

CNB's New Forecast (Inflation Report III/2015)

Meeting with Analysts

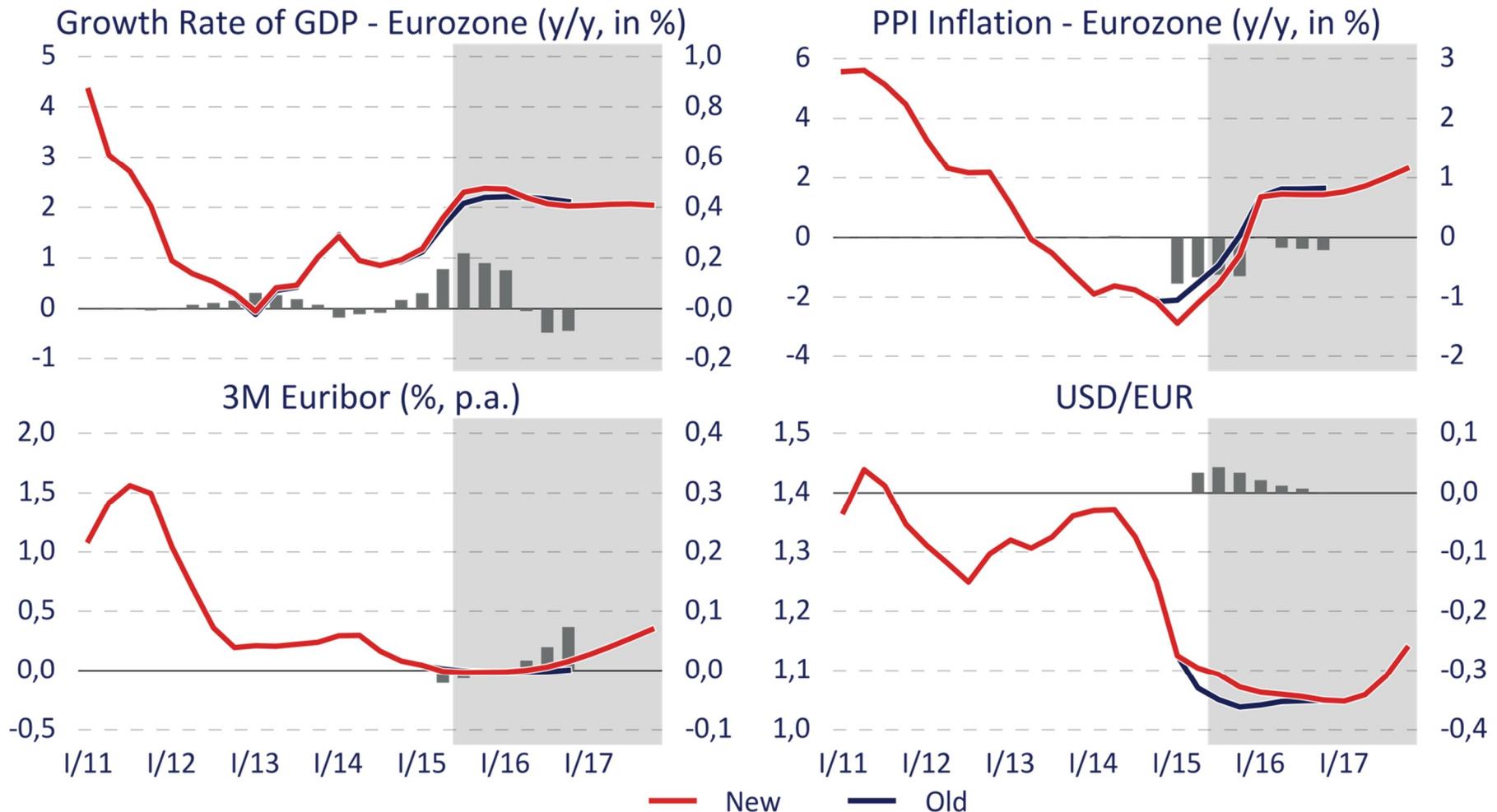
Tibor Hlédik

Prague, 7 August, 2015

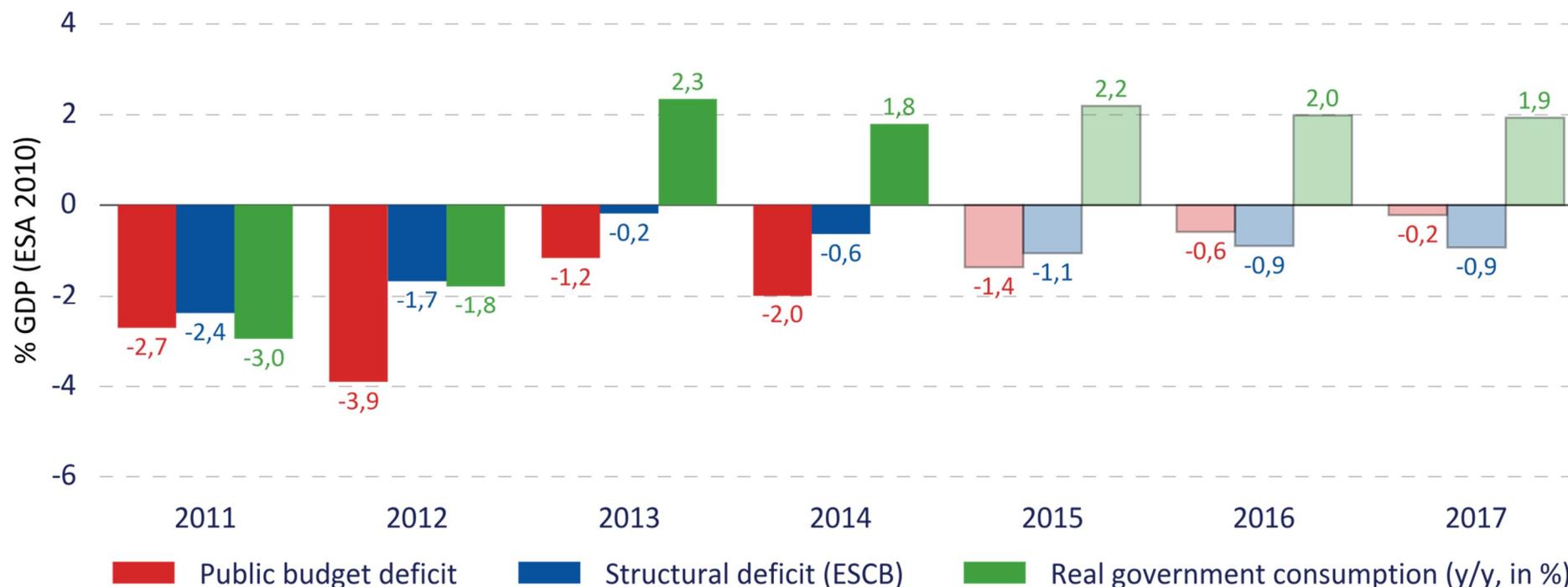


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2. The new macroeconomic forecast
3. Comparison with the previous forecast

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- External demand growth will pick up this year and stay close to 2% afterwards.
- The slump in energy commodity prices coupled with only moderate economic growth is reflected in currently falling PPI, which will start rising as from the beginning of the next year.
- 3M EURIBOR and EUR/USD reflect the ECB's easing measures.



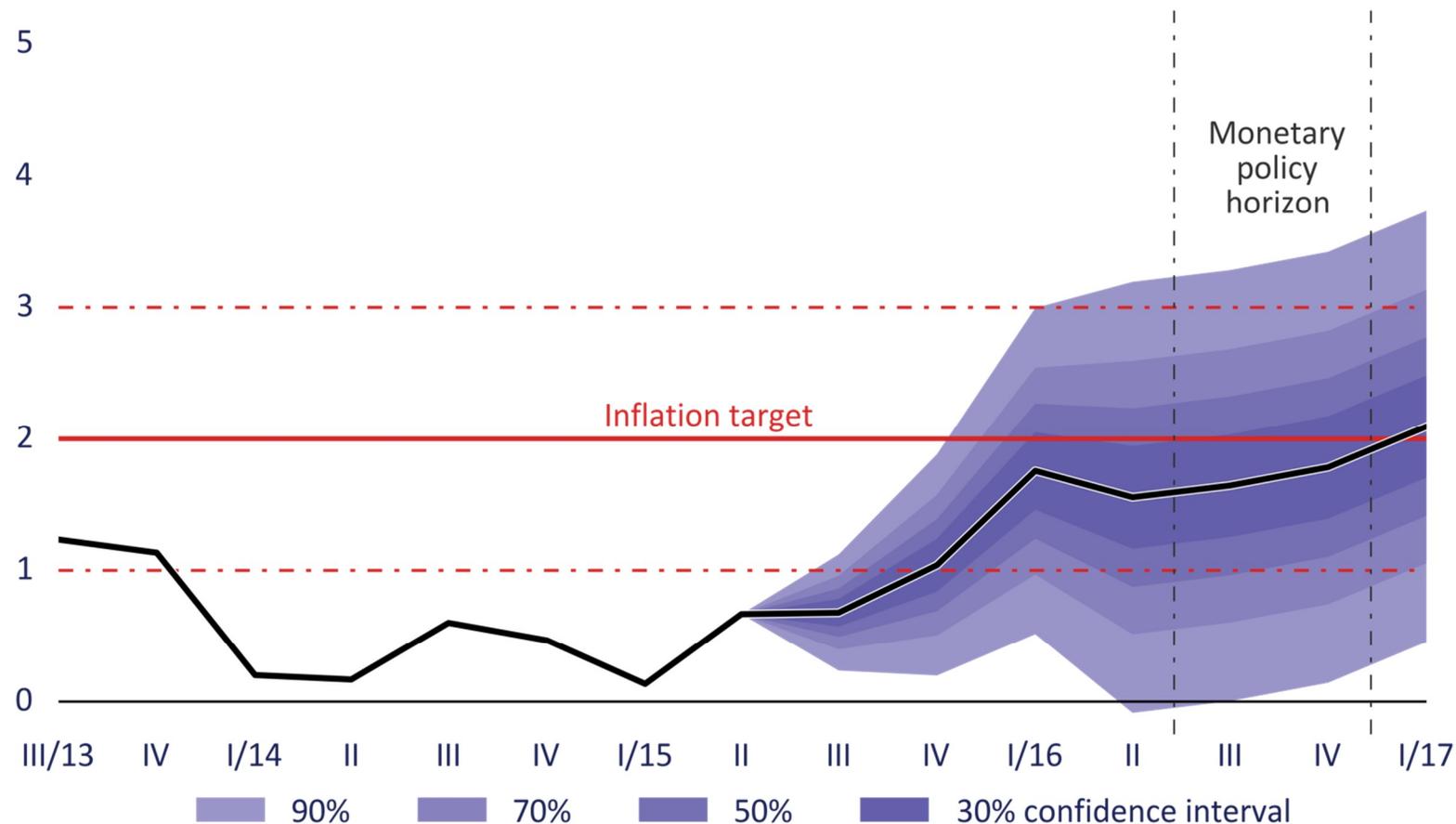
- **2015:** drop of the deficit to 1.4% of GDP due to economic growth and in spite of new 10 % reduced VAT rate, growing pensions, increase in public wages, culminating public investment financed by EU funds and domestic sources, etc.
- **2016 :** decline of the deficit to 0.6% (fall in public investment due to a smaller drawdown of EU funds, additional revenues from excise duties on cigarettes)
- **2017:** further drop of the deficit to 0.2% of GDP (higher revenues from sales of emission permits, faster drawdown of EU funds within the new programming period)
- Fiscal impulse: +0.6 p.p. in 2015, -0.3 p.p. in 2016 and +0.2 p.p. in 2017.

- The forecast assumes market interest rates to be flat at their current very low level and the exchange rate to be used as a monetary policy instrument until the end of 2016. Consistent with the forecast is an increase in interest rates in 2017.
- The short-term forecast for the exchange rate of the koruna against the euro takes into account its appreciation in July. It is expected to remain stable in the following quarters at a level that is slightly weaker than the announced asymmetric exchange rate commitment (i.e. CZK 27 to the euro).
- After the exit from the exchange rate commitment the koruna will moderately appreciate due to the positive interest rate differential and renewed – though compared with the pre-crisis period less pronounced – real convergence of the Czech economy to its advanced counterparts in the euro area.

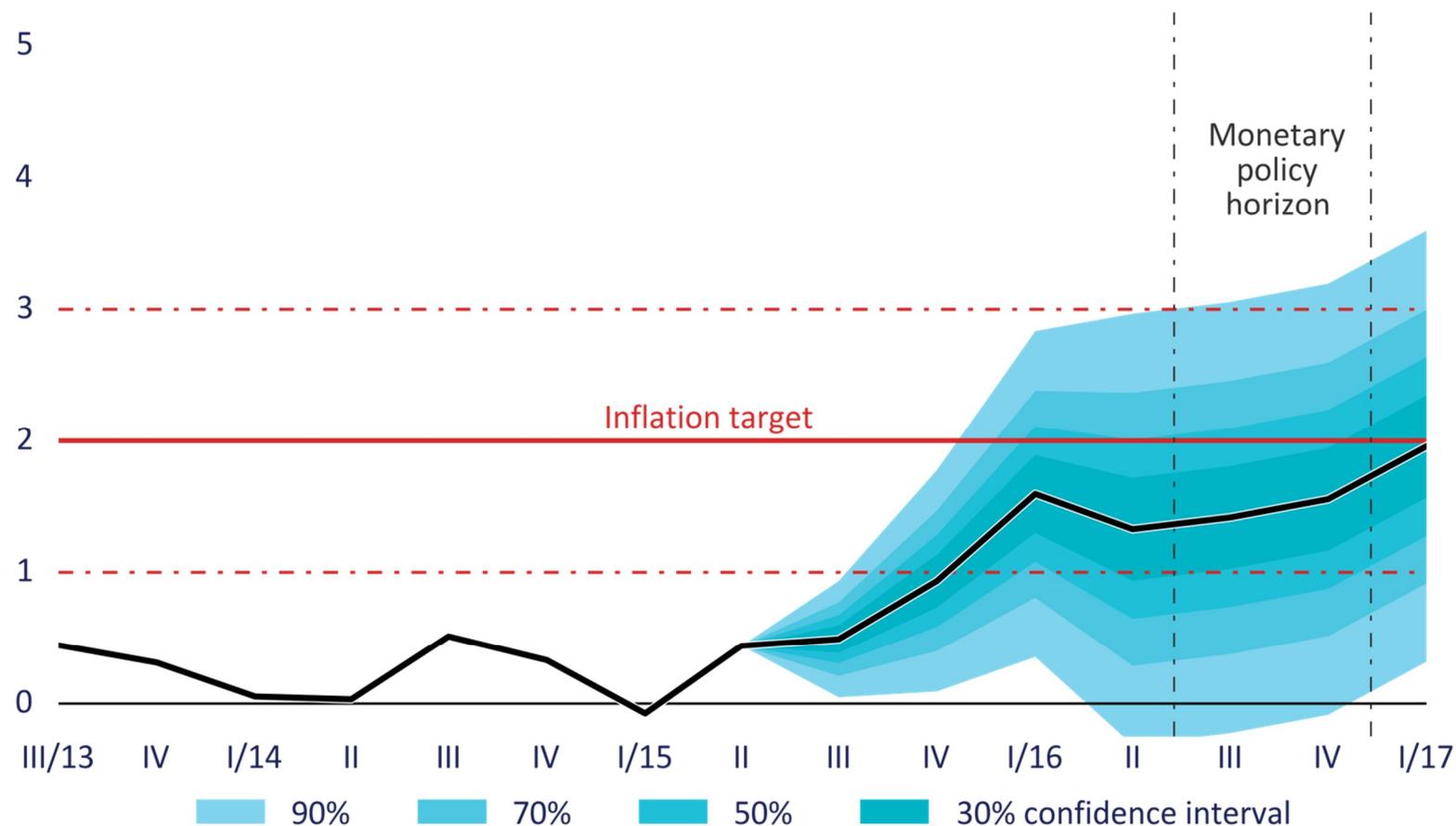
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- Both headline and monetary policy-relevant inflation increased in 2015 2Q, they, however, still remained well below the CNB's target. Inflation will increase further until the beginning of 2016, although, at the monetary policy horizon it will remain below the 2% target, that will be reached only in 2017.
- Import prices in the consumption sector will remain anti-inflationary in the near future owing to falling producer prices in the euro area, the previous decline in energy commodity prices and the recent appreciation of the koruna exchange rate against the euro. The return to growth in foreign producer prices will gradually moderate the anti-inflationary effect of import prices, and from mid-2016 onwards import prices will have a slight upward effect on costs.
- The domestic economy will contribute to price increases over the entire forecast horizon as a result of its continued robust growth and gradual acceleration in wage dynamics.

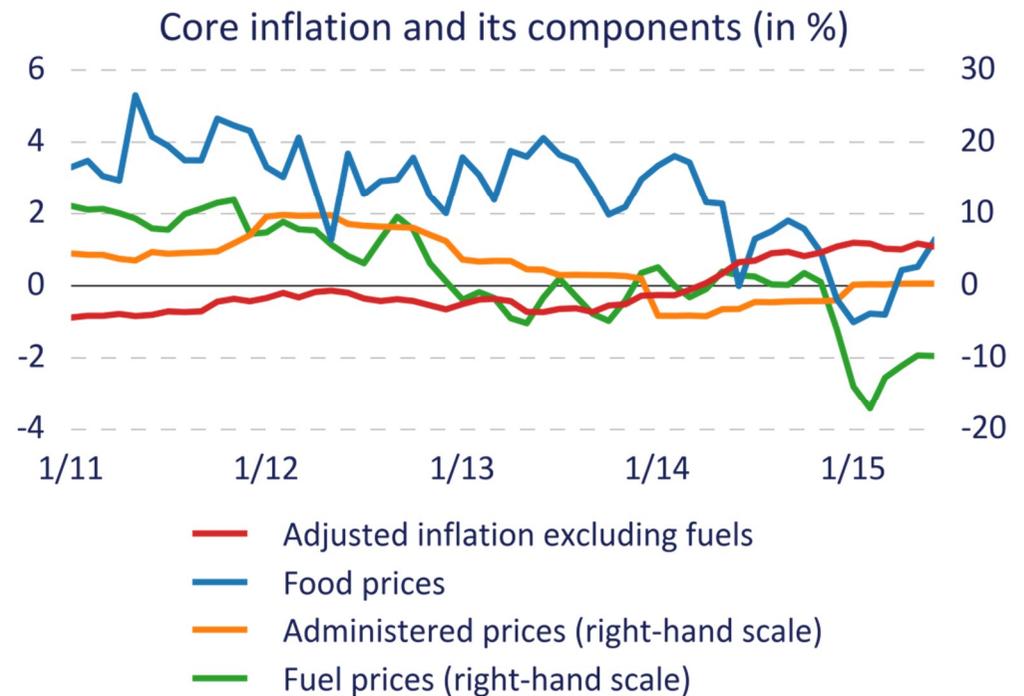
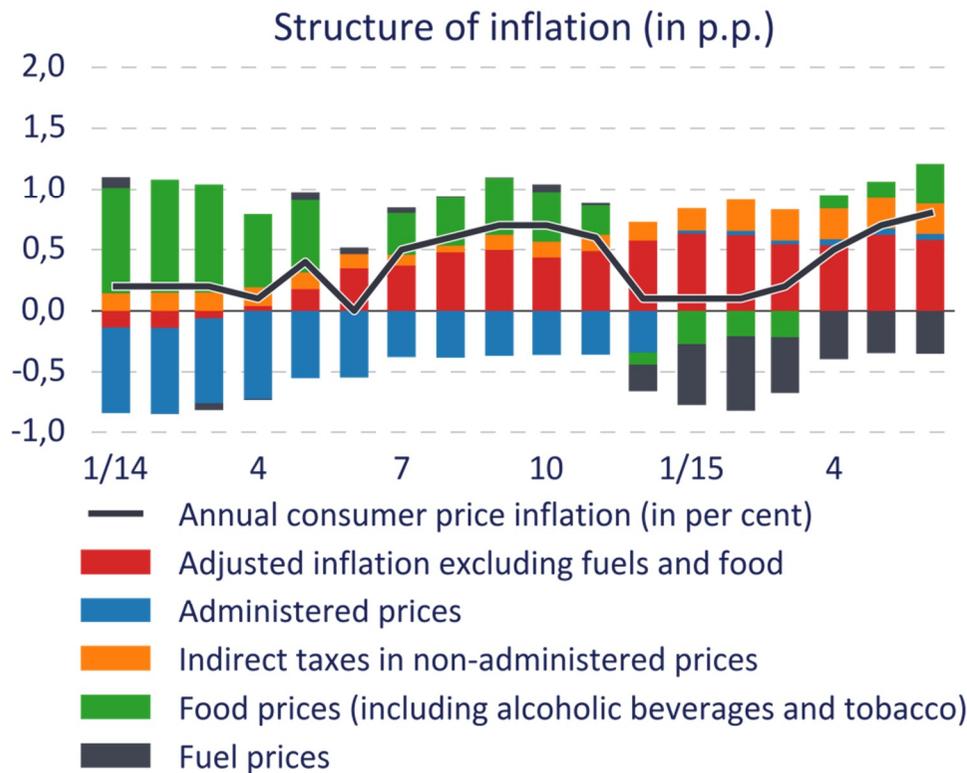
- The high GDP growth recorded at the start of this year will – despite a correction in Q2 – continue in the rest of the year thanks to expanding domestic and external demand. During 2016-2017 economic growth will be driven mainly by household consumption and the continued growth of private investment. GDP growth will thus reach 3.8% in 2015 and 2.8% during both of the following two years.
- The rising economic activity is manifesting itself in the continuing improvement in the labour market situation. In connection with the high economic growth total employment will increase by 1% this year , followed by a slightly less pronounced growth in the coming years. The general unemployment rate is expected to decrease on the whole forecast horizon.
- Wage growth in the business sector will gradually increase, from 2016 Q2 to the end of the forecast horizon it will fluctuate just above 4.5%. Wage growth in the public sector will be stable near current levels.



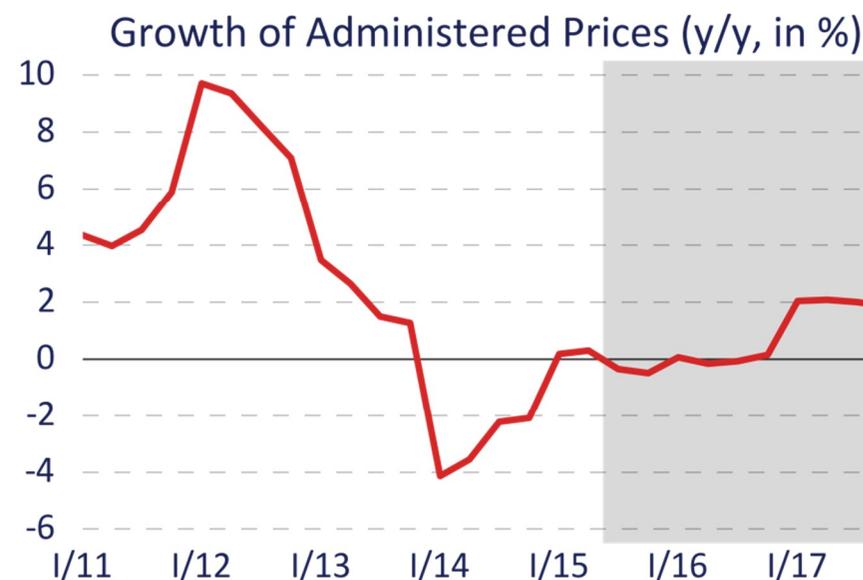
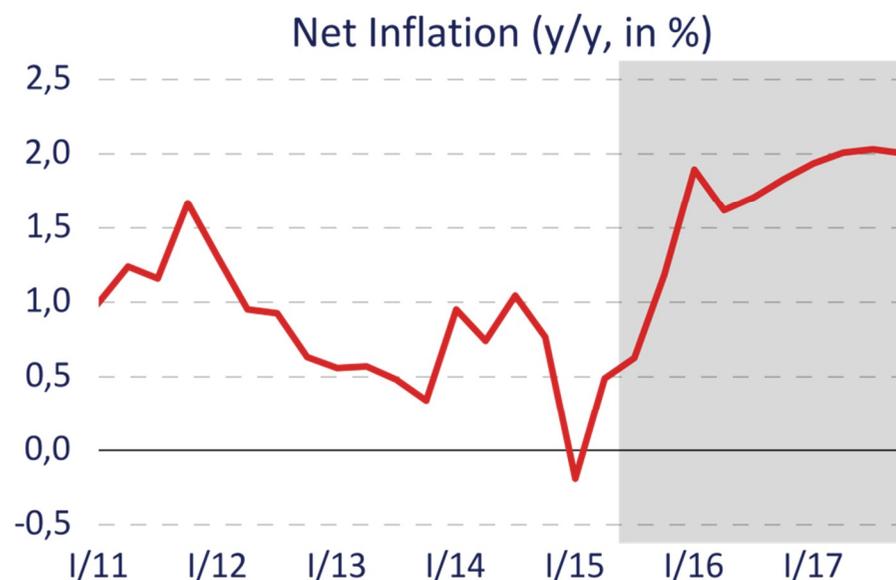
- Headline inflation reached 0.7% in 2015 2Q (food prices started to grow, the fall of fuel prices was less pronounced than in the previous quarter).
- According to the forecast headline inflation will continue to rise until the start of 2016. However, it will then dip temporarily and will thus still be below the 2% target at the monetary policy horizon.



- MP-relevant inflation went up to 0.4% in 2015 2Q. It has been still significantly below the lower boundary of the tolerance band around the CNB's target.
- Over the forecast horizon, it will follow a similar path to headline inflation, although it will be slightly lower until the end of the forecast horizon owing to positive first-round effects of changes to indirect taxes.
- It, too, will be close to the 2% inflation target as from the start of 2017.

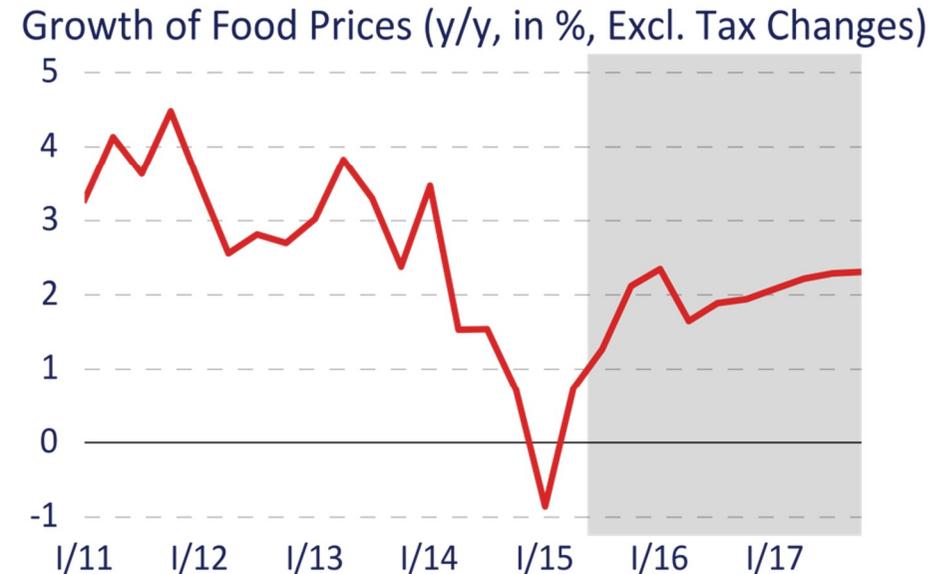
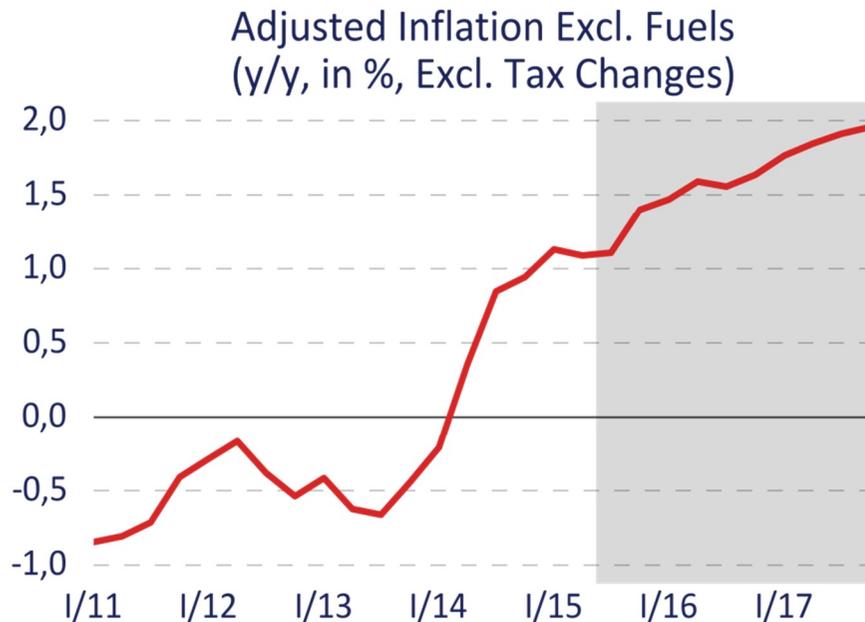


- Headline inflation increased to 0.8% in June. This increase was mainly given by a continuing pick up in food price growth, started in April.
- Core inflation remained distinctly positive, reflecting a continuing growth of both tradable- and non-tradable goods prices.
- Compared with the beginning of the year, the fall of fuel prices was less pronounced.
- The y-o-y change in administered prices was close to zero during the first half of this year.



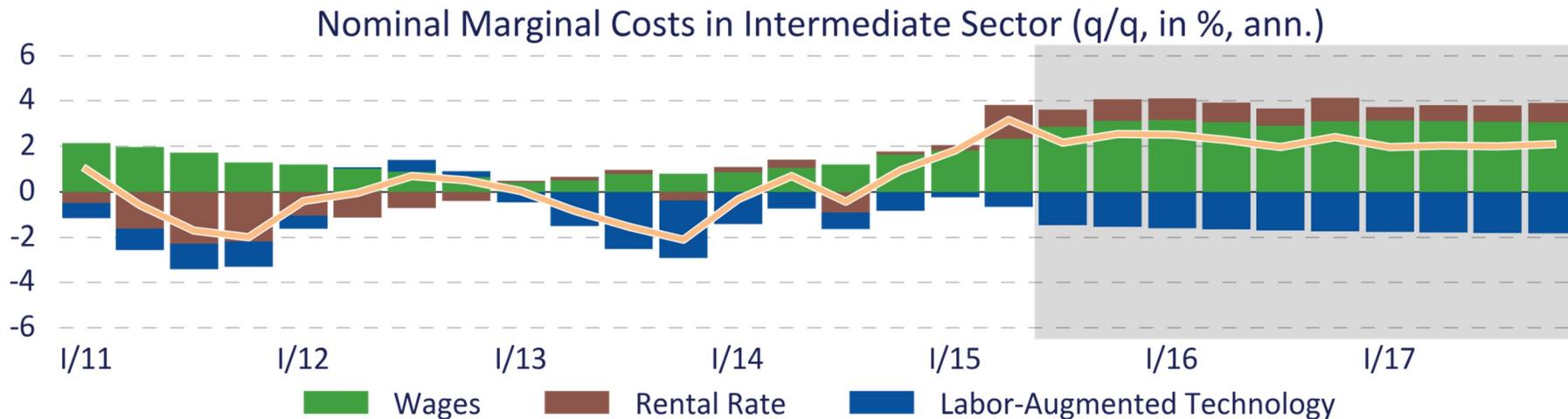
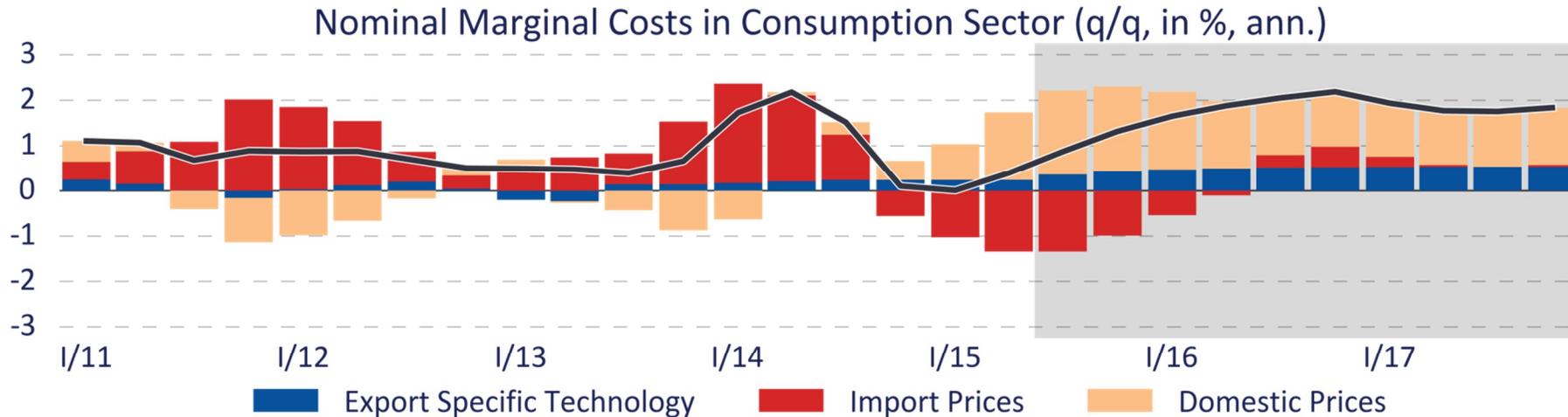
- Net inflation turned positive again in 2015 Q2, reaching 0.5%. It will rise further in the period ahead due to a further increase in food price growth and core inflation, which will reflect continuing growth of the domestic economy.
- The growth of administered prices will fluctuate around zero next year, as it will be dampened by a further decline in prices of energy for households.
- The forecast expects administered prices to increase by 2% in 2017 (renewed growth in prices of energy for households and positive contributions from its other components).

Adjusted Inflation Excluding Fuels and Food

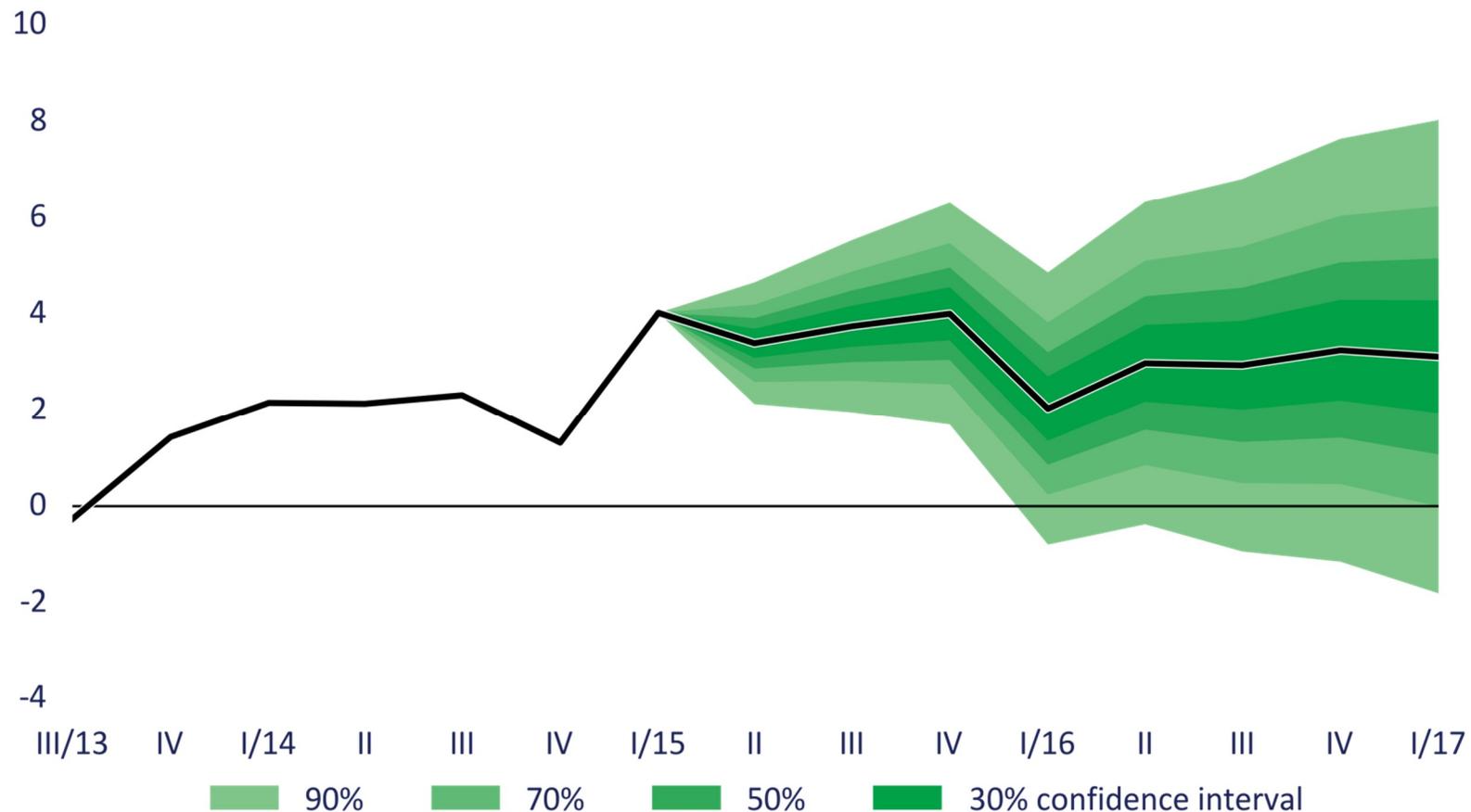


- Core inflation was unchanged in 2015 Q2, averaging 1.1%. It is expected to rise further, fostered by a continuing inflationary effect of the domestic economy and the labour market and by renewed price growth abroad (see the next slide).
- Food price growth will rise further in 2015 H2, reflecting agricultural prices, which will return to slight growth by the end of the year due to the new harvest.

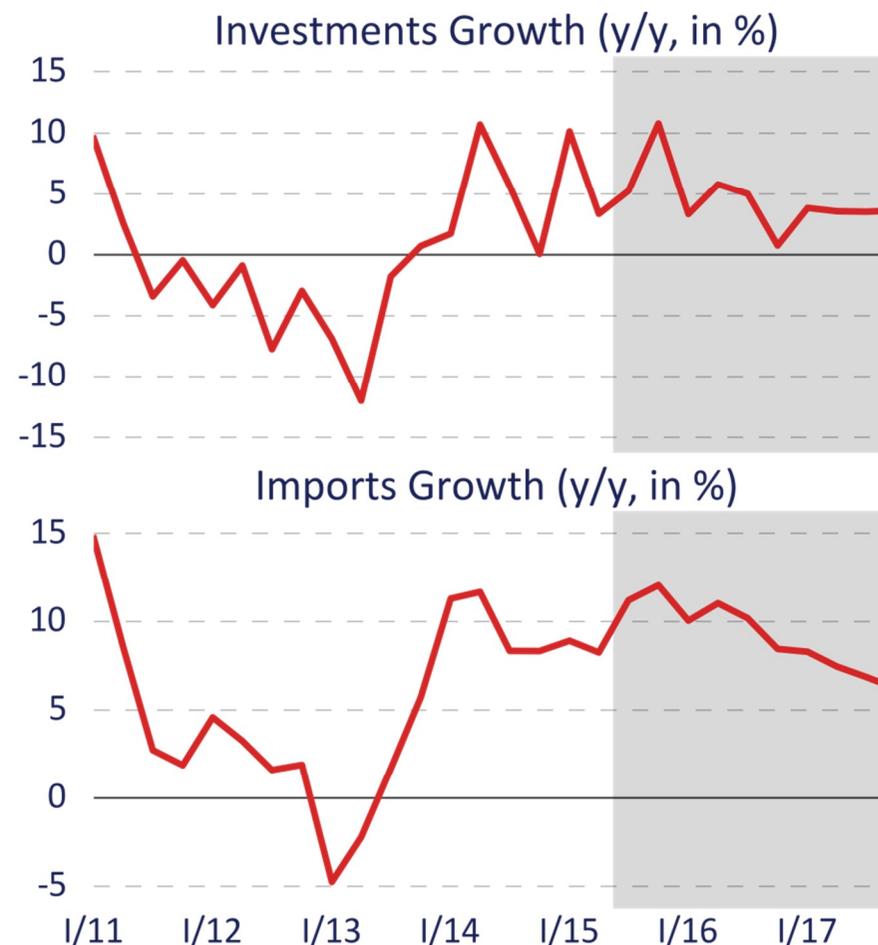
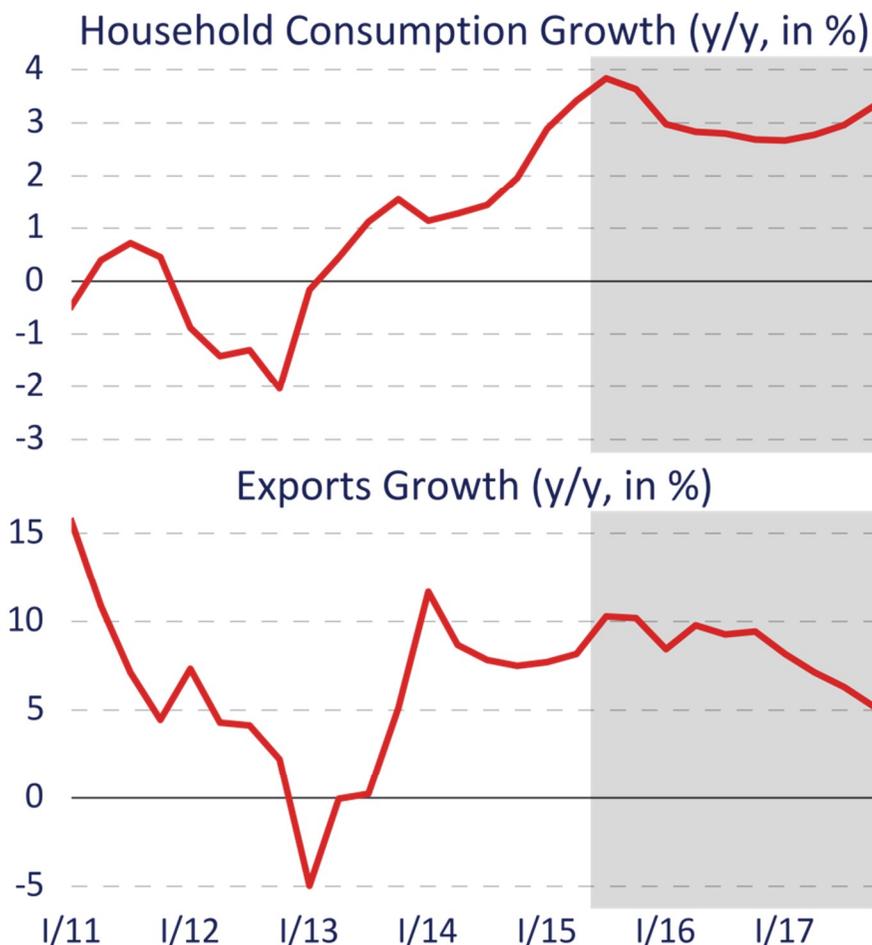
Domestic Costs vs. Import Prices



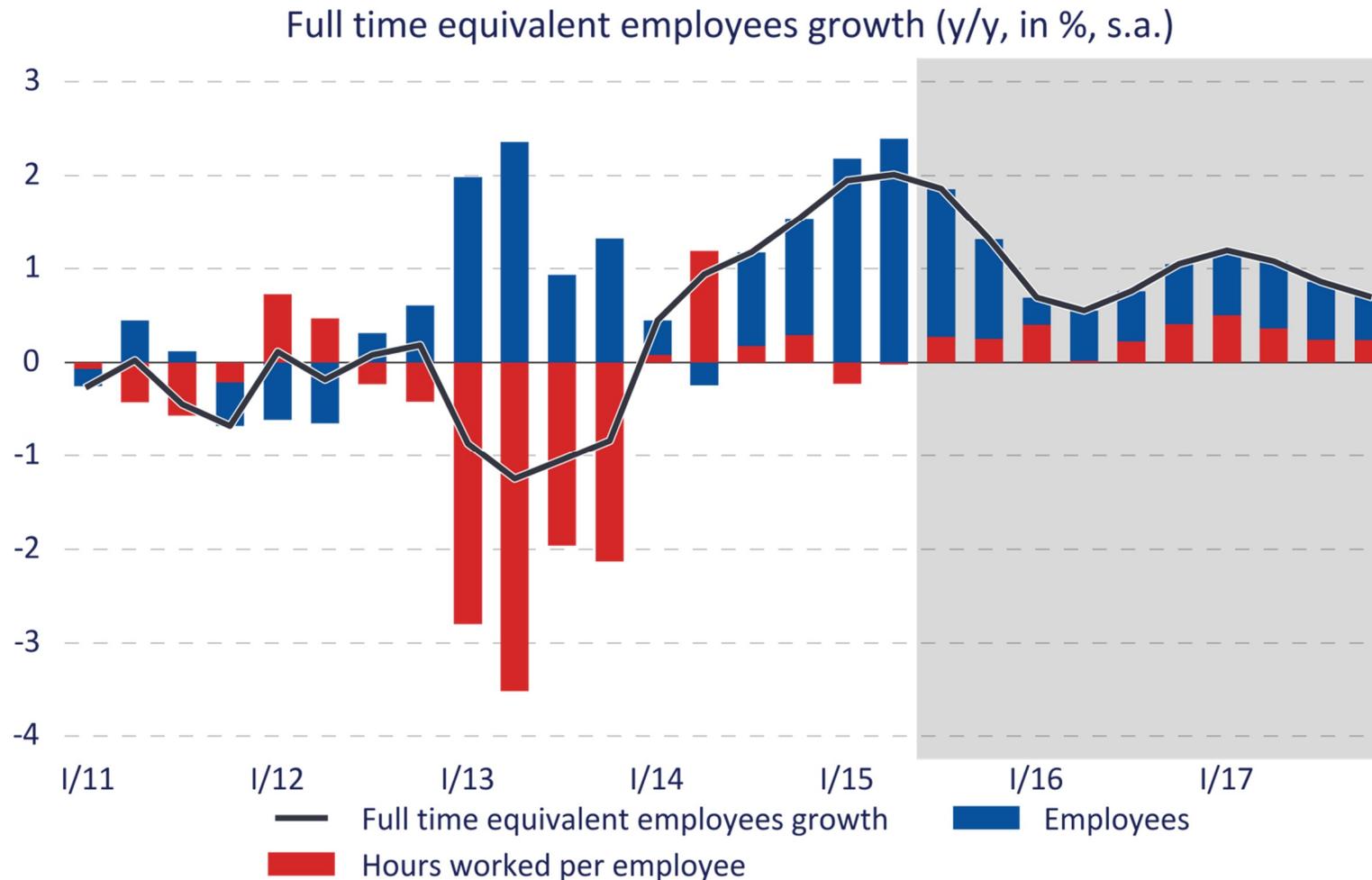
- Growth of prices in the consumption sector will be driven by the strengthening inflationary effect of domestic economy, the contribution of import prices (due to appreciated exchange rate, deeper fall in foreign PPI) is expected to be negative until mid-2016.
- Domestic costs will grow mainly due to increasing dynamics of wages.



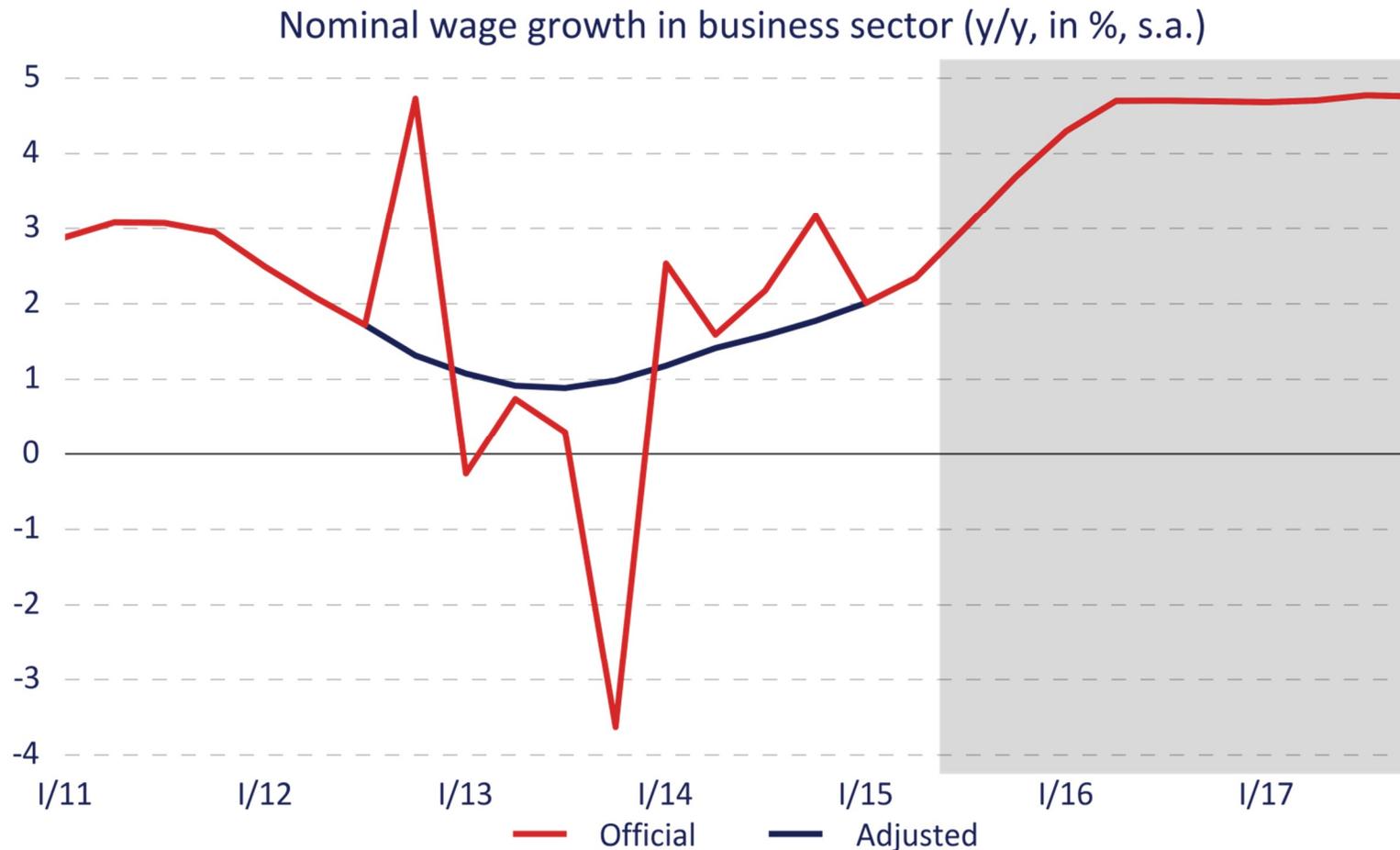
- GDP growth forecast: 3.8% in 2015; 2.8% in 2016, 2.8% in 2017.
- The economy will be boosted by a pickup in external demand, easy monetary conditions, low oil prices and in 2015 and 2017 by expansionary fiscal policy.
- Economic growth will slow down just below 3% in 2016 (unwinding of the effect of an extraordinary jump in inventories in 2015 Q1 and of the fall in oil prices, decline in government investment, recent appreciation of the koruna).



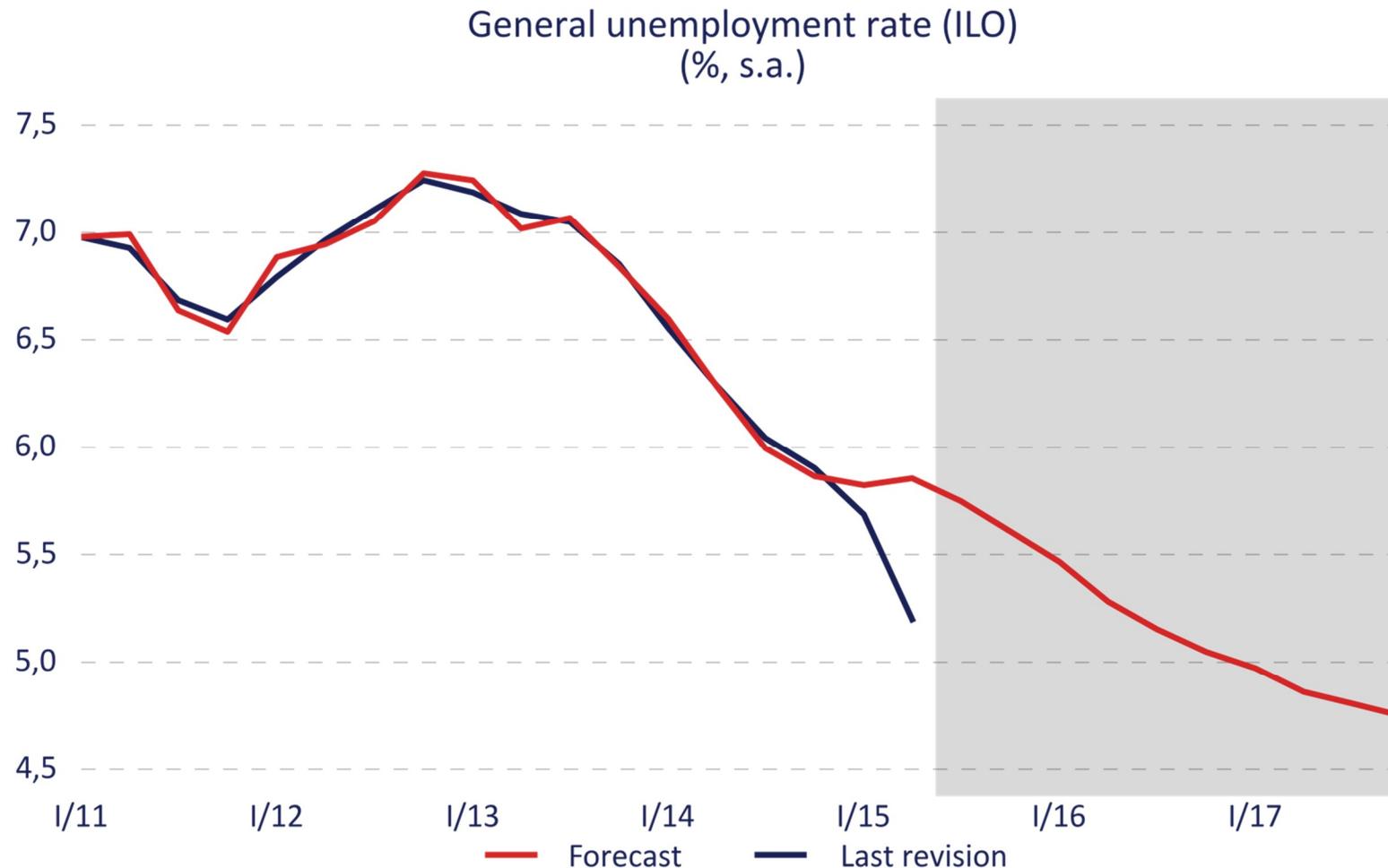
- Growth in household consumption will increase to 3.5% in 2015 and slow down slightly below 3% in the coming two years.
- Investments growth will reach 7.3% in 2015 (due to drawdown of EU funds + high inventories) and will slow down below 4% starting from 2016 4Q.
- Exports reflect the pickup in foreign demand, imports growing domestic demand and the development of exports.



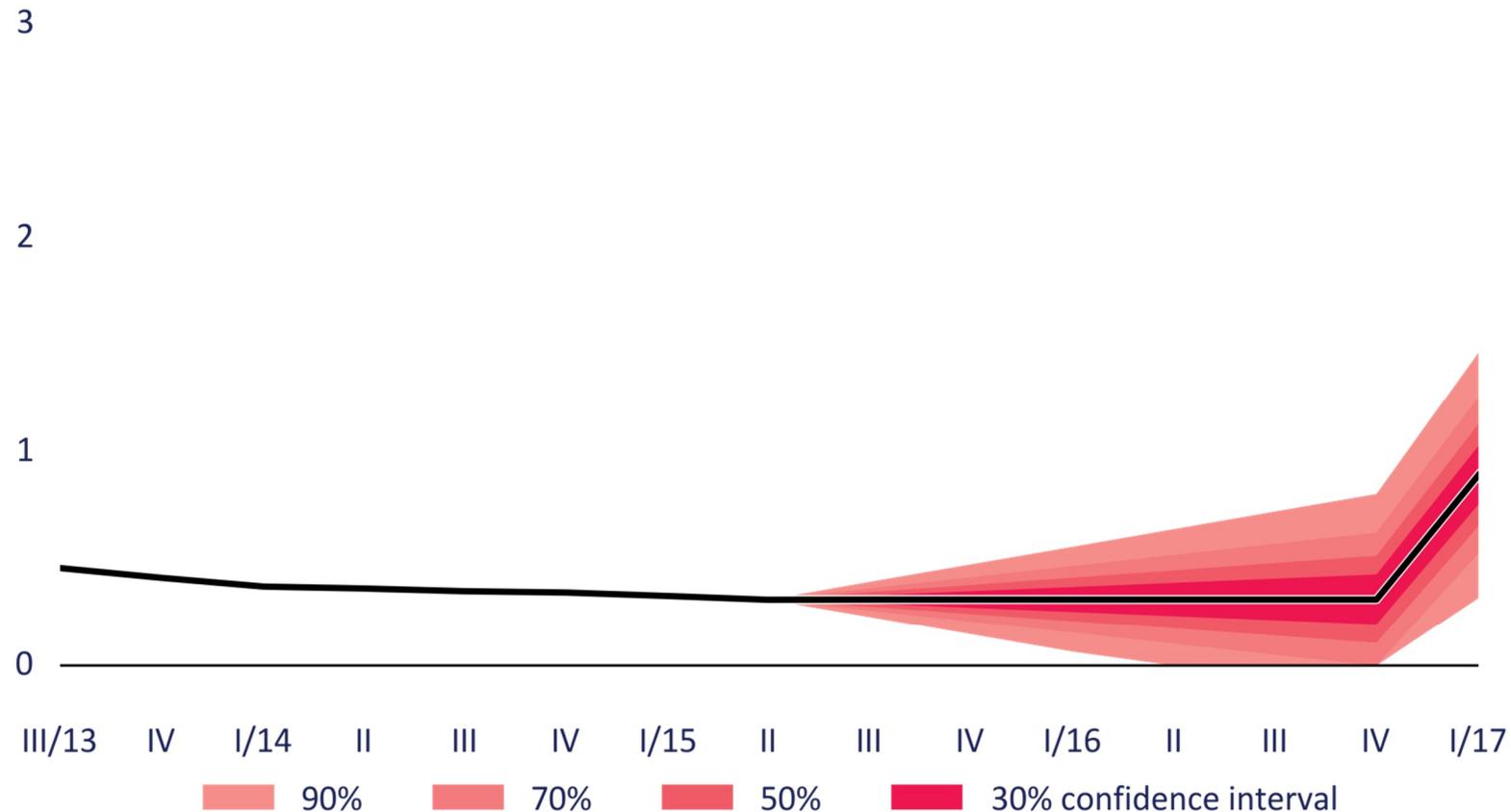
- Growth in the number of employees converted into FTE rose to 2% in 2015 Q1 (faster growth in the number of employees, slightly lower average number of hours worked).
- The growth in the number of employees converted into FTE will continue at the forecast horizon, although at a slower pace than in 2015.



- Wage growth in the business sector will increase to 2.8% for 2015 as a whole and will further accelerate to 4.6% and 4.7% in 2016 and 2017 respectively.
- Annual wage growth in the non-business sector will be stable overall in 2015–2017 at around 2.8%.



- The forecast of the general unemployment rate is not reflecting the recent data revision of the CZSO.
- The general unemployment rate will fall in the period ahead, due mainly to growth in employment associated with rising economic activity.

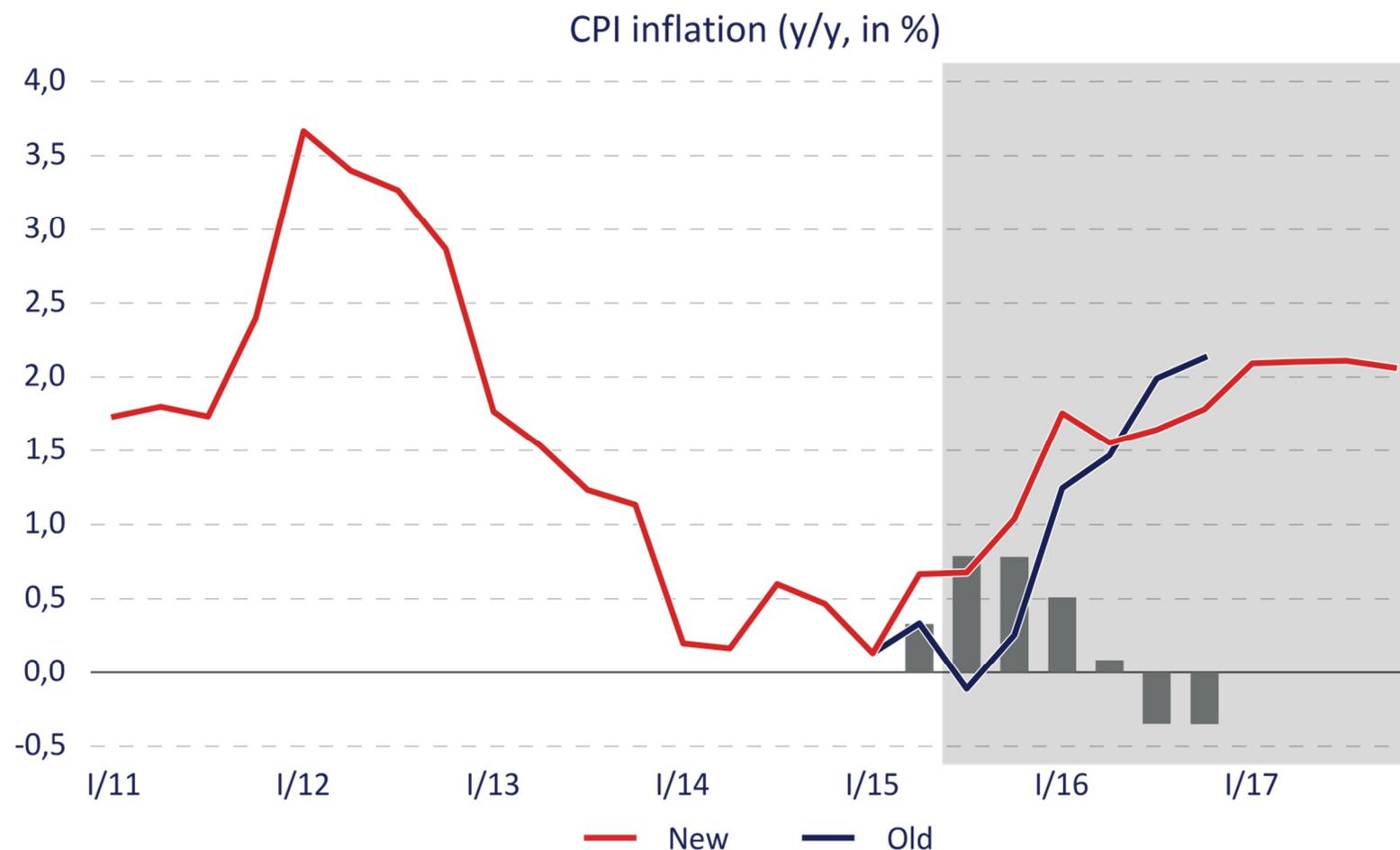


- The forecast expects market interest rates to be flat at their current very low level until the end of 2016.
- This reflects an assumption that the 2W repo rate will be left at technical zero and the money market premium will remain unchanged in the same period.
- Consistent with the forecast is an increase in interest rates in 2017

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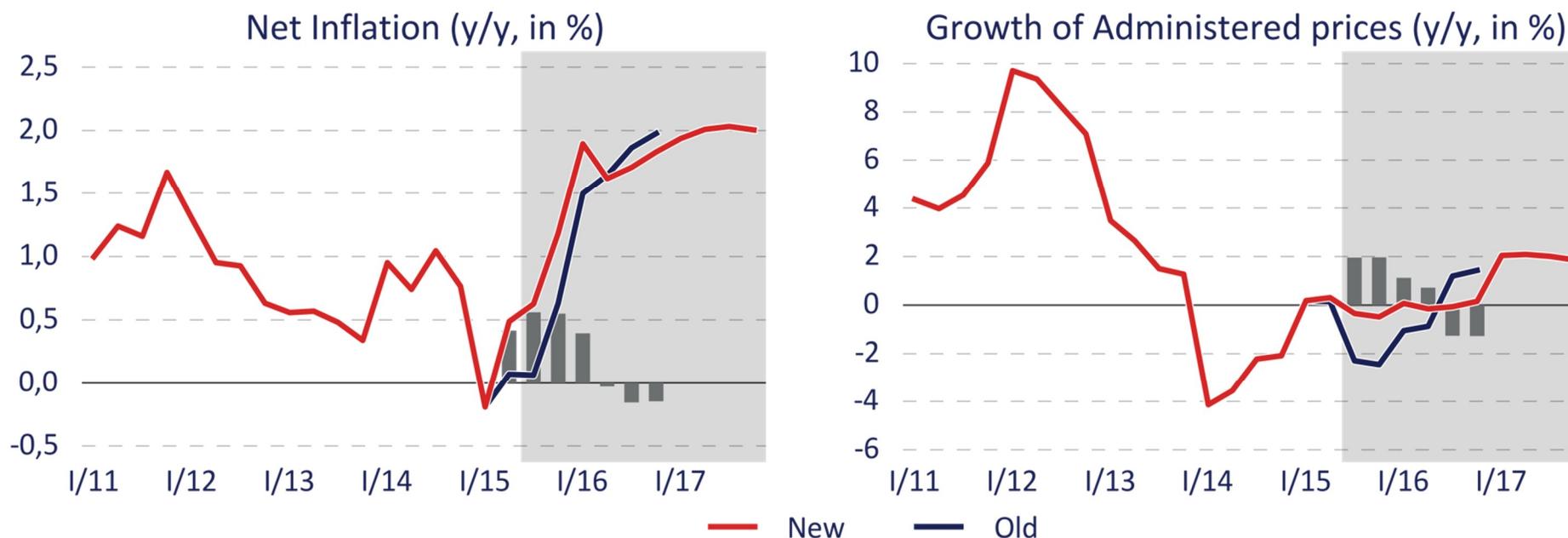
- Compared to the previous forecast, the predictions for headline and monetary policy-relevant inflation are higher until mid-2016 owing to higher observed inflation and a smaller decrease in administered prices. The forecasted levels of both these inflation indicators are slightly lower thereafter, including the monetary policy horizon.
- Stronger GDP growth in 2015 Q1 and a faster labour market recovery have led to a marked upward revision of annual GDP growth this year; the prediction for 2016 has been lowered slightly.
- Growth in nominal wages in the business sector has shifted upwards over the entire forecast horizon as a result of higher observed wage growth and a faster recovery in domestic economic activity.
- The assumption of flat market interest rates at their current very low level and the use of the exchange rate as a monetary policy instrument until the end of 2016 is unchanged.

Comparison: Inflation Forecast (i)



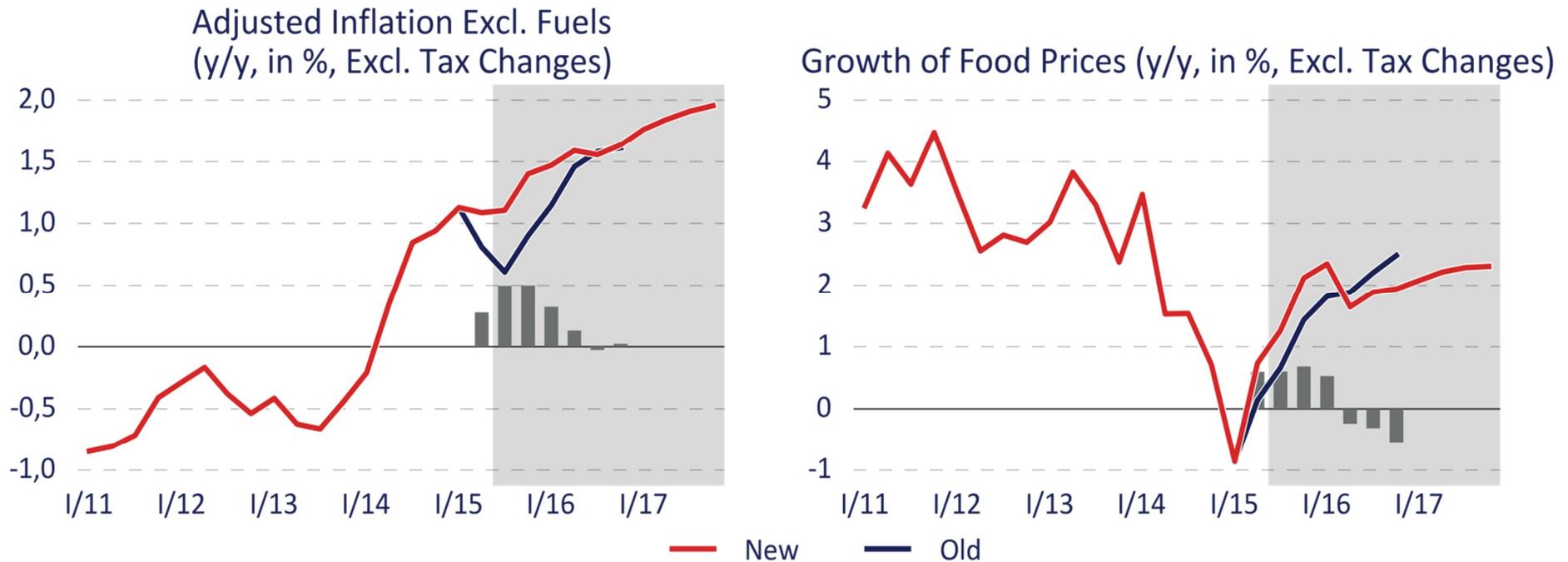
- The forecast for annual headline inflation is higher than in the previous forecast until mid-2016, but lower thereafter i.e. including monetary policy horizon.
- Compared to the previous forecast, the domestic economy in 2015 is characterized by slightly stronger cost-push pressures stemming from higher wage growth, the stronger exchange rate is acting in the opposite direction.

Comparison: Inflation Forecast (ii)



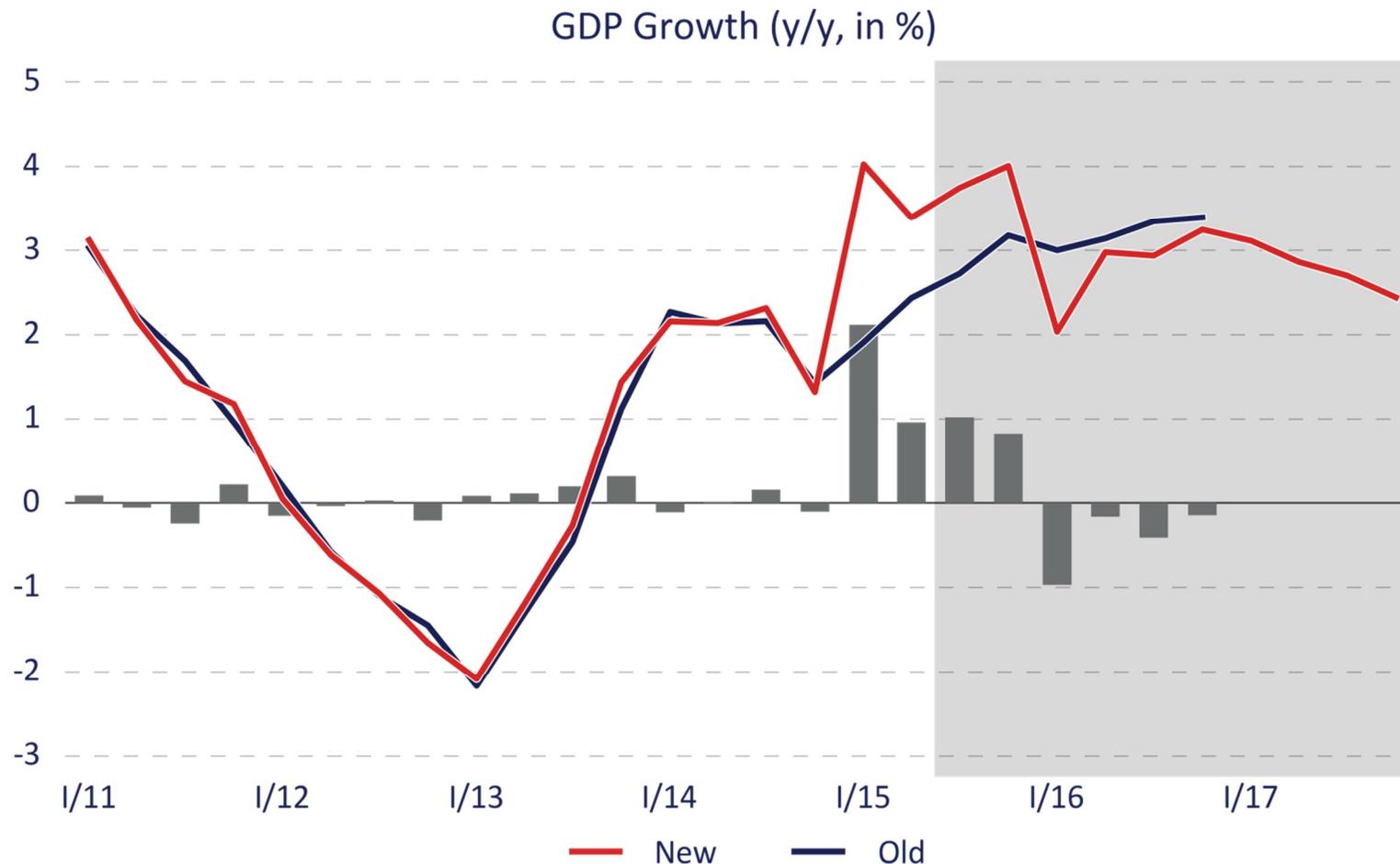
- The path of net inflation over the forecast horizon is affected by higher observed inflation in recent months and the current situation of the domestic economy.
- The revision of the administered price forecast reflects a postponed decrease in gas prices for households to the beginning of next year.

Comparison: Inflation Forecast (iii)



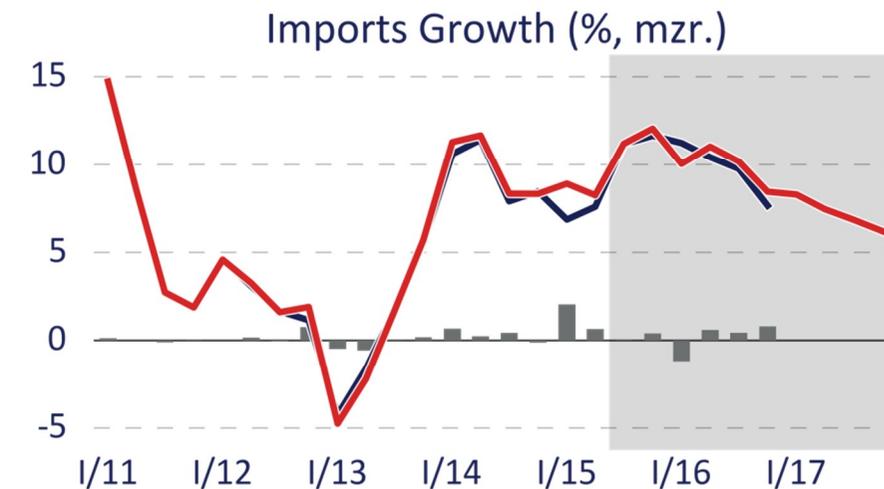
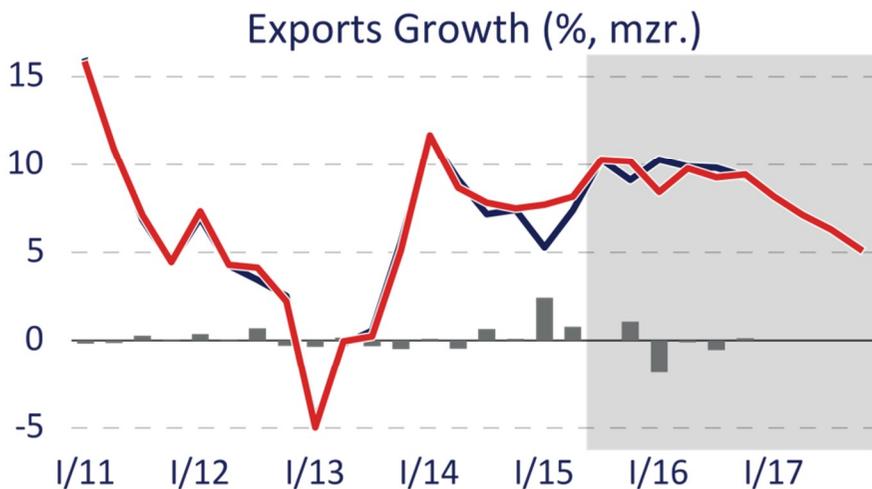
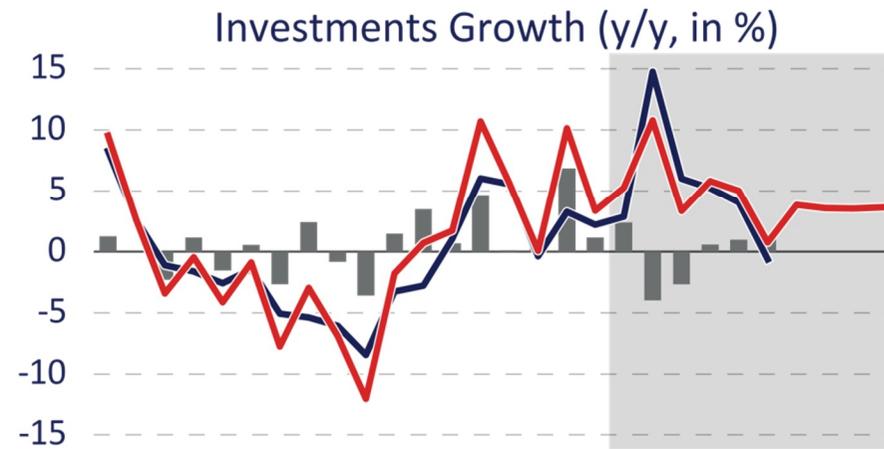
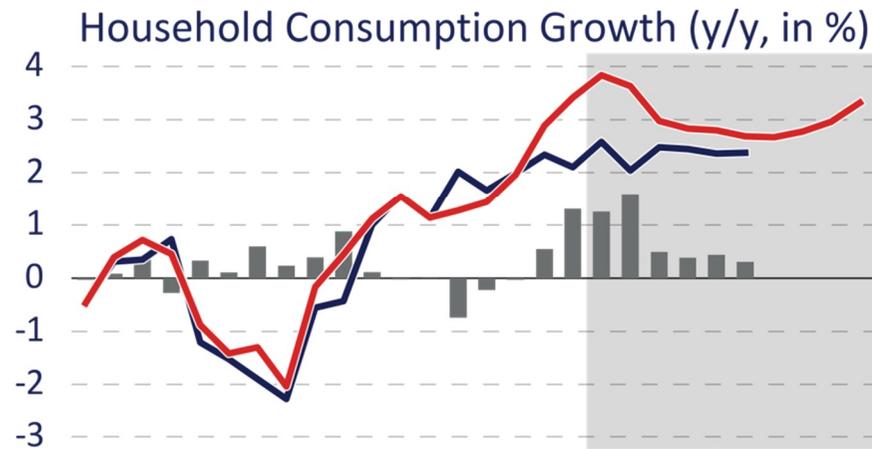
- The higher outlook for core inflation reflects higher observed core inflation in recent months and stronger domestic economic growth in 2015.
- The forecast of food prices is higher due to higher observed data, reflecting growing imported food prices.

Comparison: GDP Forecast (i)



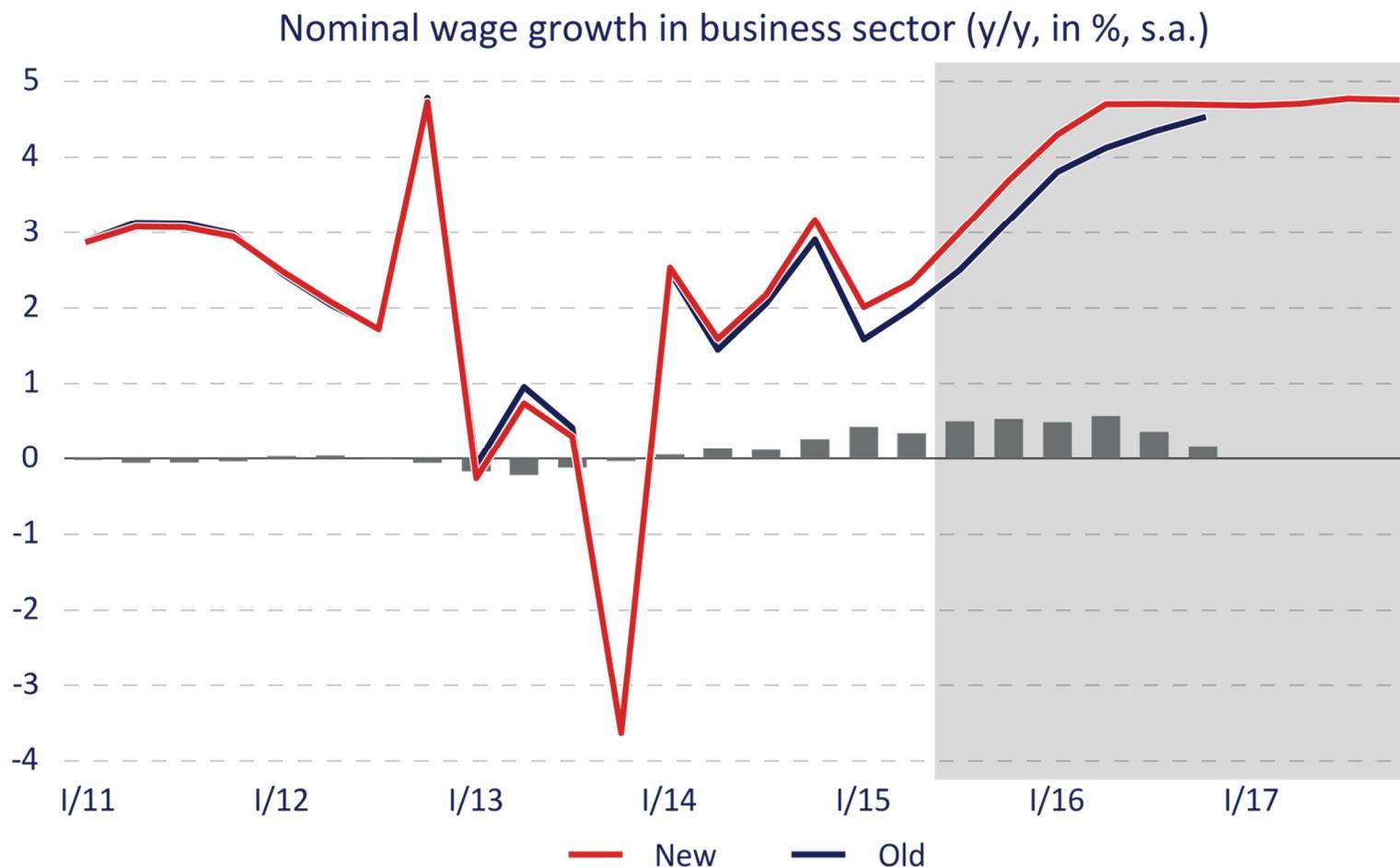
- The forecast for annual GDP growth in 2015 is significantly above the previous prediction. The revision is due mainly to considerably stronger GDP growth in 2015 Q1 and slightly higher external demand.
- The GDP growth outlook for 2016 is slightly lower, primarily because of a higher base effect (especially in Q1) and stronger koruna-euro exchange rate.

Comparison: GDP Forecast (ii)



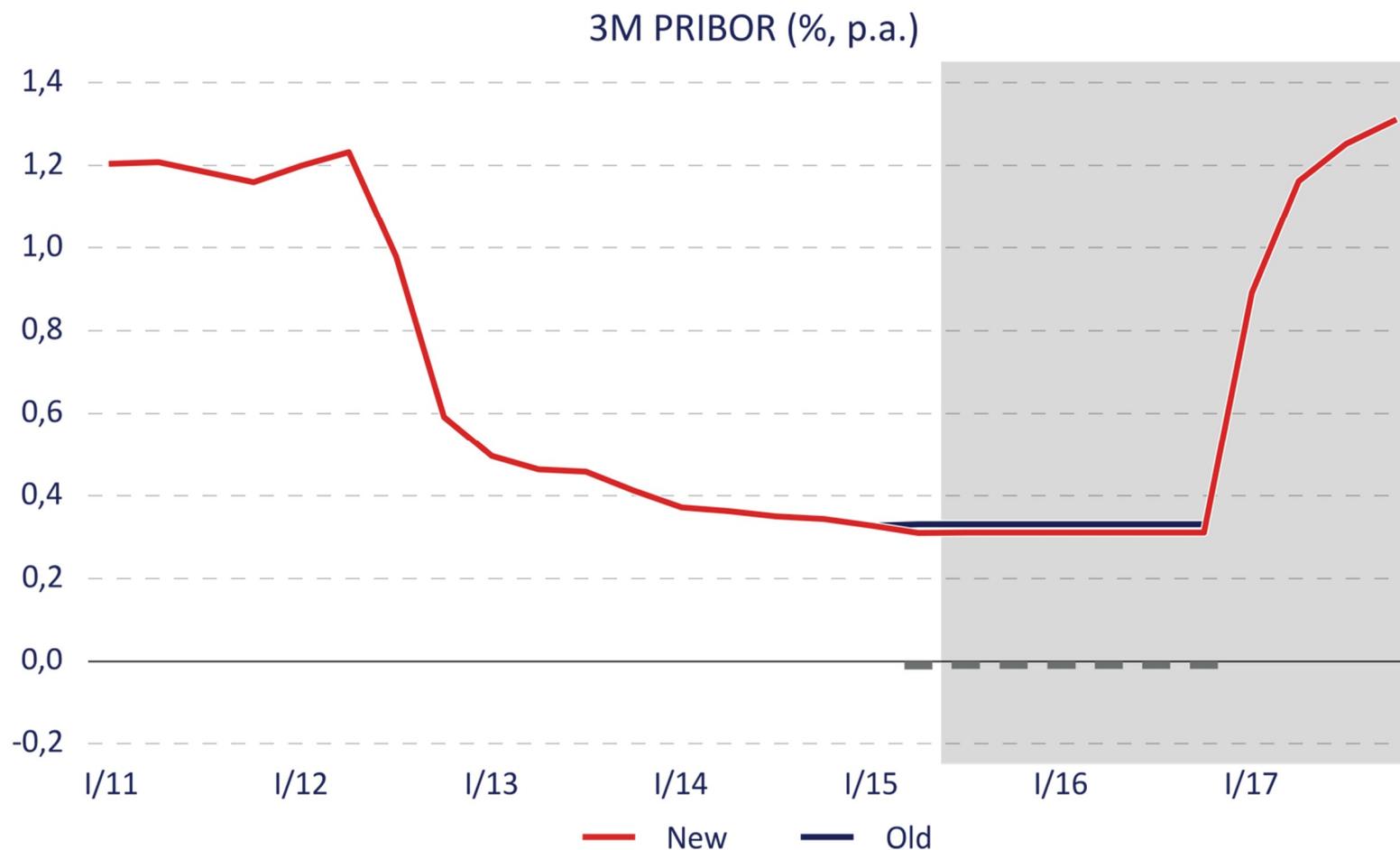
— New — Old

- The forecast for household consumption has been moved upwards in 2015-16 due to higher growth of wages and employment as well as lower savings rate.
- The contribution of net exports to GDP growth in 2015 is less negative than in the previous forecast (slightly higher growth in external demand). In 2016, by contrast, the contribution of net exports will be less positive because of slightly stronger growth in domestic demand.



- Growth in the average nominal wage in the business sector has been increased compared to the previous forecast.
- This revision primarily reflects the observed higher growth in wages and better economic prospect in 2015.

Comparison: Interest Rate Forecast



- The path of domestic market interest rates is unchanged until the end of next year.

Thank you for your attention!

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