

| Quarterly report |

Czech Economic Outlook

The way to exit is free



- **The Czech economy** should moderately accelerate this year to 2.7%. Domestic consumption will continue to support growth but we also expect a modest increase in investment.
- **Inflation** is likely to overshoot the CNB's target through 2017, to average at 2.2%. At the beginning of the year, the base effect in fuel and food prices will push inflation up, while over the rest of the year, the core element will be the main driver.
- **CNB** will scrap the FX floor in the second quarter of this year in our view. We believe that the regular May meeting will provide the right opportunity. The risk is that an extraordinary meeting could be held in April. We have dropped our negative rates call, although this remains our risk scenario.
- **Exit from the FX floor** will result in increased exchange rate volatility; in the event of extreme swings, CNB could intervene on both sides. The return to the long-term CZK appreciation trend will be gradual.
- **Short-end CZGB yields** are set to remain deeply negative until the end of the FX floor. Thereafter, the short end should move back towards zero. Long-end yields are set to gradually increase over the course of 2017.



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Hedging for free to end soon

The end of the FX floor is in the offing. The central bank's 2% inflation target was, rather unexpectedly, reached at the end of last year. We are convinced that it is no accident or isolated episode that the inflation target has been reached. Indeed, this year's average inflation will come in above the 2% target. We expect the central bankers to live up to their 'hard commitment'. **We will therefore continue to enjoy a stable spot rate until the end of March. However, anything can happen thereafter, as governor Rusnok said.**

In our *Czech Economic Outlook*, we examined the approaching end of the FX floor from various angles. Viktor Zeisel's macroeconomic forecast clearly shows that **reaching the inflation target was not a one-off event and that it also is sustainable over the horizon of the monetary policy.** Core inflation will be around 2.4% on average this year and no wonder - just look at the tight labour market, which is causing nominal wages to surge. They are expected to rise by 4.6% this year. The last time wages were growing at this rate was nine years ago.

Our forecast also assumes that **the FX floor will be discontinued as early as the second quarter of this year.** Given how transparent the central bankers have been so far, regular meeting on 4 May appears to be the most probable date to us. A new inflation forecast will be available to the CNB Board at its scheduled meeting on the monetary policy on that day. Should the CNB want to surprise, the central bankers themselves are not ruling out the option of removing the floor at an extraordinary meeting.

The ECB's policy is unlikely to influence the CNB's decisions in any way, as Jana Steckerová shows in her contribution. And according to David Kocourek, no fundamental change can be expected from the new CNB Board members. **In our main scenario, we no longer expect the central bank to introduce negative interest rates at the exit point.** One of the advocates of this scenario, Lubomír Lízal, will leave the CNB Board in February. And a shift in the opinion espoused by Vladimír Tomšík, the most prominent advocate of negative rates, was obvious in his latest interview for Thomson Reuters.

At the beginning of this year, the current and expected developments have been reflected in a strong inflow of speculative capital into the Czech market. As Marek Dřímál documents in his special box, this situation has resulted in extreme swings on the forward, money and bond markets. We estimate that, over the first three weeks in January, the CNB bought €13bn as part of its interventions in defence of the FX floor. The capital inflow slackened in the second half of January. The reason is that the Czech koruna appeared to be overbought.

How, then, will the exchange rate develop after the exit? You will find the answers in the *Czech FX Market* section. There is no question that volatility will increase. Movements of speculative capital will be the main driver for exchange rates in the first weeks and months, while economic fundamentals will play second fiddle. **For this reason, exporters should prepare for the end of the free hedging the CNB has provided to them for over three years now.**

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External Environment and Assumptions

Inflation accelerating, GDP growth driven by domestic demand



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The key assumptions underlying our prognosis remain virtually unchanged compared with our previous forecast. This year, we expect respectable GDP growth in the US, the euro area and also in the CEE region. The key driver is likely to remain domestic demand. Inflation is accelerating due to higher oil and food prices and in the US it has already reached the Fed's inflationary target. With elections due to be held in France, possibly in Italy, Germany and the Netherlands, the risks are mostly political in nature.

External factor assumptions (average values)

	4Q15	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18
Brent crude oil prices (USD/bbl)	44.7	35.2	46.8	47.0	52.8	52.5	55.0	57.5	60.0	62.0	64.0
GDP euro area (yoy)	2.0	1.7	1.7	1.8	1.8	1.7	1.8	1.7	1.5	1.4	1.4
CPI euro area (yoy)	0.2	0.1	-0.1	0.3	0.7	1.6	1.5	1.6	1.5	1.5	1.5
EUR/USD (end of period)	1.10	1.10	1.13	1.12	1.1	1.00	1.05	1.07	1.09	1.08	1.08
1Y EURIBOR	0.1	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1

Source: SG Cross Asset Research/Economics, Bloomberg, Economic & Strategy Research, Komerční banka

US: Trump effect to boost GDP growth

Household consumption likely to remain the key driver of US GDP growth.

Trump's victory in the presidential election should boost GDP growth and delay recession by a year (to the end of 2019). The US economy is expected to grow by 2.3% this year, after last year's 1.6%. Household consumption, supported by tax cuts, is likely to remain the key source of growth. The willingness of households to spend is being supported by falling unemployment and rising wages. The unemployment rate is hovering close to its lowest level since 2007 (4.7% in December) and has already reached the non-accelerating inflation rate of unemployment (NAIRU). Corporate investment and inventories have previously been a drag on GDP growth. This year, however, corporate investment is expected to grow thanks to the stabilisation of the energy sector. The risks to our prognosis lie with Trump's policy, as it is not clear to what extent his pre-election promises will translate into action.

Inflation is expected to hover around the central bank's inflationary target.

Consumer prices have finally exceeded the central bank's 2% inflationary target (they reached 2.1% yoy). Headline inflation will accelerate in the coming months due to favorable base effects in fuel prices and the recent increase in oil prices. Headline inflation is expected to reach 2.6% as early as February before gradually falling back below the Fed's target as the effect of higher oil prices evaporates. Going forward, we expect it to jump back up to the 2% level in spring 2018, where it should remain until the end of the year. The upside risk to SG's inflationary forecast is planned fiscal expenditure and the implementation of customs duties, which could be reflected in consumer prices.

The central bank is expected to hike rates twice this year.

We expect the central bank to hike rates twice this year followed by three times in 2018. In terms of monetary policy tightening, the Fed is still more hawkish than the financial markets. The central bank's median estimate has interest rates rising as high as 2.9% in 2020, while the markets assume a rise to just 1.6%. According to our estimates, interest rates will peak in mid-2019 (at 1.75-2.00%), before the Fed starts to cut then again. EUR/USD is expected trade at EUR/USD1.05 on average in 2017 and EUR/USD1.09 in 2018.

Euro area: investment activity is picking up

GDP is expected to grow by 1.7% this year. Since 2014, GDP growth has been driven mainly by domestic demand, which should also be true of the coming years. Although euro

weakness will help boost euro area export market shares, gains will not be able to entirely offset the weakness in global trade. As a result, net exports are likely to contribute negatively to GDP growth next year. The good news is that the construction sector has already found its bottom, with growth expected to average 1.9% yoy in 2017-2021 as opposed to the -2.4% yoy average in 2007-2015. As a result, the contribution of investments to GDP growth should be positive. Nevertheless, the development of investment is likely to be uneven. 75% of the total investment activity in the euro area in 2017 is likely to take place in Germany, France, Italy and Spain, while other countries lag behind. Investments should add 0.4pp to this year's GDP growth. This time the risks are mostly political in nature, as we await elections in France, Germany, possibly in Italy and the Netherlands, as well as the outcome to negotiations on the conditions for Great Britain's exit from the EU, while question marks hover over Trump's policies. All together this represents a risk for investment activity as corporations could postpone investments under such circumstances.

Inflation should gradually increase but average at only 1.5% this year.

Given the base effect stemming from energy prices, inflation is expected to accelerate to 1.5% on average in 2017. However, acceleration of inflation already became noticeable in December, when it exceeded 1% for the first time since 2013. While euro area inflation is gradually rising, it is unlikely to reach the ECB's 2% target over the coming period, as it is set to average 1.5% over 2017-2021, while core inflation will probably not exceed an average of 1.3%. For that reason, the ECB decided to prolong its asset purchase programme by nine months through to December 2017. At the same time, it announced it would lower the amount of asset purchases from €80bn to €60bn, effective from April. According to SG economists, the ECB will start tapering in July 2017 by €10bn per month. The ECB is likely to announce this decision in March, in our view. January's inflation reached 1.8%, while 4Q16 GDP showed decent growth of 0.5% qoq, which will put pressure on the ECB to end the use of non-standard monetary policy tools. The reduction of purchased bonds by €10bn a month would mean the quantitative easing programme would end in January 2018. At the same time, the ECB will probably announce the extension of the one-year TLTRO programme due to still low lending activity and the risks associated with investment activity.

Germany: the prospects are positive

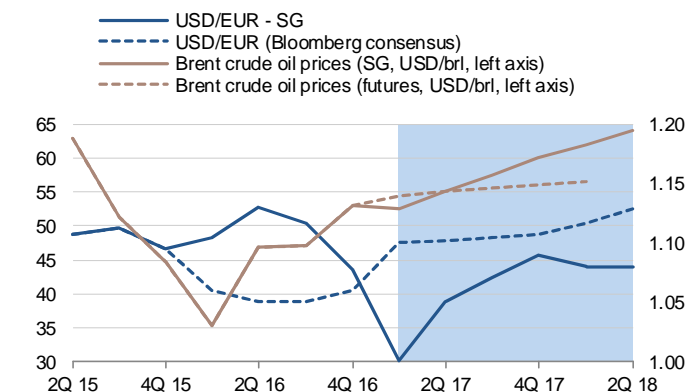
Unemployment is falling, wages are growing, corporations could finally start to invest.

Last year, the German economy grew by 1.8% (SWDA) and the outlook for this year is promising as well (GDP growth 1.6%, SWDA). The main source of growth is likely to remain domestic demand, which is supported by the good situation in the labour market. The unemployment rate remained declined to 5.9% in January, its lowest level since German unification in 1990. In 2018, the unemployment rate is expected to fall to 5.7%, which is significantly below the NAIRU, which we estimate at 6.6%. This should lead to further growth in wages. On the other hand, higher wages will push corporate profits downwards. Consequently, lower profitability will motivate corporations to try to increase their own productivity, which could be reflected in investment growth. Investments are still lagging behind the growth of the economy. Although corporations have a lot of cash and financial conditions are favorable, investment activity may be threatened by the political risks and uncertainty associated with the global economic outlook. Regarding household consumption, the risk is primarily faster inflation. This could dampen consumer confidence and the willingness of households to spend. Due to the high savings rate and rising wages, we do not give much weight to the risk of drop in consumption.

Confidence indicators confirm positive prospects for the German economy as well. The manufacturing PMI reached its highest levels since 2014 in December, while confidence in the service sector has also recovered quickly from its dramatic decline of August and September

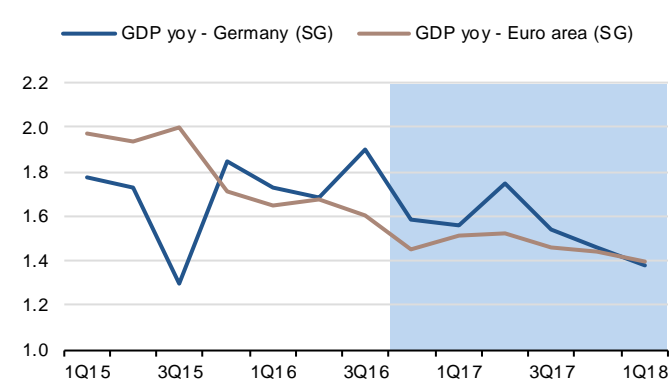
last year. The IFO index assesses the current situation in industry as being at its best since 2012. The ECB's loose monetary policy and the expected tax cuts should play into the hands of the German economy as well. Tax cuts are set to reach 0.5% of GDP, when the ruling CDU remains in power.

Oil prices and EUR/USD



Source: Macrobond, SG Cross Asset Research/Economics, Bloomberg, Economic & Strategy Research, Komerční banka

Euro area and German GDP growth (%)



Source: Macrobond, SG Cross Asset Research/Economics, Datastream, Economic & Strategy Research, Komerční banka

Investments are likely to contribute to GDP growth positively.

CEE: investment activity has already found a bottom

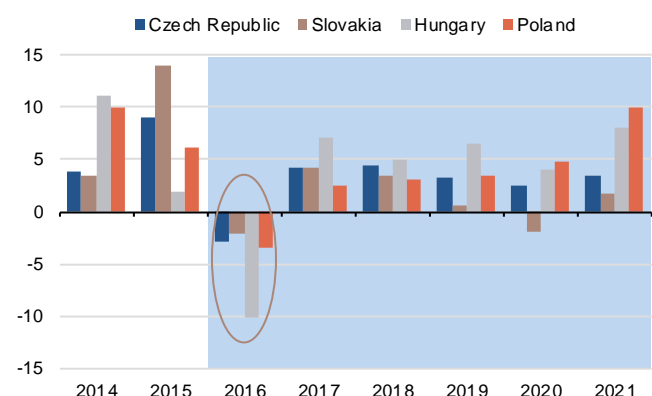
Last year, GDP growth in the CEE region was strongly affected by the slump in drawing money from EU funds. While in 2015 countries were trying to pump the last remaining money from the 2013-2017 programming period and investment activity grew sharply, 2016 (and the beginning of the new programming period) caught the region unprepared again. The lack of any framework for drawing money from EU funds and a shortage of new projects resulted in a significant slump in investment activity. This year, however, this trend should turn around and investments should start to grow again gradually. As a result their contribution to GDP growth should already be positive again this year.

Households are benefiting from a good labour market situation and rising wages.

Household consumption is to remain the main GDP growth driver in CEE this year.

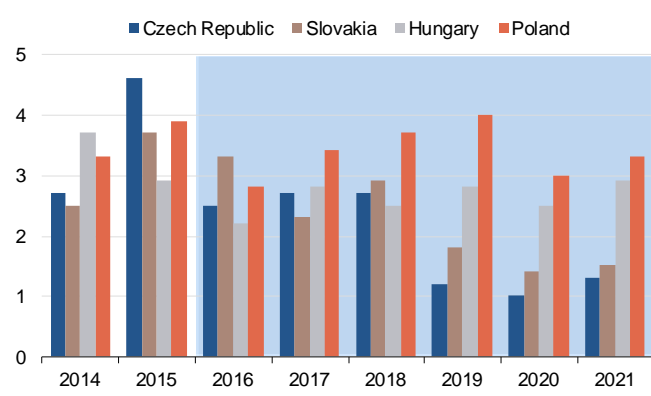
Unemployment in the region is at historical lows with some sectors already encountering difficulties finding skilled labour. In addition, the unemployment rate is already below the NAIRU. Altogether this is putting upward pressure on wage growth. In Hungary, this is being accompanied by a significant increase in the minimum wage (15% in January and a further 8% in 2018). In addition, salaries of state employees are rising as well. In Poland, there is a programme to support families with children (programme 500+). Pensions in the region are also rising. This is reflected in the positive consumer sentiment and the willingness of households to spend, which is obvious from the regional retail sales trends. Higher household consumption, together with renewed investment activity however is putting upward pressure on imports. Net exports should therefore reduce GDP growth in most countries in the region both this year and next. Nevertheless, regional economic growth is set to accelerate this year (apart from Slovakia, where we expect economic activity to slow).

Investments will not be a drag (% , yoy growth)



Source: Eurostat, Macrobond, SG Cross Asset Research/Economics, Economic & Strategy Research, Komerční banka

CEE region: GDP growth (% , yoy)

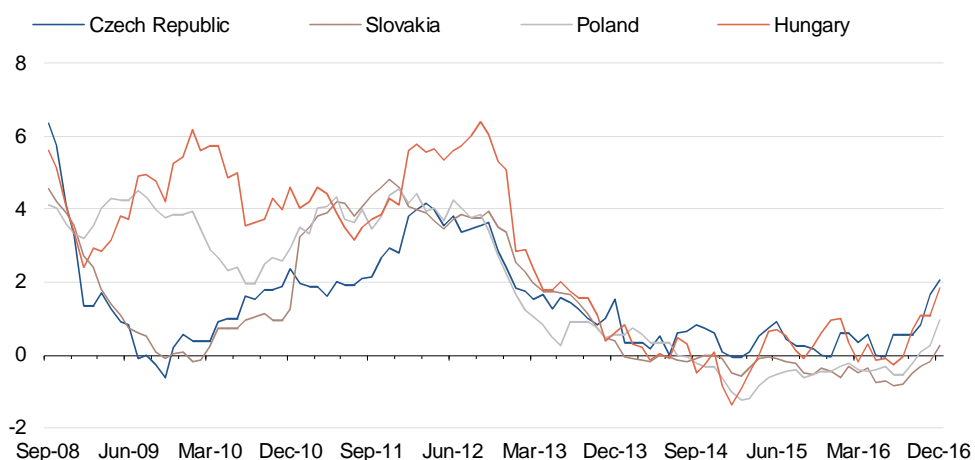


Source: Eurostat, Macrobond, SG Cross Asset Research/Economics, Economic & Strategy Research, Komerční banka

Rising inflation should give the central banks more scope.

Inflation is rising quite quickly in the region. Due to statistical base effects stemming from oil prices, it is expected to peak in 1H17 before slightly decelerating in 2H17. Food prices are likely to contribute to the rise in consumer prices as well. In Poland, inflation is set to rise to 1.5% in 1Q17, while in Hungary it should reach 2.5%. In the Czech Republic, inflation should hover above the 2% inflation target. That should free up the hands of the central banks, which have had to keep monetary policy extremely loose until now. In Poland, growing inflation could provoke speculation about an earlier interest rate hike. While we still expect the first rate hike to take place in 2018, 2017 remains our risk scenario. The Hungarian central bank will probably keep its key rate unchanged at 0.9% for a longer period, as inflation is unlikely to reach its 3% inflationary target before mid-2018. The central bank could, however, limit the use of non-standard monetary policy tools. What will the achievement of the inflation target mean for the Czech National Bank? We discuss this in the *CNB Focus* section. Regarding the development of regional currencies, we expect the uncertainty associated with the global economic outlook and political risks to keep the EUR/PLN and EUR/HUF exchange rates at current or slightly weaker levels. At the end of this year, we expect EUR/PLN to trade at 4.4 and EUR/HUF at 310.

Inflation is accelerating in the region (% , yoy)



Source: Eurostat, Macrobond, Economic & Strategy Research, Komerční banka



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Macroeconomic Outlook

Consumers to fuel growth despite inflation revival

Household purchasing power has been continually increasing. Last year, this was due mainly to higher employment, while this year households should enjoy growing wages, as the pool of available workers has shrunk. Increasing remuneration will release price pressures and inflation should stay above 2% for the whole year. The shortage of workers will likely be apparent in many sectors of the economy. The industrial sector will probably be hit the most. Industry is thus not set to post a major acceleration despite the fact that some one-off factors that impeded its growth last year will not repeat. Investment should mildly recover, while external trade will likely contribute less than last year. Overall, we expect the economy to grow 2.7% this year after 2.5% in 2016, while inflation should accelerate to 2.2% from 0.7%.

Main changes

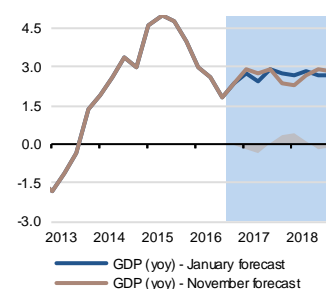
GDP:

We have not revised our GDP outlook. We believe economic growth accelerated at end last year and pulled the overall 2016 growth to 2.5%. We still forecast growth in 2017 at 2.7%.

Inflation:

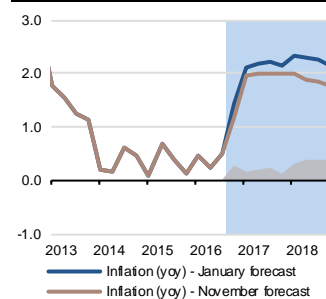
The surge in inflation at year-end pushed the average figure to 0.7% in 2016, a tick higher than our forecast. This year, average price growth should reach 2.2%, two ticks higher than our previous projection.

Change in our GDP outlook (%)



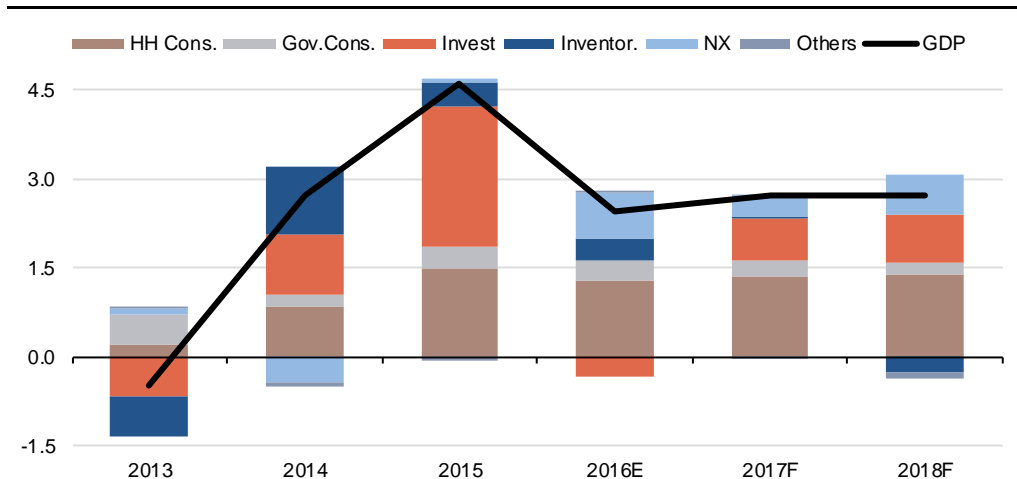
Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Change in our inflation outlook (%)



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Private consumption to drive domestic economic growth



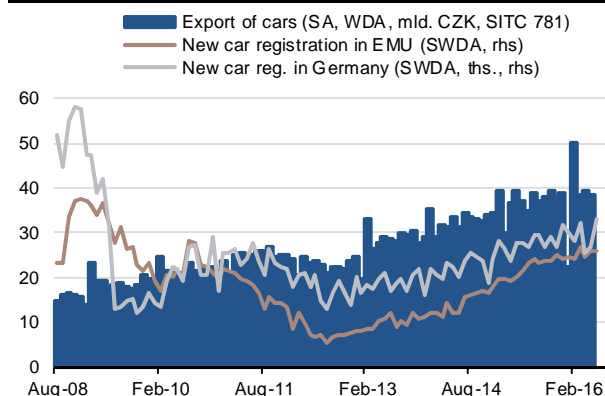
Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

German economic growth accelerated at end-2016, and we think this will give the Czech economy a boost. After decelerating to 0.2% qoq in 3Q16, Czech GDP regained momentum in 4Q, and we forecast 0.8% qoq expansion. This would put overall growth in 2016 at a solid 2.5% despite a slightly negative contribution from investments (read more about the investment cycle in our previous *Czech Economic Outlook* at <http://bit.ly/CEO4q16EN>). Investment activity has been slowly picking up, government consumption increased, external trade probably contributed moderately positively, but **the most important driver was household consumption, which created half of the growth, according to our estimates.**

These trends in the region have spilled over into the beginning of this year. Czech confidence indicators remain elevated. The German manufacturing PMI in January suggests that **economic growth in Germany has not lost steam in the beginning of 2017.** Germany is benefiting from surprisingly stable growth in China, but also due to strengthening domestic demand. Demand for cars has been increasing, although the pace is somewhat easing. We expect the European car market to expand roughly 3% this year, while Czech automakers will be gaining market share, in our view. Industrial production growth should again be pulled up by the automotive sector, though we expect the pace of car production growth to be slower than in 2016. Yet, the contribution of other subsectors should be more supportive this year as

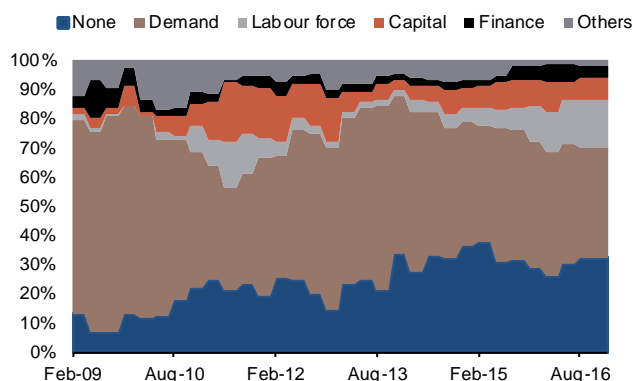
some one-offs drop out. The chemicals industry should be running at full steam for the whole year, as both of the refineries that suffered from long-term shutdowns last year are already fully functional. Also, electricity production should improve, as the Temelín nuclear power plant has planned fewer shutdowns than it had in 2016. On the other hand, the lack of available workforce will remain a drag on growth. **Thus, we see the overall growth of the industrial sector at 4.4% after last year's 3.2%.**

Demand for cars boosting Czech industrial output and exports



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Barriers to growth in industry

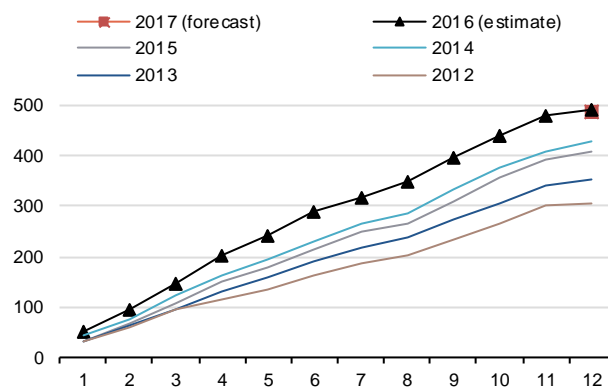


Source: European commission, Macrobond, Economic & Strategy Research, Komerční banka

Rising commodity prices on global markets and a stronger US dollar will exert pressure on the commodity balance. We expect the deficit to deepen rapidly this year. However, rising export prices and modest growth in external demand should propel Czech exports. As with industry, automakers are likely to remain the growth driver for exports, but other sectors should also benefit from the expected

revival of investment activity in the euro area, Germany in particular (see the section *External environment and Assumptions*). That said, a gradual recovery in domestic investment should boost imports on the ex-commodity balance. **Overall, we expect a slight drop in the external trade surplus (in nominal terms) from the record levels achieved last year. After adjusting for higher prices, especially on the commodity balance, we forecast a larger external trade surplus in real terms. Its contribution to real GDP growth should amount to a positive 0.4pp.**

External trade surplus to remain close to historic high (CZKbn)



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

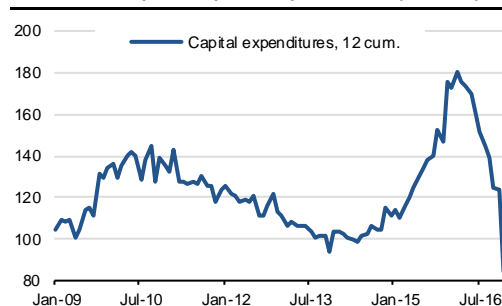
Fiscal policy

The central government budget showed a surprisingly large surplus at the end of last year of CZK61.8bn on a cash basis.

The central government budget showed a surprisingly large surplus at the end of last year of CZK61.8bn on a cash basis, compared with our estimate of CZK25bn. The difference between the actual print and the planned deficit of CZK60bn is striking. We identify two main reasons for this development.

- **Volatility in the drawing of EU funds and the related EU-funded investment:** The year 2015 saw the expiry of the previous programming period for EU funds and the government rushed to utilise as much of the EU money allocation as possible. That said, the EU paid for a significant portion of 2015 investment only at the beginning of 2016. According to the CNB, some CZK90bn of 2016 budget revenues from the EU related to 2015 projects. On the expenditure side, however, the new EU fund programming period got off to a slow start, leading to a very sharp drop in outlays in 2016.

Massive drop of capital expenditure (CZKbn)

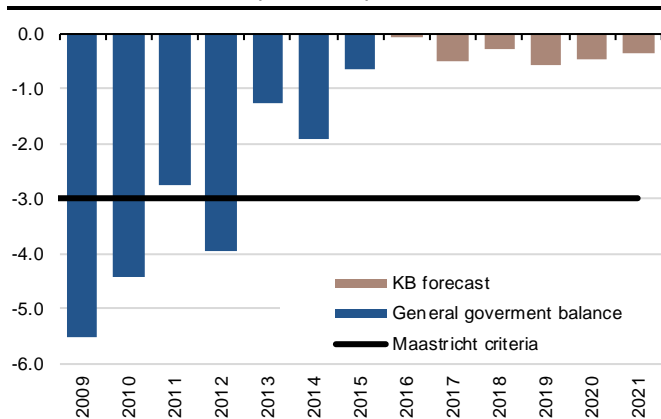


Source: Finance Ministry, Macrobond, Economic & Strategy Research, Komerční banka

- **Extraordinary economic growth in 2015, which continued into 2016, but at a slower pace:** Due to an increase in consumption and a tightening labour market, the government enjoyed significantly higher tax revenues. Thanks to increased corporate profitability and the extra taxation of 2015 profits, the corporate tax intake also surged.

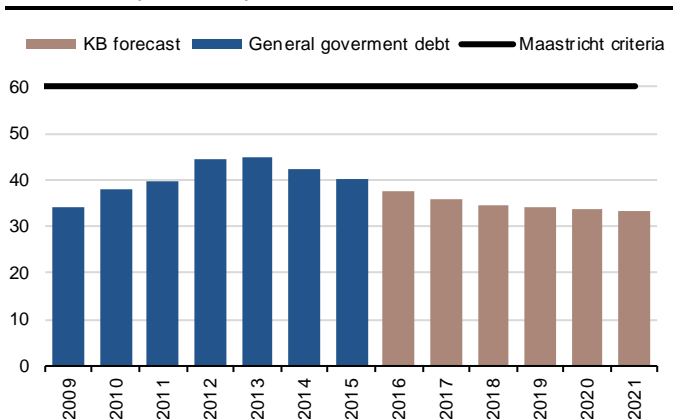
On a different note, VAT revenues increased faster than household consumption, implying some improvement in the tax collection process.

Public finance balance (% of GDP)



Source: CZSO, Economic & Strategy Research, Komerční banka

Public debt (% of GDP)



Source: CZSO, Economic & Strategy Research, Komerční banka

On an accrual base, however, we expect the public sector to record a deficit of 0.1% of GDP in 2016. In line with ESA 2010 methodology, we assume the CZK90bn of extraordinary EU fund inflows will be transferred to 2015 intakes, along with a part of the corporate tax revenues. As a result, the accrued 2016 central government budget should show a shortfall of 0.6% of GDP. In our view, this will be mitigated by local government balance surpluses.

Parliament approved the 2017 budget with a planned cash deficit of CZK60bn. We continue to expect the shortfall to eventually be lower, at CZK45bn.

Parliament approved the 2017 budget with a planned cash deficit of CZK60bn. We continue to expect the shortfall to eventually be lower, at CZK45bn on the back of better GDP growth as per our forecast. However, the economy is set to see a major fiscal stimulus this year, mainly via public sector wages, social benefits, and contributions to the healthcare system (we estimate the impact of these measures at CZK23.5bn). Additionally, the

government has decided to increase the minimum wage by CZK1,100 (11%) to CZK11,000 as of the beginning of 2017, which should stimulate consumption on the one hand, and increase expenditure on the other.

Capital expenditure is set to increase, according to the approved budget. Last year, public investment reached CZK84.7bn (versus CZK176.6bn in 2015), as EU-funded outtakes fell massively (see above). This year, the government targets capital expenditure at a solid CZK103bn (up 22% yoy) due to an increase in both national-funded and EU-funded investment. **However, we continue to see problems in the preparation of new infrastructure projects.** For instance, several construction projects that were expected to obtain exceptional environmental impact assessment (EIA) approval in 2016 were supposed to start in late 2016 or at the turn of the year. To date, however, construction has not started and there has been speculation that these projects could be postponed by another year.

Public finance dynamics

	2015	2016e	2017f	2018f	2019f	2020f
Balance (% GDP)	-0.6	-0.1	-0.5	-0.3	-0.6	-0.5
Fiscal effort (pp GDP growth)	0.3	0.9	-1.2	-	-	-
Public debt (CZKbn)	1,836	1,771	1,791	1,806	1,836	1,861
Debt ratio (% GDP)	40.3	37.4	36.0	34.6	33.9	33.6

Source: CZSO, MoF, Economic & Strategy Research, Komerční banka

Based on ESA 2010 methodology, we expect the public sector deficit to reach 0.5% of GDP in 2017.

Based on ESA 2010 methodology, we expect the public sector deficit to reach 0.5% of GDP in 2017 due to the shortfall in the central government balance, which should be mitigated by a minor local government surplus, in our view.

Public debt

Given our call for economic output to rise by a healthy 2.7%, the debt-to-GDP ratio ought to decline by 1.4pp to 36% this year, in our view.

We estimate that in 2016, public debt as a share of GDP declined by 2.9pp to 37.4%, which would be the first time it will have moved below 40% since 2011. Central government debt dropped by CZK60bn last year (slightly lower figure than the budget surplus), and we assume local government debt will have also declined by a further CZK5bn. In 2017, we forecast public debt to rise by CZK20bn due to the expected budget deficit, and be mitigated by a tapping of the liquidity reserve. **Given our call for economic output to rise by a healthy 2.7%, the debt-to-GDP ratio ought to decline by 1.4pp to 36% this year, in our view.**

Somewhat surprisingly, the law on fiscal responsibility made it through the legislative process, was signed by the President and is scheduled to take effect in 2018. We view the law as rather toothless. For more comments, please refer to our previous *Czech Economic Outlook*: <http://bit.ly/CEO4q16EN>.

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Infrastructure investment to start only gradually

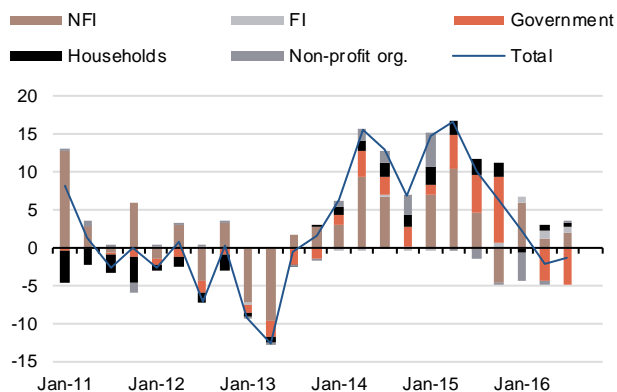
Tapping of EU funds off to a sluggish start.

The paragraphs above showed that although government has devoted a relatively large sum of money to infrastructure, we fear that it will not be able to tap all these funds. Investment activity will thus remain subdued.

An unusual investment cycle has developed in the new EU countries, including the Czech Republic. The EU has dedicated a significant amount of structural and cohesion funds. Yet, the states are unable to tap them gradually, which creates spikes at the end of the programming periods and drops in the beginning of the new programming periods. It is not only an issue of

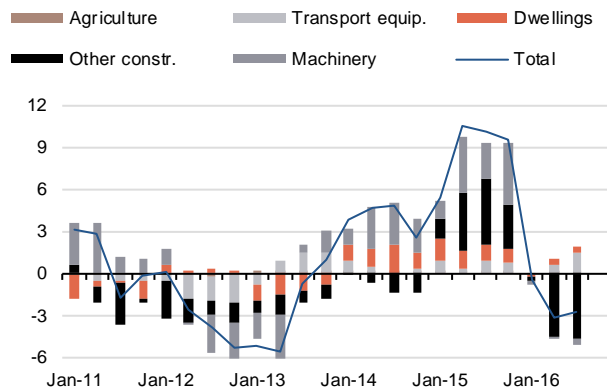
public investment, but private investment also suffers from this problem. We published an in depth analysis of the investment cycle connected with EU funds, which we described in our last *Czech Economic Outlook* which you can download here: <http://bit.ly/CEO4q16EN>.

Government investment dropped sharply (% , yoy) ...



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

... especially in the construction sector (% , yoy)



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

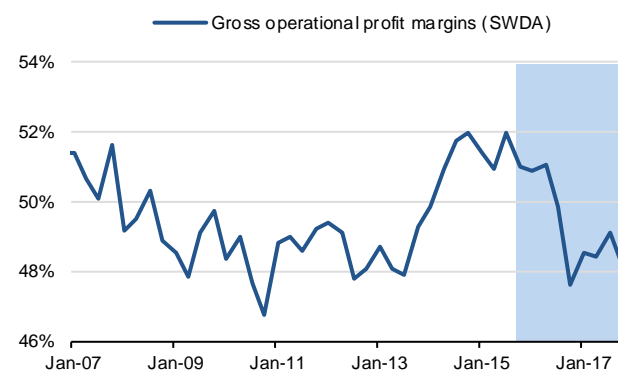
The conditions for private investment are still very favourable. The Czech economy has entered the fourth consecutive year with above-potential growth, and though the business cycle has already passed the recovery phase and is deeply in expansion mode, interest rates are still very low. **The economy's medium-term growth prospects remain decent, and the economic trends among the country's main business partners have been surprising to the upside.**

Profit margins are set to decrease due to FX volatility and rising wage pressures.

Yet, businesses remain cautious, as they face several headwinds in the long term. A lack of infrastructural development and uncertainty about its construction is among the obstacles. The fragility of external demand, magnified by a dearth of infrastructural reforms in the euro area and combined with political uncertainty are also impeding business

confidence. Moreover, the lack of available labour force is worrisome for non-financial institutions, which are left wondering whether there will be anyone to operate their new investment. The labour shortage has also turned off some investors a seeking cheap workforce in the Czech Republic.

Profit margins will come under pressure



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

One big uncertainty for non-financial corporations (NFCs) is the CNB's exit from the FX floor. CZK appreciation would cut into profit margins. In the short term, the businesses will have to deal with elevated market volatility. In the long term, they will have to deal with renewed convergence through the exchange rate. **These uncertainties are weighing on the investment plans of NFCs.** Moreover, profit margins have already started to decline, doing

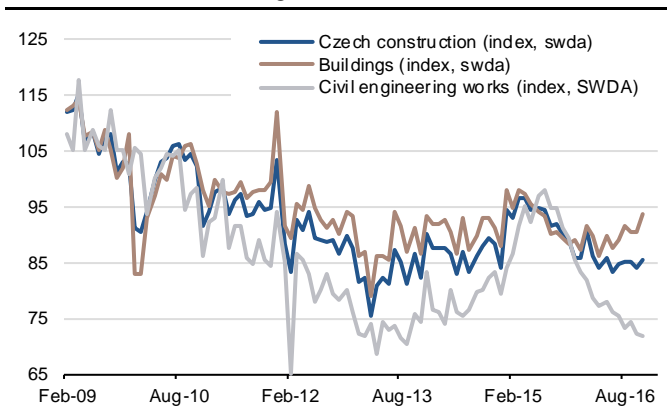
so in 3Q16, as NFCs had to increase wages significantly. This trend is set to continue, in our view. Either profit margins will decrease even more, or NFCs will find a way to increase their productivity. We expect the reality to be a combination of both scenarios. To increase productivity, some producers will need to invest to improve their technology. **Overall, we expect a gradual recovery in investment activity and forecast growth of 2.8% in 2017 after a decrease of 1.2% in 2016.**

The construction sector also faces many problems.

As described above, there is a lack of new infrastructure. The government plans to approve a new construction law this year, which should ease the approval process for new construction. The duration of the approval process is one of the biggest problems. Another issue in the construction sector is the situation in

Prague. The capital of the Czech Republic lacks a new metropolitan zoning plan that would define what areas can be used for commercial or housing construction. The development of the zoning plan is a long-term process that is not close to reaching a conclusion. This underpins our view that the construction sector's recovery will be sluggish. **We expect it to grow a modest 1.7% this year after it dropped an estimated 8.1% last year.**

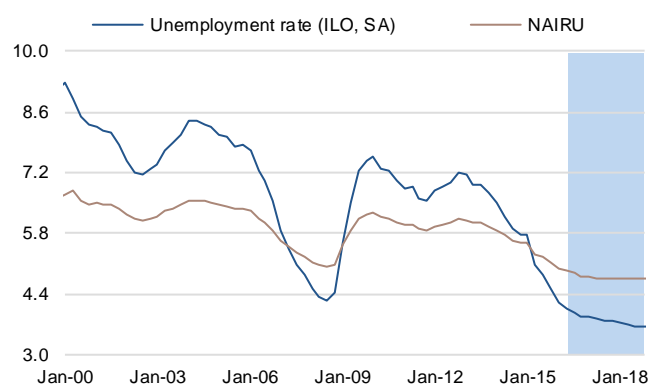
Construction sector facing headwinds



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Wage growth to boost household consumption

Unemployment rate deeply below NAIRU (%)

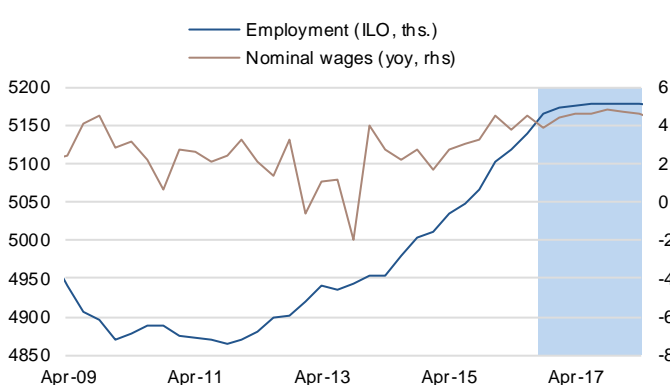


Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Household conditions remains exceptional: unemployment has hit new lows, and wage growth is accelerating.

The past two years were marked by significant growth in employment, which was the main driver of rising household purchasing power. We expect employment growth to decelerate this year. The unemployment rate has declined to a historical low (3.8%, according to ILO methodology) and is reaching a bottom, in our view. Employment was supported by an inflow of foreigners and increased participation of retirement-age people (already marked as out of the labour force). We do not expect these flows to continue with the same intensity.

Employment growth to ease; wages set to accelerate



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

The shortage of labour puts increasing pressure on wages. Last year, the pressures were not felt as strongly, as the labour supply was benefiting from external supply. The unemployment rate has dropped deeply below its NAIRU level, spurring wage growth. We expect remuneration growth to accelerate this year as the competition for workers intensifies. **Nominal wage growth will also be pushed by accelerating inflation. Overall, we expect nominal wages to add 4.6% this year. In real terms, wage growth should stabilise at 2.4%, providing a sound boost to household purchasing power.** Many businesses are still worried about the sustainability of recent expansion and thus are reluctant to offer sharp wage increases. They compensate their employees with other non-monetary benefits (company cars, extra sick days and holidays). These benefits also increase the purchasing power of households.

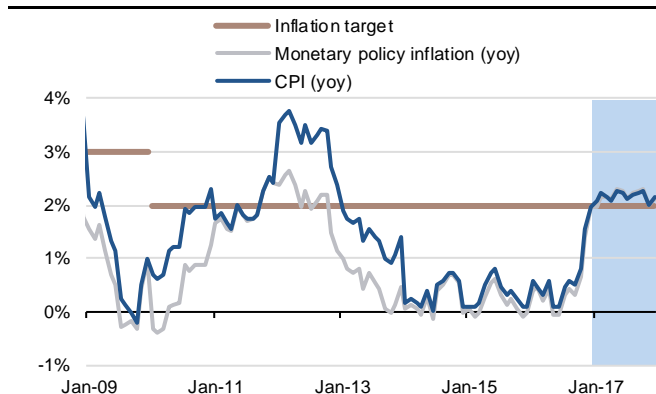
Given all the factors outlined above, we believe household consumption will continue to post sound growth. Despite all the uncertainty we have highlighted, labour market tightness should keep their employment prospects stable. The sound economic outlook and prospects for higher wages is easing the worries of employees. In January, consumer confidence matched its historical high from the beginning of 2016. **Thus, we expect household consumption growth to accelerate to 2.7% this year, two ticks higher than our estimate for 2016.** The only factor that could impede private consumption is expected price growth.

Inflation to overshoot CNB target over 2017

End-2016 was marked by an unexpected surge in inflation, which surpassed even our relatively aggressive forecast. In December, inflation hit the CNB's 2% target. The surprise was caused mainly by growth in food prices and core prices. The latter was partly due to the secondary effects of introducing the electronic registration of sales in hotels and restaurants, but we saw other pressures in core prices. Inflation was supported by all the main items with the exception of administered prices. This suggests that the growth is robust. Our estimates show that inflation is here to stay. We expect the average yoy price increase this year to amount to 2.2%. We do not expect the CNB's exit from the FX floor to have strong disinflationary effects, as we do not see the koruna appreciating beyond EUR/CZK26 (see the section *Czech FX Market*), and high volatility after the exit will likely impede the exchange rate pass-through to prices.

Core inflation, according to our calculations, climbed to 2% in December 2016. Core prices received a significant push from the introduction of electronic registration of sales in that month. After this went into effect, some restaurants decided to increase prices despite the reduction in VAT on their services. The registration itself, also thanks to lower taxes, is not a reason for such a price increase. Nevertheless, prices in the restaurants have not moved so significantly for some time, and we now see several cost pressures that justify price growth. Food prices started to grow markedly, wage pressures strengthened and rents are rising (especially in Prague). Yet, this was not the only reason for the pick-up in core inflation. Besides domestic demand pressures stemming from growing consumption, external pressures are also emerging. We see prices growing in surrounding countries, including Germany. For the Czech Republic, this means import and fuel price growth accelerated, and this is continually passing through into domestic developments. **Thus, we believe core inflation will continue growing, and it should peak around the turn of 2017-18 at 2.6%. On average, we expect core prices to rise 2.4% yoy in 2017.**

Inflation to overshoot this year



Source: CZSO, CNB, Bloomberg, Macrobond, Economic & Strategy Research, Komerční banka

Fuel price inflation is supported by the base effects, but also by a modest increase in oil prices on the global market.

Fuel price inflation has been supported recently by statistical base effects, as oil prices dropped massively in the beginning of 2015. Moreover, oil prices have risen due to the agreed OPEC production cut in December 2016. A couple of non-OPEC producers joined the agreement, and it pushed oil to \$55/bbl in early December. Since then, Brent crude has remained very close to that level. We

expect oil prices to reach \$60/bbl at the end of the year, providing domestic fuel prices with a modest push. Still, in the beginning of the year, the statistical base effect will remain strong and yoy growth in fuel prices should jump to 13.5% in 1Q17, and then ease during the rest of the year. **On average, we expect fuel prices to rise 9.1% this year.**

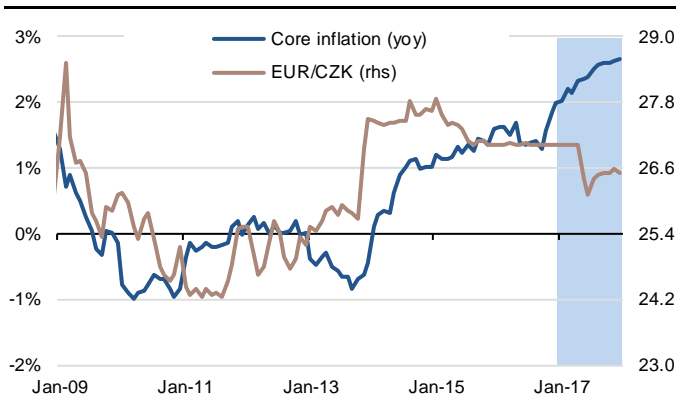
Food price inflation will be high also due to base effects.

Food prices surged in 2H16, following an increase in agricultural prices. Similarly to fuel price inflation, food price growth will be impacted by statistical base effects, as food prices remained very low through 1H16. Food prices are affected by oil price which is closely correlated with fertiliser prices, and the cost of transportation passes through to food prices to a large extent as well. We thus expect modest food price inflation this year, though **base effects should ensure that the yoy figure will print 2.4% this year.**

Administered prices will smooth the inflation dynamics.

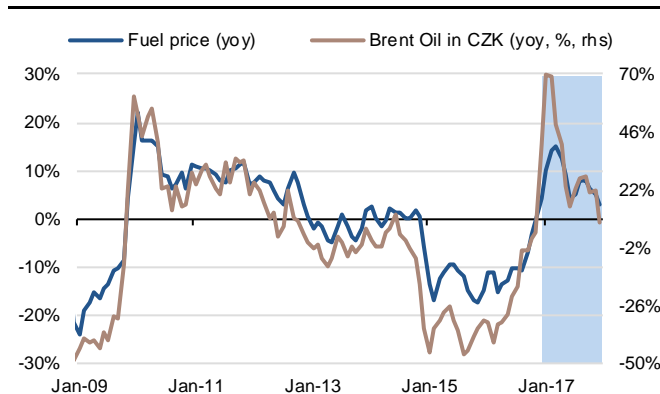
Administered prices dropped in May 2016 as gas distributors cut their prices. We expect there was a further cut of gas prices for consumers in the beginning of this year. **Administered prices should decrease 0.5% mom in January. Their disinflationary effects will partly balance out the surge in fuel and food inflation in the first months of the year. In contrast, in May, the effect of last year's decline in gas prices will fade, just when the base effects for fuel prices lose their strength.** Thus, administered prices will serve as a balancing item, which should prevent inflation from spiking early in the year and dropping when base effects disappear.

Core inflation to accelerate despite exit



Source: CZSO, Bloomberg, Macrobond, Economic & Strategy Research, Komerční banka

Fuel price inflation to surge due to base effect



Source: Bloomberg, CZSO, Macrobond SG Cross Asset Research/Economics, Economic & Strategy Research, Komerční banka

Risks: high volatility after FX floor exit might impede domestic growth

Poorly managed exit would jeopardise domestic growth.

The main event in the domestic economy this year is the exit from the FX commitment regime. It also constitutes the biggest threat to the economy. If the CNB is unable or unwilling to mitigate excessive volatility on the FX market, it could create significant problems for domestic export-oriented industry. Sharp CZK appreciation would cause excessive deflation. Both of the above effects would jeopardise the competitiveness of Czech industry and thus be drag on domestic growth.

Developments around Brexit to remain a risk.

The developments around Brexit will remain in the spotlight. UK Prime Minister Theresa May indicated that the UK will not stay in the single European market. Given the Czech Republic's strong trade ties with the UK, the deal that is ultimately reached between the EU and UK will determine the economic consequences of Brexit for the Czech economy and for all other EU states.

This is an election year in many important European countries (France, Germany, the Netherlands, and potentially in Italy). Political uncertainty in these countries might hamper economic growth, which could translate into lower external demand for Czech products.

Investment to remain a weak point in the long-term growth scenario.

Another delay with infrastructure projects in the Czech Republic would cause lower investment this year, but it would also jeopardise the economy's long-term potential. On the other hand, if the government were able to expedite the preparation phase of such projects, it would clearly provide a boost. Infrastructure construction has been crucial for recent economic growth, and the infrastructure deficit is hindering potential economic growth.

Key economic indicators

	Q4 16	Q1 17	Q2 17	Q3 17	Q4 17	Q1 18	Q2 18	Q3 18	2016	2017	2018	2019	2020	2021
GDP and its breakdown														
GDP (real, yoy)	2.4	2.7	2.4	2.9	2.7	2.7	2.8	2.7	2.5	2.7	2.7	2.3	1.5	2.0
Household consumption (real, yoy)	2.9	2.7	3.2	2.9	2.8	3.0	2.9	3.1	2.7	2.9	2.9	1.4	0.3	1.1
Government consumption (real, yoy)	1.0	1.6	0.8	1.2	1.9	1.3	1.1	1.1	1.8	1.4	1.1	1.4	1.9	1.7
Fixed investments (real, yoy)	-1.8	1.1	4.7	2.8	2.6	2.5	3.3	3.4	-1.2	2.8	3.1	3.2	4.3	5.0
Net exports (contribution to yoy)	0.3	0.6	0.1	0.4	0.3	0.7	0.5	0.7	0.8	0.4	0.7	0.5	0.3	0.2
Inventories (contribution to yoy)	1.1	0.2	-0.4	0.0	0.1	-0.2	-0.2	-0.3	0.3	0.0	-0.3	-0.3	-0.7	-0.2
Monthly data from the real economy														
Foreign trade (CZK bn) (*) (***)	117.3	117.4	121.6	123.5	125.9	130.1	129.1	130.2	491.3	487.1	520.1	538.9	551.9	564.6
Exports (nominal, yoy) (*)	-1.0	1.1	5.4	7.1	6.6	6.2	5.8	6.1	2.3	5.1	5.8	1.1	2.1	4.6
Imports (nominal, yoy) (*)	-0.8	3.6	6.9	6.5	6.4	5.8	5.8	6.2	0.1	5.9	5.7	0.8	2.0	4.9
Industrial production (real, yoy)	4.0	3.2	3.8	6.4	4.1	3.8	4.5	4.8	3.2	4.4	4.5	1.9	1.3	3.2
Construction output (real, yoy)	-4.1	-1.6	3.7	2.4	2.3	0.6	2.0	3.5	-8.1	1.7	2.6	3.7	3.0	1.5
Retail sales (real, yoy)	5.6	4.8	4.9	5.1	4.0	4.3	4.3	4.2	6.0	4.7	4.1	1.5	-0.8	0.6
Labour market														
Wages (nominal, yoy)	3.9	4.4	4.6	4.6	4.8	4.8	4.6	4.3	4.2	4.6	4.4	2.2	0.9	2.2
Wages (real, yoy)	2.4	2.2	2.3	2.3	2.6	2.3	2.2	2.0	3.5	2.4	2.0	0.4	-0.4	0.9
Unemployment rate (MLSA)	5.2	5.2	4.6	4.7	5.0	5.1	4.5	4.5	5.4	4.9	4.7	4.8	5.1	5.3
Unemployment rate (ILO 15+)	3.8	4.0	3.7	3.8	3.7	3.9	3.6	3.7	4.0	3.8	3.7	3.7	4.0	4.2
Employment (ILO 15+, yoy)	2.0	1.4	1.1	0.7	0.3	0.1	0.0	-0.1	1.8	0.9	0.0	-0.2	-0.5	-0.2
Consumer and producer prices														
CPI Inflation (yoy)	1.4	2.1	2.2	2.2	2.1	2.3	2.3	2.2	0.7	2.2	2.3	1.8	1.3	1.2
Taxes (contribution to yoy inflation)	0.1	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Core inflation (yoy) (**)	1.8	2.1	2.4	2.6	2.6	2.6	2.4	2.2	1.6	2.4	2.3	1.3	0.7	0.6
Food prices (yoy) (**)	1.2	2.8	3.0	2.2	1.7	1.3	1.4	1.3	-0.9	2.4	1.3	1.6	1.6	1.5
Fuel prices (yoy) (**)	0.2	13.5	9.4	7.8	5.7	1.7	1.2	1.1	-8.5	9.1	1.5	-2.2	-0.8	-0.5
Regulated prices (yoy) (**)	-0.1	-1.1	-0.7	-0.3	-0.2	2.4	3.1	3.8	0.2	-0.6	3.4	4.7	3.6	3.6
Producer prices (yoy)	-1.1	2.9	3.3	4.1	4.0	3.2	2.8	2.4	-3.2	3.6	2.5	1.4	1.7	2.0
Financial variables														
2W Repo (average)	0.05	0.05	0.05	0.05	0.05	0.05	0.24	0.65	0.05	0.05	0.49	1.10	0.91	1.18
3M PRIBOR (average)	0.29	0.29	0.29	0.29	0.29	0.29	0.41	0.88	0.29	0.29	0.68	1.27	1.06	1.32
EUR/CZK (average)	27.02	27.02	26.40	26.50	26.50	25.84	25.31	24.91	27.0	26.6	25.2	23.9	23.4	22.9
USD/CZK (average)	25.09	27.02	25.14	24.77	24.31	23.93	23.43	22.86	24.4	25.3	23.1	20.4	19.4	18.9
External environment														
GDP in EMU (real, yoy)	1.8	1.7	1.8	1.7	1.5	1.4	1.4	1.4	1.7	1.5	1.4	1.1	0.6	1.2
GDP in Germany (real, yoy)	1.9	1.6	1.6	1.8	1.5	1.5	1.4	1.3	1.8	1.6	1.3	1.1	0.7	1.4
CPI in EMU (real, yoy)	0.7	1.5	1.5	1.5	1.5	1.4	1.5	1.5	0.3	1.5	1.5	1.5	1.5	1.4
Brent oil price (USD/bbl, average)	51.0	52.5	55.0	57.5	60.0	62.0	64.0	66.0	45.0	56.3	65.0	70.0	75.0	75.0
EURIBOR 1Y (average)	-0.07	-0.07	-0.08	-0.08	-0.08	-0.09	-0.08	-0.08	-0.03	-0.08	-0.08	-0.08	-0.07	-0.04
EUR/USD (average)	1.08	1.00	1.05	1.07	1.09	1.08	1.08	1.09	1.11	1.05	1.09	1.17	1.21	1.21

Source: Economic & Strategy Research, Komerční banka

Note: (*) foreign trade according to cross border statistics;

(**) these parts of inflation are adjusted for the primary effect of indirect tax changes;

(***) the quarterly data are seasonally adjusted.

CNB Focus

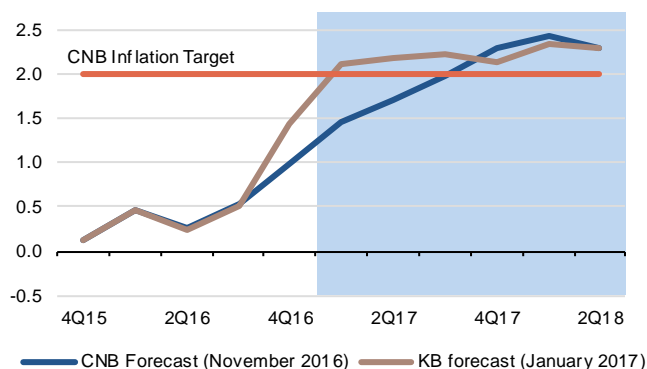


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Nothing is in the way of FX floor removal

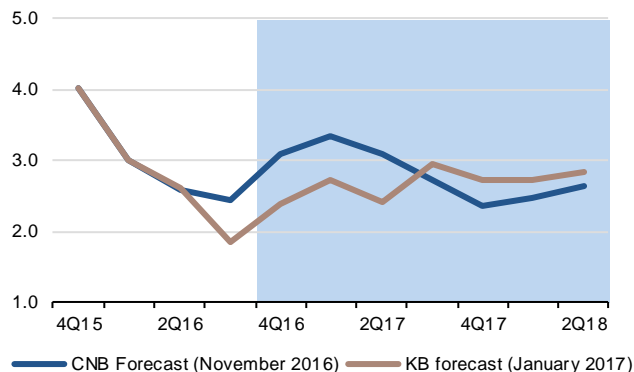
The FX floor at EUR/CZK27 will certainly stay in place until the end of 1Q17. Thereafter, it will depend on the development of inflation dynamics. In the last quarter of 2016, the inflation rate surpassed even our aggressive forecast. It was even more of a surprise for the Czech National Bank (CNB), which in its last forecast expected inflation to reach only 1.3% at the end of 2016 and expected the inflation target to be hit as late as in 3Q17. The surge in inflation attracted huge speculative inflows, but the CNB seems reluctant to react to this. The central bank will probably try to play down some inflationary factors as only temporary, yet it will have to face the overshooting of the target during most of this year. Thus we still believe that the floor will be scrapped in the second quarter, but that the CNB will tolerate slight inflation overshooting and will not deliver any hikes this year.

Inflation outlook (%)



Source: CNB, CZSO, Macrobond, Economic & Strategy Research, Komerční banka

GDP outlook (%)



Source: CNB, CZSO, Macrobond, Economic & Strategy Research, Komerční banka

The CNB keeps the FX floor at EUR/CZK27 via automatic and potentially unlimited interventions. It has proved its dedication to maintaining the floor, having already purchased euros amounting to roughly €44bn (KB estimate) since the beginning of the interventions. The CNB has committed to defending the EUR/CZK27 level at least by the end of 1Q17; after that, the CNB does not guarantee anything. The Bank Board as well as the CNB forecast expects the removal of the floor around mid-2017. The exact timing of the exit will depend on current inflation dynamics and its expected path.

CNB surprised by inflation dynamics

Czech inflation surged in the last quarter of 2016. Price growth acceleration surprised markets, but must have shocked the CNB. Inflation hit its 2% target in December, whereas the central bank had expected in 3Q17. In its last forecast, the CNB expected inflation to end 2016 at 1.3%, putting the deviation with its forecast to realized figures at a significant 0.7pp. From the CNB's standpoint, the surprise came mainly from food and core prices. In its comment on the December inflation figure, the CNB played down the reaction of businesses on the introduction of the electronic registration of sales (starting in December 2016) as a one-off, which would disappear from inflation over 12 months. However, the electronic registration of sales explains only part of the deviation from its core inflation forecast. Core prices (according to CNB's calculation) increased 1.4% yoy in the fourth quarter, while the CNB had

expected only a 1% rise in its previous forecast. Our estimates suggest that only 0.2pp of the increase was due to electronic registration of sales. The fact that core inflation started its acceleration in October simply corroborates that there are also other pressures on inflation apart from the new regulation in sales. Indeed, governor Rusnok stated in an interview with *Mlada Fronta DNES* newspaper that this recent development is probably not only a temporary upswing; however, he is waiting for a fresh forecast before making any firm judgments. Our forecast suggests that inflation will remain above the CNB's target for all of 2017 and that it should continue to overshoot in 2018. **The FX commitment already has fulfilled its objective, as it pushed inflation to the 2% target and nothing is in the way of its removal. As a result, we expect the Bank Board to scrap the floor in the second quarter of this year.**

BOX 1: ECB policy is unlikely to have a major impact on CNB policy

In November, the ECB decided to extend its asset purchase programme by nine months, until the end of this year. It also announced that from April 2017 it would reduce the amount of bonds purchased by €20bn to €60bn. In our view, the volume of asset purchases will be reduced by €10bn each month from July, meaning that the quantitative easing programme will end in January 2018.

Regarding the policy of the CNB, the extension of the ECB's asset purchases should not have a major impact. At the press conference that followed the Czech central bank's December meeting, Governor Jiri Rusnok said: *"The behavior of the ECB essentially has no impact on us. We had been expecting its decision; even we anticipated that it would continue the asset purchase program until the end of 2017 at the current level. I would not overestimate the impact on us at the moment and we do not see the need to respond."*

The ECB's quantitative easing programme could affect the Czech economy in several ways. The asset purchases should stimulate inflation and economic growth in the euro area, which could spill over into the Czech economy through higher demand for Czech goods and higher imported inflation. The ECB's asset purchase programme has pushed euro-area bond yields lower. The prospect of higher yields could attract more investors to the Czech Republic and put additional upward pressure on the Czech koruna. For foreign investors, however, Czech bonds are attractive regardless of ECB policy due to the significant drop in EUR/CZK cross currency basis swaps, which provide a cheap form of financing for foreign investors. While in the period before the intervention, cross-currency basis swaps (12M, bid) oscillated at around -40bp, due to the lack of euros in the market they have since dropped to -180bp. The significant premium that foreign investors gain for their euros motivates them to lend euros and buy Czech government bonds for the Czech koruna they obtain, and particularly short-dated bonds. This in turn pushes yields down at the short end of the yield curve. The lack of euros will dominate the market even after the floor is removed. Basis swaps should thus normalise very slowly, which means demand will remain strong at the short end of the Czech yield curve. As a result, rather than ECB policy, it is the decline in EUR/CZK basis swaps that is behind the pressure at the short end of the Czech yield curve (and this is likely to continue after the exit).

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Floor to be removed at monetary policy meeting; May the obvious candidate

The CNB announced that the Bank Board would vote on an exit at one of its monetary policy meetings. It does not necessarily have to be at one of the regular meetings, but we believe the

May regular session may be convenient. The Bank Board will have a new forecast at hand. It is sufficiently close to their guidance for the floor to be scrapped around mid-2017, but this is still relatively soon as the inflation outlook suggests that the CNB should not hesitate to remove the floor. **Thus, we expect the Bank Board to remove the floor at its regular May monetary policy meeting on 4 May.** We see a risk that the CNB will call an extraordinary monetary policy meeting in April to remove the floor as soon as its commitment allows. The risk of a later exit is significantly lower.

BOX 2: Two new CNB bank boards has completed majority named by Zeman

President Zeman has appointed two new CNB board members on 31 January effective 13 February this year. Oldřich Dědek and Marek Mora will take the seats. Now the majority of the Bank Board will be constituted by President Zeman's nominees.

We expect that the monetary policy will not change substantially. Like the previously appointed members of the CNB Bank board by Miloš Zeman they share lukewarm relationship to the exchange rate regime which are willing to accept only for a very limited time. They will use the current favourable situation to abandon the FX floor regime as we write in this report.

Oldřich Dědek is a part of the group of only lukewarm supporters of the FX floor commitment due to his earlier statements regarding the current monetary policy regime. Marek Mora as a high official of the European Commission did not comment publicly the monetary policy of the Czech Republic.

Overall, new composition of the CNB Bank Board appears to be more dovish. However, the empirical evidence we have only for O. Dědek. This evidence comes from voting records during his first term as the Deputy Governor of the Czech National Bank during 1999-2005. This analysis and more detailed evaluation of our expectations from the new bank board members in the field of monetary policy can be found in our special report "New central bank board appointees pose no risk for FX floor prolongation" available on our webpage http://bit.ly/SR_newBR_en.

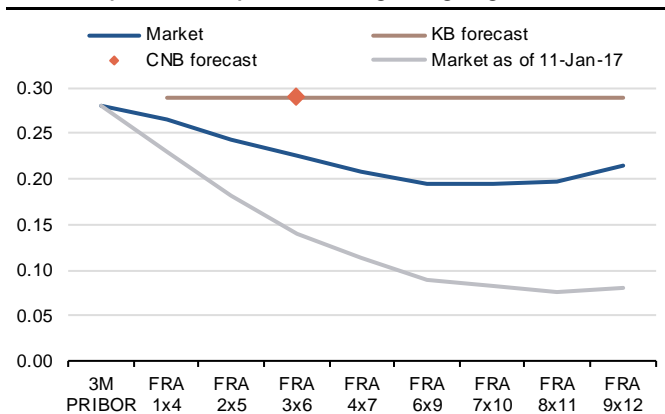
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Despite a massive speculative inflow in January, negative rates seem unlikely

In early-January, speculative flow massively increased. Our estimates show that the CNB had to purchase €13bn to underpin the floor in the full month. The market perception of CZK speculative purchases has started changing recently. The EUR/CZK appears overbought now. The inflow of new speculative capital has thus eased and the forward rates have been

going up. Although we do not believe this is the end of the story, we drop our call for negative rates. We still expect there will be another wave of CZK purchases and that the CNB will be

Market squared its expectations regarding negative rates



Source: CNB, Bloomberg, Economic & Strategy Research, Komerční banka,

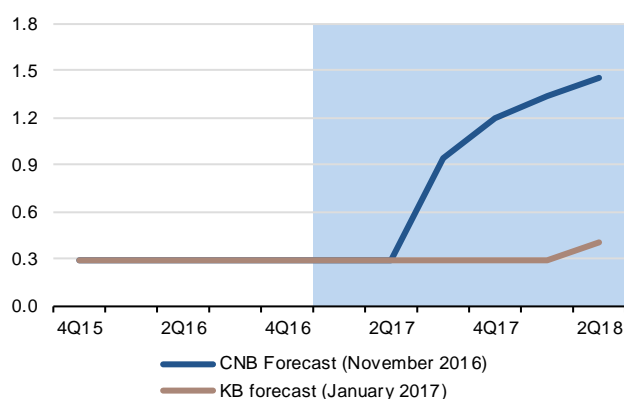
forced to intervene again. Indeed, during speculative interest recently, the CNB proved it does not have a problem intervening without limits. Moreover, the CNB even stopped threatening with negative rates, although verbal intervention would likely limit speculative inflows. The board members continue to claim that they are not worried about intervention volumes and that their monetary policy mandate cannot be limited with respect to balance sheet size. At the press conference after the last meeting, governor Rusnok mentioned that there is a minority on the Board who would like to introduce negative rates. Recent appearances by board member Lízal (statements on the panel at the Euromoney conference in Vienna, interviews for *Euro* magazine and Slovak *Hospodářské noviny* newspaper) reveal that is part of the minority pushing through the introduction of negative rates. However, Lízal's mandate ends on 12 February and this minority will thus probably become even smaller. We assume that vice-governor Tomšík will be the only member left and he downplayed the need for negative rates in his recent interview for Reuters¹. **Although negative rates are not part of our baseline scenario any longer, we still see a significant risk of their introduction in the event speculative flows intensify more than in the beginning of 2017.**

No hikes this year despite inflation overshooting

Removing the floor amounts to monetary policy tightening. Moreover, the exit will induce surge in volatility on the FX market. The CNB will thus be cautious in increasing its interest rates, in our view. First, given our forecast that the ECB will end its QE program only at end-2017 and that it is not set to increase the rates at least until 2021 as per SG forecast, hikes would widen

the interest rate differential and attract even more flows to the FX market, increasing volatility. Second, in our view, the Bank Board will want to see the effects of the floor removal on inflation before starting to further tighten monetary conditions.

CNB not to start hiking this year (%)



Source: CNB, Macrobond, Bloomberg, Economic & Strategy Research/Economics, Komerční banka

February to bring massive upside revision of inflationary forecast

We believe that the February meeting will not bring much change. The only news should be a change in the forecast. **We assume that the inflation forecast will be raised significantly.** Nevertheless, the Bank Board will confirm its commitment to maintaining the floor at least until the end of 1Q17. Central bankers likely will repeat that the data still suggest the exit will occur around mid-2017, but more precise timing will not be disclosed. They will reassure markets that the CNB is prepared for potentially unlimited intervention and the CNB will not sacrifice monetary policy goals to limit potential accounting losses. The debate about negative rates will remain within standard boundaries. We will closely watch how the CNB evaluates inflation developments. The recent surge in food and core inflation could be played down a bit.

¹ http://www.cnb.cz/en/public/media_service/interviews/media_2017/cl_17_170125_tomsik_reuters.html



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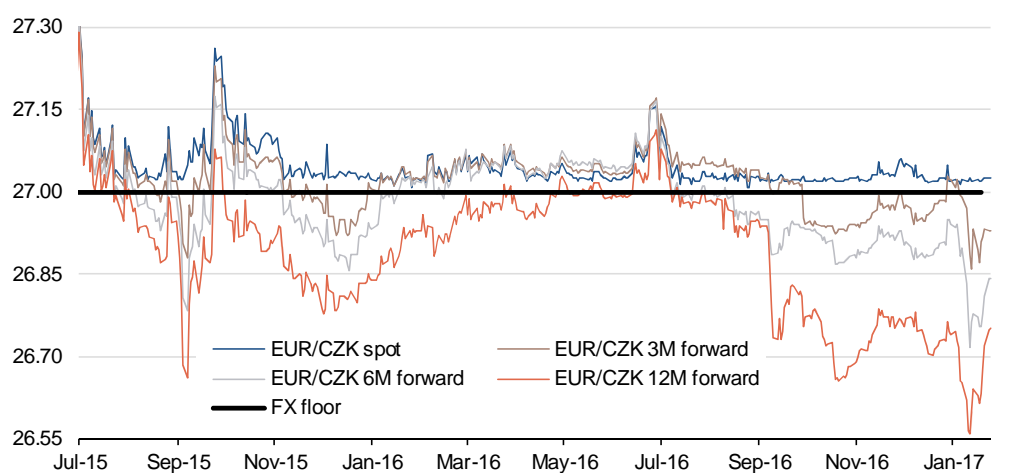
Last year, EUR/CZK volatility was the lowest since the Czech Republic introduced managed currency floating in May 1997.

Czech FX Market

Exchange rate stability to end soon

The EUR/CZK exchange rate saw little volatility in 2016, as the spot rate stayed very close to the CNB's FX floor on all but a few days. It only diverged from the EUR/CZK27 level for a very short time in periods of increased geopolitical uncertainty after the June referendum in the UK and after the November presidential election in the US.

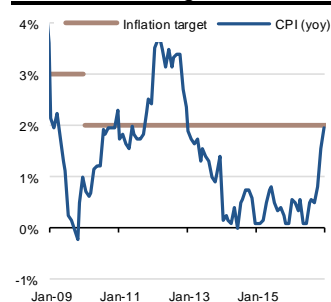
Only the EUR/CZK spot rate is stable, unlike forward rates



Source: Bloomberg, Economic & Strategy Research, Komerční banka

Volatility was much stronger on the forward market.

Czech inflation surges



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

The volatility of forward rates is all the more visible against the backdrop of exchange rate stability on the spot market. Movements of speculative capital have a major impact on this volatility. Its inflow strengthened in the 2H16, as the CNB's expected exit from the FX floor moved into the investment horizon of speculators, demand from which was also underpinned by inflation trends: price growth was picking up steam as 2016 drew to a close. In December, inflation hit the CNB's 2% target. The inflow of speculative capital swelled again, and significantly so, at the beginning of 2017. Thus, the 12m forward EUR/CZK rate hit 26.55 (bid quotes) for a short time. We focus on the forward market in more detail in the following box.

BOX 3: EUR/CZK forward market in focus

A standard FX forward is an agreement to exchange two currencies at a pre-set rate on a fixed date in the future. A forward consists of the currency spot rate and forward points, the latter determining the difference between the forward rate and the spot rate. In theory, forward points should reflect the interest rate differential. In reality, though, they also incorporate demand/supply factors, market imbalances and risk premiums.

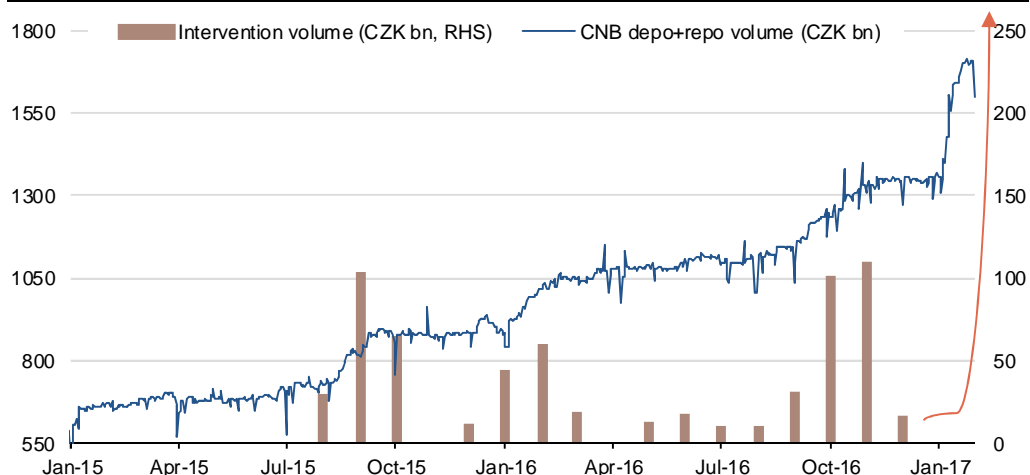
EUR/CZK forwards are among the main ways to speculate on CZK appreciation after an exit from the FX floor. Investors would make money if they sold a EUR/CZK forward at a specific rate and the EUR/CZK spot were below the forward rate at the date of maturity (it is also possible to close the position ahead of maturity and make money from the relative move of the EUR/CZK forward). This is similar to export hedging, although there are real underlying flows behind export hedging.

How do EUR/CZK forward trades affect CNB intervention? Counterparties of EUR/CZK forward sellers usually have to close their open positions, and they do it on the spot market. If the spot rate were to trade below the floor level, the CNB would have to intervene and buy the excess EUR influx. The CZK liquidity created by intervention would end up with the CNB in depo and reverse repo facilities, as the Czech banking sector has excessive liquidity.

In September and November 2016, EUR/CZK forwards fell sharply, mirroring mounting market expectations that the end of the FX floor was coming and that the CZK was set to strengthen. Inflow intensified sharply again in early January 2017, when demand for hedging also played a role.

Consequently, the volume of depo and reverse repo operations with the CNB spiked massively. In January alone, the rise in interbank liquidity was due to some €13bn of CNB intervention (roughly CZK350bn) on our estimates – the largest single monthly influx of EUR. Of this, €10bn was in the first two weeks of January, which corresponds to the sharp drop in EUR/CZK forwards at the time.

Significant increase in interbank liquidity due to CNB's intervention



Source: CNB, Economic & Strategy Research, Komerční banka

These vast inflows of capital, massive intervention by the CNB, and volatility spill over into the CZGB market. The CNB's EUR purchases and stretched market positions make EUR financing on the Czech market expensive, while CZK financing is very cheap for EUR-funded (or USD-funded) investors. This is represented by the sizeable drop in EUR/CZK cross-currency (XCCY) basis swaps, a counterpart of forward points. As a result, for hard currency investors, it is attractive to lend their EUR (or USD) to the Czech market for an attractive premium (the basis swap) and buy CZGBs with their new CZK, even at negative yields. The XCCY basis swap converts the negative yield on CZGBs into a profit in the hard currency.

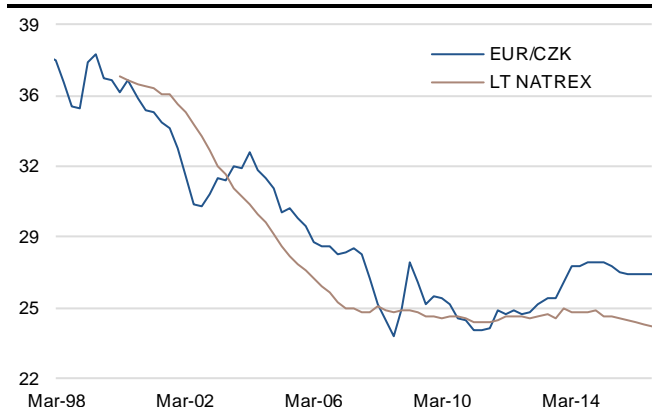
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Exchange rate volatility bound to increase after exit; stronger Czech koruna is no certainty

We see the long-term equilibrium rate at EUR/CZK24.80, but the path to this will likely be slow.

Speculators expect the CZK to strengthen in the wake of the exit. Our model of the long-term equilibrium exchange rate based on the NATREX² approach actually indicates that the koruna is currently significantly undervalued. For 2Q17, our estimate suggests EUR/CZK24.40.

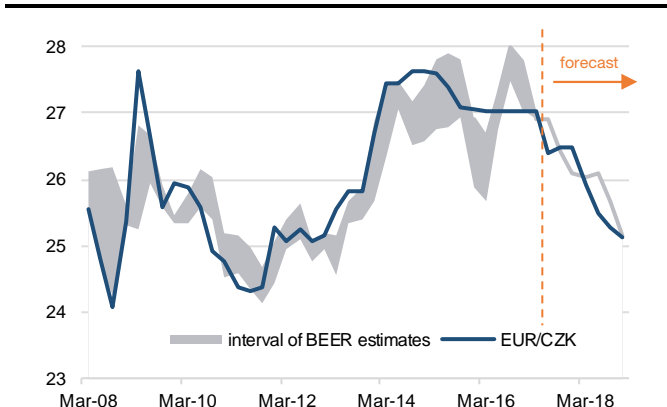
Long-term equilibrium exchange rate, EUR/CZK, based on NATREX



Source: Bloomberg, Economic & Strategy Research, Komerční banka

The CNB will discourage a rapid appreciation under EUR/CZK26.00. It would be a shock for the economy.

Medium-term equilibrium exchange, EUR/CZK rate based on BEER



Source: Bloomberg, Economic & Strategy Research, Komerční banka

For the Czech economy, which is highly dependent on exports, a sudden rise to long-term equilibrium levels would be a negative shock. The reason is that rapid koruna appreciation in real terms would in fact cause the price competitiveness of Czech exporters to decline. We take a more detailed look at the development of the real exchange rate in the special box below. A view of the medium-term equilibrium level using the BEER³ approach suggests a rate of EUR/CZK26.40 for 2Q17, when we expect the FX floor to be scrapped. Our end-2017 forecast is EUR/CZK26.00.

BOX 4: Focus on the real exchange rate

The real exchange rate is an exchange rate that is adjusted for changes in price levels in domestic and/or foreign economies to reveal the price competitiveness of a country's exports. Long-term trends in real exchange rates can therefore reflect convergence trends in the real economy.

The fast growth in the Czech economy between 1999 and 2007 saw the economy move steadily closer to the euro-area average, and manifested itself in the long-term appreciation of the Czech koruna. The falling price competitiveness of Czech exporters was more than compensated by increased productivity, resulting in a higher non-price component of competitiveness. Nevertheless, the two recessions observed in 2009 and 2012-13 stopped the currency appreciation trend in its tracks.

More recently, the Czech economy has outpaced the euro area over the past three years. Czech GDP is more than 7% above its pre-crisis 2008 level. With regard to real exports, the

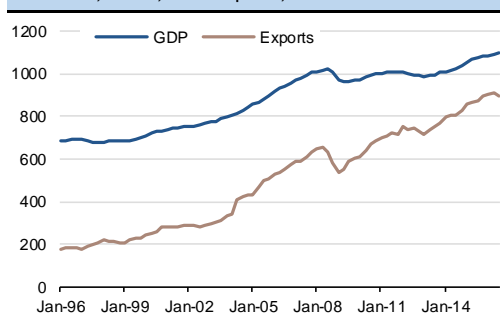
² NATREX = NATural Real EXchange rate. It is a rate of a currency which in the absence of speculative and cyclical factors brings the unemployment to its natural rate. It is therefore a measure of the long run equilibrium exchange rate.

³ BEER = Behavioural Equilibrium Exchange Rate. BEER estimates the equilibrium rate for the medium term with the help of the relation between macroeconomic variables (productivity, inflation, net foreign assets and net exports' share of the GDP) in each of the countries in a given currency pair.

picture is even rosier. Czech exports of goods and services are more than 40% above their pre-crisis peaks in real terms. However, these latest developments are not in tune with the real exchange rate.

The introduction of the exchange rate floor regime in November 2013 led not only to nominal CZK depreciation, but also to real depreciation of 6.7%. At the end of last year, the EUR/CZK real exchange rate was still more than 4% below the level seen just before the central bank started to intervene. Thus, scope to eliminate this gap should appear after the exit from the FX commitment regime. Taking price stickiness into account, this would encourage nominal CZK appreciation towards the EUR/CZK25.70/26.00 area.

Total real GDP and real exports of goods and services, CZKbn, constant prices, swda



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

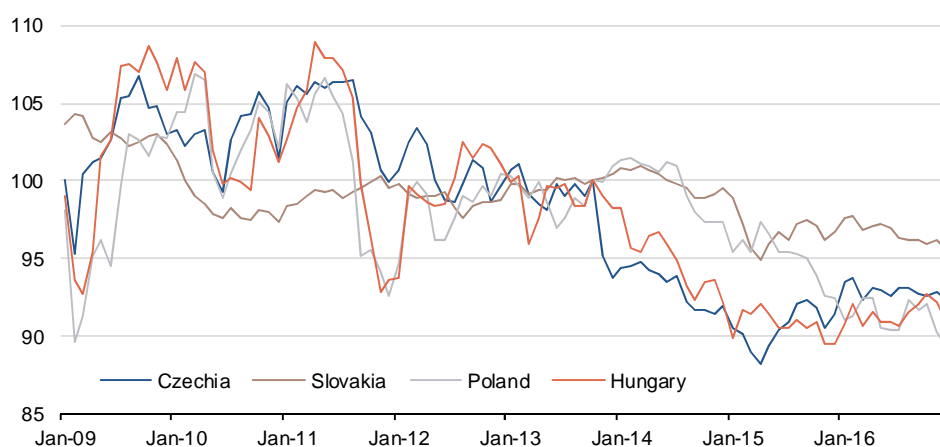
Real EURCZK exchange rate index, deflated by consumer prices indexes



Source: Economic & Strategy Research, Komerční banka

Real convergence would justify even greater appreciation of the Czech currency of more than the 4% mentioned above. However, the central bank would be against this and will continue to use the intervention tool. Overly fast real CZK appreciation would threaten the price competitiveness of Czech exporters. The competitive advantage procured by FX commitment regime implementation compared with regional counterparts did not last long as can be seen from the regional real effective exchange rate. The Polish zloty and Hungarian forint erased the gap through real depreciation.

Real effective exchange rate development of the Central European currencies



Source: BIS, Macrobond, Economic & Strategy Research, Komerční banka

Removing the FX floor might not lead to sustainable appreciation right away; we expect a period of increased exchange rate volatility at first.

EURCZK after the exit

In the first few weeks following the exit, fundamentals will be a secondary factor; speculative capital flows will play a key role in the formation of the spot and forward exchange rates.

Thus, although the fundamentals may justify some strengthening of the Czech currency, **speculative flows will determine the exchange rate for the first weeks or even months following the exit.** As discussed in the above Box 3, the huge inflow of speculative capital in early 2017 increases the risk of the missing counterparty. We understand this risk to mean a situation whereby the market lacks a party offering euros for sale when speculators want to close their positions. Foreign investors have exchanged their euros for CZK earlier, in anticipation of the FX floor's removal, while exporters are partly hedging their future euros for conversion into CZK. This could ultimately result in the CZK weakening. We continue to expect the CNB to seek to ease volatility through interventions. Central bankers claim that they will not permit rapid appreciation under a level where they started with the interventions, i.e. under EUR/CZK25.70. On the other hand, we do not think they want the CZK to depreciate over EUR/CZK28.00.

Expected EUR/CZK development after the exit



Source: Macrobond, Economic & Strategy Research, Komerční banka

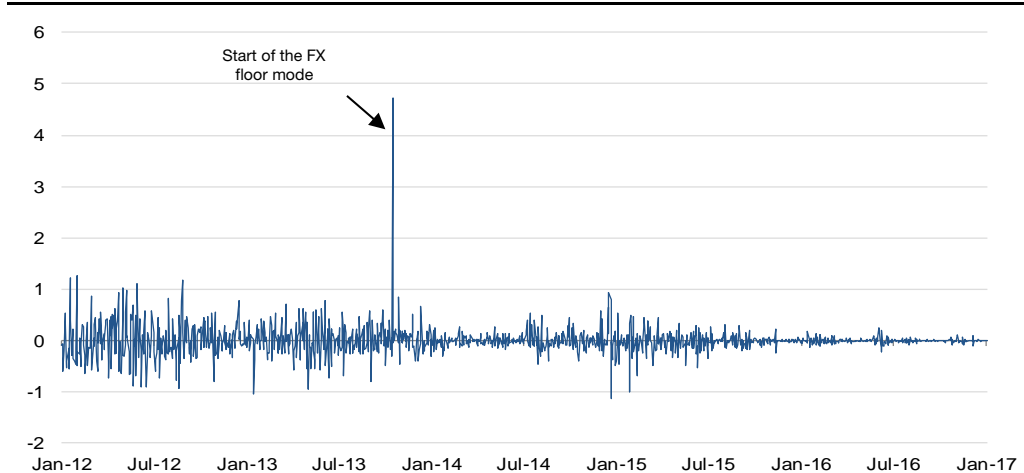
In our base case, we expect the CZK to strengthen immediately, but then correct in the second half of the year.

Following the exit, we do not expect the CZK to appreciate to levels implied by NATREX or to those before the start of the interventions in November 2013. In our base case, we expect it to strengthen in the wake of the exit (indicatively towards EUR/CZK26.00), but then correct in the second half of the year (to around 26.50). We only expect the FX market to calm down in 2018, with a return to the long-term trend of CZK appreciation. However, it is unlikely to be as prominent as before 2007. The reason is that the convergence of the Czech economy towards the euro area average will be slower.

The CNB was providing free hedging to exporters. This will end.

The exit will also mark the end of the free-of-charge hedging provided by the CNB to exporters. Exchange rate volatility on the spot market has been minimal, particularly last year. It should be noted that before the FX floor was introduced, normal daily changes in the EUR/CZK rate were 0.5%, and 1% changes over a single day were not exceptional. **And it is desirable to hedge against these movements.**

Daily profile of the EUR/CZK rate (%)



Source: Bloomberg, Economic & Strategy Research, Komerční banka

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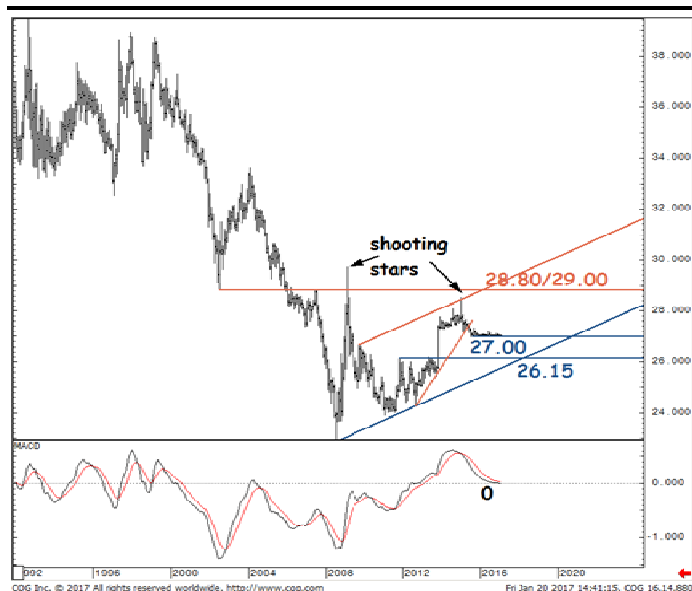
EUR/CZK Technical Analysis

27 decides about a deeper retracement

EUR/CZK formed a significant top in January 2015 as it hit the upper bound of a multiyear channel (currently at 28.80/29.00). Formation of monthly shooting star at those levels resulted in exhaustion of up move and the pair has witnessed a steady retracement since then. Recently, it has achieved an intermittent support near 27 which corresponds to the 50% retracement from lows of October 2013. With Monthly MACD resting near an equilibrium level, 27.00 will be a crucial support. In case this gives way, next leg of correction will take shape towards 26.63 and even towards 2011 highs at 26.15.

Short term, the pair is experiencing a narrow consolidation and signs of a sustainable rebound are still awaited. Graphical levels at 27.35 will decide if a pullback unfolds.

EUR/CZK, monthly chart.



EUR/CZK, weekly chart.



Source: SG Cross Asset Research/Technical Analysis

Important Disclaimer: The recommendations in the part Technical analysis is based only on analytical methods of technical analysis and may be different from the fundamental opinion of KB (or SG) presented in other parts of this documents or of other documents of KB (or SG).

Czech Government Bond and IRS Markets

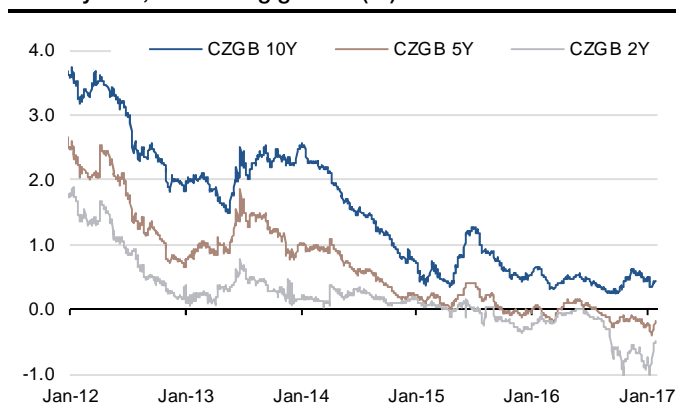


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Foreign demand for CZGBs culminates

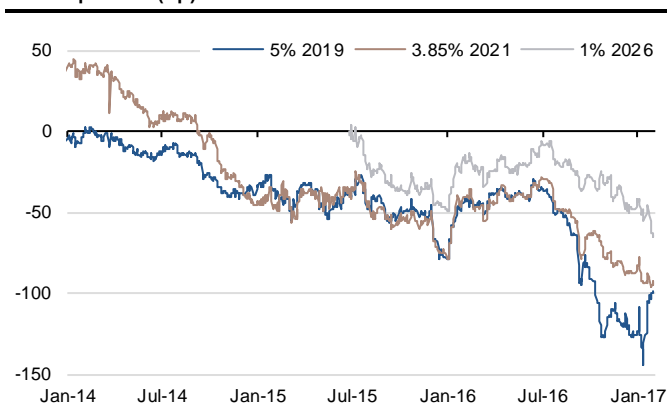
We maintain our main calls from the November forecast. We continue to expect long-end government bond yields to moderately increase in 2017 on the back of higher Bund yields and the pickup in domestic and euro-area inflation. However, we assume the Finance Ministry will frontload its financing into the first months of 2017 and focus on the short end of the curve to use negative yields due to the effects of the FX floor. The Czech IRS curve is set to bear steepen this year due to the positive inflation and economic dynamics.

CZGB yields, Bloomberg generic (%)



Source: Bloomberg, Economic & Strategy Research, Komerční banka

ASW spreads (bp)



Source: Bloomberg, Economic & Strategy Research, Komerční banka

At the very beginning of the year, Czech government bonds performed very well. The buying spree was related to vast inflows of capital into the Czech market in anticipation of the removal of the FX floor, cheap CZK financing, and fears the CNB would move rates into negative territory. The 2Y CZGB yield fell to -1% again and the 10Y dropped to below 0.35%. In the second half of January, however, inflow of liquidity slowed and many of the CNB board members downplayed the probability of negative rates. As a result, CZGBs pared a sizeable portion of their gains.

Supply side

In the 2017 Funding and Debt Management Strategy, the finance ministry put the expected 2017 gross borrowing needs at CZK290.6bn due to the planned CZK60bn budget deficit and a large debt redemption. On the financing side, guidance is scarce on details, as the ministry only indicates a minimal size of CZGB offerings in the primary market of CZK150bn. The strategy also allows for “a possibility” of T-bills and eurobond sales without any further information. The ministry’s outlook is summarised in the table on the next page, which also contains KB’s views.

We expect the budget deficit to reduce eventually, and stand at CZK45bn. Gross borrowing needs should thus reach only CZK275.6bn. On the financing side, the ministry is set to focus on CZGB primary auctions, in our view. We assume the ministry will try to frontload its issuance activity into the first months of 2017, and offer mostly short-end bonds at negative yields to make the most of the extraordinary market conditions (speculation on

In the 2017 Funding and Debt Management Strategy, the finance ministry put the expected 2017 gross borrowing needs at CZK290.6bn.

CZK strengthening, cheap financing via XCCY bases). Indeed, the ministry is planning two auctions in February, where new short-term zero-coupon bonds will be sold. That said, the bonds mature in 2020 and 2022, respectively, which may prove a bit too long for exit-related investment.

2017 gross borrowing needs and financing, CZKbn

	MinFin Dec	KB Jan
Borrowing needs		
Budget deficit	60.0	45.0
Buybacks of CZGBs		0.0
Redemption of CZGBs	207.9	207.9
Redemption of Eurobonds		0.0
Redemption of retail bonds	16.8	16.8
Redemption of T-bills	4.2	4.2
Redemption of other money market instruments	0.0	0.0
Redemption of EIB loans	1.7	1.7
Total	290.6	275.6
Financing		
Gross T-bill issuance		15.0
Other money market instruments		0.0
Gross CZGB issuance (in auctions)	min 150.0	220.0
Tap sales		10.0
Gross issuance of eurobonds		0.0
Gross issuance of retail bonds		0.0
Tapping of financial reserve		20.6
Net effect of CZGB switches		10.0
Total financing		275.6
<i>Net CZGB issuance</i>		<i>32.1</i>

Source: Economic & Strategy Research, Komerční banka, Finance Ministry

In comparison with 2016, we expect gross borrowing needs to increase by CZK64bn, and the CZGB issuance in primary-market auctions to rise by CZK28.1bn.

In comparison with 2016, we expect gross borrowing needs to increase by CZK64bn, and the CZGB issuance in primary-market auctions to rise by CZK28.1bn. That said, net CZGB issuance (redemption versus auctions, taps, and including the net effect of switches) is set to decline from CZK66.5bn in 2016 to CZK32.1bn this year, on our calculations.

Risks to this outlook are skewed towards lower CZGB issuance, in our view. The 2017 budget deficit may reduce even further than CZK45bn, which would result in lower pressure on the financing side. Also, the ministry could decide to tap more of its liquidity reserve. As of end-February 2017, more public subjects will be forced to put their balance into the common treasury system at the CNB. Finally, the ministry can switch a part of the presumed CZGB issuance for T-bill sales (with a maturity in 2018) to mitigate the pressure on the CZGB market.

Bond yields

We revised the CZGB yield outlook in late November to reflect the higher-than-expected Bund yields as per the new SG forecast. In this edition of the *Czech Economic Outlook*, we have made only very small changes. **We still expect the short end to remain deeply negative until the FX floor is removed** on the back of market speculation and cheap XCCY financing. After the floor is removed, we expect a relatively slow normalisation of yields back to zero, as possible further CNB intervention in the market likely will result in only a slow tightening of XCCY bases, in our view.

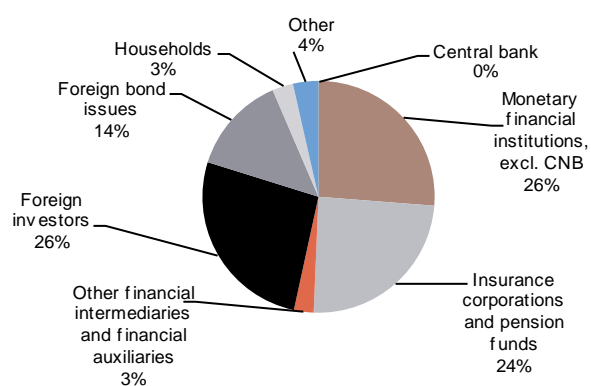
CZGB yield forecast

	1Q17f	2Q17f	3Q17f	4Q17f	1Q18f
2y CZGB yield (%)	-1.00	-0.30	0.00	0.05	0.40
10y CZGB yield (%)	0.70	0.85	1.10	1.10	1.35
10y CZGB ASW (bp)	-30	-35	-30	-45	-30

Source: Economic & Strategy Research, Komerční banka

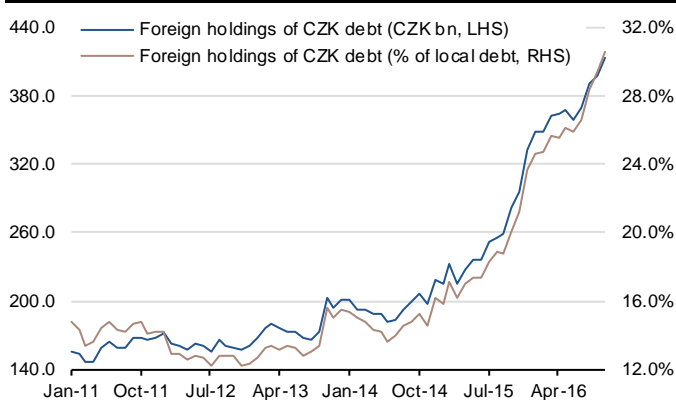
The long end of the yield curve is set to slowly increase, we assume, driven by higher Bund yields and elevated inflation. That said, the cheapening at the long end will be mitigated by debt redemptions and elevated interbank liquidity, as well as limited supply (due to the expected ministry's focus on the short end), in our view.

Holdings of Czech Republic's debt securities, end-Dec 2016



Source: Finance Ministry, Economic & Strategy Research, Komerční banka

Foreign holdings in CZK debt exceeded 30%



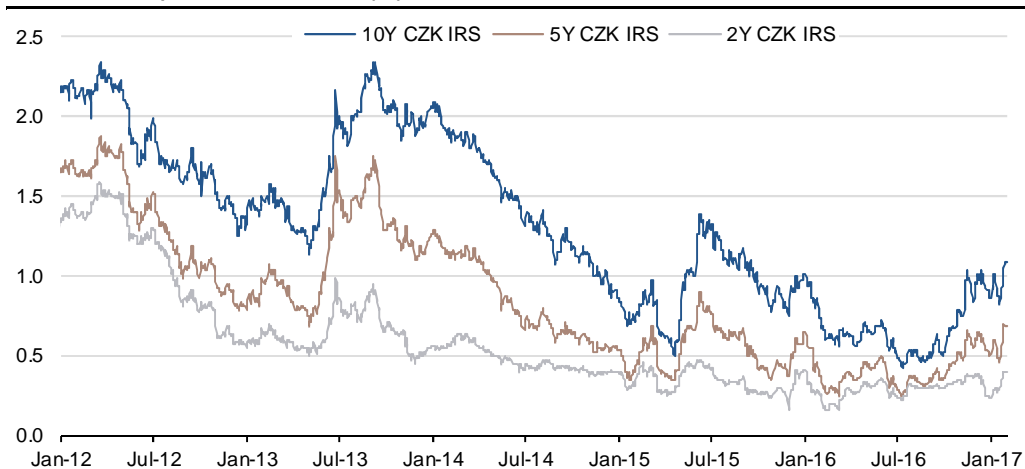
Source: Finance Ministry, Economic & Strategy Research, Komerční banka

CZGB holdings

As at the end of November, the share of non-resident holdings of CZK-denominated government debt exceeded 30% for the first time in history. This trend is driven by massive demand for short-end bonds and matching supply by the Finance Ministry.

We assume this will continue increasing until the exit from the FX floor. As we noted in the previous editions of the *Czech Economic Outlook*, the (estimated) concentration of foreign holdings at the short end comprises a risk there will be a faster-than-expected rise in CZGB yields. With the coming normalisation of external demand (lower speculative inflow, gradual normalisation of XCCY bases), the ministry will have to refinance the maturing papers with mostly domestic investors at higher yields, we expect.

Recent developments of CZK IRS (%)



Source: Bloomberg, Economic & Strategy Research, Komerční banka

CZK interest rate swaps

We no longer expect negative rates from the CNB. On the contrary, our outlook calls for the start of a hiking cycle as of 2Q18. Thus, we have revised our outlook for the CZK IRS curve. That said, we continue to assume the curve will steepen in 2017. **The long end will be driven by higher EUR rates, elevated domestic inflation, and solid economic performance.** We expect the short end to increase slowly in 2017, and this trend to accelerate in 2018 on the back of the CNB's interest rate hikes.

CZK IRS outlook (%)

	1Q17f	2Q17f	3Q17f	4Q17f	1Q18f
2Y	0.40	0.50	0.55	0.60	0.70
10Y	1.00	1.20	1.40	1.55	1.65

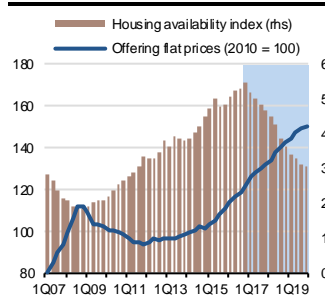
Source: Economic & Strategy Research, Komerční banka

Banking Sector



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Housing Availability Index to decline



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Growth of credit and deposits to decelerate in 2017

As in our last outlook, we expect credit growth to slow in 2017. In our view, the growth in the volume of mortgages is set to decelerate on the back of market saturation, the rise in flat prices, higher mortgage rates and the coming new binding regulations on LTVs (law approved by government and to be discussed in parliament). **Our Housing Availability Index peaked around the turn of 2016 and is set to gradually decline, mostly reflecting the greater rise in flat prices than in average wages.** We expect the volume of loans to non-financial corporations to rise more slowly than in 2016, mainly reflecting the large base effect seen last year. However, the quarter-on-quarter dynamics are set to remain strong, as the economy will continue to perform well and investment is expected to recover modestly. Interestingly, there has been an increase in EUR credit to non-financial corporates recently as a result of natural hedging ahead of the looming exit from the FX floor.

The growth in deposits is set to decelerate rapidly. We expect deposits by individuals and non-financial corporations to increase in 2017 but more slowly than in 2016. **On the other hand, deposits by financial corporations and public sector institutions are set to drop year-on-year in 2017.** The former is set to reflect the profit taking/withdrawal of positions related to the end of the CNB's FX floor. The latter is related to the latest update of the state treasury law, which requires more public institutions like health insurers to transfer their accounts from commercial banks to the treasury system with the CNB.

Bank loans and deposits (SA, yoy, %)

	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	2016	2017	2018	2019	2020	2021
Bank loans														
Total	7.6	6.8	5.8	5.6	5.5	5.5	5.8	5.8	6.9	5.9	5.7	5.4	4.1	3.6
Households - real estate loans	8.8	7.5	6.8	6.2	6.0	6.8	7.0	7.1	8.2	6.6	7.1	6.8	4.6	3.4
Households - consumer loans	5.0	4.7	5.0	5.2	4.9	5.7	5.9	6.5	4.8	4.9	6.3	7.3	5.0	4.0
Corporate loans	8.1	6.5	5.6	4.7	5.1	4.2	4.6	4.1	7.3	5.5	4.2	4.1	4.2	4.3
Deposits														
Total	11.3	3.6	5.7	4.4	0.2	2.4	2.8	3.0	7.4	3.5	3.5	4.2	2.4	2.3
Households	8.6	8.2	7.7	7.0	6.1	5.9	5.5	5.2	7.4	7.2	5.4	4.3	2.6	2.3
Non-financial corporations	7.9	4.5	5.5	2.9	3.7	4.6	5.1	4.7	6.7	4.1	4.7	4.4	1.9	1.8
Others	22.6	-6.0	1.6	0.2	-17.3	-7.7	-5.8	-3.9	8.9	-5.4	-1.6	3.9	2.7	2.8
Ratios														
Loan-to-GDP ratio	63.3	63.4	63.2	63.5	63.5	63.4	63.3	63.8	62.5	63.4	63.6	64.4	65.3	66.0
Deposit-to-GDP ratio	82.8	81.6	80.8	79.8	79.0	79.2	78.7	78.1	81.0	80.3	78.9	79.0	78.8	78.7
Loan-to-deposit ratio	76.4	77.7	78.2	79.6	80.4	80.1	80.4	81.7	77.1	79.0	80.6	81.5	82.9	83.9
Interest rates														
Real estate loans	2.1	2.2	2.2	2.3	2.4	2.5	2.6	2.8	2.2	2.3	2.7	3.2	3.6	4.0
Consumer loans	10.5	10.4	10.5	10.4	10.4	10.4	10.4	10.5	10.7	10.4	10.5	11.2	11.3	11.7
Corporate loans	0.0	0.0	0.1	0.1	0.2	0.2	0.4	0.9	1.4	0.1	0.7	1.4	1.4	1.8
Share of NPL														
Real estate loans	2.2	2.2	2.2	2.2	2.2	2.2	2.3	2.3	2.3	2.2	2.3	2.5	2.7	3.1
Consumer loans	9.3	8.8	8.5	8.5	8.6	8.6	8.7	8.7	9.6	8.6	8.7	9.1	9.8	10.3
Corporate loans	5.1	5.1	5.1	5.0	5.0	5.0	5.0	5.0	5.1	5.1	5.0	5.0	5.4	5.9

Source: CNB, CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Key Economic Indicators

Macroeconomic indicators – long-term outlook

		2014	2015	2016	2017	2018	2019	2020	2021
GDP	real, %	2.7	4.6	2.5	2.7	2.7	2.3	1.5	2.0
Inflation	average, %	0.4	0.3	0.7	2.2	2.3	1.8	1.3	1.2
Current account	% of GDP	0.2	0.9	1.8	0.9	1.2	1.4	1.3	1.1
3M PRIBOR	average, %	0.4	0.3	0.3	0.3	0.7	1.3	1.1	1.3
EUR/CZK	average	27.5	27.3	27.0	26.6	25.2	23.9	23.4	22.8
USD/CZK	average	20.8	24.6	24.4	25.3	23.1	20.4	19.3	18.9

Source: CZSO, CNB, Macrobond, Economic & Strategy Research, Komerční banka, SG Economic Research

Note: KB forecasts are in blue

FX & interest-rate outlook

		30-Jan-2017	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
EUR/CZK	end of period	27.02	27.0	26.1	26.5	26.5	25.6
USD/EUR	end of period	1.069	1.00	1.05	1.07	1.09	1.08
CZK/USD	end of period	25.27	27.0	24.9	24.8	24.3	23.7
3M PRIBOR	end of period	0.28	0.29	0.29	0.29	0.29	0.35
10Y IRS	end of period	1.08	1.00	1.20	1.40	1.55	1.65

Source: CZSO, CNB, Macrobond, Economic & Strategy Research, Komerční banka, SG Economic Research

Note: KB forecasts are in blue

Monthly macroeconomic data

		IV-16	V-16	VI-16	VII-16	VIII-16	XI-16	X-16	XI-16	XII-16
Inflation (CPI)	%, mom	0.6	-0.2	0.1	0.3	-0.2	-0.2	0.3	0.3	0.3
Inflation (CPI)	%, yoy	0.6	0.1	0.1	0.5	0.6	0.5	0.8	1.5	2.0
Producer prices (PPI)	%, mom	0.1	0.4	0.3	0.0	-0.2	0.3	0.5	0.1	0.5
Producer prices (PPI)	%, yoy	-4.7	-4.8	-4.4	-4.0	-3.4	-2.4	-1.7	-1.3	-0.4
Unemployment rate	% (MLSA)	5.7	5.4	5.2	5.4	5.3	5.2	5.0	4.9	5.2
Industrial sales	%, yoy, c.p.	0.3	5.3	1.2	-19.1	14.5	1.3	-2.3	7.8	n.a.
Industrial production	%, yoy, c.p.	4.3	9.1	4.0	-13.9	13.3	2.7	-1.7	7.1	n.a.
Construction output	%, yoy, c.p.	-13.7	-5.2	-12.4	-14.5	-4.6	-7.7	-8.5	-2.3	n.a.
Retail sales	%, yoy, c.p.	8.8	11.3	6.5	-0.4	11.4	4.7	0.5	8.6	n.a.
External trade	CZK bn (national met.)	25.6	18.6	21.6	0.4	9.8	20.4	15.5	10.8	n.a.
Current account	CZK bn	-1.7	1.5	-13.0	-23.2	-3.2	4.0	17.0	4.6	n.a.
Financial account	CZK bn	-0.4	0.2	-25.5	18.4	14.6	-14.6	36.4	-5.6	n.a.
M2 growth	%, yoy	7.4	7.6	7.7	7.1	7.6	6.7	6.3	6.6	n.a.
State budget	CZK bn (YTD cum.)	30.5	22.4	40.6	75.6	81.2	82.3	98.3	55.5	61.8
PRIBOR 3M	%, average	0.29	0.29	0.29	0.29	0.29	0.29	0.29	0.29	0.29
EUR/CZK	average	27.0	27.0	27.1	27.0	27.0	27.0	27.0	27.0	27.0
USD/CZK	average	23.8	23.9	24.1	24.4	24.1	24.1	24.5	25.1	25.7

Source: CZSO, CNB, MF, MLSA, Macrobond, Economic & Strategy Research, Komerční banka

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