
CNB's New Forecast (Monetary Policy Report Winter 2021)

Meeting with Analysts

5 February 2021

Petr Král (Executive Director, Monetary Department)



Presentation Outline

1. Assumptions of the Forecast

2. The New Macroeconomic Forecast (Baseline Scenario)

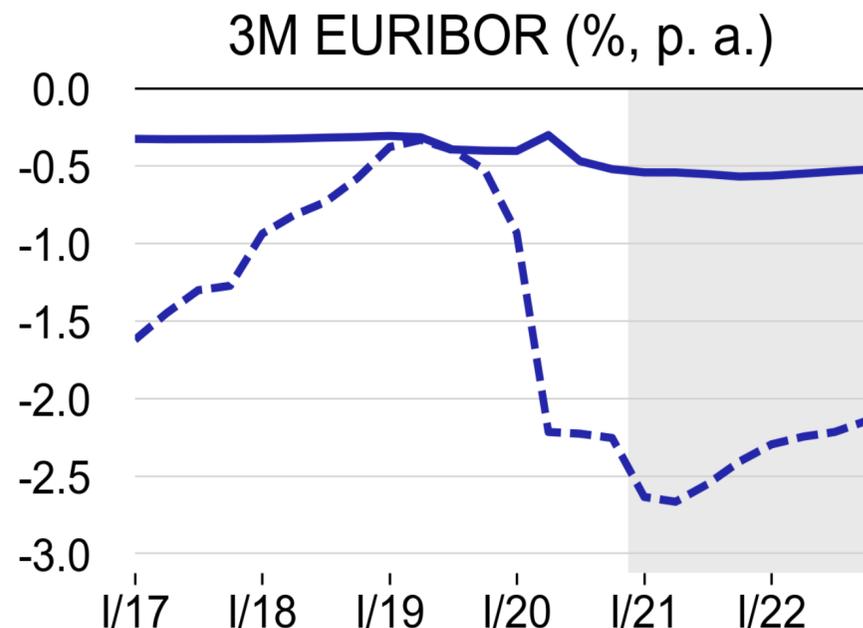
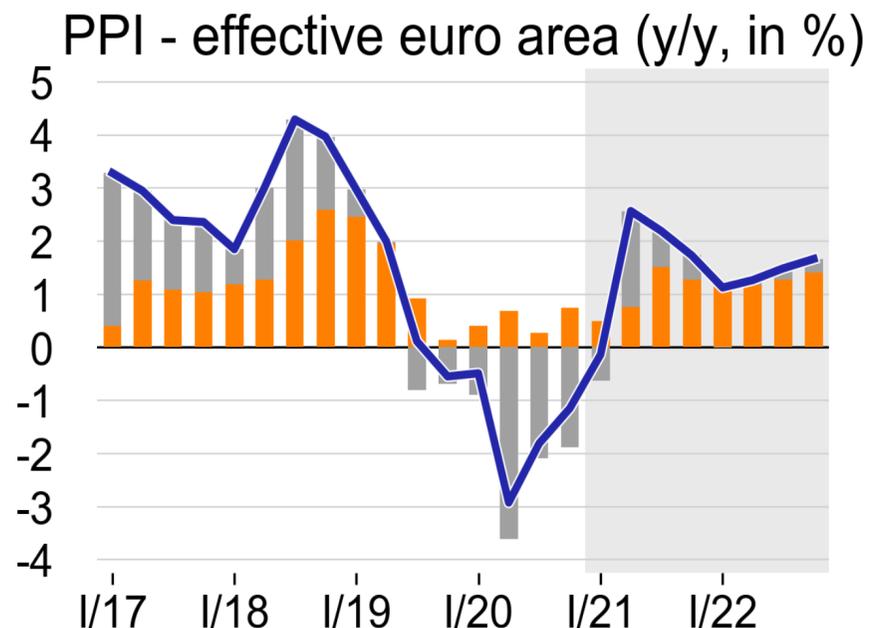
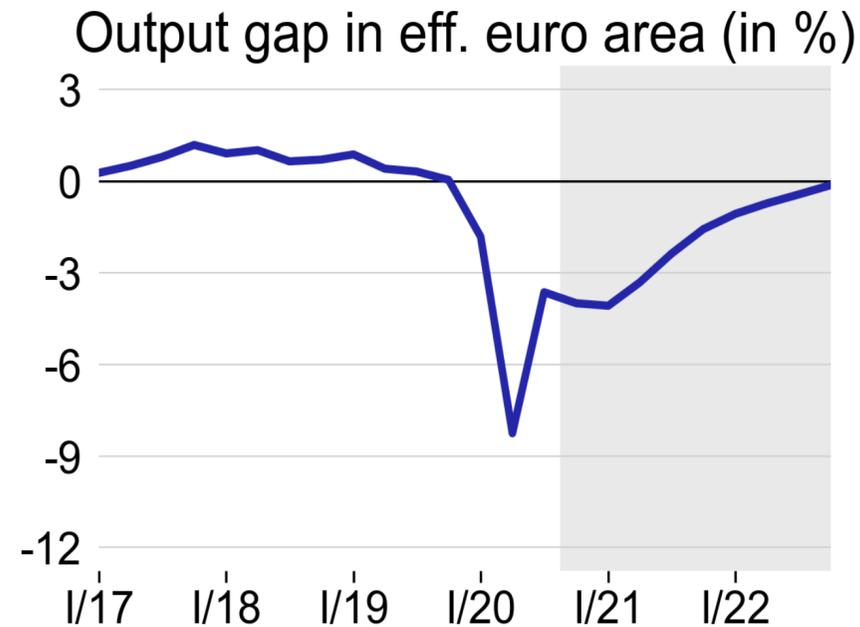
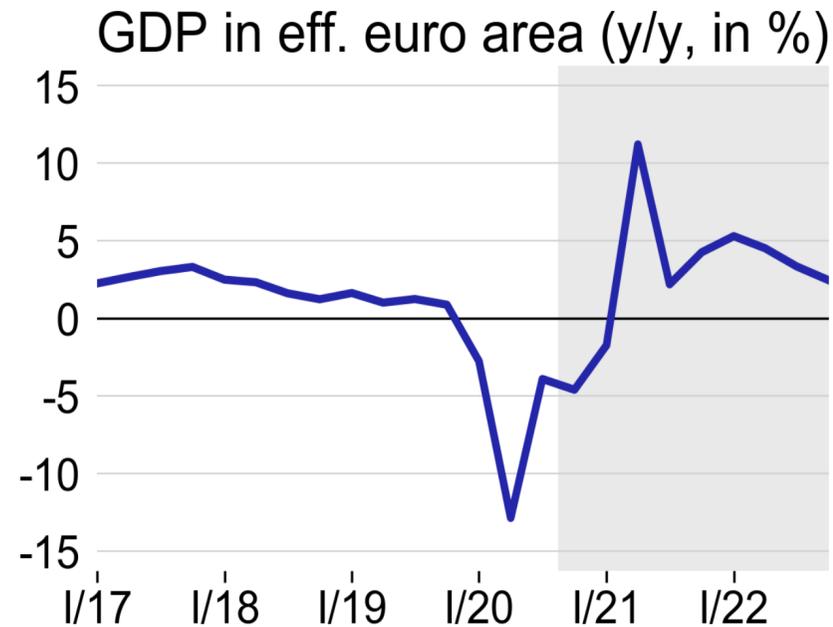
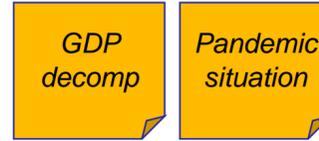
3. Comparison with the Previous Forecast

4. Longer-Lasting Pandemic-Induced Downturn Scenario

5. Monetary Policy Simulation of Unchanged Rates



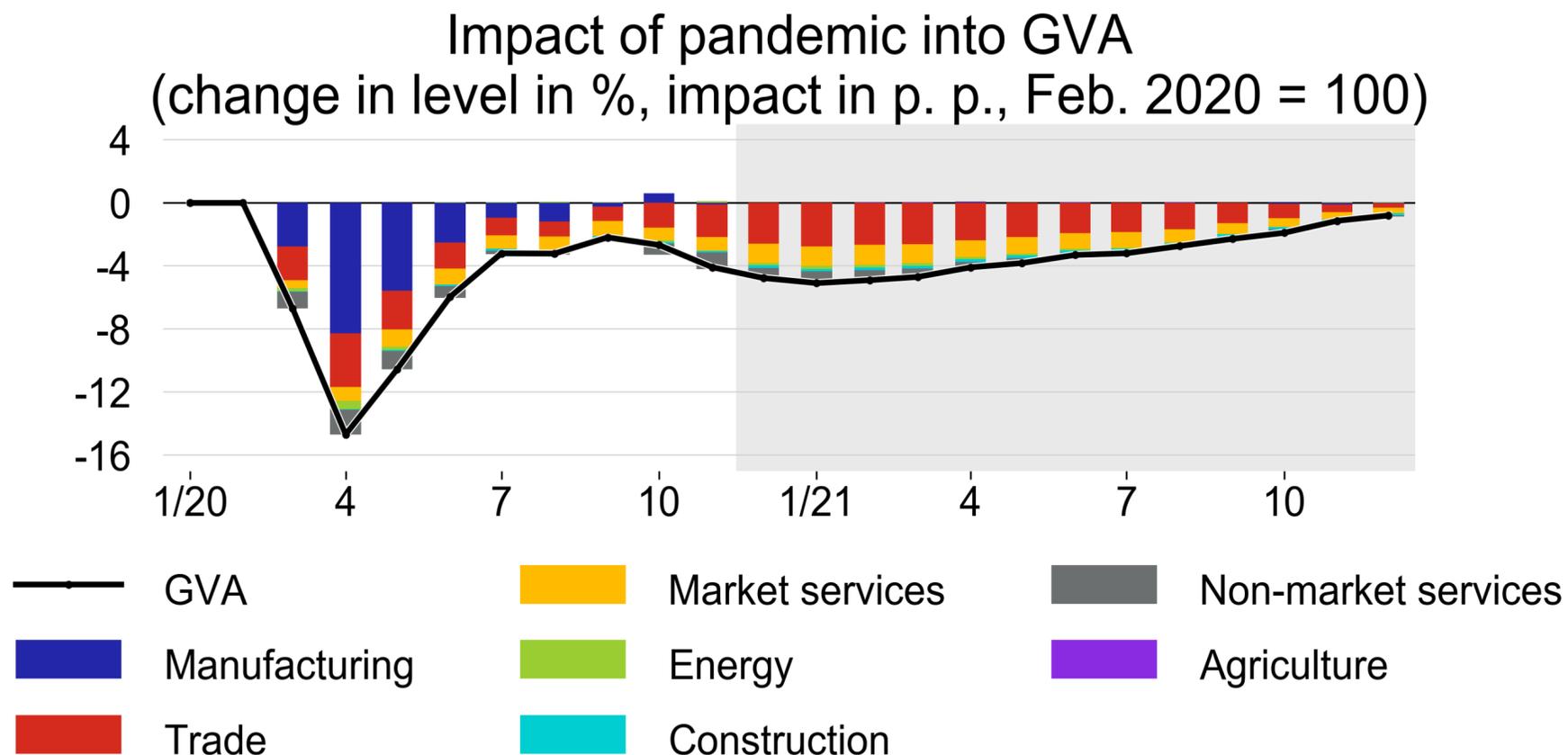
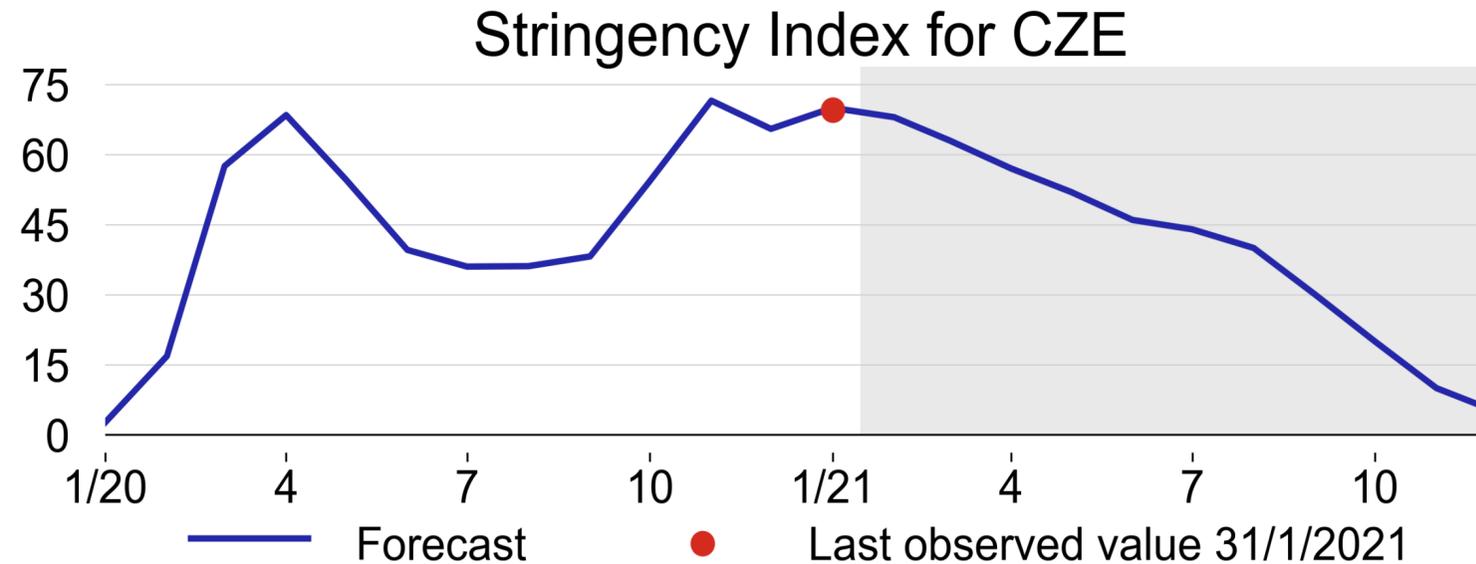
External Environment Outlook



■ Core component
 ■ Energy component
 - - - Shadow rate

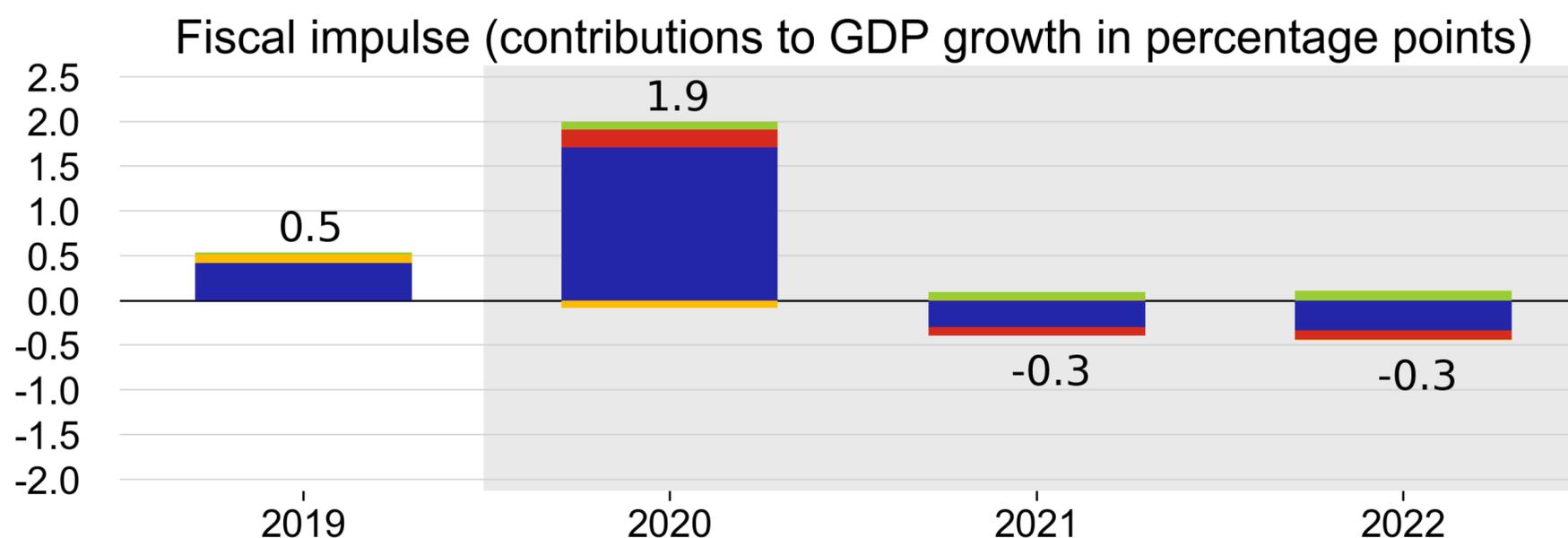
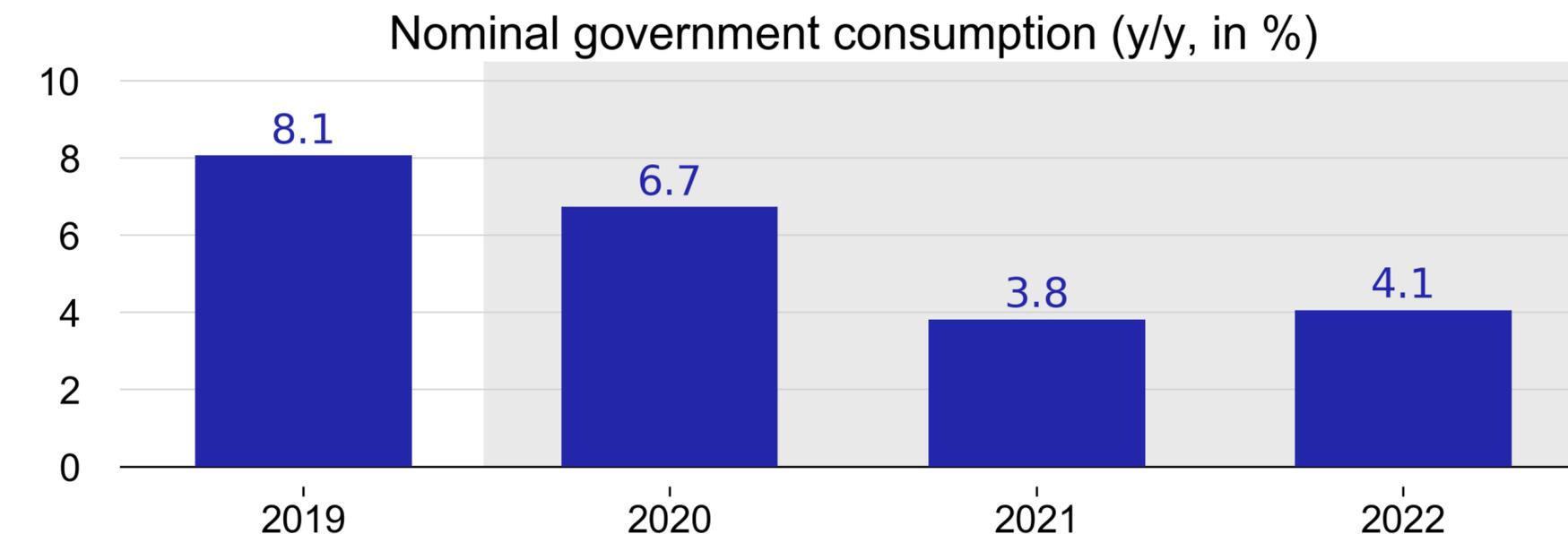
- Overall, the **effective euro area** economy will grow by almost 4 % this year and stay there in 2022.
- The expected recovery will not be enough for the currently still highly negative **output gap** to close before the end of the forecast horizon.
- Robust demand in industry and oil prices will push **industrial producer prices** up in the short term. Growth in PPI will be muted next year owing to appreciation of the euro against the dollar and only gradual closure of the negative output gap.
- The **3M EURIBOR** will remain negative over the entire forecast horizon. **Shadow interest rates** will lie significantly below market rates as they also reflect the ECB's response to the second wave of the pandemic.

Domestic Pandemic Situation



- The strength of restrictive epidemiological measures is indicated by the **Stringency Index**.
- The Stringency Index is currently at similar levels as last spring.
- In this year, however, it will gradually decrease as the pandemic slowly recedes and restrictions are lifted, because herd immunity will have a favourable effect.
- The current restrictions will gradually lessen over the course of this year, allowing the economy to start growing.
- The epidemiological measures will have **negative impacts on gross value added** until the end of this year (mainly through trade and services, domestic industry remains resilient).

Fiscal Policy



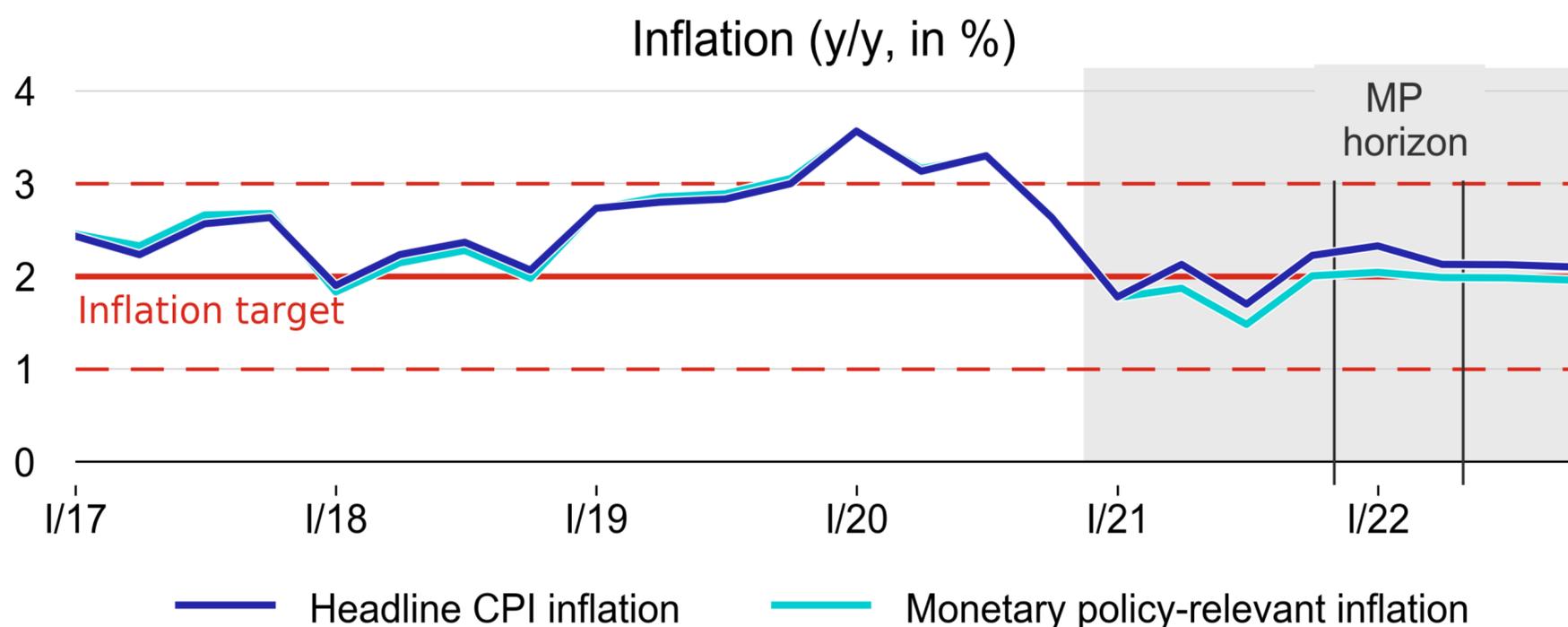
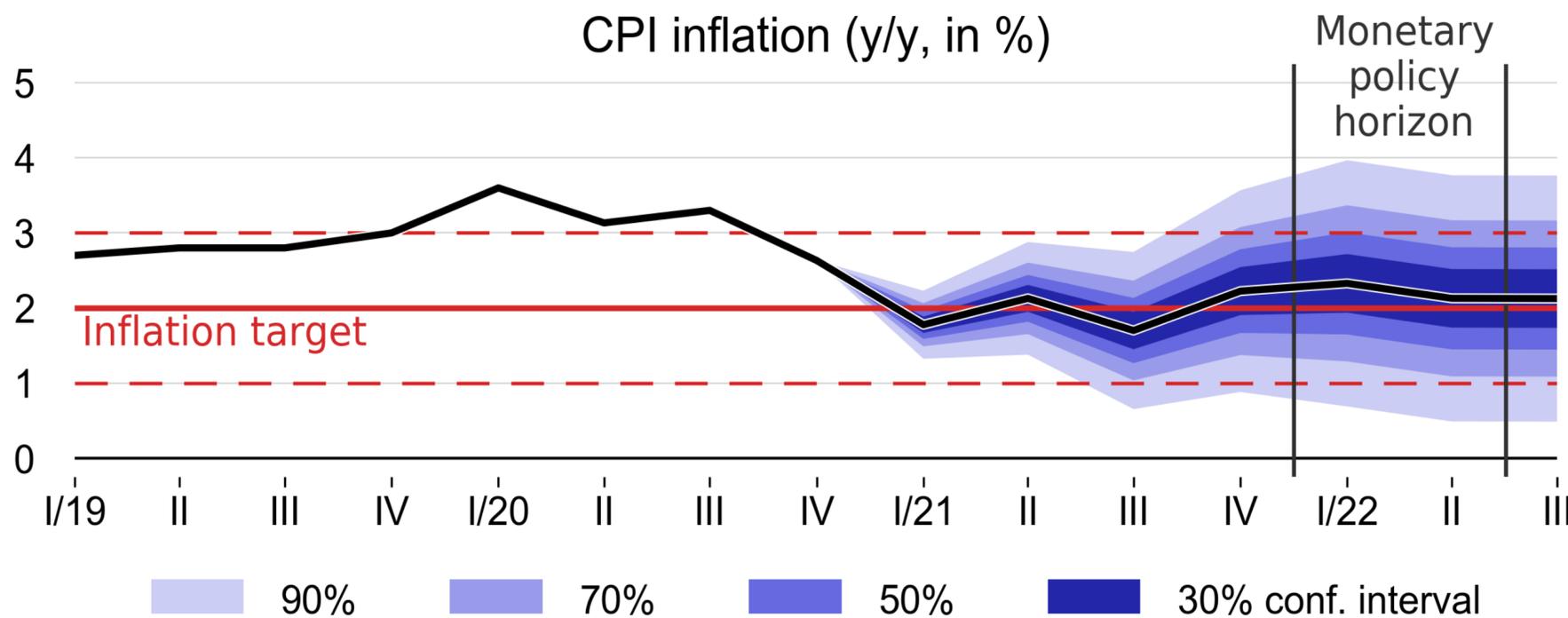
- **Government consumption** recorded solid growth last year due to increased extraordinary spending on health care and the emergency services.
- Its growth will naturally slow this year due to its unusually high level in 2020.
- Following a strongly stabilising contribution of **fiscal discretion** to GDP growth last year, this year's **fiscal impulse** is forecasted to be slightly negative because most of the support measures are temporary.
- Private consumption will be partially boosted this year by lowered wage taxation (the abolition of the super-gross wage), which acts against more negative fiscal impulse.
- Government support for businesses in areas of activity hit by the downturn remains significant (for example, subsidies and compensation for closures).

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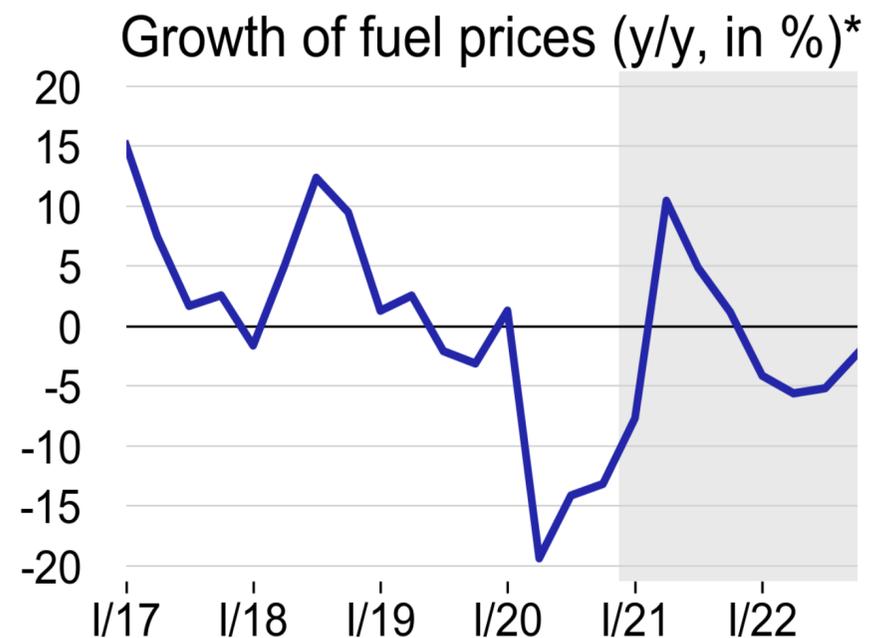
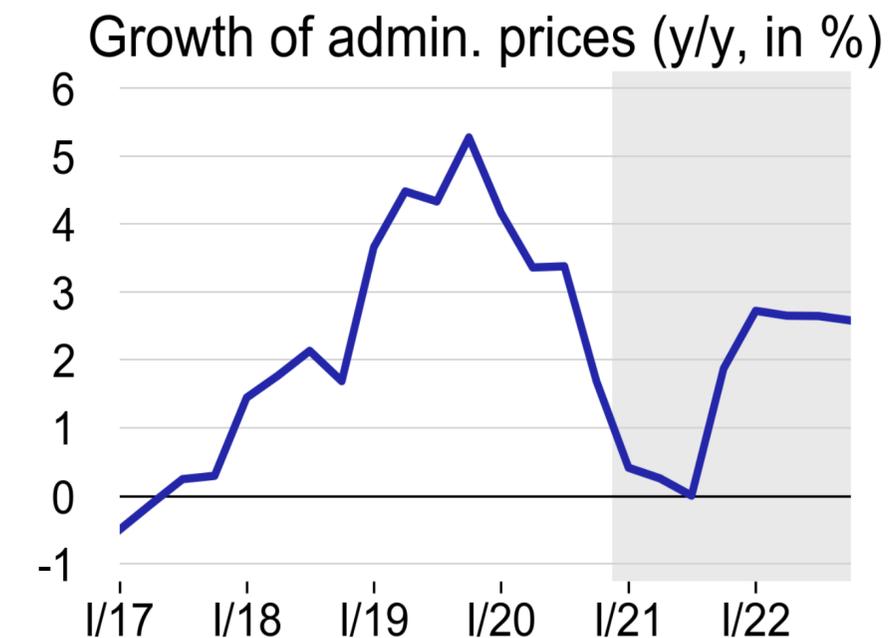
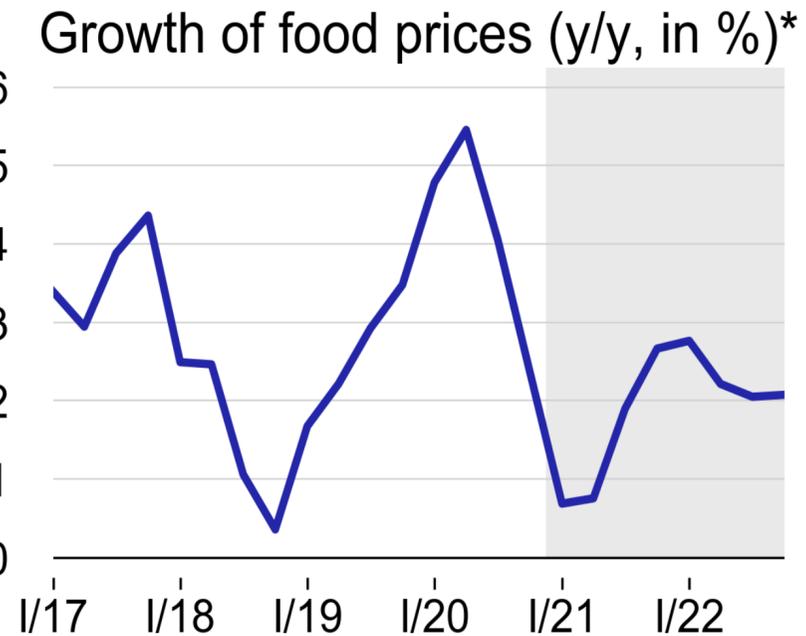
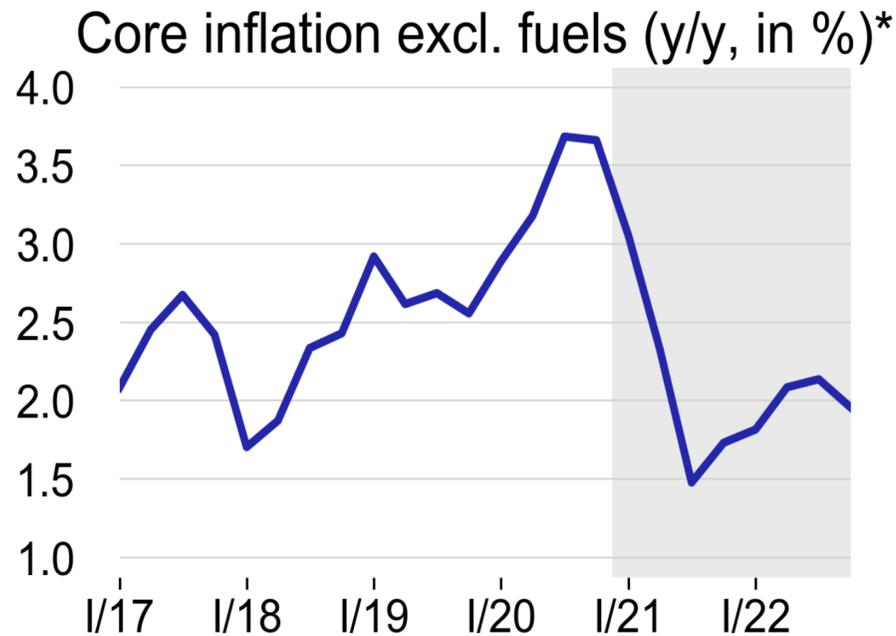


Headline and Monetary Policy-Relevant Inflation



- **Headline inflation** will fluctuate around the target this year and move slightly above it next year, aided by an increase in excise duties, to which monetary policy does not react.
- The until recently strong growth in prices will fade away in the first quarter of this year, due mainly to lowered growth in food and regulated prices. Core inflation will also fall markedly during the year (owing, among other factors, to the pandemic and koruna appreciation).
- **Monetary policy-relevant inflation** will lie slightly below headline inflation, due to the positive first-round effects of changes to excise duties.

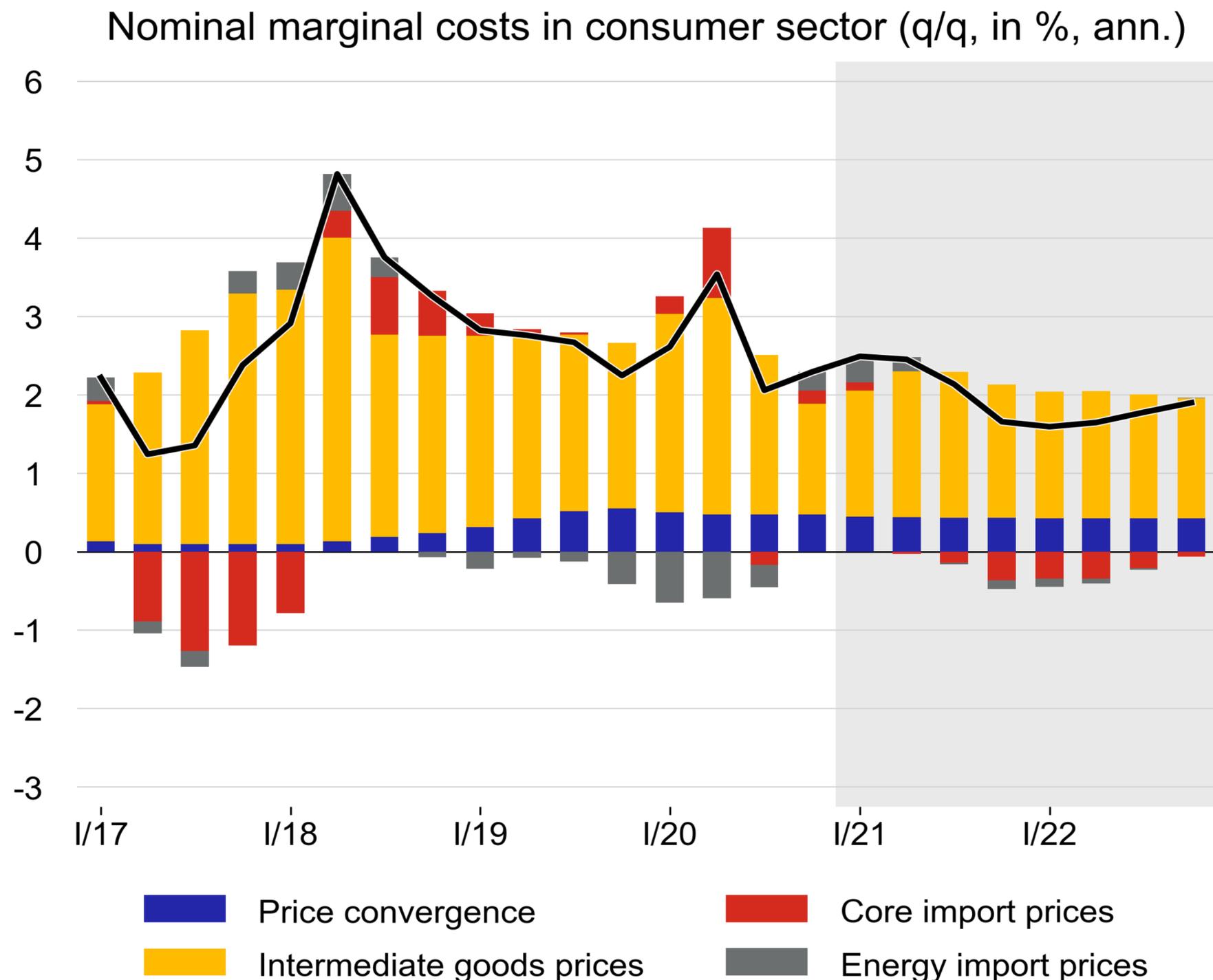
Inflation Components



- **Core inflation** will drop during coming quarters (owing to the pandemic, continued appreciation of the koruna against the euro and the dollar, a related decline in import prices and a further easing of domestic demand pressures). As the economy subsequently recovers gradually from the pandemic, it will cause core inflation to rise again.
- The dip in **food price inflation** will only be temporary. Food prices will start rising again in mid-2021 on the back of recovery of agricultural producer price inflation.
- The muted growth in **administered prices** will pick up at the close of this year, as the decline in energy prices will be only temporary.
- **Fuel prices** will record a sharp increase in as the drop in oil prices observed last spring fades out.

* excluding tax changes

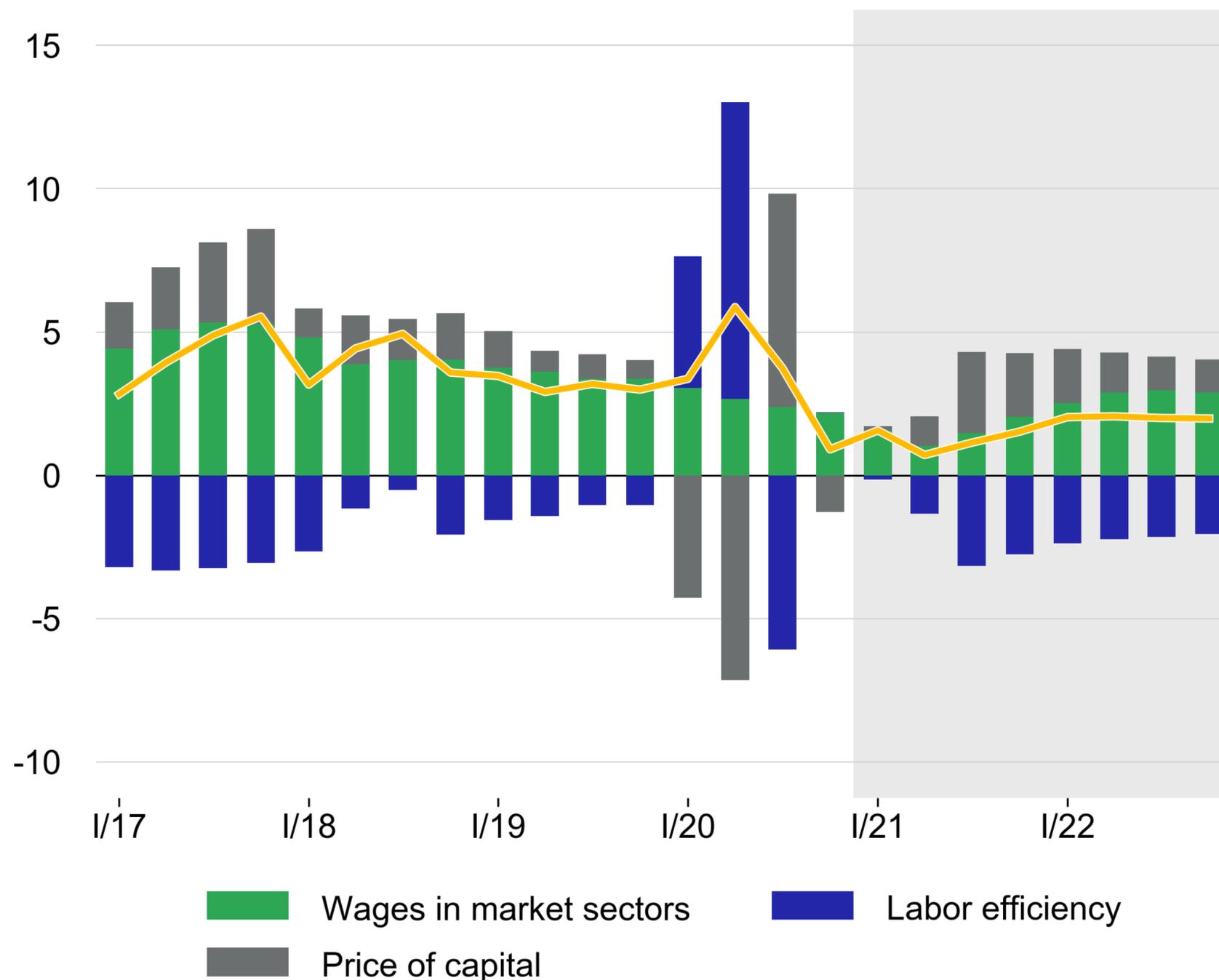
Inflation Pressures: Costs in Consumer Sector



- **Growth in total costs** will ease this year owing to a continued disinflationary effect of the domestic economy. This will be accompanied by a gradual fading of the currently positive contribution of core import prices and energy prices, which will reflect an appreciating koruna.
- In the second half of this year, import prices will start to dampen growth in overall inflation pressures. This will be due mainly to the appreciating exchange rate.
- Growth in total costs will stabilize close to its steady-state level as from the second half of this year as the impacts of the pandemic gradually subside.

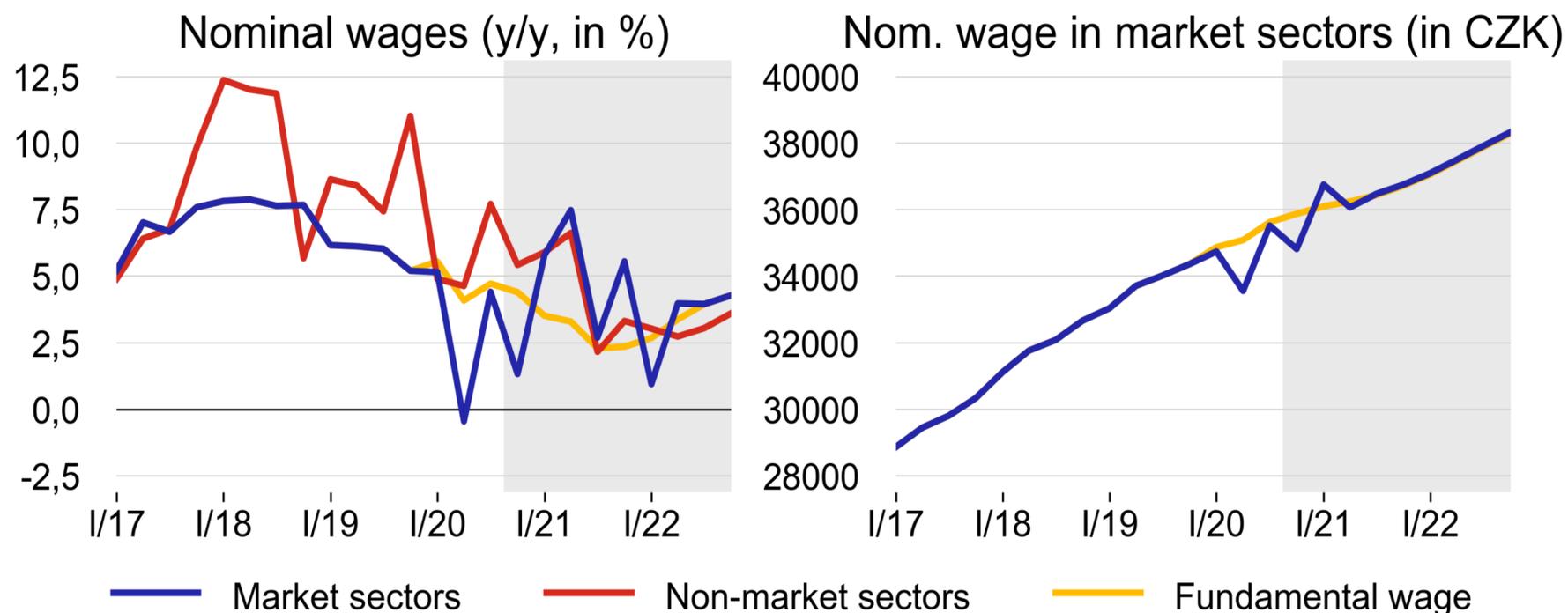
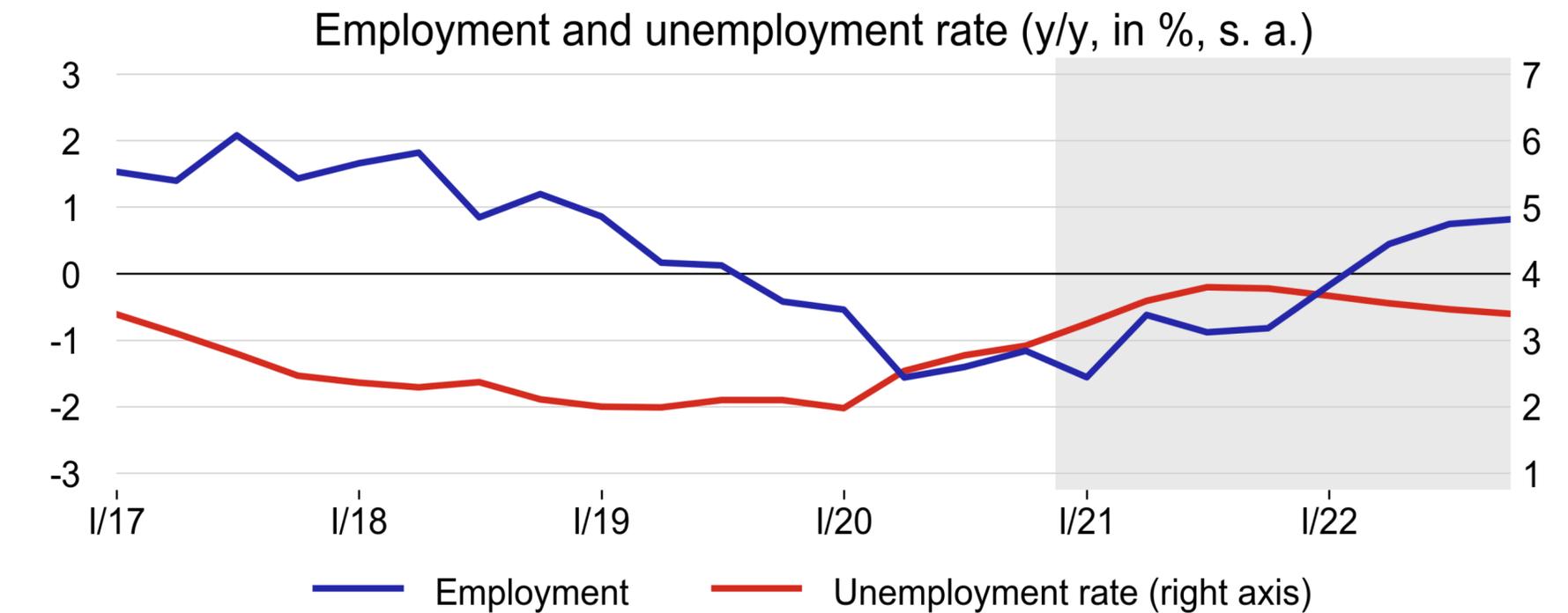
Inflation Pressures: Costs in Intermediate Goods Sector

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



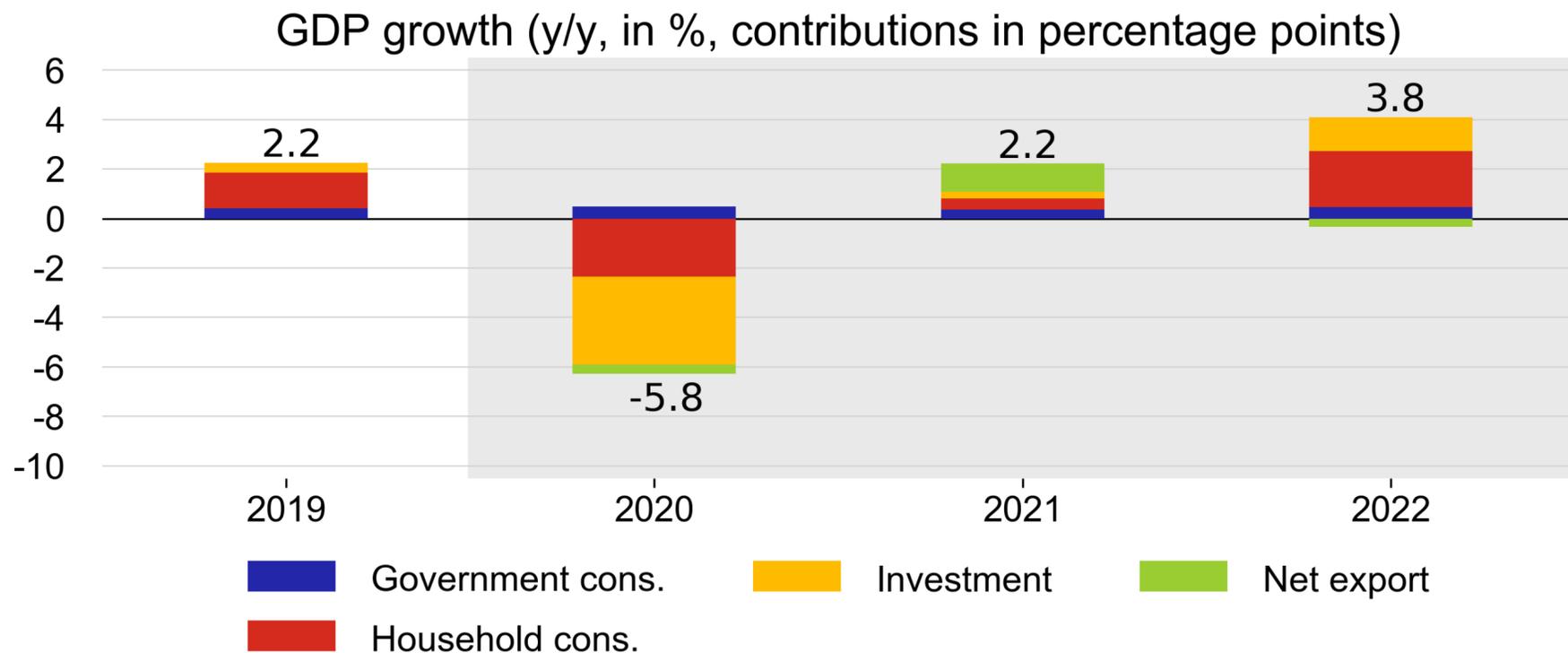
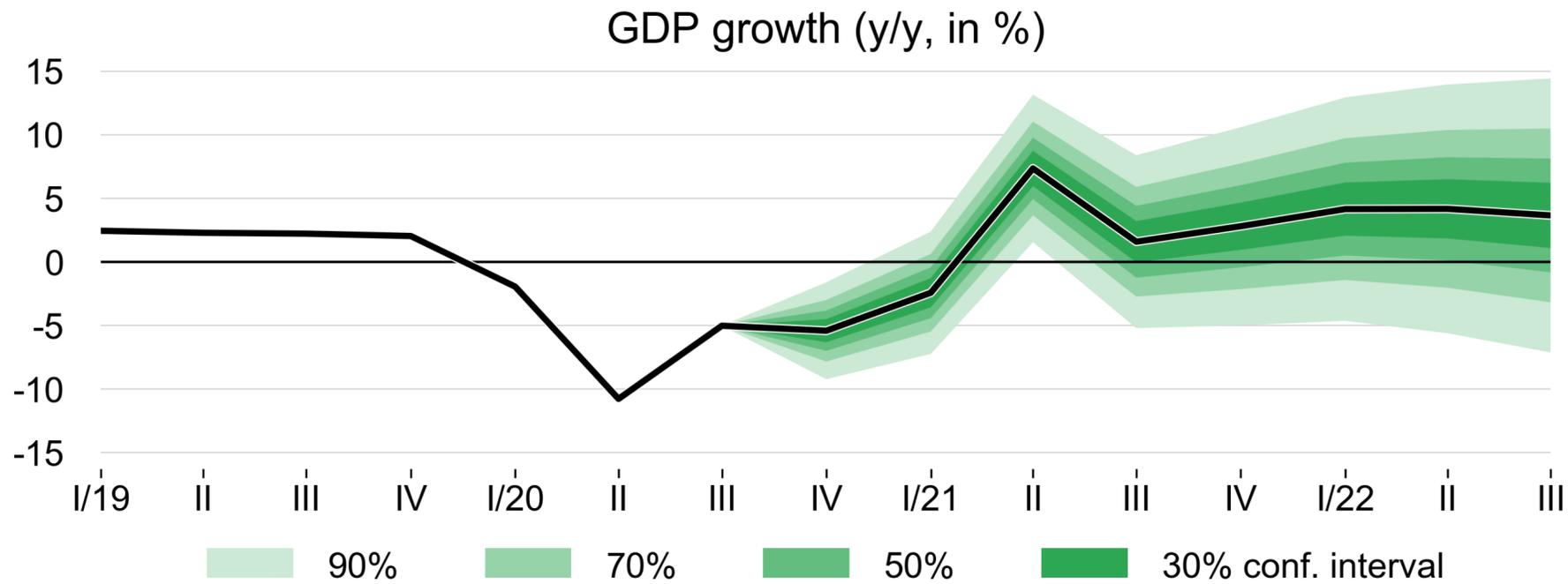
- **Growth in domestic costs** will be subdued this year and return to its steady-state level next year.
- Despite the January increase in the minimum wage, growth in domestic costs will fall further in the first half of 2021 and remain subdued for the rest of the year owing to a further cooling of the labour market.
- A substantial rise in the inflationary effect of the price of capital from mid-2021 onwards will reflect a recovery of private consumption and the domestic economy as a whole due to the reopening of most services.
- This will be offset by an initially gradual but later sharp increase in labour efficiency due to people returning to their workplaces (offices, shops and other premises).

Labour Market



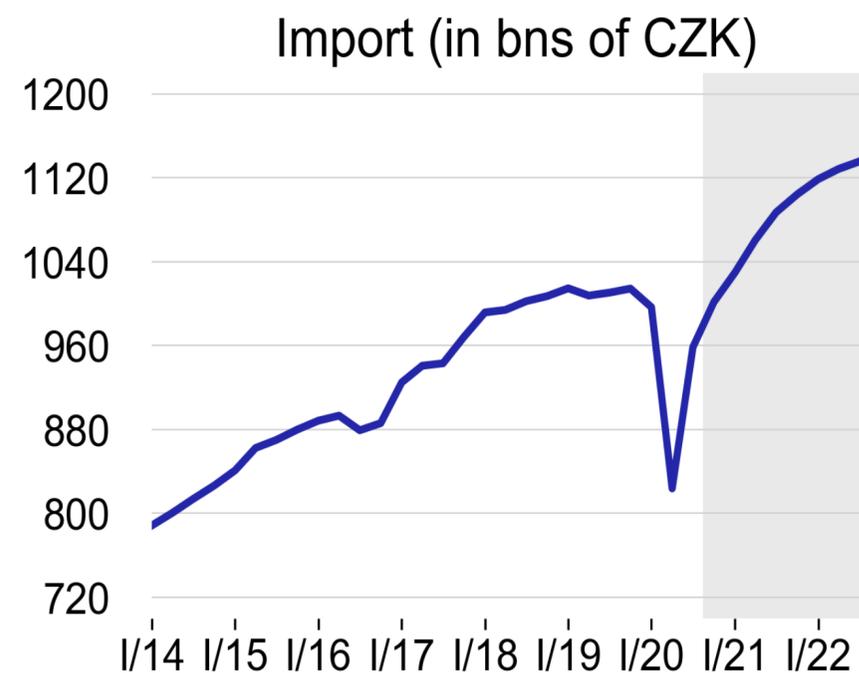
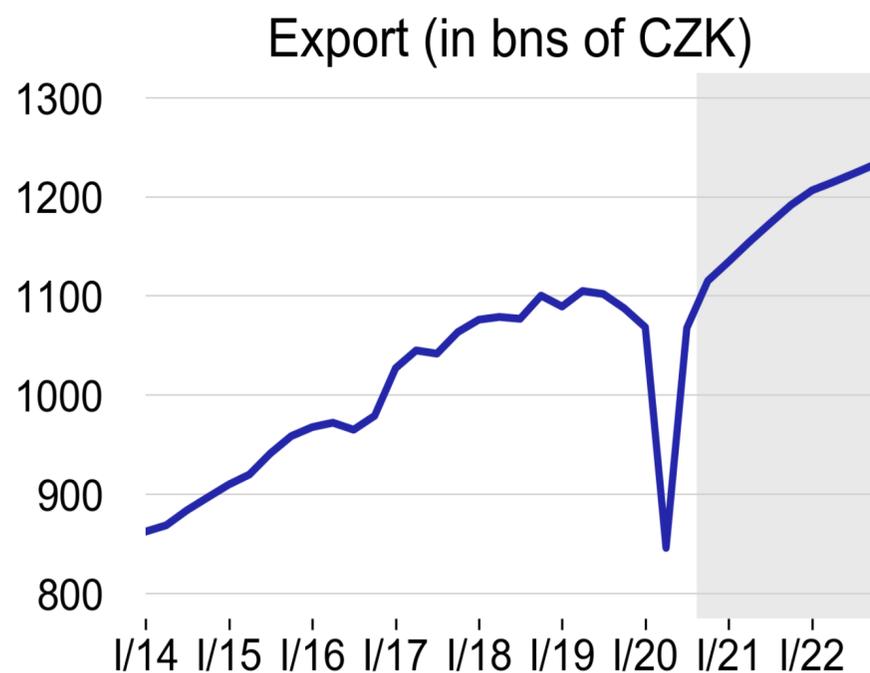
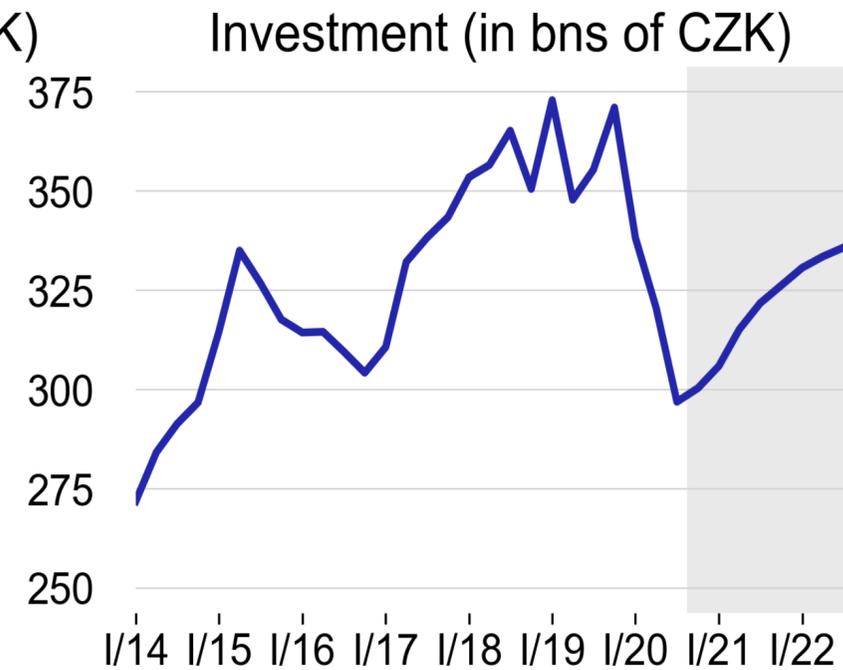
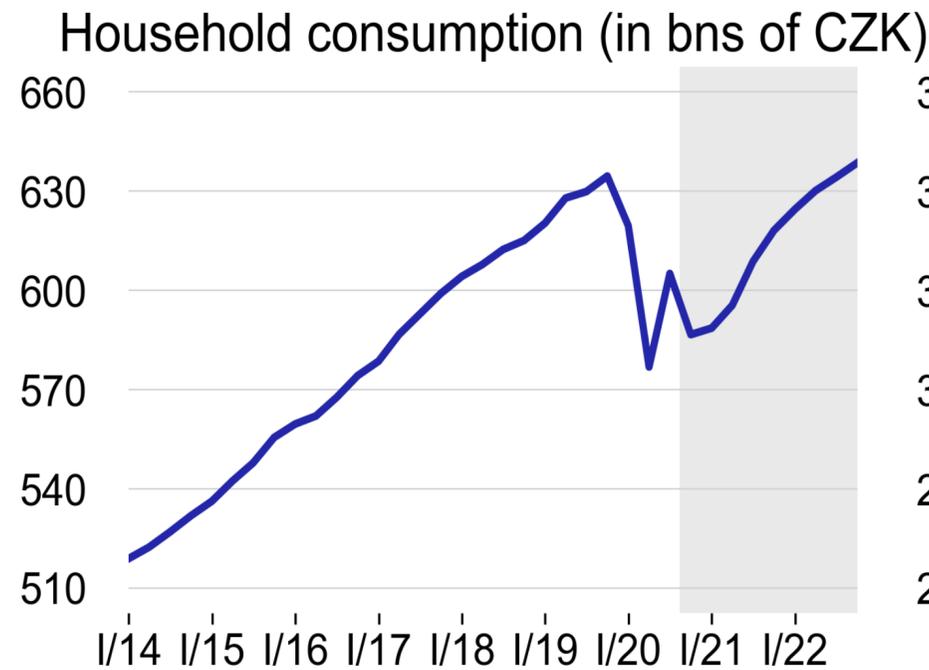
- Although **employment** has so far been protected by government support programmes, it will decline further in 2021.
- **Unemployment rate** will rise until the second half of 2021 due the pandemic-related economic downturn, despite government support measures and still solid labour demand in sectors not directly affected by the pandemic.
- **Wage growth in market sectors** will surge this year (due to a base effect) and slow again on average next year. **Growth in fundamental market wages** will decrease initially and recover only slightly in the second half of 2021.
- In **non-market sectors**, the high wage growth observed in previous years will continue to subside this year.
- Statistical effects will cause wage growth in both sectors to fluctuate.

GDP Growth Forecast



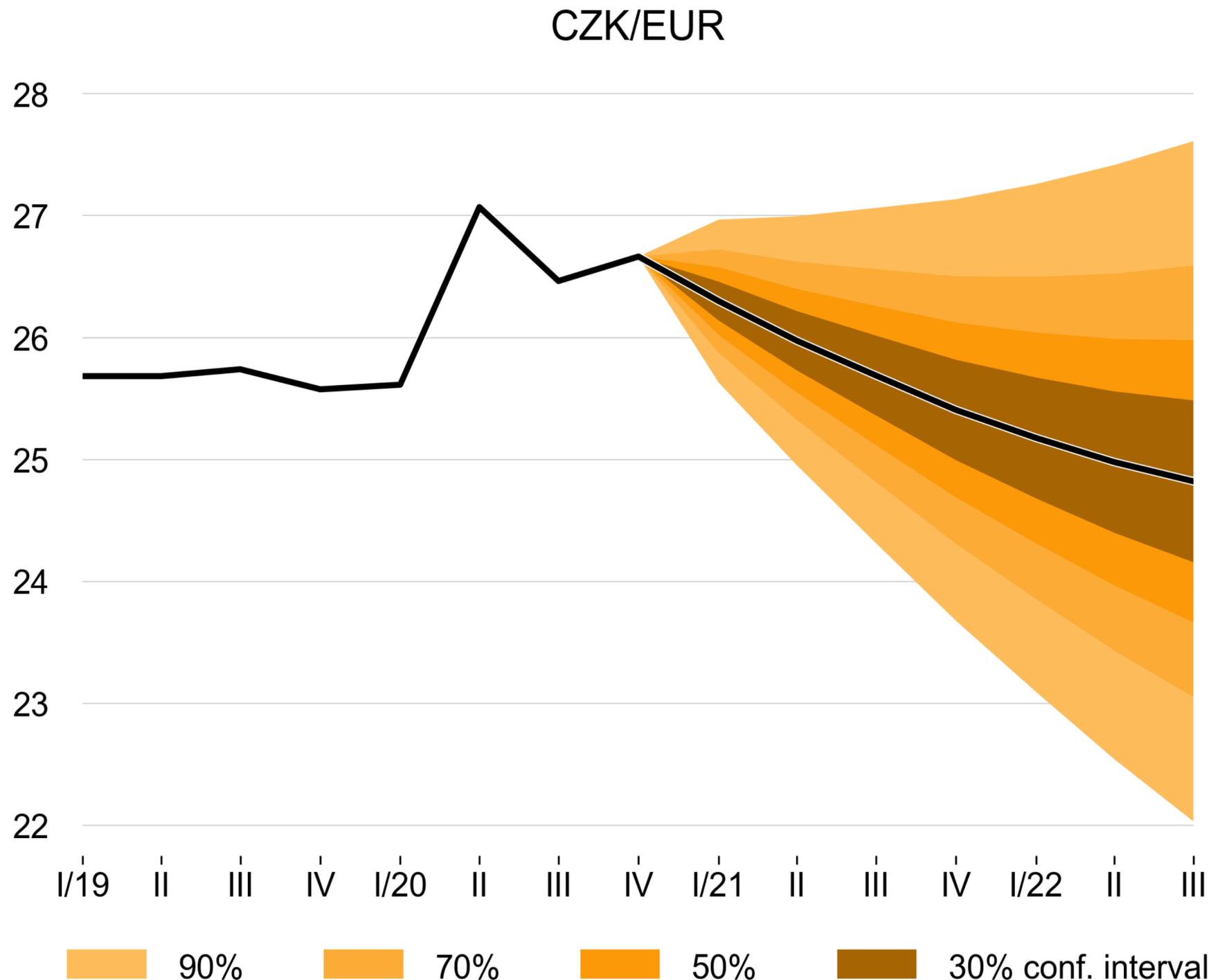
- **The worsening epidemic situation in the second wave of the pandemic** led to renewed shutdowns in the domestic economy in the autumn and winter. The closures, which will be removed during the first half of 2021, mainly concern wholesale and retail and services.
- By contrast, export-oriented industry and some related services will be hit to only a small extent, unlike during the first wave.
- The **economy will grow** by more than 2% overall this year and pick up further next year, leading to a return of domestic economic activity to the pre-pandemic level. GDP in 20Q4 broadly in line with the fcast.
- **GDP growth** will be driven in the near future by net exports. Household consumption will become the main driver of economic growth next year.

Aggregate Demand Components



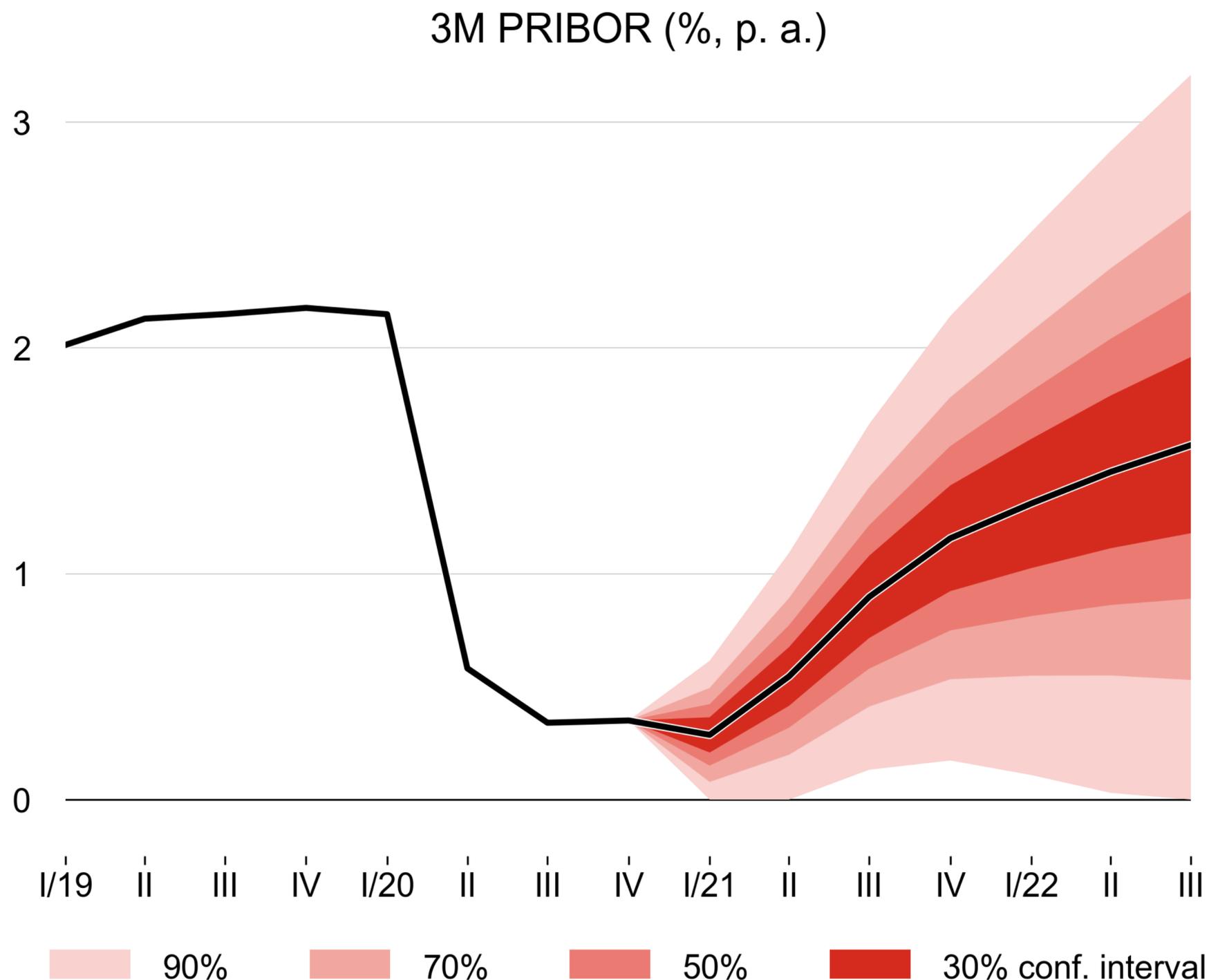
- **Household consumption** will return to sustained, robust growth this year as the adverse economic impacts of the pandemic will start to fade in the second half of the year. Household consumption will reach its pre-coronavirus level in 2022.
- **Private investment** activity is adversely affected by the impacts of the pandemic. Improving sentiment, a recovery abroad and EU money will help total investment activity to rise gradually in the course of this year.
- **Exports** will improve over the forecast horizon, as the second wave of the pandemic had only a marginal effect on demand for Czech exports.
- **Import growth** will outpace export growth in the second half of this year due to a surge in aggregate domestic demand.

Exchange Rate CZK/EUR



- The **koruna** will appreciate over the entire forecast horizon.
- The exchange rate forecast for **2021 Q1** is set at **CZK 26.3 to the euro**. This reflects the resilience of Czech export-oriented industry up to now despite the continued adverse epidemic situation.
- The receding of the pandemic together with the reopening of the economy and improved financial market sentiment this year will lead to continued appreciation of the koruna.
- A strengthening koruna will also be fostered by a gradually widening positive interest rate differential vis-à-vis the euro area. By the end of next year, the koruna will thus strengthen beyond CZK 25.

Interest Rate Path (3M PRIBOR)



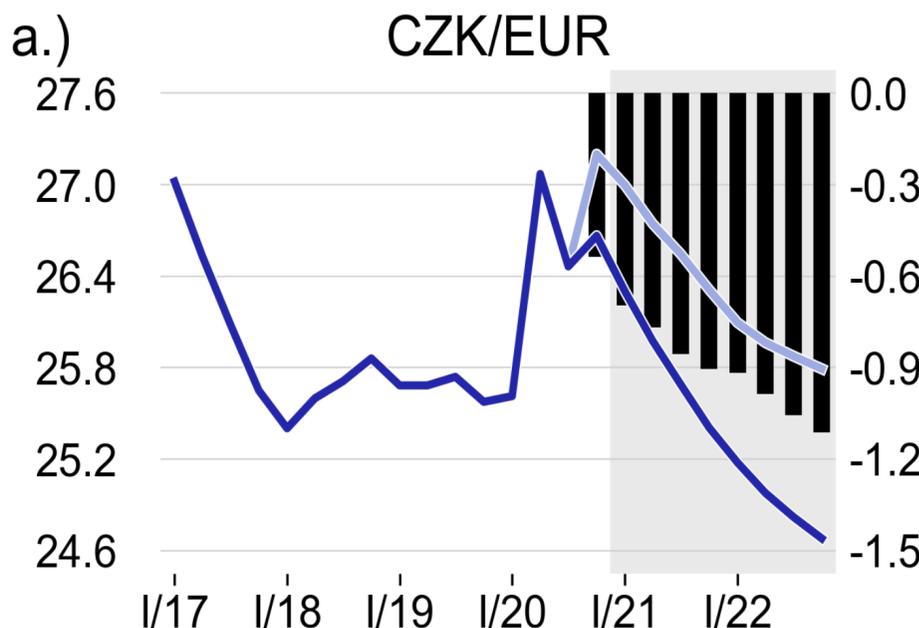
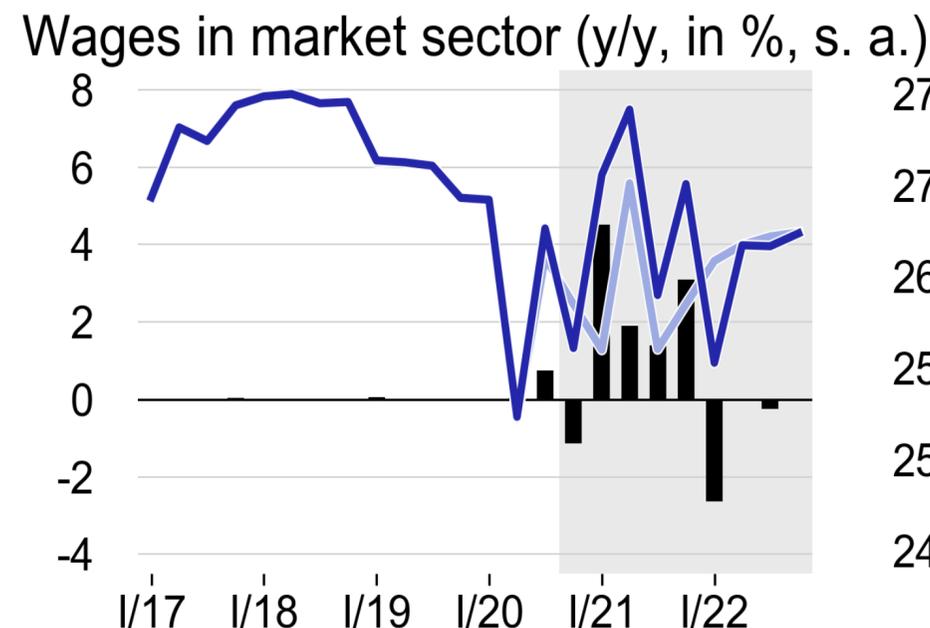
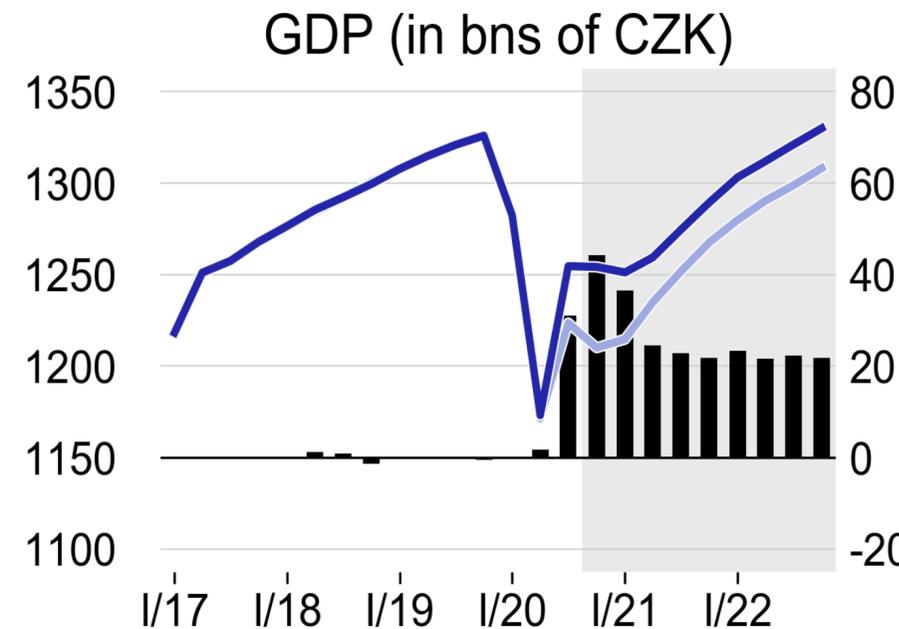
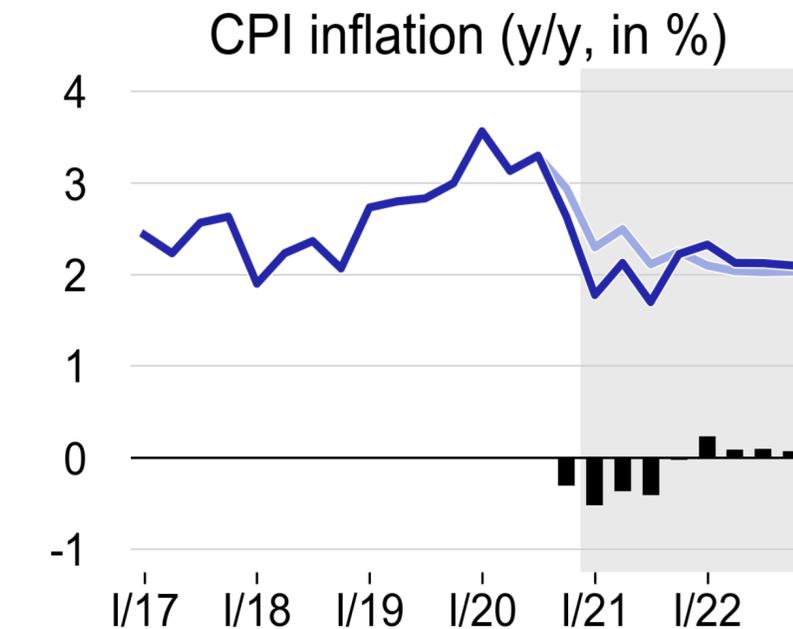
- Consistent with the forecast is **stability of market interest rates initially**, followed by a gradual rise in rates from roughly the middle of this year onwards.
- The initial stability of market interest rates reflects the need to keep monetary policy easy in a situation where the pandemic is having negative impacts on the domestic economy.
- The subsequent gradual increase in (normalisation of) interest rates stems from the expected recovery of the Czech and foreign economy with domestic inflation anchored at the target.

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Comparison with Previous Forecast

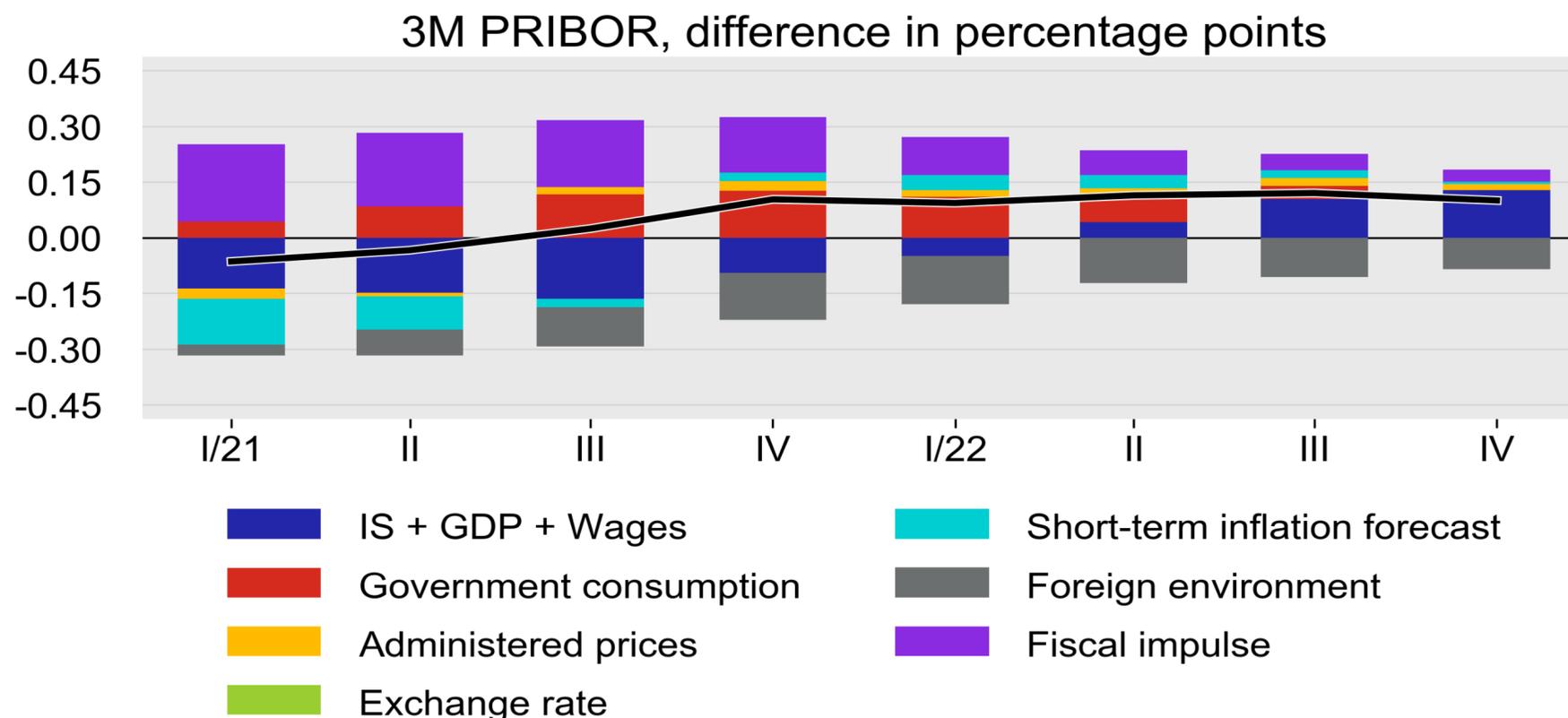
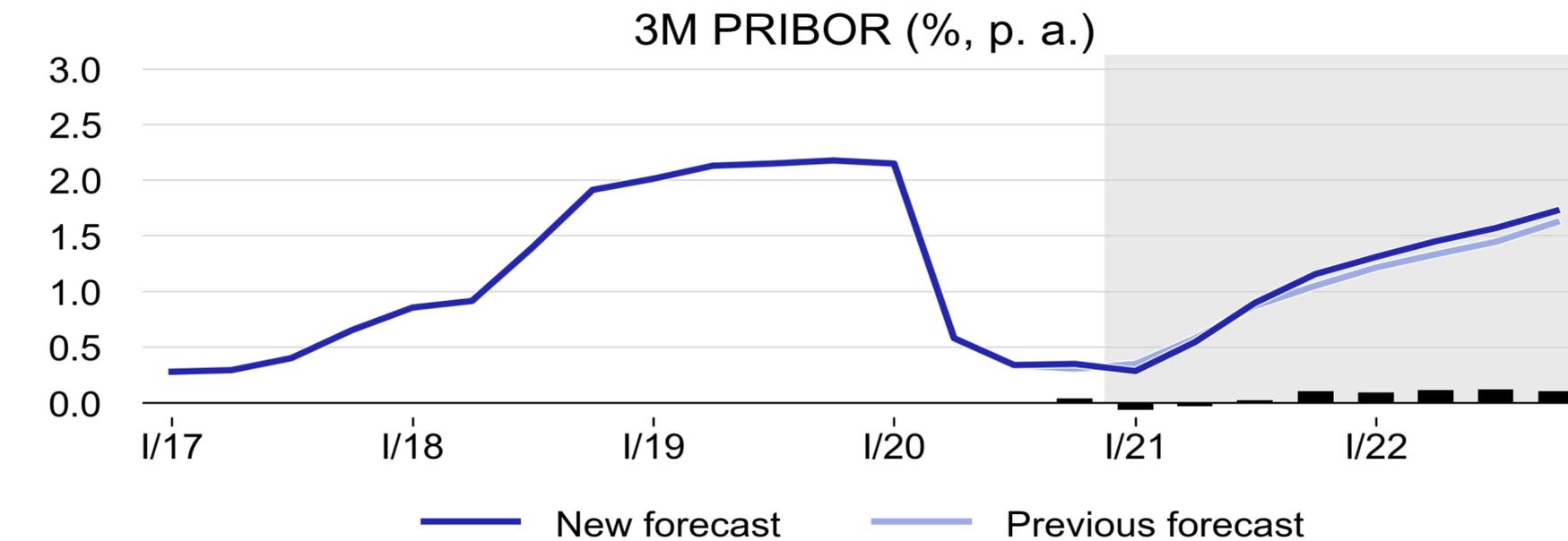


— New forecast

— Previous forecast

- The **headline inflation** will fall more markedly this year due to lower growth in food and administered prices. Next year it will be slightly higher, owing to the newly incorporated increase in excise duties.
- The outlook for **domestic economic activity** is higher due to less devastating effects of the pandemic in the second half of 2020 and a better situation in industry.
- The higher **wage growth** forecast reflects overall better economic prospects and the January increase in the minimum wage by more than 4%.
- The **koruna** will be stronger due to its appreciation at the end of 2020, the unexpectedly good condition of domestic industry and a wider interest rate differential vis-à-vis the euro area.

Comparison: Interest Rate Forecast



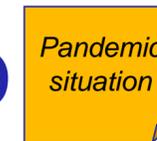
- The new forecast contains a similar **domestic interest rate** path compared to the previous one.
- More relaxed fiscal policy fosters higher rates via higher government consumption and a less restrictive fiscal impulse.
- A faster recovery in household consumption and generally easier labour market situation fosters higher rates next year, while a worse course of the pandemic leads to lower rates this year (altogether in: initial conditions + GDP + wages).
- Slower closure of the negative output gap abroad coupled with a slightly lower shadow interest rates in the euro area are in favour of lower rates.
- The short-term outlook for domestic inflation, reflecting the latest observed data, drives lower rates in the coming quarters.

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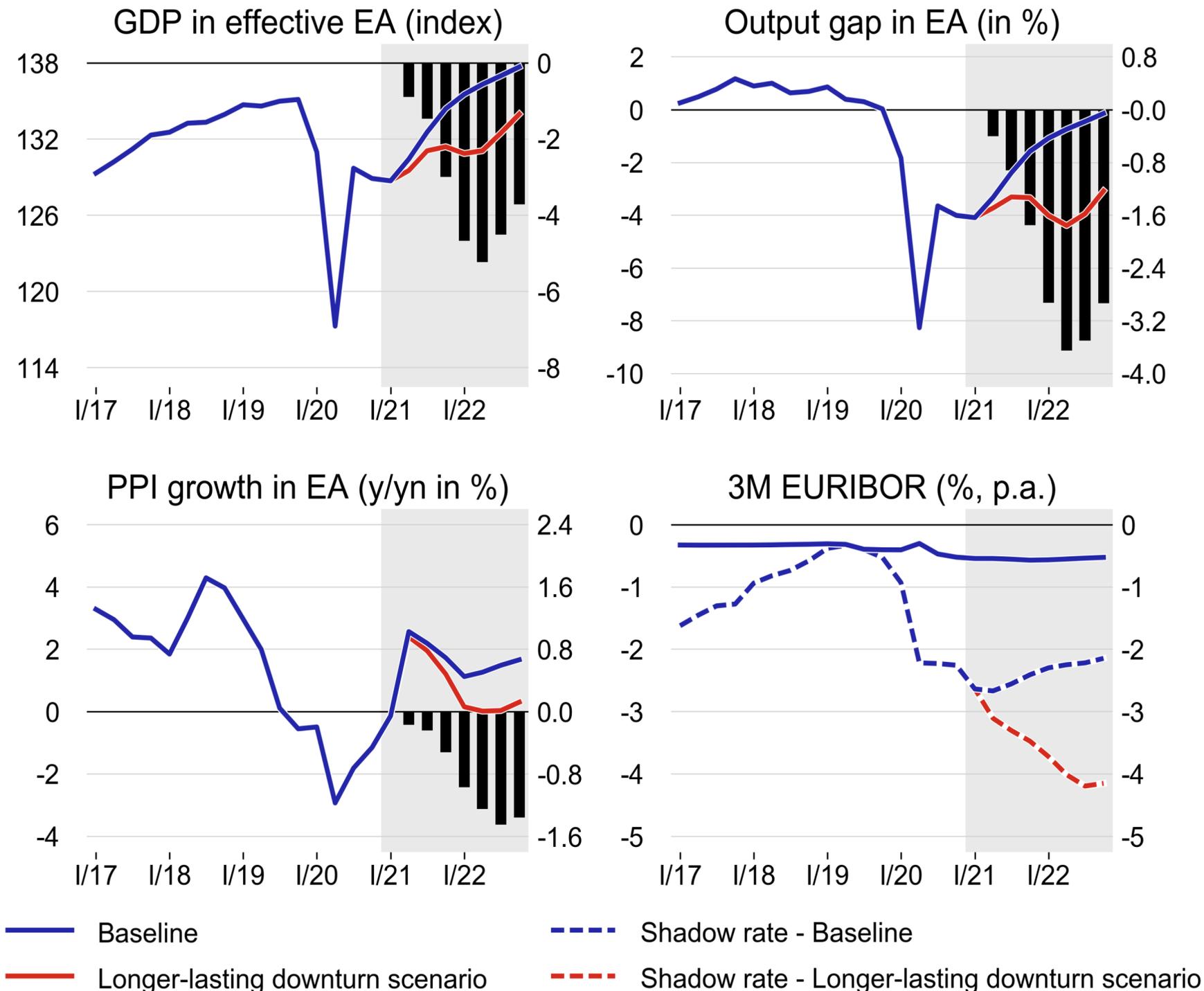


Longer-Lasting Pandemic-Induced Downturn Scenario



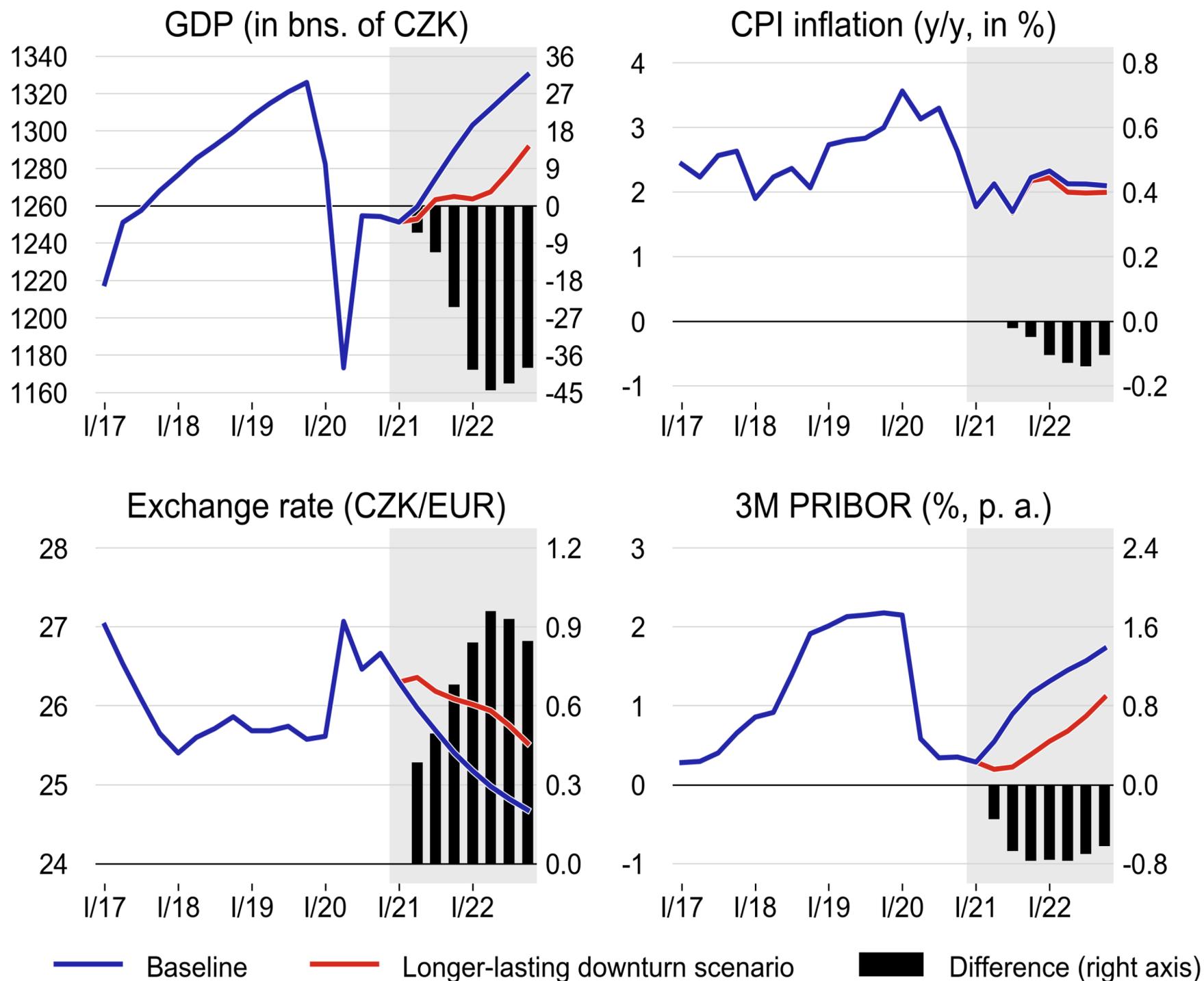
- **A worse course of the coronavirus pandemic** accompanied by a longer cyclical downturn **is a main risk to the forecast.**
- The scenario rests on a worse course of the pandemic than in the baseline scenario from 2021 Q2 onwards. It considers a marked deterioration in industry in addition to a more protracted decline in services abroad.
 - Worse economic prospects and tangible effects on the financial situation of consumers and firms will be reflected in a decline in private consumption and corporate investment.
 - **Global supply chains will be disrupted** and the intensity of international trade will decrease.
 - A slower economic recovery in the euro area will be reflected in **stronger and longer-lasting anti-inflationary demand effects.**
- For the **domestic economy**, the scenario expects **the worse course of the pandemic to be associated with longer-lasting shutdowns in the domestic economy** as well.
 - Businesses will thus exhaust their finances even more, and some will close.
 - In contrast to the baseline scenario, **industry will face a fall in demand from abroad.**
 - The worsening sentiment of firms and households will also manifest itself in industrial production.
- **The domestic economy will therefore shift to a longer cyclical downturn despite the easing of epidemiological measures in the second half of 2021.**

Longer-Lasting Downturn Scenario: External Environment



- The scenario assumes a slower **economic recovery** in the euro area than in the baseline scenario and a significantly more negative **output gap** until the end of 2022.
- This will be reflected in stronger and longer-lasting anti-inflationary demand effects.
- **Producer price inflation** will be more subdued than in the baseline scenario due to slower growth in core prices and a drop in energy prices.
- This scenario would be consistent with a further easing of **monetary conditions by the ECB** using unspecified combination of its monetary instruments reflected in a sharp drop in **shadow interest rates**.

Longer-Lasting Downturn Scenario: Domestic Economy



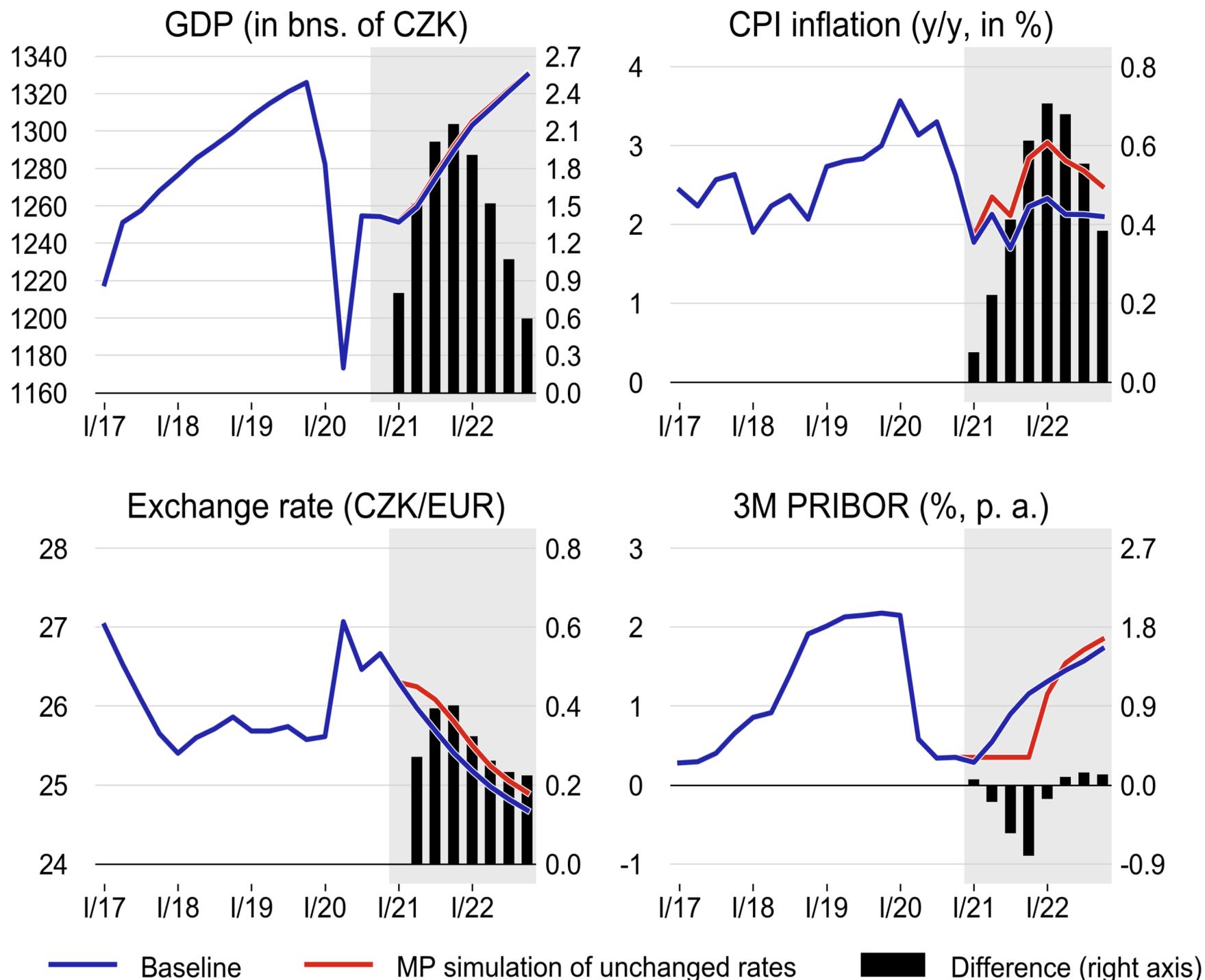
- The slower **growth of the Czech economy** than in the baseline scenario derives from weaker external and domestic demand.
- The adverse situation with worse sentiment of firms and income situation of households along with negative consumer appetite will cause investment to freeze and will lead to lower household consumption.
- The lower demand for domestic production and slower wage growth will foster lower overall **inflation pressures**. Conversely, core import prices will have an inflationary effect due to a weaker koruna.
- The adverse cyclical developments abroad weaken demand for Czech exports and act against appreciation of the **koruna**.
- The longer-lasting economic downturn generates a need for an easier **interest rate component** of the monetary conditions relative to the baseline scenario.

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Monetary Policy Simulation of Unchanged Rates



- The scenario examines **the hypothetical situation of interest rates staying at their current levels until the end of this year**. At the same time, it expects foreign developments and domestic pandemic situation to be the same as in the baseline scenario.
- The lower **interest rates** lead to a lower interest rate differential vis-à-vis the euro and results in slower appreciation of the **koruna** than in the baseline scenario.
- Both easier components of the monetary conditions will lead to distinctly higher **inflation** hitting the upper boundary of the tolerance band in the first half of 2022. GDP is also higher than in the BS.
- For inflation to return to the target, rates will need to grow quickly somewhat above the baseline scenario levels from the start of the next year.

Thank You for Your Attention



Petr Král

Executive Director, Monetary Department

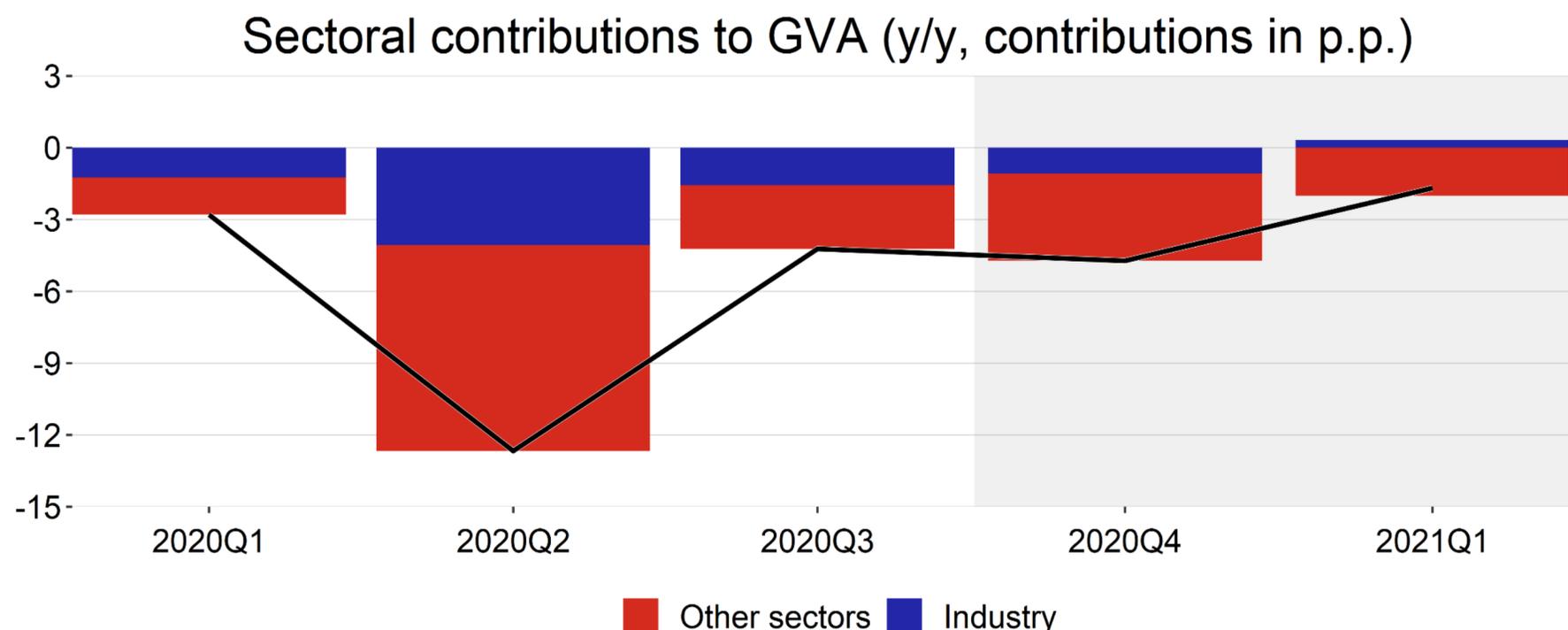
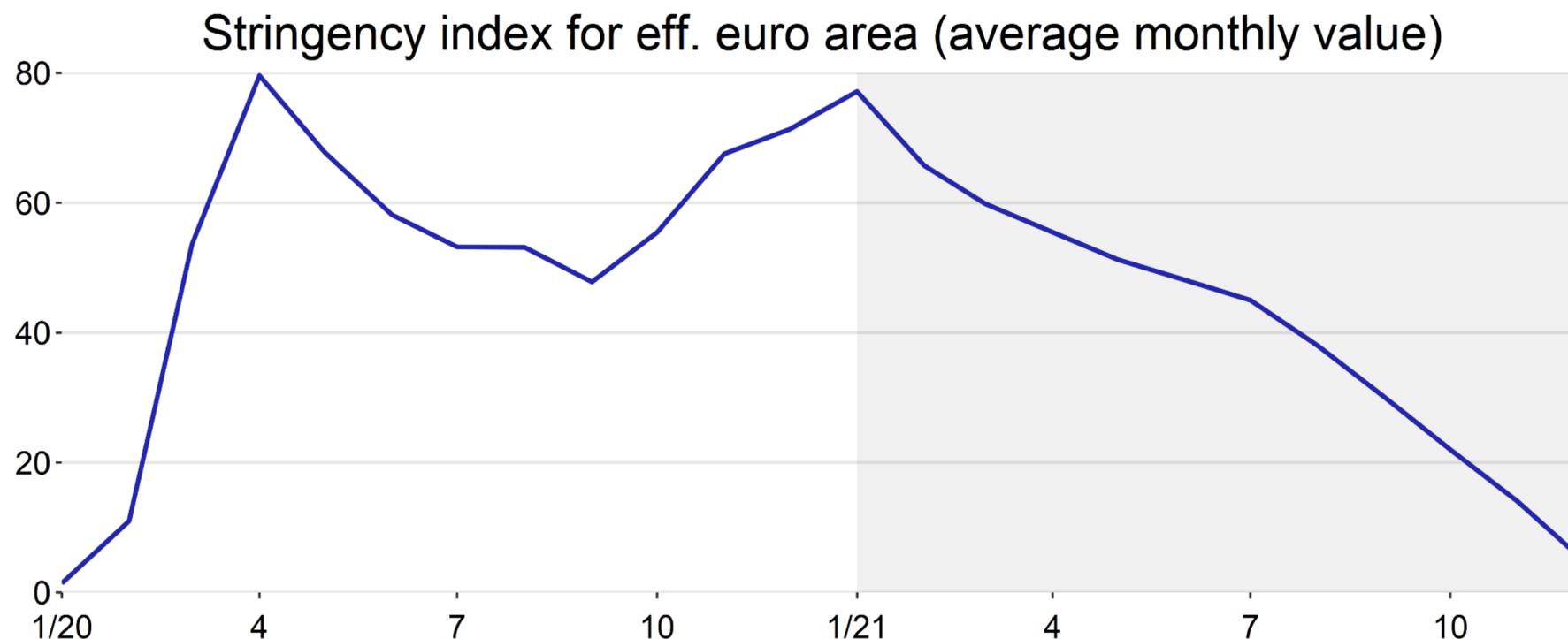
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Backup

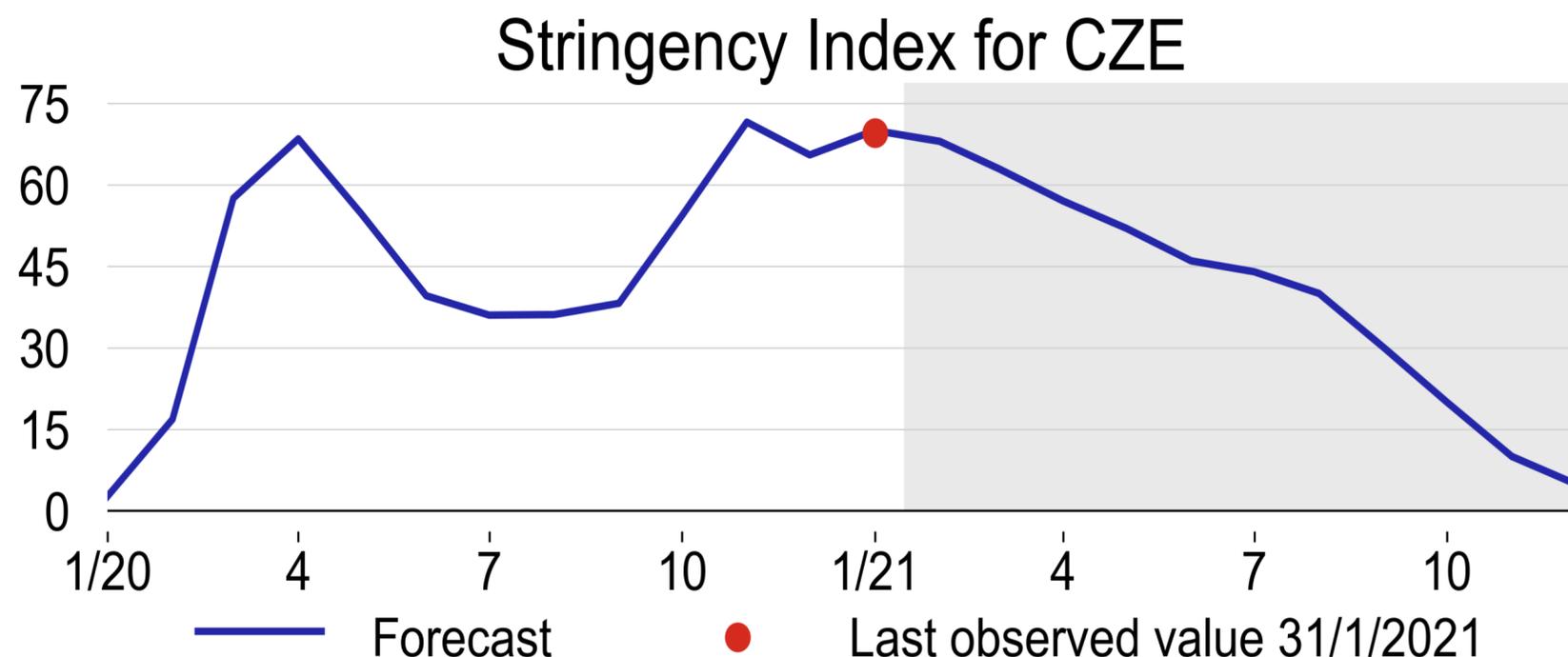
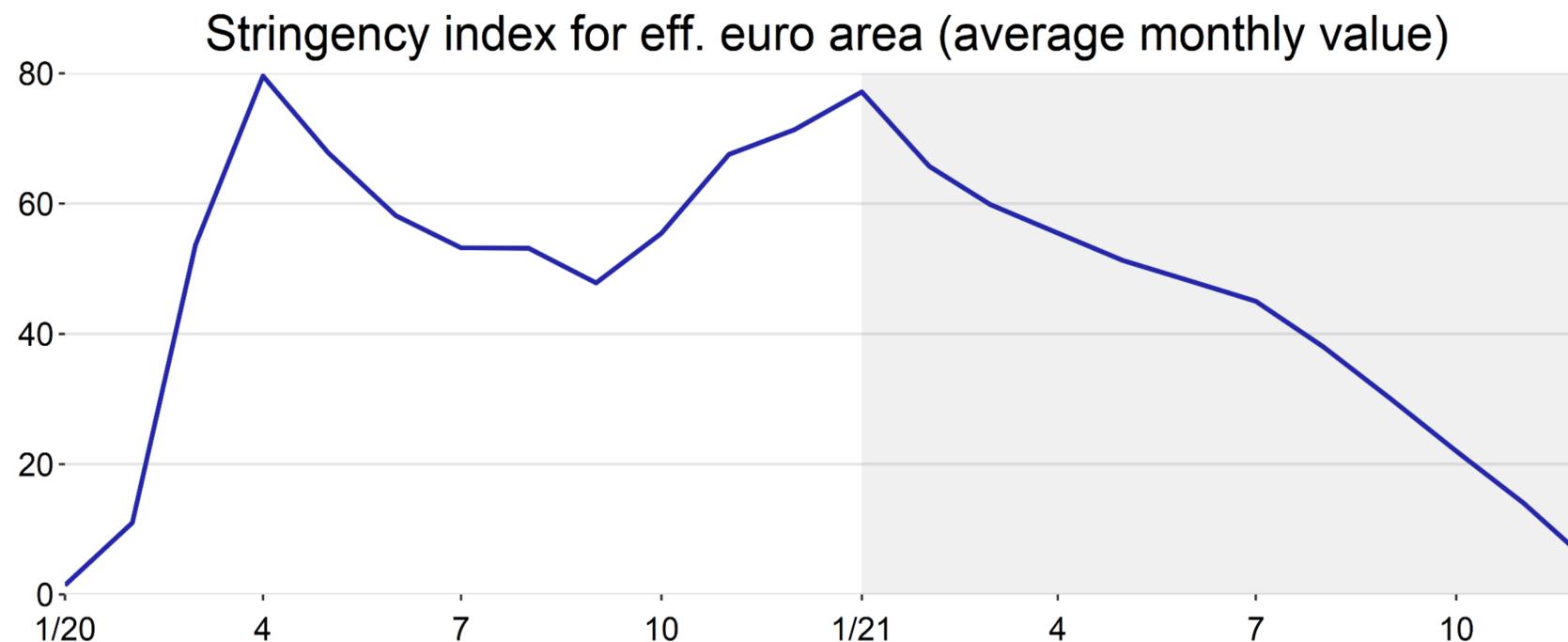


Pandemic Situation in Effective Euro Area



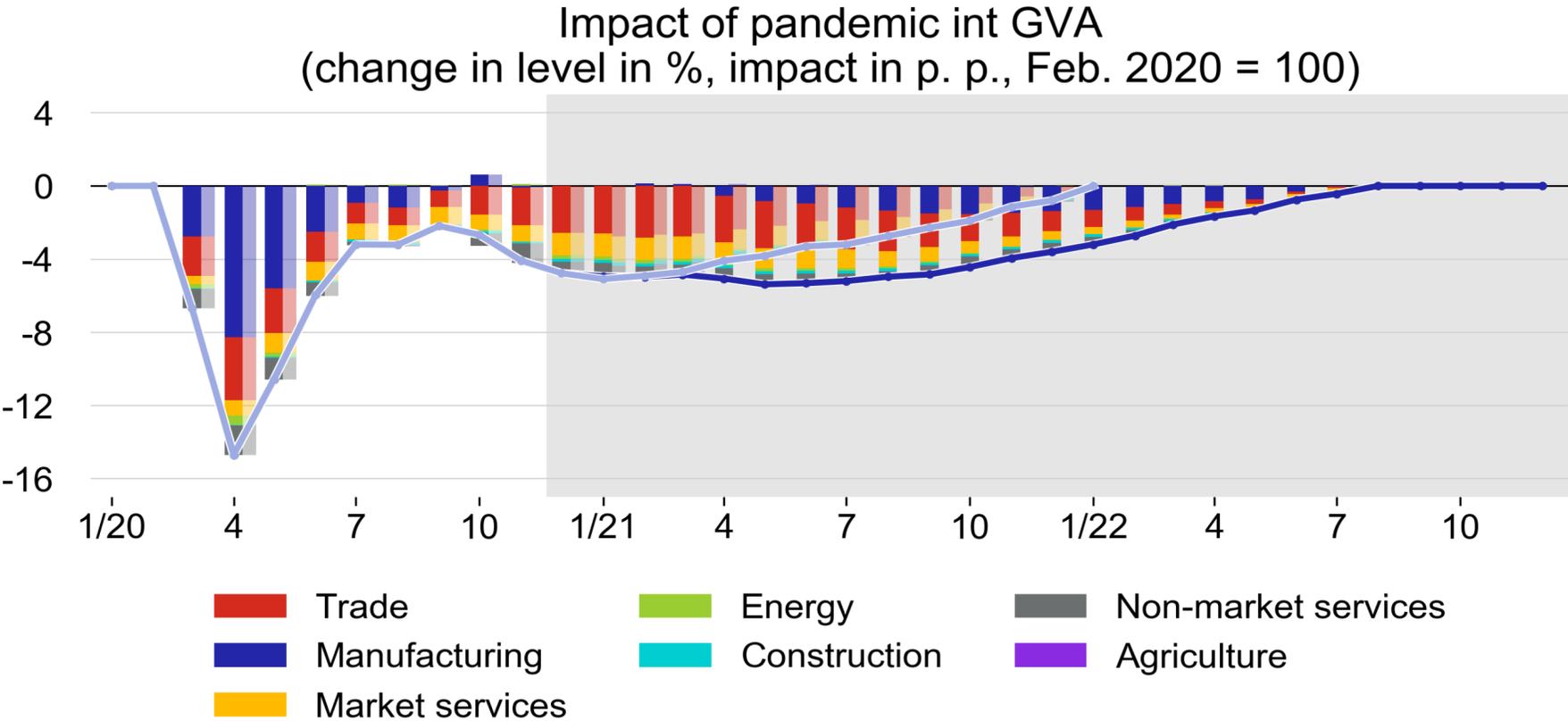
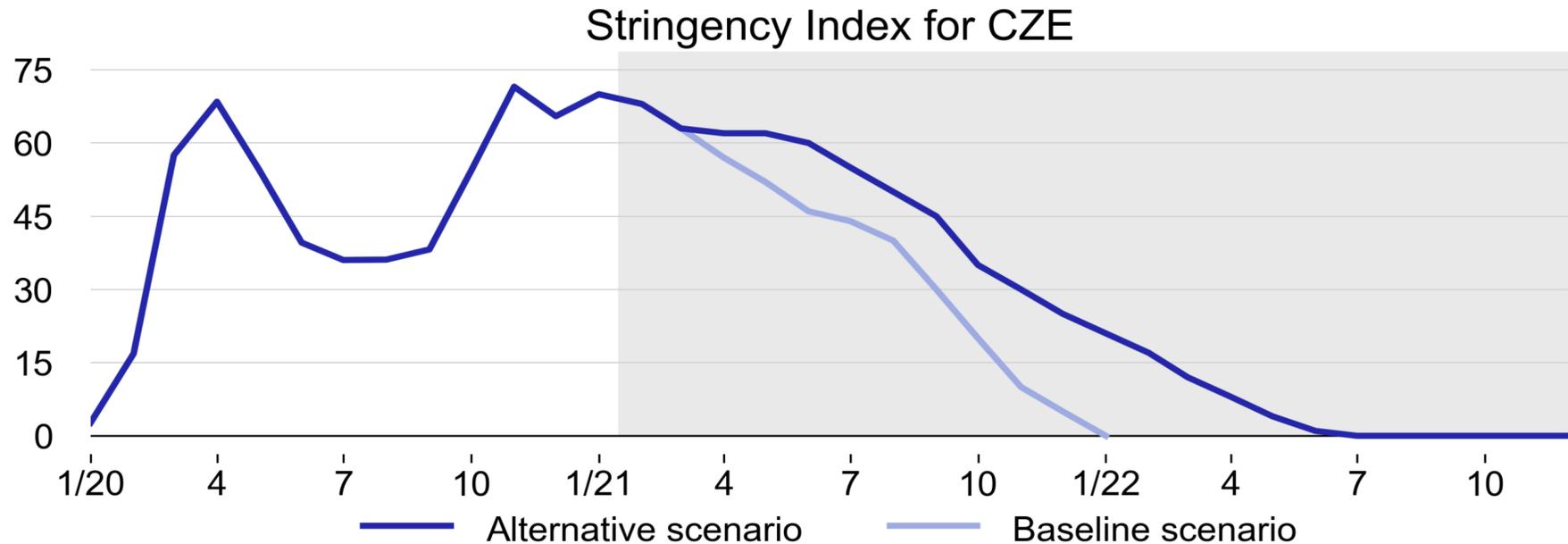
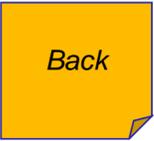
- The current restrictions will gradually lessen over the course of this year, allowing the foreign economy to start growing again.
- The epidemiological measures will have substantial **negative impacts on gross value added** until the end of this year mainly through services. Industry remains resilient in the euro area.

Assumptions: Pandemic Situation (Baseline)

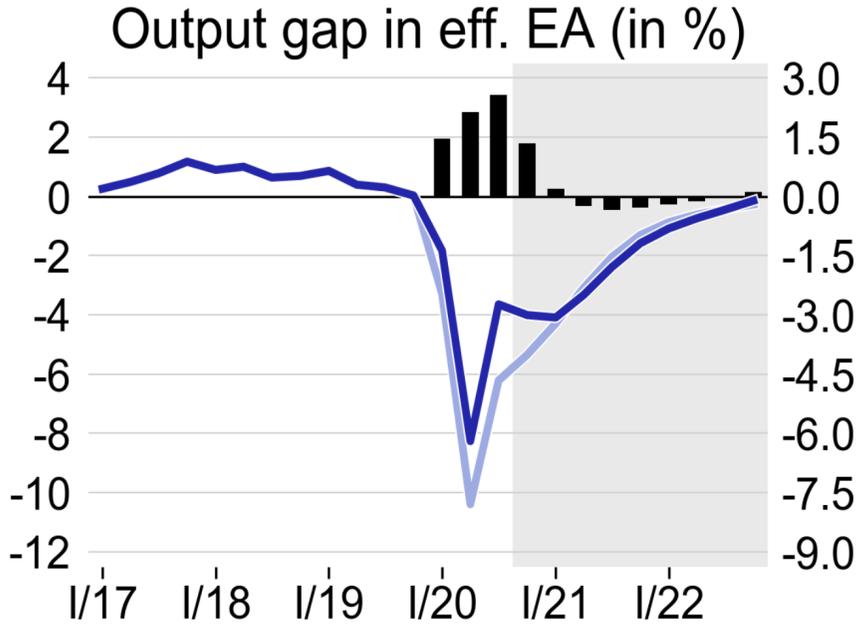
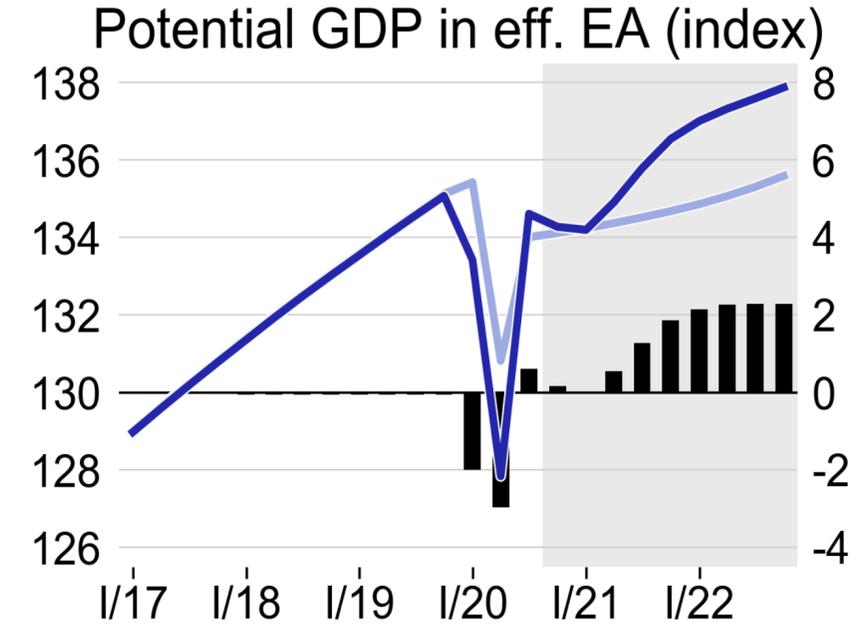
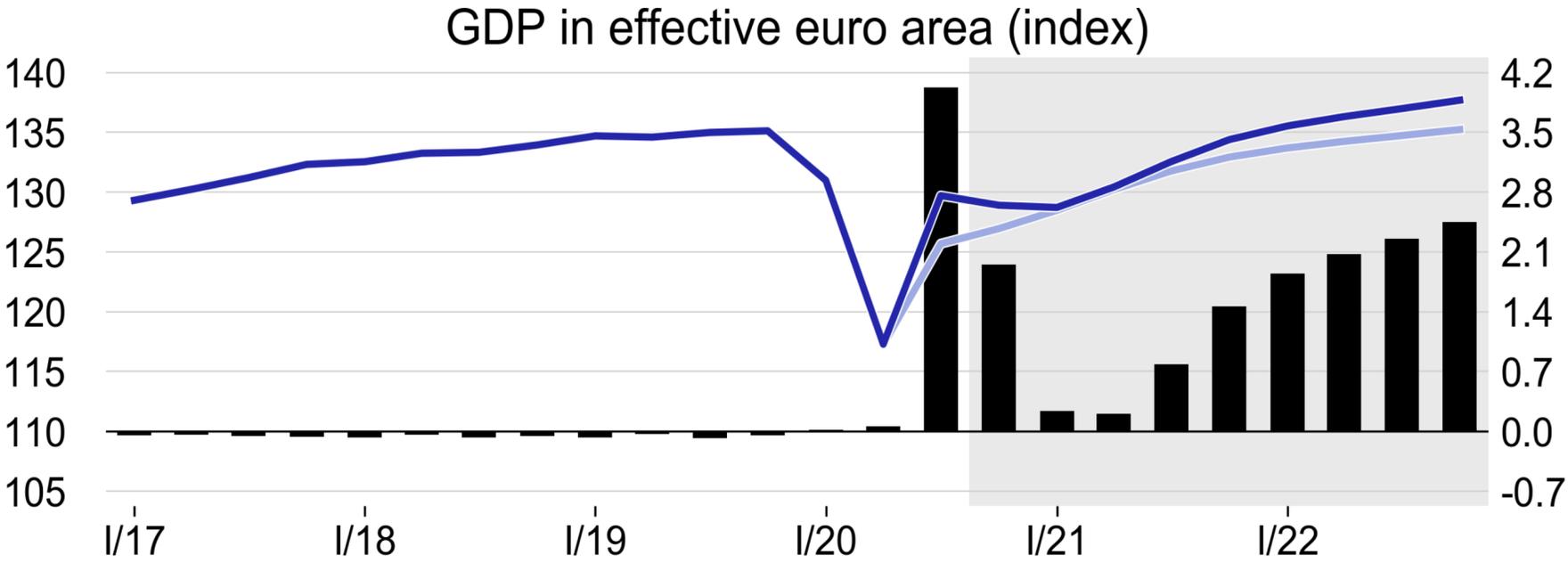
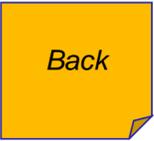


- Assumptions regarding the course of the epidemic situation are an important part of the baseline scenario of the forecast. **The adoption of a set of measures and restrictions had been anticipated** during the preparation of the forecast.
- The strength of restrictive epidemiological measures is indicated by the **Stringency Index**.
- The restrictive effect of the current governments' measures is reflected by elevated values of Stringency Indices.
- The measures are expected to be eased only gradually.

Pandemic Situation (Scenario)

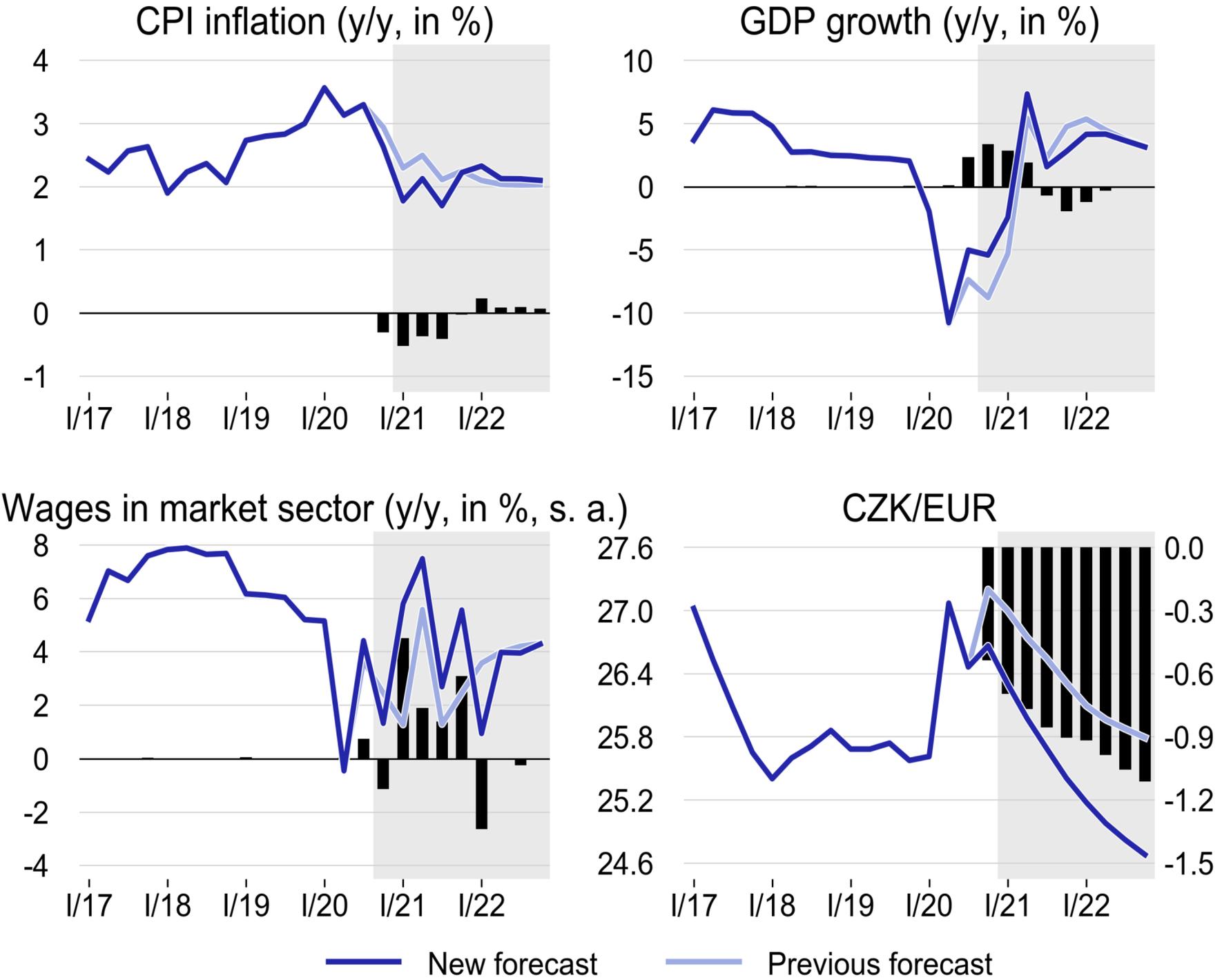


GDP in Effective Euro Area: Comparison

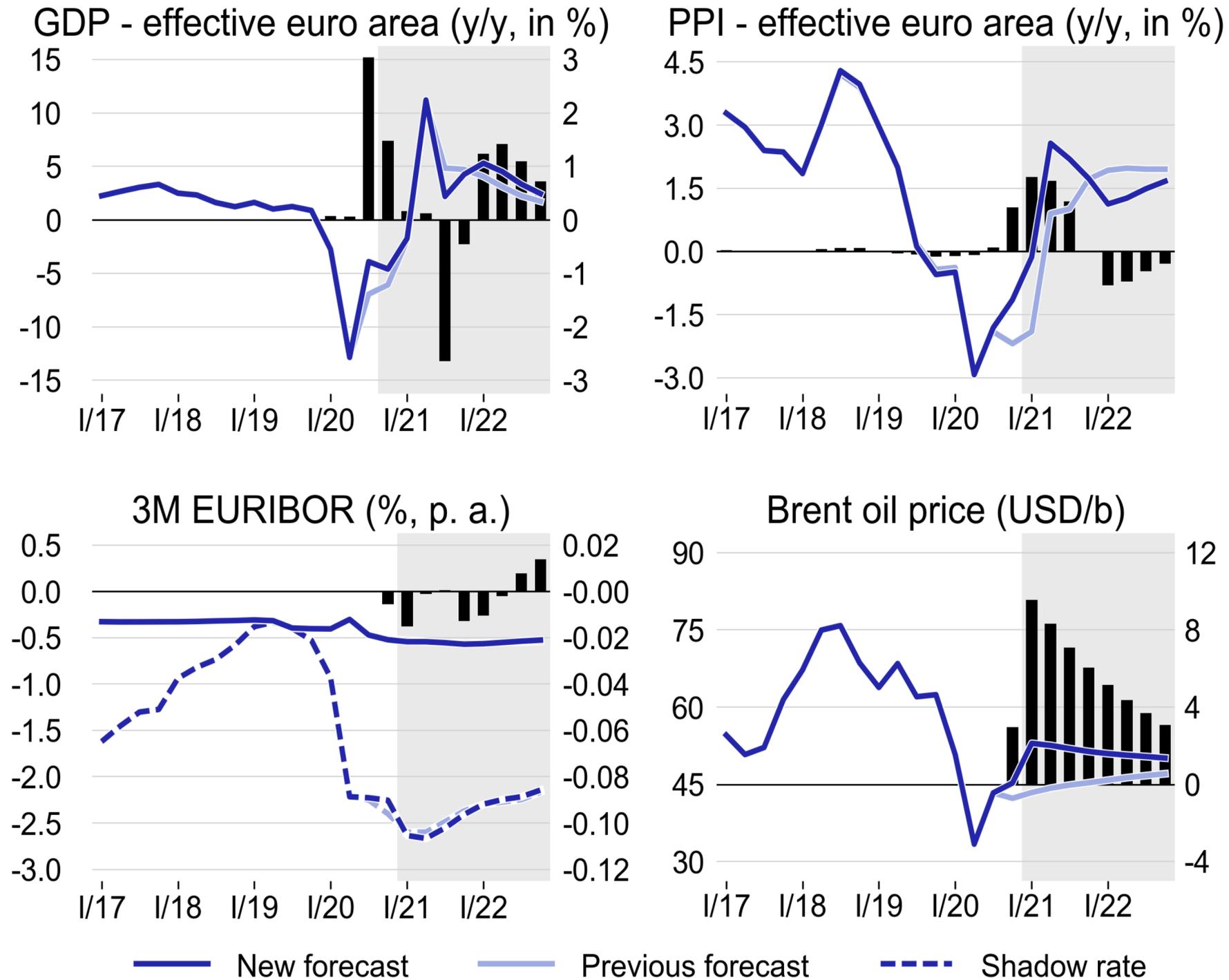


— New forecast — Previous forecast

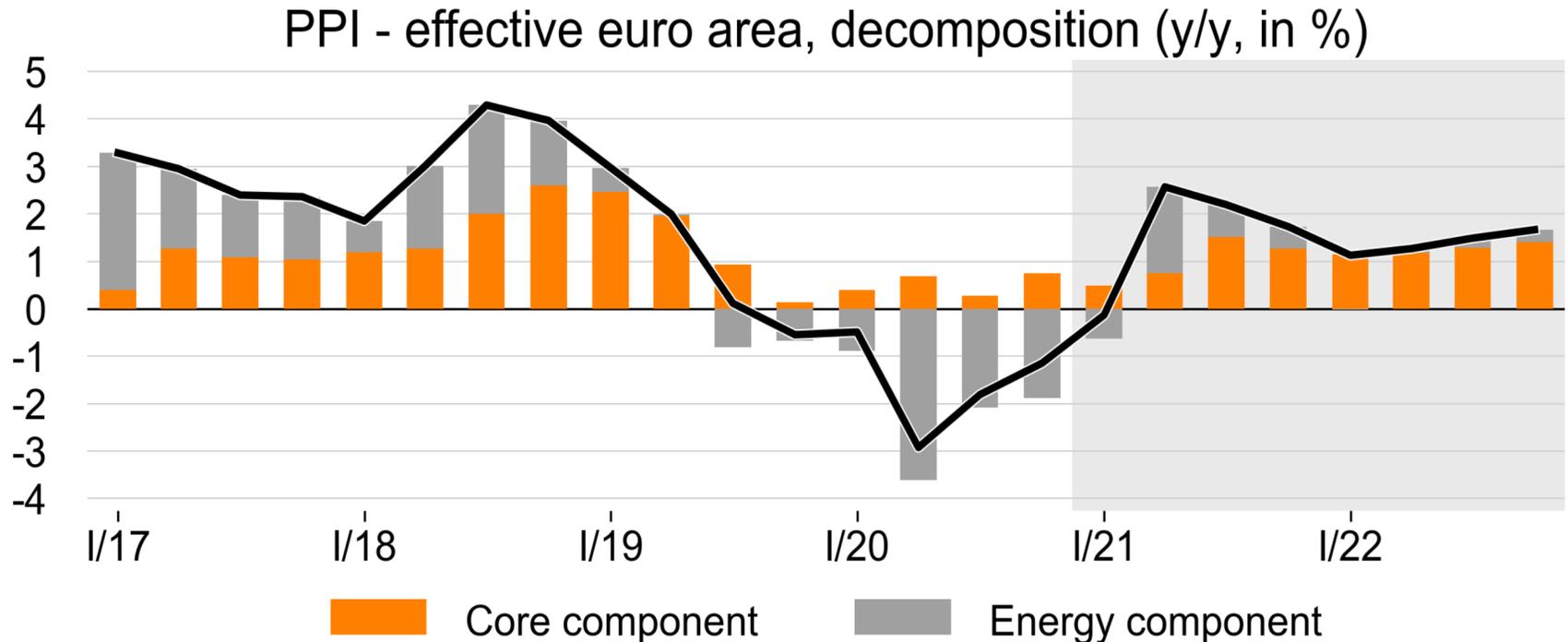
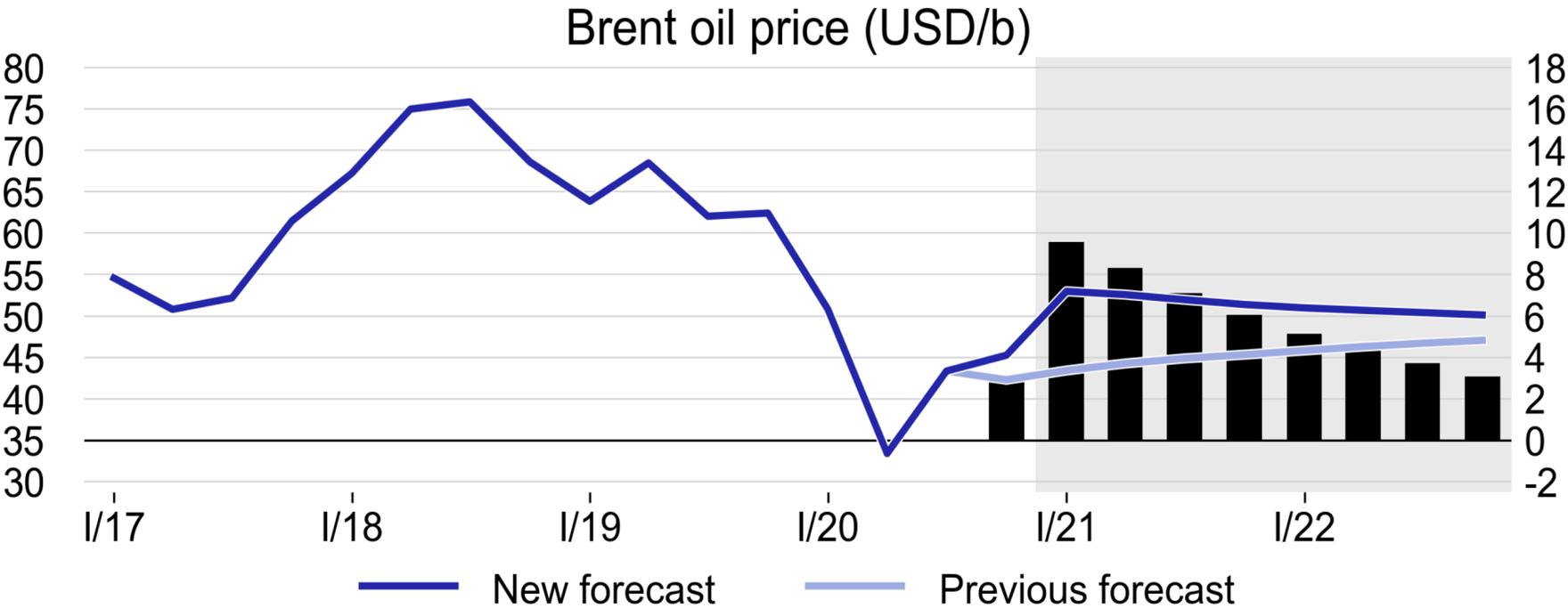
Comparison with Previous Forecast



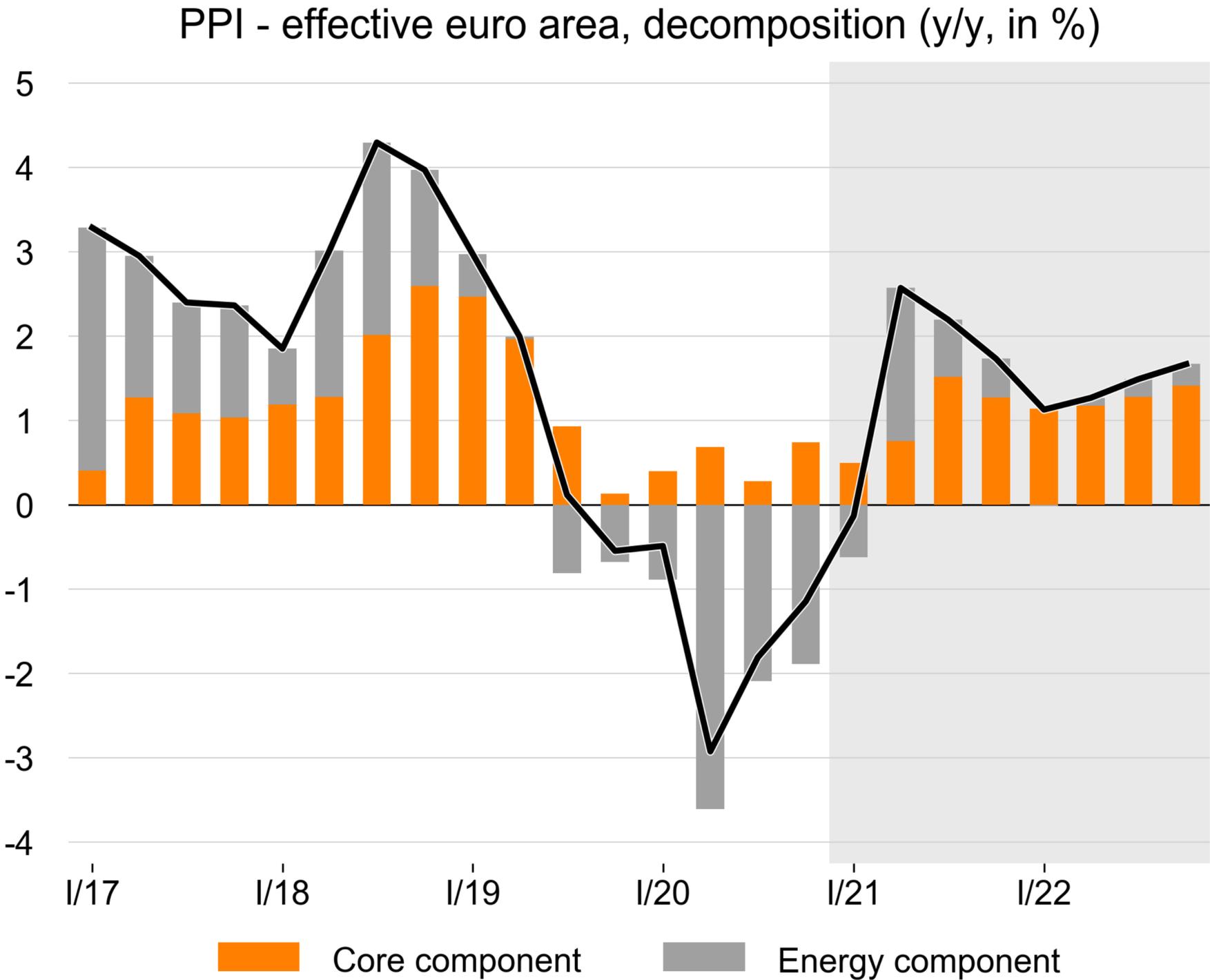
Foreign Outlook: Comparison



PPI in Effective Euro Area: Decomposition

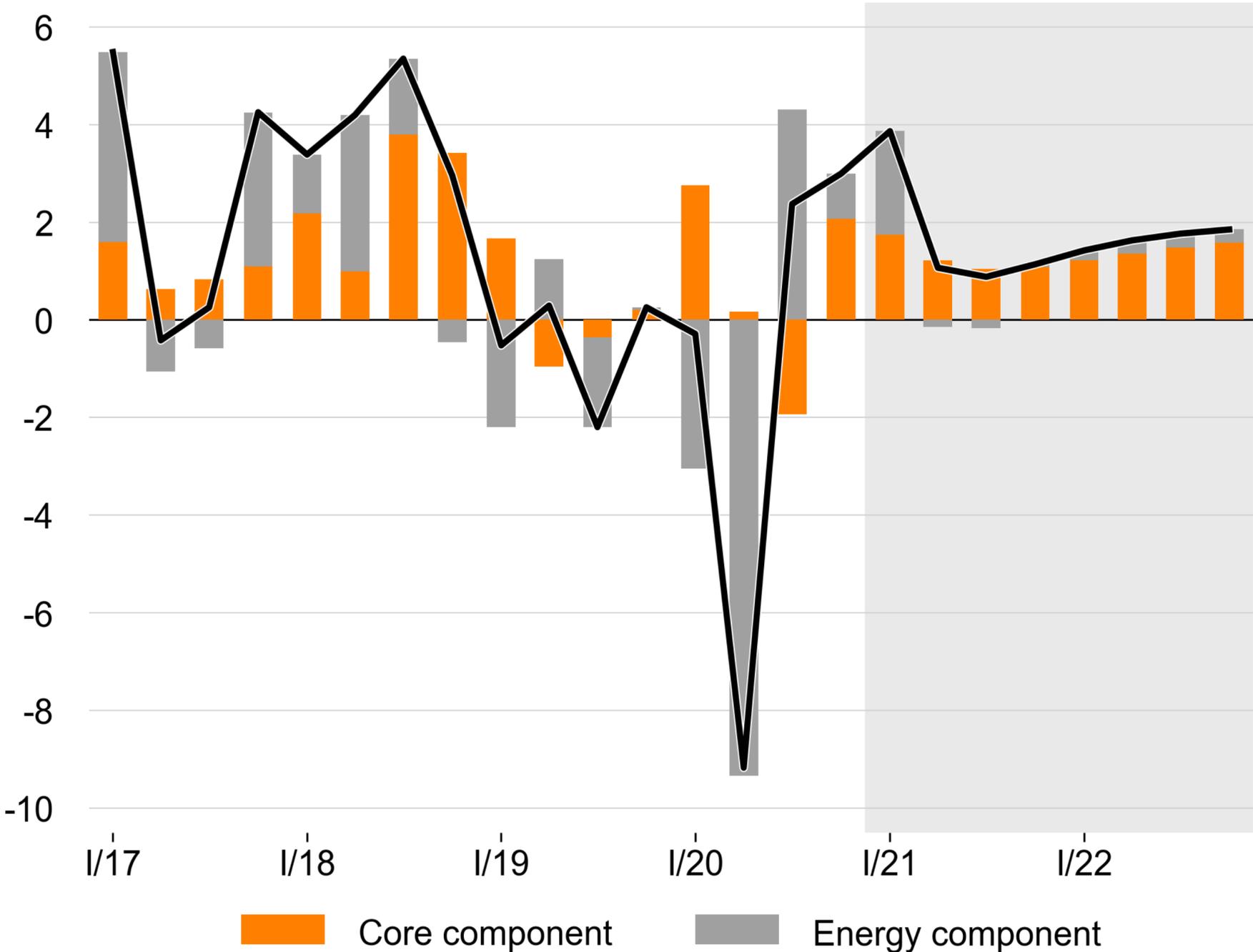


PPI in Effective Euro Area: Decomposition

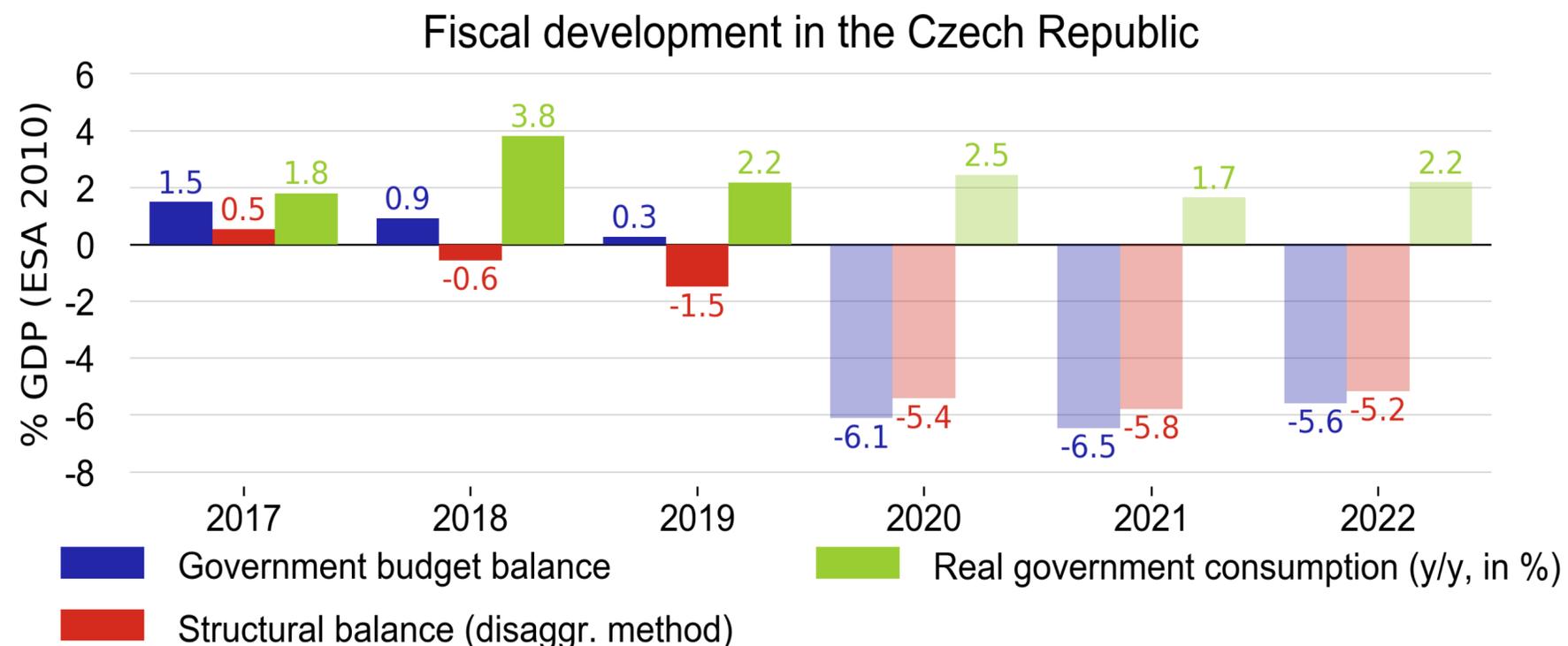


PPI in Effective Euro Area: Decomposition

PPI - effective euro area, decomposition (q/q, in %, ann.)



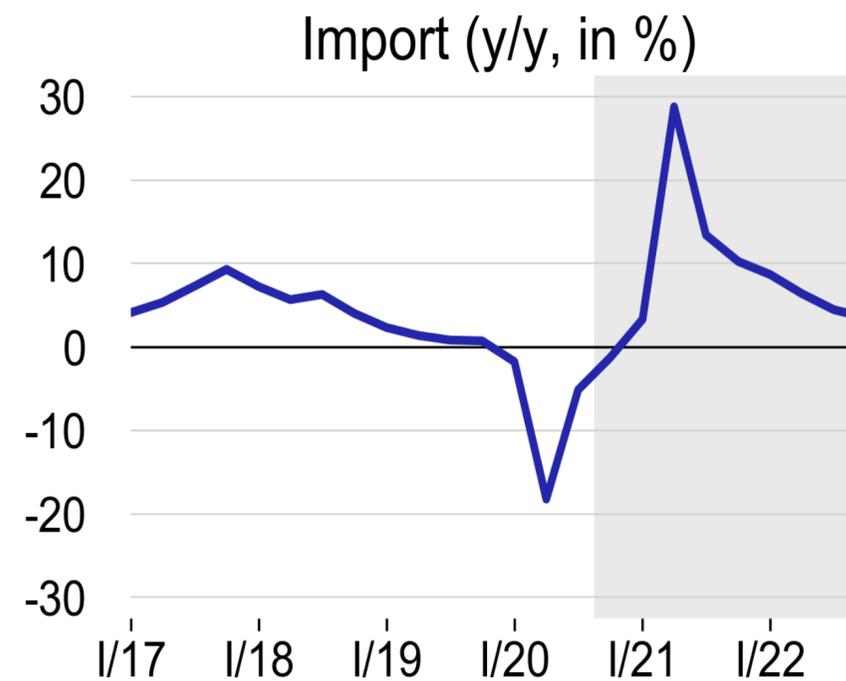
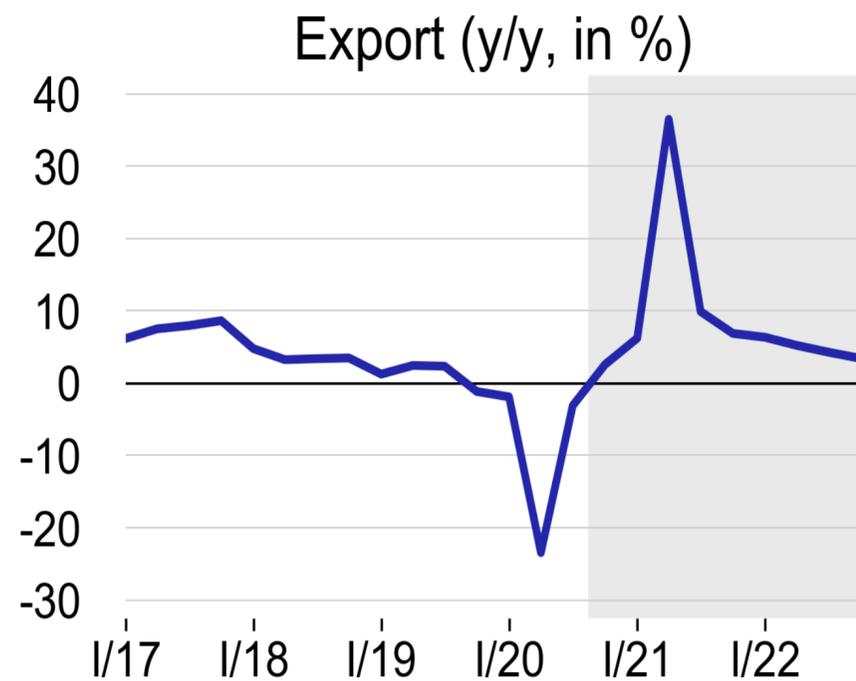
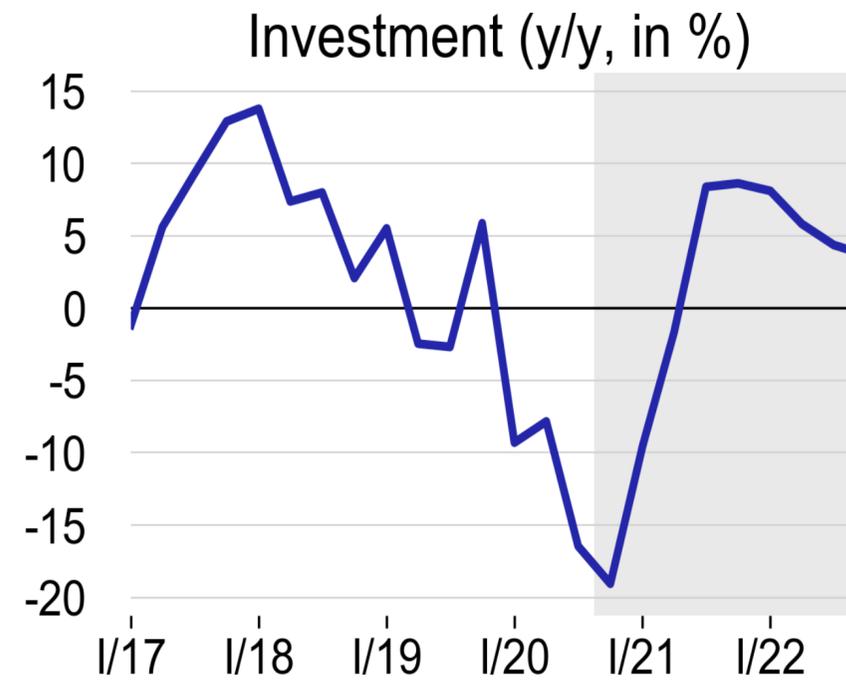
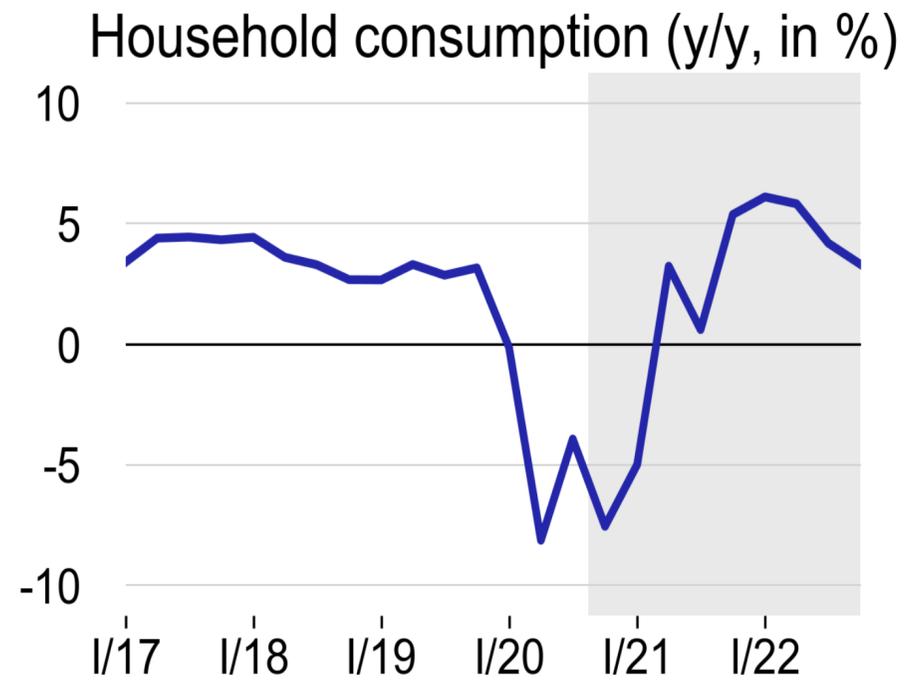
Fiscal Policy



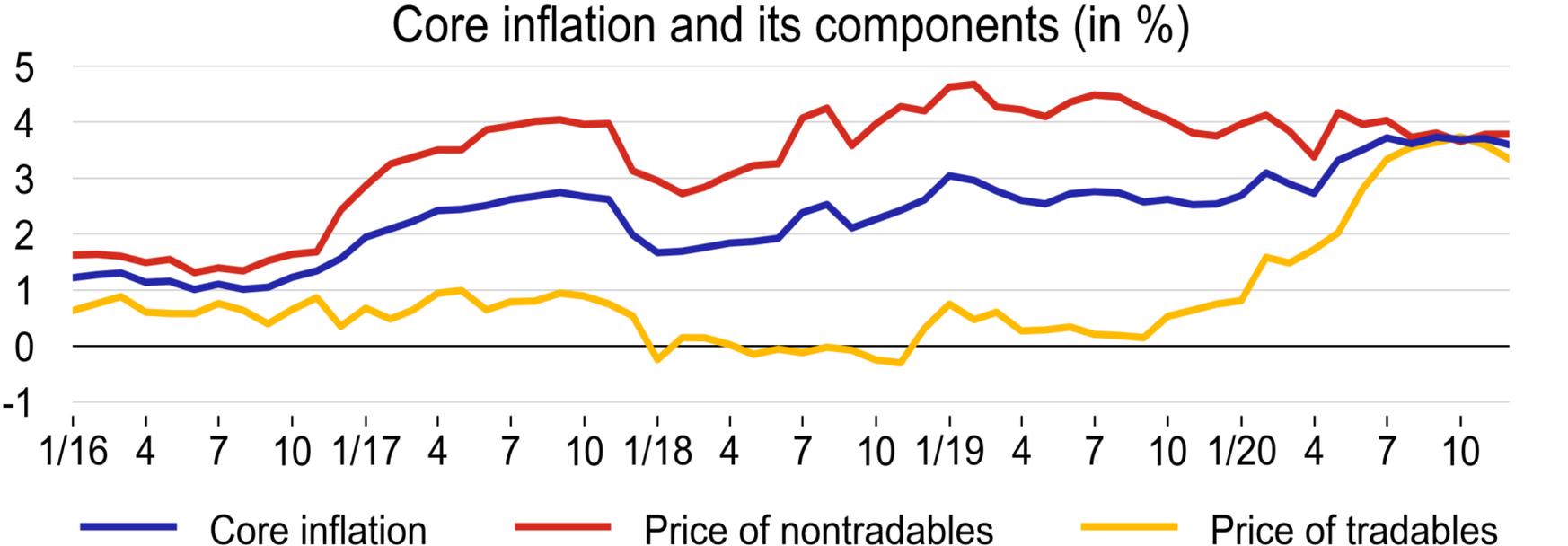
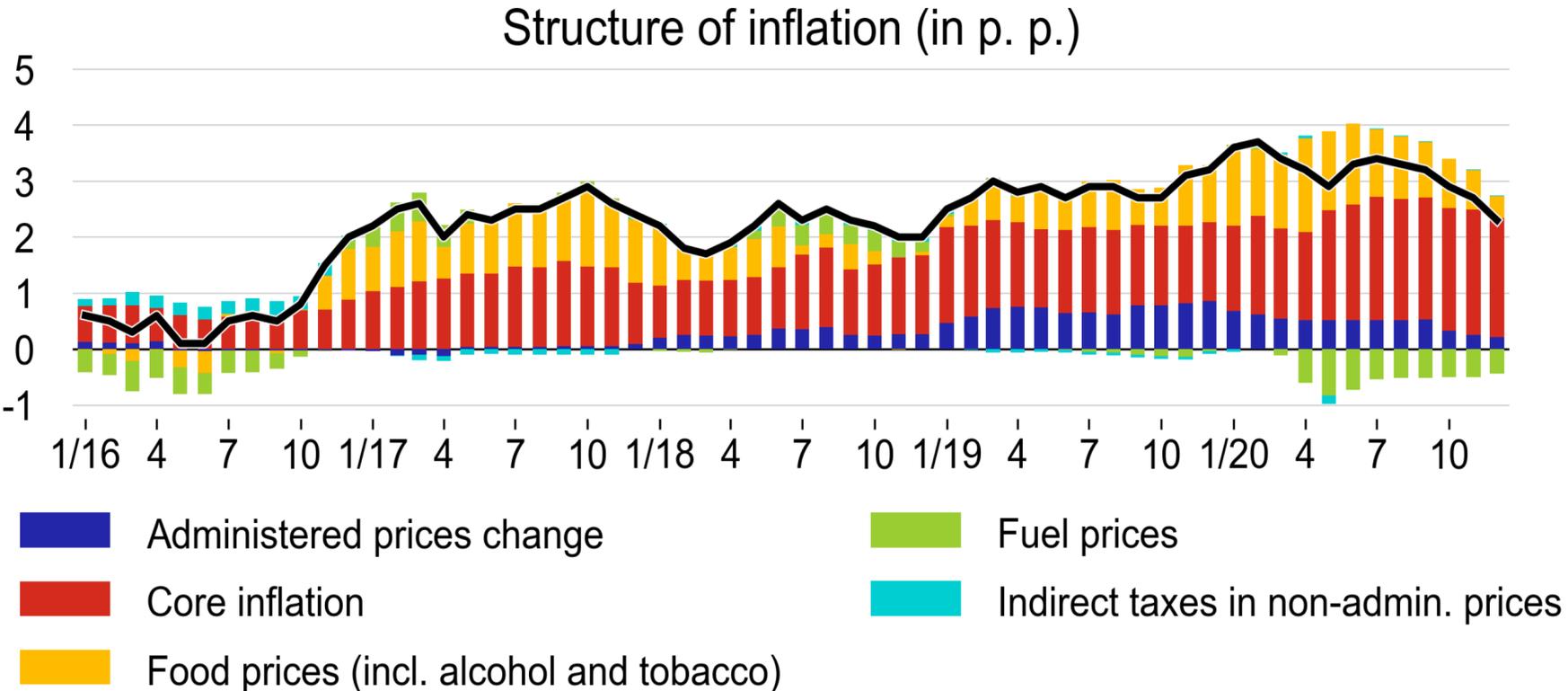
Fiscal impulse (contributions to GDP growth in percentage points)

	2019	2020	2021	2022
	actual	forecast	forecast	forecast
Fiscal impulse	0.5	1.9	-0.3	-0.3
of which impact through:				
Private consumption	0.4	1.7	-0.3	-0.3
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	0.1	0.1	0.1

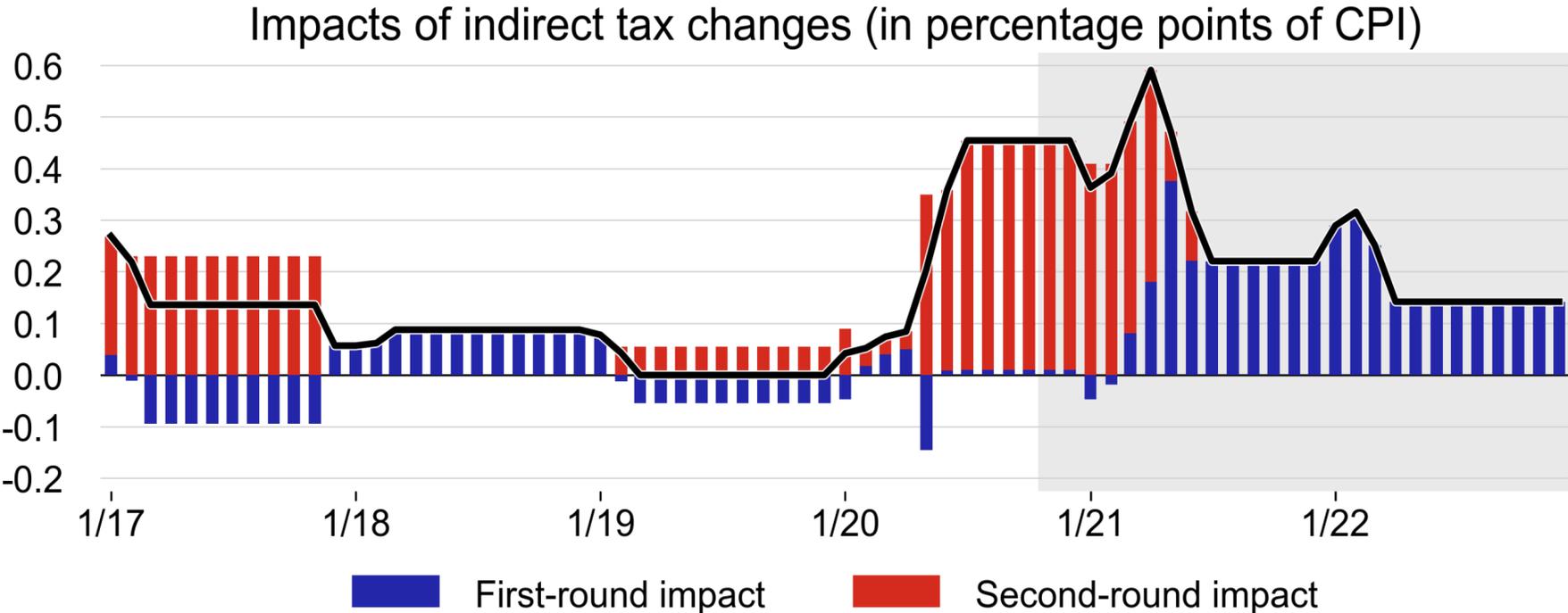
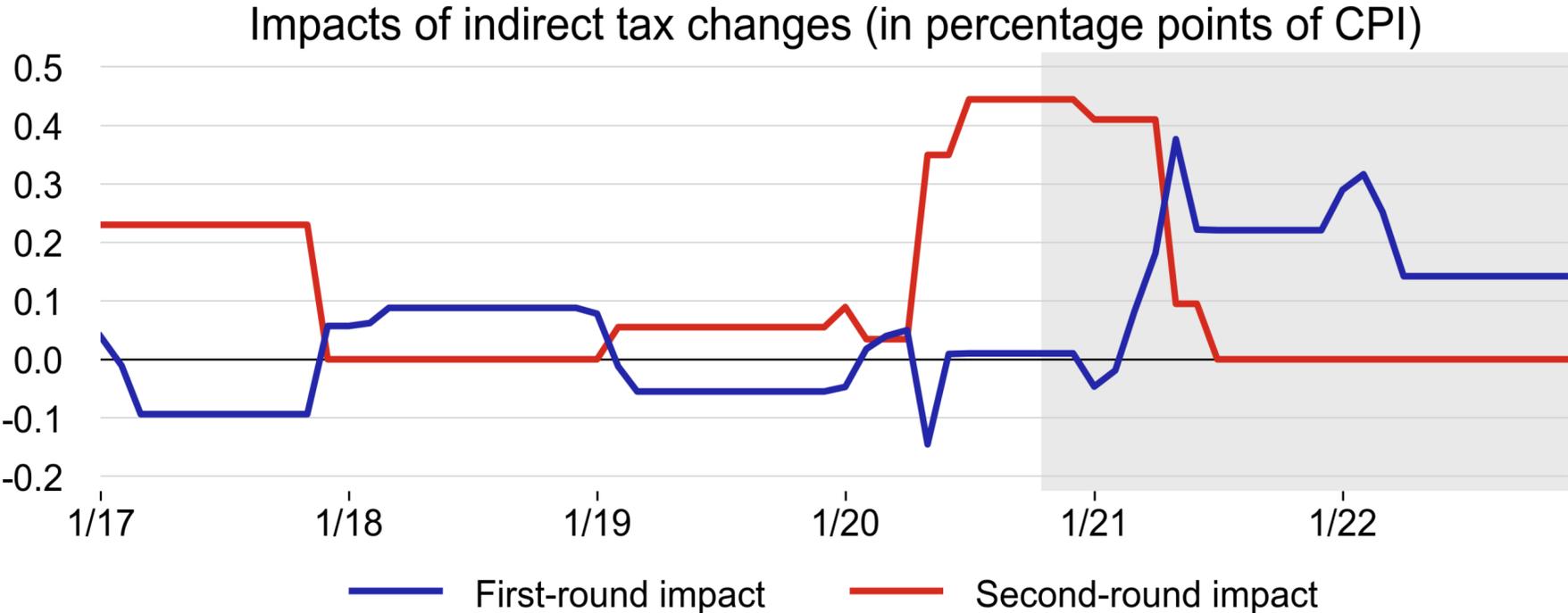
Aggregate Demand



Structure of Inflation

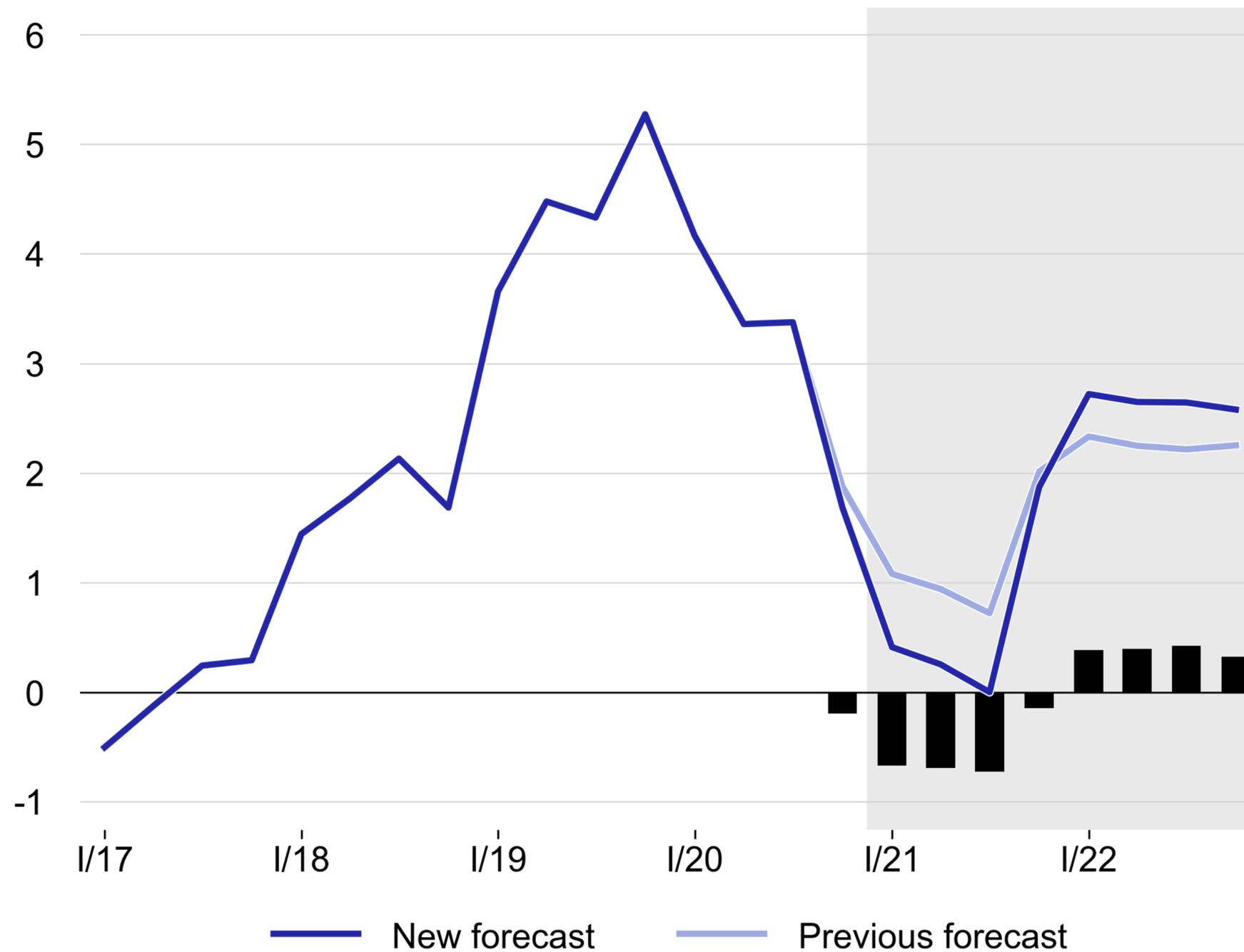


Indirect Tax Changes: Comparison

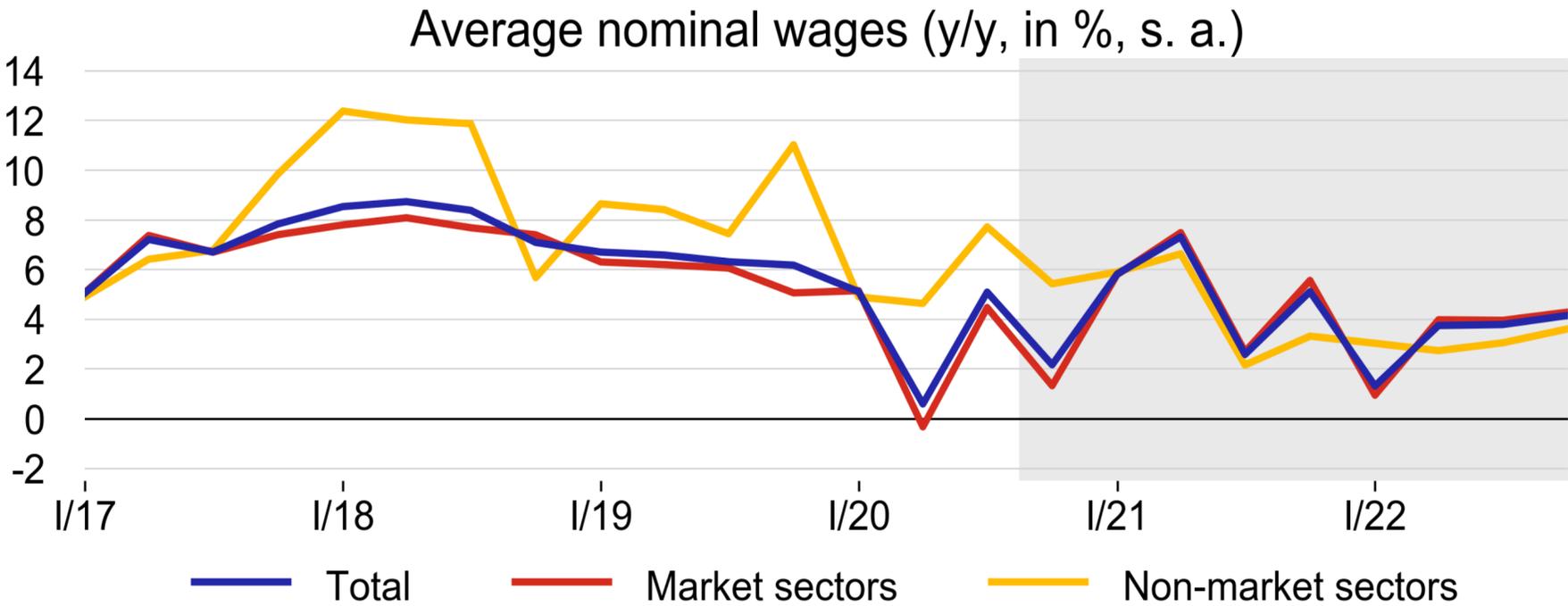
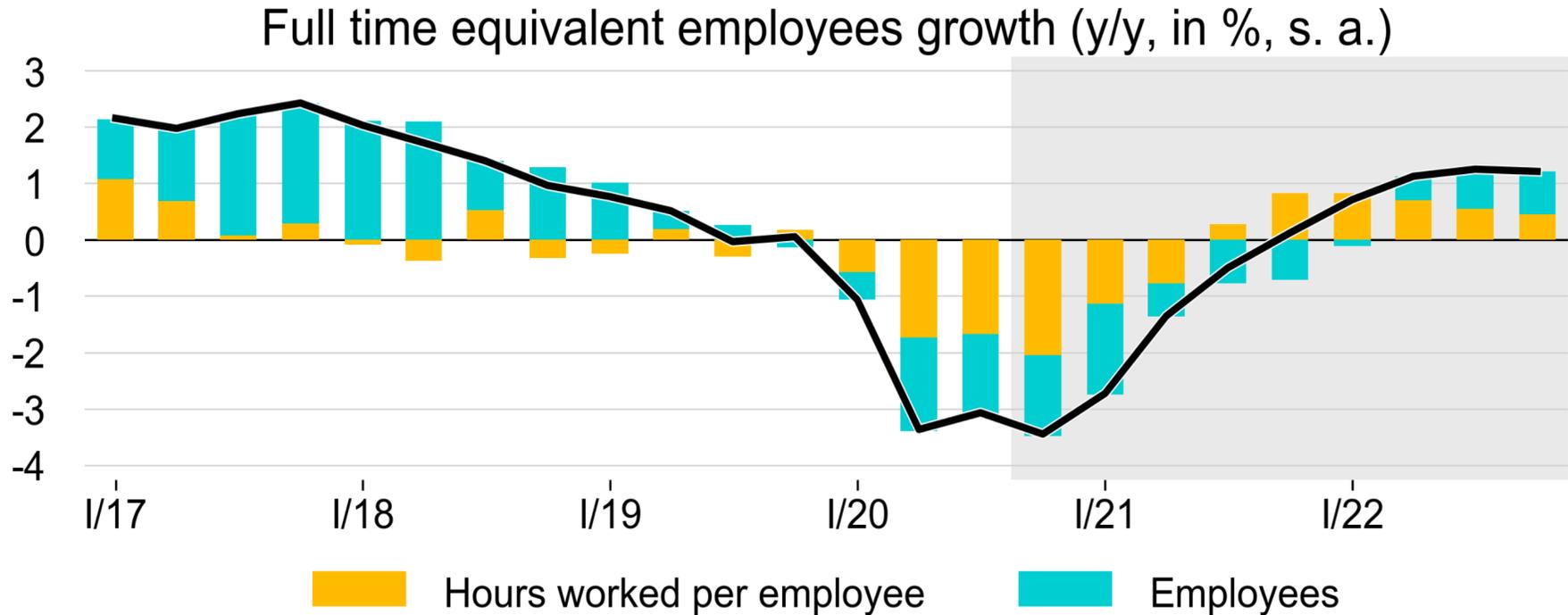


Administered Prices: Comparison

Growth of administered prices (y/y, in %)



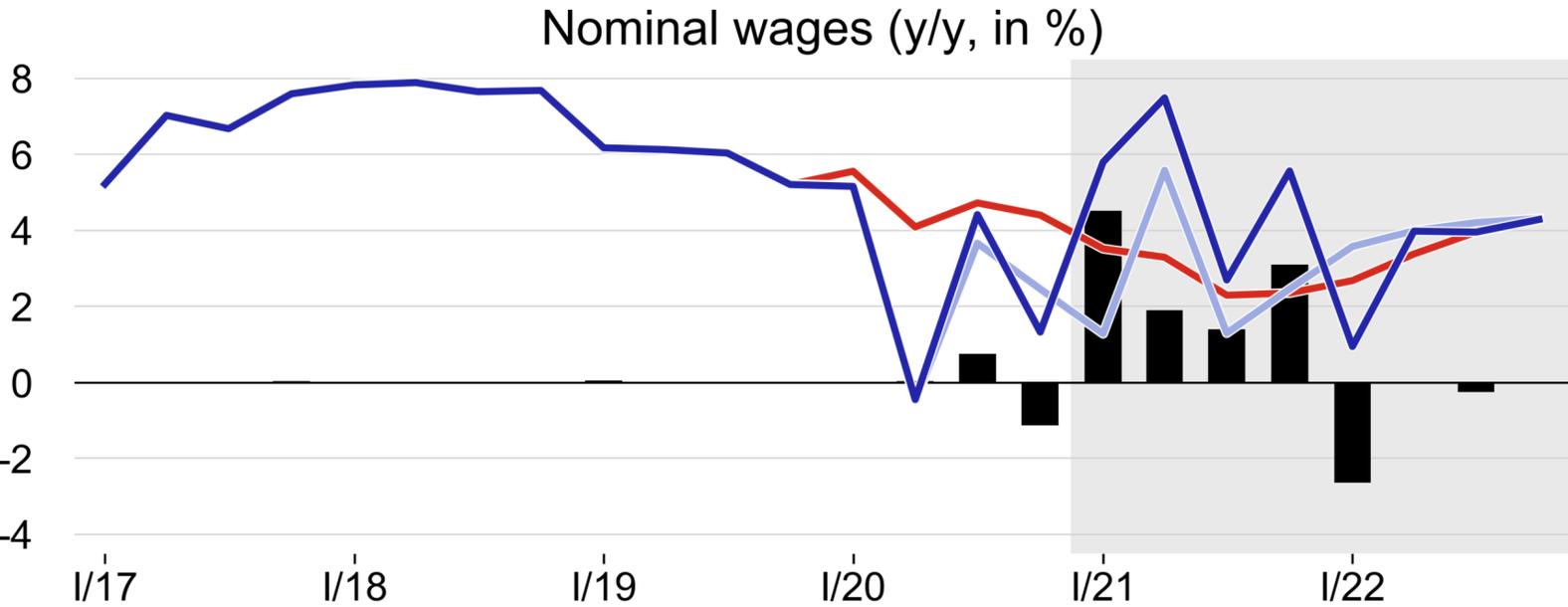
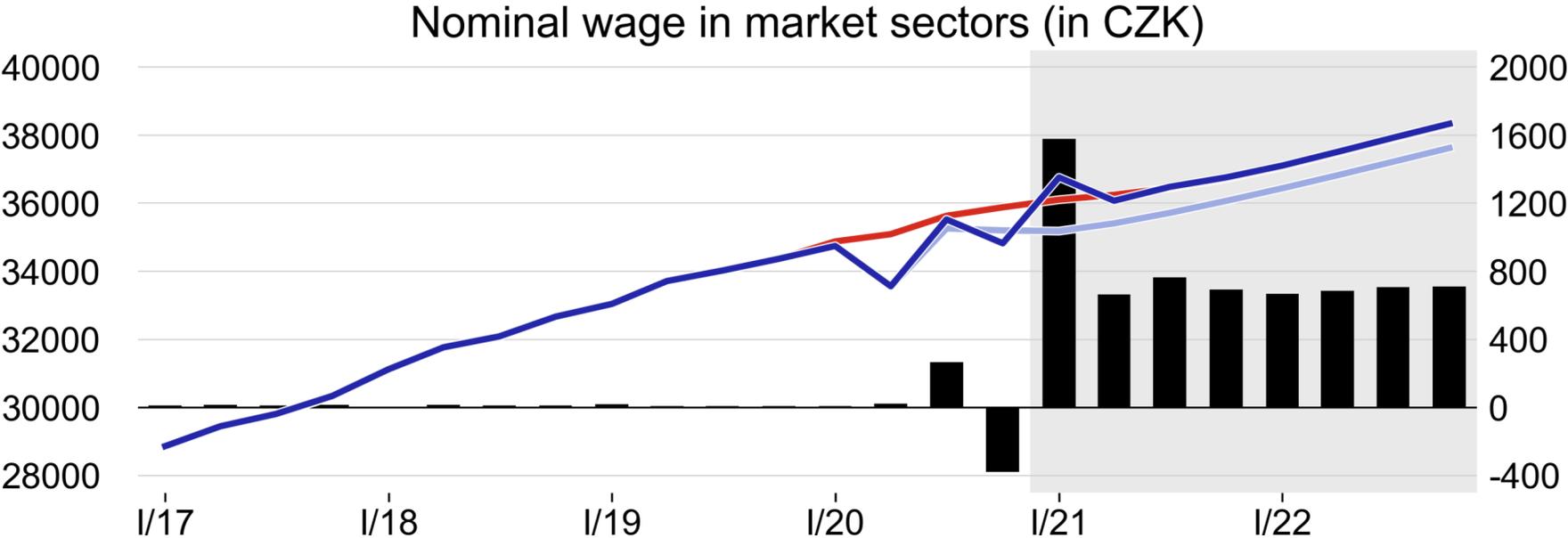
Labour Market



Wages in Market Sector: Comparison

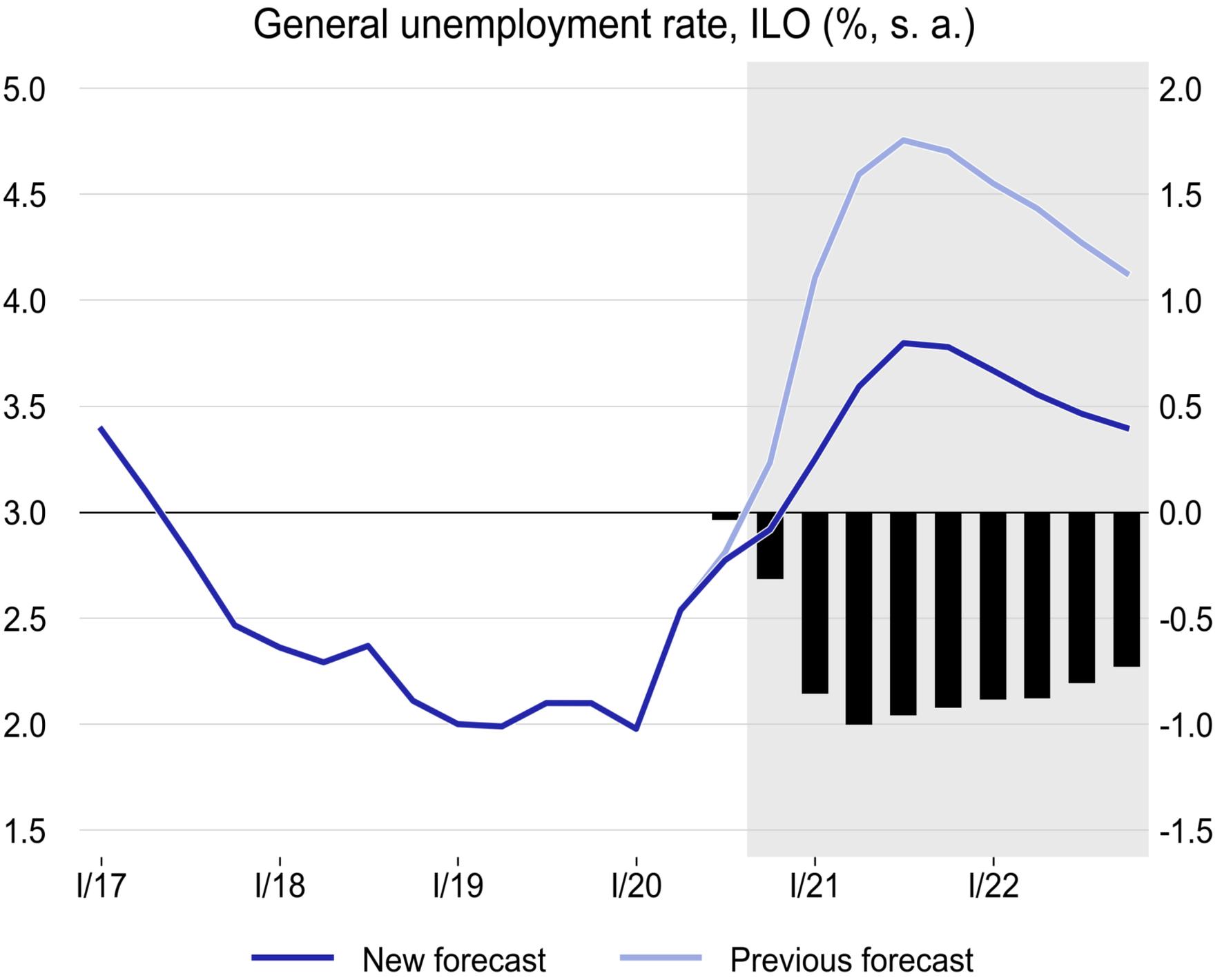


Nominal Wages: Comparison

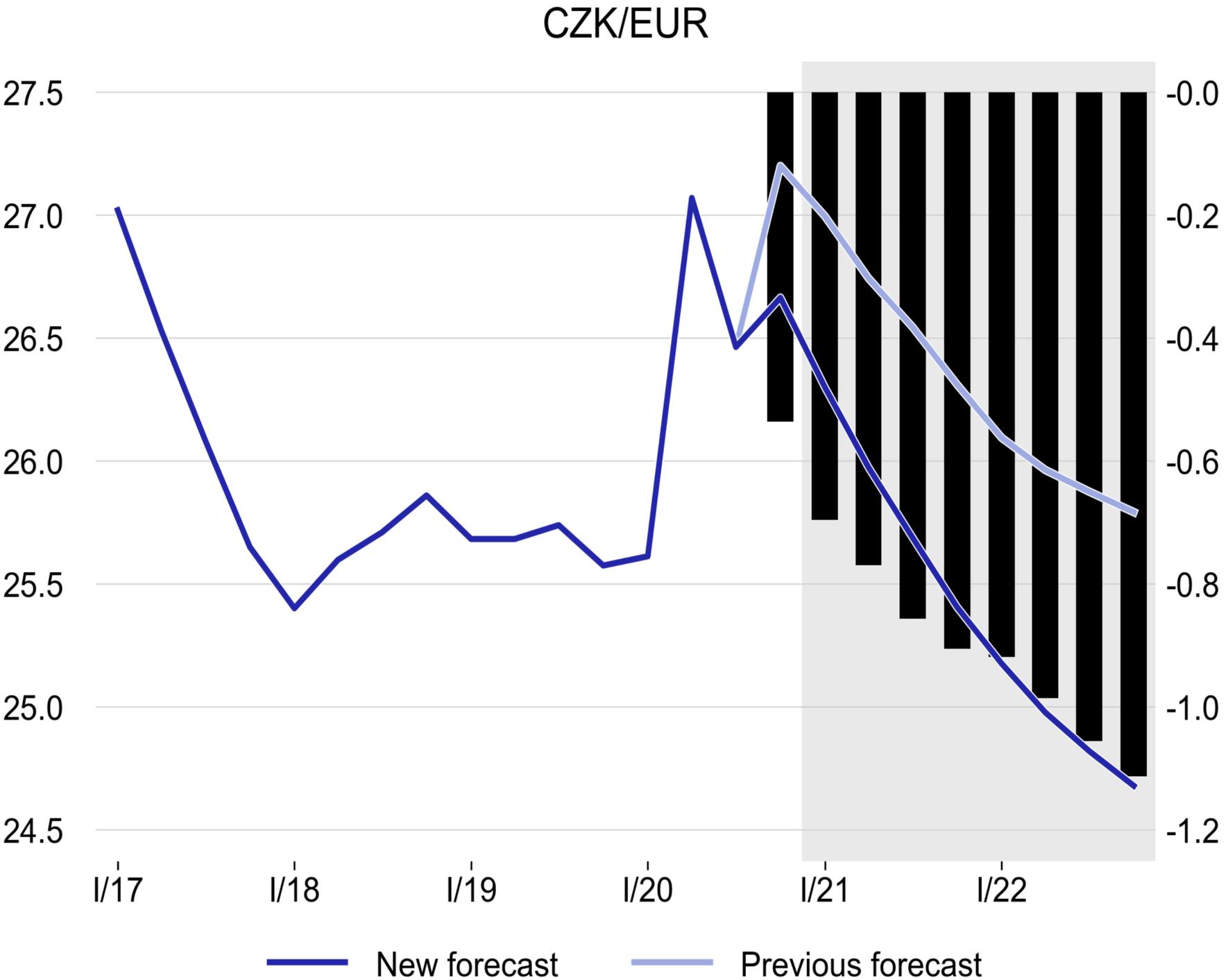


— New forecast — New forecast - fundamental
— Previous forecast

Unemployment Rate: Comparison



Exchange Rate: Comparison



Interest Rate: Comparison

