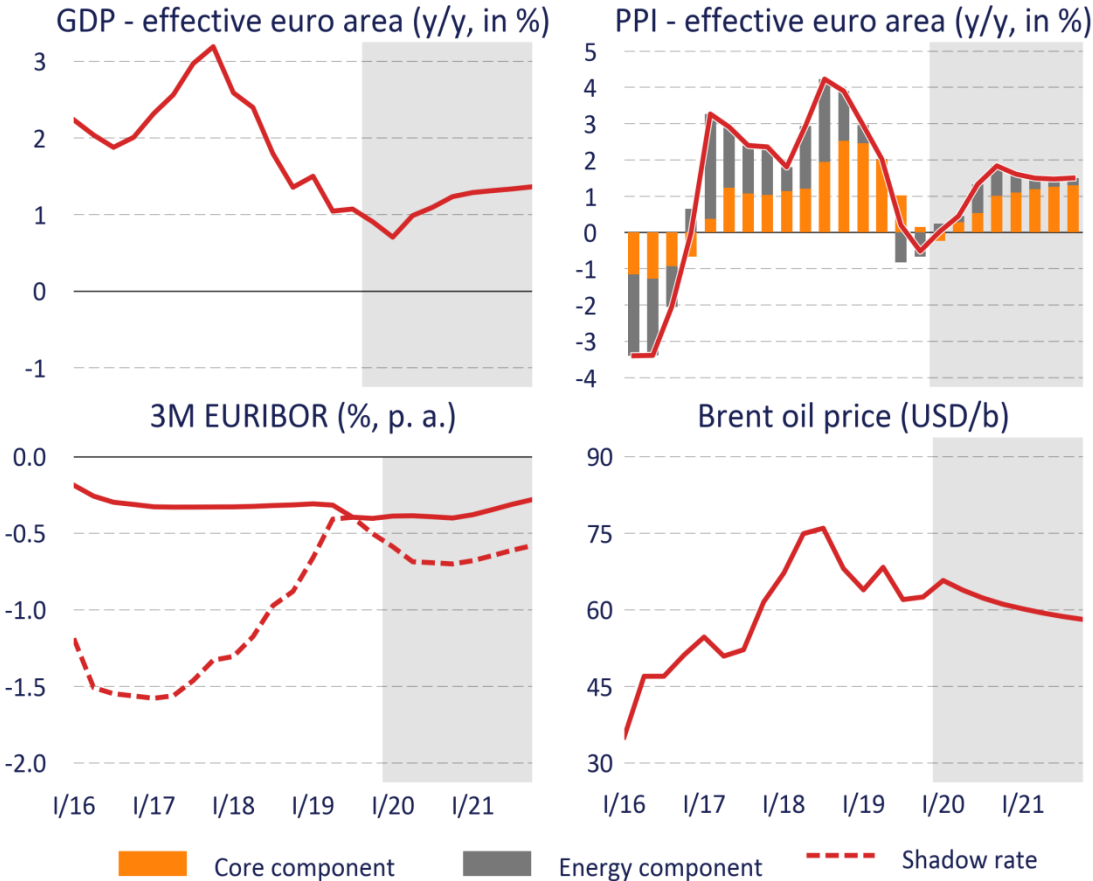


CNB's New Forecast (Inflation Report I/2020)

Meeting with Analysts

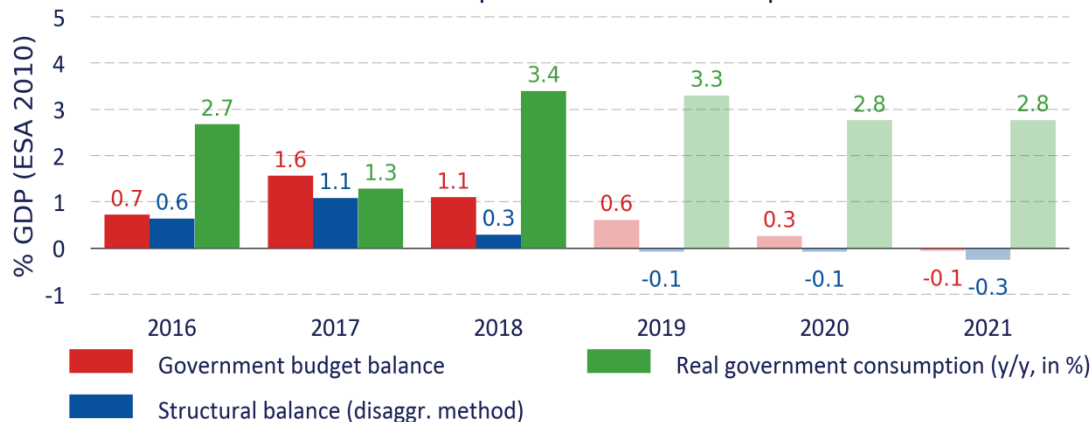
7 February 2020

- 1. Assumptions of the forecast**
2. The new macroeconomic forecast
3. Comparison with the previous forecast
4. Exchange rate sensitivity scenario



- GDP growth in the effective euro area will slow further in early 2020 but will then start to accelerate gradually.
- Industrial producer price inflation bottomed out at the close of last year and will gradually turn positive again as euro area economic growth gradually recovers. Also increase in the price of oil in 2020 Q1 will contribute to PPI inflation.
- According to the market outlook, the 3M EURIBOR will increase slightly in 2021 but will remain markedly negative.
- The euro will appreciate slightly against the dollar.

Fiscal development in the Czech Republic



Fiscal impulse (contributions to GDP growth in percentage points)

	2018	2019	2020	2021
	actual	forecast	forecast	forecast
Fiscal impulse	0.7	0.5	0.1	-0.1
of which impact through:				
Private consumption	0.4	0.4	0.1	-0.1
Private investment	0.0	0.0	0.0	0.0
Government investment, domestic	0.2	0.1	0.0	0.0
Government investment, EU funded	0.2	0.1	0.0	0.0

- After several years of surplus, the government sector will enter a slight deficit in 2021.
- Growth in real government consumption remained above 3% on average in 2019 and will drop only slightly below this level in 2020. Its growth rate will remain almost unchanged in 2021.
- Close-to-zero fiscal impulse this year and the next reflects the fact that the impacts of the discretionary fiscal measures included in the forecast (going beyond government consumption) virtually offset each other.

1. Assumptions of the forecast

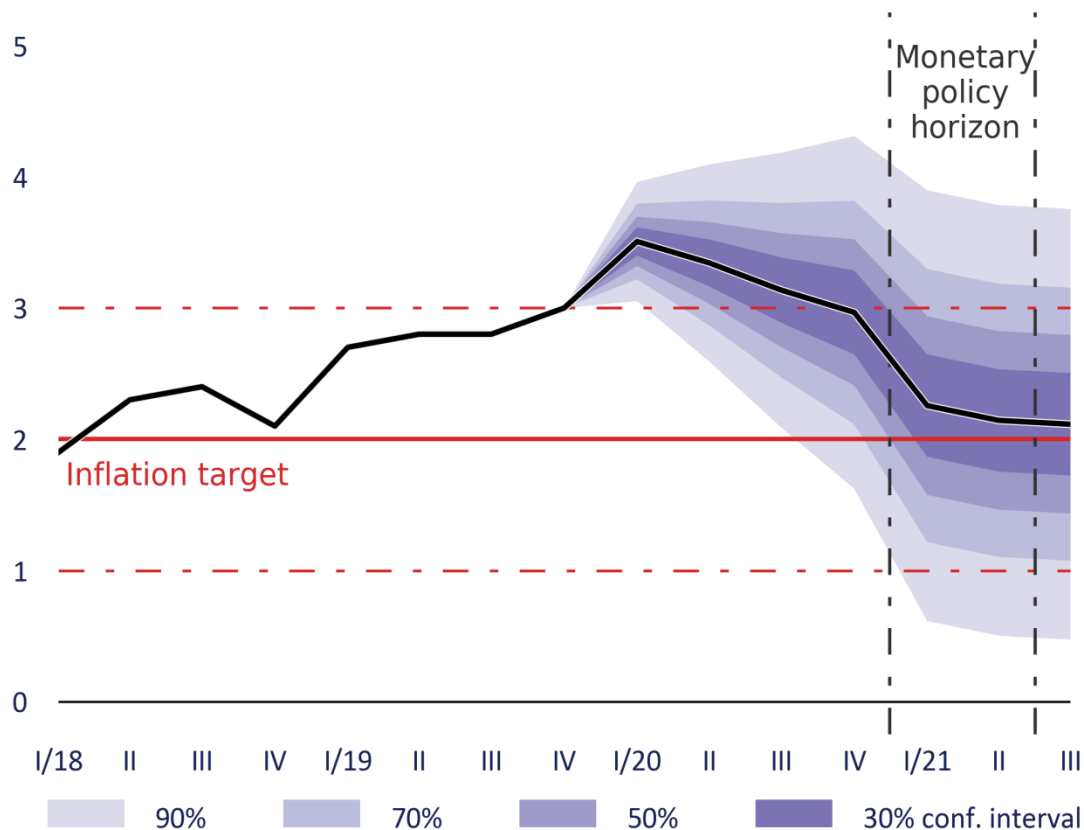
2. The new macroeconomic forecast

3. Comparison with the previous forecast

4. Exchange rate sensitivity scenario

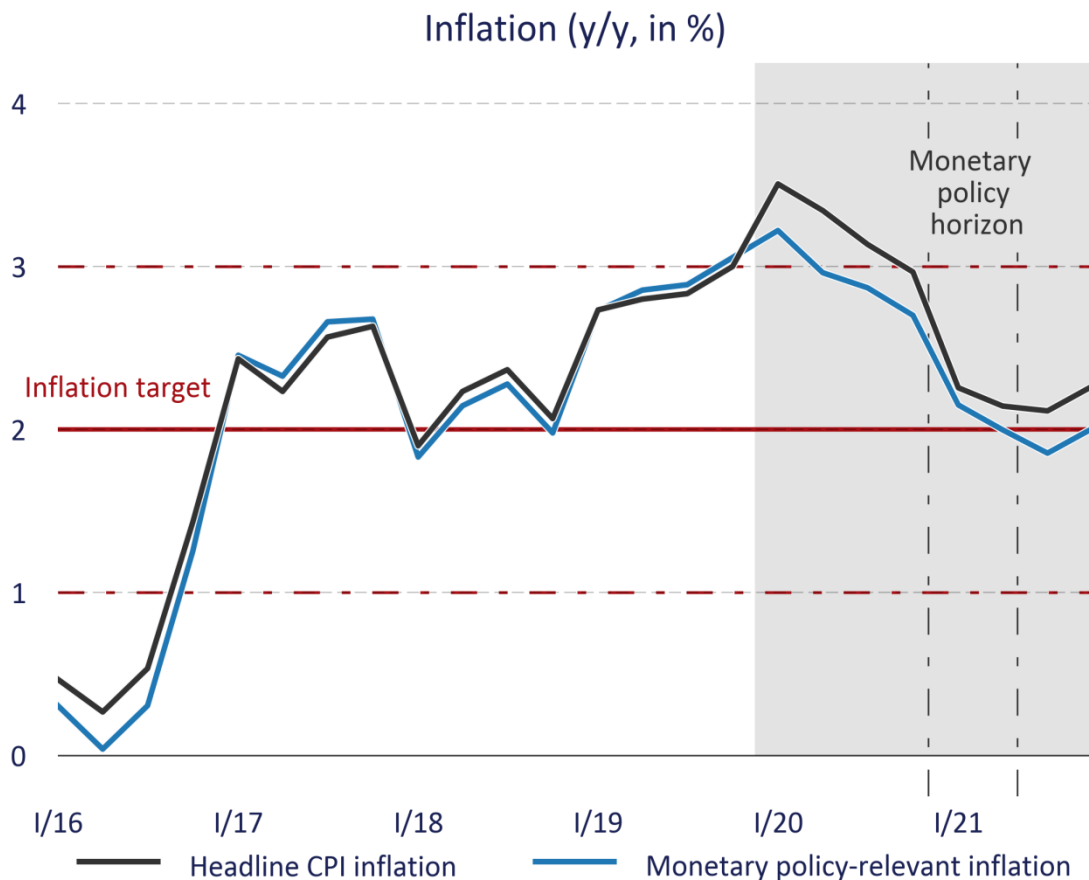
Headline Inflation Forecast

CPI inflation (y/y, in %)



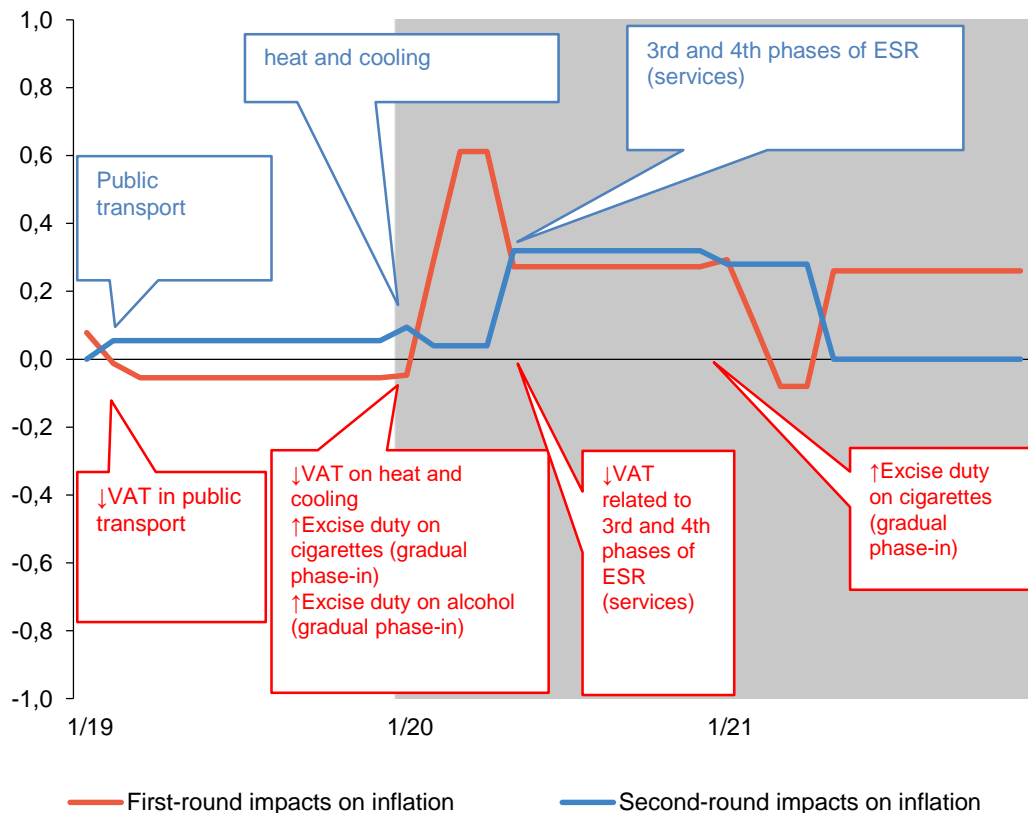
- Headline inflation will stay above the upper boundary of the tolerance band for most of this year and return close to the target in 2021.

Headline and Monetary Policy-Relevant Inflation



- Monetary policy-relevant inflation will be below headline inflation due to the impacts of indirect tax changes.
- Monetary policy-relevant inflation will return to the 2% target during the first half of next year.
- The return to the target will be supported by a tightening of the monetary conditions at the start of this year.

Effects of Changes to Indirect Taxes on Inflation Forecast

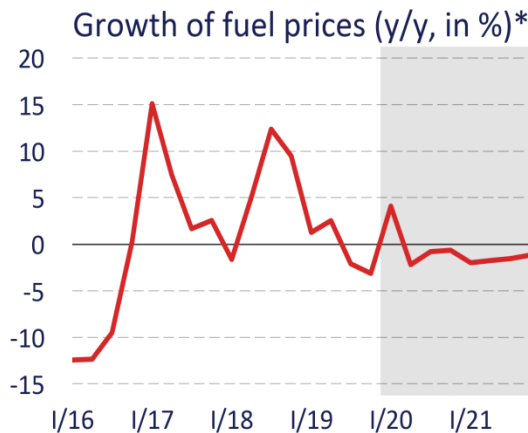
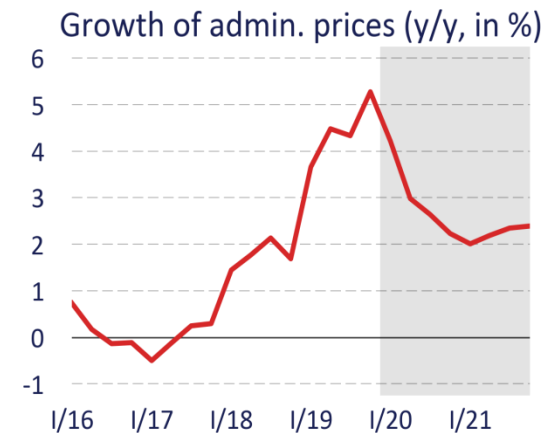
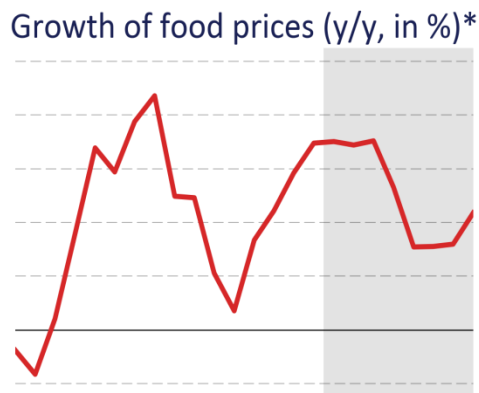
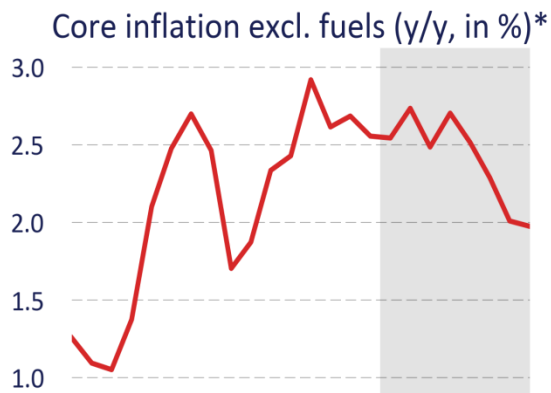


- The forecast includes the increase in excise duty on cigarettes and alcohol introduced at the start of this year.
- The third and fourth phases of ESR will be launched in May 2020. This will be associated with a decline in the VAT rate on certain consumer basket items.
- The forecast assumes only limited pass-through of the VAT rate cut to consumer prices.
- In 2021, there will be another increase in the excise duty on cigarettes.

	Jan	Feb	Mar	Apr	May	Jun
Consumer Price Index	3.3	3.5	3.6	3.7	3.2	3.2
Regulated prices	4.9	4.3	3.5	3.4	2.9	2.7
Core inflation	2.5	2.6	2.5	2.5	2.9	2.9
Food prices	3.7	3.5	3.3	4.2	2.8	3.0
Fuel prices	3.0	4.7	4.5	1.2	-1.3	-1.6
Monetary policy inflation	3.4	3.3	3.0	3.1	3.0	2.9

- Headline inflation will peak in April at 3.7%. Besides strong domestic demand and effects of indirect tax changes, this will be also owing to the base effect in food prices.
- Monetary policy-relevant inflation will remain around the upper bound of the tolerance band during the first half of 2020.

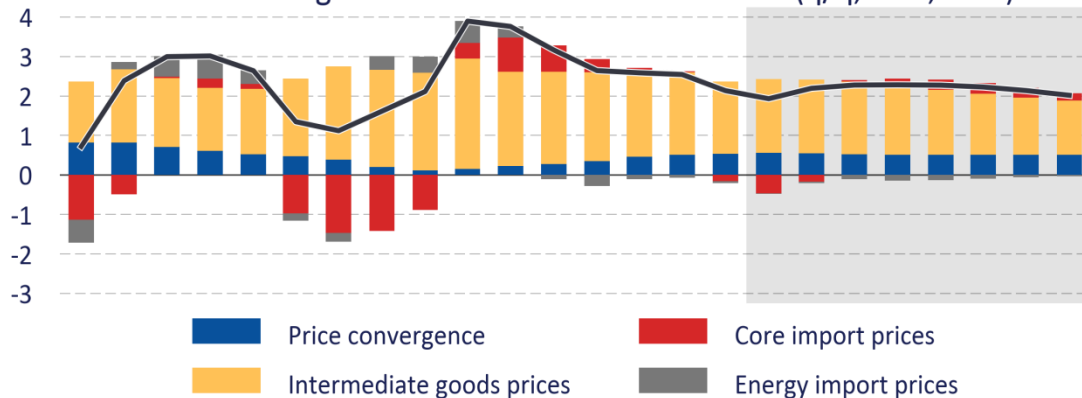
Inflation Components



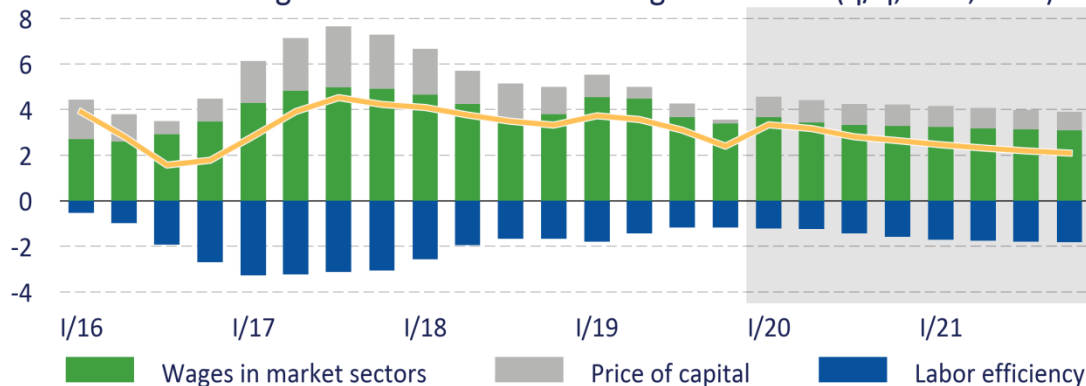
* excluding tax changes

- Core inflation will fluctuate around 2.5% this year following strong domestic fundamentals and second-round effects of indirect tax changes and will moderate during 2021.
- Food price inflation will remain elevated in the near future and moderate in late 2020 and early 2021. Food price inflation will continue to reflect persisting domestic demand pressures.
- The high growth in administered prices observed in early 2020 will moderate in the rest of the year due mainly to a gradual decline in the currently high growth in electricity prices.
- Fuel prices will mostly go down.

Nominal marginal costs in the consumer sector (q/q, in %, ann.)

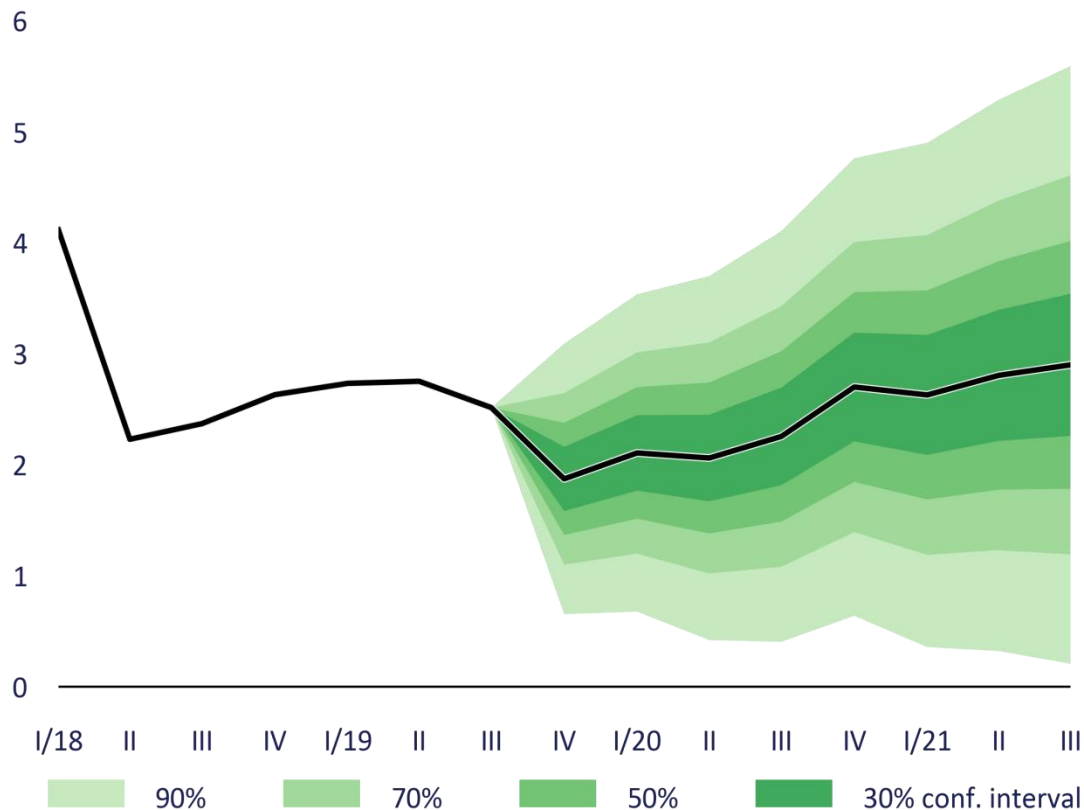


Nominal marginal costs in intermediate goods sector (q/q, in %, ann.)



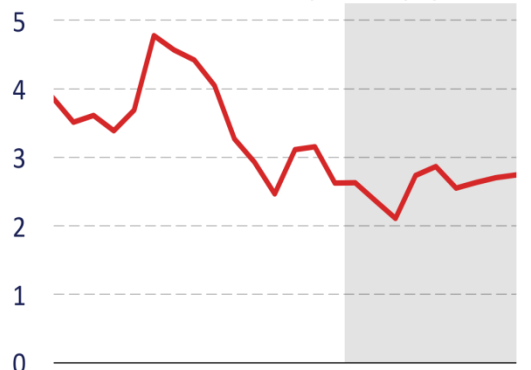
- Total nominal costs will grow at a roughly equilibrium rate of 2% this year and the next.
- Owing to the appreciation of the koruna at the start of this year, core import prices will have a modest anti-inflationary effect in the first half of 2020. It will later turn positive again due to a stable koruna and renewed growth in foreign prices.
- After a temporary pick-up in early 2020, the growth in domestic costs will gradually drop due to slowing wage growth and an increasing contribution of labour efficiency.

GDP growth (y/y, in %)

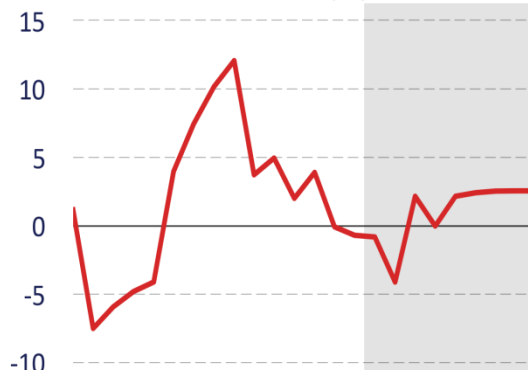


- Following a slowdown in 2019 H2, GDP growth will gradually accelerate on the back of a recovery in external demand.
- Growth in household and government consumption will continue to foster growth in the domestic economy.
- The external demand recovery will renew growth in private investment and give rise to a positive contribution of net exports to GDP growth.

Household consumption (y/y, in %)



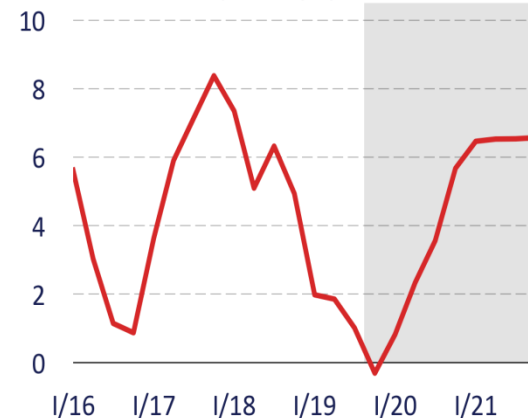
Investment (y/y, in %)



Export (y/y, in %)

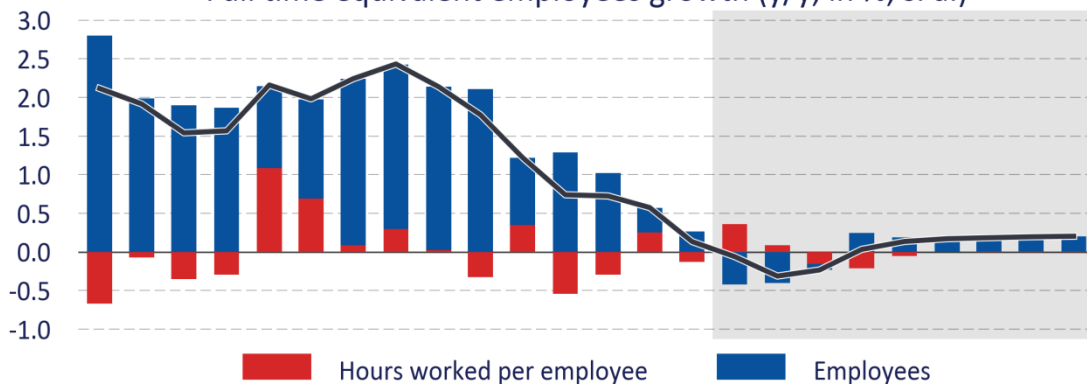


Import (y/y, in %)

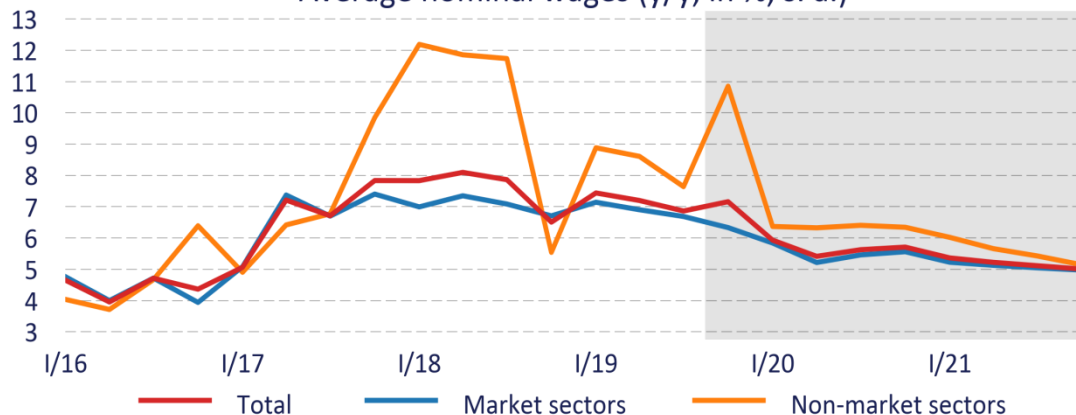


- Growth in household consumption will remain solid due to persisting high growth in wages and other income (pensions, parental benefit).
- Fixed investment will start rising again during 2020. Continued high government investment activity will be joined gradually by the private sector as growth in external demand picks up.
- Export growth halted at the end of 2019 but will turn positive again this year.
- Import growth will rise this year on the back of renewed growth in domestic investment activity and faster export growth.

Full time equivalent employees growth (y/y, in %, s. a.)

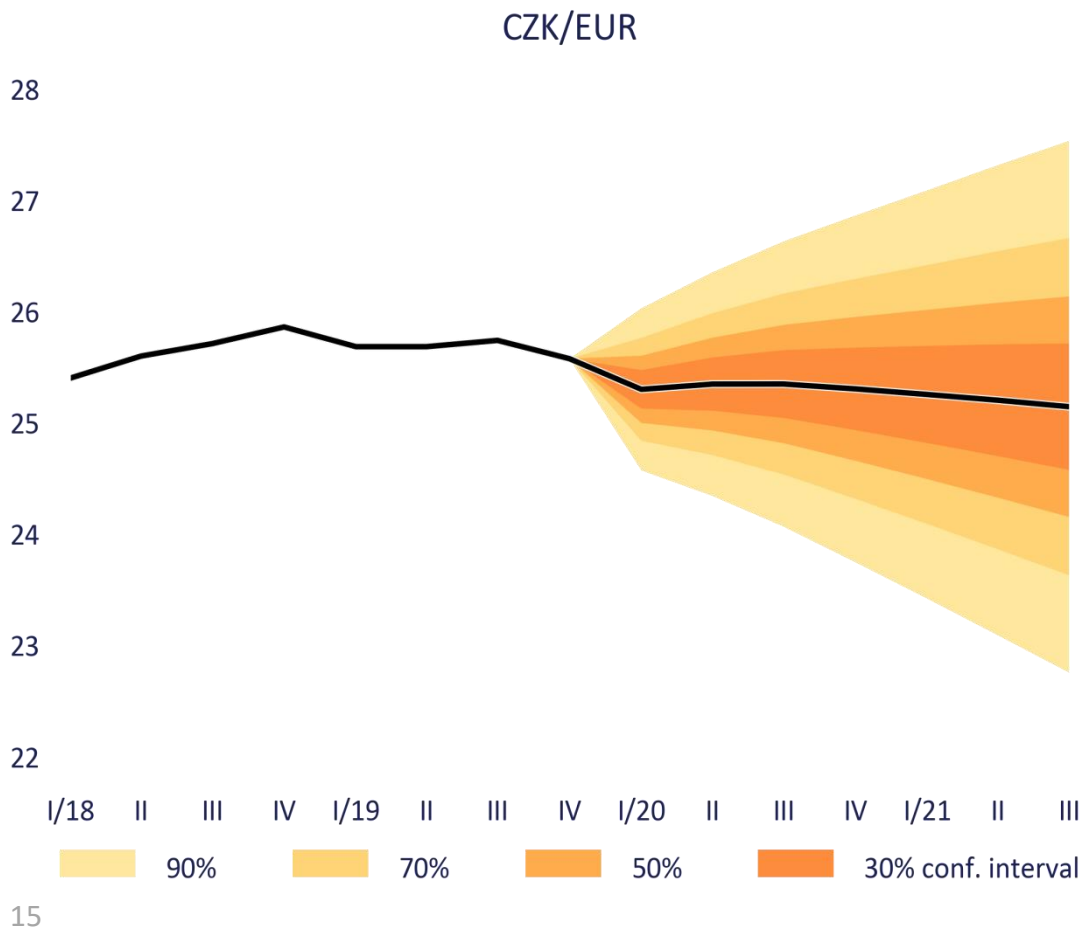


Average nominal wages (y/y, in %, s. a.)



- Employment will temporarily decline modestly due to the impacts of subdued growth of external demand on the Czech economy. The unemployment rate will remain close to its current very low levels.
- Growth in market wages will slow to 5.5% in 2020 as a whole. Wage growth will drop further to its steady-state level of 5% in 2021.
- Wage growth will be bolstered this year by another large increase in the minimum wage.
- Pronounced wage growth will continue in non-market sectors. It will reflect an increase in the wages of teachers and other public employees.

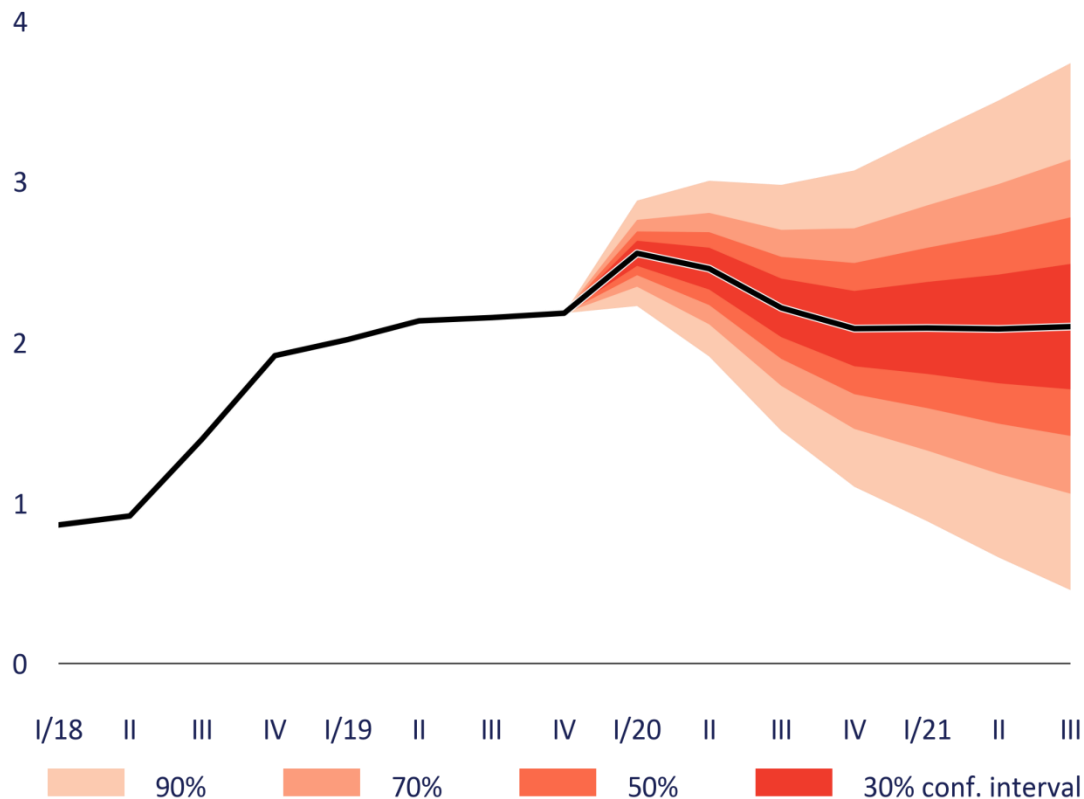
Exchange Rate CZK/EUR



- Reflecting the appreciation of the koruna at the start of this year, the exchange rate forecast for 2020 Q1 is set at 25.3 CZK/EUR.
- The rate will stay at this level until the start of next year. The effect of a temporary further widening of the interest rate differential vis-à-vis other countries will be offset by only weak economic and price growth abroad, amid only gradually fading negative global sentiment.
- Subsequently, the exchange rate will appreciate only slightly, reaching 25 CZK/EUR at the end of next year.

Interest Rate Path (3M PRIBOR)

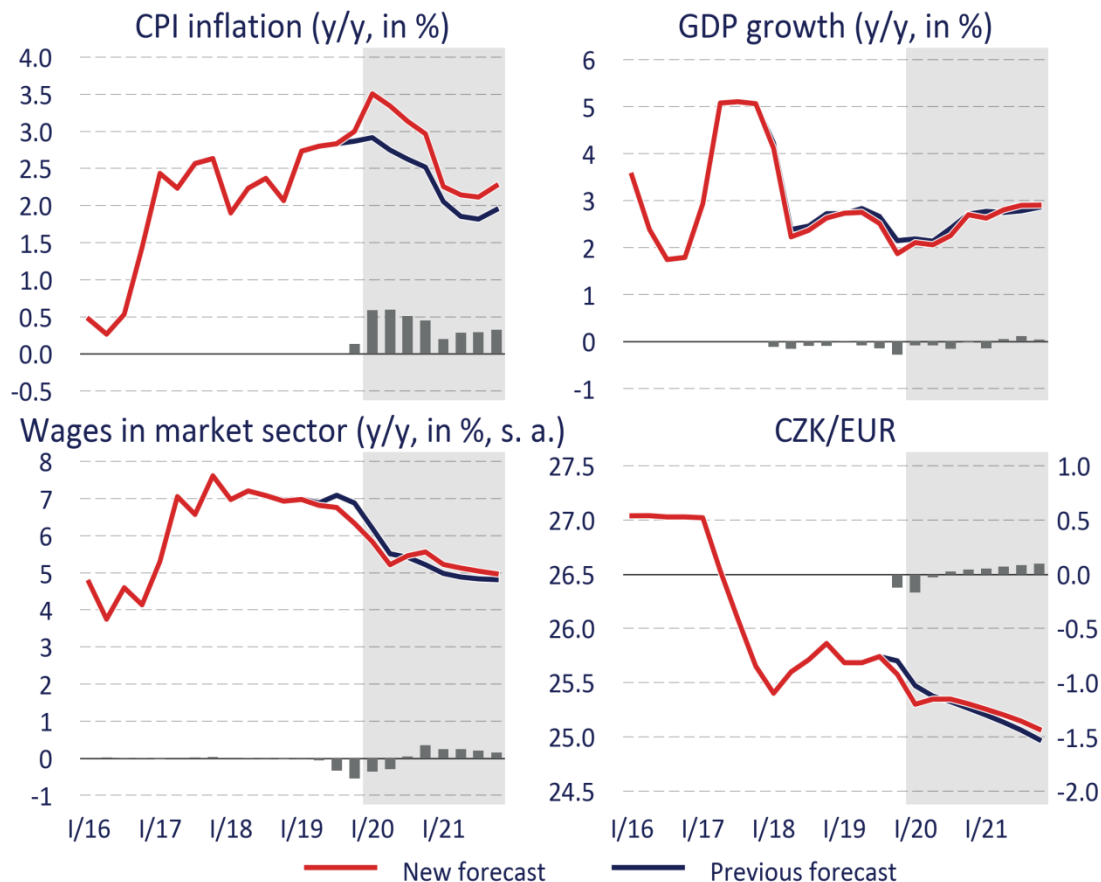
3M PRIBOR (% , p. a.)



- Consistent with the forecast is a rise in domestic market interest rates initially, followed by a decline in 2020 H2
- The initial increase in interest rates mainly reflects persisting increased domestic inflation pressures, which will be temporarily intensified by government measures boosting household consumption. The second-round effects of changes to indirect taxes, which will affect inflation in 2020 and early 2021, are also pushing up rates.
- The subsequent decline in domestic interest rates will reflect a decrease in domestic inflation pressures in an environment of still very easy monetary policy in the euro area.

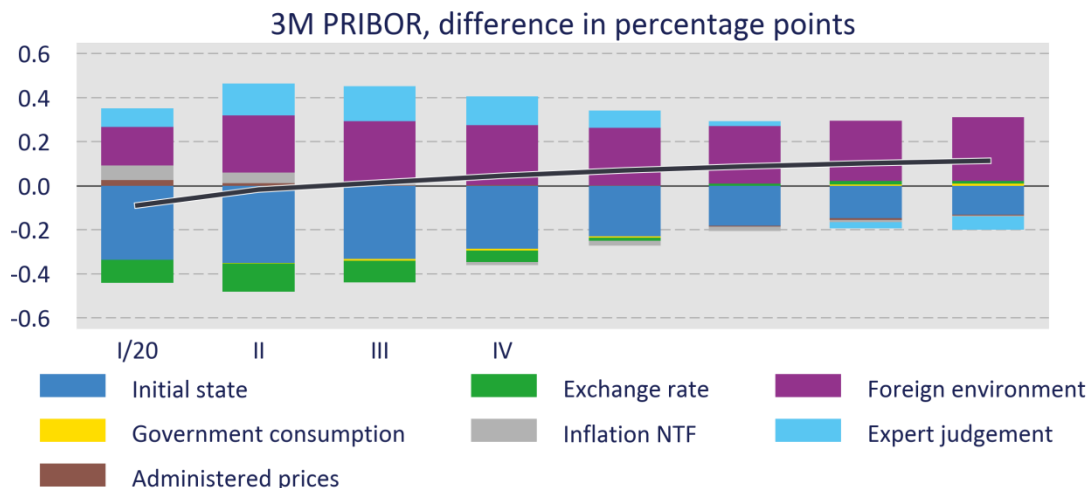
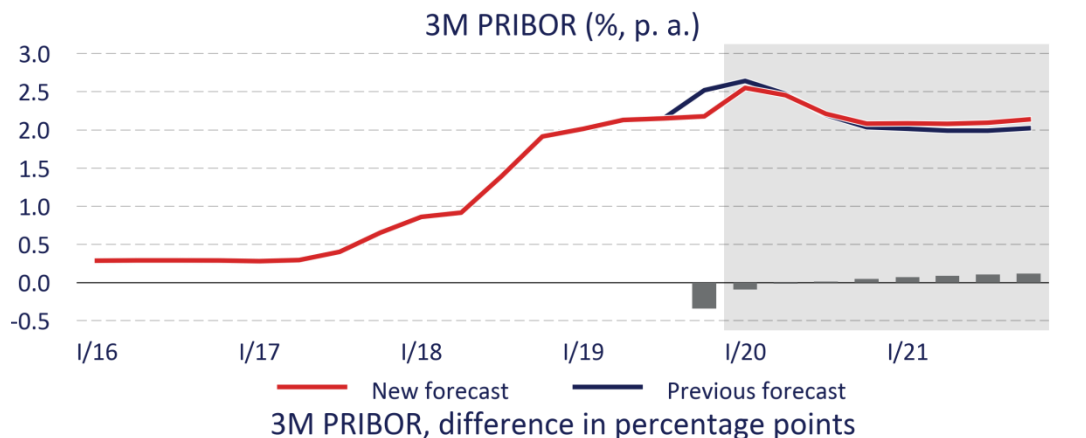
1. Assumptions of the forecast
2. The new macroeconomic forecast
- 3. Comparison with the previous forecast**
4. Exchange rate sensitivity scenario

Comparison with Previous Forecast



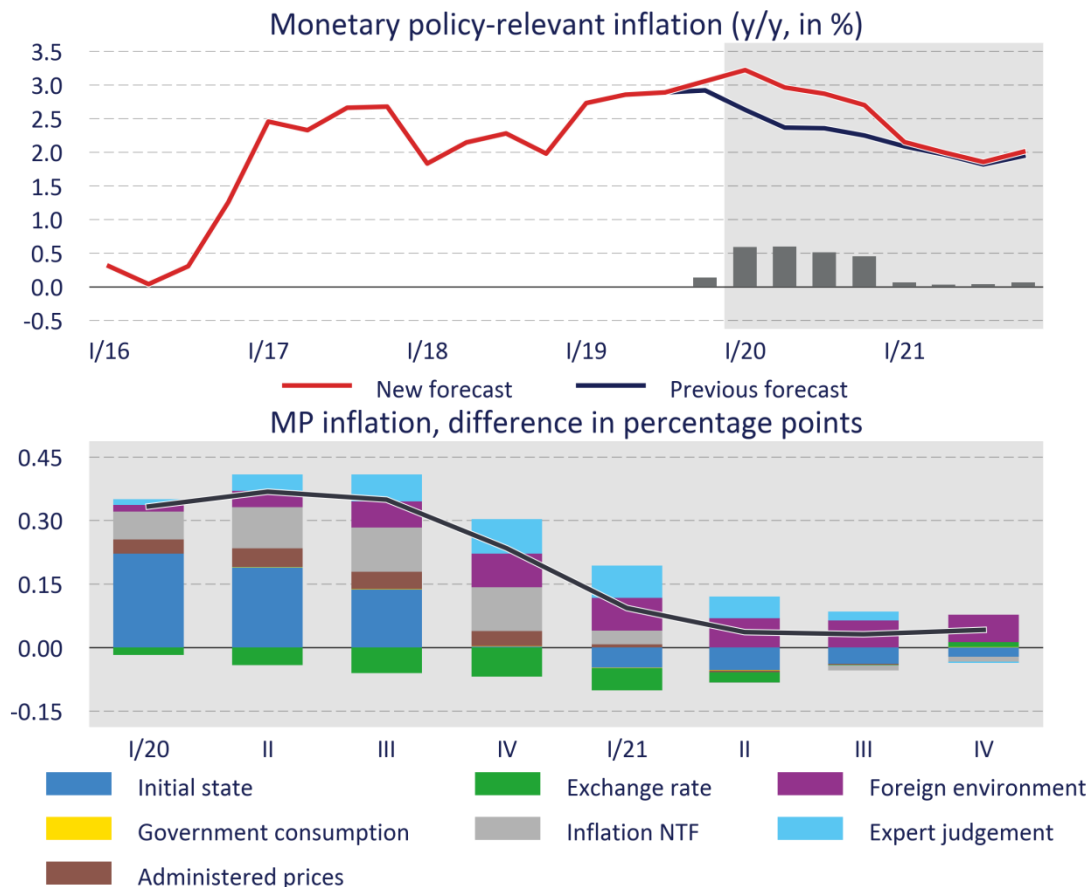
- The inflation outlook is higher due to stronger domestic price pressures, faster growth in administered prices and new tax changes in 2021.
- The forecast for domestic economic growth in 2020 has been revised down only marginally.
- Wage growth is lower in the first half of this year, after which it will be slightly higher. It reflects higher expected inflation, whose outlook remains well above the target for longer than in the previous forecast.
- The koruna is stronger at the start of this year, but will conversely appreciate more gradually in subsequent quarters.

Comparison: Interest Rate Forecast



- In the new forecast, the path of domestic interest rates is rather lower initially, but slightly higher next year.
- A negative contribution of initial state includes the effect of lower interest rates, slower wage growth and a slightly stronger koruna at the end of last year.
- The shift of the short-term koruna exchange rate forecast to a stronger level has the same effect.
- Developments abroad (upward revision of the interest rate outlook) have an effect in the opposite direction.
- A more inflationary expert judgments include a newly incorporated increase in parental allowance and a slightly larger impact of minimum wage growth.

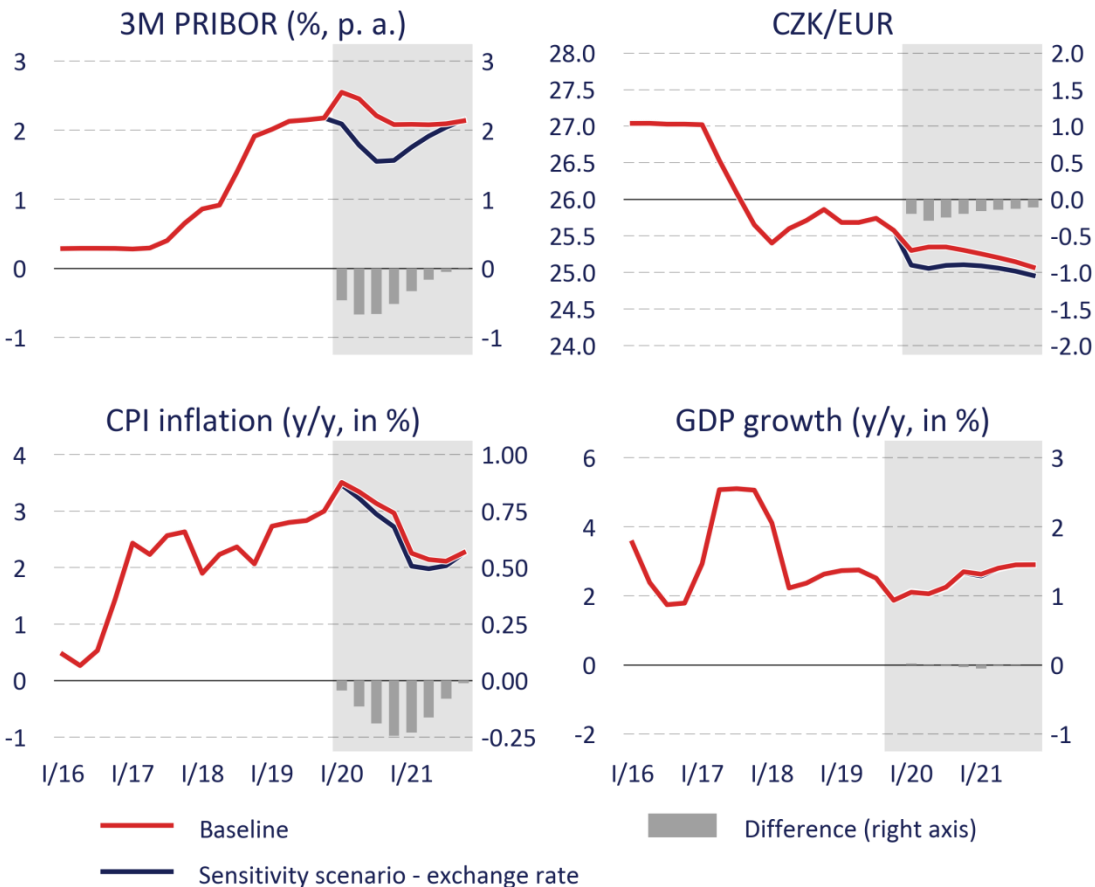
Comparison: Monetary Policy-Relevant Inflation Forecast



- The new forecast implies a higher monetary policy-relevant inflation in 2020.
- The initial state is more inflationary this year due to higher observed inflation and lower domestic interest rate.
- Foreign outlook (less negative 3M EURIBOR and higher oil prices) together with the near-term forecast of inflation reflecting stronger demand pressures shift inflation upwards.
- A more inflationary expert judgments include mainly a newly incorporated increase in parental allowance.
- The shift of the short-term koruna exchange rate forecast to a stronger level contributes to lower inflation.

1. Assumptions of the forecast
2. The new macroeconomic forecast
3. Comparison with the previous forecast
- 4. Exchange rate sensitivity scenario**

Exchange rate sensitivity scenario



- This exchange rate sensitivity scenario assumes a rapid fade-out of global factors. At the same time, this scenario sets the exchange rate at 25.1 CZK/EUR for 2020 Q1.
- The underlying strong appreciation pressure leads to a significantly lower interest rate path, and hence only slightly lower inflation, in the scenario.
- The koruna stabilises only just above 25 CZK/EUR in the quarters ahead, as it is prevented from firming further by significantly lower (even declining) interest rates than in the baseline scenario.
- The impacts on real economic growth are negligible overall.

Thank you for your attention

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Petr Král

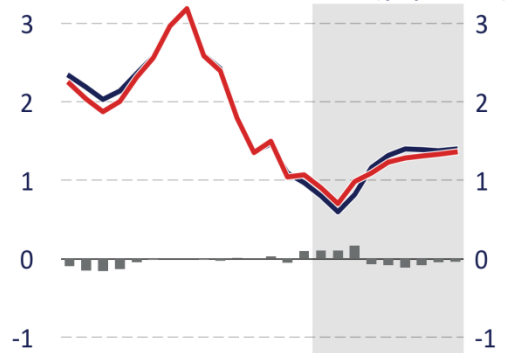
Monetary Department

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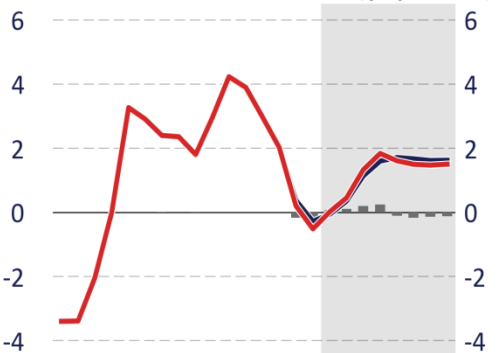
Backup

Foreign Outlook: Comparison with Previous Forecast

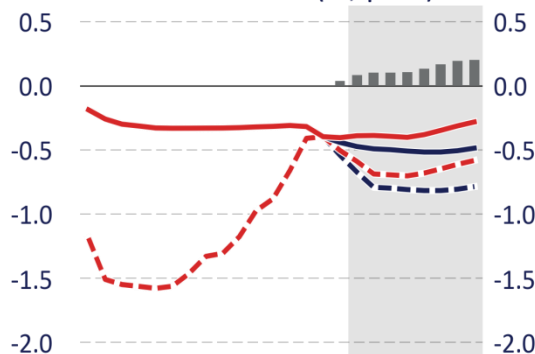
GDP - effective euro area (y/y, in %)



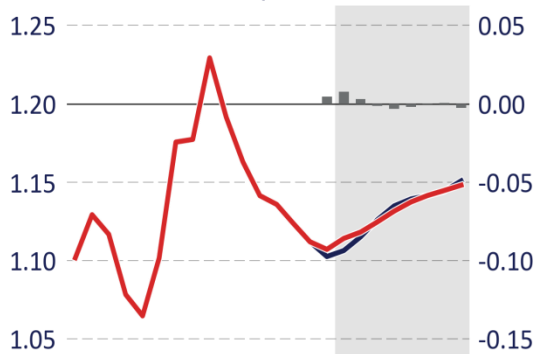
PPI - effective euro area (y/y, in %)



3M EURIBOR (% p. a.)

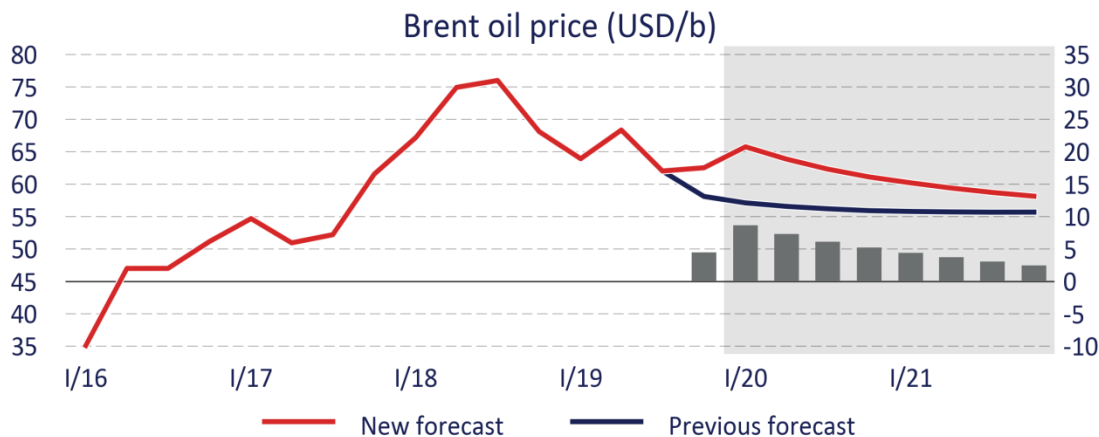


USD/EUR

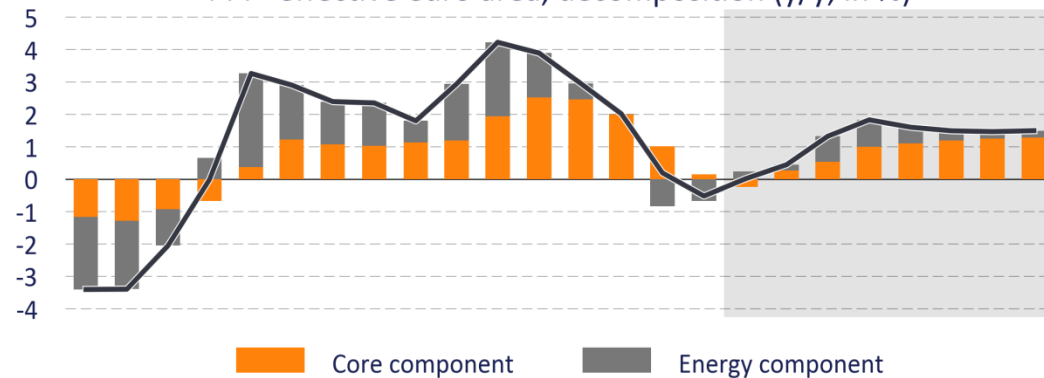


— New forecast — Previous forecast - - - Shadow rate

PPI in Effective Euro Area: Decomposition



PPI - effective euro area, decomposition (y/y, in %)



Changes to Indirect Taxes and Their Effects

(impacts on CPI in percentage points)

Item	Tax	First-round impacts	Second-round impacts
Administered prices:			
Heat and cooling	↓ VAT	-0.08	0.04
Other ^{a)}	↓ VAT	-0.10	0.05
Market prices:			
Core inflation			
Books	↓ VAT	-0.01	0.00
Other services ^{b)}	↓ VAT	-0.23	0.23
Food prices			
Alcohol ^{c)}	↑ Excise	0.09	0.00
Cigarettes ^{c) d)}	↑ Excise	0.60	0.00
2021			
Market prices:			
Food prices			
Cigarettes ^{c)}	↑ Excise	0.26	0.00
Cumulative impact as of 5/2020		0.27	0.32
Average impact in 2020 Q1		0.30	0.04
Average impact in 2020 Q2		0.39	0.23
Average impact in 2021 Q1		0.10	0.28

^{a)} e.g. water supply and sewerage collection charges

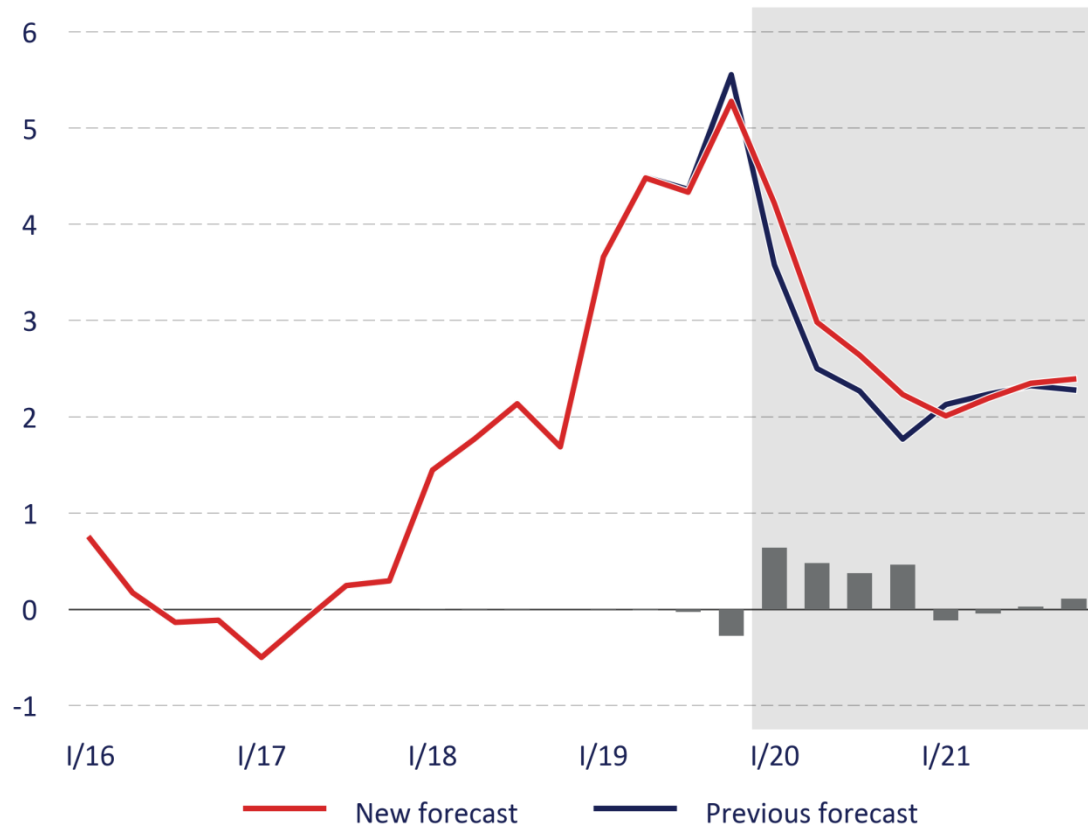
^{b)} e.g. hairdressing services and restaurants

^{c)} The impacts will appear gradually in the first three months of the year.

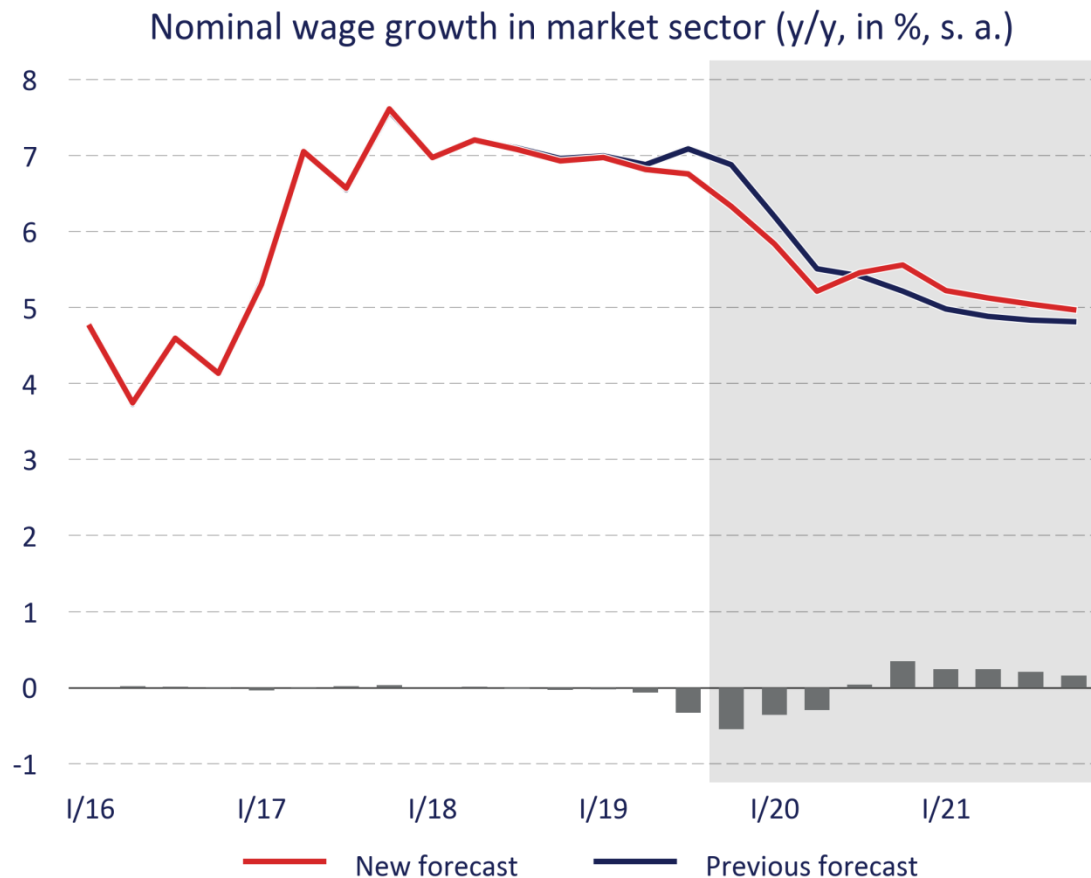
^{d)} harmonisation change

Administered Prices: Comparison with Previous Forecast

Growth of administered prices (y/y, in %)

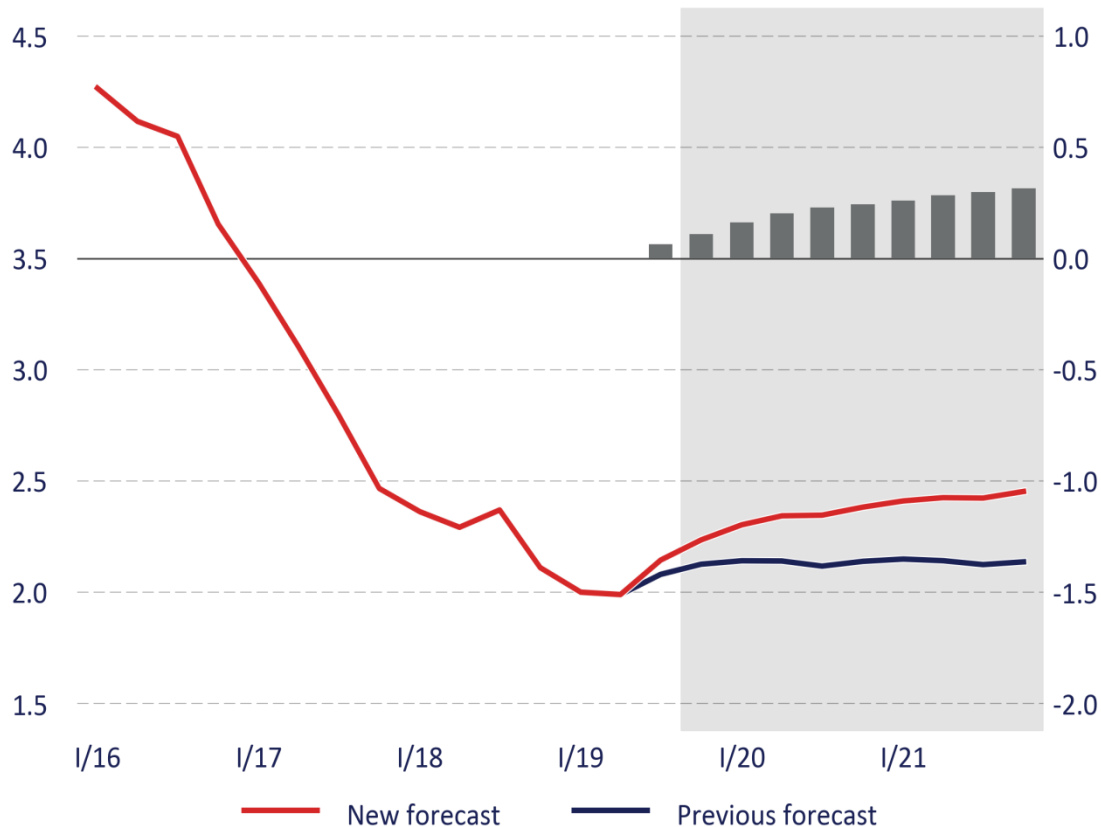


Wages in Market Sectors: Comparison with Previous Forecast



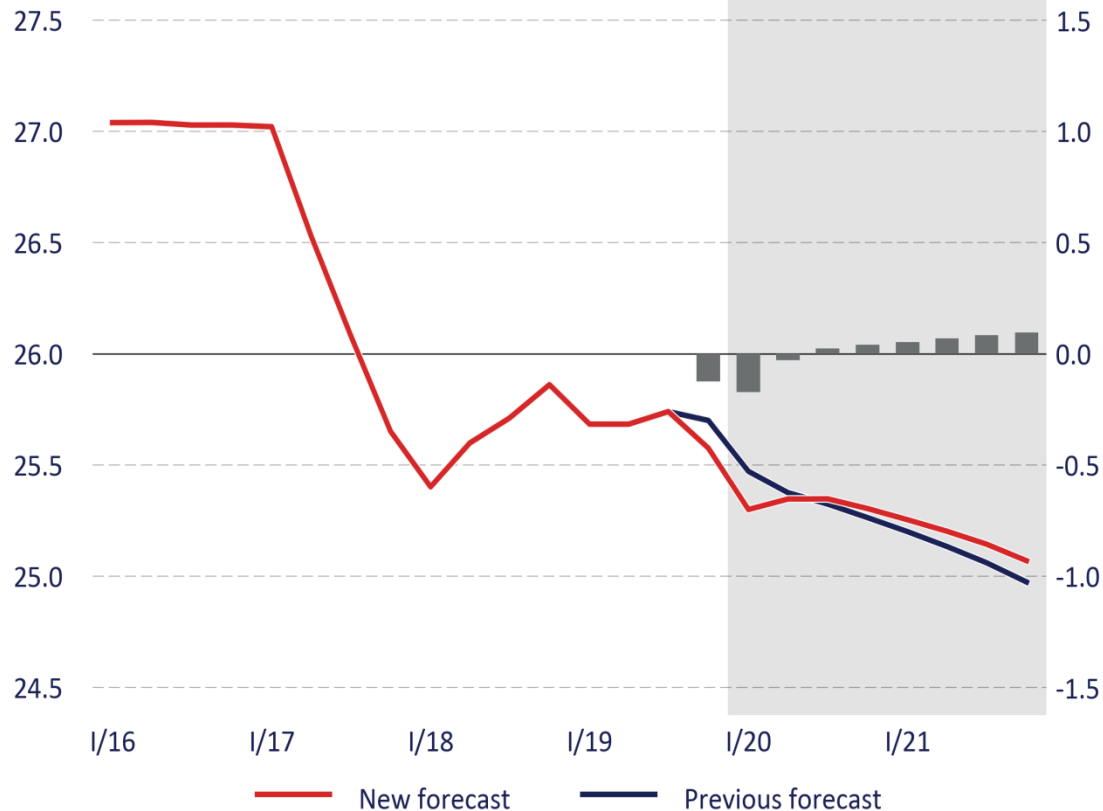
Unemployment Rate: Comparison with Previous Forecast

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



Exchange Rate: Comparison with Previous Forecast

CZK/EUR



Interest Rate: Comparison with Previous Forecast

3M PRIBOR (% p. a.)

