INFLATION REPORT / IV

2014

CNB CZECH NATIONAL BANK

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

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

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

The forecast is the key, but not the only, input to the Bank Board's decision-making. At its meetings during the quarter, the Bank Board discusses the current forecast and the balance of risks and uncertainties surrounding it. The Bank Board's final decision may not correspond to the message of the forecast due to the 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 November 2014 and contains the information available as of 24 October 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 Czech economy continued to expand strongly in 2014 Q2. Both headline and monetary-policy relevant inflation rebounded from near-zero levels in 2014 Q3, but remained below the lower boundary of the tolerance band around the CNB's target. The low inflation was due to a continuing decline in administered prices and subdued inflation in the euro area. The weakened exchange rate is still feeding through to inflation via import prices. Moreover, the domestic economy is now pushing prices upwards. GDP growth will reach 2.5% both this year and the next thanks to rising external demand, easy domestic monetary conditions and higher government investment, and pick up slightly in 2016. Headline inflation will go up owing mainly to rising economic activity and accelerating wage growth. By contrast, the inflationary effect of import prices will fade. Both headline inflation and monetary-policy relevant inflation will return to the CNB's 2% target in early 2016, i.e. at the monetary policy horizon, and will then fluctuate slightly above the target. The forecast expects market interest rates to be flat at their current very low level and the koruna exchange rate to be used as a monetary policy instrument until 2016 Q1. The subsequent return to conventional monetary policy will not imply appreciation of the exchange rate to the level recorded before the CNB started intervening.

The **Czech economy** expanded by 2.5% year on year **in 2014 Q2**, with all domestic demand components making positive contributions. By contrast, the contribution of net exports was negative. GDP continued also growing in quarter-on-quarter terms, although its growth rate dropped. The forecast predicts a similar annual GDP growth rate in the third quarter of this year as in the first and second quarter.

Both **headline and monetary-policy relevant inflation** rebounded from near-zero levels **in 2014 Q3**, but remained below the lower boundary of the tolerance band around the CNB's target (see Chart I.1). The annual decline in administered prices moderated, while food and fuel prices recorded only modest growth. Adjusted inflation excluding fuels rose further, reflecting the effects of the weakened koruna, the growth in the domestic economy and wage growth.

Economic activity in the effective euro area has slowed recently and a pronounced recovery has thus been postponed to 2015. According to the assumptions of the forecast, its growth will reach 1% this year and increase further to 2% in the next two years. Inflation in the euro area remains very subdued owing mainly to very low commodity prices in an environment of only weakly rising economic activity following a previous lengthy contraction. In the euro area, industrial producer prices are falling noticeably year on year and consumer price inflation is very low. Inflation is expected to pick up in 2015 thanks to a recovery in the growth rate of the euro area economy and a weakening exchange rate of the euro. The low outlook for 3M EURIBOR rates reflects the recent monetary policy easing by the ECB and expectations of a continued easing of monetary policy using unconventional instruments. Oil prices are expected to rise only slightly from their currently very low level.

CHART I.1

FULFILMENT OF THE INFLATION TARGET

Headline inflation was below the lower boundary of the tolerance band around the CNB's target in 2014 Q3
(year on year in %)

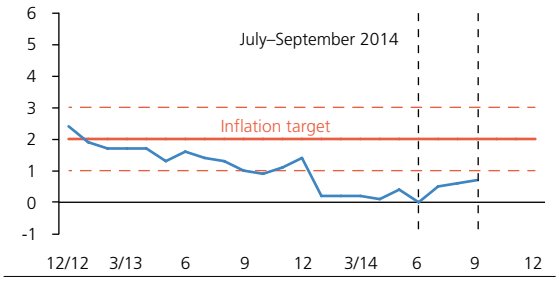
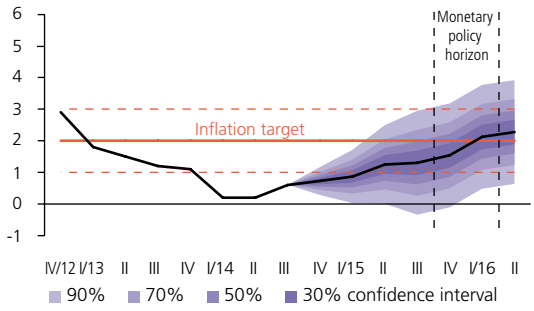


CHART I.2

HEADLINE INFLATION FORECAST

Headline inflation will rise towards the target and slightly exceed it towards the end of the monetary policy horizon
(year on year in %)



According to the forecast, both headline inflation and monetary-policy relevant inflation will continue to rise towards the CNB's 2% target, crossing it from below at the monetary policy horizon and then staying slightly above it in 2016 (see Charts I.2 and I.3). The overall upward pressures on consumer prices will temporarily ease slightly in the near future, as the strongly positive contributions of import prices will turn slightly negative due to the observed decline in producer prices in the euro area and to assumed stability of the koruna-euro exchange rate. By contrast, the growing domestic economy and accelerating wage growth will foster higher prices over the entire forecast horizon. This will result in a steady increase in adjusted inflation excluding fuels. Administered prices will decline further this year and, to a lesser extent, next year and return to modest growth in 2016. Food price inflation will slow significantly in the near future because of a deepening decline in agricultural producer prices, and accelerate in 2015. Fuel prices will fall noticeably at the start of next year due to the observed decline in global oil prices, and start rising again in 2016 in line with global petrol and oil prices.

The forecast expects market **interest rates** to be flat at their current very low level until 2016 Q1, reflecting the 2W repo rate being left at technical zero over the same time frame and the assumption of an unchanged money market premium. Short-term market rates are forecasted to increase by around 0.8 percentage point in 2016 Q2, after the expected exit from the regime of using the exchange rate as a monetary policy instrument (see Chart I.4). Market interest rates will then rise further. The **exchange rate of the koruna against the euro** is expected to remain at CZK 27.4 over the next few quarters, slightly weaker than the announced asymmetric exchange rate commitment (i.e. CZK 27 to the euro). The forecast expects the exchange rate to be used as a monetary policy instrument until 2016 Q1. By then, thanks to the economic recovery and rising wages, domestic inflationary pressures should be sufficiently restored to allow a return to conventional monetary policy. However, this return should not result in the exchange rate appreciating to the level recorded before the CNB started intervening, as the weaker exchange rate of the koruna has been in the meantime passing through to the price level and other nominal variables.

Following the contraction of the **Czech economy** over the last two years, GDP will grow significantly this year (see Chart I.5). Higher external demand and easy domestic monetary conditions via the weakened koruna and exceptionally low interest rates, coupled with a recovery in government investment, will lead to GDP growth of 2.5%. Next year, the economy will record the same growth rate, with fiscal policy making a significantly positive contribution owing mainly to the drawdown of EU funds. GDP growth will pick up slightly further in 2016, due mainly to rising growth in external demand. The rising economic activity is already manifesting itself in the **labour market** in renewed growth in the number of employees converted into full-time equivalents. This growth will continue over the forecast horizon. The unemployment rate will continue to decrease gradually. Wage growth in the business sector will increase noticeably, and the same will apply to wages in the non-business sector in the near future.

CHART I.3

MONETARY-POLICY RELEVANT INFLATION FORECAST

Monetary-policy relevant inflation will increase close to the target
(year on year in %)

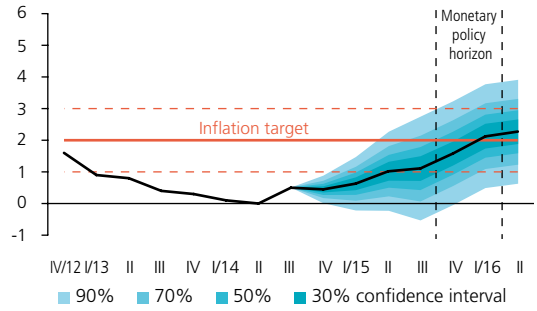


CHART I.4

INTEREST RATE FORECAST

The forecast expects market interest rates to be flat at their current very low level until 2016 Q1
(3M PRIBOR in %)

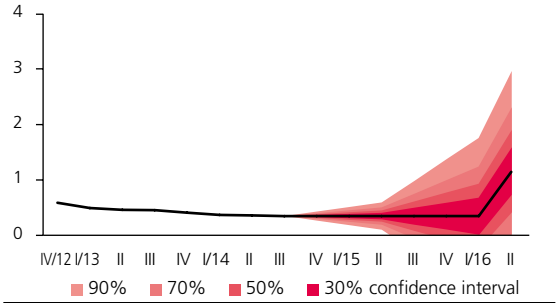


CHART I.5

GDP GROWTH FORECAST

GDP will grow at a rate of 2–3% on the back of increasing external demand, easy monetary conditions and higher government investment
(annual percentage changes; seasonally adjusted)

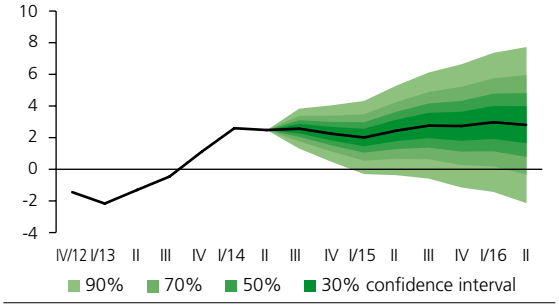


Chart 1 (Box)

CZK/EUR EXCHANGE RATE

Following the announcement of the exchange rate commitment the koruna quickly depreciated beyond CZK 27 to the euro and then stabilised slightly above it
(CZK/EUR)

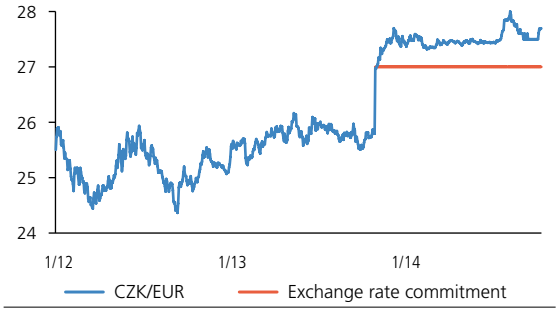


Table 1 (Box)

COMPARISON OF KEY INDICATORS

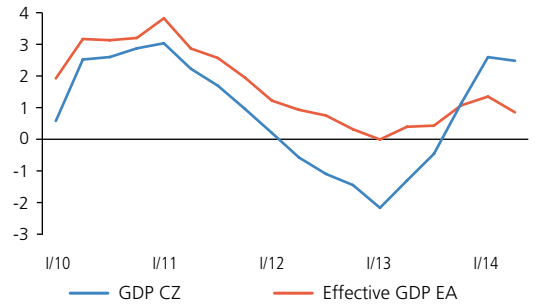
Key macroeconomic indicators are developing much more favourably than they were before November 2013; headline inflation is slightly lower
(annual percentage changes unless otherwise indicated)

	Available as of 7 Nov 2013		Available as of 31 Oct 2014	
Gross domestic product (s.a.)	II/13	-1.3	II/14	2.5
Consumer price index	9/13	1.0	9/14	0.7
Monetary-policy relevant inflation	9/13	0.2	9/14	0.6
General unemployment rate (in %, s.a.)	9/13	7.1	9/14	5.9
Average nominal wage in business sector (in CZK, s.a.)	II/13	25,199	II/14	25,542
Average nominal wage, total	II/13	1.2	II/14	2.3
Number of vacancies	9/13	39,040	9/14	56,600
Composite confidence indicator (index)	10/13	88.9	10/14	94.1

Chart 2 (Box)

GDP IN THE CZECH REPUBLIC AND EFFECTIVE EURO AREA

The domestic economy has recovered visibly more than the effective euro area
(annual percentage changes; seasonally adjusted)



BOX 1
Assessment of the economic situation one year after the exchange rate commitment was adopted

The Czech economy went through a lengthy **economic contraction** in 2012–2013 owing to weak external and in particular domestic demand reflecting consolidation of public budgets and low household and business confidence. This supported anti-inflationary tendencies, and there was an increasingly real danger of the Czech economy slipping into deflation at the start of 2014. Its consequences would have been highly unfavourable and difficult to deal with, particularly if deflation had become incorporated into the expectations of economic agents. At the same time, monetary policy rates could not be lowered any further, as they had hit the zero lower bound in autumn 2012.

In November 2013, the CNB therefore – in line with its previous communication – started to use **the exchange rate of the koruna as an additional instrument** for easing monetary policy. Specifically, it announced a one-sided exchange rate commitment at CZK 27 to the euro and expressed its readiness to prevent excessive appreciation of the koruna below this level by intervening in the foreign exchange market. On the weaker side of this level, the CNB is allowing the koruna exchange rate to float. Following the announcement of the exchange rate commitment the koruna quickly depreciated beyond CZK 27 to the euro (thanks in part to foreign exchange interventions by the CNB) and soon stabilised without further interventions close to CZK 27.5 to the euro (see Chart 1) as the exchange rate commitment quickly established a strong degree of credibility.

One year on, it is appropriate to assess the effect of the CNB's exchange rate commitment on the Czech economy. Table 1 shows that the Czech Republic's **key macroeconomic indicators** are developing much more favourably than they were before November 2013. The economy is growing noticeably, and this is having a favourable effect on the labour market and household and business confidence. Headline inflation has fallen slightly compared to last year and deviated even further from the CNB's 2% target, but – adjusted for the effect of tax changes – it has stepped back from the edge of deflation. Key economic data thus suggest that the weakening of the exchange rate has served its purpose. To assess its effect properly, however, we also have to consider other factors.

The marked **change in the evolution of the Czech economy** has been supported by a recovery in growth in the effective euro area. This recovery remains fragile, however, and economic growth in the Czech Republic's major trading partner countries

has increased subtly this year (see Chart 2). From the whole-year perspective, the current forecasts expect it to rise by only 0.5 percentage point. Another factor supporting the economic turnaround is a shift of domestic fiscal policy from a strongly restrictive effect of about -1 percentage point in 2013 to a slightly positive stimulus of approximately 0.3 percentage point this year. The above factors together explain almost 2 percentage points of the dynamics of the Czech economy this year. The dynamics, however, is another 1.5 percentage points higher, thanks to which the Czech Republic has started to outpace the effective euro area for the first time in a long time (see Chart 2).[1] This can be attributed to the easing of the monetary conditions via the weaker koruna, which has fostered a marked lead of Czech export growth over external demand growth and a recovery in domestic investment and consumption. The effect of expectations has played a strong role, as firms and households have stopped deferring their expenditure.

From the point of view of **inflation**, the assessment of the impacts of the weakening of the koruna is more complicated at first sight, as inflation is still very low and its outlook has shifted substantially downwards since November 2013. The alternative scenario of the November 2013 forecast had expected inflation to return to the target at the end of this year and rise temporarily to the upper boundary of the tolerance band around the target at the start of 2015, whereas the November 2014 forecast expects it to stay in the lower half of the tolerance band for the whole of next year (see Chart 3). This is despite the fact that the duration of the exchange rate commitment has been extended from the originally planned start of 2015 to 2016 and the fact that the koruna is at a weaker level than the exchange rate commitment.

It should be taken into account, however, that the **deflationary tendencies in the euro area** have deepened further in the meantime. This is reflected in a decline in both observed and expected foreign producer price inflation (see Chart 4). In addition, the decline in domestic administered prices is also deeper than expected last November. An analysis using the g3 core prediction model reveals that in normal circumstances the anti-inflationary effect of the above factors would have been reduced by interest rate cuts and by a fundamentally justified weakening of the nominal exchange rate of the koruna to maintain the price competitiveness of domestic production. However, given the zero lower bound on interest rates and the risks of exchange rate appreciation identified in November

CHART 3 (BOX)

COMPARISON OF INFLATION FORECASTS

The inflation forecasts have fallen noticeably since the November 2013 alternative scenario was drawn up
(annual percentage changes)

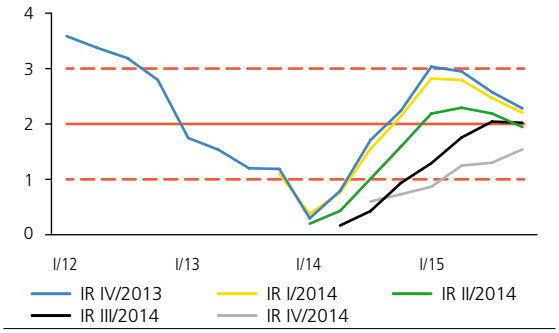
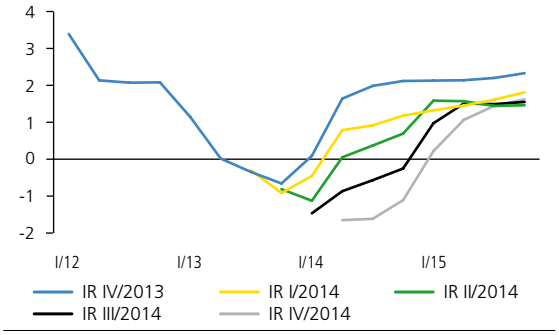


CHART 4 (BOX)

SHIFT IN THE OUTLOOK FOR EFFECTIVE PPI

The outlook for industrial producer prices in the euro area has shifted significantly downwards since last November
(annual percentage changes; seasonally adjusted)



1 In November, the CNB had expected the weakening of the koruna to boost economic growth by about one percentage point in 2014 relative to the passive monetary policy scenario.

2013, the decline in domestic inflation and the negative impact of external developments on domestic GDP and the labour market would have been significant had this monetary policy easing not occurred.

To sum up, the weakening of the koruna averted the threat of long-term deflation, which – in the light of new data – was much greater than suggested by the analyses a year ago. The weaker exchange rate of the koruna has passed through to import prices, adjusted inflation excluding fuels has turned positive for the first time in many years, and the anti-inflationary effect of the domestic economy has faded away as GDP growth has accelerated and the labour market has changed for the better.

At its monetary policy meeting on 6 November 2014, the Bank Board decided unanimously to keep interest rates unchanged at technical zero. The Bank 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 against the euro so that the exchange rate of the koruna is kept close to CZK 27 to the euro. The asymmetric nature of this exchange rate commitment is unchanged. The Bank Board assessed the risks to the new forecast as being balanced. In this situation the Bank Board repeated that the CNB would not discontinue the use of the exchange rate as a monetary policy instrument before 2016.

II. THE FORECAST, ITS CHANGES AND RISKS

II.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

The growth rate of external economic activity has slowed recently and is not expected to start rising visibly again until 2015 Q2. The continuing marked fall in producer prices this year reflects the previous lengthy economic contraction and low commodity prices. Consumer price inflation in the euro area is very low due to an only gradual recovery in demand and a fall in retail energy prices. Producer and consumer price inflation is expected to rise in 2015 on the back of an upswing in economic growth and a weaker exchange rate of the euro. The ECB responded to the very subdued inflation by further easing monetary policy. This was reflected in a lower outlook for 3M EURIBOR interest rates and a depreciation of the euro against the dollar, which is expected to continue over the forecast horizon. The outlook for the Brent crude oil price reflects its current very low level and foresees only moderate growth over the next two years.

The outlook for the **effective indicator of euro area GDP** foresees a 0.5 percentage point pick-up in economic growth to 1% this year compared to 2013 (see Chart II.1.1).[2] However, the growth has recently slowed and a more substantial recovery has been postponed to 2015 Q2. Growth of 1.6% and 2.1% respectively is expected in the next two years. The situation of the German economy, which recorded a marked slowdown in Q2, is less favourable than at the start of 2014. At the same time, leading indicators are pointing to increased pessimism among German firms and households because of slowing demand from emerging economies. Compared to the previous forecast, the whole-year outlook has shifted downwards for this year and the next and slightly upwards for 2016.

The **effective indicator of industrial producer prices in the euro area** (see Chart II.1.2) is expected to fall by 1.6% on average this year, mainly because of very low prices of industrial and agricultural commodities in an environment of only slowly rising economic activity following a previous lengthy contraction. Industrial producer price inflation is expected to turn positive again at the start of next year on the back of a renewed upswing in economic growth and depreciation of the euro against the dollar. Producer prices are expected to rise by 1.1% on average in 2015 as a whole and accelerate to 2.2% in 2016. Compared to the previous forecast the outlook is 0.8 percentage point lower for this year and little changed at the longer horizon.

2 The outlooks for euro area GDP, PPI and CPI and the dollar-euro exchange rate are based on the October Consensus Forecasts (CF). The outlooks for the 3M EURIBOR and Brent crude oil are derived from prices of market contracts as of 13 October 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 for already known facts are due, in addition to revisions, to an update of the weights of individual countries in Czech exports and to new seasonal adjustment. In the case of PPI they are due mainly to the fact that – to improve its quality – the calculation newly includes predictions from the Economist Intelligence Unit (EIU) database for the countries not covered by CF.

CHART II.1.1

EFFECTIVE GDP IN THE EURO AREA

External demand growth has slowed recently and is not expected to start rising visibly again until 2015 Q2
(annual percentage changes; differences in percentage points – right-hand scale; seasonally adjusted)

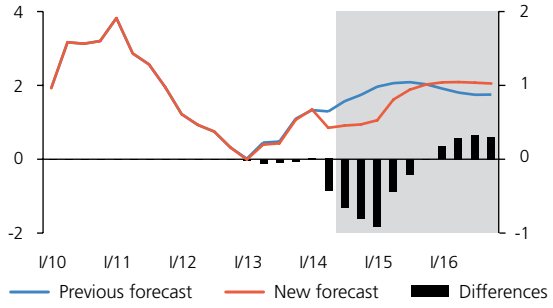


CHART II.1.2

EFFECTIVE PPI IN THE EURO AREA

Producer prices are expected to stop declining at the start of next year and then gradually accelerate
(year on year in %; differences in percentage points – right-hand scale; seasonally adjusted)

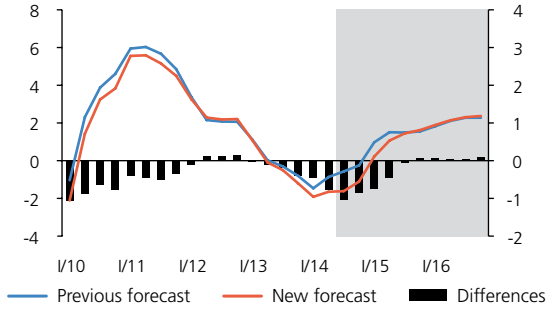


CHART II.1.3

EFFECTIVE CPI IN THE EURO AREA

The currently very low effective inflation is expected to rise gradually towards the 2% level
(year on year in %; differences in percentage points – right-hand scale; seasonally adjusted)

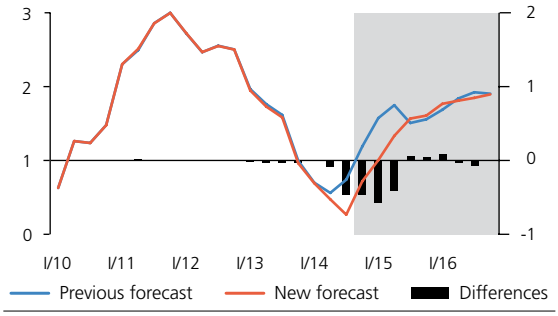


CHART II.1.4

3M EURIBOR

The low 3M EURIBOR outlook reflects the very subdued inflation and the ECB's continuing easy monetary policy
(in %; differences in percentage points – right-hand scale)

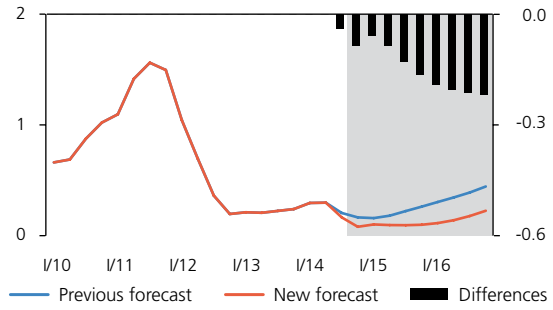


CHART II.1.5

EURO-DOLLAR EXCHANGE RATE

The euro is expected to depreciate against the dollar over almost the entire horizon
(USD/EUR; differences in % – right-hand scale)

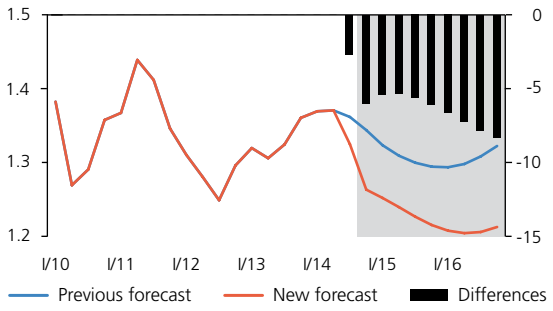
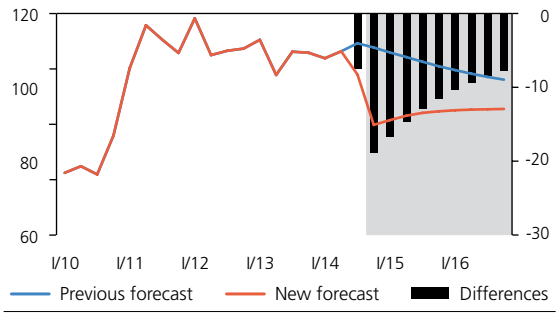


CHART II.1.6

PRICE OF BRENT CRUDE OIL

Following its current sharp drop, the price of crude oil is expected to rise only gradually over the next two years
(USD/barrel; differences in % – right-hand scale)



The expected growth of the **effective indicator of consumer prices in the euro area** reflects the sluggish recovery in demand and a decline in retail energy prices (see Chart II.1.3). In 2014 as a whole, consumer prices are expected to increase by 0.5% on average. Inflation is expected to rise to 1.4% and 1.8% respectively in 2015 and 2016 owing to accelerating economic activity and a depreciating euro. Compared to the previous forecast, this represents a downward shift in the next few quarters. There is no significant change at the longer end of the forecast.

The low level of **3M EURIBOR** interest rates over the entire forecast horizon mainly reflects the further easing of monetary policy by the ECB. At the start of September, in response to very subdued inflation, the ECB lowered its main refinancing rate by 0.1 percentage point to 0.05% and its deposit rate into more negative territory (-0.20%) and announced new unconventional measures (see section III.7). The 3M EURIBOR is expected to average 0.2% this year and 0.1% and 0.2% respectively in the next two years (see Chart II.1.4). Compared to the previous forecast, this means a downward revision of the outlook by 0.1–0.2 percentage point. The market outlook is in line with the expectations of the analysts surveyed in the October CF, who expect the 3M EURIBOR to be flat at the current level of 0.1% at the 3–12-month horizon. At the same time, most analysts expect the ECB's main refinancing rate to stay at the current level of 0.05% at least until the end of September 2015.

The outlook for the **euro-dollar exchange rate** foresees a continued trend of gradual weakening of the euro over almost the entire forecast horizon (see Chart II.1.5). CF analysts expect the euro to depreciate faster than in the previous forecast owing to further monetary policy easing in the euro area. The Fed, by contrast, is discontinuing its quantitative easing policy. The euro is expected to depreciate from the current level below USD 1.28, i.e. the lowest level since August 2012, to close to USD 1.20 over the next two years.

The outlook for the **Brent crude oil price** based on market futures contracts foresees a gradual rise from the current very low level of less than USD 90 a barrel (see Chart II.1.6). From the whole-year perspective, this represents a decline in the average level from USD 103 a barrel this year to USD 93–94 in the next two years. The present low price of oil reflects fast growing global supply, a strong dollar and concerns about a slowdown in global growth. Uncertainties surrounding future oil and natural gas supplies from Russia and tensions in the Middle East are acting in the opposite direction. The analysts surveyed in the October CF predict a price of USD 99 a barrel at the one-year horizon, i.e. USD 6 higher than the market outlook.

II.2 THE FORECAST

Both headline and monetary-policy relevant inflation rebounded from near-zero levels in 2014 Q3. The forecast expects inflation to continue rising gradually and slightly exceed the 2% target at the start of 2016. The inflationary effect of import prices will fade this year owing to the observed fall in producer prices in the euro area amid a stable exchange rate of the koruna. By contrast, the domestic economy will contribute to price growth, mainly as a result of a recovery in wage growth. After last year's GDP contraction, the economy will grow by 2.5% this year owing to higher external demand, the strong easing of the domestic monetary conditions via the exchange rate of the koruna and exceptionally low interest rates, and a recovery in government investment. Economic activity will show the same growth rate in 2015 and accelerate slightly in 2016. The contribution of fiscal policy to economic growth will be strongly positive next year and slightly negative in 2016. The economic growth will also give rise to a continuing improvement in the situation on the labour market. The forecast expects market interest rates to be flat at their current very low level and the koruna exchange rate to be used as a monetary policy instrument until 2016 Q1. The subsequent return to conventional monetary policy will not imply appreciation of the exchange rate to the level recorded before the CNB started intervening.

Annual **headline inflation** rebounded in 2014 Q3 from the zero levels seen in June (reaching 0.6% on average), but remained below the lower boundary of the tolerance band around the CNB's target. According to the forecast, headline inflation will increase slightly further to 0.7% in 2014 Q4 due to a continuing increase in adjusted inflation excluding fuels and to the impacts of the increase in excise duty on cigarettes. By contrast, food price inflation will slow. Headline inflation will increase further in 2015 owing to the unwinding of the marked fall in administered prices and the continuing inflationary effect of the domestic economy, and will be slightly above the CNB's 2% target at the start of 2016 (see Chart II.2.1).

Monetary-policy relevant inflation, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, returned to positive territory, averaging 0.5% in 2014 Q3. It thus was still 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 until the end of 2015 it will be slightly lower (see Chart II.2.1) owing to the first-round effects of changes to indirect taxes.

The contribution of changes to **indirect taxes** to annual headline inflation averaged 0.1 percentage point in 2014 Q3. This reflected two harmonisation increases in excise duties on cigarettes in January 2013 and January 2014. The impact of these increases in excise duty on prices was spread over time because of substantial frontloading of tobacco products by producers and retailers. In addition to the lagged 0.1 percentage point impact of the rise in excise duty adopted at the start of 2014, the forecast assumes a 0.2 percentage point impact

CHART II.2.1

HEADLINE INFLATION AND MONETARY-POLICY RELEVANT INFLATION

Headline inflation and monetary-policy relevant inflation will continue rising and slightly exceed the 2% target at the start of 2016

(year on year in %)

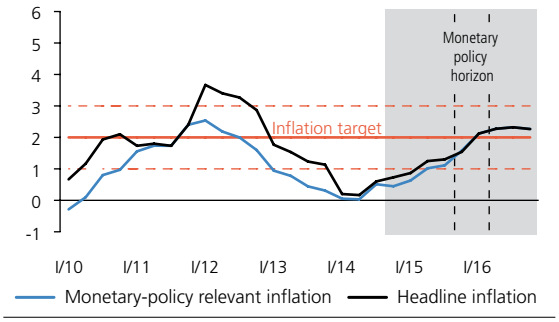


CHART II.2.2

ADMINISTERED PRICES AND FUEL PRICES

Both administered prices and fuel prices will not rise visibly until 2016

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

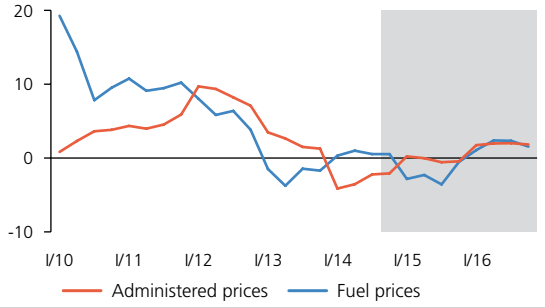


TABLE II.2.1

FORECAST OF ADMINISTRATIVE EFFECTS

The subdued administered price inflation next year will be due mainly to the abolition of fees in health care and a further decline in electricity prices

(annual average percentage changes; contributions to headline inflation in percentage points)

	2013 actual		2014 forecast		2015 forecast		2016 forecast	
Administered prices – total[a)]	2.2	0.40	-3.0	-0.51	-0.2	-0.03	1.9	0.32
of which (main changes):								
electricity	3.2	0.15	-10.3	-0.49	-1.9	-0.09	0.2	0.01
natural gas	-3.5	-0.09	-2.5	-0.07	-1.0	-0.03	1.8	0.05
heat	4.3	0.10	0.7	0.01	4.1	0.08	3.0	0.06
water	6.7	0.07	3.4	0.03	4.5	0.04	4.7	0.04
healthcare	2.6	0.05	-5.6	-0.06	-17.0	-0.20	2.0	0.02
First-round impacts of tax changes in non-administered prices		0.67		0.16		0.18		0.00

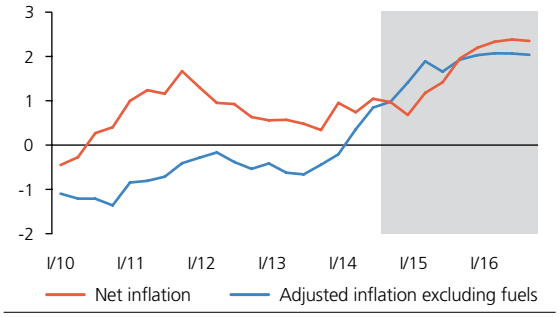
a) Including effects of indirect tax changes

CHART II.2.3

NET INFLATION AND ADJUSTED INFLATION EXCLUDING FUELS

Market price inflation will accelerate in 2015 owing to continued growth in economic activity and a gradual recovery in the labour market

(year on year in %)



of a further harmonisation increase in excise duty on cigarettes in 2014 Q4.[3] Since frontloading is legally limited to two months, this change will affect prices until the end of 2014. The forecast also assumes the introduction of a second reduced VAT rate of 10% on medicines, books and irreplaceable infant food with effect from 1 January 2015. The first-round effect of this change on headline inflation is -0.07 percentage point and pertains primarily to non-administered prices. No changes to indirect taxes are foreseen by the forecast for 2016.

The year-on-year decline in **administered prices** continued into 2014 Q3 (see Chart II.2.2) owing to a sharp fall in retail energy prices, the abolition of hospital stay fees and weaker year-on-year growth in water supply and sewerage collection charges at the start of this year. However, the decline in administered prices has moderated during the year, as gas prices have returned to annual growth due to the expiry of last year's discounts and prices of medicines and spa stays have gone up. The forecast assumes a further slight moderation of the annual decline in administered prices in 2014 Q4 due to a smaller annual decline in health care prices and a slight increase in heat prices. Administered prices will decrease by 0.2% on average in 2015, mainly due to the abolition of fees in health care (except for emergency treatment) with effect from 1 January 2015 with an impact on headline inflation of -0.2 percentage point. At the same time, the forecast assumes a further slight decrease in retail electricity prices following a decline in forward contracts for electricity generation. Gas prices will also fall slightly on average next year and not start rising until 2016. The introduction of the second reduced VAT rate of 10% will make a slight negative contribution to administered prices. The forecast assumes a slight increase in water supply and sewerage collection charges, heat prices and other administered items. Administered prices will make a positive contribution to inflation in 2016 amid subdued growth in all their components (see Table II.2.1). The following text describes the forecast excluding the first-round effects of changes to indirect taxes.

Annual **net inflation** picked up further to 1% on average in 2014 Q3 (see Chart II.2.3). This was due to rising food prices and continued growth in adjusted inflation excluding fuels as a result of the pass-through of the weakened exchange rate and the recovery in the real economy. Growth in fuel prices was very subdued. The forecast expects net inflation to decrease slightly in late 2014 and early 2015 due to a temporary drop in food and fuel prices. Net inflation will rise again in 2015, reaching 2% at the end of the year. It will fluctuate slightly above this level in 2016.

3 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. An amendment to the Excise Duty Act in effect since 1 October 2014 increases the minimum rate of excise duty to take account of the weaker koruna-euro exchange rate compared to last year, when the previous legislation was adopted.

Annual **adjusted inflation excluding fuels** picked up further in 2014 Q3, averaging 0.8%. Faster growth in prices of tradable and non-tradable commodities reflected the continued effect of the weakened exchange rate and the growing domestic economy. The forecast assumes a further rise in adjusted inflation excluding fuels in the quarters ahead, fostered by domestic inflationary pressures stemming from continued economic growth and a recovering labour market. Adjusted inflation excluding fuels will slightly exceed 2% at the start of 2016 and will remain at this level in the remainder of the year (see Chart II.2.3).

Food prices kept rising year on year in 2014 Q3. Agricultural producer prices continued to decrease year on year, while a further slight weakening of the koruna acted in the inflationary direction through prices of imported food. The forecast expects food price inflation to slow considerably in the coming quarters (temporarily into negative figures) owing to an assumed stronger annual decline in agricultural producer prices and the unwinding of the effect of the weakening of the koruna on annual growth in import prices of food. Food price inflation will go up in the second half of 2015 as agricultural producer prices and import prices of food return to growth. In 2016 it will pick up further to 3% (see Chart II.2.4).

Fuel prices continued to show subdued annual growth in 2014 Q3, reflecting a weaker koruna-dollar exchange rate and a counteracting decline in world prices of petrol and oil. Fuel prices will fall significantly at the start of next year due to the observed decline in global oil prices (see Chart II.2.5). Annual growth in fuel prices will renew at the start of 2016 as international prices of petrol and Brent crude oil return to modest growth.

Domestic money market **interest rates** remained flat at historical lows at all maturities in 2014 Q3. The forecast expects market interest rates to be flat at their current very low level until 2016 Q1, reflecting the 2W repo rate being left at technical zero over the same time frame and an assumption of an unchanged money market interest rate premium. According to the forecast, short-term market rates will increase by around 0.8 percentage point in 2016 Q2 after the expected exit from the regime of using the exchange rate as a monetary policy instrument (see Chart II.2.6). Market interest rates will then increase further.

The **exchange rate of the koruna against the euro** briefly depreciated to CZK 27.6 to the euro on average in 2014 Q3. Given its subsequent return to levels around CZK 27.4 in late September and early October, the forecast expects the exchange rate to remain at this level over the next few months, slightly weaker than the announced asymmetric exchange rate commitment (i.e. CZK 27 to the euro). The forecast expects the exchange rate to be used as a monetary policy instrument until 2016 Q1. By then, thanks to the economic recovery and rising wages, domestic inflationary pressures should be sufficiently restored to allow a return to conventional monetary policy. However, this return should not result in the exchange rate appreciating to the level recorded before the CNB started intervening,

CHART II.2.4

FOOD PRICES AND AGRICULTURAL PRODUCER PRICES

Food prices will fall temporarily at the start of 2015 owing to a decline in agricultural producer prices, but will then start rising again

(annual percentage changes)

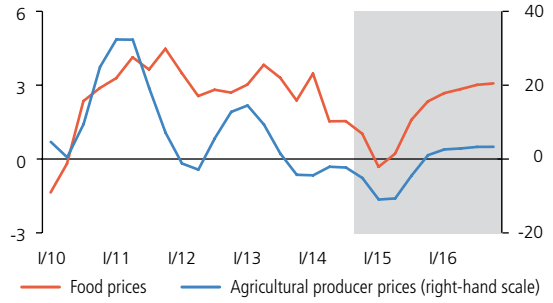


CHART II.2.5

FUEL PRICES AND OIL PRICES

Fuel prices will fall year on year in 2015 and show renewed growth in 2016

(annual percentage changes)

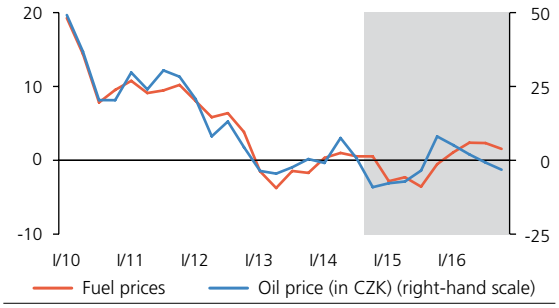


CHART II.2.6

INTEREST RATE FORECAST

The forecast expects market interest rates to be flat at their current very low level until 2016 Q1

(percentages)

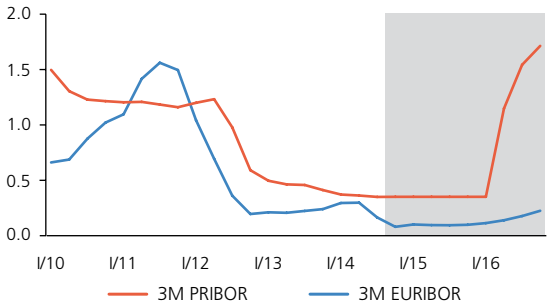


CHART II.2.7

COSTS IN THE CONSUMER SECTOR

Growth in prices in the consumer sector will reflect the inflationary effect of the domestic economy, while the effect of import prices will switch from strongly positive to slightly negative
(quarterly percentage changes; contributions in percentage points; annualised)

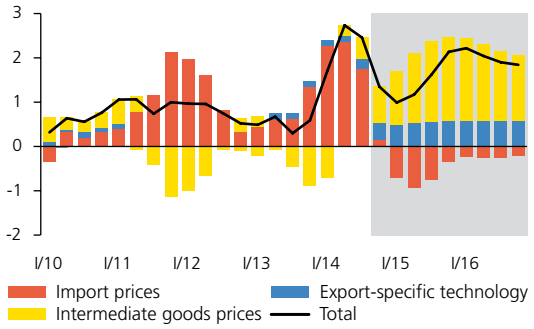


CHART II.2.8

COSTS IN THE INTERMEDIATE GOODS SECTOR

Domestic costs will rise mainly due to accelerating wage growth
(quarterly percentage changes; contributions in percentage points; annualised)

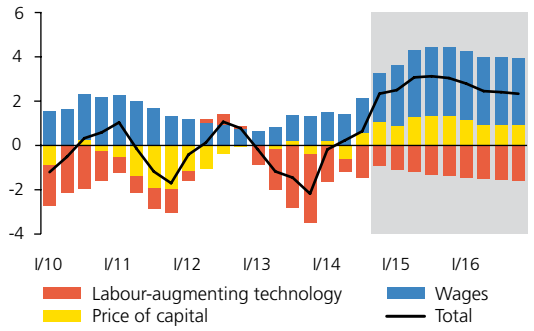
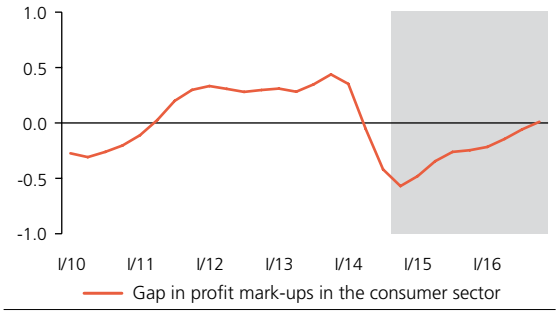


CHART II.2.9

GAP IN PROFIT MARK-UPS IN THE CONSUMER SECTOR

The negative gap in profit mark-ups will gradually close
(percentages)



as the weaker exchange rate of the koruna has been in the meantime passing 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 gradual depreciation of the koruna-dollar rate this year and the next.

Quarterly growth in **nominal marginal costs in the consumer goods sector** slowed slightly in 2014 Q3 (see Chart II.2.7), but remains a relatively strong contributor to the price level. The contribution of import prices to the growth in costs remained positive but decreased slightly owing to deflation in foreign producer prices. The rise in costs in the consumer goods sector is also increasingly due to intermediate goods prices, reflecting growing domestic activity and wages. The estimated impact on inflation of growth in export-specific technology, linked with different productivity growth in 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 temporarily ease slightly in the period ahead, as the contribution of import prices will fade due to very low foreign producer price inflation and expected stability of the koruna-euro exchange rate. Import prices will turn slightly anti-inflationary in 2015 and remain so until the end of 2016. By contrast, rising intermediate goods prices will gradually increase their positive contribution to growth in costs in the consumer sector until the start of 2016, reflecting accelerating wage growth and continued growth in the domestic economy. The contribution of export-specific technology will also start to increase gradually at the end of 2014. Growth in total costs will stabilise just below 2% at the end of the forecast horizon.

Nominal marginal costs in the intermediate goods sector rose slightly further in 2014 Q3. This was mainly due to expected nominal wage growth in the business sector outpacing labour productivity growth. The price of capital also made a positive contribution to marginal costs, reflecting a recovery in investment activity and overall economic activity (see Chart II.2.8). Domestic nominal costs will continue to rise in the quarters ahead due to accelerating wage growth and continued growth in the price of capital. However, these cost pressures will be partly offset by faster productivity growth over the entire forecast horizon.

The estimated negative gap in **profit mark-ups in the consumer goods sector** widened further in 2014 Q3 due to the weakened exchange rate and positive wage developments in a situation of currently very low inflation (see Chart II.2.9). The gap in profit mark-ups will start to close gradually at the start of the forecast horizon amid rising inflation and slowing growth in costs. It should close entirely at the end of 2016 in an environment of growing economic activity and continuing pass-through of rising costs to final prices.

Whole-economy **labour productivity** accelerated further to 2.6% year on year in 2014 Q2. The forecast expects slightly lower growth in Q3 and in 2014 as a whole on average. Productivity growth will be

around 2.5% in the following two years. Its path will be influenced by a gradual pick-up in economic growth accompanied by only slight growth in total employment.

The average nominal **wage in the business sector** rose by 2.5% year on year in 2014 Q2. The growth was still affected by tax optimisation in late 2012 and early 2013 (for details see section III.4.2). According to the forecast, the average wage should pick up pace gradually on the back of continued growth in domestic economic activity and a return of inflation to the target. The forecast expects wage growth in the business sector to reach 3.2% for 2014 as a whole and pick up to 3.8% in 2015 and 4.8% in 2016 (see Chart II.2.10).

Growth in the average nominal **wage in the non-business sector** was 1.7% in 2014 Q2. The forecast expects a relatively pronounced increase in the remainder of the year, due mainly to a rise in public sector wages of 3.5% in November (see Chart II.2.10). Wage growth is expected to average 2.9% this year. The rate of growth of wages in the non-business sector should increase further to 3.2% in 2015, amid continued GDP growth and easier fiscal policy, and slow to 2.5% in 2016.

Real GDP recorded a year-on-year increase of 2.5% and a quarter-on-quarter rise of 0.3% **in 2014 Q2** (see Chart II.2.11). All components of domestic demand made positive contributions to the year-on-year growth, with fixed investment being the main driver. Conversely, the contribution of net exports was negative (see Chart II.2.12). According to the forecast, **economic activity** rose by 2.6% year on year and 0.4% quarter on quarter **in 2014 Q3**. The expected annual GDP growth is being fostered by all components of domestic demand except inventories, and most of all by gross fixed capital formation and household consumption. The contribution of government consumption to GDP growth shrank in Q3 but stayed positive. The contribution of net exports was slightly positive.

GDP will grow by 2.5% **in 2014** as a whole, with the growth being fostered by rising external demand, still easy domestic monetary conditions via the weaker exchange rate of the koruna and exceptionally low interest rates, and partly also by fiscal policy. The forecast expects fixed investment to continue rising in the remainder of 2014. Gross fixed capital formation should be supported *inter alia* by continued growth in general government investment connected with the drawdown of EU funds and by robust growth in government investment from domestic sources.[4] Household consumption will continue to rise on the back of accelerating wage growth in conditions of low inflation. As a result of the weakening of the koruna and an

4 The positive supply effect resulting from higher investment from EU funds from the 2007–2013 programme period is partly reduced in the forecast, as these projects are not expected to have such a large and immediate impact on the creation of new production facilities and on technology growth as private sector investment. The impact of the increase in investment associated with the switch to ESA 2010 methodology is also reduced in the forecast.

CHART II.2.10

AVERAGE NOMINAL WAGE

Wage growth in the business sector will pick up noticeably
(annual percentage changes; business sector – seasonally adjusted; non-business sector – seasonally unadjusted)

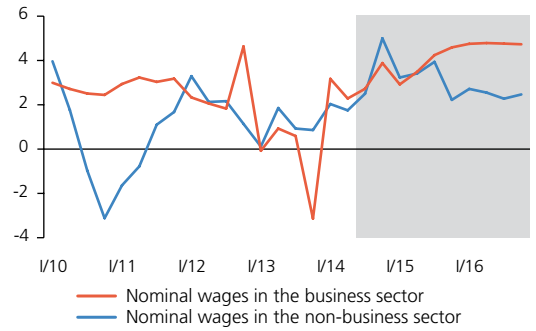


CHART II.2.11

GDP GROWTH FORECAST

GDP will grow at an annual rate of just under 3% over the forecast horizon
(percentage changes; seasonally adjusted)

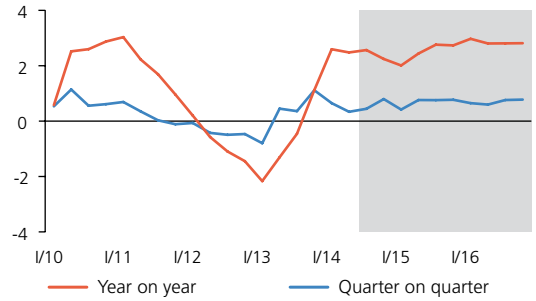
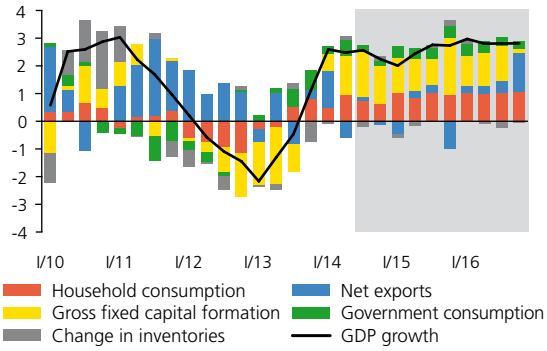


CHART II.2.12

ANNUAL GDP GROWTH STRUCTURE

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



increase in external demand, net exports will contribute positively to GDP growth from the whole-year perspective, amid faster growth in import-intensive domestic demand.

GDP will also rise by 2.5% **in 2015**, with the economy being boosted by higher external demand and in particular by more robust growth in domestic demand in an environment of more expansionary fiscal policy. Underlying this will be an expected further pick-up in government investment financed from domestic and especially European sources. In addition to gross capital formation, household consumption will make a clear positive contribution. The contribution of net exports will be slightly negative on average despite growing external demand, due to continued growth in imports of consumer goods, machinery and equipment, and intermediate goods for production of export goods.

GDP will pick up slightly to 2.8% **in 2016**, due mainly to faster growth in external demand and an improving supply side of the economy following the previous increase in investment activity. Gross capital formation will continue to increase, but its pace will be slowed by a decrease in general government investment. The other components of domestic demand and net exports will also make positive contributions to GDP growth.

The continuing growth in economic activity is favourably affecting the labour market situation. Growth in the **number of employees converted into full-time equivalents** rose to 0.6% in 2014 Q2. The forecast expects a further increase until the end of 2014, fostered mainly by a rise in average hours worked per employee (see Chart II.2.13). Growth in the number of employees converted into full-time equivalents should average 0.7% in 2014 as a whole and remain at a similar level in the next two years. The extending of average hours worked will slow amid faster growth in the number of employees. Annual growth in **total employment** will stay approximately at the Q2 level until the end of this year and average 0.4% for 2014 as a whole (see Chart II.2.14). The forecast assumes a slight slowdown in 2015, although this will be accompanied by continued year-on-year growth in average hours worked per employee. By contrast, the forecast expects total employment growth to increase slightly in 2016.

The previous fast decline in the seasonally adjusted **general unemployment rate** slowed considerably in 2014 Q3. The forecast assumes that the unemployment rate was 6.3%. It will stay around this level until the start of 2015, with modest labour force growth and employment growth roughly offsetting each other. Later, however, employment growth – building on continued economic growth – will prevail and the general unemployment rate will start to go down again gradually (see Chart II.2.14). A gradual decline in the seasonally adjusted **share of unemployed persons**, as determined by the MLSA, from its current level of just below 8% can also be expected over the entire forecast horizon. Owing to cyclicality, the supply of vacancies should edge up further, but the decrease in the number of registered unemployed persons will also be partly due to administrative changes

CHART II.2.13

NUMBER OF EMPLOYEES (FULL-TIME EQUIVALENT)

The converted number of employees will rise as the economy grows

(annual percentage changes; contributions in percentage points)

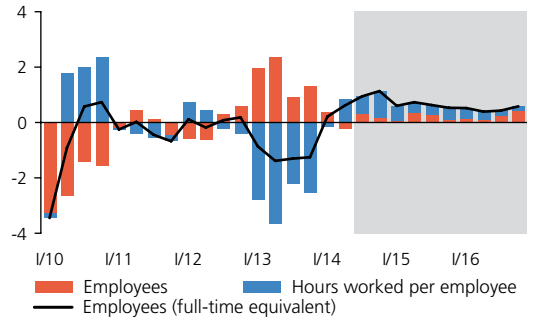
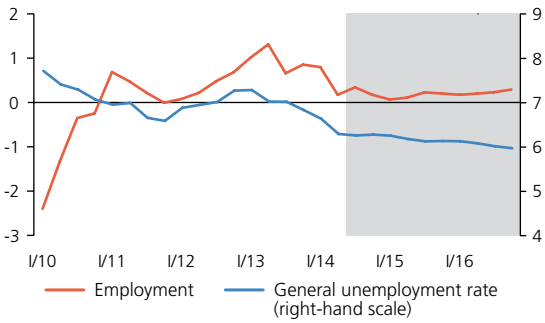


CHART II.2.14

LABOUR MARKET FORECAST

Total employment will continue rising slowly, while the unemployment rate will go down

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



(an increase in the number of persons excluded by penalty from the labour office register). The seasonally adjusted share of unemployed persons should be 7.3% at the end of 2016, even assuming a slight decline in population aged 15–64.

Year-on-year growth in real **household consumption** accelerated significantly to almost 2% in 2014 Q2 (see Chart II.2.15). This surge was fostered by short-term and long-term consumption and by household expenditure on services. The forecast expects year-on-year growth in real household consumption to slow in the second half of the year, in line with a slight decline in the consumer confidence indicator and slower annual growth in retail sales in July and August (see section III.3). Overall, household consumption will increase by 1.4% this year as economic activity recovers significantly, annual growth in wages and salaries accelerates and the effects of fiscal consolidation unwind. In the following two years it will rise to around 2%, with growth in wages and salaries and other household income outpacing the gradually accelerating consumption deflator.

Gross nominal disposable income maintained a clearly positive growth rate in 2014 Q2, due mainly to continued annual growth in the volume of wages and salaries (see Chart II.2.16). The growth in gross nominal disposable income was due increasingly to the labour market recovery and partly to tax optimisation in late 2012 and early 2013. Accelerating growth in the volume of wages and salaries will be the biggest contributor to growth in gross disposable income over the forecast horizon as well. Social benefits and profits of small businesses will continue to make positive contributions. Overall, nominal gross disposable income will rise by 3.1% this year and pick up further in the following two years, reaching 4.5% in late 2016.

Following a sizeable decline in 2013 H1, the seasonally adjusted **household saving rate** gradually increased to its previous level near 11%.[5] It will rise slightly further until the end of 2015 as growth in wages and salaries picks up pace (see Chart II.2.17). However, the switch to annual growth in household consumption outpacing gross nominal disposable income growth in 2016 will cause the household saving rate to decline gradually again.

Annual growth in real **government consumption** surged to 3% in 2014 Q2. However, the forecast expects it to slow slightly in the near future. Overall, government consumption will rise by 1.7% this year (see Chart II.2.15), mainly because of higher health care expenditure year on year. In the following two years it will grow at a pace close to 2% as a result of faster growth in compensation of employees in the government sector and government intermediate consumption.

5 In general, the saving rate is subject to frequent and major revisions: this indicator was also affected by data revisions associated with the switch to the new ESA 2010 methodology (see Box 2 in section II.3).

CHART II.2.15

REAL HOUSEHOLD AND GOVERNMENT CONSUMPTION

Household consumption and government consumption will rise at a rate of around 2%
(annual percentage changes; seasonally adjusted)

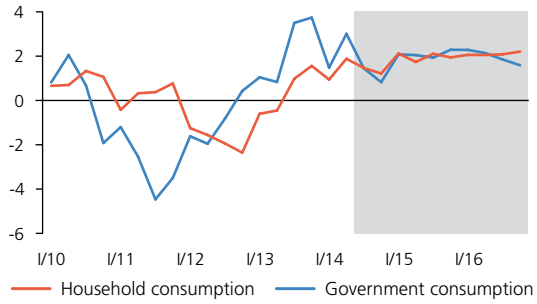


CHART II.2.16

NOMINAL DISPOSABLE INCOME

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

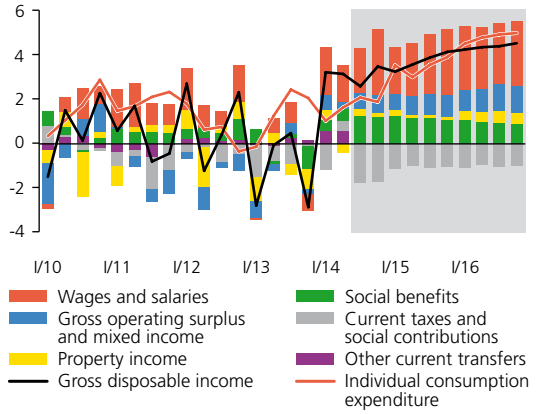


CHART II.2.17

HOUSEHOLD SAVING RATE

The saving rate will fluctuate around 11%
(percentages)

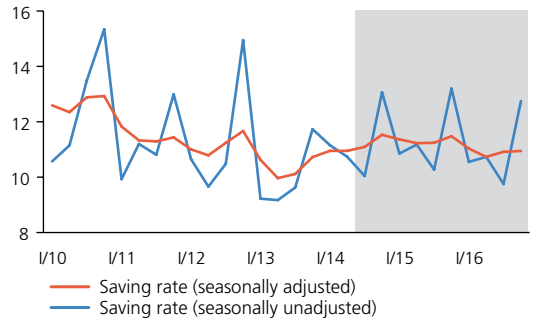


CHART II.2.18

GROSS CAPITAL FORMATION

Gross capital formation will rise quite briskly
(annual percentage changes; seasonally adjusted)

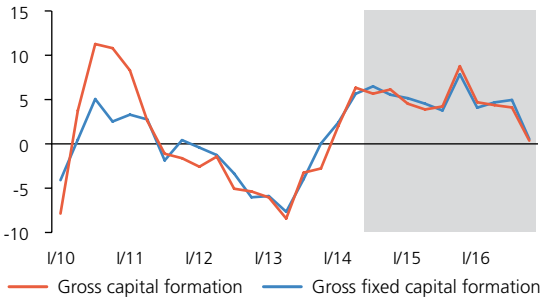


CHART II.2.19

REAL EXPORTS AND IMPORTS

Export and import growth will stay at around 10% until the start of 2016, aided by the weakened koruna
(annual percentage changes; annual changes in CZK billions; seasonally adjusted)

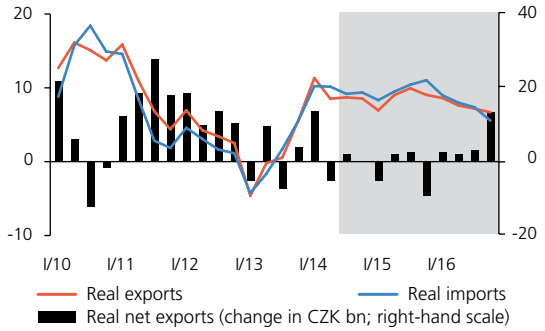


TABLE II.2.2

FORECASTS OF SELECTED VARIABLES

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

	2013 actual	2014 forec.	2015 forec.	2016 forec.
Real gross disposable income of households	-2.4	2.7	2.2	1.7
Total employment	1.0	0.4	0.2	0.2
Unemployment rate (in per cent)[a]	7.0	6.3	6.2	6.0
Labour productivity	-0.8	2.2	2.3	2.6
Average nominal wage	0.0	3.1	3.7	4.3
Average nominal wage in business sector	-0.2	3.2	3.8	4.8
Current account balance (ratio to GDP in per cent)	-1.4	0.0	0.0	0.2
M2	4.4	4.1	5.0	6.3

a) ILO methodology, 15–64 years

The annual growth rate of **gross capital formation** picked up significantly in 2014 Q2. Its growth continued to be driven by year-on-year growth in investment in manufacturing. The forecast also expects gross capital formation to record continued sizeable annual growth in 2014 Q3. This growth will stay at the current levels of around 7% until the end of 2014 as a result of a continued recovery in fixed investment. As part of this, private investment will increase due to growing external demand and easy monetary conditions. Government investment, financed from EU and domestic resources, will also increase. Overall, gross capital formation will rise by 5% in 2014. Its growth rate will increase slightly further to 5.4% in 2015 owing to the drawdown of EU funds from the 2007–2013 programme period. It will maintain positive, albeit slightly lower (due to a decline in government investment) growth in 2016 (see Chart II.2.18).[6]

Annual growth in real **exports of goods and services** slowed in 2014 Q2, but still exceeded 8%. Owing to external demand developments and the persisting effect of the weakened koruna, the forecast expects a similar growth rate until the end of 2014 (see Chart II.2.19). Exports of goods and services will rise by 9.3% in 2014 as a whole. Their growth rate will slow to 8.7% on average in 2015 as the effect of the weaker real exchange rate unwinds in year-on-year terms. On the other hand, however, external demand will accelerate. In 2016, export growth will decline slightly further to 7.5%.

Real **imports of goods and services** maintained an annual growth rate of above 10% in 2014 Q2. With export growth slowing, imports of goods and services will also grow at a somewhat weaker pace in the second half of the year. In 2014 as a whole they will rise by 9.7%. The forecast expects imports to increase by 9.8% next year in connection with a modest rise in investment and consumption growth. Import growth will slow somewhat in 2016.

The contribution of **net exports** at constant prices to annual GDP growth was negative in 2014 Q2, with annual export growth outpacing import growth. The forecast expects it to return to slightly positive levels in Q3. Net exports will make a positive contribution of 0.2 percentage point to annual GDP growth in 2014 as a whole. Owing to faster growth in import-intensive investment, however, the contribution of net exports to annual GDP growth will turn slightly negative again in 2015 (-0.2 percentage point). The contribution of net exports will be positive in 2016 (0.6 percentage point) owing to an upswing in external demand and slower growth in domestic investment (due to the unwinding of the accounting effect of an extension of the lease of supersonic fighter aircraft).

6 The forecast is also affected by an extension of the lease of JAS-39 Gripen fighter aircraft at the end of 2015, which has been incorporated into the forecast for the first time. It will cause a one-off increase in gross capital formation and an equal increase in imports. Real GDP growth will remain unaffected by this transaction.

The balance of payments forecast (see Table II.2.3)[7] expects a balanced **current account** this year and the next and a slight surplus of around 0.2% of GDP in 2016. The marked improvement in the current account in 2014[8] will be due to a relatively sharp increase in the **goods surplus** (formerly the trade surplus) and to a lesser extent also to the elimination of the secondary income deficit. The rise in the goods surplus is associated with an increase in external demand, rising international competitiveness of the domestic automotive industry, the weakened koruna and a drop in commodity prices on world markets. The further slight improvement in the goods surplus in 2015 is linked mainly with favourable terms of trade (a year-on-year decline in commodity prices on world markets) and a rise in the share of the domestic automotive industry on the European market. Faster growth in domestic demand than in external demand will run counter to the improvement in the goods surplus.

A still rising **primary income** deficit (formerly the income deficit), linked mainly with higher earnings of non-residents on foreign direct investment in the Czech Republic, will have the opposite effect on the current account balance than the goods balance. The **services surplus** will be roughly stable at the 2013 level over the entire forecast period. **Secondary income** (formerly current transfers) should be broadly balanced over the entire forecast period. This represents a slight improvement compared to 2013 owing to higher drawdown of EU funds.

The forecasted stable and relatively high **capital account** surplus (representing a slight improvement compared to 2013) is due solely to drawdown of EU funds.

The net inflow of **direct investment** into the Czech Republic will rise sharply in 2014 compared to last year. However, roughly two-thirds of this improvement is due to a turnabout in residents' international capital flows (withdrawal of funds to the Czech Republic). The expected year-on-year increase in the investment inflow into the Czech Republic of about CZK 40 billion is due chiefly to higher investment in the automotive industry and on the property market. In 2015 the net inflow of capital will drop sharply again year on year, mainly as a result of an expected return of domestic investors to investing abroad. In 2016, the net inflow of capital into the Czech Republic will be favourably affected by an already approved investment in the automotive industry. The forecast assumes that direct investment in the Czech Republic will still primarily take the form of reinvested earnings, which will record an increasing surplus.

Table II.2.3

BALANCE OF PAYMENTS FORECAST

The current account should be balanced this year

(CZK billions)

	2013	2014	2015	2016
	actual	forec.	forec.	forec.
A. CURRENT ACCOUNT	-56.8	0.0	0.0	10.0
Goods	163.6	245.0	265.0	300.0
Services	68.6	65.0	65.0	70.0
Primary income	-279.6	-310.0	-330.0	-360.0
Secondary income	-9.3	0.0	0.0	0.0
B. CAPITAL ACCOUNT	53.7	60.0	60.0	60.0
C. FINANCIAL ACCOUNT[a)]	4.7	165.0	107.0	70.0
Direct investment	-33.2	-160.0	-85.0	-115.0
Portfolio investment	-92.8	125.0	0.0	10.0
Financial derivatives	-4.7			
Other investment	-52.7	80.0	70.0	50.0
Reserve assets	188.2	120.0	122.0	125.0

a) forecast excluding operations of banking sector and financial derivatives but including changes in CNB reserves

7 The forecast was prepared using the new balance of payments manual (BPM6), which also contains new designations for some balance of payments items and a change in the sign convention for the financial account. A negative sign thus means a net investment inflow and a positive sign a net investment outflow; see section III.6 for details.

8 In 2013, the current account deficit was 1.4% of GDP.

Table II.2.4

FISCAL FORECAST

Fiscal policy will be expansionary in 2014 and 2015 and slightly restrictive in 2016
(% of nominal GDP)

	2013 actual	2014 forec.	2015 forec.	2016 forec.
Government revenue	40.7	40.4	40.6	40.3
Government expenditure	42.0	41.8	42.6	41.8
of which: interest payments	1.4	1.4	1.4	1.4
GOVERNMENT BUDGET BALANCE	-1.3	-1.4	-2.0	-1.5
of which:				
primary balance[a)]	0.0	-0.1	-0.6	-0.1
one-off measures[b)]	0.0	0.2	-0.2	0.1
ADJUSTED BUDGET BALANCE[c)]	-1.3	-1.6	-1.8	-1.6
Cyclical component (ESCB method)[d)]	-1.0	-0.5	-0.1	0.2
Structural balance (ESCB method)[d)]	-0.3	-1.1	-1.8	-1.8
Fiscal stance in pp (ESCB method)[e)]	1.6	-0.8	-0.6	0.0
Cyclical component (EC method)[d)]	-1.2	-0.8	-0.5	-0.1
Structural balance (EC method)[d)]	-0.1	-0.8	-1.3	-1.5
Fiscal stance in pp (EC method)[e)]	2.0	-0.7	-0.5	-0.1
Government debt	45.7	44.0	44.0	43.7

a) government budget balance minus interest payments
b) 2013–2016: impacts of pension reform and sales of emission permits
2014: impact of auction of mobile frequencies
2015: impact of extension of lease of supersonic fighter aircraft
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)

As regards **portfolio investment**, a significant change in capital flows amounting to more than CZK 200 billion can be expected in 2014, with a strong capital inflow being replaced by a large outflow. This change is linked mainly with a change in the behaviour of the government (a marked reduction in external debt through the repayment of foreign bonds without replacing them with new issues), a one-off reduction in the external debt of energy firm ČEZ and renewed interest of residents in investing abroad. The forecast for 2015 no longer includes any one-off effects and assumes balanced inflows and outflows, with residents' investment abroad being roughly in line with the rise in the external debt of the government and Česká exportní banka. A slight capital outflow in 2016 is associated with expected higher interest of residents in investing abroad. With regard to **other investment** (excluding banking sector operations), the forecast assumes a high – albeit slightly falling – net outflow of capital almost exclusively from the business sector (in the form of growth in deposits, growth in loans to non-residents and repayments of existing loans). The expected decline in the net outflow is due to an expected gradual recovery in investment in the Czech Republic.

The newly included item **reserve assets** – reflecting changes in the CNB's international reserves – is rising over the forecast horizon owing to a surplus on relations with the EU and income on international reserves.

The future macroeconomic developments described above and the current fiscal policy settings are reflected in the **government finance** outlook for 2014–2016 (see Table II.2.4).[9]

In **2014** the government deficit is expected to widen slightly to 1.4% of GDP owing to an upswing in government expenditure amid a rise in tax revenues resulting from economic growth. The deficit estimate for this year is also affected by a revenue shortfall stemming from the renewal of the basic discount for working pensioners based on a Constitutional Court ruling, and by extraordinary income of CZK 8.5 billion from an auction of frequency bands to mobile operators. In addition, 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 excise duties on cigarettes. However, the slightly restrictive effect of these measures on economic growth is outweighed by a significant recovery in government investment growth connected with the implementation of projects co-financed from EU funds and domestic sources and by continued wage growth in the government sector. In

9 At the end of September, the CZSO sent Eurostat data on government finance as part of the autumn government deficit and debt notifications. For the first time, the data were sent under the new ESA 2010 methodology. The CZSO revised the historical data over the entire period 1995–2013. Overall, however, this led to a negligible change in the deficit. General government debt in absolute terms saw a more pronounced increase due to the reclassification of Česká exportní banka to the general government sector. However, the ratios of the deficit and debt to GDP decreased as a result of an upward revision of nominal GDP of 4% on average.

2014, therefore, the overall effect of fiscal policy on economic activity will be slightly expansionary to the tune of around 0.3 percentage point (see Table II.2.5).

In **2015** the general government deficit will increase to 2% of GDP despite continuing economic growth.[10] This will reflect the abolition of fees in health care, the introduction of a second reduced VAT rate of 10%, an increase in benefits and deductible items for children, a one-off increase in pensions going beyond the restoration of the policy to increase them fully in line with inflation, and an increase in wage growth in the government sector.[11] The higher expenditure will also be due to a further rise in government investment growth, driven by efforts to draw as much EU money as possible from the previous programme period. The rise in the overall deficit will also be supported by the accounting effect of an extension of the lease of the JAS-39 Gripen supersonic fighter aircraft of 0.2% of GDP, which is classified as government investment under the new methodology. However, it will not have a real impact and can be regarded as an extraordinary, or one-off, measure. As a result, fiscal policy will be significantly expansionary in 2015, making a positive contribution to economic growth of around 0.5 percentage point.

In **2016** the general government deficit can be expected to fall to 1.5% of GDP, mainly as a result of continuing economic growth. Government investment will decline year on year in a context of the end of the previous programme period for drawing down EU funds and the start of the new one. Fiscal policy will therefore be slightly restrictive in 2016, making a contribution to economic growth of around -0.2 percentage point.

The general government **structural deficit** fell to around 0.2% of GDP in 2013. It will increase markedly this year and the next and will noticeably exceed the medium-term objective of 1% of GDP in 2015 and 2016.

The expected evolution of the general government deficit over the next two years will lead to stabilisation of the **ratio of general government debt to GDP** at the level expected for this year, i.e. around 44%. In addition to the expected borrowing requirements of general government owing to persisting public finance deficits, this ratio will reflect the continuing involvement of state financial assets in debt management and sizeable nominal GDP growth.

Table II.2.5

FISCAL IMPULSE

The fiscal impulse will have an impact primarily through government investment over the forecast horizon
(contributions to GDP growth in percentage points)

	2013	2014	2015	2016
	actual	forec.	forec.	forec.
Fiscal impulse[a)]	-1.0	0.3	0.5	-0.2
of which impact through:				
private consumption	-0.7	0.0	0.1	0.0
private investment	0.0	0.0	0.0	0.0
government investment, domestic	-0.3	0.0	0.1	0.0
government investment, EU funded	0.0	0.2	0.3	-0.3

a) Owing to rounding, the sum total may not be equal.

10 The forecast for next year incorporates draft legislative changes aimed at implementing the government's programme declaration, which are already in the final stage of the legislative process.

11 The increase in wage scales for employees paid from the state budget will come into force on 1 November 2014.

II.3 COMPARISON WITH THE PREVIOUS FORECAST

The forecasts for headline and monetary-policy relevant inflation are lower than in the previous prediction until early 2016, owing to a lower outlook for net inflation, and are slightly higher thereafter. GDP growth has been revised downwards for 2014 and 2015, mainly on account of a lower outlook for external demand, but is unchanged for 2016. The switch to the new ESA 2010 national accounts methodology has also had an effect on the economic activity forecast, although it influences the level of GDP more strongly than the dynamics. The expected growth rate of nominal wages in the business sector has shifted lower as a result of a more gradual rise in inflation and less pronounced economic growth this year and the next. The interest rate path mainly reflects a stronger anti-inflationary effect of the external environment and a related postponement in the forecast of the expected exit from the use of the exchange rate as a monetary policy instrument.

The forecast for annual **headline inflation** is considerably lower than in the previous forecast until early 2016 (see Chart II.3.1). This is due to a lower outlook for net inflation, reflecting a sizeable downward revision of foreign producer prices and lower future annual wage growth in the business sector. These factors are only marginally offset within headline inflation by higher growth in administered prices and a slightly weaker exchange rate in 2014 Q3. At a longer horizon, the forecast has shifted slightly higher owing to a later exit from the use of the exchange rate as a monetary policy instrument, slightly higher administered price inflation and partly also faster growth in external demand. The assumptions regarding the impacts of changes to indirect taxes remain in line with the previous forecast, so the outlook for **monetary-policy relevant inflation** has changed in a similar way as that for headline inflation.

The outlook for **administered prices** has changed only marginally compared to the previous forecast, with a less pronounced drop in retail electricity prices next year being offset by lower growth in gas prices. In 2016 the administered price outlook has shifted slightly higher owing to higher expected growth in gas prices linked with a rise in the market outlooks for prices of its commodity component.

Compared to the previous forecast, annual **net inflation** has been lowered over most of the forecast horizon (see Chart II.3.2). Within net inflation, food price inflation will fall quite sharply for a short while in reaction to an expected deepening of the decline in agricultural producer prices, whereas the previous forecast has expected renewed moderate price growth in this sector. In 2015 as a whole, lower net inflation will reflect stronger anti-inflationary pressures from the external environment and more subdued wage growth. This will result above all in a slower increase in adjusted inflation excluding fuels. Net inflation will not move above the previous forecast until 2016 H1, partly due to the expected longer use of the exchange rate as a monetary policy instrument.

Chart II.3.1

CHANGE IN THE HEADLINE INFLATION FORECAST

The forecast for headline inflation has been moved downwards considerably until the start of 2016
(year on year in %; differences in pp – right-hand scale)

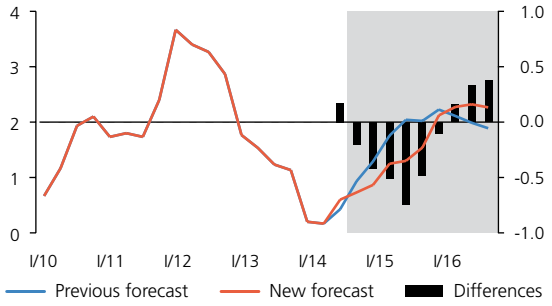
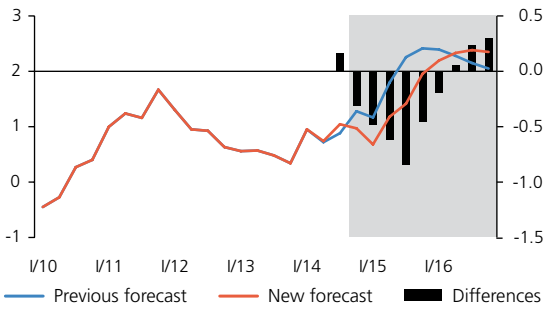


Chart II.3.2

CHANGE IN THE NET INFLATION FORECAST

The forecast for net inflation has been revised to a lower level until the start of 2016
(year on year in %; differences in pp – right-hand scale)



Turning to the **foreign assumptions**, the producer price outlook in the effective euro area has been lowered significantly for this year and the next compared to the previous forecast, more strongly reflecting the long-running downturn in economic activity coupled with falling prices of energy and agricultural commodities on foreign markets. The outlook for external demand growth for both years has also been lowered markedly to low, albeit still positive, levels. The 3M EURIBOR outlook has shifted to a lower level and its path over the forecast horizon is significantly flatter, reflecting the ECB's recent measures to further ease monetary policy.

The forecast for domestic market **interest rates** has shifted lower in late 2015 and early 2016 (see Chart II.3.3). This is because the new forecast expects the exchange rate to be used as a monetary policy instrument until 2016 Q1, whereas the previous forecast assumed it would be used only until 2015 Q3. The need for lengthier easy monetary conditions is due mainly to a lower outlook for foreign producer prices and foreign interest rates. The pace of the interest rate increase after the exit from the exchange rate commitment is similar as in the previous forecast.

At CZK 27.4 to the euro, the outlook for the **exchange rate of the koruna against the euro** in the next few quarters is the same as assumed in the previous forecast. However, the forecast expects that the use of the exchange rate will continue until 2016 Q1, i.e. longer than in the previous prediction.

The data for 2014 Q2 imply lower **GDP** growth than assumed in the previous forecast. This is due to lower observed outcomes for gross capital formation and net exports. Acting in the opposite direction was stronger growth in household and government consumption. GDP growth is forecasted to be 0.5 percentage point lower in 2014. Lower economic growth will be fostered by smaller contributions of household consumption (due to slower wage growth) and net exports as a result of weaker growth in the effective euro area. The GDP growth forecast for 2015 is also 0.5 percentage point lower, mainly as a result of weaker growth in external demand (see Chart II.3.4). The overall GDP outlook for 2016 remains unchanged. As regards its structure, however, a slightly larger contribution of government consumption will be approximately offset by lower growth in net exports. The CZSO's switch to the ESA 2010 methodology implies a smoother GDP pattern than in the previous forecast, as the one-off effects relating to cigarette frontloading by producers and retailers ahead of excise duty increases are no longer visible in real growth in gross capital formation – see Box 2 for details.

CHART II.3.3

CHANGE IN THE INTEREST RATE PATH

The market interest rate path has shifted lower in late 2014 and early 2015 owing to the assumed later return to the standard monetary policy regime

(3M PRIBOR in %; differences in pp – right-hand scale)

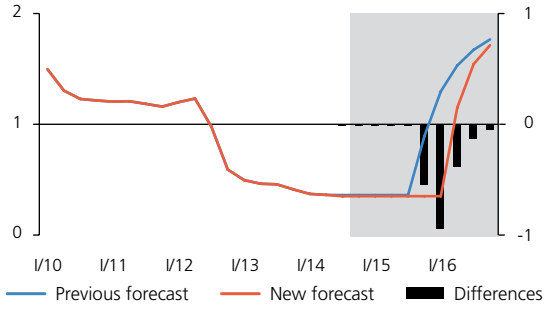


CHART II.3.4

CHANGE IN THE GDP FORECAST

The GDP growth forecast is lower this year and the next and unchanged for 2016

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

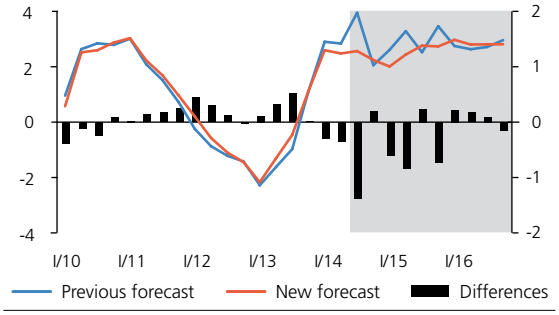


CHART 1 (BOX)

REVISION OF NOMINAL GDP

The level of GDP has been increased by CZK 40–50 billion due to the revision

(difference in GDP before and after revision; CZK billions; current prices; seasonally adjusted)

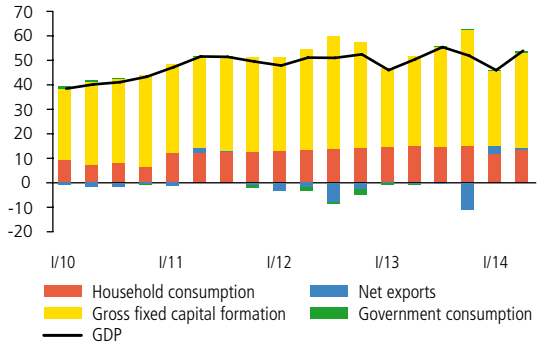
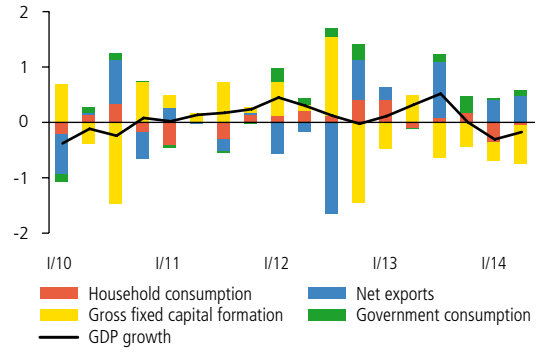


CHART 2 (BOX)

REVISION OF ANNUAL GDP GROWTH

The revision of the annual growth rate of GDP is only modest

(annual changes in percentage points; current prices; seasonally adjusted)



BOX 2
Revision of the national accounts following the switch to ESA 2010

In early October 2014, the CZSO published an **extraordinary revision of the national accounts** following the switch to the new European ESA 2010 methodological standard, which is based on the global SNA 2008 standard. The most important changes pertain to expenditure classified as investment in gross fixed capital. In line with ESA 2010, fixed investment now also includes assets with lower acquisition costs and a useful life of over one year (typically computers and telephones), military expenditure on long-term assets, and research and development expenditure. In addition, methodological changes have been made in the area of non-life insurance. Besides the implementation of ESA 2010, changes have also been made to the sources and methods used, along with a standard annual revision of the national accounts.

As a result of the above-mentioned changes, both the **nominal and real GDP levels** have shifted upwards (see Chart 1). The largest shift has occurred for gross capital formation owing to the methodological changes regarding investment. The biggest contributors to the shift are a change to the capitalisation of small tools and the inclusion of research and development in investment. Household consumption has also been revised upwards owing to new estimation methods for housing services (a different method for calculating imputed rent and more precise data on the number of houses) and to a lesser extent to methodological changes in the area of non-life insurance. The revisions of other expenditure items are almost negligible from the longer-term perspective.

By contrast, the revision of the historical data has had only a relatively small impact on the **dynamics of total real GDP** (see Chart 2). Annual real GDP growth has been revised slightly upwards from 2011 onwards (with the exception of the first two quarters of 2014). This is due mainly to slightly higher annual growth in household consumption and government consumption, whereas the much larger revisions made to gross capital formation and net exports roughly offset each other in the individual quarters. As regards annual investment growth in real terms, the volatility of this time series has decreased considerably after the revision (at the expense of higher volatility of the investment deflator); the effect of cigarette frontloading linked with excise duty changes is no longer visible here.

The contribution of **net exports** to GDP growth in 2014 Q2 was more negative than in the previous forecast. It is less positive over the forecast horizon than in the previous prediction, owing to slower growth in external demand this year and the next. The lower external demand outlook is also reflected in a decrease in expected export and import growth in the next few quarters, which nevertheless remains high.

The forecast for growth in the average **nominal wage** in the business sector has shifted downwards over the entire forecast horizon despite higher observed past outcomes. This revision is due primarily to slower growth of the Czech economy and lower inflation this year and the next.

Table II.4.1

EXPECTED INDICATORS OF FMIE AND CORPORATIONS

The analysts' inflation expectations are very close to the CNB's target of 2%

(at 1Y; annual percentage changes unless otherwise indicated)

	6/14	7/14	8/14	9/14	10/14
FMIE:					
CPI	2.2	2.1	2.0	2.0	1.9
CPI, 3Y horizon	2.0	2.0	2.1	2.1	2.0
Real GDP in 2014	2.5	2.5	2.7	2.6	2.5
Real GDP in 2015	2.7	2.7	2.8	2.7	2.5
Nominal wages in 2014	2.4	2.6	2.5	2.5	2.6
Nominal wages in 2015	2.9	3.0	3.0	3.0	3.1
CZK/EUR exchange rate (level)	27.0	27.1	27.3	27.3	27.3
2W repo rate (in per cent)	0.12	0.07	0.05	0.05	0.05
1Y PRIBOR (in per cent)	0.7	0.7	0.6	0.6	0.6
Corporations:					
CPI	1.8			1.8	

Chart II.4.1

PERCEIVED AND EXPECTED INFLATION

Perceived inflation decreased in 2014 Q3, while inflation expectations were stable

(source: European Commission Business and Consumer Survey)

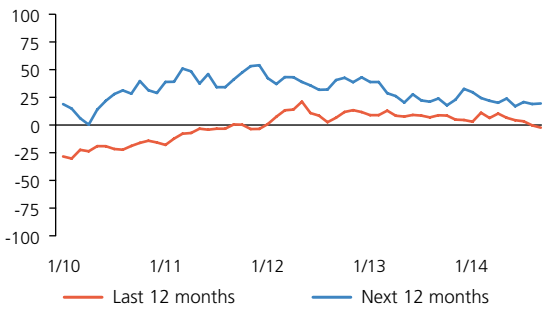


Table II.4.2

CF EXPECTED INDICATORS

The CF analysts expect the economy to grow at a rate of 2.5% this year and the next

(at 1Y; annual percentage changes unless otherwise indicated)

	6/14	7/14	8/14	9/14	10/14
Real GDP in 2014	2.3	2.5	2.6	2.6	2.5
Real GDP in 2015	2.7	2.7	2.7	2.6	2.5
Nominal wages in 2014	2.2	2.3	2.5	2.5	2.7
Nominal wages in 2015	3.2	3.4	3.3	3.3	3.5
CZK/EUR exchange rate (level)	26.9	27.0	27.0	27.2	27.1
3M PRIBOR (in per cent)	0.5	0.5	0.5	0.5	0.4

II.4 FORECASTS BY OTHER ENTITIES

Analysts' inflation expectations have been very close to the CNB's target of 2% at both the one-year and three-year horizons in recent months. The indicator of inflation perceived by households decreased to slightly negative levels, while the indicator of expected inflation is positive with no major changes. The analysts expect the economy to grow at a rate of 2.5% both this year and the next. According to the analysts, the exchange rate of the koruna should appreciate close to CZK 27 to the euro at the one-year horizon. A large majority of the analysts expect that the exchange rate commitment will not be discontinued before 2016. All the analysts were expecting key interest rates to be left unchanged both at the CNB Bank Board's November meeting and at the one-year horizon. The market rate outlook one year ahead also indicates expectations of flat interest rates and is very close to the interest rate path consistent with the new CNB forecast over the entire forecast horizon.

In recent months, **inflation expected by financial market analysts** has been very close to the CNB's target of 2% at both the one-year and three-year horizons. The inflation expectations of business managers remain just below the target (see Table II.4.1).

The indicator of **inflation perceived by households**[12] turned slightly negative for the first time in almost three years in 2014 Q3 (see Chart II.4.1). Households therefore feel on average that prices stayed roughly the same over the last 12 months. However, a relatively significant group perceived a price decline. By contrast, the indicator of **expected inflation** has long been positive. Following a temporary slight increase in the last two months of 2013 (i.e. after the CNB announced that it had started using the exchange rate as an instrument for easing monetary policy), the indicator declined slightly again at the start of this year and has shown no major changes since then. This signals 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 2.5% this year (see Tables II.4.1 and II.4.2). Next year, the economy is expected to maintain this growth rate, but wage growth is expected to accelerate significantly. At the one-year horizon, the analysts expect the koruna to appreciate close to CZK 27 against the euro. Based on the CNB's previous communication, a large majority of the analysts expect that the exchange rate commitment will not be discontinued before 2016;

12 A qualitative assessment of past inflation and expected future inflation by households. These indicators are collected as part of the European Commission Business and Consumer Survey, which is conducted monthly in the Czech Republic on a sample of 1,000 respondents. Overall indices of perceived inflation and inflation expectations of consumers are constructed as the balance of the responses. For more details on the construction of these indicators, see Box 2 in the July 2007 Inflation Report.

the new CNB forecast expects the exit to happen in 2016 Q2. Before the CNB Bank Board meeting in November, 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 flat at 0.05% at the one-year horizon.

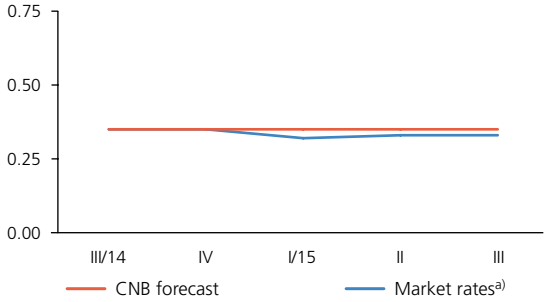
Overall, the analysts expect the same real GDP growth in both 2014 and 2015 **compared to the CNB's new forecast**. Inflation expected by the analysts at the one-year horizon is somewhat above the CNB forecast. The analysts' expectations regarding the 2W repo rate and market rates are in line with the 3M PRIBOR path in the new CNB forecast.

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 flat rates at least at the one-year horizon, i.e. currently until the end of 2015 Q3. This is in line with expectations of flat monetary policy interest rates at the one-year horizon and a money market premium close to the current level. The market outlook is very close to the interest rate path consistent with the new CNB forecast over the entire horizon.

CHART II.4.2

FRA RATES VERSUS THE CNB FORECAST

The interest rate outlook derived from FRA quotations is in line with the interest rate path consistent with the new CNB forecast over the entire horizon
(percentages)



a) for 2014 Q3 and 2014 Q4 the 3M PRIBOR and for 2015 Q1–2015 Q3 the average values of the FRA 3*6, 6*9 and 9*12 rates for the last 10 trading days as of 24 October 2014

III. CURRENT ECONOMIC DEVELOPMENTS

III.1 INFLATION

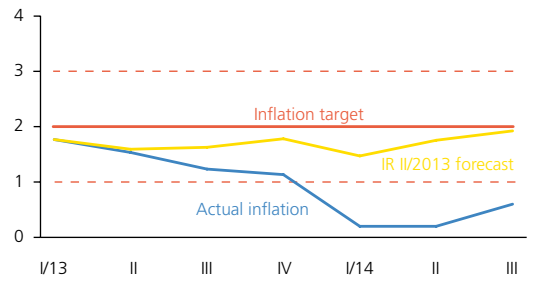
The CNB's decision of November 2013 to start using the exchange rate as an additional monetary policy instrument contributed to averting the threat of deflation driven by insufficient demand and the economic downturn. Annual headline inflation increased in 2014 Q3, averaging 0.6%. The price level adjusted for the effects of changes to indirect taxes rose by 0.5% year on year on average in Q3. Inflation was thus still below the lower boundary of the tolerance band around the CNB's target. The weakened exchange rate has so far been feeding through to inflation mainly via higher import prices, but it is also contributing to growth in the domestic economy. Its previous long-term anti-inflationary effect has thus faded quickly so far this year, thanks in part to the easy monetary conditions, and the domestic economy is beginning to foster higher inflation. This has contributed to a rise in adjusted inflation excluding fuels, which is noticeably positive for the first time in a very long time. The higher inflation in 2014 Q3 was also due to a moderation of the annual decline in administered prices.

III.1.1 Fulfilment of the inflation target

Chart III.1.1

FORECAST VERSUS ACTUAL INFLATION

Inflation was well below the IR II/2013 forecast in 2014 Q3
(year on year in %)



In 2014 Q3, both **headline inflation and monetary-policy relevant inflation** were on average below the lower boundary of the tolerance band around the CNB's target (see Chart III.1.1). 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 2014 Q3, we have to examine the period roughly from January 2013 to June 2014, which takes into account the different lengths of transmission of interest rates and the exchange rate. This is because monetary policy passes through to inflation with a substantially shorter lag in the regime where the exchange rate is used as a monetary policy instrument than when interest rates are used. For the sake of clarity, however, the analysis of the accuracy of the forecasts is limited here to a comparison of the Inflation Report II/2013 forecast with subsequent inflation.

The **Inflation Report II/2013 forecast** expected headline inflation to be slightly below the 2% target in 2013 and 2014 despite substantial impacts of rising indirect taxes (see Chart III.1.1). Monetary-policy relevant inflation was expected to be close to the lower boundary of the tolerance band owing to generally subdued economic activity and then return slowly towards the target. Import prices were expected to be inflationary because of projected stable foreign inflation and depreciation of the koruna against the euro in 2013 H1 and subsequent only very slow appreciation over the forecast horizon. By contrast, the

anti-inflationary pressures from the domestic economy were expected to subside only slowly and start to push inflation slightly upwards only in 2014. This, together with a closing gap in profit mark-ups, was expected to cause both headline and monetary-policy relevant inflation to gradually converge towards the target at the monetary policy horizon. The forecast assumed slowing growth in administered prices and food prices and a temporary decline in fuel prices.

Headline **inflation in reality** was below the forecast over the entire period and the deviation increased gradually in 2014. The 1.3 percentage point deviation of actual inflation from the forecast in 2014 Q3 was due to an unexpected decline in administered prices and a slower recovery in adjusted inflation excluding fuels. Food and fuel prices were approximately in line with the forecast (see Table III.1.1).

External economic factors contributed significantly to domestic inflation. External economic activity did not differ much from the assumptions of the forecast initially and was lower only at the end of the forecast horizon. The same applied to foreign interest rates (see Table III.1.2). External producer price inflation was well below the forecast, being negative over the entire period. Only oil prices were somewhat higher than assumed in the forecast. Overall, then, external developments had a downward effect on domestic inflation and interest rates. In reality, however, the zero lower bound meant that rates could not be lowered, so the external price developments were thus reflected more strongly in lower inflation.

Domestic market **interest rates** were broadly stable. They were affected by the zero lower bound on monetary policy rates amid a persisting money market risk premium. The **exchange rate** was slightly weaker than forecasted in 2013, owing – among other things – to CNB communication. The deviation has increased significantly since November 2013 due to the use of the exchange rate as an additional instrument for easing monetary policy (see Table III.1.3).

Based on the CNB's current knowledge, the **developments in the Czech economy since the forecast under review was drawn up** can be summed up in the following way. Domestic GDP growth was lower at first. In addition to a substantial data revision (including the switch to ESA 2010), this was due to a sharp contraction in domestic demand in reaction to the uncertainty surrounding future developments, and in particular to a fall in investment, which outweighed higher-than-expected government consumption. From 2013 Q4 onwards, however, GDP growth was higher than forecasted, thanks mainly to increasing real household and government consumption and real investment. Real household consumption growth turned positive in 2013 despite being accompanied by an unexpected slowdown in nominal wage growth. Actual export and import growth was close to the forecast in 2013, but in 2014 it rose noticeably above the forecast thanks to the weakened exchange rate of the koruna.

Table III.1.1

FULFILMENT OF THE INFLATION FORECAST

The deviation of inflation from the forecast was due to an unexpected decline in administered prices and low adjusted inflation excluding fuels

(annual percentage changes; contributions in percentage points)

	IR II/2013 forecast	2014 Q3 outturn	Contribution to total difference
CONSUMER PRICES	1.9	0.6	-1.3
Breakdown into contributions:			
administered prices	2.9	-2.2	-0.9
first-round impacts of changes to indirect taxes[a)]	0.1	0.1	0.0
food prices[b)]	1.4	1.6	0.1
fuel prices[b)]	0.5	0.5	0.0
adjusted inflation excl. fuels[b)]	1.7	0.8	-0.5

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

Table III.1.2

FULFILMENT OF THE EXTERNAL ASSUMPTIONS

External factors had an anti-inflationary effect overall, fostering a need for noticeably easier monetary conditions

(annual percentage changes unless otherwise indicated)

		II/13	III/13	IV/13	I/14	II/14	III/14
GDP in euro area[a), b), c)]	p	0.3	0.5	1.2	1.5	1.5	1.6
	o	0.4	0.4	1.1	1.3	0.9	-
PPI in euro area[b), c)]	p	1.7	1.9	2.1	2.1	2.1	2.1
	o	-0.1	-0.5	-1.2	-1.9	-1.6	-
3M EURIBOR	p	0.2	0.2	0.3	0.3	0.3	0.4
(percentages)	o	0.2	0.2	0.2	0.3	0.3	0.2
USD/EUR exchange rate	p	1.29	1.29	1.29	1.28	1.28	1.27
(levels)	o	1.31	1.32	1.36	1.37	1.37	1.32
Brent crude oil price	p	105.4	104.4	103.4	102.4	101.6	100.6
(USD/barrel)	o	103.3	109.7	109.4	107.9	109.8	103.5

p – prediction, o – outturn
a) at constant prices
b) seasonally adjusted
c) IR II/2013 outlook for effective indicator

Table III.1.3

FULFILMENT OF THE FORECAST FOR KEY VARIABLES

Observed GDP growth was initially below the forecast, but has been faster since the end of 2013

		II/13	III/13	V/13	I/14	II/14	III/14
3M PRIBOR	p	0.2	0.2	0.3	0.5	0.6	0.6
(percentages)	o	0.5	0.5	0.4	0.4	0.4	0.4
CZK/EUR exchange rate	p	25.7	25.6	25.5	25.4	25.3	25.3
(levels)	o	25.8	25.9	26.7	27.4	27.4	27.6
Real GDP[a)]	p	-0.8	-0.2	0.2	1.0	1.5	2.1
(annual perc. changes)	o	-1.3	-0.5	1.1	2.6	2.5	-
Nominal wages[b)]	p	2.1	2.3	0.4	4.8	2.9	3.1
(annual perc. changes)	o	1.0	1.5	-2.3	3.6	2.5	-

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**. The Bank Board assessed the risks of the forecasts mostly as being either slightly on the downside or balanced over the entire key period. As the zero lower bound on interest rates had been reached, the CNB at the start of 2013 started communicating its readiness to use the koruna exchange rate as an instrument if further monetary policy easing became needed. The Bank Board took this step in November 2013 on the basis of the forecast in Inflation Report IV/2013. In line with the alternative scenario of this forecast, the exchange rate commitment level was set at CZK 27 to the euro. This level was left unchanged in 2014 H1, but the expected duration of the commitment was extended by one quarter to 2015 Q2 and a further postponement of the exit from this regime was not ruled out (such a postponement was actually declared in July 2014, when the Bank Board stated that it would not end the exchange rate commitment before 2016).

To sum up, with the benefit of hindsight, it can be said that most of the identified risks materialised in the key period, with anti-inflationary risks strongly prevailing overall. The stronger domestic anti-inflationary factors and falling prices in the euro area were only partly offset by a weaker koruna, affected initially by CNB communication and from November 2013 onwards also by the CNB's exchange rate commitment. The weakened exchange rate has so far been feeding through to inflation mainly via higher import prices, but it is also contributing to growth in the domestic economy. Its previous long-term anti-inflationary effect has thus faded quickly so far this year, thanks in part to the easy monetary conditions. The inflation target is being significantly undershot at present, but the November decision to start using the exchange rate as an additional monetary policy instrument contributed considerably to averting the threat of deflation and thus also of overall macroeconomic instability. Without this measure, headline inflation would have been strongly negative in 2014 H1. Overall, based on current knowledge, it seems that the monetary policy pursued between January 2013 and June 2014 should have been even easier, i.e. the monetary policy easing implemented via the weakening of the koruna should have been made earlier and with even greater force.

CHART III.1.2

INFLATION

Annual inflation rebounded from zero levels in 2014 Q3
(year on year in %)

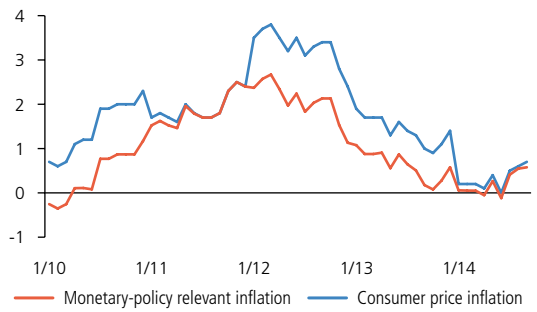
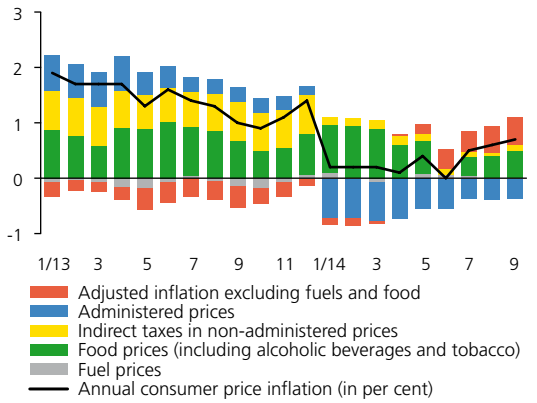


CHART III.1.3

STRUCTURE OF INFLATION

The year-on-year decline in administered prices was more than offset by continuing growth in the market components of inflation
(annual percentage changes; contributions in percentage points)



III.1.2 Current inflation

In 2014 Q3, **annual inflation**[13] rebounded from the zero levels recorded in June and rose to 0.7% in September (see Chart III.1.2). This increase was largely due to food prices, which returned to growth after declining in June. The increase in headline inflation was also fostered by rising adjusted inflation excluding fuels and a moderation

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

of the annual decline in administered prices. By contrast, fuel prices recorded only weak growth. As in the previous quarter, their contribution to annual inflation was negligible.

Turning to the **structure of annual inflation**, the decline in administered prices was more than offset by a rise in all components of market prices (see Chart III.1.3). Food prices and adjusted inflation excluding fuels, which is continuing to rise gradually after turning positive again, made a positive contribution to inflation. Changes to indirect taxes also had a slight upward effect on the price level.

The contribution of changes to **indirect taxes** to annual inflation was 0.1 percentage point in 2014 Q3 and was due exclusively to harmonisation adjustments to excise duty on cigarettes and tobacco. The impact of this increase in excise duty on prices is spread over time owing to substantial frontloading of tobacco products by retailers.

Monetary-policy relevant inflation, i.e. inflation adjusted for the first-round effects of the changes to indirect taxes, returned to positive territory in July and continued to rise in the months that followed. It averaged 0.5% in 2014 Q3, remaining below the lower boundary of the tolerance band around the CNB's target.

The year-on-year decline in **administered prices**, caused by a sharp fall at the start of this year, continued into 2014 Q2. However, its pace slowed compared to the previous quarter (from -3.2% in June to -2.2% in September; see Chart III.1.4). The annual decline in administered prices was caused by a reduction in retail energy prices (decreases in electricity and natural gas prices and a significant weakening of heat price growth) and the abolition of hospital stay fees. This decline was gradually partly offset by other items of administered prices; in health care, the biggest contribution came from rising prices of medicines and spa stays, while retail gas prices were affected by the expiry of discounts offered in 2013. The following text describes the year-on-year evolution of the main components of market price inflation adjusted for the tax changes.

Annual **market price inflation**, as measured by net inflation, rose in 2014 Q3 (from 0.5% in June to 1.2% in September). This rise was due to stronger growth in market prices excluding food and fuels. The increase in most of the market components of inflation still reflects the weakened koruna and continuing economic growth. By contrast, annual fuel price inflation moderated as a result of falling global petrol and oil prices.

After recording a year-on-year decline in June, **food prices** returned to growth in July. This rise picked up further in the following two months, reaching 1.8% in September. Food prices were thus the fastest growing component of annual inflation in 2014 Q3. However, their growth was still moderate compared to that in the previous three years, mainly due to a sustained decline in agricultural producer prices (see Chart III.1.5). The renewed annual food price growth was

CHART III.1.4

INFLATION COMPONENTS

Administered prices continued to decline in 2014 Q3, food prices returned to growth and adjusted inflation excluding fuels rose further

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

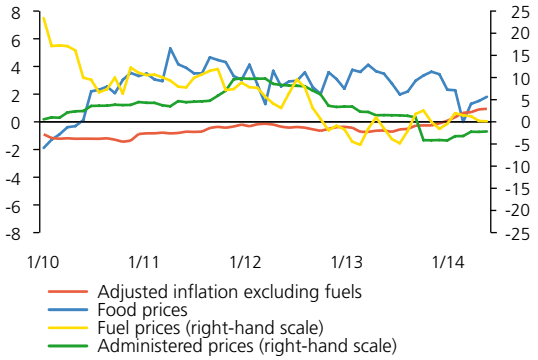


CHART III.1.5

FOOD PRICES

Food prices returned to modest growth

(annual percentage changes)

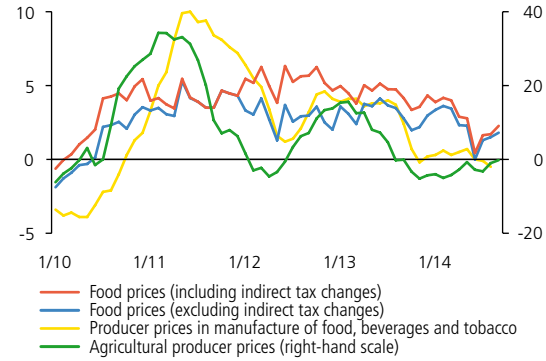


CHART III.1.6

STRUCTURE OF FOOD PRICE INFLATION

The fall in fruit and vegetable prices faded out, whereas the growth in prices of dairy products and eggs slowed

(contributions in percentage points to annual percentage changes)

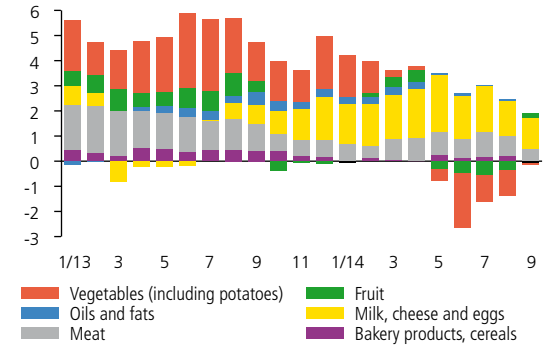
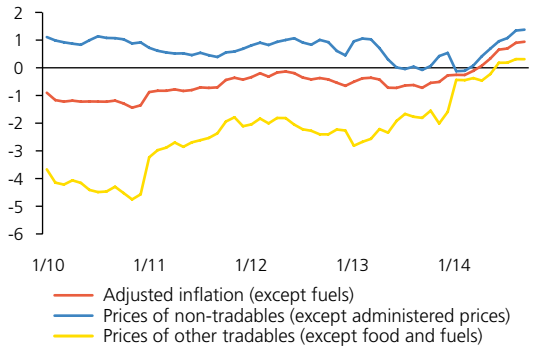


CHART III.1.7

ADJUSTED INFLATION EXCLUDING FUELS

Adjusted inflation excluding fuels rose further, aided by both its components
(annual percentage changes)



fostered by the fading out of the fall in vegetable prices and a switch of fruit price growth to positive figures (see Chart III.1.6). By contrast, growth in prices of dairy products and eggs slowed.

Annual **adjusted inflation excluding fuels** rose further in 2014 Q3 (from 0.7% in June to 0.9% in September; see Chart III.1.7) owing to **prices of non-tradable commodities**,[14] whose annual growth rose further (from 1.0% in June to 1.4% in September). This mainly reflected the continuing pronounced recovery in domestic economic activity and on the labour market. A modest increase was also recorded for **prices of other non-tradable commodities** (from 0.2% in June to 0.3% in September), which returned to growth in June after a long period of annual decline. These prices were thus clearly affected by the weakening of the exchange rate.

Fuel price growth moderated year on year in 2014 Q3 (from 1.5% in June to 0.1% in September). This reflected a marked decrease in global petrol and Brent crude oil prices, which was only partly offset by the weakening of the koruna against the dollar.

14 This segment consists mainly of services.

III.2 IMPORT PRICES AND PRODUCER PRICES

According to the latest data for August, annual import price inflation picked up noticeably. This change was due mostly to strengthening growth in prices of products with a high degree of processing and semi-finished products. By contrast, import prices of energy and non-energy commodities kept falling year on year. Industrial producer prices showed a slight annual decline in 2014 Q3. This was due to a continuing decline in producer prices in the energy and mining and quarrying industries, which was, however, almost fully offset by growth in producer prices in manufacturing. The renewed modest growth in construction work prices and prices of market services in the business sector continued. Agricultural producer prices kept falling in year-on-year terms.

III.2.1 Import prices

Import prices in the first two months of 2014 Q3 continued to follow the trend of accelerating growth observed since May this year. According to the latest data for August, import prices were up by 3.3% on a year earlier overall (see Chart III.2.1). Their fluctuations so far this year have been due mainly to changes in the growth rates of import prices of products with higher value added, semi-finished products and energy commodities.

Annual import price inflation continued to be driven primarily by prices in the category of **commodities with a high degree of processing** (see Chart III.2.2). Within this category, machinery and transport equipment and miscellaneous manufactured articles recorded a marked pick-up in annual import price growth (to 5.4% and 3.3% respectively). At the same time, import prices in the former category still showed very mixed developments.[15]

Annual growth in import prices of **semi-finished products**, which contributed significantly to annual import price inflation in the period under review, picked up further as well (to 5.1% in August; see Table III.2.1). Import prices of chemicals and related products followed a similar pattern, but their growth was more moderate. By contrast, prices of **food and live animals** rose much more slowly on average in July and August than in the previous quarter (by 3.9% in August) owing to a decline in global prices of agricultural commodities and the prohibition of imports of some foodstuffs to Russia.

On the other hand, import prices of energy and non-energy commodities continued falling year on year in the first two months of 2014 Q3. Import prices in the category of **non-energy commodities**

15 Within this import category, import prices of electrical equipment, devices and appliances and general industrial machinery recorded the fastest growth (8.4% and 6.8% respectively) in August, while those of road vehicles recorded modest growth (1.5%).

CHART III.2.1

IMPORT PRICES AND PRODUCER PRICES

Import price inflation increased, prices in industry went down slightly overall, and prices in construction and market services continued to record modest growth
(annual percentage changes)

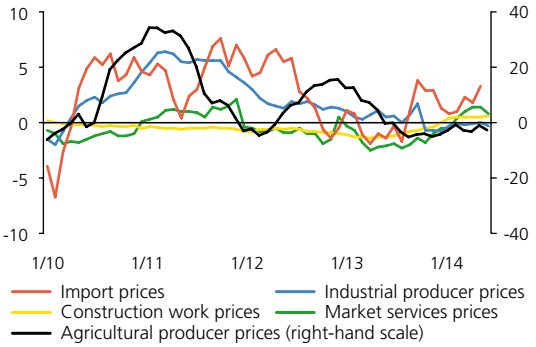


CHART III.2.2

IMPORT PRICES

High-value-added commodities and semi-finished products continued to contribute the most to import price inflation
(annual percentage changes; contributions in percentage points)

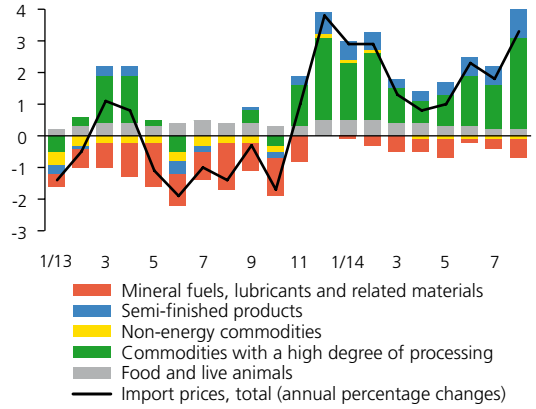


CHART III.2.3

MINERAL FUELS AND LUBRICANTS

Prices of imported mineral fuels reflected falling prices of natural gas and slowing growth in oil prices, while the koruna-dollar exchange rate had the opposite effect
(annual percentage changes)

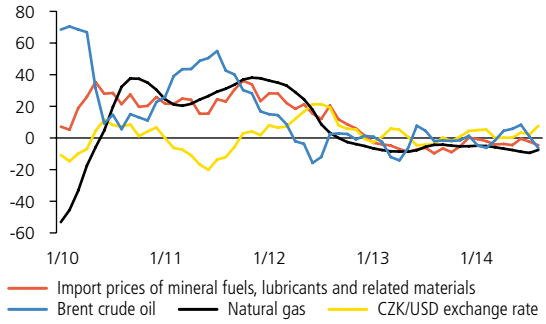


TABLE III.2.1

STRUCTURE OF IMPORT PRICE INFLATION

Import prices went up in most categories, but prices of energy and non-energy commodities went down
(annual percentage changes)

	5/14	6/14	7/14	8/14
IMPORTS, TOTAL	1.0	2.3	1.8	3.3
of which:				
food and live animals	4.8	5.2	3.5	3.9
beverages and tobacco	2.7	2.7	1.1	2.7
crude materials inedible, except fuels	-5.3	-5.0	-5.8	-5.2
mineral fuels and related products	-4.5	-0.5	-2.4	-4.6
animal and vegetable oils	-7.7	-7.2	-10.2	-7.6
chemicals and related products	1.2	1.8	2.0	3.7
manufactured goods classified chiefly by material	2.0	3.2	3.4	5.1
machinery and transport equipment	2.0	2.9	2.8	5.4
miscellaneous manufactured articles	0.3	1.7	1.6	3.3

CHART III.2.4

INDUSTRIAL PRODUCER PRICES

Industrial producer prices were flat or slightly falling in 2014 Q3, but went up in manufacturing
(annual percentage changes; contributions in percentage points)

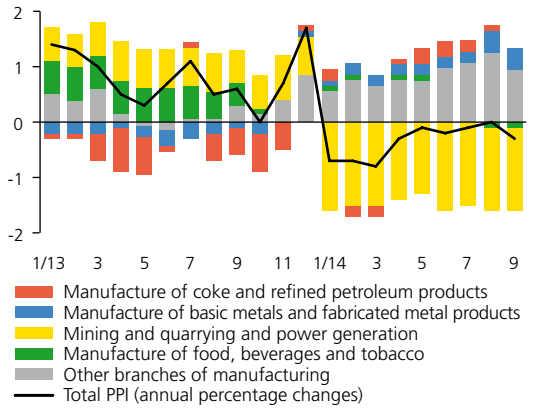
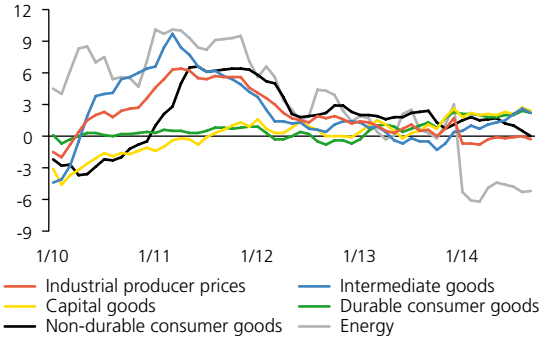


CHART III.2.5

PRODUCER PRICES BY MAIN INDUSTRIAL GROUPINGS

The minor decline in industrial producer prices was due to a fall in energy producer prices, as prices in other categories mostly went up
(annual percentage changes)



decreased to a larger extent on average than in the previous quarter (by 5.2% year on year according to the latest data for August). The annual decline in import prices of **mineral fuels** deepened as well (to 4.6% in August) owing to a continuing fall in global gas prices. The decline in prices in this category was also due to a sizeable weakening of year-on-year growth in world oil prices in July and a subsequent fall in those prices in August. By contrast, world coal prices went up in August,[16] and the decrease in koruna prices of mineral fuels was also counteracted by the weakened koruna-dollar exchange rate (see Chart III.2.3).

III.2.2 Producer prices

Industrial producer prices

Industrial producer prices continued to decline slightly in 2014 Q3, except for a stagnation in August. In September they dropped by 0.3% year on year (see Chart III.2.4).

An analysis of the **structure of industrial producer price inflation** reveals that their minor decline overall at the end of 2014 Q3 was a result of a combination of a continuing decline in prices in the mining and energy supply sectors and a continuing increase in prices in manufacturing (see Chart III.2.5). The decline in the former category was still due in part to changes in the European coal and electricity market.[17] This factor also affected coal prices on the domestic market, which kept falling year on year in 2014 Q3. The decline in some producers' input costs was also due to falling global gas prices, a renewed downswing in growth and subsequent decline in global oil prices and, to a lesser extent, to a persisting sharp decline in import prices of non-energy commodities. The effect of the still clearly growing import prices of food was still not visible in producer prices in the food industry in 2014 Q3, as it was outweighed by a decline in agricultural producer prices. Conversely, the continuing annual growth in producer prices in the other branches of manufacturing in 2014 Q3 reflected the weakening of the koruna and a recovery in demand for their products.

Turning to the **individual branches of manufacturing**, producer prices in the manufacture of coke and refined petroleum products had recorded one of the fastest rates of growth in 2014 Q2. In 2014 Q3, however, their growth slowed sharply and switched to stagnation in September owing to oil price developments. Producer price inflation also decreased in the food industry, with prices switching to a year-on-year decline in 2014 Q3 (of 0.8% in September) after rising modestly in Q2, mainly due to prices of inputs of vegetable origin. By contrast, producer prices in the manufacture of basic metals and

16 The recovery in global coal prices following a two-year annual decline has not yet passed through to domestic prices.
17 For more details see Box 4 in Inflation Report IV/2013.

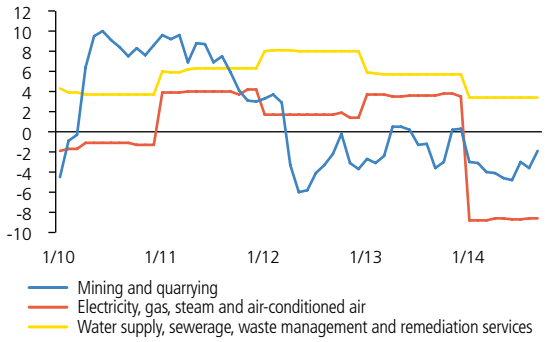
fabricated metal products showed relatively fast growth in Q3 (3.7% in September). This was probably due in part to strengthening growth in prices of imported semi-finished products. Prices in the other branches of manufacturing, comprising the manufacture of high-value-added products, rose slightly overall. However, their annual growth rate in 2014 Q3 was almost unchanged overall from the previous quarter, reaching 2% in September.

Prices in **mining and quarrying** showed a persisting annual decline in 2014 Q3, although this was more moderate than in Q2 (at 1.9% in September). The falling producer prices in this sector in turn fostered a decrease in producer prices in the **electricity, gas, steam and air conditioning industries**, which have been declining at a rate of almost 9% since the start of 2014 (8.6% in September; see Chart III.2.6). By contrast, prices in the water supply and sewerage-related services industry, whose activities and sources are difficult to substitute, continued to rise steadily year on year in September (by 3.4%).

CHART III.2.6

PRICES OF ENERGY AND WATER-RELATED SERVICES

Electricity prices have been falling sharply since the start of 2014
(annual percentage changes)



Agricultural producer prices

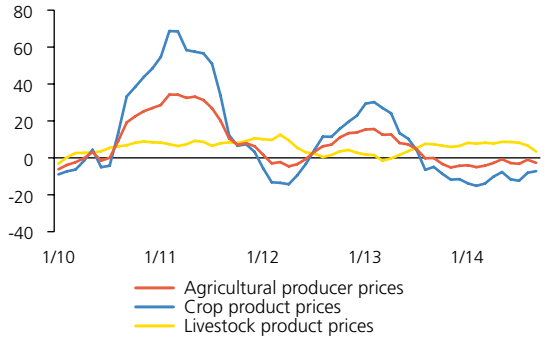
The year-long annual decline in **agricultural producer prices** continued into 2014 Q3, showing no major change compared to the previous quarter (see Chart III.2.7). According to the latest figures, the decline was 2.7% in September, down only marginally from June. Turning to the structure, however, there were more marked changes in the growth rates of prices of the major components. Crop prices kept falling significantly year on year, although less so than in the previous quarter (7.2% in September). This was due to prices of cereals, as prices of most other crop products saw a deepening annual decline.[18] On the other hand, the long-lasting annual growth in livestock product prices slowed sharply (from 8.6% in June to 3.4% in September). Nonetheless, prices of some livestock commodities, particularly milk and eggs, continued to show strong growth.

The main **factor** underlying the fall in agricultural producer prices observed since 2013 H2 was the above-average harvest in 2013 both in the Czech Republic and abroad. At the end of 2013, its positive effect was partly offset by the year-on-year weakening of the koruna. The decline in agricultural commodity prices moderated in 2014 H1 due to short-term inflationary factors such as an extremely hard winter in the USA and the unstable geopolitical situation in Ukraine. In mid-2014, their temporary effect was gradually outweighed by an improving outlook for this year's harvest, although this has so far affected domestic agricultural producer prices only partially. The increase in livestock product prices was predominantly due to milk prices, whose growth was due to rising demand and falling global production. This factor faded gradually during 2014 Q3 but has not yet passed through fully to domestic prices.

CHART III.2.7

AGRICULTURAL PRODUCER PRICES

The decline in crop product prices moderated, while growth in livestock product prices slowed
(annual percentage changes)

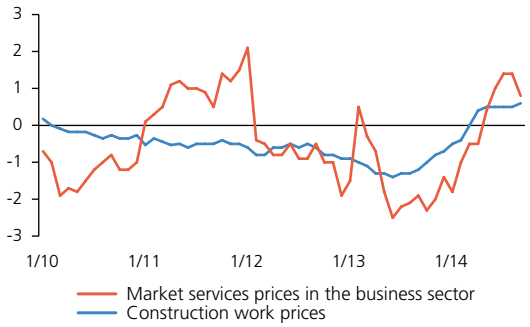


18 Prices of vegetables, fruit and oil crops fell particularly significantly.

CHART III.2.8

OTHER PRICE CATEGORIES

Prices of construction work and market services continued to show modest growth
(annual percentage changes)



Other producer prices

The renewed modest annual growth in **construction work prices** continued into 2014 Q3 amid a gradual recovery in construction output (see Chart III.2.8). In September it was only slightly higher than at the end of the previous quarter, standing at 0.6%. At the same time, the moderate annual growth in prices of materials and products consumed in construction continued to pick up gradually, reaching 1.5% in September.

Annual growth in **prices of market services** for the business sector slowed to 0.8% in September. Underlying this generally subdued growth were mixed price movements in individual service categories. In most categories, however, prices went up. The strongest price growth was recorded by financial intermediation, except insurance (7.2% year on year in September). Growth in prices of other services was slower and did not exceed 3%. Only in advertising services and market research and in rental and operational leasing services were prices still falling.

III.3 DEMAND AND OUTPUT

Annual real GDP growth slowed slightly to 2.5% in 2014 Q2. In quarter-on-quarter terms, economic activity increased by 0.3%. The year-on-year GDP growth was due to all components of domestic demand, whereas the contribution of net exports was negative. On the supply side, manufacturing was the biggest contributor to GDP growth, but value added also increased in most other sectors. The output gap has been closing since 2013 H2.

III.3.1 DOMESTIC DEMAND

Annual **domestic demand** growth rose noticeably in 2014 Q2 (to 3.3%). All its components contributed to this growth, most of all fixed investment, whose growth rate rose significantly compared to the previous quarter (see Chart III.3.2). The positive contributions of household consumption and government consumption increased as well. Additions to inventories, which had been falling in the previous two quarters, also made a minor contribution to annual domestic demand growth.

Final consumption

Real **final consumption expenditure of households** continued to grow year on year in 2014 Q2 for the fourth quarter in a row. At 1.9%, the annual growth was one percentage point higher than in the previous quarter.[19] The growth rate of household consumption increased amid continuing pronounced growth in real gross disposable income, which was slightly faster than in the previous quarter (see Chart III.3.3).

Annual growth in **gross nominal disposable income** was driven by growth in wages and salaries associated with rising productivity and increasing demand for labour in an environment of continued economic growth.[20] Nominal gross disposable income grew by 3.2% year on year in 2014 Q2. Its **real purchasing power** increased by 3% year on year amid low inflation.[21]

In 2014 Q2, the **structure** of the annual growth in households' nominal gross disposable income was again dominated by wages and salaries, which are its largest component in terms of volume (see Chart III.3.4).[22] To a lesser extent, the growth in disposable income was also due to relatively fast growth in other transfers (7.4% year on year) and social benefits (2.0%). The contribution of business

19 According to seasonally adjusted CZSO data under the new ESA 2010 methodology.
20 The effect of tax optimisation in late 2012 and early 2013 was still passing through to annual wage growth – see section III.4.
21 As measured by the household consumption deflator.
22 In 2014 Q2, households' wages and salaries accounted for 58% of total gross disposable income.

CHART III.3.1

GROSS DOMESTIC PRODUCT

Annual GDP growth slowed slightly in 2014 Q2
(annual and quarterly percentage changes at constant prices; seasonally adjusted data)

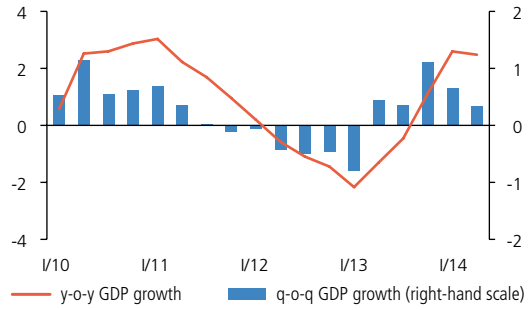


CHART III.3.2

STRUCTURE OF ANNUAL GDP GROWTH

All components of demand except net exports contributed to the annual GDP growth in 2014 Q2
(contributions in percentage points; seasonally adjusted data)

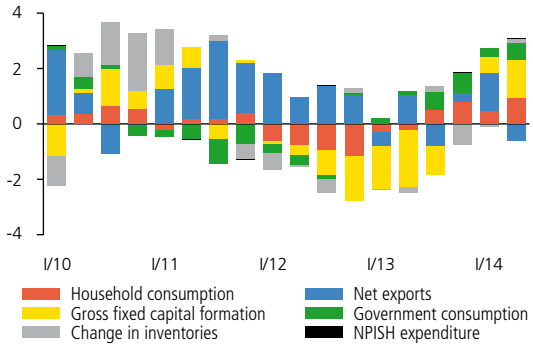


CHART III.3.3

HOUSEHOLD CONSUMPTION EXPENDITURE

Gross disposable income recorded continued high growth in 2014 Q2
(annual percentage changes; seasonally unadjusted data)

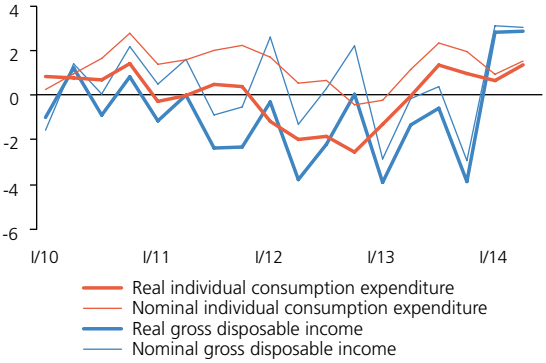


CHART III.3.4

DISPOSABLE INCOME

All components of income contributed to the continued growth in nominal gross disposable income
(annual percentage changes; contributions in percentage points; current prices)

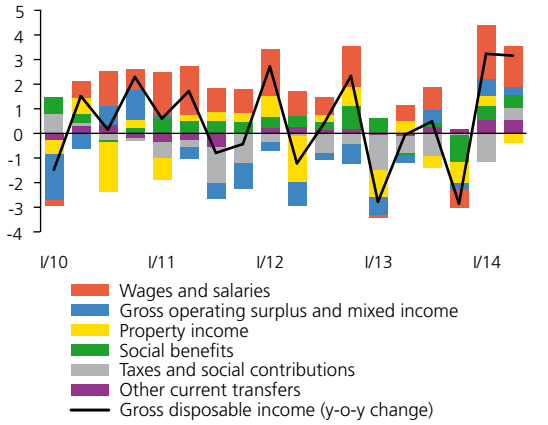


CHART III.3.5

STRUCTURE OF HOUSEHOLD CONSUMPTION

Consumption increased in all categories, and most of all in services, in 2014 Q2
(annual percentage changes; contributions in percentage points; constant prices)

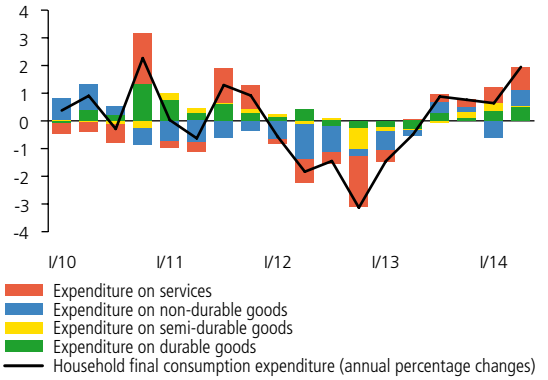
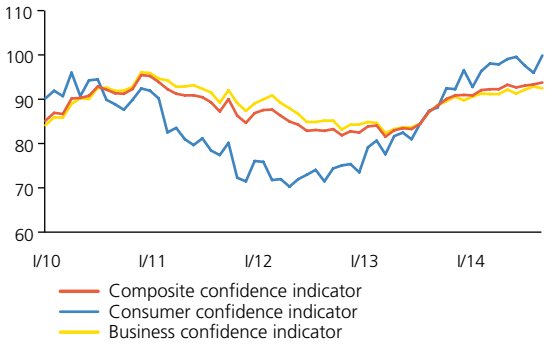


CHART III.3.6

CONFIDENCE INDICATORS

Consumer confidence returned to a higher level in October after having fallen in the preceding two months
(2005 average = 100; source: CZSO)



income (gross operating surplus plus mixed income) was positive for the second consecutive quarter. In 2014 Q2, however, it was relatively small, as this income rose by only 1% year on year. Only property income fell year on year in Q2.

With nominal gross disposable income rising faster than consumption expenditure, the **saving rate of households** increased markedly in 2014 Q2, reaching almost 11% (see Chart II.2.17). Consumer credit growth meanwhile remained subdued (2.7% in June), indicating weak household interest in credit financing of consumption (see section III.5).

The strong increase in annual growth in consumption in 2014 Q2 was accompanied by some changes in the **structure of household consumption expenditure**. All consumption categories contributed positively to the annual growth, albeit to varying extents (see Chart III.3.5). In particular, there was a renewed increase in spending on current consumer goods (i.e. services and non-durable goods),[23] consumption of which households had reduced in the previous period of mostly falling real disposable income. At the same time, households' expenditure on durable goods increased quite considerably (by 6.2% year on year), while growth in expenditure on semi-durable goods moderated significantly.

According to the latest available **leading indicators**, seasonally adjusted annual retail sales growth continued in July and August 2014, although at a more moderate pace than in the previous period. This was apparent in quickly rising sales not only in the automotive segment, but also in the rest of the retail sector. In the non-motor-vehicle segment, annual growth in sales[24] of non-food retail goods increased, while sales of food and fuels switched to a decline. After having fallen in the preceding two months, the consumer confidence indicator rose again in October, mainly thanks to improved perceptions of the outlook for the financial situation and employment in the next twelve months (see Chart III.3.6).

Annual growth in real **government final consumption expenditure** rose markedly in 2014 Q2 compared to the previous quarter, to 3%.

Investment

With economic activity continuing to recover, year-on-year growth in **fixed investment** rose to a significant 5.7%[25] in 2014 Q2 (see Chart III.3.7). Fixed investment grew faster than in the previous quarter in quarter-on-quarter terms as well (by 1.4%).

23 This spending accounts for 86% of household consumption expenditure.
24 According to seasonally unadjusted data.
25 According to seasonally adjusted data. According to seasonally unadjusted data, on which Chart III.3.7 and Chart III.3.8 are based, the increase was 5.6%.

As in the previous three quarters, the continued recovery in investment activity in 2014 Q2 was mostly driven by **non-financial corporations** (see Chart III.3.7). The fast annual growth in fixed investment in this sector (10.7%) was linked mainly with a sharp rise in investment in machinery and equipment. Non-financial corporations also probably contributed to the increase in investment in other buildings and structures, transport equipment and intangible fixed assets in this period (see Chart III.3.8). The continuing investment growth in the non-financial corporations sector can thus still be regarded as reflecting their positive view of future demand. This view is supported by the latest business survey conducted by the CNB and the Confederation of Industry in September, according to which non-financial corporations also expect investment to increase at the six-month and twelve-month horizons.[26]

Overall investment growth in 2014 Q2 was also supported to an increased extent by investment in the **government sector**, which switched to annual growth in Q1 after four years of decline (see Chart III.3.7). The sharp growth in government investment in 2014 Q1 and Q2 (of 4.4% and 20% respectively) was chiefly due to an increased effort to accelerate the drawdown of EU funds. This investment was based on public orders issued since the beginning of 2013, which started to be implemented in 2014.

The decline in investment in the **household sector** slowed noticeably in 2014 Q2 (to 2% year on year). Investment in dwellings, which accounts for a significant proportion of the total fixed investment of households, showed a renewed modest increase (of 0.9% year on year) after having declined in the previous quarter (see Chart III.3.9). Leading indicators continue to indicate a gradual improvement in household investment in dwellings. Households' confidence in future growth of the economy, employment and wages, which is improving as the economy continues to grow, remains the main factor. Financing conditions for investment in dwellings are still favourable. A considerable year-on-year rise (of almost 16%) in the number of housing starts in 2014 Q2 suggests an improvement in developers' view of future household demand for investment in housing.

The contribution of **changes in inventories** to annual GDP growth was slightly positive in 2014 Q2 (0.2 percentage point; see Chart III.3.2). This was due to a rebound in inventories for future production (commodities, materials and semi-manufactures) and to increases in work-in-progress and finished goods. Growth in inventories in all these categories in 2014 Q2 was indicated by a survey of non-financial corporations conducted by the CNB and the Confederation of Industry of the Czech Republic and by CZSO statistical data on the financial results of non-financial corporations.

26 A further increase in investment activity is expected in the remainder of this year, thanks to the construction of LTE networks by the three largest mobile operators.

CHART III.3.7

INVESTMENT BY SECTOR

The continued growth in fixed investment was still driven by non-financial corporations and newly also by the government
(annual percentage changes; contributions in percentage points; constant prices; seasonally unadjusted data)

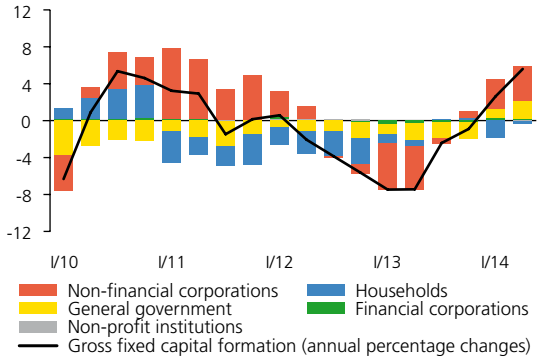


CHART III.3.8

FIXED CAPITAL FORMATION

There was growth in investment in machinery and equipment and buildings and structures in particular
(annual percentage changes; contributions in percentage points; constant prices; seasonally unadjusted data)

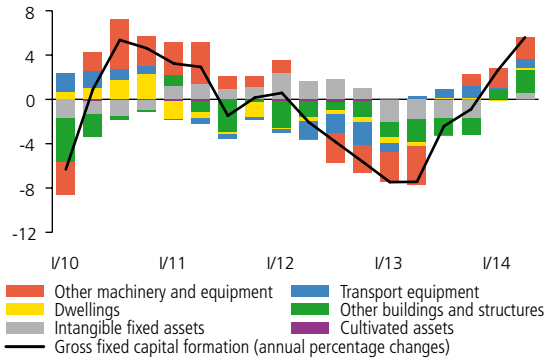


CHART III.3.9

INVESTMENT IN DWELLINGS

The number of housing starts increased considerably in 2014 Q2
(annual percentage changes)

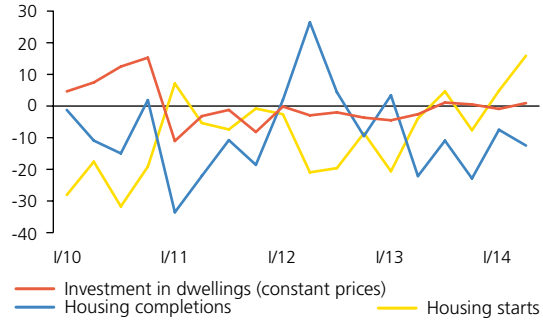


CHART III.3.10

NET EXPORTS

Net exports decreased in 2014 Q2 after two quarters of growth
(seasonally adjusted data; constant prices)

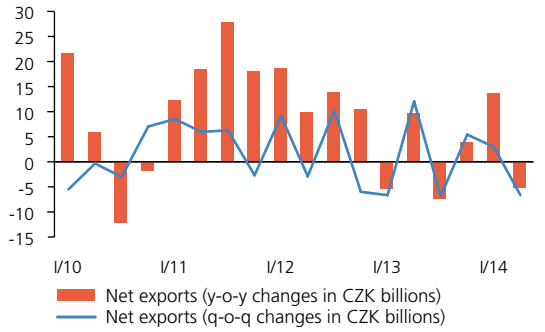


CHART III.3.11

EXPORTS AND IMPORTS

Growth in trade turnover slowed slightly in 2014 Q2, with import growth outpacing export growth
(annual percentage changes; percentage points; constant prices; seasonally adjusted data)

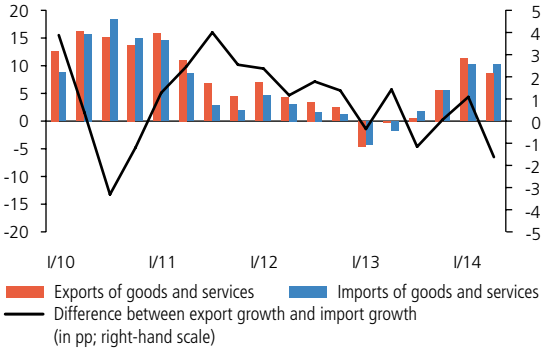
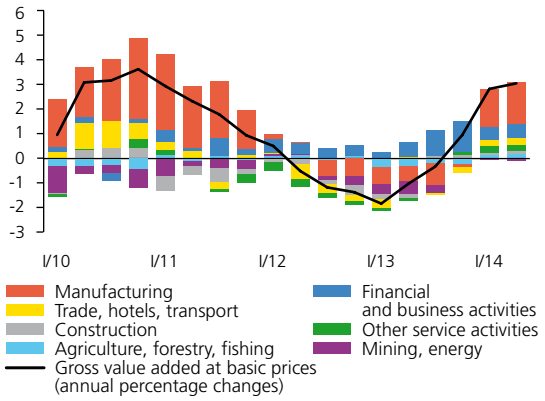


CHART III.3.12

CONTRIBUTIONS OF BRANCHES TO GVA GROWTH

Manufacturing was the biggest contributor to the growth in gross value added in 2014 Q2, but most other sectors increased as well
(annual percentage changes; contributions in percentage points)



III.3.2 Net external demand

Net exports of goods and services[27] decreased in 2014 Q2 after two consecutive quarters of growth. The net export surplus shrank by CZK 5.1 billion year on year and also fell in quarter-on-quarter terms (by almost CZK 7 billion; see Chart III.3.10). The year-on-year decline in net exports was chiefly due to the trade balance, whose surplus narrowed noticeably, unlike in the previous quarter, when it had recorded quite fast growth. As in 2014 Q1, the services surplus also decreased slightly. In these circumstances, the contribution of net exports to GDP growth was negative in Q2, at -0.6 percentage point (see Chart III.3.2).

The year-on-year decline in net exports was a result of import growth outpacing export growth (of 1.6 percentage points). In the previous quarter, the relationship had been the other way round, with exports leading imports (see Chart III.3.11). **Total exports** rose by 8.5% year on year, their growth rate slowing by 2.8 percentage points from the previous quarter. The weaker growth in total exports was linked with more moderate growth in external demand in the Czech Republic's major trading partner countries and was due solely to exports of goods, as exports of services picked up compared to 2014 Q1.

By contrast, the growth rate of **total imports** was unchanged in 2014 Q2, as imports grew by 10.2% year on year, the same as in Q1. With import-intensive exports slowing, this fast rate of import growth was maintained in 2014 Q2 thanks to rising growth in total domestic demand. This growth led mainly to an increase in imports of commodities for investment purposes and, to a lesser extent, to faster growth in imports of services. Annual growth in total foreign trade turnover moderated slightly overall in 2014 Q2 owing to slowing growth in exports.

III.3.3 Output

Gross value added at basic prices continued rising in 2014 Q2 in line with the trend seen since the end of 2013 (see Chart III.3.12). The rate of growth picked up further, being 0.2 percentage point higher than in 2014 Q1 and reaching 3%. In quarter-on-quarter terms, value added grew for the fifth consecutive quarter. In 2014 Q2 alone the quarter-on-quarter growth was 0.5%. Underlying this development was rising external demand, whose growth rate, however, slowed somewhat, together with growth in domestic demand, which conversely strengthened.

The pass-through of the rising demand to the output of **individual sectors** was again most apparent in industry and, within it, in manufacturing, but value added also increased in most other sectors (see Chart III.3.12). The contribution of industry to the overall

27 At 2010 prices, seasonally adjusted.

annual rise in gross value added in 2014 Q2 was thus the largest (1.7 percentage points). Only mining, energy supply and insurance and financial intermediation made negative contributions to annual gross value added growth.

The continuing gross value added growth in industry in 2014 Q2 was consistent with the data on **industrial production** (see Chart III.3.13),[28] which grew by 5.7% year on year in real terms. This rise was due almost exclusively to fast growing production in **manufacturing**, whose year-on-year growth rate reached a significant 7.2%.[29] In terms of use, production for investment rose the fastest – by 8.3% year on year. However, rapid growth was also recorded in production for long-term and intermediate consumption (6.9% and 7.5% respectively). Production for short-term consumption grew at only a modest annual rate (2.6%). The growth in manufacturing output was quite broad-based, with most of the industries under review (almost 80%) contributing to it.

According to the latest available **monthly indicators**, the evolution of industrial production was quite uneven in July and August. Its accumulated annual growth in these two months slowed to 1.7% (see Chart III.3.13).[30] According to the CZSO, the year-on-year data for August were strongly affected by different timing of company holidays in the two holiday months in 2013 and 2014. Total **sales from industrial activity** at current prices showed a similar pattern, with rapid growth in July being replaced by a decline in August (from 14.8% year on year in July to -1.5% in August). A closer look at the structure reveals that sales growth fell sharply in both sales segments in August, although only domestic sales[31] recorded a year-on-year decline in August. The growth rate of **industrial orders** also saw a pronounced downswing in August, with new orders rising by only 1.4% year on year overall. The growth in foreign orders was even lower, whereas the growth in domestic orders was higher, although it did not exceed 3% (see Chart III.3.14).

Nevertheless, according to the October results of the CZSO's business survey the effect of **insufficient demand as a barrier** to growth in industry decreased while the proportion of industrial firms not constrained by any barriers increased (see Chart III.3.15). At the same time, there was an increase in **capacity utilisation** compared to the previous survey.

The overall contribution of **trade and services** to annual gross value added growth was again positive in 2014 Q2 (1.1 percentage points). This was due to almost all services sectors, the exception being financial services. The biggest contribution was made by scientific,

28 According to seasonally adjusted data.
29 Production in mining and quarrying increased by 0.8% year on year in 2014 Q2. Production in the gas, heat and air-conditioned air supply industry decreased year on year (by 2.4%).
30 According to seasonally adjusted data, industrial production rose by 5.7% year on year in July and dropped by 2.6% in August.
31 Domestic sales include indirect exports through non-industrial corporations.

CHART III.3.13

INDUSTRIAL PRODUCTION

Industrial production growth was significantly affected in July and August by different timing of company holidays in the holiday period
(basic index; year 2010 = 100)

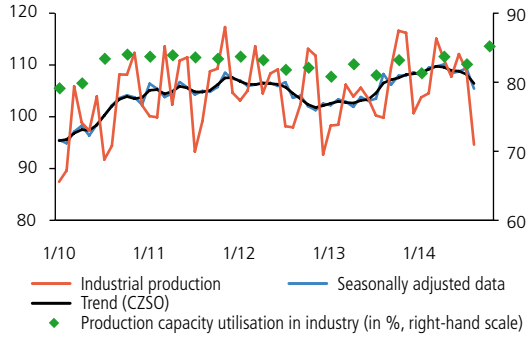


CHART III.3.14

NEW ORDERS IN INDUSTRY

Growth in new industrial orders slowed noticeably in August
(annual percentage changes)

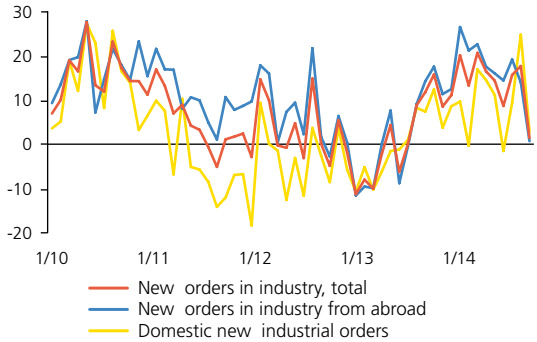


CHART III.3.15

BARRIERS TO GROWTH IN INDUSTRY

The effect of insufficient demand as the main barrier to growth in industrial production decreased further
(percentages)

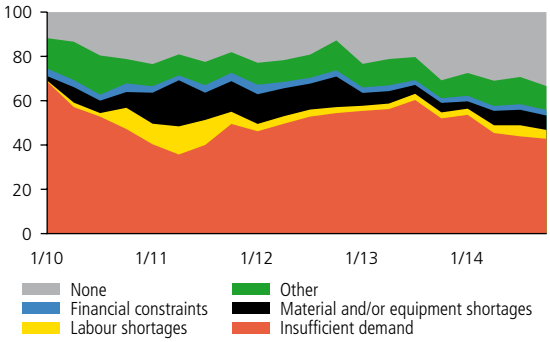


CHART III.3.16

ECONOMIC SENTIMENT

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

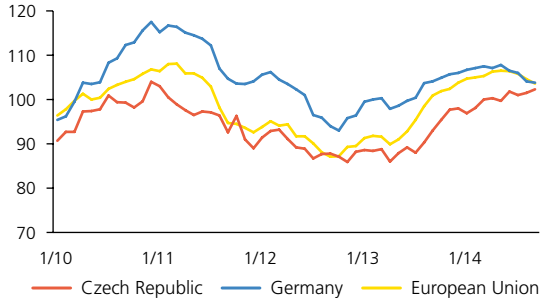


CHART III.3.17

POTENTIAL OUTPUT

The rate of growth of potential output was above 1% in 2014 Q2 according to all the methods used
(annual percentage changes)

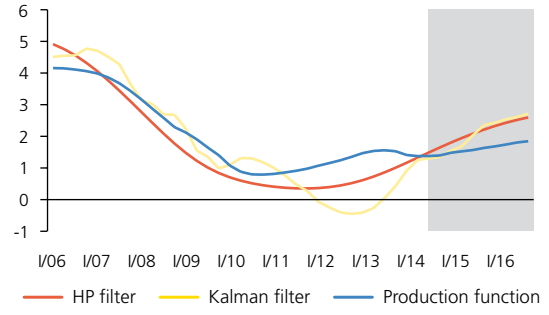
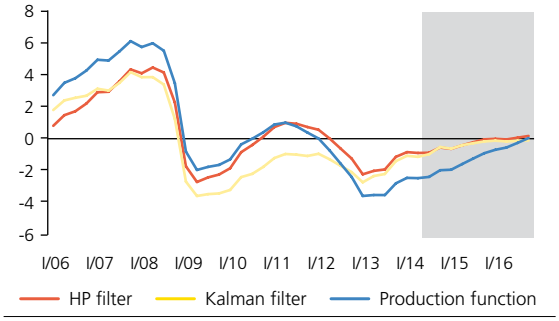


CHART III.3.18

OUTPUT GAP

The output gap is gradually closing according to all the methods used
(in % of potential output)



technical and administrative activities, where annual value added growth reached 5.9%. The latest August data on retail sales are still favourable, with growth being recorded in both the automotive and non-automotive segments.

Value added growth in **construction** accelerated to 2.5% in 2014 Q2 (see Chart III.3.12). This was largely a result of a recovery in output in civil engineering. The CZSO's latest available monthly data show that construction output was flat in August following a decline in July due to base effects (as a result of construction work after the floods). However, fast double-digit annual growth in new orders in construction according to the CZSO survey in 2014 Q2 suggests continued growth in construction work in the period ahead, although only in civil engineering, as new orders in building construction are falling. The approximate value of building notifications and permits also increased overall in August (by 14.8%), although their number fell.

An **international comparison of economic sentiment**, based on data for September, shows a continued upward tendency in this indicator in the Czech Republic. In Germany and in the EU as a whole, by contrast, the upward trend halted in June and the confidence indicator then slowly decreased (see Chart III.3.16). The economic sentiment indicators for the Czech Republic, Germany and the EU thus converged significantly in September.

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 above 1% in 2014 Q2 (see Chart III.3.17). The moderation in quarterly growth in economic activity observed in 2014 Q2 resulted in stagnation of the output gap, which thus remained significantly negative (-2.5% of potential output; see Chart III.3.18). This method suggests an insignificant pick-up in potential output growth this year and the next to just below 2%. The **individual factors entering the production function** point to an increasing contribution of productivity over the forecast horizon, amid a broadly flat aggregate contribution of employment and capital (see Chart III.3.19). The output gap will continue to close gradually, nearing zero at the end of 2016.

An alternative estimate using the **HP filter**[32] indicates a similar growth rate of potential output (1.3% in 2014 Q2) to that calculated using the production function. Under this method, the output gap is currently less negative (by more than 1 percentage point) and the HP filter indicates closure of the gap in late 2015 and early 2016 amid faster potential output growth going forward. A calculation using the

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

Kalman filter shows the same annual potential output growth rate in 2014 Q2 as the HP filter and a similar pattern over the forecast horizon. 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 and faster convergence to zero over the forecast horizon.

CHART III.3.19

CONTRIBUTIONS TO POTENTIAL OUTPUT GROWTH

The contribution of productivity will gradually increase over the forecast horizon

(production function; annual percentage changes)

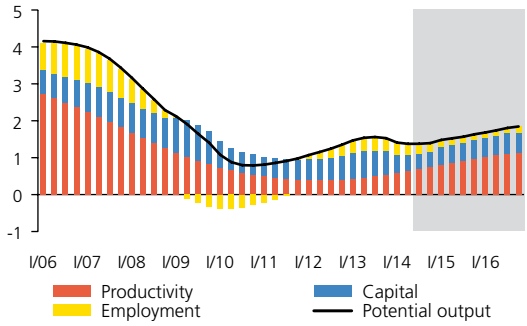


CHART III.4.1

LABOUR MARKET INDICATORS

Employment growth slowed, but the increase in the number of employees converted into full-time equivalents picked up further, and the average wage continued to go up

(annual percentage changes)

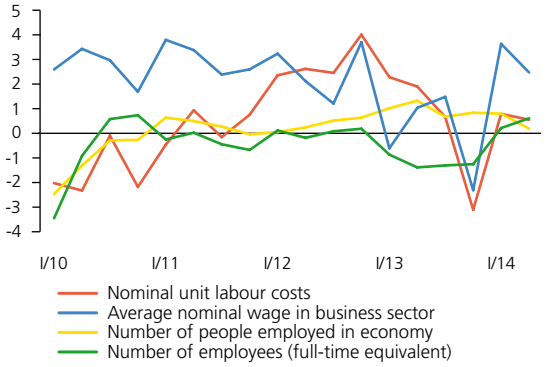
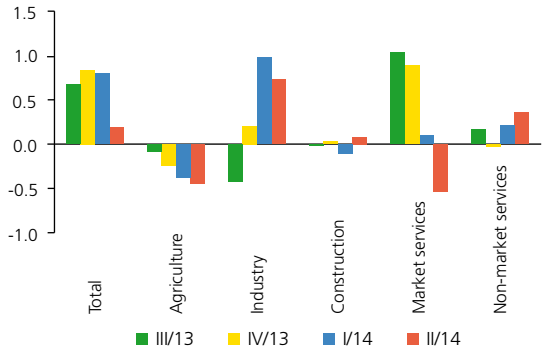


CHART III.4.2

EMPLOYMENT BREAKDOWN BY BRANCHES

The continuing growth in employment was due mostly to industry and non-market services, while employment fell in market services and agriculture

(contributions in percentage points to annual change; selected branches; source: LFS)



III.4 THE LABOUR MARKET

The labour market continued to be positively affected by continued growth in economic activity in 2014 Q2. Although growth in total employment slowed, the increase in the number of employees converted into full-time equivalents picked up further year on year. Amid a slight annual rise in employment accompanied by a more significant decline in the labour force, the general unemployment rate went down further. The share of unemployed persons also declined in 2014 Q2 and Q3. Annual growth in the average wage moderated, especially in the business sector, which was, nevertheless, connected with the effect of tax optimisation. Growth in whole-economy labour productivity picked up further. Unit labour costs rose more slowly than in the previous quarter, mainly because of lower growth in the volume of wages and salaries.

III.4.1 Employment and unemployment

Annual growth in **total employment**[33] slowed considerably in 2014 Q2. It was 0.6 percentage point lower than in the previous quarter, amounting to 0.2% (see Chart III.4.1). Employment (adjusted for seasonal effects) in fact declined in quarter-on-quarter terms (by 0.1%). The slowdown in annual employment growth was due to a slight decline in the number of employees, while growth in the number of entrepreneurs stayed above 2%.

Employment grew most in the **secondary sector** (see Chart III.4.2). This suggested rising demand for labour mainly in industry owing to continued growth in economic activity. Nevertheless, following slower growth in the previous quarter, employment in the tertiary sector surprisingly declined year on year in 2014 Q2. This was caused by a pronounced decrease in employment in market services. Employment also fell year on year in the primary sector, mainly because of a further deepening of the decline in the number of employees in agriculture.

Growth in employment in the **secondary sector** continued at roughly the same rate in 2014 Q2 as at the start of this year (2.2% year on year). Although the largest annual growth in the number of employed persons continued to be observed in manufacturing, the electricity and water supply sectors also showed fast growth in employment. According to the latest figures for July and August, the registered number of employees[34] in industry rose further (by 1.7% in both months). Following a long period of decline, employment in construction also recorded a year-on-year increase according to the latest figures for August.

33 Employment according to the LFS. These data differ from the national accounts concept of employment. The LFS uses the national concept and expresses the employment of all residents of the Czech Republic, whereas the national accounts work with the domestic concept, under which employment of both residents and non-residents in domestic production units is followed. As for the sector structure of employment, the LFS uses the activity principle, while the national accounts apply the institutional principle.

34 Corporations with 50 employees or more, excluding agency workers.

The noticeable change in employment growth in the **tertiary sector** (from 0.5% in 2014 Q1 to -0.3% in 2014 Q2 in year-on-year terms) was due to a further sharp fall in employment growth in market services. This was driven mainly by a pronounced decline in the number of persons employed in wholesale and retail trade and repair of motor vehicles, financial intermediation and insurance,[35] and transport and storage. There was also a significant downswing in growth in the number of people employed in information and communication activities and in administration and other support activities, where the opposite trend had been observed in the previous quarter. Unlike in market services, employment in non-market services continued to rise. This trend was renewed in 2014 Q1 and accelerated slightly thanks mainly to continued growth in the number of persons employed in health and social care, education and culture.

With economic activity continuing to rise, the renewed growth in the **number of employees converted into full-time equivalents** observed in early 2014 picked up further in Q2 (to 0.6%; see Chart III.4.3). This was fostered by both the business and non-business sectors, with the former showing renewed annual growth after a decline lasting more than a year. Growth in this indicator in the non-business sector remained at roughly the previous quarter's level. The increase in the converted number of employees was due exclusively to longer average hours worked per employee at the whole-economy level.

However, the number of employees and average hours worked per employee were still very mixed across the sectors of the national economy. Average hours worked per employee were shortened in **industry** and **non-market services**, where the number of employees grew faster than the converted number of employees. By contrast, **market services**, where the number of employees has been declining for two consecutive quarters, saw a slight increase in the converted number of employees and thus a rise in the average number of hours worked per employee. The converted number of employees in **construction** has long been decreasing.

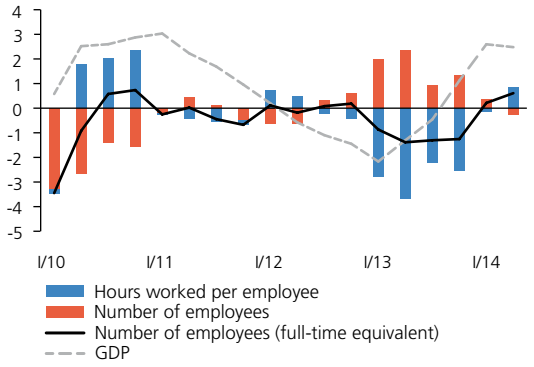
Amid a slight annual rise in employment accompanied by a more significant decline in the labour force, the **general unemployment rate**[36] decreased further to 6.3% in 2014 Q2 (see Chart III.4.4). The year-on-year decline in the labour force coupled with an even more pronounced decline in the population also resulted in a further increase in the **rate of economic activity**,[37] which reached one of the highest levels in the history of the Czech Republic (73.2% after seasonal adjustment). The increase was due, among other things, to an increase in the retirement age, demographic developments and

CHART III.4.3

NUMBER OF EMPLOYEES (FULL-TIME EQUIVALENT)

Growth in the converted number of employees picked up further and was linked with longer average hours worked per employee

(annual percentage changes; contributions in percentage points)



35 The number of employees fell by 30,500 year on year in wholesale and retail trade and repair of motor vehicles and by 19,700 in financial intermediation and insurance.

36 In the 15–64 age category. Measured by the ILO methodology according to the LFS.

37 The rate of economic activity is defined as the ratio of employed and unemployed persons to the population in each age category.

CHART III.4.4

UNEMPLOYMENT INDICATORS

The general unemployment rate and the share of unemployed persons both decreased further in 2014 Q2
(percentages; seasonally adjusted data; source: MLSA, CZSO)

CHART III.4.5

BEVERIDGE CURVE

The number of vacancies has been rising and the number of unemployed persons falling since the start of 2014
(seasonally adjusted numbers in thousands; source: MLSA)

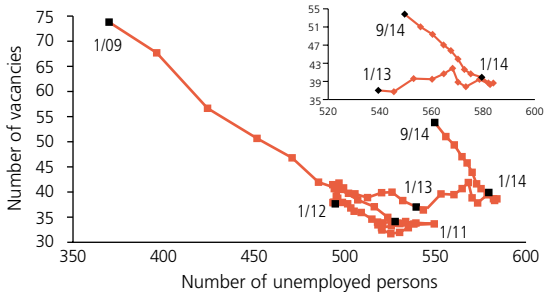
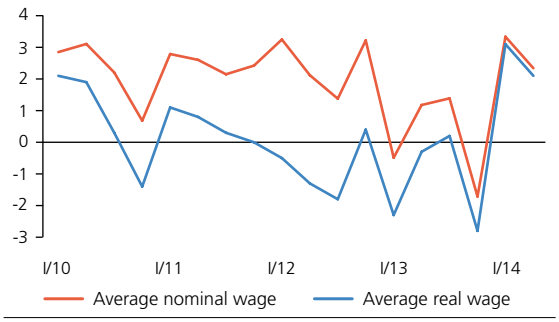


CHART III.4.6

AVERAGE WAGE

Growth in the average nominal and real wage slowed in 2014 Q2
(annual percentage changes)



the use of shorter working hours. According to the latest figures, the seasonally adjusted general unemployment rate was 6.2% and 6.3% in July and August respectively, and the rate of economic activity rose slightly.

The **share of unemployed persons**,[38] published by the MLSA, also decreased in 2014 Q2 (see Chart III.4.4). This (seasonally adjusted) unemployment indicator then declined further to 7.7% in 2014 Q3 owing to a larger decrease in the number of available job applicants than in the population in the given age group.

A gradual improvement of the labour market situation is also indicated by the latest available data for 2014 Q3, according to which there is a gradual shift along the **Beveridge curve**[39] in the north-westerly direction. This shift is due to a decrease in the seasonally adjusted number of registered job applicants, driven by an increase in the number of persons excluded from the register due to finding jobs or by penalty,[40] coupled with growth in the number of vacancies, which is at its highest level in more than five years (see Chart III.4.5).

III.4.2 Wages and productivity

Following a sizeable pick-up in 2014 Q1, annual growth in the **average nominal wage** slowed to 2.3% in Q2 (see Chart III.4.6). This was due mainly to a moderation in average wage growth in the business sector, while the effect of weaker wage growth in the non-business sector was less significant. With annual inflation low, the **real average wage** increased by 2.1% (see Table III.4.1).

After reaching the high level of 3.6% at the start of the year, annual growth in the average wage in the **business sector** fell back to 2.5% in Q2. In real terms the average wage in this sector rose by 2.3%. This high wage volatility was still due largely to the tax optimisation recorded in late 2012 and early 2013.[41] This is confirmed by calculations of growth in the volume of wages (bonuses) in the individual quarters of 2013–2014 which would have been recorded if enterprises had not shifted bonuses from 2013 to 2012 Q4 due to tax optimisation. The calculations were performed using new detailed

38 The share of unemployed persons is the ratio of available job applicants aged 15–64 to the population of the same age.
39 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.
40 The main reasons for excluding a person from the labour office register by penalty include refusal to take a suitable job, illegal work, refusal to do community service, refusal to do agreed retraining and failure to cooperate with the labour office.
41 A "solidarity" tax, i.e. an increase of 7 percentage points in the tax rate for employed persons with income exceeding CZK 103,536 a month, was introduced on 1 January 2013, and the cap on health insurance premium payments was abolished at the same time. In many sectors that usually display the largest proportions of performance-related bonuses for the previous year, these bonuses were therefore moved from 2013 to 2012 Q4. These sectors mainly included financial intermediation, energy and heat supply, and cultural, entertainment and recreational activities.

data obtained from the Average Earnings Information System survey. According to the revised CNB estimate, bonuses amounting to around CZK 7.9 billion were shifted – not only from 2013 Q1 to 2012 Q4, but also from the other quarters of 2013. According to time series adjusted for this extraordinary effect, annual growth in the average wage gradually recovered during 2013 and later also in 2014 H1. This revised and seasonally adjusted average wage increased by 0.6% quarter on quarter in 2014 Q2, i.e. at roughly the same rate as in the previous quarter.

As regards the **branches of the business sector**, the average wage increased the most in wholesale and retail trade and repair of motor vehicles (by 3.9% year on year), where employment simultaneously fell sharply. Fast wage growth of 3% was recorded in manufacturing. Financial intermediation and insurance, mining and quarrying and information and communication activities recorded only slightly lower growth rates. However, the July and August data for industry and construction suggest more moderate wage growth in the business sector in 2014 Q3 than in Q2.

Annual average wage growth in the **non-business sector** also slowed in 2014 Q2 (to 1.7%). This still generally subdued growth was due to a rise in the average wage in central government and local government (of 1.9% in both cases). Only in the negligible-weight sector of social security funds did wages rise more markedly (by more than 5%). Given the low annual inflation, real average wage growth was only slightly different from nominal wage growth, reaching 1.5% in 2014 Q2 (see Table III.4.1).

With real GDP growth continuing to rise and employment falling,[42] annual growth in **whole-economy labour productivity**[43] accelerated further in 2014 Q2 (to 2.6% year on year). This was mostly due to industry, where labour productivity rose by a considerable 5.8% year on year[44] (see Chart III.4.7). In construction, however, following a surge in Q1, its annual growth rate decreased significantly (to 1.8%). By contrast, productivity in market and non-market services grew noticeably faster in 2014 Q2 than in the previous quarter (by 1.6 % and 2.4% respectively year on year). Growth in **hourly labour productivity** also picked up (to 4.3% year on year)[45] and was much higher than whole-economy productivity. Hourly productivity grew most in construction, with industry also showing a high growth rate. The growth rate of hourly labour productivity also increased in market and non-market services.

TABLE III.4.1

WAGES, PRODUCTIVITY, UNIT LABOUR COSTS

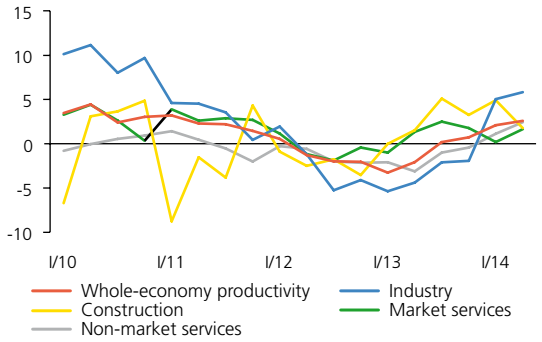
Annual growth in the average nominal wage decreased to just above 2%, while labour productivity growth increased further
(annual percentage changes)

	III/13	IV/13	I/14	II/14
Average wage in Czech Republic				
nominal	1.4	-1.7	3.3	2.3
real	0.2	-2.8	3.1	2.1
Average wage in business sector				
nominal	1.5	-2.3	3.6	2.5
real	0.3	-3.4	3.4	2.3
Average wage in non-business sector				
nominal	0.9	0.9	2.0	1.7
real	-0.3	-0.2	1.8	1.5
Whole-economy labour productivity	0.2	0.7	2.1	2.6
Nominal unit labour costs	0.7	-3.1	0.8	0.5

CHART III.4.7

WHOLE-ECONOMY PRODUCTIVITY

Growth in whole-economy labour productivity was strongest in industry, but was also recorded in other sectors
(annual percentage changes)

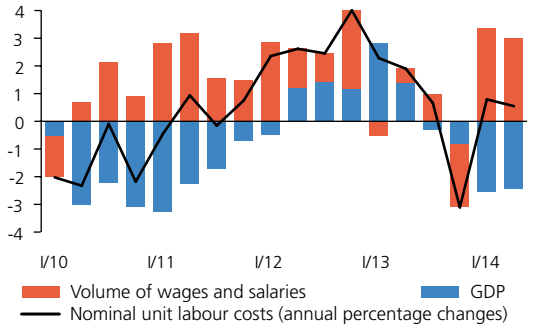


42 According to the CZSO's national accounts.
43 Productivity is calculated on the basis of seasonally unadjusted data.
44 Productivity growth in manufacturing amounted to 7.1%.
45 This increase was due to a combination of 2.5% GDP growth and a decline of 1.8% in the number of hours worked.

CHART III.4.8

UNIT LABOUR COSTS

Growth in nominal unit labour costs slowed slightly due to lower growth in the volume of wages and salaries
(contributions in percentage points; annual percentage changes)



A moderate fall in the volume of wages and salaries[46] coupled with the above development in economic activity resulted in a slight slowdown in annual growth in **unit labour costs** [47] in 2014 Q2 (to 0.5%; see Chart III.4.8). As regards sectors, nominal unit wage costs rose mainly in market and non-market services. By contrast, they recorded an annual decline in industry and an even more pronounced fall in manufacturing itself. Unit labour costs continued to fall quickly year on year in construction.

46 Following a fall of 2.3% in 2013 Q4, the volume of wages and salaries increased by 3.4% in 2014 Q1. Their growth slowed to 3.0% in 2014 Q2.

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

III.5 FINANCIAL AND MONETARY DEVELOPMENTS

The annual growth rate of M2 decreased in 2014 Q3. Highly liquid overnight deposits were the main component contributing to M2 growth. Growth in net external assets slowed. The growth rate of deposits of non-financial corporations declined. This notwithstanding, the acid-test ratio of corporations remains higher than last year. Following a previous increase, the annual growth rate of loans to non-financial corporations decreased in August. Growth in loans to households for house purchase and consumer credit slowed slightly. Money market interest rates were flat and long-term government bond yields fell further. Client interest rates on new loans declined or remained at historical lows. Banks' average interest margins declined in all credit market segments. The koruna weakened against the euro and especially against the dollar in 2014 Q3. Residential property prices recorded year-on-year growth.

III.5.1 Money

The annual growth rate of **M2** decreased during 2014 Q3, reaching 3.5% in August (see Chart III.5.1). On the bank assets side, the slower M2 growth mainly reflected a smaller increase in net external assets. This year's money growth rate is similar to or slightly lower than that of nominal GDP. This means that the previous decline in the velocity of money has come to a halt or that the velocity of money has risen in the past two quarters. The annual growth rate of **M3** also fell in Q3 (to 4.4% in August). M3 growth in the Czech Republic is about two percentage points above the euro area average. However, this difference has narrowed recently as M3 growth in the euro area has recovered.

As in the euro area, a **preference for liquidity** in conditions of low interest rates is continuing to foster a pick-up in the already quite high M1 growth in the Czech Republic (to 8.8% in August; see Chart III.5.1). This reflects increased demand of non-financial corporations and households for overnight deposits (see Chart III.5.2). Conversely, the decline in other short-term deposits has deepened. Long-term deposits have remained flat despite some banks' efforts to make them more attractive.

Turning to the **sector structure of deposits**, M2 growth was fostered most of all by household deposits in 2014 Q3. Their growth rate increased in line with the labour market recovery, reaching 4.1% in August. By contrast, the annual growth rate of deposits of non-financial corporations dropped to 3.4% on average (see Chart III.5.3). The lower growth in corporate deposits was consistent with a slight decline in the acid-test ratio of corporations, although its level remains higher than last year. Corporate deposits as a whole reflected a decline in foreign currency deposits and, to a lesser extent, lower growth in koruna deposits. Deposits of financial non-monetary institutions have decreased year on year over recent months. Within the structure of their financial assets, there was a slight increase in loans to corporations and households and investment fund shares. The share of foreign currency deposits in total resident deposits included in M2 remained close to 9%.

CHART III.5.1

MONETARY AGGREGATES

The growth rates of M2 and M3 slowed during 2014 Q3
(annual percentage rates of growth)

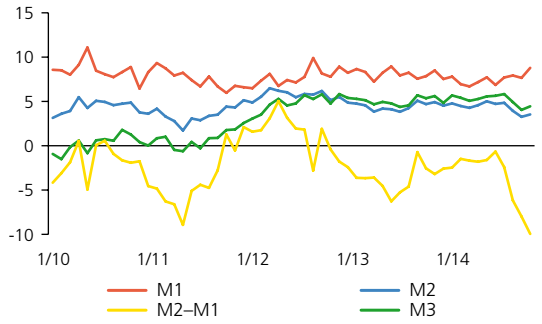


CHART III.5.2

MAIN COMPONENTS OF M2

The preference for liquidity increased in conditions of low interest rates
(annual flows in CZK billions)

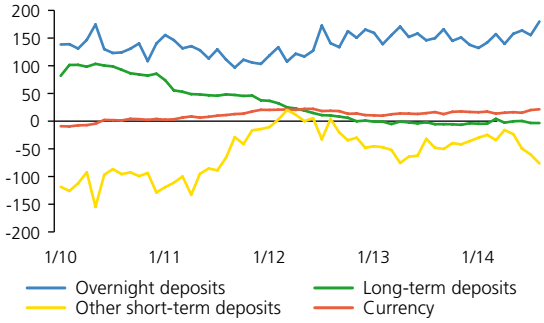


CHART III.5.3

DEPOSIT STRUCTURE OF M2

Money supply growth was fostered by household deposits, while the contribution of deposits of corporations decreased
(contributions in percentage points; annual percentage rates of growth)

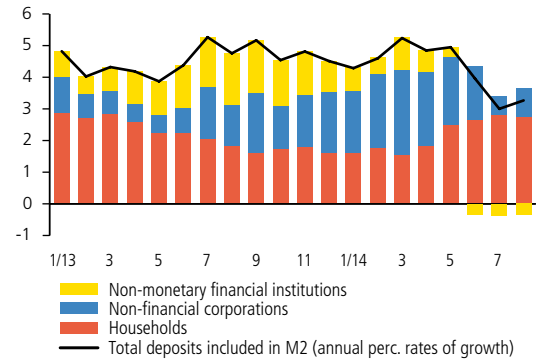


TABLE III.5.1

CHANGES IN BANKS' CREDIT CONDITIONS

Demand for corporate loans increased in 2014 Q3; this was accompanied by easier credit standards in this segment of the credit market

(net percentages; positive value = tightening standards/conditions, demand growth; negative value = easing standards/conditions, demand decrease)

	Credit supply: of which			Demand for loans
	Credit standards	Average margin for loans	Margin on riskier loans	
Loans to non-financial corporations				
I/14	0 (2)	0	20	-26 (29)
II/14	-28 (-16)	-29	3	30 (54)
III/14	-21 (-32)	-46	-18	36 (56)
IV/14	(-38)			(51)
Loans for house purchase				
I/14	-4 (-4)	-2	36	-11 (-2)
II/14	4 (4)	-37	-33	57 (35)
III/14	1 (-42)	-25	-4	-29 (31)
IV/14	(-11)			(8)
Consumer credit				
I/14	-18 (16)	-25	-25	76 (-28)
II/14	35 (22)	0	4	-5 (69)
III/14	25 (9)	-9	0	-21 (-12)
IV/14	(-27)			(-28)

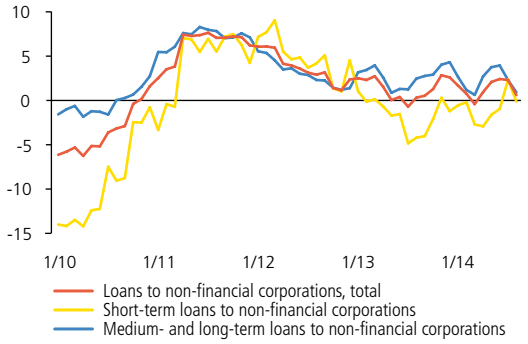
Note: Net percentages are calculated as the difference between the percentage share of loans provided by banks reporting that standards/conditions have been tightened (or demand increased) and the percentage share of loans provided by banks reporting that standards/conditions have been eased (or demand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

CHART III.5.4

LOANS TO NON-FINANCIAL CORPORATIONS

Growth in corporate loans slowed in August 2014

(annual percentage rates of growth)



III.5.2 Credit

The annual growth rate of **loans to the private sector** slowed to 3.6% in August 2014. According to the bank lending survey, lending was supported in 2014 Q3 by more relaxed credit standards for corporate loans and unchanged standards for loans for house purchase, in line with the phase of continued economic growth. This was reflected in a decline in average interest margins in all credit market segments (see Table III.5.1). In 2014 Q3, banks perceived continuing growth in corporate demand for loans and a quarter-on-quarter decline in household demand for loans for both house purchase and consumption.

The results of the bank lending survey in the **euro area** generally suggest a possible turnaround in the credit market. In 2014 Q2, for the first time since 2012, euro area banks reported a net easing of credit standards and growing demand in all credit market segments. The decline in loans to the private sector has recently moderated to -0.9% (August 2014), reflecting weak growth in loans to households and some signs of levelling-off in the decline in loans to enterprises.[48]

The year-on-year growth rate of **loans to non-financial corporations** in the Czech Republic fell back to 0.6% in August 2014 following a previous increase (see Chart III.5.4). Growth in loans to foreign-controlled corporations slowed, loans to domestic corporations decreased. The previous long-running year-on-year decline in new koruna loans recently halted (see Chart III.5.5). According to the bank lending survey, banks perceived continuing growth in demand for loans in 2014 Q3. Demand grew most strongly in medium-sized enterprises and for long-term loans. This was due to the financing of fixed investment, mergers and acquisitions (especially for developers) and working capital and inventories. By contrast, increased issuance of corporate bonds reduced demand for loans. Annual growth in the stock of corporate bond issued amounted to around 7% in 2014 Q2, although a slowdown has recently been observed. According to banks, demand for loans to corporations will continue to increase in 2014 Q4. Growth in loans to corporations from leasing and factoring companies edged up in 2014 H1.

48 The easing of credit standards applied to loans to enterprises in the euro area in 2014 Q2 was due to an improved macroeconomic and firm-specific outlook, in line with the moderate economic recovery in the euro area. Increased competition is having a similar effect, whereas the risk on collateral demanded is fostering tighter credit standards. Demand for loans to enterprises in the euro area reflects increased financing needs, especially related to working capital. As regards loans to households for house purchase, the easing of credit standards was fostered by factors associated with banks' balance sheets, more favourable risk perceptions, and competitive pressures. Demand increased in this segment of the credit market. Turning to terms and conditions, euro area banks reduced their average interest margins while leaving margins on riskier loans unchanged.

Annual growth in **investment loans**, which had been strongly affected by growth in investment by developers in the first half of this year, slowed to 0.7% in 2014 Q3 (see Chart III.5.6).[49] This growth was also buoyed by loans to industry (in particular the energy sector and slightly also manufacturing for the first time). Investment loans to construction, trade and some other branches (such as mining and quarrying) recorded a decline.

The interest of Czech corporations in **foreign currency loans** persisted in 2014 Q3, but the annual growth rate of such loans adjusted for exchange rate movements and other non-transaction effects declined to 5.1% in August 2014 (see Chart III.5.7). This development was again due mainly to loans to developers (the construction of commercial development projects is usually funded by euro-denominated loans so that rents can be set in euro). The share of foreign currency loans in total corporate loans stayed at around 21%.

Banks' **credit standards** applied to corporate loans were eased in 2014 Q3, mainly due to competitive pressures and the macroeconomic outlook (see Table III.5.1). On the other hand, perceptions regarding the outlook for some sectors and corporations, more specifically the outlook for some exporting firms owing to developments in Ukraine and Russia, worsened for the first time since the end of 2013. The easing of standards was reflected in more favourable terms and conditions applied by banks to new loans. Almost half of the banking market lowered average interest margins, 18% of the market reduced interest margins on riskier loans, and almost 40% of the market relaxed collateral requirements. The easing of standards and terms and conditions was more pronounced for large corporations. Banks expect credit standards to ease further in 2014 Q4, this time more widely for small and medium-sized enterprises (see Table III.5.2).

The annual growth rate of **loans to households** slowed slightly in 2014 Q3, reaching 5.1% in August (see Chart III.5.8). This was associated mainly with **loans for house purchase**. With interest rates continuing to go down, mortgage growth slowed slightly (to 6.7% in August), while the decline in building society loans gradually eased (to -5.3%). According to the bank lending survey, households' demand for loans for house purchase recorded a quarter-on-quarter decline in 2014 Q3. This reflected unusually strong volatility in demand for such loans earlier in the year – a very weak first quarter (temporarily reflecting legal uncertainty linked with the entry into effect of the new Civil Code and Cadastral Act) had been followed by a relatively strong second quarter (see Table III.5.1). Demand was favourably affected by the outlook for the residential property market, in line with a slight increase in investment in dwellings and property prices, and also by consumer confidence. Banks' credit standards remained broadly unchanged. Banks' expectations for 2014 Q4 point

49 However, annual growth in investment in buildings and structures amounted to 7.9% in nominal terms and 7.4% in real terms in 2014 Q2, fostering growth in total fixed investment.

CHART III.5.5

NEW KORUNA LOANS TO NON-FINANCIAL CORPORATIONS

The previous long-running year-on-year decline in new koruna loans to corporations recently halted

(annual percentage rates of growth; interest rate in %)

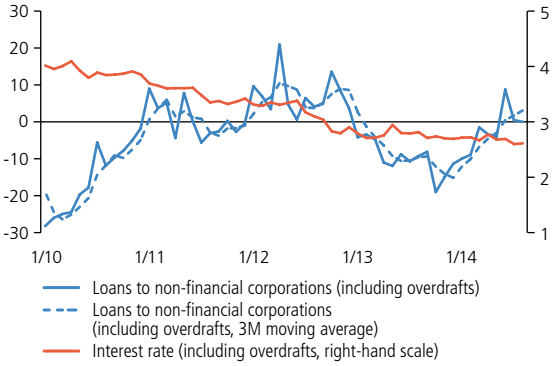


CHART III.5.6

LOANS TO CORPORATIONS FOR FUNDING FIXED INVESTMENT

Growth in investment loans to property developers slowed in 2014 Q3; the volume of such loans in manufacturing started to edge up

(contributions in percentage points; annual percentage rates of growth; annual percentage changes)

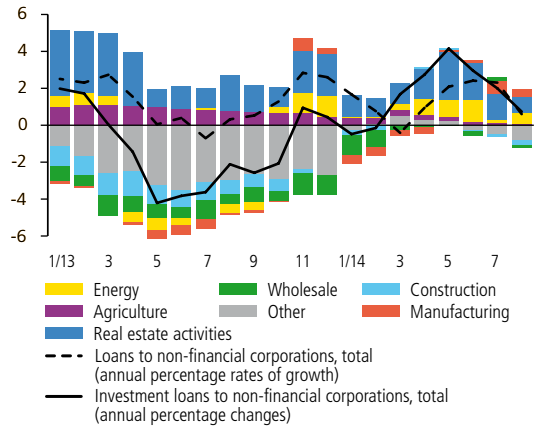


CHART III.5.7

CURRENCY STRUCTURE OF CORPORATE LOANS

The annual rate of growth of foreign currency loans to domestic non-financial corporations slowed

(annual percentage rates of growth adjusted for exchange rate changes and other non-transaction effects; annual percentage changes)

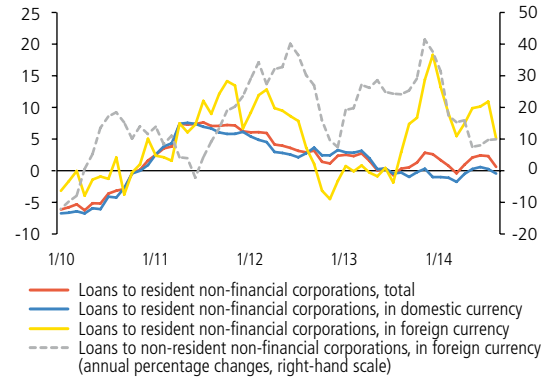


TABLE III.5.2

CREDIT STANDARDS AND SELECTED CREDIT CONDITIONS BY CORPORATION SIZE

The easing of standards and terms and conditions was more pronounced for large corporations

(net percentages; positive value = tightening standards/conditions; negative value = easing standards/conditions)

	Quarterly averages					
	2012	2013	2014 Q1	2014 Q2	2014 Q3	2014 Q4[a)]
Credit standards						
Small and medium-sized enterprises	13	4	0	-26	-4	(-58)
Large corporations	22	0	0	-46	-21	(-38)
Banks' average margin on loans						
Small and medium-sized enterprises	-1	-16	0	-27	-27	
Large corporations	18	-8	-18	-46	-46	
Size of loans						
Small and medium-sized enterprises	13	3	0	0	0	
Large corporations	29	10	-4	-4	-21	
Collateral requirements						
Small and medium-sized enterprises	26	9	9	0	-21	
Large corporations	25	1	-8	-35	-35	

Note: Net percentages are calculated as the difference between the percentage share of loans provided by banks reporting that standards/conditions have been tightened and the percentage share of loans provided by banks reporting that standards/conditions have been eased. The individual responses are thus weighted by the volumes of loans of a given type.

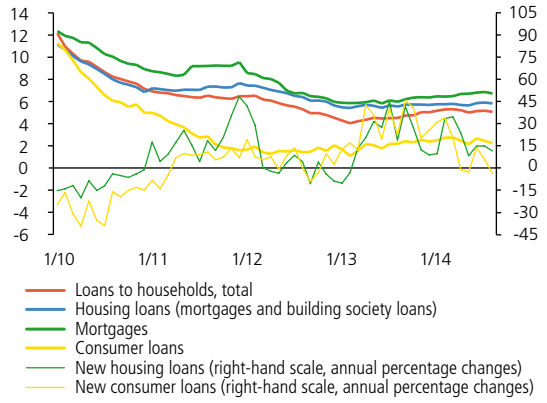
a) Banks' expectations for current period reported in the III/14 survey given in parentheses.

CHART III.5.8

LOANS TO HOUSEHOLDS

Growth in loans to households for house purchase and consumption slowed slightly in 2014 Q3

(annual percentage rates of growth; annual percentage changes)



to an easing of standards and renewed growth in demand in a small section of the banking market. The decline in demand for loans for house purchase was reflected in slower annual growth in new loans in Q3, but their growth rate remains in double figures (see Chart III.5.8). According to Hypoindex data for September 2014, the volume and number of mortgages edged up compared to the previous month amid a further decrease in interest rates.

Turning to new loans for house purchase, the share of **refinancing** of existing loans is lower than at the start of 2014, accounting for 43% in August compared to 51% in January 2014. This reflected a decline in the share of renegotiated loans to 31%. The share of refinancing of existing loans from other banks was unchanged at 12%.[50]

The annual growth rate of **consumer credit** slowed despite the economic recovery, amounting to 2.2% in August (see Chart III.5.8). According to banks' perceptions, household demand for consumer credit declined. Demand was adversely affected by households' persisting cautious approach to obtaining such credit. Banks expect demand for consumer credit to follow a similar trend in 2014 Q4. Credit standards were tightened further. On the other hand, there was a slight increase in households' interest in consumer credit from non-banks, which increased by 0.8% year on year in 2014 Q2.

Total household debt decreased somewhat to 65.5% of total annual disposable income in 2014 Q2. This reflected a rebound in income growth accompanied by slower annual growth in the total financial liabilities of households (see Chart III.5.9). This ratio remains much lower than in the euro area, where it is 98% on average. The net interest burden on Czech households (including interest expenses and income on bank loans and deposits) remained close to 2% of disposable income. It has been fluctuating around this level over the last four years.

III.5.3 Interest rates

Monetary policy interest rates

The monetary policy decision-making of the CNB Bank Board in 2014 Q3 was based on the macroeconomic forecast published in the previous Inflation Report. The forecast assumed that market interest rates would be flat at their current very low level and the exchange rate would be used as a monetary policy instrument until 2015 Q3. At its meeting in July, the Bank Board decided unanimously to leave **key interest rates** unchanged at their current level, i.e. at technical zero[51] (see Chart III.5.10). The Board also decided to continue using the **exchange**

50 The interest rate declined in all these categories of new loans for house purchase. The lowest rate – due to competition – was on refinanced loans from other banks (2.7% compared to 3.2% for new loans and for renegotiated loans).

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.

rate as an additional instrument for easing the monetary conditions. It also confirmed the CNB's commitment to intervene on the foreign exchange market if needed to weaken the koruna against the euro so that the exchange rate of the koruna is kept close to CZK 27 to the euro. The risks to the previous forecast were assessed by the Board as being slightly anti-inflationary. The Bank Board therefore decided to continue using the exchange rate as a monetary policy instrument at least until 2016. It said that it would have to find a further noticeable increase in anti-inflationary factors before moving the exchange rate commitment to a weaker level. At its meeting in September, the Bank Board also decided unanimously to leave key interest rates unchanged. At the same time, it confirmed the above foreign exchange commitment. The balance of the risks to the forecast was assessed as being moderately anti-inflationary; in this situation the Bank Board reiterated that the CNB would not discontinue the use of the exchange rate as a monetary policy instrument before 2016.

At its monetary policy meeting on 6 November 2014, the Bank Board decided unanimously to keep interest rates unchanged at technical zero. The Bank 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 against the euro so that the exchange rate of the koruna is kept close to CZK 27 to the euro. The asymmetric nature of this exchange rate commitment is unchanged. The Bank Board assessed the risks to the new forecast as being balanced. In this situation the Bank Board repeated that the CNB would not discontinue the use of the exchange rate as a monetary policy instrument before 2016.

Financial market interest rates

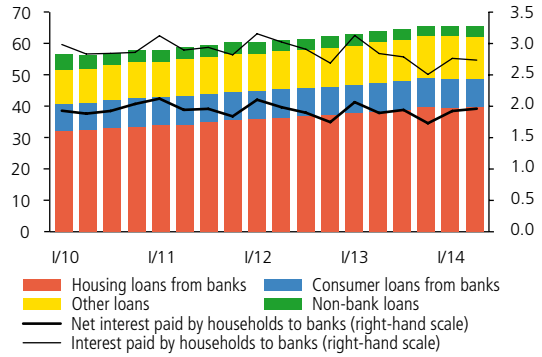
PRIBOR interest rates remained at historical lows at all maturities in 2014 Q3. They thus reflected the setting of the CNB's key interest rates at technical zero (see Chart III.5.11). Three-month **FRA derivative rates** were little changed overall. Their slight deviations – in the order of hundredths of a percentage point – reflected the published domestic macroeconomic data (retail sales, industrial production, inflation, GDP) and the temporary depreciation of the koruna in the first half of August. The market outlook for 3M rates according to end-October FRA quotations continues to imply stability of the 3M PRIBOR at least at the one-year horizon, i.e. currently until the end of 2015 Q3. This is in line with the prevailing expectations that monetary policy interest rates will be left at technical zero at least until the same date given the current money market premium remaining unchanged. The market outlook is very close to the interest rate path consistent with the new CNB forecast over the entire horizon (see section II).

Domestic **interest rates with longer maturities** mostly decreased in line with euro area rates, which mainly reflected concerns about slower economic growth both in Germany (the largest European economy) and on the global scale. This slowdown was suggested by some published macroeconomic indicators and leading indicators. Medium-term

CHART III.5.9

HOUSEHOLD DEBT

Households' debt-to-income ratio decreased somewhat
(quarterly data; 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.5.10

CNB KEY RATES

The CNB left its key interest rates at "technical zero" in 2014 Q3
(percentages)

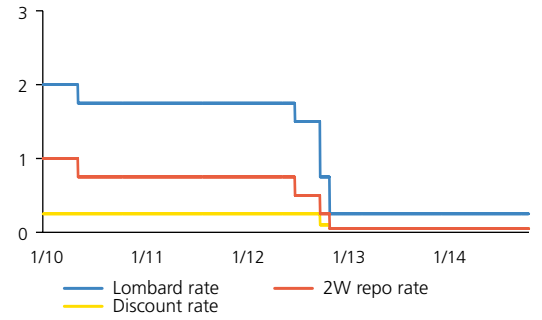
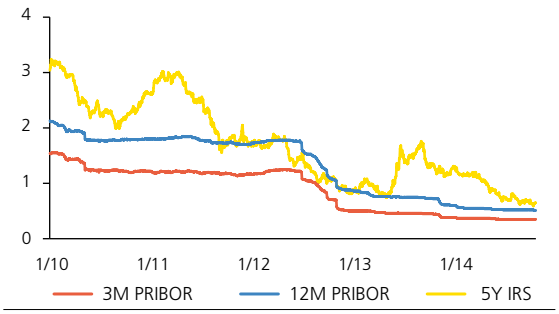


CHART III.5.11

MARKET INTEREST RATES

Money market interest rates were flat at historical lows, while rates with longer maturities went down
(percentages)



and long-term rates were also affected by the expected – and later implemented – use of additional unconventional monetary policy instruments by the ECB, which are aimed at further easing the monetary conditions in an environment of impending deflation and still fragile recovery in the euro area. However, doubts have emerged on markets regarding the potential of these measures to boost credit activity in the euro area (by contrast, there was speculation in the USA about the timing of the first increase in key interest rates by the Fed after it discontinued its asset purchase programme). The downward trend in foreign rates was partly also due to geopolitical risks, which increased market nervousness and thus boosted demand for safer assets. In Q3, the decline in domestic IRS interest rates and bond yields with longer maturities amounted to around 0.1–0.4 percentage point depending on maturity. This decline continued into October. IRS rates and bond yields were at historical lows at all maturities at the end of October.

The average **3M PRIBOR** in 2014 Q3 was just below 0.4%, in line with the level foreseen by the previous forecast. The credit premium, as measured by the spread between the 3M PRIBOR and the 2W repo rate, stood at 0.3 percentage point.

The shape and slope of the **PRIBOR yield curve** were unchanged in 2014 Q3. The spread between the 1Y PRIBOR and the 2W PRIBOR was 0.4 percentage point on average in September 2014. The **IRS yield curve** shifted to a lower level in 2014 Q3, although only at its longer end, so its positive slope decreased at the same time. In September, the average 5Y–1Y spread was 0.3 percentage point and the 10Y–1Y spread 0.9 percentage point.

Short-term **interest rate differentials** vis-à-vis the two main world currencies (PRIBOR/CZK–EURIBOR/EUR and LIBOR/USD) reflected the approximate stability on the domestic and US financial markets. Short-term rates fell slightly in the euro area in early September following the easing of monetary policy by the ECB. The differentials vis-à-vis dollar rates thus remained close to zero, while those vis-à-vis euro rates widened slightly (see Chart III.5.12). The 3M PRIBOR–3M EURIBOR differential was 0.2 percentage point on average in 2014 Q3. At the end of October 2014, it was 0.3 percentage point.

Two auctions of fixed coupon bonds and two auctions of variable coupon bonds were held on the primary **government bond market** in 2014 Q3 and October 2014. The total volume of bonds issued was CZK 27.4 billion.[52] Demand exceeded supply in all the auctions. The bid-to-cover ratio was 2.3 on average. The government bonds were subscribed at historically low yields. The government bond yield curve – like the IRS curve – shifted downwards in its medium and longer sections. Its positive slope thus decreased (see Chart III.5.13).

CHART III.5.12

INTEREST RATE DIFFERENTIALS

Interest rate differentials vis-à-vis the dollar were close to zero, while those vis-à-vis the euro widened slightly
(percentage points)

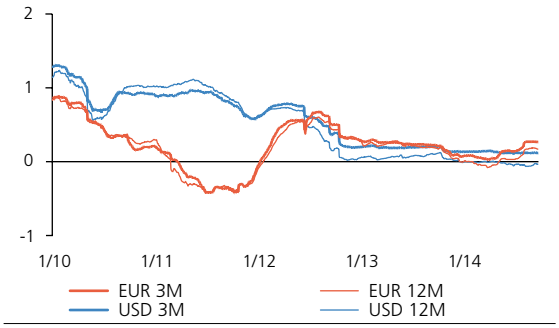
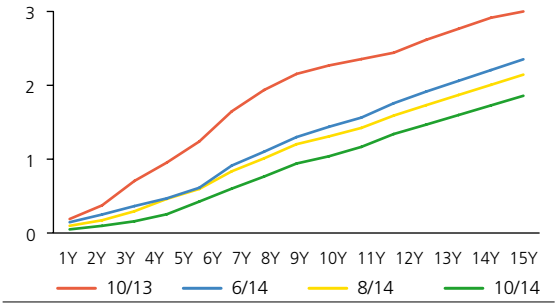


CHART III.5.13

GOVERNMENT BOND YIELD CURVE

The government bond yield curve shifted downwards and its positive slope decreased
(percentages)



52 The Czech Republic's Funding and Debt Management Strategy for 2014 assumes issues amounting to CZK 119.2–280.1 billion. Bonds totalling CZK 144.3 billion have been issued since the start of this year.

Client interest rates

Client interest rates on new loans and deposits mostly declined slightly or were little unchanged in 2014 Q3. This development was recorded in an environment of a stable 3M PRIBOR and a continued decline in the ten-year government bond yield to 1.2% in September compared to 1.6% in June. The ex ante real interest rate in August was virtually zero for corporate loans. As for households, it remained close to 1% for loans for house purchase and at 11.8% for consumer credit. The real interest rate on household deposits with agreed maturity remained negative at -0.8%, while that on deposits with an agreed maturity of over two years was approximately zero.

The **interest rate on loans to non-financial corporations** decreased slightly further to 1.9% in nominal terms (August 2014). Rates with short-term and long-term fixations both declined (see Chart III.5.14). The decline in short-term rates amid flat money market rates reflects competitive pressure in this segment of the credit market. The average rate on large loans of over CZK 30 million fell slightly to 1.8% and the rate on small loans to 2.7%. At less than 1 percentage point, the spread between these rates is slightly above the average recorded since 2007. The spread between the short-term rate on corporate loans and the 3M PRIBOR narrowed slightly (see Chart III.5.16). Rates on corporate loans in the euro area also decreased slightly in the period under review (to 2.3% on average).

Turning to households, the **interest rate on loans for house purchase** remained at a historical low of 3.1% in August 2014 (2.9% for mortgages). The rate on loans fixed for over one year and up to five years, whose share dropped to around 68% of all house purchase loans, was flat at 3% (see Chart III.5.15). The long-term rate fixed for over five years and up to ten years and the rate fixed for over ten years showed the most pronounced declines. This was reflected in increased interest in these loans. By contrast, the short-term rate of up to one year edged up. The spread between short-term client and market rates widened slightly in 2014 Q3. The spread between the average rate on loans for house purchase and the long-term financial market rate also increased, mainly on account of a decline in long-term government bond yields (see Chart III.5.16). The interest rate on house purchase loans in the euro area fell further to 2.7%.

The **interest rate on consumer credit** dropped slightly to 14% in August, the lowest level recorded this year (see Chart III.5.15). This was due in part to rates with long-term fixations of over five years. The APRC also declined to 14.8%. Conversely, the rate on overdrafts and revolving loans was flat at 14.2% and the rate on credit card debt rose to 24.8%. Due to higher credit risk, the rate on consumer credit remains well above that in the euro area, where it stands at 6.4% on average.

CHART III.5.14

INTEREST RATES ON LOANS TO CORPORATIONS

The interest rate on loans to non-financial corporations decreased slightly

(new business; percentages)

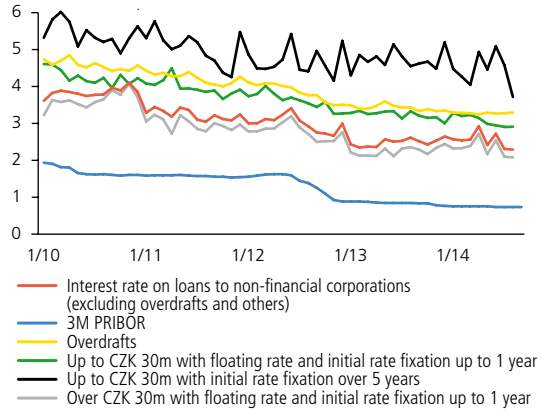


CHART III.5.15

INTEREST RATES ON LOANS TO HOUSEHOLDS

The interest rate on loans to households for house purchase is at a historical low

(new business; percentages)

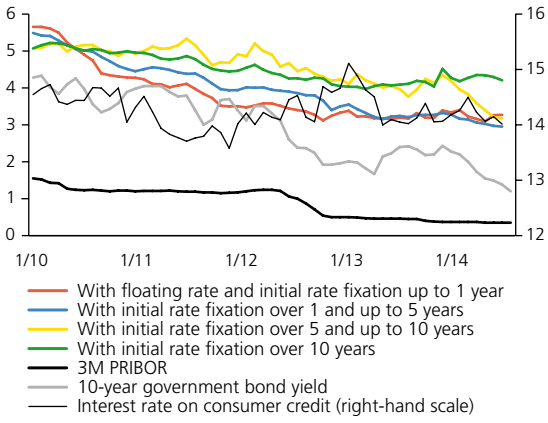


CHART III.5.16

CLIENT AND MARKET INTEREST RATE SPREADS

The spread between short-term client and market rates narrowed in the case of corporate loans but widened slightly in the case of loans for house purchase

(percentage points)

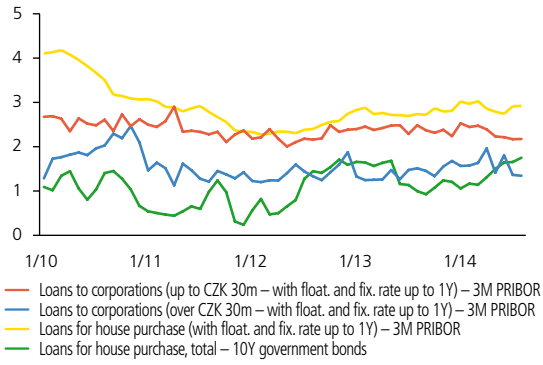


CHART III.5.17

INTEREST RATES ON DEPOSITS

The interest rate on long-term household deposits with agreed maturity increased to 2.1% on average
(percentages)

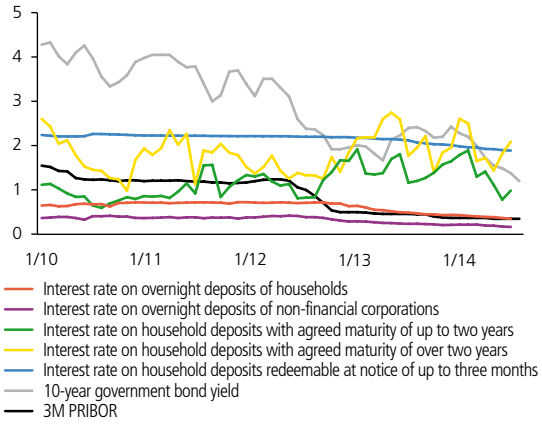


CHART III.5.18

EX ANTE REAL RATES

Ex ante real interest rates on new loans have been fluctuating below 4% since the start of this year
(percentages)

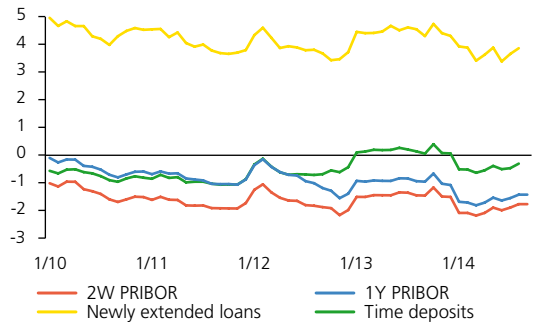
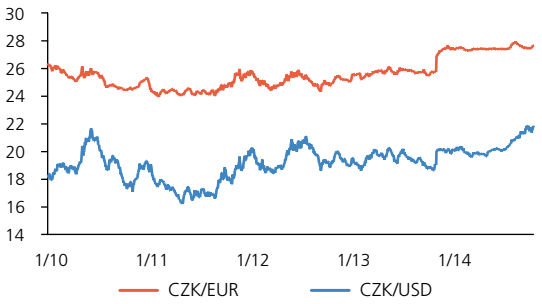


CHART III.5.19

CZK/EUR AND CZK/USD EXCHANGE RATES

The koruna weakened against the euro and especially against the dollar in 2014 Q3



Interest rates on client deposits were little changed in the period under review. Rates on overnight deposits stayed at 0.4% 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 and stably remunerated building society deposits, was also flat at 1.9%. Some banks have recently renewed their efforts to make rates on long-term household deposits with agreed maturity more attractive. This rate increased to 2.1% on average, while the rate on short-term deposits was 1% in August (see Chart III.5.17). The equivalent rates in the euro area decreased slightly and are currently generally lower than those in the Czech Republic.

Real client interest rates[53] increased slightly during 2014 Q3 owing to lower expected inflation, while nominal rates showed no major changes. Real rates on new loans were 3.9% on average in August, while real rates on time deposits were -0.3% (see Chart III.5.18).

III.5.4 The exchange rate

The average **exchange rate of the koruna against the euro** was CZK 27.6 in 2014 Q3. This represents a year-on-year depreciation of 6.8% and a quarter-on-quarter depreciation of 0.6% (see Chart III.5.19). The koruna remained at around CZK 27.4 against the euro at the start of the quarter, but started to weaken quite quickly in late July, to almost CZK 28 against the euro in mid-August. However, it then appreciated to CZK 27.5 against the euro at the end of September. It fluctuated around this level in the first three weeks of October.

Fairly large exchange rate movements were also observed in **world financial markets** in Q3. In particular, the US dollar (and to a smaller extent the Canadian dollar) and the renminbi appreciated sharply. European and Latin American currencies weakened, but the rouble depreciated much more strongly.

The koruna's exchange rate was affected by several **factors** in 2014 Q3. The main factor was the CNB's decision not to discontinue the use of the exchange rate as a monetary policy instrument before 2016. The second factor was the escalation of the conflict in the east of Ukraine, which led to the imposition of economic sanctions on Russia by the EU, the USA and some other countries and to retaliatory measures by Russia. The military conflict and sanctions exacerbated the adverse economic trends in Ukraine and Russia which had already been apparent before the conflict broke out. Less than 5% of Czech exports went to these countries in 2013. The escalating conflict also had a negative impact on monetary developments in other Central European countries due to their relatively significant trade ties. The

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

third factor was the downturn in economic growth in the euro area in Q2 and the related downward revision to the forecasts for economic growth in the euro area in 2014 and 2015, which, together with subdued inflation, resulted in a further easing of monetary policy by the ECB. Conversely, the published information from the domestic economy was essentially in line with financial market expectations and had little effect on the exchange rate. The exchange rate situation continued to require no actual foreign exchange market interventions by the CNB.

The average **exchange rate of the koruna against the dollar** was CZK 20.8 in 2014 Q3. This represents a year-on-year depreciation of 6.8% and a quarter-on-quarter depreciation of 4.1%. During the quarter, the koruna depreciated against the dollar from around CZK 20.0 to almost CZK 22.0 at the start of October. It then corrected slightly and fluctuated around CZK 21.6 to the dollar in late October.

III.5.5 Economic results of non-financial corporations

The **financial results** of non-financial corporations with 50 employees or more[54] were favourable again in 2014 Q2 (see Chart III.5.20). Corporations' output and sales maintained the high annual growth rate recorded in the previous quarter. Output continued to grow faster than intermediate consumption, although the difference between their growth rates narrowed further. This, in turn, was reflected in slowing annual growth in book value added, which, however, remained high (8.6%). Gross operating surplus (operating profit) also rose at a very strong pace in Q2. Its growth rate reached double figures (14.5% year on year) despite slowing compared to the previous quarter.

The continuing rapid – albeit slower – annual growth in the main financial indicators of non-financial corporations in 2014 Q2 was again due to several **factors**. The strong annual growth in sales and output was still due mainly to continuing growth in both domestic and external demand and to the weakened koruna exchange rate since November 2013. As mentioned in section III.3.2, however, the favourable effect of external demand weakened in 2014 Q2 and was partly offset by faster growth in domestic demand.

Prices of production inputs also affected the financial results of the monitored set of corporations. Although the exchange rate weakening was still reflected in the annual change in import prices of commodities and materials, the **material cost-output ratio**[55] fell again in 2014 Q2 (by 0.3 percentage point; see Table III.5.3), albeit to a noticeably smaller extent than in the previous quarter. The slowdown in the decline was due chiefly to manufacturing, where the annual

54 The segment of corporations with 50 employees or more consisted of 9,000 non-financial corporations at the end of 2014 Q2.

55 The material cost-output ratio defined as the ratio of intermediate consumption to output.

Chart III.5.20

KEY FINANCIAL INDICATORS

The main financial indicators of non-financial corporations continued to rise rapidly in 2014 Q2

(annual percentage changes)

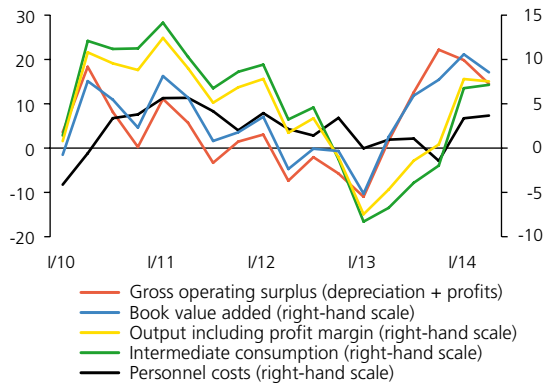


Table III.5.3

PERFORMANCE INDICATORS OF NON-FINANCIAL CORPORATIONS

The material cost-output ratio and the personnel cost-output ratio both decreased

	2013 Q2	2014 Q2	Annual percentage changes
Output incl. profit margin (CZK billions)[a]	1,364.8	1,467.5	7.5
Personnel costs (CZK billions)	205.6	213.2	3.7
Intermediate consumption (CZK billions)	990.4	1,061.1	7.1
Book value added (CZK billions)	374.4	406.4	8.6
Sales (CZK billions)	1,805.1	1,937.0	7.3
Gross operating surplus (CZK billions)	168.8	193.3	14.5
	Percentages	**Percentages**	**Annual changes in pp**
Ratio of personnel costs to value added[a]	54.9	52.4	-2.5
Material cost-output ratio	72.6	72.3	-0.3
Personnel cost-output ratio	15.1	14.5	-0.5
Ratio of book value added to output	27.4	27.7	0.3
Margin rate – ratio of gross operating surplus to value added (%)	45.1	47.6	2.5

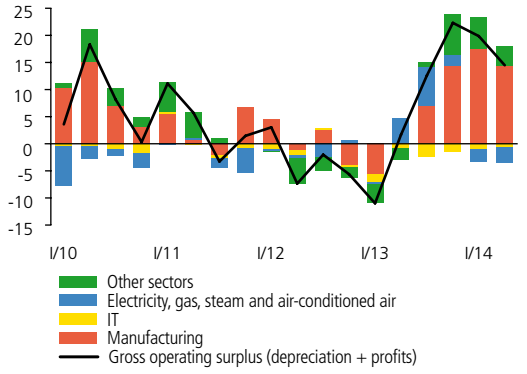
a) CNB calculation

CHART III.5.21

OPERATING PROFIT BY SECTOR

Corporations in manufacturing were the biggest contributor to the high growth in operating profit

(annual percentage changes; contributions in percentage points)



growth rate of intermediate consumption exceeded that of output in 2014 Q2. This was probably due to the temporarily renewed growth in world prices of oil, which was clearly reflected in producer prices in the manufacture of coke and refined petroleum products. The **personnel cost-output ratio**[56] also fell year on year (by 0.5 percentage point in 2014 Q2), even though personnel costs increased year on year. However, output grew at a considerably faster pace (see Table III.5.3).

The annual growth in sales, output and operating profit was due mainly to corporations in **manufacturing** (see Chart III.5.21), which generated more than 50% of the gross operating surplus in the monitored set of corporations with 50 employees or more. With regard to the **ownership structure of corporations**, this indicator was again affected above all by foreign-owned corporations, whose production is mostly export-oriented. Their share in the annual increase in operating profit within the same set of non-financial corporations was 60% in 2014 Q2.

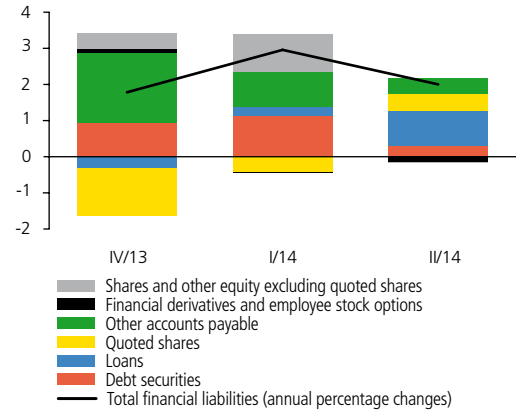
Data for the narrower **segment of large corporations**[57] (with 250 employees or more) indicate similar trends in the main financial indicators in 2014 Q2 as in the larger segment of corporations.

CHART III.5.22

FINANCIAL LIABILITIES OF NON-FINANCIAL CORPORATIONS

Growth in the financial liabilities of corporations slowed in 2014 Q2

(annual percentage changes; contributions in percentage points)



III.5.6 Financial position of corporations and households

In October 2014, the quarterly financial accounts statistics switched over to the new European **ESA 2010 methodology**. This methodological change entails a more detailed breakdown of selected instruments and sectors. In particular, the financial corporations sector is broken down into more subsectors. The statistics now also contain the instrument *Financial derivatives and employee stock options.* Owing to the methodological changes, data comparable over time are so far only available from 2012 Q4 onwards.

The annual growth rate of **financial liabilities of non-financial corporations** slowed in 2014 Q2 (see Chart III.5.22). This was due to a decline in the value of shares and other equity and also to lower growth in debt securities and other accounts payable. By contrast, the contribution of loans increased. Annual growth in the **financial assets of non-financial corporations** slowed to 7% in Q2. This was due mainly to loans and shares and other equity (changes in corporations' registered capital). The negative net financial position of non-financial corporations fell to 80% of GDP, with financial assets rising faster than financial liabilities. The net financial position of non-financial corporations is thus improving gradually.

56 The personnel cost-output ratio defined as the ratio of personnel costs to output.
57 The segment of corporations with 250 employees or more consisted of 1,700 non-financial corporations at the end of 2014 Q2.

Households are traditionally net creditors in the national economy. Their net financial position is stable at around 70% of GDP. Annual growth in the **net financial assets of households** accelerated to 6.7% in 2014 Q2. This increase represented 8.5% of the annual gross disposable income of households (see Chart III.5.23). Growth in gross **financial assets** also increased, to 5.6%. It was fostered mainly by currency and deposits, and especially transferable deposits. By contrast, the contribution of debt securities acted towards a slowdown in growth in financial assets. Growth in the **financial liabilities of households** slowed to 3.5% year on year on account of a smaller contribution of long-term loans and a larger negative contribution of short-term loans.

III.5.7 The property market

Asking prices of older apartments continued to rise in 2014 Q3, in line with the growth recorded in the first half of this year. Annual growth in these prices accelerated most of all in Prague according to both CZSO data (from 5.3% to 6.7%) and alternative data sources (from 4.6% to 7.6% according to the IRI; see Chart III.5.24). Asking prices of apartments also increased outside Prague, albeit more moderately. According to the CZSO, their year-on-year growth slowed from 2.6% to 2.4%. Asking price developments in regions outside Prague were still very mixed according to the IRI, with price changes ranging from -4.3% to 7.7% (2% on average). Compared to the previous quarter, however, the number of regions recording year-on-year price growth increased.

A property market recovery is also suggested by **transaction prices of apartments based on the CZSO survey** in 2014 Q2, which indicates a 2% year-on-year price increase both in Prague and outside Prague. Renewed moderate growth in transaction prices of apartments in 2014 following their decline in previous years is also confirmed by the alternative HB index data, according to which apartment prices in the Czech Republic saw an overall year-on-year rise of 1.3% in Q2. According to data from the CZSO survey, however, transaction prices of new apartments in Prague fell by 0.6% quarter on quarter, and year-on-year growth in these prices slowed by one-half (to 1.2%). Sales of new apartments in Prague continued to rise in 2014 Q3 (by 28% year on year). The share of apartments purchased for investment purposes increased to 30%.[58]

CHART III.5.23

STRUCTURE OF HOUSEHOLD FINANCIAL ASSETS

Growth in the net financial assets of households accelerated
(contributions in percentage points; annual percentage changes and percentage ratios)

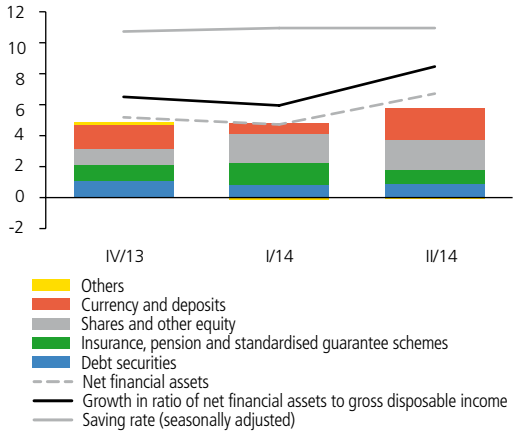
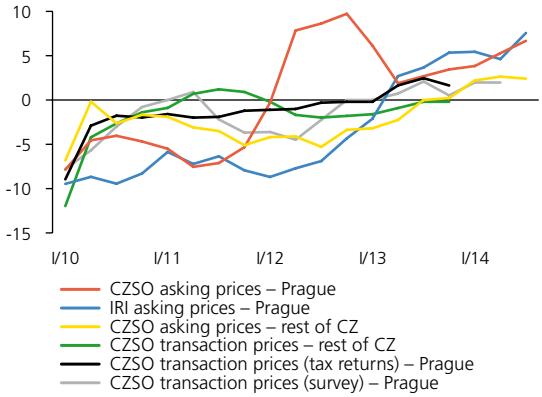


CHART III.5.24

TRANSACTION AND ASKING PRICES OF APARTMENTS

Property prices continued to rise both in Prague and in the rest of the Czech Republic
(annual percentage changes; source: CZSO, Institute for Regional Information)

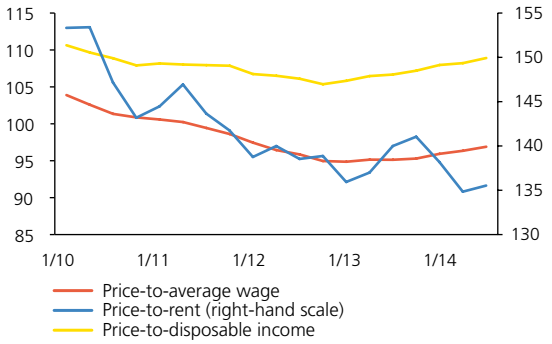


58 Harmonised data from property developers Ekospol, Skanska Reality and Trigema. These data are currently the only available information on transactions, as earlier COSMC data on the number of entries of proceedings ceased to be published at the end of 2013 due to legislative changes. Publication is expected to resume by the end of 2014.

CHART III.5.25

APARTMENT PRICE SUSTAINABILITY INDICATORS

Property price sustainability indicators rose slightly in 2014 Q3
(2000–2007 average = 100; source: CZSO, Institute for Regional Information)



Property price sustainability indicators rose slightly in 2014 Q3 in response to the price recovery (see Chart III.5.25). The indicators of housing affordability,[59] i.e. the **price-to-average wage ratio** and the **price-to-disposable income ratio**, recorded quarter-on-quarter growth of 0.5 and 0.7 percentage point respectively, up by 2.1 and 3.4 percentage points from the lows reached in late 2012. The **price-to-rent ratio** rose by 0.7 percentage point but is at relatively low levels. However, the evolution of this indicator is relatively mixed across regions. In Prague it continued to decrease (by 1.5% quarter on quarter) despite the relatively strong growth in prices, but in the rest of the Czech Republic it rose by 3.5% on average.

Overall, the property market developments are in line with the gradual growth in domestic economic activity. The property market recovery can be seen as a correction of the previous relatively sizeable decline. Property prices are increasing, with asking prices of apartments rising faster than transaction prices at this stage. Like other methods, the property price sustainability indicators still suggest no marked overvaluation of property prices. Moderate growth in property prices can still be expected to continue in the rest of 2014 and 2015, owing to the economic recovery, rising wages and easy monetary conditions.

59 In the calculation of the housing affordability indicators for 2014 Q3, the increase in apartment transaction prices was proxied by growth in asking prices according to the CZSO. The historical data on the price-to-disposable income ratio were revised following the switch to ESA 2010.

III.6 BALANCE OF PAYMENTS[60]

In 2014 Q2, the balance of payments was characterised by a very high primary income deficit, linked mainly with direct investment income in the form of 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 goods surplus. On the financial account, portfolio investment recorded a large net outflow, owing mainly to repayments of residents' bonds issued on foreign markets. However, this outflow was outweighed by a net inflow of capital in the form of direct and other investment.

III.6.1 The current account

Following a high surplus in 2014 Q1, the **current account** recorded a deficit of CZK 29.6 billion in Q2. In year-on-year terms, the deficit widened by more than CZK 18 billion. The increase in the overall deficit was related mainly to the evolution of primary income (formerly the income balance; see Chart III.6.1). The annual moving current account total turned into a deficit again in Q2. The annual moving ratio of the current account to GDP reached -0.2%, down by 0.4 percentage point from Q1, when it had been positive.

The **goods** surplus amounted to CZK 69.5 billion in Q2, up by almost CZK 11 billion on a year earlier. The rise in the trade surplus was due solely to price developments associated with a positive year-on-year change in the terms of trade, one-half of which was offset by a decline in the balance in real terms. Annual growth in nominal trade turnover slowed compared to the previous quarter, but remained in double figures. As in the previous quarter, it was supported mainly by developments in real terms. The moderation of trade turnover growth was linked chiefly with slower growth in goods exports (down to less than 13% year on year) as a result of slower growth in demand in the Czech Republic's main trading partner countries. On the other hand, export growth continued to be supported by the weakening of the koruna. The acceleration in total domestic demand combined with the weaker koruna led to further rapid nominal growth in goods imports, in particular a very strong increase in imports for investment purposes.

60 For the first time, the data in the text are based on data compiled according to the new balance of payments manual (BPM6). This is the IMF's new international standard for the balance of payments and introduces several major changes compared to the previous methodology. First, the names of many items have been changed (for example, the trade balance has been renamed the goods balance and the income balance is now the primary income balance). Second, the use of signs on the financial account has been modified: as in the international investment position, the minus sign is now also used for a net increase in residents' liabilities to non-residents in the context of direct investment, and the plus sign is now used for a net increase in residents' claims on non-residents. Third, some material changes have been made in the balance of payments. For example, processing and repairs have been moved from the trade balance to the services balance, charges for the use of intellectual property have been transferred from the capital account to the services balance, and changes in the central bank's international reserves are now included in the financial account under reserve assets.

Chart III.6.1

CURRENT ACCOUNT

The current account switched from surplus to deficit in 2014 Q2, due mainly to an increase in the primary income deficit
(CZK billions)

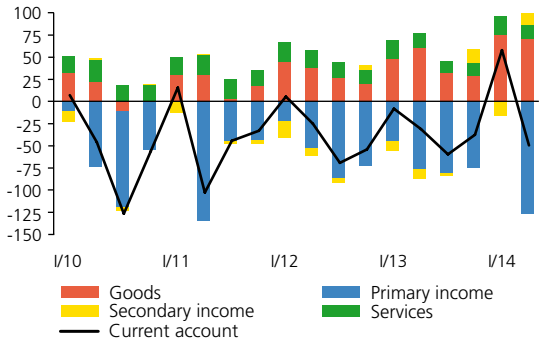


Chart III.6.2

EXTERNAL TRADE IN GOODS

The year-on-year growth in the surplus on external trade in goods was affected most strongly in 2014 Q2 by an increase in the machinery surplus
(Q2 of relevant year in CZK billions; national concept)

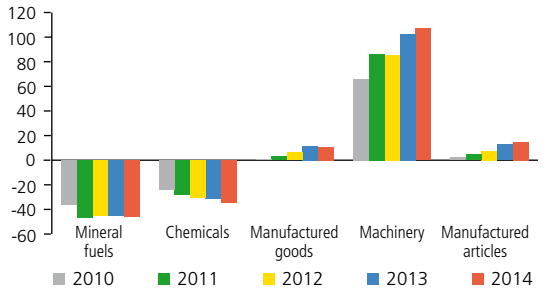


Chart III.6.3

SERVICES

Travel, manufacturing and repair and transport contributed to the services surplus in 2014 Q2
(CZK billions)

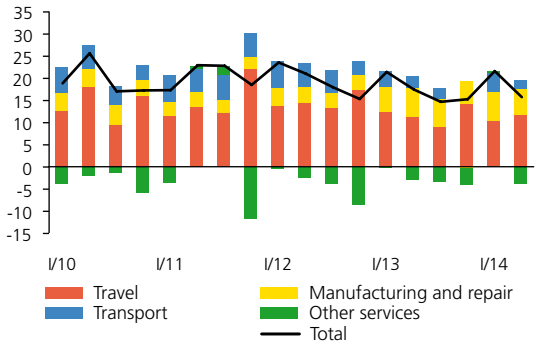


CHART III.6.4

PRIMARY INCOME

Within primary income, the investment income deficit increased significantly in 2014 Q2
(CZK billions)

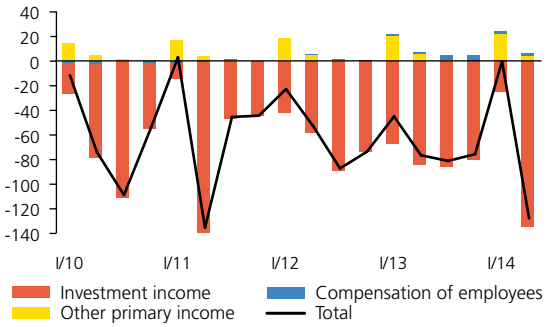


CHART III.6.5

FINANCIAL ACCOUNT

The financial account switched from net lending to net borrowing in 2014 Q2, primarily due to a change of flows in other investment
(CZK billions)

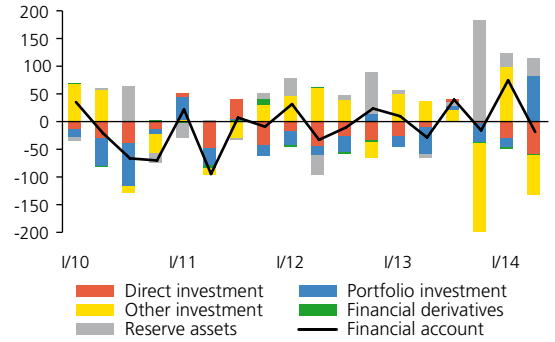
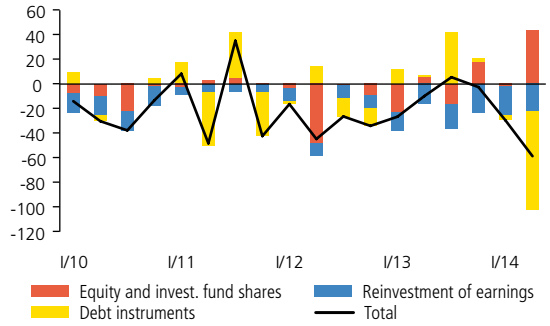


CHART III.6.6

DIRECT INVESTMENT

Debt instruments contributed the most to net borrowing from direct investment in 2014 Q2
(CZK billions)



Turning to the commodity structure, growth in the machinery and transport equipment surplus was the biggest contributor to the year-on-year rise in the overall surplus (see Chart III.6.2). The total surplus continued to rise year on year during 2014 Q3, growing by CZK 9 billion for July to August.

The **services** surplus reached CZK 15.7 billion in Q2 (see Chart III.6.3). This represents a slight year-on-year decrease. The services surplus was due mainly to a surplus on travel (CZK 11.7 billion). Production and repair services also ended in a slight surplus, as did transport. Unlike in 2014 Q1, other services recorded a moderate deficit, owing chiefly to deficits on charges for the use of intellectual property and insurance services. Other services also contributed to the year-on-year decrease in the overall services surplus, mainly on account of a sharp rise in expenditure on business services.

In contrast to the goods and services surplus, **primary income** (formerly the income balance) showed a deficit of CZK 128 billion in 2014 Q2, up by more than CZK 51 billion year on year owing to rapid growth in debits. The largest component of the overall balance was the investment income deficit (see Chart III.6.4), stemming mainly from a direct investment deficit of CZK 125 billion. 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 primary income deficit was also due above all to direct investment income, especially dividends. Portfolio investment income also recorded a deficit, mainly as a result of interest on debt securities paid to non-residents. By contrast, slight surpluses were recorded by compensation of employees, other investment income and other primary income, associated with transfers from the EU budget.

Secondary income (formerly current transfers) recorded a surplus of CZK 13.3 billion in Q2, up by almost CZK 24 billion on a year earlier. Its biggest component was a surplus on current international cooperation (CZK 26.1 billion), linked primarily with net drawdown of funds from the EU budget. The year-on-year rise in the overall balance was also mostly due to higher credits in this item. By contrast, the Czech Republic's payments to the EU budget fostered a moderation of the overall surplus.

III.6.2 The capital account

The **capital account** also recorded a surplus, although only a very modest one in this quarter (CZK 0.7 billion) owing to the absence of significant drawdown of funds from the EU budget. In year-on-year terms, the surplus decreased by more than CZK 3 billion as a result of a faster decline in credits than in debits.

III.6.3 The financial account[61]

The **financial account** recorded a net inflow of capital totalling CZK 18.5 billion in 2014 Q2, due above all to inflows of direct and other investment. Portfolio investment and the (newly included) increase in reserve assets fostered a moderation of the overall capital inflow (see Chart III.6.5).

Direct investment recorded a net capital inflow of CZK 58.6 billion in 2014 Q2 (see Chart III.6.6), up by almost CZK 49 billion on a year earlier. Czech investment abroad was driven mostly by repayments of loans by foreign firms to domestic companies, in particular a considerable reverse investment between affiliated energy firms. The net inflow of direct investment into the Czech Republic was affected most strongly by loans accepted. By contrast, a drop in equity capital in energy firms fostered a moderation of the inflow.

Unlike in the previous two quarters, **portfolio investment** recorded a high outflow totalling CZK 81.5 billion in 2014 Q2 (see Chart III.6.7). The largest operations were repayments of government and corporate bonds issued on foreign markets. By contrast, purchases slightly dominated trading in domestic shares. The higher outflow of portfolio investment was also due to purchases of foreign securities by domestic investors, especially investment fund shares and units. The year-on-year change in portfolio investment of almost CZK 130 billion amid a switch from capital inflow to outflow was caused by this year's repayments of bonds issued abroad. Last year, by contrast, new bonds had been issued on foreign markets.

Settlement of **financial derivatives and employee stock options** led to net borrowing of CZK 0.5 billion, representing a very slight year-on-year decrease.

Other investment recorded a net inflow of CZK 73.7 billion, linked primarily with an increase in short-term foreign deposits at domestic monetary financial institutions. Short-term loans provided by monetary financial institutions to non-residents, repayments of long-term loans from non-residents by the government and corporations, and a rise in trade credits extended to foreign customers acted in the opposite direction. The marked year-on-year change in other investment flows – exceeding CZK 110 billion – was due chiefly to currency and deposits.

Reserve assets increased for the fourth consecutive quarter. In 2014 Q2 they grew by CZK 32.8 billion (see Chart III.6.8) due to a surplus on transactions executed for CNB clients.

CHART III.6.7

PORTFOLIO INVESTMENT

Portfolio investment recorded high net lending (net capital outflow) in 2014 Q2 due mainly to repayments of bonds to non-residents
(CZK billions)

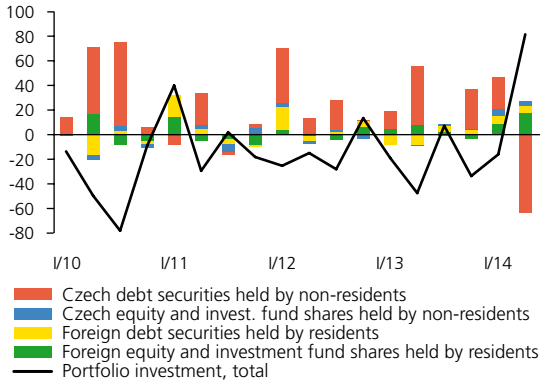
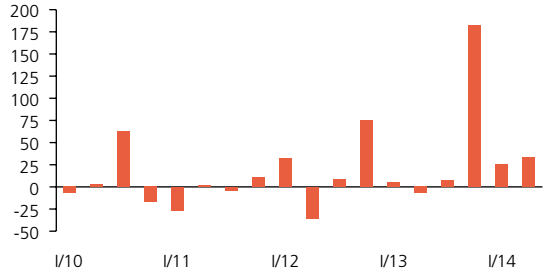


CHART III.6.8

CNB RESERVE ASSETS

Reserve assets increased further in 2014 Q2 due to transactions for clients
(changes in CZK billions)



61 In the text on the financial account, several terminological changes pertaining to individual items have arisen under BPM6. The term "net acquisition of financial assets" is newly used on the asset side and "net incurrence of liabilities" is newly used on the liabilities side. A positive value is now used for a rise in both net acquisition of assets and net incurrence of liabilities; conversely, a negative value is used for a drop in both net acquisition of assets and net incurrence of liabilities. The balances are calculated as the difference between net acquisition of assets and net incurrence of liabilities. A positive result represents "net lending" (formerly a net capital outflow) and a negative result "net borrowing" (formerly a net capital inflow).

III.7 THE EXTERNAL ENVIRONMENT

In 2014 Q2 the euro area economy recorded a slowdown in year-on-year growth and quarter-on-quarter stagnation, owing mainly to a contraction of the German and Italian economy. Subdued growth is also expected in 2014 Q3. In September, the ECB reacted to the very low inflation and persisting disinflation pressures by lowering its interest rates again and introducing measures to further ease monetary policy. By contrast, satisfactory developments in the US economy allowed the Federal Reserve to continue tapering its stimulus measures. The opposite trends in monetary policy in the euro area and the USA caused the euro to weaken, which it is also expected to do going forward. The strong dollar is pushing down commodity prices. However, commodity prices also fell as a result of rapid supply growth at a time of weakening growth in the global economy.

III.7.1 The euro area

The annual growth rate of **euro area GDP** decreased in Q2 (from 1% in Q1 to 0.7%; see Chart III.7.1). This was a result of a negative contribution of net exports and a lower contribution of gross fixed capital formation; by contrast, the positive contributions of households and the government to GDP growth increased by comparison with the previous quarter. In quarter-on-quarter terms, euro area GDP was unchanged following four consecutive quarters of growth (0.2% in Q1).[62] The halt in quarter-on-quarter growth in the euro area was due to developments in the three largest economies – GDP contracted in Germany and Italy and continued to stagnate in France. By contrast, Spain, the Netherlands and Portugal recorded relatively strong economic growth. The slowdown in euro area economic growth can partly be explained by temporary and technical factors (a mild winter in Q1 and the timing of holidays) and geopolitical tensions. Nevertheless, a cyclical slowdown is apparent in the economy. This was also observed in the monthly indicators for 2014 Q2.

The available **coincident and leading indicators** for 2014 Q3 point to continuing muted developments in the euro area. Construction output saw a month-on-month increase of more than 1% in August, as did retail sales. However, industrial production dropped significantly in August (by 1.8% month on month) after rising in July, owing mainly to developments in German industry. The PMI in manufacturing declined to a 14-month low (50.3),[63] with the new orders component decreasing for the first time in more than a year. The ZEW economic sentiment indicator is also on the verge of stagnation. The monitored outlooks for euro area GDP growth have been revised downwards, pointing to

CHART III.7.1

GDP IN THE EURO AREA

A year-on-year decline in net exports and a slowdown in fixed investment growth contributed to the slowdown in annual GDP growth

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

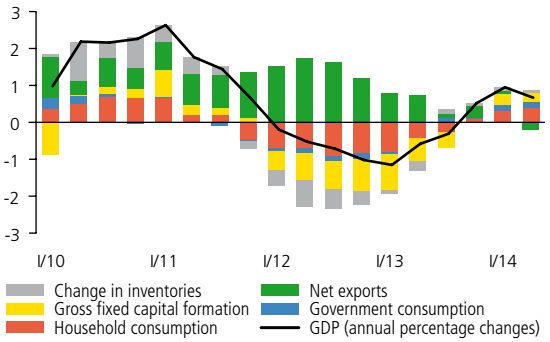
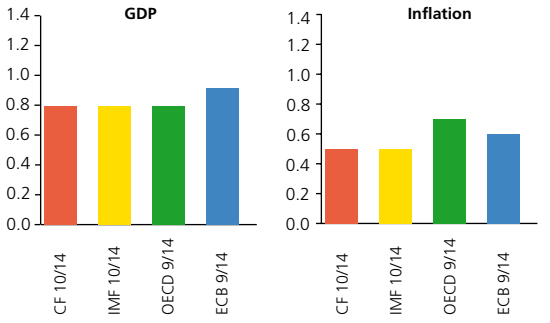


CHART III.7.2

EURO AREA GDP AND INFLATION OUTLOOKS FOR 2014

Euro area GDP growth is expected to be just below 1% in 2014, while inflation is expected to remain very 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.

62 Quarterly GDP growth was fostered by household consumption; on the other hand, the contribution of investment (both fixed investment and inventories) was negative. The contribution of government consumption was neutral. Net exports had a positive impact on GDP growth, as export growth accelerated and import growth slowed compared to 2014 Q1.

63 According to a flash estimate, the euro area PMI in manufacturing rose to 50.7 in October.

euro area growth of around 0.8% this year (see Chart III.7.2). Next year it is expected to pick up pace by almost 0.5 percentage point.

Euro area HICP inflation has been below 1% for a year and fell to 0.3% in September, the lowest level since October 2009 (see Chart III.7.3). The decline in inflation was due chiefly to a negative contribution of energy commodity prices and a drop in the positive contribution of other consumer basket items except food prices. The inflation outlook is also low – inflation is expected to reach only about 0.5% this year and approach 1% next year. Its levels will be affected by weak domestic and external demand and lower energy prices, while a weaker euro and accommodative ECB monetary policy will act in the opposite direction.

At its September meeting, the **ECB** reacted to the long-running muted inflation by lowering its key interest rates by 10 basis points: the minimum bid rate on the main refinancing operations of the Eurosystem to 0.05%, the rate on the deposit facility to -0.2% and the rate on the marginal lending facility to 0.3%. In addition, two private sector asset purchase programmes were unveiled: an asset-backed securities purchase programme (ABSPP), which will be launched in 2014 Q4, and an additional financial sector covered bond purchase programme (CBPP3). The first round of CBPP3 was launched on 20 October. September also saw the launch of the first round of targeted longer-term refinancing operations (the TLTRO programme introduced on 5 June 2014). Their take-up was well below market expectations. However, some banks might prefer the next round (in December 2014), owing among other things to the completion of the Asset Quality Review (AQR) and the euro area bank stress test by the ECB. The resilience of 130 euro area banks was tested using data as of 31 December 2013. According to the results published on 26 October 2014, 25 of the banks examined failed the tests; 12 of these have already sufficiently increased their capital during 2014 above the level required in the adverse scenario assumed. In addition, the Asset Quality Review revealed that the book value of the assets of the banks tested was overstated to the tune of EUR 48 billion. Based on the harmonised classification of non-performing loans (NPLs), the volume of NPLs was increased by EUR 136 billion to EUR 879 billion.

In 2014 Q2 the **German economy** contracted by 0.2% quarter on quarter following growth of 0.7%. The annual growth rate fell by 0.9 percentage point to 1.3% (see Chart III.7.4). This was due to weaker growth in household consumption, fixed investment and net exports. The economic downturn in 2014 Q2 was caused by a very warm winter, which led to a shift of economic activity, especially investment, from Q2 to Q1. Other factors included a slowdown in growth in some key target countries for German exports and the military and political crisis in Ukraine.

The **October CF** expects stagnation or only weak quarterly economic growth in 2014 Q3. The Bundesbank published a similar outlook for 2014 H2. The German government and leading German economic

CHART III.7.3

INFLATION AND PRODUCER PRICES IN THE EURO AREA

Inflation went down further in 2014 Q3 compared to the previous quarter, while producer prices continued to decline
(annual percentage changes; source: Datastream)

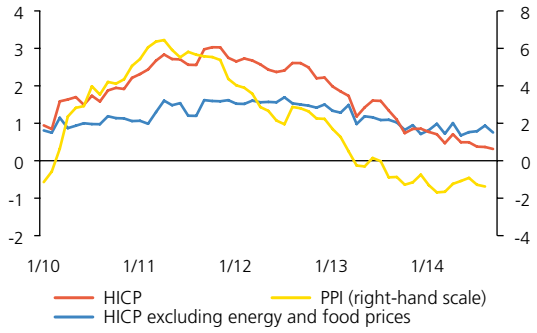
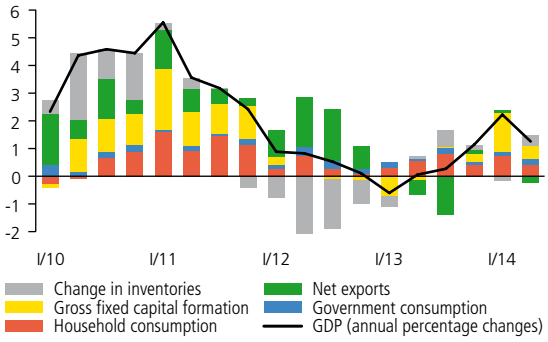


CHART III.7.4

GDP IN GERMANY

The rate of economic growth fell significantly in 2014 Q2 due to weaker growth in household consumption, fixed investment and net exports
(annual percentage changes; contributions in percentage points; seasonally adjusted; source: Datastream)



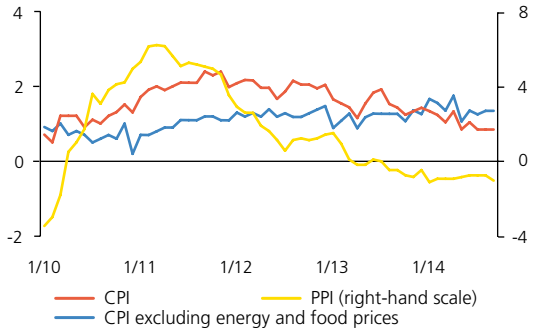
institutes are even more pessimistic, predicting a slight quarterly decline in GDP in this period. The negative outlook for 2014 Q3 is also supported by a marked deterioration in industrial production growth in the first two months of 2014 Q3[64] (month-on-month contraction and year-on-year stagnation) compared to 2014 Q2. Leading indicators mostly decreased. The PMI in industry rose to 51.6 in September, but only after dropping below 50 in August. By contrast, retail turnover increased in July and August, employment rose for the sixth consecutive quarter (by 0.8%), the unemployment rate stayed at 4.9%, the number of vacancies rose further and real wages will go up by roughly 2% this year, so strong growth in household consumption can be expected. By comparison with July, the October CF also lowered its whole-year GDP growth estimates from 2% in both 2014 and 2015 to 1.4% and 1.5% respectively. The German government made an even more pronounced downward revision to its economic growth prediction, to 1.2% and 1.3% respectively.

Chart III.7.5

INFLATION AND PRODUCER PRICES IN GERMANY

Inflation remained at 0.8% for the third consecutive month in September, while industrial producer prices continued to fall noticeably

(annual percentage changes; source: Datastream)



Inflation in Germany remained at 0.8% for the third consecutive month in September (see Chart III.7.5). Stronger growth in food prices was offset by a sharper decrease in energy prices. Core inflation stayed at 1.3%. According to the October CF, inflation will rise to 1.2% in 2014 Q4 and accelerate further in 2015, converging to the 2% level from below.

The **Slovak economy** maintained high quarterly and annual rates of GDP growth in 2014 Q2 (0.6% and 2.4% respectively). A decline in net exports, caused mainly by a decrease in demand for Slovak exports in the euro area, was offset by a rise in domestic demand. The rapid economic growth was accompanied by a drop in the unemployment rate, which fell by 1.1 percentage points year on year to 13.3% in July, and a rise in employment of 0.5% in 2014 Q2. The October CF expects quarterly and annual GDP growth in the rest of this year to be roughly at the level recorded in 2014 H1. Economic growth is expected to be 2.5% in 2014 as a whole and increase to 2.9% in 2015 owing to stronger growth in domestic demand.

The decline in **consumer prices** in Slovakia, observed for the fourth consecutive month, moderated somewhat in September (to -0.1%). The negative inflation rate was due mainly to falling food and energy prices. The October CF further reduced its estimate of average inflation to 0.1% for 2014 as a whole. Consumer price inflation is expected to accelerate to 1.4% next year.

64 These two months should be analysed together, as the timing of school holidays – and in turn also employees' holidays – shifted significantly in Germany this year, so the numbers of days worked in July and August changed considerably. These shifts (a rise in July and a drop in August) affected the automotive industry in particular.

BOX 3
The impacts of the military and political crisis in Ukraine on the Czech Republic

This box discusses the estimated impacts of the **military and political crisis in Ukraine** on the Czech Republic. First, we quantify the immediate direct impacts of the drop in foreign trade with Ukraine and Russia caused by the trade sanctions that have already been adopted. In addition, the NiGEM global economic model is used to simulate the effects of a hypothetical sharp decrease in Russian imports in order to more broadly quantify the economic impacts on the Czech Republic if the economic and political situation deteriorates further.

Foreign trade turnover with Russia and Ukraine accounted for 4.5% and 0.8% respectively of the Czech Republic's total foreign trade in 2013. The escalation of tensions between the West and Russia, which has resulted in mutual trade restrictions,[65] may have an adverse effect in the shape of a drop in Czech machinery exports to both countries and possibly also a decline in tourism revenues. On the import side, this would necessitate a re-direction of supplies and an increase in imports of oil, gas, iron ore and semi-finished products from alternative territories. The **immediate direct impact** of the EU's trade sanctions against Russia and the Russian sanctions on food imports can be expected to be insignificant from the macroeconomic perspective (but may be sizeable for individual corporations or sectors). The drop in exports will not exceed CZK 1 billion in 2014 and will stay below CZK 2 billion in 2015.

The impact of the Ukraine conflict on the Czech economy was further simulated using the **NiGEM global economic model**, assuming a hypothetical decline in Russian real imports of 20% for one year (from 2014 Q4 to 2015 Q3). In addition to trade sanctions, the drop in imports may stem from lower growth of the Russian economy and depreciation of the rouble (see Charts 1 and 2). According to the simulation, this negative demand shock would adversely affect the Czech economy not only via the direct trade channel, but also indirectly through a negative impact on the euro area, whose growth would be 0.2 percentage point slower in 2015 as a result. The effect on euro area inflation would not materialise until 2016, when price growth would be 0.1 percentage point lower. The effect on oil prices and the dollar-euro exchange rate would be almost negligible. The Czech economy would also record

CHART 1 (BOX)

GDP AND INFLATION OUTLOOKS FOR THE RUSSIAN FEDERATION FOR 2014 ACCORDING TO CF

The outlooks for the Russian economy have been worsening as a consequence of increasing tensions in Ukraine and subsequent sanctions
(annual percentage changes)

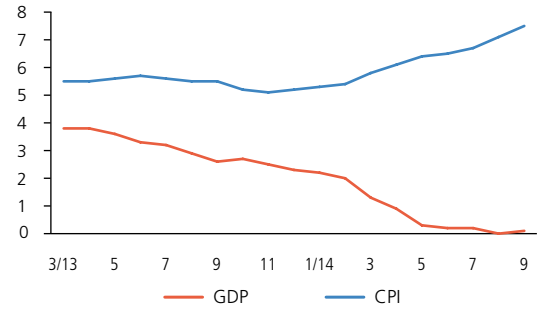
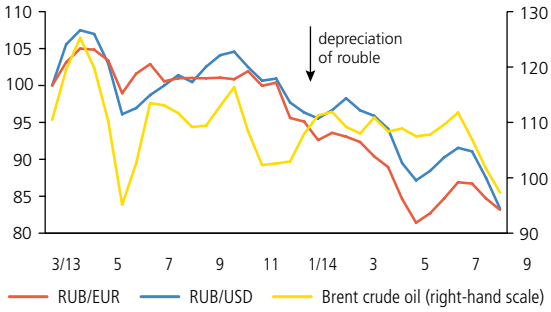


CHART 2 (BOX)

EXCHANGE RATE OF THE ROUBLE AGAINST USD AND EUR AND BRENT CRUDE OIL PRICES

Capital outflows from the Russian Federation and a fall in the oil price have caused the rouble to weaken
(January 2012 = 100; right-hand scale: USD/barrel)



65 In the third phase of the EU's sanctions against Russia in September 2014, restrictions on trade in weapons, exports of dual-use goods and technology and exports of technology for the oil industry and related sectors were adopted (relating to new contracts only, not existing ones).

TABLE 1 (BOX)

SIMULATION OF THE EFFECT OF LOWER RUSSIAN IMPORTS ON THE CZECH REPUBLIC IN THE NiGEM MODEL

A drop in Russian imports of 20% lasting one year has no substantial impact on the Czech economy
(percentage points)

	2015	2016
GDP	-0.4	0.1
CPI	0.0	-0.1
3M PRIBOR	-0.1	-0.1

slower growth in 2015 (by 0.4 percentage point), followed by a slight acceleration in 2016 (see Table 1). As in the euro area, the effect on inflation would be negligible. The 3M PRIBOR would be slightly lower.[66]

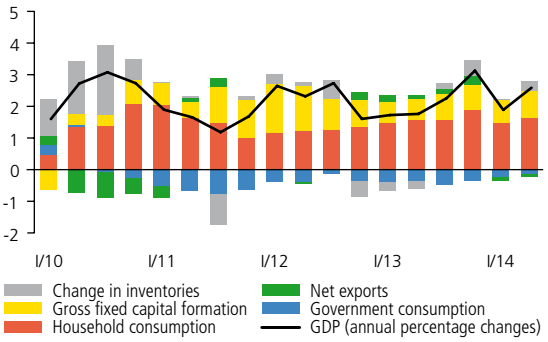
In the event of a permanent shock to Russian imports of the same magnitude (a 20% decrease), the impact on the Czech Republic in the near future would be comparable to that in the one-year shock scenario. Differences between the two scenarios are visible only in the longer term – the effects of the permanent shock do not fade away quickly in 2016, but decrease only gradually over a longer period of time. In such case, Czech GDP would then slow in 2015 to roughly the same extent as in the previous scenario and would be 0.1 percentage point lower year on year in 2016 (compared to growth of 0.1 percentage point in the one-year shock scenario). The impact on inflation would remain negligible. A slightly larger effect would be observed for the 3M PRIBOR in 2016 (towards a lower level).

III.7.2 The United States

CHART III.7.6

GDP IN THE USA

GDP growth picked up pace again in 2014 Q2
(annual percentage changes; contributions in percentage points; seasonally adjusted; source: Datastream)



After slackening in 2014 Q1, annual **economic growth in the USA** picked up pace to 2.6% in 2014 Q2. Household consumption and gross capital formation were the biggest contributors to annual growth in 2014 Q2, whereas net exports and government consumption had a roughly neutral effect (see Chart III.7.6). Real exports and real imports rose at approximately the same pace (3.9% and 3.8% respectively). In quarter-on-quarter terms, GDP growth increased considerably to 4.4% (annualised) in Q2. The annual cumulative current account deficit stabilised at 2.3% of GDP in 2014 Q2. Similarly, the annual cumulative government deficit was flat at around 3.1% of GDP for the third consecutive quarter.

Industrial production developed favourably in 2014 Q3. Its year-on-year growth edged up further to 4.4%. Although the PMI in industry fell slightly in September, it remains in the expansion band. The Michigan Consumer Sentiment Index improved further in October, rising for the fourth consecutive month. By contrast, the consumer confidence index (Conference Board) fell in September. However, consumer confidence is still close to its medium-term highs. In 2014 Q3 as a whole, retail sales at current prices increased by 4% (annualised) compared to the previous quarter. This also indicates a continued favourable trend in the consumer sector, aided by a falling unemployment rate (5.9% in September).

66 This simulation does not take into account the existence of the zero lower bound on interest rates. The scenario from the g3 core prediction model which takes into account the aforementioned impact of a 20% drop in Russian real imports on foreign variables implies very similar second-round effects on the Czech economy.

The US **GDP growth outlook** for 2014 is favourable compared to other advanced countries. Annual GDP growth was 2.2% in 2014 H1 and the same rate of growth is expected in the rest of the year (see Chart III.7.7). The economy is expected to pick up pace further by around 1 percentage point in 2015.

Annual **consumer price inflation** is expected to stay below the Fed's target of 2%. According to CF, moreover, inflation expectations fell further in October. As in the previous month, consumer prices rose by 1.7% year on year in September. Annual growth in industrial producer prices slowed in September (see Chart III.7.8), recording a month-on-month decrease for the second consecutive month. The lower inflation pressures are stirring up a discussion about the Fed postponing its first interest rate hike, which is currently expected to happen in mid-2015 based on outlooks implied by market yield curves. The expected ten-year yield fell slightly at the one-year horizon, suggesting that the monetary policy tightening may not be that fast.

The **Federal Reserve** decided at its October meeting to completely terminate its MBS and long-term government bond purchases. It had published the principles of the switch to standard monetary policy back in September. According to those principles, the Fed will reduce the asset holdings in its balance sheet some time after the first key interest rate hike by ceasing to reinvest the principal repayments.

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

In 2014 Q3, the **exchange rate of the euro against major world currencies** continued to be affected by the monetary policy settings in advanced economies. The euro continued to depreciate markedly against the US dollar, breaking through the USD 1.26 level at the end of September. This represents a year-on-year weakening of more than 6%. The depreciation was due to a further easing of monetary policy by the ECB, not only in the form of lower key rates, but also in the form of two programmes of purchases of selected securities. Continuing subdued growth and inflation in the euro area is confirmed by many indicators, whereas the outlook for the US economy has improved further. As a result of the favourable evolution of the US economy and persisting geopolitical risks, the US dollar also appreciated against other major world currencies and most emerging country currencies in 2014 Q3.

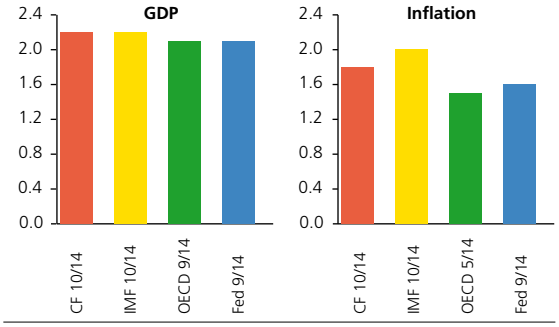
The euro weakened against the **British pound** in 2014 Q3, whereas its exchange rate vis-à-vis the Japanese yen showed no clear trend. The pace of recovery in the United Kingdom in 2014 H1 was a positive surprise, with economic growth being fostered chiefly by services and construction. In August, however, annual inflation fell unexpectedly to the lowest level in five years (1.2%), so expectations of a monetary policy tightening shifted to 2015 H2. By contrast, the growth outlook for the Japanese economy was revised downwards. Even a weaker

Chart III.7.7

US GDP AND INFLATION OUTLOOKS FOR 2014

Relatively rapid GDP growth is expected 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

Consumer price inflation fell to 1.8% in 2014 Q3

(annual percentage changes; source: Datastream)

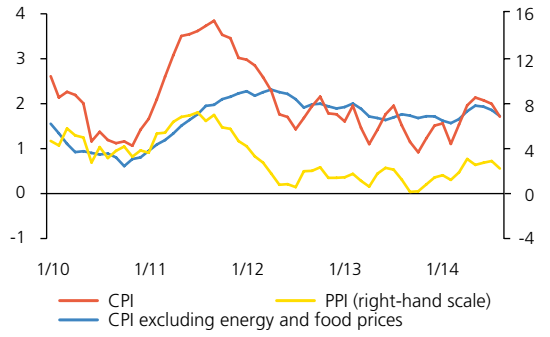


CHART III.7.9

EURO EXCHANGE RATE AGAINST MAJOR CURRENCIES

The euro depreciated further against major world currencies in 2014 Q3

(January 2010 = 100; source: Datastream, outlook from CF)

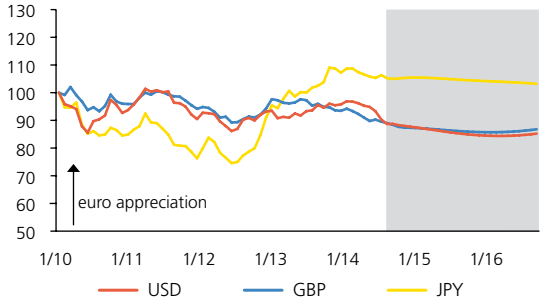


CHART III.7.10

OIL AND NATURAL GAS PRICES IN USD

The oil price dropped significantly between mid-June and mid-October 2014, and prices of long-term natural gas contracts should also fall with a lag

(oil in USD/barrel; natural gas [Russian in Germany] in USD/1,000 m³ – right-hand scale; source: IMF, Bloomberg, CNB calculation)

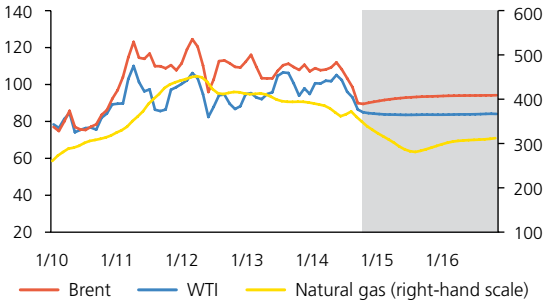
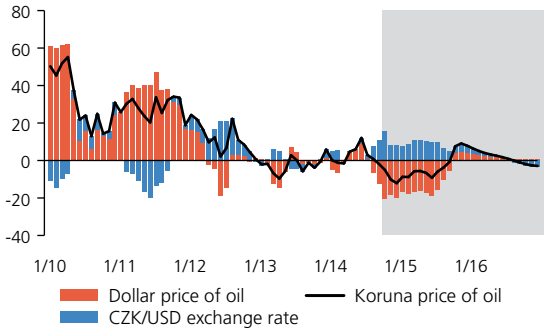


CHART III.7.11

DECOMPOSITION OF KORUNA OIL PRICE GROWTH

The fall in dollar prices of oil is partly offset by depreciation of the koruna against the dollar

(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)



yen-dollar rate failed to provide significant support for industrial production and exports, while domestic demand remained subdued.

In the first half of October 2014, the euro strengthened slightly against major world currencies. Concerns of a downturn in global economic growth increased, causing a rise in risk aversion and a drop in the yields on German and US government bonds.

At the one-year horizon, the **October CF** expects the euro to depreciate by 4% against the US dollar and by 3.7% against the British pound. However, the euro should remain stable against the Japanese yen (see Chart III.7.9).

III.7.4 Prices of oil and other commodities

The current rapid downward trend in oil prices has been ongoing since mid-June 2014. The average monthly **Brent crude oil price** fell from USD 112 a barrel in June to USD 98.6 a barrel in September (see Chart III.7.10). It has now fallen below USD 90 a barrel for the first time in 27 months (and for only the second time since February 2011). The price decline is mainly due to rapid extraction growth in North America and renewed supplies from Libya, slackening demand in the euro area, Japan and China, and to appreciation of the US dollar over the entire period mentioned above. The price decline accelerated further in the first half of October, when it became clear that most OPEC members were not intending to curb production in response to the low prices in order to avoid losing market share. In mid-October the price of Brent crude oil levelled out at around USD 85 a barrel.

This raises the question whether the current **oil price decline** is temporary or longer-lasting. OPEC representatives were only recently claiming that the price decline was seasonal and would fade away once the autumn maintenance in refineries ahead of the winter season had been completed. However, representatives of Saudi Arabia have said that they are not intending to curb production and would not be troubled by prices falling close to USD 80 a barrel for a year or two. Most OPEC countries have followed suit in an effort to maintain their shares on the oil market. Thus, a definitive answer probably will not become clear until the regular OPEC meeting on 27 November, which some analysts believe could lower extraction limits, leading to an oil price recovery. However, production might also be limited in North America, where some oil sands and shale facilities could become unviable at a low oil price. Low oil prices might also stimulate stronger growth in demand, which would also contribute to renewed market equilibrium.

Although the average monthly dollar price of Brent crude oil fell by 19.7% between June 2014 and the first half of October 2014, the **decrease in the average koruna price of oil** (13.5%) was roughly one-third lower on account of the weakening of the koruna against the dollar (see Chart III.7.11).

The **market outlook** for Brent prices expects a gradual rise from the current level to around USD 94 a barrel in late 2016. This is markedly lower than the EIA forecast (USD 102 a barrel in 2015) and the October CF estimate (USD 99.4 a barrel at the one-year horizon). The EIA also lowered its estimate of the average WTI discount to Brent for 2015 from USD 10 to USD 7 a barrel.

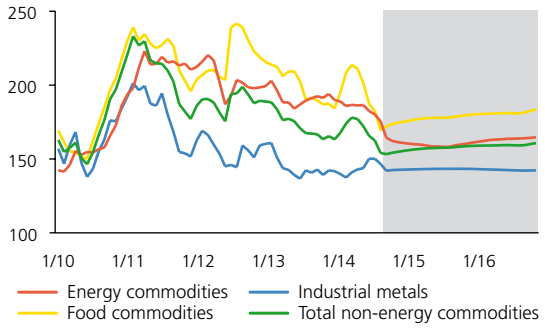
Most US refineries do not have technology optimised for **processing light WTI oil**, so they mix this oil with heavier, mostly imported, types of crude. The current rapid growth in extraction of domestic light oil is causing imports of this oil type to decrease. The decrease in oil imports to the USA therefore consists mainly in a decline in light oil imports, whose share in total imports is gradually approaching zero. Unless the USA approves exports of crude oil, this phenomenon could gradually lead to renewed growth in stocks of WTI and an increase in its discount to Brent.

Prices across commodity markets remain under pressure from the appreciating dollar. The overall **non-energy commodity index** has been decreasing since May this year. This decrease accelerated in September, with the index reaching its lowest level since November 2009 (see Chart III.7.12). This was fostered both by the industrial metals price index and – in particular – by the food commodity price index. Grain prices declined as a result of a good global harvest, but their decline came to a halt in October. As for metal prices, the strong supply side was joined by weakening industrial production in China, and the index continued to fall even in the first half of October. However, the outlooks for both sub-indices are now rising slightly.

Chart III.7.12

COMMODITY PRICES

The sharp fall in the industrial metals and food commodity price indices halted in October and the outlook is rising slightly
(January 2007 = 100; source: Bloomberg, CNB calculation)



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).

ABBREVIATIONS

ABSs	asset-backed securities
APRC	annual percentage rate of charge
CF	Consensus Forecasts
CNB	Czech National Bank
COSMC	Czech Office for Surveying, Mapping and Cadastre
CPI	consumer price index
CZK	Czech koruna
CZSO	Czech Statistical Office
ECB	European Central Bank
EIA	Energy Information Administration
EIB	European Investment Bank
EIU	Economist Intelligence Unit
ESA	European System of 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
HICP	harmonised index of consumer prices
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
MBS	mortgage-backed securities
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 (1W, 1M, 1Y)	Prague Interbank Offered Rate (one-week, one-month, one-year)
repo rate	repurchase agreement rate
TLTROs	targeted longer-term refinancing operations
USD	US dollar
VAT	value added tax
WTI	West Texas Intermediate
ZEW	Zentrum für Europäische Wirtschaftsforschung (Centre for European Economic Research)

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
Evolution and structure of shorter working hours	(Box)	II/2014
The Czech Republic's trade relations with Ukraine and Russia	(Box)	II/2014
The life cycle of foreign direct investment and its impact on the balance of payments	(Box)	III/2014
Assessment of the economic situation one year after the exchange rate commitment was adopted	(Box)	IV/2014
Revision of the national accounts following the switch to ESA 2010	(Box)	IV/2014
The impacts of the military and political crisis in Ukraine on the Czech Republic	(Box)	IV/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.

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, financial derivatives and employee stock options, other investment and reserve assets.

Fiscal impulse: A variable taking into account the effect of fiscal policy on economic activity in the short run.

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.

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-average wage ratio: The ratio of the price of an apartment to the sum of the annual average 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.

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.

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 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.

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).

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										
		2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
DEMAND AND SUPPLY												
Gross domestic product												
GDP	CZK bn, constant p. of 2010, seas. adjusted	3,751.2	3,958.1	4,058.6	3,867.8	3,950.6	4,028.5	3,999.1	3,970.7	**4,068.8**	**4,170.0**	**4,288.8**
GDP	%, y-o-y, real terms, seas. adjusted	7.1	5.5	2.5	-4.7	2.1	2.0	-0.7	-0.7	**2.5**	**2.5**	**2.8**
Household consumption	%, y-o-y, real terms, seas. adjusted	3.8	4.1	2.8	-0.6	0.9	0.3	-1.8	0.4	**1.4**	**2.0**	**2.1**
Government consumption	%, y-o-y, real terms, seas. adjusted	0.4	0.4	1.1	3.0	0.4	-2.9	-1.0	2.3	**1.7**	**2.1**	**2.0**
Gross capital formation	%, y-o-y, real terms, seas. adjusted	10.5	14.3	0.9	-17.8	4.2	1.9	-3.6	-5.2	**5.0**	**5.4**	**3.3**
Exports of goods and services	%, y-o-y, real terms, seas. adjusted	14.8	11.0	3.8	-9.5	14.4	9.3	4.3	0.3	**9.3**	**8.7**	**7.5**
Imports of goods and services	%, y-o-y, real terms, seas. adjusted	11.9	12.8	2.8	-10.7	14.5	6.7	2.6	0.3	**9.7**	**9.8**	**7.4**
Net exports	CZK bn, constant p. of 2010, seas. adjusted	88.5	60.3	86.9	108.1	121.8	198.4	251.1	252.0	**262.4**	**252.4**	**273.6**
Coincidence indicators												
Industrial production	%, y-o-y, real terms	8.3	10.6	-1.8	-13.6	8.6	5.9	-0.8	-0.1	**-**	**-**	**-**
Construction output	%, y-o-y, real terms	6.0	7.1	0.0	-0.9	-7.4	-3.6	-7.6	-6.7	**-**	**-**	**-**
Receipts in retail sales	%, y-o-y, real terms	10.8	10.0	2.7	-4.7	1.5	1.7	-1.1	1.2	**-**	**-**	**-**
PRICES												
Main price indicators												
Inflation rate	%, end-of-period	2.5	2.8	6.4	1.1	1.5	1.9	3.3	1.4	**-**	**-**	**-**
Consumer Price Index	%, y-o-y, average	2.6	2.5	6.4	1.1	1.5	1.9	3.3	1.4	**0.4**	**1.2**	**2.2**
Regulated prices (18.70%)*	%, y-o-y, average	9.4	4.9	15.6	8.4	2.6	4.7	8.6	2.2	**-3.0**	**-0.2**	**1.9**
Net inflation (81.30%)*	%, y-o-y, average	0.5	1.5	2.4	-0.9	0.0	1.3	1.0	0.5	**0.9**	**1.3**	**2.3**
Food prices (including alcoholic beverages and tobacco) (24.58%)*	%, y-o-y, average	-0.1	3.8	3.0	-0.9	0.9	3.9	2.9	3.1	**1.9**	**1.0**	**2.9**
Adjusted inflation excluding fuels (53.32%)*	%, y-o-y, average	0.7	0.5	2.0	0.0	-1.2	-0.7	-0.3	-0.5	**0.5**	**1.7**	**2.1**
Fuel prices (3.39%)*	%, y-o-y, average	3.7	-0.1	4.3	-11.1	12.8	9.9	6.0	-2.1	**0.6**	**-2.3**	**1.8**
Monetary-policy inflation (excluding tax changes)	%, y-o-y, average	2.3	1.9	4.3	0.9	0.4	1.9	2.1	0.6	**0.3**	**1.1**	**2.2**
GDP deflator	%, y-o-y, seas. adjusted	0.7	3.5	2.0	2.6	-1.4	-0.2	1.4	1.7	**2.1**	**2.2**	**1.2**
Partial price indicators												
Producer prices	%, y-o-y, average	1.5	4.1	4.5	-3.1	1.2	5.6	2.1	0.8	**-0.4**	**0.5**	**1.9**
Agricultural prices	%, y-o-y, average	1.3	16.4	10.8	-24.3	7.7	22.7	3.6	5.2	**-3.5**	**-6.3**	**3.0**
Construction work prices	%, y-o-y, average	2.9	3.9	4.5	1.2	-0.2	-0.5	-0.7	-1.1	**-**	**-**	**-**
Brent crude oil	%, y-o-y, average	20.0	9.9	35.4	-36.5	28.4	38.2	0.7	-2.6	**-5.6**	**-9.9**	**1.6**
LABOUR MARKET												
Average monthly wage	%, y-o-y, nominal terms	6.6	7.2	7.8	3.3	2.2	2.5	2.5	0.0	**3.1**	**3.7**	**4.3**
Average monthly wage	%, y-o-y, real terms	4.0	4.3	1.4	2.3	0.7	0.6	-0.8	-1.4	**2.7**	**2.4**	**2.1**
Number of employees	%, y-o-y	1.1	1.8	1.6	-2.2	-2.2	0.0	-0.1	1.6	**0.2**	**0.2**	**0.2**
Unit labour costs	%, y-o-y	0.2	2.6	4.8	3.0	-1.7	0.3	2.9	0.4	**1.3**	**1.8**	**1.9**
Unit labour costs in industry	%, y-o-y	-7.2	2.4	-3.3	5.4	-6.3	0.8	4.2	2.8	**-**	**-**	**-**
Aggregate labour productivity	%, y-o-y	5.5	3.3	0.4	-3.1	3.3	2.0	-1.2	-0.8	**2.2**	**2.3**	**2.6**
ILO general unemployment rate	%, average, age 15–64	7.2	5.4	4.5	6.7	7.3	6.8	7.0	7.0	**6.3**	**6.2**	**6.0**
Share of unemployed	%, average	6.1	4.9	4.1	6.2	7.0	6.7	6.8	7.7	**7.7**	**7.5**	**7.3**
PUBLIC FINANCE												
Public finance deficit (ESA 2010)	CZK bn, current p.	-79.1	-26.6	-84.6	-216.2	-174.5	-115.0	-161.5	-53.2	**-60.5**	**-89.8**	**-70.5**
Public finance deficit / GDP**	%, nominal terms	-2.3	-0.7	-2.1	-5.5	-4.4	-2.9	-4.0	-1.3	**-1.4**	**-2.0**	**-1.5**
Public debt (ESA 2010)	CZK bn, current p.	978.9	1,065.5	1,150.7	1,335.7	1,508.5	1,647.8	1,841.9	1,869.2	**1,881.8**	**1,973.3**	**2,038.4**
Public debt / GDP**	%, nominal terms	27.9	27.8	28.7	34.1	38.2	41.0	45.5	45.7	**44.0**	**44.0**	**43.7**
EXTERNAL RELATIONS												
Current account												
Trade balance	CZK bn, current p.	0.0	0.0	-4.4	65.0	40.4	75.5	123.8	163.6	**245.0**	**265.0**	**300.0**
Trade balance / GDP	%, nominal terms	0.0	0.0	-0.1	1.7	1.0	1.9	3.1	4.0	**5.8**	**6.0**	**6.4**
Balance of services	CZK bn, current p.	0.0	0.0	89.3	81.9	78.5	81.3	77.6	68.6	**65.2**	**65.0**	**70.0**
Current account	CZK bn, current p.	0.0	0.0	-75.3	-89.2	-141.8	-84.8	-63.3	-56.8	**0.2**	**0.0**	**10.0**
Current account / GDP	%, nominal terms	0.0	0.0	-1.9	-2.3	-3.6	-2.1	-1.6	-1.4	**0.0**	**0.0**	**0.2**
Foreign direct investment												
Direct investment	CZK bn, current p.	0.0	0.0	-36.3	-37.7	-95.0	-46.8	-121.3	-33.2	**-160.0**	**-85.0**	**-115.0**
Exchange rates												
CZK/USD	average	22.6	20.3	17.1	19.1	19.1	17.7	19.6	19.6	**-**	**-**	**-**
CZK/EUR	average	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.	-5.1	-2.2	-12.6	5.3	-4.6	-2.1	1.5	3.5	**-**	**-**	**-**
CZK/EUR	%, y-o-y, real (PPI euro area), avg.	-1.3	-3.7	-8.6	4.6	-4.1	-3.1	2.6	2.3	**-**	**-**	**-**
Foreign trade prices												
Prices of exports of goods	%, y-o-y, average	-1.2	1.3	-4.6	0.2	-1.0	1.7	2.9	1.2	**3.6**	**1.0**	**0.3**
Prices of imports of goods	%, y-o-y, average	0.2	-1.0	-3.3	-3.5	2.0	4.3	4.2	-0.2	**1.7**	**0.0**	**0.3**
MONEY AND INTEREST RATES												
M2	%, y-o-y, average	9.5	11.6	9.5	5.7	4.3	3.6	5.6	4.4	**4.1**	**5.0**	**6.3**
2W repo rate	%, end-of-period, CNB forec. = avg.	2.50	3.50	2.25	1.00	0.75	0.75	0.05	0.05	**0.05**	**0.05**	**0.89**
3M PRIBOR	%, average	2.3	3.1	4.0	2.2	1.3	1.2	1.0	0.5	**0.4**	**0.4**	**1.2**

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

2012				2013				2014				2015				2016			
QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV
1,006.6	1,002.3	997.4	992.7	984.8	989.2	992.8	1,003.9	1,010.4	1,013.8	**1,018.3**	**1,026.4**	**1,030.7**	**1,038.5**	**1,046.4**	**1,054.5**	**1,061.3**	**1,067.6**	**1,075.8**	**1,084.1**
0.2	-0.6	-1.1	-1.4	-2.2	-1.3	-0.5	1.1	2.6	2.5	**2.6**	**2.2**	**2.0**	**2.4**	**2.8**	**2.7**	**3.0**	**2.8**	**2.8**	**2.8**
-1.2	-1.6	-1.9	-2.4	-0.6	-0.5	1.0	1.6	0.9	1.9	**1.5**	**1.2**	**2.1**	**1.7**	**2.1**	**1.9**	**2.1**	**2.1**	**2.1**	**2.2**
-1.6	-2.0	-0.8	0.4	1.0	0.8	3.5	3.7	1.5	3.0	**1.4**	**0.8**	**2.1**	**2.0**	**1.9**	**2.3**	**2.3**	**2.1**	**1.8**	**1.6**
-2.6	-1.4	-5.1	-5.4	-6.0	-8.4	-3.3	-2.8	2.0	6.3	**5.7**	**6.1**	**4.5**	**3.9**	**4.2**	**8.8**	**4.7**	**4.4**	**4.1**	**0.4**
7.0	4.2	3.4	2.5	-4.6	-0.2	0.6	5.6	11.3	8.5	**8.7**	**8.6**	**6.9**	**9.0**	**9.9**	**9.0**	**8.6**	**7.6**	**7.2**	**6.7**
4.6	3.1	1.7	1.1	-4.3	-1.6	1.7	5.5	10.2	10.2	**9.2**	**9.4**	**8.3**	**9.5**	**10.4**	**11.0**	**9.0**	**8.0**	**7.4**	**5.6**
61.3	58.4	68.7	62.7	56.0	68.1	61.2	66.6	69.6	63.0	**63.2**	**66.6**	**64.3**	**65.1**	**65.8**	**57.2**	**66.9**	**67.1**	**69.0**	**70.7**
2.6	-0.8	-0.9	-4.1	-5.9	-2.8	3.7	5.0	6.7	5.7	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
-10.0	-5.9	-6.2	-9.0	-11.2	-11.8	-3.9	-3.2	8.3	4.2	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
0.9	-2.2	-1.1	-1.7	-2.7	0.4	2.9	3.8	6.7	4.7	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
2.4	2.7	3.2	3.3	2.8	2.3	1.8	1.4	1.0	0.7	0.5	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
3.7	3.4	3.3	2.9	1.8	1.5	1.2	1.1	0.2	0.2	0.6	**0.7**	**0.9**	**1.2**	**1.3**	**1.5**	**2.1**	**2.3**	**2.3**	**2.3**
9.7	9.4	8.2	7.1	3.5	2.6	1.5	1.3	-4.1	-3.5	-2.2	**-2.1**	**0.2**	**0.0**	**-0.6**	**-0.4**	**1.7**	**2.0**	**2.0**	**1.8**
1.3	1.0	0.9	0.6	0.6	0.6	0.5	0.3	1.0	0.7	1.0	**1.0**	**0.7**	**1.2**	**1.4**	**2.0**	**2.2**	**2.3**	**2.4**	**2.3**
3.5	2.6	2.8	2.7	3.0	3.8	3.3	2.4	3.5	1.5	1.5	**1.0**	**-0.3**	**0.2**	**1.6**	**2.3**	**2.7**	**2.8**	**3.0**	**3.1**
-0.3	-0.2	-0.4	-0.5	-0.4	-0.6	-0.7	-0.4	-0.2	0.4	0.8	**1.0**	**1.4**	**1.9**	**1.7**	**1.9**	**2.0**	**2.1**	**2.1**	**2.0**
8.0	5.8	6.4	3.8	-1.5	-3.8	-1.4	-1.7	0.3	1.0	0.5	**0.5**	**-2.8**	**-2.3**	**-3.6**	**-0.5**	**1.1**	**2.4**	**2.3**	**1.5**
2.5	2.2	2.0	1.6	0.9	0.8	0.4	0.3	0.1	0.0	0.5	**0.4**	**0.6**	**1.0**	**1.1**	**1.6**	**2.1**	**2.3**	**2.3**	**2.3**
1.7	1.5	1.2	1.3	1.6	1.4	1.6	2.1	2.3	2.7	**2.4**	**1.0**	**1.0**	**1.7**	**2.6**	**3.6**	**2.3**	**1.2**	**0.7**	**0.5**
3.6	1.8	1.7	1.6	1.2	0.5	0.7	0.8	-0.7	-0.2	-0.1	**-0.6**	**-0.2**	**0.3**	**0.6**	**1.2**	**1.9**	**1.9**	**1.8**	**1.8**
-1.2	-2.9	5.6	12.7	14.5	9.3	1.4	-4.3	-4.4	-2.1	-2.3	**-5.1**	**-11.0**	**-10.7**	**-4.5**	**1.0**	**2.6**	**2.8**	**3.3**	**3.3**
-0.7	-0.6	-0.6	-0.8	-1.0	-1.3	-1.3	-0.8	-0.3	0.5	0.5	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
12.7	-7.2	-2.2	1.0	-4.6	-4.3	0.3	-0.7	-4.2	6.2	-5.7	**-17.8**	**-15.6**	**-15.9**	**-9.8**	**4.1**	**2.9**	**1.8**	**1.0**	**0.7**
3.2	2.1	1.4	3.2	-0.5	1.2	1.4	-1.7	3.3	2.3	**2.7**	**4.1**	**3.0**	**3.5**	**4.2**	**4.1**	**4.4**	**4.4**	**4.3**	**4.3**
-0.5	-1.3	-1.8	0.4	-2.3	-0.3	0.2	-2.8	3.1	2.1	**2.1**	**3.3**	**2.1**	**2.2**	**2.8**	**2.6**	**2.2**	**2.1**	**1.9**	**2.0**
-0.6	-0.6	0.3	0.6	2.0	2.4	0.9	1.3	0.4	-0.2	**0.3**	**0.2**	**0.1**	**0.4**	**0.3**	**0.1**	**0.1**	**0.1**	**0.2**	**0.4**
2.4	2.6	2.5	4.0	2.3	1.9	0.7	-3.1	0.8	0.5	**1.1**	**3.0**	**1.6**	**1.8**	**2.0**	**1.9**	**1.9**	**1.9**	**1.9**	**2.0**
1.6	3.3	5.9	6.0	3.7	4.0	3.0	0.5	-0.4	-1.7	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
0.5	-1.3	-2.0	-2.0	-3.3	-2.1	0.2	0.7	2.1	2.6	**2.2**	**2.1**	**1.9**	**2.3**	**2.5**	**2.5**	**2.8**	**2.6**	**2.6**	**2.5**
7.2	6.8	7.0	7.2	7.5	6.8	7.0	6.7	6.8	6.1	**6.2**	**6.3**	**6.6**	**6.0**	**6.0**	**6.1**	**6.5**	**5.9**	**5.9**	**6.0**
7.1	6.5	6.6	7.0	8.0	7.5	7.5	7.8	8.5	7.6	**7.4**	**7.4**	**8.1**	**7.3**	**7.1**	**7.2**	**7.9**	**7.1**	**7.0**	**7.1**
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43.3	36.2	25.7	18.7	47.0	58.9	30.6	27.1	73.5	69.5	**53.0**	**49.0**	**78.0**	**74.0**	**58.0**	**55.0**	**85.0**	**82.0**	**67.0**	**66.0**
4.5	3.5	2.5	1.8	5.0	5.8	2.9	2.5	7.4	6.5	**4.9**	**4.4**	**7.5**	**6.7**	**5.1**	**4.7**	**7.8**	**7.0**	**5.6**	**5.4**
23.5	21.0	17.9	15.3	21.3	17.4	14.6	15.2	21.5	15.7	**14.0**	**14.0**	**21.0**	**16.0**	**14.0**	**14.0**	**22.0**	**17.0**	**15.0**	**16.0**
25.4	-5.2	-49.3	-34.2	11.8	-11.2	-39.7	-17.6	77.8	-29.6	**-38.0**	**-10.0**	**49.0**	**-10.0**	**-38.0**	**-1.0**	**52.0**	**-11.0**	**-38.0**	**7.0**
2.7	-0.5	-4.8	-3.2	1.2	-1.1	-3.8	-1.6	7.9	-2.8	**-3.5**	**-0.9**	**4.7**	**-0.9**	**-3.4**	**-0.1**	**4.8**	**-0.9**	**-3.2**	**0.6**
-16.3	-44.6	-26.3	-34.0	-26.5	-9.7	5.6	-2.5	-29.5	-58.6	-	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
19.1	19.7	20.0	19.4	19.4	19.8	19.5	19.6	20.0	20.0	20.9	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
25.1	25.3	25.1	25.2	25.6	25.8	25.9	26.7	27.4	27.4	27.6	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
2.0	2.9	2.0	-0.7	2.1	2.5	3.5	5.9	7.8	6.7	6.5	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
2.5	4.4	3.3	0.2	1.8	1.7	1.9	4.0	6.0	4.7	5.3	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
4.0	3.9	3.3	0.3	0.9	0.6	0.4	2.9	4.1	3.4	**4.8**	**2.3**	**0.4**	**1.2**	**0.9**	**1.6**	**1.1**	**0.5**	**0.1**	**-0.4**
5.7	5.7	4.7	1.0	-0.3	-0.7	-0.9	1.0	2.4	1.3	**2.8**	**0.5**	**-1.1**	**0.0**	**-0.3**	**1.3**	**1.2**	**0.6**	**0.1**	**-0.6**
6.0	5.8	5.7	5.0	4.2	4.1	4.9	4.6	4.6	4.5	3.4	**3.8**	**4.1**	**4.6**	**5.4**	**5.8**	**6.4**	**6.7**	**6.3**	**5.9**
0.75	0.75	0.50	0.12	0.05	0.05	0.05	0.05	0.05	0.05	0.05	**0.05**	**0.05**	**0.05**	**0.05**	**0.05**	**0.05**	**0.85**	**1.24**	**1.41**
1.2	1.2	1.0	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.4	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**1.1**	**1.5**	**1.7**

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