

CNB's New Forecast

October 2007

Tomáš Holub

Monetary and Statistics Department

(Tomas.Holub@cnb.cz)

Meeting with analysts, Prague, 2 November 2007

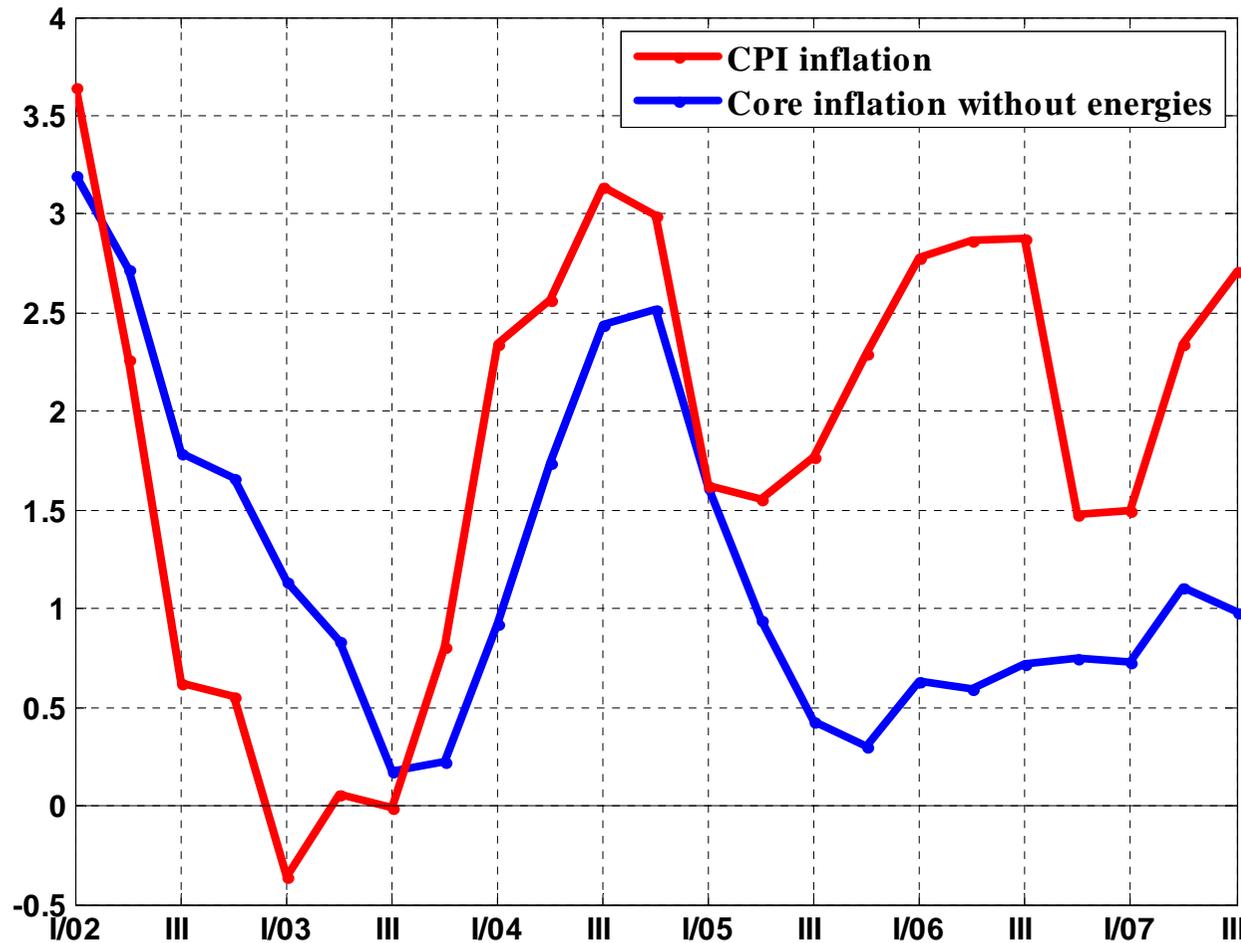
CNB

CZECH CNB NATIONAL BANK

Outline

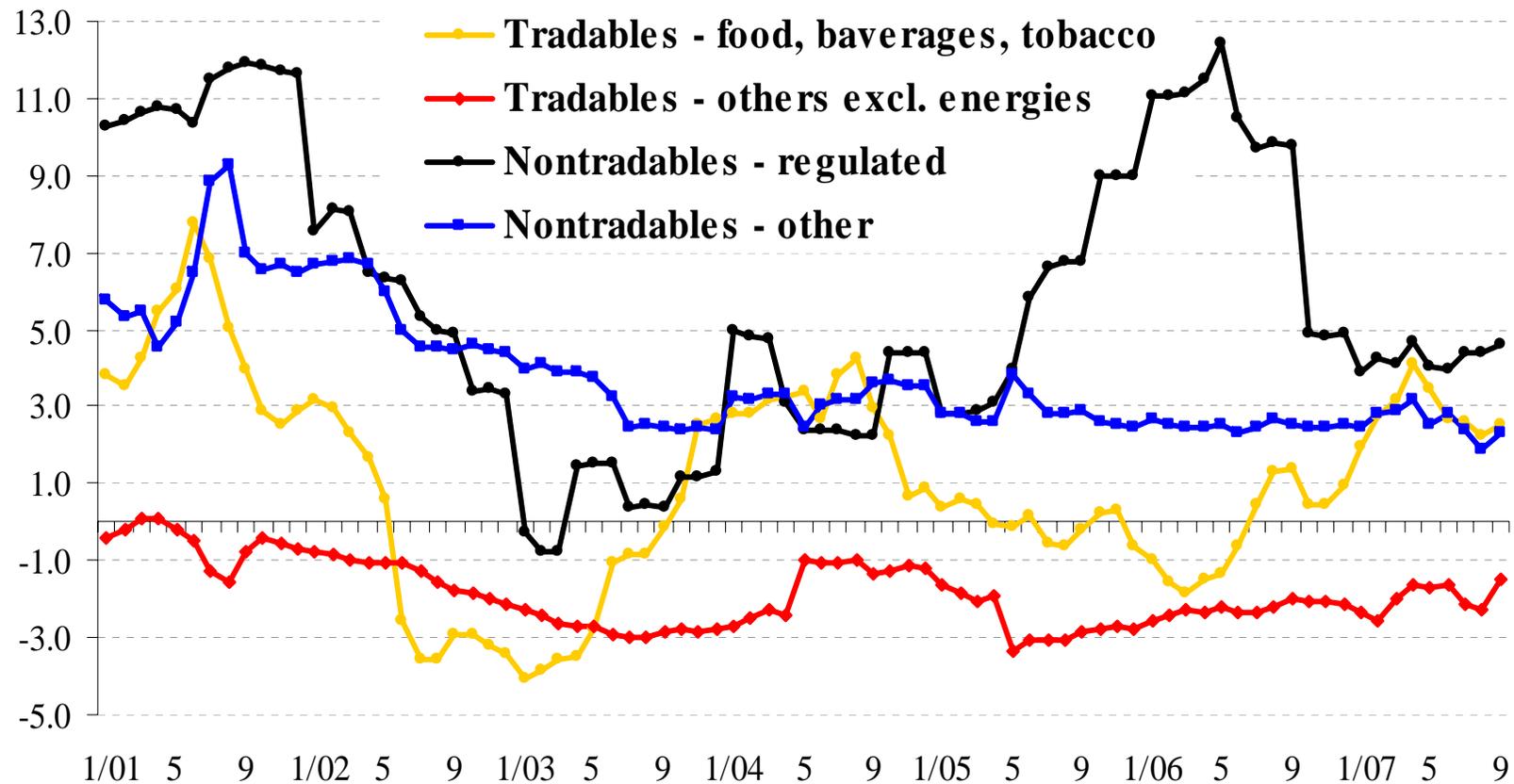
- Recent trends in inflation;
- Economic growth and labour market;
- External assumptions of the forecast;
- Fiscal policy assumptions;
- Regulated prices and tax changes;
- Exchange rate and imported inflation;
- Forecast of GDP and inflation.

Inflation



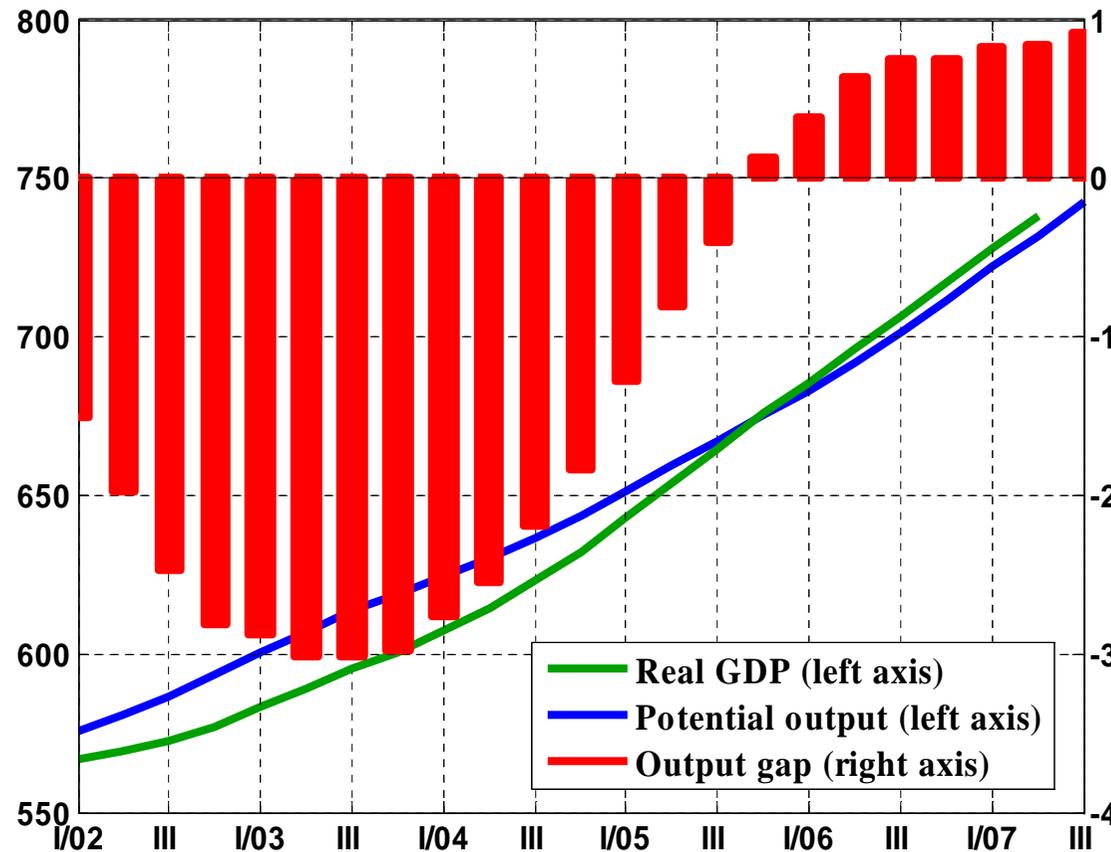
- Headline inflation in September just 0.1 p.p. below the July forecast;
- Core inflation well below the forecast (but measurement problems – new CPI basket);
- Higher food prices, tax effects and fuel prices.

Structure of Inflation (excluding taxes)



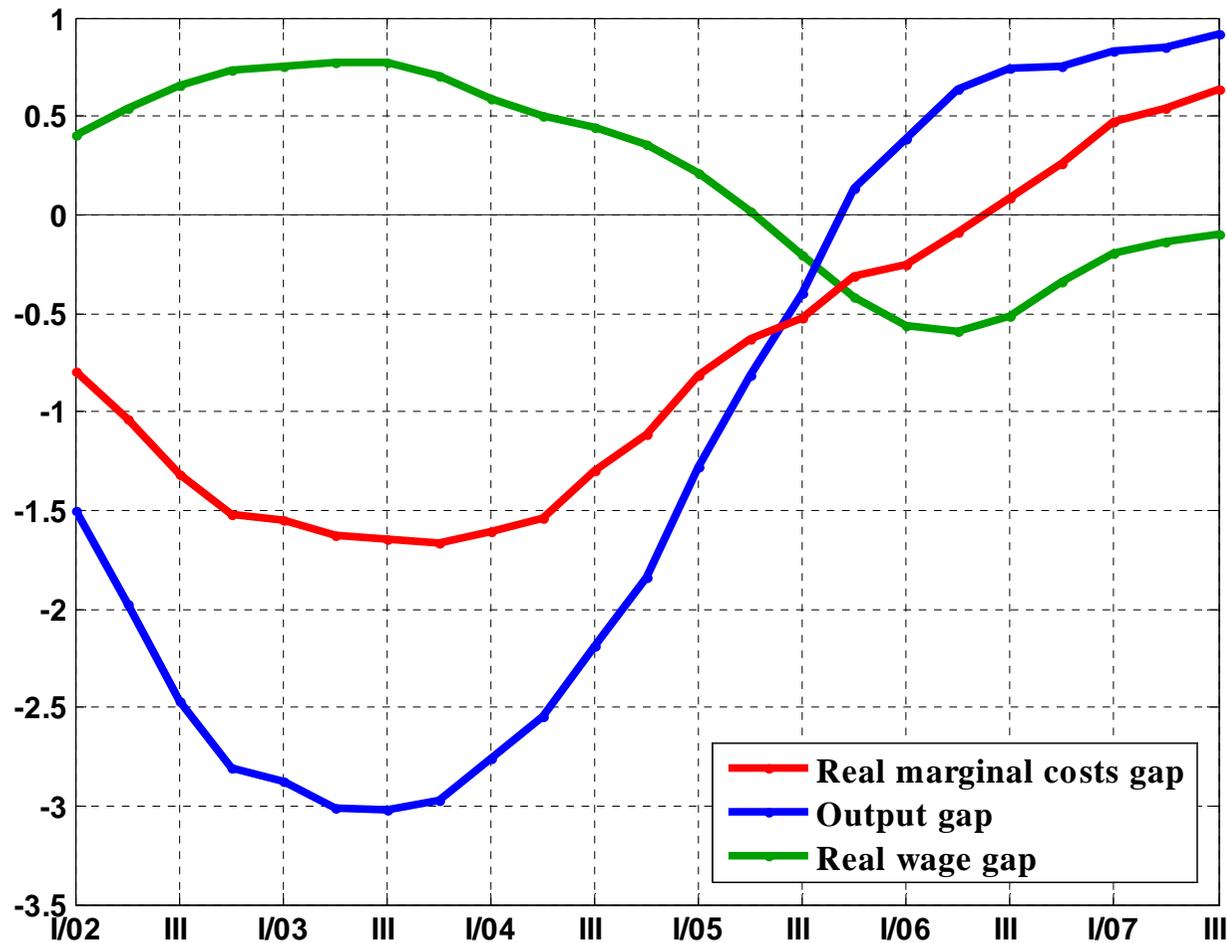
- Food price growth ex taxes still relatively benign (but turned around in September);
- Persistent decline in tradable prices.

GDP – Actual and Potential



- The economy grew at 6 % in Q2/07;
- Growth pulled by domestic demand;
- GDP roughly 1 % above its non-inflationary potential;
- Overall monetary conditions broadly neutral.

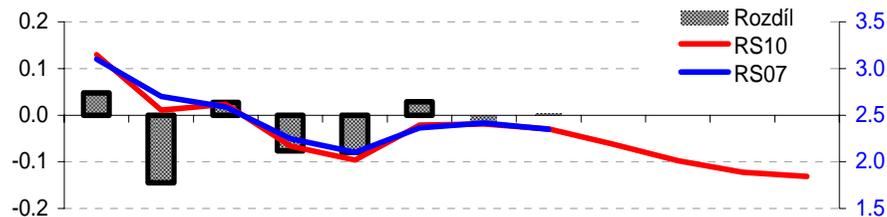
Pressures from the Real Economy



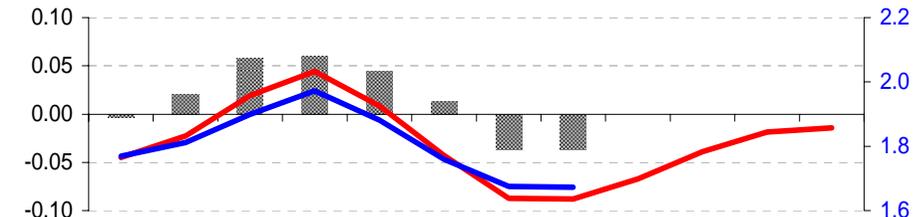
- Nominal wage growth speeded up towards 8 %;
- NULC growth at around 3 %;
- Real wages not anti-inflationary any more;
- Ongoing decline in unemployment (below NAIRU);
- Pressures from the real economy pro-inflationary.

External Assumptions (CF09)

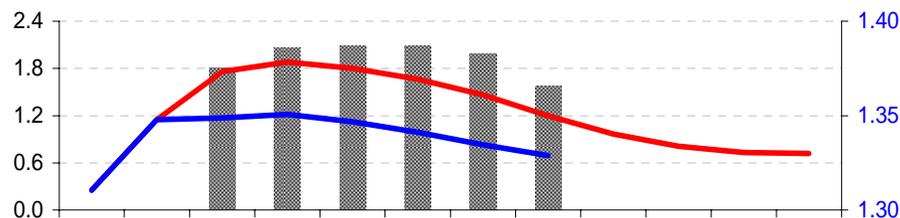
(difference in p.p.) Eurozone Effective GDP (y/y %)



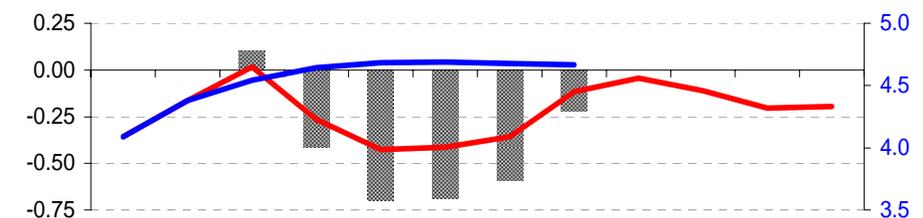
(difference in p.p.) Eurozone Effective CPI (y/y v %)



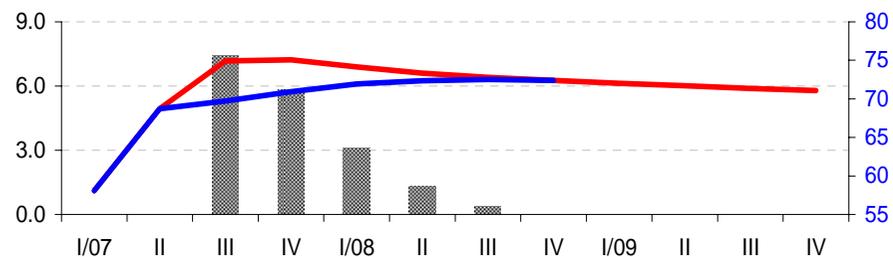
(difference in p.p.) USD/EUR (USD/EUR)



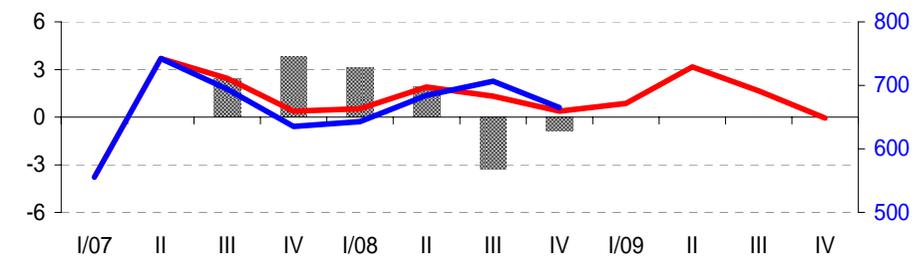
(difference in p.p.) 1R Euribor (% p.a.)



(difference in p.p.) Oil Brent (USD/barrel)

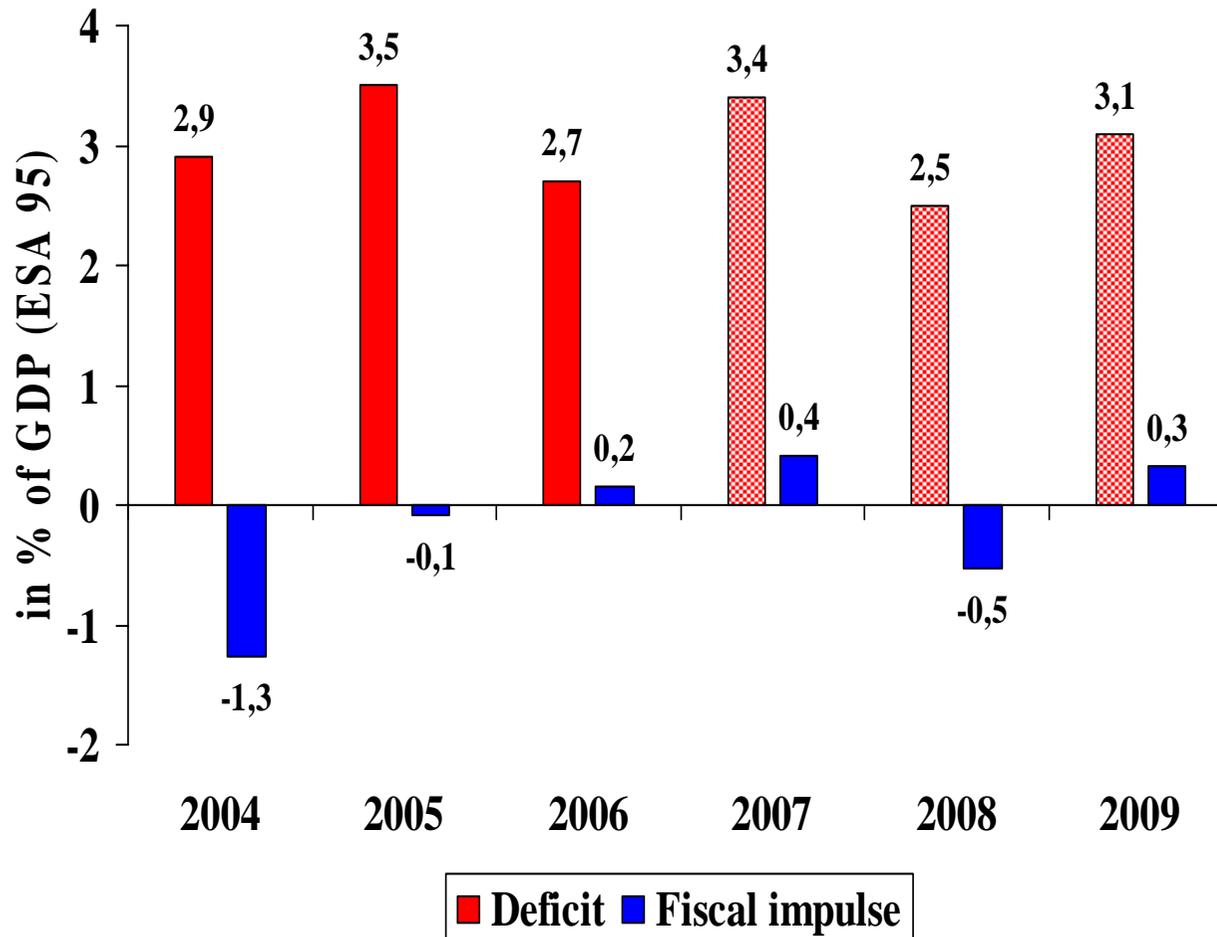


(difference in p.p.) Petrol Prices (USD/1000kg)



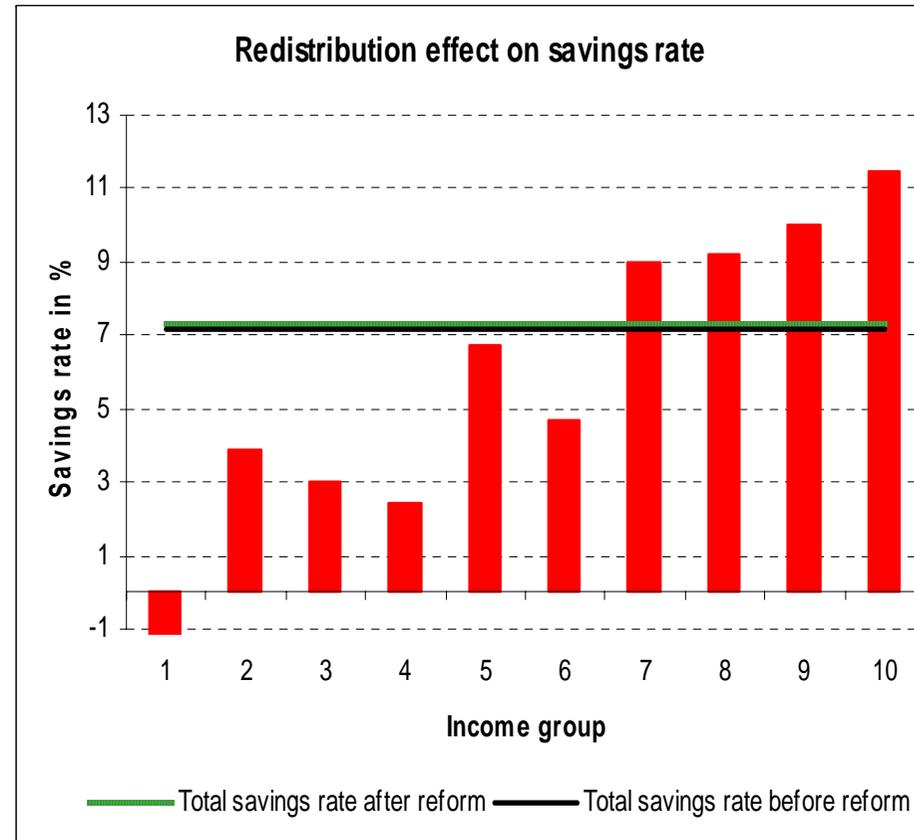
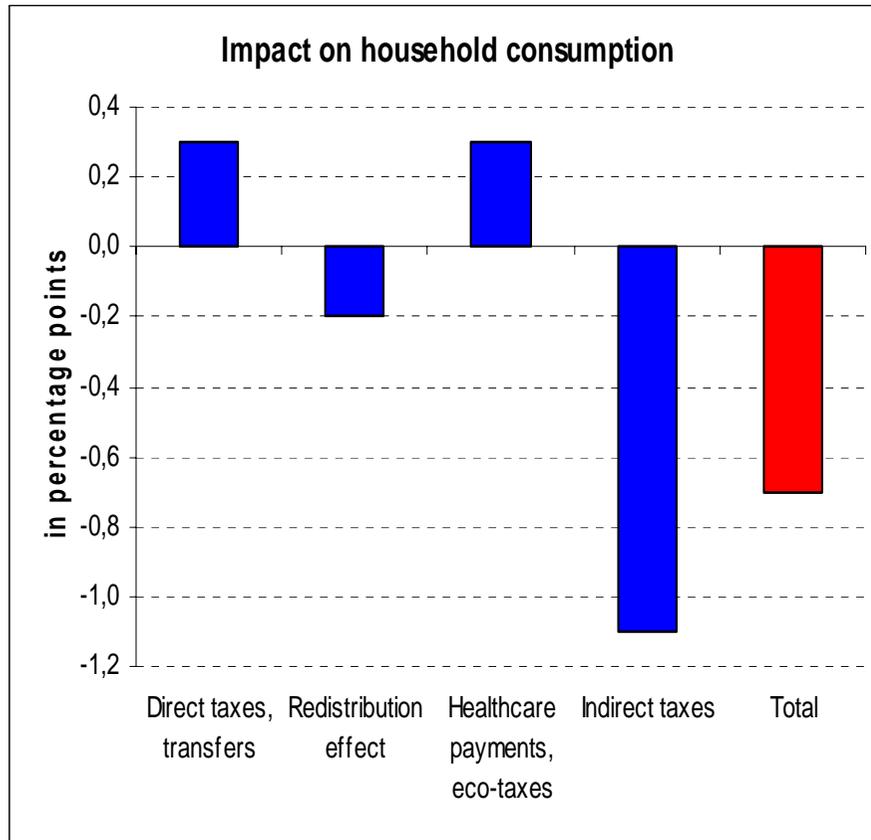
- Lower outlook for Euribor following the market turbulence;
- Weaker USD vs. higher oil prices.

Fiscal Policy Assumptions



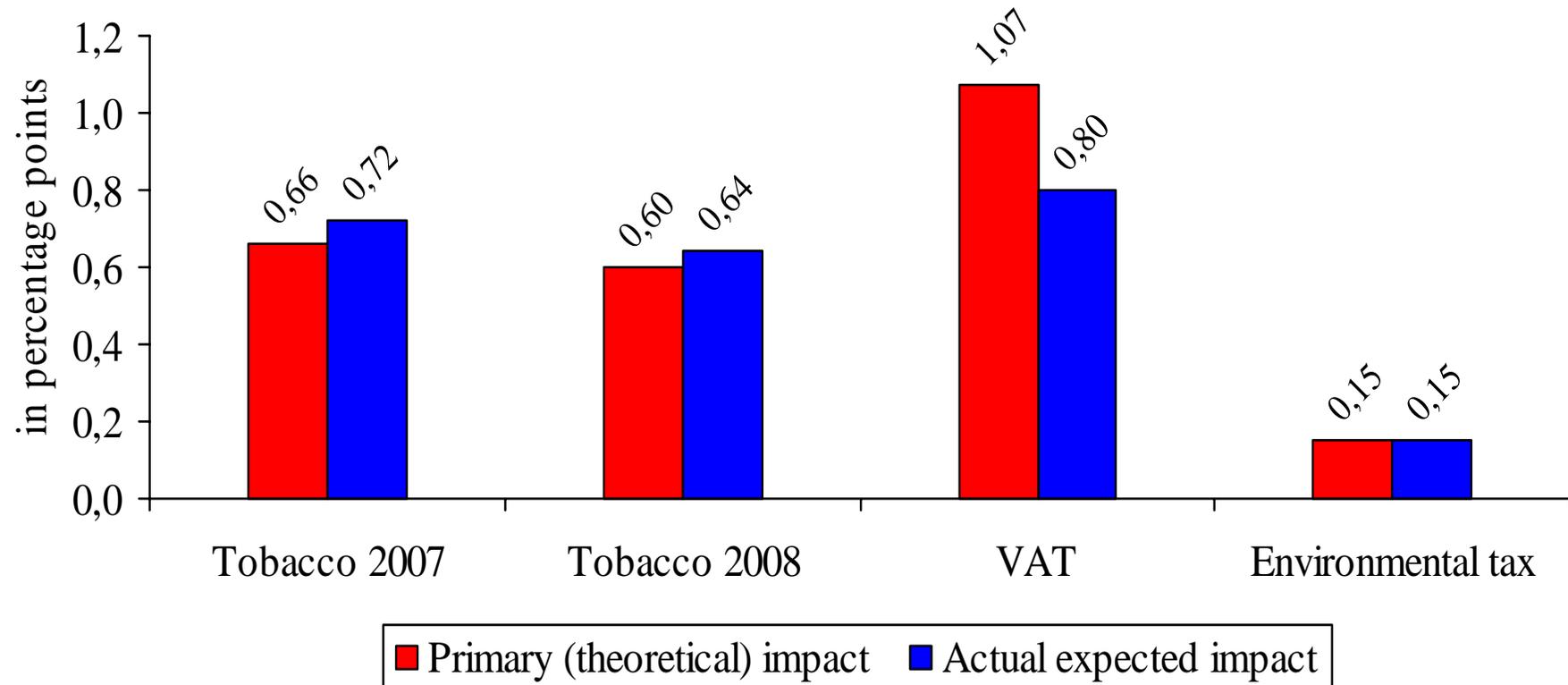
- Fully incorporate the fiscal reform;
- Deficit at 2.5 % of GDP in 2008;
- But part of the measures only temporary (further tax cuts in 2009 etc.);
- Without further measures, deficit would increase again in 2009.

Fiscal Impact on Consumption



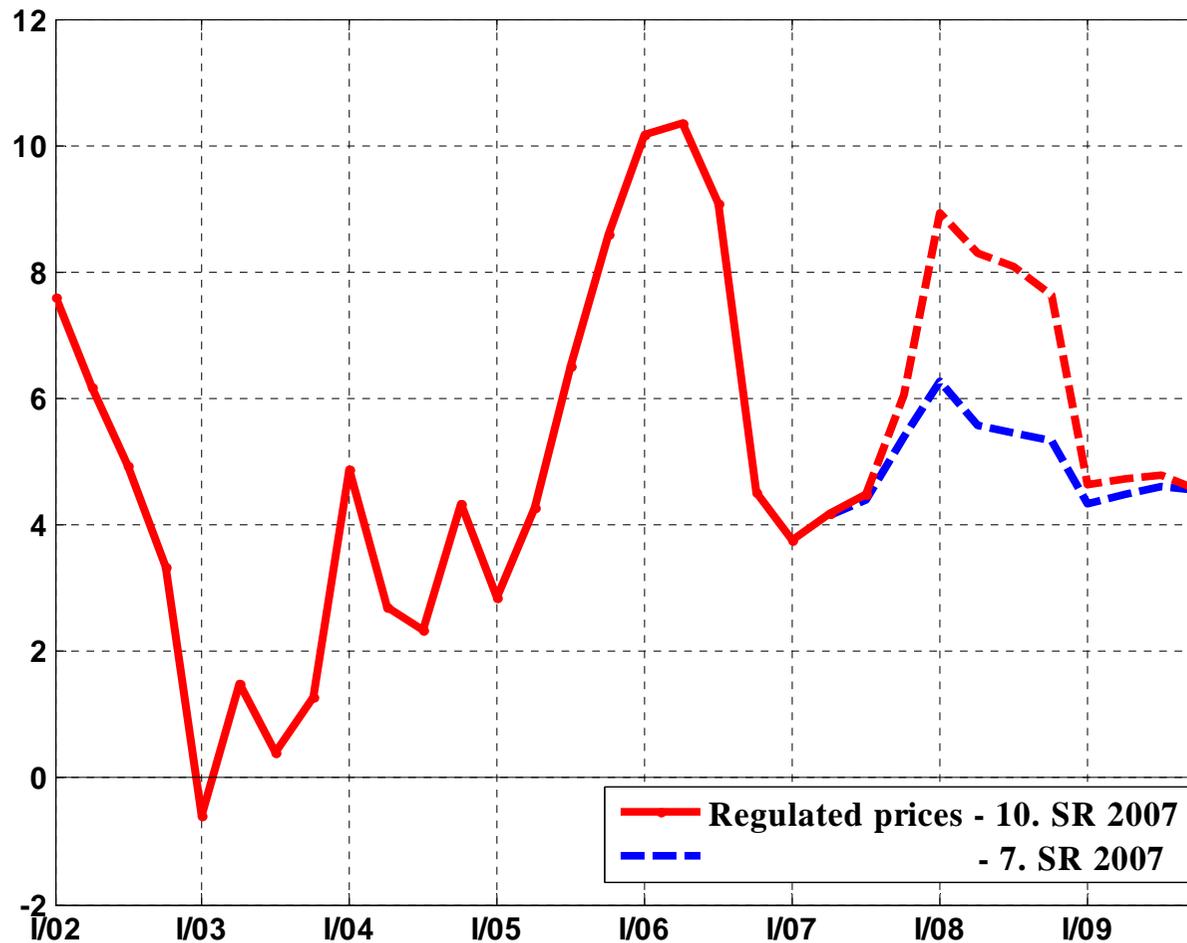
- Fiscal reform will slow down household consumption, partly through its redistribution effect (0.1-0.3. p.p.).

Impact of the Tax Changes



- Full impact expected for tobacco and regulated prices;
- Impact of VAT increase on market prices less than full (past experience of Czech Rep., Germany or Slovakia).

Regulated Prices (including taxes)



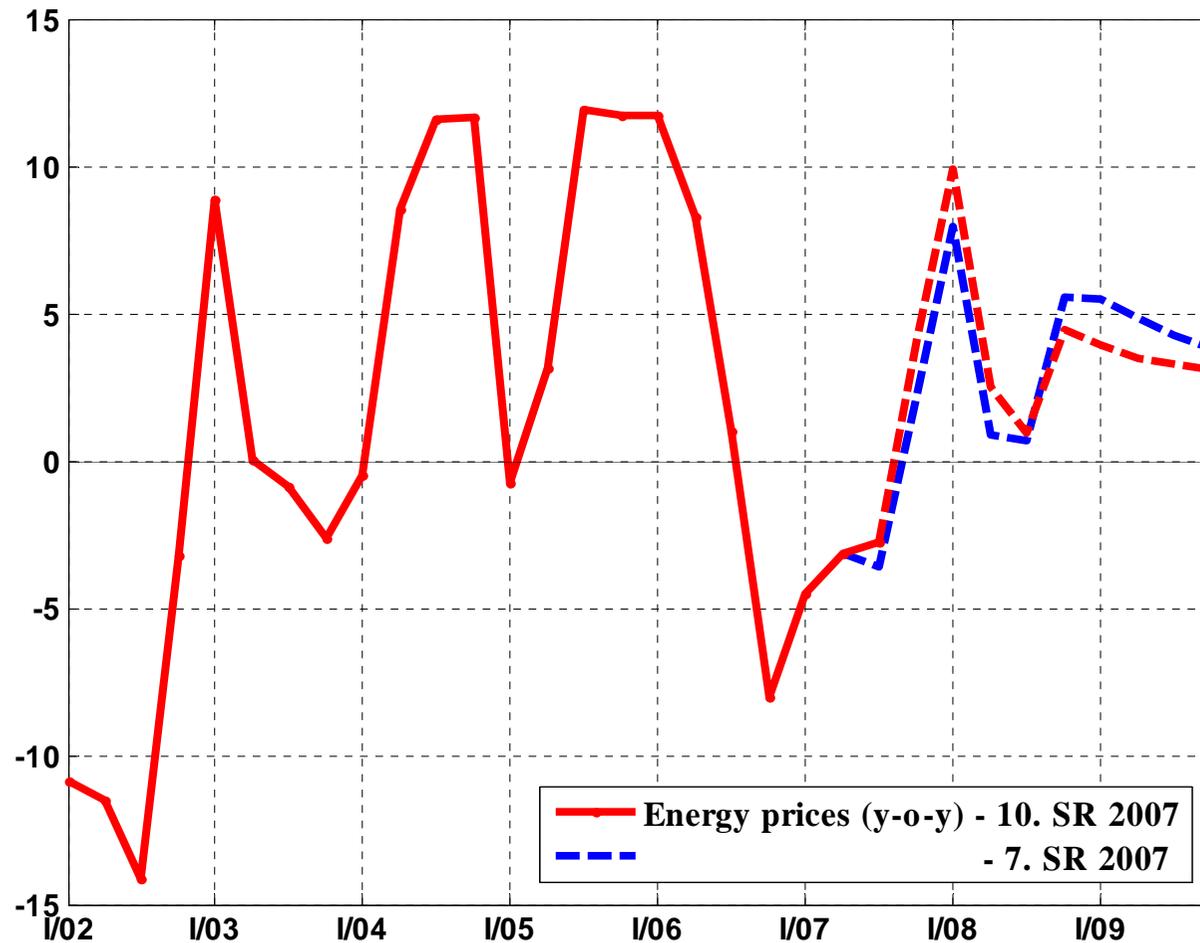
- Forecast of the y/y growth rate raised due to taxes (VAT);
- But also higher increase in rents and gas prices;
- Total impact of administrative measures:
2.2 p.p. end-2007,
2.8 p.p. end-2008,
0.8 p.p. end-2009.

Administrative Measures (selected items and total impact)

Year/date	Indirect tax changes in nonregulated prices		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	3.5%	0,11 p.p.
Total		1,09 p.p.		6.4%	1,08 p.p.
			including impact of tax changes: 0,00 p.p.		
2008 1Q 2008	Excise duties on tobacco products (delayed impact: 1Q+2Q)	0,60 p.p.	Regulated rents	20.0%	0,35 p.p.
	VAT 5 % --> 9 %	0,80 p.p.	Electricity	8.5%	0,33 p.p.
	Tax of energy (solid fuels)	0,03 p.p.	Heating	7.0%	0,22 p.p.
			Natural gas	6.0%	0,14 p.p.
			Water	6.3%	0,08 p.p.
Total		1,43 p.p.		7.9%	1,37 p.p.
			including impact of tax changes: 0,39 p.p. (VAT 5% --> 9%, tax of energy - electricity, heating)		
2009 1Q 2009			Regulated rents	15.0%	0,30 p.p.
			Electricity	7.0%	0,28 p.p.
			Natural gas	3.0%	0,07 p.p.
			Heating	2.0%	0,06 p.p.
Total		0,00 p.p.		4.7%	0,83 p.p.
			including impact of tax changes: 0,00 p.p.		

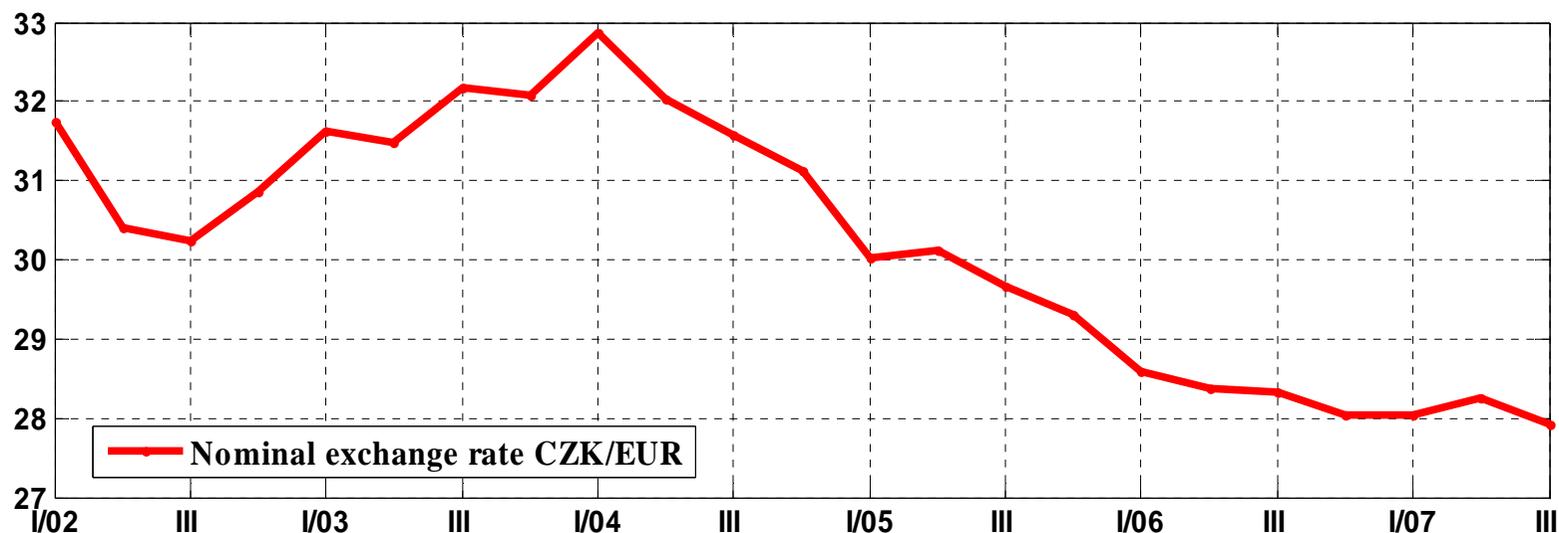
- Increase in VAT rate and introduction of environmental taxes will partly affect regulated energy prices.

Energy Prices



- Relatively small changes compared to the July forecast (higher oil prices vs. weaker USD).

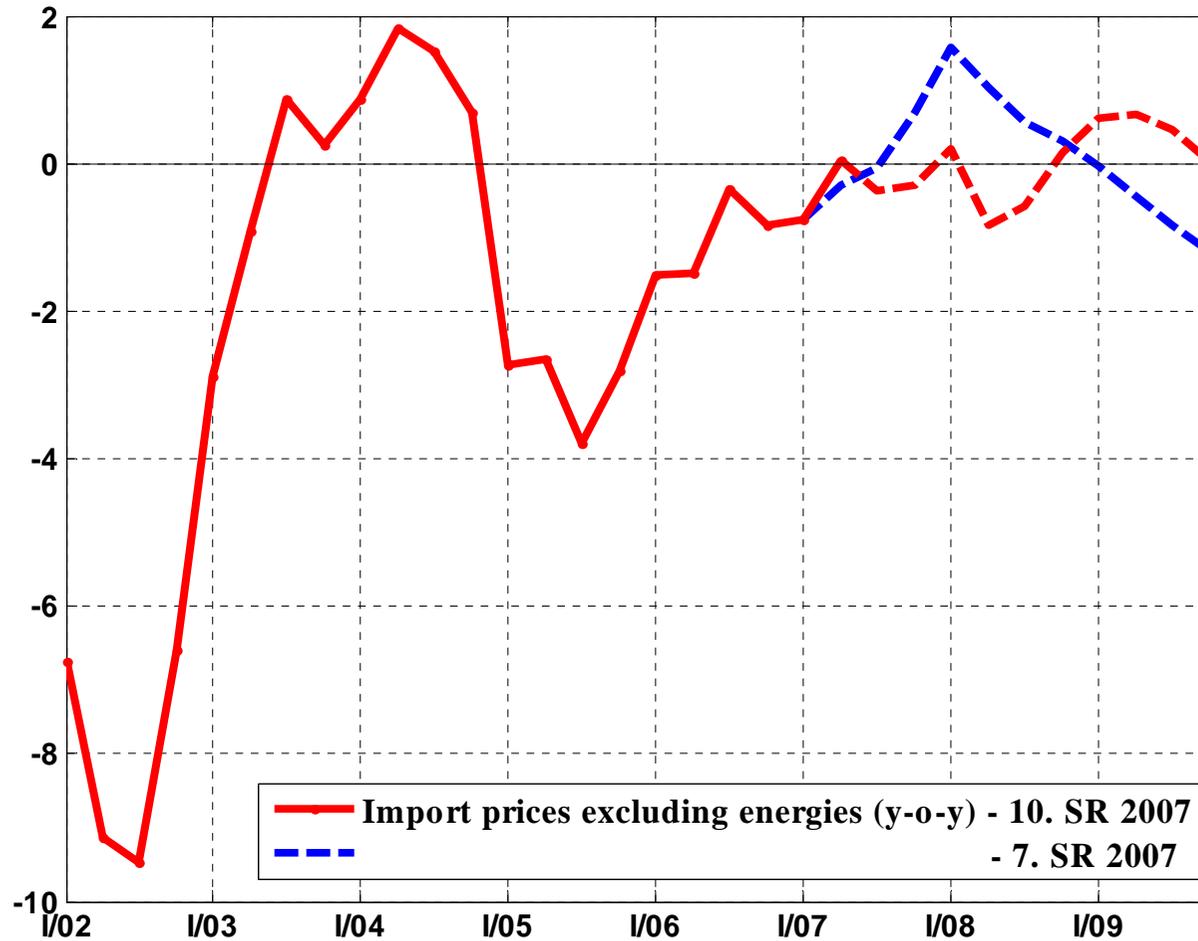
Exchange Rate



External forecasts of CZK/EUR

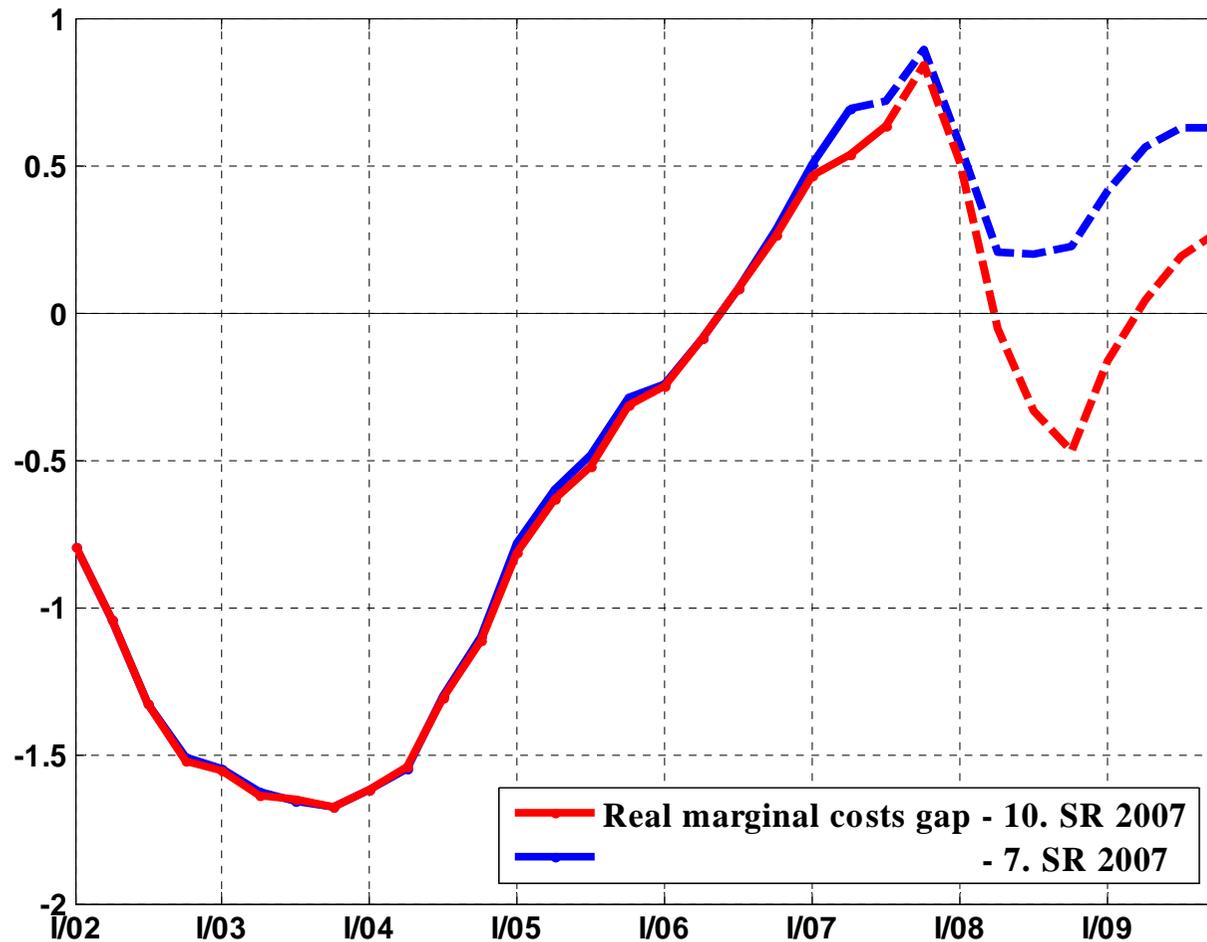
Date of forecast	Next quarter	1Y horizon	
	Consensus Forecasts	CNB's survey	Consensus Forecasts
10/06	28.2	27.6	27.8
1/07	27.5	27.1	27.6
4/07	28.0	27.2	27.7
7/07	28.5	27.4	27.9
10/07	27.6 (4Q07)	26.9	27.6

Import Prices excluding Energy



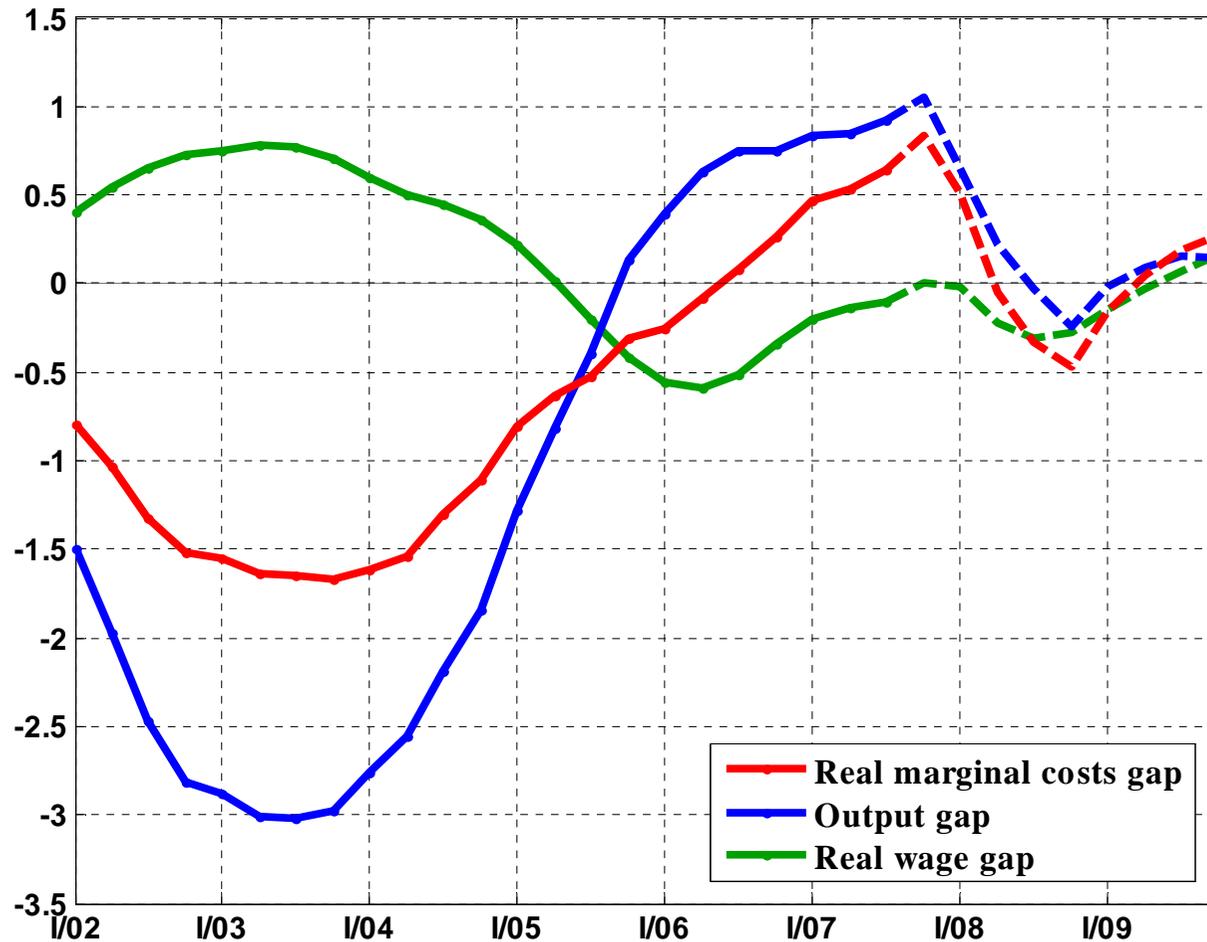
- Forecast revised down due to stronger exchange rate.

Pressures from the Real Economy



- Real economy will turn slightly anti-inflationary in 2008 due to fiscal restrictions.

Pressures from the Real Economy



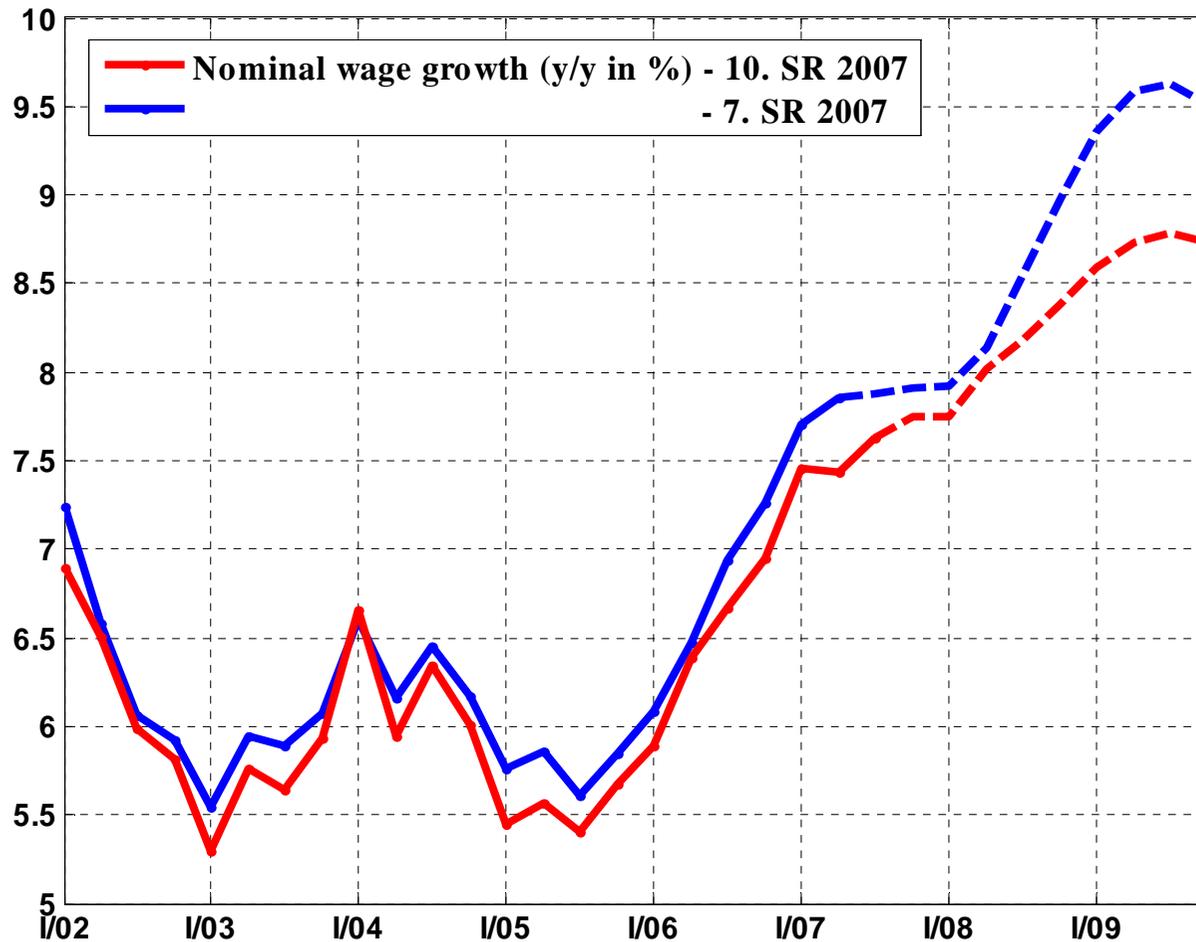
- Output gap will turn slightly negative in 2008 due to fiscal restrictions (overall monetary conditions and EU growth broadly neutral);
- Real wages will return to slightly anti-inflationary in 2008, but nominal wages accelerating.

GDP Growth Forecast

y/y change	2007	2008	2009
Gross domestic product	6.2	5.0	5.6
Household consumption	6.2	3.6	4.2
Government consumption	0.6	-0.1	0.7
Total investment	9.9	8.2	9.6
Exports	14.0	12.6	11.2
Imports	14.0	12.0	10.9

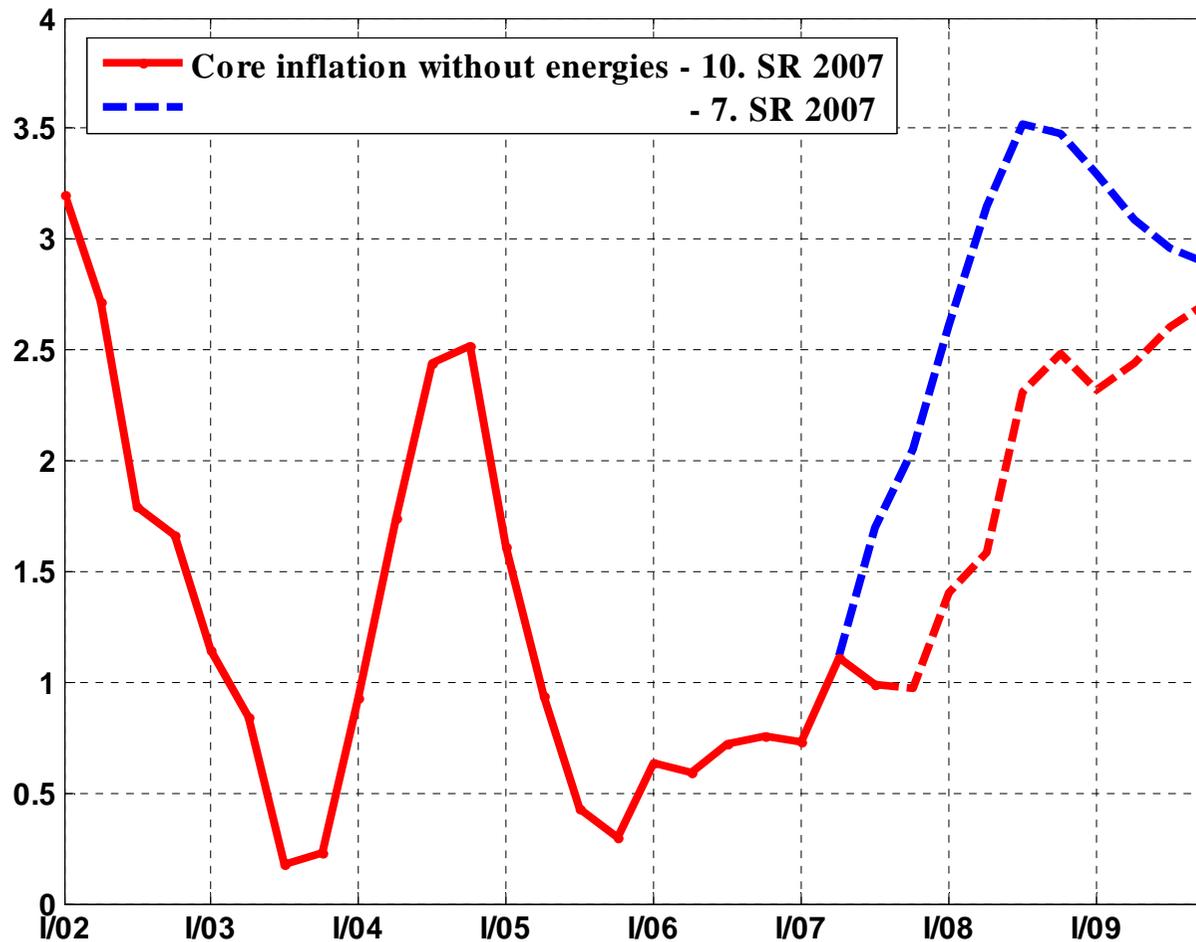
- GDP growth forecast revised down by 0.4 p.p. for 2008;
- Lower forecast of household consumption growth in 2008 (fiscal restrictions – see above);
- Total investments in 2009 slightly supported by tax cuts.

Nominal Wage Growth



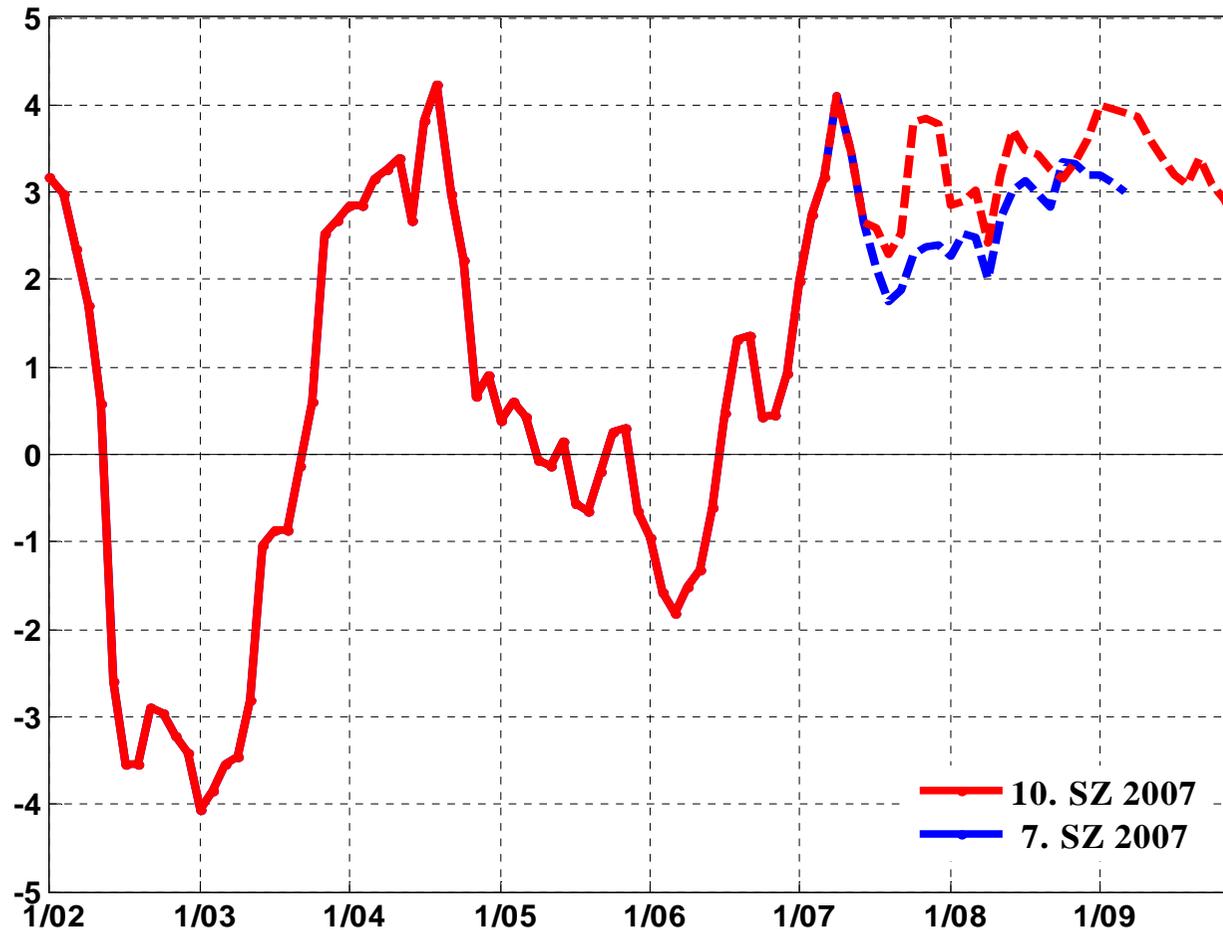
- Growth rate of average nominal wage in business sector: 8.7 % in 2008, 8.9 % in 2009;
- NULC growth: 3.0 % in 2008; 1.8 % in 2009.

Core Inflation



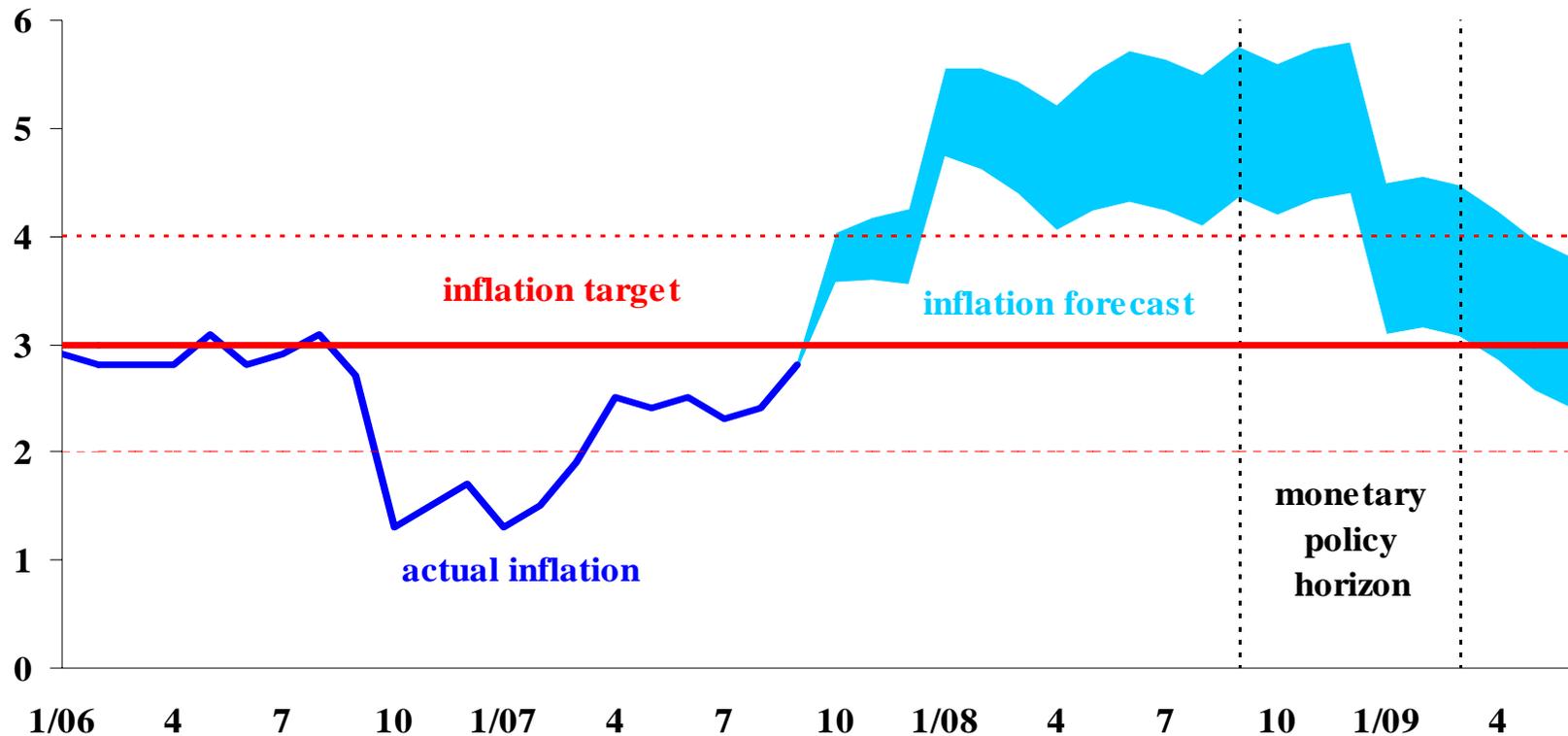
- Forecast substantially lowered due to lower Q3/07 outcome, stronger CZK and weaker pressures from the real economy;
- Forecasted acceleration: rising inflation expectations driven by supply-side pressures.

Food Prices (excluding taxes)



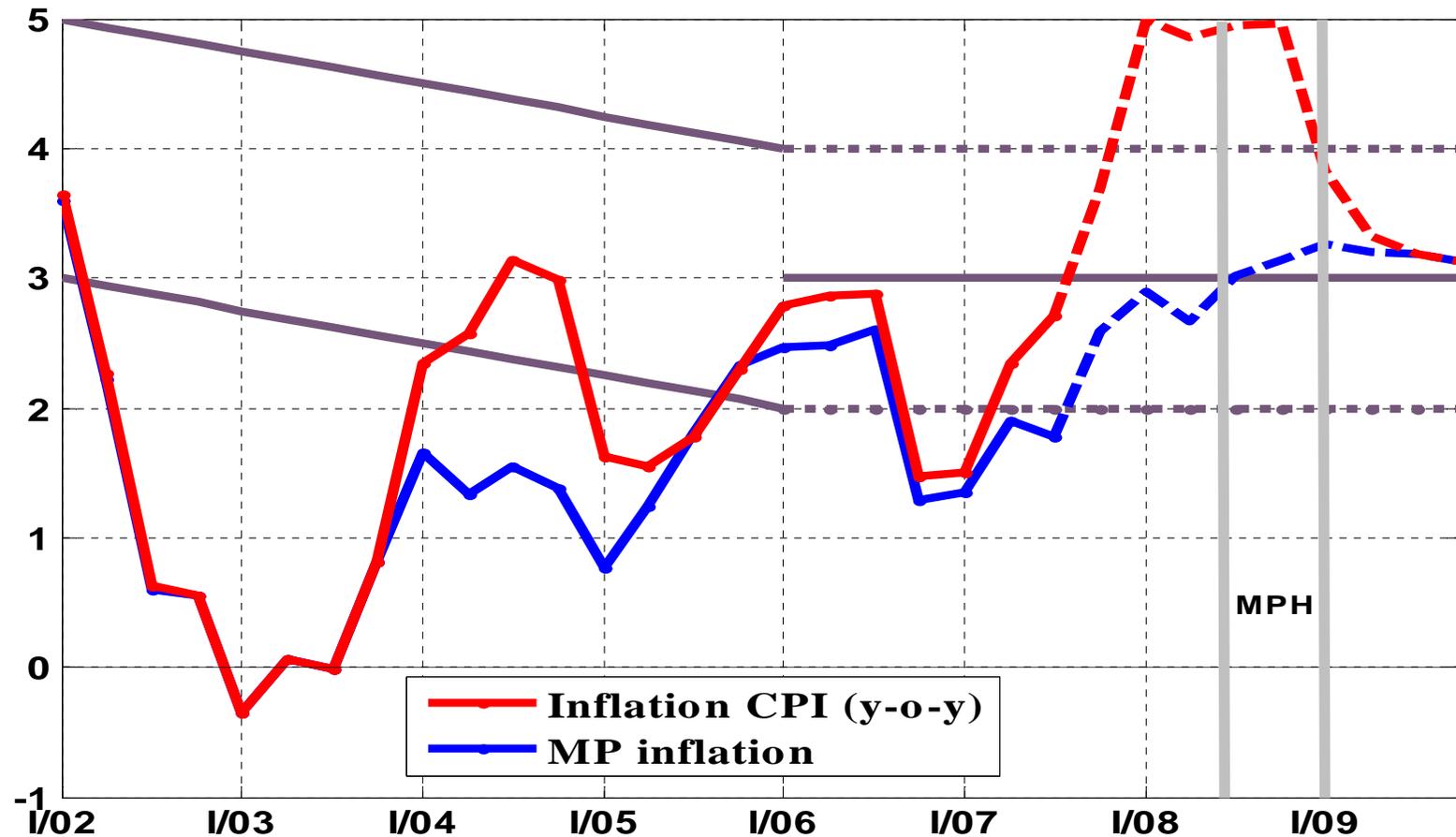
- Forecast increased due to recent developments and higher import food prices.

Overall Inflation



- Forecast increased mainly due to one-off measures;
- Consistent with the macroeconomic forecast and its assumptions is growth in nominal interest rates.

Inflation Net of Tax Changes



- Monetary policy inflation slightly above 3 % on the MP horizon (forecast lowered).

Thank you
for your attention.