CZECH NATIONAL BANK

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

Meeting with Analysts

7 May 2021

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Presentation Outline

1. **Assumptions of the Forecast**
2. The New Macroeconomic Forecast (Baseline Scenario)
3. Comparison with the Previous Forecast
4. Longer-Lasting Pandemic Scenario
5. Monetary Policy Simulations

External Environment Outlook

GDP decomp

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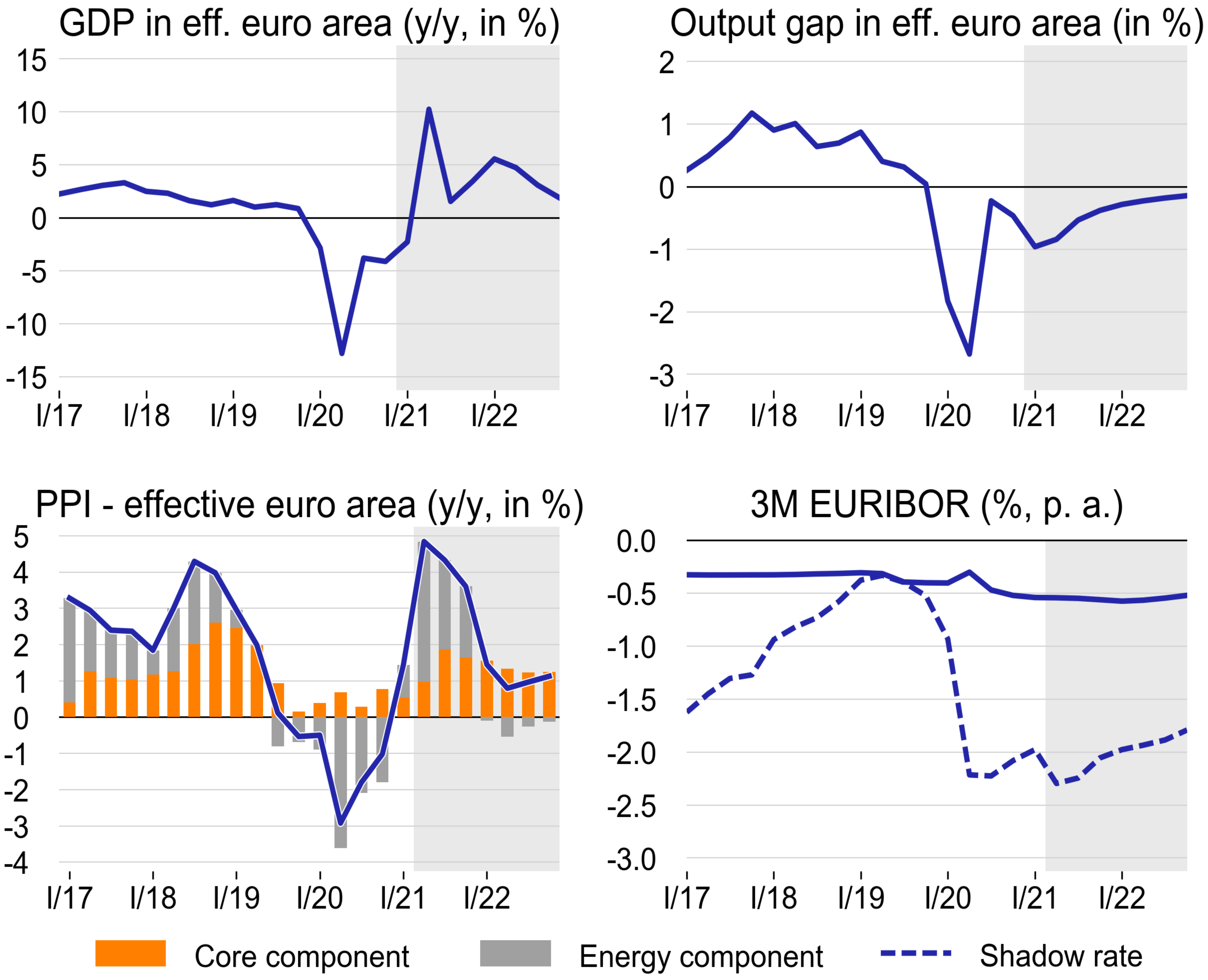
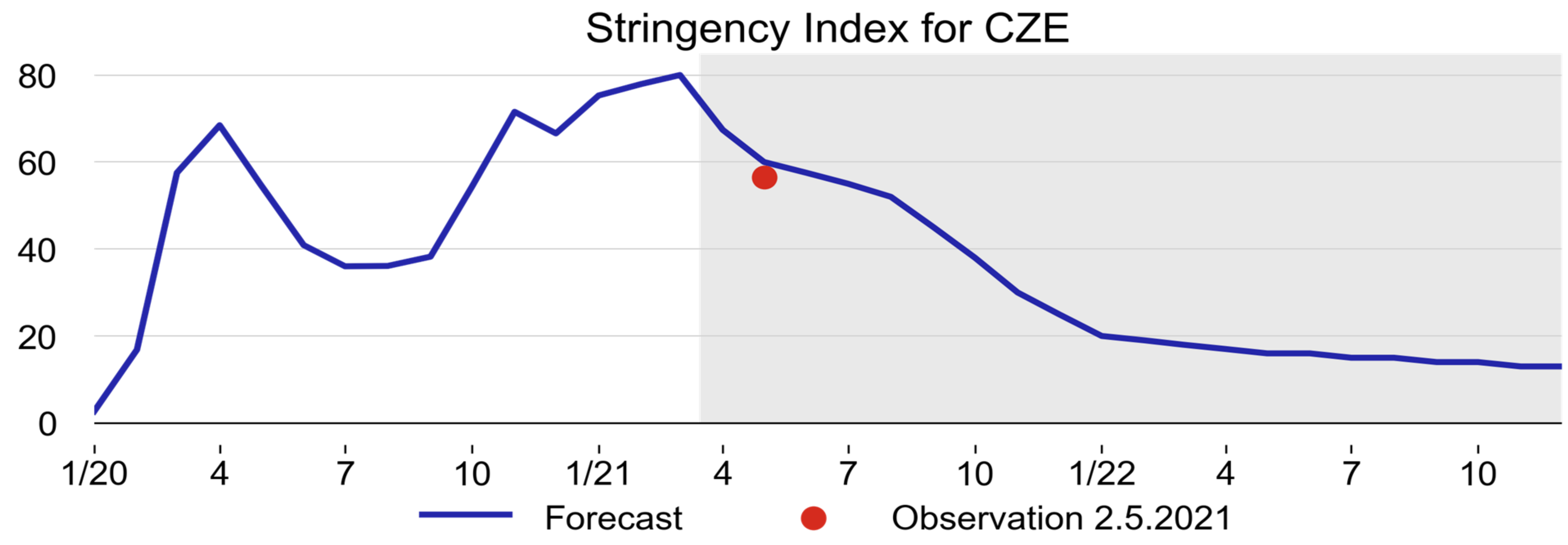
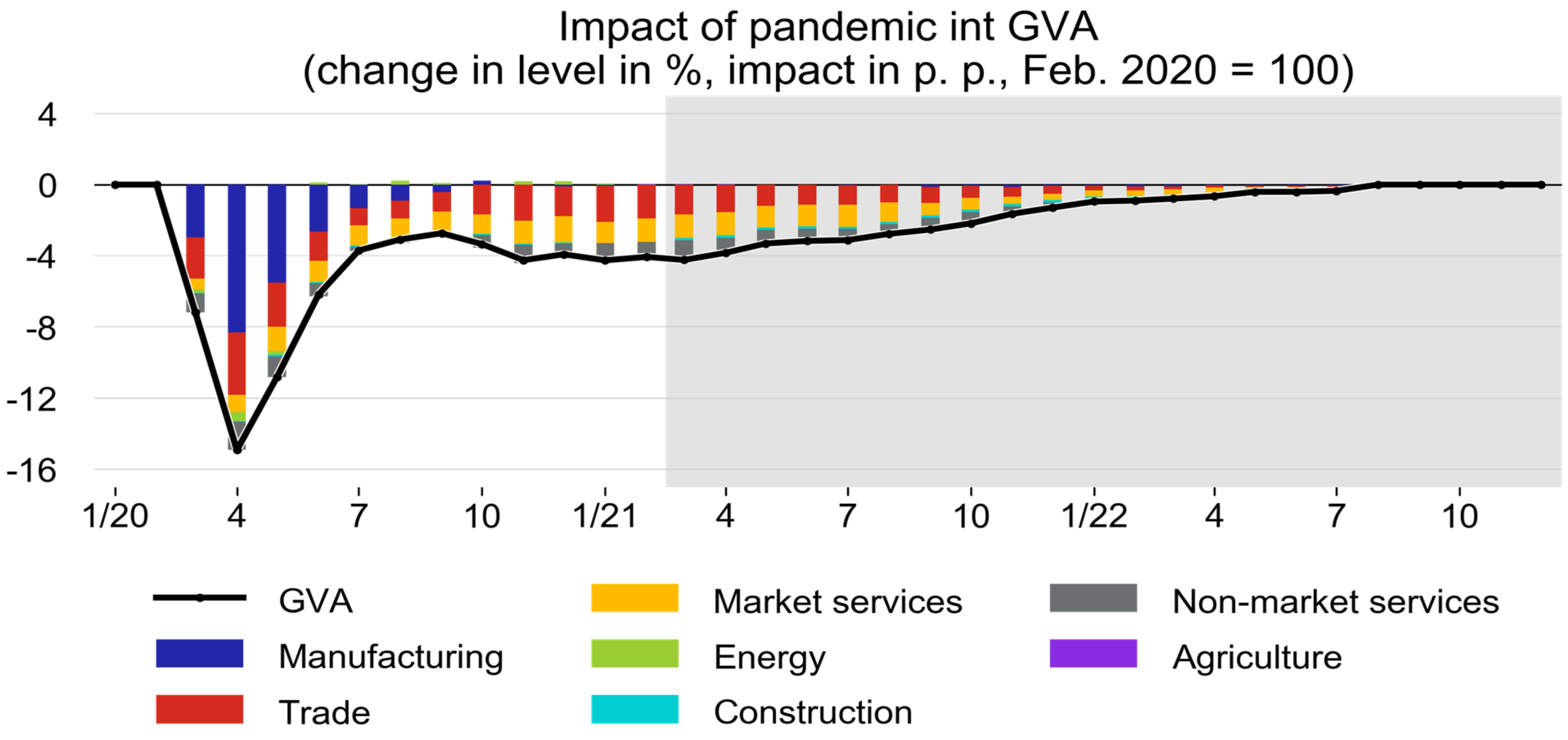


- Buoyant **GDP growth** in the effective euro area will resume during the year owing to growing vaccination coverage and reopening economies.
- The economy will return to its potential output level over the forecast horizon, i.e. the negative **output gap** will gradually close.
- The pressures on **industrial producer prices** will strengthen considerably this year. In addition to growth in prices of oil and other commodities, stronger demand for industrial goods will have an inflationary effect.
- The **3M EURIBOR** outlook remains negative. The effect of unconventional monetary policy on the **shadow interest rate** is gradually diminishing.

Domestic Pandemic Situation





- After peaking in March, the **Stringency Index** started to decline and will continue to do so for the rest of the year; however, the restrictions during spring and summer 2021 will be rather greater than last year.
- Government anti-epidemic **measures** are mainly **affecting wholesale**, **retail** and **services**, while industry has hardly been affected by the administrative restrictions at all.
- The direct economic impacts of the fight against the pandemic were smaller in Q1 2021 than in spring 2020, even though the Stringency Index has been higher so far this year than a year earlier.

Fiscal Policy

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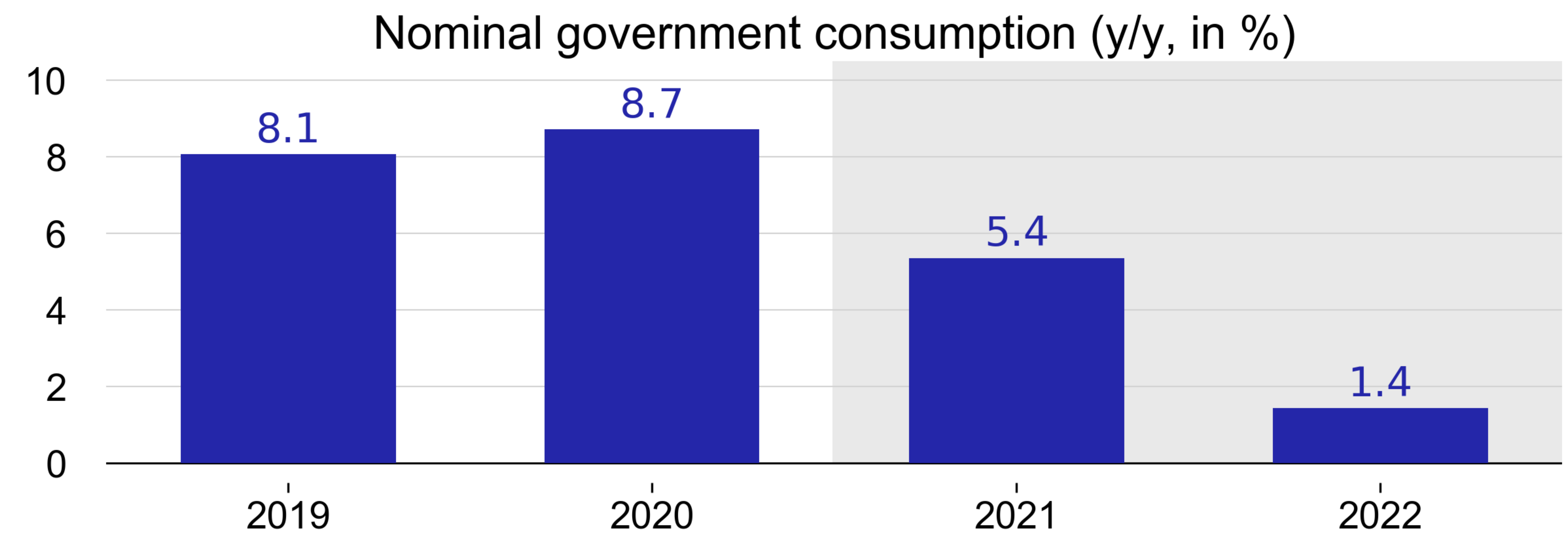

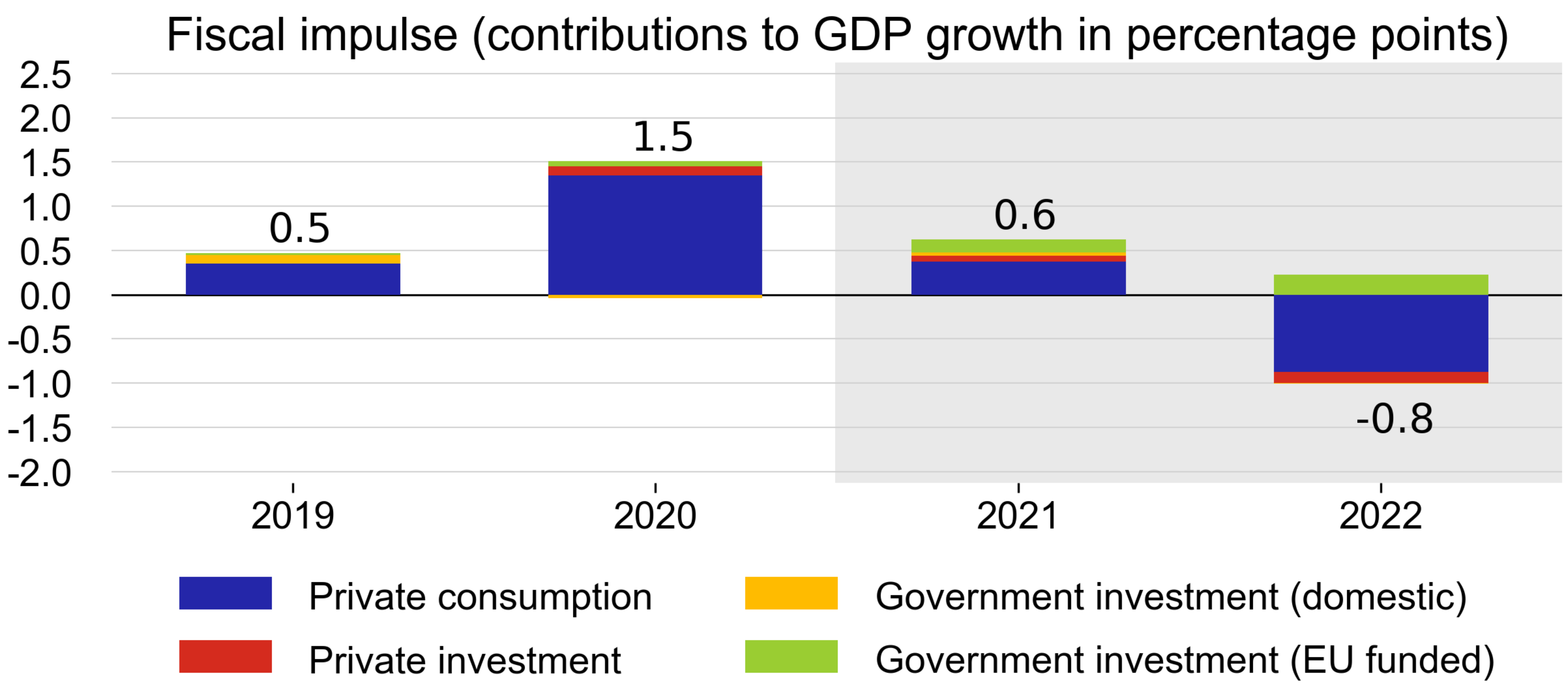

- **Government consumption** will continue to rise this year on average, albeit more slowly due to last year's high expenditure.
- Following last year's exceptionally high **contribution of fiscal policy to GDP growth** this year's fiscal impulse is also forecasted to be strongly positive. It will continue to be implemented predominantly via support for household income and consumption.
- The spring forecast contains **additional measures** approved on an ongoing basis to support households and firms in response to the continuing pandemic.

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Headline and Monetary Policy-Relevant Inflation

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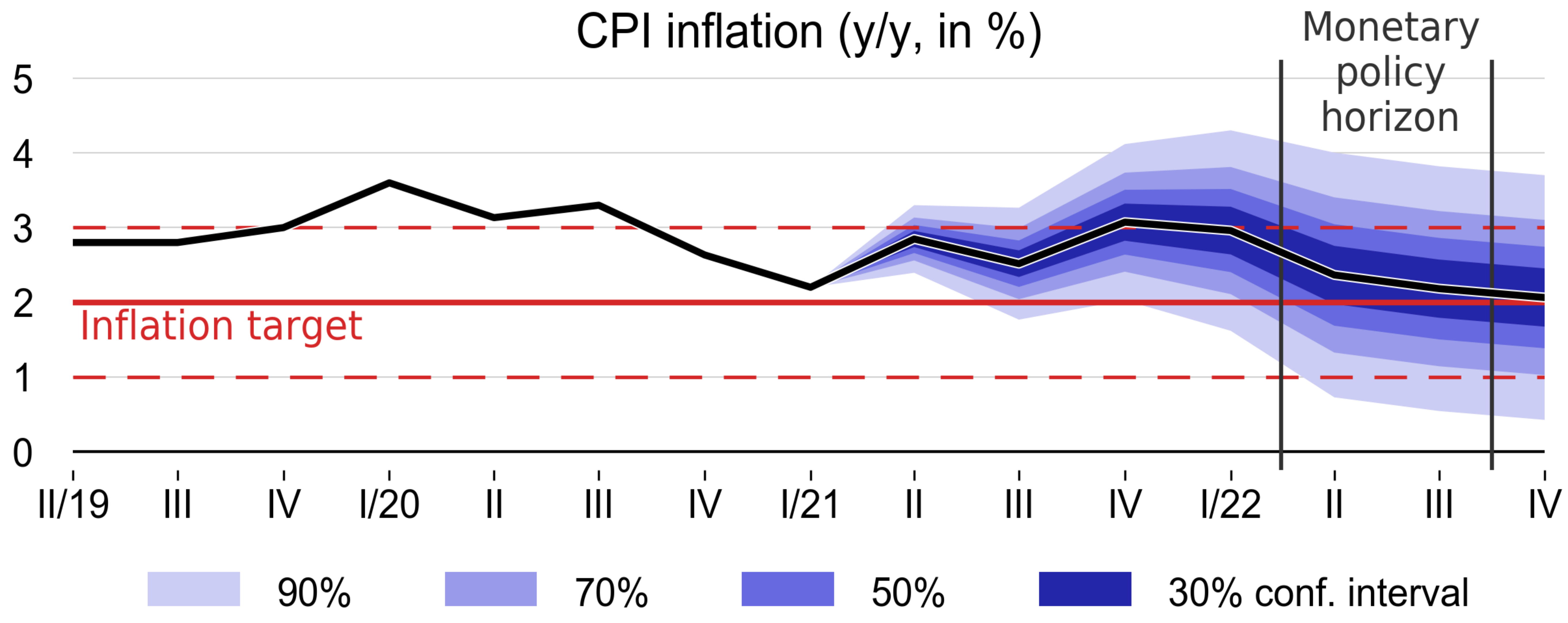
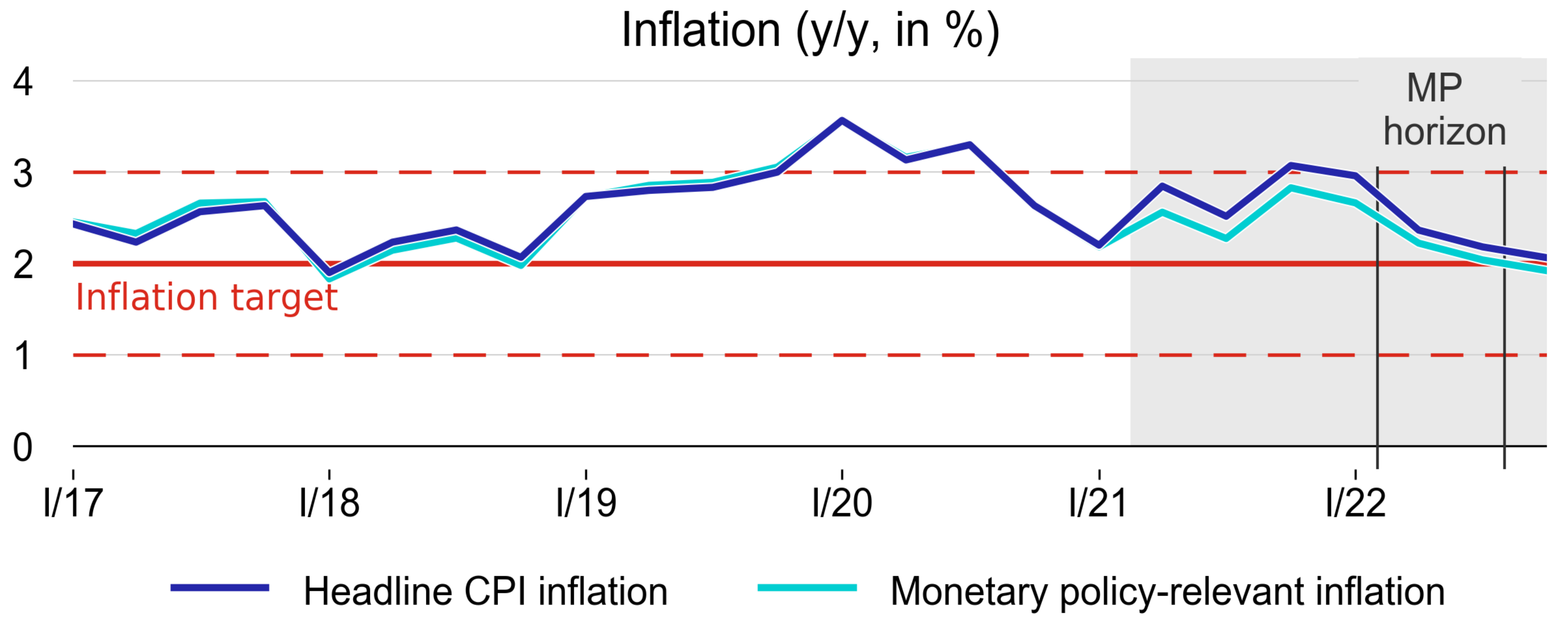
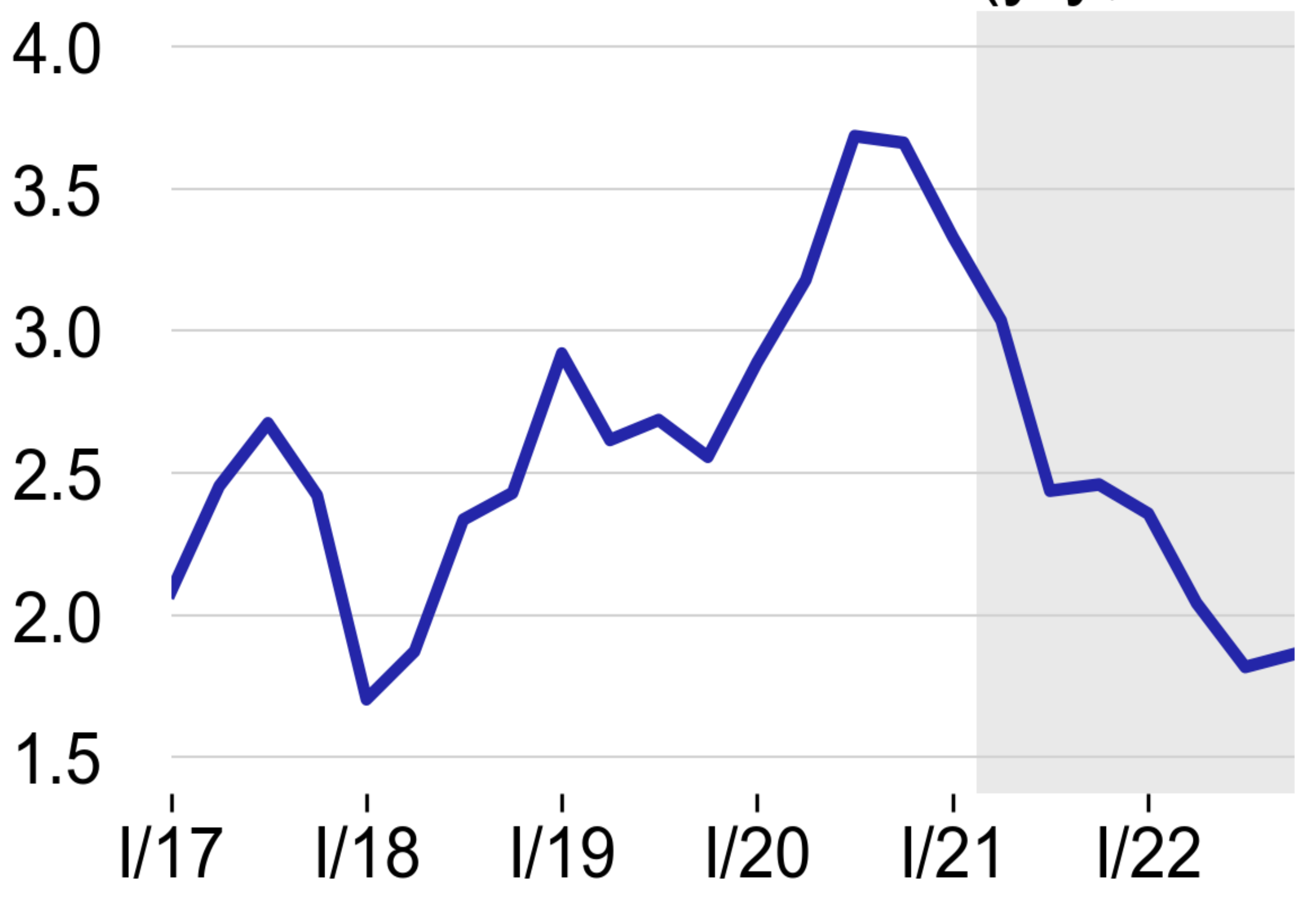




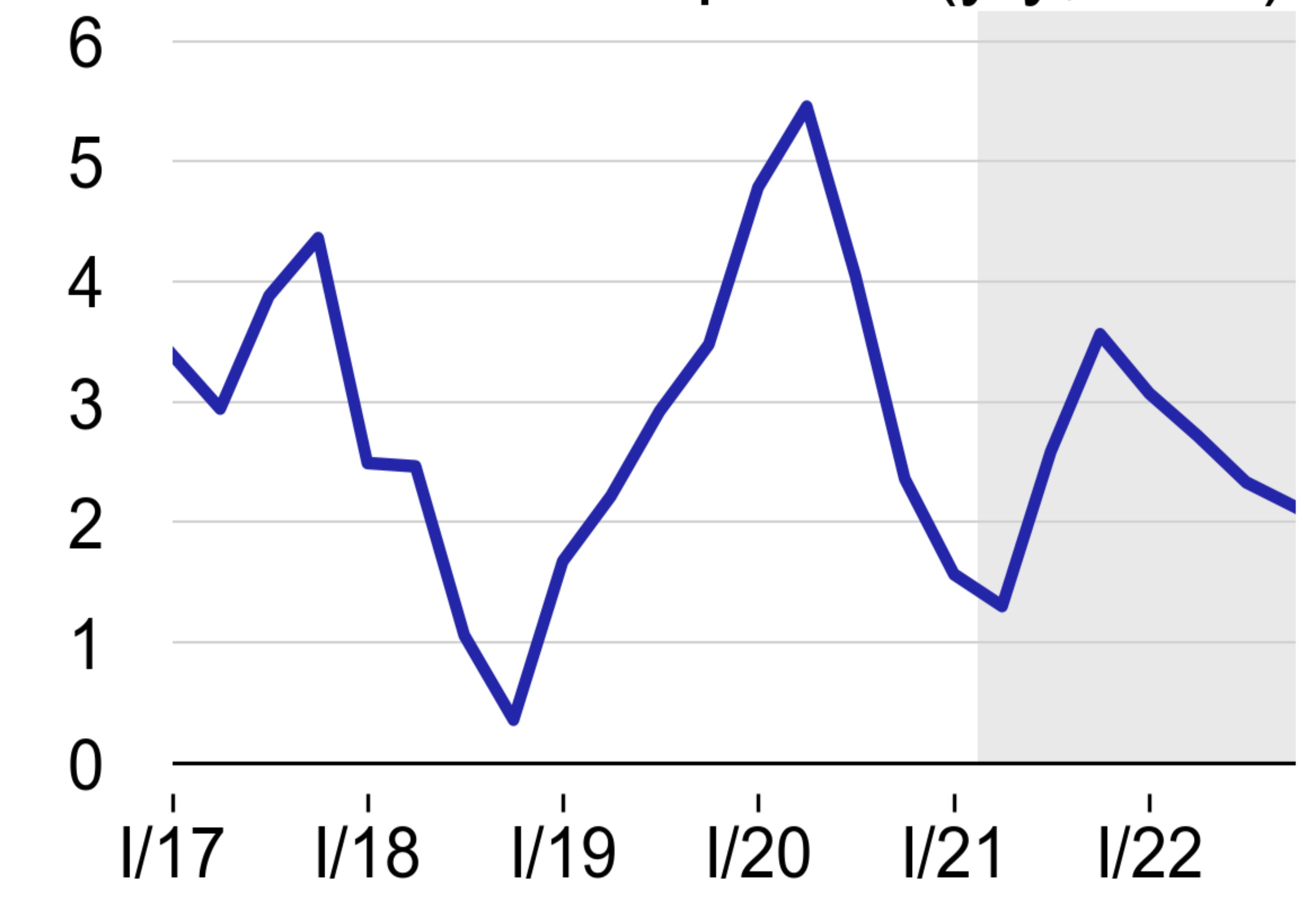
- Following its recent drop close to the 2% target, inflation will rise back towards **the upper boundary of the tolerance band** in the quarters ahead.
- This will be due initially to a sharp increase in **fuel prices**. Later, however, **food prices** will start to rise significantly again, and **administered prices** will also begin to go up at the end of the year. All this will be going on amid only gradually falling **core inflation**.
- Inflation will return close to the target next year, aided by **a gradual decrease in the expansionary nature of the monetary conditions**.
- Headline inflation will be slightly above monetary policy-relevant inflation owing to a rise in excise duties.

Inflation Components

Core inflation excl. fuels (y/y, in %)*

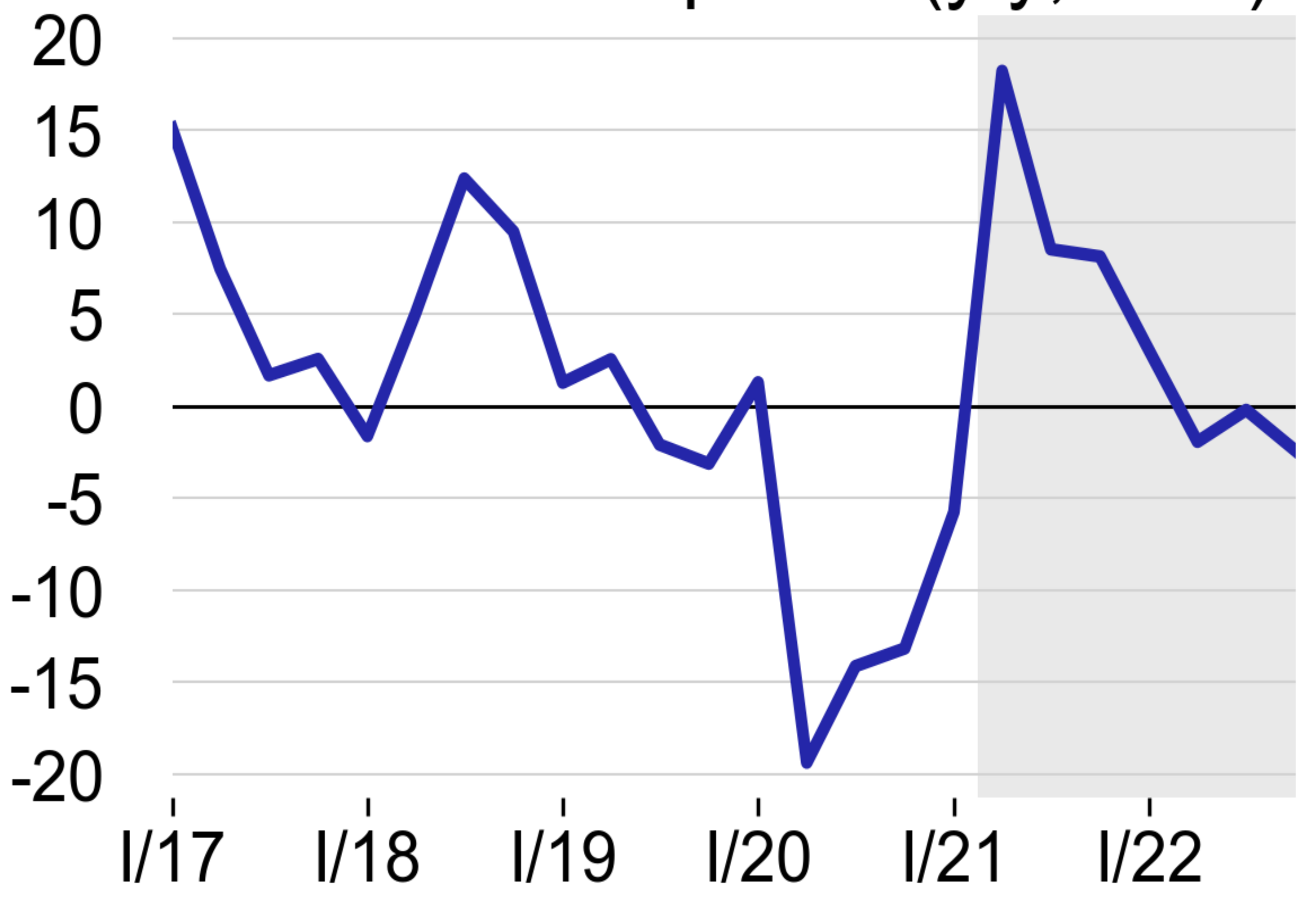


Growth of food prices (y/y, in %)*



Growth of admin. prices (y/y, in %)

Growth of fuel prices (y/y, in %)*

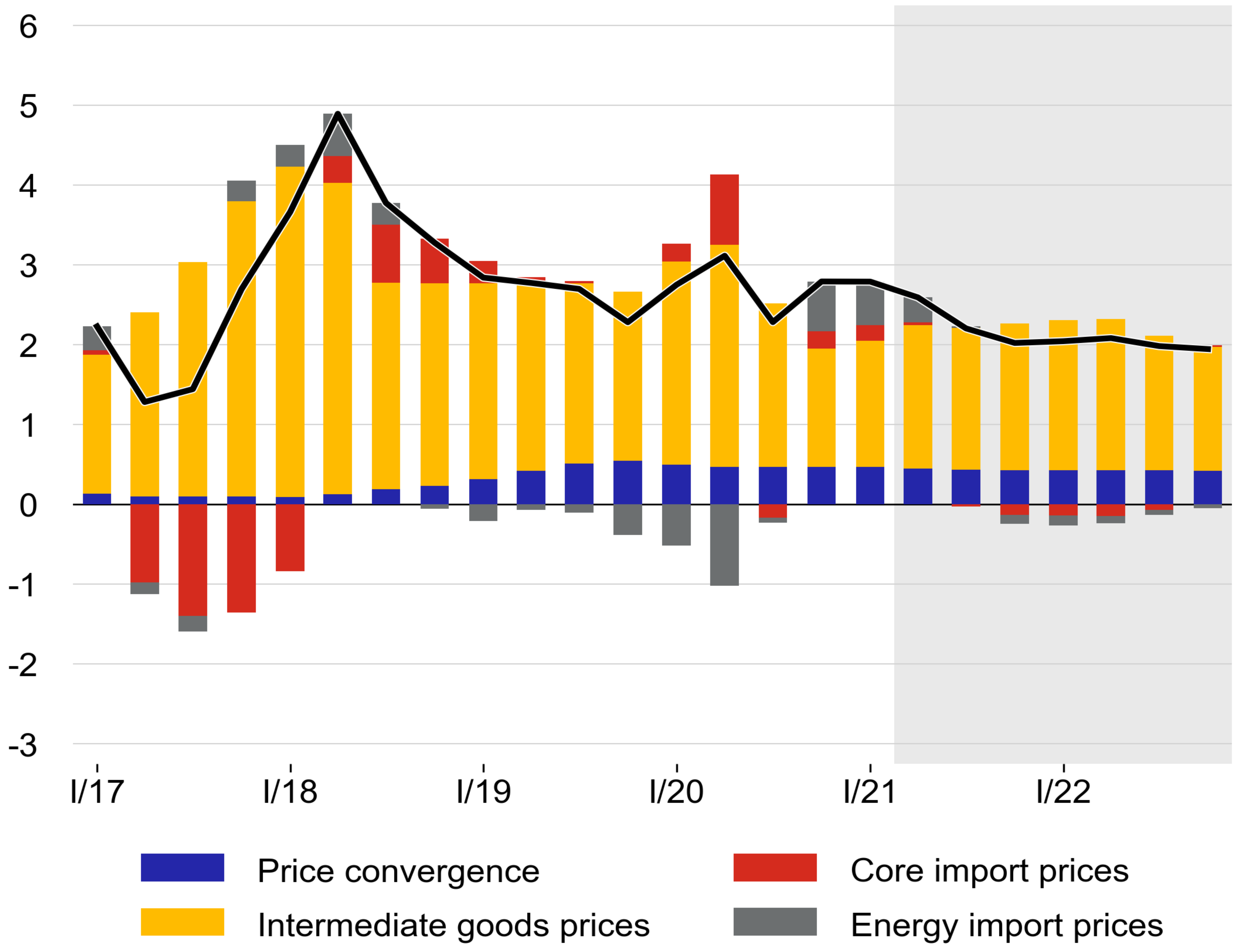


* excluding tax changes

- Domestic demand will start to manifest itself in upward price pressures. Together with renewed growth in industrial producer prices abroad, this will slow the decline in **core inflation**.
- A surge in year-on-year growth in **fuel prices** reflects both last year’s low base and the recent sharp rise in oil prices.
- Growth in **food prices** will pick up substantially in the second half of the year. This will be due to growth in global agricultural commodity prices.
- **Administered price inflation** will be muted for most of the year but will start to rise sharply in the autumn as the temporary decrease in energy prices subsides.

Inflation Pressures: Costs in Consumer Sector

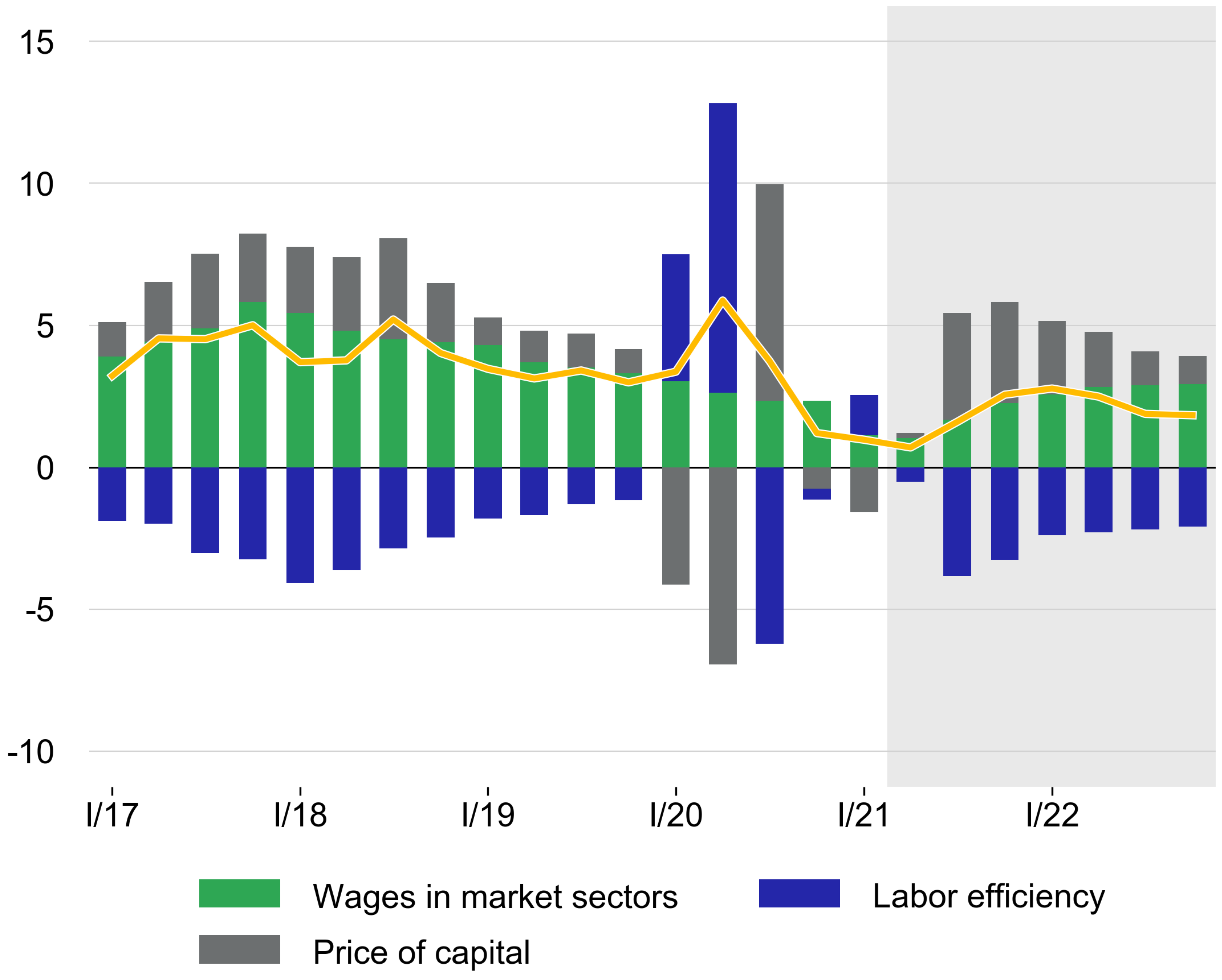
Nominal marginal costs in consumer sector (q/q, in %, ann.)



- **The overall inflation pressures** will gradually ease this year as both components of import prices turn from inflationary to anti-inflationary.
- Growth in costs will then stabilize near its steady-state level, with the **domestic economy** making the dominant contribution.
- Initial positive contribution of the **energy component** to growth in costs is linked with the surge in oil prices.
- Despite the anti-inflationary effect of significant appreciation of the koruna, the contribution of **core import prices** will initially have a broadly neutral effect on growth in total costs due to a solid growth in the core foreign prices this year and the observed rise in agricultural commodity prices.

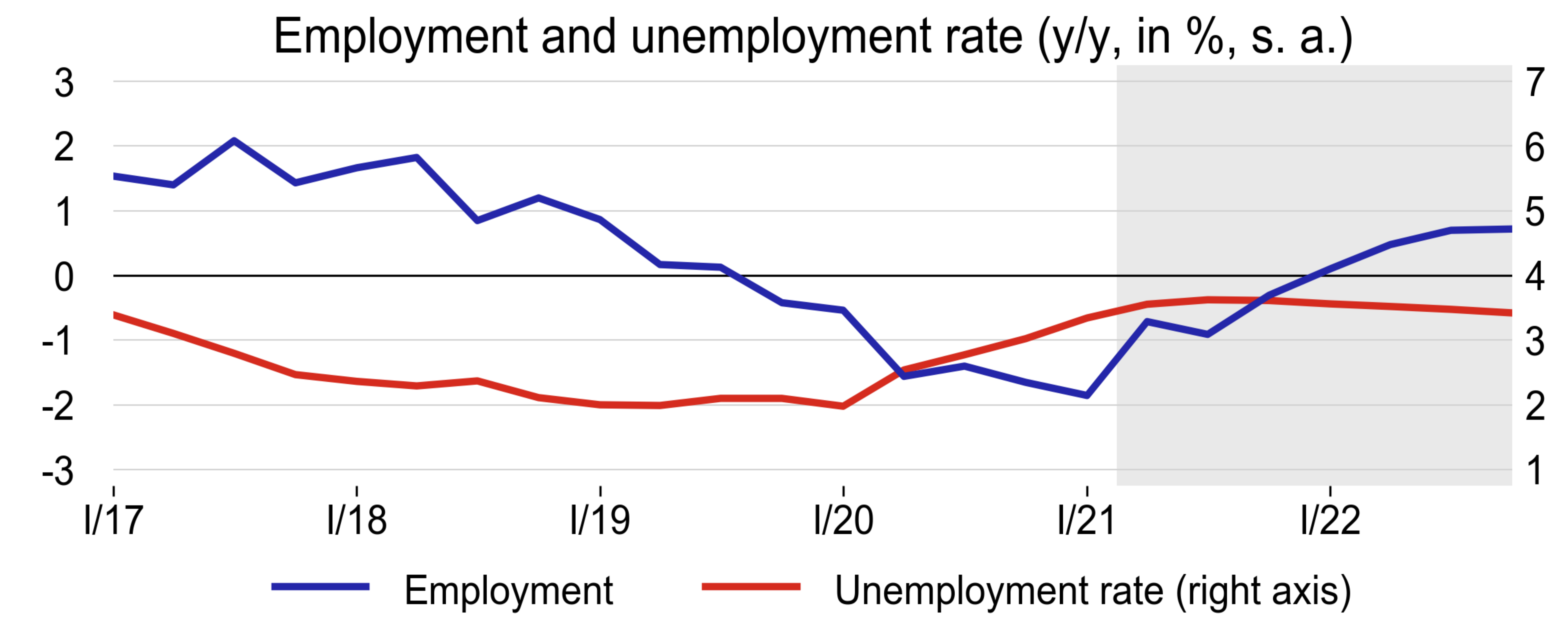
Inflation Pressures: Costs in Intermediate Goods Sector

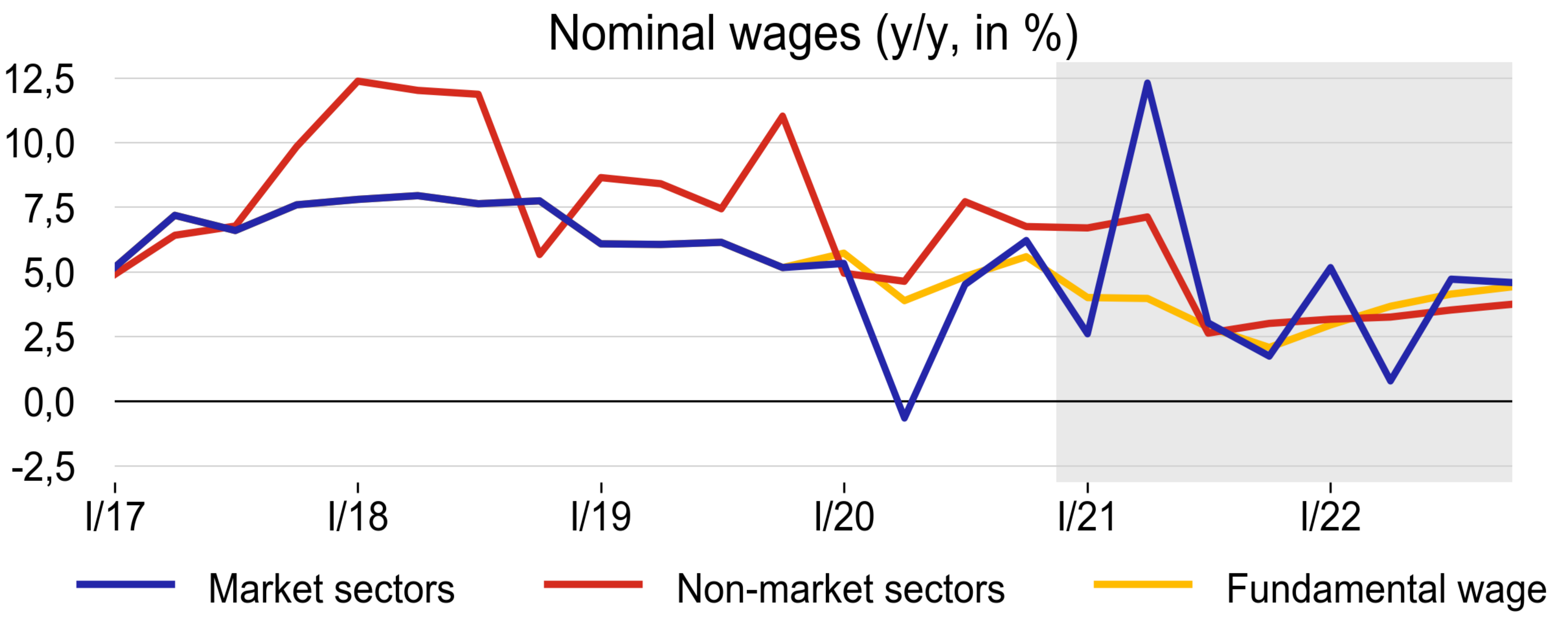
Nominal marginal costs in intermediate goods sector (q/q, in %, ann.)



- Growth in **domestic costs** remained subdued at the turn of the year and will stay low during the spring months mainly due to a gradual cooling of the labour market.
- Growth in domestic costs will start to pick up in the middle of this year on the back of a sharp rise in domestic demand captured by the contribution of the price of **capital**. The economic recovery will foster a gradual increase in the **contribution of wages**.
- However, the inflation pressures from the domestic economy will be dampened to a large extent by improving **labour efficiency** due to people returning to their workplaces after the shutdowns in services and retail end.
- After a temporary rise, overall growth in domestic costs will stabilise close to its steady-state level next year.

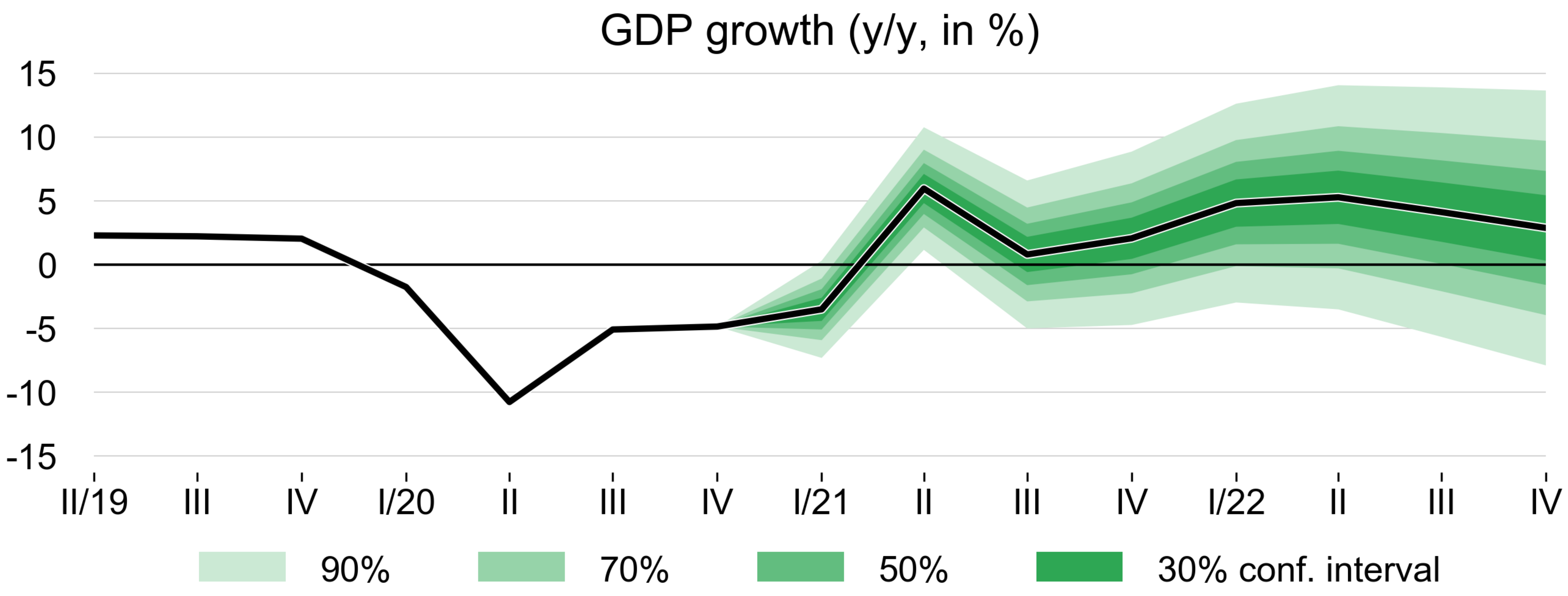
Labour Market

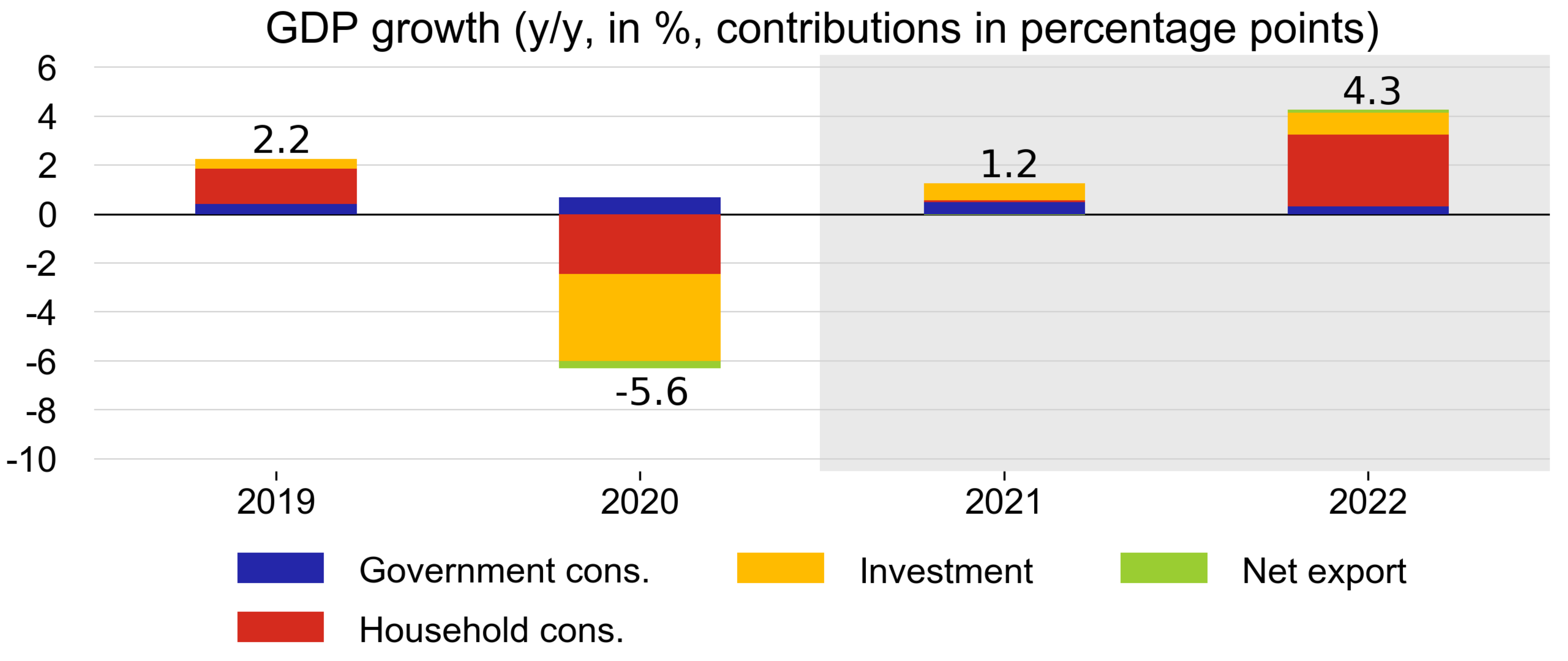




- The decline in **employment** will be due mainly to services in market sectors such as hotels and restaurants. The decrease in employment in industry will fade out in mid-2021 due to a recovery in external demand.
- The general **unemployment rate** will rise until the second half of 2021 despite government support measures and still solid labour demand.
- **Fundamental wage growth** will initially slow further and then start to recover gradually at the end of this year, while **wage growth in non-market sectors** will slow sharply this year.
- **Statistical effects** will cause wage growth in both sectors to fluctuate.

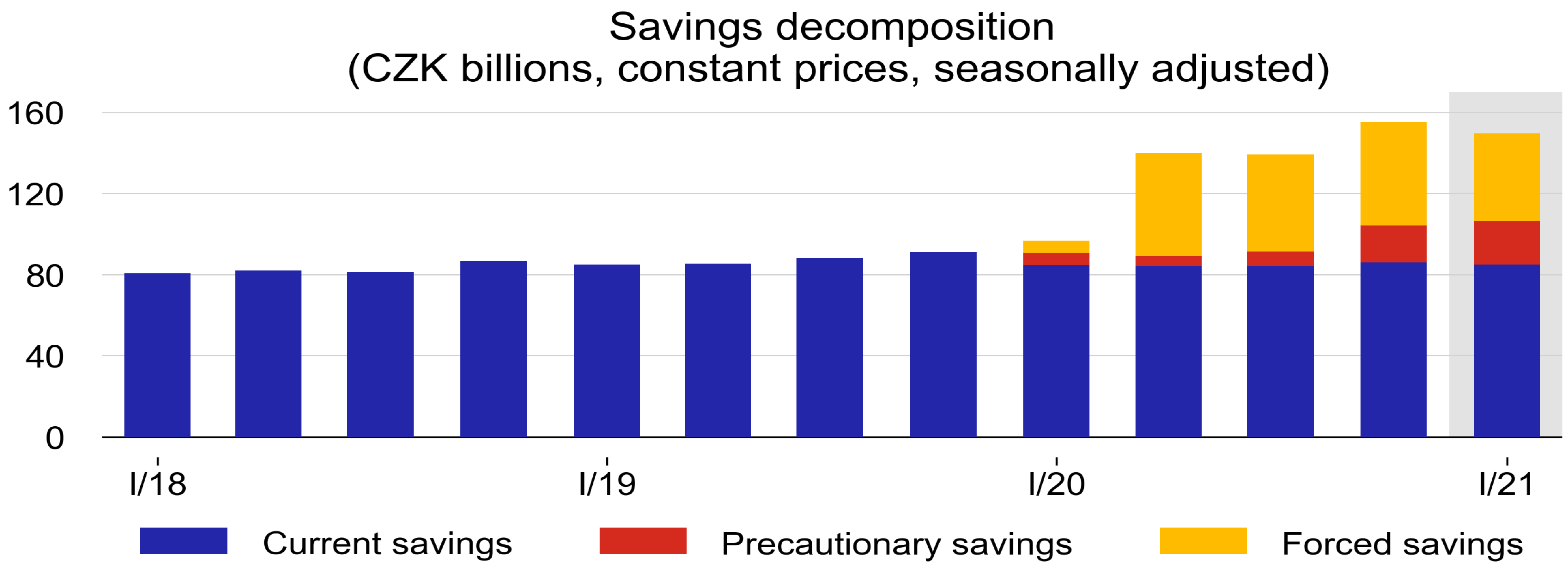
GDP Growth Forecast

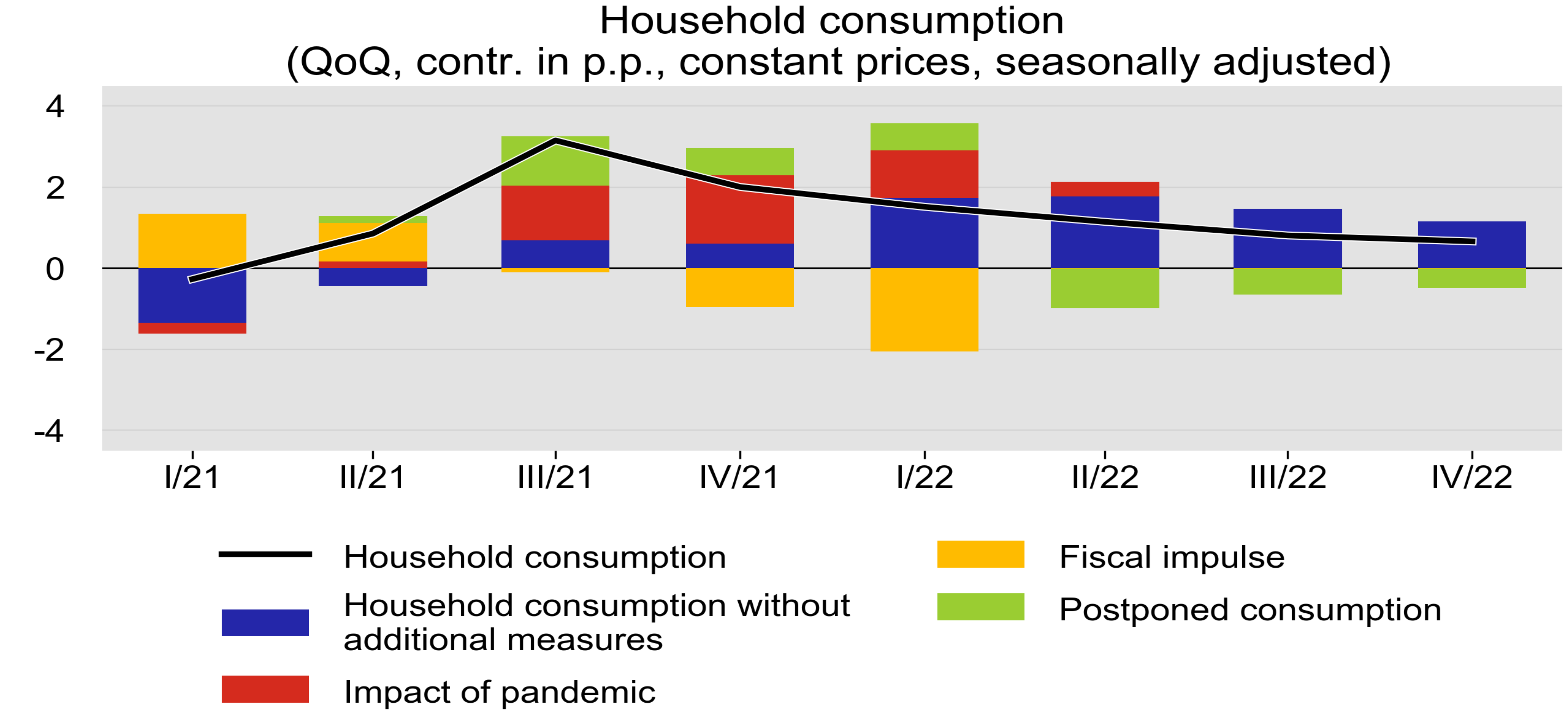




- **Economic activity** will recover in the second half of the year as retail and services reopen and industry begins to run smoothly again. Household consumption will be a driver of growth next year.
- In whole-year terms, the Czech economy will grow by more than **1%**. In 2022, GDP growth will exceed **4 %**.
- Besides government shutdowns, the production performance of the domestic economy is currently suffering due to problems with supplies of materials because of **overloaded global supply chains**.
- This will lead to net exports making a negative contribution to GDP growth in the first half of the year. We expect these global supply chain issues to disappear and exports and industry to recover in the second half of the year.

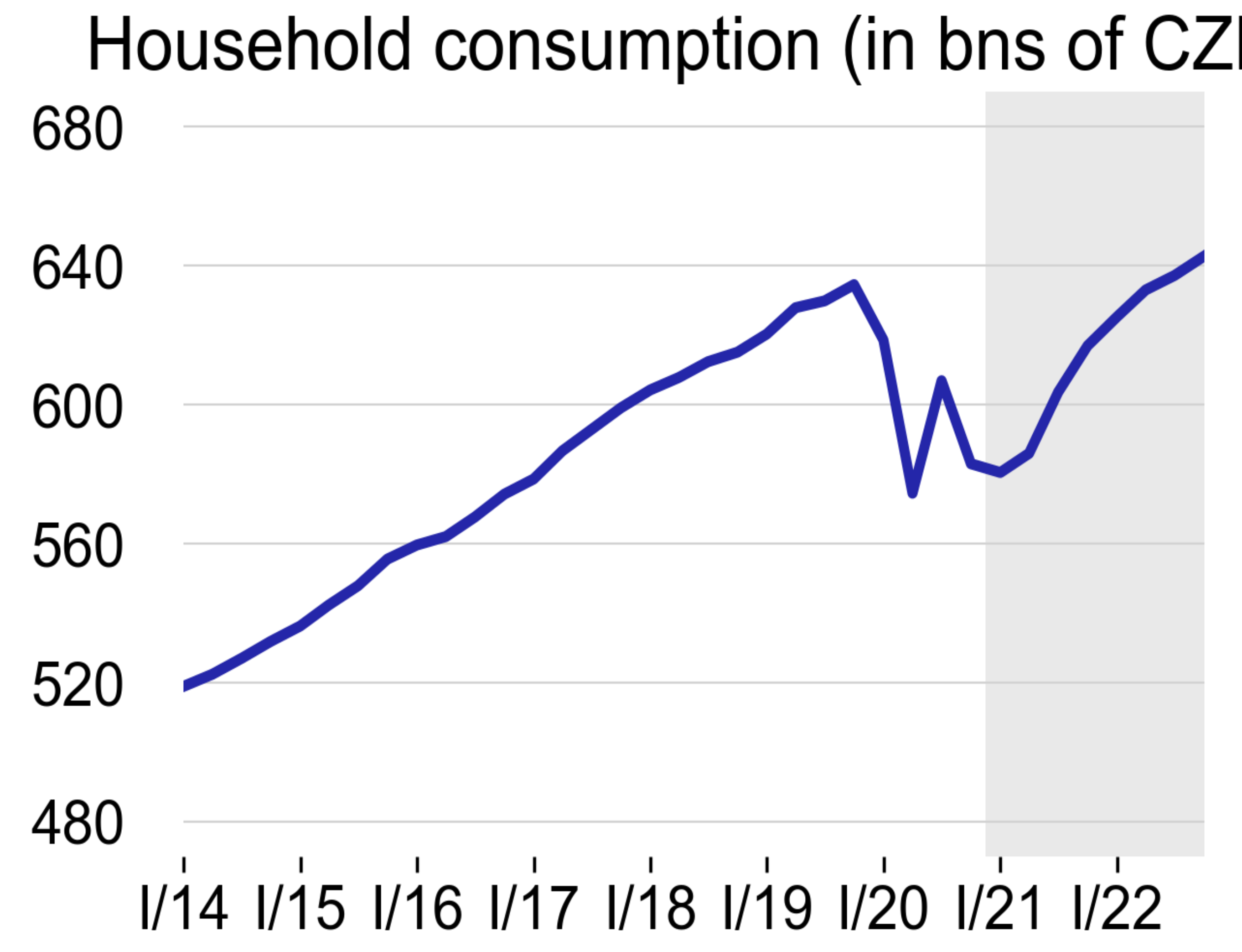
Household Postponed Consumption

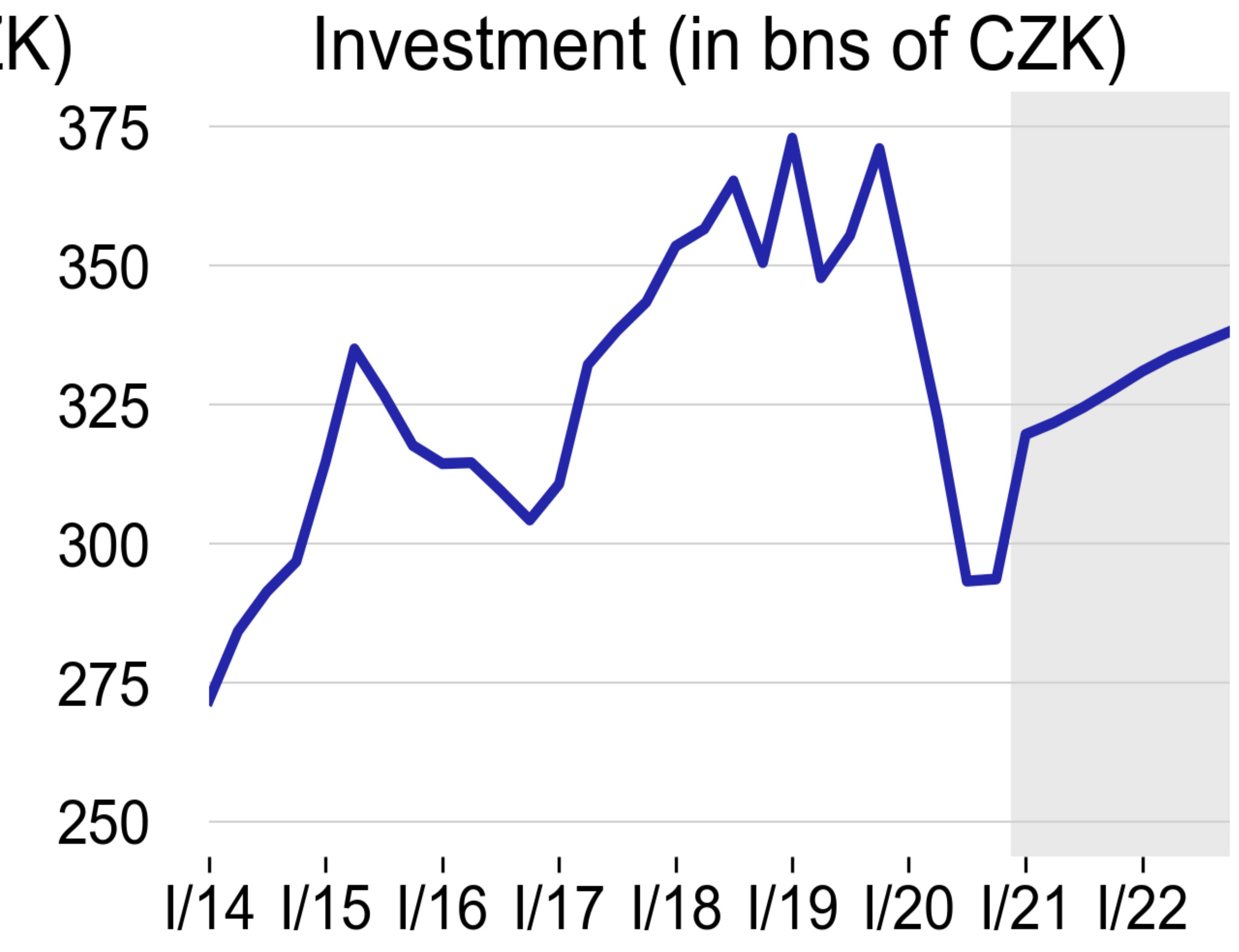


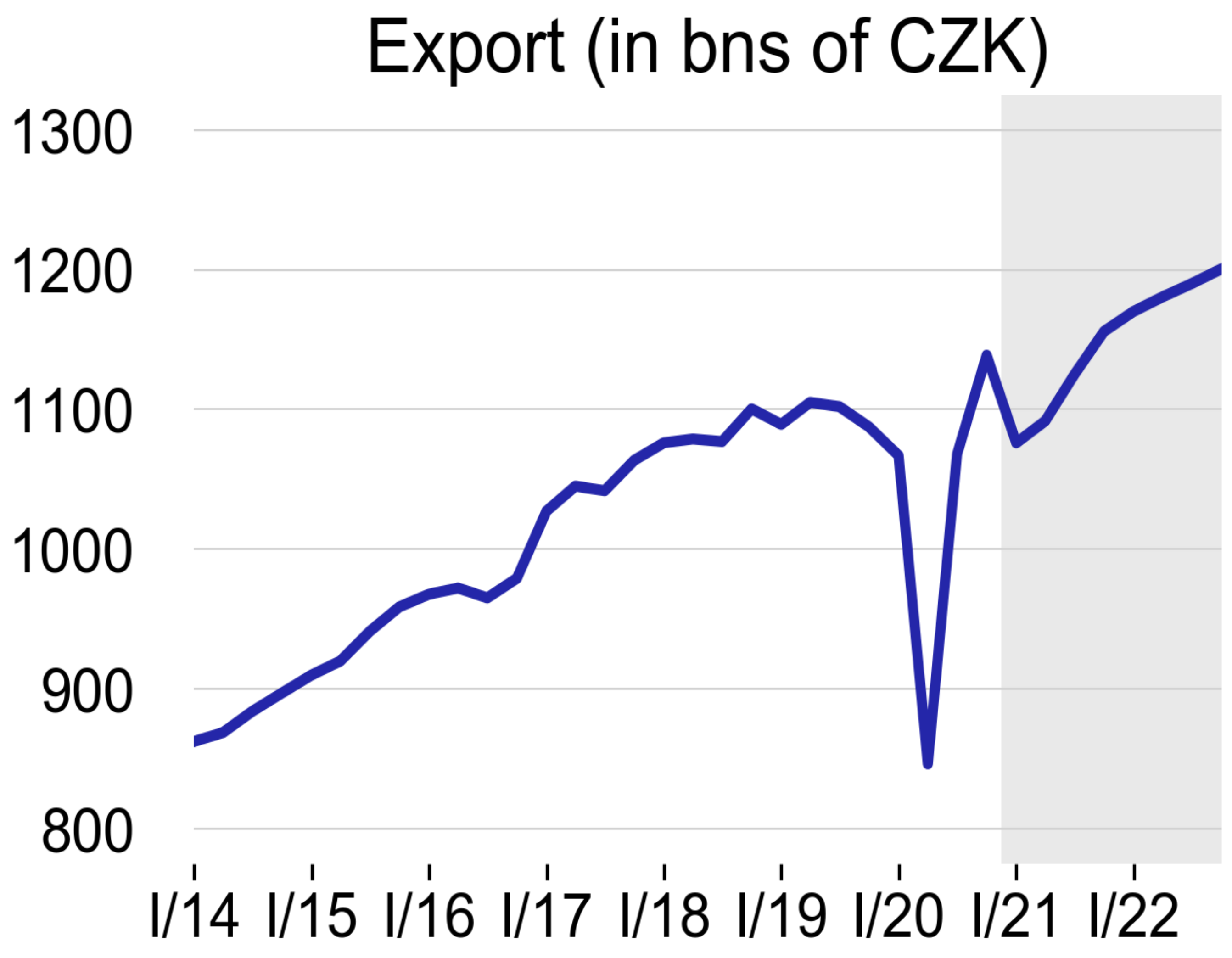


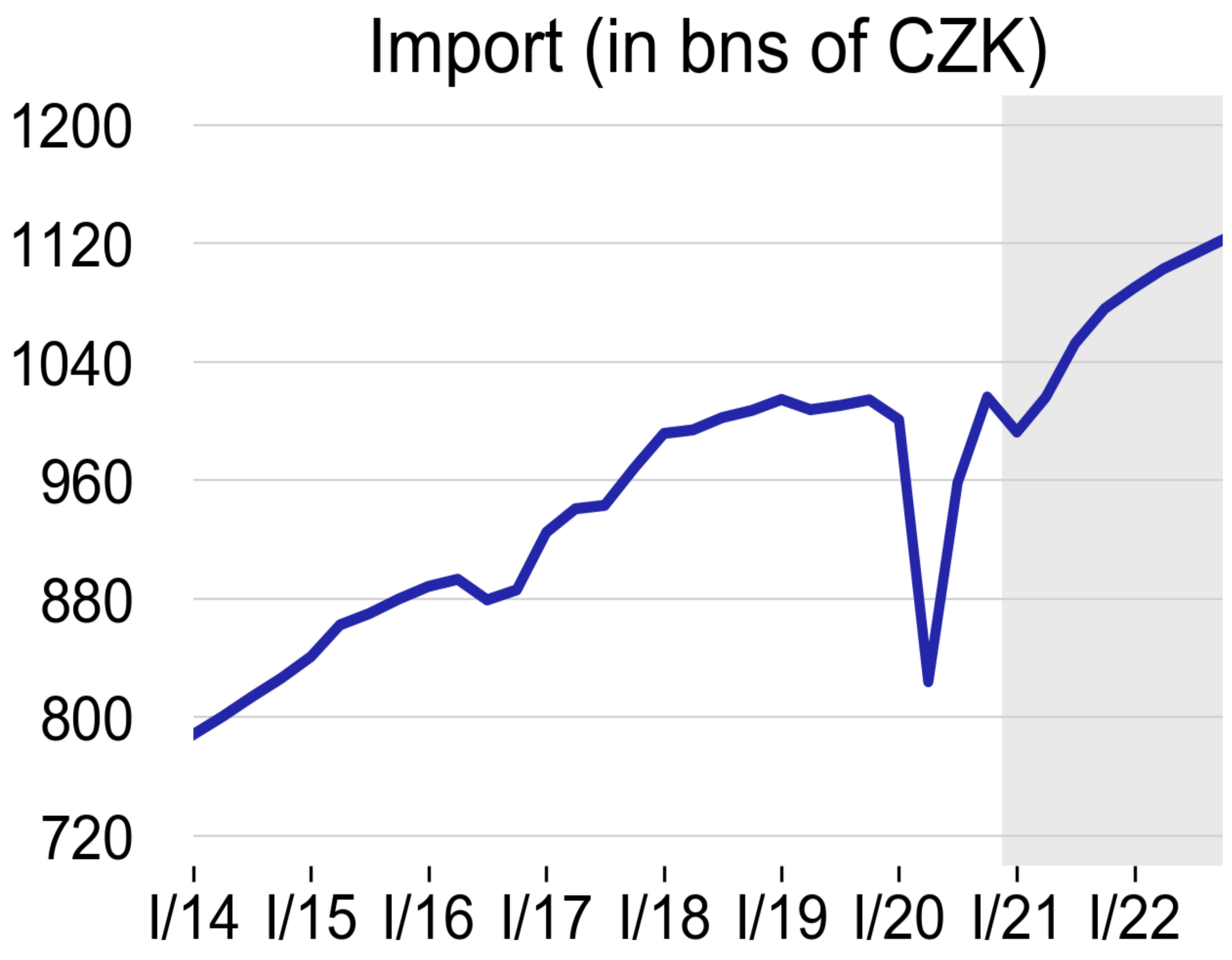
- **Forced savings** due to the inability to spend on consumption during shutdowns account for the bulk of additional household savings.
- We expect that part of forced savings will be used for **deferred (additional) consumption** from the middle of this year onwards, especially once shops and services reopen.
- In the second half of 2021, consumption will pick up due to the return of individual sectors to normal, as shown by **the contribution of the pandemic**.
- By contrast, **the fiscal impulse** will begin to dampen household consumption growth once government support measures are discontinued.

Aggregate Demand Components









- As the economy reopens, **consumption**-hungry households will begin to return to their usual shopping habits and will also realise part of their previously involuntarily deferred consumption during summer.
- Growth in private **investment** activity will not recover until the second half of this year, while government investment will rise steadily over the entire forecast horizon.
- The wobble in industry will be reflected at first in muted growth in **exports** of goods and services, which, however, will recover significantly in the second half of the year.
- **Imports** are being affected by domestic shutdowns and will recover with domestic economic activity.

Exchange Rate CZK/EUR

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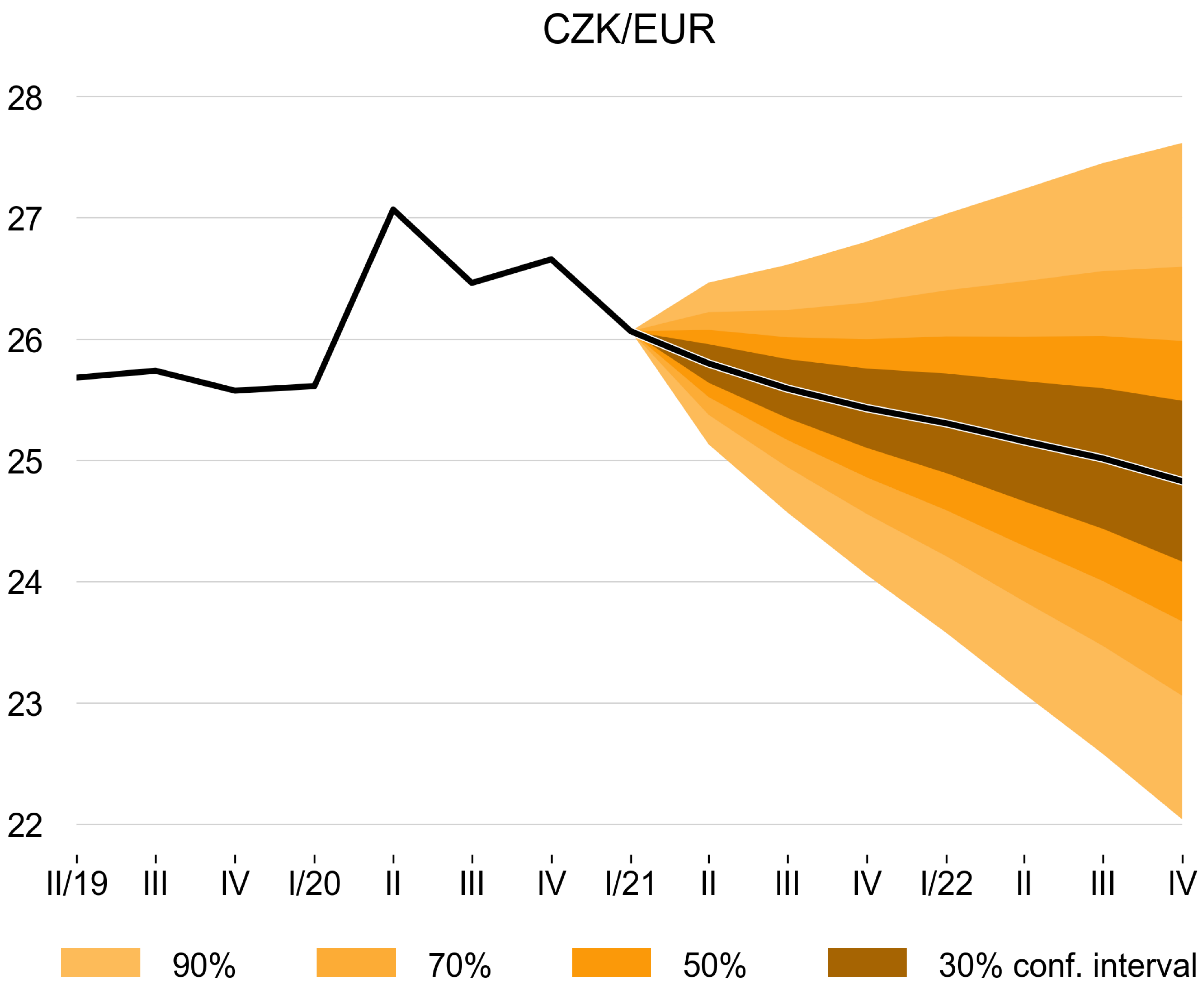
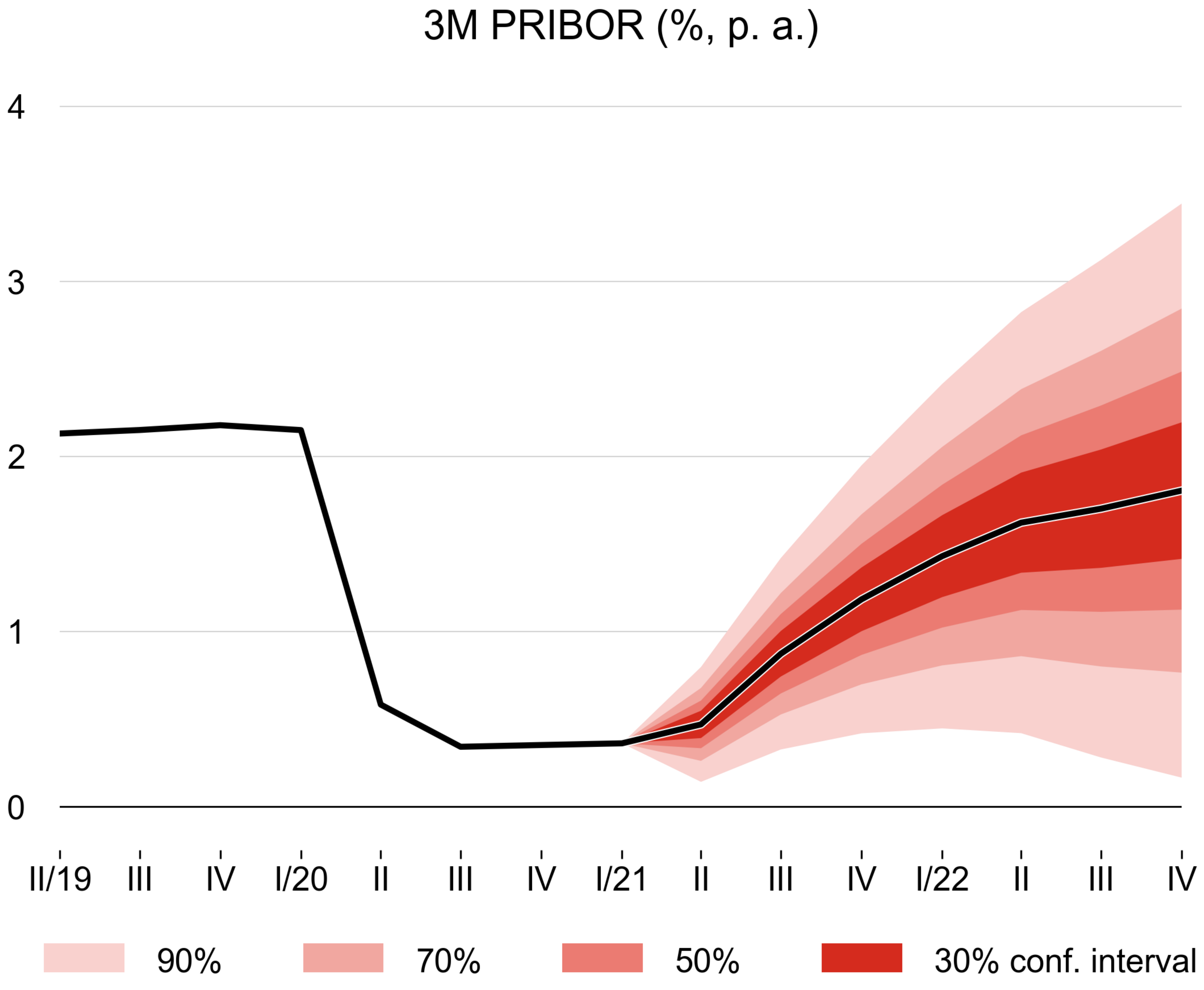


- The **koruna** will appreciate further.
- The exchange rate forecast for **2021 Q2** is set at **CZK 25.8 to the euro**. This mainly reflects an improving epidemic situation.
- The fade-out of the temporary wobble in industry and the slow reopening of the economy, coupled with gradual growth in vaccination coverage, will lead to further appreciation.
- This will also be fostered by a widening interest rate differential vis-à-vis the euro area due to a rise in domestic market rates.
- The exchange rate will thus appreciate slightly beyond CZK 25 to the euro by the end of next year.

Interest Rate Path (3M PRIBOR)



- Consistent with the forecast is **stability of market interest rates initially**, followed by a rise in rates from roughly the middle of this year onwards.
- The initial stability of market interest rates reflects a continued need for easy monetary policy responding to the impacts of the pandemic and government epidemic restrictions.
- Solid price pressures from the domestic and foreign economy and a further improvement in economic activity next year will require an increase in market interest rates in the second half of this year to stabilize inflation close to the CNB’s 2% target.
- The interest rate component of the monetary conditions will continue to get less easy and move toward a neutral stance next year.

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Comparison with Previous Forecast

Output gaps

Dom. GDP decomp

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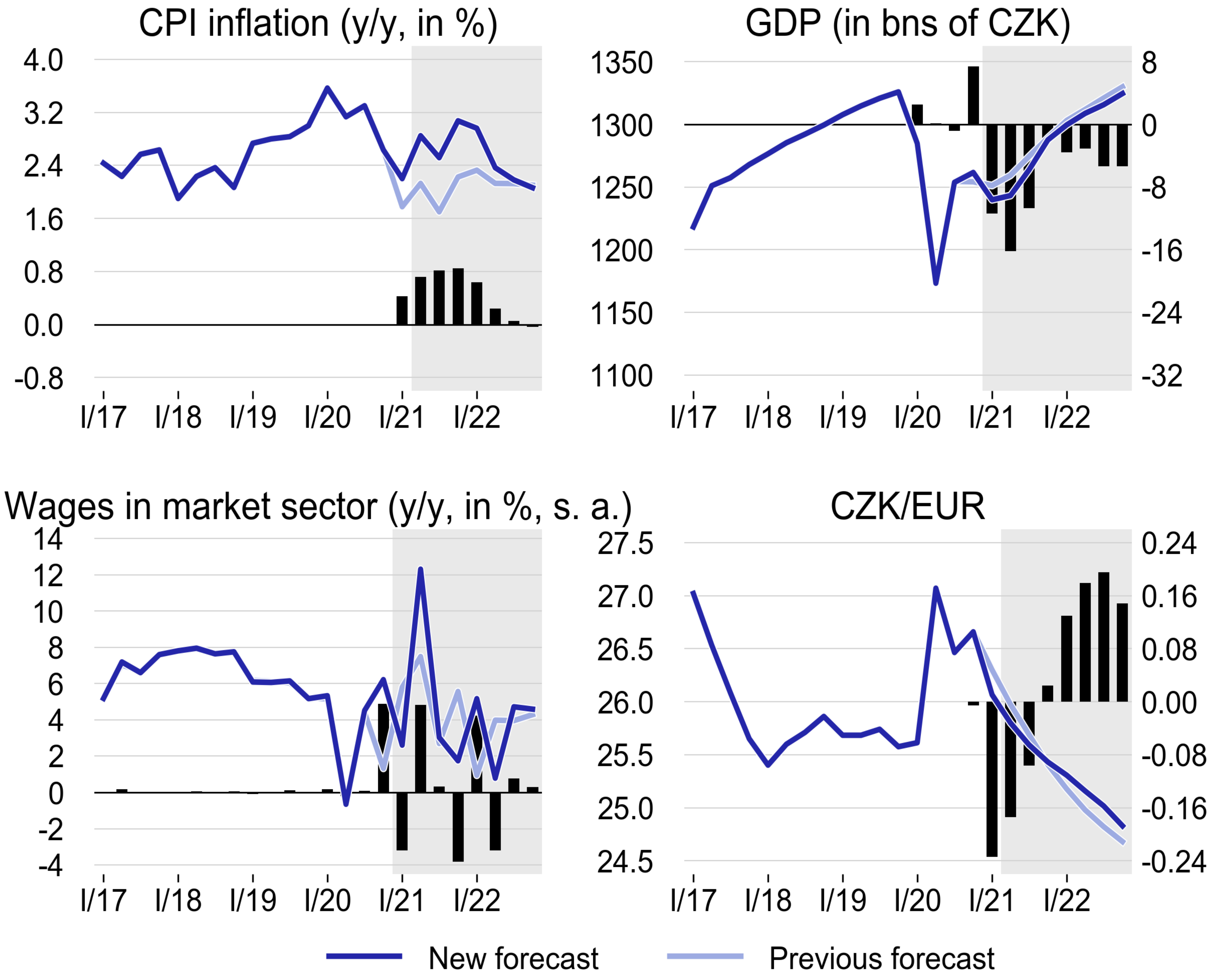
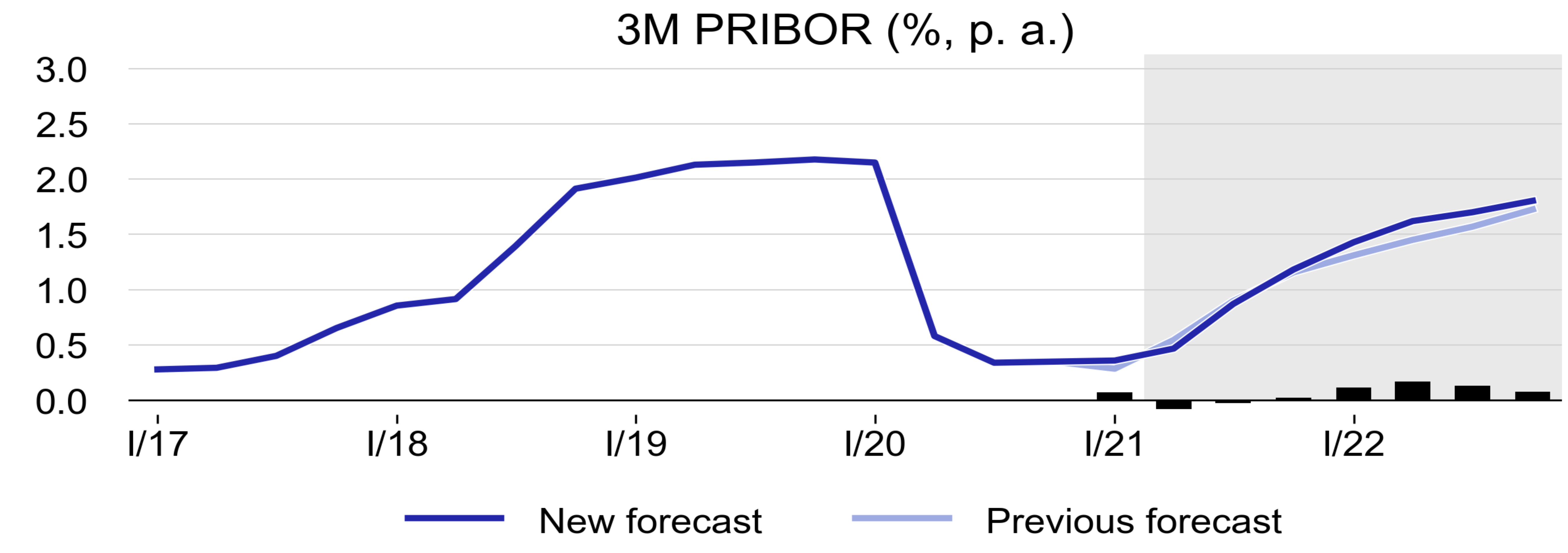
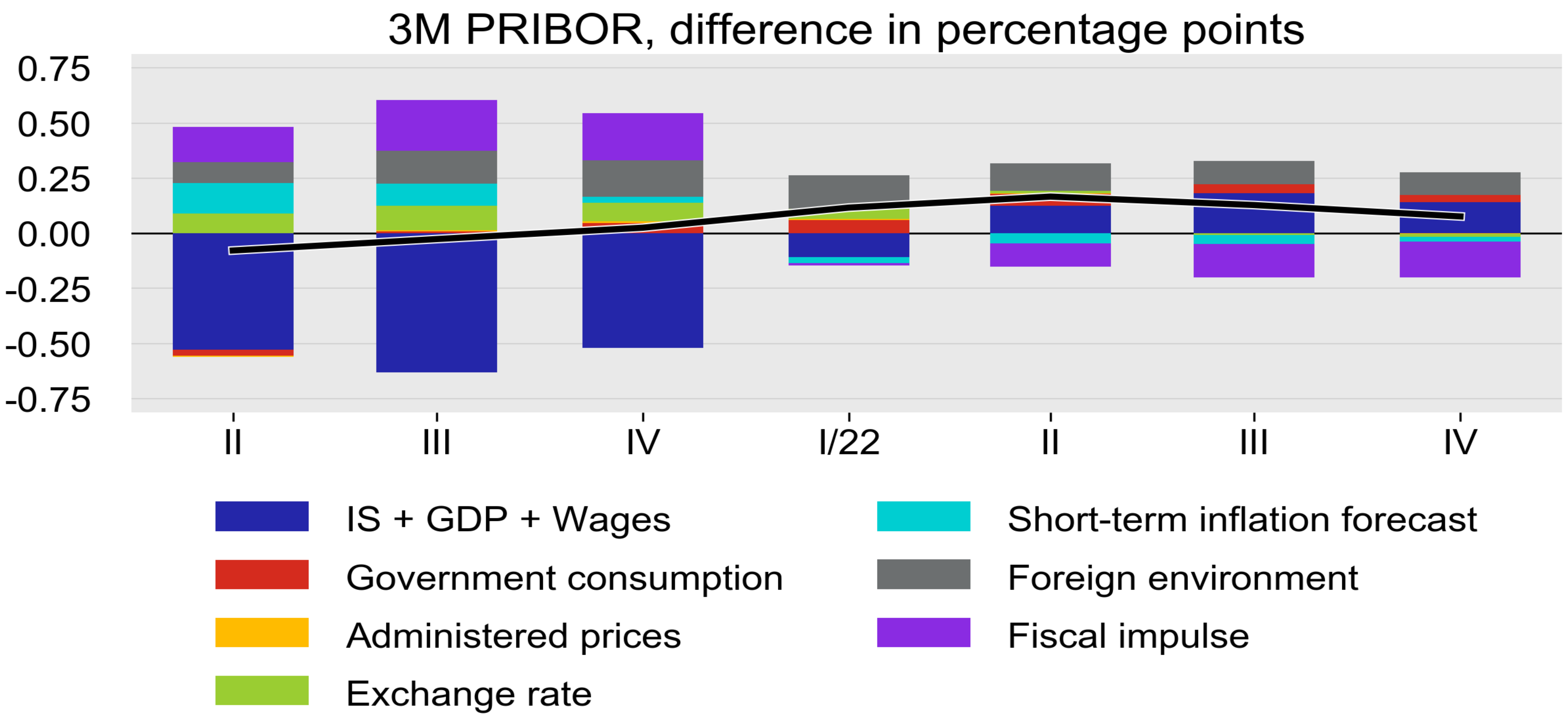


- The upward revision of the **inflation forecast** this year is due to all its components except administered prices, whose growth remains temporarily subdued.
- The **GDP forecast** for this year has been revised downwards due to the longer duration of the pandemic and the wobble in industry recorded in the first half of 2021.
- The revision to the average yearly **wage growth** is linked mostly with statistical effects.
- In the near term, the slightly stronger exchange rate of the **koruna** mainly reflects the rate observed in mid-April. The subsequent more moderate appreciation reflects the outlook for a more gradual domestic recovery.

Comparison: Interest Rate Forecast





- The interest rate path is initially similar to that in the previous forecast but shifts slightly higher next year.
- A temporarily worse domestic economic outlook is reflected in an initially negative contribution of the **initial conditions + GDP + wages** category, while the recovery of the Czech economy is more pronounced next year and leads to higher rates.
- The **fiscal impulse** temporarily fosters slightly higher rates. Unlike in the previous forecast, it is expansionary this year.
- **External developments**, especially the outlook for somewhat less accommodative ECB monetary policy coupled with a higher oil price, foster slightly higher domestic rates.

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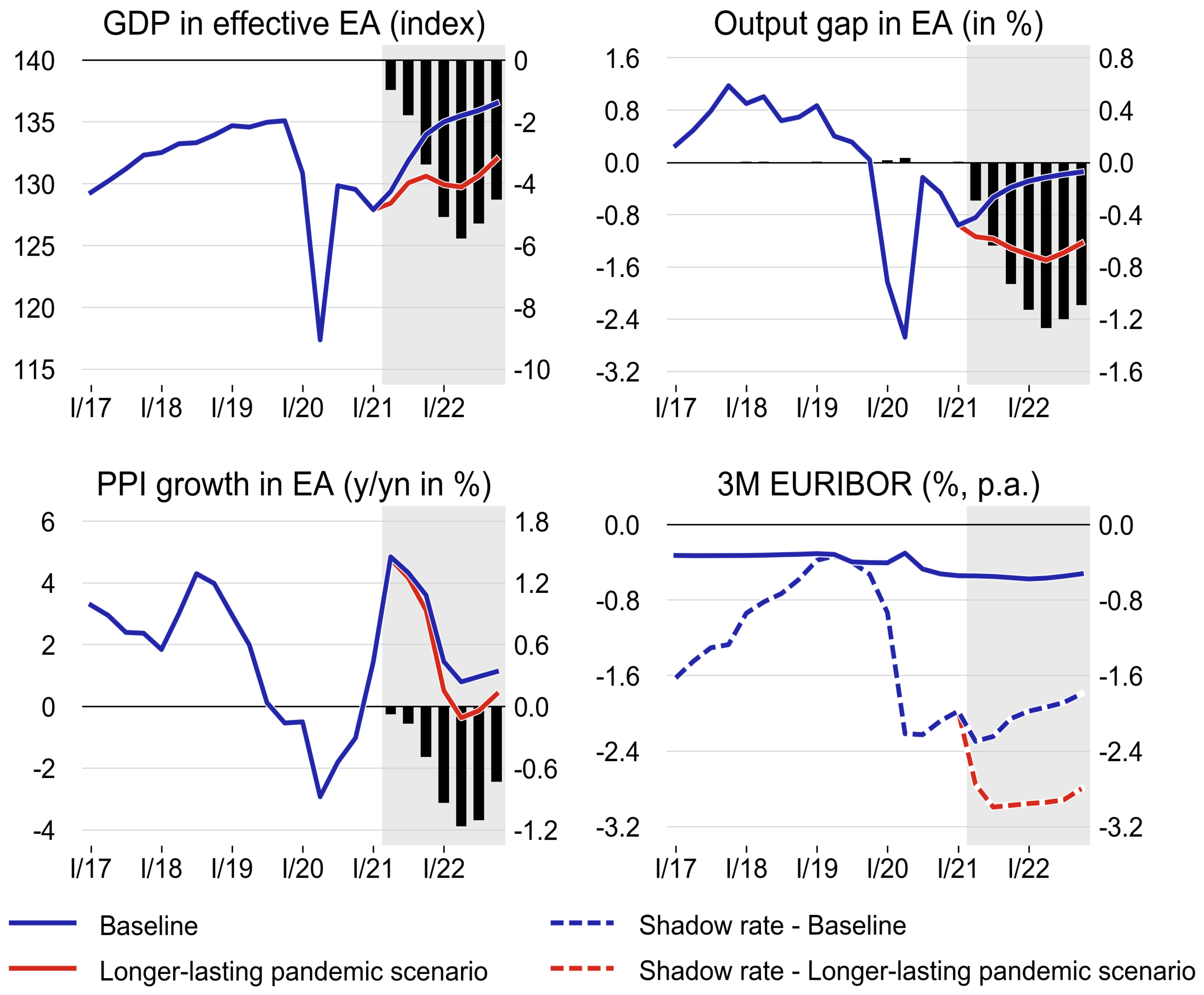
Longer-Lasting Pandemic Scenario: External Environment



- The longer-lasting pandemic scenario leads to a markedly **slower economic recovery in the euro area** than in the baseline scenario.
- The decline in GDP mainly reflects a decrease in potential output due to the longer-lasting shutdowns. However, it will also be reflected to a lesser extent in the **output gap** opening into more negative territory.
- The result is **more subdued overall producer price inflation**, which will stagnate in 2022.
- Longer-lasting anti-inflationary demand effects are consistent with a **further easing of monetary conditions** by the ECB using an unspecified combination of instruments, which will be reflected in a drop in shadow interest rates relative to the baseline.

Longer-Lasting Pandemic Scenario: Domestic Economy

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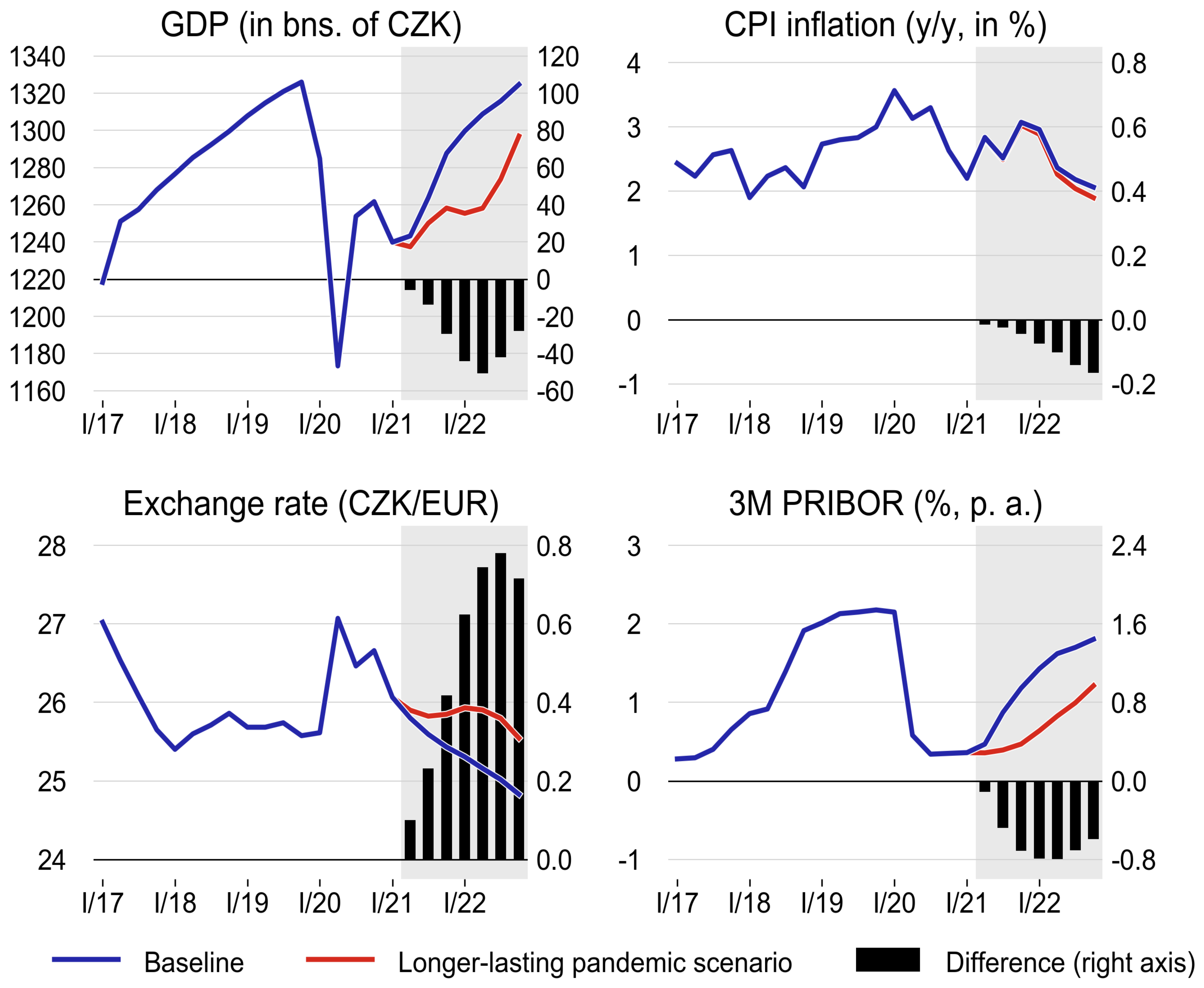

- The weaker external demand coupled with the stronger domestic cyclical impacts of the more gradually receding pandemic will result in substantially **slower growth** of the Czech economy.
- The more negative foreign output gap over the entire outlook fosters a **weaker koruna** via lower demand for Czech exports.
- The lower demand for domestic production and slower wage growth will foster **more subdued overall inflation pressures** and a need to increase interest rates later than in the baseline scenario.
- **Interest rates will therefore not be raised until the start of next year** in this scenario. The easier monetary conditions than in the baseline scenario will ensure that inflation will be close to the **inflation target** at the monetary policy horizon.

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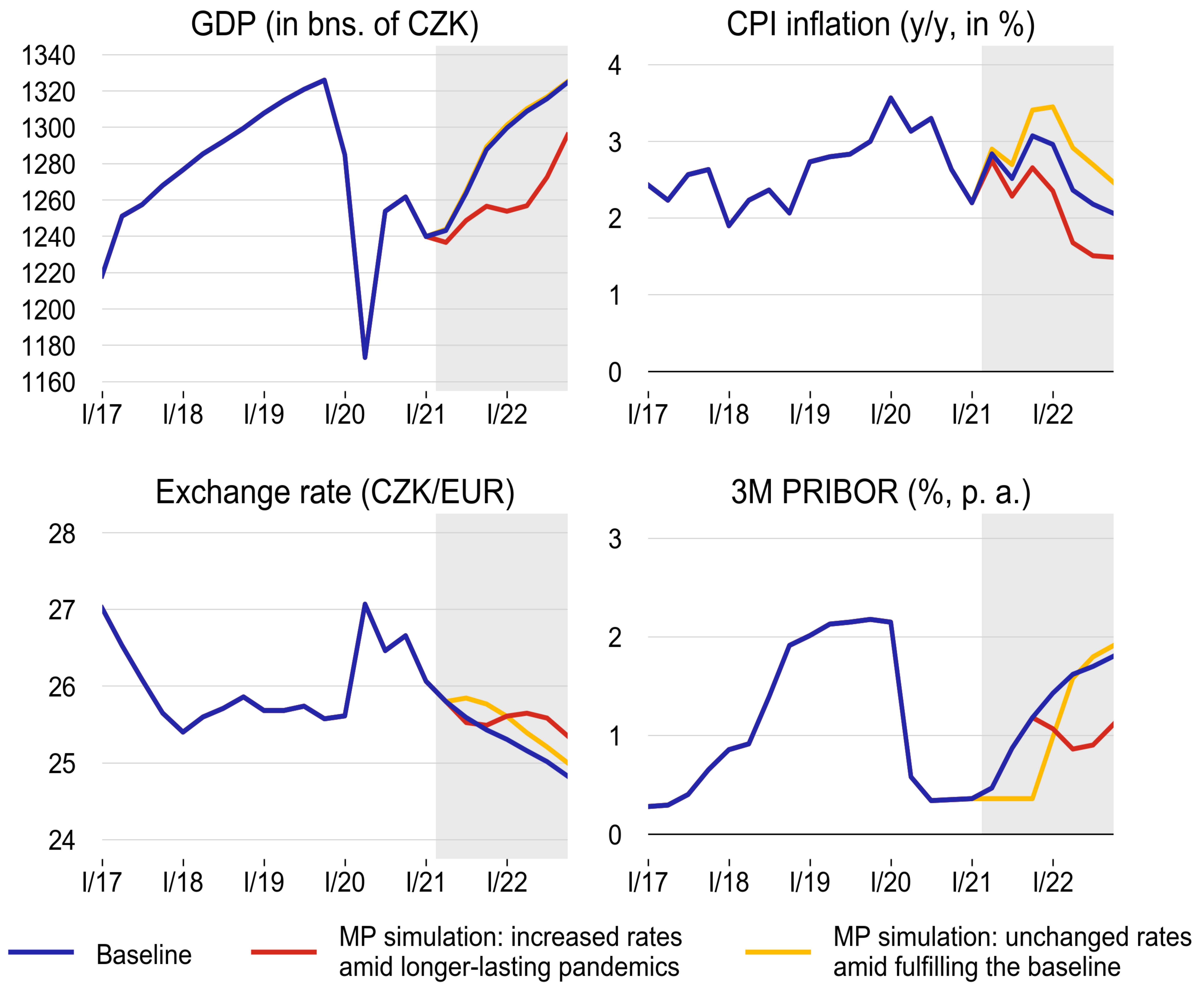
Monetary Policy Simulations



- The first simulation (the yellow line) describes the situation where **interest rates stay unchanged until the end of this year while the assumptions and path of the baseline scenario (an easing of anti-pandemic restrictions and an economic recovery) materialise**. It results in distinctly higher inflation, which will **markedly exceed the upper boundary of the tolerance band** around the inflation target at the end of this year.
- The second simulation (the red line) captures the situation where the **longer-lasting pandemic scenario materialises but interest rates rise in the second half of this year in line with the baseline scenario**. It results in inflation falling **below the inflation target**, albeit within the bounds of the tolerance target.

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Thank You for Your Attention

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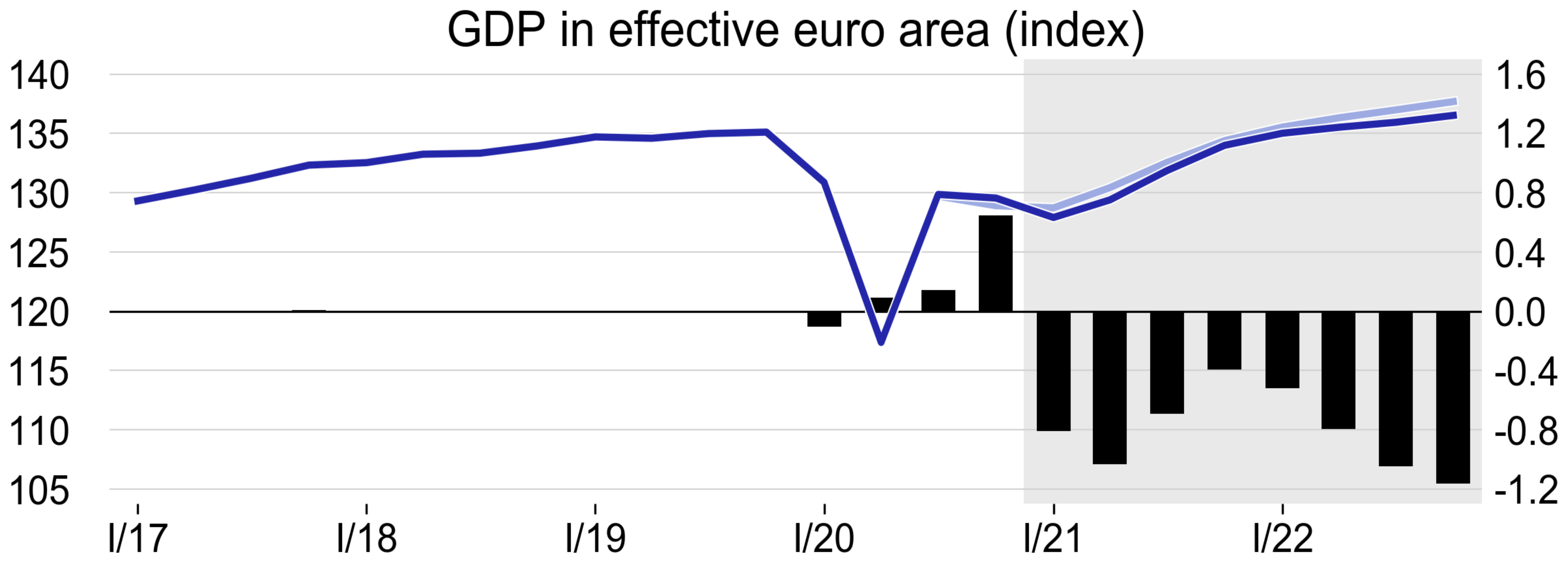
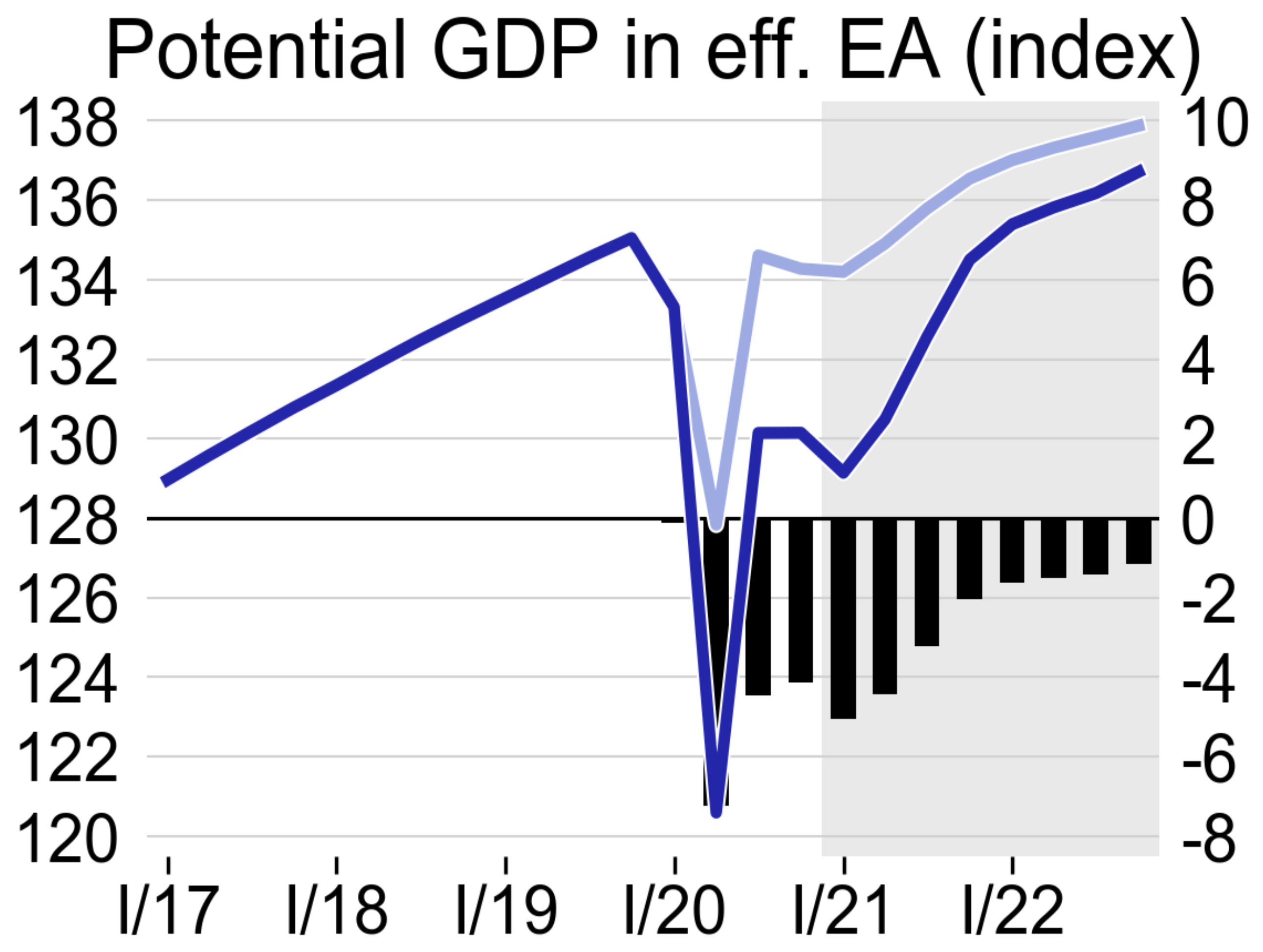
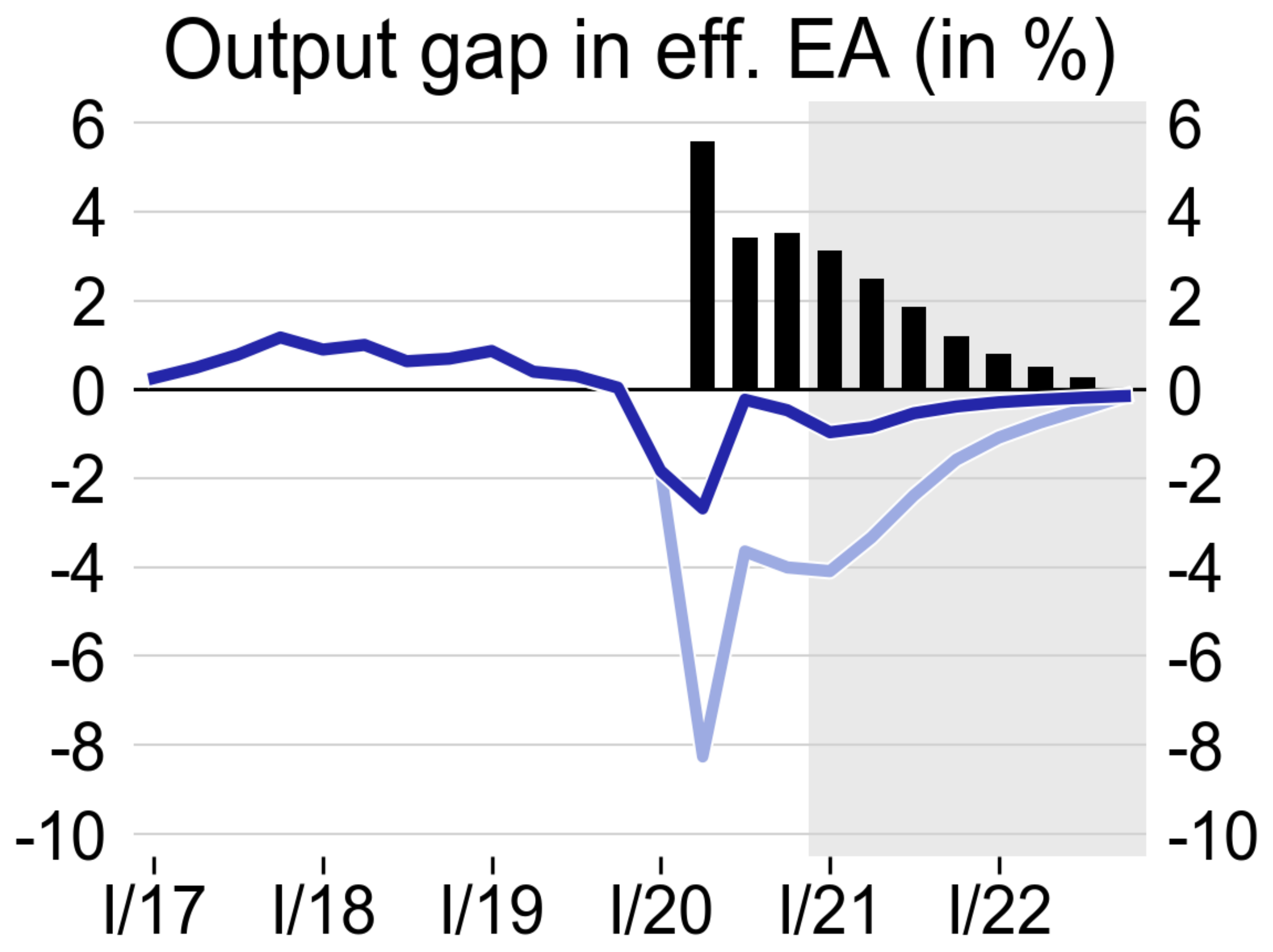
Backup

GDP in Effective Euro Area: Comparison

Back





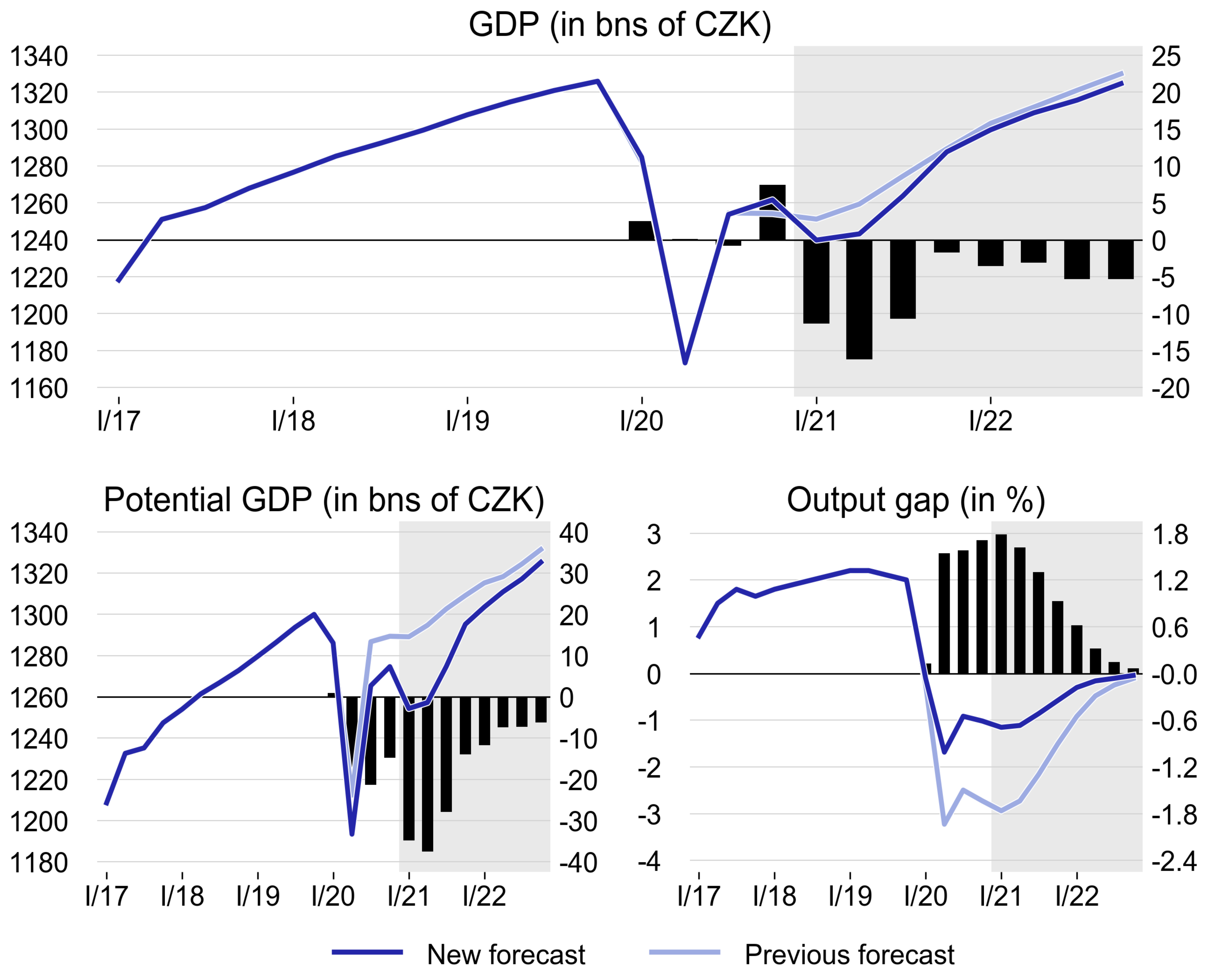


New forecast
Previous forecast

- The negative output gap has been **revised towards a significantly narrower gap** compared with the winter forecast. This better matches the observed **inflation pressures**, especially **in industry**.
- The euro area experienced the deepest decline in its economic cycle in Q2 2020.
- Relaxation of restrictions owing to an improving epidemic situation led to a surge in supply (the potential of the economy) and a narrowing of the negative output gap in Q3. As the epidemic situation worsened again at the close of the year, the output gap turned more negative.
- Given the expected recovery, the economy will return to its potential output level over the forecast horizon, i.e. the negative **output gap will gradually close**.

Back

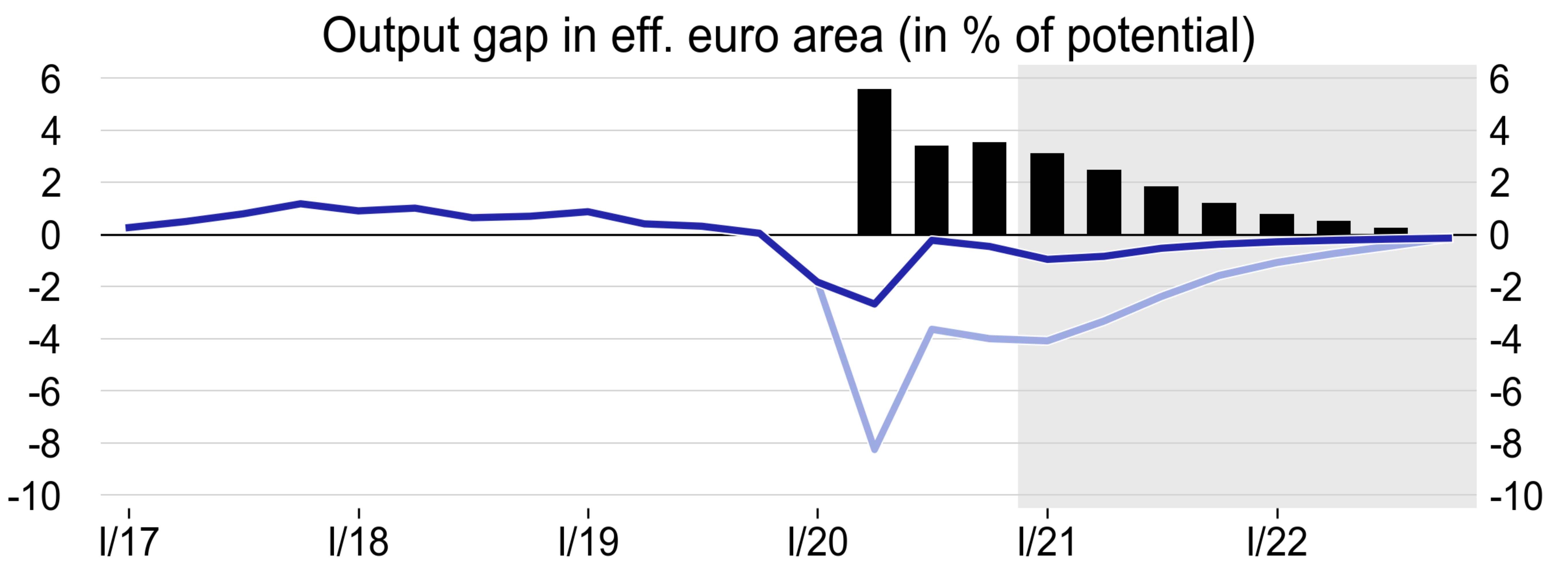
Domestic GDP: Comparison

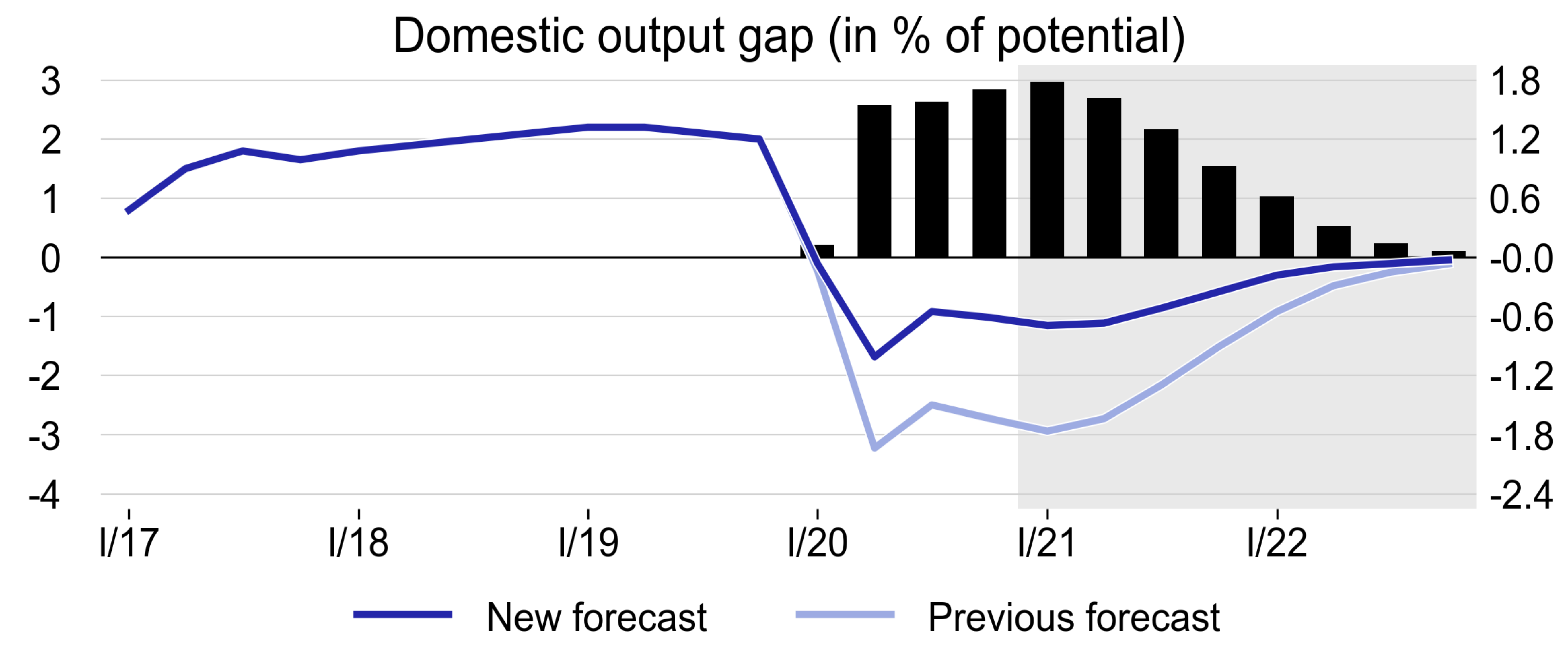


- The estimate of the phase of the economic cycle **has shifted appreciably compared to the winter forecast**.
- The change in view is **due to the developments observed previously during the pandemic**.
- It turns out that the Czech (and foreign) economy coped with the pandemic beyond expectations last year.
- **Aggregate demand fell only to a limited extent**, aided by easy fiscal and monetary policies, with households partially transferring their spending from services to (miscellaneous manufactured) articles, real estate, housing-related goods and so on.
- The domestic **labour market cooled partly**, but not significantly. This was reflected in only gradually decreasing **inflation**, which **remains above the target**.

Output Gaps: Comparison

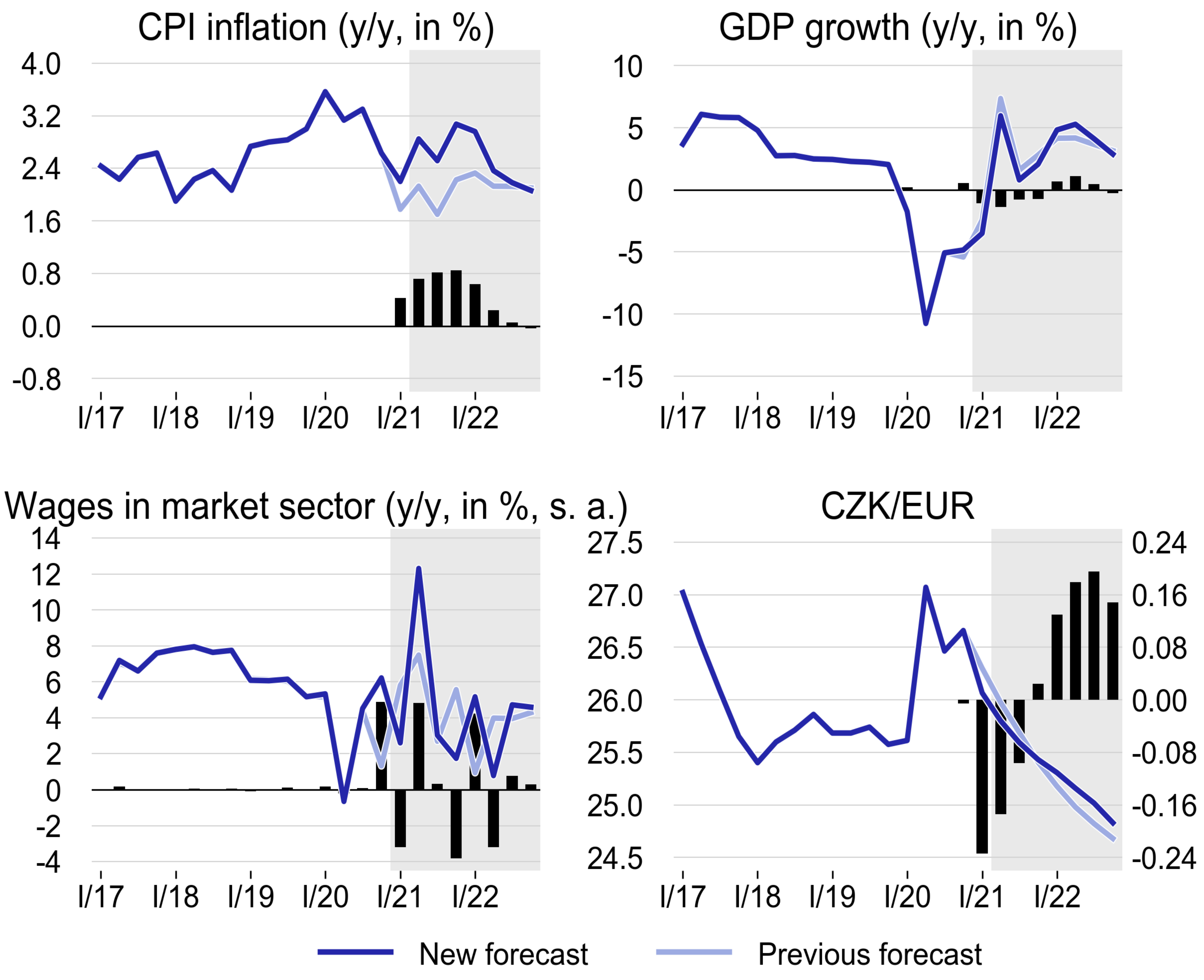
Back



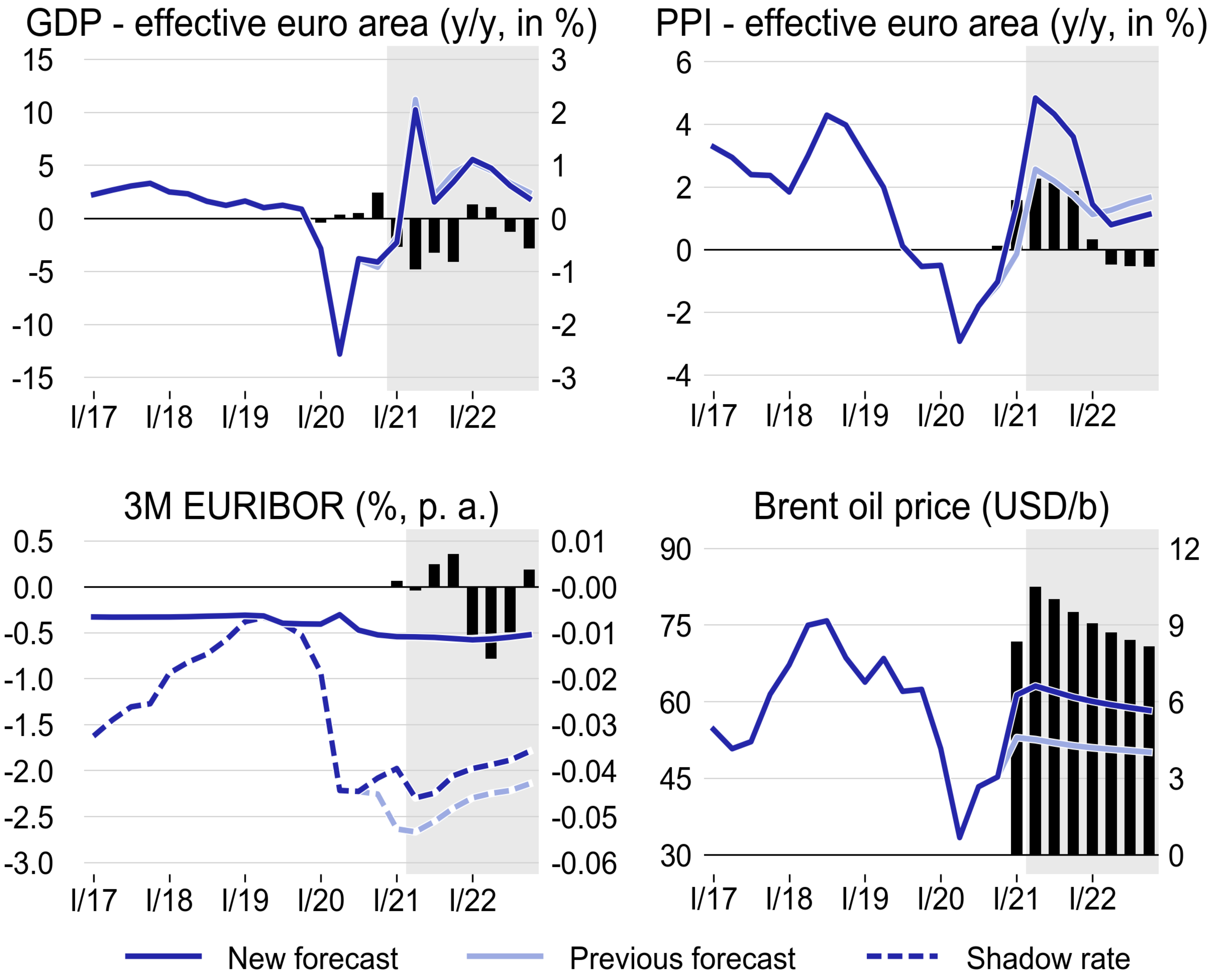


- The domestic (and foreign) output gap has been revised towards a smaller widening into negative territory, i.e. a less anti-inflationary effect, during last year.

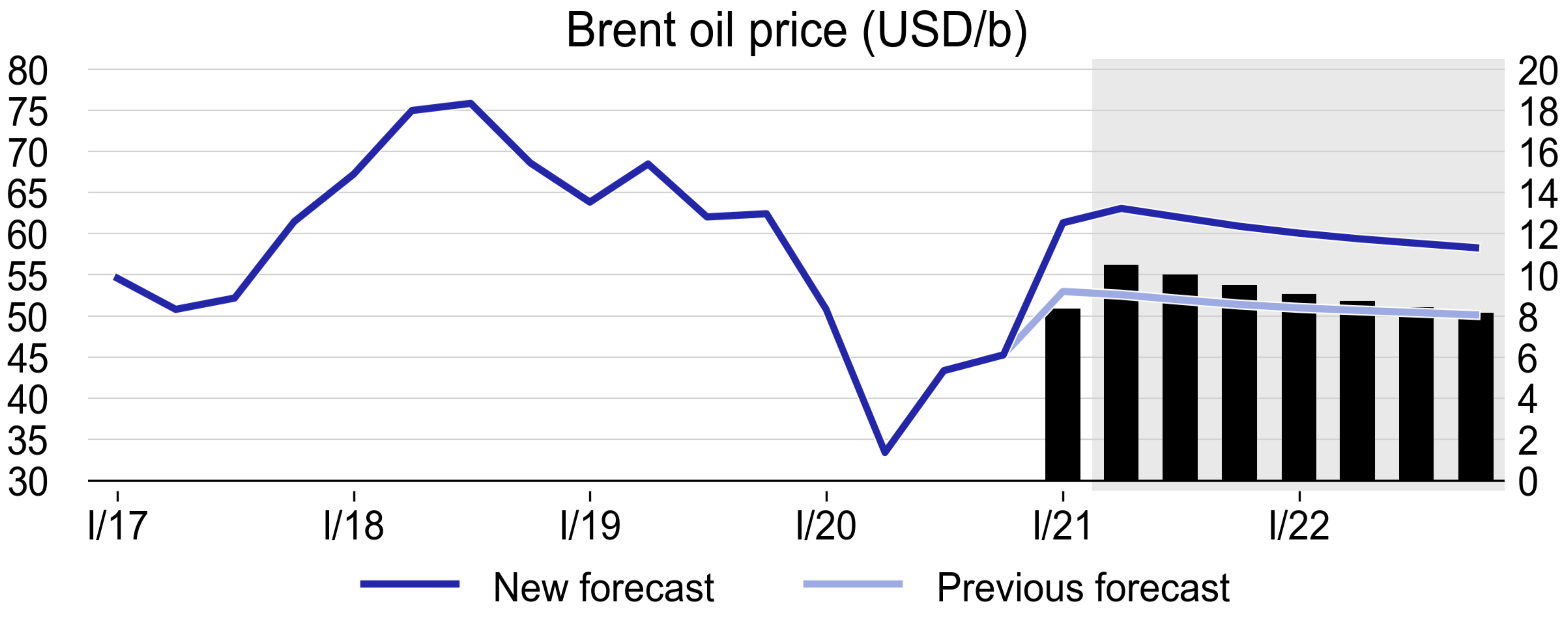
Comparison with Previous Forecast

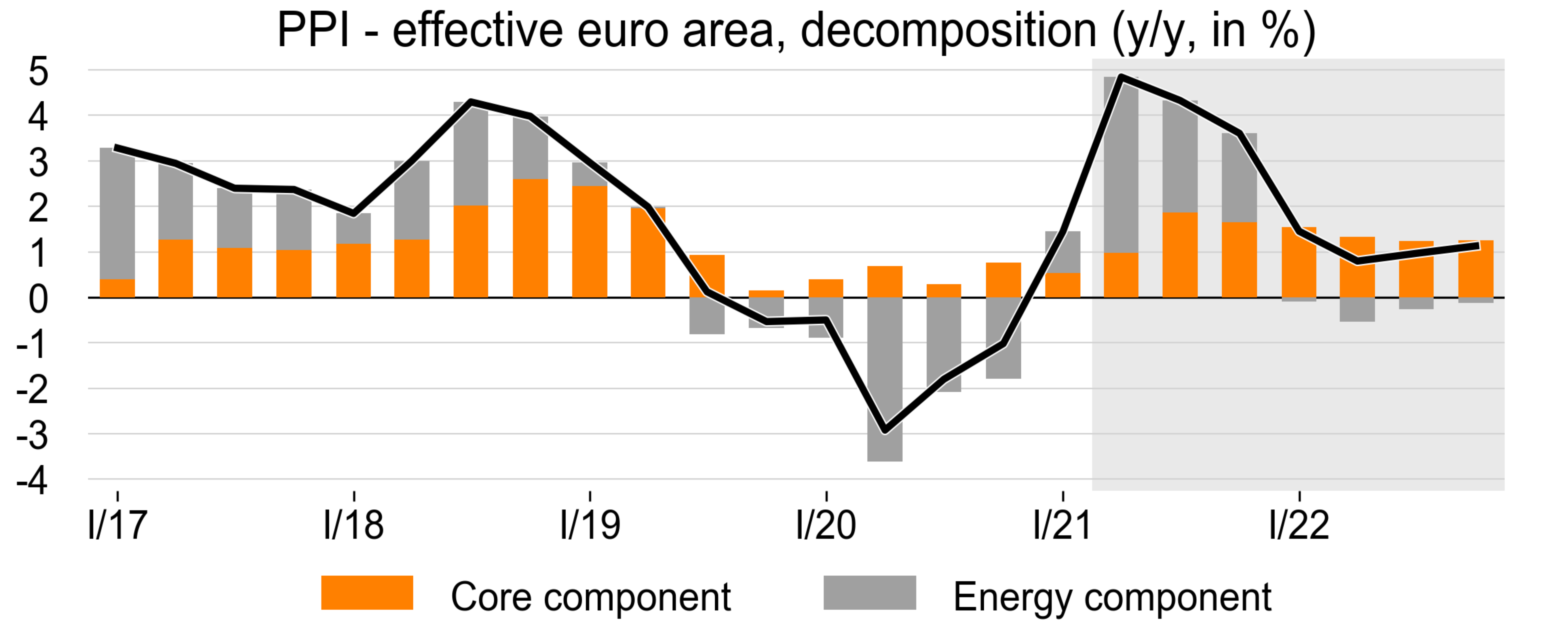


Foreign Outlook: Comparison



PPI in Effective Euro Area: Decomposition





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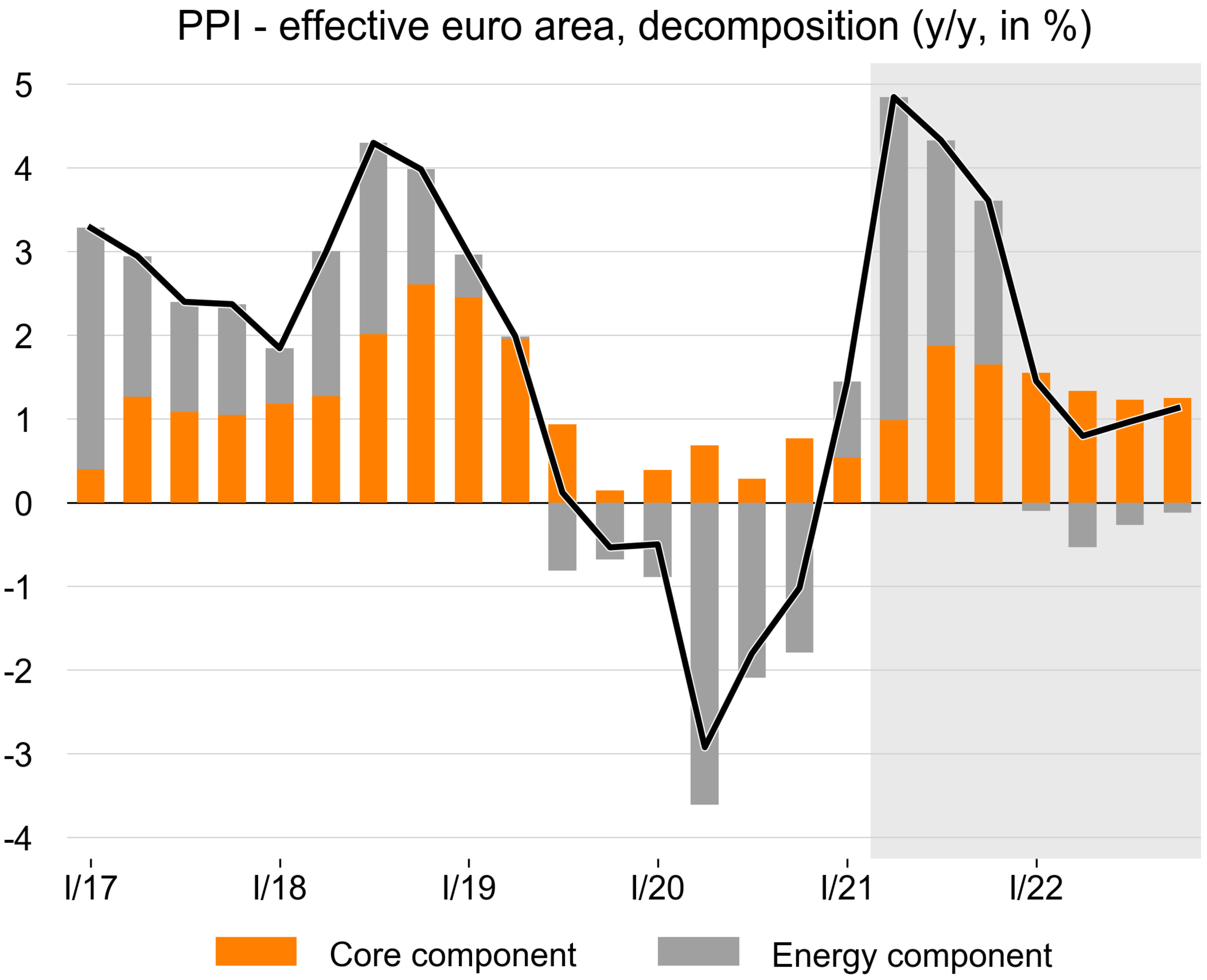
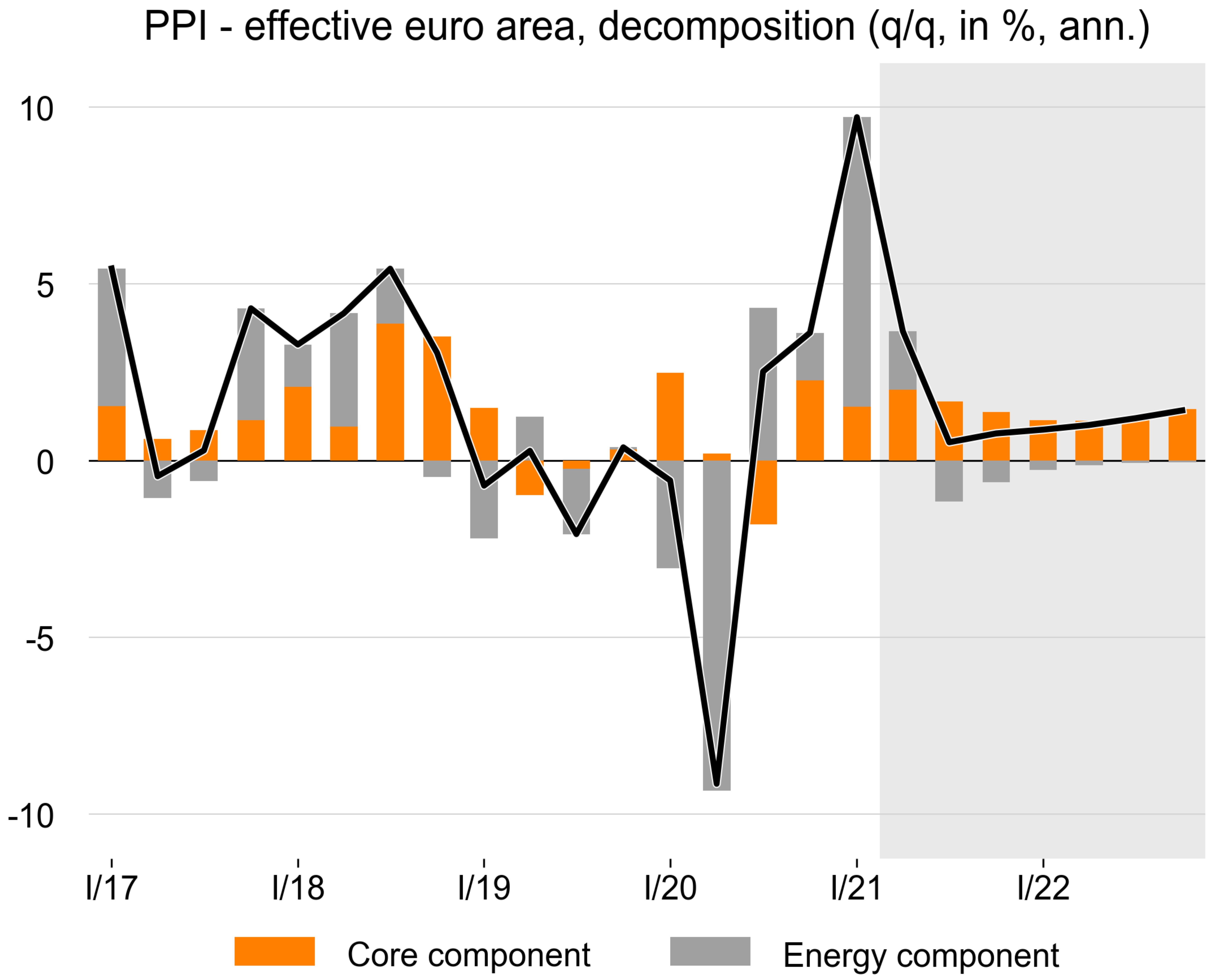


PPI in Effective Euro Area: Decomposition



Fiscal Policy

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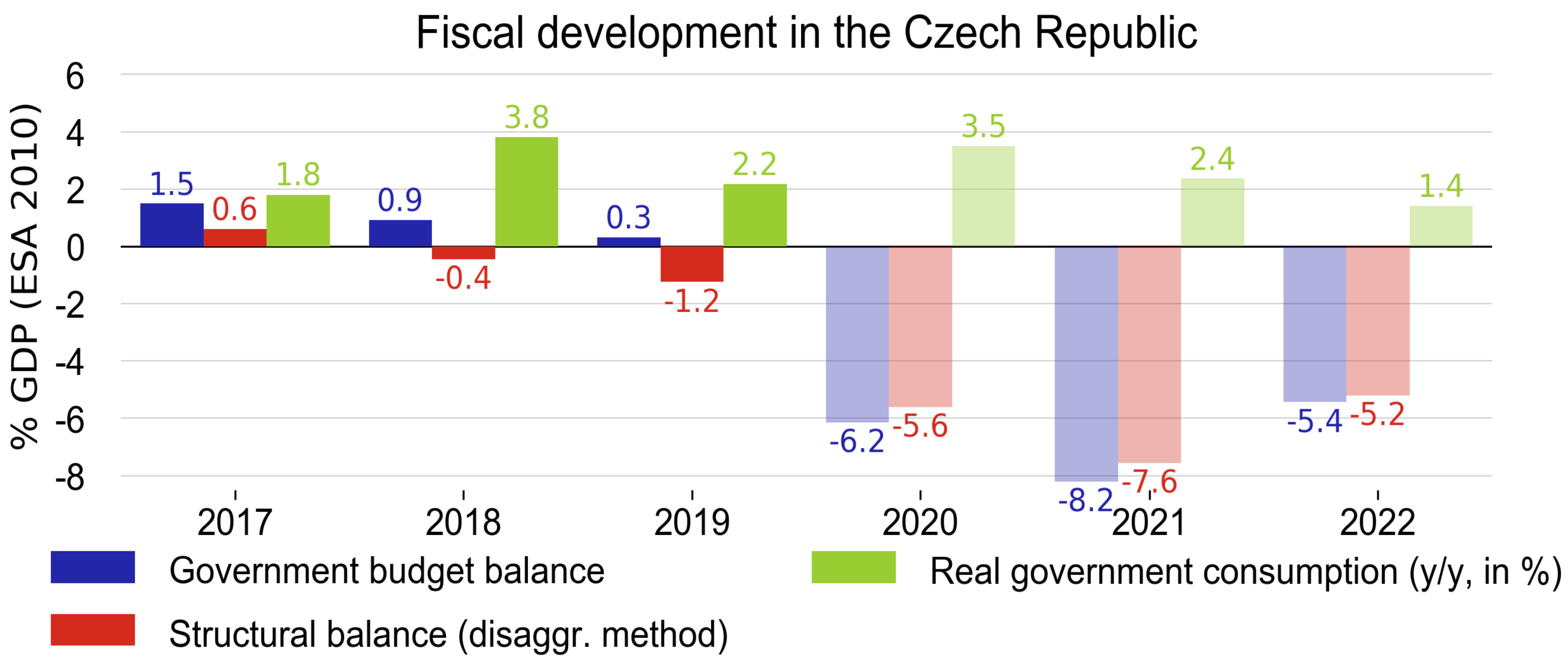
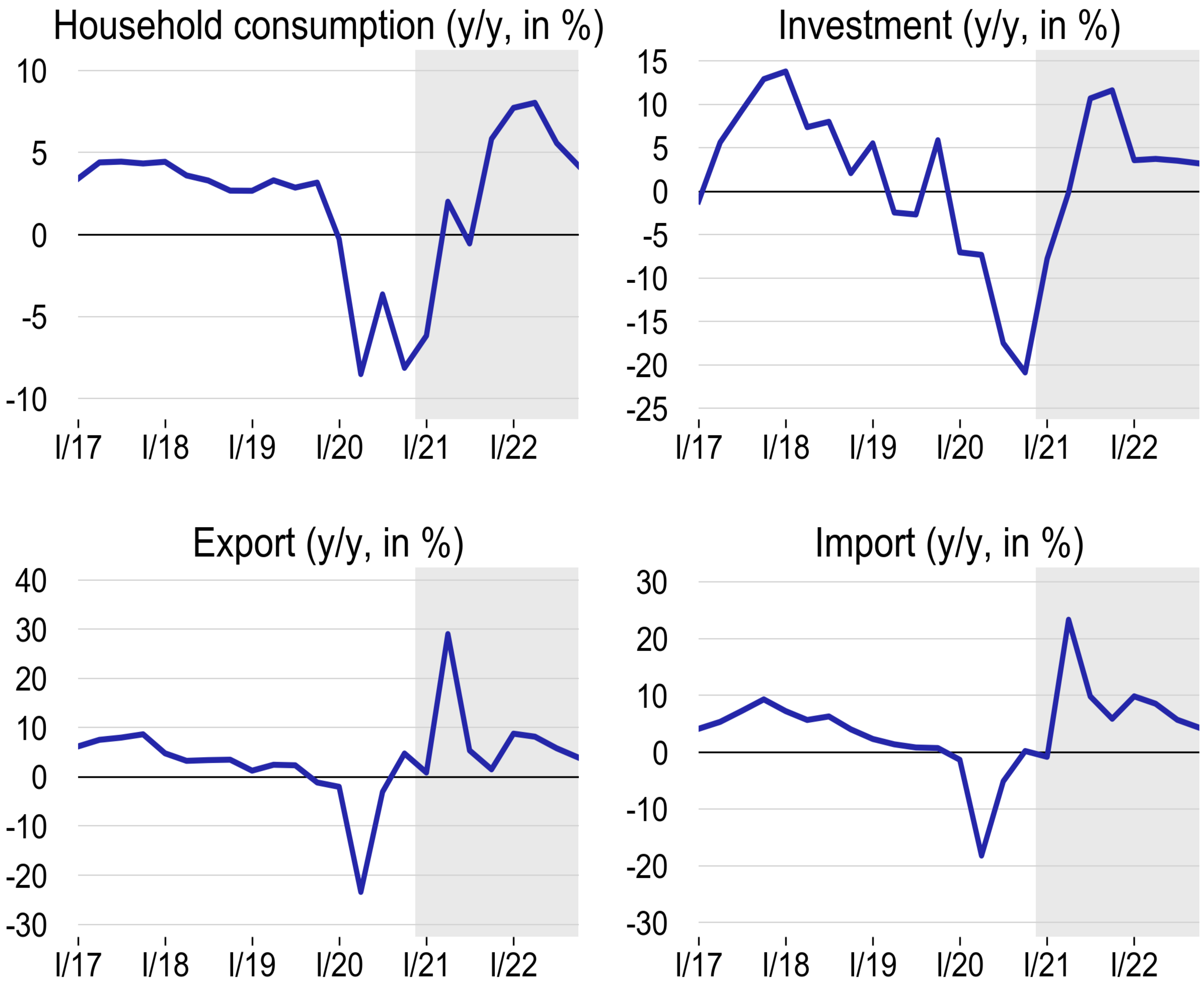


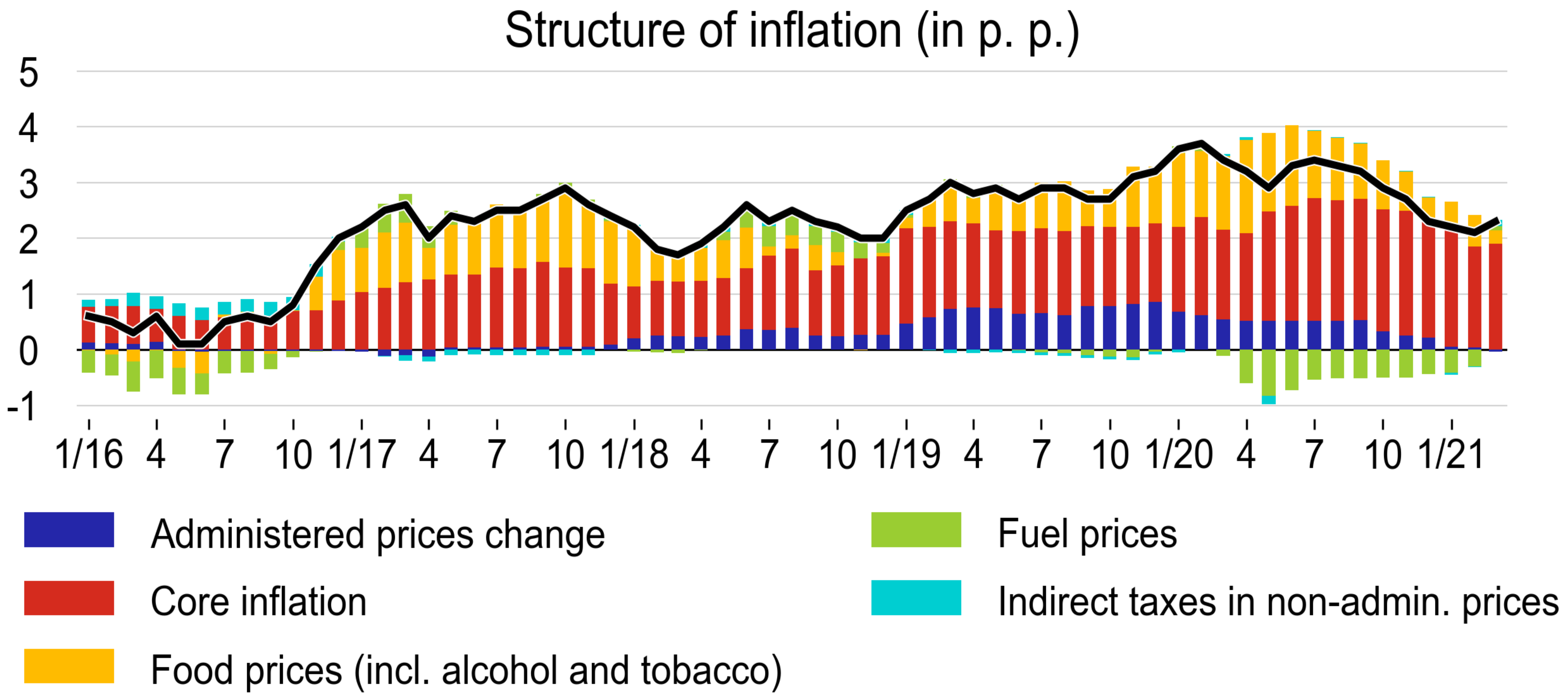
Fiscal impulse (contributions to GDP growth in percentage points)

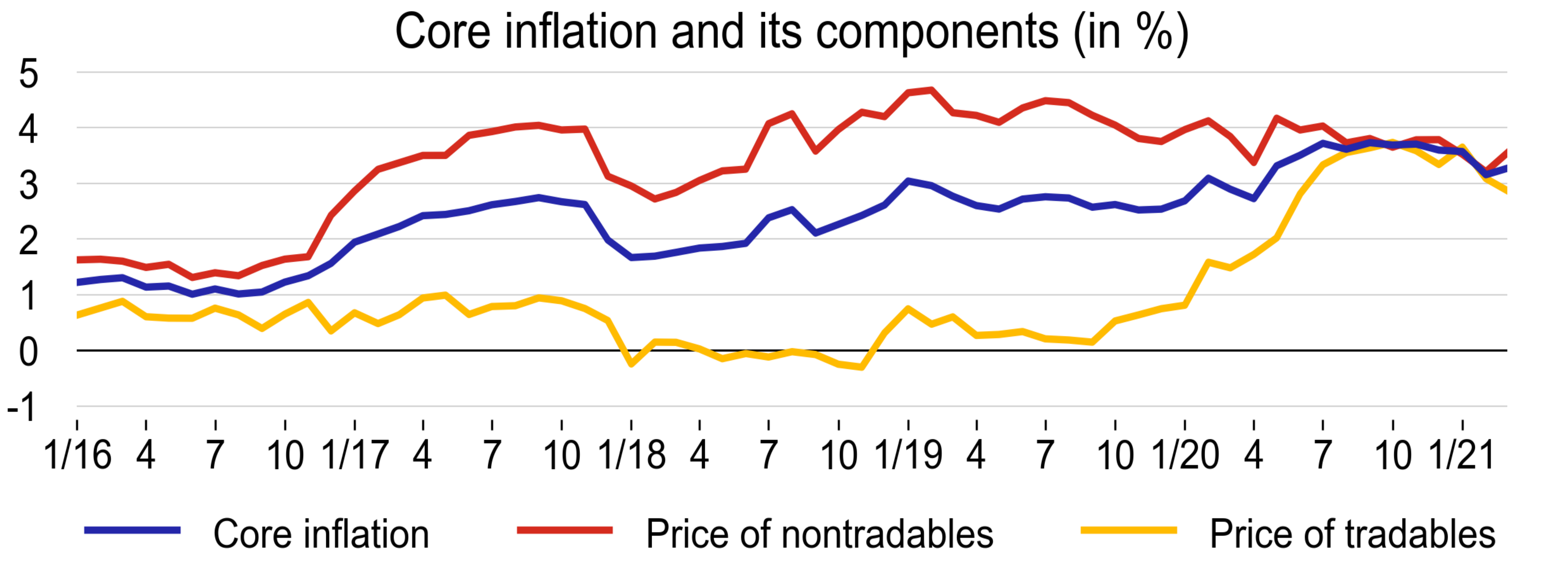
	2019	2020	2021	2022
	actual	forecast	forecast	forecast
Fiscal impulse	0.5	1.5	0.6	-0.8
of which impact through:				
Private consumption	0.3	1.3	0.4	-0.9
Private investment	0.0	0.1	0.1	-0.1
Government investment, domestic	0.1	0.0	0.0	0.0
Government investment, EU funded	0.0	0.1	0.1	0.2

Aggregate Demand

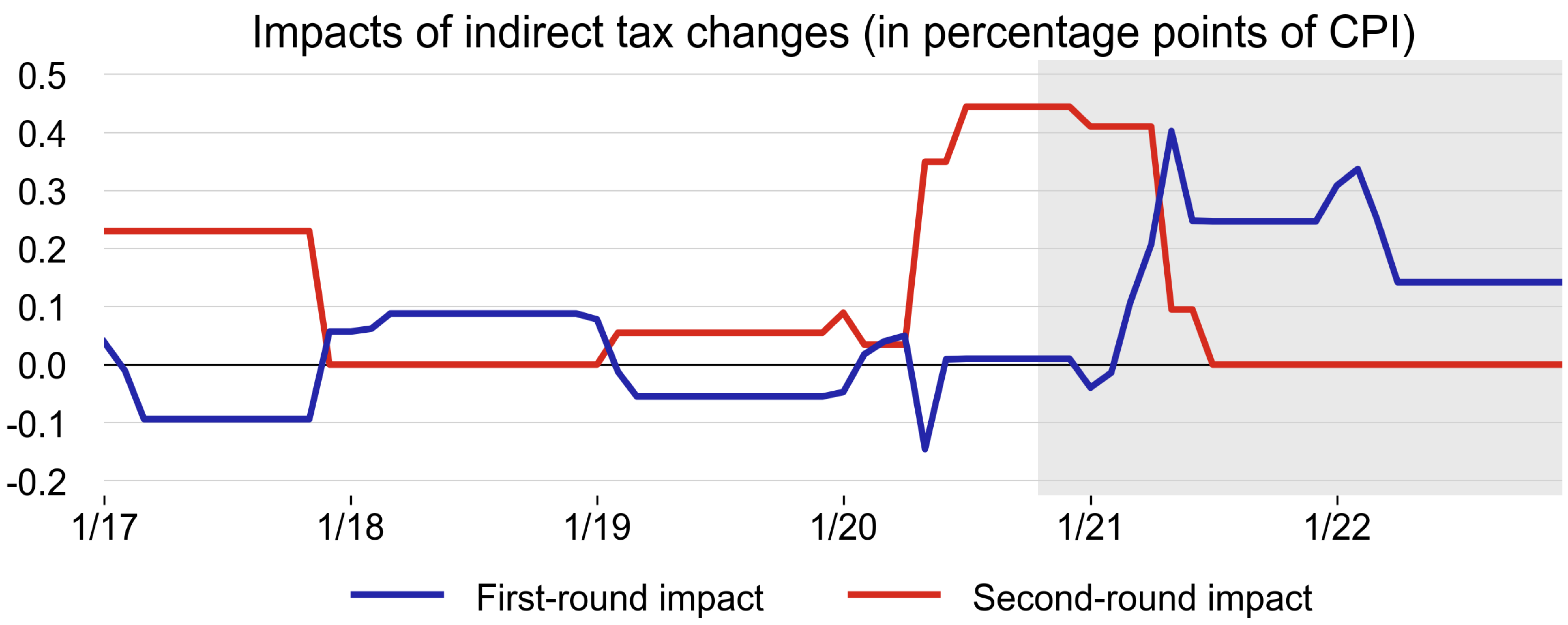


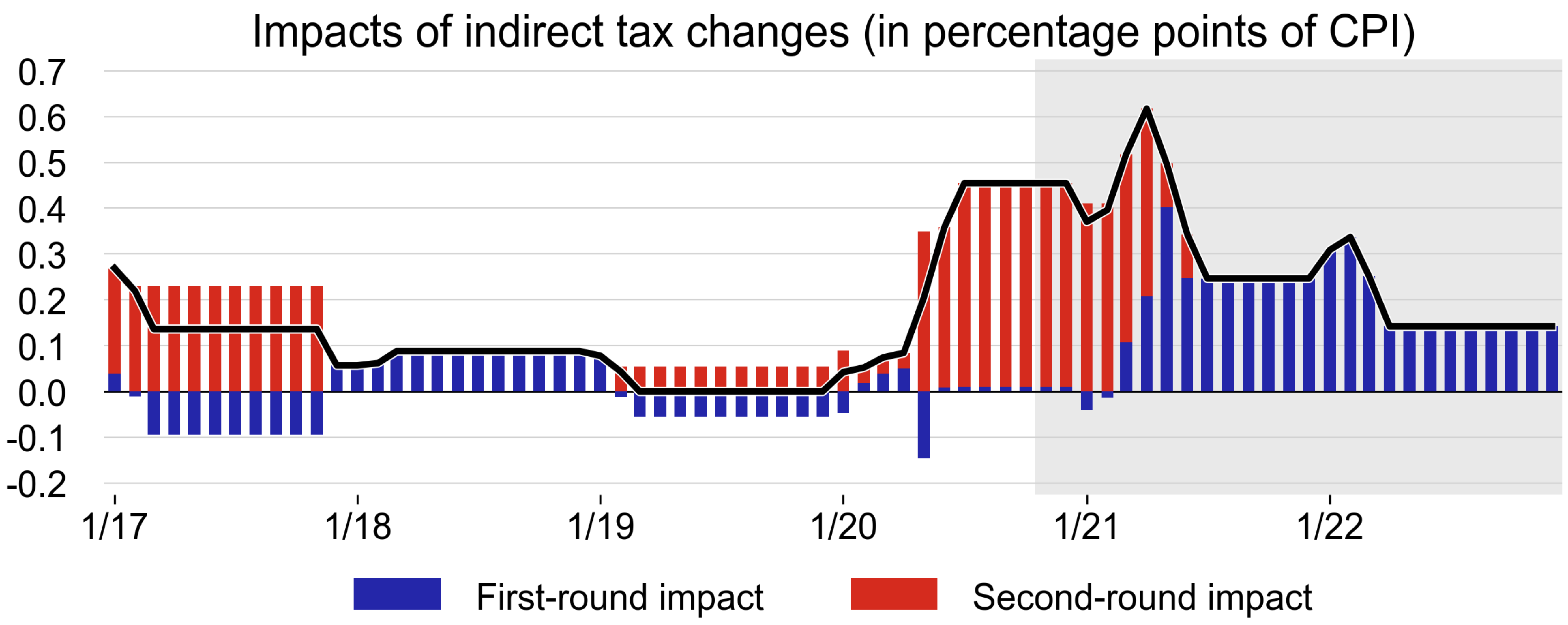
Structure of Inflation



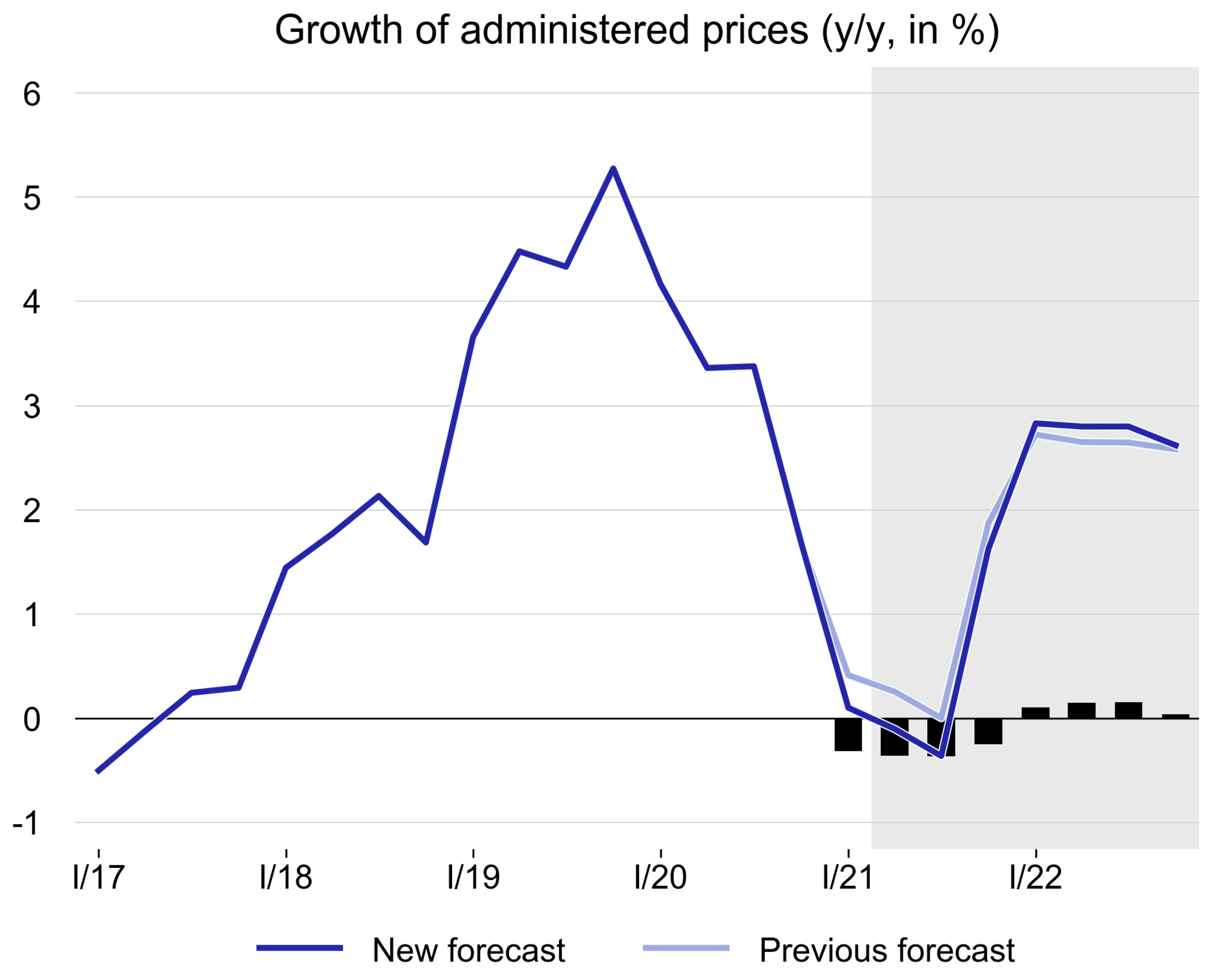


Indirect Tax Changes: Comparison





Administered Prices: Comparison



Labour Market

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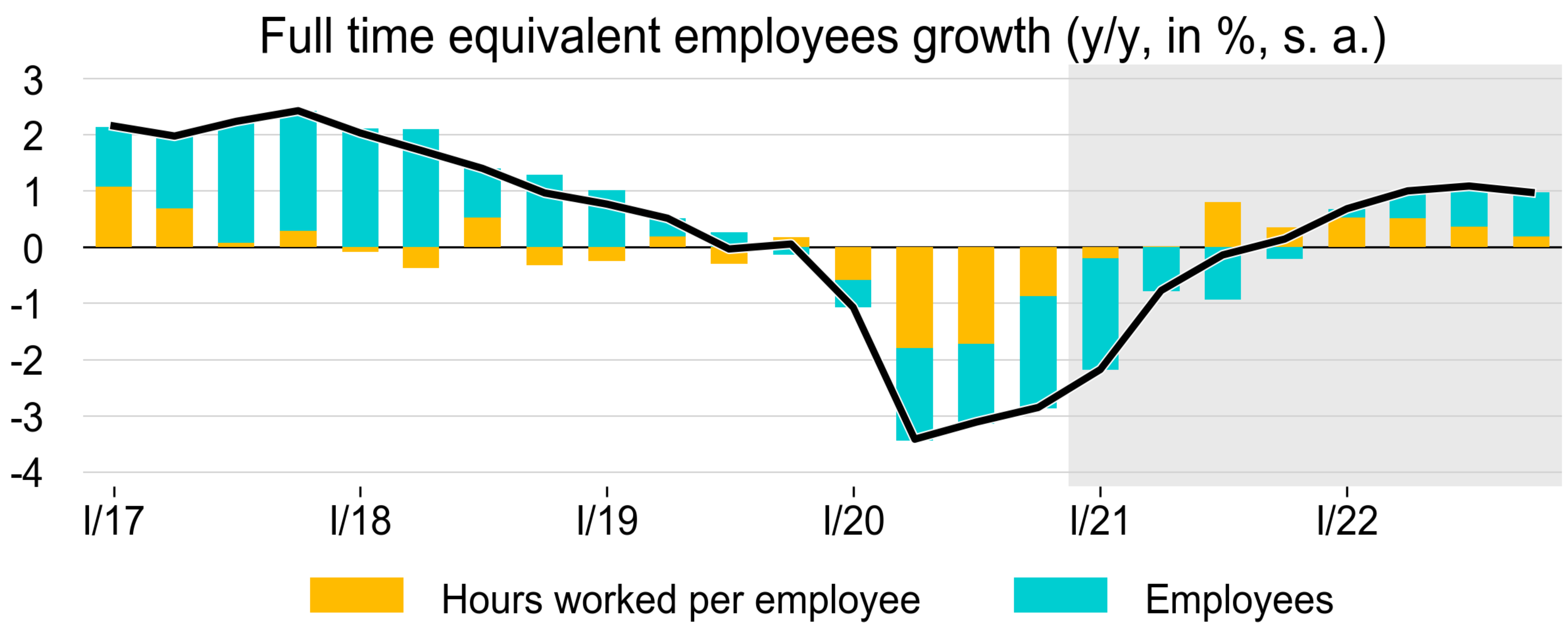

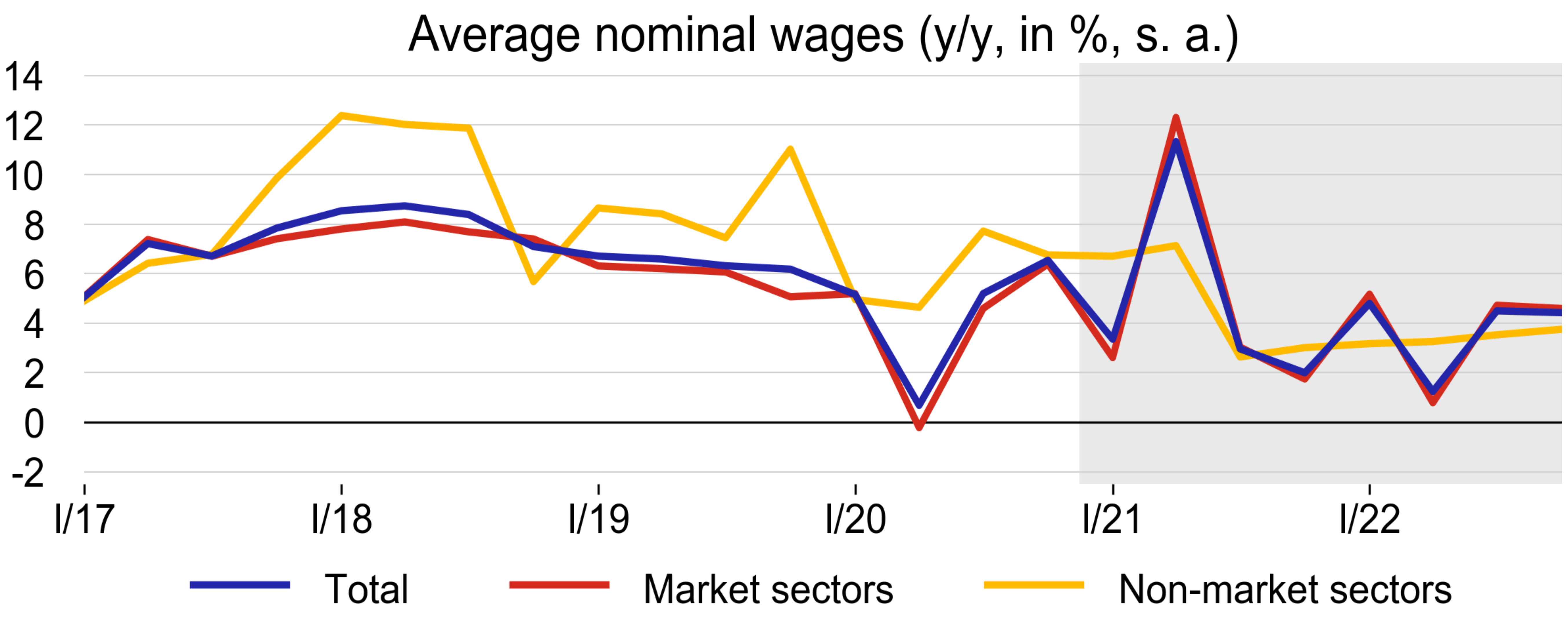

Wages in Market Sector: Comparison

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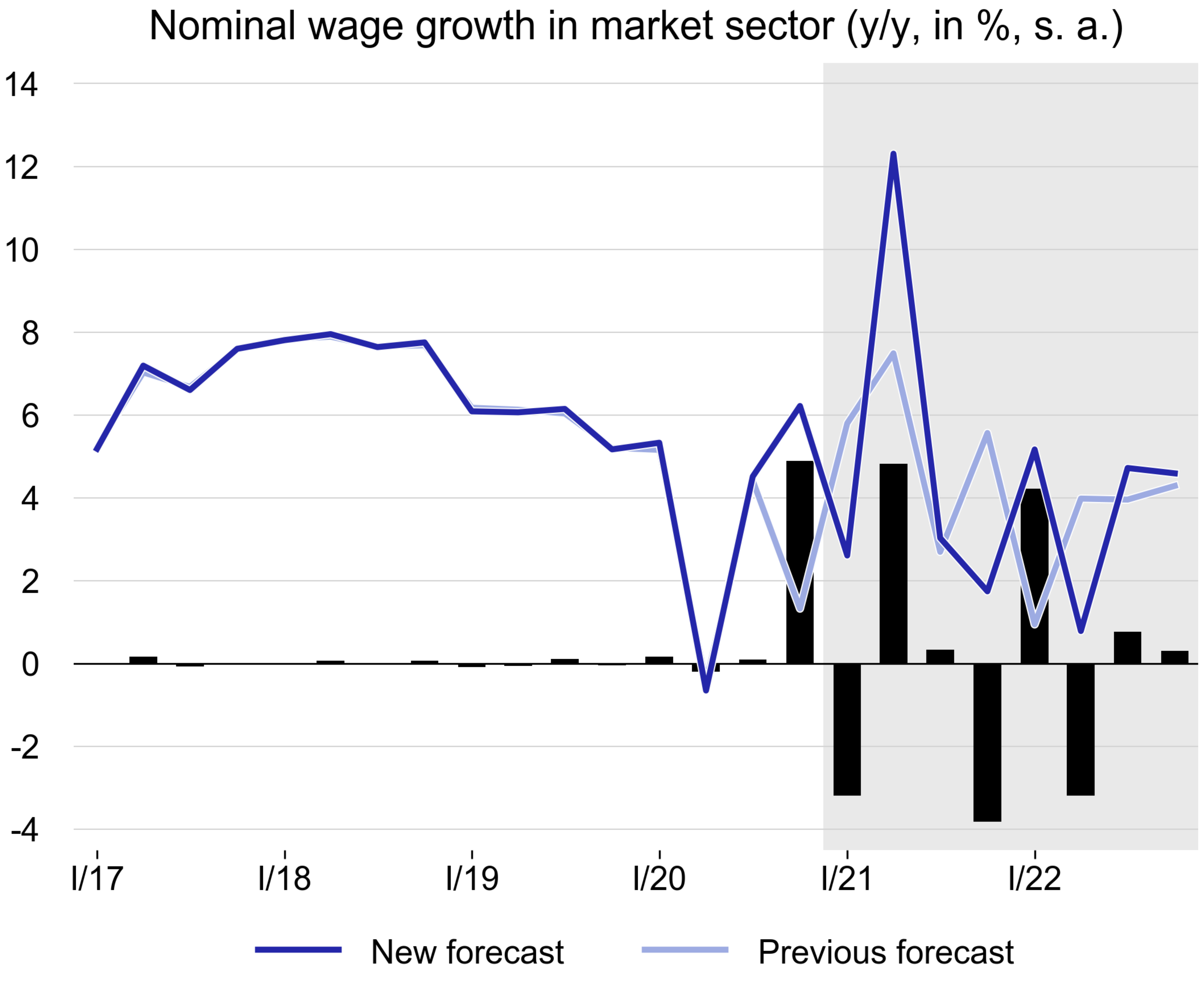
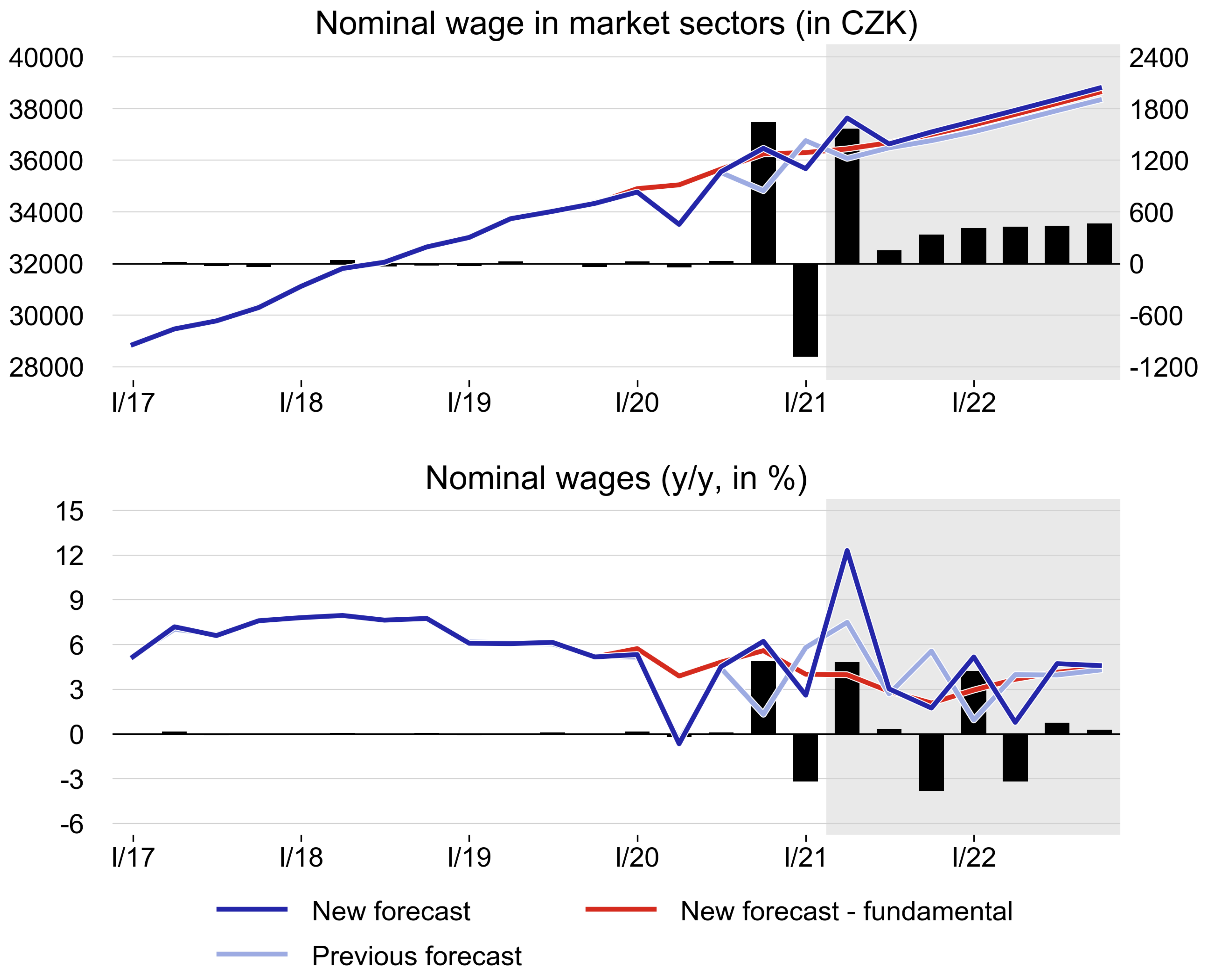
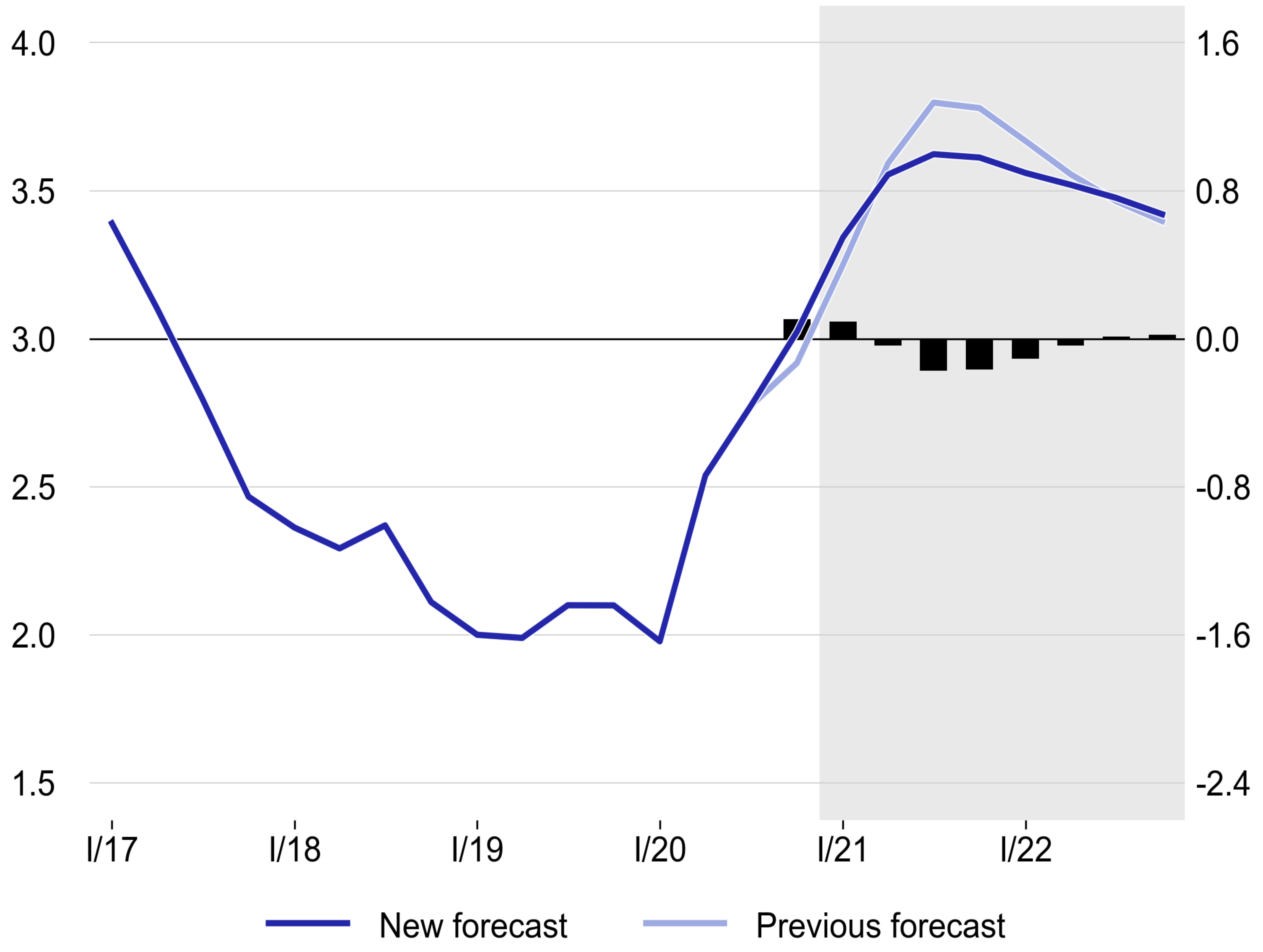


Nominal Wages: Comparison

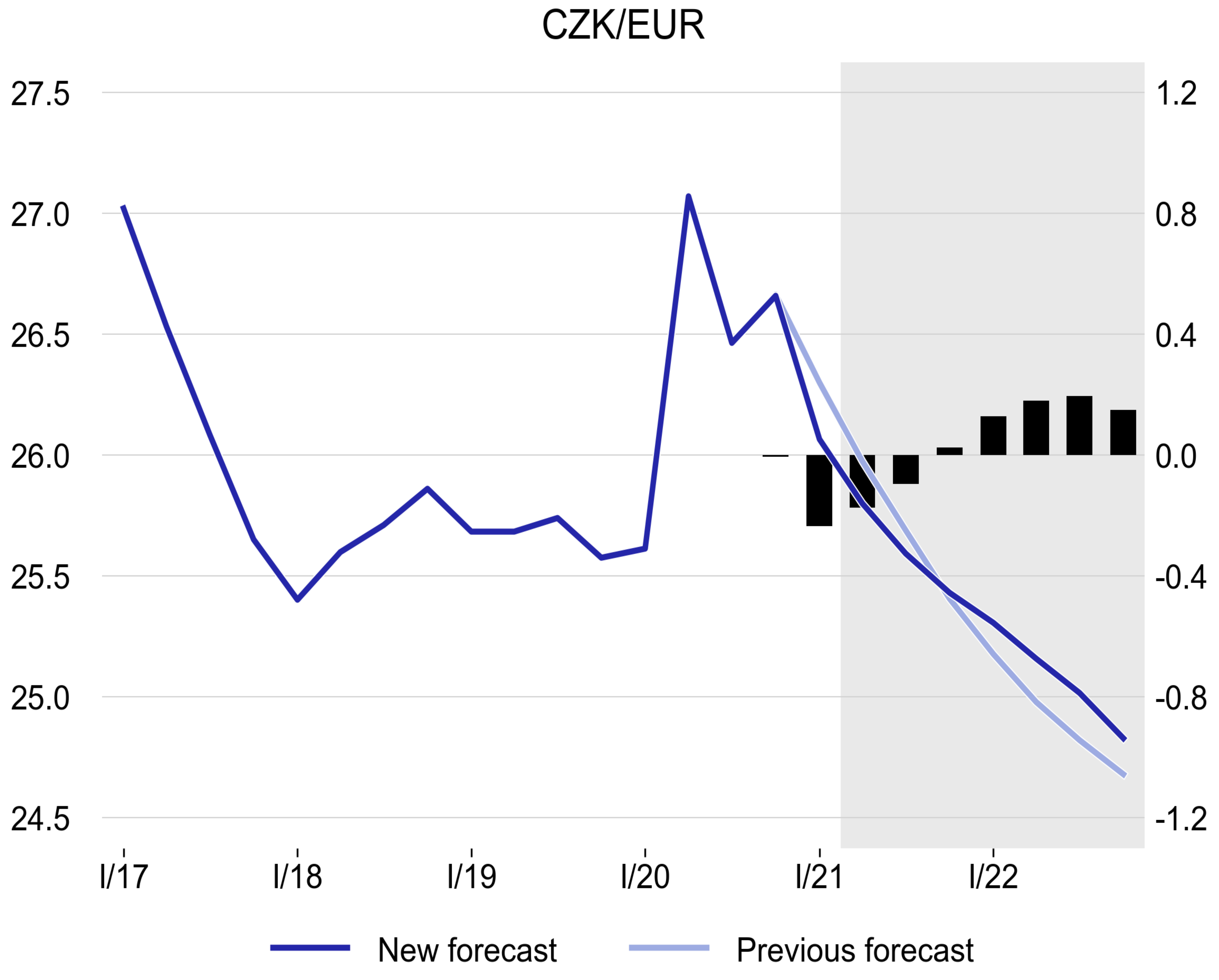


Unemployment Rate: Comparison

General unemployment rate, ILO (%, s. a.)



Exchange Rate: Comparison



Interest Rate: Comparison

3M PRIBOR (%, p. a.)