

## Summary of the Forecast

According to the CZSO's current data, real GDP rose by 0.2% QoQ in Q3 2013, but it continued to fall in annual terms. We estimate that economic recovery continued also at the end of 2013. Nonetheless, GDP probably decreased by 1.4% in the whole of 2013, in particular due to a decline in fixed capital investment. However, with positive contribution from both domestic demand and foreign trade, the economy may grow by 1.4% in 2014. In 2015, GDP growth could accelerate to 2.0%.

Despite a 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 effects (especially a decrease in electricity prices) should have an anti-inflationary impact throughout 2014. The inflation rate could thus reach 1.0% this year. In 2015, consumer price growth could accelerate to 2.4% in relation to the economic recovery and delayed effects of the weakened koruna.

Employers' efforts to increase labour productivity by rationalizing the number of employees should lead to a *de facto* stagnation of employment in both 2014 and 2015. We also expect an impact on the unemployment rate (LFS), which should fluctuate around 7%, in spite of gradual economic growth.

In 2014, the wage bill could increase by 2.2%. For 2015 we expect growth to accelerate to 4.3%. The planned transfer of 2 pp of the statutory health insurance contribution rate from employers to employees is expected to be partially compensated by an increase in employees' wages.

We estimate that the government sector deficit reached 2.5% of GDP in 2013. It should be well below 3% of GDP also in 2014. The deficit adjusted for the impact of the business cycle and one-off and temporary measures was probably only 1.2% of GDP in 2013. For the first time in history, therefore, the structural balance has nearly reached the level of the medium-term budgetary objective for the Czech Republic.

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.

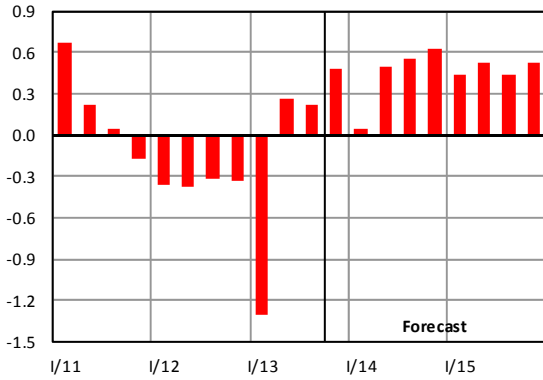
Table: **Main Macroeconomic Indicators**

|   |                               | 2010             | 2011 | 2012 | 2013 | 2014 | 2015 | 2013              | 2014 |
|---|-------------------------------|------------------|------|------|------|------|------|-------------------|------|
|   |                               | Current forecast |      |      |      |      |      | Previous forecast |      |
| <b>Gross domestic product</b>                     | <i>growth in %, const.pr.</i> | 2.5              | 1.8  | -1.0 | -1.4 | 1.4  | 2.0  | -1.0              | 1.3  |
| <b>Consumption of households</b>                  | <i>growth in %, const.pr.</i> | 0.9              | 0.5  | -2.1 | -0.2 | 0.6  | 1.5  | 0.2               | 0.9  |
| <b>Consumption of government</b>                  | <i>growth in %, const.pr.</i> | 0.2              | -2.7 | -1.9 | 1.6  | 1.0  | 0.4  | 0.8               | 0.2  |
| <b>Gross fixed capital formation</b>              | <i>growth in %, const.pr.</i> | 1.0              | 0.4  | -4.5 | -4.8 | -0.3 | 2.6  | -4.8              | -0.8 |
| <b>Contr. of foreign trade to GDP growth</b>      | <i>p.p., const.pr.</i>        | 0.6              | 1.9  | 1.7  | -0.2 | 0.7  | 0.5  | 0.6               | 0.6  |
| <b>Contr. of increase in stocks to GDP growth</b> | <i>p.p., const.pr.</i>        | 1.0              | 0.1  | -0.1 | -0.2 | 0.3  | 0.1  | -0.7              | 0.4  |
| <b>GDP deflator</b>                               | <i>growth in %</i>            | -1.6             | -0.9 | 1.6  | 1.6  | 1.7  | 1.3  | 1.2               | 0.5  |
| <b>Average inflation rate</b>                     | <i>%</i>                      | 1.5              | 1.9  | 3.3  | 1.4  | 1.0  | 2.4  | 1.4               | 0.7  |
| <b>Employment (LFS)</b>                           | <i>growth in %</i>            | -1.0             | 0.4  | 0.4  | 0.9  | 0.1  | 0.1  | 1.2               | 0.4  |
| <b>Unemployment rate (LFS)</b>                    | <i>average in %</i>           | 7.3              | 6.7  | 7.0  | 7.0  | 7.0  | 6.9  | 7.1               | 7.3  |
| <b>Wage bill (domestic concept)</b>               | <i>growth in %, curr.pr.</i>  | 0.8              | 2.2  | 1.8  | -0.2 | 2.2  | 4.3  | 0.8               | 2.5  |
| <b>Current account / GDP</b>                      | <i>%</i>                      | -3.9             | -2.7 | -2.4 | -1.7 | -0.2 | -0.4 | -1.7              | -1.4 |
| <u>Assumptions:</u>                               |                               |                  |      |      |      |      |      |                   |      |
| <b>Exchange rate CZK/EUR</b>                      |                               | 25.3             | 24.6 | 25.1 | 26.0 | 27.3 | 27.2 | 25.8              | 25.8 |
| <b>Long-term interest rates</b>                   | <i>% p.a.</i>                 | 3.7              | 3.7  | 2.8  | 2.1  | 2.4  | 2.5  | 2.1               | 2.4  |
| <b>Crude oil Brent</b>                            | <i>USD/barrel</i>             | 80               | 111  | 112  | 109  | 104  | 101  | 108               | 103  |
| <b>GDP in Eurozone (EA-12)</b>                    | <i>growth in %, const.pr.</i> | 1.9              | 1.6  | -0.6 | -0.4 | 0.9  | 1.5  | -0.3              | 1.0  |

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

### Gradual economic recovery expected

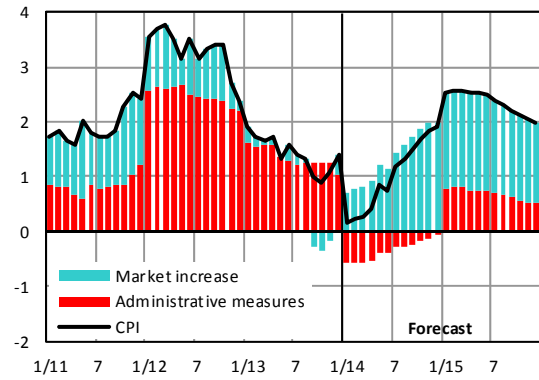
real GDP, QoQ growth rate, in %, seasonally adjusted



Source: CZSO, own calculations

### Growth in CPI affected by the CNB's FX interventions

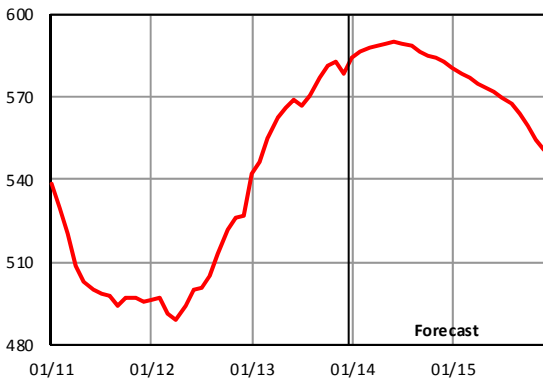
decomposition of YoY growth of CPI, contributions in pp



Source: CZSO, own calculations

### Unemployment culminating in mid-2014

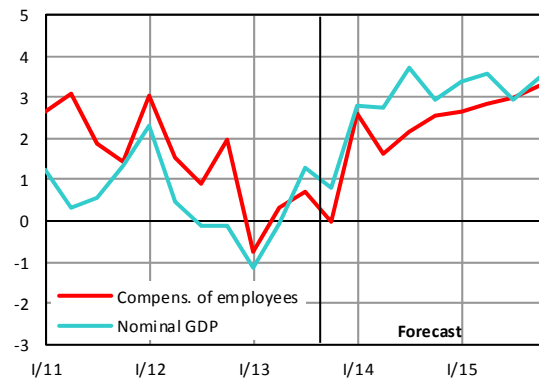
registered unemployment, in thousands of persons, seasonally adjusted



Source: Ministry of Labour and Social Affairs, own calculations

### Compensation of employees to GDP ratio declining

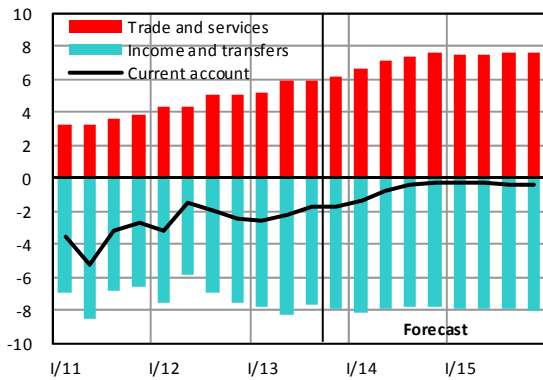
YoY growth rate, in %



Source: CZSO, own calculations

### Current account almost balanced

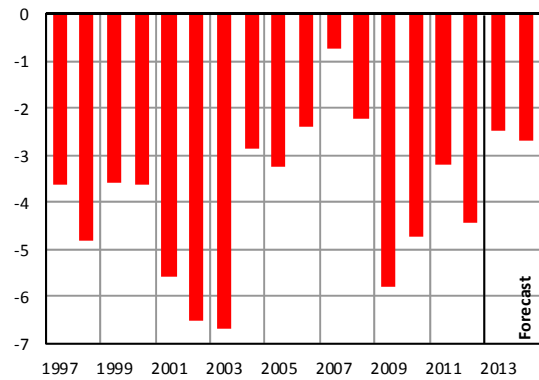
in % of GDP (moving sums of the latest 4 quarters)



Source: CNB, CZSO, own calculations

### General gov. deficit successfully under 3% of GDP

general government balance, in % of GDP



Source: CZSO, own calculations