CNB's New Forecast (Inflation Report III/2017)

Meeting with Analysts

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Outline

1. Assumptions of the forecast
2. The new macroeconomic forecast
3. Comparison with the previous forecast

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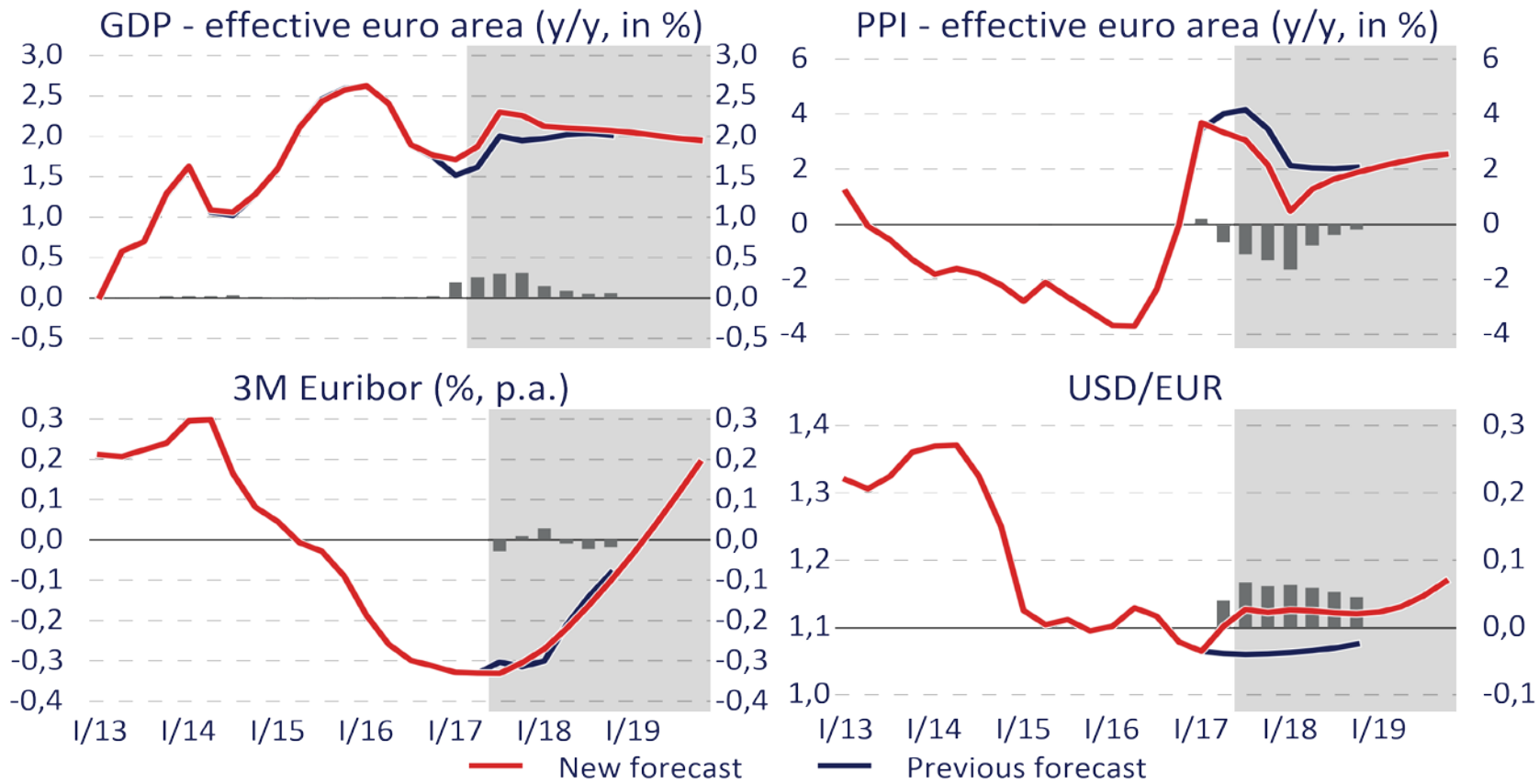
External Environment Outlook



- Economic growth in the effective euro area will accelerate above 2% this year and then gradually return to that level.
- The strong growth in PPI seen at the start of this year will gradually slow down until the start of next year and then return slightly above 2%.
- According to the market outlook, the 3M EURIBOR interest rate will not turn positive until 2019, the euro-dollar rate will be relatively stable.

Fiscal Impulse

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Contributions to GDP growth in percentage points	2016	2017	2018	2019
	actual	forecast	forecast	forecast
Fiscal impulse	-1.0	0.5	0.3	0.1
of which impact through:				
private consumption	0.0	0.2	0.3	0.0
private investment	-0.1	-0.1	0.0	0.0
government investment, domestic	-0.2	0.1	0.0	0.0
government investment, EU funded	-0.8	0.2	0.1	0.1

- The expansionary effect of fiscal policy will be strongest this year and then gradually weaken.
- In 2017 positive fiscal policy contribution to economic activity of 0.5 percentage point is related mainly to a recovery in government investment growth after last year's slump.
- Fiscal expansion will continue in the next year, materializing to a greater extent through household consumption. This will be driven by a package of new social measures and continued buoyant growth in public sector pay.

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Summary of the New Forecast

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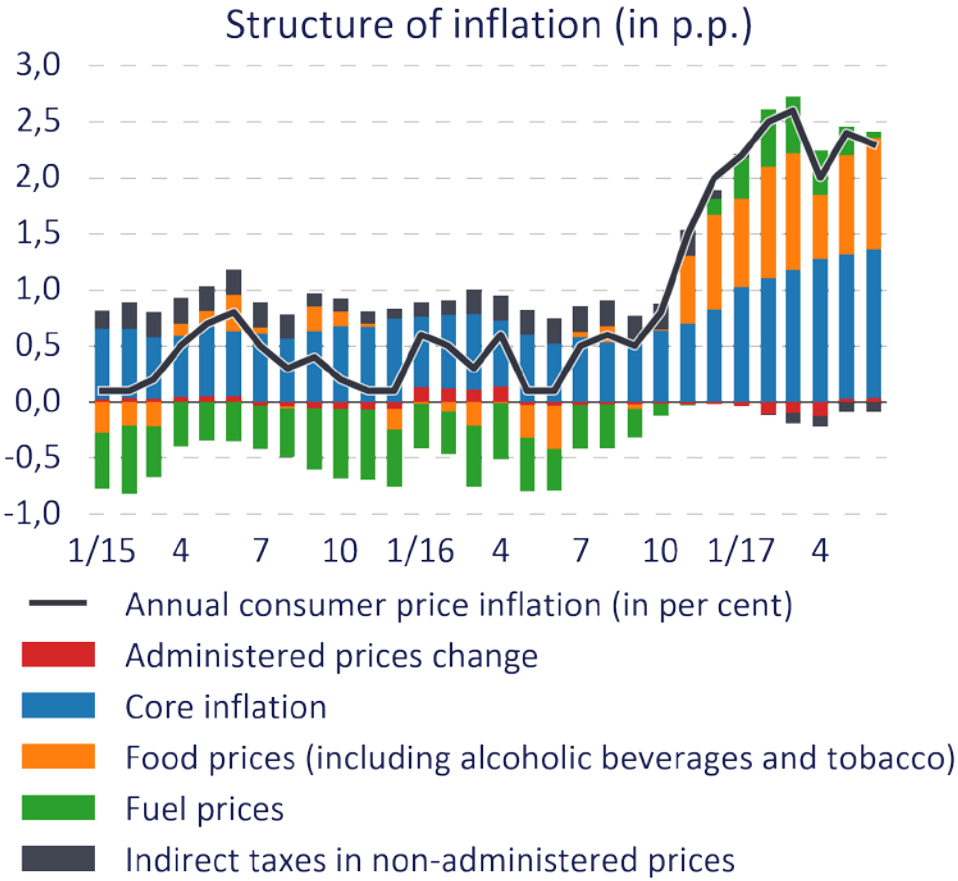
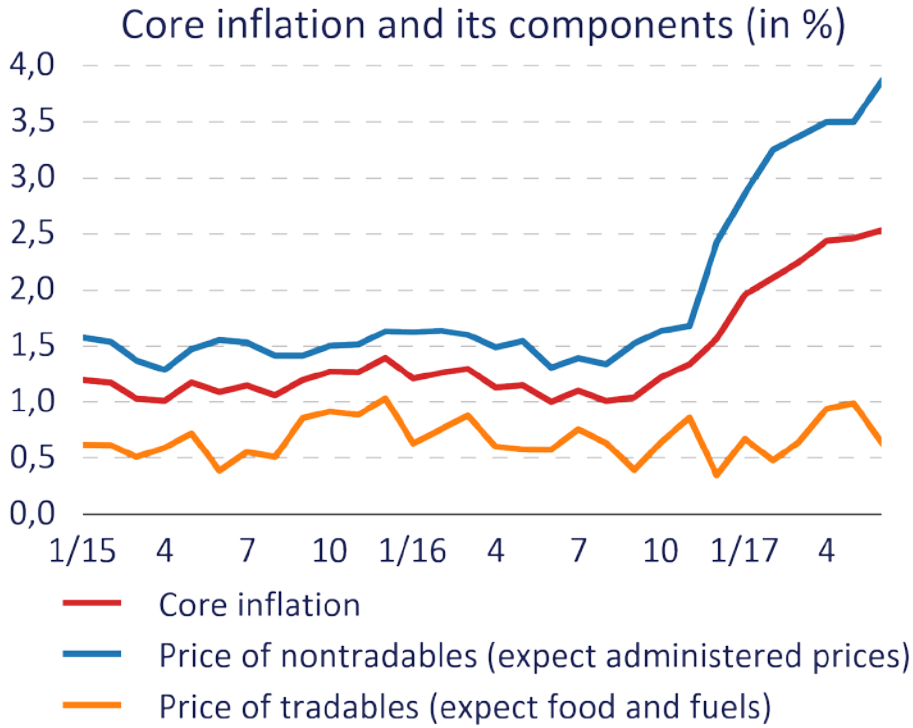
- Headline inflation will stay in the upper half of the tolerance band this year and return to the 2% target at the start of next year. Monetary policy-relevant inflation, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, will be very close to headline inflation.
- The growth of the Czech economy will accelerate visibly above 3% this year and will stay slightly above 3% in the following two years.
- The domestic economic activity will be driven mainly by robust growth in household consumption, continuous growth of foreign demand and gradual renewal of government investment co-financed from EU funds.
- Growing labour demand will, in combination with the lack of available work-force, result in an accelerated growth of wages.
- The koruna will appreciate further against the euro (positive interest rate differential, quantitative easing by the ECB and renewed real convergence).
- The monetary conditions will continue to shift towards a neutral stance.
- Consistent with the forecast is an increase in domestic market interest rates in 2017 Q3 and subsequently also in the following two years.

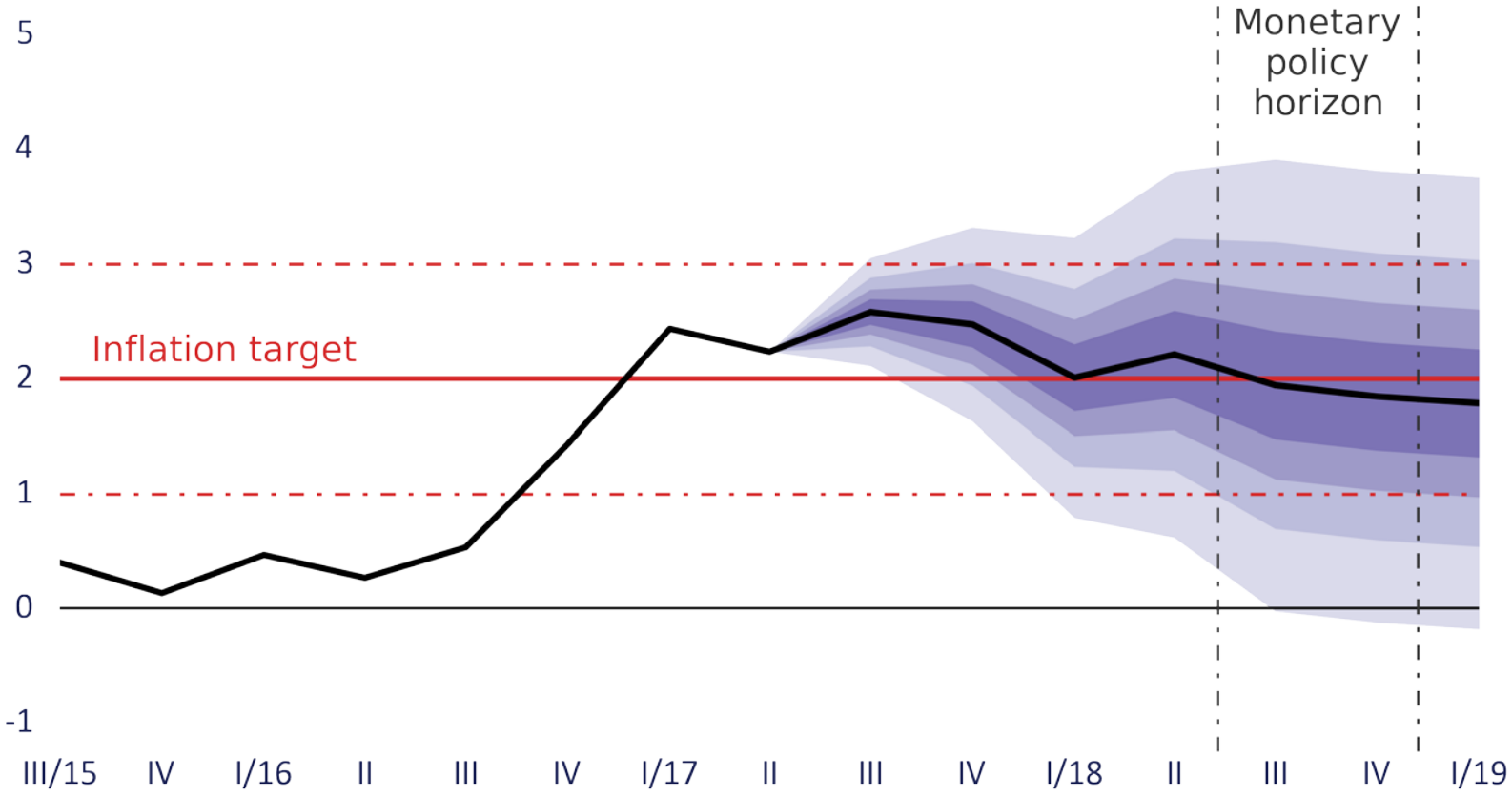
Structure of Inflation





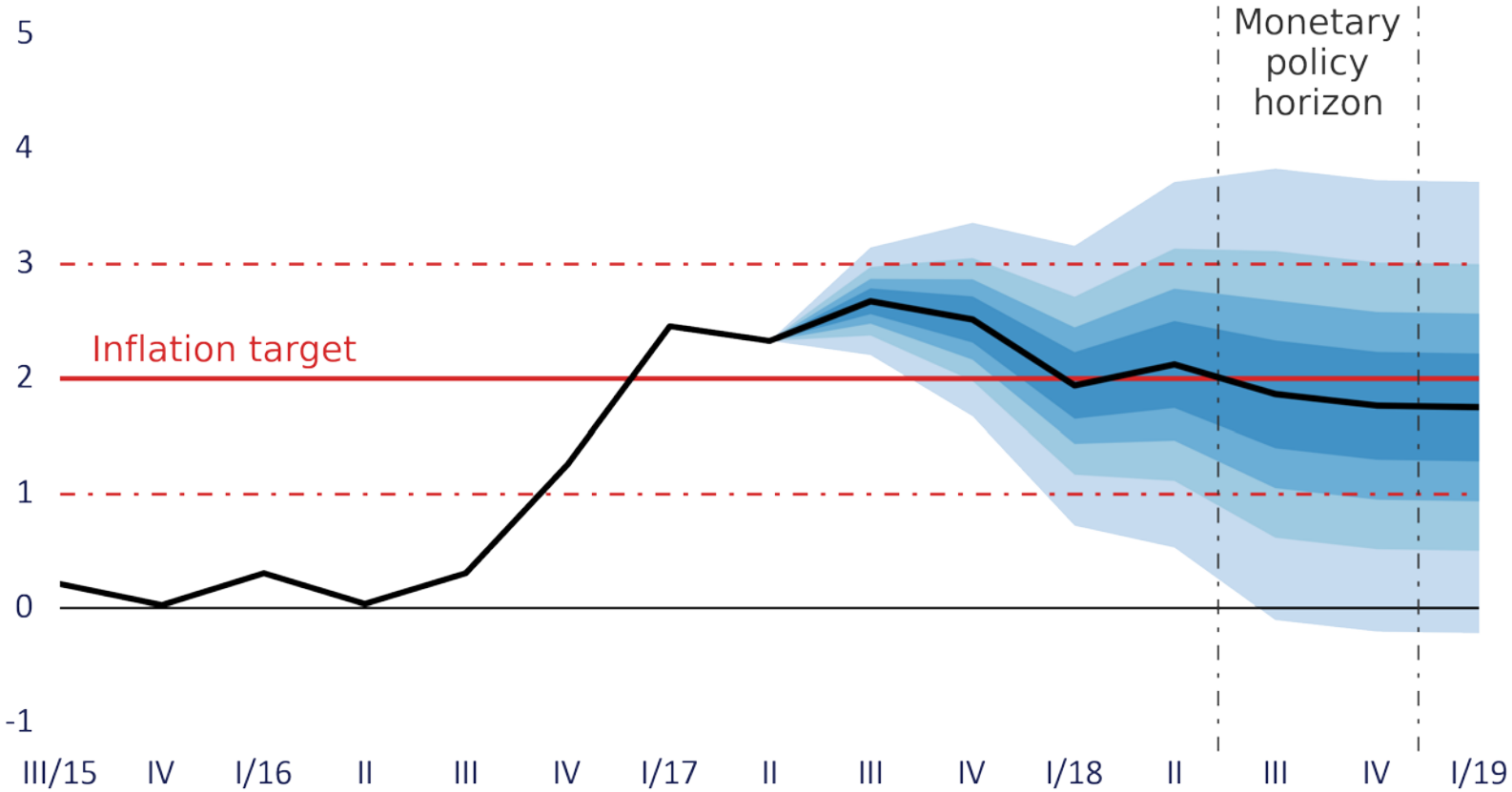
- The growth in consumer prices was driven by a further increase in core inflation and faster growth in food prices, while the contribution of fuel prices gradually decreased.
- Core inflation rose further owing to faster growth in non-tradables prices.

Headline Inflation Forecast



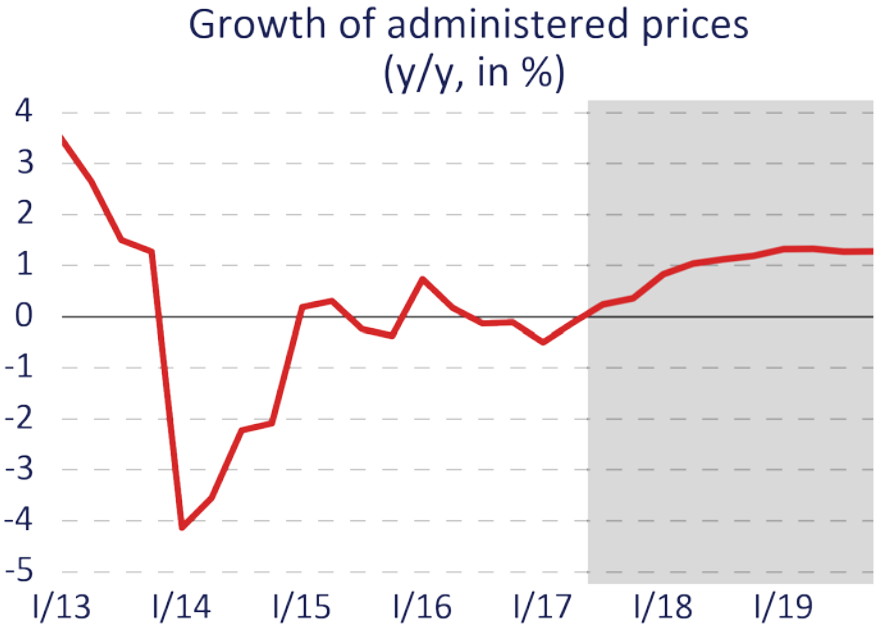
- Inflation pressures are currently peaking, reflecting accelerating wage growth amid robust growth of the domestic economy.
- Headline inflation will decline at the start of next year and will be slightly below the 2% target over the monetary policy horizon.

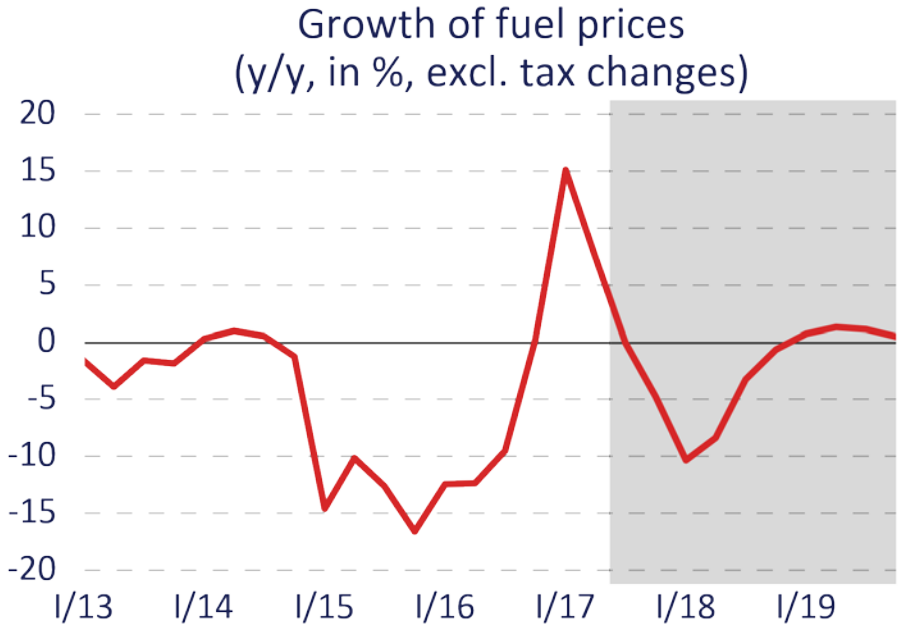
Monetary Policy-Relevant Inflation Forecast



- MP-relevant inflation will differ only marginally from headline inflation.
- The impact of indirect tax changes on headline inflation will be negligible, with increases in excise duty on tobacco products being broadly offset by a reduction in the VAT rate applying to restaurants from 21% to 15% (from December 2016) coupled with a decrease in VAT rate on newspapers and magazines from 15% to 10% (from March 2017).

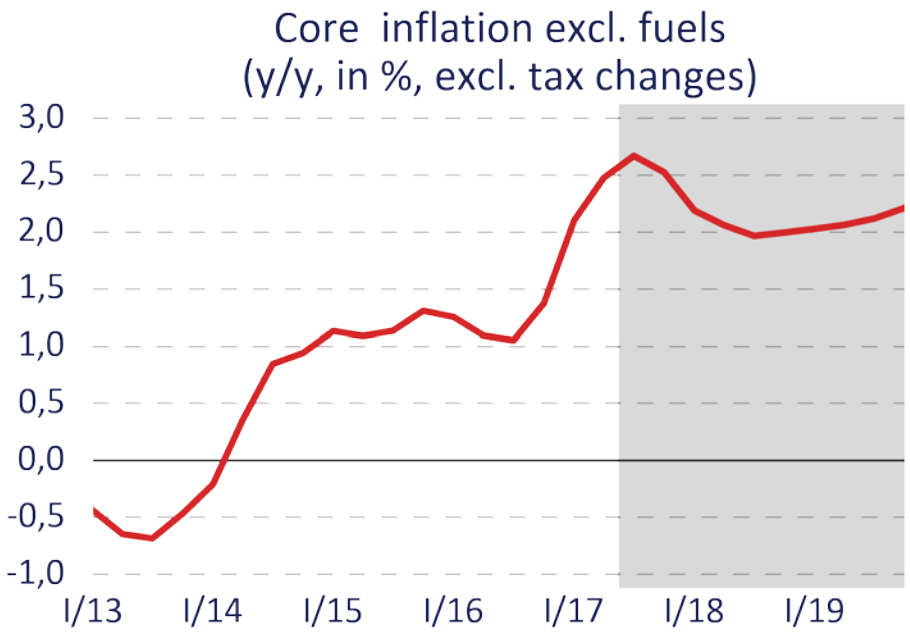
Administered and Fuel Prices

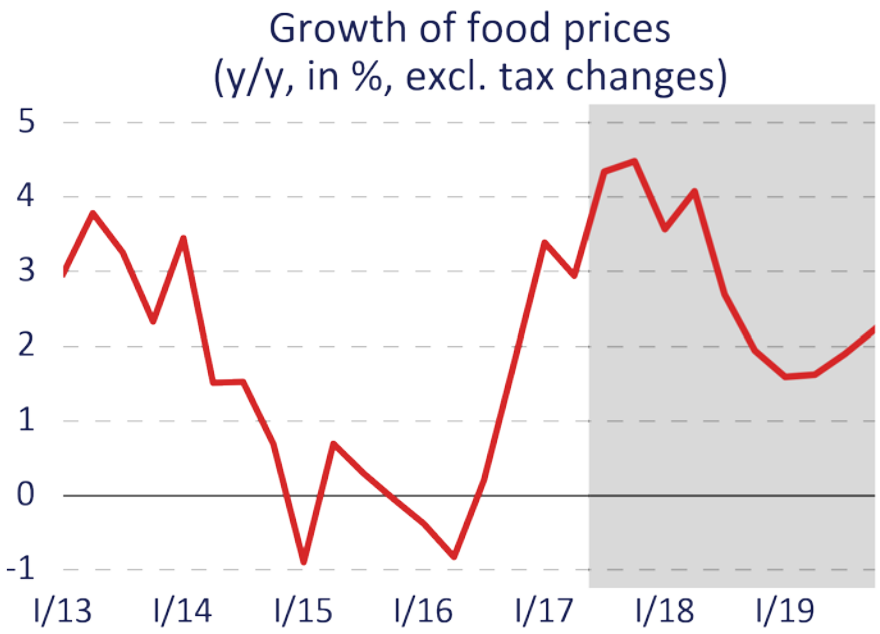




- Administered prices will not go up until 2018, they will accelerate only slightly to 1.3% in 2019. Faster growth will be prevented by almost flat prices of energy commodities accompanied by a slightly appreciating koruna-dollar rate.
- According to available indicators, fuel prices were lower in July than in previous months, so the deceleration in their year-on-year growth is continuing. On the forecast horizon fuel prices will fall temporarily in line with global oil prices.

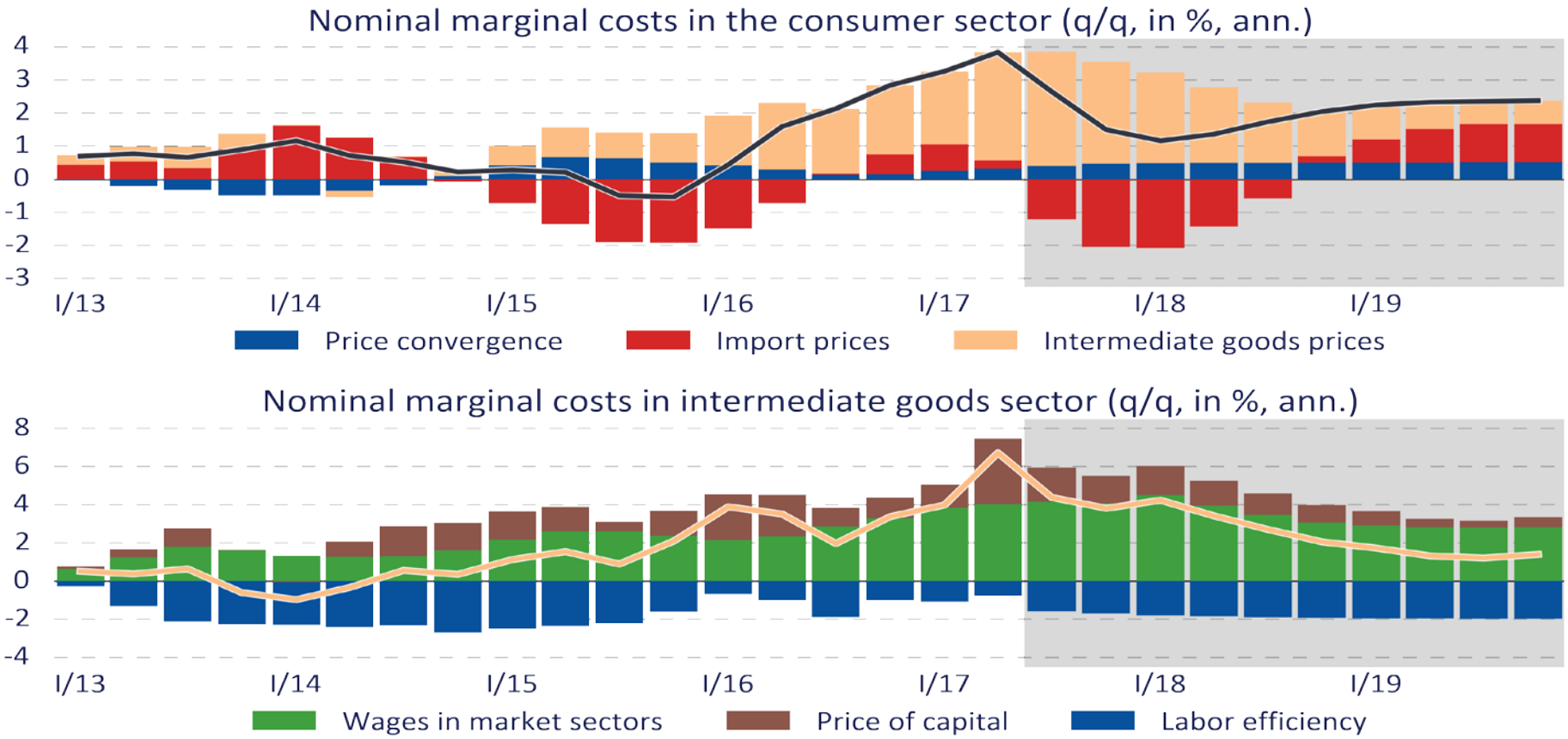
Core Inflation and Food Prices





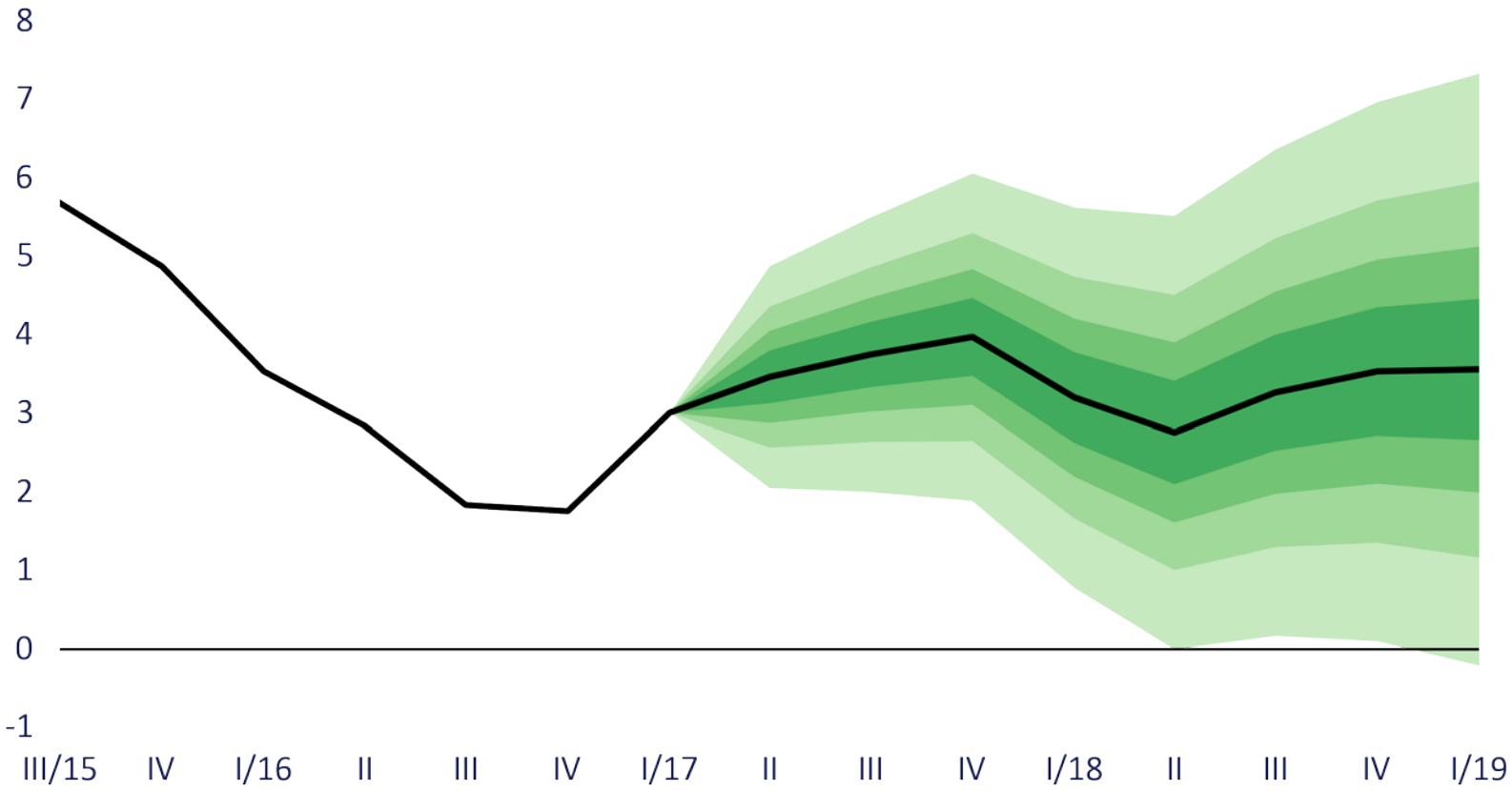
- In the near term core inflation will accelerate further as a result of the currently strong cost pressures and then slow down to 2% owing to a decline in import prices. The surge in price growth will particularly be visible in the case of non-tradables due to inflation pressures from the domestic economy.
- Food price growth will temporarily rise further owing to growth in agricultural commodity prices. Annual food price inflation will thus exceed 4% in the 2017 H2. The forecast expects it to go down gradually from early 2018 onwards.

Domestic Costs vs. Import Prices



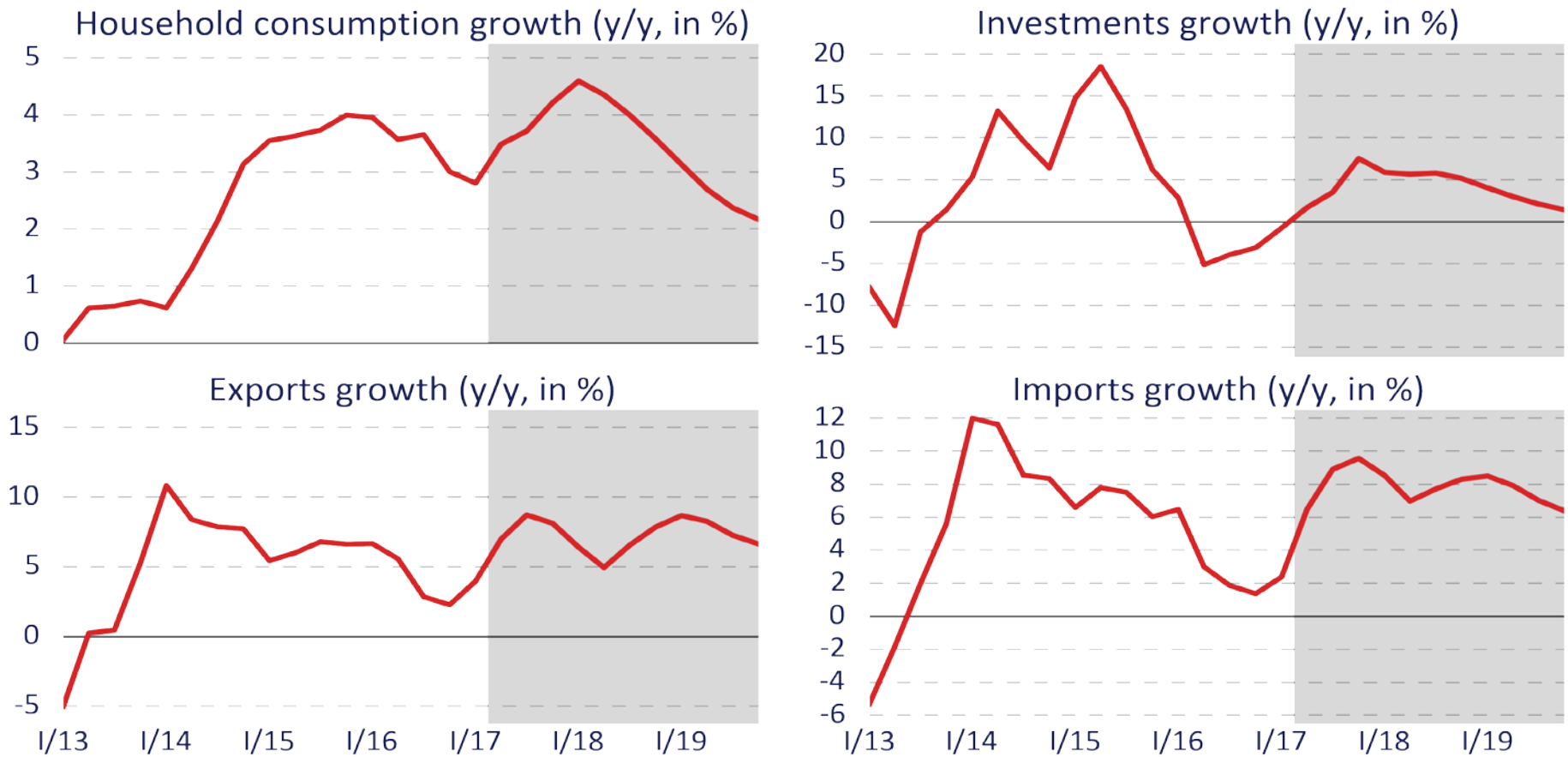
- The currently peaking inflation pressures will ease somewhat this year, mainly reflecting anti-inflationary import prices.
- Domestic costs will continue to rise, although at a slower pace than at present, on the back of accelerated wage growth and a rising price of capital amid an upswing in labour efficiency.

GDP Growth Forecast



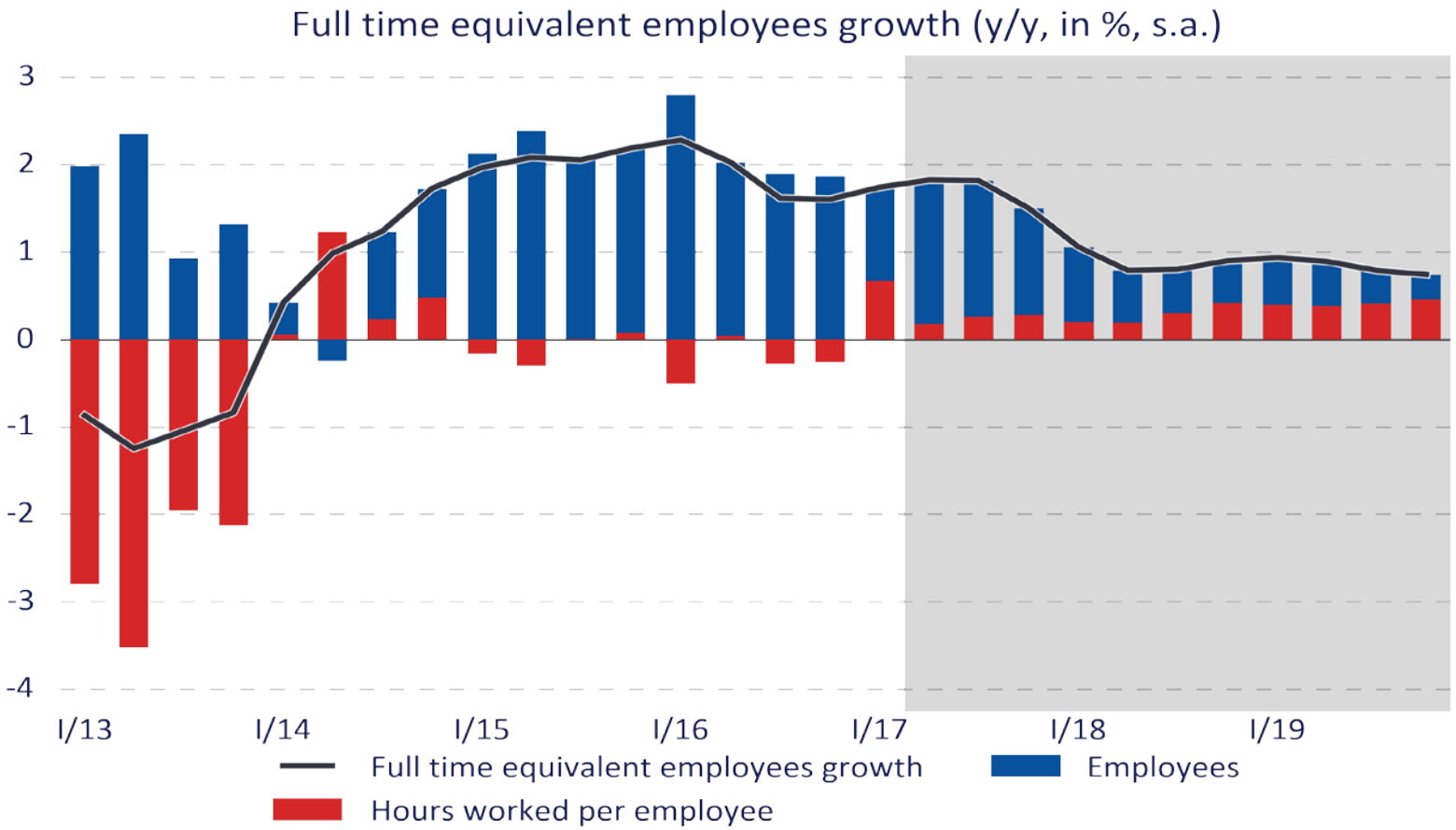
- GDP growth will rise to 3.6% this year and fluctuate close to 3% in the following years.
- Growth in domestic economic activity will be driven mainly by robust growth in household consumption, reflecting consumers' optimism in an environment of continued growth in employment, faster growth in wages and low interest rates.

Aggregate Demand



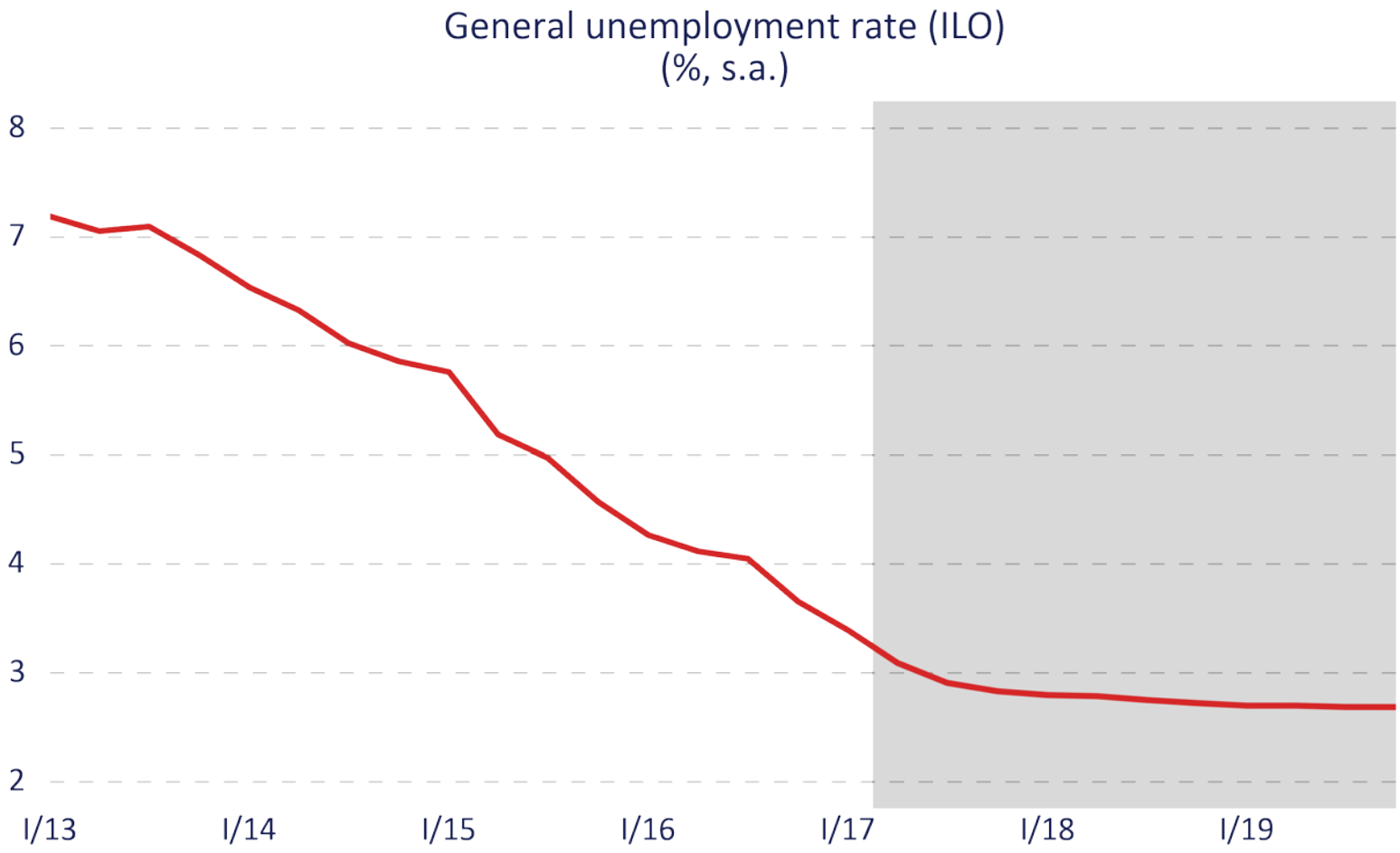
- The strong household consumption growth will reflect a further rise in the wages and salaries and other income.
- Growth in investment will recover thanks to renewed drawdown of EU funds and faster growth in private investment (low real rates, high foreign demand).
- Net exports will make a positive contribution to GDP growth this year and a negative one in 2018 due to a recovery in investment and koruna appreciation.

Labor Market: Employment



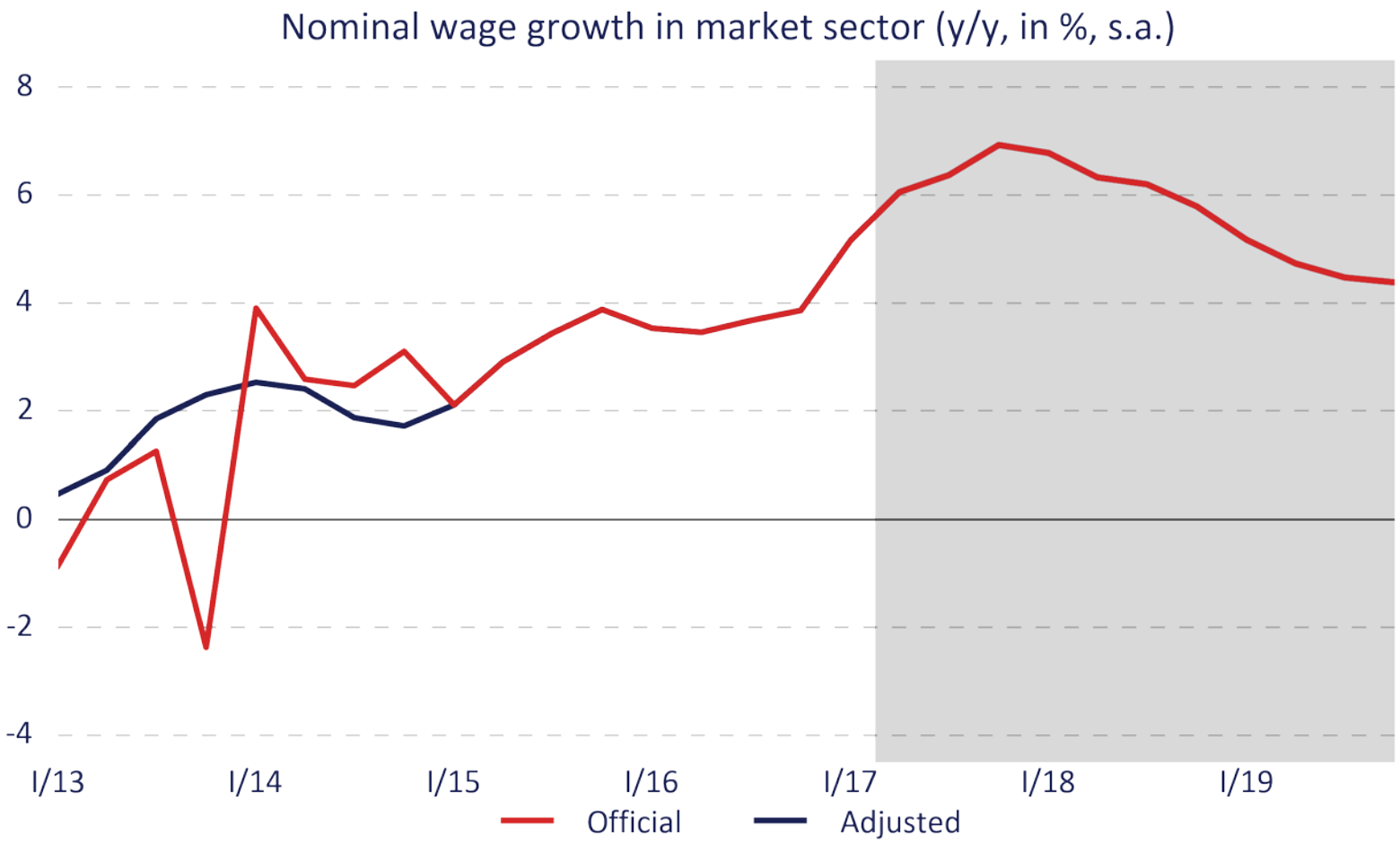
- Growth in the number of employees converted into full-time equivalents will be pronounced throughout 2017 (gradually slowing growth in the number of employees and modest increase in average hours worked).
- It will continue to rise significantly in the next two years but the pace of growth will be about half that recorded this year.

Labor Market: Unemployment



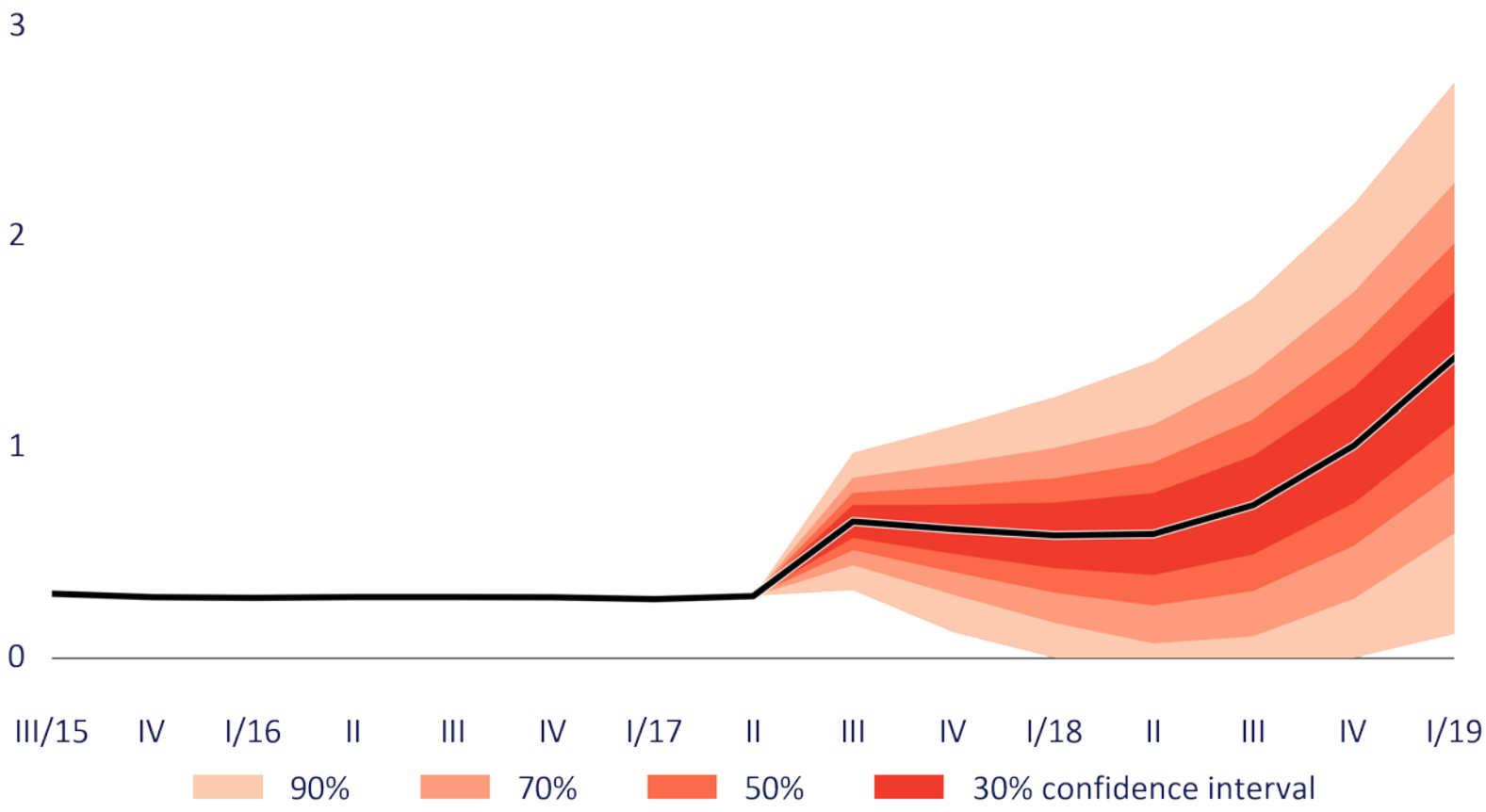
- The now very low unemployment rate is preventing unemployment from falling significantly further.
- The general unemployment rate will thus go down only slowly this year and in the next two years (to 2.7% in 2019).

Labor Market: Wage Growth in Business Sector



- The growing tightness in the labour market will exert upward pressure on wage growth in market sectors.
- Wage growth in market sectors will later slow to close to its assumed long-term equilibrium level, aided by gradually tightening monetary conditions.

Interest Rate Path (3M PRIBOR)



- Consistent with the forecast is an increase in domestic market interest rates in 2017 Q3 and later also in the following two years.

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Comparison with Previous Forecast

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- The new inflation forecast is almost unchanged due to an unchanged level of overall inflation pressures. However, the structure of those pressures is somewhat different. The domestic economy will have a more inflationary effect via higher growth in wages and economic activity. This, however, will be broadly offset by substantially slower growth in foreign producer prices.

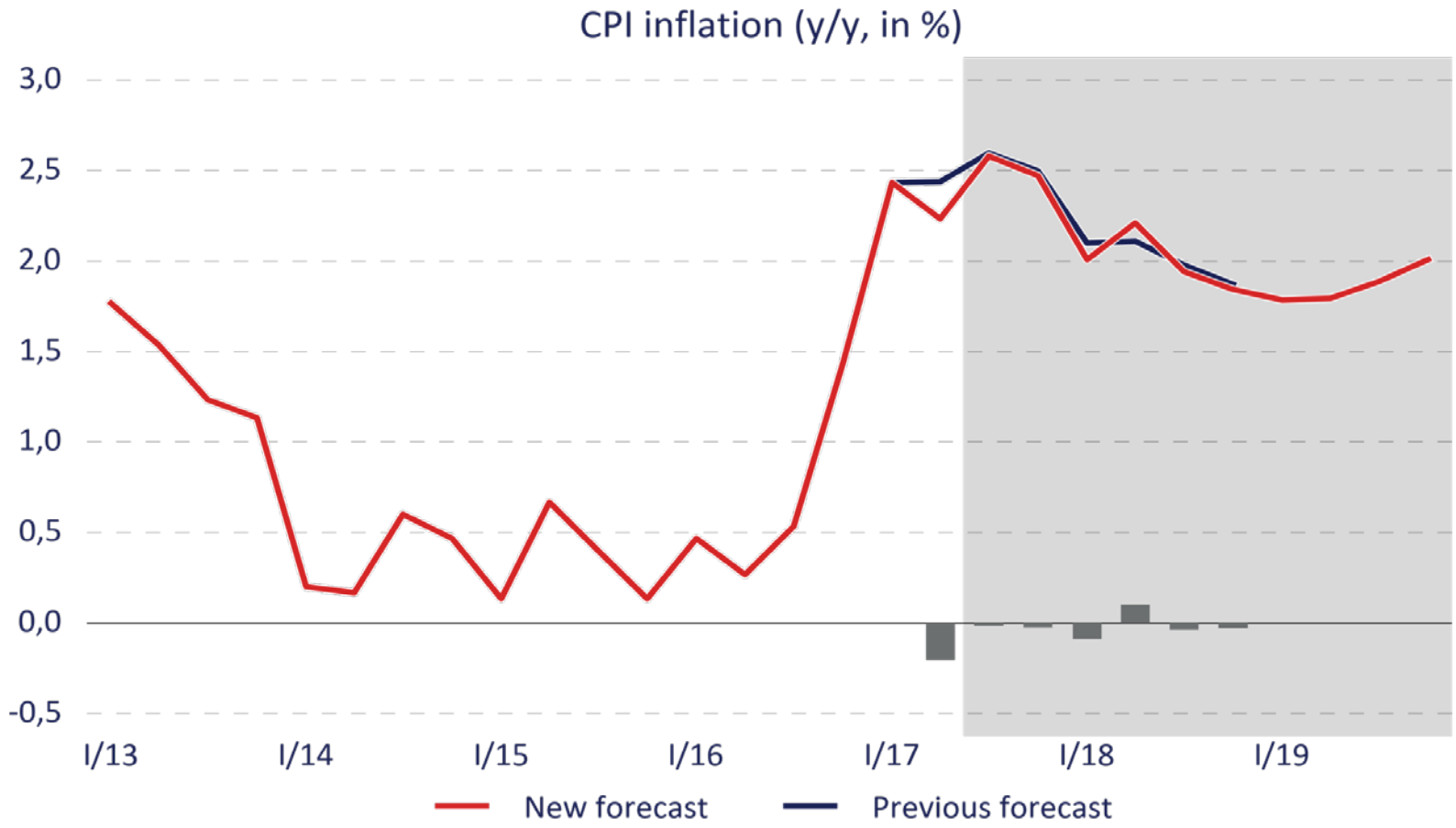
- The forecast for growth in domestic economic activity this year and the next has shifted upwards.

- The developments observed in 2017 Q1, monthly data from industry and higher economic growth have led to an increase in the nominal wage forecast.

- The koruna will appreciate slightly less than expected in the previous forecast up to the end of this year, but its path will then be similar.

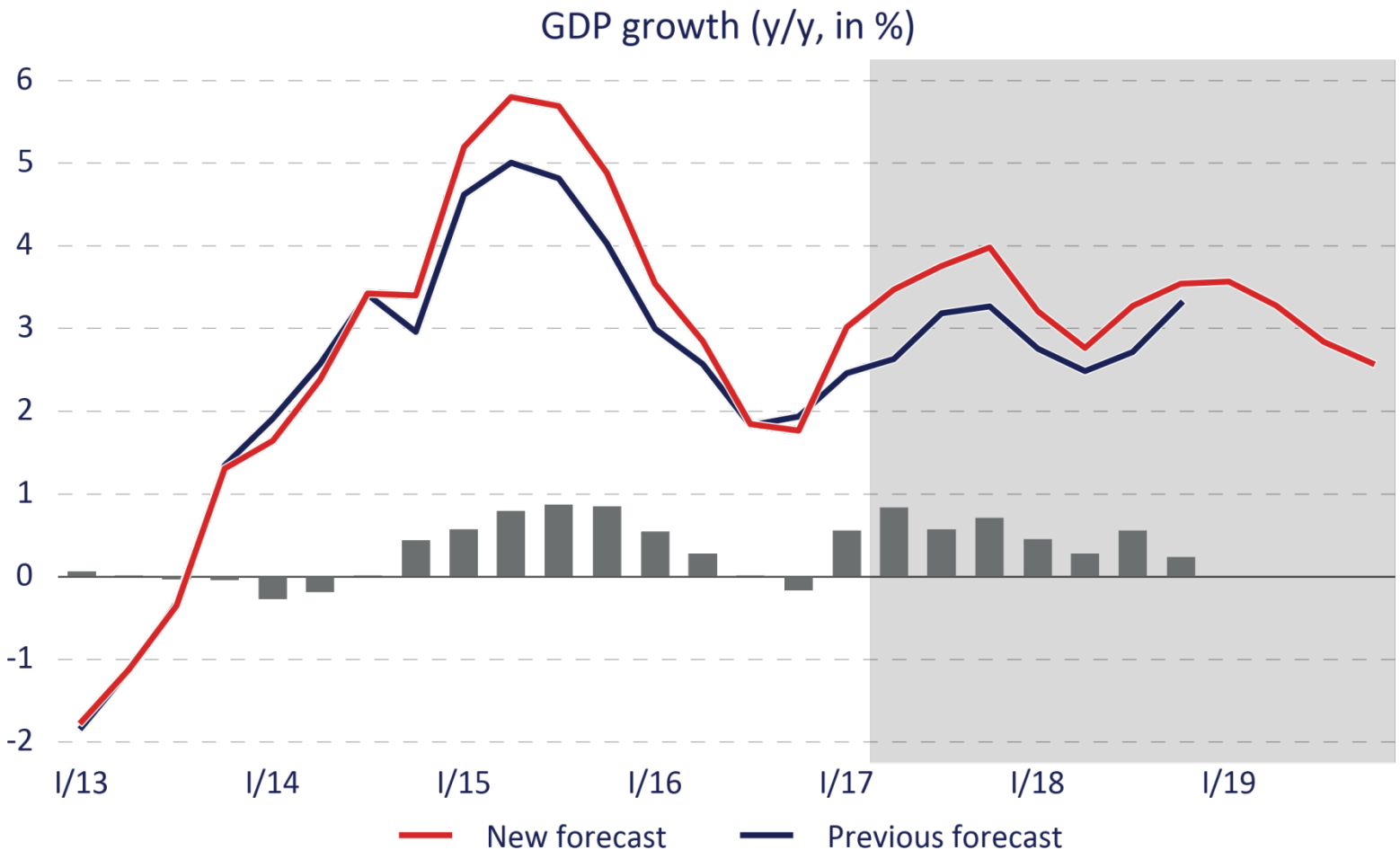
- The path of market interest rates is virtually the same as in the previous forecast.

Comparison: Inflation Forecast



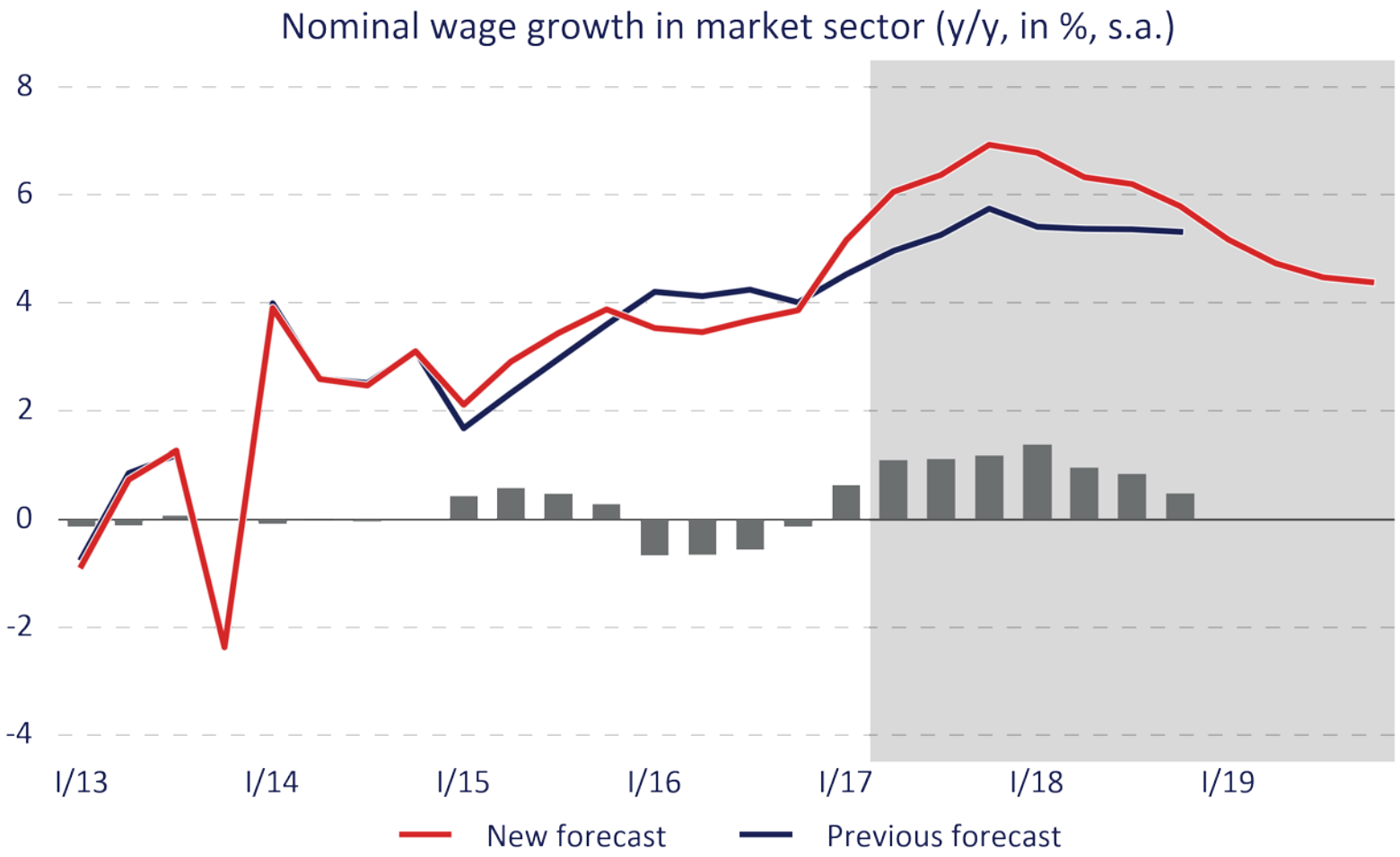
- The forecast for headline inflation is little changed, but the structure of the cost pressures is somewhat different.
- The domestic economy will be more inflationary over the forecast horizon. However, this will be offset by a stronger anti-inflationary effect of import prices stemming from lower growth in foreign PPI.

Comparison: GDP Forecast (i)



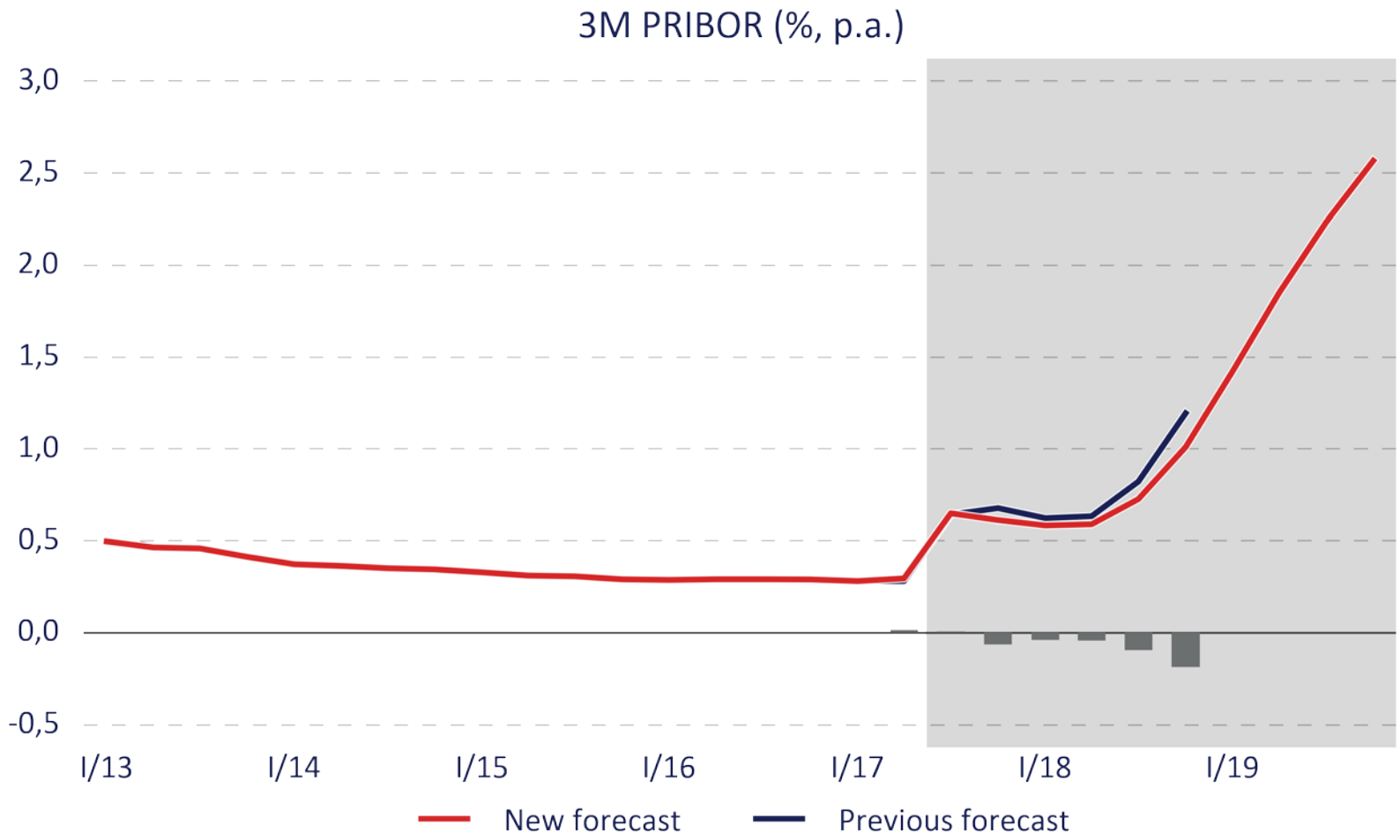
- The forecast for growth in domestic economic activity this year and the next has shifted upwards.
- This revision is due largely to household consumption, which is a result of stronger observed and expected growth in wages and salaries.

Comparison: Nominal Wage



- The wage forecast has moved upwards significantly as a result of higher observed figures and leading indicators.
- The faster wage growth is mainly driven by a tighter labour market and higher external demand.

Comparison: Interest Rate Forecast



- The path of market interest rates is virtually the same as in the previous forecast.
- This reflects similar expected paths of overall inflation pressures, the koruna exchange rate and foreign interest rates.

Thank you for your attention!

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