CZECH NATIONAL BANK

CNB’s New Forecast

Monetary Policy Report – Summer 2024

Meeting with Analysts

2 August 2024

Karel Musil (Director, Macroeconomic Forecasting Division)

Summer 2024 Forecast – Summary

- **Inflation** will be close to the CNB's 2% target over the entire outlook, including the monetary policy horizon.
- **Economic growth** continues to recover at a moderate pace. It will be boosted mainly by accelerating **household consumption** this year. Next year, **investment** will also start growing again amid recovering external demand and falling domestic and foreign rates.
- **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 summer forecast is a modest decline in **market interest rates.**

	2024	2025	2026
Headline inflation (%)	**2.2**	**2.0**	**2.0**
	(-0.1)	(-0.0)	-
GDP (%)	**1.2**	**2.8**	**2.4**
	(-0.2)	(0.1)	-
Average nominal wage (%)	**7.4**	**6.4**	**5.2**
	(0.2)	(0.3)	-
3M PRIBOR (%)	**5.1**	**3.8**	**3.3**
	(0.1)	(0.3)	-
Exchange rate (CZK/EUR)	**25.1**	**25.0**	**24.7**
	(0.0)	(0.2)	-

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Presentation Outline

Changes in Czech Economy Equilibria

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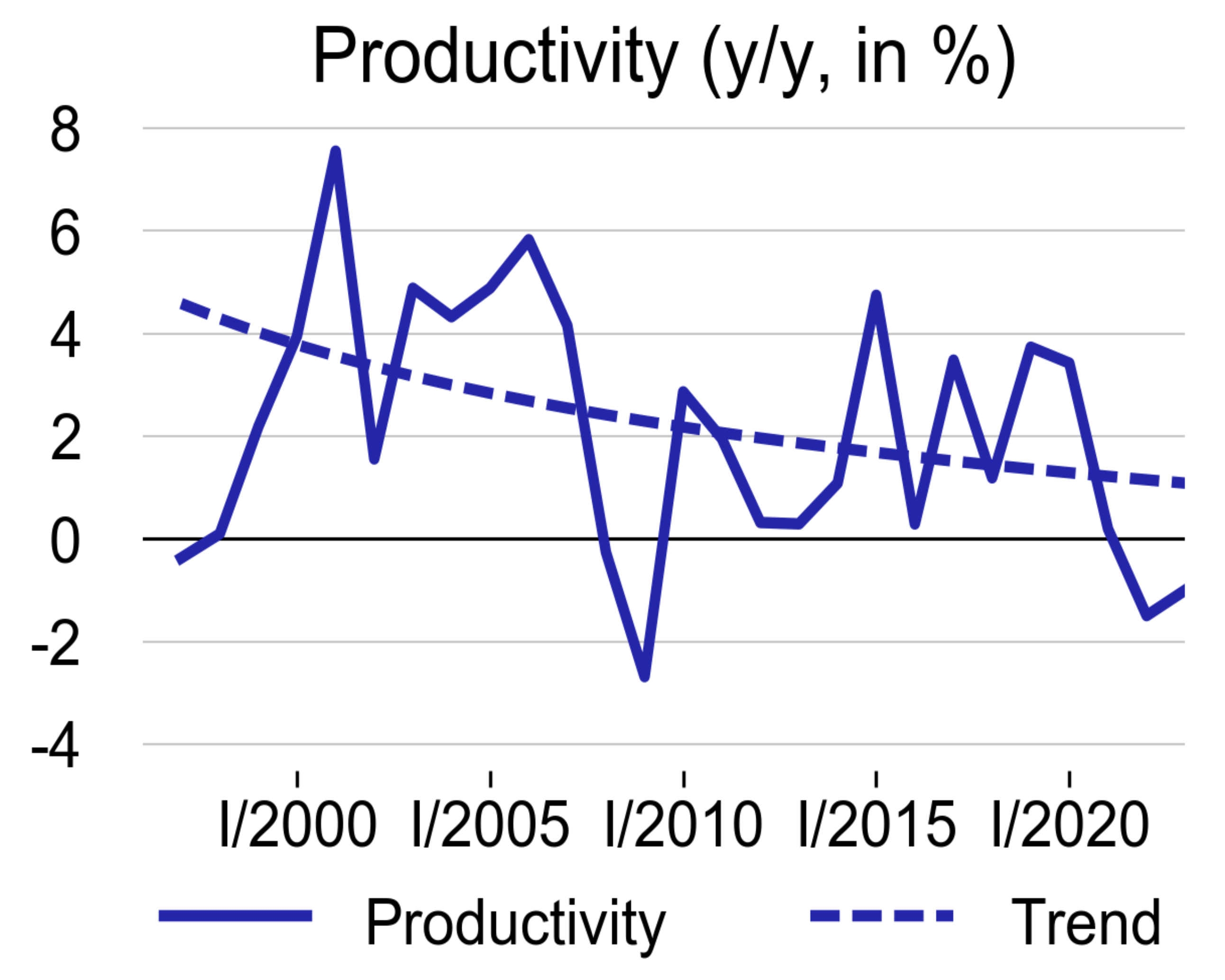
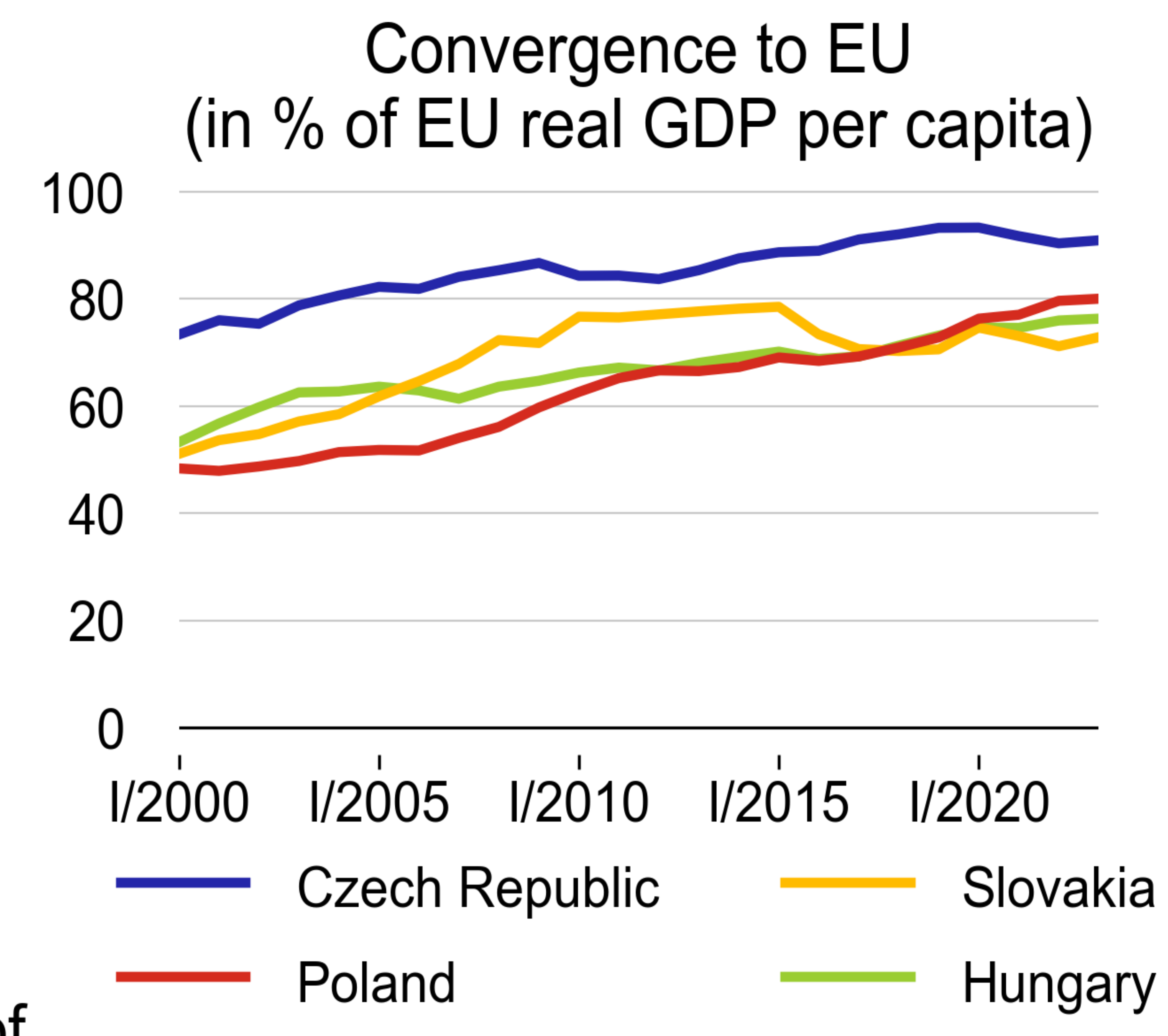
- The summer forecast assumes a reduction **in the potential GDP growth** and **the equilibrium pace of the koruna's appreciation**. These adjustments are incorporated into the summer forecast through expert adjustments. The autumn forecast will be prepared using a recalibrated model.
- The following shifts occur in the equilibrium year-on-year growth rates:

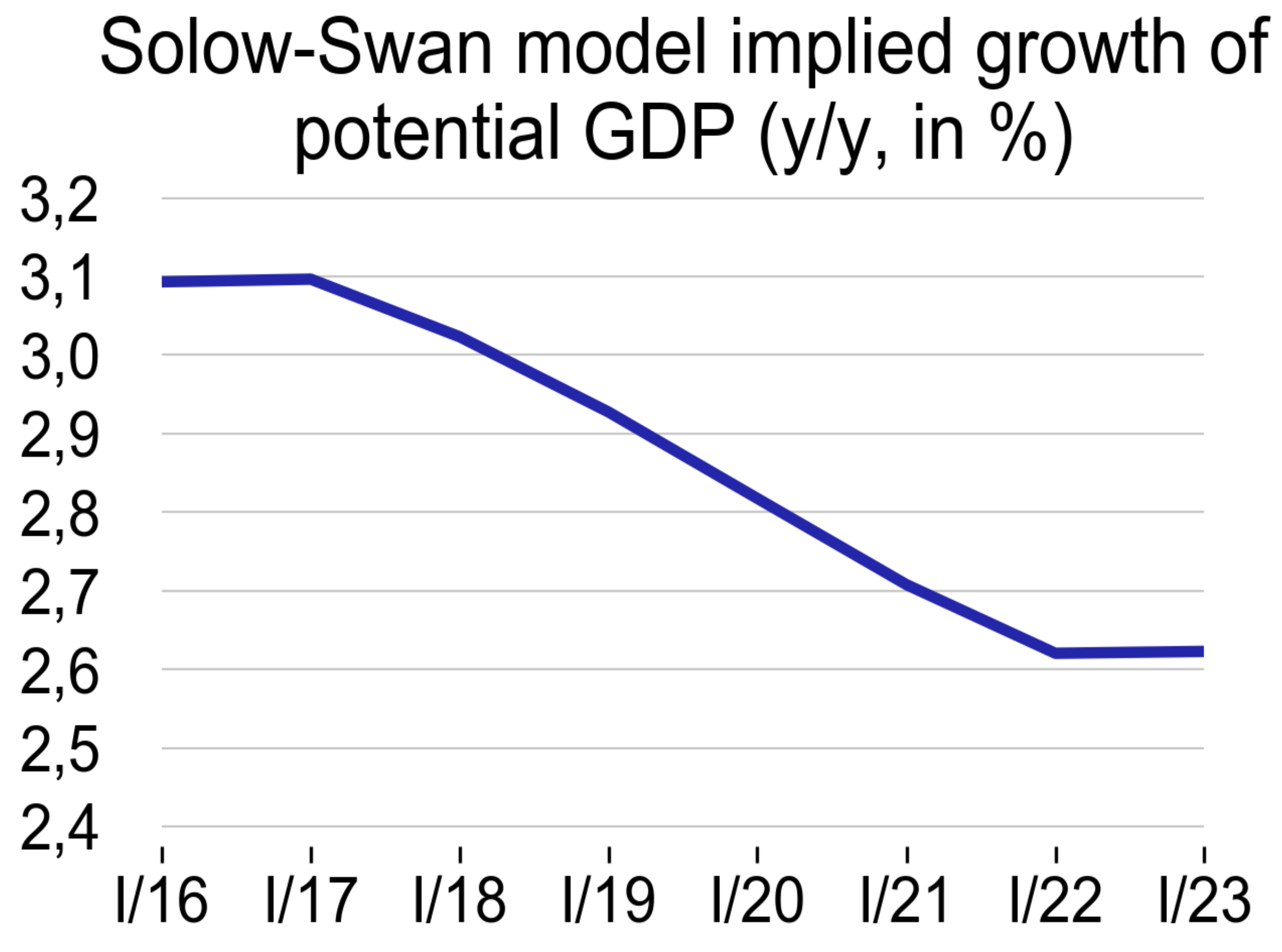
Variable	Former equilibrium	New equilibrium
GDP (inc. domestic components)	3%	2.5%
Productivity	3%	2.5%
Nominal wages	5%	4.5%
Koruna appreciation	1.5%	1%

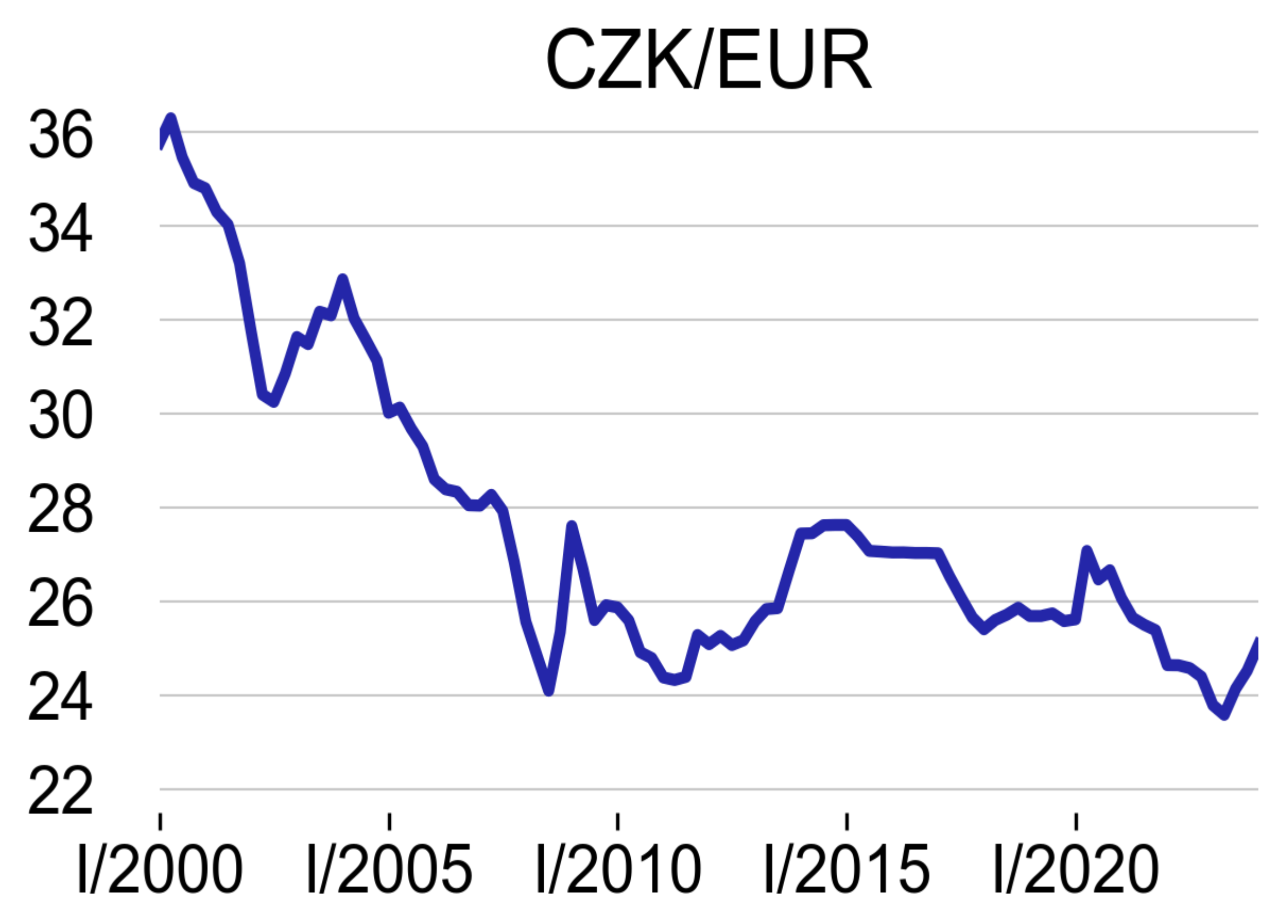
- The shift in medium-term equilibria does not concern the growth of **exports** and **imports**. Their values were reduced from 6.4% to 4.8% already in the spring 2024 forecast during the transition to the updated core prediction model g3+. At that time, the link between foreign trade growth and economic growth in the effective euro area was reduced.
- The equilibrium growth of **foreign GDP** was reduced in 2019 from 1.8% to 1.6%.

Structural Changes in the Czech Economy









- Based on a Chow test analysis of approximately 30 series, we identified **structural changes in the Czech economy in 2016**.
- **Productivity growth** has long been slowing in the Czech economy.
- The **convergence** of the Czech economy to the EU average has slowed since 2016.
- The **growth of potential GDP** implied by the Solow-Swan model has decreased since 2016.
- The pace of **appreciation of the Koruna** has slowed after the Global Financial and Economic Crisis.

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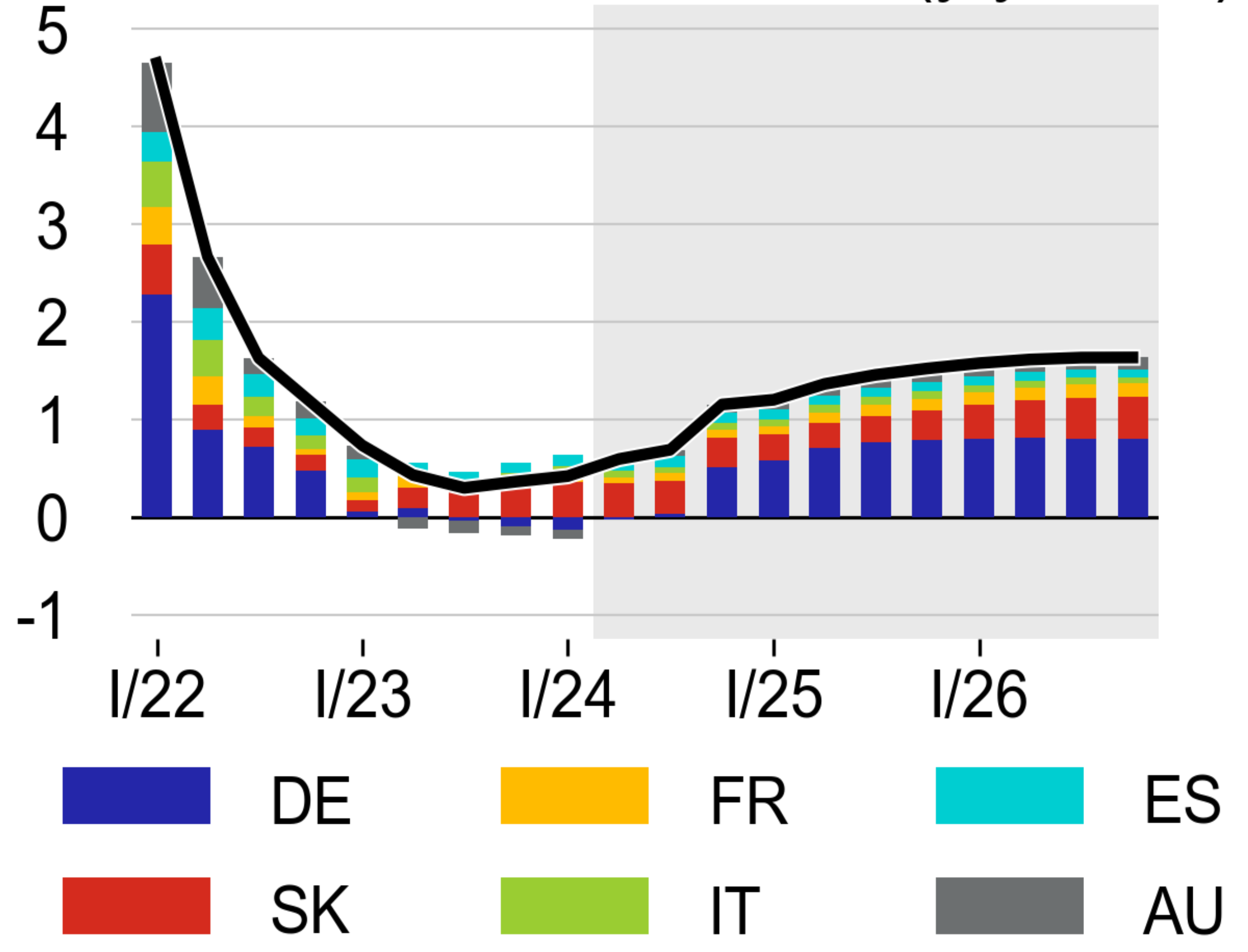
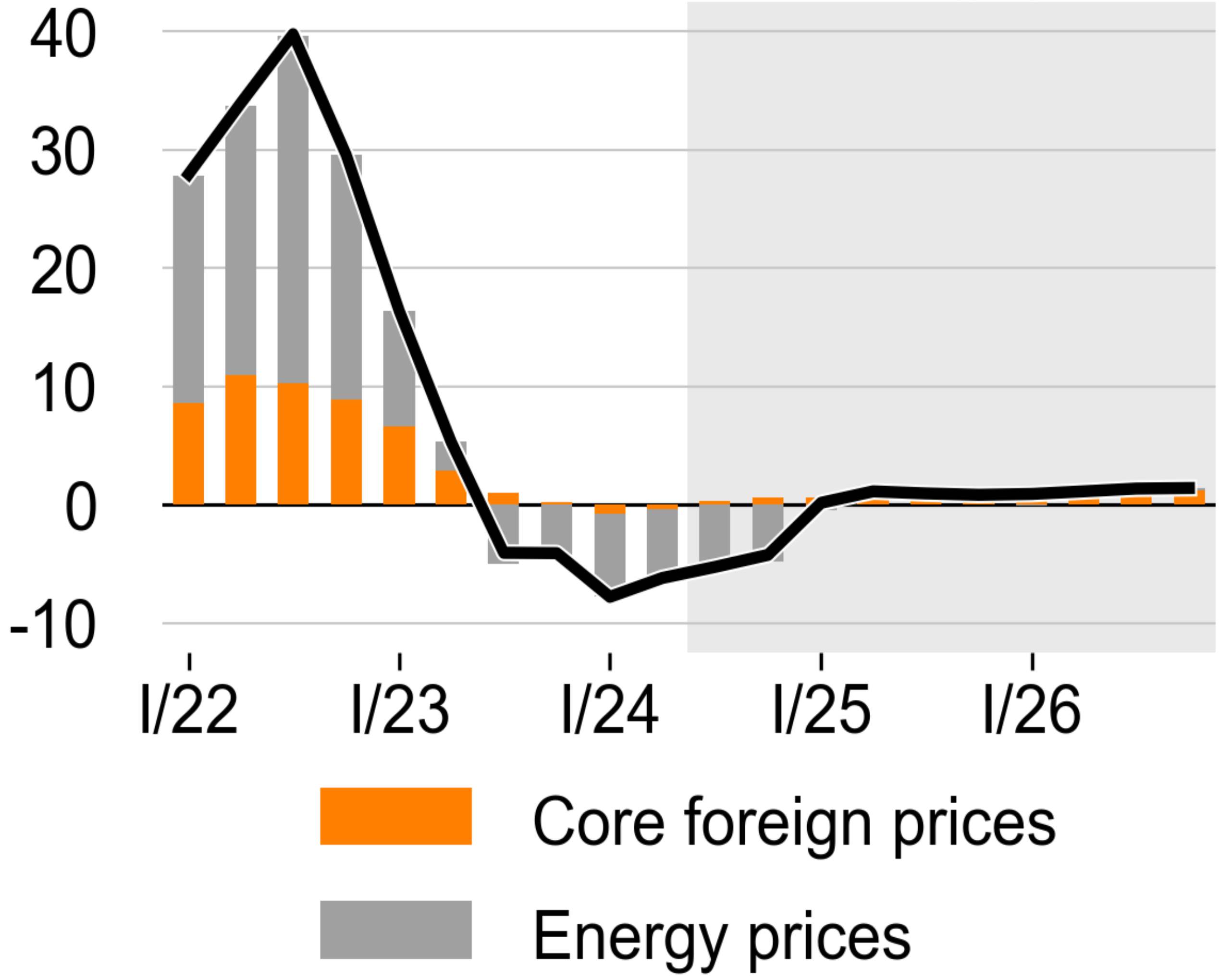
1. Structural Changes and New Equilibria
2. **Assumptions of the Forecast**
3. The New Macroeconomic Forecast
4. Comparison with the Previous Forecast
5. Scoreboard Risks

Foreign Environment Outlook

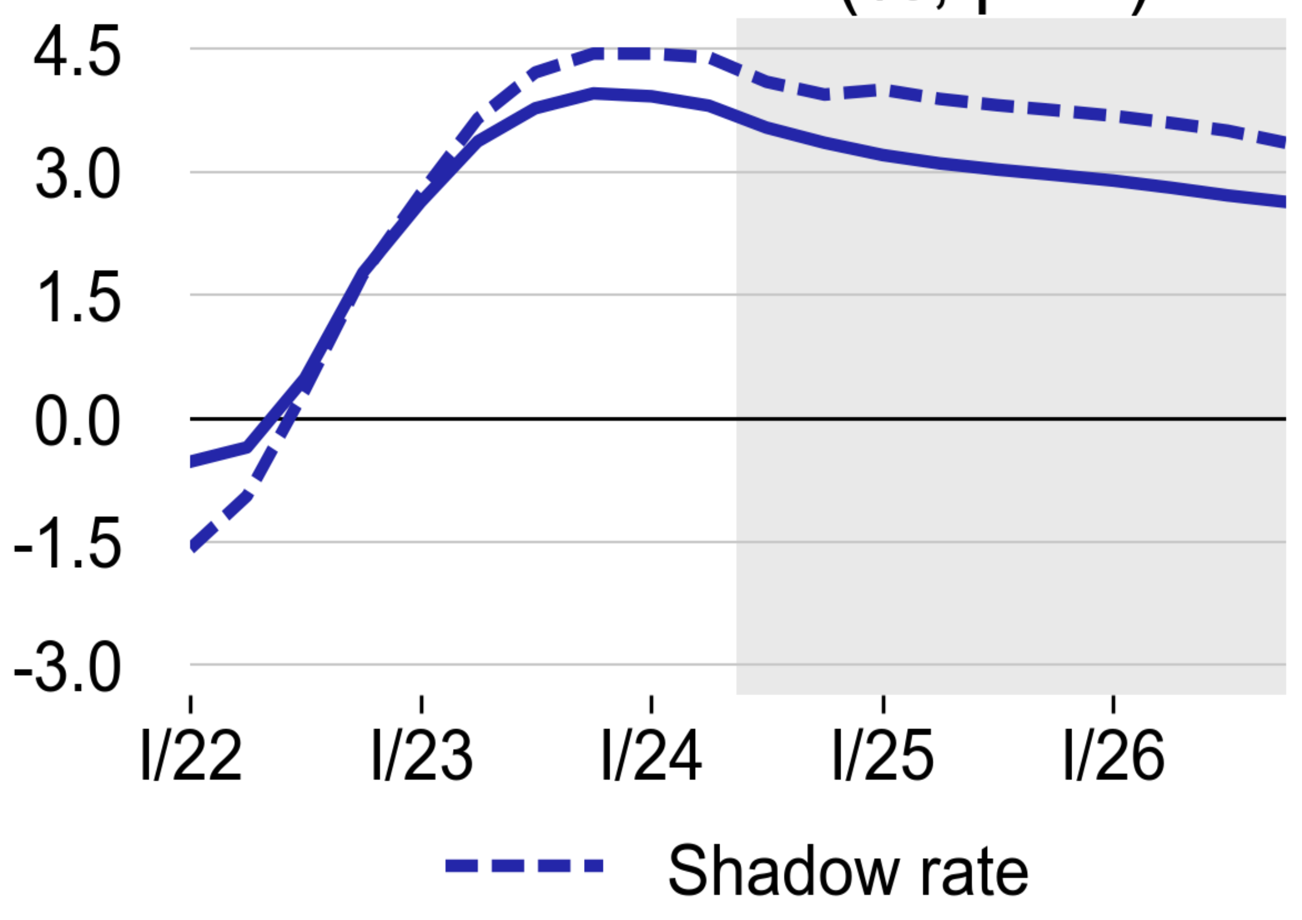
GDP - effective euro area (y/y, in %)



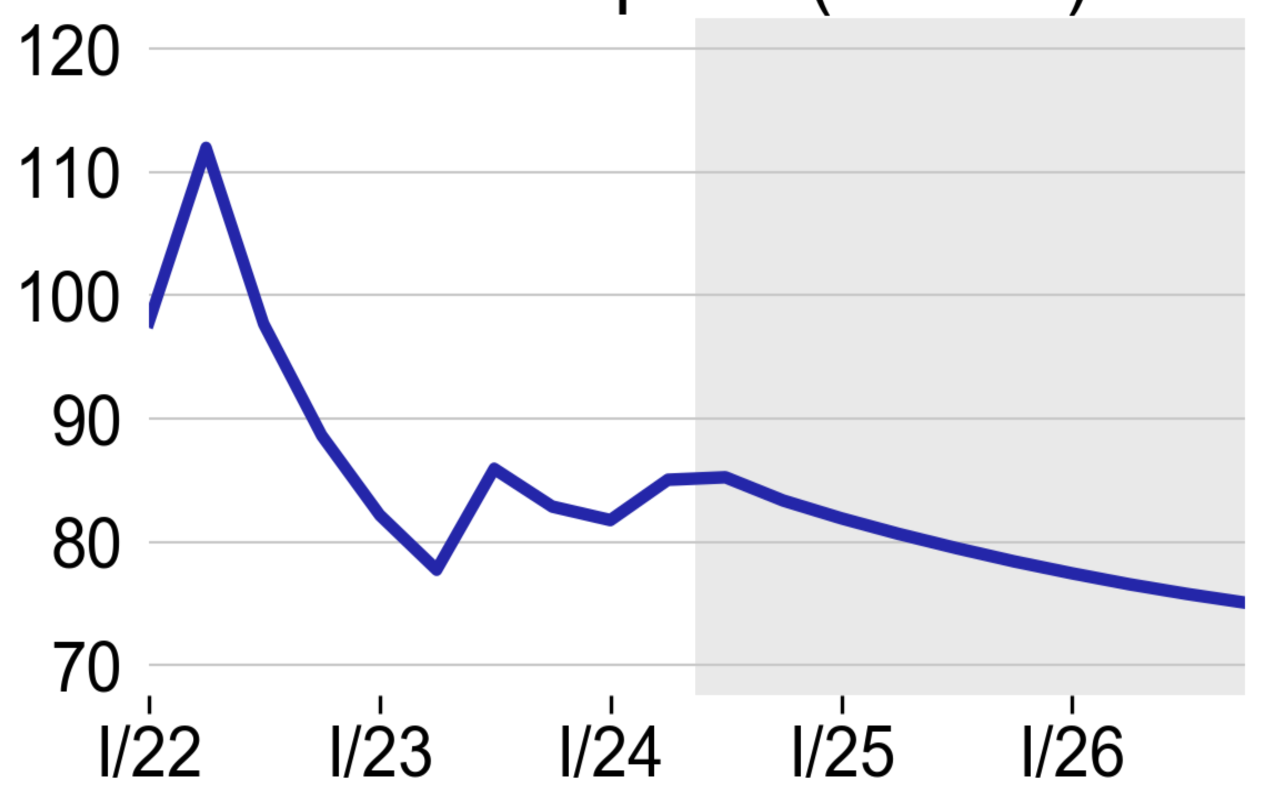
PPI - effective euro area (y/y, in %)



3M EURIBOR (%, p. a.)



Brent oil price (USD/b)



- **GDP growth in the effective euro area** will accelerate gradually with the improving **performance of German economy** as household consumption and global demand recover in an environment of decreasing interest rates.
  - Czech exports to Germany are further analysed in box *The position of Czech exporters on the German market by comparison with Poland.*
- **Industrial producer prices** will continue to fall this year, mainly because of their energy component, and start to rise again in 2025.
- **Euro area interest rates** will go down further 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

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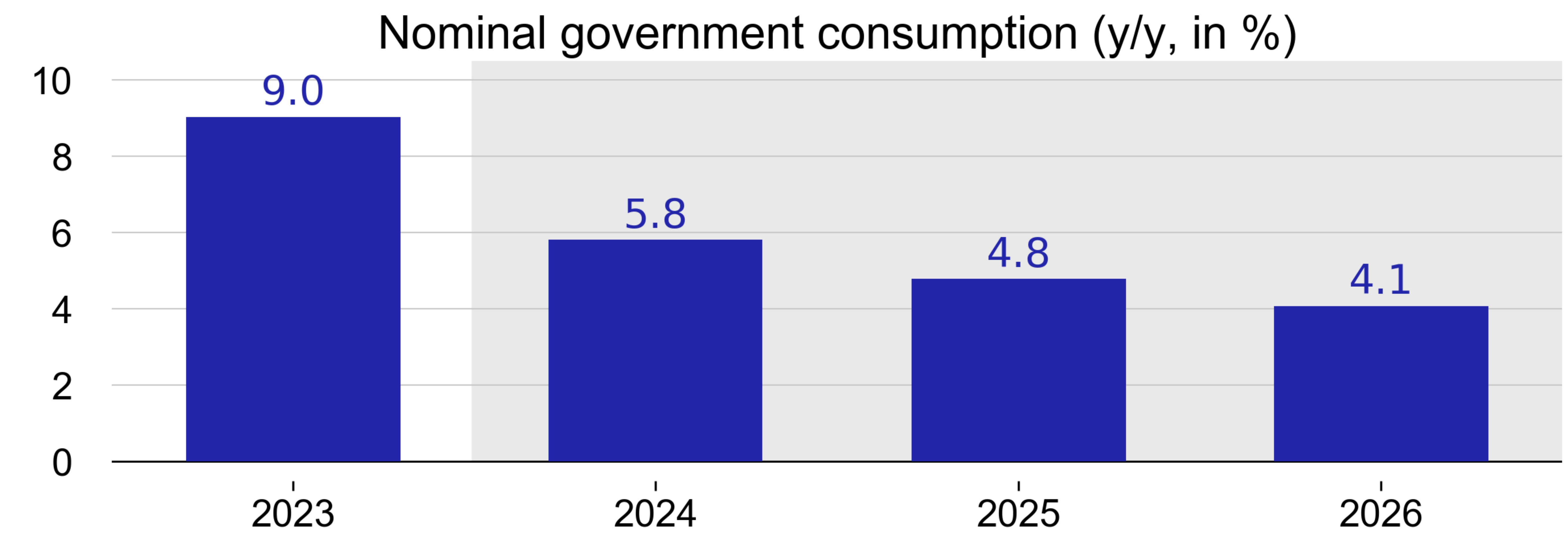
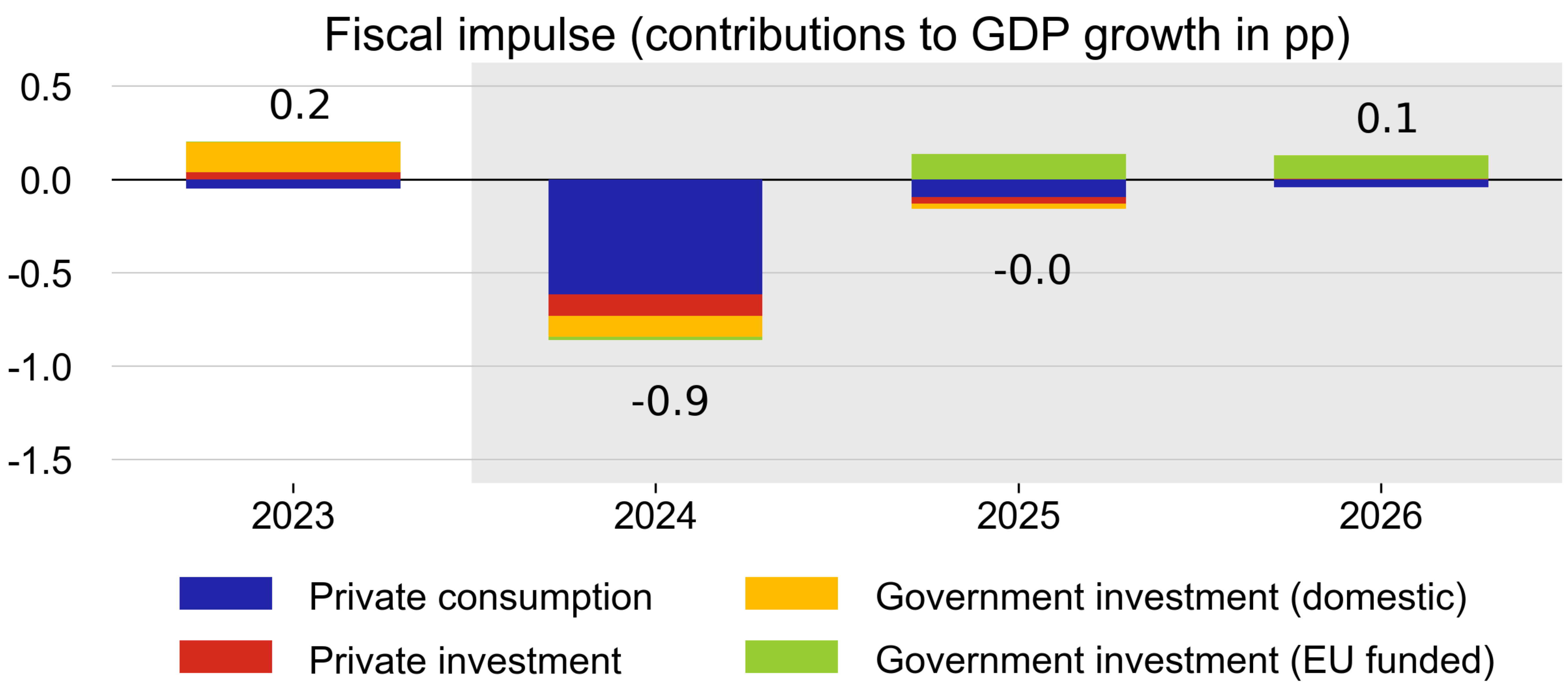
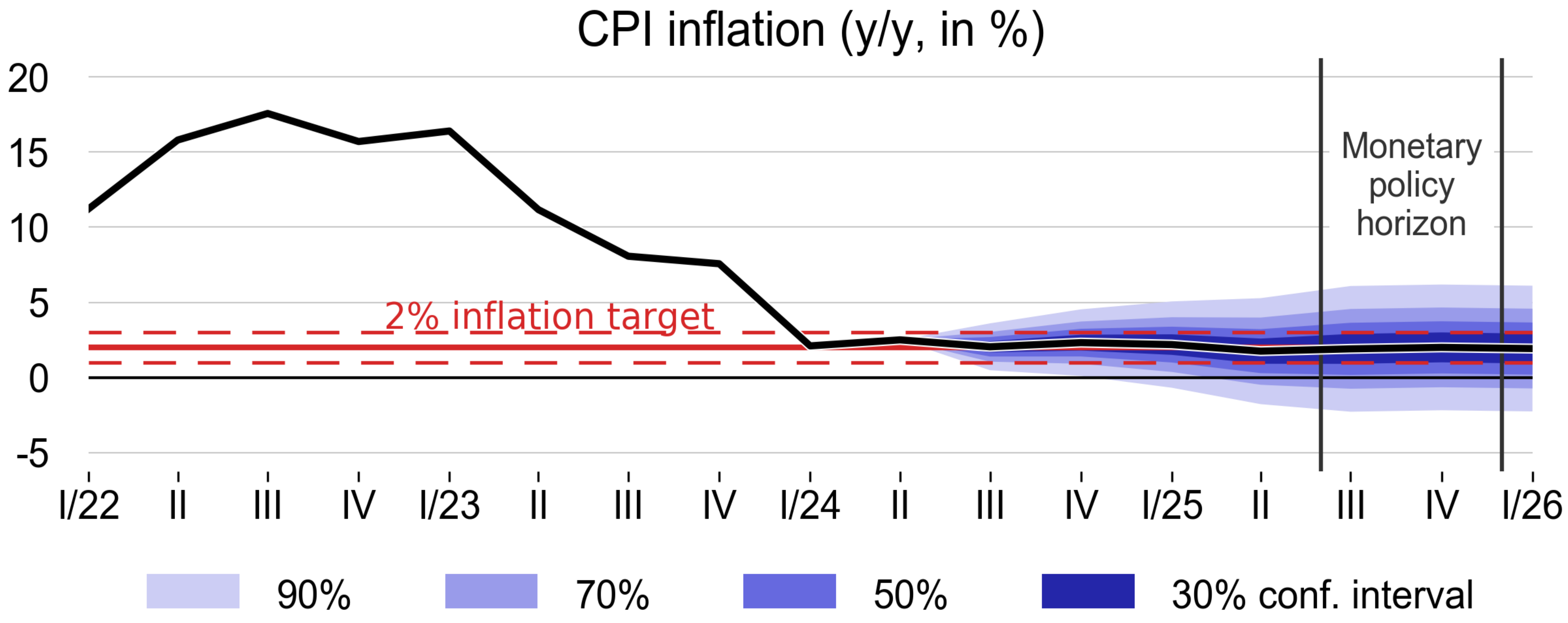


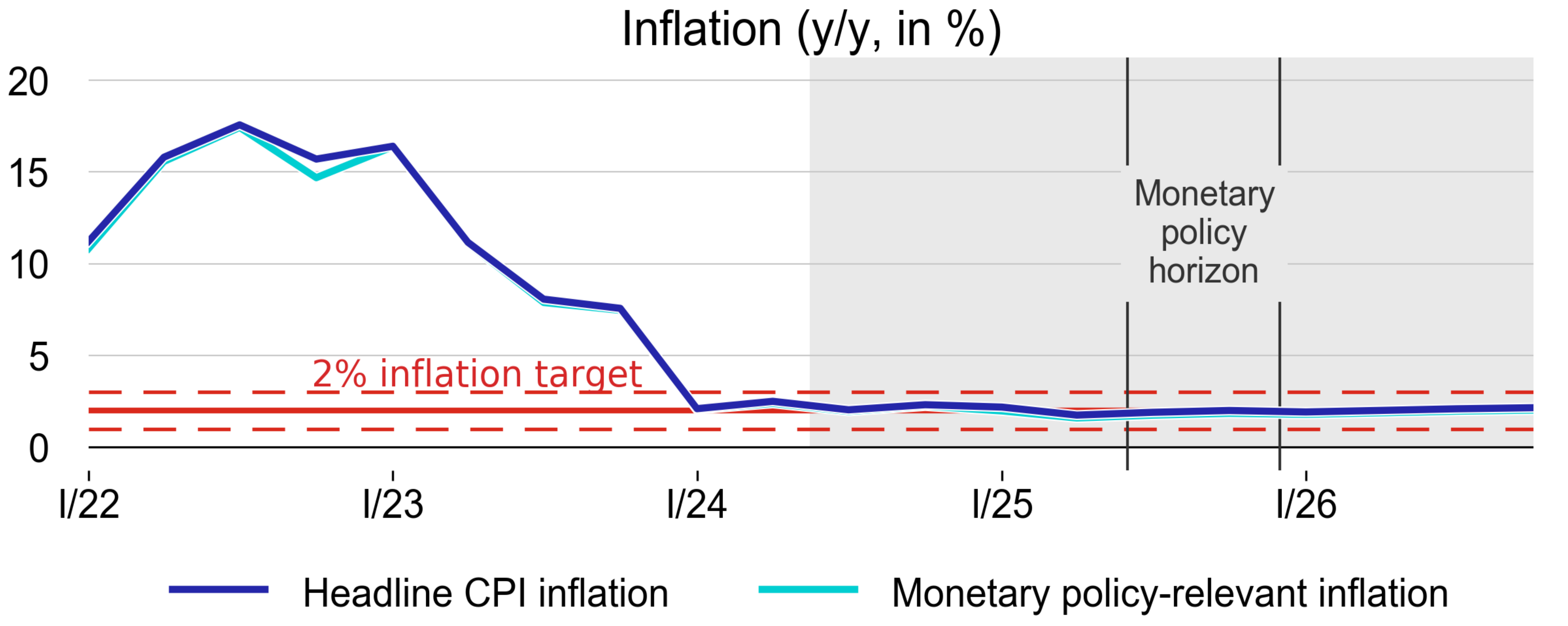


- Growth in **nominal general government consumption** will slow despite expected renewed brisk growth in public sector pay this year and the next.
  - Reduction in operating expenditure under the consolidation package;
  - Partial fade-out of last year's effect of increased expenditure linked with the arrival of Ukrainian war refugees.
- **Fiscal policy** is significantly dampening GDP growth this year (due mainly to the consolidation package) and will have a neutral effect next year.

Presentation Outline

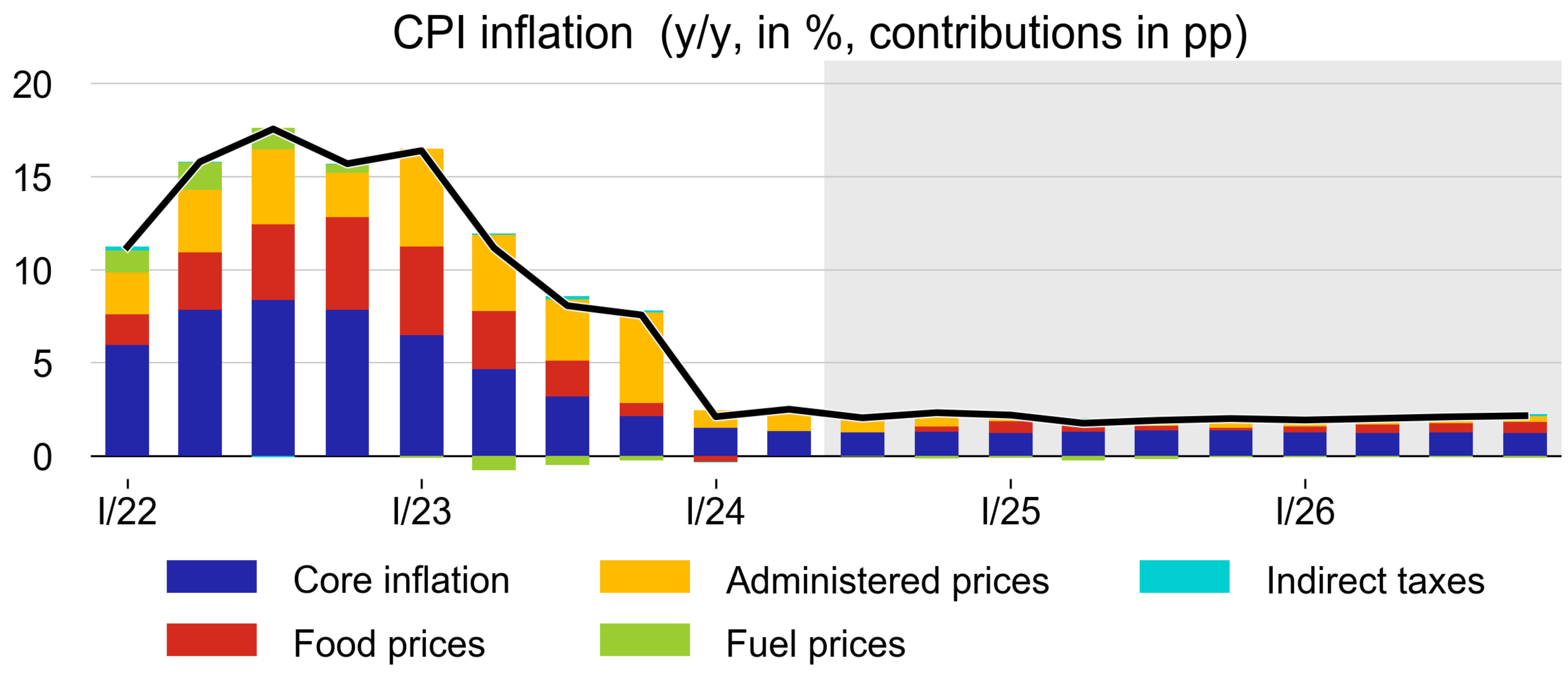
Headline and Monetary Policy-Relevant Inflation

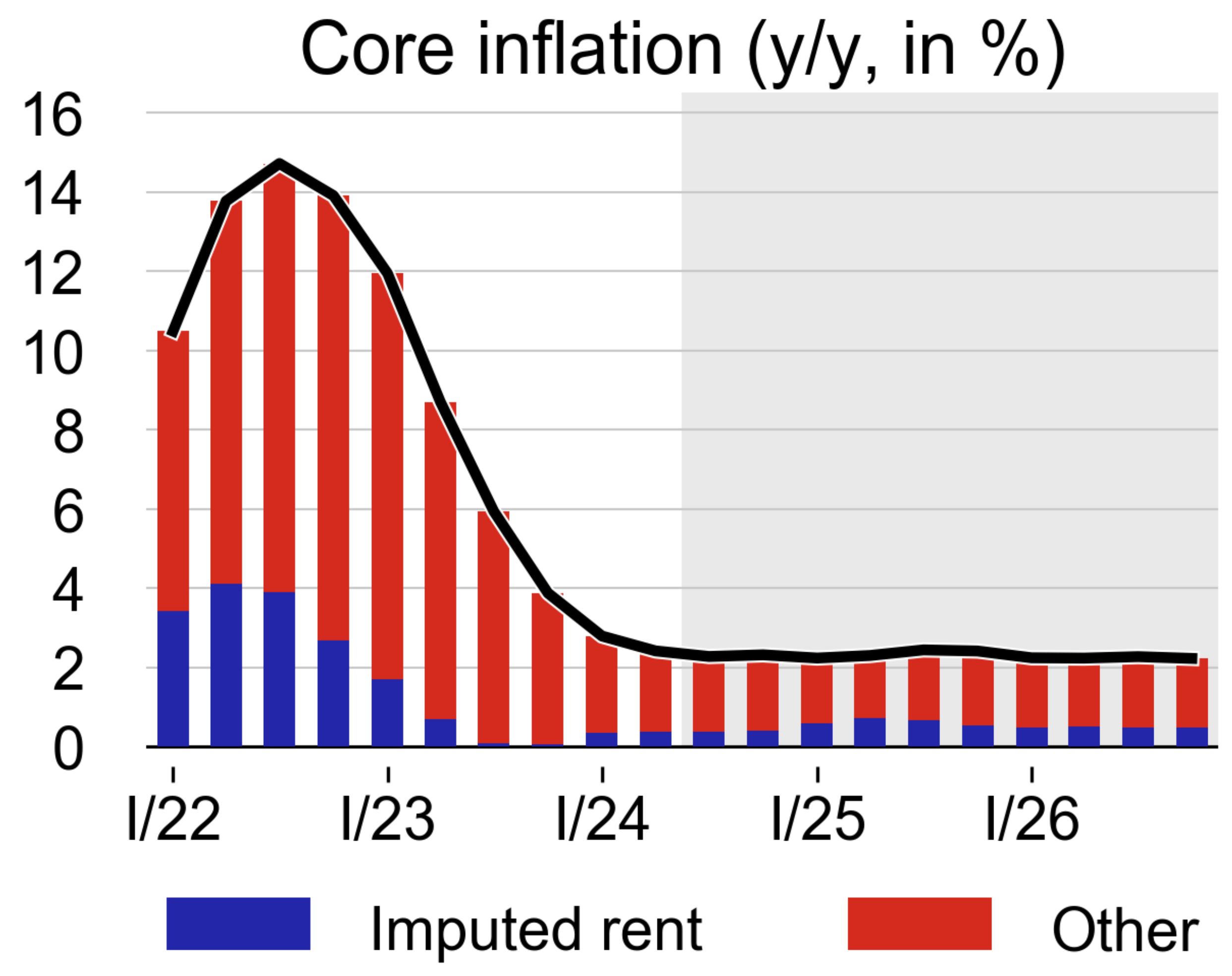


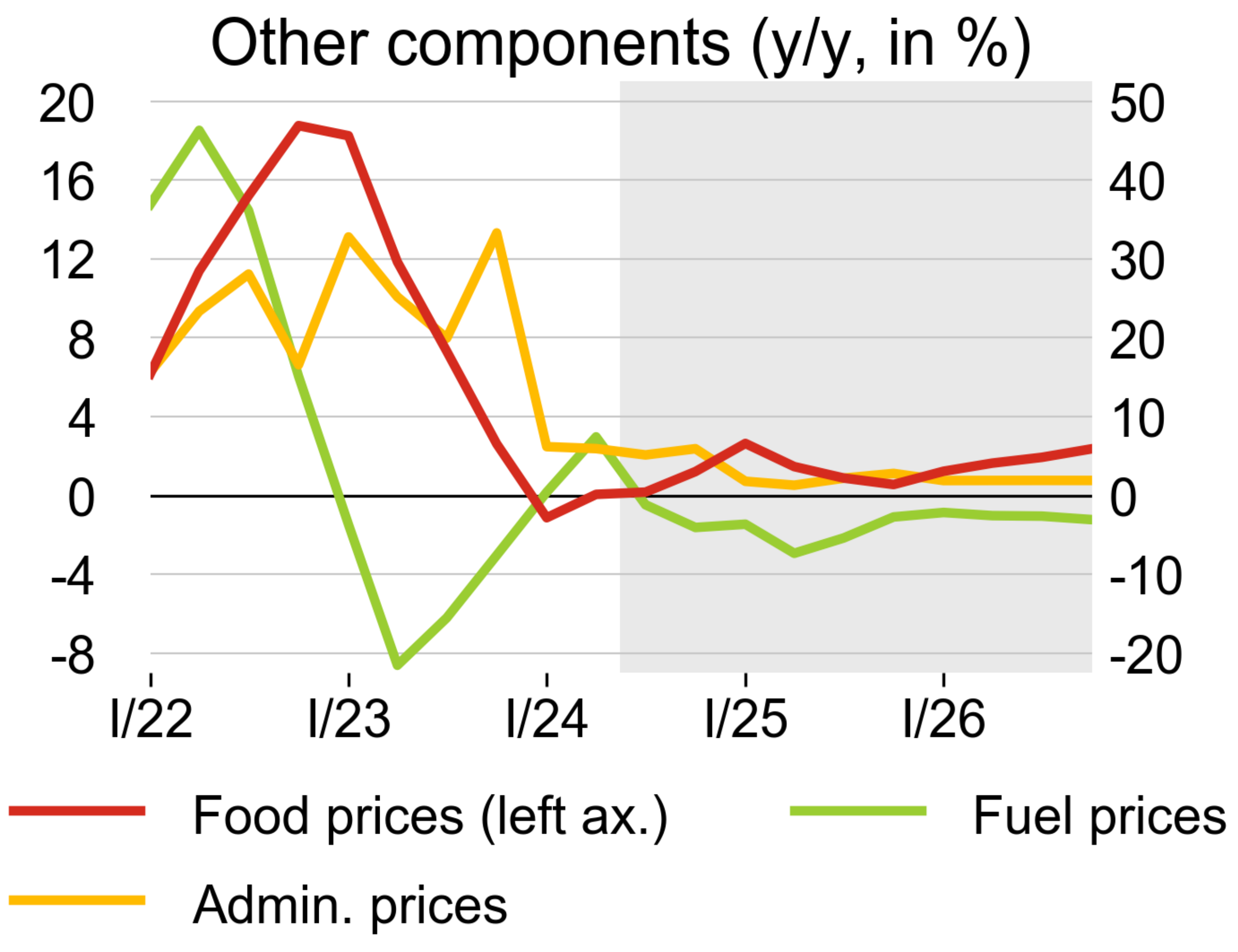


- **Inflation** will be close to the **2% target** for the rest of this year and stay there over the monetary policy horizon.
- Headline inflation will be slightly above **monetary policy-relevant inflation** due mainly to slightly inflationary effect of increase in excise duty on tobacco and alcohol.

CPI Inflation, Core Inflation and Administered Prices



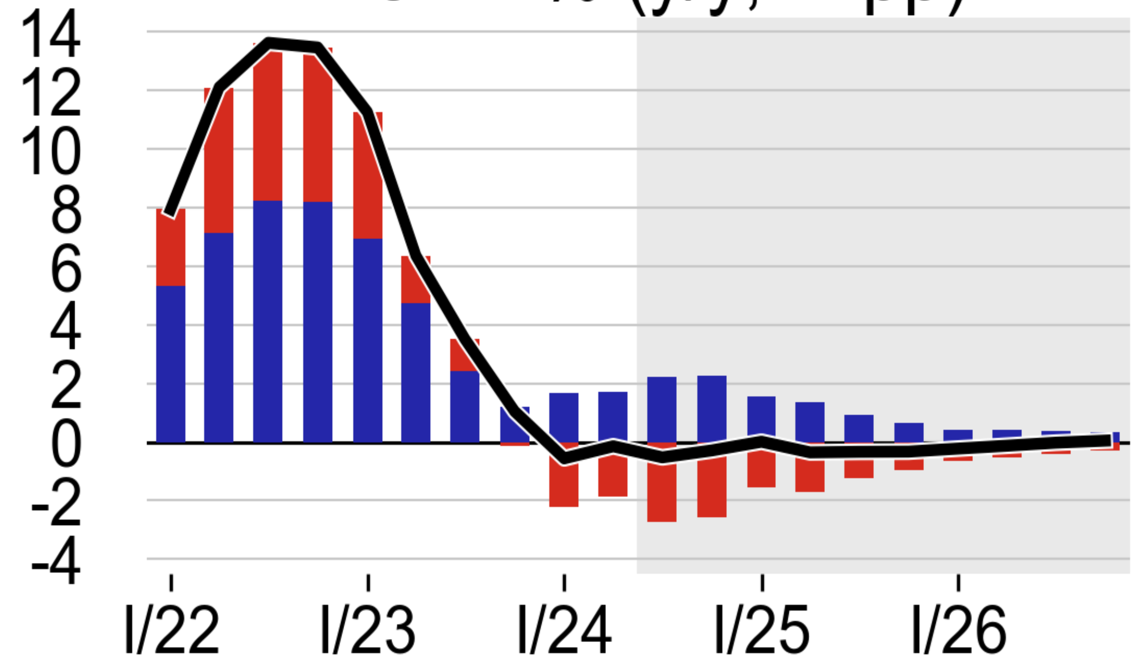




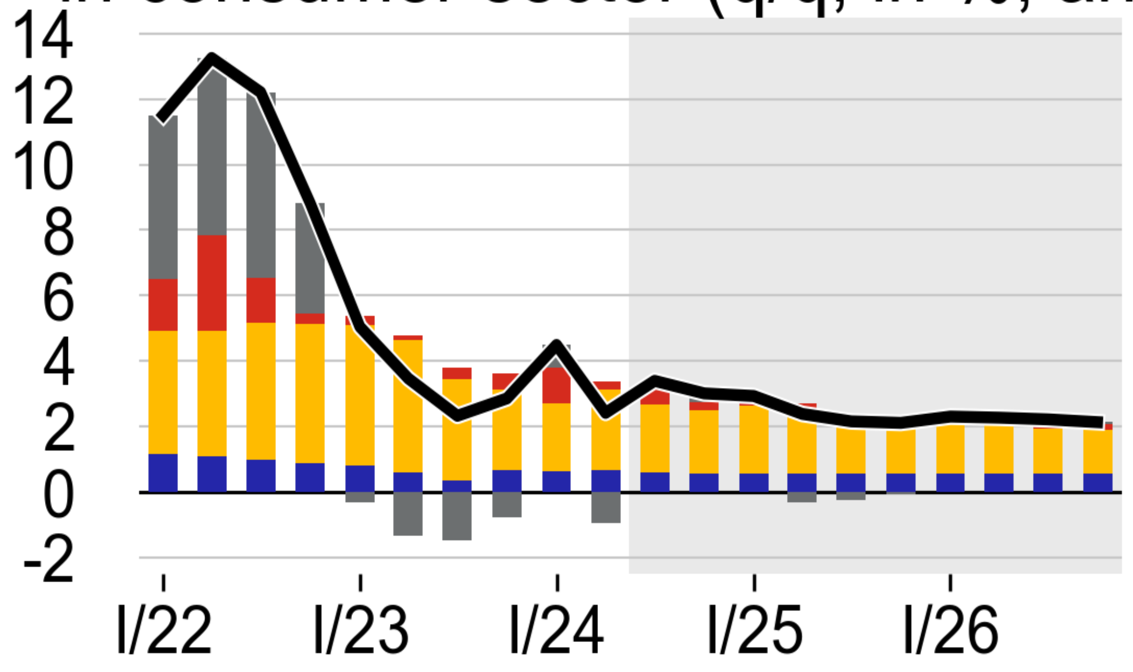
- **Consumer price inflation** slowed sharply at the start of this year and was exactly at the CNB's 2% target in June. Inflation will fall slightly in Q3 due mainly to lower contribution of core inflation and will be at the CNB's 2% inflation target on average.
- **Core inflation** will remain close to 2% amid a gradually increasing contribution of imputed rent.
- **Food price inflation** will accelerate at the end of Q3 and then also in Q4 due to base effects.
- **Administered price inflation** will decline to its long-term average in 2025.
- **Fuel price inflation** will be negative in the following quarters, mainly because of a gradual correction of the currently somewhat elevated oil prices.

Cost Pressures and Profit Mark-ups

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



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



Costs

Surcharge to costs

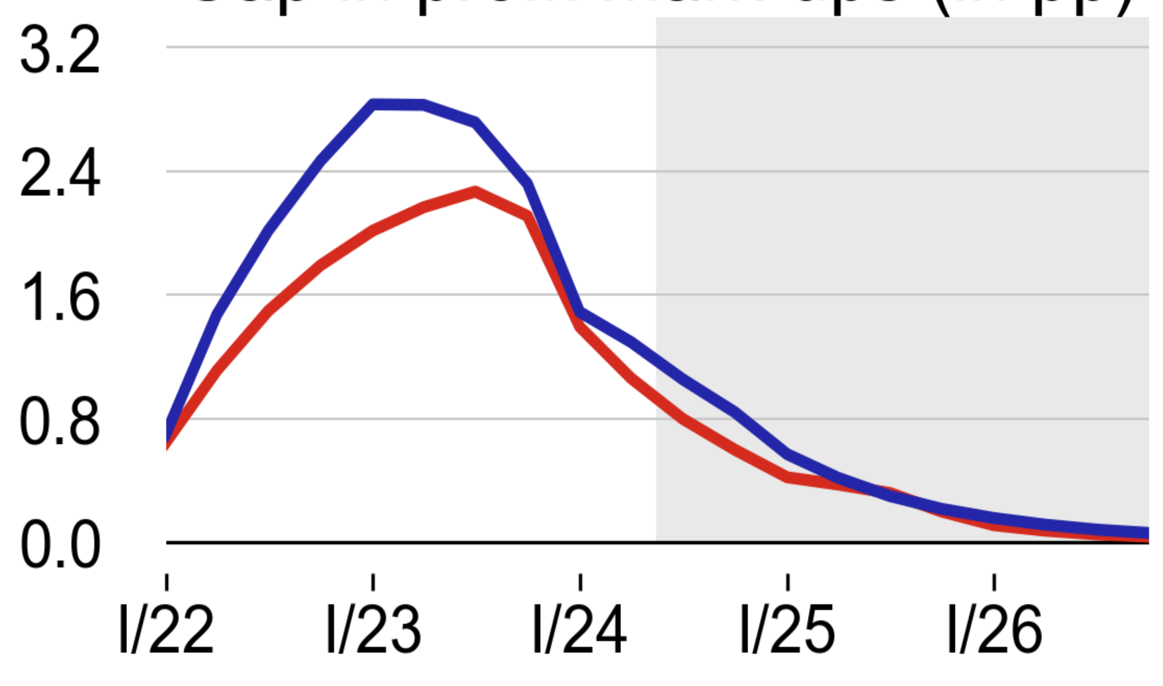
Price convergence

Interm. goods prices

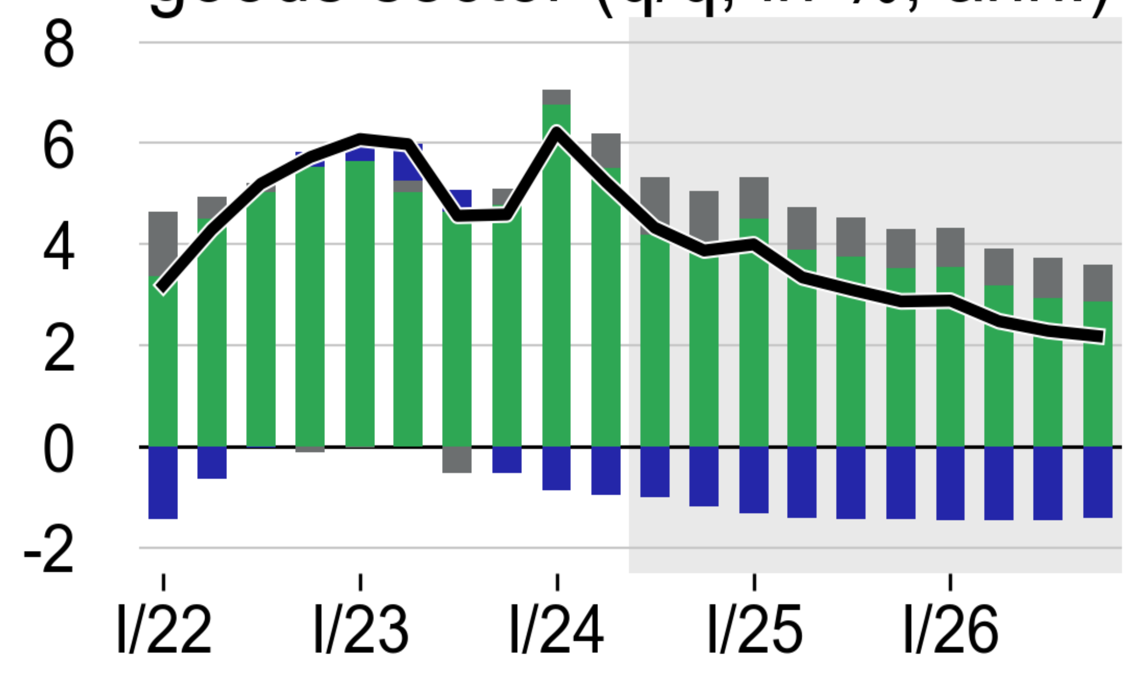
Core imp. prices

Energy imp. prices

Gap in profit mark-ups (in pp)



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



Consumer Sector

Intermediate sector

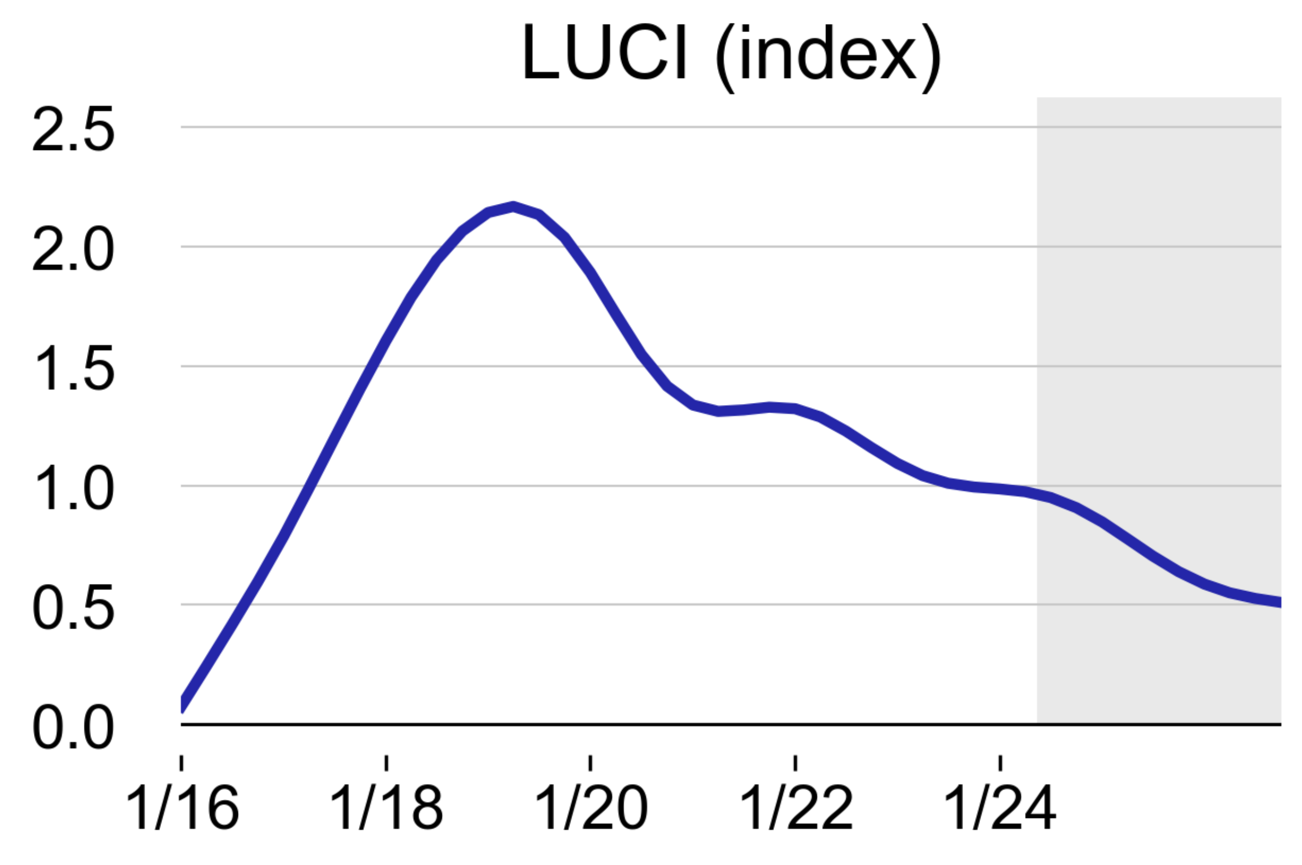
Wages in market sectors

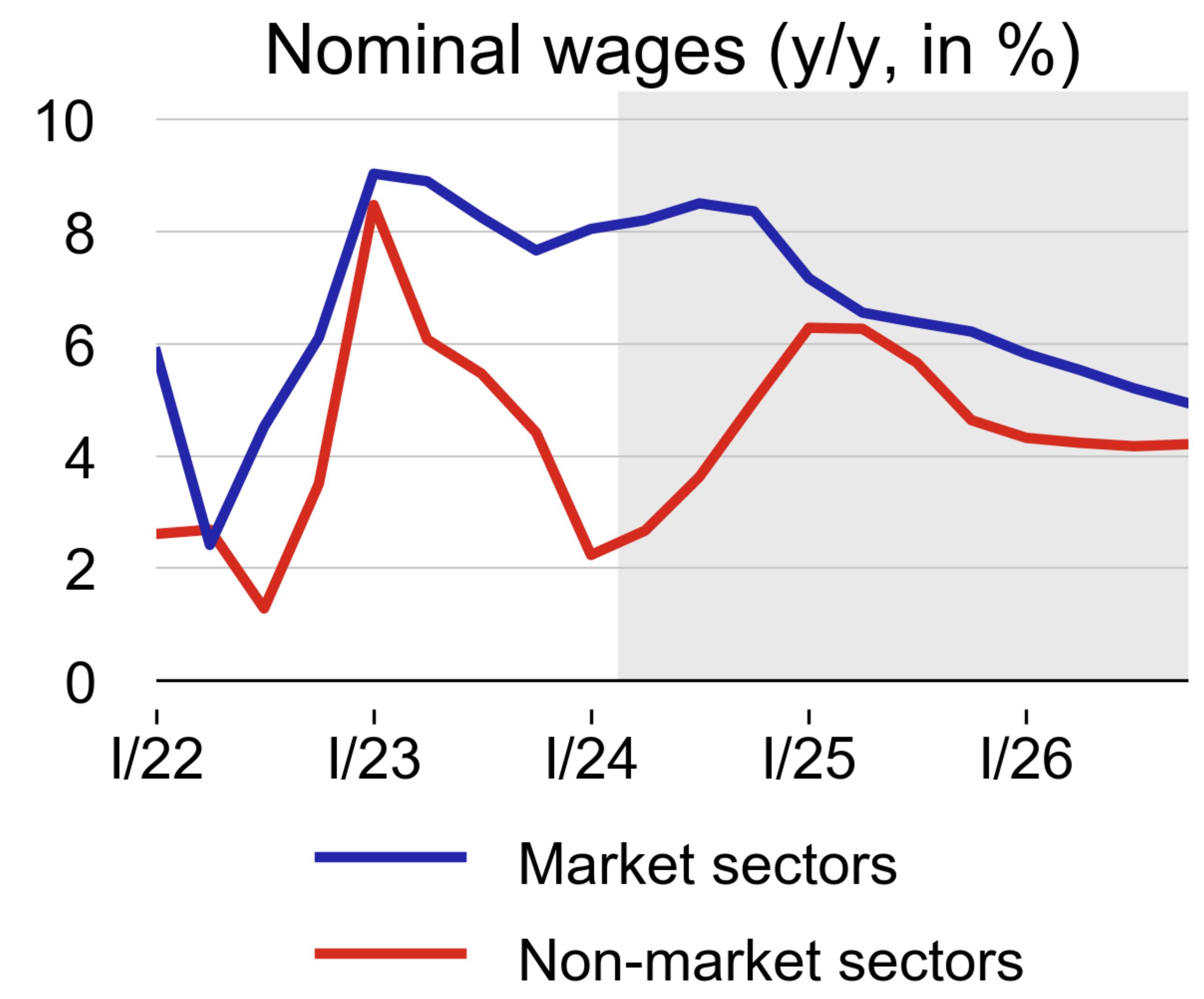
Price of capital

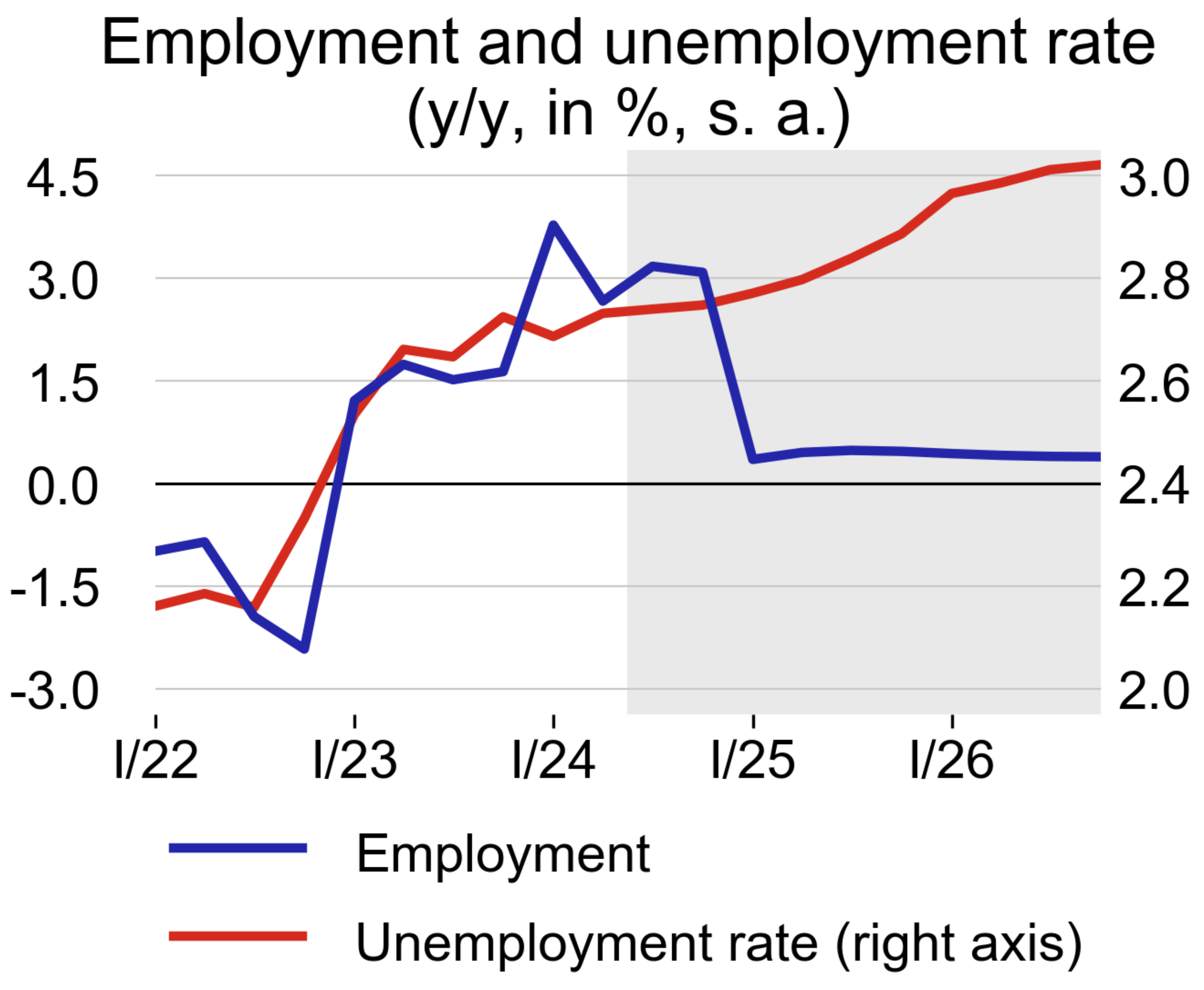
Labor efficiency

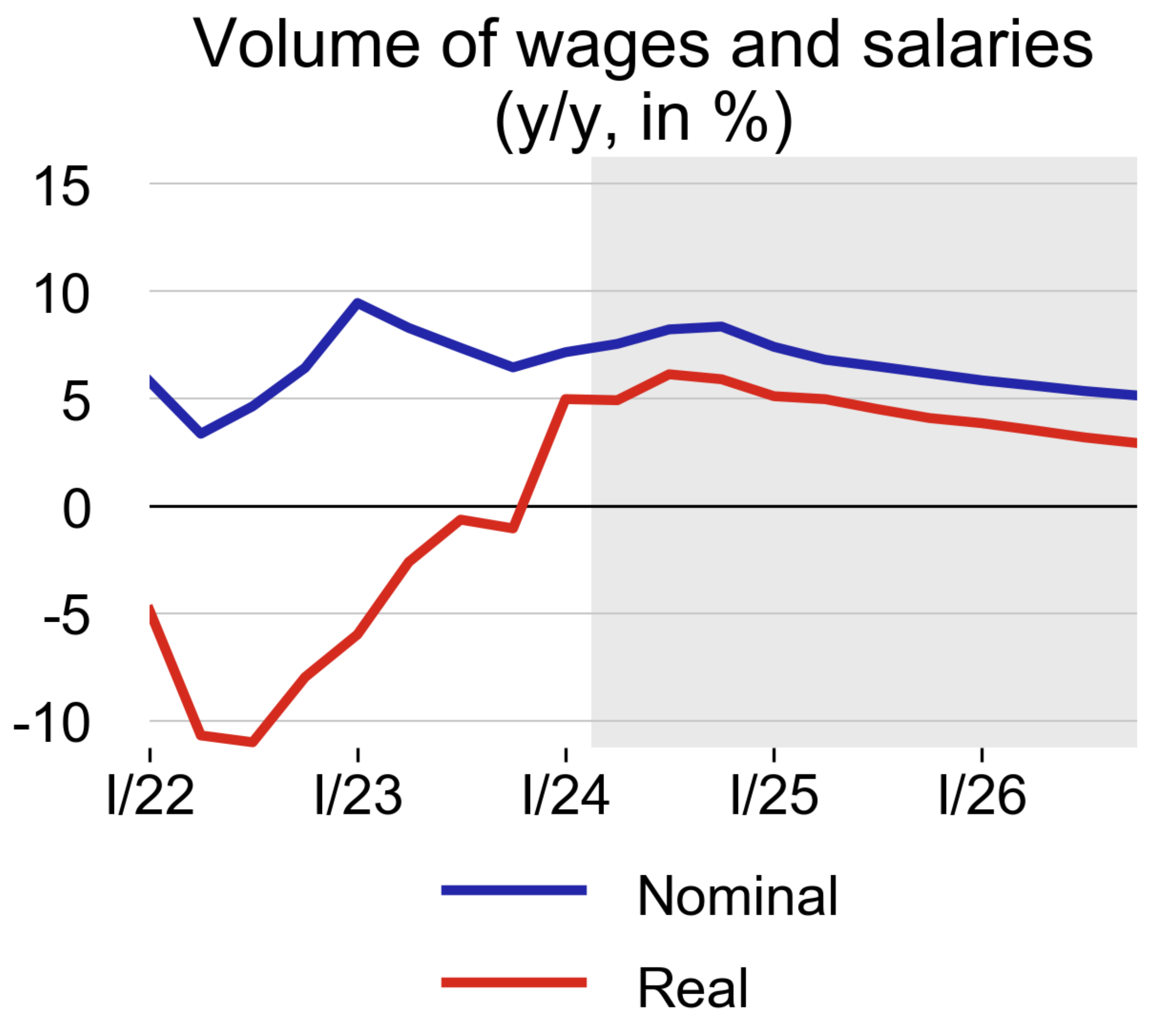
- **Market price growth** over the past two years has been driven by rising costs and a price **surcharge**, which has gone well beyond the corresponding increase in **costs**.
  - This year, the contribution of the surcharge to costs turned negative. Despite continued elevated cost growth, retailers re-priced only to a limited extent due to the current tight monetary policy.
  - On the outlook, the surcharge to costs remains negative and costs will continue to contribute positively.
- The elevated **overall cost pressures** will decline next year amid a gradual decline in the inflationary effect of the domestic economy and renewed gradual 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



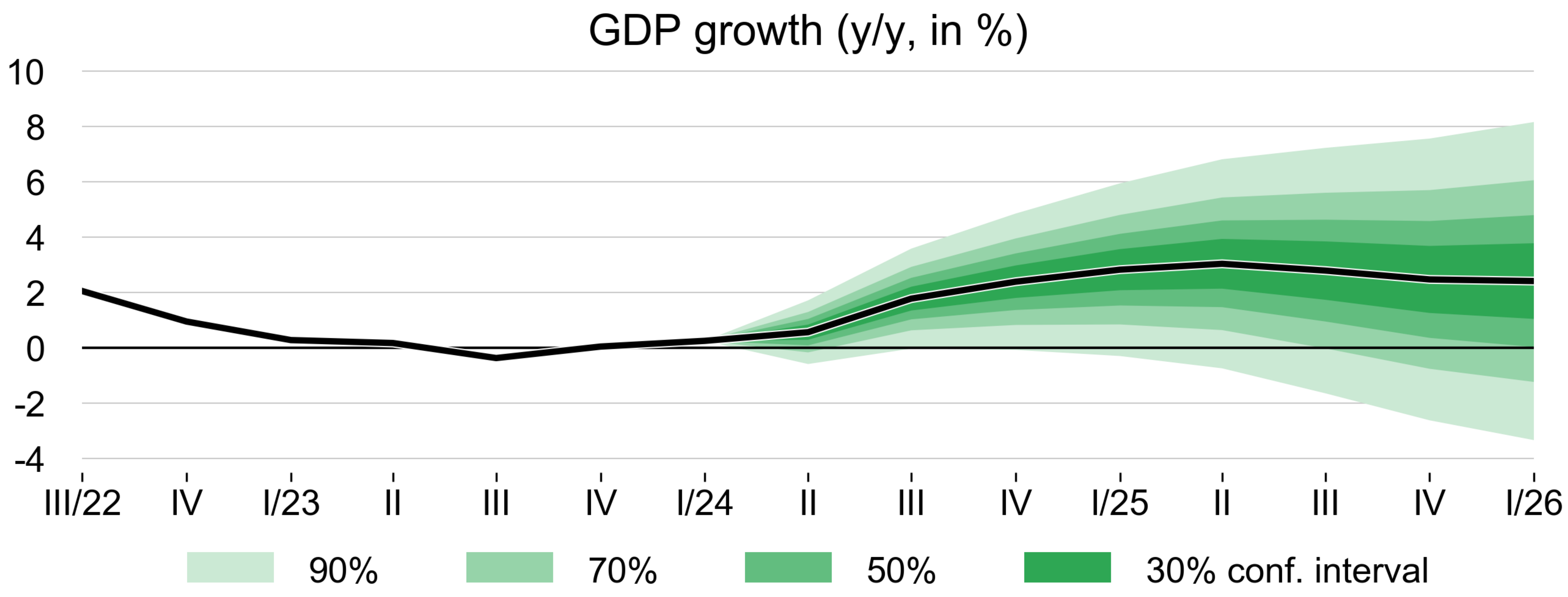


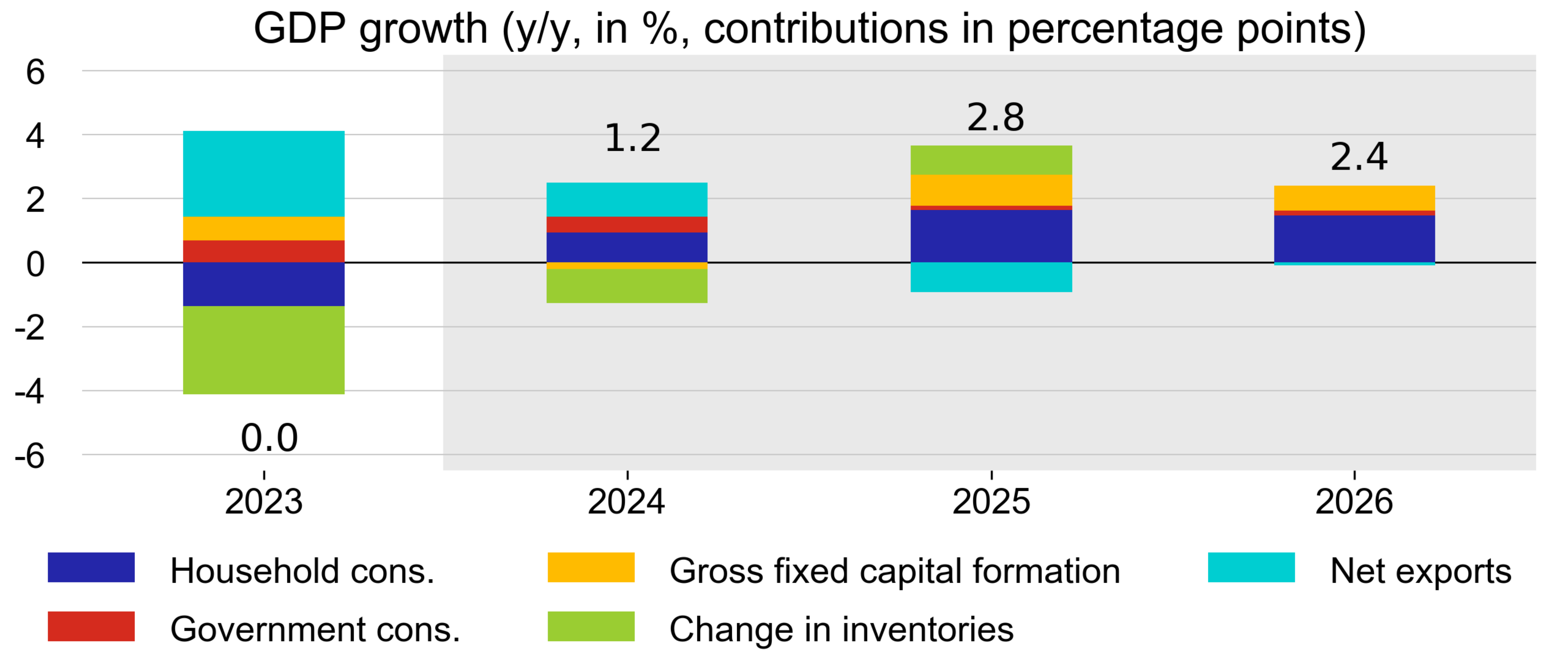




- From the perspective of the **LUCI**, the tightness in the labour market will gradually decrease further.
- **Nominal wage growth** will remain elevated from the long-term perspective and slow only gradually.
- **Employment** will surge this year due to a statistical effect at the start of the year; **unemployment rate** will increase only slowly.
- The **real wage** has started to growth again 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.

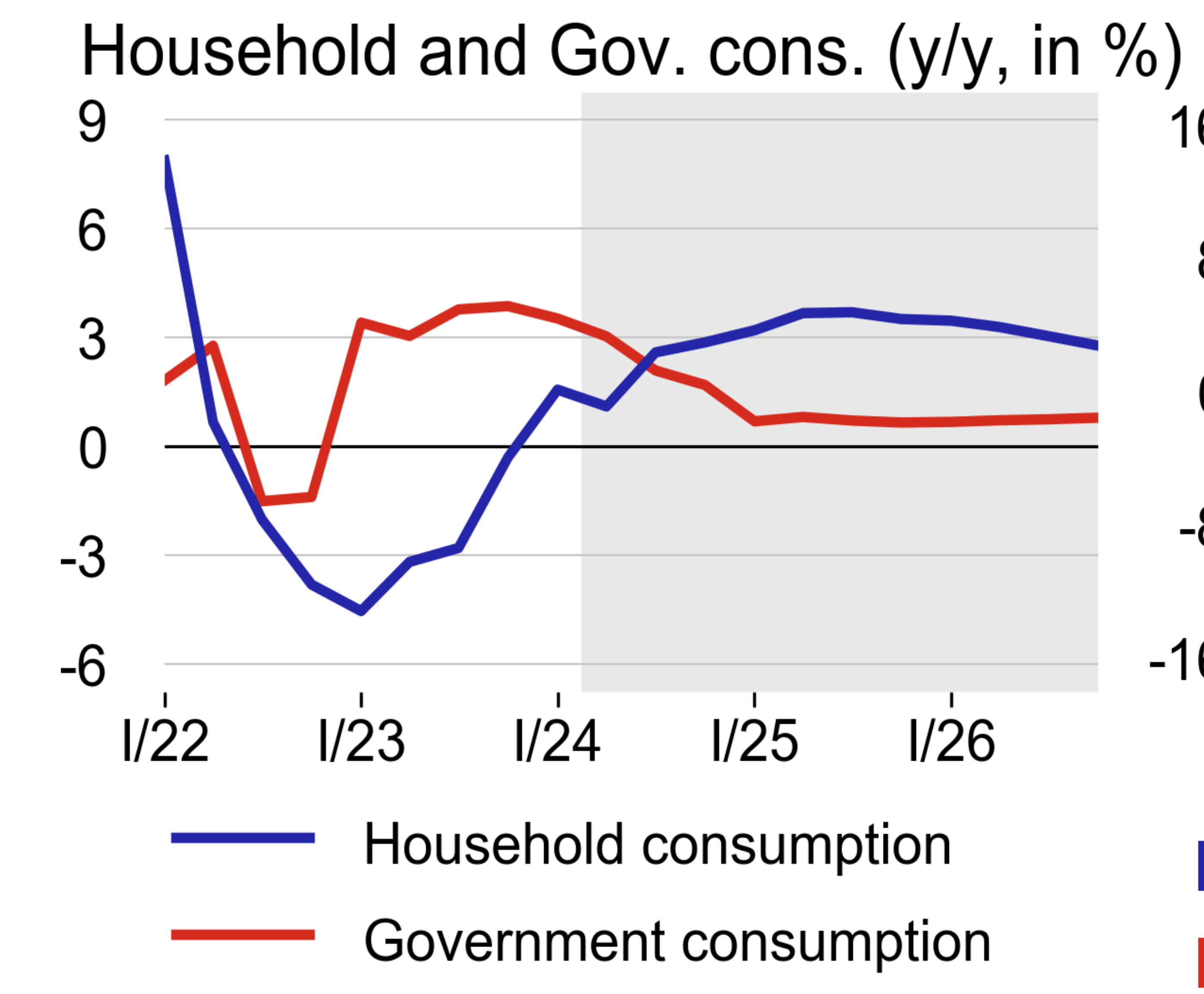
GDP Growth Forecast

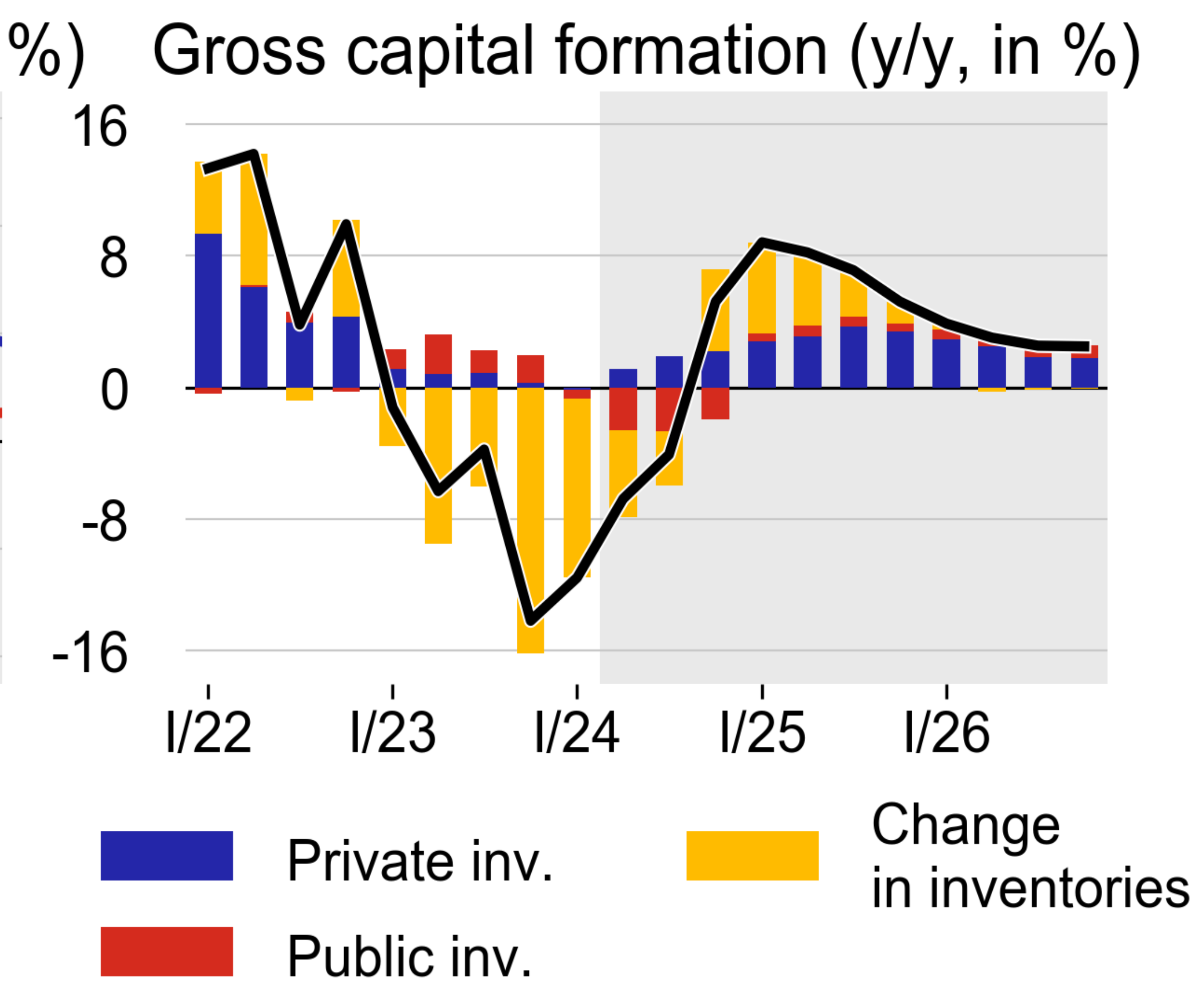


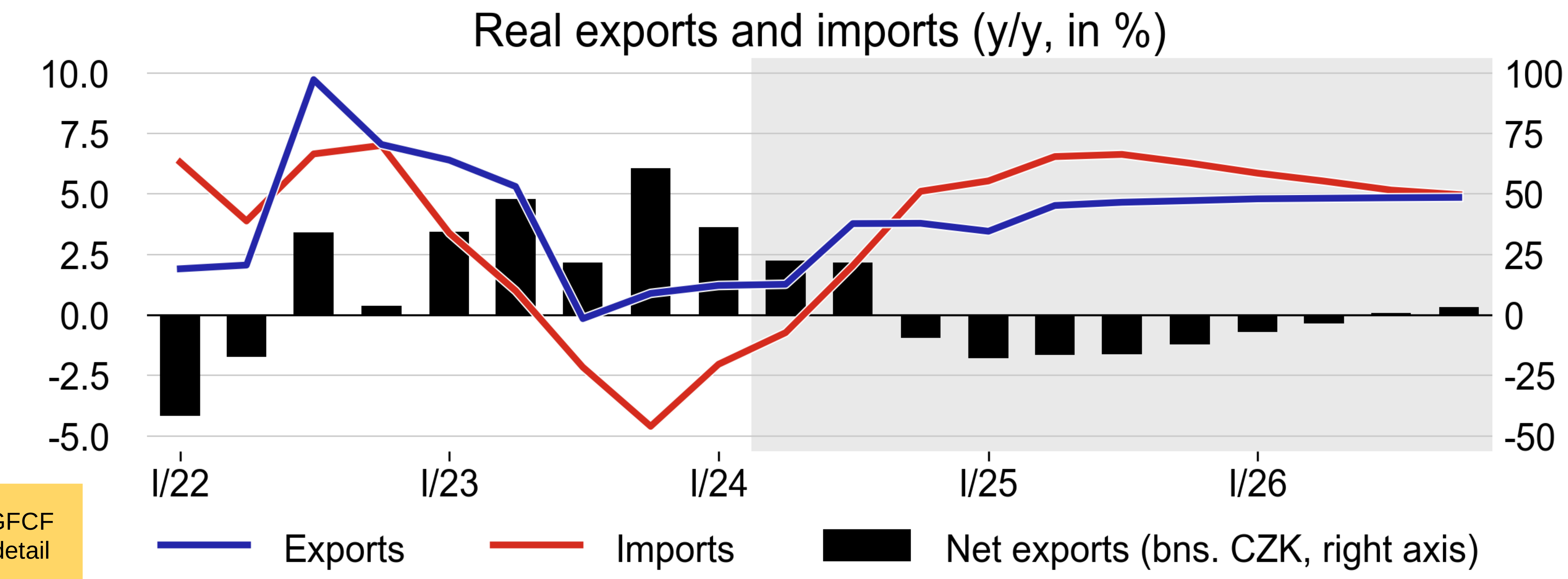


- The **economy** will expand this year and **GDP growth** will pick up further next year.
- In whole-year terms, **GDP** will grow by **1.2%**. In 2025, the growth will pick up to **2.8%**. It will slow in 2026 close to new equilibrium of **2.5%**.
- According to a preliminary CZSO estimate, the Czech GDP increased by **0.3%** quarter-on-quarter and by **0.4%** year-on-year in 2024 Q2. This is slightly lower than the CNB forecast.

GDP Components



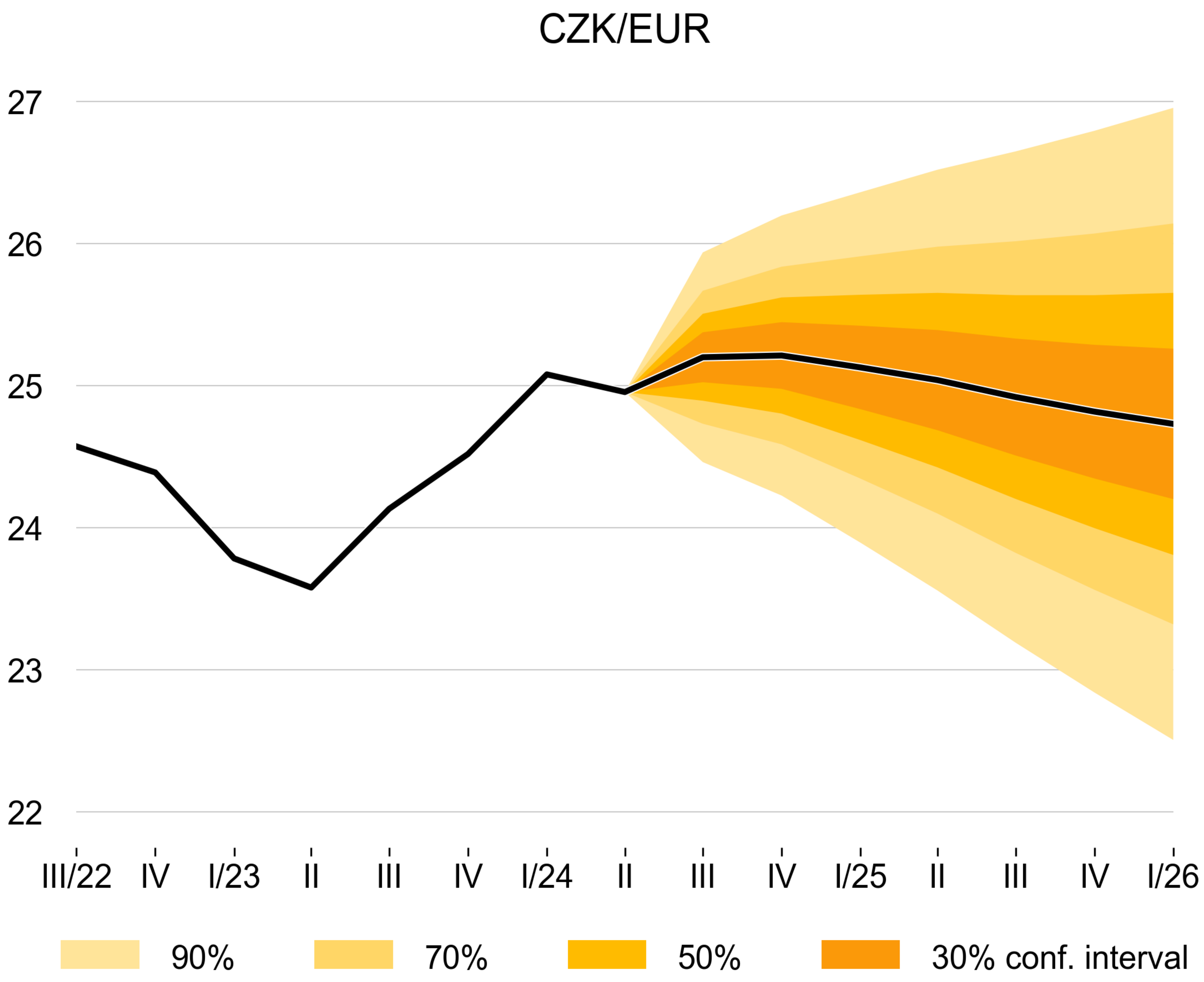




GFCF detail

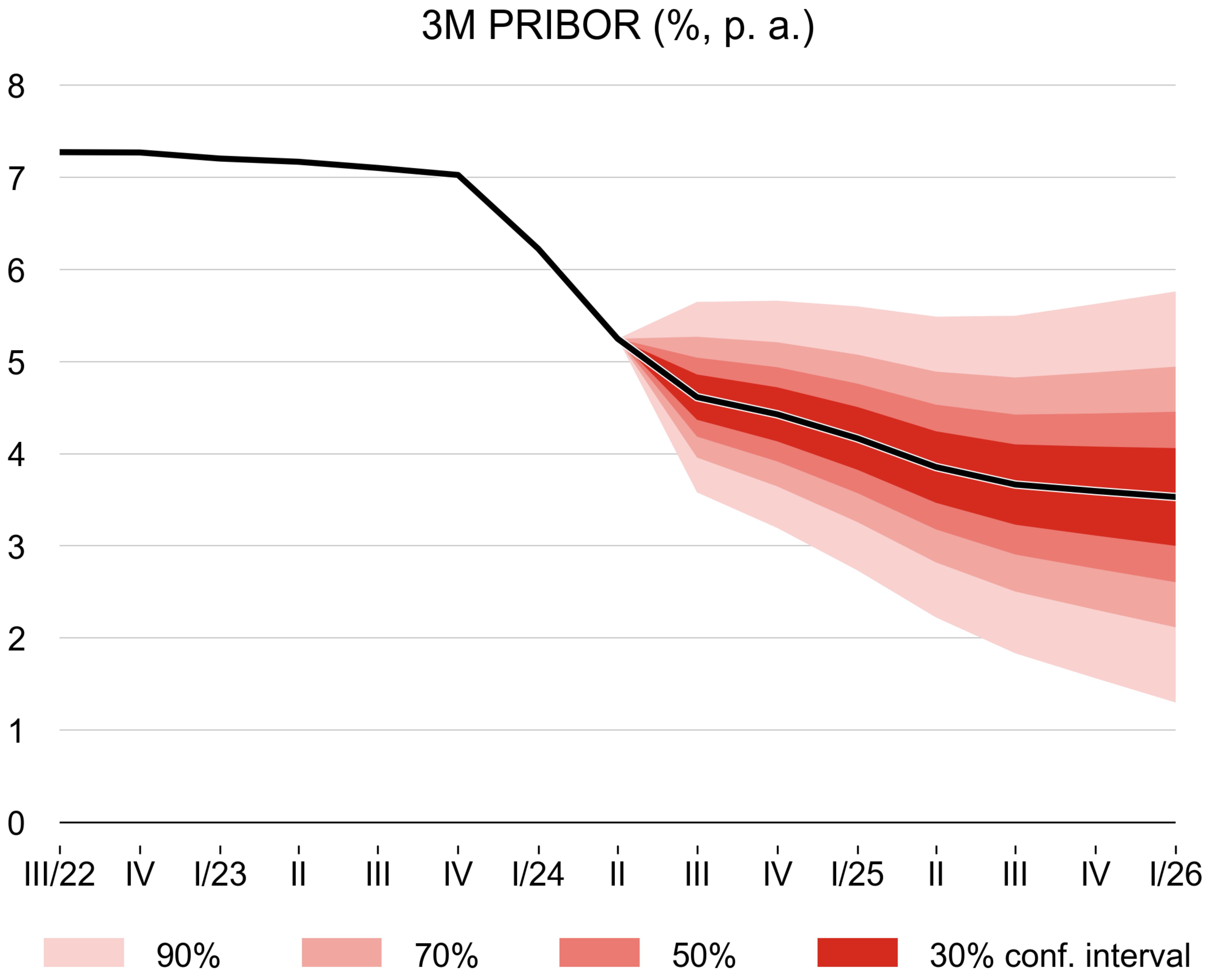
- Growth in **household consumption** will recover rapidly on the back of swiftly rising real wages.
- **Government consumption** will grow at a subdued pace.
- Growth in total **gross capital formation** will be volatile due to **inventories**, while growth in **private fixed investment** will accelerate gradually following an initial downturn.
- **General government investment** will decline this year due mainly to consolidation efforts.
- **Export** and **import** growth will gradually accelerate this year as external and domestic demand slowly recovers.

Exchange Rate CZK/EUR



- The spring forecast expects the koruna to average **CZK 25.2** to the euro in 2024 Q3.
- After broadly stagnating at the end of this year, the koruna will start to appreciate slightly, due mainly to favourable **net exports** of goods and services and continued **growth in economic activity**.
- The appreciation of the koruna will be dampened by a gradually narrowing **interest rate differential** vis-à-vis the euro area.

Interest Rate Path (3M PRIBOR)



- Consistent with the baseline scenario is a modest decline in **market interest rates**.
- Although growth in costs will still be slightly elevated this year due to the repercussions of the previous extraordinary inflation pressures, this will not reverse the need to ease monetary policy further.
- The inflationary effect of the growth in costs will be offset by a decline in firms' profit margins. Inflation will thus stay close to the 2% target over the entire outlook.

Presentation Outline

1. Structural Changes and New Equilibria
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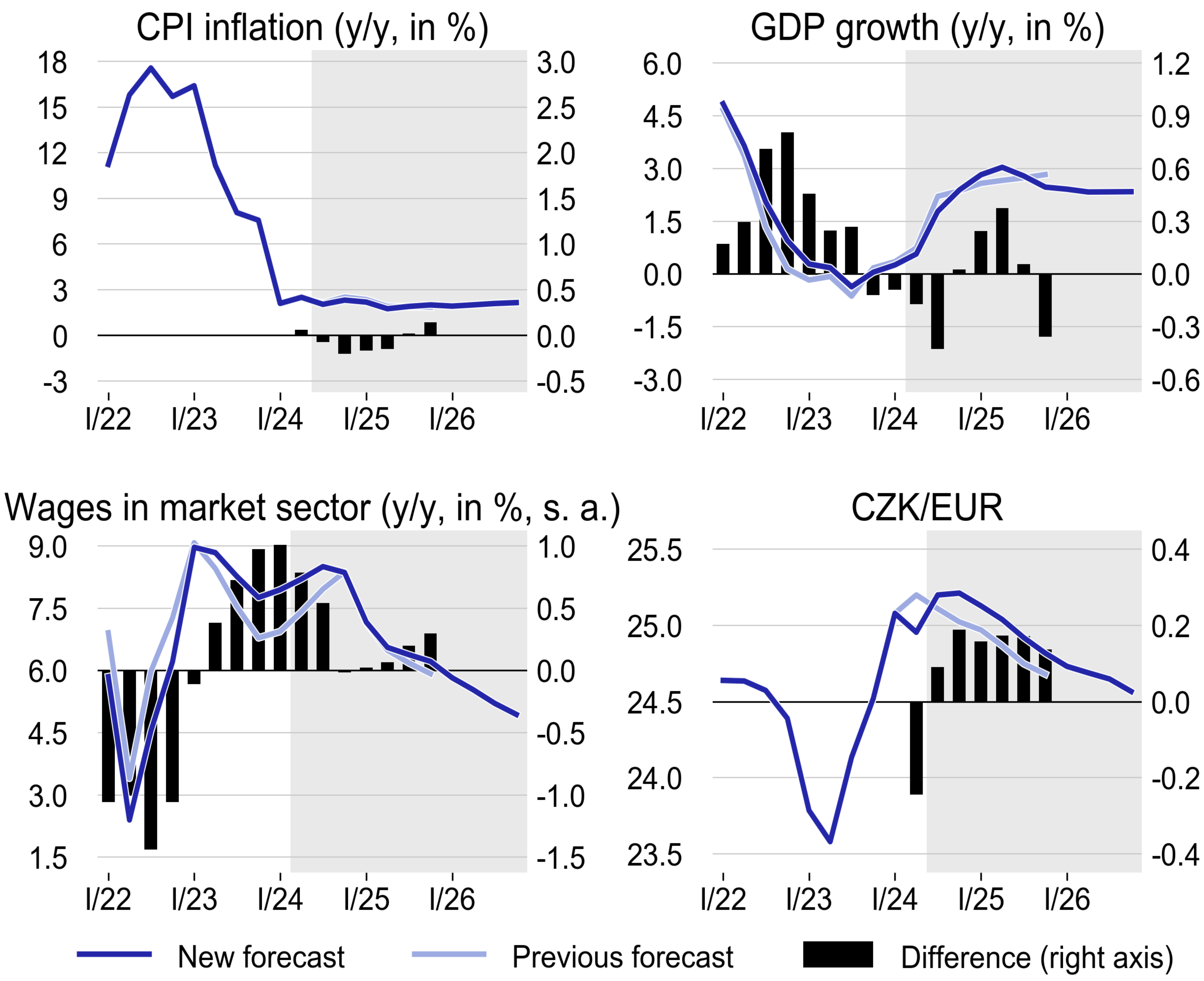
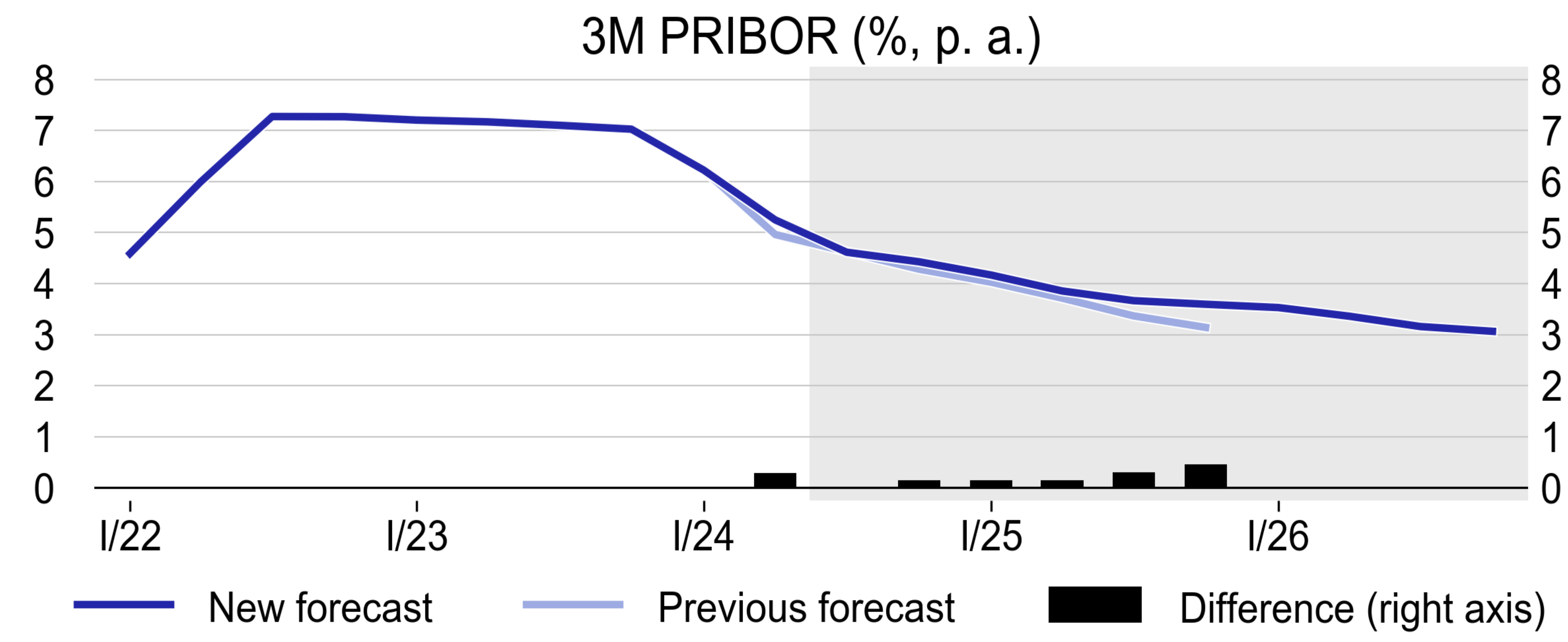
5. Scoreboard Risks

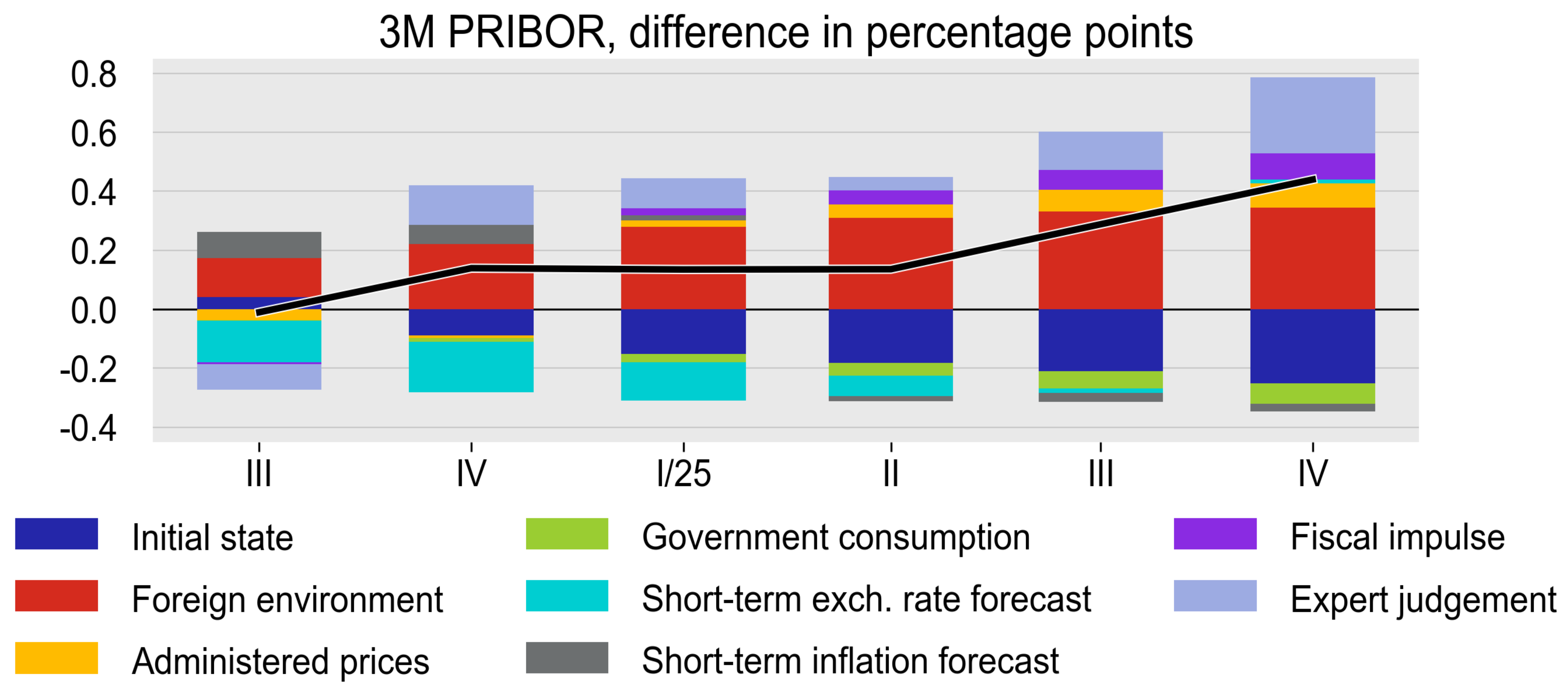
Comparison of the Forecasts: Domestic Economy



- The **inflation** forecast for this year has shifted down slightly owing to a lower outlook for fuel prices and slightly lower core inflation.
- The **GDP outlook** for this year is slightly lower due to weaker domestic demand; average GDP growth is almost the same next year.
- The higher expected **wage growth** reflects the initially observed wage growth in market sectors at the start of 2024.
- The **short-term exchange rate forecast** mainly reflects the **observed levels**, which shift it to a weaker initial level than in the previous forecast. 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 **interest rate** path is slightly higher on average than in the spring forecast
- The **initial state** fosters slightly lower rates due to lower energy import prices and a stronger koruna observed in the previous quarter. A revision of the national accounts has the same effect.
- The positive contribution of the **foreign environment** mainly reflects an increased market outlook for ECB interest rates and a weaker outlook for the **euro-dollar rate**.
- **Expert adjustments** foster the lower rates at first as they incorporate the initial levels of domestic rates, which were 0.5 pp lower at the start of Q3 than the average for Q2. The subsequently slightly positive contributions mainly reflect adjustments fostering faster wage growth and lower productivity growth due to lower steady-state potential growth.

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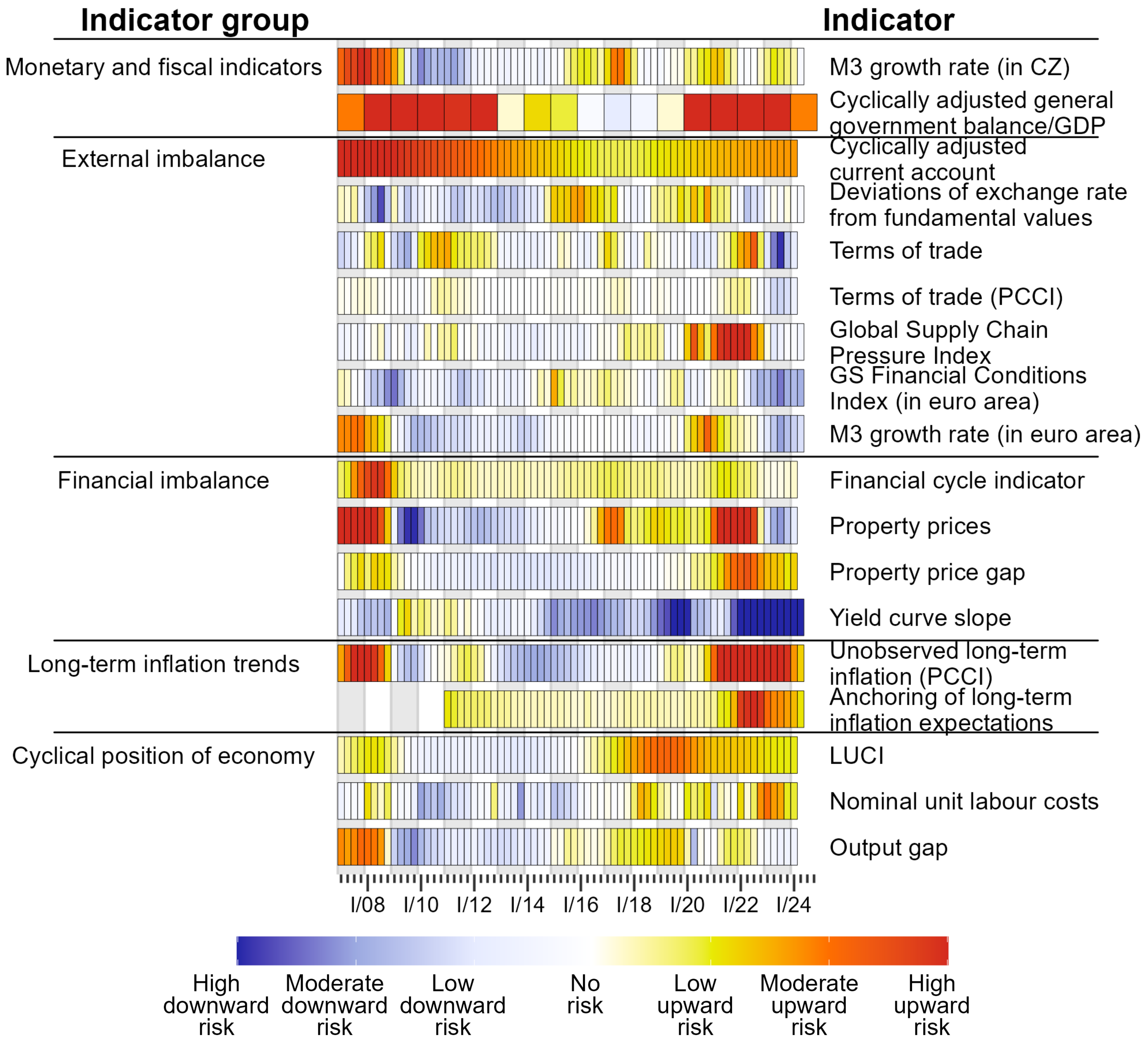
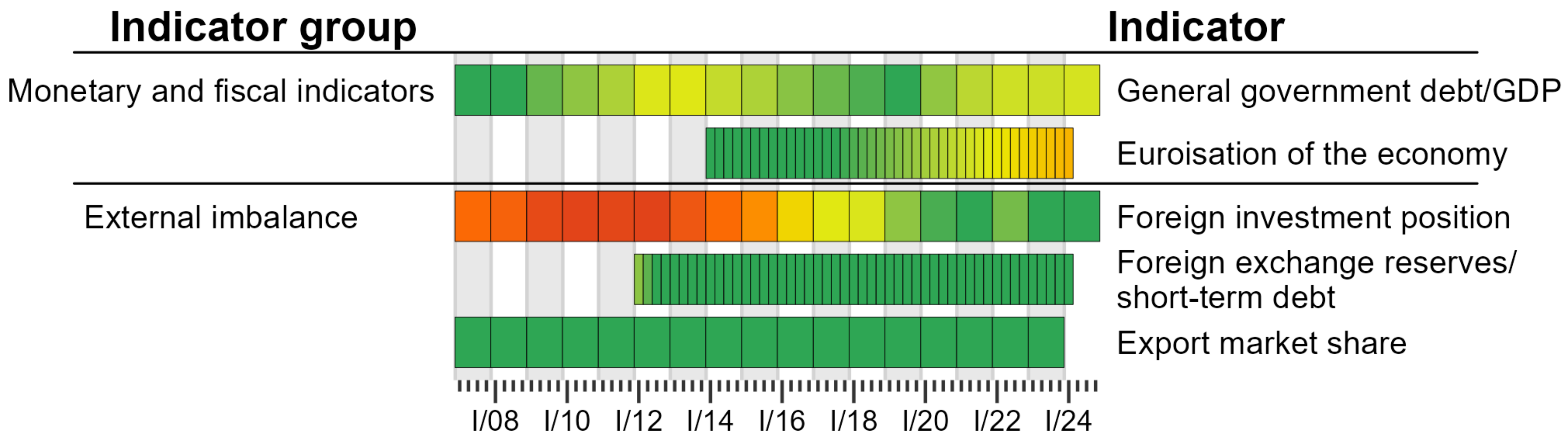
Presentation Outline

Risks identified by the Scoreboard

Inflation risks

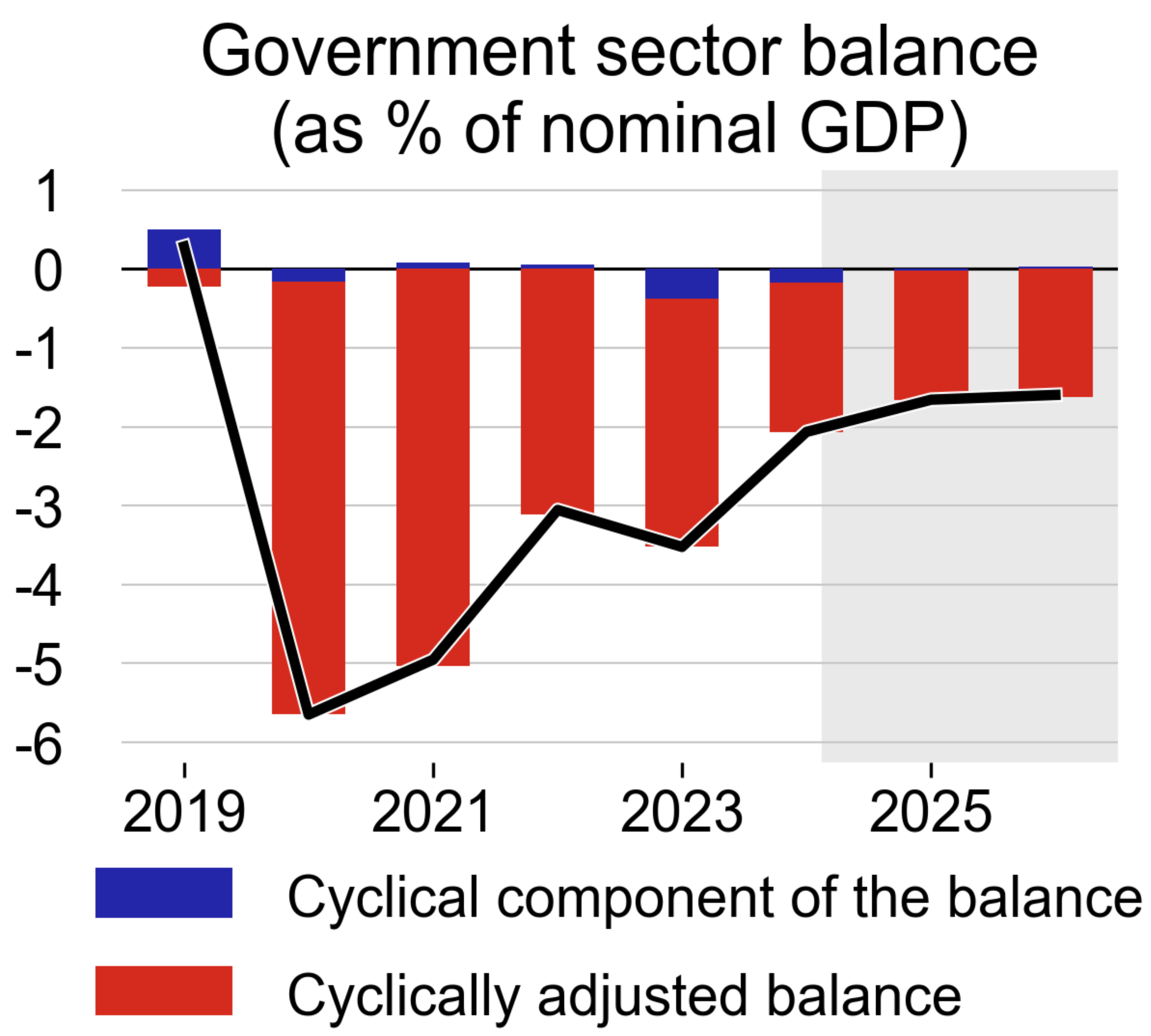


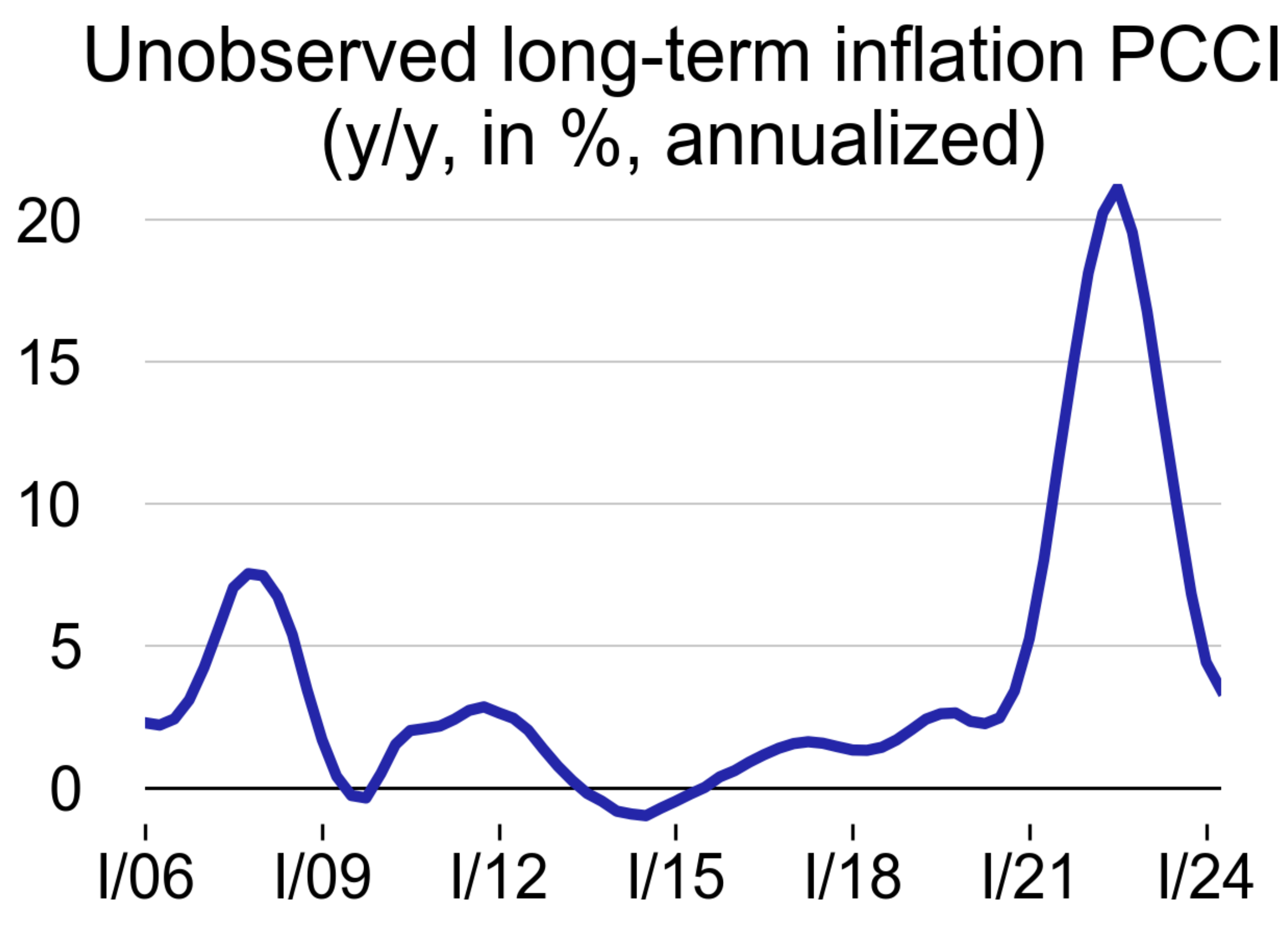
Other monetary policy risks

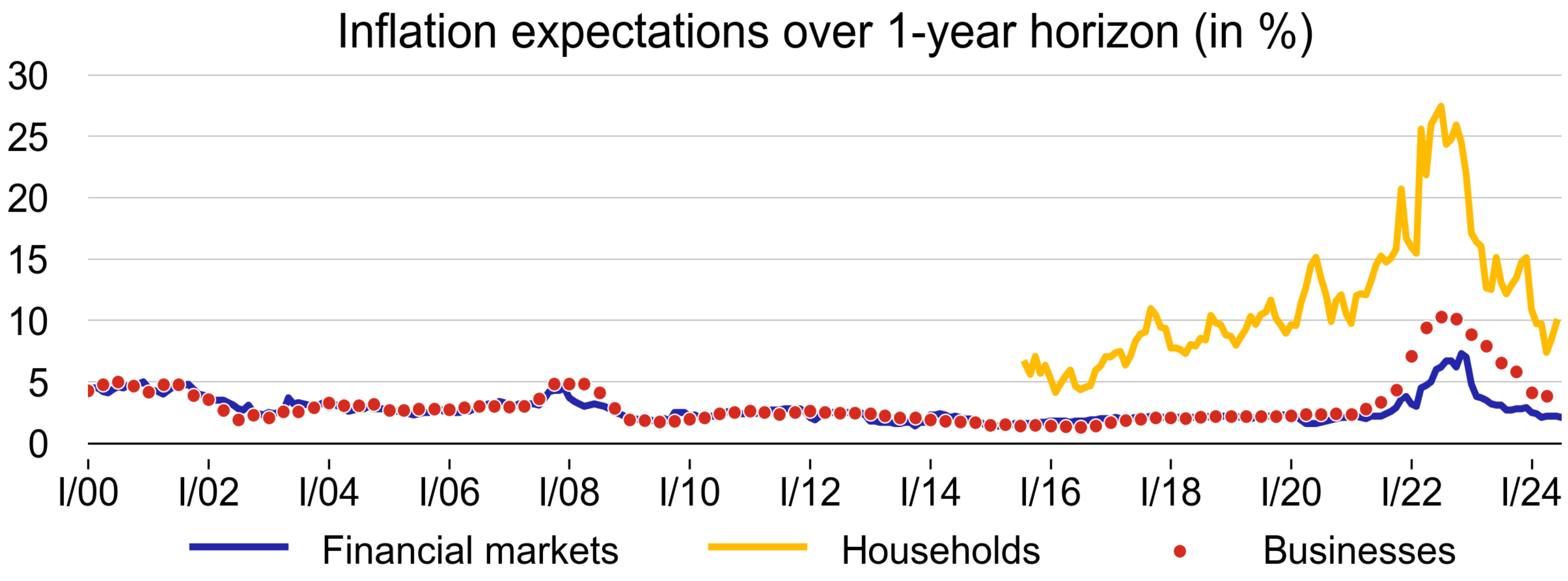


- The Inflation and Monetary Policy Risks Scoreboard is indicating diminishing **inflationary risks** (especially due to weakening *Long-term inflation trends* and *Monetary and fiscal indicators*).

Main Scoreboard Risks







- There is a gradual easing of the pro-inflationary risk in the area of **deficit spending by government** for this year.
- The risk of **long-term inflation** is also gradually weakening.
- **Inflation expectations** have declined but remain well above the 2% target especially in the case of firms.

Thank you for your attention

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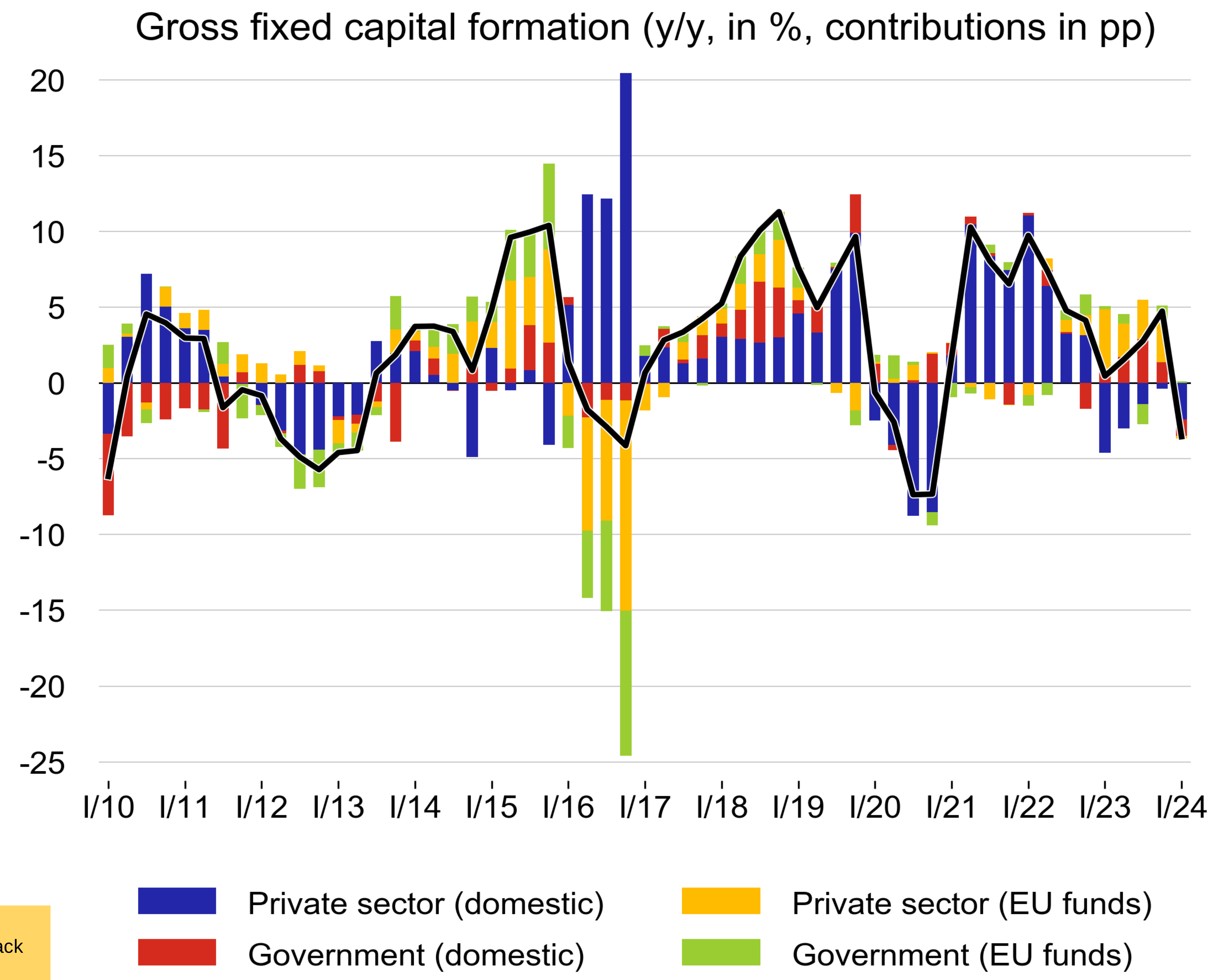
Gross Fixed Capital Formation



- The growth of **fixed investments** last year was significantly supported by **private sector investments**, which were financed by **EU funds**.
- Private companies utilized approximately CZK 53 billion from EU funds; however, this year we expect withdrawals of only CZK 25 billion.
- This year, total investments will slightly decline, driven by the shortfall in EU funds that financed private investments last year.
- A similar situation to that of 2015-2016 will occur, although to a lesser extent.
- In contrast, **government investments** financed by EU funds will reach approximately the same level as in the the last year.

Back