

## Summary of the Forecast

Real GDP increased by 0.8% QoQ in the first quarter of 2014 (gross value added rose at an even faster pace, by 1.1% QoQ), which far surpassed the estimate from the April Macroeconomic Forecast. We have therefore revised the forecast for GDP growth in 2014 up to 2.7%. Such a substantial change – 1.0 pp – is almost exclusively due to better than expected developments in the first quarter. The economy should continue to grow at a moderate pace also in 2015, when GDP could increase by 2.5%. Main expenditure components should all contribute positively to GDP growth in both 2014 and 2015. Domestic demand should account for roughly three quarters of the growth, while balance of foreign trade for the remaining part.

Despite the weakening of the Czech koruna due to the CNB's foreign exchange interventions, the year 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. Average inflation rate could thus reach 0.6% this year. Consumer price growth should accelerate in 2015, but we assume that inflation will still be hovering below the CNB's inflation target.

Much better than previously estimated economic developments in the first quarter of 2014, which led to

the change in the forecast for GDP, were also reflected in the improvement in expected developments on the labour market. Compared to the April Macroeconomic Forecast, we assume a faster decline in unemployment rate, which could average 6.1% in 2015. Also, employment should grow stronger in 2014 than we thought so far.

Total wage bill could increase by 2.8% this year. In 2015 we expect its growth to accelerate to 3.8%. A proposed increase in the wage bill in state administration, apart from an expected gradual improvement in the state of the private sector, should impact positively on total wage bill.

We expect the government sector to post a deficit of 1.5% of GDP this year. The balance should thus remain unchanged from the previous year. At the same time, the government sector debt should decline by 2.0 pp to 44.0% of GDP.

For the first time since 1993, the current account of the balance of payments could post a small surplus this year, mainly thanks to positive developments in the trade balance. In 2015, the current account should be balanced.

We regard risks to the Forecast as balanced.

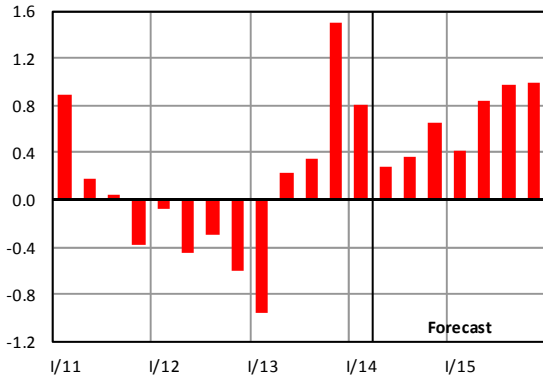
Table: **Main Macroeconomic Indicators**

		2010	2011	2012	2013	2014	2015	2013	2014	2015
		Current forecast					Previous forecast			
<b>Gross domestic product</b>	<i>bill. CZK</i>	<b>3 791</b>	<b>3 823</b>	<b>3 846</b>	<b>3 884</b>	<b>4 061</b>	<b>4 216</b>	3 884	4 023	4 173
<b>Gross domestic product</b>	<i>growth in %, const.pr.</i>	<b>2.5</b>	<b>1.8</b>	<b>-1.0</b>	<b>-0.9</b>	<b>2.7</b>	<b>2.5</b>	-0.9	1.7	2.0
<b>Consumption of households</b>	<i>growth in %, const.pr.</i>	<b>0.9</b>	<b>0.5</b>	<b>-2.1</b>	<b>0.1</b>	<b>1.6</b>	<b>1.4</b>	0.1	0.6	1.5
<b>Consumption of government</b>	<i>growth in %, const.pr.</i>	<b>0.2</b>	<b>-2.7</b>	<b>-1.9</b>	<b>1.6</b>	<b>1.9</b>	<b>1.6</b>	1.6	0.8	0.7
<b>Gross fixed capital formation</b>	<i>growth in %, const.pr.</i>	<b>1.0</b>	<b>0.4</b>	<b>-4.5</b>	<b>-3.5</b>	<b>4.1</b>	<b>3.5</b>	-3.5	2.7	2.0
<b>Contr. of foreign trade to GDP growth</b>	<i>p.p., const.pr.</i>	<b>0.6</b>	<b>1.9</b>	<b>1.7</b>	<b>-0.3</b>	<b>0.6</b>	<b>0.5</b>	-0.3	0.5	0.6
<b>Contr. of increase in stocks to GDP growth</b>	<i>p.p., const.pr.</i>	<b>1.0</b>	<b>0.1</b>	<b>-0.1</b>	<b>-0.2</b>	<b>0.0</b>	<b>0.2</b>	-0.2	0.2	0.1
<b>GDP deflator</b>	<i>growth in %</i>	<b>-1.6</b>	<b>-0.9</b>	<b>1.6</b>	<b>1.9</b>	<b>1.8</b>	<b>1.3</b>	1.9	1.8	1.7
<b>Average inflation rate</b>	<i>%</i>	<b>1.5</b>	<b>1.9</b>	<b>3.3</b>	<b>1.4</b>	<b>0.6</b>	<b>1.7</b>	1.4	1.0	2.3
<b>Employment (LFS)</b>	<i>growth in %</i>	<b>-1.0</b>	<b>0.4</b>	<b>0.4</b>	<b>1.0</b>	<b>0.5</b>	<b>0.2</b>	1.0	0.2	0.2
<b>Unemployment rate (LFS)</b>	<i>average in %</i>	<b>7.3</b>	<b>6.7</b>	<b>7.0</b>	<b>7.0</b>	<b>6.4</b>	<b>6.1</b>	7.0	6.8	6.6
<b>Wage bill (domestic concept)</b>	<i>growth in %, curr.pr.</i>	<b>0.8</b>	<b>2.2</b>	<b>1.8</b>	<b>-0.9</b>	<b>2.8</b>	<b>3.8</b>	-0.9	1.8	3.5
<b>Current account / GDP</b>	<i>%</i>	<b>-3.9</b>	<b>-2.7</b>	<b>-1.3</b>	<b>-1.4</b>	<b>0.4</b>	<b>0.0</b>	-1.4	-0.4	-0.3
<b>Assumptions:</b>										
<b>Exchange rate CZK/EUR</b>		<b>25.3</b>	<b>24.6</b>	<b>25.1</b>	<b>26.0</b>	<b>27.4</b>	<b>27.4</b>	26.0	27.3	27.2
<b>Long-term interest rates</b>	<i>% p.a.</i>	<b>3.7</b>	<b>3.7</b>	<b>2.8</b>	<b>2.1</b>	<b>1.9</b>	<b>2.4</b>	2.1	2.4	2.6
<b>Crude oil Brent</b>	<i>USD/barrel</i>	<b>80</b>	<b>111</b>	<b>112</b>	<b>109</b>	<b>108</b>	<b>104</b>	109	105	101
<b>GDP in Eurozone (EA-12)</b>	<i>growth in %, const.pr.</i>	<b>1.9</b>	<b>1.6</b>	<b>-0.6</b>	<b>-0.4</b>	<b>1.1</b>	<b>1.6</b>	-0.4	1.1	1.5

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

### Economic recovery should continue

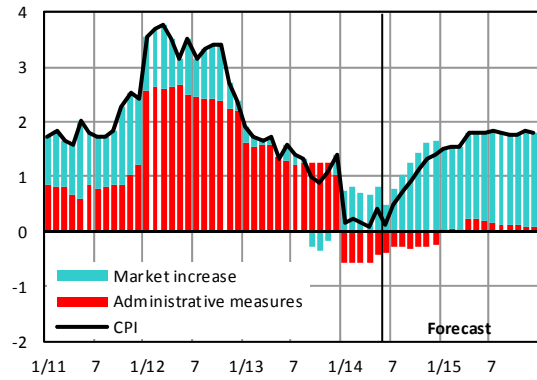
real GDP, QoQ growth rate, in %, seasonally adjusted



Source: CZSO, own calculations

### Inflation gradually approaching the inflation target

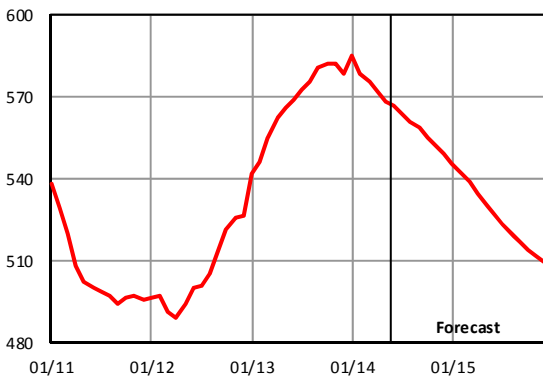
decomposition of YoY growth of CPI, contributions in pp



Source: CZSO, own calculations

### Unemployment likely to have peaked

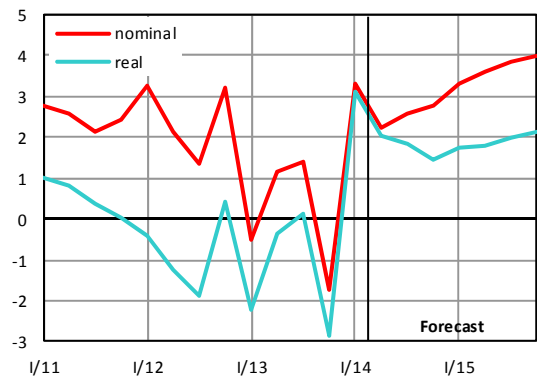
registered unemployment, in thousands of persons, seasonally adjusted



Source: Ministry of Labour and Social Affairs, own calculations

### Moderate growth of real wage

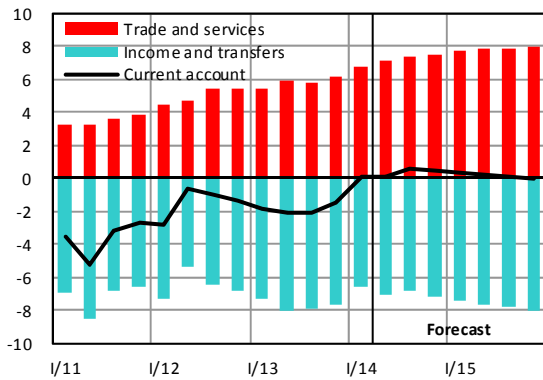
YoY growth rate, in %



Source: CZSO, own calculations

### A small surplus on the current account

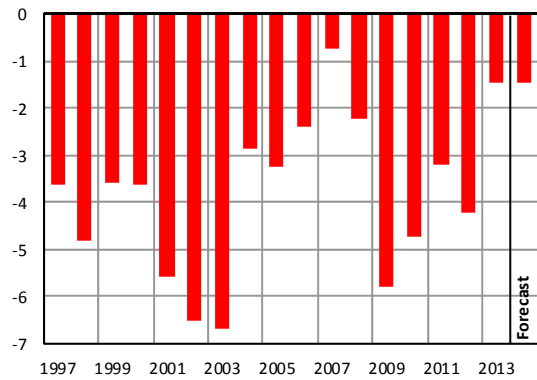
in % of GDP (moving sums of the latest 4 quarters)



Source: CNB, CZSO, own calculations

### General government deficit well under 3% of GDP

general government balance, in % of GDP



Source: CZSO, own calculations