

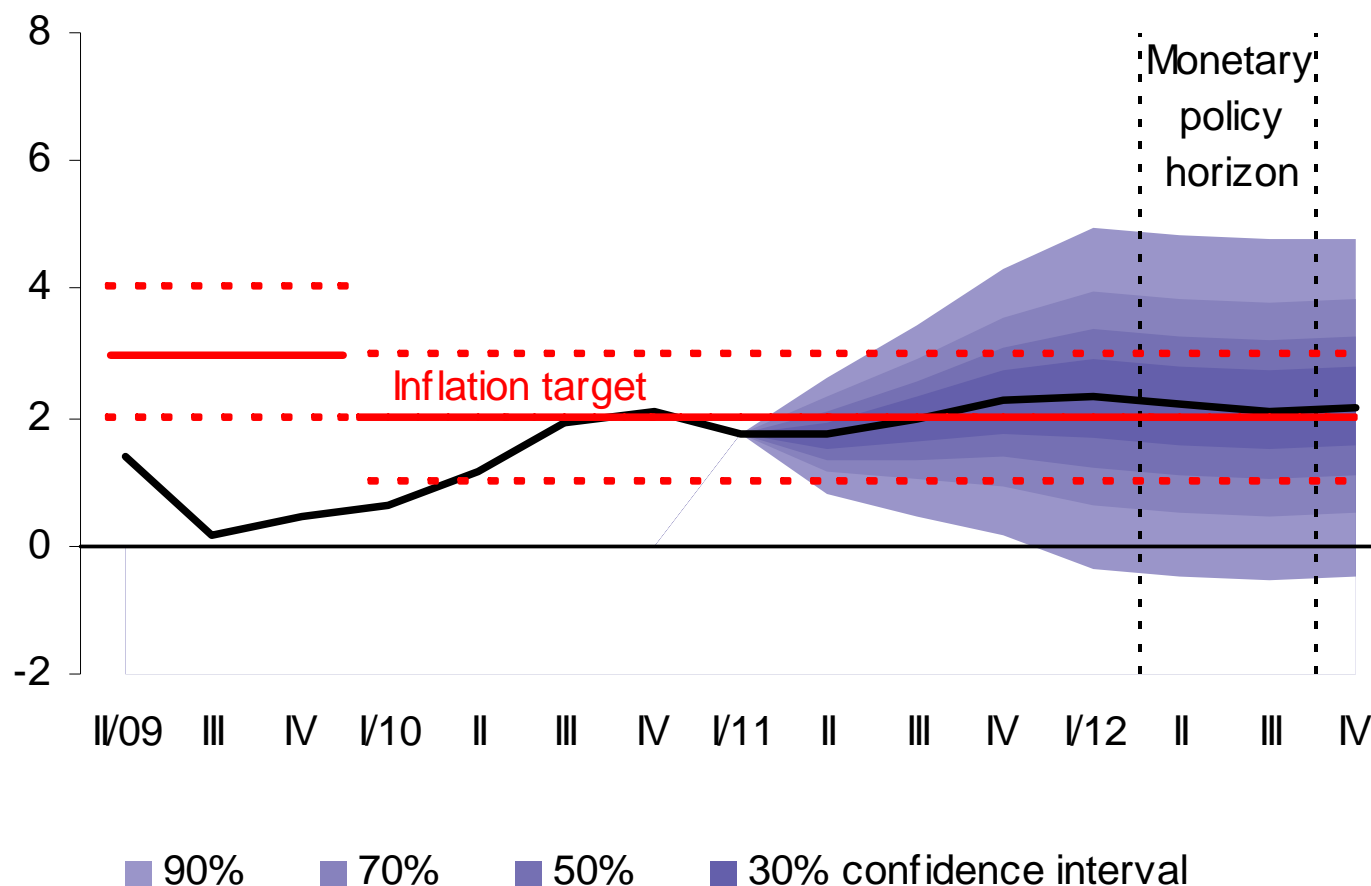
Meeting with Analysts

Tomáš Holub

Prague, May 13, 2011

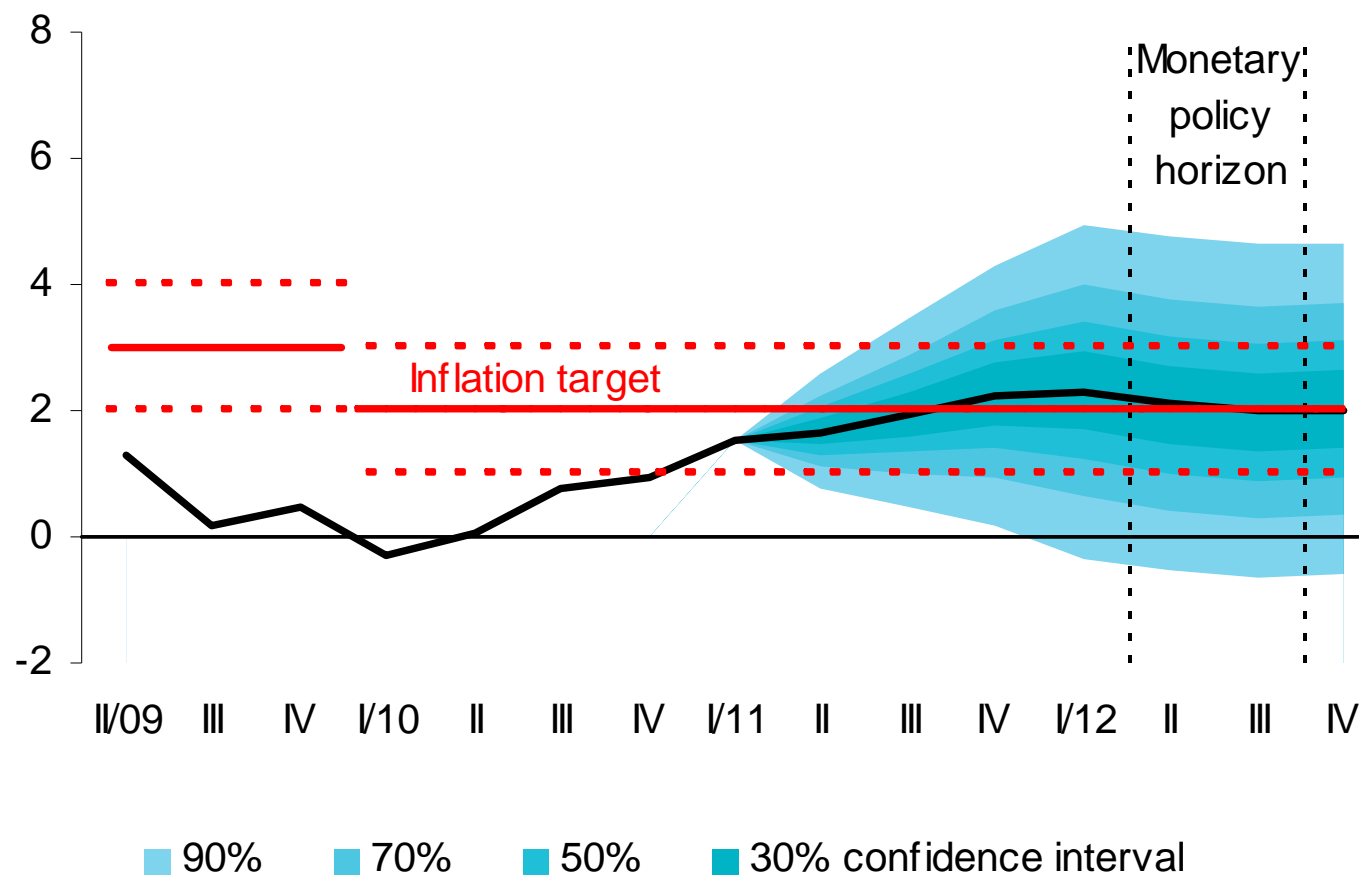
- Both headline and MP-relevant inflation will increase slightly and then stay close to the 2% target over the forecast horizon.
- Net inflation and administered price growth will speed up in 2011.
- Foreign inflation outlook as well as the future 3M EURIBOR path reflect the high commodity prices.
- Commodity prices are the main source of inflation in the Czech Republic, too. Domestic inflationary pressures are not apparent currently and will strengthen only gradually over the forecast.
- Exchange rate appreciation will outweigh the effect of import prices on net inflation, reverting back to anti-inflationary side.
- In 2011, GDP growth will slow down due to fiscal restriction, fading inventory cycle and a decline in external demand growth.
- Recently low wage growth will start to pick up gradually.

Headline Inflation Forecast



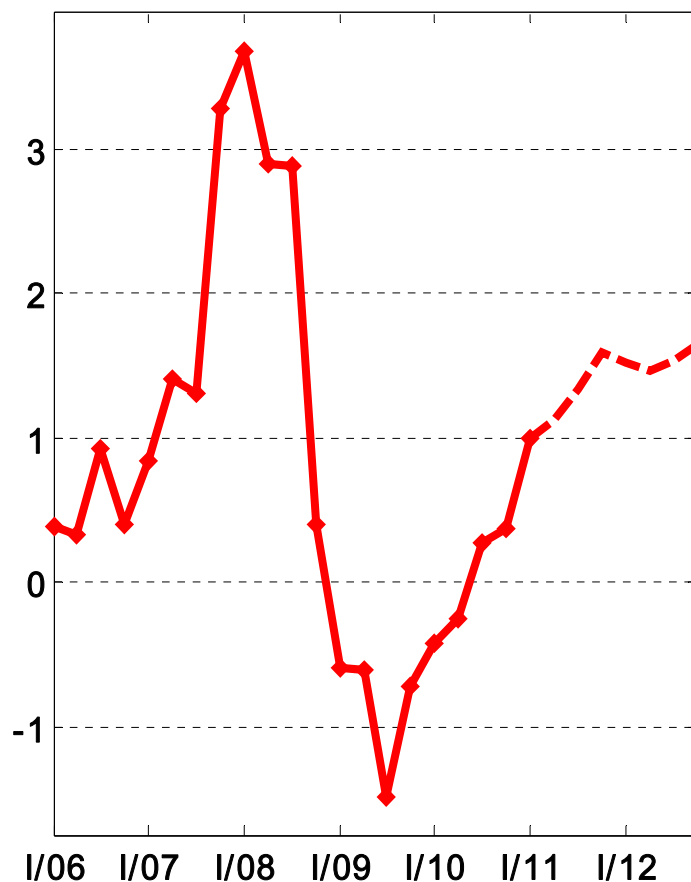
- Compared to the most recent figure (1.6% y/y in April), inflation will increase slightly, but it will stay close to the 2% target during the entire forecast horizon.
- VAT hike from 10 % to 14 % not yet included in the baseline.

MP-Relevant Inflation Forecast

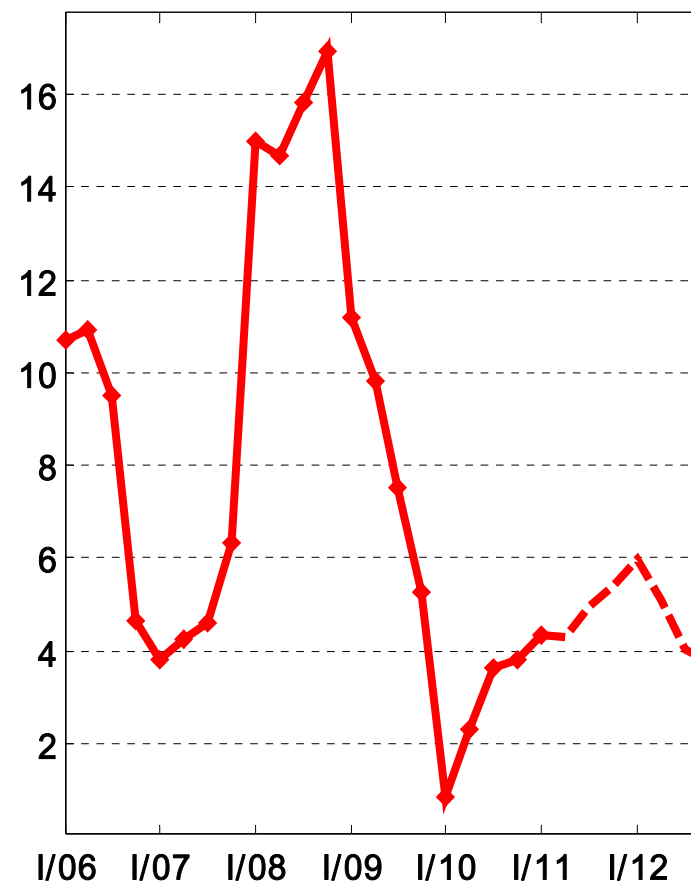


- MP-relevant inflation will increase to the target and stay there during the entire forecast horizon.

Net Inflation (y/y, in %)

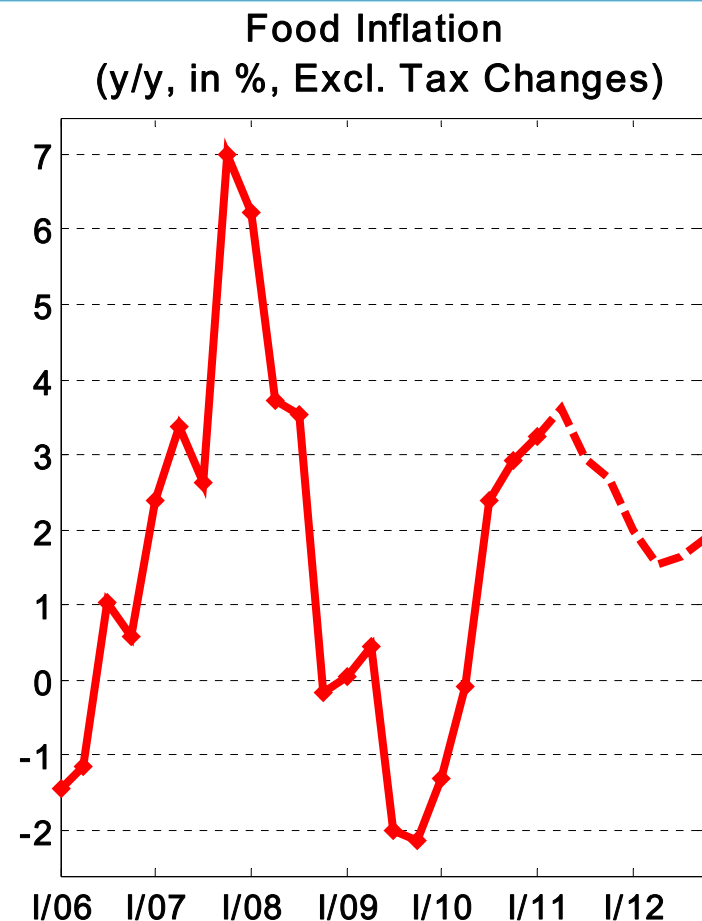
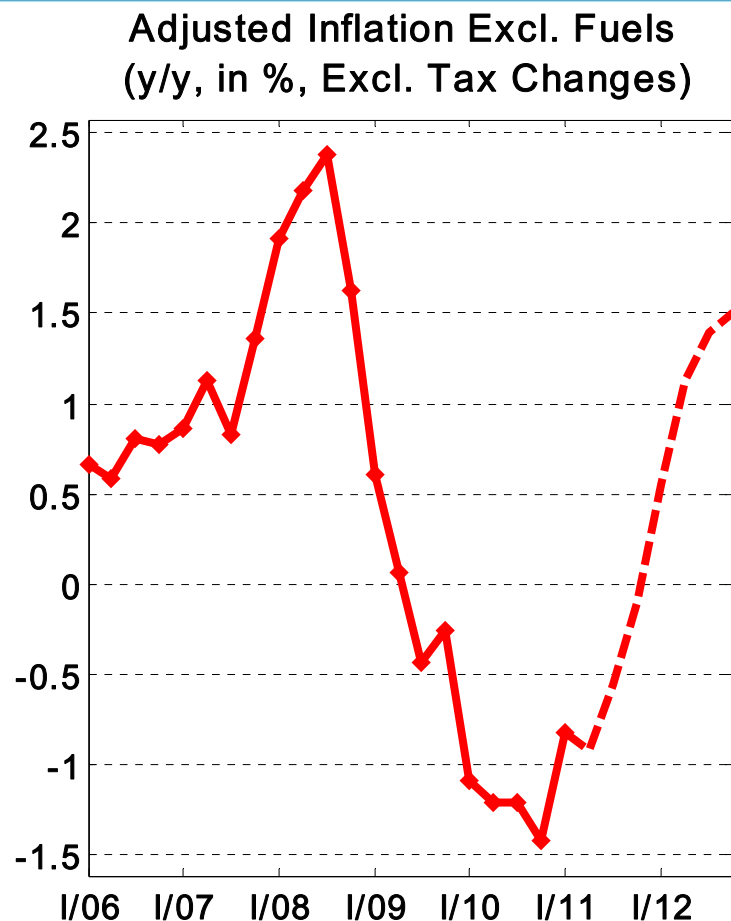


Growth of Administered Prices (y/y, in %)



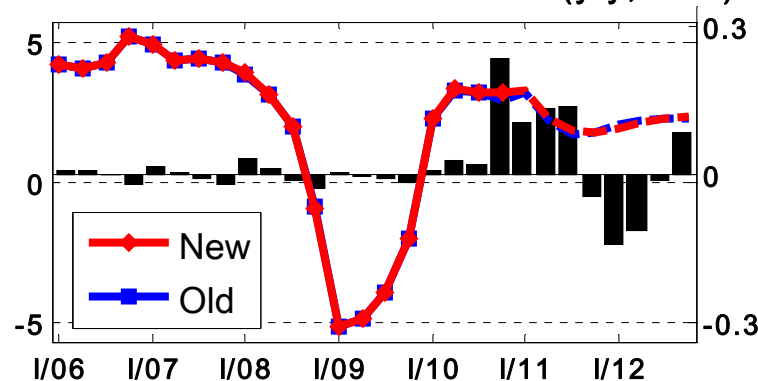
- Net inflation will accelerate due to commodity prices in the short term and an increase in domestic pressures in the medium term.
- Growth in rents and rising prices of electricity and natural gas will be the main sources of growth in administered prices.

Adjusted Inflation Excl. Fuels and Food Prices

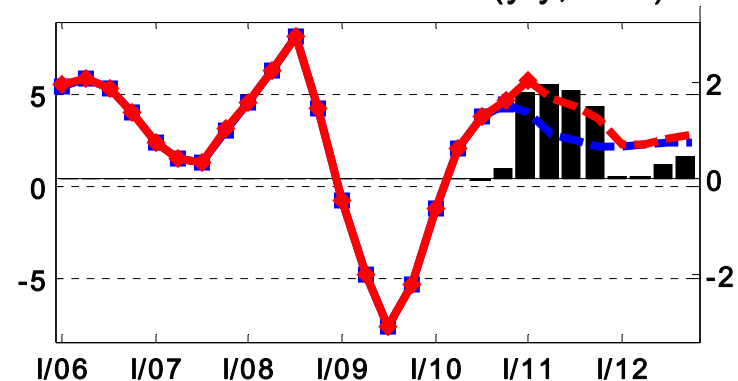


- Adjusted inflation excluding fuels (i.e. "core" inflation) will turn positive at the end of 2011.
- Food price growth will culminate soon. Then, once the effect of high agricultural commodity prices vanishes, it will ease.

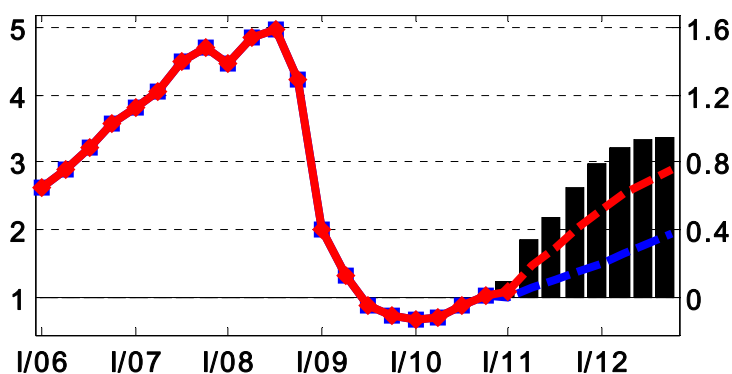
Growth Rate of GDP - Eurozone (y/y, in %)



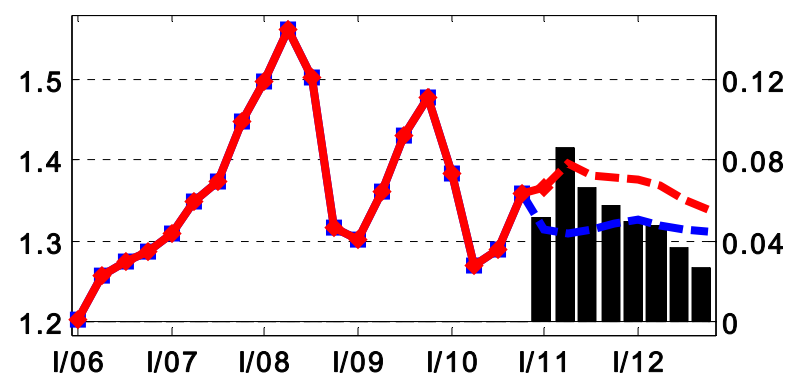
PPI Inflation - Eurozone (y/y, in %)



3M EURIBOR

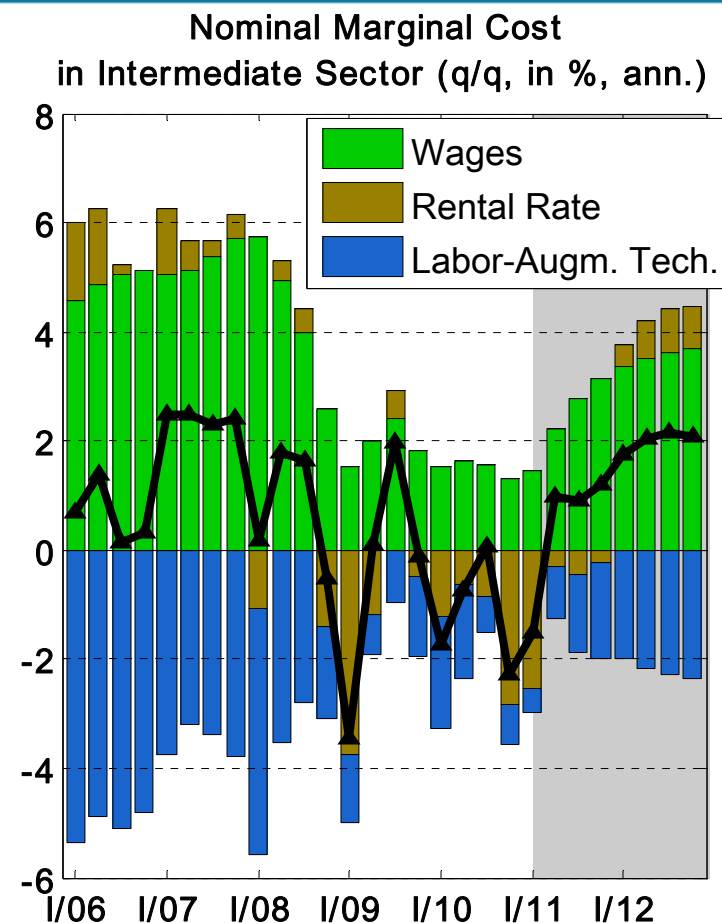
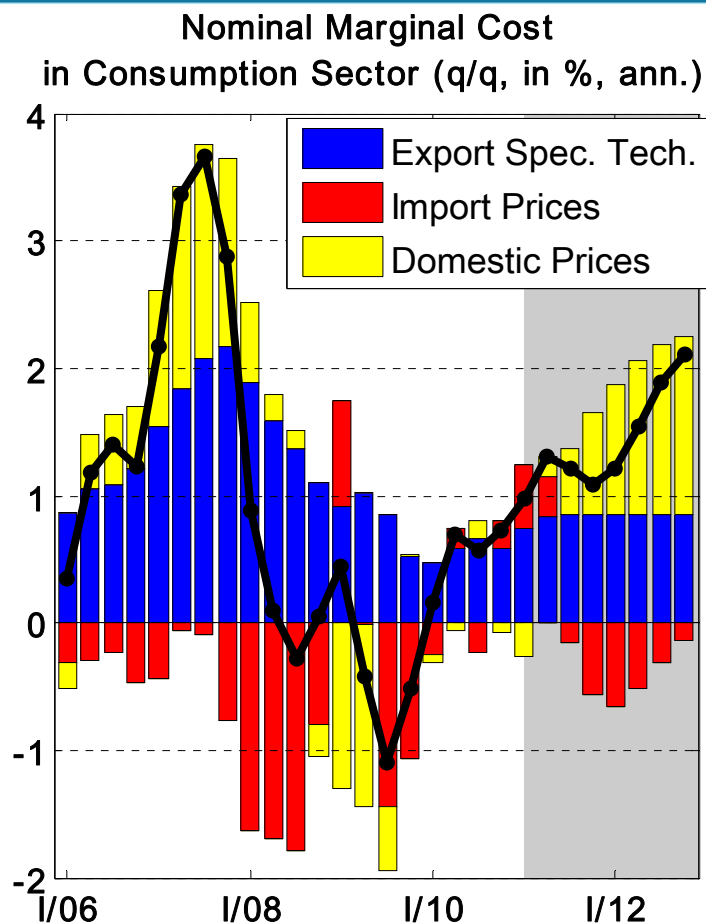


USD/EUR



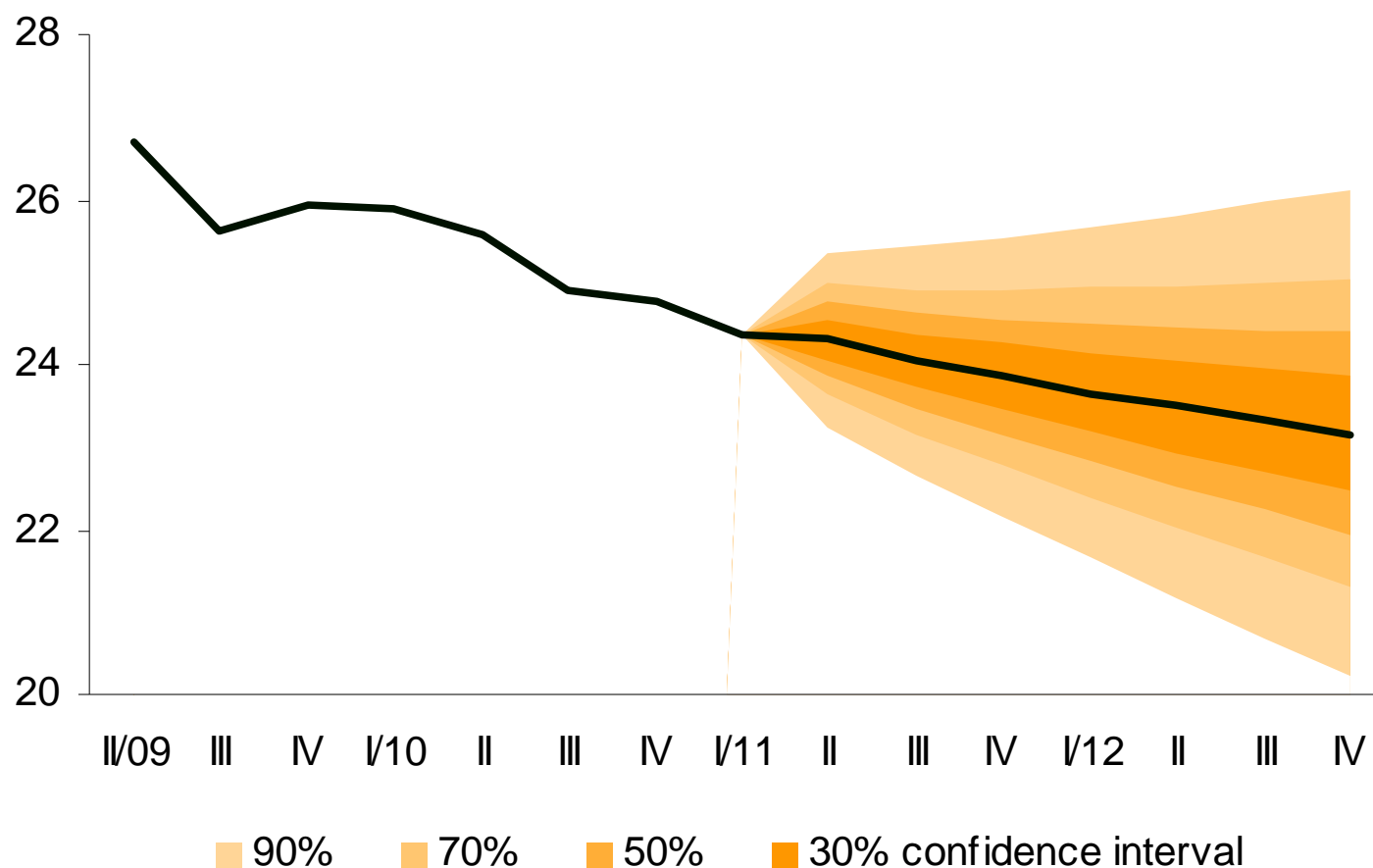
- External environment outlook reflects the high commodity prices: currently fast PPI growth and a steeper increase in 3M EURIBOR.
- A slowdown in effective GDP growth still expected in 2011-2012.

Domestic Costs vs. Import Prices



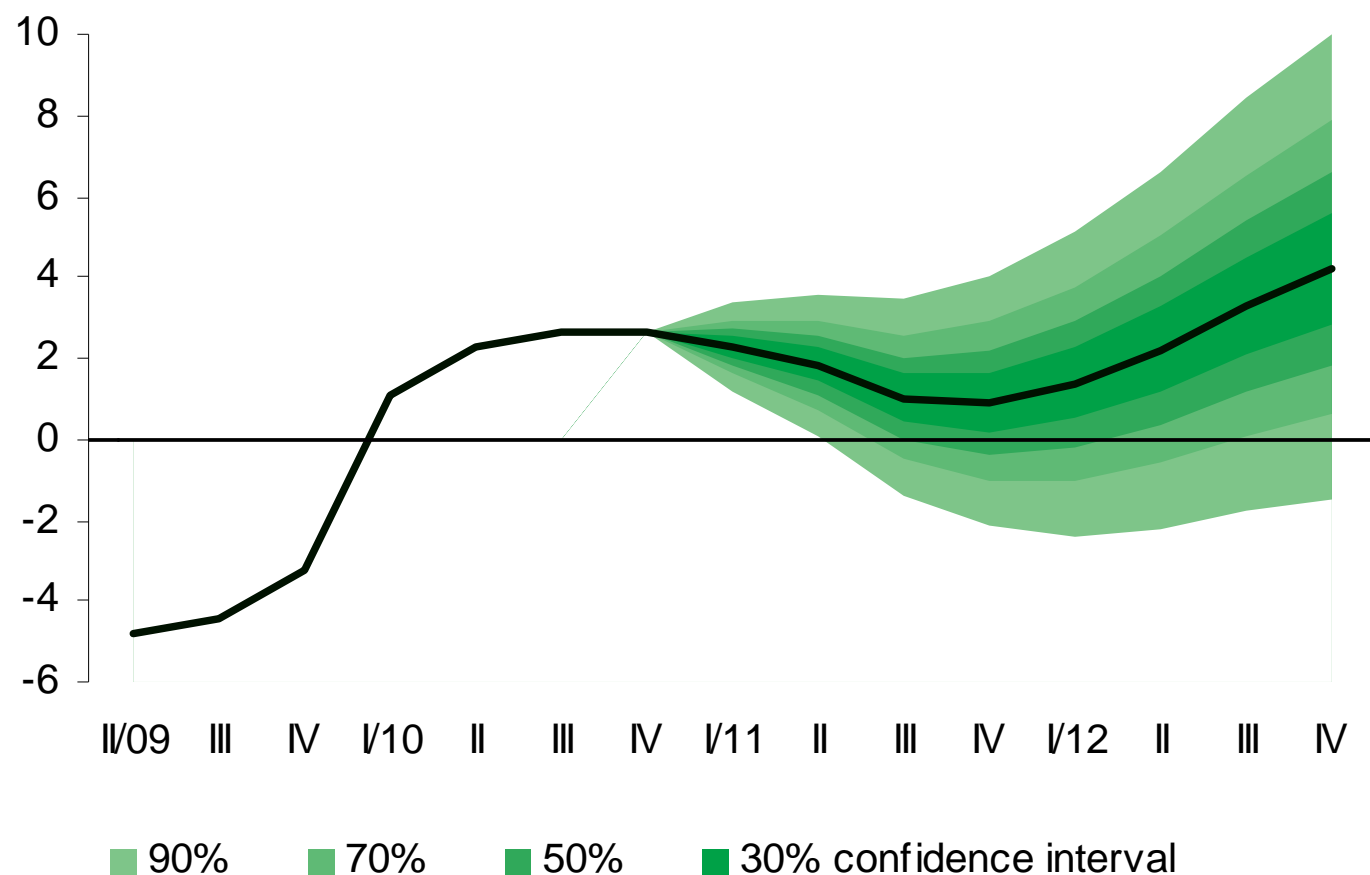
- Pro-inflationary effect of import prices due to commodities will later on be outweighed by the effect of exchange rate appreciation.
- Domestic inflationary pressures have not been apparent (low wage growth, decline in rental rate), but will strengthen gradually.

Exchange Rate Forecast



- Nominal exchange rate will gradually appreciate due to growing net exports (decline in risk premium) and renewed convergence.
- By contrast, low domestic interest rates will attenuate the exchange rate appreciation via a negative interest rate differential.

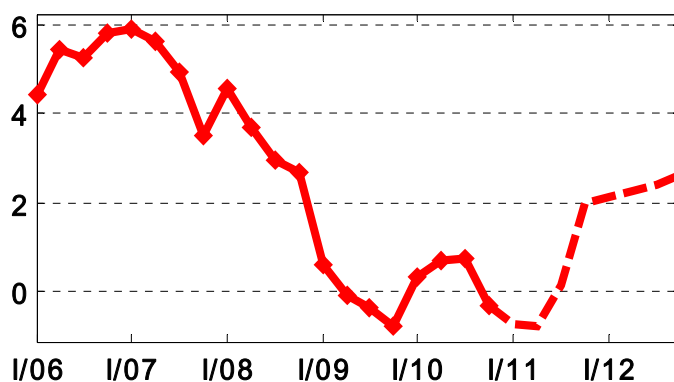
GDP Growth Forecast



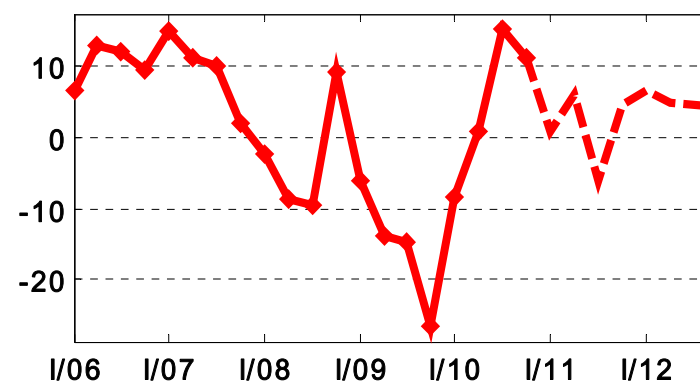
- In 2011, the GDP growth will slow down to 1.5% (the effect of fiscal restriction, fading investment, slowdown in external demand).
- Considerable acceleration in the growth to 2.8% in 2012.

Forecast of Aggregate Demand

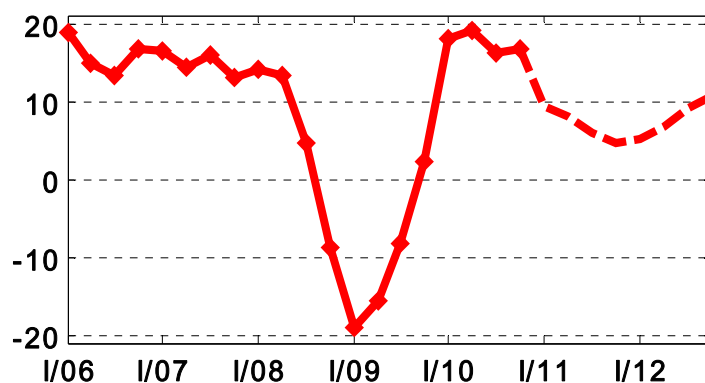
Household Consumption Growth (y/y, in %)



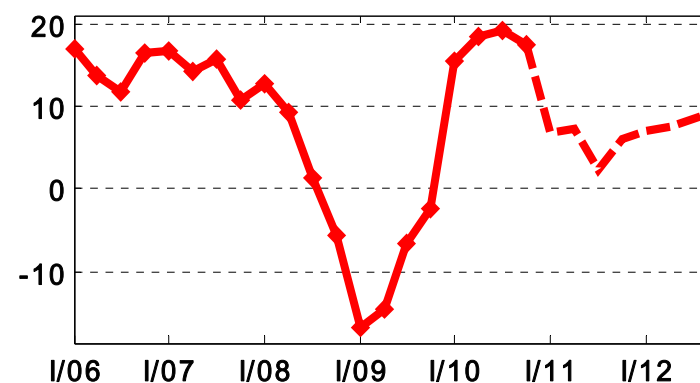
Investments Growth (y/y, in %)



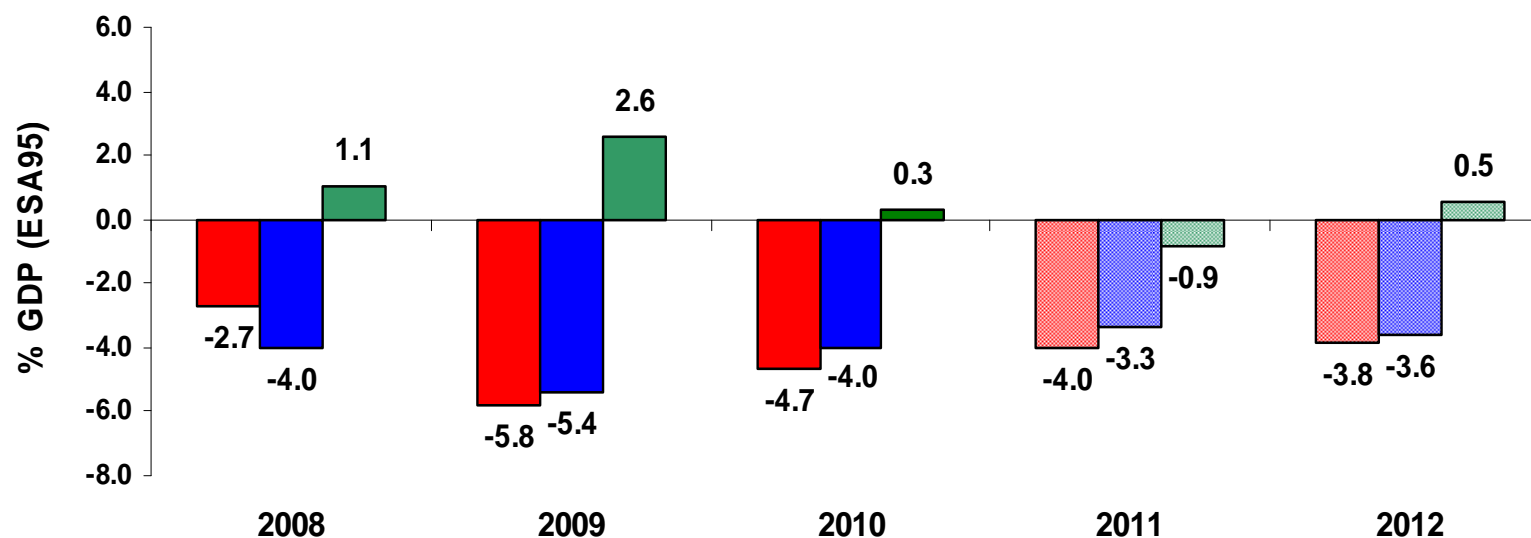
Exports Growth (y/y, in %)



Imports Growth (y/y, in %)



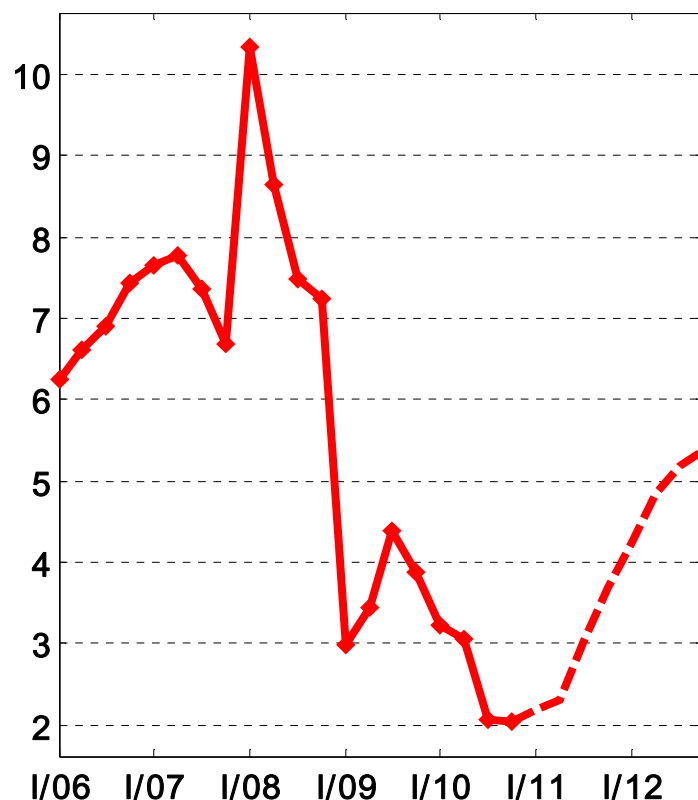
- Weak domestic demand will contribute to the slowdown in GDP growth in 2011, but it will pick up in 2012.
- Contribution of net exports to the GDP growth will be positive, while both the export and import growth rate will decline in 2011. ¹¹



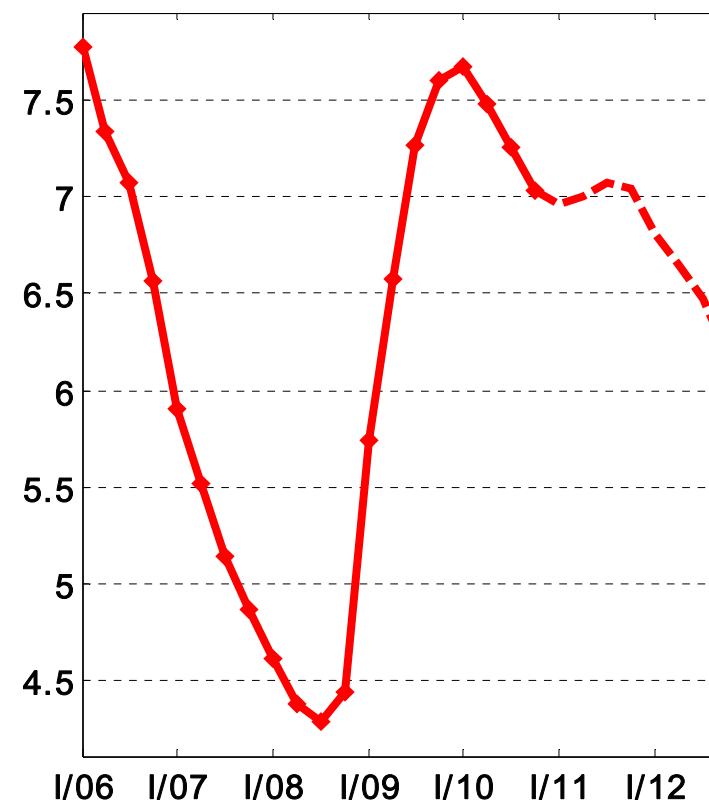
■ Public budget deficit
 ■ Structural deficit (EC)
 ■ Real government consumption (y-o-y %)

- In 2010, public budget deficit reached 4.7% of GDP (significant decline in government consumption at the end of the year).
- In 2011, the budget deficit will decline to 4% of GDP due to the fiscal consolidation (incl. a fall in government consumption).
- Forecast for 2012 assumes no policy change and a positive cyclical effect.

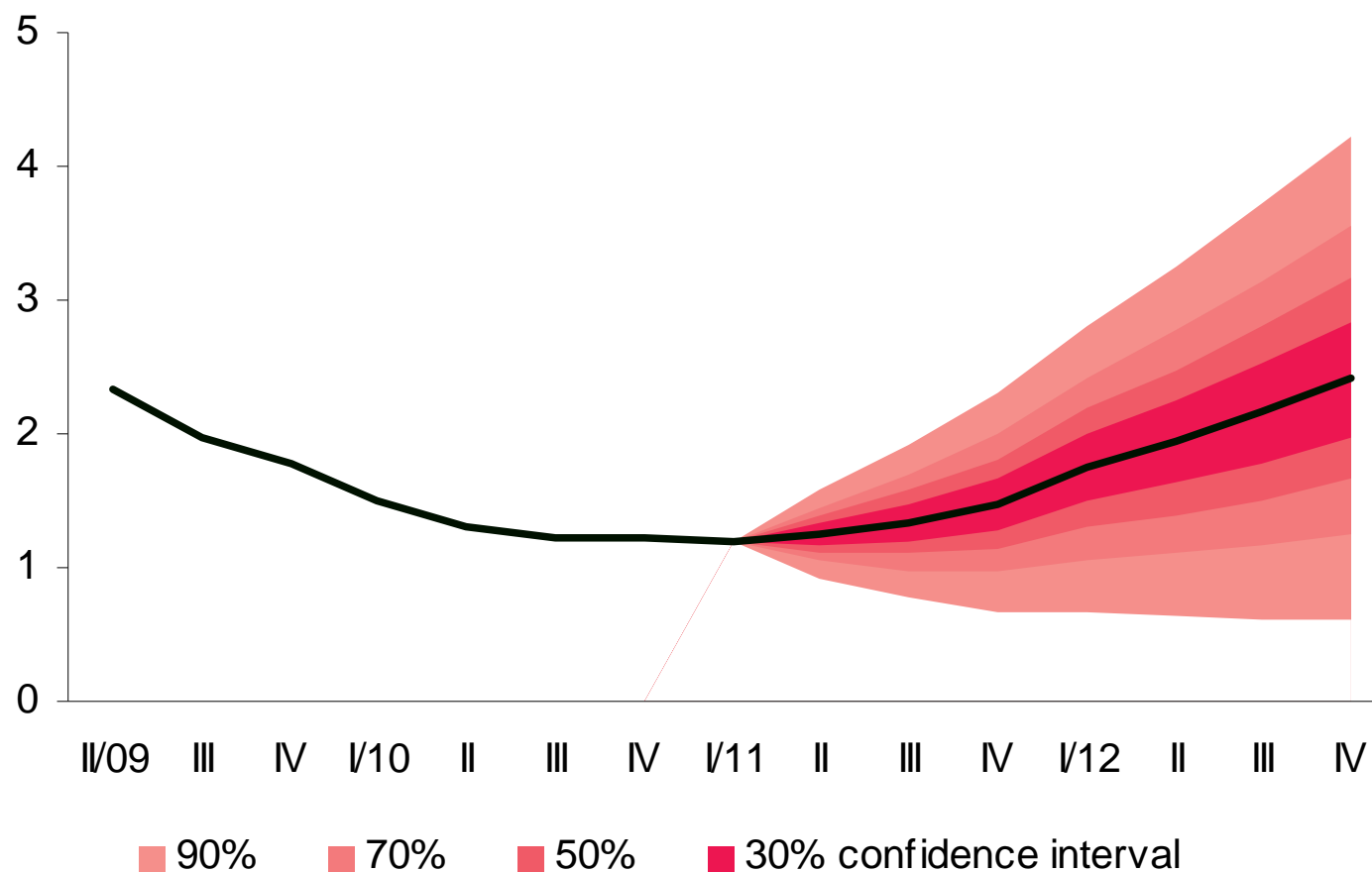
Nominal wage growth in business sector
(y/y, in %, s.a.)



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



- Weak wage growth in business sector is currently a key reason for the absence of domestic inflationary pressures.
- A noteworthy improvement in the labour market situation will not come before the turn of 2012.

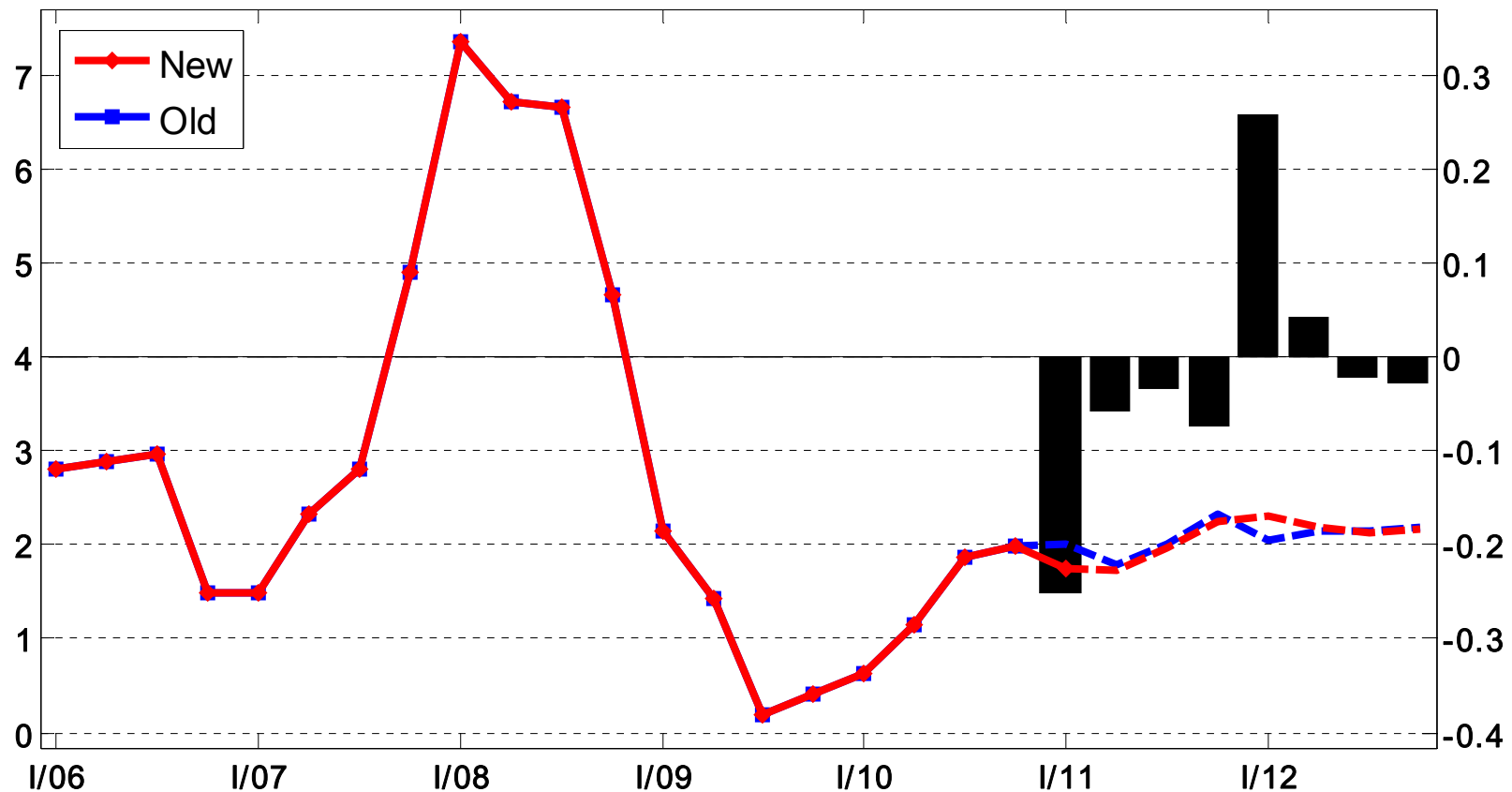


- Consistent with the forecast is broad stability of market interest rates in the near future and a gradual rise in rates starting in 2011 Q4.

- The overall change in inflation forecast is small.
- Slightly lower net inflation forecast is offset by an expected higher administered price growth.
- Faster future exchange rate appreciation (due to higher net exports) contributes to the lower net inflation forecast.
- GDP growth forecast is marginally lower.
- The forecast of nominal wage growth in the business sector is lower (with an exception of the end of 2012) .
- The interest rate path is slightly higher from 2011 H2 onwards.

Comparison with Previous Inflation Forecast (i)

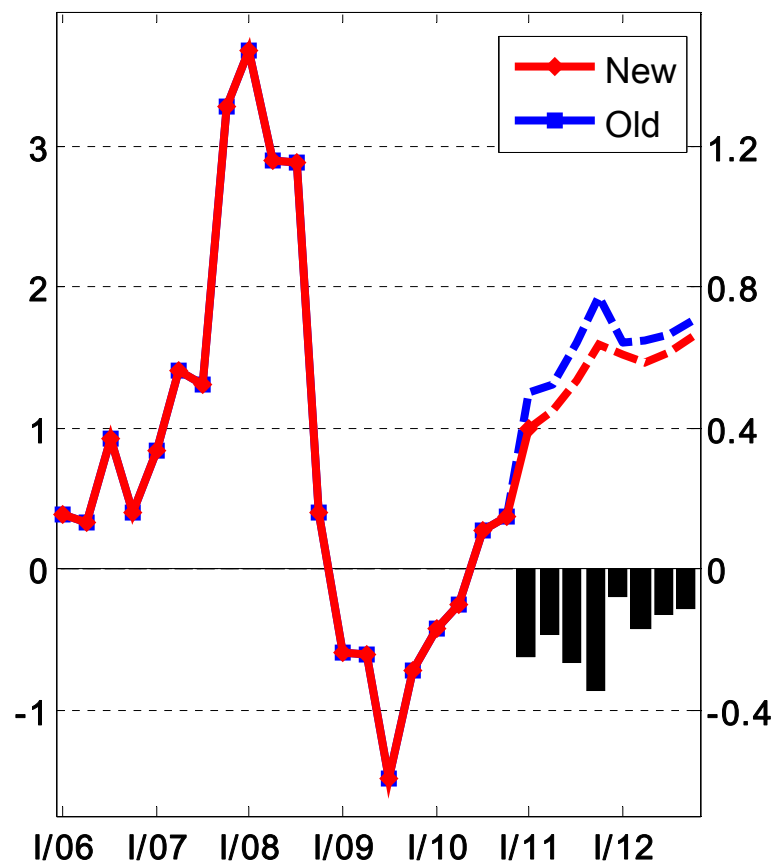
CPI Inflation (y/y, in %)



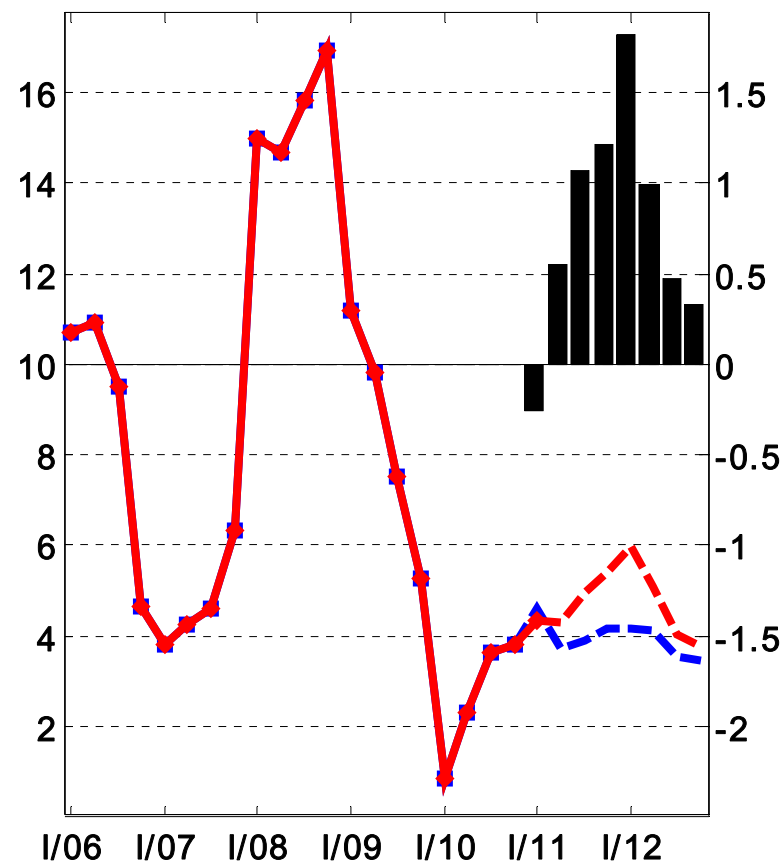
- The change in inflation forecast is negligible, in spite of the downward surprise in 2011 Q1.

Comparison with Previous Inflation Forecast (ii)

Net Inflation (y/y, in %)

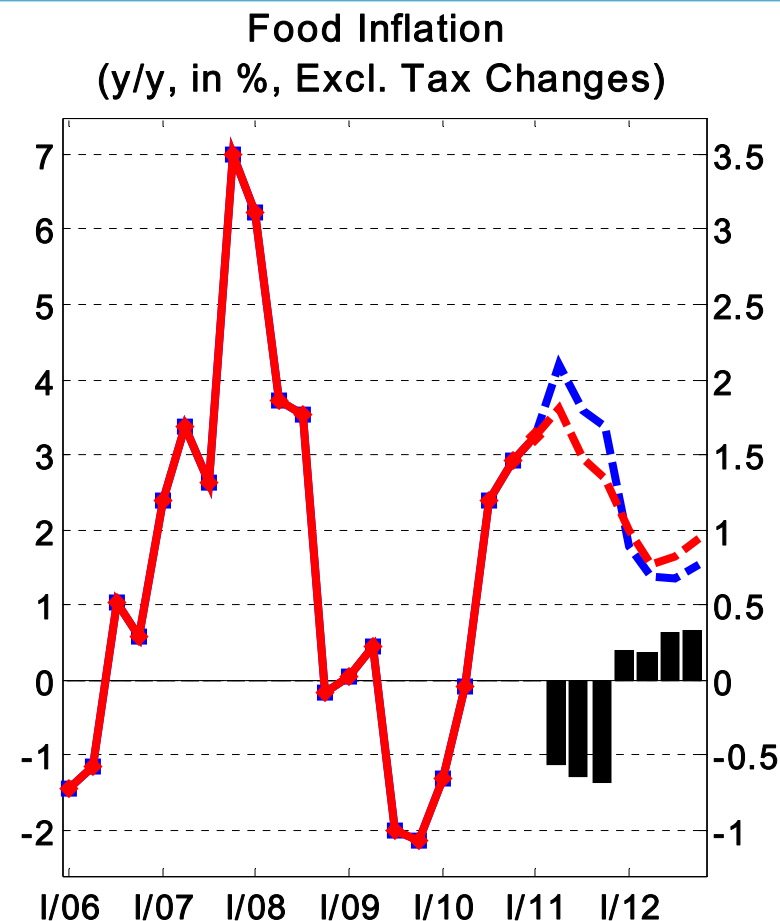
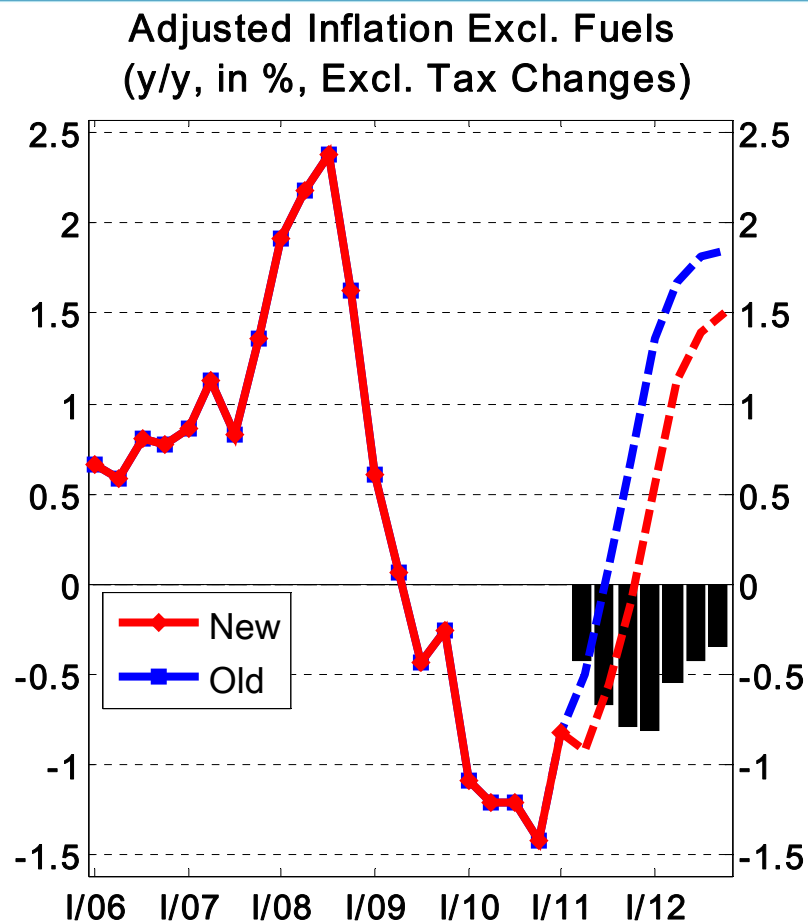


Growth of Administered Prices (y/y, in %)



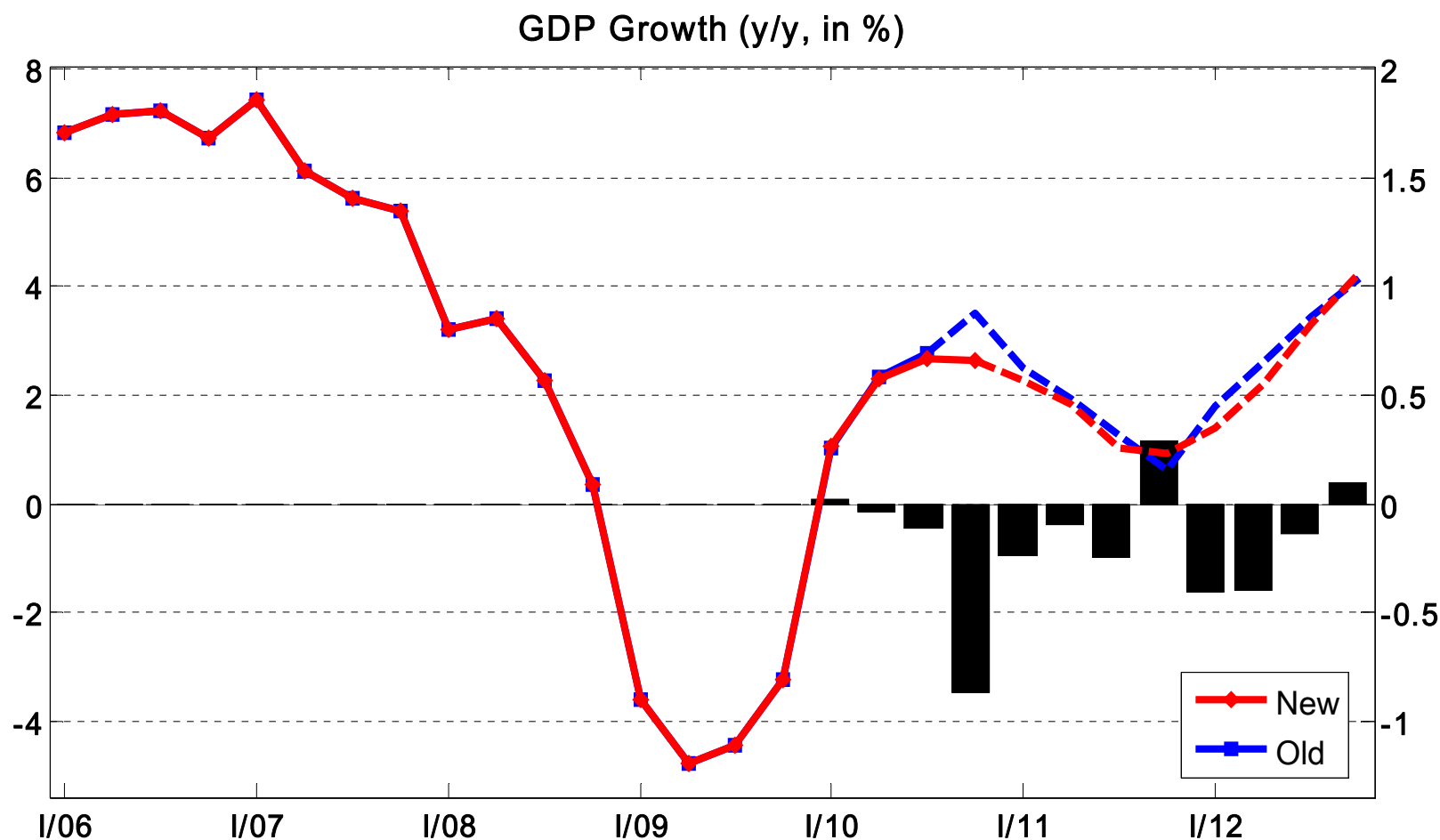
- Net inflation forecast is lower during the entire forecast horizon.
- On the contrary, administered price growth is higher in 2011 due to commodity prices and in 2012 due to electricity prices.

Comparison with Previous Inflation Forecast (iii)



- Adjusted inflation excl. fuels is lower owing to the subdued domestic economy and faster exchange rate appreciation.
- Slightly lower forecast of food price growth reflects mainly the observed data in 2011 Q1.

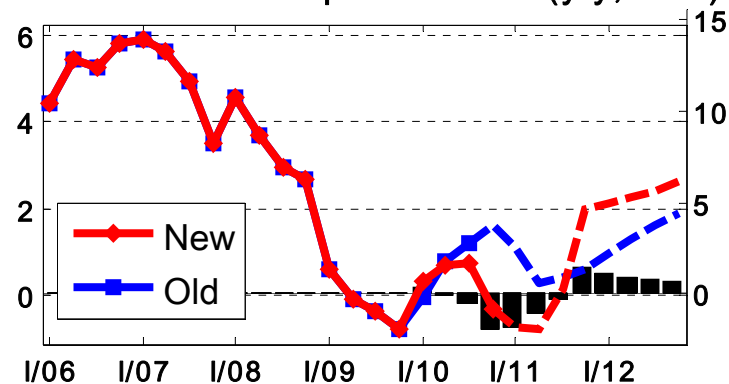
Comparison with Previous GDP Forecast (i)



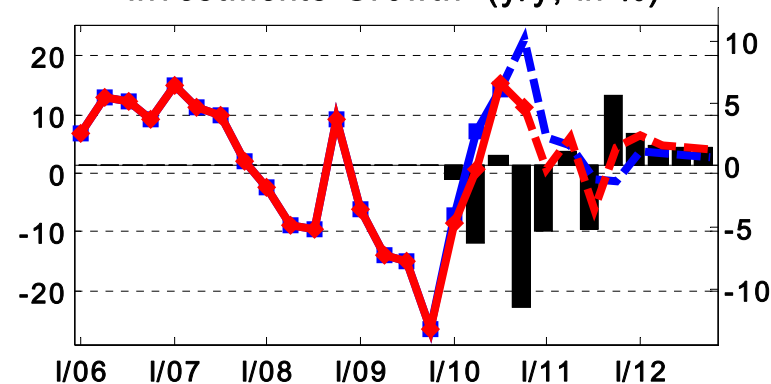
- Small change in the GDP growth forecast reflects mainly the lower than expected growth in 2010 Q4 (plus data revisions).

Comparison with Previous GDP Forecast (ii)

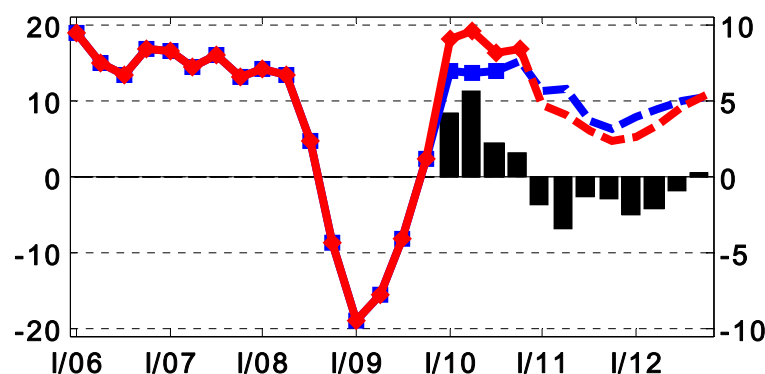
Household Consumption Growth (y/y, in %)



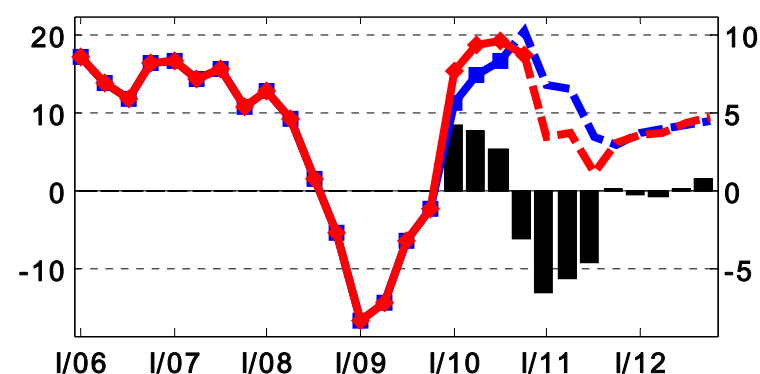
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)



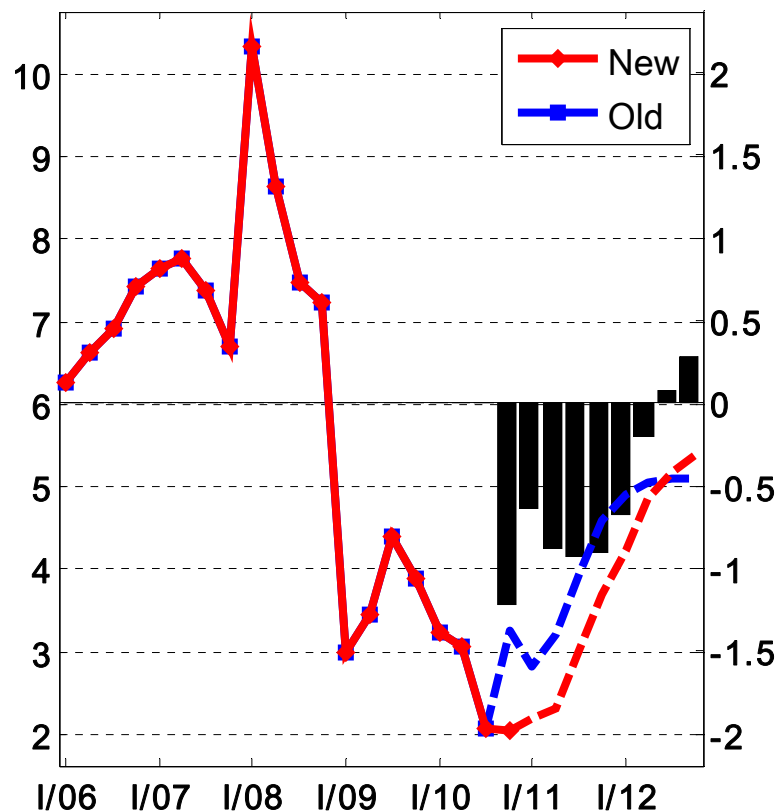
Imports Growth (y/y, in %)



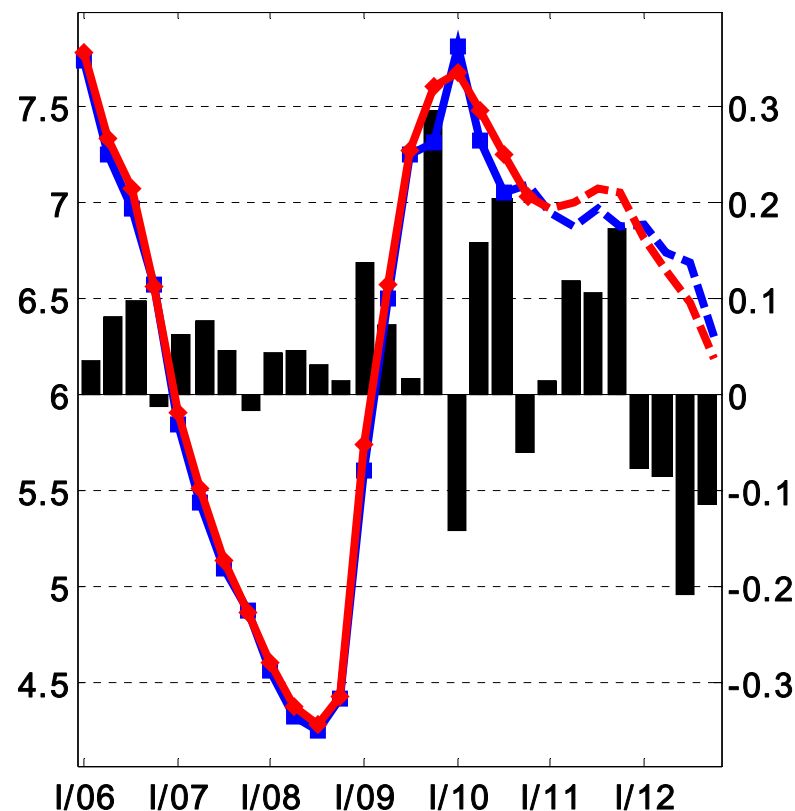
- Changes in the expected structure of GDP growth are more important than the change in overall GDP forecast.
- Lower domestic demand outlook reflects the data in 2010 Q4.
- Net export forecast is higher.

Changes in Labour Market Forecast

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

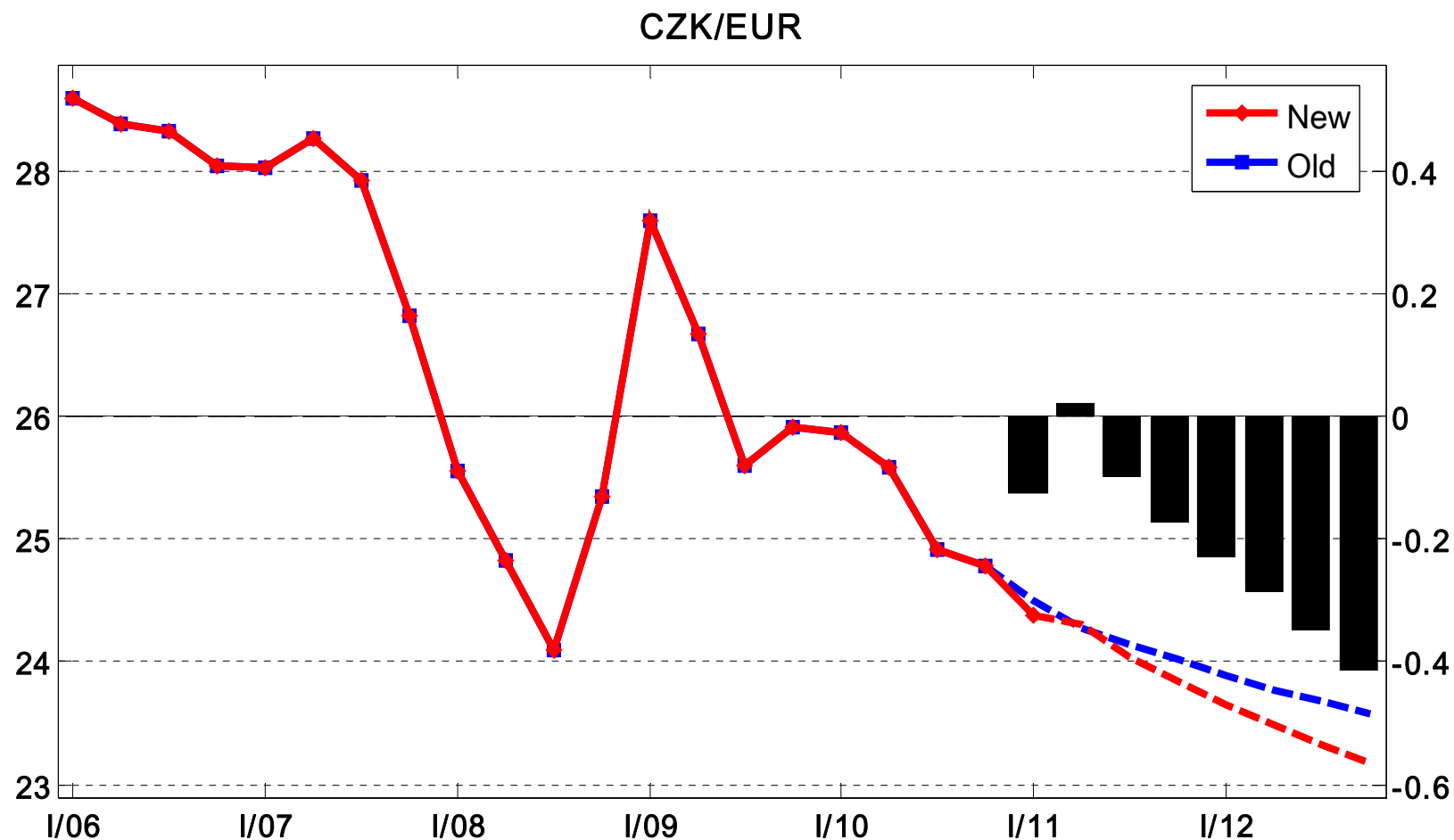


General unemployment rate (ILO)
(in %, s.a.)



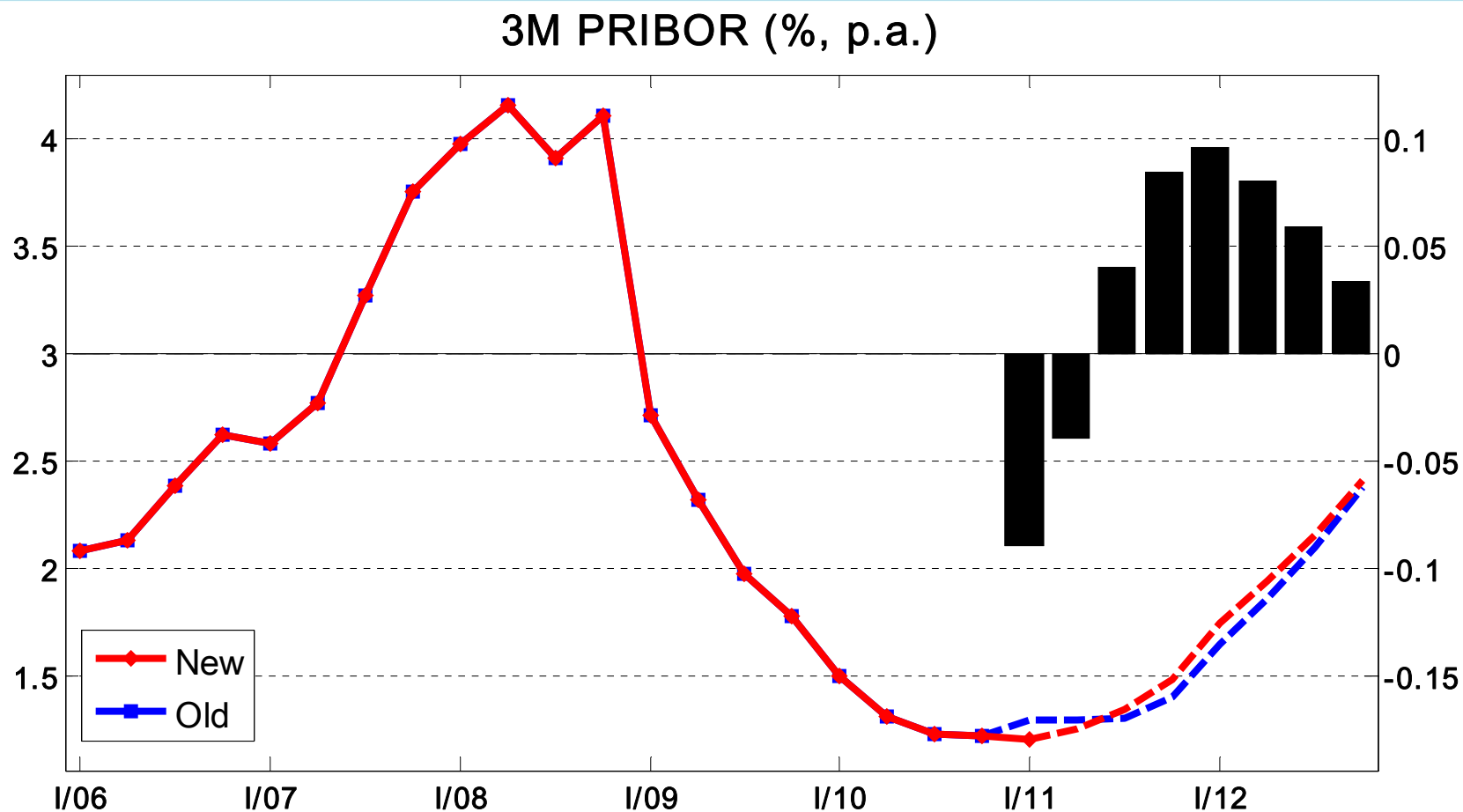
- The forecast of nominal wage growth in the business sector takes into account the weak data in 2010 Q4.

Changes in Exchange Rate Forecast



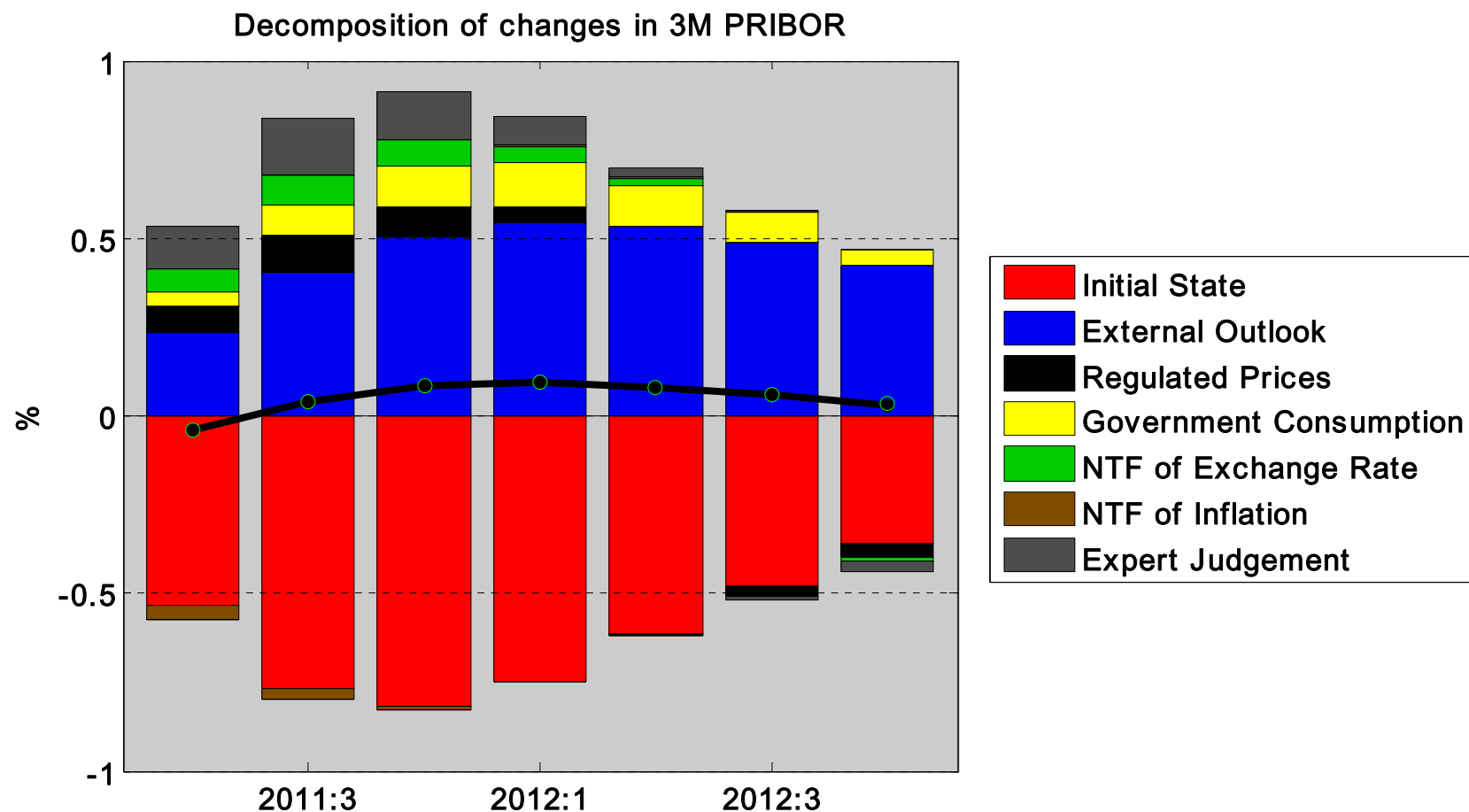
- Faster exchange rate appreciation is fostered by higher net export forecast (decline in country risk premium) and is attenuated by higher foreign interest rate outlook.

Changes Interest Rate Forecast



- The forecast for market interest rates is slightly higher from 2011 H2 onwards.

Interest Rate Forecast Change Decomposition

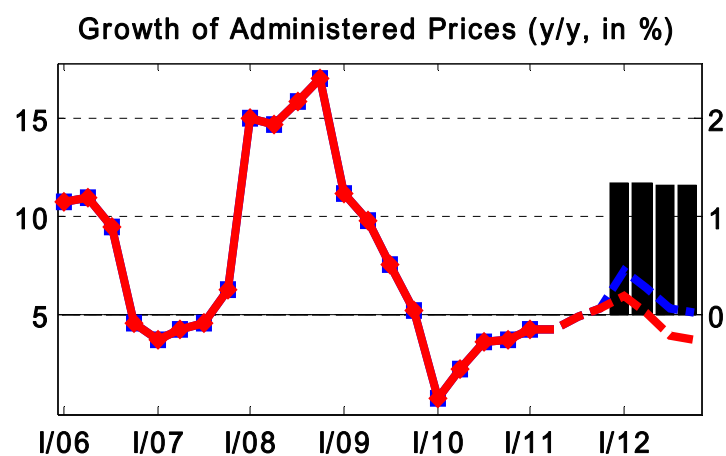
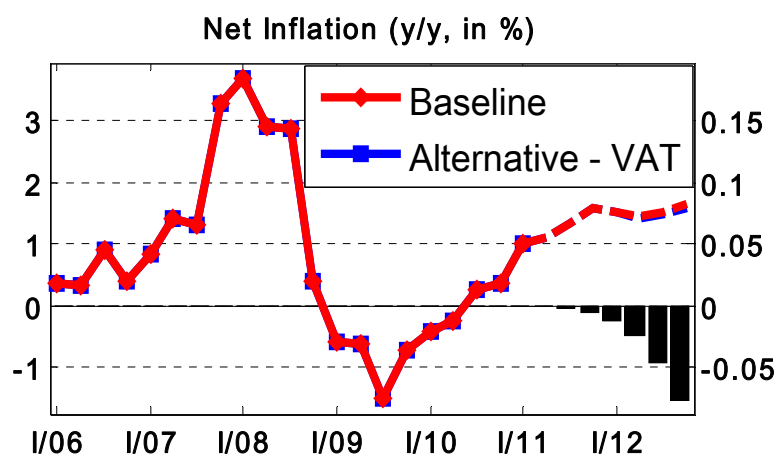
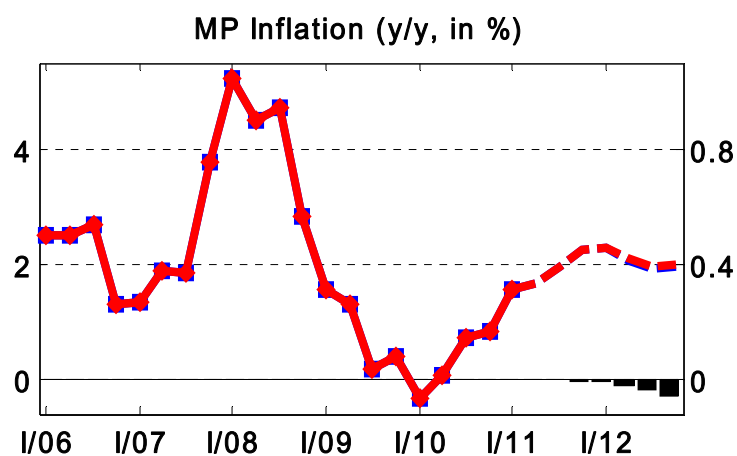
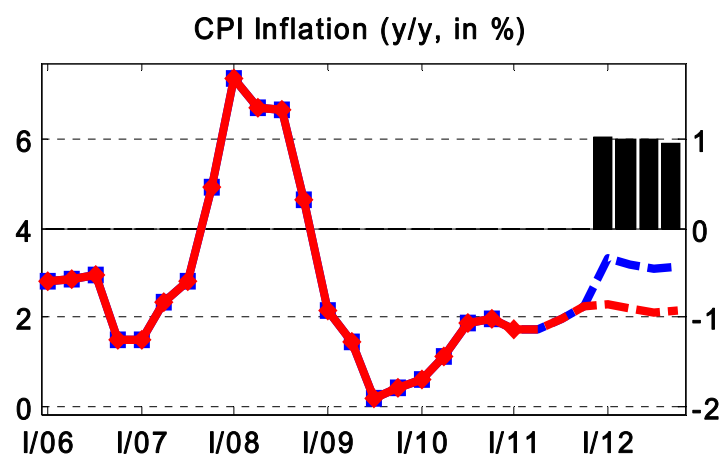


- An upward impact of the new external environment outlook and of other factors is largely offset by a downward effect of the initial state.

VAT rate increase

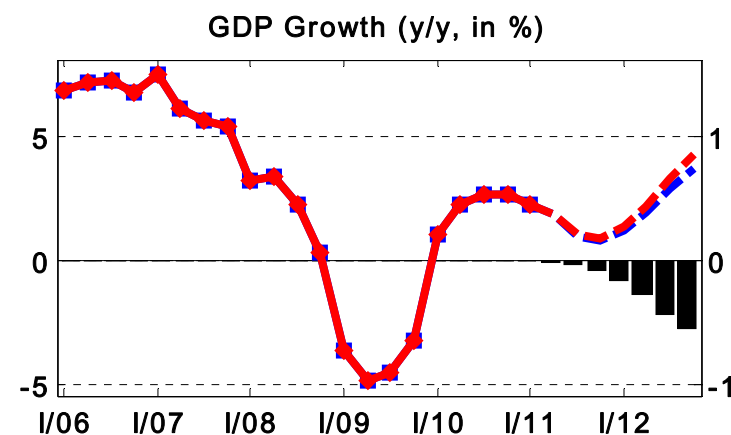
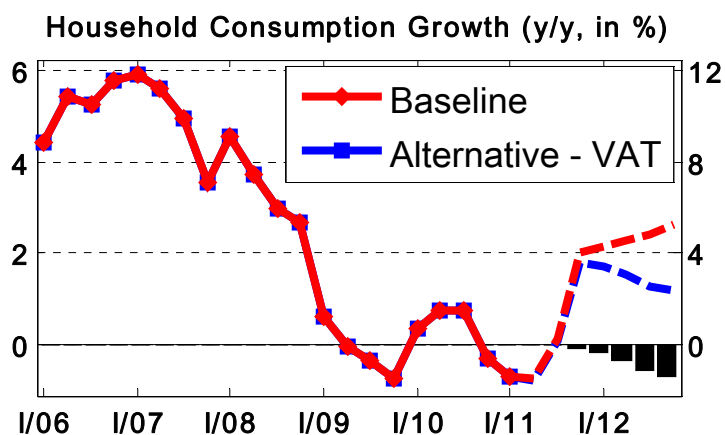
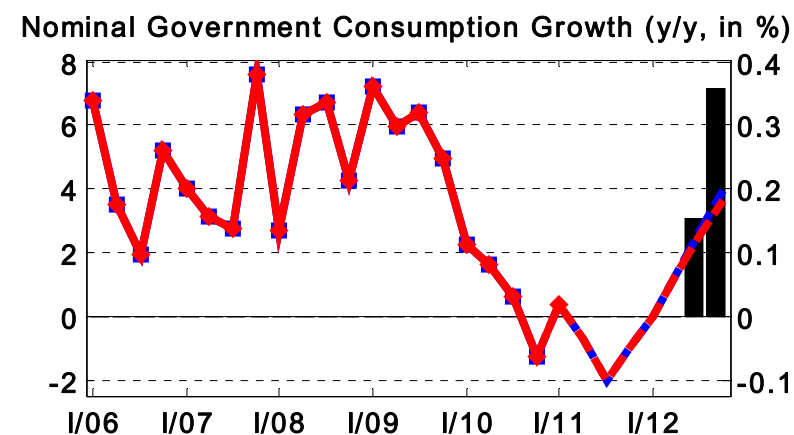
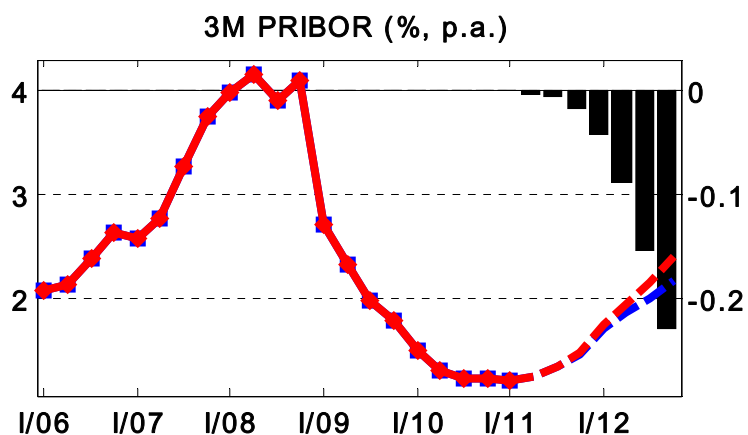
- Reflects government plan (related to fiscal consolidation and pension system reform).
- An increase in the reduced VAT rate from 10% to 14% with effect from 1 January 2012.
- The first-round effects of indirect tax changes are not included in monetary-policy relevant inflation.
- The second-round effects are expected to be negligible.
- The impact on GDP is restrictive and affects economic activity through a decline in household consumption expenditure caused by lower real disposable income.

Comparison of Alternative with Baseline (i)



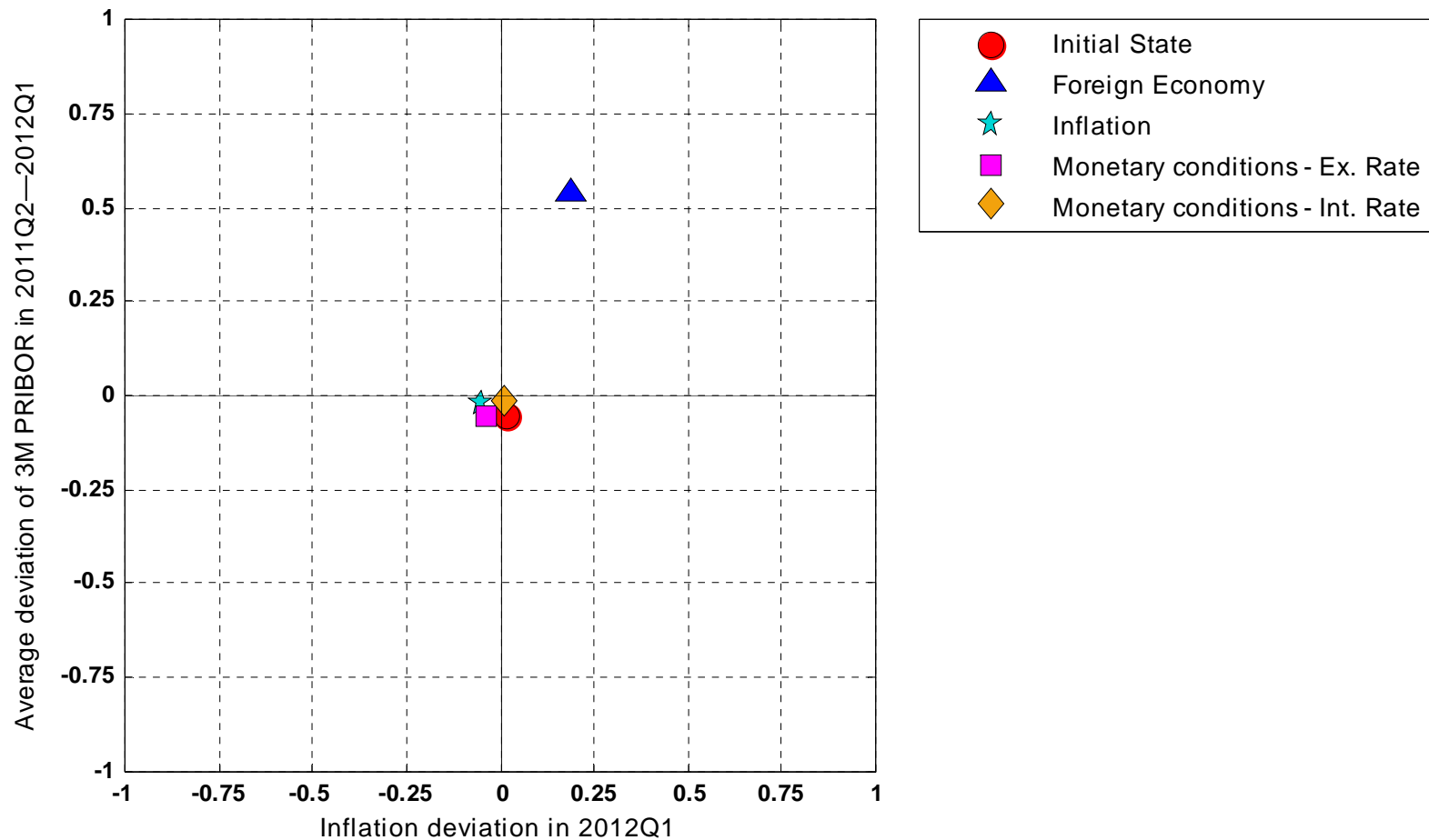
- Headline inflation will temporarily increase by 1 p.p. in 2012, the change in MP-relevant inflation is negligible.

Comparison of Alternative with Baseline (ii)





- The impact of the change in VAT rate on interest rates is small (slight decline in 2012).
- GDP growth is lower roughly by 0.4 p.p. in 2012.

- Starting from the MP meeting in June 2011, the CNB will begin publishing the GRIP after all meetings at which no new forecast is available (March, June, September, December).
- The GRIP will be published along with the Minutes, accompanied by a short explanatory text.
- The Board decided to publish the GRIP in order to further enhance the transparency of monetary policy.
- The GRIP in its current form has been used since [June 2004](#).
- It shows risks to the inflation projection and future interest rate path related to the newly available pieces of information.
- It is based on simulations in the core projection model (currently g3; previously QPM), helping to quantify the risks of the last available forecast in a systematic manner.



- On the horizontal axis, the impact of including new information is shown in terms of inflation deviation from the forecast in Q+4.
- On the vertical axis, the same is done for average 3M PRIBOR in Q+1 to Q+4.

- Initial state: reflects differences in the new national account data (including possible past data revisions) and wages compared to the forecast assumptions.
- Foreign economy: changes to the outlook for foreign variables (Consensus Forecasts and market outlook).
- Inflation: new inflation figures (data for the last 2 months available), changes to the outlook for administered prices and indirect taxes.
- Monetary conditions – ex. rate: difference between the average CZK/EUR in the current quarter and its near-term forecast.
- Monetary conditions – int. rate: difference between the average 3M PRIBOR in the current quarter and its forecast.

- The simulations are done in a relatively mechanical manner.
- Some points thus may be counterintuitive and may not be confirmed by the next forecast.
- The counterintuitive points are commented in the accompanying text and are identified as an issue for the next forecast.
- The new forecast then reassesses the initial state of the economy, exogenous assumptions and judgements in a full-fledged way.
- Example: March 2011
 - Initial state in the GRIP was only marginally to the downside. 
 - But the data were perceived as more anti-inflationary (both by the staff and the Board – overall risks assessed as „roughly balanced“).
 - In the new forecast, initial state indeed offset the upward factors. 

Thank you for your attention

www.cnb.cz

Tomáš Holub

Monetary and Statistics Dep't

Tomas.Holub@cnb.cz