

Summary of the Forecast

According to the CZSO's current data, real GDP decreased by 0.9% in the whole of 2013. The surprisingly strong QoQ growth of 1.8% in Q4 2013 was largely a product of one-off factors (stockpiling cigarette tax stamps as a consequence of an increase in the excise tax on cigarettes as of 1 January 2014). This will be negatively reflected in growth particularly in Q1 2014; however, gradual economic recovery should continue. GDP could increase by 1.7% in 2014, while in 2015 growth could accelerate to 2.0%. In both 2014 and 2015, all expenditure components should contribute positively to economic growth. Domestic demand should account for two thirds of economic growth and foreign trade balance for the remainder.

Despite the weakening of the Czech koruna due to the CNB's foreign exchange interventions, 2014 should be characterized by very low inflation. Unlike in previous years, administrative measures (especially a decrease in electricity prices) should have an anti-inflationary impact throughout 2014. Inflation rate could thus reach 1.0% this year. In 2015, consumer price growth could accelerate to 2.3% in relation to the economic recovery and delayed effects of the weaker koruna. The planned introduction of the third VAT rate of 10% for selected goods and services, which is expected to take effect in 2015, together with the abolition of regulatory

fees for visit to a doctor, will have a slight anti-inflationary impact.

Employers' efforts to increase labour productivity should lead to only minimal growth of employment in both 2014 and 2015. We also expect an impact on the unemployment rate (LFS), which should in both years decrease only slightly, in spite of gradual economic growth.

In 2014, the wage bill could increase by 1.8%; for 2015 we expect growth to accelerate to 3.5%.

According to the CZSO's preliminary estimate, the government sector deficit reached 1.4% of GDP in 2013. In spite of the negative output gap, fiscal effort reached 1.3 pp. In 2014, an expansionary fiscal policy leading to a deficit of around 1.8% of GDP is expected. In 2013, the government sector debt as a percentage of GDP decreased slightly to 46%. In 2014, we expect it to fall further to 44% because of changes in liquidity management.

Owing in particular to the favourable development of the foreign trade balance, we expect that the current account deficit of the balance of payments will be negligible in 2014 and 2015.

We regard the forecast risks as balanced.

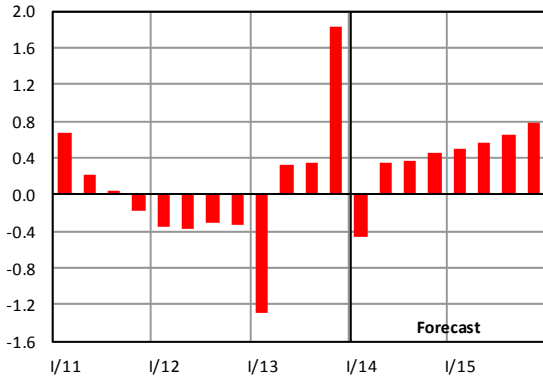
Table: Main Macroeconomic Indicators

		2010	2011	2012	2013	2014	2015	2013	2014	2015
		Current forecast						Previous forecast		
Gross domestic product	<i>growth in %, const.pr.</i>	2.5	1.8	-1.0	-0.9	1.7	2.0	-1.4	1.4	2.0
Consumption of households	<i>growth in %, const.pr.</i>	0.9	0.5	-2.1	0.1	0.6	1.5	-0.2	0.6	1.5
Consumption of government	<i>growth in %, const.pr.</i>	0.2	-2.7	-1.9	1.6	0.8	0.7	1.6	1.0	0.4
Gross fixed capital formation	<i>growth in %, const.pr.</i>	1.0	0.4	-4.5	-3.5	2.7	2.0	-4.8	-0.3	2.6
Contr. of foreign trade to GDP growth	<i>p.p., const.pr.</i>	0.6	1.9	1.7	-0.3	0.5	0.6	-0.2	0.7	0.5
Contr. of increase in stocks to GDP growth	<i>p.p., const.pr.</i>	1.0	0.1	-0.1	-0.2	0.2	0.1	-0.2	0.3	0.1
GDP deflator	<i>growth in %</i>	-1.6	-0.9	1.6	1.9	1.8	1.7	1.6	1.7	1.3
Average inflation rate	<i>%</i>	1.5	1.9	3.3	1.4	1.0	2.3	1.4	1.0	2.4
Employment (LFS)	<i>growth in %</i>	-1.0	0.4	0.4	1.0	0.2	0.2	0.9	0.1	0.1
Unemployment rate (LFS)	<i>average in %</i>	7.3	6.7	7.0	7.0	6.8	6.6	7.0	7.0	6.9
Wage bill (domestic concept)	<i>growth in %, curr.pr.</i>	0.8	2.2	1.8	-0.9	1.8	3.5	-0.2	2.2	4.3
Current account / GDP	<i>%</i>	-3.9	-2.7	-1.3	-1.4	-0.4	-0.3	-1.7	-0.2	-0.4
<u>Assumptions:</u>										
Exchange rate CZK/EUR		25.3	24.6	25.1	26.0	27.3	27.2	26.0	27.3	27.2
Long-term interest rates	<i>% p.a.</i>	3.7	3.7	2.8	2.1	2.4	2.6	2.1	2.4	2.5
Crude oil Brent	<i>USD/barrel</i>	80	111	112	109	105	101	109	104	101
GDP in Eurozone (EA-12)	<i>growth in %, const.pr.</i>	1.9	1.6	-0.6	-0.4	1.1	1.5	-0.4	0.9	1.5

Source: CNB, CZSO, Eurostat, U. S. Energy Information Administration, own calculations

Gradual economic recovery expected

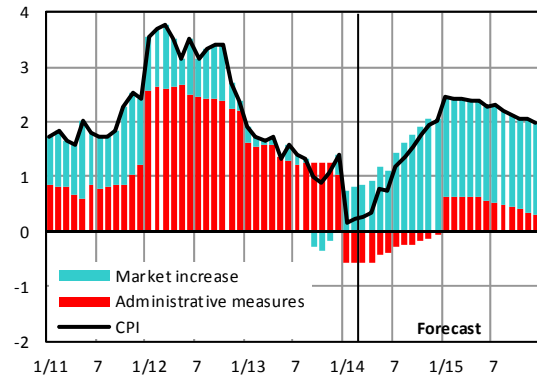
real GDP, QoQ growth rate, in %, seasonally adjusted



Source: CZSO, own calculations

Growth in CPI affected by the CNB's FX interventions

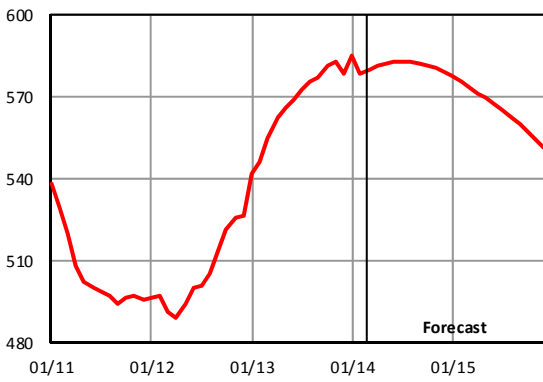
decomposition of YoY growth of CPI, contributions in pp



Source: CZSO, own calculations

Unemployment to start declining in mid-2014

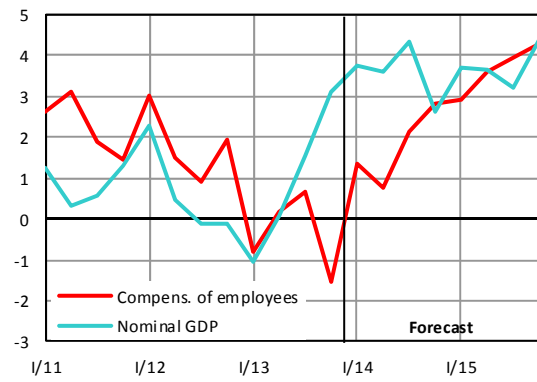
registered unemployment, in thousands of persons, seasonally adjusted



Source: Ministry of Labour and Social Affairs, own calculations

Compensation of employees/GDP to decline this year

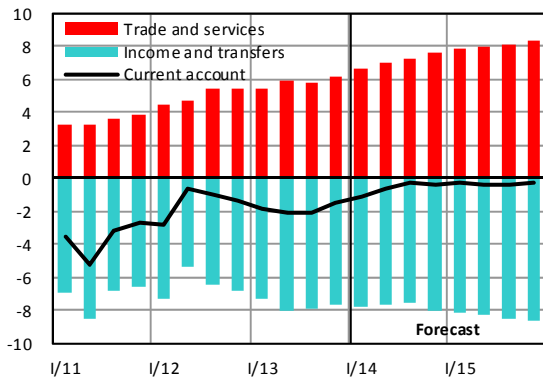
YoY growth rate, in %



Source: CZSO, own calculations

Current account almost balanced

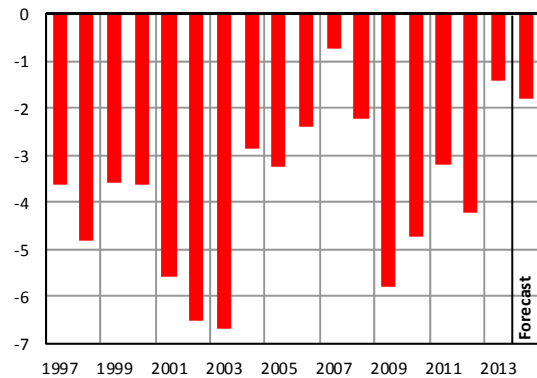
in % of GDP (moving sums of the latest 4 quarters)



Source: CNB, CZSO, own calculations

General government deficit well under 3% of GDP

general government balance, in % of GDP



Source: CZSO, own calculations