



CNB's New Forecast (Inflation Report I/2010)

Meeting with Analysts

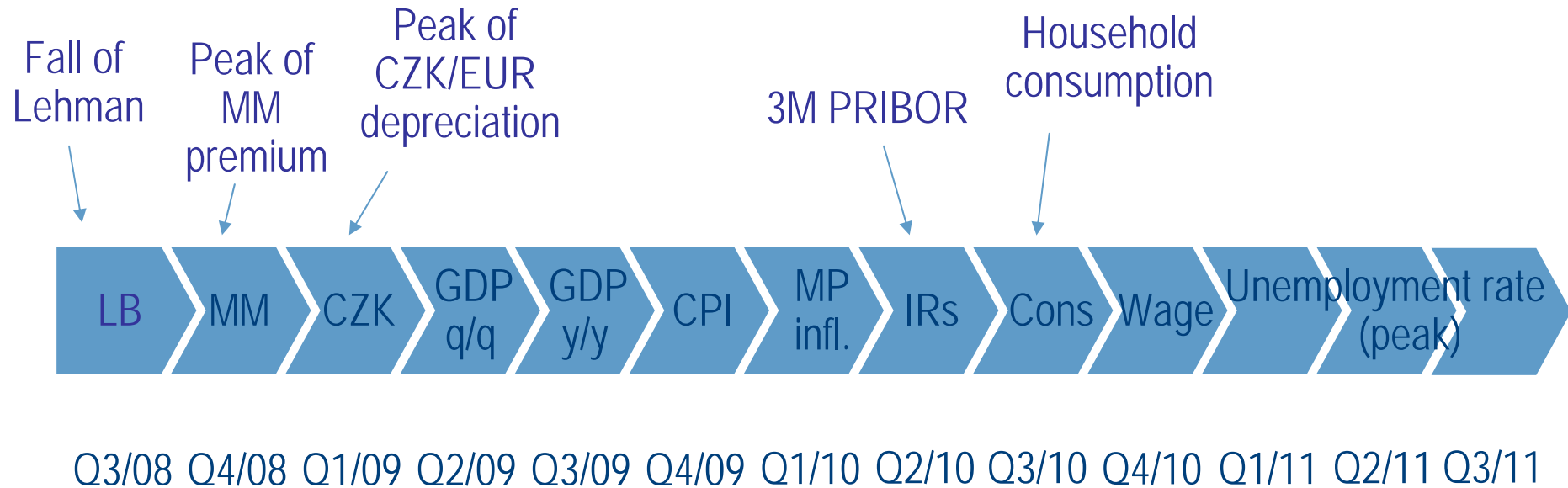
Tomáš Holub

Prague, February 12, 2010

Summary of the Inflation Forecast

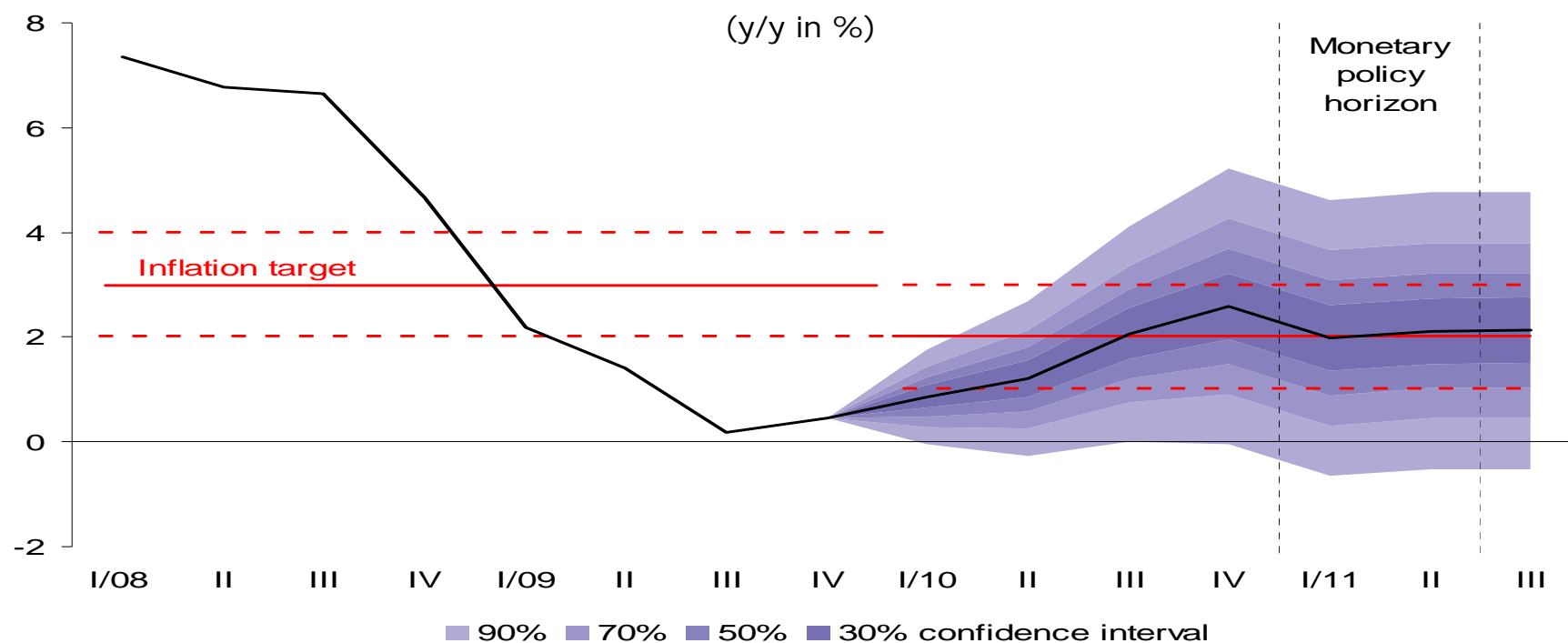
- Inflation will slightly exceed the 2% target in late 2010 due to tax changes, but will return back to target on the MP horizon.
- Inflation forecast was slightly increased for 2010 and marginally reduced for 2011.
- Import prices are falling, no inflationary pressures are seen in the domestic economy (but: wage growth?). Margins are depressed, and will gradually increase in the future.
- The GDP will grow by 1.4% in 2010 and 2.1% in 2011 (W-shaped recovery), labour market slack will persist.

“Bottoming Out”



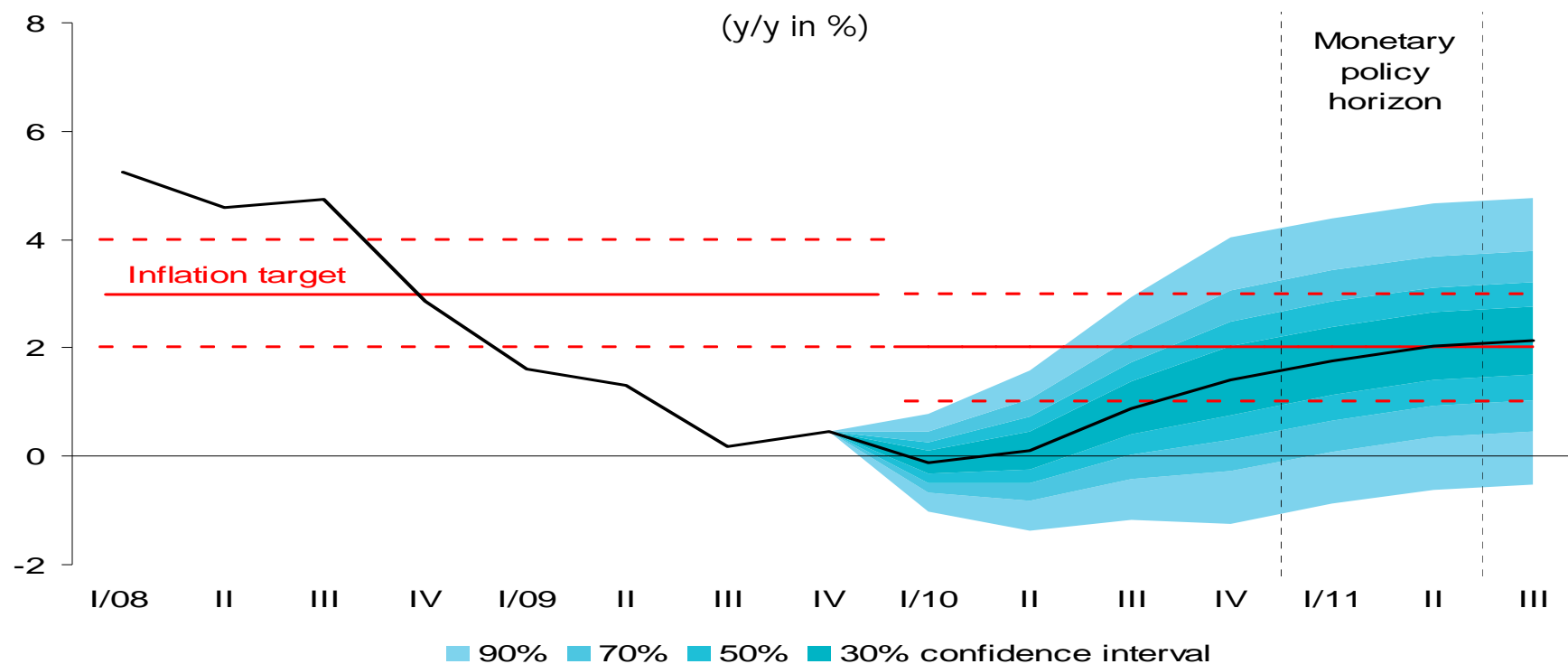
- Financial variables, GDP and inflation have bottomed out.
- We are close to the bottom of MP inflation and interest rates.
- The worst is still to come in terms of consumption, wages and the unemployment rate.

Headline Inflation Forecast



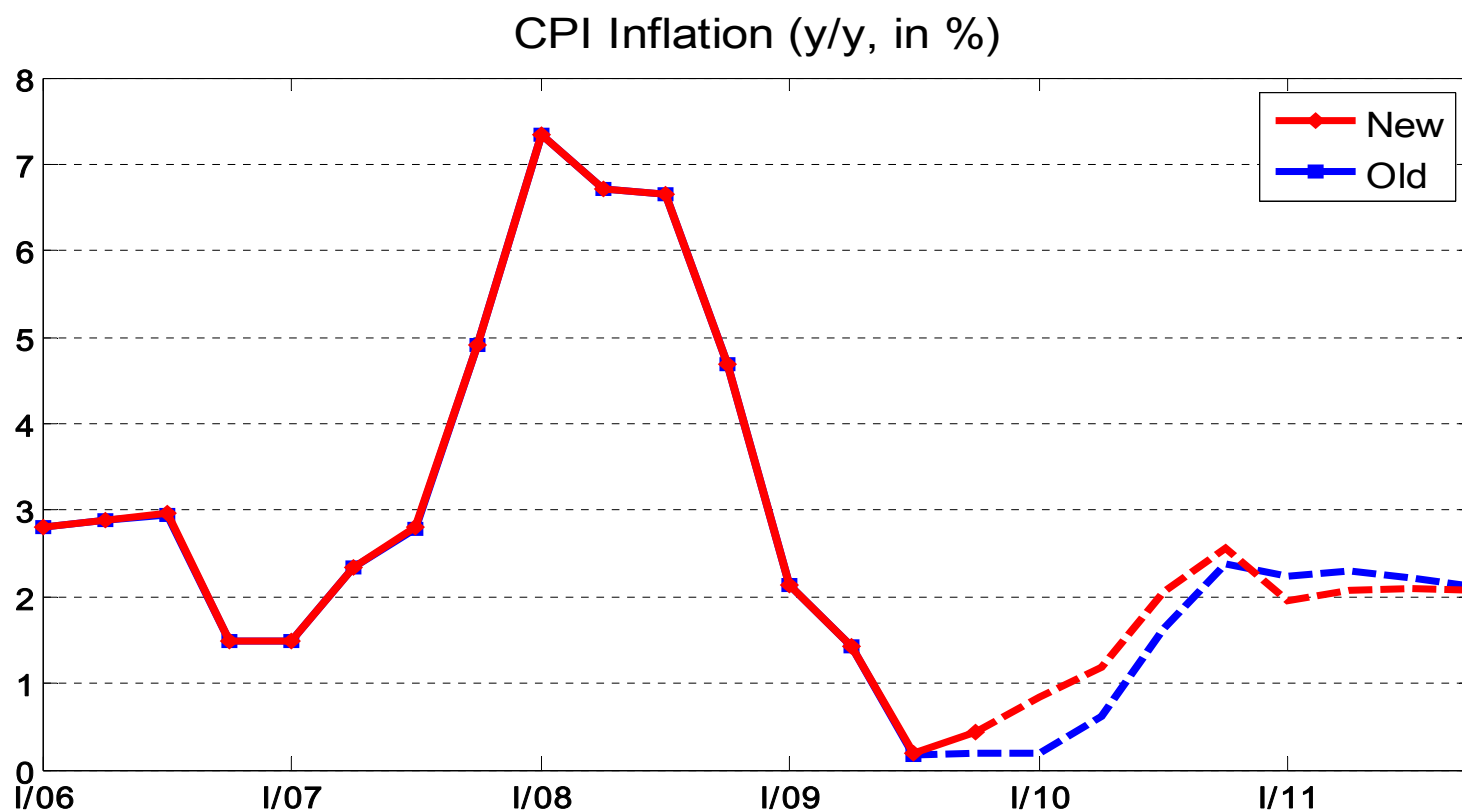
- Forecast slightly above the 2% target in late 2010 (taxes).
- The January 2010 figure (0.7% y/y) was slightly below the forecast due to lower core inflation.

MP-Relevant Inflation Forecast



- MP-relevant inflation forecast below the headline inflation forecast (due to tax changes).
- Approaching the new inflation target from below.

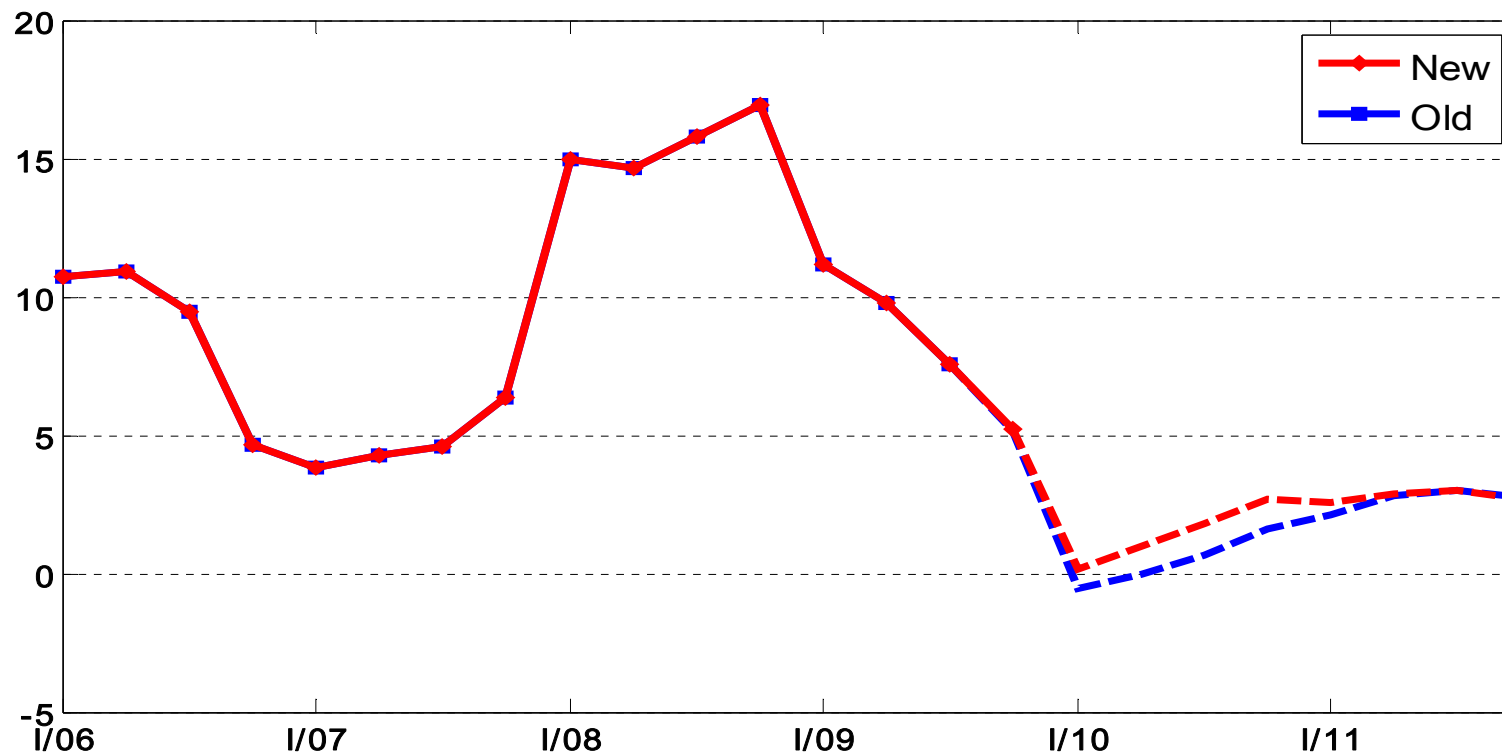
Comparison with Previous Forecast



- Forecast slightly increased for 2010, and marginally lowered for 2011.

Regulated Prices

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



- The growth of regulated prices will be low this year.
- But the forecast was revised slightly upwards for 2010. 7

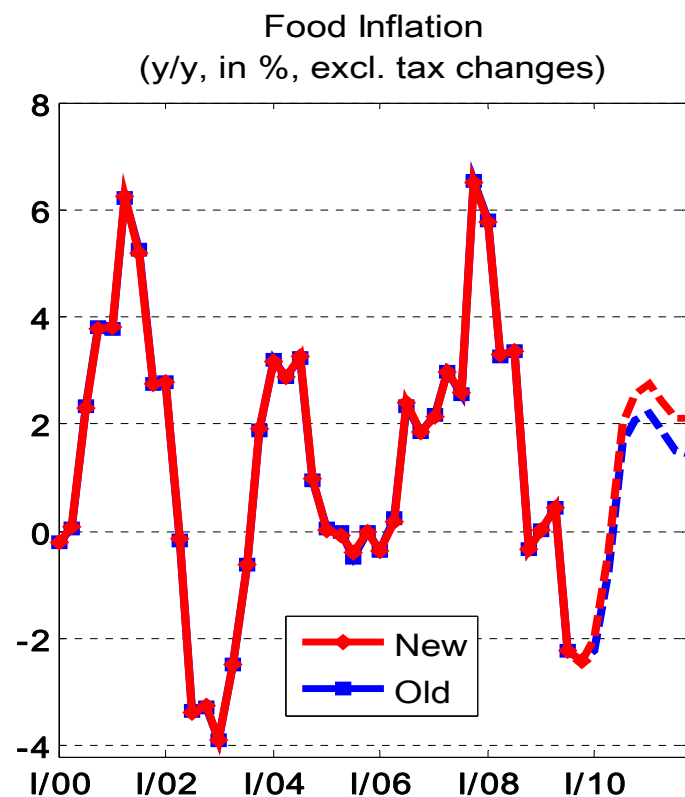
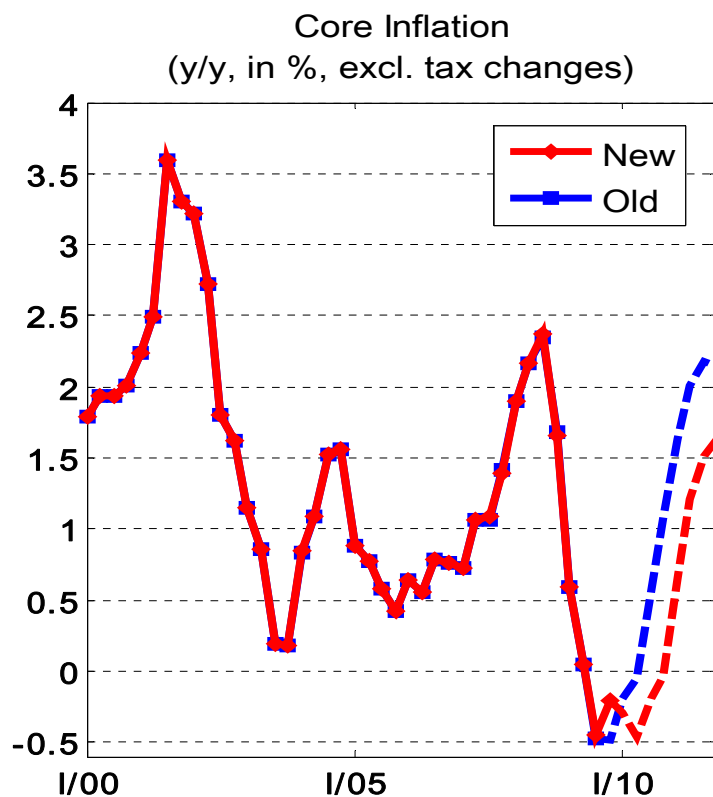
Administrative Measures

(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	5,0	0,96	2,4	0,48	3,2	0,64
of which (selected items):						
Regulated rents	27,6	0,56	15,0	0,38	8,5	0,25
Electricity	11,4	0,46	-3,0	-0,13	2,0	0,08
Natural gas	-11,7	-0,33	-3,0	-0,08	4,0	0,09
Heating	3,9	0,13	2,9	0,10	2,0	0,07
Healthcare	-5,2	-0,10	2,6	0,04	2,0	0,04
Primary impact of tax changes on non-regulated prices		0,00		1,08		0,00

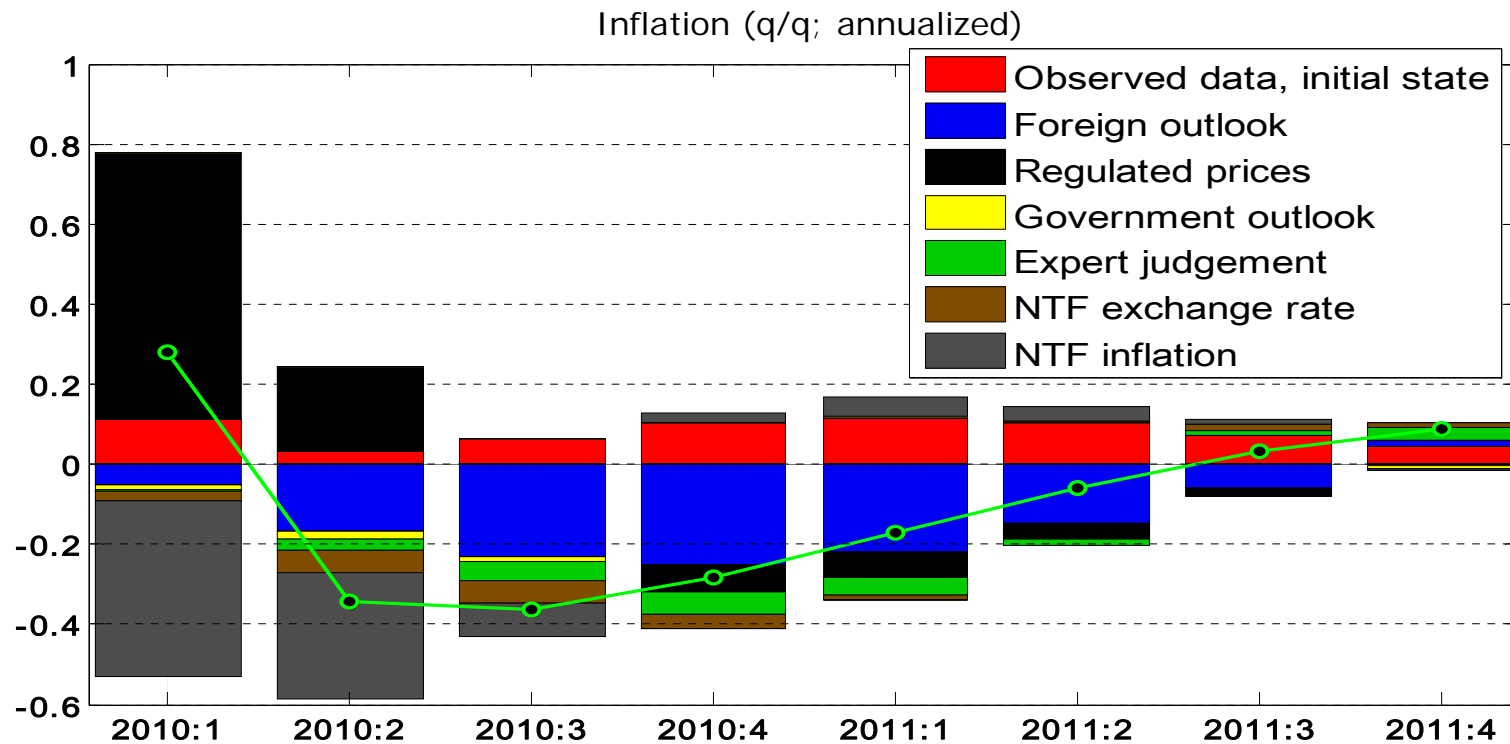
- Falling energy prices vs. increases in indirect taxes and regulated rents in 2010.
- The new forecast does not include a shift to the lower VAT rate for certain services (rejected by Parliament).

Core Inflation and Food Prices



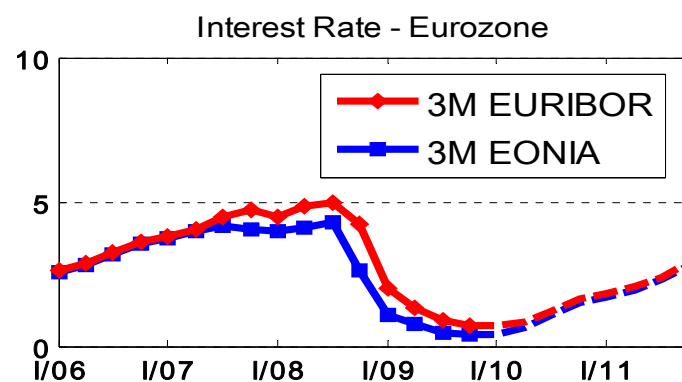
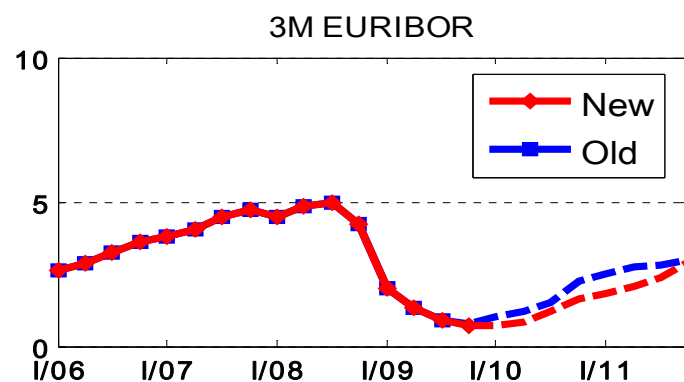
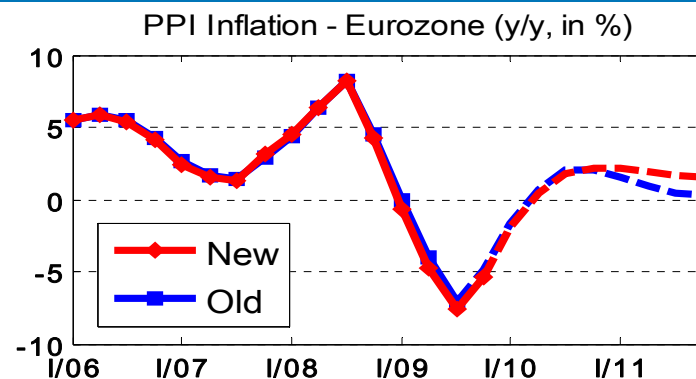
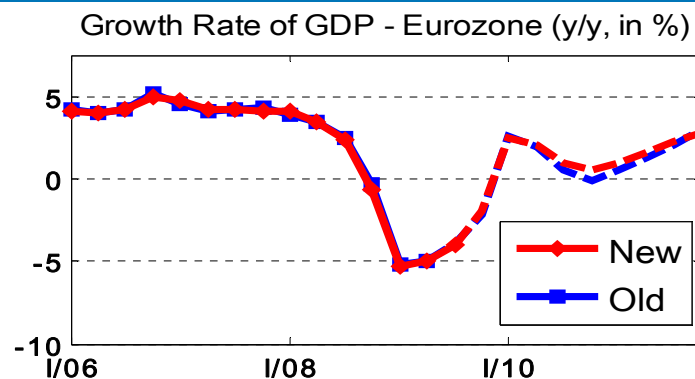
- Food price growth will return to positive figures sooner than the core inflation (forecast revised down).

Inflation Forecast Change Decomposition



- Downward impact of near-term inflation forecast and foreign outlook vs. higher regulated prices and slightly more inflationary initial conditions .

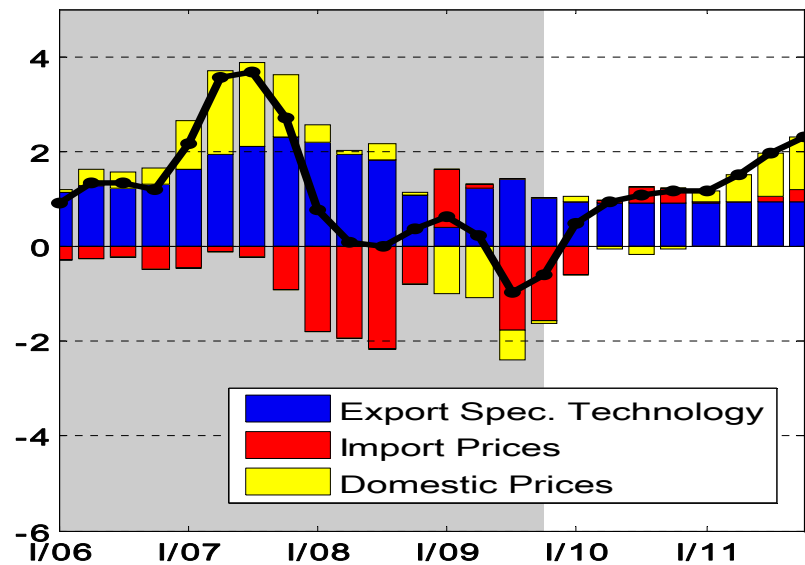
External Assumptions



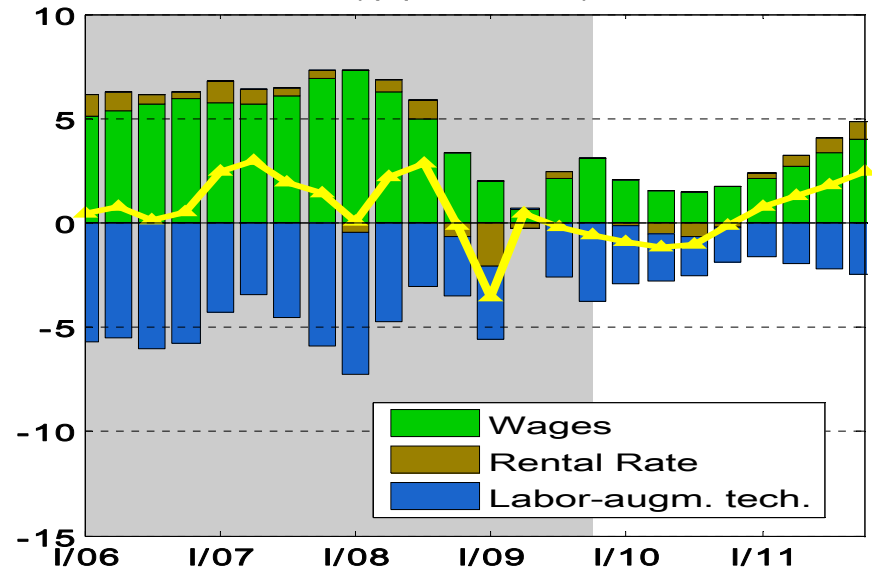
- The growth of interest rates in euro area will be more gradual than assumed in the previous forecast.

Domestic Costs vs. Import Prices

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

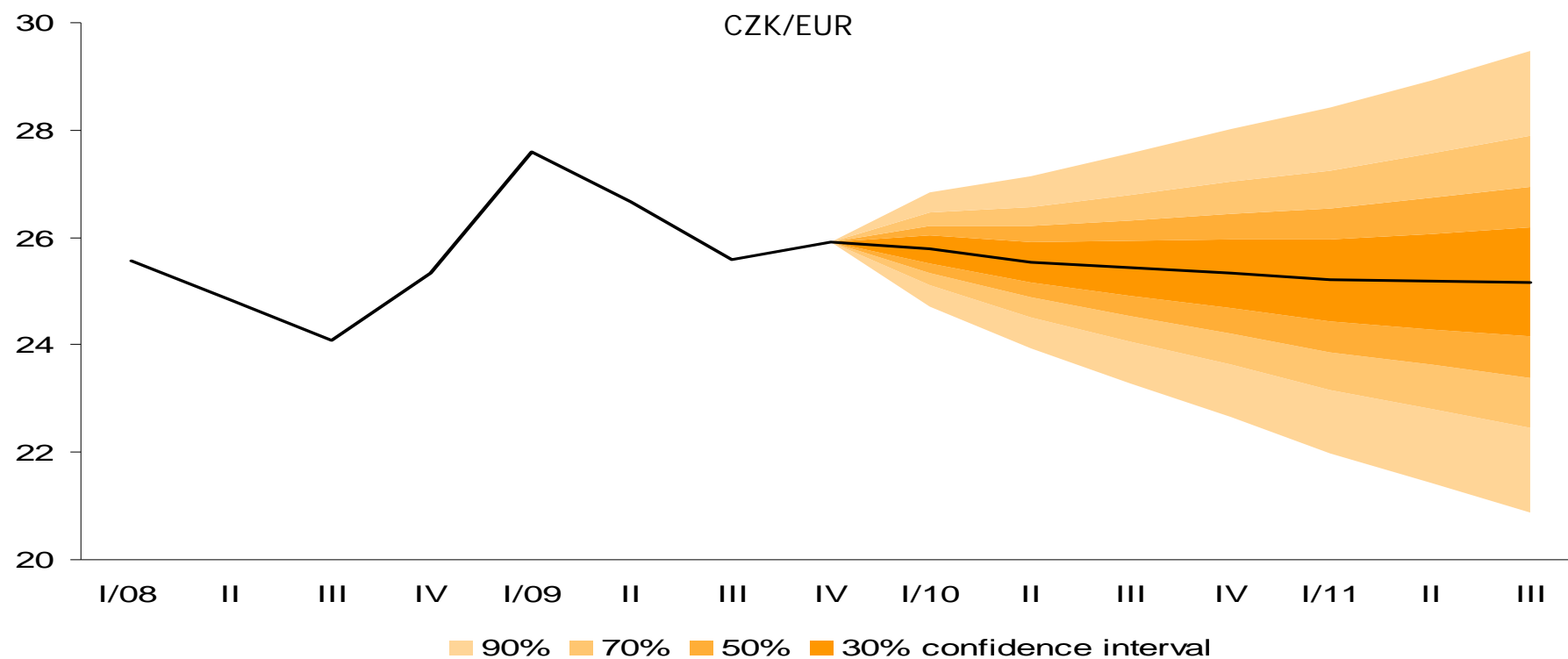


Nominal Marginal Cost in Domestic Sector
(q/q, in %, ann.)



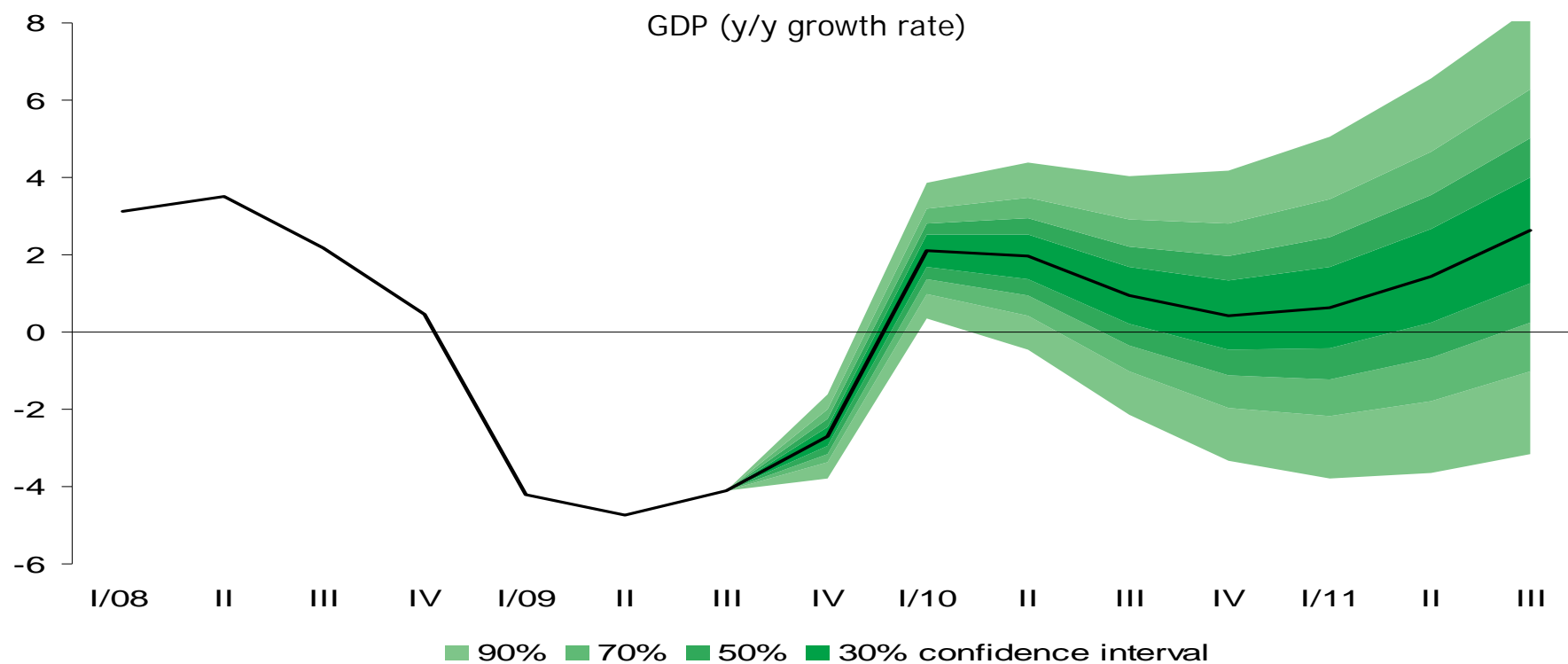
- Import prices are falling; no apparent pressures from the domestic economy (but: expert judgement on wages).
- Anti-inflationary effect of import prices will fade away.
- Gradual correction of depressed margins will take place.

Exchange Rate Forecast



- The nominal exchange rate will be gradually appreciating.
- Import prices will return to slightly positive growth rates due to increasing foreign prices.

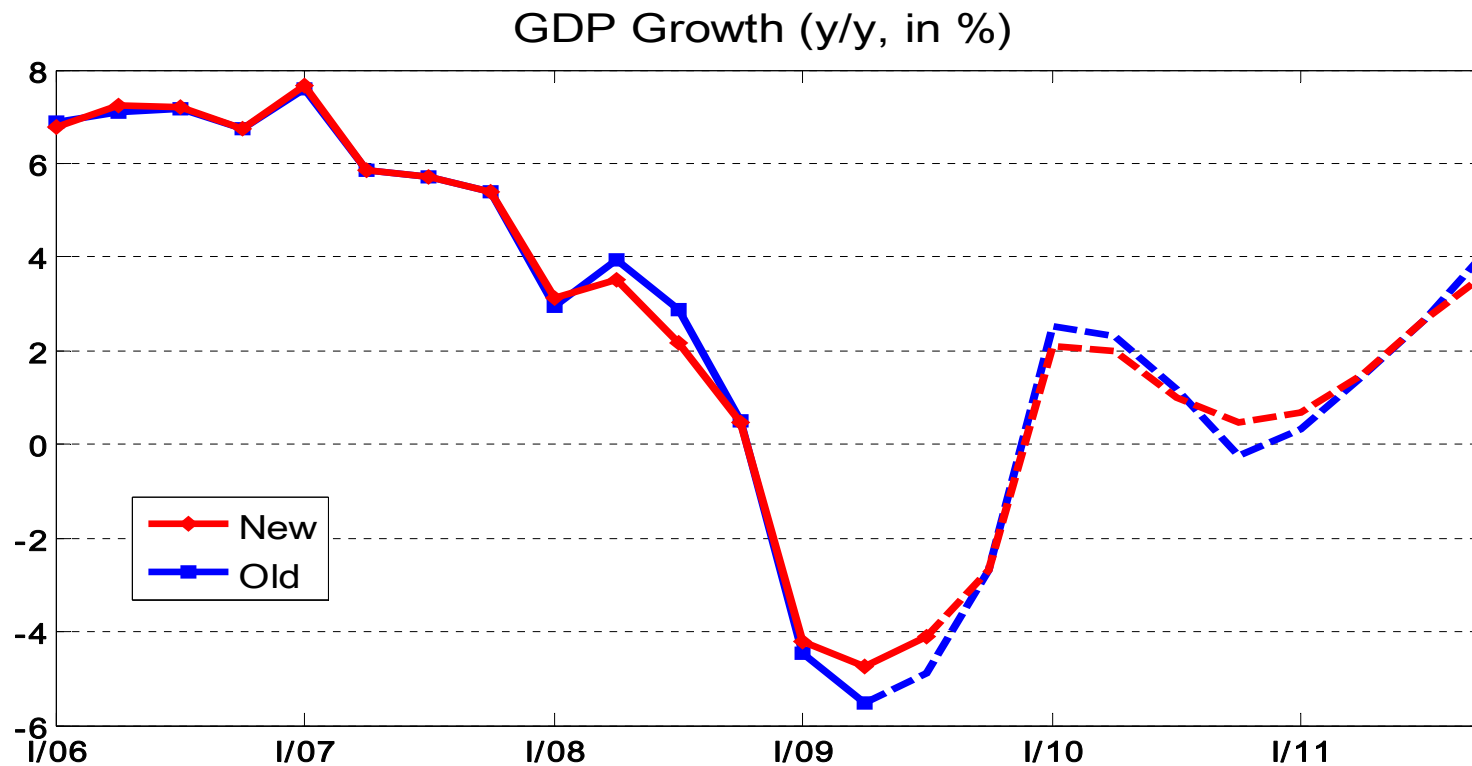
GDP Growth Forecast



- 'W-shaped' recovery reflects the outlook for foreign demand, labour market slack and fiscal measures.

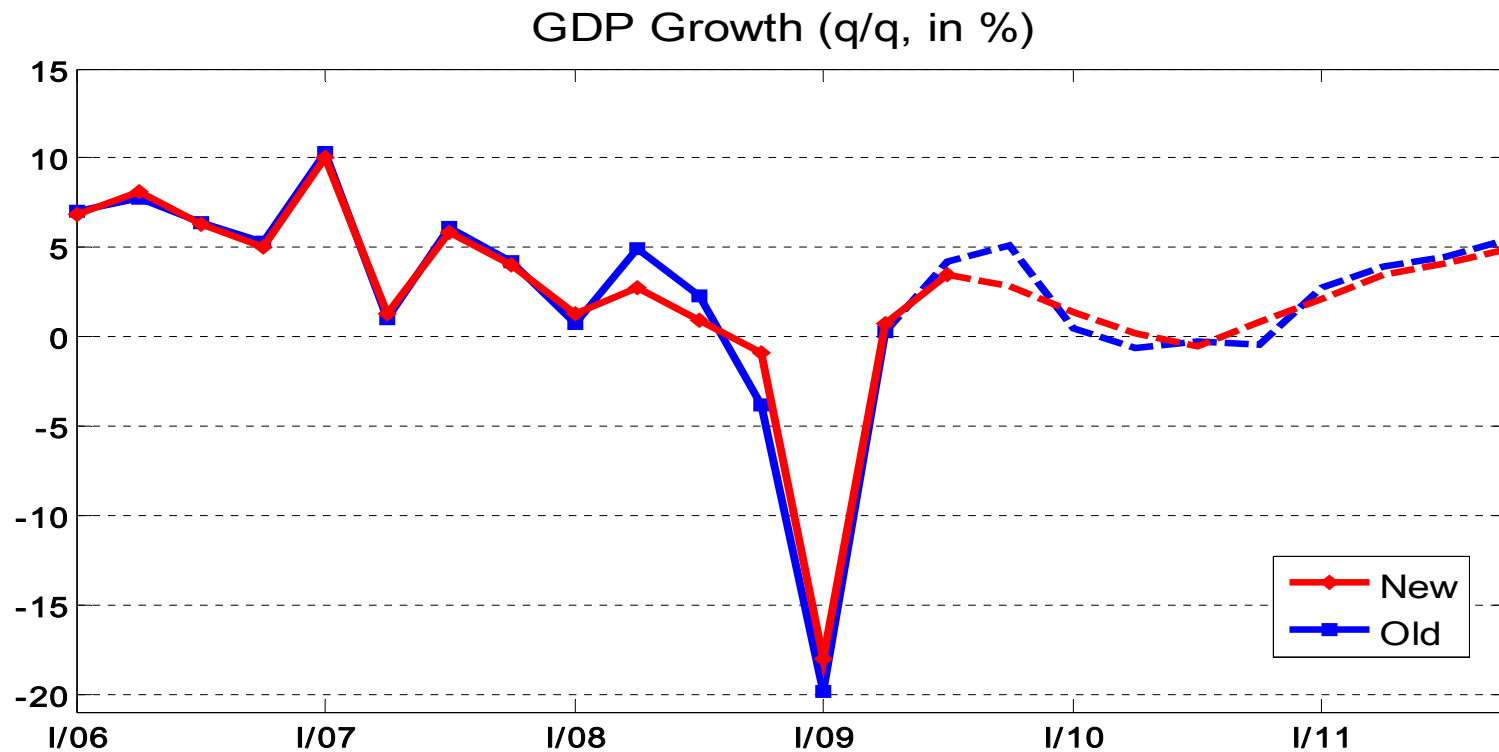
- Averages for 2009: -3.9%; 2010: +1.4%; 2011: 2.1%. ¹⁴

Comparison with Previous GDP Forecast (i)



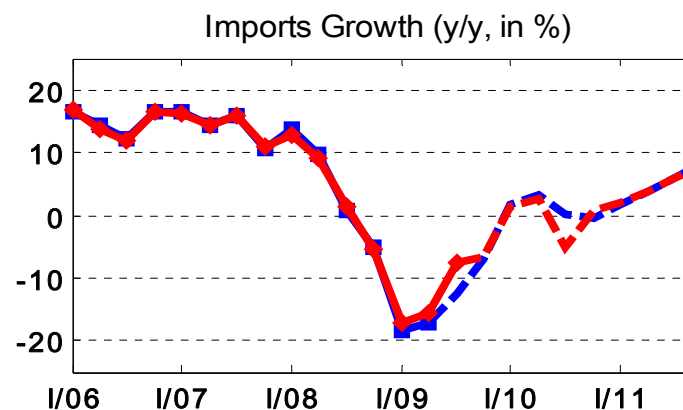
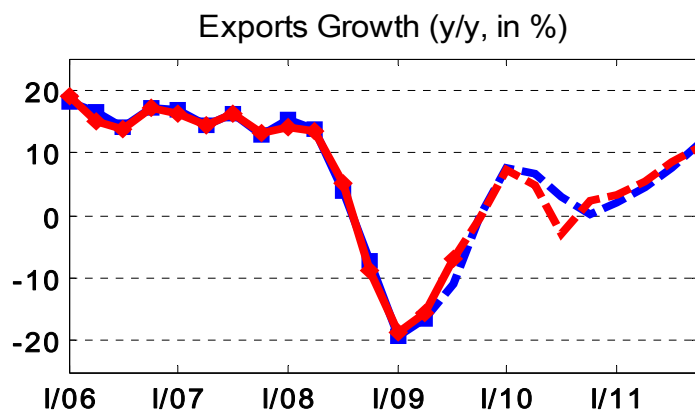
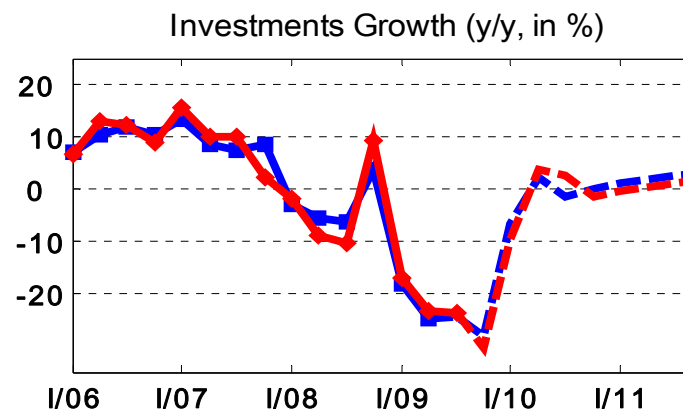
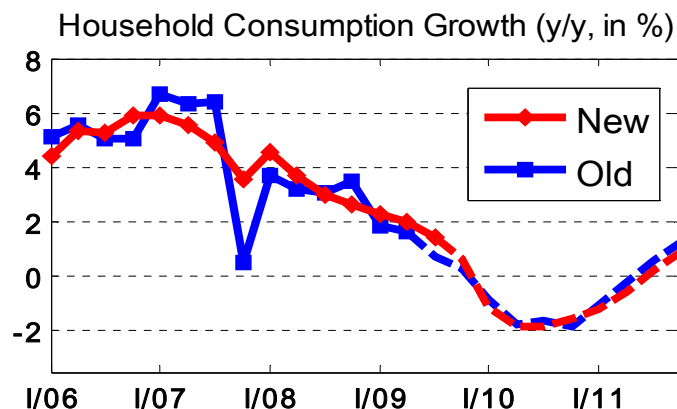
- The y/y GDP outlook remains similar to the previous forecast (the „W” shape is only slightly ‘shallower’).

Comparison with Previous GDP Forecast (ii)



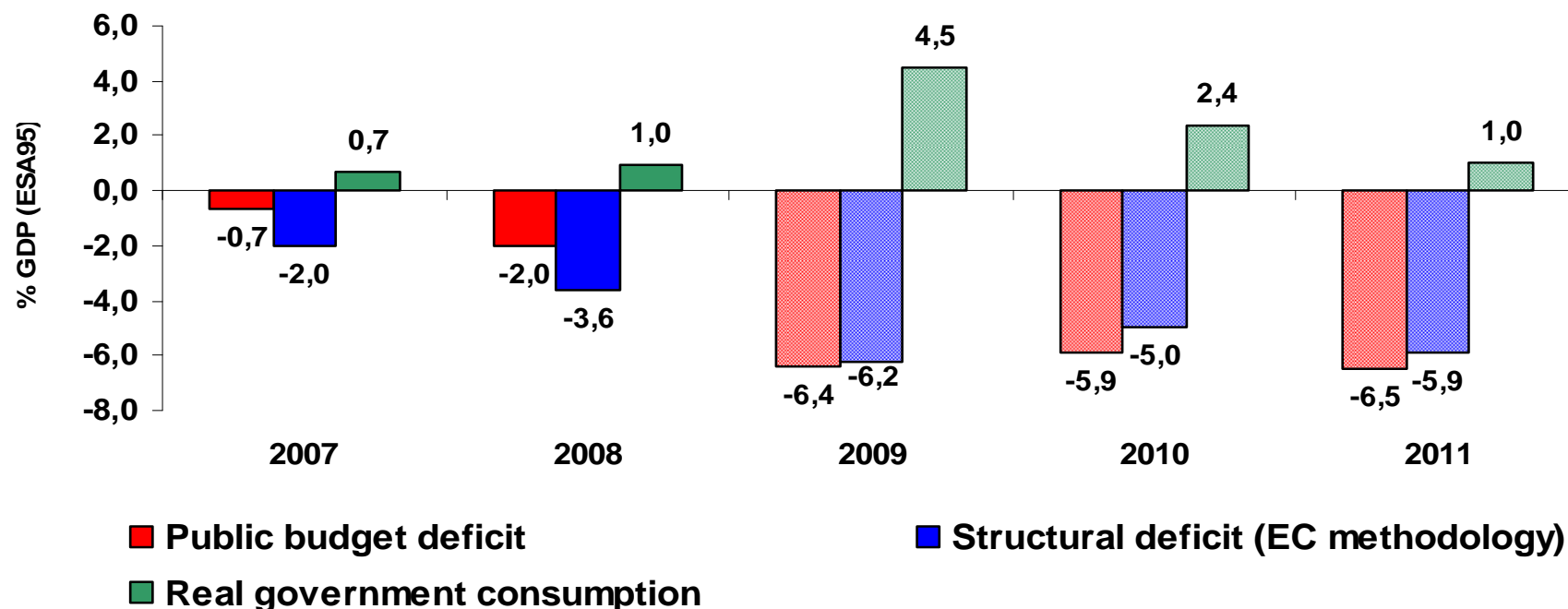
- The q/q GDP outlook has not changed much either.
- The q/q growth should fall back towards zero this year, before a more sustained recovery in 2011.

Forecast of Aggregate Demand



- Household consumption will be a drag on recovery this year, the main support will be from net exports.

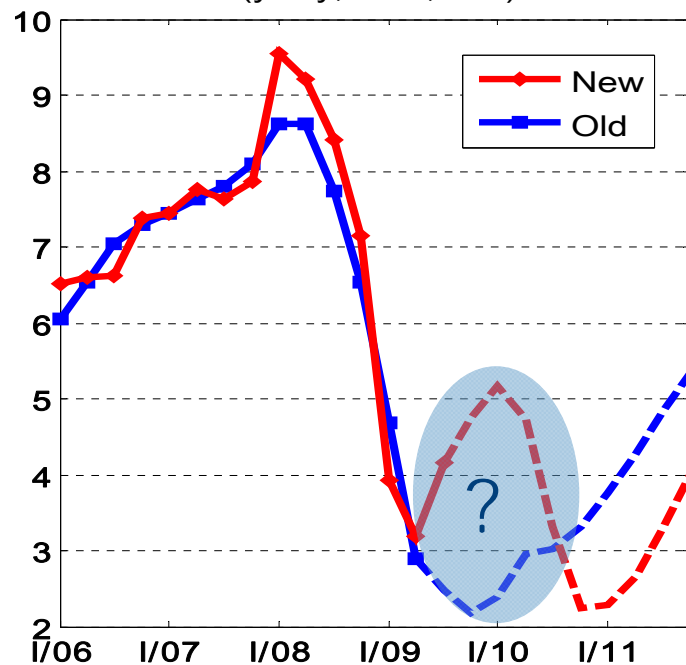
Public Budgets



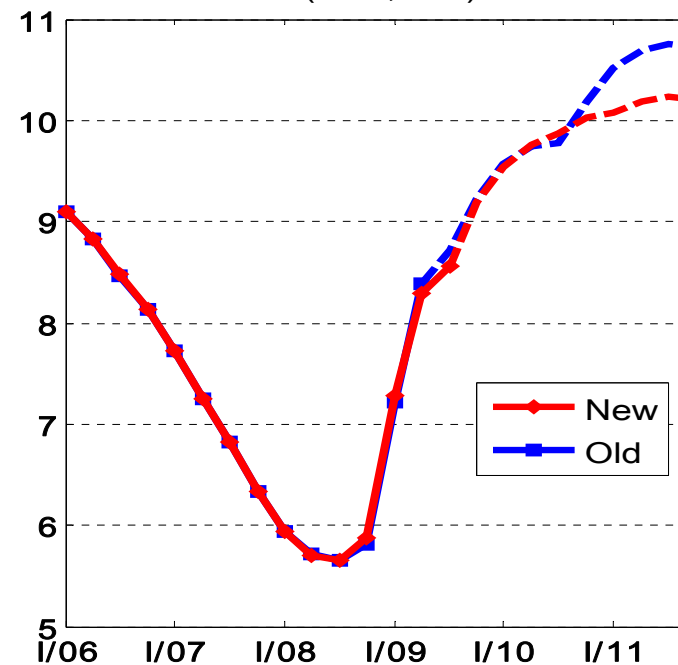
- Public budget deficits will remain high (in spite of some decrease due to the austerity measures in 2010).
- Expected deficits higher than in previous forecast.

Labour Market Forecast

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

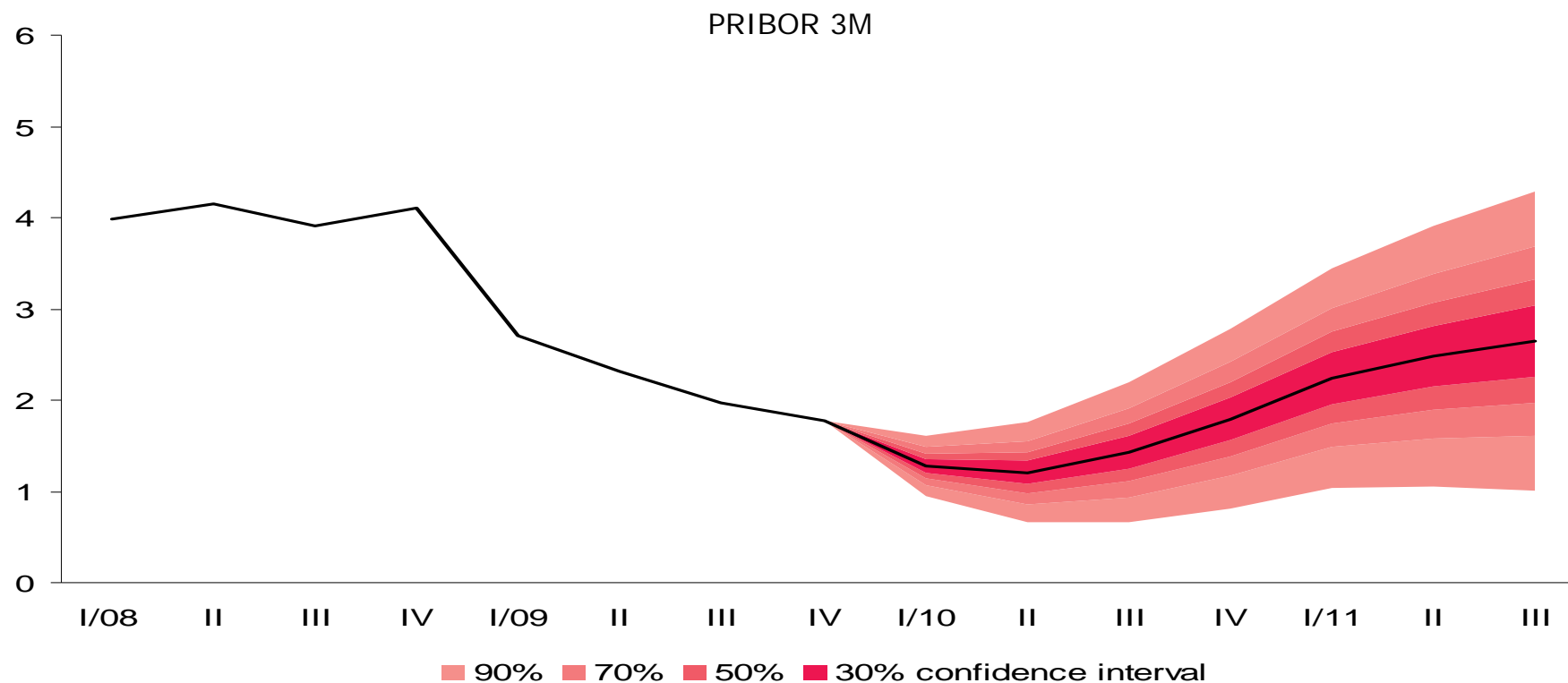


Total registered unemployment rate
(in %, s.a.)



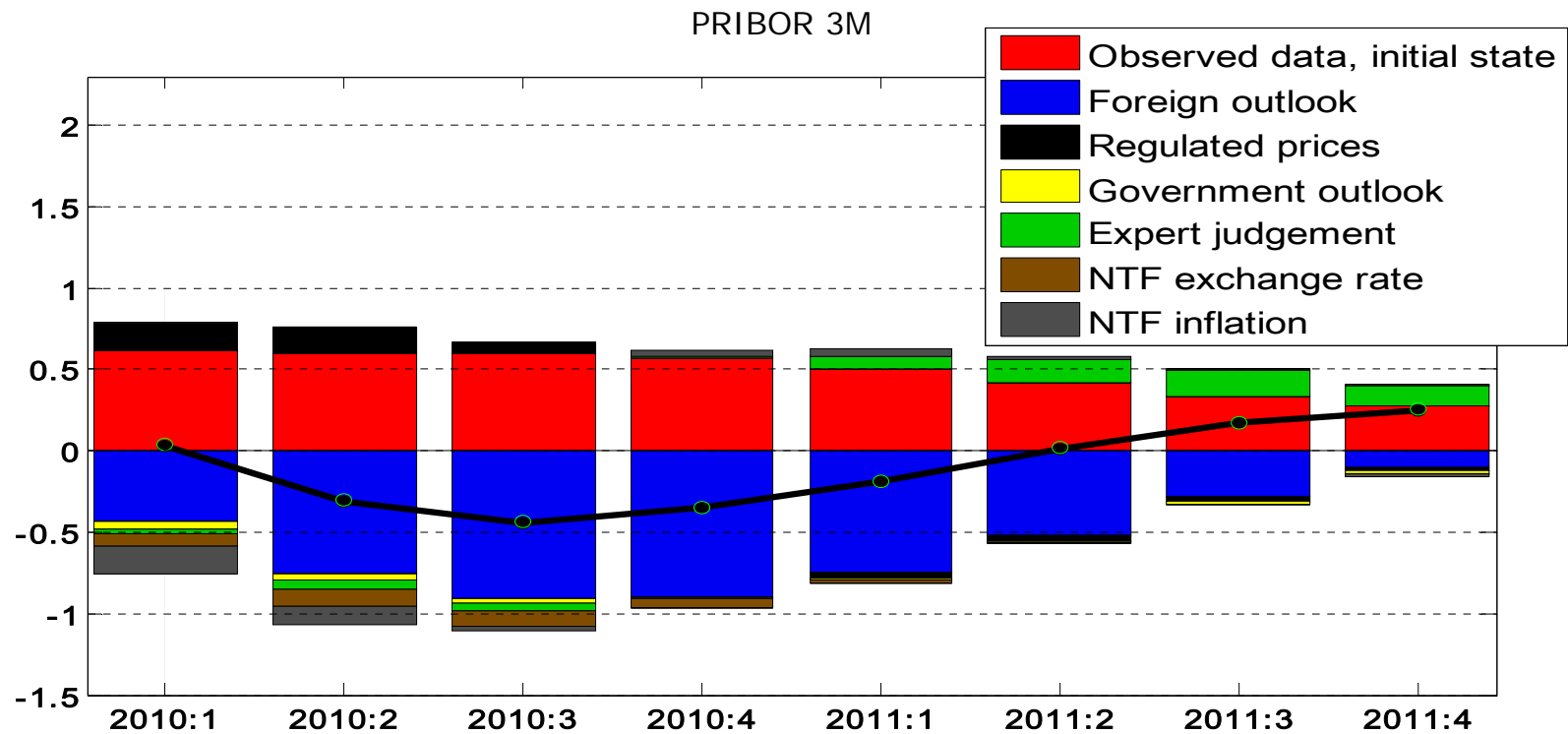
- The observed fast nominal wage growth is “puzzling”, and is partly given by one-off / statistical factors.
- Unemployment rate will peak in 2011.

Interest Rate Forecast



- Consistent with the forecast is stability of short-term interest rates close to their current levels in the first half of this year and a gradual rise in rates thereafter.

Interest Rate Forecast Change Decomposition



- Downward impact of foreign outlook vs. upward impact of initial state (wage growth, household and public consumption, weaker exchange rate).

Comparison of the CNB's Forecast with Analysts' View

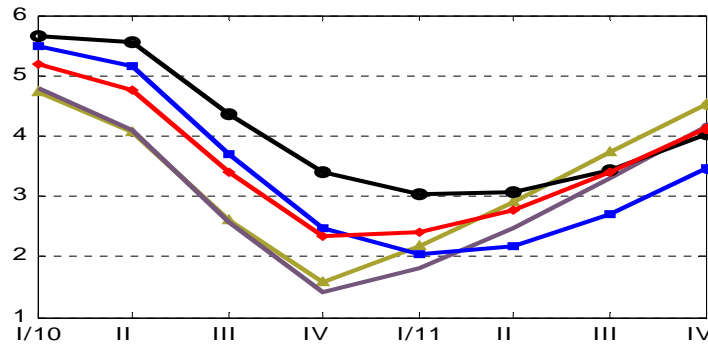
	CNB	ANALYSTS
GDP in % (2010)	1.4	1.7
GDP in % (2011)	2.1	2.8
CPI in %	2.0 (1Q/2011)	2.2 (1/2011)
Exchange rate CZK/EUR	25.2 (1Q/2011)	24.9 (1/2011)
Interest rate in %	3M PRIBOR 2.2 (1Q/2011)	2T REPO 1.8 (1/2011) 12M PRIBOR 2.7 (1/2011)
Nominal wages in % (2010)	3.3	2.4
Nominal wages in % (2011)	2.8	4.3

Source: Financial Markets Inflation Expectations (CNB's Survey), January 2010

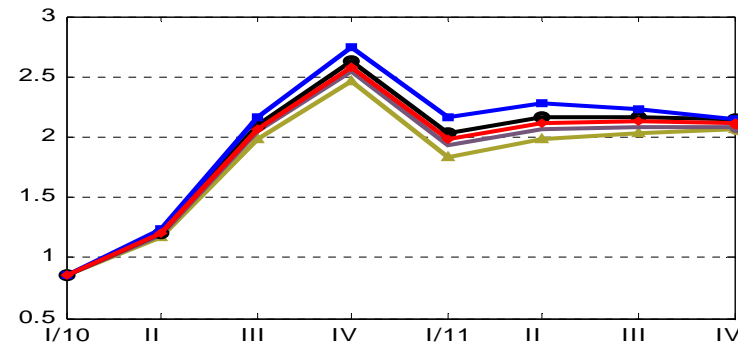
- Analysts expect slightly faster GDP growth, more appreciated exchange rate and slower wage growth this year.

Sensitivity Analysis: Uncertainty About Wage Growth

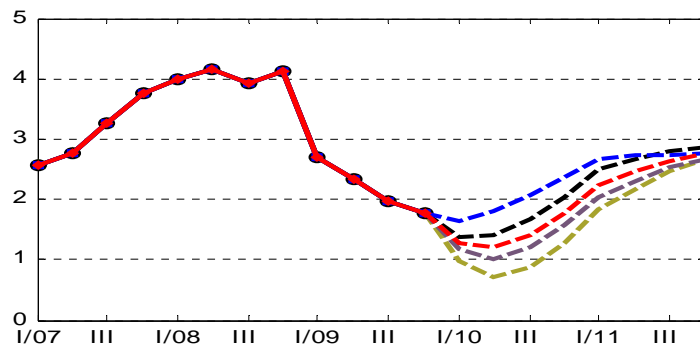
Nominal Wage Growth (y/y, in %)



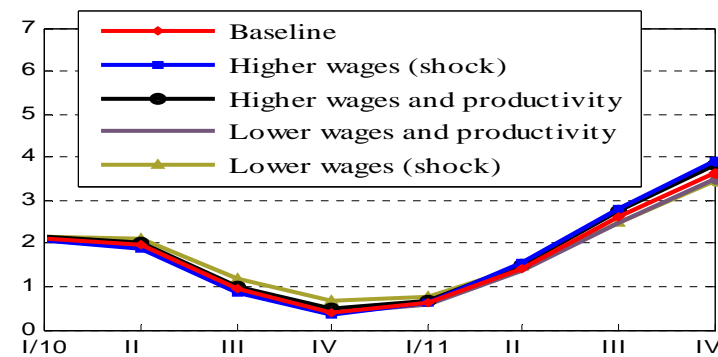
CPI Inflation (y/y, in %)



3M PRIBOR (in %)



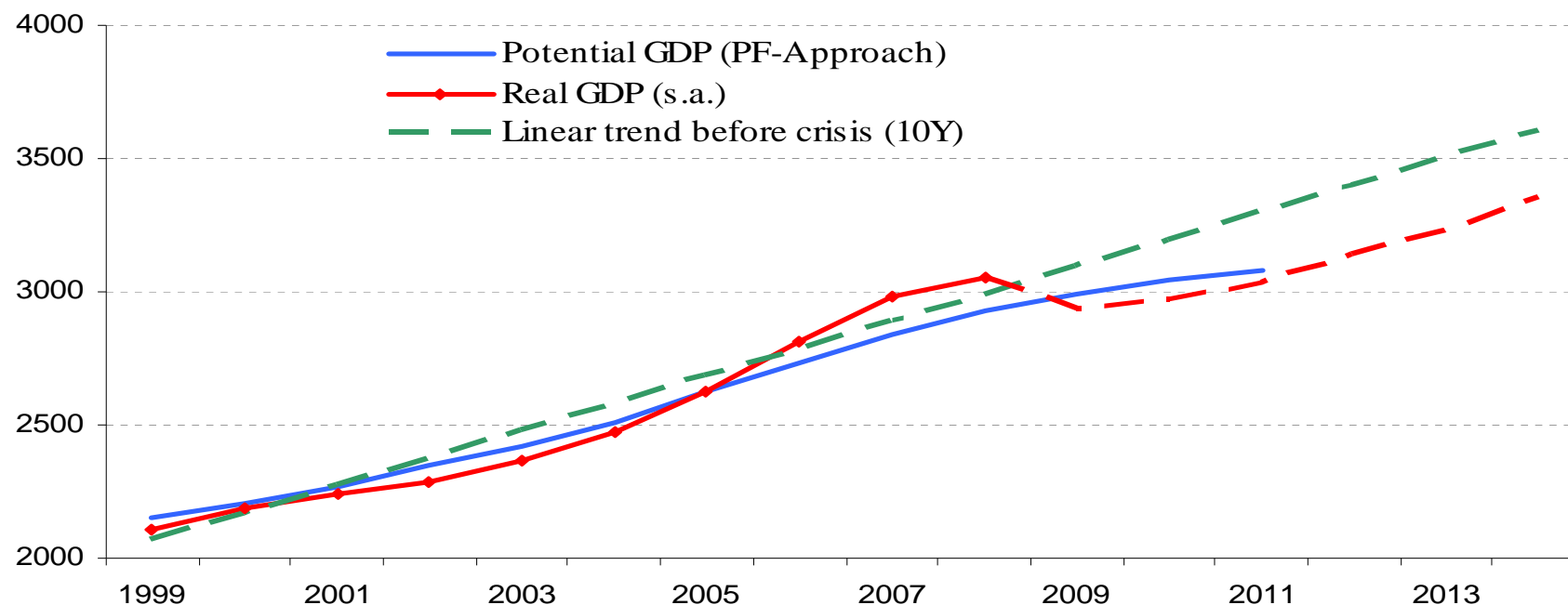
GDP Growth (y/y, in %)



- The uncertainty goes in both directions.

Long-Term Impact of Crisis

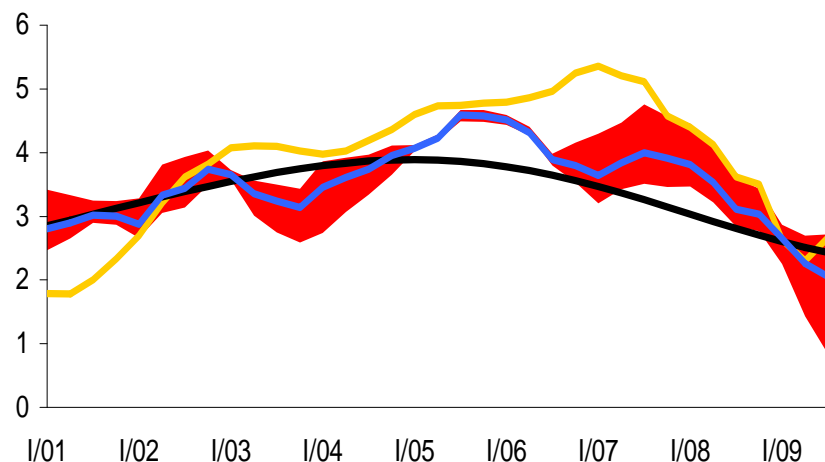
GDP Level and Potential Output (CNB's Forecast)



- The long-term assumptions of the CNB's forecast: permanent loss in output level, but not in growth rate (see also IMF, WEO, Oct 2009).

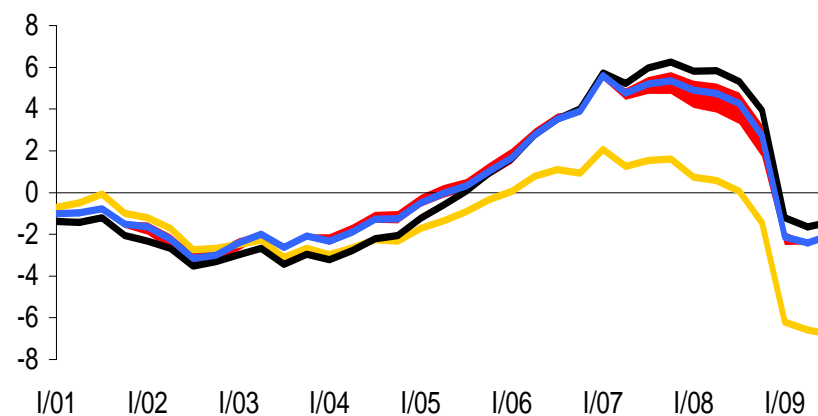
Uncertainty About Potential Growth and Output Gap

Potential output
(annual percentage changes)



■ Range of 3 estimates of production function
— Average estimate of production function
— HP filter
— Kalman filter

Output gap
(in % of potential GDP)



■ Range of 3 estimates of production function
— Average estimate of production function
— HP filter
— Kalman filter

- The range of estimates of the output gap is now unusually wide (KF leads to the most negative results).



Thank you for your attention

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