

CNB's New Forecast

Inflation Report I/2009

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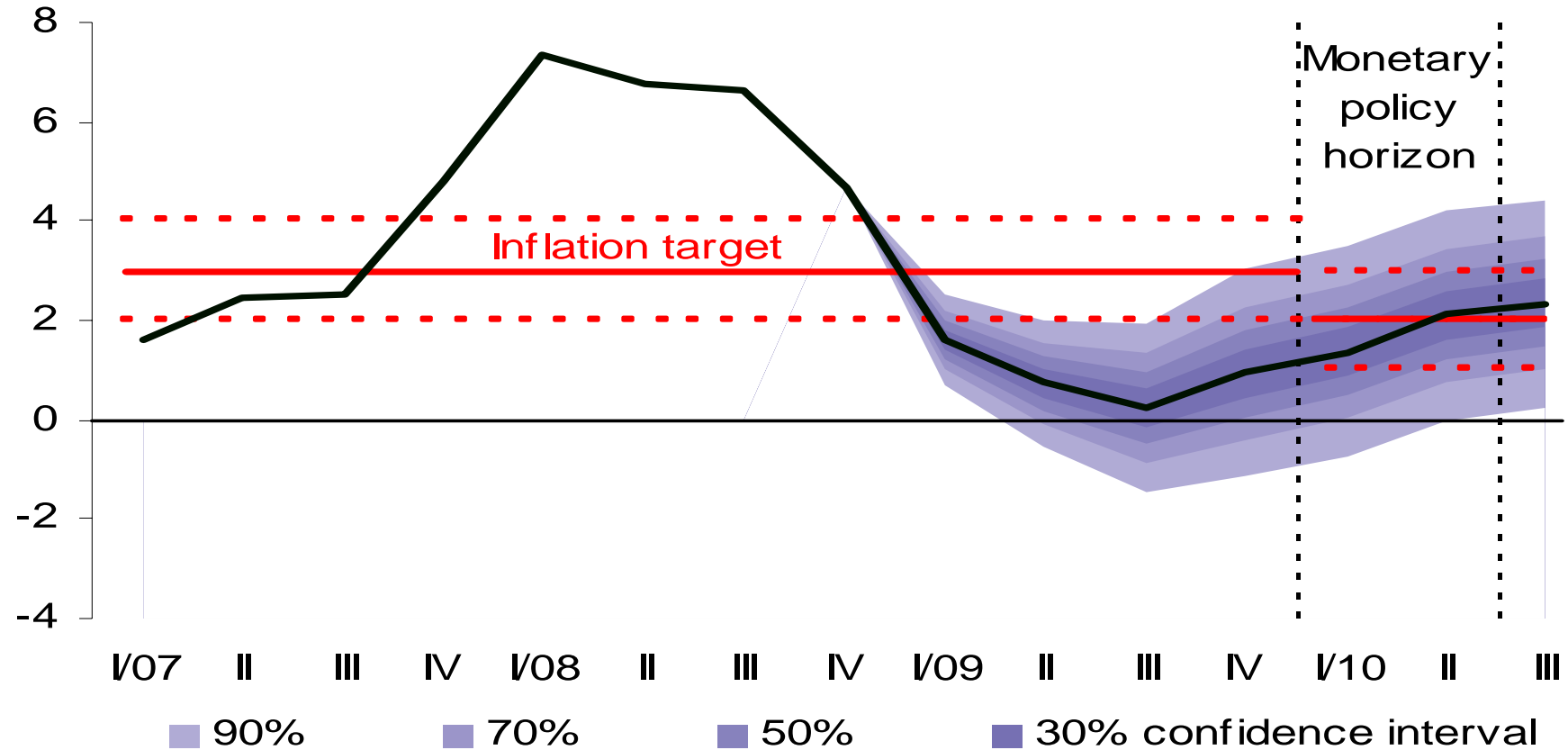
Monetary and Statistics Department

Meeting with analysts, Prague, 13 February 2009

Summary of the Inflation Forecast

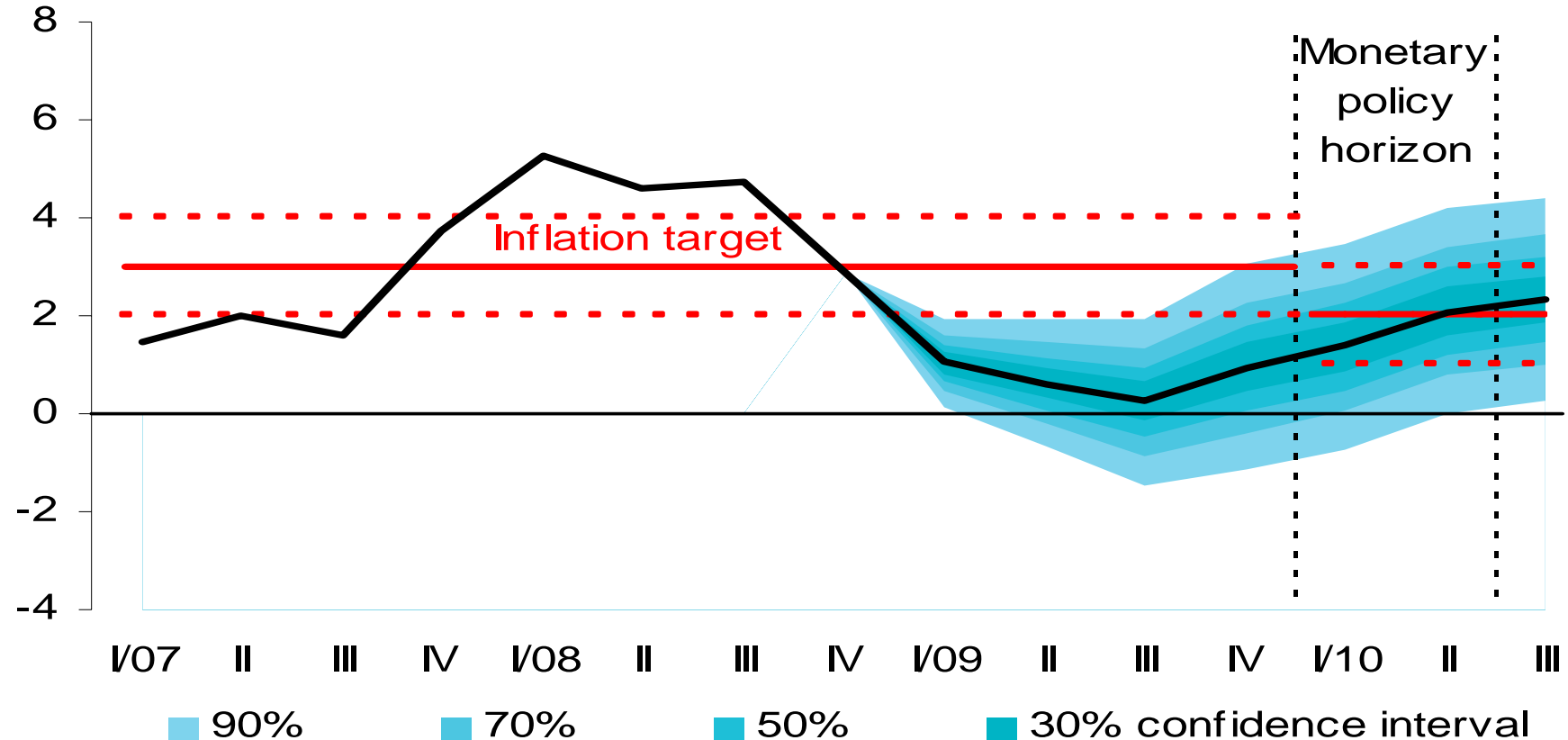
- Overall and MP-relevant inflation will fall towards zero in the short-term, but on the MP horizon will be close to the new 2% target;
- Inflation forecast is substantially lower than the previous one;
- Lower forecast of regulated prices as well as market prices;
- Reflects mainly the observed drop in oil and food prices;
- Weaker CZK is pushing the macroeconomic pressures towards pro-inflationary;
- Domestic pro-inflationary pressures fading away quickly;
- Fall in GDP (-0.3%) and pronounced wage slowdown is underway.

Headline Inflation Forecast



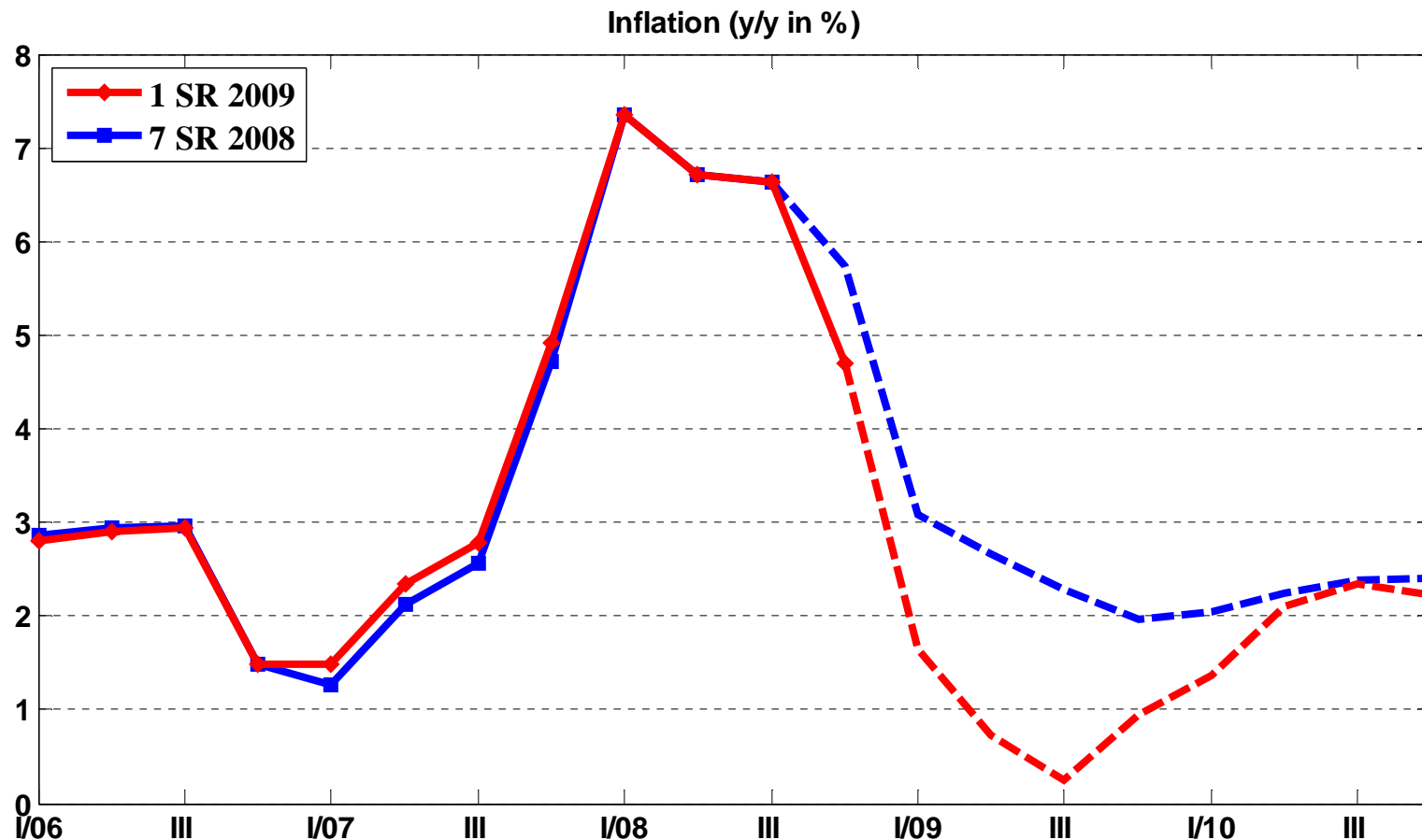
- Inflation will fall down almost to zero in Q3/09;
- Heading to the new 2% target on the MP horizon.

MP-Relevant Inflation Forecast



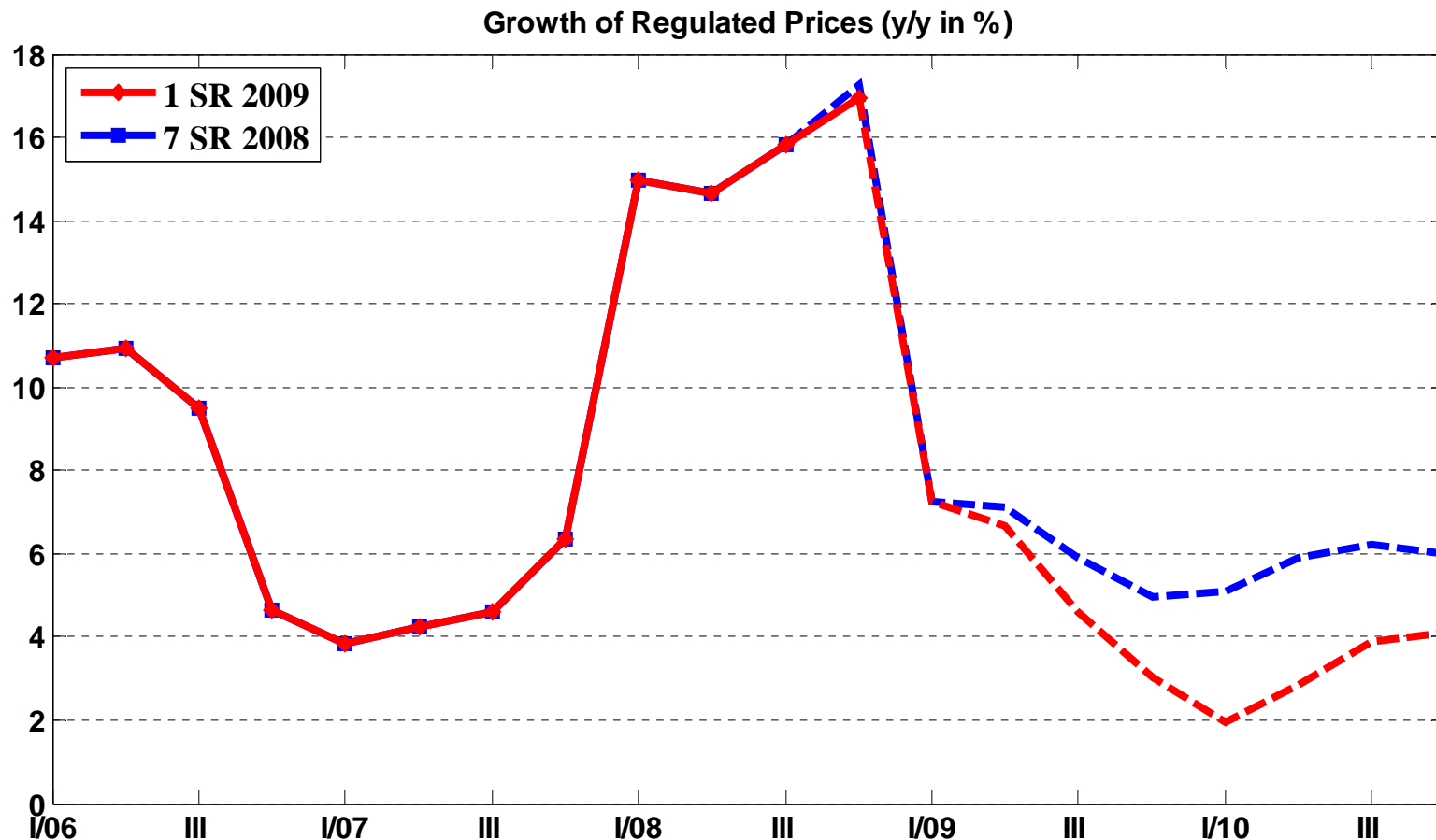
- No further indirect tax changes assumed;
- Forecast coincides with headline inflation from Q3/2009.

Comparison with Previous Inflation Forecast



- Forecast substantially lowered at its short end;
- The forecast is only marginally lower from Q2/2010.

Regulated Prices



- Forecast decreased due to lower international energy prices and assumed smaller increase in regulated rents in 2010.

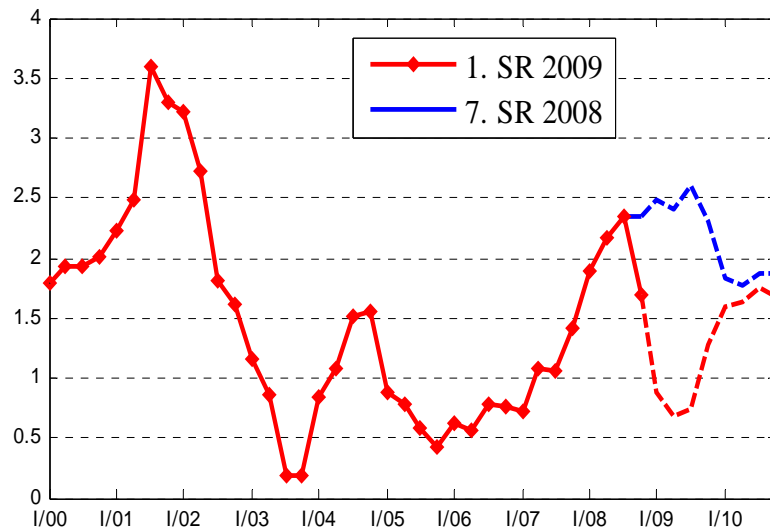
Administrative Measures (selected items and total impact)

	2008		2009		2010	
	Y/Y growth	Impact in p.p.	Y/Y growth	Impact in p.p.	Y/Y growth	Impact in p.p.
Regulated prices - total	17,1	2,93	3,2	0,61	5,0	0,98
of which (selected items):						
Regulated rents	22,2	0,38	27,0	0,55	24,0	0,61
Electricity	9,5	0,37	12,1	0,49	0,0	0,00
Natural gas	34,0	0,75	-24,2	-0,70	7,2	0,15
Heating	14,4	0,44	4,0	0,13	2,0	0,07
Healthcare	41,9	0,56	2,0	0,04	2,0	0,04
Primary impact of tax changes on non-regulated prices		1,43		0,00		0,00

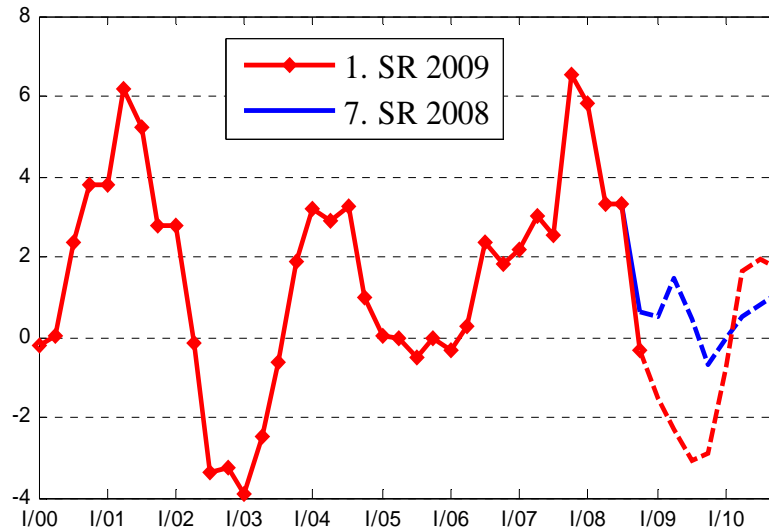
- Much lower impact of administrative measures in 2009-10 than in 2008 (but still a major source of inflation);
- January 2009: impact above forecast, roughly by 0.1 p.p.

Core Inflation and Food Prices

“Core” Inflation (in %, excl. tax changes)

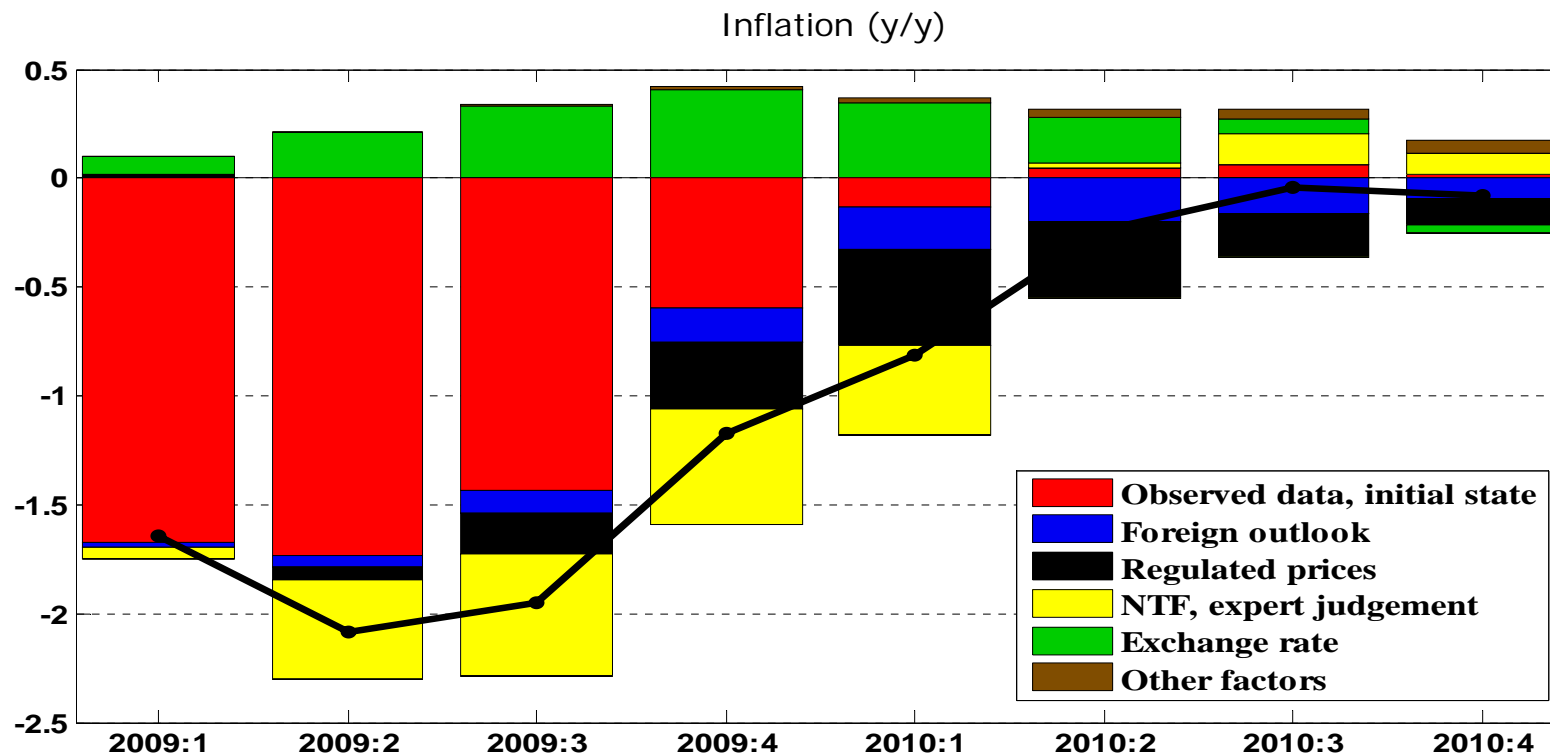


Food Price Growth (in %, excl. tax changes)



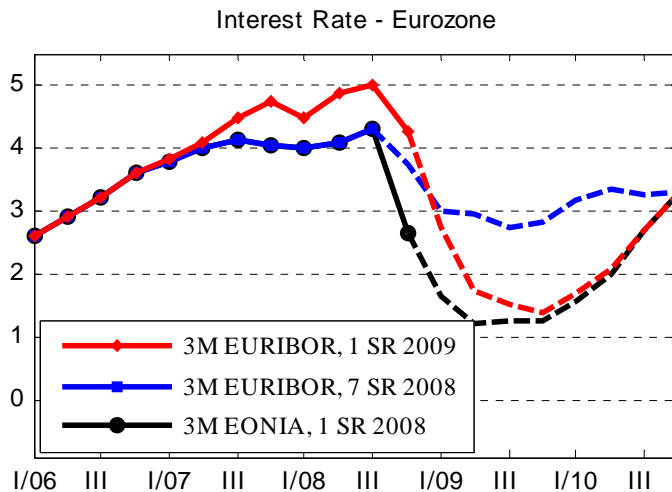
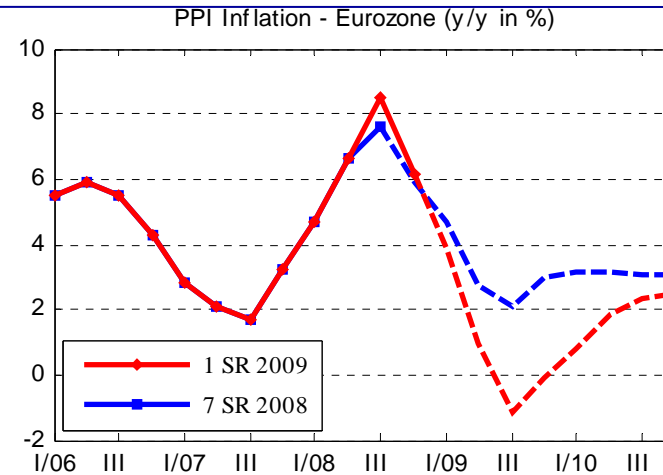
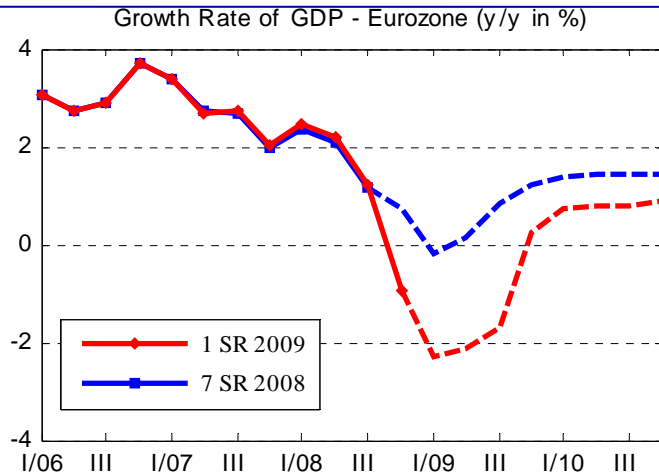
- Forecast lowered for all components of the market prices;
- Falling food and fuel prices, core inflation remains positive;
- Increase of inflation from late-2009: depreciated exchange rate, going NULC, base effects.

Inflation Forecast Change Decomposition



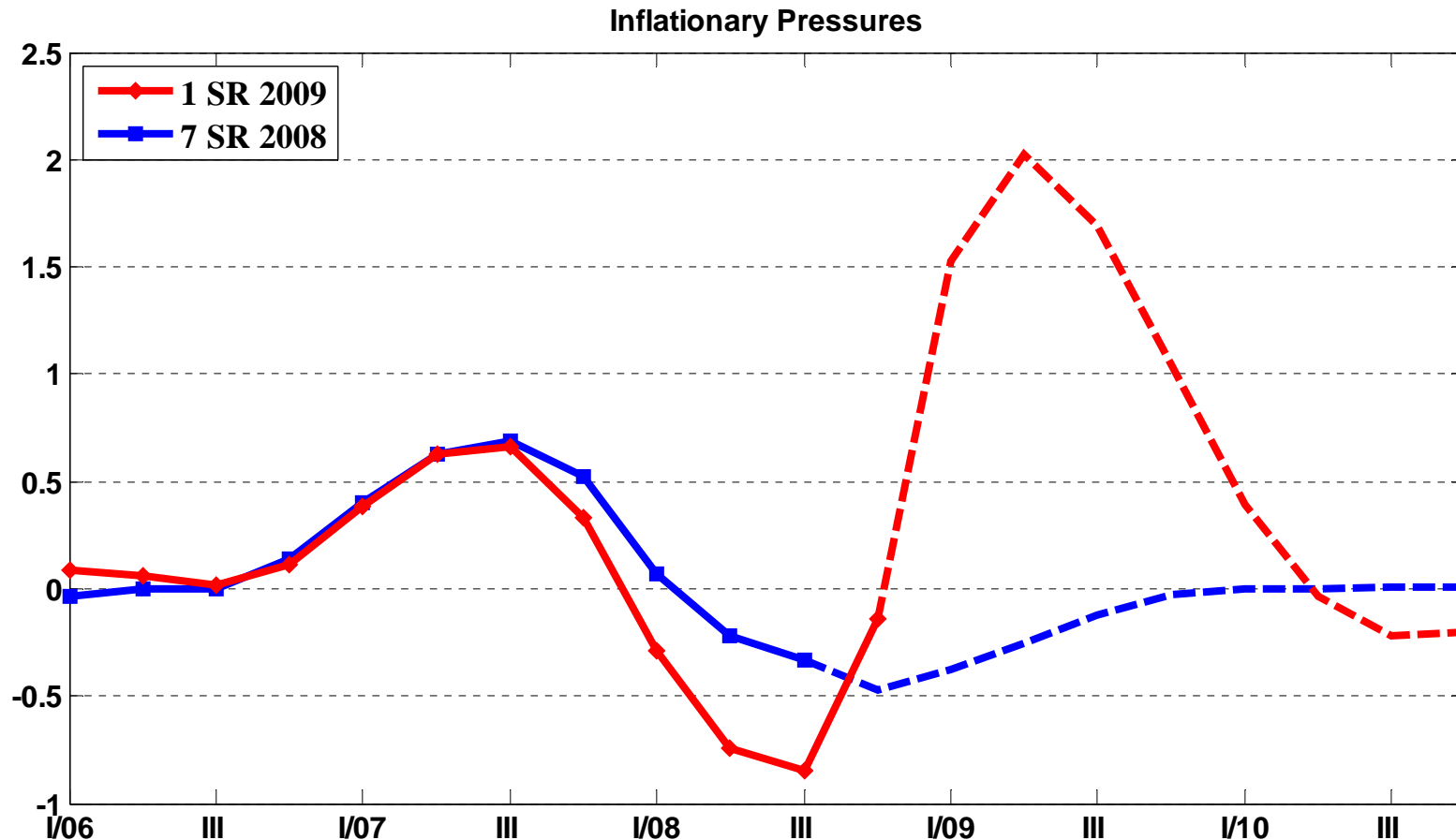
- Lower forecast due to observed and expected further fall in energy and food prices (and also core inflation);
- Pro-inflationary impact of the exchange rate;
- Foreign outlook: small anti-inflationary impact.

External Assumptions



- Large downward impact on the Czech GDP growth and interest rate outlook;
- Note: switch back from EONIA to 3M EURIBOR (symmetric treatment of the credit premium).

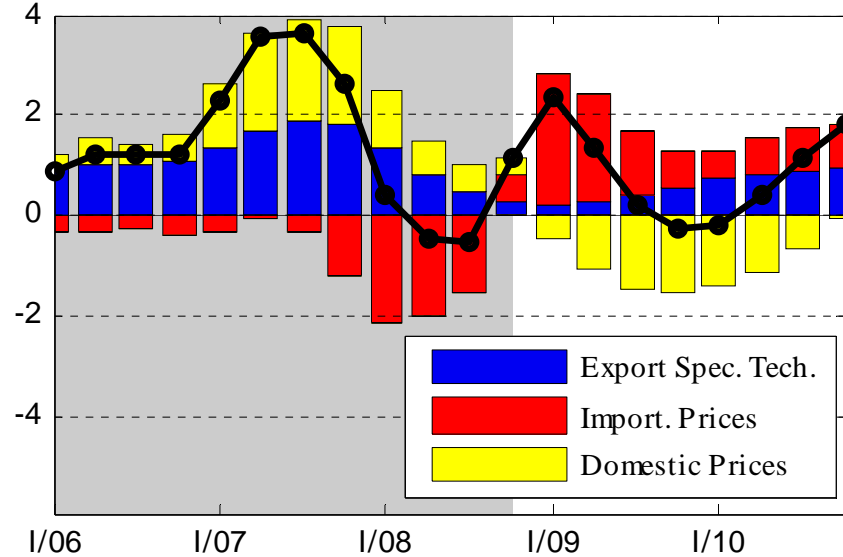
Overall Inflationary Pressures



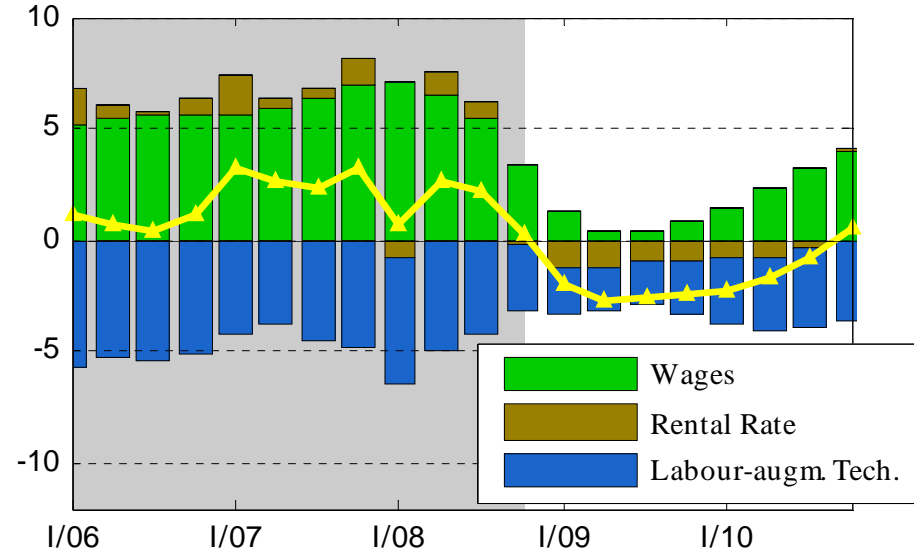
- Anti-inflationary pressures fading away quickly;
- More inflationary macro outlook due to weaker CZK.

Domestic Pressures vs. Import Prices

Nominal Marginal Cost in Consumption Sector (q/q in %, ann.)

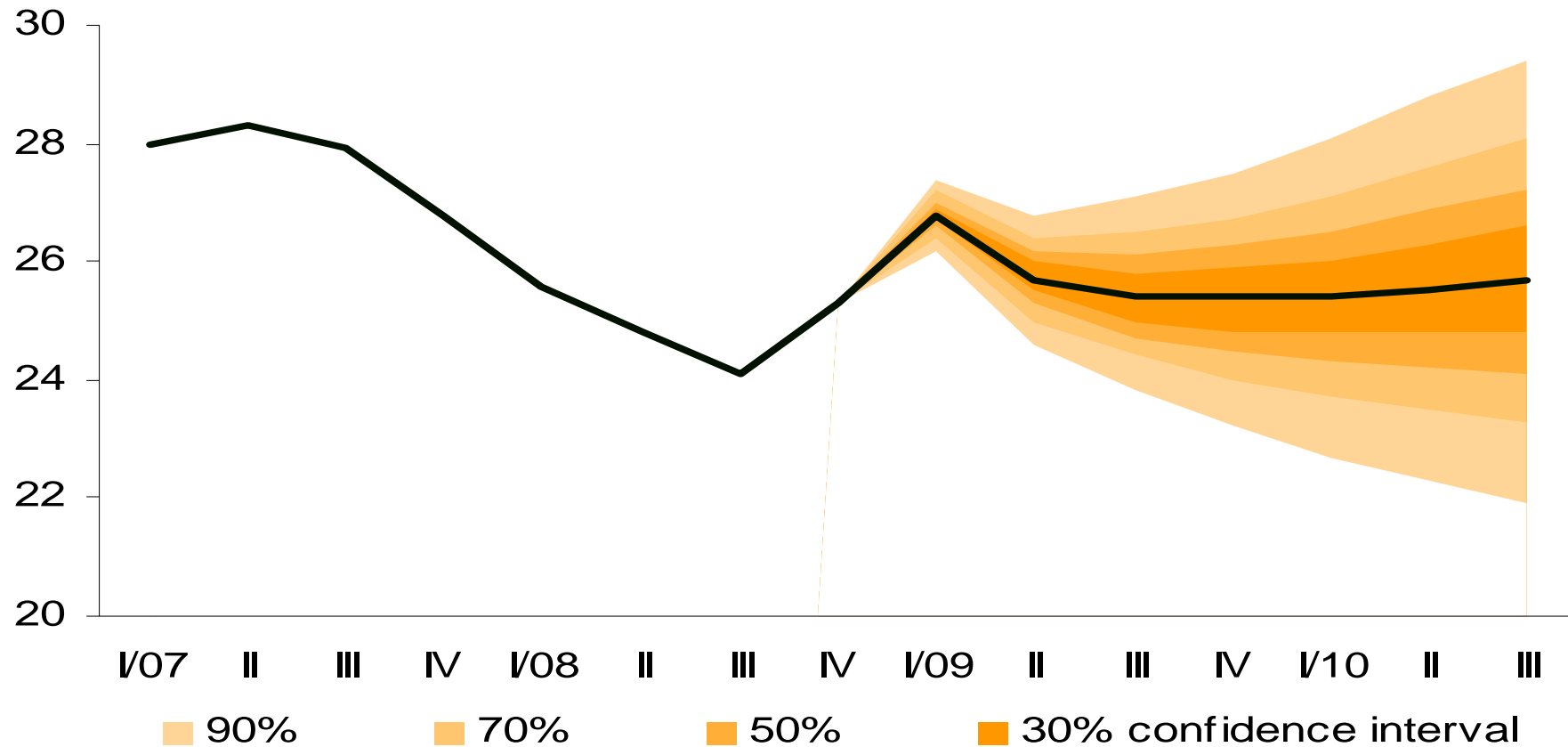


Nom. Marginal Cost in Domestic Prod. (q/q in %, ann.)



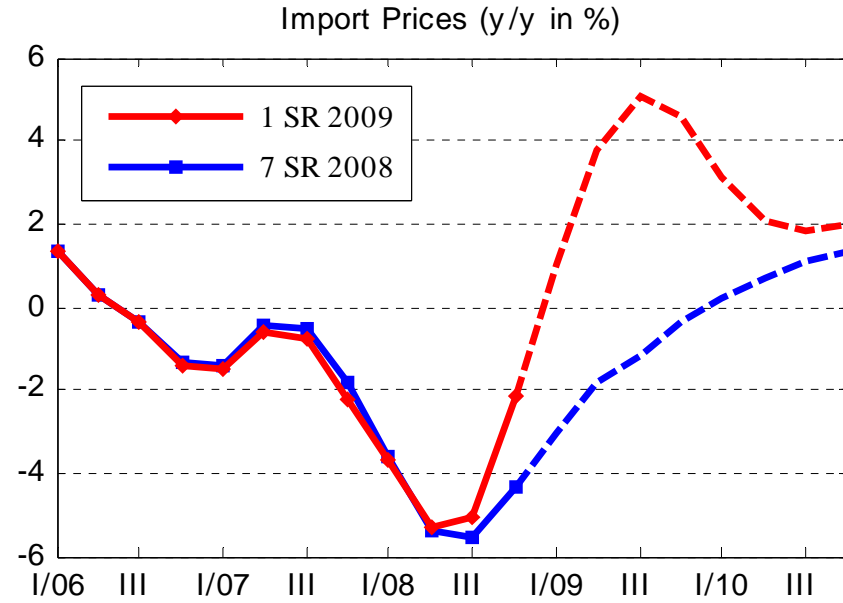
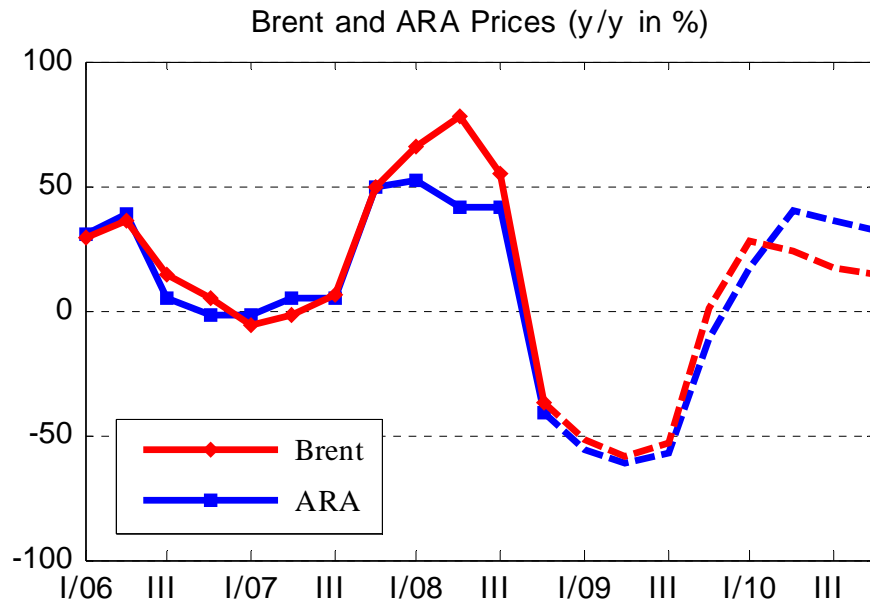
- Pro-inflationary impact of the import prices due to the observed exchange rate depreciation (direct channel);
- It will be partly offset by anti-inflationary developments of the domestic economy (much slower wage growth; but productivity growth weaker as well).

Exchange Rate Forecast (CZK/EUR)



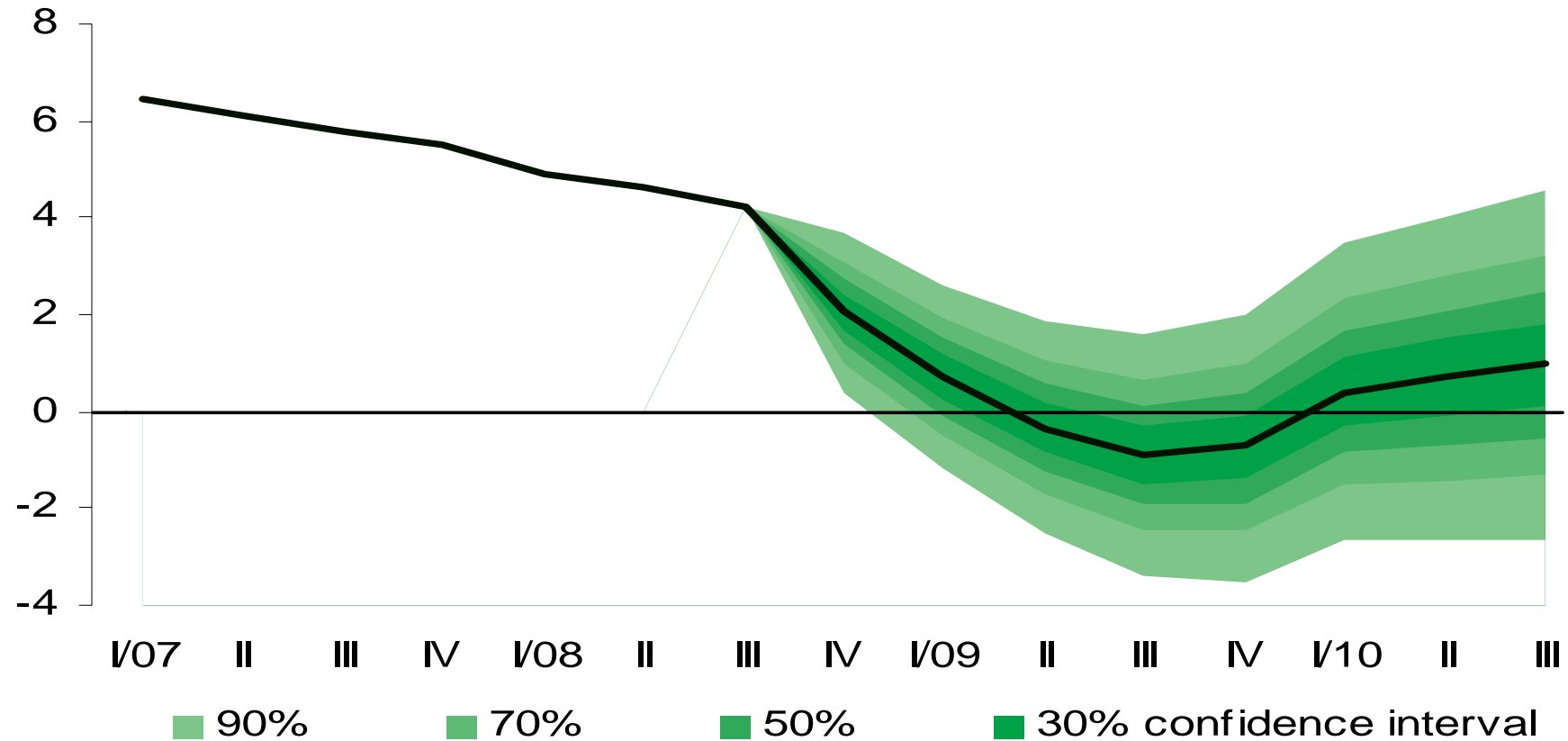
- CZK will initially correct its depreciation observed at the beginning of 2009 and will be broadly stable thereafter;
- Substantial uncertainty due to large volatility.

Import Prices



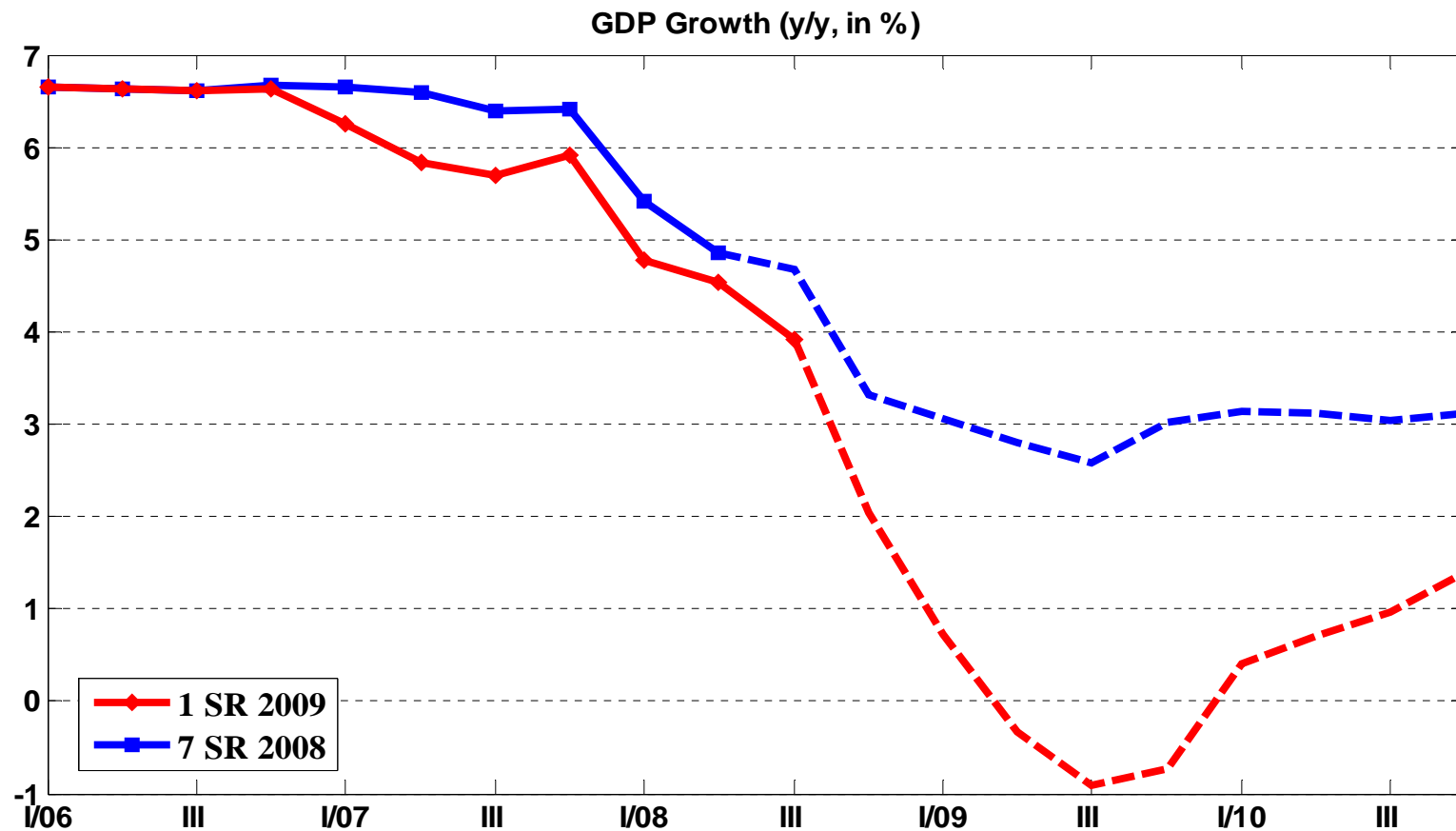
- Pro-inflationary impact of import prices on the whole forecast horizon due to the depreciated exchange rate;
- Partly offset by falling fuel prices and slower PPI growth in the eurozone.

GDP Growth Forecast



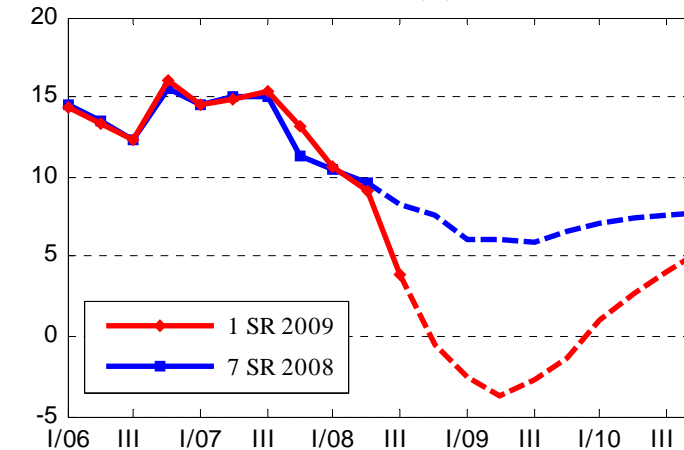
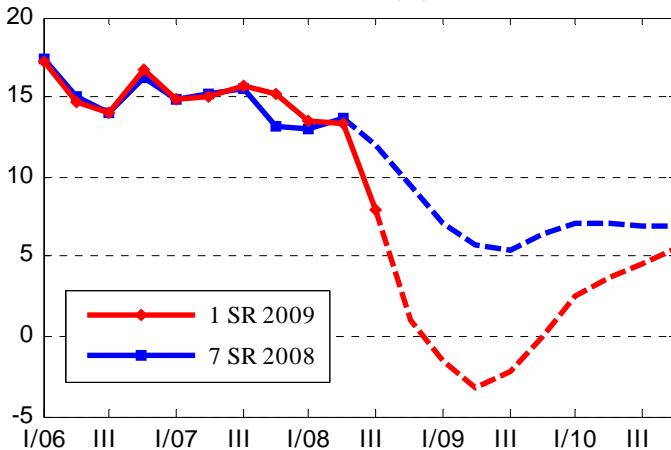
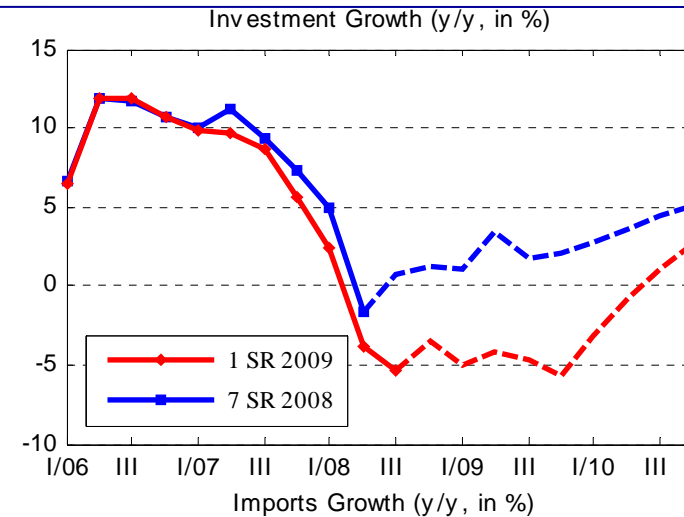
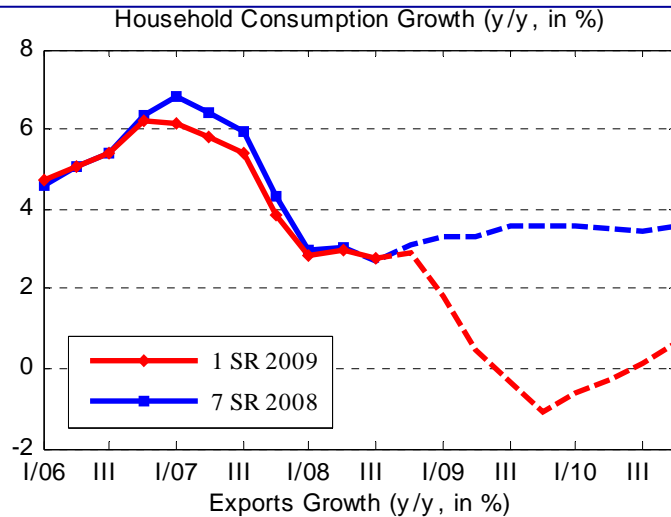
- Moderate recession followed by a gradual recovery in 2010;
- Yearly averages: 2008: 3,8 %; 2009: -0,3 %, 2010: 0,9 %;
- Note: poor data releases for Q4/2008.

Comparison with Previous GDP Forecast



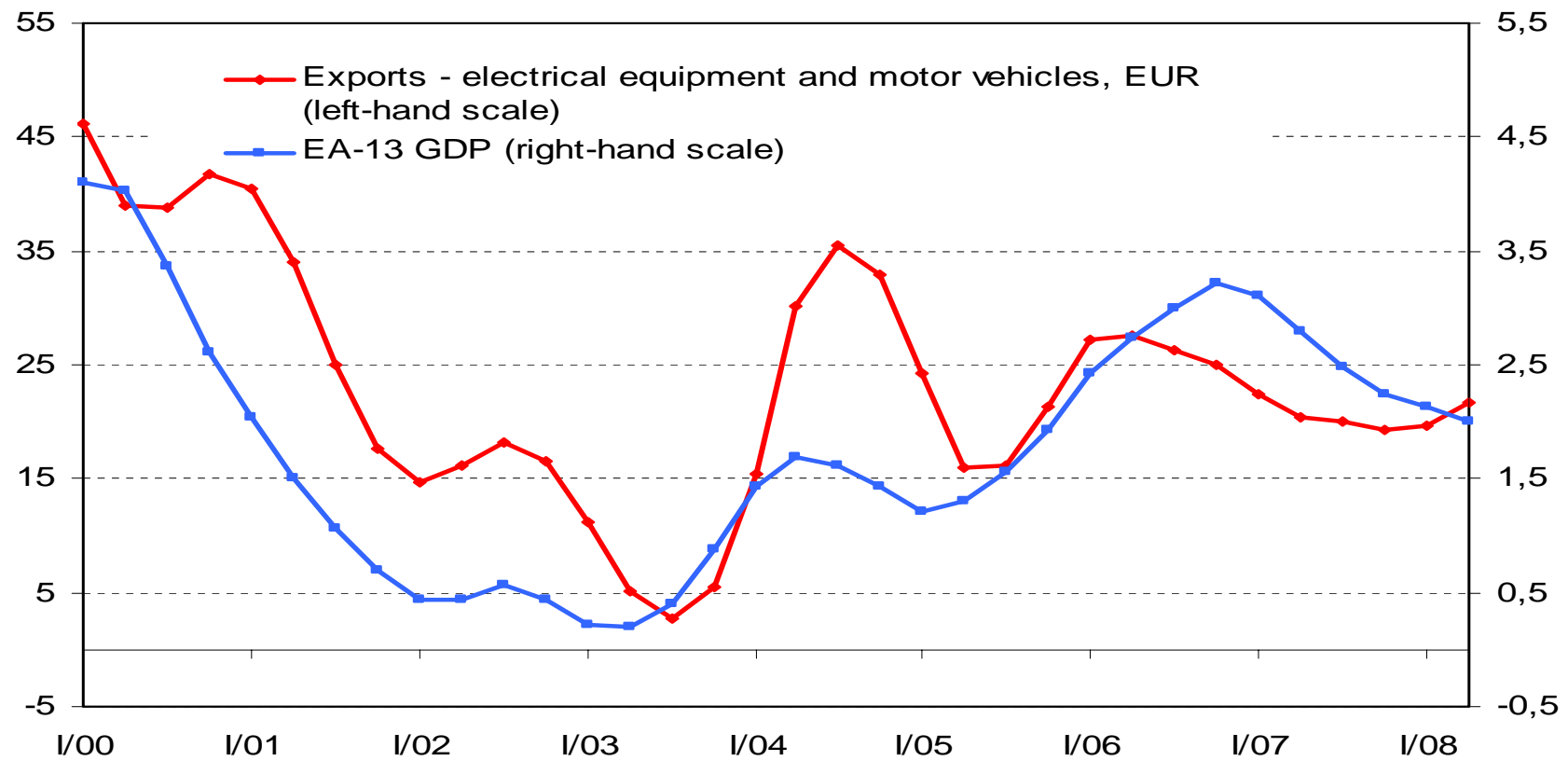
- GDP outlook revised down substantially;
- Forecast even below the previous alternative scenario.

Forecast of Aggregate Demand



- Fall in exports, imports and investment;
- Household consumption broadly flat (yearly averages).

Cyclicality of Czech Exports



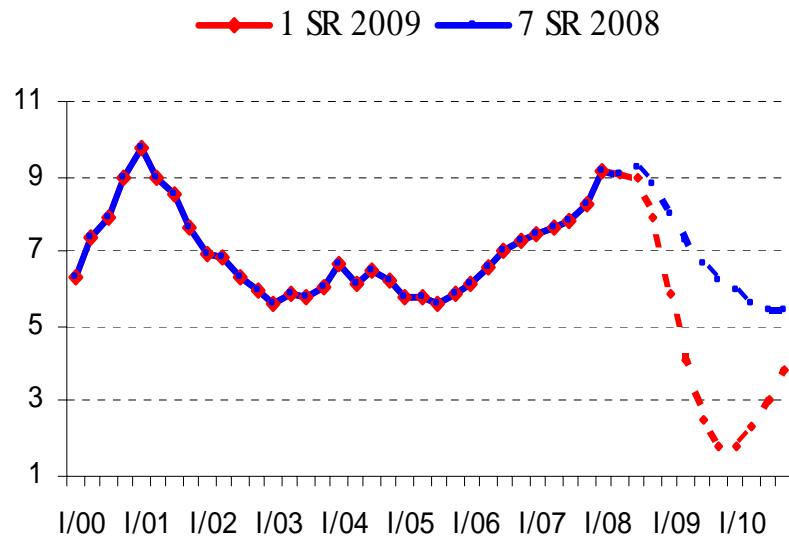
Source: Analyses of current economic alignment with the euro area, 2008



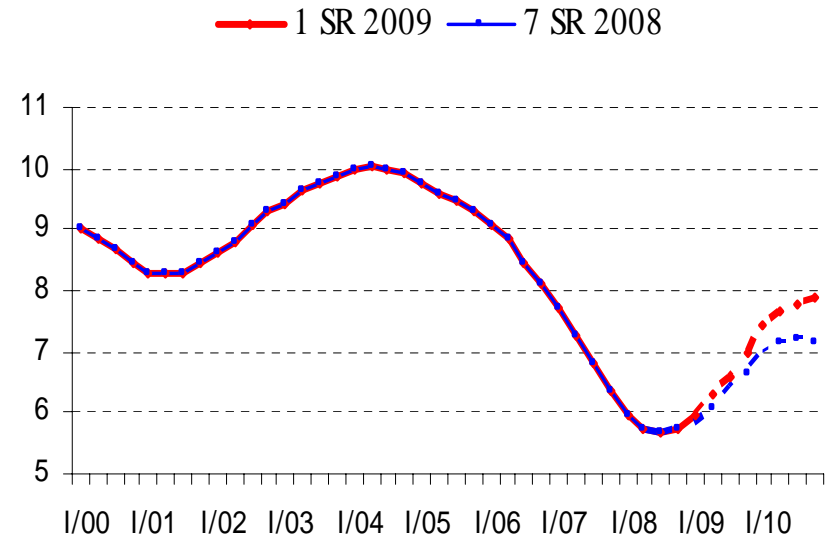
- Czech exports concentrated in heavily cyclical industries;
- Asymmetric nature of the shock (in terms of magnitude).

Labour Market Forecast

Nominal wage growth in business sector
(y/y in %, seasonally adjusted)

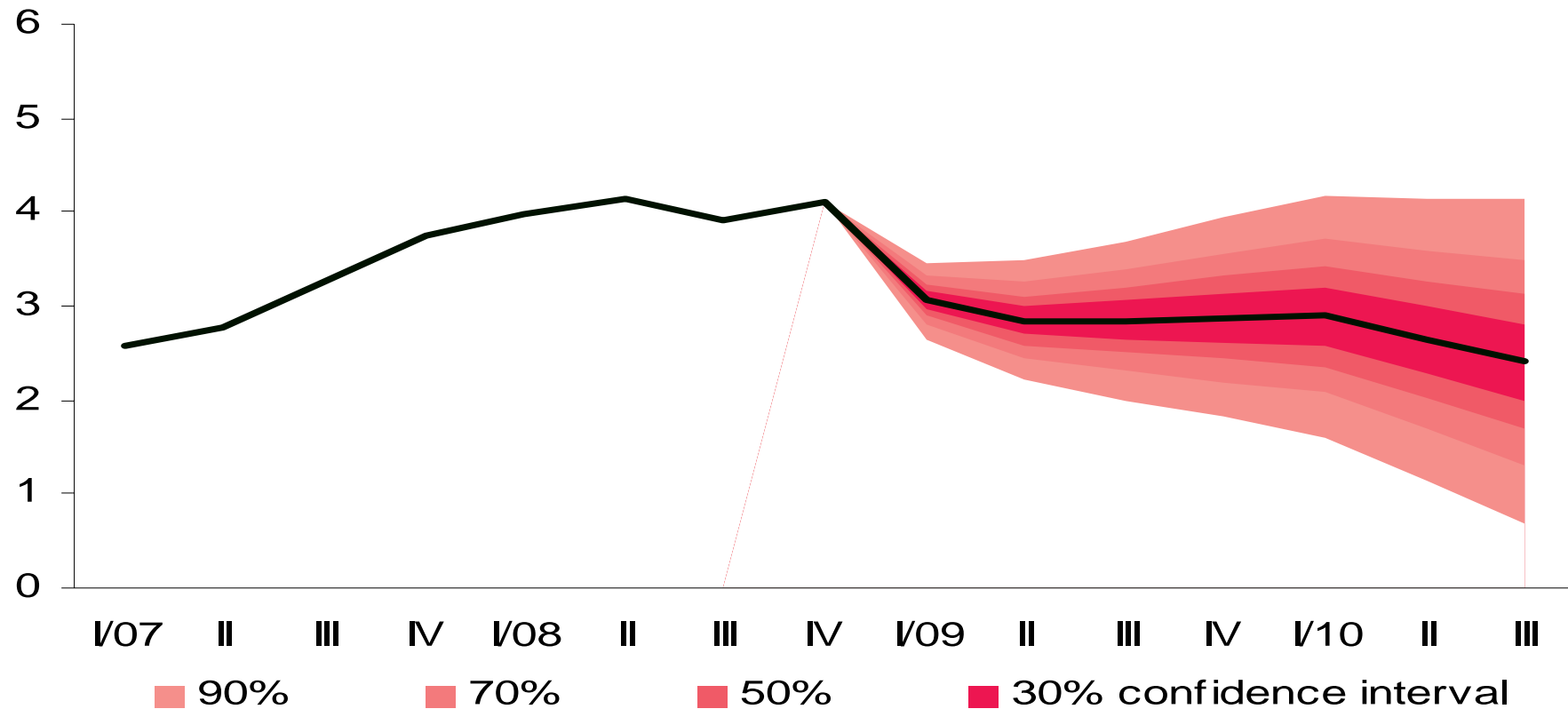


Total registered unemployment
(in %, seasonally adjusted)



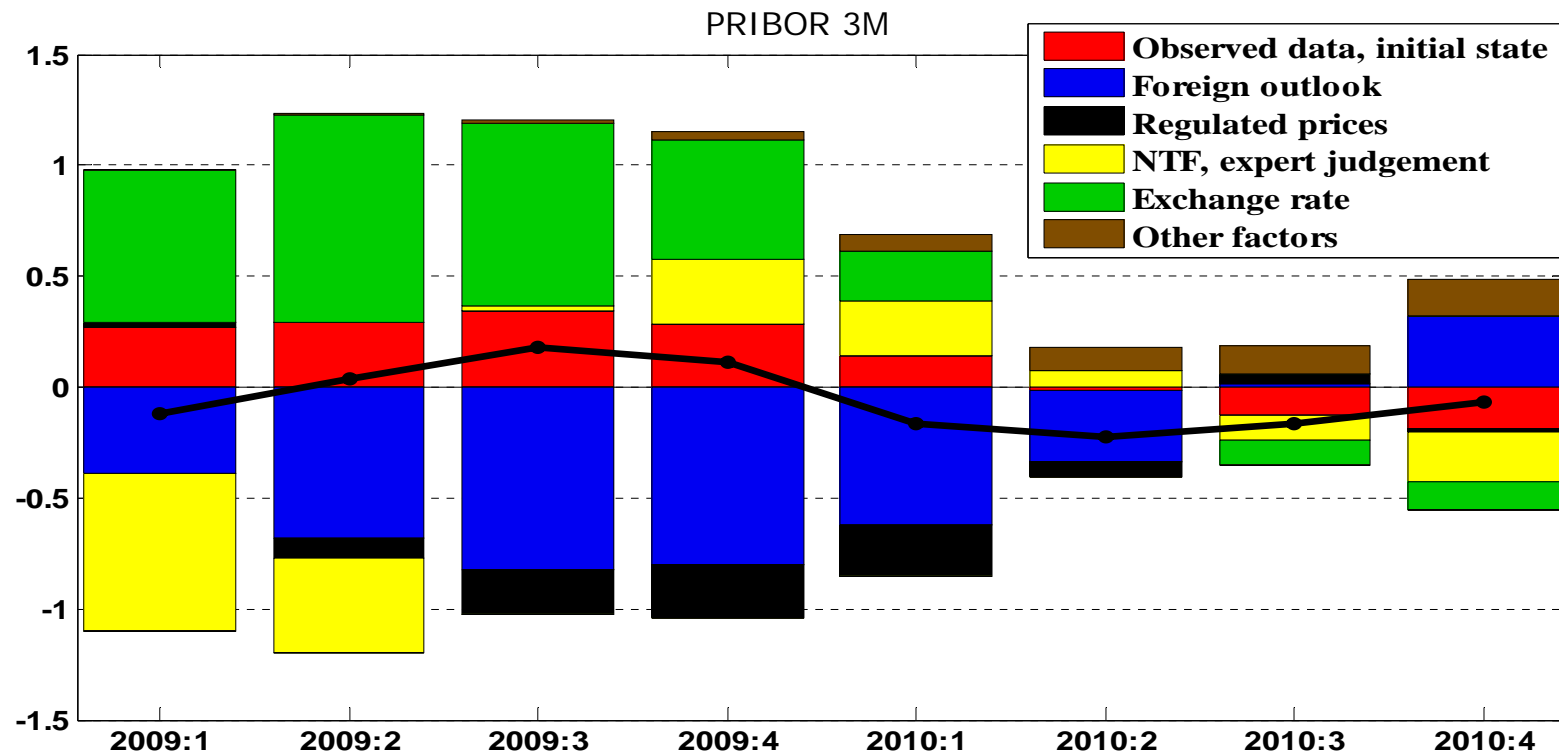
- A pronounced slowdown in nominal wage growth expected (incl. reduced bonuses, working days etc.);
- Increase in registered unemployment to 8 %;
- January 2009: unemployment above expectations.

Interest Rate Forecast



- Consistent with the forecast and its assumptions is a decline in market interest rates;
- Compared to previous forecast, the interest rate path lies slightly higher in 2009 but, on the contrary, lower in 2010.

Interest Rate Forecast Change Decomposition



- Downward impact of near-term forecast, foreign outlook and regulated prices;
- Upward impact of exchange rate and initial IR level (credit premium).

Comparison of the CNB's Forecast with Analysts' View

	CNB	ANALYSTS
GDP in % (2009)	-0.3	0.5
GDP in % (2010)	0.9	2.5
CPI in %	1.4 (1Q/2010)	2.1 (1/2010)
Exchange Rate CZK/EUR	25.4 (1Q/2010)	25.3 (1/2010)
Interest Rate in %	3M PRIBOR 3.0 (1Q/2010)	2T repo 1.6 (1/2010)
		12M PRIBOR 2.5 (1/2010)
Nominal Wages in % (2009)	4.0	4.0
Nominal Wages in % (2010)	2.7	4.5

Source: Financial Markets Inflation Expectations (CNB's Survey), January 2009

- Predictions broadly similar for the CZK and wages;
- Analysts on average more optimistic regarding the GDP growth (does it still hold?);
- CNB expects lower inflation on the 1Y horizon.

Major Uncertainties Identified in the Board's Discussion

Risks are pronounced.

Major risks and uncertainties:

- deeper and longer-lasting decline in economic activity abroad
- depreciated exchange rate



Thank you
for your attention.

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