

CNB's New Forecast

Inflation Report II/2009

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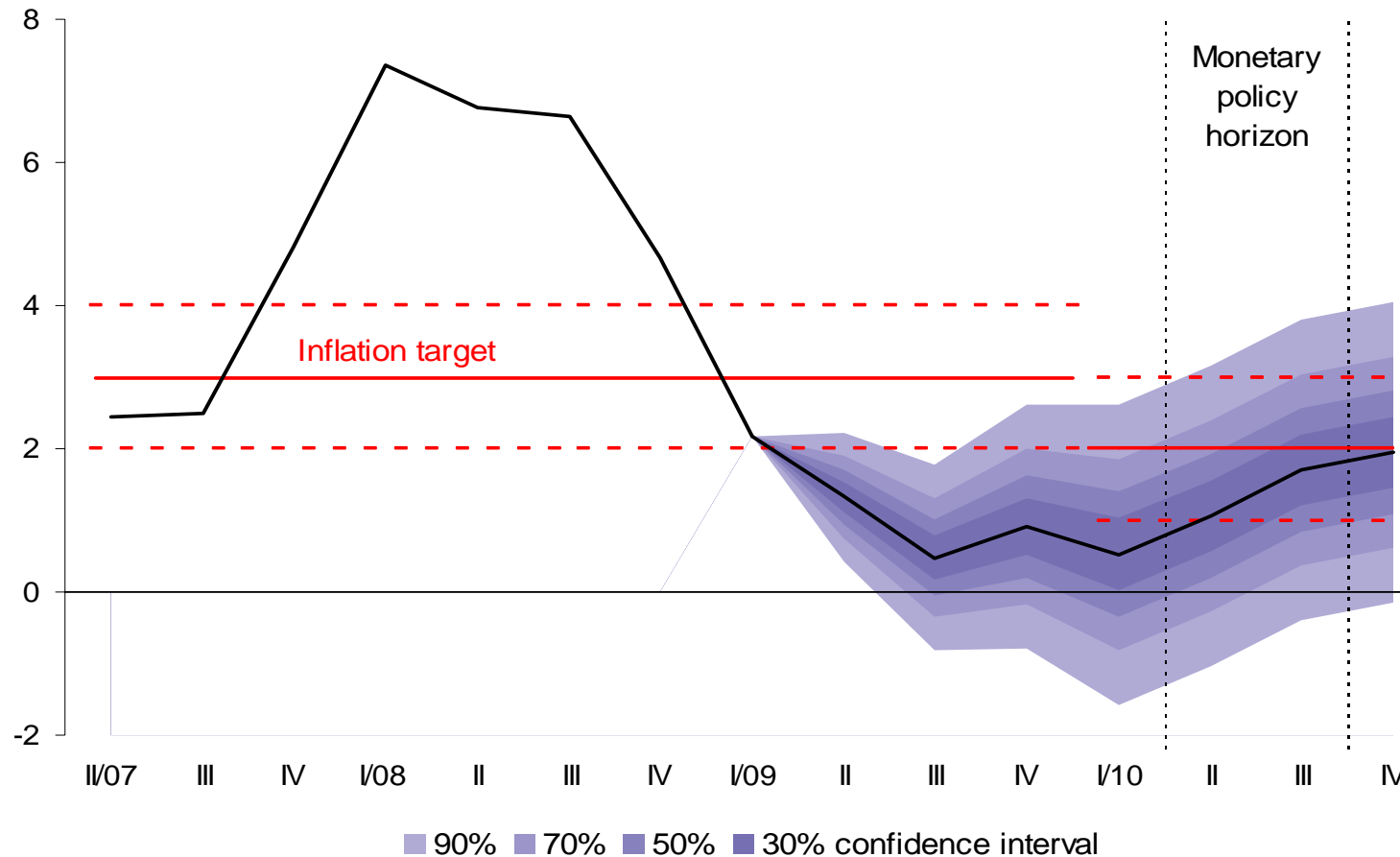
Monetary and Statistics Department

Meeting with analysts, Prague, 15 May 2009

Summary of the Inflation Forecast

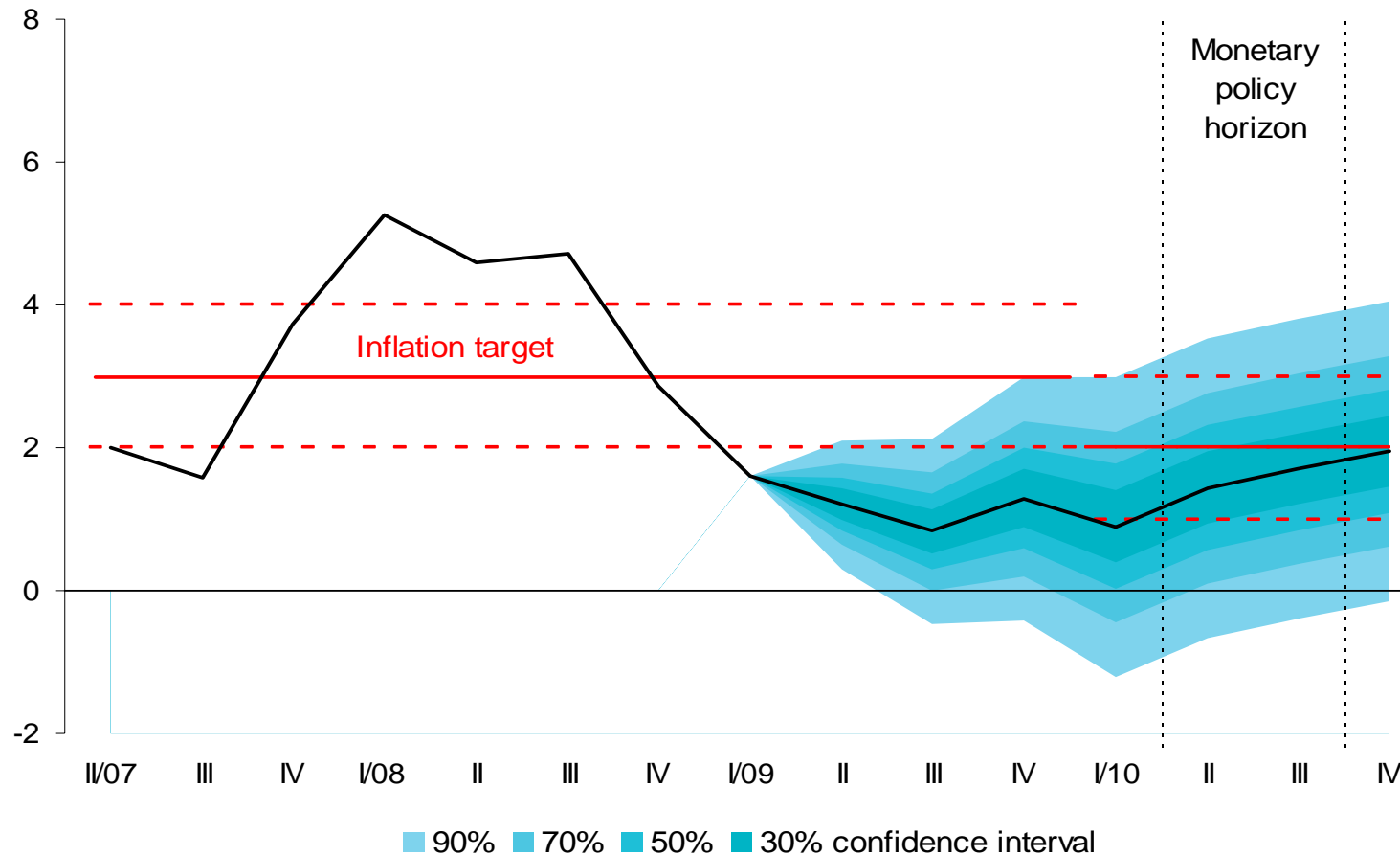
- Overall and MP-relevant inflation will fall but remain positive in 2009, and will gradually increase to the new 2% target in 2010;
- Inflation forecast was increased for 2009, but reduced for 2010;
- The forecast revision for regulated prices follows a similar pattern, the outlook for market prices was increased;
- This reflects the inflation figures in Q1/09 and weaker exchange rate, foreign outlook works in the opposite direction;
- The overall macroeconomic environment is pro-inflationary due to the exchange rate depreciation;
- But the domestic economy is anti-inflationary: drop in GDP by 2.4 % in 2009, strong labour market slack.

Headline Inflation Forecast



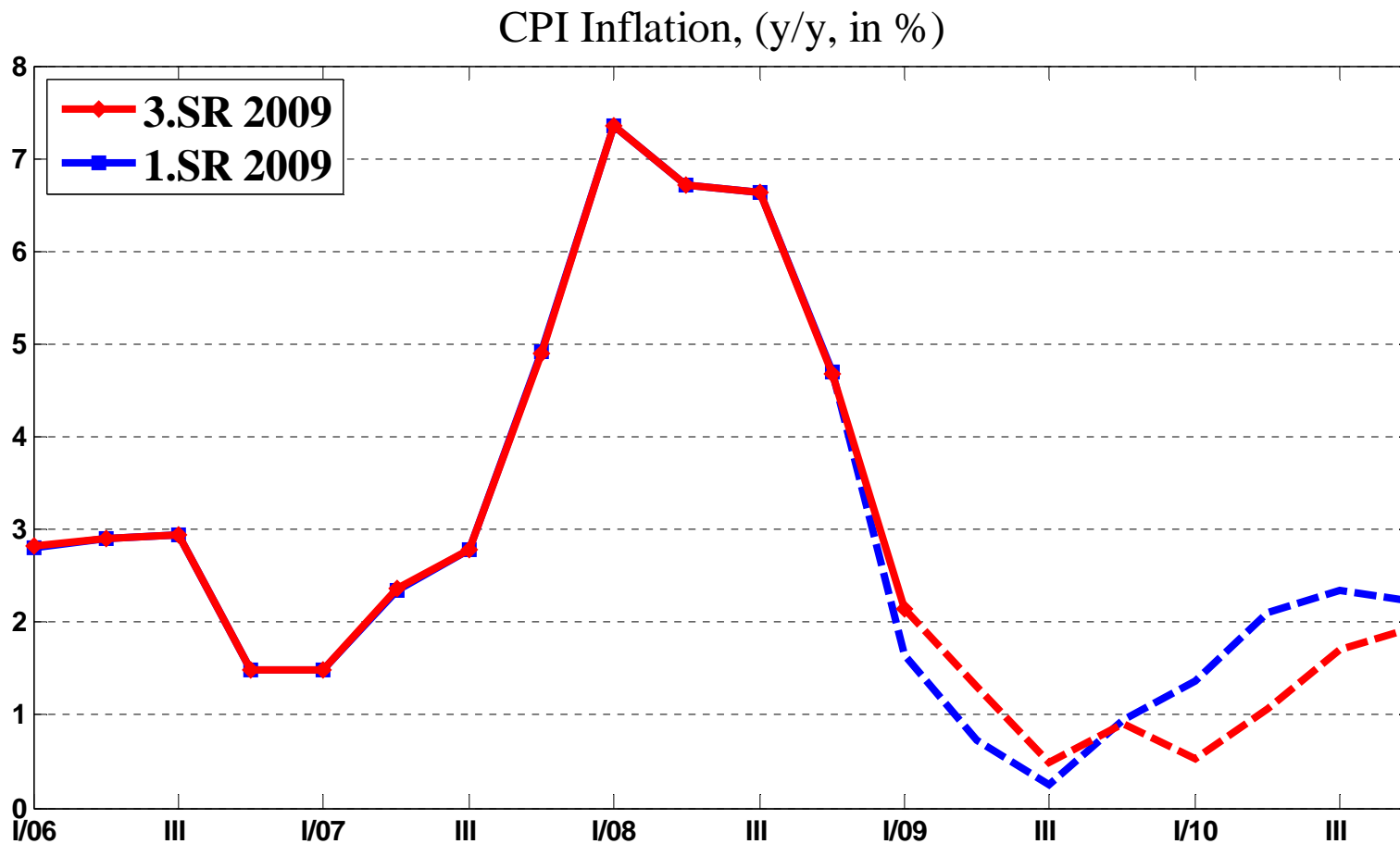
- Inflation will fall further this year, but remain positive;
- Heading for the new 2% target at the end of 2010.

MP-Relevant Inflation Forecast



- A shift of some services to the lower VAT rate assumed;
- Forecast coincides with headline inflation from Q3/2010.

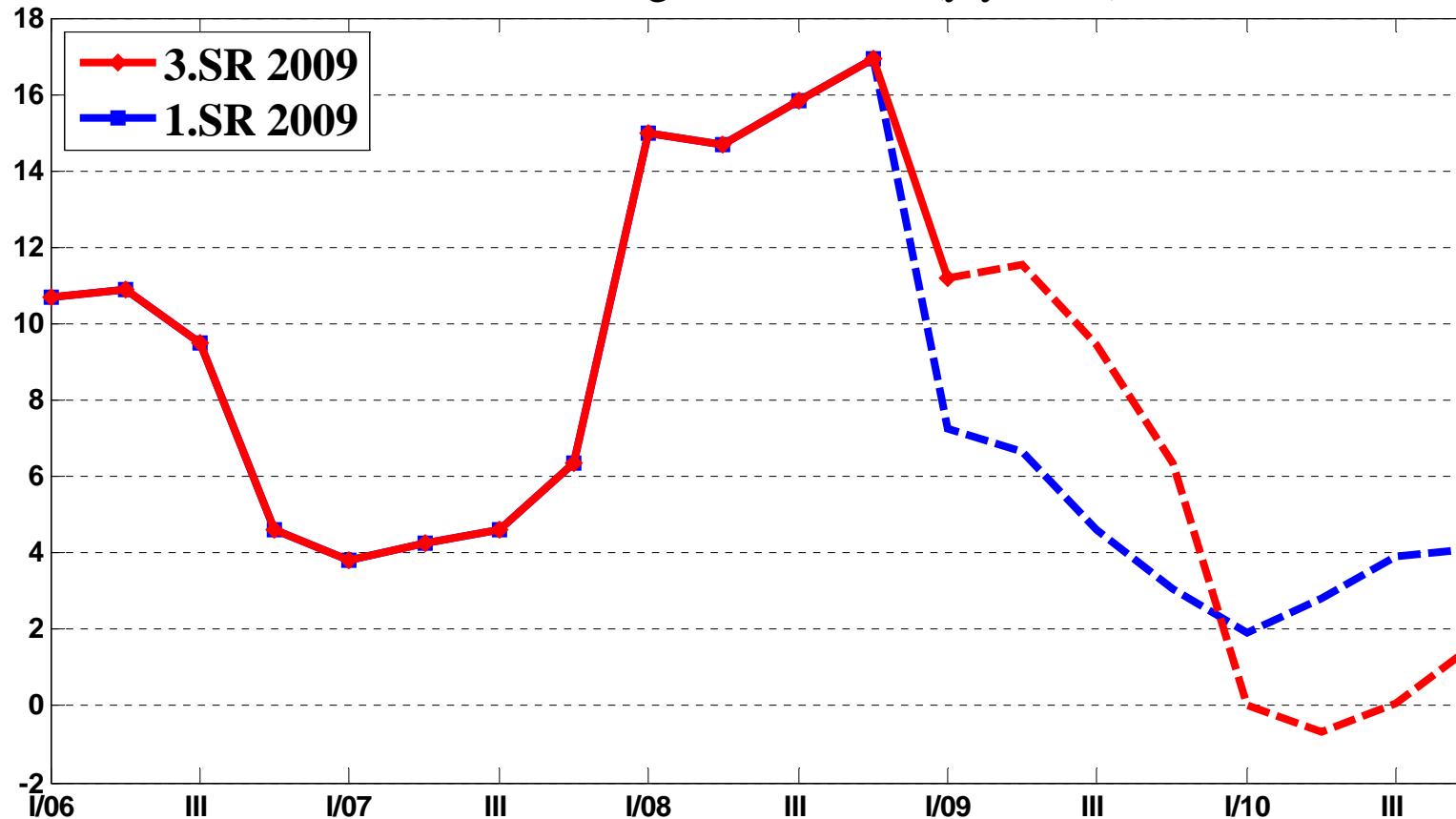
Comparison with Previous Inflation Forecast



- Forecast increased slightly in 2009, but lowered for 2010.

Regulated Prices

Growth of Regulated Prices, (y/y, in %)



- Forecast increased in 2009 (slower decline of gas prices);
- In 2010, the growth will temporarily turn negative.

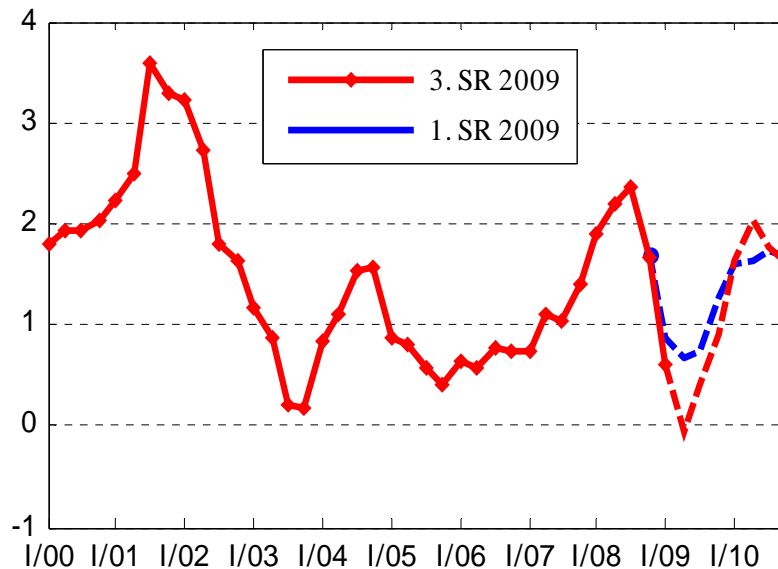
Administrative Measures (selected items and total impact)

	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	0.62	2.8	0.55
of which (selected items):						
Regulated rents	22.2	0.38	27.0	0.55	24.0	0.62
Electricity	9.5	0.37	11.6	0.47	-2.0	-0.09
Natural gas	34.0	0.75	-23.6	-0.68	-8.4	-0.18
Heating	14.4	0.44	2.3	0.08	2.0	0.07
Healthcare	41.9	0.56	-1.0	-0.02	2.0	0.04
Primary impact of tax changes on non-regulated prices		1.43		-0.37		0.00

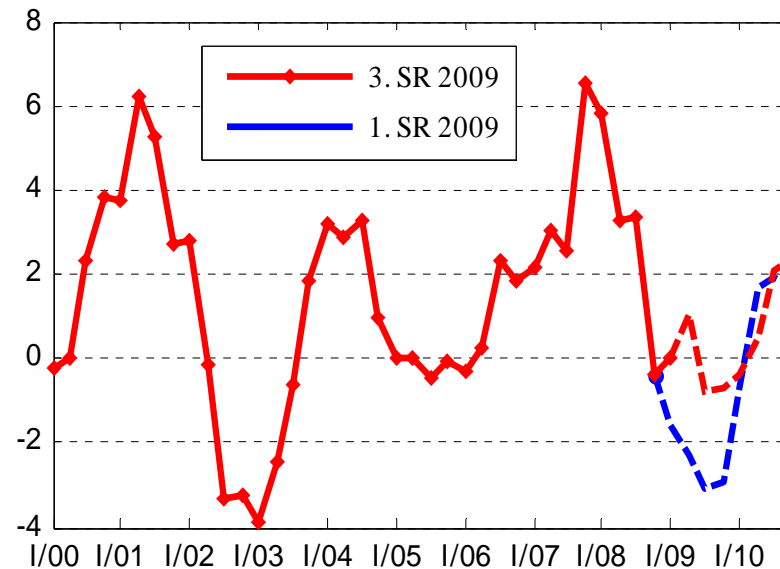
- Lower forecast for 2010 reflects an assumed decline in gas and electricity prices;
- The actual price effect of the reduced VAT on certain services will be less than proportionate.

Core Inflation and Food Prices

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

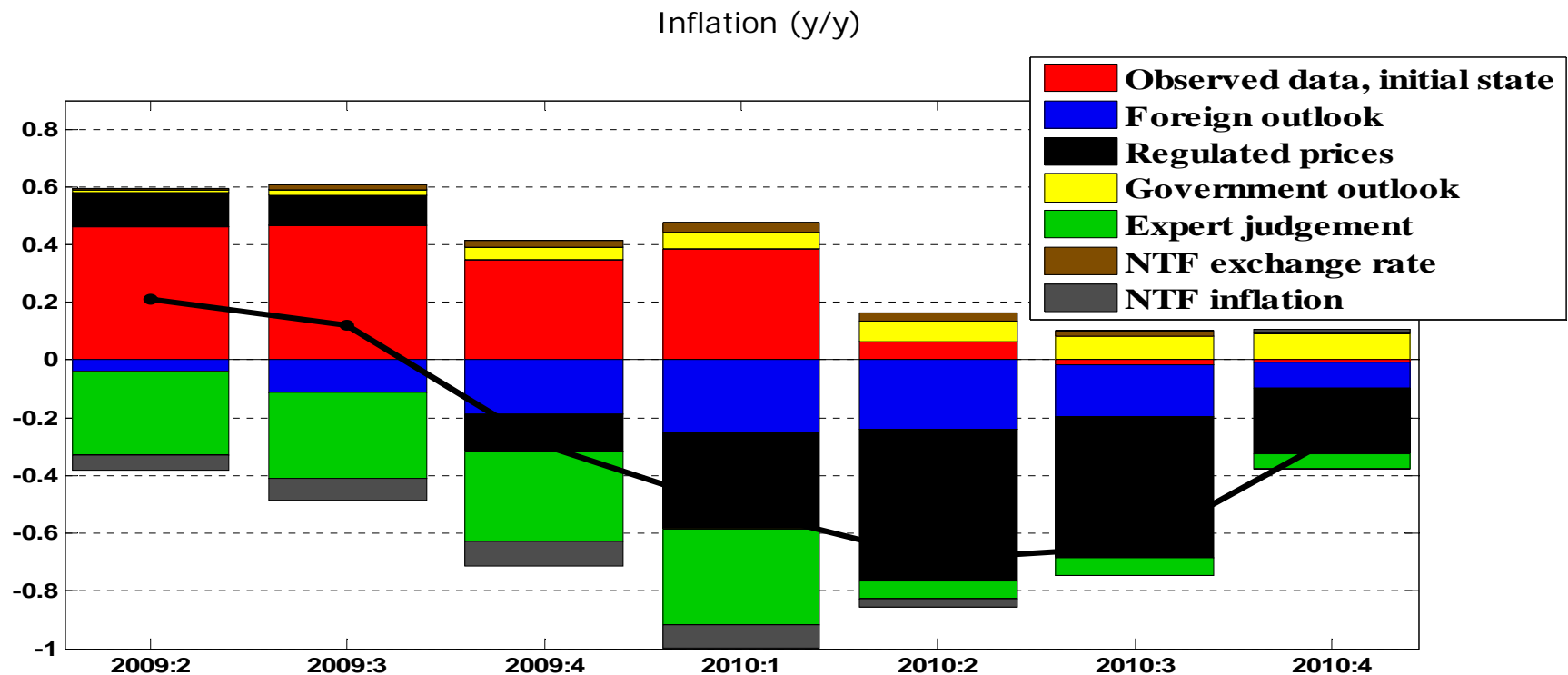


Food Price Growth (in %, excl. tax changes)



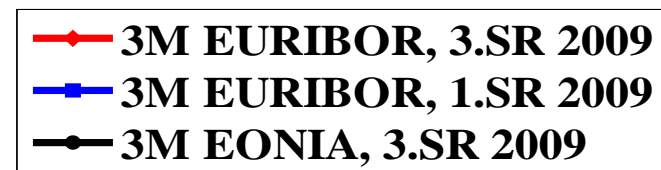
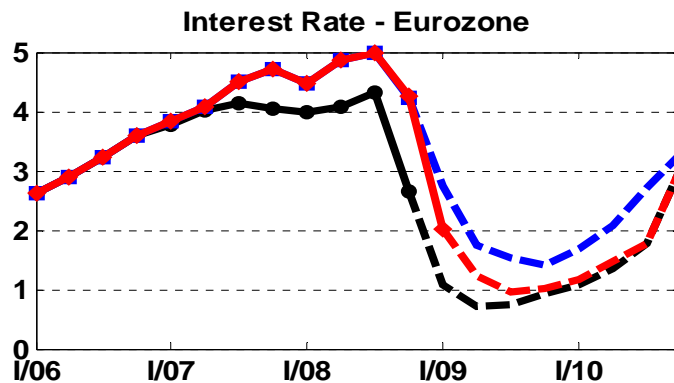
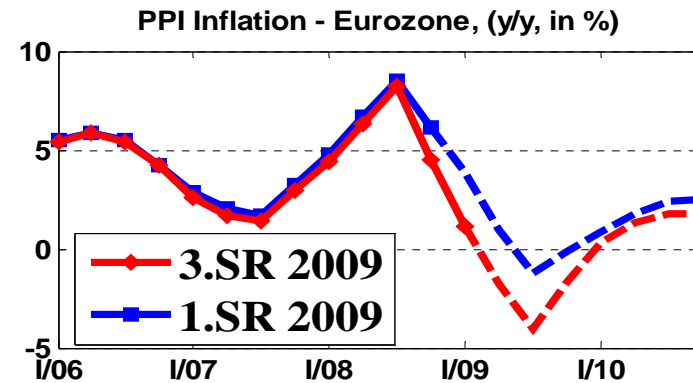
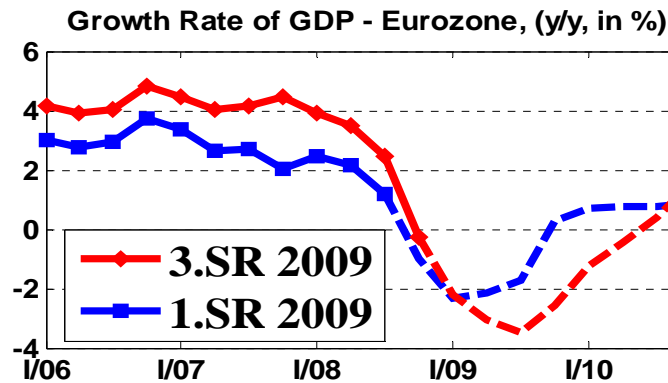
- Forecast of core inflation revised downwards due to domestic anti-inflationary pressures and slowdown in NT price growth;
- Less pronounced decline in fuel and food prices in comparison to the previous forecast (in line with the observed developments in Q1/09).

Inflation Forecast Change Decomposition



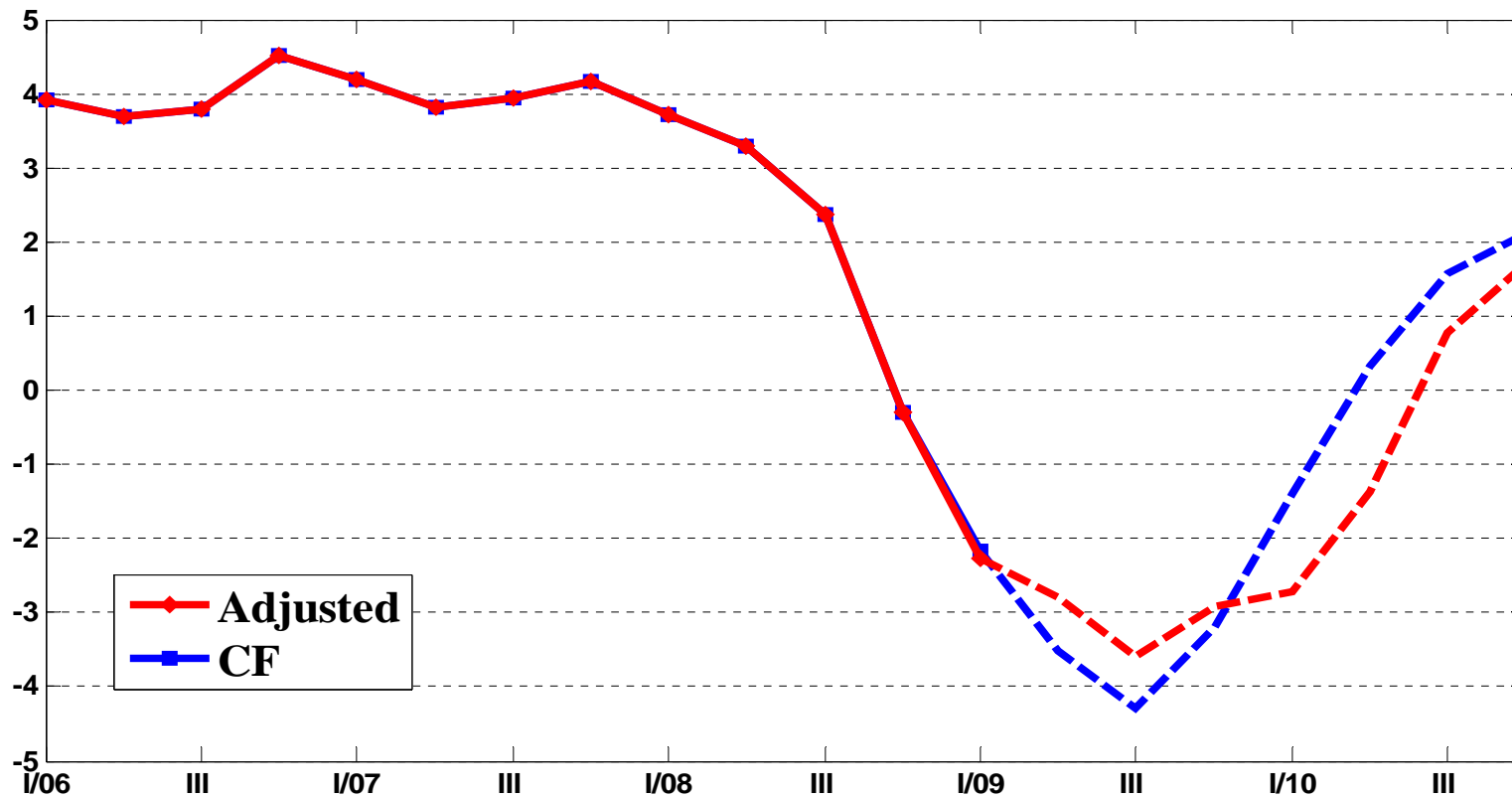
- Pro-inflationary impact of the observed data (actual inflation in Q1/09, depreciated exchange rate);
- Anti-inflationary impact of foreign outlook and regulated prices (partly captured also by the 'expert judgement').

External Assumptions



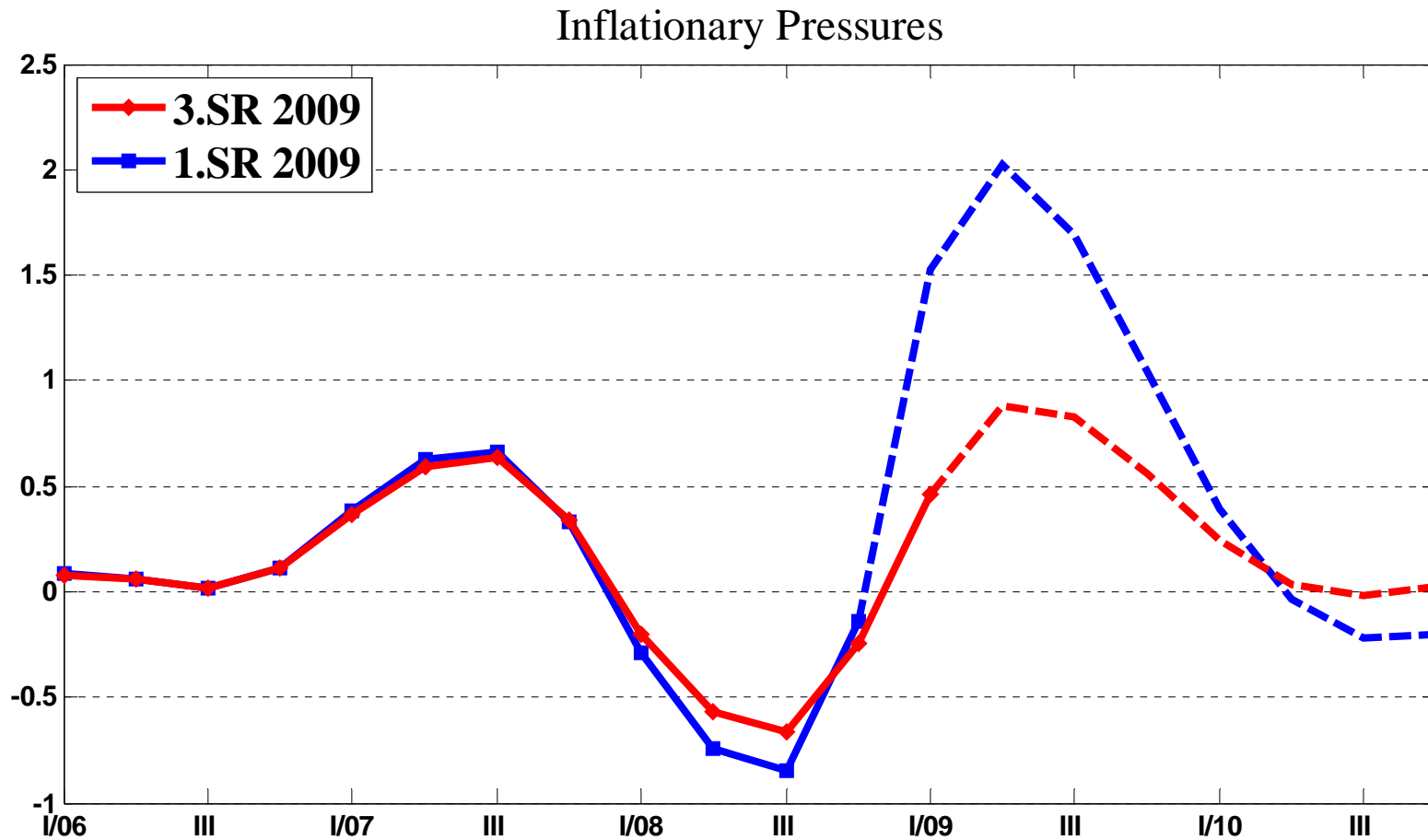
- Slovakia and other countries have been incorporated into the effective eurozone measures;
- Anti-inflationary shift in GDP outlook, foreign inflation and interest rates.

Effect of Car-Scrapping Subsidies



- On top of their impact on foreign GDP outlook in the CF, it is assumed that the subsidies will raise the effective demand for Czech exports in 2009, but reduce it in 2010.

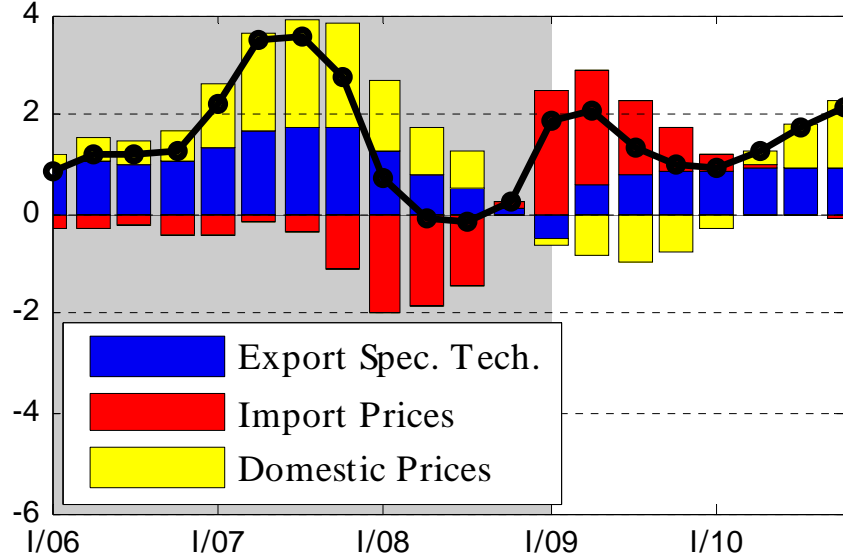
Overall Inflationary Pressures



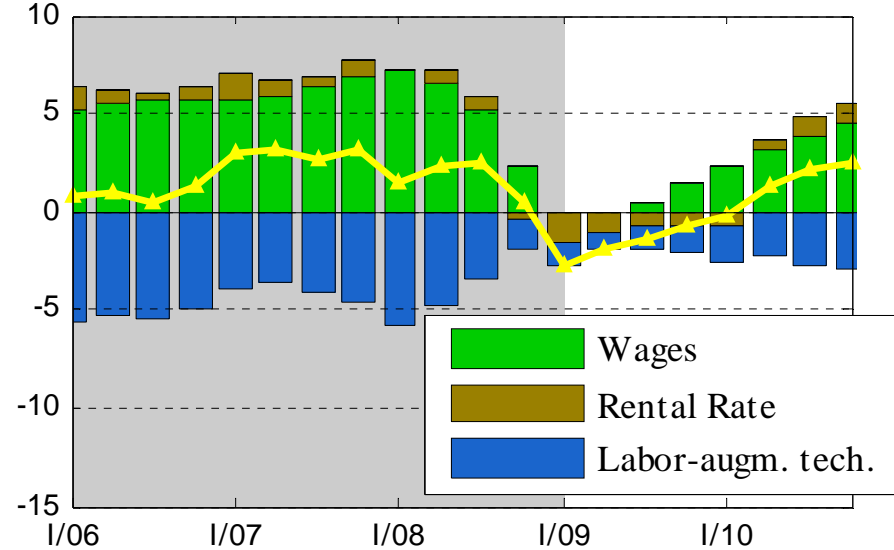
- Pro-inflationary macroeconomic environment, but to a lesser extent than in the previous forecast.

Domestic Pressures vs. Import Prices

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

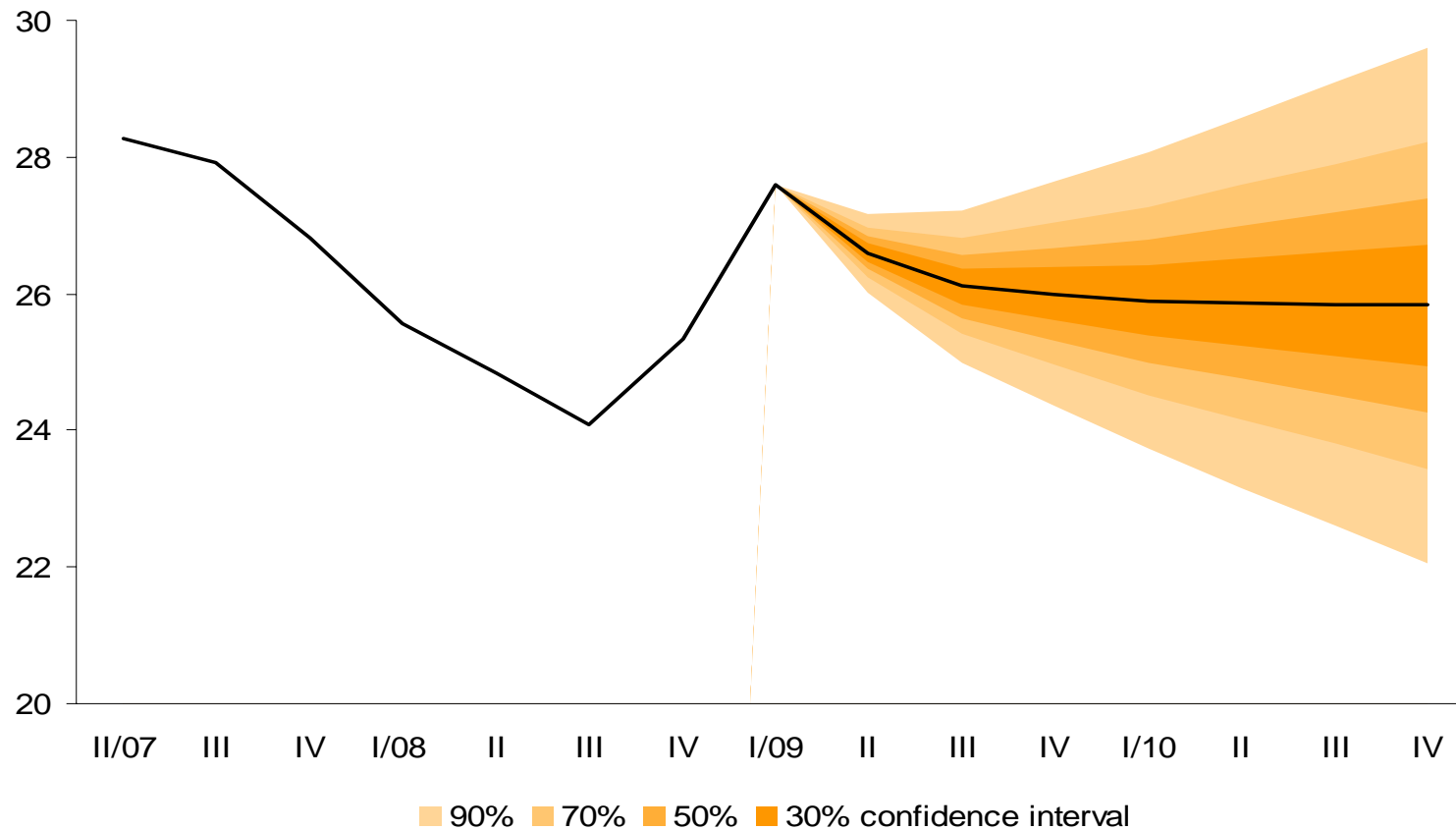


Nom. Marginal Cost in Domestic Sector (q/q, in %, ann.)



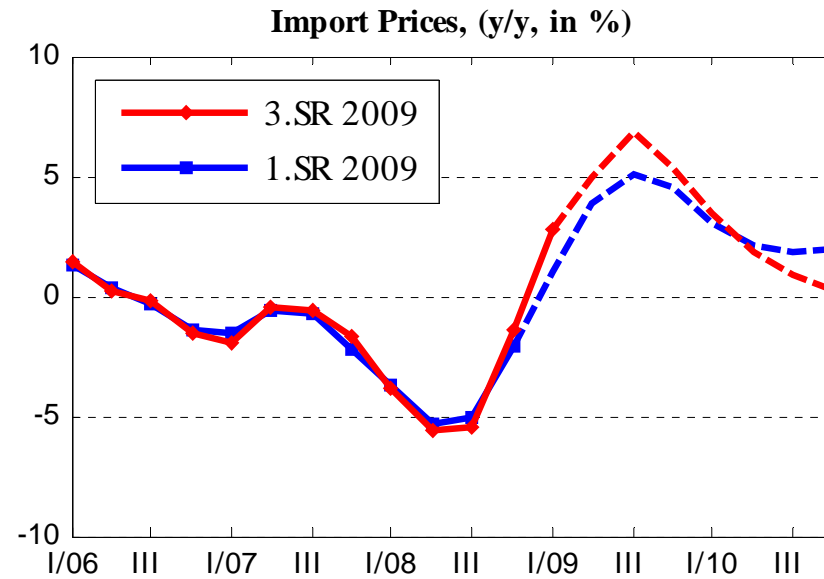
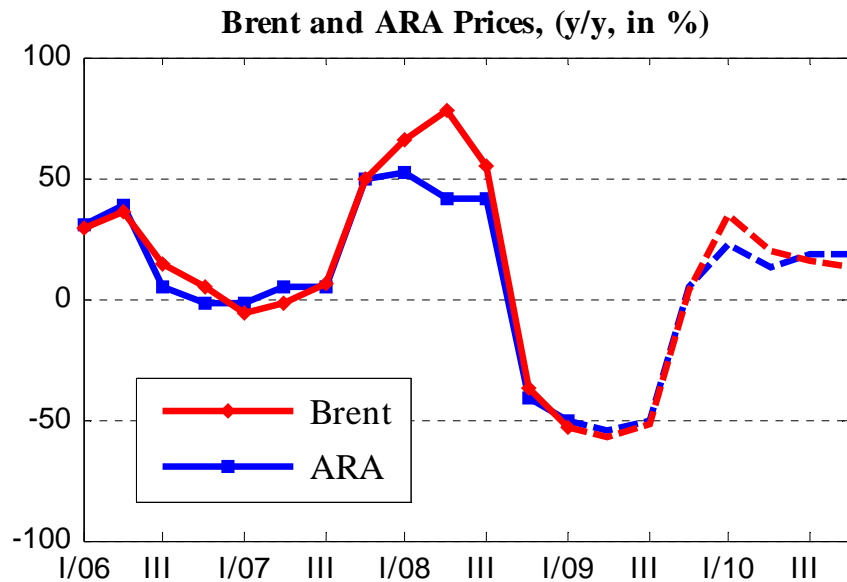
- The more depreciated exchange rate is offset by domestic anti-inflationary pressures;
- These pressures reflect a substantial slowdown in the wage growth, excess capacity and weaker B-S effect.

Exchange Rate Forecast (CZK/EUR)



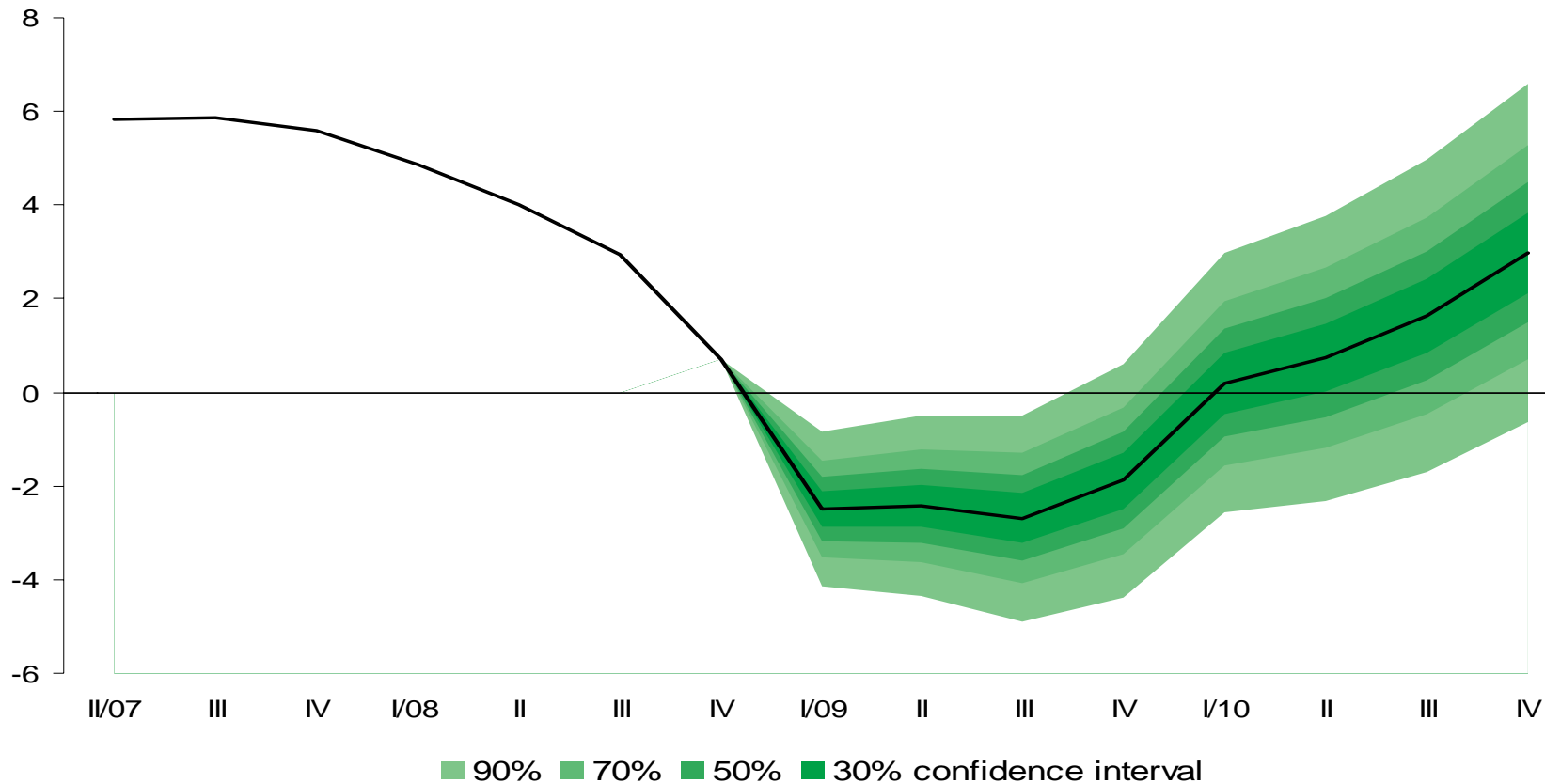
- The whole exchange rate trajectory is weaker than in the previous forecast;
- Correction of the depreciation in Q2-3/09, then stability.

Import Prices



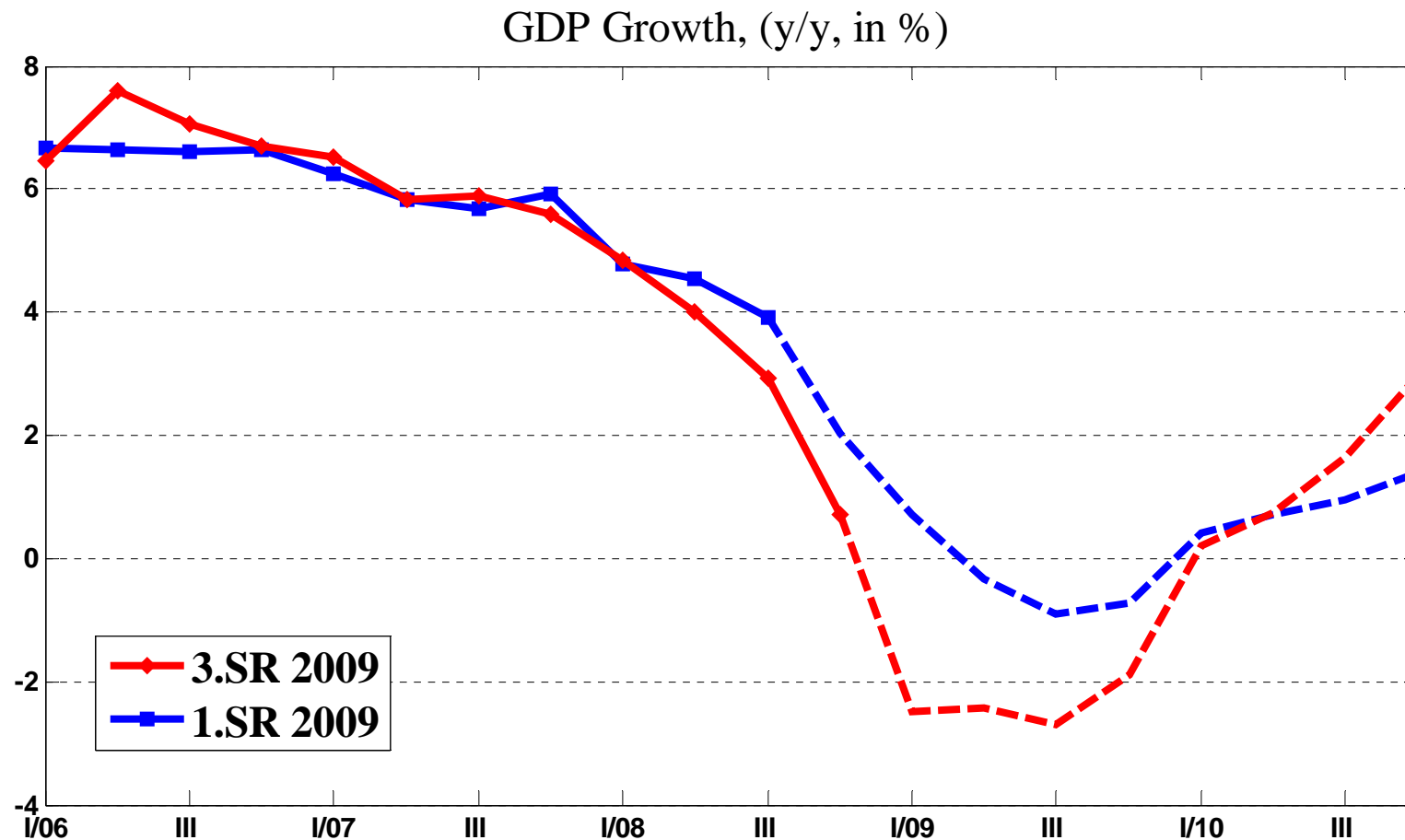
- Pro-inflationary impact of import prices on the whole forecast horizon due to the depreciated exchange rate;
- Partly offset by falling fuel prices and slower (negative) PPI growth in the eurozone.

GDP Growth Forecast



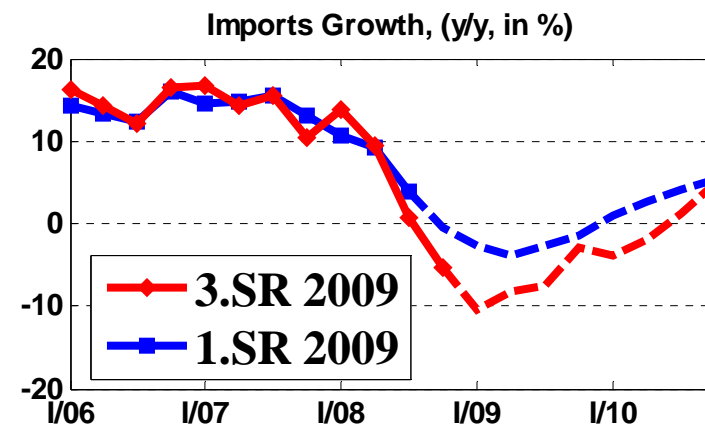
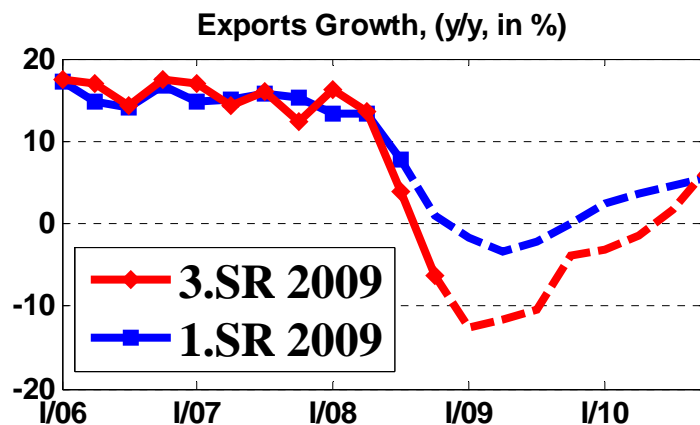
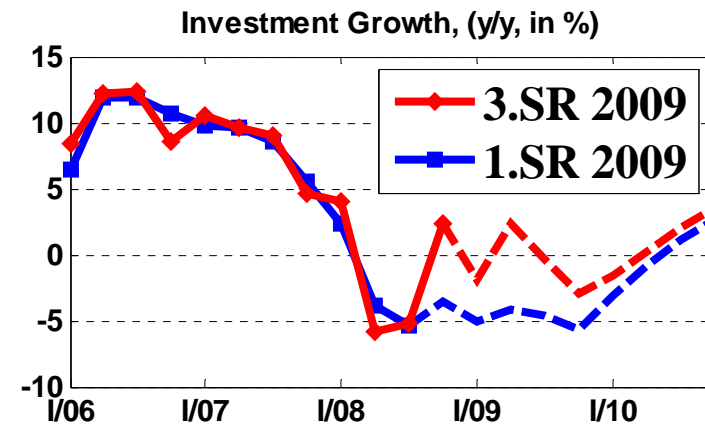
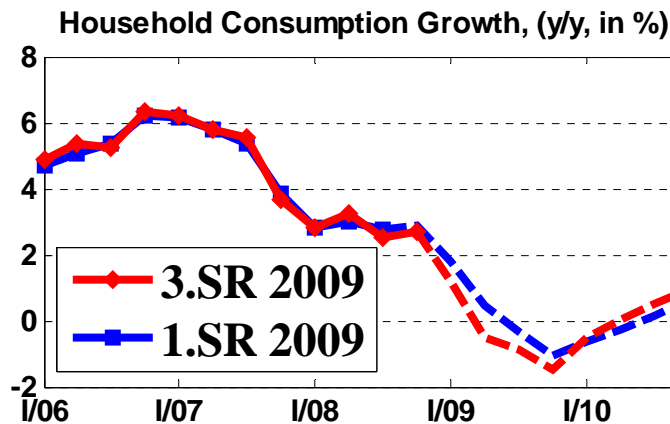
- A recession in 2009 followed by a gradual recovery in 2010;
- Yearly averages: 2009: -2.4 %, 2010: +1.4 %;
- The deepest drop has probably already happened in Q1/09.

Comparison with Previous GDP Forecast



- GDP outlook revised down substantially for 2009;
- Recovery in 2010 dependent on revival in foreign demand.

Forecast of Aggregate Demand

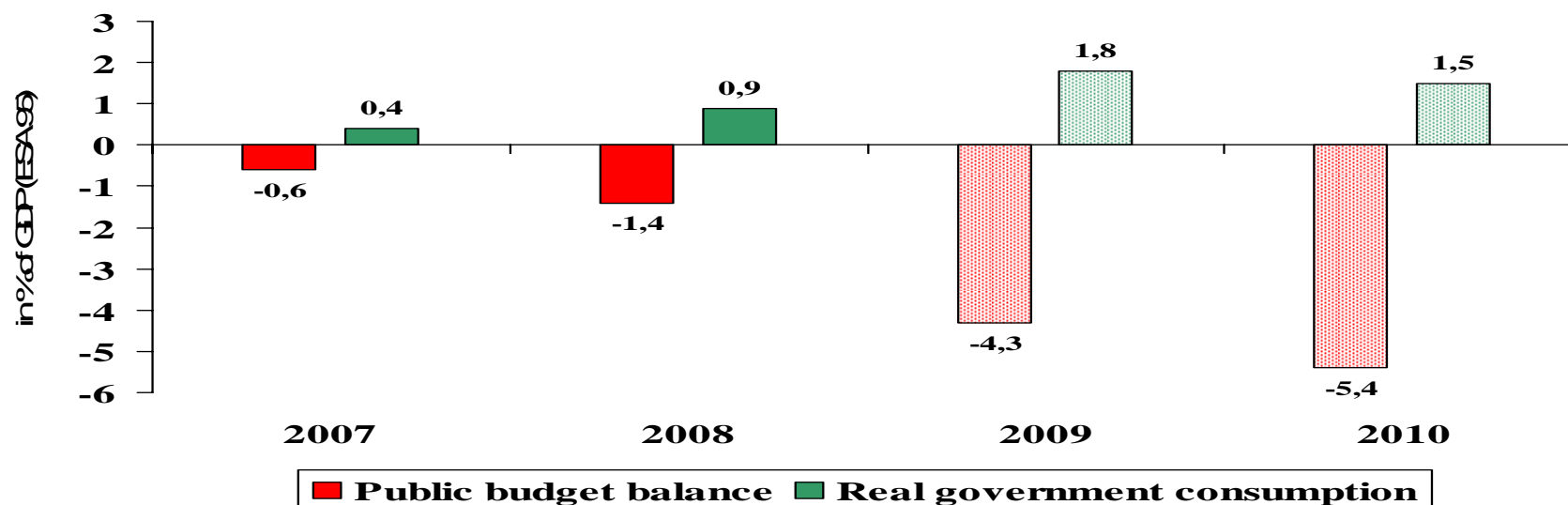


- Strongly negative contribution of net exports;
- Domestic demand will be declining as well.

New Fiscal Measures and Forecast

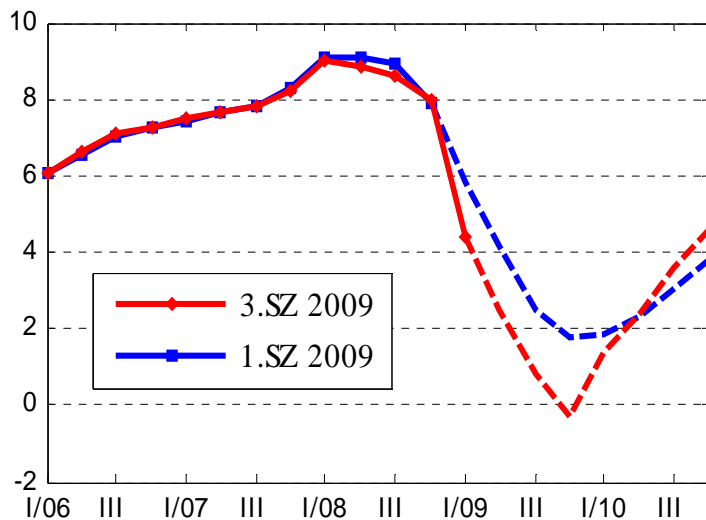
New fiscal measures (in CZK bn.) (forecast includes only measures known during its preparation)	Impact in 2009 (CZK bn.)		Impact in 2009 (CZK bn.)	
	Revenues	Expenditure	Revenues	Expenditure
Former government measure	-33.3	4.1	-30.9	8.0
Opposition measures	-1.0	4.3	-1.0	6.0
TOTAL impact on fiscal balance	-42.7		-45.9	
in % of GDP	-1.1%		-1.2%	

Fiscal deficits and government consumption

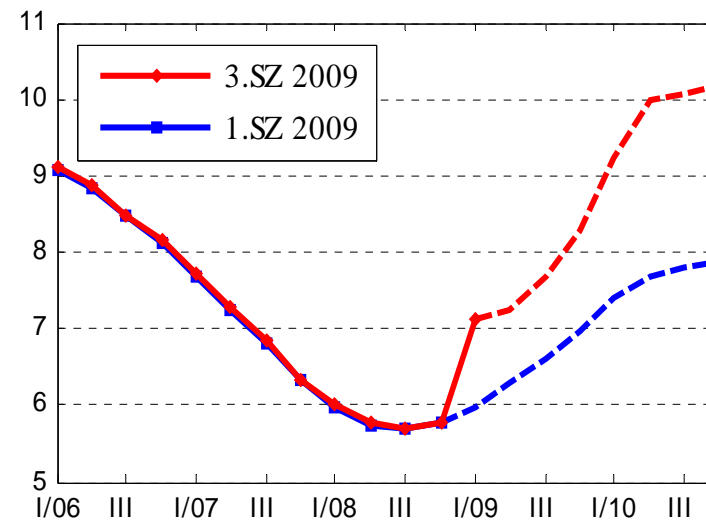


Labour Market Forecast

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

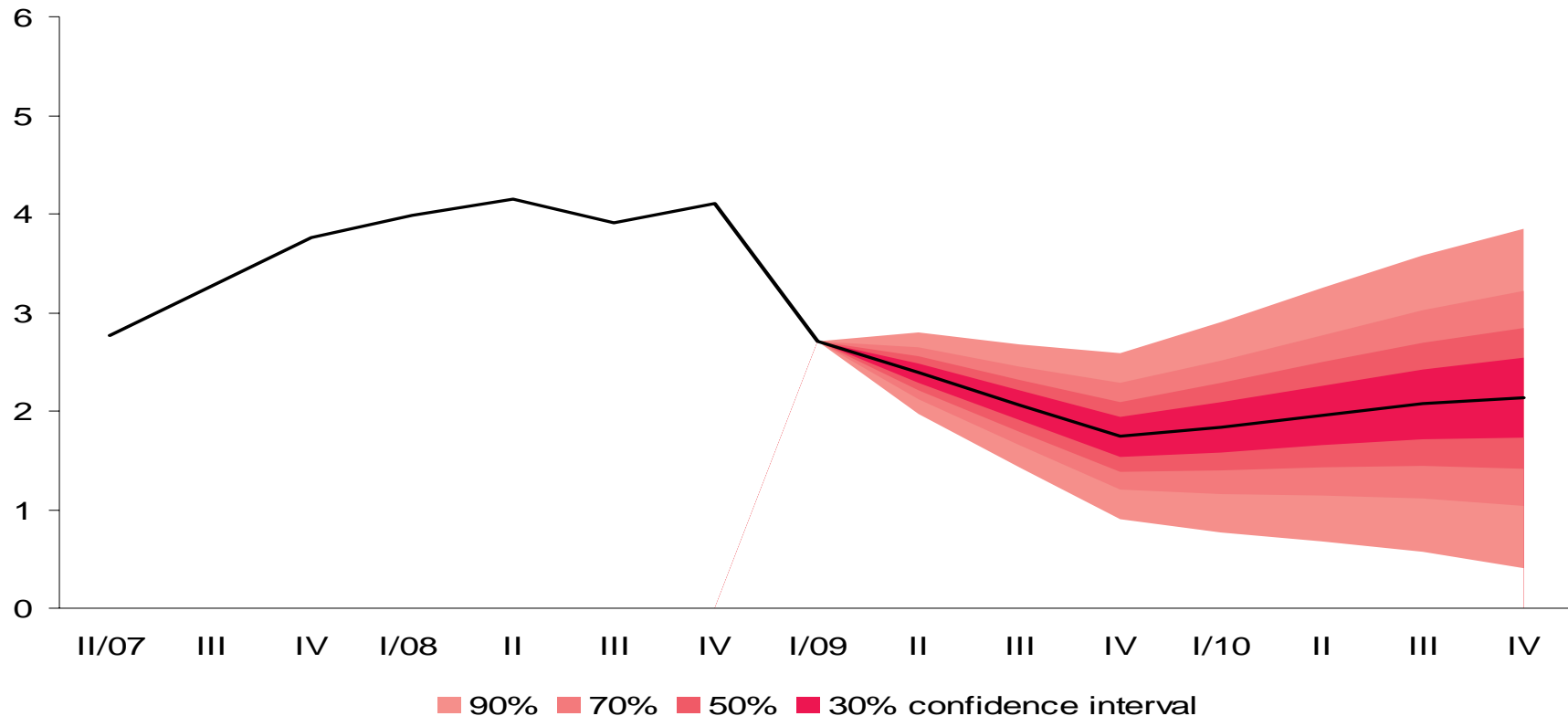


Total registered unemployment rate
(in %, seasonally adjusted)



- Nominal wage growth is expected to fall towards zero in 2009, and to gradually recover in 2010;
- Increase in registered unemployment above 10 %;
- April 2009: unemployment once again above expectations.

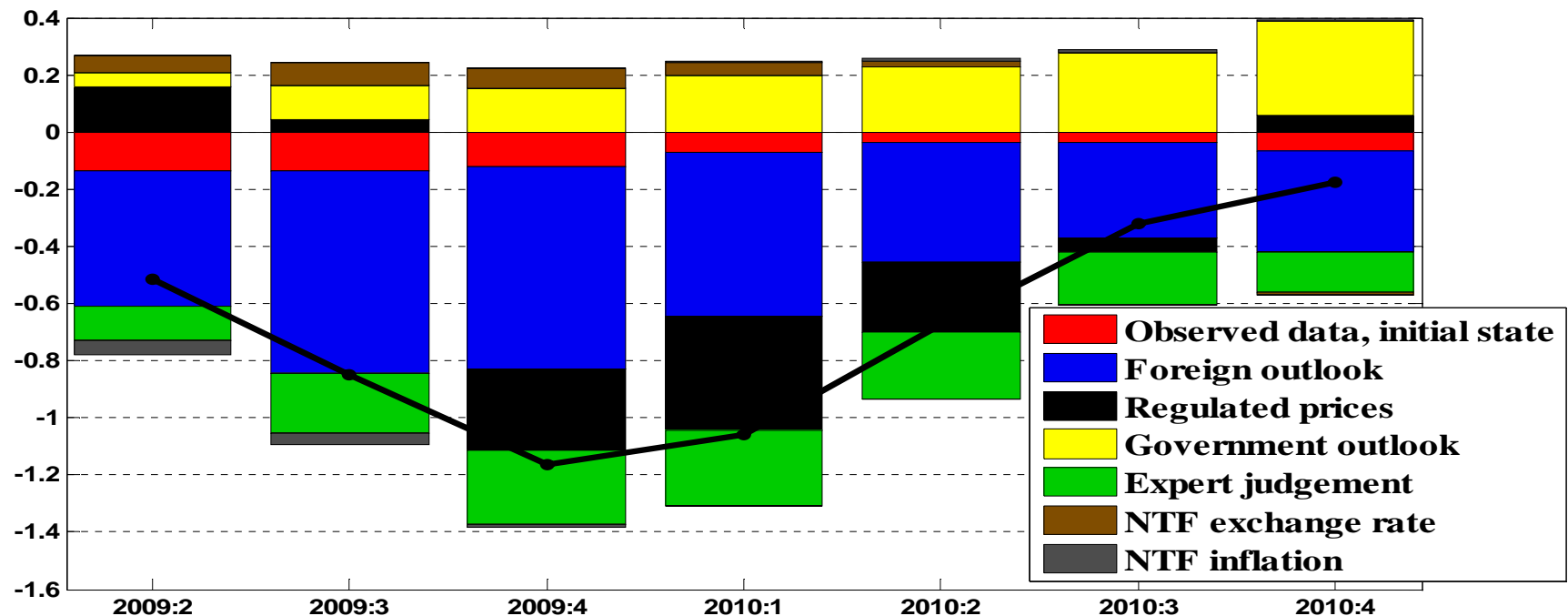
Interest Rate Forecast



- Consistent with the forecast is a decline in market interest rates this year followed by a modest rise in 2010;
- Compared to previous forecast, the interest rate path lies lower on the whole forecast horizon.

Interest Rate Forecast Change Decomposition

PRIBOR 3M



- Downward impact of foreign outlook, slower wage growth (captured by 'expert judgement') and regulated prices;
- Slight upward impact of government anti-crisis measures and near-term forecast for the exchange rate.

Comparison of the CNB's Forecast with Analysts' View

	CNB	ANALYSTS
GDP in % (2009)	-2,4	-2,2
GDP in % (2010)	1,4	1,2
CPI in %	1,1 (2Q/2010)	1,9 (4/2010)
Exchange Rate CZK/EUR	25,9 (2Q/2010)	25,5 (4/2010)
Interest Rate in %	3M PRIBOR 2,0 (2Q/2010)	2T repo 1,8 (4/2010)
		12M PRIBOR 2,6 (4/2010)
Nominal Wages in % (2009)	2,3	2,7
Nominal Wages in % (2010)	2,9	3,8

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

- Predictions broadly similar for most variables;
- CNB expects lower inflation and wage growth;
- The range of estimates remains larger than normal for the 2009 GDP (-3,7;-1,0), CZK/EUR and wages.

Major Uncertainties Identified in the Board's Discussion

***Forecast risks are balanced,
a high degree of uncertainty persists***

Inflation risks on the downside:

- deeper and longer-lasting depression in economies abroad

Inflation risks on the upside:

- smaller drop in growth of nominal wages in domestic economy



Thank you
for your attention.

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