

## Abstract

The goal of this thesis is to identify domestic and foreign shocks that mostly explain variation in the Czech price level. This goal is accomplished by the use of structural vector autoregression. As the Czech Republic is considered to be a small open economy, it is crucial to include foreign variables into the model which are represented by shocks in euro zone. Furthermore, a block exogeneity restriction is imposed because it is unlikely that shocks in the Czech economy can influence macroeconomic development in euro zone. The results of the thesis indicate that foreign shocks explain 70% variability in Czech price level out of which 50% is explained by euro zone's price level shocks. It is likely that in near future Czech economy will experience deflation for a while. Nevertheless, by 2018 Czech inflation rate should be in 1-3% band.