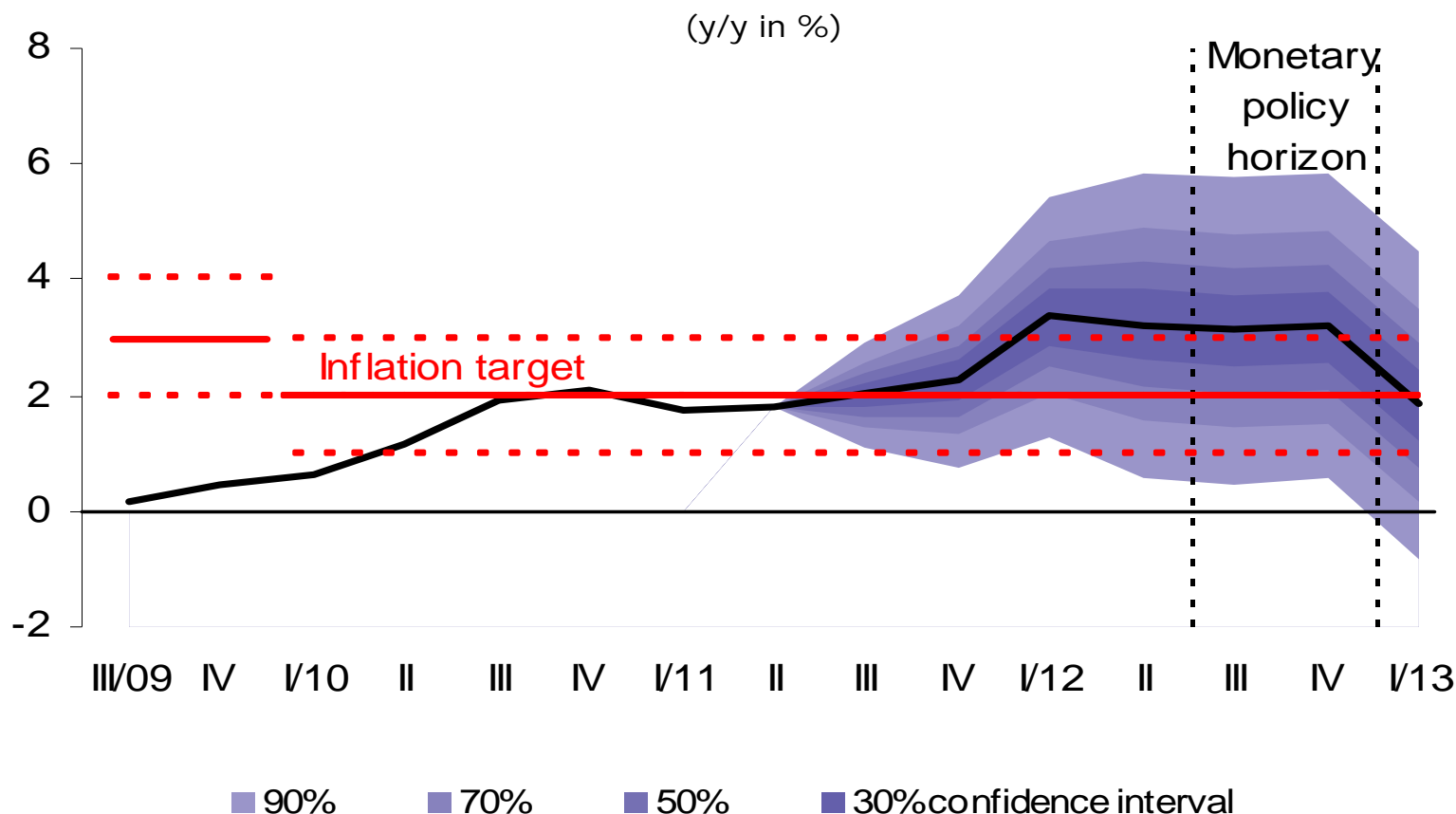


Meeting with Analysts

Tomáš Holub

Prague, August 12, 2011

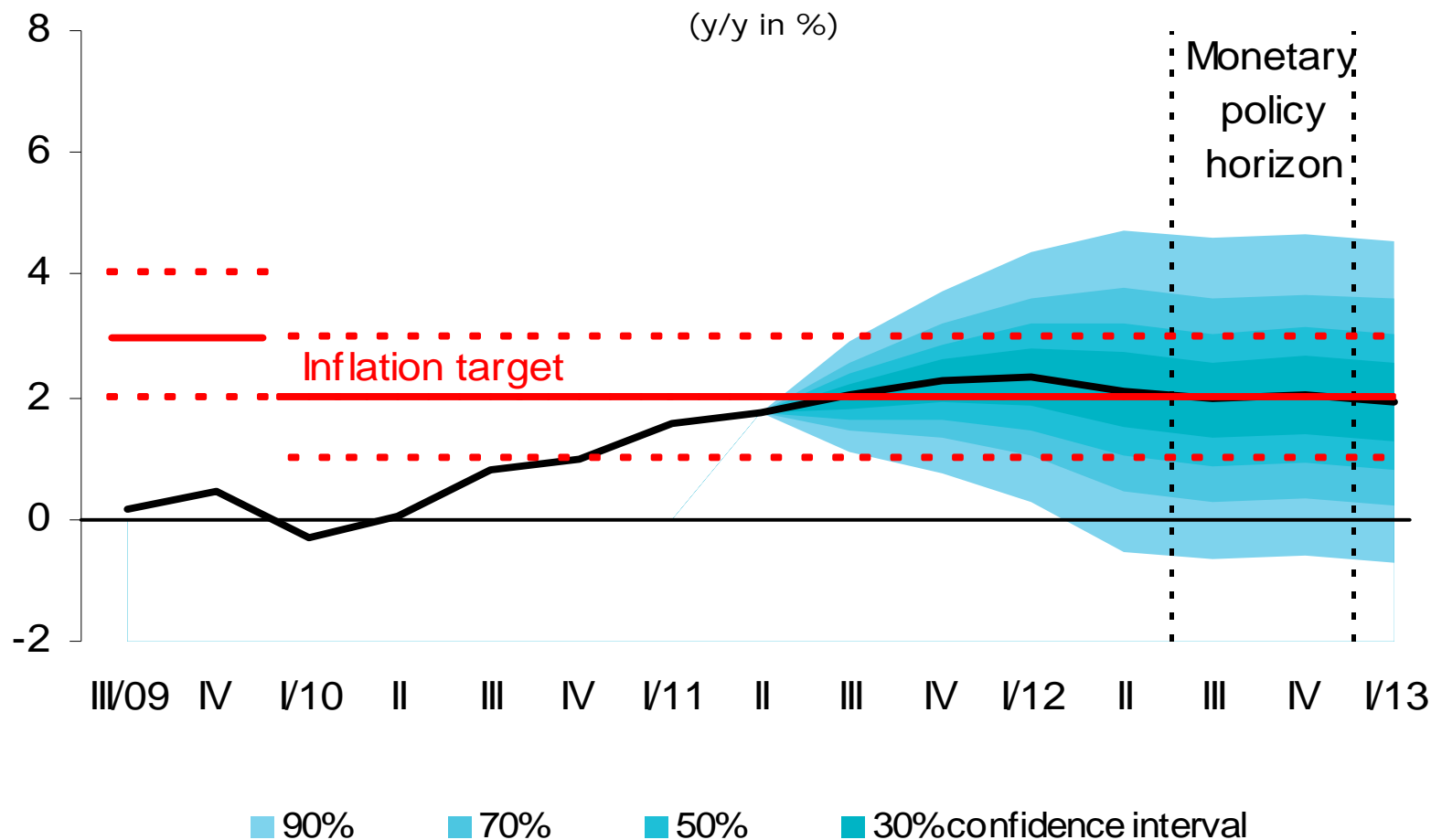
- Headline inflation will get slightly above 3 % in 2012 due to the VAT increase, but will move back to the target in early-2013.
- MP-relevant inflation will stay close to the target.
- Food price growth is near its peak, 'core' inflation will speed up.
- Foreign GDP growth will slow down from the strong Q1. Future interest rate increases in the euro area will be very gradual.
- Commodity prices will cease to be the main source of inflation, the exchange rate appreciation will push import prices back to anti-inflationary side in 2012.
- The domestic inflationary pressures are currently not significant, but will strengthen in the future due to faster wage growth.
- During 2011, GDP growth will be affected by the fiscal restriction, fading inventory cycle and a decline in external demand growth. In 2012, the VAT change will have an impact, too.



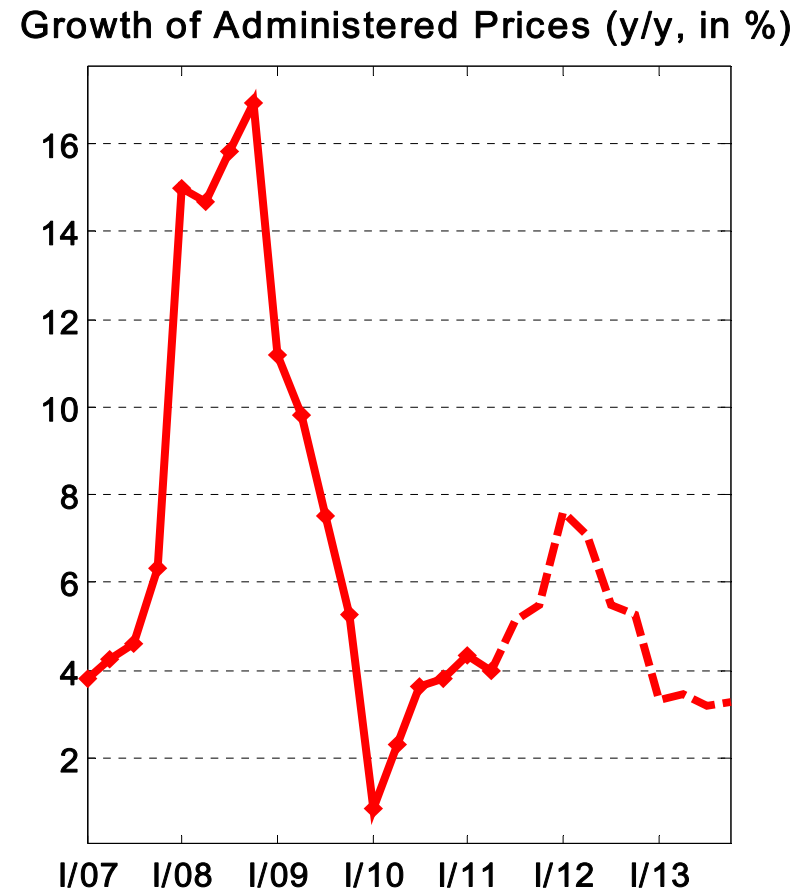
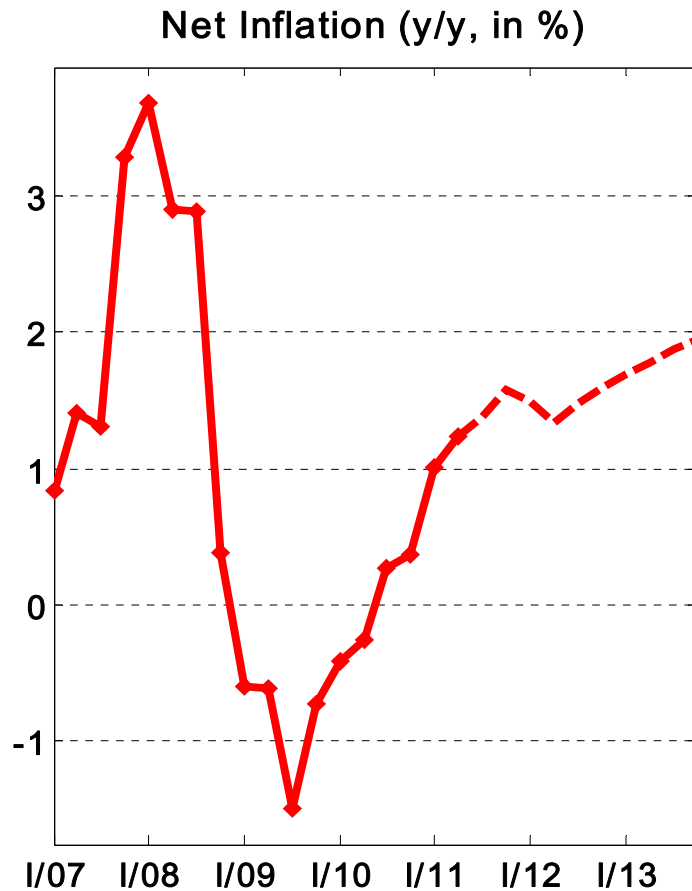
- Compared to the most recent figure (1.7% y/y in July), inflation will increase somewhat in the rest of this year.
- In 2012, inflation will temporarily get slightly above 3% due to the reduced VAT rate increase from 10% to 14%.

	First-round impacts	
	2012	2013
Inflation total	1,1	-0,2
Administered prices	0,3	0,1
Food prices	0,6	0,3
Adjusted inflation excluding fuels	0,2	-0,6
of which:		
Tradables	0,1	-0,4
Non-tradables	0,1	-0,2
Fuel prices	0,0	-0,1

- The primary effects will reach 1.1 p.p., and will impact mainly on the food and administered prices in 2012.
- In 2013, the overall primary effect of unifying the VAT rate at 17.5% will be slightly negative (but the price level may not decline in reality due to the stickiness of prices in the 'core' inflation category).

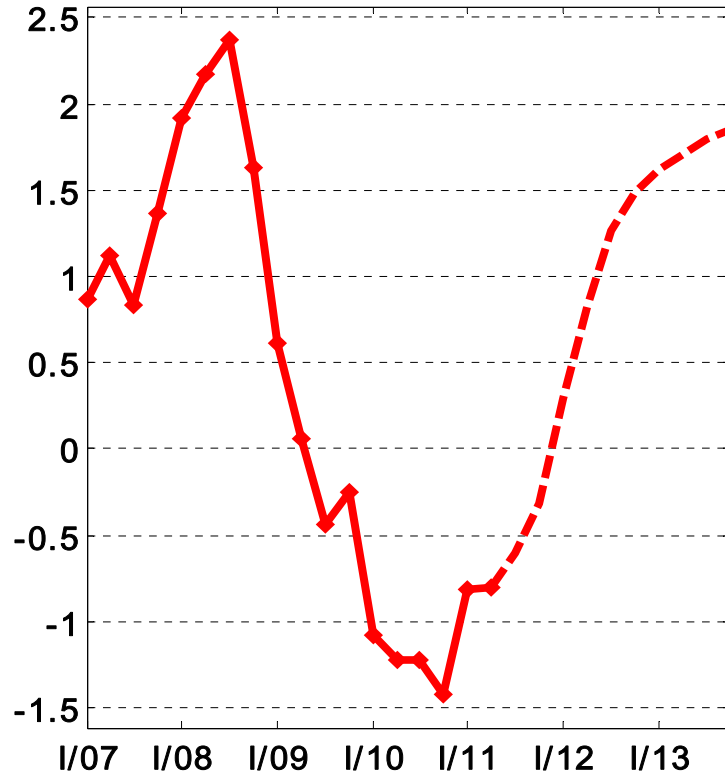


- MP-relevant inflation will also increase slightly in the near-term, but overall will remain close to the target during the forecast horizon.
- Second-round effects of the VAT changes assumed to be small.

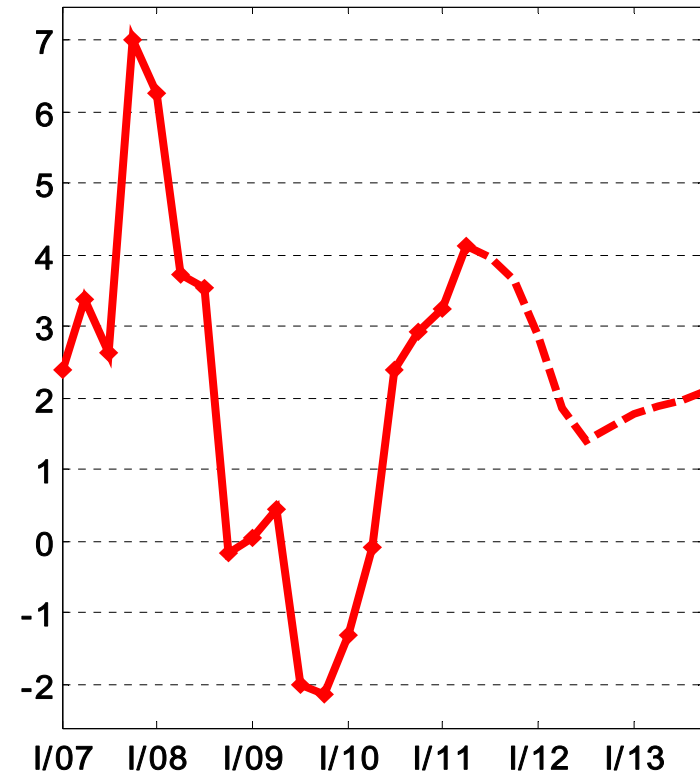


- Net inflation will be driven up by 'core' inflation, while the food price growth is close to its peak.
- The forecast of regulated prices reflects the planned VAT change, higher energy prices and rents.

Adjusted Inflation Excl. Fuels
(y/y, in %, Excl. Tax Changes)

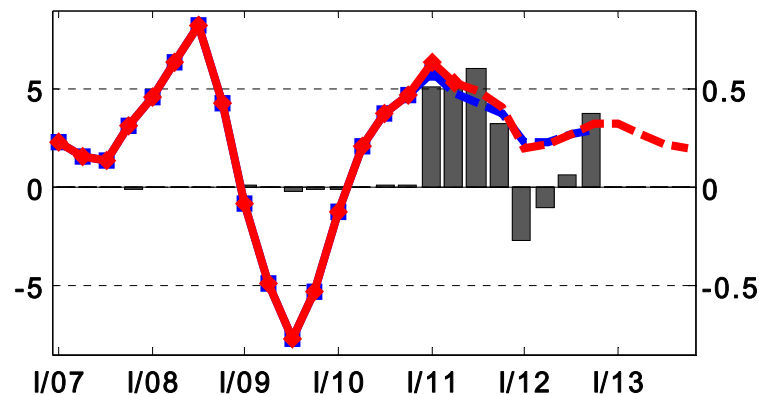
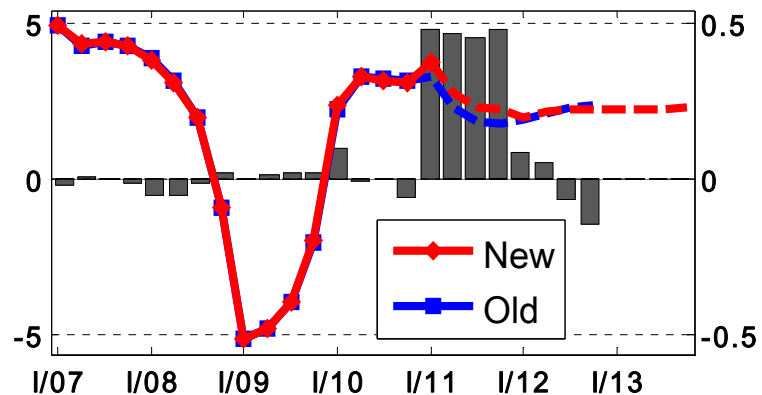


Food Inflation
(y/y, in %, Excl. Tax Changes)

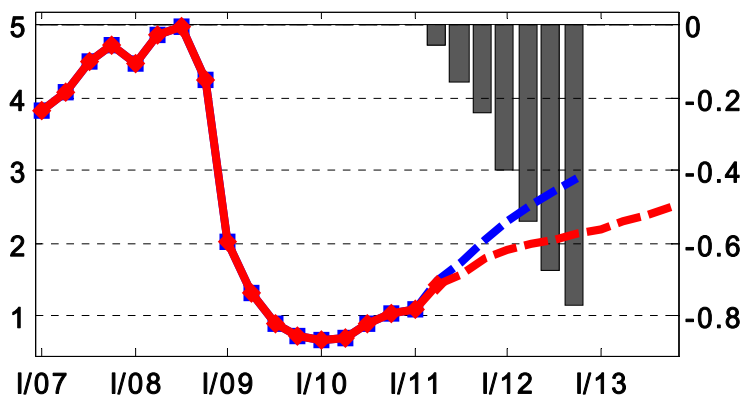


- Adjusted inflation excluding fuels (i.e. 'core' inflation) will turn positive in early-2012.
- Food price growth will slow down, reflecting the stabilisation of agricultural commodity prices.

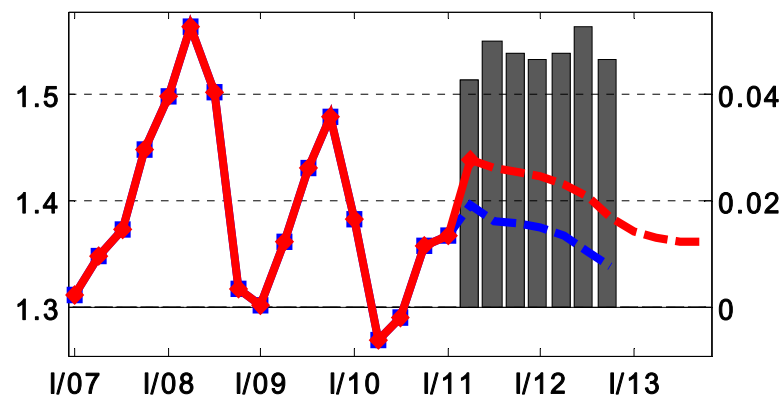
Growth Rate of GDP - Eurozone (y/y, in %) PPI Inflation - Eurozone (y/y, in %)



3M EURIBOR



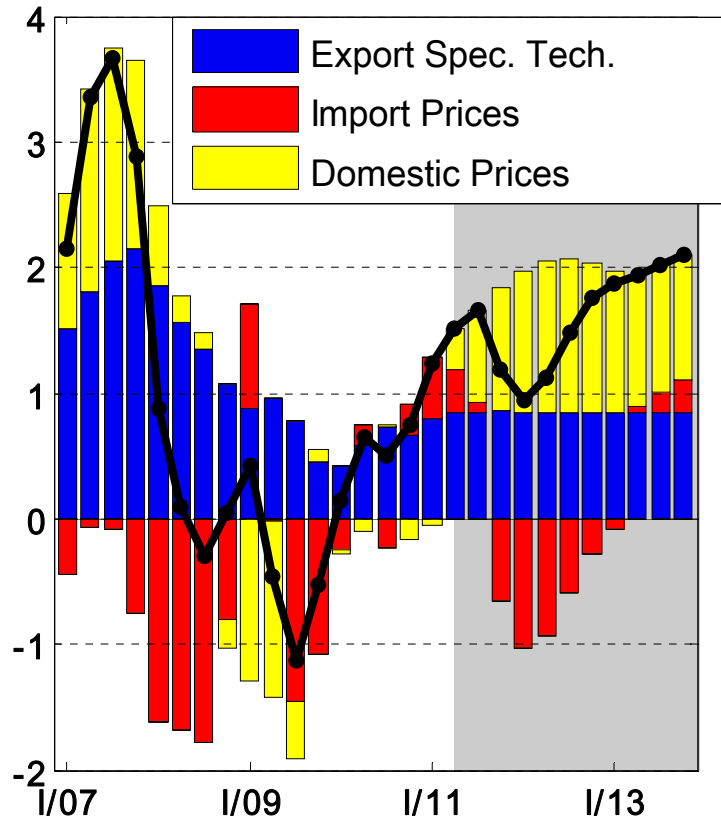
USD/EUR



- A slowdown in effective GDP growth is still expected in 2011-2012, in spite of the strong 2011 Q1 outcome.
- The EA sovereign crisis has shifted down the interest rate outlook.

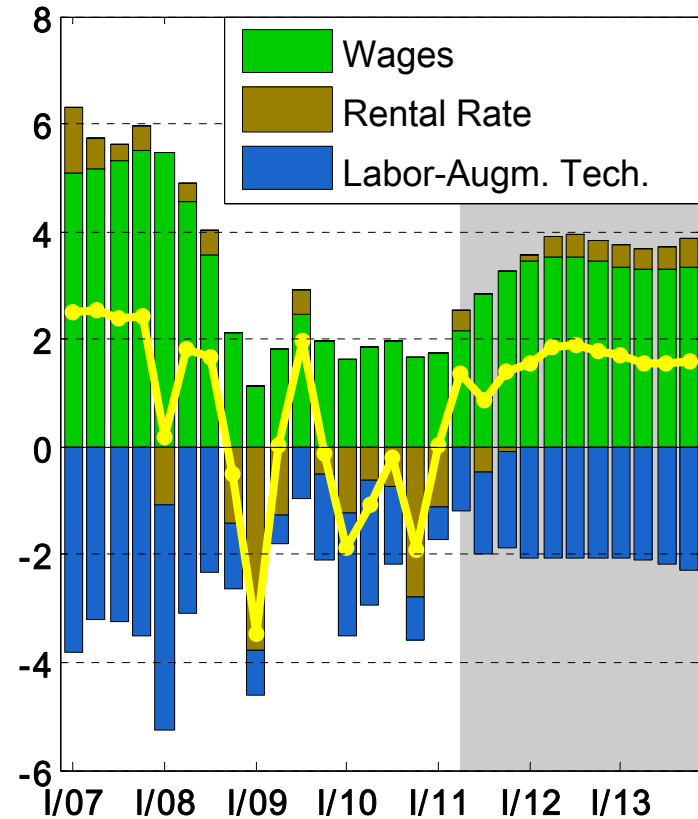
Nominal Marginal Cost

in Consumption Sector (q/q, in %, ann.)

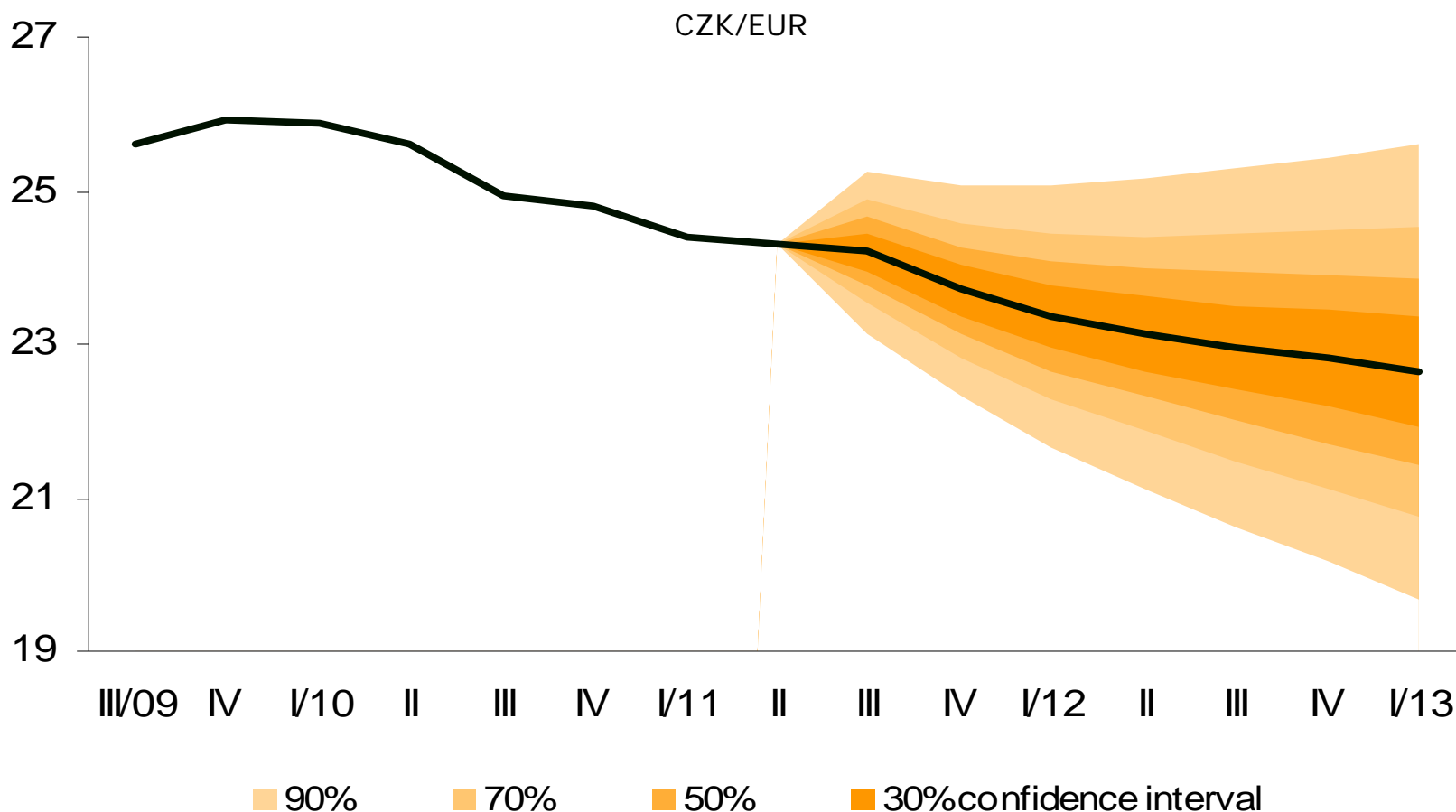


Nominal Marginal Cost

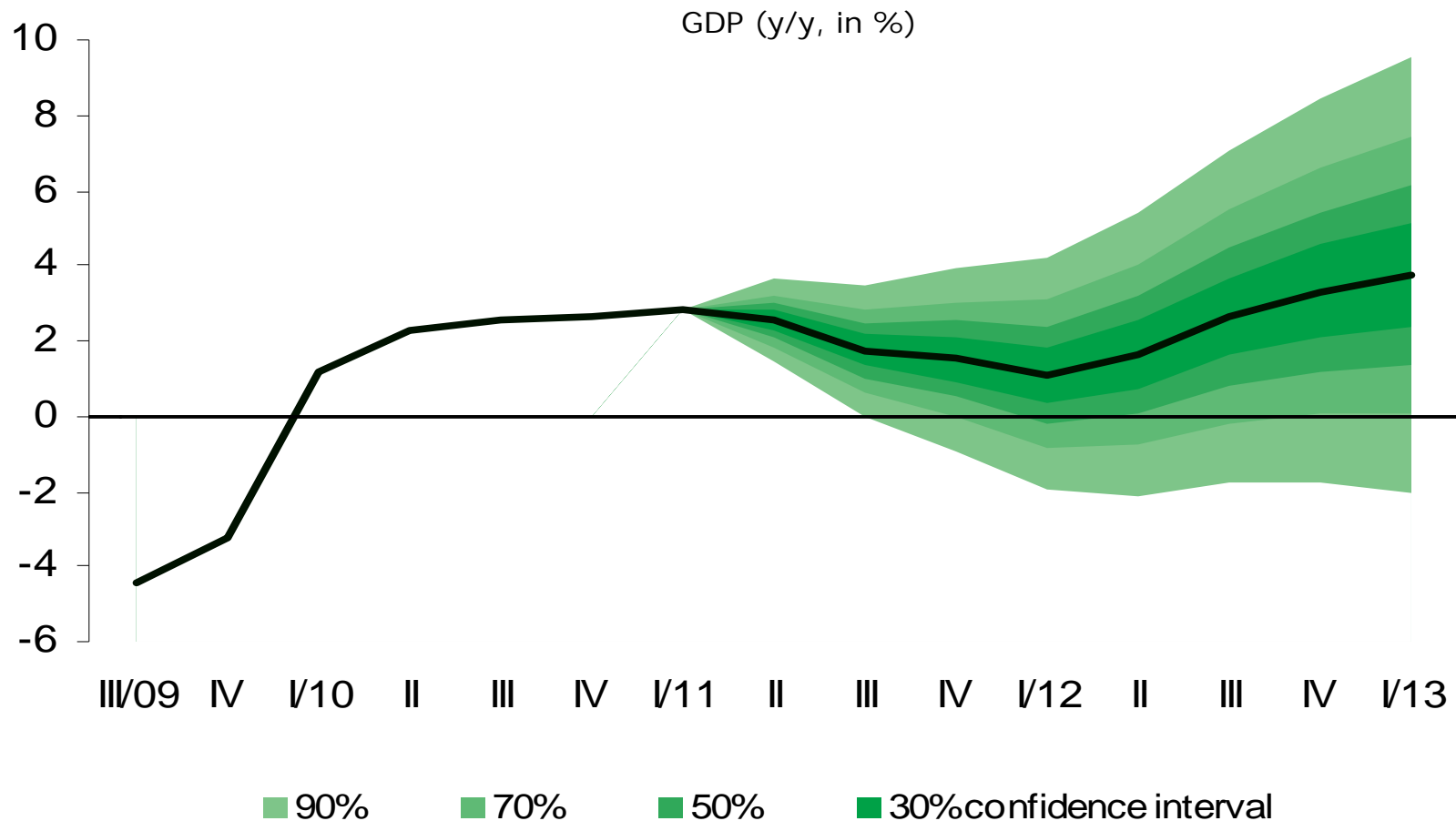
in Intermediate Sector (q/q, in %, ann.)



- The current inflationary effect of commodity prices will fade away and the CZK appreciation will push import prices down.
- Domestic inflationary pressures have not been significant so far (low wage growth, muted demand), but will strengthen gradually.

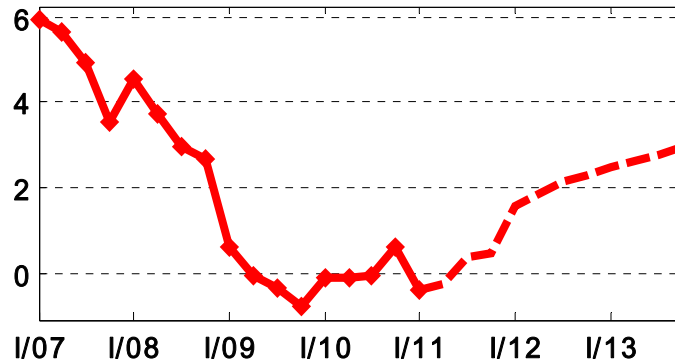


- CZK will gradually appreciate due to favourable outlook for net exports, fiscal consolidation and renewed convergence later on.
- By contrast, low domestic interest rates will attenuate the exchange rate appreciation via a negative interest rate differential.

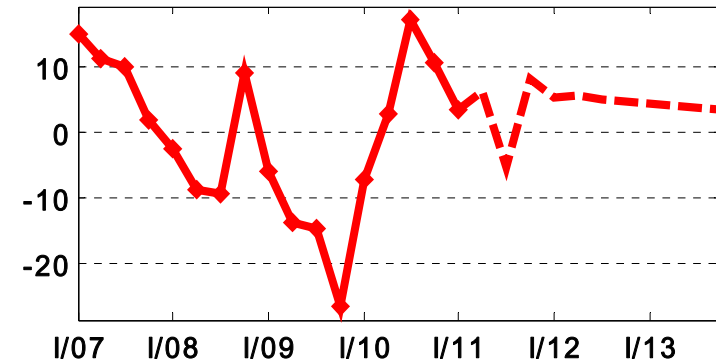


- In 2011, the GDP will increase by 2.1%. During the year, the growth will slow down due to the effect of fiscal restriction, fading inventory cycle and the slowdown in external demand.
- In 2012, the growth will reach 2.2% (VAT increase, foreign demand).

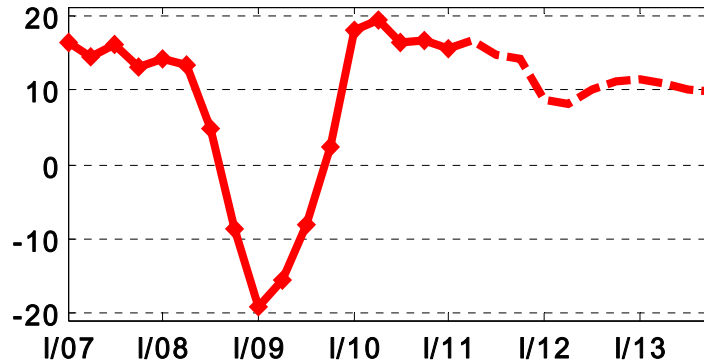
Household Consumption Growth (y/y, in %)



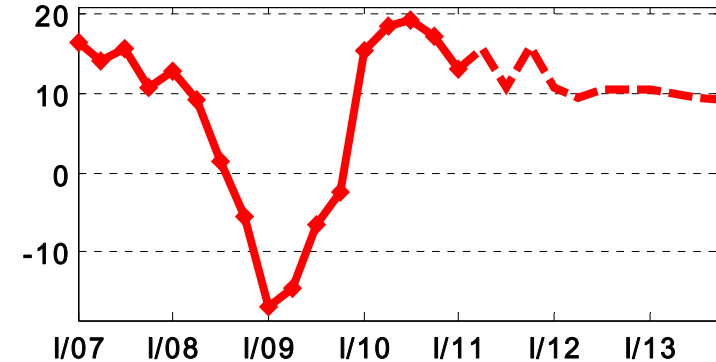
Investments Growth (y/y, in %)



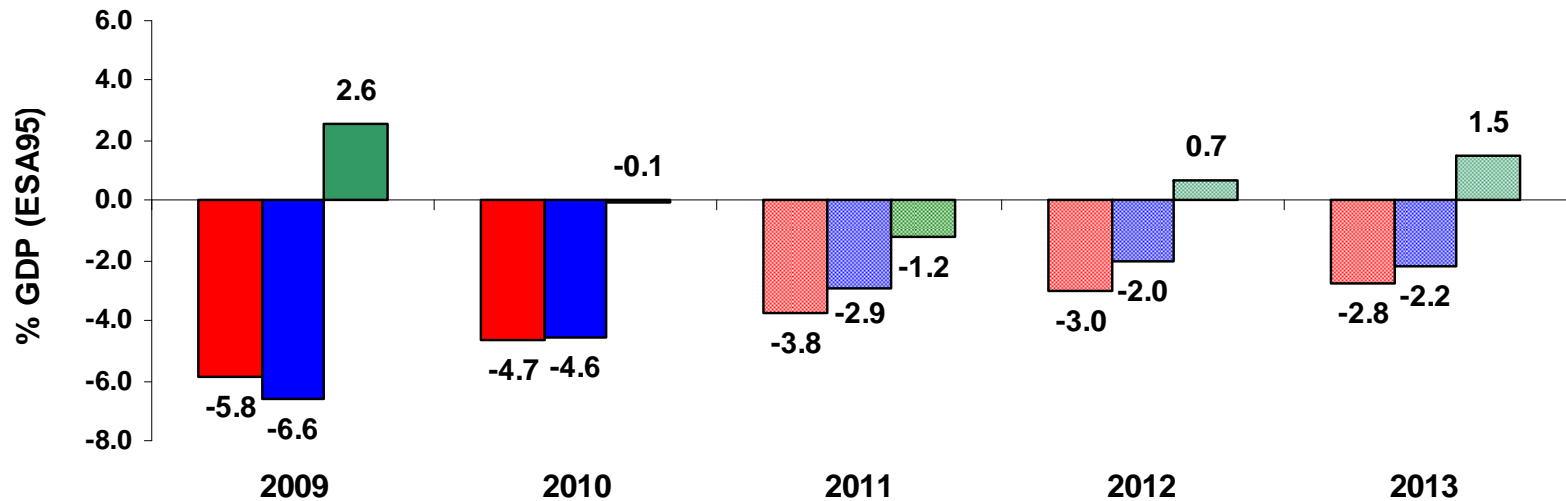
Exports Growth (y/y, in %)



Imports Growth (y/y, in %)



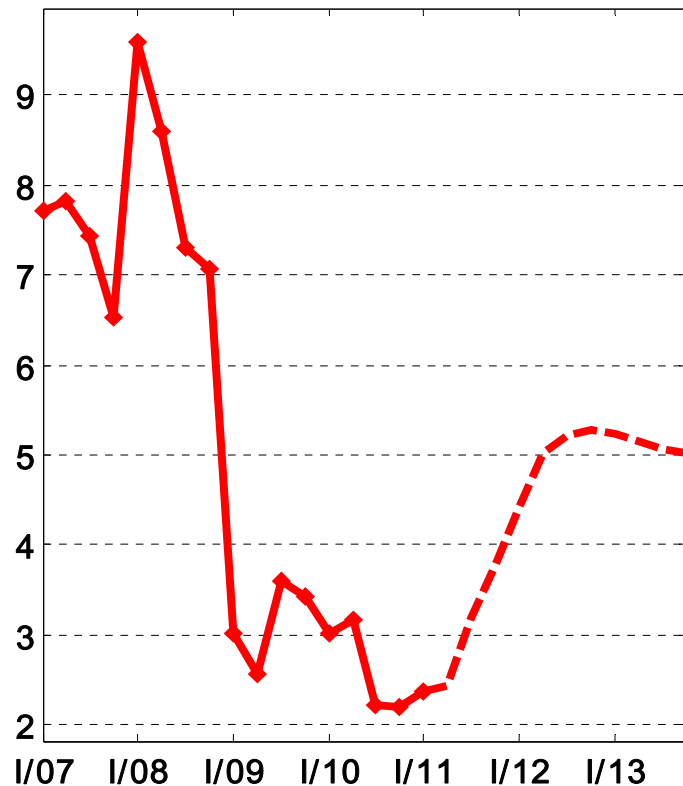
- Private consumption growth will start to speed up, but its pace will be moderated by the still weak labour market and the VAT change.
- The export growth will decline in late 2011/early 2012 due to slower foreign demand growth.



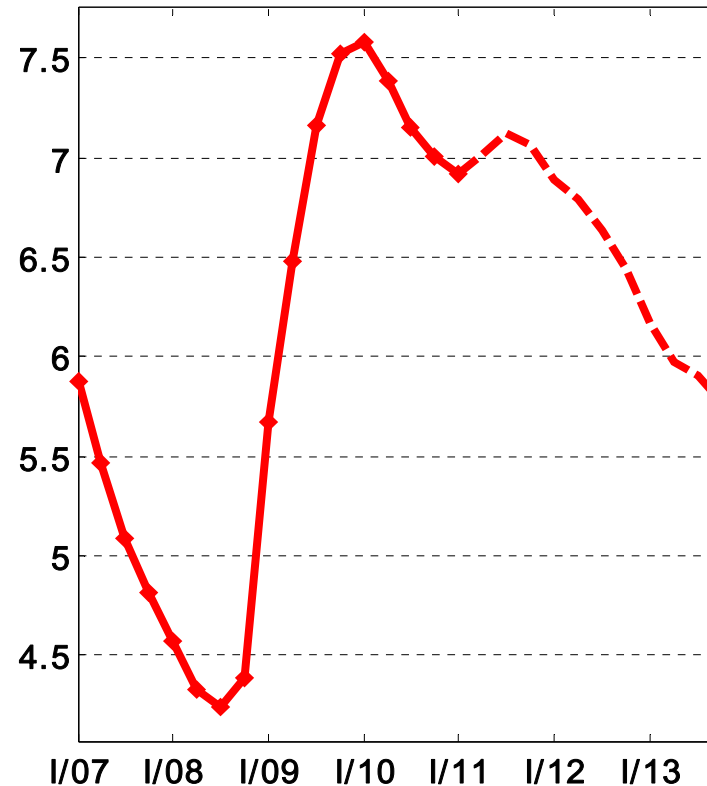
■ Public budget deficit ■ Structural deficit (ESCB) ■ Real government consumption (y-o-y %)

- In 2011, public budget deficit will decline slightly below 4% of GDP due to the adopted consolidation measures.
- In 2012, a further decline to 3% of GDP will be due to the reduced VAT rate increase from 10% to 14%.
- In 2013, the expected small improvement is (so far) purely cyclical.

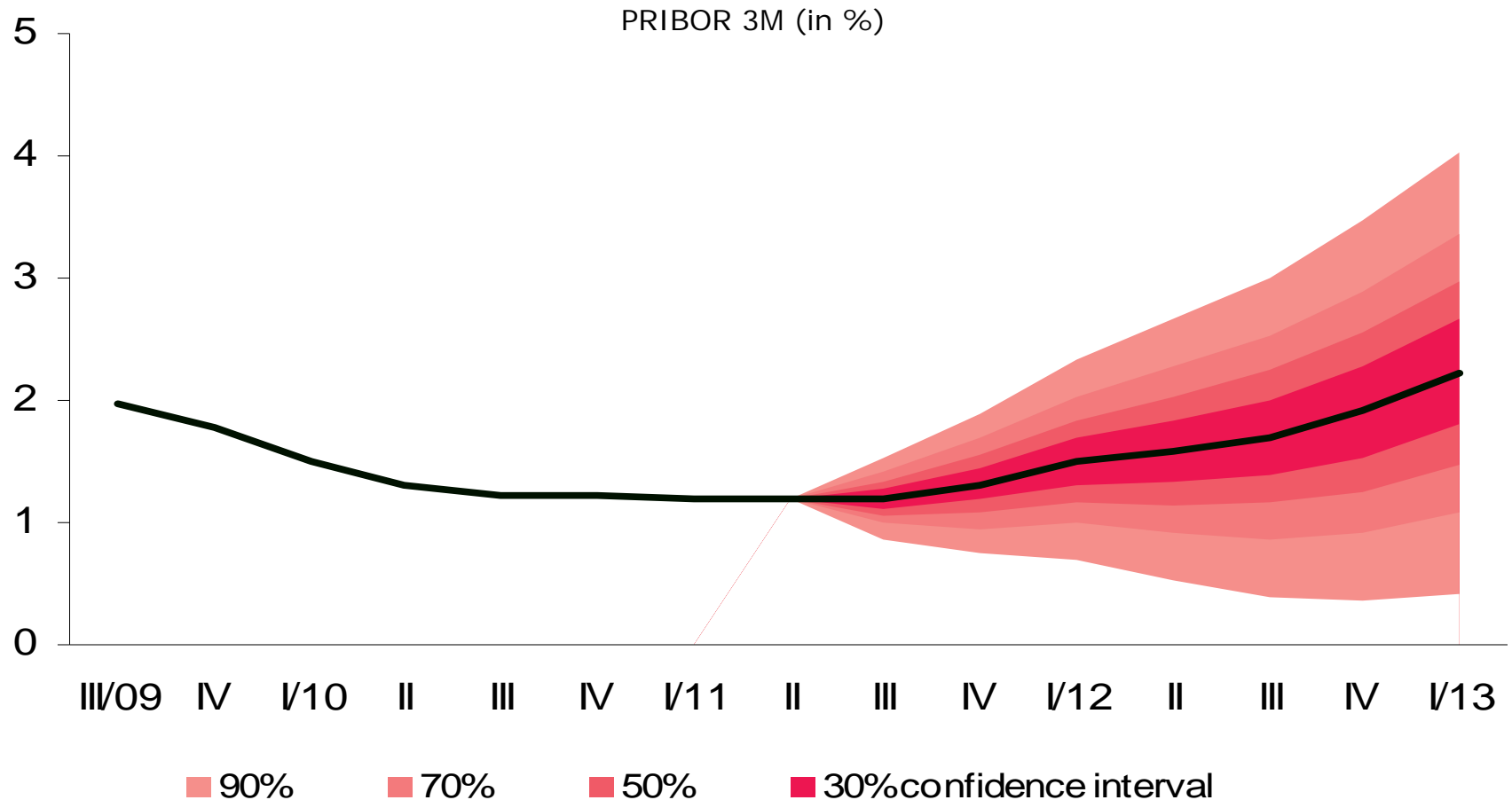
Nominal wage growth in business sector
(y/y, in %, s.a.)



General unemployment rate (ILO)
(in %, s.a.)

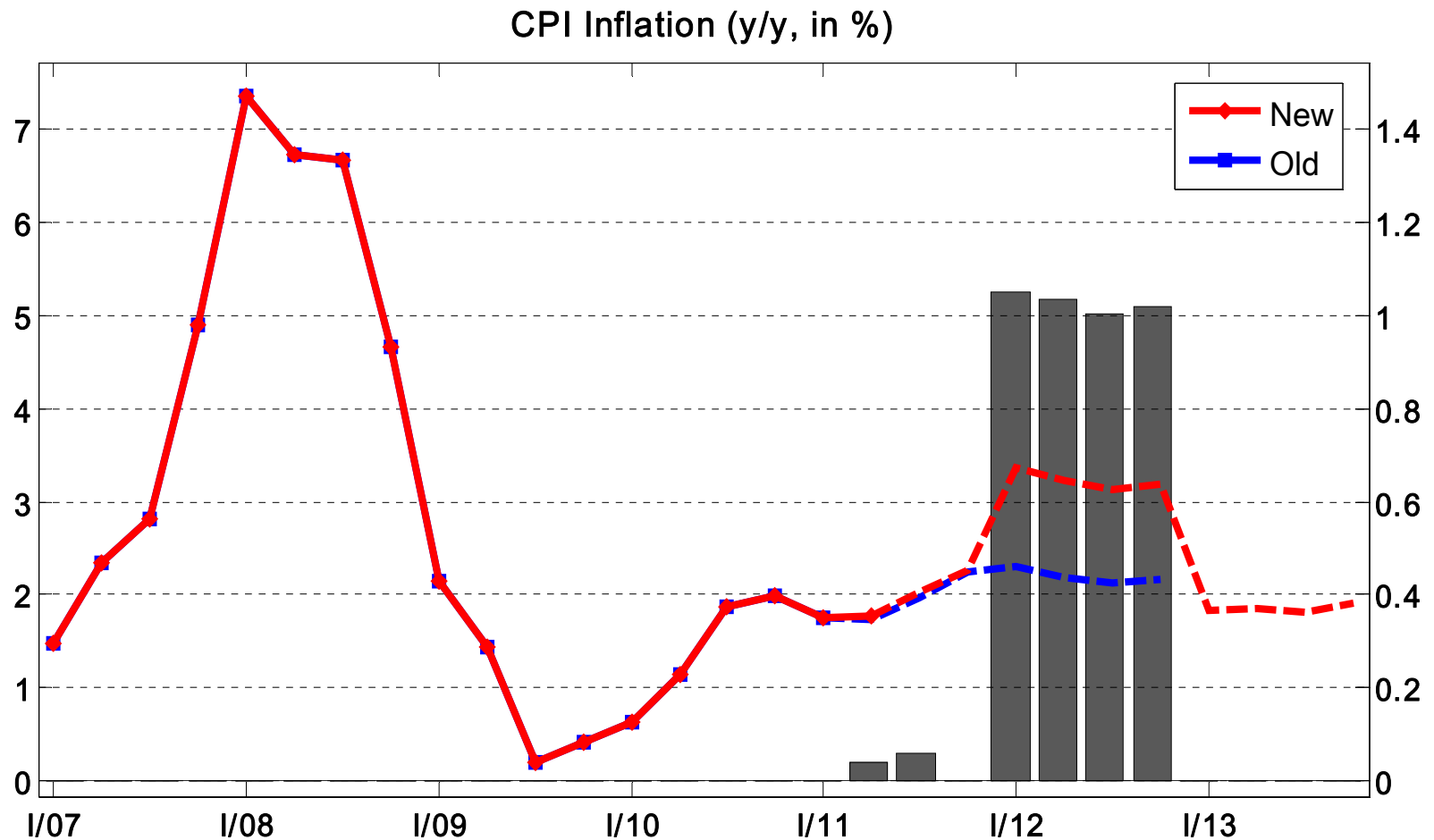


- The wage growth in private sector remains low, contributing to the absence of domestic inflationary pressures, but it will speed up.
- The employment growth will resume in 2012 and lead to a lower general unemployment rate.

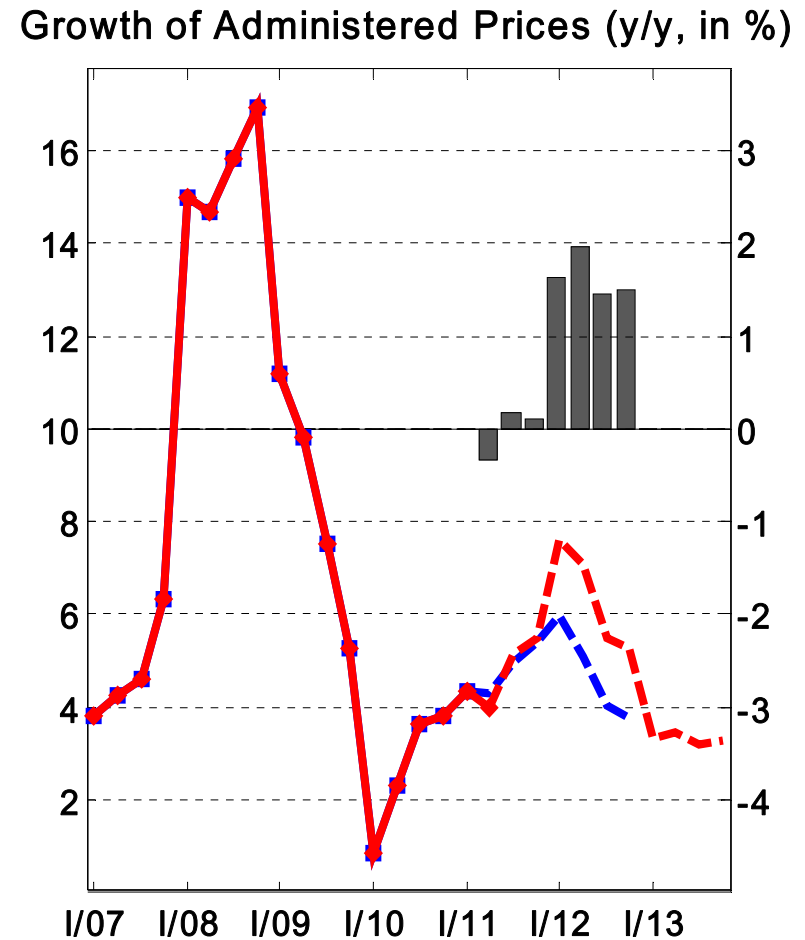
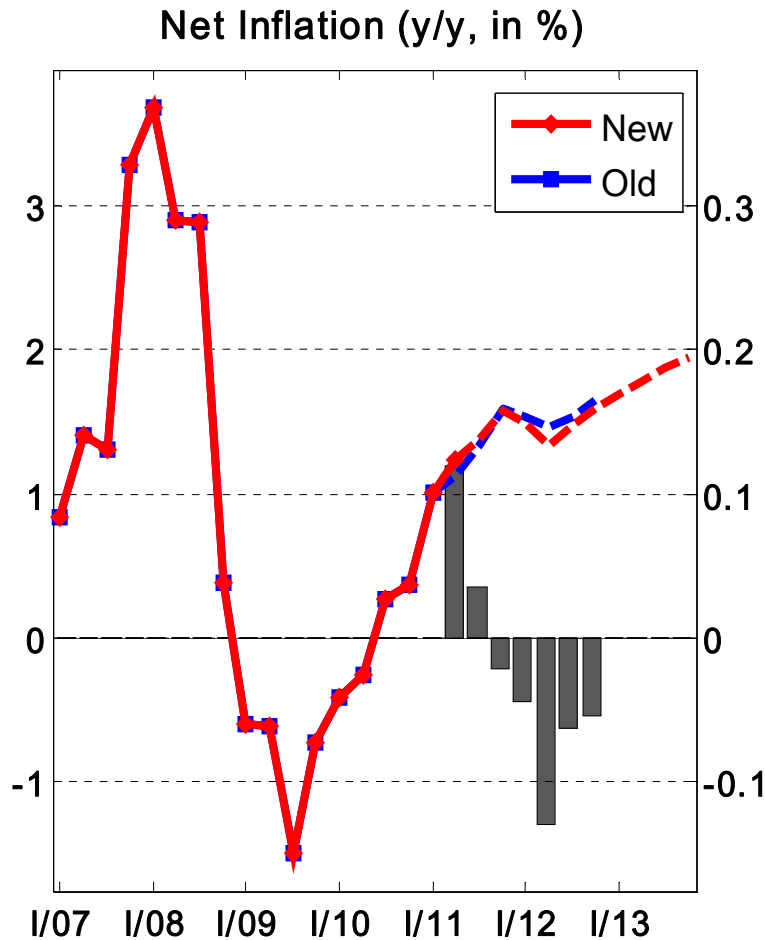


- Consistent with the forecast is broad stability of market interest rates at the start of the forecast horizon and a gradual rise in rates starting in late 2011/early 2012.

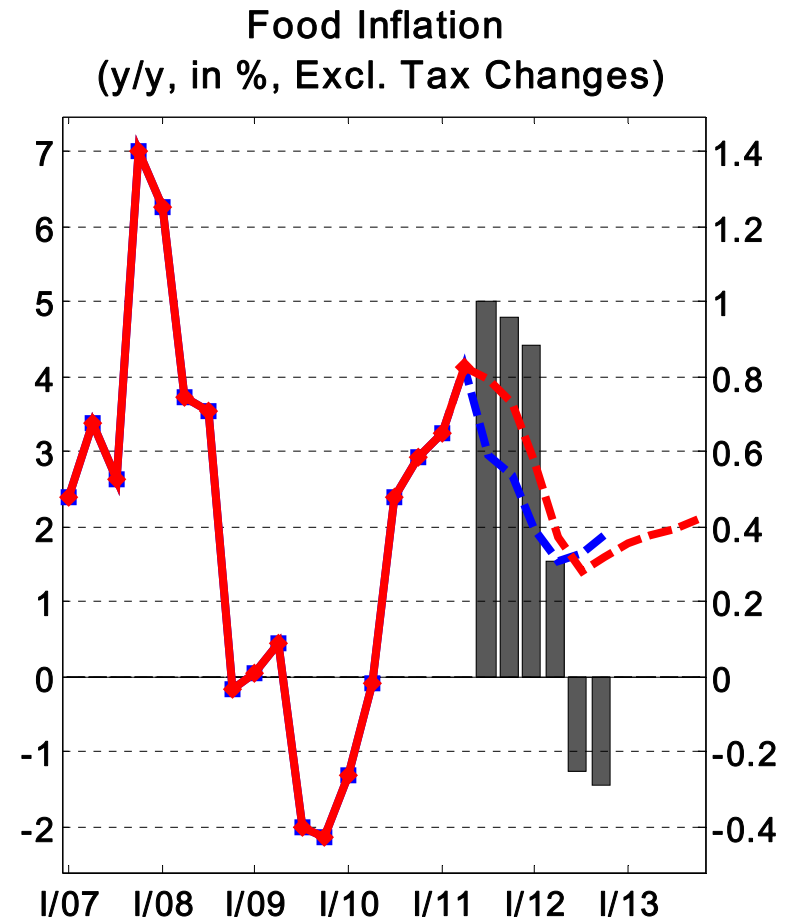
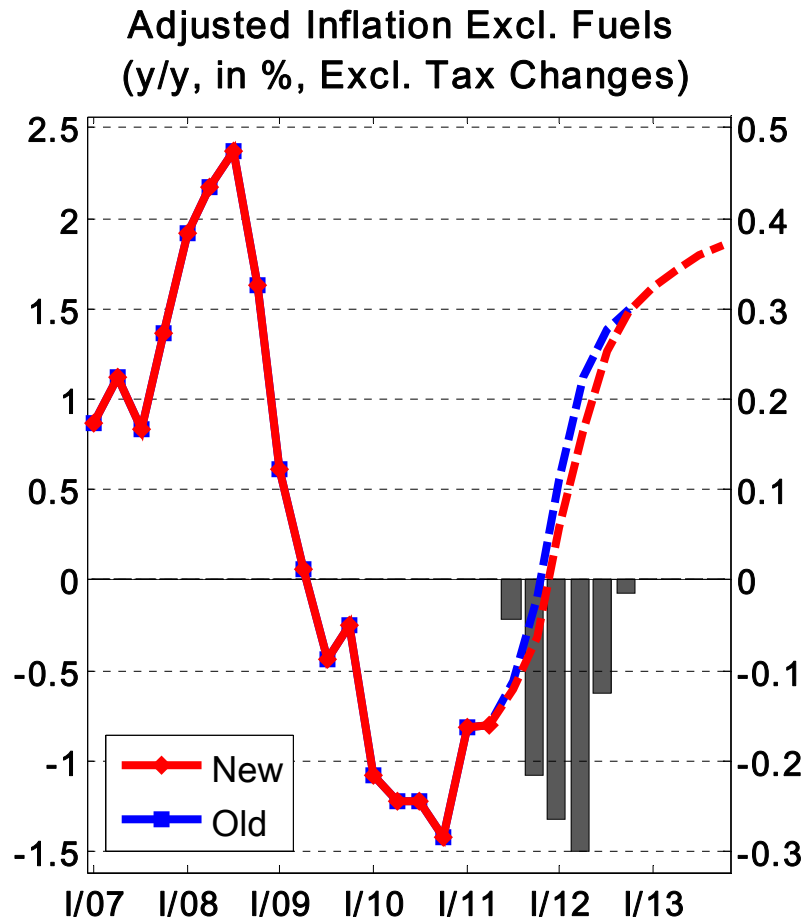
- The increased headline inflation forecast reflects incorporation of the VAT changes (first-round effects not policy-relevant).
- Slightly lower net inflation forecast in 2012 due to lower food prices and 'core' inflation; higher administered price growth (but mainly due to the VAT increase).
- GDP growth forecast is higher for 2011, but lower for 2012.
- The labour market forecast changes only marginally.
- The future exchange rate appreciation is faster due to higher net exports and less negative interest rate differential (lower EURIBOR).
- The interest rate path is lower mainly due to the downward shift in foreign interest rate outlook.



- The change reflects mainly the reduced VAT rate increase from 10% to 14% in 2012.

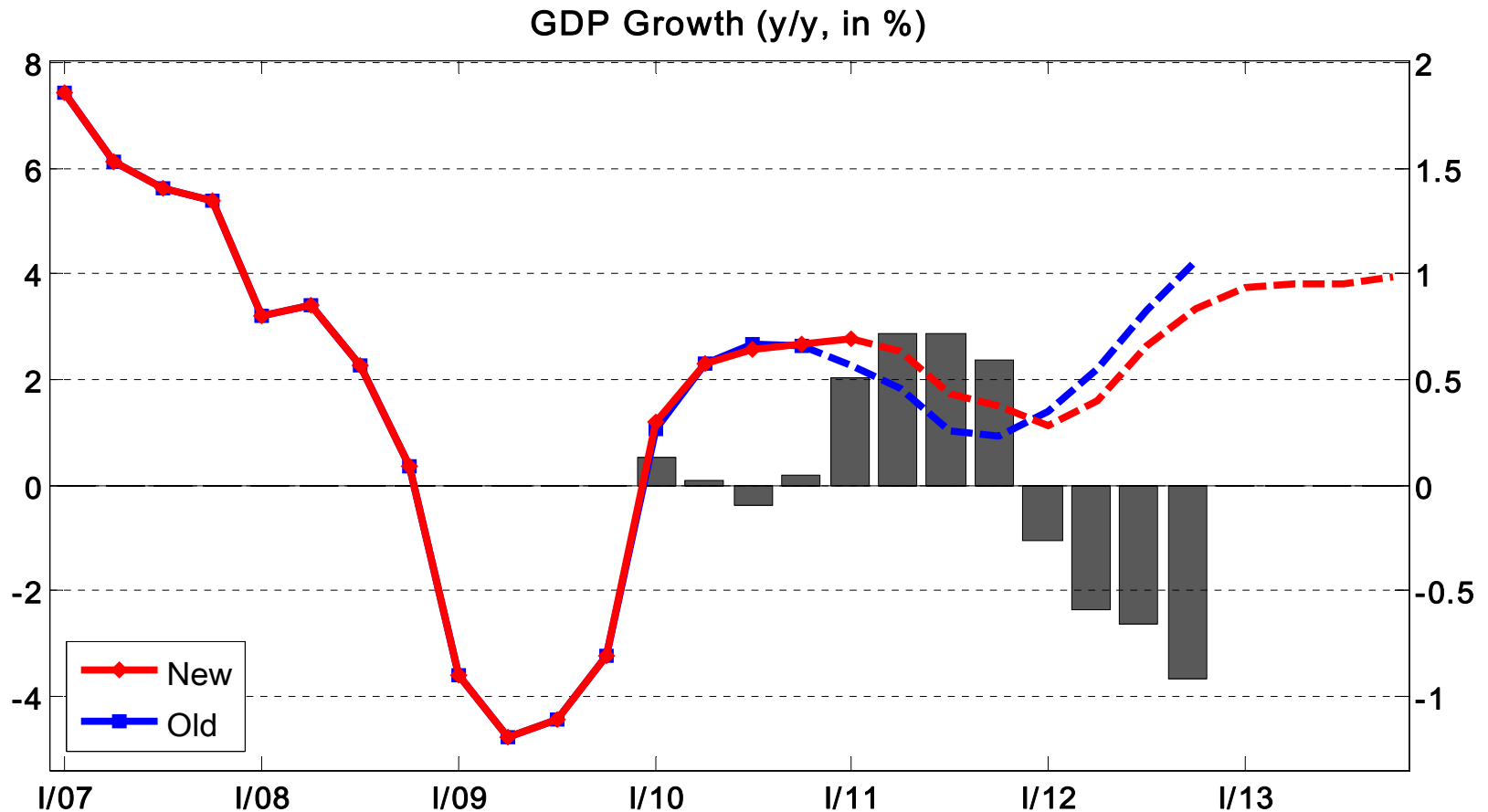


- Net inflation forecast is marginally lower in 2012.
- The administered price growth includes the impact of higher VAT.



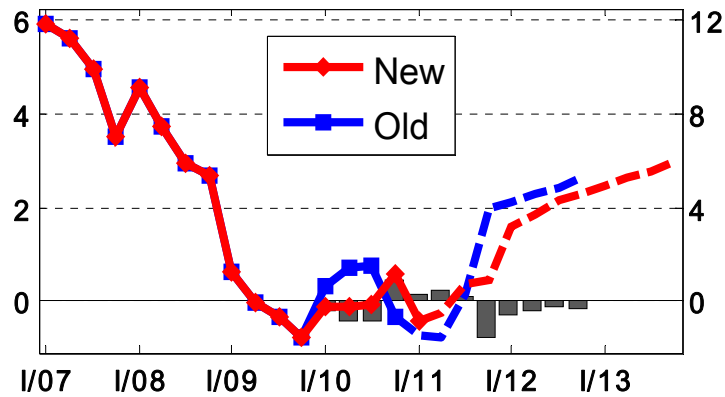
- The forecast of adjusted inflation excluding fuels is slightly lower due to a faster exchange rate appreciation.
- The food price growth is currently higher, but should decline below the previous forecast in H2 2012 (lower agricultural prices).

Comparison with Previous GDP Forecast (i)

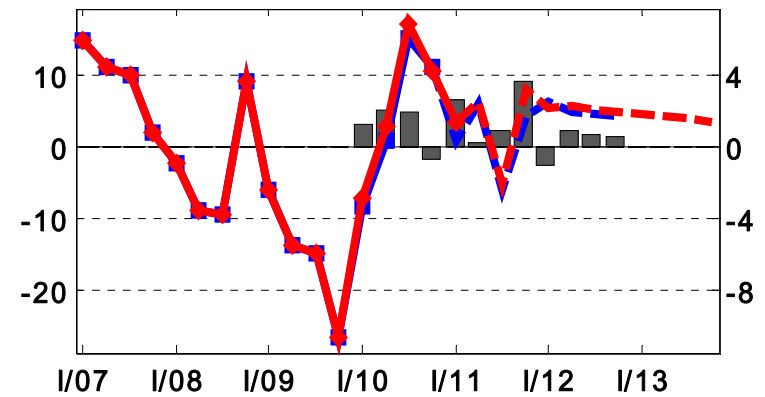


- Higher forecast in 2011 due to the strong Q1 both in the euro area and the Czech Republic.
- Lower 2012 prediction due to the VAT increase and foreign growth slowdown (now shifted more into 2012).

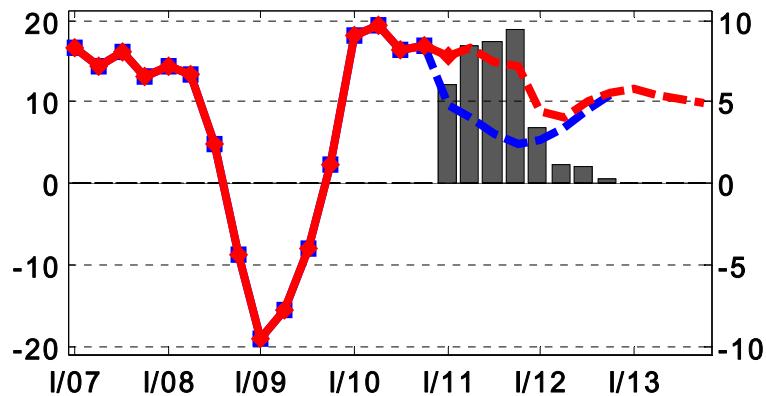
Household Consumption Growth (y/y, in %)



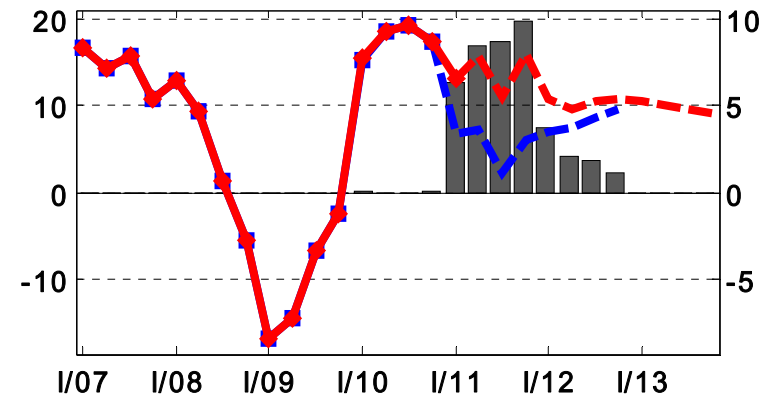
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)

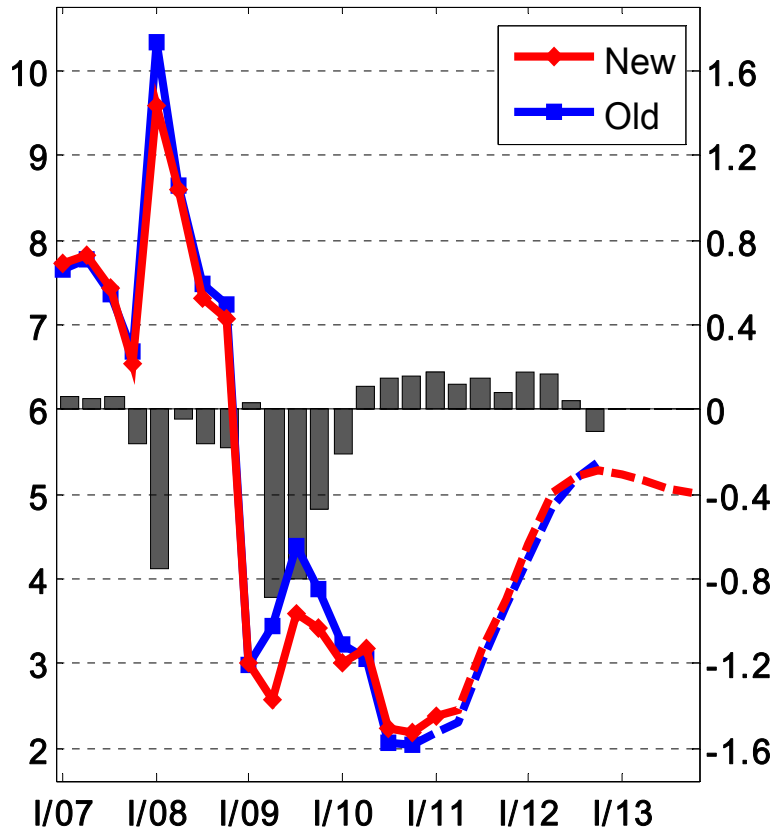


Imports Growth (y/y, in %)

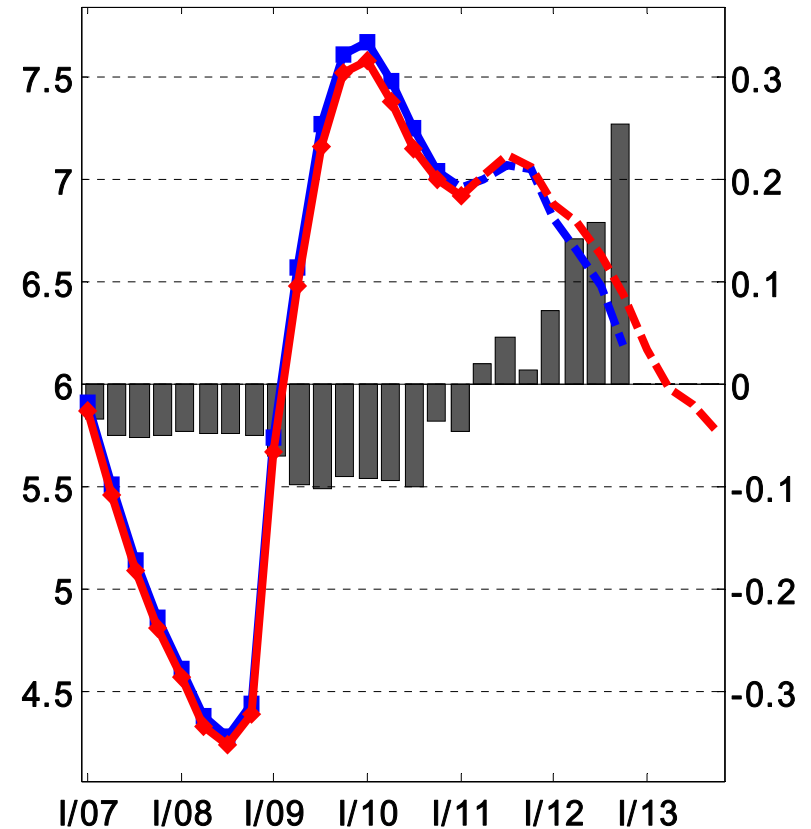


- Slower consumption growth in 2012 due to the VAT rate increase.
- Faster growth of both exports and imports in 2011, with a higher contribution of net export to the GDP growth.

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

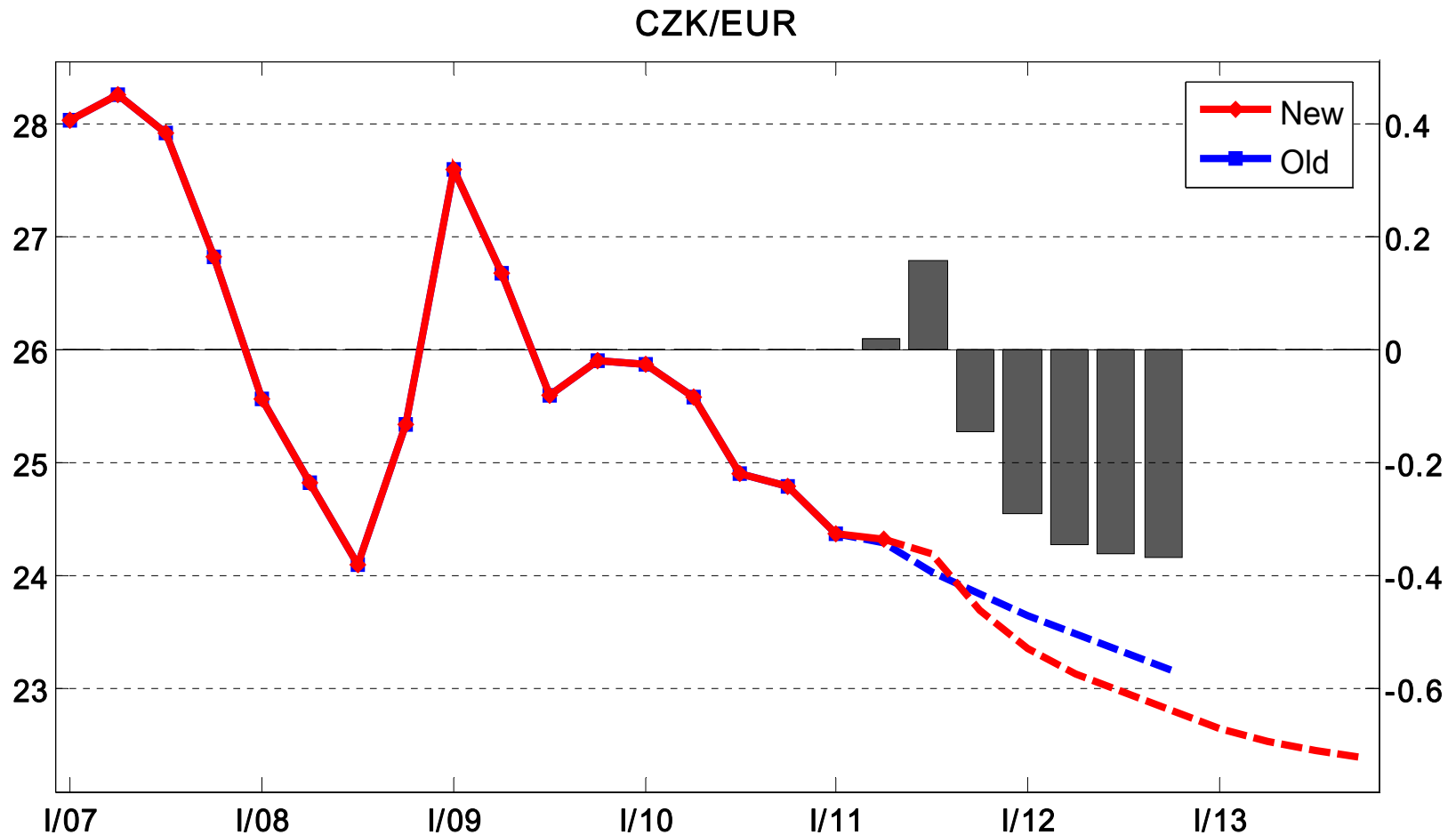


General unemployment rate (ILO)
(in %, s.a.)



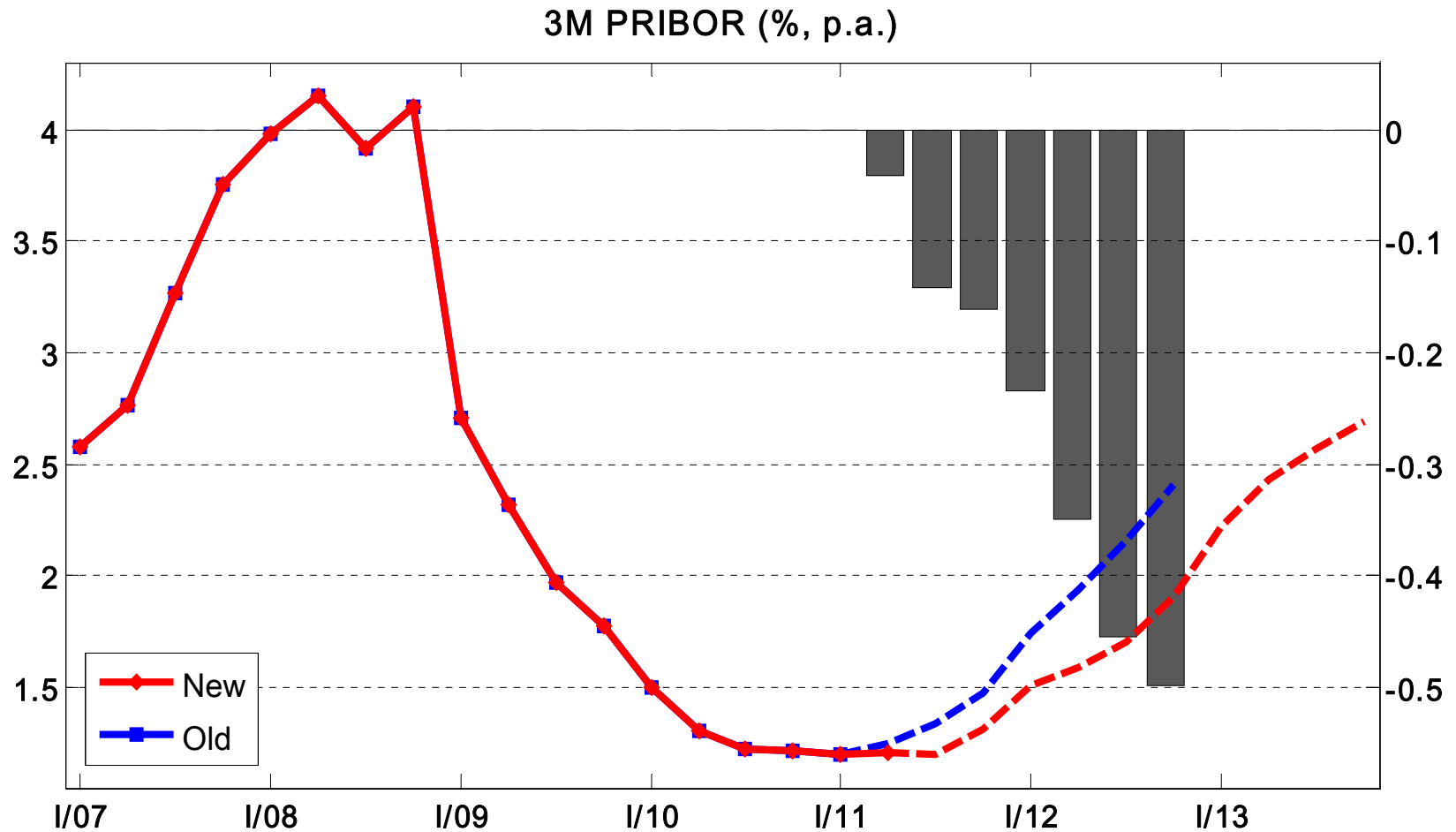
- The labour market forecast does not change fundamentally.

Changes in Exchange Rate Forecast

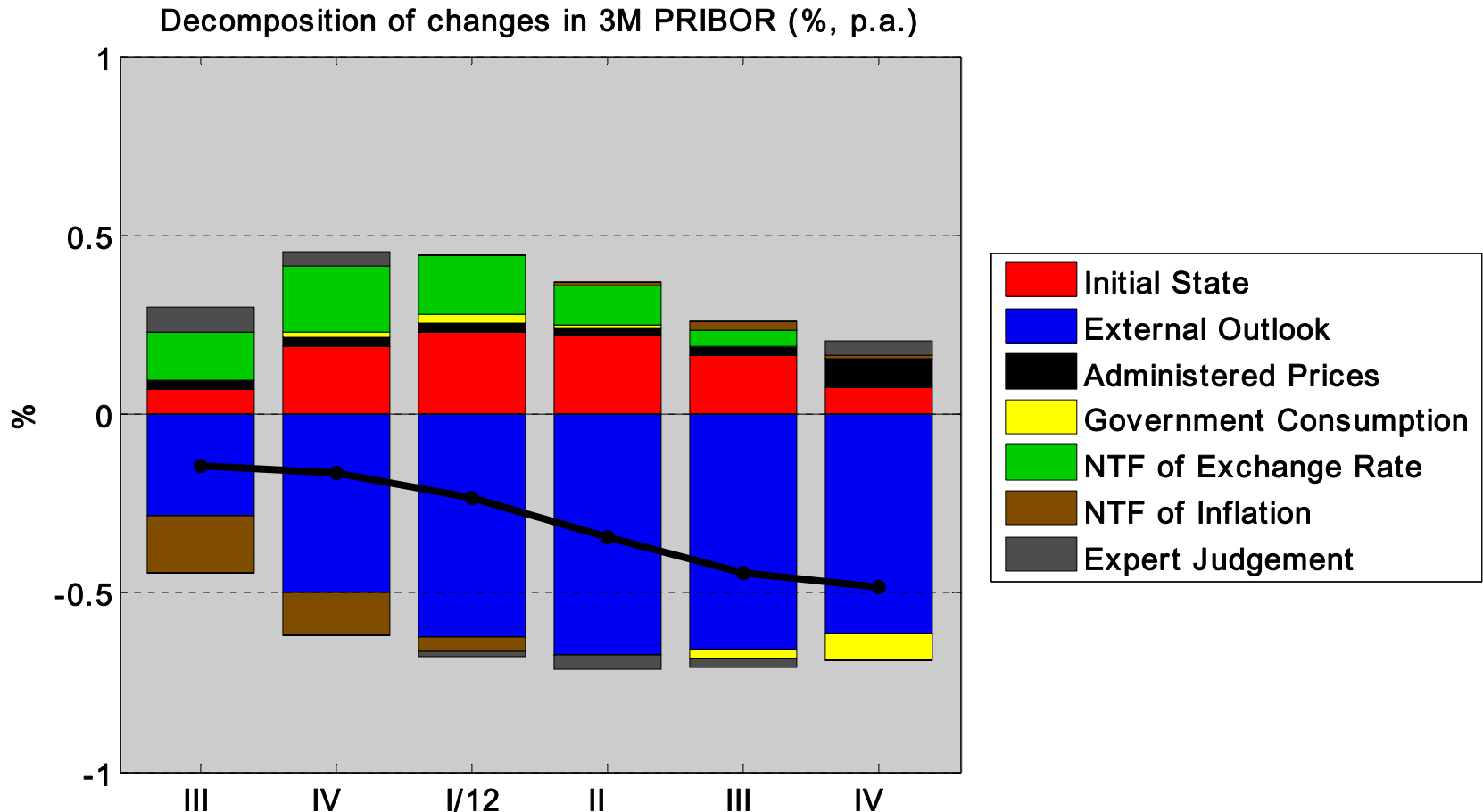


- Faster exchange rate appreciation is caused by higher net export forecast and lower foreign interest rate outlook (less negative interest rate differential).

Changes in Interest Rate Forecast



- The forecast for domestic money market interest rates is lower.



- The downward impact of the new external economic outlook (mainly lower EURIBOR) is only partly offset by an upward effect of the near-term exchange rate forecast, initial state and expert judgement.

The risks to the forecast are balanced.

Downside risk:

- lower foreign interest rates

Upside risk:

- weaker koruna exchange rate

Foreign interest rate sensitivity scenario

(deviations from baseline scenario)

	CPI inflation (in p.p.)	3M PRIBOR (in p.p.)	GDP growth (in p.p.)	Nominal ex. rate (CZK/EUR)	Foreign interest rate (v p.b.)
III/11	0,0	0,0	0,0	0,0	0,0
IV/11	0,0	-0,1	0,0	-0,1	-0,1
I/12	0,0	-0,1	0,0	-0,1	-0,1
II/12	0,0	-0,2	0,0	-0,1	-0,2
III/12	0,0	-0,2	-0,1	-0,2	-0,2
IV/12	0,0	-0,2	0,0	-0,2	-0,2
I/13	0,0	-0,2	0,0	-0,2	-0,3
II/13	0,0	-0,2	0,0	-0,2	-0,3
III/13	0,0	-0,1	0,0	-0,1	-0,3
IV/13	0,0	-0,1	0,0	-0,1	-0,3

- The baseline scenario includes the EURIBOR outlook immediately after the July ECB hike but before the crisis spilled over to Italy.
- The EURIBOR outlook has shifted down since the pressures on Italy started, which would imply a lower outlook for the domestic rates, too.

Exchange rate sensitivity scenario

(deviations from baseline scenario)

	CPI inflation (in p.p.)	3M PRIBOR (in p.p.)	GDP (in p.p.)	Nominal ex. rate (CZK/EUR)
III/11	0,0	0,0	0,2	0,7
IV/11	0,0	0,3	0,3	0,2
I/12	0,1	0,3	0,2	0,0
II/12	0,2	0,2	0,1	0,0
III/12	0,2	0,1	-0,2	0,0
IV/12	0,1	0,0	-0,3	0,0
I/13	0,1	0,0	-0,2	0,0
II/13	0,0	-0,1	-0,1	0,0
III/13	0,0	0,0	0,0	0,0
IV/13	0,0	0,0	0,1	0,0

- A weaker exchange rate e.g. due to an increased risk aversion associated with the euro area debt crisis would lead to higher inflation and domestic interest rates.

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