CNB CZECH NATIONAL BANK

CNB’s New Forecast

Monetary Policy Report – Spring 2022

Meeting with Analysts

6 May 2022

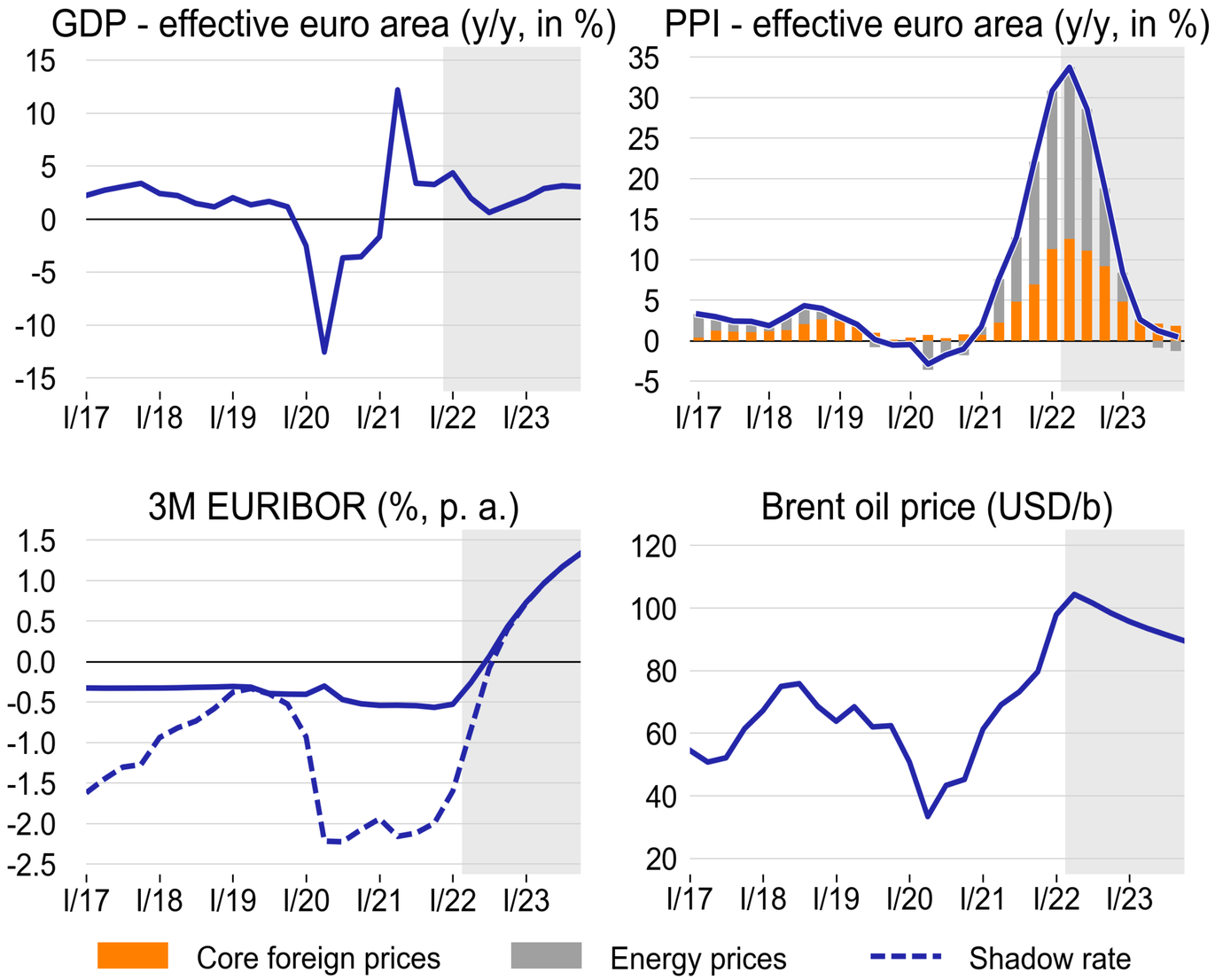
Luboš Komárek (Monetary Department)

CNB CZECH NATIONAL BANK

Presentation Outline

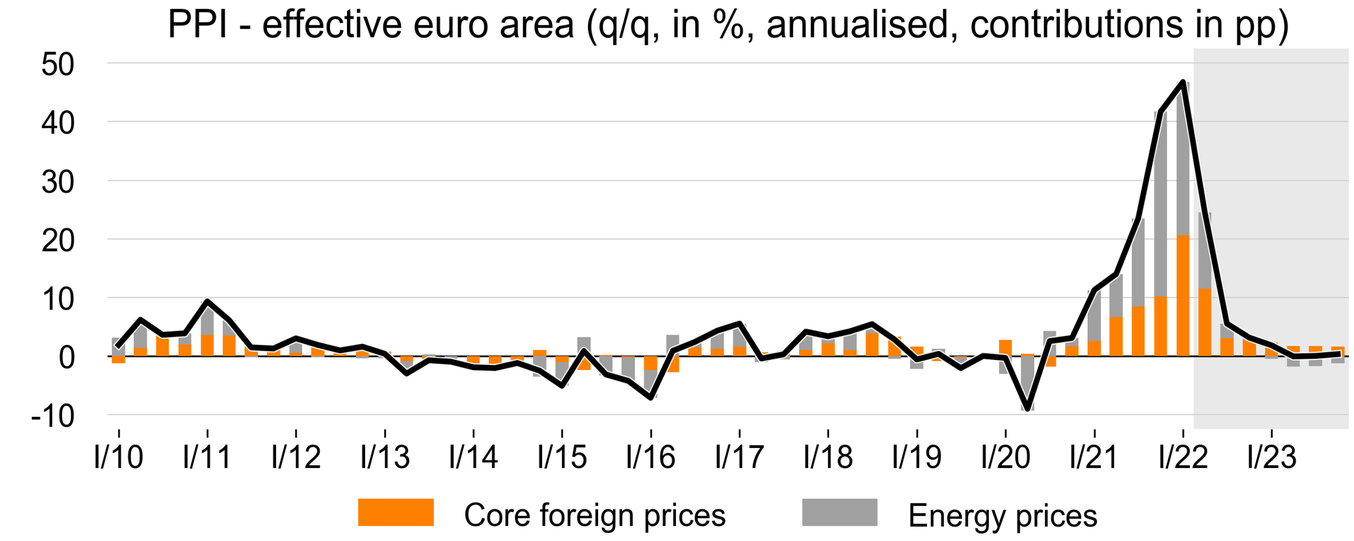
1. **Assumptions of the Forecast**
2. The New Macroeconomic Forecast
3. Comparison with the Previous Forecast
4. Monetary Policy Scenario

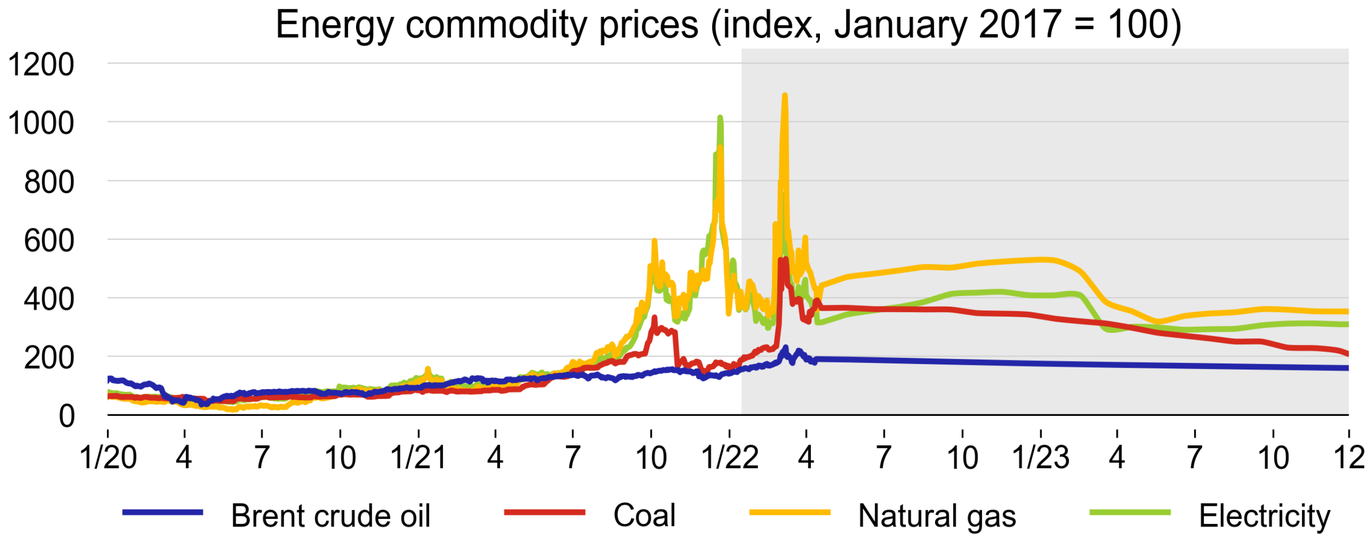
External Environment Outlook



- In February, the economic recovery was interrupted by Russia's military attack on Ukraine. The supply chain disruptions, which are currently the most severe ever, will thus probably drag on until 2023.
- **Effective euro area GDP** will grow by 2% overall this year, recovering appreciably in the second half of the year. It will accelerate further next year.
- The current extraordinary **price growth in industry abroad** is being driven mainly by energy prices. The forecast assumes that the pressure on core and energy production prices will ease next year.
- The **ECB's monetary policy** is shifting towards an expected sharper interest rate hike.

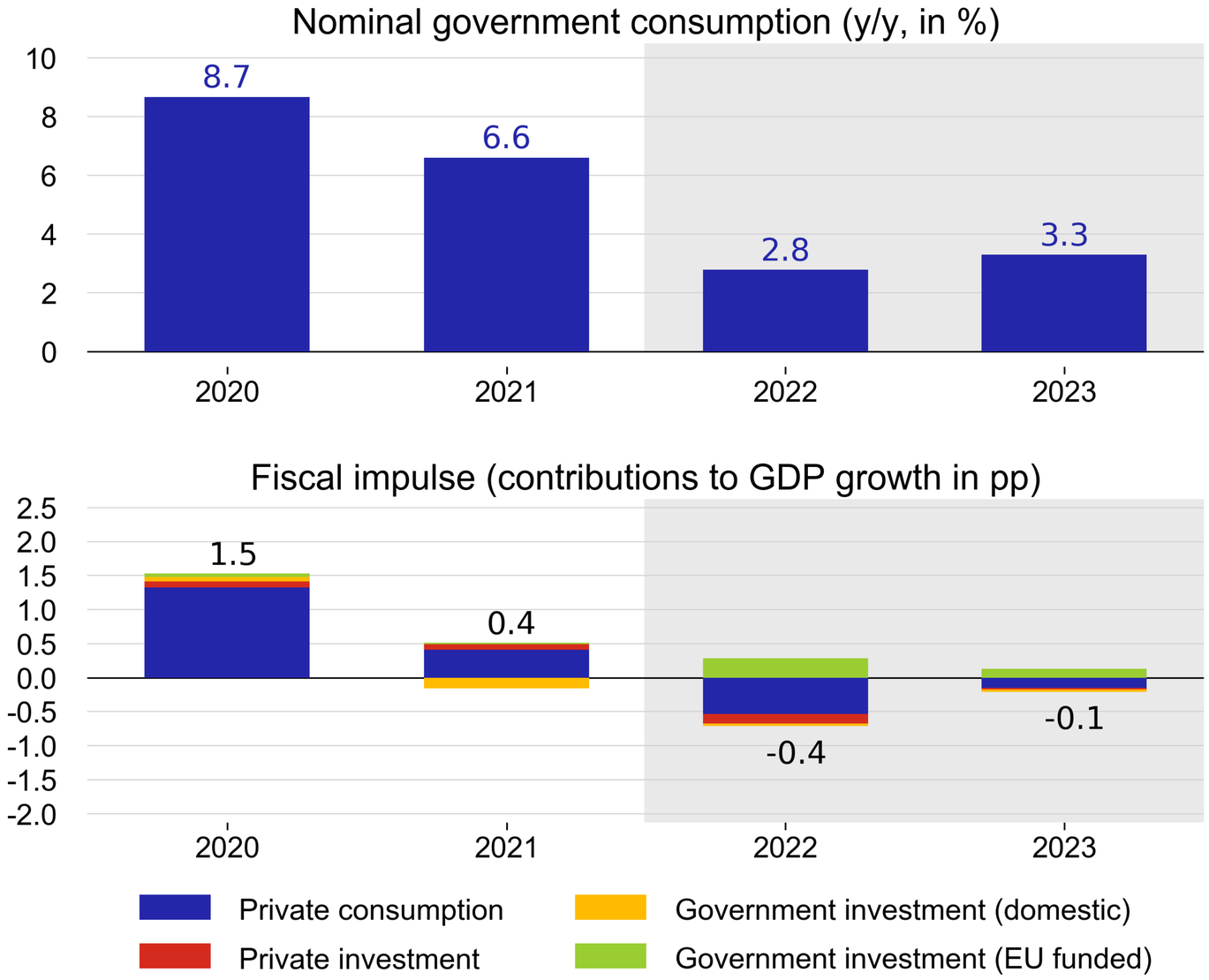
Producer Prices in Effective EA and Commodity Prices





- The **inflation pressures in the industrial production** sector had already strengthened sharply in the second half of 2021 and intensified in early 2022 as a result of the war in Ukraine.
- The shock to **natural gas and electricity** prices, which rose further from already historically high levels, had a particularly strong inflationary effect, as, newly, did a marked increase in **Brent crude oil** prices.
- However, growth in prices of other industrial commodities and persisting stress in global supply chains, which is visible in **core producer price inflation**, are also passing through to inflation.
- An expected partial correction of **energy commodity prices** and the fade-out of the supply chain stress will have an anti-inflationary effect next year.

Fiscal Policy



- **Nominal government consumption** growth slowed only slightly last year. A large part of previously high pandemic-related spending, especially in health care, will be ended this year. Together with a wage freeze for government employees, this will lead to a pronounced slowdown in government consumption in 2022.
- Rising health and education expenditure linked with the arrival of Ukrainian refugees will have the opposite effect.
- Due to the termination of many of the support programmes that supported the economic recovery for most of last year, **the fiscal impulse** will slightly dampen GDP growth this year.
- This will be partly offset by other measures on both the revenue and expenditure sides of public budgets.

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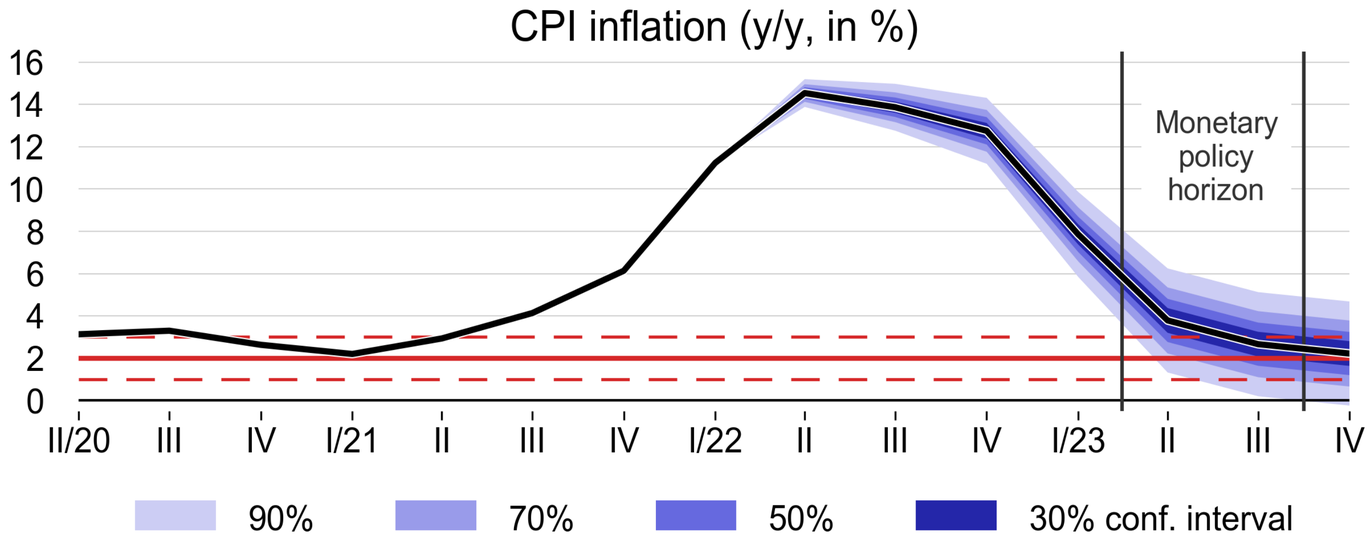
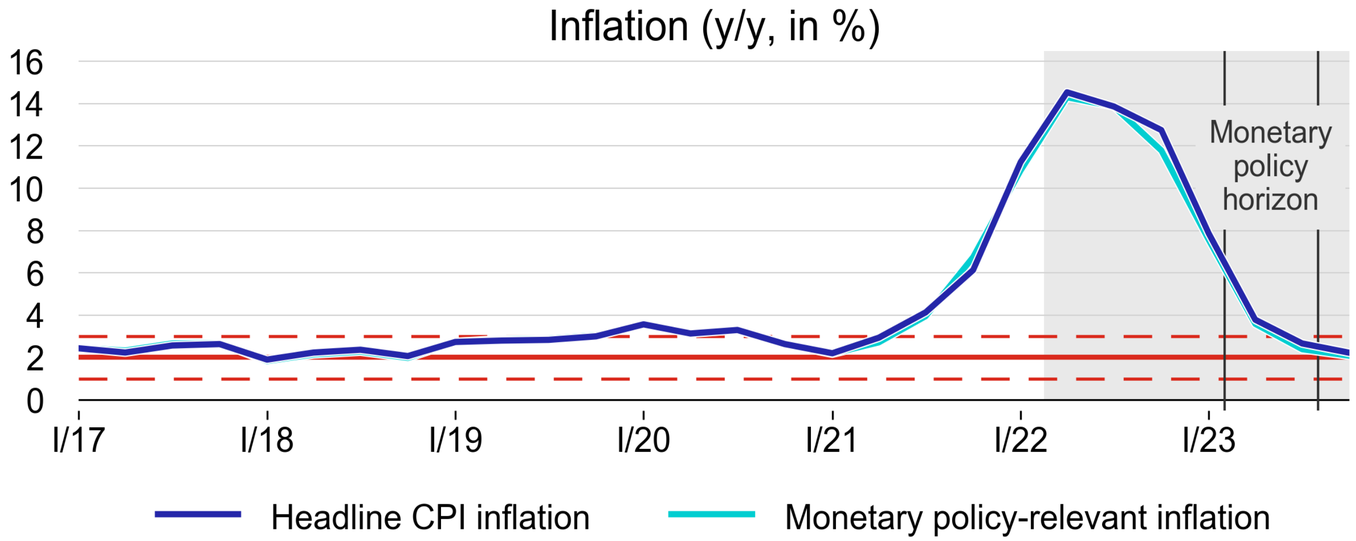
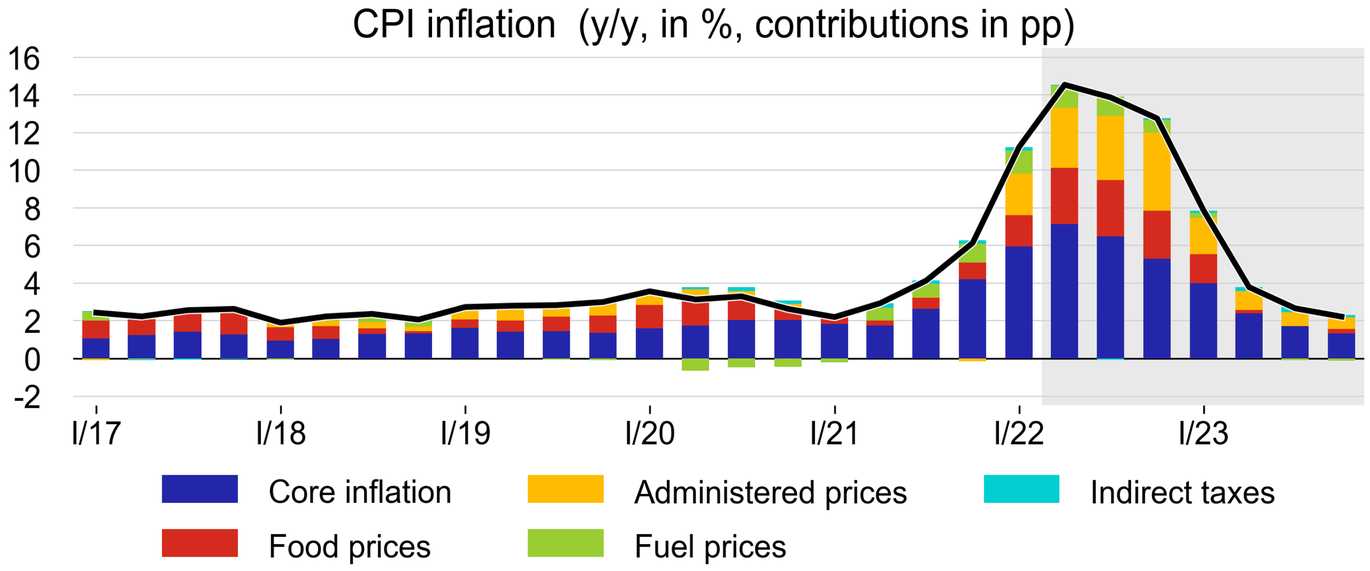
Headline and Monetary Policy-Relevant Inflation

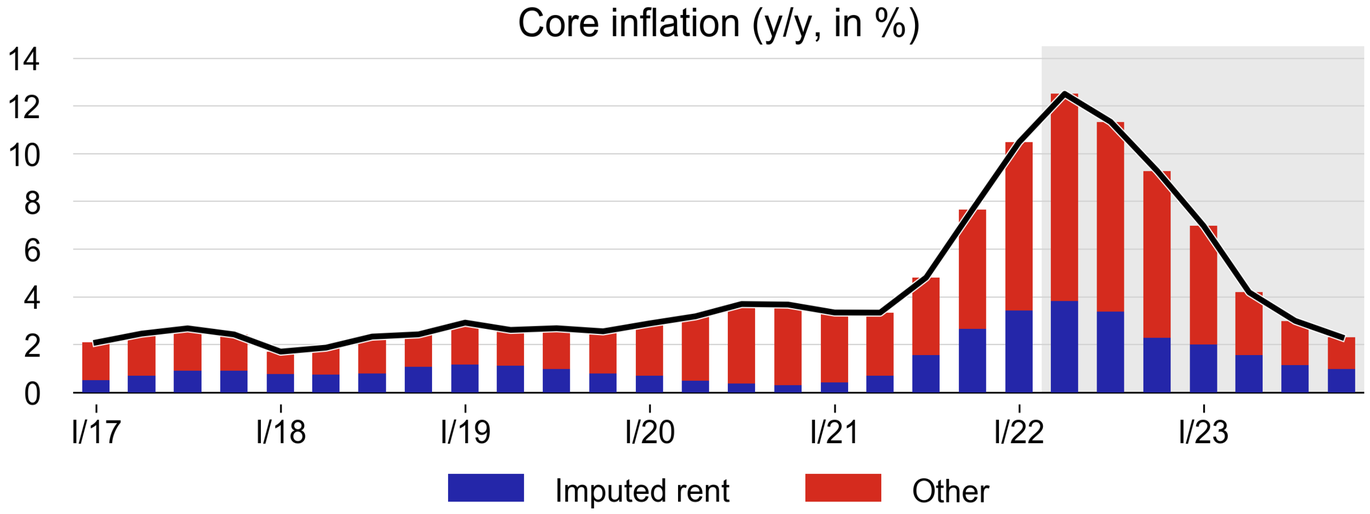




- **CPI inflation** will accelerate significantly further in 2022 Q2 and be in double figures for the rest of the year.
- It will fall close to the inflation target at the end of the monetary policy horizon owing to an easing of the current exceptional price pressures and to the previous tightening of domestic monetary conditions.
- **Monetary policy-relevant inflation** will be below headline inflation over the entire forecast horizon due to changes in excise duties.

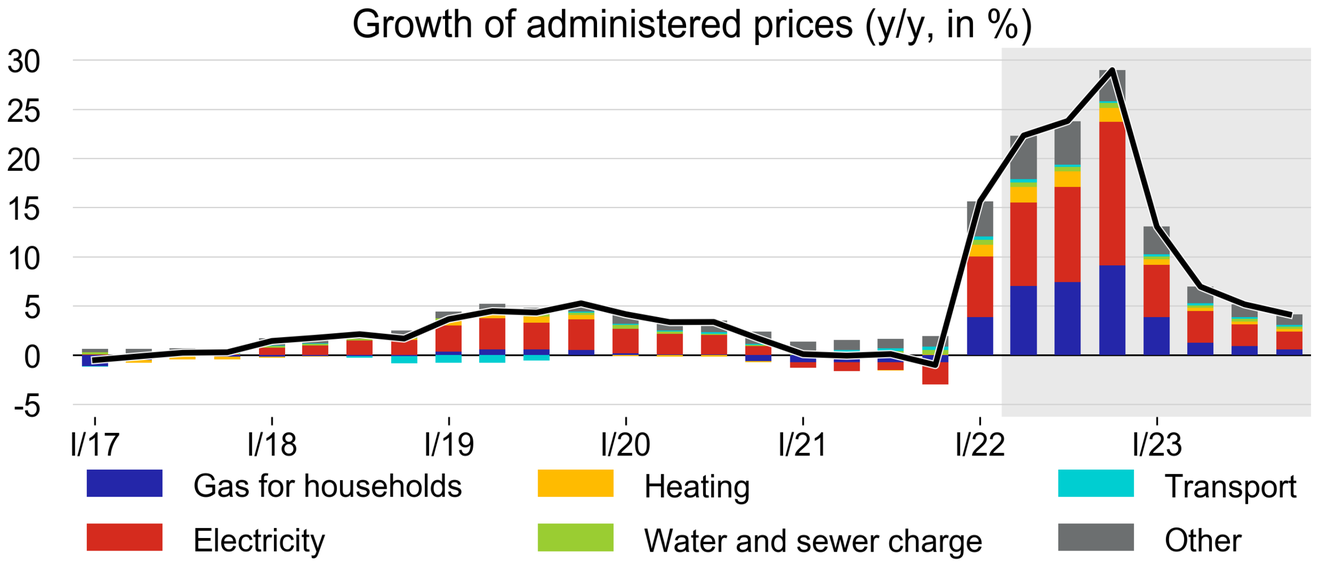
Inflation Components and Core Inflation

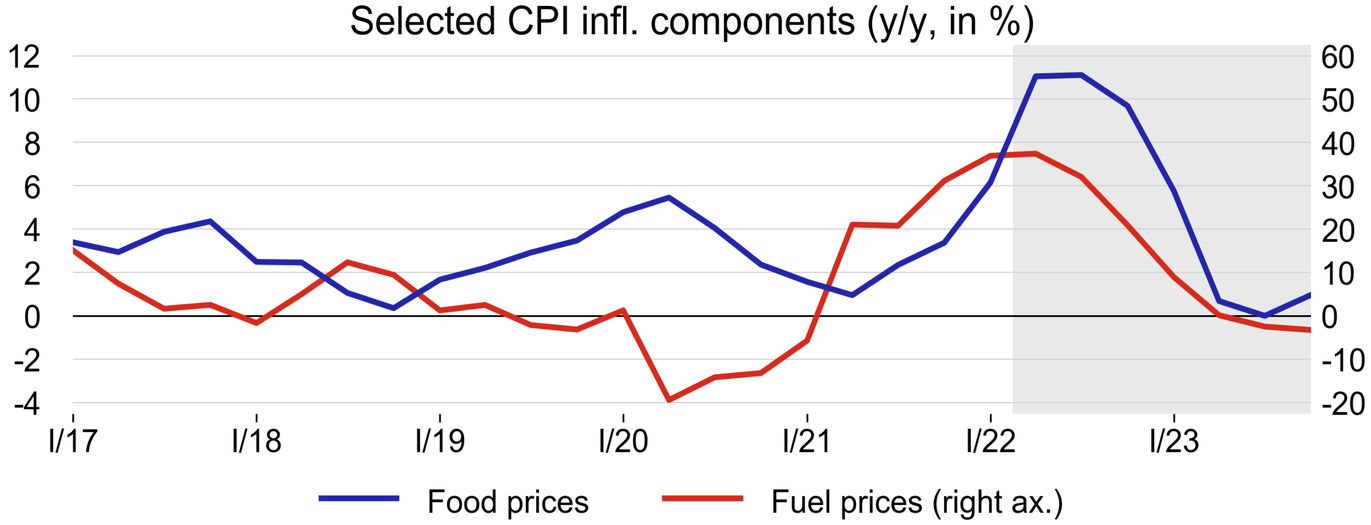




- The escalating **price growth** will continue to be dominated by core inflation, but growing contributions of administered prices and a marked rise in food prices will also play a significant role.
- Within **core inflation**, prices of both tradables and non-tradables are rising sharply. The already massive contribution of imputed rent will increase further in Q2 2022 but start to decrease gradually in the second half of the year.
- The growth in **imputed rent** reflects continuing sharp growth in prices of new properties and high growth in prices of construction work and construction materials. This is due in large part to the global supply chain difficulties, which are giving rise to shortages of building materials.

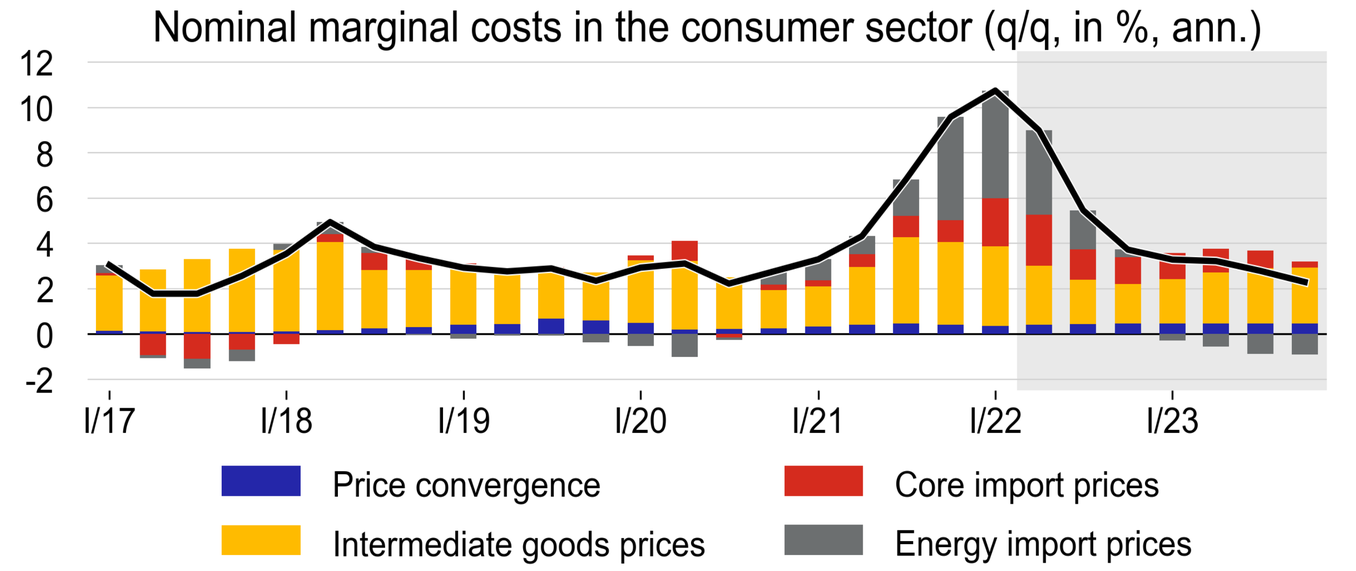
Administered, Food and Fuel Prices

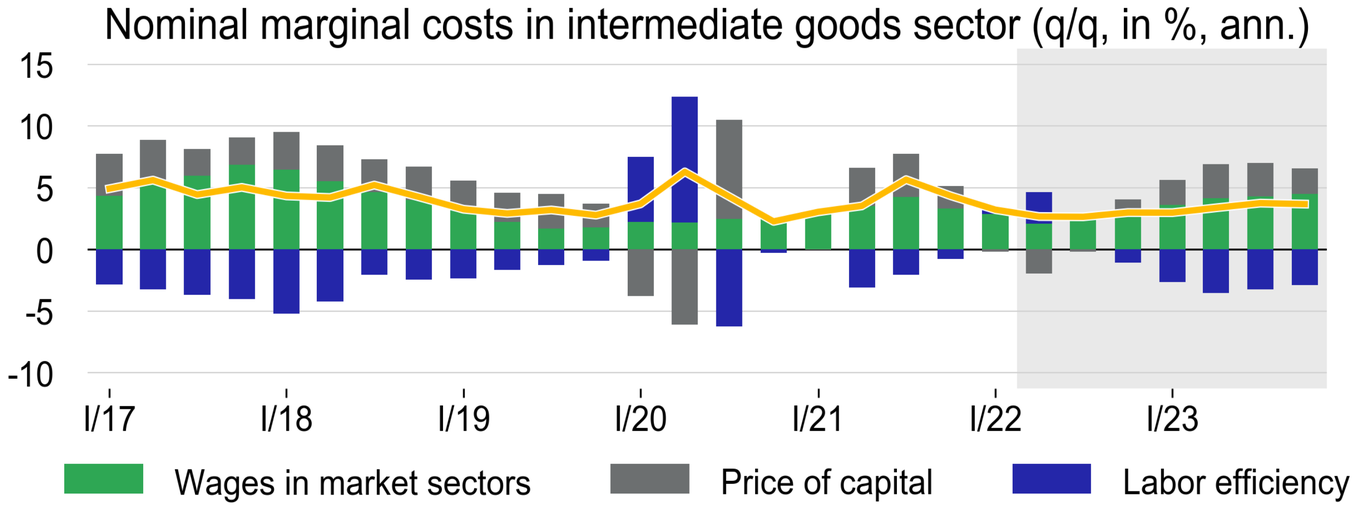




- Following a sharp rise early this year, **administered prices** will increase further. They will reflect high exchange prices of energy, whose growth to levels unseen until recently is also being fostered by Russia's invasion of Ukraine. Housing-related energy (electricity, natural gas, heating) will continue to get more expensive.
- In 2023, the administered price growth will slow but remain elevated due to the gradual pass-through of the previous growth in prices on energy exchanges.
- The growth of **fuel prices** will remain high through this year but will start to fall due mainly to a drop in global oil prices.
- Growth in **food prices** will intensify in the near future, being driven mainly by growth in world agricultural commodity prices.

Cost Pressures



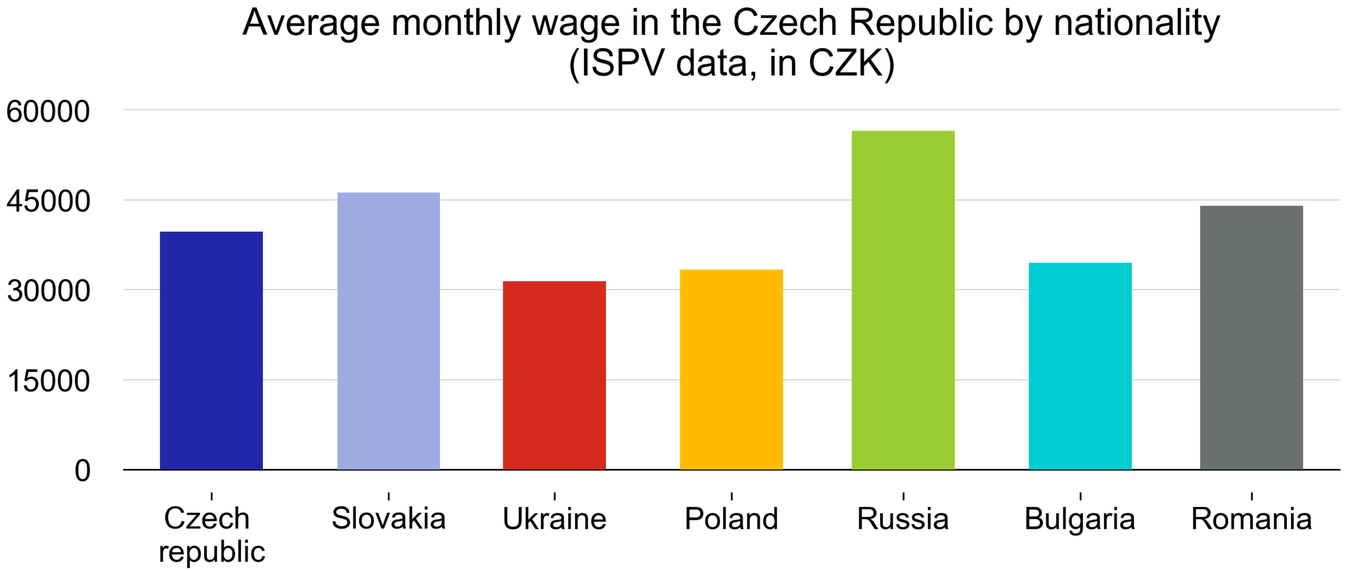


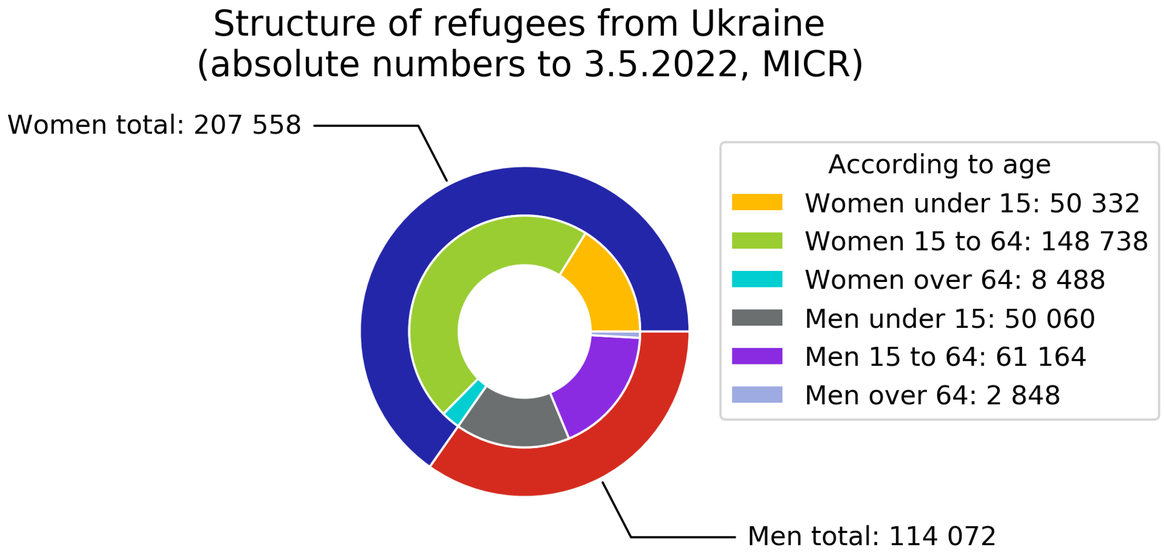
- The strong growth in **overall cost pressures** at the turn of the year was driven mainly by energy import prices. The increasing contribution of core import prices was driven by accelerating growth in core foreign producer prices.
- The growth in costs will gradually slow this year due mainly to slower growth in energy prices and also to lower growth in prices of domestic intermediate goods.
- **Domestic cost pressures** will ease this year as the contribution of wages will decrease further. Most wages will be only partly indexed to the high inflation.
- The contribution of wages to growth in domestic costs will start to strengthen gradually this summer due to efforts to make up at least partly for the high inflation. This effect will intensify even further next year.

Labour Market

- **Employment** will continue to rise on the back of strong demand for labour among Czech firms and higher labour supply due to workers arriving from Ukraine. **The unemployment rate** will rise slightly in the coming quarters but remain very low.
- Despite still strong demand for labour, inflation will not be significantly reflected in **wage growth** in the first half of this year. Firms are facing high costs during the energy crisis. Also, the problems in GVC have been exacerbated by the war. This will weaken the bargaining position of employees in numerous sectors. The arrival of a large number of refugees will also foster lower wage growth.
- Moderate nominal wage growth together with high CPI inflation will result into a deep decline of **real volume of wages and salaries** this year.

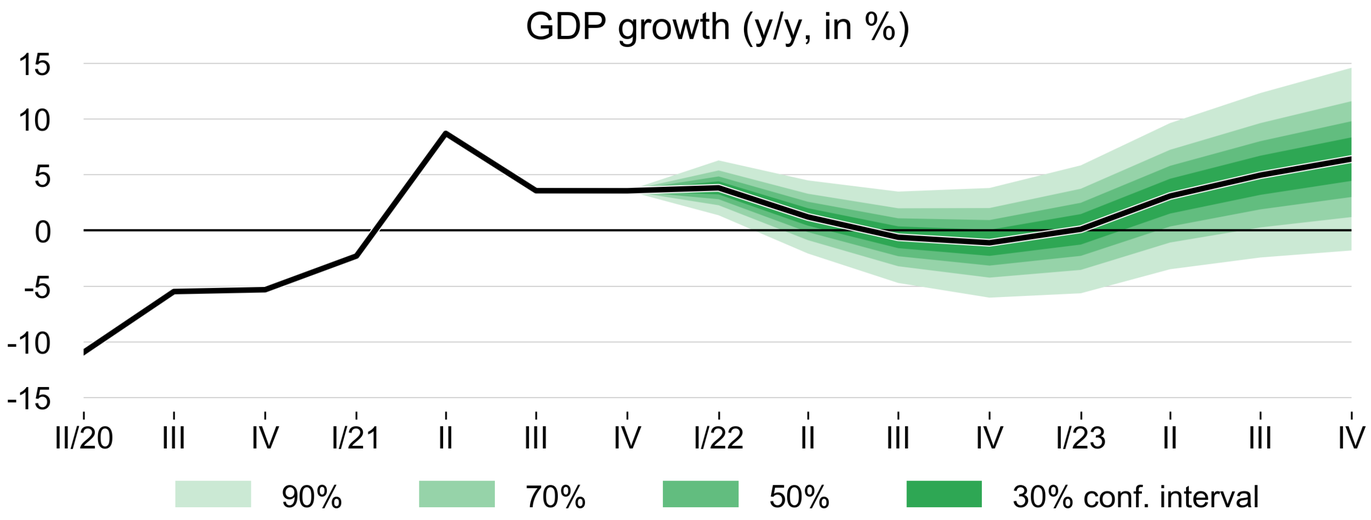
Ukraine Nationals on the Czech Labour Market

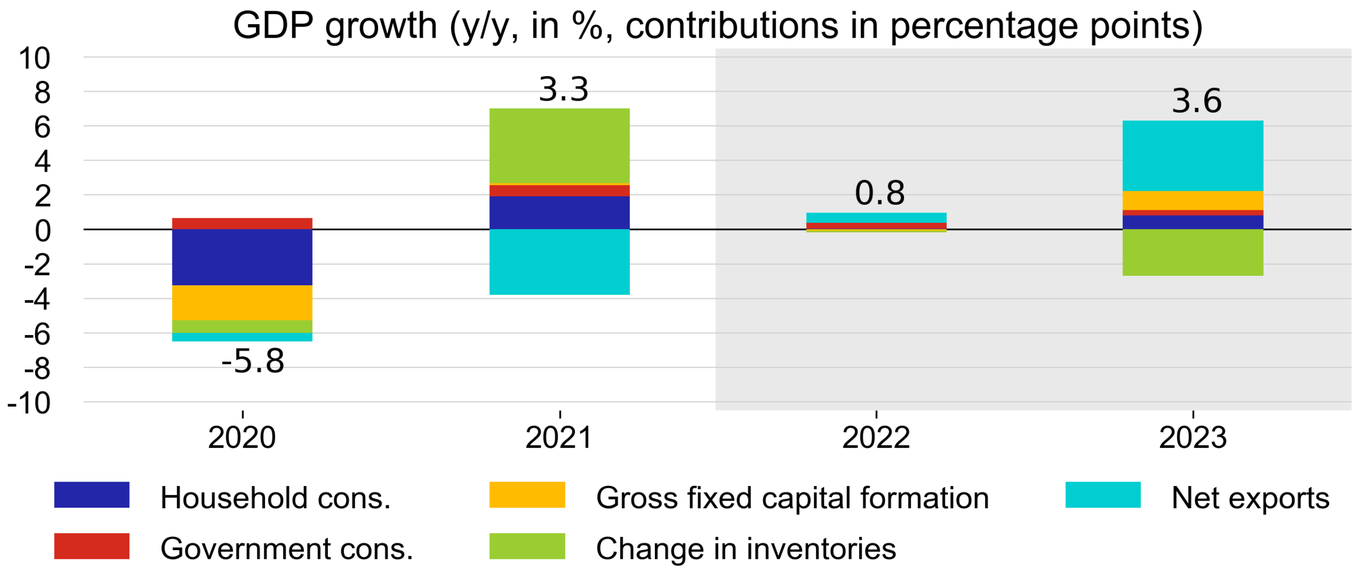




- Ukrainians in the Czech Republic earn less on average than workers from other countries and Czechs, as they work in **lower-paid occupations**. However, their wages in given occupations are very similar to those of Czech workers.
- The arrival of large numbers of Ukrainians in the Czech Republic will put a **downward pressure** on future **wage growth**:
  - Due to **composition effect** – as Ukrainians will probably, at least initially, take positions at the lower end of the wage spectrum.
  - And also due to **higher competition** on the labour market – since higher labour supply in the Czech Republic will decrease the currently high labour market tightness.

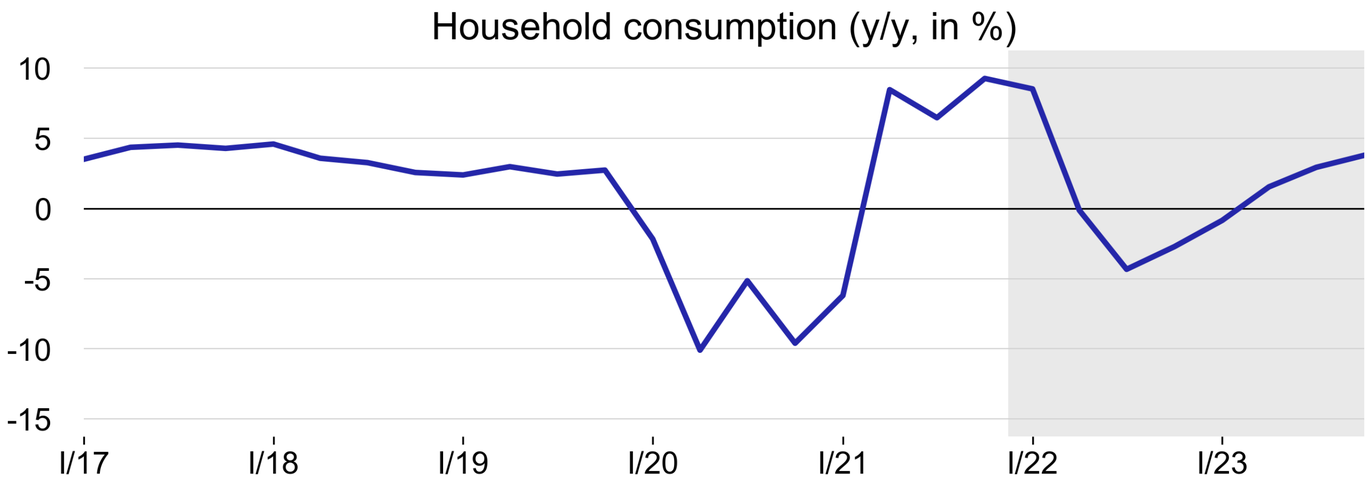
GDP Growth Forecast

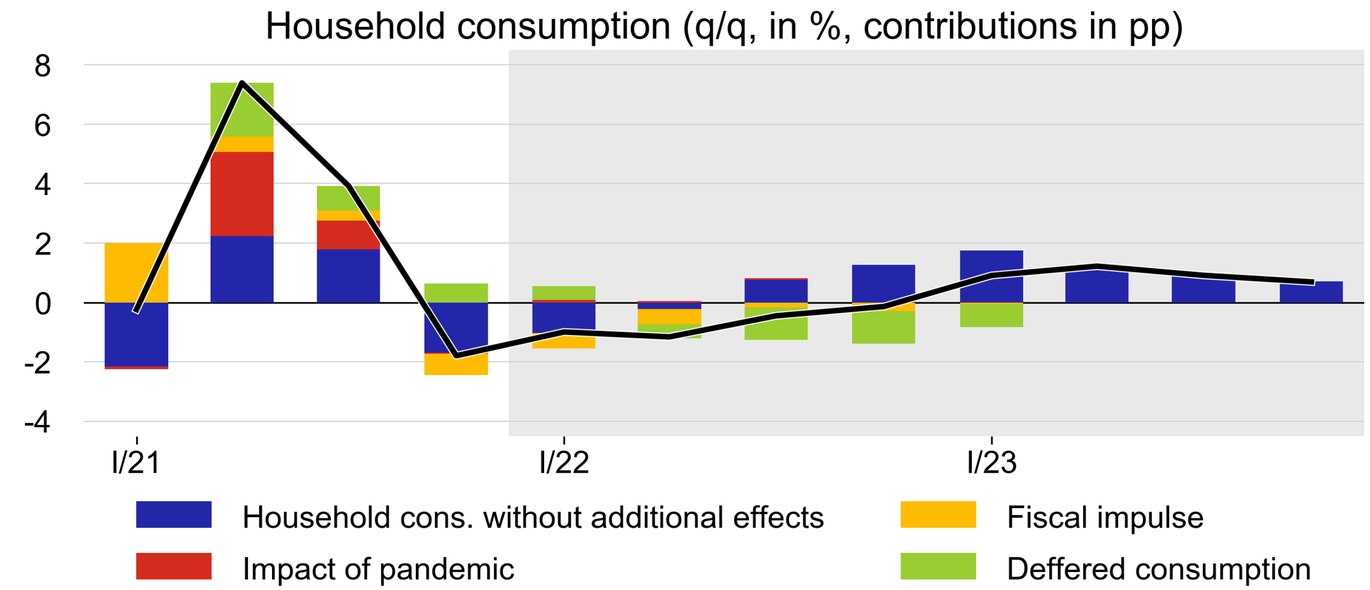




- **Economic growth** will be dampened again this year by problems in global value chains, exacerbated by the war in Ukraine and by worse sentiment of Czech firms and households.
- The economy will contract briefly this year and start to expand again in 2023.
- GDP growth will slow significantly to below **1%** this year in **whole-year terms**. In 2023, it will pick up to around **3.5%**.
- According to a **preliminary CZSO estimate**, Czech GDP increased by **4.6%** year on year in 2022 Q1, which is above the CNB forecast.
- The previous overheating of the economy will subside quickly this year and the economy will temporarily operate below its **potential**.

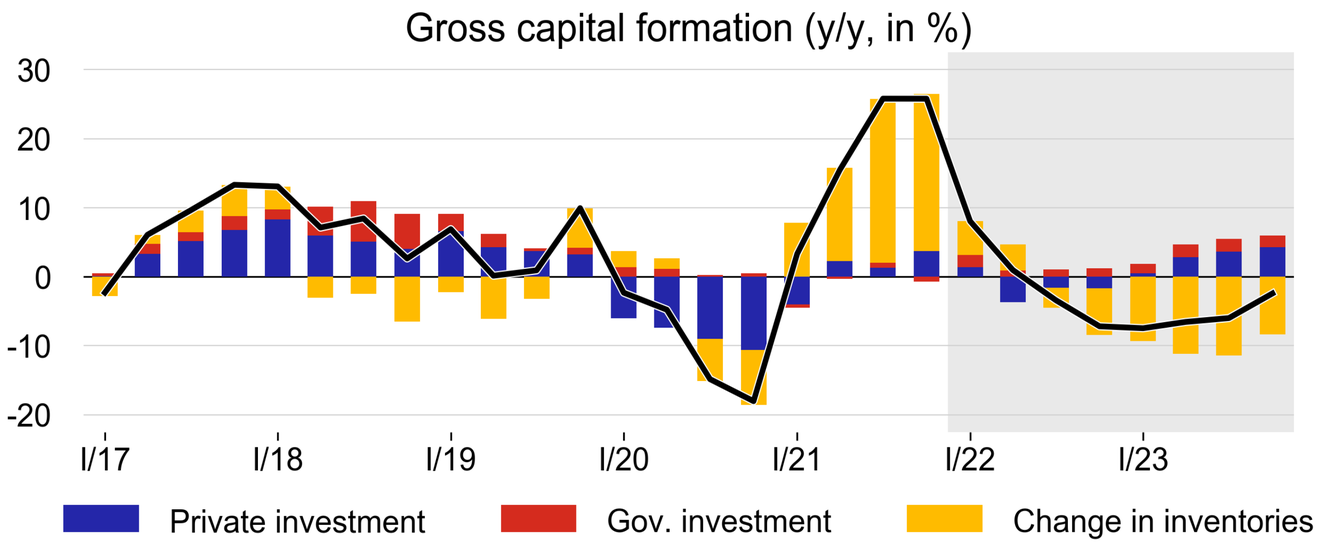
Household Consumption

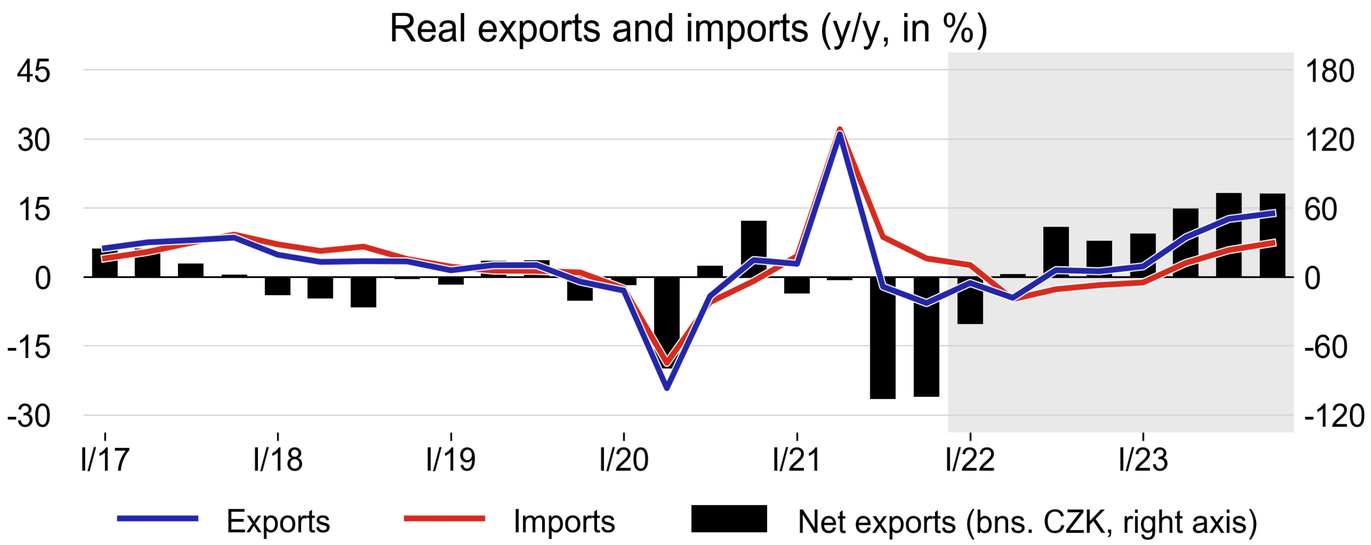




- **Growth in household consumption** will halt this year and resume next year.
- Consumer appetite will be suppressed by a further increase in inflation, which will exacerbate the fall in households' **purchasing power**.
- Fast-growing **housing-related expenditure** (especially on energy), will meanwhile drain another large part of the forced savings created by households during the pandemic.
- **Consumer sentiment** will not be favourable this year, either. In addition, household spending will be dampened by growth in market interest rates.
- As inflation falls and wage growth picks up next year, the income situation of households will improve and their real consumption will start to rise again.

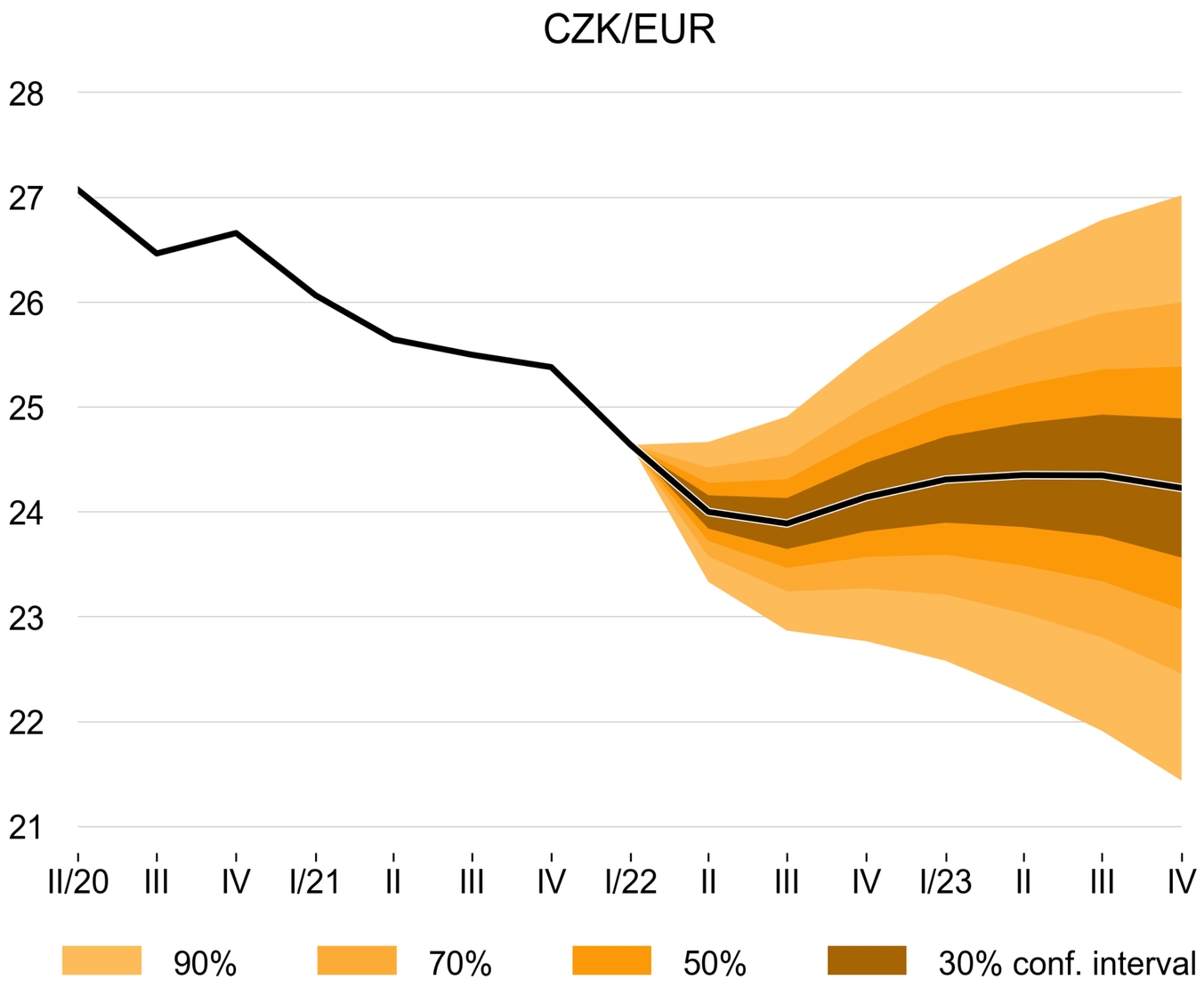
Gross Capital Formation





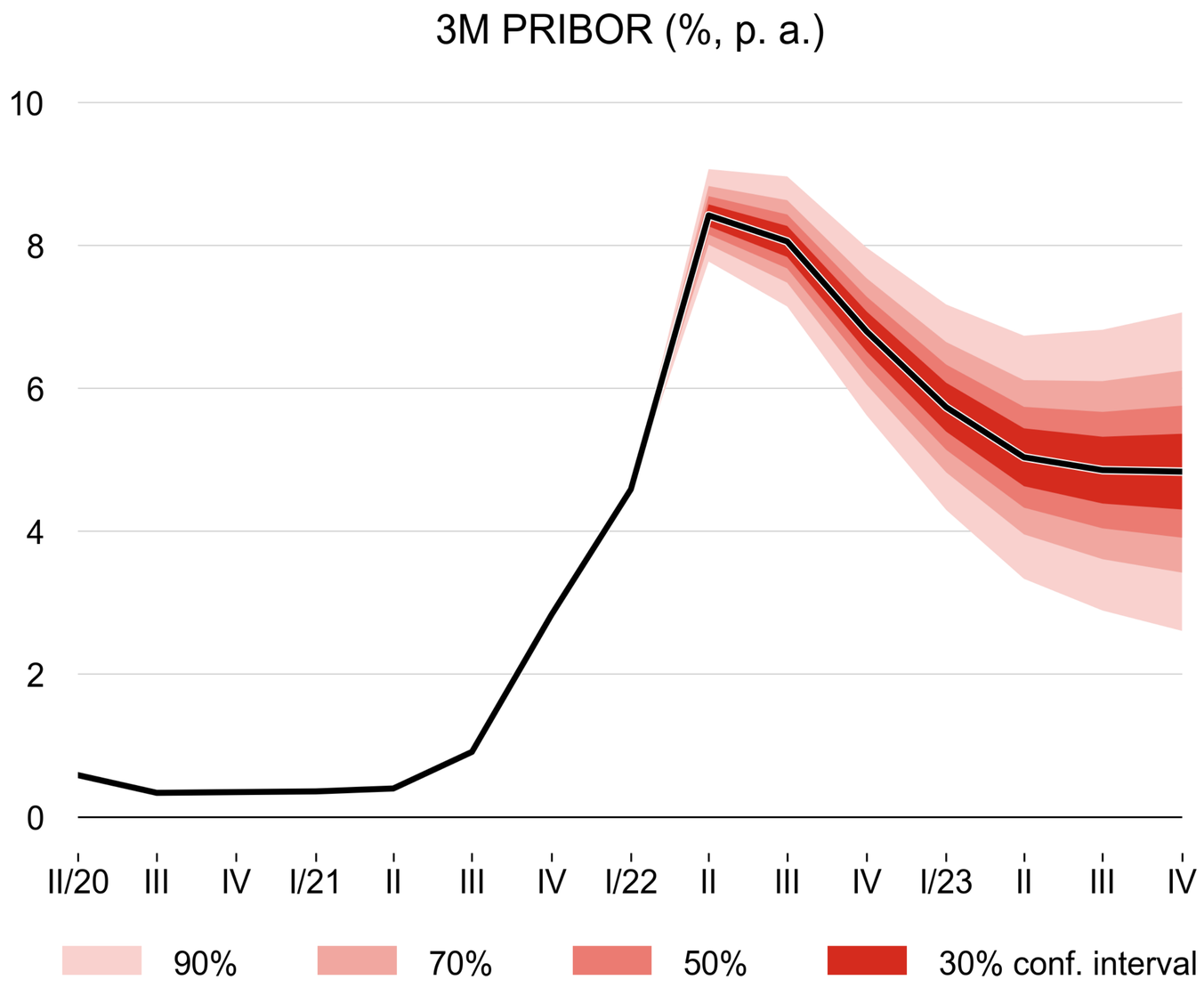
- **Private fixed investment** will decline overall this year. It will continue to grow next year as the difficulties in global production chains fade away and external demand picks up.
- **Government investment** will continue to increase in 2022 with financial support from EU funds and NGEU programmes. In 2023, it will rise further, supported by absorption of EU funds and a planned purchase of army helicopters.
- Additions to **inventories** will remain close to last year's extreme levels until mid-2022 and then fall only gradually.
- **Exports** will be dampened this year by continued supply disruptions and by the war in Ukraine, and will start to grow again as these issues fade out.
- The fall in **imports** will exceed that in exports due to a significant cooling of the domestic demand.

Exchange Rate CZK/EUR



- According to the forecast, the **koruna** will strengthen close to CZK 24 to the euro in Q2, due to a further widening of the interest rate differential vis-à-vis the euro area.
- The koruna exchange rate will fluctuate in a wider range just above this level next year.
- Stronger appreciation will be prevented by still fevered sentiment on global financial markets related to the war in Ukraine and continuing difficulties in international trade, which, coupled with high commodity prices, will be reflected in a sizeable goods and services deficit.
- This will be joined at the end of this year by a tightening of ECB monetary policy amid a gradual decline in domestic interest rates, which will also prevent the koruna from appreciating.

Interest Rate Path (3M PRIBOR)



- Consistent with the baseline scenario of the forecast, in which the central bank sets interest rates in order to achieve the 2% target at the standard monetary policy horizon, is a further sharp rise in **market interest rates** until the middle of the year, followed by a gradual decline.
- The forecasted surge in rates is a response to a combination of exceptionally strong price pressures from abroad and persisting domestic inflation pressures, reflected in accelerating and broad-based price growth.
- The subsequent decline in rates in the forecast reflects an expected decrease in inflation pressures next year, conditional on the initial monetary policy response.

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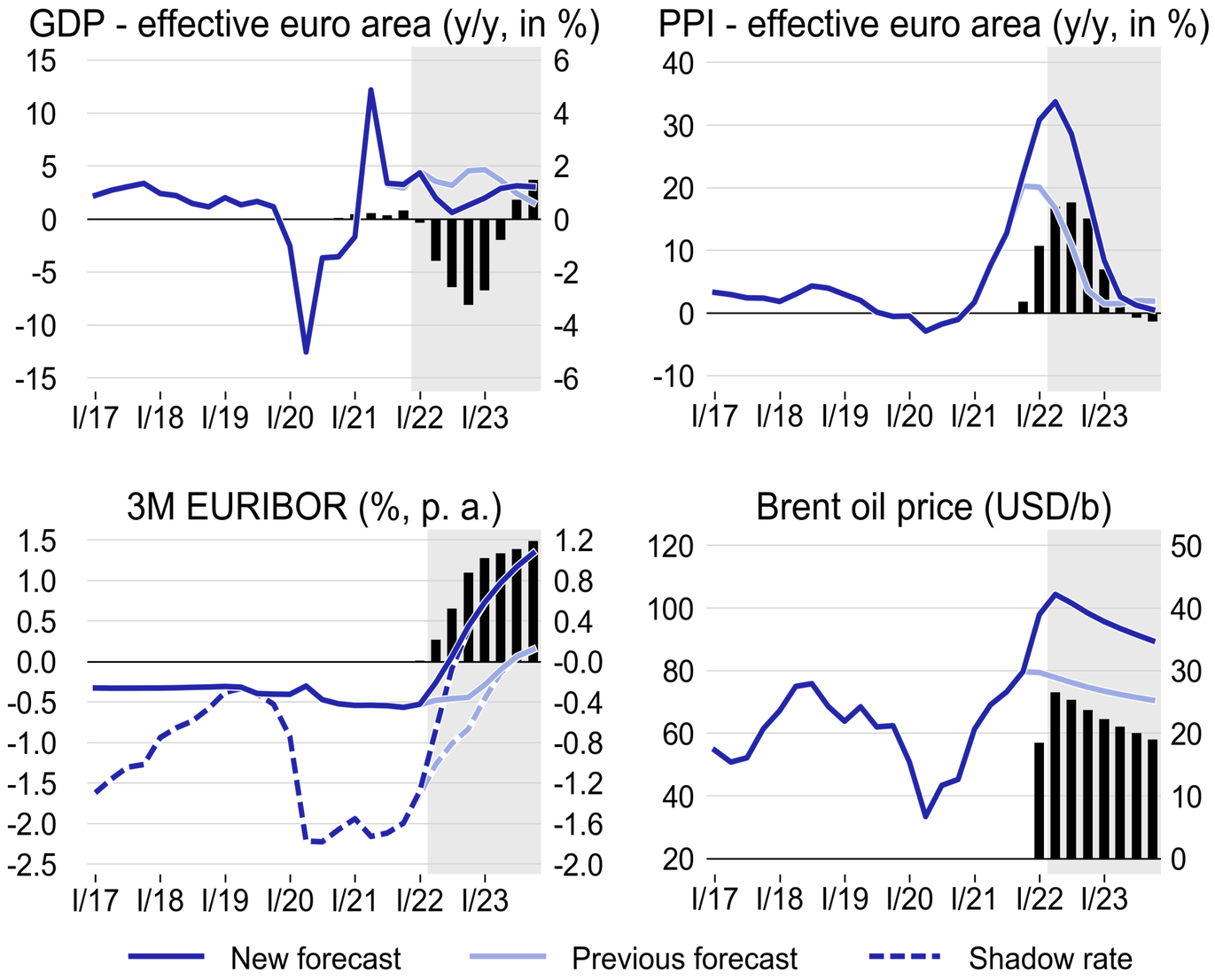
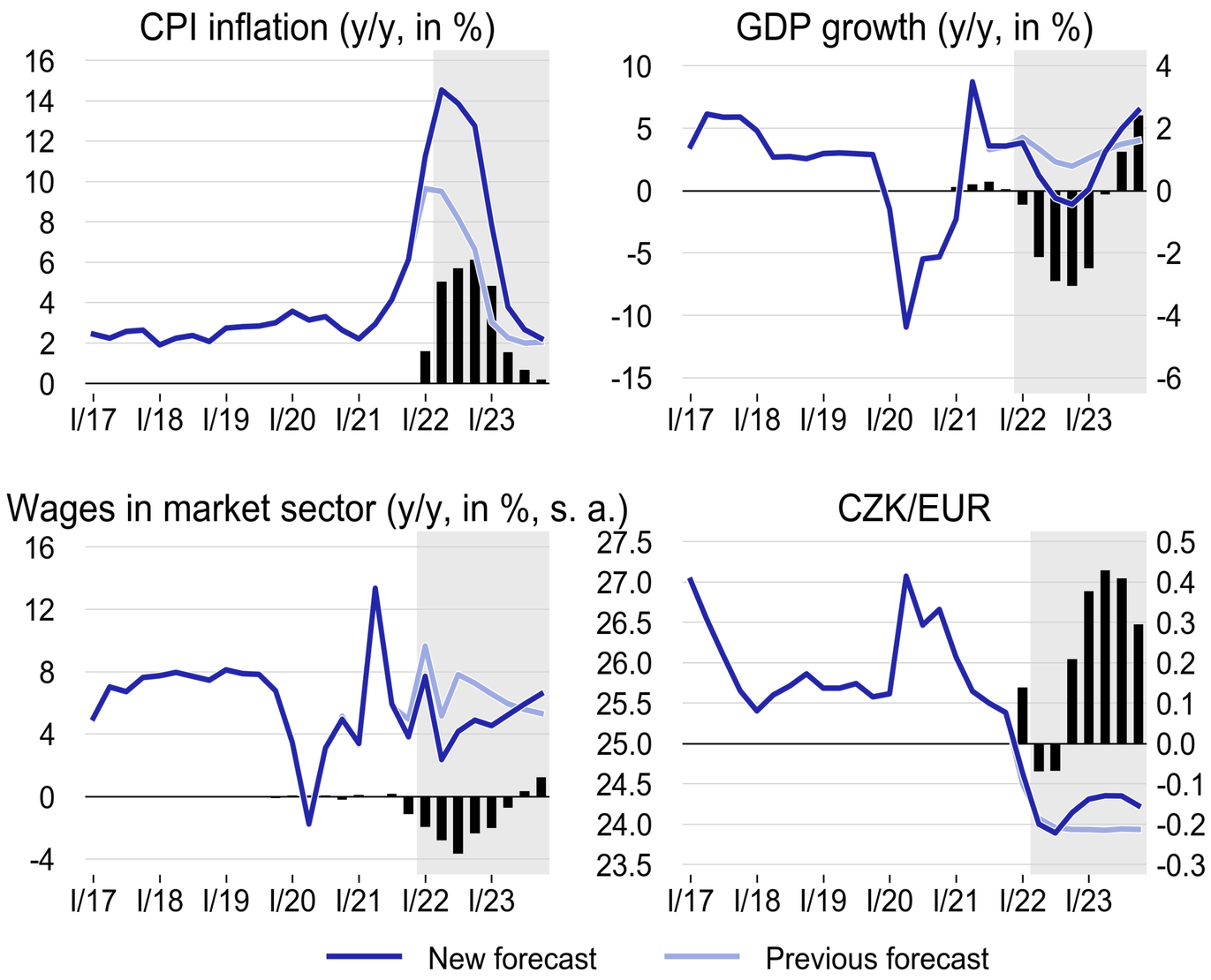
Comparison with Previous Forecast: Foreign Outlook



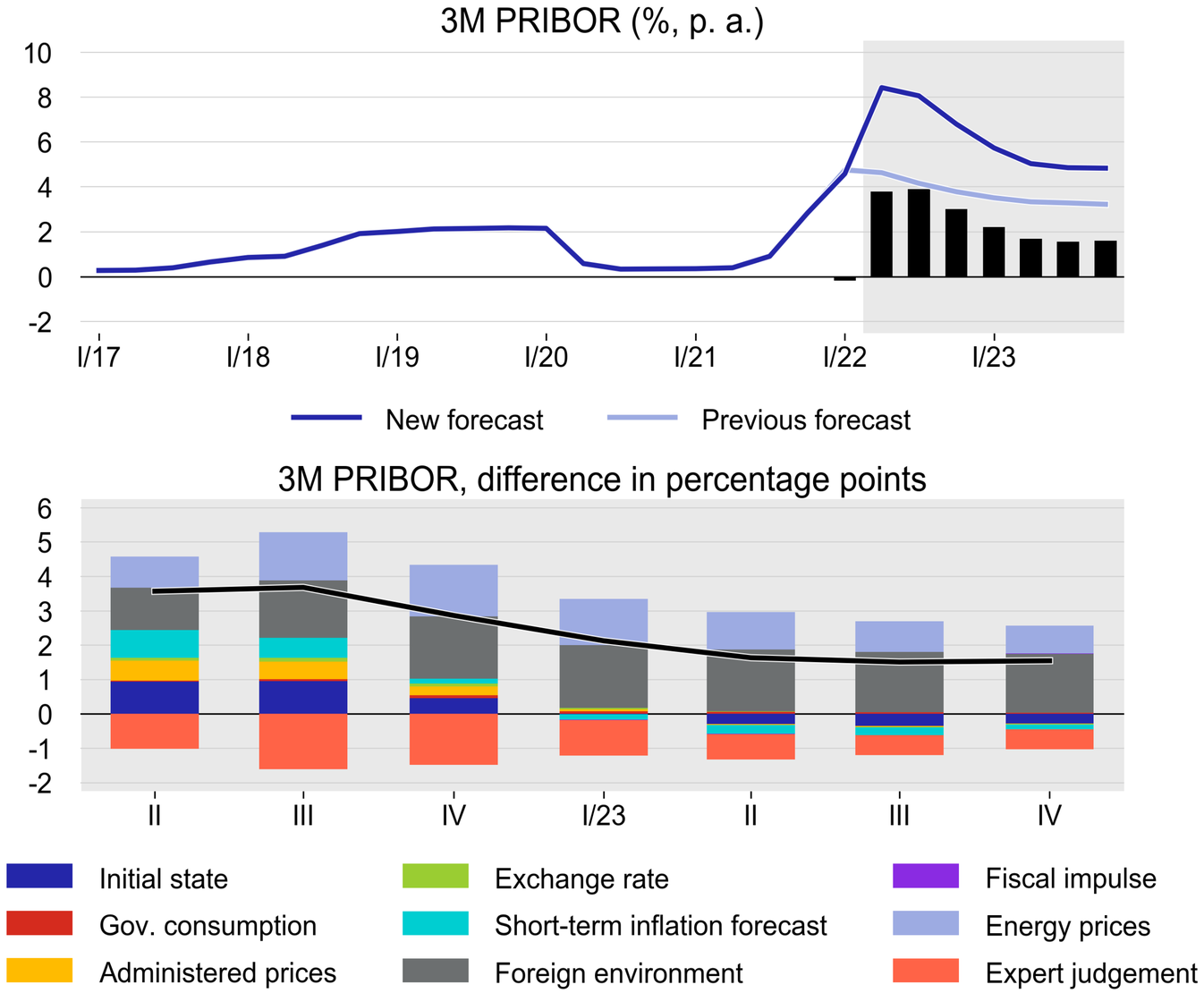
- The **foreign economic growth** outlook has been revised down for both years, this year mainly because of longer-lasting supply chain problems along with the impacts of the war in Ukraine.
- The marked increase in the **foreign producer price** outlook reflects a jump in prices of most commodities coupled with supply chain problems newly aggravated by the war.
- The markedly higher **Brent crude oil** outlook is subject to exceptional uncertainty and is associated predominantly with the impact of sanctions on Russian oil exports.
- The expected **3M EURIBOR** market interest rate has shifted higher due to the ECB's expected reaction to the higher inflation outlook.

Comparison with Previous Forecast: Domestic Economy



- The **GDP growth** outlook for this year is substantially lower, due mainly to a greater-than-expected cooling of domestic demand.
- The marked upward revision of the **CPI inflation** forecast in 2022 is due to all its components.
  - Faster growth in inflation abroad has moved the outlook for domestic core inflation upwards considerably.
  - The further rise in the administered price outlook is due to higher energy price growth.
  - The food price forecast is significantly higher, due to higher growth in agricultural commodity prices.
- **Wage growth** is lower mainly for this year, due to weaker economic activity amid high production costs, with employment of refugees also playing a role.
- **The koruna** will be weaker than in the previous forecast over the entire outlook.

Comparison with Previous Forecast: 3M PRIBOR



- **The interest rate** path has shifted significantly higher.
- **The initial state** fosters higher rates in 2022, mainly reflecting faster growth in foreign production prices at the start of the year.
- The higher rates are also due to the **short-term inflation** forecast and the outlook for faster growth in **administered prices**.
- The **foreign outlook** fosters higher rates over the entire forecast horizon, reflecting less accommodative ECB monetary policy and stronger contribution of the core foreign PPI.
- The contribution of the **energy** component of import prices reflects a higher outlook for exchange prices of oil, gas and electricity.
- **Expert adjustments** foster lower rates over the entire forecast horizon (easing of demand-driven inflation pressures in the economy, faster than usual fadeout of the currently high growth in prices).

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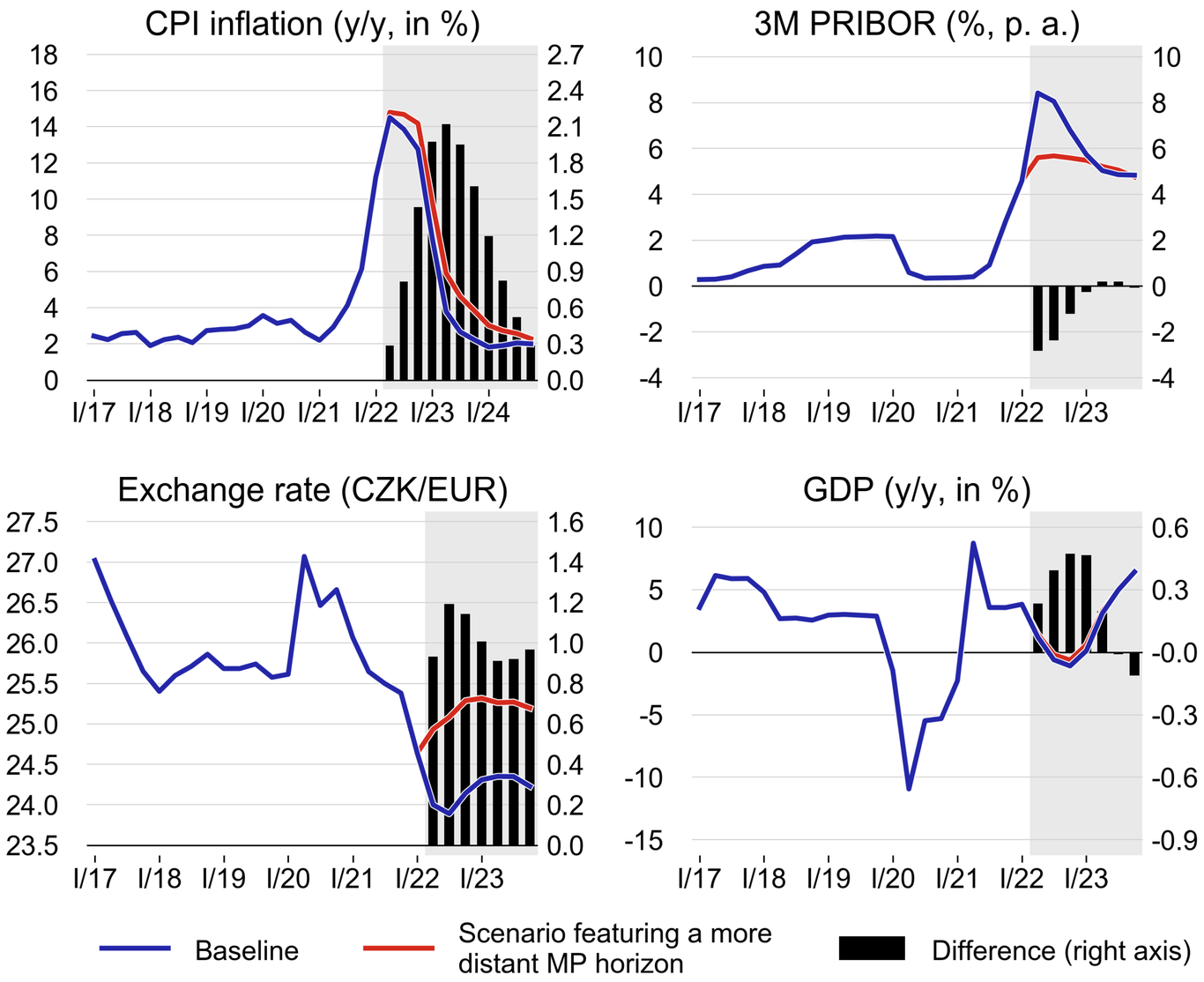
Scenario Featuring a More Distant MP Horizon



- **Monetary policy horizon** in the Taylor rule **is shifted by two quarters into the future.**
- **Thus, the CB abstracts from inflation development**, which is being directly affected by exogenous price shocks that will influence inflation **at a horizon of 12–18 months**.
- The scenario also assumes that **inflation expectations remain anchored** to the target.
- **The market interest rate** path is **lower than in the baseline scenario**, especially this year (peaking at almost 6%).
- **The exchange rate** of the koruna is **significantly weaker**, due to a substantially narrower interest rate differential.
- The lower interest rates, coupled with the weaker exchange rate, lead to **distinctly higher inflation** than in the baseline scenario. The inflation target is overshot by more than 2 pp at the standard MP horizon.

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Thank you for your attention

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