

CNB's New Forecast

April 2007

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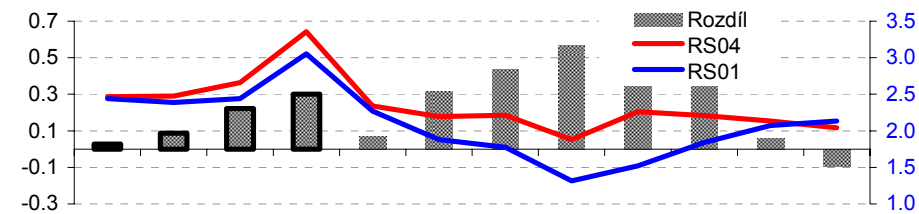
Meeting with analysts, Prague, 4 May 2007

Outline

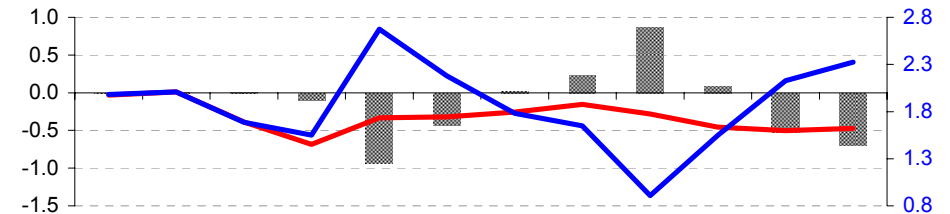
- External assumptions;
- Recent trends in inflation + new basket;
- Economic growth and labour market;
- Fiscal policy;
- Regulated prices and energy prices;
- Exchange rate and imported inflation;
- Forecast of GDP and inflation;
- Changes in MP framework; Fiscal reform.

External Assumptions (CF03)

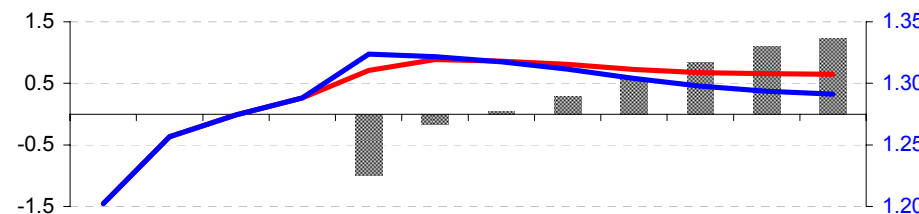
(difference in p.p.) **Eurozone effective GDP** (y/y)



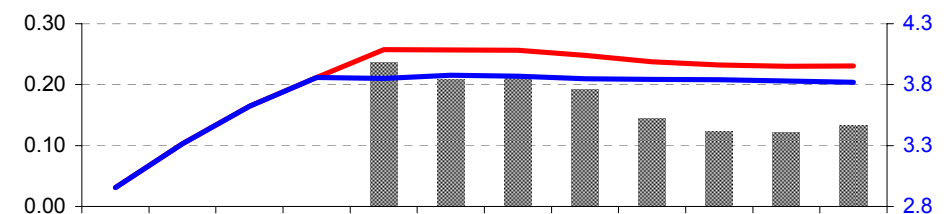
(difference in p.p.) **Eurozone effective CPI** (y/y)



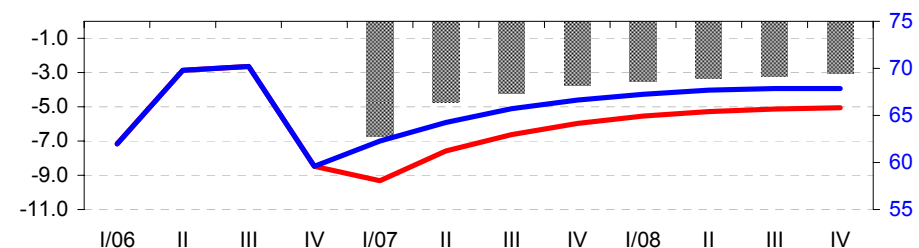
(difference in %) **USD/EUR** (USD/EUR)



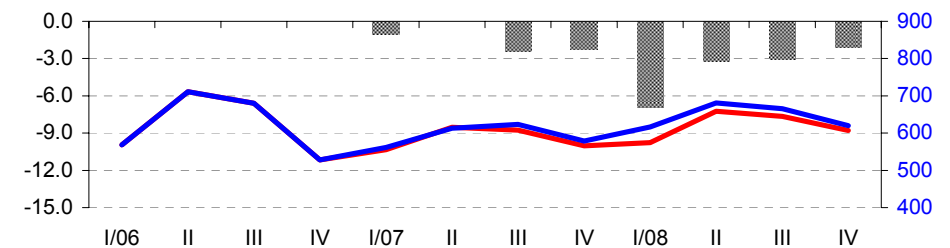
(difference in p.p.) **1Y Euribor** (% p.a.)



(difference in %) **Price of oil Brent** (USD/barrel)

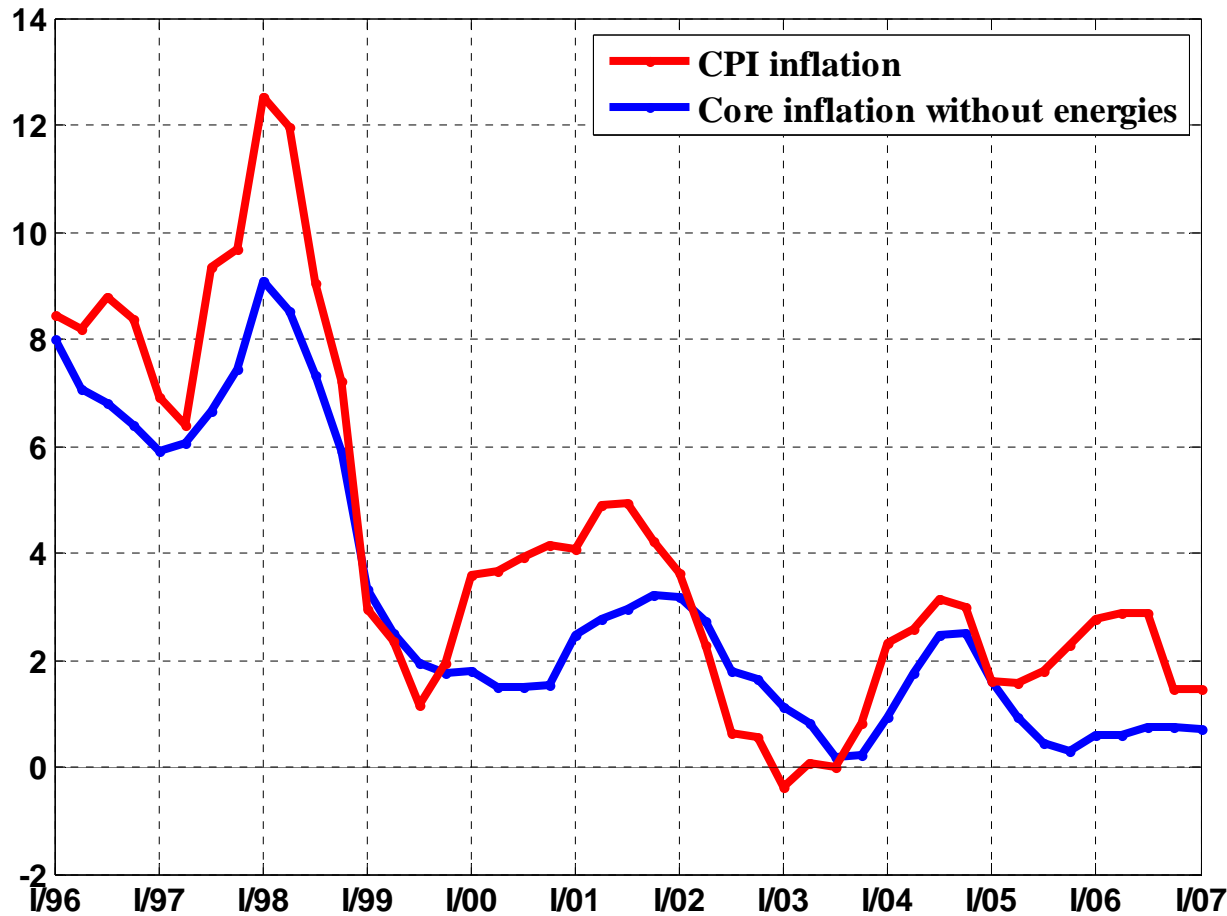


(difference in %) **Petrol price** (USD/1000kg)



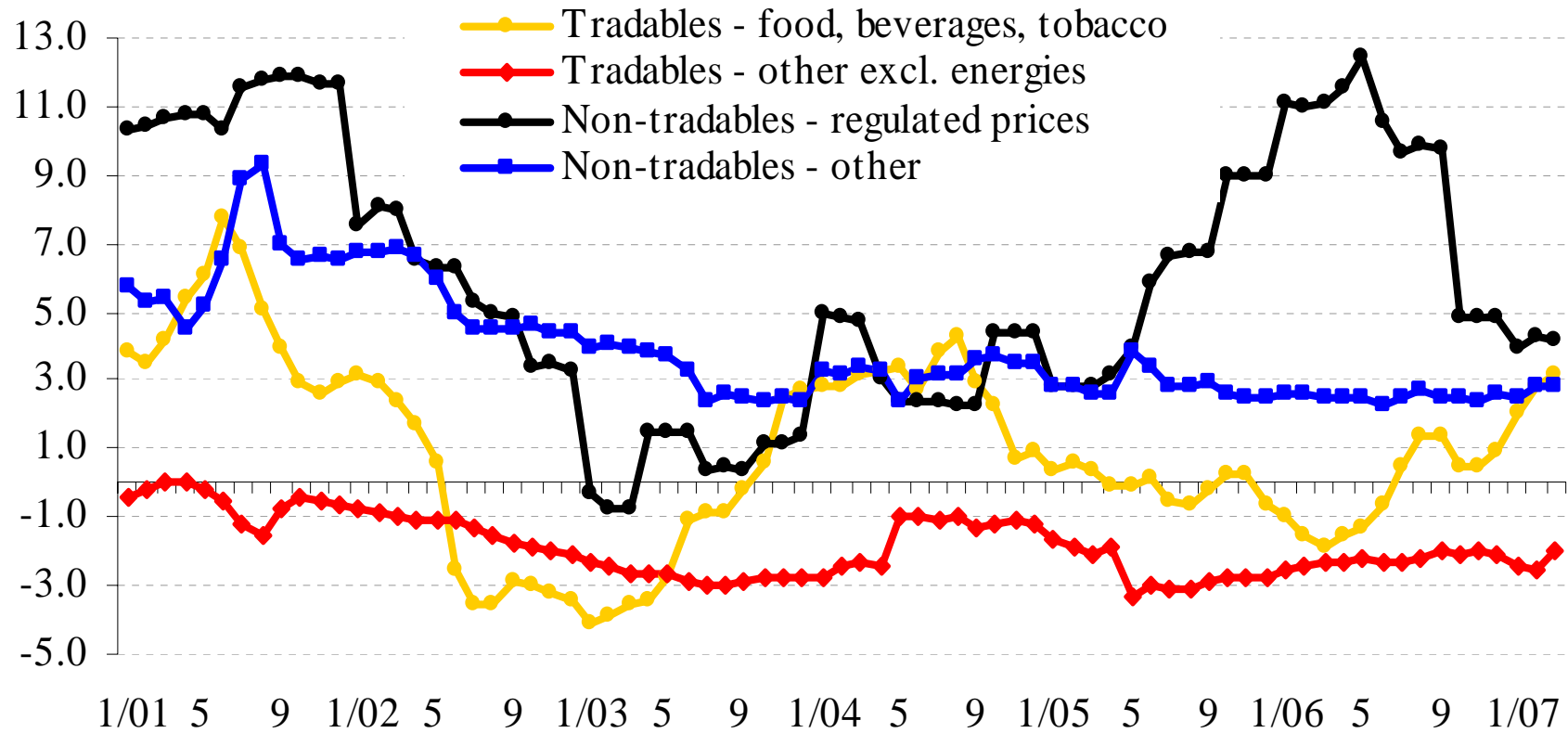
- Little impact on CPI forecast, ↑ impact on output gap and interest rate trajectory.

Inflation



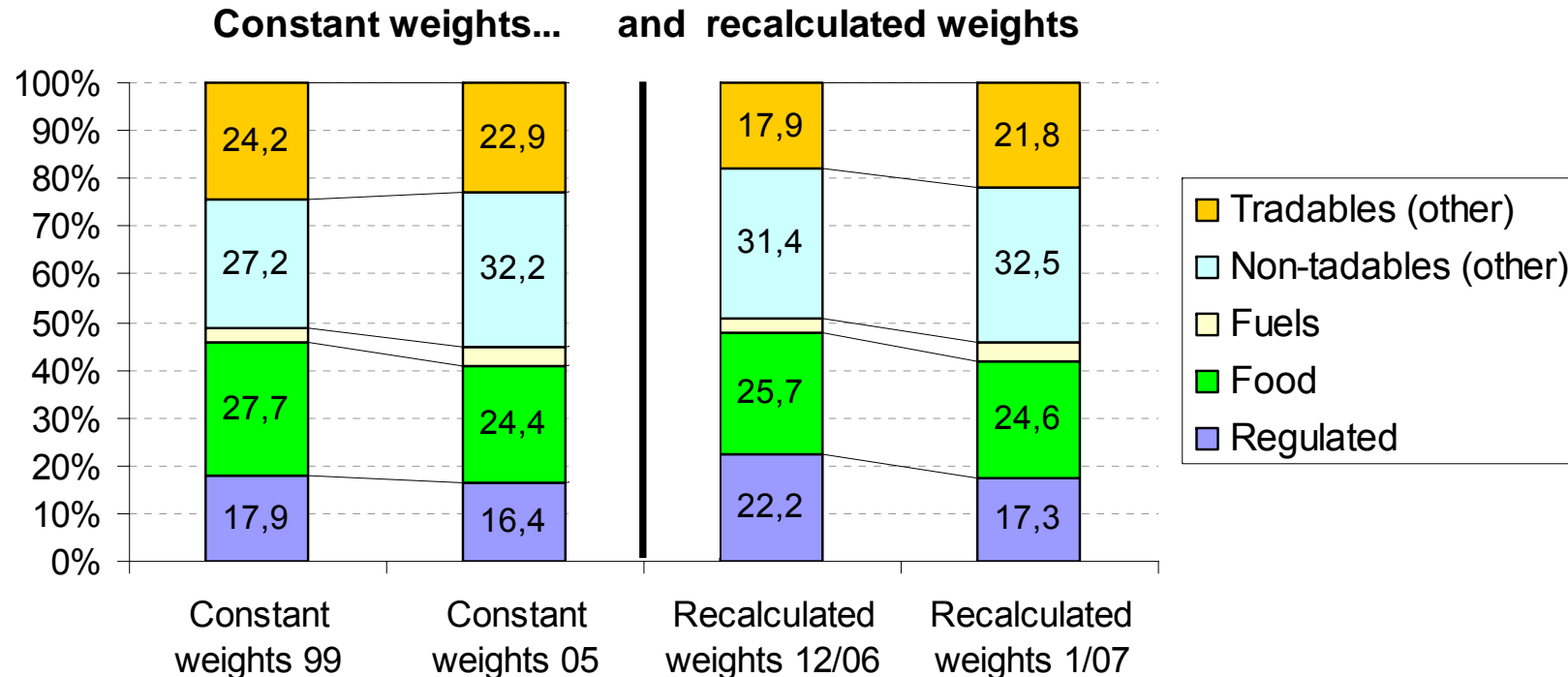
- Inflation in Q1/07 below the January forecast (in March already close to the forecast);
- Core inflation remains low, below the forecast;
- Pressures from the real economy offset by past CZK appreciation (+new basket).

Structure of Inflation (without taxes)



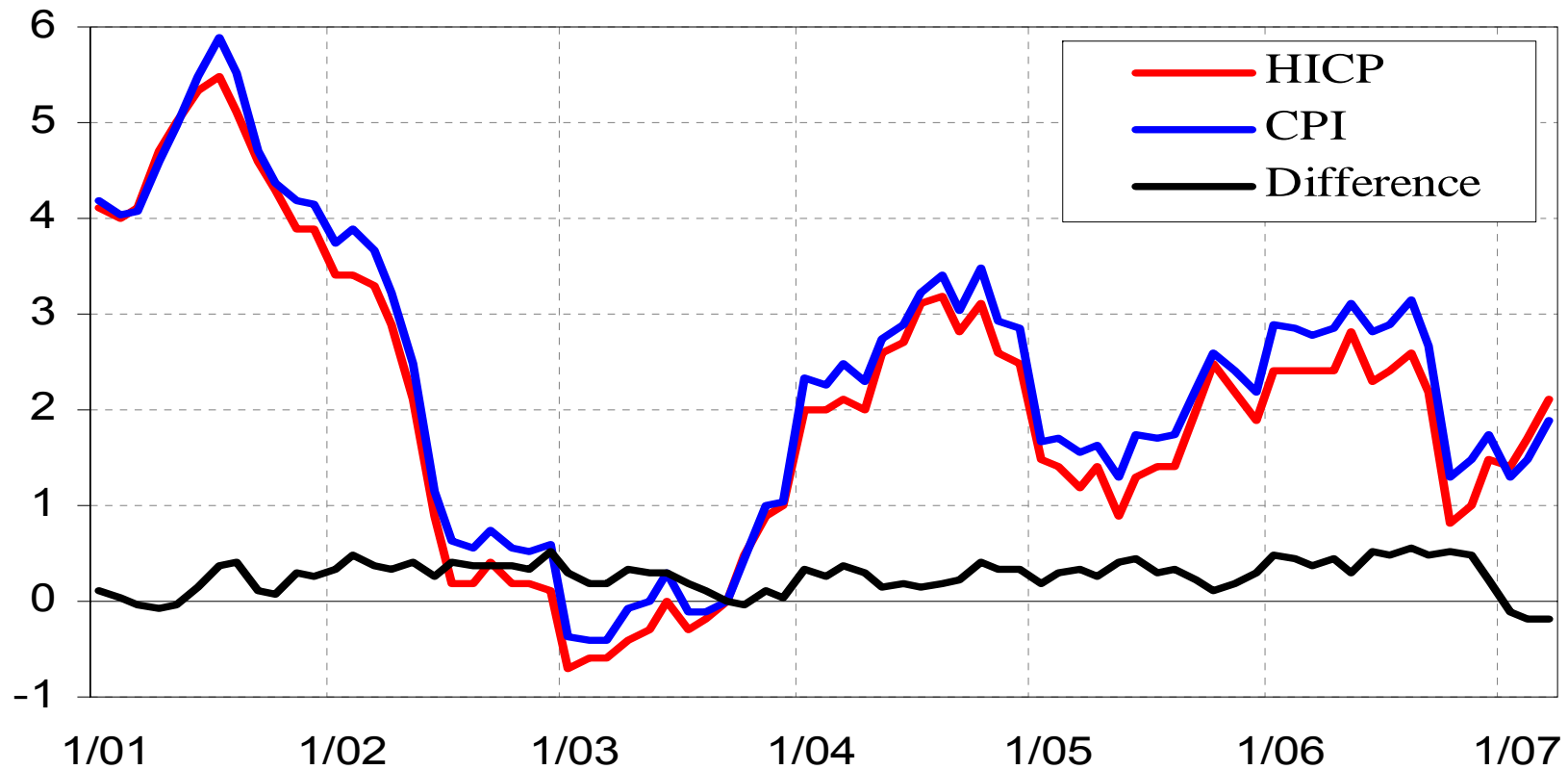
- Food price growth accelerating (above forecast).

New CPI Basket



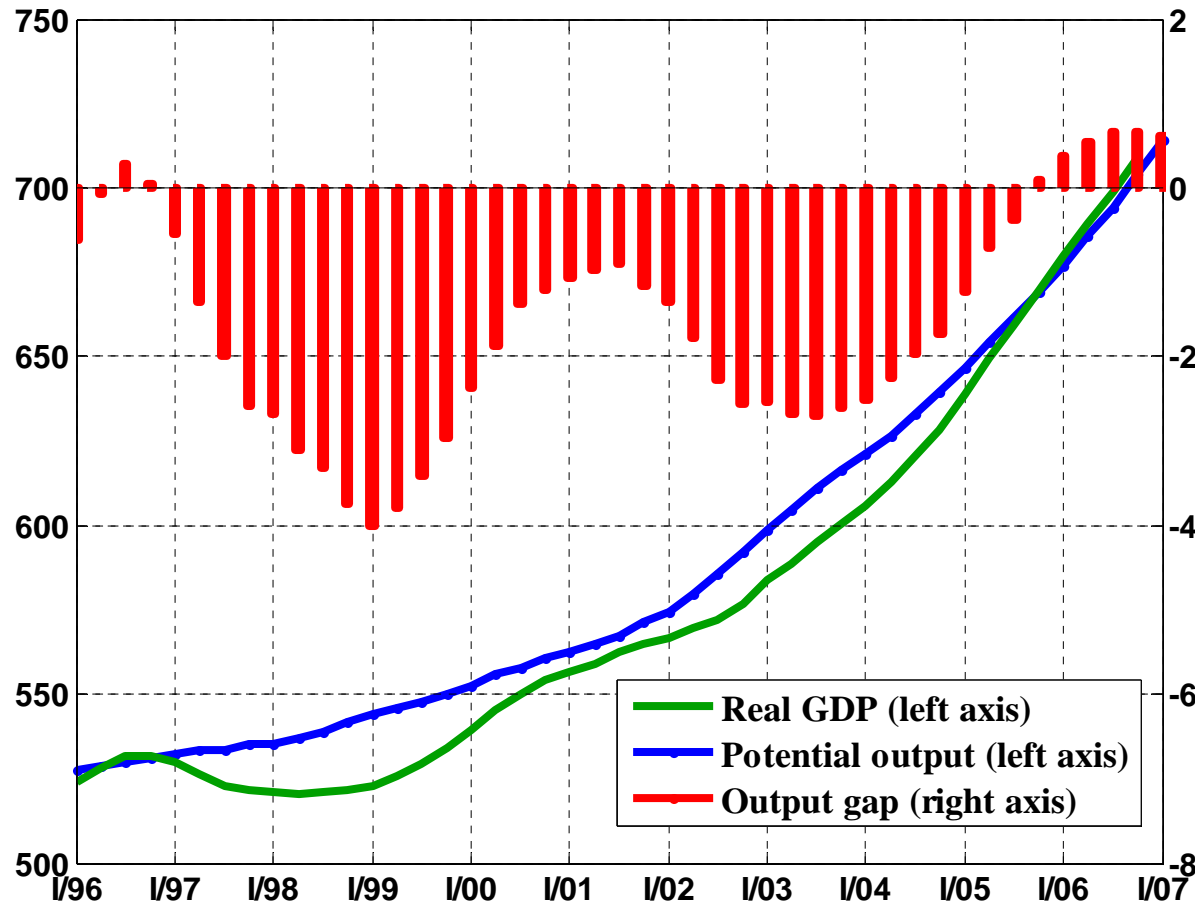
- Lower (recalculated) weight of regulated and food prices;
- Higher weight of core inflation, especially tradables;
- Impact on inflation in January-March 2007: ↓ 0.2-0.3 p.p.

CPI vs. HICP Inflation



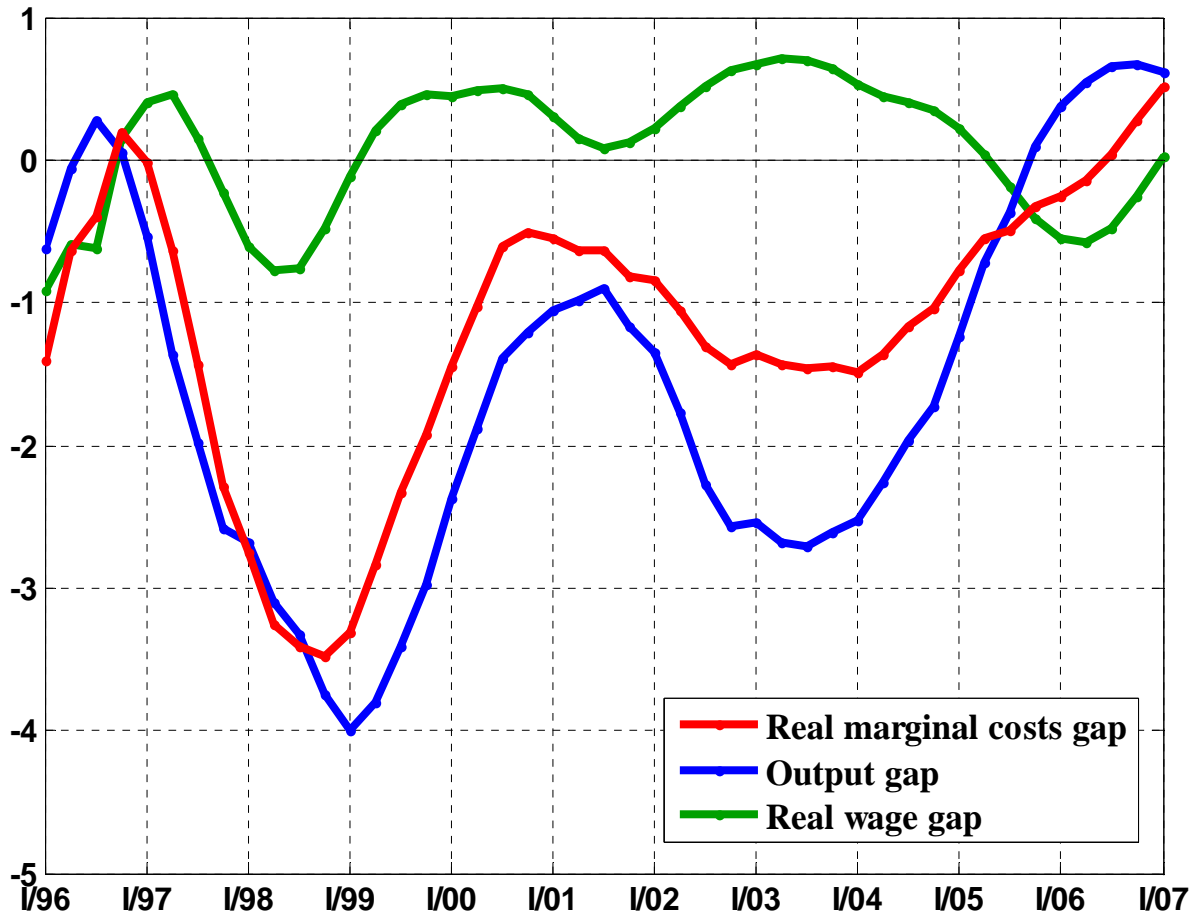
- CPI inflation has fallen below HICP (1.9 % vs. 2.1 %).

GDP – Actual and Potential



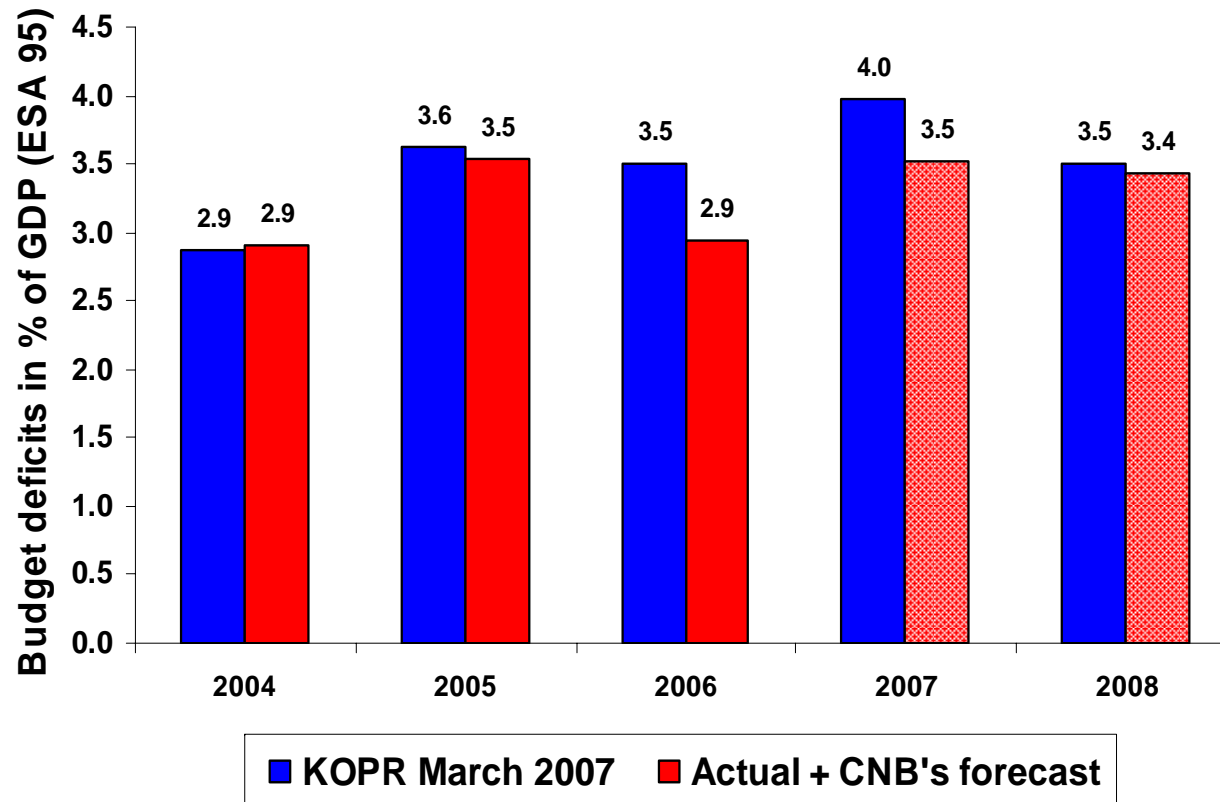
- The economy slightly above its non-inflationary potential (0.6 %) for six quarters;
- Acceleration in household consumption;
- Monetary conditions neutral.

Pressures from the Real Economy



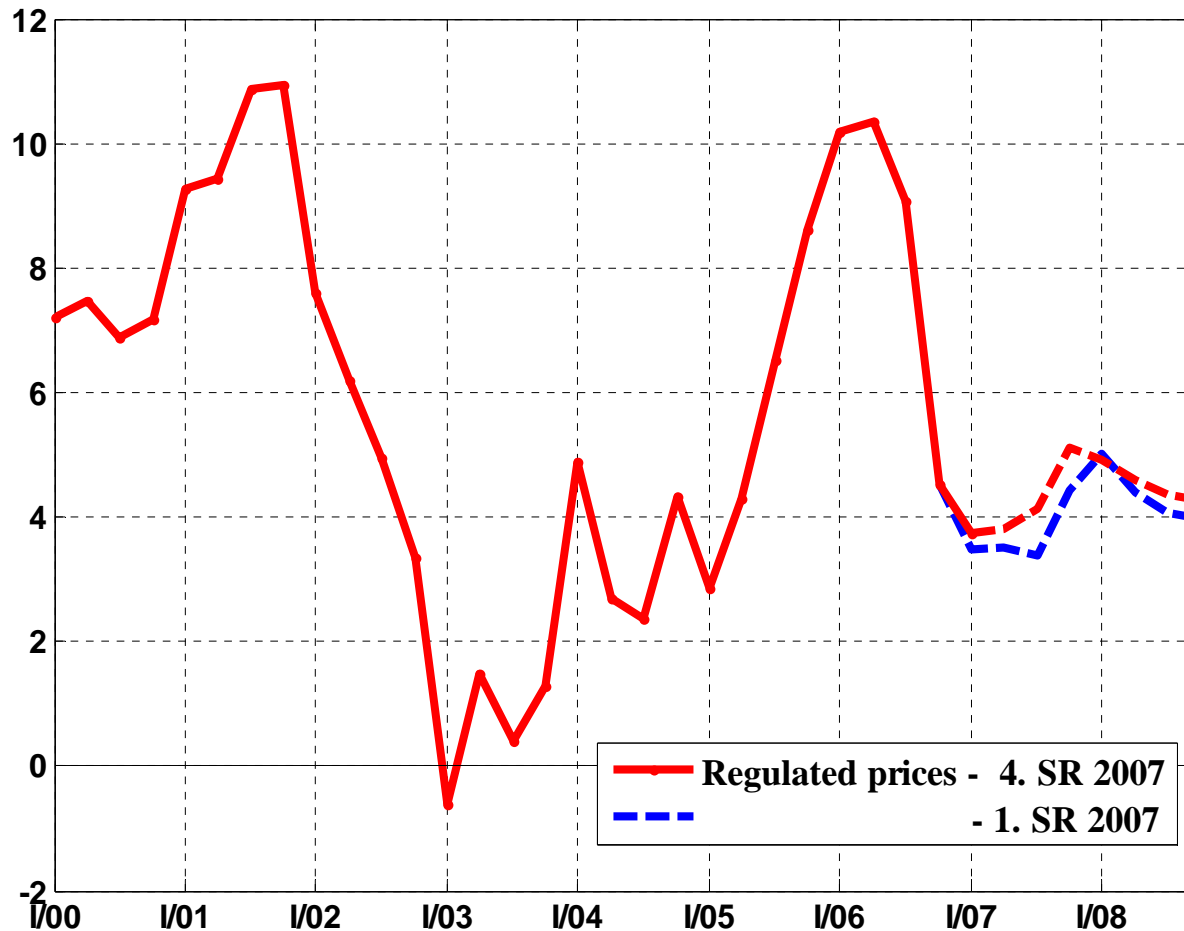
- Impact of real wages neutral;
- Real wage growth accelerated due to low inflation in Q4/06 and Q1/07;
- Fast decline in unemployment.

Fiscal Situation



- Deficit in 2006 lower than previously thought;
- CNB's forecast for 2007-08 lowered accordingly;
- Fiscal impulse similar to the January forecast (expansion mainly in 2007).

Regulated Prices



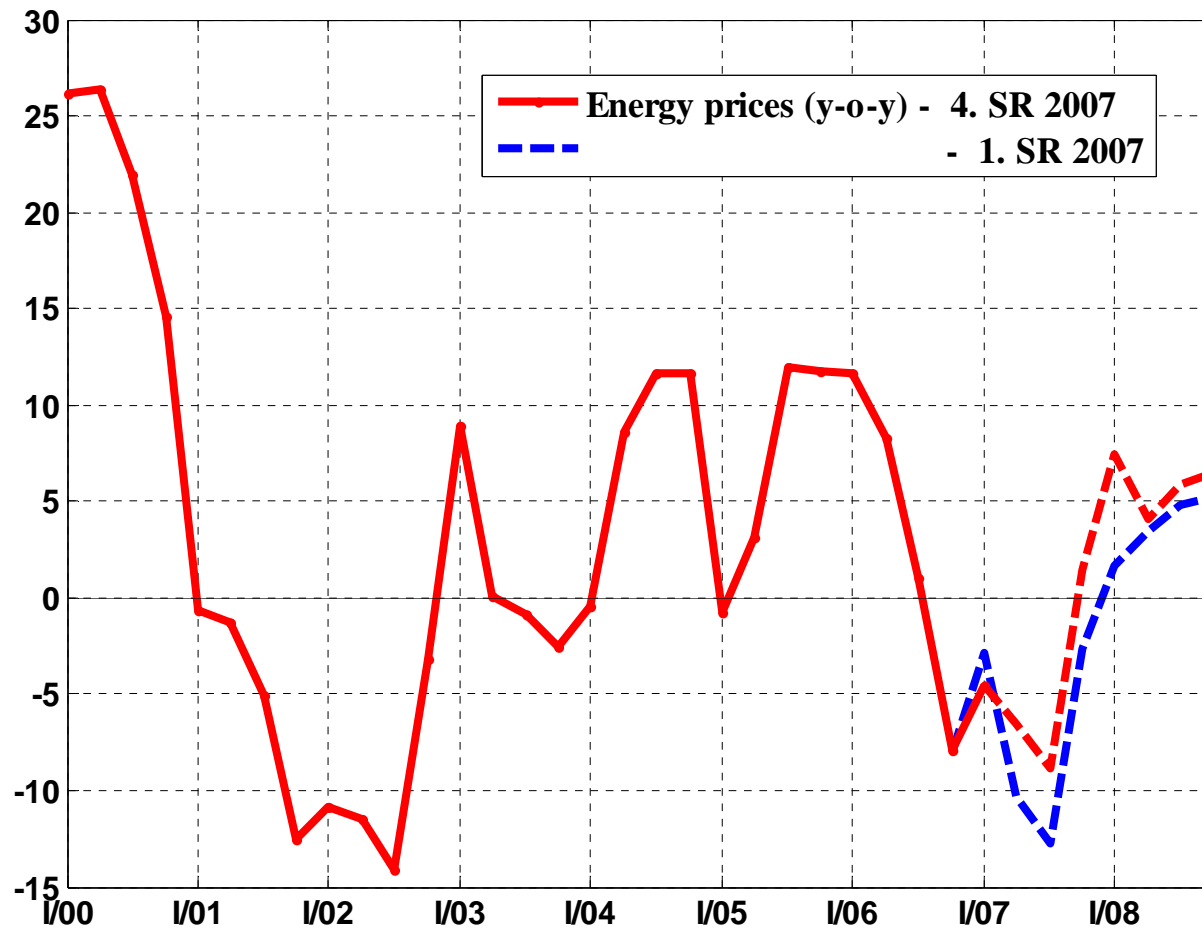
- Forecast of y/y growth rate slightly increased, but contribution to inflation actually lowered (new basket);
- Together with taxes, contribution to inflation: 2.0 p.p. end-2007, 1.2 p.p. end-2008.

Administrative Measures

(selected items and total impact)

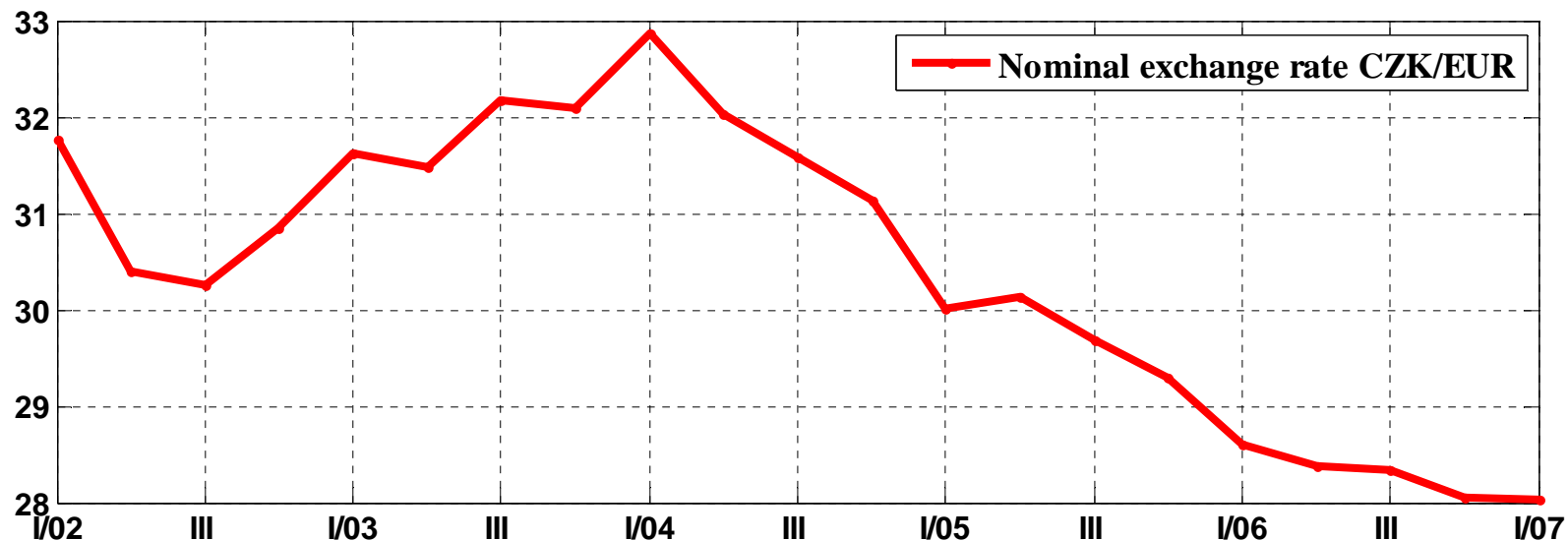
Year/date	Indirect taxes		Regulated prices		
	Item	Impact on CPI inflation	Item	Change in price	Impact on CPI Inflation
2006-Total		0,16 p.p.		4.9%	1,08 p.p.
2007	Excise duties on tobacco products	1,09 p.p.	Electricity	7.9%	0,30 p.p.
1Q 2007	(delayed impact: 1Q+2Q+3Q)		TV	20.0%	0,08 p.p.
			Regulated rents	17.0%	0,26 p.p.
			Heating	2.5%	0,08 p.p.
Total		1,09 p.p.		5.4%	0,91 p.p.
2008	Excise duties on tobacco products	0,40 p.p.	Electricity	7.0%	0,27 p.p.
1Q 2008	(delayed impact: 1Q+2Q)		TV	12.5%	0,06 p.p.
			Regulated rents	15.0%	0,26 p.p.
			Heating	1.5%	0,05 p.p.
Total		0,40 p.p.		4.4%	0,76 p.p.

Energy Prices



- Forecast slightly increased due to near-term indicators and exchange rate (vs. lower outlook for oil prices).

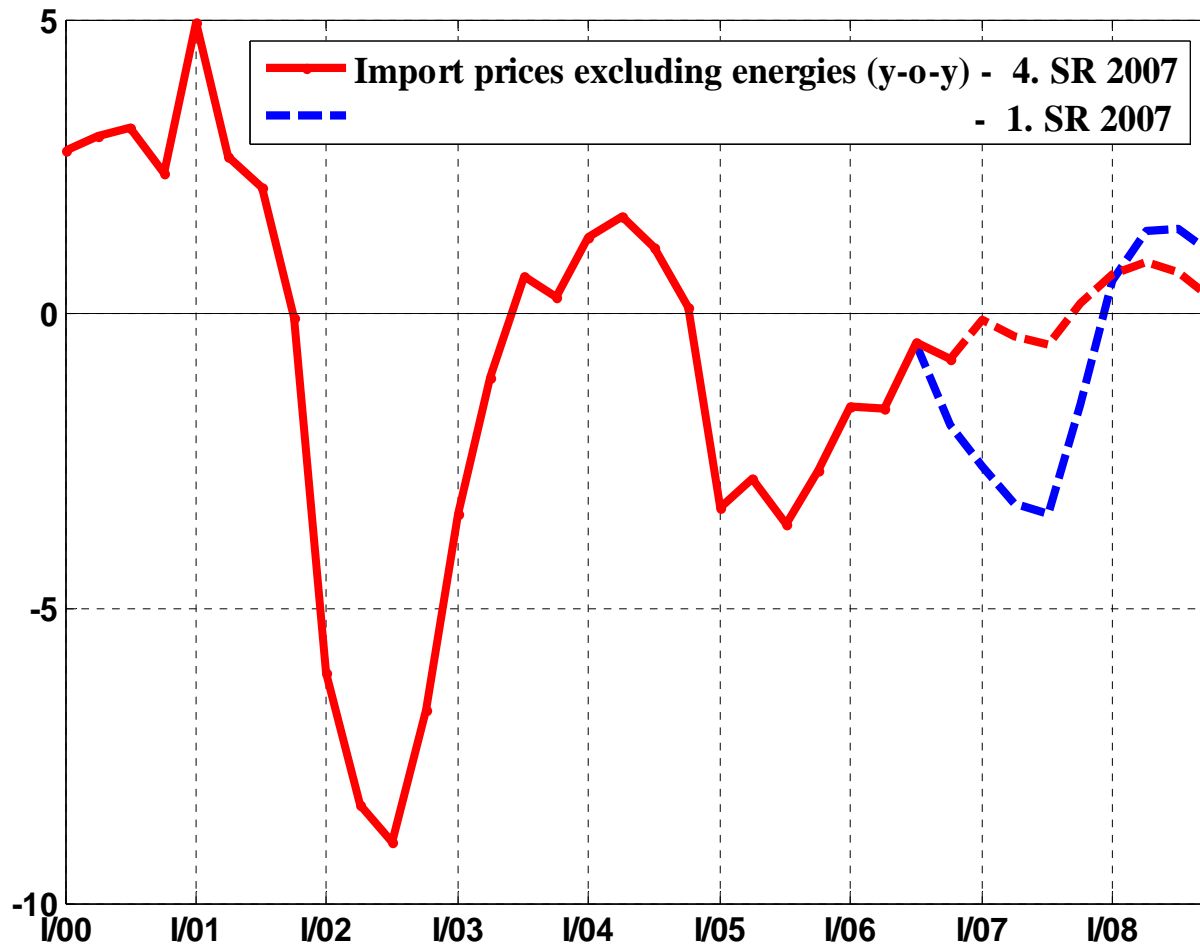
Exchange Rate



External forecasts of CZK/EUR

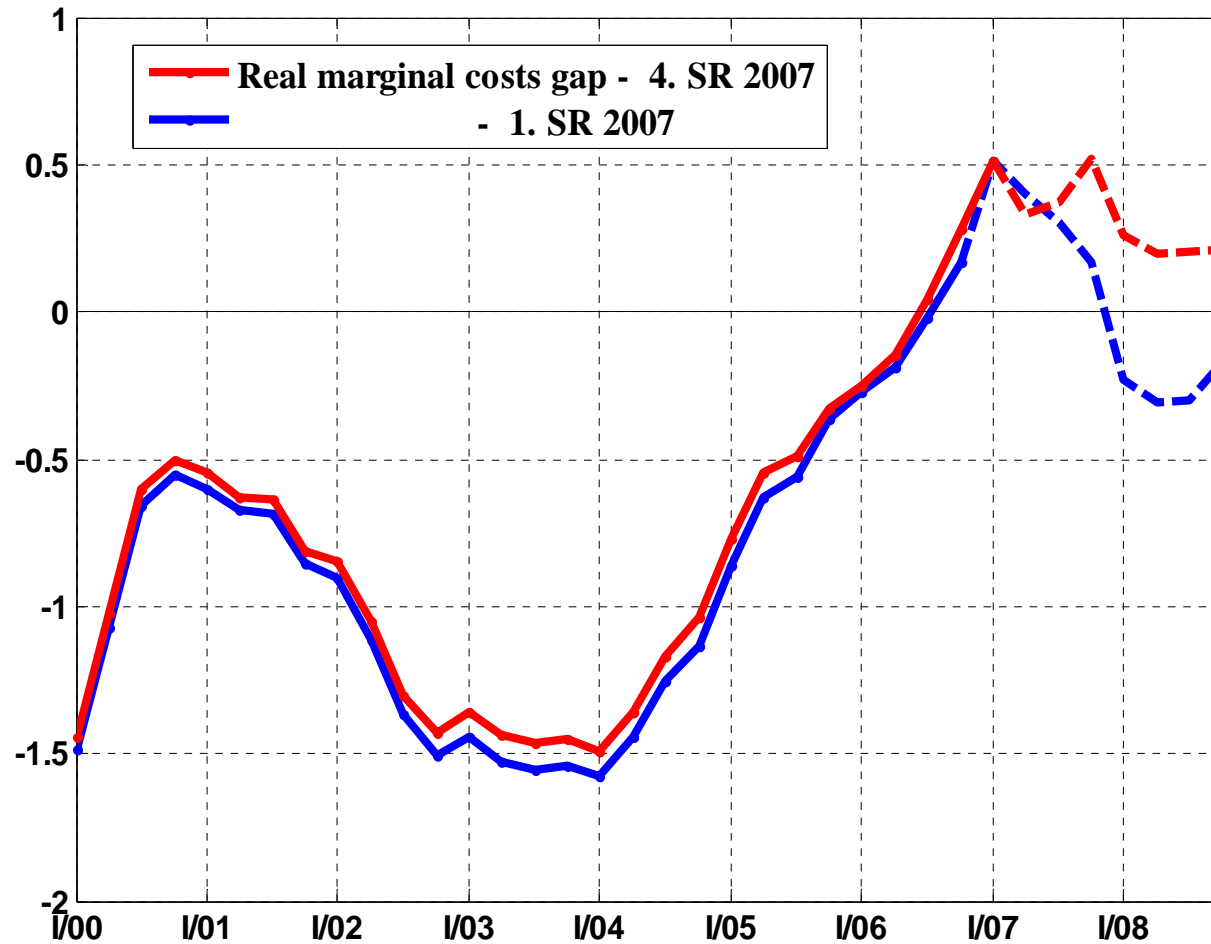
Date of forecast	Next quarter	1Y horizon	
	CF	Financial market	CF
4/06	28.7	27.9	28.2
7/06	28.5	27.7	28.0
10/06	28.2	27.6	27.8
1/07	27.5	27.1	27.6
4/07	28.0 (2Q07)	27.2	27.7

Import Prices excl. Energy



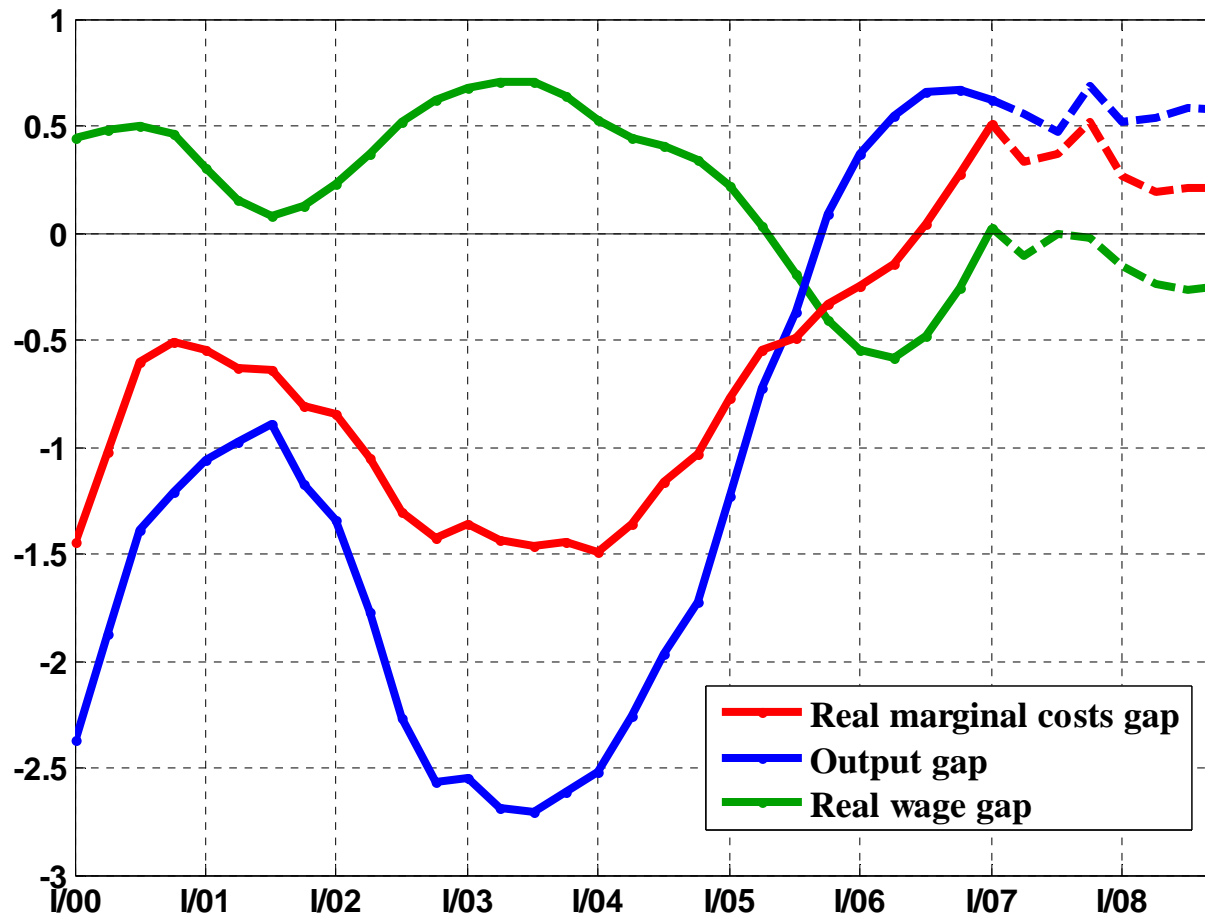
- Revised to less anti-inflationary for 2007;
- Impact of recent data and CZK's correction in early-2007.

Pressures from the Real Economy



- Slightly pro-inflationary pressures from the real economy on the whole forecast horizon.

Pressures from the Real Economy



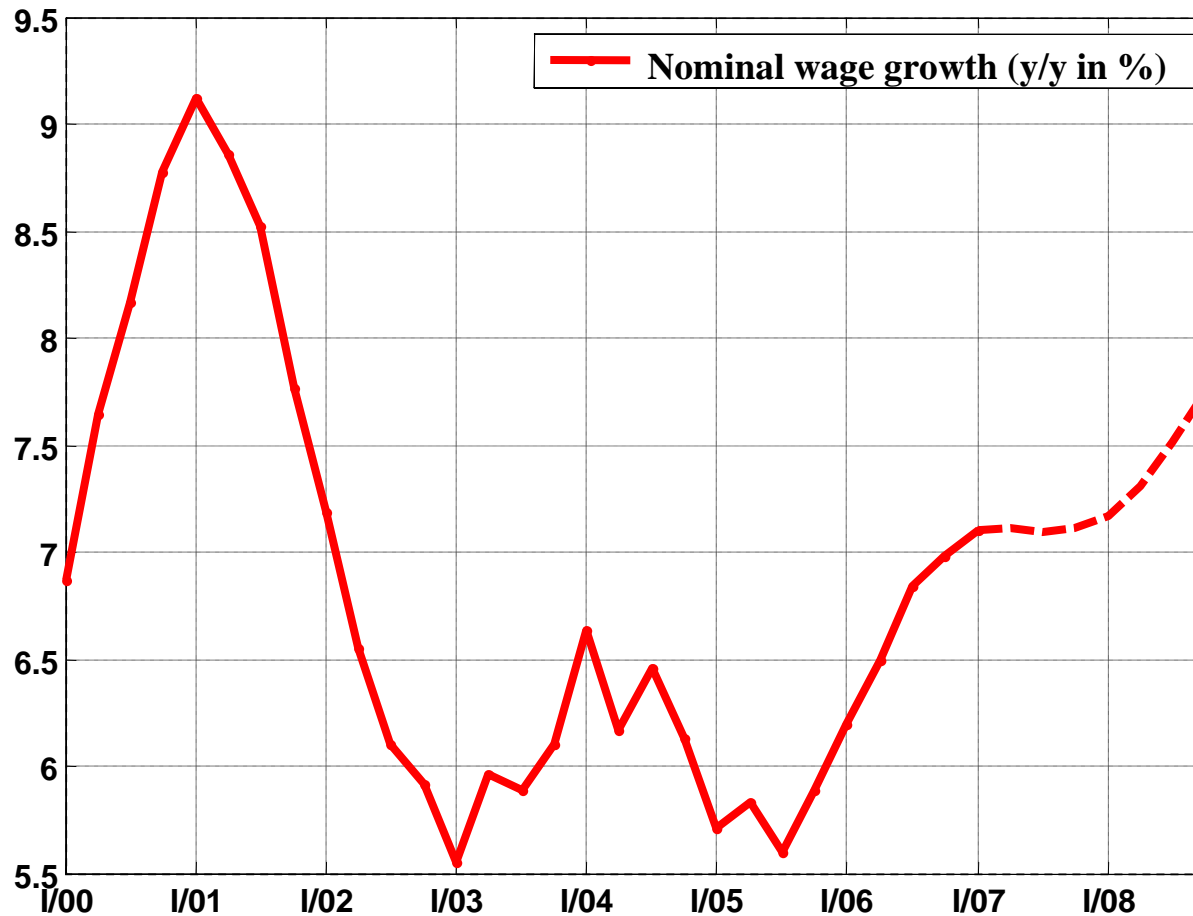
- Output gap will remain close to current level (fiscal impulse, stability of CZK in 2007, more optimism on EU growth);
- Real wages neutral in 2007 and slightly anti-inflationary in 2008.

GDP Growth Forecast

y/y change	2006	2007	2008
Gross domestic product	6.1	5.7	5.3
Household consumption	4.6	5.6	4.1
Government consumption	0.3	1.0	0.9
Fixed investment	7.3	7.9	7.9
Exports	14.6	12.7	13.2
Imports	14.2	12.1	12.7

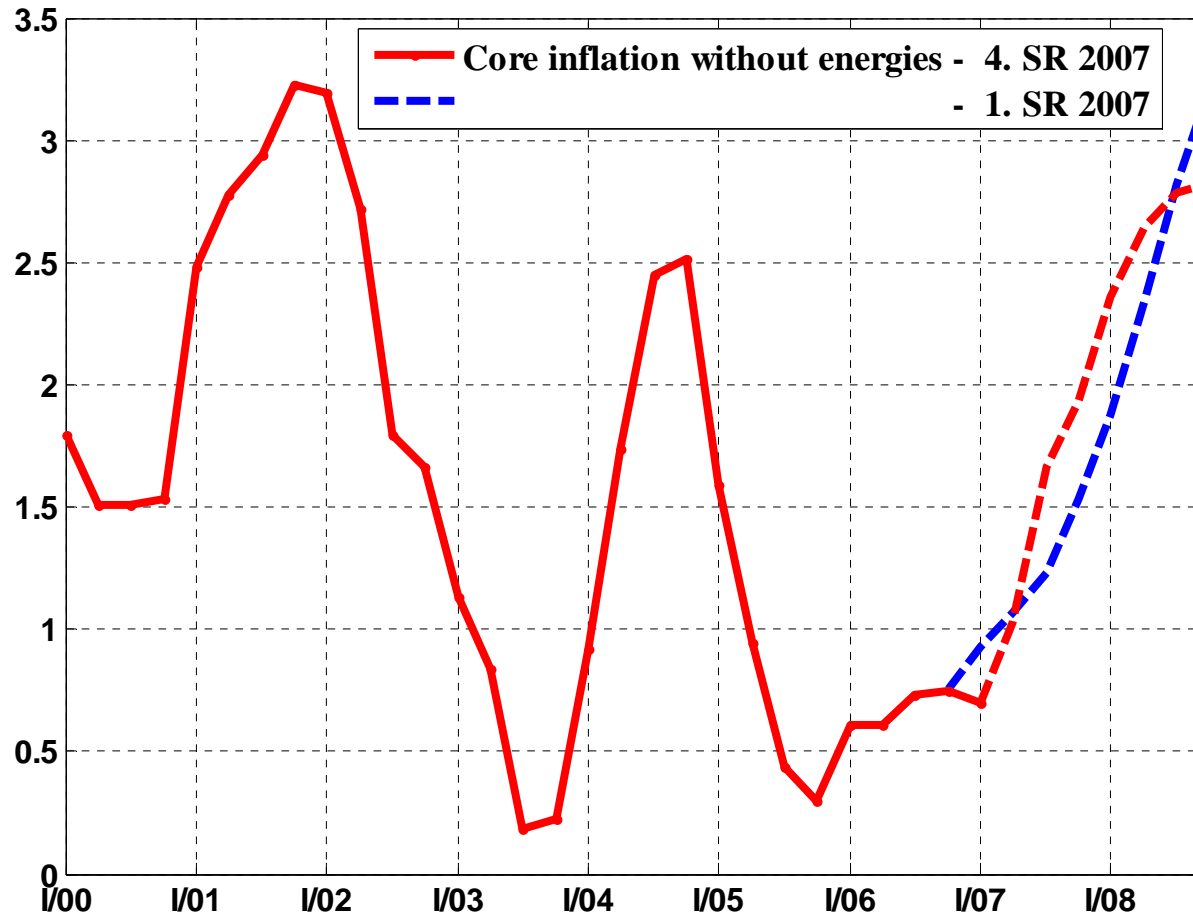
- GDP growth revised up by 0.4-0.5 p.p. for 2007-08;
- Higher household consumption growth, exports and imports;
- Main contribution to growth from domestic demand.

Nominal Wage Growth



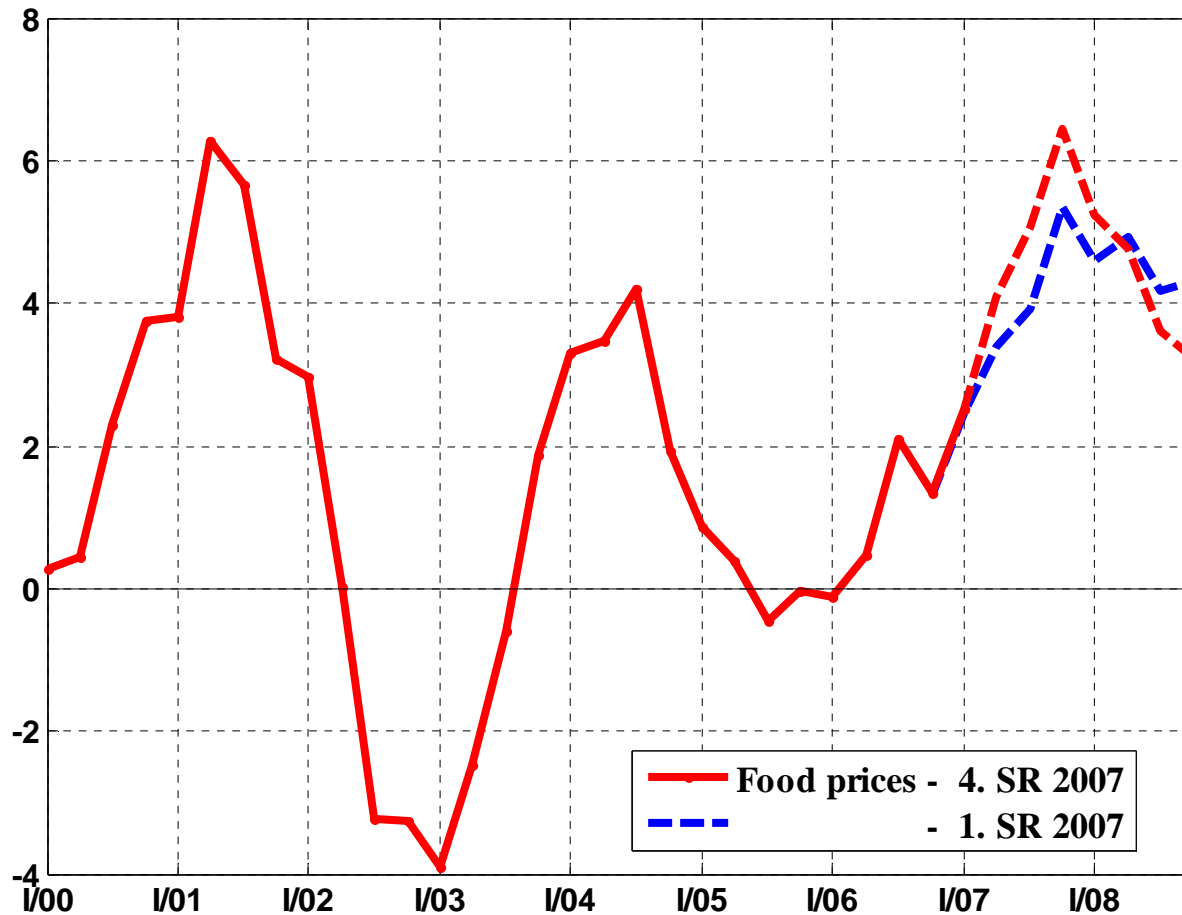
- Growth rate of average nominal wage in business sector: 7.1 % in 2007, 7.7 % in 2008;
- Revised up compared to January forecast.

Core Inflation



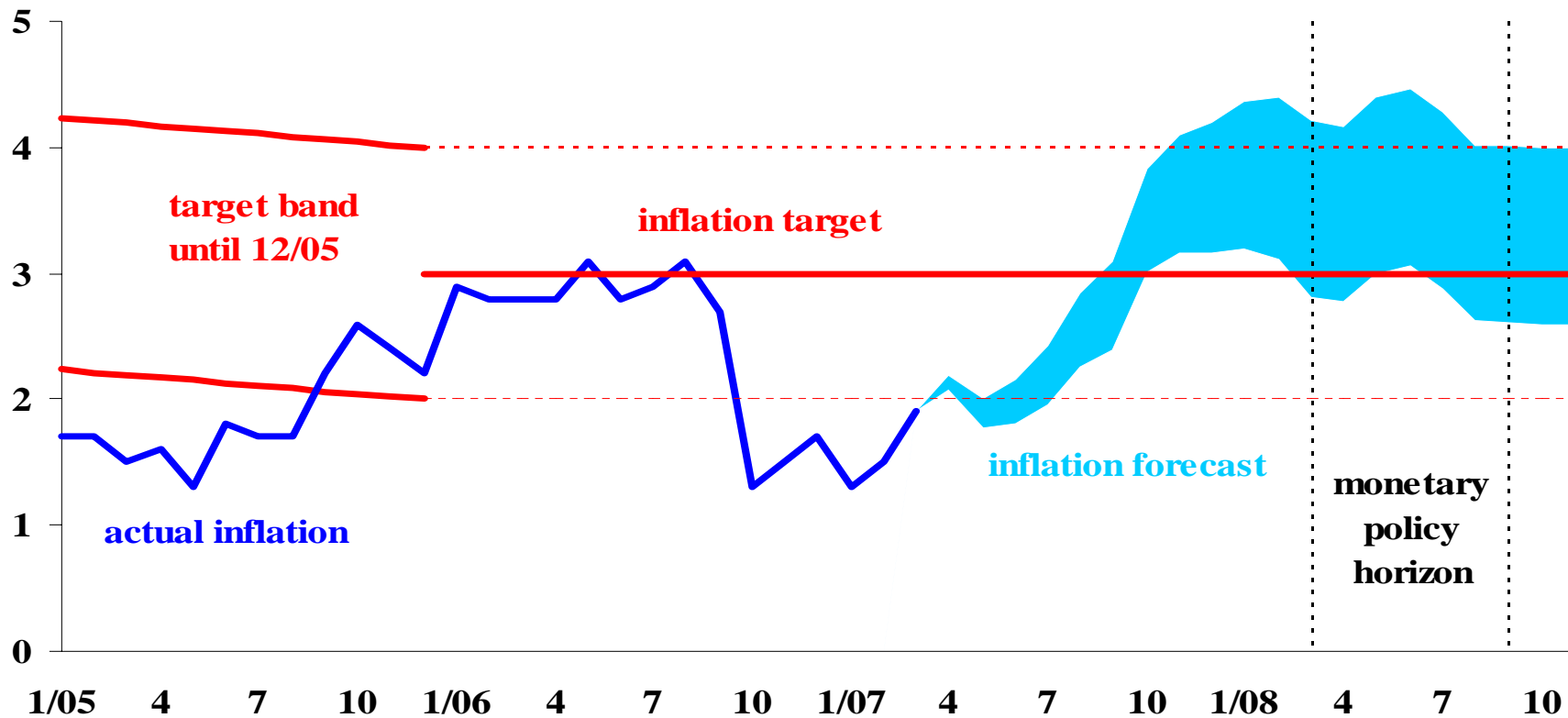
- Initially lower due to Q1/07 data (incl. new basket);
- Higher afterwards due to less anti-inflationary import prices and more pressures from real economy;
- Lower expectations in late-2008.

Food Prices (including taxes)



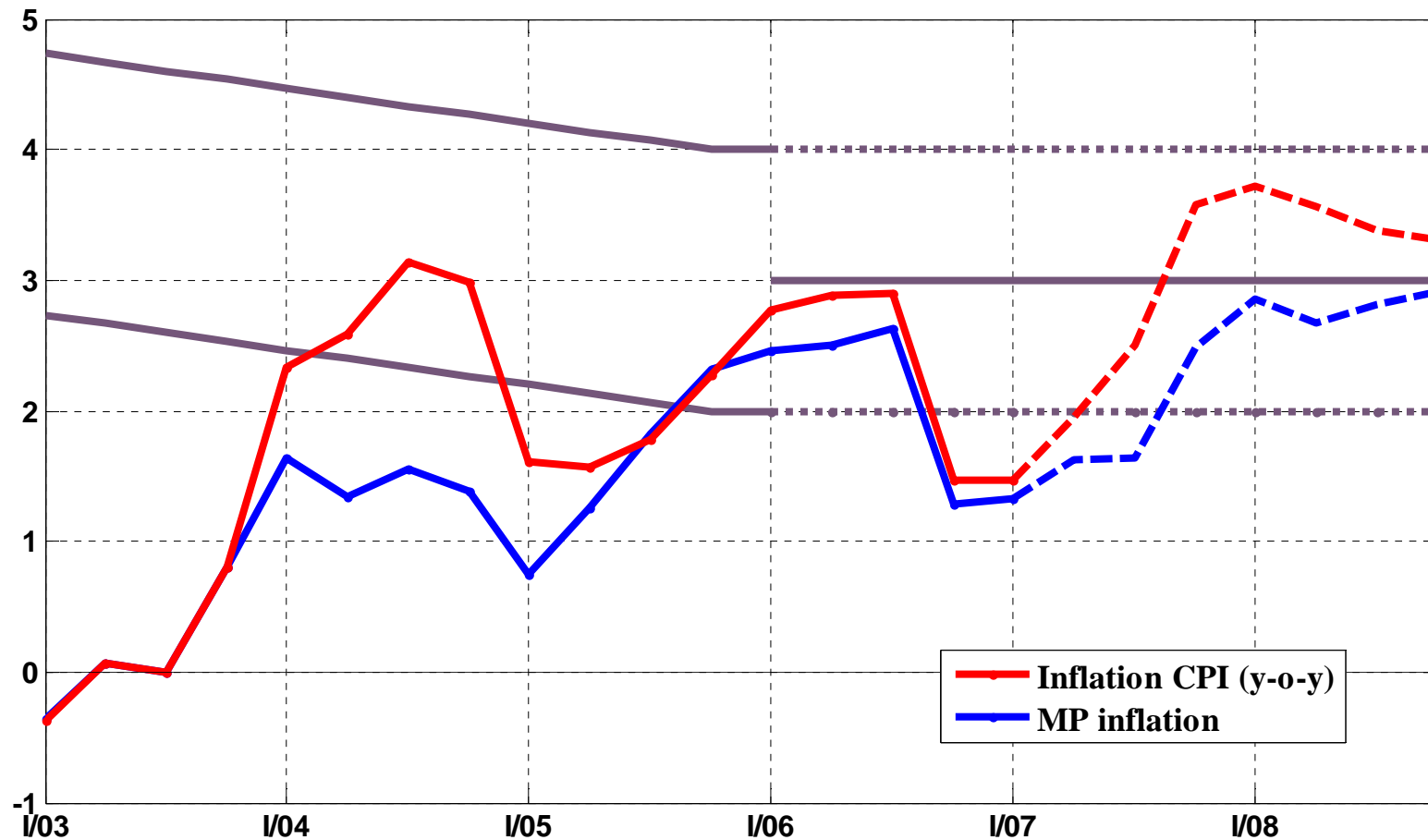
- Near-term outlook higher than in January forecast;
- Short-term indicators, exchange rate, pressures from real economy.

Overall Inflation



- Consistent with the forecast and its assumptions is a gradual rise in nominal interest rates over the entire forecast horizon.

Inflation Net of Tax Changes



- Monetary policy reacts to inflation excl. primary effects of indirect tax changes – slightly below 3 % on MP horizon.

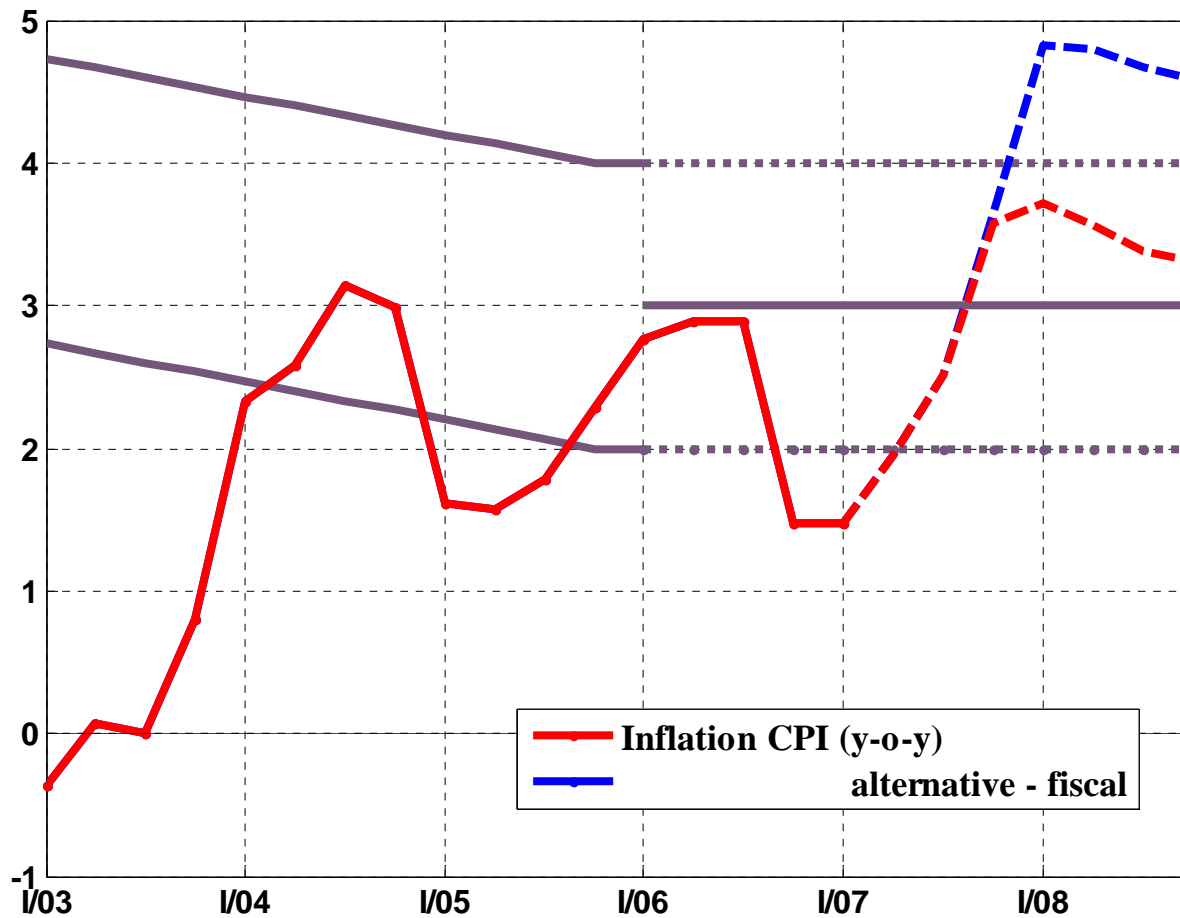
Changes in MP Framework

- New inflation target 2 % (\pm 1 %) from January 2010;
- Publication of interest rate path as fan chart from 2008;
- Publication of votes cast by name from 2008;
- Reduction in number of meetings to 8 from 2008.

Fiscal Reform

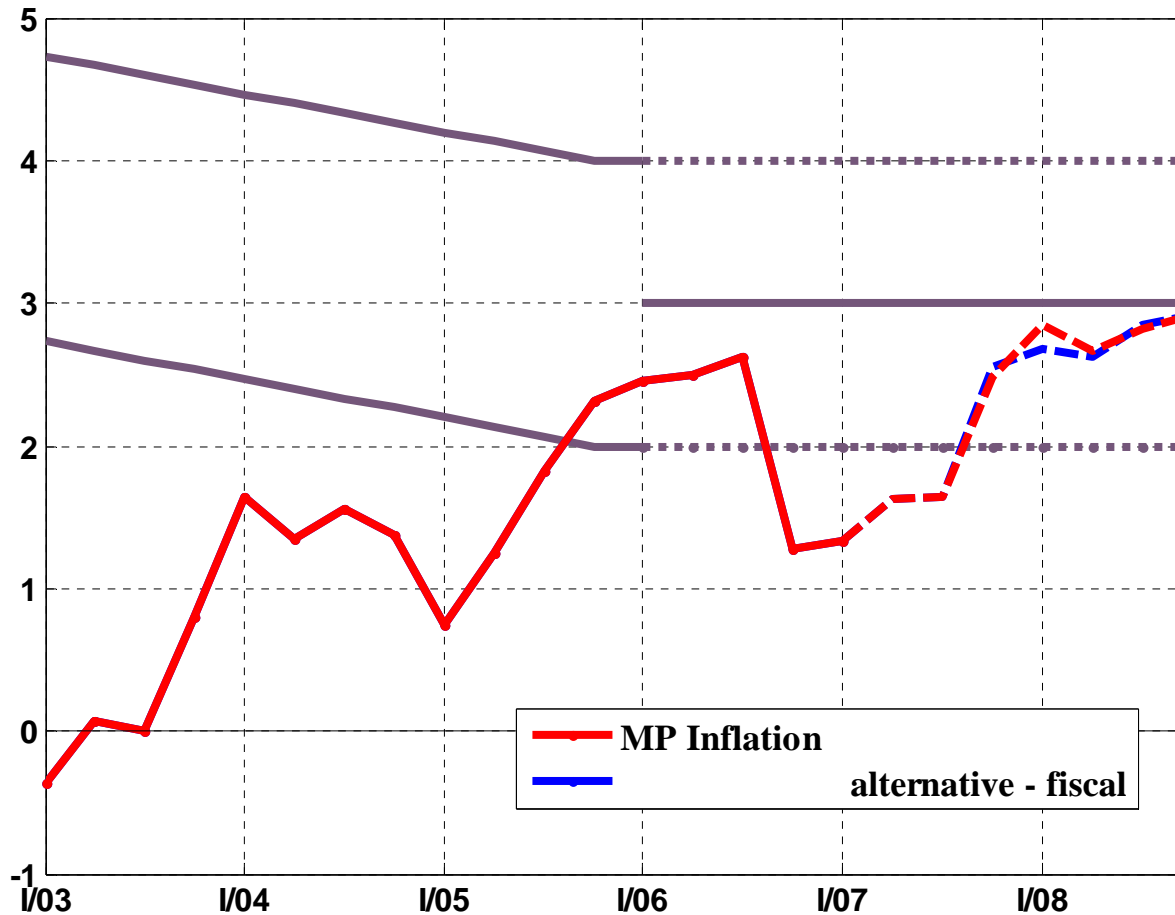
- ↑ in reduced VAT rate from 5 % to 9 % (max. impact on CPI 1.1 p.p.; assumed de facto impact 0.8 p.p.);
- Introduction of ecological taxes (0.2 p.p. impact on CPI);
- Faster consolidation of public budgets (3 % in 2008)
- Concentrated into 2008 (fiscal impulse lower by 0,6 p.p.).

Fiscal Reform – Headline Inflation



- Headline inflation higher due to primary effects of indirect tax changes;
- Monetary policy reacts to secondary impacts only.

Fiscal Reform – MP Inflation



- Higher expectations offset by lower pressures from real economy (restrictive fiscal policy);
- Weak response of monetary policy and exchange rate.



Thank you
for your attention.