



Press conference of the CNB Bank Board

3rd Situation Report on Economic and Monetary Developments

3 May 2012

The monetary policy decision taken and the ratio of the votes cast

- At the close of the meeting the Board decided by a majority vote to leave the two-week repo rate unchanged at 0.75%.
- Four members voted in favour of this decision, two members voted for lowering rates by 0.25 percentage point, and one member voted for increasing rates by 0.25 percentage point.

Reasons for the decision

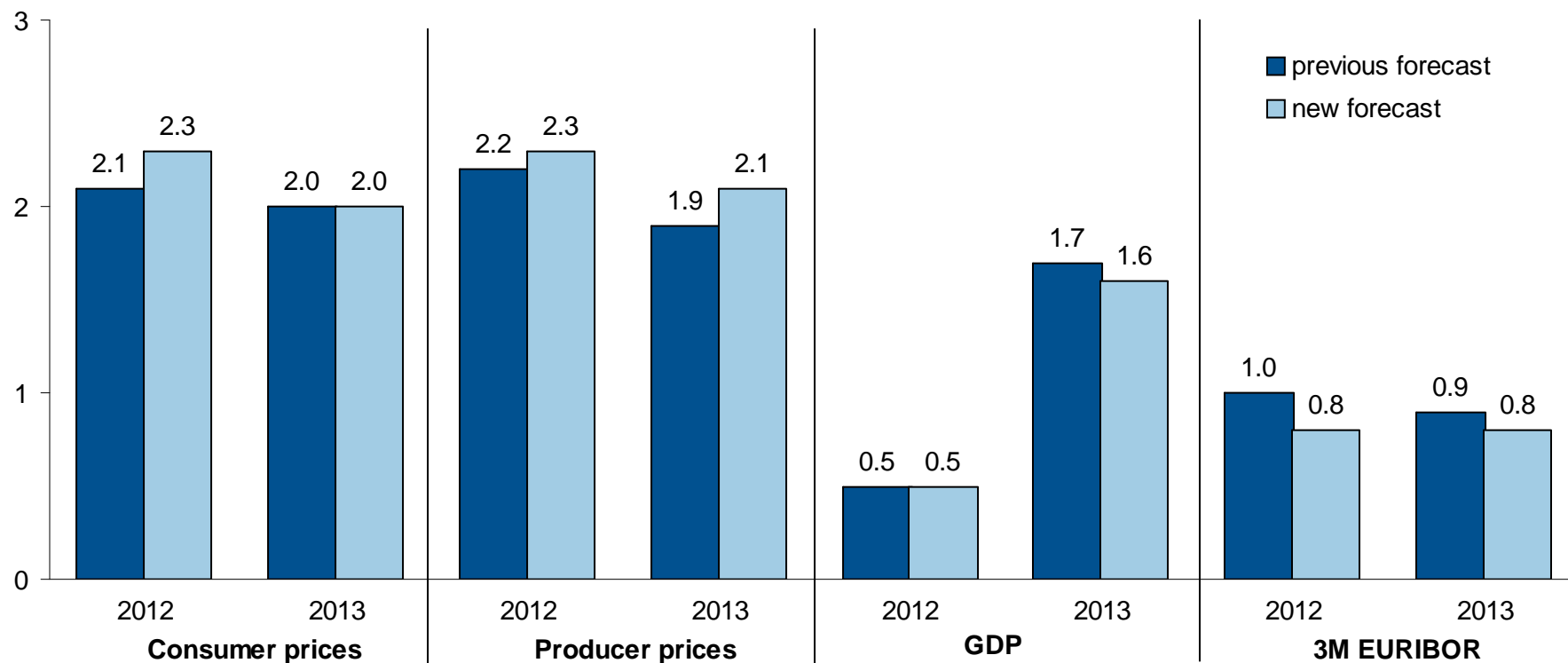
- Headline inflation will be close to its current elevated level as a result of a VAT increase. Monetary-policy relevant inflation will be in the upper half of the tolerance band this year. Both headline and monetary-policy relevant inflation will fall slightly below the target in 2013.
- Consistent with the forecast is a decline in market interest rates in the remainder of this year followed by a rise in rates as from 2013 H2.
- The risks to the forecast are on the upside.

The message of the forecast baseline scenario

- Domestic factors (weak domestic demand and moderate wage growth) are currently curbing inflation. The VAT increase, food prices, administered prices and the gradual pass-through of the past weaker exchange rate to prices are the main sources of inflation.
- Headline inflation will be close to the current elevated values in 2012, but will fall below the target in 2013. Monetary-policy relevant inflation will be in the upper half of the tolerance band this year, but will fall slightly below the target in 2013.
- The Czech economy will stagnate this year as a result of a marked slowdown in external demand and continuing domestic fiscal consolidation. Next year, in connection with an external demand recovery, GDP growth will be just below 2%.
- The nominal exchange rate is gradually appreciating.
- Consistent with the forecast is a decline in market interest rates in the remainder of this year followed by a rise in rates as from 2013 H2.

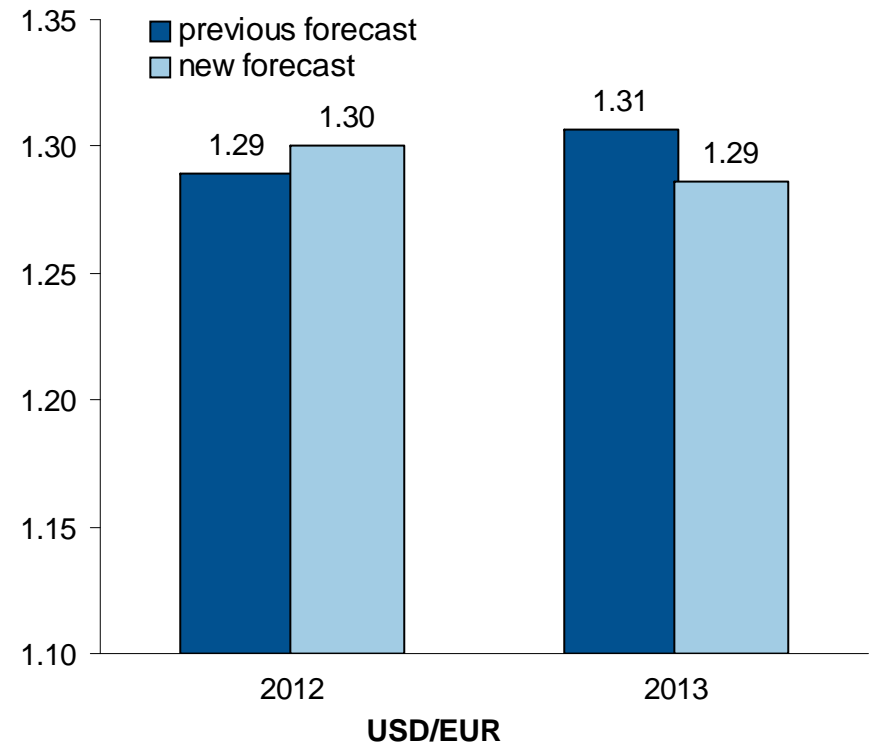
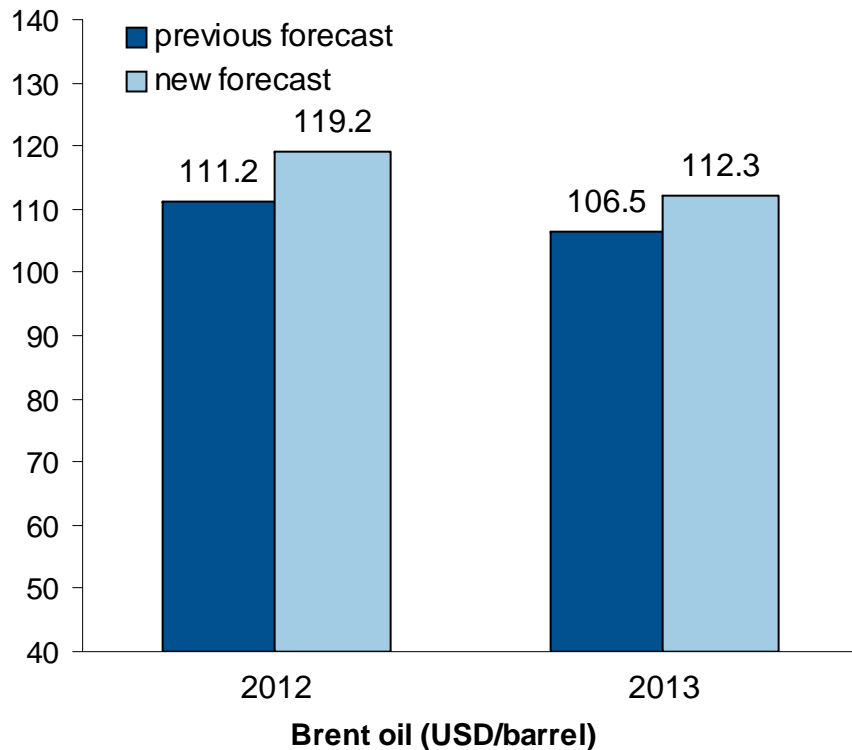
The external environment (i)

Comparison between the assumptions of the new and previous forecasts for the effective euro area

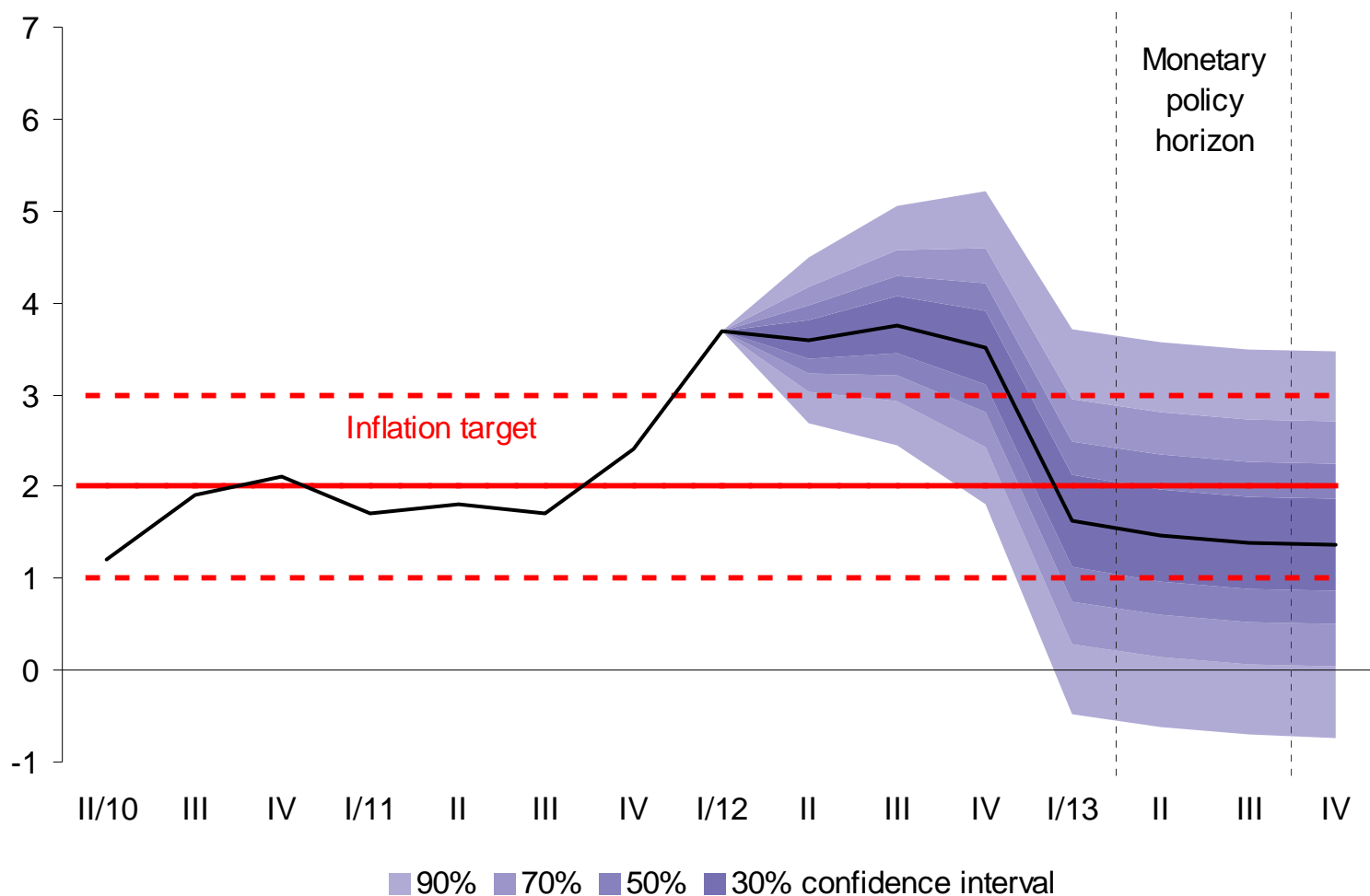


The external environment (ii)

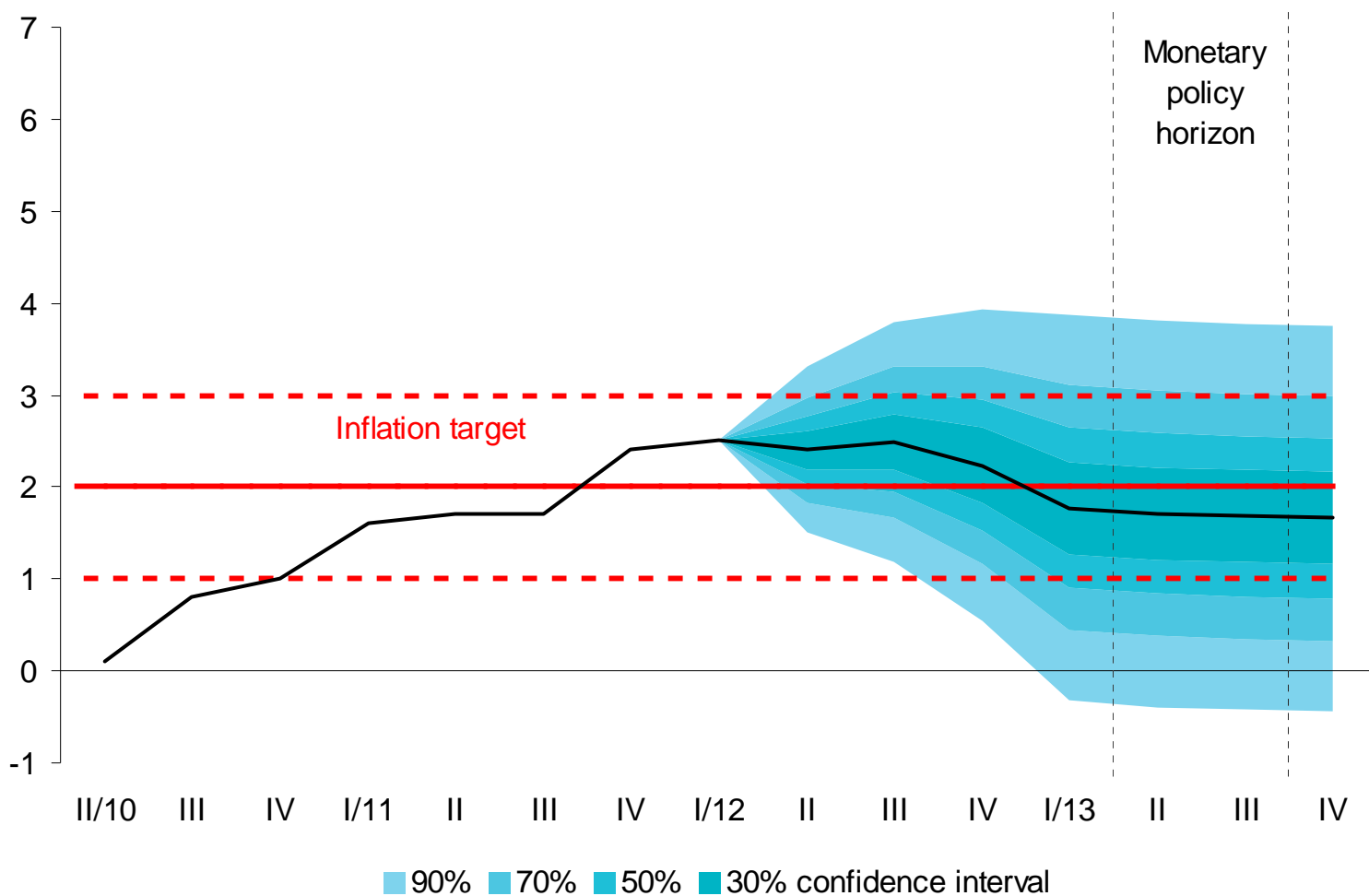
Comparison between the assumptions of the new and previous forecasts



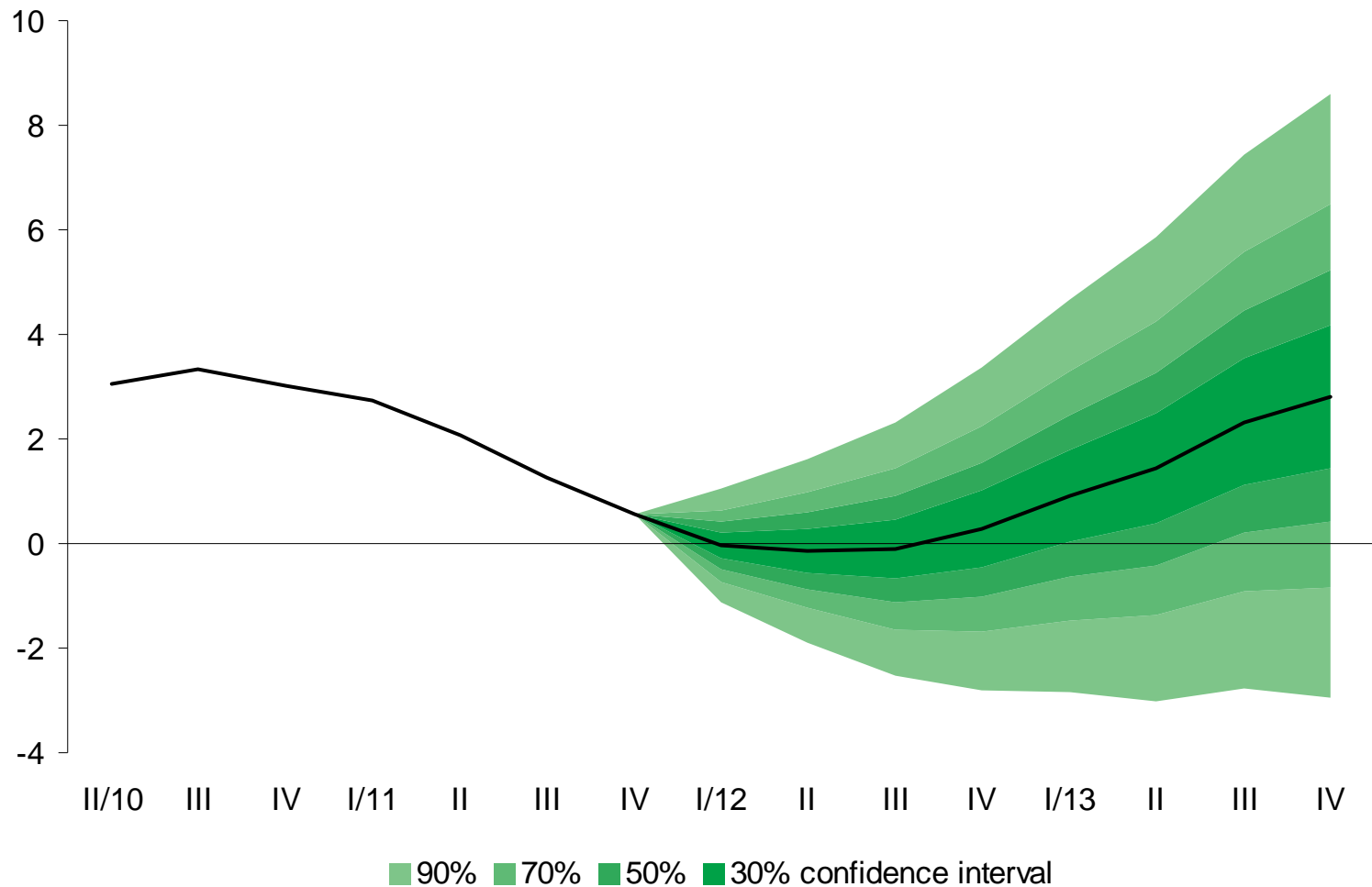
The forecast for headline inflation



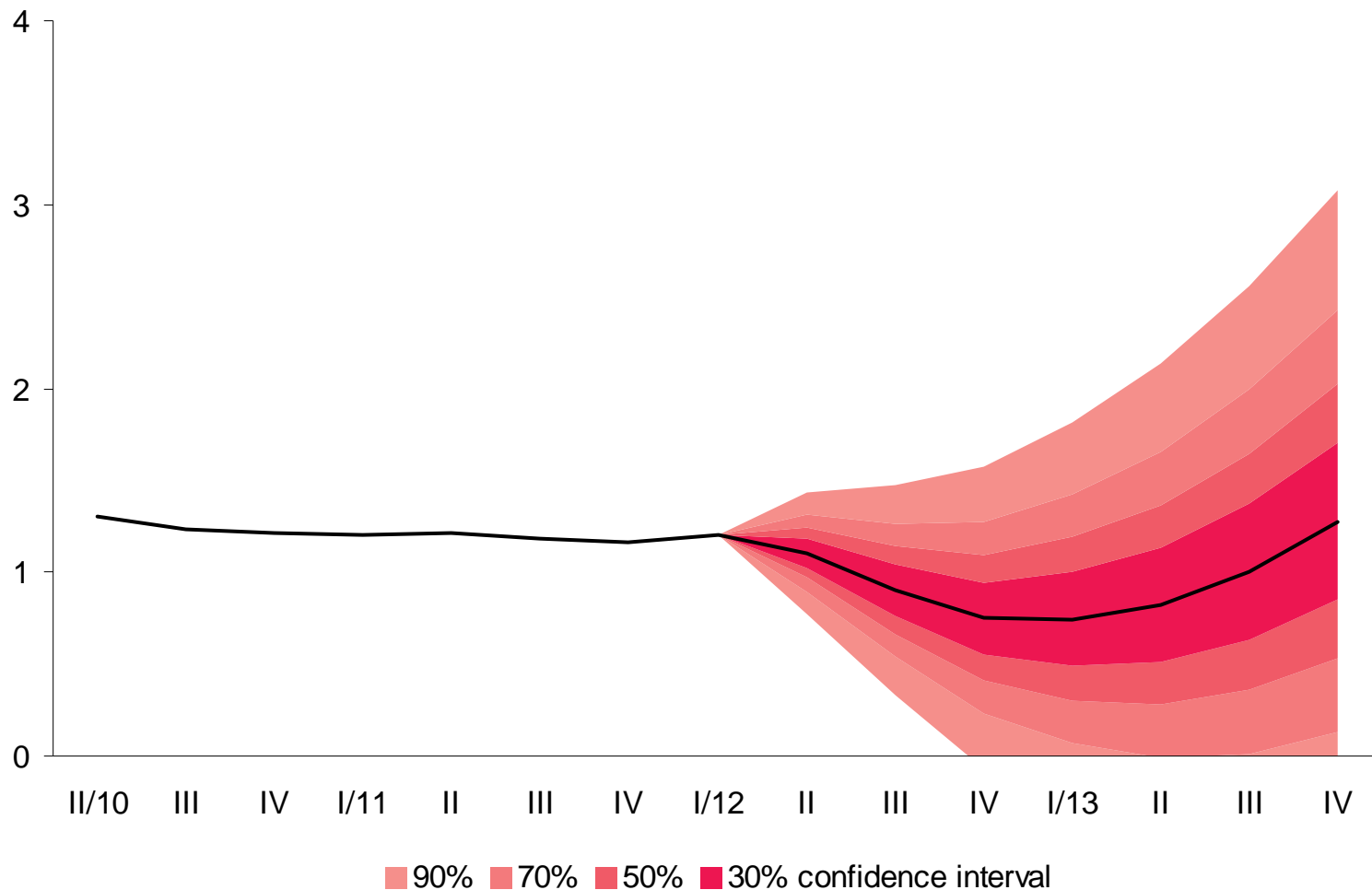
The forecast for monetary-policy relevant inflation



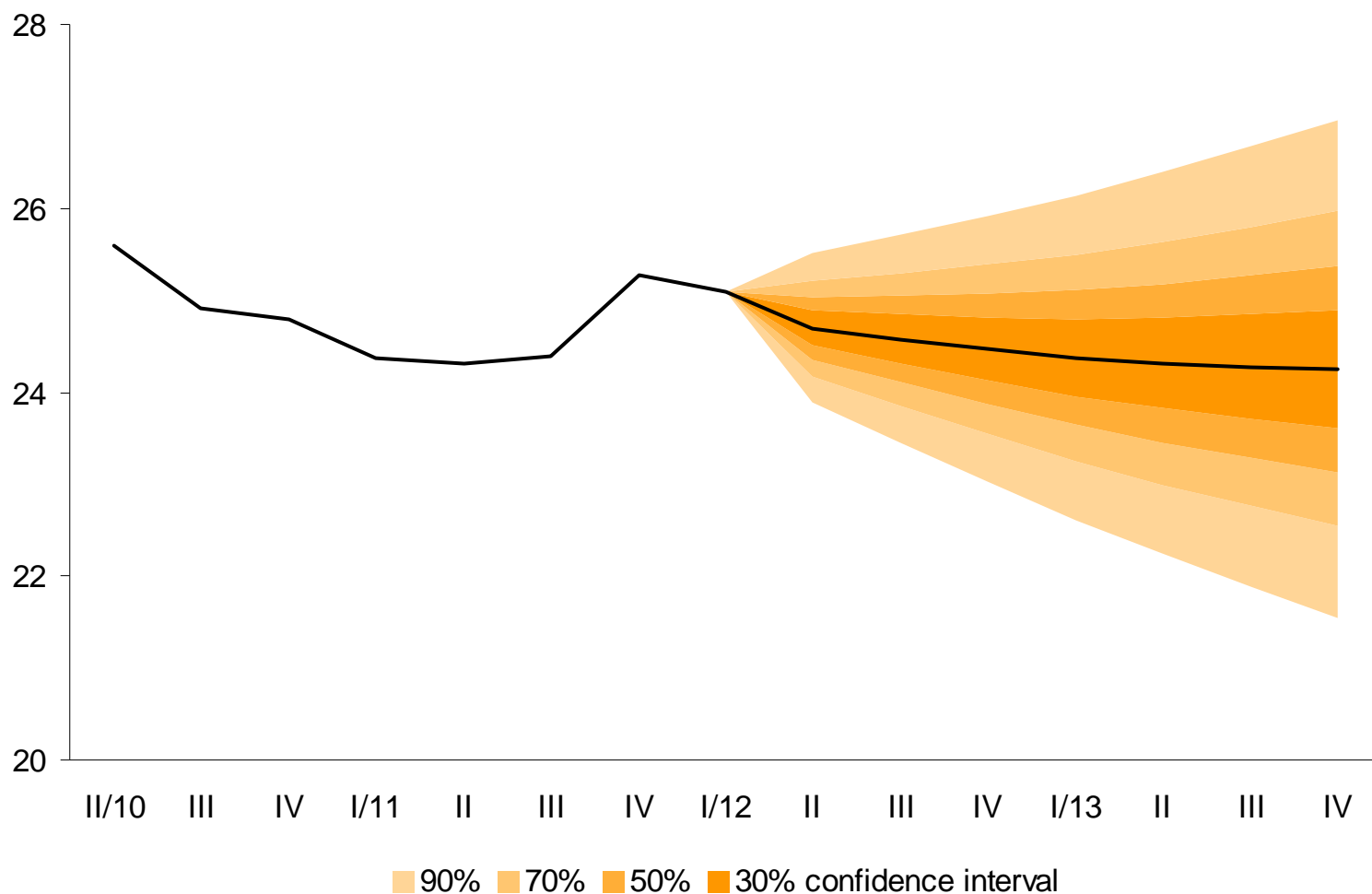
The forecast for GDP



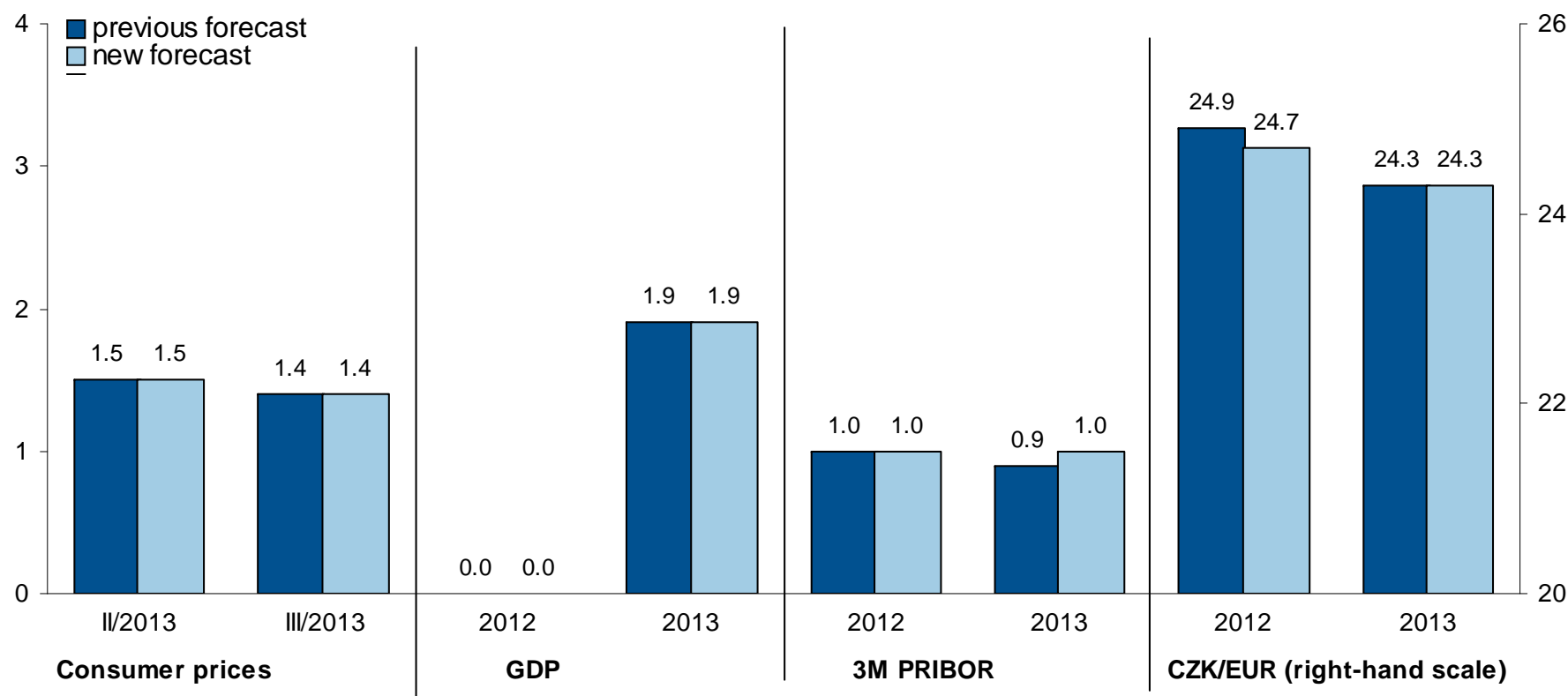
The forecast for interest rates (3M PRIBOR)



The forecast for the CZK/EUR exchange rate (quarterly averages)



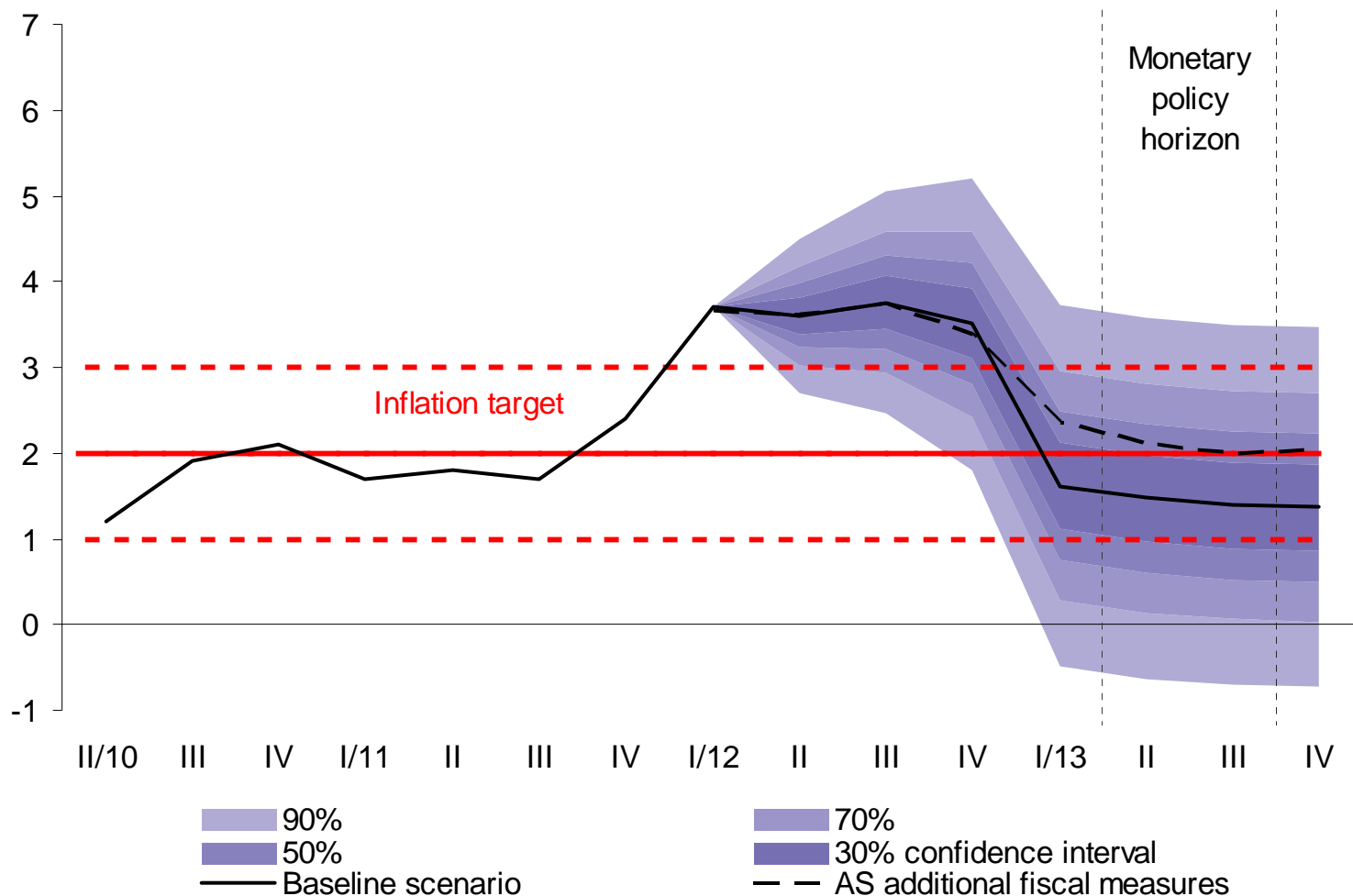
Comparison with the previous forecast



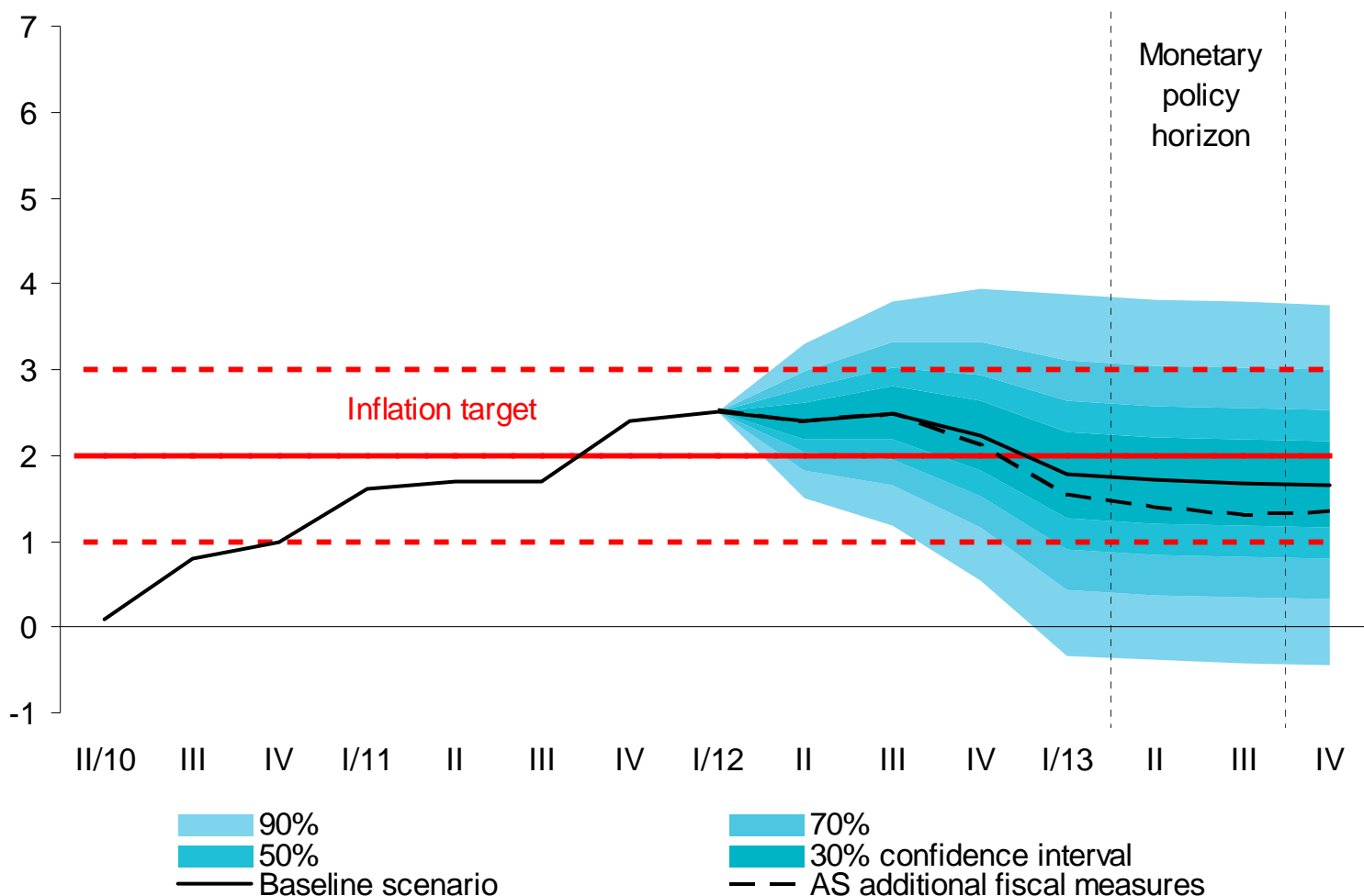
Alternative scenario: additional budgetary measures

- The alternative scenario captures proposed government measures for 2013 aimed at further fiscal consolidation, which for the most part require changes to the legislation in force.
- Fiscal restriction through a rise in both VAT rates and lower nominal disposable income of households will reduce household consumption in particular. This will result in slower GDP growth compared to the baseline scenario.
- The first-round effects of the increase in both VAT rates will cause headline inflation to rise.
- In line with past experience and the subdued economic activity, no significant second-round effects of the VAT rate hike on inflation are expected.
- The lower interest rates from the end of 2012 onwards are thus reacting only to the anti-inflationary pressure (visible in monetary-policy relevant inflation) generated by the slower GDP growth.
- The exchange rate is almost the same as in the baseline scenario.

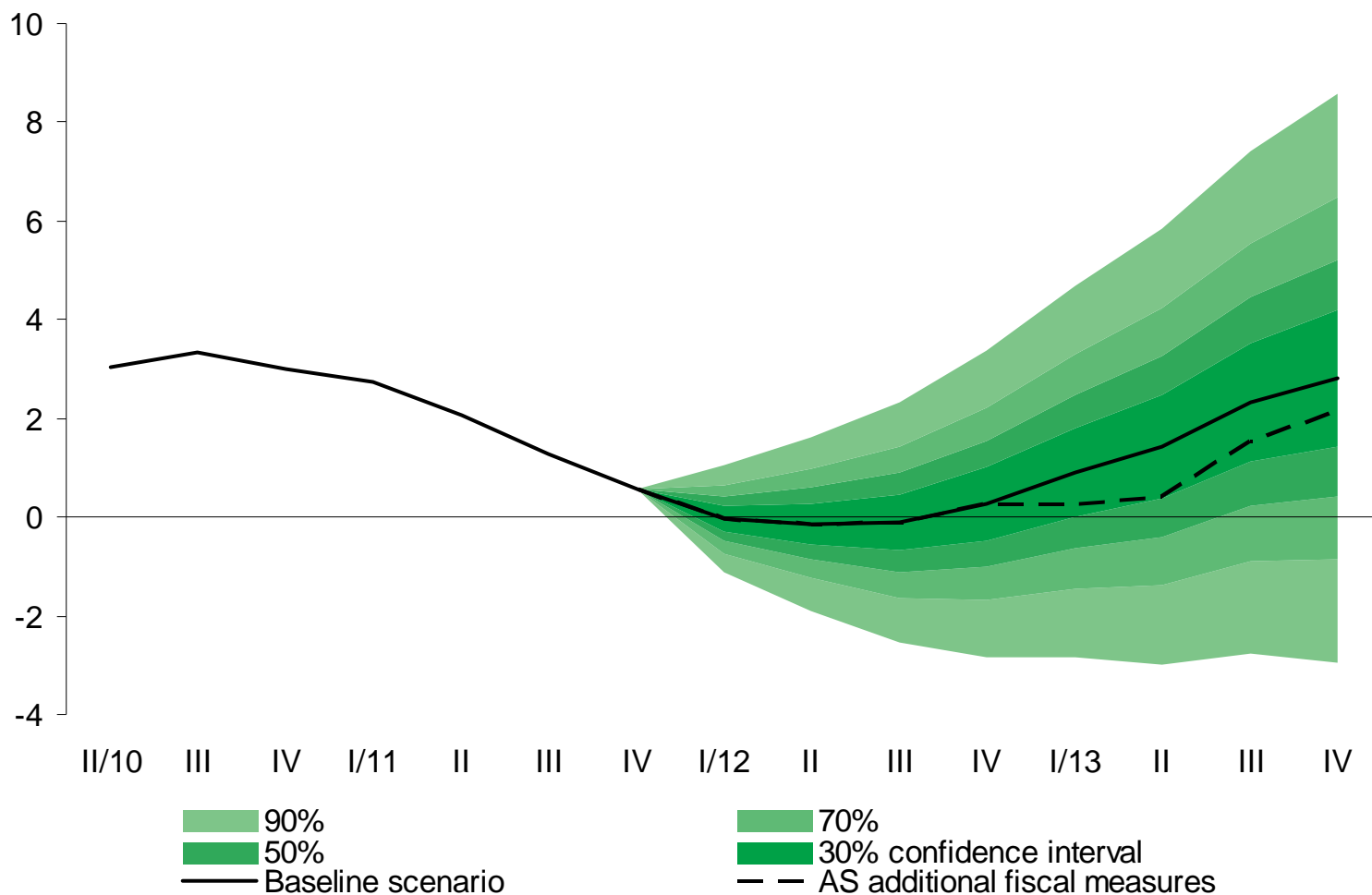
Alternative scenario: additional budgetary measures – headline inflation



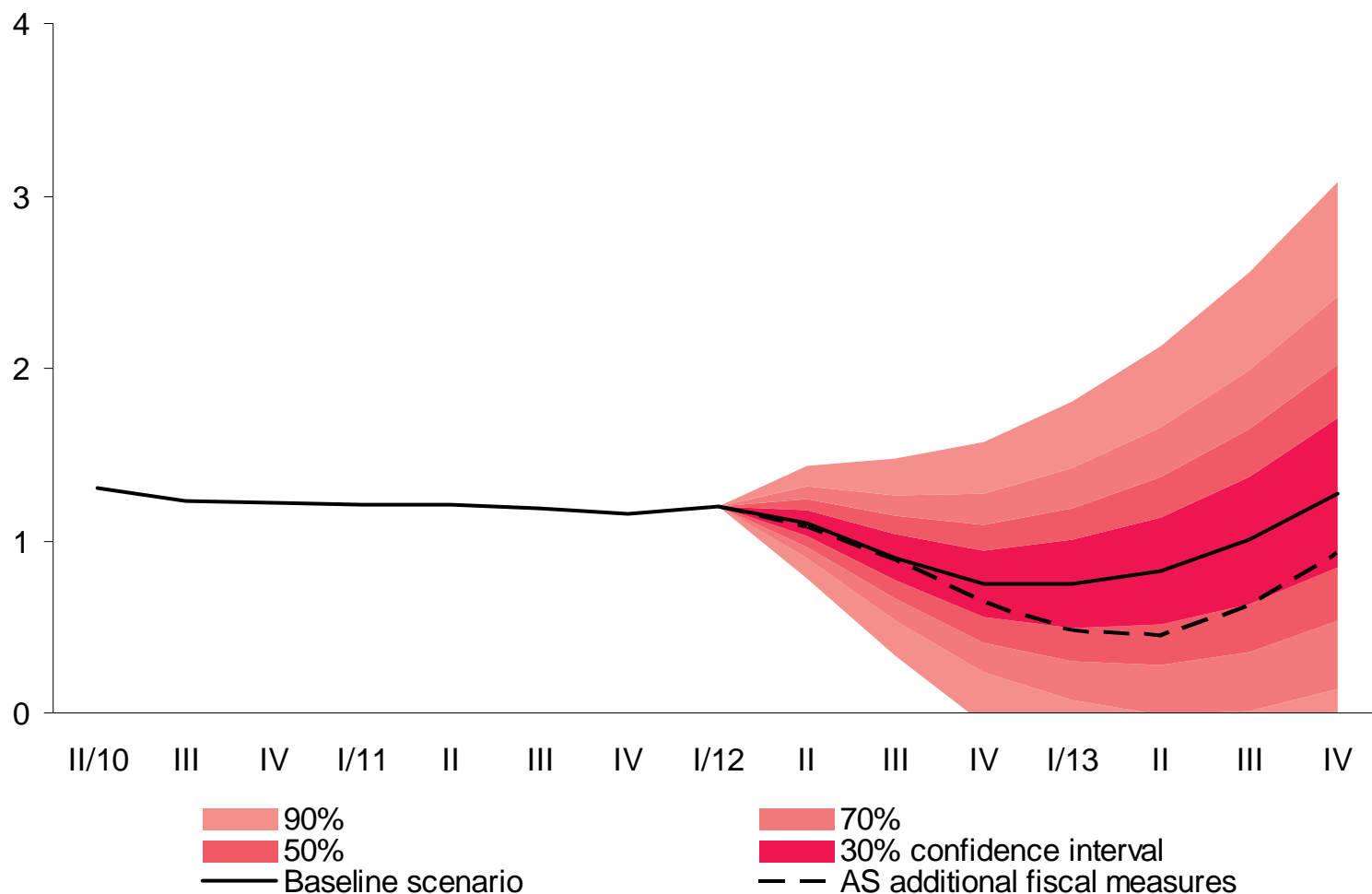
Alternative scenario: additional budgetary measures – monetary-policy relevant inflation



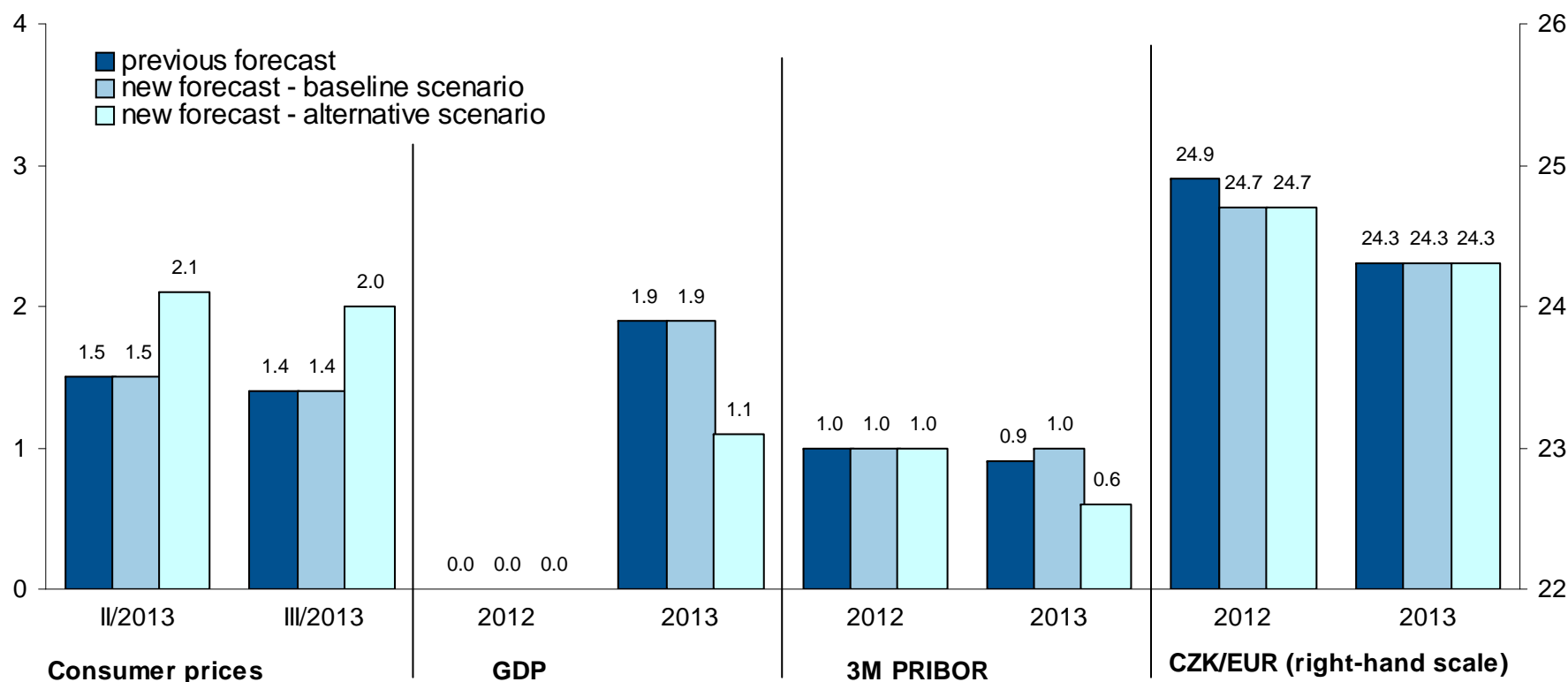
Alternative scenario: additional budgetary measures – GDP



Alternative scenario: additional budgetary measures – 3M PRIBOR



Comparison of the alternative scenario with the baseline scenario and with the previous forecast



Major risks to the forecast

The risks to the forecast are on the upside

Downside risk:

- demand-side impact of the additional fiscal measures (in line with the alternative scenario)

Upside risks:

- potential rise in inflation expectations
- slightly weaker koruna-euro exchange rate
- higher prices of commodities, especially crude oil

Two-sided risk:

- economic developments abroad



Thank you for your attention

More information about the forecast
can be found at

http://www.cnb.cz/en/monetary_policy/forecast/

and in Inflation Report II/2012,
to be published 11 May 2012.