



# CNB's New Forecast (Inflation Report II/2010)

Meeting with Analysts

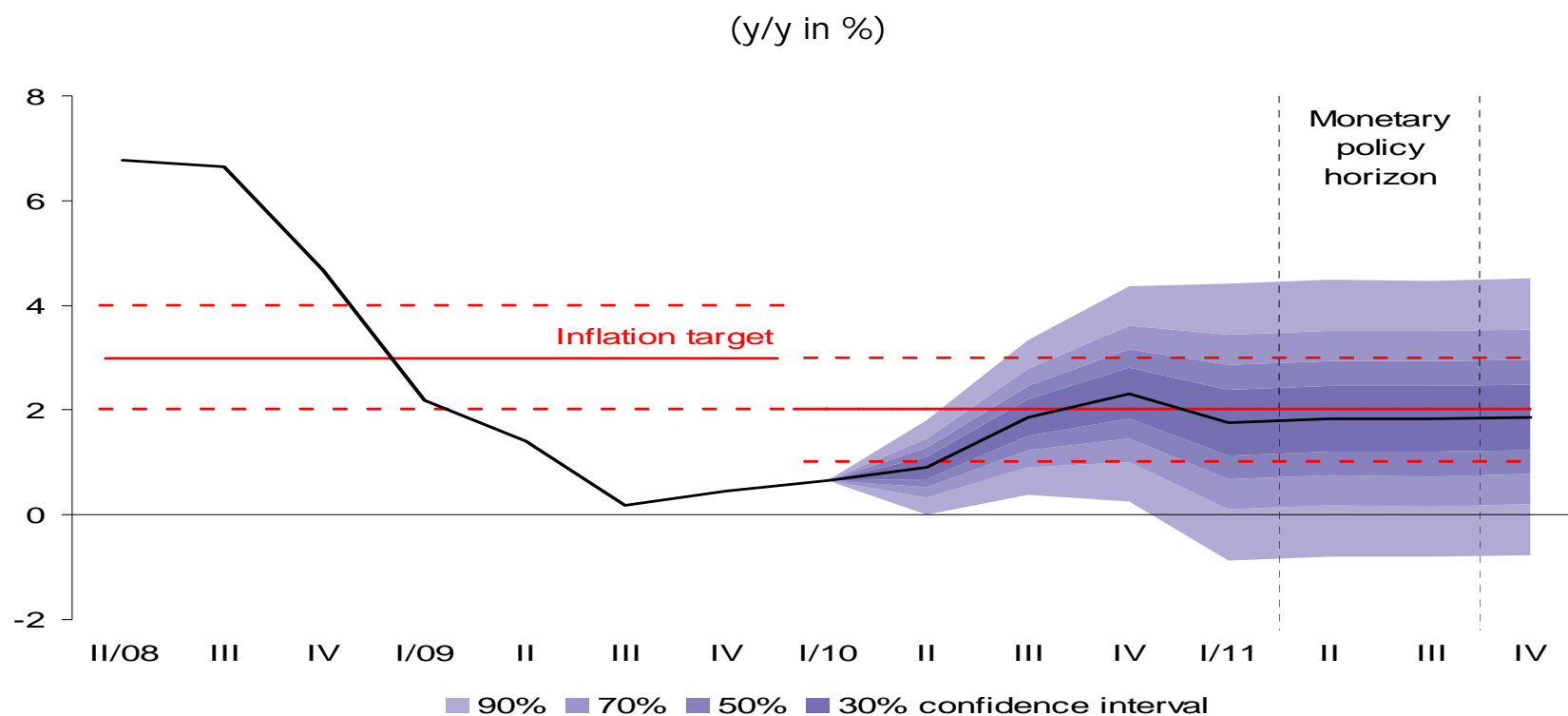
Tomáš Holub

Prague, May 14, 2010

# Summary of the Inflation Forecast

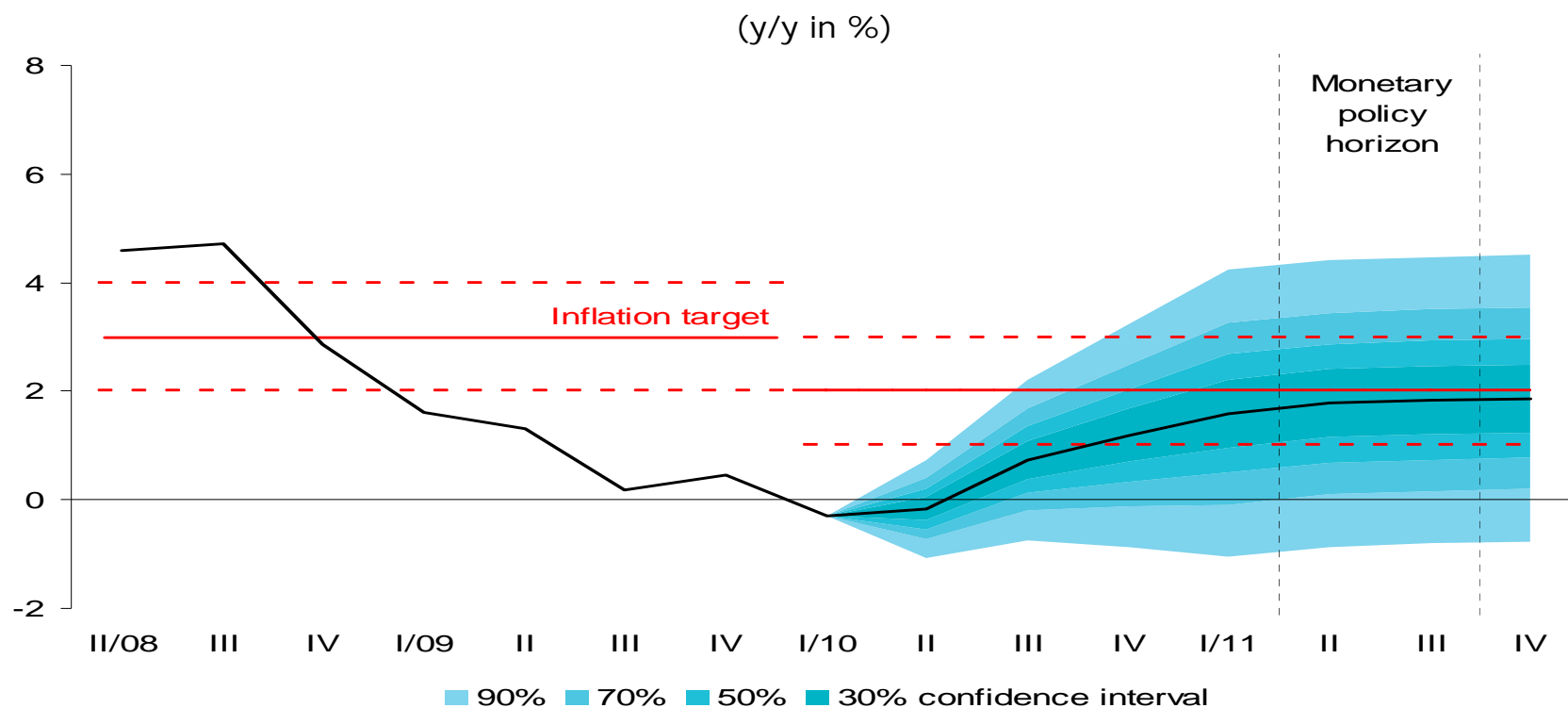
- Inflation will slightly exceed the 2% target in late 2010 due to realized tax changes, but will return back to target on the MP horizon.
- Expected recovery of net inflation from currently negative levels, moderate growth of regulated prices.
- The growth of euro area interest rates will be gradual. Foreign demand is still 'W-shaped'.
- No inflationary pressures are seen in the domestic economy in 2010. Anti-inflationary effect of import prices will fade away. Profit margins are depressed, and will gradually increase in the future.
- The GDP will grow by 1.4% in 2010 and 1.8% in 2011 (W-shaped recovery), labour market slack will persist.

# Headline Inflation Forecast



- Forecast slightly above the 2% target in late 2010 (taxes).
- The April 2010 figure (1.1% y/y) was slightly above the forecast mainly due to higher fuel prices.

# MP-Relevant Inflation Forecast



- MP-relevant inflation forecast below the headline inflation forecast (due to tax changes).
- Approaching the new inflation target from below.

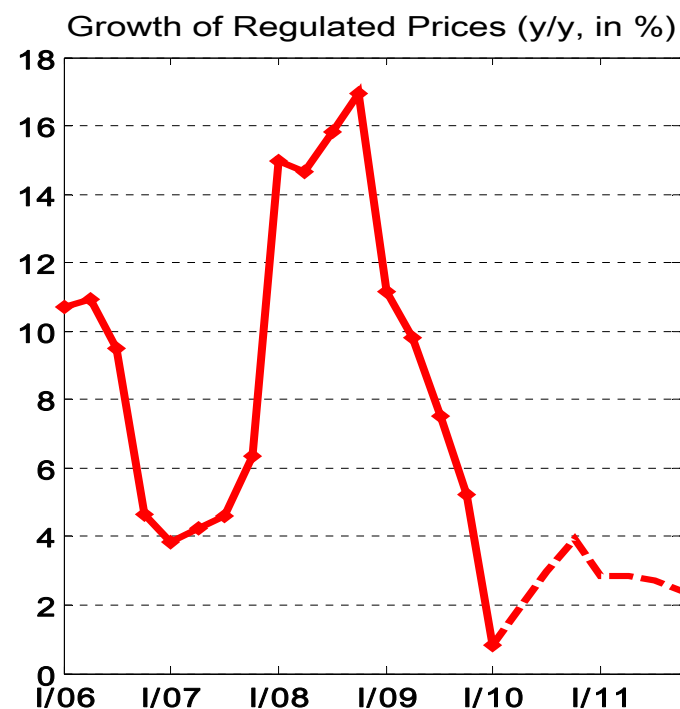
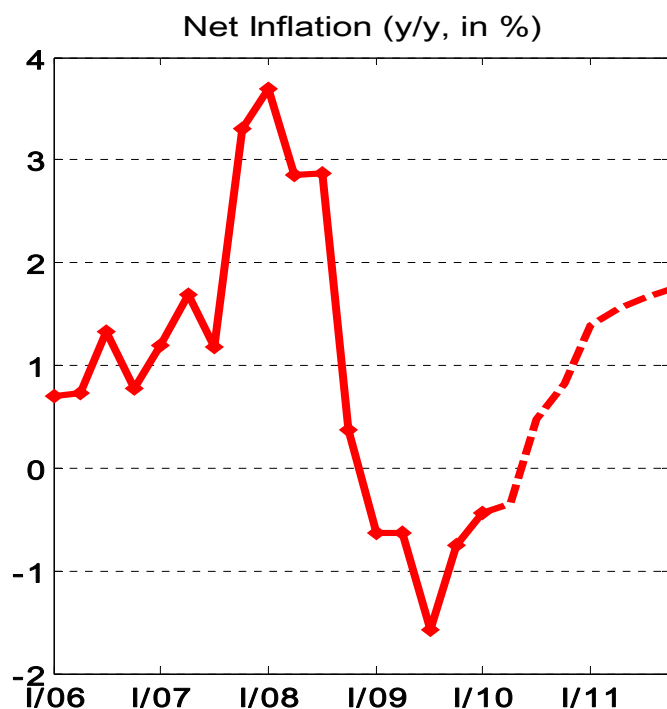
# Administrative Measures

(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	5,0	0,96	3,0	0,52	2,9	0,51
of which (selected items):						
Regulated rents	27,6	0,56	16,5	0,23	8,5	0,13
Electricity	11,4	0,46	-2,5	-0,09	2,0	0,07
Natural gas	-11,7	-0,33	2,1	0,05	4,0	0,10
Heating	3,9	0,13	3,5	0,08	2,0	0,05
Healthcare	-5,2	-0,10	5,5	0,11	2,0	0,04
Primary impact of tax changes on non-regulated prices		0,00		1,02		0,00

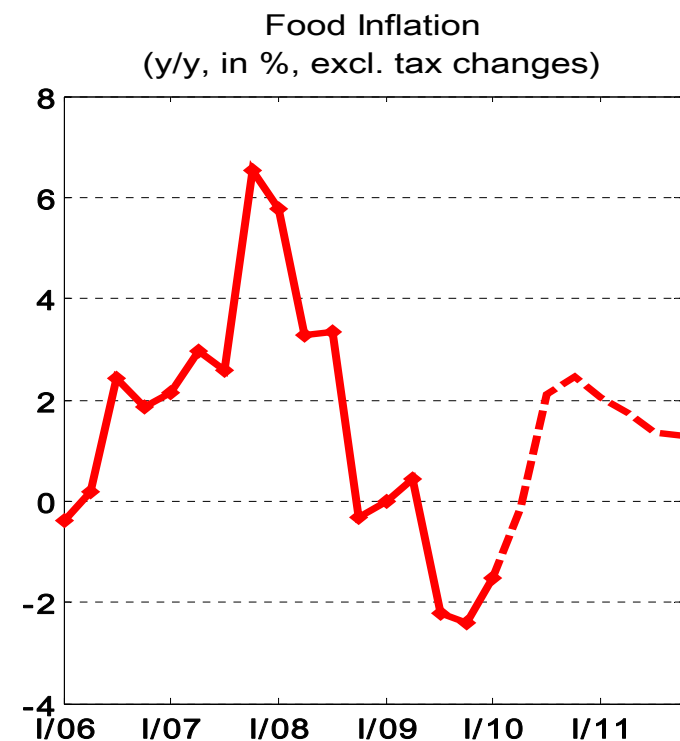
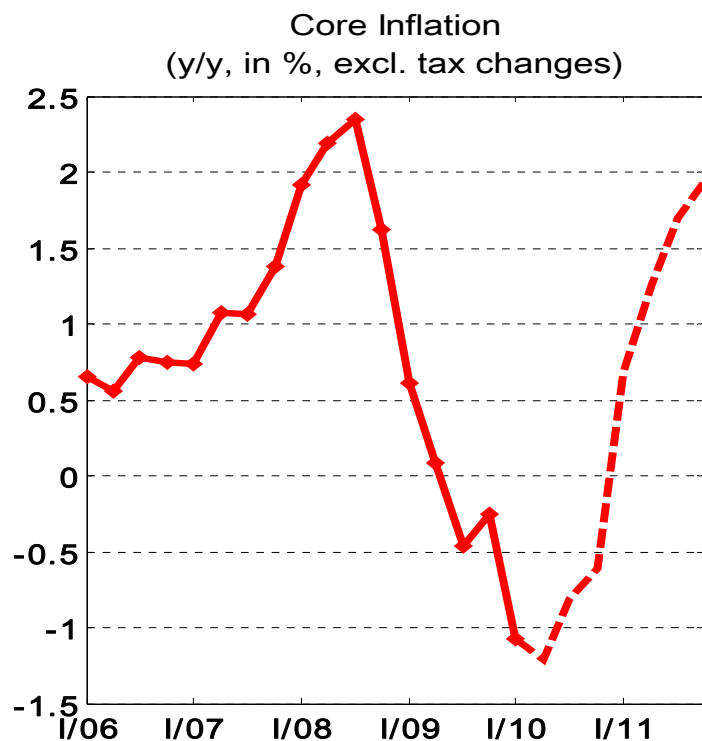
- Falling electricity prices vs. increases in indirect taxes and regulated rents in 2010.
- So far the pass-through of tax changes into the market-determined prices has been incomplete (as expected).

# Net Inflation and Regulated Prices



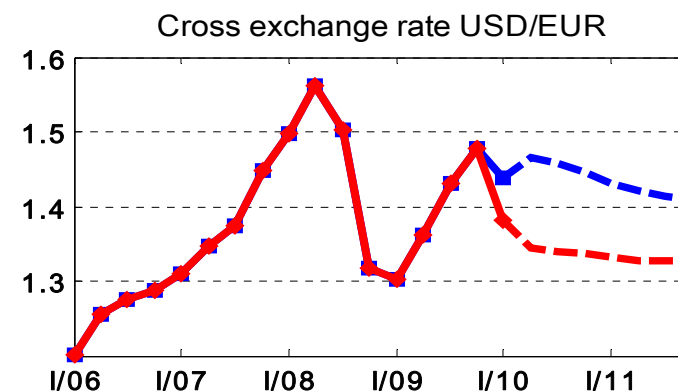
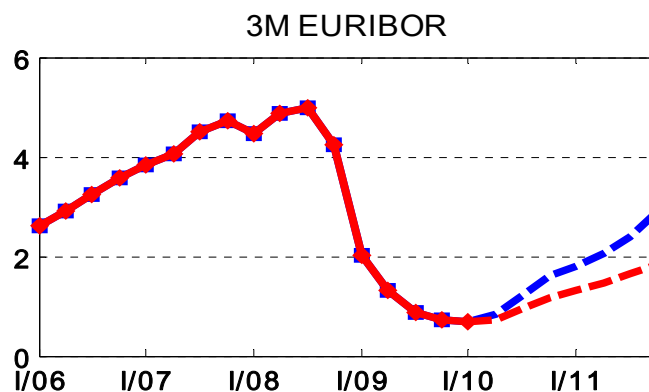
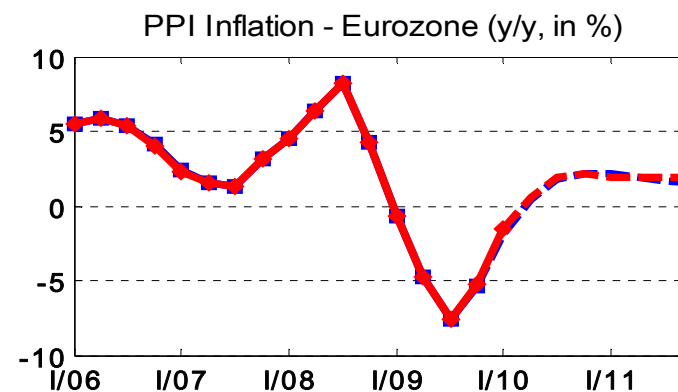
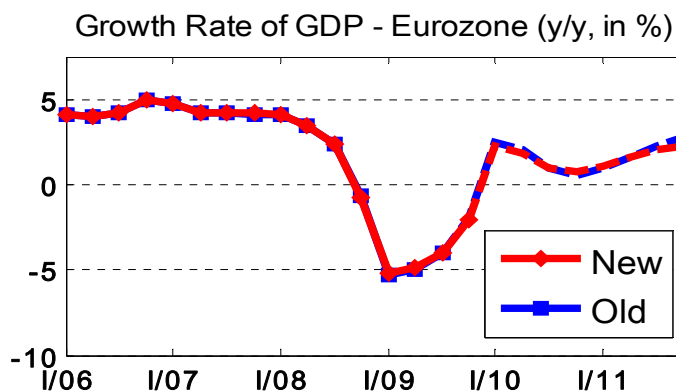
- Gradual recovery of net inflation from negative levels.
- Slight acceleration of regulated prices due to increased prices of gas.

# Core Inflation and Food Prices



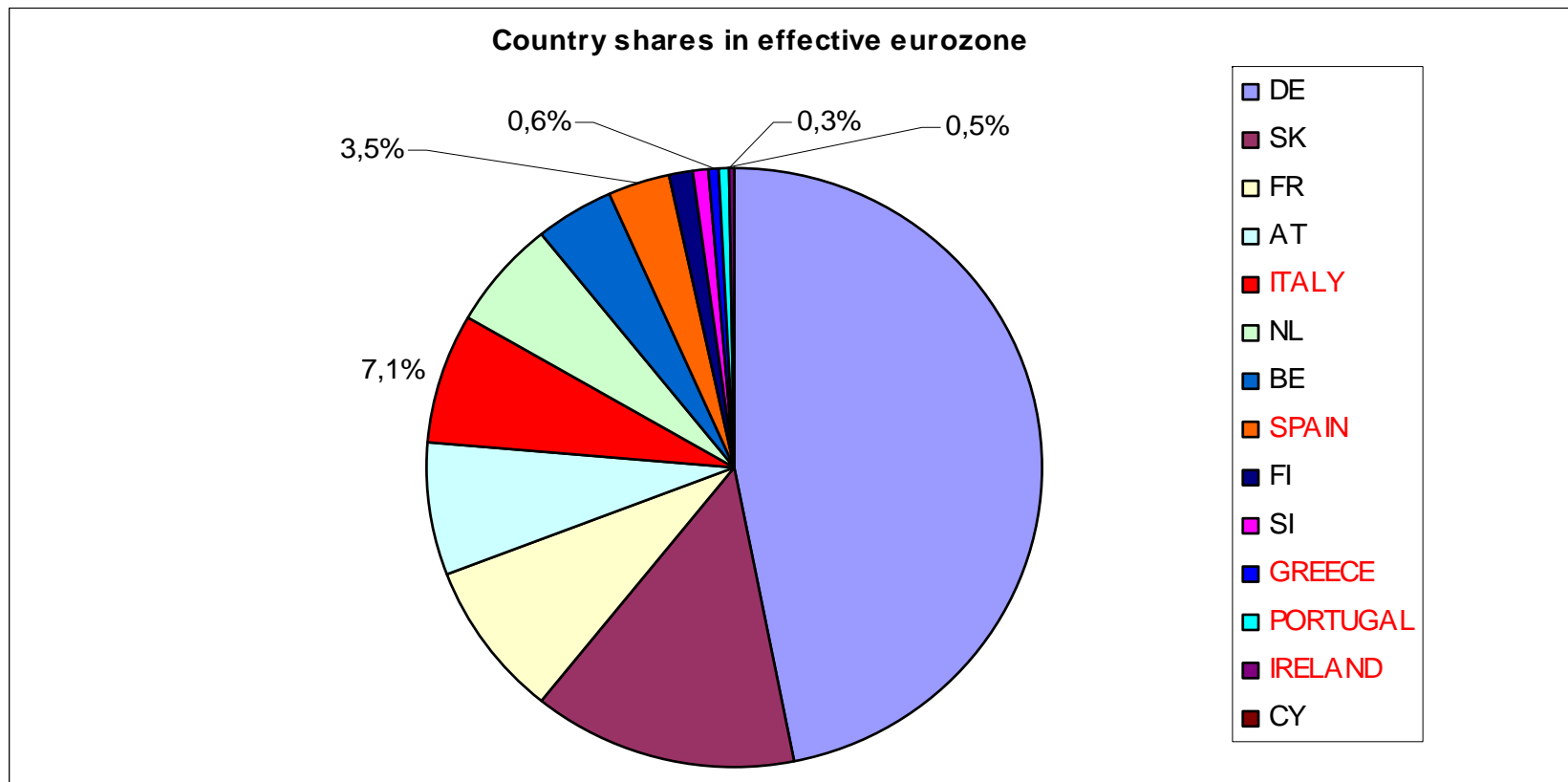
- Recovery of core inflation in 2011 together with the domestic economy and increase in foreign inflation.
- Growth of food prices due to agricultural commodities.

# External Assumptions



- The growth of interest rates in euro area will be more gradual than assumed in the previous forecast.

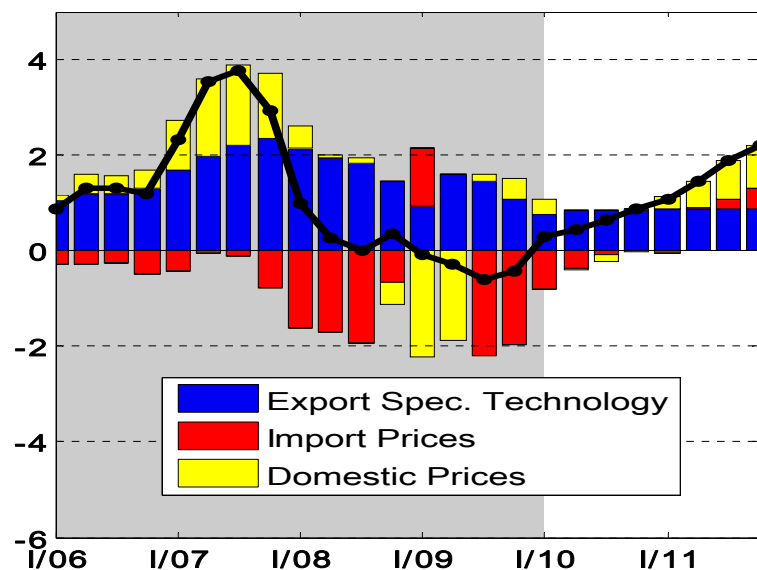
# Country Shares in Effective Eurozone



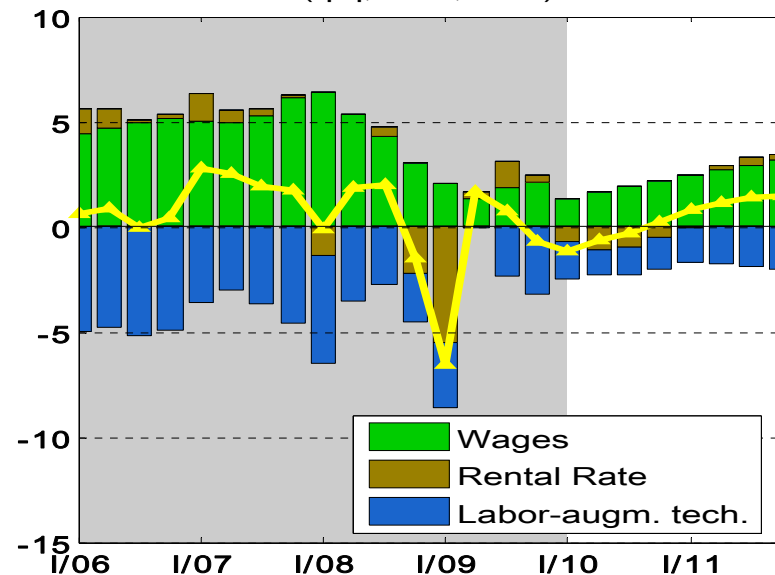
- The direct impact of PIGS on Czech exports is limited, but the indirect effect may be important.

# Domestic Costs vs. Import Prices

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

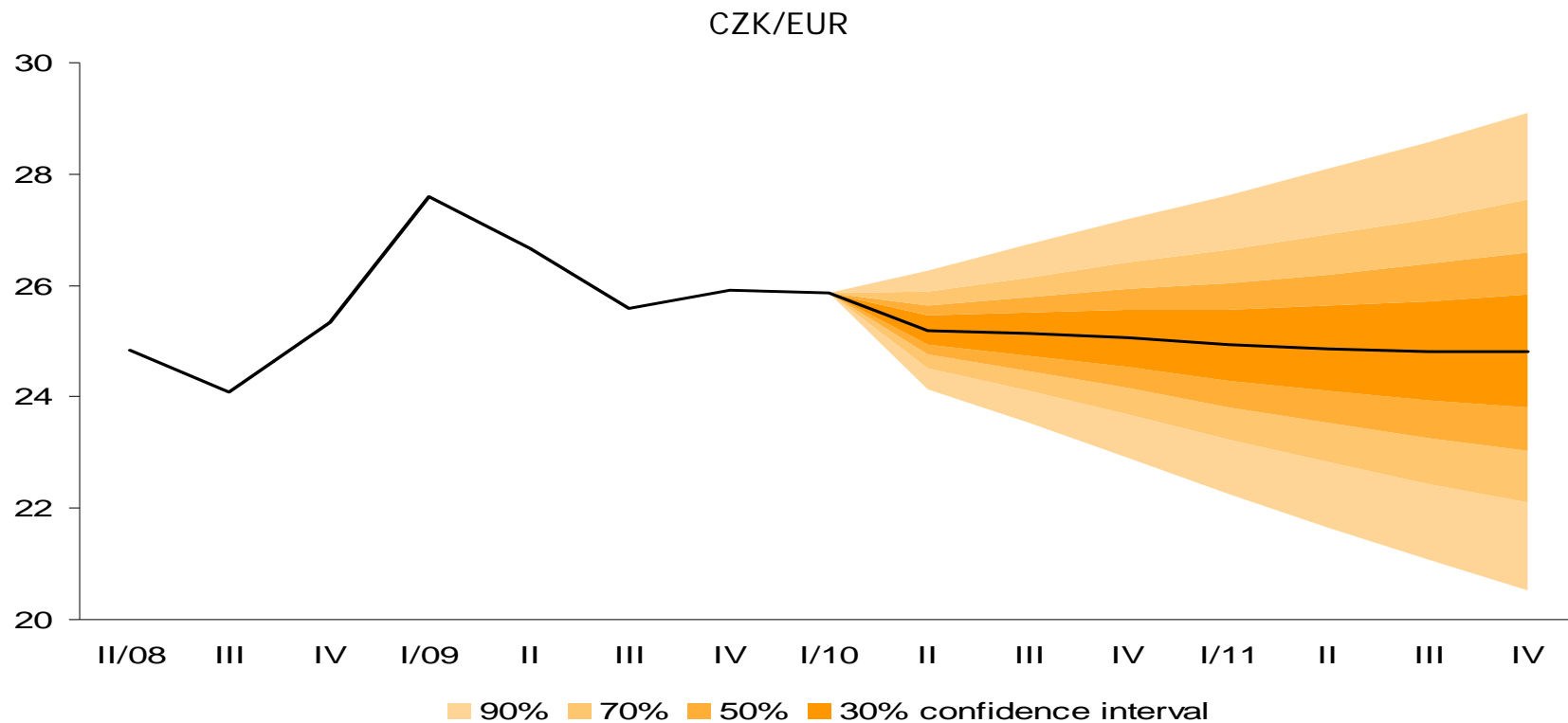


Nominal Marginal Cost in Domestic Sector  
(q/q, in %, ann.)



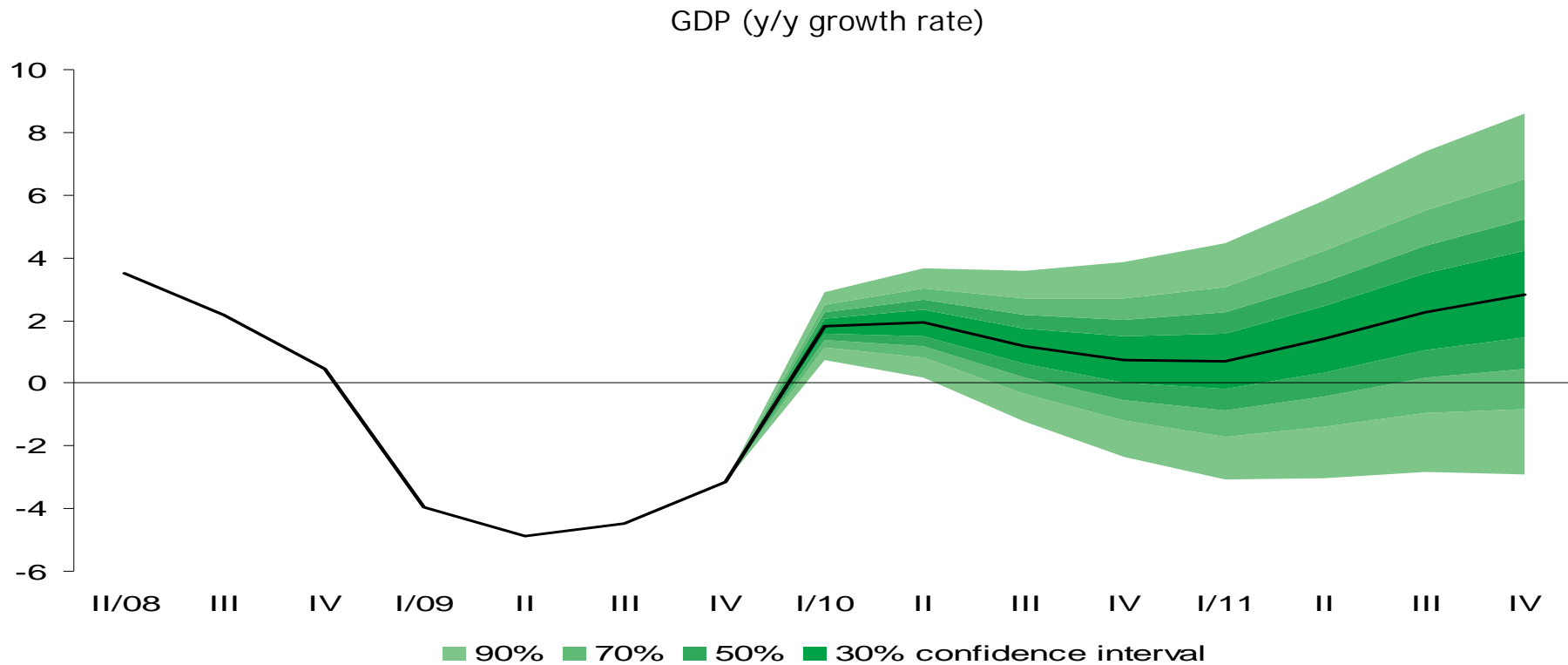
- The effect of falling import prices will fade away.
- No domestic inflationary pressures before 2011.
- Gradual correction of depressed margins will take place.

# Exchange Rate Forecast



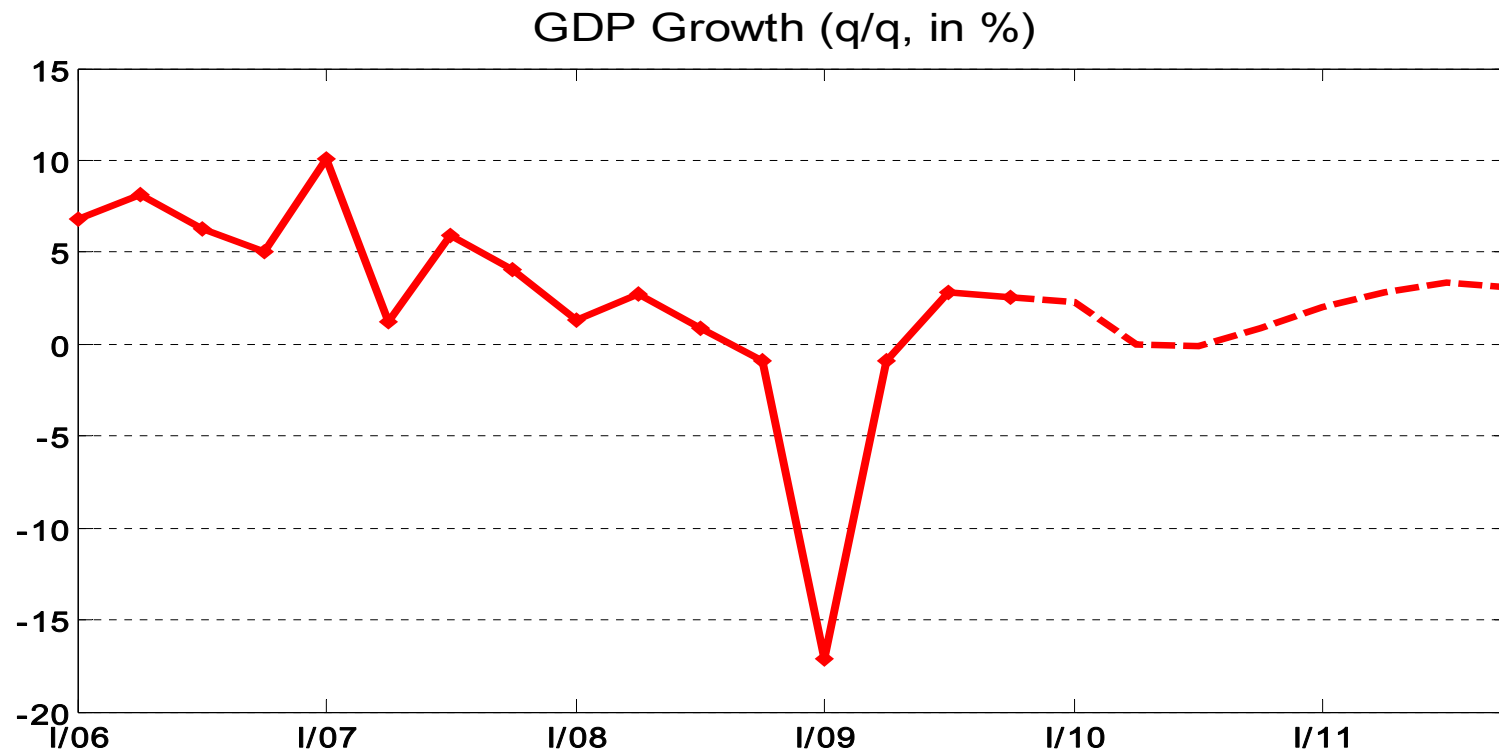
- The nominal exchange rate will be gradually appreciating.
- Import prices will return to slightly positive growth rates due to increasing foreign prices.

# GDP Growth Forecast (i)



- 'W-shaped' recovery reflects the outlook for foreign demand, labour market slack and fiscal measures.
- Averages for 2010: 1.4%; 2011: 1.8%.

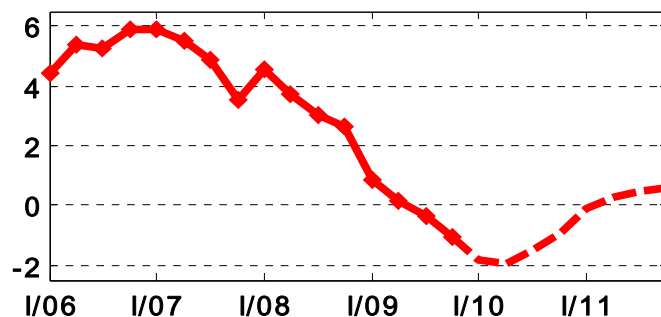
# GDP Growth Forecast (ii)



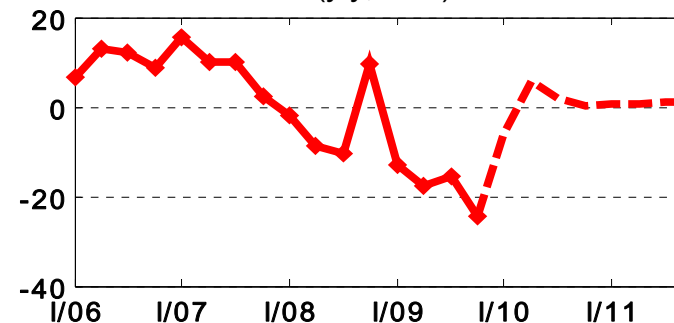
- The q/q growth should fall back towards zero this year, before a more sustained recovery in 2011.

# Forecast of Aggregate Demand

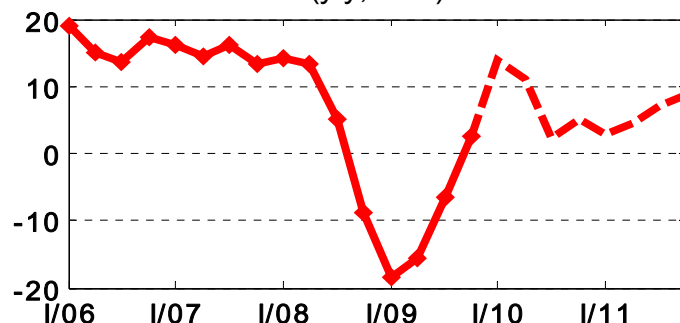
Household Consumption Growth  
(y/y, in %)



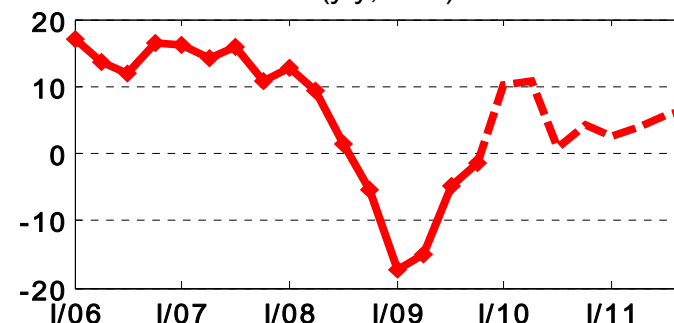
Investments Growth  
(y/y, in %)



Exports Growth  
(y/y, in %)

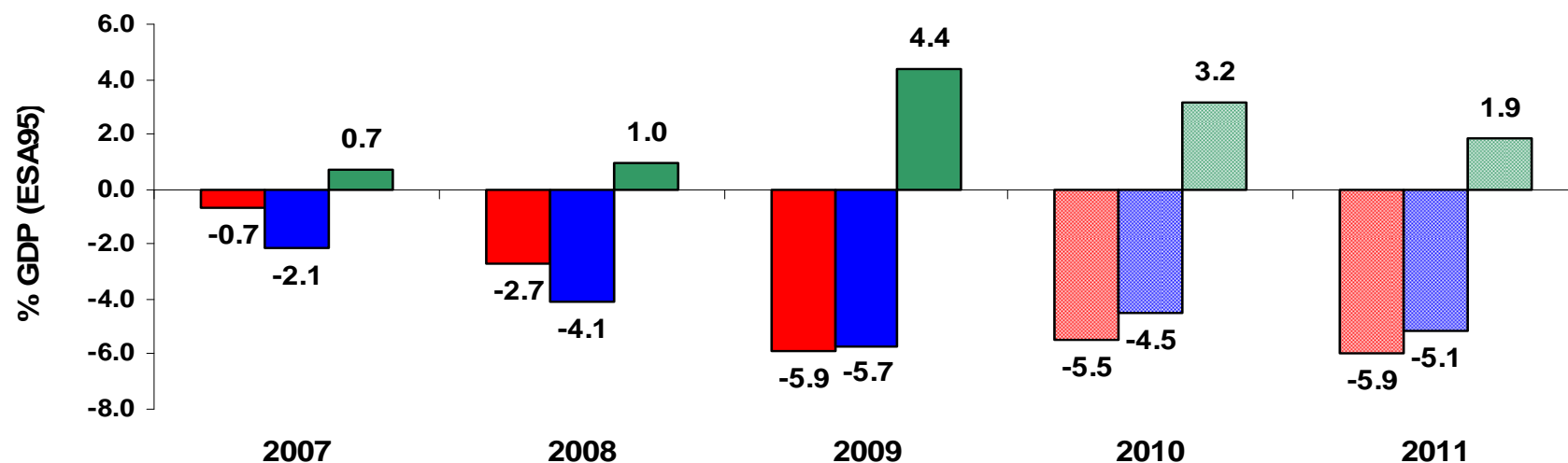


Imports Growth  
(y/y, in %)



- Household consumption will start reviving in 2011.
- The growth will be driven by net exports.

# Public Budgets

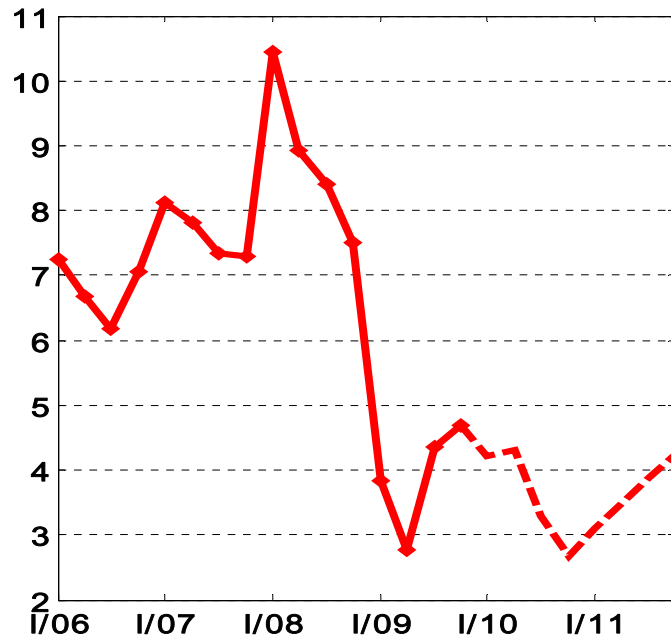


■ Public budget deficit ■ Structural deficit (EC) ■ Real government consumption (y-o-y %)

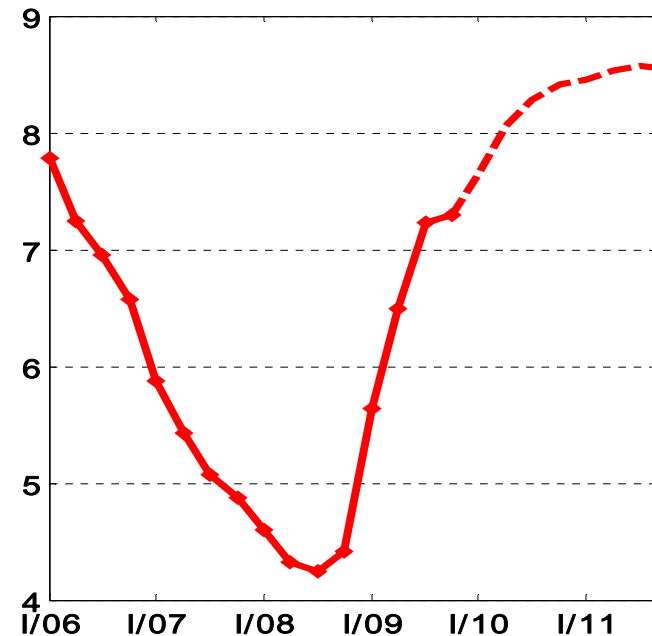
- Without further austerity measures, public budget deficits will remain high.
- The structural deficit is around 5 % of GDP.

# Labour Market Forecast

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

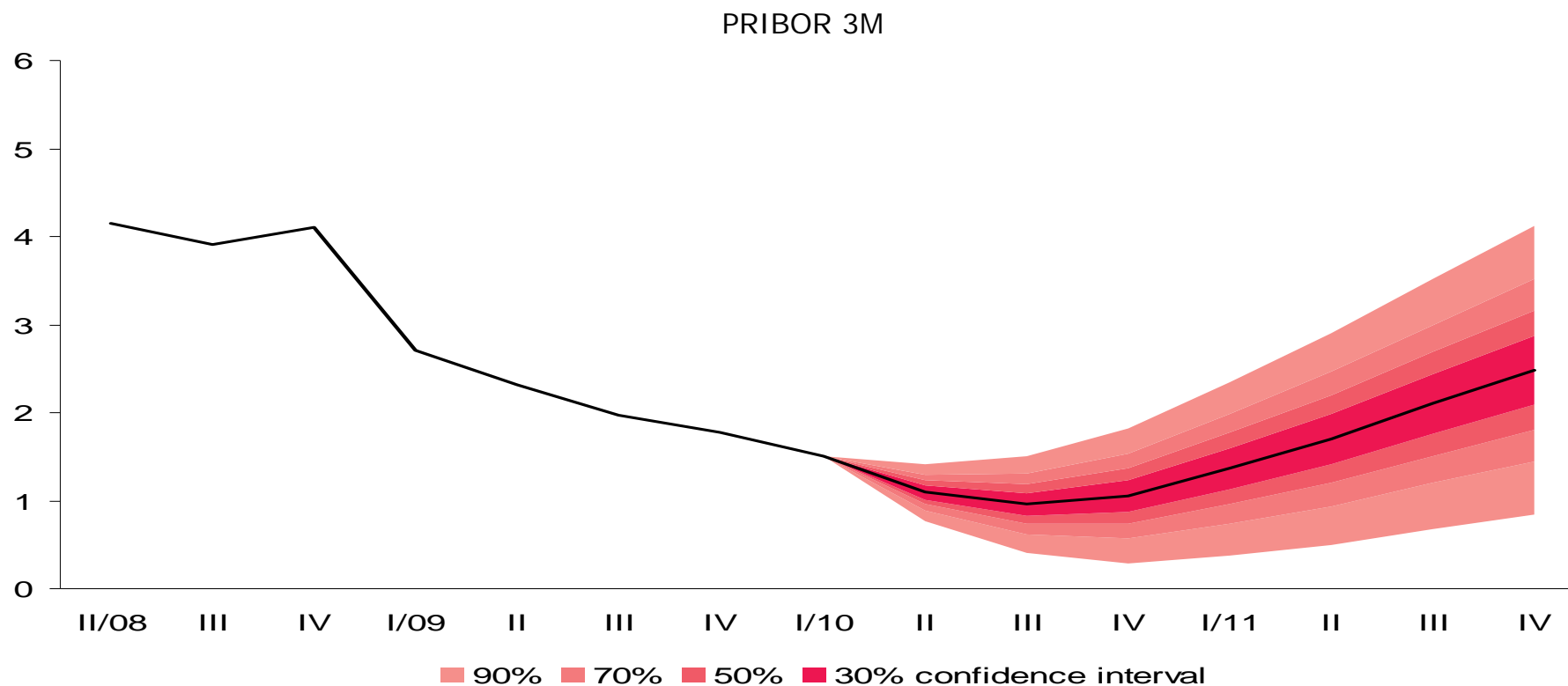


General unemployment rate (ILO)  
(in %, s.a.)



- The "underlying" wage growth is probably low, the high headline figures are due to one-off / statistical factors.
- Unemployment rate is still expected to peak in 2011.

# Interest Rate Forecast



- Consistent with the forecast is initially a moderate decline in market interest rates followed by stability and gradual rise in rates since 2011.

# Comparison of the CNB's Forecast with Analysts' View

	Date	CNB	Analysts
GDP (%)	2010	1.4	1.7
GDP (%)	2011	1.8	2.5
CPI (%)	2Q/2011	1.8	2.1
Exchange rate CZK/EUR	2Q/2011	24.9	24.6
Interest rate (%)	2Q/2011	3M PRIBOR 1.7	2T REPO 1.7
	2Q/2011		12M PRIBOR 2.6
Nominal wages (%)	2010	3.0	2.3
Nominal wages (%)	2011	3.2	4.2

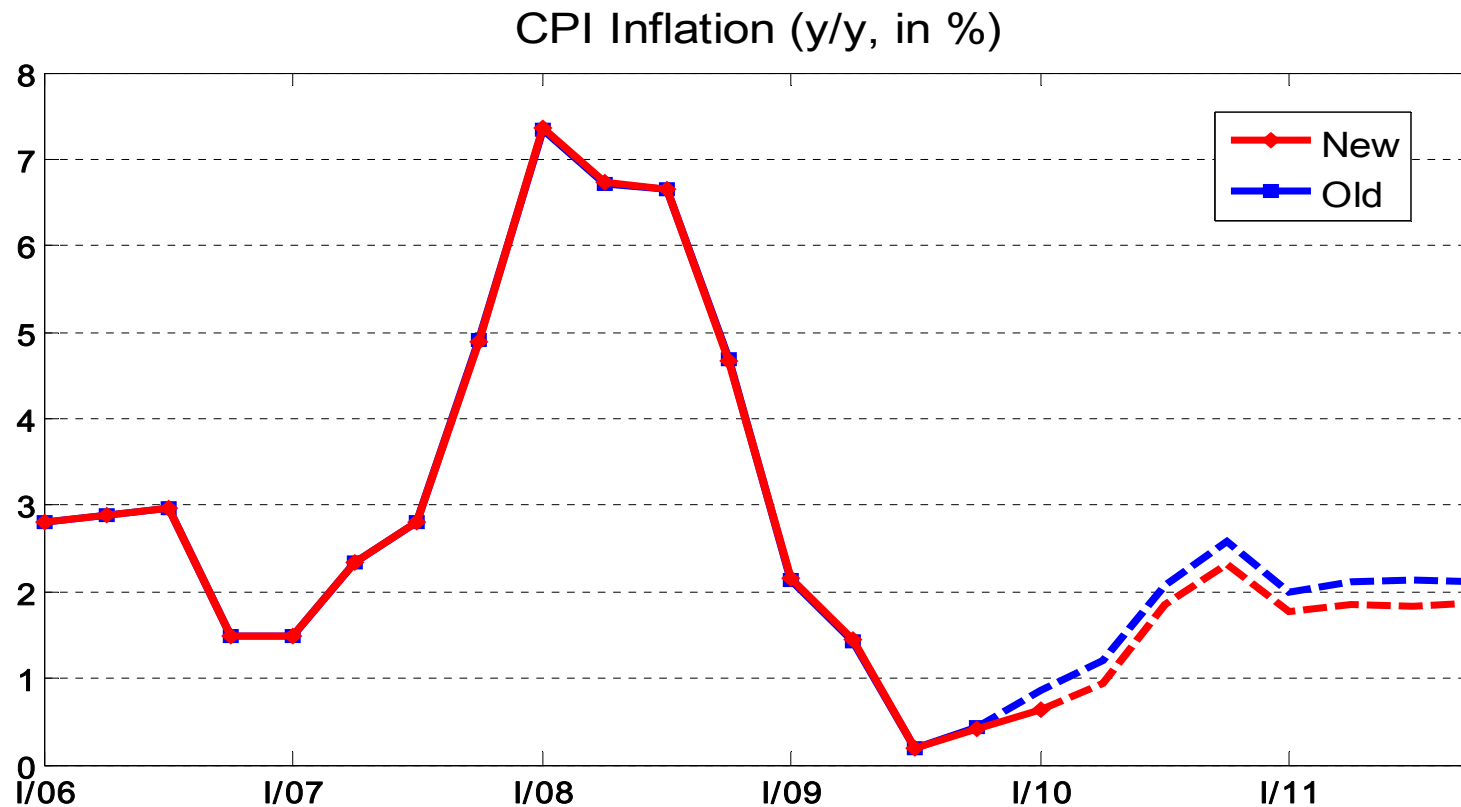
Source: Financial Markets Inflation Expectations (CNB's Survey), April 2010

- Analysts expect slightly faster GDP growth, more appreciated exchange rate and slower wage growth this year.

# Summary of the Comparison with Previous Forecast

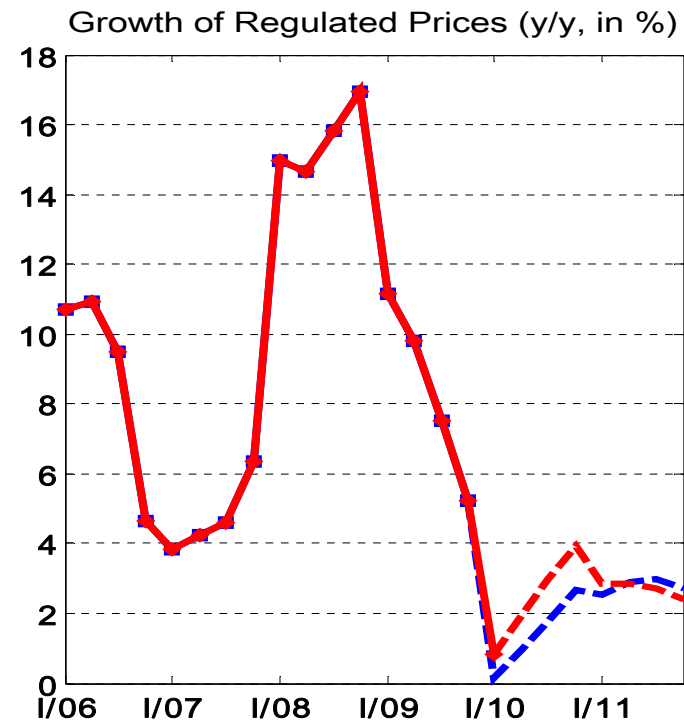
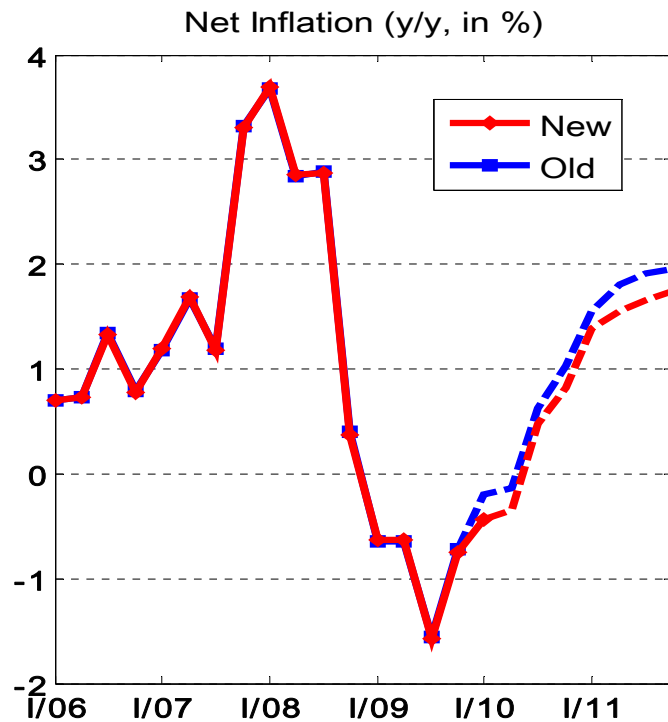
- Inflation forecast was slightly decreased.
- Lower net inflation; slightly higher growth of regulated prices in 2010.
- The GDP outlook remains similar to the previous forecast.
- Lower domestic interest rates, mainly due to the lower outlook for rates in the euro area.

# Comparison with Previous Inflation Forecast (i)



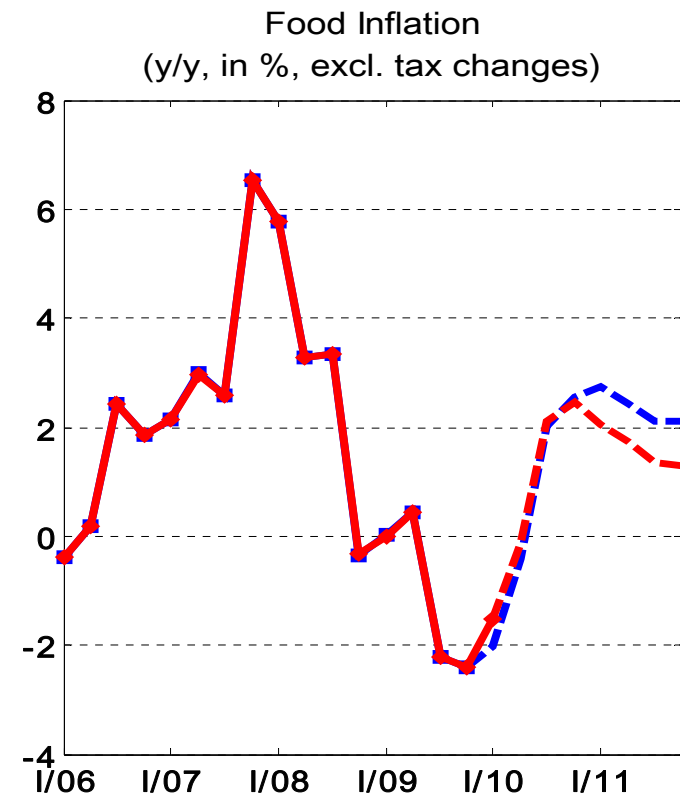
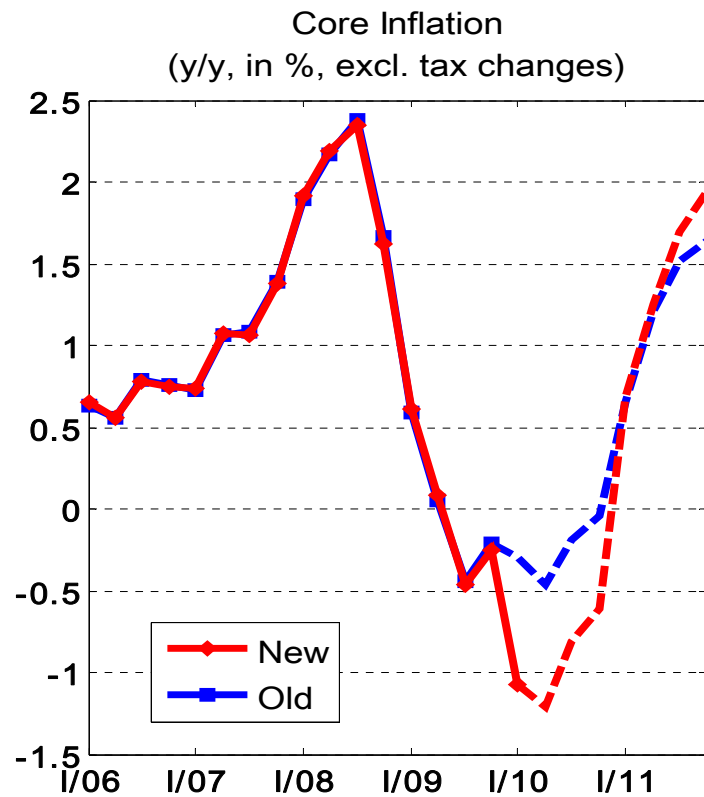
- Forecast slightly decreased due to weaker domestic as well as foreign inflation pressures.

# Comparison with Previous Inflation Forecast (ii)



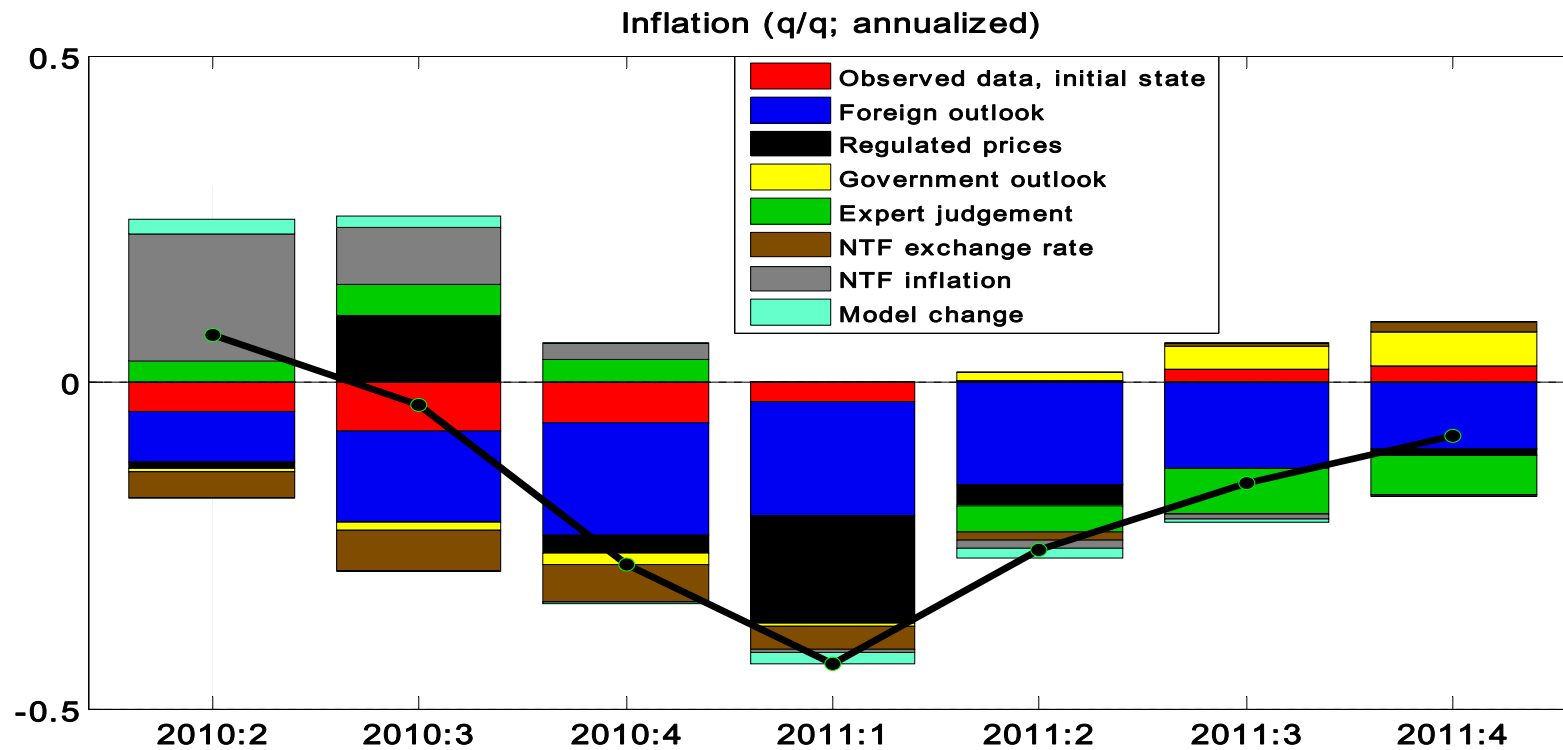
- Lower net inflation reflects the observed low core inflation.
- Growth of regulated prices higher due to increased prices of gas.

# Comparison with Previous Inflation Forecast (iii)



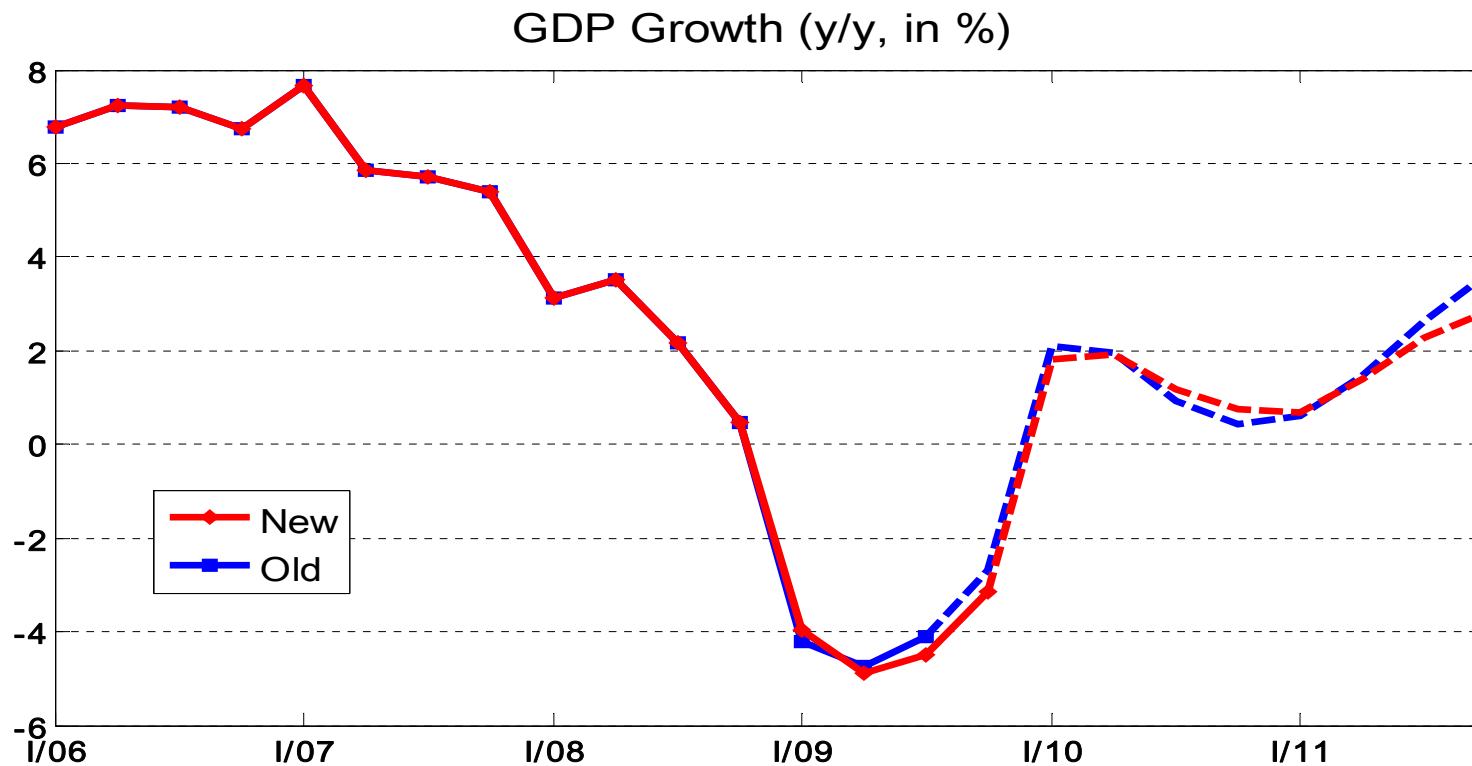
- Low observed core inflation in 1.Q 2010.
- Only small changes to the outlook of food prices.

# Inflation Forecast Change Decomposition



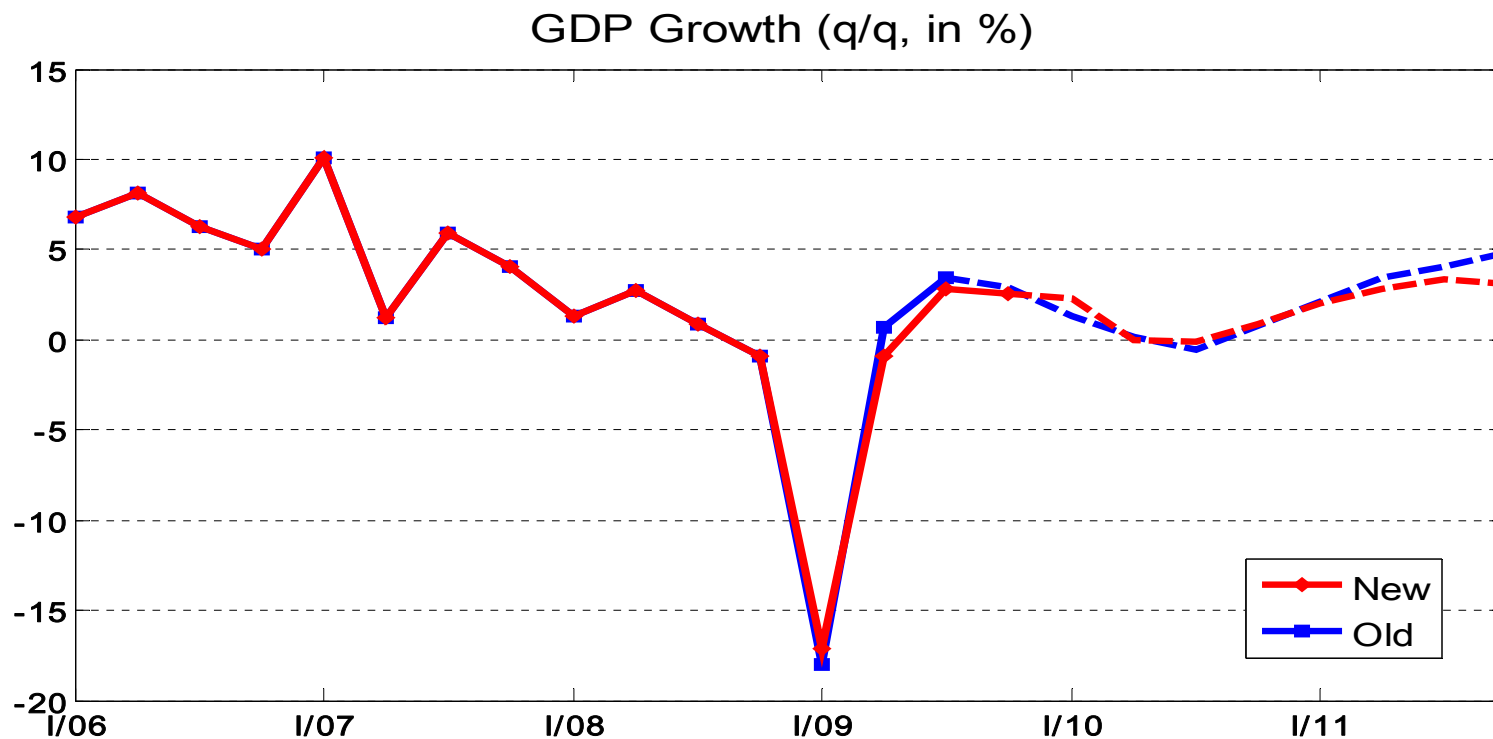
- Downward impact of foreign outlook, observed data and near-term exchange rate forecast.

# Comparison with Previous GDP Forecast (i)



- The y/y GDP outlook remains similar to the previous forecast (the „W” shape is only slightly ‘shallower’).

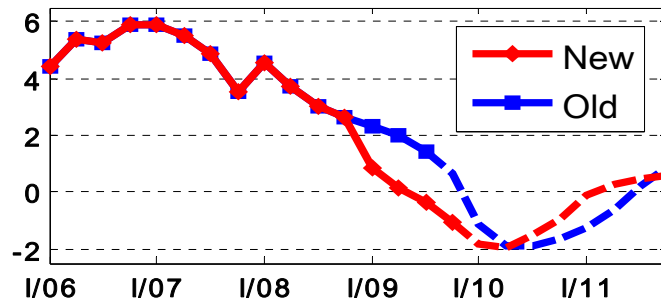
# Comparison with Previous GDP Forecast (ii)



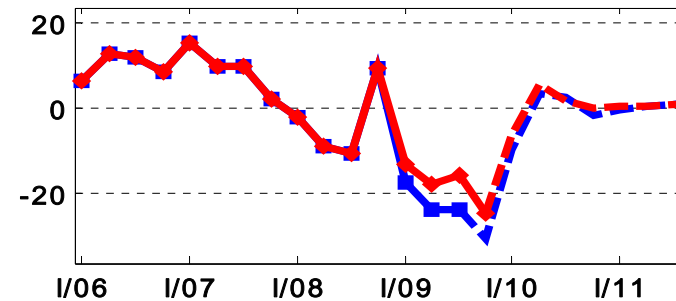
- The q/q GDP outlook has not changed much either.

# Comparison with Previous Aggregate Demand Forecast

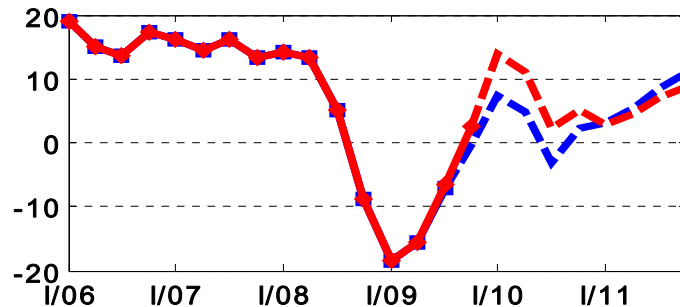
Household Consumption Growth  
(y/y, in %)



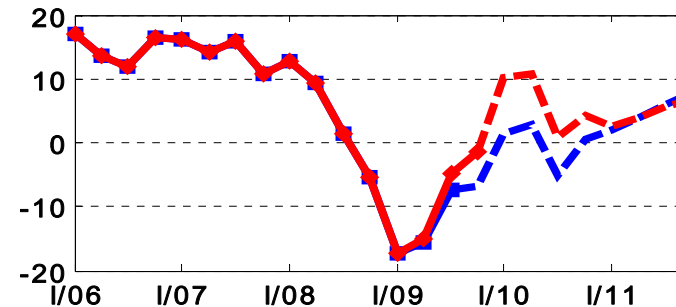
Investments Growth  
(y/y, in %)



Exports Growth  
(y/y, in %)



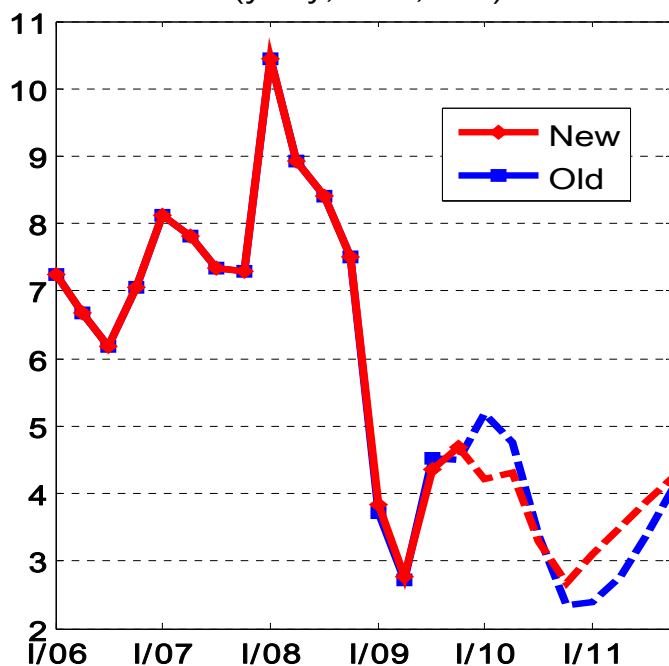
Imports Growth  
(y/y, in %)



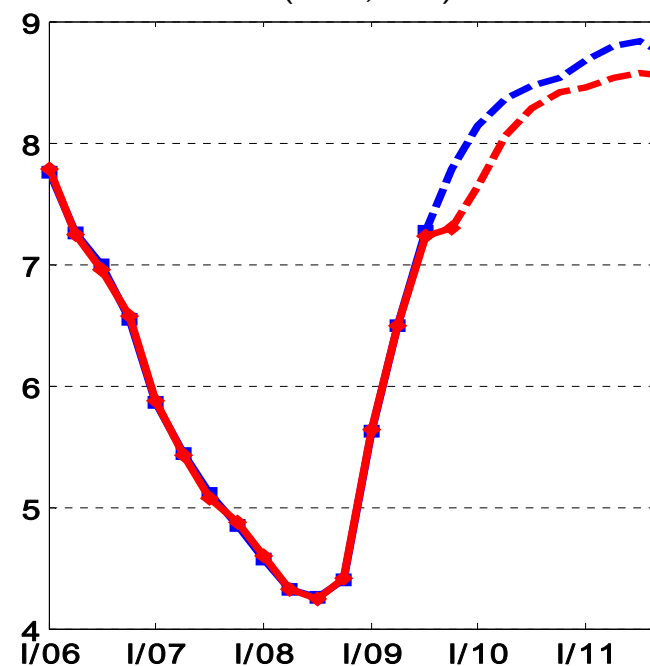
- Slightly increased domestic demand and lower contribution of net export to GDP growth.

# Comparison with Previous Labour Market Forecast

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

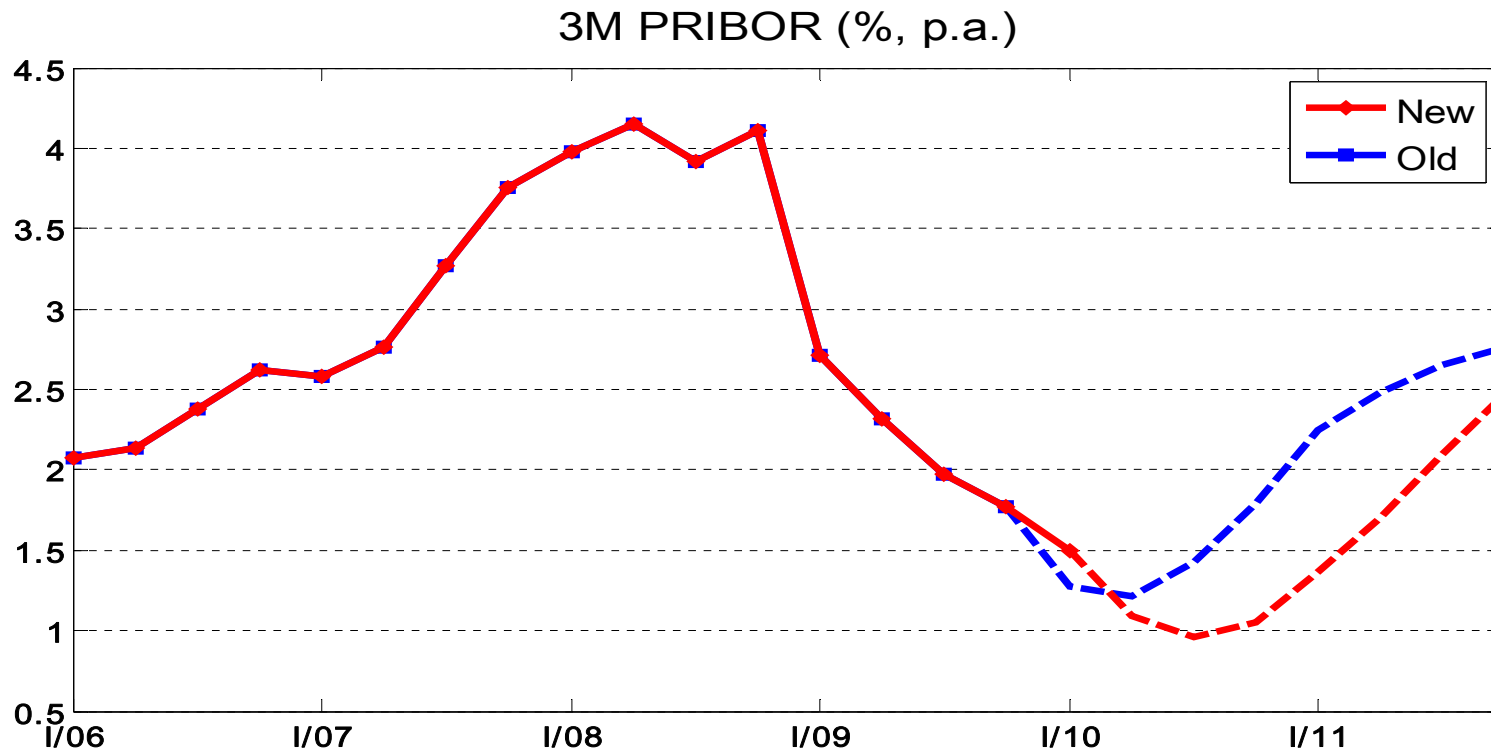


General unemployment rate (ILO)  
(in %, s.a.)



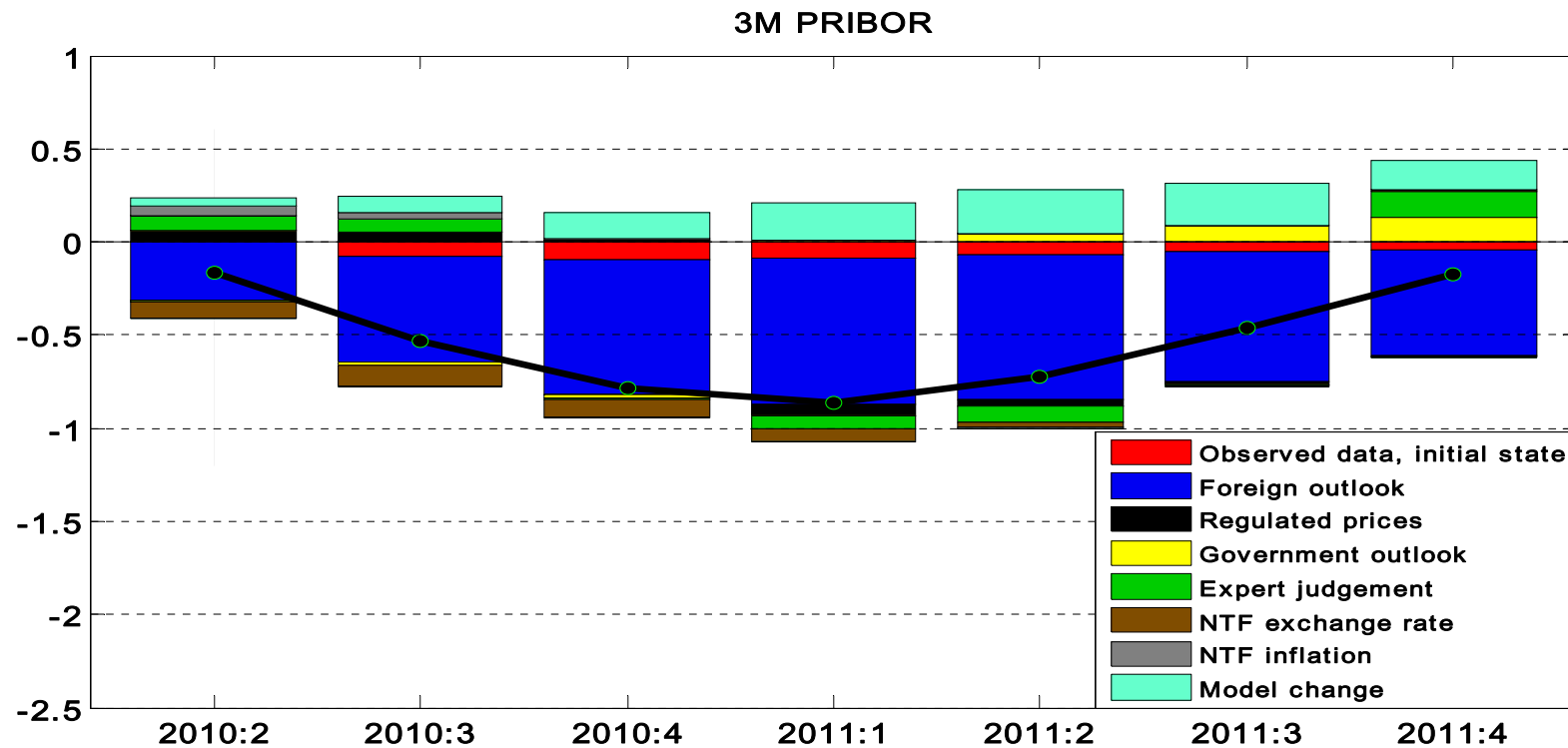
- The forecast of nominal wage growth was slightly reduced for this year, and increased for 2011.
- The peak of the unemployment rate (ILO) is lower.

# Comparison with the Previous Interest Rate Forecast



- The interest rate path is markedly lower.

# Interest Rate Forecast Change Decomposition



- Downward impact of foreign outlook, especially foreign interest rates.



Thank you for your attention

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