CZECH NATIONAL BANK

CNB’s New Forecast (Monetary Policy Report Winter 2022)

Meeting with Analysts

4 February 2022

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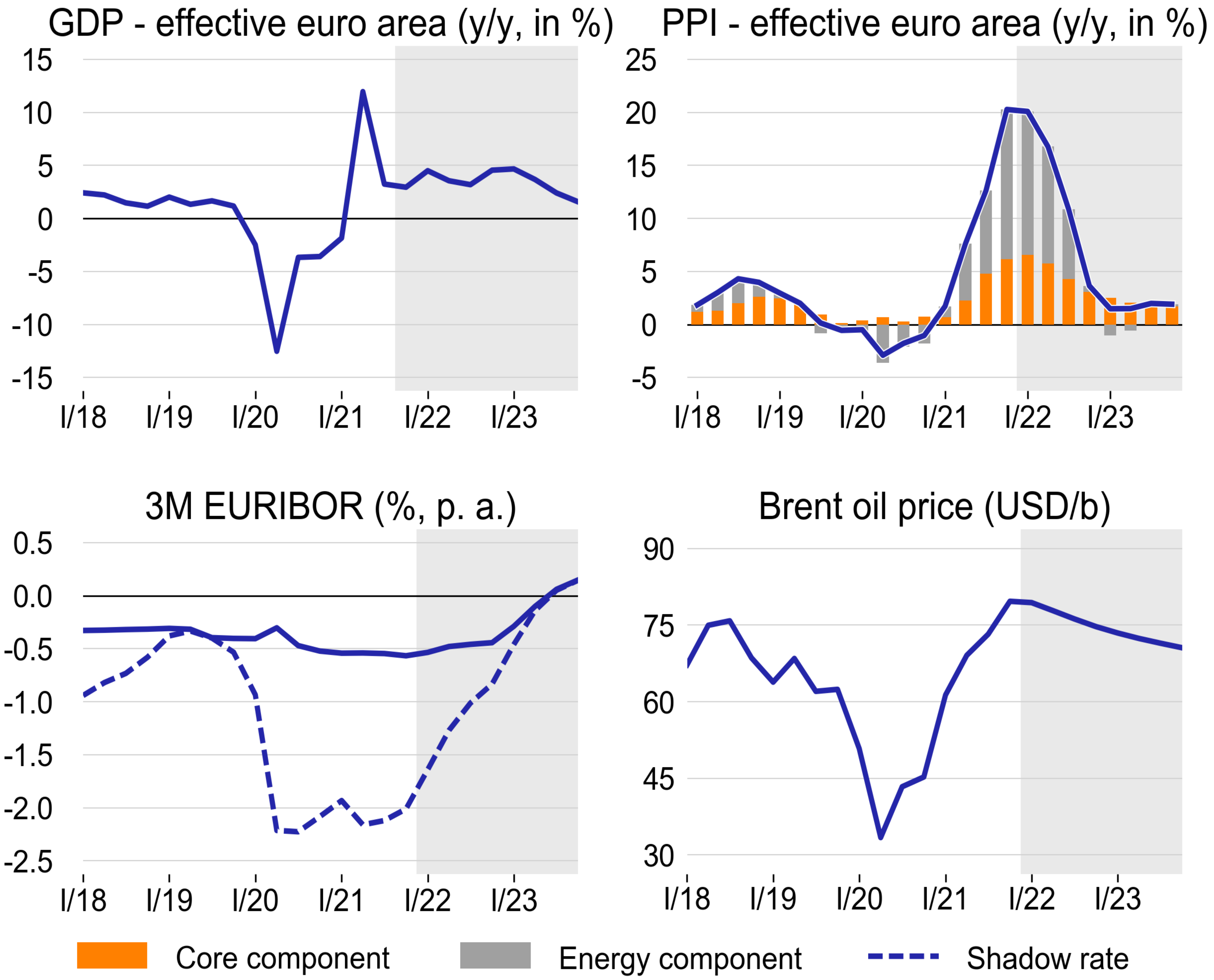
Presentation Outline

1. **Assumptions of the Forecast**
2. The New Macroeconomic Forecast
3. Comparison with the Previous Forecast

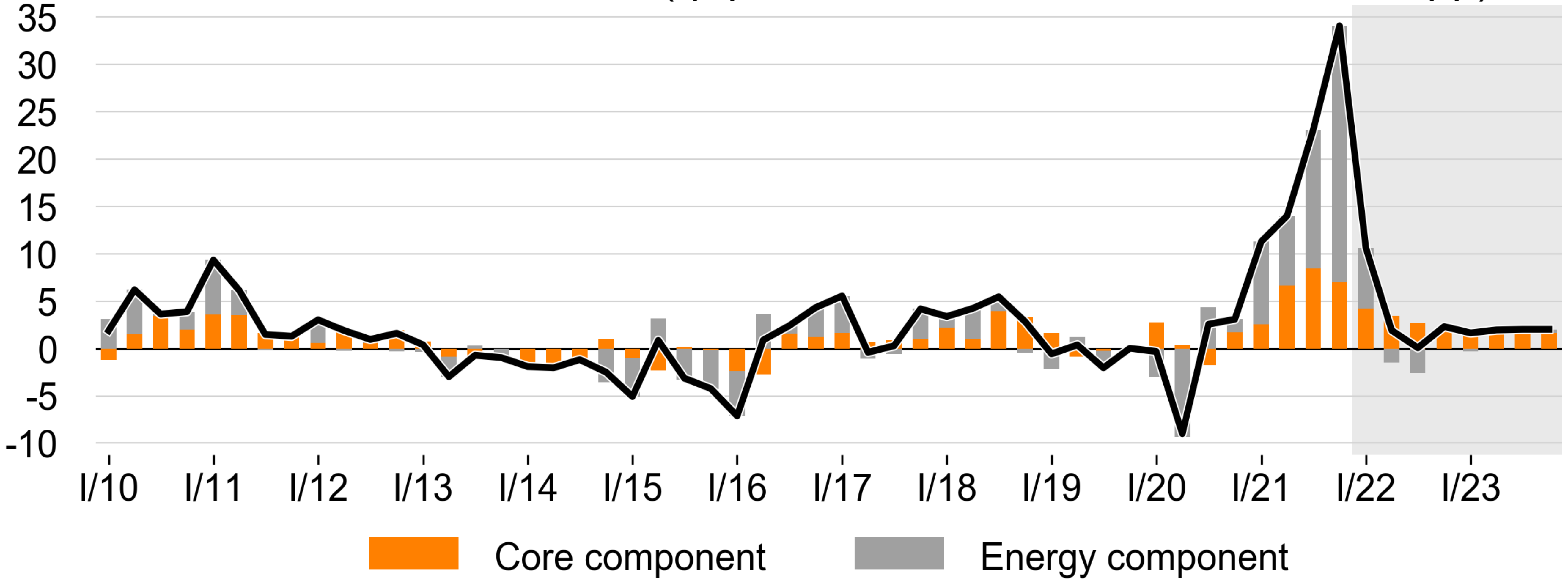
External Environment Outlook



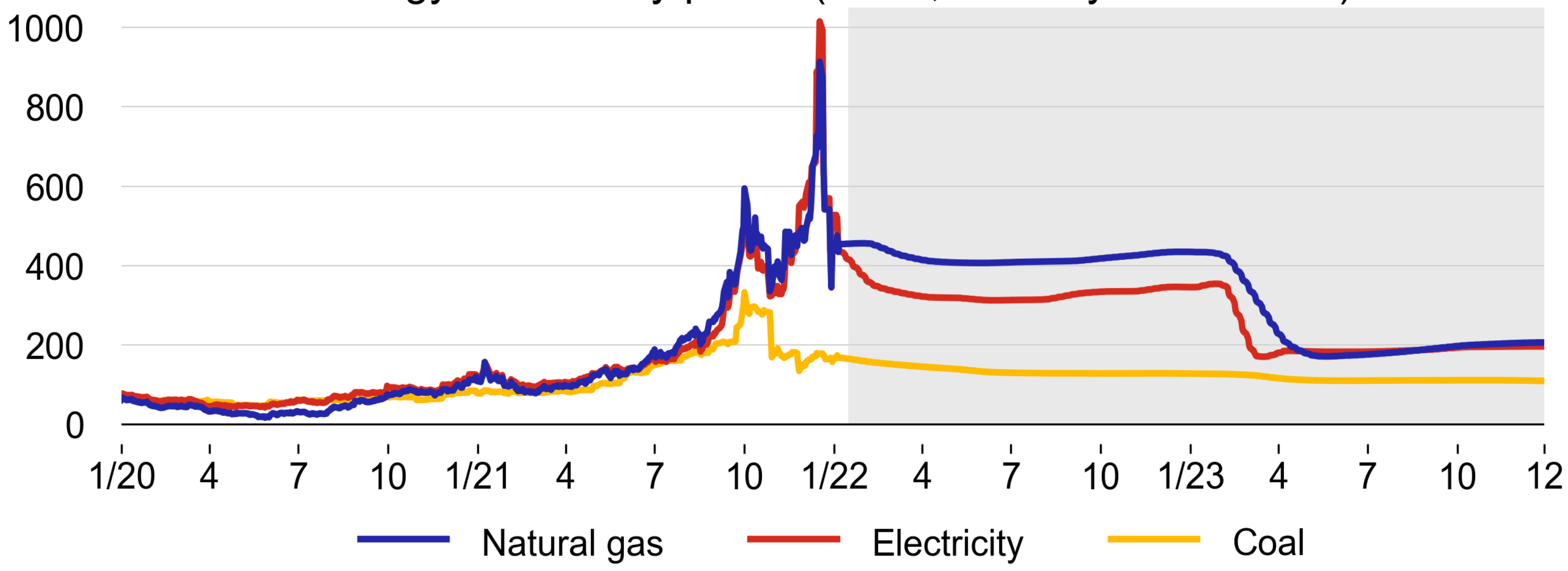
- The stress in global chains will start easing for good in roughly mid-2022. Coupled with a better epidemic situation and spending under national recovery and resilience plans, this will give the effective EA economy a growth impulse.
- Overall, **GDP growth in the effective EA** will reach 4% this year and slow slightly next year.
- The **inflation pressures in the production sector** hit a historical high at the end of 2021. The price growth abroad will be driven by energy prices.
- **Oil prices** will edge down in the next two years from the currently elevated levels.
- At its last meeting, **the ECB** confirmed the expected reduction in asset purchases; this is reflected in a rising **3M EURIBOR shadow rate**. The US Fed is expected to tighten monetary policy relatively quickly.

Producer Prices in Effective EA and Commodity Prices

PPI - effective euro area (q/q, in %, annualised, contributions in pp)

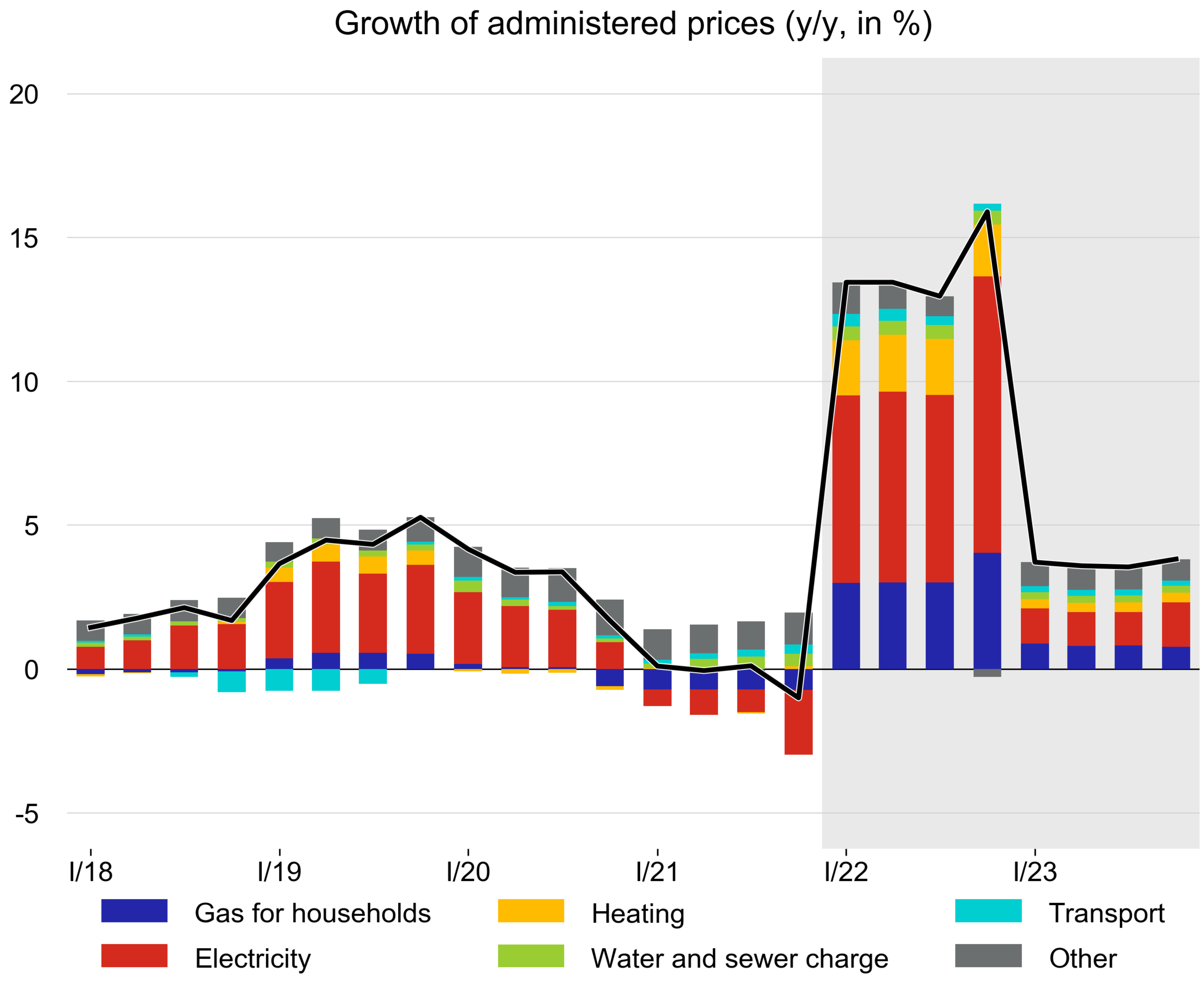


Energy commodity prices (index, January 2017 = 100)



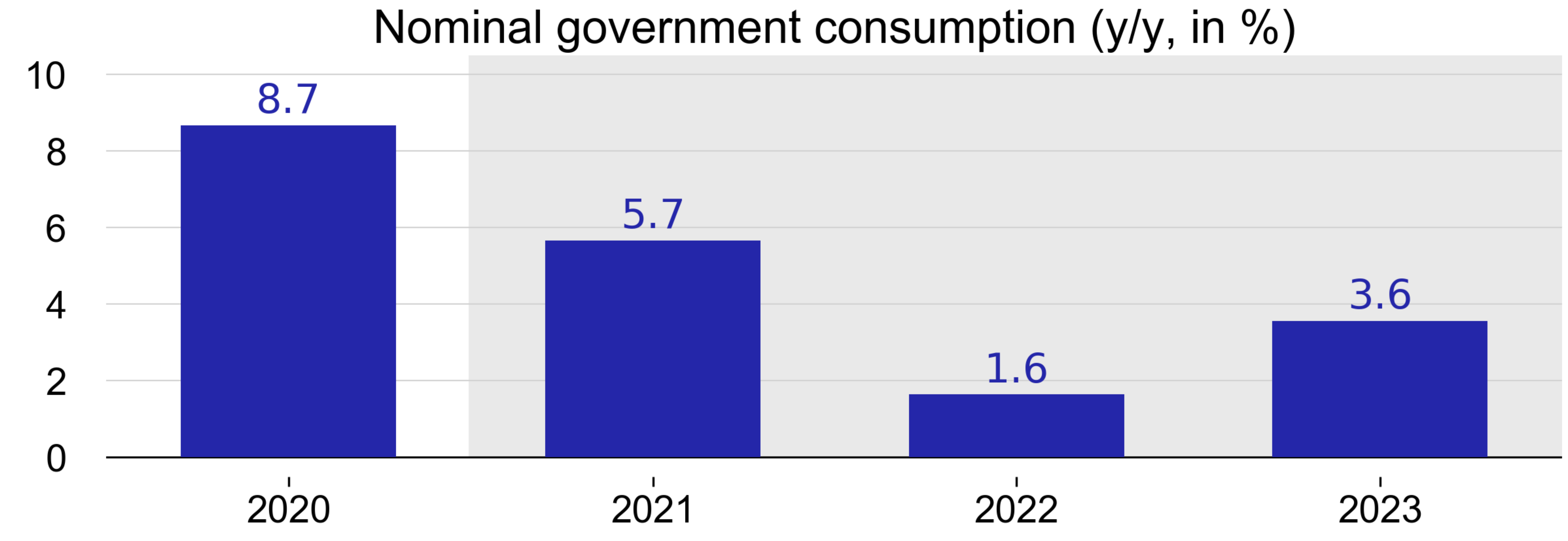
- The **inflation pressures in industrial production** strengthened exceptionally in 2021 Q4, mainly due to record-high prices of natural gas and electricity (captured by the **energy component**).
- Robust demand for industrial goods is being reflected in producer price inflation via its **core component.**
- In the longer run, falling prices of energy commodities will reduce the inflation pressures. However, according to market expectations, these commodities cannot be expected to become significantly cheaper until 2023.

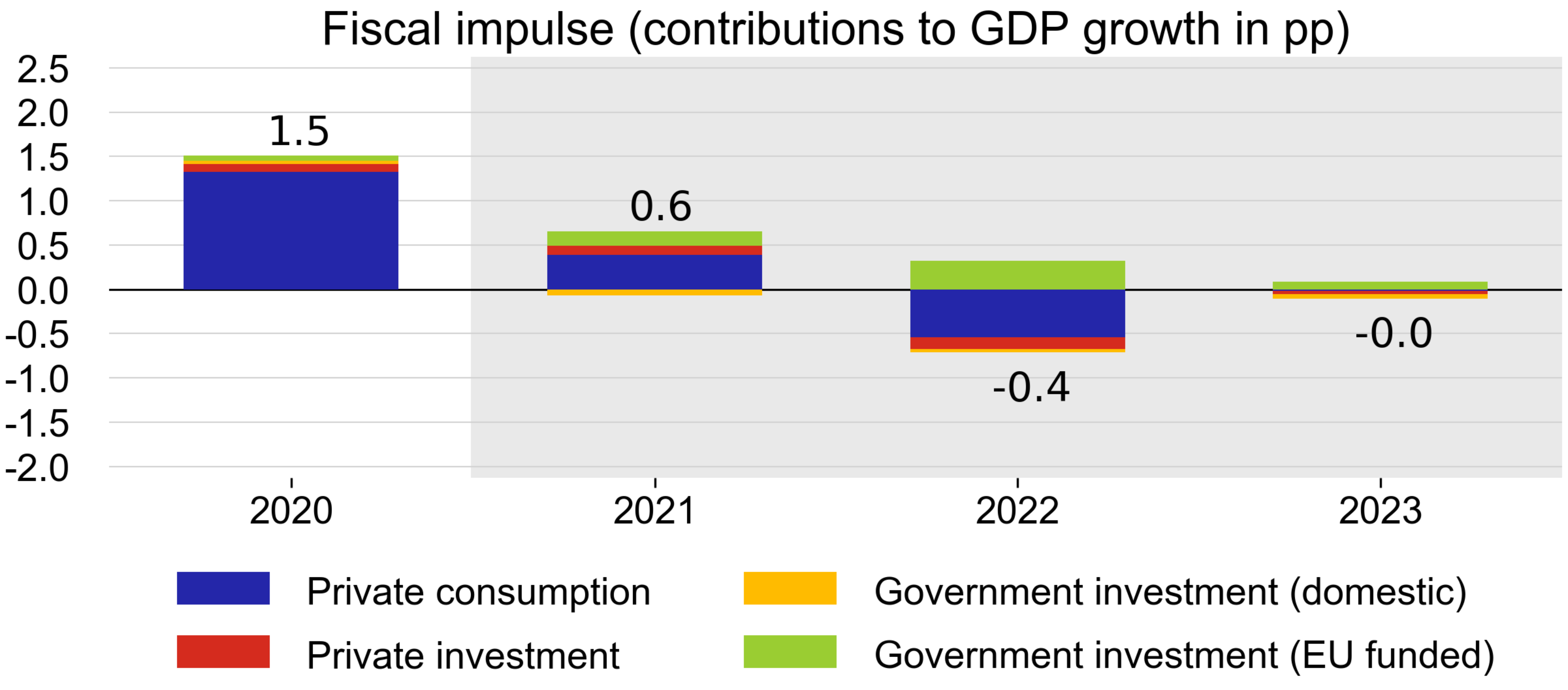
Growth of Administered Prices



- Following a temporary drop in 2021 Q4, **administered prices** will rise sharply at the start of this year, due to the surge in energy prices.
- They will reflect high commodity exchange prices of energy. Housing-related energy (electricity, natural gas, heating) will thus become significantly more expensive in the domestic administered price segment.
- Overall, administered price inflation will fluctuate around 13% during most of this year. In 2023, it will slow but will still be close to 4%, due to high prices on commodity exchanges.

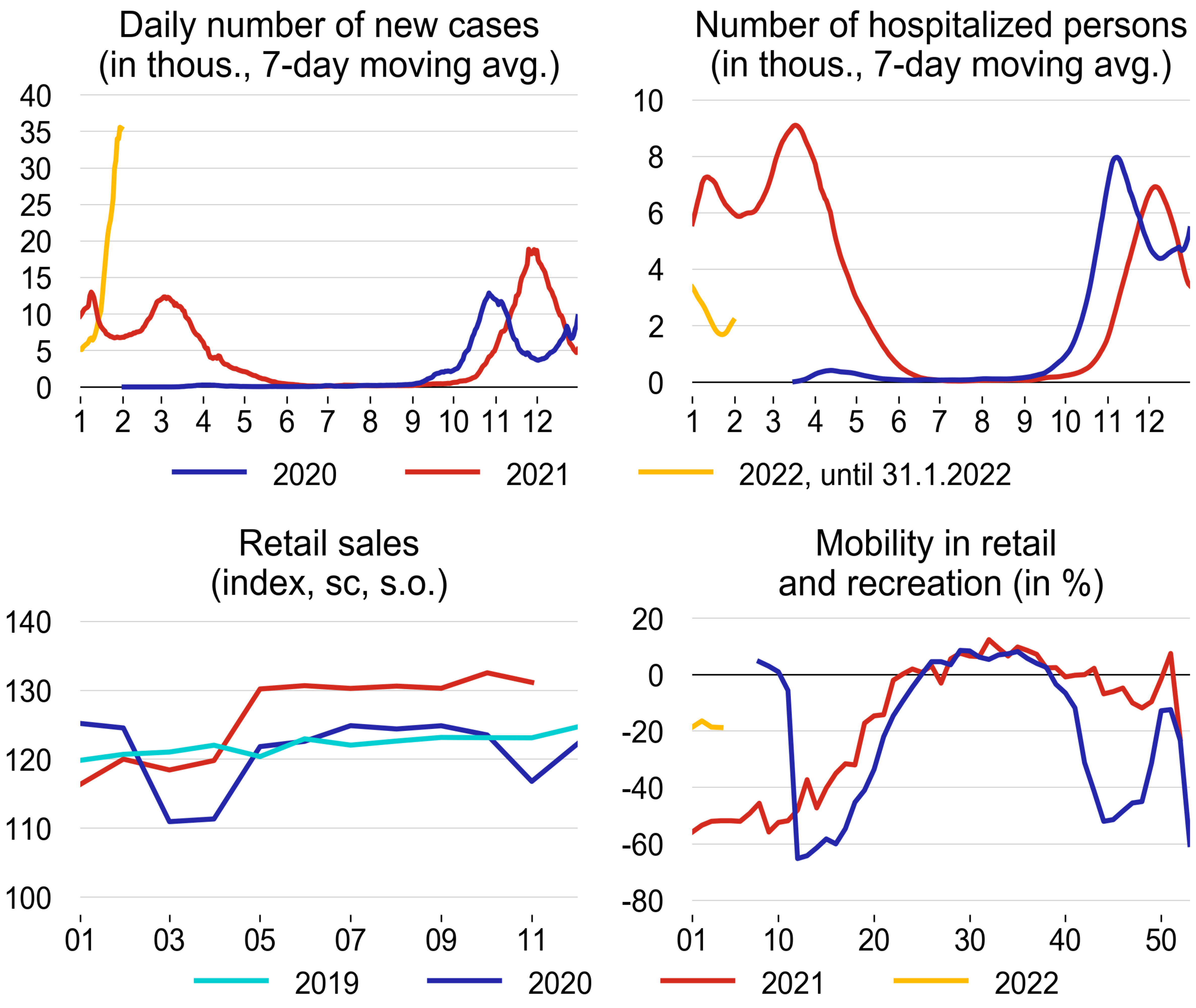
Fiscal Policy





- **Nominal government consumption** growth slowed last year due to base effects, despite continued high pandemic-related spending, especially in health care. A large part of this expenditure should fade out this year, leading to another slowdown in government consumption.
- The **fiscal impulse** will dampen GDP growth this year. This will be due to the termination of many of the measures that supported the economic recovery for most of last year.
- However, the restrictive effect associated with the phasing out of stabilisation measures this year will be partly offset by an increase in pensions and faster absorption of EU funds among others.

Pandemic Development and Consumer Behaviour



Note: Google mobility represents the percentage change in the average value of the working week compared to normal pre-pandemic activity (3.1. - 6.2.2020).
Google mobility data is seasonally unadjusted.

- The **number of new cases** is rising again at the start of this year as Omicron spreads, hitting all-time daily highs.
- Despite this, the **forecast assumes** that there will be **no additional epidemiological measures with visible economic impacts** (due to, for example, the lower risk of severe illness with Omicron).
- The anti-pandemic measures in place so far have not brought about visible changes in consumer behaviour.
- Over most of last year, **retail sales** were already well above their pre-pandemic value.
- **Mobility in shops and recreation facilities** was well above 2021 at the beginning of this year.

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Headline and Monetary Policy-Relevant Inflation

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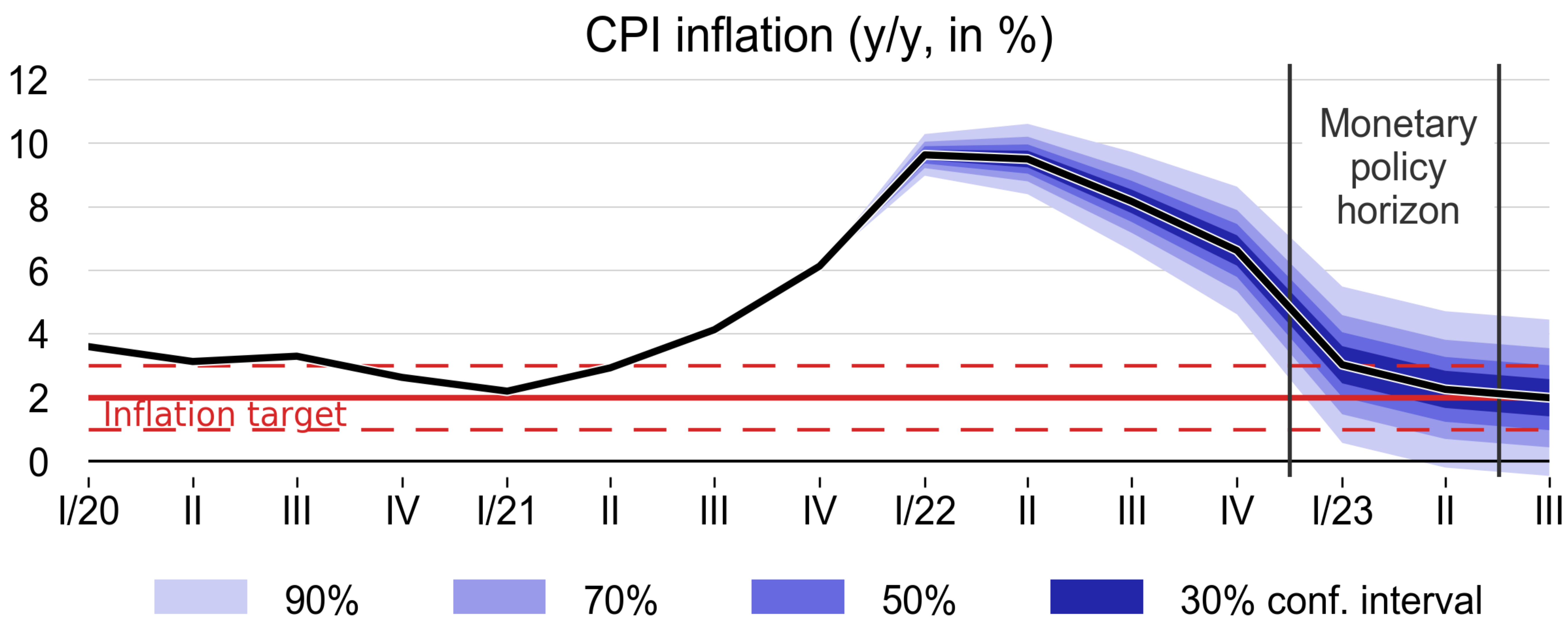
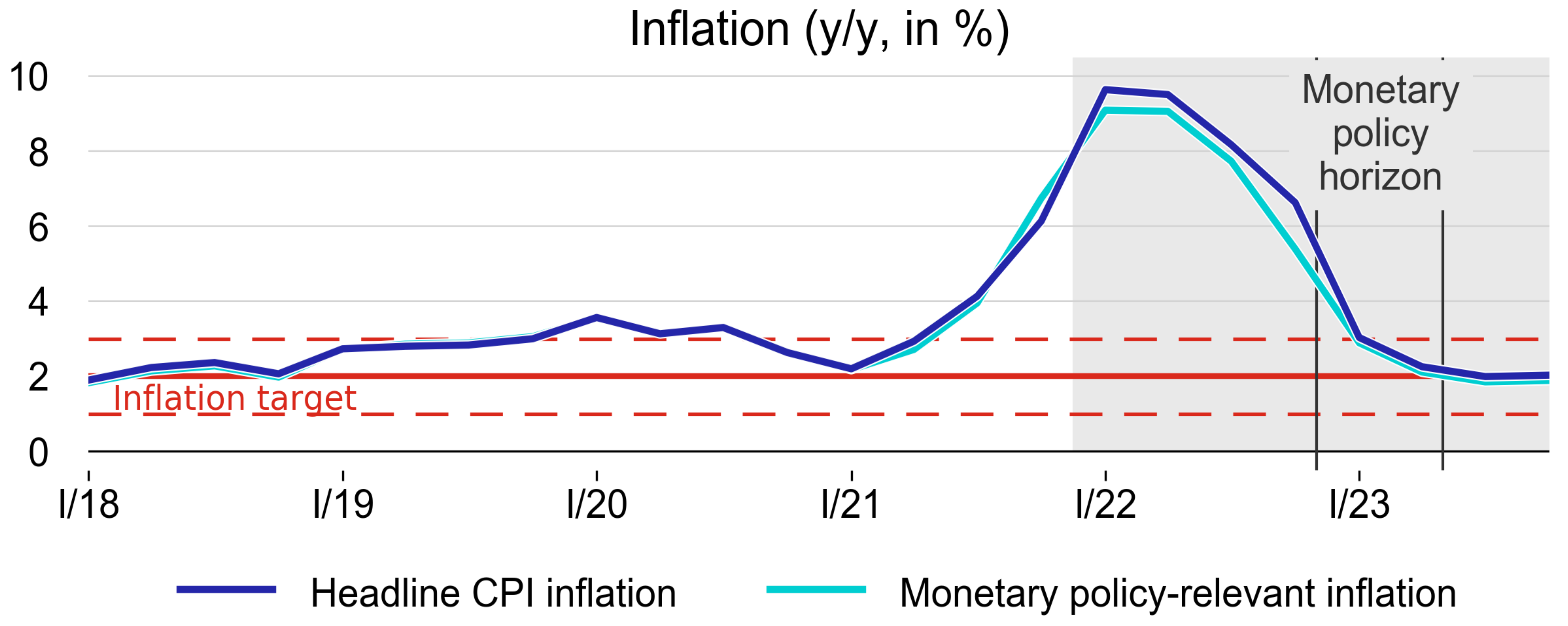
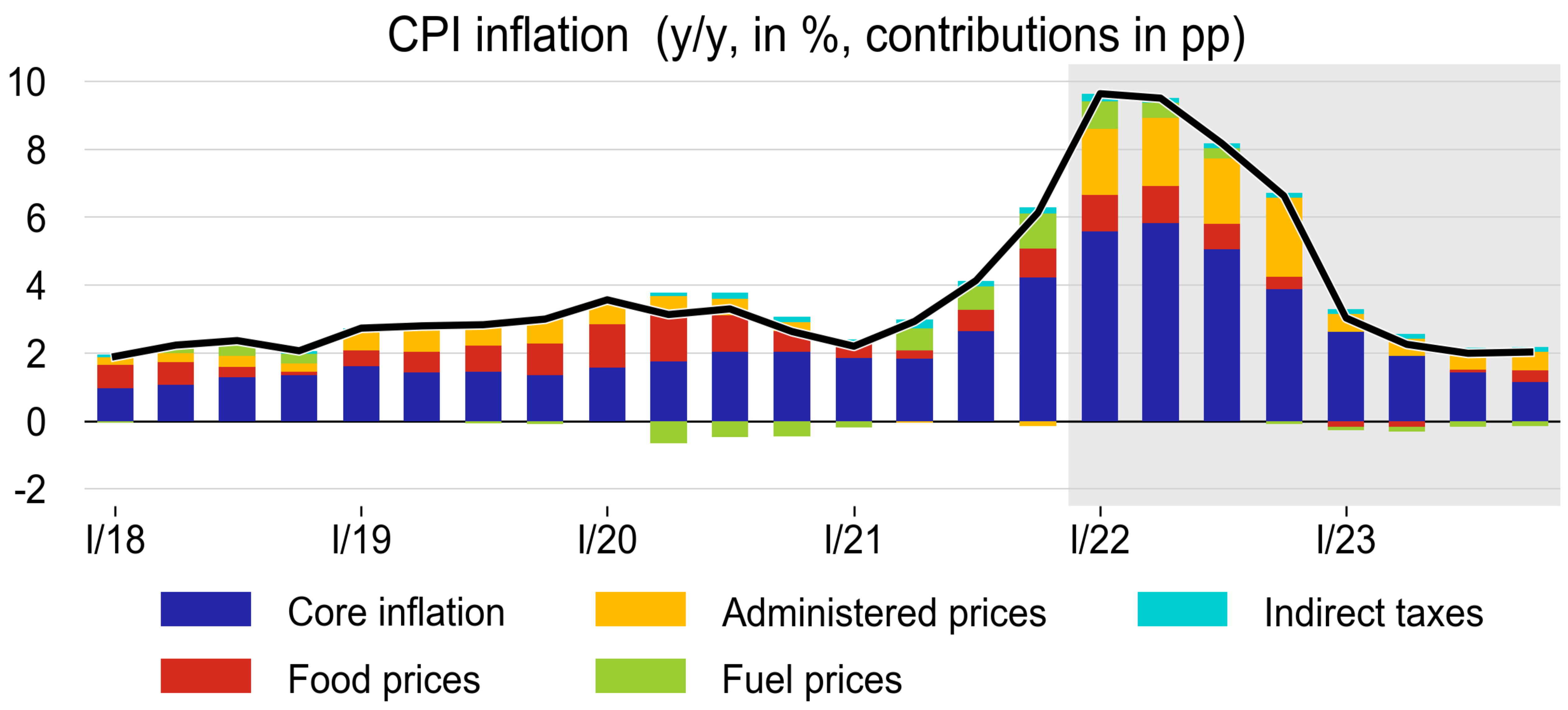
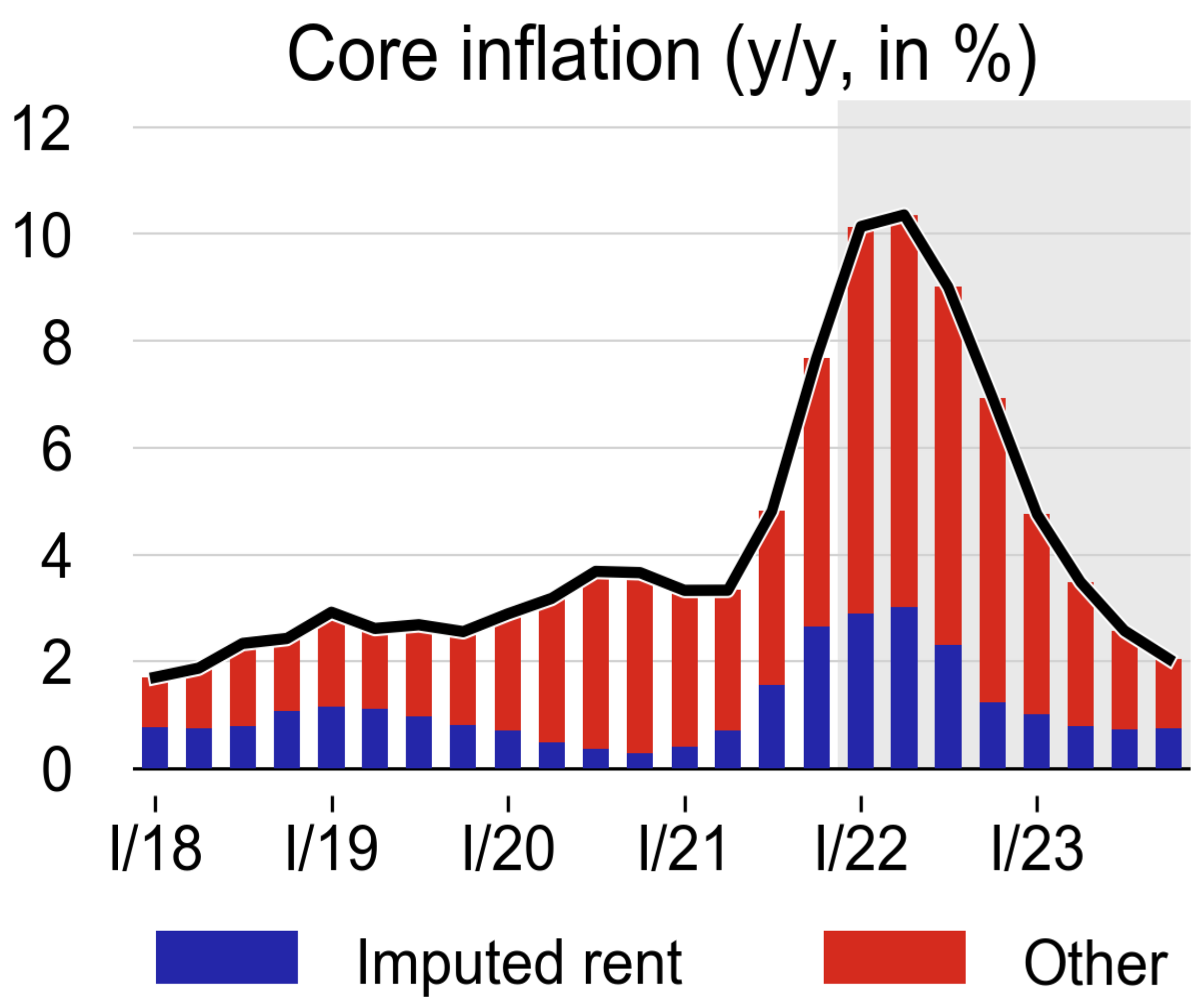


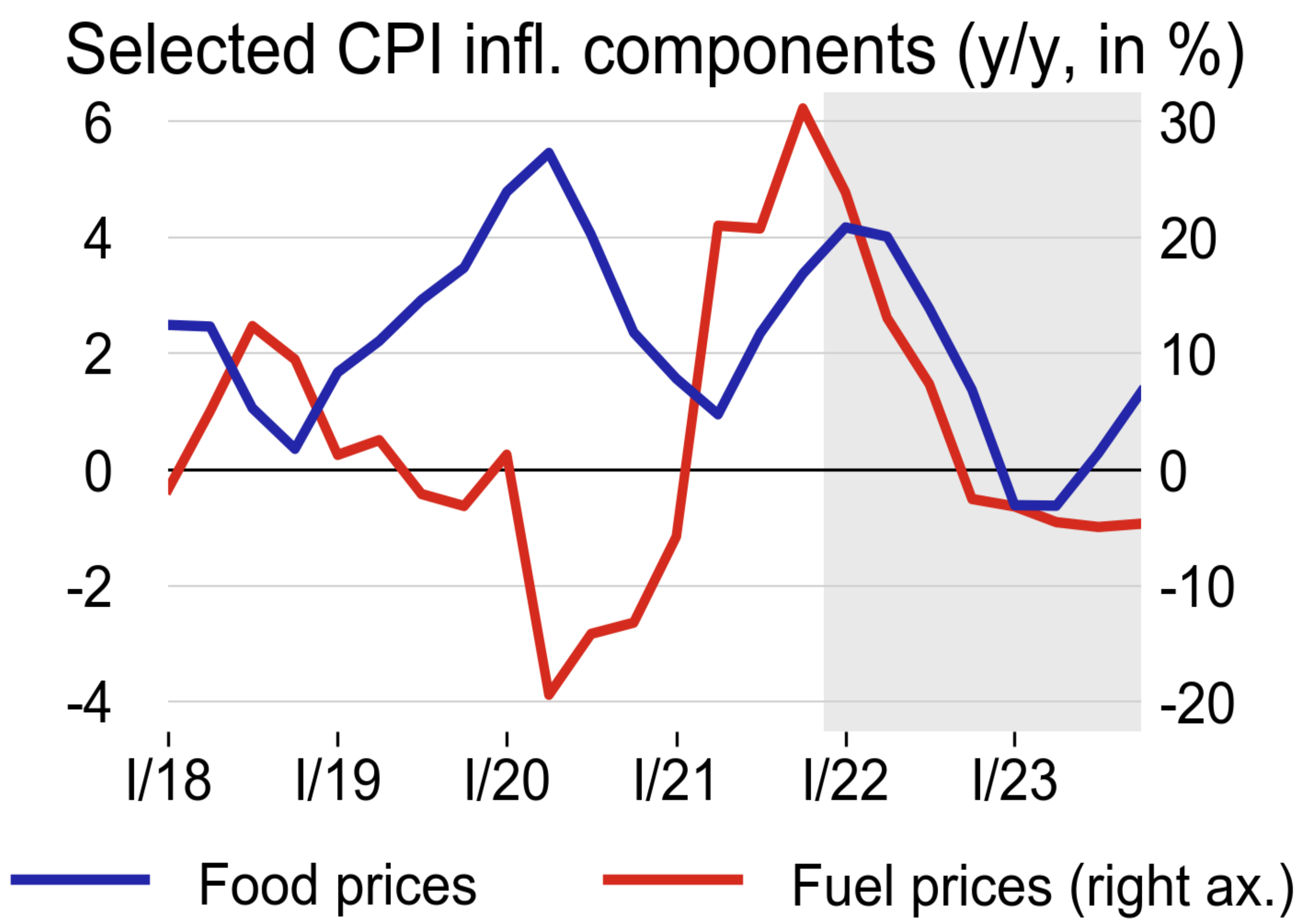


- **CPI inflation** will rise to almost 10% in 2022 Q1 but will start to fall rapidly in 2022 H2 and decline close to 2% over the monetary policy horizon.
- **Domestic demand pressures** will push prices up further until mid-2022 as the positive gap in mark-ups in the consumer sector continues to grow.
- The inflationary effect of domestic demand will fade out at the end of this year, due to the previous monetary policy tightening.
- **Monetary policy-relevant inflation** will be below headline inflation over the entire forecast horizon.
- The first-round effects of changes to indirect taxes will reflect an increase in excise duty on tobacco and base effects of waiver of VAT on energy at the end of 2021.

Inflation

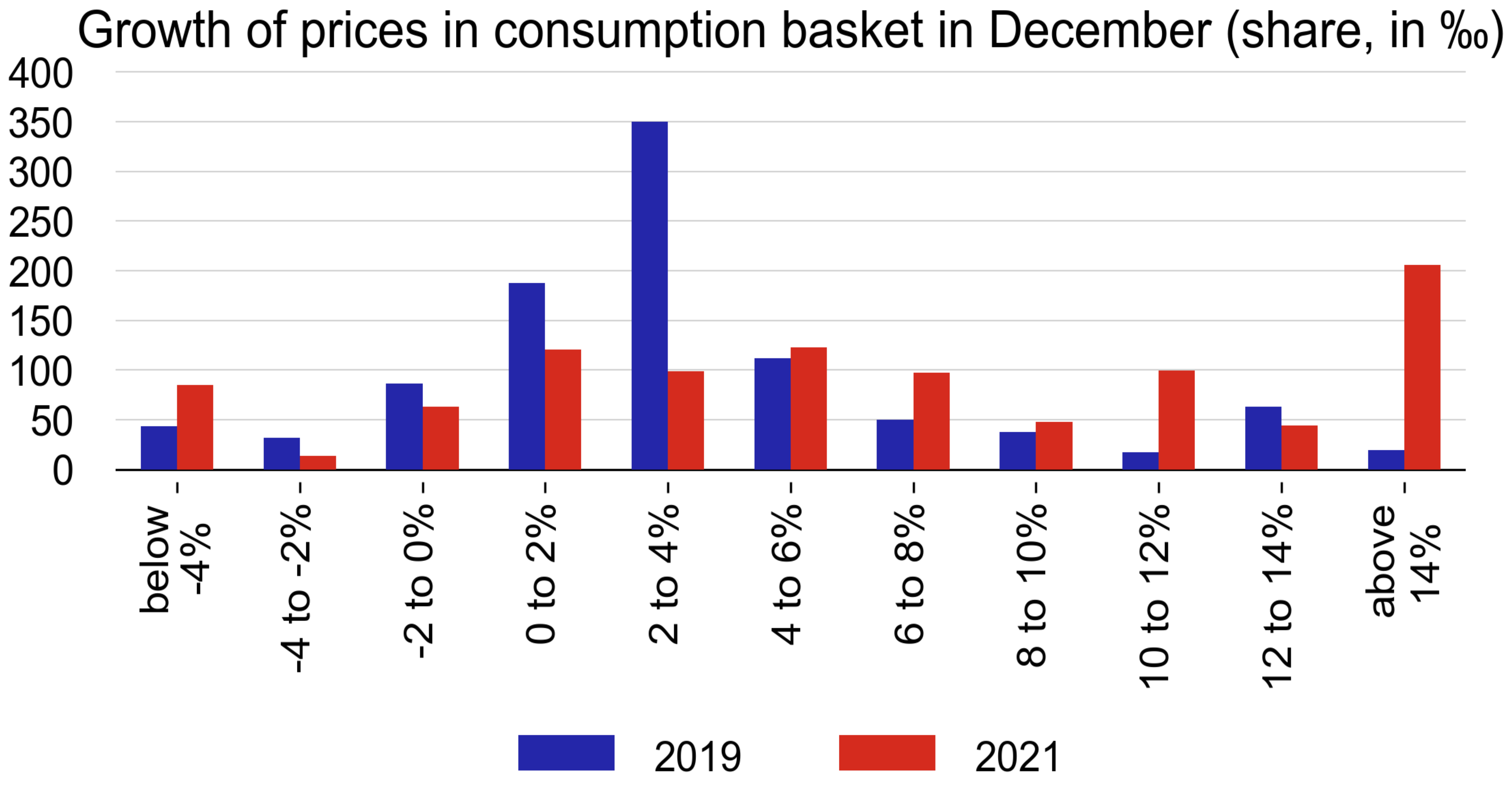


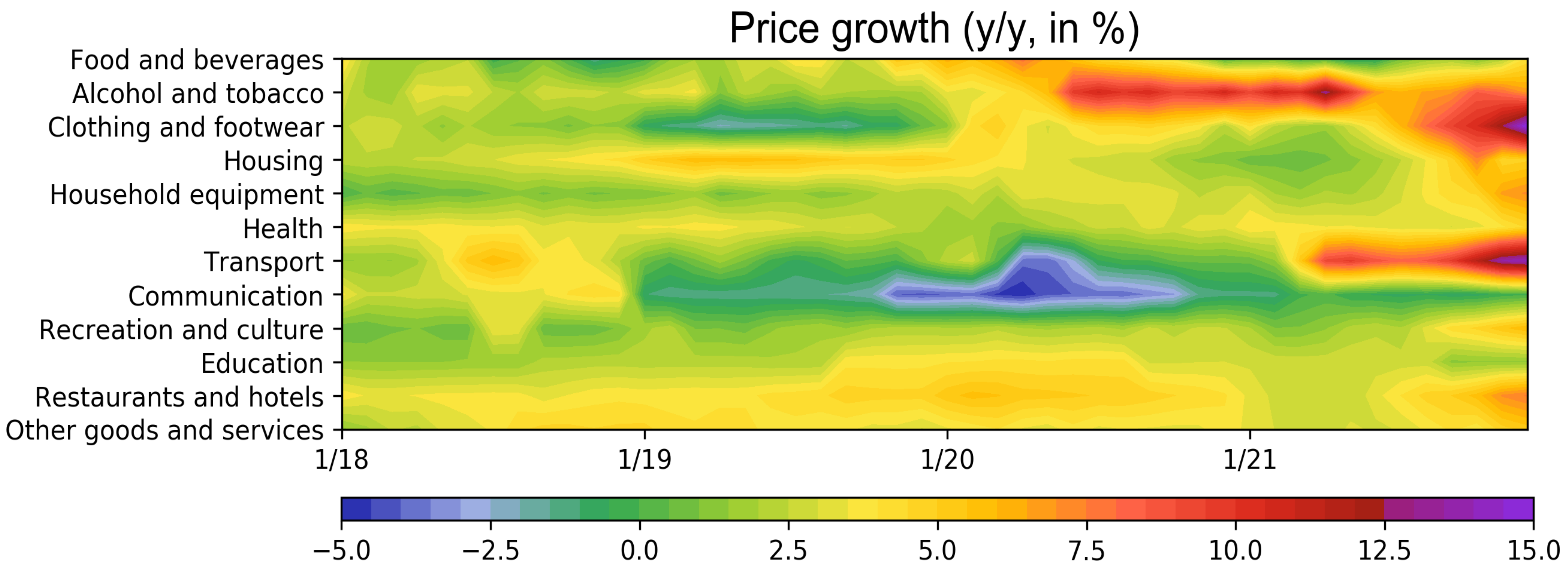




- Besides further growth in **core inflation**, a surge in **administered price inflation** will foster growth in headline inflation. Rising **food and fuel prices** will also support inflation.
- **Core inflation** will continue to rise apace at the start of this year, caused by the traditional January adjustments to price lists after the substantial increase in costs including prices of energies seen in the second half of last year. Within core inflation, **imputed rent** plays a big role.
- The surging **food price inflation**, mostly reflecting strong demand pressures and growth in global agricultural commodity prices, will peak in the first half of this year.
- **Fuel price inflation** will go down in 2022 H2, due to the previous firming of the koruna and stabilisation of global oil prices.

Broad-Based Price Growth

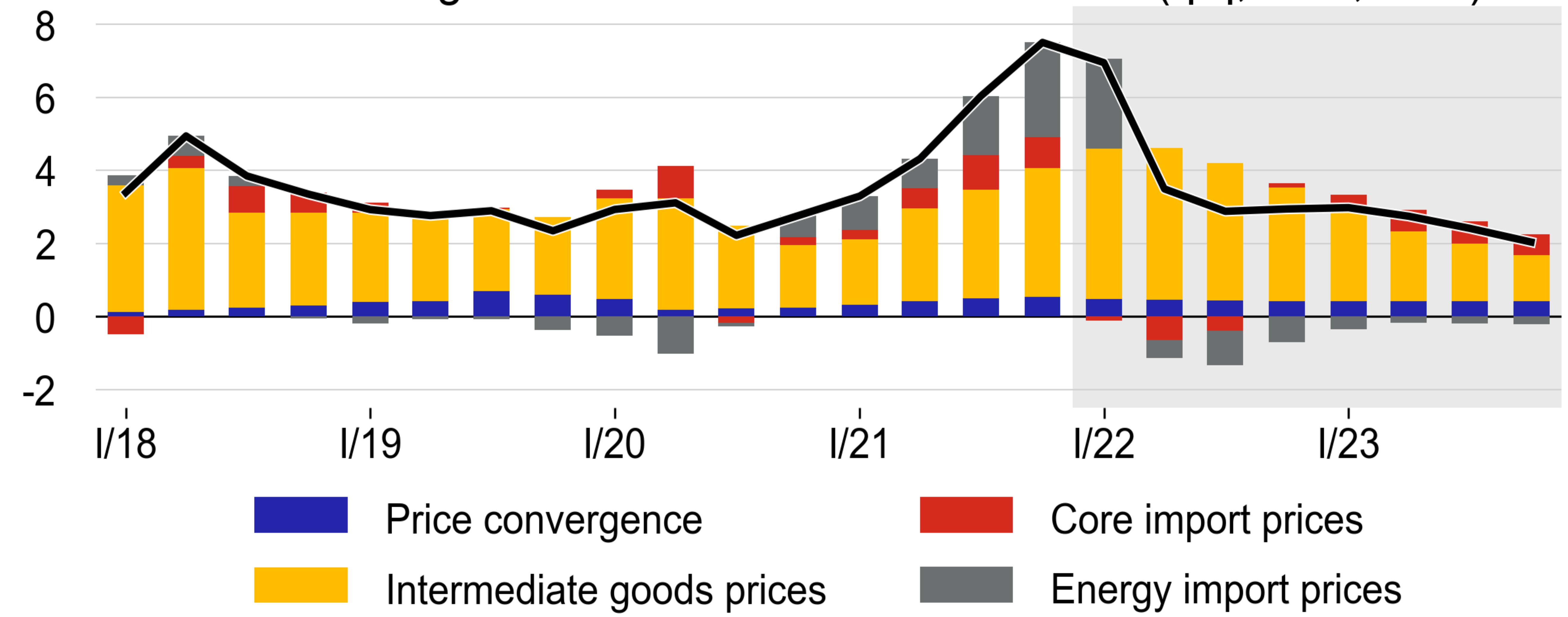




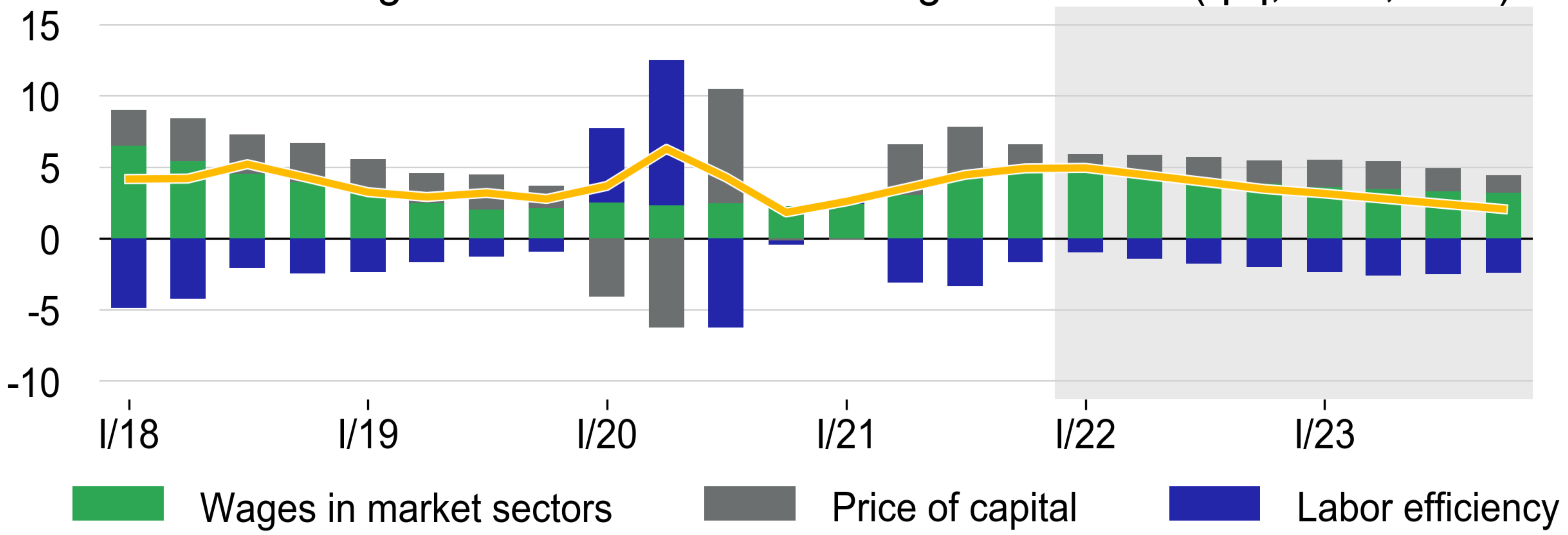
- The current **exceptionally high and still rising inflation** can be characterised by two phenomena:
  - **the intensity of the growth**,
  - **the broad nature of the rise in prices** across the items of the consumer basket.
- At the end of 2021, most of the consumer basket had moved to higher price growth than in 2019. The current elevated inflation is therefore not the result of significant growth in the prices of only a few items, but is broad-based.
- Domestic and global factors will most likely increase further in intensity in the current quarter, taking domestic inflation to its highest levels in the last two decades.

Cost Pressures

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

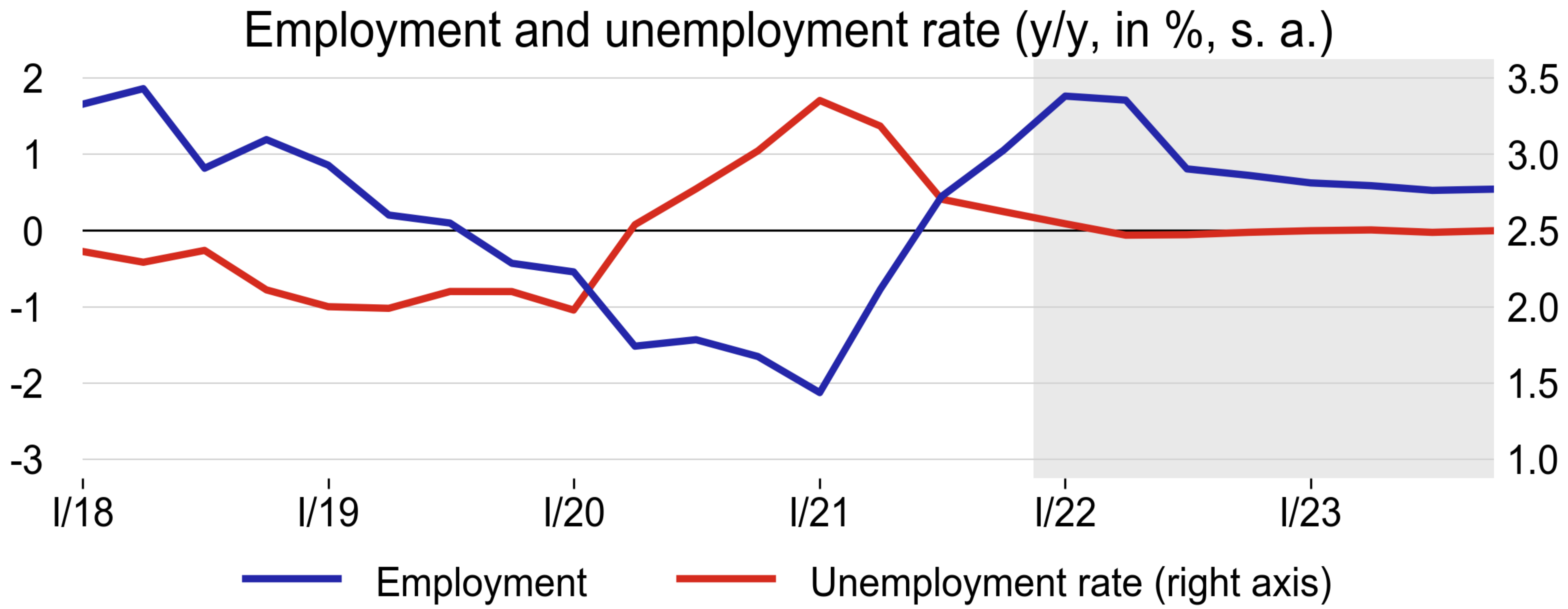


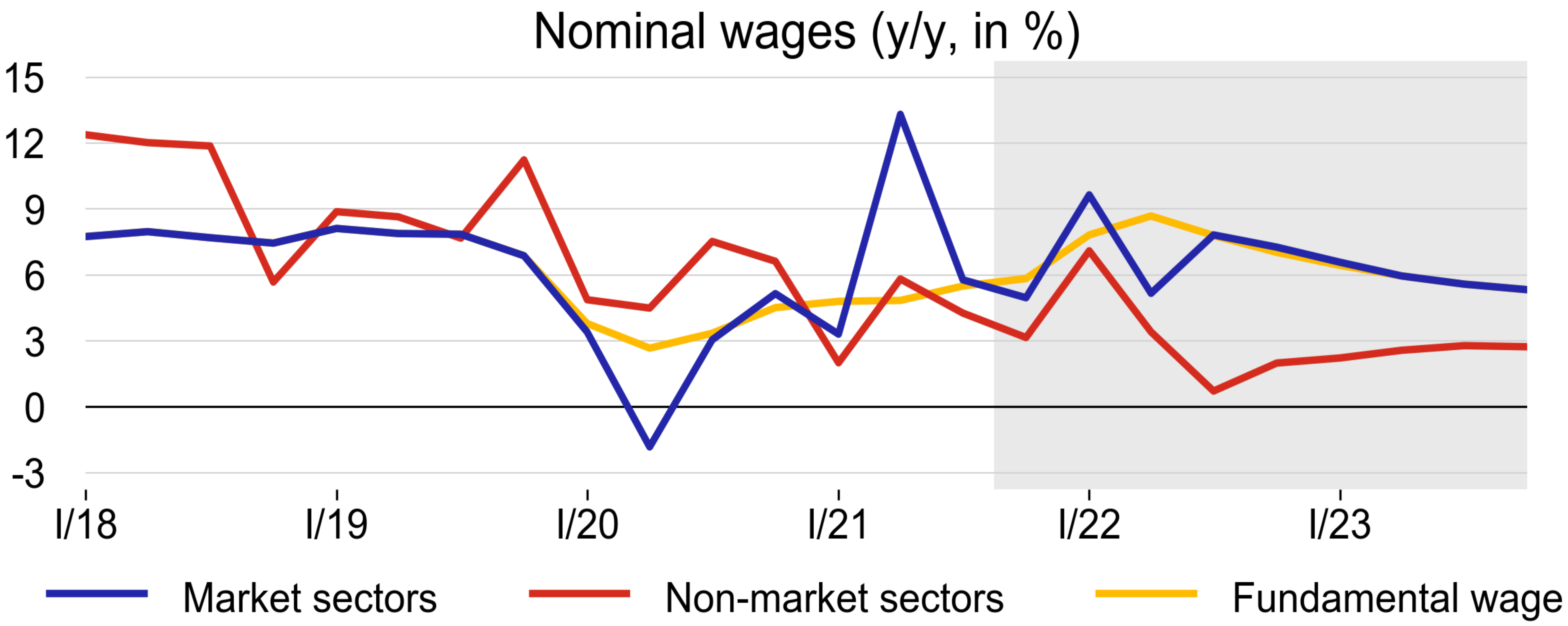
Nominal marginal costs in intermediate goods sector (q/q, in %, ann.)



- The strong **overall cost pressures** are currently being fostered mainly by the domestic economy and energy import prices, but the price pressures will ease in the course of this year.
- This will be due mainly to a halt in growth in **energy prices,** a slowdown in growth in **foreign core prices** (as a result of fading supply chain disruptions) and a strengthening koruna.
- **Growth in domestic costs** will remain brisk in the coming quarters, as **fundamental wages** will continue to rise rapidly. The positive contribution of the **price of capital** will rise slowly as the problems in domestic industry related to issues in supply chains abate gradually. **Labour efficiency** will increase over the entire outlook, due in part to continued automation of production.

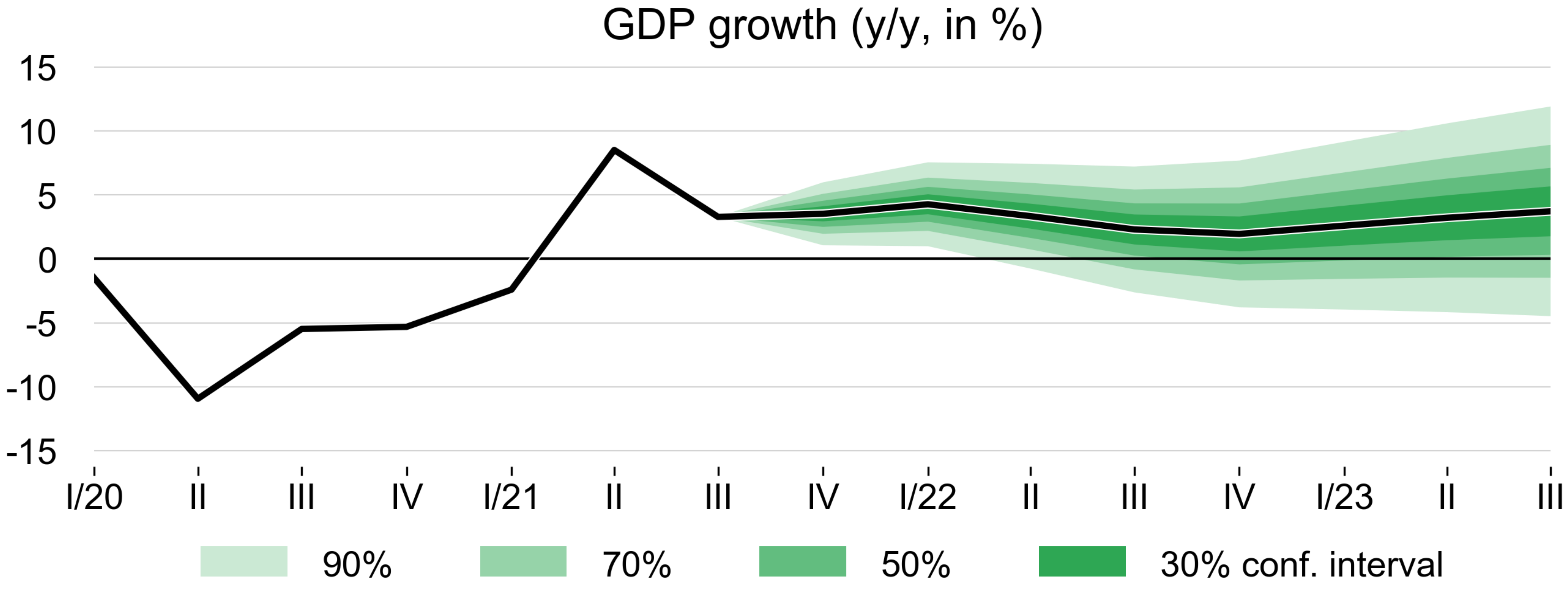
Labour Market

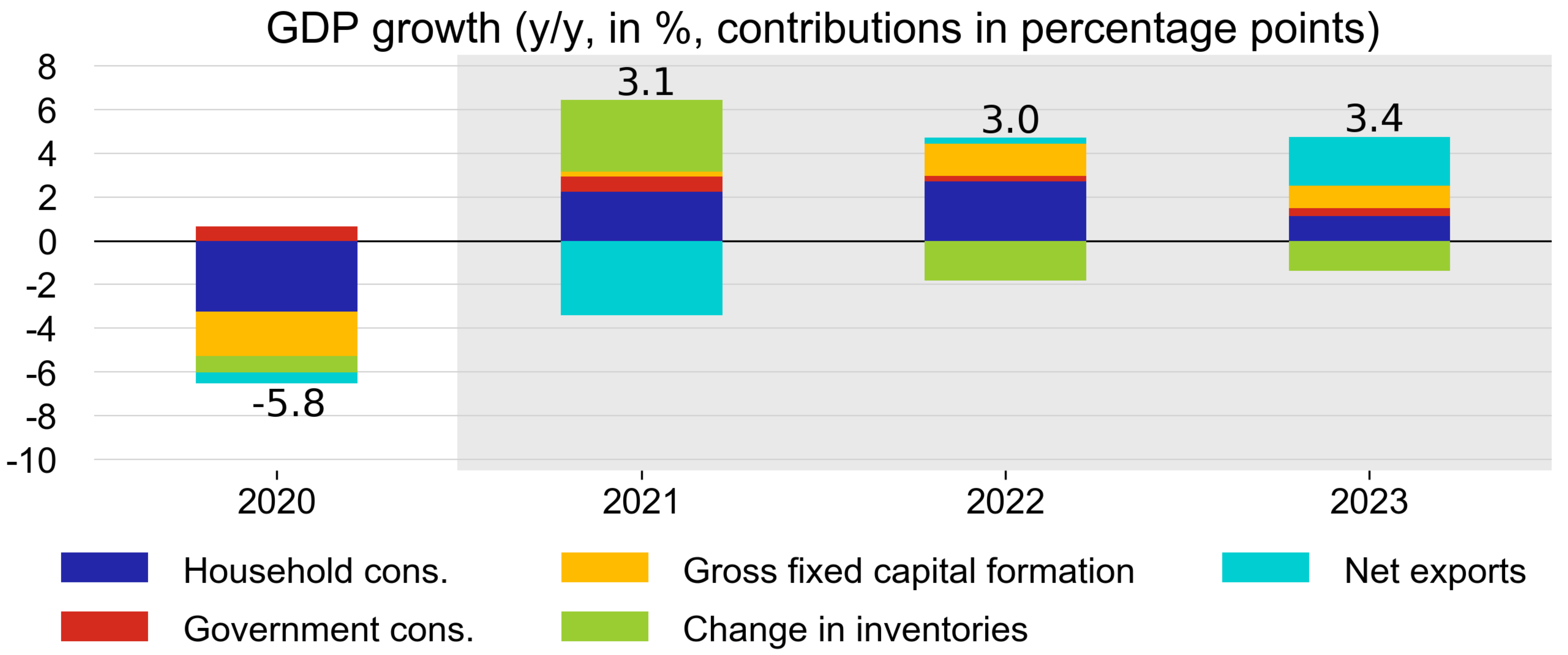




- **Employment** will continue to rise on the back of strong demand for labour. This will be because of persisting elevated expected recruitment by employers and a high number of job vacancies.
- The decline in the **unemployment rate** has slowed. The room for a more substantial decline, however, has been exhausted.
- **Fundamental market wage growth** will accelerate markedly this year in an environment of an overheated labour market and as a result of efforts to keep up with inflation. Further, wage growth will be supported by marked increase in the minimum wage in January 2022.
- **Wages in market sectors** will continue to be affected this year by one-off factors and base effects.

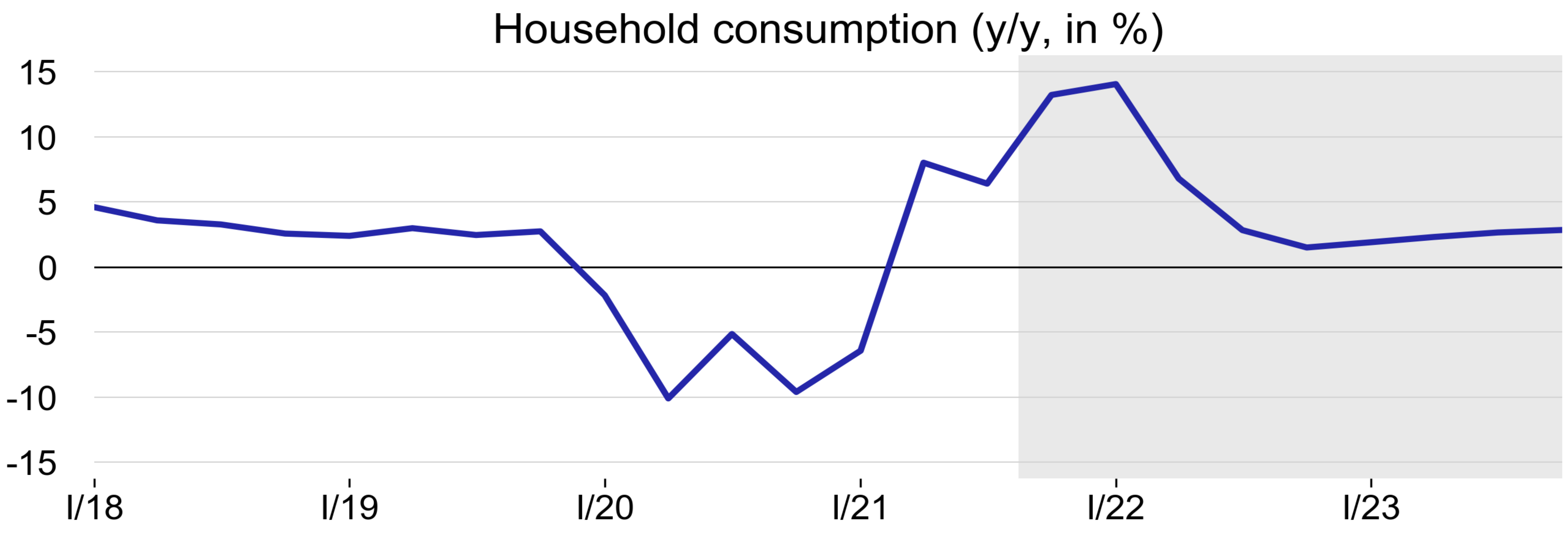
GDP Growth Forecast

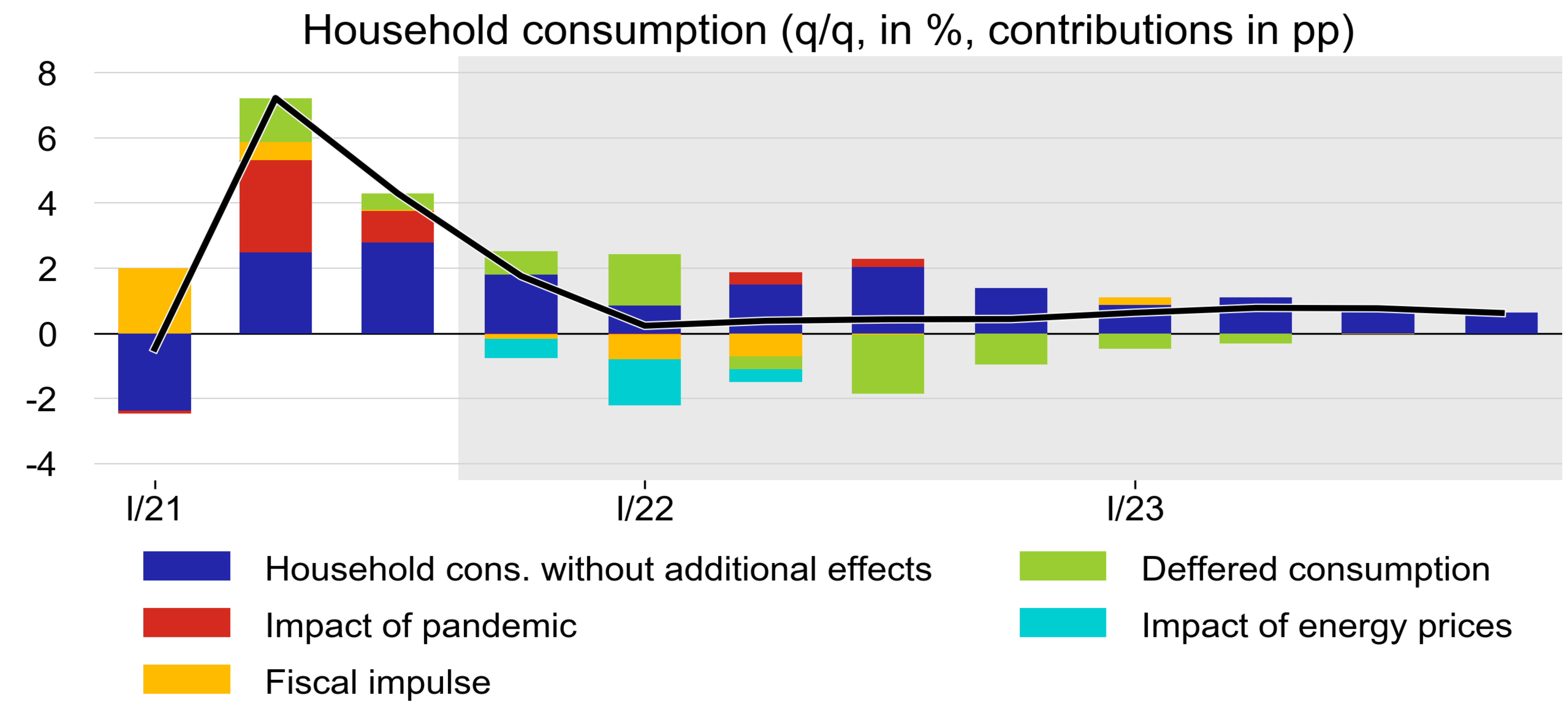




- The **economic activity will continue to recover from the pandemic** this year despite persisting issues in global production and supply chains. The issues will start to ease gradually in the second half of the year and virtually disappear by the year-end.
- **Annual GDP growth** will be driven this year by household consumption, initially aided significantly by last year's low base. Next year, net exports will play the prominent role.
- Similarly to last year, **GDP growth** will average around 3% in 2022 as a whole. In 2023, it will edge up to around 3.5%.
- The CNB's backcast for 2021 is close to the flash estimate of the CZSO.
- The Czech economy is still overheating, but will return to its potential in 2023.

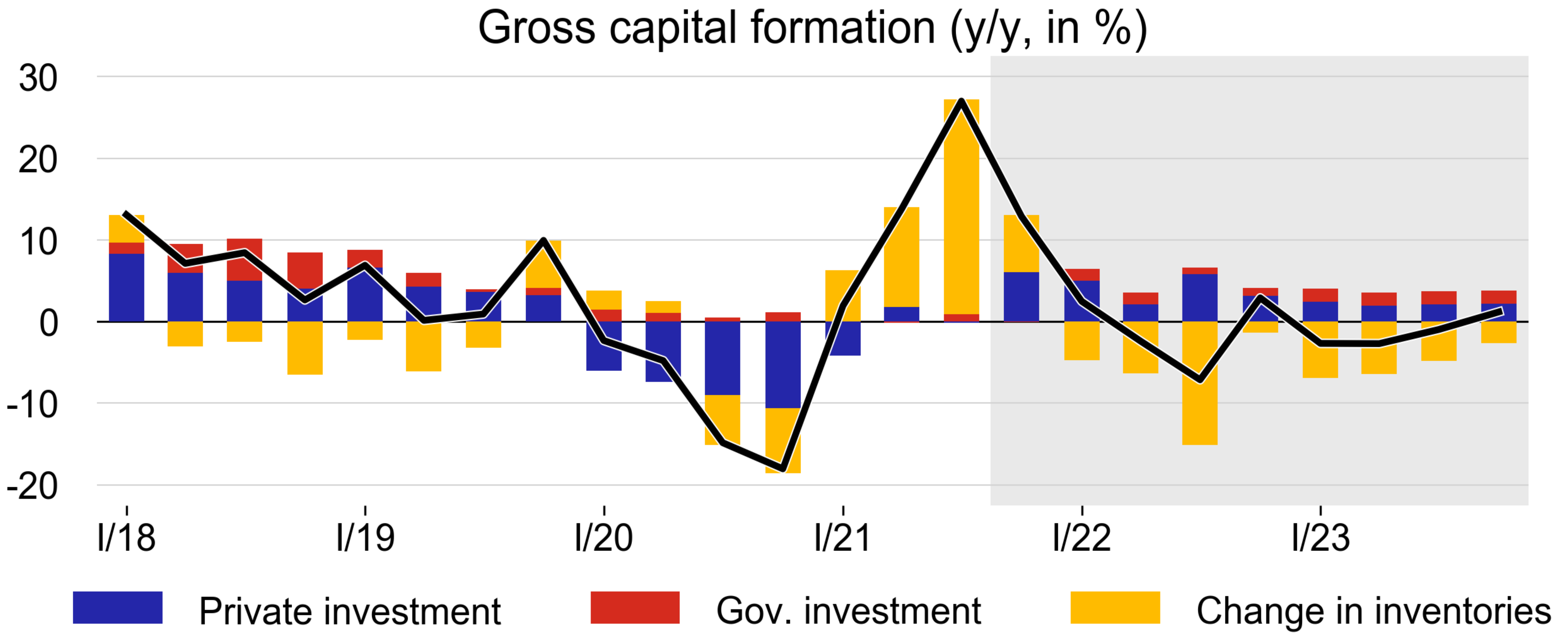
Household Consumption

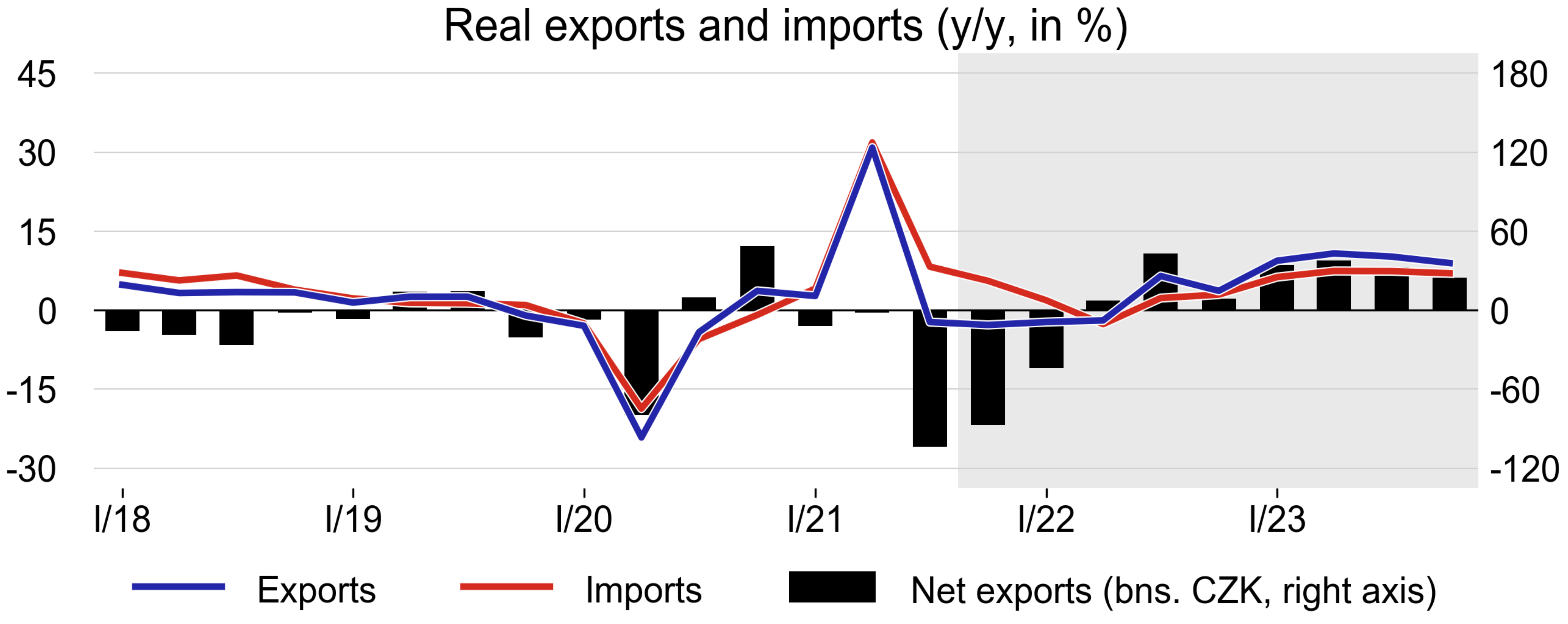




- **Year-on-year household consumption growth** will initially be very strong this year due to base effects and will then slow sharply.
- Household consumption started to be negatively affected last autumn by a surge in inflation, which slowed the growth in the purchasing power. This was counteracted by renewed growth in labour market tightness, and by partial spending of past forced savings.
- The **quarterly growth in household consumption** will slow sharply, due mainly to escalating inflation, fading fiscal support and elevated interest rates. The rise in energy prices will drain another large part of the forced savings created by households during the pandemic.

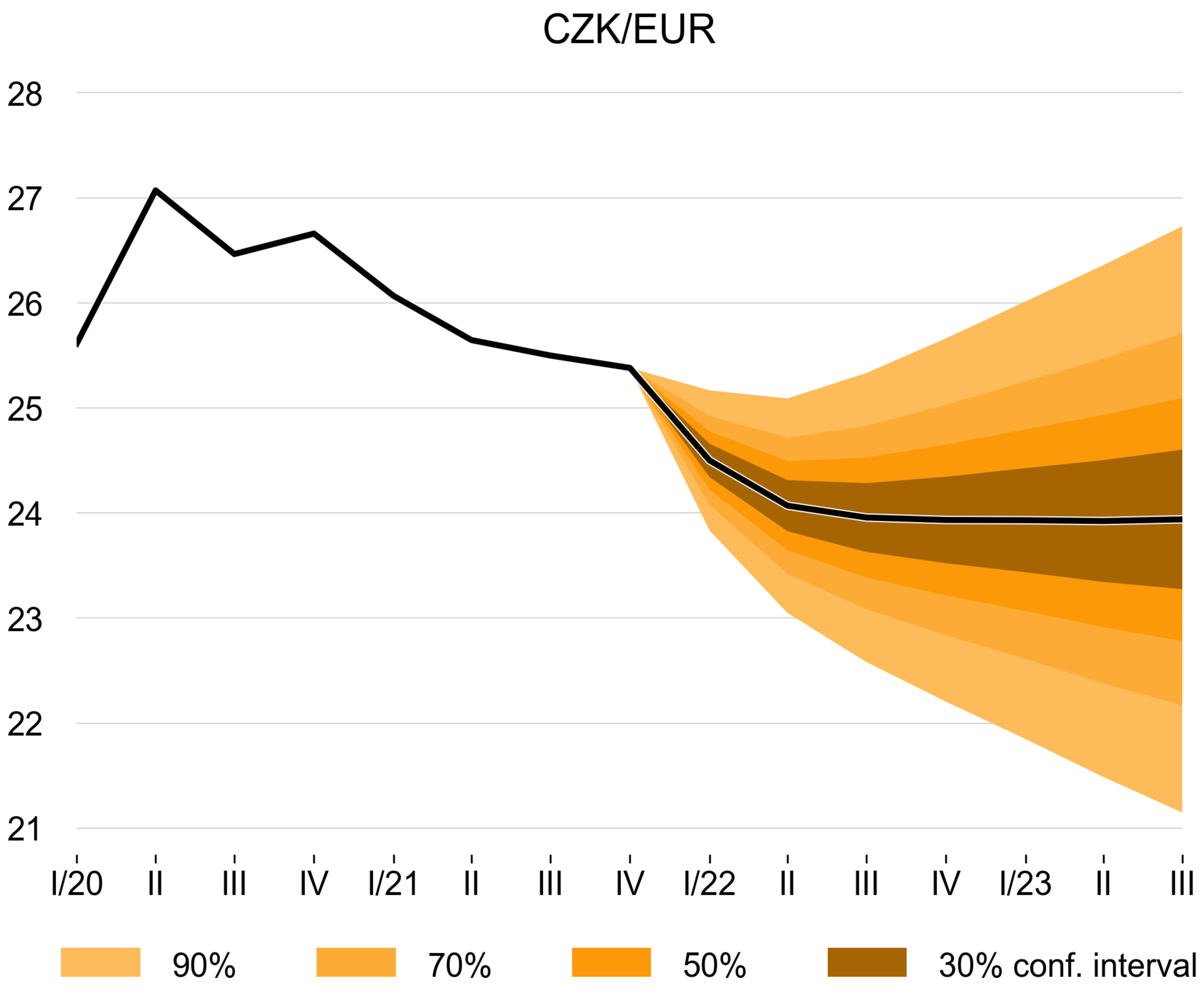
Gross Capital Formation





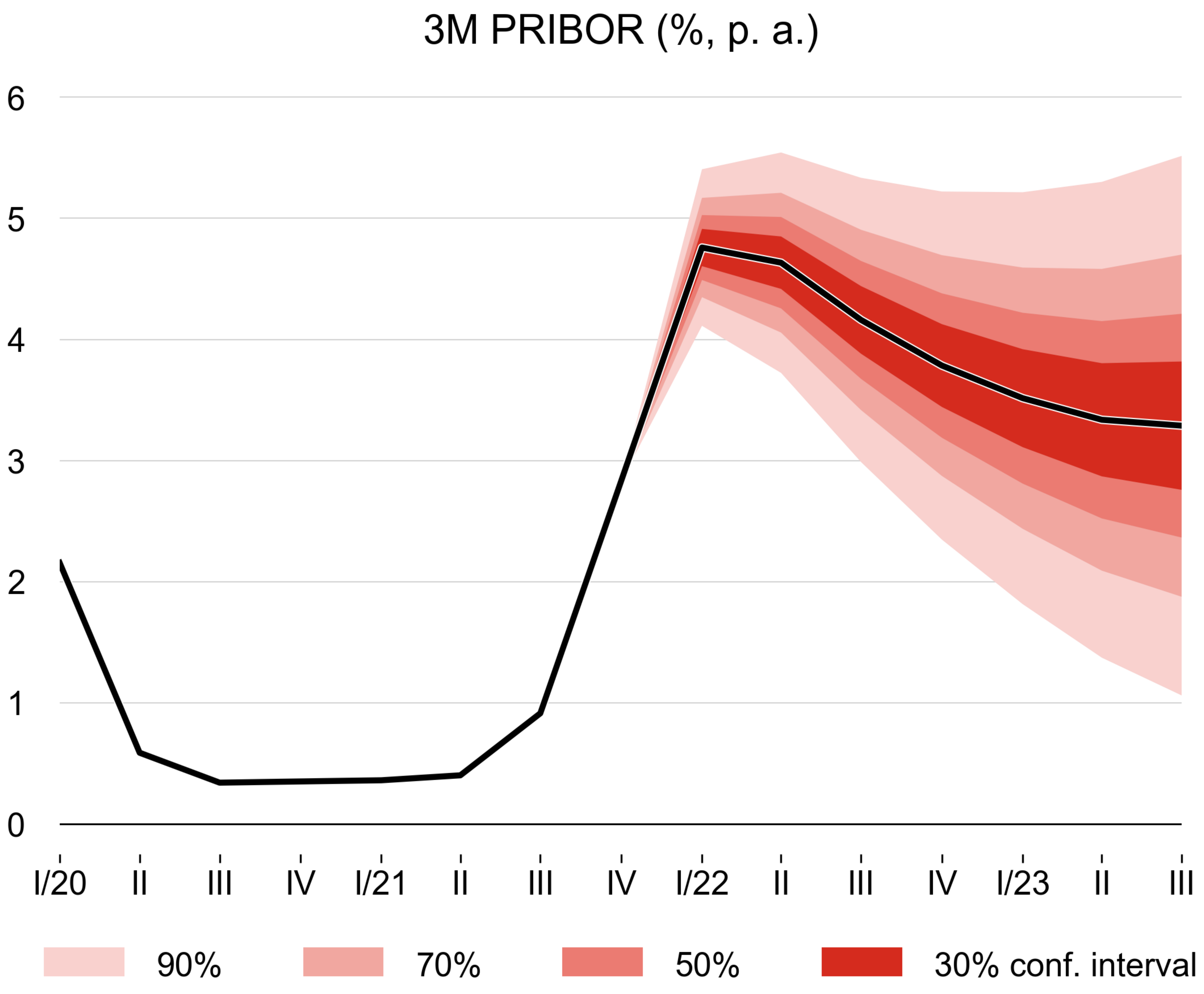
- **Growth in total investment** will be volatile due mainly to inventories. The investment boom will be dampened by production and supply chain disruptions throughout 2022, although their negative effect will gradually fade.
- **Private investment activity** will be spurred this year as firms will try to automate production. Fixed investment will also subsequently be supported by resurging external demand.
- **Government investment** will increase and will be supported by absorption of EU funds.
- **Exports** will initially be dampened this year by continued disruptions to material and component supplies and will start growing again as these issues fade out, leading to positive contributions of net exports.

Exchange Rate CZK/EUR



- We expect the **exchange rate** to be CZK 24.5 to the euro on average in 2022 Q1.
- The koruna will strengthen significantly in the first half of the year, due to a further pronounced widening of the interest rate differential vis-à-vis the euro area.
- The gradual decline in domestic interest rates towards their long-run neutral level in the second half of this year onwards, coupled with monetary policy abroad gradually becoming less accommodative, will imply latent depreciation pressure. A gradual recovery in exports in the second half of this year and continued real equilibrium appreciation will have the opposite effect.
- These opposing forces will ultimately lead to a stable koruna around CZK 24 to the euro.

Interest Rate Path (3M PRIBOR)



- Consistent with the forecast is a substantial rise in **market interest rates**, followed by a gradual decline from the second half of this year onwards.
- The initial increase in rates reflects a need to react to the combination of extraordinarily strong price pressures from the domestic and foreign economies, which are reflected in high and broad-based domestic price growth.
- Tighter monetary policy will dampen excessive demand and import price growth, limit the pass-through of the current price pressures to inflation in the longer term, and help anchor inflation expectations.
- In the middle of the year, interest rates will be able to start decreasing gradually due to an expected decrease in inflation pressures in the Czech economy in 2023.

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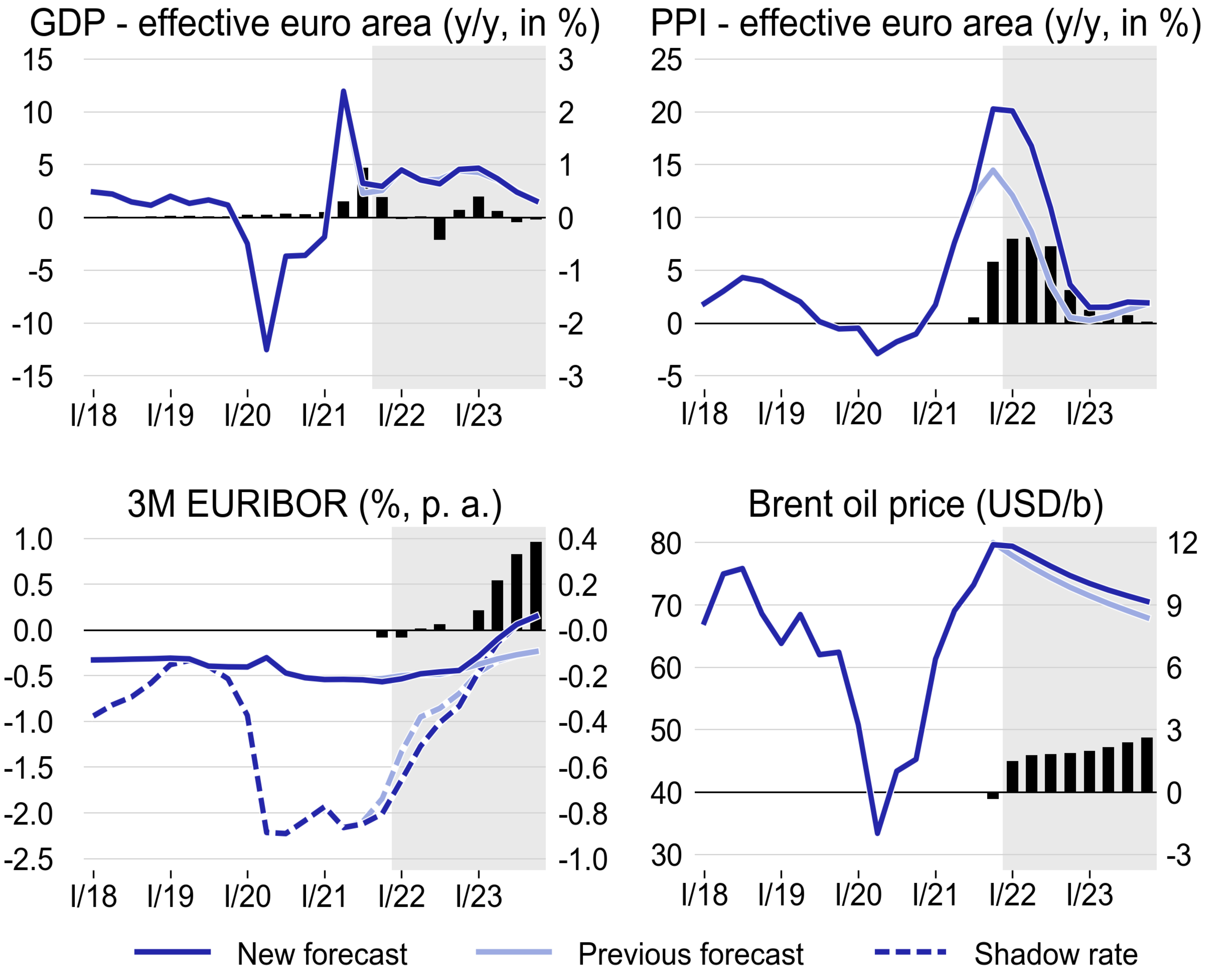
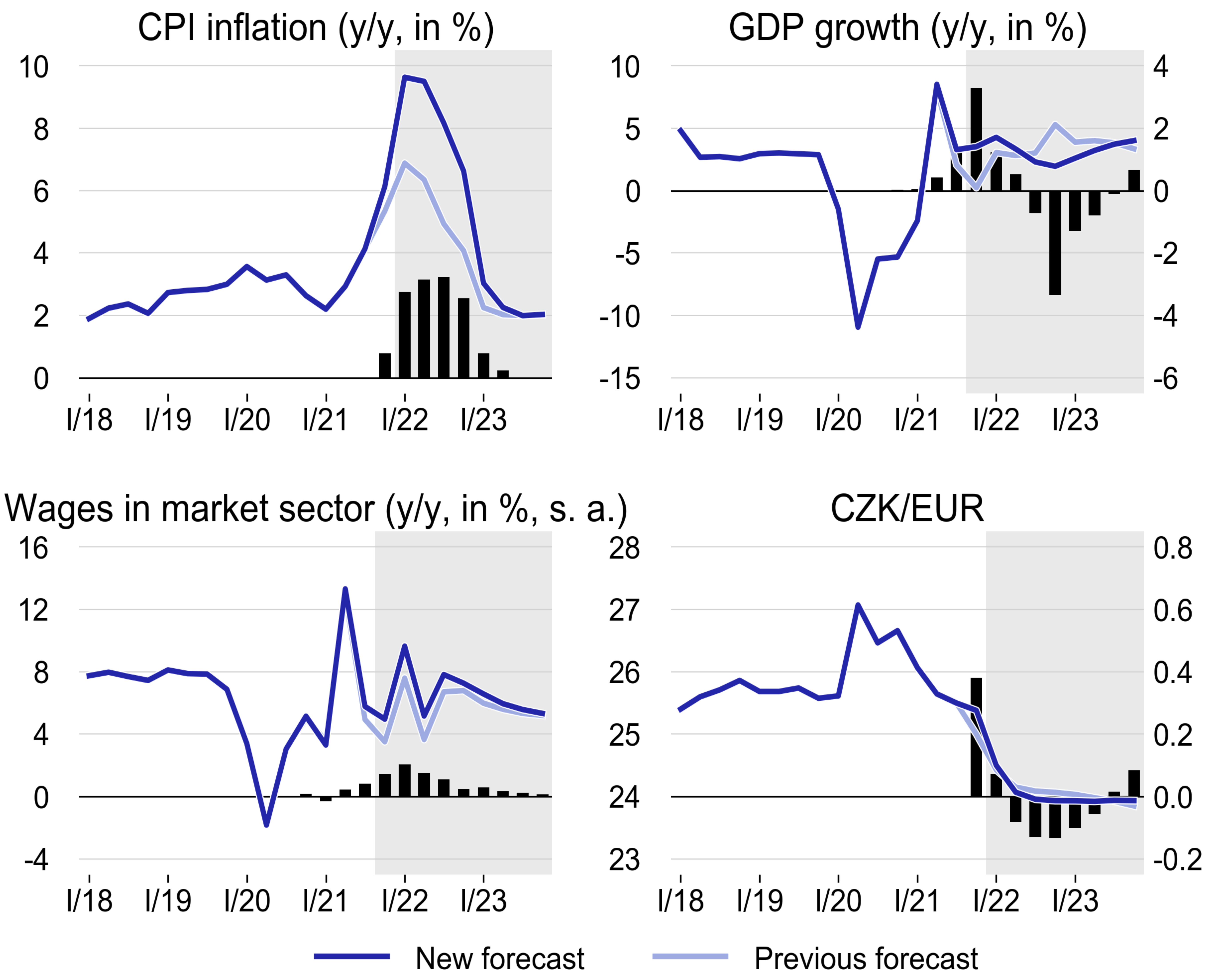
Comparison with Previous Forecast: Foreign Outlook



- The **economic growth outlook for effective EA** for this year and the next is little changed. A gradual easing of supply chain problems remains the key assumption.
- Higher energy commodity prices coupled with longer-lasting overloading of production and supply chains are reflected in a sizeable upward revision of the **producer price** outlook.
- The slightly higher **3M EURIBOR** outlook for 2023 reflects higher market expectations regarding future inflation and hence a slightly stronger monetary policy reaction to it by the ECB.
- The **Brent crude oil** outlook has shifted slightly higher, due to underproduction and more robust global demand among others.

Comparison with Previous Forecast: Domestic Economy



- The marked upward revision of the **CPI inflation** forecast in 2022 is due to all its components except food.
- The **GDP** forecast has been initially revised upwards due to higher observations from the second half of the previous year. In 2023, the economic activity is expected to be lower due mainly to a reduction in the outlook for household consumption.
- The higher forecasted inflation and overall labour market tightness are reflected in higher **wage growth**.
- The **koruna** will appreciate below CZK 24 to the euro earlier than in the previous forecast owing to a more rapidly widening positive interest rate differential vis-à-vis the euro area.

Comparison with Previous Forecast: 3M PRIBOR

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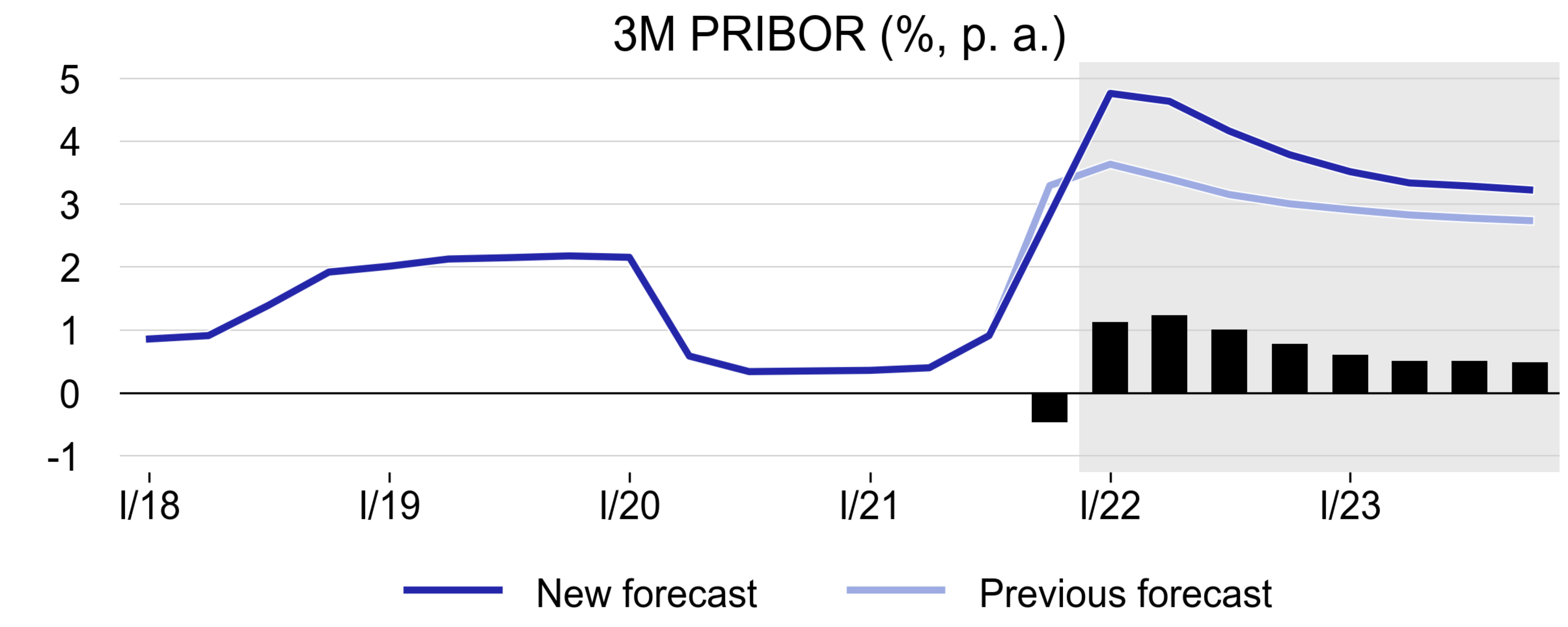

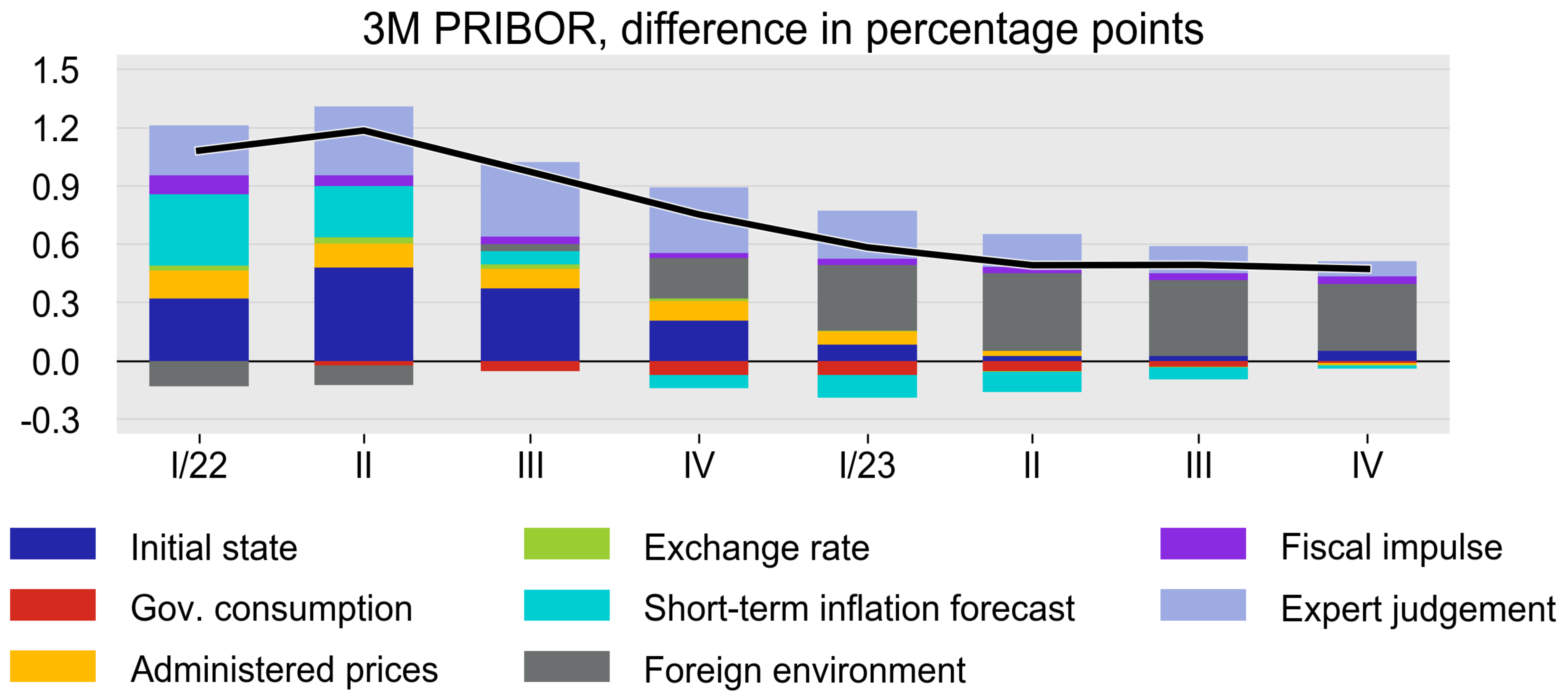

- The **interest rate path** has shifted markedly higher.
- The **initial state** fosters higher rates in 2022, mainly reflecting faster growth in wages and import prices in the second half of last year.
- The higher rates are also due to the **short-term inflation forecast** and the outlook for faster growth in **administered prices** than in the previous forecast.
- The **foreign outlook** fosters higher rates from the end of this year onwards, reflecting less accommodative ECB monetary policy at the end of the horizon and a weaker euro-dollar rate.
- **Expert adjustments** contribute to higher rates over the entire forecast horizon. They reflect longer-running supply chain issues via slower growth in labour efficiency.

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Thank you for your attention

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