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

Meeting with Analysts

7 August 2020

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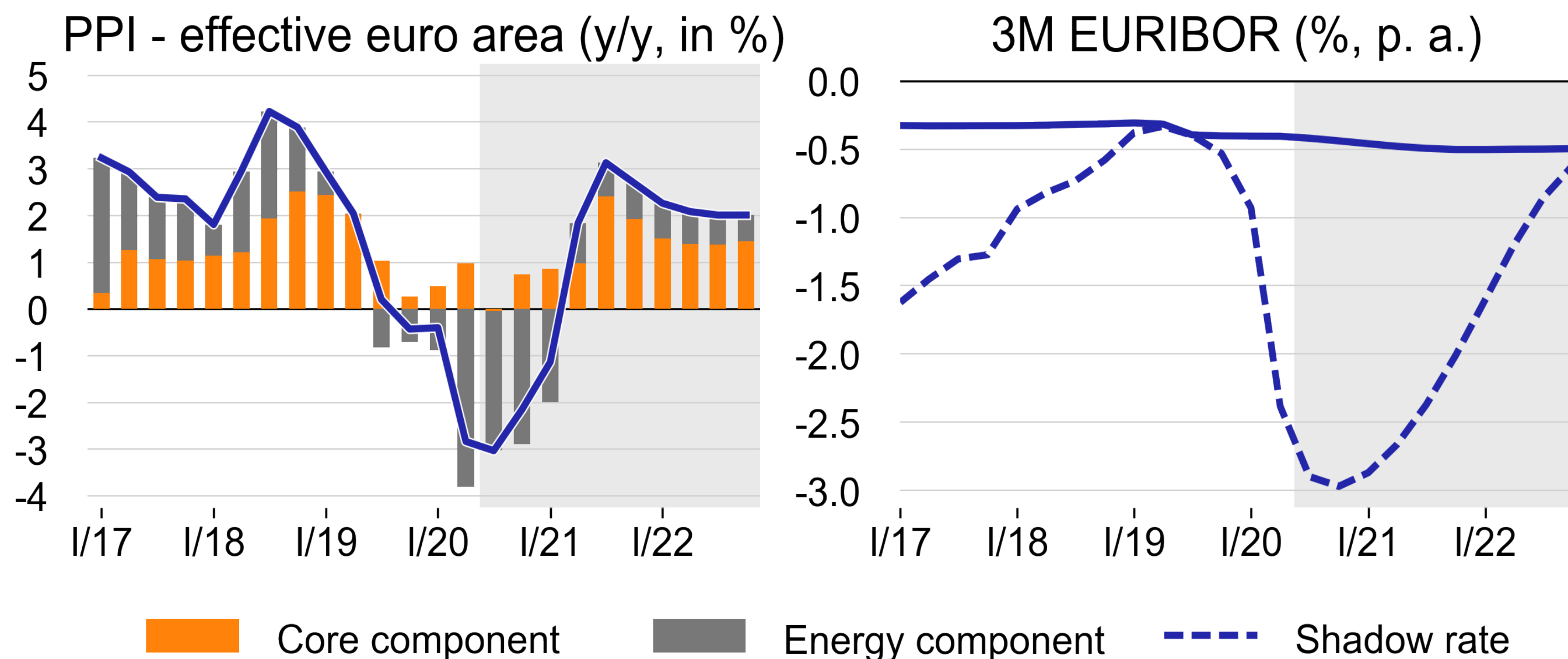
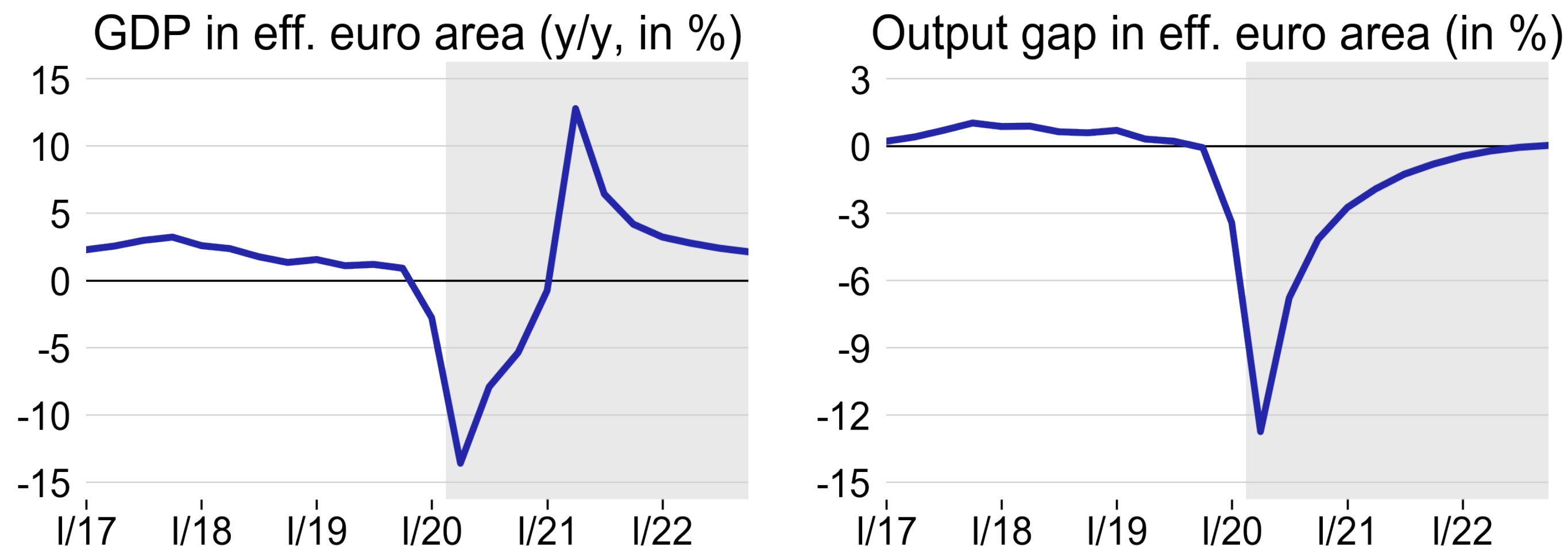


Presentation outline

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

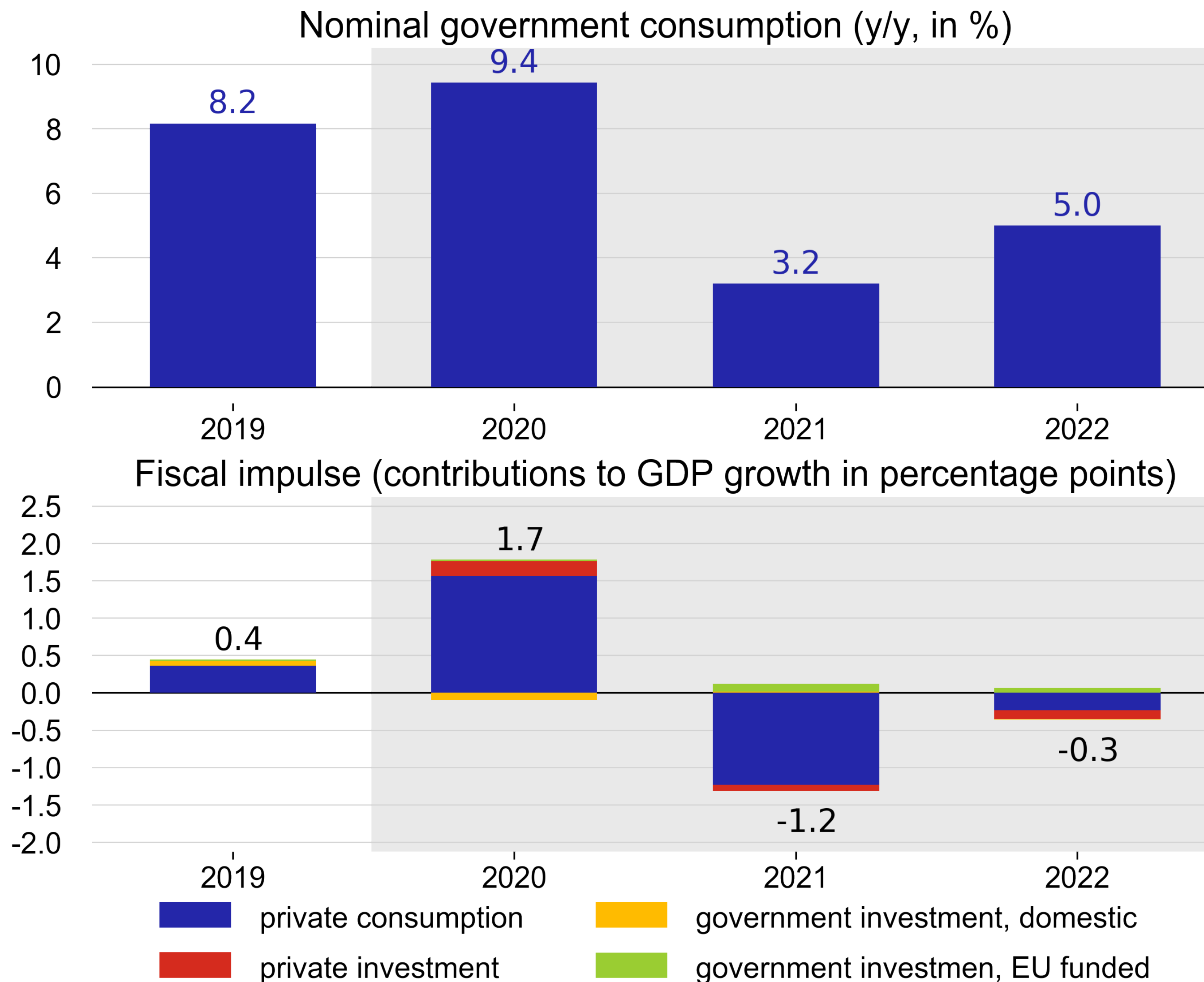


External Environment Outlook



- Overall, the **effective euro area** economy will decline by more than 7% this year and grow by more than 5% next year.
- The expected recovery will not be enough for the currently highly negative **output gap** to close before the end of the forecast horizon.
- Strongly negative contributions of the energy component will lead to a sizeable decline in **industrial producer prices** overall amid a fall in economic activity.
- The **3M EURIBOR** will remain negative over the entire forecast horizon. The forecast takes into account expectations regarding the ECB's asset purchase programme through adjustments using **shadow interest rates**, which are significantly lower than market rates.

Fiscal Policy



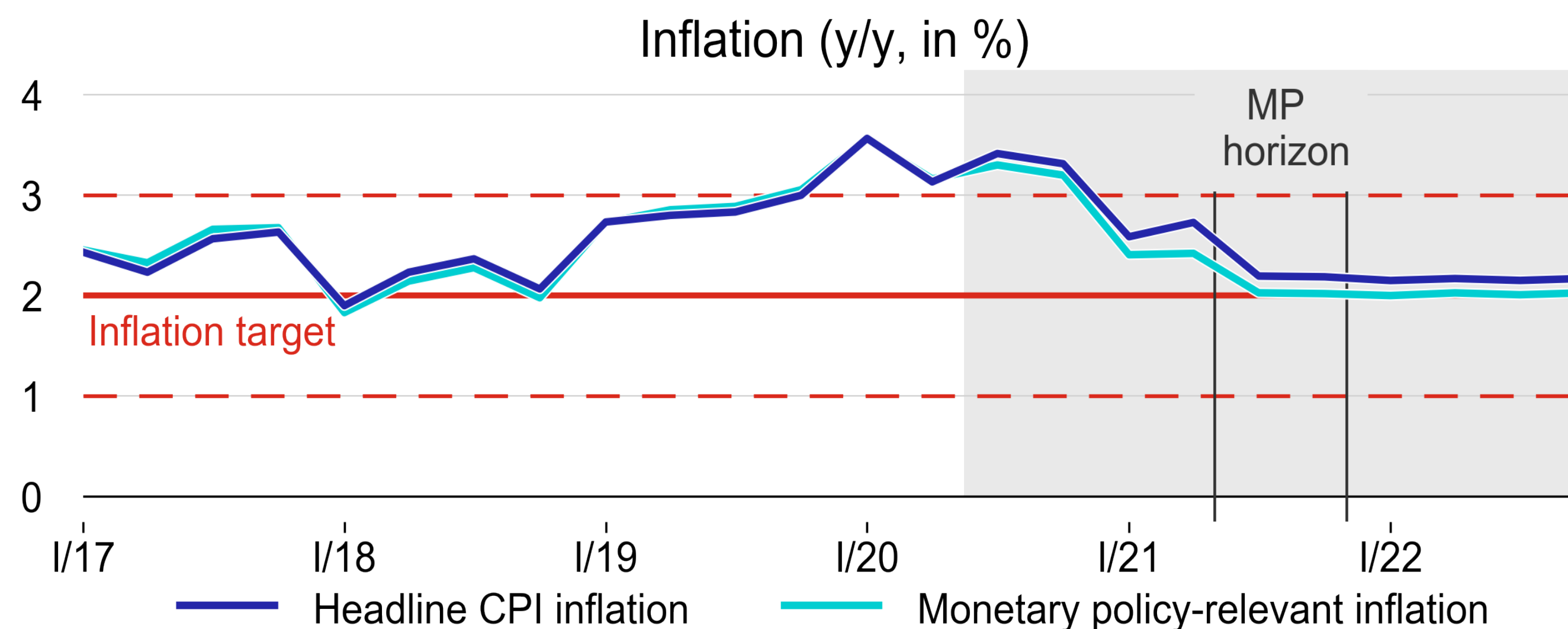
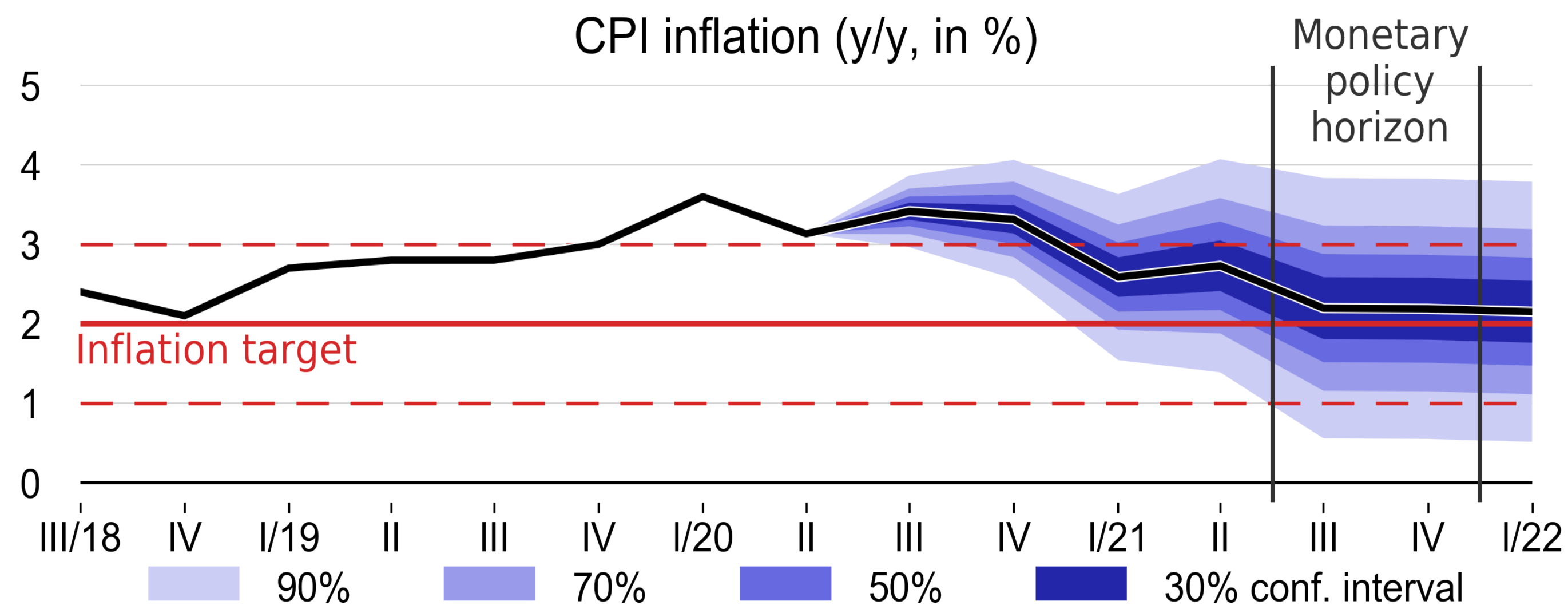
- Acceleration in **government consumption** in nominal terms will reflect mainly a rise in expenditure in the health and emergency services.
- **Fiscal stabilisation policy** is being implemented primarily through substantial support for household consumption this year.
- A **positive fiscal impulse** this year is largely a result of the extraordinary measures taken to support the economy due to the epidemic (Antivirus, „25“, care allowance etc.).
- As most of the support measures will be temporary, the forecast expects a **negative fiscal impulse** in 2021 and 2022.

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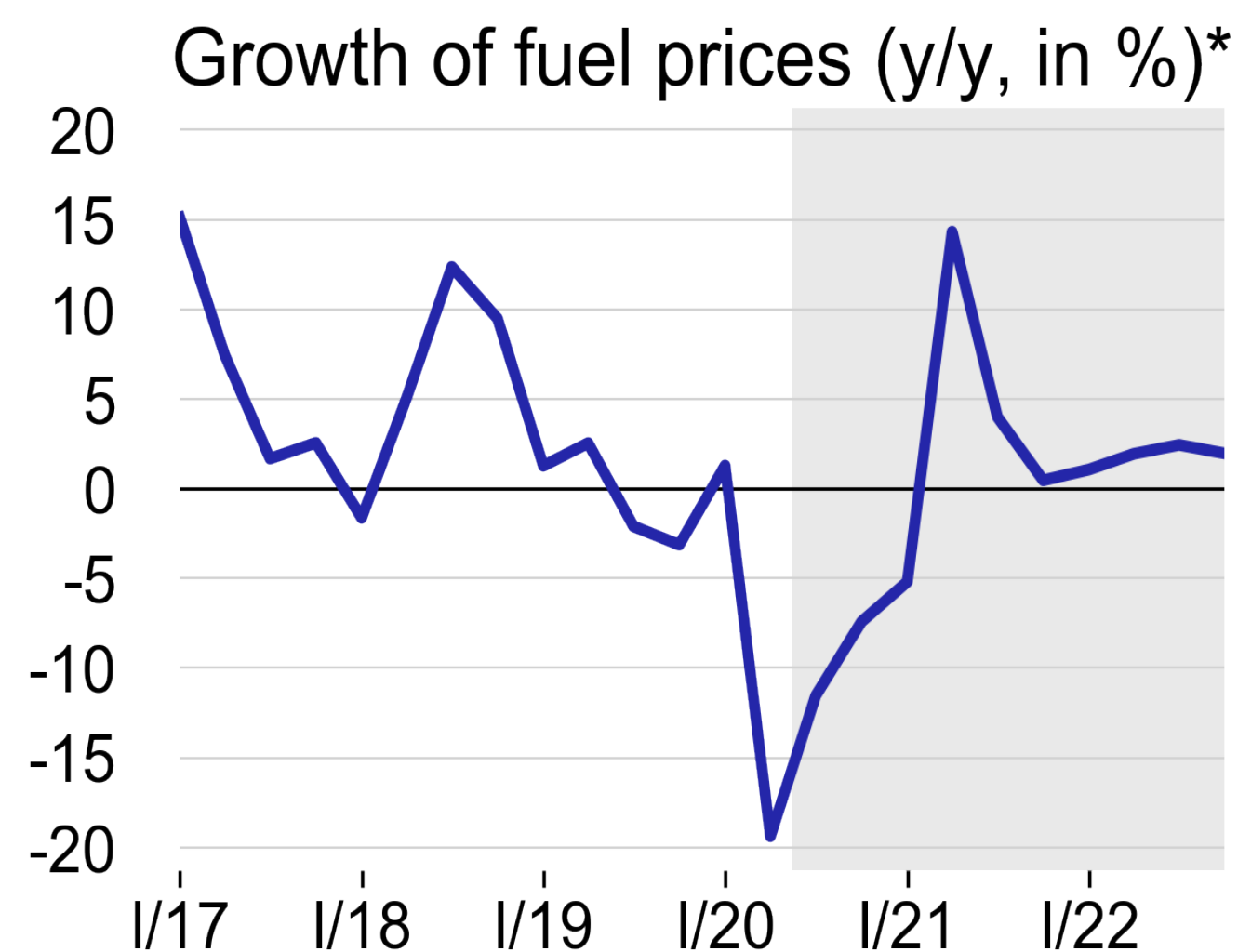
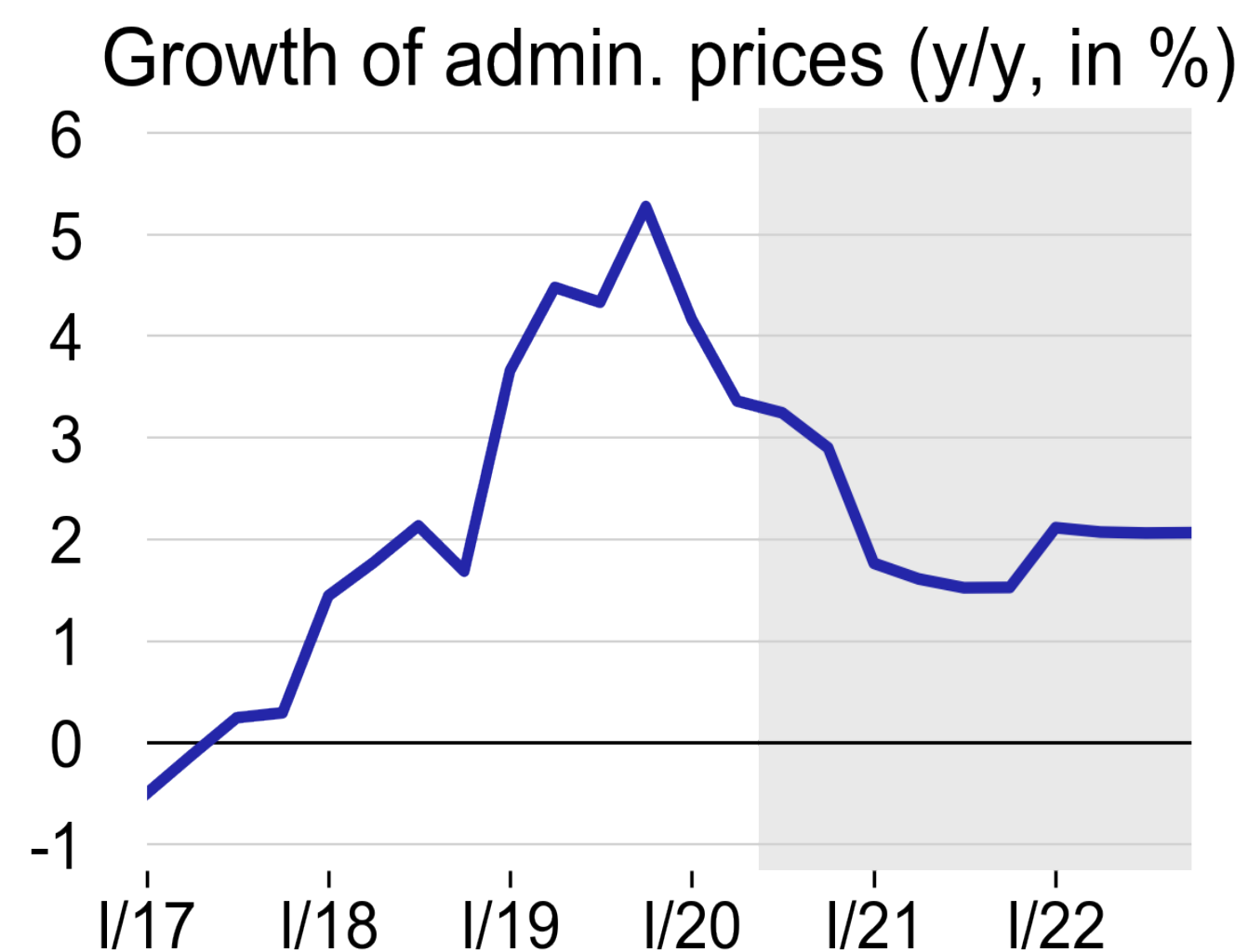
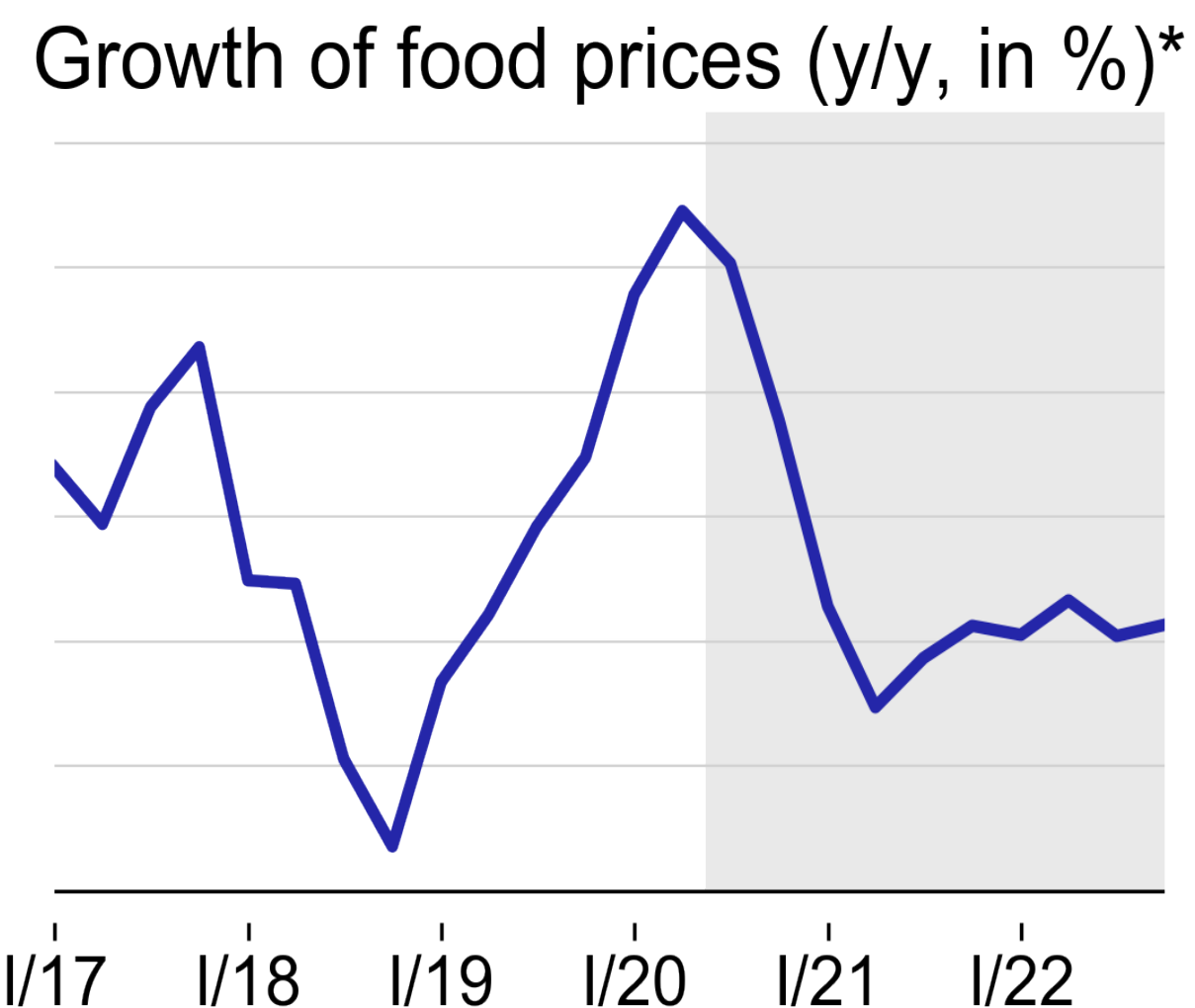
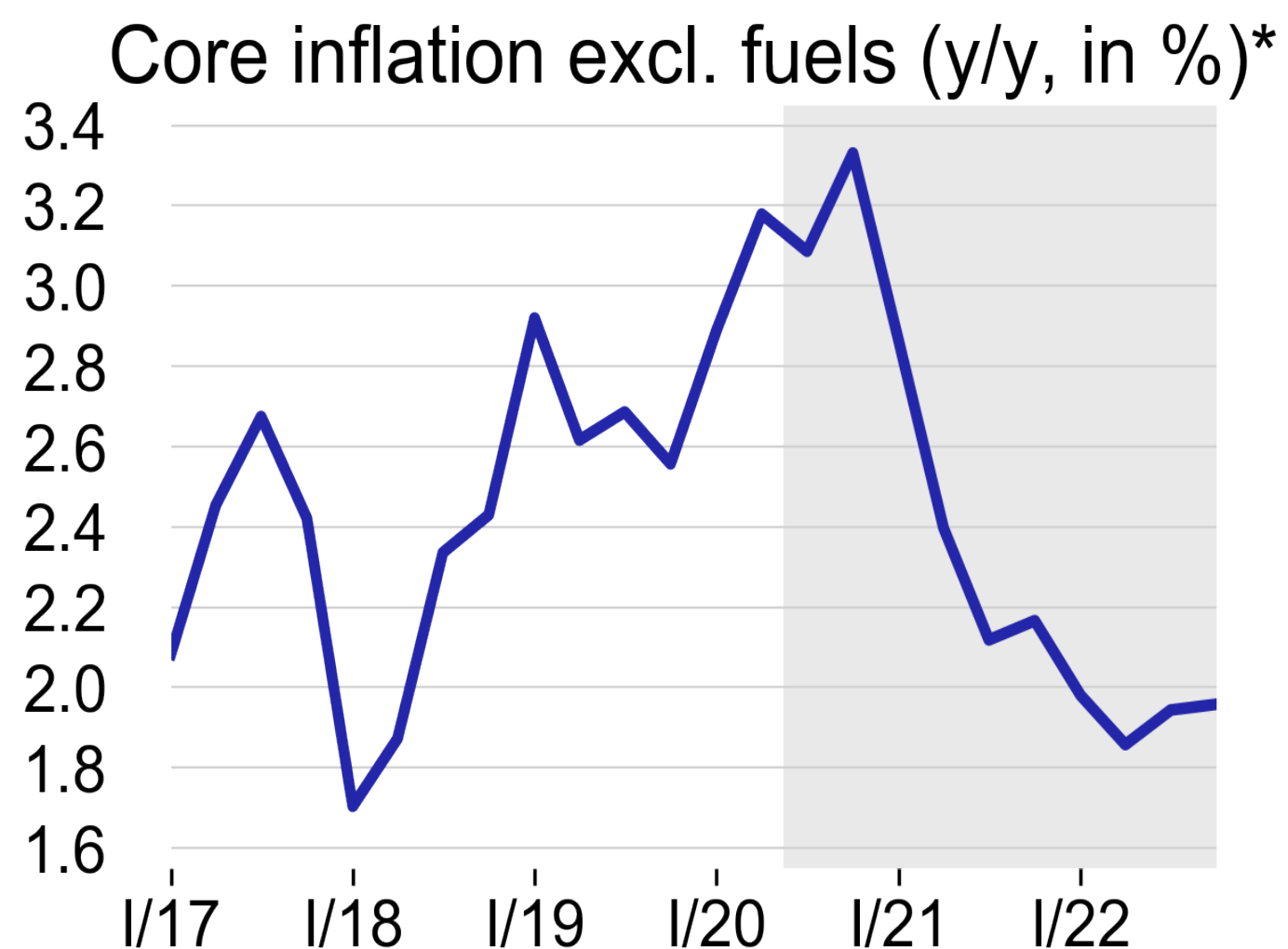


Headline and Monetary Policy-Relevant Inflation



- **Headline inflation** will stay above the upper boundary of the tolerance band for the rest of this year and return close to the target next year.
- A drop in firms' revenues and growth in their costs during the coronavirus pandemic will foster continued price growth until the end of 2020, despite a deep decline in demand and overall economic activity.
- Inflation will fall more markedly at the start of 2021 in connection with lower growth in domestic costs, slightly appreciating koruna and cooling of the labour market.
- **Monetary policy-relevant inflation** will be slightly lower than headline inflation, as the first-round effects of changes to indirect taxes will be slightly positive overall.

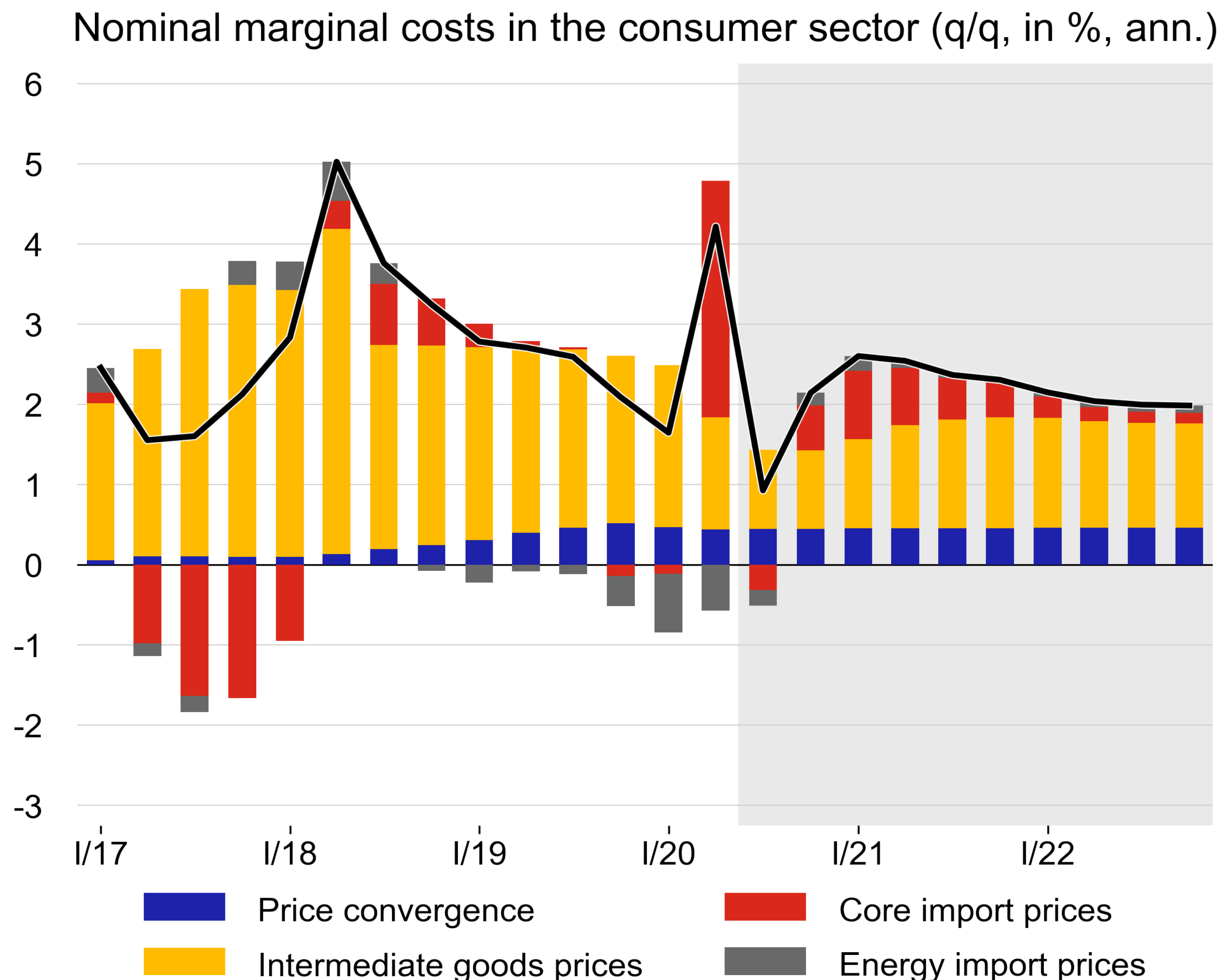
Inflation Components



- **Core inflation** will remain elevated until the end of this year. This will reflect the fading strong demand pressures connected with the until recently tight labour market and temporarily higher costs caused by the coronavirus pandemic.
- Still solid consumer demand and elevated costs will foster continued growth in **food prices** in the near future.
- Growth in **administered prices** will continue to slow for the rest of this year. This will be due mainly to a gradual decline in the currently high growth in electricity prices and a decrease in heat prices.
- The fall in **fuel prices** resulting from the previous collapse of global oil prices will gradually dissipate.

* excluding tax changes

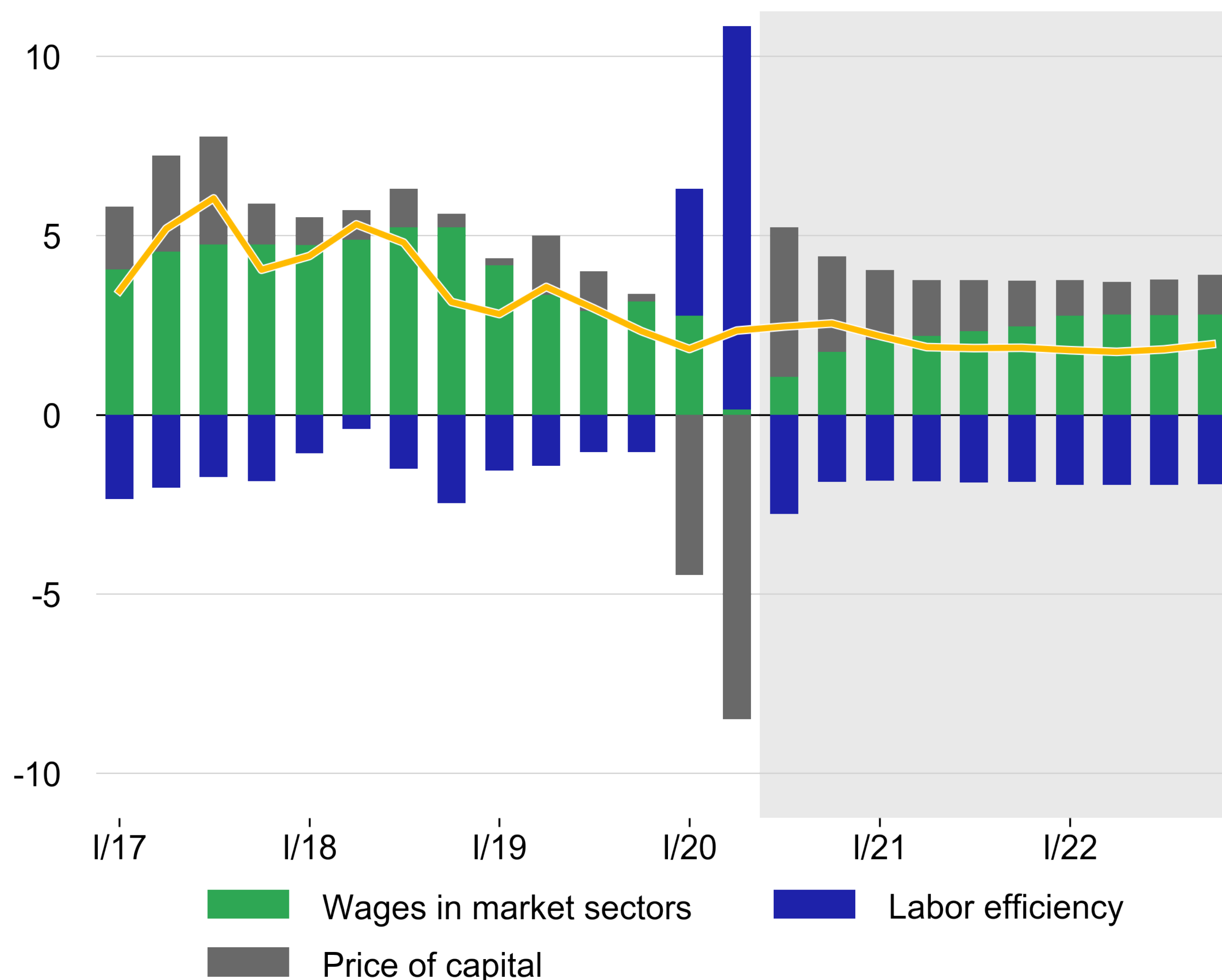
Inflation Pressures: Costs in Consumer Sector



- **Growth in total costs** will slow temporarily on account of a stronger exchange rate, but then will accelerate again due to a recovery in foreign inflation.
- The negative contribution of **energy import prices** to growth in total costs will fade out owing to an increase in oil prices.
- The contribution of the **domestic economy** will fall further in 2020 Q3; its subsequent increase will reflect a recovery in domestic economic activity.
- The contribution of **price convergence** will be constantly positive over the entire forecast horizon.

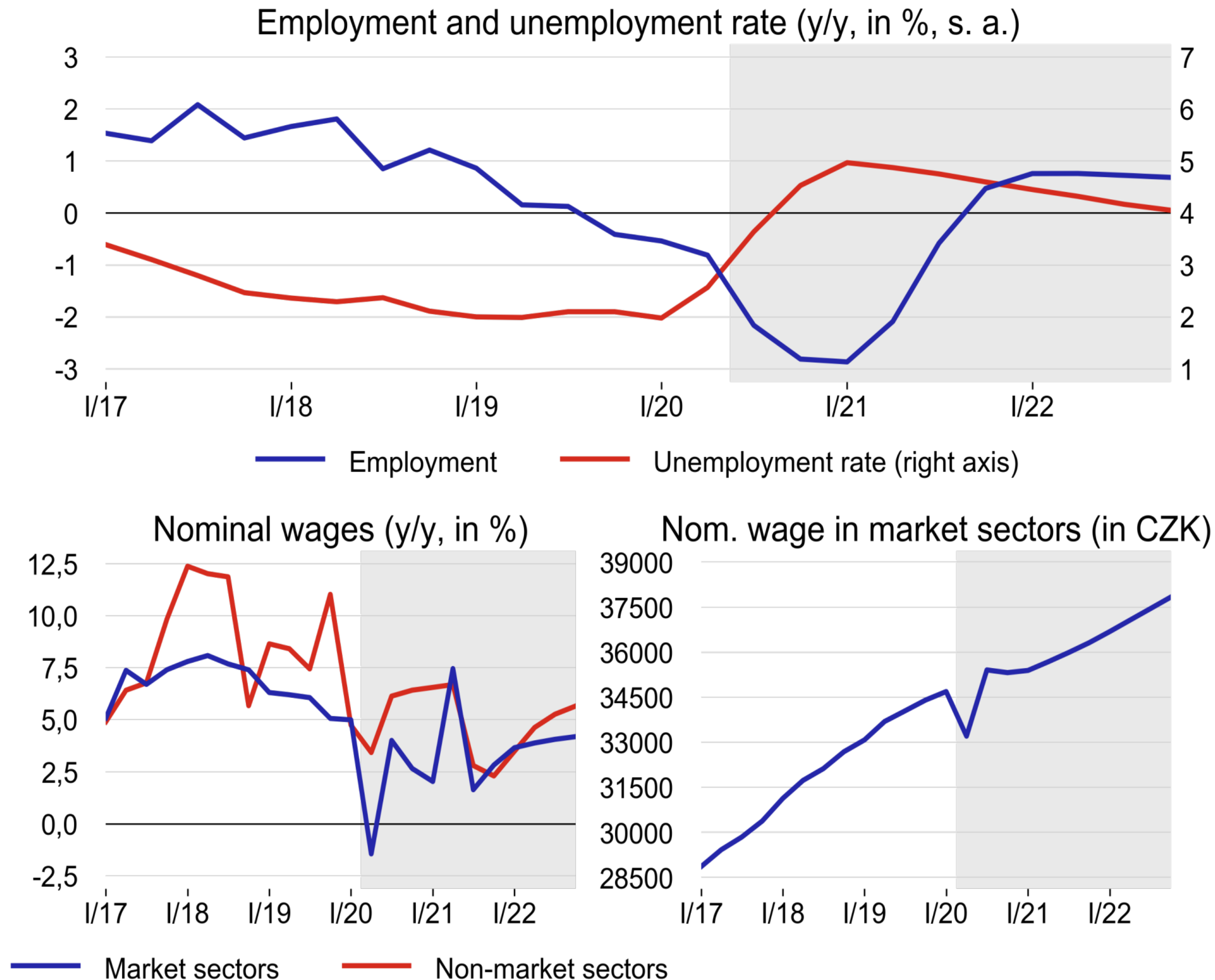
Inflation Pressures: Costs in Intermediate Goods Sector

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



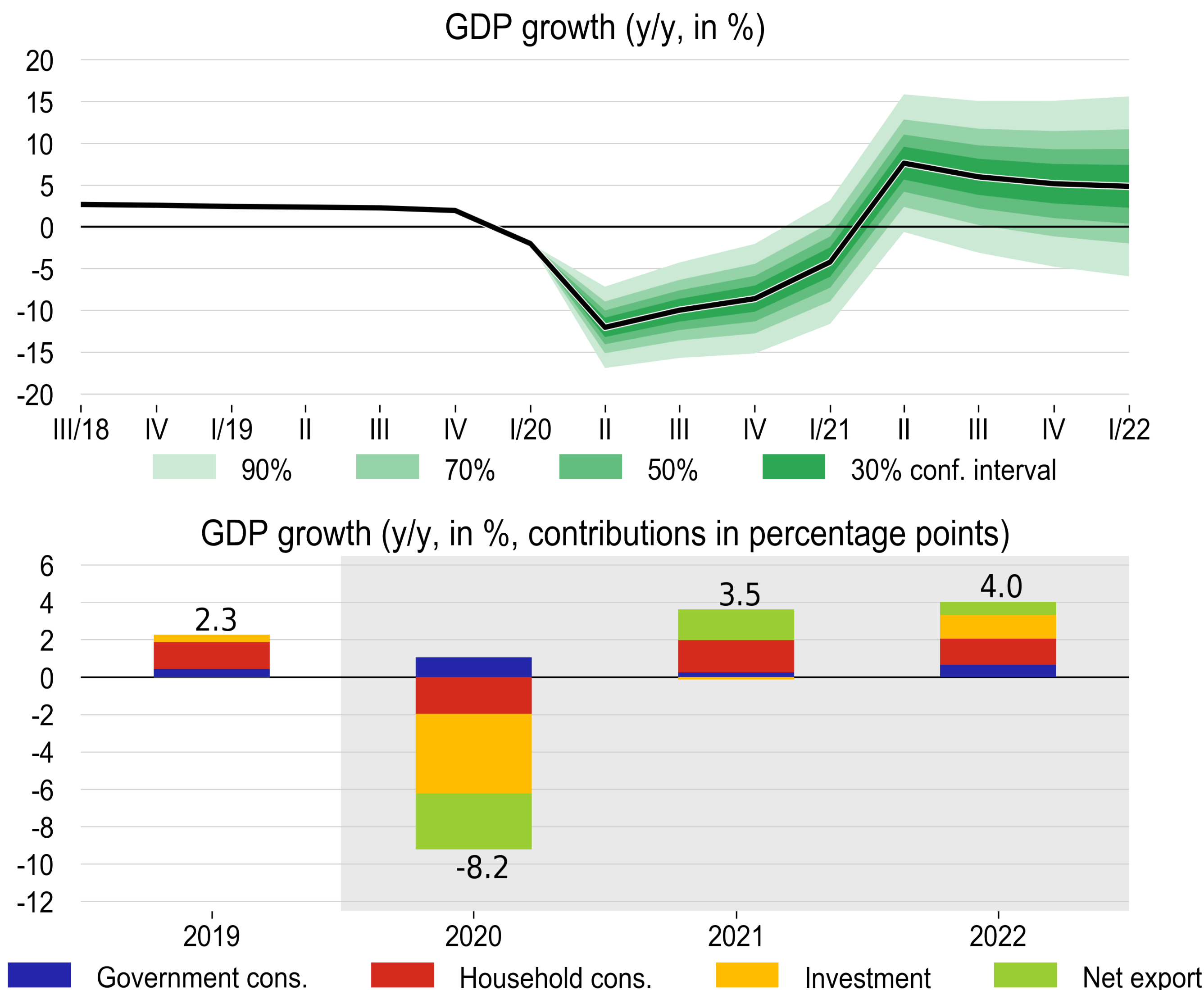
- **Domestic costs** will rise at a faster pace until the end of this year and then slow to their steady-state growth rate.
- Growth in **fundamental wage costs** almost halted, and the shutdown of part of the economy was reflected in a deeply negative contribution of the **price of capital**. However, this was countered by a deep decline in **labour efficiency** related to falls in output and restricted operation of firms.
- Domestic costs will accelerate slightly in the second half of this year owing to the **gradual recovery** in domestic economic activity. This will cause the price of capital to go up and the contribution of wages to resume gradually. At the same time, the contribution of labour efficiency will start to dampen growth in costs again.

Labour Market



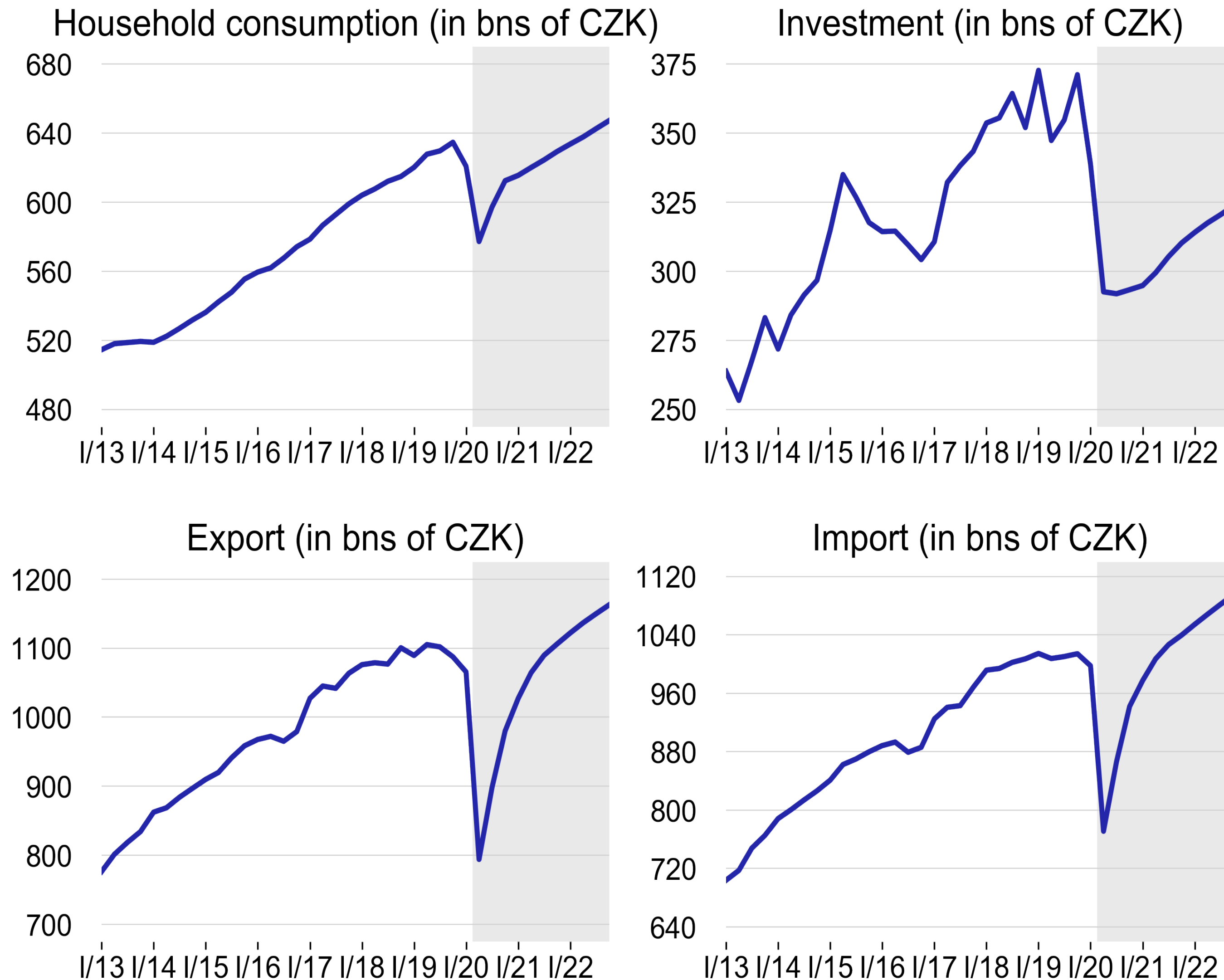
- **Employment** will decline appreciably almost until the end of next year owing to the fall in economic activity.
- The **unemployment rate** will increase rapidly, peaking at the start of 2021. More marked growth in unemployment will be prevented mainly by a high initial number of vacancies and lay-offs of foreign workers.
- **Wage growth in market sectors** will slow significantly this year owing to the rapid labour market cooling and government quarantine measures, and will then gradually recover.
- **Wage growth in non-market sectors** will remain high this year.
- Statistical effects will cause wage growth in both sectors to fluctuate.

GDP Growth Forecast



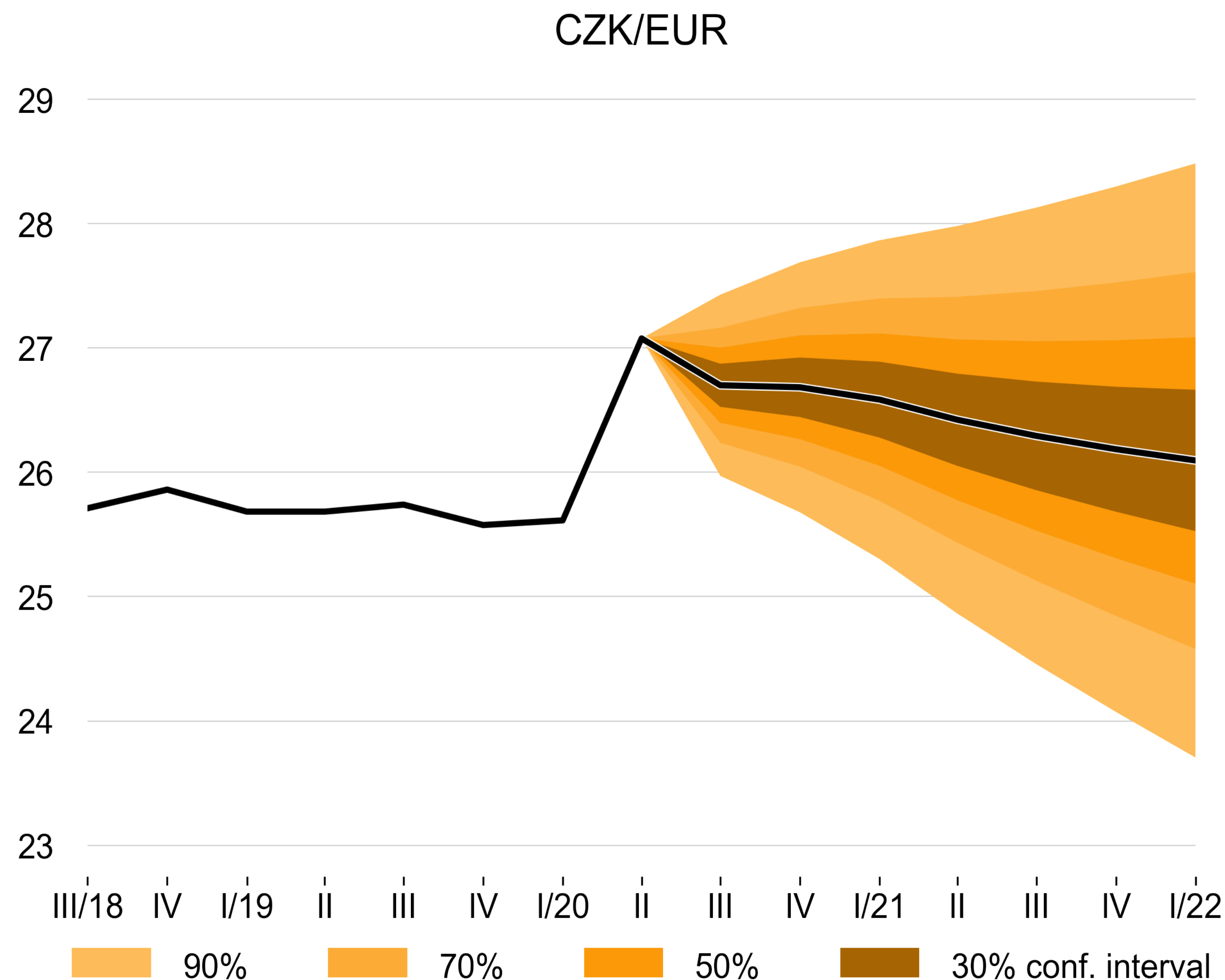
- **Domestic economic activity** will fall sharply this year as a result of the coronavirus pandemic.
- This year's decline in GDP will be due mainly to **private investment**, but also to net exports and household consumption.
- Conversely, accelerating growth in **government consumption** helps reduce the negative impacts of the coronavirus pandemic this year.
- As a result, GDP will decline by around 8% this year. Renewed economic growth next year (of 3.5%) will be driven mainly by household consumption and net exports.
- All the components of GDP will contribute positively to growth in 2022.

Aggregate Demand Components



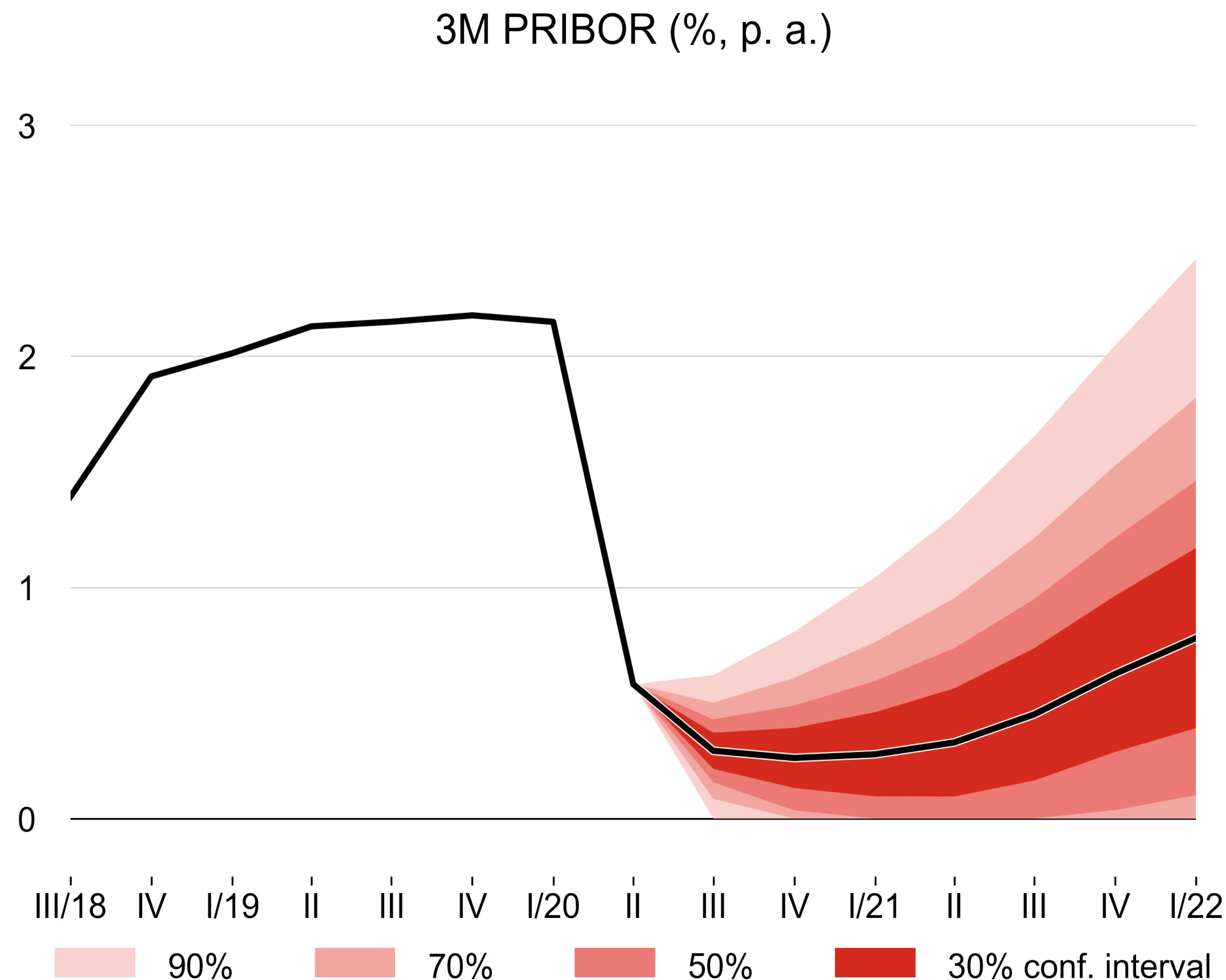
- **Household consumption** will drop this year as a result of the coronavirus pandemic and the abrupt cooling of the labour market.
- The effects of the coronavirus pandemic and the sharp deterioration in corporate sentiment will be adversely reflected in private **investment activity**. Government investment will conversely maintain modest growth.
- **Exports** of goods and services will drop sharply as a result of the drop in external demand.
- **Imports** will decrease significantly this year due to the drop in domestic demand and exports.

Exchange Rate CZK/EUR



- The **koruna** will appreciate gradually over the entire forecast horizon.
- The exchange rate forecast for **2020 Q3** is set at **CZK 26.7 to the euro**. It thus reflects the appreciation recorded in late May caused by a change in global sentiment connected with the easing of the quarantine measures in Europe and the Czech Republic.
- A relatively moderate course of the pandemic in the domestic economy and in Europe will then allow the rate to appreciate gradually further over the forecast horizon.
- This will be due to renewed growth in external demand and, in turn, domestic economic activity, against a backdrop of continued real convergence of the Czech economy.

Interest Rate Path (3M PRIBOR)



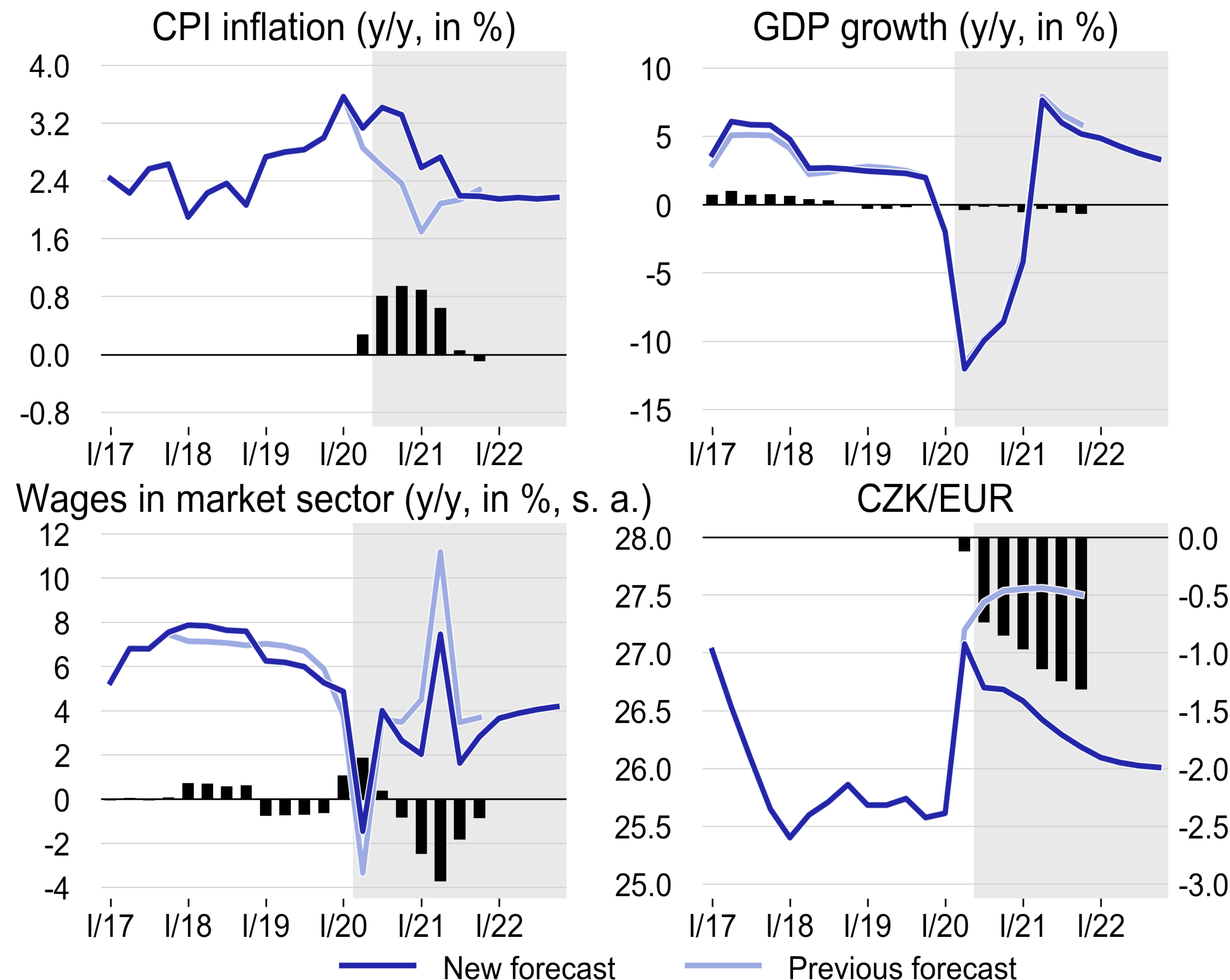
- Consistent with the forecast is **stability of domestic market interest rates** until mid-2021, followed by a gradual rise in the rates.
- Following a sizeable decrease in 3M PRIBOR market interest rates in the first half of this year, which reflected the CNB's response to the negative impacts of the coronavirus pandemic, rates will remain stable for a few quarters.
- The forecast indicates a gradual rise in market interest rates from 2021 H2 onwards as domestic economic recovers, amid stabilisation of inflation close to the target.

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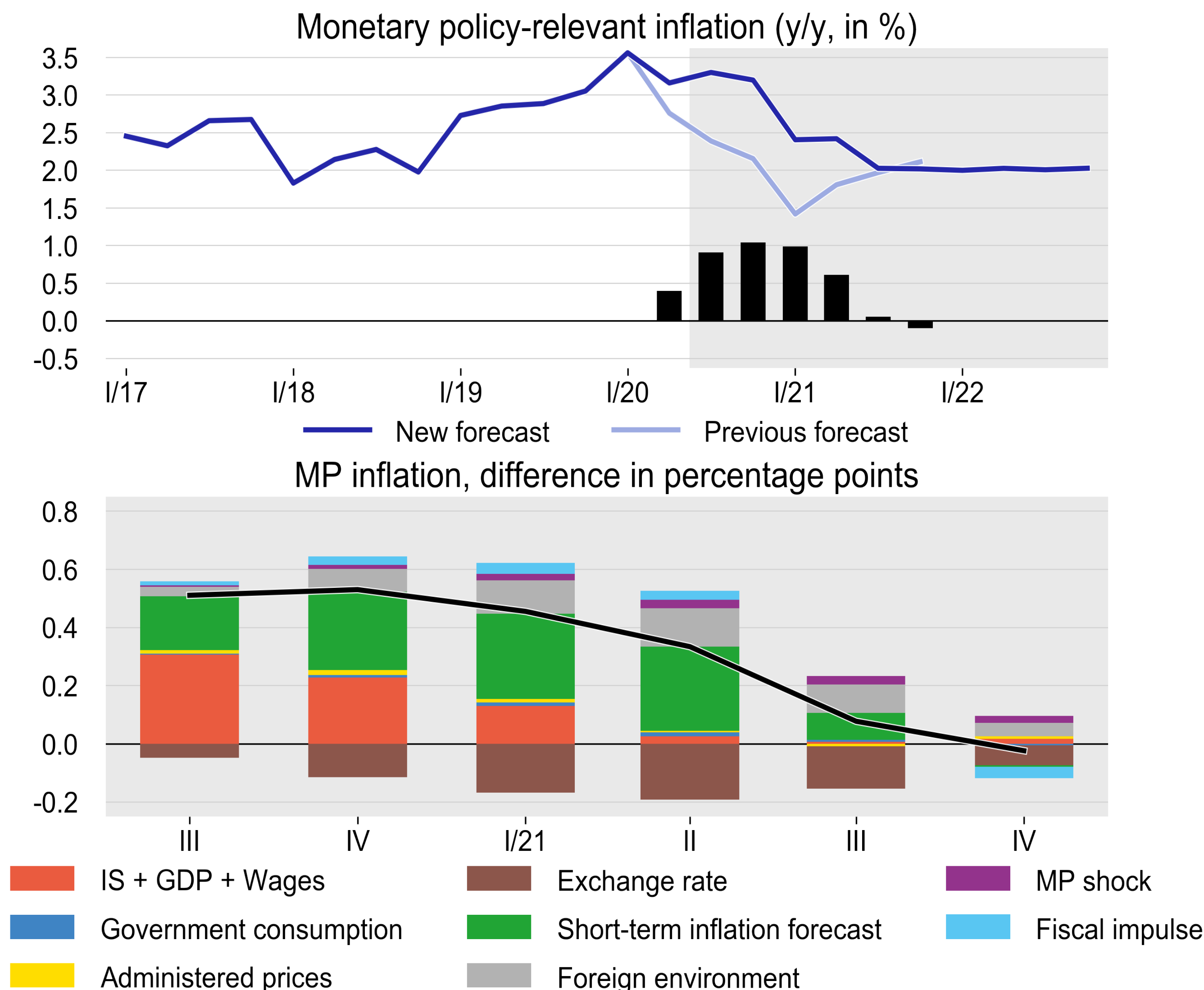


Comparison with Previous Forecast



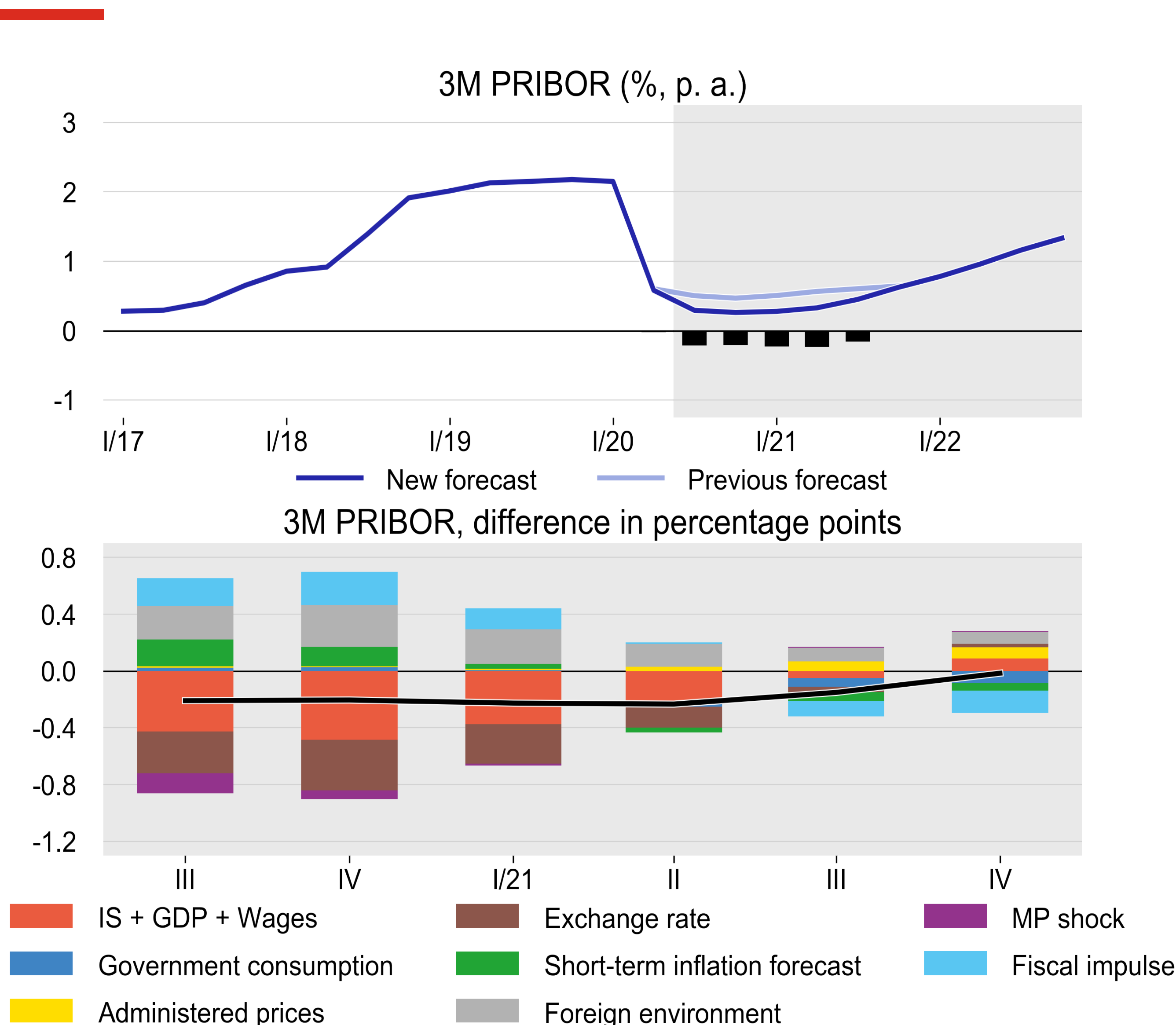
- The **inflation outlook** is higher due to a more gradual fading of the previous high demand and to stronger cost pressures. The observed consumer price data and stronger cost pressures lead to a higher forecast for inflation (especially its core components).
- The forecast for **domestic economic activity** has been revised down slightly, owing mainly to a more marked drop in investment.
- The **wage growth** forecast revision reflects milder fundamental pressures and a revision of statistical effects.
- The **exchange rate** forecast has been revised towards a stronger koruna over the entire forecast horizon, mainly due to a change in sentiment on financial markets.

Comparison: Inflation Forecast



- Compared with the previous forecast, **monetary policy-relevant inflation** has moved upward.
- The **short-term forecast of inflation** and the overall contribution of the **initial state** and **expert GDP** and **wage outlooks** are the dominant factors fostering higher MP inflation over the entire forecast horizon.
- Foreign outlook** (due to growth in core foreign producer prices) also shifts inflation upward.
- Positive **fiscal impulse** has an upward effect on inflation.
- The shift of the short-term koruna **exchange rate forecast** to a stronger level contributes to lower inflation.

Comparison: Interest Rate Forecast



- The new forecast contains **a slightly lower path** of domestic interest rates than the previous one.
- The overall contribution of the initial state + expert outlooks of GDP and wage is the dominant factor fostering lower interest rates over the forecast horizon.
- Lower rates are also fostered by the actual short-term koruna outlook for 2020 Q3, which is markedly stronger than in the previous forecast.
- The effect of the sharp reduction in interest rates in 2020 Q2 acts in the same direction this year.
- Changes in the external outlook and a stronger positive fiscal impulse have an upward effect on rates.

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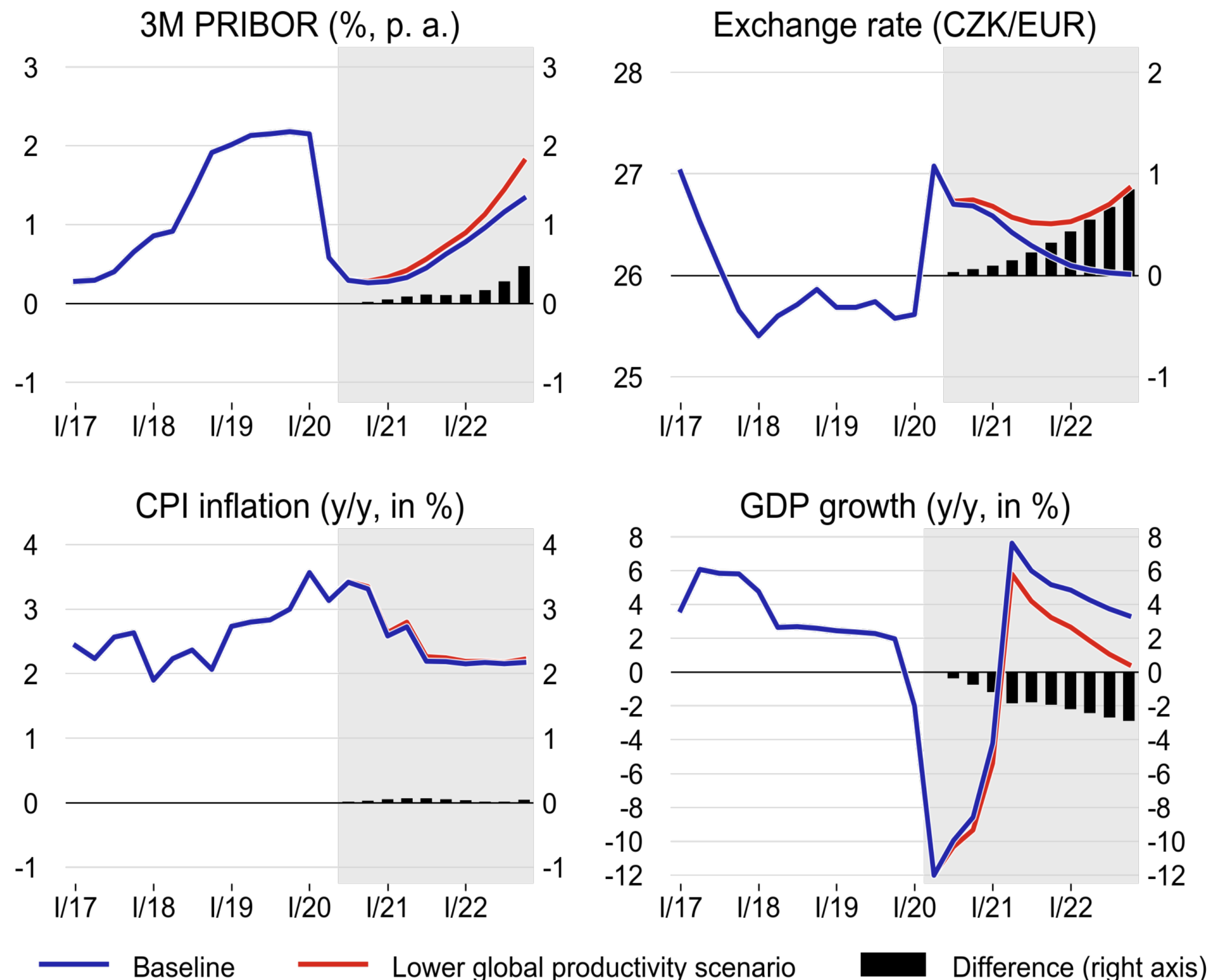
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Lower Global Productivity Scenario

- The scenario of lower global productivity describes the impacts of **stronger barriers to international trade** and the division of labour as a result of, among other things, a strategic shortening of supply chains, whose smooth operation was disrupted by new, previously non-existent frictions when the pandemic broke out.
- These changes lead to a visible **fall in the efficient use of production factors** in the global economy and the scenario assumes a gradual decline in total global factor productivity over next years.
- The scenario also assumes that the world's major central banks (including the ECB) will prefer **easy monetary conditions** to strict inflation targeting in this period in order to support an economic recovery.
- This will result in **a lower rate of global economic growth** coupled with **higher global inflation**, as the replacement of cheaper imports with more expensive substitutes will be reflected in faster growth in prices of production inputs and consumer goods worldwide.
- The scenario leads to an **economic slowdown** and **faster inflation** in the effective euro area. Given the long-term nature of the shock, the **contrary tendencies** in inflation and the real economy **gradually strengthen** over time.

Lower Global Productivity Scenario: Domestic Economy



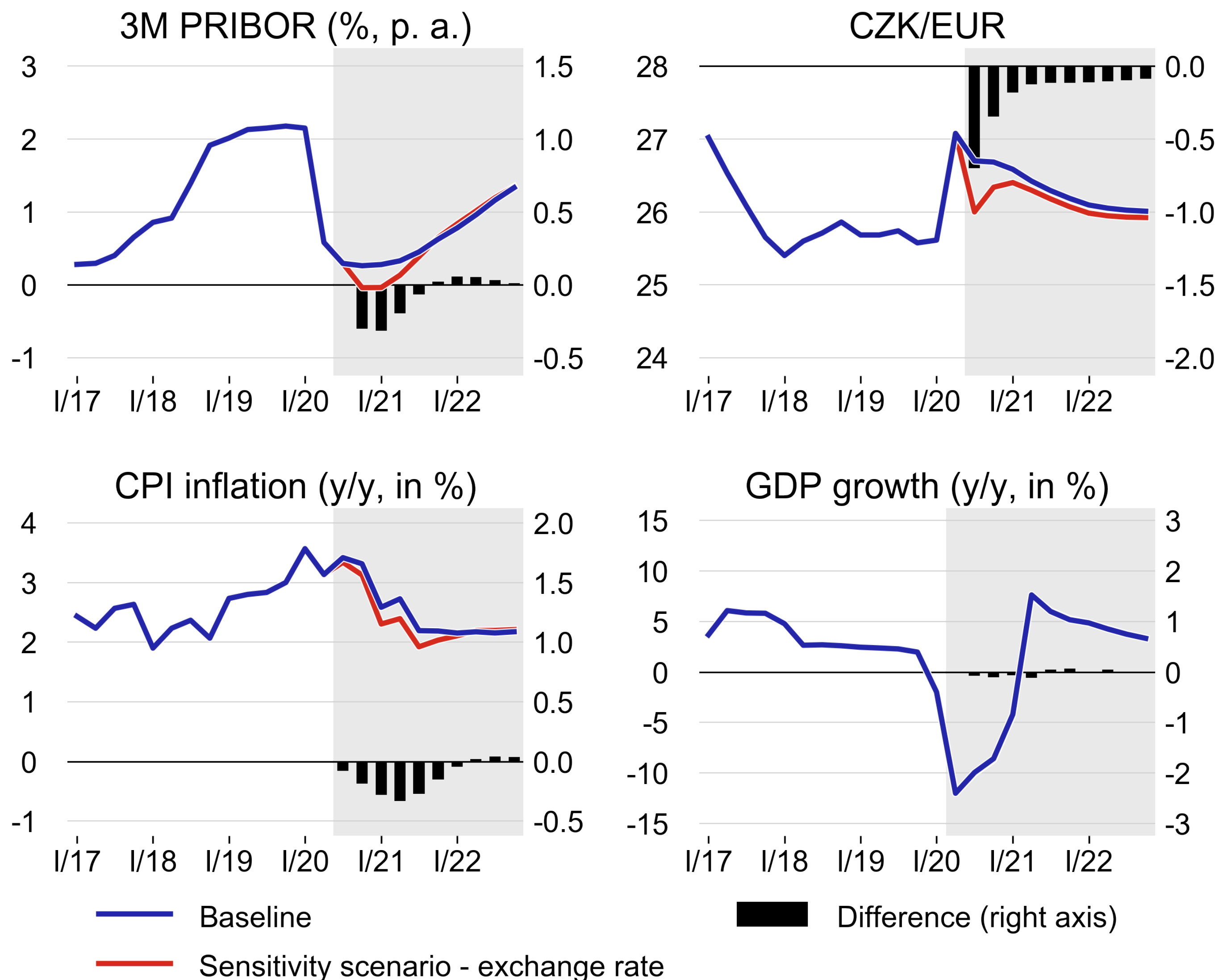
- The decrease in the productivity of global production capacity is **reflected** in the domestic economy solely **through** the outlook for the **external environment**.
- The worse outlook for external demand will be reflected mainly in **more subdued domestic activity** (slower investment growth and deteriorating net exports) and a **weaker koruna**.
- Together with the higher inflation abroad, this results in higher import prices and related upward pressure on **consumer price inflation**.
- Only **slightly higher market interest rates** than in the baseline scenario are sufficient to keep inflation at the target.

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Exchange Rate Scenario



- The recent increase in volatility of the koruna is captured by the stronger exchange rate scenario.
- The scenario assumes that the koruna will strengthen temporarily to **CZK 26 to the euro in 2020 Q3** and then gradually return close to the path contained in the baseline scenario.
- Consistent with the stronger exchange rate scenario is a **slightly lower interest rate path** than in the baseline scenario.
- Monetary policy responds to the fact that the stronger exchange rate contributes to the **fall in import prices** leading to weaker inflation pressures.
- The resulting path of **GDP** will be similar overall to that in the baseline scenario of the forecast.

Thank you for your attention



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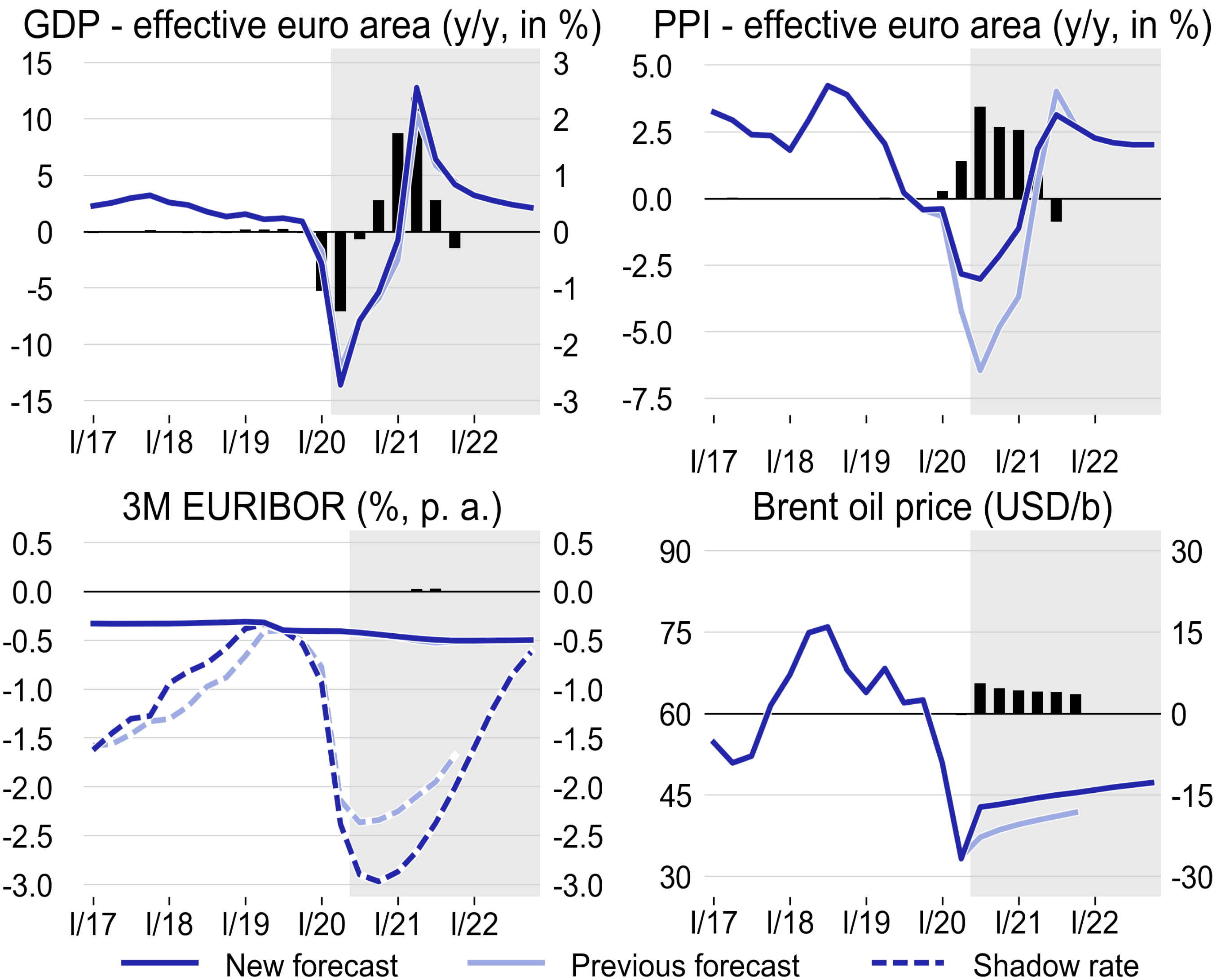
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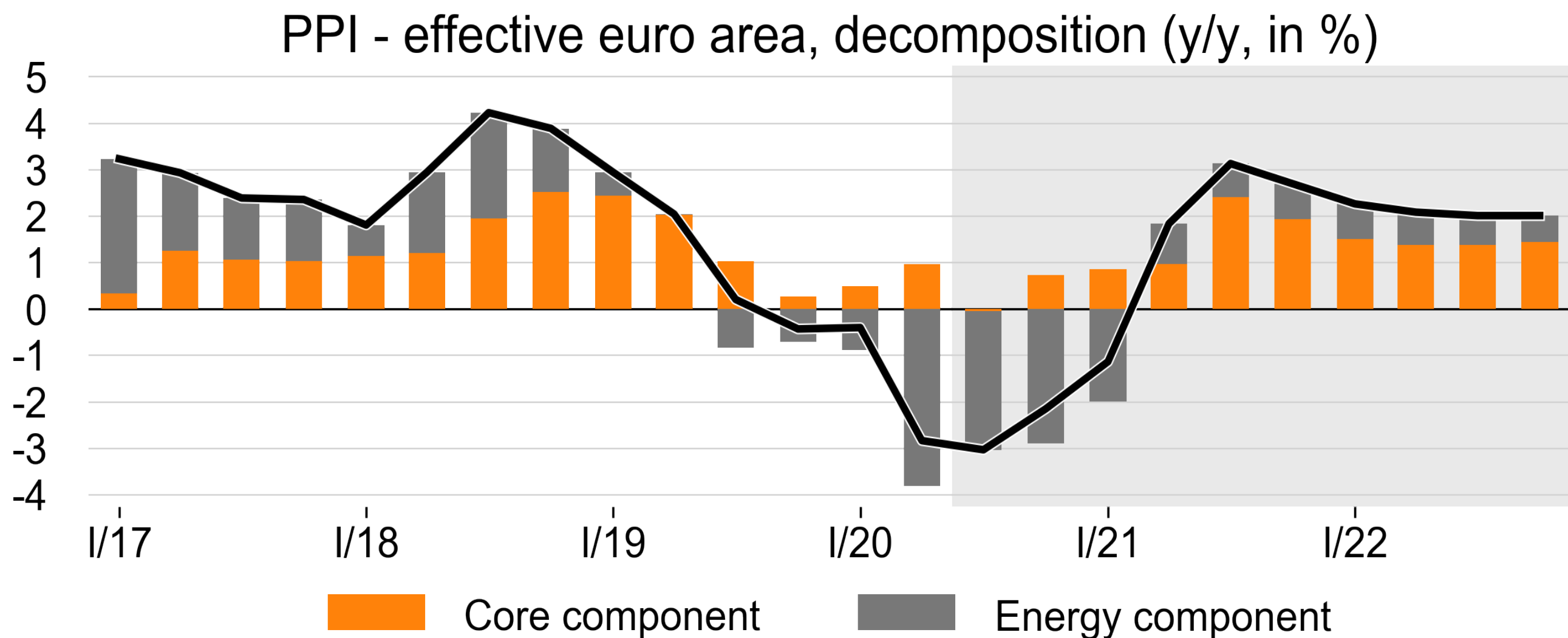
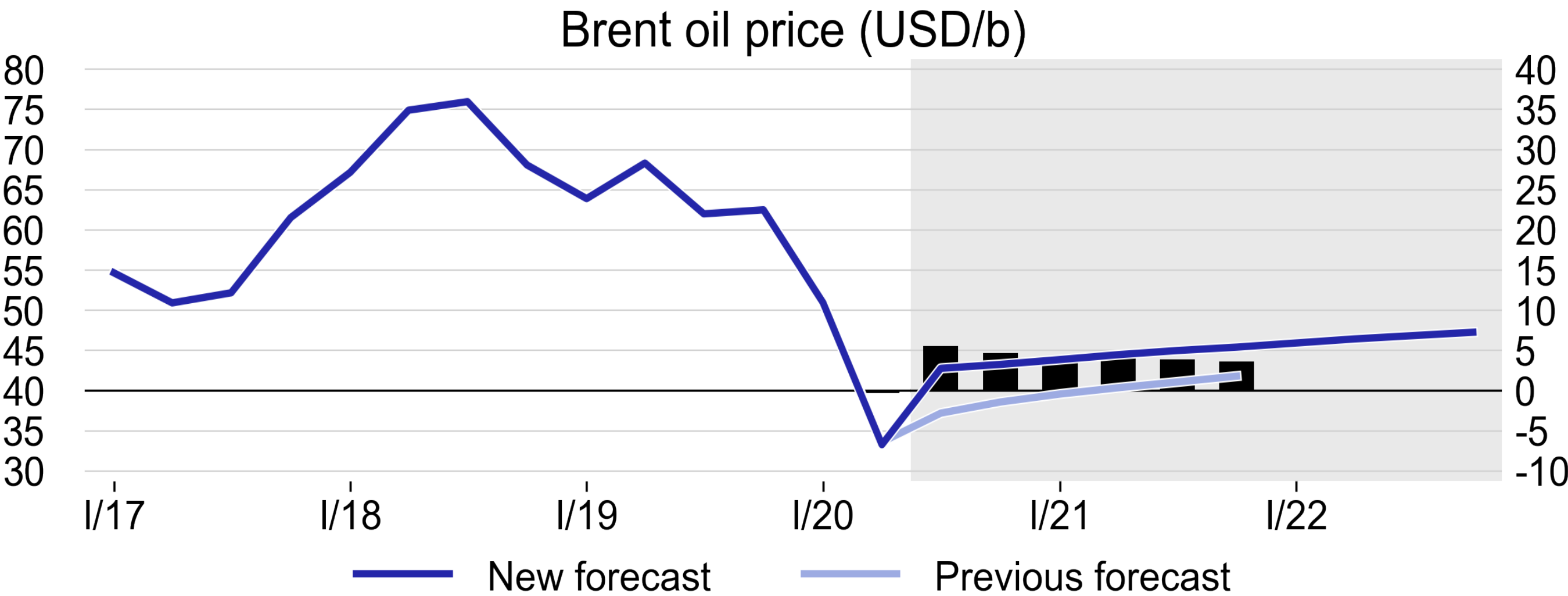
Backup



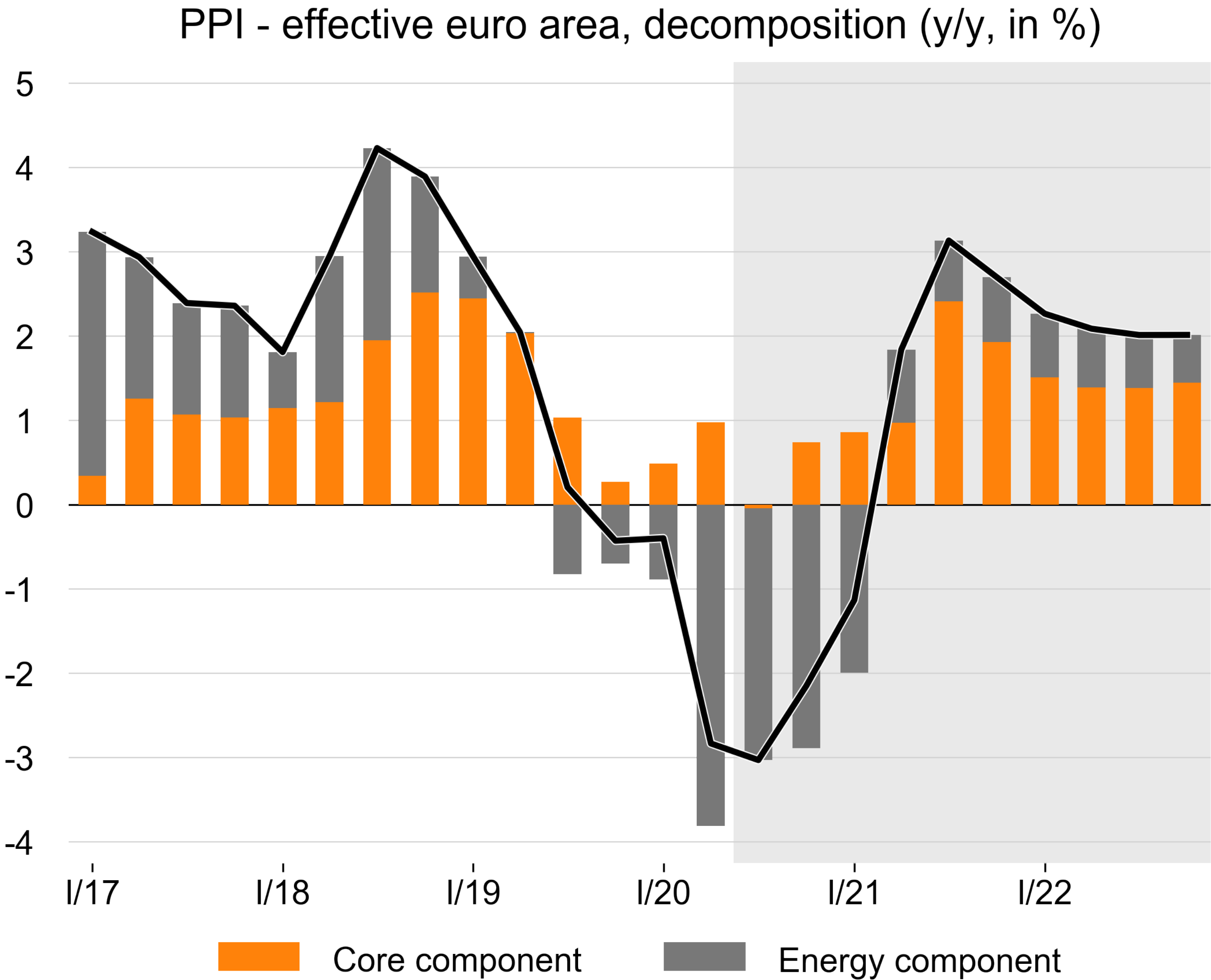
Foreign Outlook: Comparison



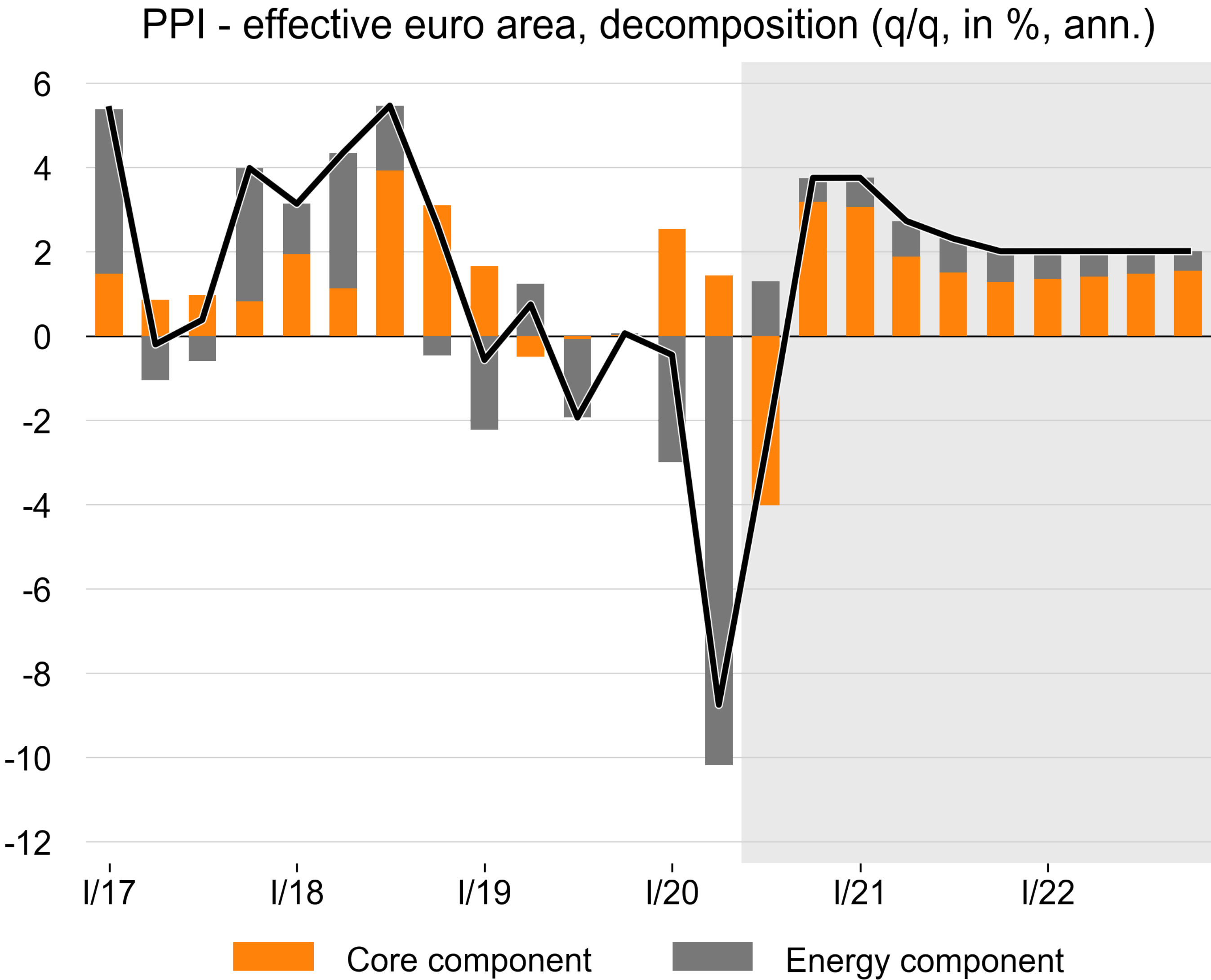
PPI in Effective Euro Area: Decomposition

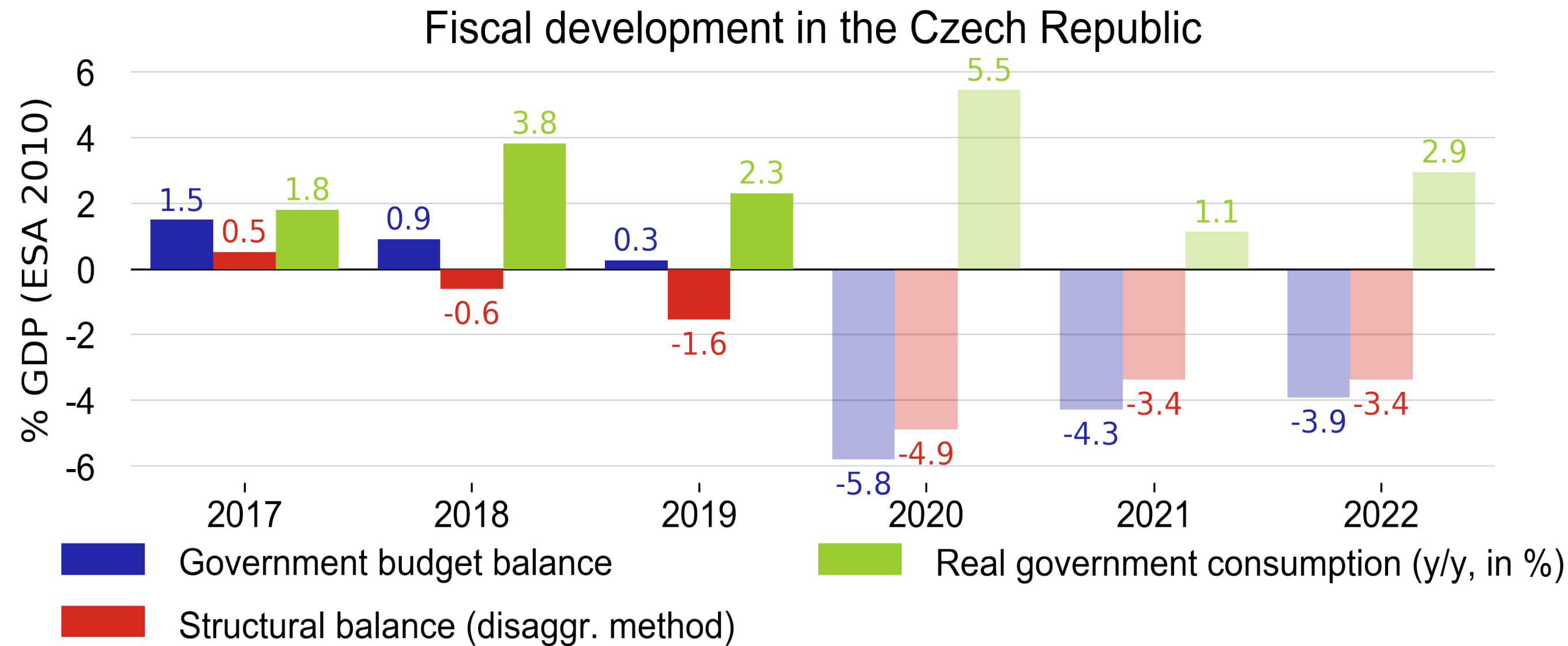


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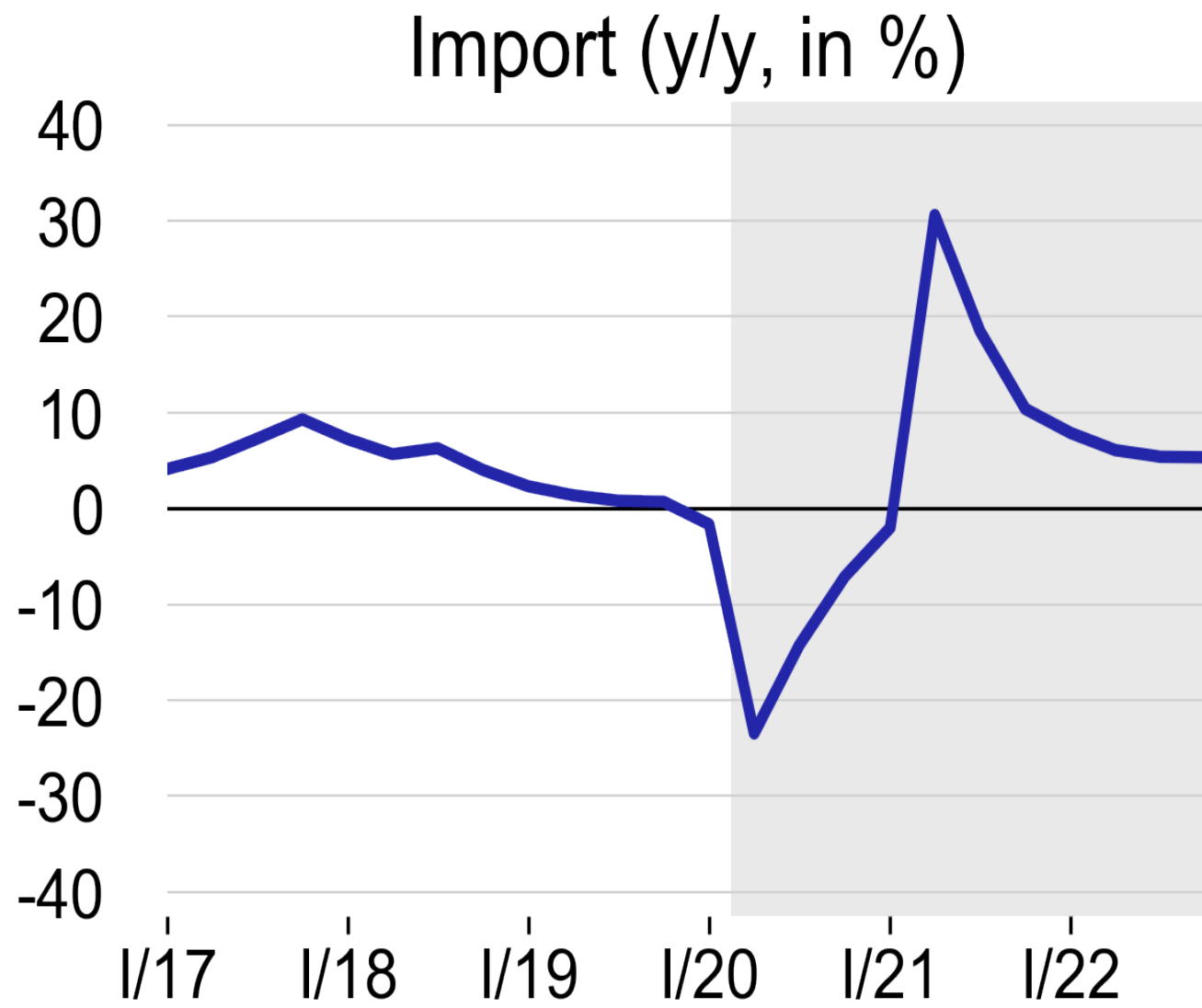
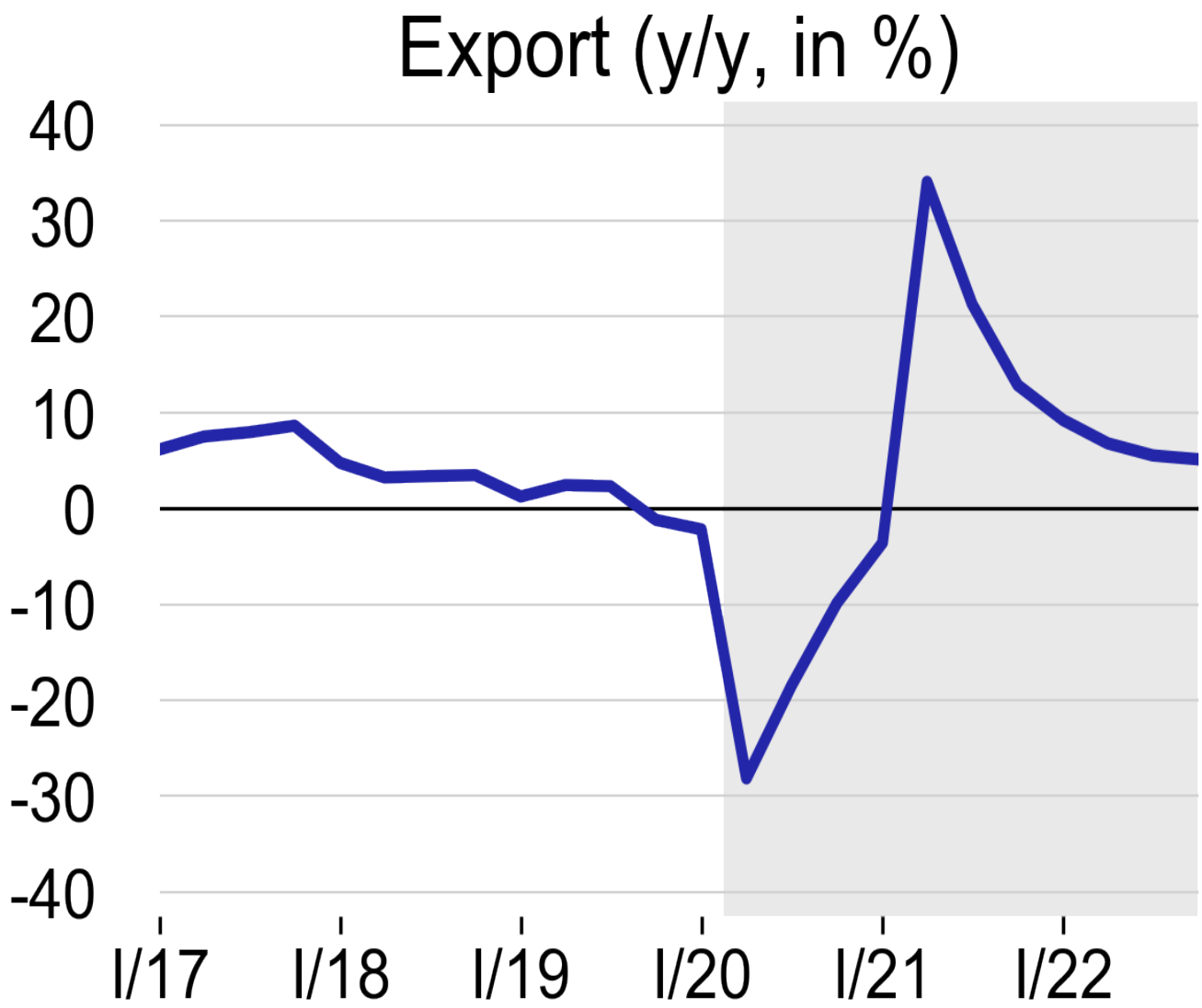
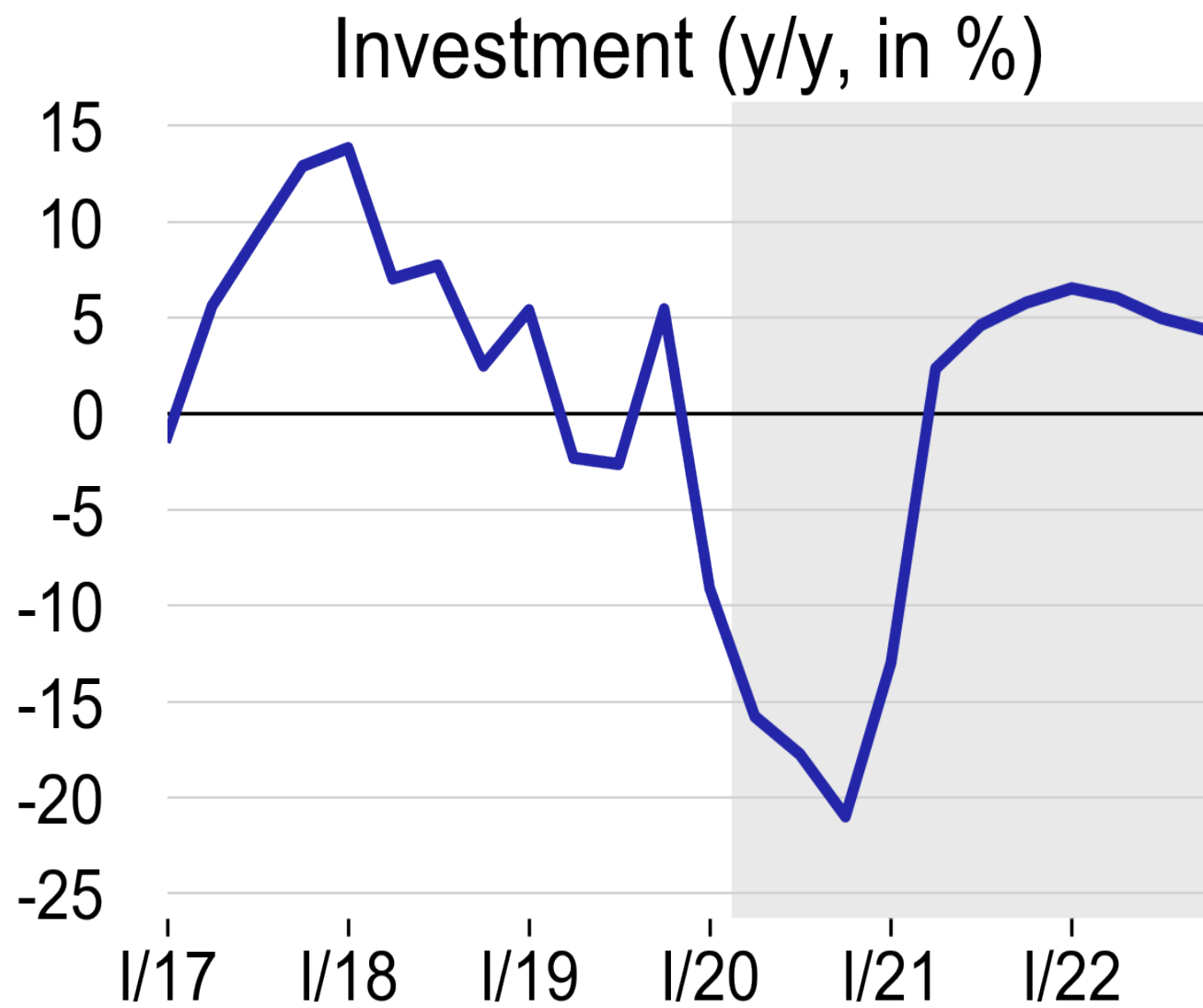
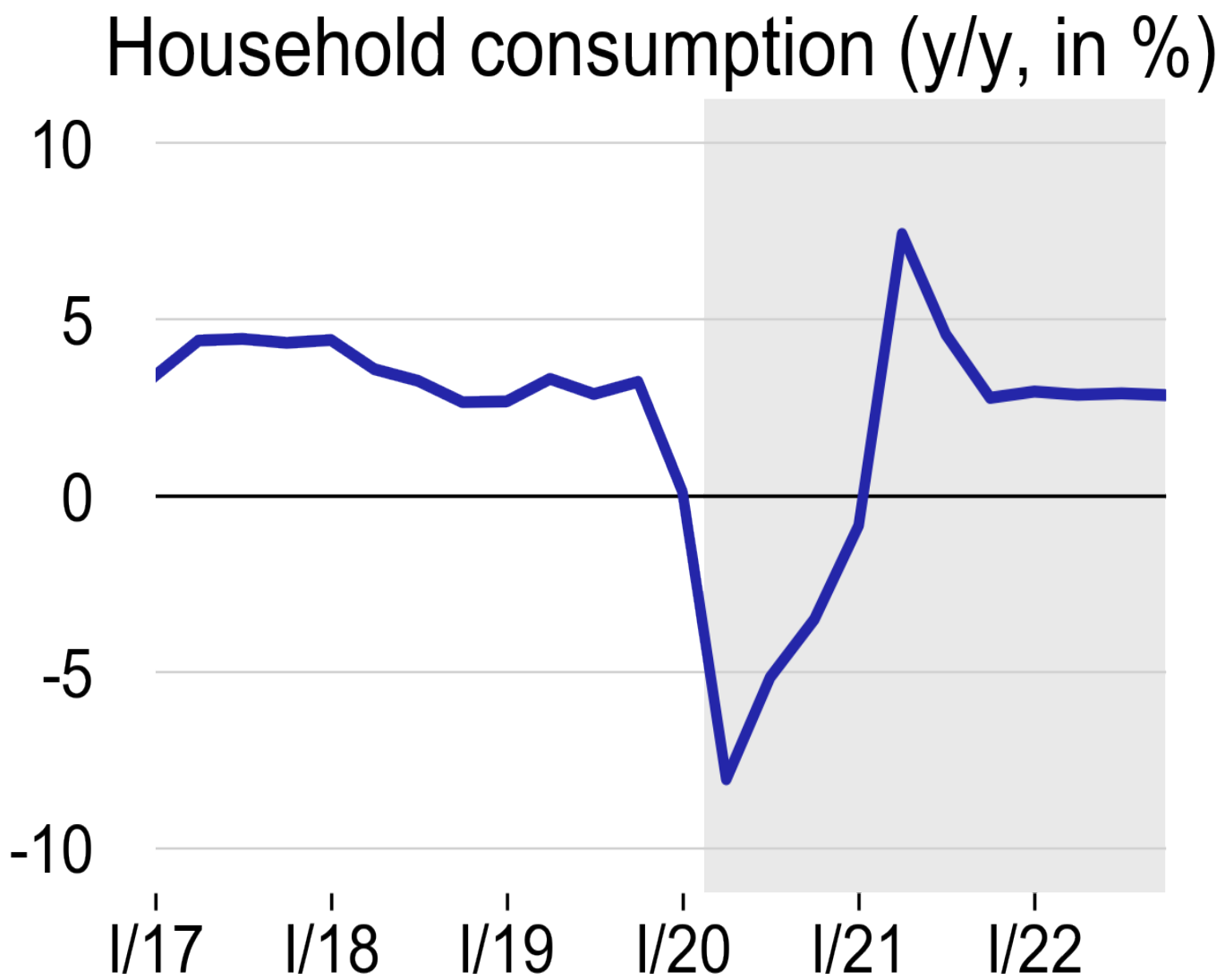




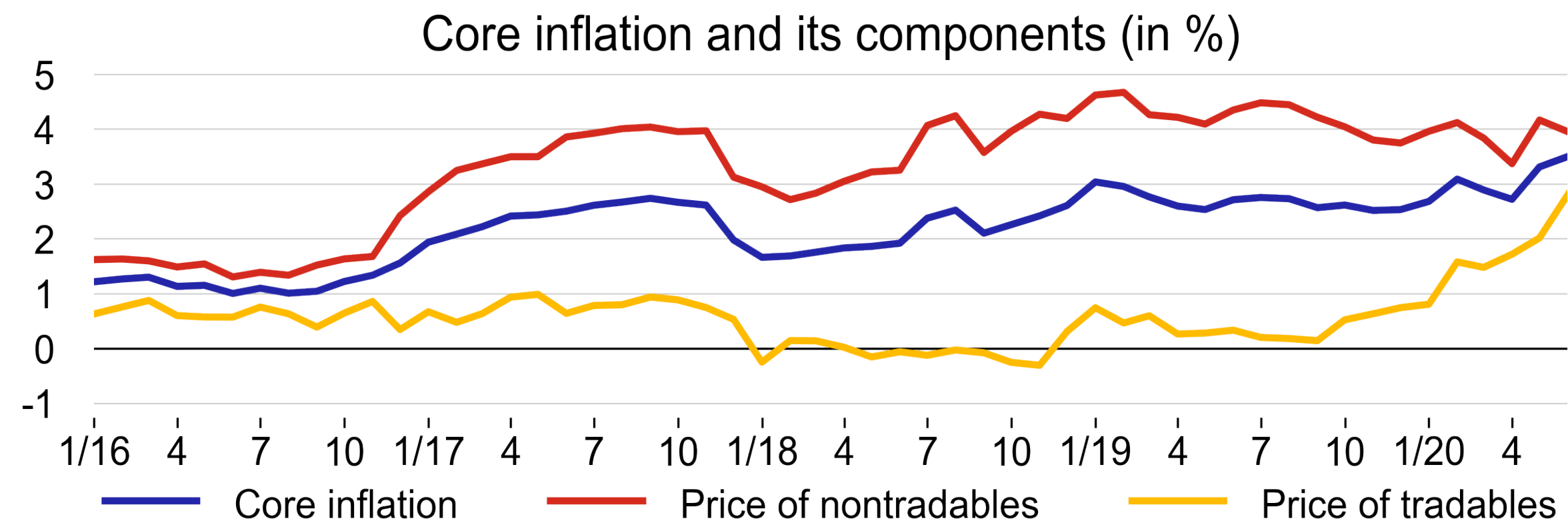
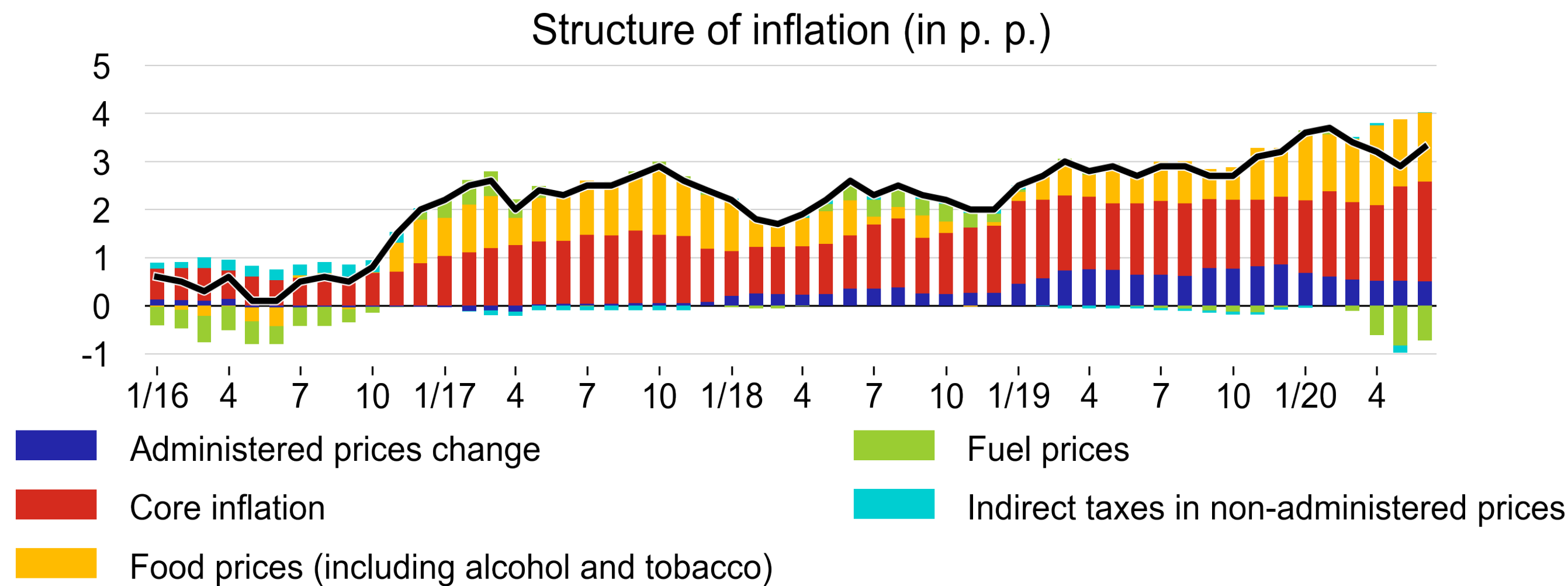
Fiscal impulse (contributions to GDP growth in percentage points)

	2019	2020	2021	2022
	actual	forecast	forecast	forecast
Fiscal impulse	0.4	1.7	-1.2	-0.3
of which impact through:				
Private consumption	0.4	1.6	-1.2	-0.2
Private investment	0.0	0.2	-0.1	-0.1
Government investment, domestic	0.1	-0.1	0.0	0.0
Government investment, EU funded	0.0	0.0	0.1	0.1

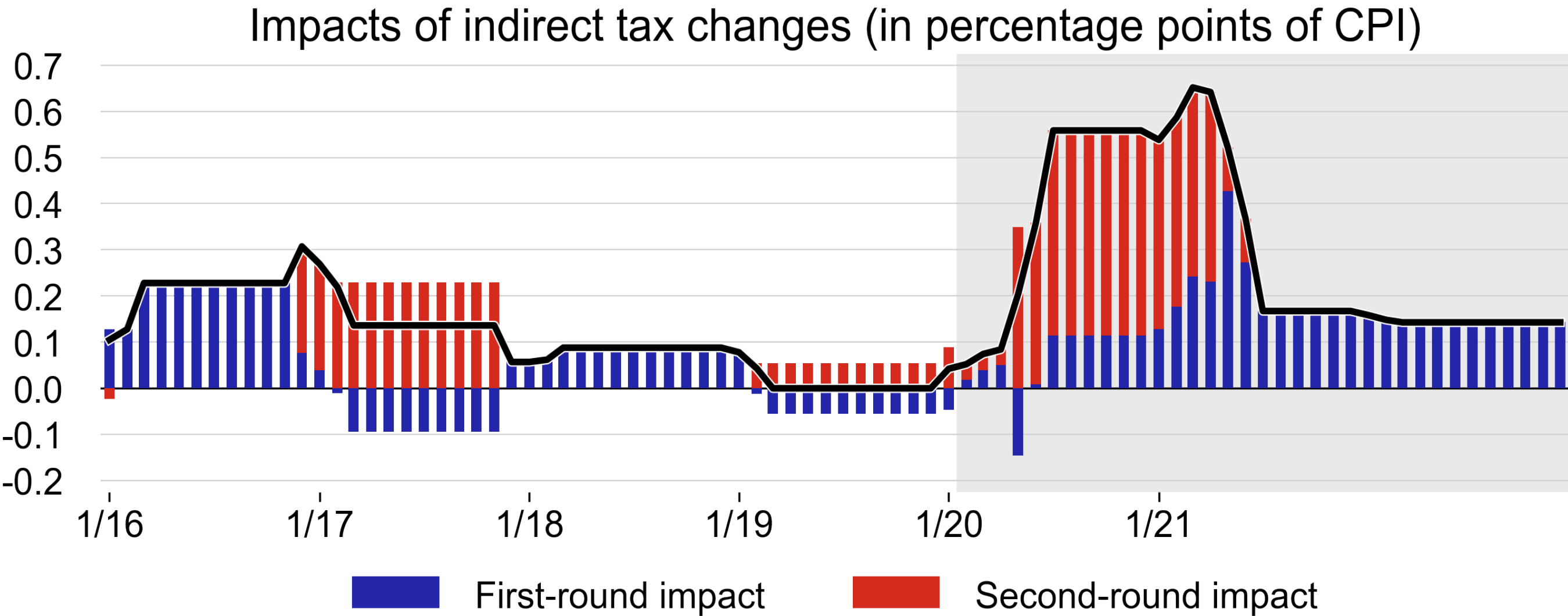
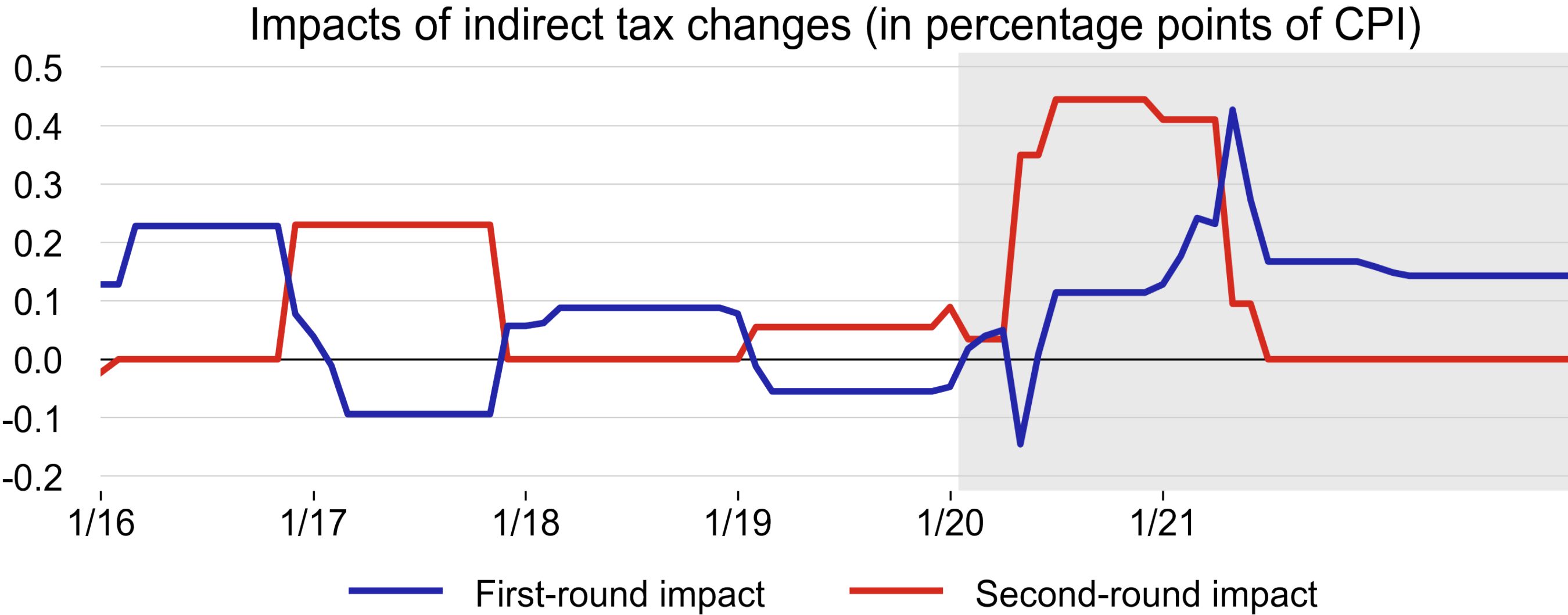
Aggregate Demand



Structure of Inflation



Comparison with Previous Forecast

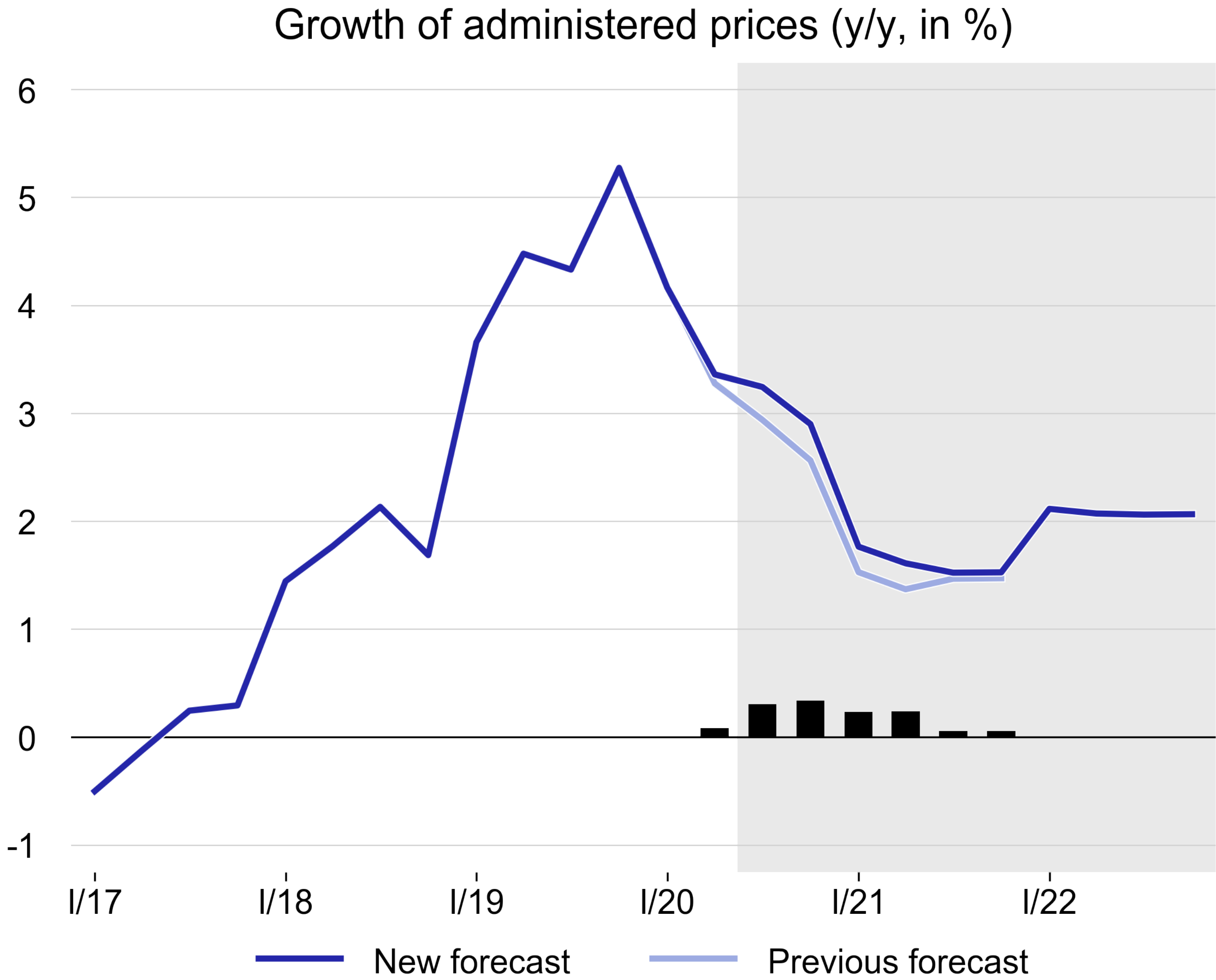


Item		Weight <i>in %</i>	Tax type	Harmonizing	First-round effect <i>in p. p. into CPI</i>	Second-round effect <i>in p. p. into CPI</i>	Date
Administrated prices:	Heat energy	1.58	VAT ↓		-0.07	0.03	1.1.2020
	Other*	2.32	VAT ↓		-0.10	0.06	1.5.2020
Market prices:	Catering	3.59	VAT ↓		-0.20	0.20	1.5.2020
	Hairdressing	0.56	VAT ↓		-0.05	0.05	1.5.2020
	Other services**	0.40	VAT ↓		-0.02	0.02	1.5.2020
	Alcohol	1.78	Excise ↑		0.09	0.00	1.1.2020, gradual pass-through
	Tobacco	4.85	Excise ↑	X	0.56	0.00	1.3.2020, gradual pass-through
	Culture and sport	1.32	VAT ↓		-0.06	0.06	1.7.2020
	Accommodation	0.85	VAT ↓		-0.04	0.04	1.7.2020
	Tobacco	4.85	Excise ↑		0.17	0.00	1.1.2021, gradual pass-through
	Tobacco	4.85	Excise ↑		0.14	0.00	1.1.2022, gradual pass-through
Average effect in Q3 2020					0.11	0.44	

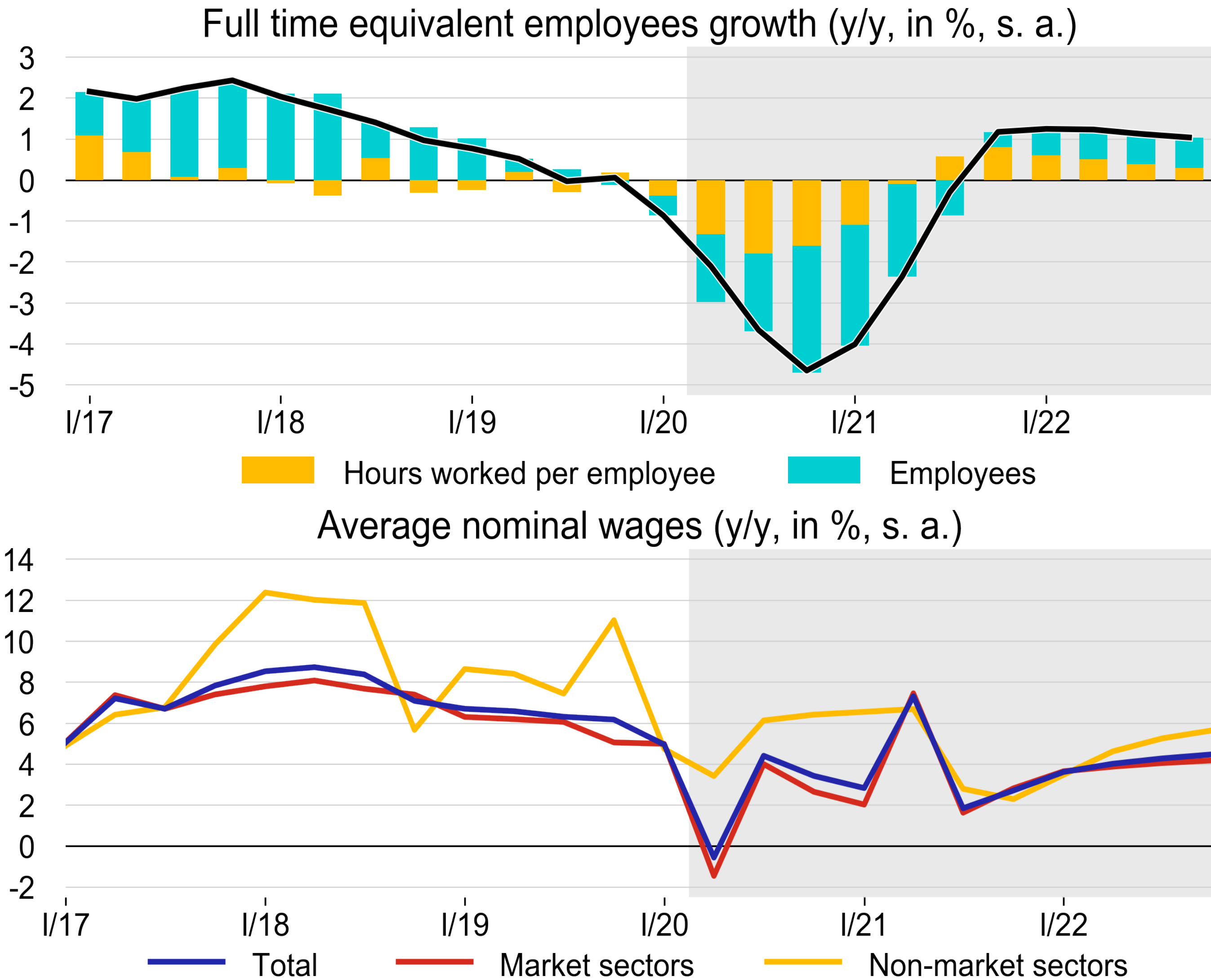
* Water supply, sewerage, lunch delivery, complete lunch or dinner (menu) in a canteen

**** Domestic services by paid staff, carpet cleaning, change of women's heel - express, centering of bike's back wheel, books**

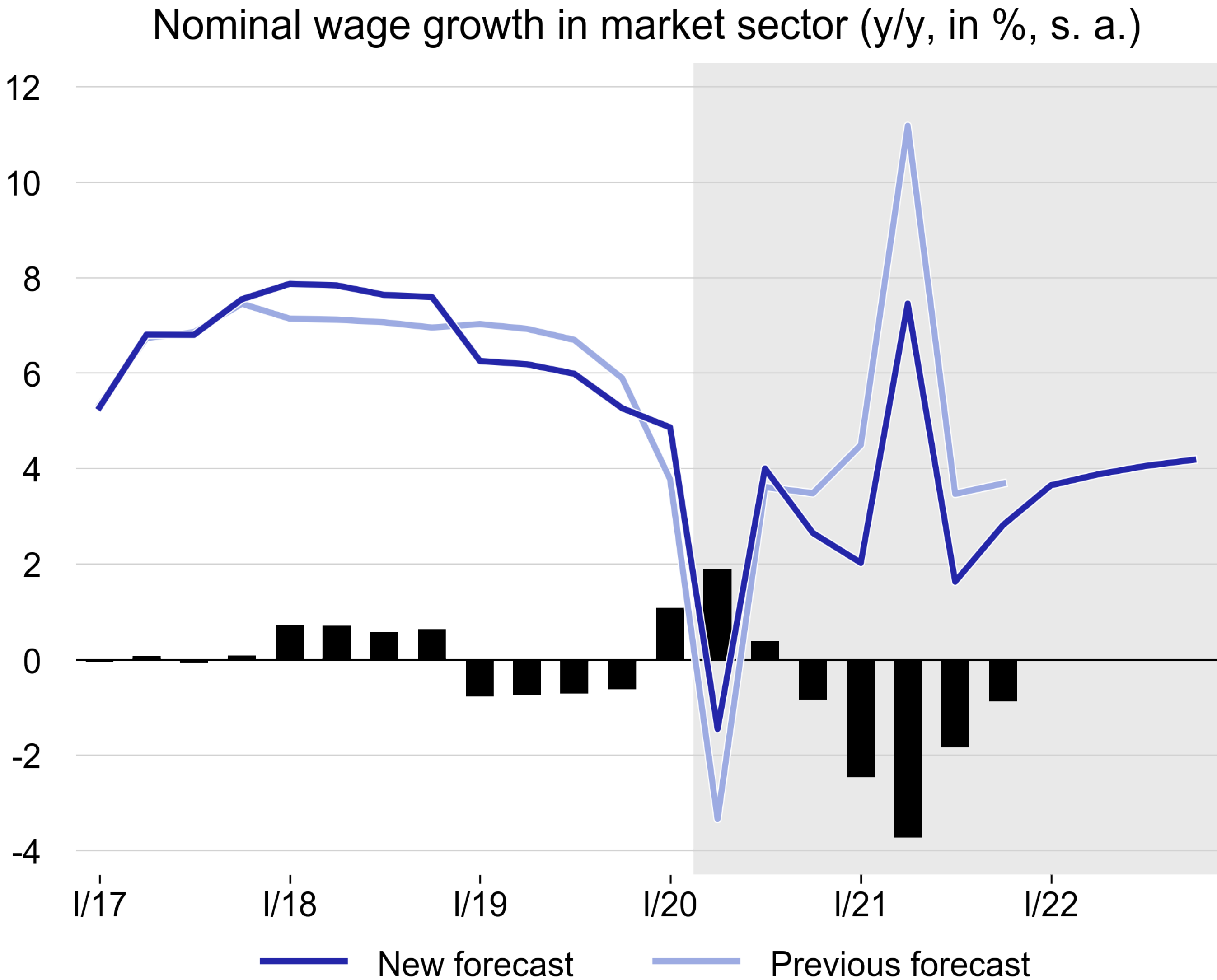
Administered Prices: Comparison



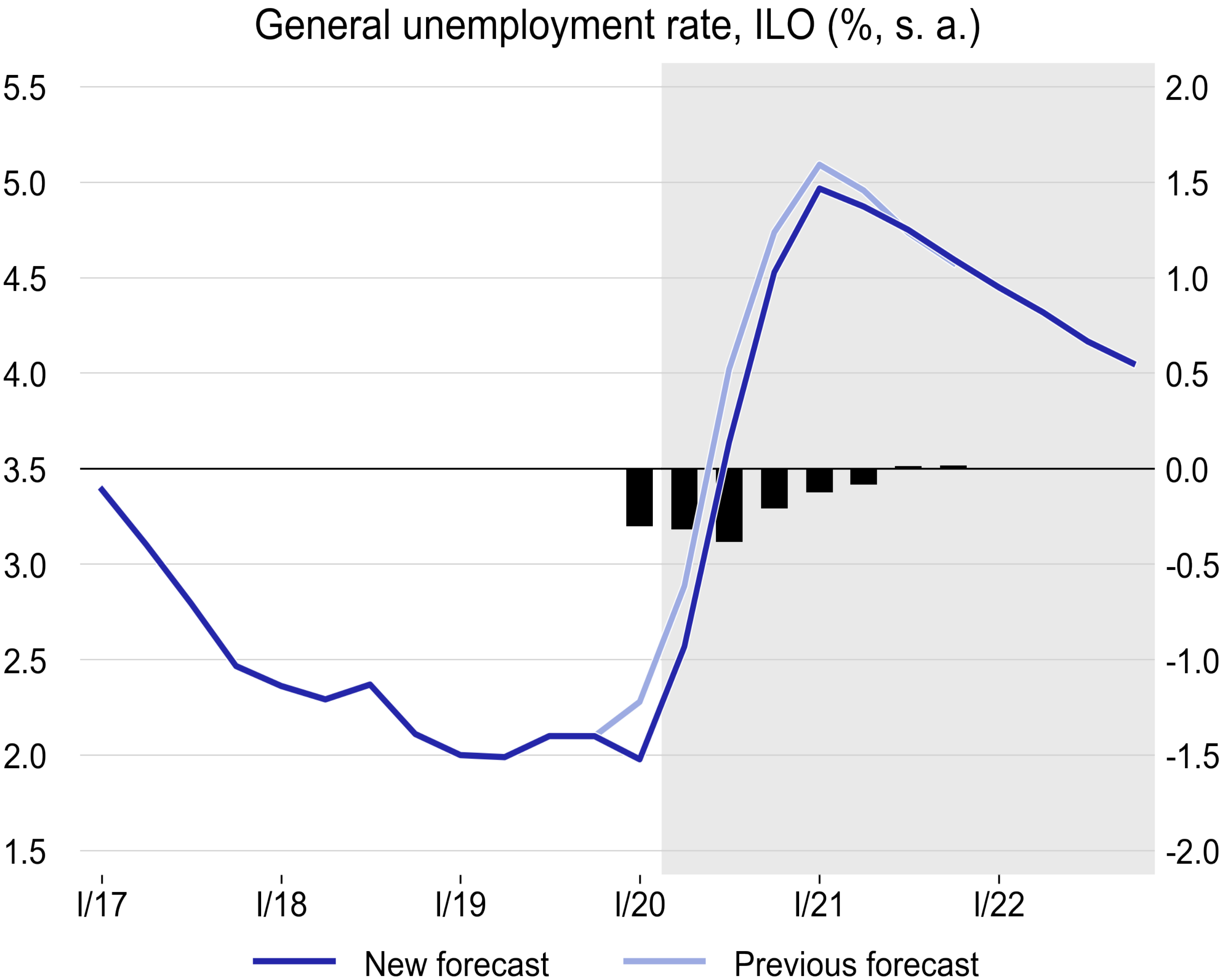
Labour Market



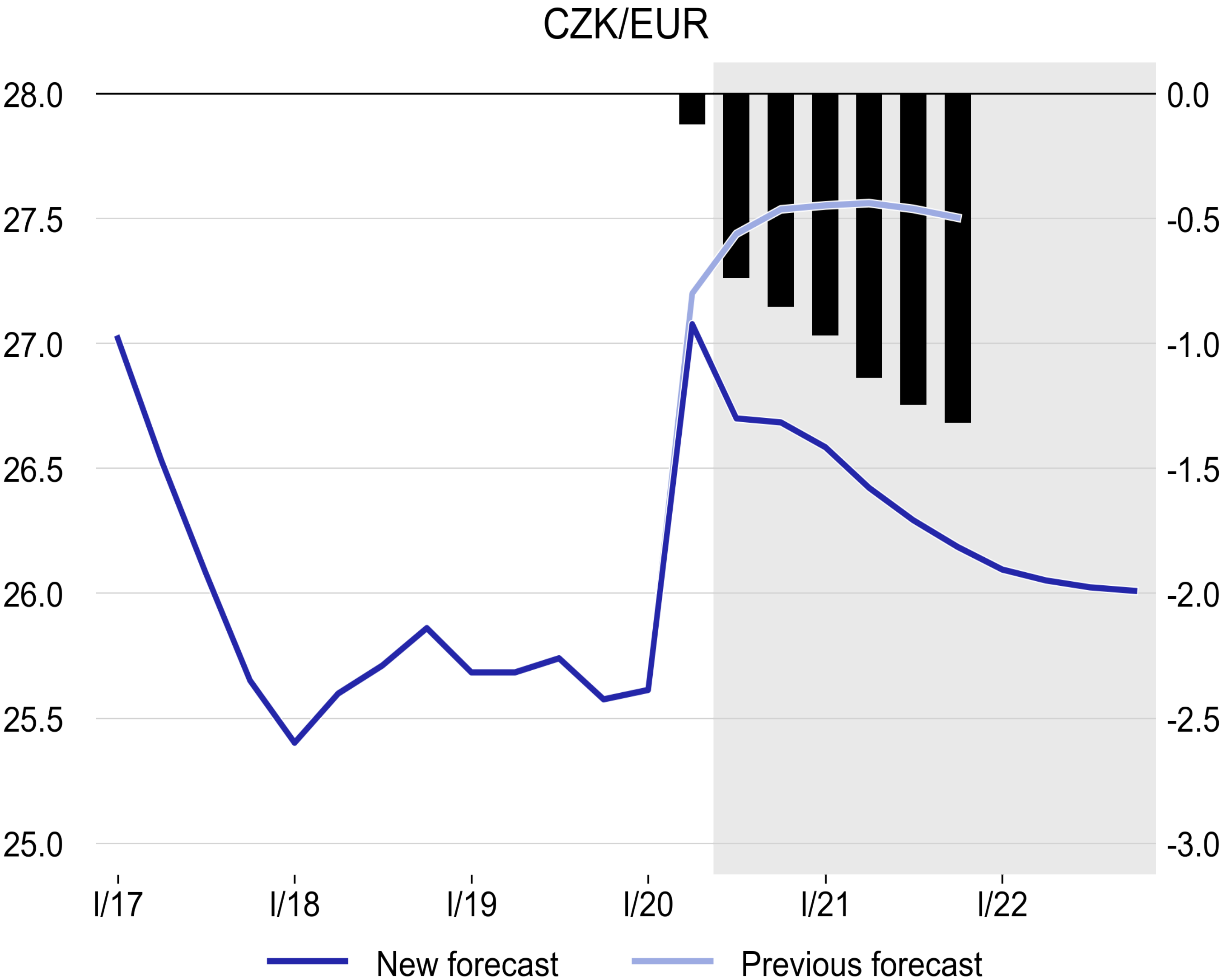
Wages in Market Sectors: Comparison



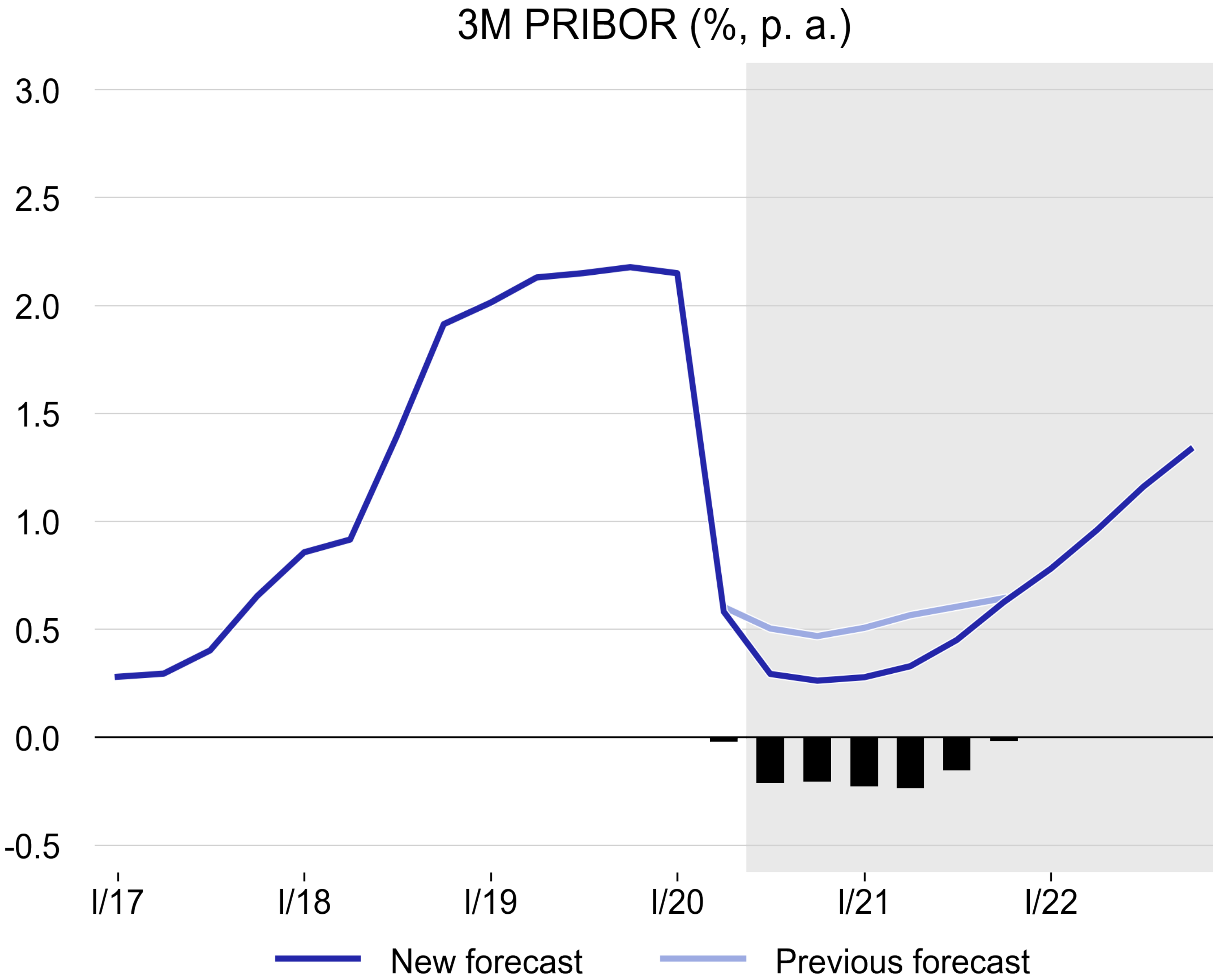
Unemployment Rate: Comparison



Exchange Rate: Comparison



Interest Rate: Comparison



Nominal Wages: Comparison

