

CNB's New Forecast

Inflation Report III/2009

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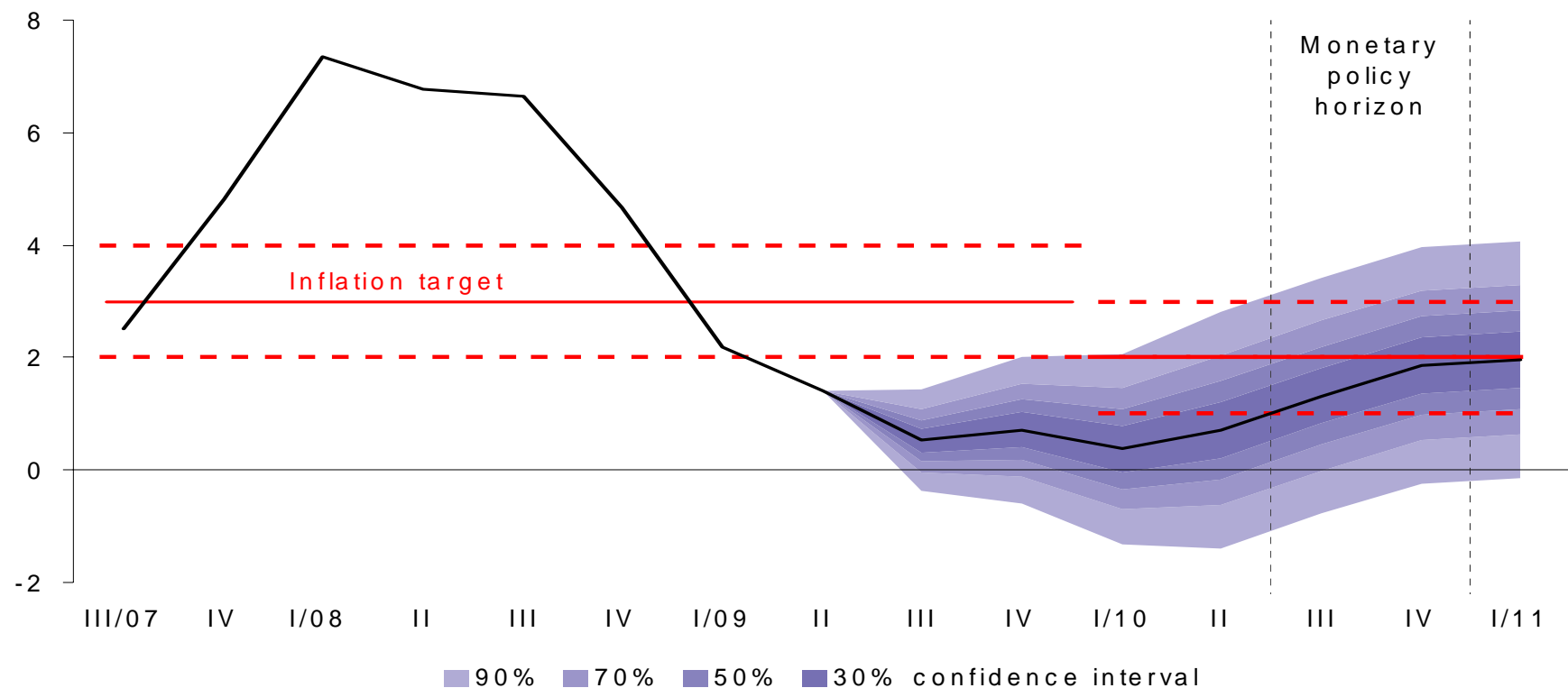
Monetary and Statistics Department

Meeting with analysts, Prague, 14 August 2009

Summary of the Inflation Forecast

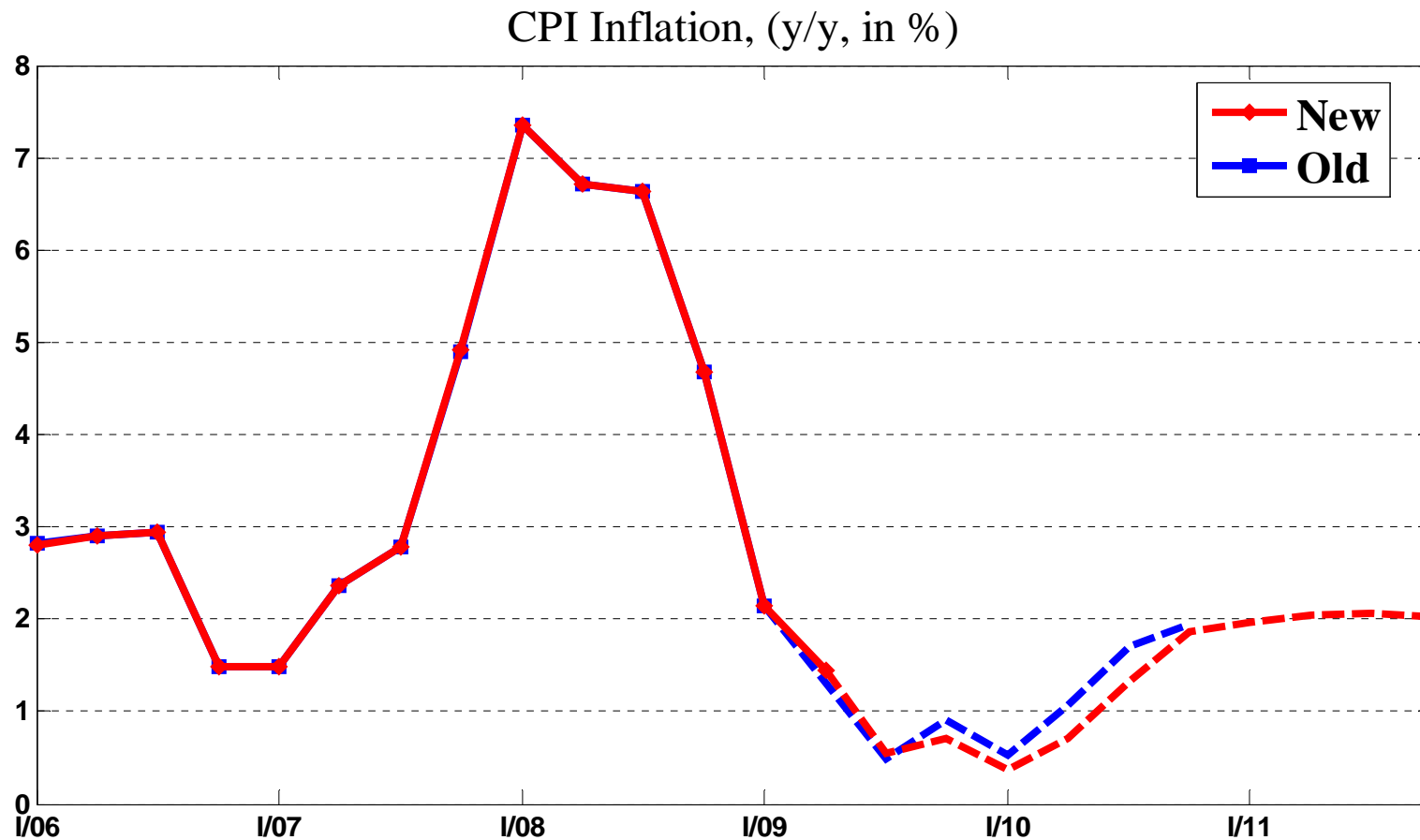
- Inflation will fall to low-but-positive levels in 2009, and then it will gradually increase toward the new 2% target in 2010;
- Inflation forecast was slightly reduced;
- The forecast revision is due mainly to a lower outlook for market-determined prices;
- This reflects a more benign inflationary environment, foreign developments and the near-term outlook for inflation;
- The inflationary impact of previous CZK depreciation is partly offset by falling prices abroad and reduced margins of importers;
- The domestic economy is anti-inflationary: drop in GDP by 3.8 % in 2009, substantial 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 inflation slightly above the headline rate (VAT change);
- July inflation figure below the forecast by 0.2 p.p.

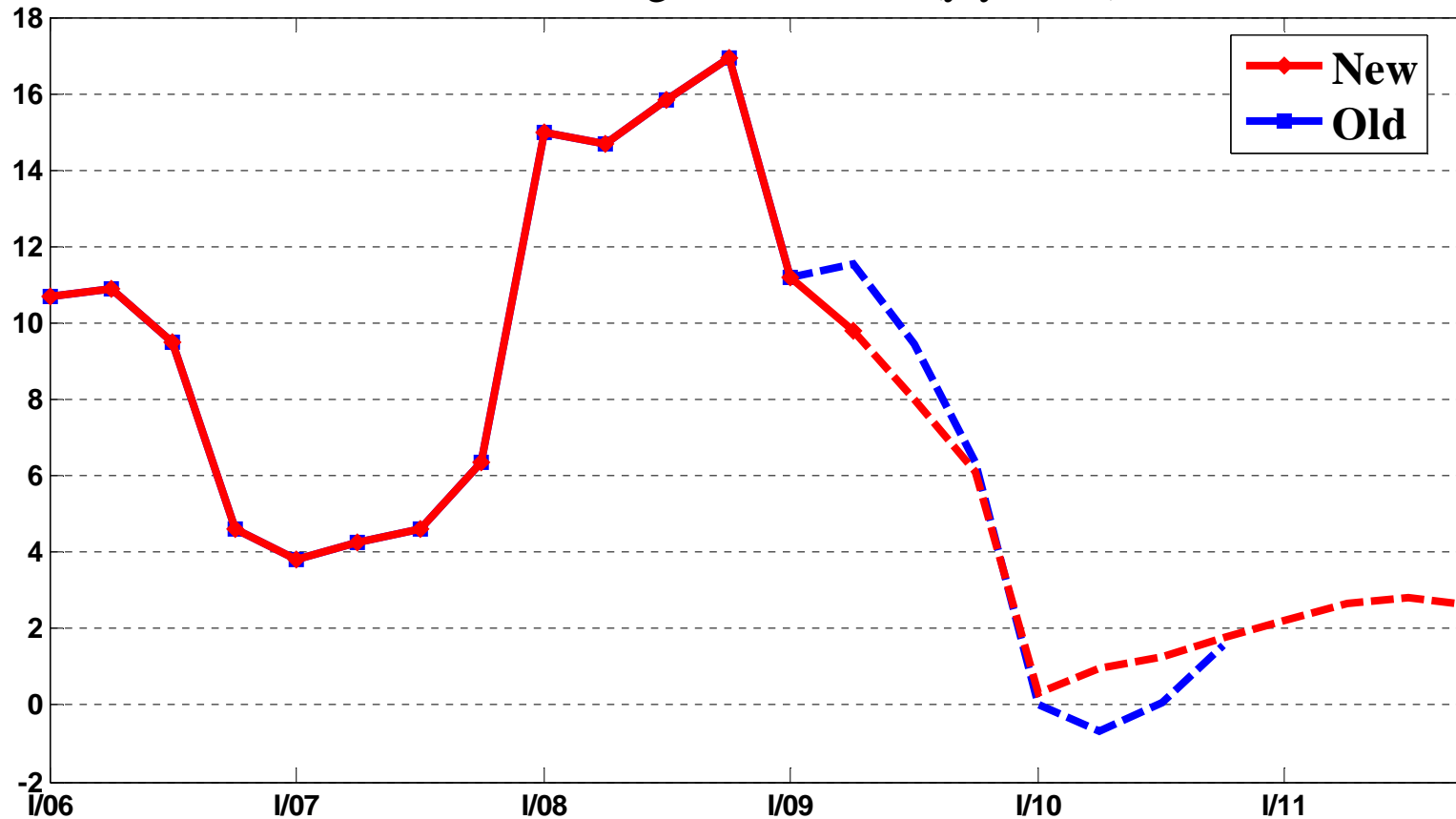
Comparison with Previous Inflation Forecast



- The new forecast is slightly below the old one;
- Increase to 2% slightly more delayed.

Regulated Prices

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



- The forecast is broadly similar – the main change concerns the outlook for natural gas prices.

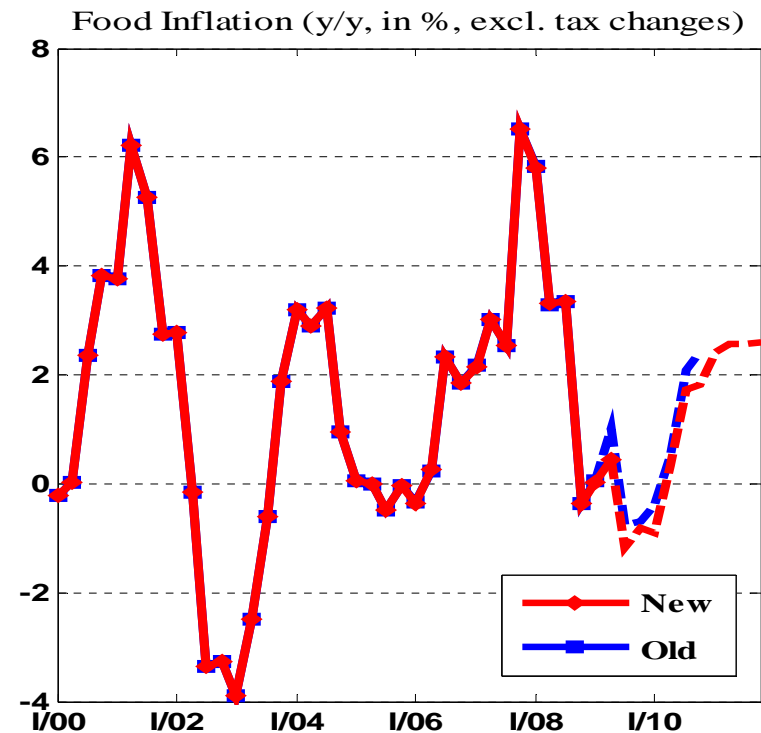
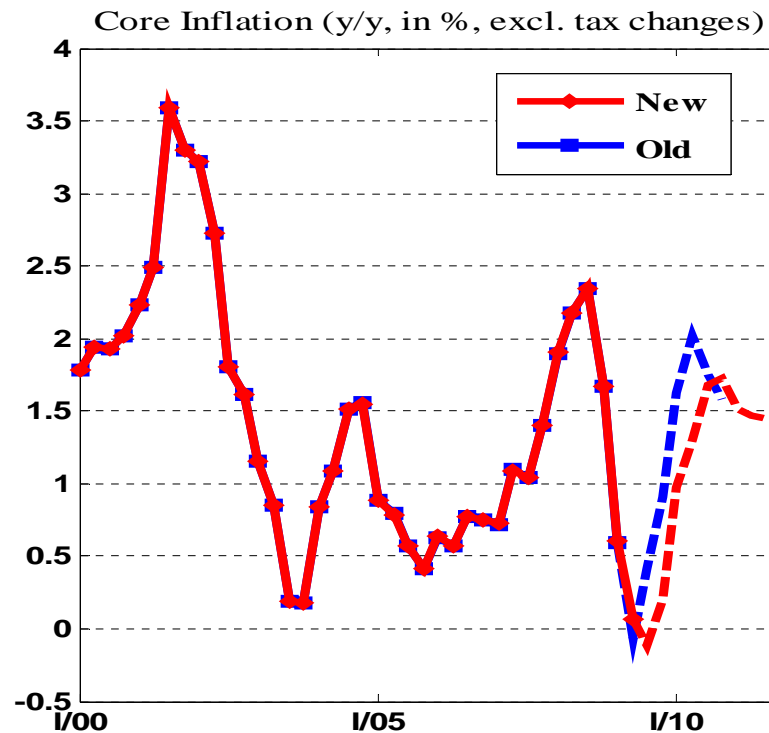
Administrative Measures

(selected items and total impact; end-of-year)

| | 2009 | | 2010 | | 2011 | |
|--|------------|----------------|------------|----------------|------------|----------------|
| | Y/Y growth | Impact in p.p. | Y/Y growth | Impact in p.p. | Y/Y growth | Impact in p.p. |
| Regulated prices - total | 5.1 | 0.99 | 1.9 | 0.39 | 3.0 | 0.61 |
| of which (selected items): | | | | | | |
| Regulated rents | 27.0 | 0.55 | 24.0 | 0.61 | 7.0 | 0.22 |
| Electricity | 11.6 | 0.47 | -2.0 | -0.09 | 2.0 | 0.09 |
| Natural gas | -9.8 | -0.28 | -13.5 | -0.34 | 4.0 | 0.09 |
| Heating | 2.8 | 0.09 | 2.0 | 0.07 | 2.0 | 0.07 |
| Healthcare | -4.6 | -0.08 | 2.0 | 0.03 | 2.0 | 0.03 |
| Primary impact of tax changes on non-regulated prices | | -0.37 | | 0.00 | | 0.00 |

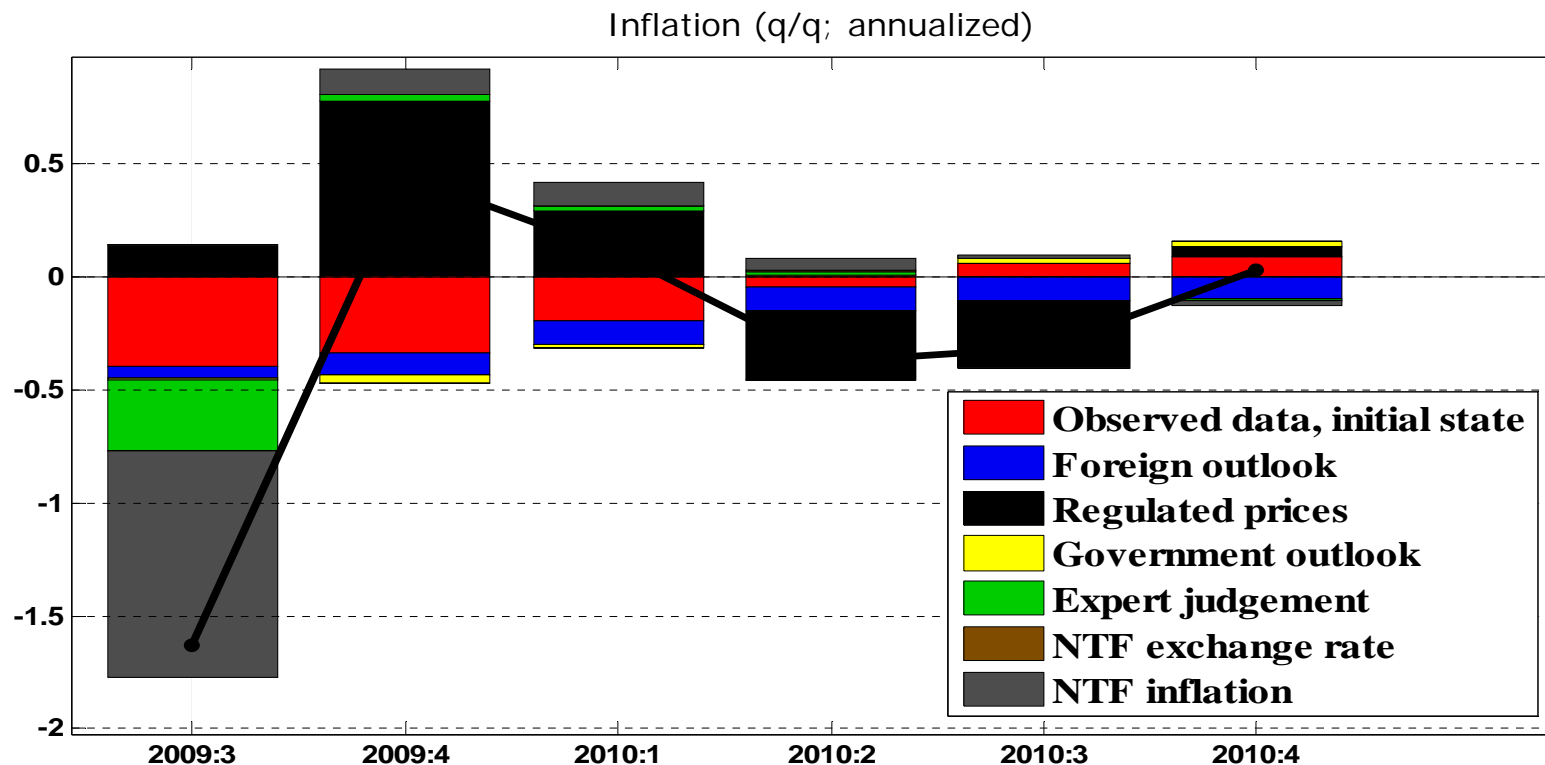
- Rents will be the main driver of regulated prices;
- Energy prices will decline in 2010;
- Reduction of the VAT rate on certain services postponed to Q4/2009.

Core Inflation and Food Prices



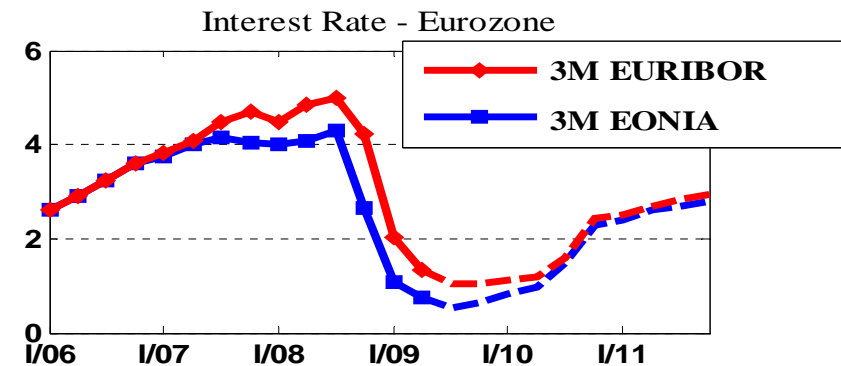
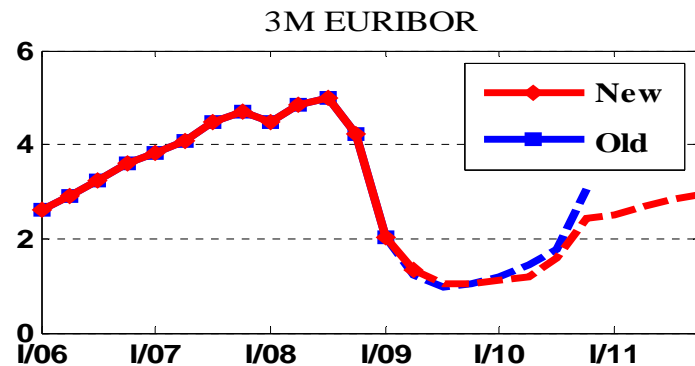
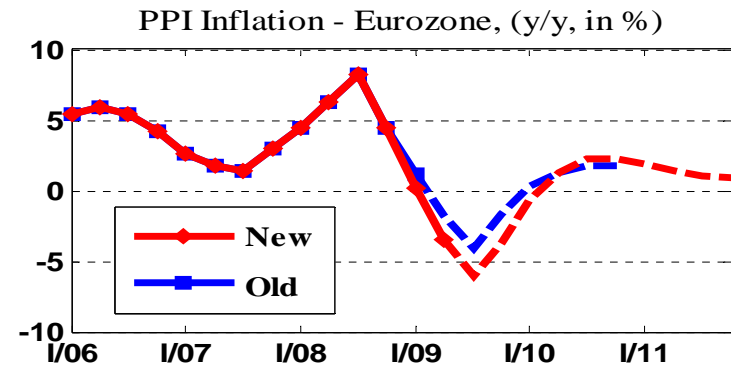
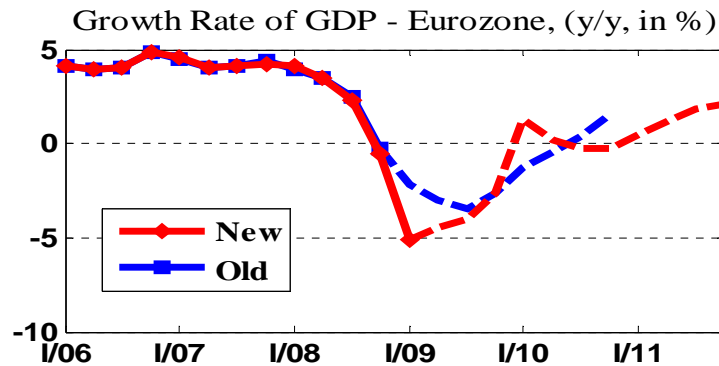
- Lower outlook both for core inflation and food prices;
- Reflects weaker macroeconomic inflationary pressures and sharply falling prices of agricultural commodities.

Inflation Forecast Change Decomposition



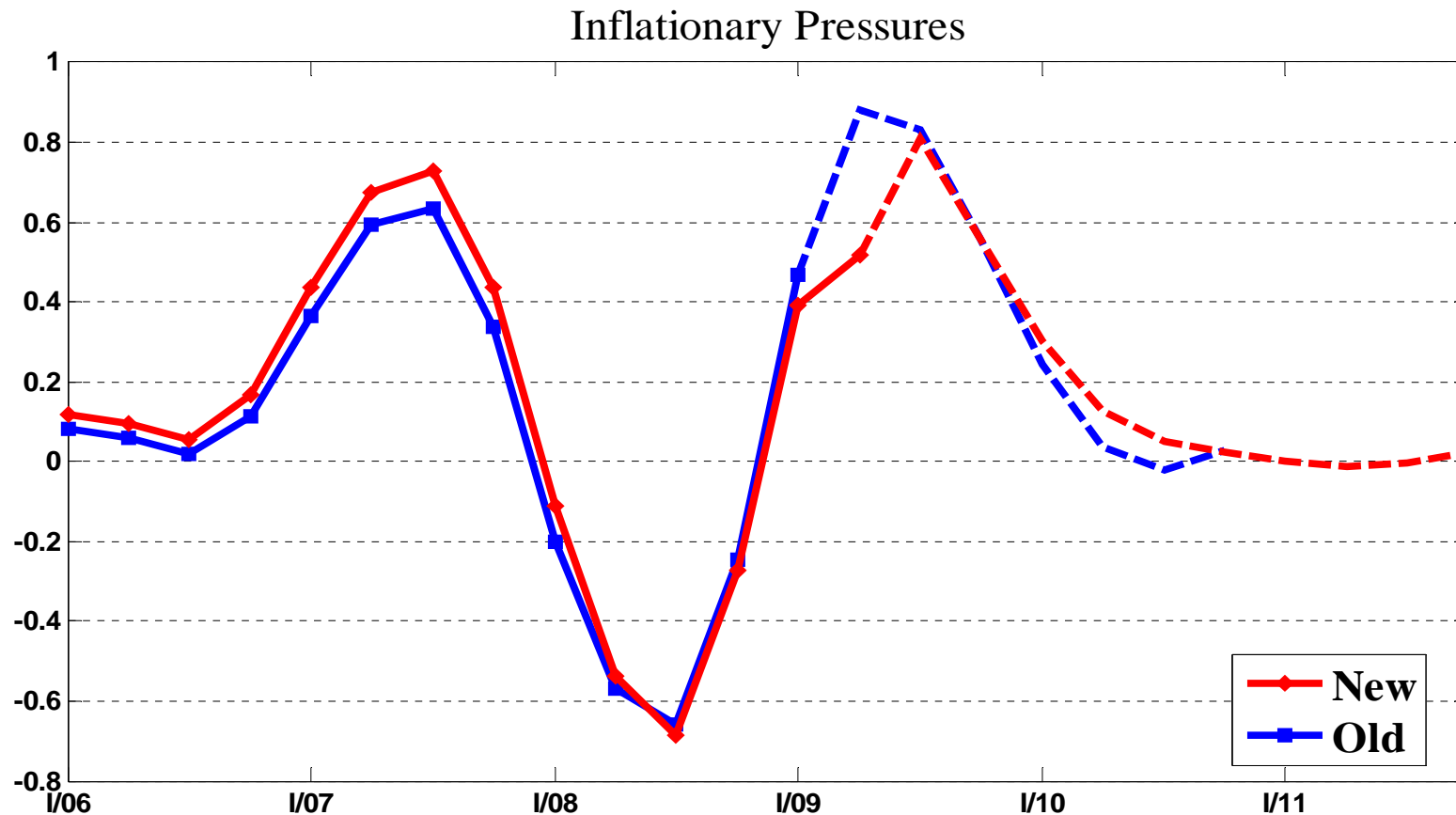
- Different time profile of regulated price and VAT changes;
- Weaker macroeconomic inflationary pressures;
- Lower near-term inflation forecast in Q3 2009 (offsets higher than expected inflation in Q2 2009 in y/y figures).

External Assumptions



- Somewhat mixed, 'W-shaped' outlook for foreign GDP;
- Lower forecast of foreign prices and interest rates.

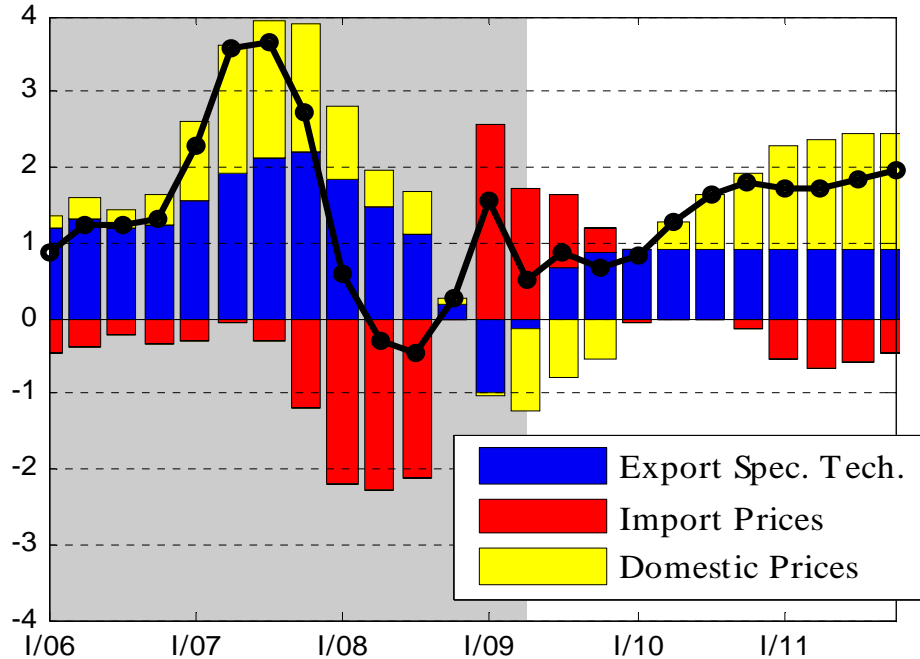
Overall Inflationary Pressures



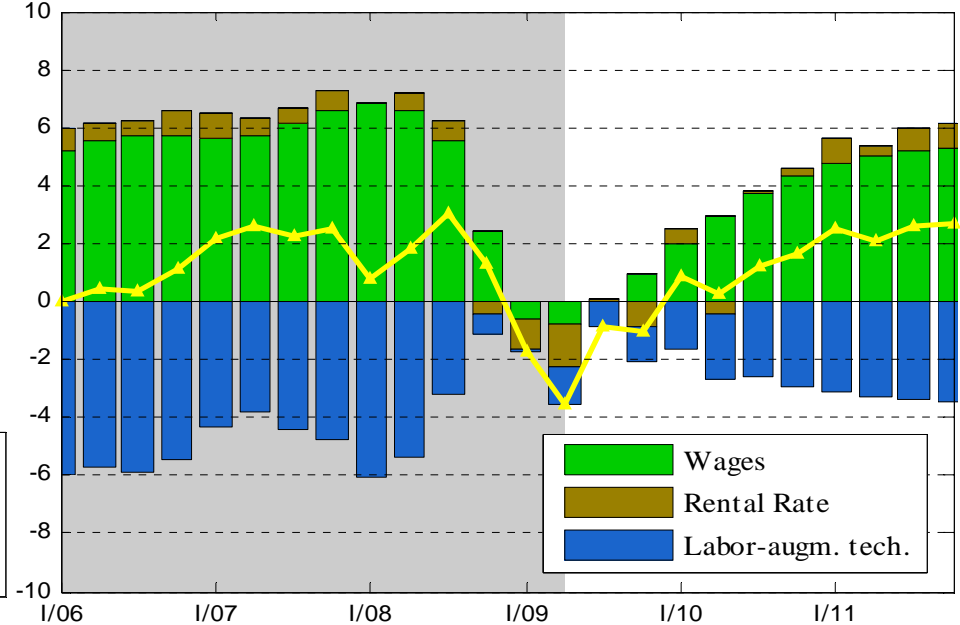
- Pro-inflationary macroeconomic environment, but to a lesser extent than in the previous forecast.

Domestic Pressures vs. Import Prices

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

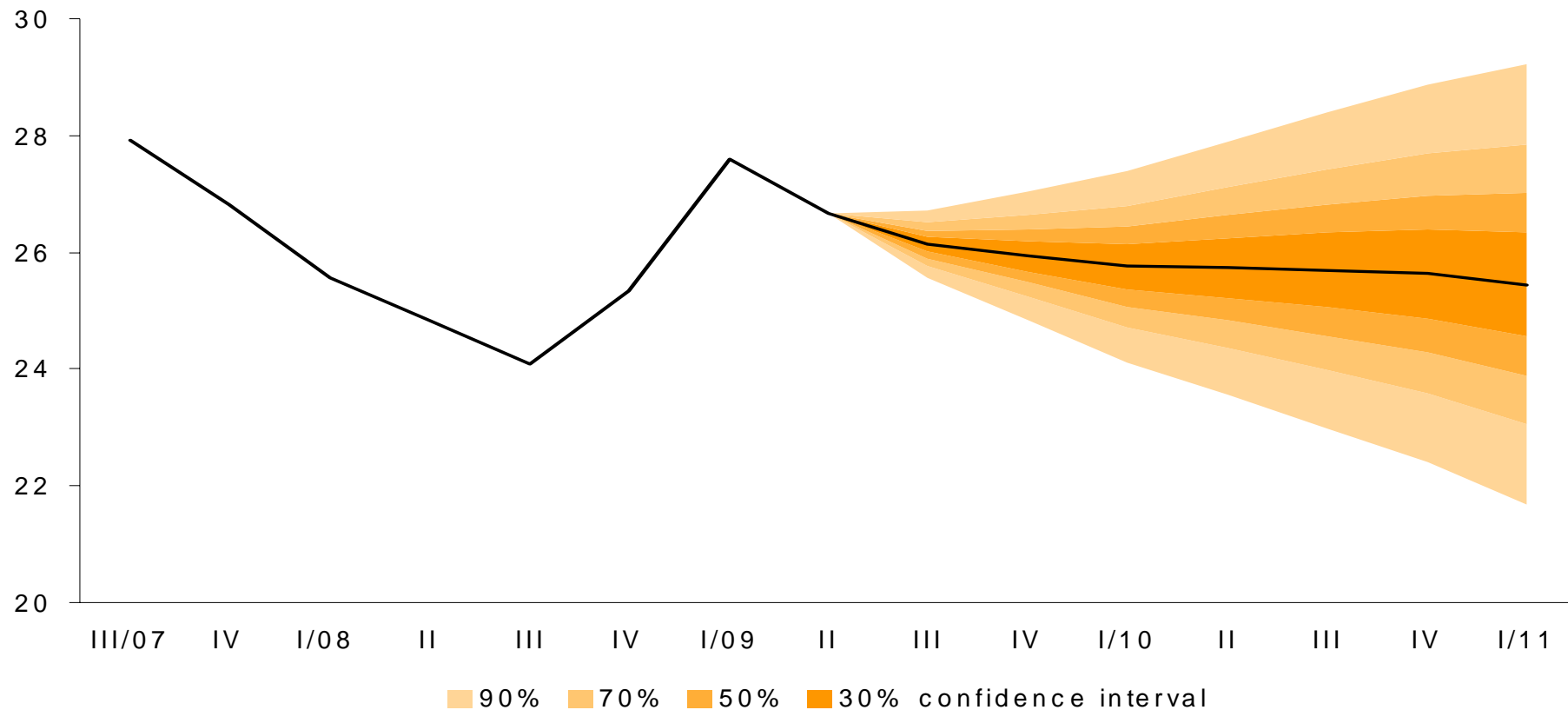


Nom. Marginal Cost in Domestic Sector (q/q, in %, ann.)



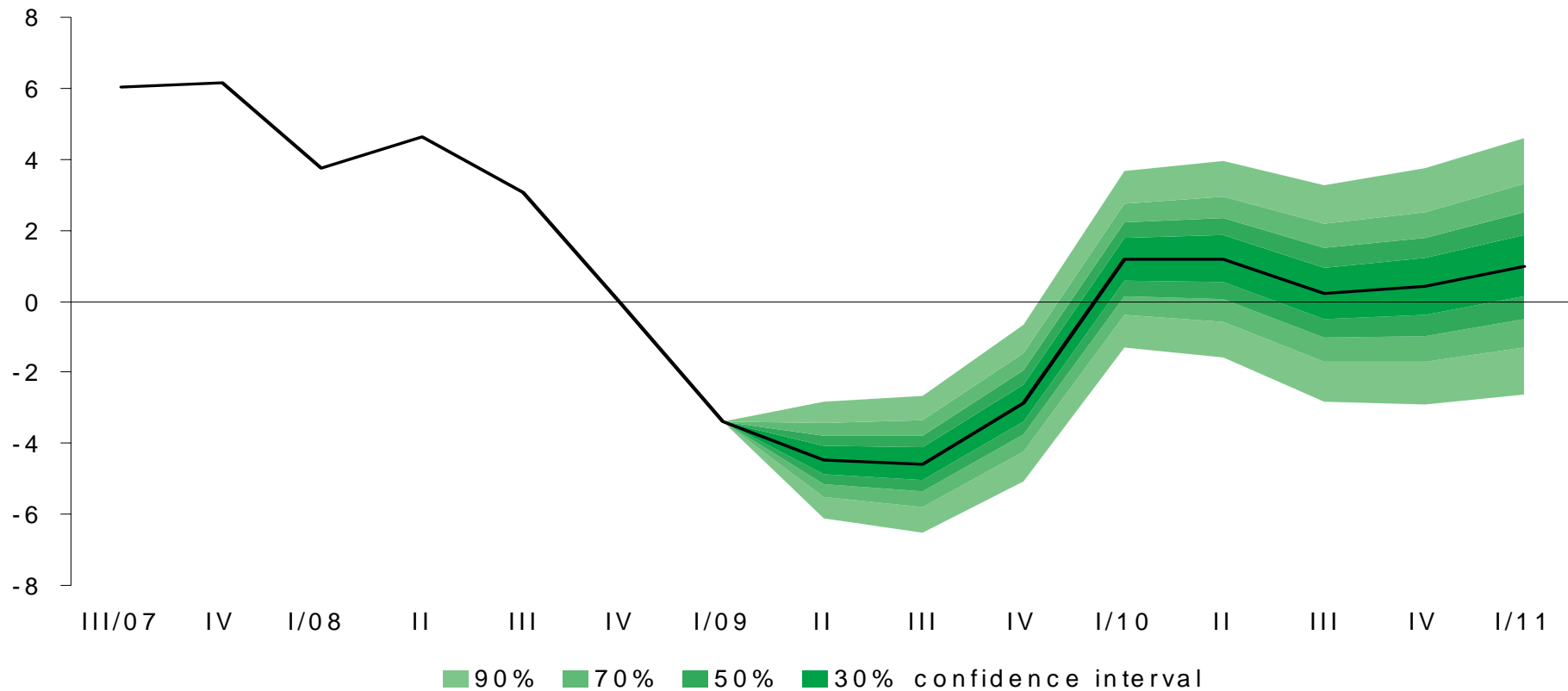
- The inflationary impact of past CZK depreciation is weaker than in the previous forecast (falling prices abroad, reduction of importers' margins);
- The domestic anti-inflationary pressures have become more intense (falling wages in q/q terms, free capacities).

Exchange Rate Forecast (CZK/EUR)



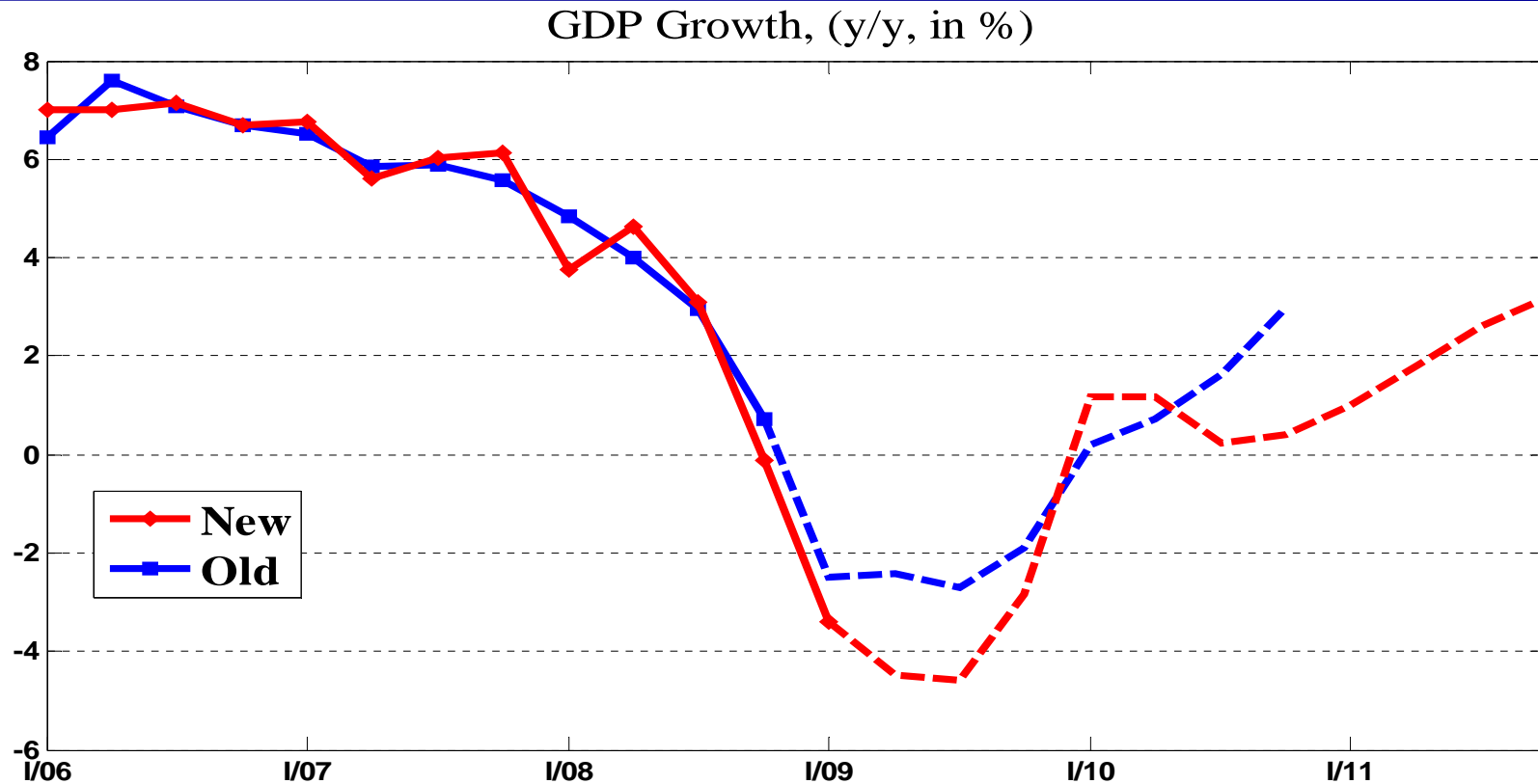
- The nominal exchange rate is modestly appreciating over the forecast horizon;
- The exchange rate trajectory is slightly stronger than in the previous forecast.

GDP Growth Forecast



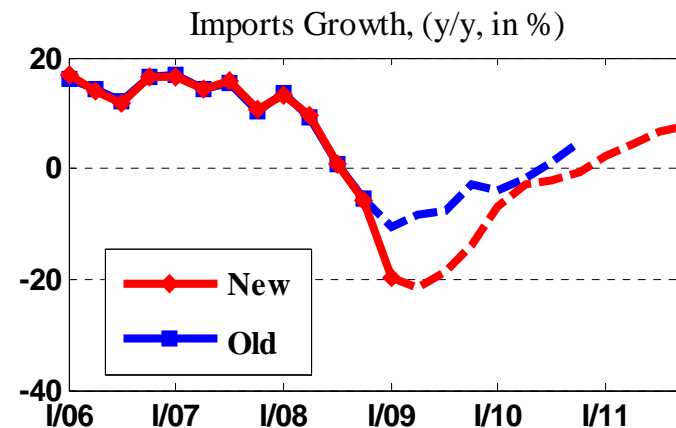
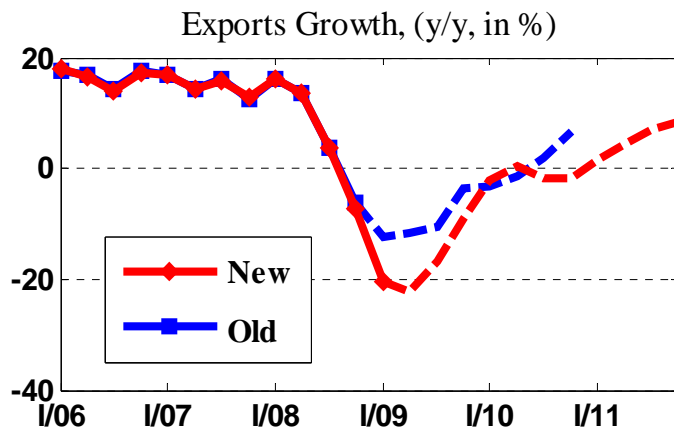
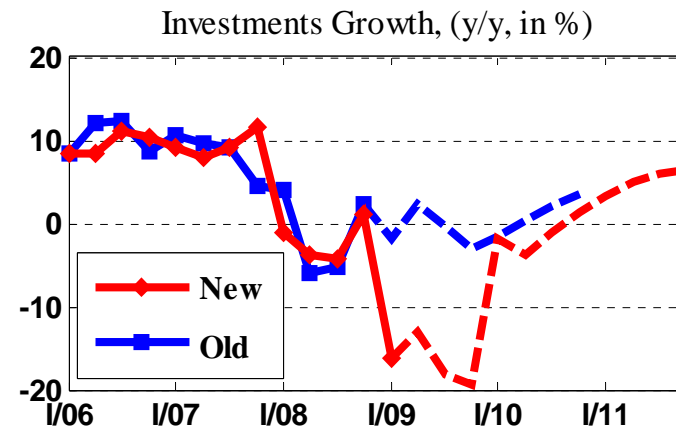
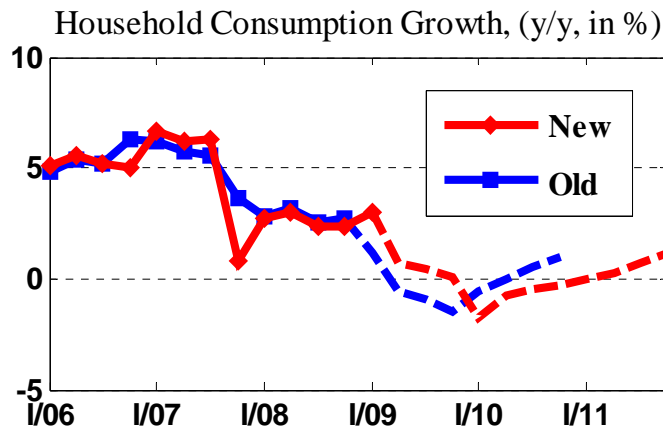
- A recession in 2009 followed by a gradual recovery in 2010;
- Yearly averages: 2009: -3.8%, 2010: +0.7%, 2011: +2.2%;
- Positive q/q growth rates from Q3/2009.

Comparison with Previous GDP Forecast



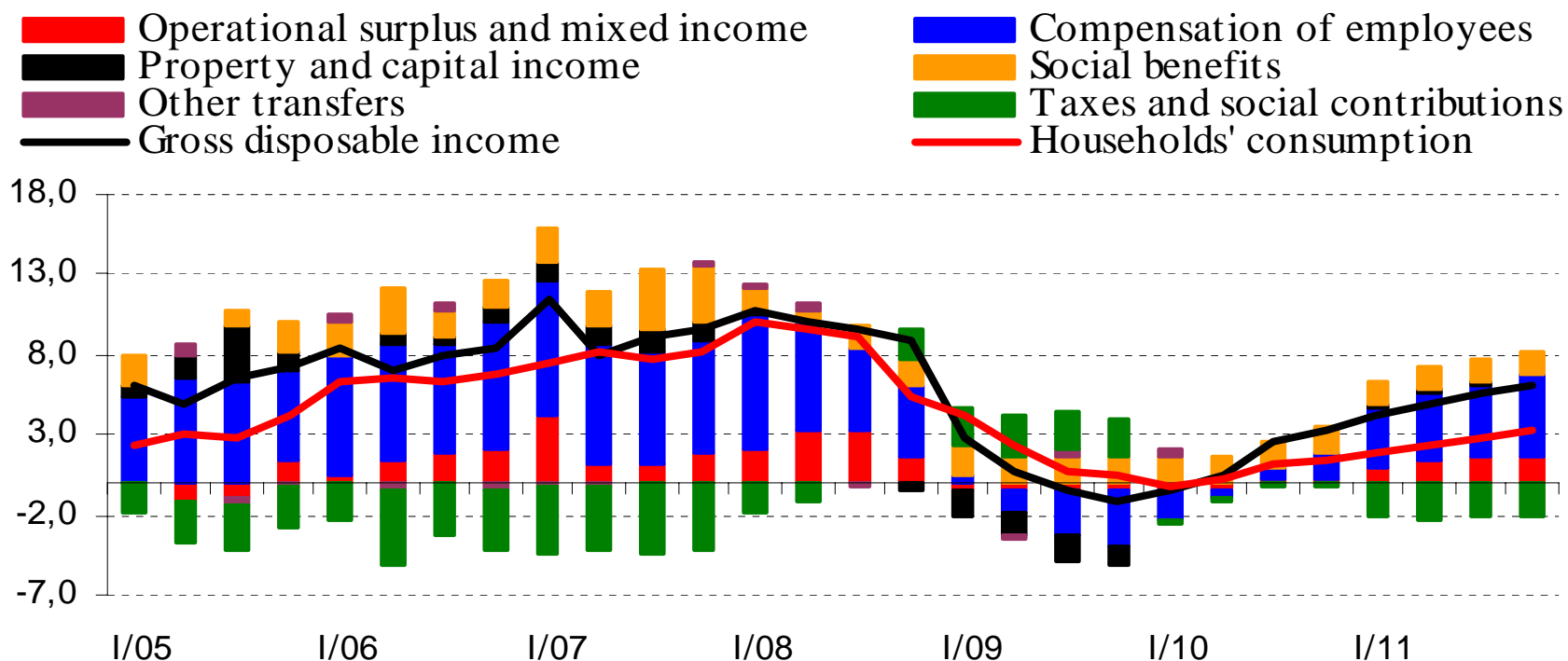
- GDP outlook revised down substantially for 2009;
- Recovery in 2010 affected by sluggish pick up in foreign demand and the end of car-scraping subsidies abroad.

Forecast of Aggregate Demand



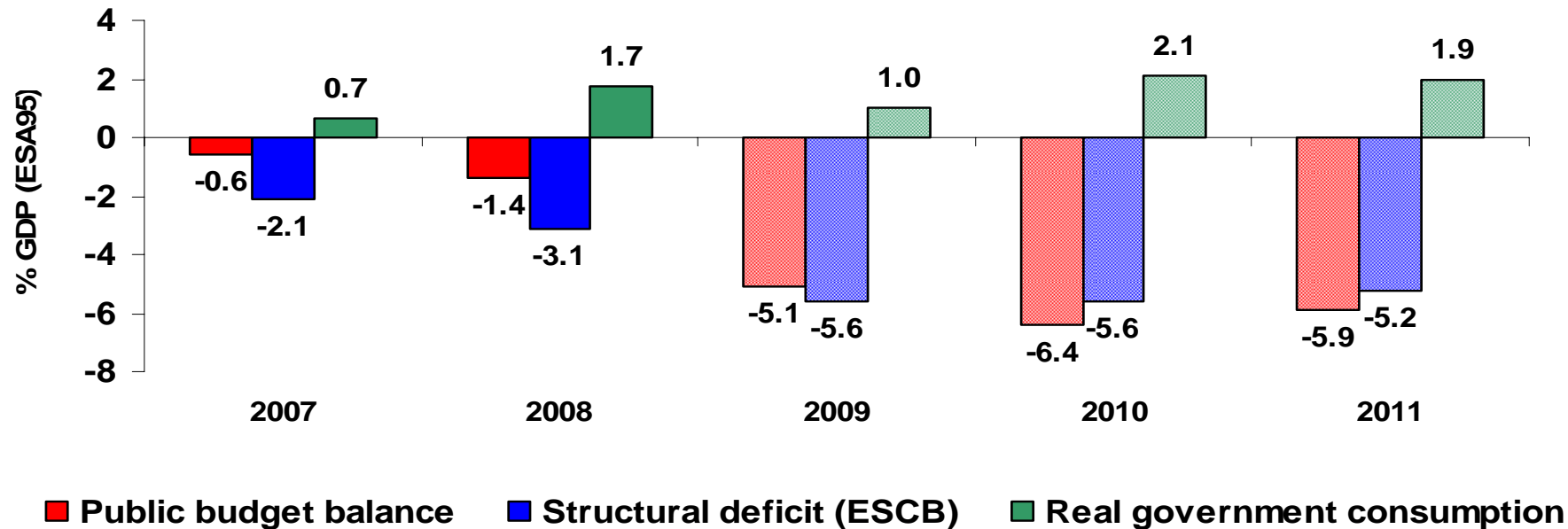
- Sharp drop in exports, imports and investment in 2009;
- A decline in household consumption expected in 2010.

Nominal Consumption and Disposable Incomes Growth



- Falling labour, property and capital incomes partly offset by lower taxes and social contributions and by higher social benefits (fiscal discretion and built-in stabilizers);
- Savings rate currently falling.

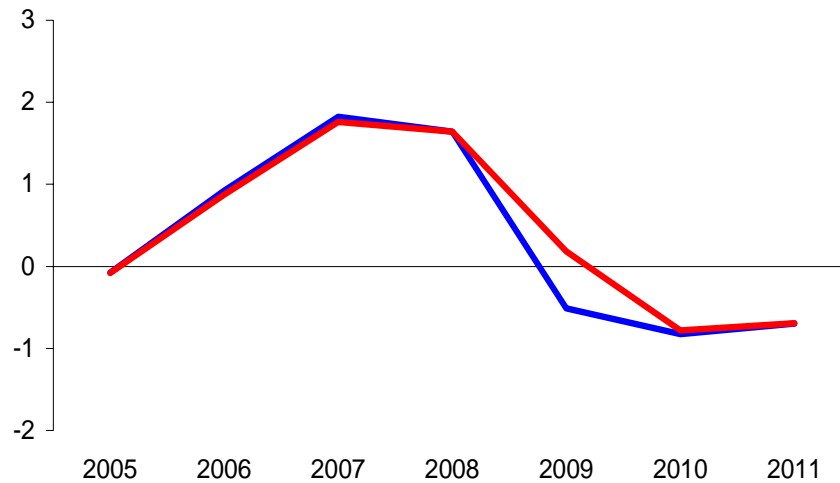
Public Budgets



- Forecast of fiscal deficits raised by about 1 p.p. due to the deeper observed economic slump;
- The impact of (domestic, as well as foreign) anti-crisis measures the same as in the previous forecast;
- Government consumption will continue to grow modestly.

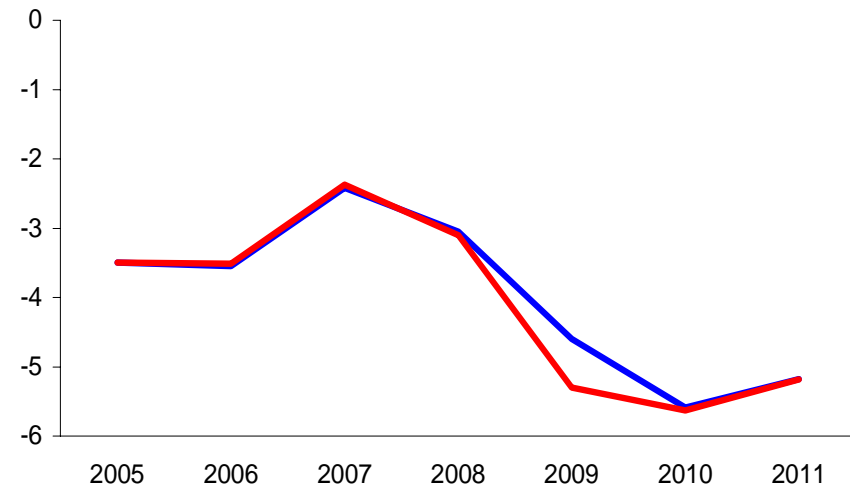
Cyclical vs. Structural Deficits

Cyclical component of public budgets (in % of GDP)



— Output Gap Approach — ESCB Approach

Cyclically-adjusted budget balance (in % of GDP)

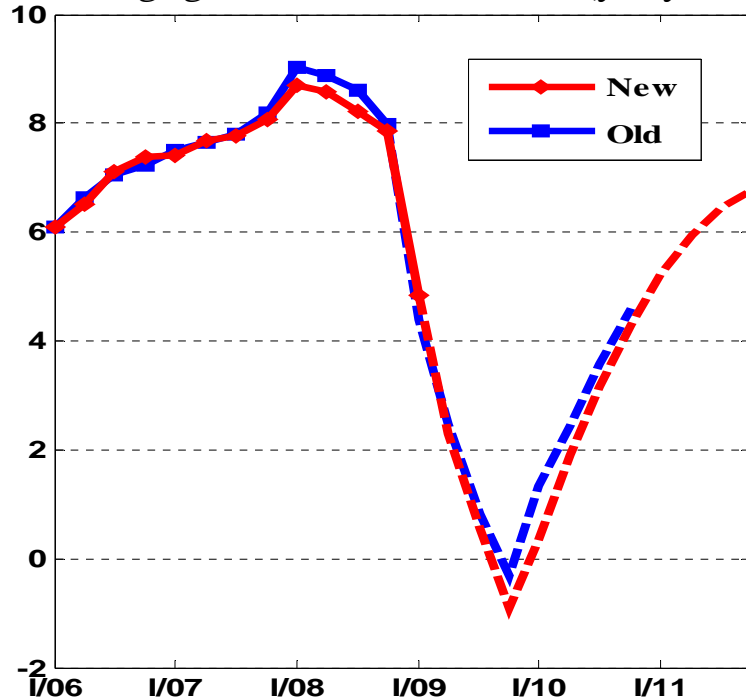


— Output Gap Approach — ESCB Approach

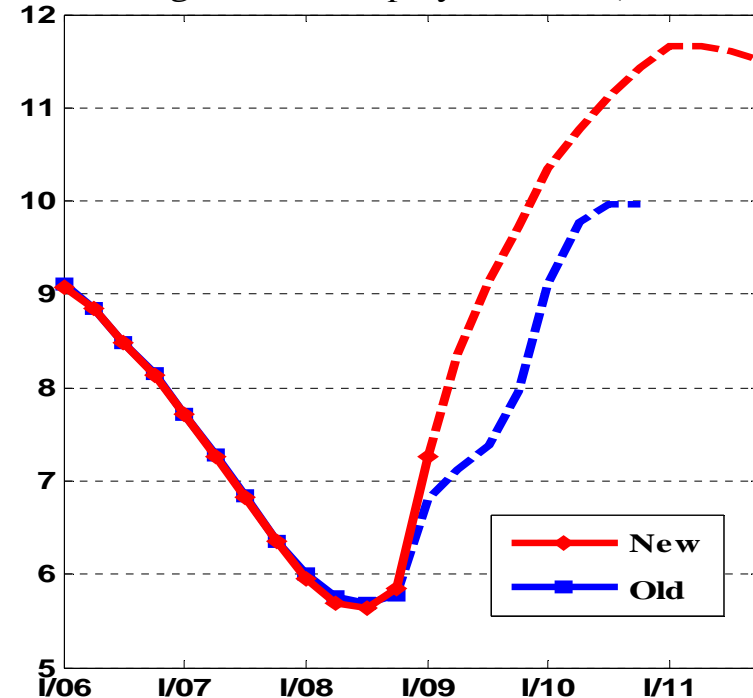
- Deterioration of budgets is partly structural (previous reforms, anti-crisis measures) and partly cyclical;
- Cyclical position of the economy is very uncertain (strong end-point bias, large dispersion of output gap estimates).

Labour Market Forecast

Nominal wage growth in business sector (y-o-y, in %, s.a.)



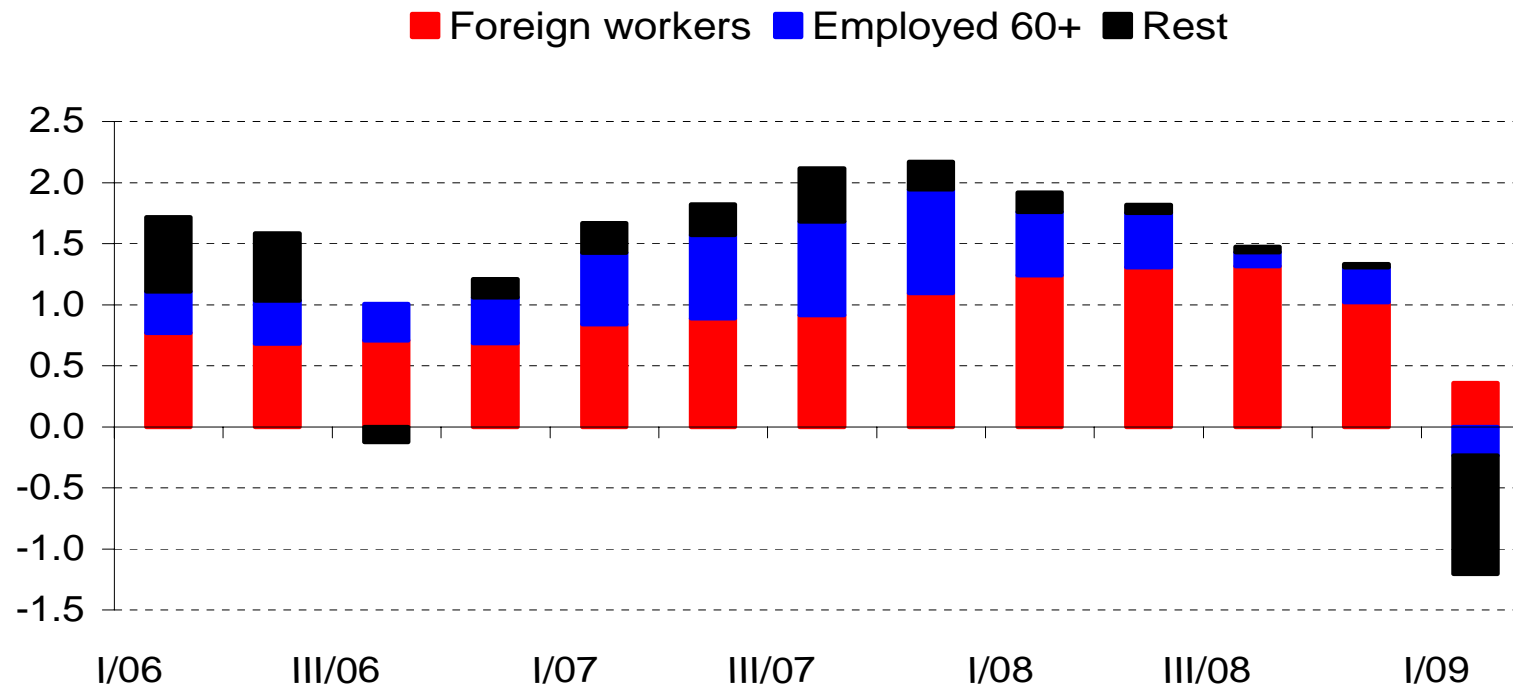
Total registered unemployment rate (in %, s.a.)



- Forecast of nominal wage growth slightly reduced;
- Increase in registered unemployment rate almost to 12%;
- July 2009: unemployment slightly below forecast.

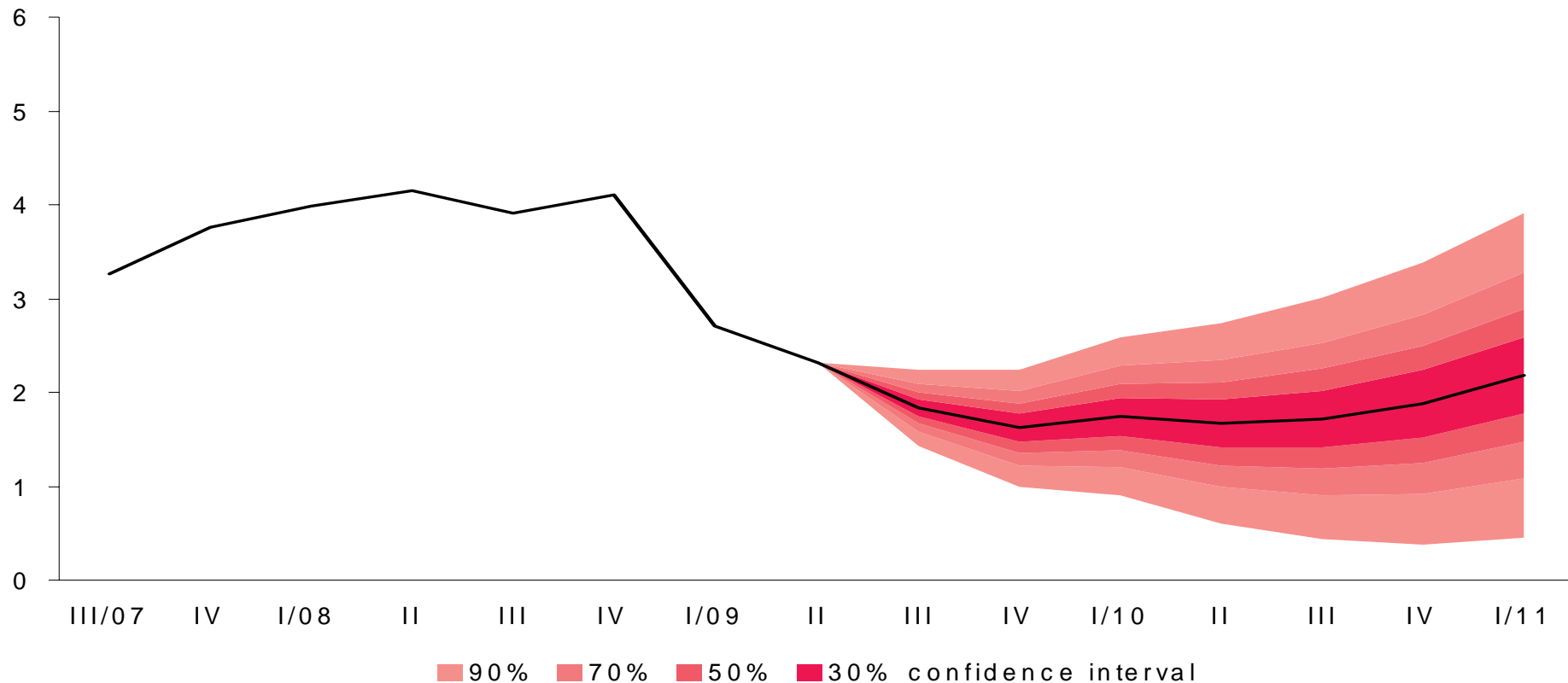
Structure of Employment

Contributions to the growth of employed people (in percentage points)



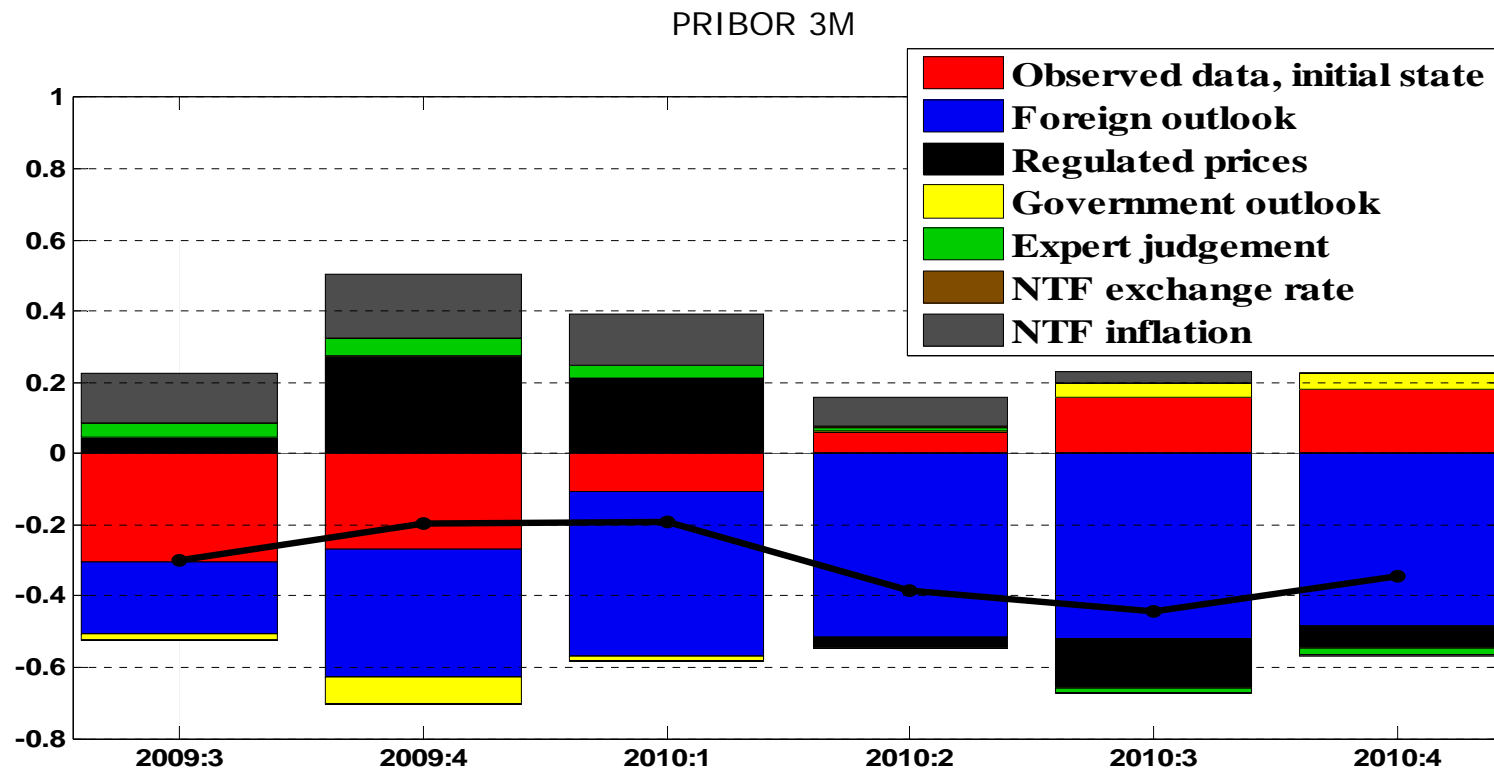
- The employment of all groups has been significantly affected by the economic recession;
- ‘Core workers’ affected more than previously expected.

Interest Rate Forecast



- Consistent with the forecast is a decline in market interest rates this year followed by a modest rise from 2010 H2 onwards;
- Compared to previous forecast, the interest rate path is lower on the whole forecast horizon.

Interest Rate Forecast Change Decomposition



- Downward impact of foreign outlook and 'initial state';
- Small upward impact of regulated prices and near-term inflation outlook.

Comparison of the CNB's Forecast with Analysts' View

| | CNB | | ANALYSTS | |
|---------------------------|-----------|----------------|------------|---------------|
| GDP in % (2009) | | -3.8 | | -3.4 |
| GDP in % (2010) | | 0.8 | | 1.3 |
| CPI in % | | 1.3 (3Q/2010) | | 1.9 (7/2010) |
| Exchange rate CZK/EUR | | 25.7 (3Q/2010) | | 25.4 (7/2010) |
| Interest rate in % | 3M PRIBOR | 1.7 (3Q/2010) | 2T REPO | 1.7 (7/2010) |
| | | | 12M PRIBOR | 2.7 (7/2010) |
| Nominal wages in % (2009) | | 1.9 | | 2.3 |
| Nominal wages in % (2010) | | 2.2 | | 3.3 |

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

- Analysts slightly more optimistic as regards the GDP;
- CNB expects lower inflation and wage growth;
- Analysts forecast somewhat faster CZK appreciation.



Thank you
for your attention.

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