# CNB's New Forecast (Inflation Report IV/2017)

# Meeting with Analysts

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Prague, 3 November 2017

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# Outline

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

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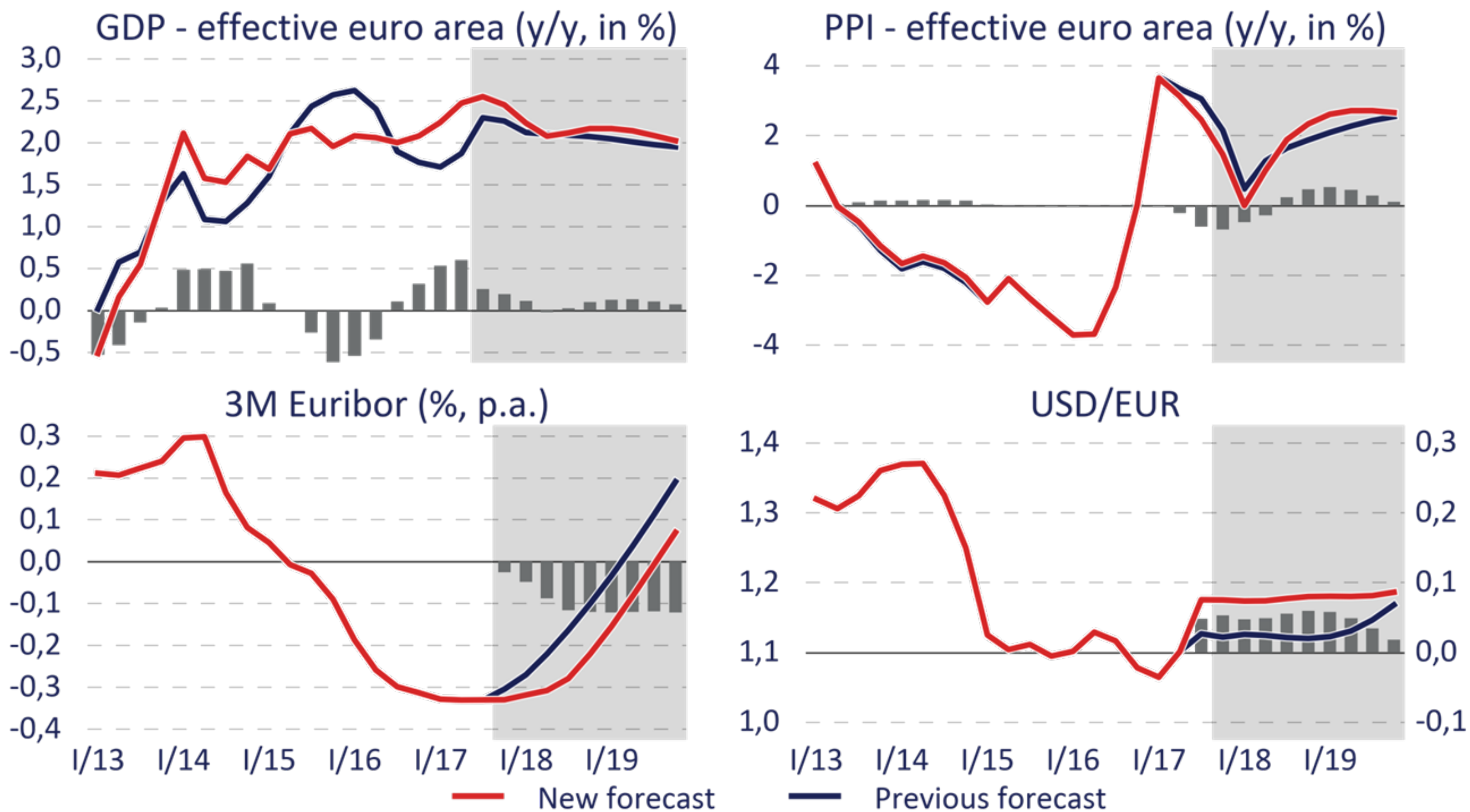
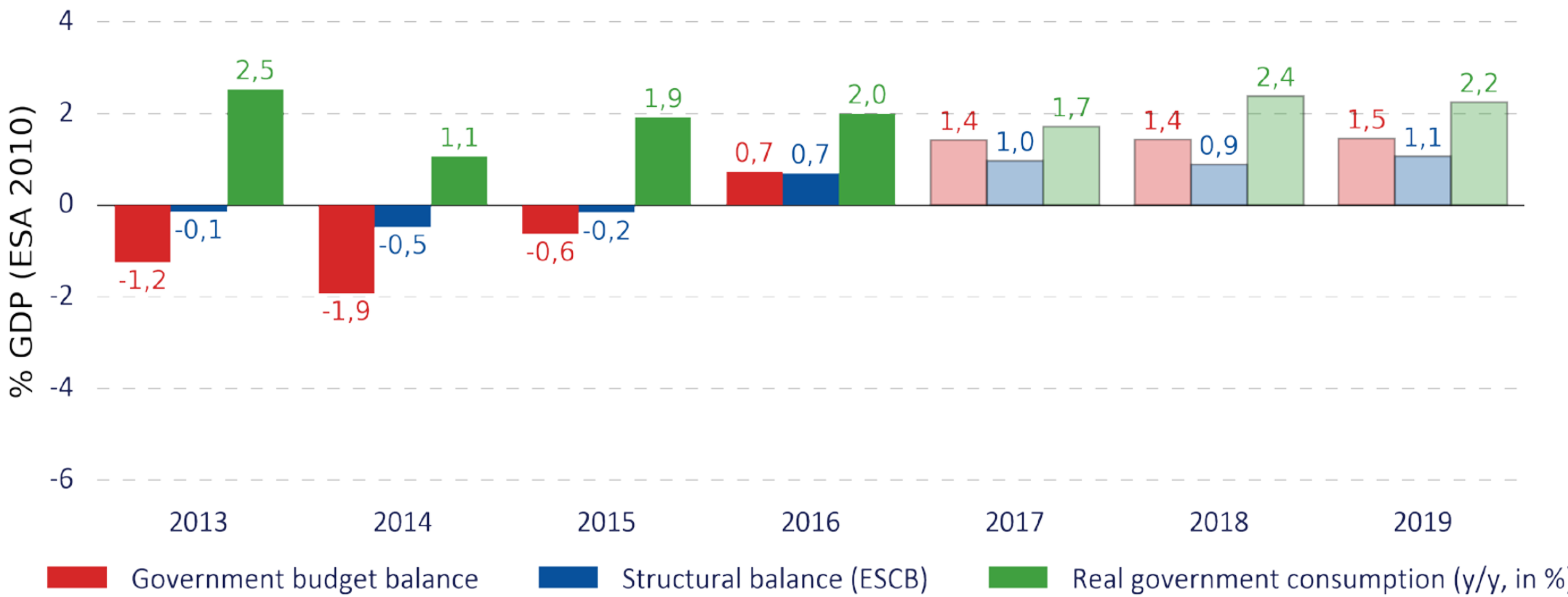
# External Environment Outlook




- The growth in the effective eurozone further accelerates in 2H 2017, and then gradually returns to approx. 2%.
- Growth in industrial producer prices will slow to zero by the start of 2018 and then rebound and accelerate above 2%.
- The outlook for 3M EURIBOR reflects continued easy monetary policy of the ECB. The euro is expected to be steadily slightly below 1.20 USD/EUR.

# Fiscal Policy




- Increasing government budget surpluses reflect increase in tax revenues due to continued economic growth and policy measures.
- In this year the government surplus will reach 1.4% GDP, and will remain at this level for the next two years. This will translate into further increase in structural surplus and decrease in government debt.
- The government consumption will grow by 1.7% in 2017. The forecast expects even higher growth of more than 2% in 2018-2019.

# Fiscal Impulse

| Contributions to GDP growth in percentage points | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|
| | actual | forecast | forecast | forecast |
| Fiscal impulse | -1.1 | 0.4 | 0.4 | 0.0 |
| 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 | 0.1 | 0.0 |
| government investment, EU funded | -0.8 | 0.2 | 0.1 | 0.0 |

- Fiscal policy will be expansionary this and next year, and neutral in 2019.
- In 2017 positive fiscal impulse of 0.4 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, faster growth of pensions, and continued buoyant growth in public sector pay.

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# Summary of the New Forecast

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- Both headline and monetary policy-relevant inflation will remain in the upper half of the tolerance band around the CNB's target for most of 2018. Inflation will return to the 2% target at the monetary policy horizon.
- GDP growth will reach 4.5% in 2017, and will slow down to slightly above 3% in the following two years.
- The economy will be supported by strong household consumption, renewed investment activity and continuous growth of foreign demand.
- Growing labour demand will, in combination with the lack of available work-force, result in buoyant growth of wages.
- Exchange rate will appreciate further due to the effect of positive interest rate differential, ECB's quantitative easing, and long-term real convergence.
- In addition to appreciation of the koruna, the return of inflation to the target will be fostered by a continuing rise in domestic market interest rates.

# Structure of Inflation

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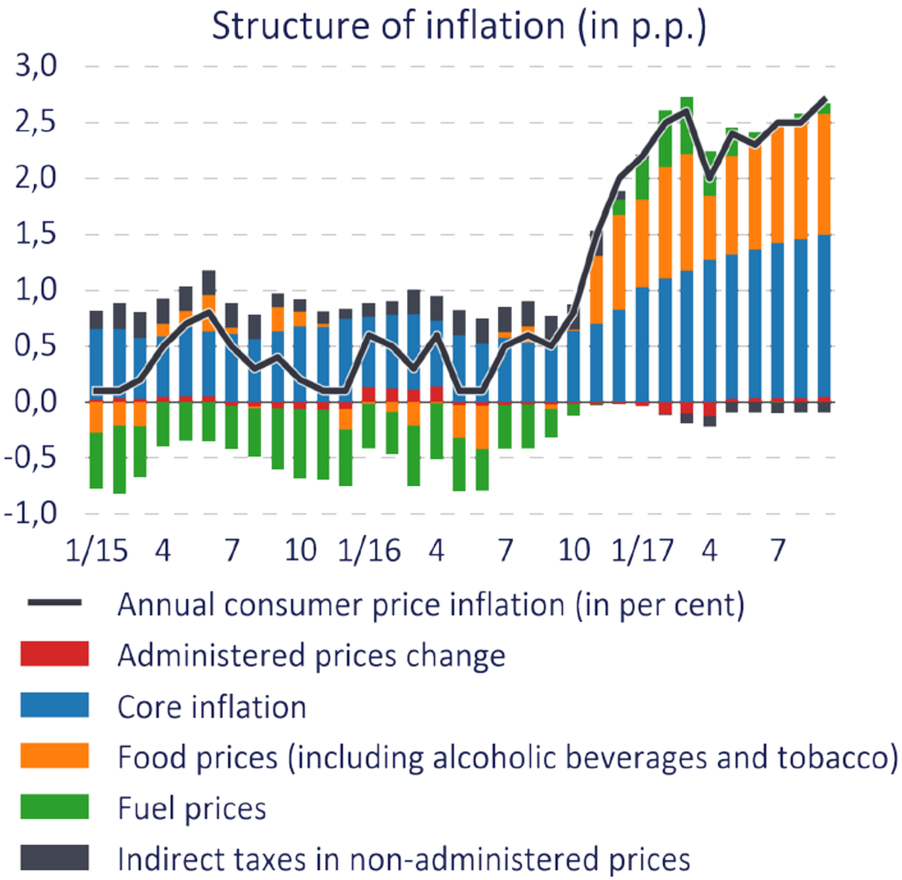
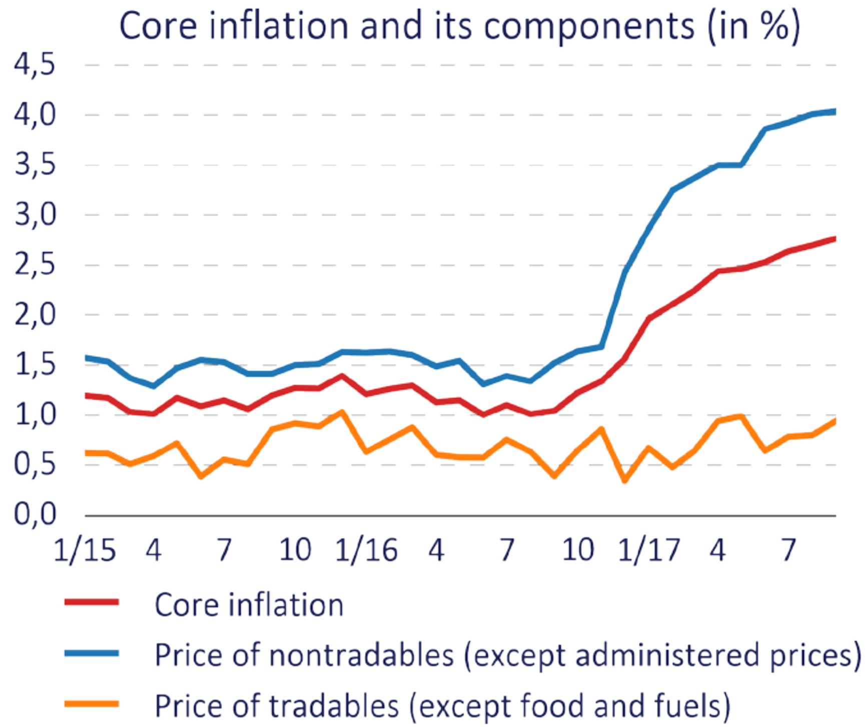
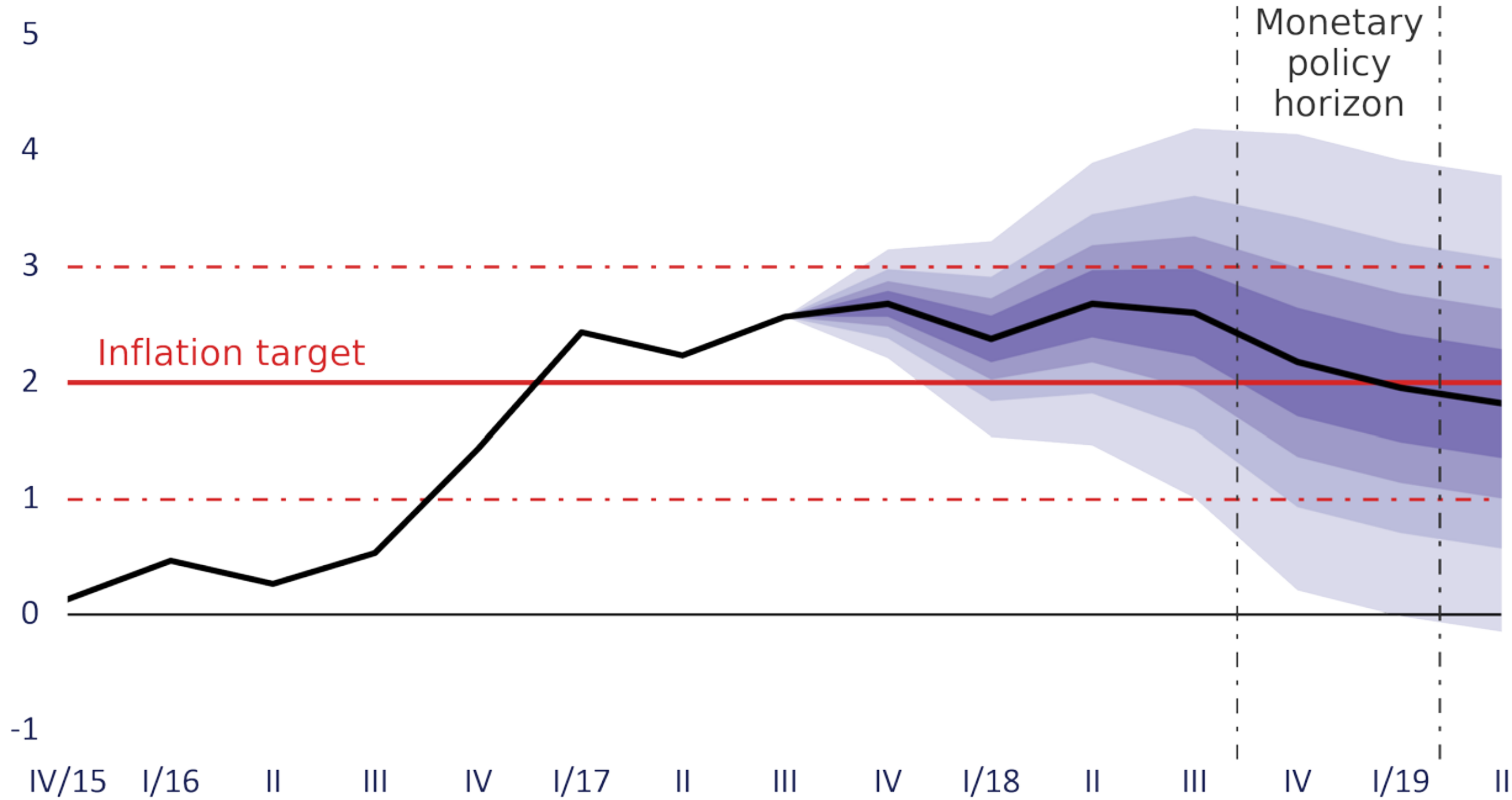


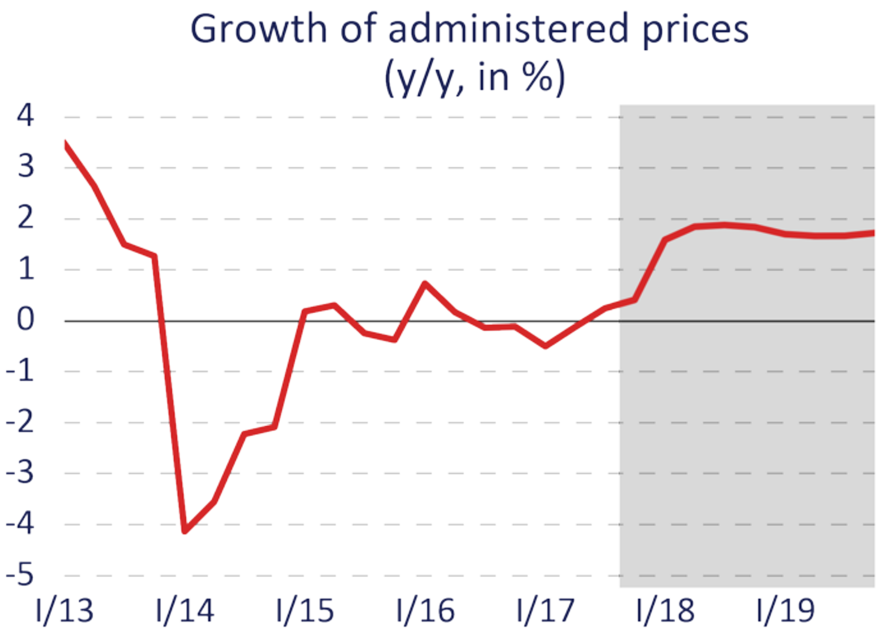

- The growth in consumer prices was driven by a further increase in core inflation and fast growth in food prices observed amid accelerated GDP and wage growth.
- Core inflation rose further owing to faster growth in non-tradables prices, mainly due to faster dynamics of imputed rent.

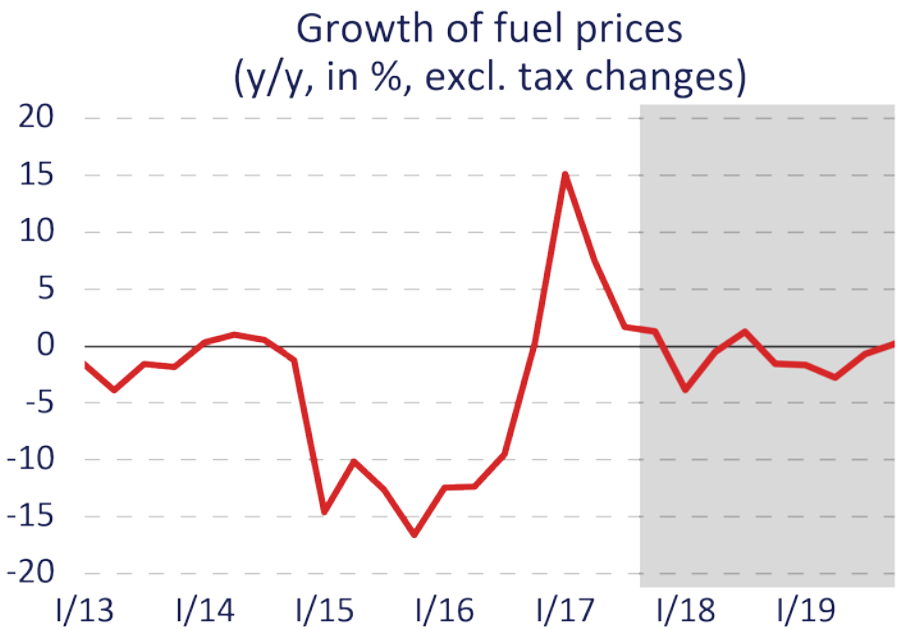
# Headline Inflation Forecast




- Headline inflation will stay above the 2% target for the most of 2018, and will be close to it over the monetary policy horizon.
- MP-relevant inflation will differ only marginally from headline inflation.

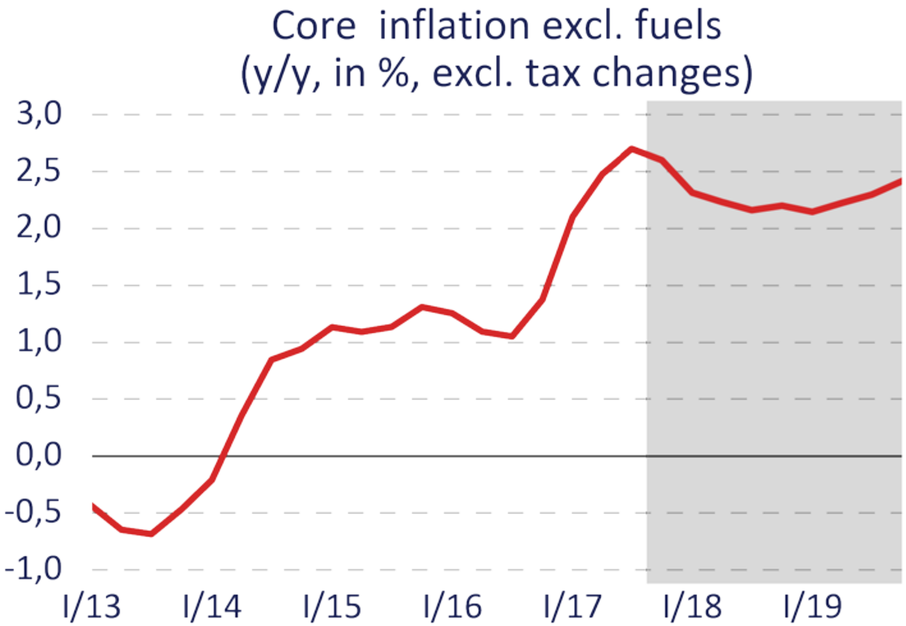
# Administered and Fuel Prices

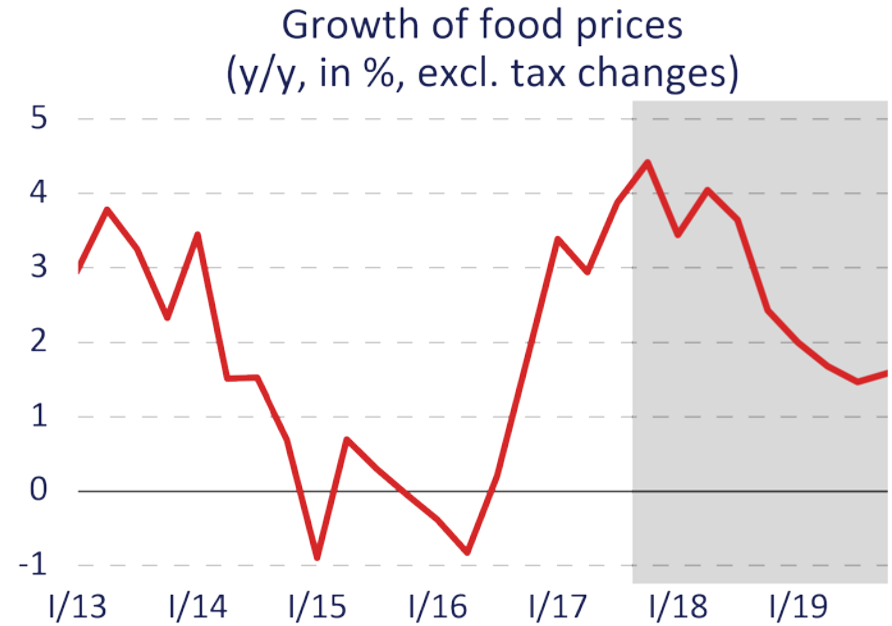



- Growth in administered prices will resume in relation to renewed growth in energy prices. Overall, administered prices are expected to rise by about 1,8% on average in both 2018 and 2019.
- Fuel prices will moderately decline due to the previous decrease in world oil prices and a contribution of the exchange rate appreciation in the next year.

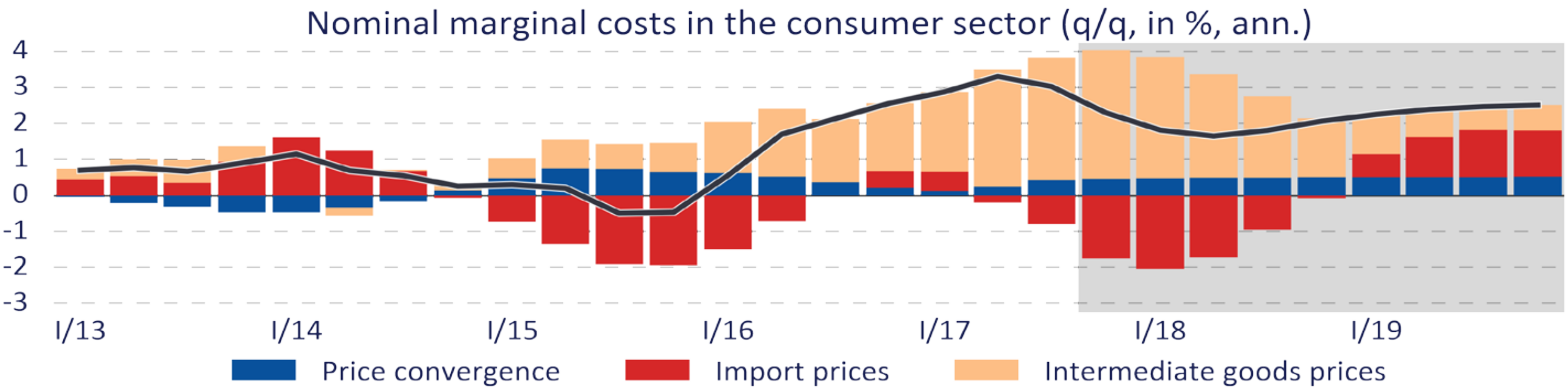
# Core Inflation and Food Prices

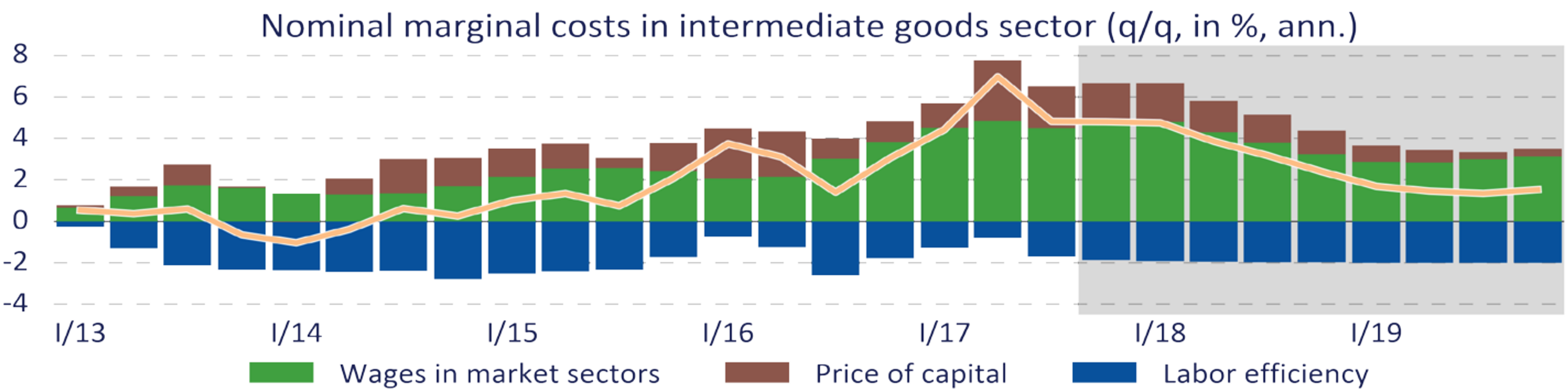



- Core inflation will slow down next year due to a decline in imported prices and fading out of the one-time effects.
- Growth of food prices will speed up temporarily. In the next year it will slow down markedly as a result of the fading agricultural commodities prices growth and appreciation of koruna.

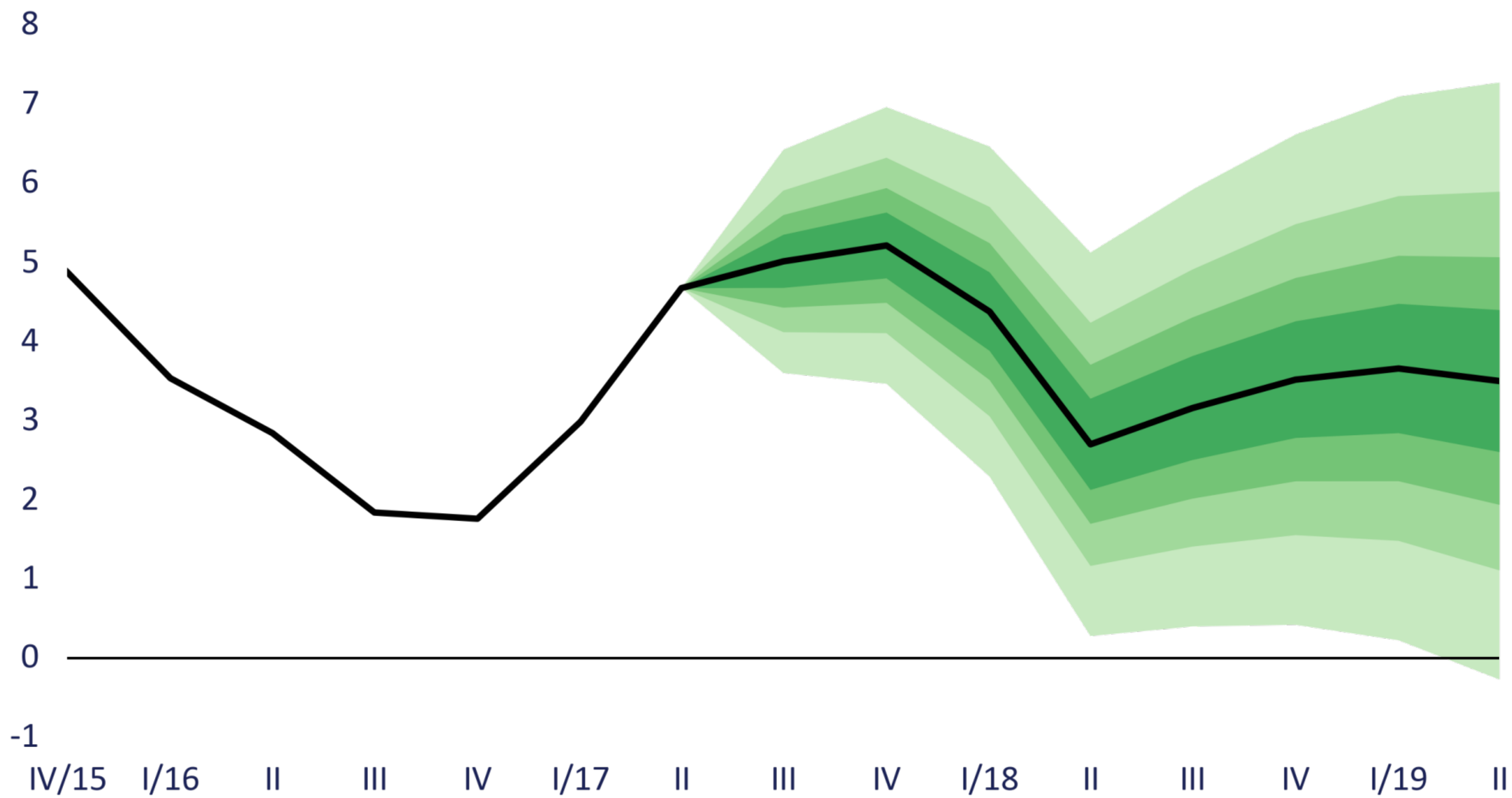
# Inflation pressures



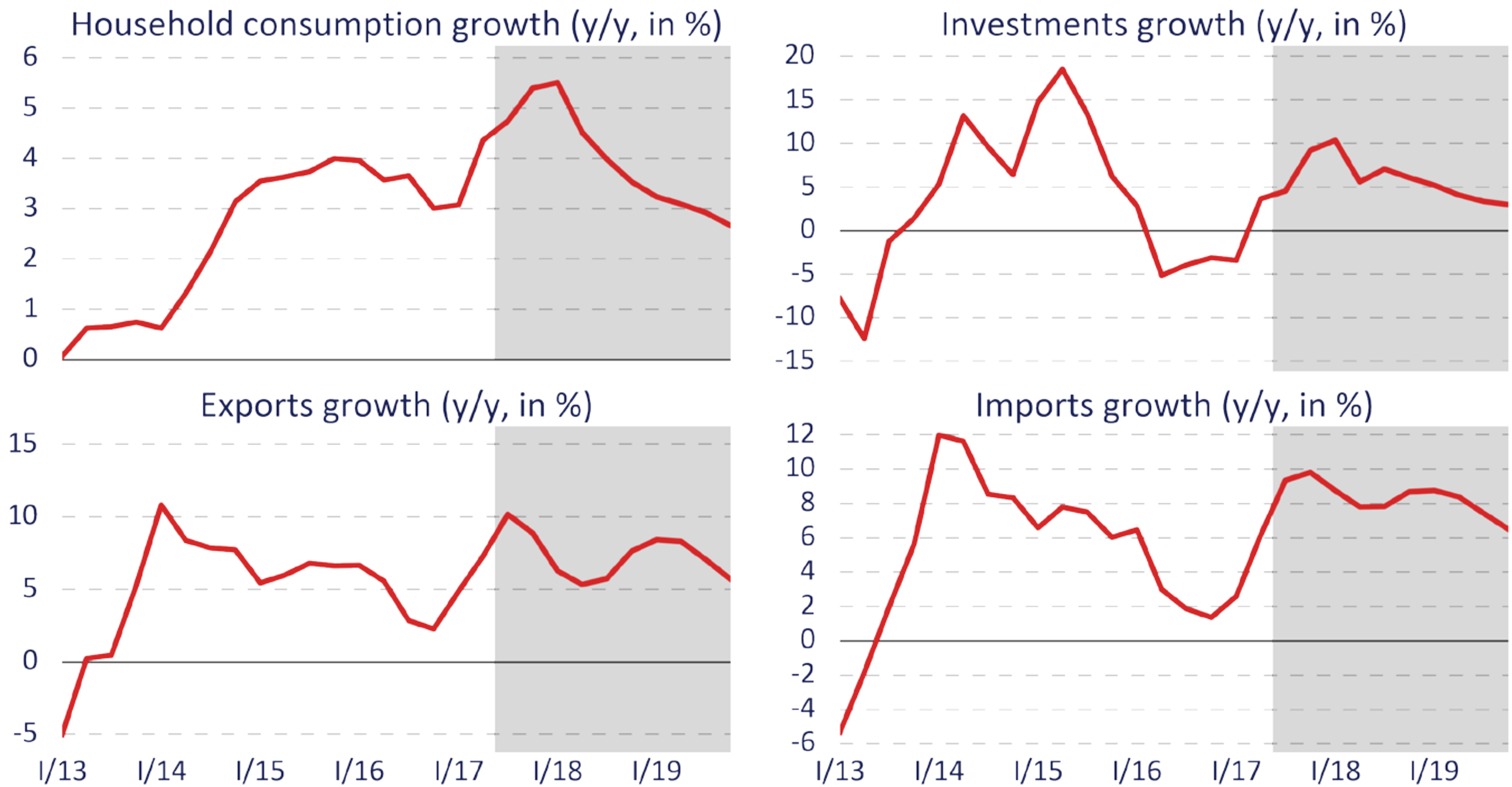

- Currently peaking total inflation pressures in the consumer sector will ease, reflecting the decrease in import prices.
- Domestic pressures will go up further in the near term, followed by a slowdown due to gradual decrease in costs‘ dynamics and faster labour efficiency growth.

# GDP Growth Forecast




- GDP growth will reach 4.5% this year, and slow down to slightly above 3% on average in the next two years.
- Dynamics of GDP will be fueled by buoyant growth of household consumption, growing foreign demand and renewal of investment in the public sector.

# Aggregate Demand




- Household consumption growth will further accelerate by the end of the year reflecting continued growth of total disposal income.
- Investment growth will be faster due to renewed drawing from EU funds.
- Both export and import dynamics will speed up in the near term, reflecting positive external demand outlook as well as growing domestic demand.

# Labour Market: Employment

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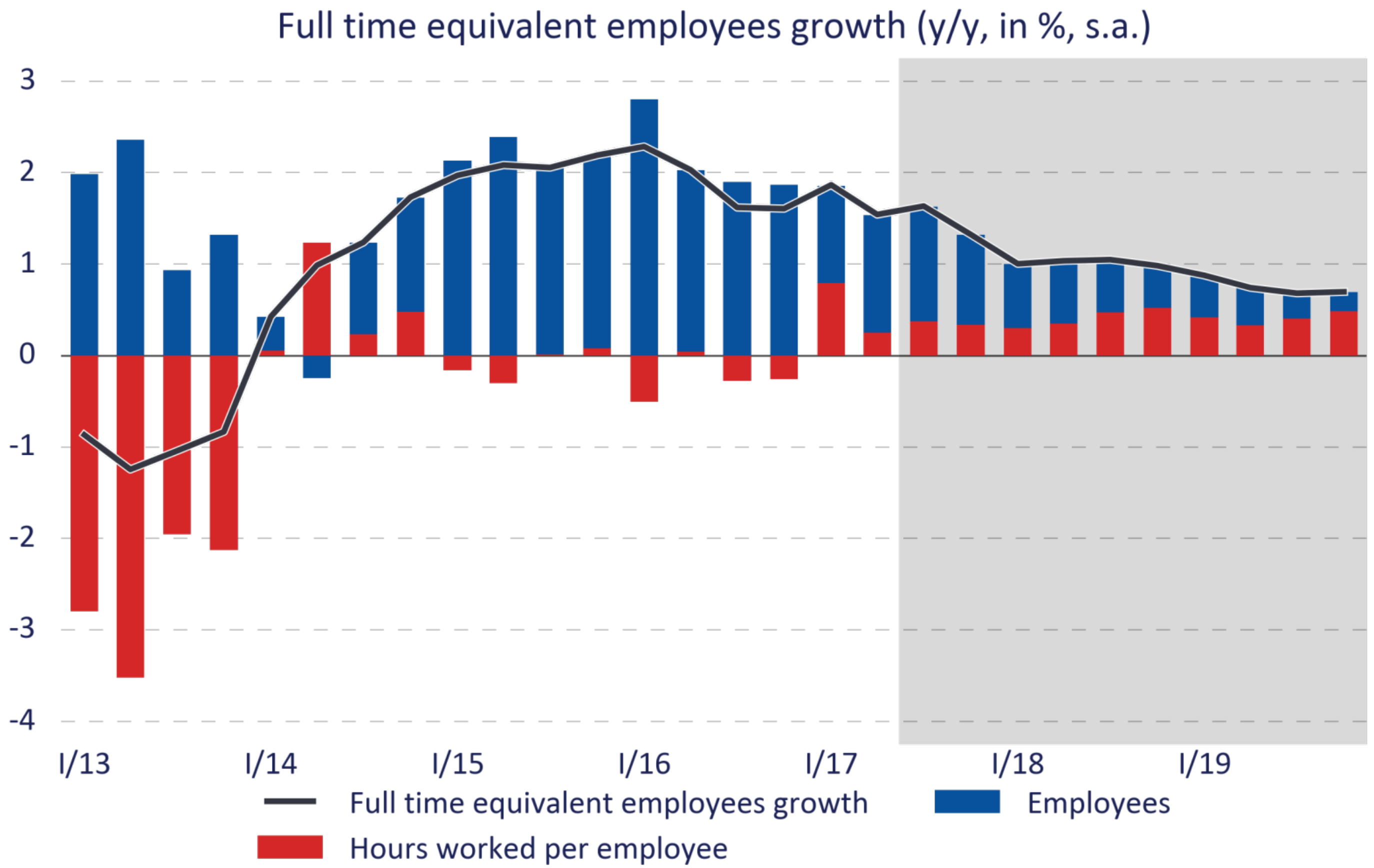


- Growth in the number of employees will slow down compared to 2016 as continued demand for labour is facing lack of available work force. This will be only partly offset by a modest cyclical increase in average hours worked.
- Growth in the labour force will be fostered by a gradual increase in statutory retirement age.

# Labour Market: Unemployment

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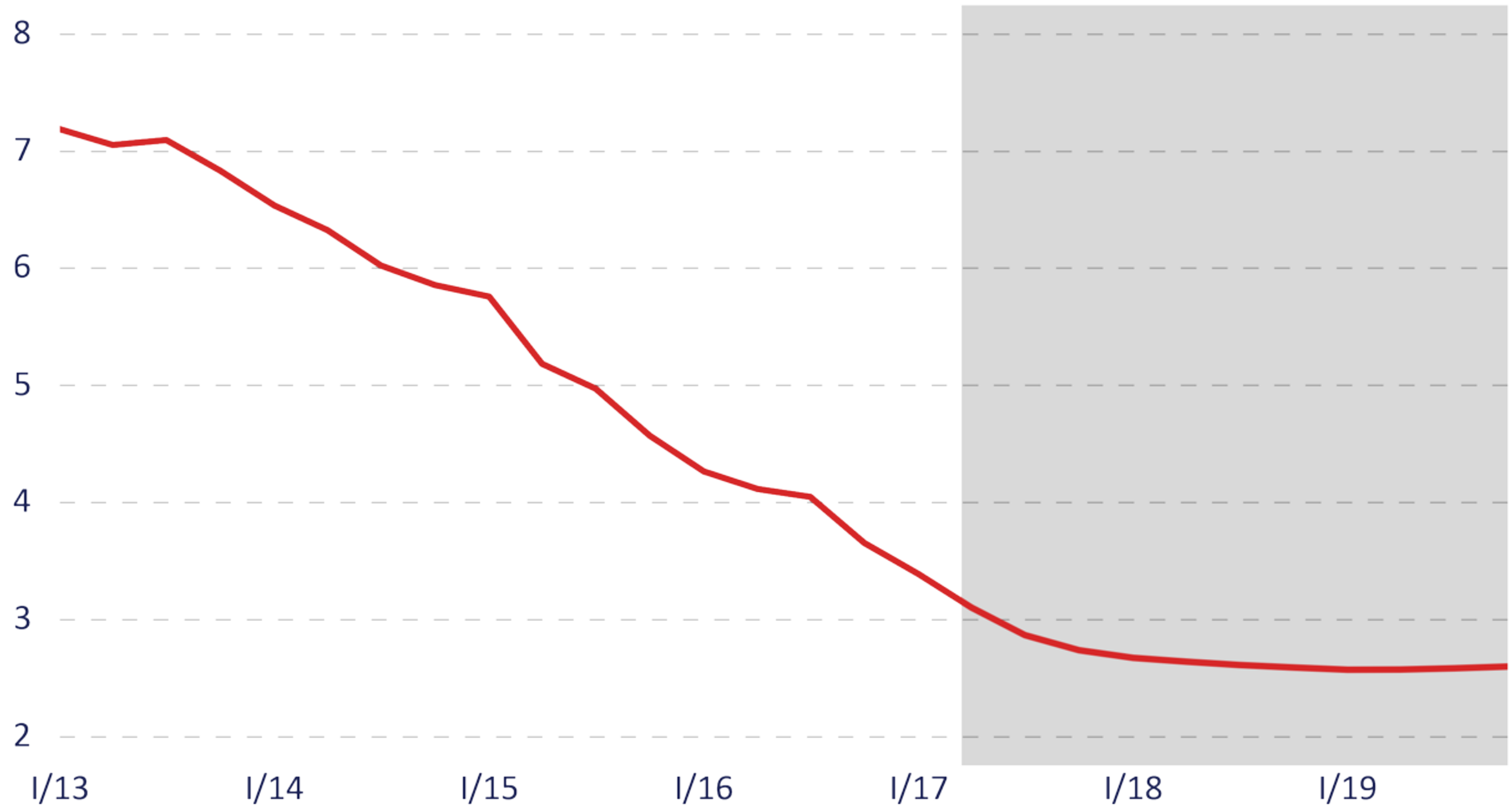
General unemployment rate (ILO)
(%, s.a.)




- Long-term decline in general unemployment rate to its current very low levels limits any further significant drop. Therefore, the unemployment rate will decrease only slowly and reach 2.6% in 2019.

# Labour Market: Wage Growth in Market Sectors

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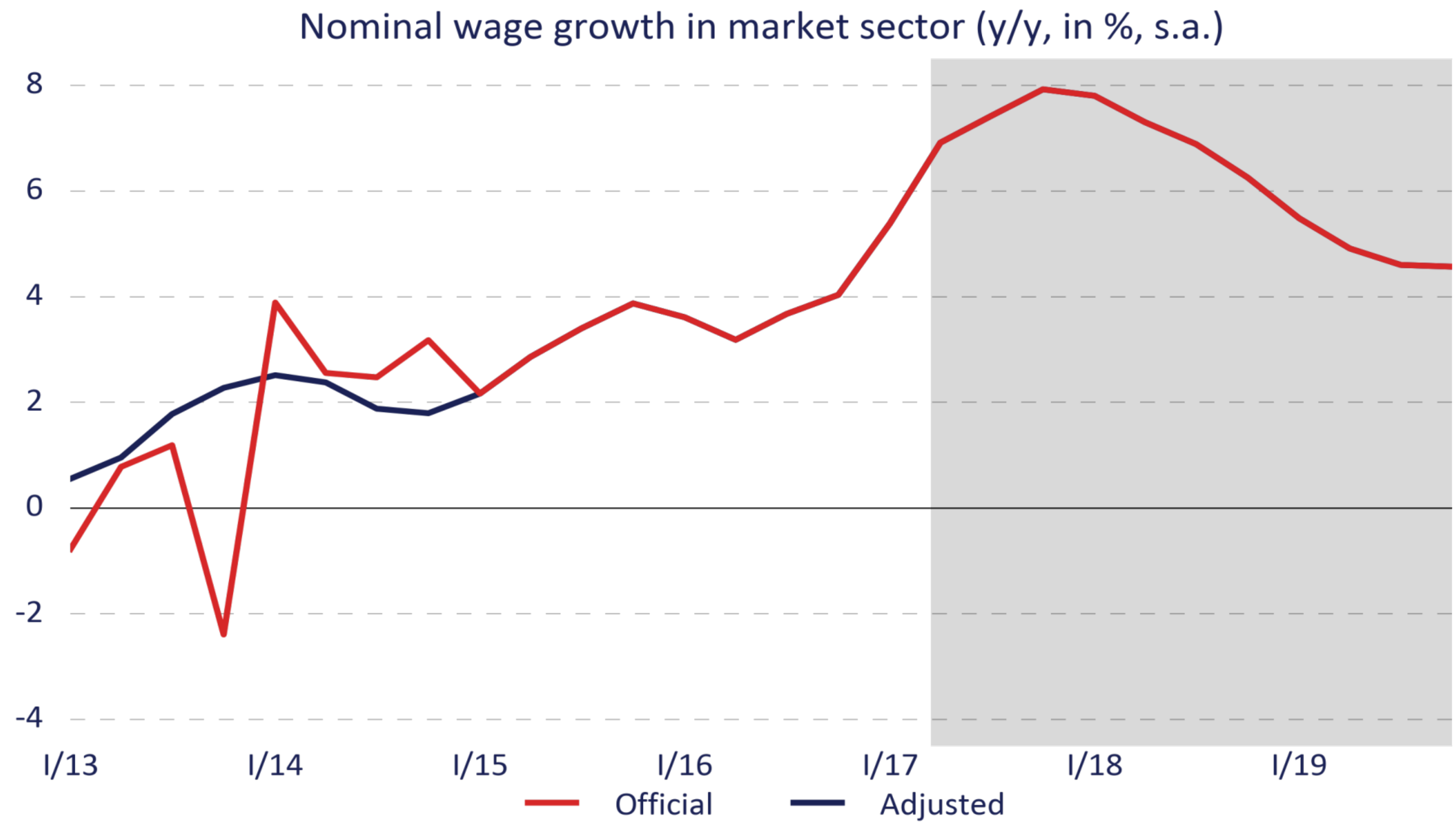


- Growing tightness on the labour market and further increase in the minimum wage as from January 2018 will push towards higher wage dynamics in the business sector, peaking in early 2018. Wage growth will later slow gradually to close to its assumed long-term level, due, among other things, to tightening monetary conditions.

# Comparison: Nominal Wage Growth in Non-market Sector

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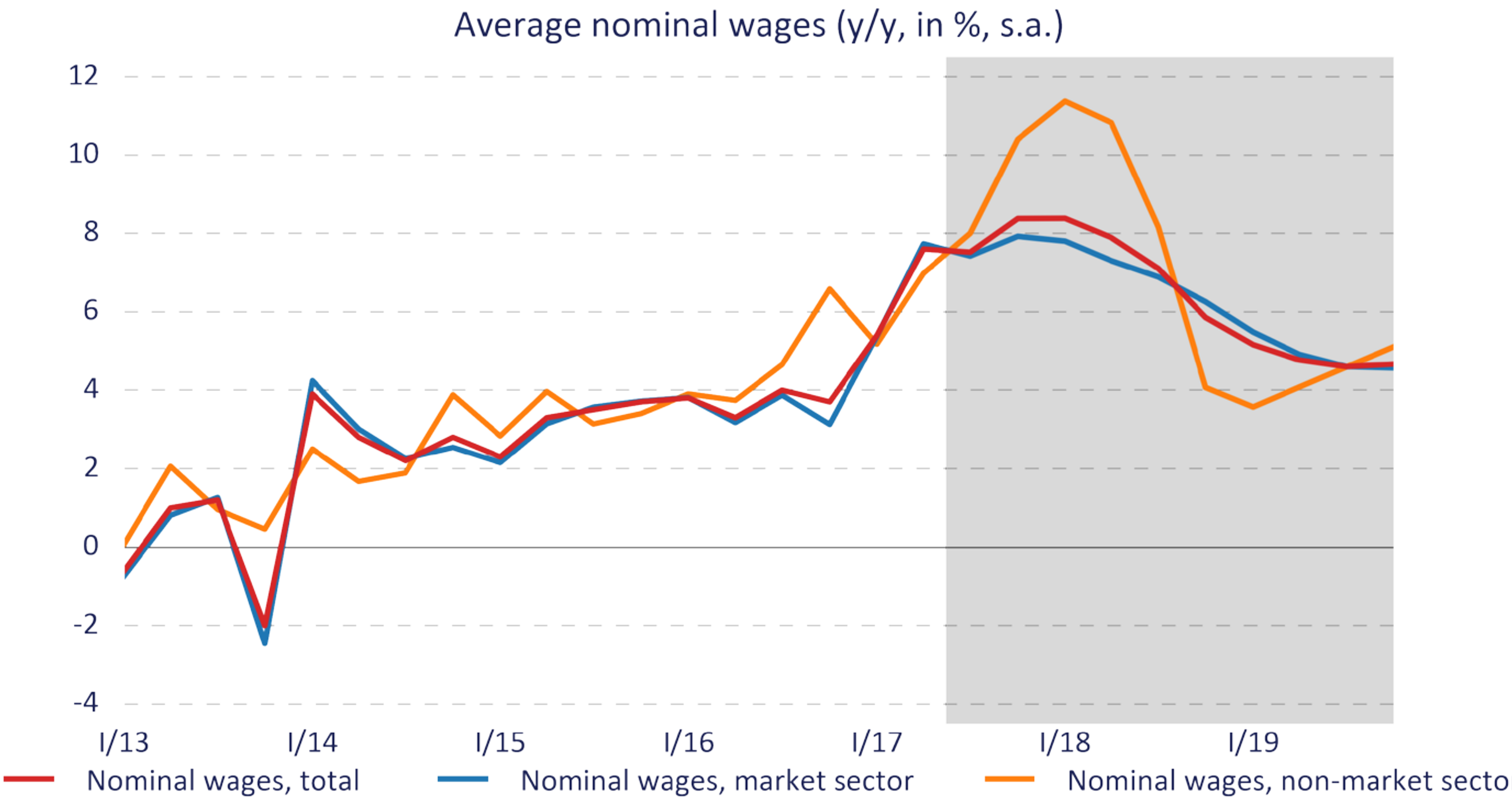
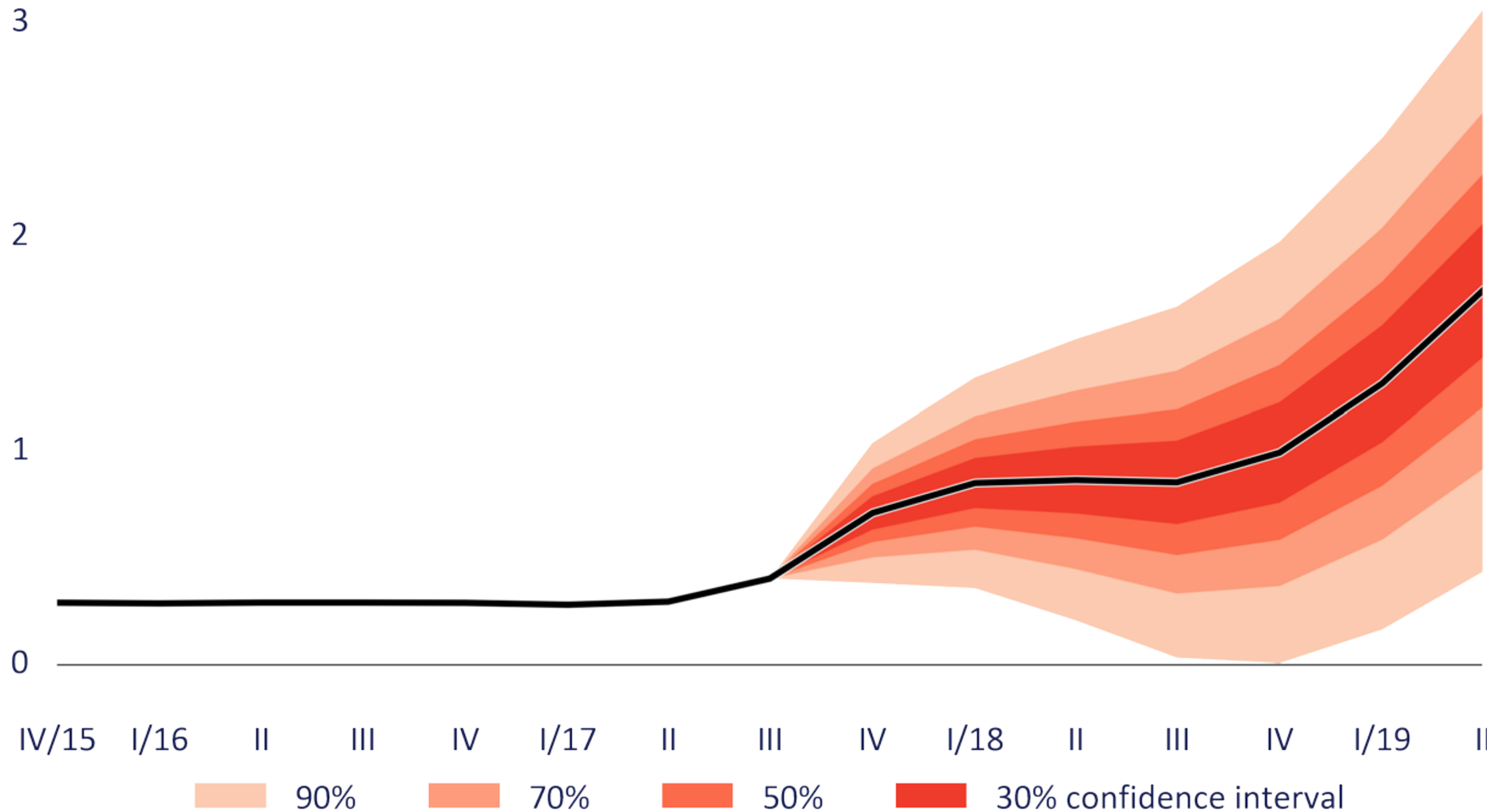



- Even more pronounced profile is expected for wages in public sector, with exceptionally strong growth in 2017 a 2018 implied by recent generous increases in wages of state employees.

# Interest Rate Path (3M PRIBOR)




- Continued exchange rate appreciation will be driven by a faster tightening of domestic monetary policy as compared to eurozone, and long-term real convergence.
- The return of inflation to the target will be fostered by a continuing rise in domestic market interest rates in addition to appreciation of the koruna.

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# Comparison with Previous Forecast

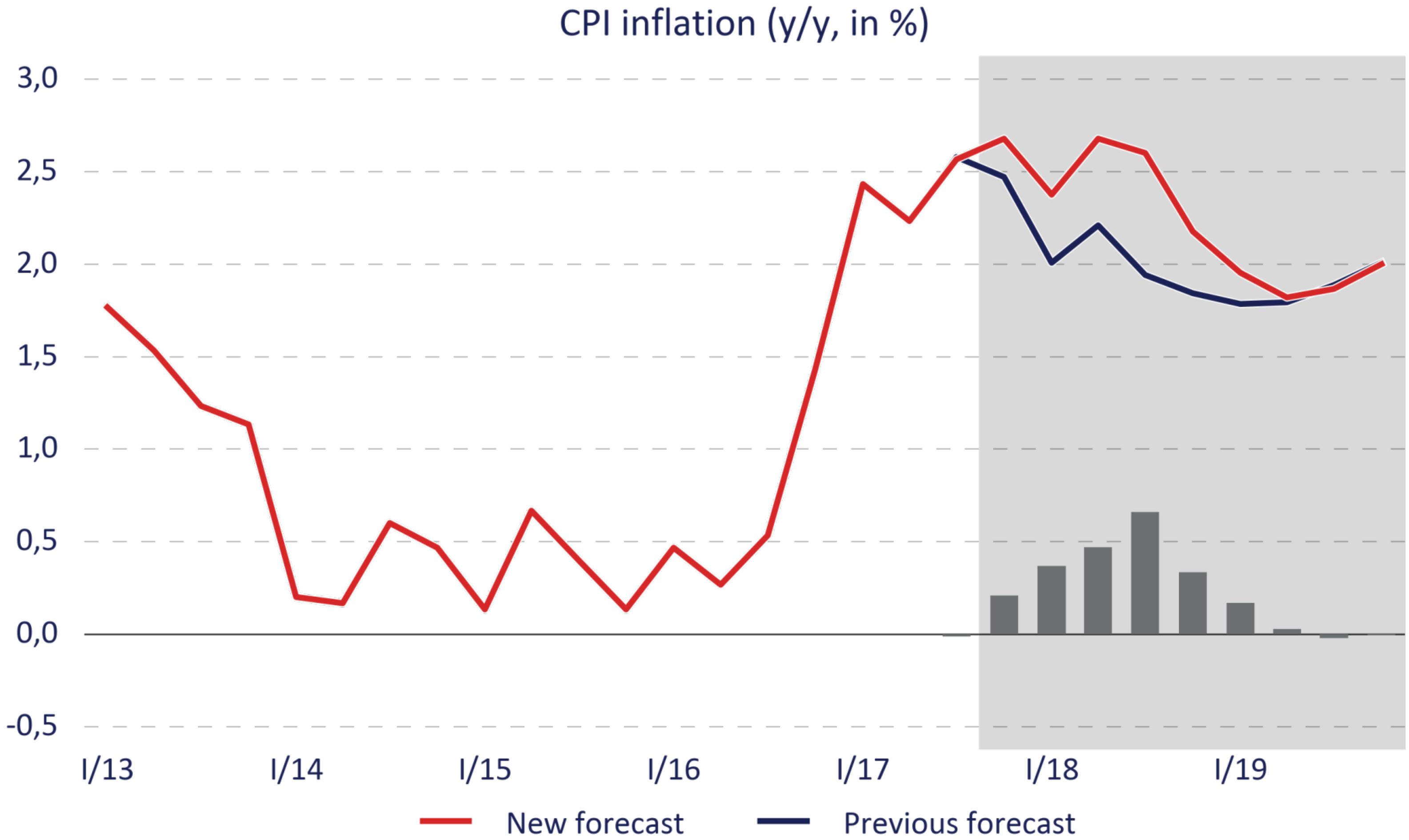
- The prediction of headline inflation is revised upwards. More pronounced total inflationary pressures reflect higher growth of domestic costs, mainly faster dynamics of nominal wages amid more robust economic activity.

- The GDP growth forecast has been increased for the next couple of quarters, and remains unchanged in the longer time horizon.

- Growth of nominal wages in the business sector is revised upwards reflecting the surprisingly strong growth in the second quarter and higher than expected GDP growth.

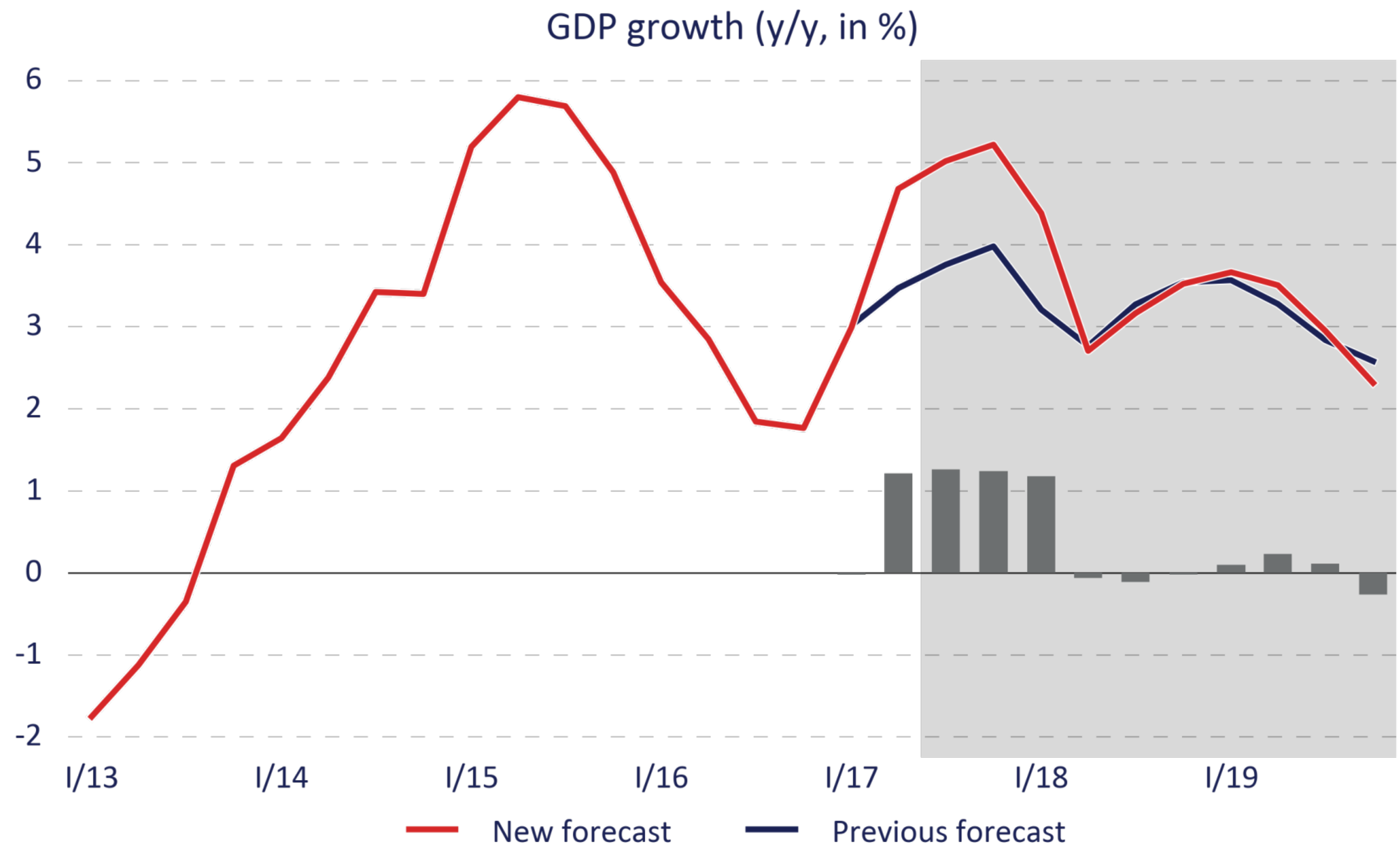
- Trajectory of market interest rates shifts upwards the on first half of the forecast horizon compared to previous forecast.

# Comparison: Inflation Forecast



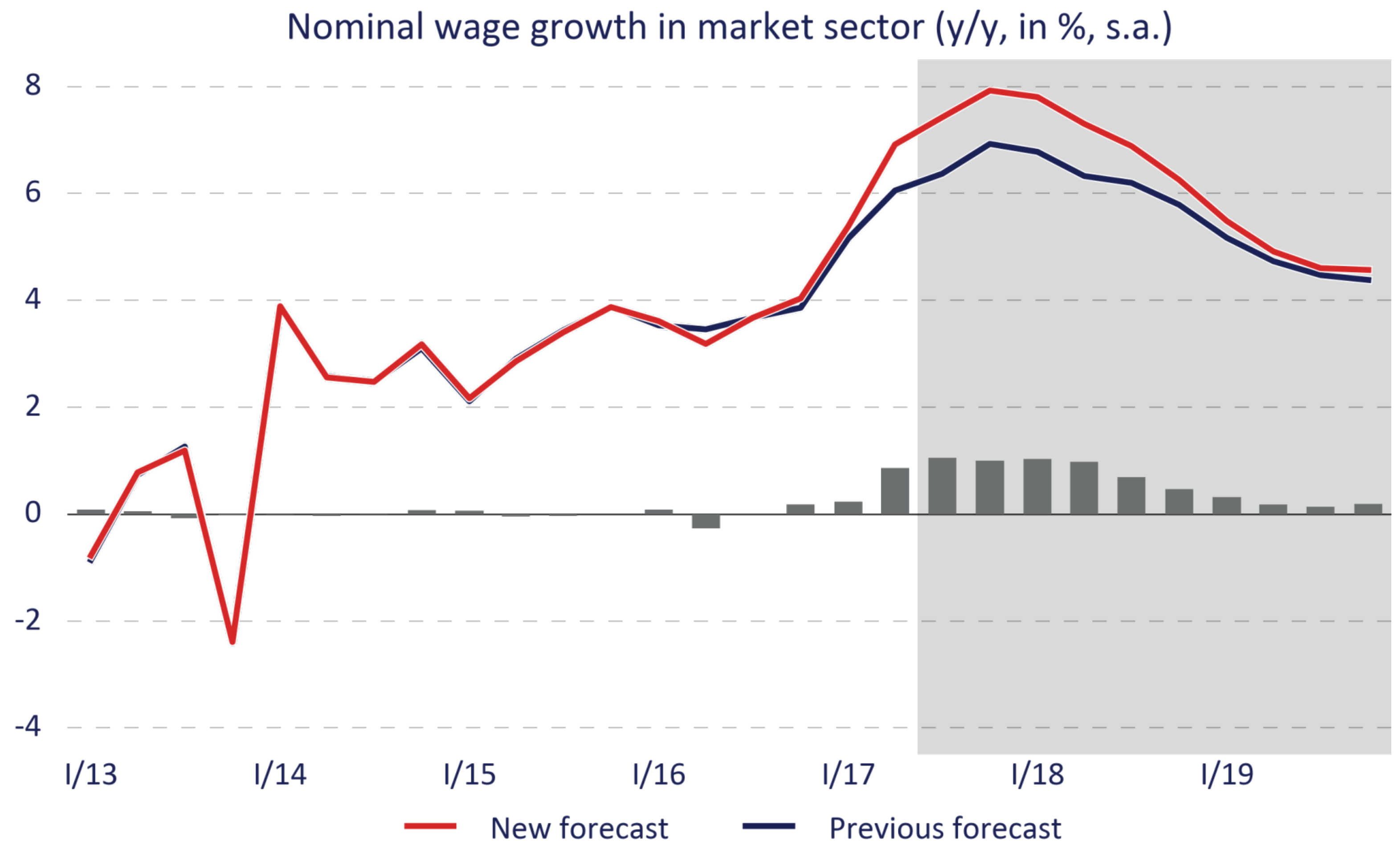

- Higher forecast of headline inflation is implied by stronger inflation pressures from domestic economy, especially wages.

# Comparison: GDP Forecast



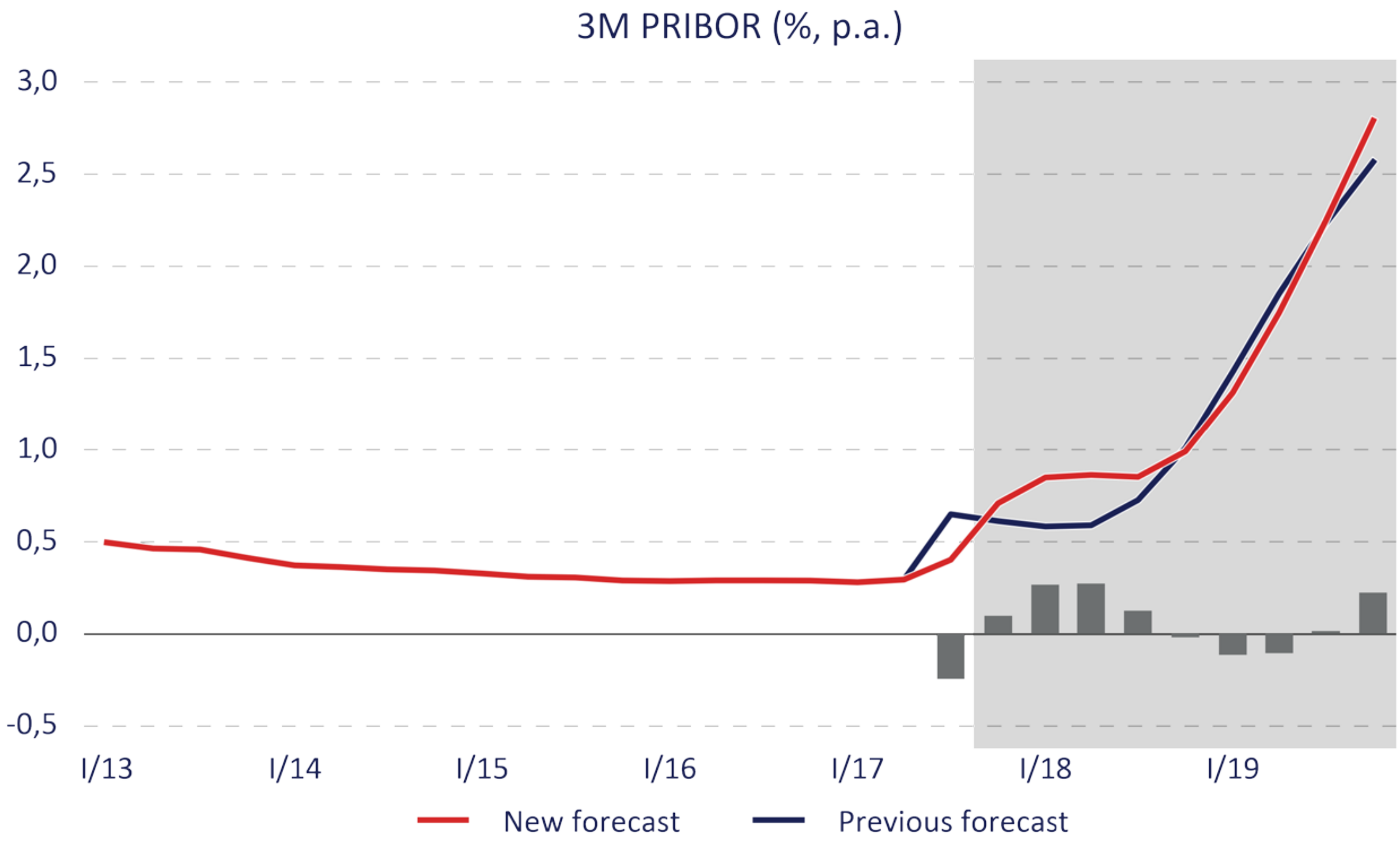

- The GDP growth forecast is higher especially for this year, driven by a stronger growth in household consumption and investment.
- GDP outlook remains almost unchanged over the longer horizon.

# Comparison: Nominal Wage




- Along with higher GDP growth, unexpectedly fast wage growth in Q2 contributed to an increase in the wage forecast.

# Comparison: Interest Rate Forecast




- The path of domestic market interest rates increase has been shifted upwards in the first half of the forecast horizon, due to greater accumulation of inflation pressures from the domestic economy.

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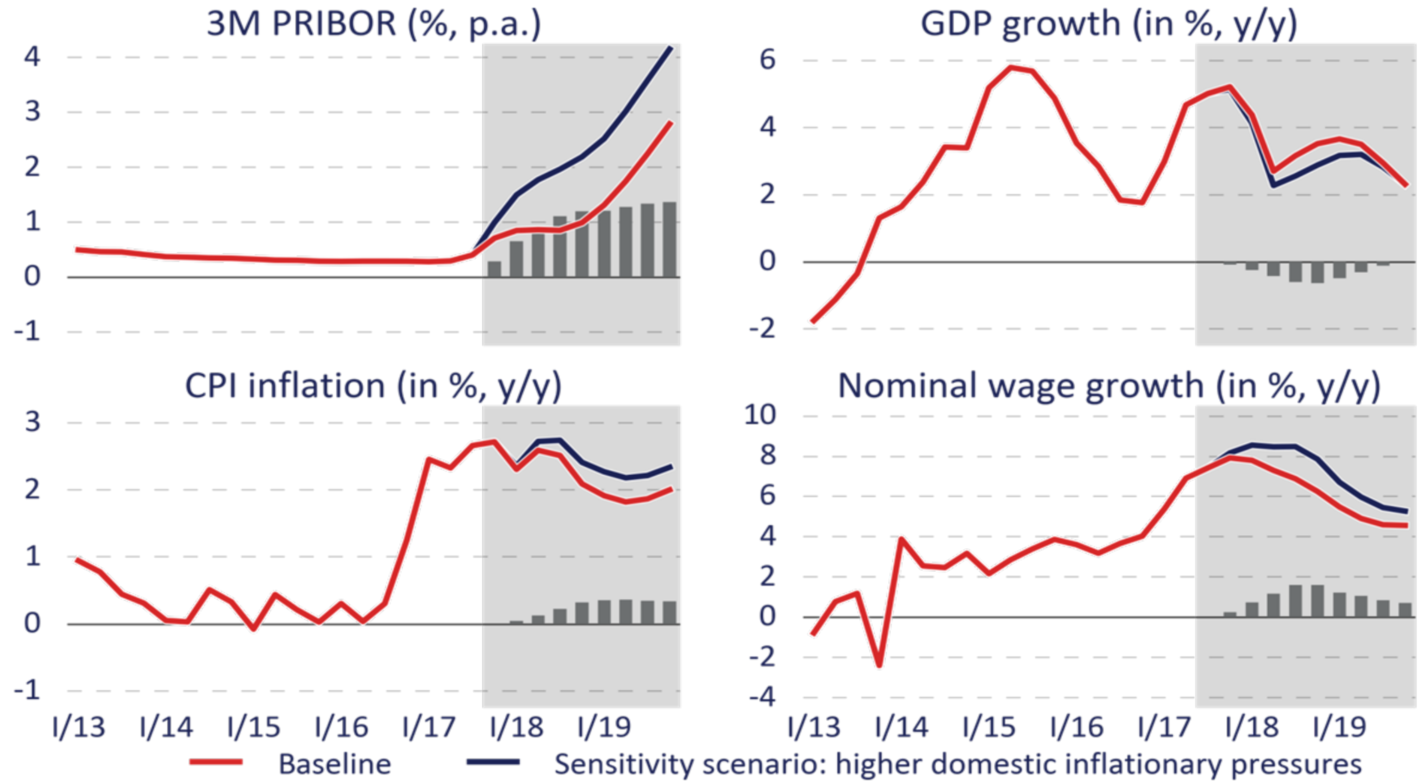
# Sensitivity Scenario – Higher Domestic Inflation Pressures




- The sensitivity scenario of higher domestic inflation pressures describes the impacts of stronger and longer-lasting pressures from the labour market.
- In this scenario, the monetary conditions need a stronger tightening in both the interest rate and exchange rate components, as inflation drives higher.
- The slower GDP growth subsequently contributes to a gradual calming of the labour market situation.

# Thank you for your attention!

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