CNB's New Forecast

Inflation Report II/2008

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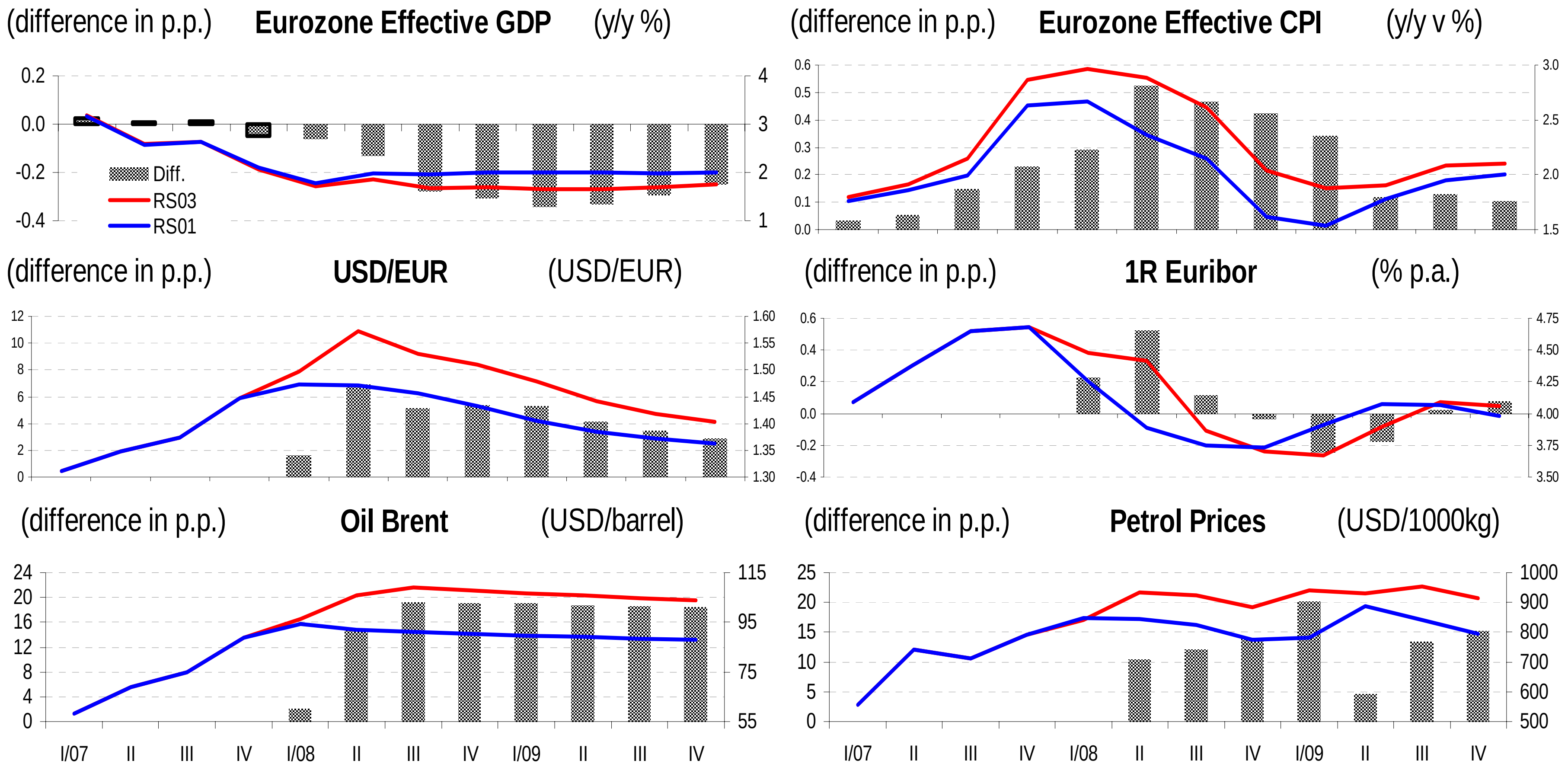
CZECH CNB NATIONAL BANK

Outline

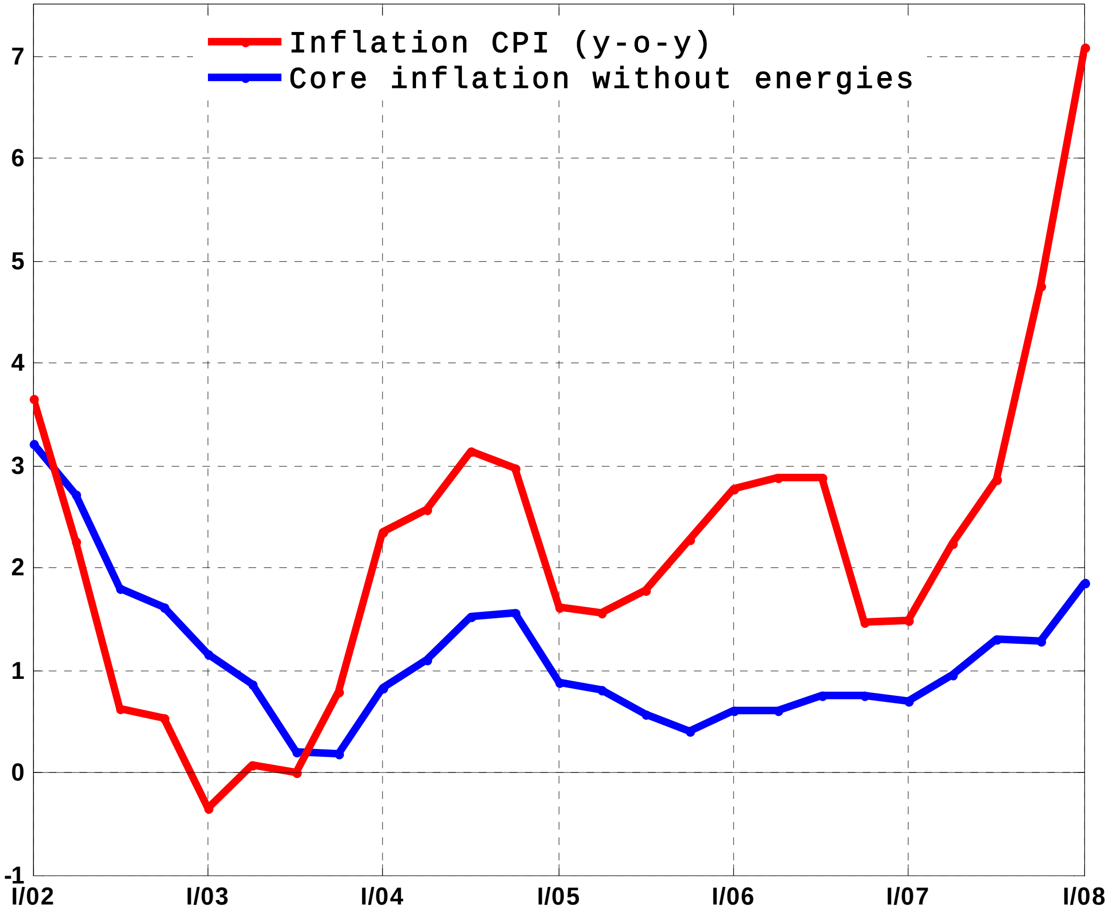
- External assumptions;
- Recent trends in inflation and the economy;
- Fiscal policy;
- Regulated prices and tax changes;
- Exchange rate and imported inflation;
- Forecast of GDP, inflation and interest rates;
- <u>Alternative forecast scenario (g3 model)</u>.

External Assumptions (CF04)



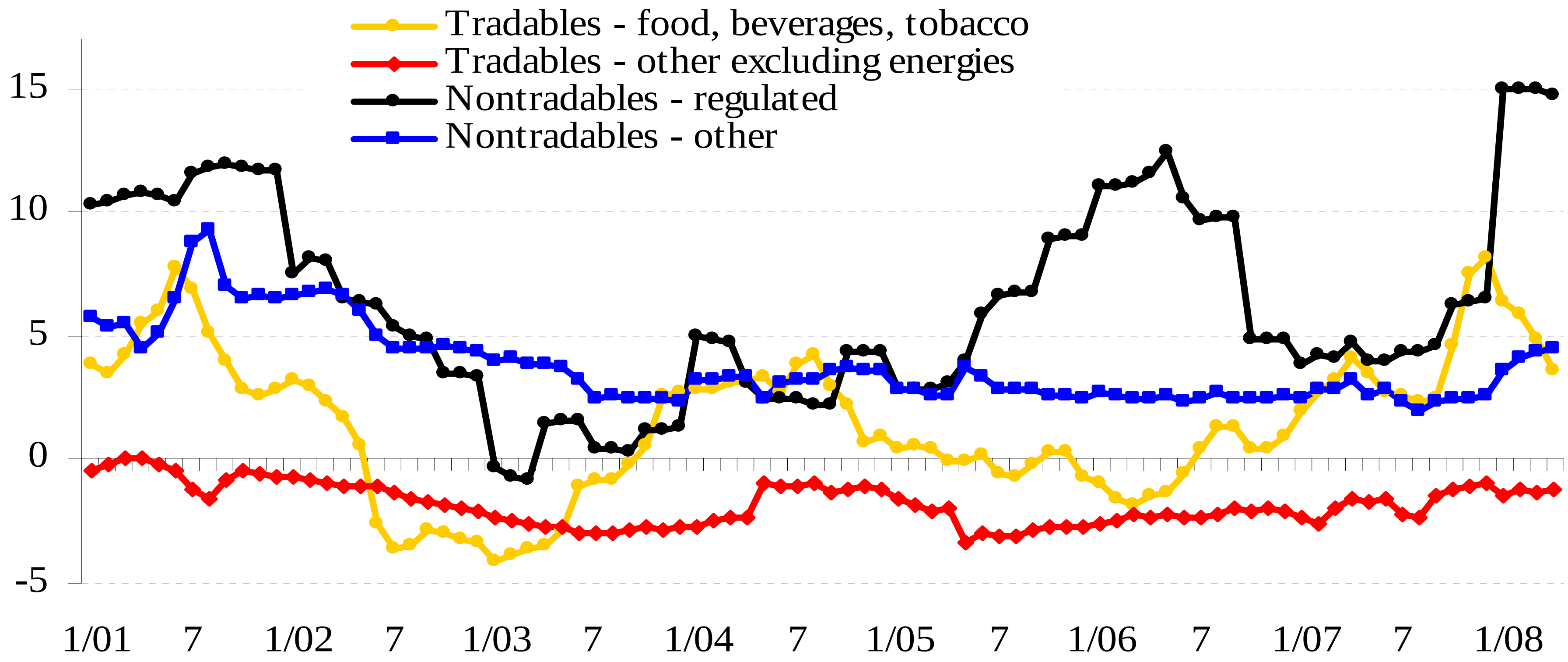
- Reduced growth optimism vs. higher inflation and energy prices; changing interest rate outlook.

Inflation



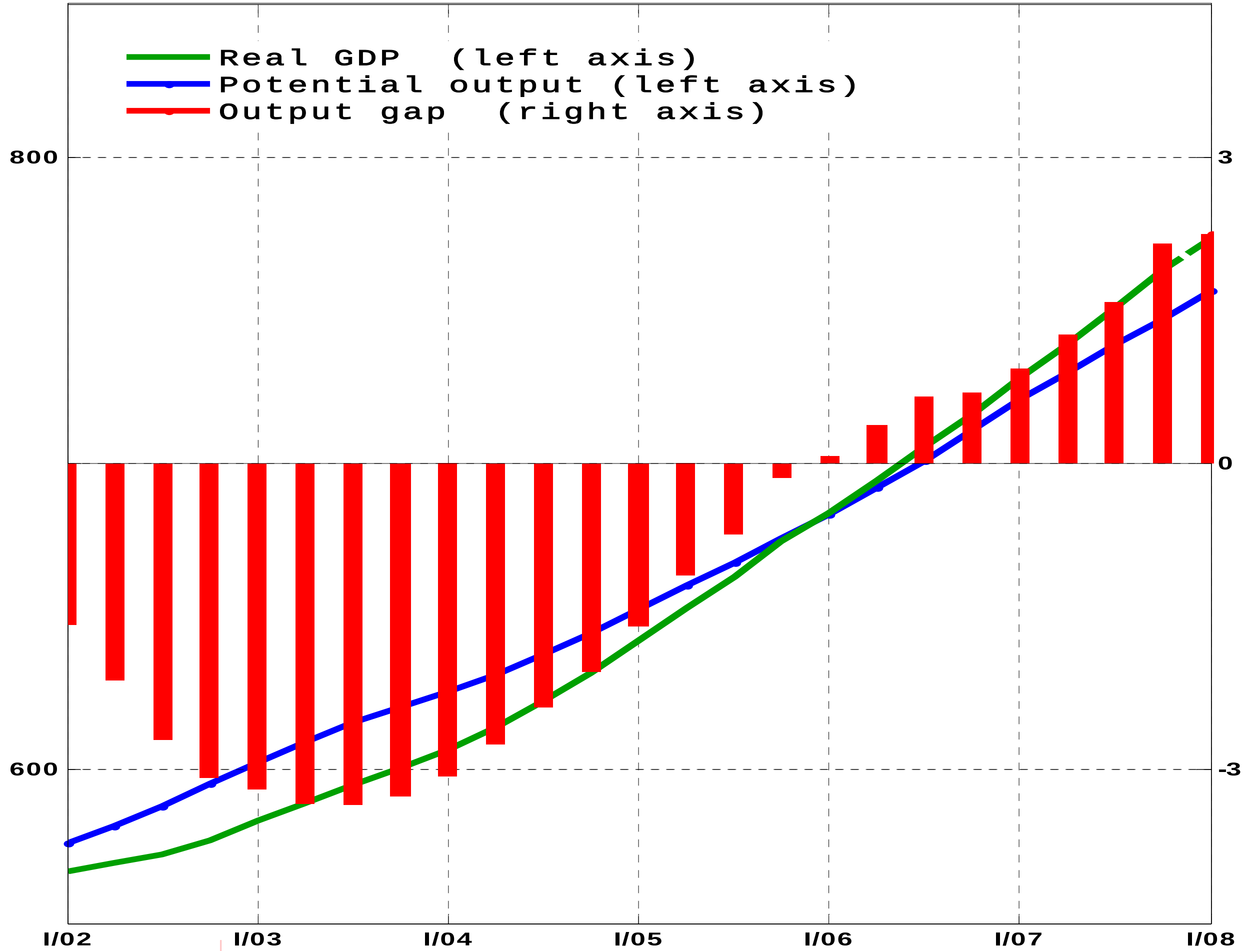
- Inflation in Q1/08 above previous forecast;
- Regulated prices and core inflation higher than expected;
- April 2008: headline inflation (6.8 %) and MP inflation (4.7 %) slightly above new forecast.

Structure of Inflation
(excluding taxes)



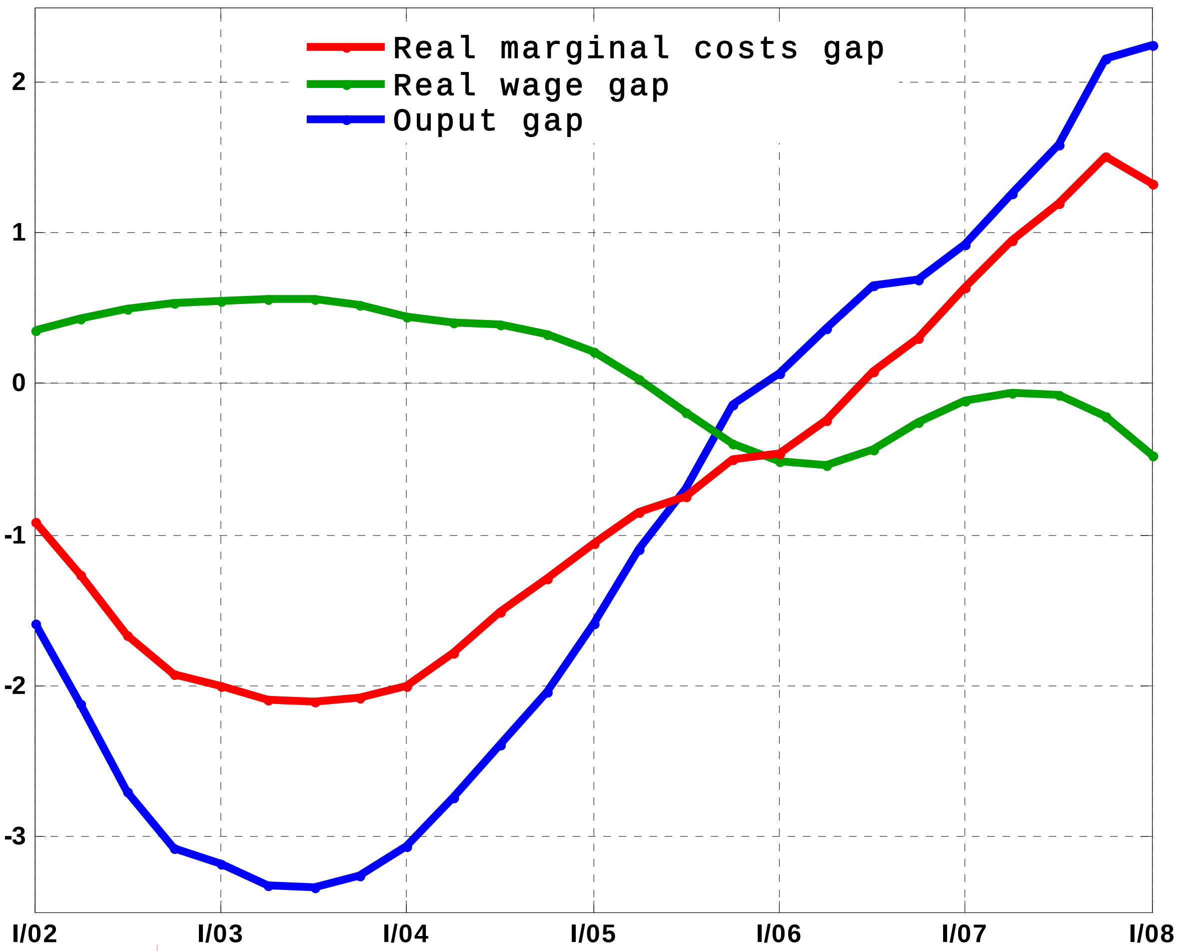
- Food, beverages and tobacco price growth excluding taxes has slowed down;
- Acceleration in prices of NT goods (restaurants, imputed rents, pressure from domestic economy).

GDP – Actual and Potential



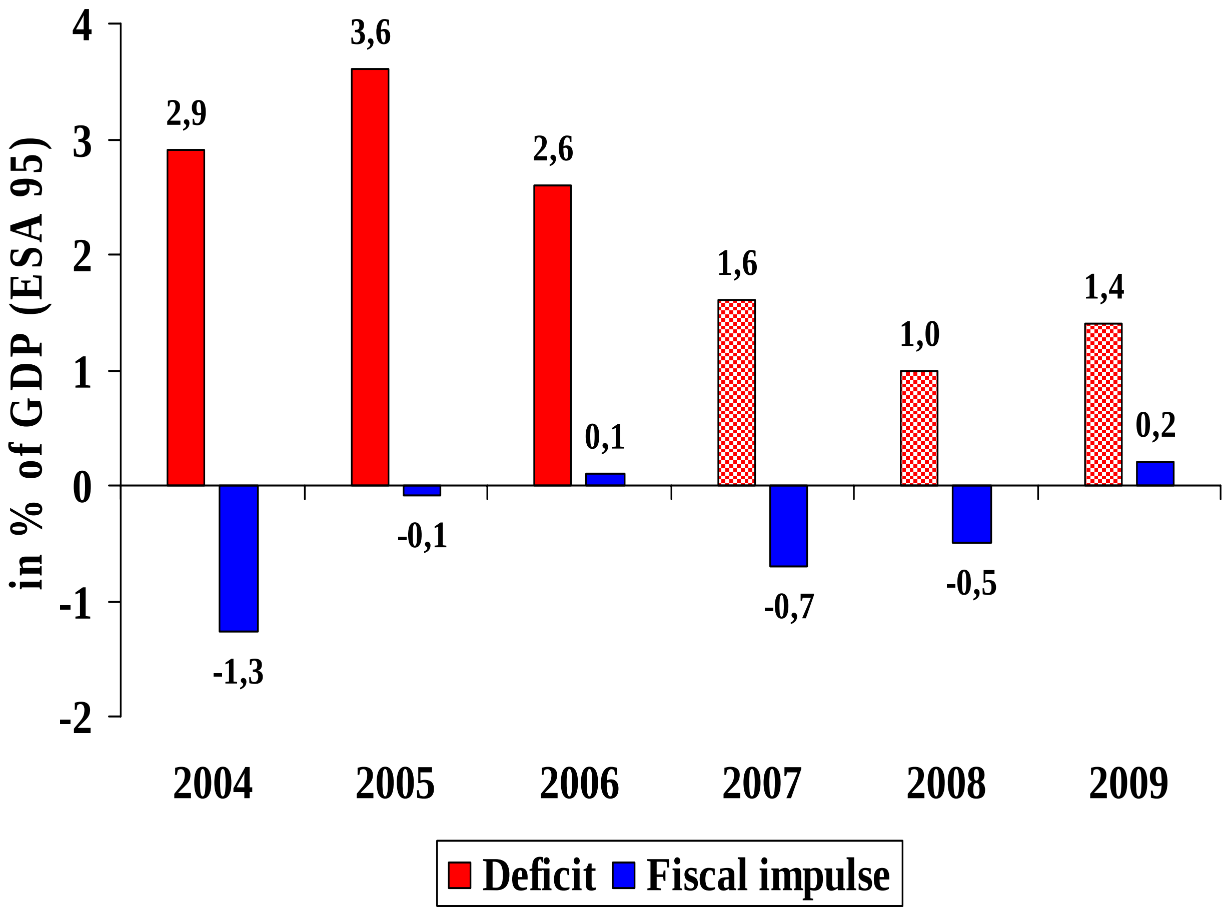
- The output gap estimate (2.2 %) has been revised up;
- Slowdown in household consumption growth;
- Monetary conditions in Q1/08 slightly tight (tight exchange rate component, slightly loose interest rates).

Pressures from the Real Economy



- Real wages anti-inflationary;
- Nominal wage growth in business sector below forecast in Q4/07;
- But a marked speed-up in Q1/08 (partly tax optimisation);
- Overall pressures from the real economy pro-inflationary.

Fiscal Situation



- Deficit in 2007 lower than expected;
- Forecast of deficit for 2008 and 2009 lowered further;
- Assumed fiscal impulse still restrictive in 2008 and slightly expansionary in 2009.

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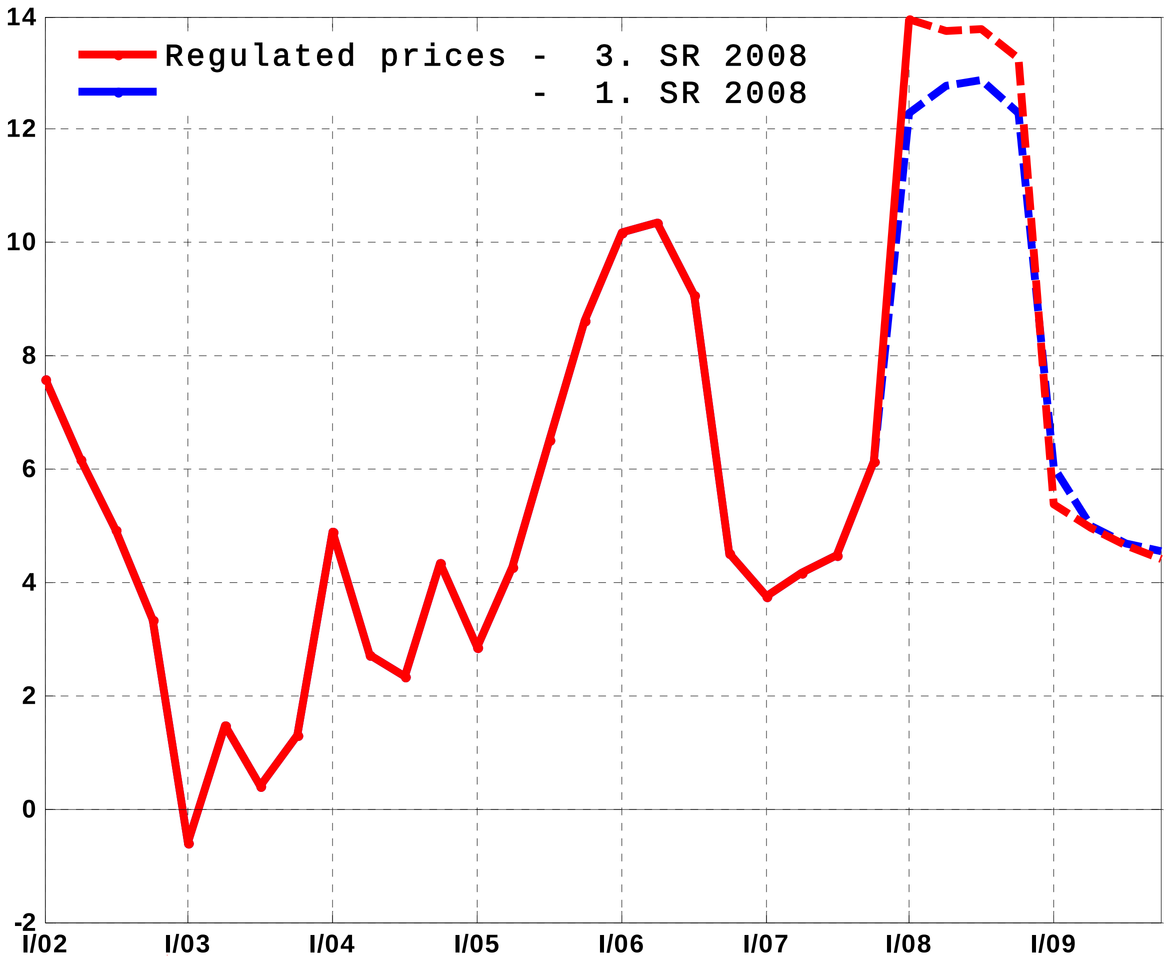
Regulated Prices



- Forecast for 2008 raised due to higher impact of healthcare fees;
- Together with indirect taxes, the contribution to inflation will reach: 3.8 p.p. end-2008, 0.8 p.p. end-2009.

Administrative Measures
(selected items and total impact)

Year/date	Indirect tax changes in nonregulated prices		Regulated prices (with tax changes)		
	Item	Impact on CPI inflation	Item	Change in price	Impact on CPI Inflation
2006-Total		**0,16 p.p.**		**4.9%**	**1,08 p.p.**
2007-Total		**1,09 p.p.**		**6.5%**	**1,11 p.p.**
2008	Excise duties on tobacco products (delayed impact: 1Q+2Q)	0,60 p.p.	Regulated rents	23.0%	0,40 p.p.
			Electricity	9.5%	0,37 p.p.
			Heating	11.0%	0,33 p.p.
	VAT 5 % --> 9 %	0.80 p.p.	Natural gas	15.6%	0,35 p.p.
			Water	9.3%	0,11 p.p.
	Tax of energy (solid fuels)	0,03 p.p.	Health	42.0%	0,57 p.p.
Total		**1,43 p.p.**		**14.1%**	**2,42 p.p.**
				including impact of tax changes:	**0,39 p.p.**
				(VAT 5% --> 9%, tax of energy - electricity, heating)	
2009			Regulated rents	20.0%	0,40 p.p.
			Electricity	7.0%	0,28 p.p.
			Heating	2.0%	0,06 p.p.
			Health	2.0%	0,04 p.p.
Total		**0,00 p.p.**		**4.5%**	**0,84 p.p.**
				including impact of tax changes:	**0,00 p.p.**

- Actual impact of higher excise duties on tobacco prices will probably be delayed to H2/2008.

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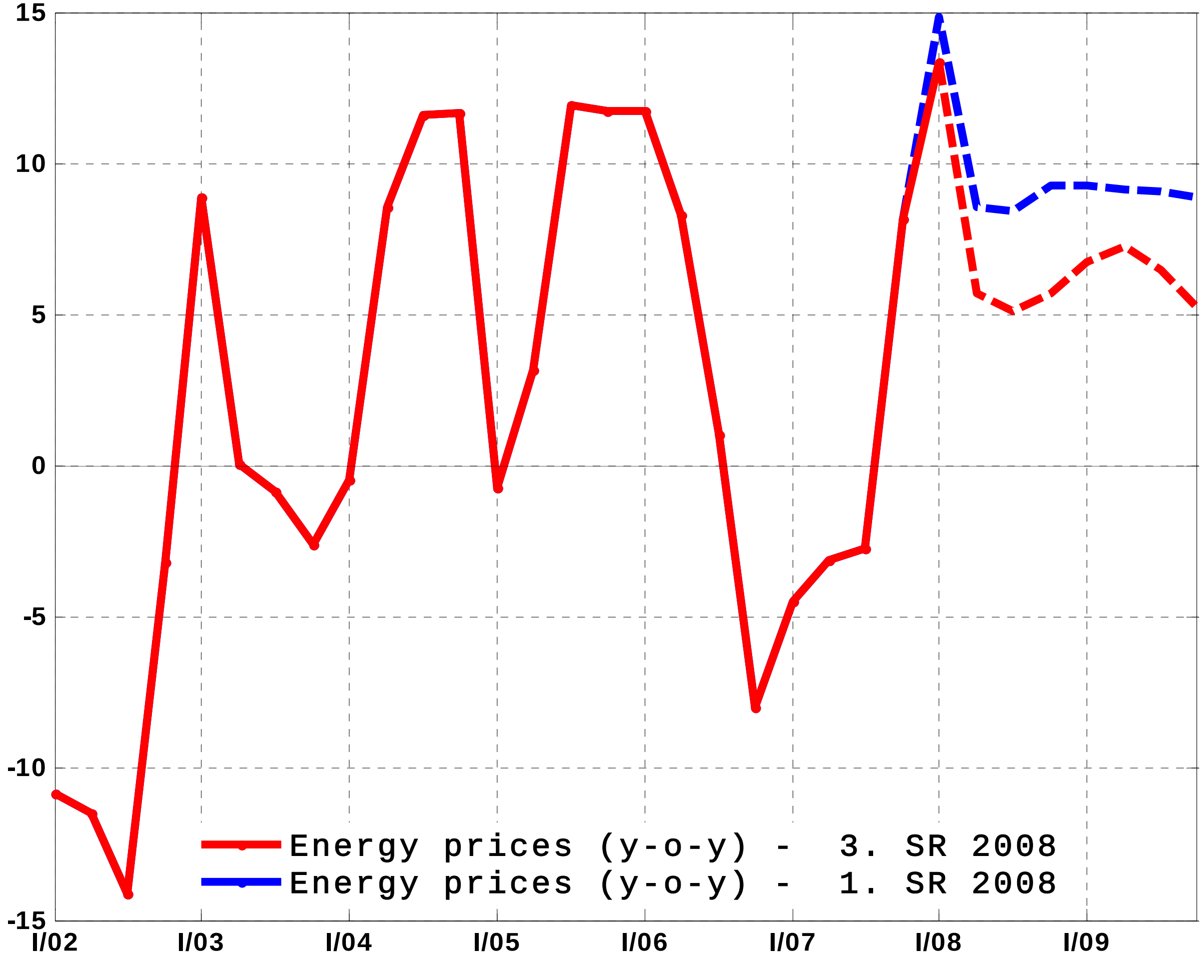
Energy Prices



- Forecast slightly lowered despite higher oil prices (only partly offset by weaker USD) due to a model change;
- Overall impact on the forecast negligible.

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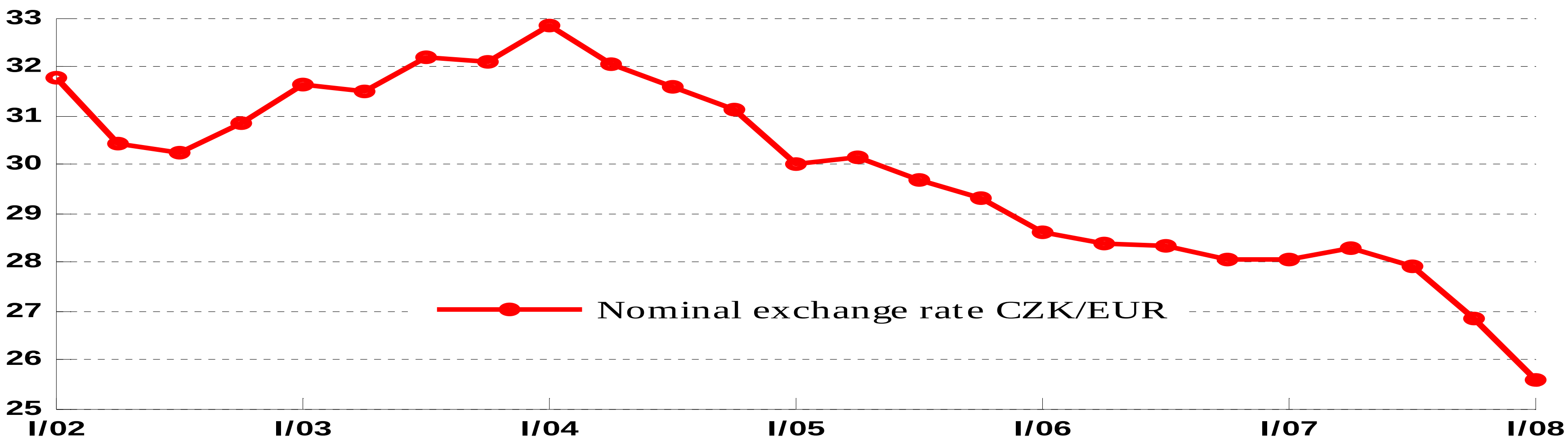
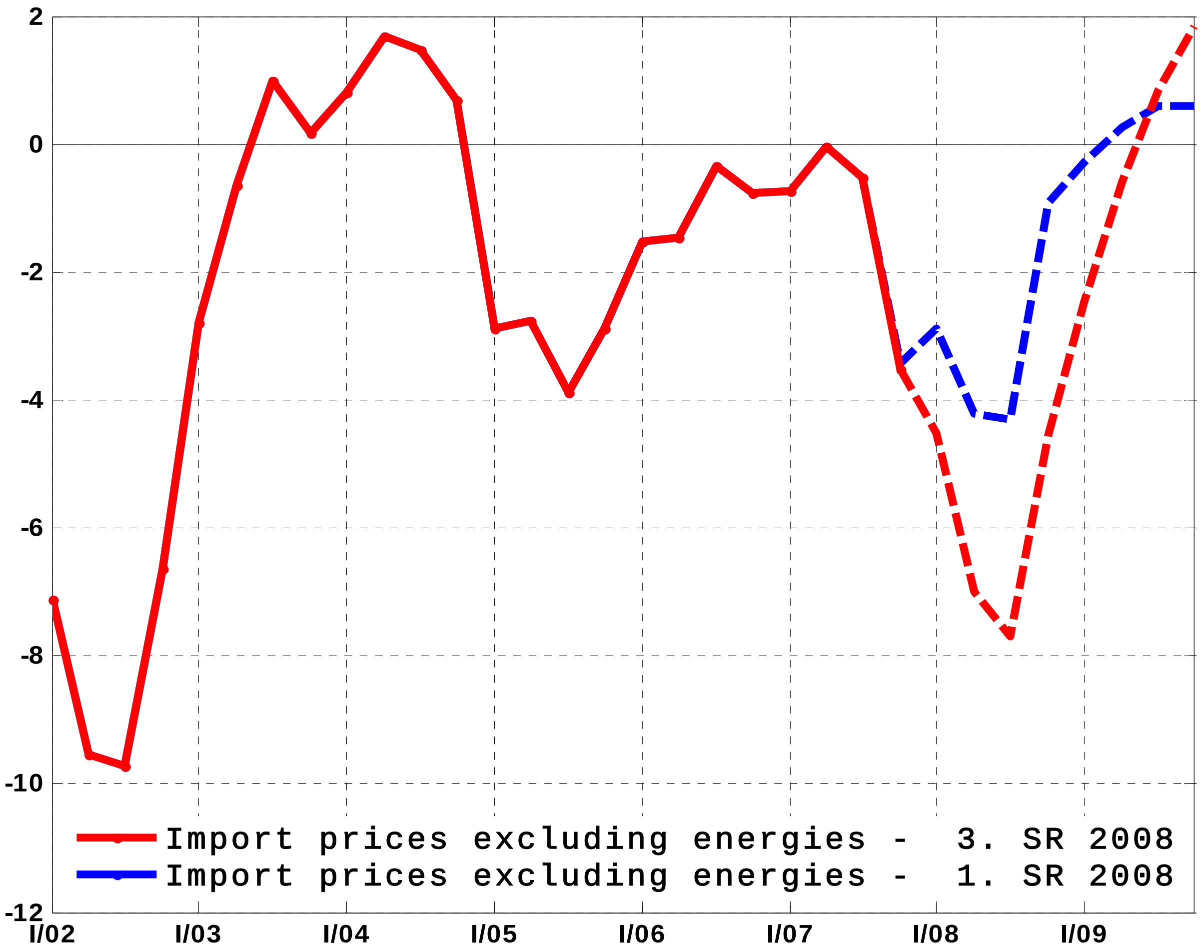
Exchange Rate



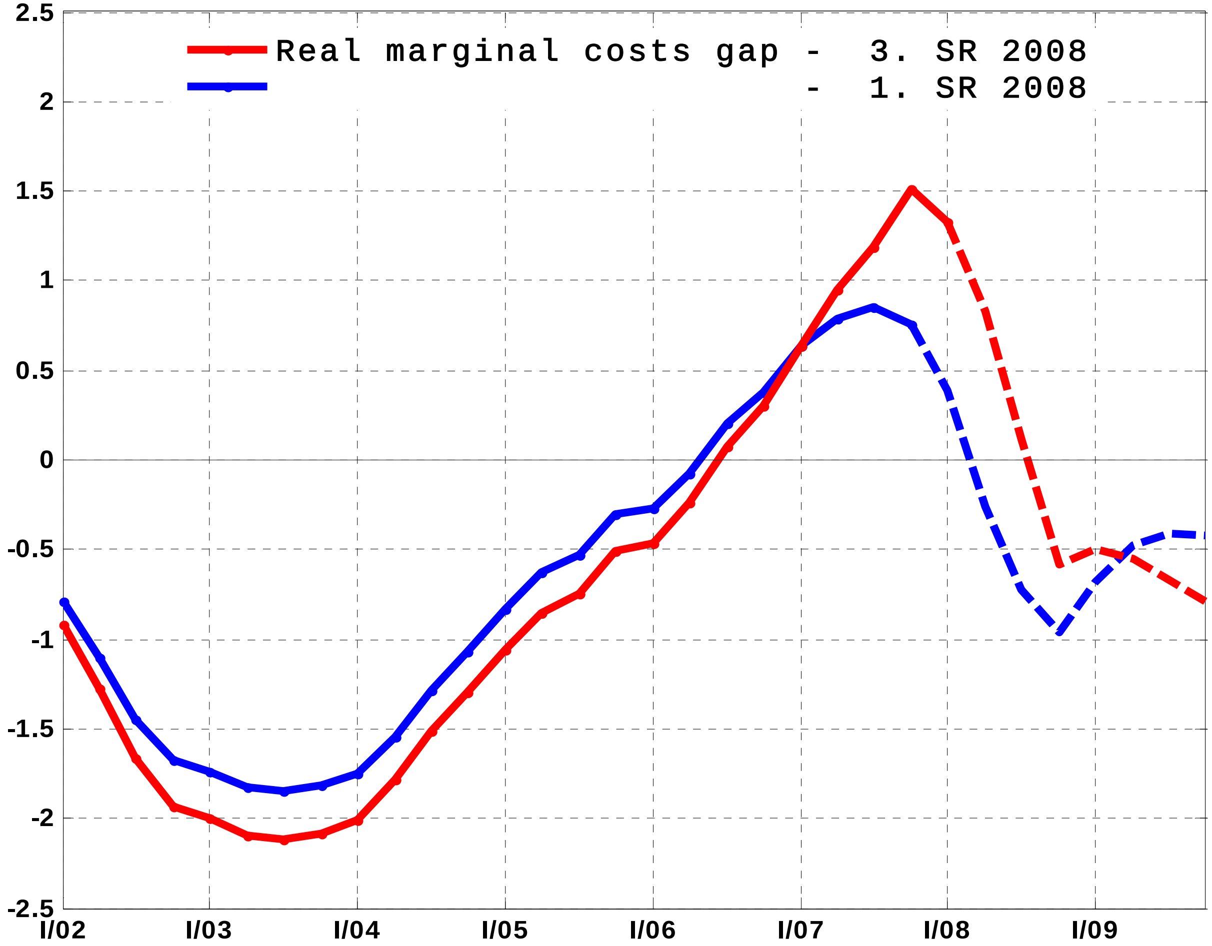
External forecasts of CZK/EUR			
Date of forecast	**Next quarter**	**1Y horizon**	
	CF	CNB‘s survey	CF
4/07	28.0	27.2	27.7
7/07	28.5	27.4	27.9
10/07	27.6	26.9	27.6
1/08	26.2	25.8	26.2
4/08	25.4	25.2	25.5

Import Prices excl. Energy



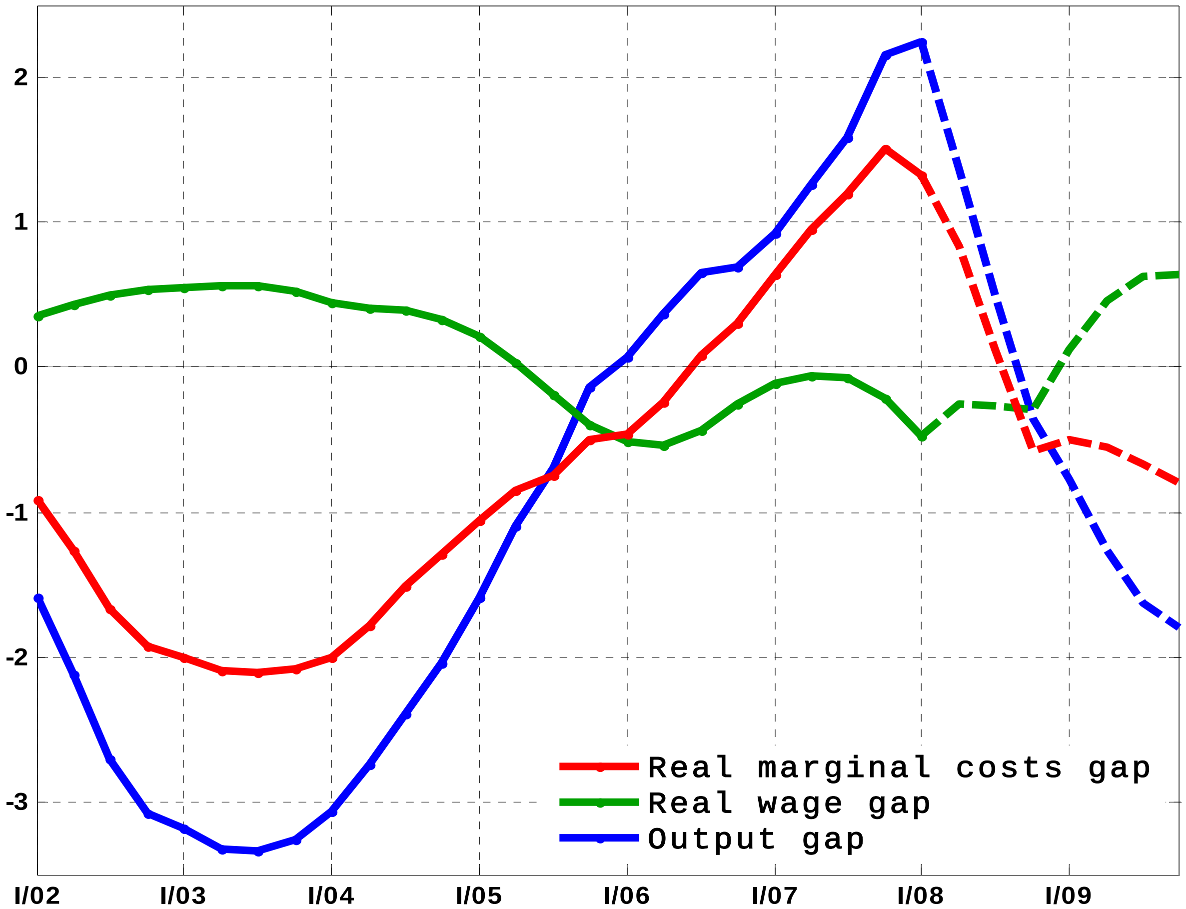
- Much more anti-inflationary due to stronger exchange rate compared to the previous forecast.

Pressures from the Real Economy



- More inflationary initially, but the pressures will fade away quite fast.

Pressures from the Real Economy



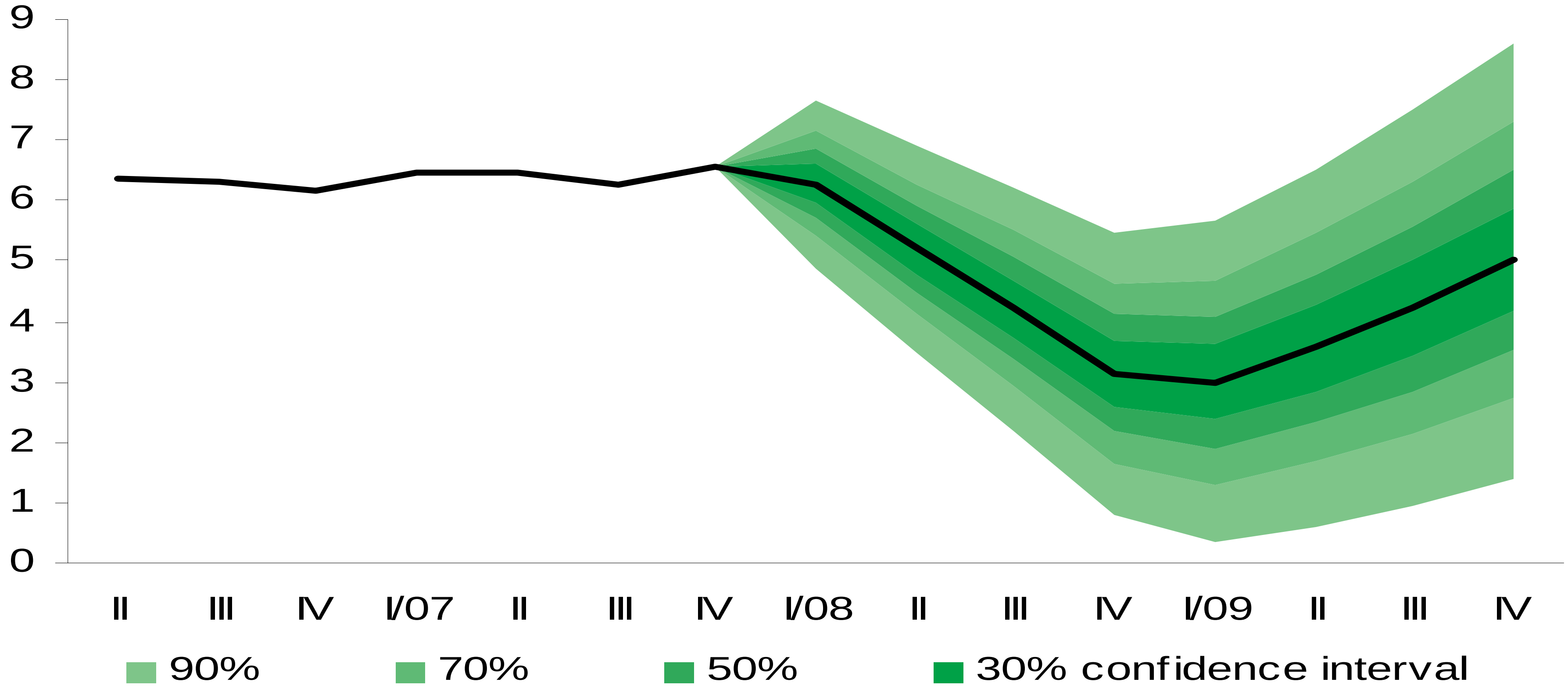
- Output gap will turn negative (restrictive fiscal impulse, exchange rate and weak foreign growth);
- Real wages will turn pro-inflationary in 2009 due to fast nominal wage growth and sharp drop in inflation.

GDP Growth Forecast

y/y change	2007	2008	2009
Gross domestic product	**6.5**	**4.7**	**4.0**
Household consumption	**5.7**	**3.2**	**4.9**
Government consumption	**0.9**	**0.3**	**1.8**
Fixed investment	**6.1**	**7.9**	**7.2**
Exports	**14.5**	**9.5**	**11.4**
Imports	**13.7**	**9.6**	**12.6**

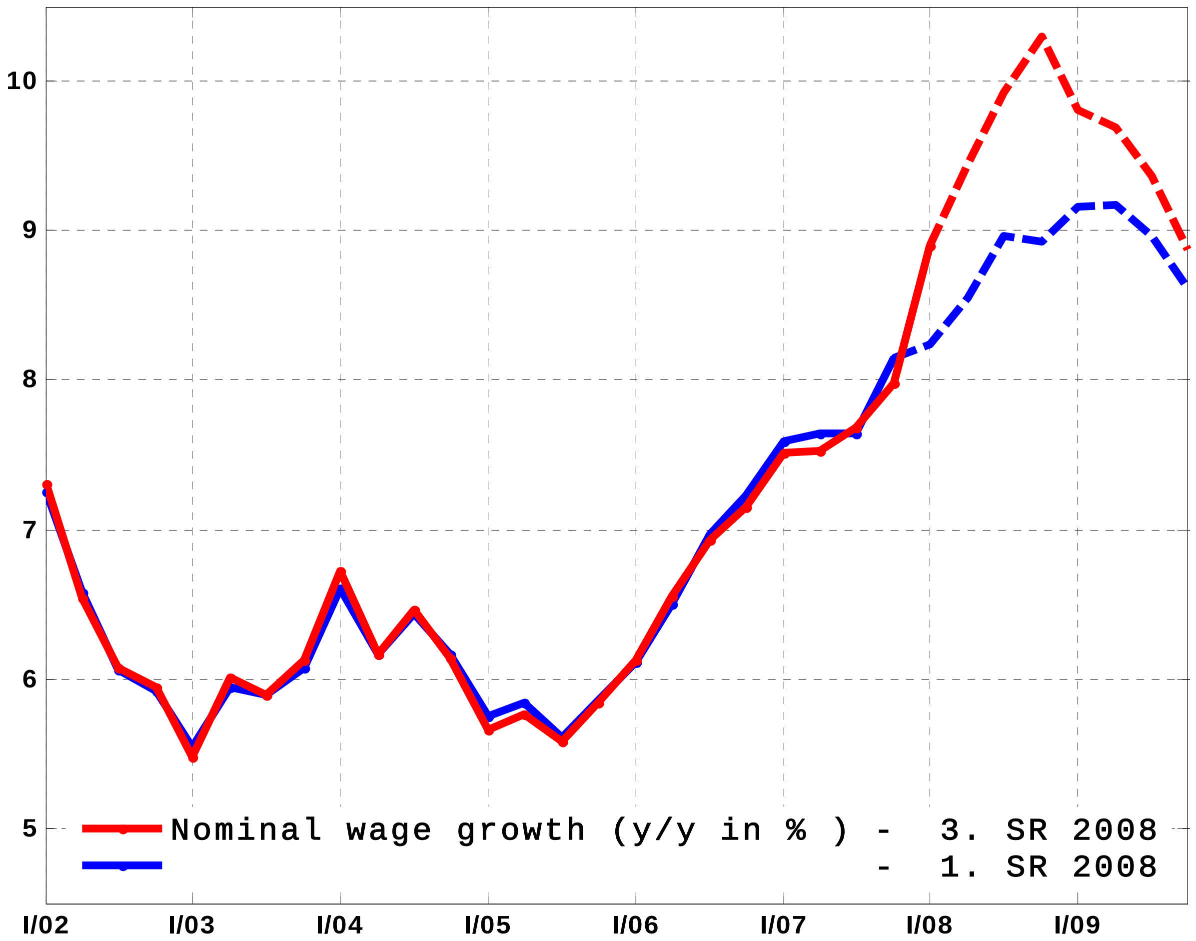
- GDP growth forecast revised up by 0.6 p.p for 2008, but lowered for 2009 by the same amount;
- Slightly higher forecast of consumption growth due to higher wages and increase in pensions;
- Investments and net exports lowered for 2009.

GDP Growth Forecast



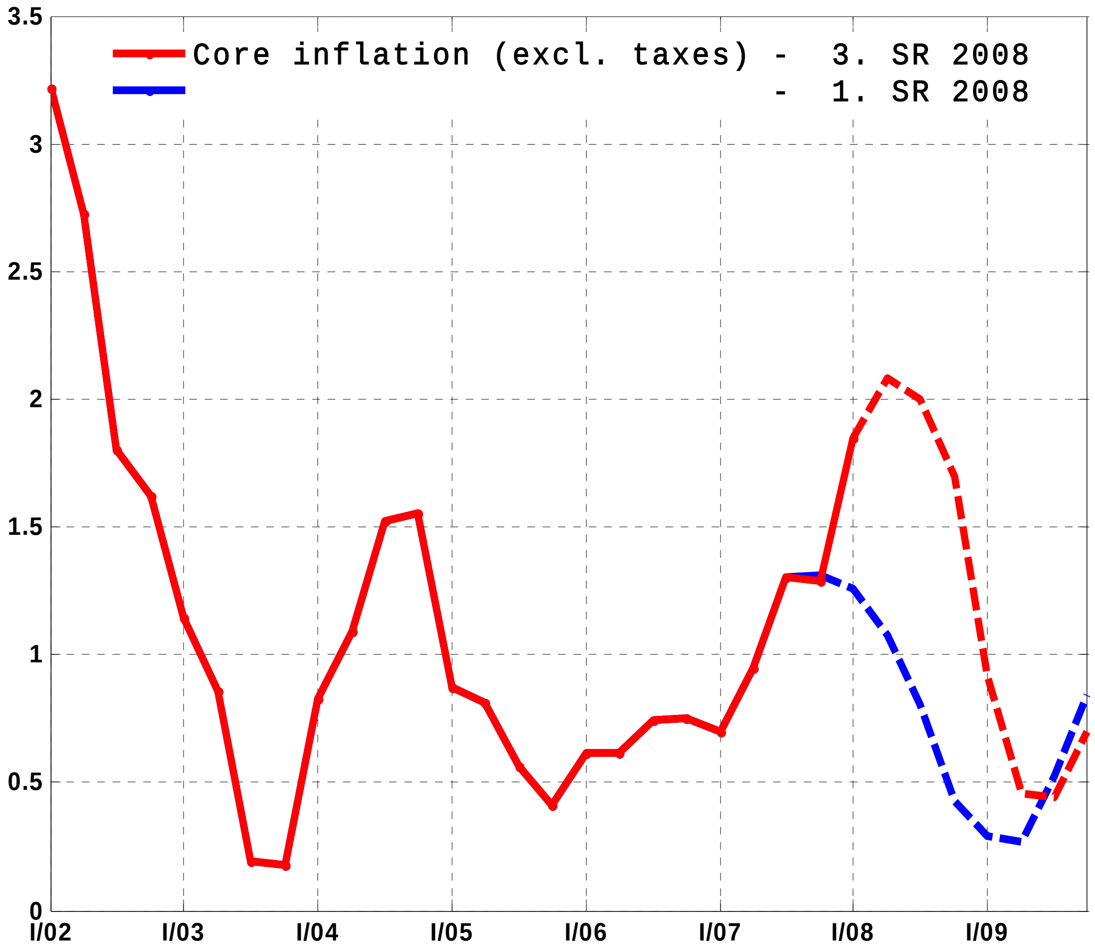
- Pronounced slowdown in growth in 2008, but a turn-around during 2009;
- Uncertainty about speed / strength of exchange rate impact.

Nominal Wage Growth



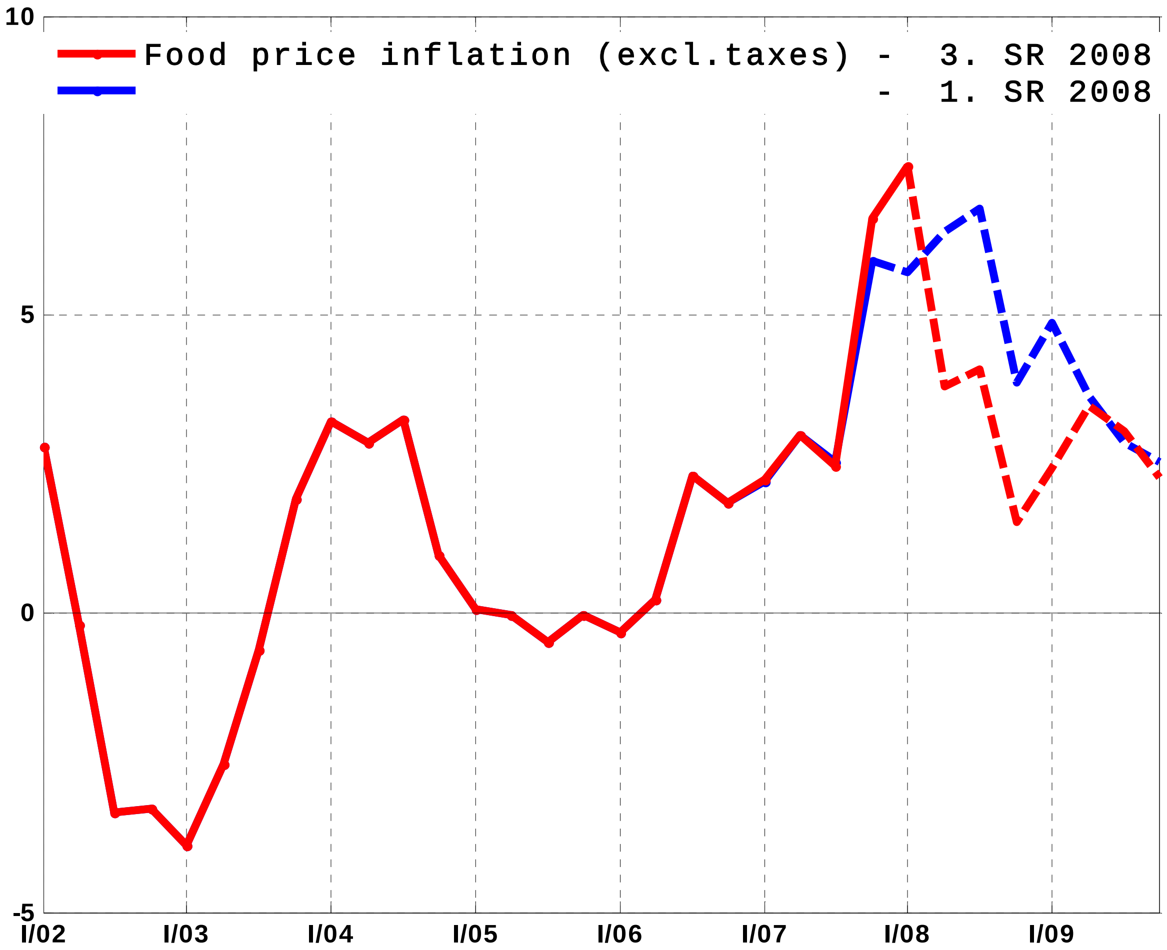
- Figure adjusted for the effect of tax optimisation;
- Growth rate of average nominal wage in business sector: 10.4 % in 2008, 9.0 % in 2009;
- Revised up for both years;
- NULC growth: 4.1 % in 2008, 3.3 % in 2009.

Core Inflation



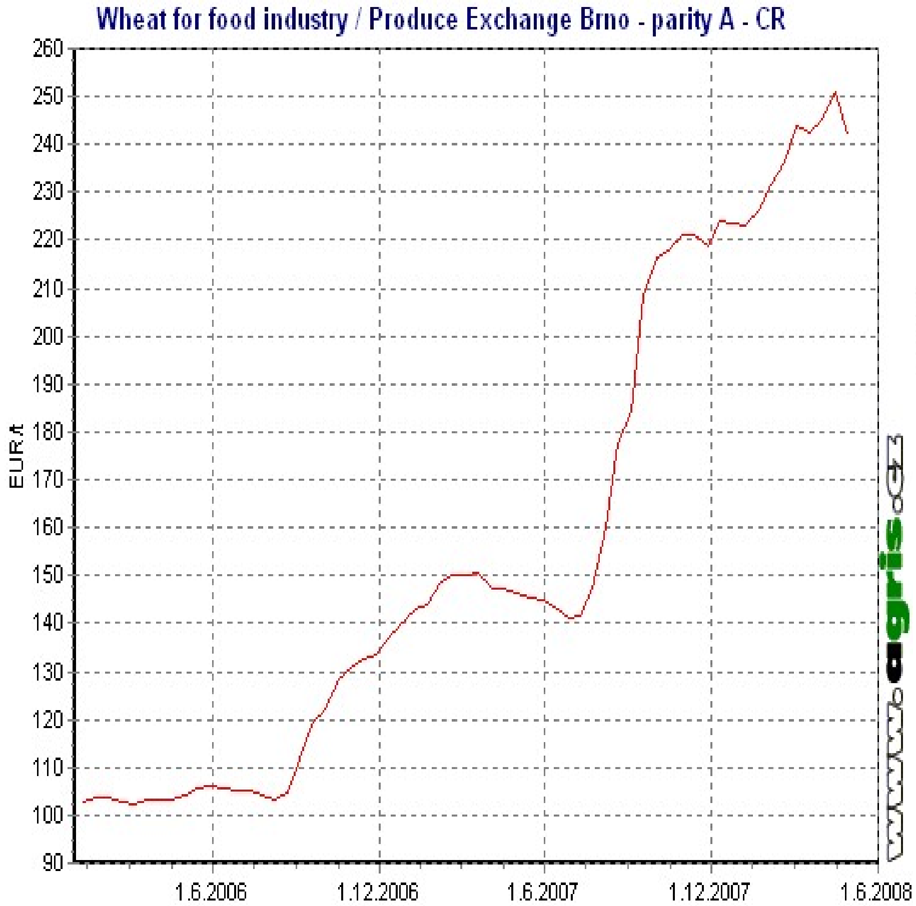
- Forecast initially much higher due to Q1/08 outcomes and stronger pressures from real economy;
- Later on, the domestic pressures will vanish and the anti-inflationary exchange rate impact will dominate.

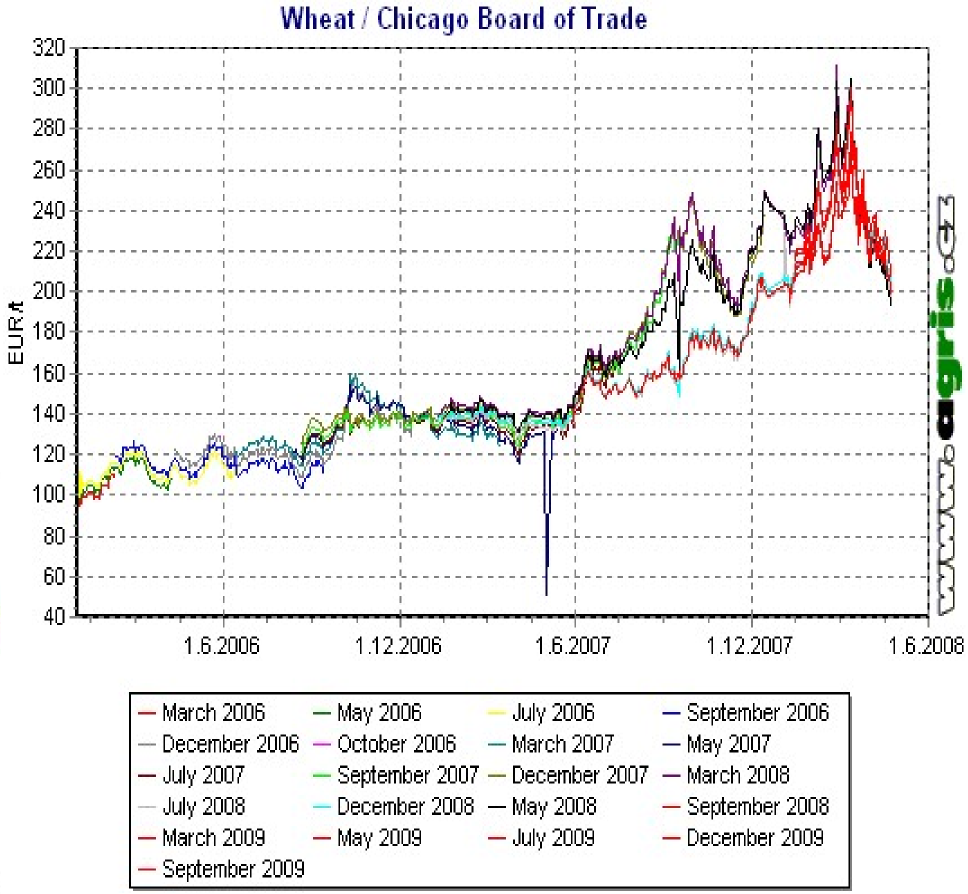
Food Prices
(excluding taxes)



- Forecast lowered due to delayed impact of higher tobacco taxes and stronger exchange rate;
- Uncertainty high, but recent information not suggesting further price level increases.

Agricultural Commodity Prices





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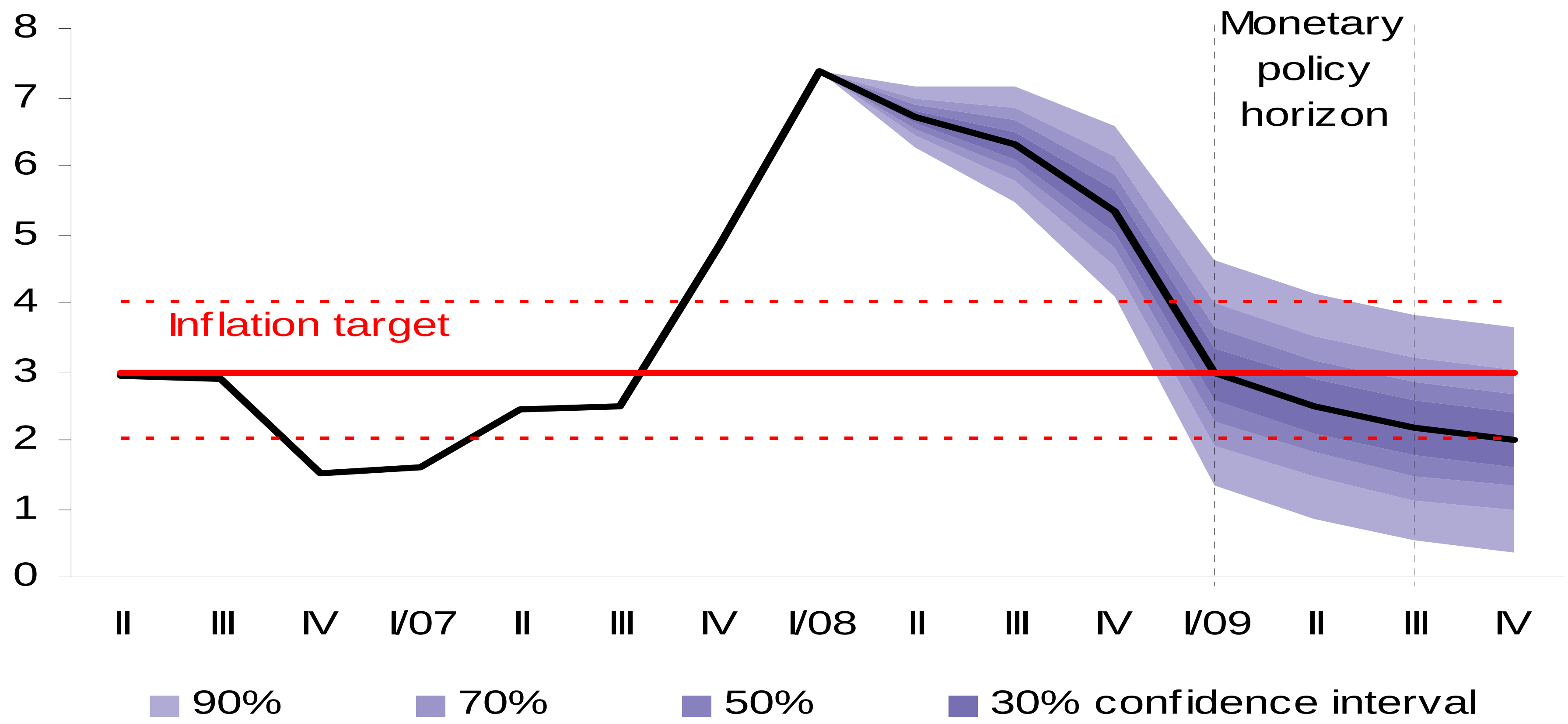
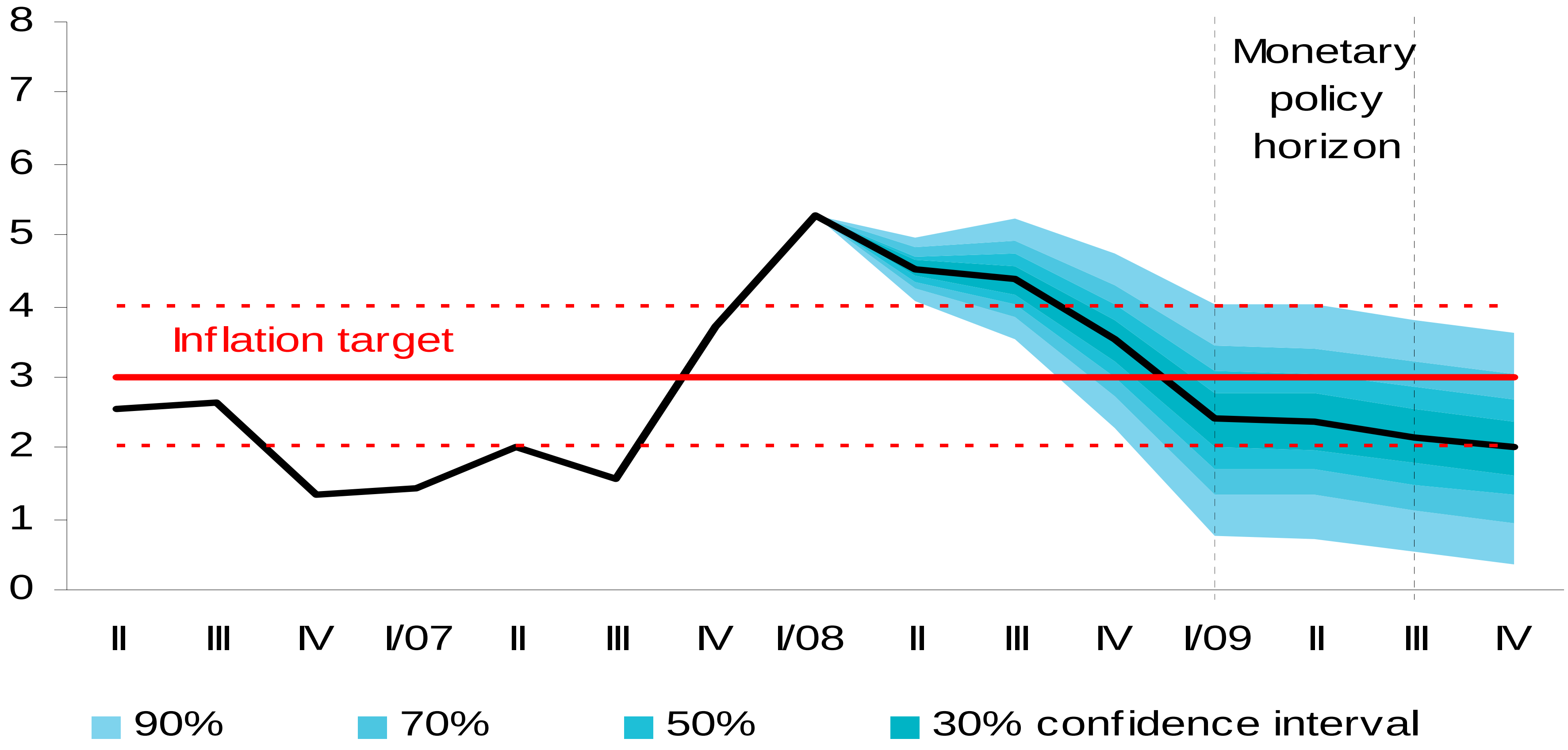
- Prices have levelled-off (or have started to fall);
- Optimistic harvest and future inventories estimates.

Headline Inflation Forecast



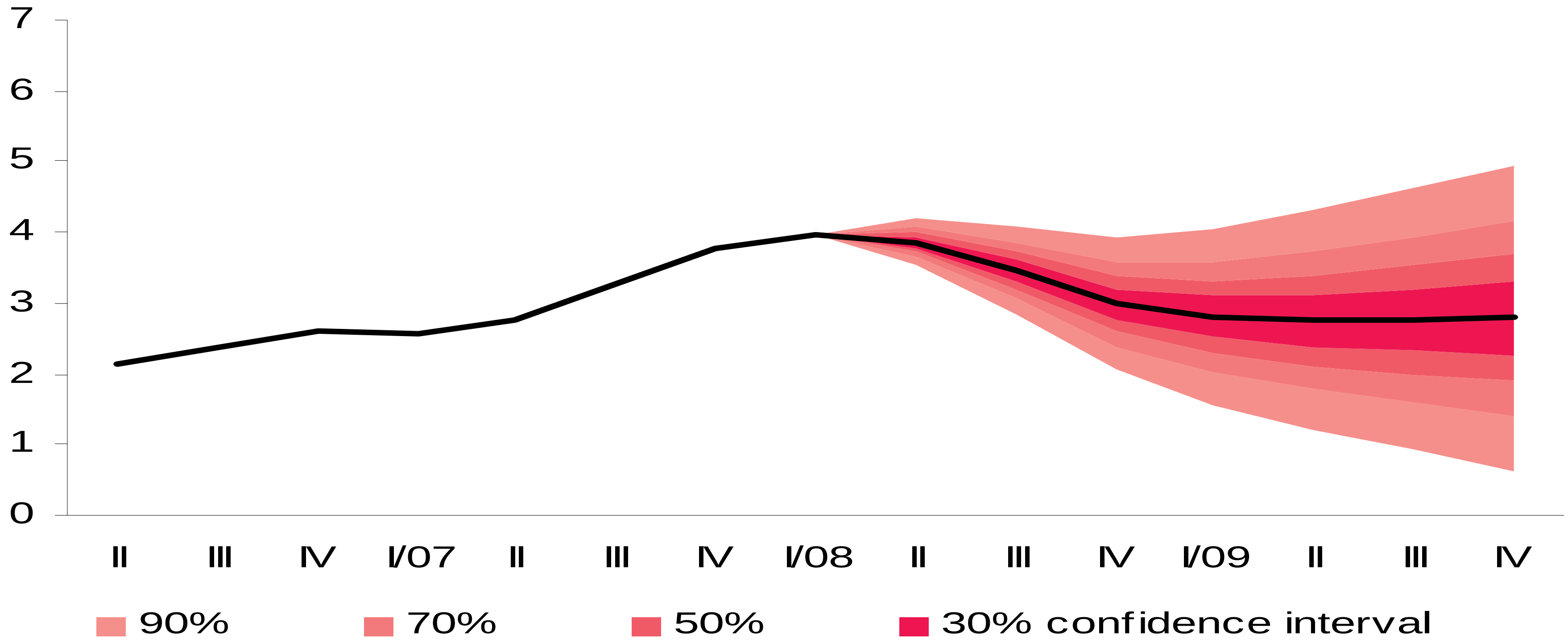
- Overall, the forecast has seen only subtle changes;
- Inflation slightly below the 3% target on the MP horizon.

MP Inflation Forecast



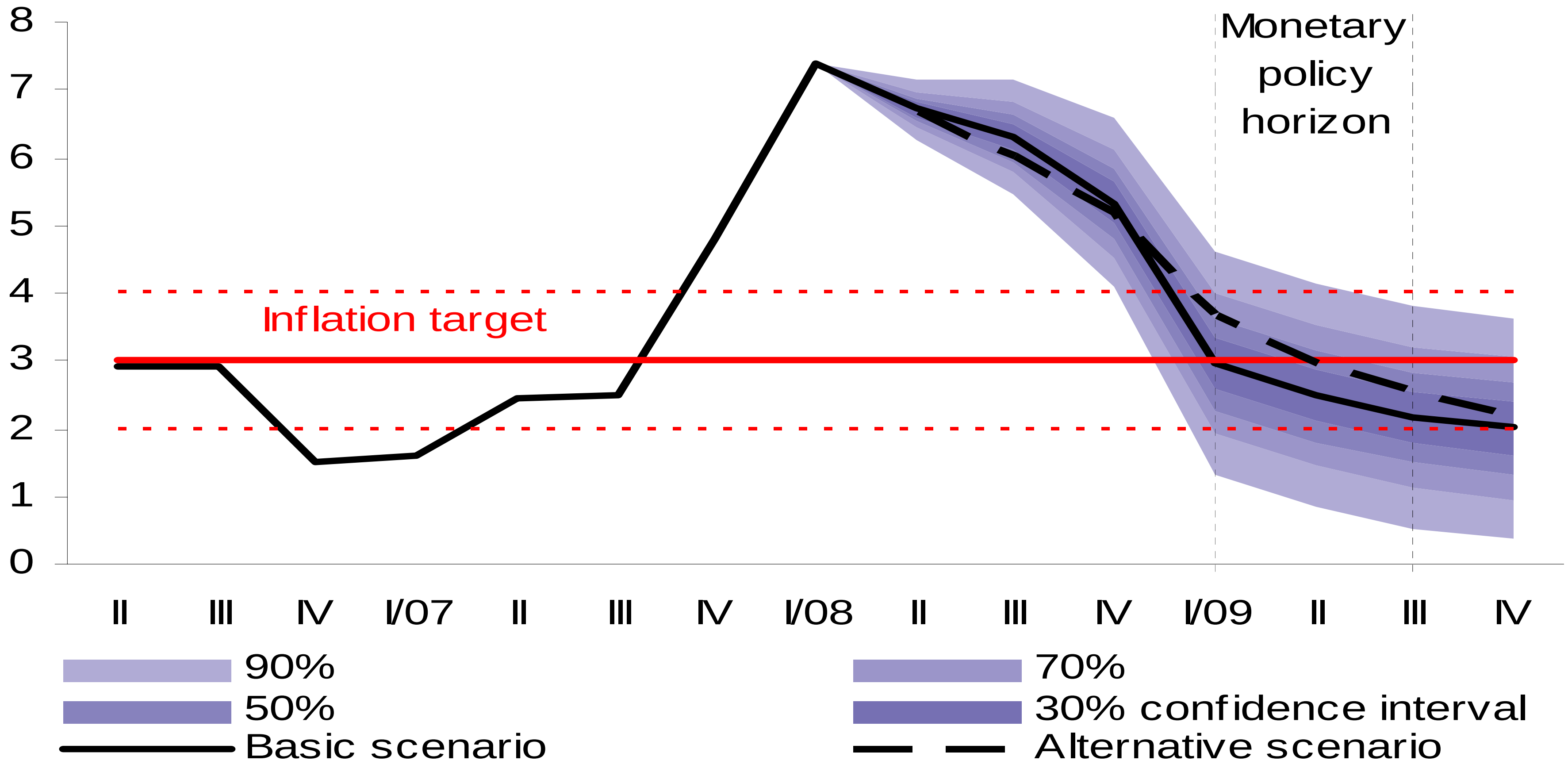
- The impact of tax changes will fade away in 2009.

Interest Rate Forecast



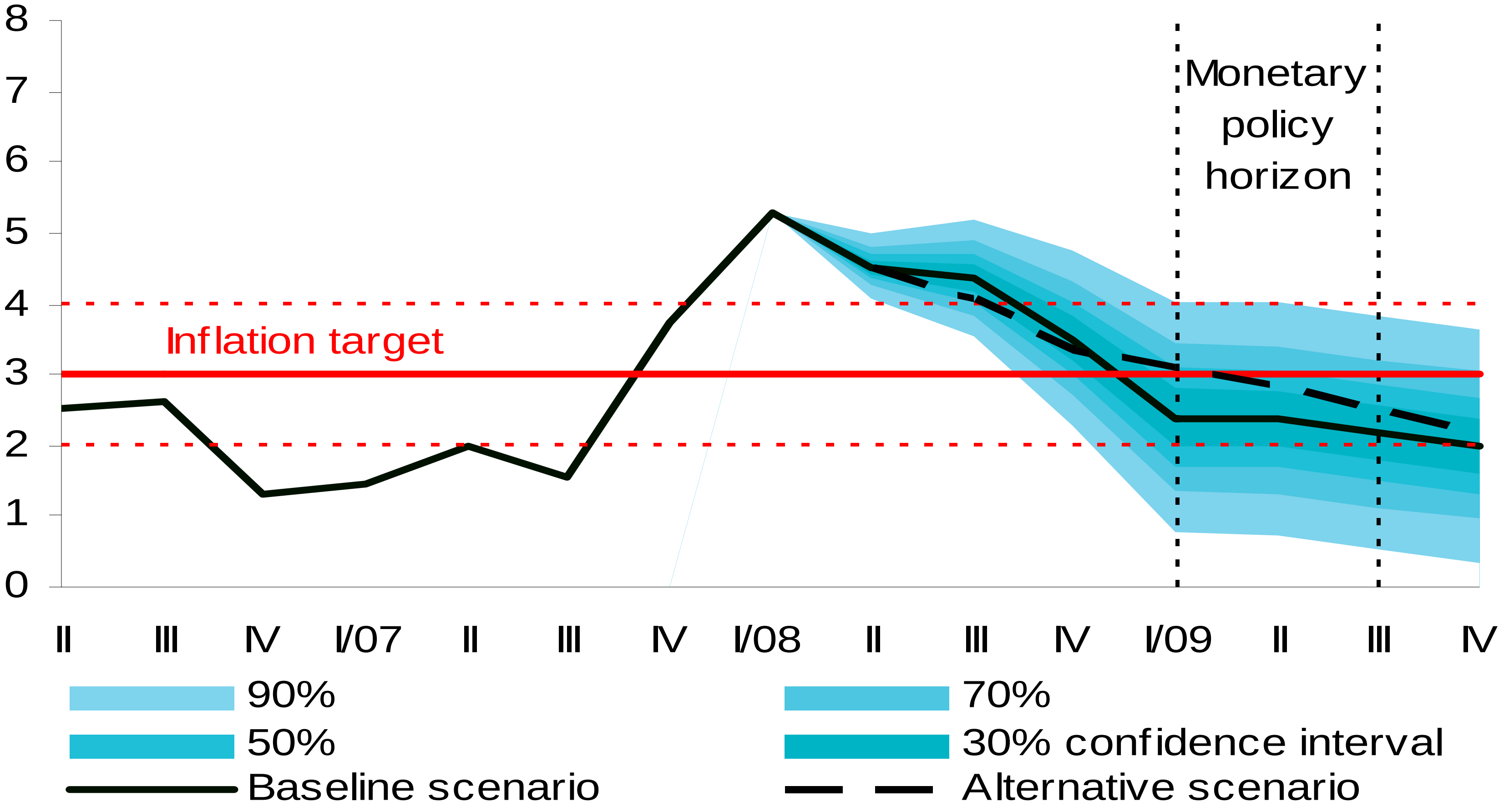
- Consistent with the forecast and its assumptions is broad stability in nominal interest rates initially, followed by a decline still in 2008 and stability in 2009.

Headline Inflation – Alternative Scenario („g3“ model)



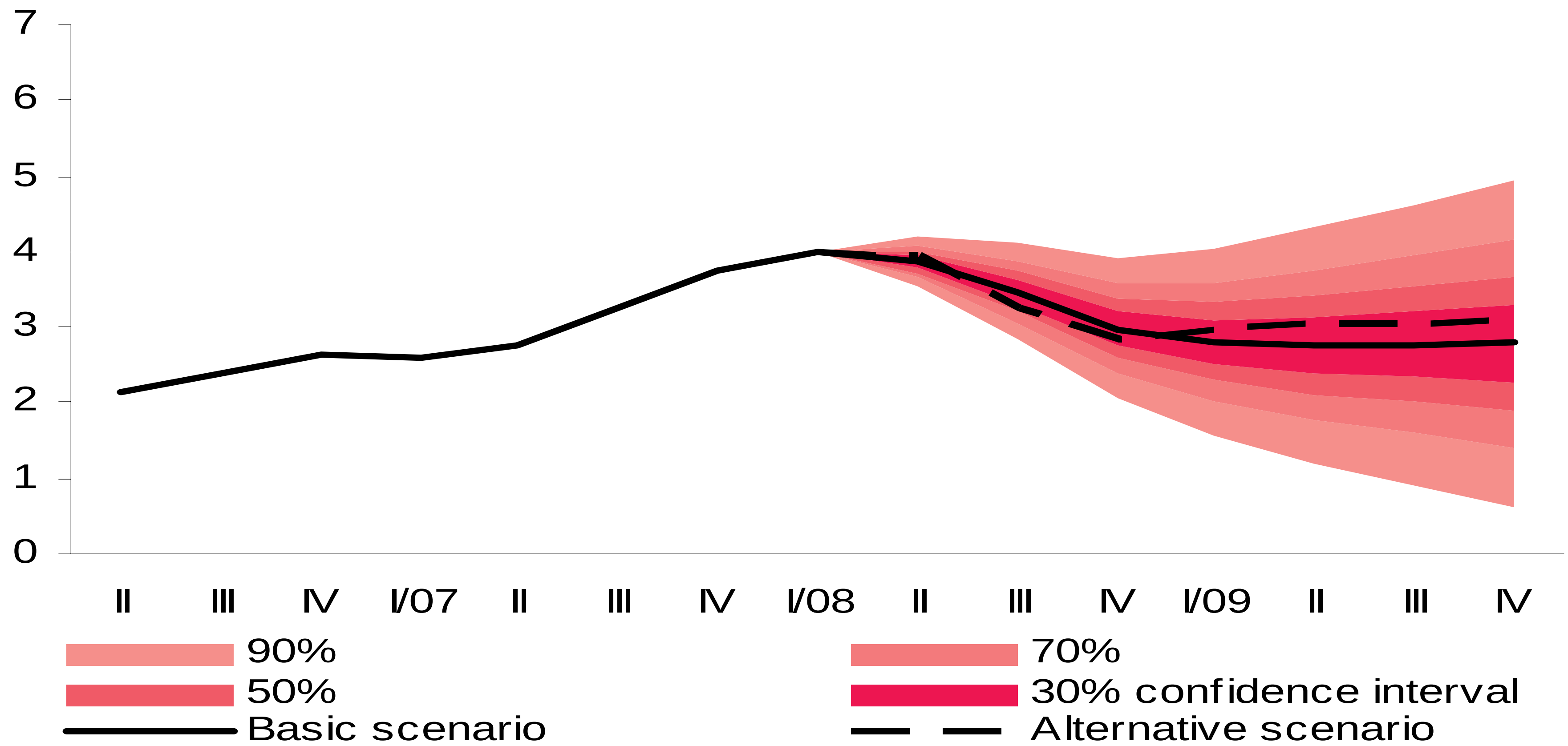
- Alternative scenario slightly higher on the MP horizon than the baseline, inflation close to the 3 % target.

MP Inflation – Alternative Scenario



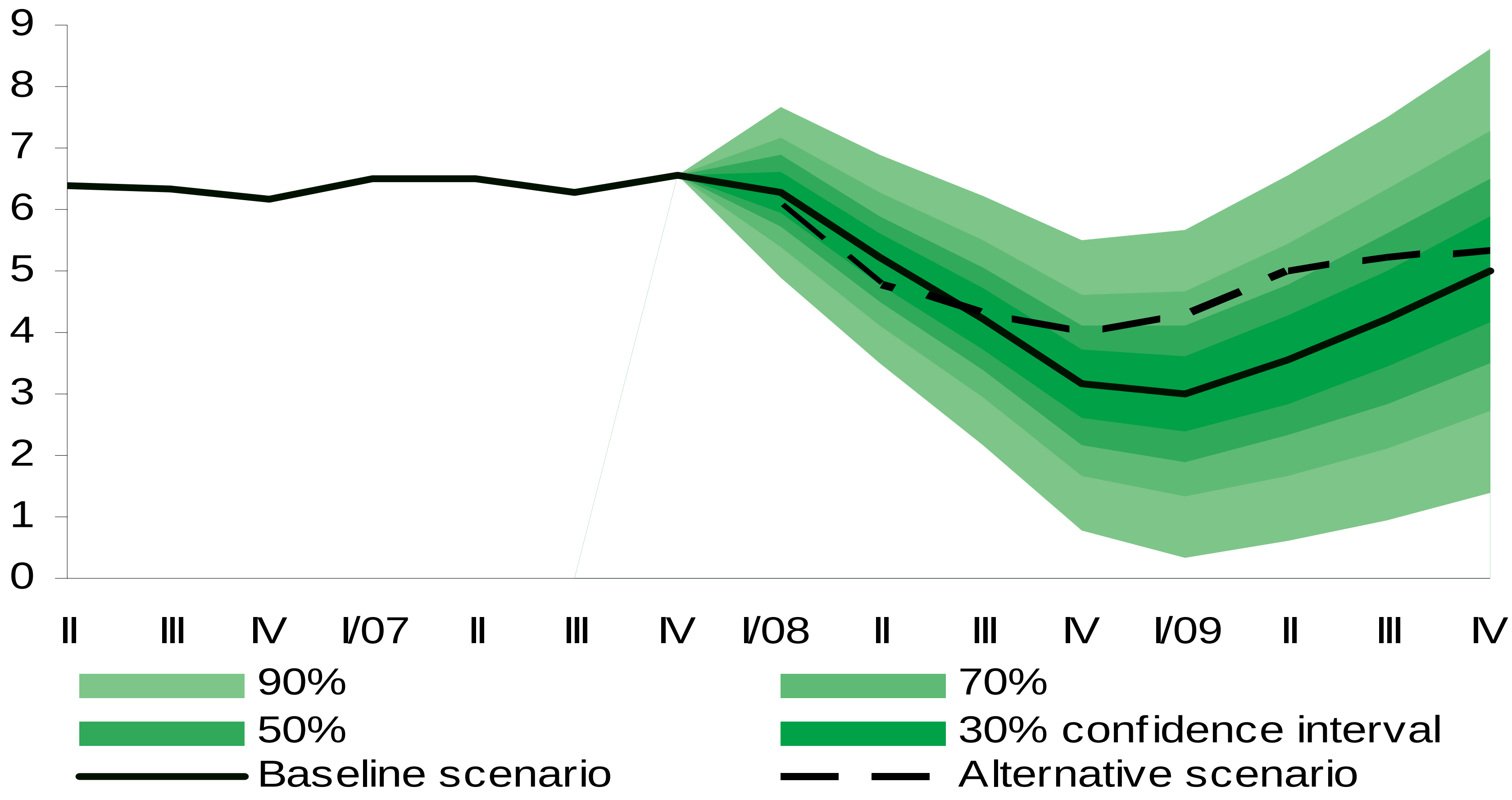
- MP inflation also close to the target.

Interest Rate Forecast – Alternative Scenario



- The interest rate outlook is quite similar to the baseline.

GDP Growth Forecast – Alternative Scenario



- The projected growth slow-down is less pronounced in the alternative scenario than in the baseline.

Thank you
for your attention.

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