

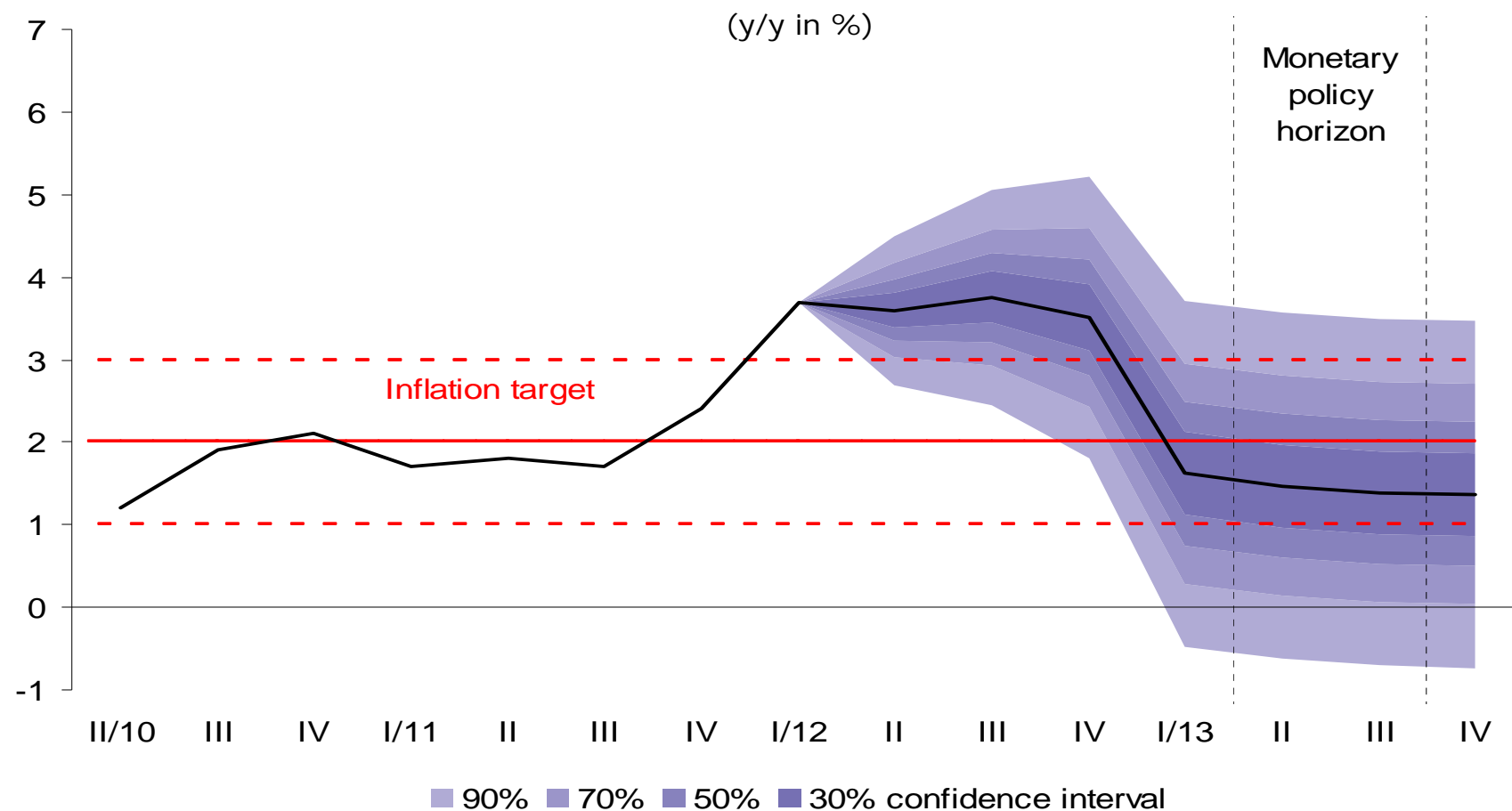
Meeting with Analysts

Tomáš Holub

Prague, 11 May, 2012

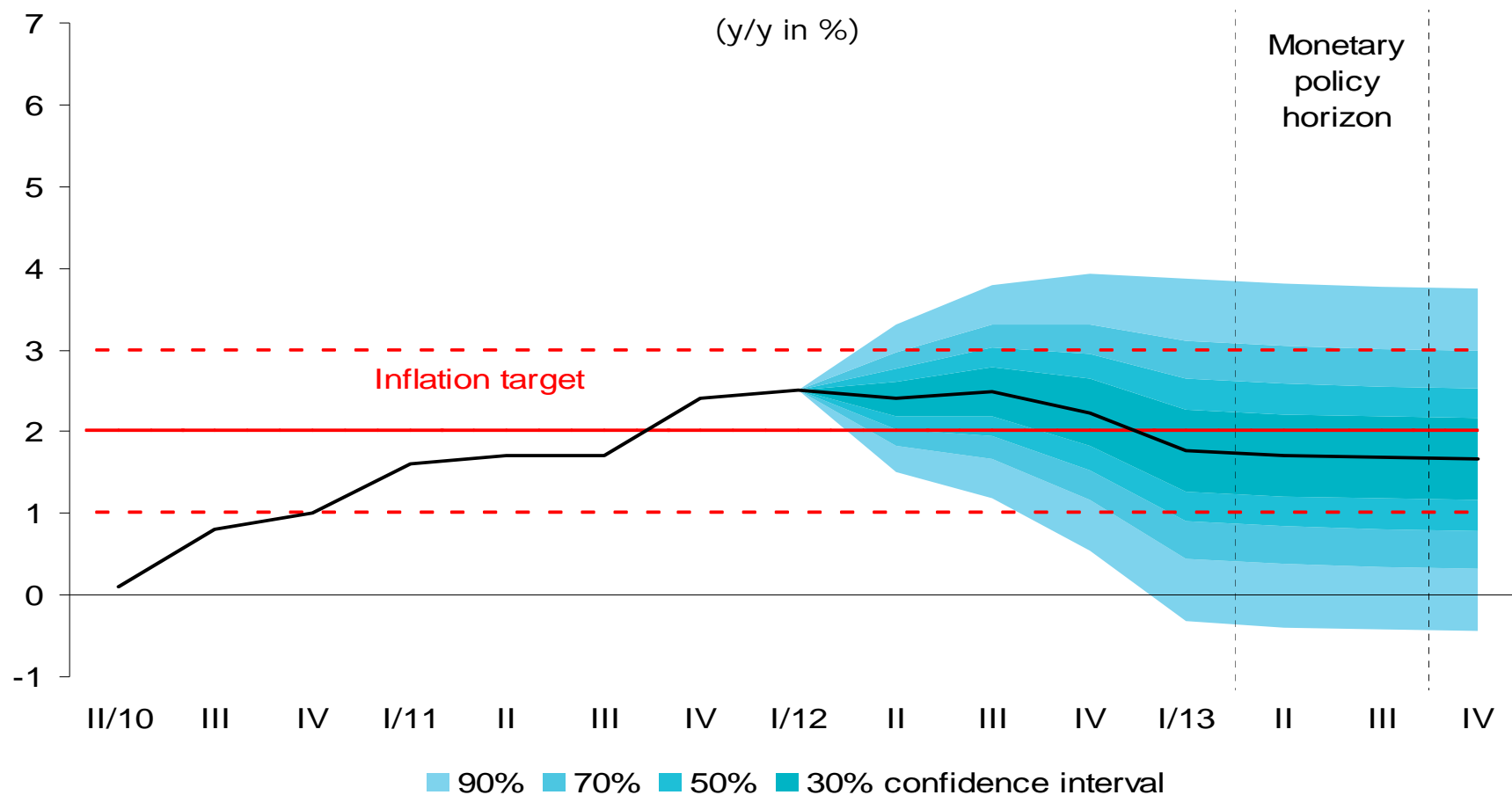
- Headline inflation will be close to the current elevated values in 2012, but will fall below target in 2013. MP relevant inflation will be in the upper half of the tolerance band this year, but will fall slightly below target in 2013.
- Inflation is currently driven by temporary factors: the VAT increase, food and administered prices, and the past weaker exchange rate.
- Domestic economic developments are curbing inflation, moderate price pressures will emerge from 2012 H2.
- The forecast is strongly influenced by a weak foreign demand outlook for 2012 and low euro area interest rates on the whole forecast horizon.
- The Czech economy will stagnate this year as a result of a marked slowdown in external demand and continuing domestic fiscal consolidation. Next year, GDP growth will be just below 2%.
- The nominal exchange rate will be gradually appreciating.
- Consistent with the forecast is a decline in market interest rates in the remainder of this year followed by a rise in rates as from 2013 H2.

Headline Inflation Forecast



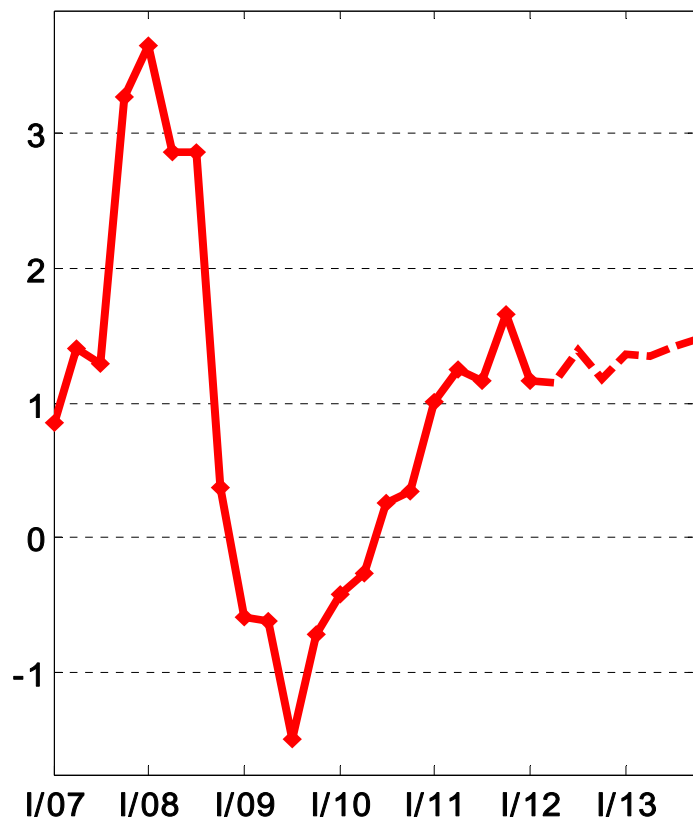
- In 2012, inflation will stay close to the current elevated level due mainly to the reduced VAT rate increase.
- In 2013, inflation will fall below the target.

MP-Relevant Inflation Forecast

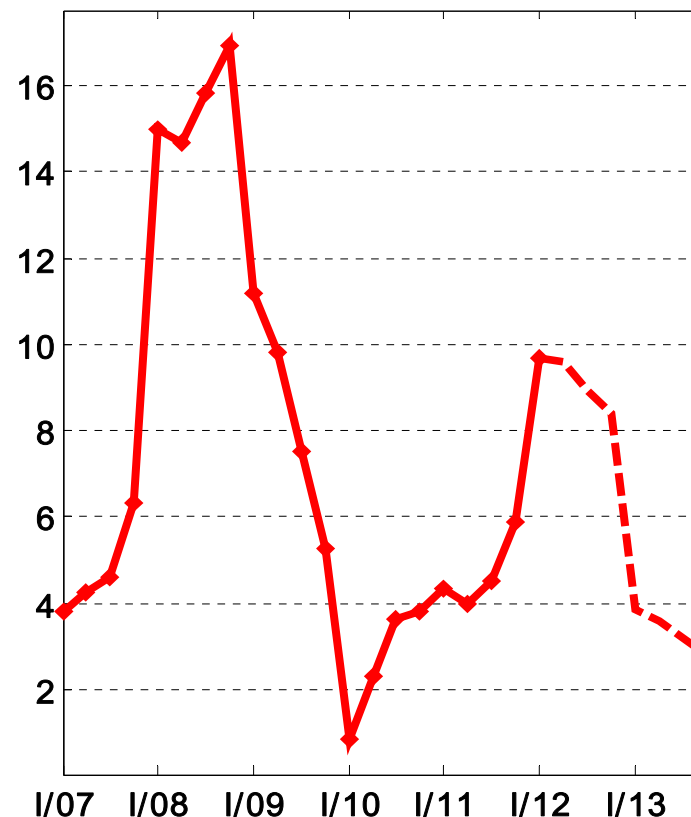


- MP-relevant inflation will be in the upper half of the target's tolerance band in 2012, but will fall slightly below the target in 2012.
- Second-round effects of VAT changes (on inflation expectations and wage formation) are assumed negligible.

Net Inflation (y/y, in %)

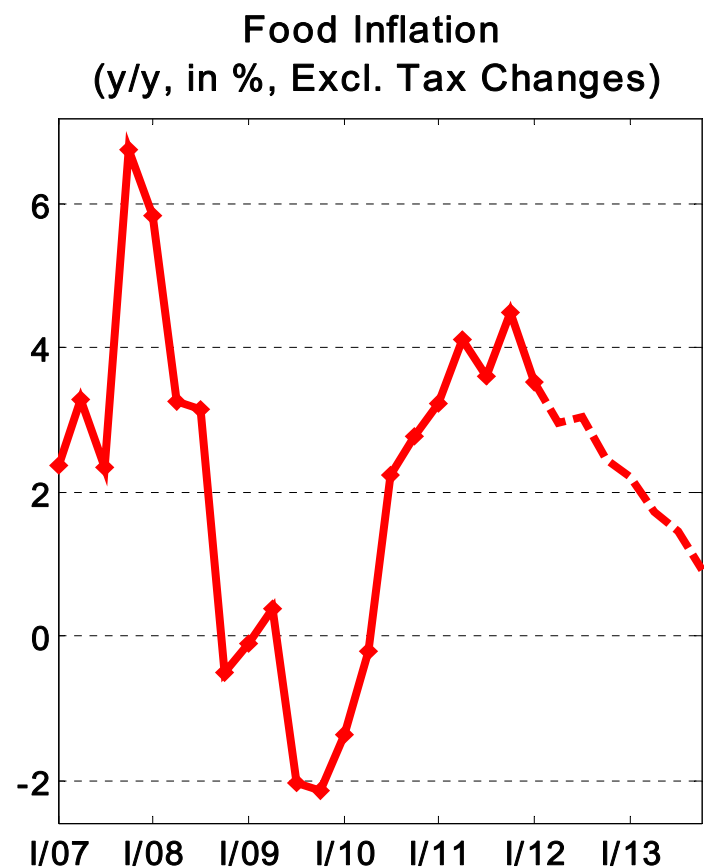
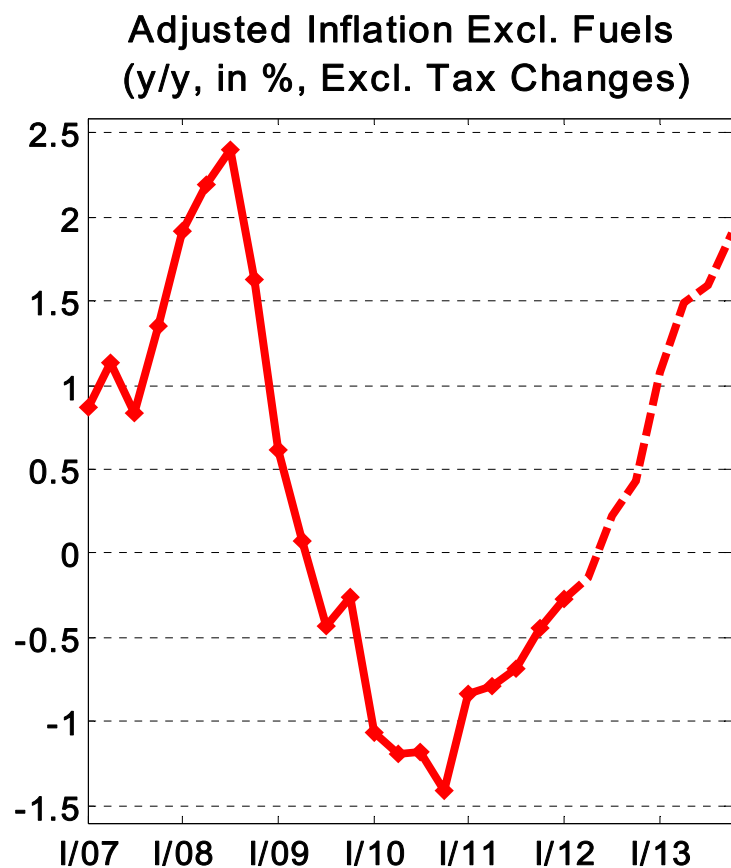


Growth of Administered Prices (y/y, in %)



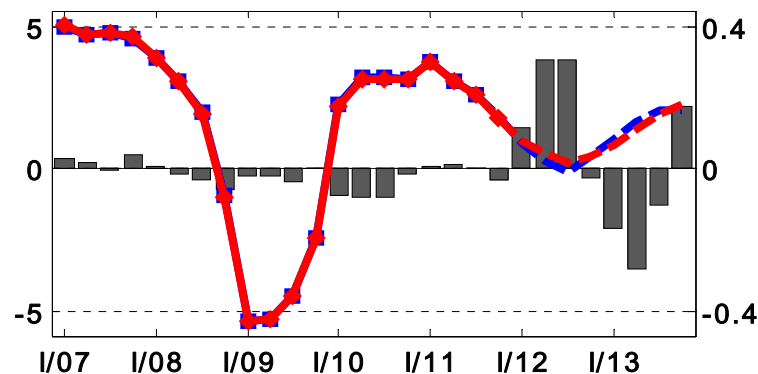
- Net inflation will be broadly stable this year, followed by a gradual acceleration next year.
- Growth of administered prices has reached its peak, and will slow down mainly at the beginning of 2013 (partly due to VAT changes).

Adjusted Inflation Excluding Fuels; Food Prices

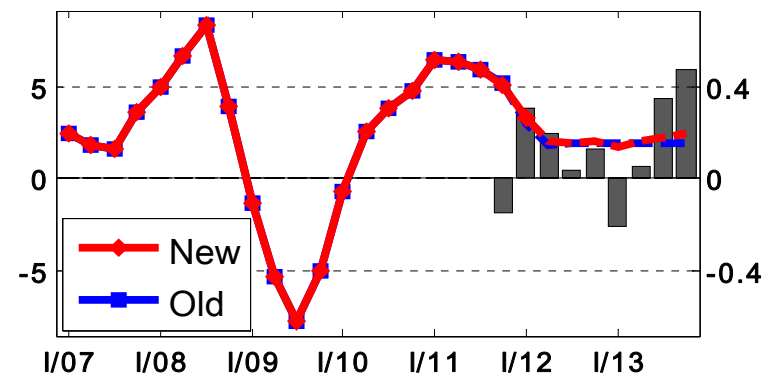


- Core inflation has remained negative due to subdued economic activity and slow wage growth. It will turn positive in 2012 Q3 and grow further.
- Food prices surprised on the upside in 2012 Q1 (full VAT pass-through), but are expected to slow down (y/y fall in agricultural producer prices).

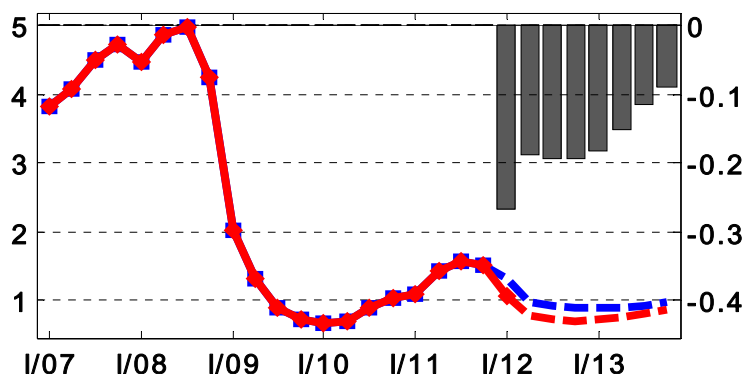
Growth Rate of GDP - Eurozone (y/y, in %)



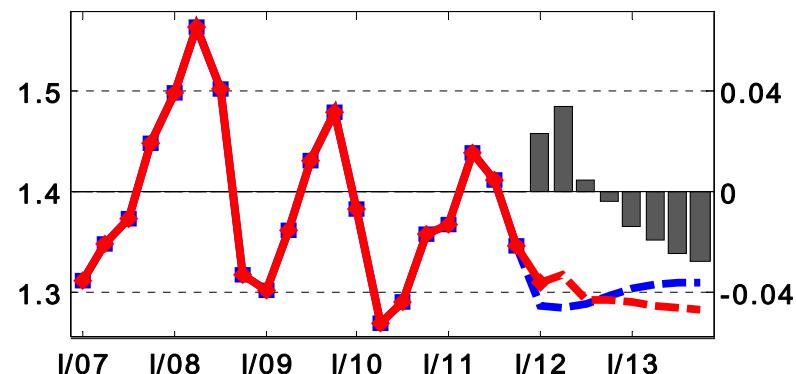
PPI Inflation - Eurozone (y/y, in %)



3M EURIBOR



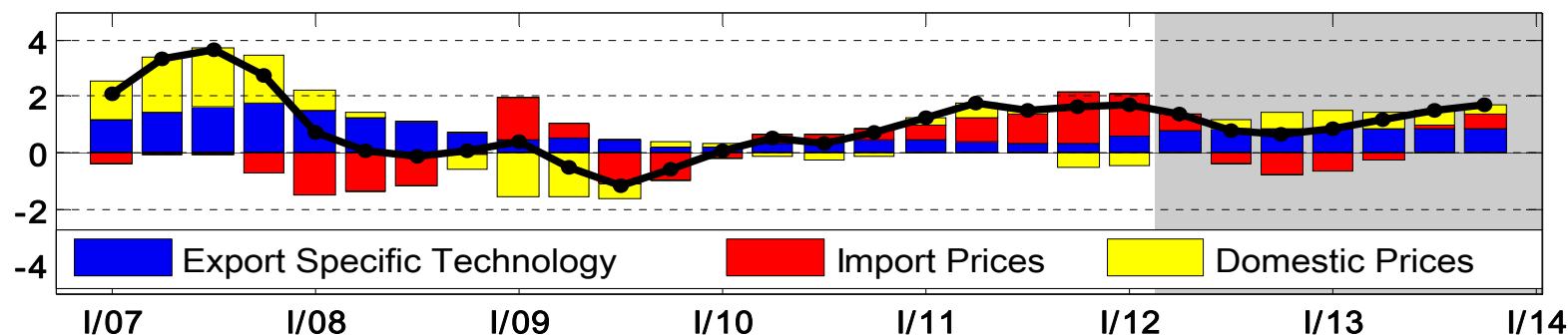
USD/EUR



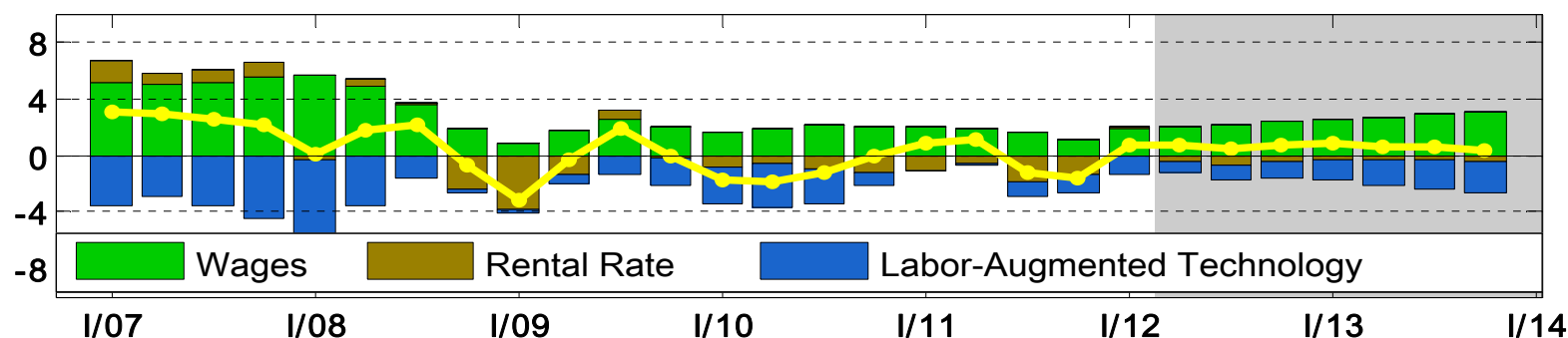
- Significant GDP slowdown in the effective euro area in 2012
- Low 3M EURIBOR reflecting the ECB's measures and weak growth
- PPI growth expected to slow down (fading effect of commodities)

Domestic Costs vs. Import Prices

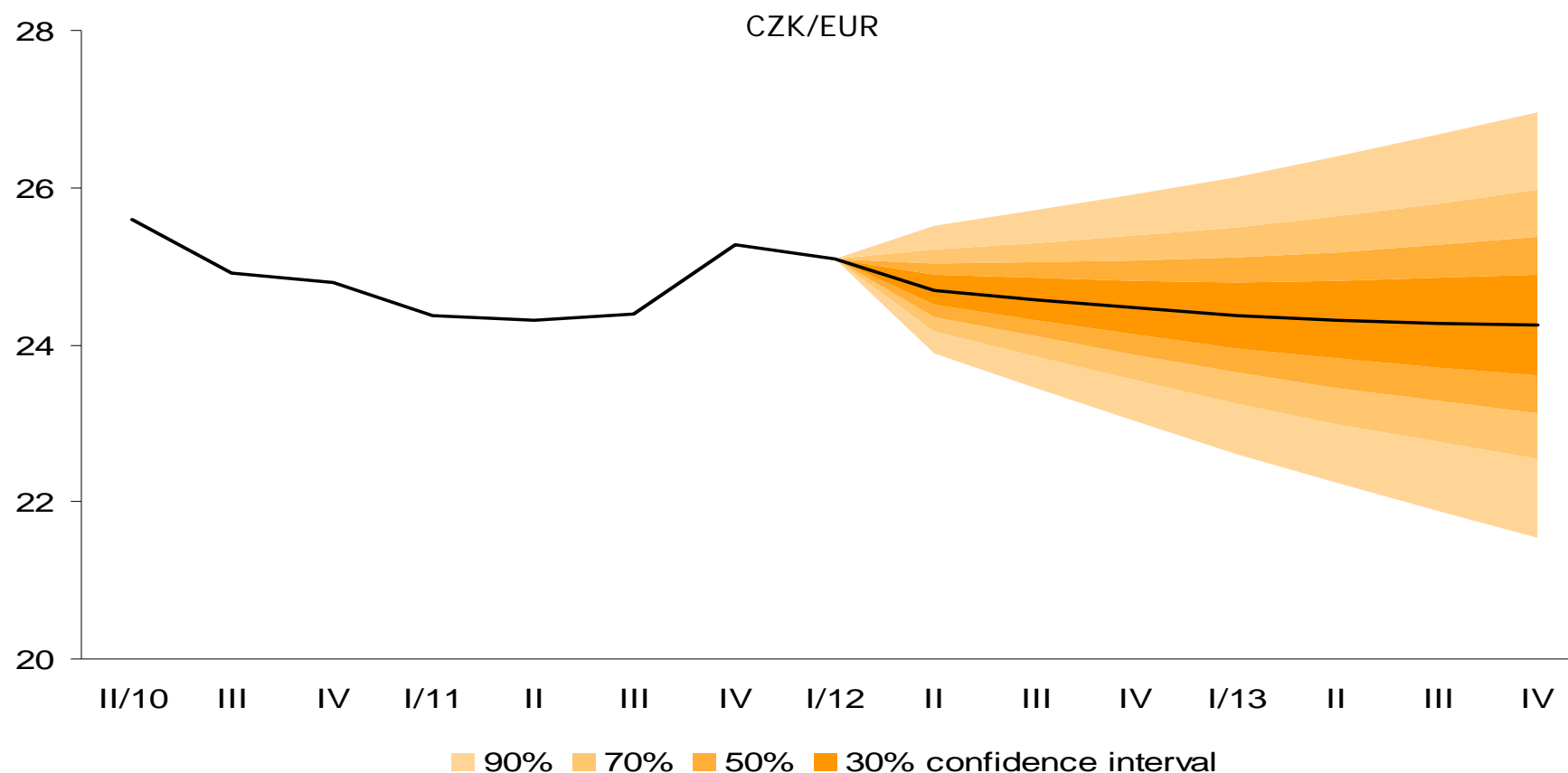
Nominal Marginal Cost in Consumption Sector (q/q, in %, ann.)



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

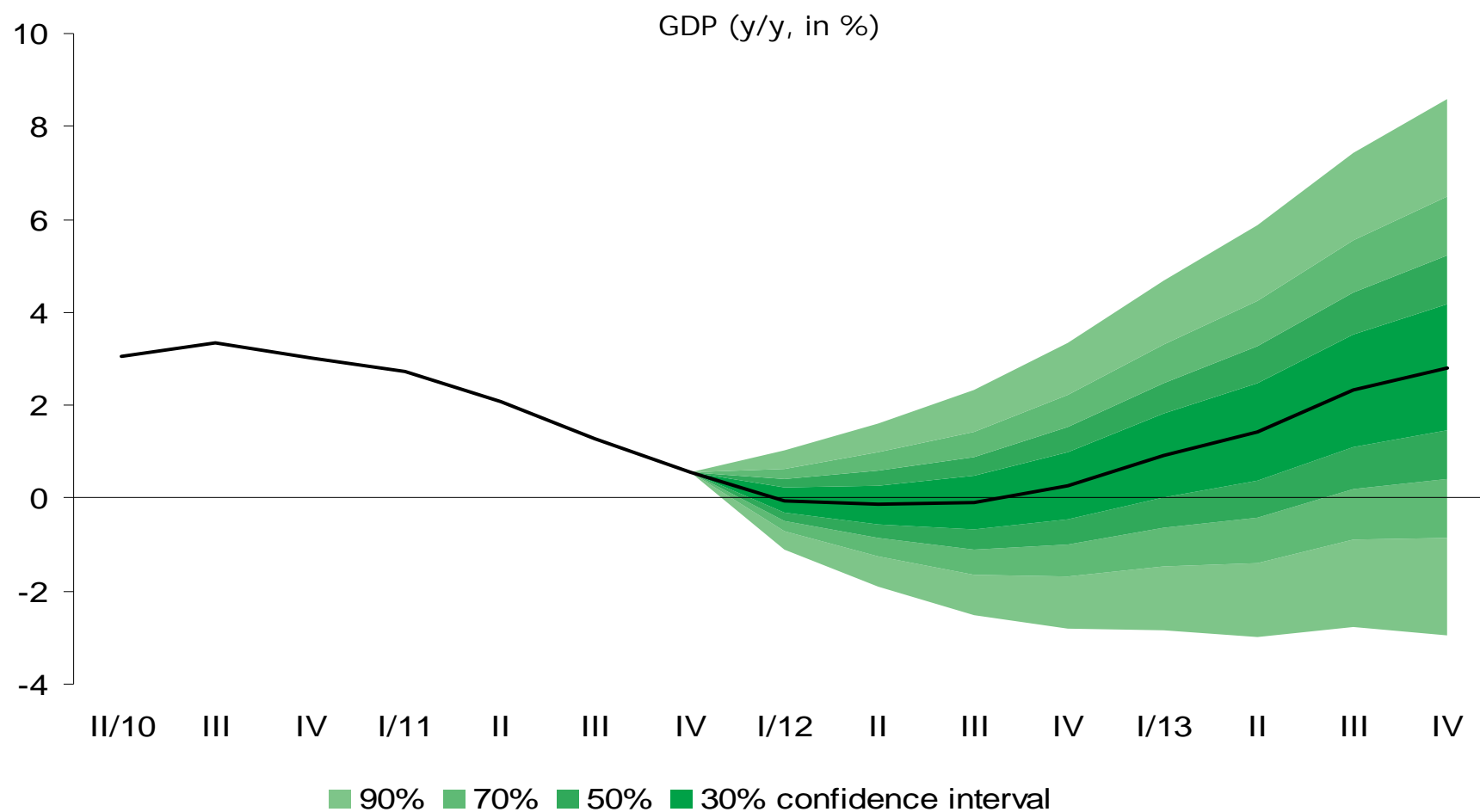


- Inflationary pressures currently stem from import prices, domestic economy is subdued and contributes to slower price growth.
- The situation will reverse from 2012 H2, but the intensity of domestic inflationary pressures will still remain moderate.



- Near-term forecast for 2012 Q2: CZK/EUR 24.7 (developments in Q1, good foreign trade performance in early-2012, interest rate differential)
- The exchange rate will appreciate gradually (expected recovery in foreign demand and renewed long-term convergence).

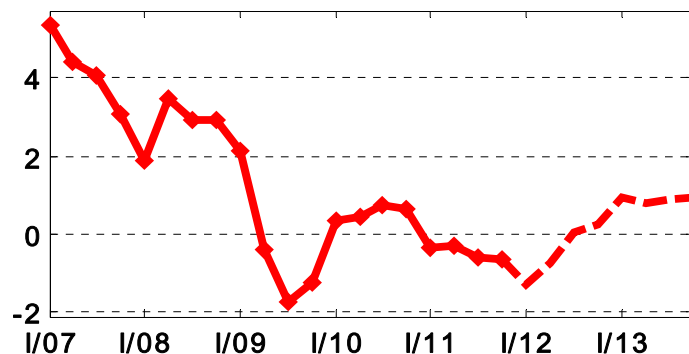
GDP Growth Forecast



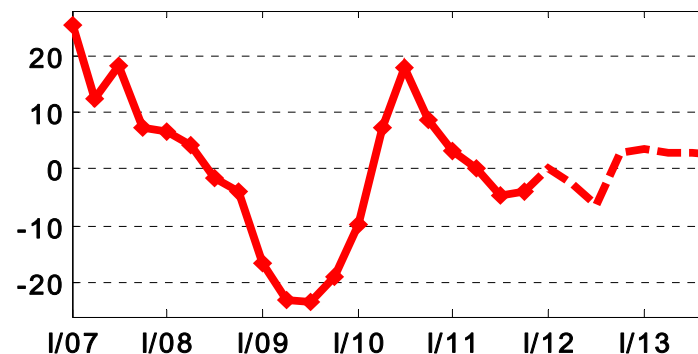
- GDP growth forecast: 0% for the current year and 1.9% in 2013
- Stagnation in 2012 due to the foreign economic slowdown and ongoing domestic fiscal consolidation

Forecast of Aggregate Demand

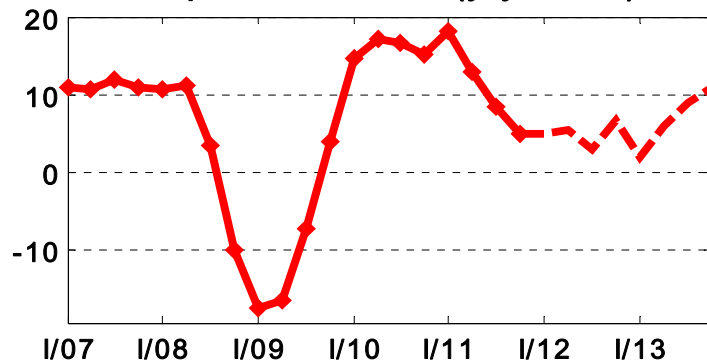
Household Consumption Growth (y/y, in %)



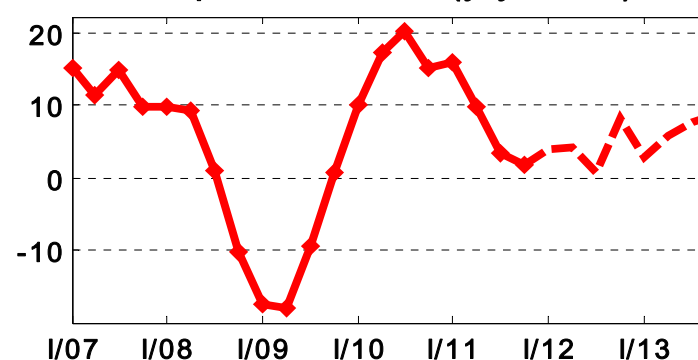
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)

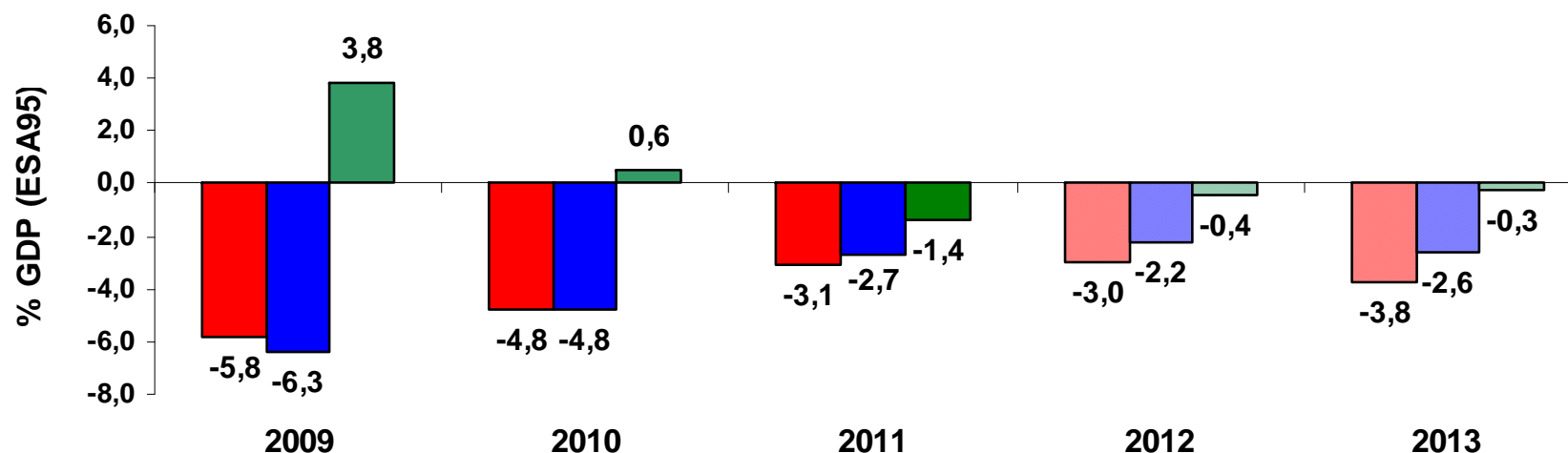


Imports Growth (y/y, in %)



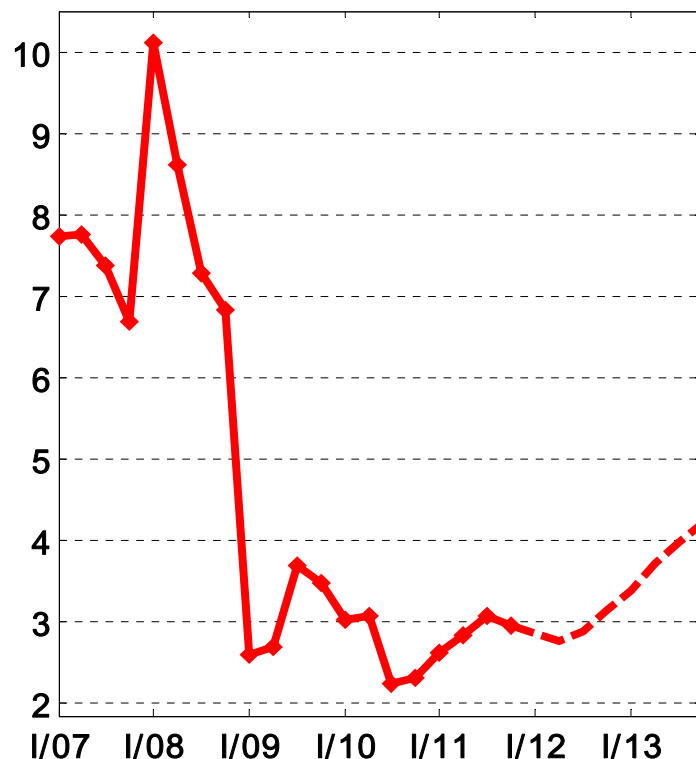
- Private consumption growth will revive only gradually due to labour market slack as well as the elevated inflation level in 2012.
- Low investment growth as a reaction to weak demand
- Slow export growth, but positive contribution of net exports

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

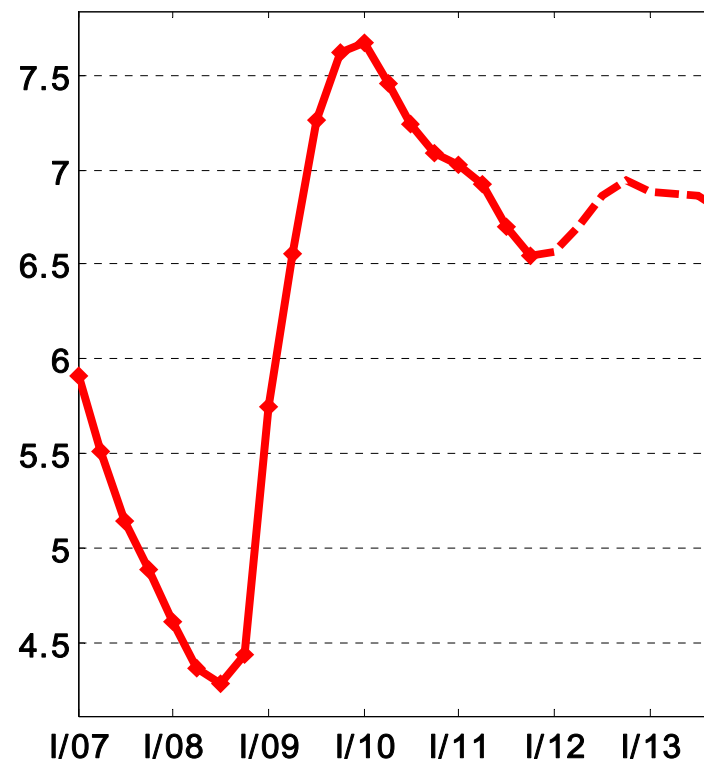


- 2011: downward surprise (deficit at 3.1% GDP) caused by weak government investment; fiscal impulse -1 p.p. to GDP growth
- 2012: government deficit at 3.0% of GDP; fiscal impulse -0,2 p.p.
 - (reduced VAT rate 10%→14% vs. pick-up in gov't investments).
- 2013 baseline: government deficit at 3.8% of GDP; zero fiscal impulse
 - (VAT rates unification at 17.5%, launch of pension reform, growth in gov't investments, further gov't consumption restraint)

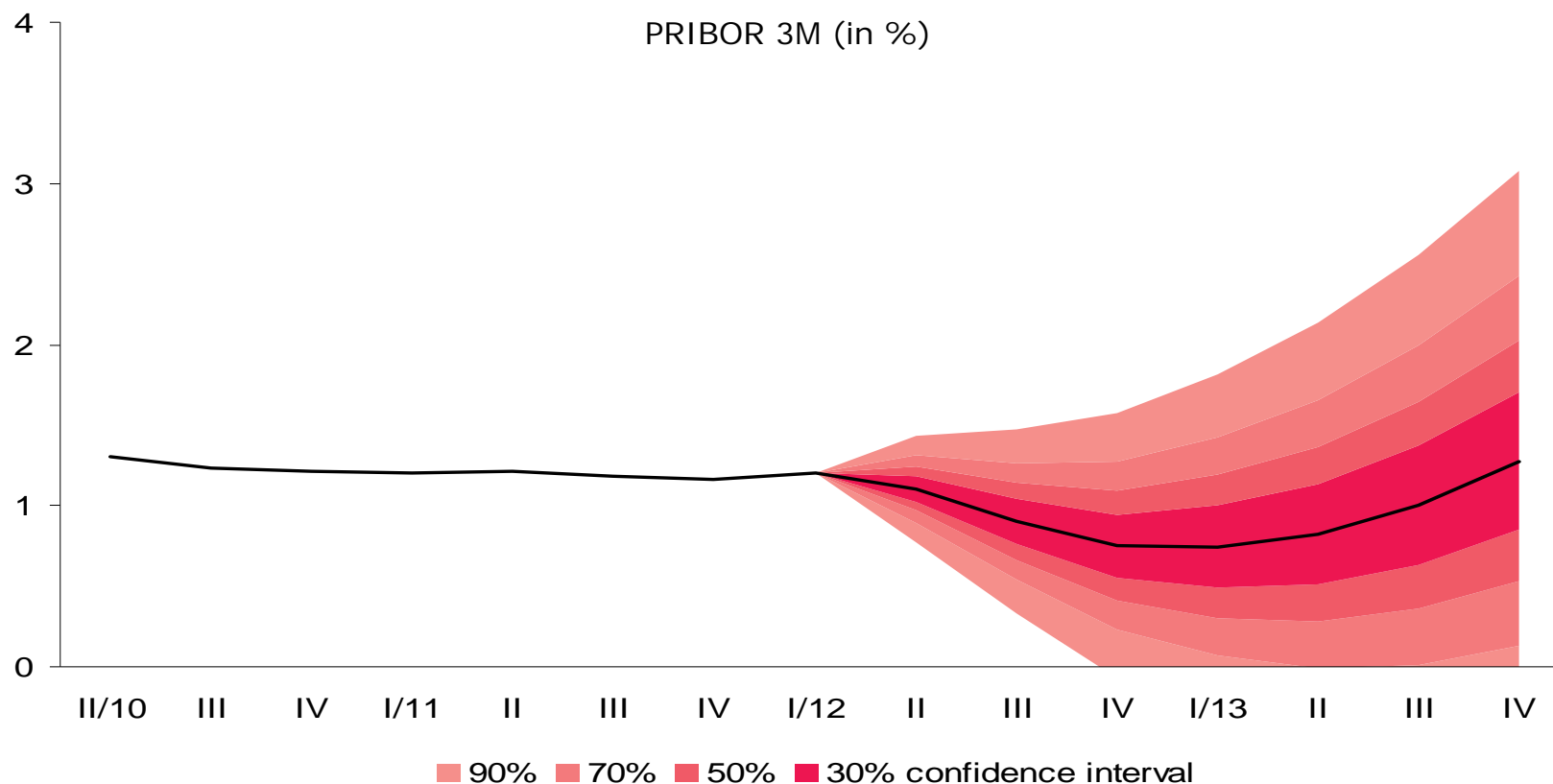
Nominal wage growth in business sector
(y/y, in %, s.a.)



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



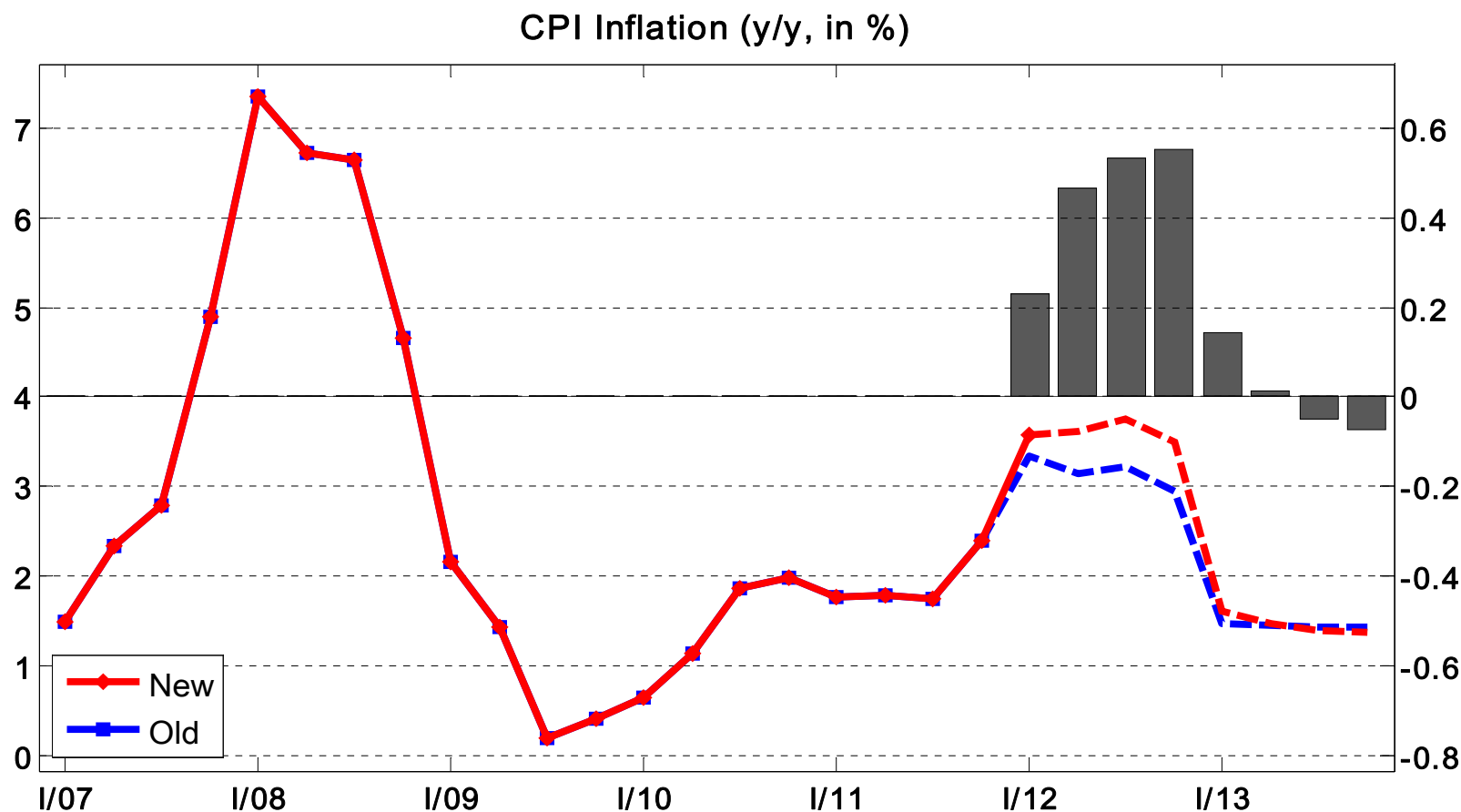
- Nominal wage growth will gradually accelerate from 2012 H2, together with (expected) revival in economic growth.
- The unemployment rate (ILO) will increase slightly due to a moderate decline in employment.



- Consistent with the forecast is a decline in market interest rates in the remainder of this year followed by a rise in rates as from 2013 H2.
- Subdued domestic economy and slow wage growth, low foreign interest rate outlook; In the near term, these factors are only partly counter-balanced by elevated inflation, administered and import prices.

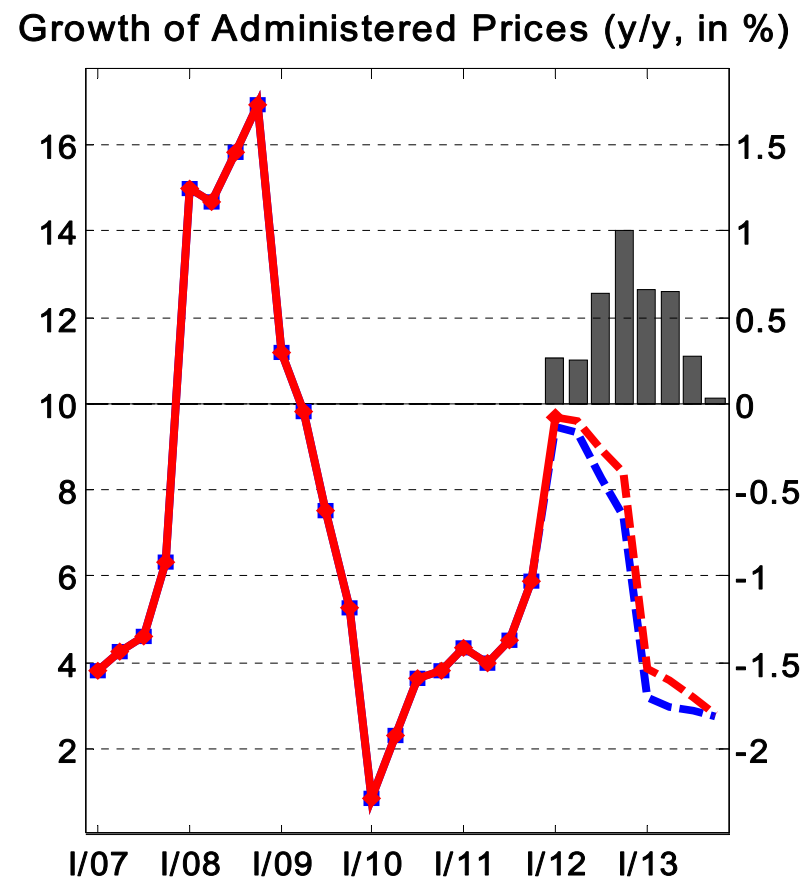
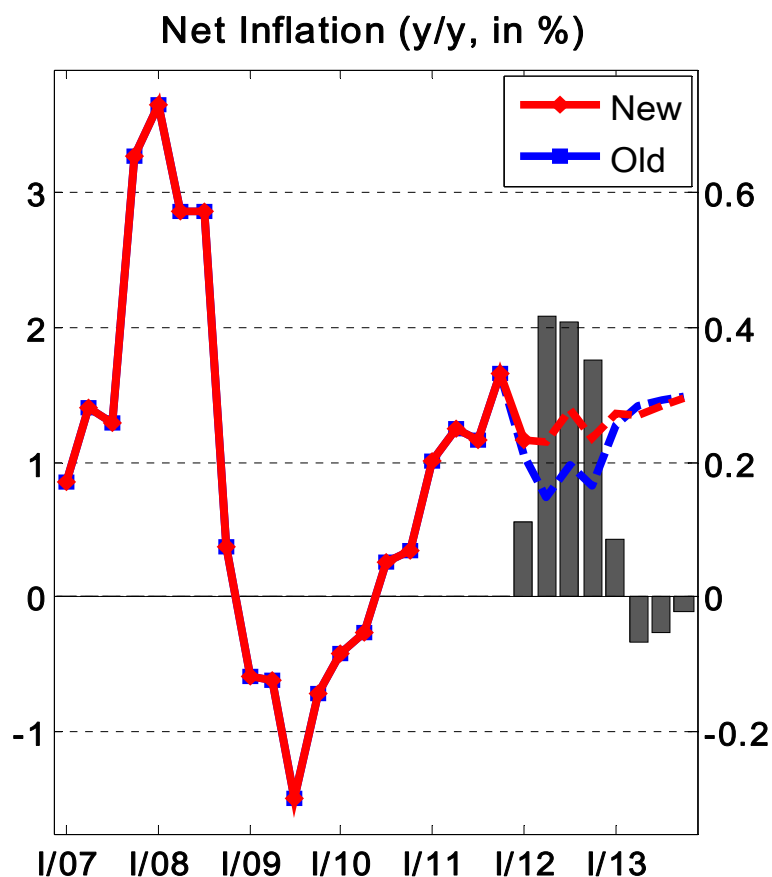
- The forecast of headline and MP-relevant inflation was increased for this year due to the upside surprise in Q1 2012. The forecast for 2013 remains almost unchanged.
- Food prices and regulated prices were revised up, core inflation down (on the entire forecast horizon).
- The GDP forecast did not change significantly.
- Slightly faster growth of nominal wages.
- The exchange rate path is stronger in the near-term, but unchanged for the longer-term.
- The interest rate path is insignificantly lower for the near-term, and slightly higher at its longer end.

Comparison with Previous Inflation Forecast (i)



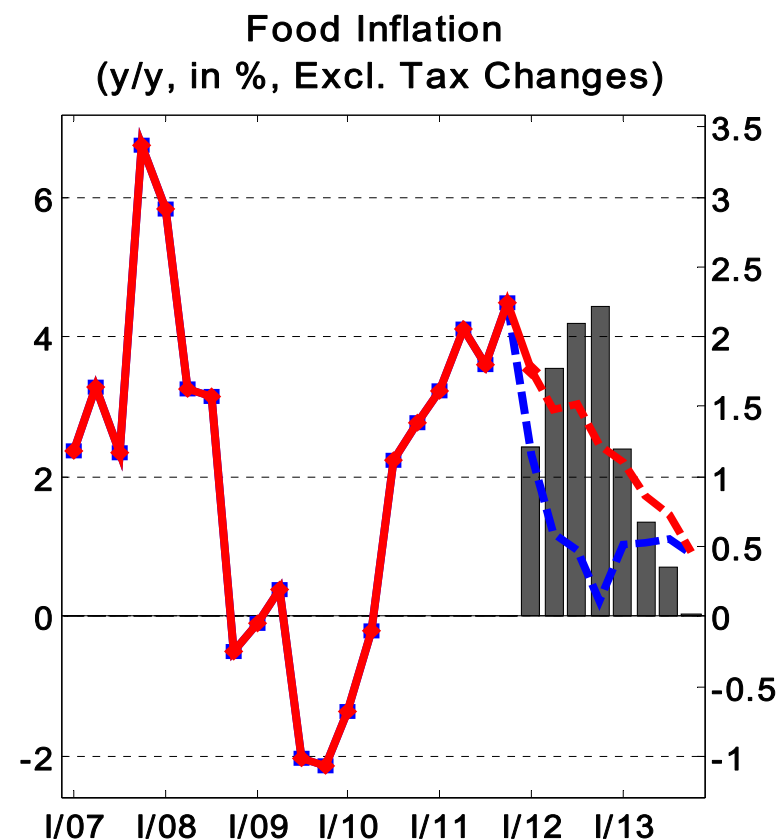
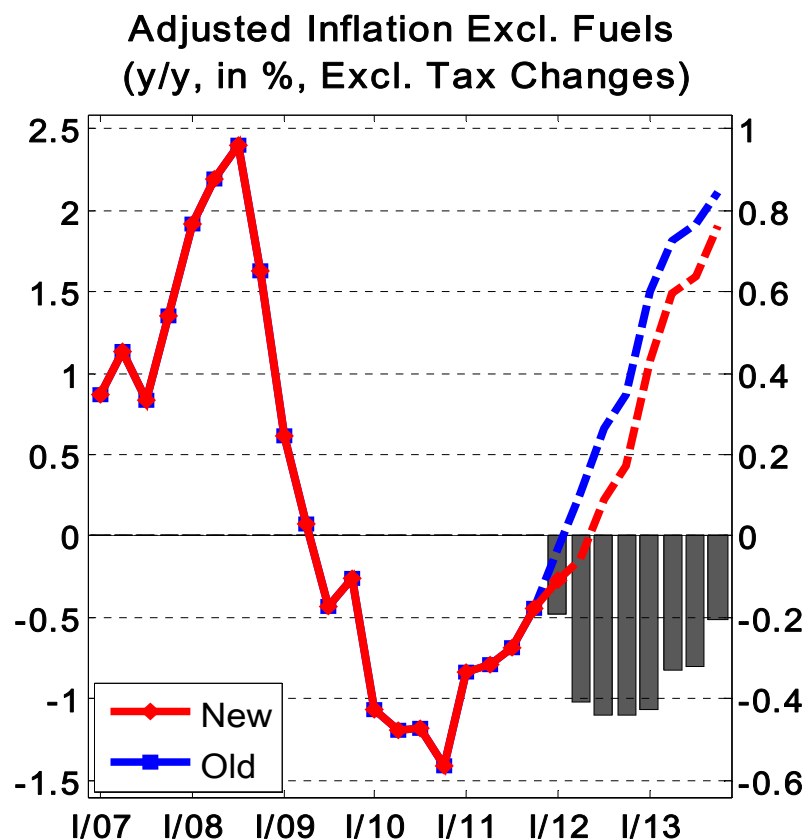
- The forecast of headline (as well as MP-relevant) inflation for 2012 was increased, but remains almost unchanged for 2013 (and thus for the monetary policy horizon).

Comparison with Previous Inflation Forecast (ii)



- Net inflation forecast is higher in 2012, reflecting mainly a faster growth of food prices (and to a lesser extent fuel prices).
- Growth of administered prices is also higher on the entire forecast horizon (gas prices, healthcare, water supply and sewage).

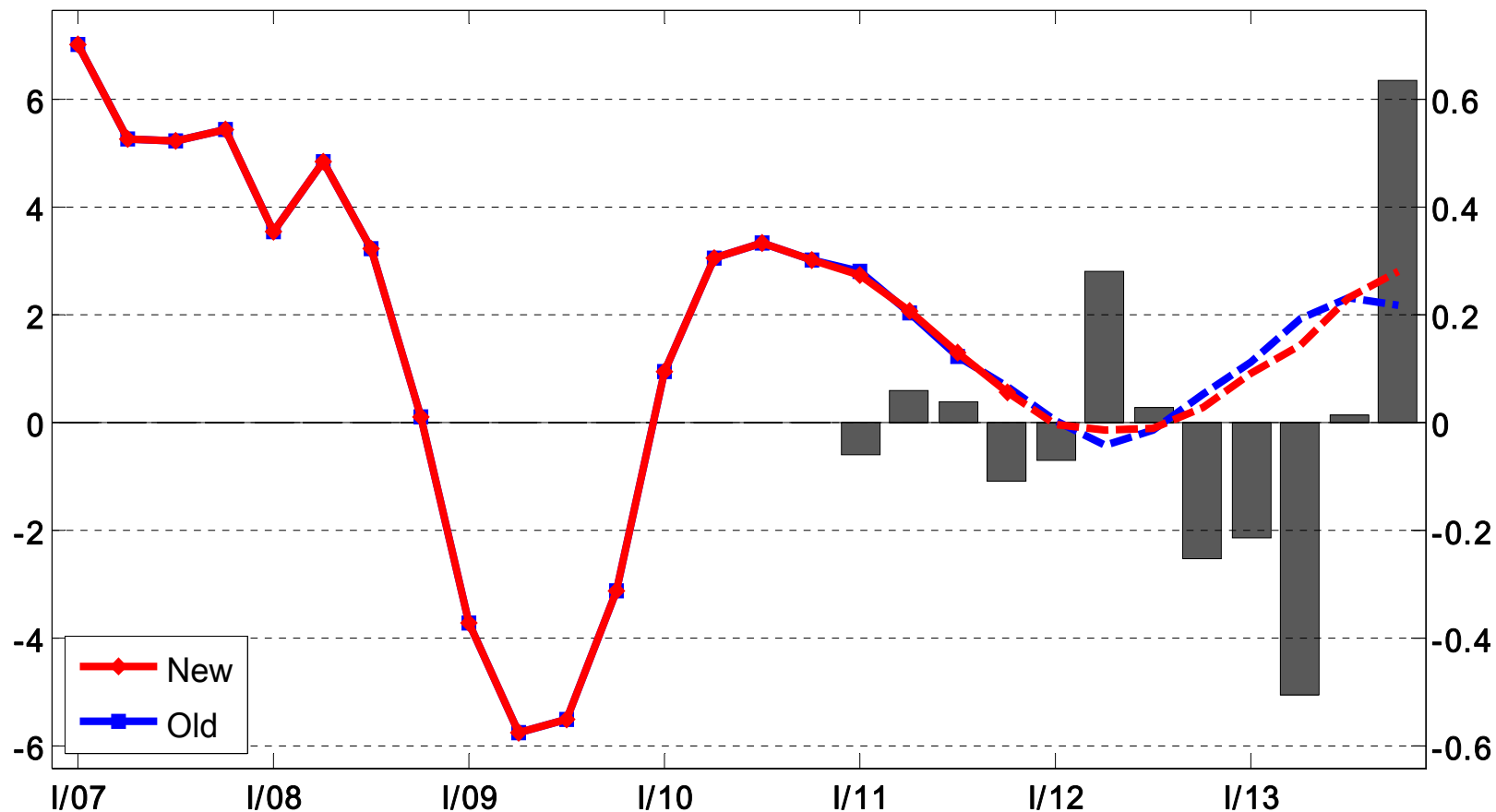
Comparison with Previous Inflation Forecast (iii)



- The lower forecast of core inflation reflects its 2012 Q1 level, stronger exchange rate and more anti-inflationary domestic economy.
- Forecast of food price growth was increased due to the recent upward surprise and slightly higher outlook for agricultural commodity prices.

Comparison with Previous GDP Forecast (i)

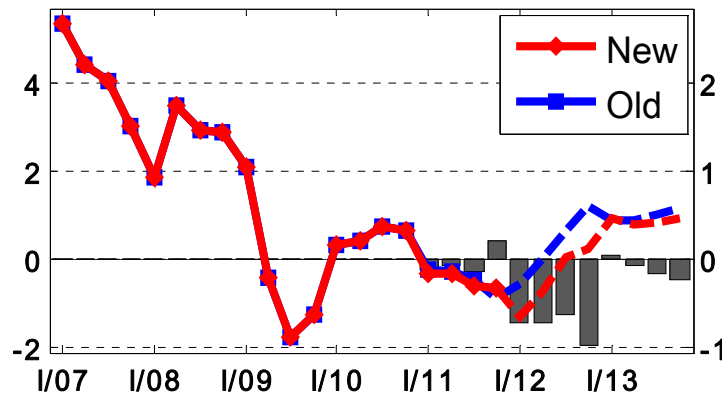
GDP Growth (y/y, in %)



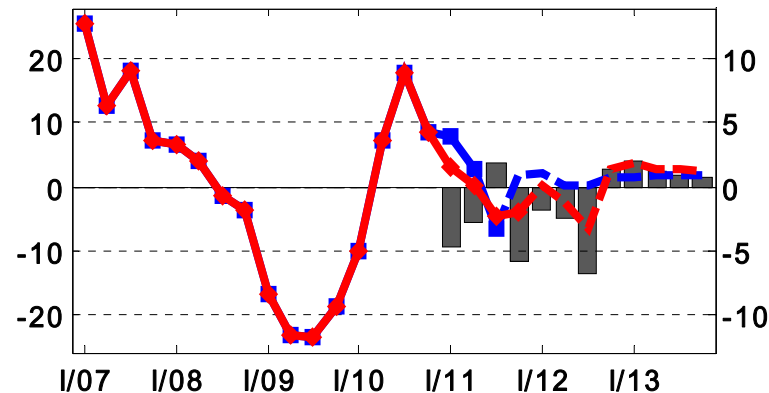
- The overall GDP forecast did not change significantly, some shifts are apparent in its structure only.

Comparison with Previous GDP Forecast (ii)

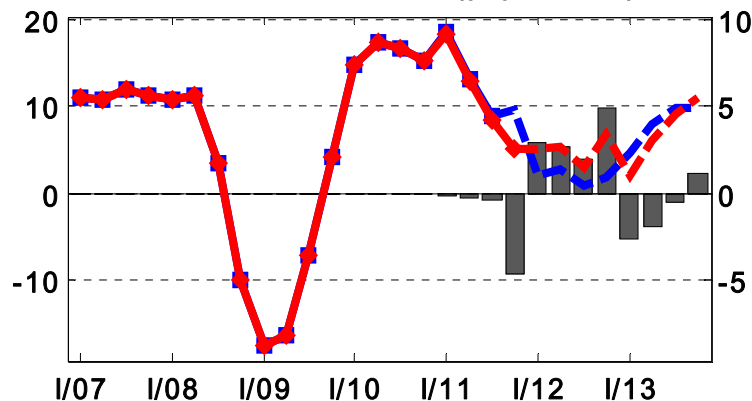
Household Consumption Growth (y/y, in %)



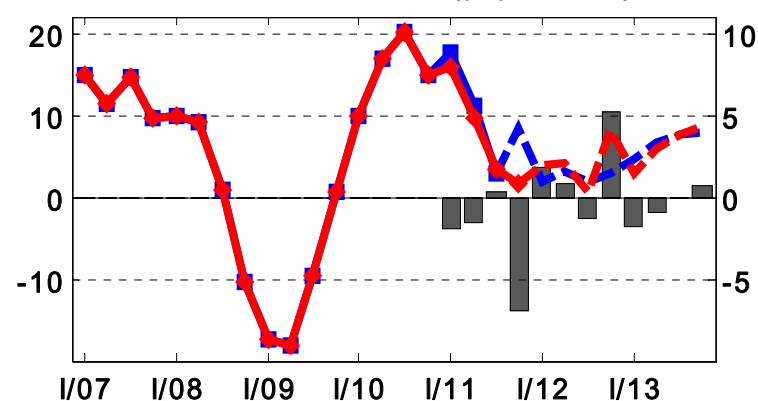
Investments Growth (y/y, in %)



Exports Growth (y/y, in %)



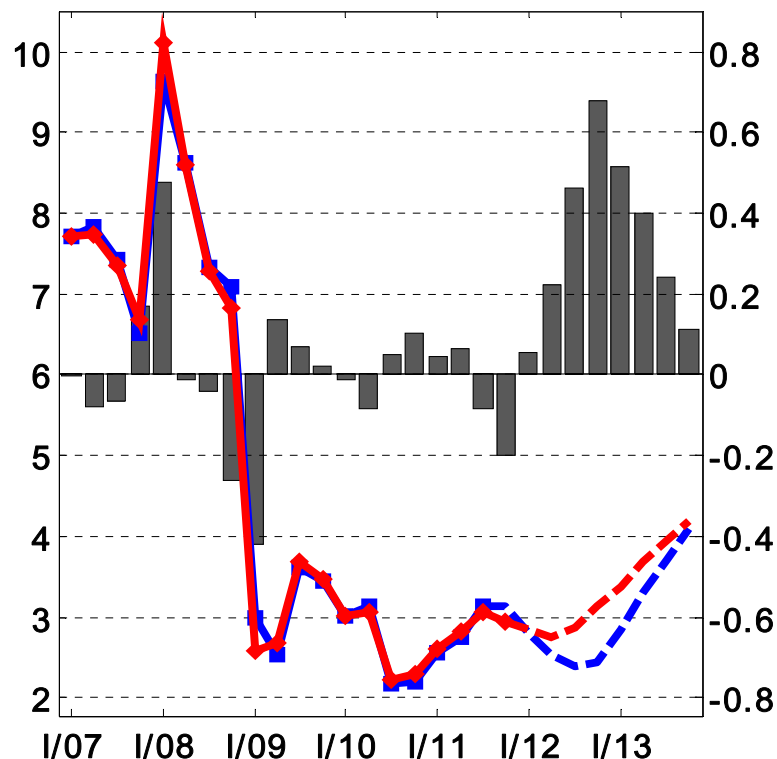
Imports Growth (y/y, in %)



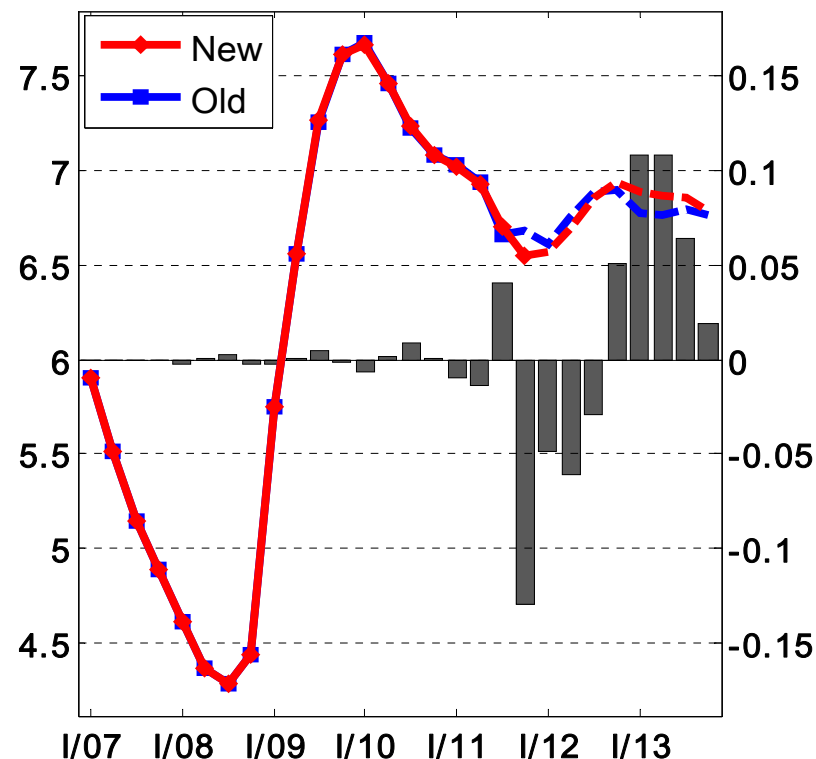
- Weaker domestic demand vs. more positive net exports in 2012
- Growth of exports and imports revised up for this year due to a good foreign trade performance in January and February.

Changes in Labour Market Forecast

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

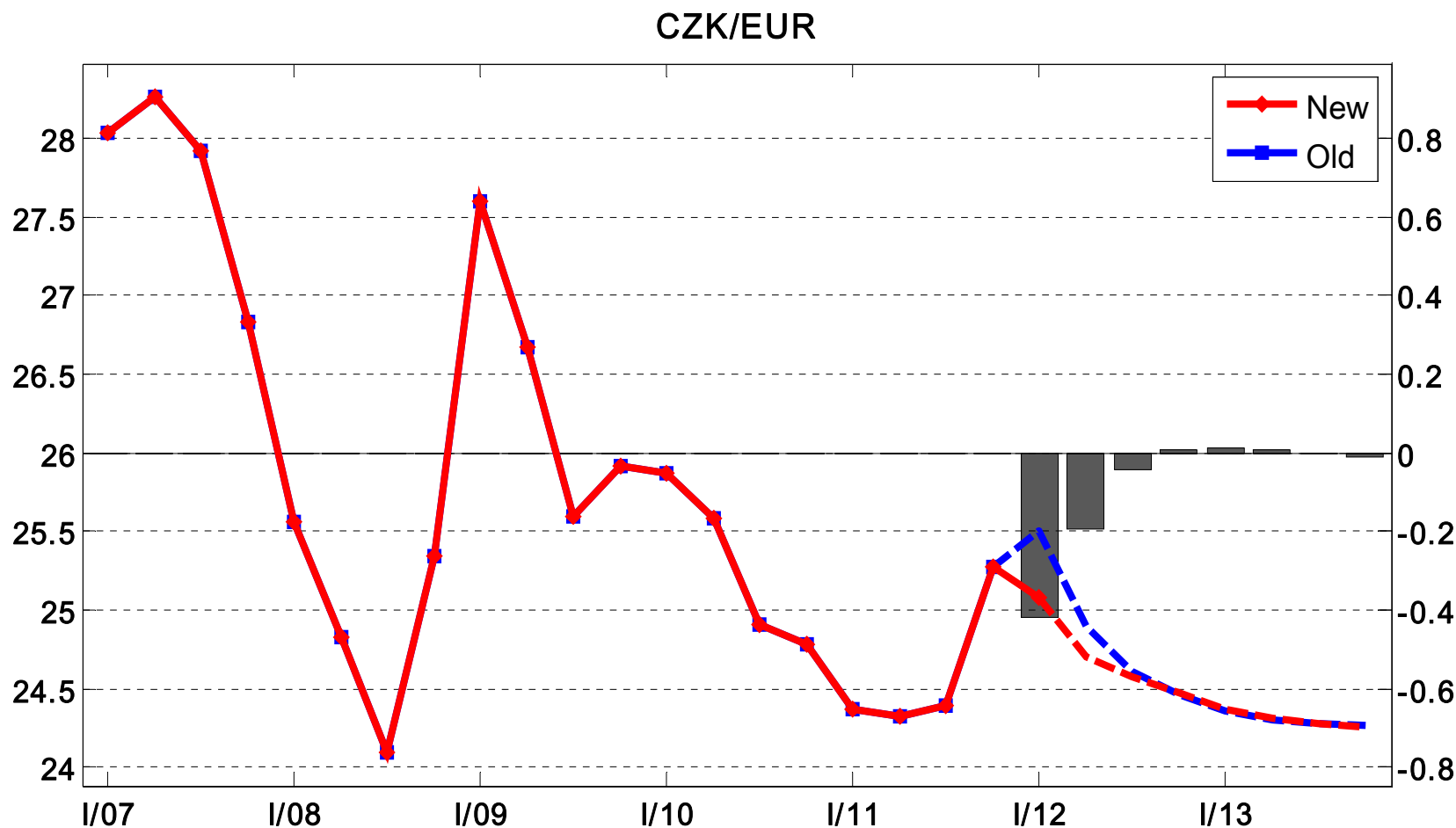


General unemployment rate (ILO)
(in %, s.a.)



- Slightly higher growth of nominal wages reflects mainly the observed faster growth of wages in the industry in early-2012.
- Forecast of the unemployment rate is almost unchanged.

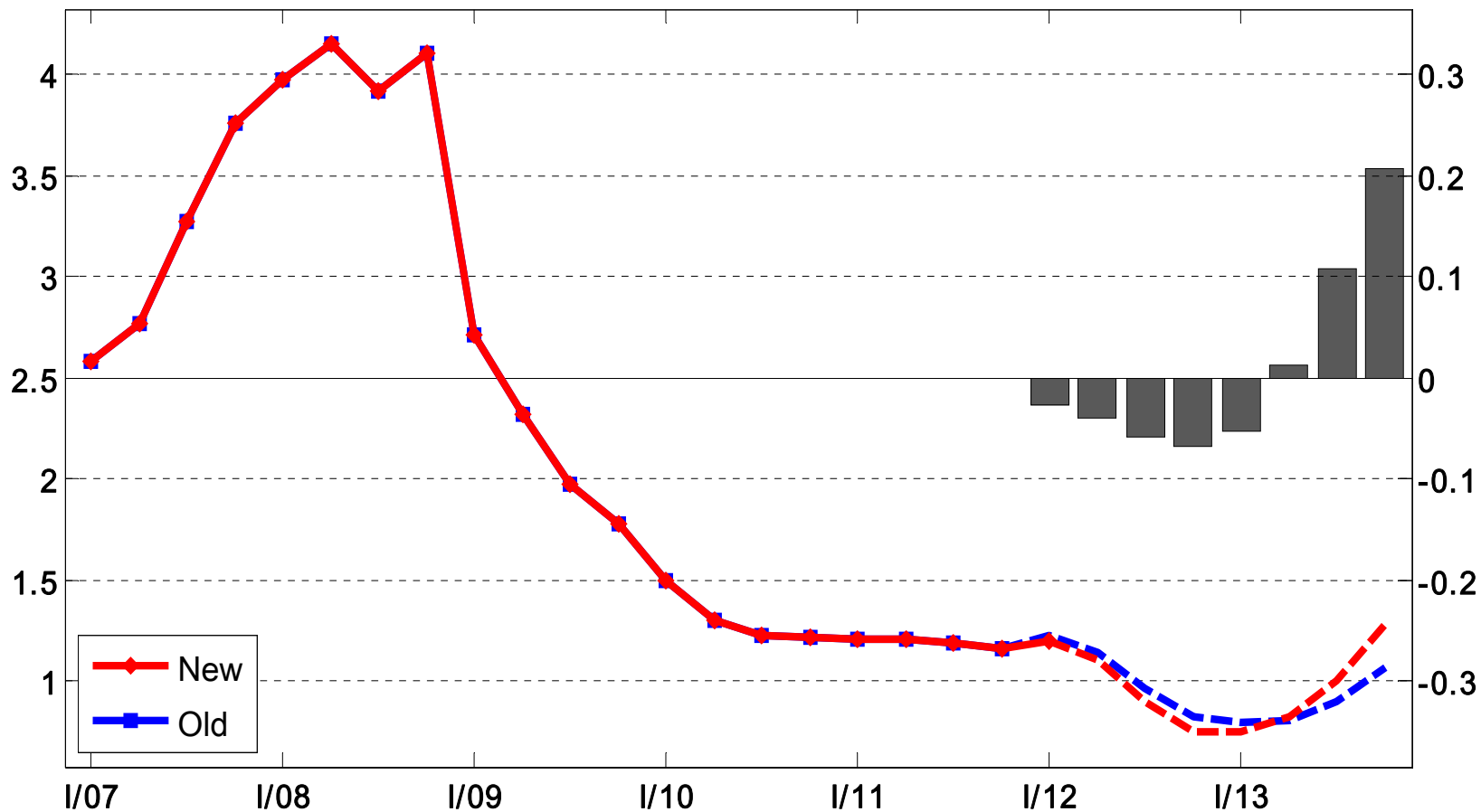
Changes in Exchange Rate Forecast



- Stronger exchange rate in the near-term reflects the developments in 2012 Q1 and favourable foreign trade performance so far.
- No change in the longer-term forecast.

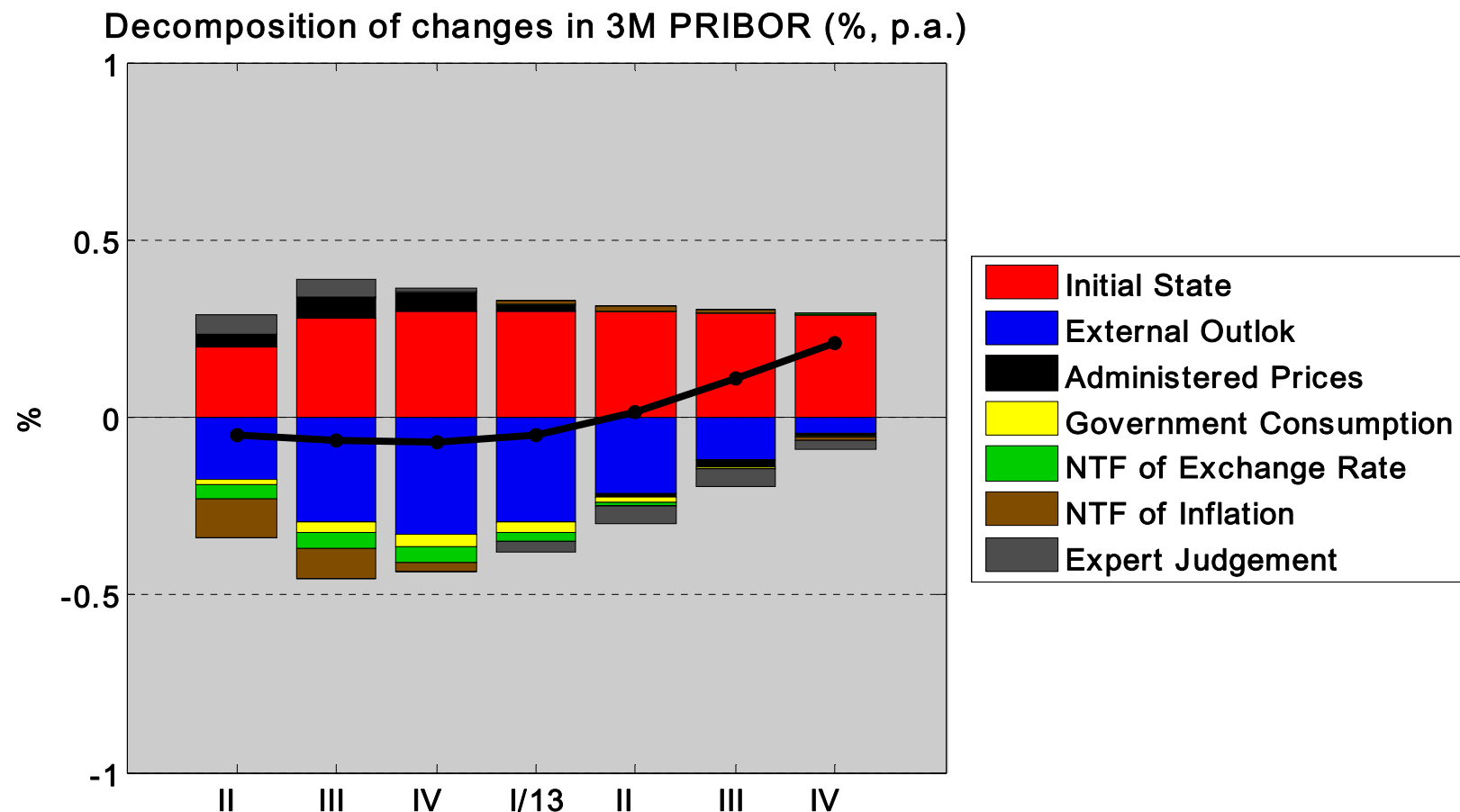
Changes in Interest Rate Forecast

3M PRIBOR (% p.a.)



- The interest rate path has changed only slightly, mainly at its longer end.

Interest Rate Forecast Change Decomposition



- The upward impact of initial state (observed higher inflation and import prices), regulated prices and expert judgement offset by lower foreign interest rates, and by near-term forecasts of inflation and exchange rate.

government-approved measures

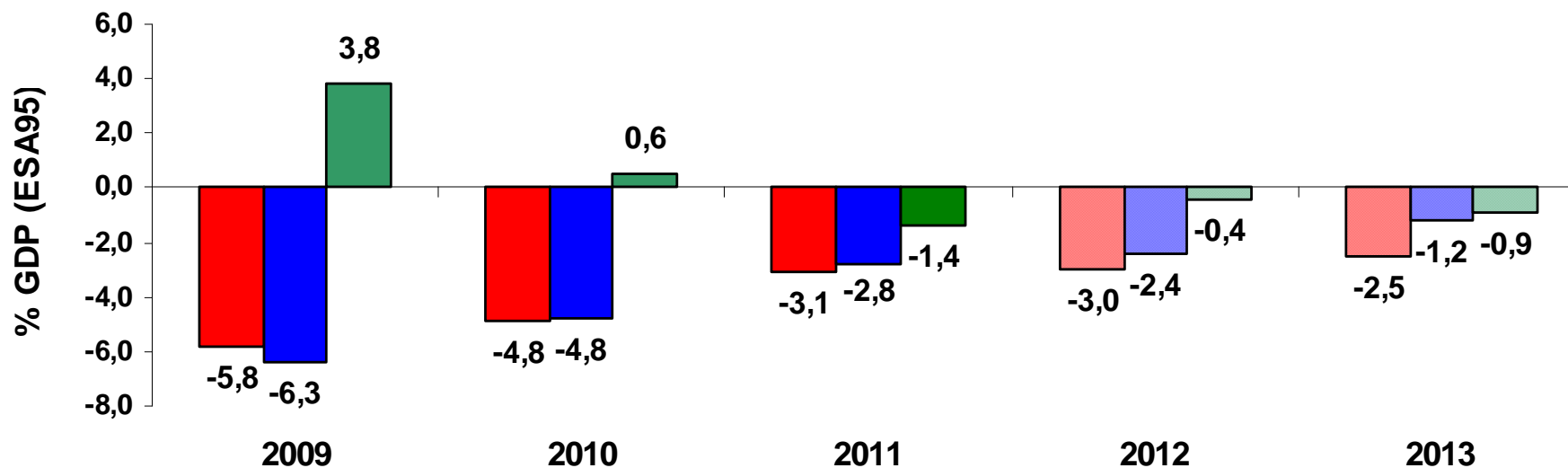
(CZK billions unless otherwise indicated)

REVENUE MEASURES	39,8
7% additional solidarity personal income tax	1,8
Abolition of basic allowance for working pensioners	2,0
Reduction of flat-expense deductions for self-employed	3,5
Increase of withholding tax against tax havens to 35%	0,6
1 pp increase in VAT to 15% and 21% ^{a)}	19,6
Abolition of "green diesel" for agricultural producers	1,6
Higher tax on tobacco	0,1
Abolition of health insurance ceiling	1,8
Increase in real estate tax	1,8
Profit transfer from Lesy CR state company	4,0
Sales of emission permits	2,9
EXPENDITURE MEASURES	18,0
Lower indexation of pensions	9,5
Freezing of wages for state employees	5,5
Abolition of housing benefit subsidy	0,8
Lower subsidies on renewable energy resources	2,0
Lower subsidy to SFDI state fund	0,2
TOTAL REVENUE AND EXPENDITURE MEASURES	57,8
% of GDP ^{a)}	1,4
Fiscal impulse to GDP in percentage points^{a)}	0,8

^{a)} CNB estimate

Alternative scenario: Public Budgets

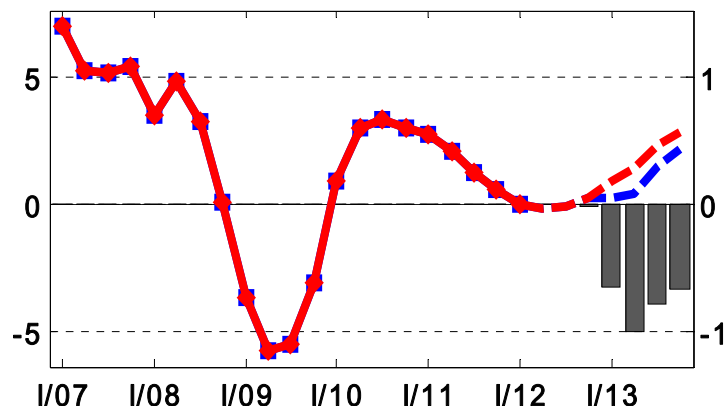
■ Public budget deficit ■ Structural deficit (ESCB) ■ Real government consumption (y-o-y %)



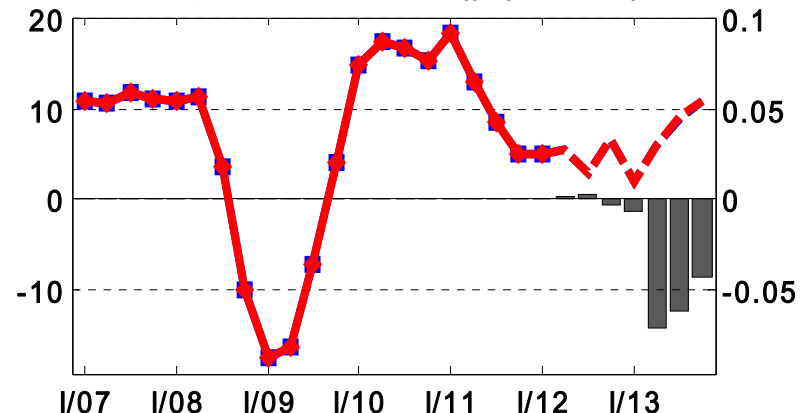
- Budgetary measures as of Apr 2012 affecting developments in 2013–2015:
 - Revenues: main effect from an increase in both VAT rates by 1 p.p., other tax- (and similar) measures with smaller effects
 - Expenditures: lower indexation of old-age pension, freeze on remuneration in public sector
- 2013: Deficit at 2.5% of GDP; fiscal impulse -0,8 p.p.

Alternative Scenario: Real Economy

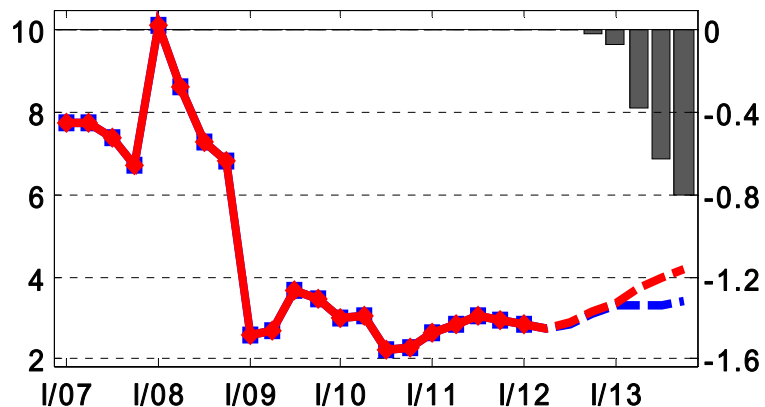
GDP Growth (y/y, in %)



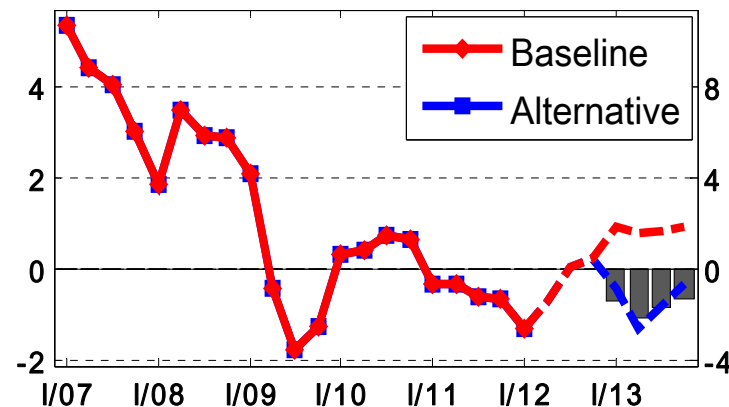
Exports Growth (y/y, in %)



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



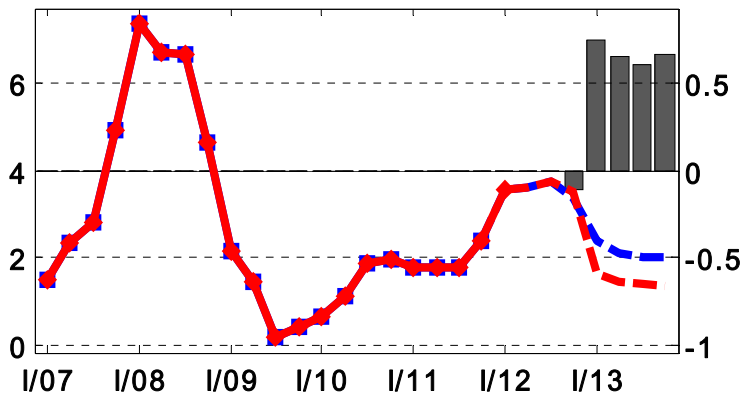
Household Consumption Growth (y/y, in %)



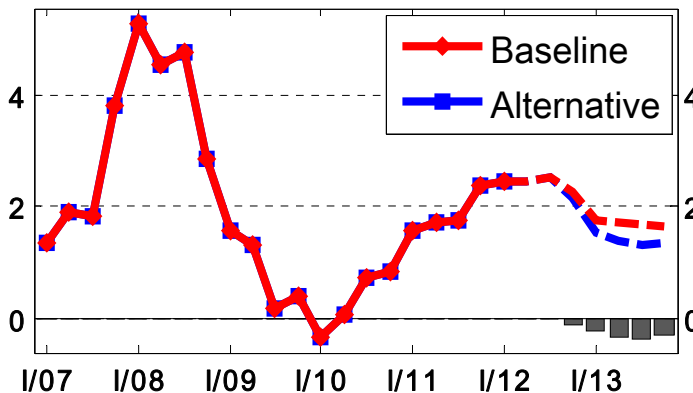
- More gradual recovery in 2013, mainly due to reduced household consumption (weaker growth of nominal disposable income and increased headline inflation).

Alternative Scenario: Inflation

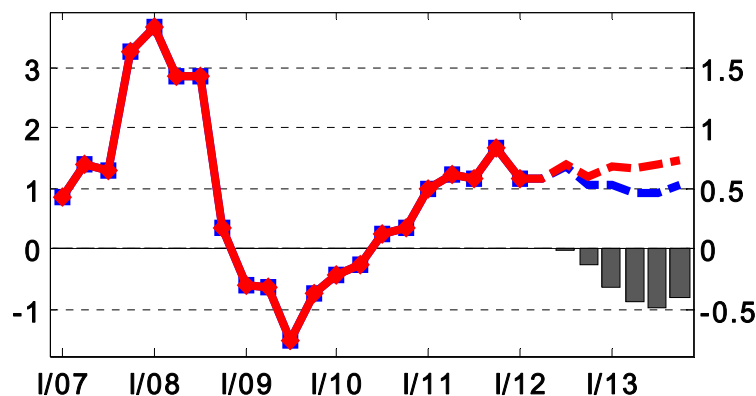
CPI Inflation (y/y, in %)



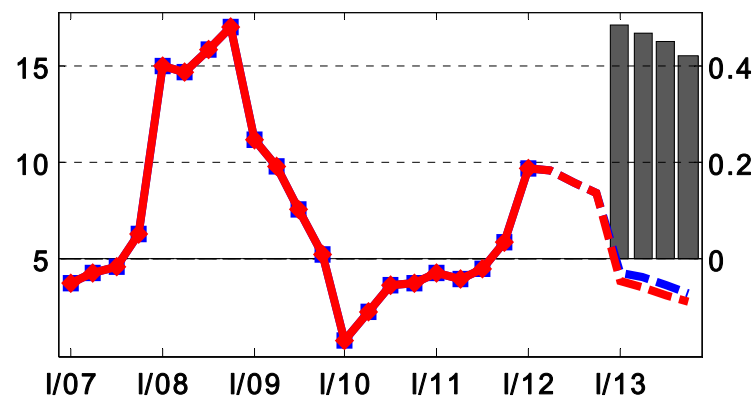
MP Inflation (y/y, in %)



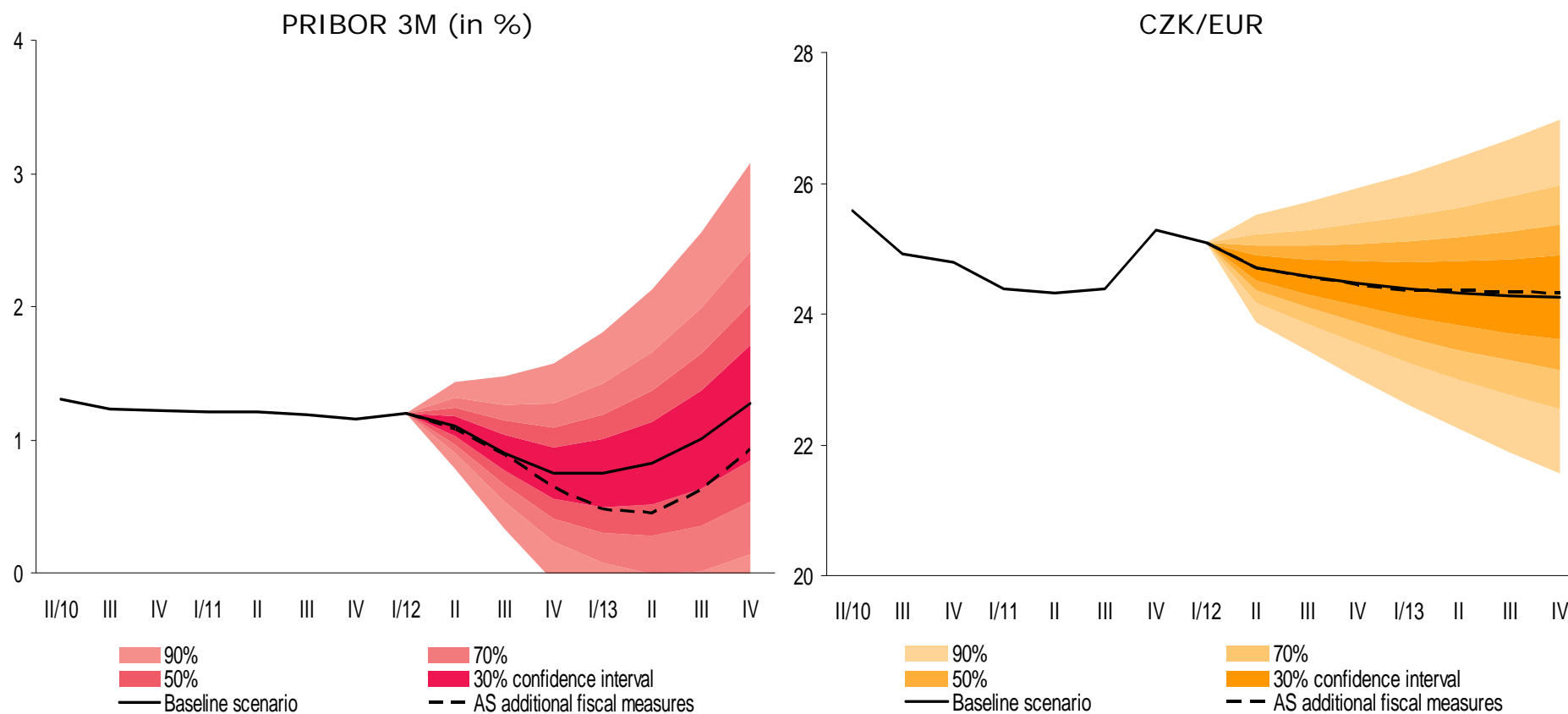
Net Inflation (y/y, in %)



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



- Higher headline inflation due to the first-round effect of VAT changes (second-round effects assumed negligible).
- MP-relevant inflation lower due to the more subdued economy.



- Interest rate path lower due to the lower MP-relevant inflation.
- Exchange rate forecast almost unaffected.

Thank you for your attention

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