

# CNB's New Forecast

*Tomáš Holub*

*([tomas.holub@cnb.cz](mailto:tomas.holub@cnb.cz))*

*Monetary and Statistics Department*

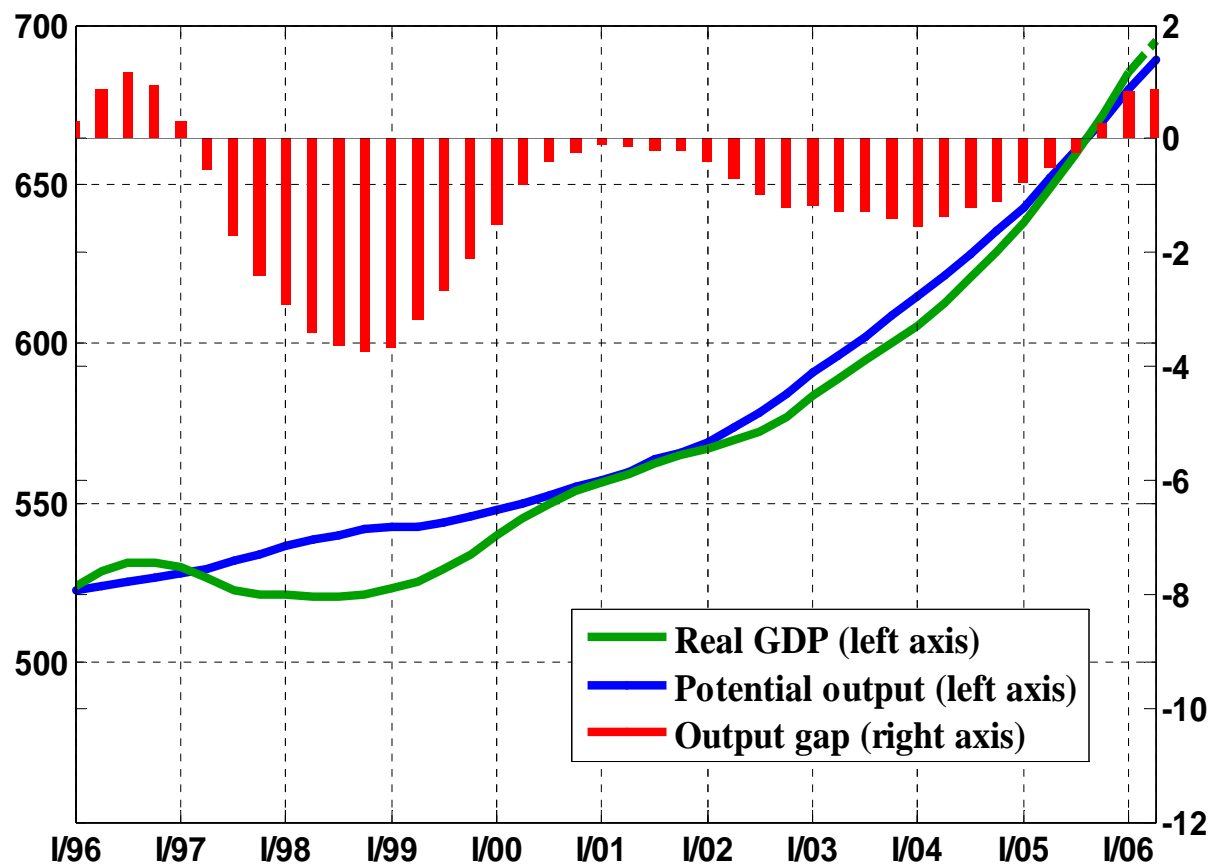
***Meeting with analysts***

***4 August 2006***

# *Outline*

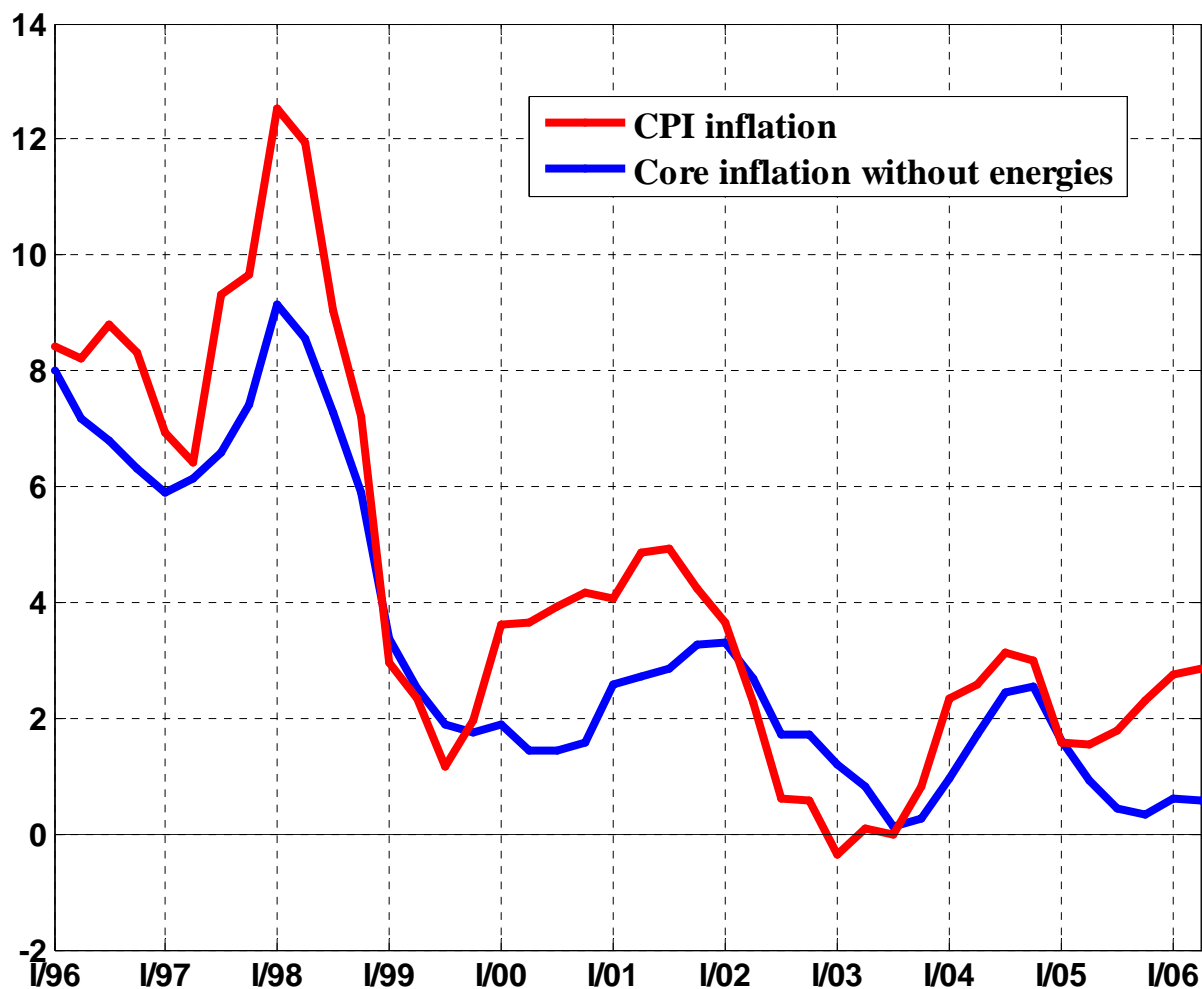
- Economic growth and the output gap;
- Recent trends in inflation;
- Fiscal policy;
- External assumptions;
- Regulated prices and energy prices;
- Exchange rate and imported inflation;
- Forecast of GDP and inflation;
- Alternative scenario with extended model.

# ***GDP – Actual and Potential***



- The economy has overcome the 2002-03 slack, and may now start generating modest pressures on inflation;
- Growth still pulled by net exports, but domestic demand strengthens, too.

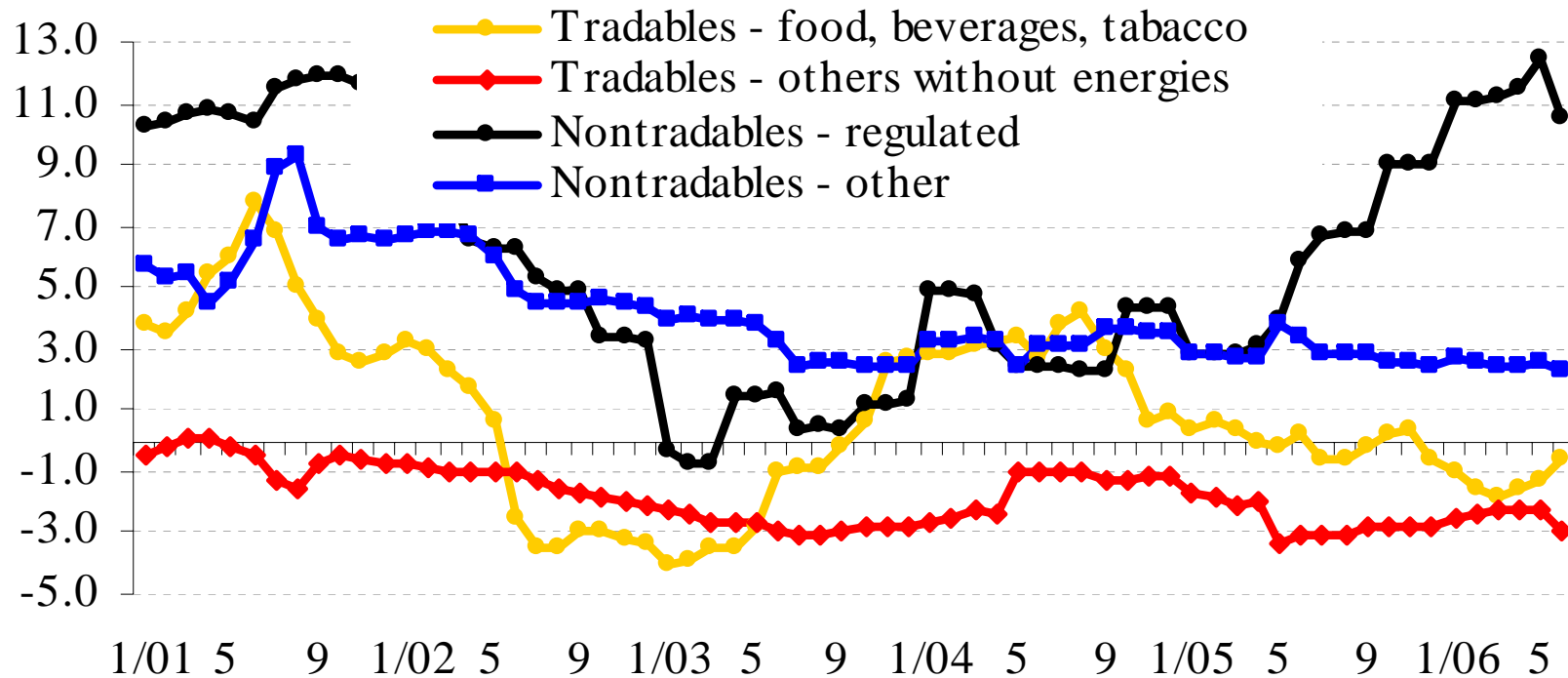
# *Inflation*



- Headline inflation close to target;
- Core inflation remains low due to CZK's appreciation, which so far offsets any pressures from the real economy and 2nd-round effects.

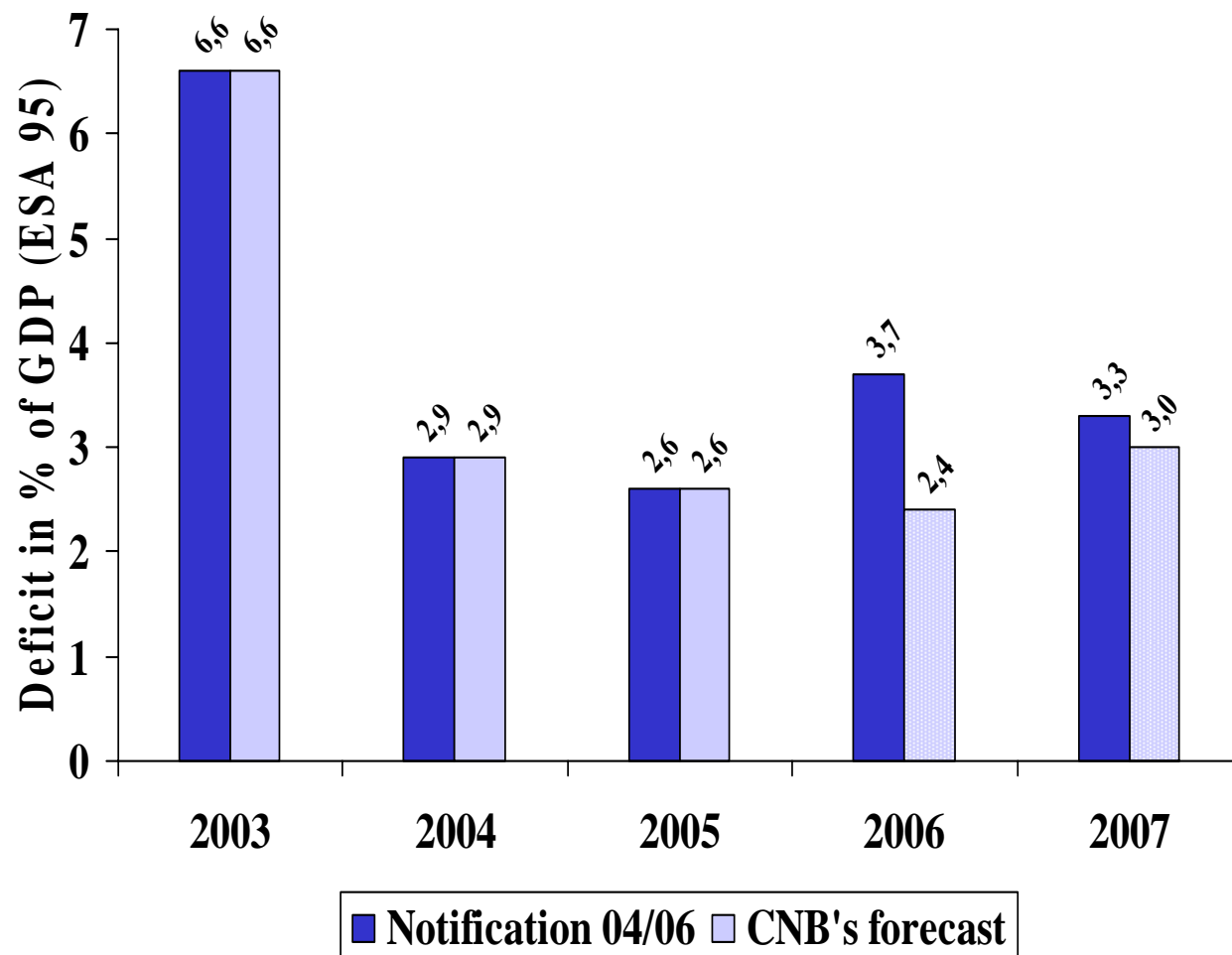
# *Structure of Inflation*

*(without taxes)*



- Inflation still driven by regulated prices (energies, telecom.);
- Food prices have turned around;
- Tradables and nontradables: no acceleration observed.

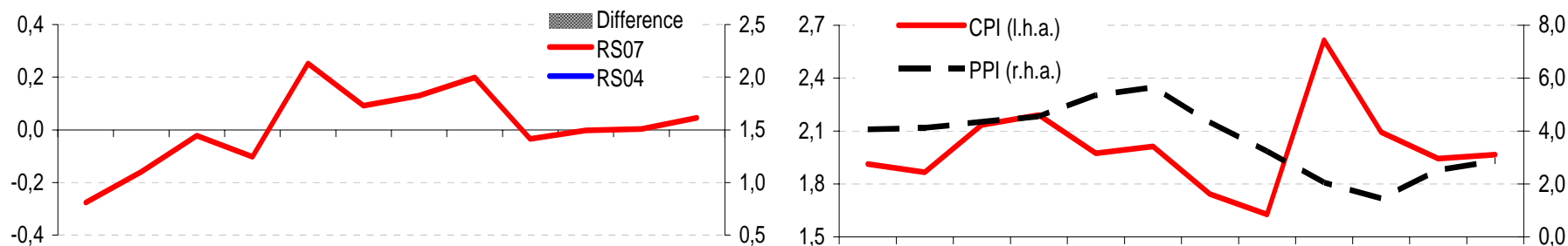
# Fiscal Situation



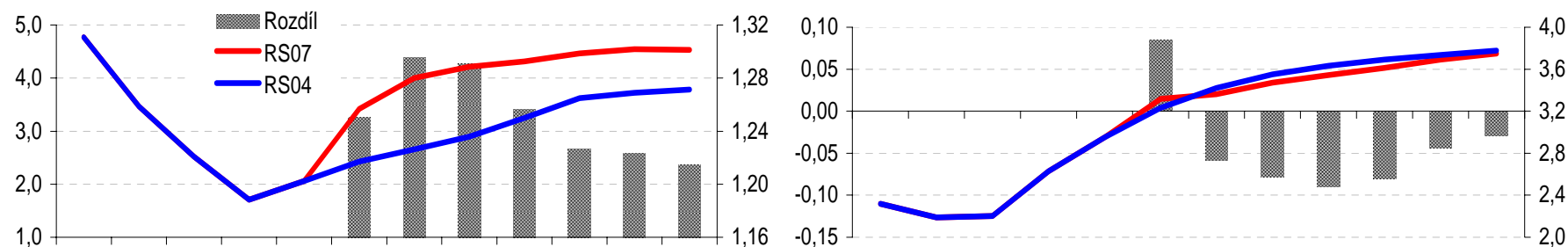
- CNB remains more optimistic than official plans for 2006;
- State budget close to balance so far;
- Net of one-offs, there will be a fiscal expansion in 2006-07;
- Great political uncertainty.

# External Assumptions

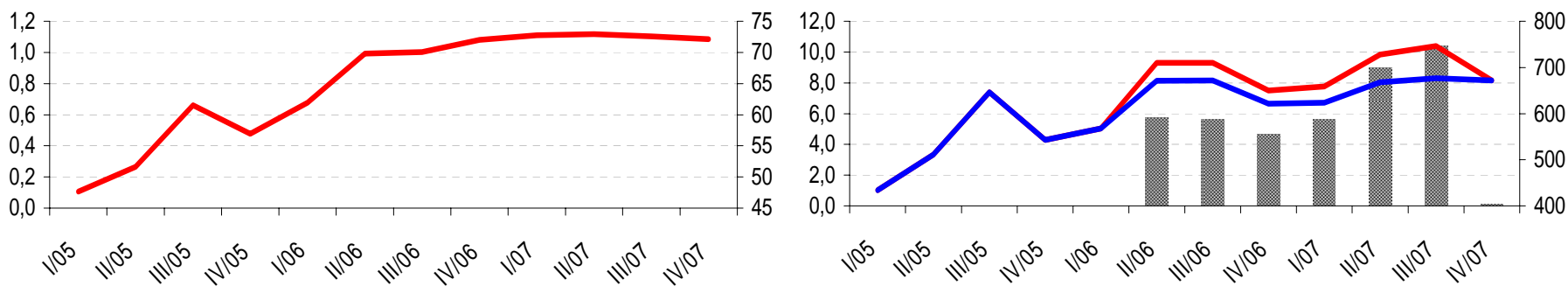
(difference in p.p.s) **Effective eurozone GDP** (y/y in %) (y/y in %) **Effective eurozone CPI, PPI** (y/y in %)



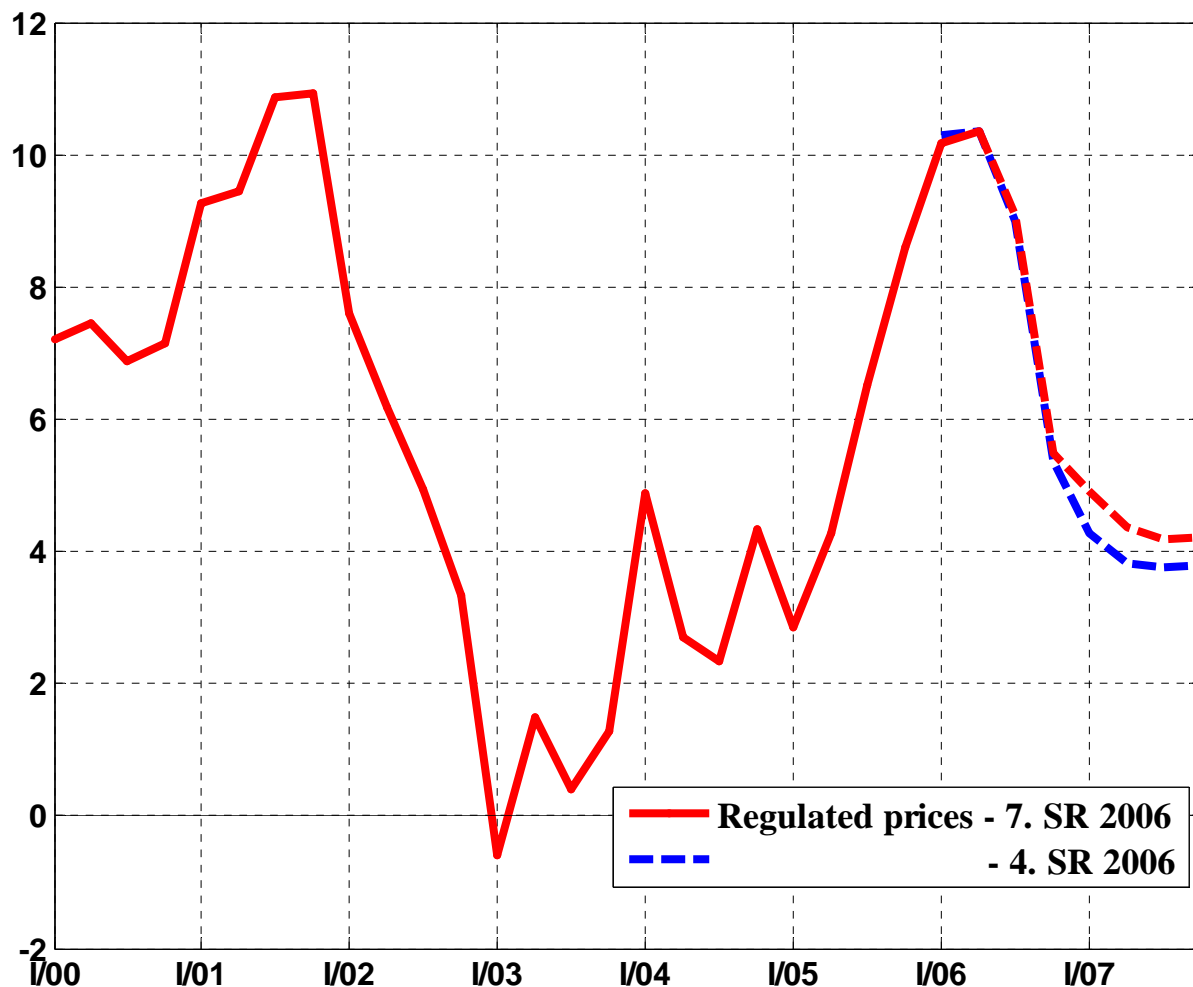
(difference in %) **Exchange rate** (USD/EUR) (difference in p.p.s) **Euribor 1Y** (rate in %)



(difference in %) **Brent oil price** (USD/barrel) (difference in %) **Gasoline price** (USD/1000kg)



# Regulated Prices



- Base effects will be pushing the y/y growth rate down;
- Very little change compared to April forecast (rents);
- Together with tax changes, contribution to inflation 1.9 p.p.s at the end of both 2006 and 2007.

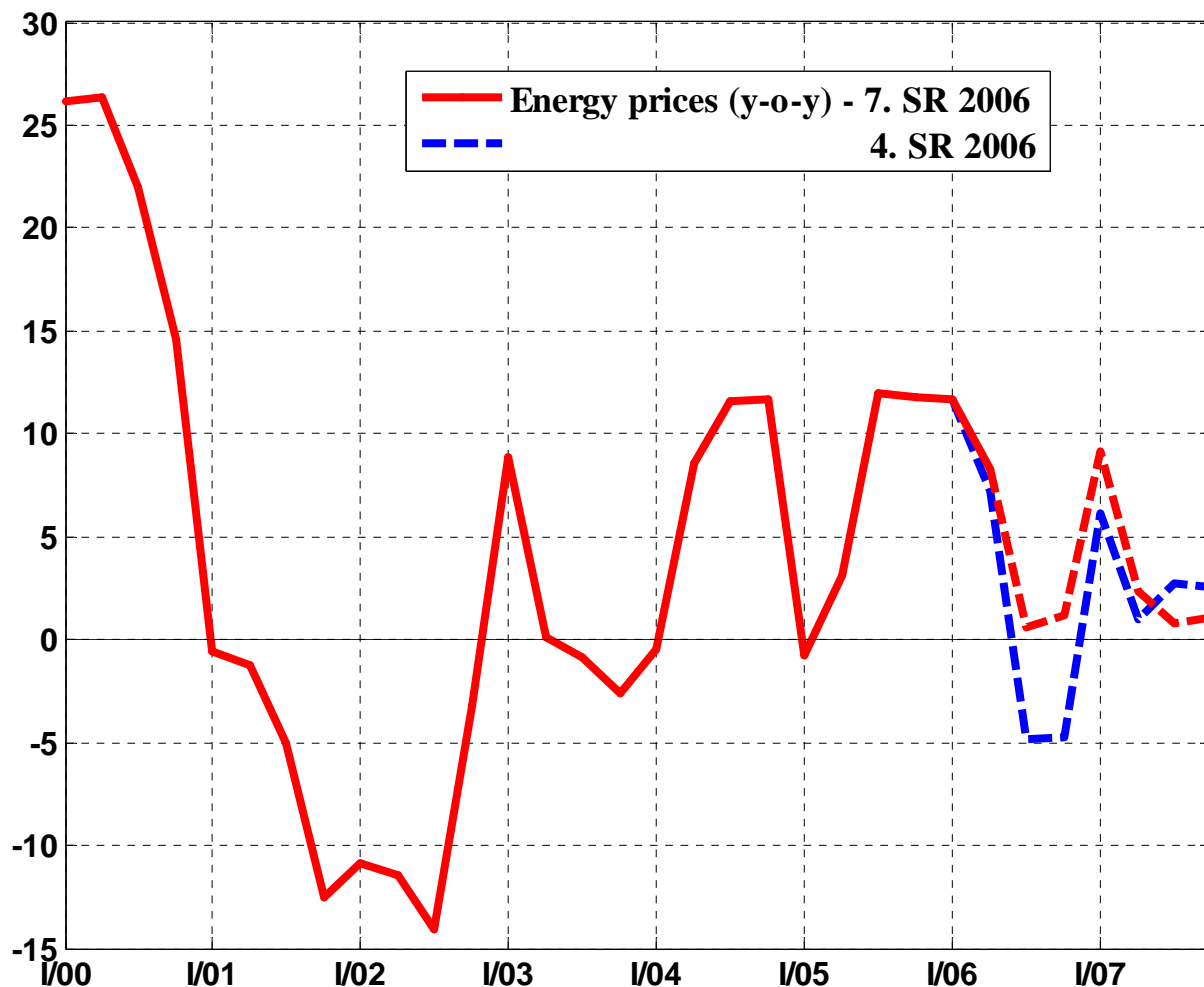


# *Administrative Measures*

## *(selected items and total impact )*

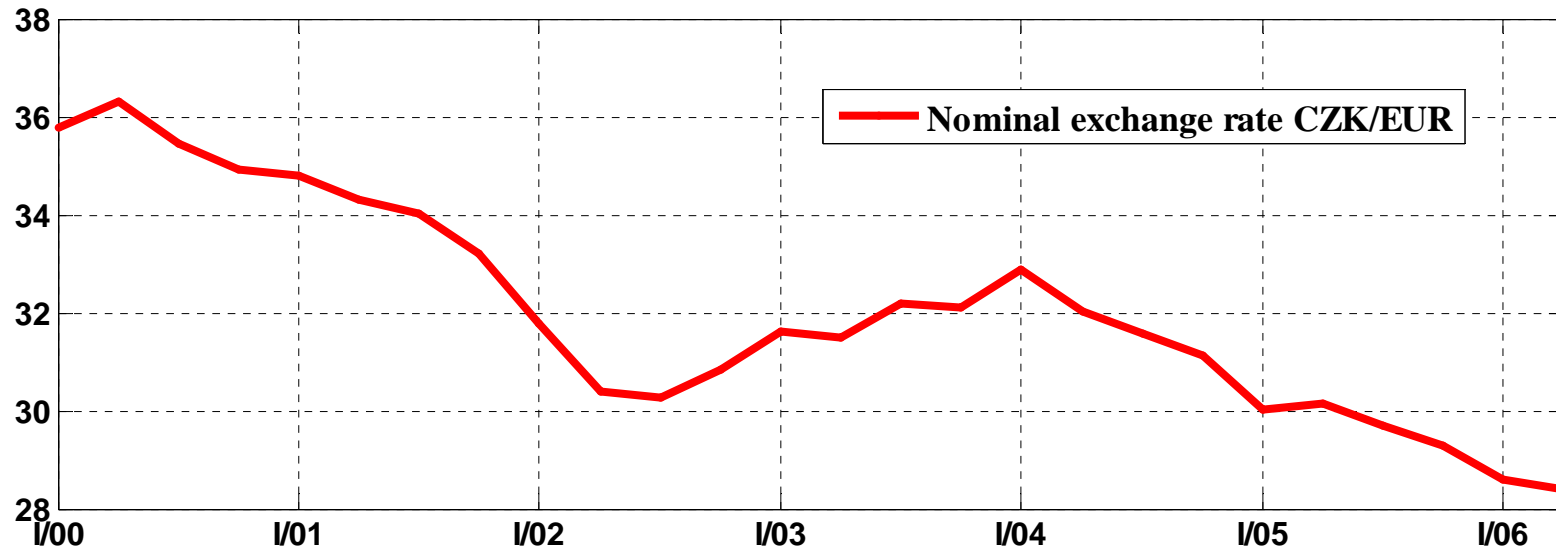
Year/date	Indirect taxes		Regulated prices		
	Item	Impact on CPI inflation	Item	Change in price	Impact on CPI inflation
<b>2006</b>					
1Q 2006	Decrease of VAT at language schools	-0.02 p.p.	Electricity	9,0%	0.38 p.p.
	Excise duties on tobacco products	0.35 p.p.	Water	5,7%	0.07 p.p.
			Natural gas	4,8%	0.16 p.p.
			Heating	8,5%	0.31 p.p.
2Q 2006			Natural gas	1,4%	0.05 p.p.
2H 2006	Excise duties on tobacco products	0.43 p.p.	Telecommunications	8,0%	0.13 p.p.
	Decrease of VAT on sweets, tea, coffey	-0.18 p.p.			
<b>Total</b>		<b>0.59 p.p.</b>		<b>6,0%</b>	<b>1.29 p.p.</b>
<b>2007</b>					
1Q 2007			Electricity	4,0%	0.18 p.p.
			TV	20,0%	0.10 p.p.
			Natural gas	2,0%	0.07 p.p.
			Regulated rents	19,2%	0.38 p.p.
			Heating	1,5%	0.06 p.p.
2Q+3Q 2007	Excise duties on tobacco products	0.93 p.p.			
<b>Total</b>		<b>0.93 p.p.</b>		<b>4,3%</b>	<b>0.95 p.p.</b>

# Energy Prices



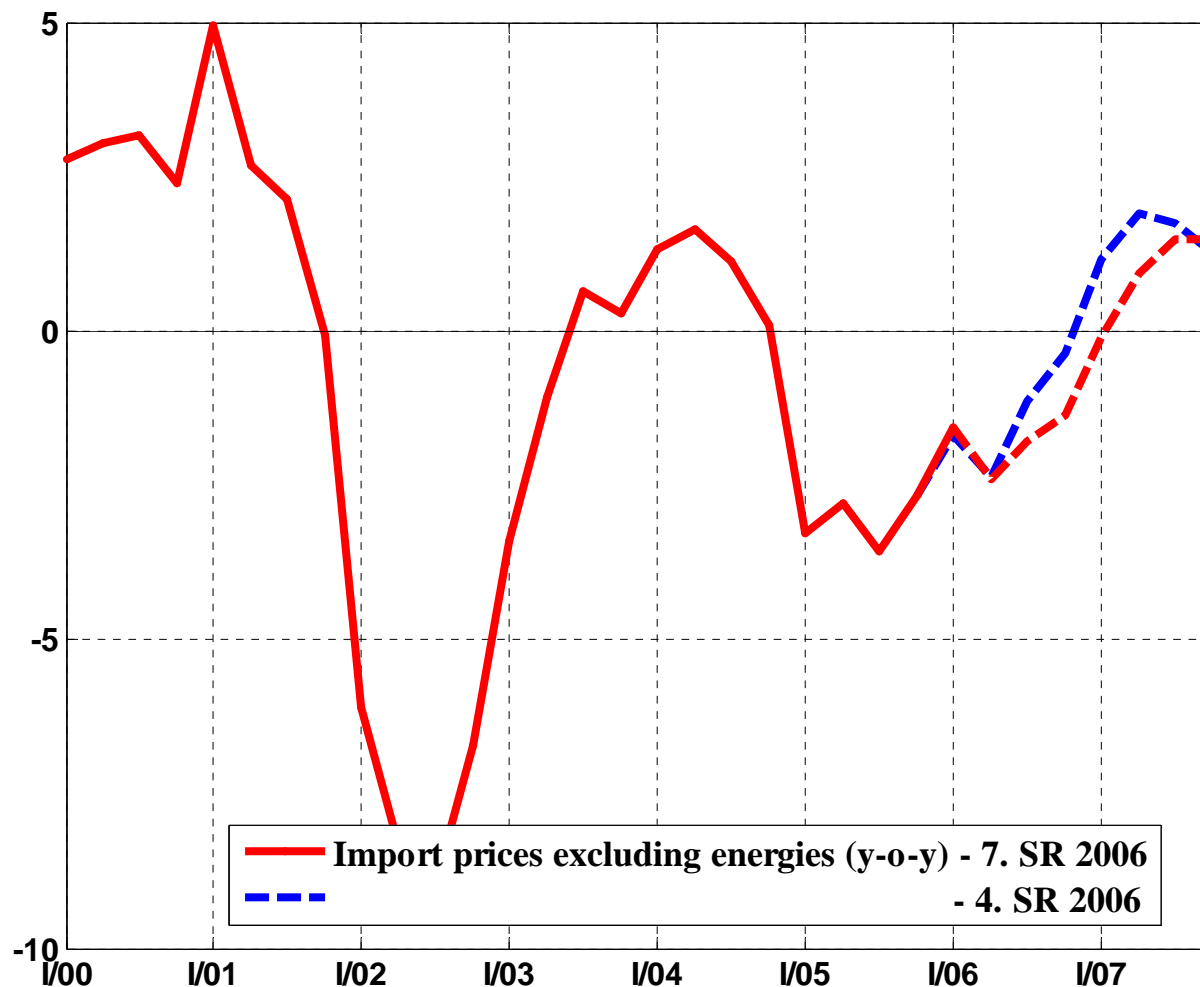
- Forecast increased due to higher market outlook for gasoline and oil prices;
- In the near term, base effects will push the y/y growth rate towards zero, not below it.

# Exchange Rate



External forecasts of CZK/EUR			
Date of forecast	Next quarter	1Y horizon	
	CF	Financial market	CF
7/05	30.0	29.3	29.6
10/05	29.7	28.8	29.2
1/06	29.1	28.3	28.8
4/06	28.7	27.9	28.2
6/06	28.4 (3Q06)	27.7	28.0

# Import Prices ex Energy



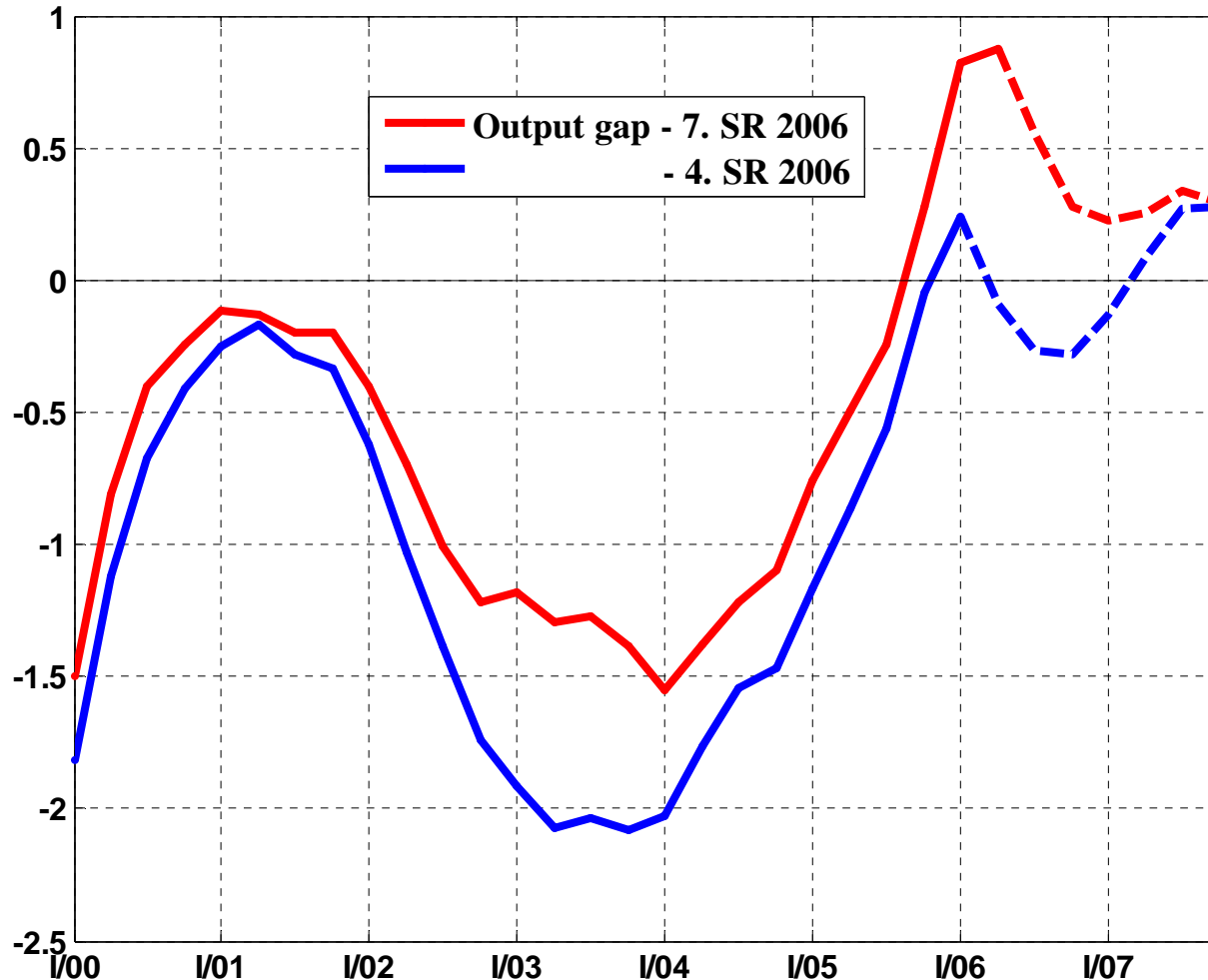
- Lower forecast due to stronger level of CZK in Q2/06, which shifts the whole exchange rate trajectory down (but no further appreciation expected).

# ***GDP Growth Forecast***

y/y change	2005	2006	2007
<b>Gross domestic product</b>	<b>6.1</b>	<b>6.6</b>	<b>5.1</b>
<b>Household consumption</b>	<b>2.4</b>	<b>3.8</b>	<b>3.8</b>
<b>Government consumption</b>	<b>0.7</b>	<b>0.4</b>	<b>-1.2</b>
<b>Fixed investment</b>	<b>3.6</b>	<b>7.2</b>	<b>6.0</b>
<b>Exports</b>	<b>4.9</b>	<b>14.0</b>	<b>9.8</b>
<b>Imports</b>	<b>4.8</b>	<b>12.4</b>	<b>8.3</b>

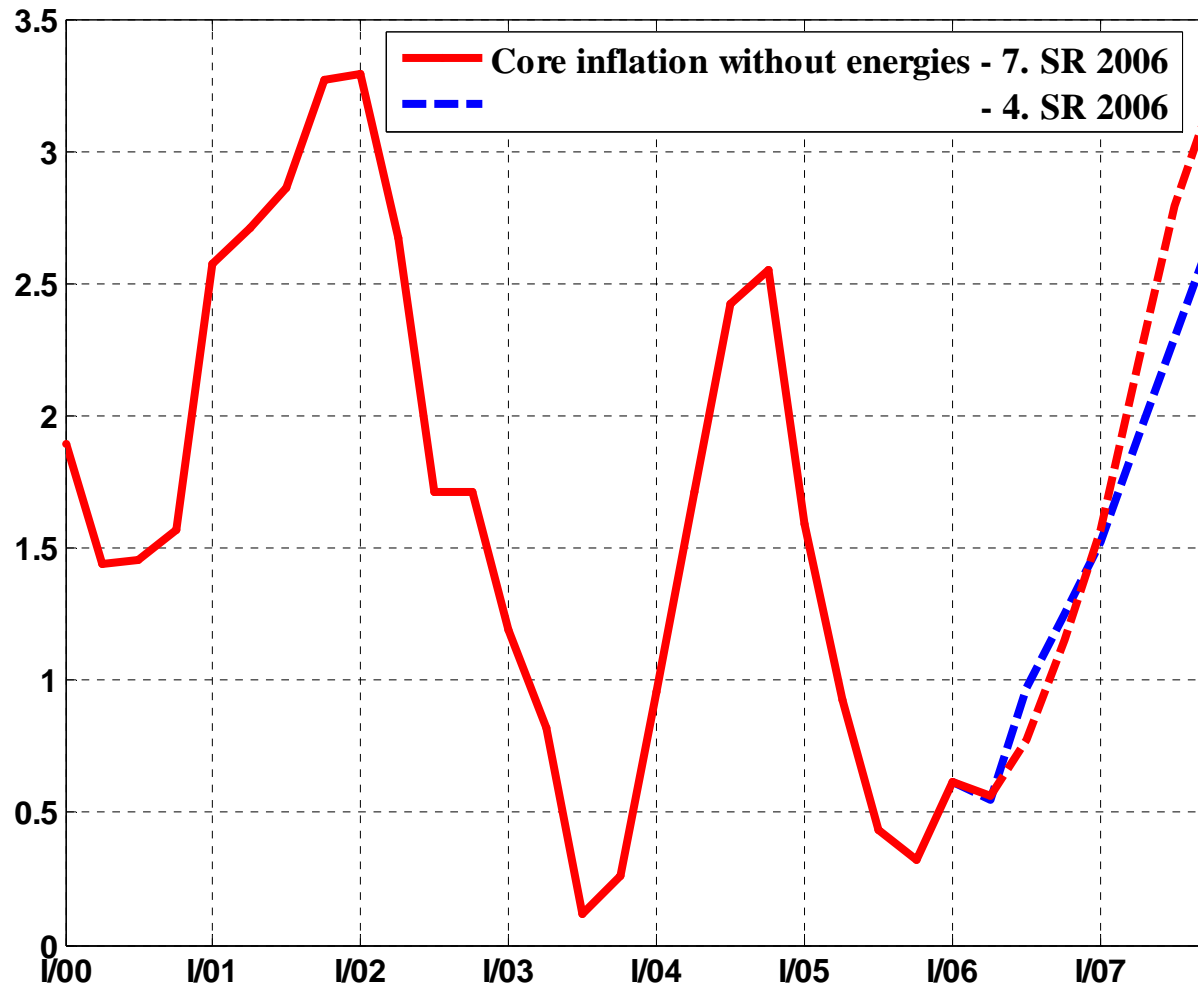
- GDP growth will be high, but slowing down in 2006-07;
- Forecast revised up for 2006, but slightly lowered for 2007;
- Consumption growth will be faster than expected in April;
- Net exports will continue to support growth, but contribution of domestic demand will increase.

# Output Gap



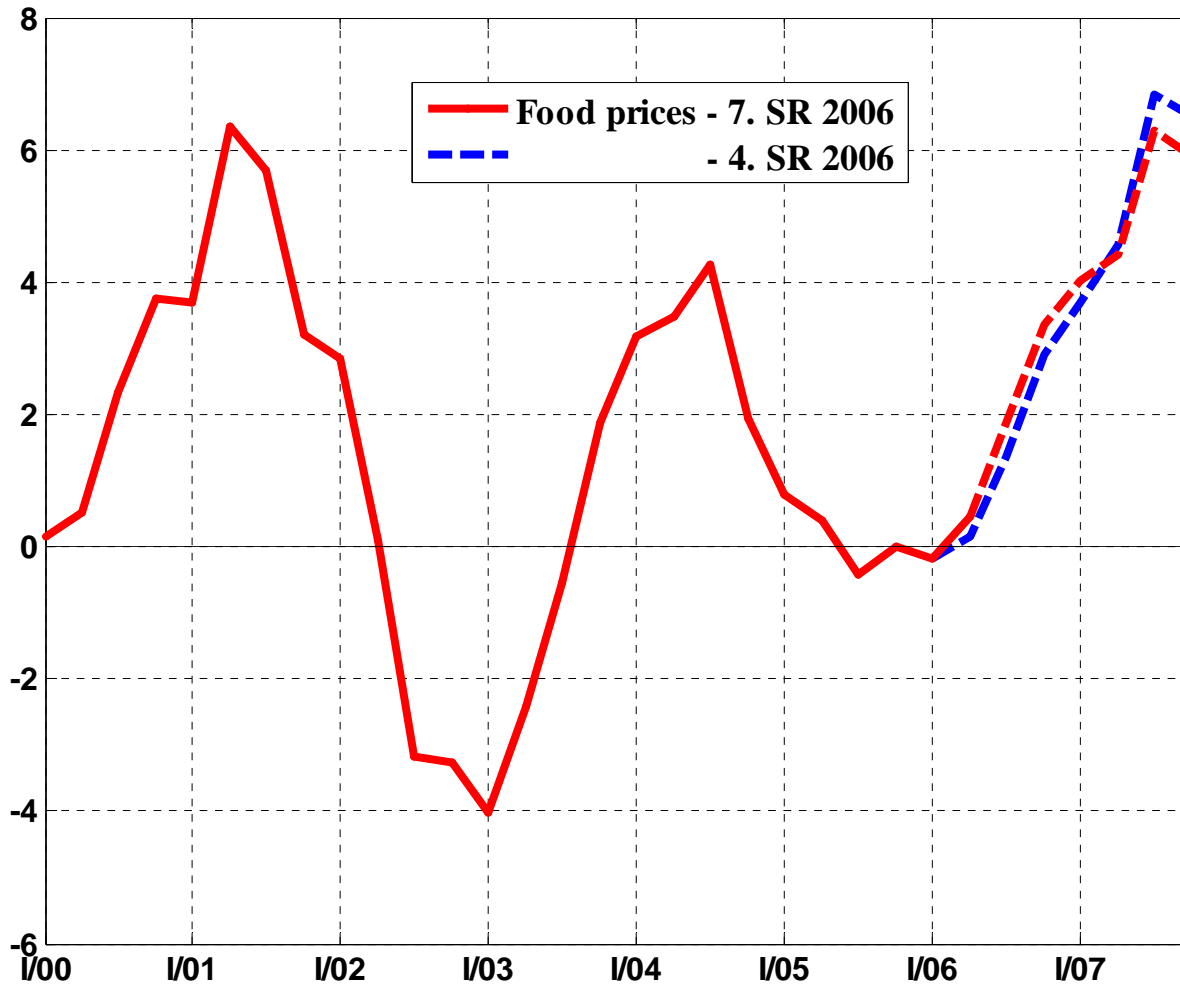
- Initial output gap higher (new GDP data, etc.);
- 2006: Past CZK's appreciation and still sluggish foreign demand will prevent overheating.
- 2007: loosening of the real monetary conditions and fiscal impulse.

# Core Inflation



- Lower in the near-term due to stronger CZK in Q2/06;
- But acceleration still expected (2nd-round effects, import prices ex energy, output gap, long-run price convergence).

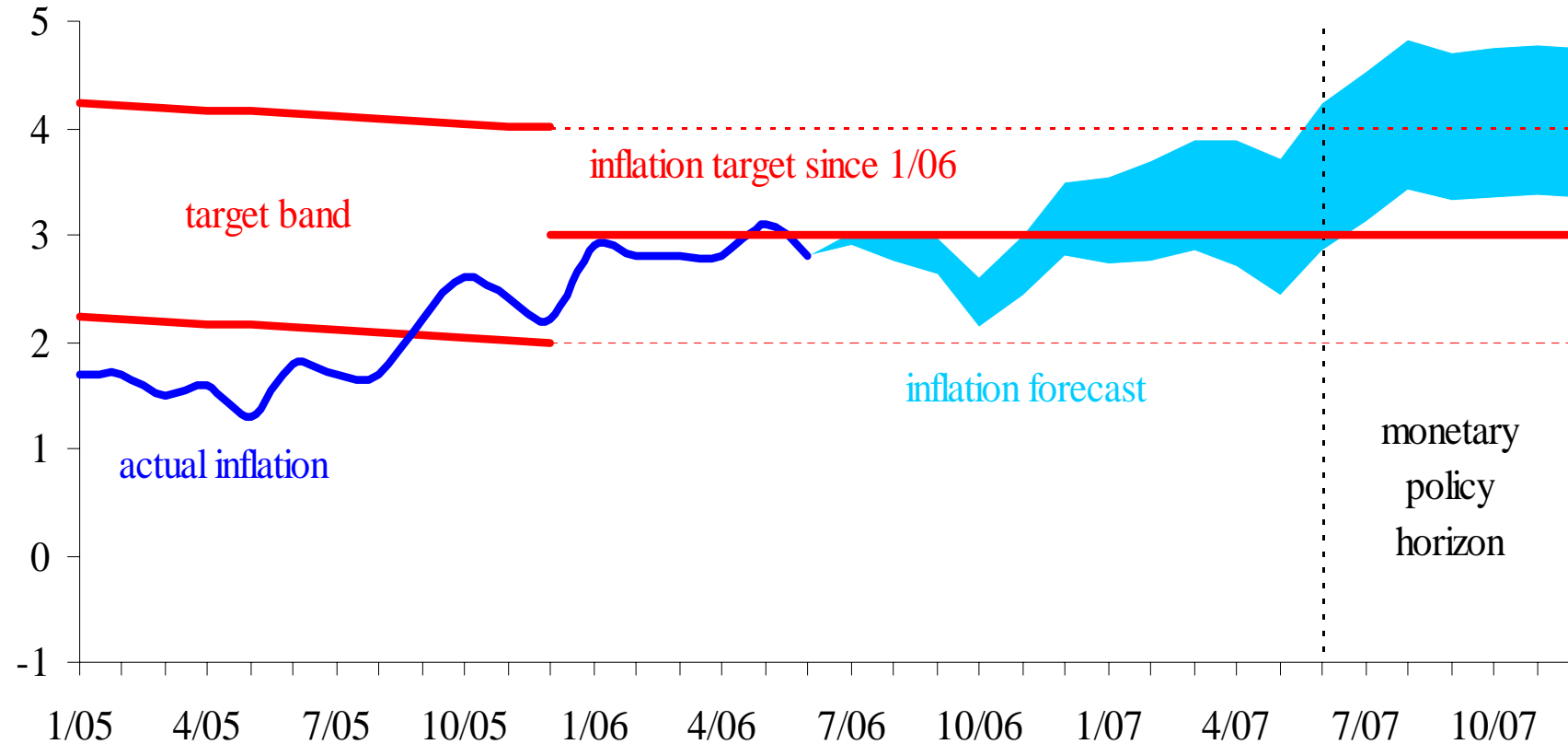
# Food Prices (including taxes)



- Forecast slightly increased in the near-term;
- CZK's impact and cut in taxes compensated by recent data on food and agricultural prices.

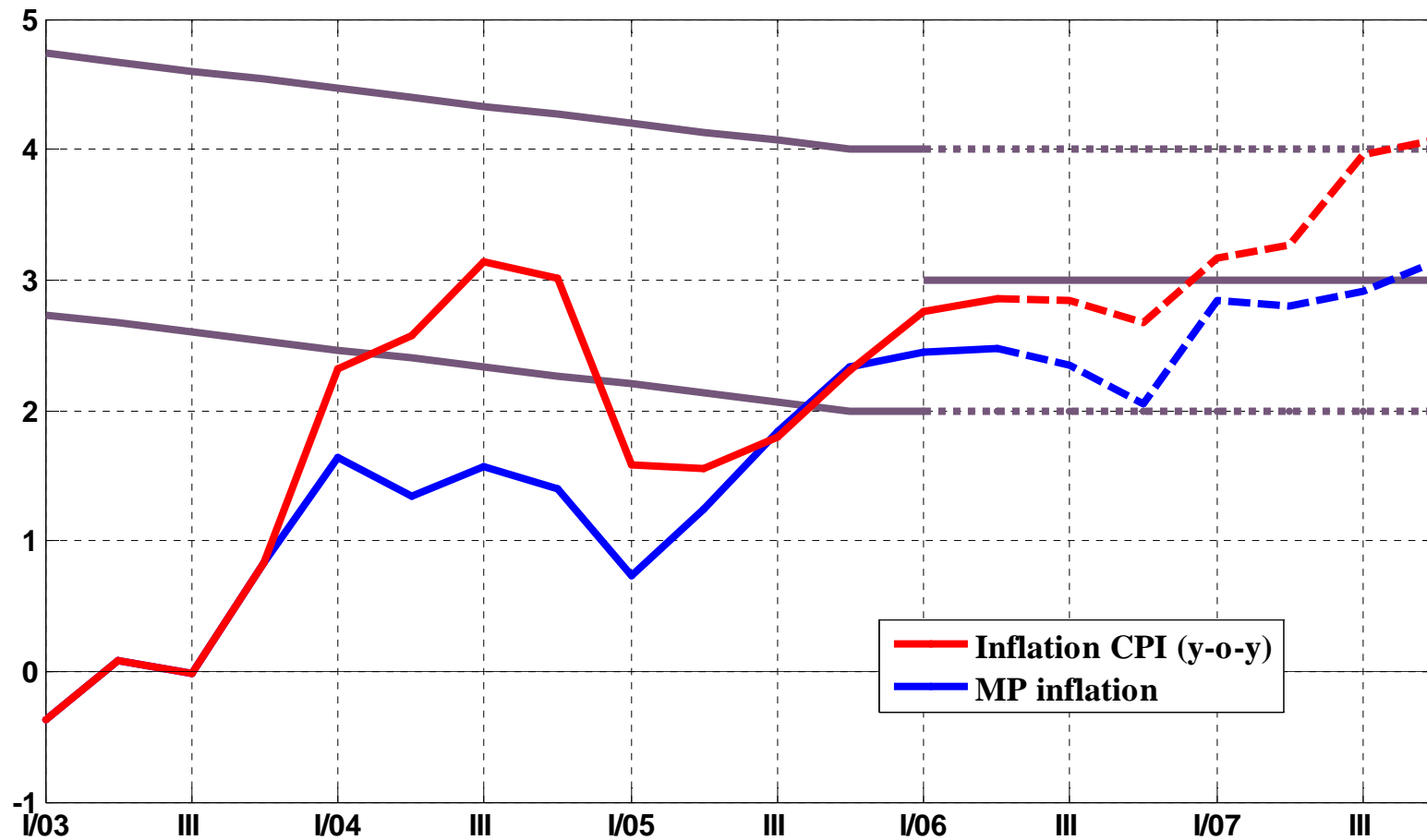


# Overall Inflation

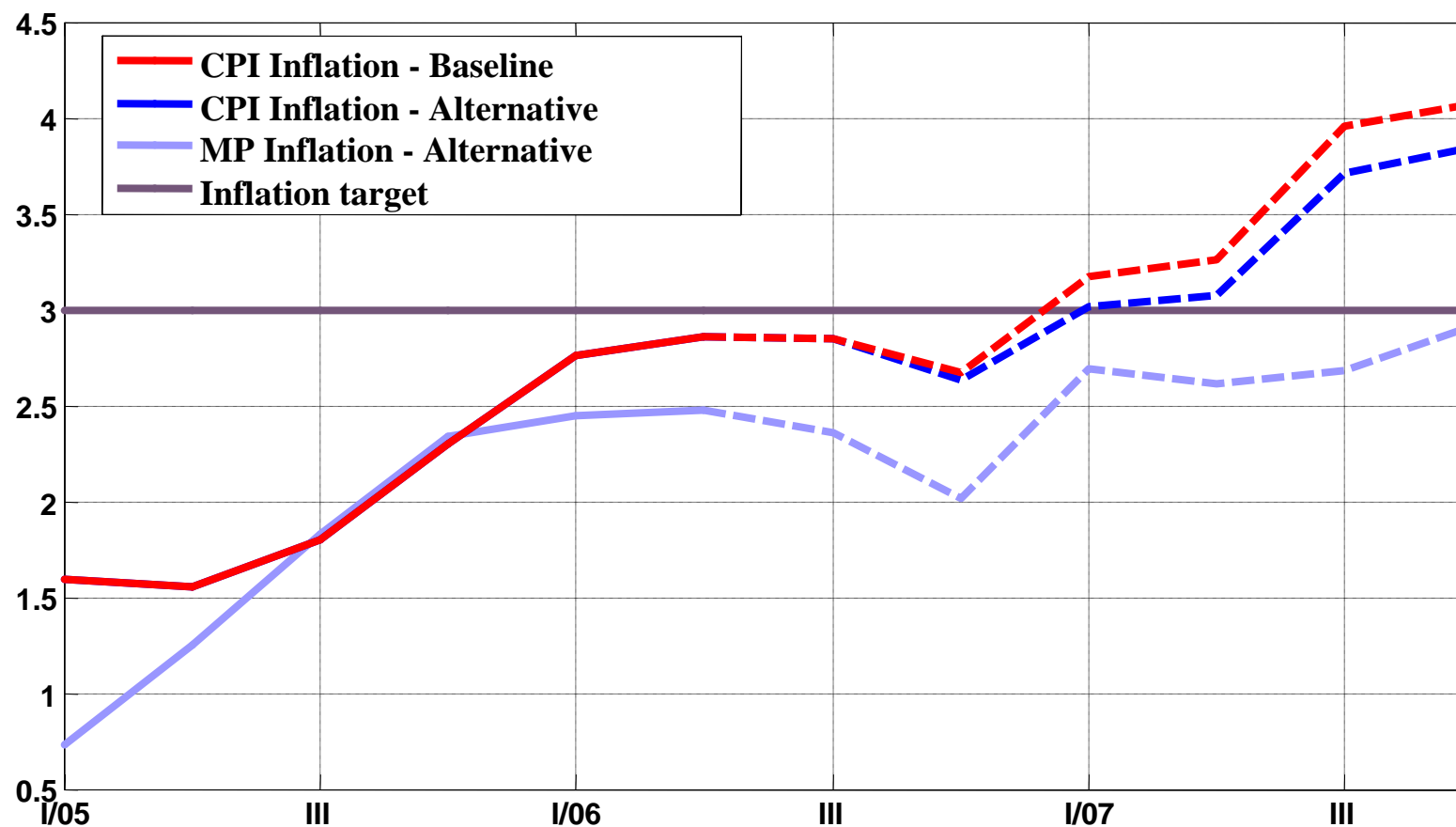
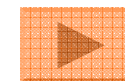


- Consistent with the forecast and its assumptions is a gradual rise in interest rates;
- According to the Board, timing and magnitude uncertain.

# *Inflation Net of Tax Changes*



# *Alternative Scenario*

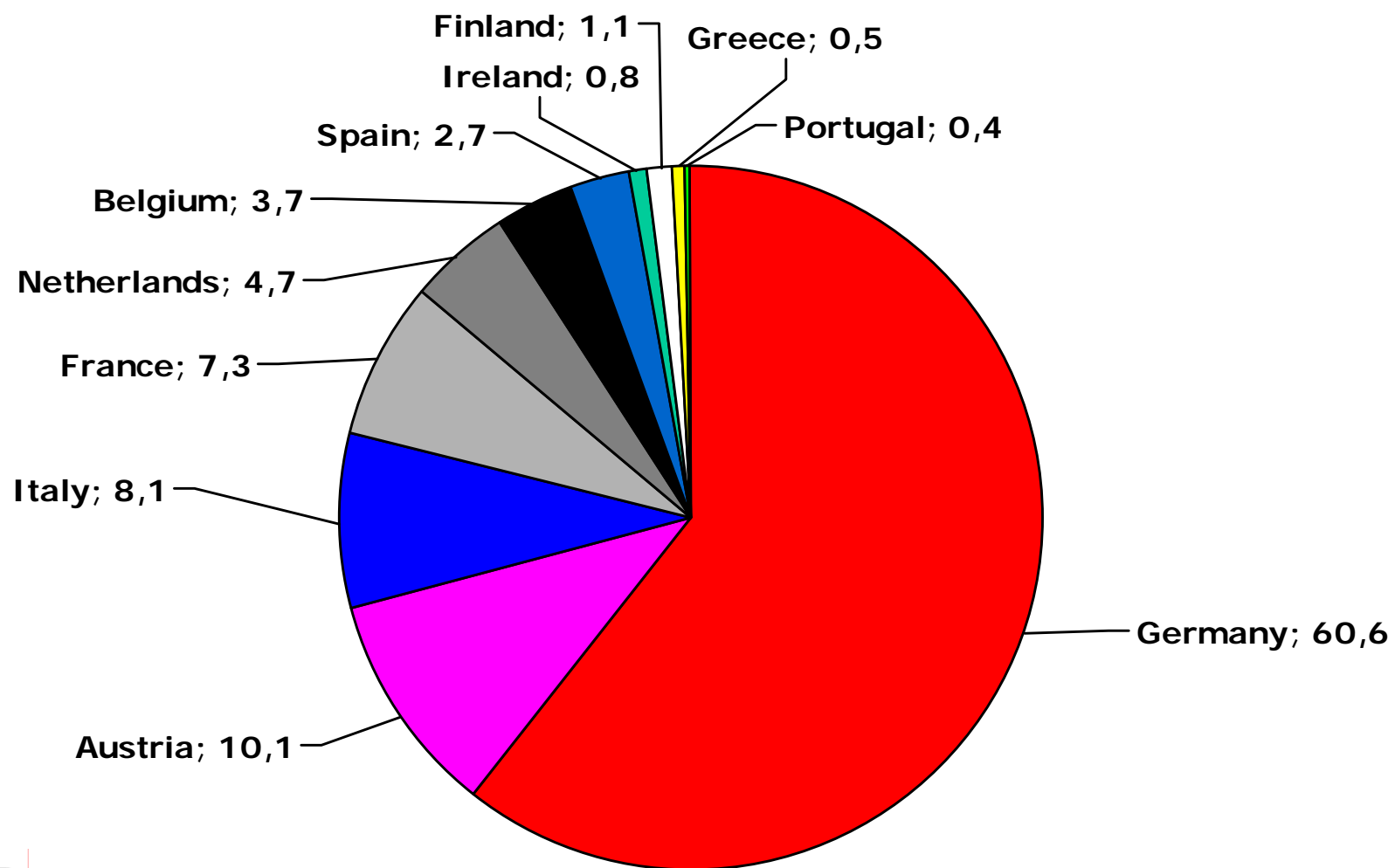


- Simulated using an extended version of QMP with real marginal wage costs (and sticky nominal wages);
- Addresses the uncertainty on pressures from the real economy.

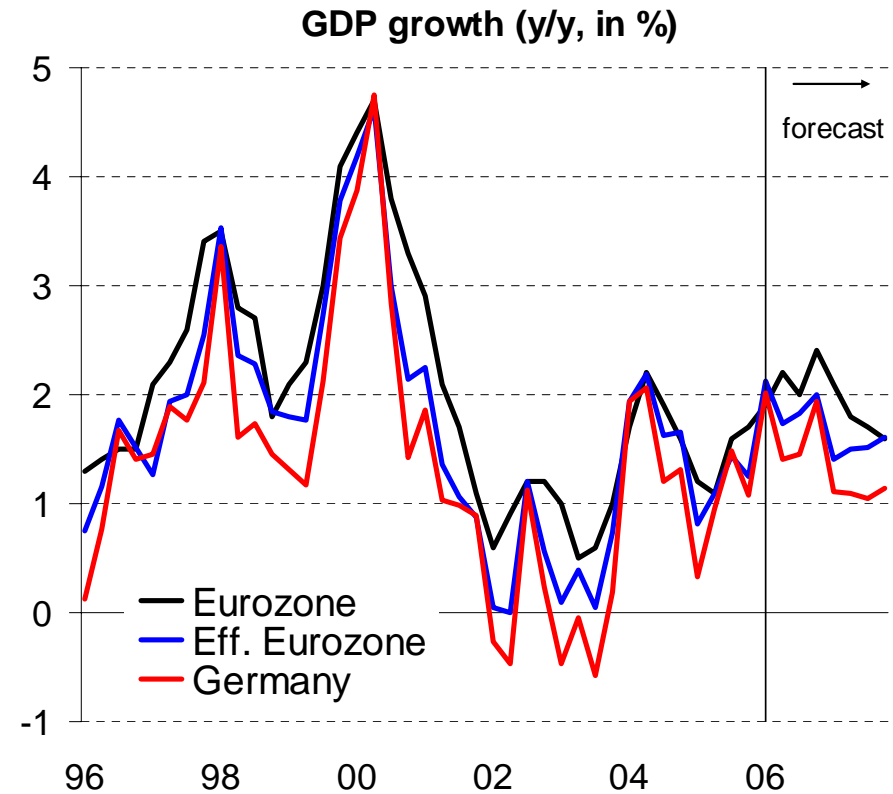
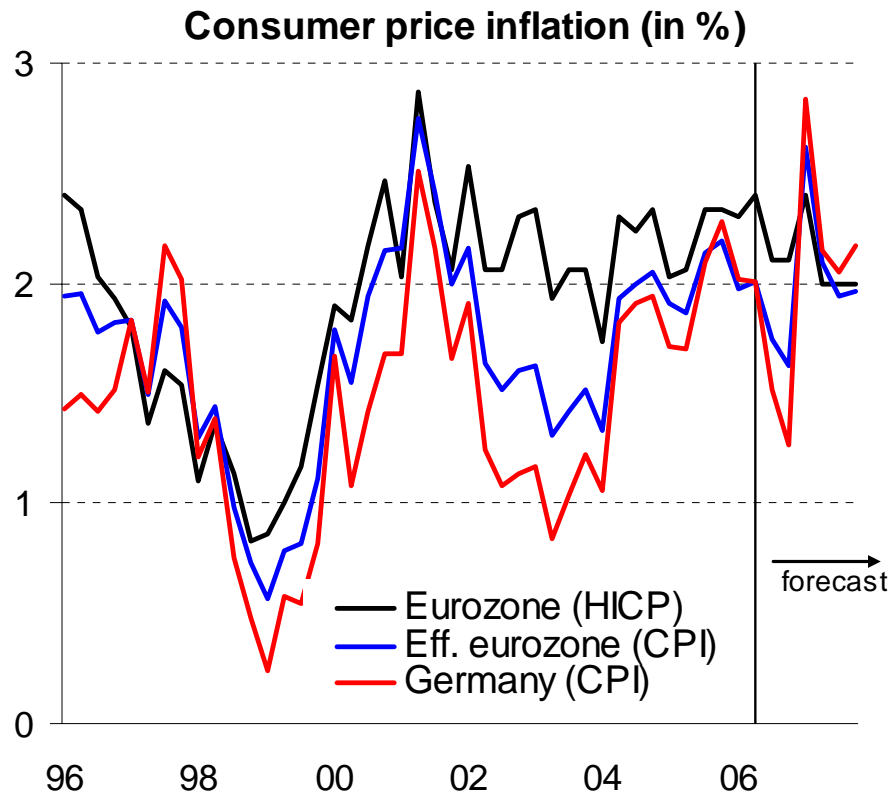
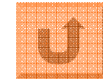
***Thank you  
for your attention.***

***Additional Slides.***

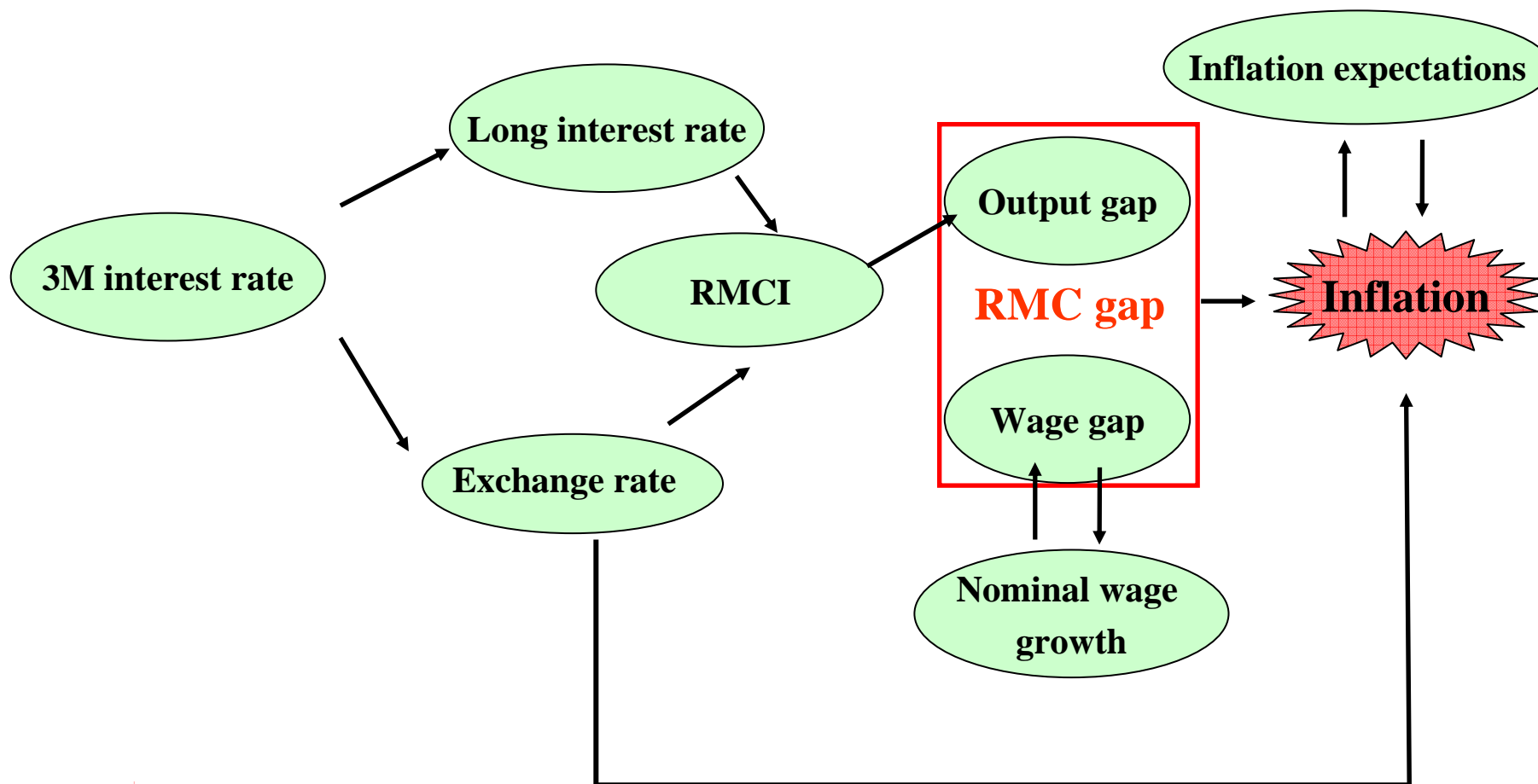
# *Effective Eurozone*



# Effective Eurozone

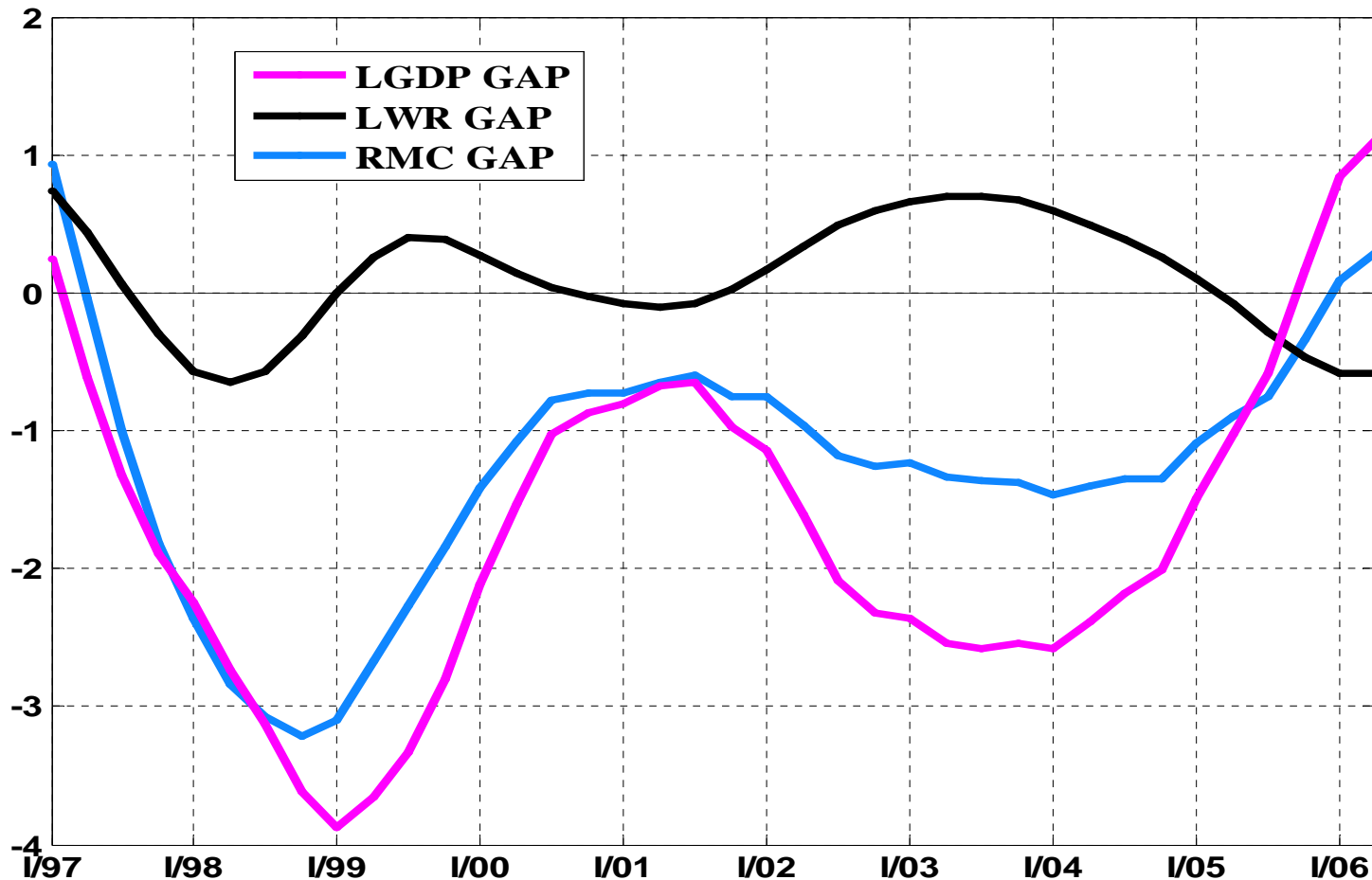


# *Transmission in Extended QPM*



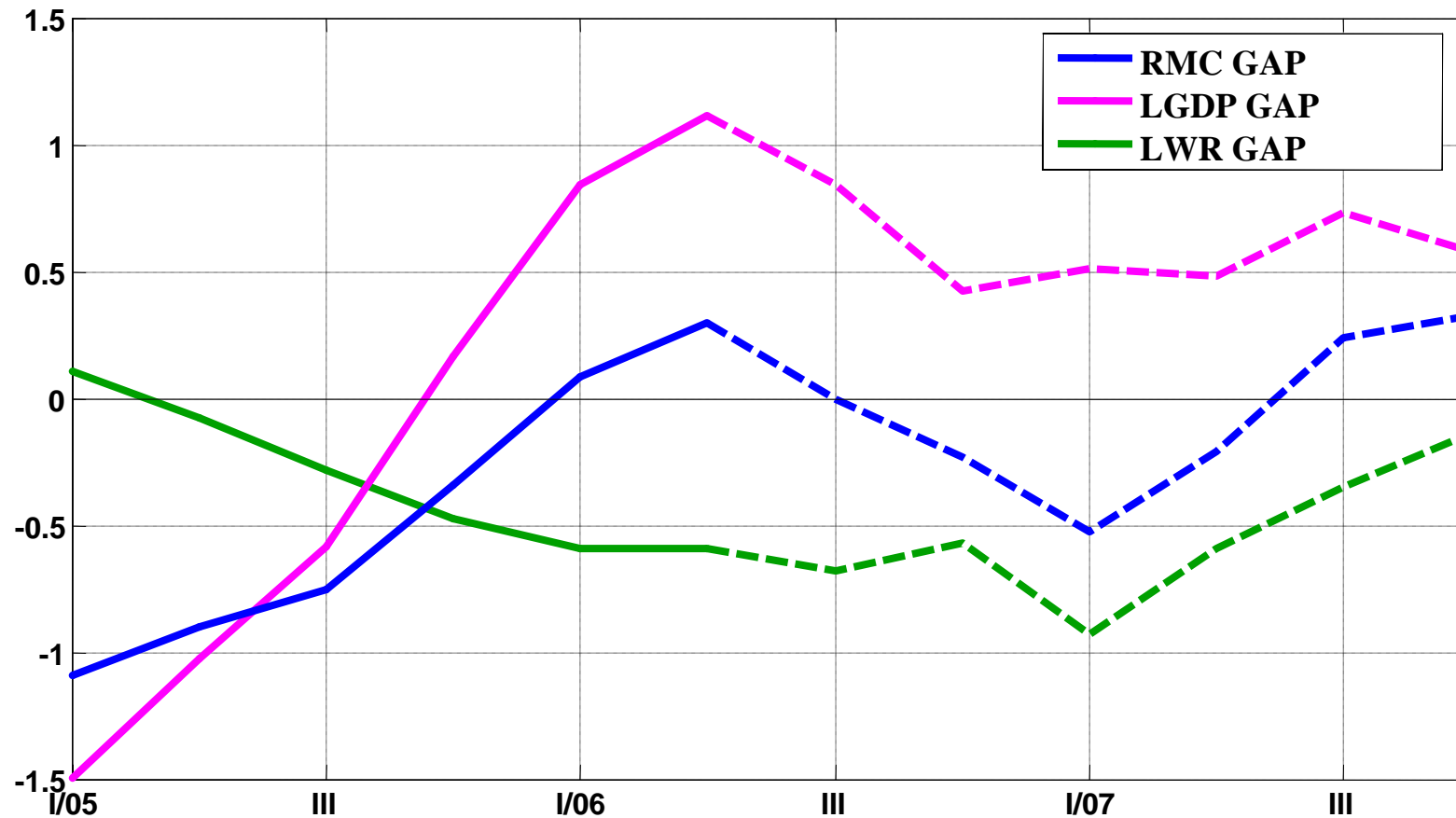
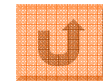


# *Real Marginal Costs*



- GDP exceeds its non-inflationary level (LGDP\_GAP), but is largely compensated by anti-inflationary wages (LWR\_GAP).

# RMC - Forecast



- Inflationary pressures from the real economy will remain muted (temporarily even slightly negative) in the alternative scenario.