

CNB's New Forecast

Inflation Report III/2009

Tomáš Holub

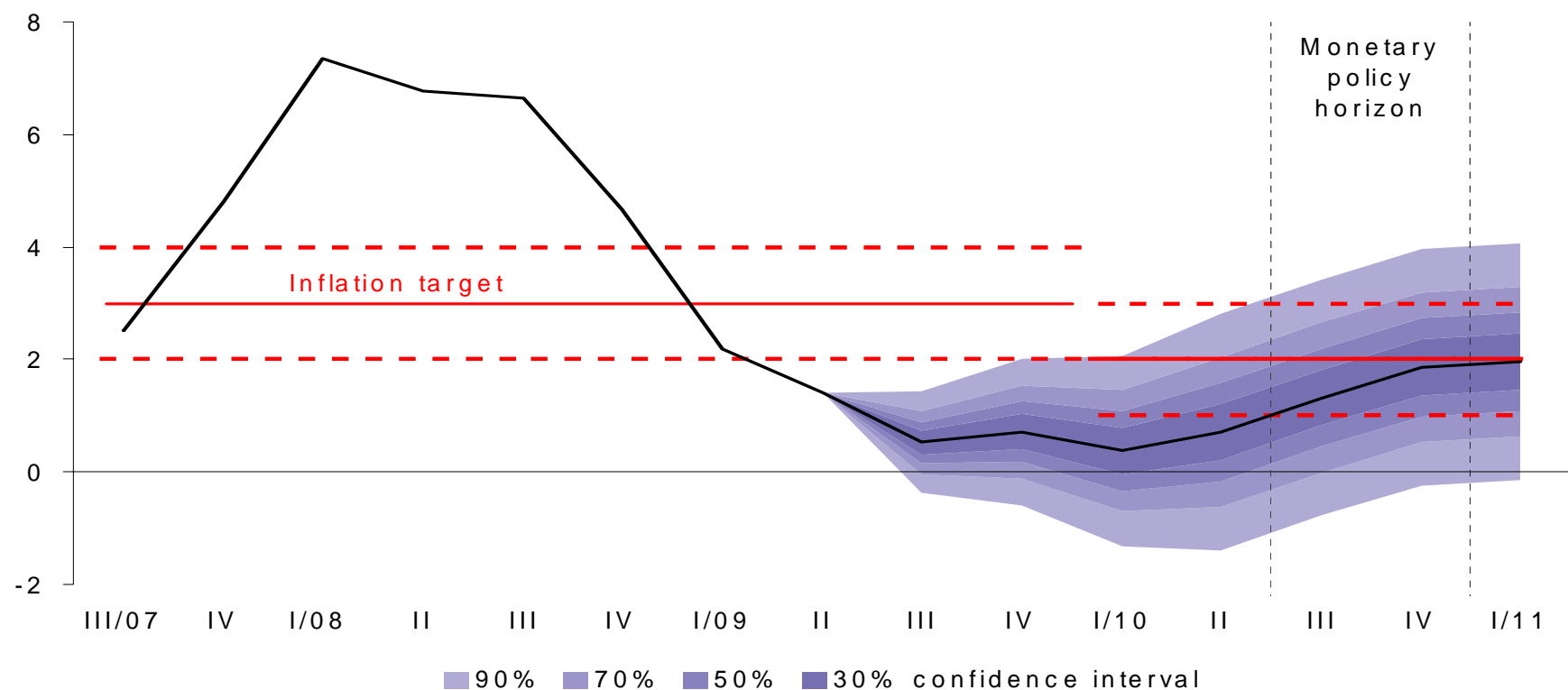
Monetary and Statistics Department

Meeting with analysts, Prague, 14 August 2009

Summary of the Inflation Forecast

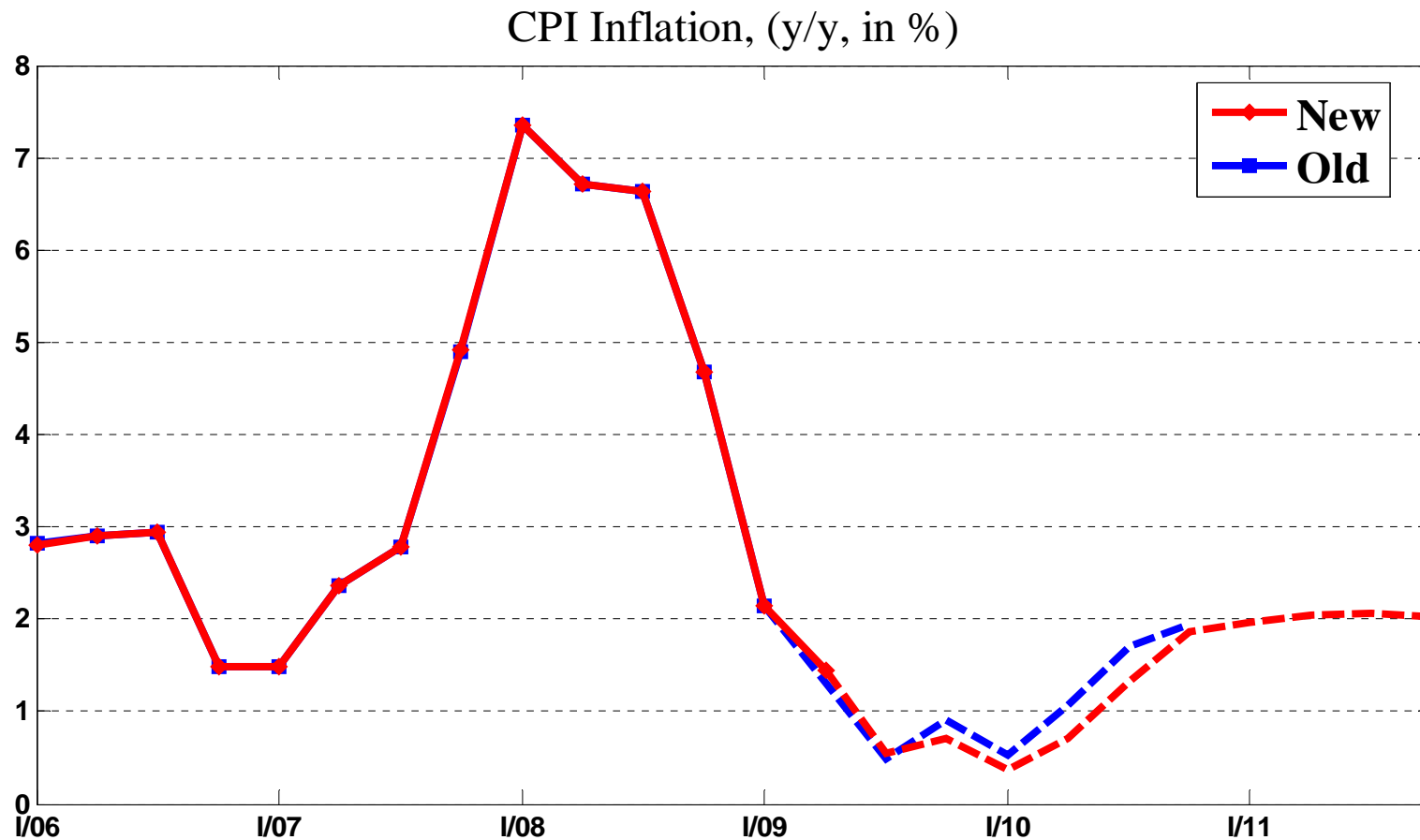
- Inflation will fall to low-but-positive levels in 2009, and then it will gradually increase toward the new 2% target in 2010;
- Inflation forecast was slightly reduced;
- The forecast revision is due mainly to a lower outlook for market-determined prices;
- This reflects a more benign inflationary environment, foreign developments and the near-term outlook for inflation;
- The inflationary impact of previous CZK depreciation is partly offset by falling prices abroad and reduced margins of importers;
- The domestic economy is anti-inflationary: drop in GDP by 3.8 % in 2009, substantial labour market slack.

Headline Inflation Forecast



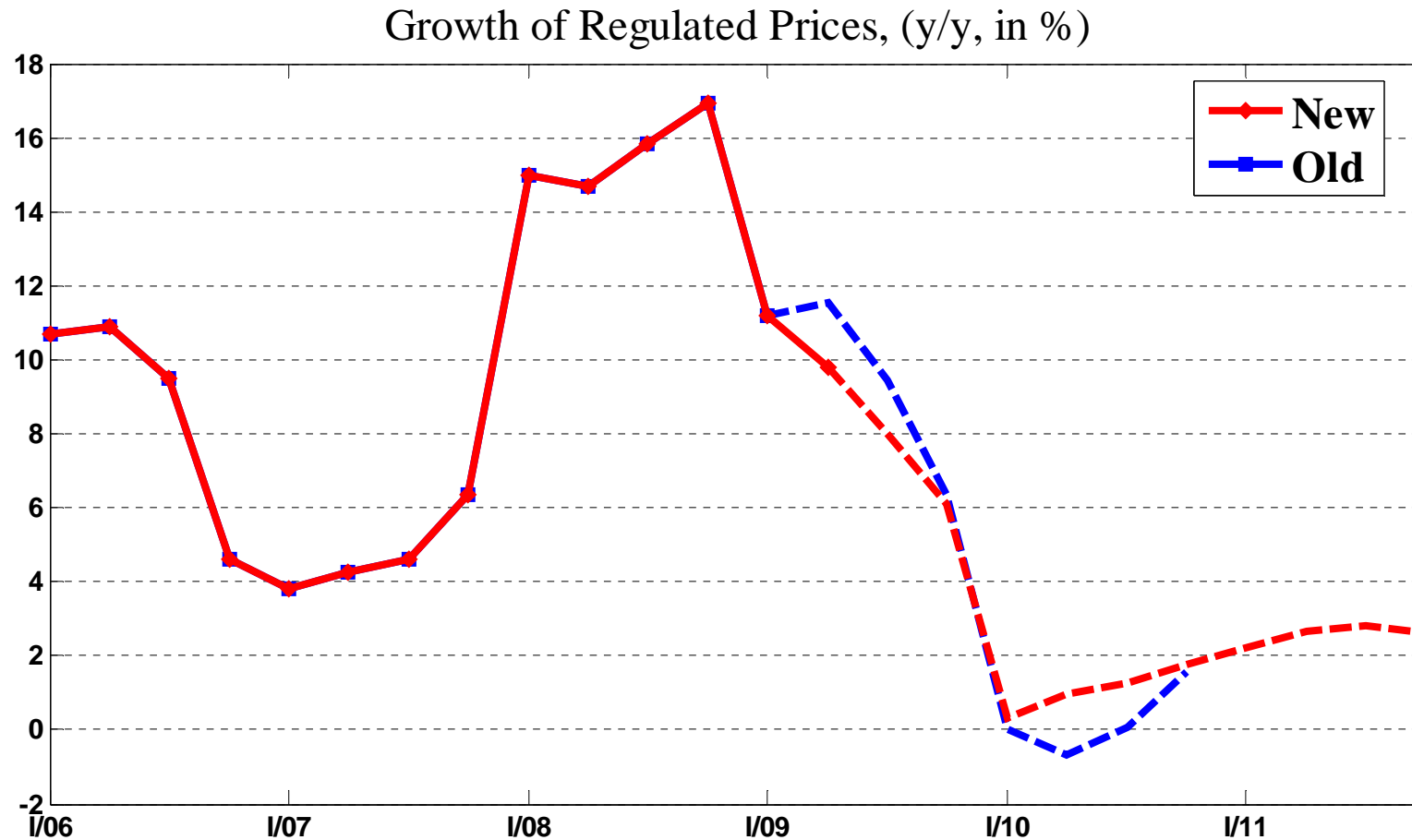
- Inflation will fall further this year, but remain positive;
- Heading for the new 2% target at the end of 2010;
- MP inflation slightly above the headline rate (VAT change);
- July inflation figure below the forecast by 0.2 p.p.

Comparison with Previous Inflation Forecast



- The new forecast is slightly below the old one;
- Increase to 2% slightly more delayed.

Regulated Prices



- The forecast is broadly similar – the main change concerns the outlook for natural gas prices.

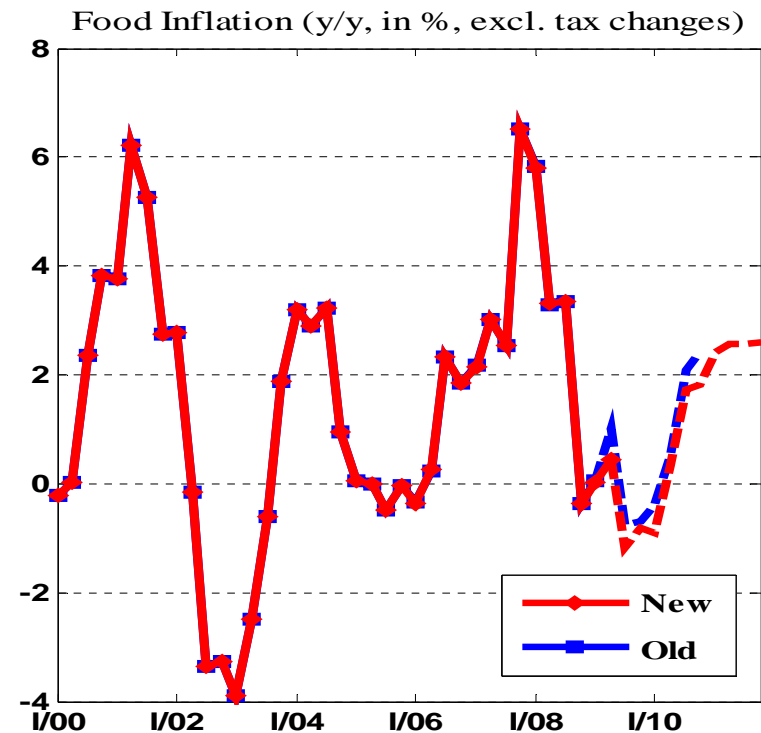
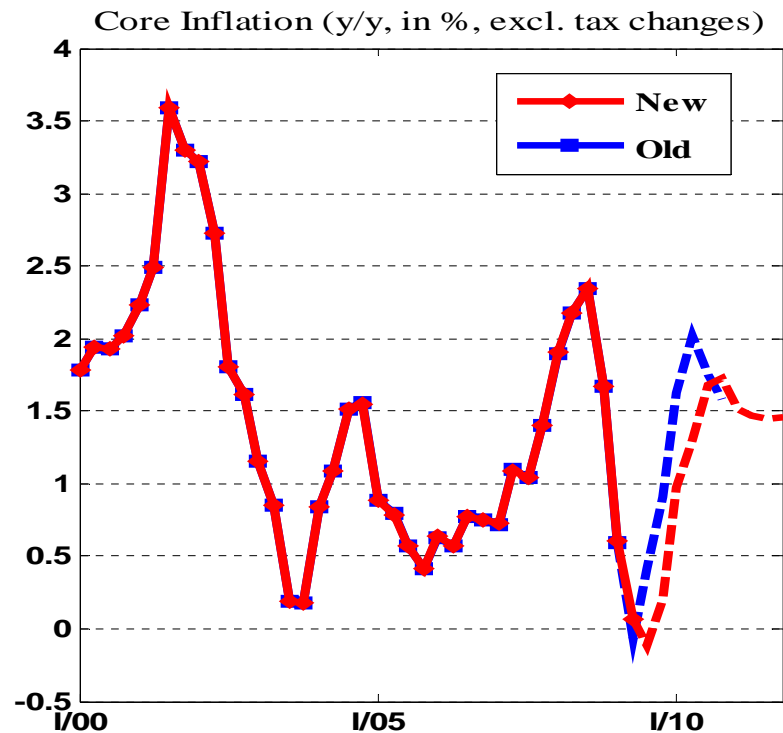
Administrative Measures

(selected items and total impact; end-of-year)

	2009		2010		2011	
	Y/Y growth	Impact in p.p.	Y/Y growth	Impact in p.p.	Y/Y growth	Impact in p.p.
Regulated prices - total	5.1	0.99	1.9	0.39	3.0	0.61
of which (selected items):						
Regulated rents	27.0	0.55	24.0	0.61	7.0	0.22
Electricity	11.6	0.47	-2.0	-0.09	2.0	0.09
Natural gas	-9.8	-0.28	-13.5	-0.34	4.0	0.09
Heating	2.8	0.09	2.0	0.07	2.0	0.07
Healthcare	-4.6	-0.08	2.0	0.03	2.0	0.03
Primary impact of tax changes on non-regulated prices		-0.37		0.00		0.00

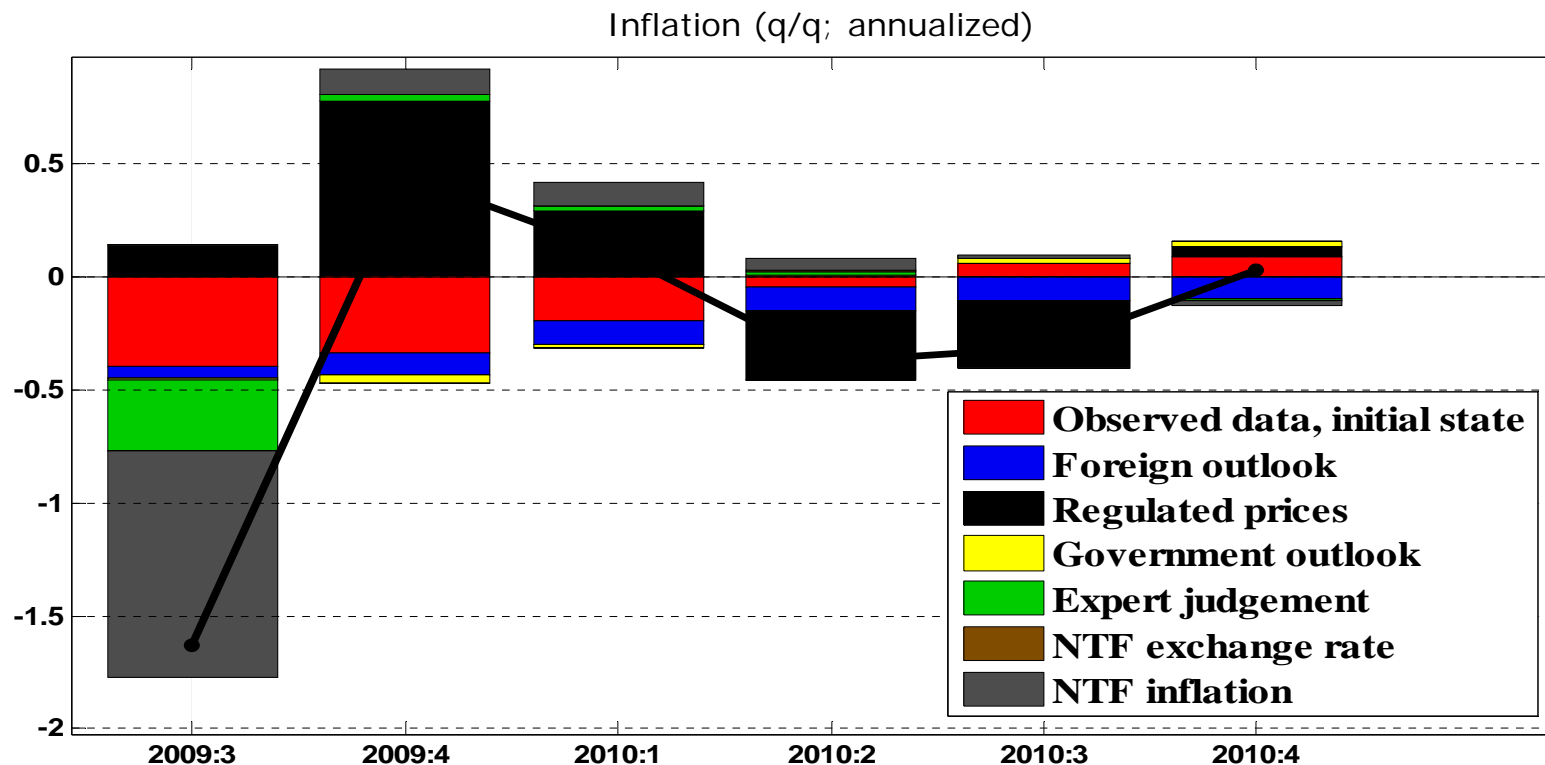
- Rents will be the main driver of regulated prices;
- Energy prices will decline in 2010;
- Reduction of the VAT rate on certain services postponed to Q4/2009.

Core Inflation and Food Prices



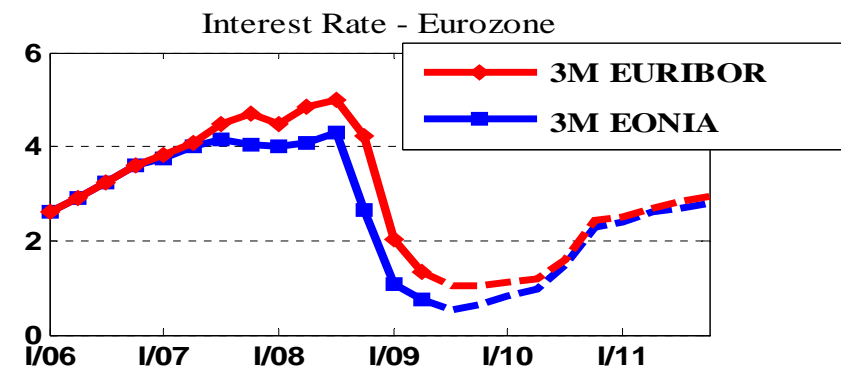
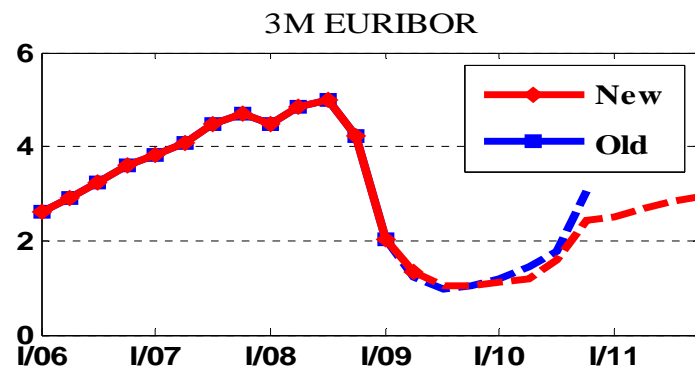
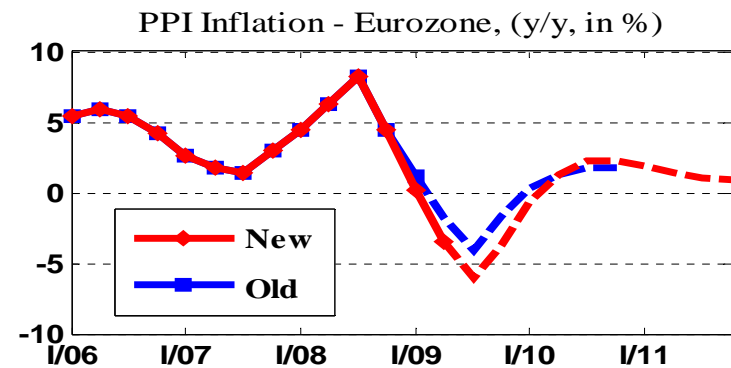
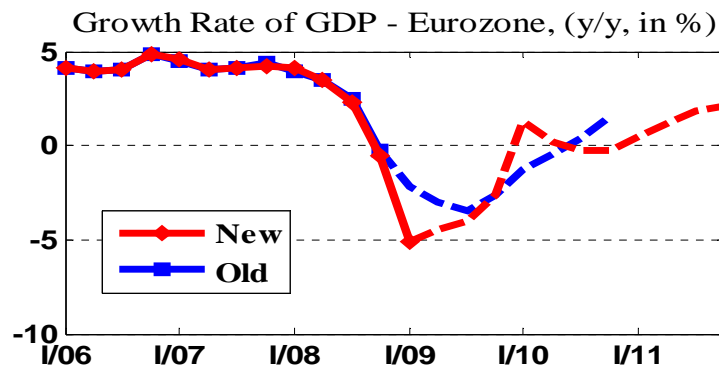
- Lower outlook both for core inflation and food prices;
- Reflects weaker macroeconomic inflationary pressures and sharply falling prices of agricultural commodities.

Inflation Forecast Change Decomposition



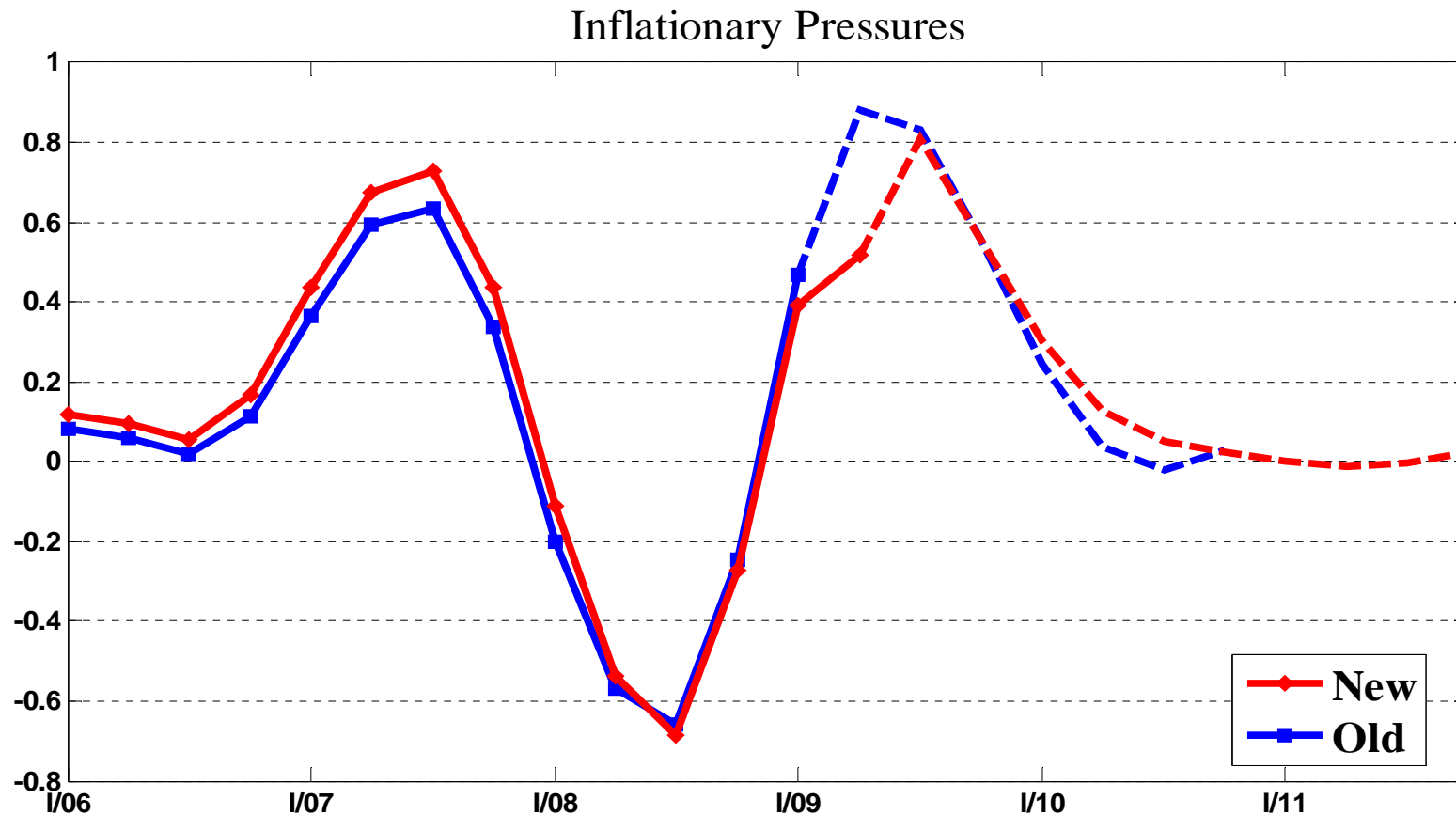
- Different time profile of regulated price and VAT changes;
- Weaker macroeconomic inflationary pressures;
- Lower near-term inflation forecast in Q3 2009 (offsets higher than expected inflation in Q2 2009 in y/y figures).

External Assumptions



- Somewhat mixed, 'W-shaped' outlook for foreign GDP;
- Lower forecast of foreign prices and interest rates.

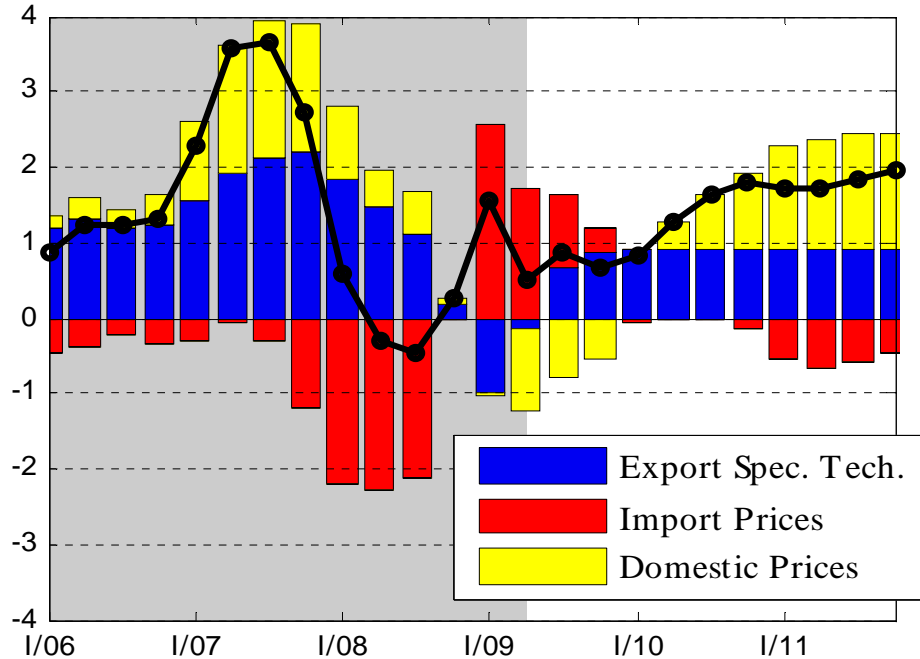
Overall Inflationary Pressures



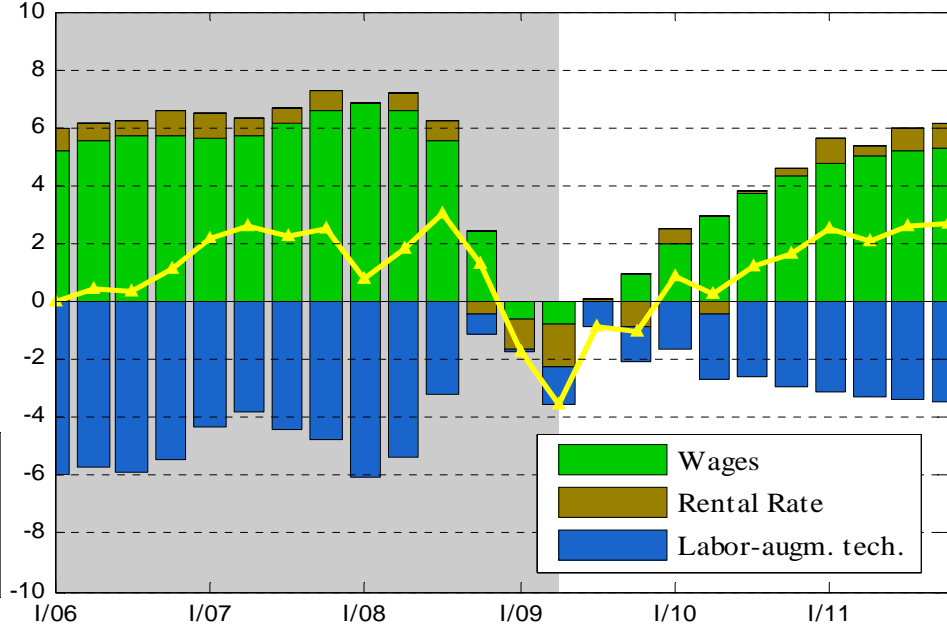
- Pro-inflationary macroeconomic environment, but to a lesser extent than in the previous forecast.

Domestic Pressures vs. Import Prices

Nom. Marginal Cost in Consumption Sector (q/q, in %, ann.)

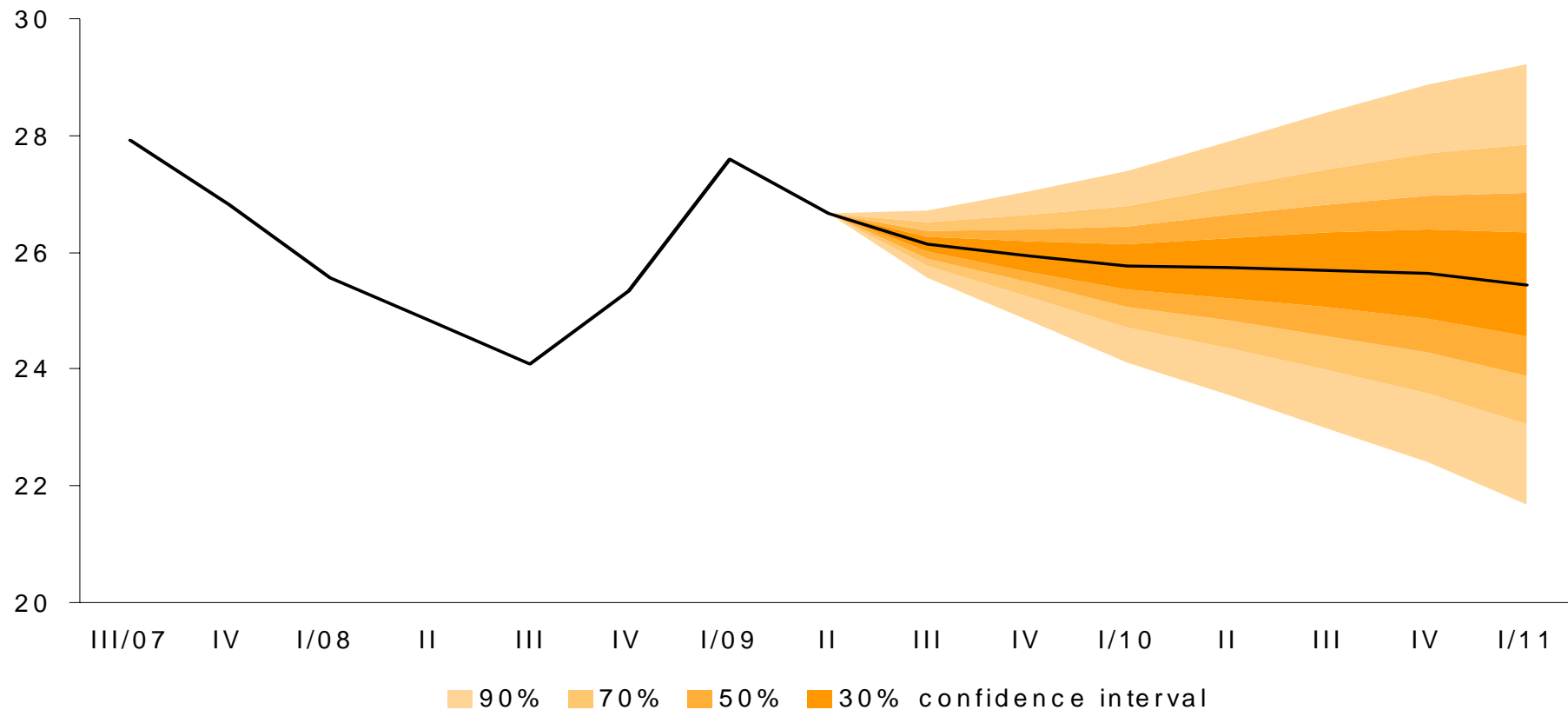


Nom. Marginal Cost in Domestic Sector (q/q, in %, ann.)



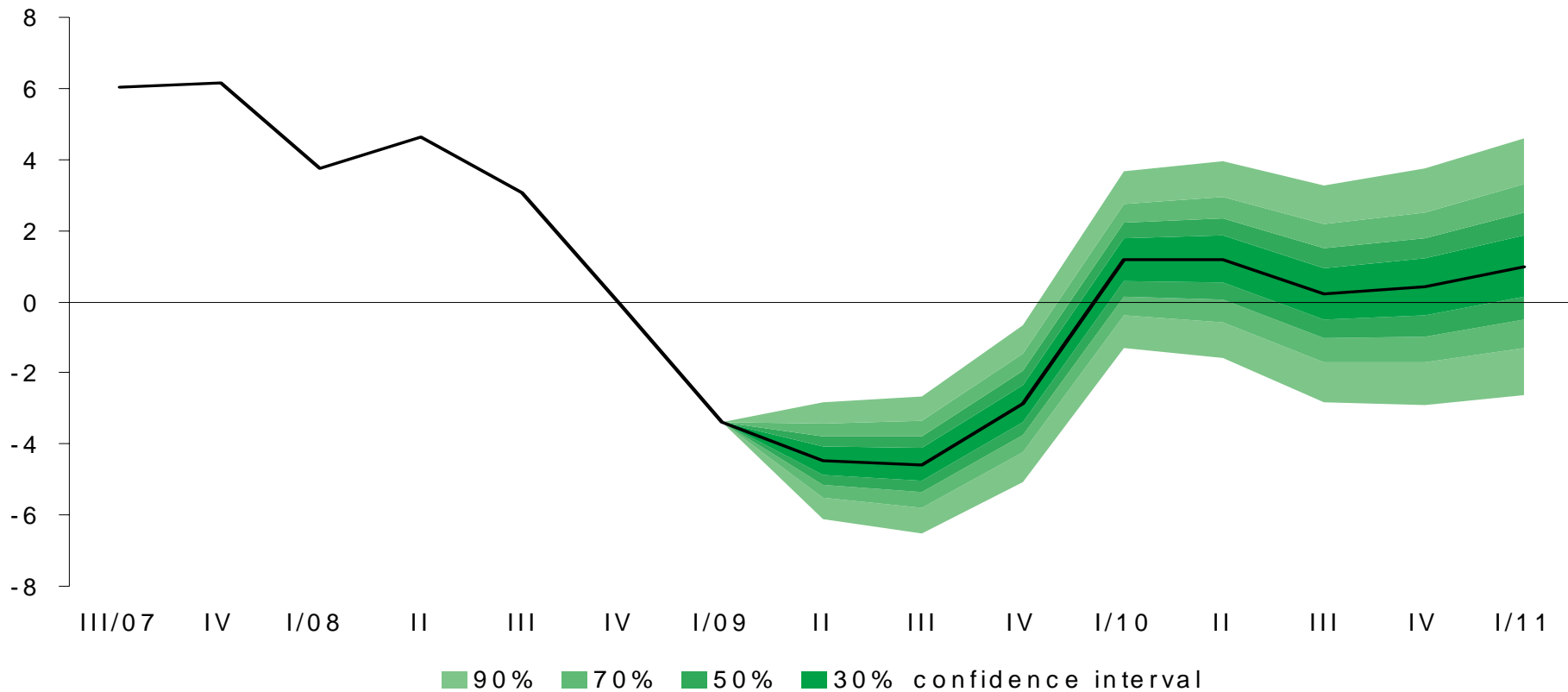
- The inflationary impact of past CZK depreciation is weaker than in the previous forecast (falling prices abroad, reduction of importers' margins);
- The domestic anti-inflationary pressures have become more intense (falling wages in q/q terms, free capacities).

Exchange Rate Forecast (CZK/EUR)



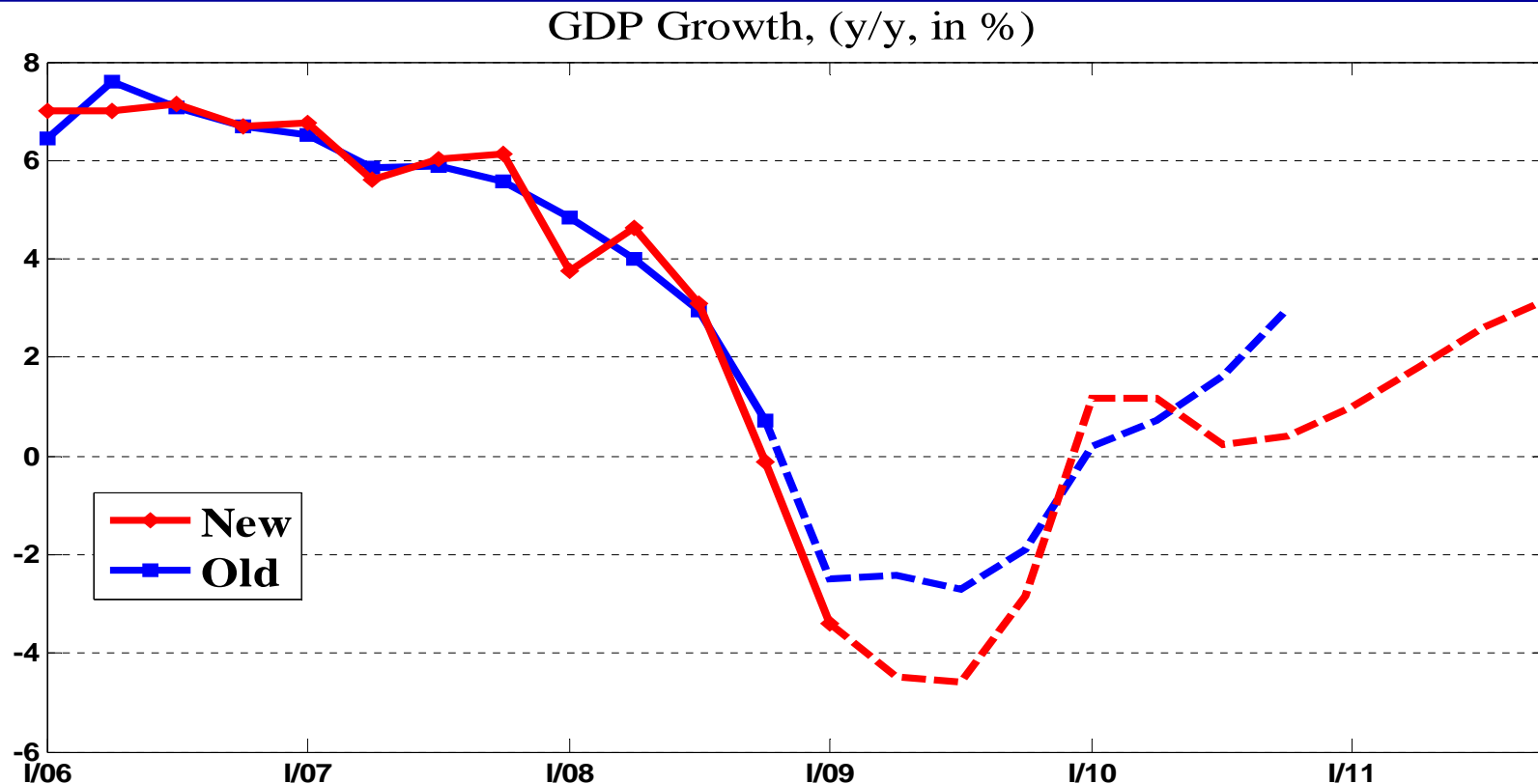
- The nominal exchange rate is modestly appreciating over the forecast horizon;
- The exchange rate trajectory is slightly stronger than in the previous forecast.

GDP Growth Forecast



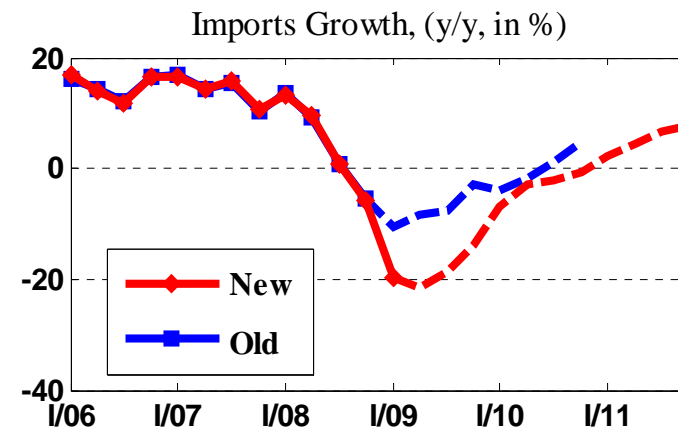
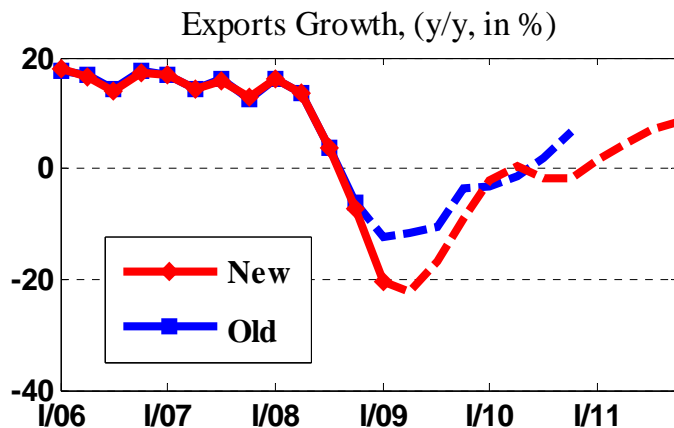
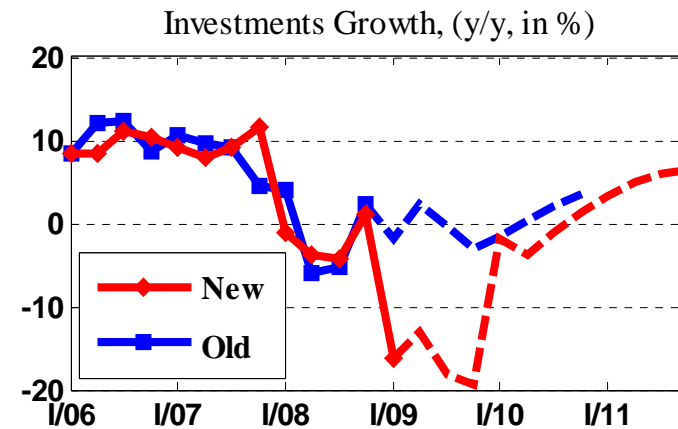
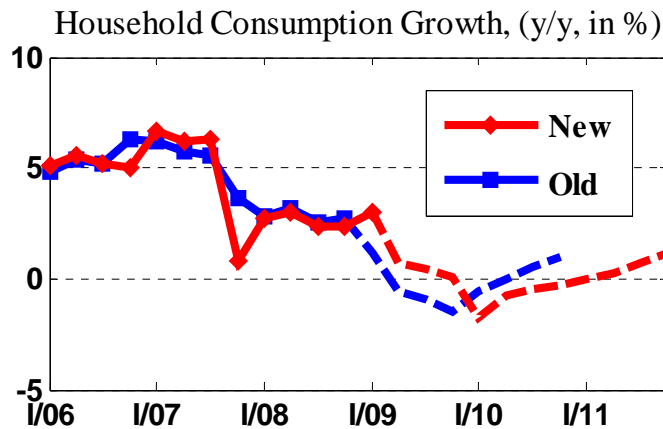
- A recession in 2009 followed by a gradual recovery in 2010;
- Yearly averages: 2009: -3.8%, 2010: +0.7%, 2011: +2.2%;
- Positive q/q growth rates from Q3/2009.

Comparison with Previous GDP Forecast



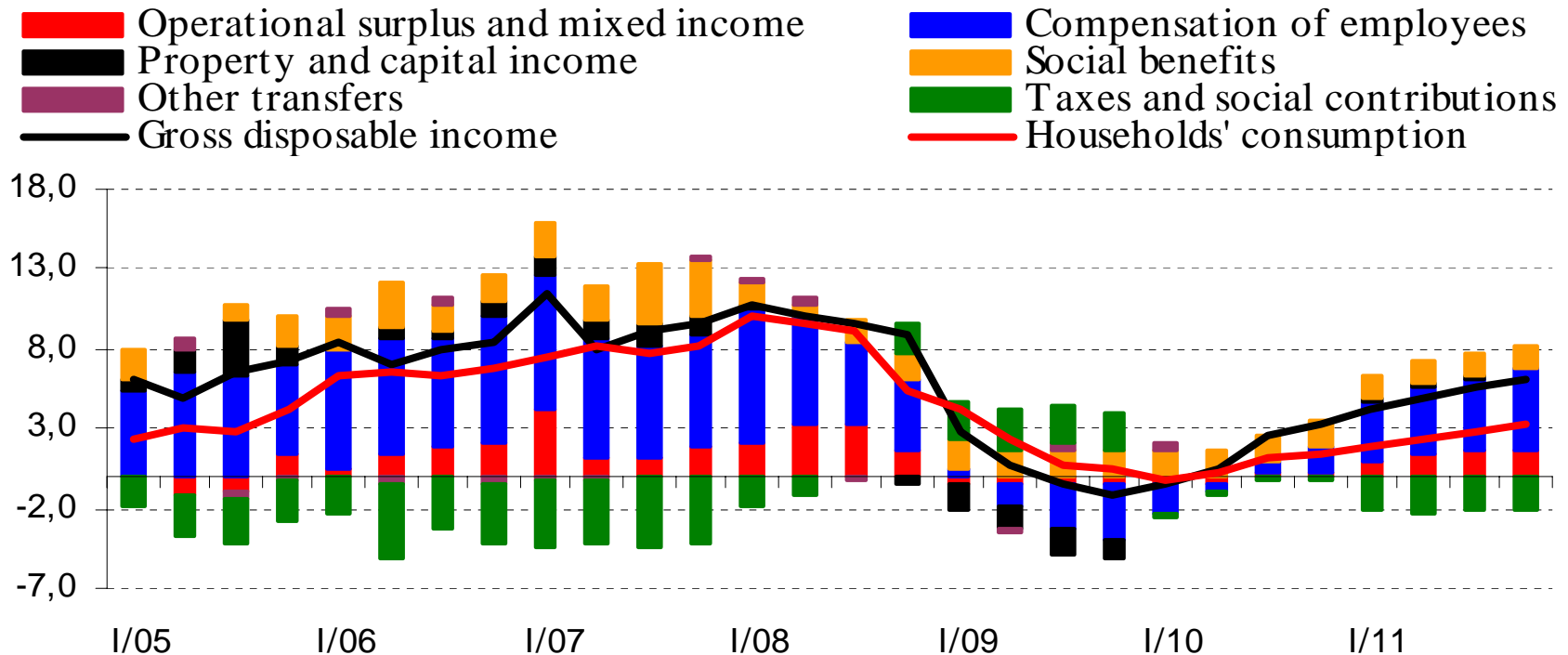
- GDP outlook revised down substantially for 2009;
- Recovery in 2010 affected by sluggish pick up in foreign demand and the end of car-scraping subsidies abroad.

Forecast of Aggregate Demand



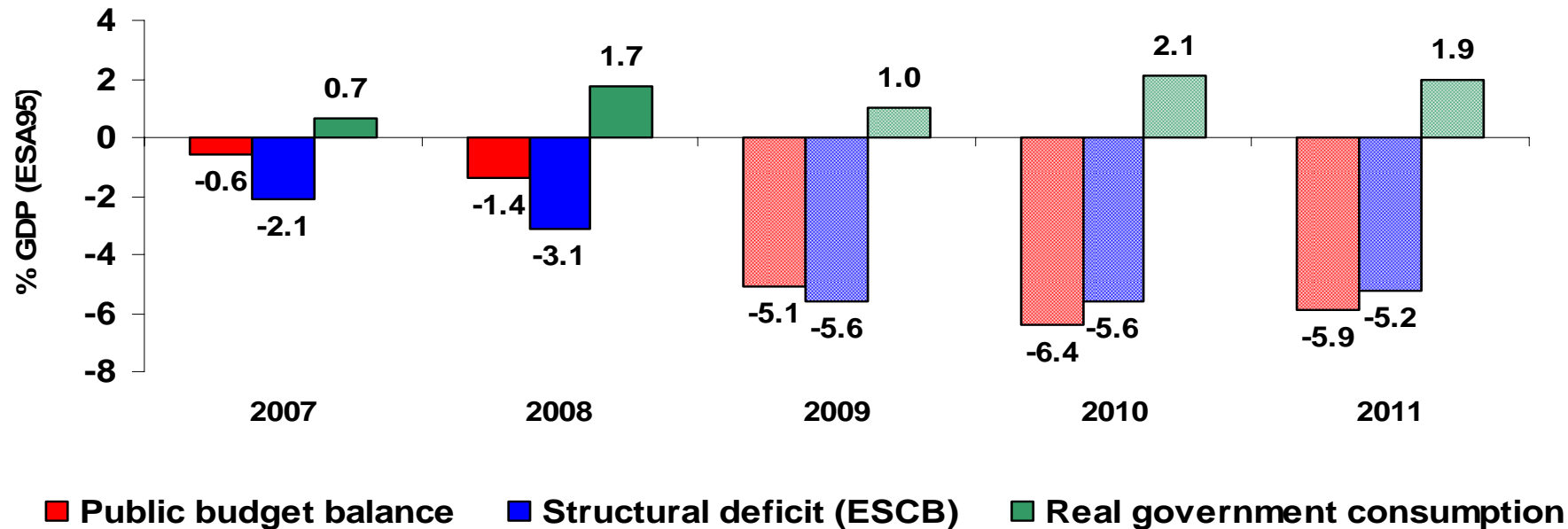
- Sharp drop in exports, imports and investment in 2009;
- A decline in household consumption expected in 2010.

Nominal Consumption and Disposable Incomes Growth



- Falling labour, property and capital incomes partly offset by lower taxes and social contributions and by higher social benefits (fiscal discretion and built-in stabilizers);
- Savings rate currently falling.

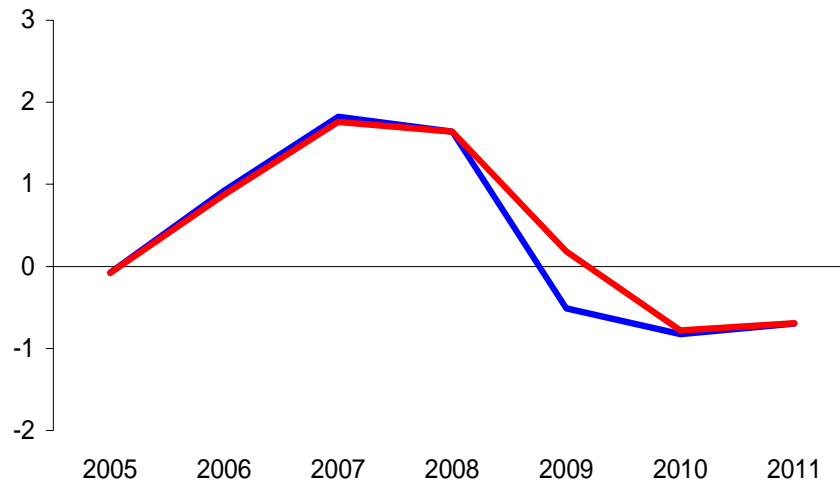
Public Budgets



- Forecast of fiscal deficits raised by about 1 p.p. due to the deeper observed economic slump;
- The impact of (domestic, as well as foreign) anti-crisis measures the same as in the previous forecast;
- Government consumption will continue to grow modestly.

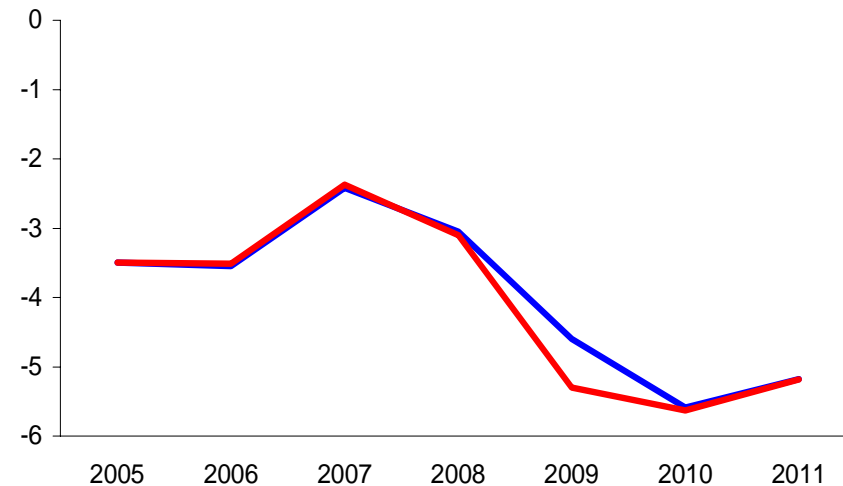
Cyclical vs. Structural Deficits

Cyclical component of public budgets (in % of GDP)



— Output Gap Approach — ESCB Approach

Cyclically-adjusted budget balance (in % of GDP)

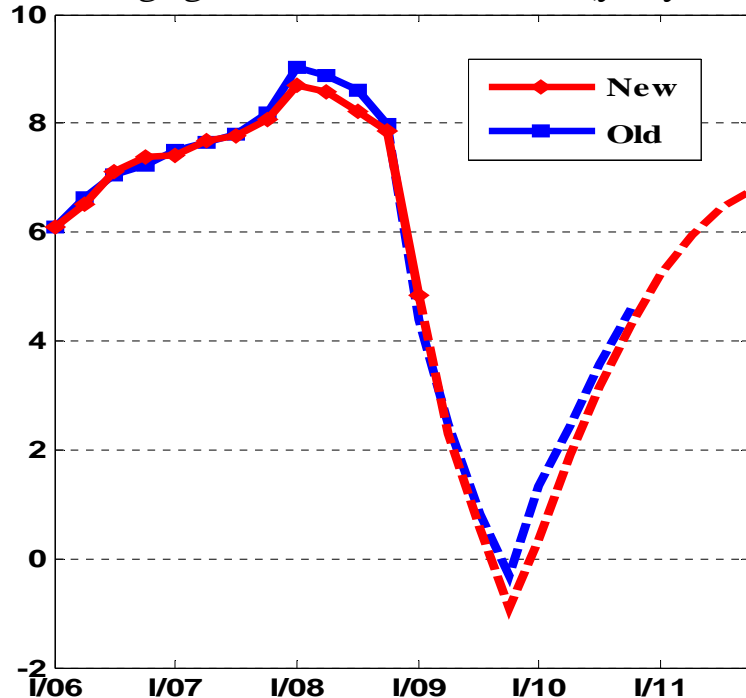


— Output Gap Approach — ESCB Approach

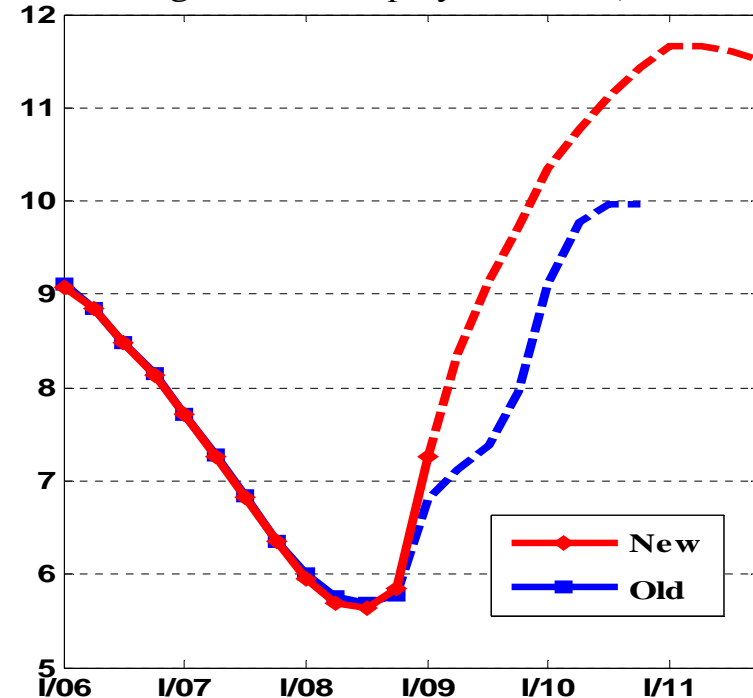
- Deterioration of budgets is partly structural (previous reforms, anti-crisis measures) and partly cyclical;
- Cyclical position of the economy is very uncertain (strong end-point bias, large dispersion of output gap estimates).

Labour Market Forecast

Nominal wage growth in business sector (y-o-y, in %, s.a.)



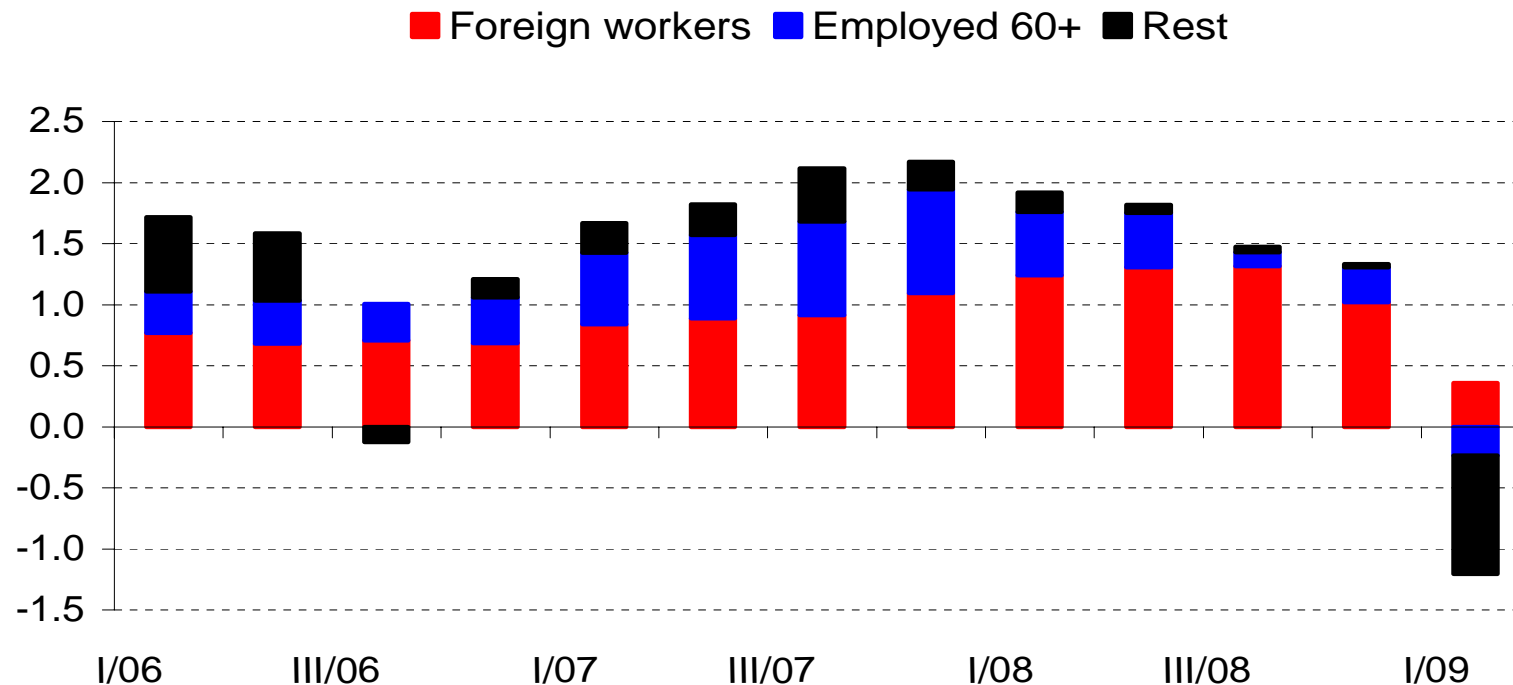
Total registered unemployment rate (in %, s.a.)



- Forecast of nominal wage growth slightly reduced;
- Increase in registered unemployment rate almost to 12%;
- July 2009: unemployment slightly below forecast.

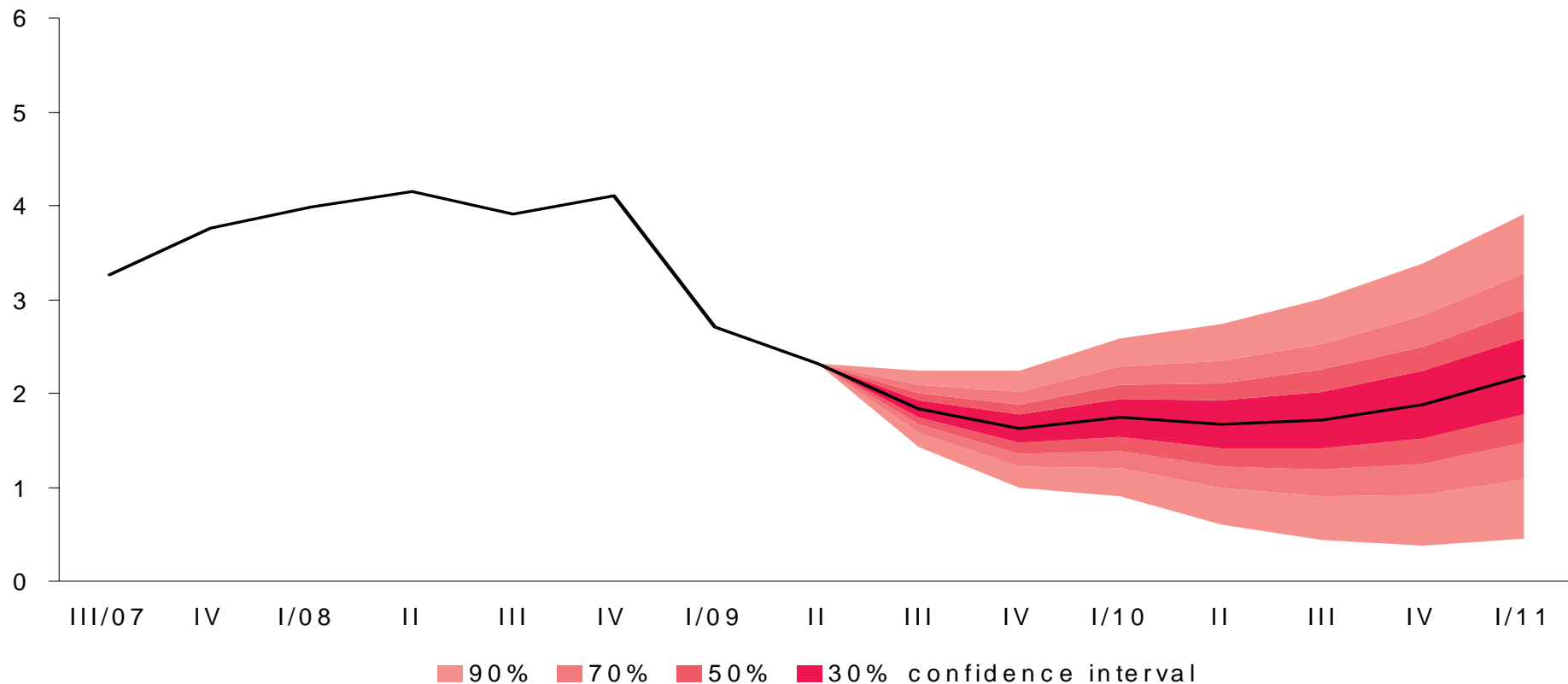
Structure of Employment

Contributions to the growth of employed people (in percentage points)



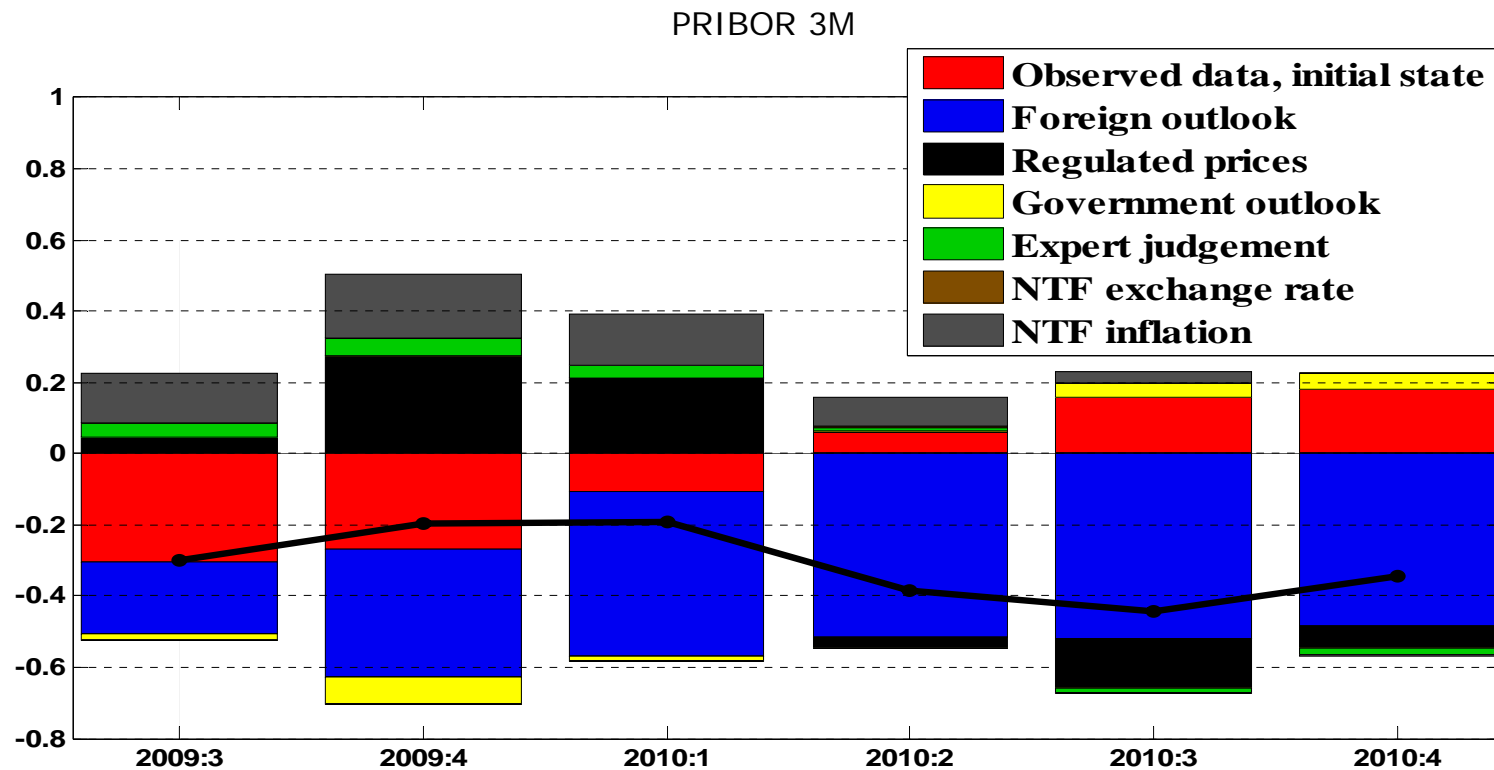
- The employment of all groups has been significantly affected by the economic recession;
- ‘Core workers’ affected more than previously expected.

Interest Rate Forecast



- Consistent with the forecast is a decline in market interest rates this year followed by a modest rise from 2010 H2 onwards;
- Compared to previous forecast, the interest rate path is lower on the whole forecast horizon.

Interest Rate Forecast Change Decomposition



- Downward impact of foreign outlook and 'initial state';
- Small upward impact of regulated prices and near-term inflation outlook.

Comparison of the CNB's Forecast with Analysts' View

	CNB		ANALYSTS	
GDP in % (2009)		-3.8		-3.4
GDP in % (2010)		0.8		1.3
CPI in %		1.3 (3Q/2010)		1.9 (7/2010)
Exchange rate CZK/EUR		25.7 (3Q/2010)		25.4 (7/2010)
Interest rate in %	3M PRIBOR	1.7 (3Q/2010)	2T REPO	1.7 (7/2010)
			12M PRIBOR	2.7 (7/2010)
Nominal wages in % (2009)		1.9		2.3
Nominal wages in % (2010)		2.2		3.3

Source: Financial Markets Inflation Expectations (CNB's Survey), July 2009

- Analysts slightly more optimistic as regards the GDP;
- CNB expects lower inflation and wage growth;
- Analysts forecast somewhat faster CZK appreciation.



Thank you
for your attention.

(Tomas.Holub@cnb.cz)