

# Pursuing price stability

## INTERVIEW WITH ZDENEK TUMA

GOVERNOR, CZECH NATIONAL BANK



### ZDENEK TUMA

graduated from the Faculty of Trade at the University of Economics, Prague. Initially in his career he worked at the University and joined the Institute for Forecasting of the Czech Academy of Sciences in 1986. He was a Director of the European Bank for Reconstruction and Development from 1998-99, before joining the Czech National Bank. He was appointed Deputy Governor of the CNB in 1999 and raised to Governor the following year, being reappointed for a further six-year term in 2005.

### What are the principal priorities and responsibilities of the Czech National Bank and how are these distinct from those of the Ministry of Finance?

Similarly to central banks in the rest of the developed world, the Czech National Bank's primary objective is to maintain price stability. Provided that this primary objective is not violated, the Czech National Bank supports other government policies leading to sustainable economic growth. However, some distinction in responsibilities arises, as the Czech National Bank is the supervisor of the whole financial market. It thus takes care not only of the banking sector, but also of the capital market, investment funds and insurance companies.

### You have always underlined the importance of maintaining price stability and the overall health of the Czech macro-economic environment. To what extent has your strategy and implementation fulfilled your objectives in these areas.

In my view the Czech National Bank has been successful in maintaining a low inflation environment over recent years, with no negative impact on economic growth.

### What are the current figures for GDP growth and has there been any change in the GDP growth structure compared to 2006?

GDP grew by 6.6 per cent in 2007 and 5.3 per cent in the first quarter of this year. This figure is quite similar to those for 2006. The difference I see is that while last year net exports made a positive contribution to GDP growth, this year GDP is being driven mainly by domestic demand.

### The banking sector has continued to demonstrate growth. What are the current assets and net profit in this sector and what is the sector's capital adequacy ratio? Have funds under management of the insurance, pension and collective funds sector shown continued growth?

The total assets of the banking sector rose by CZK394.8 billion (11.8 per cent) to CZK3,747.5 billion in 2007 and the net profit of the banking sector reached about CZK47 billion in the same period. The capital adequacy ratio of the banking sector stood at 11.5 per cent at the end of 2007 (compared to 11.41 per cent at the end of 2006). Funds under the management

of non-banking financial institutions continued to rise; for example, total premiums written by insurance companies grew by 8.8 per cent in 2007.

### How are preparations proceeding for the Czech Republic's entry into the European Monetary Union?

At the end of August 2007 the Czech Government approved an updated version of the Czech Republic's Euro-area Accession Strategy, a joint document of the Czech National Bank and the Czech Government that lays down the basic framework for our considerations about euro-area accession. In a nutshell, the document summarizes what has been achieved so far, such as the level of nominal convergence, and what remains to be done, for instance reforms of the labour market, the pension system and public finances in general. We do not specify any exact date for potential accession, because our general strategy is to do our homework first and only then discuss the possible dates.

### The exchange rate plays an important role for the Czech economy – what is your forecast and strategy in this field? What are the benefits of uncovered interest rate parity?

The exchange rate indeed plays an important role for the Czech economy, but the same holds for any small open economy. Regarding your question about our strategy the answer is quite simple. As we operate in an inflation targeting regime and implement an independent monetary policy, the exchange rate is fully market determined. The exchange rate is only one of the many endogenous variables of our macroeconomic forecast.

### What is your forecast for the key economic indicators of the Czech economy over the coming period?

Given the coming administrative changes to VAT and the quite sharp increase in administrative prices such as rents, in our forecast we expect headline inflation to reach roughly 6 per cent during 2008 and decline back to our target (about 3 per cent) during 2009. However, inflation adjusted for these administrative changes remains moderate and should not exceed the one percentage point tolerance band of our point inflation target. As regards real economic activity, we expect GDP growth to slow a little to roughly 4–4.5 per cent in 2008 and 2009. **F**