CNB CZECH NATIONAL BANK

CNB’s New Forecast

Monetary Policy Report – Spring 2024

Meeting with Analysts

3 May 2024

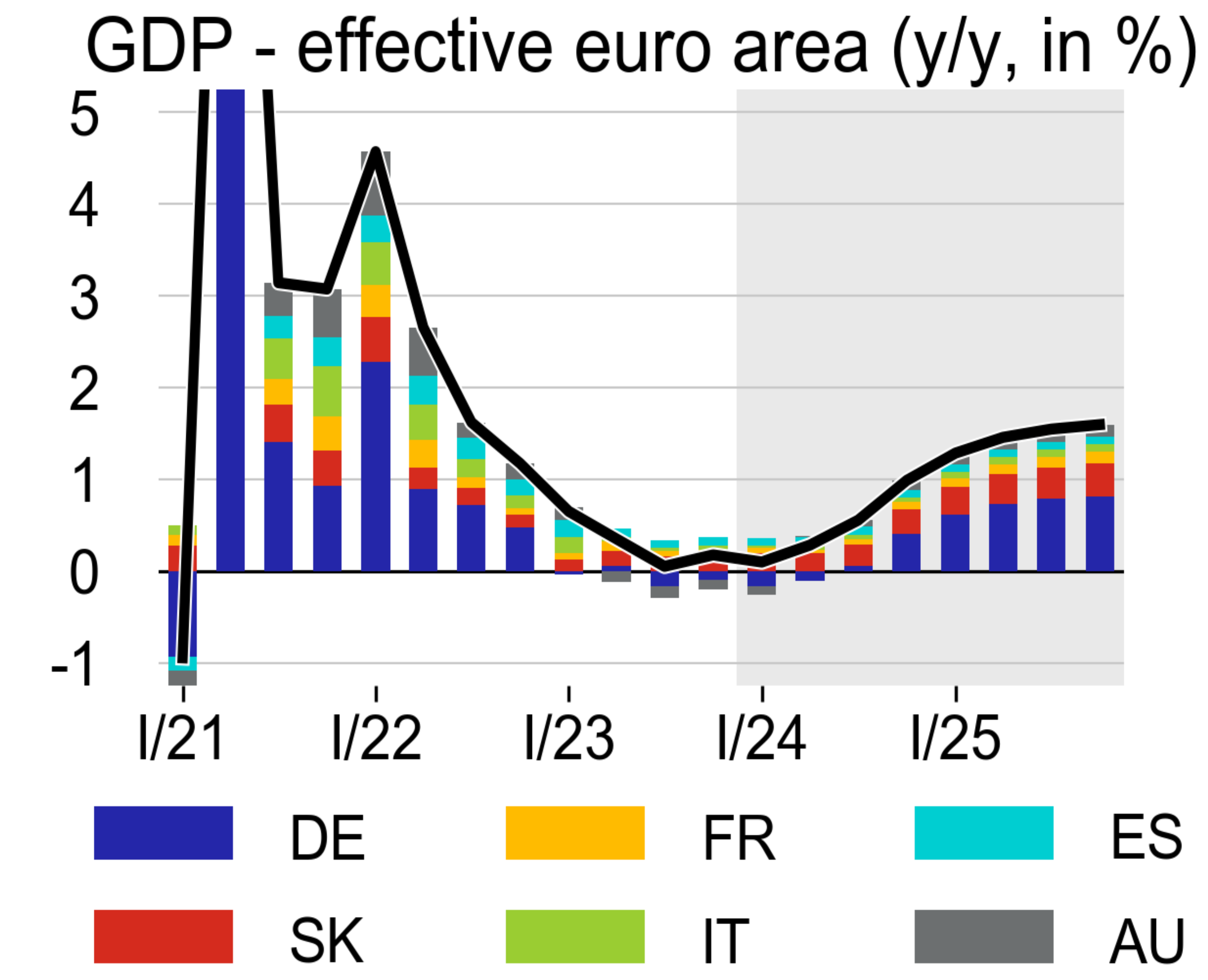
Petr Král (Executive Director, Monetary Department)

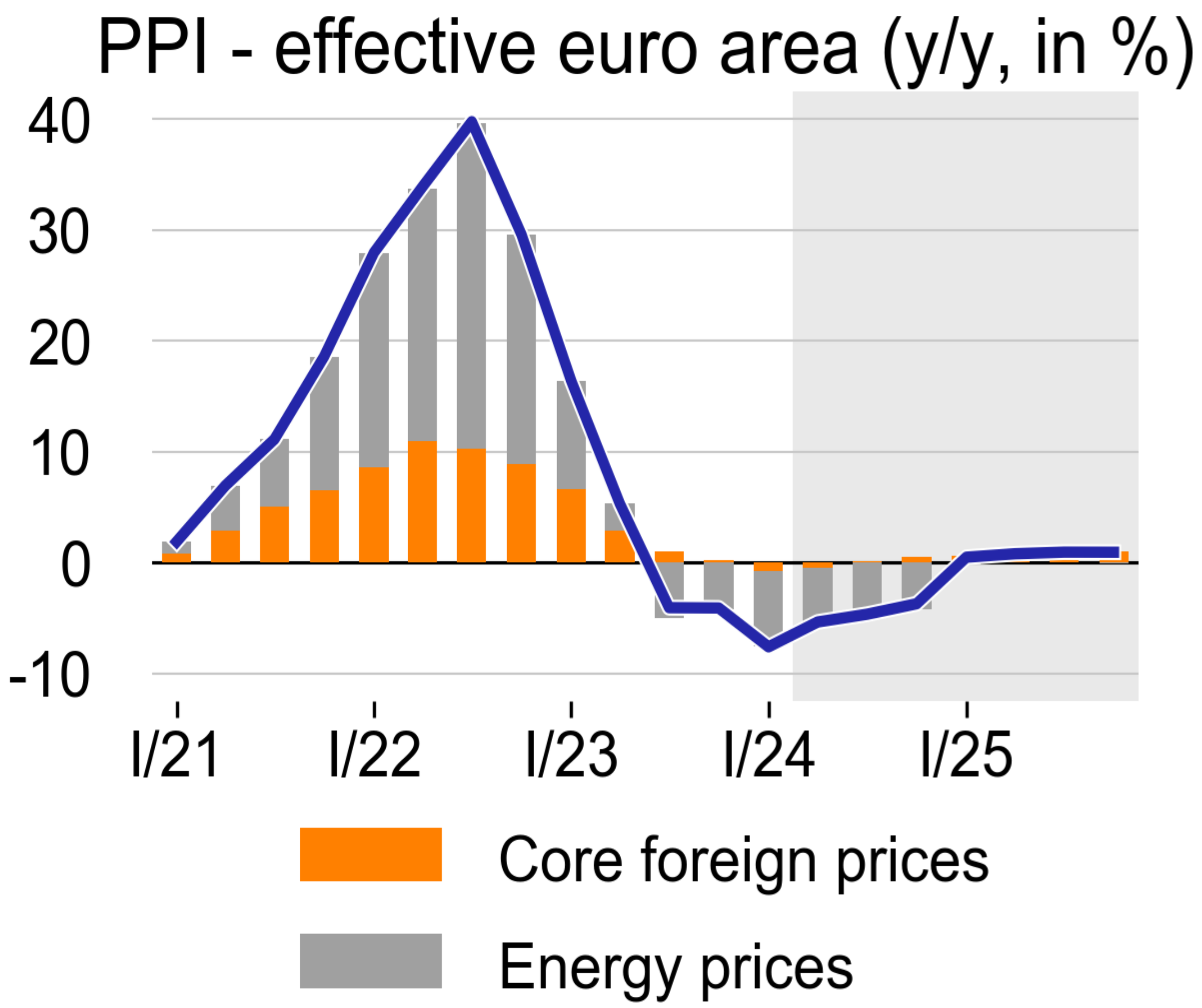
CNB CZECH NATIONAL BANK

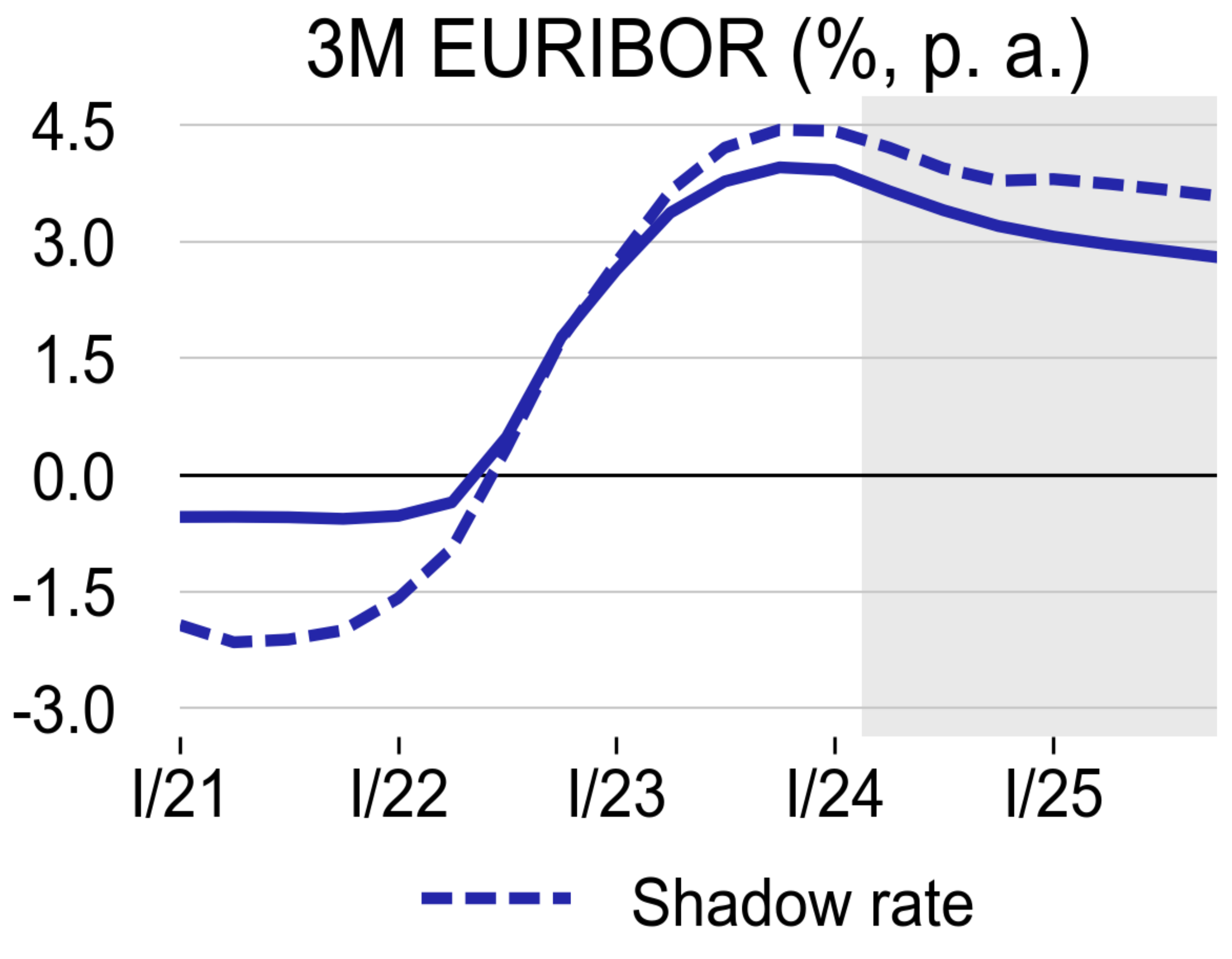
Presentation Outline

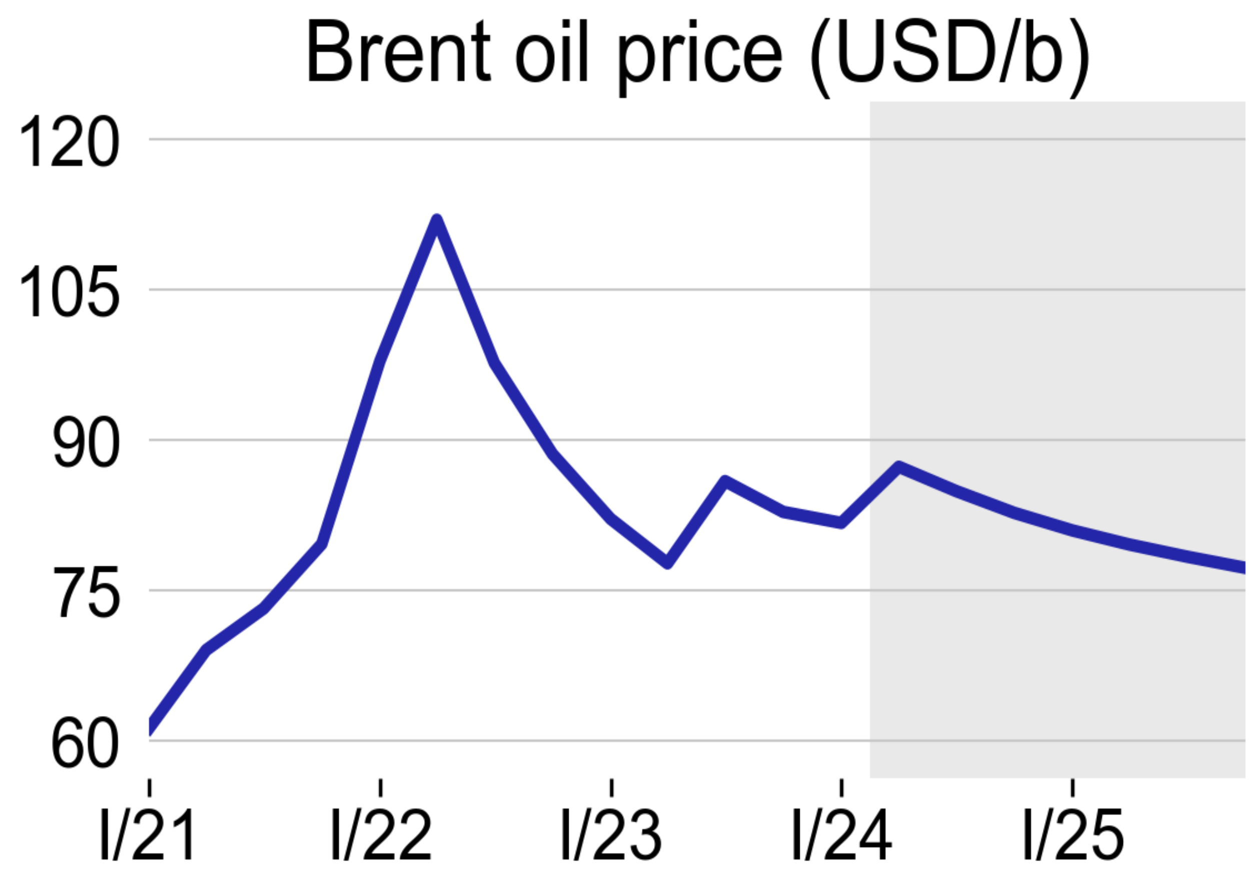
1. **Assumptions of the Forecast**
2. The New Macroeconomic Forecast
3. Comparison with the Previous Forecast
4. Further Scenarios

Foreign Environment Outlook



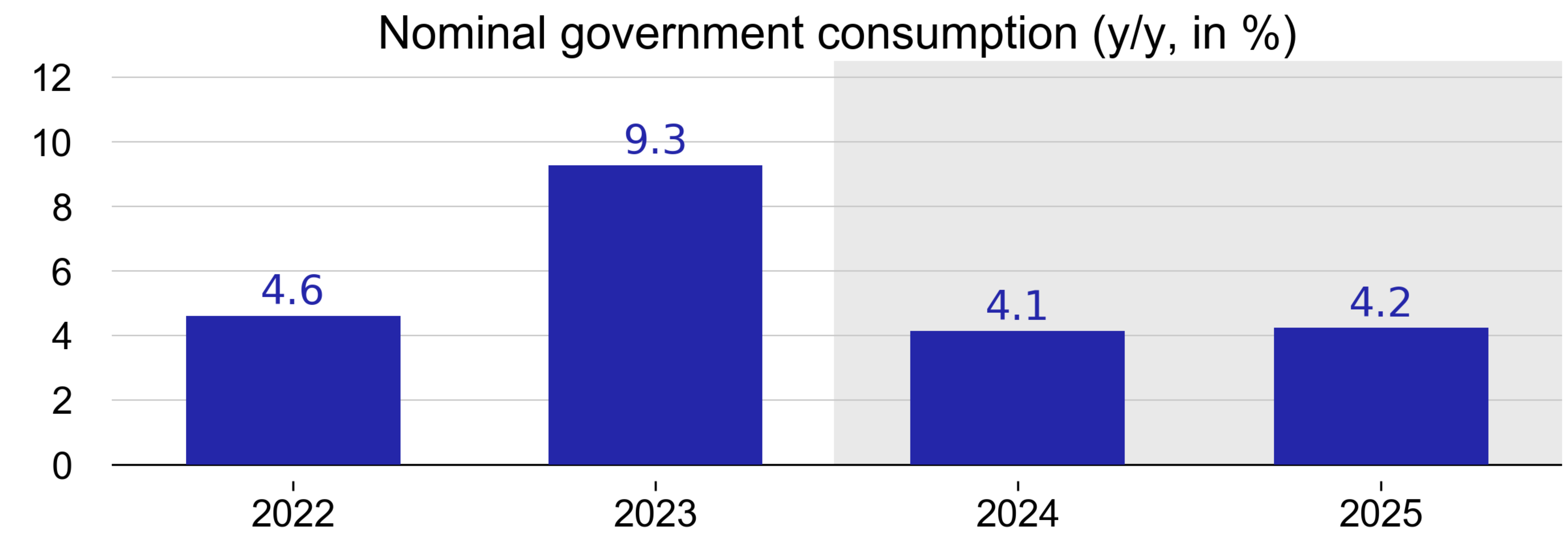


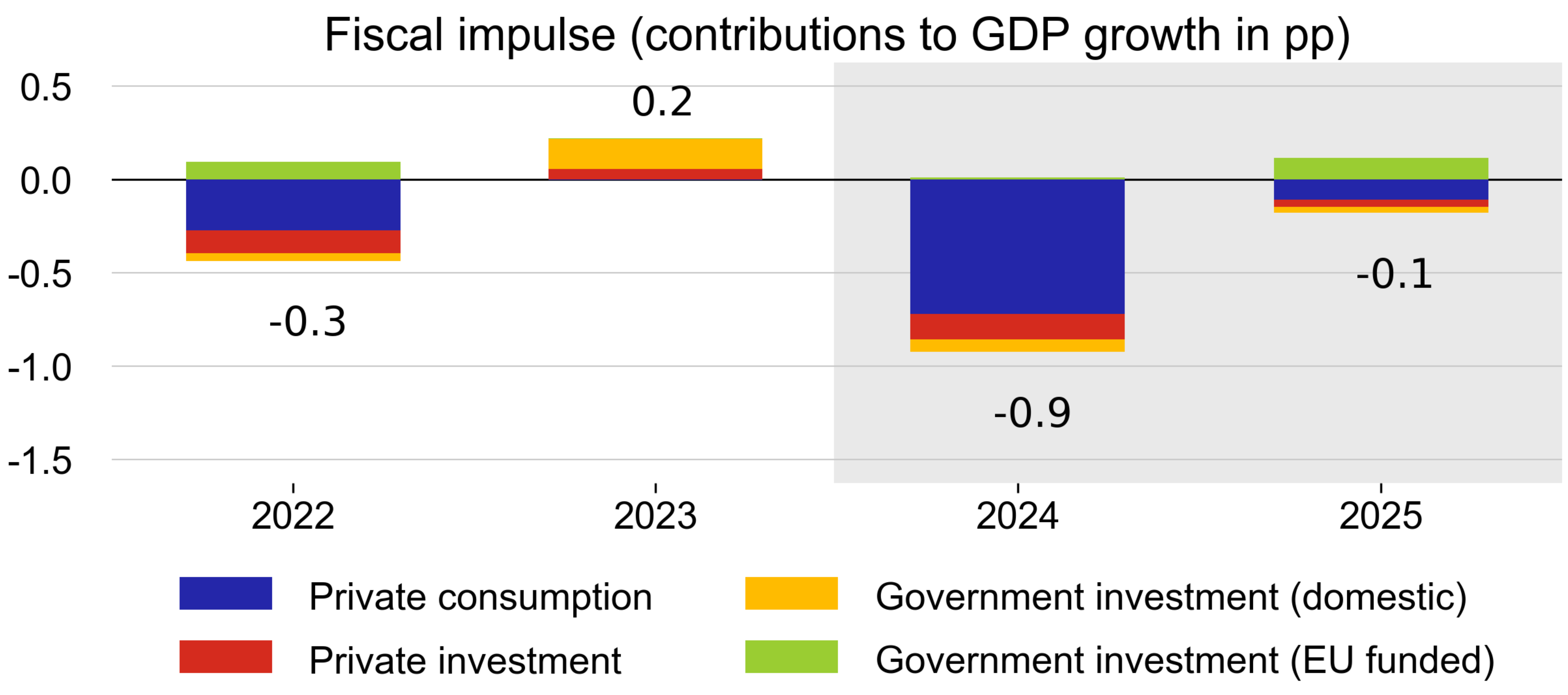




- The **effective euro area economy** will recover in the rest of this year. The recovery will be driven by improving **performance of German economy**. In the medium term, the **euro area** economy will be supported by a gradual easing of ECB monetary policy.
- **Industrial producer prices** will continue to fall this year, mainly because of their energy component, and will not return to growth until 2025.
- According to financial markets, **euro area interest rates** will go down this year. The decline in the **shadow rate** will be dampened by an expected decrease in the rate of reinvestment by the ECB.
- The **Brent crude oil price** has risen since the start of this year, but its outlook remains falling.

Fiscal Policy





- Growth in **nominal government consumption** will slow, due in part to the wage savings also included in the consolidation package.
- **Fiscal policy** is significantly dampening GDP growth this year (due mainly to the consolidation package) and will have a roughly neutral effect next year.

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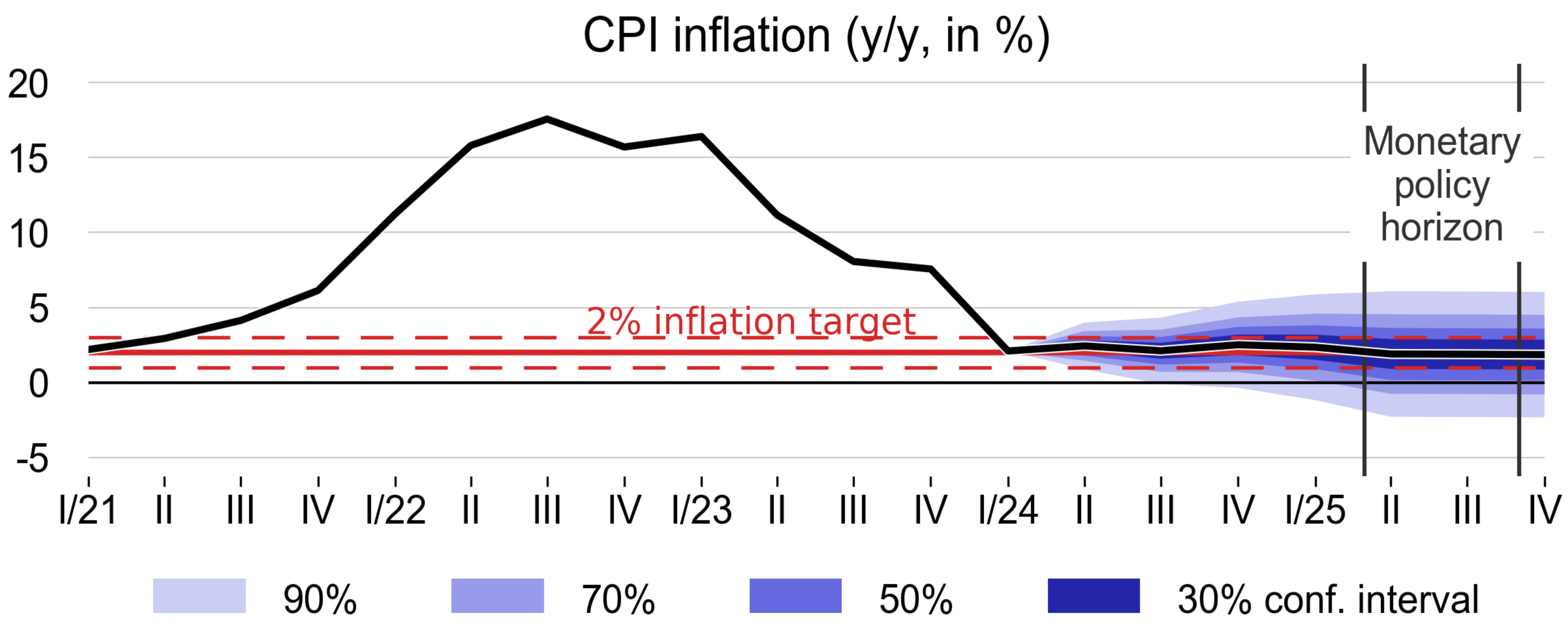
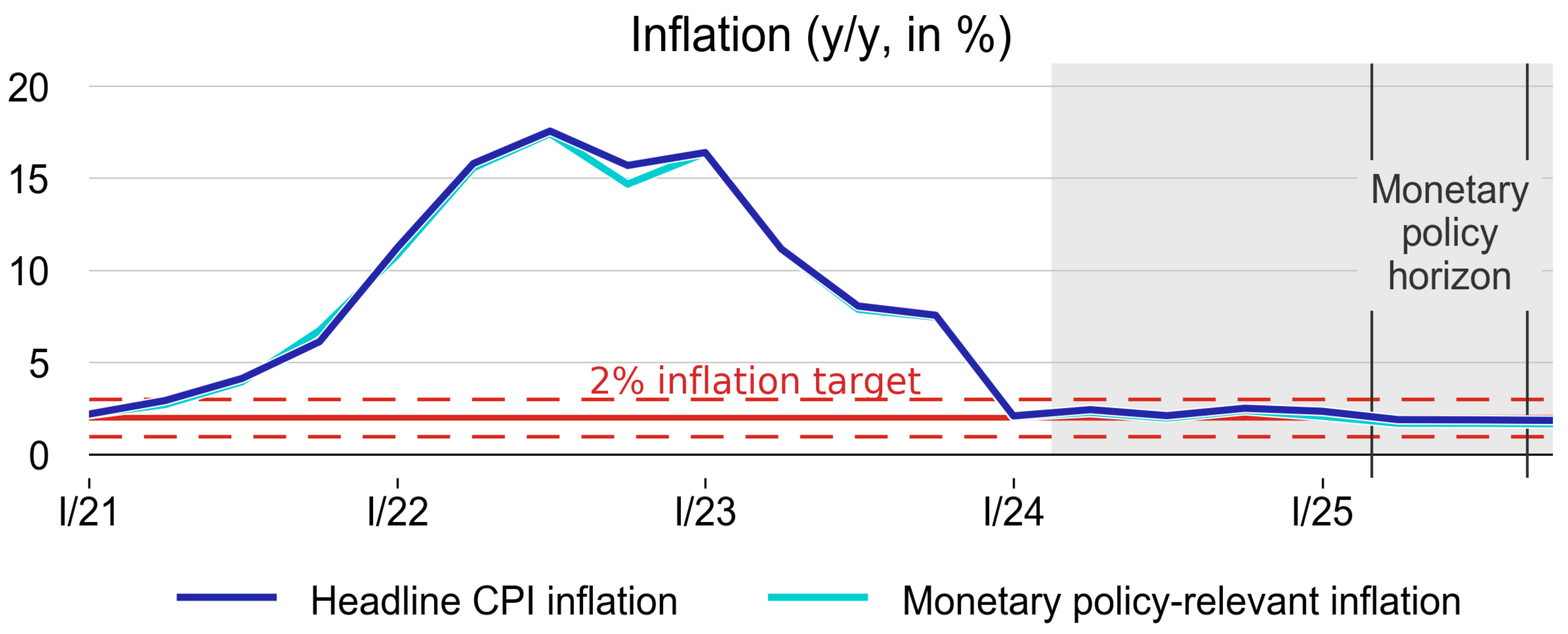
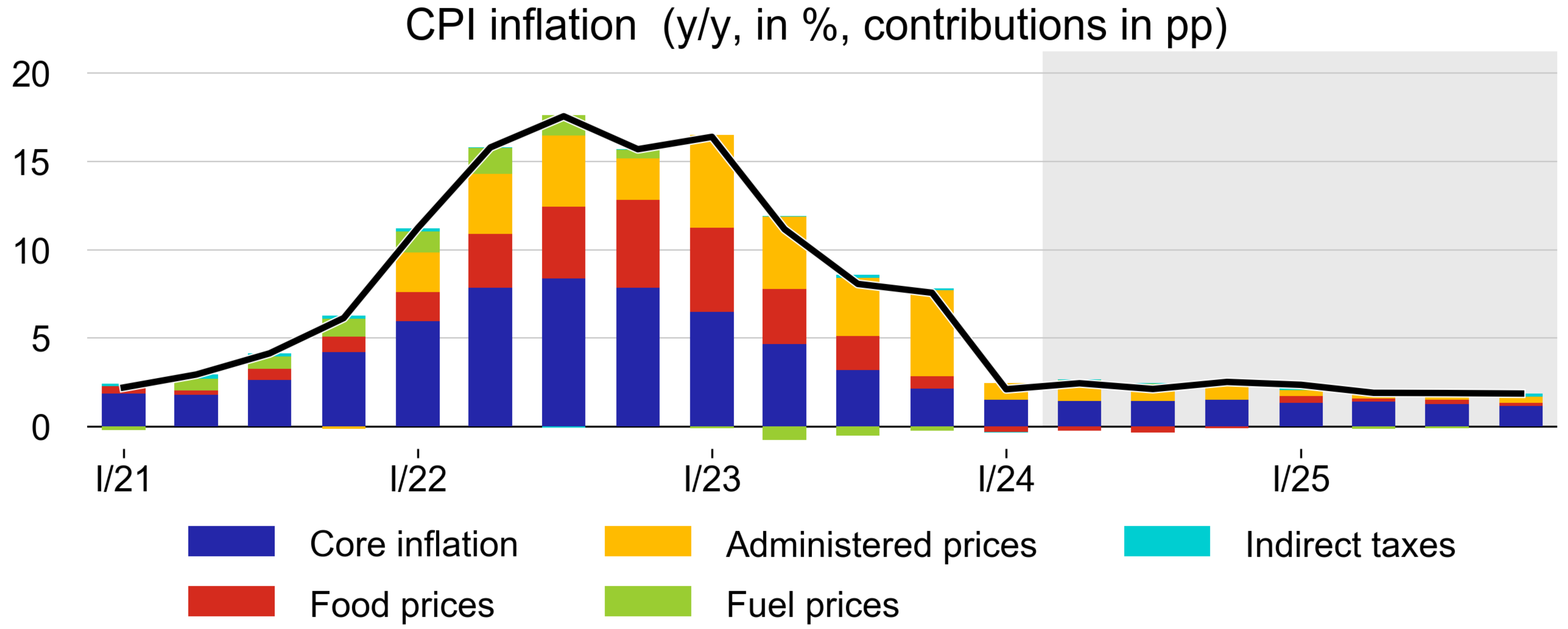
Headline and Monetary Policy-Relevant Inflation

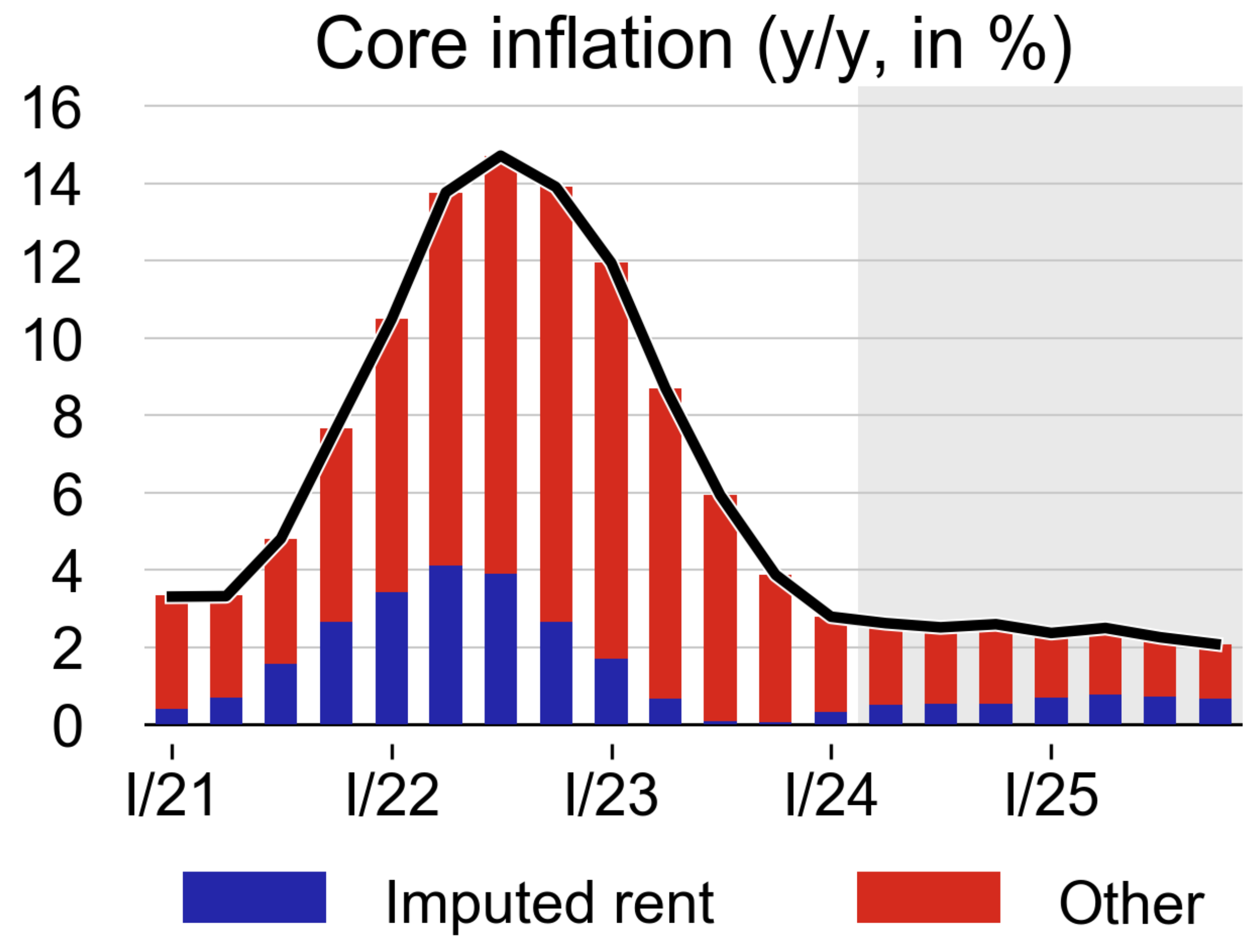


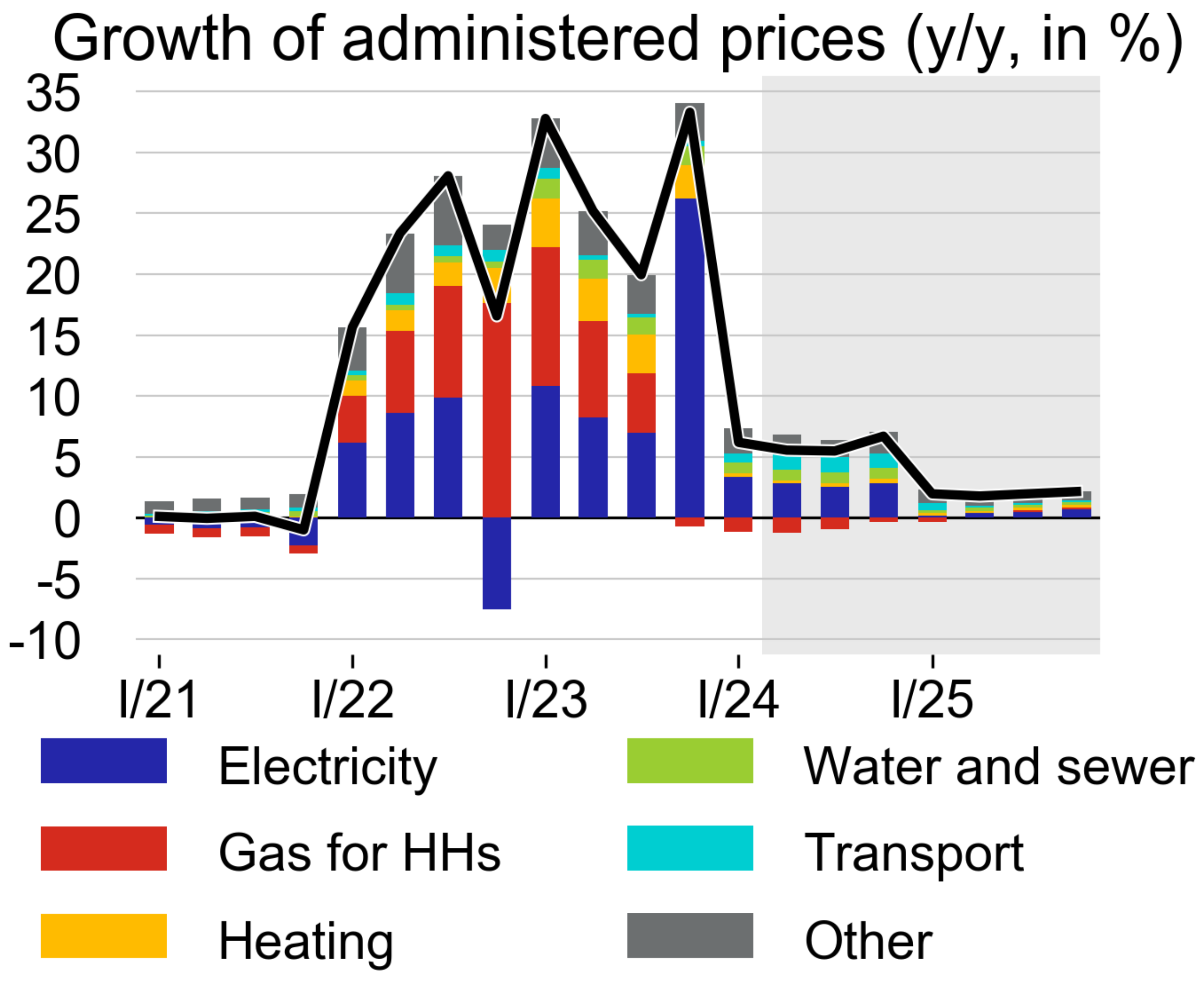


- **Inflation** will remain close to the **2% inflation target** during the course of this year and stay there over the monetary policy horizon.
- Headline inflation will be slightly above **monetary policy-relevant inflation**.

CPI Inflation, Core Inflation and Administered Prices



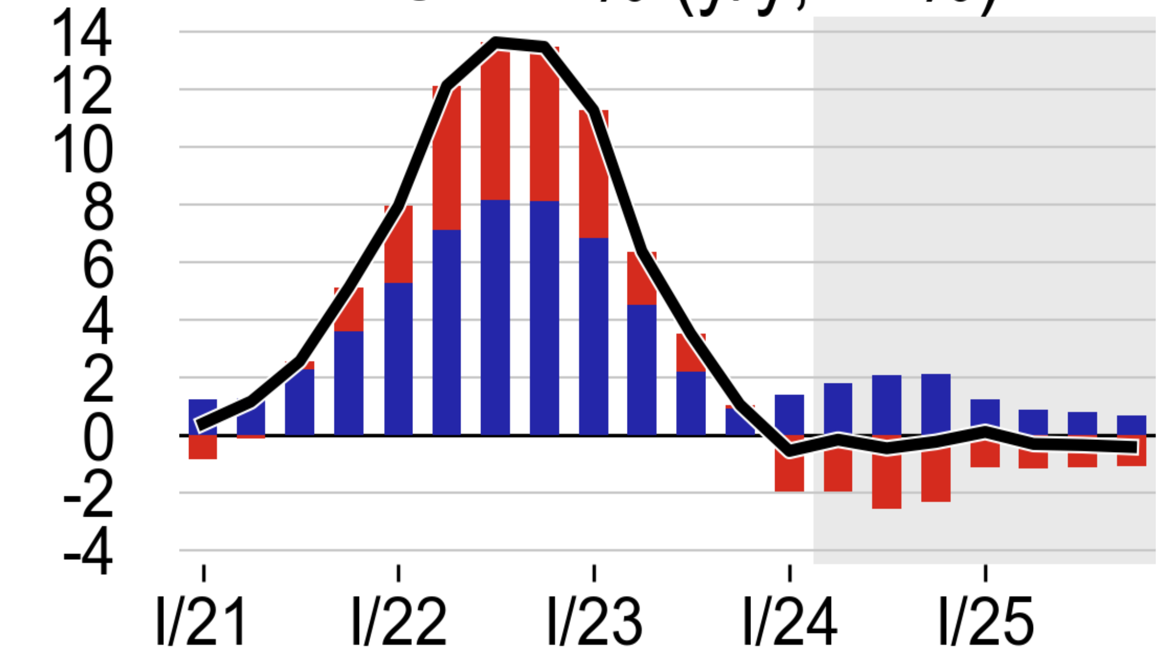




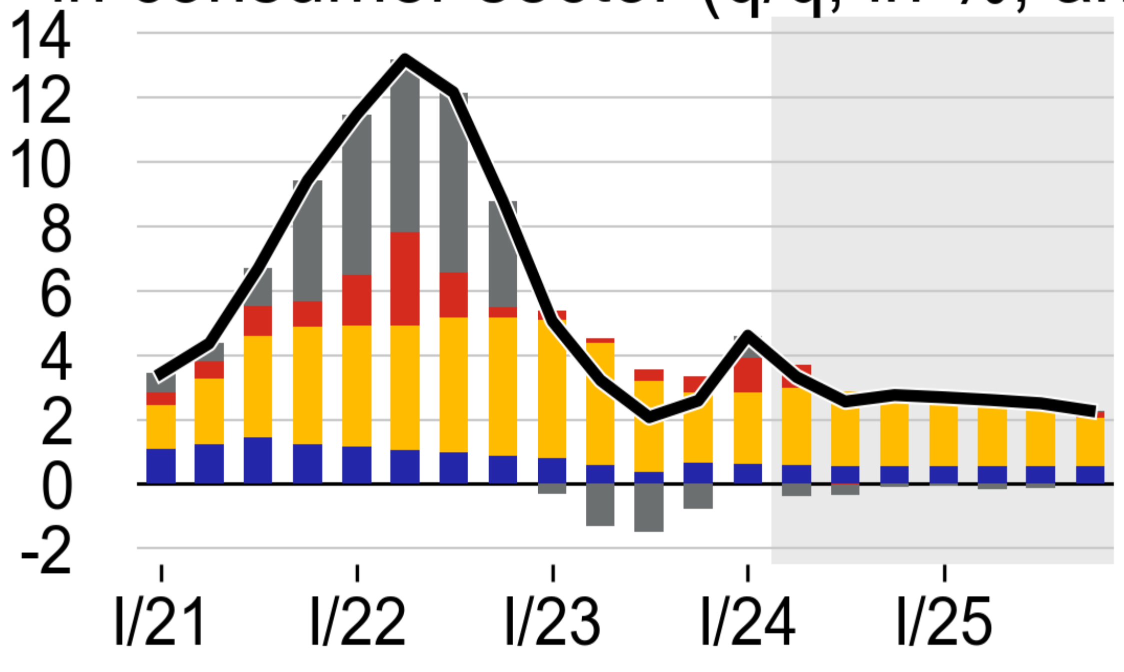
- **Consumer price inflation** slowed sharply at the start of this year and was exactly at the CNB's 2% target in February and March.
- An increase in the contribution of **fuel prices** will contribute to a rise in consumer price inflation in 2024 Q2.
- The current long-running sharp decline in **core inflation** will virtually halt this year and core inflation will remain slightly elevated amid a still low contribution of imputed rent.
- **Administered price inflation** will be above-average from a historical perspective this year, it will return to its long-term average in 2025.
- The contribution of **food prices** will be slightly negative this year because of decline in domestic agricultural producer prices.

Cost Pressures and Profit Mark-ups

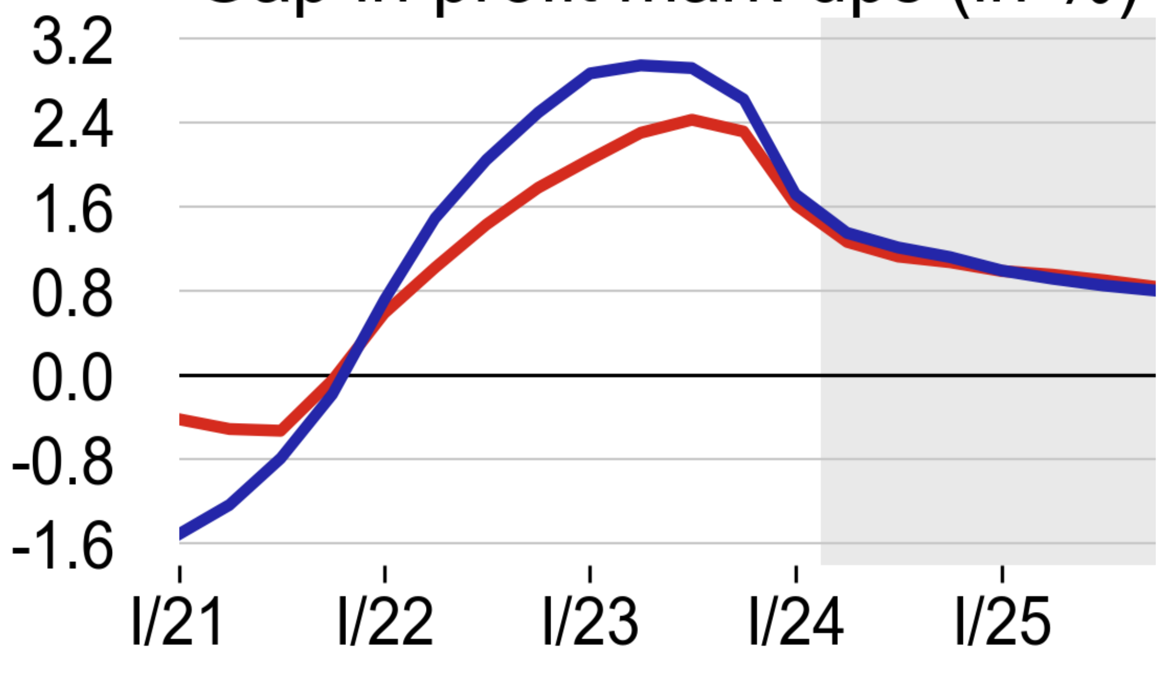
Deviation of market prices from 2 % (y/y, in %)



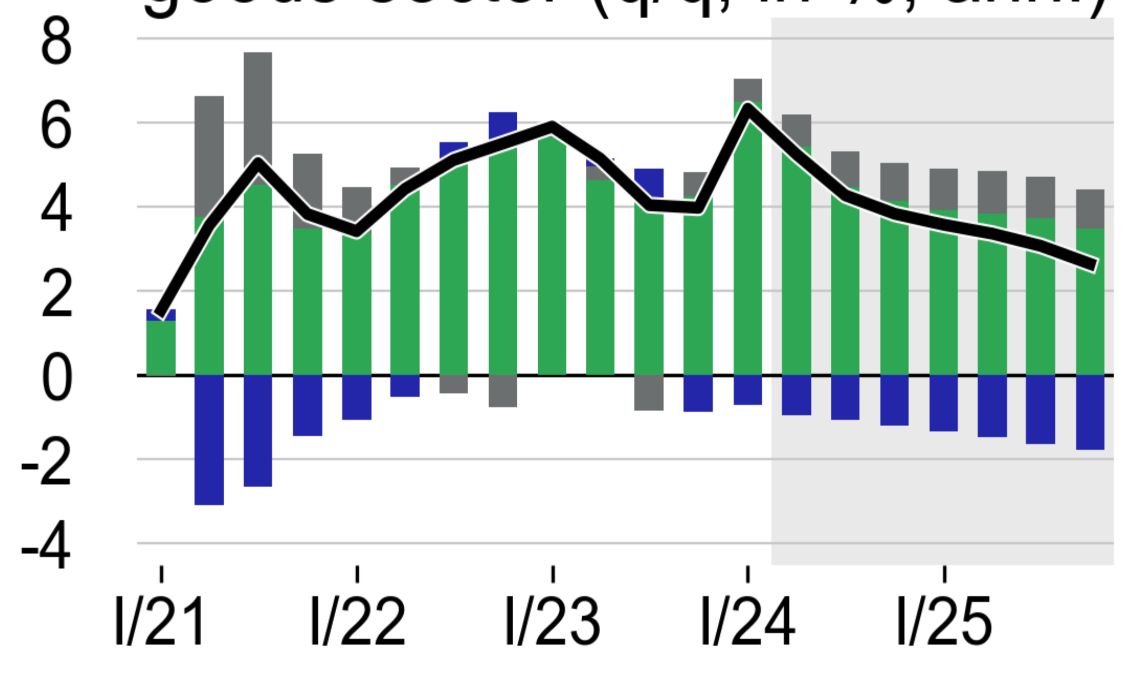
Nominal marginal costs in consumer sector (q/q, in %, ann.)



Gap in profit mark-ups (in %)

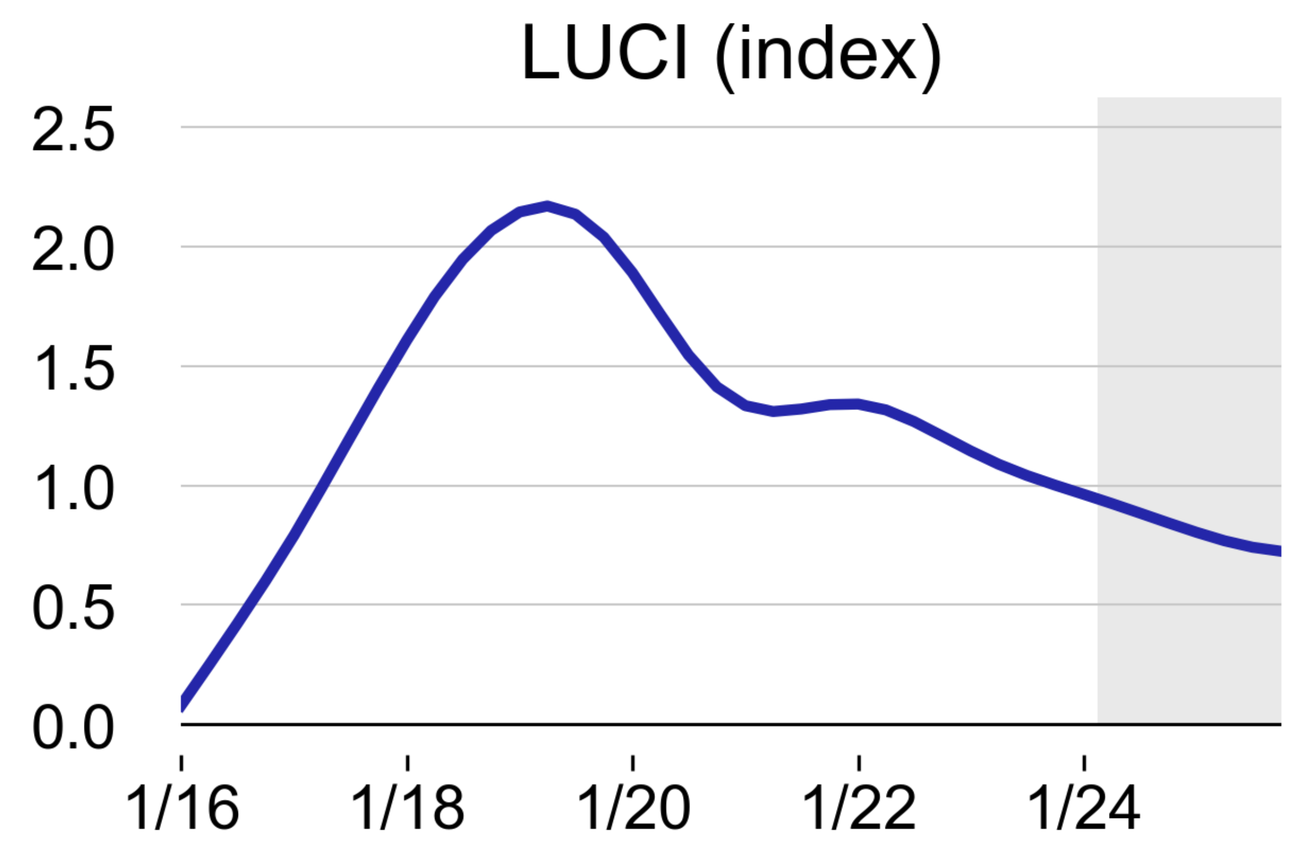


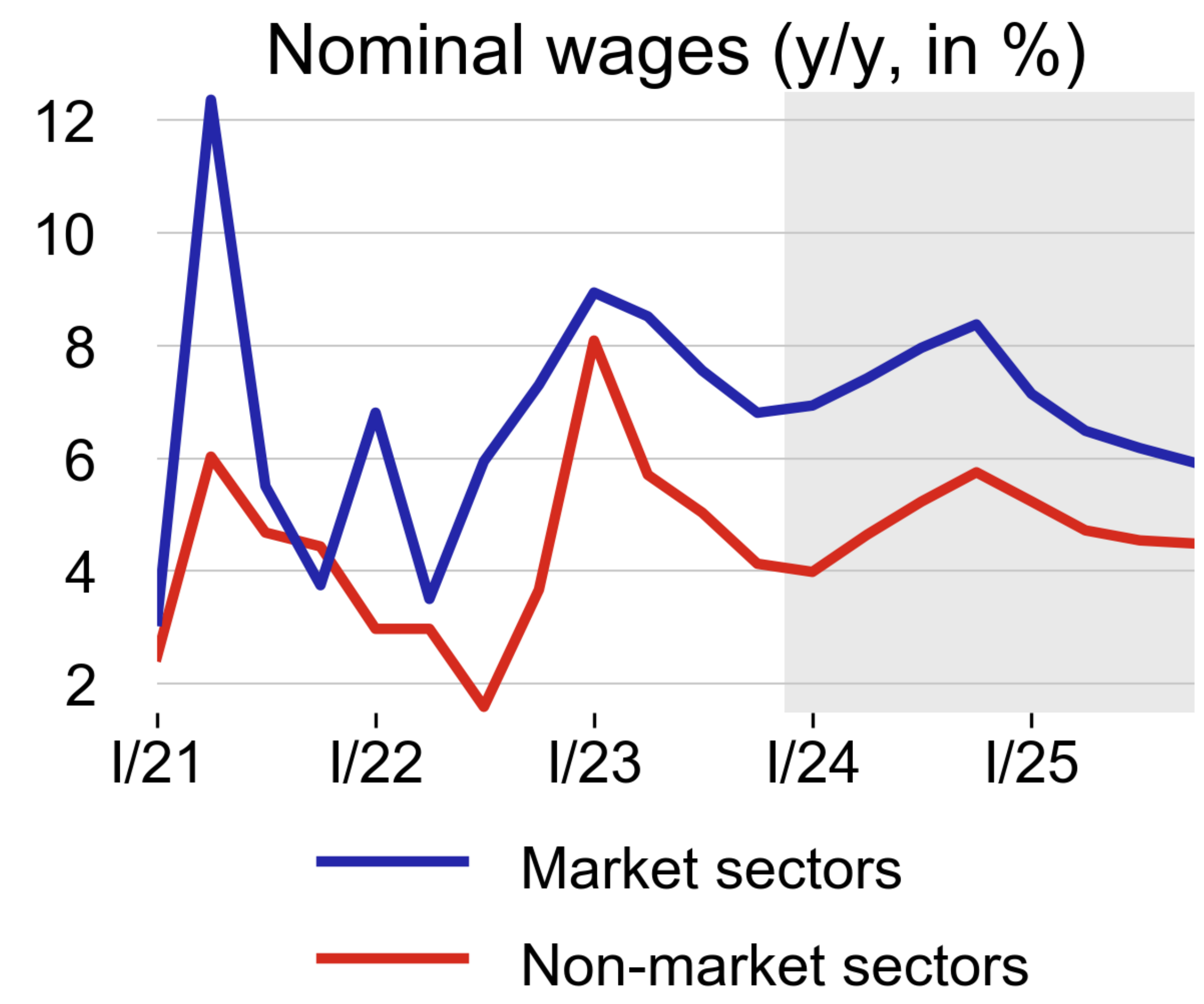
Nominal marginal costs in intermediate goods sector (q/q, in %, ann.)

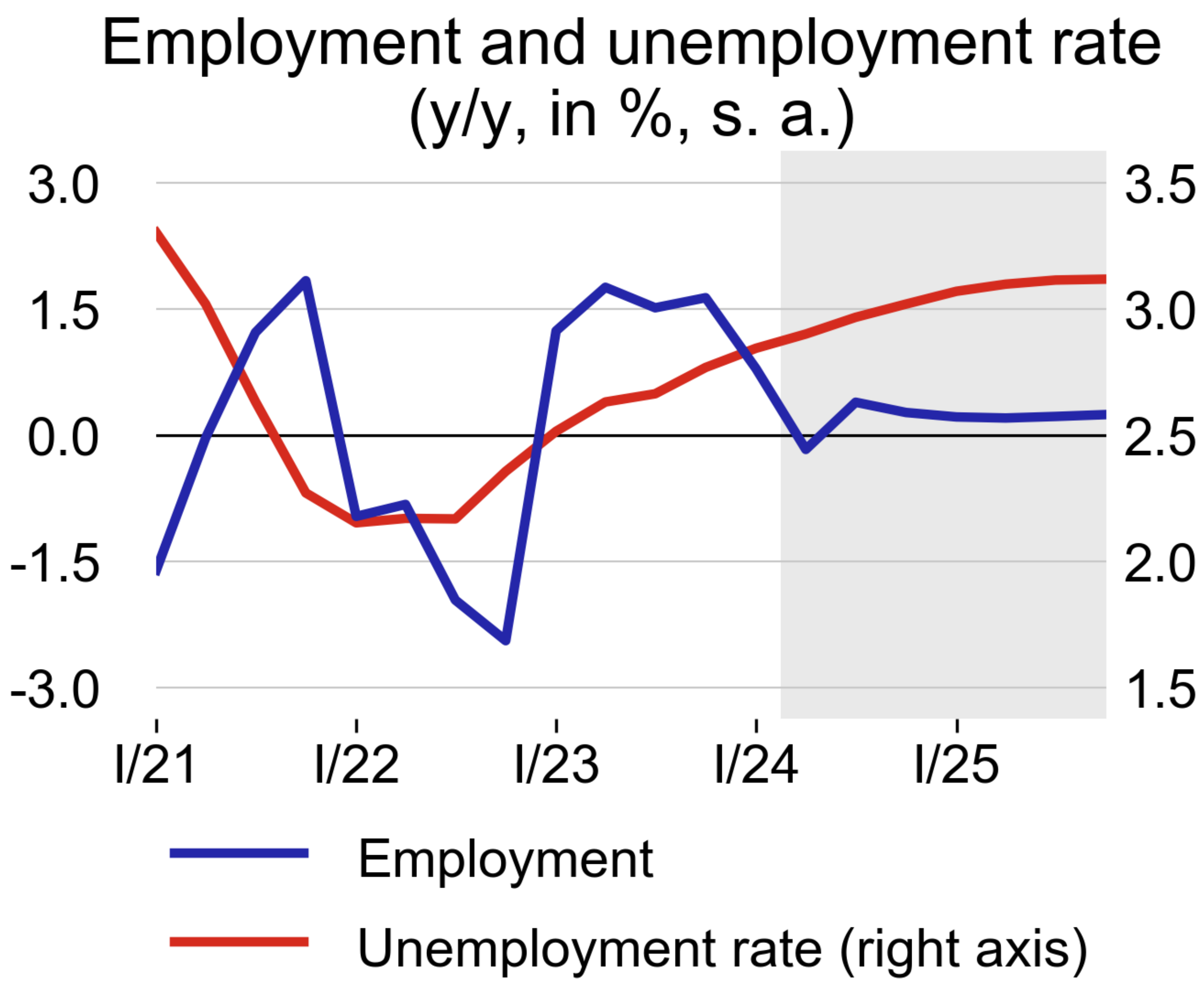


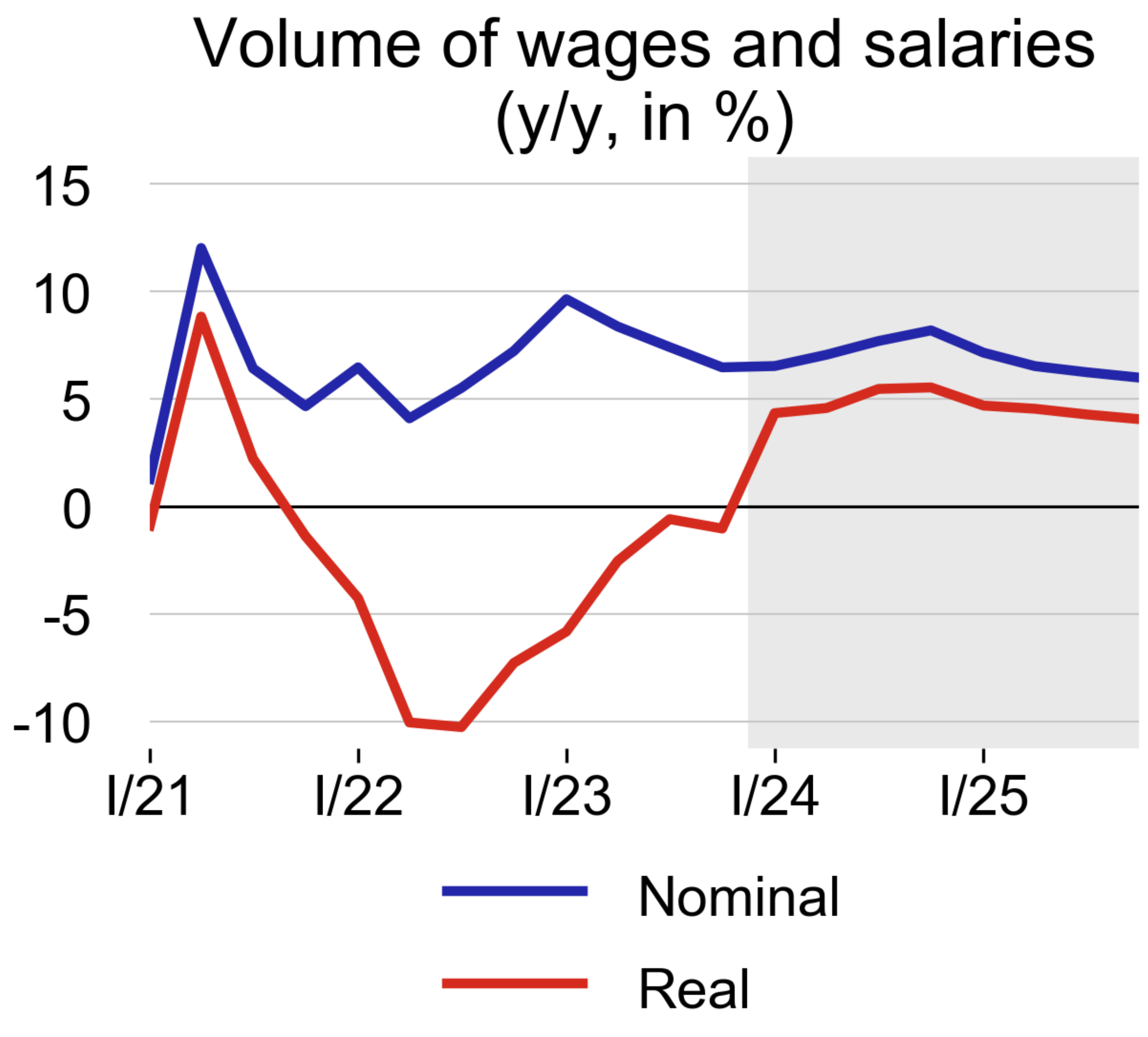
- **Market price growth** over the past two years has been driven by rising costs for firms, as well as a significant price **surcharge**, which has gone well beyond the corresponding increase in **costs**.
  - At the beginning of this year, the contribution of the surcharge to costs started to turn negative. Despite continued elevated cost growth, retailers re-priced only to a limited extent due to weak demand and thus squeezed their mark-ups.
  - On the outlook, the surcharge to costs remains negative and costs will continue to contribute slightly positively.
- The temporarily slightly elevated **overall cost pressures** will decline in mid-2024, aided by renewed appreciation of the **koruna**.
- The **domestic cost pressures** will ease gradually over the outlook as quarter-on-quarter **growth in market wages** decreases.

Labour Market



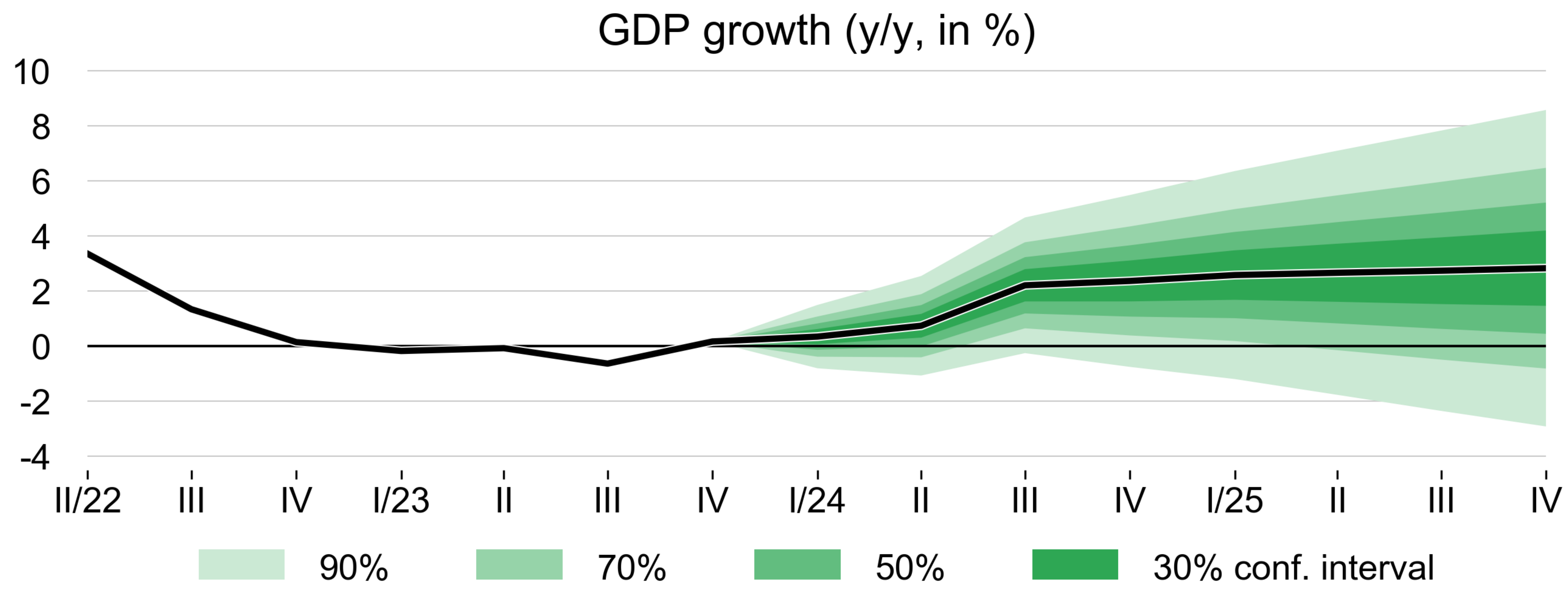


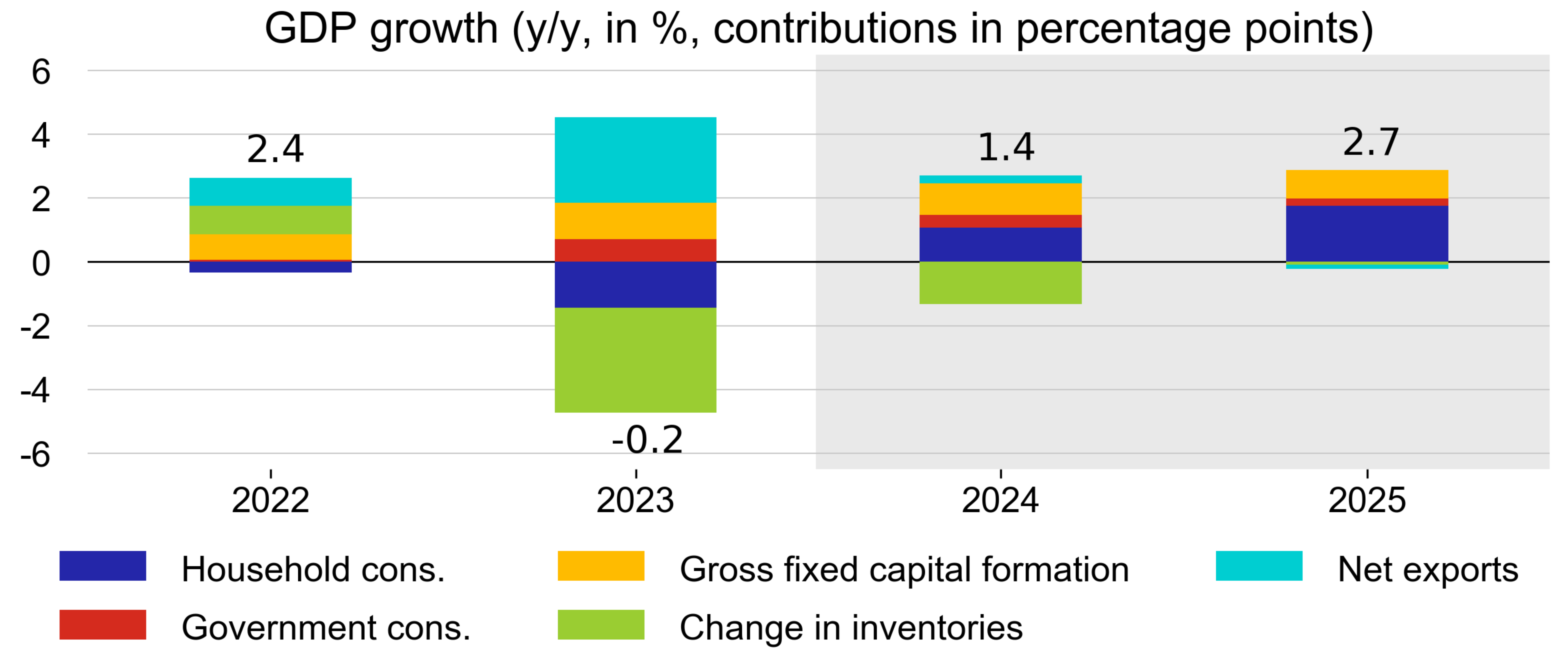




- From the perspective of the **LUCI**, the tightness in the labour market will decrease further.
- **Nominal wage growth** will remain elevated from the long-term perspective.
- **Employment** will be broadly flat due to prevailing caution in corporate recruitment, while **unemployment** will grow only very slightly.
- The **real wage** has started to growth again (in year-on-year terms) this year after more than two years of decline and will continue to rise throughout the year, due mainly to a significant slowdown in inflation to close to the 2% target amid continued, solid nominal wage growth.
- Growth in the **real wage bill** will thus help household consumption to recover.

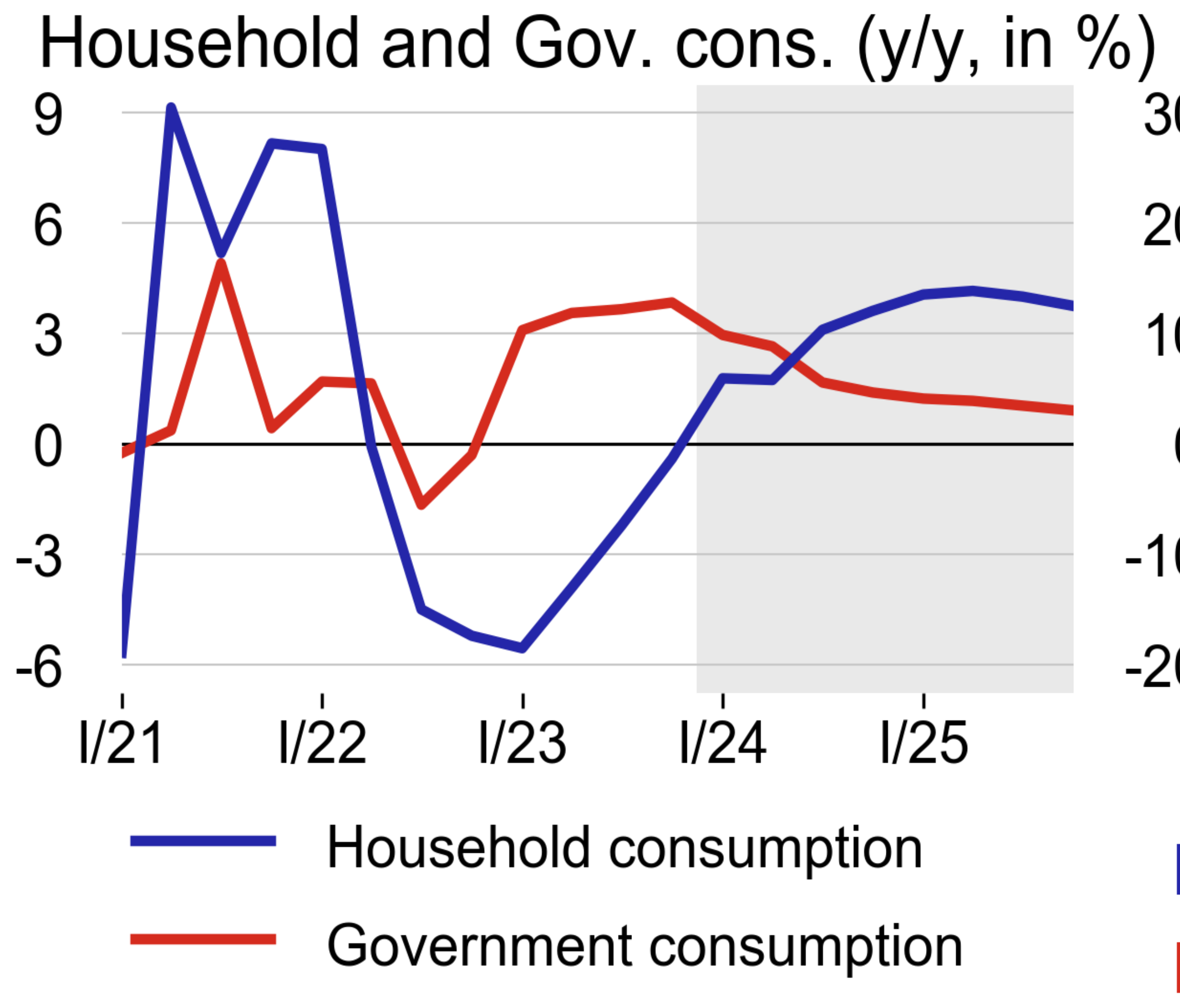
GDP Growth Forecast

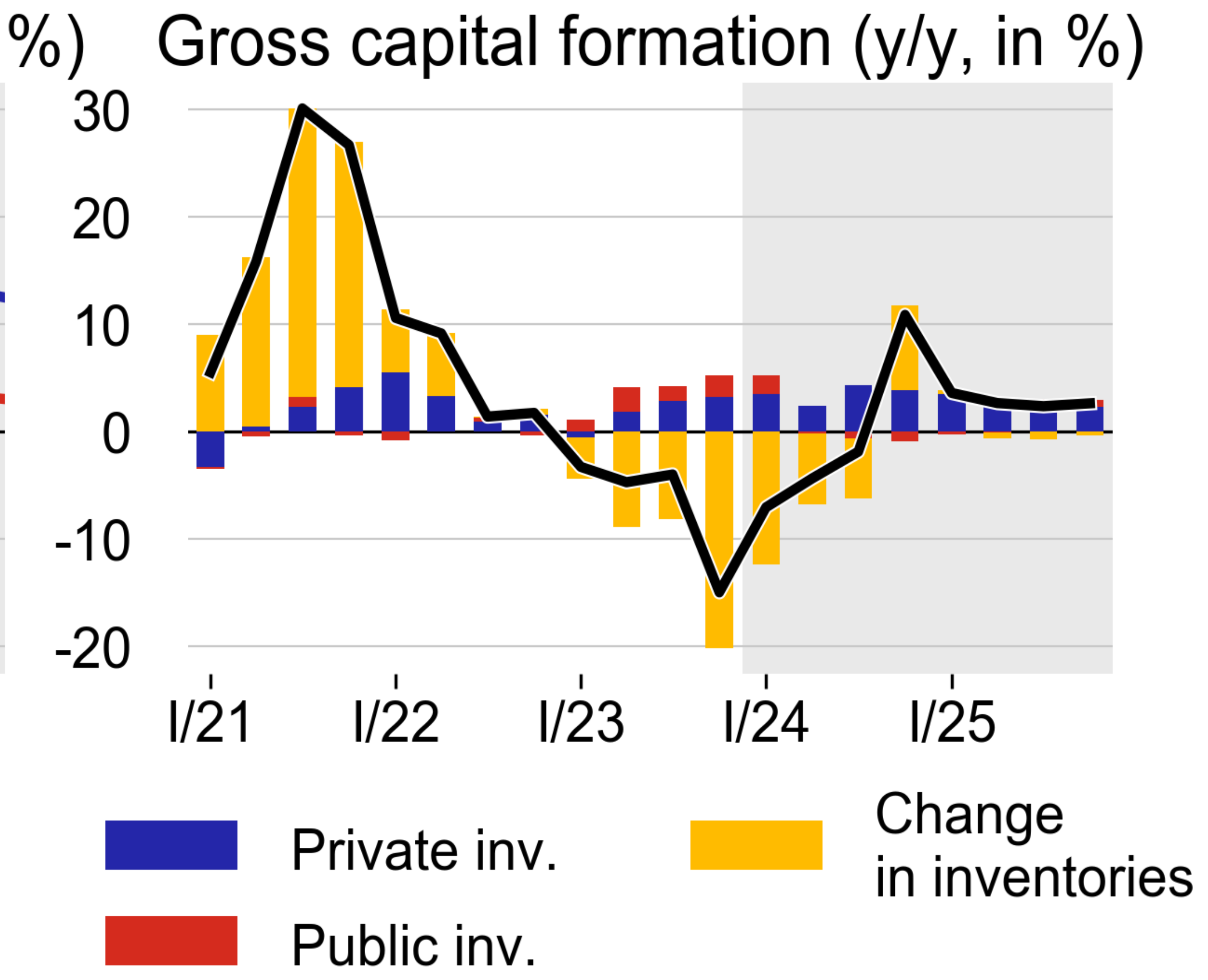


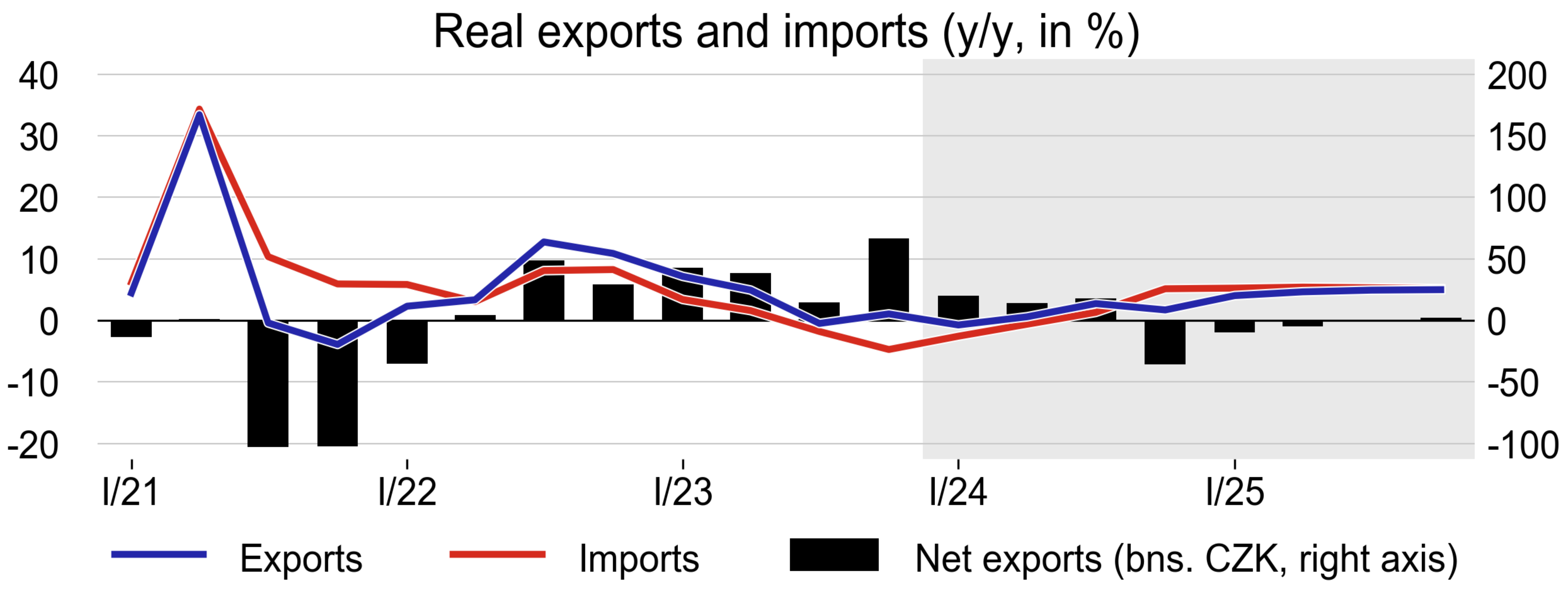


- **Economic growth** will resume this year and pick up further next year.
- In whole-year terms, **GDP** will grow by **1.4%**. In 2025, the growth will pick up to **2.7%**.
- According to a preliminary CZSO estimate, the Czech GDP increased by 0.5% quarter-on-quarter and by 0.4% year-on-year in 2024 Q1. This is broadly in line with the CNB forecast.

GDP Components

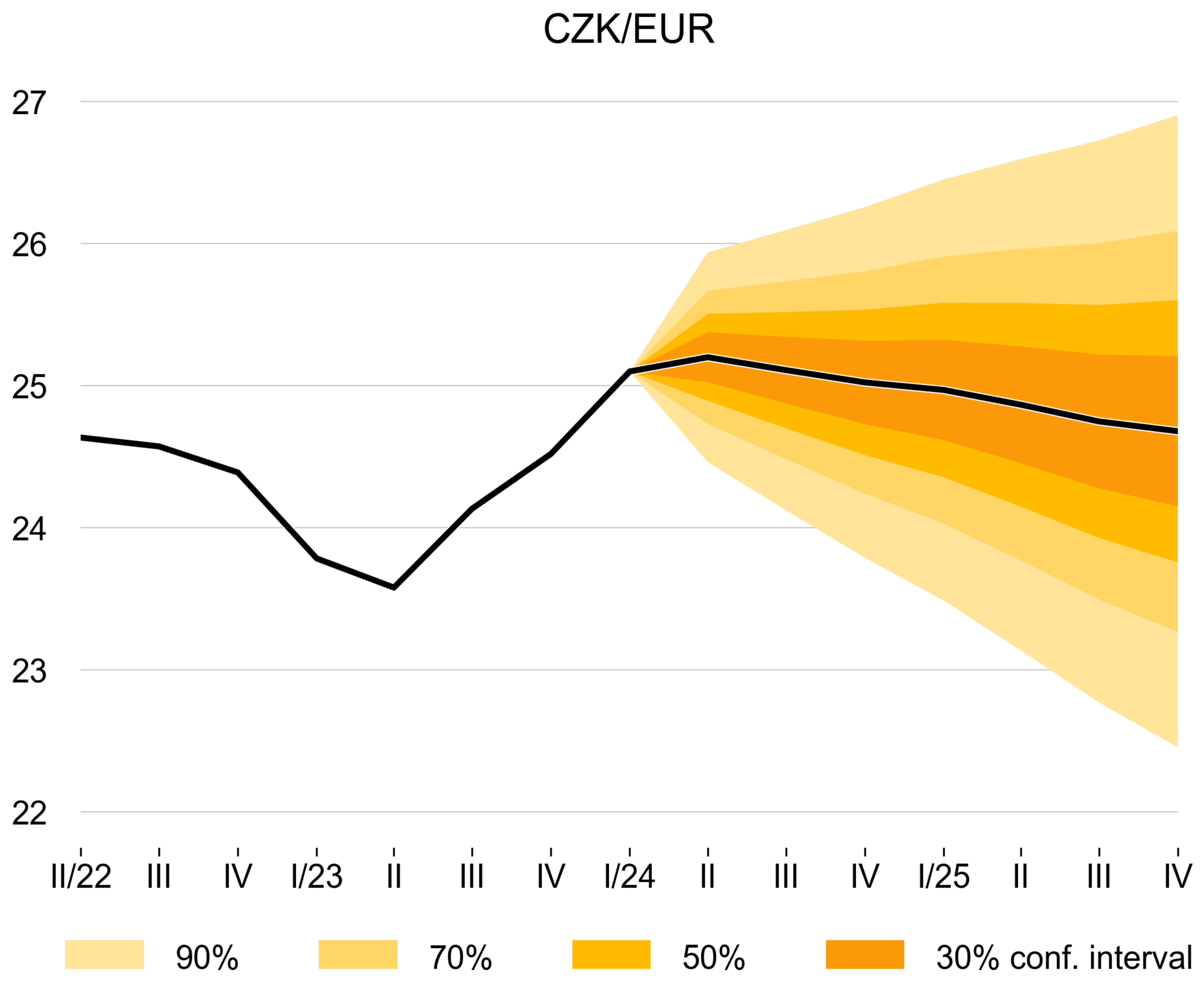






- Growth in **household consumption** will recover rapidly on the back of swiftly rising real wages.
- **Government consumption** will grow at a subdued pace.
- Growth in **total gross capital formation** will still be negatively affected by **inventories** for most of 2024, while **private fixed investment** will grow.
- **Export** and **import** growth will bottom out this year and growth in foreign trade turnover will accelerate gradually as external and domestic demand recovers (except for 2024 Q4 due to the increased benchmark quarter from previous year).

Exchange Rate CZK/EUR



- The spring forecast expects the koruna to average **CZK 25.2** to the euro in 2024 Q2.
- The Czech currency will then appreciate slightly, due mainly to favourable **net exports** of goods and services.
- The appreciation of the koruna will be dampened by a gradually narrowing **interest rate differential** vis-à-vis the euro area, which will close at the end of next year.

Interest Rate Path (3M PRIBOR)

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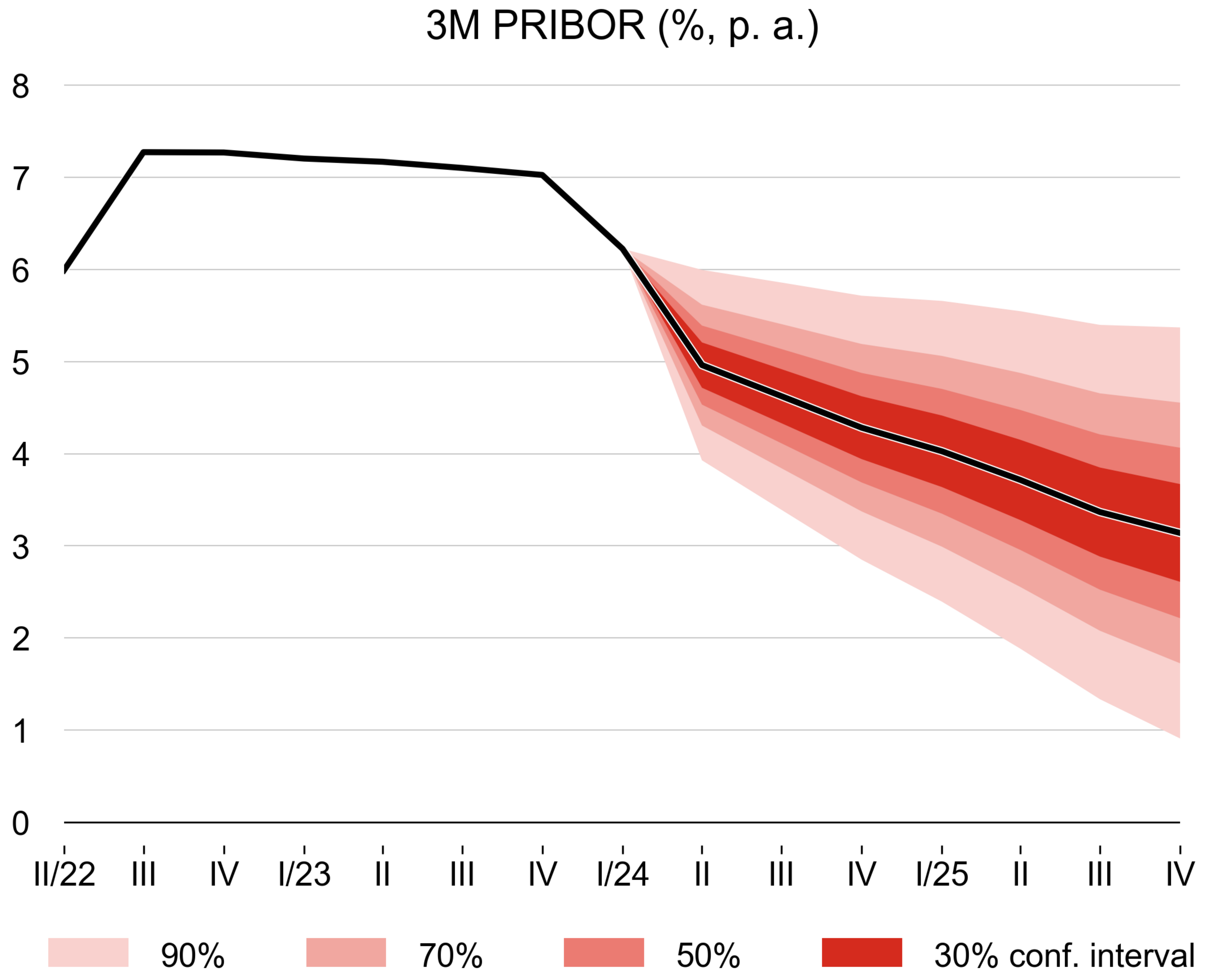

- Consistent with the baseline scenario of the forecast is a further decline in **market interest rates**.
- Interest rates are close to the **policy-neutral level** at the end of 2025.
- This is due to the fade-out of the extraordinary inflation pressures from the foreign environment and to subdued domestic demand-pull inflation.
- Although growth in costs will still be elevated in the first half of 2024, this will not reverse the need to ease monetary policy, as the inflationary effect of the growth in costs will be offset by a decline in firms' profit margins, which will dampen growth in prices.

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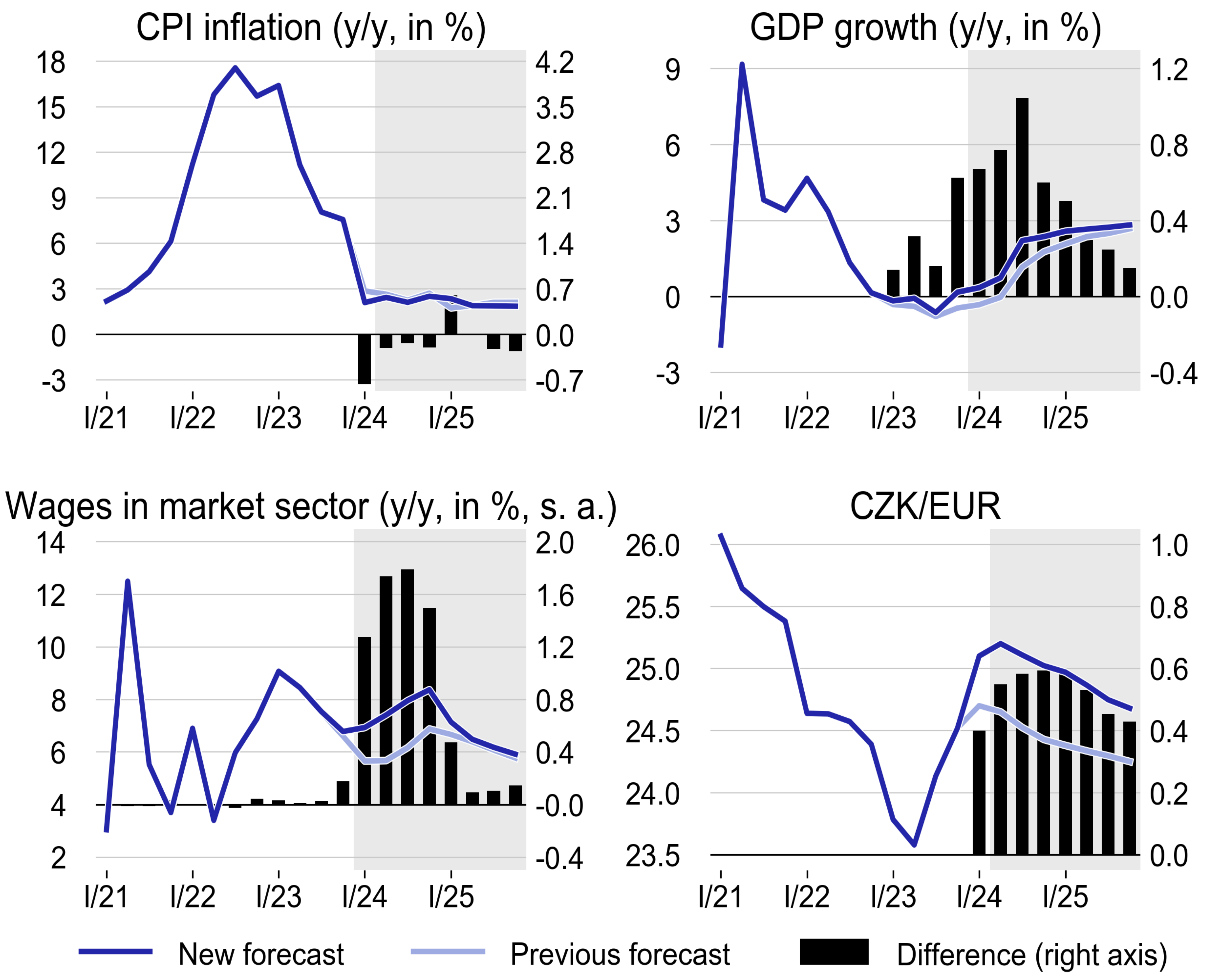
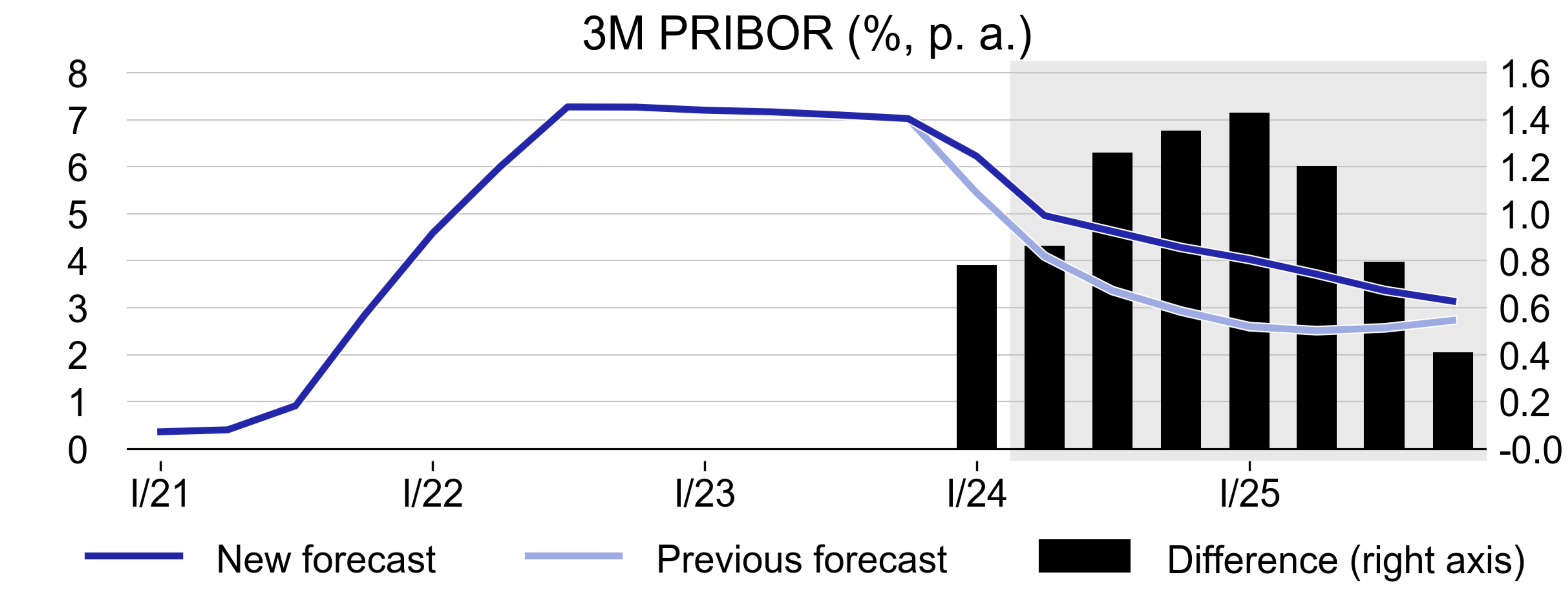
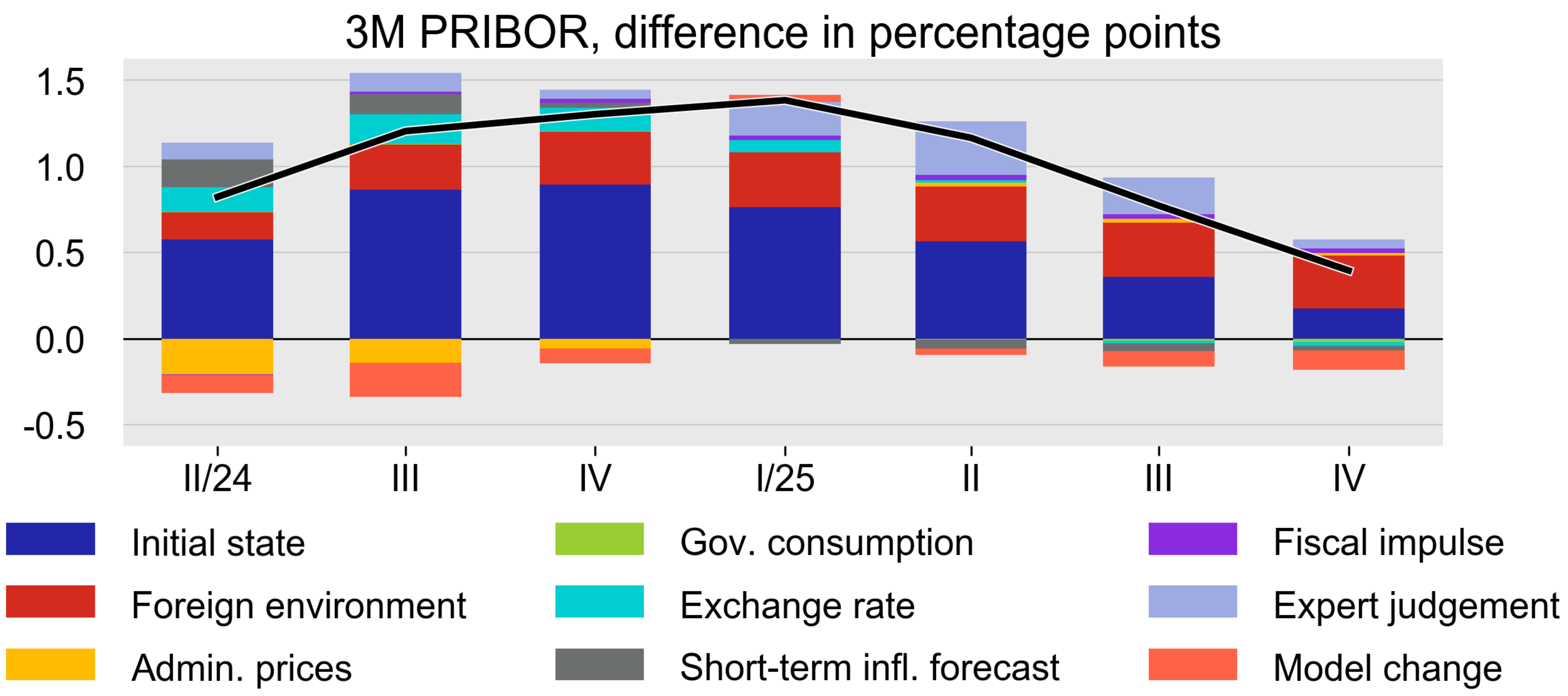
Comparison with the Previous Forecast: Domestic Economy



- The **inflation** forecast for this year has shifted downwards owing to a lower outlook for administered prices and core inflation.
- The **GDP outlook** is higher over the entire forecast horizon due to stronger domestic demand than in the previous forecast.
- The higher expected **wage growth** reflects faster expected wage growth at the start of this year and higher economic activity than in the previous forecast.
- The **short-term exchange rate forecast** mainly reflects the **observed levels**, which shift it to a weaker initial level than in the previous forecast.
  - This in turn reflects a change in financial market expectations regarding the prudent approach of global central banks to reducing interest rates.
  - The koruna will appreciate over the outlook horizon at a broadly similar pace as in the previous forecast.

Comparison with the Previous Forecast: 3M PRIBOR





- The **initial state** fosters distinctly higher rates due to higher expected quarterly wage growth and faster GDP growth at the start of 2024. The weaker observed koruna exchange rate has the same effect.
- The positive contribution of the **foreign environment** mainly reflects an increased market outlook for ECB interest rates.
- **Expert adjustments** foster slightly higher rates. This is due mainly to adjustments that accelerate the growth of household consumption owing to a relatively rapid improvement in sentiment and a downscaling of the previous expert adjustments to the koruna exchange rate.
- The **model change** reflects the switch to the updated g3+ core forecasting model.

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Sensitivity scenario of a temporarily different exchange rate path

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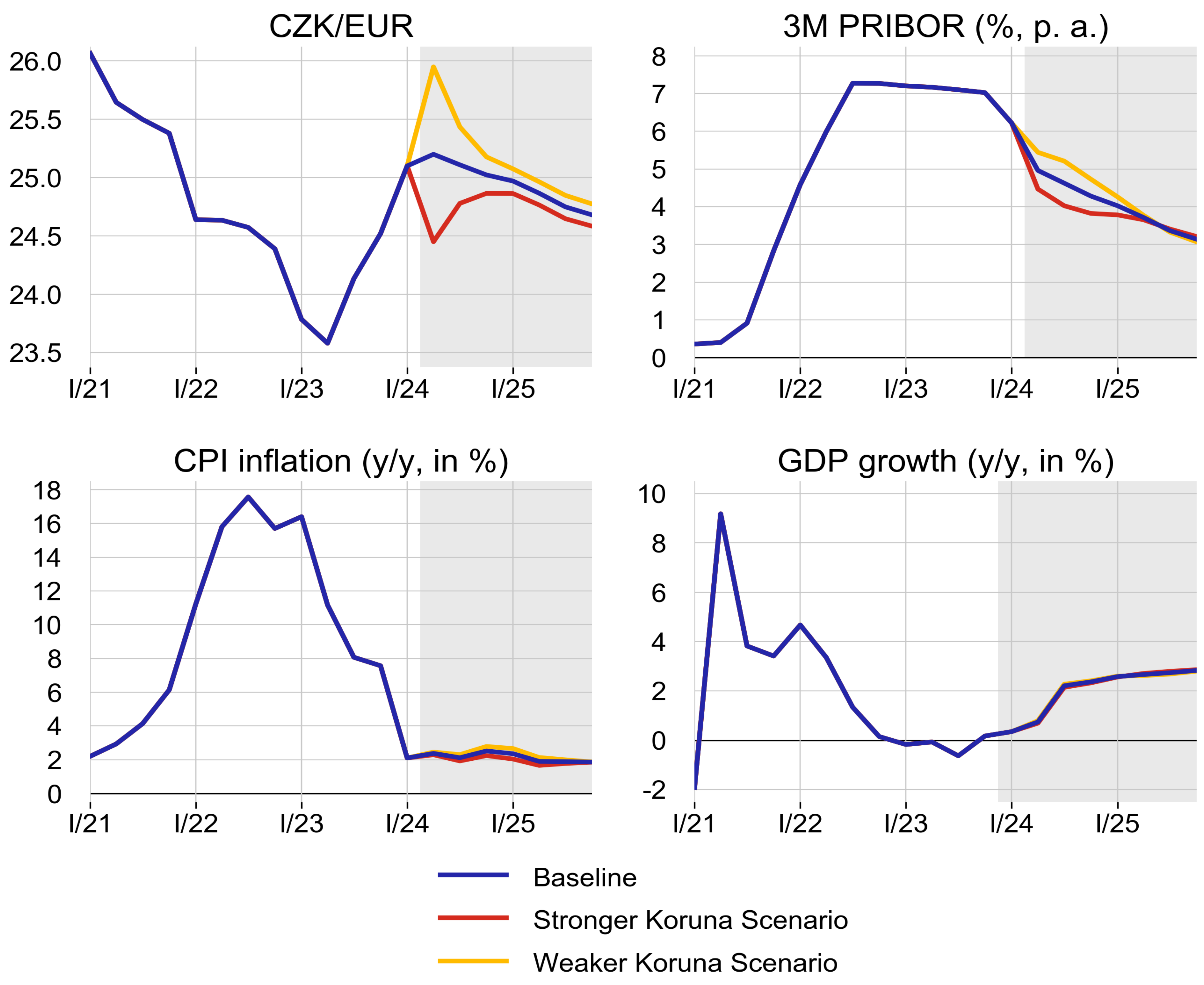
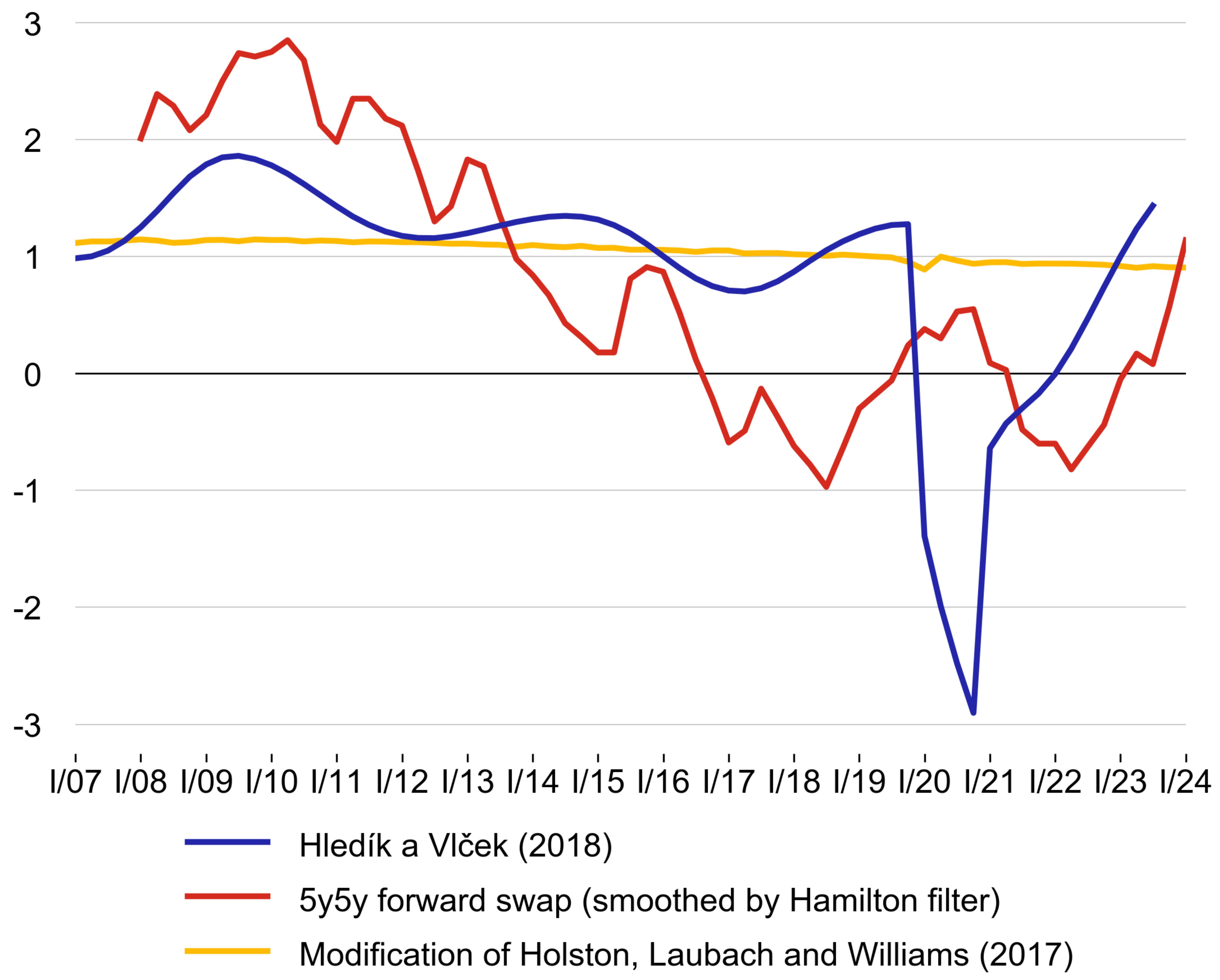


- This symmetric scenario shows the effects of a hypothetical situation where the **exchange rate temporarily deviates by ±3%** (75 hellers) from its baseline scenario level in 2024 Q2.
- If the **koruna** is **stronger** (**weaker**), the central bank responds to the **weaker** (**stronger**) inflation pressures with **lower** (**higher**) **interest rates** compared to the baseline scenario.
- The **interest rate** path differs the most in 2024 Q3, when interest rates are about 50 basis points **lower** (**higher**).
- Interest rates affect the economy later than the exchange rate, the central bank does not fully suppress the **lower** (**higher**) inflation pressures. **Inflation** is thus 0.3 pp **lower** (**higher**) than in the baseline scenario in late 2024 and early 2025.

Estimates of the natural rate of interest (r*)

Estimates of the natural rate of interest for the Czech economy (%, p. a.)



- An international debate has recently been going on about **whether the r* has increased.**
- Effects influencing the balance between savings and investments were mentioned (the green transformation, higher climate risks, digitalisation and AI, as well as higher defence spending). Higher government spending and a rise in public debt creates increased demand for funds and can push the r* up.
- Partial deglobalisation also affects the potentially higher r*. The population ageing can act in both directions.
- **The r* in the Czech R.** may have increased by higher fiscal deficits, higher riskiness, slower real convergence and appreciation of REReq, and spillover of higher r* from abroad.
- **Three estimation methods** were used to assess the possible size of the shift in r*.
- Their results do not call into question the **current level of 1%**.

Estimates of the natural rate of interest

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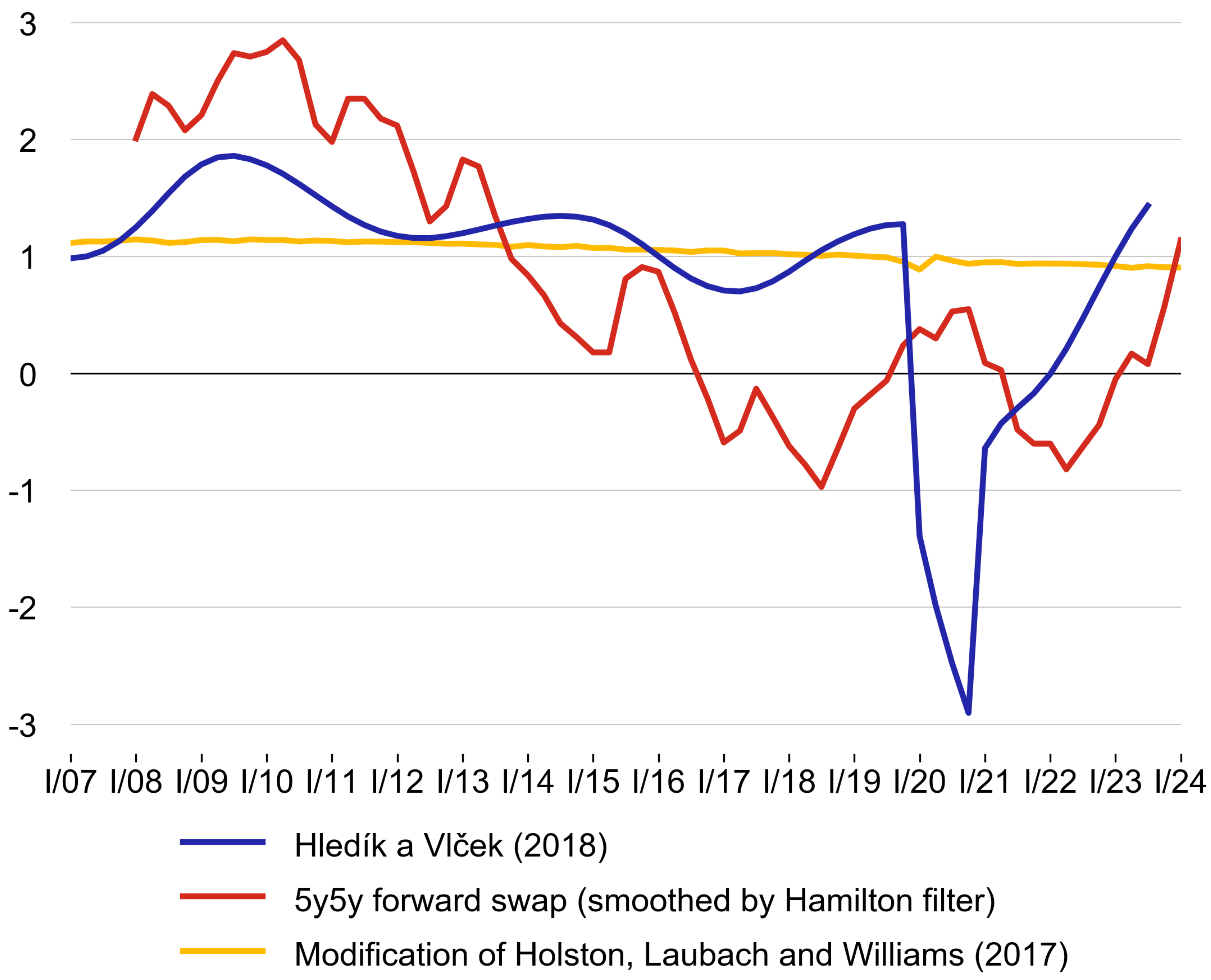
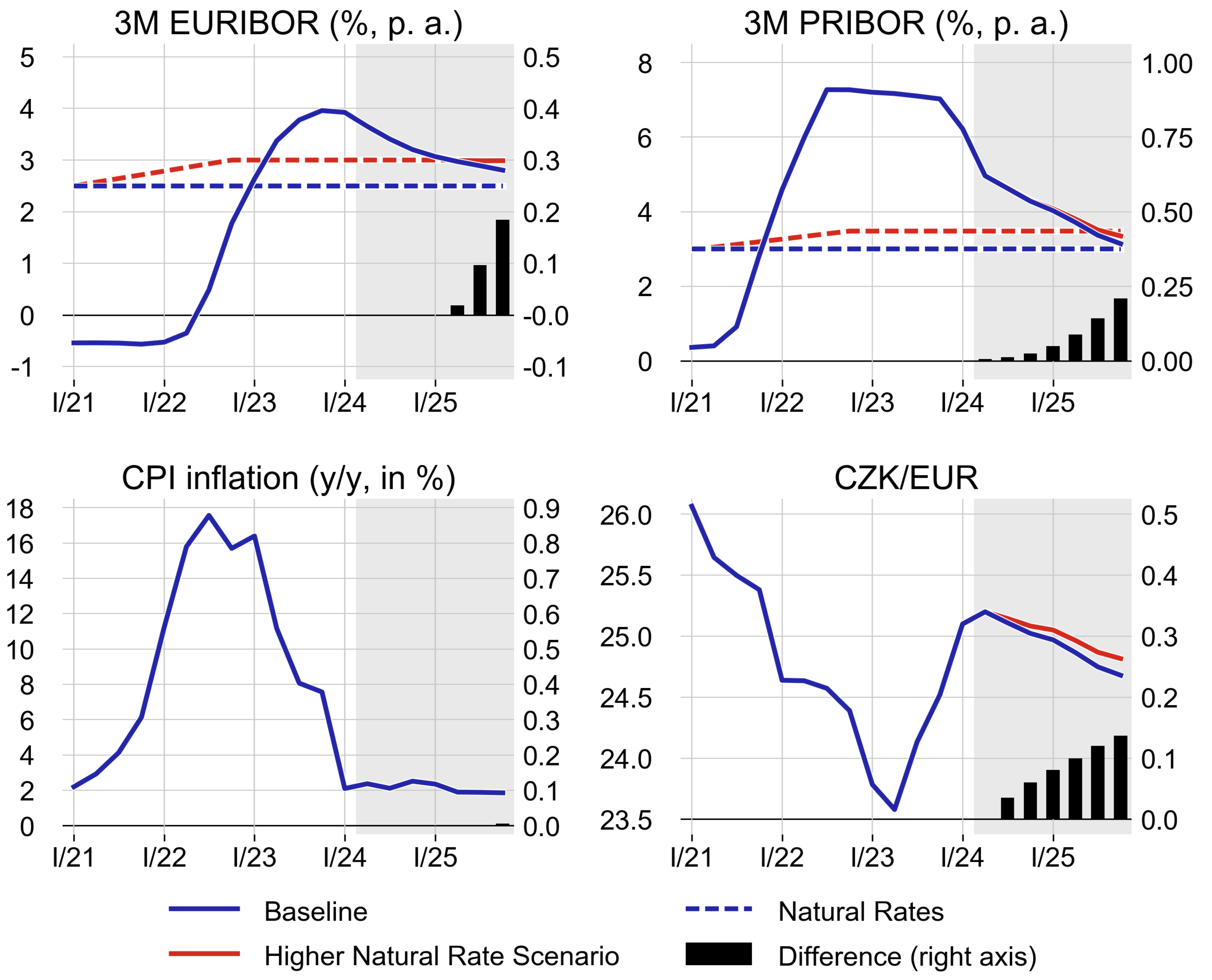


- An estimate based on **a structural model of a small open economy:**
  - after the period disrupted by pandemic shocks, there was a gradual increase in the natural rate of interest slightly above the level assumed in the baseline scenario of the forecast.
- Another method is the **filtration of long-term interest rates** (the 5Y5Y interest rate swap):
  - very low for a long time; it has been heading towards 1% only in recent years, and it is now heading slightly above that level.
- The **third estimate:**
  - based on the Federal Reserve's approach, which is modified for a small open economy like the Czech Republic; it has recently shown a downward tendency.

Scenario of a higher natural rate of interest (r*)



- Assumptions:
  - a gradual increase in the **foreign monetary policy-neutral nominal interest rate** of the ECB in 2021 and 2022 by 0.5 pp to 3%;
  - a parallel rise in the **domestic monetary policy-neutral nominal interest rate** from 3% to 3.5%.
- In this scenario, **foreign interest rates** in 2025 and 2026 stop declining at the **new neutral level** of 3%. **Domestic interest rates** are maintained at a slightly higher level than in the baseline scenario.
- In this scenario, the outlook for the achievement of the **inflation target** in the future means that interest rates will fall slightly below the neutral level of 3.5% at the end of 2025. This, along with the expected evolution of foreign interest rates fosters a slightly **weaker koruna** with no visible impact on **inflation** at the forecast horizon.

Thank you for your attention

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Spring 2024 Forecast – Summary

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- **Inflation** will be close to the CNB's 2% target over the entire outlook, including the monetary policy horizon.
- **Domestic demand** will recover this year. It will be driven by renewed growth in **household consumption**, supported above all by rapid growth in **real income**. By contrast, the consolidation package will reduce the ability to spend.
- **Nominal wage growth** will remain elevated from the long-term perspective.
- **Real household income** started to grow again in year-on-year terms at the start of this year; its previous falls will be offset only partially.
- Consistent with the spring forecast is a further decline in **market interest rates.**

	2023	2024	2025
Headline inflation (%)	**10.7**	**2.3**	**2.0**
	(0.0)	(-0.3)	(0.0)
GDP	**-0.2**	**1.4**	**2.7**
	(0.3)	(0.8)	(0.3)
Average nominal wage	**7.5**	**7.2**	**6.1**
	(0.1)	(1.4)	(0.3)
3M PRIBOR (%)	**7.1**	**5.0**	**3.6**
	(0.0)	(1.1)	(1.0)
Exchange rate (CZK/EUR)	**24.0**	**25.1**	**24.8**
	(0.0)	(0.5)	(0.5)