CZECH NATIONAL BANK

The CNB's Forecast (Monetary Policy Report Winter 2024 – update)

Karina Kubelková, Luboš Komárek
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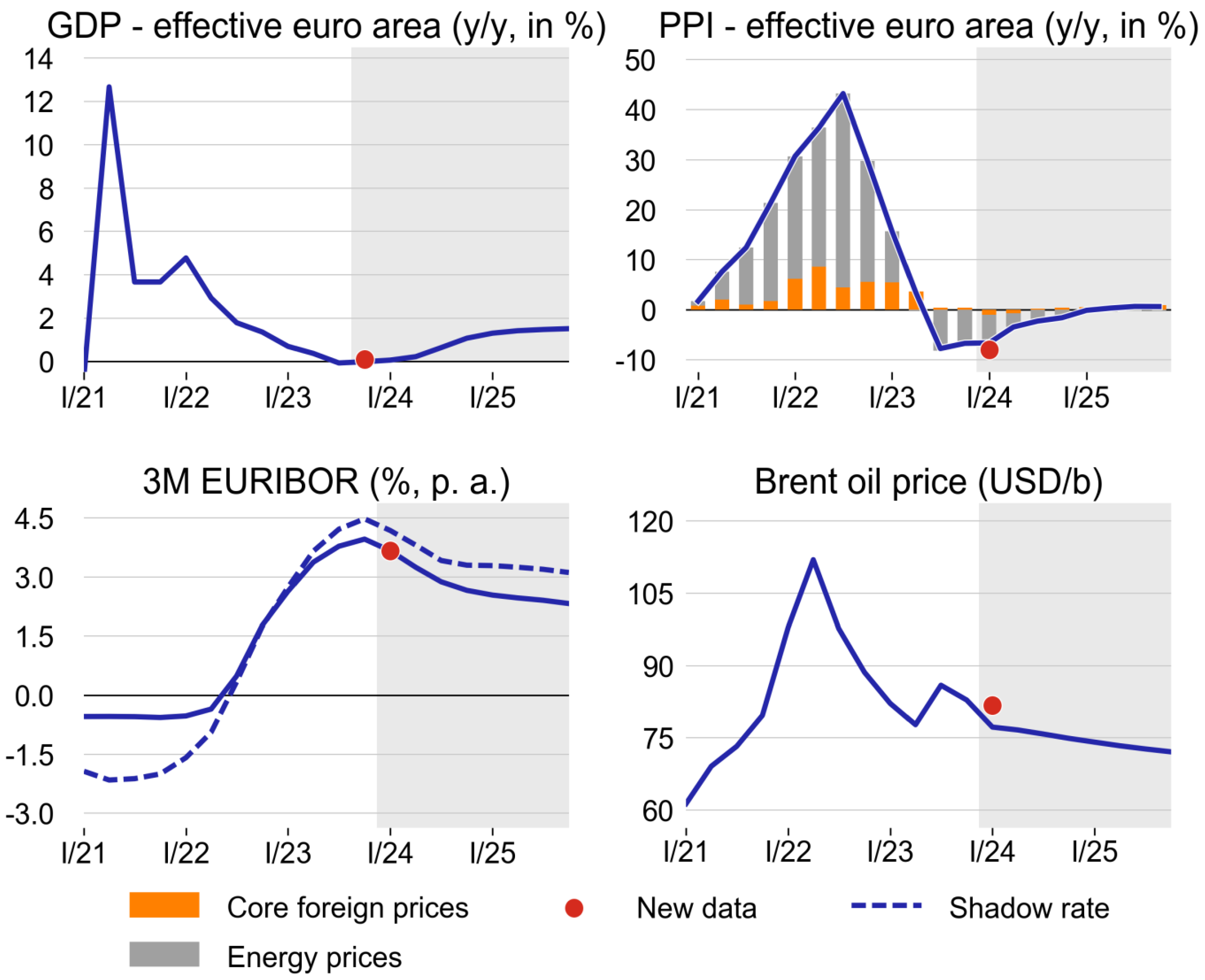
Presentation Outline

1. **Assumptions of the Forecast**

2. Winter 2024 Macroeconomic Forecast

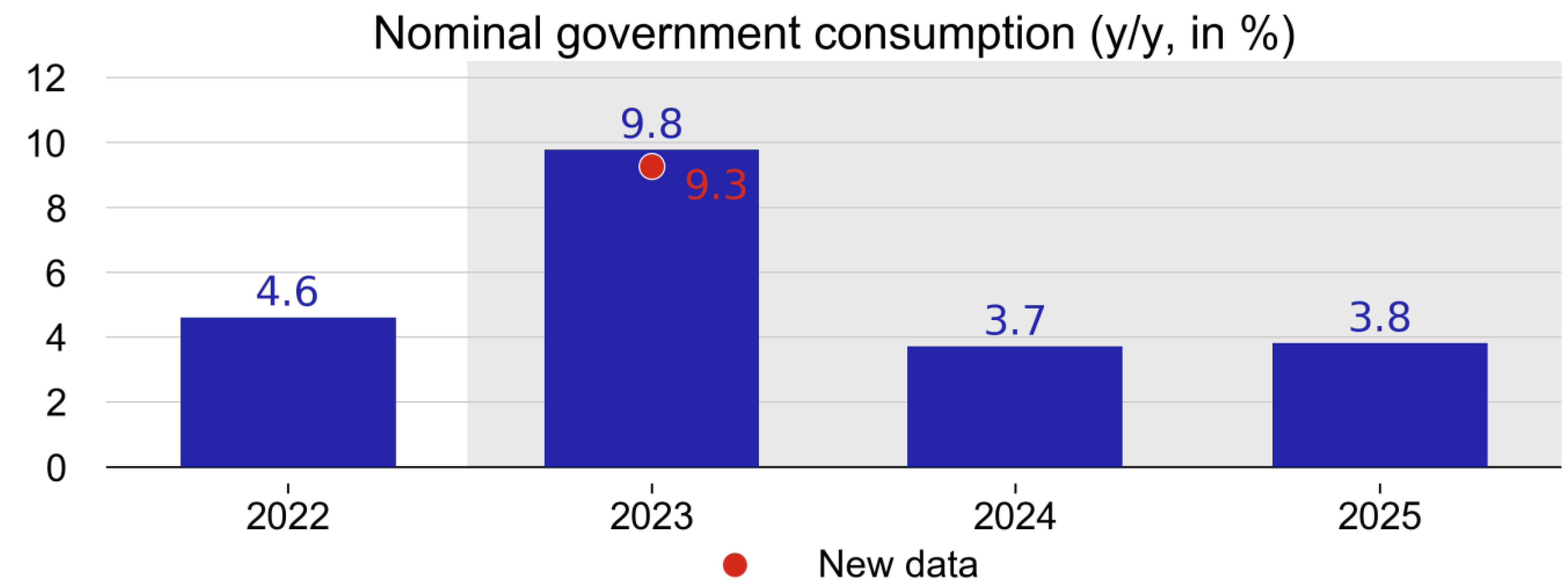
3. The Updated g3+ Core Forecasting Model and the Shadow Forecast

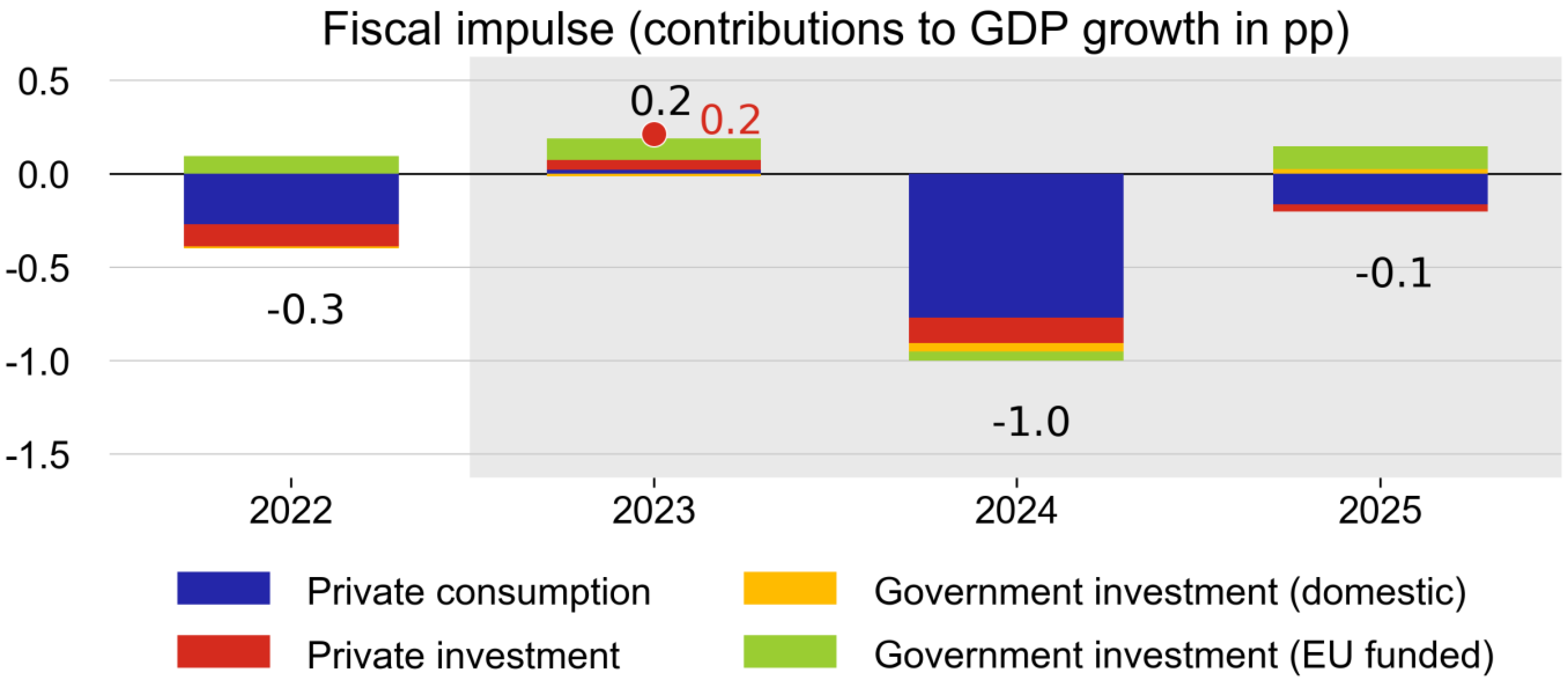
Foreign Environment Outlook



- The **effective euro area** economy will revive in the second half of this year on the back of improving global demand and consumer purchasing power, while monetary conditions will ease slightly.
- The year-on-year decline in **industrial producer prices** in the effective euro area will be driven by the energy component this year.
- According to the financial markets, the **3M EURIBOR** will go down this year, but the decline in the shadow rate will be held back by a falling rate of reinvestment.
- The outlook for the **Brent crude oil** price is slightly decreasing.

Fiscal Policy





- Growth in **nominal general government consumption** will slow due to the announced freeze of the public sector wage bill and cuts in operating expenditure related to the consolidation package.
- **Fiscal policy** will significantly dampen GDP growth this year, due mainly to the consolidation package.
- The **fiscal impulse** is expected to be -1 p.p. to GDP growth in 2024 and roughly neutral in 2025

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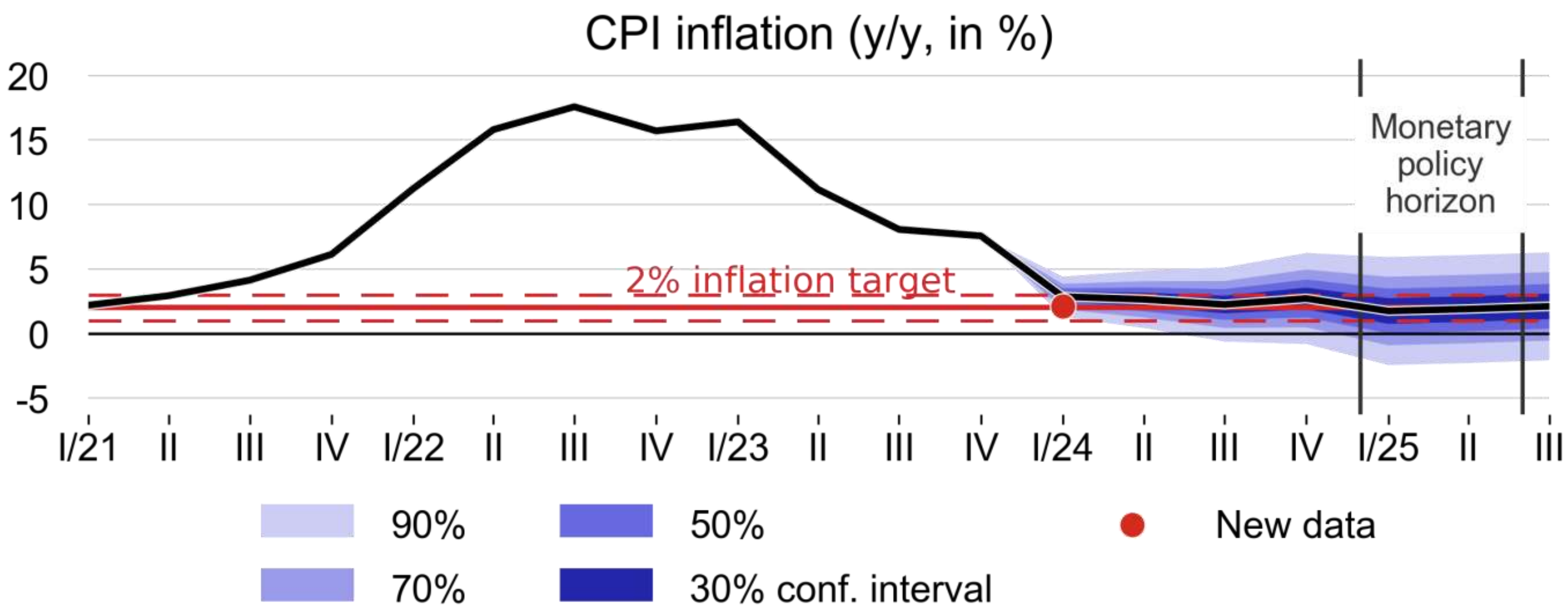
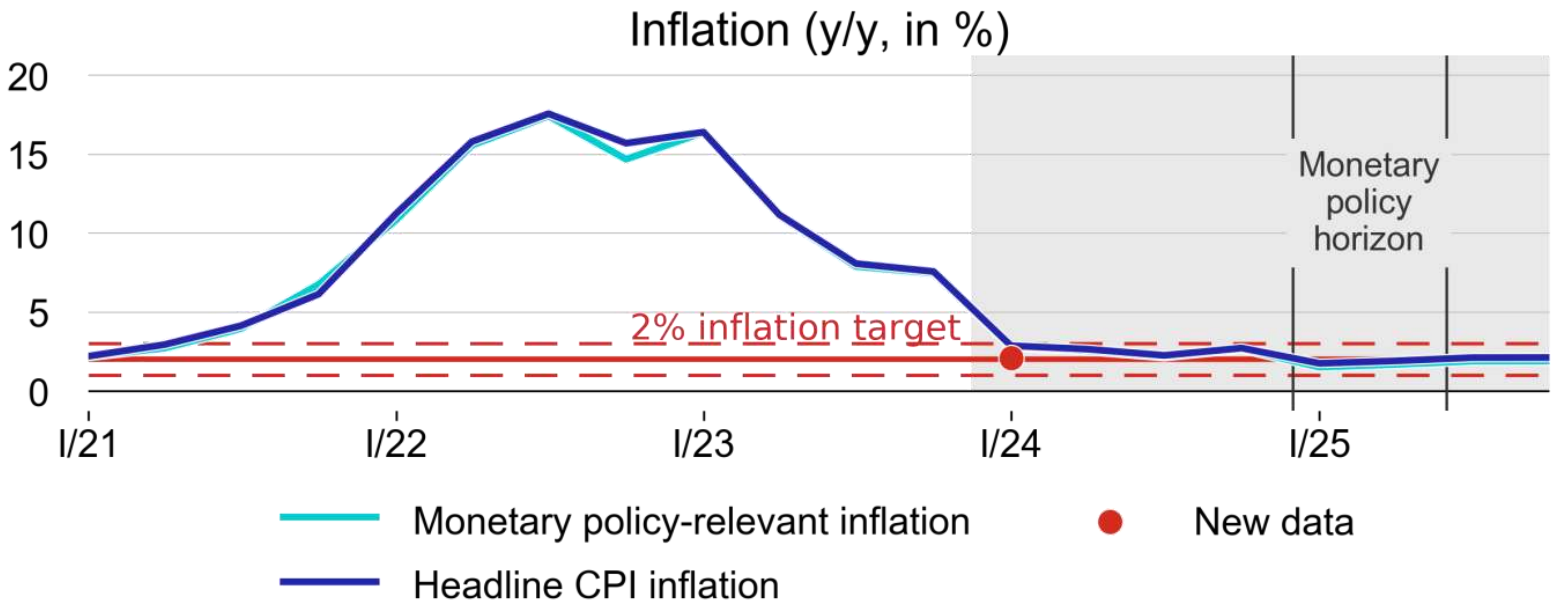
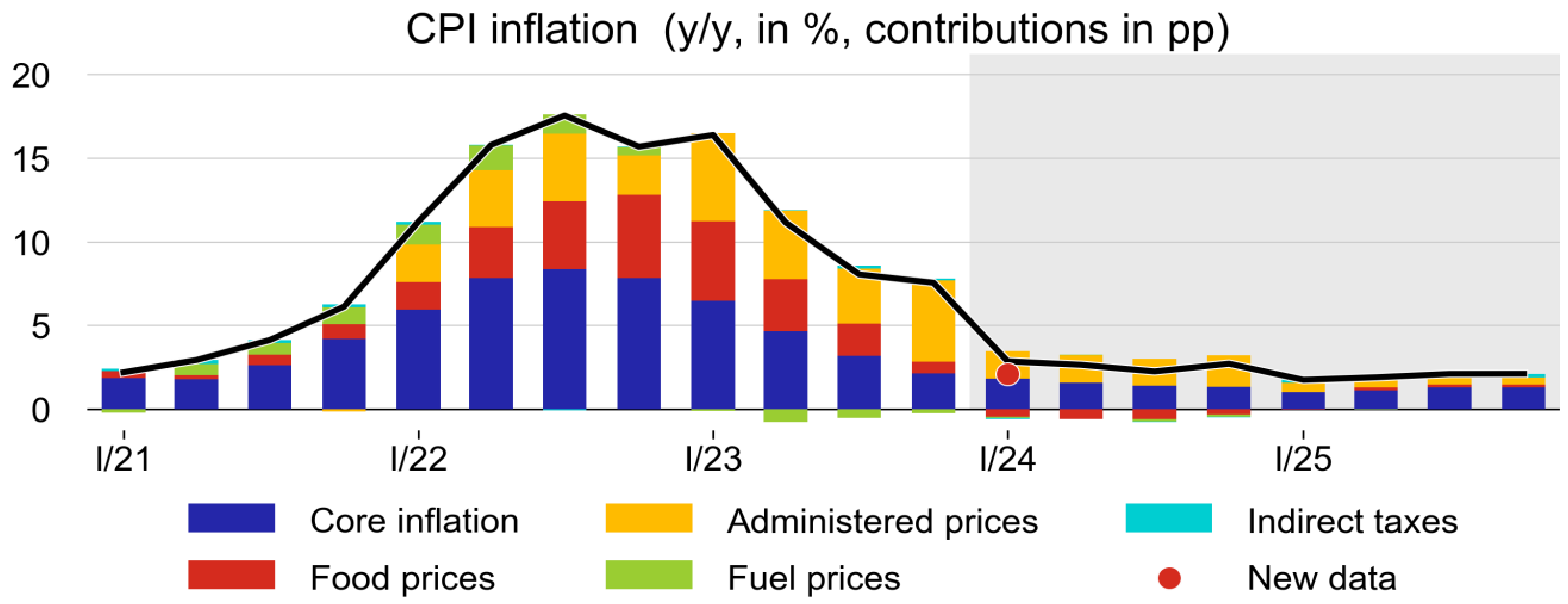
Headline and Monetary Policy-Relevant Inflation

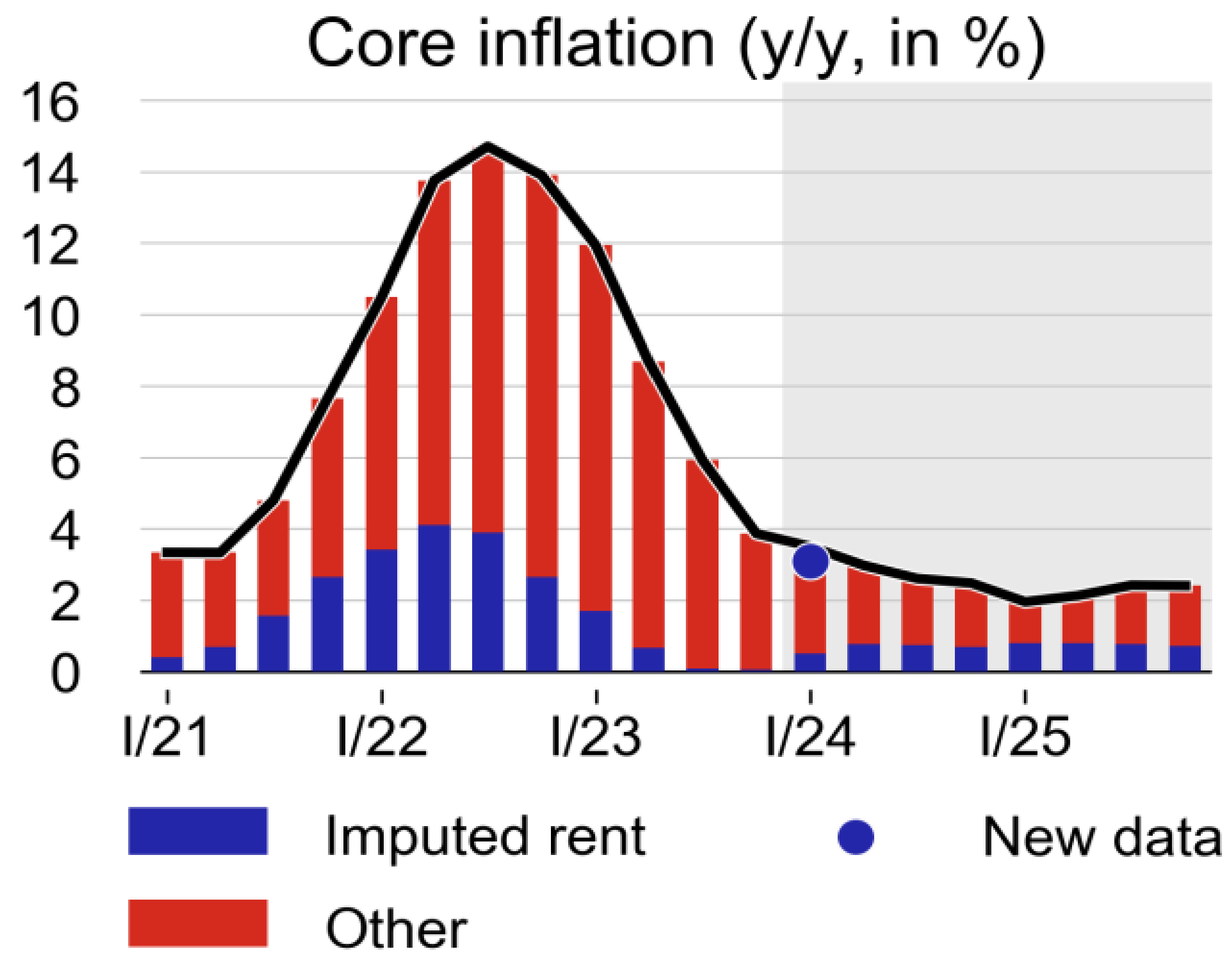


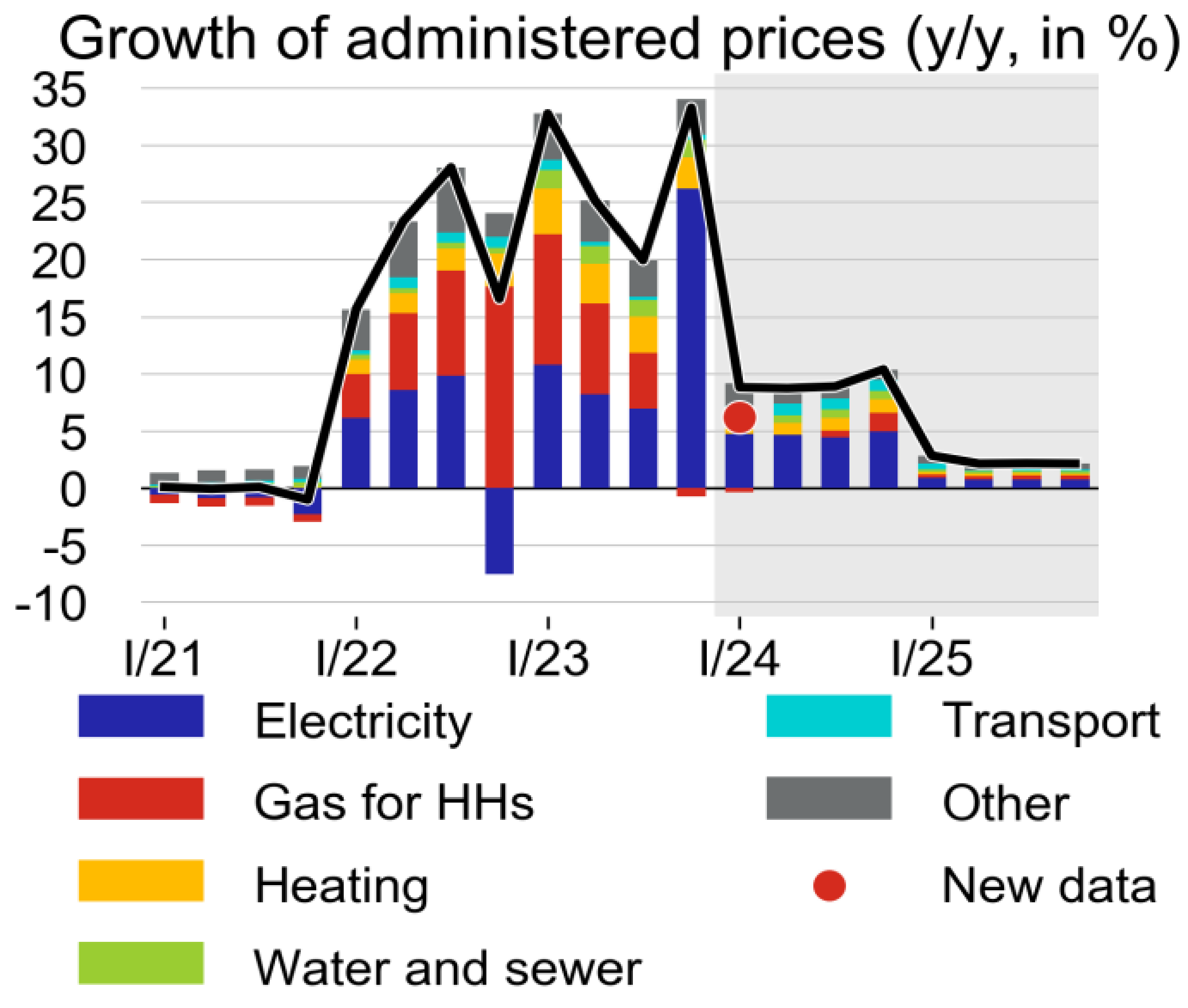


- **Inflation** will fall towards the upper boundary of the tolerance band at the start of this year.
  - The contribution of administered prices will decrease significantly, although their growth will remain somewhat elevated.
  - The contribution of market prices will also fall, due to subdued cost pressures from abroad and the rapid dissipation of the inflationary effects of the domestic economy.
  - The previous increase in the profit margins of domestic producers, retailers and service providers is undergoing a correction.
- Headline inflation will be slightly above **monetary policy-relevant inflation**.

CPI Inflation, Core Inflation and Administered Prices

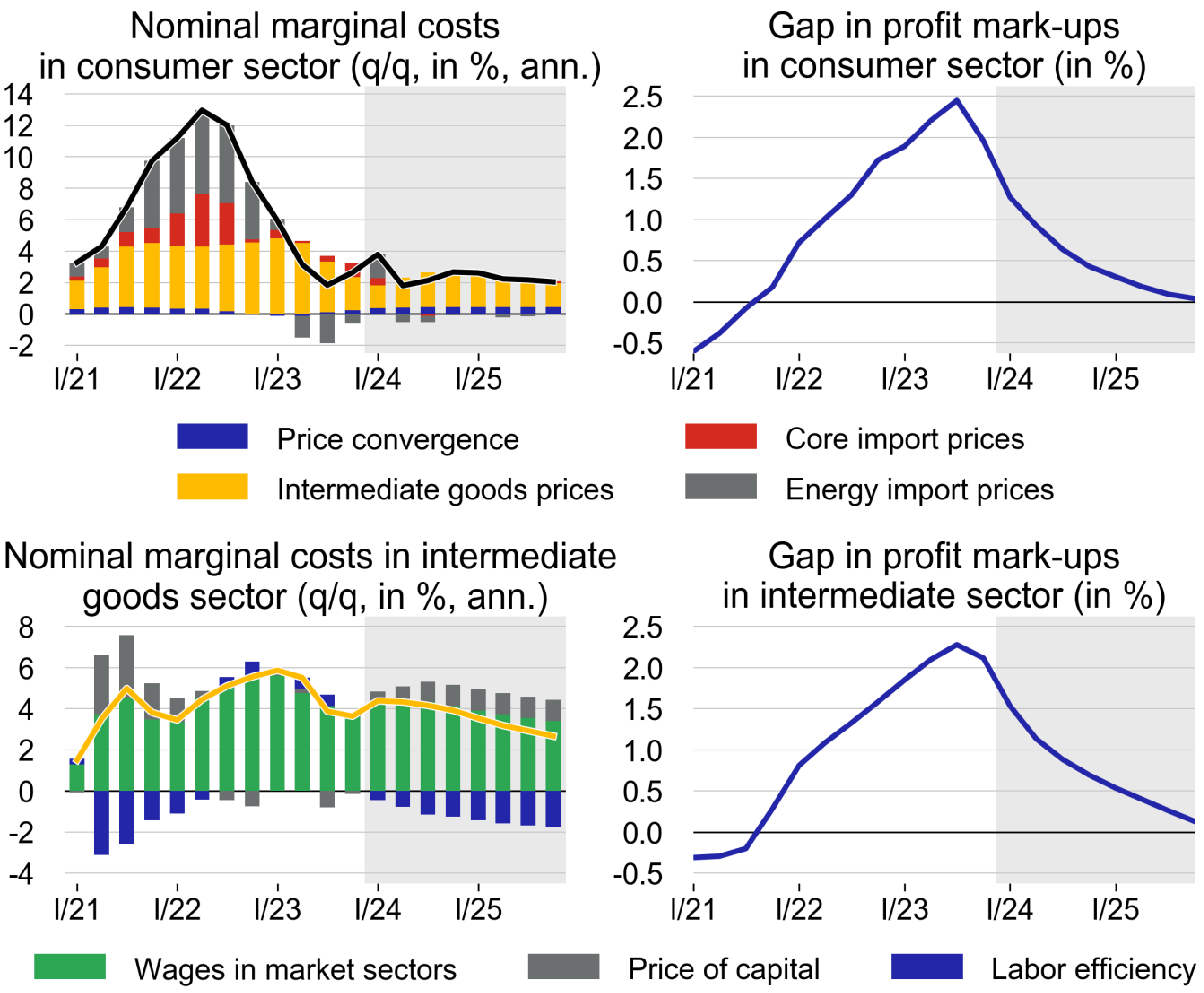






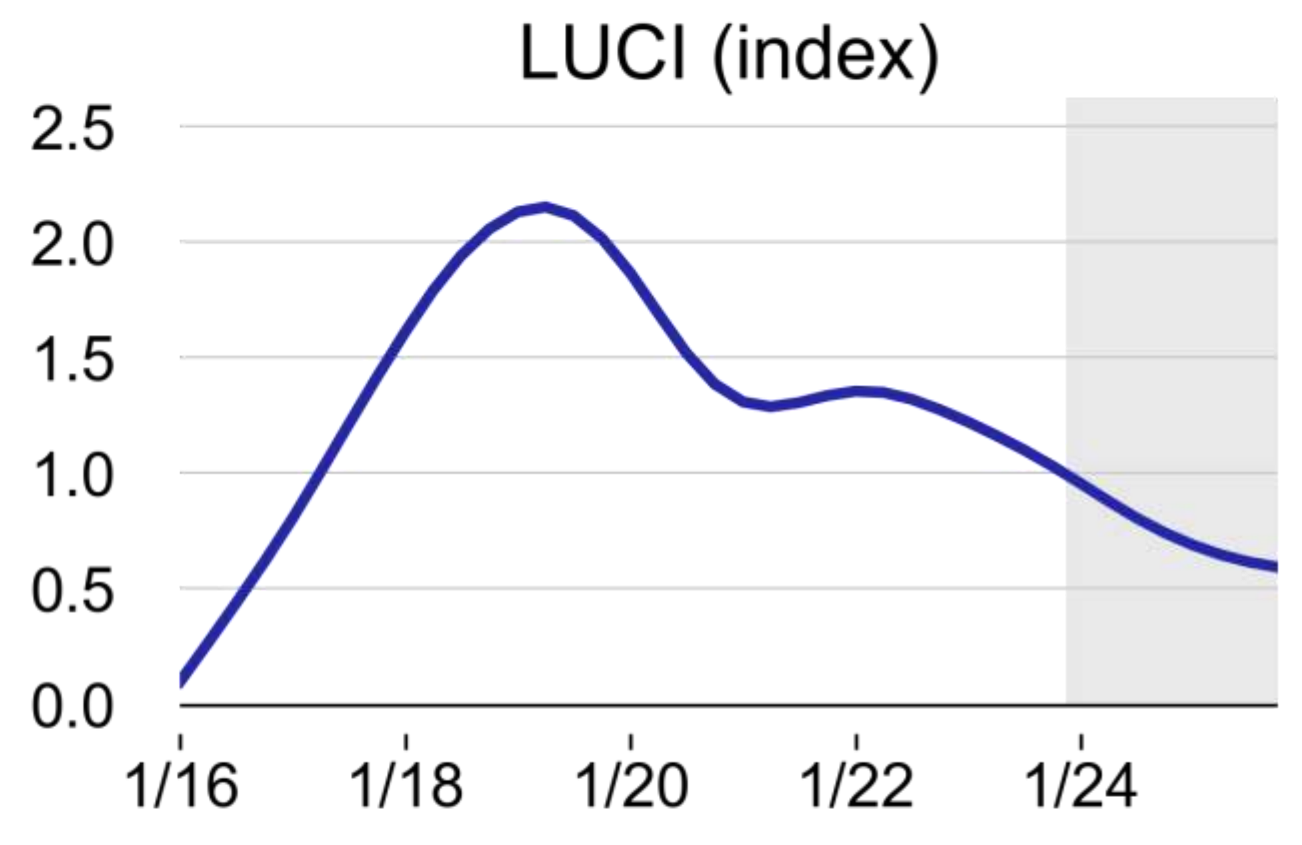
- **Consumer price inflation** will slow sharply at the start of this year, with most components contributing to the decline.
- **Core inflation** will continue to slow this year, due to fading inflation pressures. The currently low contribution of imputed rent will revive only partially.
- **Administered price inflation** will fall sharply at the start of 2024 as the base effect drops out, but will remain elevated from a longer-term perspective.

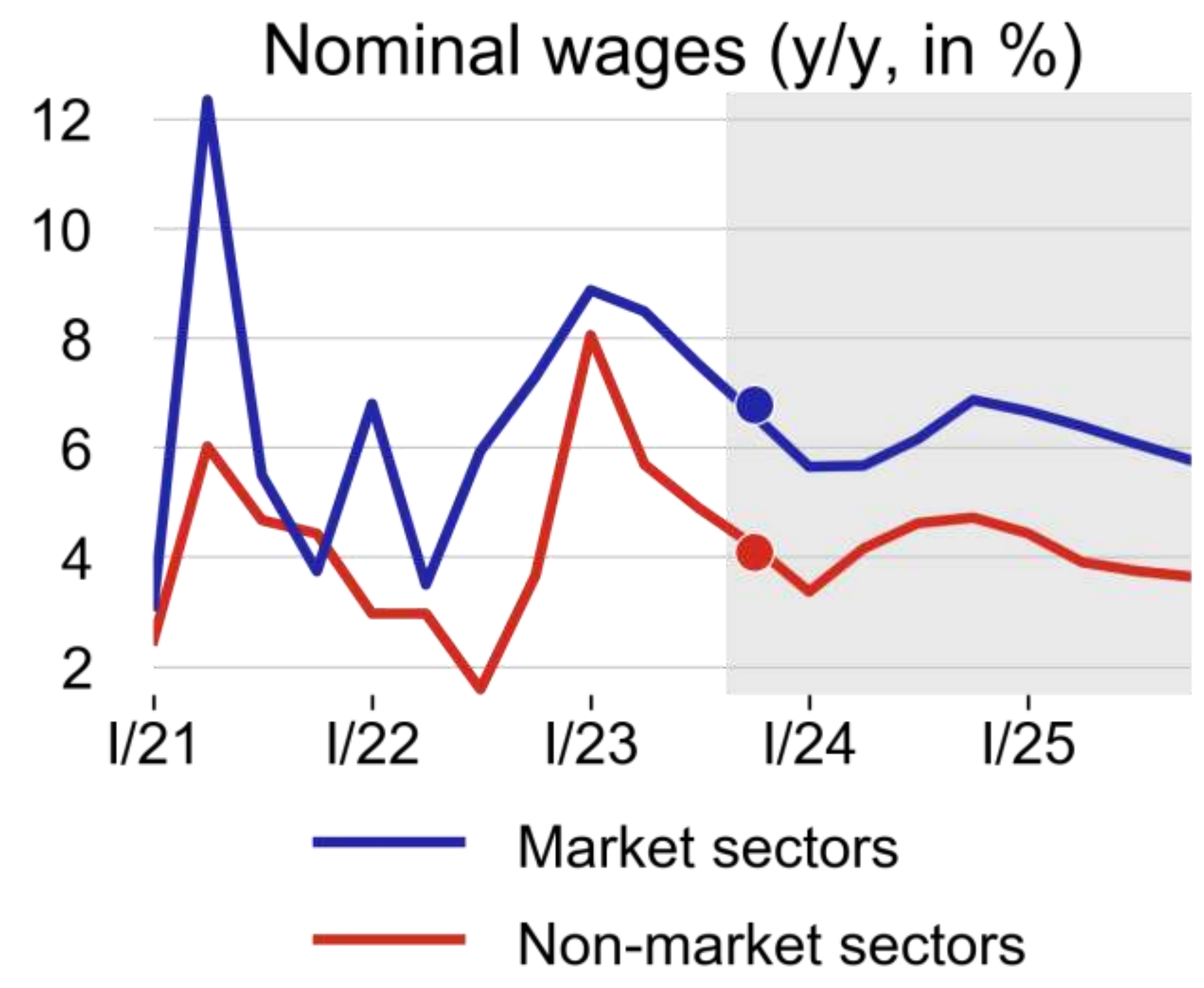
Cost Pressures and Profit Mark-ups

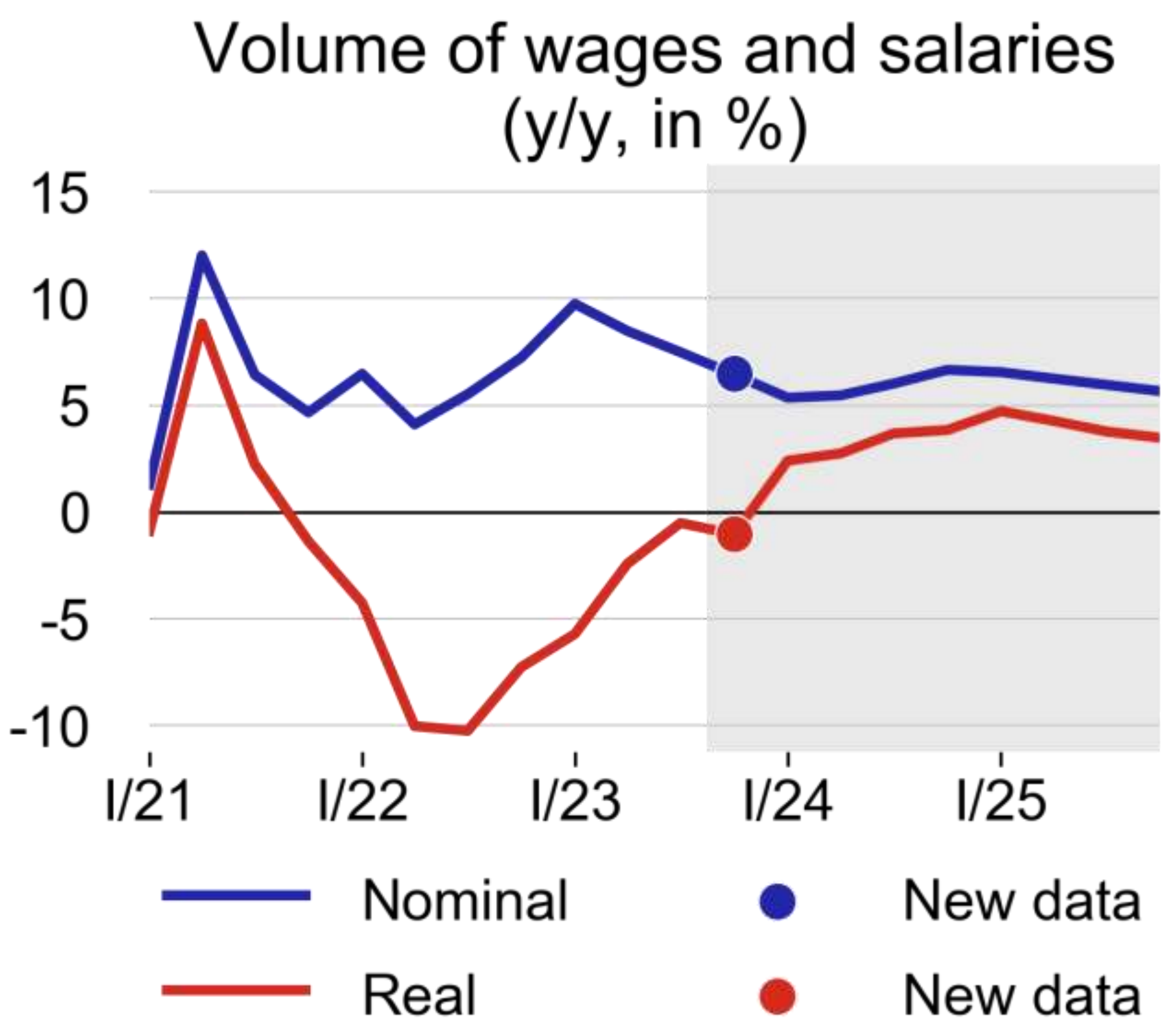


- The **overall cost pressures** will strengthen temporarily at the start of the year due to an increase in the administered component of **energy prices for firms** and a weakening **koruna**.
- Once the effect of the increase in the administered component of energy prices for firms at the start of 2024 fades out, growth in total costs will slow. In 2025, it will fall gradually to the steady-state level consistent with the fulfilment of the inflation target.
- The **domestic cost pressures** will ease gradually from the end of this year onwards as **wage growth** steadily decreases.
- The positive **gap in mark-ups** has started to narrow noticeably amid only slowly recovering domestic demand.

Labour Market

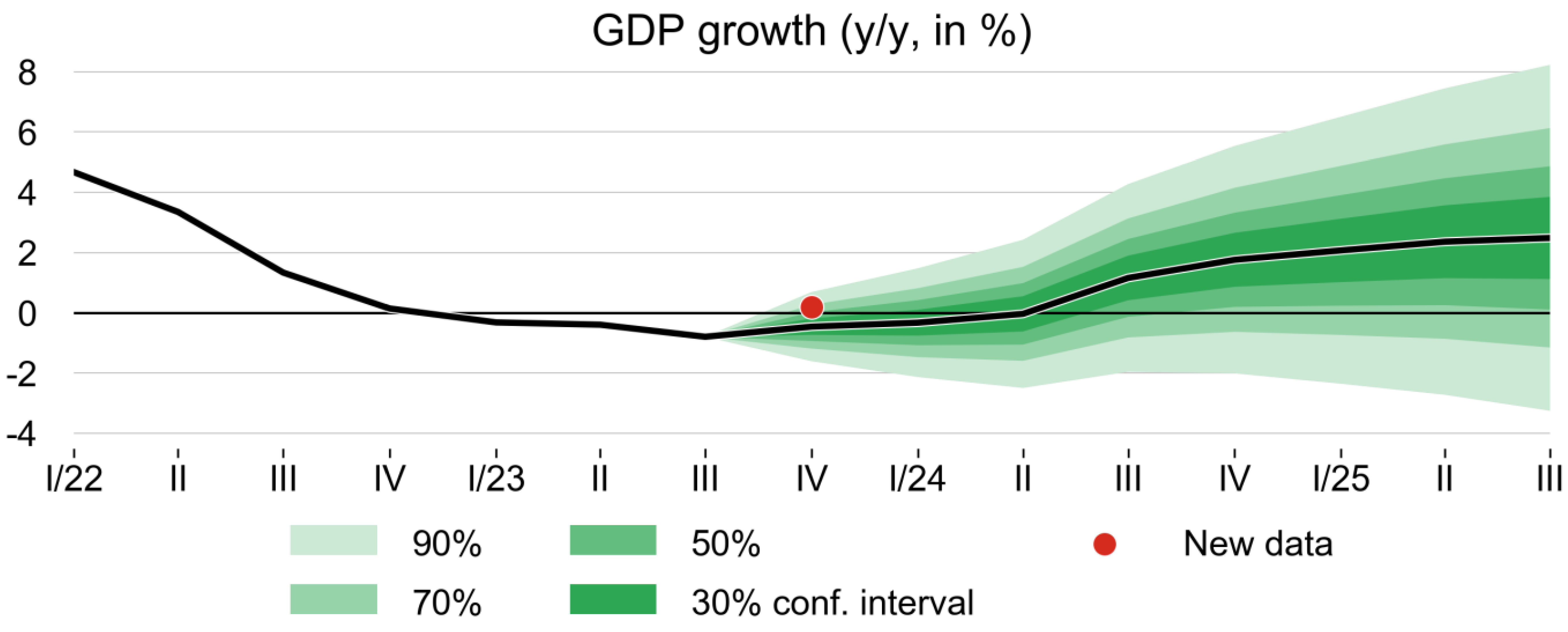


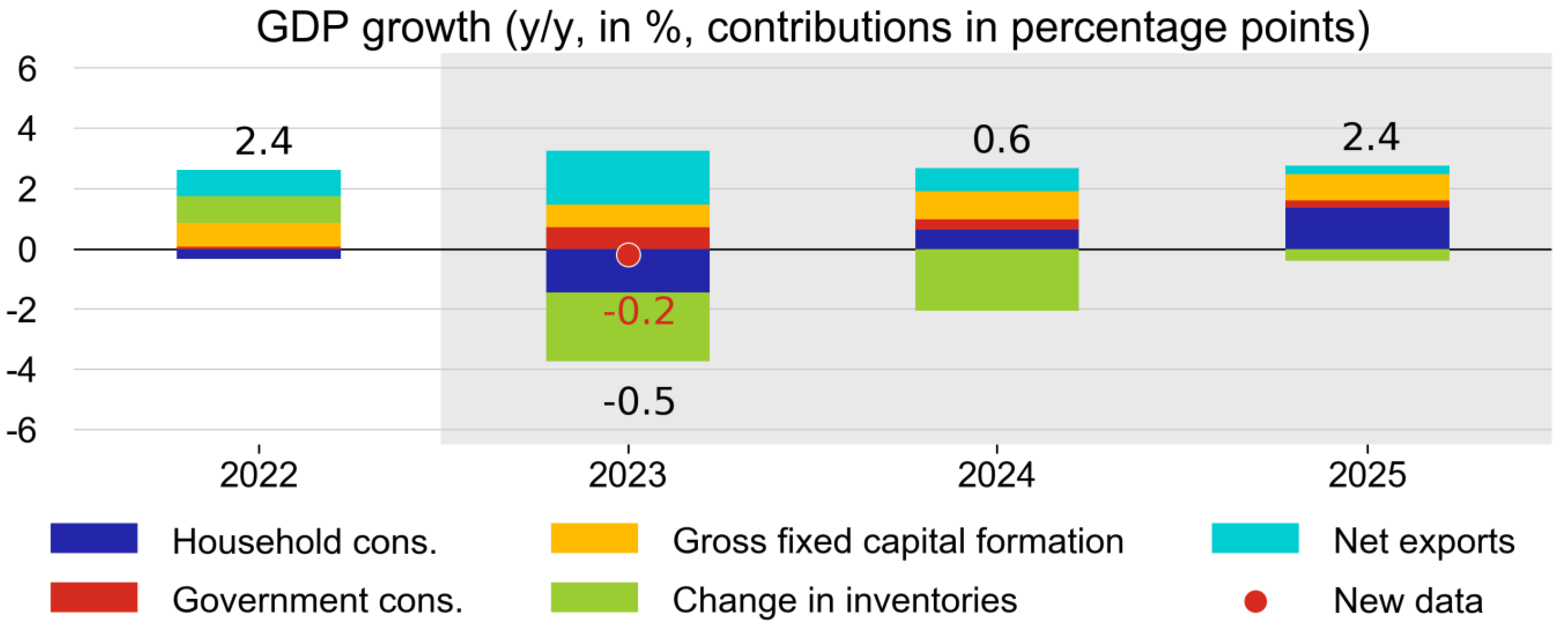




- From the perspective of the **LUCI**, the tightness in the labour market will moderate gradually but will remain significant.
- **Nominal wage growth in market sectors** will remain slightly elevated from the long-term perspective.
- On average, **employment** will stagnate this year, with **unemployment** increasing slowly.
- The **real wage** will grow at the start of 2024 after more than two years of decline and will rise slightly further over the outlook horizon. This will be due mainly to a marked slowdown in inflation amid still slightly elevated nominal wage growth.
- Growth in the **real wage bill** will thus contribute to the recovery in household consumption.

GDP Growth Forecast

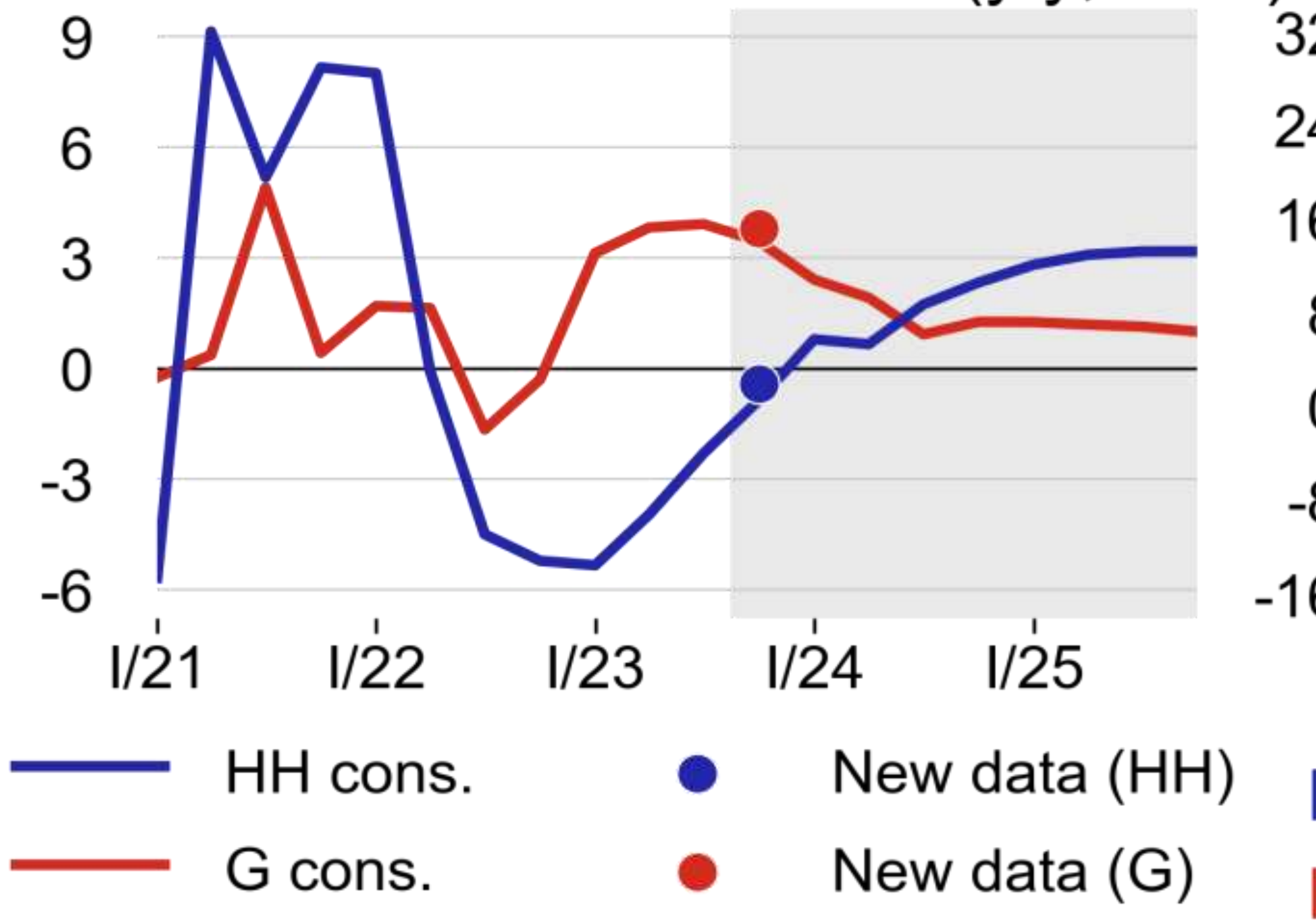




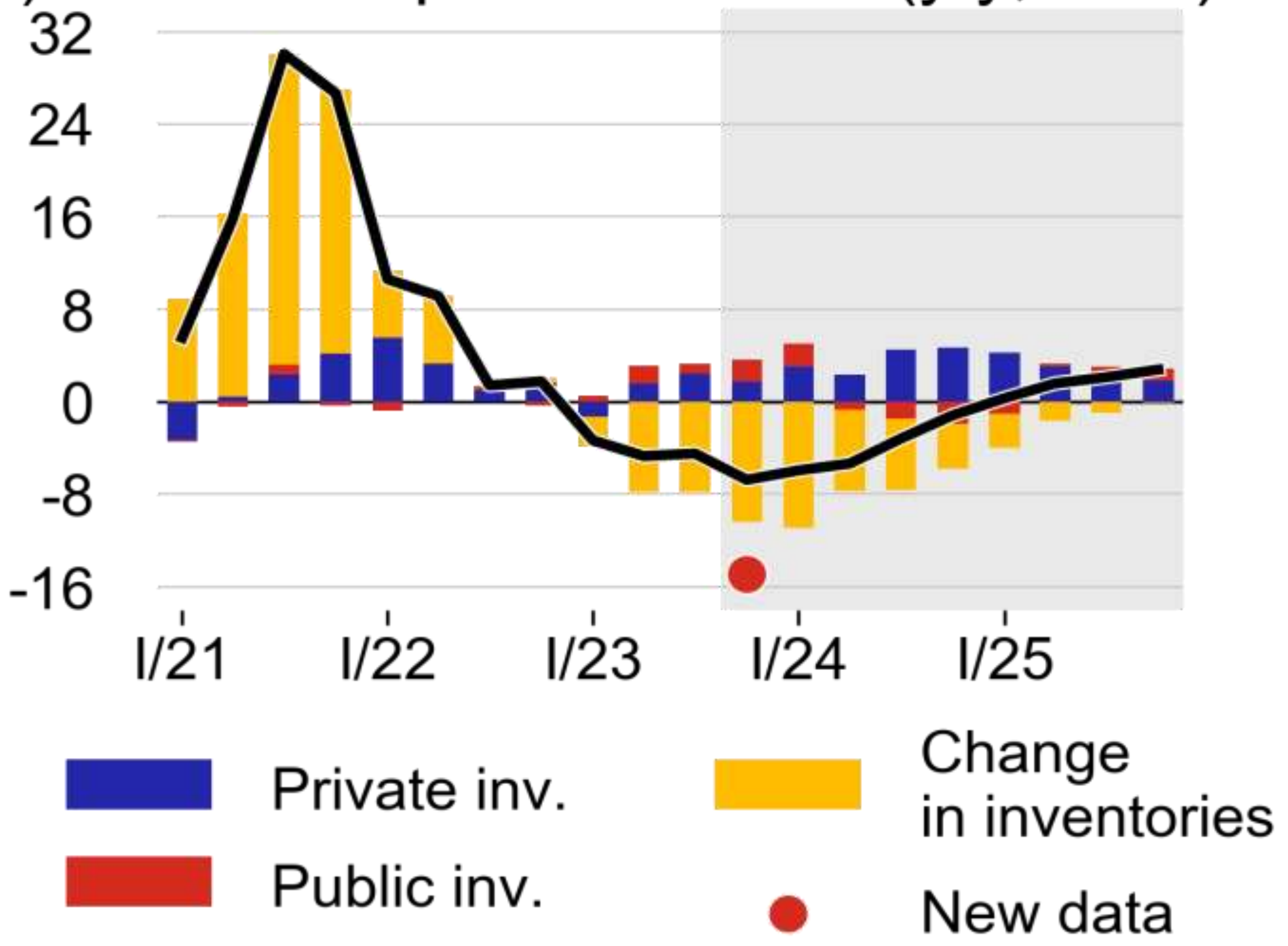
- **Economic activity** declined in 2023; it will return to growth, but the recovery will be very modest and gradual.
- This year, **GDP** will grow by **0.6%**. In 2025, the growth will pick up to **2.4%**. The recovery will also be dampened by the consolidation package.
- Another important factor is an expected further decline in the accumulation of **inventories** as the supply-side constraints fade and firms return to standard modes of operation
- According to a preliminary CZSO estimate, Czech GDP increased by 0.2% quarter on quarter and decreased by -0.2% year on year in 2023 Q4. This is only slightly higher than the CNB forecast.

GDP Components

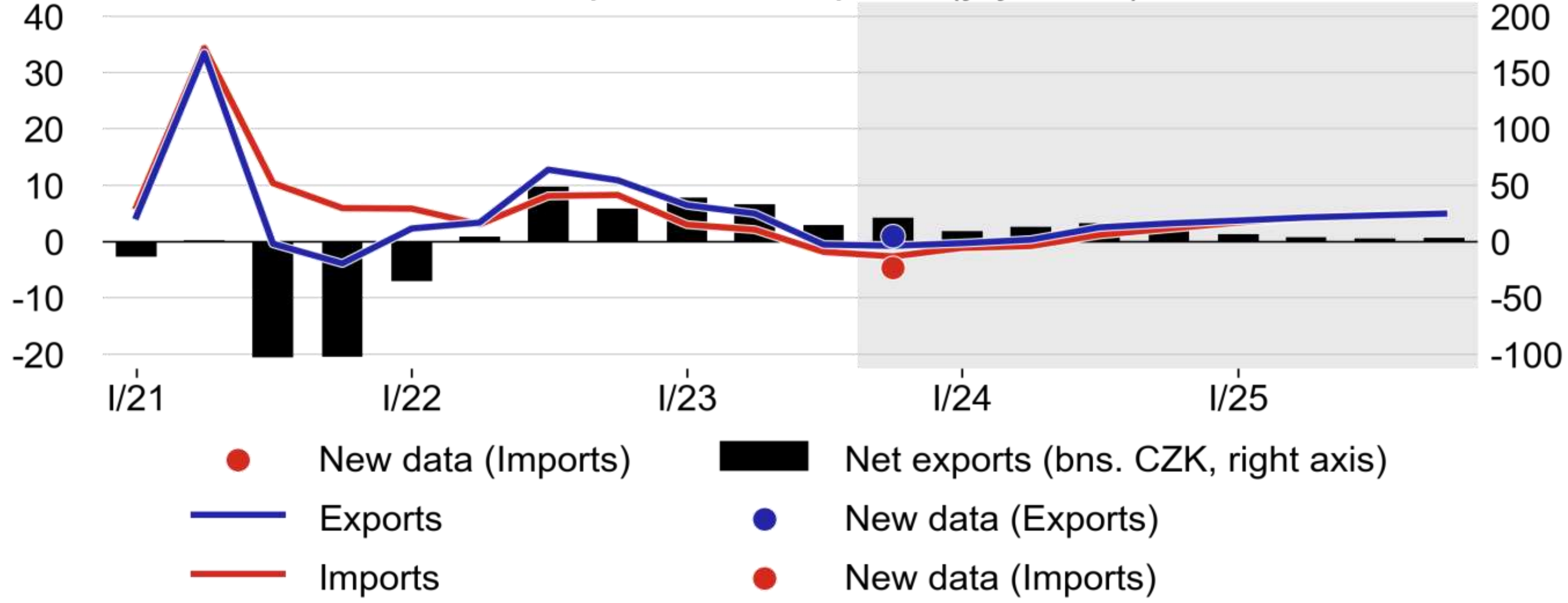
Household and Gov. cons. (y/y, in %)



Gross capital formation (y/y, in %)

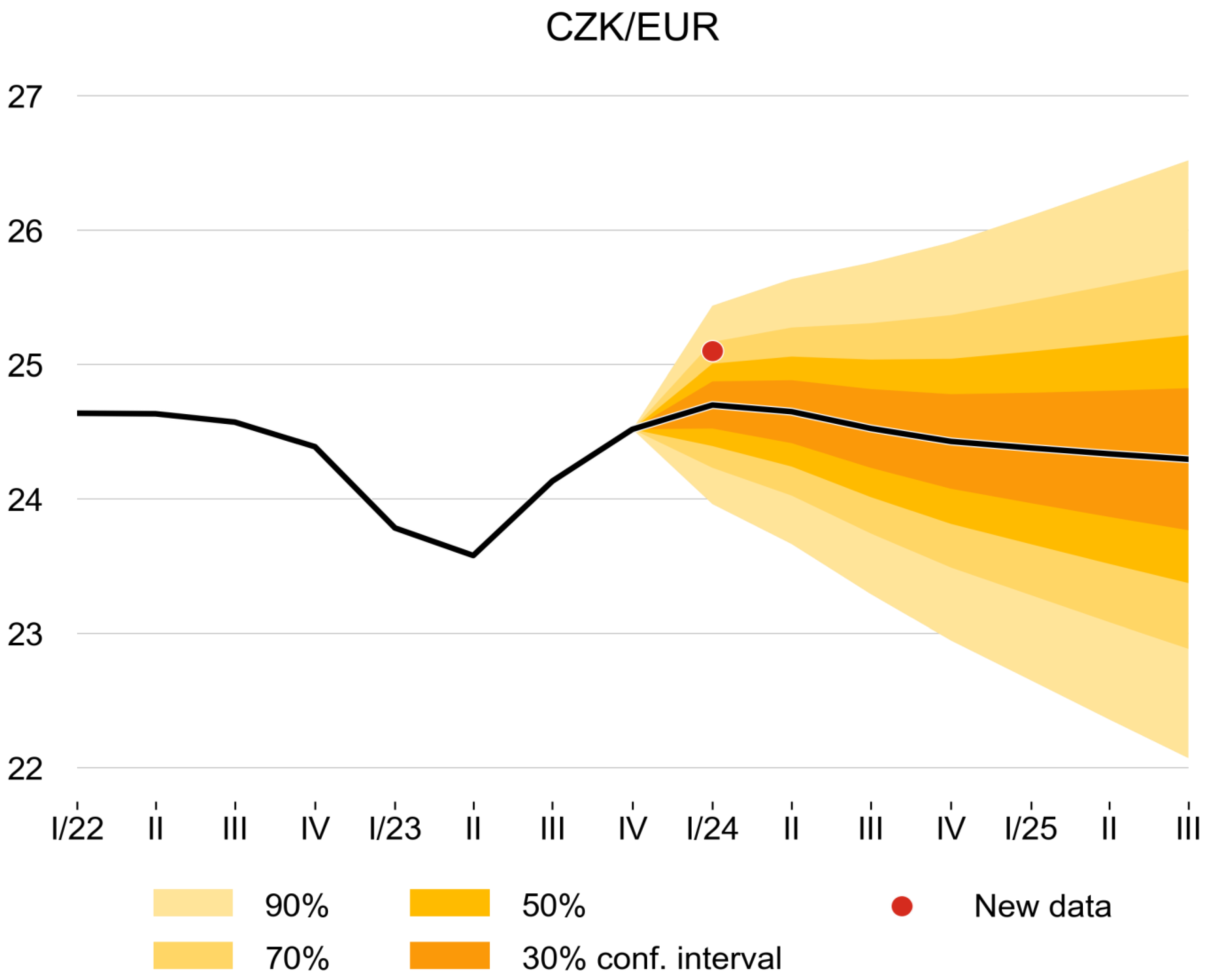


Real exports and imports (y/y, in %)



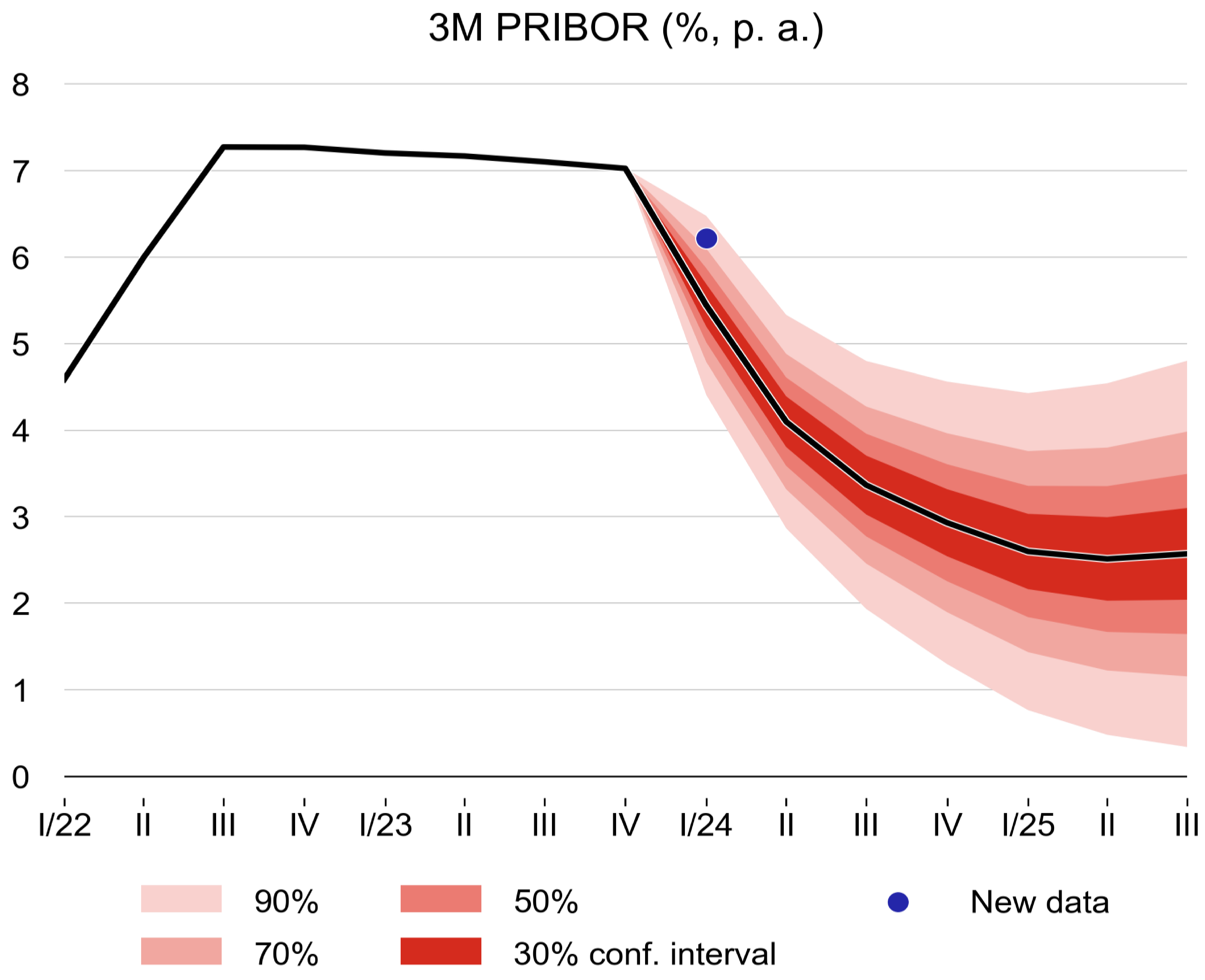
- **Household consumption** will return to year-on-year growth this year on the back of recovering purchasing power
- **Government consumption** will grow at a subdued pace in real terms, reflecting the fiscal consolidation efforts.
- Growth in **total gross investment** will be negatively affected by **change in inventories** until the end of 2024, while private investment will grow as financial conditions ease and foreign demand improves.
- **Exports** and **imports** will return to growth only gradually. Net exports will continue to contribute positively to GDP growth.

CZK/EUR Exchange Rate



- Following an initial weakening, the koruna will **appreciate** slightly over the outlook horizon, mostly reflecting favourable current account developments.
- The improvement in the goods and services balance will be due to initially still very subdued domestic demand amid a gradual pick-up in export activity linked with recovering foreign economies.
- The appreciation will be partially offset by a narrowing **interest rate differential** vis-à-vis the euro area, which will close at the end of the year.
- Towards the end of the year, the koruna is forecasted to average 24.4 EUR/CZK.

Interest Rate Path (3M PRIBOR)



- Consistent with the baseline scenario of the forecast is a rapid decline in **market interest rates** in the course of this year.
- The extraordinary cost pressures from the foreign environment have faded and domestic demand remains subdued.
- These factors lead to the return of a **low-inflation environment**, which is maintained over the monetary policy horizon.
- A temporary increase in cost pressures in early 2024 will not prevent consumer price inflation from declining towards the upper boundary of the tolerance band around the CNB's target early this year.
- The 3M PRIBOR is forecasted to average 2.9% in 2024 Q4.

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The Updated g3+ Core Forecasting Model

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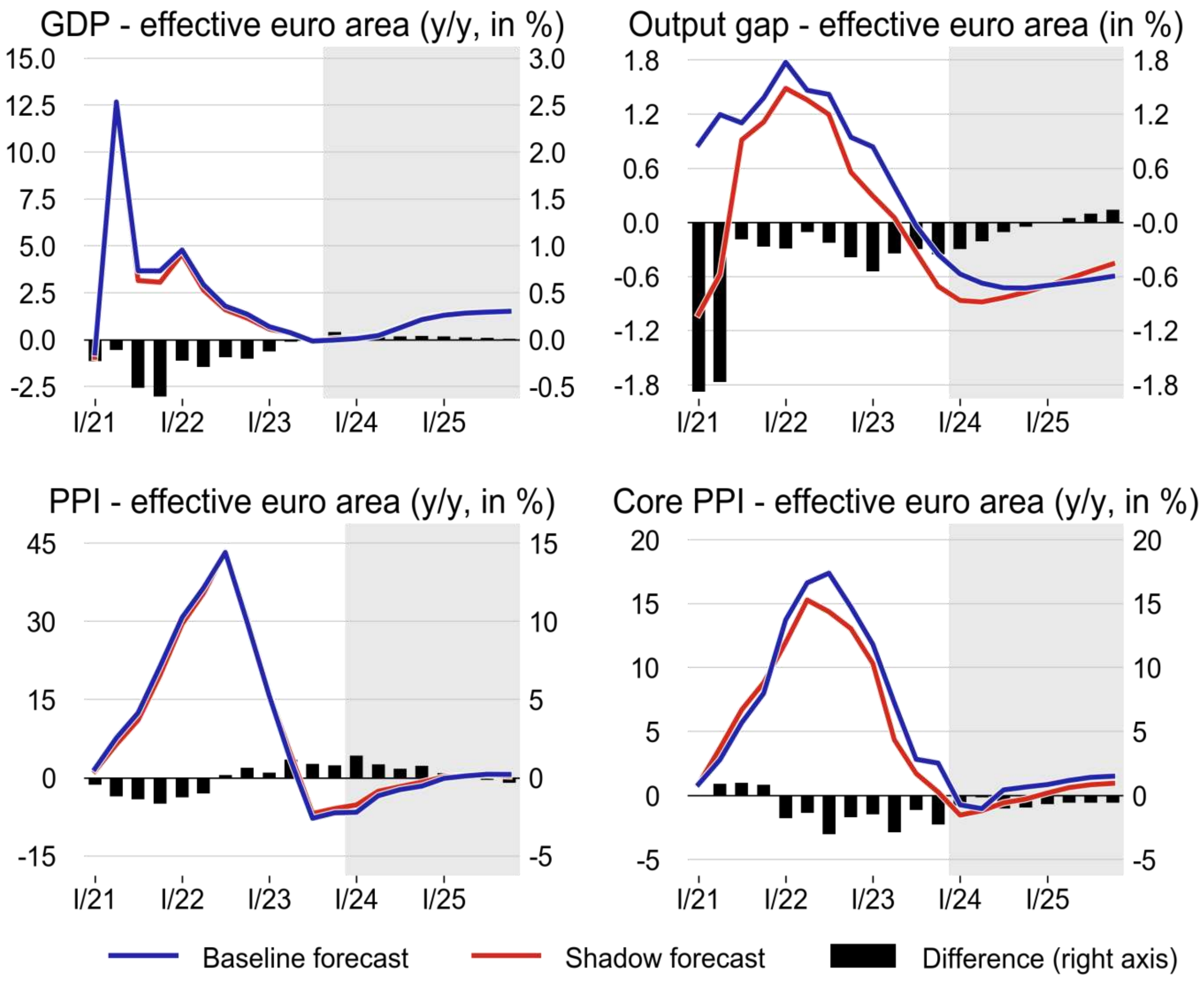
- **Steps for implementing the updated g3+ core forecasting model into practice**
  - MPR – Winter 2024: preparation for model implementation, preparation of the shadow forecast using the updated model and presentation of the main model changes in the appendix of the MPR.
  - MPR – Spring 2024: preparation of the baseline scenario using the updated model.
  - Throughout this year: preparation of a research article describing the change in detail in the form of a CNB WP.

- **Benefits of the updated model**
  - More direct representation of foreign and domestic developments in the model structure (including treatment of the extraordinary economic events of recent years).
  - Consistency of the effective euro area aggregate on the history and forecast (EA6), endogenous filtering of the foreign output gap, explicit treatment of imported energy prices, recalibrations...
  - Replacement of some existing expert judgement with new connections in the model.

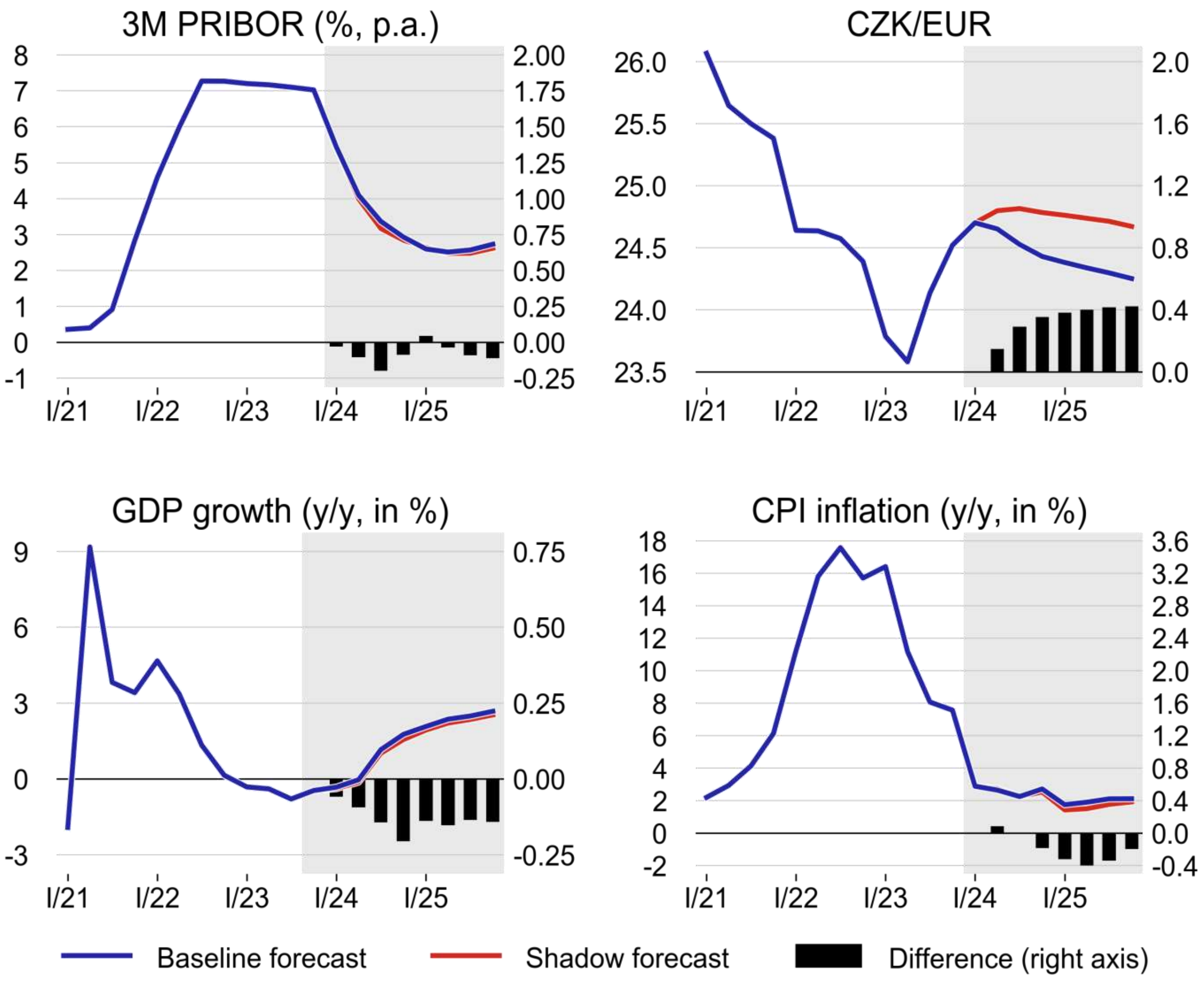
- **Improved forecasting properties:** The updated model shows better forecasting properties for most macroeconomic variables (e.g. components of GDP, wages, exchange rate).

Shadow Forecast: Foreign Assumptions



- Greater **consistency of the effective euro area aggregates**, from EA17 on history and EA5 for the forecast to EA6 over the whole sample, along with **new structural relationships**, lead to slightly different external assumptions in the shadow forecast.
- **Foreign GDP growth** shows only slight differences compared to the baseline scenario, due to an increase in the effective EA weights of countries that grew at slower rates. Given the similar potential output growth for the two aggregates, the lower GDP growth is reflected in a **more negative output gap**.
- Growth of **core PPI** is lower, while growth in **energy PPI** is less negative than in the baseline scenario. The path of total PPI is similar to that in the baseline scenario.

Shadow Forecast: Domestic Variables



- The shadow forecast prepared using the updated g3+ model provides a similar view of the present state and future path of the domestic economy.
- **GDP growth** is predicted to be slightly lower in the shadow forecast, due to weaker domestic investment and export activity, reflecting a wider negative output gap in the effective euro area this year and the modified structural relationships in the updated model.
- The weaker domestic demand results in somewhat lower **inflation**.
- Despite the rather weaker inflationary pressure, the decline in **interest rates** is similar as in the baseline scenario.
- The lower export activity caused by the more negative foreign output gap leads to a more pronounced depreciation of the **koruna** this year.

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MP decision (8 Jan), risks and uncertainties of the forecast

5.25%	**6.25%**	7.25%
discount rate	**2W repo rate**	Lombard rate

VOTING ON 2W REPO RATE

DECREASE to 6.25%	**DECREASE to 6.00%**
6	1

The Bank Board confirmed its determination to **continue its tight monetary policy until inflation is stabilised near the 2% target.**

The Bank Board assessed the **risks and uncertainties** of the baseline scenario of the winter forecast as being broadly inflationary.

Inflationary risks:

- slower decline in the elevated inflation expectations
- higher-than-expected inertia in services prices
- halt in tradables disinflation
- acceleration of money creation in the economy stemming from excessive lending activity in the property market in the longer term

Anti-inflationary risk:

- stronger-than-expected downturn in global economic activity and German economic output

Uncertainty:

- future monetary policy stance abroad

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MP decision (20 Mar), risks and uncertainties of the forecast

4.75%	5.75%	6.75%
discount rate	**2W repo rate**	Lombard rate

VOTING ON 2W REPO RATE

DECREASE to 5.75%	DECREASE to 5.50%
5 votes	2 votes

The Bank Board confirmed its determination to **continue its tight monetary policy in order to stabilise inflation near the 2% target in the long term.**

The Bank Board assessed the **risks and uncertainties** of the baseline scenario of the winter forecast as being modestly inflationary.

Inflationary risks:

- slower decline in the elevated inflation expectations
- higher-than-expected inertia in services prices
- halt in tradables disinflation
- exchange rate of the koruna
- acceleration of money creation in the economy stemming from a significant recovery in lending activity in the longer term

Anti-inflationary risk:

- stronger-than-expected downturn in global economic activity and weaker German economic output

Uncertainty:

- future monetary policy stance abroad

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Thank you for your attention

Karina Kubelková

Board Member

Karina.Kubelkova@cnb.cz

Luboš Komárek

Director, External Economic Relations Division, Monetary Department

Lubos.Komarek@cnb.cz