3 indicated a gradual recovery of production growth in manufacturing.[32] The decline in production in the mining and energy supply sectors moderated. After about a year of decline, seasonally adjusted production in industry as a whole rose by 1.3% in 2013 Q3. In manufacturing alone, its annual real growth was even stronger, reaching 2.7%.

A recovery in production growth was recorded in most manufacturing sectors (about three-quarters of those monitored). According to the latest available **leading indicators**, the relatively fast real growth in industrial production continued into October and November (8.6% in November; see Chart III.3.13).[33] In November, the biggest positive contribution came from the manufacture of motor vehicles, trailers and semi-trailers (contribution 2.3 percentage points, growth 13.7%). By contrast, mining and quarrying made the biggest negative contribution to industrial production (contribution -0.4 percentage point, decline 8.2%). In addition, the latest available data on fast growing direct export sales (up by 10.8% at current prices in November) indicated an improvement in export growth in 2013 Q4.

According to the January results of the CZSO's business survey, the effect of insufficient demand as a **barrier to growth in industry** again increased somewhat after a decline in the previous quarter (see Chart III.3.14). Despite this, the significance of this barrier is still below the level observed in the previous five quarters.[34] **Capacity utilisation** also decreased slightly. At the same time, however,

31 According to seasonally adjusted data.
32 The difference in the evolution of value added and output was caused by movements in the value added deflator.
33 According to seasonally adjusted data.
34 With the exception of the previous survey, where insufficient demand was lower.

Chart III.3.12

CONTRIBUTIONS OF BRANCHES TO GVA GROWTH

The decline in gross value added slowed
(contributions in percentage points; annual percentage changes)

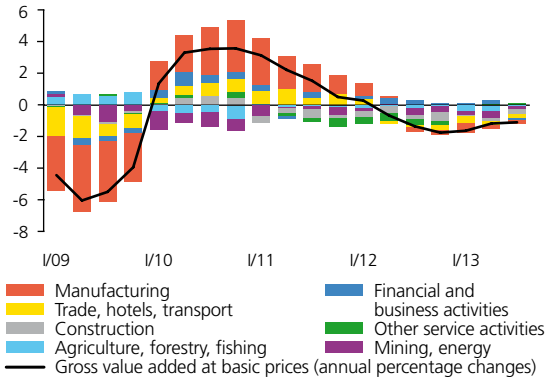


Chart III.3.13

INDUSTRIAL PRODUCTION

The data for November confirmed a rapid recovery in industrial production
(basic index; year 2010 = 100)

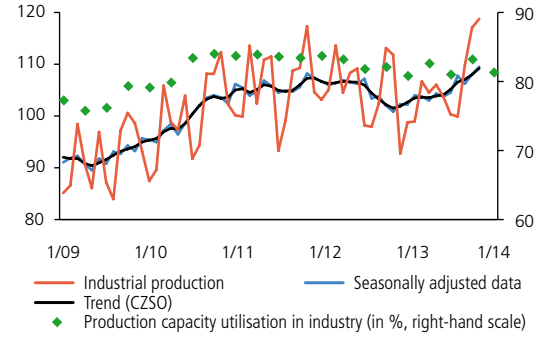


Chart III.3.14

BARRIERS TO GROWTH IN INDUSTRY

The effect of insufficient demand as the main barrier to growth in industrial production decreased slightly for the first time in a long time at the end of 2013
(percentages)

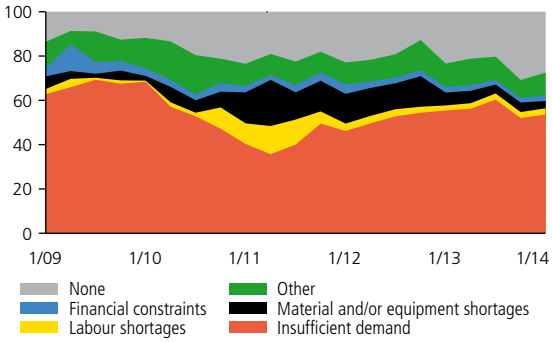


CHART III.3.15

NEW ORDERS IN INDUSTRY

New industrial orders continued to rise
(annual percentage changes)

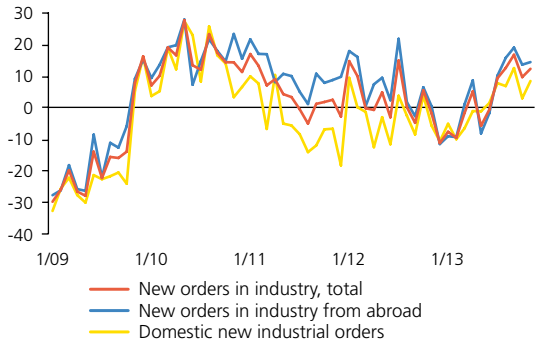


CHART III.3.16

ECONOMIC SENTIMENT

Economic sentiment in the Czech Republic, Germany and the EU is continuing to improve
(long-term average = 100; seasonally adjusted data; source: Eurostat)

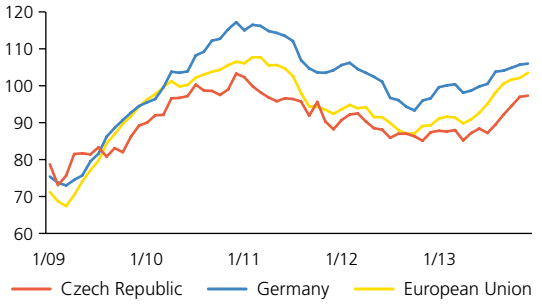
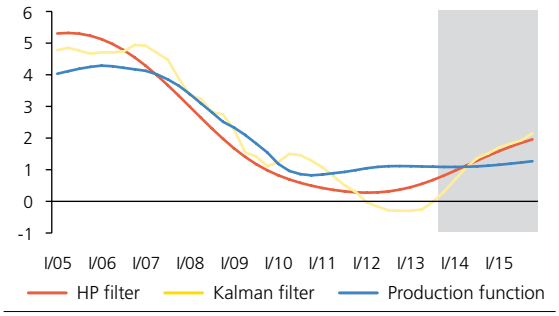


CHART III.3.17

POTENTIAL OUTPUT

The rate of growth of potential output remained only just above 1% in 2013 Q3 according to the production function calculation
(annual percentage changes)



a continuing year-on-year rise in both foreign and domestic **new industrial orders** in the first two months of 2013 Q4 suggests an improvement in the conditions for growth in industrial production in the period ahead (see Chart III.3.15).

The contribution of **trade and services** to the year-on-year evolution of gross value added was negative (-0.3 percentage point). This was mostly due to real estate activities, where gross value added fell by almost 5% year on year in 2013 Q3. Value added also continued to decrease in trade, transportation, accommodation and food services. On the other hand, financial and insurance activities saw continuing fast year-on-year value added growth exceeding 10%.[35] The CZSO's latest leading statistics are signalling a rise in value added in trade in 2013 Q4, more so in the automotive segment than in other retail segments.

Gross value added in **construction** continued to be adversely affected in 2013 Q3 by the persisting strong contraction in demand for construction work, particularly from the government. In these circumstances, the year-on-year decline in gross value added at basic prices continued, deepening further to -4.8% (see Chart III.3.12). This was fostered mainly by a continued year-on-year decline in construction output, with the decline in civil engineering remaining in double figures (almost 12%). The latest available CZSO data do not indicate any improvement in the trend either, since both construction output and the number of building permits continued to fall significantly in November.

An **international comparison of economic sentiment**, based on data for December, confirms the previous trends in this indicator both in the Czech Republic and in Germany and the EU as a whole. The upward trend observed in Germany and the EU since the second half of 2012 is thus continuing (see Chart III.3.16). Economic sentiment in the Czech Republic recorded similar developments.

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

According to the **Cobb-Douglas production function** calculation, the annual growth rate of potential output remained only just above 1% in 2013 Q3 (see Chart III.3.17). The only modest quarterly increase in economic activity observed in 2013 Q3 resulted in a slight opening of the output gap, which thus remained deep in negative territory (-3.7% of potential output; see Chart III.3.18). This method suggests stable annual potential output growth this year, with a renewed

35 Value added also went up slightly in public administration and defence, education and health and social care and in other activities (by 0.2% and 2.3% year on year respectively).

gradual recovery at the longer end of the forecast horizon. The output gap should then gradually close as the economy starts to grow again, nearing zero in late 2015.

The breakdown of the **contributions of the individual factors** entering the production function points to stability in employment and an increase in the contribution of productivity to the detriment of the contribution of capital compared to 2013 Q2. The contributions of both capital and employment will gradually shrink over the forecast horizon, while the gradually increasing positive contribution of productivity will offset these effects. Overall, annual growth in potential output will pick up only slightly to levels of around 1.3% in 2015 (see Chart III.3.19).

An alternative estimate using the **HP filter**[36] indicates even lower potential output growth (0.7% in 2013 Q3) than the production function calculation. Under this method, the output gap is narrower in the near future and the HP filter indicates somewhat earlier closure of the output gap in 2015 amid slightly accelerating potential output growth. The **Kalman filter** indicates that annual potential output growth will stay at zero in 2013 Q3. Over the forecast horizon, potential output will start rising again and accelerate above 2% in 2015. Compared to the Cobb-Douglas production function calculation, the Kalman filter also indicates a more moderate opening of the output gap to negative levels at present, but slower closure over the forecast horizon.

CHART III.3.18

OUTPUT GAP

The output gap remains significantly negative
(in % of potential output)

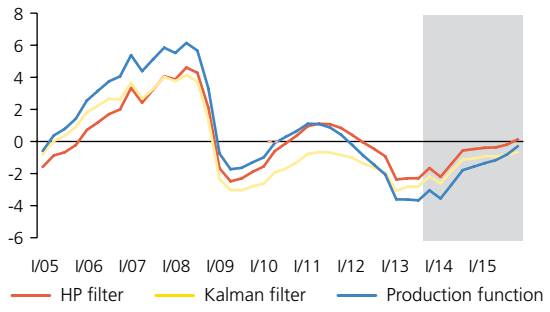
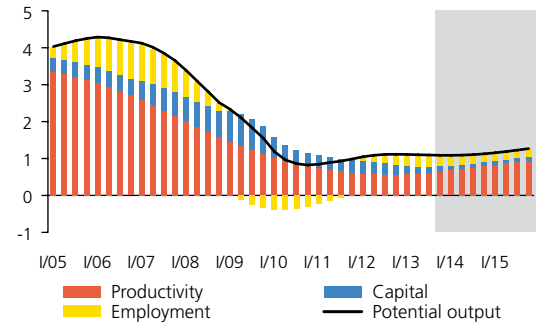


CHART III.3.19

CONTRIBUTIONS TO POTENTIAL OUTPUT GROWTH

The contribution of productivity will gradually increase over the forecast horizon
(baseline production function; annual percentage changes)



36 The estimate using the HP filter used coefficient λ = 1,600.

CHART III.4.1

LABOUR MARKET INDICATORS

The number of employees converted into full-time equivalents declined further in 2013 Q3, but the number of employed persons kept rising
(annual percentage changes)

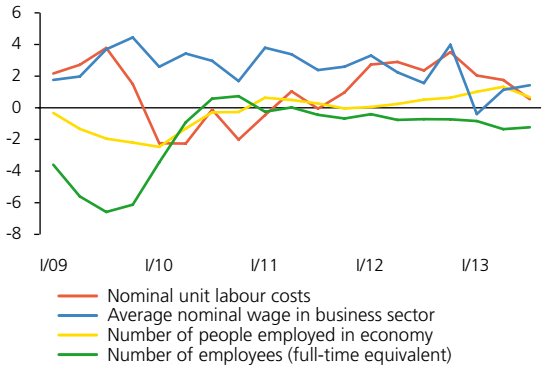
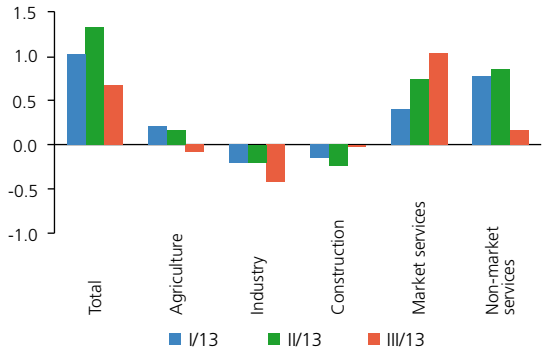


CHART III.4.2

EMPLOYMENT BREAKDOWN BY BRANCHES

The continuing growth in employment was due solely to services
(contributions in percentage points to annual change; selected branches; source: LFS)



III.4 THE LABOUR MARKET

The labour market continued to be affected in 2013 Q3 by the previous contraction in economic activity. Year-on-year growth in total employment and the number of employees slowed. At the same time, cuts in hours worked continued in a number of industries due to low demand, so the number of employees converted into full-time equivalents recorded a further annual decline. The general unemployment rate was flat in year-on-year terms amid equal growth in the labour force and total employment. By contrast, the share of unemployed persons increased owing to a decrease in the working age population and a rise in the number of unemployed persons. Nominal wage growth remained low, and the average wage went up only marginally in real terms. The marked moderation in the decline in economic activity led to a slower decrease in whole-economy labour productivity and lower growth in unit labour costs.

III.4.1 Employment and unemployment

The gradual upward trend in **total employment**,[37] which had been going on for more than a year, came to a halt in 2013 Q2. The year-on-year growth slowed noticeably in Q3 (from 1.3% to 0.7%; see Chart III.4.1). In quarter-on-quarter terms, total employment (adjusted for seasonal effects) declined by 0.3% after six quarters of growth. The generally moderate year-on-year growth in total employment continued to be driven by an increasing number of employees, albeit to a lesser extent than in the previous quarter, while the number of entrepreneurs continued to fall year on year.

As regards sectors, the year-on-year growth in employment was due solely to the **tertiary sector** (see Chart III.4.2). Nevertheless, the growth in this sector in 2013 Q3 (2% year on year) was also more moderate than in the previous quarter. The higher growth in employment in non-market services observed in previous quarters faded away, and this factor was not fully offset by the simultaneously strengthening growth in employment in market services. The year-on-year growth in the number of persons employed in market services was meanwhile concentrated in just two sectors – information and communication services, and administration and other support services.

Employment in the **secondary sector** decreased further year on year. The decline in employment in manufacturing intensified. According to the latest CZSO figures for November, the renewed growth in orders and industrial production has yet to significantly affect the registered number of employees,[38] which recorded a slight year-on-year decline (of 0.3%). At the same time, the number of employees in construction continued to fall significantly. Employment in the **primary sector** decreased again after two quarters of year-on-year growth.

37 Employment according to the LFS.
38 Corporations with 50 employees or more, excluding agency workers.

As in previous quarters, total employment was significantly affected in 2013 Q3 by the use of alternative forms of employment, especially shorter working hours. This was indicated by different paths of the number of employees and the **number of employees converted into full-time equivalents**. A continued year-on-year decline in the latter indicator (see Chart III.4.3) was recorded in the business sector (industry and construction in particular). In the non-business sector, by contrast, the converted numbers of employees recorded a further year-on-year increase.

By cutting hours worked, employers continued to address the issue of **adjustment of employment** in the face of uncertainty about future demand. In this way they cut labour costs amid falling production and simultaneously reduced the risk of losing permanent qualified workers, who might be difficult to find during the recovery phase. Shorter hours worked were also used in other cases, especially upon returning to work after parental leave. The number of shorter working hours arrangements increased by 15.4% year on year in Q3.

The **general unemployment rate**[39] was flat at 7% in year-on-year comparison owing to similar year-on-year growth in the labour force and total employment (see Chart III.4.4).[40] The year-on-year growth in the labour force despite a continued decline in the population was due to an increasing **participation rate**[41] in all age groups. The overall participation rate reached a historical high for the Czech Republic (72.9% after seasonal adjustment). The increase was due, among other things, to an extension of the retirement age, demographic developments and also to the use of shorter working hours. According to the October and November figures, the seasonally adjusted unemployment rate decreased slightly to 6.9% and the participation rate edged up further.

However, the **share of unemployed persons**[42] showed a marked change, rising further in both annual and quarterly terms in 2013 Q3 (see Chart III.4.4). This (seasonally adjusted) unemployment indicator then increased further to 8% in 2013 Q4. This was due to both an increase in the registered unemployed and a continued decline in the population in the given age group.

The latest figures for 2013 Q4 indicate that the deterioration in the labour market situation is probably coming to an end, as the gradual shift of the **Beveridge curve**[43] in approximately the easterly direction has halted in recent months. This is due to only gradual growth in the number of registered job applicants amid a stagnating low number of vacancies (see Chart III.4.5).

39 In the 15–64 age category. Measured by the ILO methodology according to the LFS.
40 Adjusted for seasonal effects it was flat in quarter-on-quarter comparison.
41 The participation rate is defined as the ratio of employed and unemployed persons to the population in each age category.
42 The share of unemployed persons is the ratio of available job applicants aged 15–64 to the population of the same age. It is an MLSA indicator.
43 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.

CHART III.4.3

NUMBER OF EMPLOYEES (FULL-TIME EQUIVALENT)

The decline in average working hours did not deepen further
(contributions in percentage points; annual percentage changes)

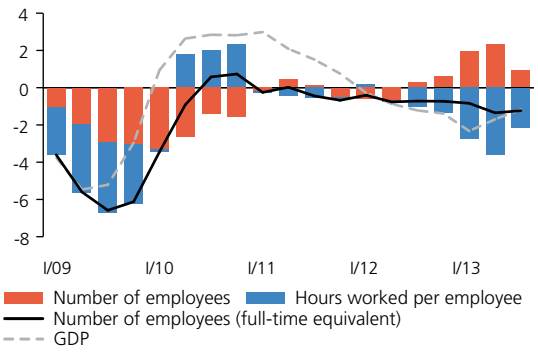


CHART III.4.4

UNEMPLOYMENT INDICATORS

The general unemployment rate was flat year on year in 2013 Q3, but the share of unemployed people rose
(percentages; seasonally adjusted data; source: MLSA, CZSO)

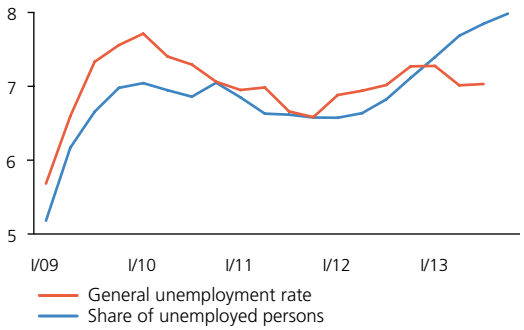


CHART III.4.5

BEVERIDGE CURVE

The rise in the number of unemployed people halted
(seasonally adjusted numbers in thousands; source: MLSA)

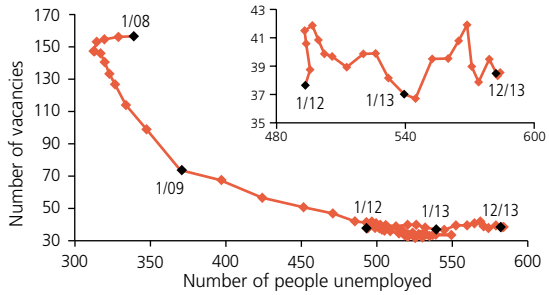


Chart III.4.6

AVERAGE WAGE

The rate of growth of the average nominal wage was low, while the real wage rose slightly
(annual percentage changes)

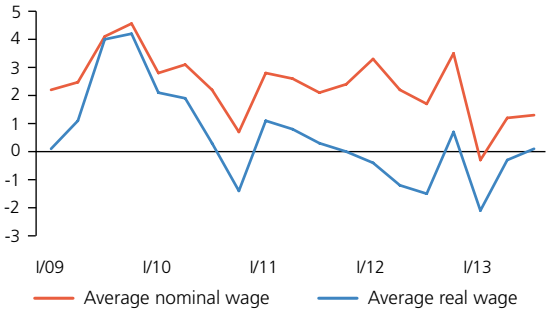


Table III.4.1

WAGES, PRODUCTIVITY, UNIT LABOUR COSTS

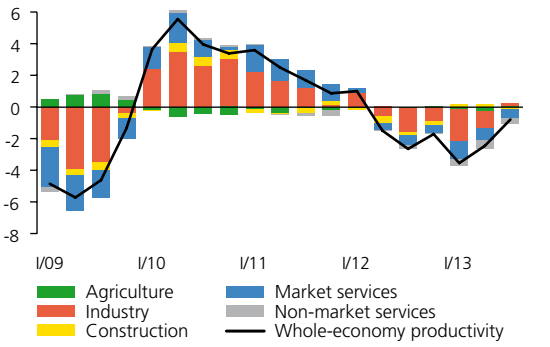
The average nominal wage increased only slightly in 2013 Q3
(annual percentage changes)

	IV/12	I/13	II/13	III/13
Average wage in Czech Republic				
nominal	3.5	-0.3	1.2	1.3
real	0.7	-2.1	-0.3	0.1
Average wage in business sector				
nominal	4.0	-0.4	1.1	1.4
real	1.2	-2.3	-0.4	0.2
Average wage in non-business sector				
nominal	1.2	0.0	1.7	0.8
real	-1.6	-1.8	0.4	-0.4
Whole-economy labour productivity	-1.8	-3.9	-2.9	-0.9
Nominal unit labour costs	3.5	2.0	1.8	0.5

Chart III.4.7

WHOLE-ECONOMY PRODUCTIVITY

The slowdown in the decline of whole-economy labour productivity was due mostly to industry
(annual percentage changes; contributions in percentage points)



III.4.2 Wages and productivity

The generally moderate annual growth in the **average nominal wage** continued into 2013 Q3. Compared to the previous quarter, it rose only slightly to 1.3% (see Chart III.4.6). This rise was due to an upswing in average wage growth in the business sector, as wage growth in the non-business sector slowed noticeably. With annual inflation falling, the **real average wage** rose slightly (by 0.1%), following a small decline in the previous quarter (see Table III.4.1).

Annual average wage growth in the **business sector** was low at 1.4%, despite accelerating in 2013 Q3. Nevertheless, from the longer-term perspective, a downward trend in average wage growth in this sector has been apparent since 2009, despite some fluctuations.[44] The persisting low growth continued to testify to low economic activity and excess supply on the labour market. This view is supported by the year-on-year growth in the **average wage in individual sectors**: with the exception of education and accommodation and food services, annual average wage growth remained low in 2013 Q3, with the average wage falling year on year in about one-third of sectors. Following previous decreases, the real average wage in the business sector went up year on year, although only slightly (by 0.2%; see Table III.4.1).

By contrast, the average nominal wage in the **non-business sector** rose much more slowly in 2013 Q3 than in the previous quarter (moderating by almost 1 percentage point year on year to 0.8%). This continued growth was due to a significant annual rise in the average wage in central government (of 2.7%), while wages decreased in local government. Overall, inflation thus outpaced nominal average wage growth in this sector. This was reflected in a renewed year-on-year decline in the real average wage in Q3 (of 0.4%; see Table III.4.1).

The marked moderation in the annual decline in real GDP and slower growth in employment were reflected in a significant slowdown in the decline of **whole-economy labour productivity**[45] in 2013 Q3 (to -0.9% year on year; see Chart III.4.7). This was due mostly to industry, where the sizeable year-on-year decline in productivity observed in 2013 H1 turned slightly positive (see Chart III.4.8[46]), mainly because of renewed (seasonally unadjusted) growth in value added in this sector. The negative contribution of services – primarily non-market services – to whole-economy activity also continued to shrink gradually in 2013 Q3.

44 For example, in late 2012 and early 2013, it was significantly affected by one-off effects of changes in taxes and contributions introduced on 1 January 2013 (an increase of 7 percentage points in the tax rate for employed persons with income exceeding CZK 103,536 a month, and abolition of the cap on health insurance premium payments).
45 Productivity is calculated on the basis of seasonally unadjusted data.
46 Both the individual contributions in this chart and the summation curve are calculated as a proportion of gross value added and employment (i.e. excluding taxes on products and subsidies on products). The sums may thus differ from the data in Table III.4.1.

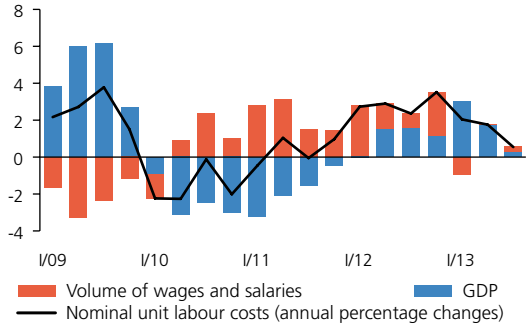
These developments in economic activity as measured by GDP, coupled with an only slight increase in the volume of wages and salaries, were reflected in a further slowdown in annual growth in **unit labour costs**[47] to close to zero (0.5% in 2013 Q3; see Chart III.4.8). As regards sectors, nominal unit wage costs grew mainly in construction and to a lesser extent in services. By contrast, nominal unit wage costs declined year on year in industry, especially in manufacturing.

CHART III.4.8

UNIT LABOUR COSTS

Annual growth in nominal unit labour costs slowed further to a very low level

(contributions in percentage points; annual percentage changes)



47 The wage cost-output ratio as measured by nominal unit wage costs was calculated on the basis of seasonally unadjusted data.

CHART III.5.1

MONETARY AGGREGATES

The annual growth rates of M2 and M3 were almost unchanged in 2013 Q4
(annual percentage rates of growth)

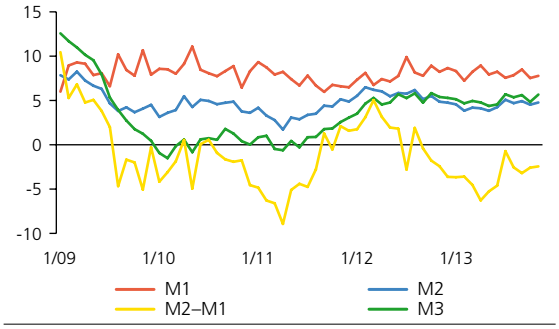


CHART III.5.2

MAIN COMPONENTS OF M2

Overnight deposits remain the main component contributing to M2 growth
(annual flows in CZK billions)

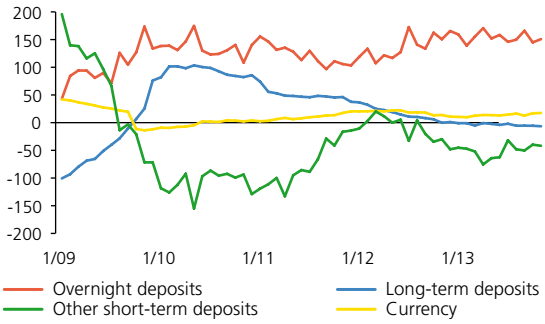
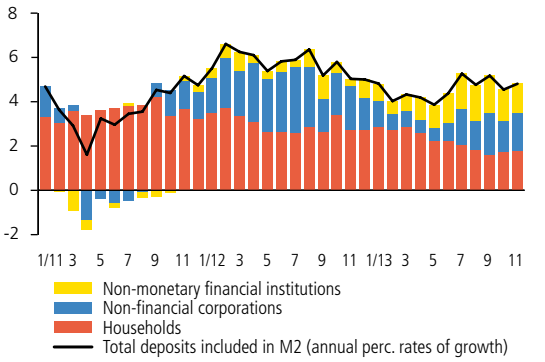


CHART III.5.3

DEPOSIT STRUCTURE OF M2

Unlike in the past, the contributions of all the monitored sectors to M2 growth are evenly distributed
(contributions in percentage points; annual percentage rates of growth)



III.5 FINANCIAL AND MONETARY DEVELOPMENTS

The annual growth rate of M2 was just above 5% at the end of 2013, but its velocity continued to decline sharply. M1 remained the only component contributing to M2 growth, as a result of an increase in overnight deposits by both corporations and households. The effect of the CNB's foreign exchange interventions has so far been marginal. The annual growth rate of loans to the private sector went up, mainly due to corporations' increased demand for loans. The growth rate of loans to households also rose slightly. Households' debt increased further as a percentage of income, amid persisting growth in their net financial assets. Client interest rates on new loans to households and corporations were broadly flat and increased slightly, respectively, at the end of the year. The 3M PRIBOR edged down during 2013 Q4. The performance indicators of non-financial corporations improved. Prices of apartments in Prague saw a recovery towards the end of 2013. Transaction prices outside Prague continued to go down.

III.5.1 Money

The annual growth rate of **M2** edged up to 4.8% in November 2013, having hovered at roughly this level over the previous few months (see Chart III.5.1). M2 growth remains significantly lower than in the pre-crisis period. With nominal GDP growth increasing by just 0.4% year on year in 2013 Q3, the velocity of money continued to slow sharply. The annual growth rate of M3 showed similar developments and was around 4 percentage points higher than the euro area average. On the asset side, money growth was fostered mainly by growth in loans to the private sector and in net foreign assets.

A preference for liquidity maintained the growth rate of M1 high at 7.8% (see Chart III.5.1). This was due to an increase in **overnight deposits** of corporations and households (see Chart III.5.2). Growth in currency showed a slight upward tendency. The decline in short-term time deposits (included in M2–M1) slowed, reflecting the evolution of deposits with an agreed maturity of up to two years and subdued growth in deposits redeemable at notice of up to three months. Long-term deposits included in M2 continued to decline in an environment of low interest rates.

Turning to the **sector structure of deposits**, the M2 growth was fostered almost equally by deposits of households, non-financial corporations and non-monetary financial institutions other than insurance corporations and pension funds (see Chart III.5.3). The annual growth rate of deposits of non-financial corporations increased to 6.2% in November 2013. Its increase corresponded to a persisting elevated acid-test ratio of corporations. The growth rate of household deposits also edged up to 2.6%. Issuance of state saving bonds was reflected in a CZK 21 billion outflow of household deposits into these instruments at the very end of last year.

The effect of the CNB's foreign exchange **interventions** on M2 has so far been marginal. The share of foreign currency resident deposits in total resident deposits in M2 decreased from 8.7% in October to 8.2% in November 2013, while the share of koruna deposits increased to 91.8%. Sales of foreign currency deposits during the interventions were recorded in non-financial corporations. As regards net foreign assets, koruna deposits and non-residents' loans with domestic banks increased by CZK 150 billion. This was more than offset by an increase in the CNB's international reserves. Additional liquidity resulting from the CNB's purchases of foreign currency from domestic banks amounting to around CZK 200 billion was deposited by these banks with the CNB in standard transactions.

III.5.2 Credit

The annual growth rate of **loans to the private sector** increased, reaching 4.1% in November 2013. According to the bank lending survey, demand for loans increased mainly in corporations in 2013 Q4. On the supply side, credit standards for approving loans were unchanged in all major segments of the credit market (see Table III.5.1).[48]

Loans to non-financial corporations recorded a year-on-year increase of 2.8% in 2013 Q4. Loans with longer maturities recorded higher growth, while short-term loans recovered slightly (see Chart III.5.4). This was observed for both domestic and foreign-controlled corporations. The growth in loans was fostered mainly by loans to developers. These were euro loans obtained under previously concluded loan agreements to finance the construction of business and shopping centres. The growth rate of loans to industry (especially energy, mining and quarrying) and in activities related, for example, to corporate governance advice rose to a lesser extent. Demand for loans increased in large firms and, for the first time in a year, also rose slightly in small and medium-sized enterprises. Demand was favourably affected by financing of mergers and acquisitions (especially in the energy sector), fixed investment (mainly in the developers sector), inventories and working capital. On the other hand, new corporate loans recorded a decrease.

48 In the euro area, the results of the bank lending survey for 2013 Q3 suggest a continued, albeit less broad-based, decline in demand of corporations for loans linked with demand for fixed investment financing loans. Households' demand for loans started to go up. Credit standards on loans to corporations and households for house purchase tightened further, although not across the board. The decline in loans to the private sector stabilised (at around 2%), broadly in line with the current phase of the business cycle, accompanied by low demand for loans and tightened credit standards and terms and conditions by banks (due mainly to banks' capital positions in some euro area countries). The delayed effects of the cycle on credit are due to firms' reliance on internal sources of funding (see the ECB Monthly Bulletin, January 2014).

Table III.5.1

CHANGES IN BANKS' CREDIT CONDITIONS

Corporate demand for loans increased; banks left their credit standards virtually unchanged

(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	Margin on riskier loans	Demand for loans
Loans to non-financial corporations				
I/13 a)	0 (22)	7	46	23 (-21)
II/13 b)	17 (9)	-36	3	19 (-1)
III/13 c)	0 (20)	-21	0	-7 (23)
IV/13 d)	-2 (0)	-20	2	27 (-8)
I/14 e)	(2)			(29)
Loans for house purchase				
I/13 a)	-6 (-7)	-27	-26	12 (-19)
II/13 b)	4 (-26)	-43	-4	67 (17)
III/13 c)	-4 (-22)	-53	20	61 (-7)
IV/13 d)	0 (27)	22	8	11 (6)
I/14 e)	(-4)			(-2)
Consumer credit				
I/13 a)	-1 (2)	23	1	5 (9)
II/13 b)	26 (30)	7	7	69 (-7)
III/13 c)	0 (0)	-9	0	-34 (-15)
IV/13 d)	0 (-7)	-9	-9	-9 (2)
I/14 e)	(16)			(-28)

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 IV/12 survey given in parentheses.
b) Banks' expectations reported in the I/13 survey given in parentheses.
c) Banks' expectations reported in the II/13 survey given in parentheses.
d) Banks' expectations reported in the III/13 survey given in parentheses.
e) Banks' expectations reported in the IV/13 survey given in parentheses.

Chart III.5.4

LOANS TO NON-FINANCIAL CORPORATIONS

Loans to non-financial corporations increased mainly as a result of growth in long-term loans

(annual percentage rates of growth; annual percentage changes)

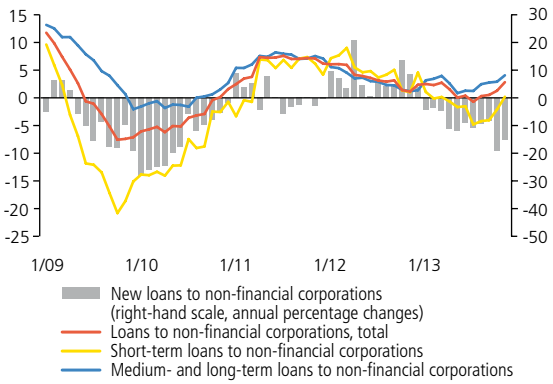
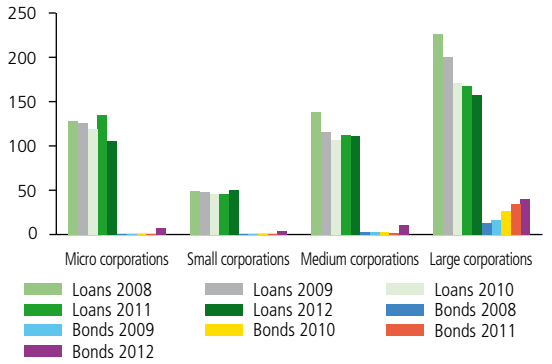


CHART III.5.5

LOANS AND BONDS BROKEN DOWN BY SIZE OF NON-FINANCIAL CORPORATIONS

In 2008–2012, the decline in bonds was biggest in large corporations; this was partly offset by greater issuance of bonds by such corporations

(volumes in CZK billions; source: Bank de France BACH database, CNB calculations)



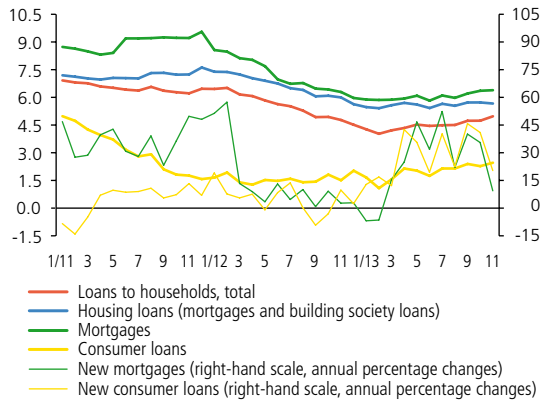
Note: Micro-corporations – 0–9 employees, small corporations – 10–49 employees, medium-sized corporations – 50–249 employees, large corporations – 250 employees or more. The sample consists of 9,156 corporations over the last five years.

CHART III.5.6

LOANS TO HOUSEHOLDS

The annual growth rate of loans to households rose steadily

(annual percentage rates of growth; annual percentage changes)



Banks' **credit standards** for approving corporate loans were unchanged in 2013 Q4. The tightening associated with perceived risk regarding the outlooks for specific sectors and firms observed in the previous six quarters came to a halt.

As regards firm size, in 2008–2012 total loans recorded the biggest decline in large corporations and, to a lesser extent, in medium-sized and micro-corporations (up to nine employees), while the loan volume in small enterprises was unchanged (see Chart III.5.5). In **large corporations**, this decline was accompanied by an increase in issuance of bonds, which in 2012 amounted to around one-quarter of the loan volume. Issuance of corporate bonds at the aggregate level increased year on year in 2013 Q3 (by around 29%), although less so than in the previous period.

The bond volume in **small and medium-sized enterprises** is about one-tenth of the loan volume. Interest rates on small loans – usually provided to smaller firms – are still higher than those on large loans. Moreover, these firms recorded the largest decline in book value added in 2012, which further increased their debt burden, while the debt burden in large firms was unchanged.[49] Despite this decline, however, the share of small and medium-sized enterprises in the formation of total book value added was significant, amounting to around 40% in 2012.

The annual growth rate of **loans to households** reached 5% in November 2013. However, the growth in the stock of loans to households overall and in their two main components – loans for house purchase and consumer credit – was accompanied by lower growth in new loans in those two segments (see Chart III.5.6).

The annual growth rate of **loans for house purchase** was flat. Following an increase in November, the growth rate of mortgages stayed at 6.4%, while building society loans continued to decline. The rise in household demand for house purchase loans perceived in previous quarters by a majority of the banking market slowed in 2013 Q4. Better outlooks for the residential property market and improved consumer confidence had a favourable effect on demand. Banks left their credit standards for house purchase loans unchanged in 2013 Q4. Growth in the number and volume of new mortgages slowed to 7% and 3.2% respectively in December 2013. According to Hypoindex, the **number of new mortgages** for property construction declined, while growth in mortgages for property purchase decreased and growth in other mortgages – associated among other things with refinancing of old loans – was only moderate at the end of 2013

49 The ratio of loans and bonds to book value added still decreases with increasing corporation size. In 2012 it was 400% for micro-corporations, 76% for small corporations, 39% for medium-sized corporations and 28% for large corporations.

(see Chart III.5.7). The proportion of the number of mortgages for refinancing is around 23%, as compared to 29% in the middle of last year.[50]

The annual growth rate of bank **consumer credit** edged up to 2.5% in November 2013. Consumer credit obtained by households from non-banks was flat in year-on-year terms. Growth in new consumer credit declined, following a previous sizeable increase driven by consolidation of old consumer credit (see Chart III.5.6). According to banks, demand for consumer credit decreased owing to still low consumer confidence and the availability of other sources of financing.

In 2013 Q3, the ratio of total **household debt** to gross disposable income increased further to 60% (or around 66% including other accounts payable). The equivalent ratio in the euro area has recently been flat at around 100%. The net interest burden on Czech households rose to 2%, where it has been fluctuating since 2010. This mainly reflected a decline in interest received from banks amid flat interest paid (see Chart III.5.8).

III.5.3 Interest rates

Monetary policy interest rates

The monetary policy decision-making of the CNB Bank Board in 2013 Q4 was based on the macroeconomic forecast published in the previous Inflation Report. Consistent with the baseline scenario of the forecast and its assumptions was a sharp decline in market interest rates well below zero. Given the zero lower bound on monetary policy rates, this pointed to a need to ease monetary policy using other instruments. At its meeting in November, the Bank Board decided unanimously to leave key **interest rates**[51] unchanged at technical zero (see Chart III.5.9). At the same time, it decided that the CNB would start to use the **exchange rate of the koruna as an instrument for easing monetary policy** and would intervene in the foreign exchange market to weaken the koruna so as to maintain the exchange rate of the koruna against the euro close to CZK 27/EUR. With this Board decision, the alternative scenario in the previous forecast, in which the exchange rate of the koruna took over the stabilising role of monetary policy, became the most likely description of expected future economic developments. According to the Board's decision, the CNB's foreign exchange commitment is one-sided, i.e. the CNB will prevent excessive appreciation of the koruna below CZK 27/EUR. At its meeting in December, the Bank Board also decided unanimously to leave key interest rates unchanged. At the same time, it confirmed the above foreign exchange commitment.

50 Banks expect credit standards and household demand for house purchase loans to remain broadly unchanged in 2014 Q1.

51 The two-week repo rate and the discount rate were set at 0.05% and the Lombard rate at 0.25% with effect from 2 November 2012.

CHART III.5.7

STRUCTURE OF NUMBER OF NEW MORTGAGES

The contribution of the number of new mortgages, associated mainly with refinancing of old loans and house purchase and construction, saw a decrease

(contributions in percentage points; annual percentage changes; source: Fincentrum Hypoindex)

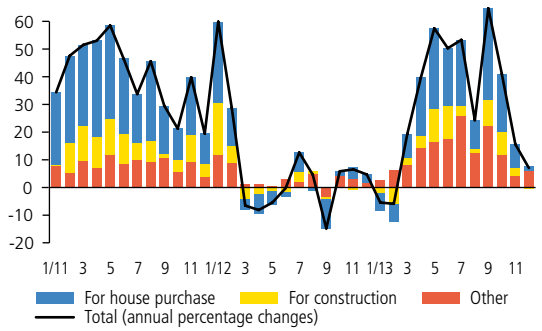
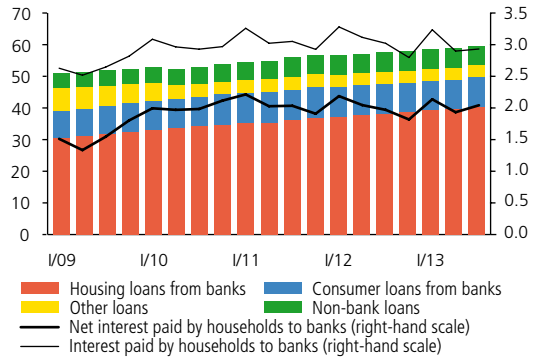


CHART III.5.8

HOUSEHOLD DEBT

The debt and net interest payments of households in relation to income increased further in 2013 Q3

(percentage ratios to gross disposable income)



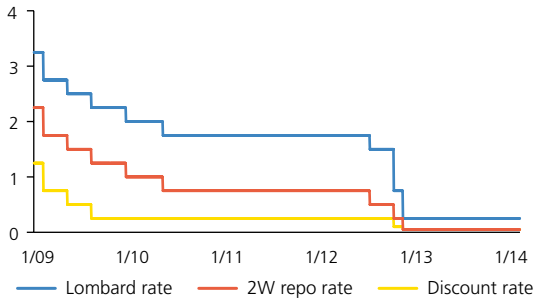
Note: Net interest paid represents the difference between households' loan interest expenses and bank deposit interest income. Interest paid consists of households' borrowing-related interest expenses.

CHART III.5.9

CNB KEY RATES

The CNB left its key interest rates at "technical zero" in 2013 Q4

(percentages)

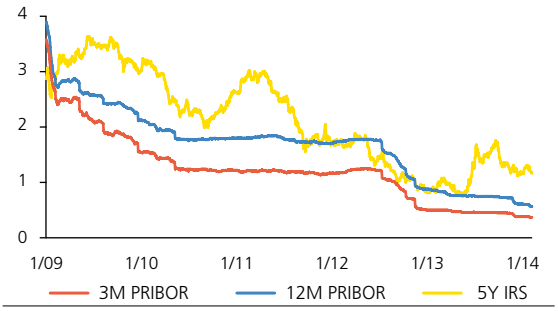


At its monetary policy meeting on 6 February 2014, the Bank Board of the Czech National Bank decided unanimously to keep interest rates unchanged, i.e. at technical zero. The Board also decided to continue **using the exchange rate as an additional instrument for easing the monetary conditions** and confirmed the CNB's commitment to intervene on the foreign exchange market if needed to weaken the koruna so that the exchange rate of the koruna against the euro is kept close to CZK 27 to the euro. The nature of this exchange rate commitment is unchanged. The Bank Board continues to view the level of the exchange rate commitment as appropriate, as it delivers the necessary easing of the monetary conditions. The Bank Board foresees this exchange rate commitment being maintained at least until the start of 2015.

CHART III.5.10

MARKET INTEREST RATES

Money market interest rates fell slightly due to increased liquidity resulting from the CNB's foreign exchange interventions
(percentages)



Financial market interest rates

Money market interest rates fell slightly in 2013 Q4 due to an increase in excess koruna liquidity[52] after the CNB started to use the exchange rate as an instrument for easing monetary policy. PRIBOR interest rates were thus at historical lows at all maturities (see Chart III.5.10). **FRA derivative rates** fell by 0.1–0.2 percentage point after the Board meeting in November. In addition to the koruna liquidity surplus, the lowered outlook for these rates seems to have reflected the GDP and inflation data published in the first half of November. The market outlook for 3M rates according to end-January FRA quotations implies expected approximate stability of these rates at least until the end of the year. The market outlook is broadly 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 reflected the higher koruna liquidity. The efforts to place liquidity (bolstered by the fact that no auctions of government bonds took place at the end of the year) pushed down government bond yields and partly also IRS rates, amid large trading volumes. As regards external factors, domestic interest rates were temporarily affected by the ECB's monetary policy easing in November and especially by the announcement of the tapering of the qualitative easing programme in the USA at the Fed's meeting in December. Nevertheless, the published foreign macroeconomic indicators sent a mixed message in terms of global and, subsequently, domestic growth, and so foreign and domestic interest rates did not show any clear direction. Overall, IRS rates with shorter maturities (up to four years) declined by 0.1 percentage point compared to the end of September, while rates with longer maturities increased to the same extent.

The average **3M PRIBOR** in 2013 Q4 was 0.4%, in line with the level foreseen by the alternative scenario of the previous forecast, which had included the use of the exchange rate as an instrument for easing

52 Banks started to make greater use of 2W repos and the overnight deposit facility, through which they deposited excess liquidity. The CNB bought foreign exchange worth around CZK 200 billion in its interventions.

monetary policy. The money market credit premium, as measured by the spread between the 3M PRIBOR and the 2W repo rate, averaged 0.4 percentage point. This spread narrowed slightly after the launch of foreign exchange interventions, fluctuating just above 0.3 percentage point.

The positive slope of the **PRIBOR yield curve** decreased in 2013 Q4. The spread between the 1Y PRIBOR and the 2W PRIBOR was 0.4 percentage point on average in December 2013. The **IRS yield curve** shifted to a lower level in 2013 Q4 and its positive slope also decreased. In December, the average 5Y–1Y spread was 0.8 percentage point and the 10Y–1Y spread 1.6 percentage points.

Short-term **interest rate differentials** vis-à-vis the two main world currencies (PRIBOR/CZK–EURIBOR/EUR, or LIBOR/USD) reflected the slight decrease in rates in the Czech Republic and the only marginal changes in rates on foreign financial markets. The differentials vis-à-vis euro and dollar rates thus declined somewhat to only slightly positive levels (see Chart III.5.11). The 3M PRIBOR–3M EURIBOR interest rate differential was 0.2 percentage point on average in 2013 Q4. At the end of January 2014, it was 0.1 percentage point.

Nine auctions of fixed coupon bonds and one auction of variable coupon bonds were held on the primary **government bond market** in 2013 Q4 and January 2014. The total volume of bonds issued was CZK 49.6 billion.[53] Demand strongly exceeded supply in all the auctions. The bid-to-cover ratio was 2.1 on average. Government bonds continued to be subscribed with very low yields close to their historical lows. The Ministry of Finance also issued a fifth issue of state saving bonds totalling CZK 21.3 billion. The government bond yield curve – like the IRS curve – shifted slightly downwards in 2013 Q4 and then moved up again, similar to the developments seen on foreign bond markets. Its positive slope was broadly unchanged (see Chart III.5.12).

Client interest rates

Client interest rates on new loans to non-financial corporations and households were mostly broadly unchanged in 2013 Q4, increasing only in the case of loans to households with long-term fixations. Ex ante real interest rates were little changed for corporate loans and loans for house purchase in 2013 Q4, while increasing for consumer credit.

The **interest rate on loans to non-financial corporations** increased slightly in nominal terms to 2.1% in November 2013. This reflected a rise in rates with short-term fixations, at which the overwhelming majority of corporate loans are provided (see Chart III.5.13).

53 Overall, sales of government bonds on the primary market amounted to CZK 136.1 billion in 2013; the revised Funding and Debt Management Strategy for 2013 assumed issues amounting to CZK 96.7–170.7 billion.

CHART III.5.11

INTEREST RATE DIFFERENTIALS

Interest rate differentials vis-à-vis the euro and the dollar decreased slightly towards zero
(percentage points)

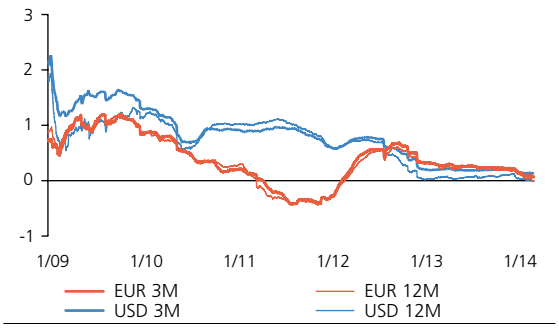


CHART III.5.12

GOVERNMENT BOND YIELD CURVE

The shape and slope of the government bond yield curve were little changed from September
(percentages)

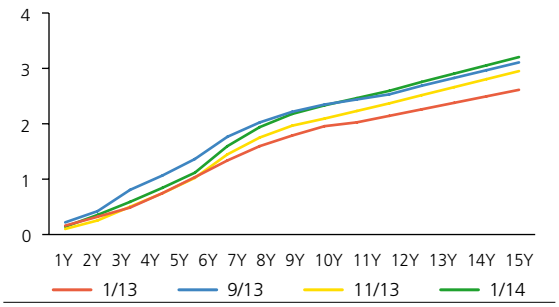


CHART III.5.13

INTEREST RATES ON LOANS TO CORPORATIONS

The interest rate on loans to non-financial corporations increased slightly on average
(new business; percentages)

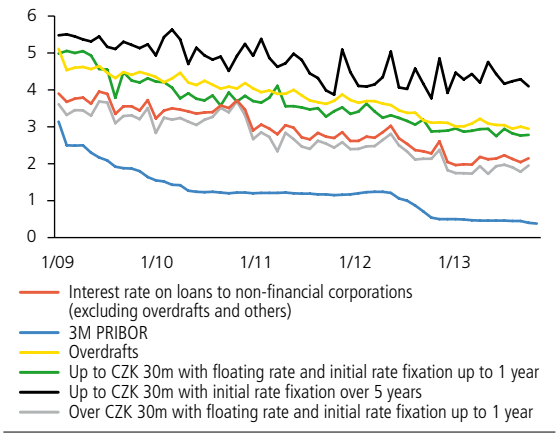


CHART III.5.14

INTEREST RATES ON LOANS TO HOUSEHOLDS

Interest rates on loans to households with long-term fixations went up, while those with shorter fixations were flat
(new business; percentages)

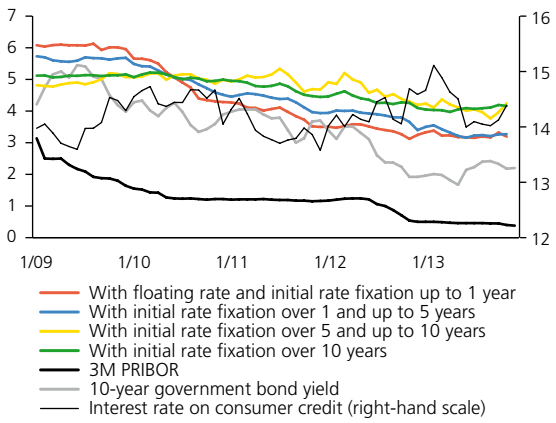


CHART III.5.15

CLIENT AND MARKET INTEREST RATE SPREADS

The spread between the short-term rate on small and large corporate loans and the 3M PRIBOR increased slightly
(percentage points)

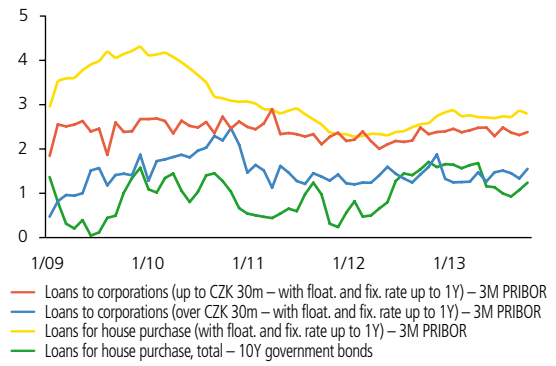
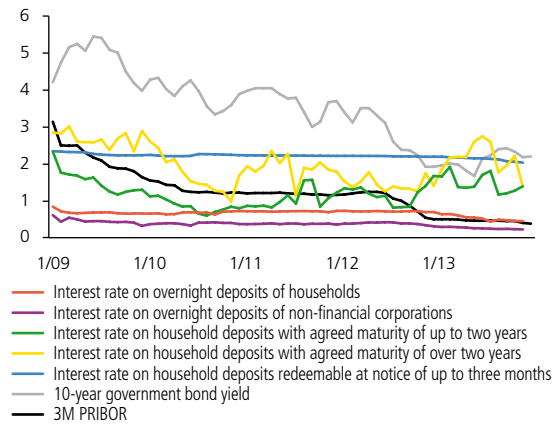


CHART III.5.16

INTEREST RATES ON DEPOSITS

Interest rates on household time deposits mostly continued to fall steadily
(percentages)



The average rate on large loans of over CZK 30 million edged up to 2%, while the rate on small loans was 3%. The spread between these rates declined further, but is still slightly above its long-term trend. With the 3M PRIBOR declining slightly, the spread between the short-term rate on large and small loans and the 3M PRIBOR increased (see Chart III.5.15). Some rates in the euro area also increased and are still higher than those in the Czech Republic (the average rate in the euro area was 2.8%).

The **interest rate on loans for house purchase** for households was 3.4% on average in November 2013 (3.2% for mortgages). The rate on loans with fixations of over one year and up to five years, which account for 76% of all house purchase loans, was flat at 3.3% (see Chart III.5.14). Floating rates and rates fixed for up to one year showed similar developments. By contrast, some rates with fixations of over five years increased further, due mainly to the previous rise in long-term financial market interest rates. Banks currently perceive that competitive pressures are falling. The spread between short-term client and market rates was broadly unchanged in 2013 Q4 (see Chart III.5.15). By contrast, the spread between the average rate on loans for house purchase and the long-term financial market rate increased due to a fall in the ten-year government bond yield in November. According to banks, their average margin increased for the first time in a year. According to Hypoindex, the interest rate on new mortgages fell slightly in December 2013. According to the latest data for November, the interest rate on loans for house purchase in the euro area increased to 3.1% on average.

The **interest rate on consumer credit** increased to 14.4% in November 2013, while the APRC, which includes non-interest charges, fell to 14.9% (see Chart III.5.14). Banks made no changes to their credit standards for such loans in 2013 Q4. As regards terms and conditions, a small section of the bank credit market lowered its average margins on home equity loans and also its margin on riskier loans and its non-interest charges. The rate on overdrafts and revolving loans edged up to 14.7% and the rate on credit card debt to 24.2%. The rate on consumer credit in the euro area also increased slightly, but at 6.6% on average is still well below that in the Czech Republic.

Interest rates on deposits of households and corporations showed mixed trends in the period under review but tended to fall from the longer-term perspective. Rates on overnight deposits stayed at 0.5% and 0.2% for households and non-financial corporations respectively. The rate on deposits redeemable at notice of up to three months, comprising relatively highly remunerated building society deposits, fell slightly (to around 2%). By contrast, the short-term rate on household deposits with an agreed maturity of up to two years went up as a result of banks' efforts to make them more attractive, while the interest rate on long-term deposits declined. The two rates currently stand at the same level (1.4%; see Chart III.5.16).

Real client interest rates[54] were little changed overall in 2013 Q4 owing to broadly flat nominal rates and expected inflation. Real rates on new loans were 4.4% in November, while real rates on time deposits were 0.1% (see Chart III.5.17).

III.5.4 The exchange rate

The average **exchange rate of the koruna against the euro** was CZK 26.7 in 2013 Q4. This represents a year-on-year depreciation of 5.9% and a quarter-on-quarter depreciation of 3.1% (see Chart III.5.18). The koruna weakened abruptly to around CZK 27 to the euro (after previously fluctuating between CZK 25.5 and CZK 26.0) as a result of the CNB's decision of 7 November 2013. It then showed a tendency to weaken further, reaching CZK 27.7 to the euro in mid-December. The weakening subsequently came to a halt, and in the following period the koruna fluctuated around CZK 27.5 to the euro. As a result, it was one of the convertible currencies to record a significant depreciation in 2013 Q4. The Australian dollar, the South African rand, the Turkish lira and the Thai baht, for example, weakened to a similar extent. The Japanese yen saw an even greater weakening. At the end of January 2014 the exchange rate of the koruna was still around CZK 27.5 to the euro.

The main factor affecting the exchange rate of the koruna in 2013 Q4 was the CNB's **foreign exchange interventions** based on the decision of the Bank Board to weaken the koruna to close to CZK 27 against the euro and to prevent it subsequently appreciating significantly beyond this level. However, the further depreciation of the koruna beyond this level in November and in the first half of December was caused solely by the foreign exchange markets with no further interventions by the CNB.

The average **exchange rate of the koruna against the dollar** was CZK 19.6 in 2013 Q4. This represents a year-on-year depreciation of 0.9% and a quarter-on-quarter depreciation of 0.5%. The koruna depreciated from around CZK 19.0 against the dollar at the start of the quarter to CZK 19.9 at the end. The koruna depreciated less against the dollar than against European currencies owing to a weakening of the dollar on world markets in the period under review. In late January, the koruna was trading at around CZK 20.3 to the dollar (owing to a slight appreciation of the dollar on world markets at the start of this year).

CHART III.5.17

EX ANTE REAL RATES

Ex ante real interest rates on new loans and deposits recorded no major changes
(percentages)

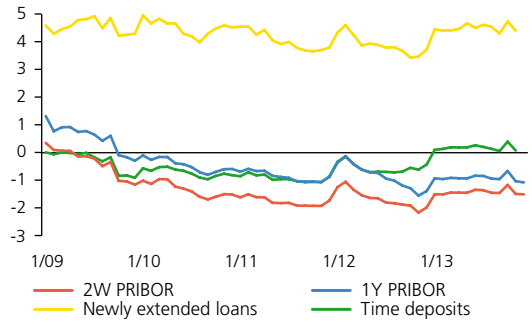
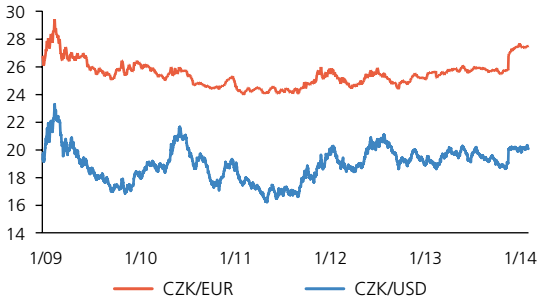


CHART III.5.18

CZK/EUR AND CZK/USD EXCHANGE RATES

The koruna weakened against the euro in 2013 Q4



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

CHART III.5.19

KEY FINANCIAL INDICATORS

The main financial indicators saw renewed growth or slower declines in 2013 Q3

(annual percentage changes)

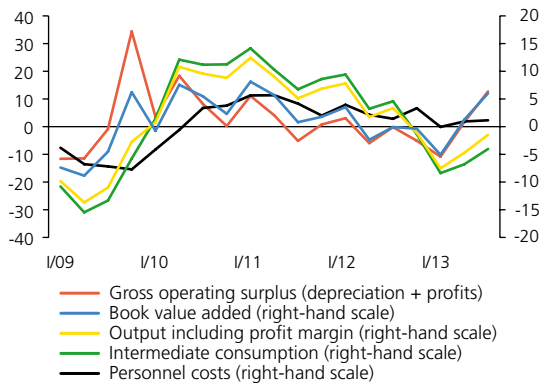


TABLE III.5.2

PERFORMANCE INDICATORS OF CORPORATIONS

The material cost-output ratio decreased further and the personnel cost-output ratio increased

	2012 Q3	2013 Q3	Annual percentage changes
Output incl. profit margin (CZK billions)[a]	1,382.9	1,362.5	-1.5
Personnel costs (CZK billions)	202.8	205.1	1.1
Intermediate consumption (CZK billions)	1,032.2	990.7	-4.0
Book value added (CZK billions)	350.7	371.8	6.0
Sales (CZK billions)	1,809.1	1,805.8	-0.2
	Percentages	**Percentages**	**Annual changes in pp**
Ratio of personnel costs to value added[a]	57.8	55.2	-2.7
Material cost-output ratio[a]	74.6	72.7	-1.9
Personnel cost-output ratio[a]	14.7	15.1	0.4
Ratio of book value added to output[a]	25.4	27.3	1.9

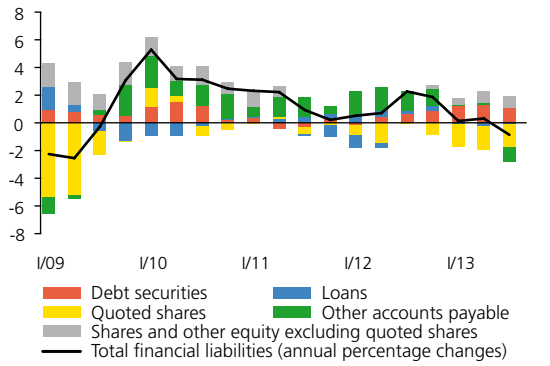
a) CNB calculation

CHART III.5.20

FINANCIAL LIABILITIES OF NON-FINANCIAL CORPORATIONS

The financial liabilities of corporations fell slightly in 2013 Q3

(annual percentage changes; contributions in percentage points)



III.5.5 Economic results of non-financial corporations

The financial results of **non-financial corporations with 50 employees or more**[55] in 2013 Q3 suggested a modest recovery in economic activity. Compared to the previous quarter, the annual decrease in output and sales slowed further (to -1.5% and -0.2% respectively). Annual growth in book value added picked up pace amid a less sharp drop in intermediate consumption (see Chart III.5.19). Gross operating surplus also recorded an annual increase, even though growth in personnel costs accelerated slightly compared to the previous quarter.

With intermediate consumption falling faster than output, the **material cost-output ratio**[56] fell further year on year in 2013 Q3 (by 1.9 percentage points; see Table III.5.2). A sharp decrease in the material cost-output ratio of 32.2% occurred in the electricity, gas, heat and air-conditioned air supply industry. Significant declines were also recorded in mining and quarrying and real estate activities.

By contrast, the **personnel cost-output ratio**[57] recorded further moderate annual growth of 0.4 percentage point in 2013 Q3 (see Table III.5.2). This was due chiefly to a continuing – albeit less pronounced – annual decline in output stemming from the persisting low demand, accompanied by a moderate annual rise in personnel costs.

Data for the narrower **segment of large corporations** (with 250 employees or more)[58] indicate similar trends in the main financial indicators in 2013 Q3 as in the larger segment of corporations, although the rate of decrease of intermediate consumption and output including profit margins was even more pronounced for large corporations.

III.5.6 Financial position of corporations and households

The **financial liabilities of non-financial corporations** fell slightly year on year in 2013 Q3 (see Chart III.5.20). Financial liabilities saw a moderate decline owing chiefly to revaluation of quoted shares and to other accounts payable. Positive contributions were recorded for debt securities and shares and other equity excluding quoted shares. As regards the **assets of non-financial corporations**, the volume of shares and the amount of currency and deposits increased in Q3. Securities other than shares also made a positive contribution to the

55 The segment of corporations with 50 employees or more consisted of almost 9,300 non-financial corporations at the end of 2013 Q3.
56 The material cost-output ratio defined as the ratio of intermediate consumption to output.
57 The personnel cost-output ratio defined as the ratio of personnel costs to output.
58 The segment of corporations with 250 employees or more consisted of almost 1,700 non-financial corporations at the end of 2013 Q3.

annual growth in corporations' financial assets.[59] In addition, there was a rise in other accounts receivable in Q3. However, the balance sheet developments described above did not significantly affect the overall net financial position of corporations, which has long been negative and currently stands at -88% of GDP.

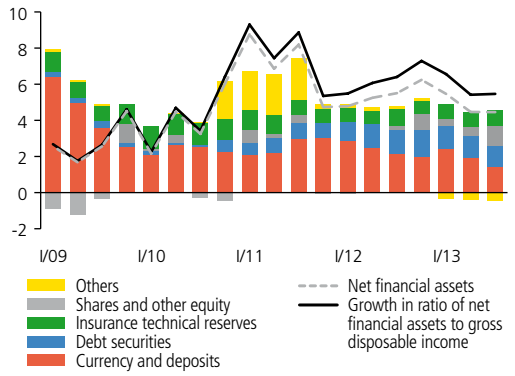
The main **balance sheet trends** in non-financial corporations are reflected in the financial indicators; the acid-test ratio of corporations recorded a year-on-year rise in Q3 and the market-based financing ratio fell slightly. Corporate solvency increased in 2013 Q3 following previous subdued developments.

Households are net creditors in the national economy and their net financial position is 70% of GDP. The **net financial assets of households** rose by 4.5% year on year in Q3 (see Chart III.5.21). As in previous quarters, all components of financial assets except other assets recorded an increase. Currency and deposits were the biggest contributors to the growth in financial assets, although their increase slowed again in Q3. Debt securities and pension fund reserves maintained similar growth rates as in the previous quarter.[60] Growth in the **financial liabilities of households** accelerated slightly. Long-term loans again made the dominant contribution (almost 4 percentage points) to annual growth in financial liabilities. In 2013 Q3, annual growth in the net financial assets of households again stood at 5.5% of the annual gross disposable income of households.

CHART III.5.21

STRUCTURE OF HOUSEHOLD FINANCIAL ASSETS

Net financial assets continued to grow at a brisk pace
(contributions in percentage points; annual percentage changes and percentage ratios)



III.5.7 The property market

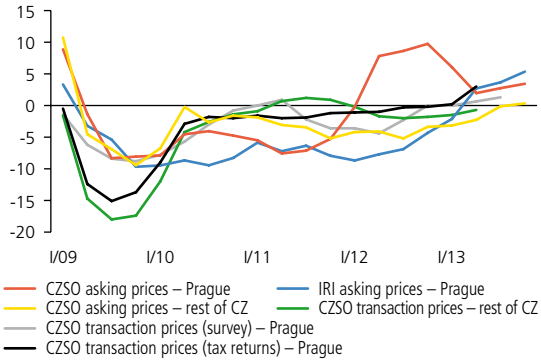
Growth in **asking prices of older apartments** continued to recover in 2013 Q4. According to CZSO data, these prices went up in both year-on-year terms (by 3.4% in Prague and by 0.3% outside Prague; see Chart III.5.22) and quarter-on-quarter terms (by 1.5% in Prague and by 0.8% outside Prague) for the first time in five years. The recovery in asking prices is confirmed by alternative data sources. According to the Institute for Regional Information, for example, the annual growth was 5.4% in Prague and 1.9% on average outside Prague.

As regards **transaction prices**, new data from the 2013 Q3 CZSO **survey** indicate considerably lower price growth in Prague (year-on-year growth of 1.3% for older apartments and 0.4% for new apartments), while prices are still falling in the rest of the Czech Republic (by 4.4% year on year). The CZSO revised upwards its estimates for the **transaction price index based on property transfer tax returns** for 2012. While the previous estimates had

CHART III.5.22

TRANSACTION AND ASKING PRICES OF APARTMENTS

Apartment prices saw a recovery in growth towards the end of 2013, but transaction prices outside Prague are still falling
(annual percentage changes; source: CZSO, Institute for Regional Information)



59 Within the assets of non-financial corporations, loans provided have been falling for three consecutive quarters, indicating that repayments of these loans by debtors – which include both non-financial and financial corporations – outweigh the volume of new loans provided.

60 The positive contribution of shares was due mainly to investment by households in investment funds and quoted shares issued by non-residents. Revaluation effects accounted for about one-third of the increase in the value of these categories.

indicated annual price decreases of 3.8% in Prague and a marked 10.7% in the rest of the Czech Republic, latest estimated decreases are only 0.2% and 1.8% respectively.[61] This revision brought the historical data on transaction prices based on tax returns closer to the other price indicators, so it can be regarded as representing a decrease in data uncertainty. Besides the revision of previous estimates, the CZSO published new estimates of transaction prices based on tax returns for 2013 H1. These new estimates are broadly in line with transaction price developments according to other sources; as of the end of 2013 H1, they rose by 3% year on year in Prague and declined by 0.7% in the rest of the Czech Republic. Overall, asking and transaction prices indicate a slight market recovery following a protracted period of decline, although the recovery is highly differentiated across regions.

A mixed situation on the property market across regions is also indicated by the **number of property market transactions**. In 2013, the number of proceedings on entry of ownership rights to houses and apartments rose by 2.5% in Prague[62] but fell by 10.4% in the rest of the Czech Republic. In 2014 Q4 alone, the number of transactions in houses and apartments increased by 15.4% in Prague[63] but dropped by 8.3% outside Prague. A recovery in demand for apartments in Prague is confirmed by data on the sales of new apartments in property development projects, which rose by roughly one-quarter in 2013.

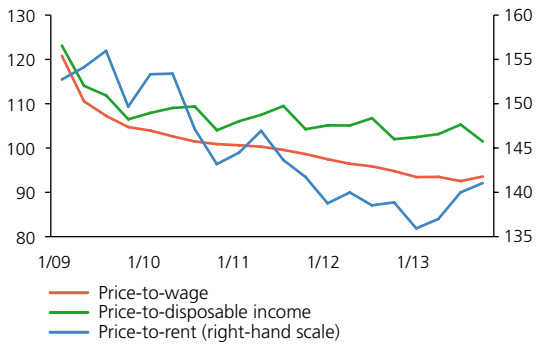
The property price sustainability indicators were mostly increasing as of the end of 2013 (see Chart III.5.23). According to the IRI, the **price-to-rent ratio** rose by 0.7% quarter on quarter in reaction to the increase in apartment prices, and is now 3.8% above the low recorded in early 2013. The **price-to-wage ratio** increased by 1.1% quarter on quarter, whereas the **price-to-disposable income ratio** fell by 3.6% quarter on quarter.[64] All three indices are still relatively low compared to the levels observed in 2008 and, together with alternative estimates, indicate some potential for growth in property prices. Given these findings and the gradual recovery in domestic economic activity, labour market developments and demographic developments, stagnation followed by a slow recovery in prices can be expected in the Czech Republic as a whole. However, the trends will remain mixed across regions (with Prague seeing stronger price growth).

Chart III.5.23

APARTMENT PRICE SUSTAINABILITY INDICATORS

Except for the price-to-disposable income ratio, the property price sustainability indicators increased

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



61 The revision also included a rebasing of the index and changes to the index weights, so the index also changed for previous years. However, the largest revision pertained to 2012.
62 The source of the data is COSMC.
63 Part of the increase in the number of transactions as of the year-end can be attributed to one-off transactions related to tax changes (VAT payments on building plots). However, these changes relate mainly to building plots and transactions by business entities.
64 The values of both indices for 2012 shifted upwards following the above-mentioned revisions to CZSO transaction prices.

III.6 BALANCE OF PAYMENTS

In 2013 Q1–Q3, the balance of payments was still characterised by a high income deficit, linked mainly with direct investment dividends 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 amid a flat services surplus. Portfolio investment recorded the biggest surplus on the financial account, owing chiefly to bond issues abroad, followed by direct investment. However, these net inflows were outweighed by a net outflow of other investment due to rapid growth in long-term foreign deposits and loans by monetary financial institutions and by a high net outflow in the corporate sector.

III.6.1 The current account

The **current account** recorded a deficit of CZK 30.2 billion in 2013 Q1–Q3. In year-on-year terms, the deficit fell by more than CZK 27 billion. The decline in the overall deficit was related mainly to a year-on-year increase in the trade surplus. The annual moving current account deficit decreased by more than CZK 19 billion from the previous quarter (see Chart III.6.1). The annual moving ratio of the current account deficit to GDP fell for the second consecutive quarter, to 1.7%.

The **trade surplus** for 2013 Q1–Q3 rose by more than CZK 34 billion year on year to CZK 154.4 billion. The higher trade surplus was due chiefly to price effects, i.e. a positive year-on-year change in the terms of trade. Developments in real terms accounted for about one-fifth of the increase. Following a marked annual decline in Q1, export growth rebounded during Q2. This was followed by a renewal of import growth in Q3. The subdued growth in external demand was reflected in a very modest rise in exports. Annual nominal growth in goods exports was just below 1% in 2013 Q1–Q3. Goods imports saw a decrease of more than 1% in these three quarters. This decrease was partly due to a downturn in total domestic demand in the first half of the year and a drop in energy input prices. Imports were also affected by weaker growth in traditionally highly import-intensive exports. However, nominal foreign trade turnover fell only marginally, owing to year-on-year depreciation of the koruna against the euro. Turning to the commodity structure, annual growth in the machinery and transport equipment surplus was the biggest contributor to the rise in the overall surplus (see Chart III.6.2). This was counteracted mainly by a widening of the mineral fuels deficit. The year-on-year growth in the trade surplus observed in previous quarters continued during 2013 Q4, exceeding CZK 12 billion for October–November.

The **services surplus** reached CZK 39.6 billion in 2013 Q1–Q3, almost the same as a year earlier (see Chart III.6.3). The surplus was due mainly to travel, followed by transport. However, these surpluses declined in year-on-year terms, especially in the case of travel, mainly as a result of higher expenditure by residents on private travel. Other

CHART III.6.1

CURRENT ACCOUNT

The annual moving current account deficit decreased in 2013 Q3, primarily due to a decrease in the income deficit
(annual moving totals in CZK billions)

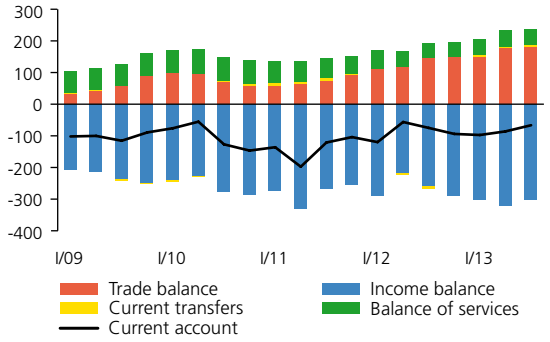


CHART III.6.2

TRADE BALANCE

The year-on-year change in the trade balance was affected most strongly in 2013 Q1–Q3 by an increase in the machinery surplus
(accumulation since start of year in CZK billions; change of ownership principle)

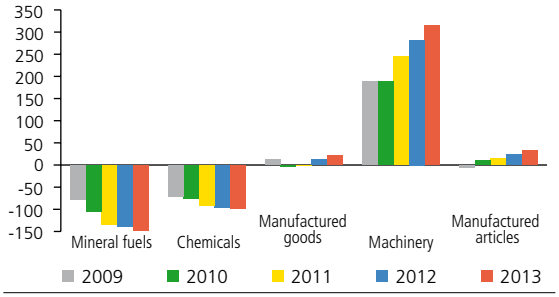


CHART III.6.3

BALANCE OF SERVICES

Travel and transport contributed to the services surplus in 2013 Q1–Q3
(CZK billions)

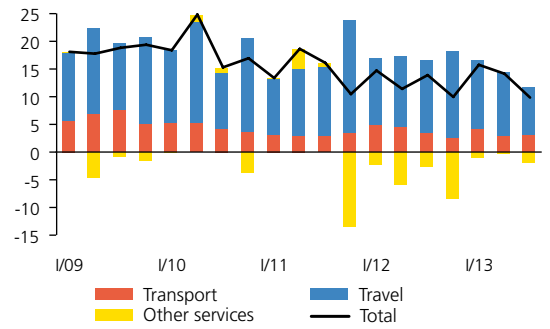
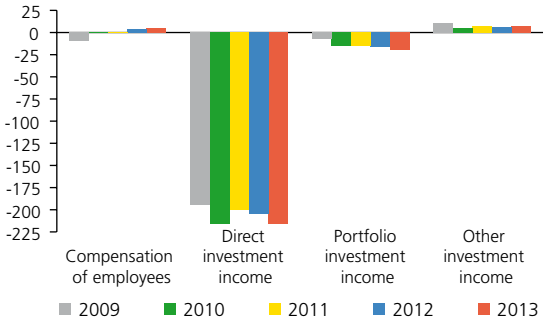


CHART III.6.4

INCOME BALANCE

Within the income balance, the direct investment income deficit increased in particular year on year in 2013 Q1–Q3
(accumulation since start of year in CZK billions)



services recorded a slight deficit, which, however, decreased year on year mainly owing to a sharp increase in credits, almost offsetting the lower surpluses on travel and transport. The narrowing of the other services deficit was due mainly to the evolution of the merchanting balance.

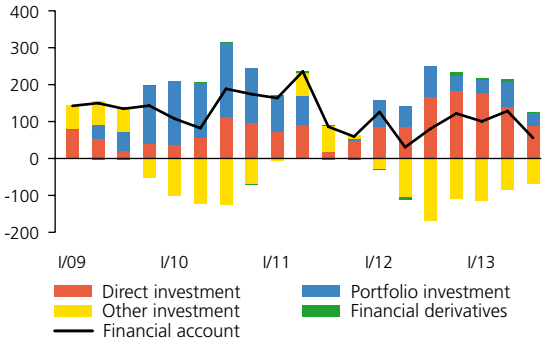
In contrast to the goods and services surplus, the **income balance** showed a deficit of CZK 223.9 billion, up by more than CZK 13 billion year on year. The largest component of the overall balance was again a direct investment income deficit of CZK 216.2 billion (see Chart III.6.4). It was linked mainly with income in the form of dividends paid to non-residents and, to a lesser extent, with estimated reinvested earnings in the Czech Republic. The year-on-year increase in the overall deficit was also due above all to a higher direct investment income deficit amid significantly higher dividend payments to non-residents, whereas earnings reinvested in the Czech Republic and interest payments to non-residents decreased year on year. Portfolio investment income also ended in a deficit. By contrast, other investment income and compensation of employees recorded modest surpluses.

Current transfers recorded a very small deficit of CZK 0.2 billion for 2013 Q1–Q3, down by almost CZK 7 billion from a year earlier. A surplus on government transfers of CZK 13.5 billion was outweighed only marginally by a deficit on transfers of other sectors. This stemmed mainly from a surplus on transfers of funds between the Czech Republic and the EU (CZK 15.3 billion). The year-on-year narrowing of the overall current transfers deficit was due mainly to higher government transfers from the EU budget.

CHART III.6.5

FINANCIAL ACCOUNT

The annual moving financial account surplus decreased in 2013 Q3 due mainly to a decrease in the direct and portfolio investment surpluses
(annual moving totals in CZK billions)



III.6.2 The capital account

The **capital account** recorded a large surplus of CZK 54.7 billion, up by almost CZK 48 billion year on year, owing to developments in 2013 Q3. The overall surplus and its marked year-on-year increase were related to income of CZK 26.1 billion from the EU budget and one-off income connected with the outcome of international arbitration between non-financial corporations in the gas industry.

III.6.3 The financial account

The **financial account** ended 2013 Q1–Q3 in a small deficit of CZK 5.6 billion due to a net outflow of other investment (see Chart III.6.5). However, the net outflow of other investment was largely offset by surpluses on the other three balances, especially net inflows of portfolio and direct investment.

In 2013 Q1–Q3, **direct investment** recorded a surplus of CZK 29 billion (see Chart III.6.6), down by almost CZK 94 billion year on year owing to both a lower inflow into the Czech Republic and a higher outflow abroad. The overall gross inflow amounted to CZK 79.5 billion, due in equal measure to equity capital investment, linked mainly with an equity capital increase resulting from a one-off operation by a foreign energy company, and to estimated reinvested earnings of CZK 65.5 billion. As regards credit relations, however, these contributions were significantly reduced by net repayment by domestic subsidiaries to foreign parent companies. At the same time, a year-on-year rise in gross other capital outflows was the biggest contributor to the moderation of the overall net direct investment inflow. Czech direct investment abroad was affected mainly by an equity capital outflow resulting from a significant foreign acquisition by a Czech company and increases in equity shares. With regard to industries, the foreign capital inflow (excluding reinvestment) was channelled primarily into administrative activities and business services. Capital outflows abroad went mainly into financial and insurance activities.

Portfolio investment also recorded a net inflow (of CZK 59.2 billion; see Chart III.6.7). The largest operations were bond issues by domestic – mostly non-financial – corporations on foreign markets. Holdings of shares by non-residents increased only marginally amid sharply rising interest of foreign investors in domestic bonds. Overall, the inflow of portfolio investment on the liabilities side reached almost CZK 62 billion. Purchases also slightly dominated trading in foreign securities. However, they were associated solely with growth in holdings of foreign shares. By contrast, holdings of foreign bonds by residents declined, largely offsetting the share purchases. The year-on-year decrease in the net inflow of portfolio investment of more than CZK 9 billion was largely due to a lack of significant government bond issues on foreign markets.

Settlement of **financial derivatives** recorded a net inflow of CZK 2.6 billion, down by almost CZK 4 billion year on year.

By contrast, **other investment** saw a high net outflow totalling CZK 96.5 billion. The overall deficit was due mainly to a net outflow of CZK 51.6 billion in the corporate sector, linked with repayment of trade credits and financial loans received from abroad together with growth in loans to, and deposits with, non-residents. In addition, a net capital outflow of CZK 46 billion was recorded by the monetary financial institutions sector, owing mainly to growth in long-term loans and deposits abroad. Other investment in the government sector also ended in a modest deficit associated mainly with the repayment of a foreign loan from the EIB. A slight net inflow was recorded only for the CNB. The year-on-year decrease in the overall net outflow was due above all to a change in the evolution of the short-term position of monetary financial institutions.

CHART III.6.6

DIRECT INVESTMENT

Reinvested earnings contributed the most to the direct investment surplus in 2013 Q1–Q3, while other capital recorded an outflow

(CZK billions)

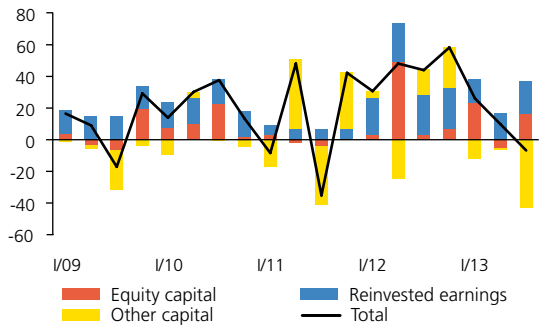


CHART III.6.7

PORTFOLIO INVESTMENT

Portfolio investment recorded a net inflow in 2013 Q1–Q3, owing mainly to issuance of bonds abroad

(CZK billions)

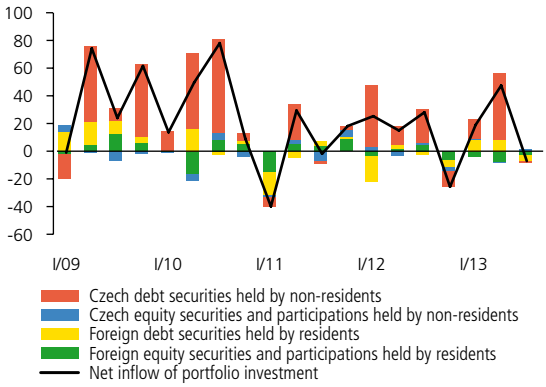
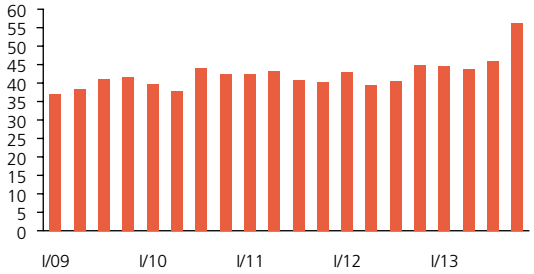


CHART III.6.8

CNB INTERNATIONAL RESERVES

The CNB's international reserves increased significantly in 2013 Q4 compared to the previous quarter
(USD billions, end of quarter)



The CNB's **international reserves** totalled CZK 1,116.9 billion at the end of 2013, representing a quarter-on-quarter increase of more than CZK 244 billion. The strong rise in international reserves was due mainly to the CNB's own transactions, i.e. its foreign exchange interventions to weaken the koruna. In dollar terms, the reserves rose by USD 10.4 billion to USD 56.1 billion in the same period (see Chart III.6.8). The CNB's international reserves covered almost 45% of all external debt liabilities of domestic entities at the end of 2013 Q3.

III.7 THE EXTERNAL ENVIRONMENT

The annual economic decline in the euro area moderated further in 2013 Q3 and the euro area economy recorded modest quarterly growth. The euro area is thus rebounding only slowly. This is consistent with persisting very subdued price pressures and expectations of only moderate economic growth in 2014. The US economy, which grew at an accelerating pace during 2013 amid relatively muted inflation, is developing more favourably. The Fed therefore announced a reduction of its monthly bond purchases in December, which it continued with in January, and is expected to exit from quantitative easing completely in the course of 2014. In line with these developments, the US dollar will probably strengthen slowly against the euro over the next two years. The Brent crude oil price declined at the start of 2014 and is expected to follow a slightly falling trend in the period ahead.

III.7.1 The euro area

Quarterly **GDP growth in the euro area** was 0.2 percentage point slower in 2013 Q3 than in 2013 Q2, standing at 0.1%. However, GDP still contracted by 0.4% in annual terms (see Chart III.7.1). The quarterly growth was driven by domestic demand, whereas the contribution of net exports to output growth was negative for the first time since 2010. As regards the components of domestic demand, the contributions of inventories and fixed investment to GDP growth were positive, while household and government consumption had a neutral effect on growth. The growth rates of both exports and imports slowed in Q3 and net exports made a negative contribution of 0.3 percentage point to quarterly growth.

Overall, the data for Q4 suggest a further (albeit moderate) **recovery in the euro area**. Although industrial production fell month on month for the second consecutive month in October, as did construction output, it rebounded by a marked 1.8% in November. Unemployment remains at record highs but has stabilised since April. It stood at 12.1% in November. Employment decreased by 0.8% year on year in 2013 Q3. The available indicators point to an improvement in the economic situation in 2013 Q4. For example, the PMI in manufacturing reached its highest level in more than two years in December. The recovery in household consumption is reflected in retail sales, which rose at a surprisingly strong pace in November.

The **GDP growth outlooks** for 2014 expect a slight recovery, with economic growth reaching around 1% (see Chart III.7.2). The January CF outlook thus improved slightly compared to October. The recovery should accelerate by almost 0.5 percentage point in 2015.

Headline **inflation in the euro area** fell to 0.8% and core inflation to 0.7% in December. Prices of telecommunication services, fuels and health care services recorded the largest negative contributions. The low inflation pressures are also reflected in producer prices,

CHART III.7.1

GDP IN THE EURO AREA

An improvement in the dynamics of domestic demand in the euro area led to a reduction of the annual contraction in GDP in 2013 Q3

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

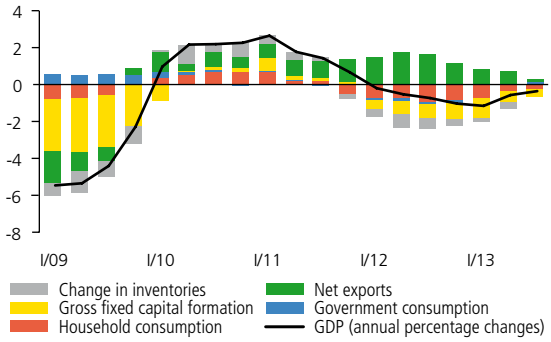
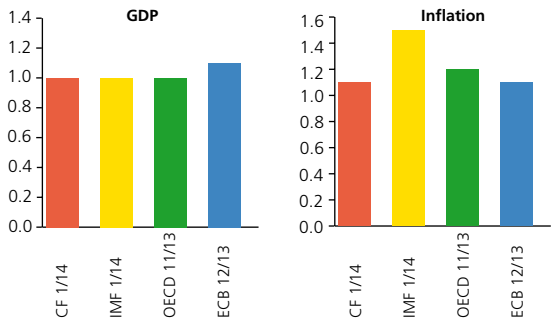


CHART III.7.2

EURO AREA GDP AND INFLATION OUTLOOKS FOR 2014

Euro area GDP should be approximately 1% in 2014, while inflation should be low

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

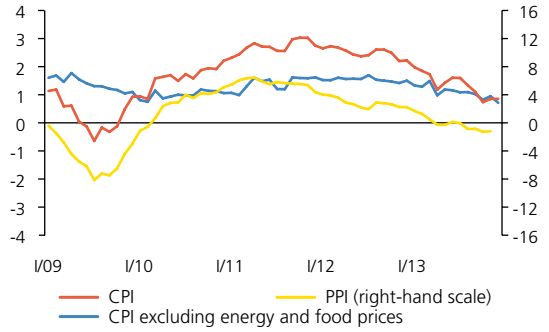


Note: Horizontal axis shows most recent forecast data in format "Source month/year of publication". Midpoint of range for ECB.

CHART III.7.3

INFLATION AND PRODUCER PRICES IN THE EURO AREA

Inflation went down in 2013 Q4, while producer prices fell
(annual percentage changes; source: Datastream)



which declined for the second consecutive month in November (see Chart III.7.3). Inflation is expected to be just above 1% this year. Next year it should accelerate but remain below 1.5%.

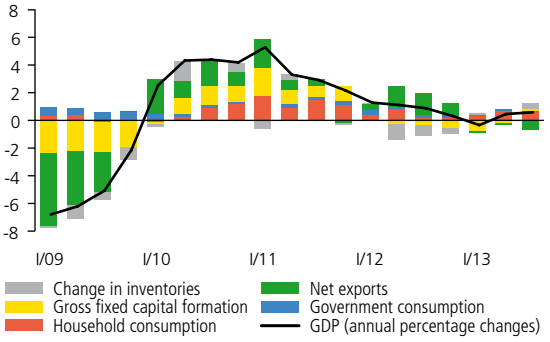
At its November meeting, the ECB cut its key interest rate and its marginal lending facility rate by 25 basis points to 0.25% and 0.75% respectively, while the deposit rate was left unchanged at 0%. The ECB thus responded above all to low inflation. However, at the January meeting the ECB stressed that inflation expectations were firmly anchored over the medium term, although in the short term the euro area would experience low levels of inflation similar to those observed in December. The forward guidance that rates would be left at present or lower levels for an extended period of time was repeated. The ECB is ready to react using various instruments to any significant downward deterioration in the inflation outlook or unwarranted increase in money market rates that would jeopardise the pace of the euro area recovery.

Ireland left the international rescue programme after three years in December 2013 and successfully issued ten-year government bonds in January. This boosted investor confidence, and in January the **spreads between the yields on the bonds of euro area periphery countries** and German bonds fell to their lowest levels in at least two years.

CHART III.7.4

GDP IN GERMANY

All components of German domestic demand contributed to the further modest acceleration in GDP growth in 2013 Q3
(annual percentage changes; contributions in percentage points; seasonally adjusted; source: Datastream)



Economic growth in Germany slowed by 0.4 percentage point quarter on quarter to 0.3% in 2013 Q3. This was due to a decrease in the contribution of net exports, which was more pronounced than the impact of stronger domestic demand. In year-on-year terms, the rise in domestic demand outweighed the decline in net exports and annual GDP growth went up slightly to 0.6% (see Chart III.7.4). A further quarter-on-quarter slowdown and year-on-year acceleration of economic growth can be expected for 2013 Q4. Industrial production and retail turnover are providing rather mixed signals, as their month-on-month declines deepened further in October, but both indicators increased markedly in month-on-month and year-on-year terms in November. It is not clear whether this is only a one-month fluctuation or a significant change in trend. Unemployment was unchanged at 5.2% in November.

According to a preliminary estimate, **economic growth in Germany** reached 0.4% in 2013 as a whole. Net exports declined compared to the previous year, when GDP had recorded growth of 0.7%. However, this decline was only partly offset in terms of GDP growth by a rise in household and government consumption. The January CF increased its GDP growth prediction for 2014 to 1.8%. Growth in domestic demand (mainly investment) and exports, which will benefit from expected more favourable developments in the global economy and in the euro area, should accelerate by comparison with 2013. Similar outlooks were published by other institutions (the German government, the Bundesbank and the European Commission). A turnaround towards faster economic growth, at least in 2014 H1, is also indicated by a rise in almost all leading indicators.

German inflation rose to 1.4% in December 2013 (see Chart III.7.5). It reached 1.5% on average for 2013 as a whole. The January CF expects it to rise slightly to 1.6% in 2014 and increase further to 2% in 2015.

The quarterly and annual **growth of the Slovak economy** in 2013 Q3 was almost unchanged from the previous period. The economy expanded by 0.2% quarter on quarter and 0.7% year on year. Quarterly declines in fixed investment and net exports were outweighed by growth in government consumption and inventories. An annual decrease in fixed investment was also offset by growth in inventories. According to the January CF, the annual growth rate of GDP was 0.9% for 2013 as a whole, but should surge to 2.2% in 2014 and 3.0% in 2015. The more favourable economic developments should be driven mainly by renewed growth in investment and faster growth in household consumption.

Inflation in Slovakia fell further to 0.4% in December, continuing its downward trend observed for more than a year now. In 2013 it averaged 1.4% and in 2014 it is expected to rise to 1.5%. Low inflation pressures are also evidenced by a drop in industrial producer prices in November, which deepened further to -2%.

III.7.2 The United States

Annual **economic growth in the USA** rose further, from 1.6% in 2013 Q2 to 2% in 2013 Q3 (see Chart III.7.6). At the same time, quarterly GDP growth increased significantly from 0.6% to 1%. The stronger annual growth was chiefly due to household consumption, which rose by 1.9%, and to investment, which went up by 5.5%. In addition, total exports rose faster than total imports, so the contribution of net exports to overall GDP growth was also slightly positive. Only a decline in government expenditure, which fell by 2.7% year on year, had a negative effect. In addition, the US external imbalance improved further in 2013 Q3, with the annual cumulative current account deficit falling to 2.4% of GDP.

Industrial production growth accelerated in the second half of 2013. In October and November, industrial production rose by 3.4% and 3.2% respectively year on year. Continuing favourable developments in industry are also confirmed by the PMI leading indicator. Both consumer confidence indicators (Conference Board and University of Michigan) also improved considerably in December, which may be reflected in a further increase in consumer demand. This could also be aided by gradually falling unemployment, which reached 6.7% in December. Retail sales (at current prices) developed steadily in the course of 2013, rising by 4.3% in the year as a whole.

According to the January CF, **GDP growth in 2014** should reach 2.8%. This represents an upward revision compared to previous CF forecasts (see Chart III.7.7). It is also higher than in 2013, which was adversely affected by budget sequestration.

CHART III.7.5

INFLATION AND PRODUCER PRICES IN GERMANY

Inflation went down in 2013 Q4, mainly due to prices of energy and food. Industrial producer prices declined
(annual percentage changes; source: Datastream)

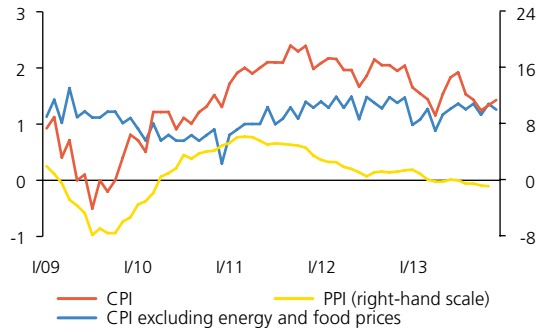


CHART III.7.6

GDP IN THE USA

GDP growth rose further in 2013 Q3
(annual percentage changes; contributions in percentage points; seasonally adjusted; source: Datastream)

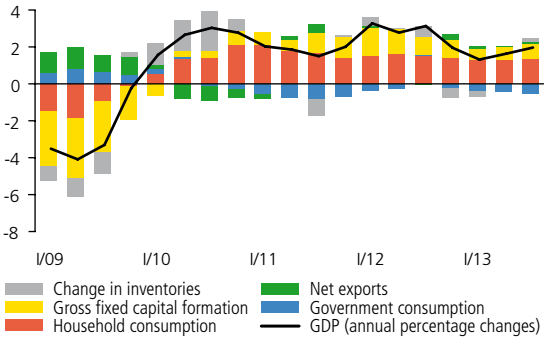
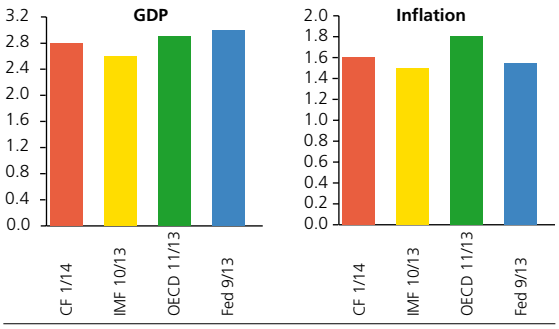


CHART III.7.7

US GDP AND INFLATION OUTLOOKS FOR 2014

GDP growth will probably be relatively buoyant in 2014, while inflation pressures will be subdued
(annual percentage changes; source: CF, IMF, OECD, Fed)

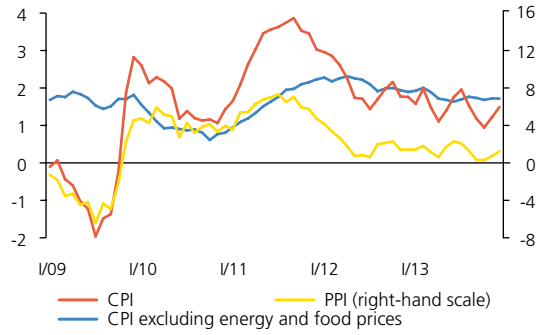


Note: Horizontal axis shows most recent forecast data in format "Source month/year of publication". Midpoint of range for Fed.

CHART III.7.8

INFLATION AND PRODUCER PRICES IN THE USA

Inflation has been at relatively low levels since 2012 Q2
(annual percentage changes; source: Datastream)



Annual **inflation** started edging up in October, reaching 1.5% in December. Nevertheless, headline inflation has remained quite subdued since 2012 Q2, as has inflation excluding energy and food prices (see Chart III.7.8). Similarly, the outlooks for 2014 do not expect inflation to reach 2% (see Chart III.7.7).

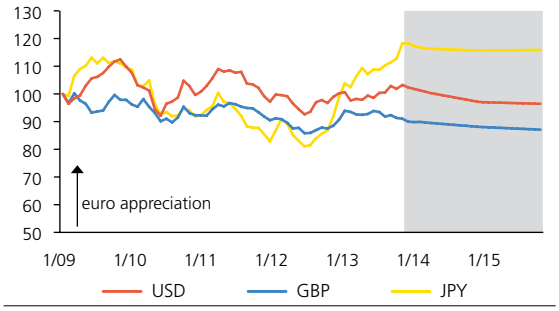
In December, the **Fed decided to reduce its monthly bond purchases** by USD 10 billion from USD 85 billion. At its January meeting it reduced these purchases by a further USD 10 billion. The Fed will thus probably completely exit its quantitative easing policy in 2014. Judging among other things from statements made by its representatives, however, it will probably not raise its key rates until 2015 at the earliest, depending on further developments in economic conditions. This is reflected in the market outlook for short-term money market rates, which remains at record lows for 2014.

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

CHART III.7.9

EURO EXCHANGE RATE AGAINST MAJOR CURRENCIES

The euro appreciated most strongly against the Japanese yen in 2013 Q4
(January 2009 = 100; source: Datastream, outlook from CF)



In 2013 Q4, the **exchange rate of the euro against major world currencies** continued the trends observed in the previous quarter (see Chart III.7.9). The euro appreciated further vis-à-vis the US dollar and the Japanese yen, but continued to weaken against the British pound. Central bank measures were still one of the main factors underlying exchange rate movements. In November, the ECB cut its key rate to an all-time low to further ease monetary policy. On the other hand, the recovery in the USA, which is visible in a number of economic sectors, prompted the Fed to announce a reduction in its monthly bond purchases in both December and January.

At the end of December, the euro was trading at USD 1.37, which represents a year-on-year strengthening of 4.5%. Its year-on-year appreciation against the Japanese yen even exceeded 27%, as the rate of depreciation of the yen vis-à-vis major world currencies increased at the close of the year. Although signs of recovery are visible in the Japanese economy as a result of the government's reforms, it remains uncertain whether the declared targets will be met. The robustness of the recovery in the UK, which is one of the strongest among the advanced economies, is being confirmed. In this context, the British pound strengthened against major world currencies at the end of 2013. In addition, inflation in the UK fell closer to the central bank's target, dampening expectations of early discontinuation of the BoE's support programmes.

In the first half of January 2014, the euro showed no clear trend against major currencies. The ECB left its monetary policy settings unchanged but did not rule out further steps to boost the economy. By contrast, the Fed's discussions and subsequent communications were focused on the negative impacts of quantitative easing (e.g. destabilisation of the financial sector), and further tapering cannot be ruled out in the months ahead.

The **January CF** expects the euro to depreciate slightly against the dollar to USD 1.29 at the one-year horizon. The British pound should continue to strengthen against the euro given the increased growth outlook in the UK. According to the new CF, the exchange rate of the Japanese yen against the euro will not change significantly.

III.7.4 Prices of oil and other commodities

The **price of Brent crude oil** fell in the second half of October, reaching its lowest level in more than four months in early November (USD 103.5 a barrel; see Chart III.7.10). However, it rose rapidly during the following two weeks, offsetting the previous decline. In the rest of 2013, it mostly stayed above USD 110 a barrel. The start of this year saw a decrease to around USD 107 a barrel, and the Brent crude oil price remained below this level in the rest of the first half of January.

The price increase in November was due to a recovery in oil demand and shortfalls in supplies from OPEC countries, especially Libya. The oil price was also supported by favourable economic news from the USA and China and by OPEC's decision not to increase its current extraction target for 2014 H1. By contrast, the sharp decrease in early January was driven by optimism about political developments in North Africa and the strengthening of the US dollar. However, a more marked rise in oil prices in the near future will be hindered by several **factors** including rapid growth in global extraction (in the USA and Canada in particular), which should outpace expected consumption growth, and a gradual tapering of the monetary stimulus in the USA, which should be accompanied by further appreciation of the dollar and an outflow of investment from commodity markets. By contrast, a stronger decline in prices is still being prevented by the tense political situation in North Africa and the Middle East.

The **evolution of WTI oil prices** was determined by different fundamentals than Brent throughout 2013. Owing to persisting logistical oil transport problems in North America, the price was depressed by rapidly rising local oil extraction for most of the year. The Brent-WTI spread changed as a result of the different developments. It fell towards zero in mid-July 2013 but has been rising gradually since then. WTI oil can increasingly be transported from the US inland to refineries on the Gulf Coast, but it cannot reach the global market because of the ban on exports of crude oil from the USA. Therefore, the only result so far is that oil prices in the Gulf of Mexico, represented by the LLS (Louisiana Light Sweet) benchmark, no longer stem from the global price (Brent) and have converged to a greater extent towards the WTI oil price. In its January report, the US EIA increased its estimate of the Brent-WTI spread for 2014 by USD 3 to USD 12 a barrel.

Demand for oil rose in the USA in 2013 Q4 owing to higher production at its refineries, while in China demand grew at a rather subdued pace. Growing demand in OECD countries led the IEA to

CHART III.7.10

OIL AND NATURAL GAS PRICES IN USD

The price of Brent crude oil was flat in December but fell sharply at the start of January 2014. Its outlook is still slightly falling

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

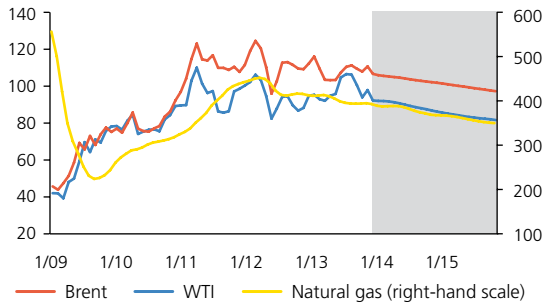


CHART III.7.11

DECOMPOSITION OF KORUNA OIL PRICE GROWTH

The koruna price of oil should be broadly flat in 2014, with a decline in the dollar price being offset by a weaker koruna-dollar exchange rate

(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)

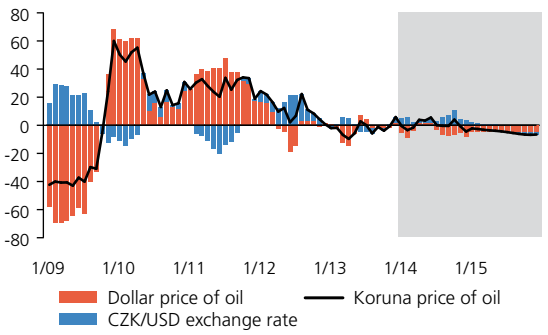
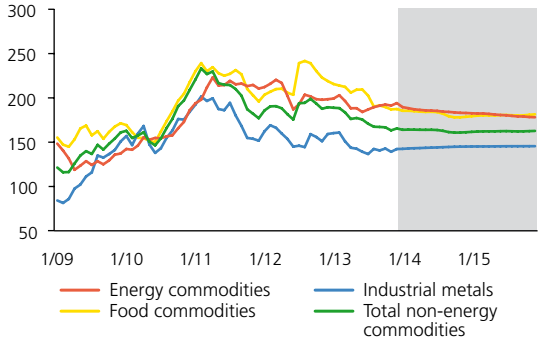


CHART III.7.12

COMMODITY PRICES

The outlook for energy and food commodity prices is modestly falling, while the forecast for the industrial metals index is modestly rising

(January 2007 = 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).

further increase its estimates for global consumption growth in 2013 (to 1.2 million barrels a day) and 2014 (to 1.3 million barrels a day). However, non-OPEC production should rise even faster according to the EIA (by 1.9 million barrels a day). Thus, market equilibrium will probably be ensured by reduced extraction in OPEC countries.

The **Brent crude oil price outlook** according to the January CF is flat just below USD 106 a barrel at the one-year horizon. The current EIA forecast expects prices to come down gradually to USD 105 a barrel this year and USD 102 a barrel next year on average. The falling market outlook based on futures contracts is only slightly steeper in 2015, with an average price of just under USD 100 a barrel.

The **commodity markets** recovered in December from their modest November decline, but started falling again during the first half of January owing mainly to energy and food commodities, which also have a slightly declining price outlook. The industrial metals index maintained its December level in mid-January, and its outlook is slightly increasing (see Chart III.7.12). We have recently seen a shift in commodity demand growth from emerging economies to advanced countries, and this trend should continue for the time being. However, rising economic activity in OECD countries could foster a renewed recovery in growth in emerging economies and a further rise in commodity demand on their part, too.

ABBREVIATIONS

APRC	annual percentage rate of charge
CF	Consensus Forecasts
CNB	Czech National Bank
CPI	consumer price index
CZK	Czech koruna
CZSO	Czech Statistical Office
COSMC	Czech Office for Surveying, Mapping and Cadastre
ECB	European Central Bank
EDP	Excessive Deficit Procedure
EIA	Energy Information Administration
EIB	European Investment Bank
ESA 95	European System of National Accounts
ESCB	European System of Central Banks
EU	European Union
EUR	euro
EURIBOR	Euro Interbank Offered Rate
FDI	foreign direct investment
Fed	US central bank
FMIE	Financial Market Inflation Expectations
FRA	forward rate agreement
GBP	pound sterling
GDP	gross domestic product
GVA	gross value added
HP filter	Hodrick-Prescott filter
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
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

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
Consumption, savings and debt burden of household income groups in 2012	(Box)	III/2013
The announced reduction of quantitative easing in the USA and its effect on yield curves	(Box)	III/2013
Using the exchange rate as an instrument to ease the monetary conditions	(Box)	IV/2013
New steady-state settings in the g3 model	(Box)	IV/2013
Comparison of corporate investment and employment from the perspective of ownership and reinvestment	(Box)	IV/2013
The impact of the growth in unconventional gas extraction on global prices of energy commodities	(Box)	IV/2013
Effects of the weakened exchange rate on consumer prices (input-output analysis)	(Box)	I/2014

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-disposable income ratio: The ratio of the price of an apartment to the sum of disposable income over the last four quarters. Higher values of this indicator usually mean that apartments are overpriced. The index is calculated from property transaction prices; the latest data are estimated from asking prices.

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. This indicator is calculated from asking rents and asking prices of apartments according to the Institute for Regional Information.

Price-to-wage ratio: The ratio of the price of an apartment to the sum of the annual wage over the last four quarters. Higher values of this indicator usually mean that apartments are overpriced. The index is calculated from property transaction prices; the latest data are estimated from asking prices.

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 the one hand, 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. The second, alternative source of data on transaction prices is CZSO data from a survey in estate agencies, for which the time lag is considerably shorter.

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 share of unemployed persons, as determined by the Ministry of Labour and Social Affairs.

KEY MACROECONOMIC INDICATORS

		years										
		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
DEMAND AND SUPPLY												
Gross domestic product												
GDP	CZK bn, constant p. of 2005, seas. adjusted	3,113.5	3,338.4	3,529.4	3,632.1	3,473.9	3,554.0	3,619.0	3,585.0	**3,539.0**	**3,618.3**	**3,718.2**
GDP	%, y-o-y, real terms, seas. adjusted	6.8	7.2	5.7	2.9	-4.4	2.3	1.8	-0.9	**-1.3**	**2.2**	**2.8**
Household consumption	%, y-o-y, real terms, seas. adjusted	3.0	4.4	4.1	2.9	0.3	0.9	0.5	-2.1	**-0.3**	**0.6**	**1.6**
Government consumption	%, y-o-y, real terms, seas. adjusted	1.6	-0.6	0.4	1.2	4.0	0.2	-2.7	-1.9	**1.9**	**1.5**	**1.3**
Gross capital formation	%, y-o-y, real terms, seas. adjusted	4.5	10.6	15.5	1.5	-20.0	5.1	0.9	-4.8	**-6.3**	**0.1**	**2.7**
Exports of goods and services	%, y-o-y, real terms, seas. adjusted	11.9	14.3	11.2	3.5	-10.5	15.0	9.6	4.7	**0.3**	**9.3**	**6.6**
Imports of goods and services	%, y-o-y, real terms, seas. adjusted	6.1	11.2	12.8	2.3	-11.7	14.9	7.0	2.5	**0.4**	**7.9**	**5.8**
Net exports	CZK bn, constant p. of 2005, seas. adjusted	84.8	156.3	139.3	174.7	185.3	213.3	297.2	370.1	**368.8**	**440.3**	**493.3**
Coincidence indicators												
Industrial production	%, y-o-y, real terms	3.9	8.3	10.6	-1.8	-13.6	8.6	5.9	-0.8	-	-	-
Construction output	%, y-o-y, real terms	5.2	6.0	7.1	0.0	-0.9	-7.4	-3.6	-7.6	-	-	-
Receipts in retail sales	%, y-o-y, real terms	8.1	10.8	10.0	2.7	-4.7	1.5	1.7	-1.1	-	-	-
PRICES												
Main price indicators												
Inflation rate	%, end-of-period	1.9	2.5	2.8	6.4	1.1	1.5	1.9	3.3	1.4	-	-
Consumer Price Index	%, y-o-y, average	1.9	2.5	2.8	6.4	1.1	1.5	1.9	3.3	1.4	**1.2**	**2.6**
Regulated prices (18.70%)*	%, y-o-y, average	5.7	9.3	4.8	15.6	8.4	2.6	4.7	8.6	2.2	**-1.5**	**2.8**
Net inflation (81.30%)*	%, y-o-y, average	0.7	0.4	1.7	2.4	-0.9	0.0	1.3	1.0	0.5	**1.6**	**2.4**
Food prices (including alcoholic beverages and tobacco) (24.58%)*	%, y-o-y, average	0.0	-0.2	3.8	3.0	-0.9	0.9	3.9	2.9	3.1	**3.0**	**2.6**
Adjusted inflation excluding fuels (53.32%)*	%, y-o-y, average	0.7	0.6	0.7	2.0	0.0	-1.2	-0.7	-0.3	-0.5	**0.8**	**2.3**
Fuel prices (3.39%)*	%, y-o-y, average	7.8	3.7	-0.3	4.3	-11.1	11.8	9.9	6.0	-2.1	**2.6**	**2.1**
Monetary-policy inflation (excluding tax changes)	%, y-o-y, average	1.8	2.3	2.2	4.4	0.9	0.4	1.9	2.1	0.6	**1.0**	**2.4**
GDP deflator	%, y-o-y, seas. adjusted	-0.3	0.5	3.3	1.9	2.3	-1.6	-0.9	1.6	**1.7**	**1.0**	**1.2**
Partial price indicators												
Producer prices	%, y-o-y, average	3.1	1.5	4.1	4.5	-3.1	1.2	5.6	2.1	0.8	**0.5**	**0.8**
Agricultural prices	%, y-o-y, average	-10.0	1.3	16.4	10.8	-24.3	7.7	22.7	3.6	5.2	**-1.2**	**0.4**
Construction work prices	%, y-o-y, average	3.0	2.9	3.9	4.5	1.2	-0.2	-0.5	-0.7	-1.1	-	-
Brent crude oil	%, y-o-y, average	45.0	18.4	11.4	35.4	-36.5	28.4	38.2	0.7	-2.6	**-4.1**	**-4.6**
LABOUR MARKET												
Average monthly wage	%, y-o-y, nominal terms	5.0	6.6	7.2	7.8	3.3	2.2	2.5	2.7	**0.5**	**2.7**	**4.2**
Average monthly wage	%, y-o-y, real terms	3.0	4.0	4.3	1.4	2.3	0.7	0.6	-0.6	**-0.9**	**1.5**	**1.5**
Number of employees	%, y-o-y	2.0	1.1	1.8	1.6	-2.2	-2.2	0.0	-0.1	**1.6**	**0.1**	**0.9**
Unit labour costs	%, y-o-y	0.6	0.2	2.4	4.3	2.6	-1.7	0.4	2.9	**0.8**	**0.9**	**3.0**
Unit labour costs in industry	%, y-o-y	-7.2	-7.2	2.4	-3.3	5.4	-5.7	0.4	4.4	-	-	-
Aggregate labour productivity	%, y-o-y	4.6	5.6	3.5	0.8	-3.5	3.5	1.9	-1.4	**-2.1**	**2.3**	**2.5**
ILO general unemployment rate	%, average, age 15–64	8.0	7.2	5.4	4.5	6.7	7.3	6.8	7.0	**7.1**	**7.4**	**7.4**
Share of unemployed	%, average	6.6	6.1	4.9	4.1	6.2	7.0	6.7	6.8	7.7	**8.0**	**7.6**
PUBLIC FINANCE												
Public finance deficit (ESA95)	CZK bn, current p.	-101.1	-79.2	-26.7	-85.0	-217.4	-177.1	-121.9	-169.4	**-112.4**	**-104.3**	**-115.3**
Public finance deficit / GDP**	%, nominal terms	-3.2	-2.4	-0.7	-2.2	-5.8	-4.7	-3.2	-4.4	**-2.9**	**-2.6**	**-2.8**
Public debt (ESA95)	CZK bn, current p.	885.4	948.1	1,023.4	1,104.3	1,299.3	1,454.4	1,583.3	1,775.4	**1,834.2**	**1,936.2**	**2,047.3**
Public debt / GDP**	%, nominal terms	28.4	28.3	27.9	28.7	34.6	38.4	41.4	46.2	**47.5**	**48.5**	**49.3**
EXTERNAL RELATIONS												
Current account												
Trade balance	CZK bn, current p.	48.6	59.3	46.9	25.7	87.3	53.8	90.3	145.8	**195.4**	**245.0**	**260.0**
Trade balance / GDP	%, nominal terms	1.6	1.8	1.3	0.7	2.3	1.4	2.4	3.8	**5.1**	**6.1**	**6.3**
Balance of services	CZK bn, current p.	37.9	49.0	59.2	73.9	73.9	75.3	58.4	49.8	**49.6**	**55.0**	**60.0**
Current account	CZK bn, current p.	-30.9	-67.1	-156.9	-81.3	-89.3	-146.6	-104.0	-94.0	**-39.7**	**20.0**	**20.0**
Current account / GDP	%, nominal terms	-1.0	-2.0	-4.3	-2.1	-2.4	-3.9	-2.7	-2.4	**-1.0**	**0.5**	**0.5**
Foreign direct investment												
Direct investment	CZK bn, current p.	279.6	90.3	179.1	36.3	37.7	95.0	46.8	181.1	**35.0**	**40.0**	**75.0**
Exchange rates												
CZK/USD	average	24.0	22.6	20.3	17.1	19.1	19.1	17.7	19.6	19.6	**-**	**-**
CZK/EUR	average	29.8	28.3	27.8	25.0	26.5	25.3	24.6	25.1	26.0	**-**	**-**
CZK/EUR	%, y-o-y, real (CPI euro area), avg.	-4.5	-2.4	-2.3	-10.4	0.0	-3.4	0.8	1.4	2.5	**-**	**-**
CZK/EUR	%, y-o-y, real (PPI euro area), avg.	-5.6	-1.4	-3.8	-8.8	4.4	-3.2	-2.7	2.6	1.9	**-**	**-**
Foreign trade prices												
Prices of exports of goods	%, y-o-y, average	-1.5	-1.2	1.3	-4.6	0.2	-1.0	1.7	2.9	**1.2**	**4.7**	**-0.5**
Prices of imports of goods	%, y-o-y, average	-0.5	0.3	-1.0	-3.3	-3.5	2.0	4.3	4.2	**-0.2**	**3.5**	**-1.0**
MONEY AND INTEREST RATES												
M2	%, y-o-y, average	6.0	9.5	11.6	9.5	5.7	4.3	3.6	5.6	**4.4**	**4.4**	**4.6**
2W repo rate	%, end-of-period, CNB forec. = avg.	2.00	2.50	3.50	2.25	1.00	0.75	0.75	0.05	0.05	**0.05**	**0.75**
3M PRIBOR	%, average	2.0	2.3	3.1	4.0	2.2	1.3	1.2	1.0	0.5	**0.4**	**1.1**

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

2011				2012				2013				2014				2015			
QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV
903.5	905.5	905.8	904.3	901.0	897.6	894.7	891.7	880.0	882.3	884.3	**892.4**	**890.1**	**900.6**	**911.5**	**916.1**	**921.0**	**925.6**	**931.8**	**939.8**
3.0	2.1	1.5	0.8	-0.3	-0.9	-1.2	-1.4	-2.3	-1.7	-1.2	**0.1**	**1.1**	**2.1**	**3.1**	**2.7**	**3.5**	**2.8**	**2.2**	**2.6**
0.4	0.3	1.0	0.5	-1.4	-1.9	-2.1	-3.1	-1.3	-0.3	-0.1	**0.4**	**-0.3**	**0.2**	**1.3**	**1.2**	**1.6**	**1.6**	**1.6**	**1.5**
-0.9	-2.5	-4.1	-3.2	-2.8	-2.5	-1.5	-0.9	1.3	1.4	2.5	**2.3**	**0.5**	**2.0**	**1.5**	**2.1**	**1.6**	**1.3**	**1.2**	**1.1**
8.3	2.3	-3.9	-2.2	-5.5	-2.2	-11.1	-0.1	-5.2	-12.3	-1.2	**-6.4**	**-2.7**	**4.0**	**-0.8**	**0.0**	**4.8**	**3.3**	**1.2**	**1.8**
16.5	11.3	7.0	4.3	6.9	4.4	4.6	2.9	-3.8	0.5	0.3	**4.4**	**8.8**	**8.7**	**9.9**	**9.6**	**7.7**	**6.4**	**5.9**	**6.3**
15.9	8.9	2.6	1.9	3.8	3.0	0.5	2.6	-3.1	-0.9	2.3	**3.4**	**7.0**	**8.7**	**7.7**	**8.3**	**6.7**	**5.7**	**5.3**	**5.4**
66.8	76.7	70.8	83.0	92.2	89.2	101.7	87.1	83.6	99.5	88.3	**97.4**	**103.2**	**108.7**	**112.8**	**115.6**	**118.2**	**120.5**	**124.4**	**130.2**
10.8	8.2	2.3	2.6	2.6	-0.8	-0.9	-4.1	-5.4	-2.4	3.9	-	-	-	-	-	-	-	-	-
5.7	-5.3	-9.1	-0.9	-10.0	-6.0	-6.2	-9.0	-12.7	-13.9	-6.5	-	-	-	-	-	-	-	-	-
5.2	1.1	0.3	0.7	0.9	-2.2	-1.1	-1.7	-3.0	0.3	2.6	-	-	-	-	-	-	-	-	-
1.7	1.9	1.8	1.9	2.4	2.7	3.2	3.3	2.8	2.3	1.8	1.4	-	-	-	-	-	-	-	-
1.7	1.8	1.7	2.4	3.7	3.4	3.3	2.8	1.8	1.5	1.2	1.1	**0.4**	**0.8**	**1.5**	**2.1**	**2.8**	**2.8**	**2.5**	**2.2**
4.4	4.0	4.5	5.9	9.7	9.4	8.2	7.1	3.5	2.7	1.6	1.3	**-2.7**	**-1.9**	**-0.8**	**-0.7**	**3.0**	**2.8**	**2.6**	**2.7**
1.0	1.2	1.2	1.7	1.3	1.0	0.9	0.6	0.6	0.6	0.5	0.3	**0.9**	**1.2**	**1.8**	**2.5**	**2.5**	**2.5**	**2.4**	**2.1**
3.2	4.1	3.6	4.5	3.5	2.5	2.8	2.7	3.0	3.8	3.3	2.4	**3.0**	**2.6**	**3.1**	**3.4**	**2.7**	**2.6**	**2.6**	**2.5**
-0.8	-0.8	-0.7	-0.4	-0.3	-0.2	-0.4	-0.5	-0.4	-0.6	-0.7	-0.4	**-0.2**	**0.4**	**1.2**	**1.9**	**2.3**	**2.4**	**2.3**	**2.0**
10.8	9.1	9.5	10.2	8.0	5.8	6.4	3.8	-1.5	-3.8	-1.4	-1.7	**1.3**	**2.8**	**1.5**	**4.8**	**3.5**	**2.8**	**1.8**	**0.1**
1.6	1.7	1.7	2.4	2.5	2.2	2.0	1.5	0.9	0.8	0.4	0.3	**0.2**	**0.6**	**1.3**	**1.9**	**2.6**	**2.6**	**2.4**	**2.2**
-1.9	-1.7	-0.9	0.8	2.2	1.9	1.4	1.0	1.8	1.6	1.6	**1.6**	**1.4**	**0.3**	**1.0**	**1.4**	**-0.3**	**1.5**	**1.9**	**1.5**
5.4	6.0	5.6	5.2	3.6	1.8	1.6	1.6	1.2	0.5	0.7	0.8	**0.0**	**0.6**	**0.7**	**0.6**	**0.6**	**0.7**	**0.8**	**0.9**
32.4	32.3	19.2	7.1	-1.2	-2.9	5.6	12.7	14.5	9.3	1.4	-4.3	**-5.8**	**-3.5**	**1.8**	**2.8**	**-1.0**	**-0.6**	**0.9**	**2.4**
-0.4	-0.5	-0.5	-0.5	-0.7	-0.6	-0.6	-0.8	-1.0	-1.3	-1.3	-0.8	-	-	-	-	-	-	-	-
36.1	47.6	45.9	25.1	12.7	-7.2	-2.2	1.0	-4.6	-4.3	0.3	-0.7	**-5.8**	**1.5**	**-5.4**	**-6.2**	**-4.4**	**-4.5**	**-4.6**	**-4.7**
2.8	2.6	2.1	2.4	3.3	2.2	1.7	3.5	-0.3	1.2	1.3	**-0.1**	**3.2**	**2.0**	**2.5**	**3.0**	**3.8**	**4.2**	**4.3**	**4.3**
1.1	0.8	0.3	0.0	-0.4	-1.2	-1.5	0.7	-2.1	-0.3	0.1	**-1.3**	**2.8**	**1.2**	**0.9**	**0.9**	**0.9**	**1.3**	**1.8**	**2.1**
-0.2	0.4	0.1	-0.5	-0.6	-0.6	0.3	0.6	2.0	2.4	0.9	**1.0**	**-0.4**	**-0.5**	**0.4**	**0.7**	**1.0**	**0.9**	**0.8**	**0.9**
-0.5	1.0	-0.1	1.0	2.7	2.9	2.4	3.5	2.0	1.8	0.5	**-1.1**	**1.5**	**0.2**	**0.3**	**1.6**	**1.8**	**2.9**	**3.7**	**3.5**
-1.1	0.7	-0.2	2.4	2.2	4.4	6.0	5.1	3.2	2.2	-0.4	-	-	-	-	-	-	-	-	-
3.0	2.0	1.6	0.9	0.1	-1.7	-2.0	-1.8	-3.9	-2.9	-0.9	**-0.6**	**1.0**	**2.4**	**3.1**	**2.6**	**3.4**	**2.6**	**1.9**	**2.2**
7.2	6.8	6.6	6.5	7.2	6.8	7.0	7.2	7.5	6.8	7.0	**6.9**	**7.6**	**7.2**	**7.3**	**7.4**	**7.9**	**7.3**	**7.3**	**7.2**
7.4	6.5	6.4	6.4	7.1	6.5	6.6	7.0	8.0	7.5	7.5	7.8	**8.7**	**7.9**	**7.7**	**7.7**	**8.4**	**7.4**	**7.2**	**7.3**
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
33.3	27.3	6.5	23.2	51.8	34.1	34.2	25.6	53.9	61.8	38.7	**41.0**	**69.0**	**68.0**	**55.0**	**53.0**	**73.0**	**72.0**	**58.0**	**57.0**
3.8	2.8	0.7	2.3	5.7	3.5	3.5	2.6	6.0	6.4	3.9	**4.0**	**7.5**	**6.9**	**5.4**	**5.0**	**7.7**	**7.0**	**5.5**	**5.2**
13.3	18.6	16.1	10.4	14.7	11.4	13.9	9.9	15.7	14.1	9.8	**10.0**	**17.0**	**15.0**	**12.0**	**11.0**	**18.0**	**16.0**	**14.0**	**12.0**
32.9	-89.7	-29.9	-17.3	17.0	-26.1	-48.6	-36.3	13.7	-14.7	-29.1	**-9.5**	**31.0**	**11.0**	**-33.0**	**11.0**	**34.0**	**3.0**	**-33.0**	**16.0**
3.7	-9.3	-3.1	-1.7	1.9	-2.7	-5.0	-3.6	1.5	-1.5	-3.0	**-0.9**	**3.4**	**1.1**	**-3.2**	**1.0**	**3.6**	**0.3**	**-3.1**	**1.4**
-8.4	48.1	-35.2	42.3	30.7	48.1	44.0	58.3	26.0	9.7	-6.8	-	-	-	-	-	-	-	-	-
17.8	16.9	17.3	18.8	19.1	19.7	20.0	19.4	19.4	19.8	19.5	19.6	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
24.4	24.3	24.4	25.3	25.1	25.3	25.1	25.2	25.6	25.8	25.9	26.7	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
-2.0	-1.0	1.6	4.5	2.6	2.6	1.6	-1.1	1.3	0.7	1.5	3.9	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
-5.4	-5.0	-2.0	1.6	2.7	4.2	3.2	0.1	1.8	1.8	2.1	4.3	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
0.8	-0.1	1.6	4.6	4.0	3.9	3.3	0.3	1.0	0.7	0.4	**3.0**	**5.5**	**4.5**	**5.5**	**3.3**	**-1.1**	**-0.7**	**-0.4**	**0.0**
4.7	2.4	3.5	6.5	5.7	5.7	4.7	1.0	-0.3	-0.7	-0.9	**1.2**	**3.8**	**3.2**	**4.3**	**2.9**	**-1.0**	**-1.0**	**-1.0**	**-0.8**
3.4	2.6	3.7	4.8	6.0	5.8	5.7	5.0	4.2	4.1	4.9	**4.6**	**4.5**	**4.7**	**3.9**	**4.4**	**5.2**	**5.0**	**4.4**	**3.8**
0.75	0.75	0.75	0.75	0.75	0.50	0.50	0.05	0.05	0.05	0.05	0.05	**0.05**	**0.05**	**0.05**	**0.05**	**0.70**	**0.80**	**0.74**	**0.77**
1.2	1.2	1.2	1.2	1.2	1.2	1.0	0.6	0.5	0.5	0.5	0.4	**0.4**	**0.4**	**0.4**	**0.4**	**1.0**	**1.1**	**1.1**	**1.1**

Issued by:
CZECH NATIONAL BANK
Na Příkopě 28
115 03 Praha 1
CZECH REPUBLIC

Contact:
COMMUNICATIONS DEPARTMENT
Tel.: +420 22441 3494
Fax: +420 22441 2179

http://www.cnb.cz

Produced by: Jerome s.r.o.
Design: Jerome s.r.o.

ISSN 1803-2419 (Print)
ISSN 1804-2465 (Online)