Meeting with Analysts

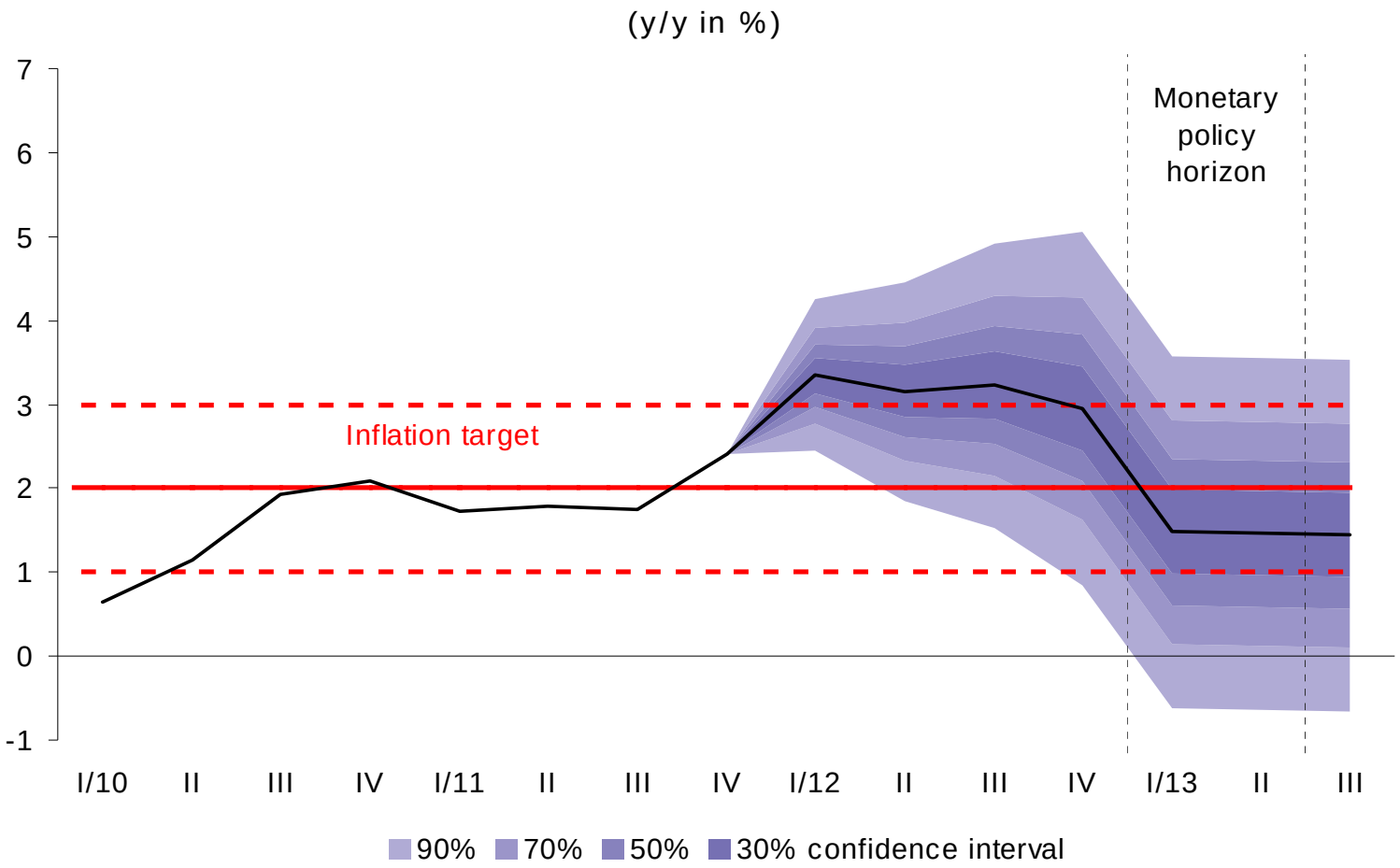
Petr Král

Prague, 10 February, 2012

Summary of the Inflation Forecast

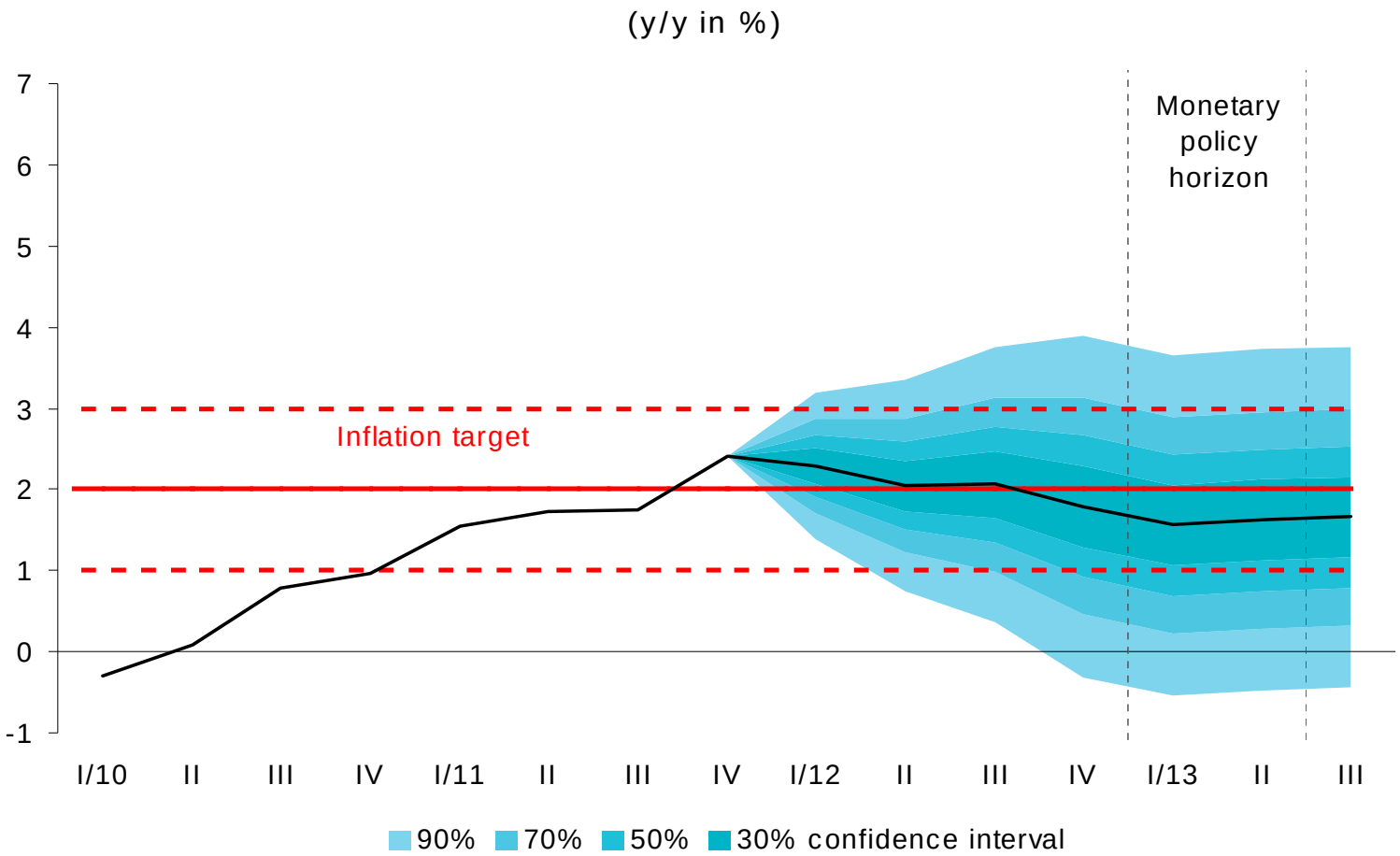
- Headline inflation will rise to just above 3% in 2012 due to the VAT increase but will decline below the target in early 2013. MP-relevant inflation will stay close to the 2% target on the entire horizon.
- Administered price growth will peak at the beginning of 2012, while net inflation will decline in the same time horizon.
- Outlook for euro area interest rates was revised downwards. The forecast of foreign GDP growth was also decreased, approaching the values from the alternative scenario in the previous Inflation Report.
- Domestic inflationary pressures will be subdued until the end of 2012.
- The exchange rate will slowly appreciate from its currently weakened levels, eventually pushing import prices back to the anti-inflationary side.
- Forecasted GDP growth is 0% for 2012. Stagnation reflects significant decrease in foreign demand growth and ongoing domestic fiscal consolidation. Economic growth will revive again in 2013.
- Growth of wages in business sector will decelerate in 2012.

Headline Inflation Forecast



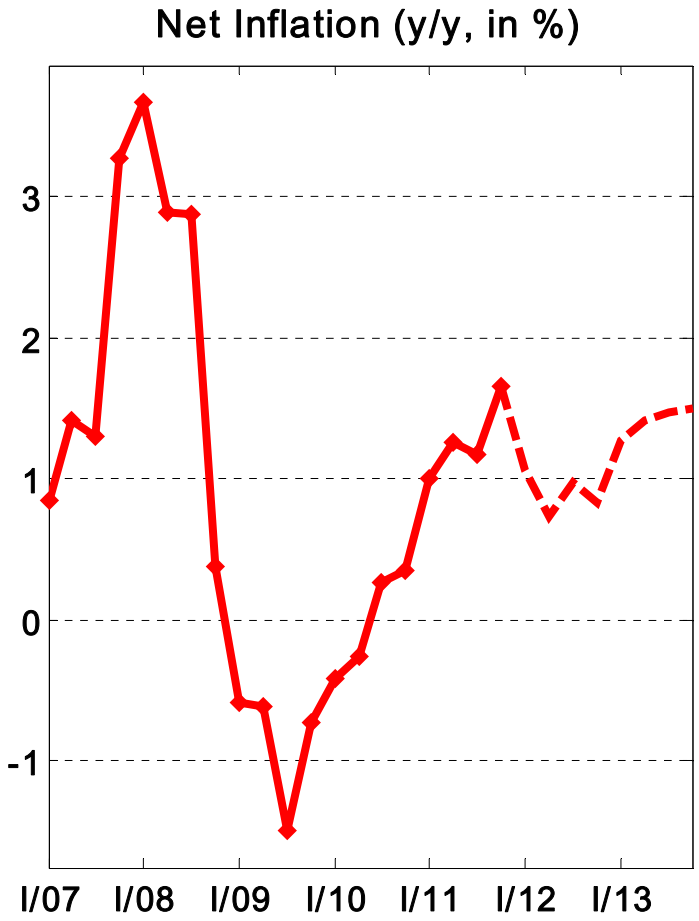
- In 2012, inflation will temporarily get to just above 3% due to the reduced VAT rate increase.
- In 2013, inflation will be below the target.

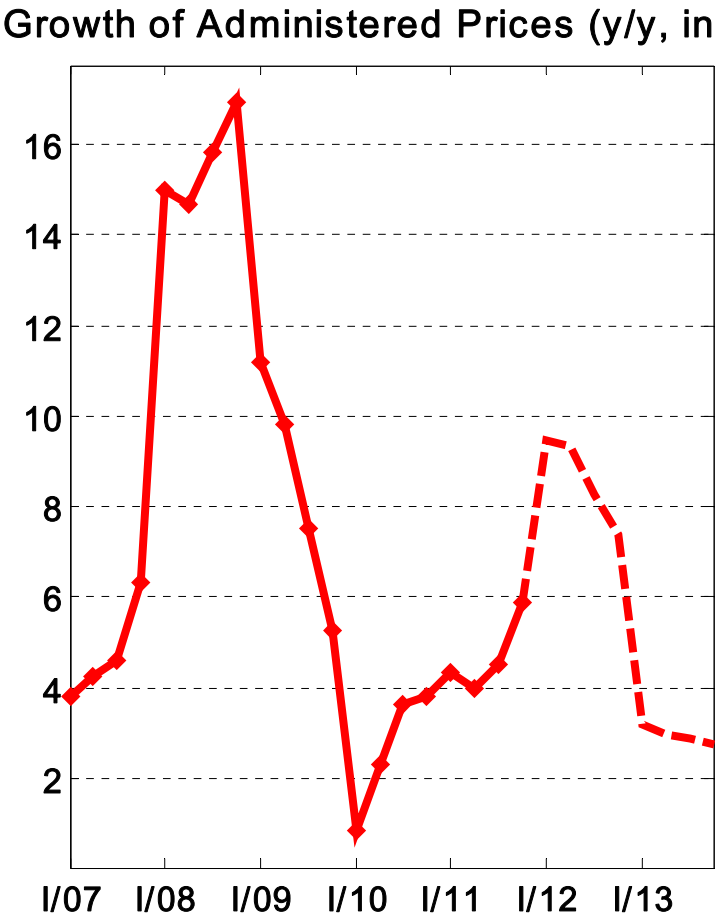
MP-Relevant Inflation Forecast



- MP-relevant inflation will remain close to the target during the entire forecast horizon (with slightly declining tendency).
- Second-round effects of VAT change (inflation expectations and wage formation) assumed negligible.

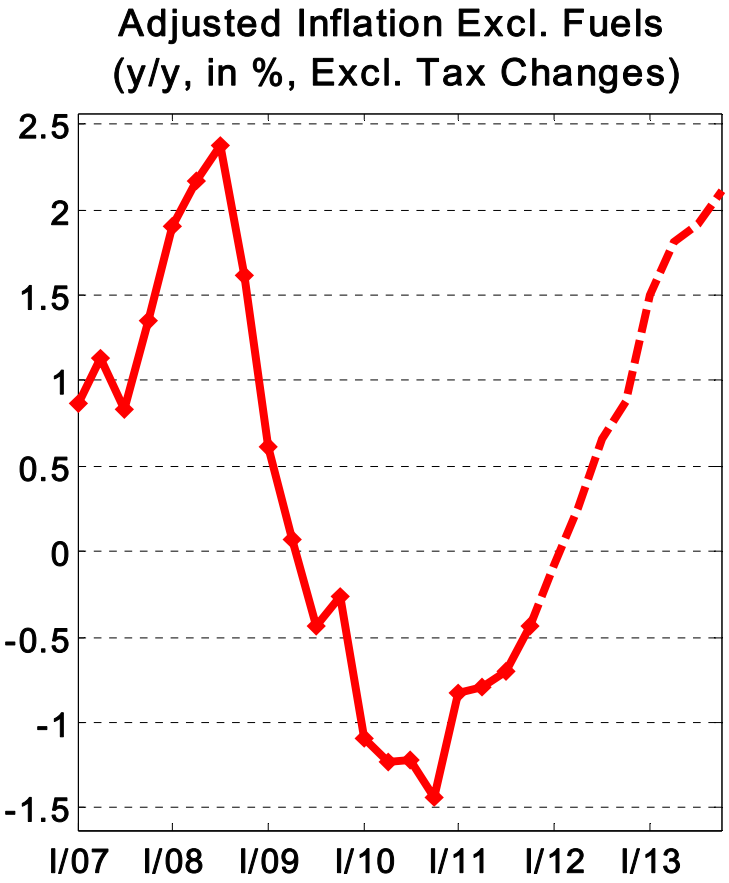
Market and Administered Prices

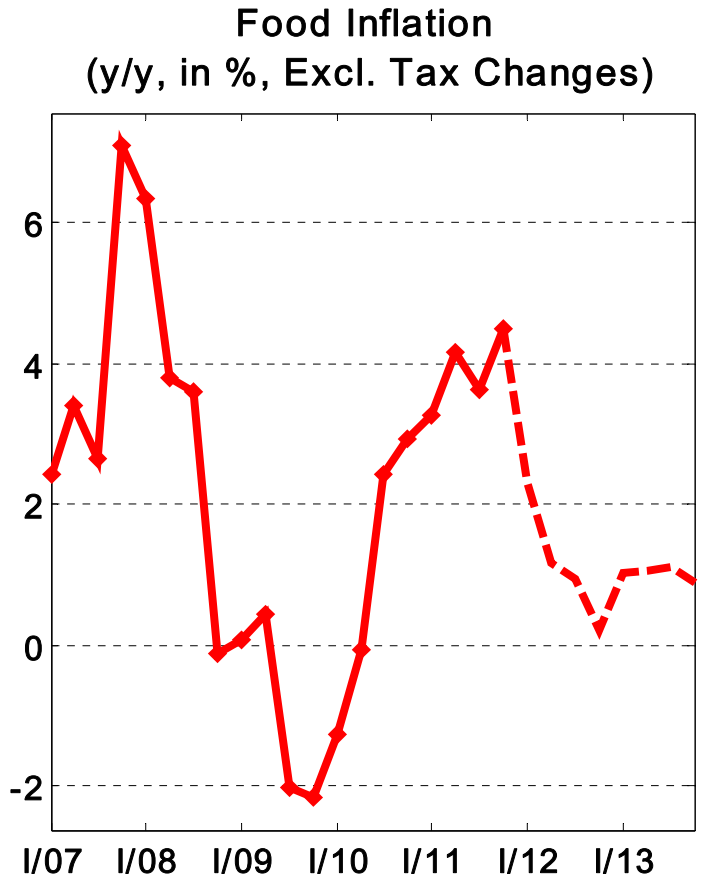




- Initial decline in net inflation due to lower food price growth, later on accompanied by slow-down of domestic demand.
- Growth of administered prices will accelerate reflecting mainly higher increases of energy prices for households and faster growth of reg. rents.

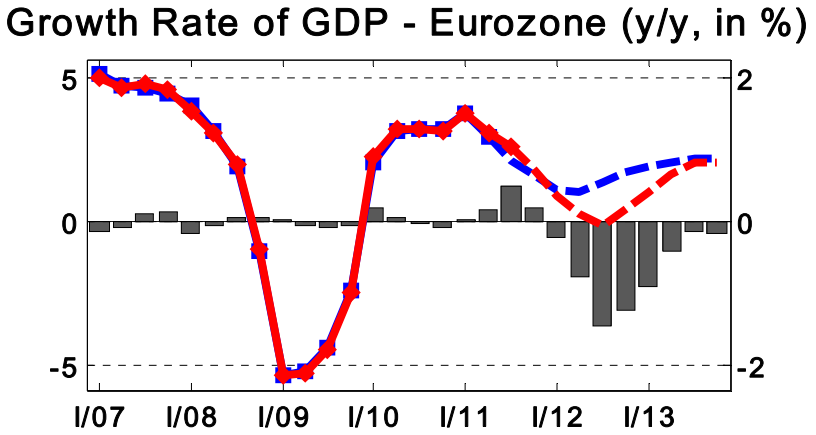
Adjusted Inflation Excluding Fuels and Food

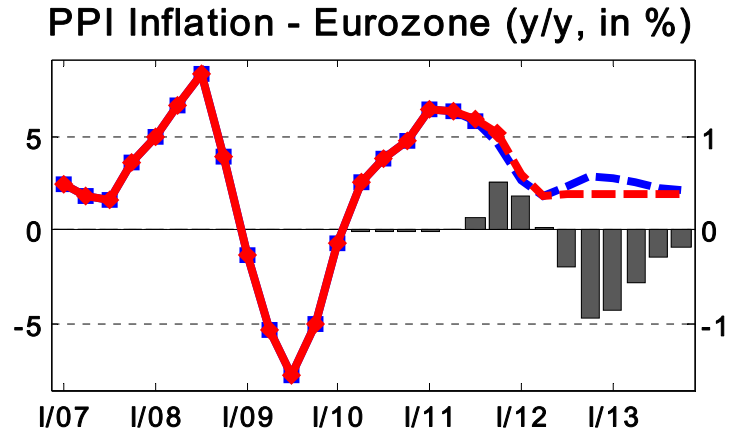


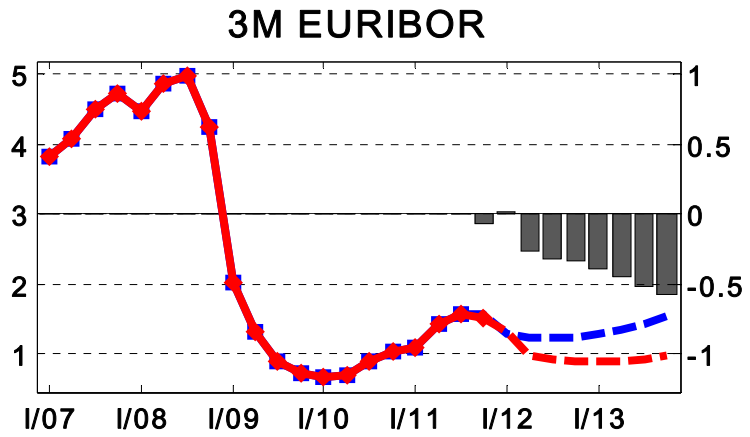


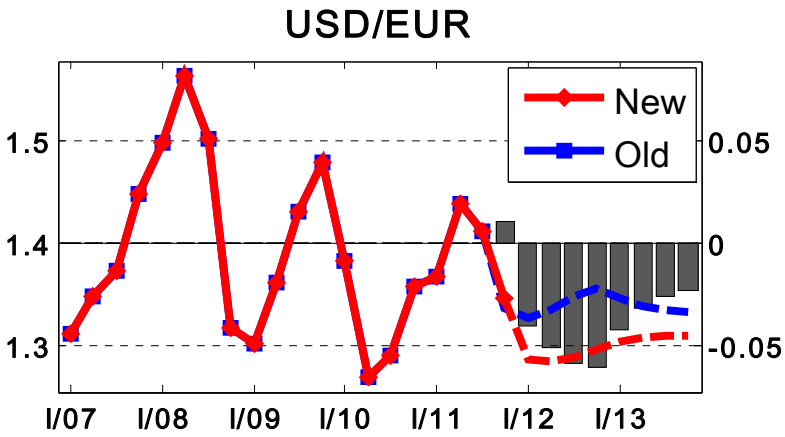
- Core inflation still negative due to subdued domestic pressures. It will turn positive during 2012 and grow further as evaporating growth of import prices will be replaced by gradually surging domestic inflationary pressures.
- Food price growth in Q4 2012 attributed to partial early pass-through of VAT increase. Effects of high world energy and commodity prices will fade away.

External Environment Outlook



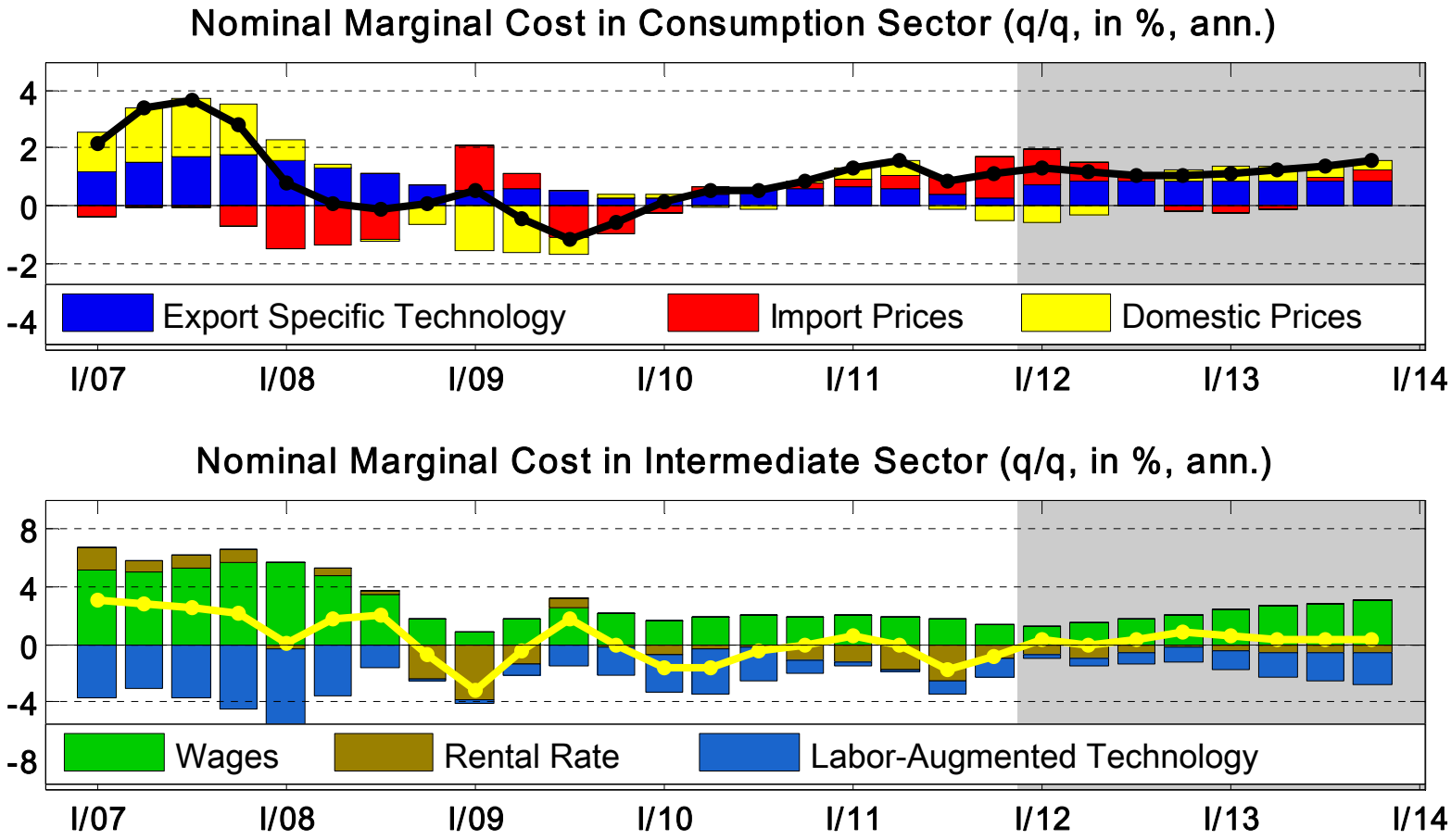






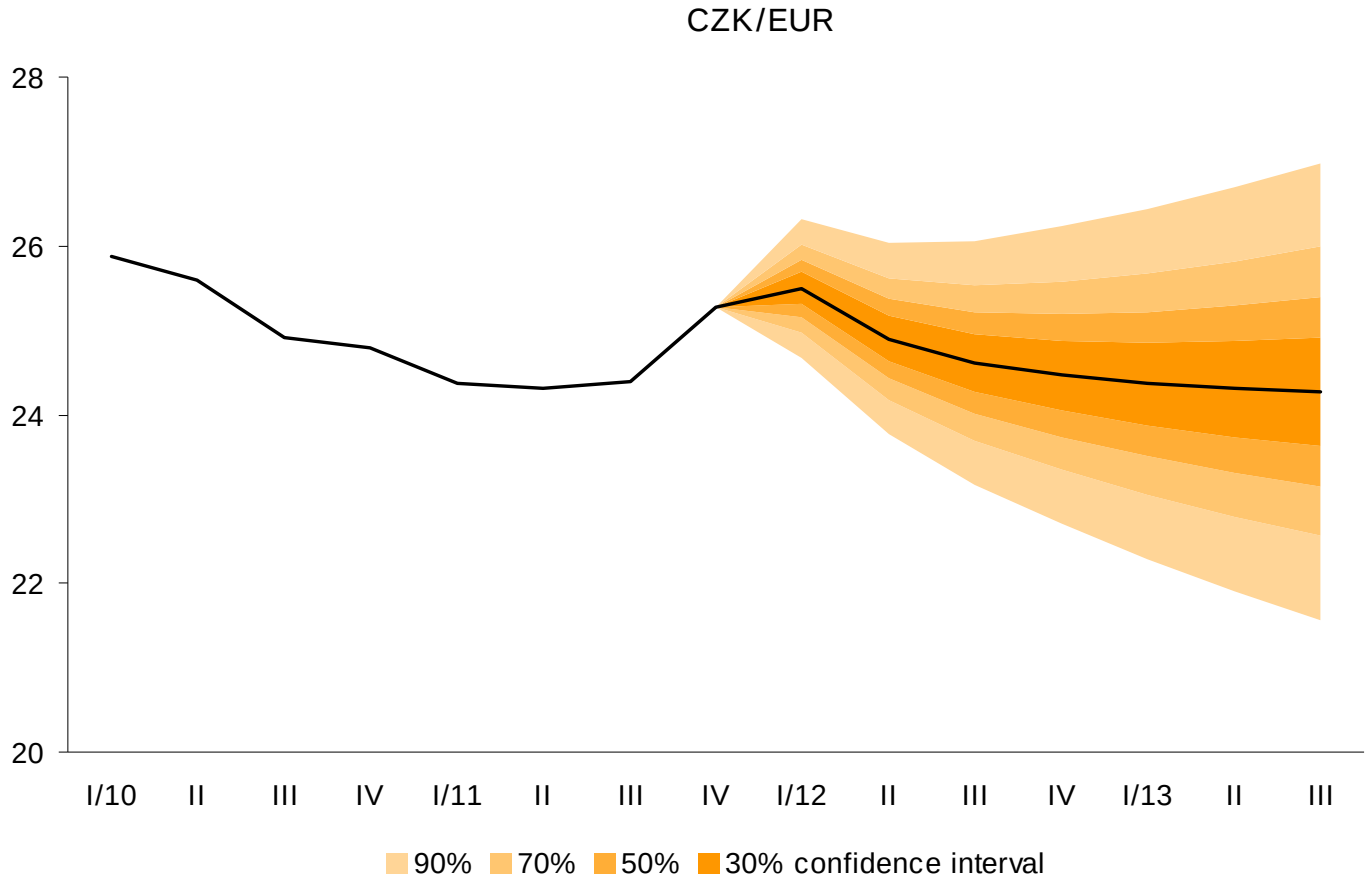
- Significantly lower outlook for GDP growth in the euro area (approaching the previous forecast‘s alternative scenario). Flat PPI inflation (lowered).
- 3M EURIBOR trajectory shifted down again.
- Stronger USD vis-à-vis EUR in coming quarters.

Domestic Costs vs. Import Prices



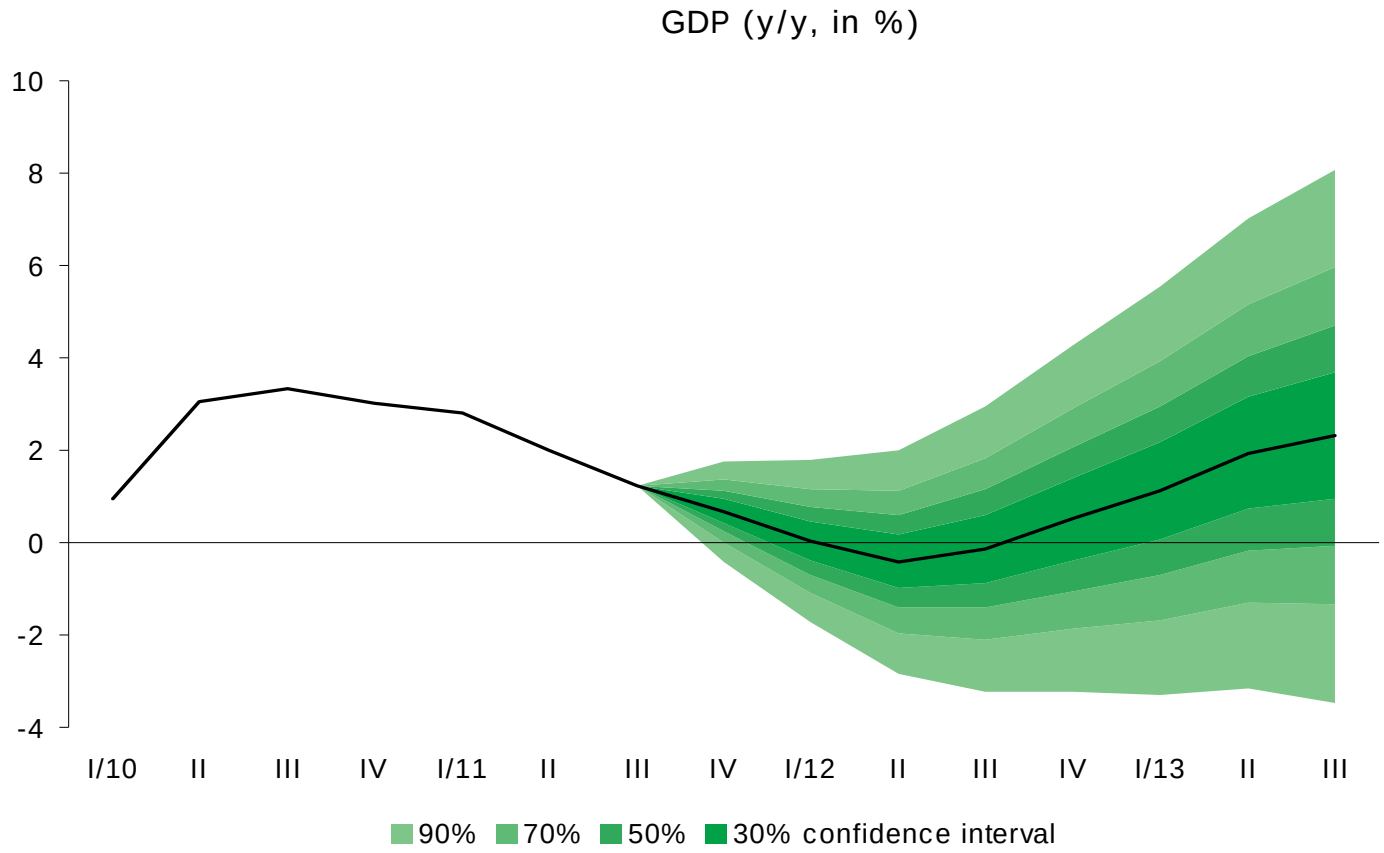
- Inflationary effect of import prices until the 1H 2012 due to recent CZK depreciation. Domestic inflationary pressures subdued until the end of 2012. Currently almost closed gap of margins will open again to negative territory.
- Domestic cost pressures remain weak: low wage growth, compensated by the productivity growth as well as low cost of capital.

Exchange Rate Forecast



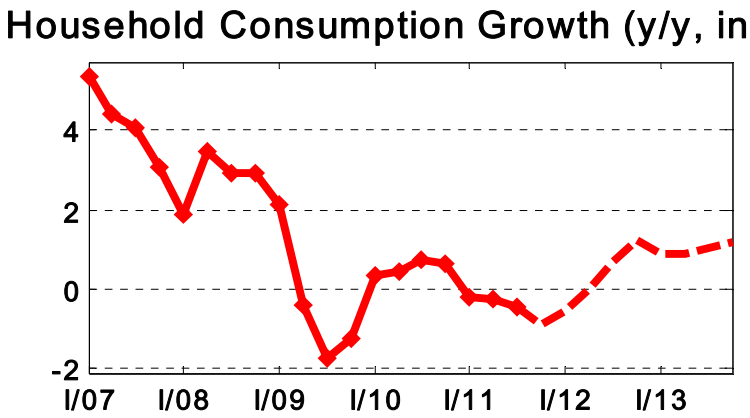
- Recent depreciation of CZK reflects the uncertainty stemming from the euro area sovereign debt crisis. On the forecast, the exchange rate will be gradually appreciating from these weakened levels.
- The exchange rate forecast affected by decline of foreign demand (NFA), revision of nominal NX and expected renewal of long-term convergence.

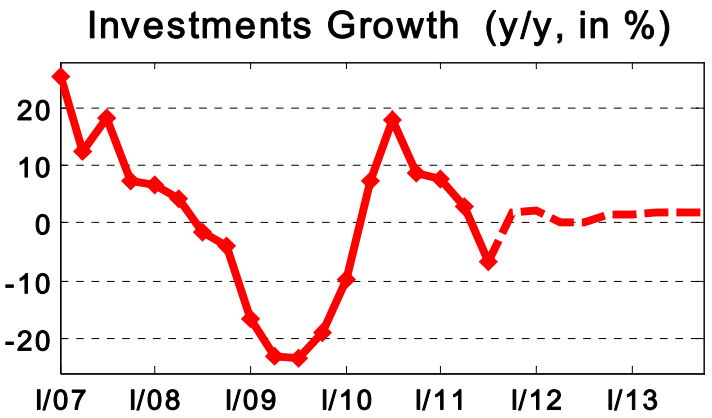
GDP Growth Forecast

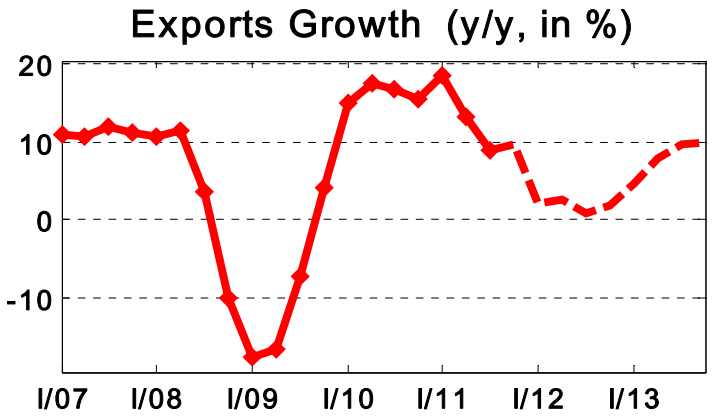


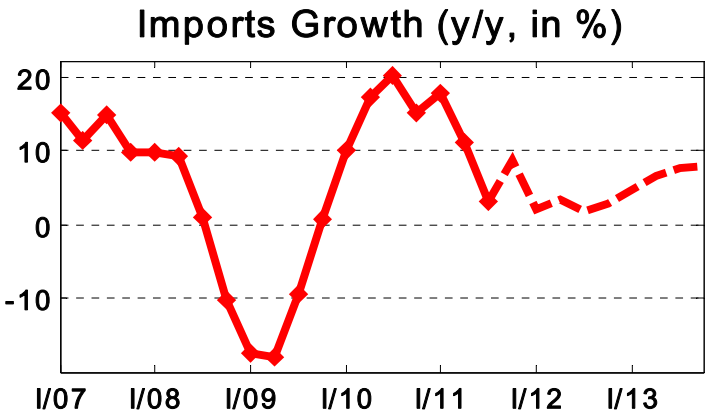
- GDP growth forecast: 0% for the current year and 1.9% in 2013
- Determined by pessimistic outlook for foreign economic activity and ongoing domestic fiscal consolidation.

Forecast of Aggregate Demand



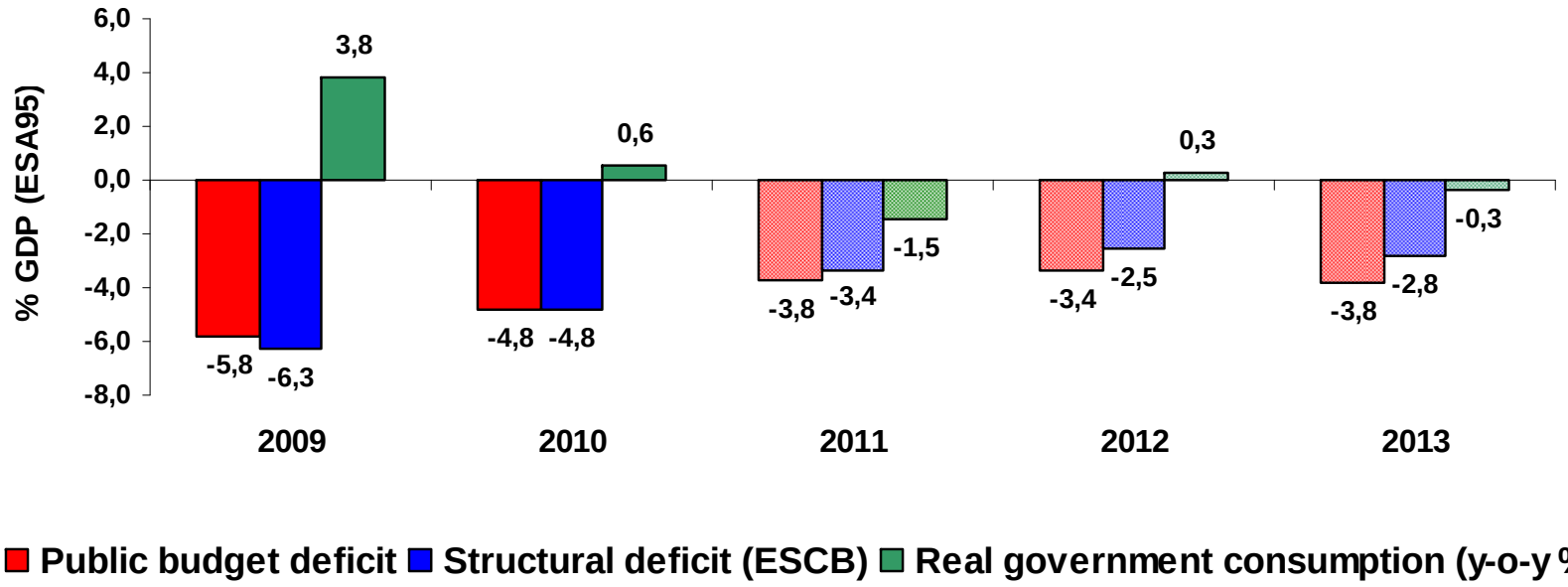






- Just slowly reviving private consumption growth reflects slack labor market as well as curbing effect of VAT increase on the disposable income.
- Low investment growth as a reaction to the economic stagnation.
- Decline in foreign and domestic demand growth implies slow down of both exports and imports dynamics; negative NX contribution in 2012.

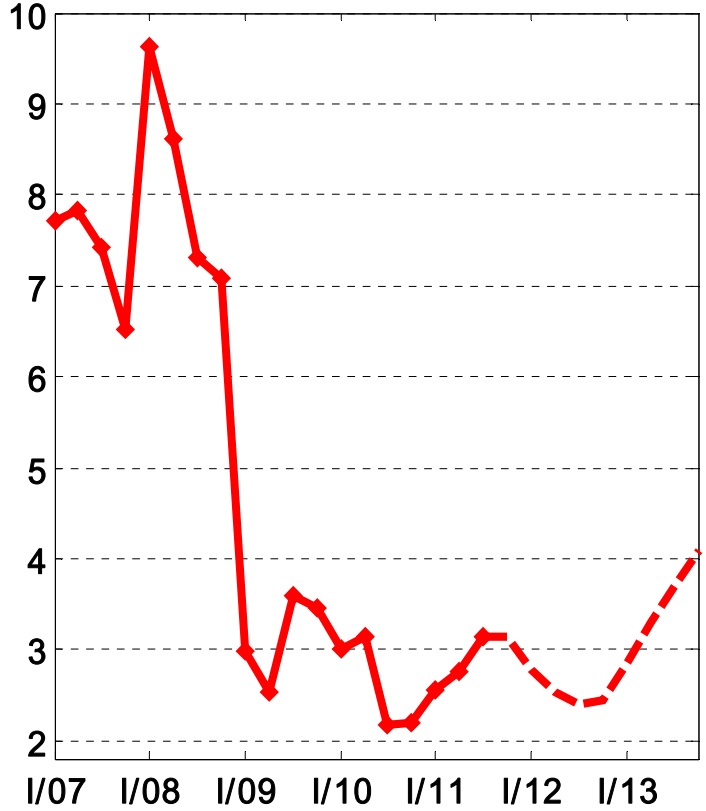
Public Budgets



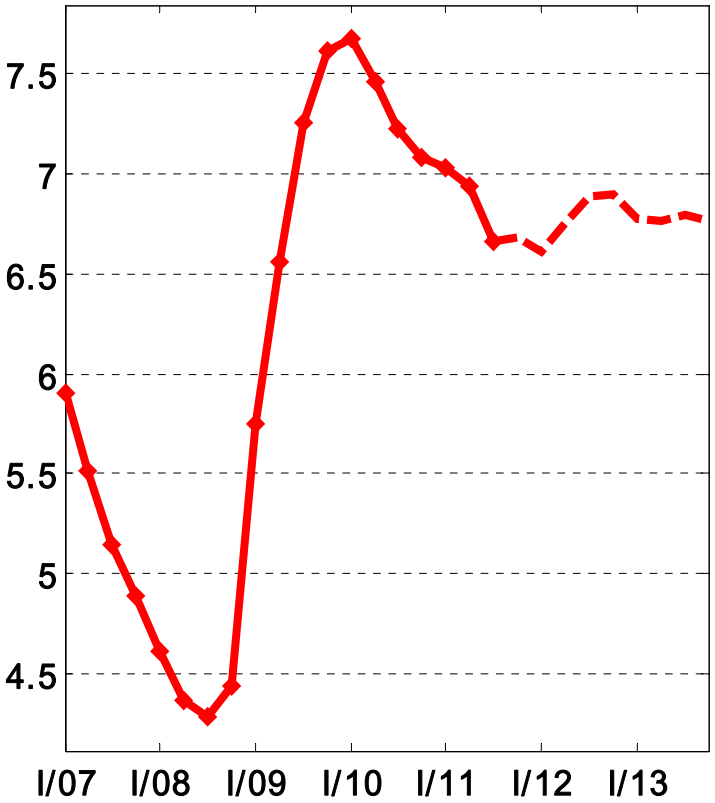
- In 2012, the government deficit will decline to 3.4% of GDP, mainly as a result of the reduced VAT rate increase from 10% to 14%.
- Decrease in the expected tax revenues due to GDP stagnation in 2012.
- Further expenditure cuts in government consumption expected in 2013.
- For 2013, forecast incorporates (as the previous one) the decrease of revenues (SSC) due to the launch of pension reform. Unification of both VAT rates on 17.5% will have only negligible effect on deficit.

Labour Market Forecast

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

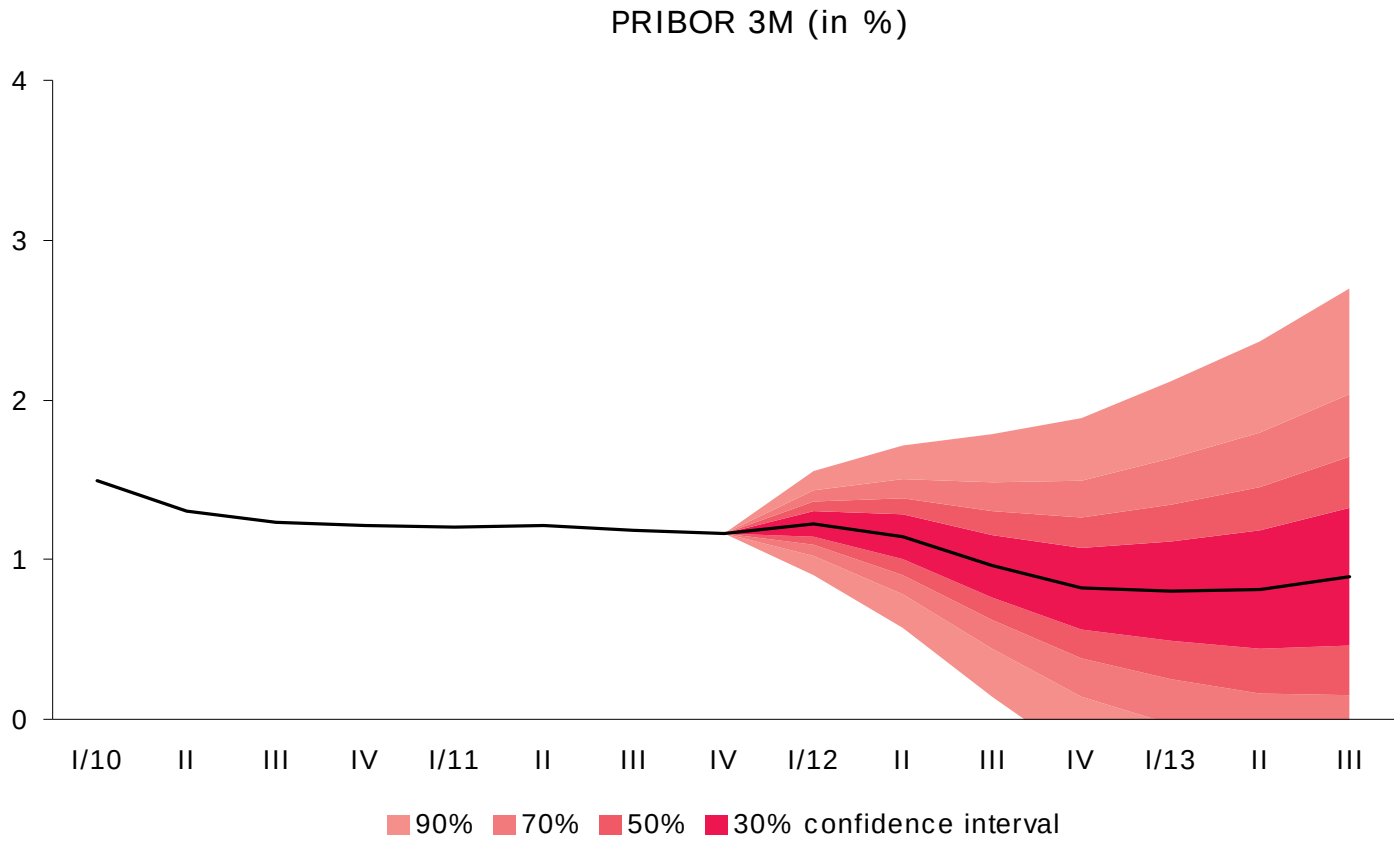


General unemployment rate (ILO)
(in %, s.a.)



- Decelerating growth of nominal wages during 2012 reflects the slowdown of economic activity. Moderate growth of average wage in public sector in both 2012 and 2013.
- Total employment and the rate of unemployment (ILO) will be stagnating.

Interest Rate Forecast

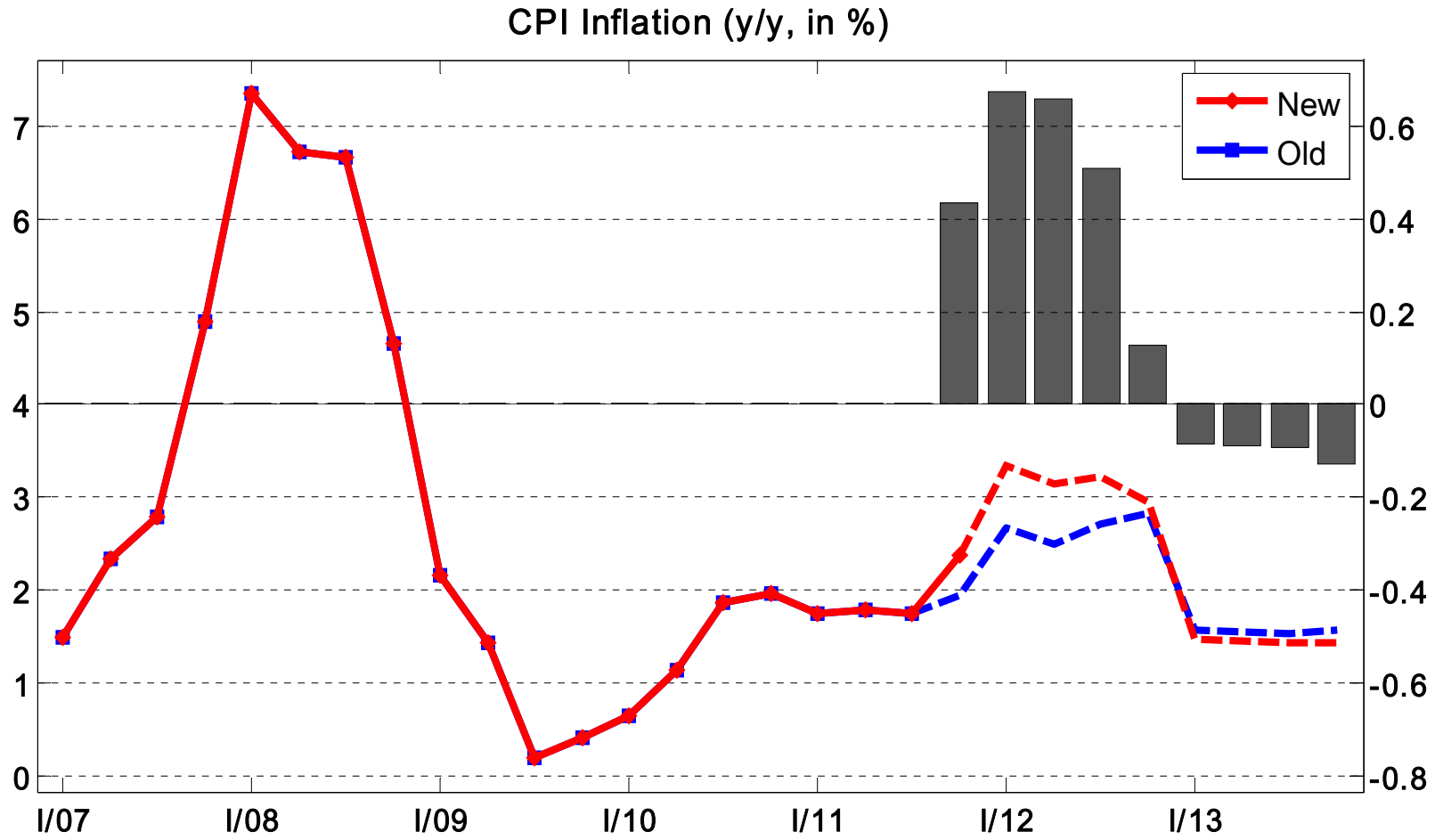


- Consistent with the forecast is stability of market interest rates in the near future and a modest decline thereafter.
- Subdued domestic pressures and low foreign interest rate outlook push the domestic interest rates downwards on the entire horizon. In the near term, these factors are counterbalanced by weakened koruna exchange rate and by short-term inflation outlook (culminating regulated prices).

Comparison with Previous Forecast

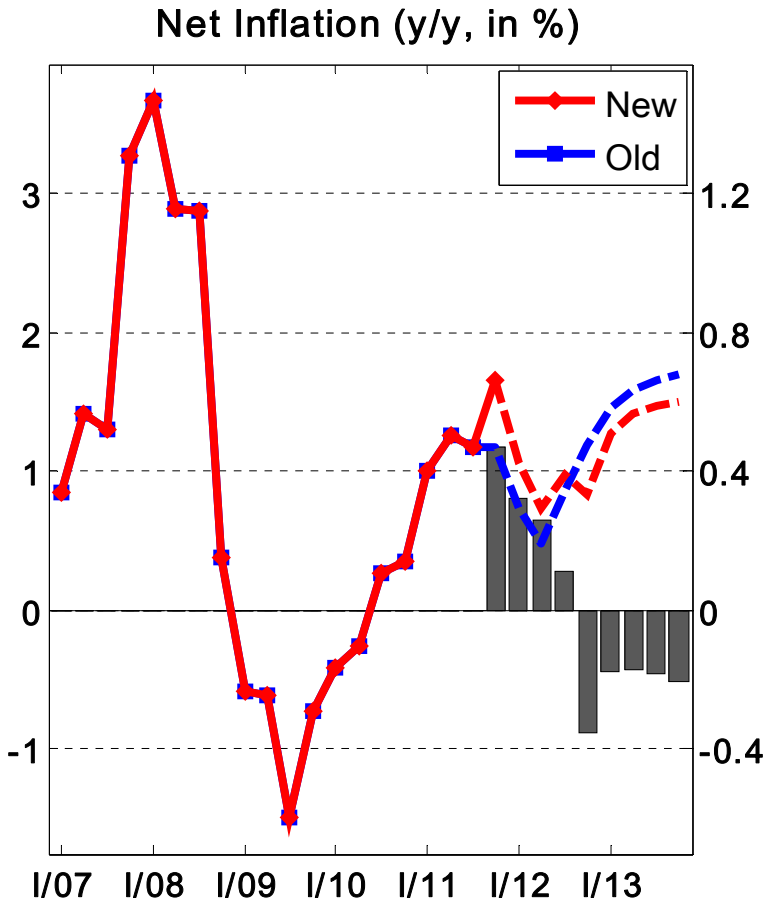
- The forecast of headline inflation increased for 2012 due to upward revision of both administered prices and net inflation outlook.
- The lower net inflation forecast in the longer term reflects subdued economic activity in 2012.
- Weaker exchange rate forecast is primarily determined by more pronounced decline in foreign demand growth and by revision of nominal net exports in the past.
- GDP forecast revised significantly downwards on the whole forecast horizon.
- Outlook for nominal wages growth is lower.
- The interest rate path is higher in the beginning of the forecast, while it is lower starting last quarter 2012.

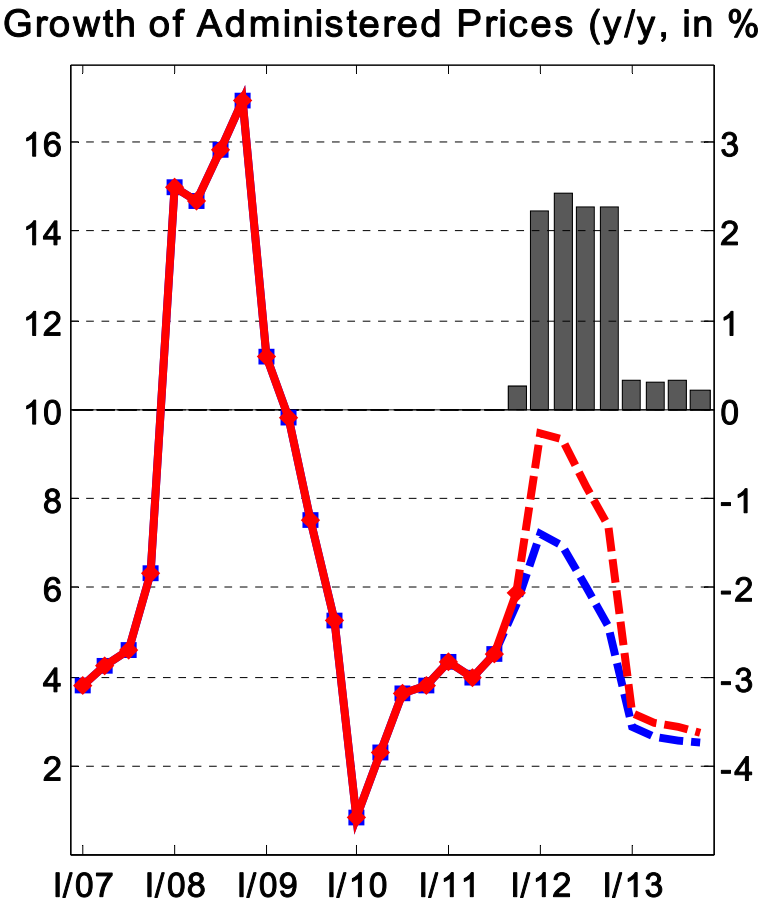
Comparison with Previous Inflation Forecast (i)



- The forecast of headline (as well as MP-relevant) inflation for 2012 increased due to higher outlook for both administered price growth and net inflation.

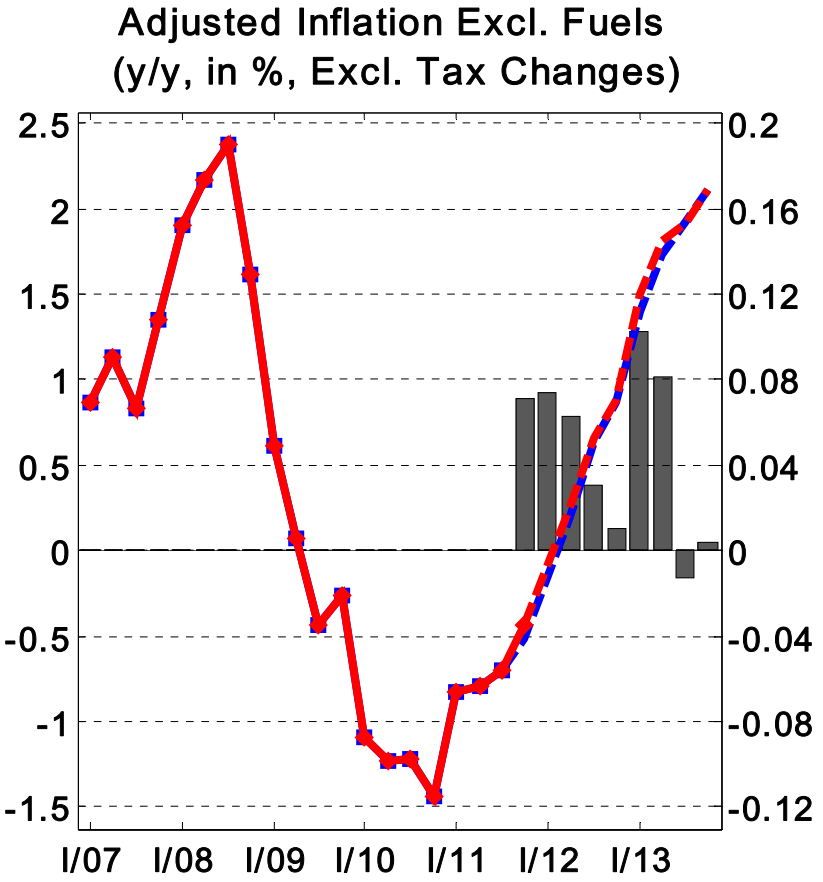
Comparison with Previous Inflation Forecast (ii)

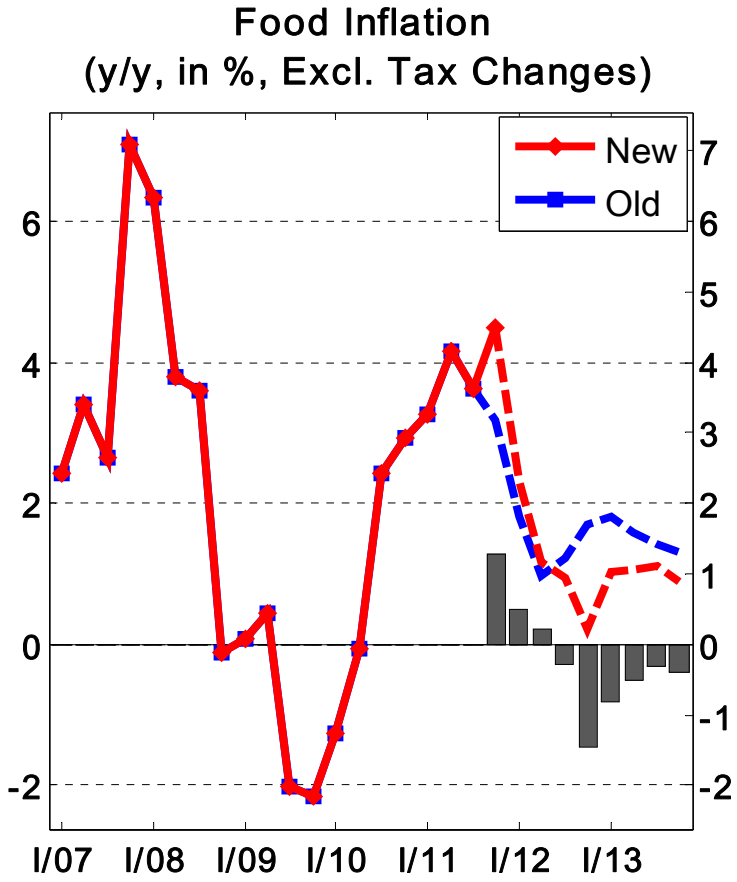




- Net inflation forecast is revised upwards in 2012 affected by higher energy prices and weaker koruna exchange rate. In the longer term downward revision caused by more subdued economic activity.
- Growth of administered prices is higher due mainly to higher increases in prices of energy for households and faster regulated rents growth.

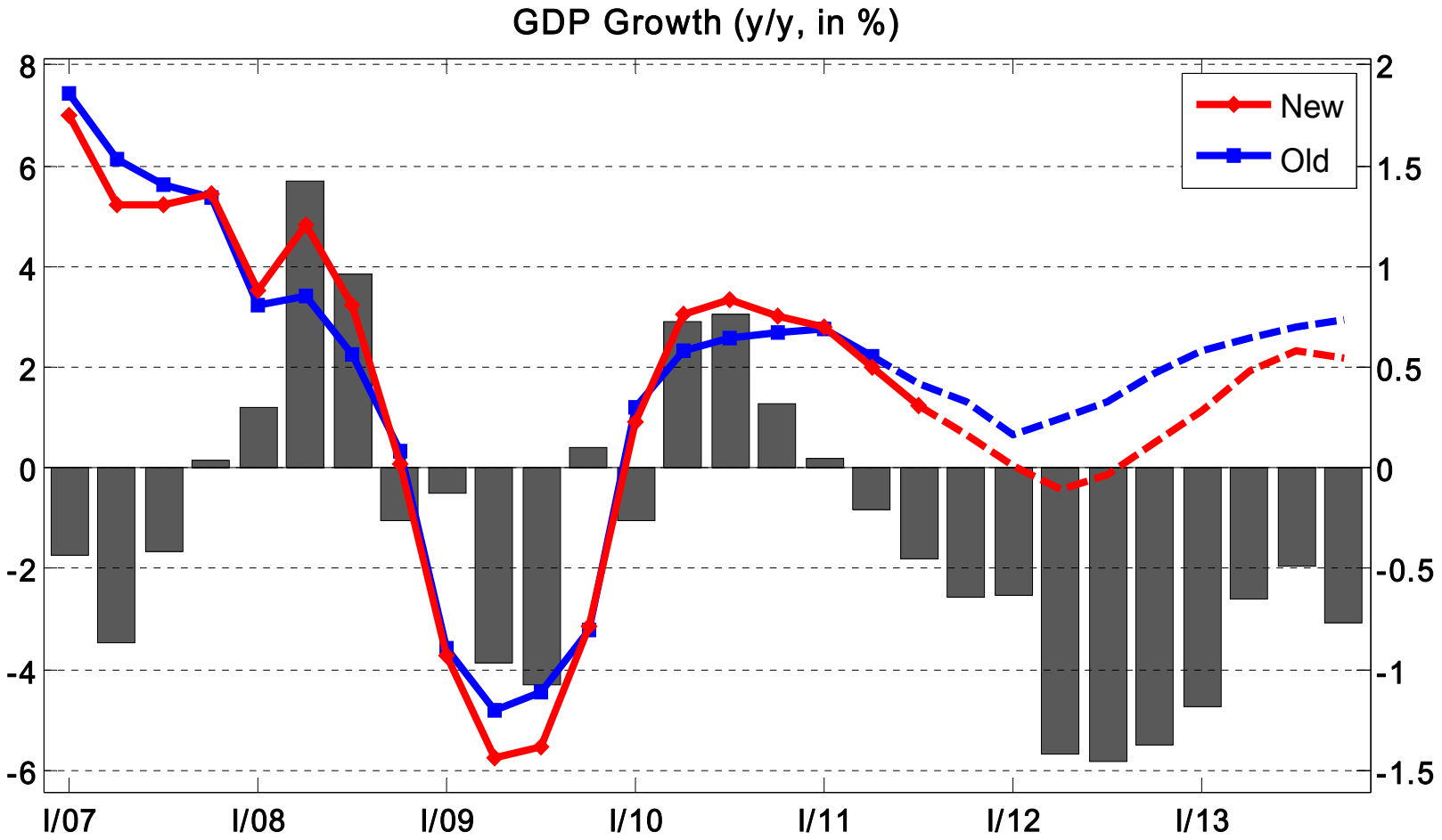
Comparison with Previous Inflation Forecast (iii)





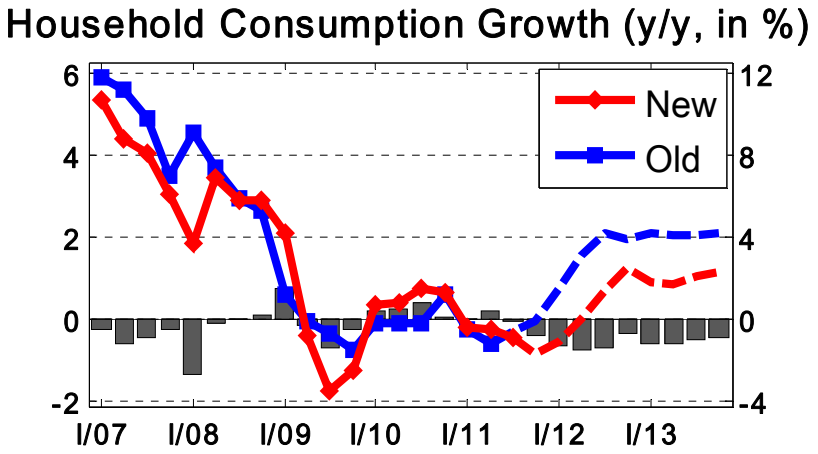
- The forecast of core inflation is broadly the same as in the previous forecast as weaker exchange rate is countervailed by more depressed demand.
- Outlook for food price growth shifted up in the near term caused by (disappearing) higher world energy and commodity prices whereas revised downwards in the long term due to lower economic activity.

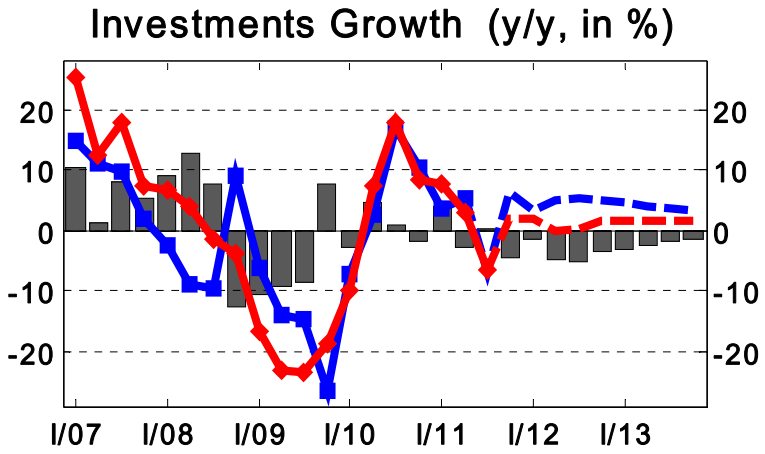
Comparison with Previous GDP Forecast (i)

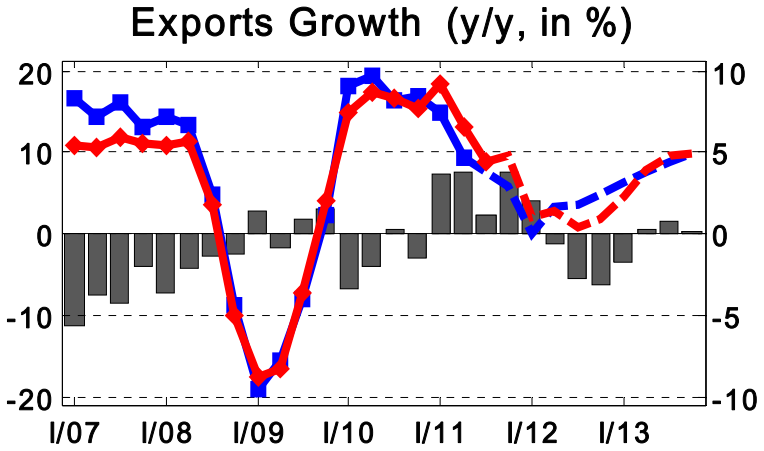


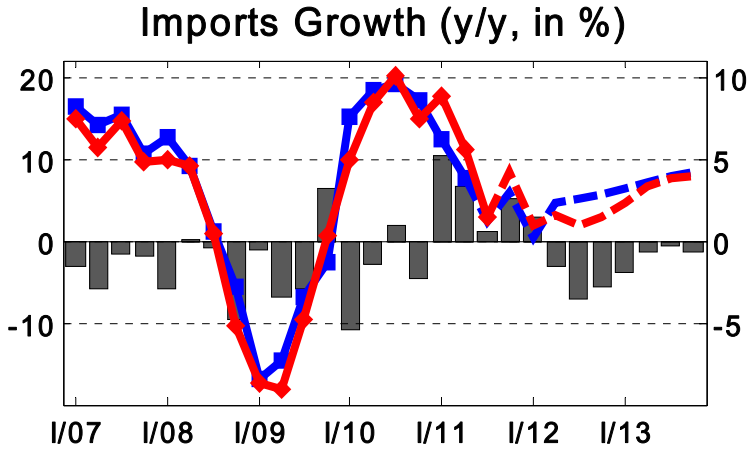
- Substantially lowered GDP forecast primarily as implication of more pronounced slowdown of foreign demand growth.

Comparison with Previous GDP Forecast (ii)





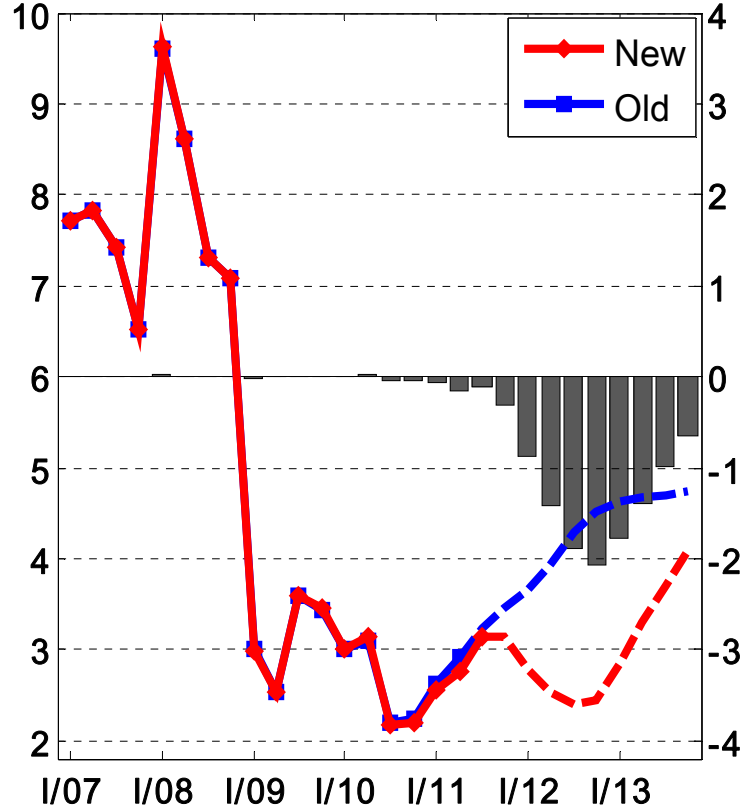




- Lower consumption growth reflecting more subdued labour market.
- Slower investment growth as a reaction to the stagnating economy.
- More contained growth of exports and imports due to more pronounced decrease in both foreign and domestic demand dynamics.

Changes in Labour Market Forecast

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



General unemployment rate (ILO)
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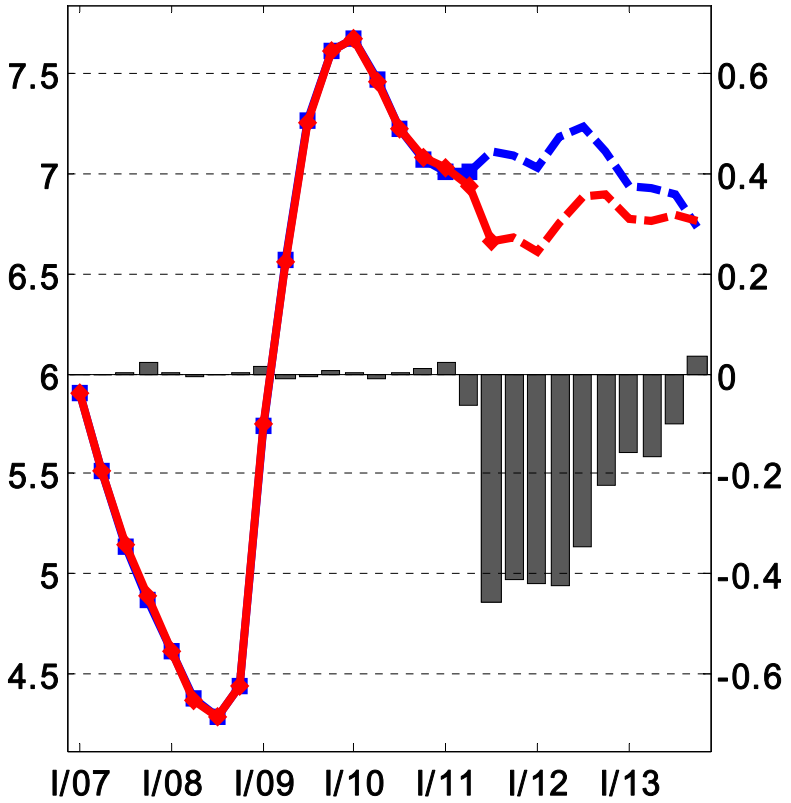
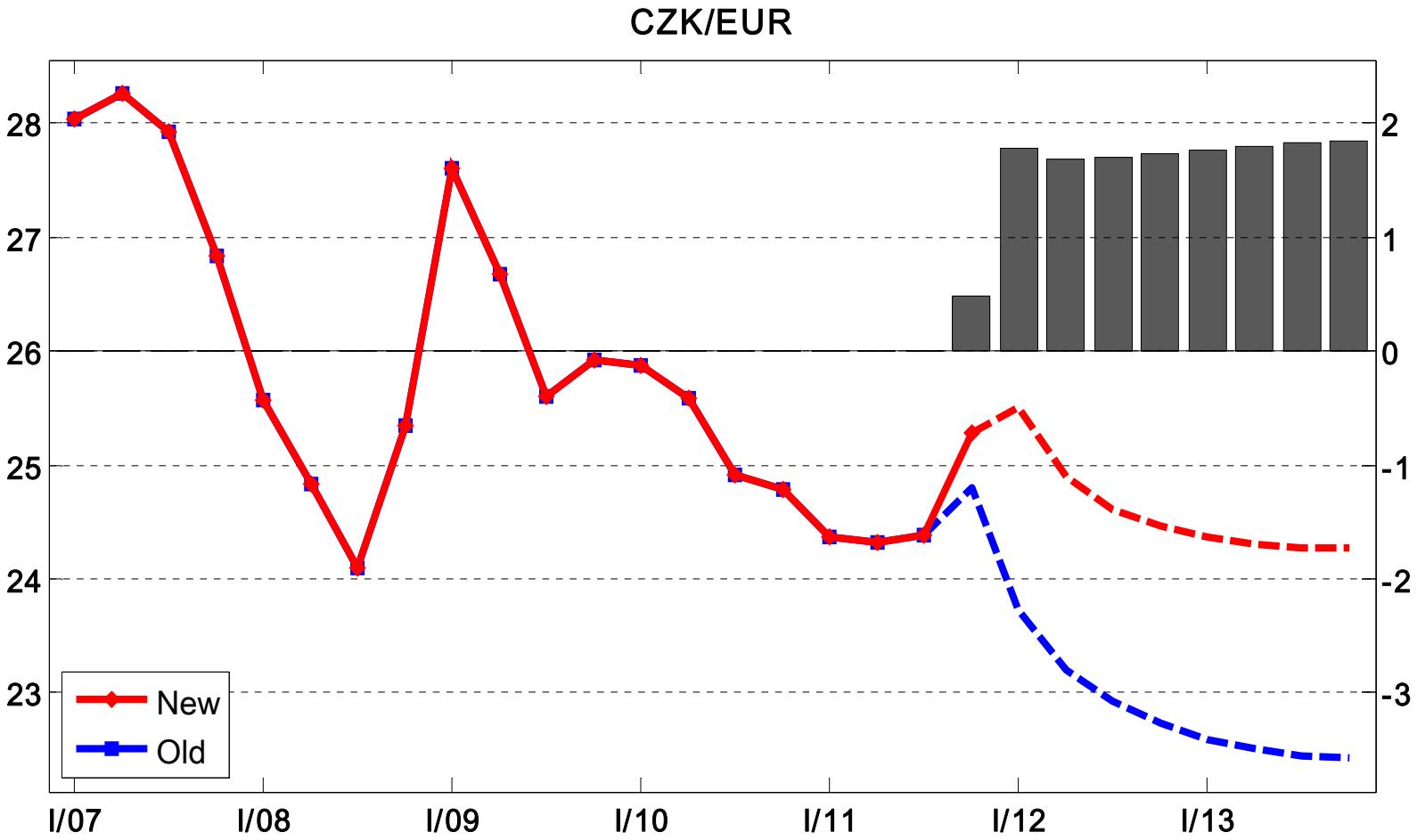


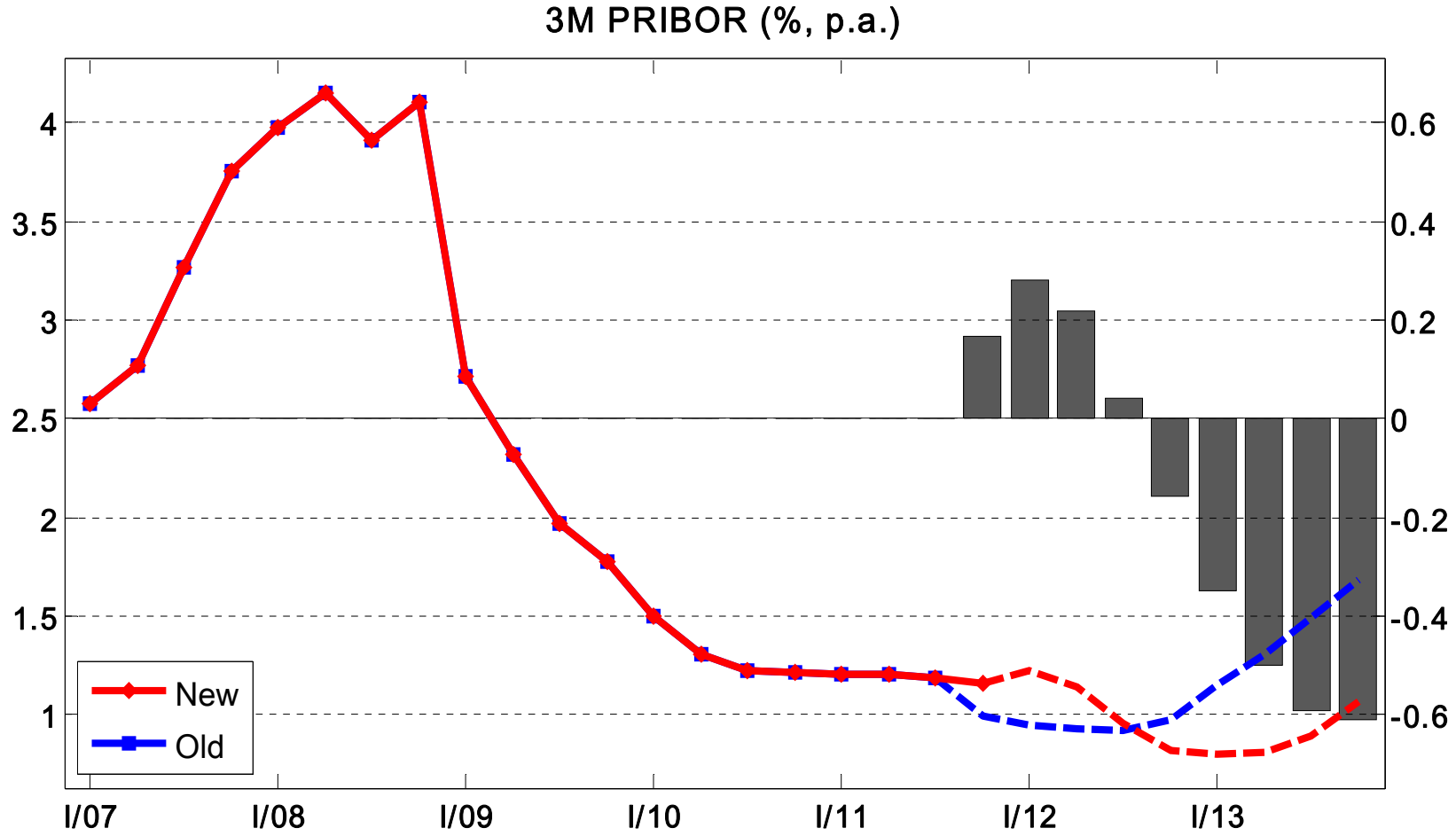
- Reduced outlook for growth of nominal wages reflects worsened prospect for economic activity.
- Forecast of the rate of unemployment lowered due mainly to modified outlook for labour force. Employment forecast slightly decreased.

Changes in Exchange Rate Forecast



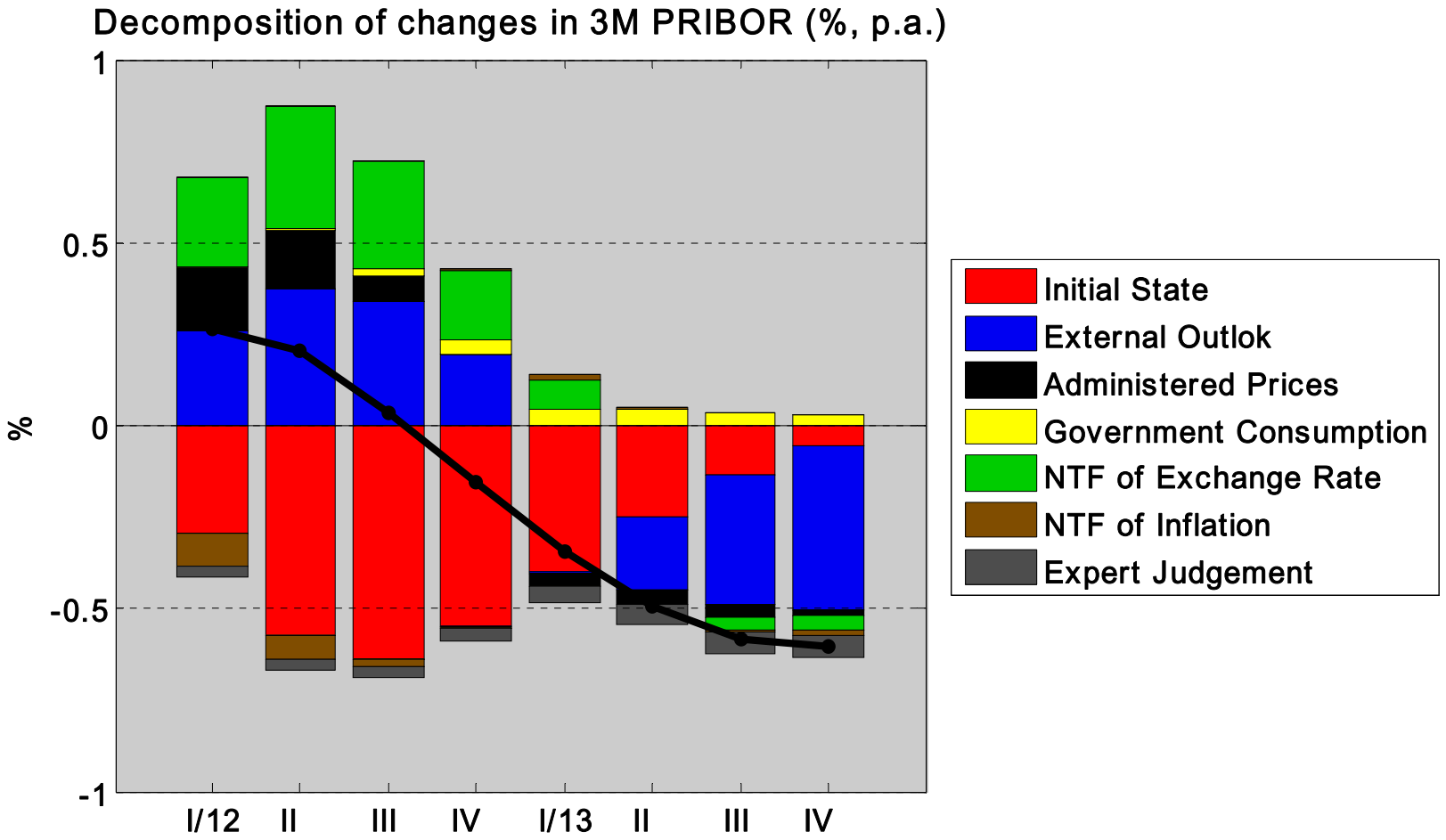
- Weaker exchange rate on the whole horizon caused by recent currency depreciation, downward shift in foreign demand and by revision of nominal net exports in the past.

Changes in Interest Rate Forecast



- Forecast for market interest rates is lower at the longer horizon due mainly to more muted initial domestic inflationary pressures and the decline in foreign interest rate outlook.

Interest Rate Forecast Change Decomposition



- The upward pressure of near-term exchange rate forecast, administered prices and external outlook are gradually offset by more anti-inflationary initial state and lower forecast of EURIBOR.

Major Risks to the Forecast

The risks to the forecast are balanced.

Downside risk:

additional fiscal consolidation measures

Upside risk:

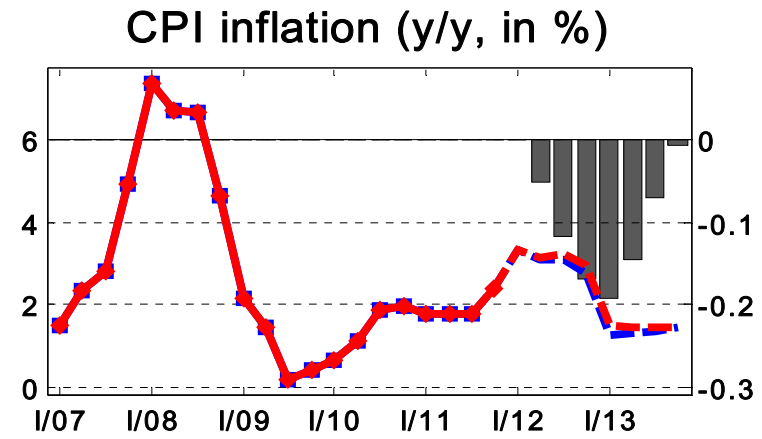
faster food prices growth

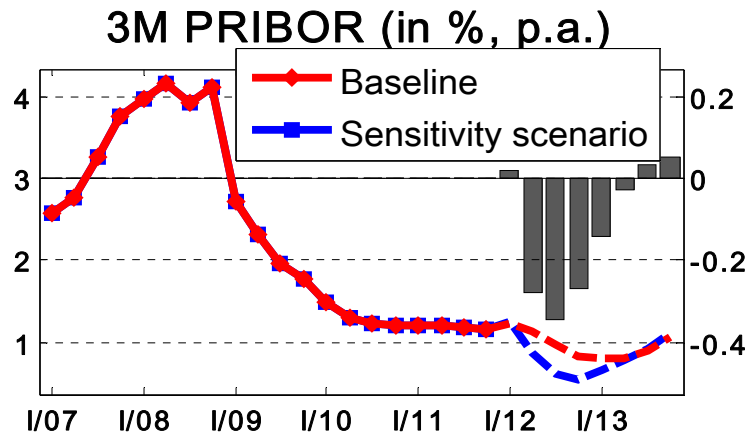
Two-sided risks:

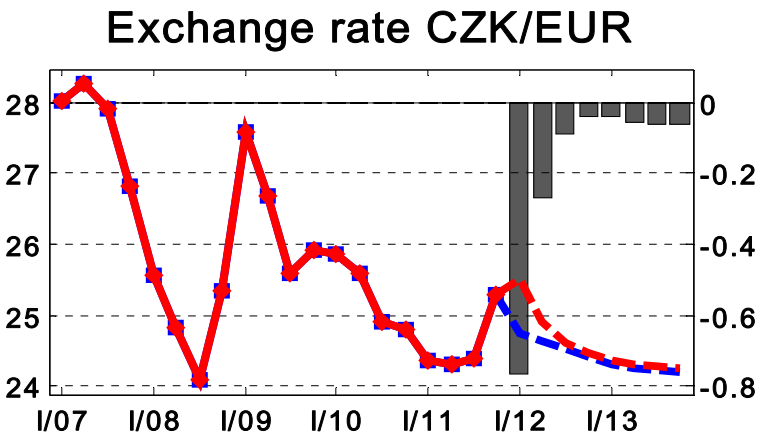
economic developments abroad

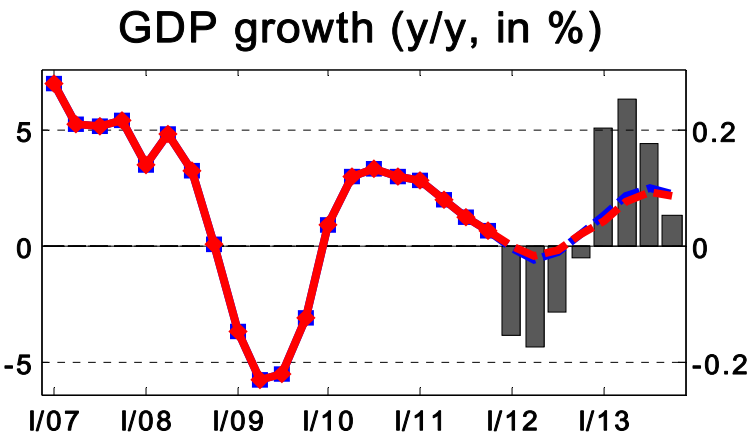
koruna exchange rate

Exchange Rate Sensitivity Scenario (appreciation side)





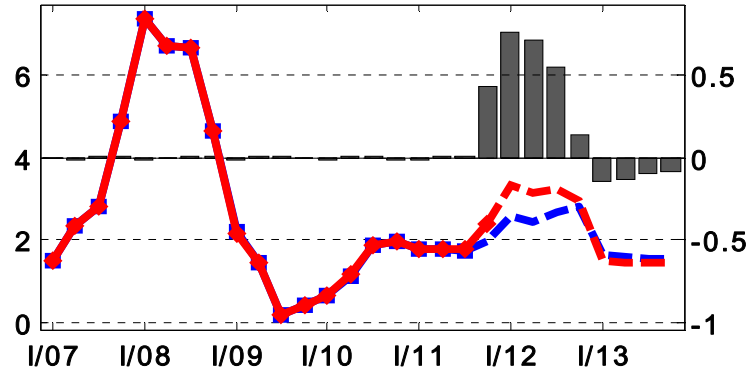




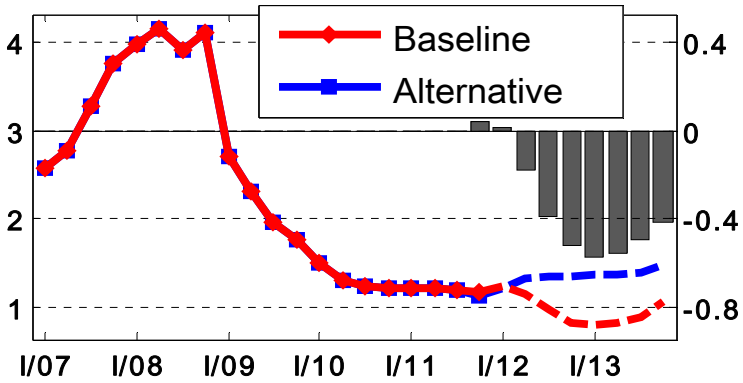
Comparison with Previous Forecast's Alternative Scenario

CNB CZECH NATIONAL BANK

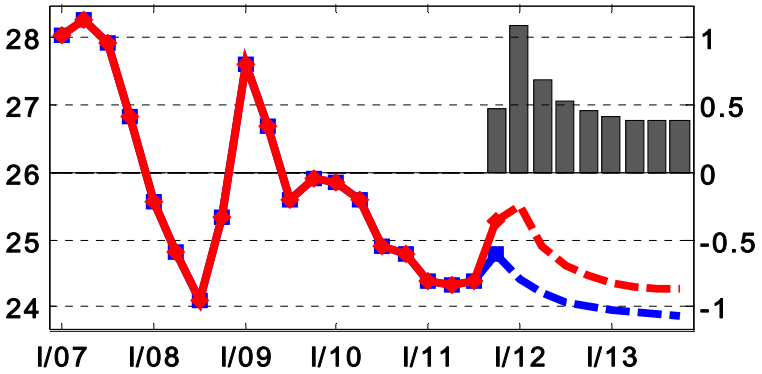
CPI inflation (y/y, in %)



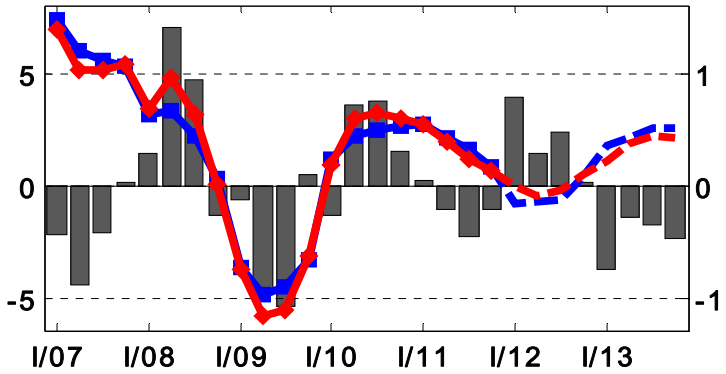
3M PRIBOR (in %, p.a.)



Exchange rate CZK/EUR



GDP growth (y/y, in %)



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