

CNB's New Forecast

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Tomáš Holub

Monetary and Statistics Department

(Tomas.Holub@cnb.cz)

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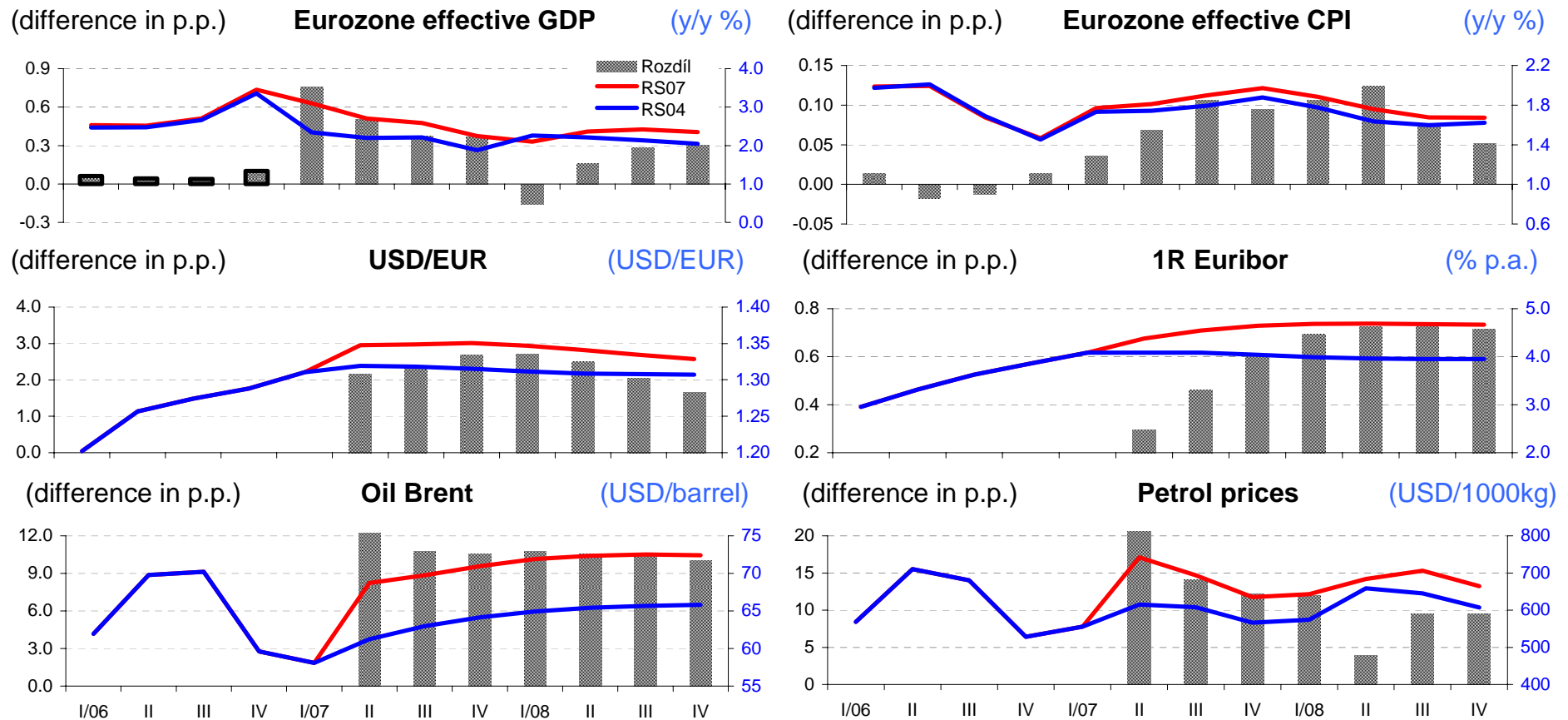
CNB

CZECH CNB NATIONAL BANK

Outline

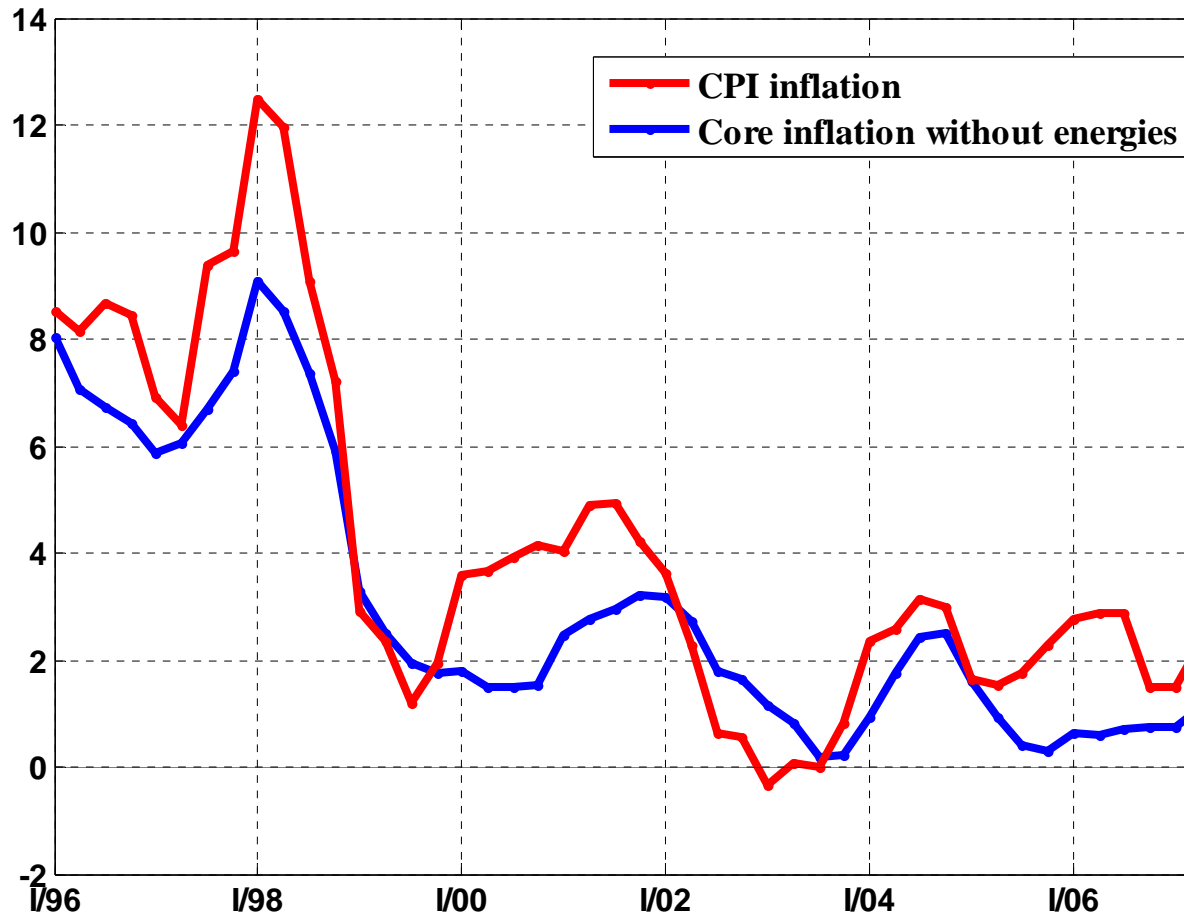
- External assumptions;
- Recent trends in inflation;
- Economic growth and labour market;
- Fiscal policy;
- Regulated prices and tax changes;
- Exchange rate and imported inflation;
- Forecast of GDP and inflation.

External Assumptions (CF06)



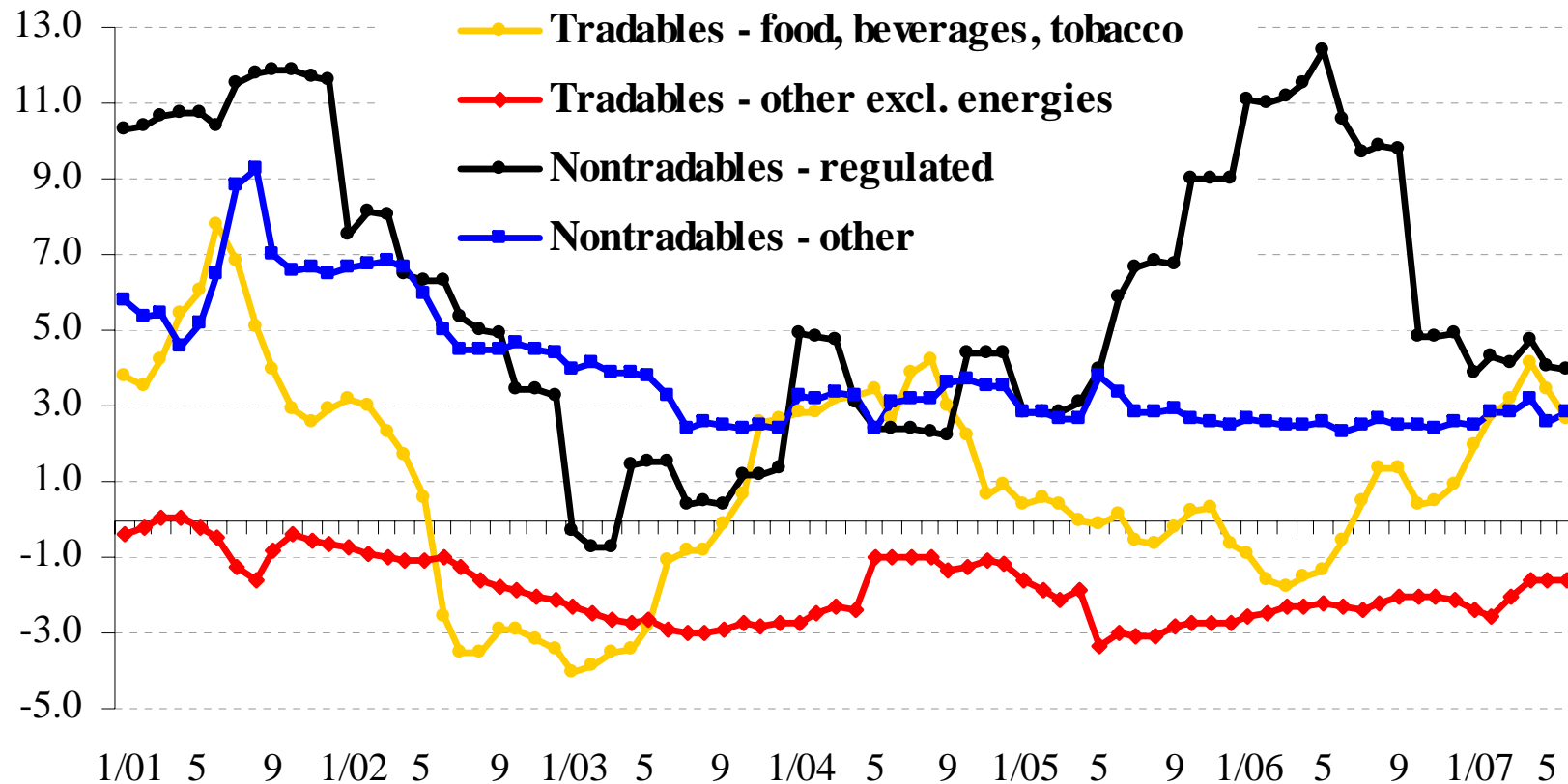
- Pro-inflationary shift in external assumptions of the forecast (except of USD/EUR).

Inflation



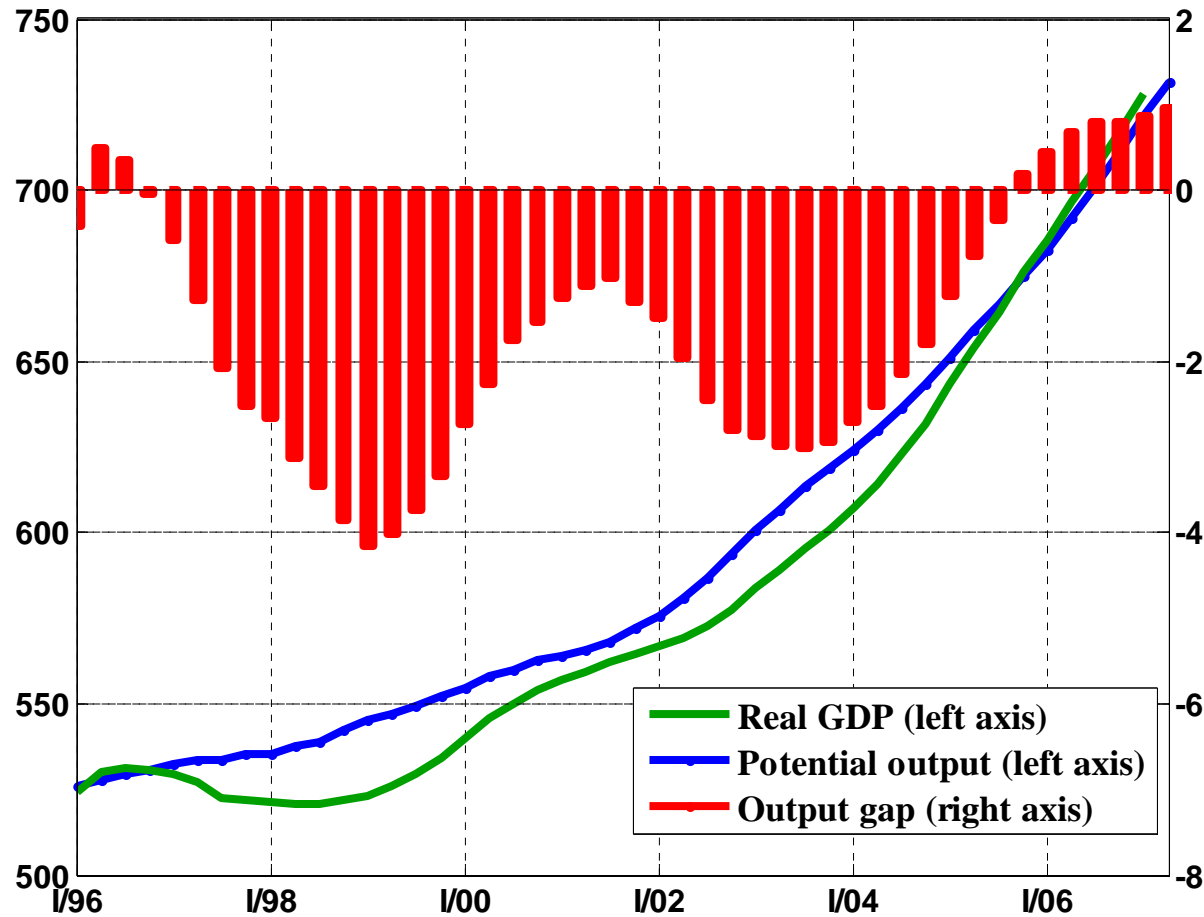
- Inflation in Q2/07 0.5 % above the April forecast;
- Higher fuel prices and earlier impact of tax changes;
- Core inflation broadly in line with the forecast, gradually rising.

Structure of Inflation (without taxes)



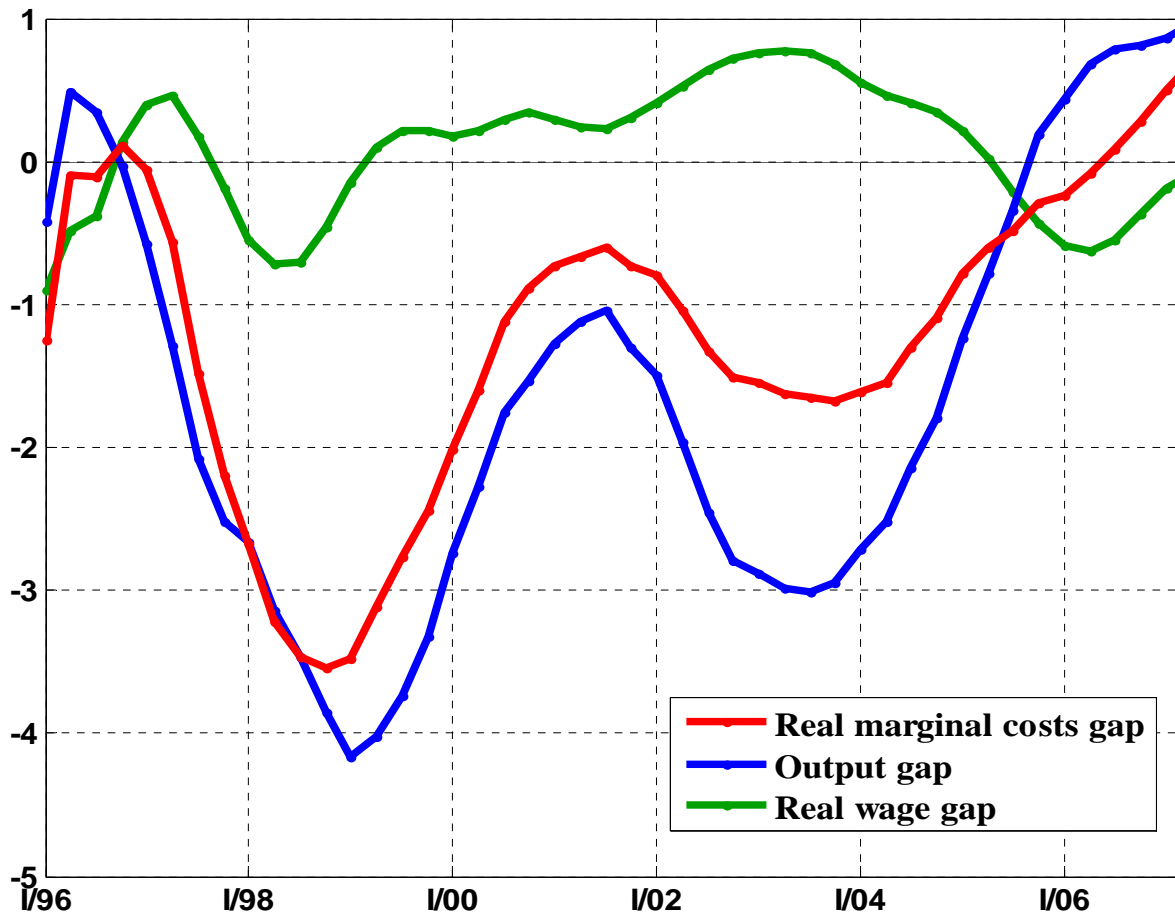
- Food price growth accelerated in April, but slowed down in the subsequent two months;
- Decline in tradable prices still persists.

GDP – Actual and Potential



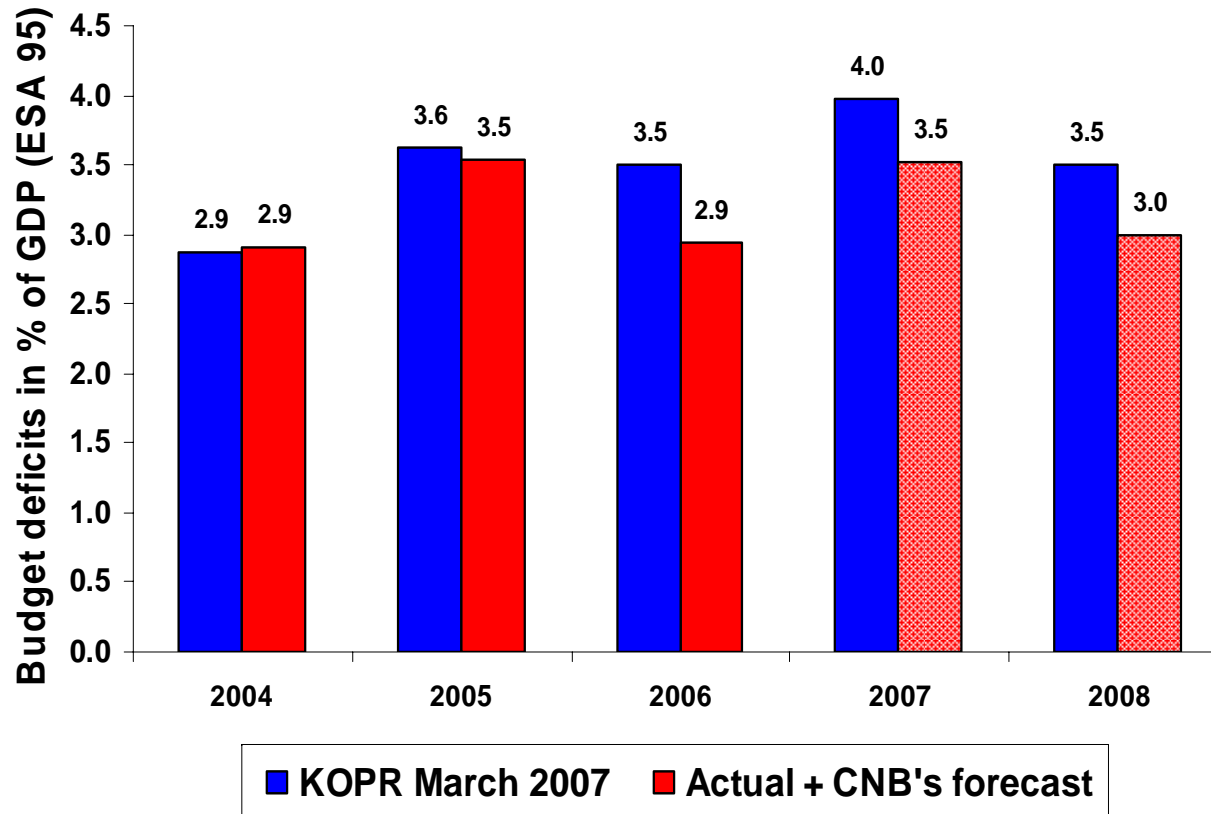
- The economy roughly 1 % above its non-inflationary potential;
- Growth pulled by domestic demand, mainly accelerating household consumption;
- Monetary conditions slightly loose in the exchange rate component.

Pressures from the Real Economy



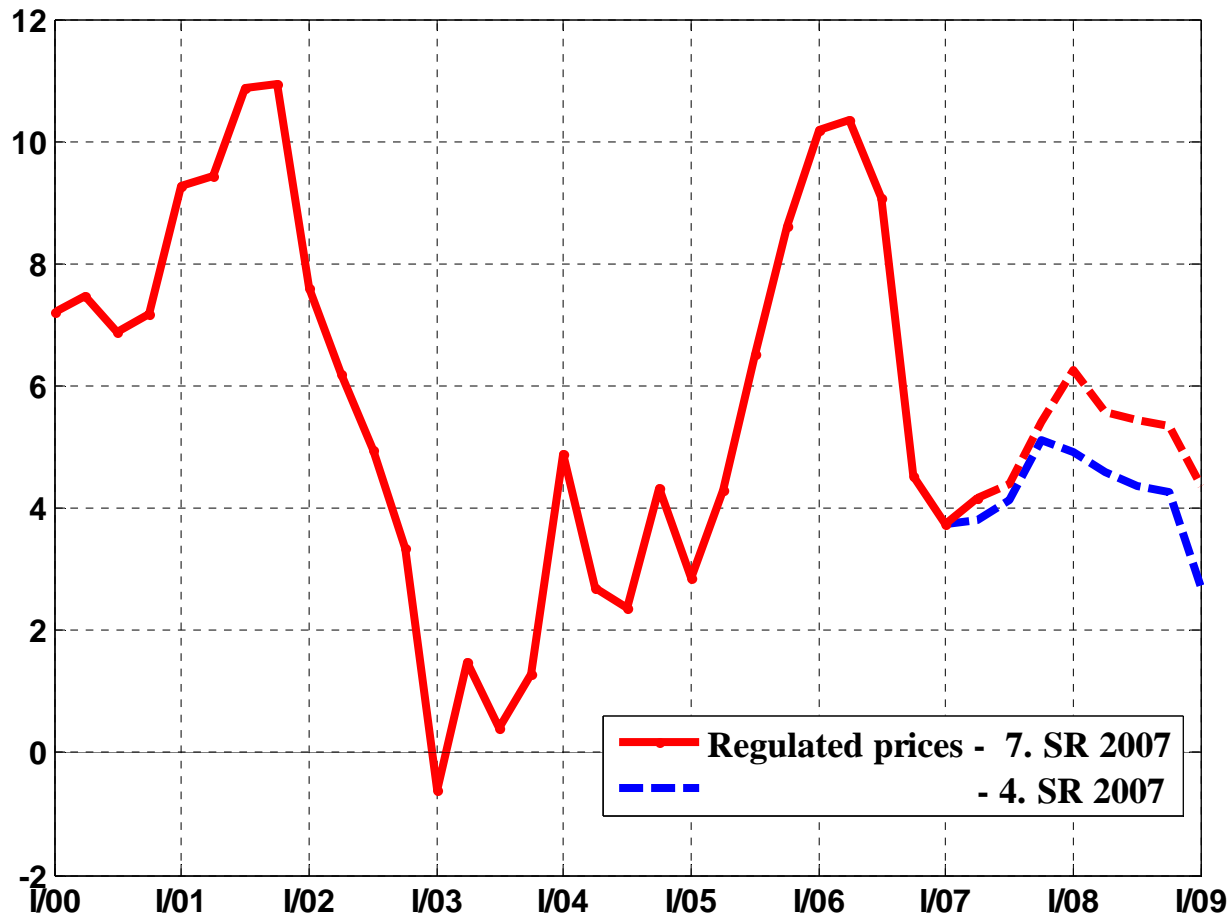
- Real wages not anti-inflationary any more;
- Nominal wage growth speeded up, faster growth in NULC (3.5 % in Q1/07);
- Ongoing decline in unemployment;
- Overall pressures from the real economy pro-inflationary.

Fiscal Situation



- Deficit in 2007 at 3.5 %, fiscal impulse expansionary;
- Forecast for 2008 lowered to 3 %, slightly restrictive impact;
- The main reform tax and social security changes still not included in the baseline.

Regulated Prices



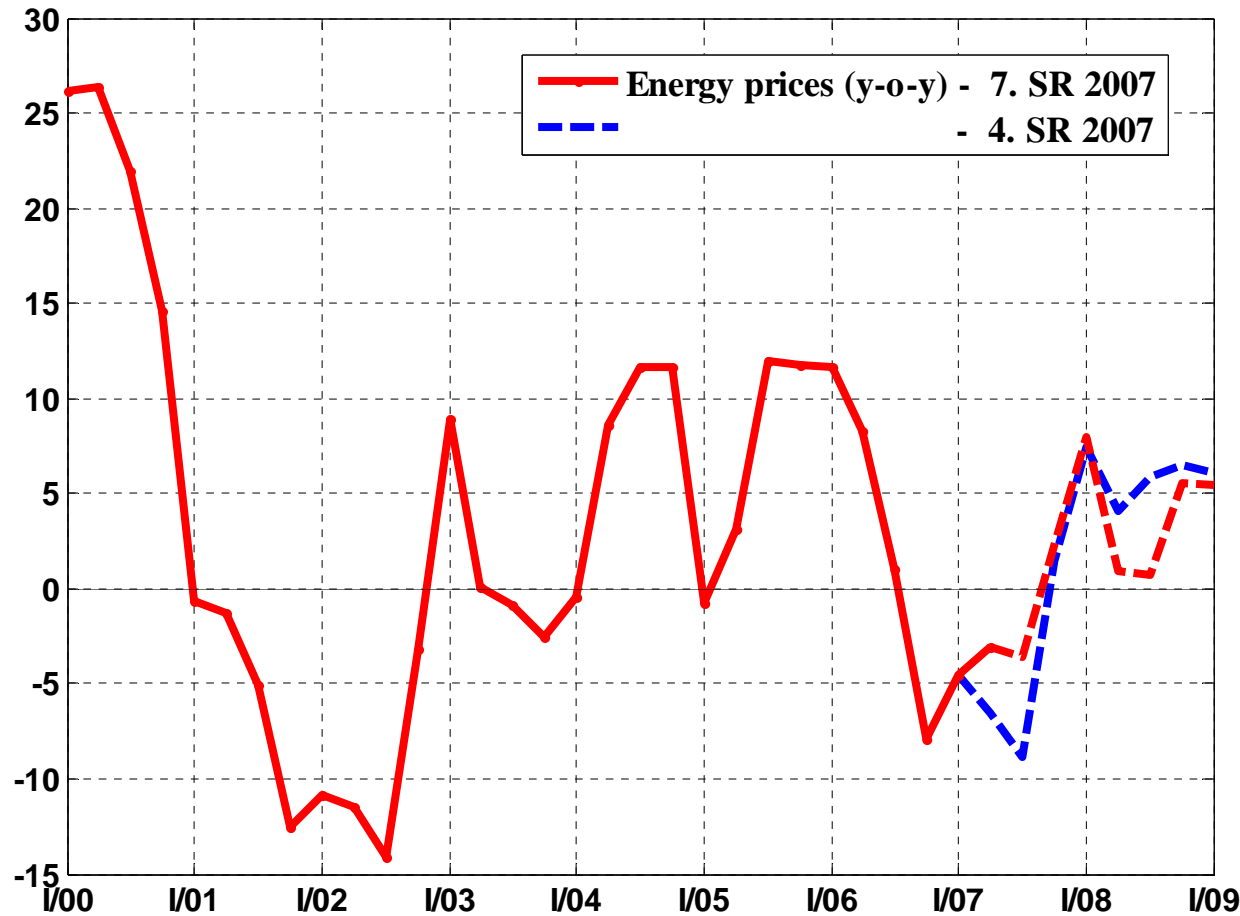
- Forecast of the y/y growth rate raised due to ecological taxes;
- Together with excise duties, the contribution to inflation will reach: 2.1 p.p. end-2007, 1.3 p.p. end-2008.

Administrative Measures (selected items and total impact)

| Year/date | Indirect taxes | | Regulated prices (with tax changes) | | |
|------------------------|--|-------------------------|-------------------------------------|----------------------|-------------------------|
| | 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 1Q 2007 | Excise duties on tobacco products (delayed impact: 1Q - 4Q) | 1,09 p.p. | Electricity | 7.9% | 0,30 p.p. |
| | | | TV | 20.0% | 0,08 p.p. |
| | | | Regulated rents | 17.0% | 0,26 p.p. |
| | | | Heating | 2.7% | 0,08 p.p. |
| Total | | 1,09 p.p. | | 5.6% | 0,95 p.p. |
| 2008 1Q 2008 | Excise duties on tobacco products (delayed impact: 1Q+2Q) | 0,35 p.p. | Electricity | 8.5% | 0.33 p.p. |
| | | | Natural gas | 5.8% | 0.12 p.p. |
| | | | TV | 12.5% | 0,06 p.p. |
| | Tax of energy (electricity, natural gas, solid fuels) | 0.21 p.p. | Regulated rents | 15.0% | 0,26 p.p. |
| | | | Heating | 1.5% | 0,05 p.p. |
| Total | | 0,56 p.p. | | 5.5% | 0,95 p.p. |
| | | | | without tax changes: | 0.77 p.p. |

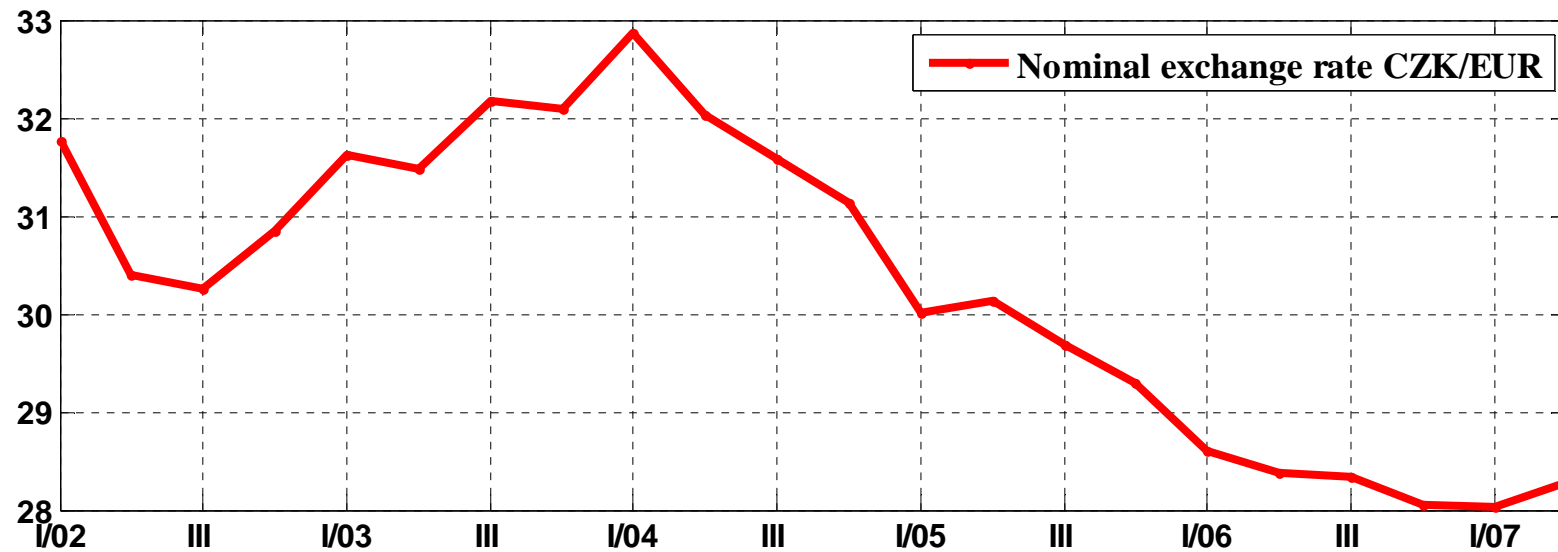
- Ecological taxes will affect mainly the regulated energy prices (impact on CPI roughly 0.2 p.p.).

Energy Prices



- Currently less anti-inflationary than in the April forecast due to developments of oil and gasoline prices.

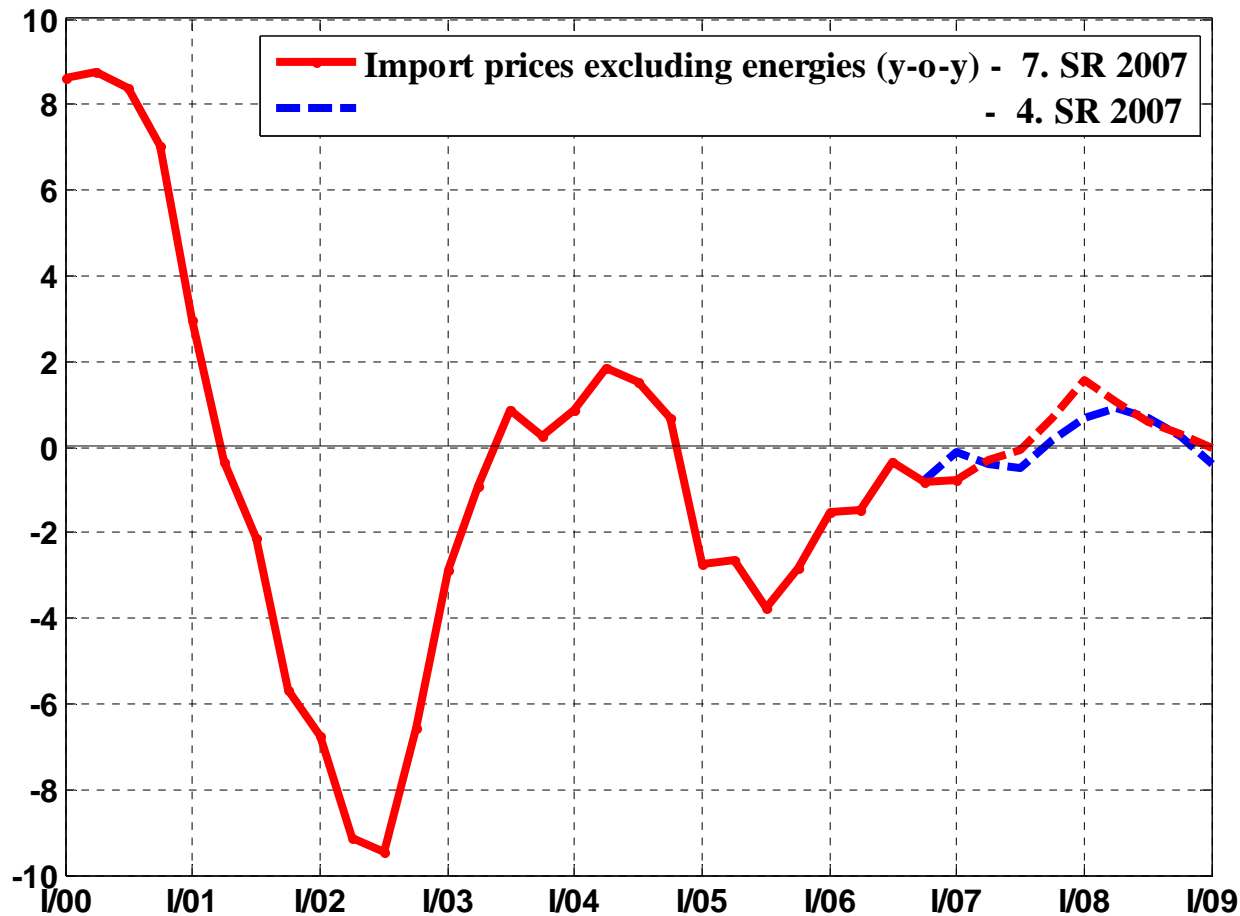
Exchange Rate



External forecasts of CZK/EUR

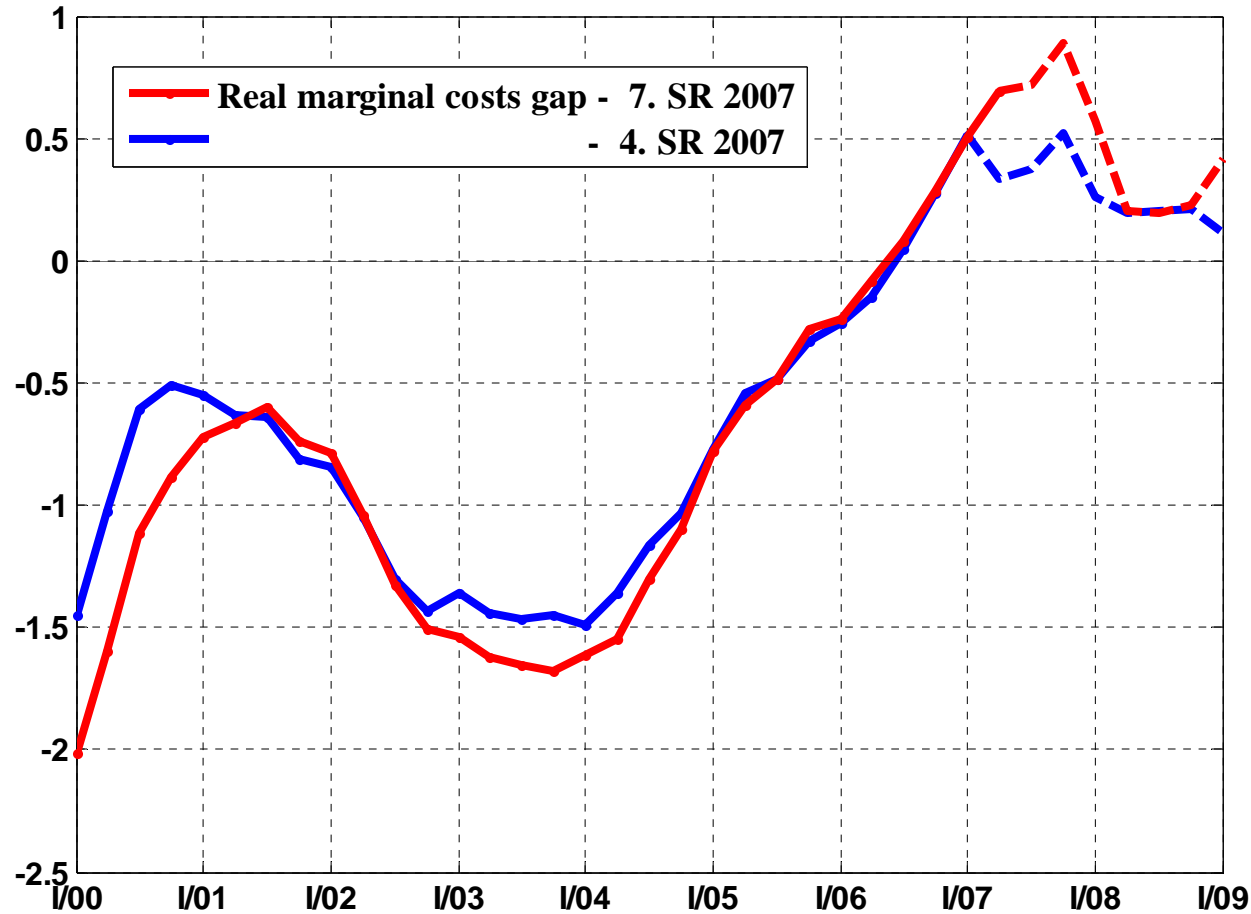
| Date of forecast | Next quarter | 1Y horizon | |
|------------------|--------------|------------------|------|
| | CF | Financial market | CF |
| 7/06 | 28.5 | 27.7 | 28.0 |
| 10/06 | 28.2 | 27.6 | 27.8 |
| 1/07 | 27.5 | 27.1 | 27.6 |
| 4/07 | 28.0 | 27.2 | 27.7 |
| 7/07 | 28.5 (3Q07) | 27.4 | 27.9 |

Import Prices excl. Energy



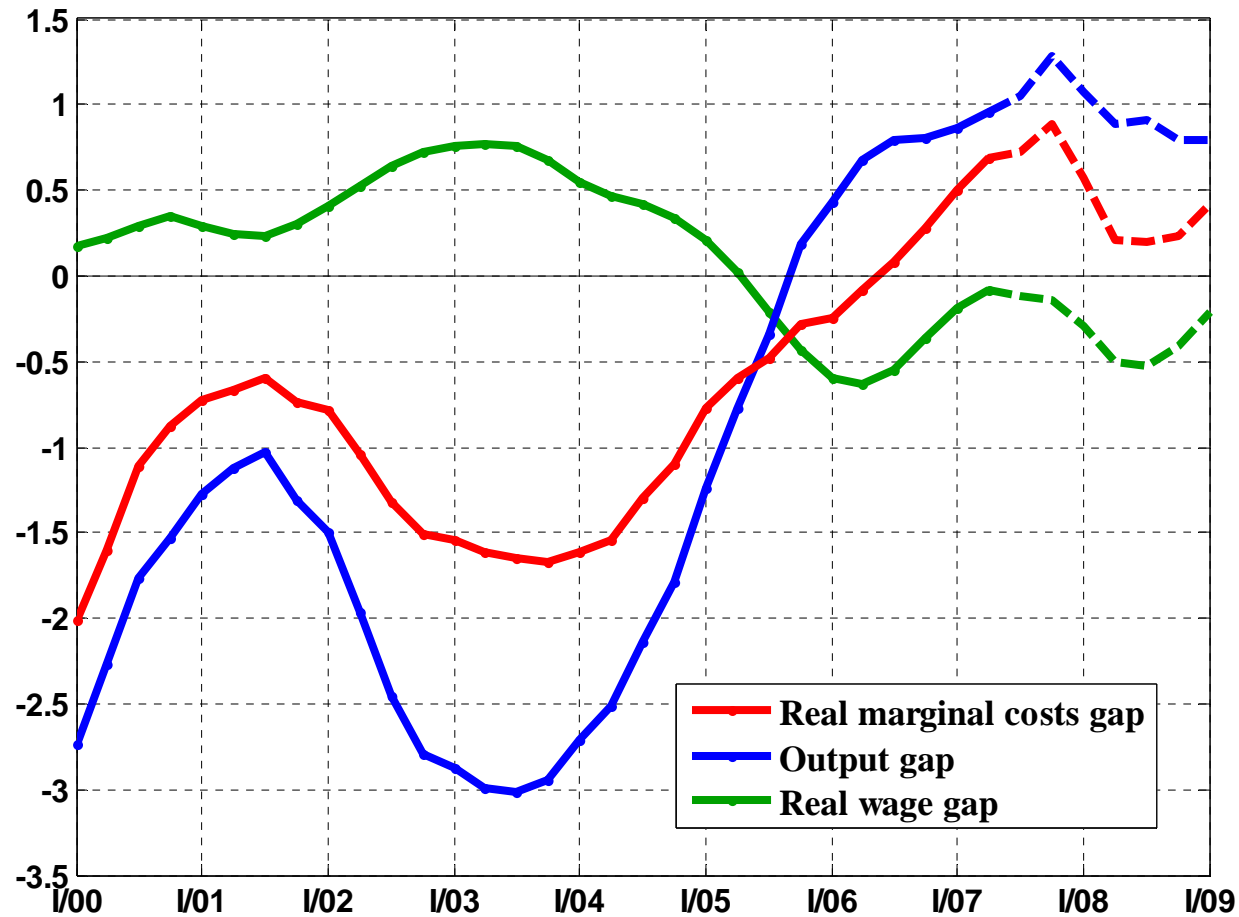
- Forecast revised up due to weaker exchange rate.

Pressures from the Real Economy



- More inflationary until Q1/08 due to higher output gap.

Pressures from the Real Economy



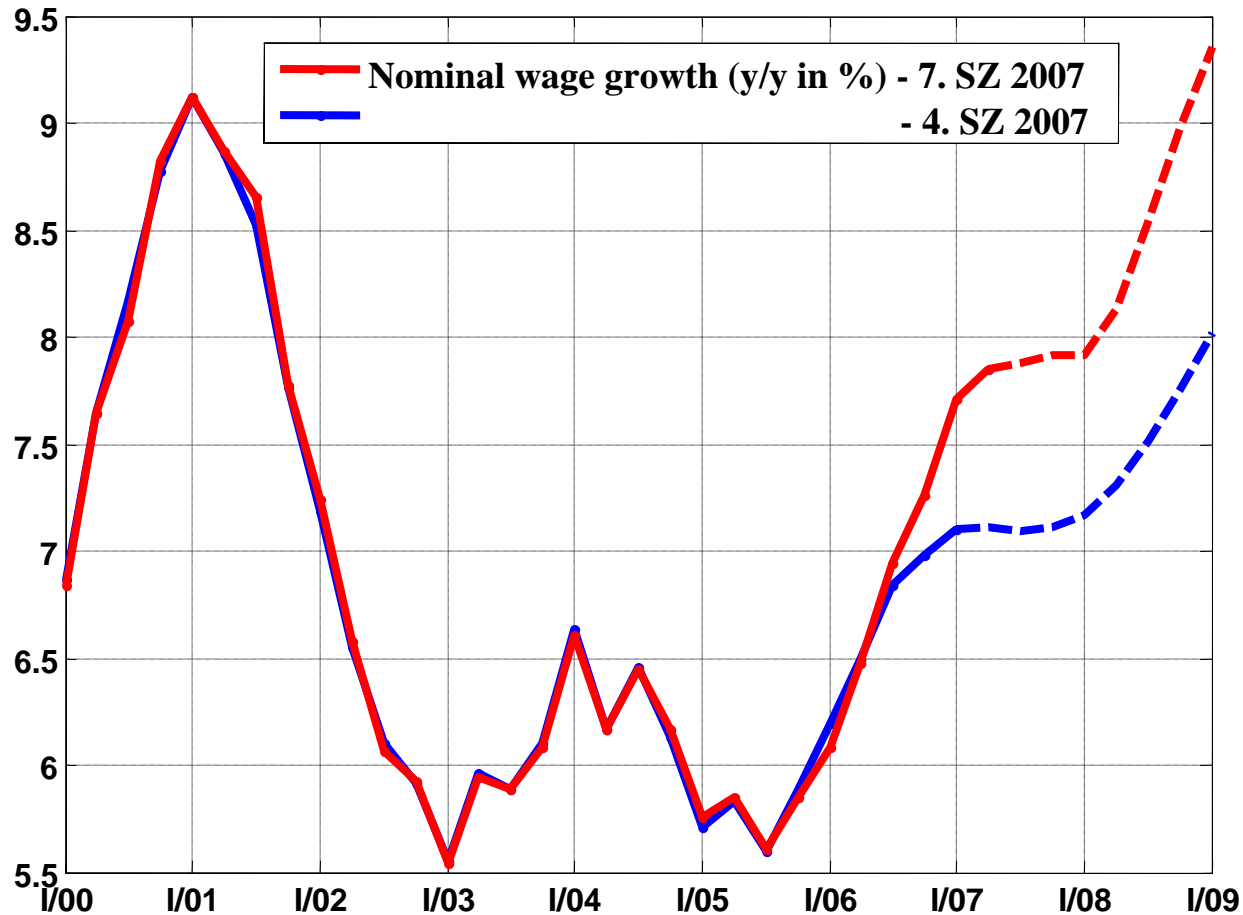
- Output gap will remain positive (loose monetary conditions, expansionary fiscal impulse in 2007, more optimism on EU growth);
- Real wages will return to slightly anti-inflationary in 2008, but nominal wages accelerating.

GDP Growth Forecast

| y/y change | 2006 | 2007 | 2008 |
|-------------------------------|-------------|-------------|-------------|
| Gross domestic product | 6.4 | 6.2 | 5.4 |
| Household consumption | 4.4 | 6.1 | 4.3 |
| Government consumption | 1.1 | 1.3 | -0.4 |
| Fixed investment | 7.6 | 6.9 | 9.6 |
| Exports | 15.9 | 14.2 | 13.0 |
| Imports | 15.2 | 14.5 | 12.3 |

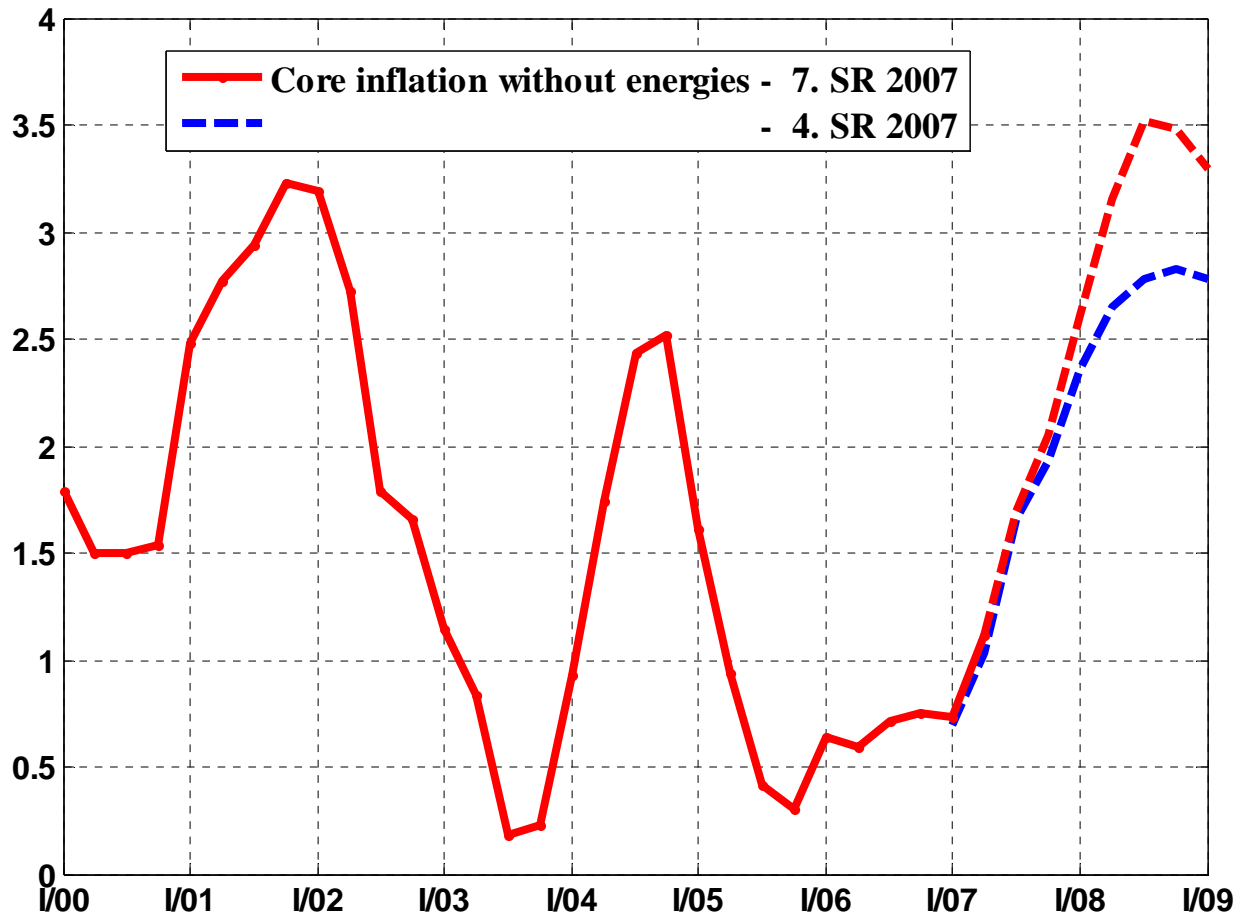
- GDP growth forecast revised up by 0.5 p.p. for 2007 and by 0.1 p.p. for 2008;
- Higher forecast of household consumption growth (faster real wage growth);
- Fixed investments forecast affected by Q1/07 data (total investment gradually decelerating over time).

Nominal Wage Growth



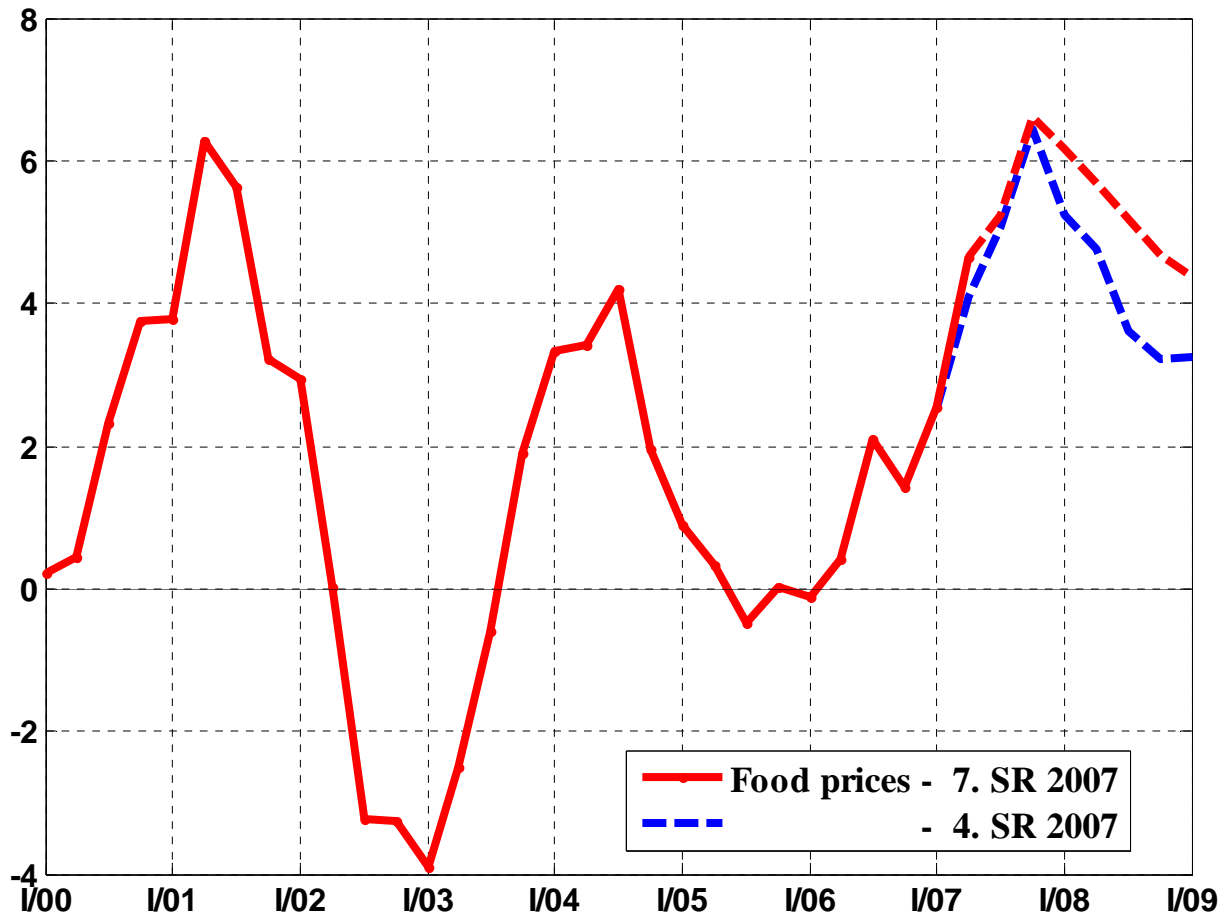
- Growth rate of average nominal wage in business sector: 8.0 % in 2007, 8.7 % in 2008;
- Revised up by 1 p.p. compared to April forecast;
- NULC growth around 3 % in 2007-08.

Core Inflation



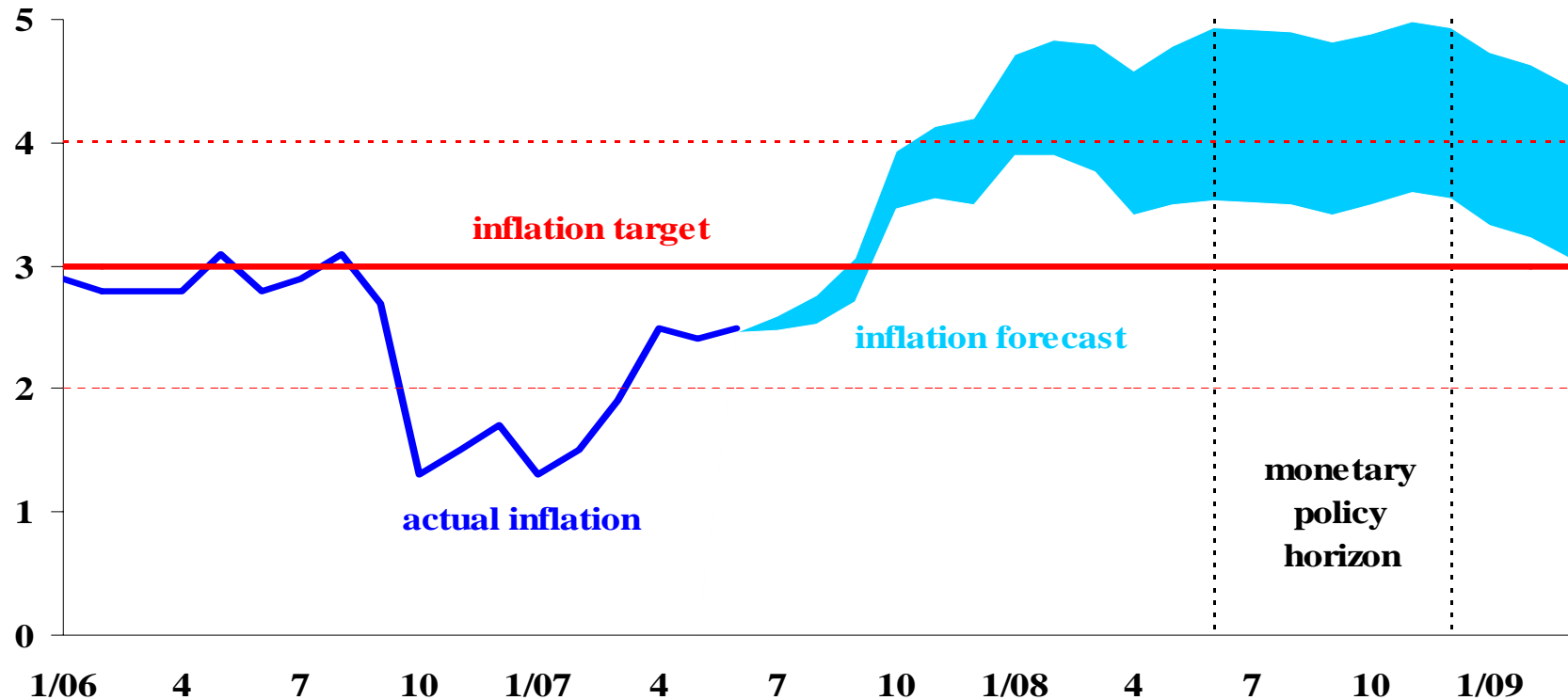
- Forecast increased due to higher import prices, pressures from the real economy and higher inflation expectations (impact of higher observed inflation, etc.).

Food Prices (including taxes)



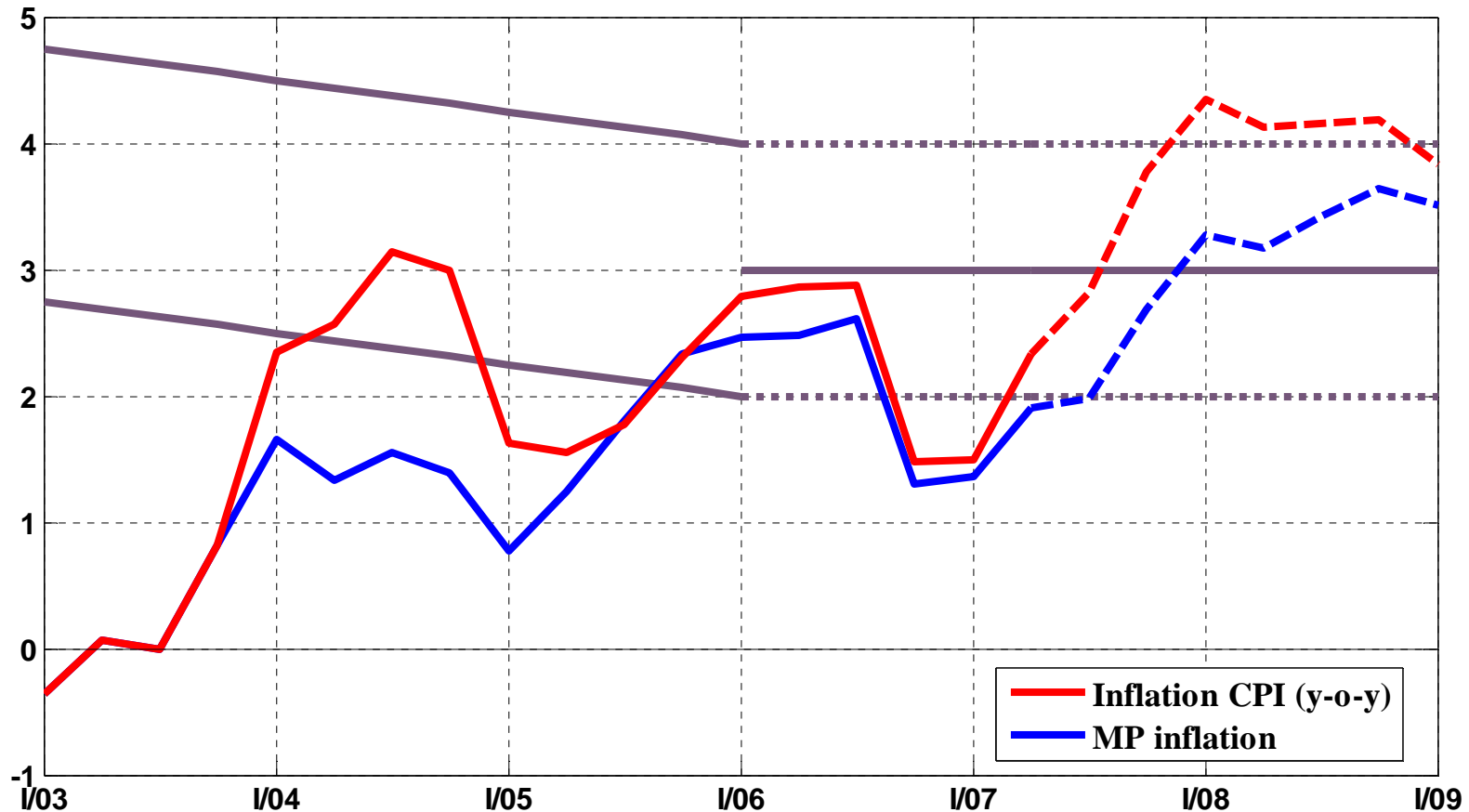
- Forecast also increased due to higher food import prices and real economy pressures.

Overall Inflation



- Forecast increased due to a combination of upward surprises in virtually all relevant areas;
- Consistent with the macroeconomic forecast and its assumptions is growth in nominal interest rates.

Inflation Net of Tax Changes



- CNB** • Monetary policy inflation around 3.5 % on the MP horizon.



Thank you
for your attention.