CZECH NATIONAL BANK

CNB’s New Forecast

Monetary Policy Report – Autumn 2023

Meeting with Analysts

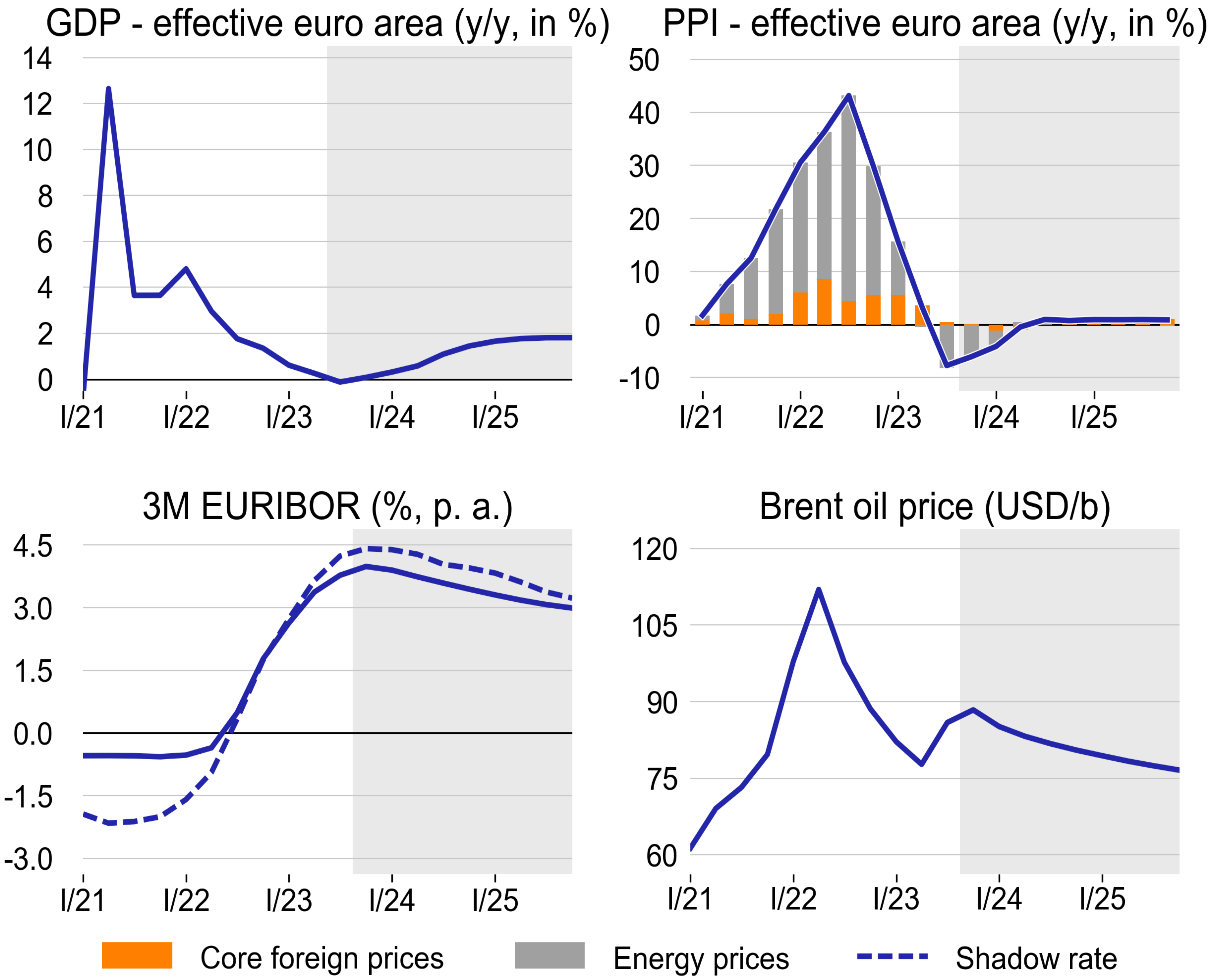
3 November 2023

Petr Král (Executive Director, Monetary Department)

Presentation Outline

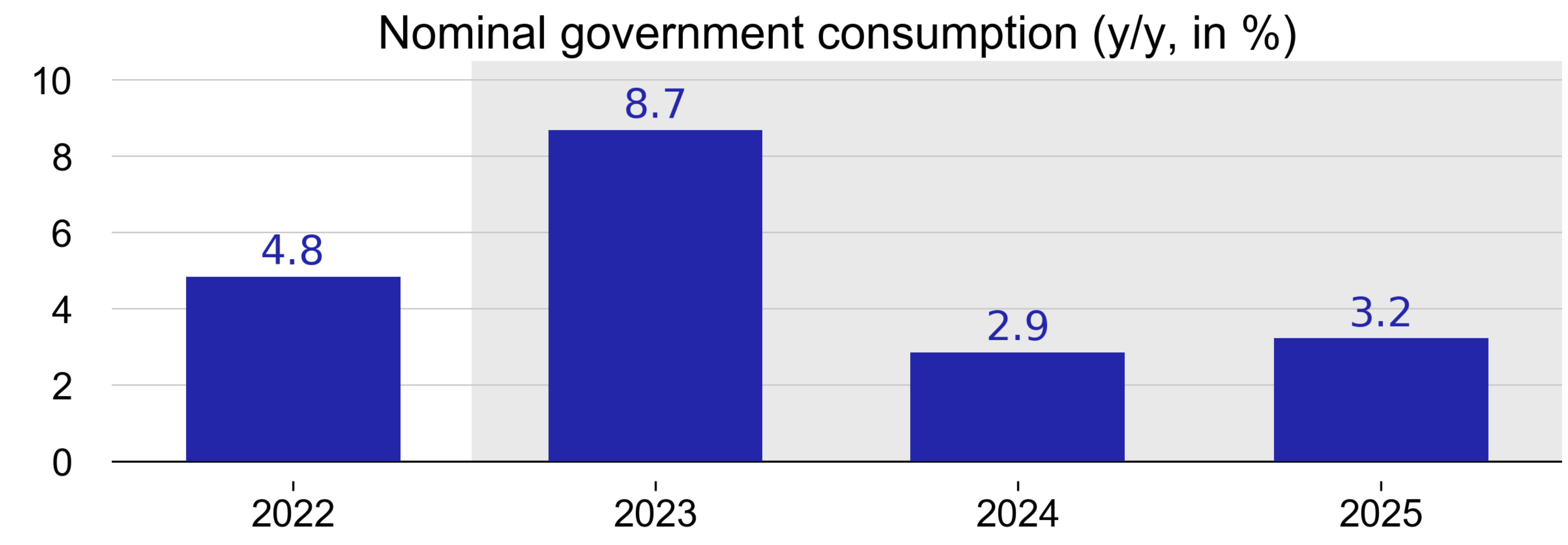
1. **Assumptions of the Forecast**
2. The New Macroeconomic Forecast
3. Comparison with the Previous Forecast
4. Further Scenario

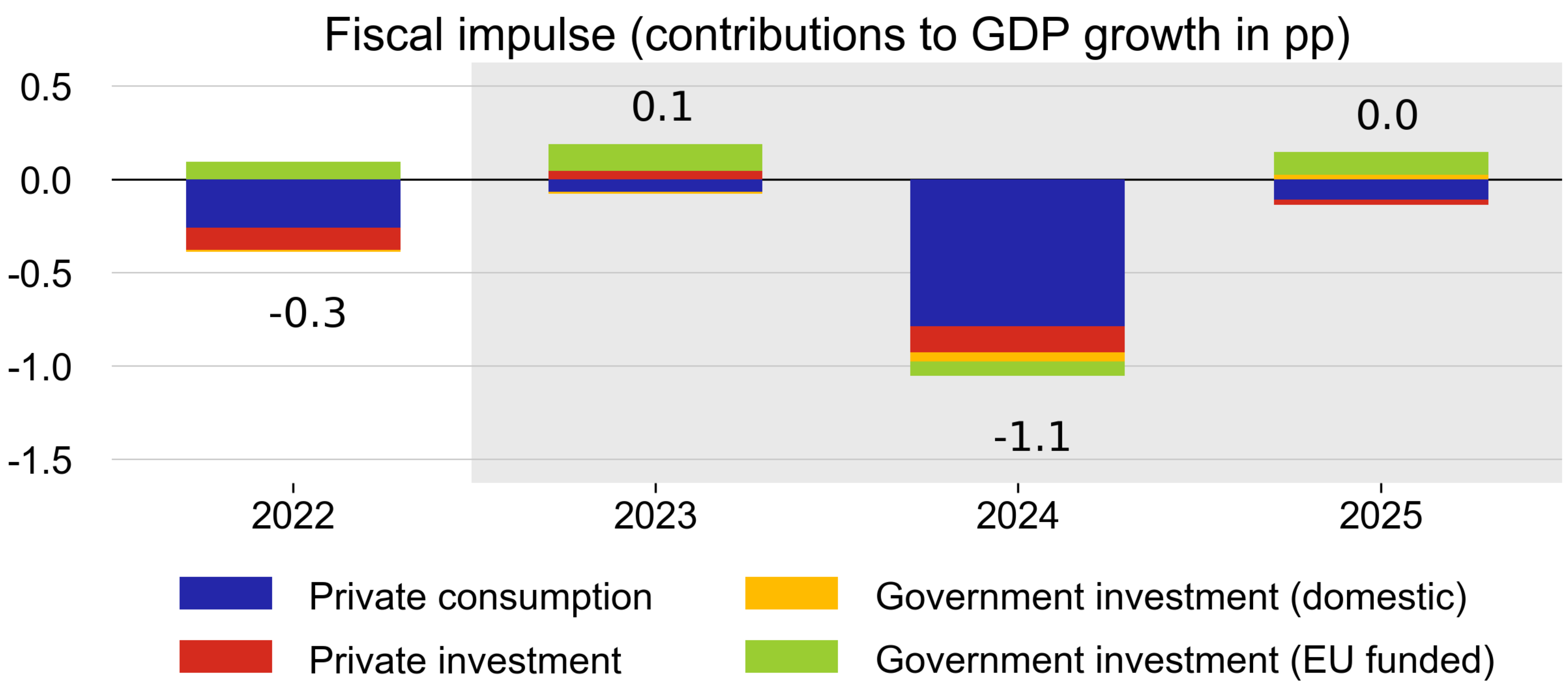
External Environment Outlook



- The **effective euro area** economy is stagnant this year as a result of a slowdown in global demand and restrictive monetary conditions in advanced economies. The EA economy will recover in 2024.
- The year-on-year decline in **industrial producer prices** in the effective euro area has been driven this year by the energy component.
- The **3M EURIBOR** interest rate outlook and the shadow rate reflect delivered tightening by the ECB and the ongoing reduction of its balance sheet.
- The outlook for the **Brent crude oil** price remains slightly falling.

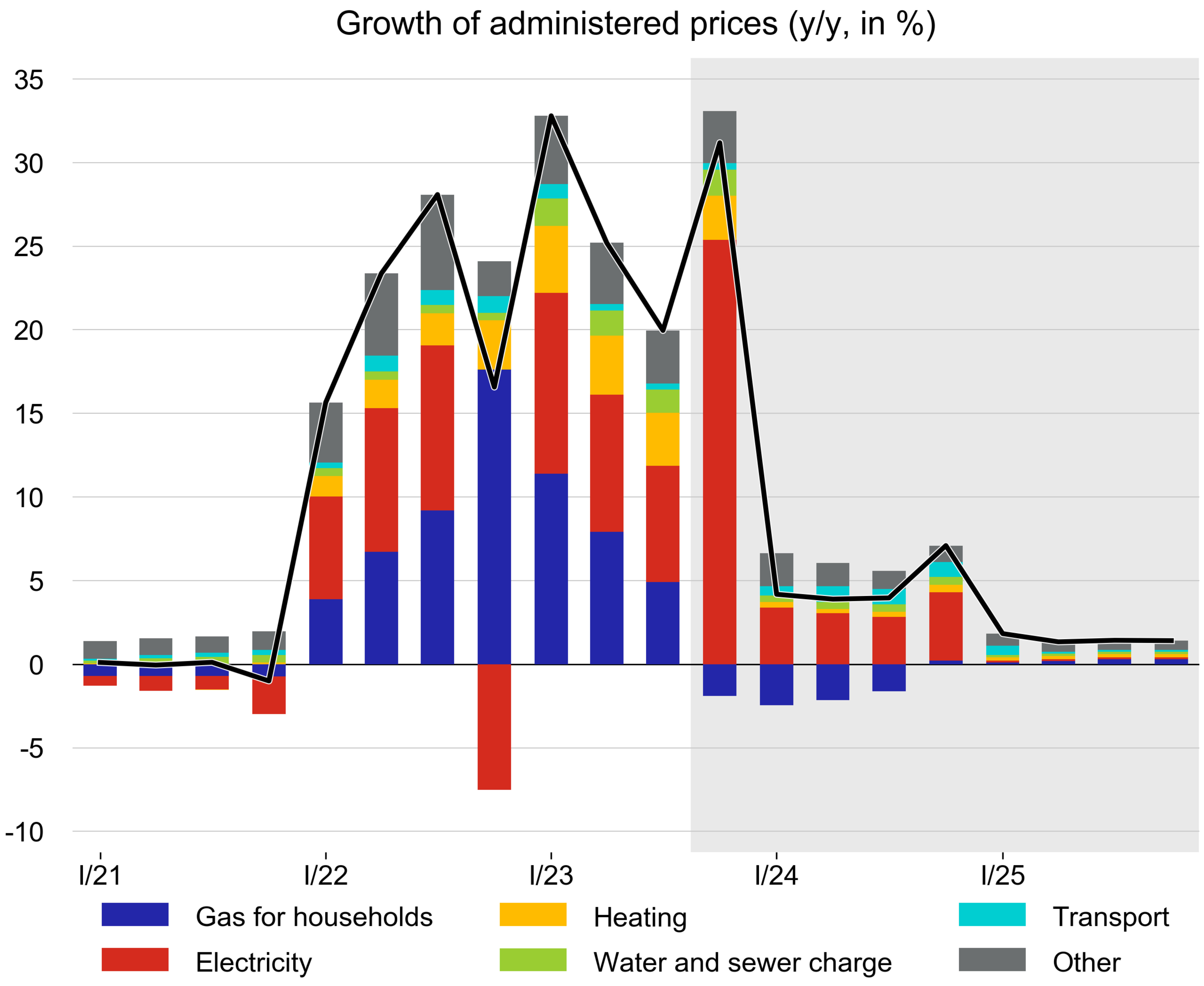
Fiscal Policy





- Growth in **nominal general government consumption** will slow in the years ahead due to wage limitations and cuts in operating expenditure under the consolidation package.
- **Fiscal policy** will make a roughly neutral contribution to GDP growth this year and dampen it significantly next year due to the consolidation package.

Administered price inflation



- **Administered price inflation** will increase sharply in 2023 Q4. This will be due almost solely to the contribution of electricity prices. It will reflect the extraordinary **base effect** caused by the introduction of the energy savings tariff at the end of last year (lowering the base).
- Administered price inflation will fall sharply at the start of next year as the base effect drops out, but will remain elevated at around 4%.
- A decrease in the commodity component of **energy prices** to well below the **government price caps** effective this year will be outweighed by a surge in the administered component of energy prices linked with the abolition of **government energy distribution subsidies** and the reintroduction of the fee for renewable sources

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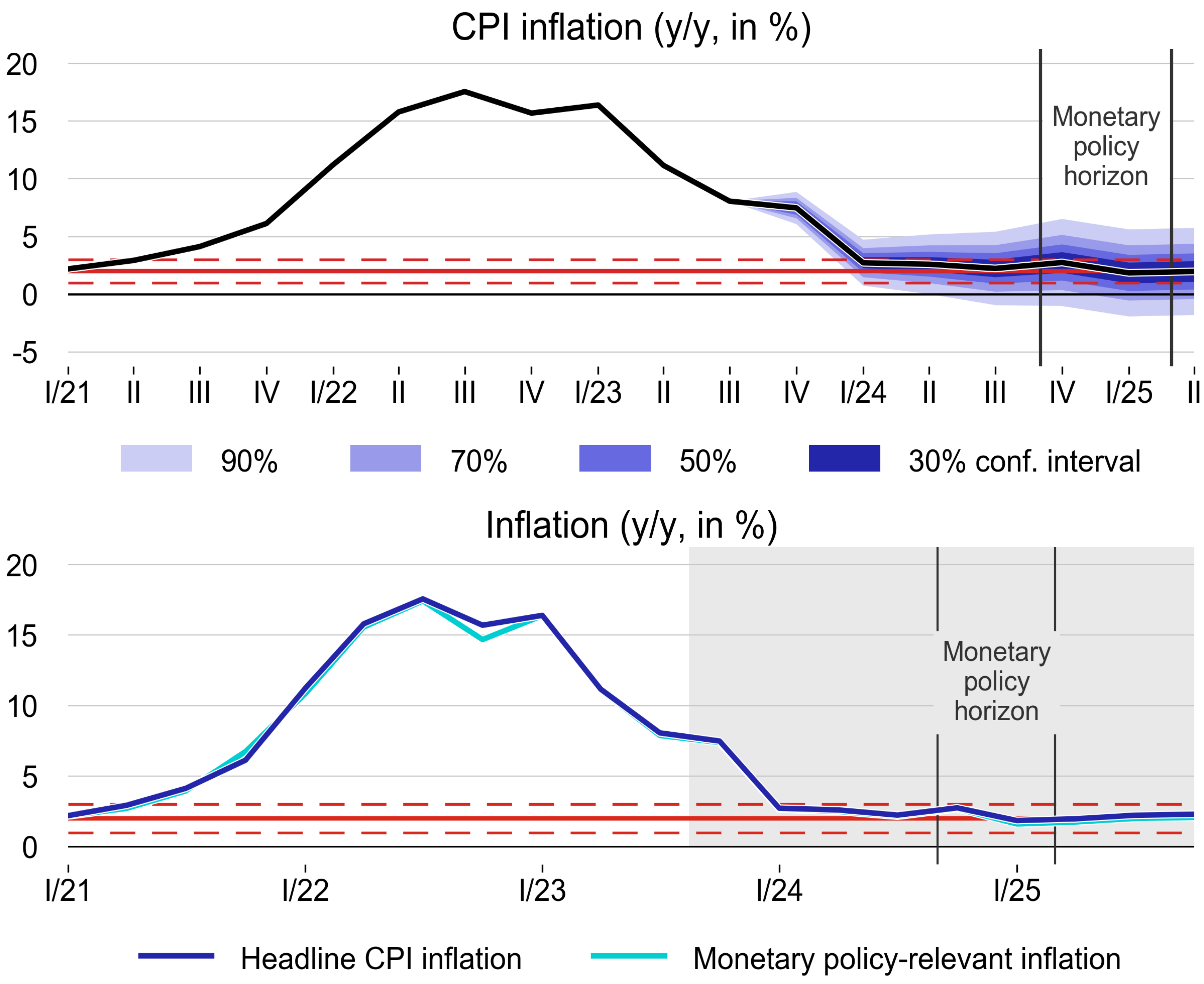
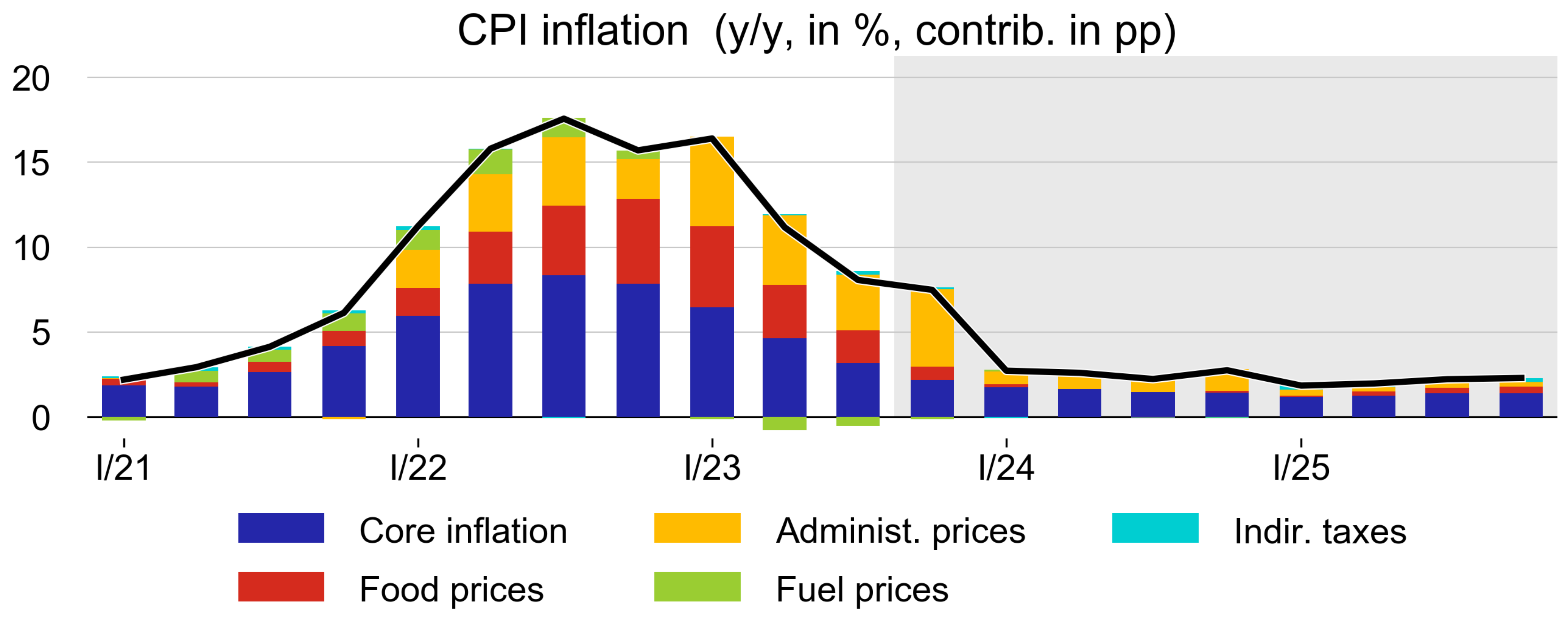
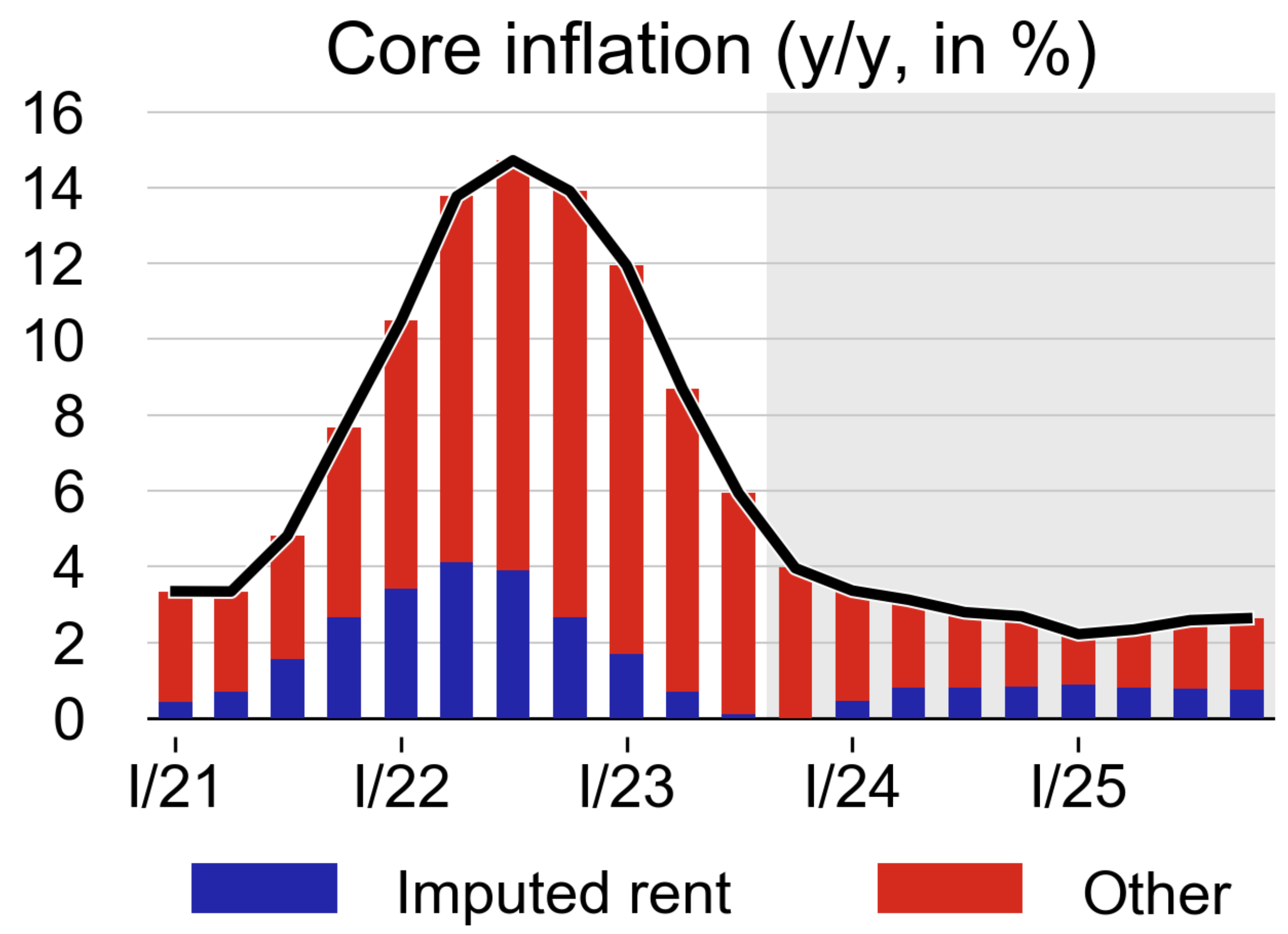
Headline and Monetary Policy-Relevant Inflation

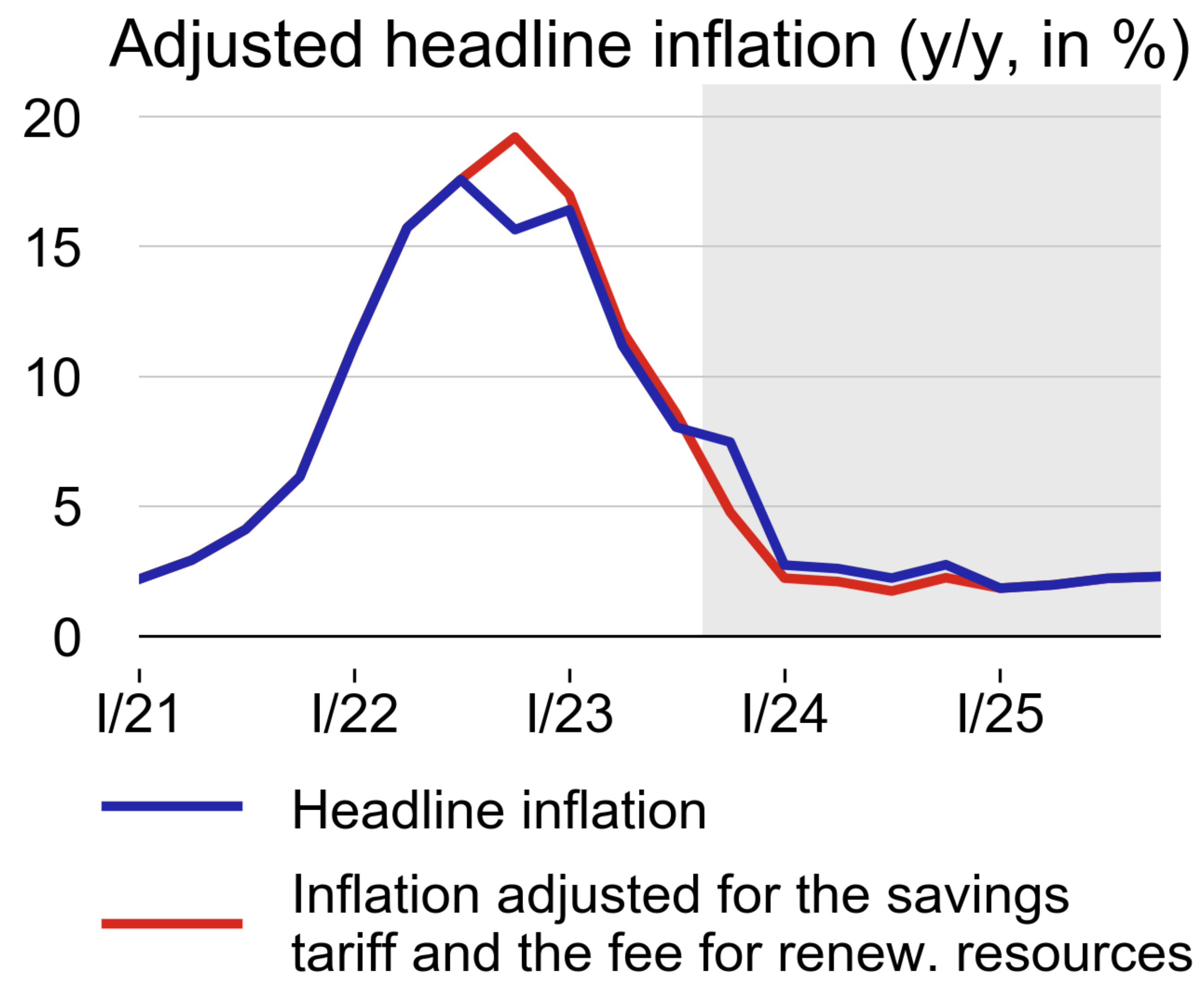


- **Inflation** will fall to close to the 2% inflation target at the start of next year.
  - Growth in market prices will continue to slacken due to subdued cost pressures from abroad and continued moderation of the inflationary effect of the domestic economy.
  - The profit margins of domestic producers, retailers and service providers will undergo a gradual correction.
- Headline inflation will be slightly above **monetary policy-relevant inflation**.

CPI Inflation, Core Inflation and Adjusted Inflation



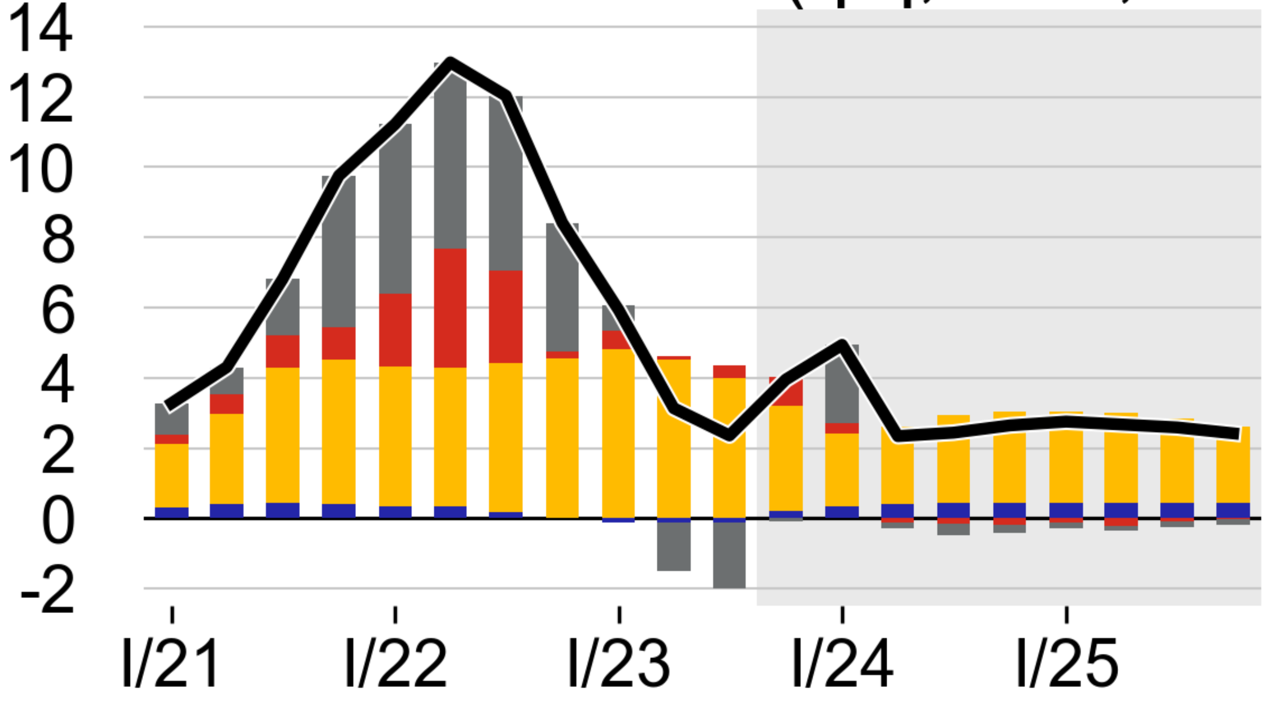




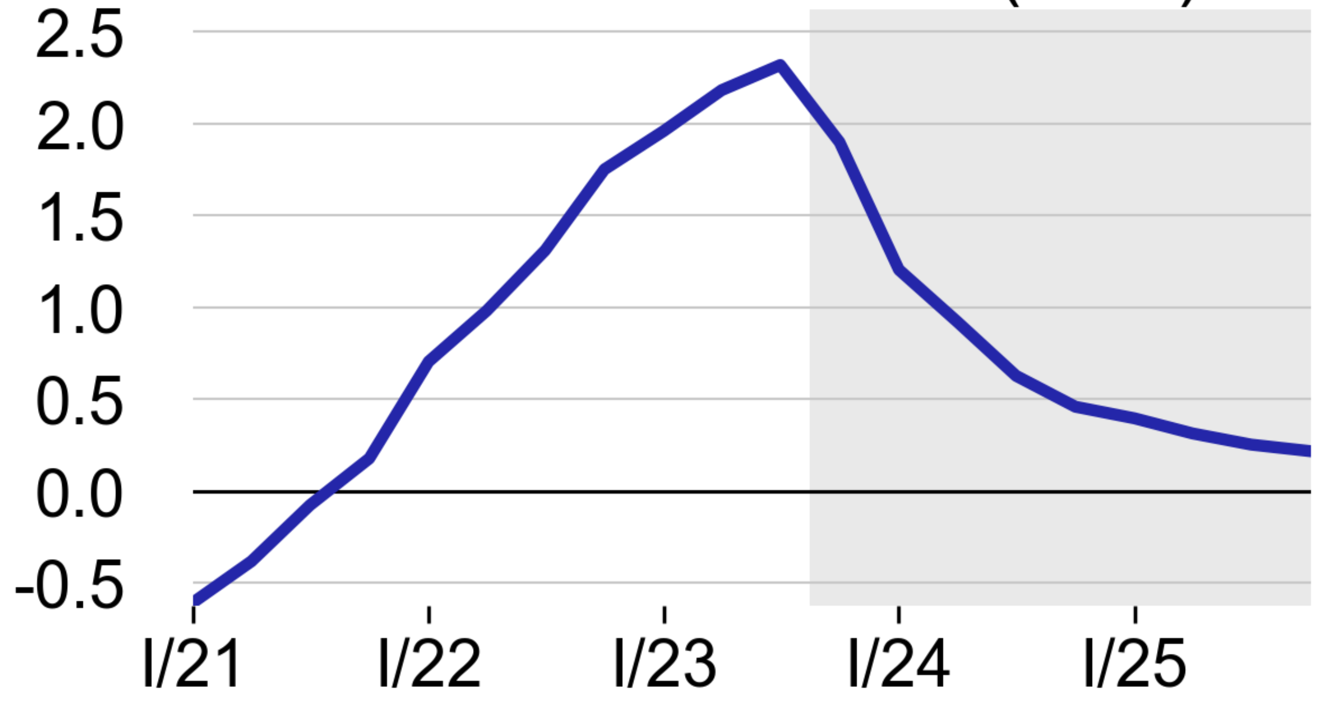
- **Consumer price inflation** will remain elevated in 2023 Q4 due to base effects and will slow sharply at the start of 2024, with most components contributing.
- **Core inflation** will continue to slow for the rest of this year and next year due to a decline in overall inflation pressures amid a low contribution of imputed rent.

Cost Pressures and Profit Mark-ups

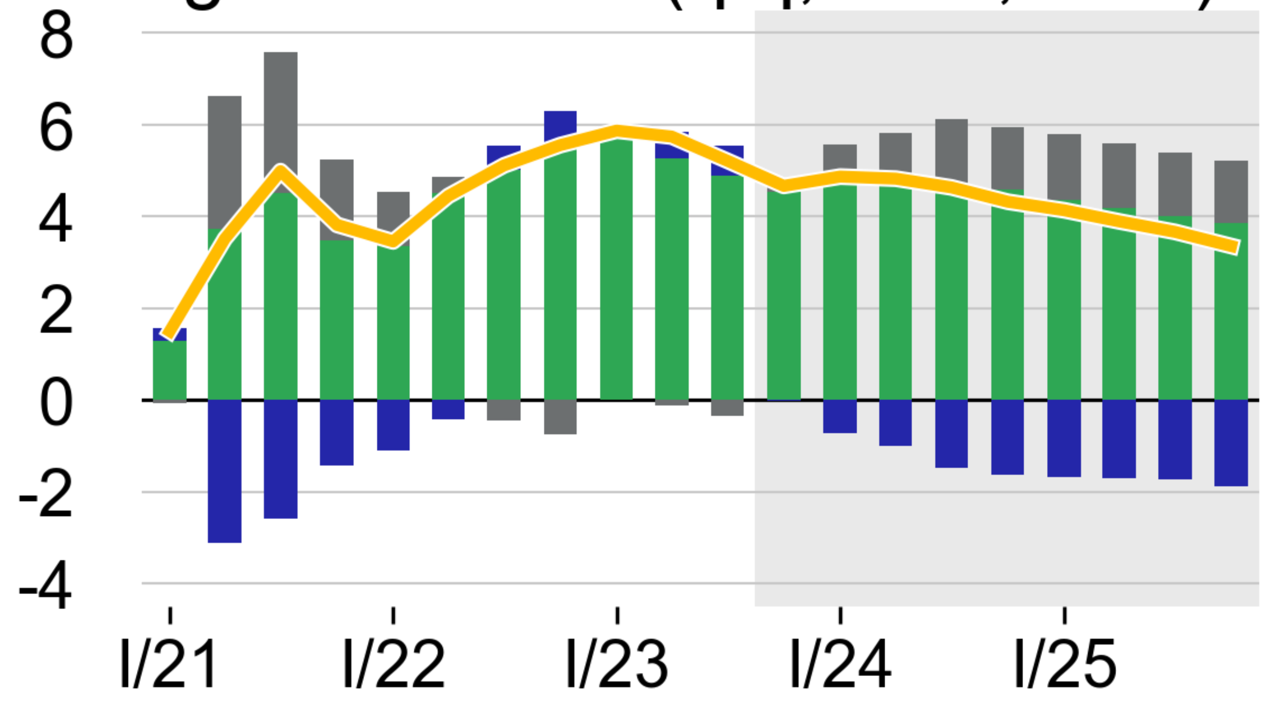
Nominal marginal costs
in consumer sector (q/q, in %, ann.)



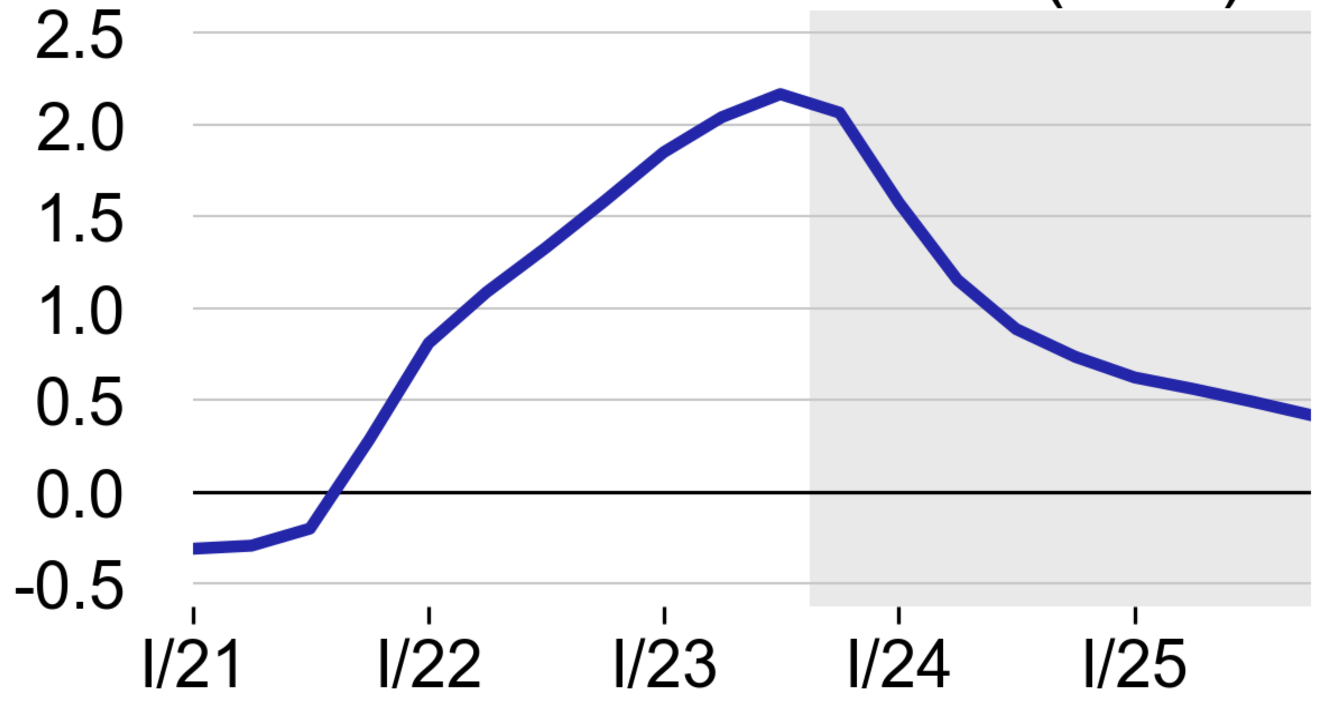
Gap in profit mark-ups
in consumer sector (in %)



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

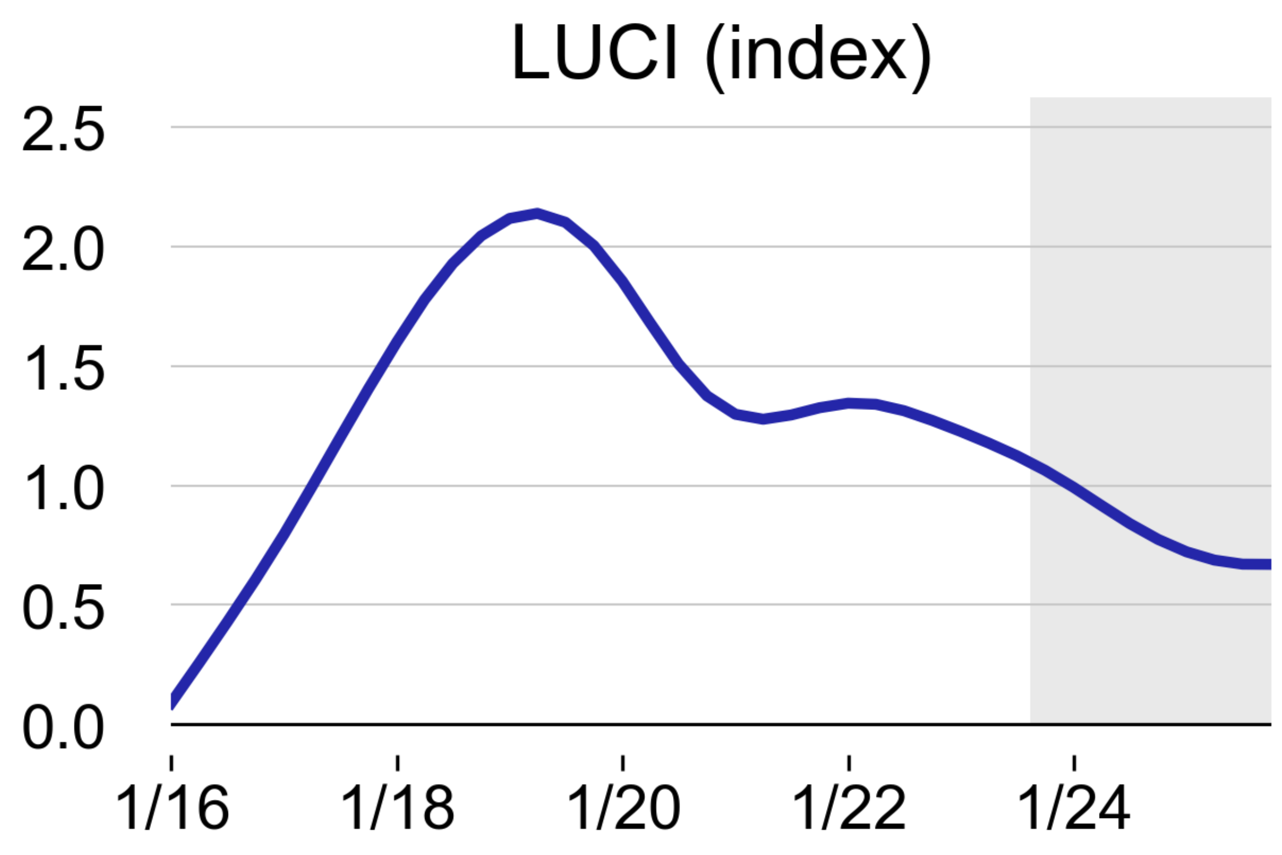


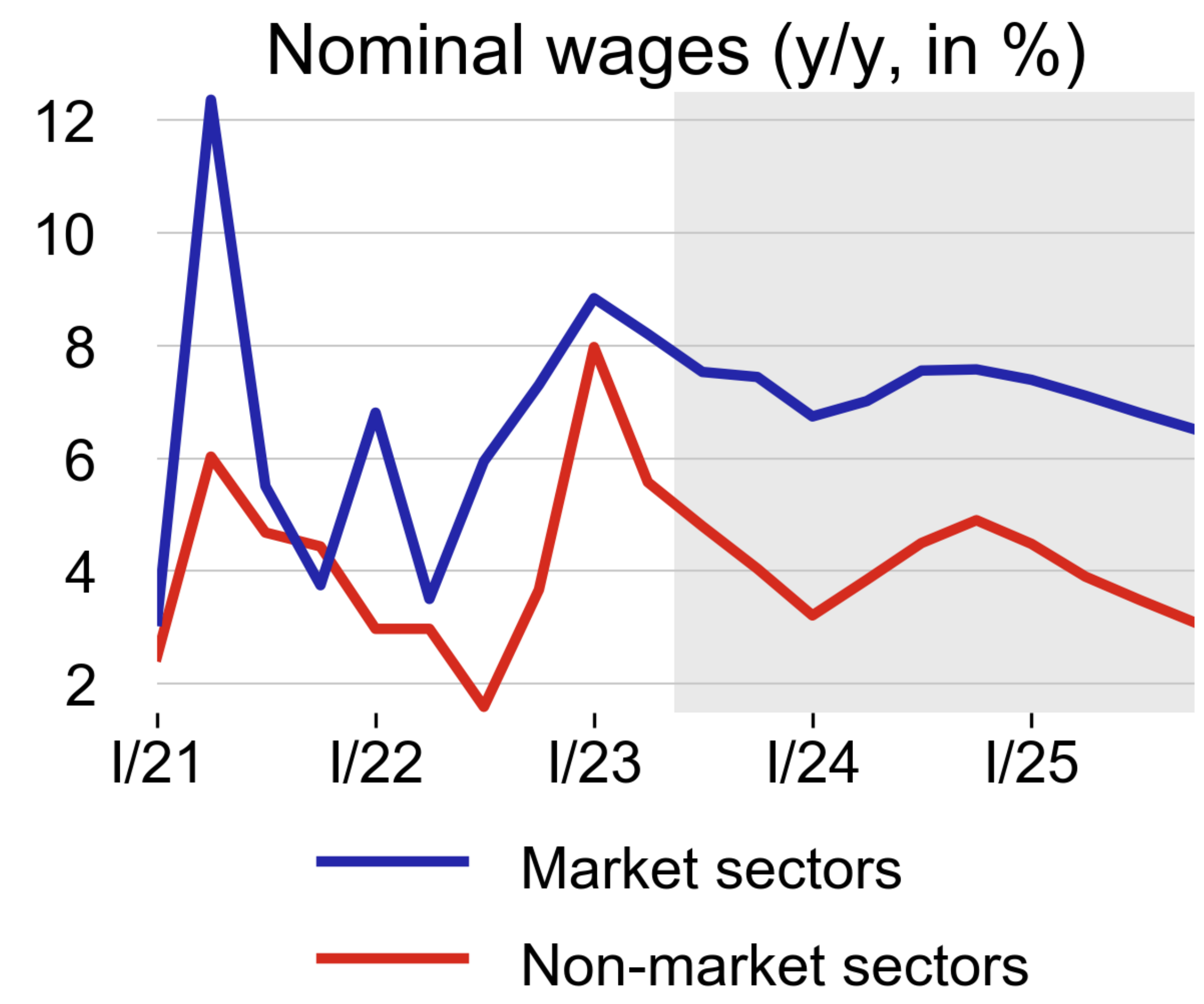
Gap in profit mark-ups
in intermediate sector (in %)

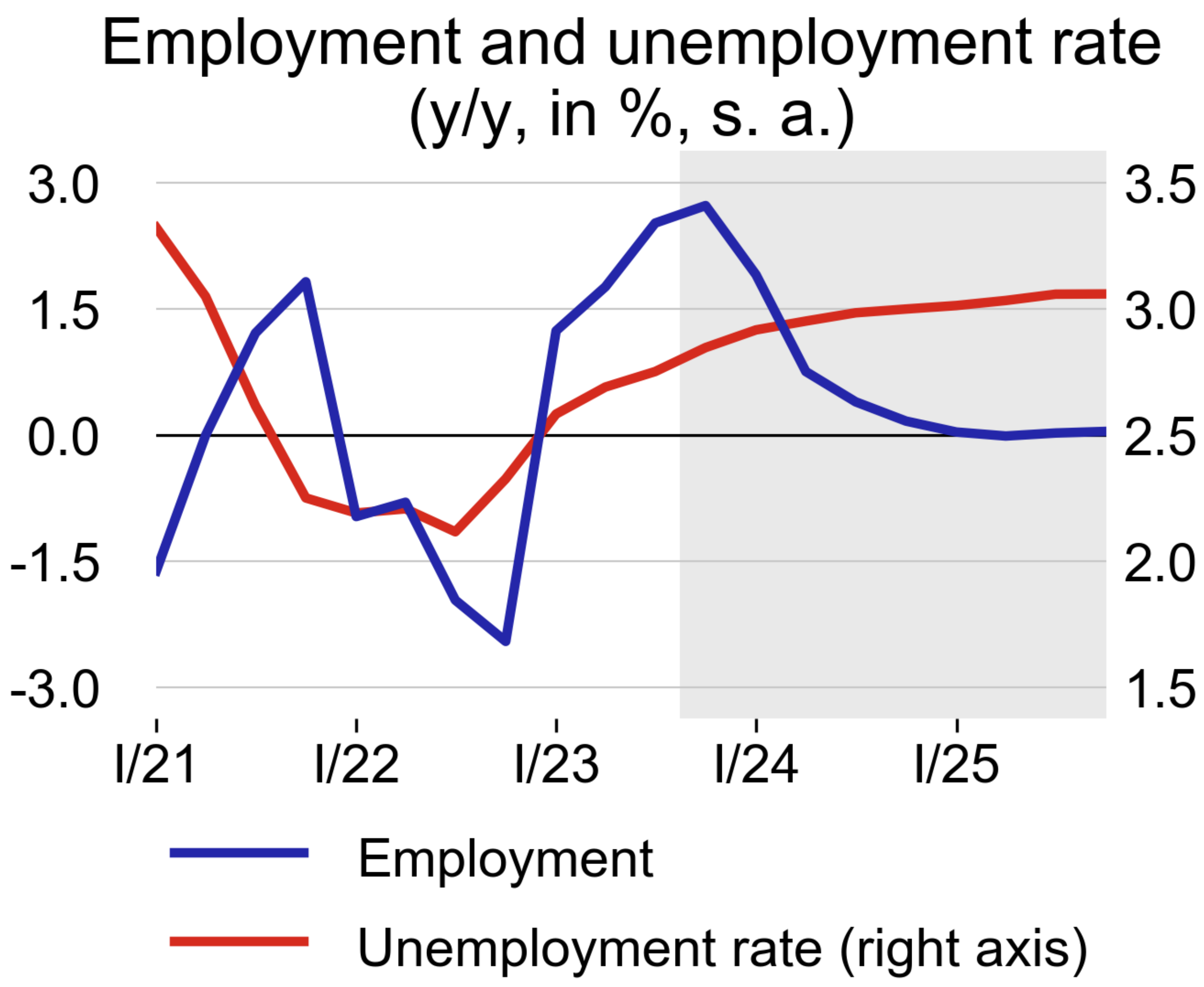


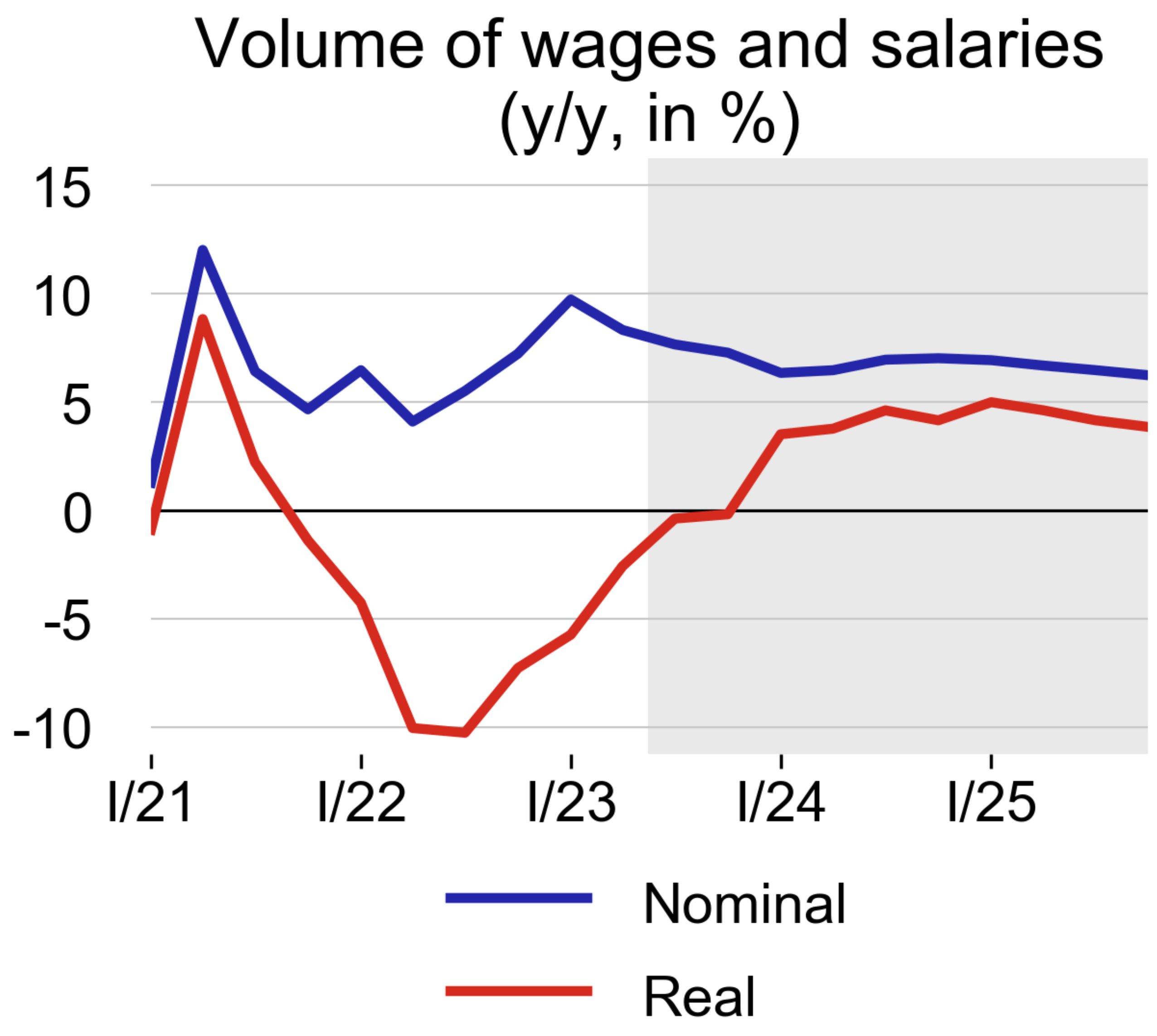
- The **overal cost pressures** will strengthen temporarily in late 2023 and early 2024 due to a significant increase in the administered component of **energy prices for firms** and a weakening **koruna**.
- Once the effect of the increase in the administered component of energy prices for firms at the start of 2024 fades out, growth in total costs will slow again. In 2025, it will fall gradually to the steady-state level consistent with the fulfilment of the inflation target.
- The **domestic cost pressures** will ease gradually from mid-2024 onwards as **wage growth** steadily decreases.
- The positive **gap in mark-ups** will start to narrow noticeably amid only slowly recovering domestic demand dampened by the tight monetary policy to date and by restrictive fiscal policy next year.

Labour Market





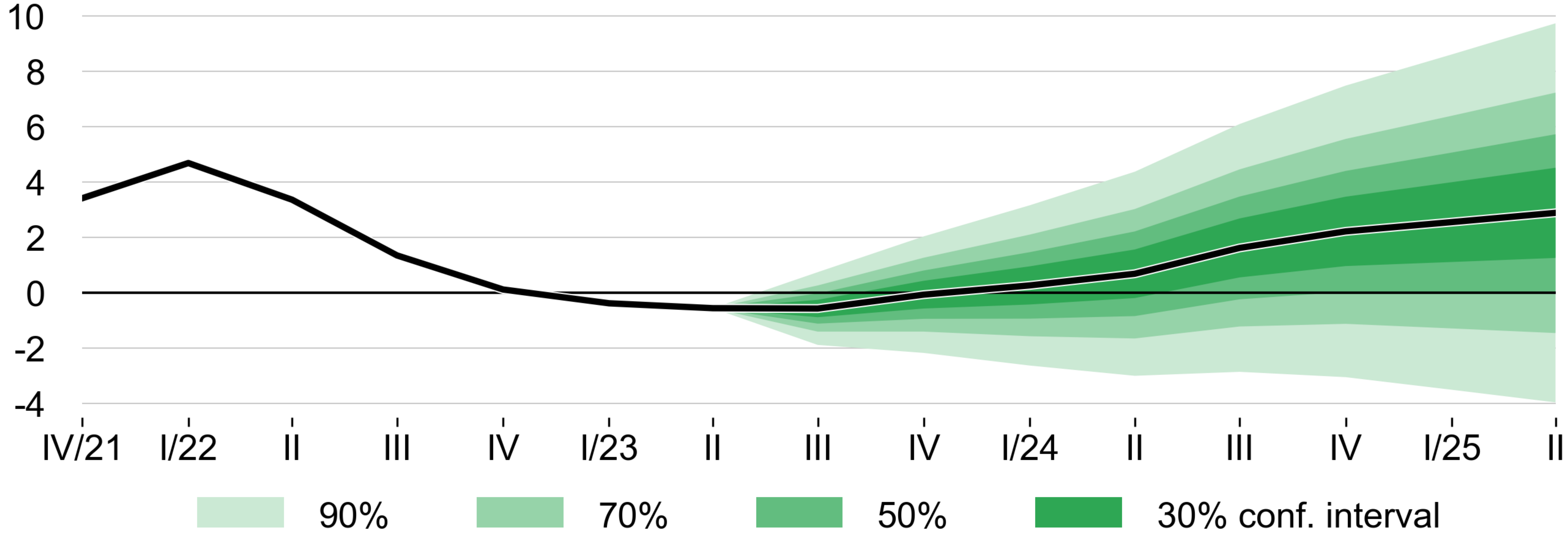




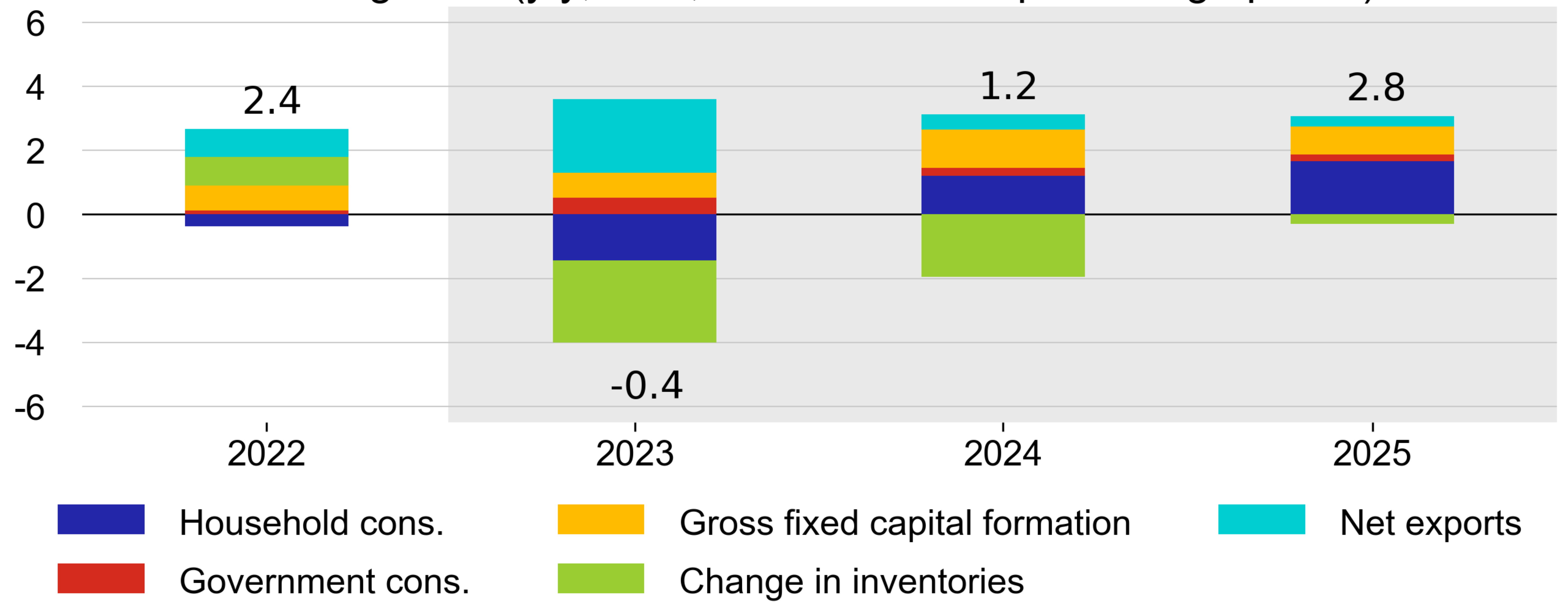
- From the perspective of the **LUCI**, the tightness in the labour market will moderate gradually but will remain significant.
- **Nominal wage growth** will remain elevated due to the previous high inflation and still tightened labour market.
- **Employment** will grow moderately further this year and **unemployment** will increase slightly.
- Growth in the **real wage bill** will turn positive again at the start of 2024 and will pick up further over the outlook horizon. This will reflect continued brisk wage growth and a rapid decline in inflation back to the inflation target. Growth in real wages and salaries will thus contribute significantly to the recovery in HH consumption supported further by a decline in savings rate.

GDP Growth Forecast

GDP growth (y/y, in %)



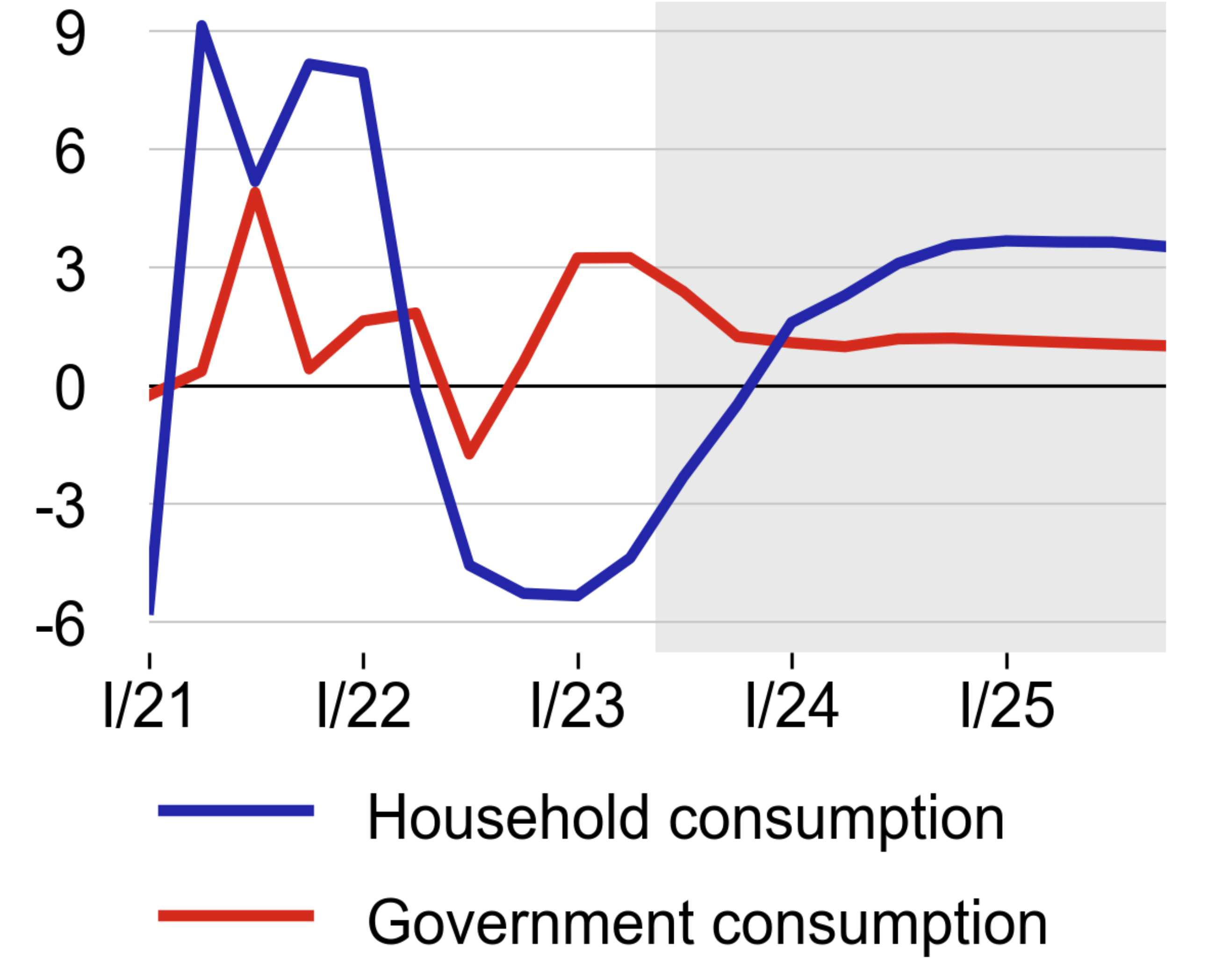
GDP growth (y/y, in %, contributions in percentage points)



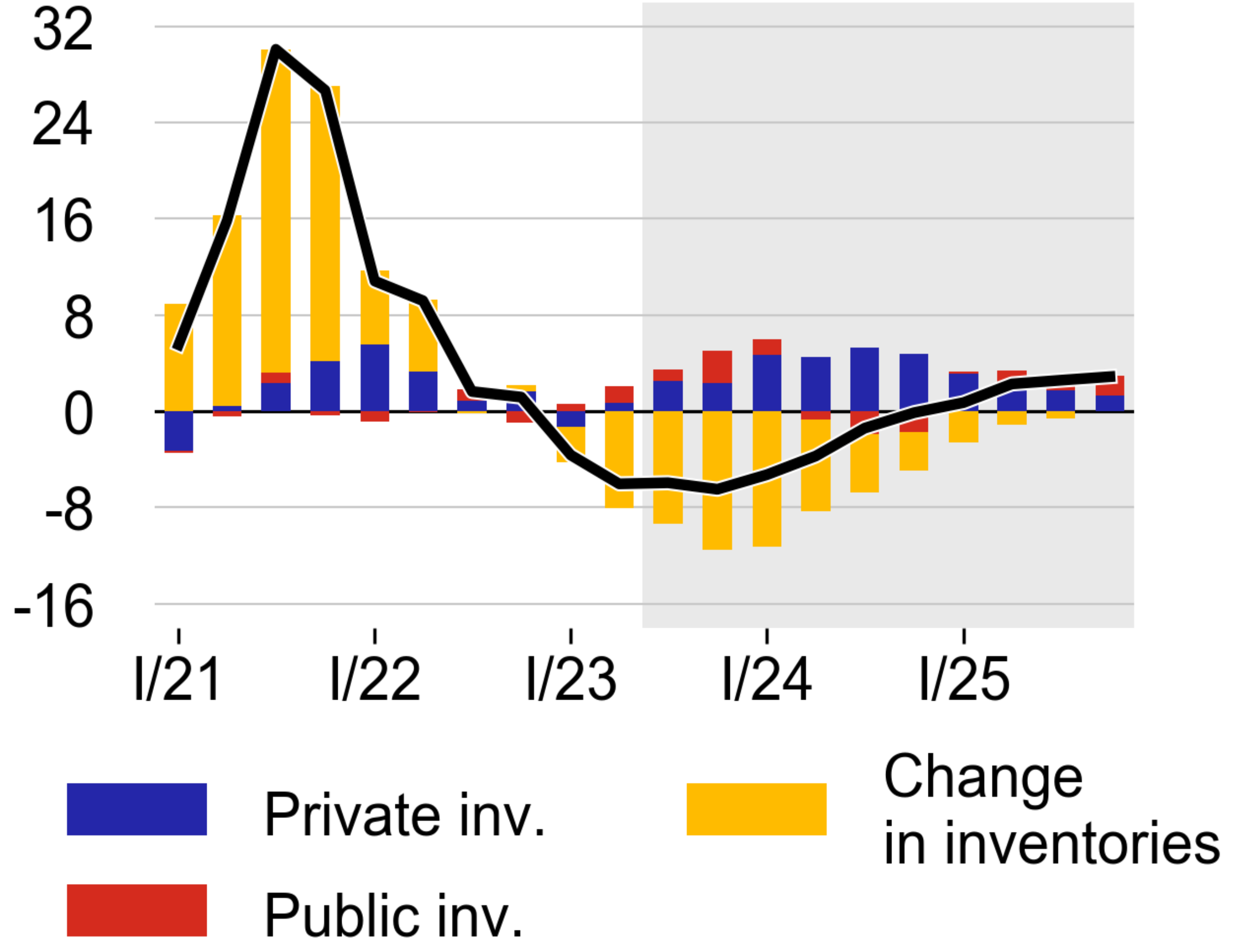
- **Economic activity** is declining this year, due mainly to falling household consumption, which, however, will pick up and conversely drive economic growth next year.
- In whole-year terms, **GDP** will decline this year by **-0.4%**. In 2024, the economy will grow by **1.2%.** Its recovery will be dampened by a fiscal consolidation package. In 2025, GDP growth will pick up to **2.8%.**
- According to a preliminary CZSO estimate, Czech GDP decreased by 0.3% quarter on quarter and 0.6% year on year in 2023 Q3. This is almost fully in line with the CNB forecast.

GDP Components

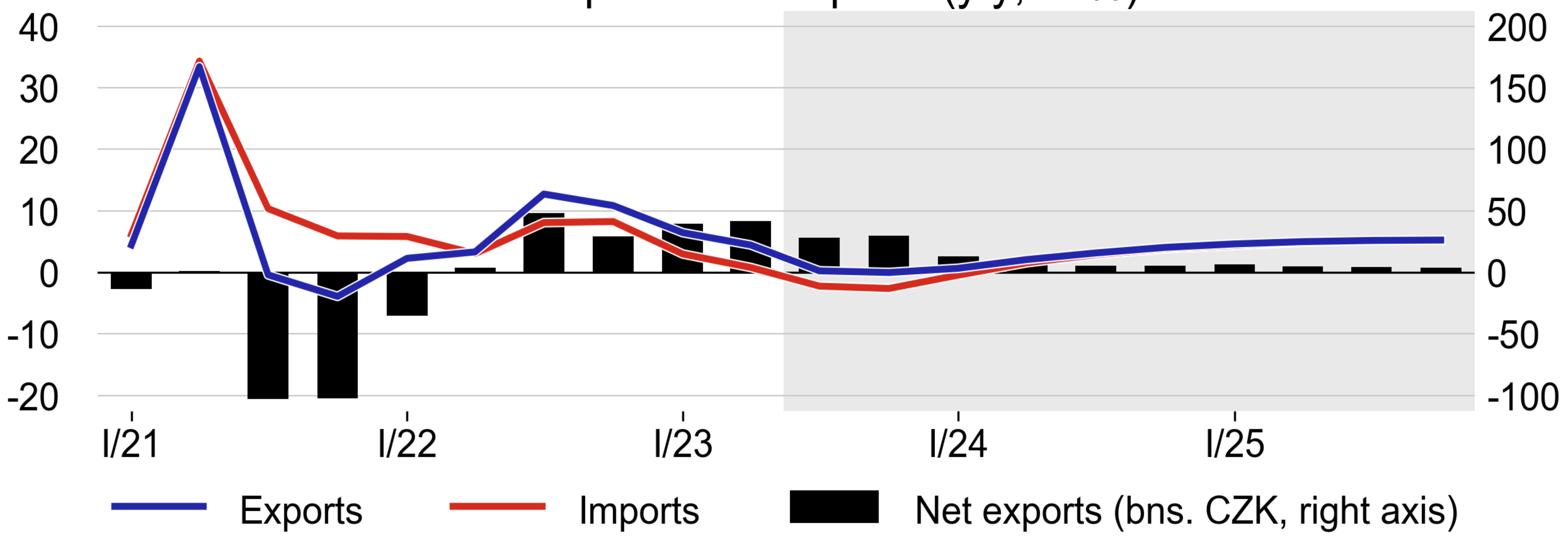
Household and Gov. cons. (y/y, in %)



Gross capital formation (y/y, in %)

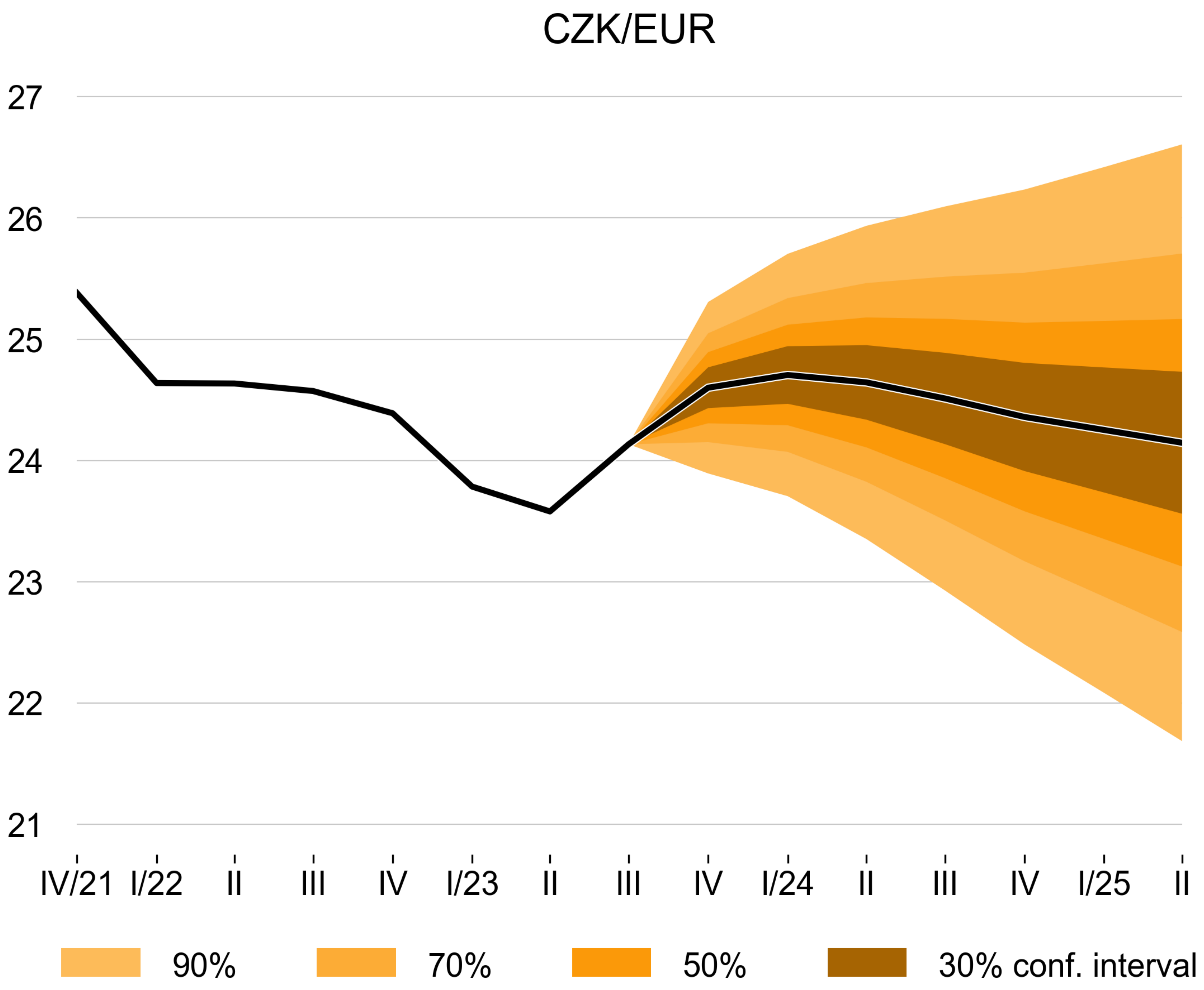


Real exports and imports (y/y, in %)



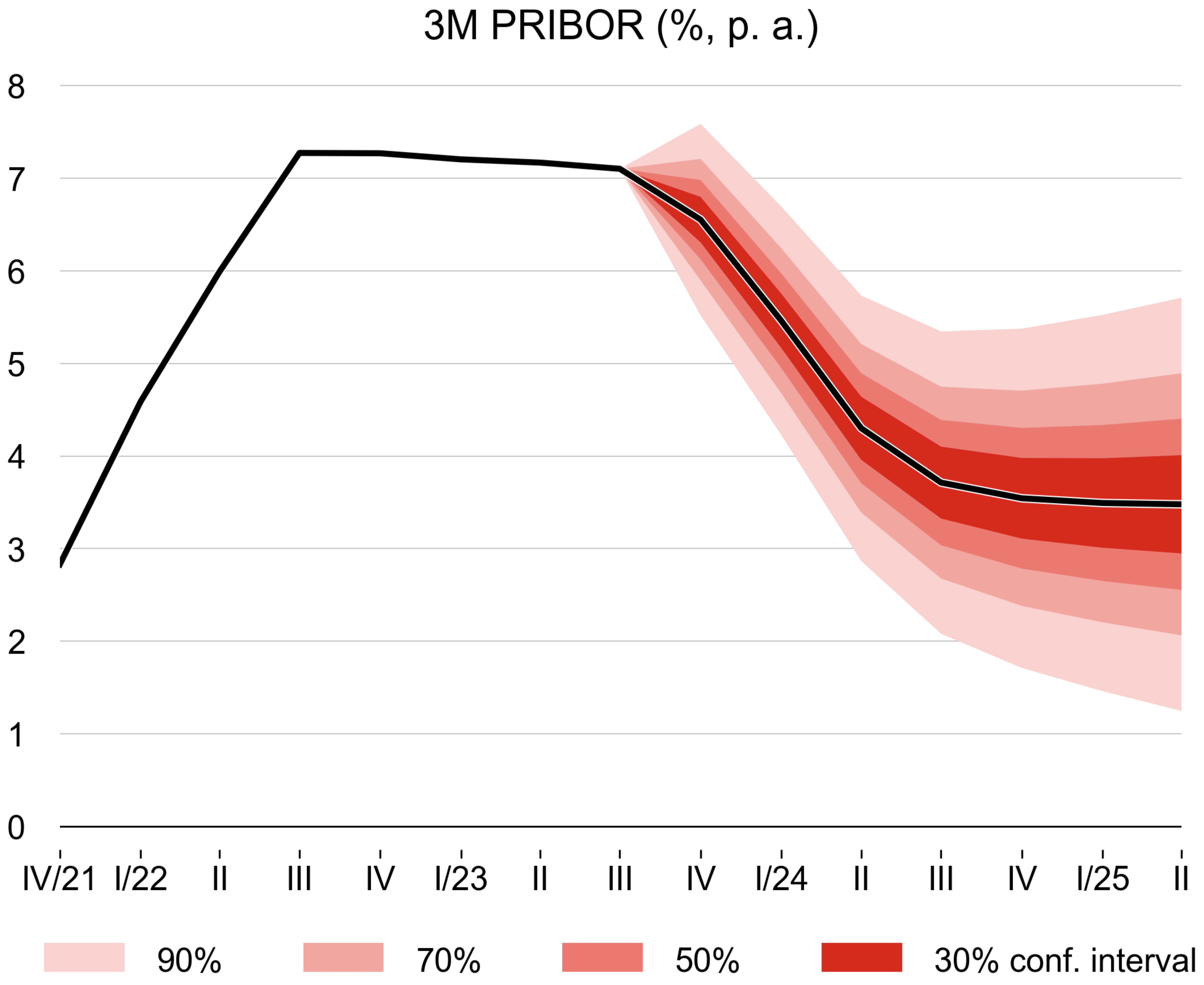
- **Household consumption** will fall in year-on-year terms throughout 2023 and will not start to grow again until early next year.
- **Government consumption** will grow at a subdued pace.
- Growth in **total gross investment** will be affected predominantly by a negative contribution of **change in inventories** until the end of 2024.
- **Export** and **import** growth will initially slow due to weak external and domestic demand.

Exchange Rate CZK/EUR



- The autumn forecast expects the **koruna** to average **CZK 24.6** to the euro in 2023 Q4.
- The koruna will **depreciate** slightly further in early 2024, mainly because of a narrowing **interest spread** vis-à-vis the euro area, which will, however broadly stabilise at the end of next year.
- A subsequent slight **appreciation** of the koruna will reflect above all a recovery in external demand and a related upswing in the domestic economy and its export performance.

Interest Rate Path (3M PRIBOR)



- Consistent with the baseline scenario of the forecast is a decline in **market interest rates** from 2023 Q4 onwards.
- This is in line with the fading of the extraordinary cost pressures from the external environment and the easing of inflation factors from the domestic economy.
- With an outlook for **low inflation** next year (including over the monetary policy horizon), the moment at which continuing with the current monetary policy stance would have an **excessively tight effect** has moved closer. The high interest rates have served their purpose, as lending has dropped sharply in the case of mortgages and koruna loans to corporations.
- The inflation pressures in the Czech economy have diminished and will stay subdued for most of the next two years.

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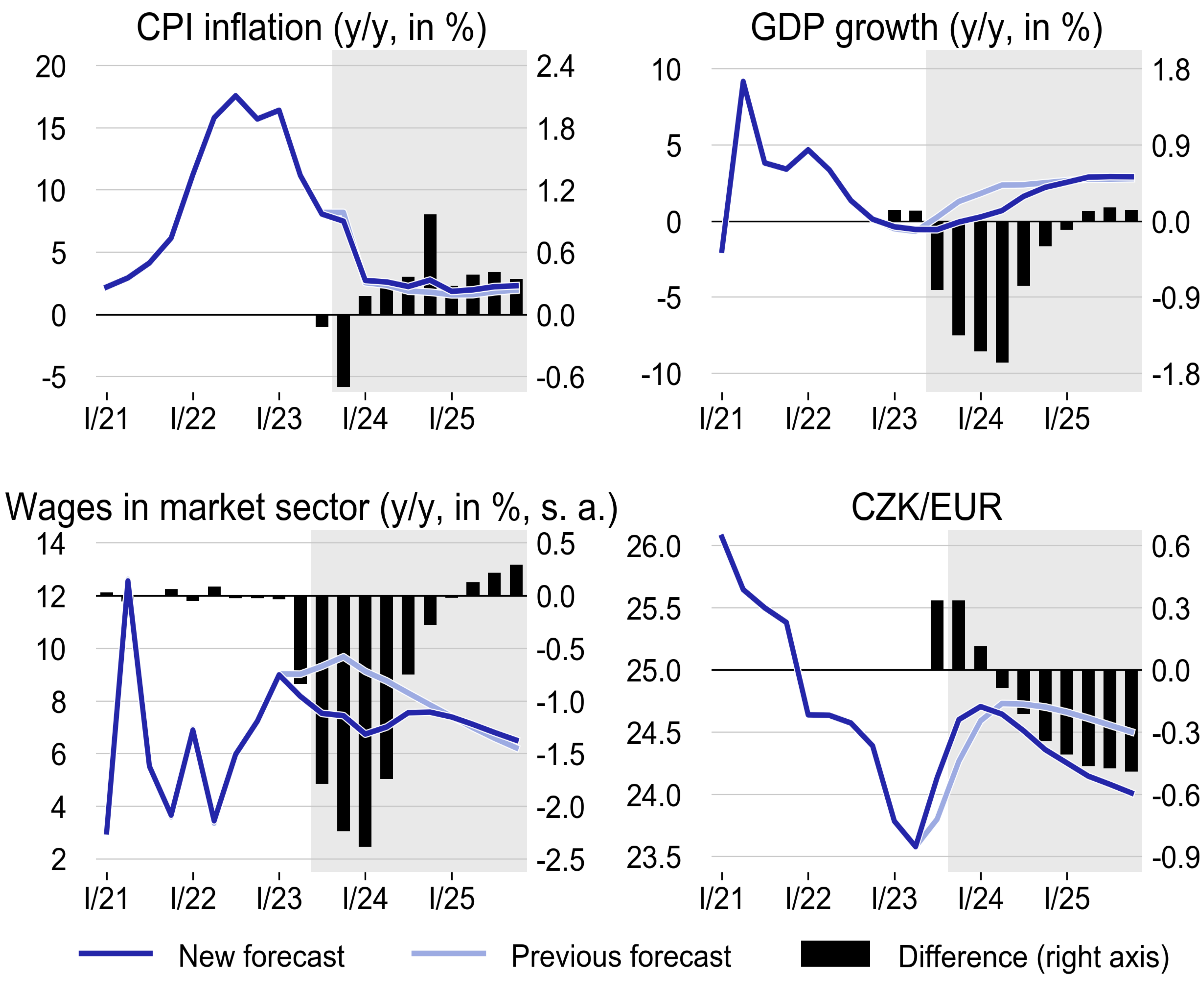
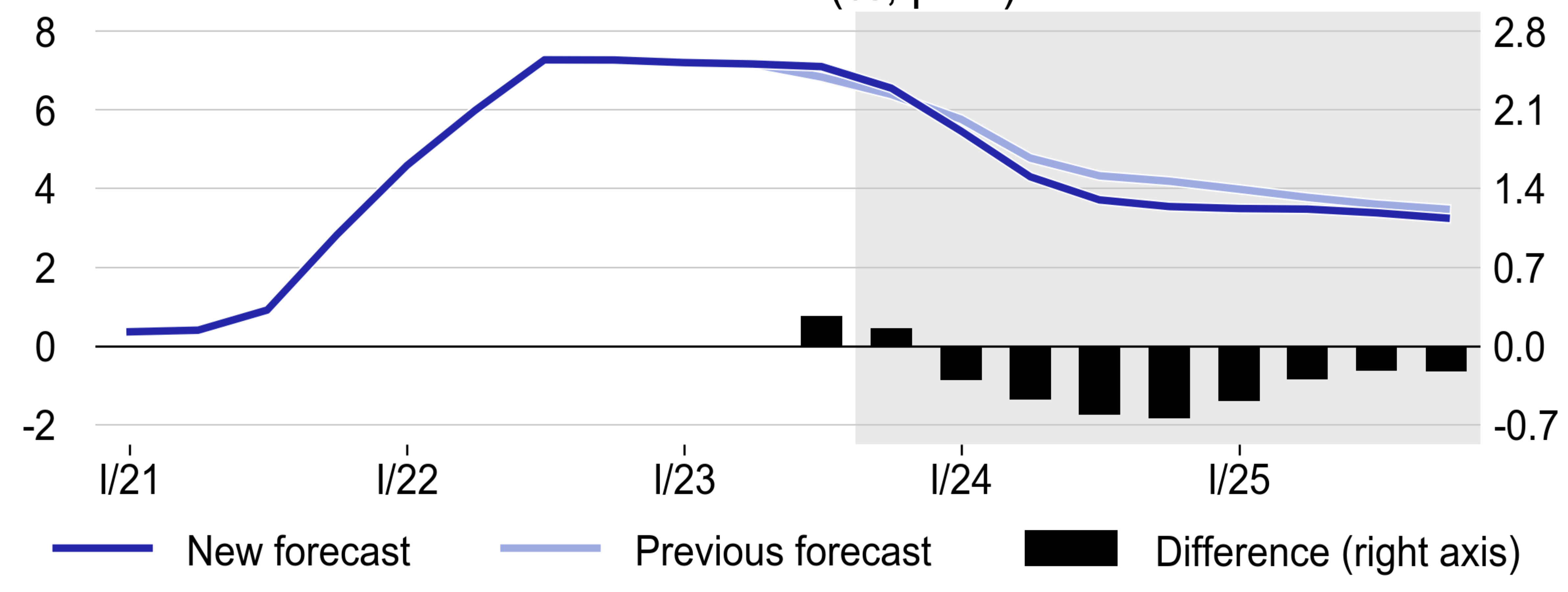
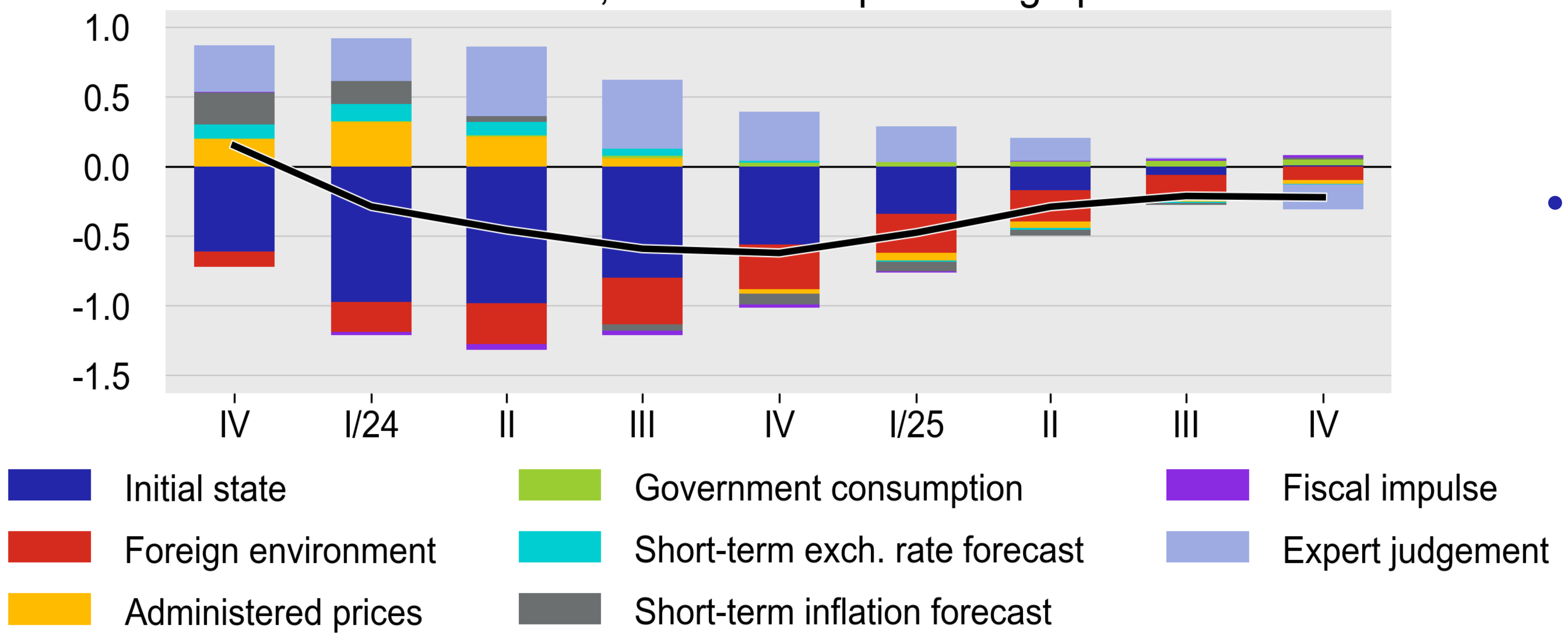
Comparison with the Previous Forecast: Domestic Economy



- The **inflation** forecast has been revised up for next year, due mainly to higher administered price inflation.
- The **GDP growth** outlook is lower due mainly to weaker external demand.
- The lower **wage growth** in 2023 and 2024 reflects the weaker nominal wage growth observed in H1 2023 and more subdued economic activity than in the previous forecast.
- The shift in the **exchange rate** to weaker levels at the nearer end of the forecast horizon is due primarily to its **observed levels**. An initially more quickly narrowing **interest rate differential** vis-à-vis the euro area and a **worse balance of payments outlook** act in the same direction. By contrast, the more marked appreciation next year reflects faster growth in **nominal net exports** over the outlook horizon.

Comparison with the Previous Forecast: 3M PRIBOR





- The **initial state** of the domestic economy fosters visibly lower rates due to lower observed wage growth and more subdued GDP growth. A revision of energy import prices acts in the same direction.
- The negative contribution of the **foreign environment** mainly reflects a lower outlook for the core component of PPI and rather faster expected interest rates cuts by the ECB.
- The positive contributions of **administered prices** in the next few quarters reflect an expected increase in the administered component of energy prices at the start of 2024.
- **Expert adjustments** foster higher interest rates due predominantly to an expected rise in the administered component of electricity prices for firms at the start of next year, this effect is partly offset by expert adjustments lowering wage growth and curbing recovery in household consumption.

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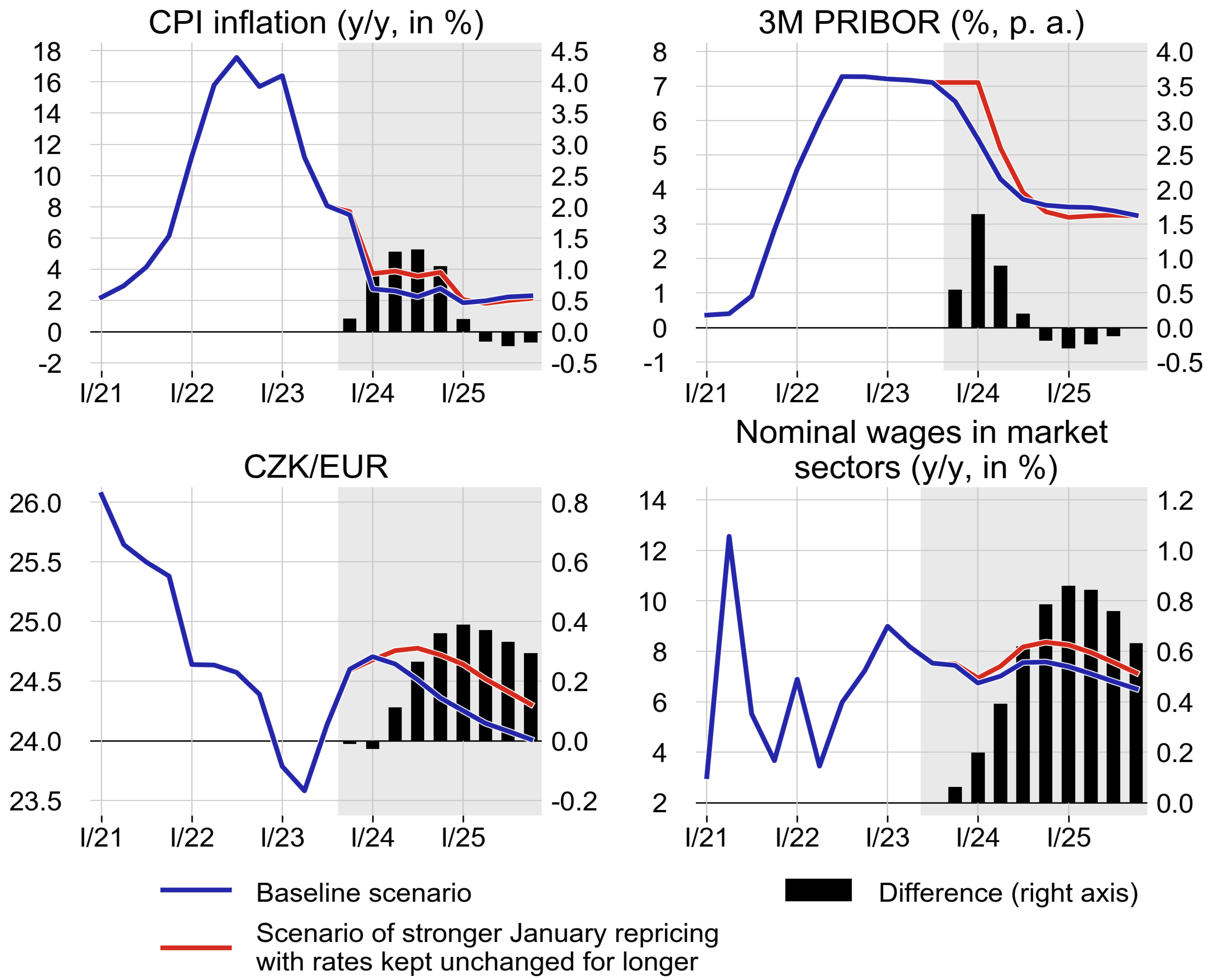
Scenario of Stronger January Repricing with Rates Kept Unchanged for Longer



- The scenario assumes higher growth in **market prices** in January 2024 compared to the baseline scenario, with an impact of **1 pp** on annual **headline inflation**. Inflation then remains significantly elevated throughout next year and does not return close to the target until 2025.
- Monetary policy responds to the stronger repricing with tighter **interest rates** than in the baseline scenario. Interest rates will stay at their current level until the end of the first quarter of next year.
- Despite the temporarily higher interest rate path, the **koruna** will weaken above the levels in the baseline scenario, owing to higher domestic inflation.
- The higher inflation and weaker koruna will also be reflected in faster **nominal wage growth** than in the baseline scenario.

Thank you for your attention

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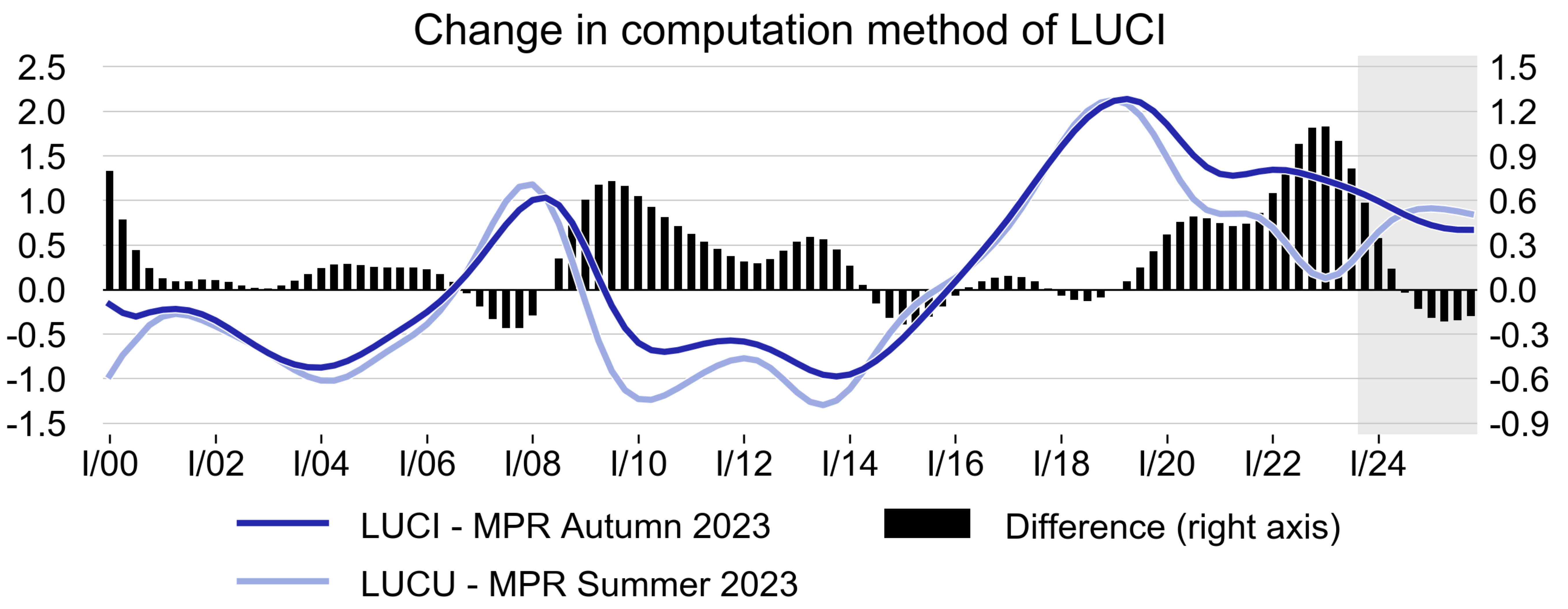
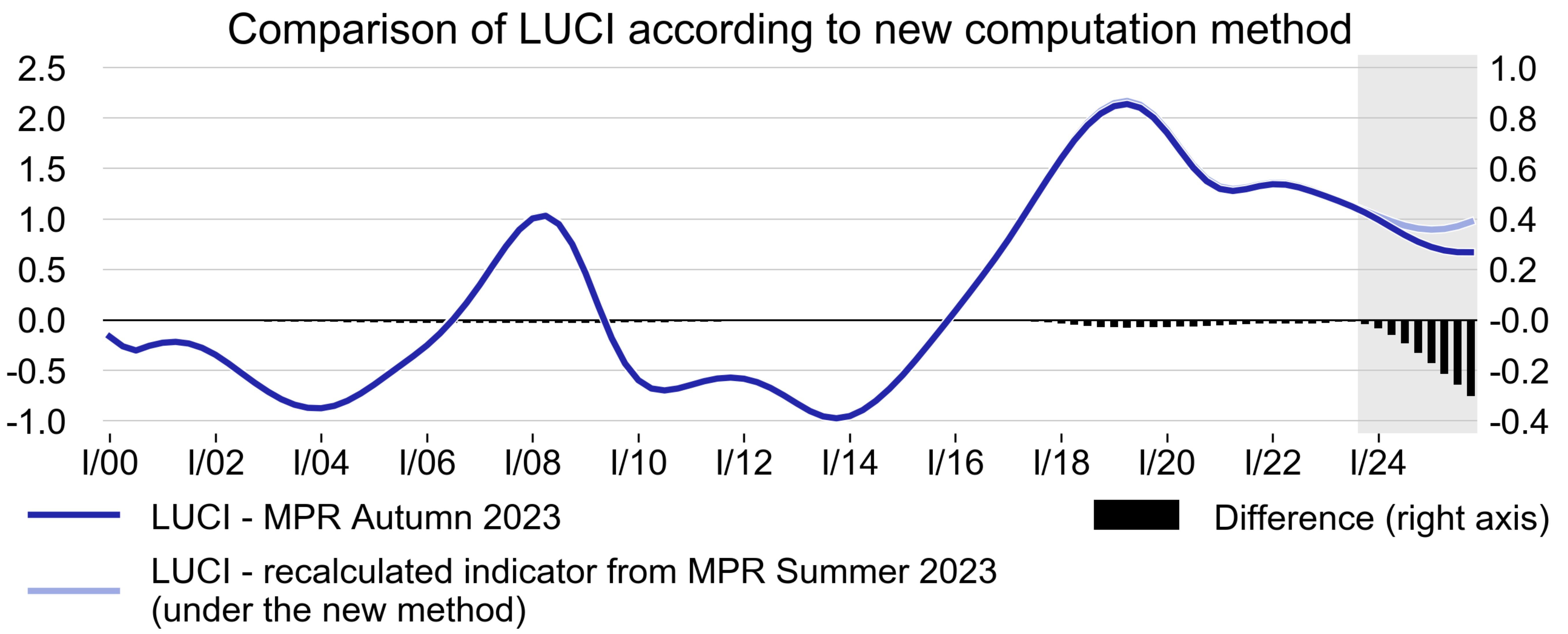
Change in Computation Method of LUCI





Decomposition of LUCI