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# CNB's New Forecast (Monetary Policy Report Summer 2021)

## Meeting with Analysts

6 August 2021

Karel Musil (Director, Macroeconomic Forecasting Division)



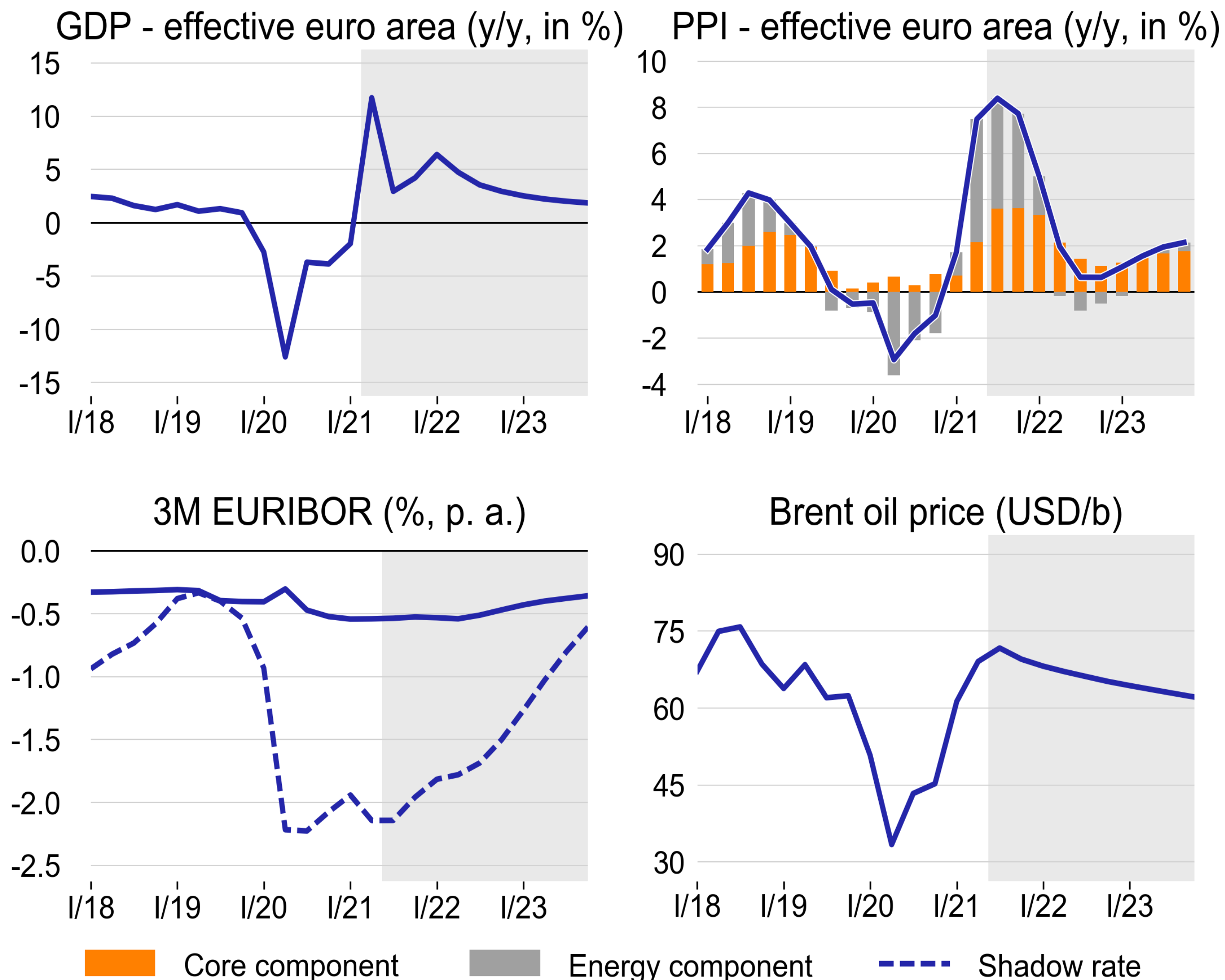
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# Presentation Outline

- 1. Assumptions of the Forecast**
2. The New Macroeconomic Forecast
3. Comparison with the Previous Forecast
4. Monetary Policy Simulations

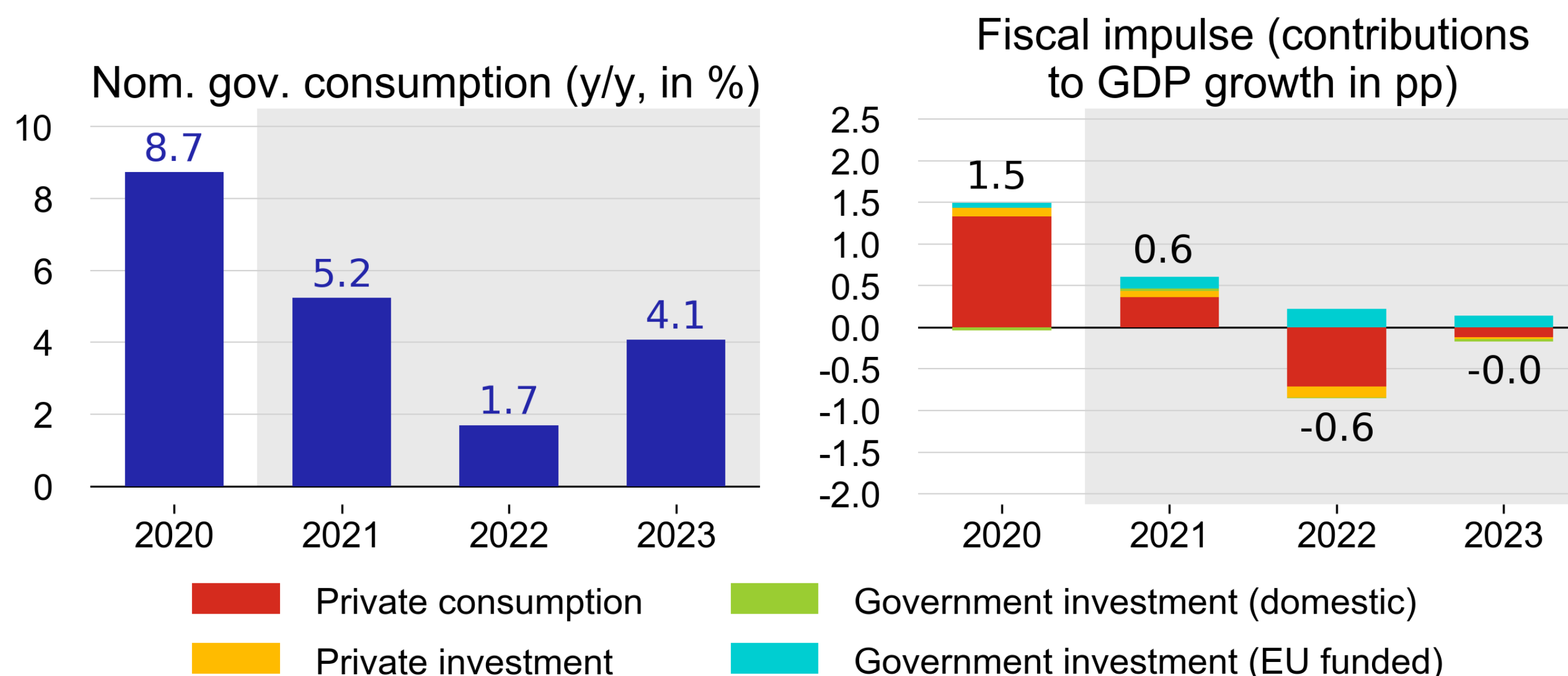
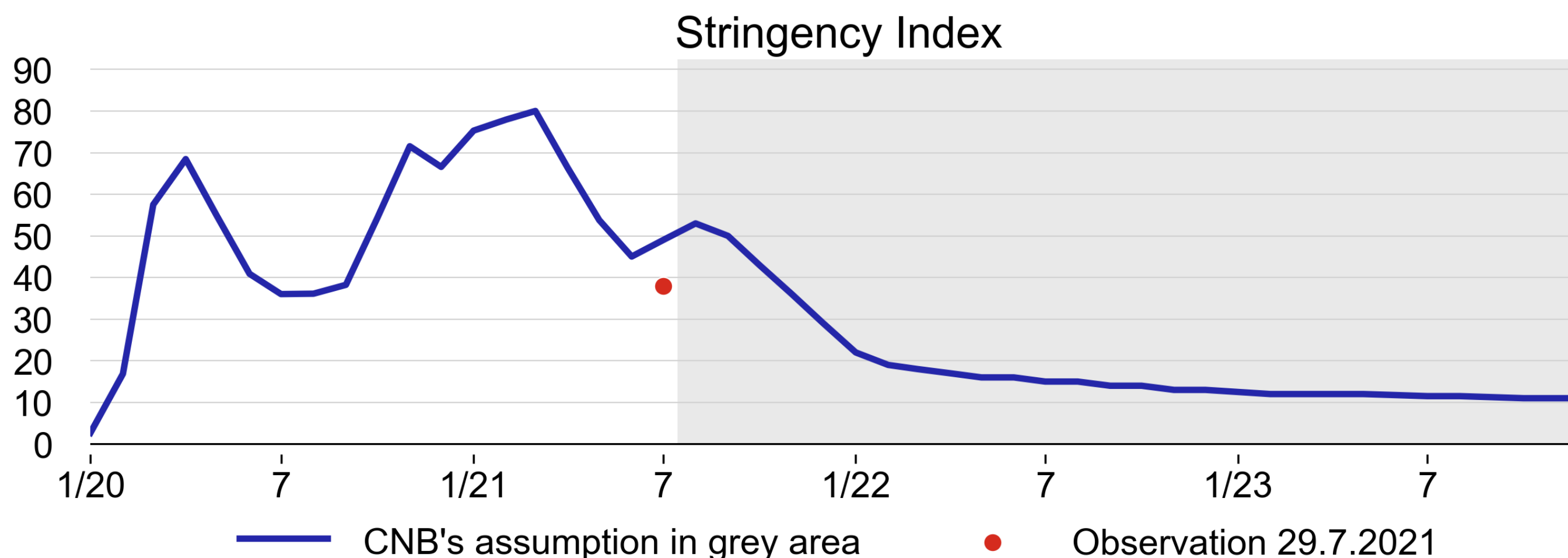


# External Environment Outlook



- The recovery of **economic activity** in the effective euro area will be driven by a reopening of services supported by spending of part of the forced savings created during lockdowns.
- The **price pressures in industrial production** are exceptionally strong at the moment. Both components – core and energy – will contribute to a sharp rise in foreign producer prices this year.
- The pressures on industrial producer prices reflect growth in prices of **crude oil** and other commodities as well as strong demand for industrial goods.
- The **3M EURIBOR** outlook remains negative. The effect of unconventional monetary policy on the **shadow interest rate** is gradually diminishing. <sup>3</sup>

# Domestic Developments



- After an upward summer episode, the **Stringency Index** will fall rapidly again in the coming months. This summer episode should have no major impacts on the consumption of households. Next year, the Stringency Index will be at levels that will not have tangible effects on the economy.
- **Government consumption** will rise this year, albeit more slowly than before due to last year's high expenditure.
- Fiscal policy is increasing GDP growth this year mainly via support for household income and consumption; the **fiscal impulse** will be negative in 2022. Its restrictive effect stemming from the phasing out of support measures will be softened by an extraordinary increase in pensions.

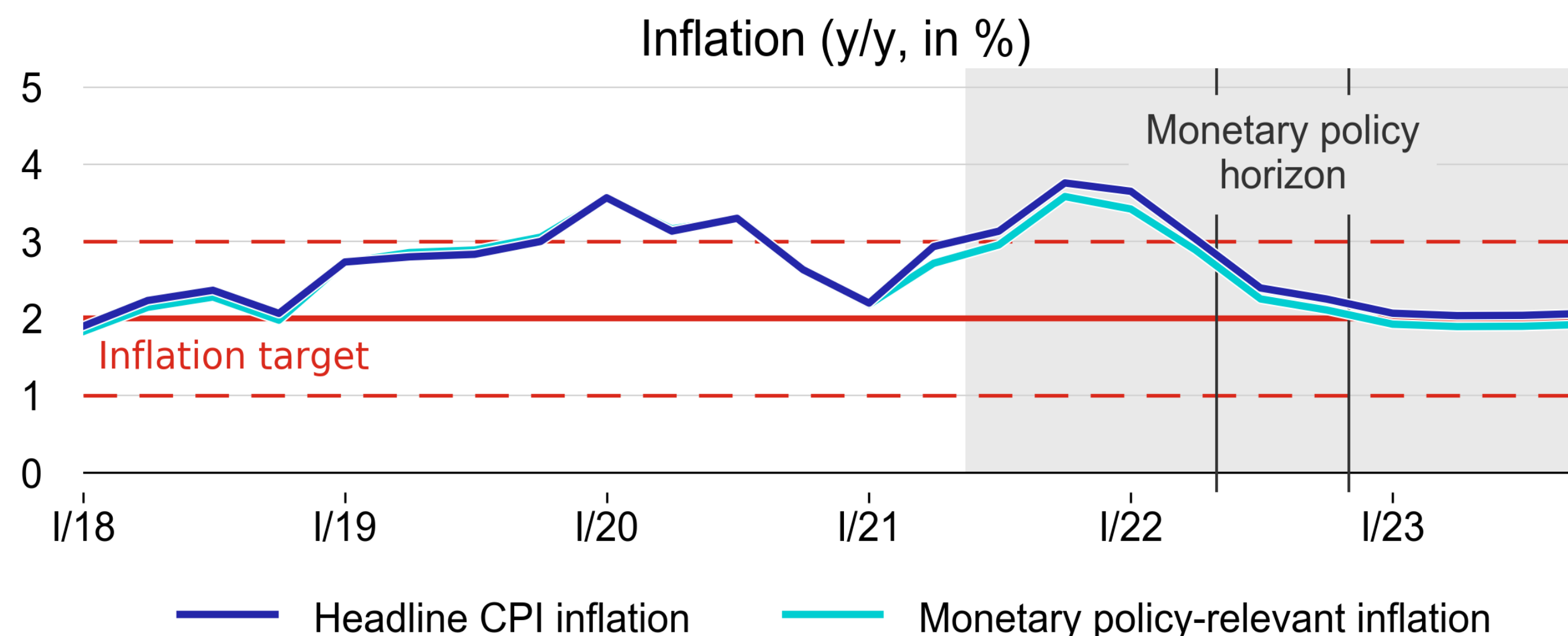
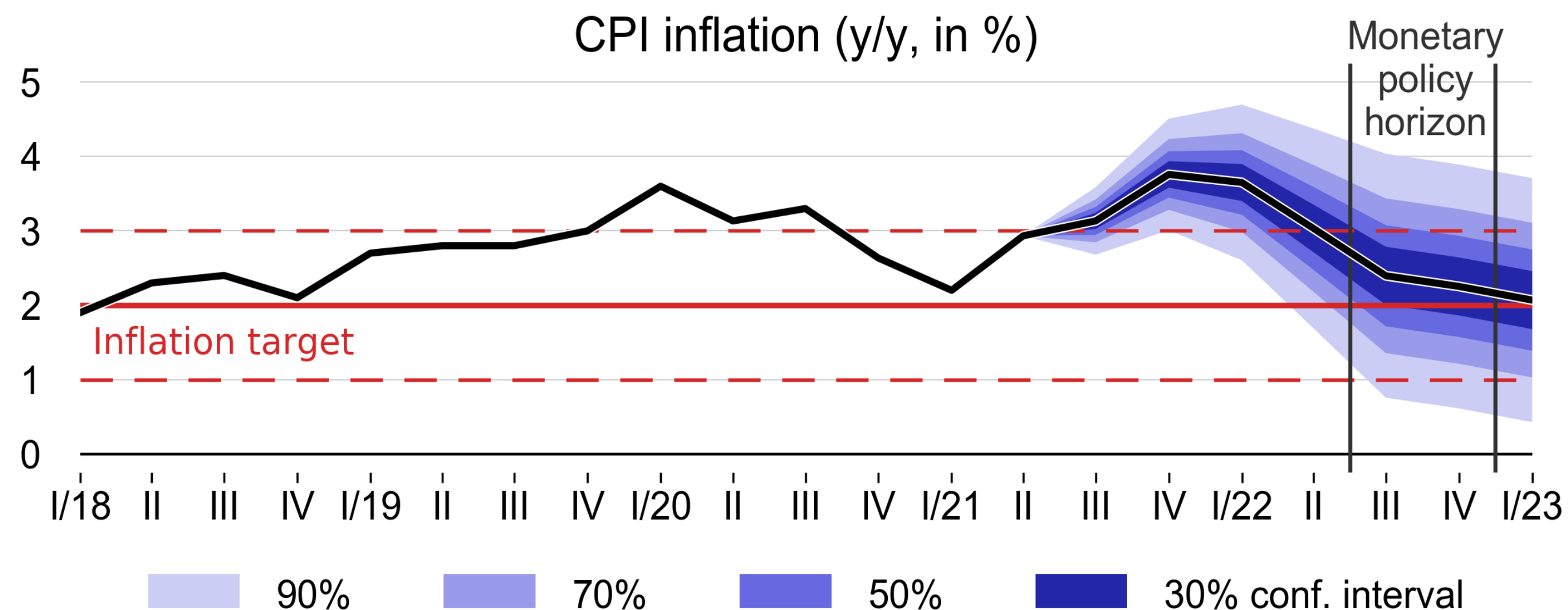
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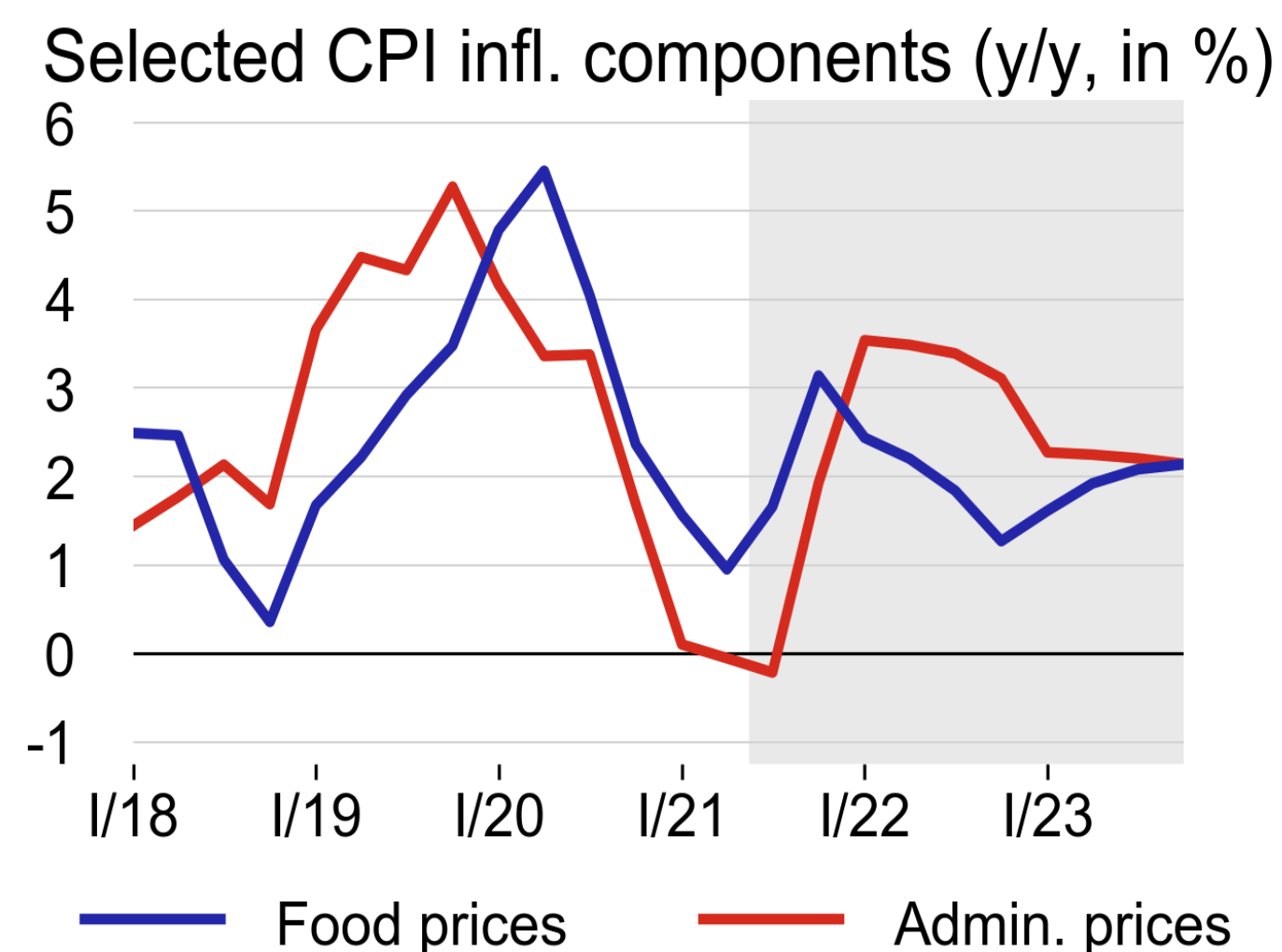
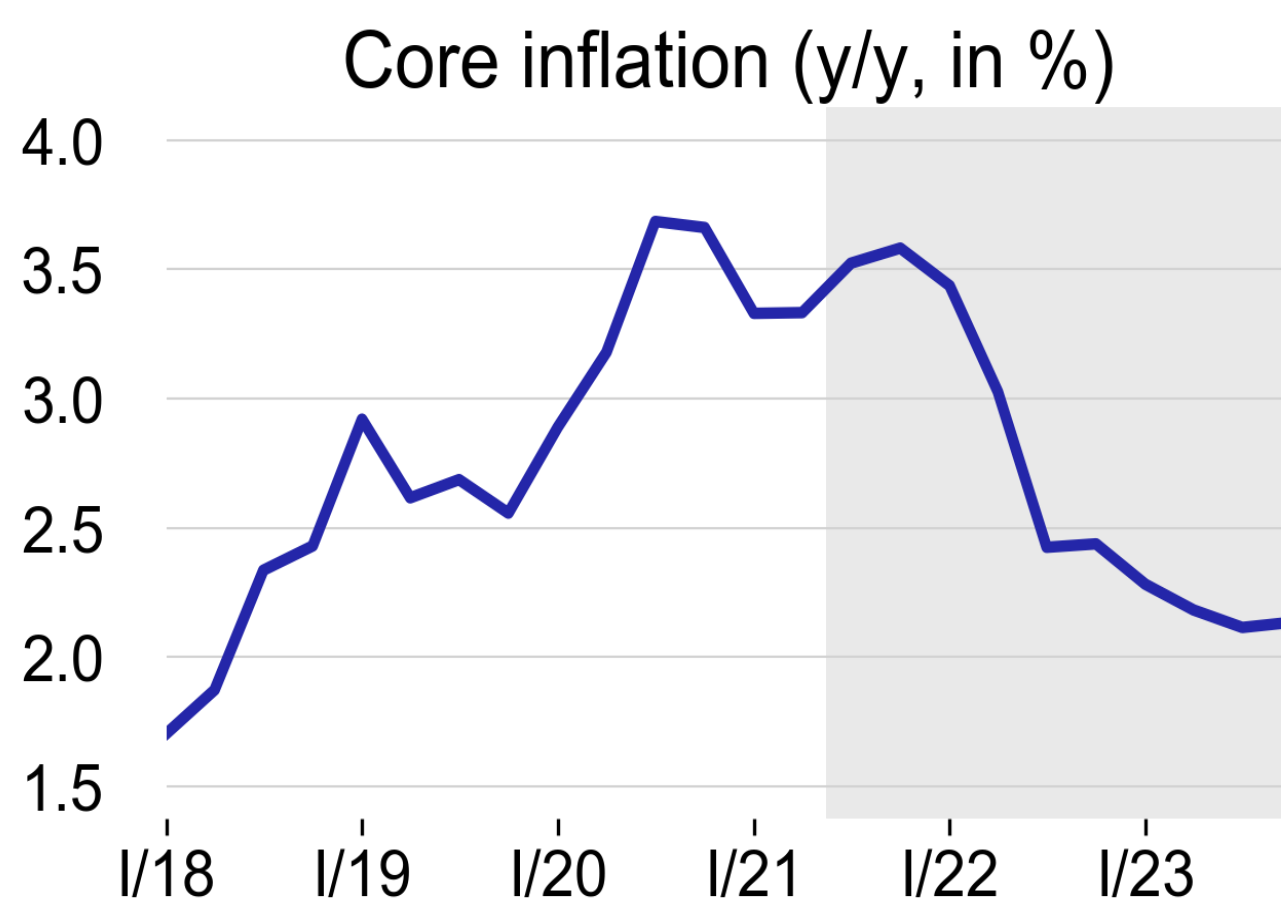
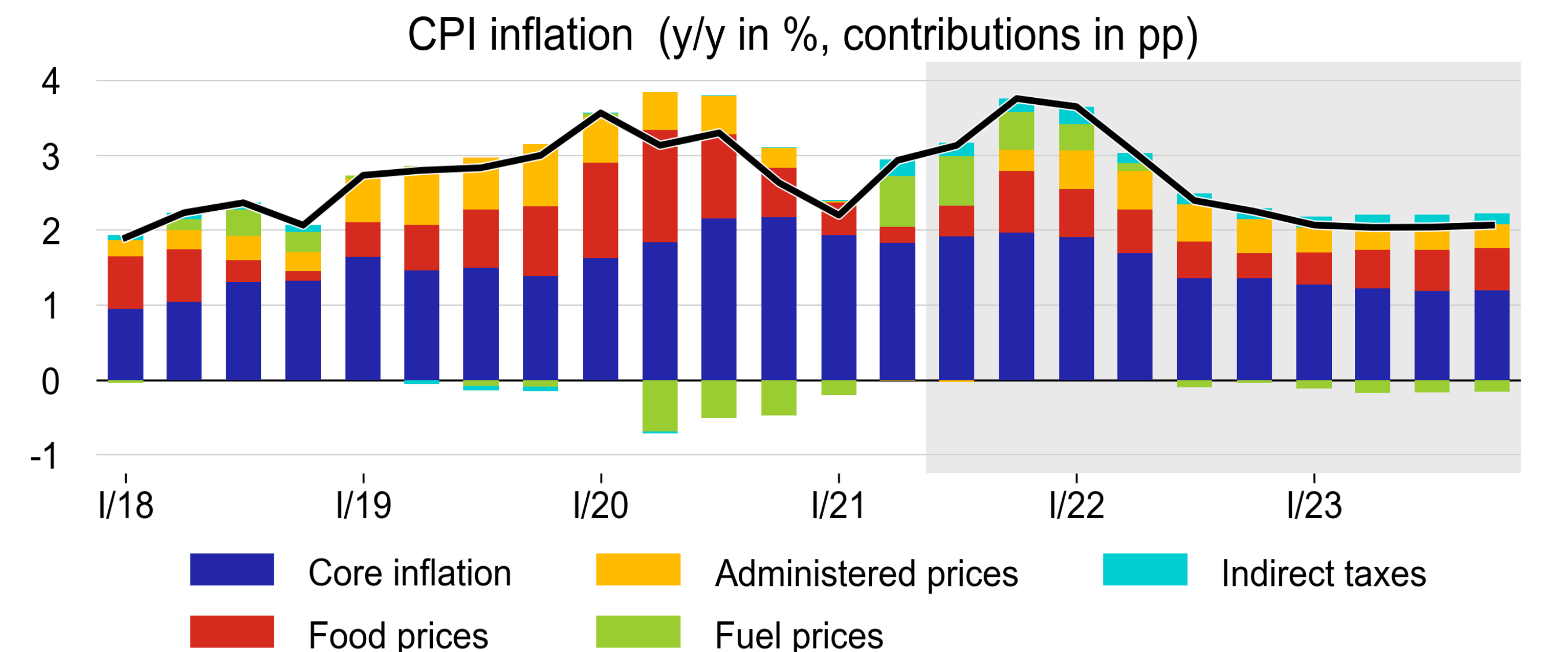


# Headline and Monetary Policy-Relevant Inflation



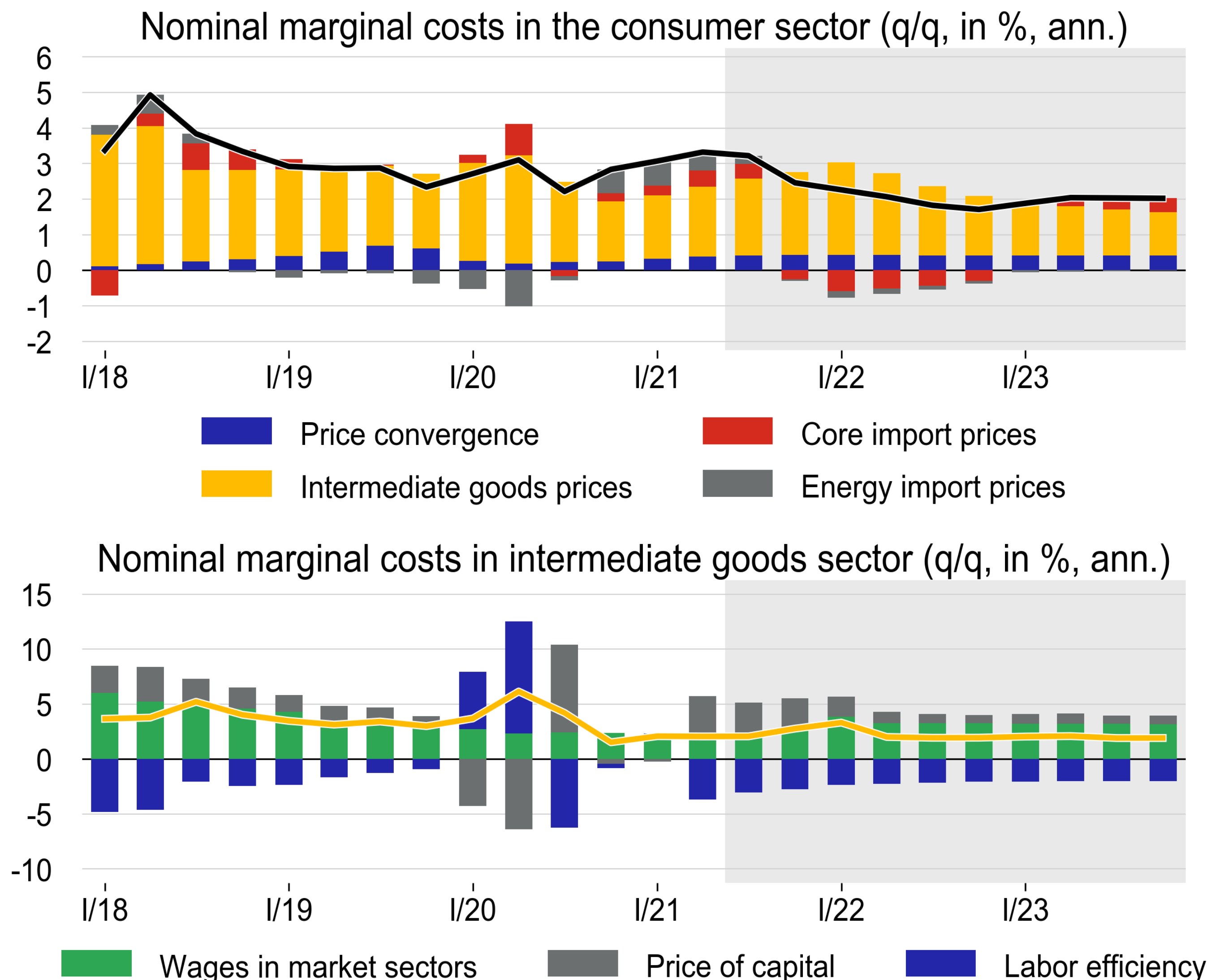
- **Inflation** will rise well above the upper boundary of the tolerance band in the second half of the year and slow towards the 2% target next year.
- Headline inflation will accelerate initially due to a pick-up in **food price** inflation and later also renewed **administered price** inflation. In addition, **core inflation** will remain strong and **fuel prices** will continue to rise apace.
- Next year, inflation will start to return to the target, aided by this year's significant tightening of monetary conditions.
- Headline inflation will be slightly above monetary policy-relevant inflation due to changes in excise duties.

# Inflation



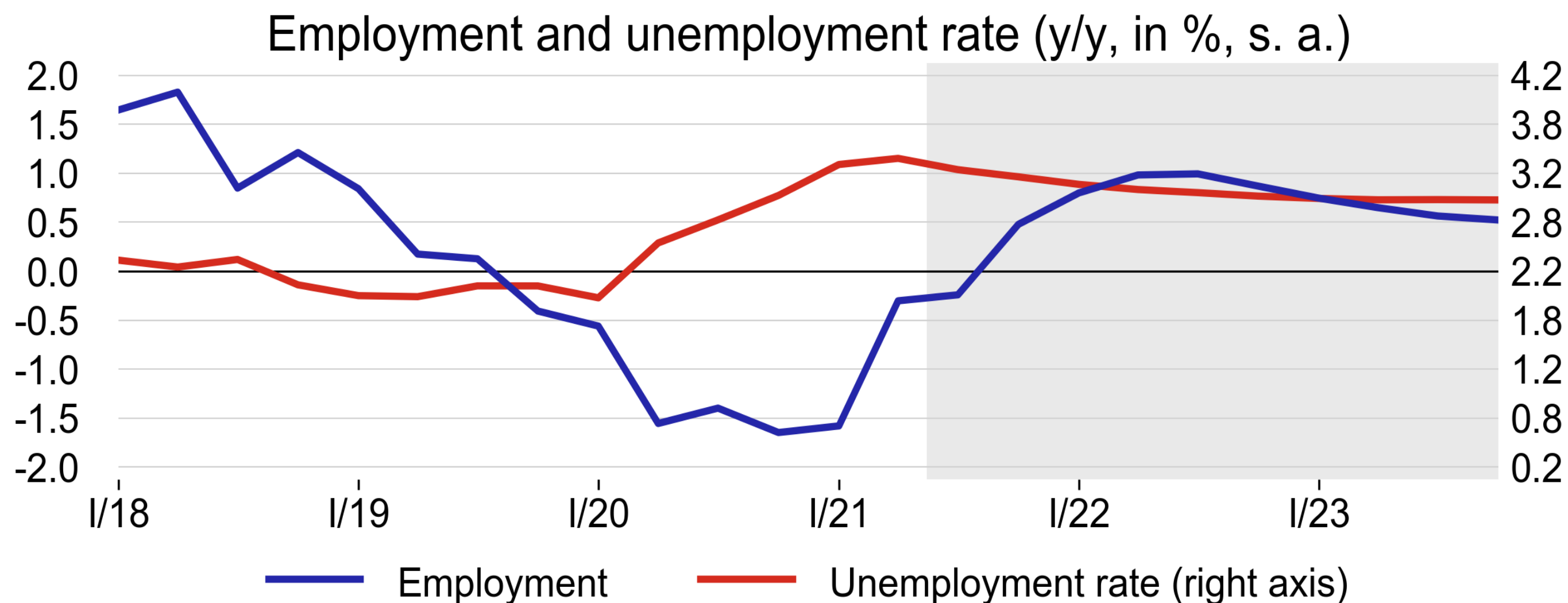
- Inflation will continue to be dominated by core inflation; the temporarily subdued contributions of food prices and administered prices will soon intensify again.
- Observed rapid growth in **fuel prices** reflects both last year's low base and the recent sharp rise in oil prices.
- Growth in **core inflation** is being driven largely by cost factors and strong domestic demand.
- The temporarily muted growth in **administered prices** will start to rise sharply at the end of the year due to growing energy prices.
- **Food price** inflation is volatile; it will start to rise from its currently subdued levels and peak at the end of this year.

# Inflation Pressures

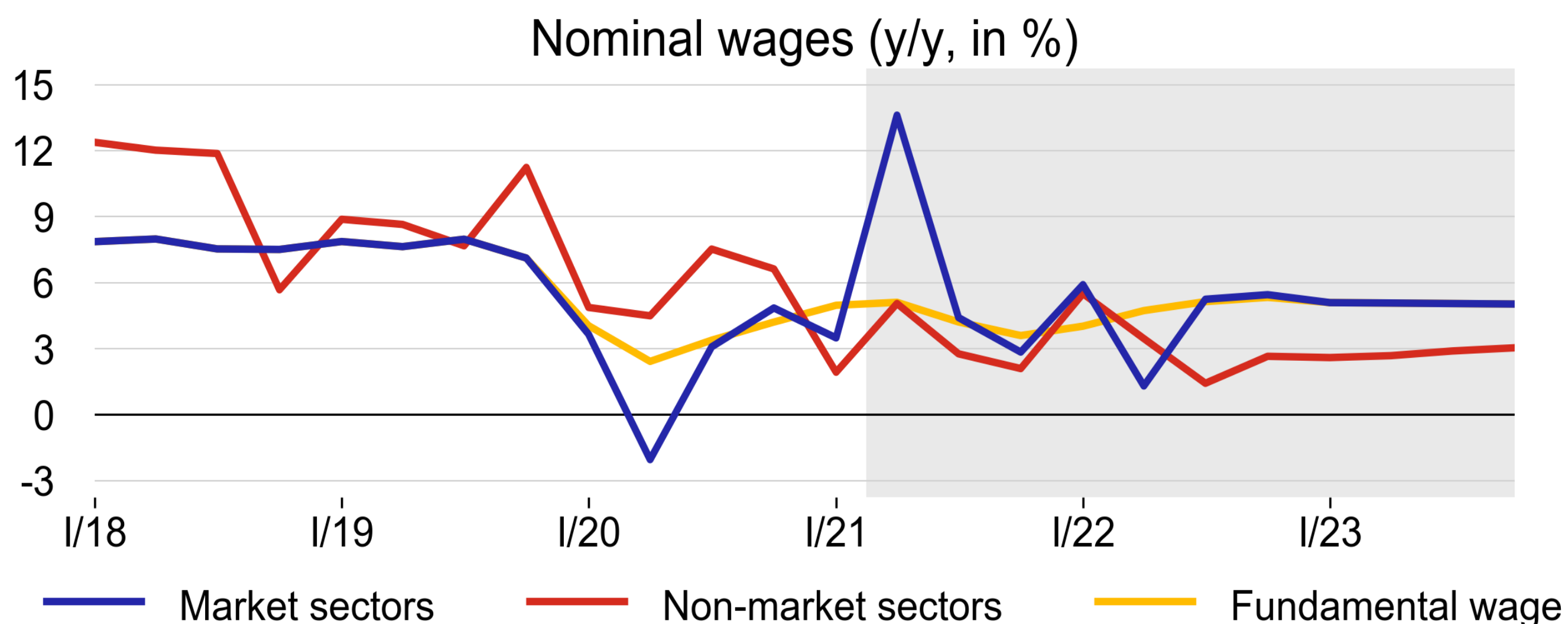


- The currently strong **overall inflation pressures** will ease at the end of the year as the high growth in import prices fades away.
- Distinctly positive contributions of the **energy and core components** will turn anti-inflationary at the end of this year owing to appreciation of the koruna, coupled with slower growth in foreign producer prices. The currently elevated overall inflation pressures will therefore ease.
- **Domestic cost** pressures will strengthen temporarily in the quarters ahead owing to increased consumer demand and a recovery in wage growth supported by a further increase in the minimum wage.

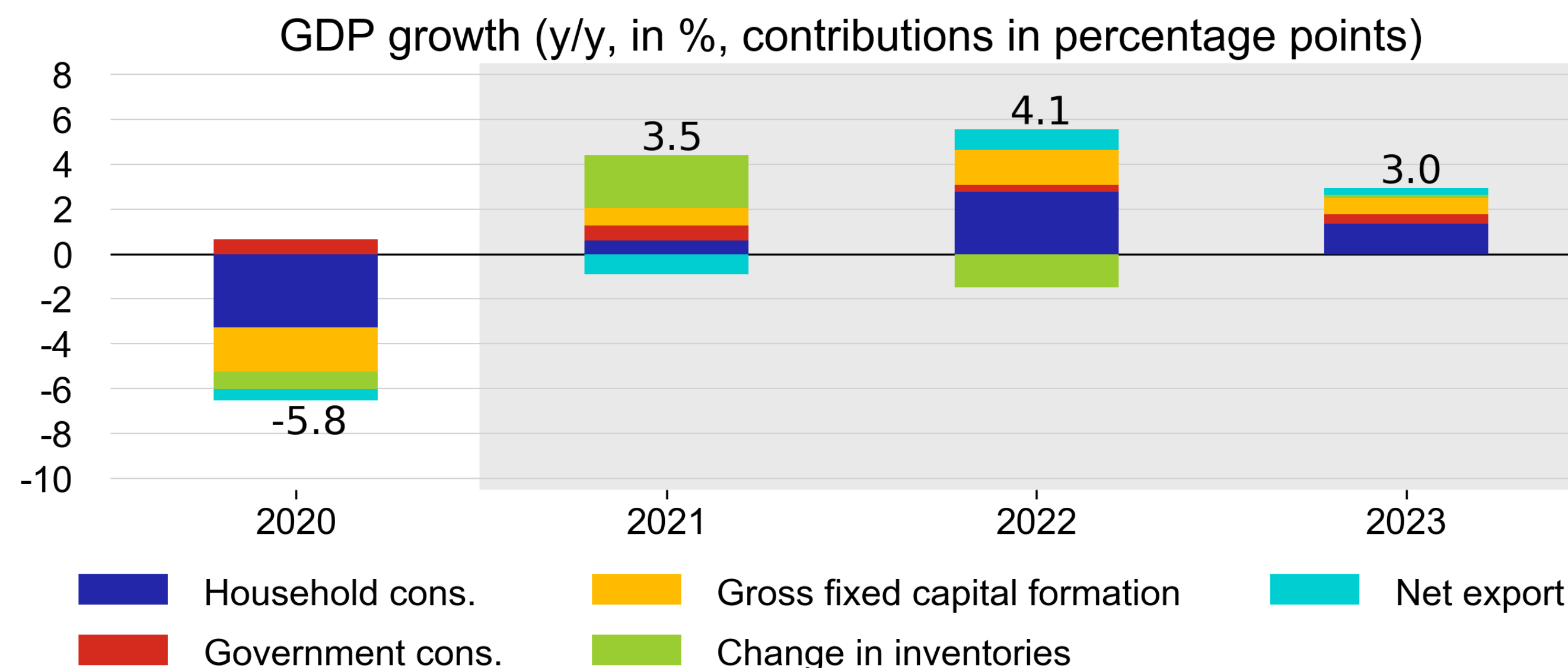
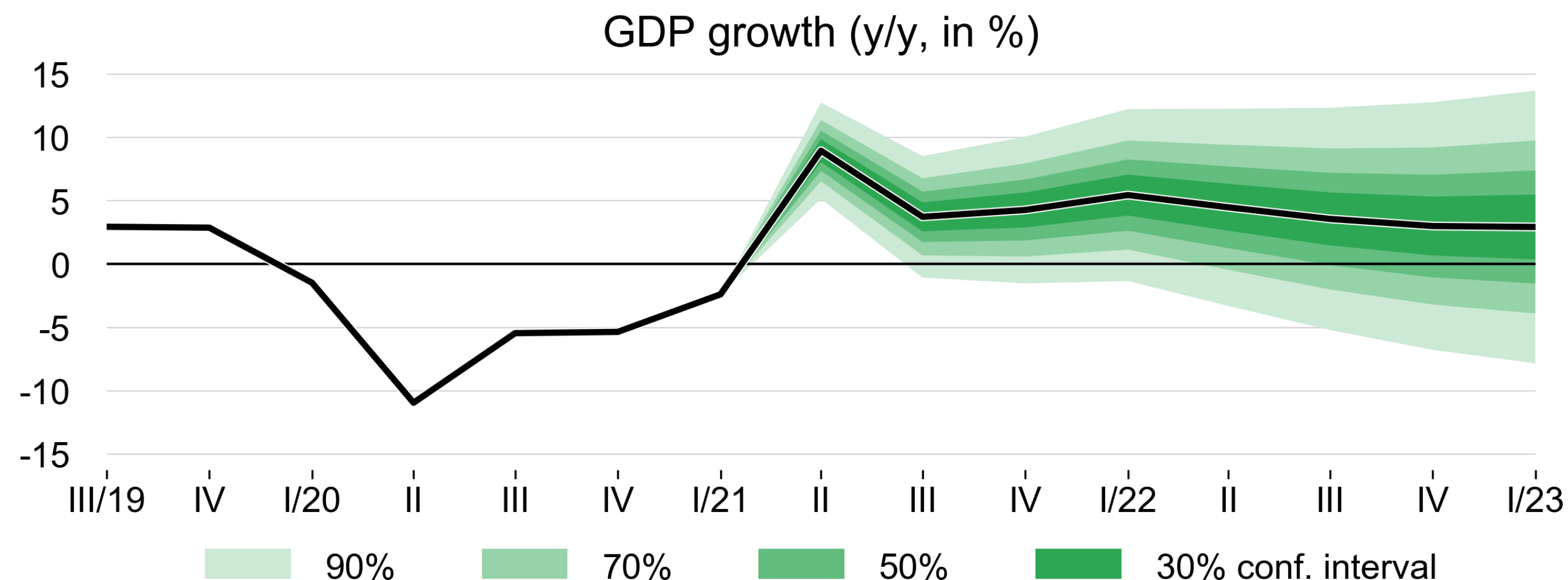
# Labour Market



- The **labour market** will see a turnaround in the second half of this year and will gradually overheat again.
- The decline in **employment** will subside at the end of the year, subsequent growth in overall employment will be driven mainly by a rising number of employees.
- The general **unemployment rate** will fall slightly for the rest of this year on the back of the reopening of the economy.
- **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** is expected to be rather muted on average.
- **Statistical effects** will cause wage growth in both sectors to fluctuate.

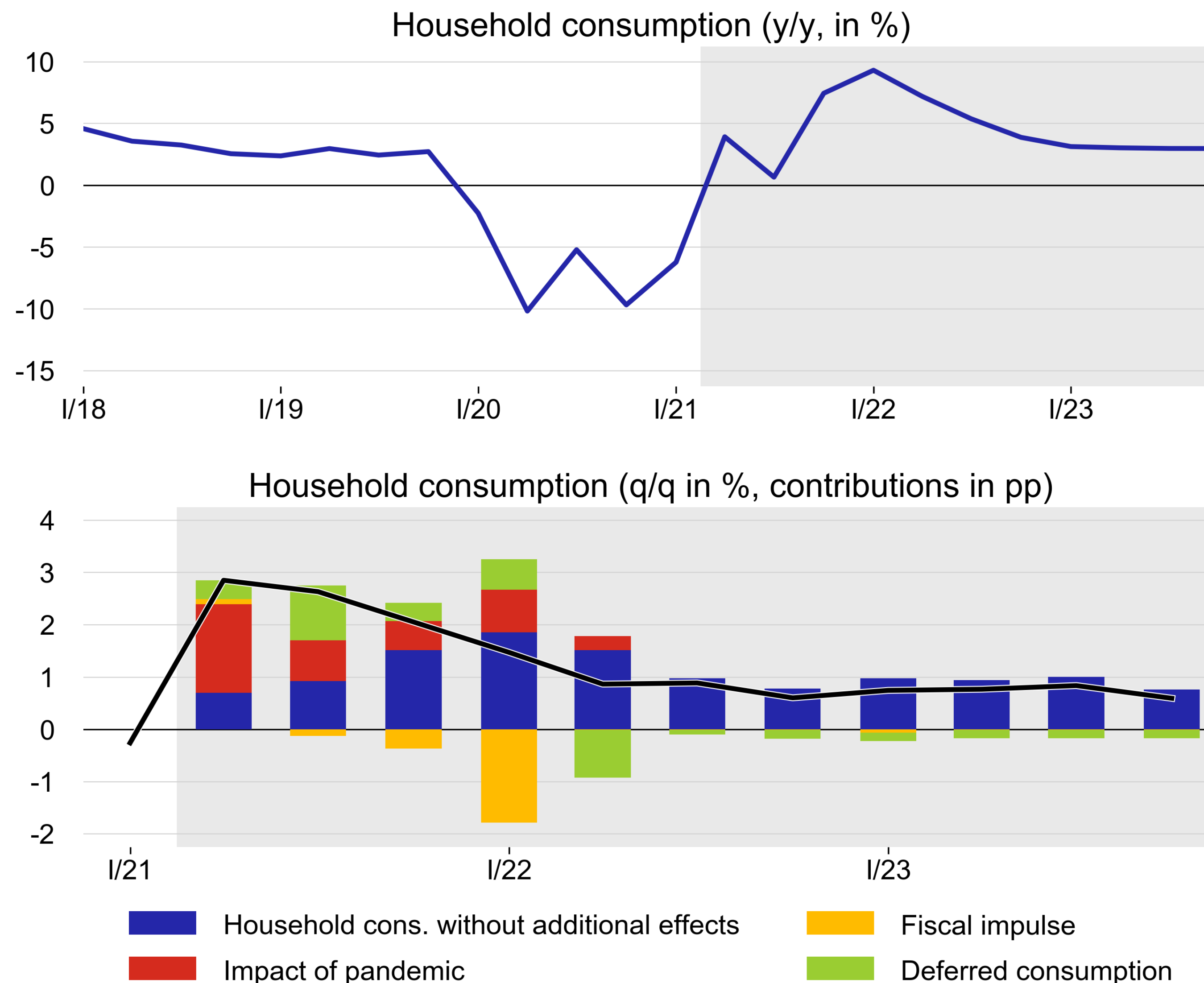


# GDP Growth Forecast



- Annual **GDP growth** will remain highly volatile. Owing to the reopening of the economy in Q2, growth will briefly leap to 9% according to the forecast. This is due mostly to the low base of last year, when a record plunge was recorded during the first wave of the pandemic. Subsequently, the economy will grow at a more stable rate overall.
- In whole-year terms, the Czech economy will grow by **3.5 %** this year. In 2022, GDP growth will exceed **4 %**.
- The current **overloading of production and supply chains**, which is hindering the production and export performance of Czech industry, will persist temporarily. This will also lead to building up of inventories.

# Household Consumption



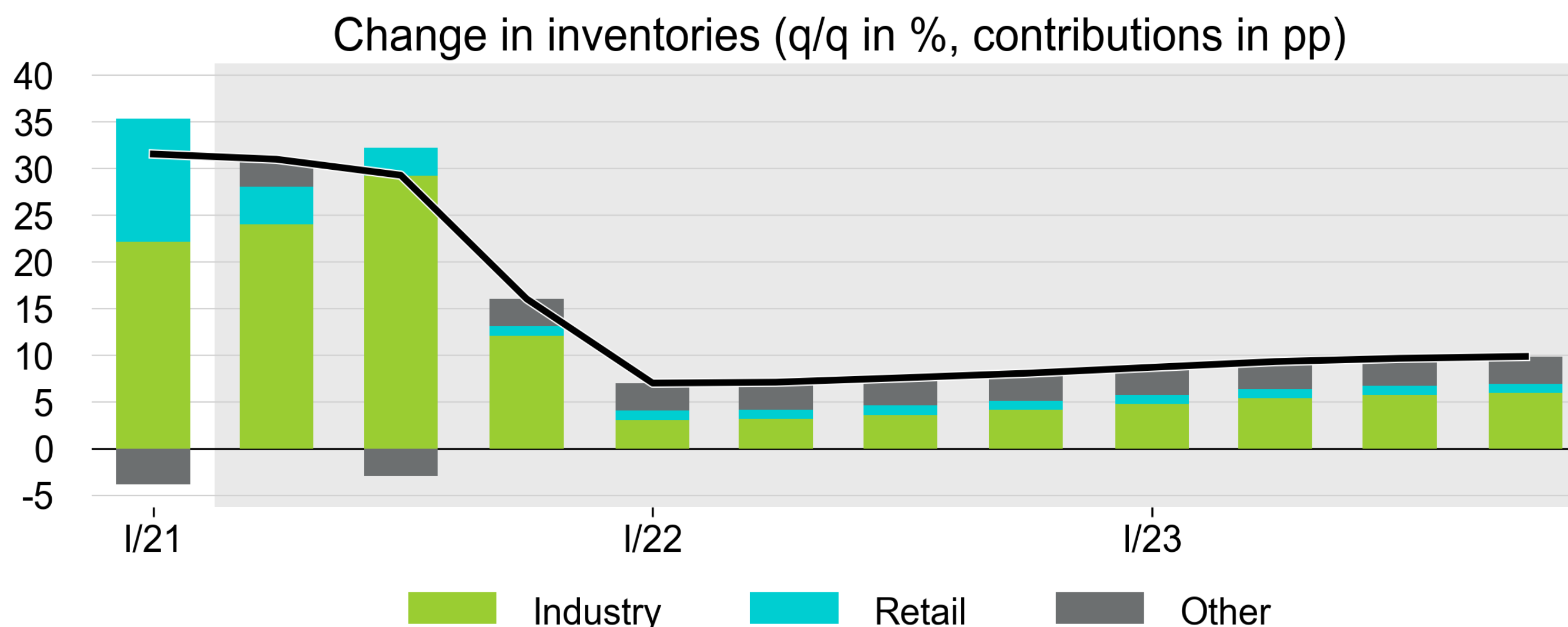
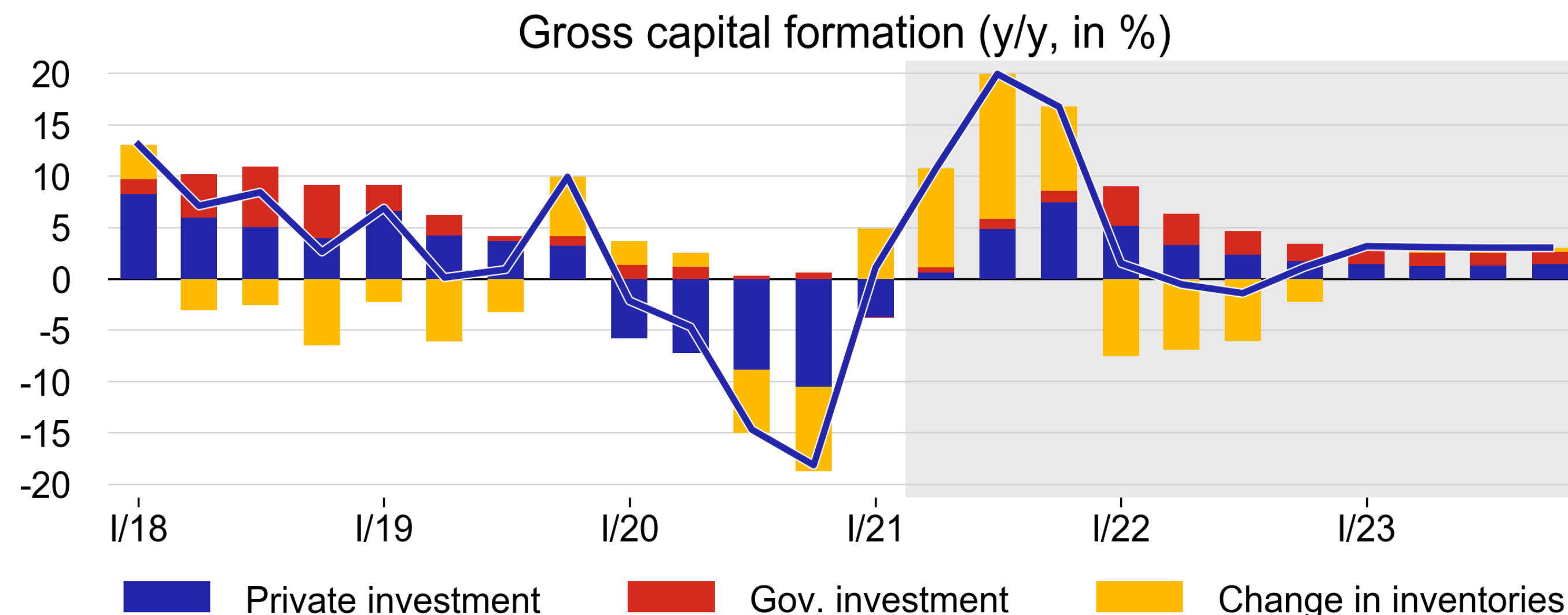
- **Household consumption** recovered after the spring easing and will start to rise quickly again this year.
- The **reopening of the economy due to the fade-out of the pandemic** will support growth in household consumption in the second half of the year. Household consumption will therefore become the main driver of the domestic economic recovery.
- It will be aided by spending of part of the forced savings created during lockdowns (**deferred consumption**).
- The termination of numerous **fiscal support measures** will have the opposite effect.
- Household consumption will reach its pre-pandemic level at the end of 2022.

# Gross Capital Formation

Levels

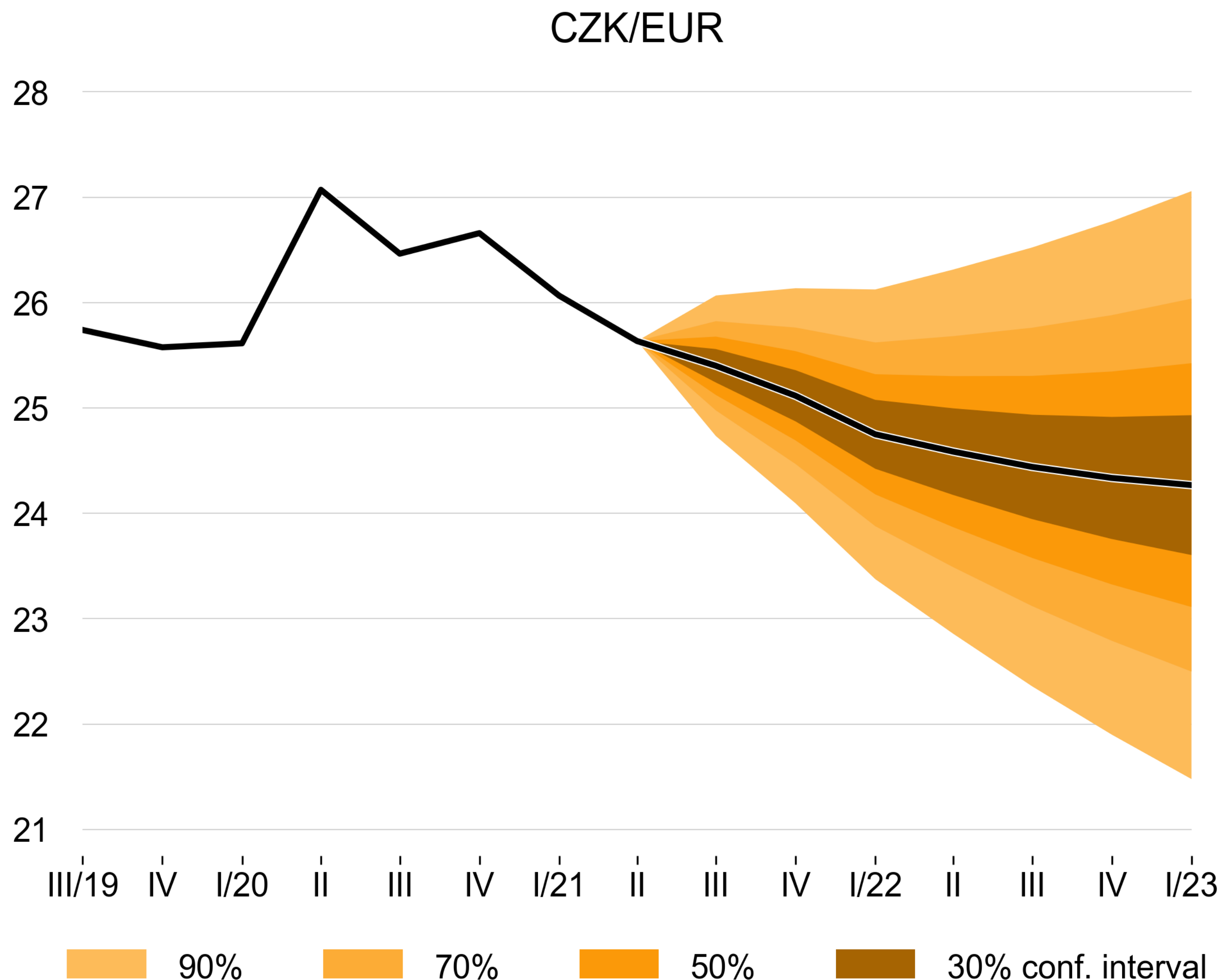
Other components

CNB CZECH NATIONAL BANK



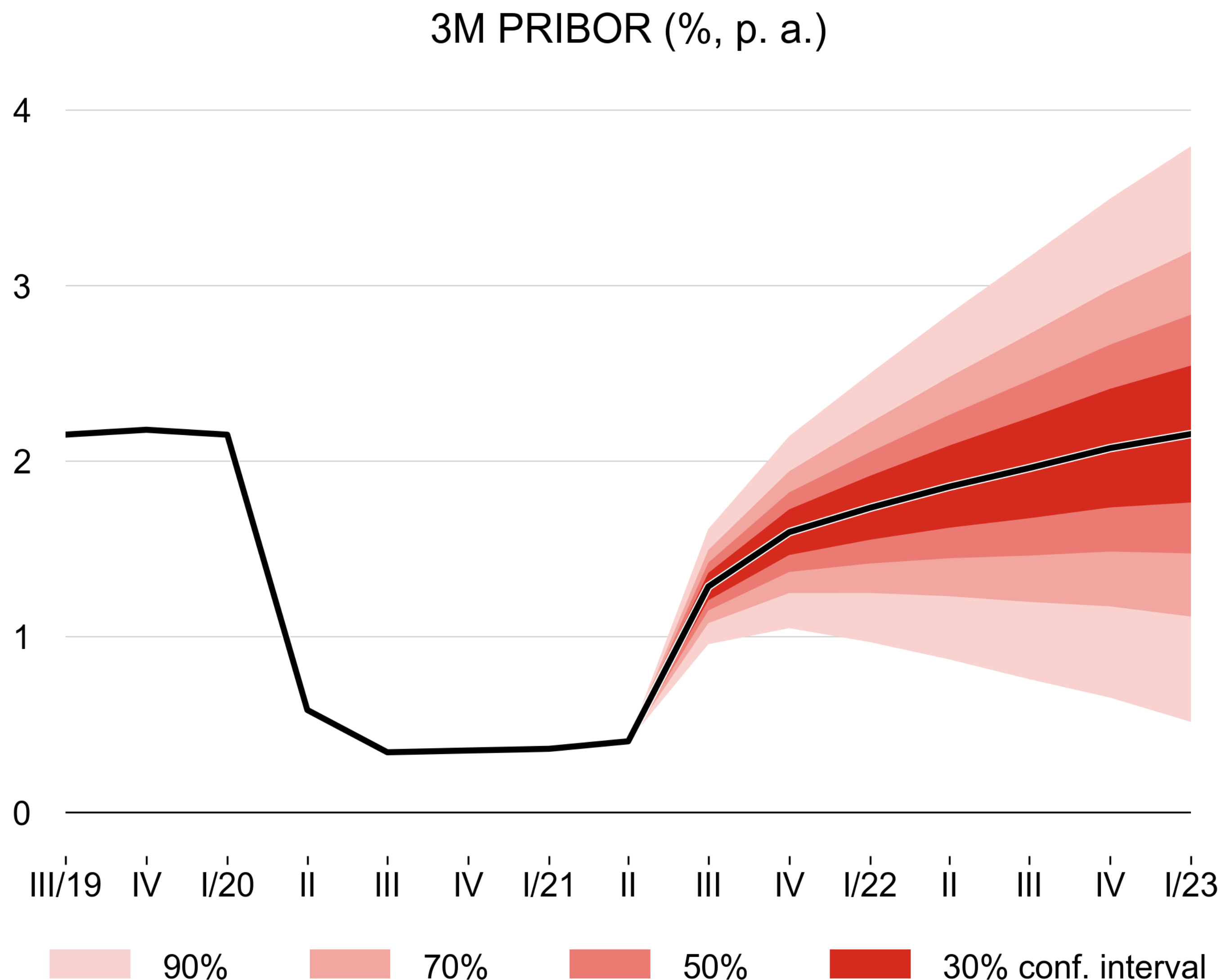
- **Investment activity** is recovering as the economy reopens, despite the issues in production and supply chains.
- **Fixed investment** will increase only slightly this year despite last year's low base, amid recovering year-on-year growth in **private investment** and continued growth in **government investment**.
- Growth in gross capital formation will additionally be supported this year by continued high additions to **inventories**.
- **Inventories in industry** are building up because of overloaded production and supply chains. In **retail**, by contrast, we assume high additions to inventories seen at the start of 2021 to be only temporary and will diminish as demand rises.

# Exchange Rate CZK/EUR



- The **koruna** will appreciate further.
- The exchange rate forecast for **2021 Q3** is set at **CZK 25.4 to the euro**. This reflects an improvement in economic fundamentals and positive sentiment in global markets.
- A recovery in aggregate demand, the export of as yet unfinished products, and an inflow of foreign capital due to improved sentiment will lead to continued appreciation of the koruna over the forecast horizon
- This will also be strongly 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 towards CZK 24 to the euro by the end of 2023.

# Interest Rate Path (3M PRIBOR)



- Consistent with the forecast is **a rise in market interest rates** from the middle of this year onwards.
- The Czech economy is facing increased price pressures from the foreign and domestic economies (recovering domestic demand, strengthening wage growth, buoyant growth in foreign producer prices).
- The fulfilment of the inflation target at the monetary policy horizon requires a monetary policy tightening and a gradual return of market interest rates to pre-pandemic levels.
- The initial sharp response of domestic interest rates will cause inflation to decline close to the 2% target in the course of 2022. The interest rate component of the monetary conditions will continue to tighten next year.

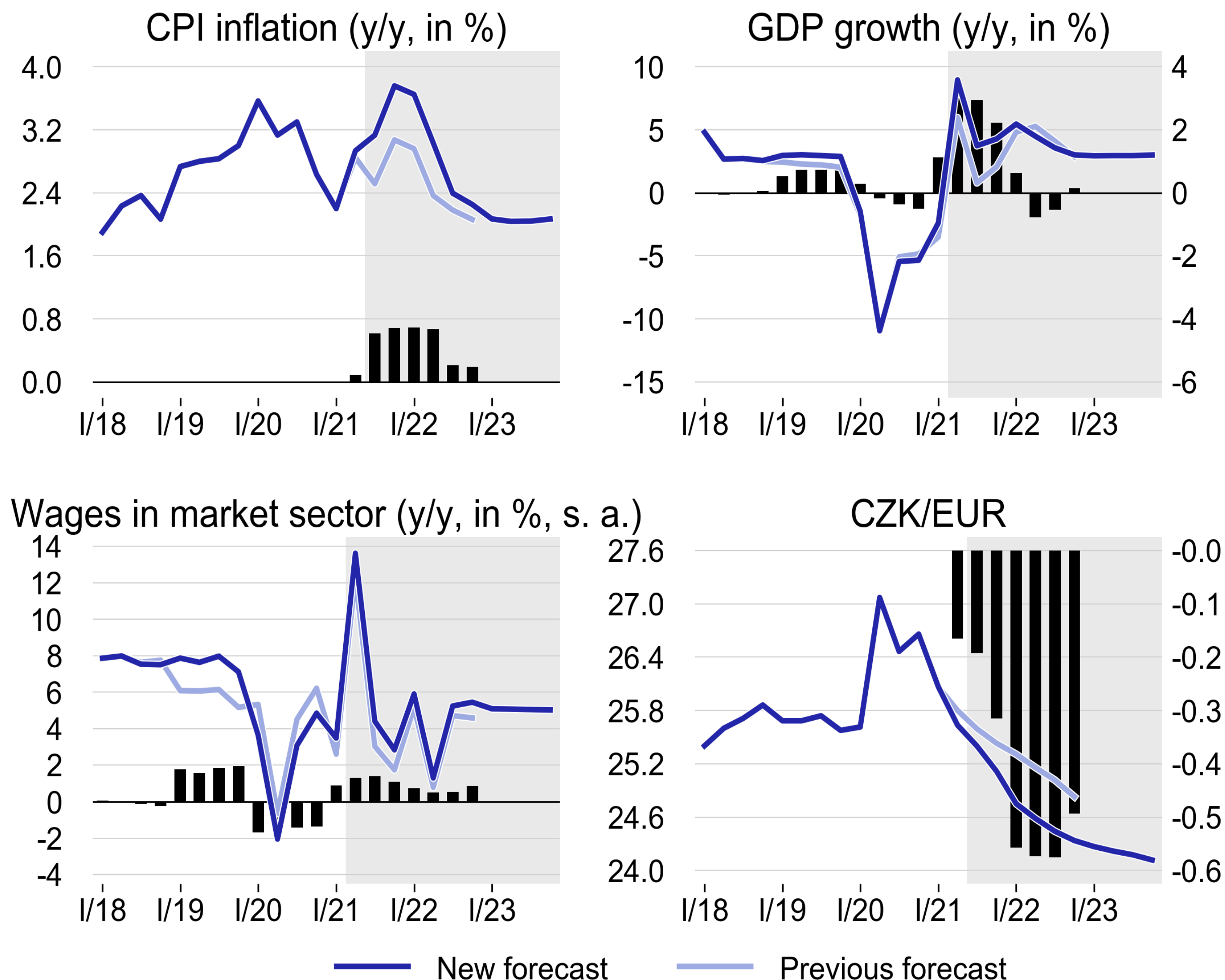
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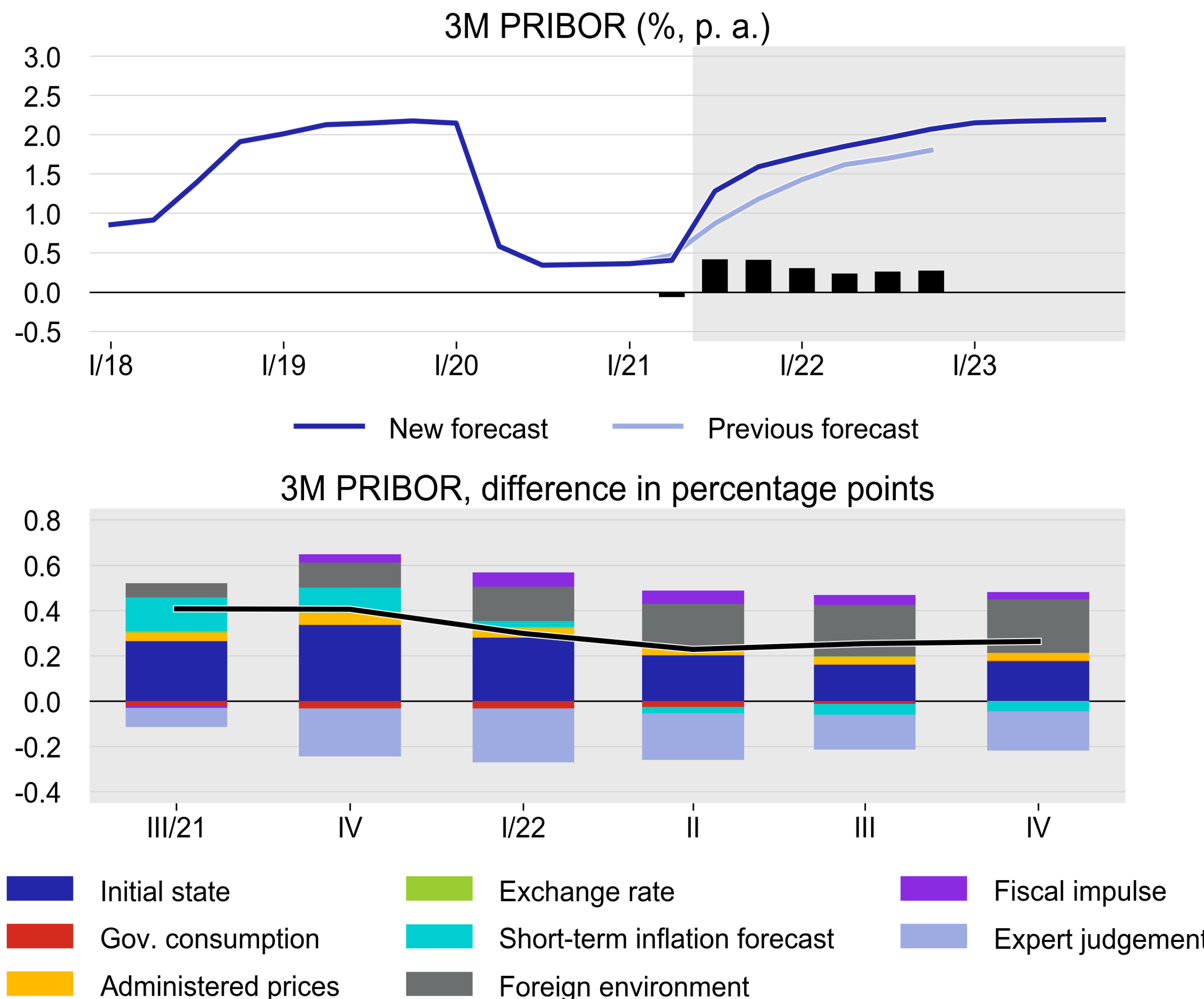


# Comparison with Previous Forecast



- The upward revision of the **inflation forecast** this year is due to all its components (except food) mainly due to a more substantial recovery in inflation abroad, higher growth in fuel prices and stronger domestic demand.
- The **GDP forecast** for this year has been revised significantly upwards due to earlier and more pronounced lifting of shutdowns and higher total investment.
- A better labour market situation and an expected increase in the minimum wage at the start of 2022 are reflected in higher **wage growth**.
- Initial faster appreciation of the **koruna** is fostered by greater competitiveness of Czech exporters. The stronger koruna is also due to a more strongly widening interest rate differential.

# Comparison: Interest Rate Forecast



- The interest rate path has shifted higher.
- The better performance of the domestic economy and stronger foreign price pressures in the first half of this year foster an increase in rates (**initial state**).
- The **short-term forecast for domestic inflation** and **the foreign outlook** (faster growth of foreign prices, somewhat less accommodative ECB monetary policy and a weaker euro against the dollar) also push interest rates up.
- The slightly higher interest rate path is also due to the **fiscal impulse** in 2022 mainly reflecting an increase in pensions.
- **Expert adjustments** foster lower interest rates and reflect the one-off nature of this summer's inflationary effects, which will not be repeated in the quarters ahead.

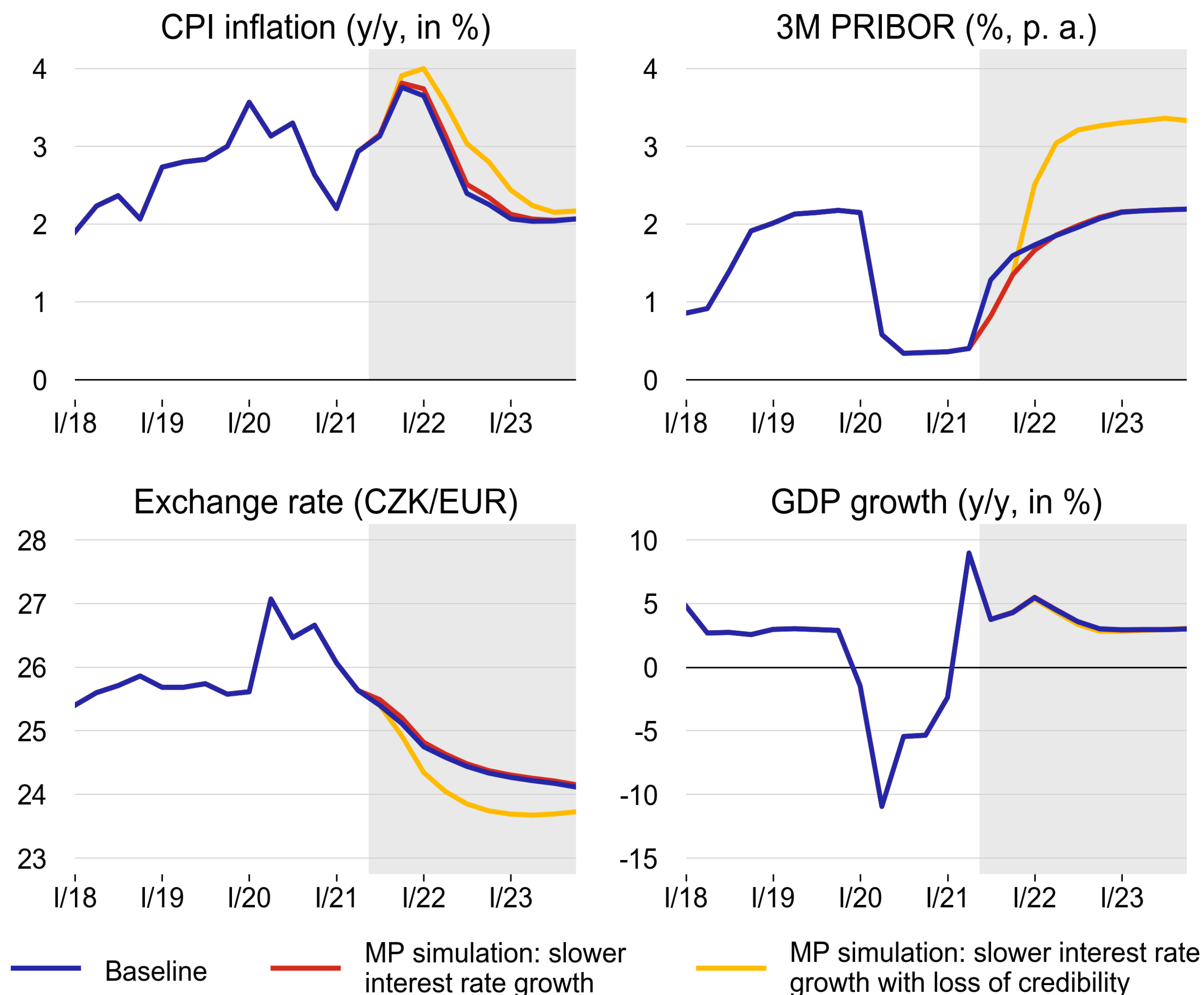
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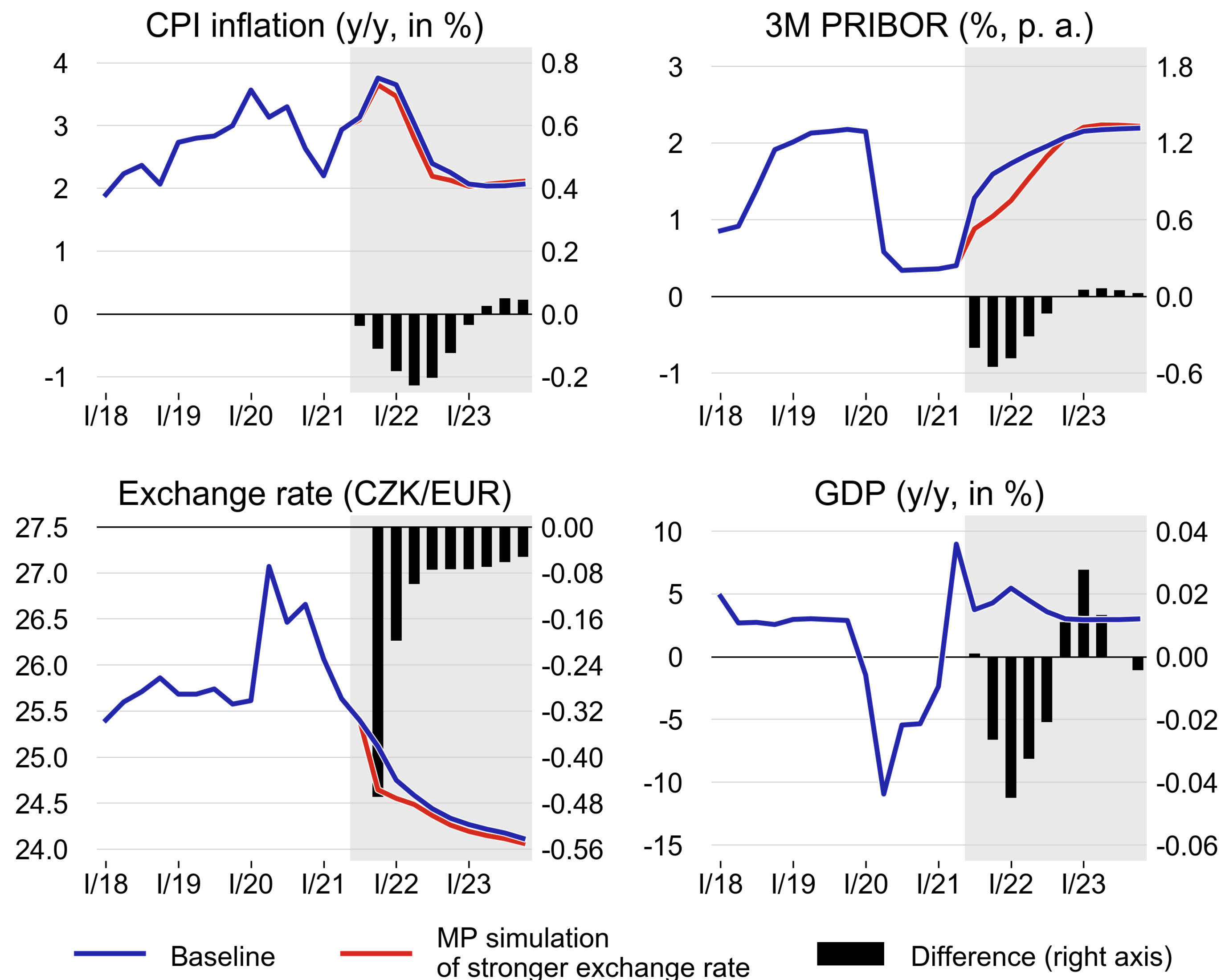


# MP Simulations: Slower Interest Rate Growth



- The two monetary policy simulations illustrate the situation of the central bank increasing interest rates by 0.25 pp at each monetary policy meeting in 2H 2021.
- The first simulation (the red line) describes the situation where **the central bank's lag behind the baseline rate path will not jeopardise its credibility to fulfil the inflation target**. The simulation results only in slightly higher inflation as the interest rate path deviation from the baseline is only temporary and inflation expectations are well-anchored.
- The second simulation (the yellow line) assumes that **the central bank's target loses credibility**. The deviation of the perceived inflation target from 2% creates gradually mounting additional price pressures in the economy leading to appropriate MP tightening at the start of 2022.

# MP Simulation: Stronger Exchange Rate



- The **simulation of a stronger koruna** assumes that the koruna appreciates more strongly in Q4 than in the baseline scenario due to a larger inflow of capital onto the financial account resulting from a marked improvement in financial market sentiment.
- The expected stronger appreciation causes lower growth in import prices, which leads to somewhat lower inflation.
- Given the tighter monetary conditions in the exchange rate component, slower growth in interest rates than in the baseline is consistent with stabilisation of inflation close to the target at the monetary policy horizon.

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Thank you for your attention



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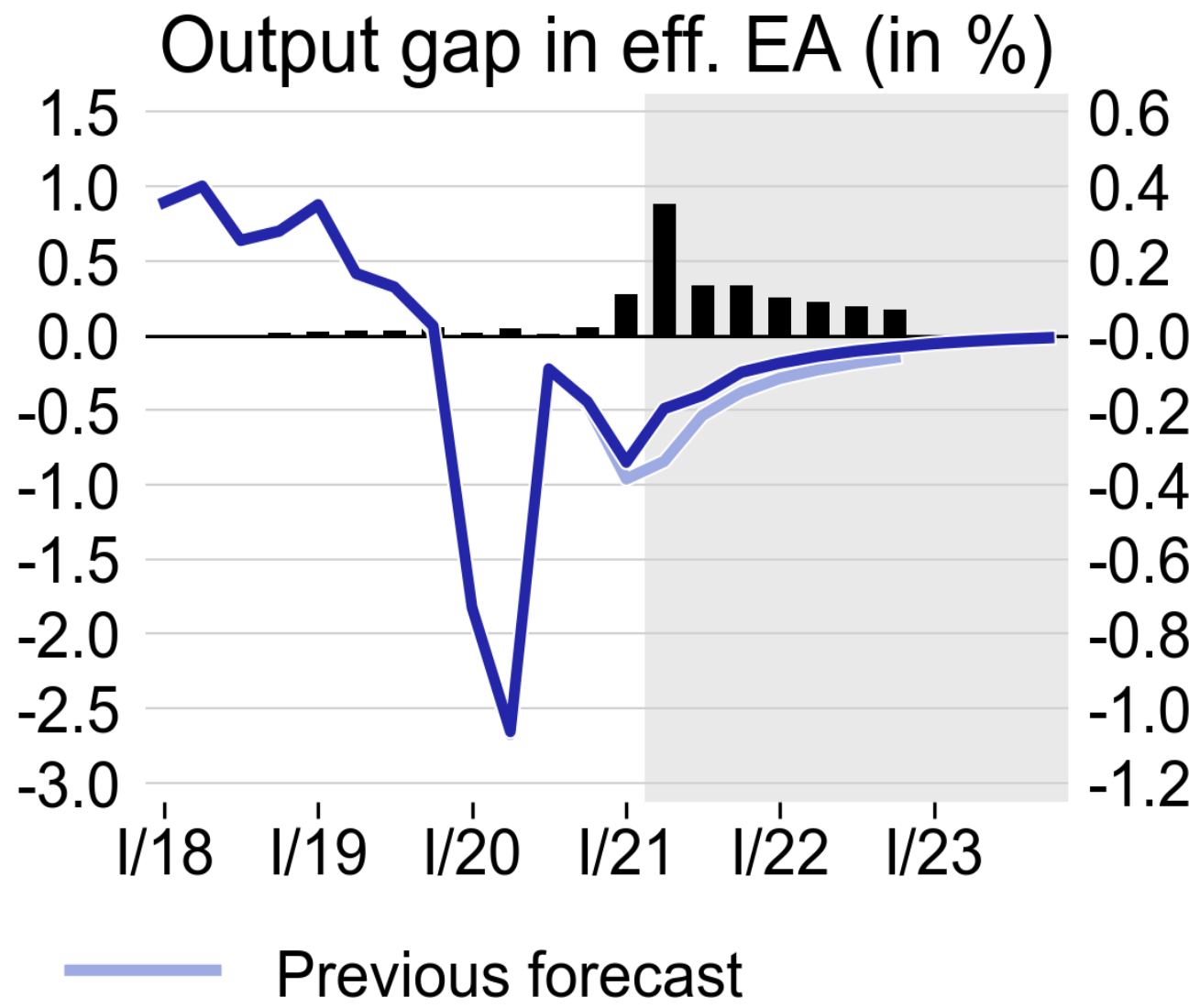
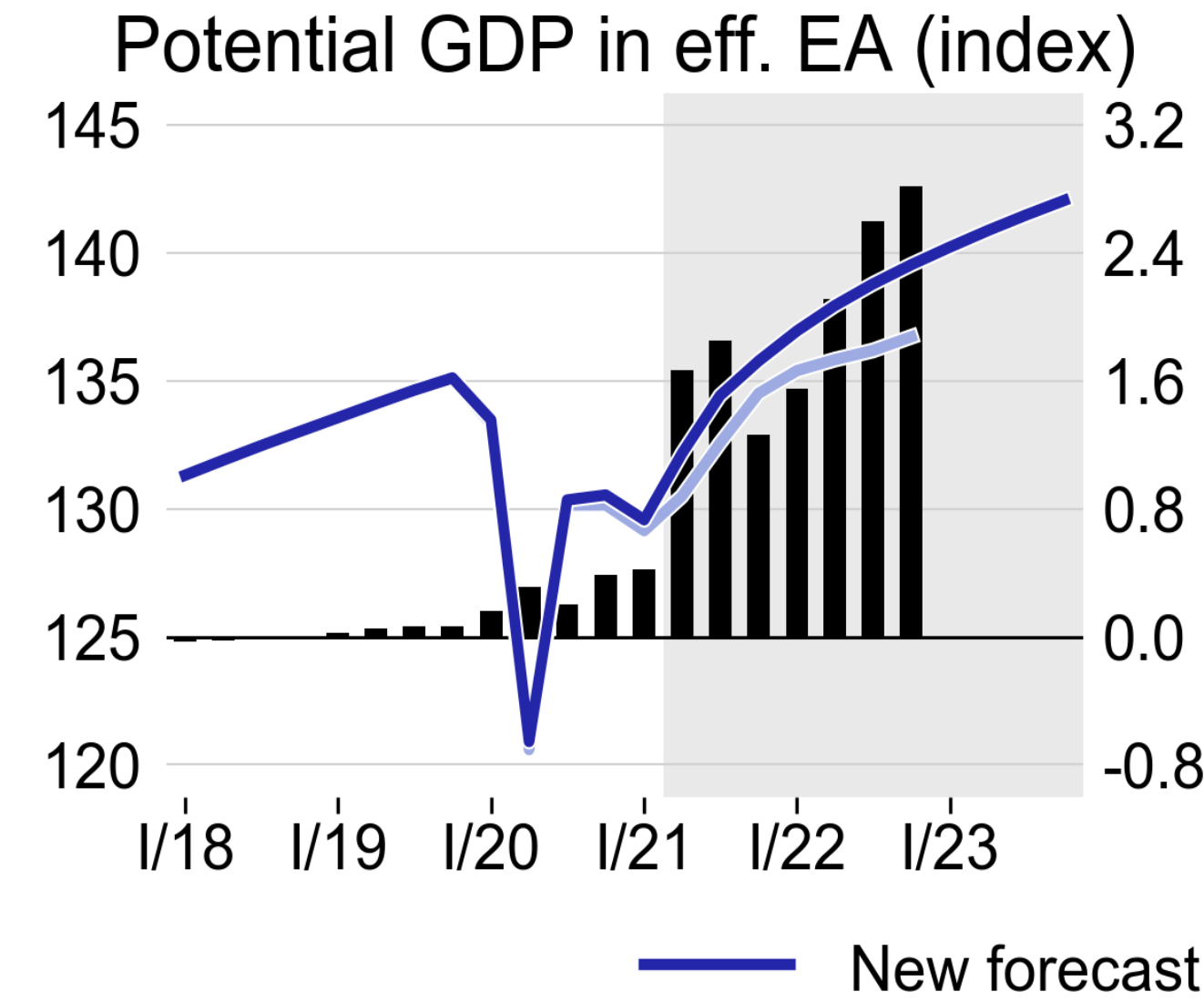
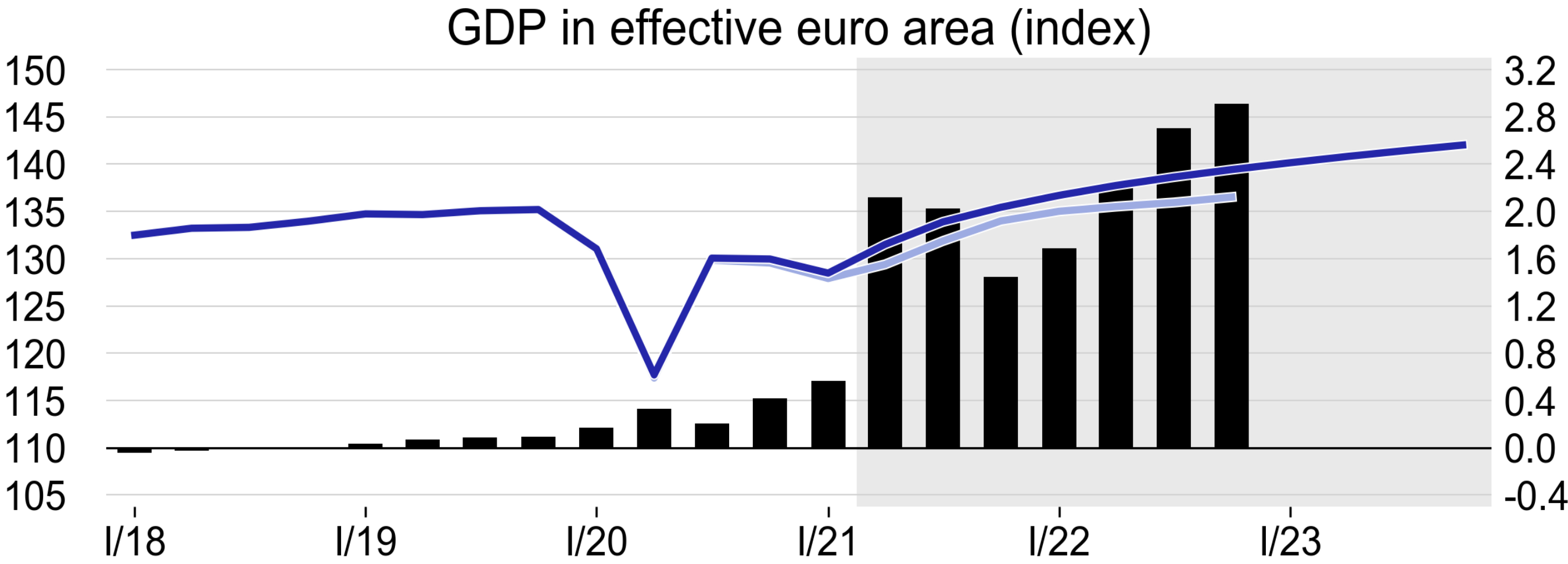


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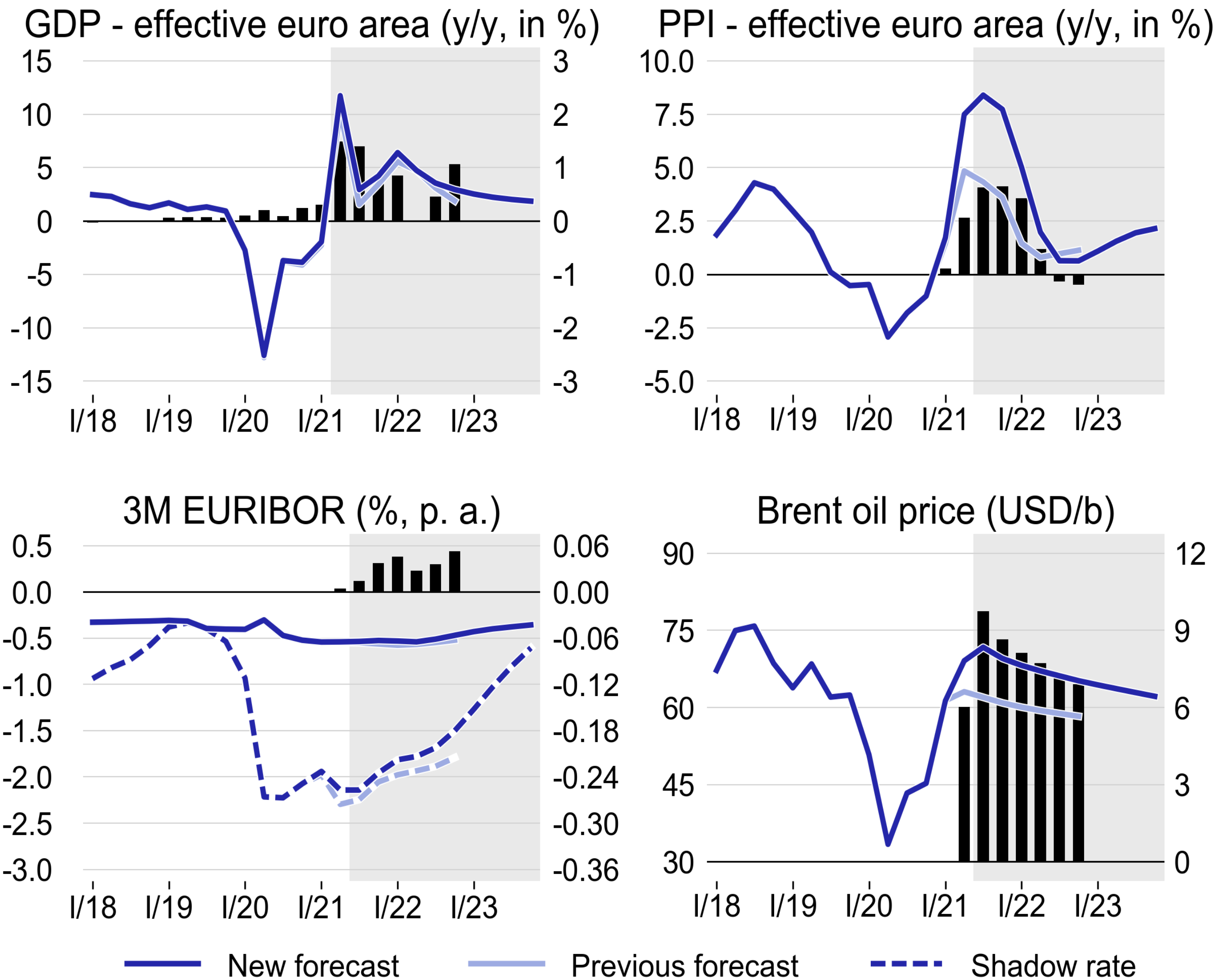
# Backup



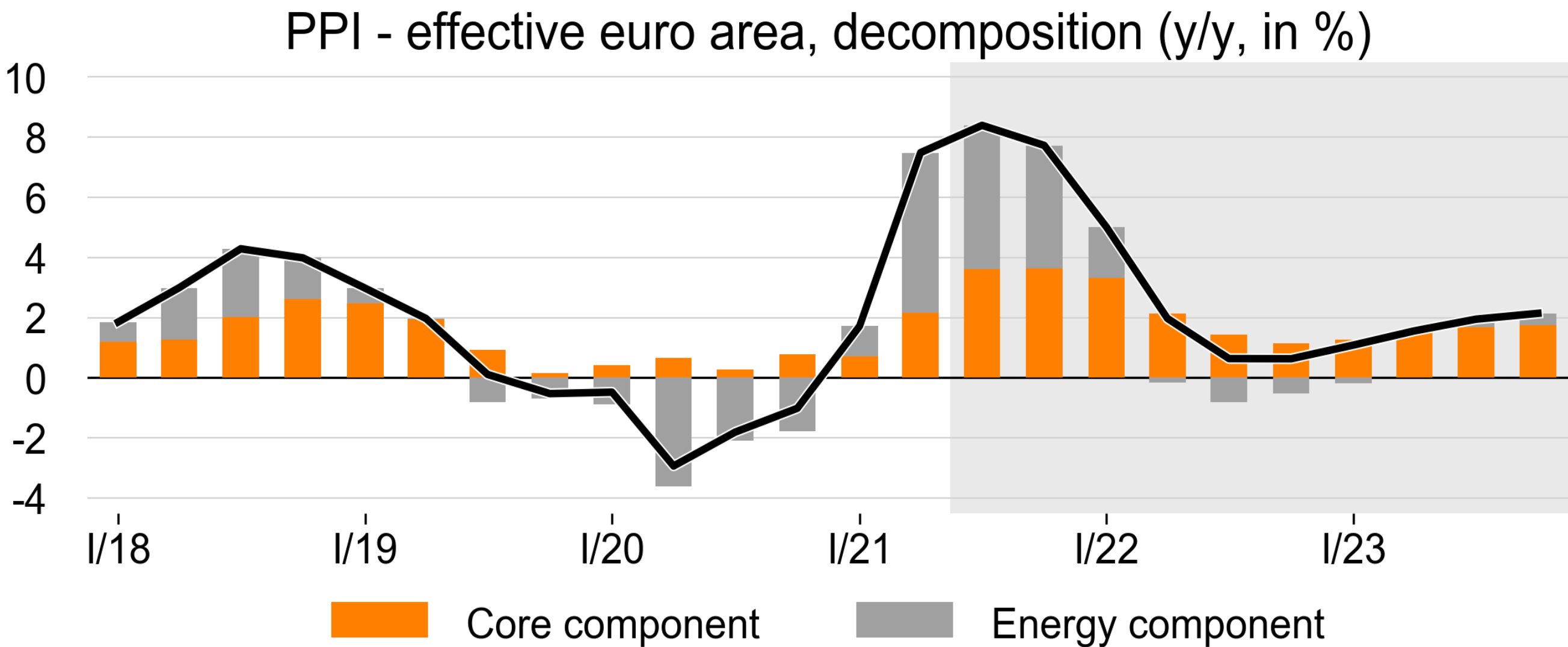
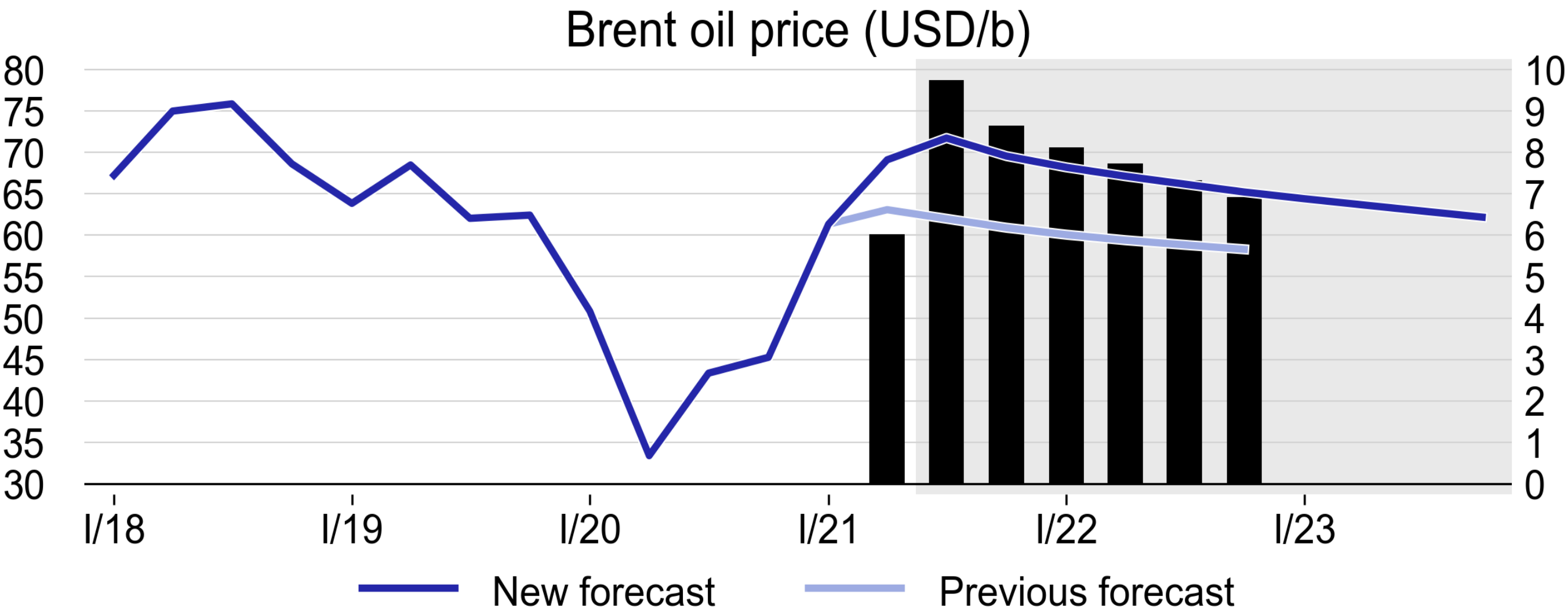
# GDP in Effective Euro Area: Comparison



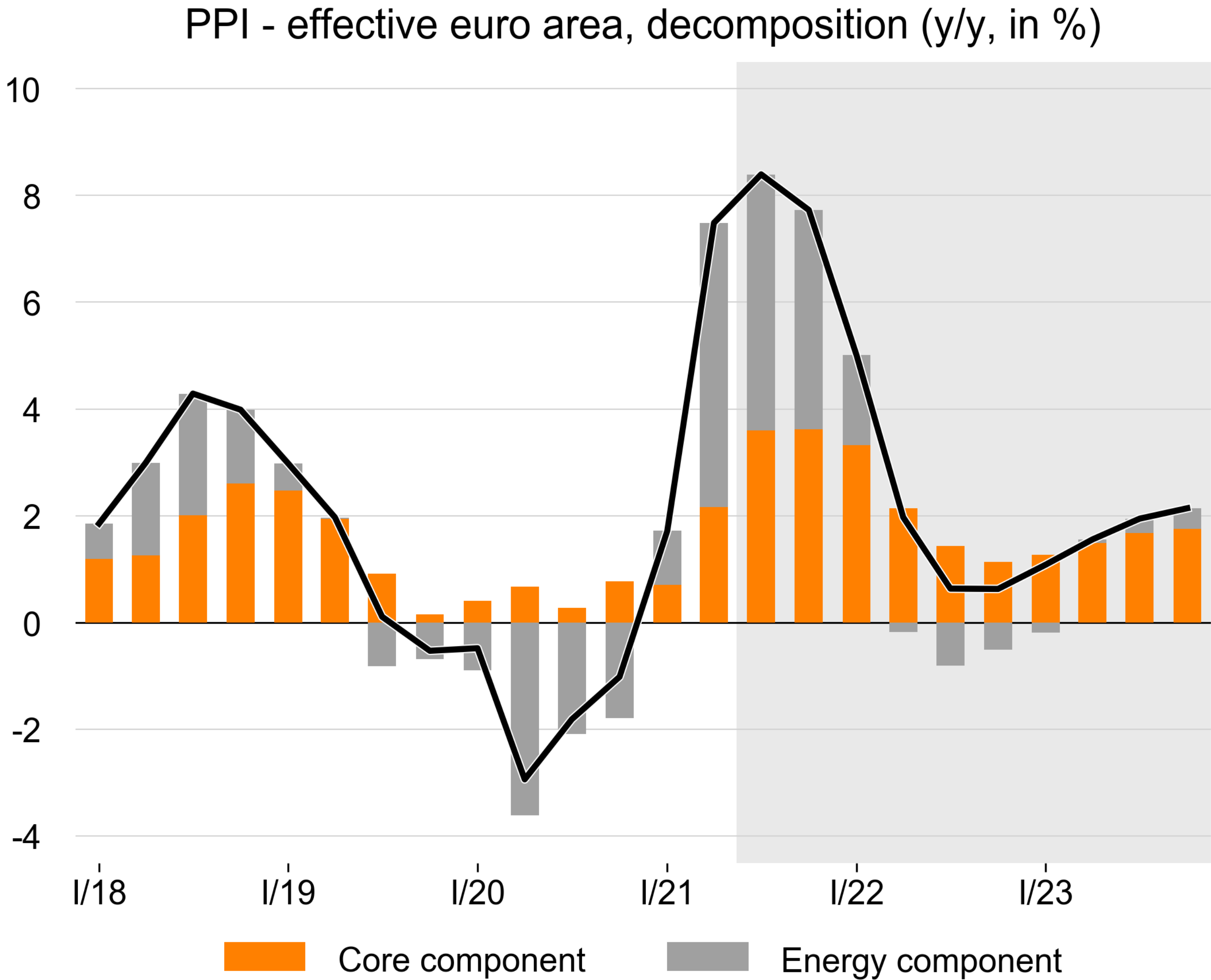
# Foreign Outlook: Comparison



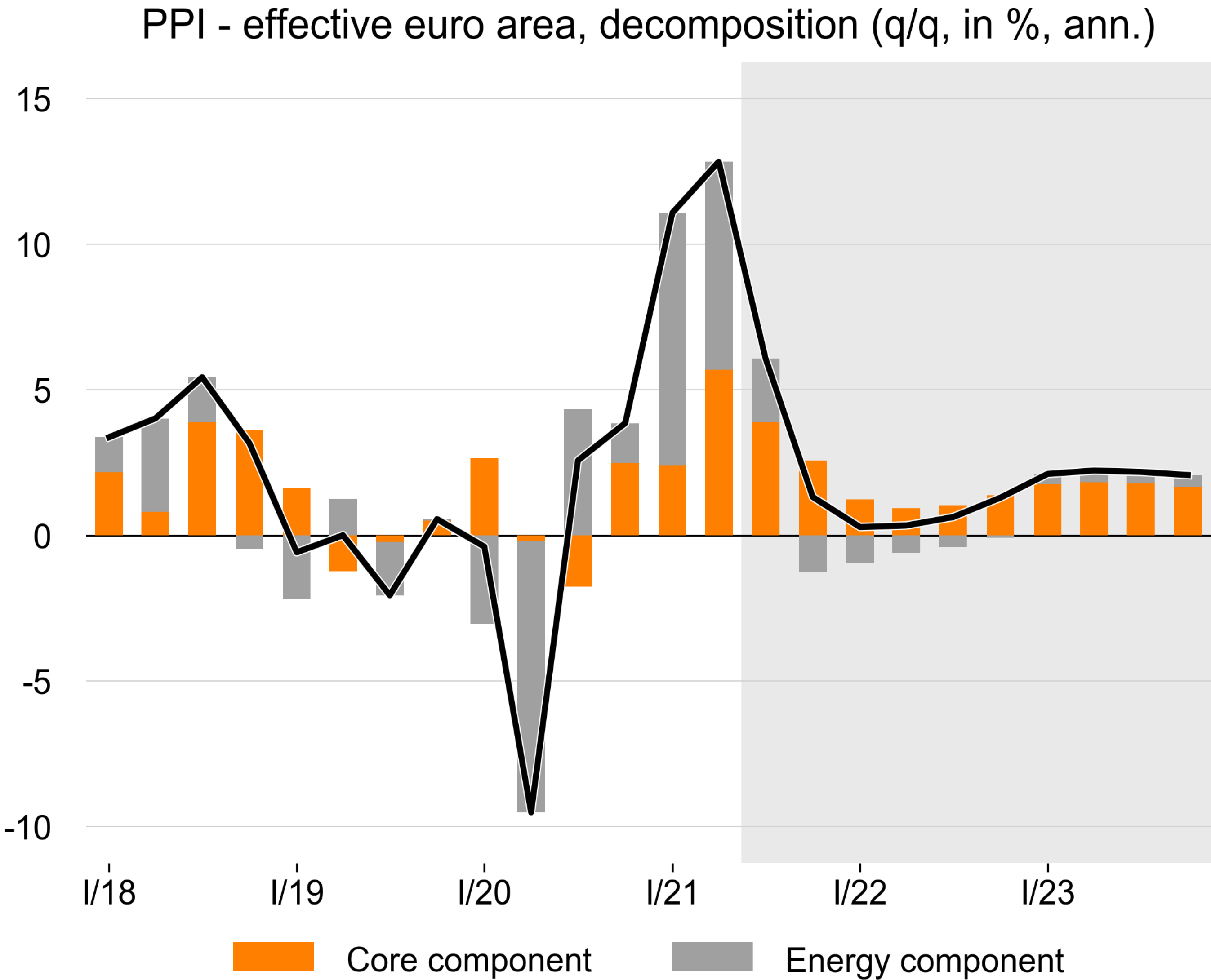
# PPI in Effective Euro Area: Decomposition



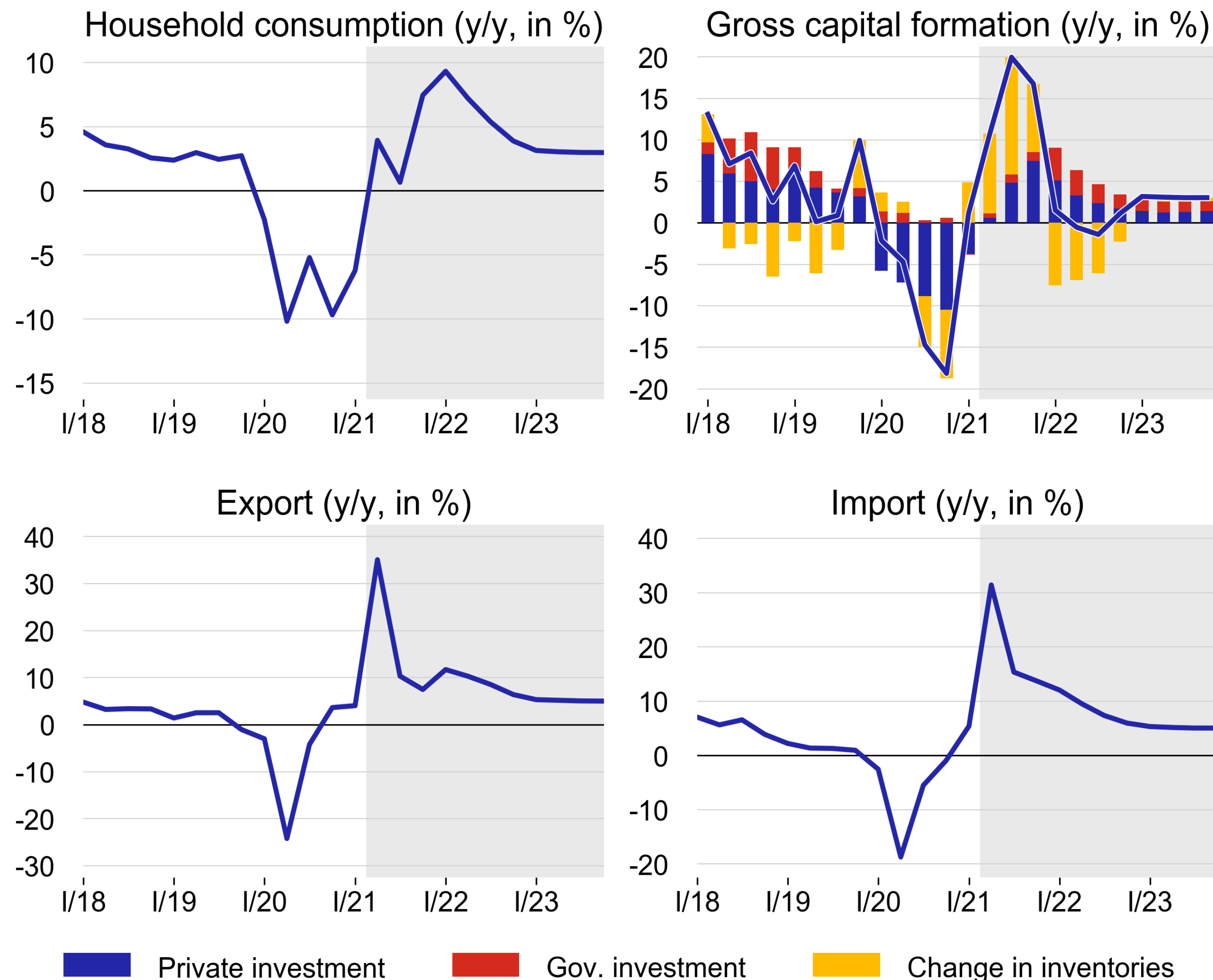
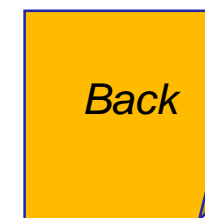
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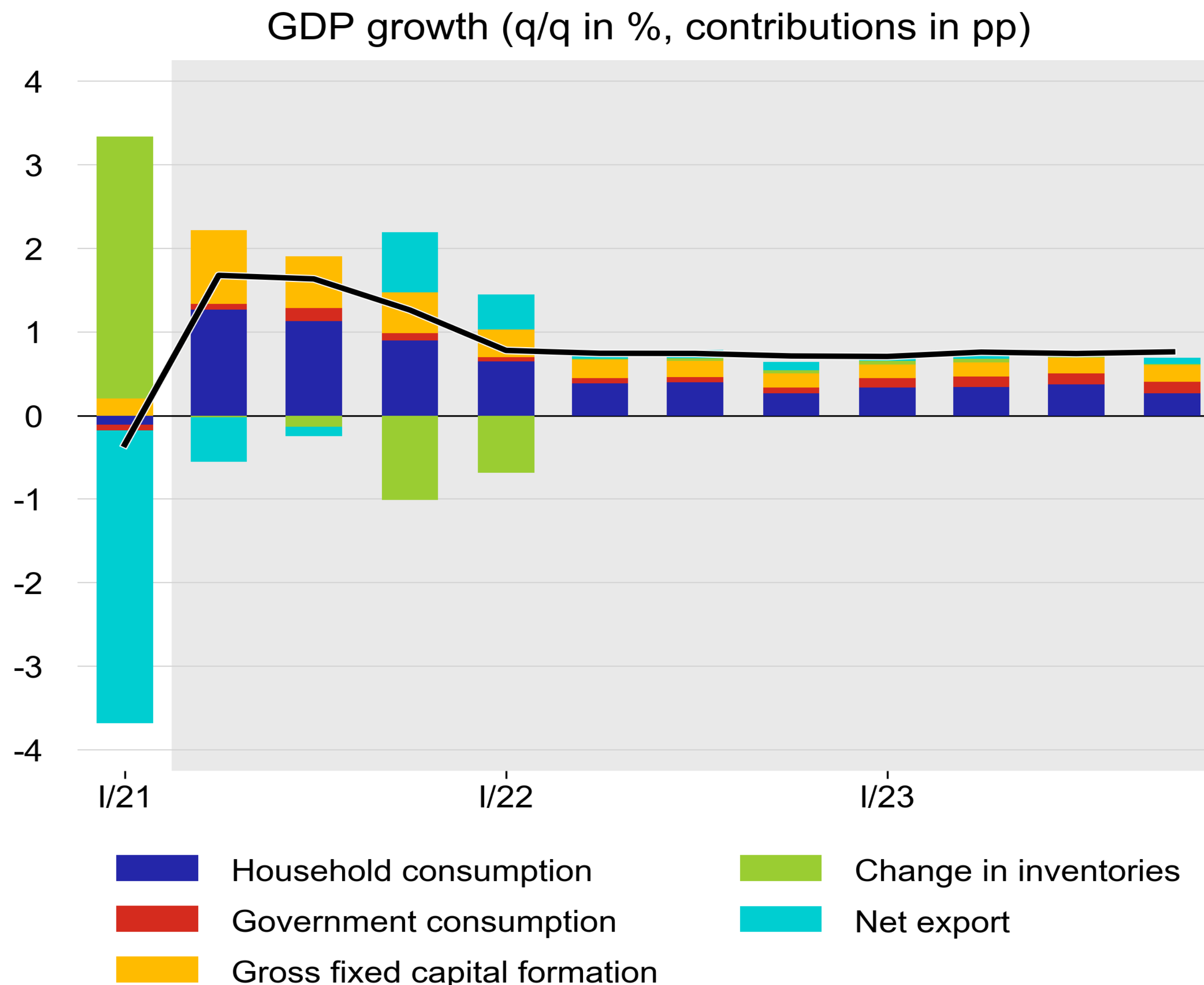


# Aggregate Demand Components



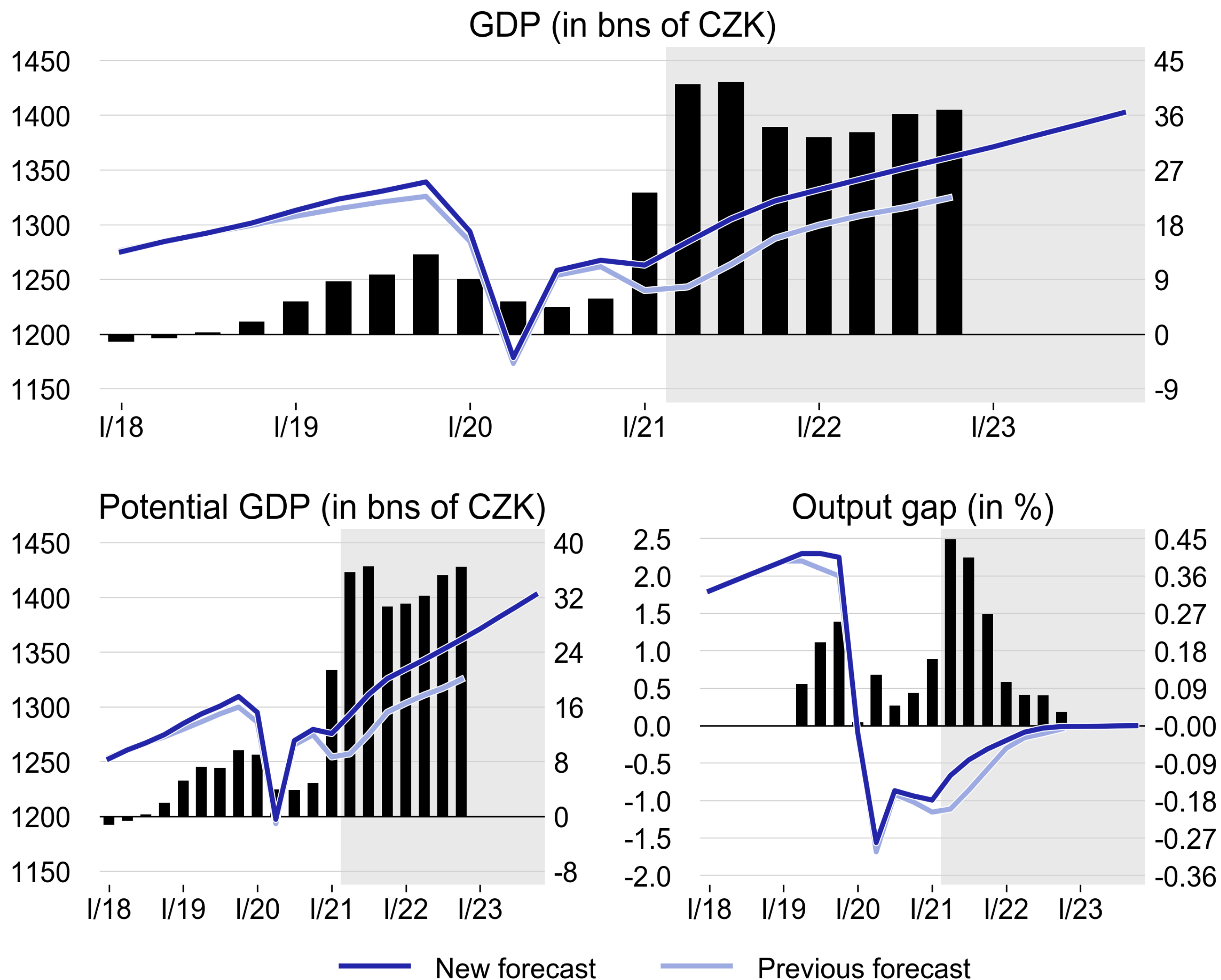
- **Household consumption** will start to rise quickly again this year. In addition to the lifting of pandemic measures, the recovery in household consumption growth will be due to the release of part of forced savings.
- Inventories will contribute to strong growth in total investment this year but will dampen growth in **gross capital formation** next year.
- **Exports** will reflect the growth and subsequent release of inventories this year, while **import** growth will also be driven by the easing of domestic shutdowns.

# GDP Growth (QoQ)



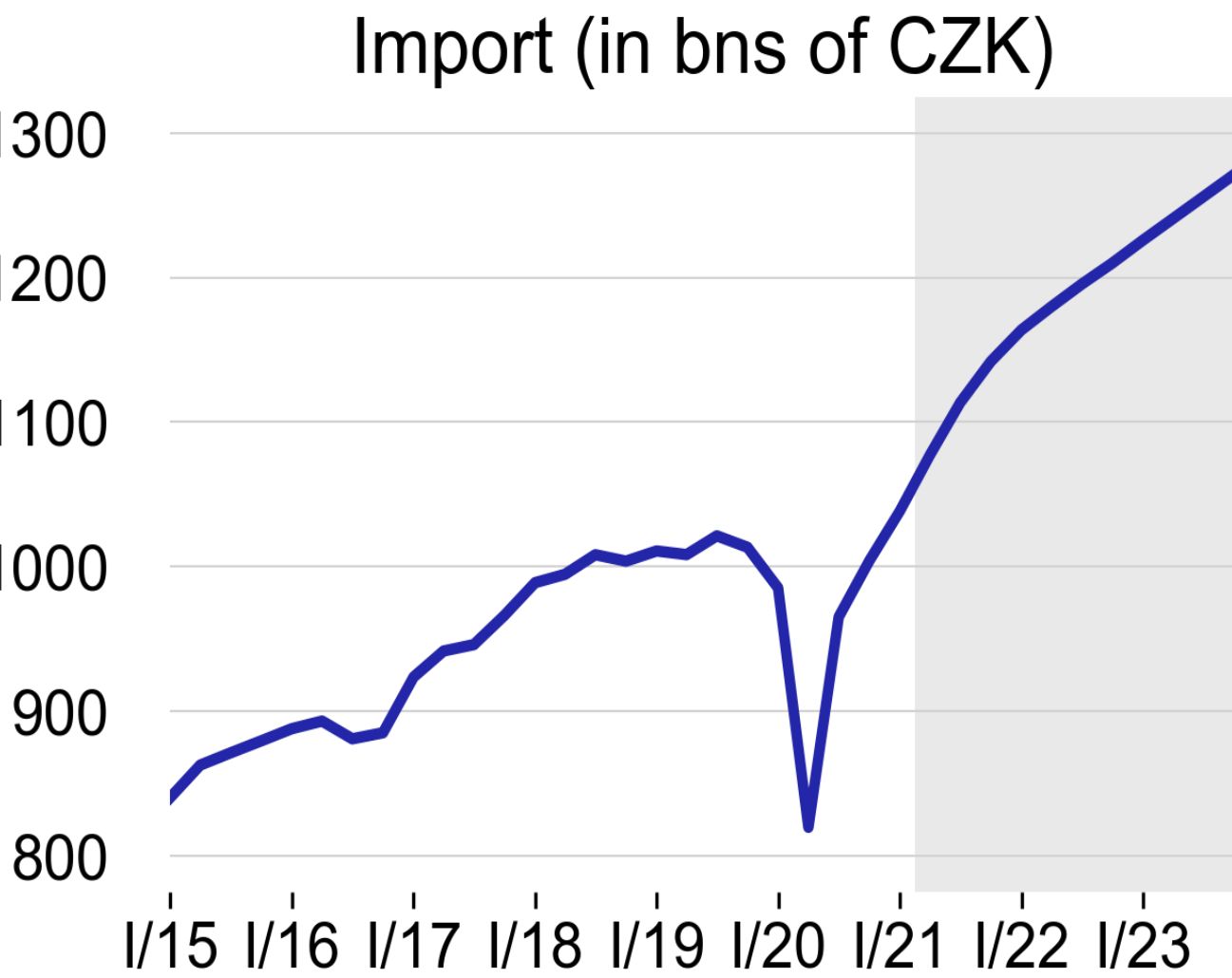
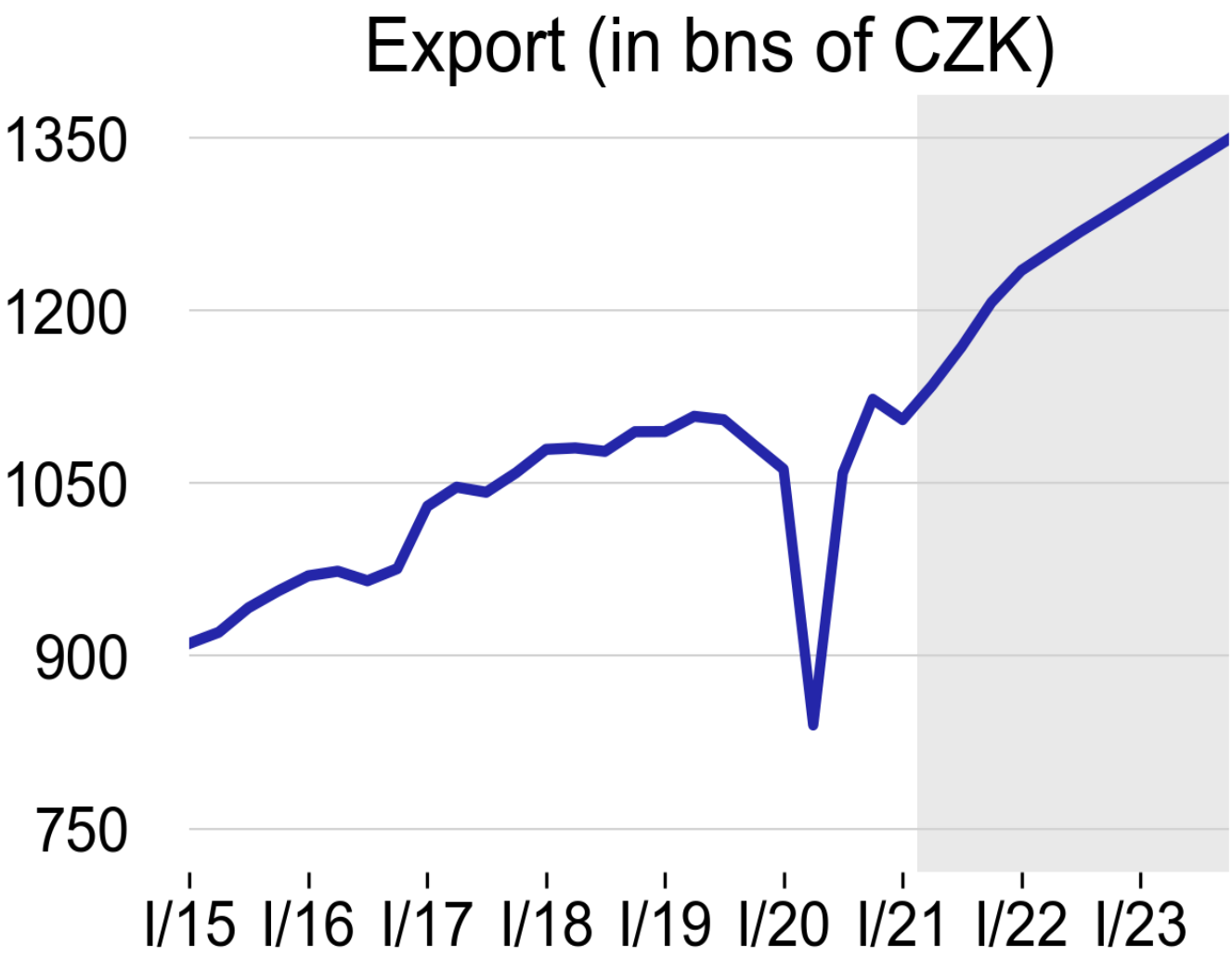
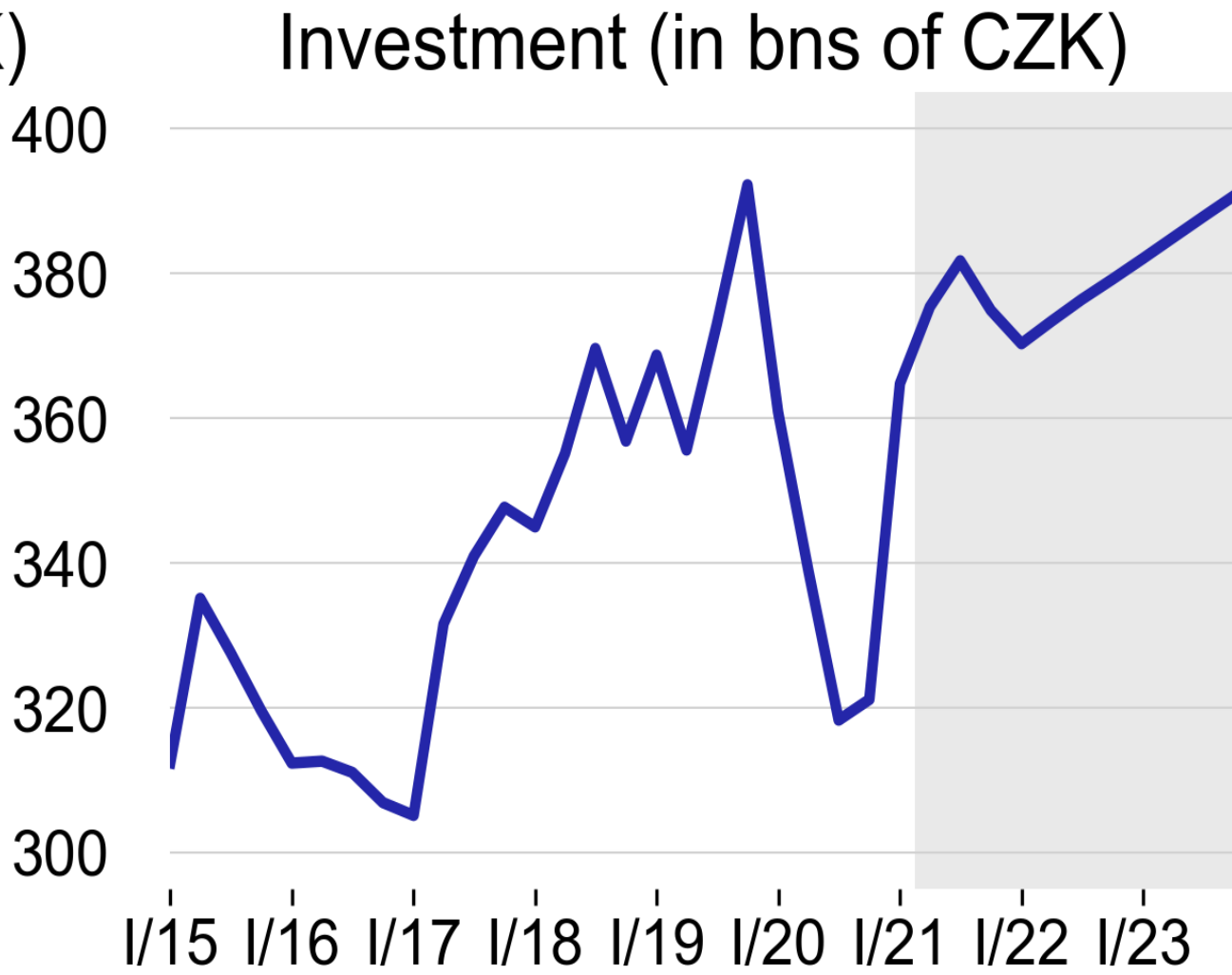
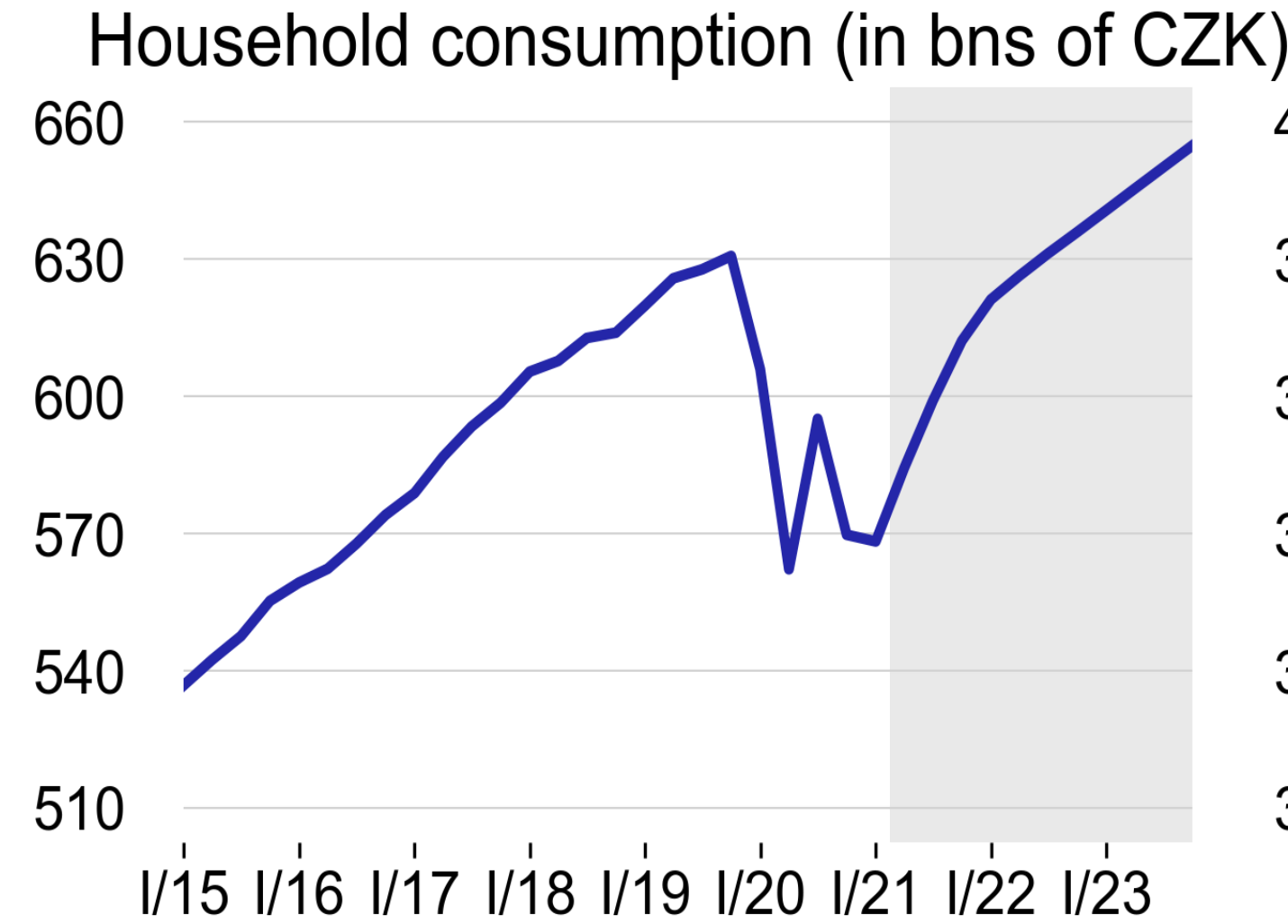
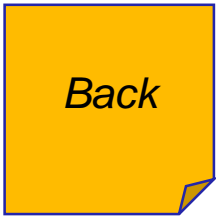
- Shortages of parts and forced stockpiling of unfinished production will initially be reflected in slower export growth, which, however, will later accelerate.
- We expect a large part of the supply chain issues to fade out in Q4. This will lead to fast finalisation of unfinished production and a temporary increase in quarterly export growth.
- Among other things, this will help to diminish inventories in industry at the turn of this year and the next.

# Domestic GDP: Comparison

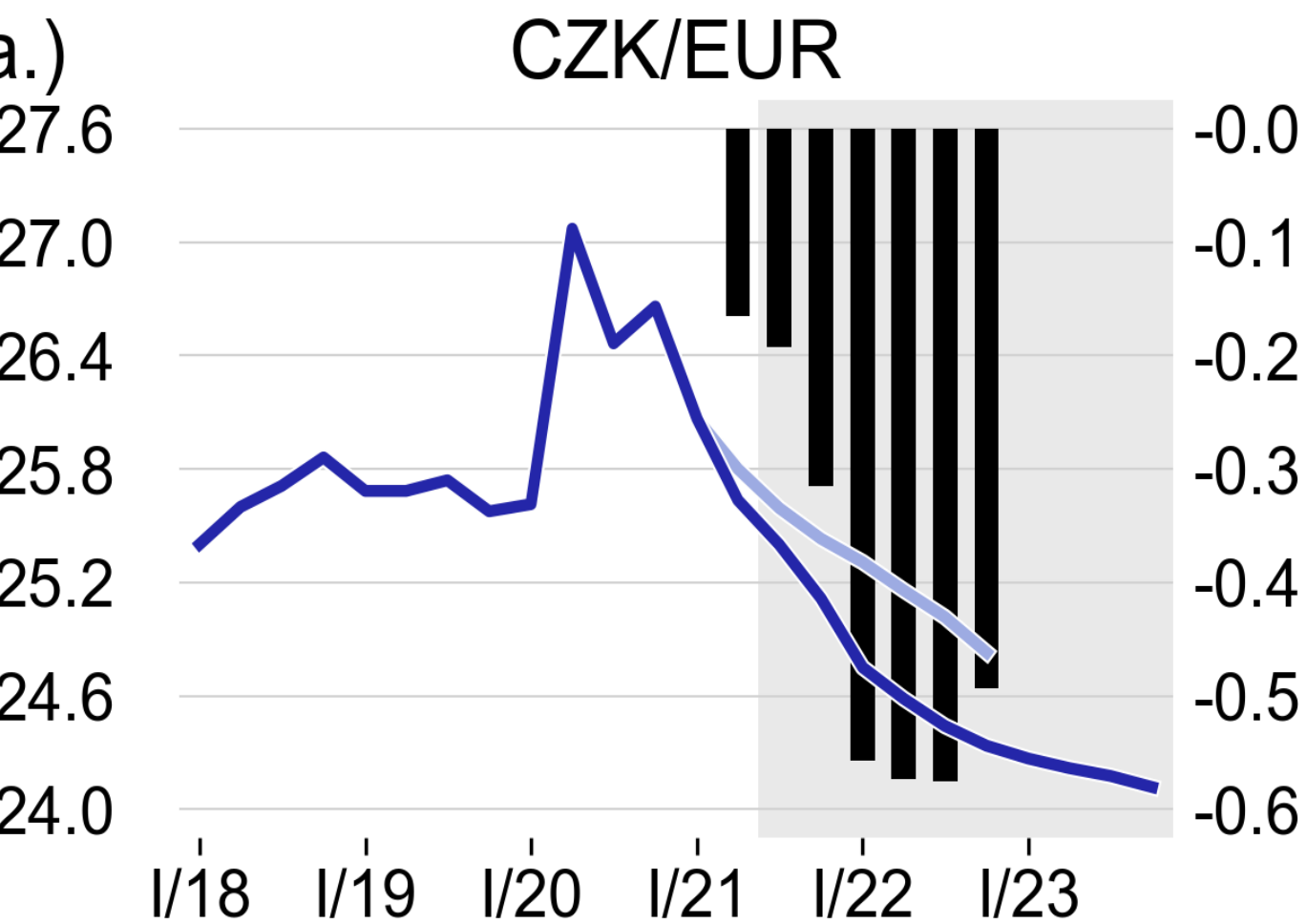
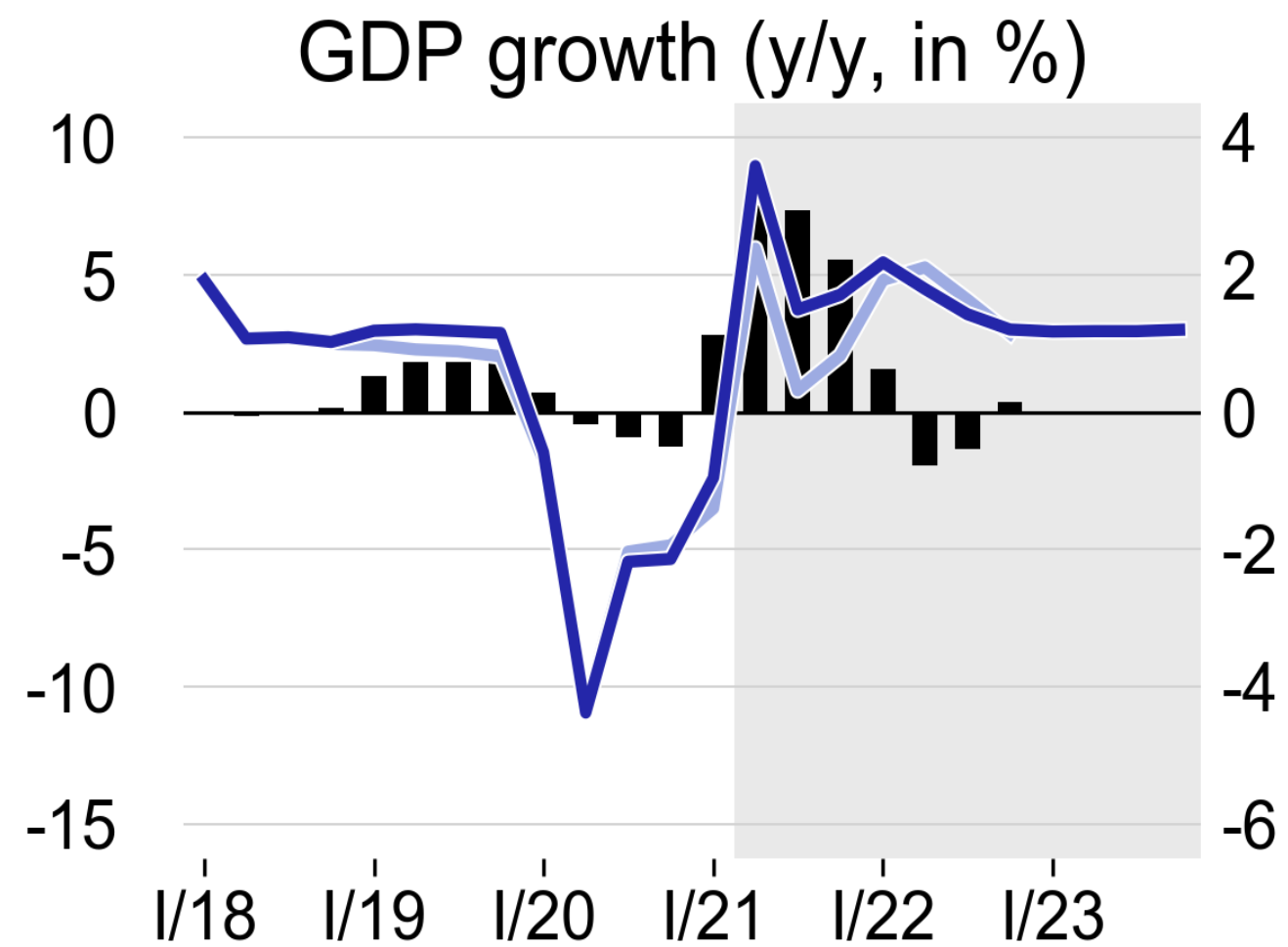
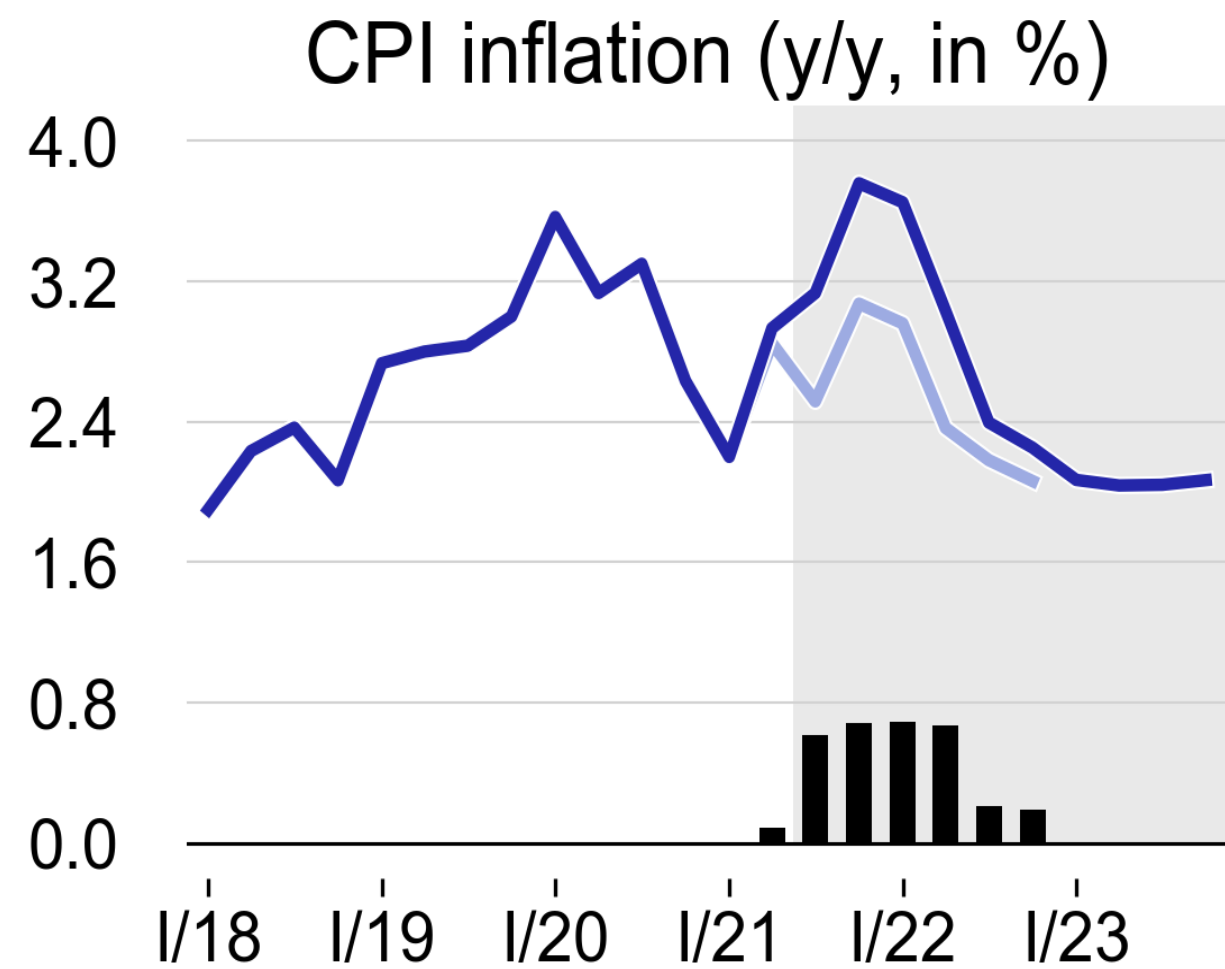


- The lifting of anti-epidemic measures will lead to a recovery in growth of the **potential** of the economy. The negative **output gap** will close next year.
- The growth rate of potential output accelerated sharply after the shutdowns in wholesale, retail and services ended in the spring. Household and corporate sentiment are also improving, and demand and economic activity are picking up quickly.
- Compared to the previous forecast, the potential has been revised upwards due mainly to the developments observed in the first half of this year.

# Aggregate Demand

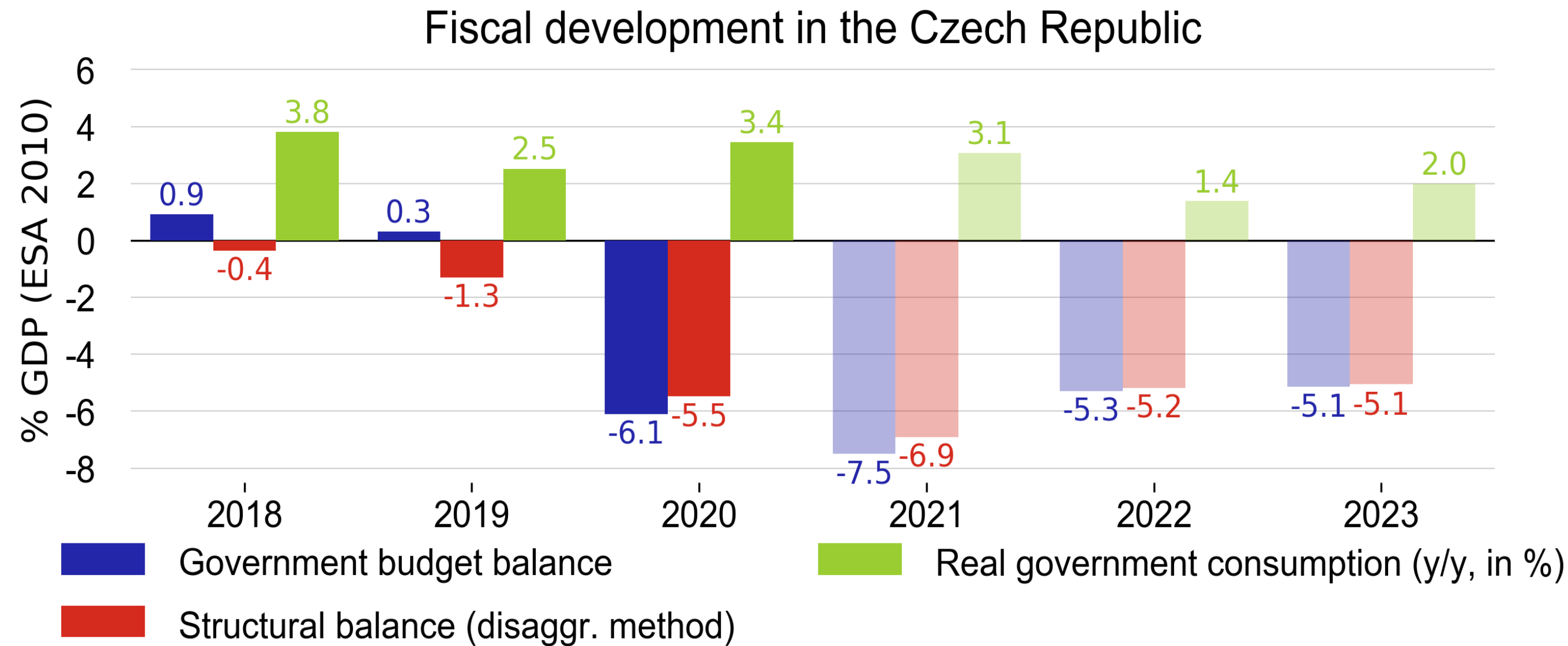


# Comparison with Previous Forecast



— New forecast

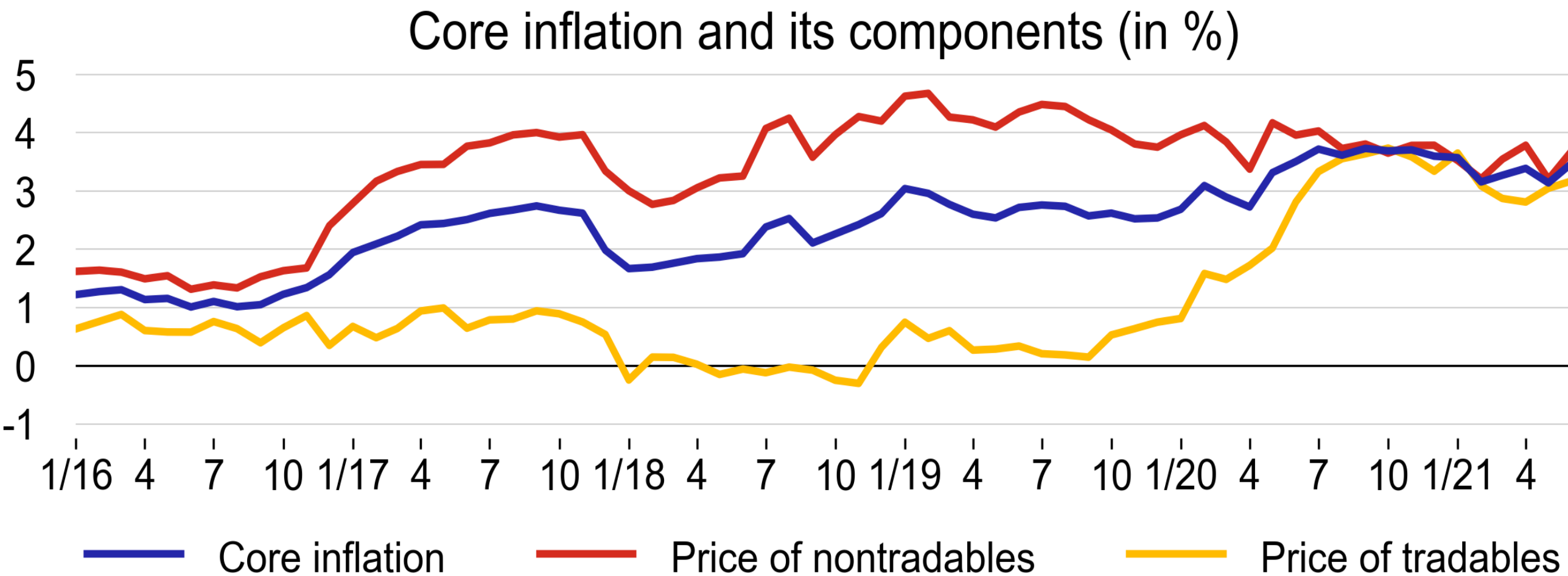
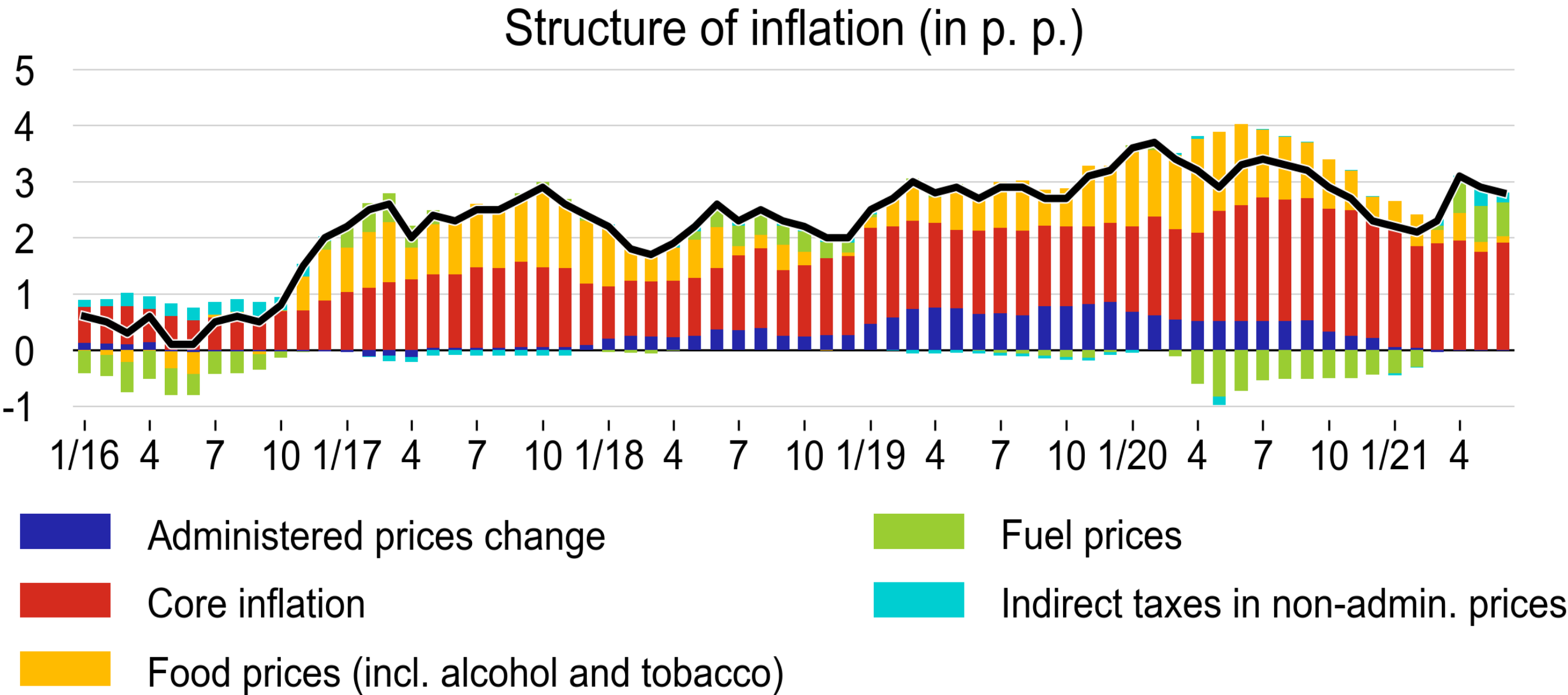
— Previous forecast



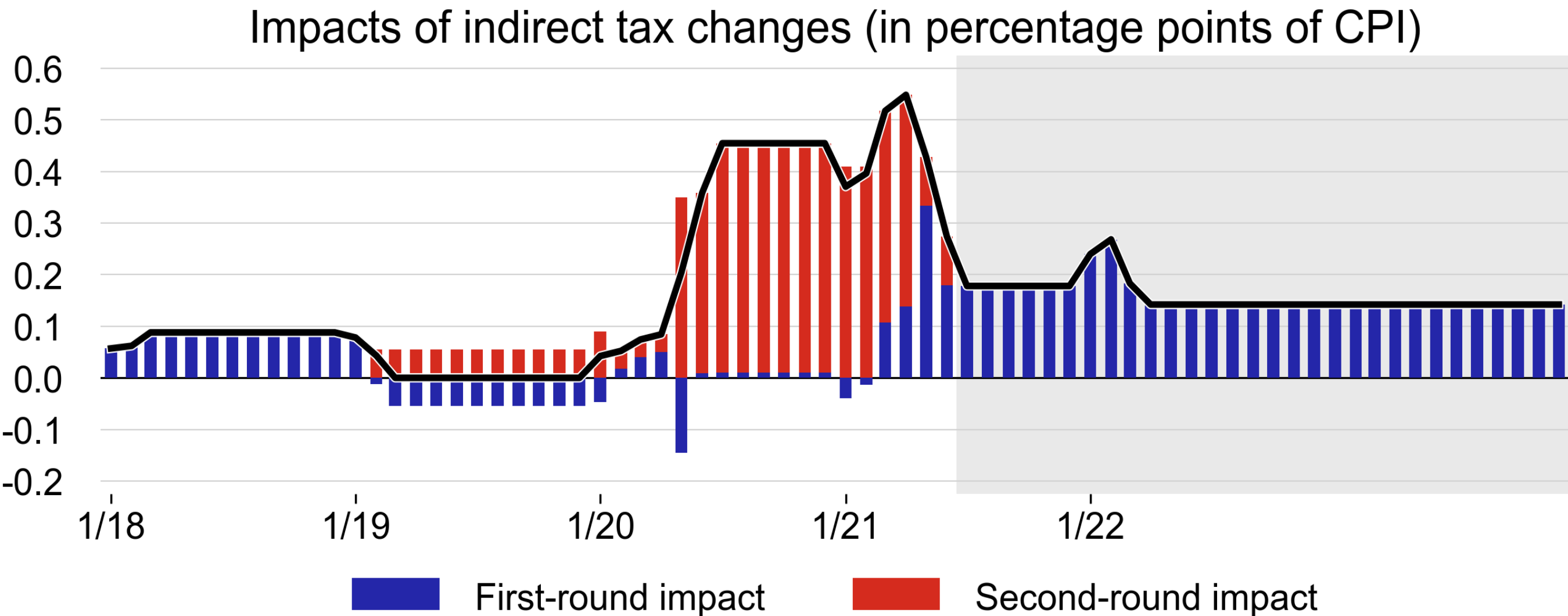
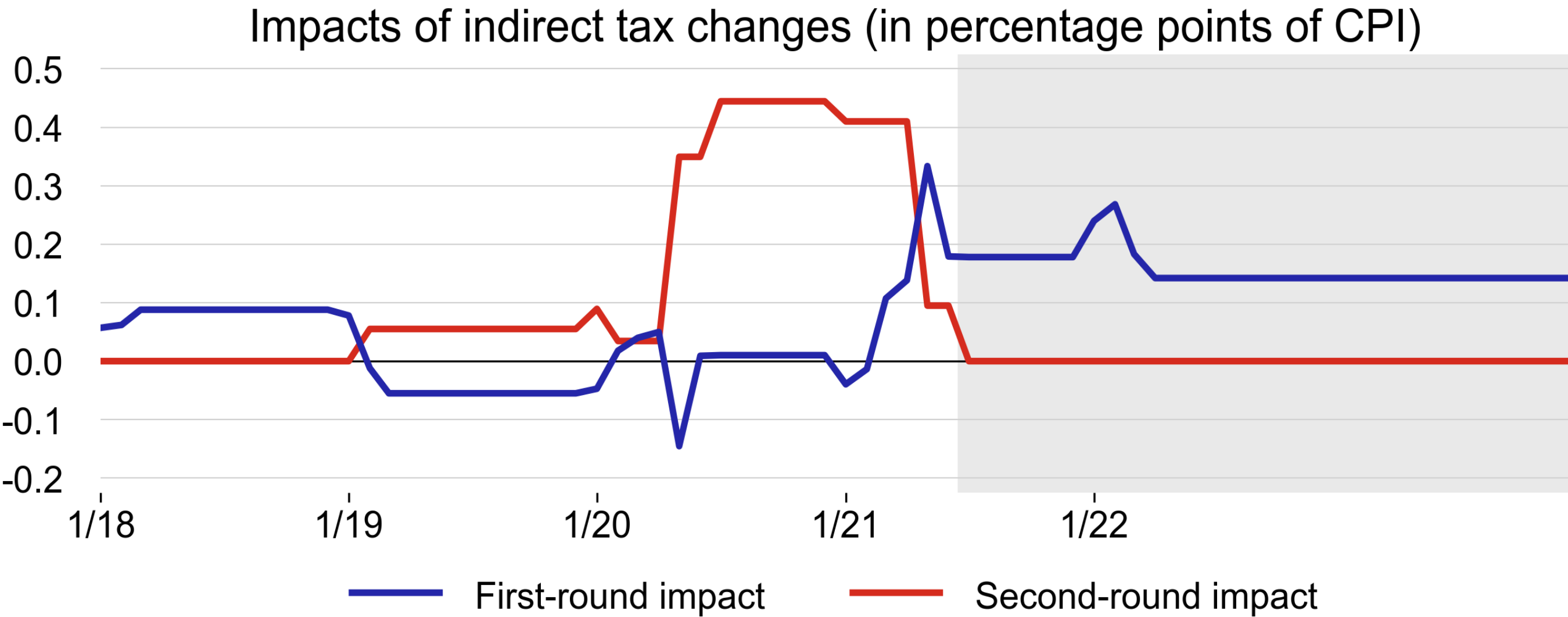
## Fiscal impulse (contributions to GDP growth in percentage points)

	2020	2021	2022	2023
	actual	forecast	forecast	forecast
Fiscal impulse	1.5	0.6	-0.6	0.0
of which impact through:				
Private consumption	1.3	0.4	-0.7	-0.1
Private investment	0.1	0.1	-0.1	0.0
Government investment, domestic	0.0	0.0	0.0	0.0
Government investment, EU funded	0.1	0.1	0.2	0.1

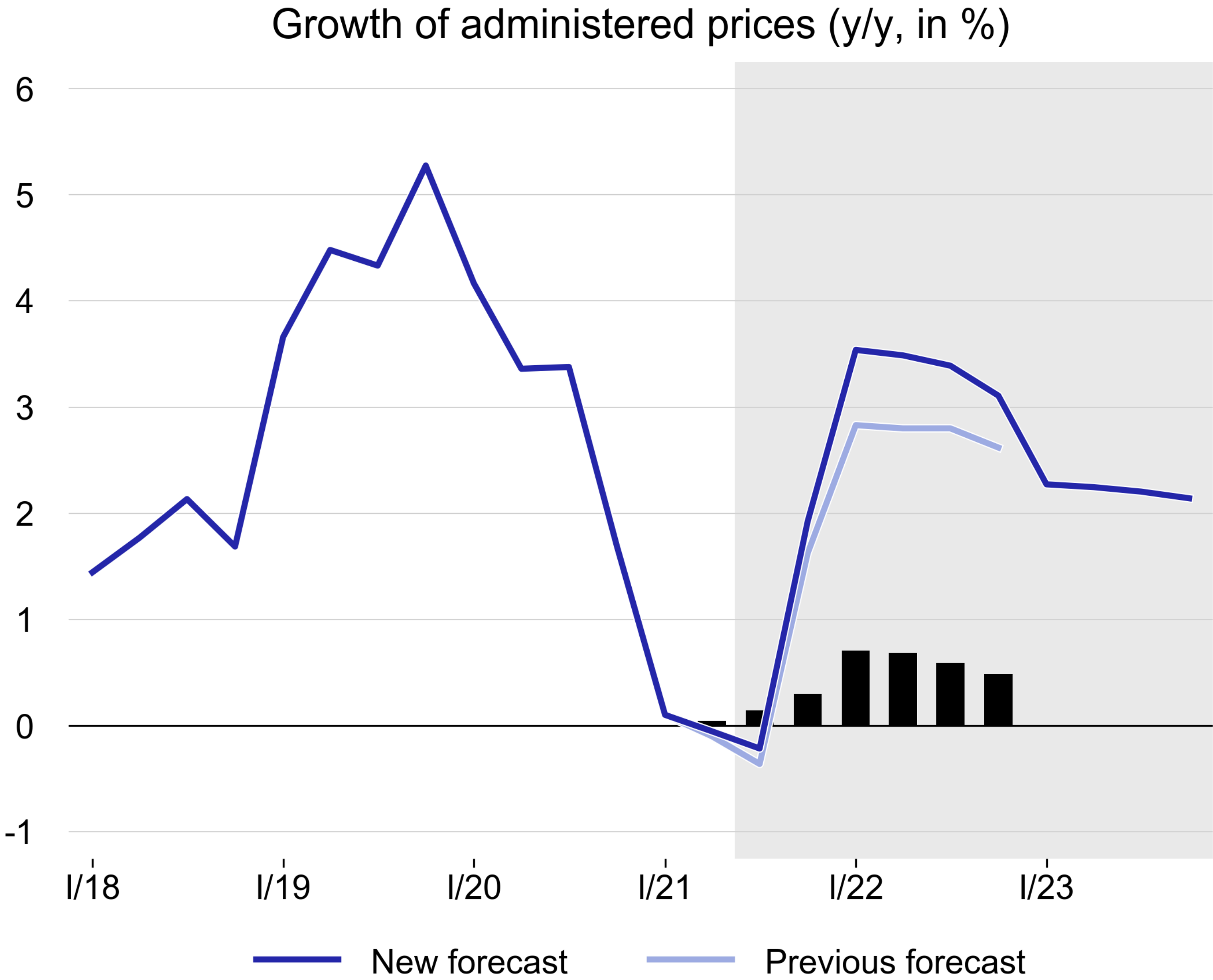
# Structure of Inflation



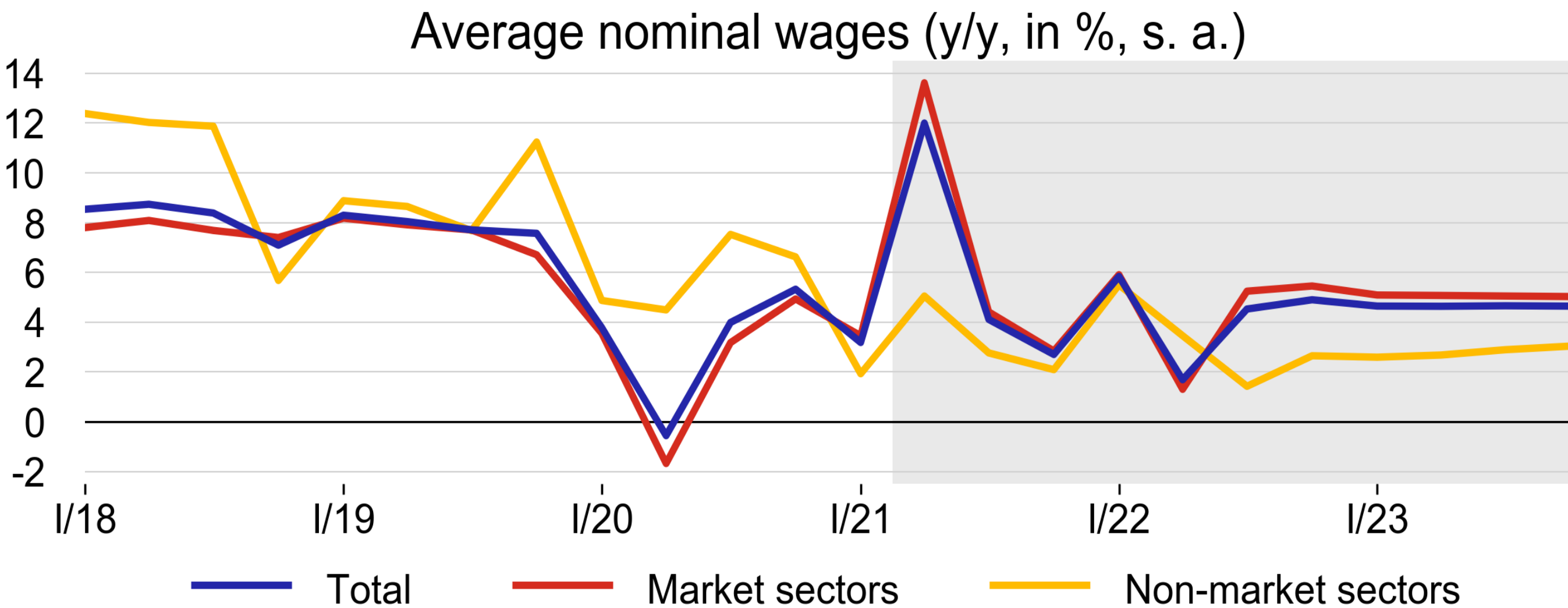
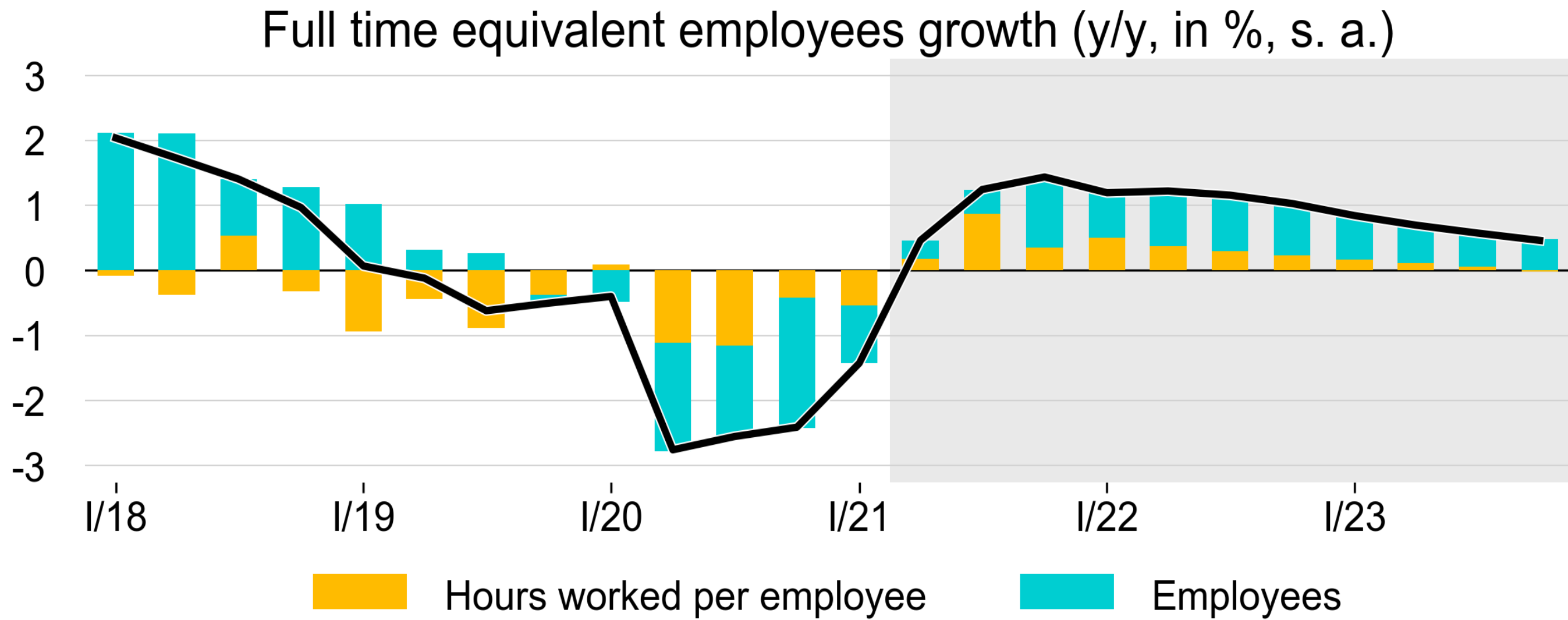
# Indirect Tax Changes: Comparison



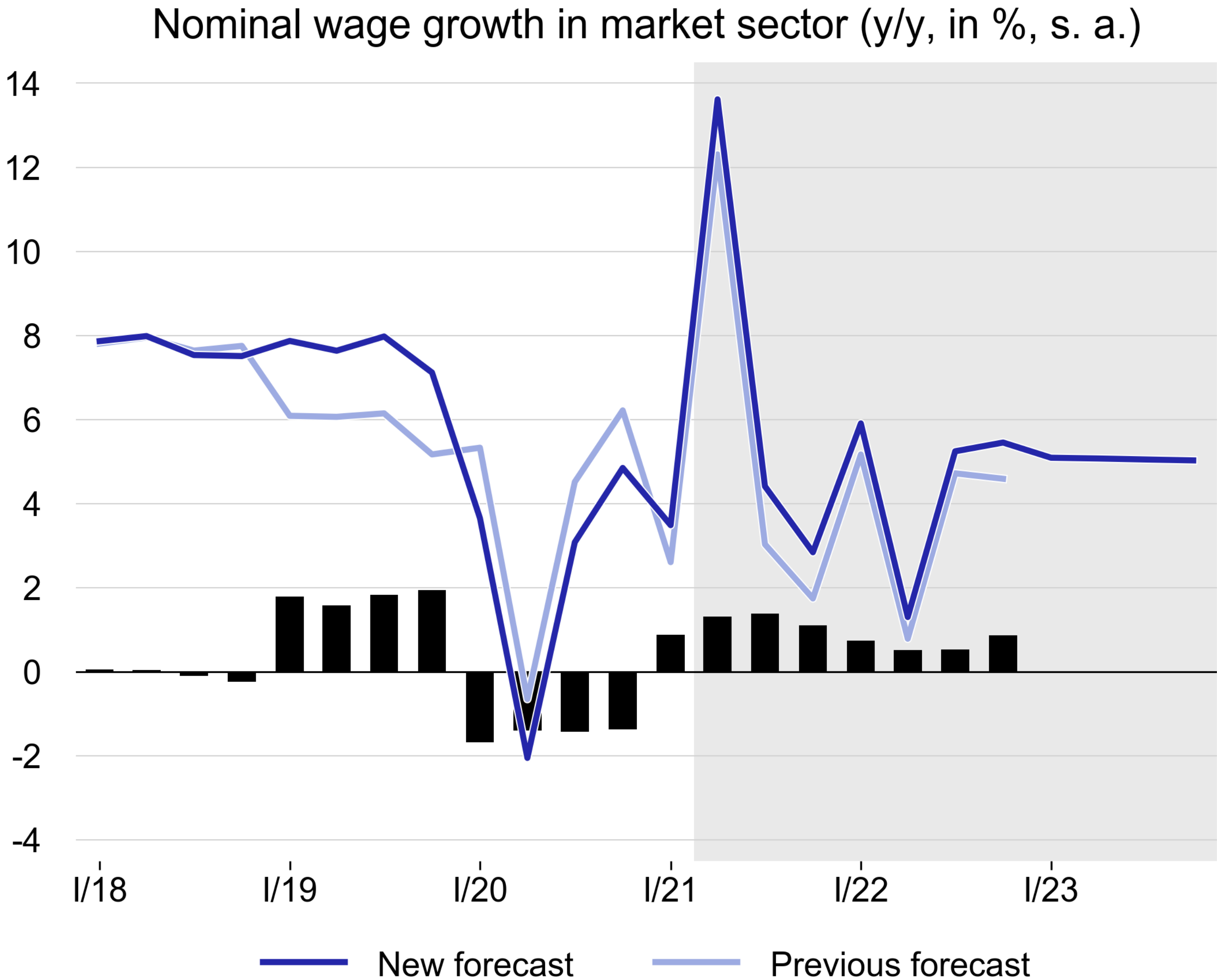
# Administered Prices: Comparison



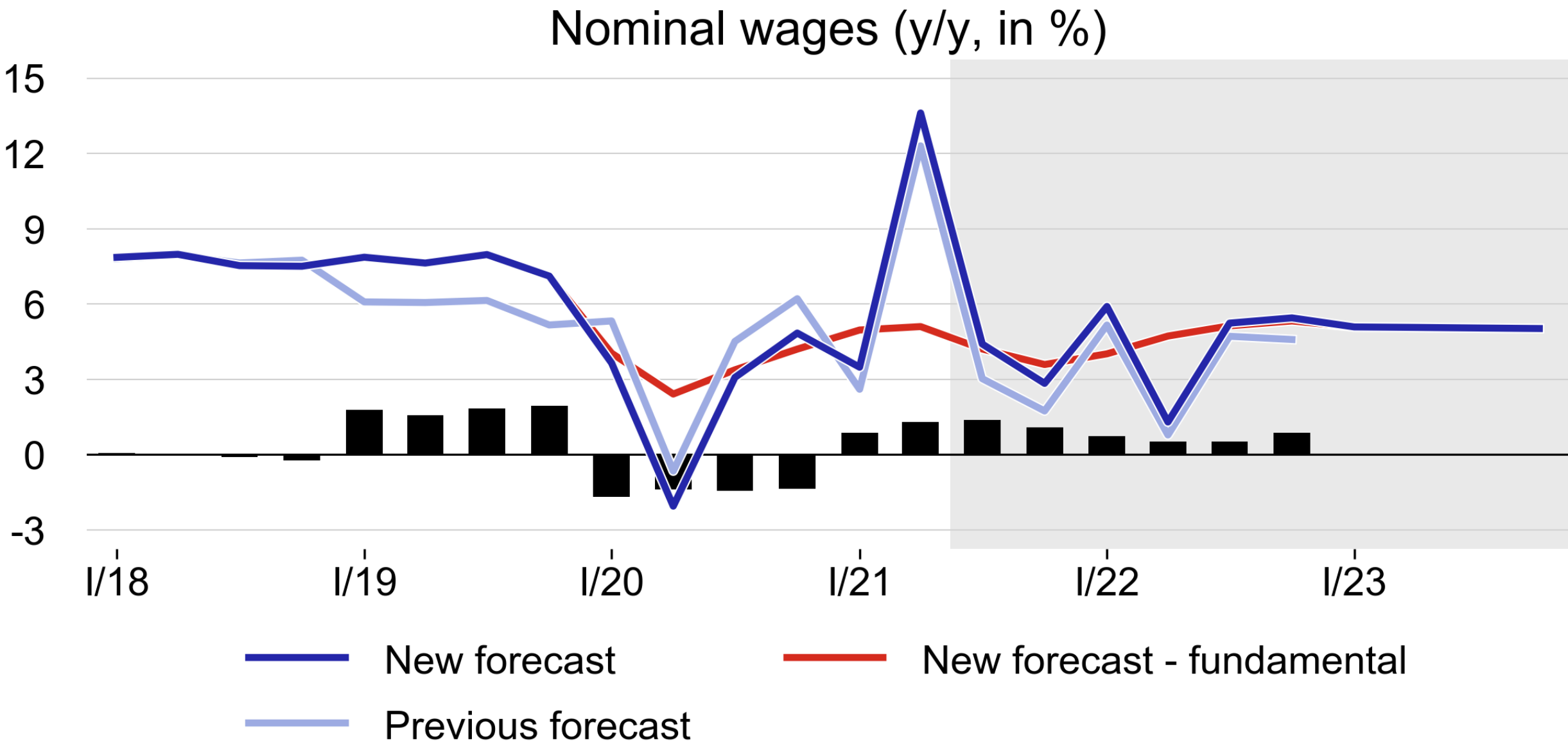
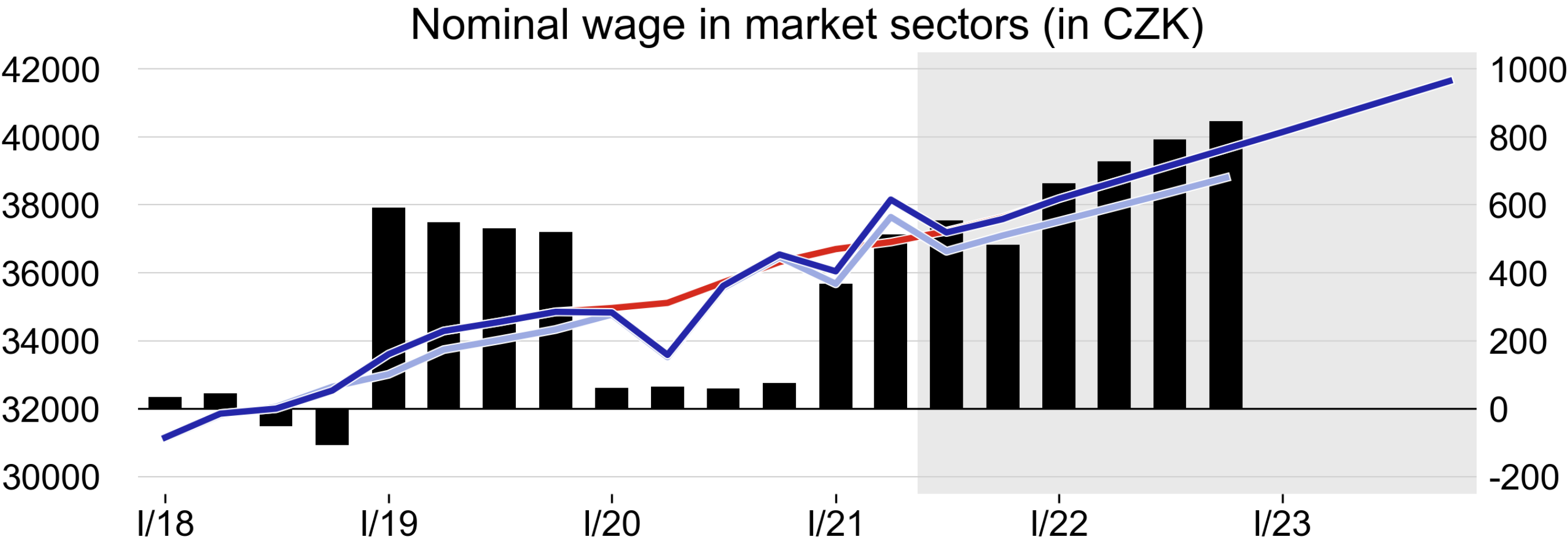
# Labour Market



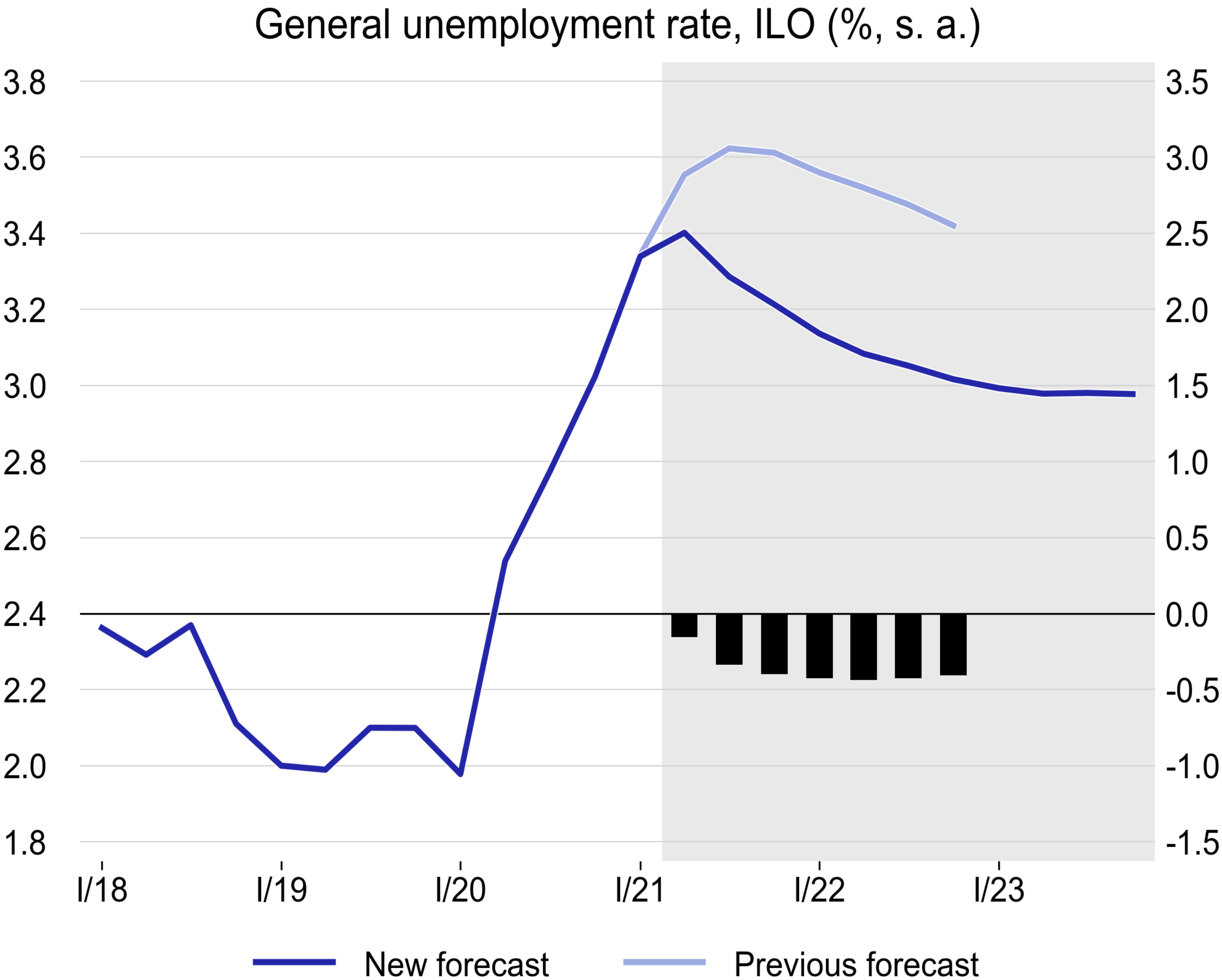
# Wages in Market Sector: Comparison



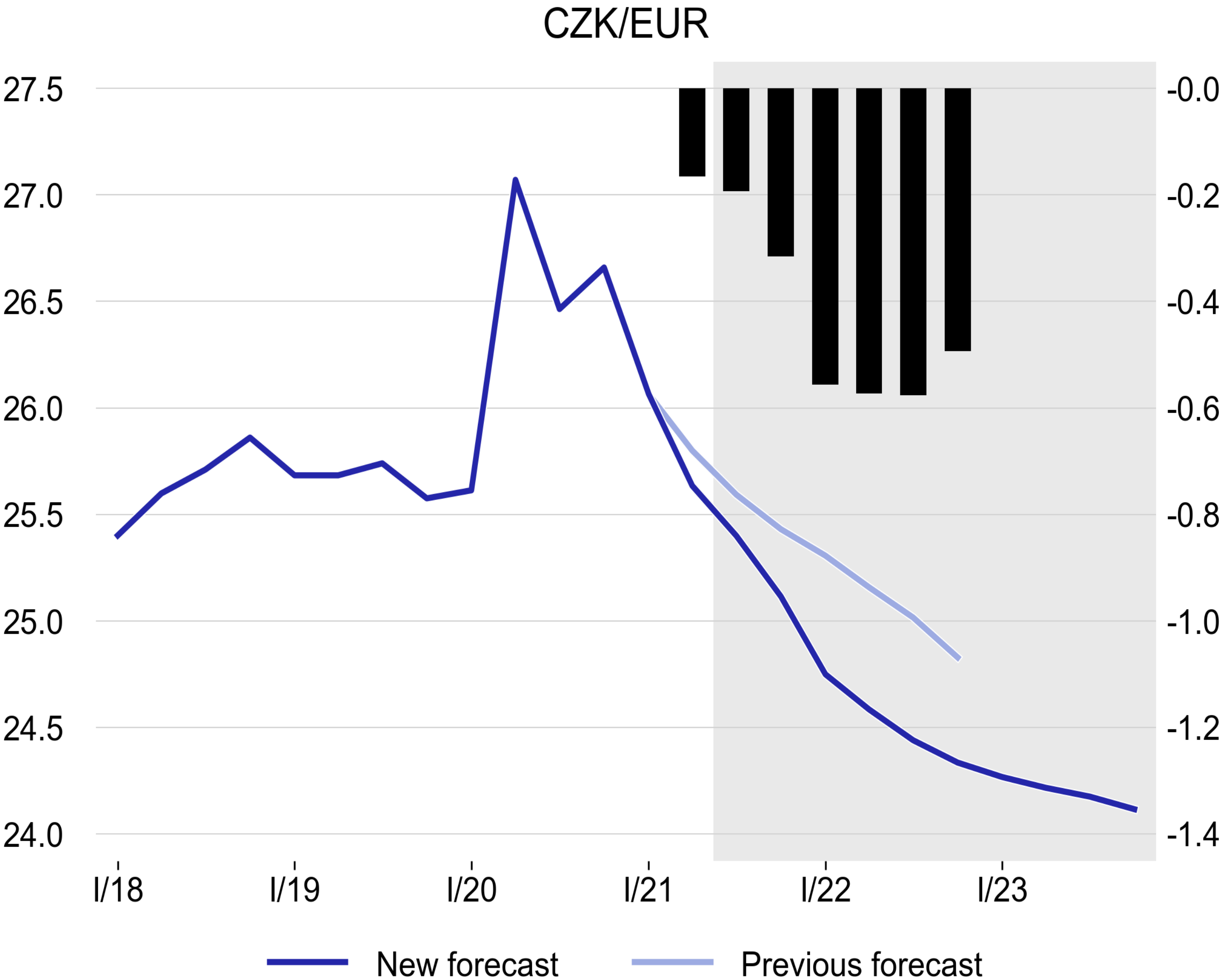
# Nominal Wages: Comparison



# Unemployment Rate: Comparison



# Exchange Rate: Comparison



# Interest Rate: Comparison

