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# CNB's New Forecast

## Monetary Policy Report – Autumn 2024

### Meeting with Analysts

8 November 2024

Petr Král (Executive Director, Monetary Department)



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# Presentation Outline

## 1. Structural Changes and New Equilibria

2. Assumptions of the Forecast

3. The New Macroeconomic Forecast

4. Comparison with the Previous Forecast

5. Scenarios and Scoreboard Risks



# Changes in Czech Economy Equilibria

- Already the summer forecast assumed a reduction **in the potential GDP growth** and **the equilibrium pace of the koruna's appreciation**.
- These adjustments were incorporated into the summer forecast through expert adjustments.
- The autumn forecast was prepared using a recalibrated model (changes in steady-state parameters).
- The following shifts occur in the equilibrium year-on-year growth rates:

Variable	Former equilibrium	New equilibrium
<b>GDP</b> (inc. domestic components)	3%	2.5%
<b>Productivity</b>	3%	2.5%
<b>Nominal wages</b>	5%	4.5%
<b>Koruna appreciation</b>	1.5%	1%



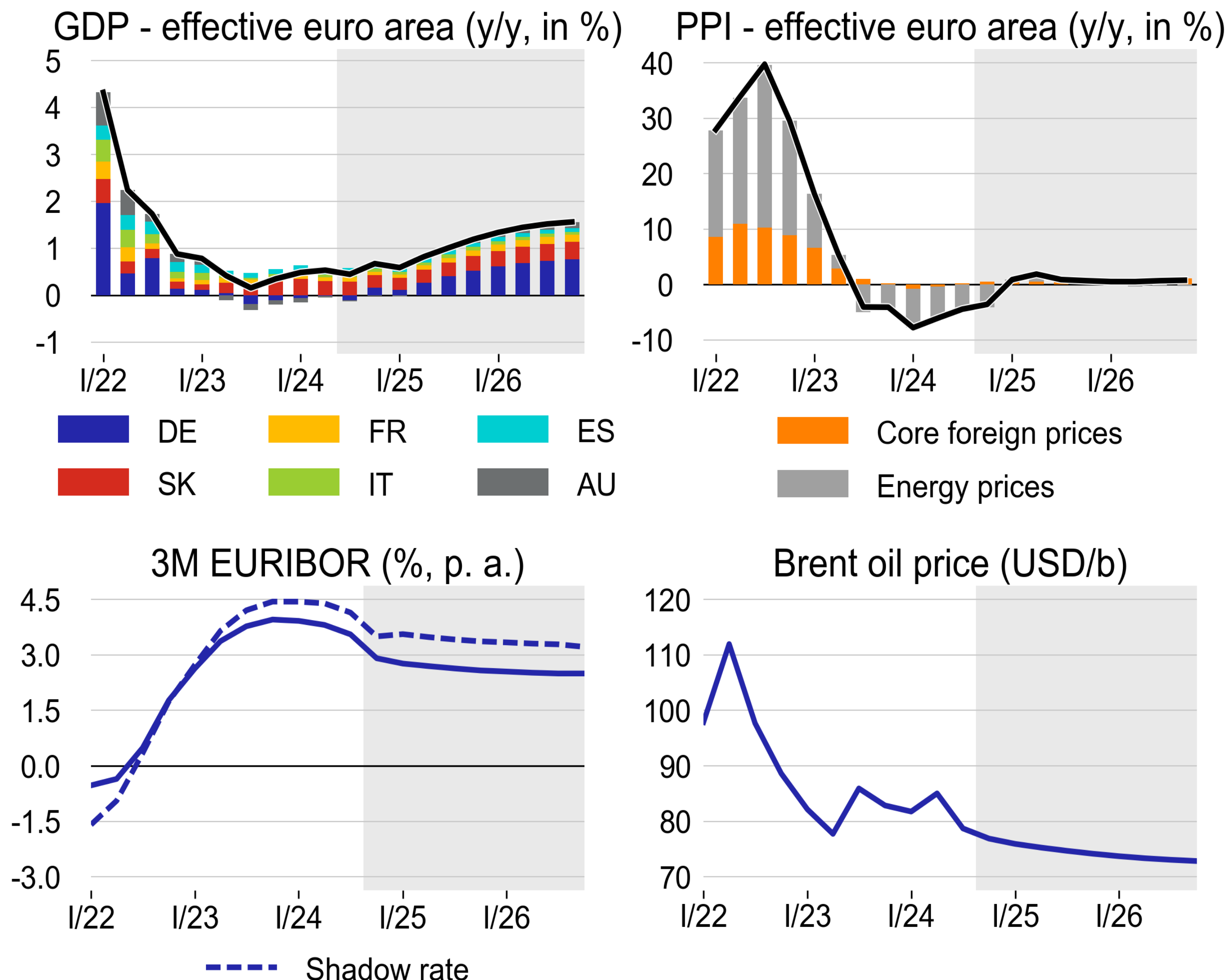
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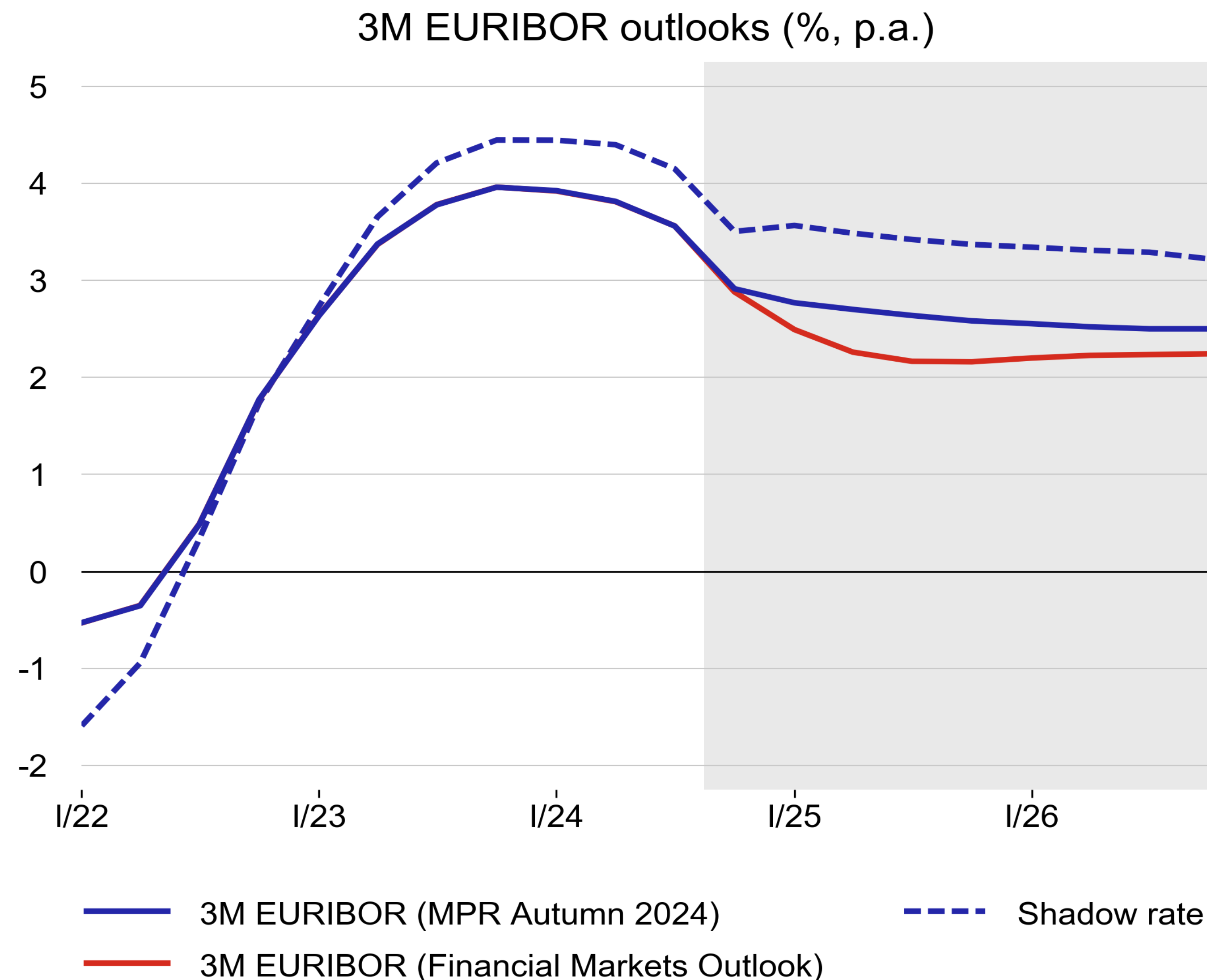


# Foreign Environment Outlook



- **GDP in the effective** euro area will grow by 0.5% on average in 2024 as a whole and accelerate to around 1% next year. This will be mainly due to the gradual recovery of the German economy.
- This year's decline in **industrial producer prices** will fade out next year, mainly due to the energy component.
- **Euro area interest rates** will go down further; the decline in the **shadow rate** will be dampened by an expected decrease in the rate of reinvestment by the ECB.
- **The Brent crude oil price** fell in Q3 but rose again in October; however, its outlook remains slightly falling.

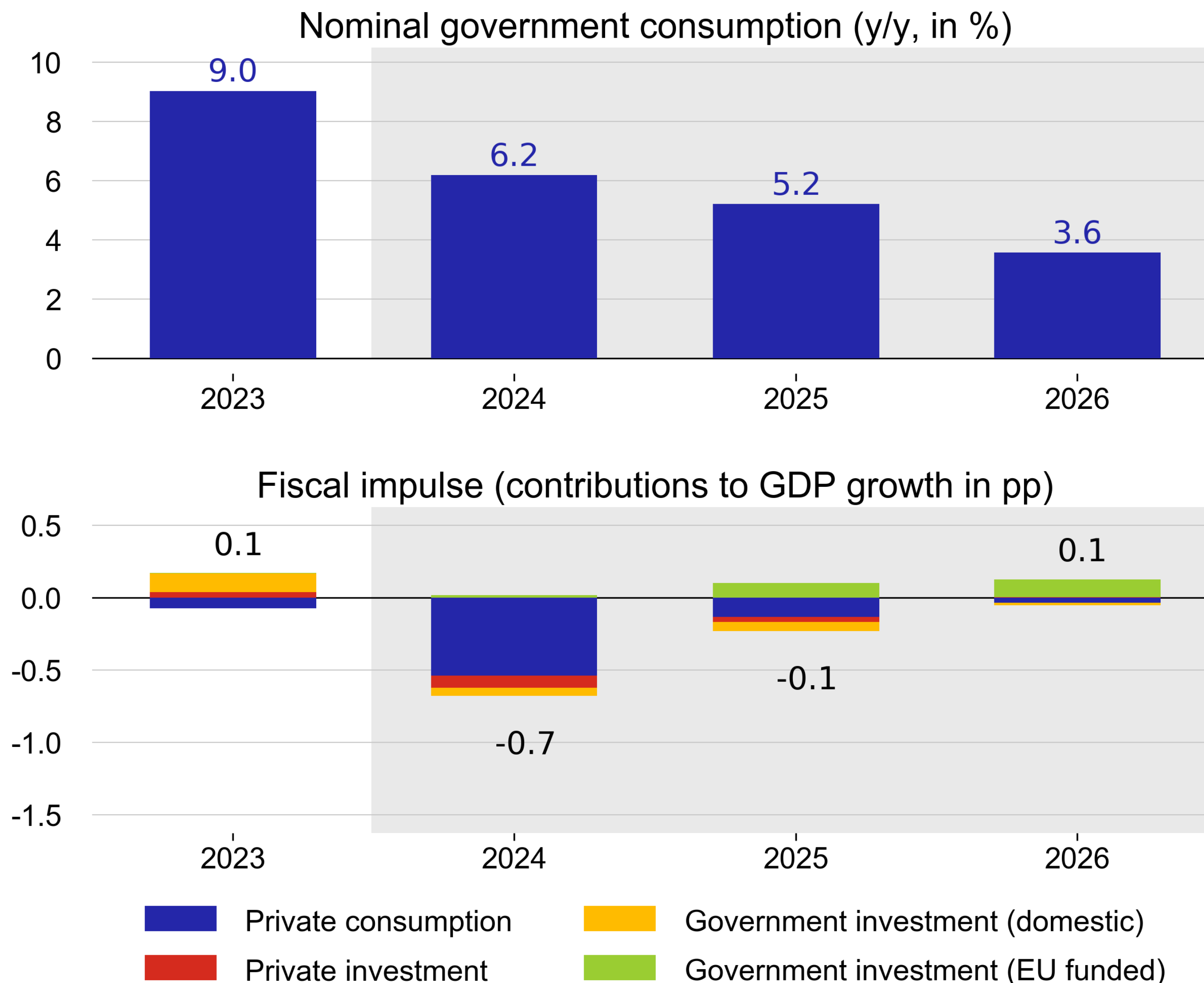
# 3M EURIBOR Outlooks



- **The market outlook for the 3M EURIBOR** has been particularly volatile over the last year. It has been a frequent source of significant reassessments of the domestic monetary policy outlooks. It is sensitive above all to the weak economic growth in the euro area (and Germany in particular) and reflects concerns of a recession. On the other hand, the ECB's cautious communication has not changed much.
- The market is also reacting sensitively to new data because the ECB continues to emphasise a **data-dependent approach**.
- The path of the market outlook in the CNB's autumn forecast has undergone **expert adjustment**. It assumes that the ECB will lower its rates more gradually than currently expected by the financial market, which has recently tended to be overly pessimistic.



# Fiscal Policy



- Growth in **nominal government consumption** will slow gradually, due mainly to cuts in operating expenditures and the declining effect of extraordinary expenditures after the floods.
- **Fiscal policy** is significantly dampening GDP growth this year, owing mainly to:
  - the consolidation package,
  - the definitive termination of energy support measures
- Extraordinary expenditures related to reconstruction after floods is having the opposite effect.
- In 2025 and 2026, the overall effect of fiscal policy will be broadly neutral.

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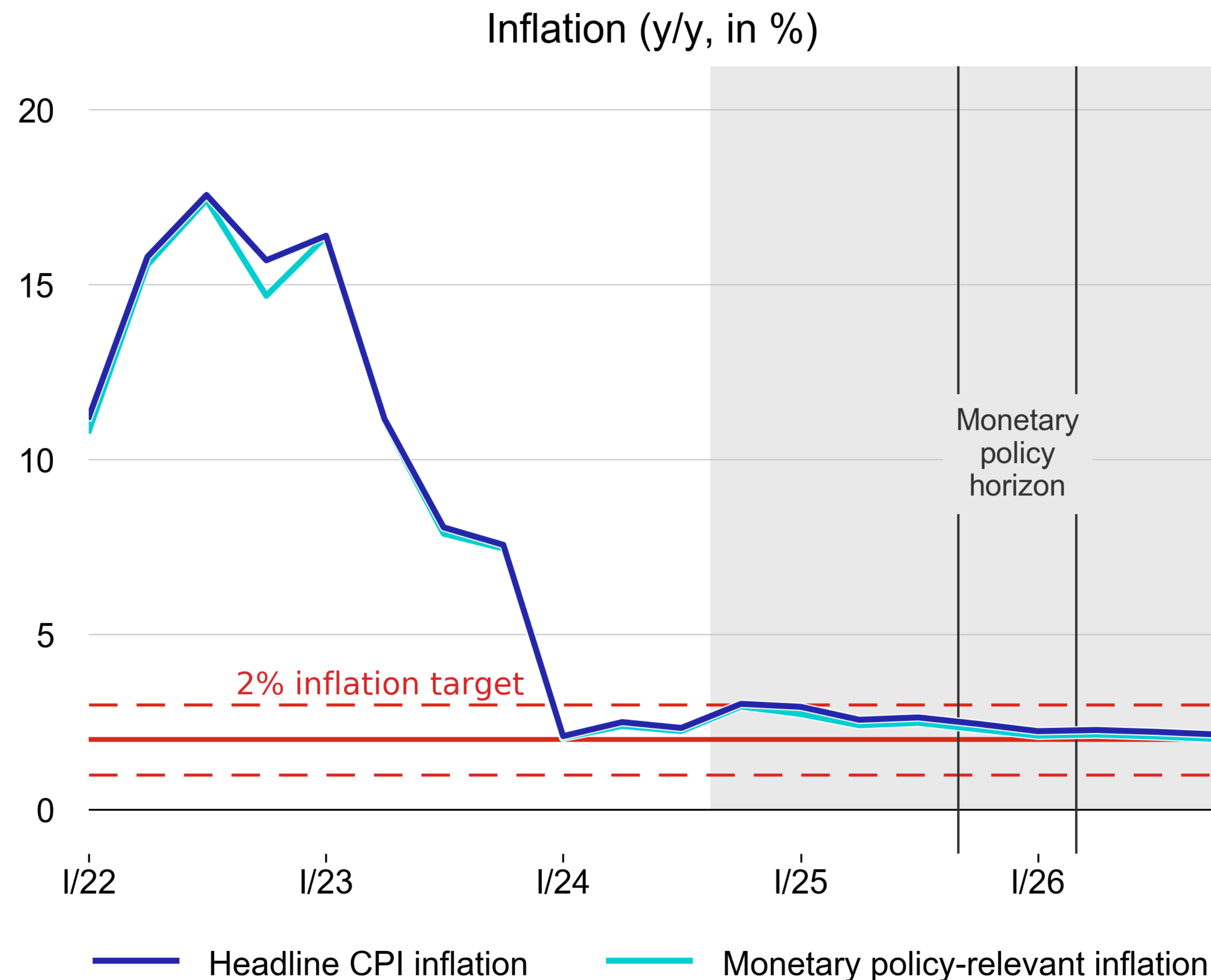
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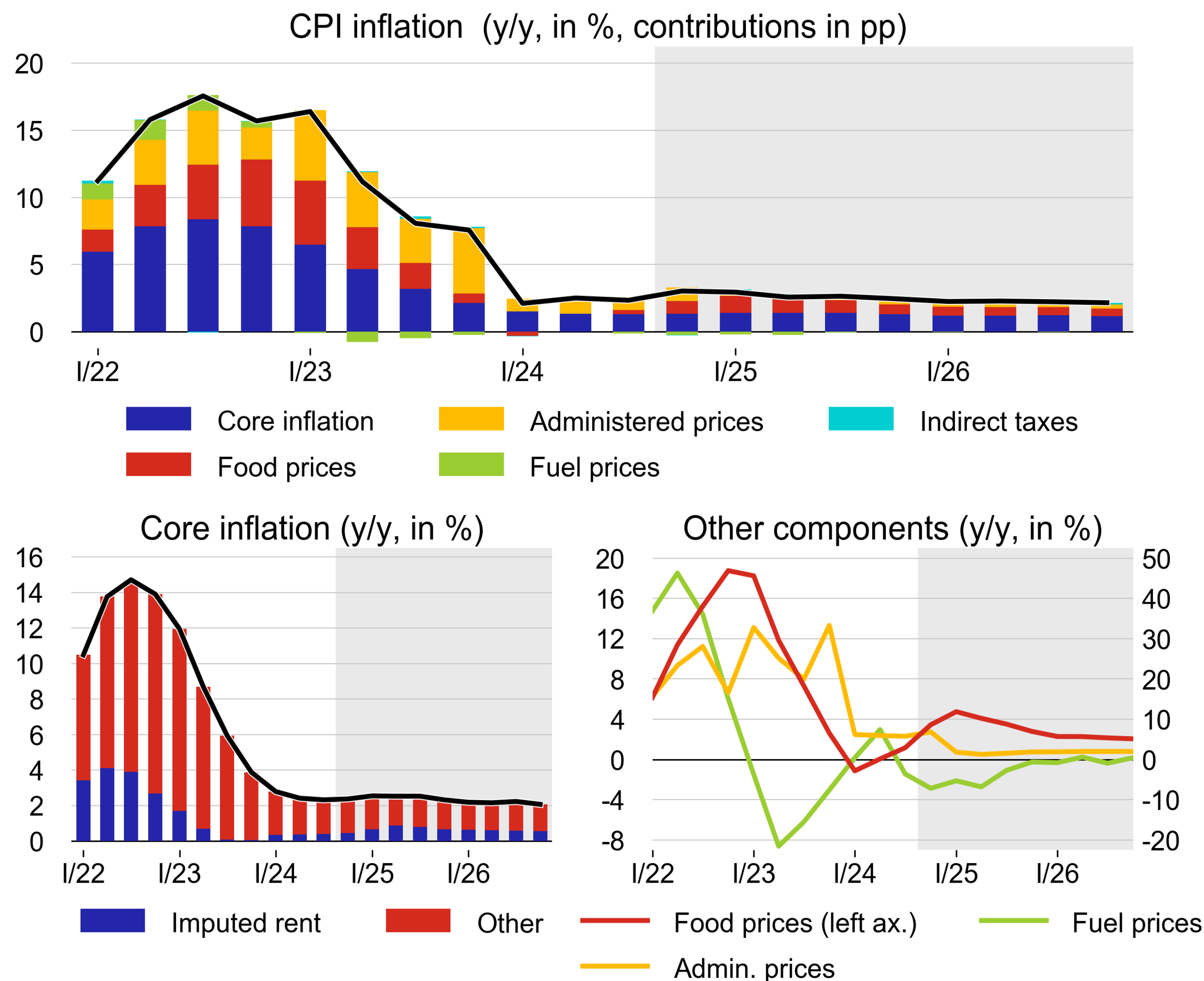


# Headline and Monetary Policy-Relevant Inflation



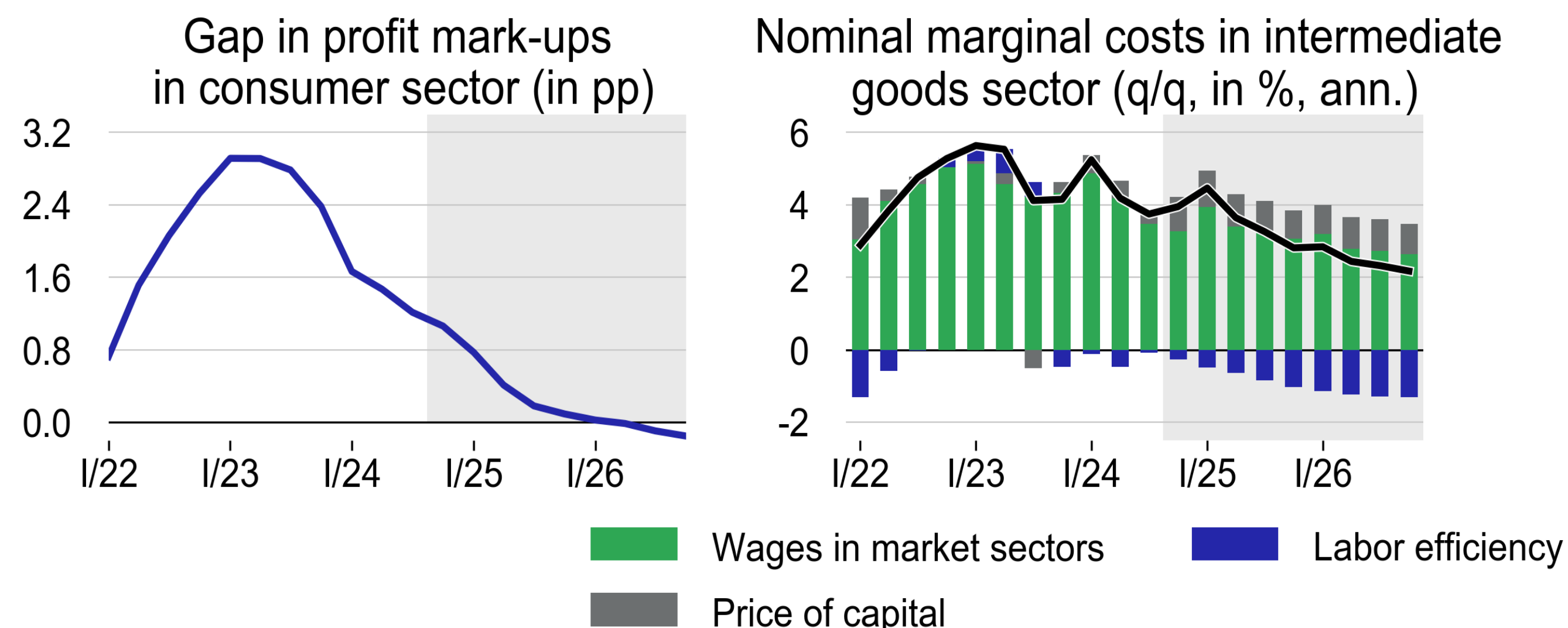
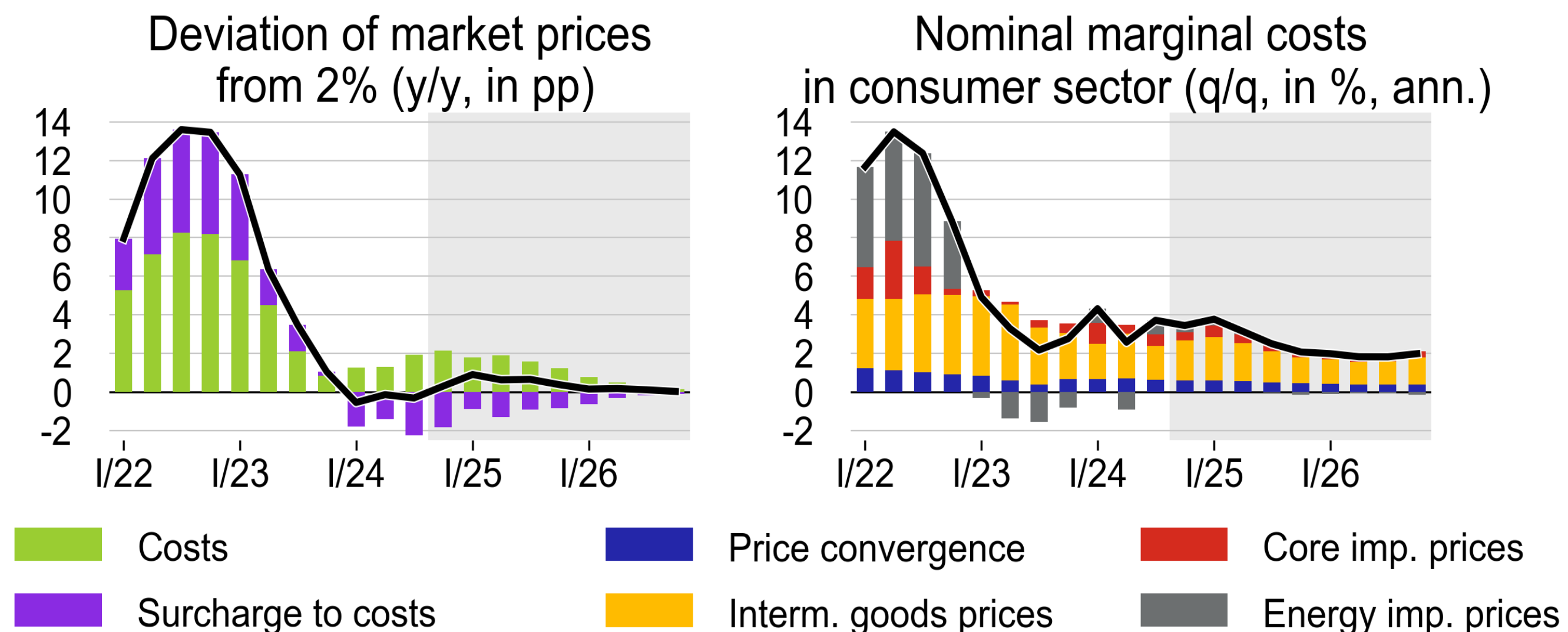
- **Inflation** will be close to the upper boundary of the tolerance band around the target at the turn of the year and will then start to decline gradually towards the 2% target.
- Headline inflation will be slightly above **monetary policy-relevant inflation** (excluding primary effects of indirect taxation changes) due mainly to slightly inflationary effect of increase in excise duty on tobacco and alcohol.

# Core Inflation, Administered, Food and Fuel Prices



- **Consumer price inflation** was close to the 2% target in the summer. It will pick up further in Q4 and will be at the upper boundary of the tolerance band and (possibly) briefly will increase modestly above it at the turn of the year.
- **Core inflation** will stay slightly above 2% amid a gradually increasing contribution of imputed rent.
- **Food price inflation** will go up further in the coming quarters.
- **Administered price inflation** will fall significantly at the start of 2025 and stabilise close to 2% over the next two years.
- **Fuel price inflation** will remain negative in the following quarters, mainly because of slightly falling oil prices, whose effect will be dampened by a modest weakening of the koruna.

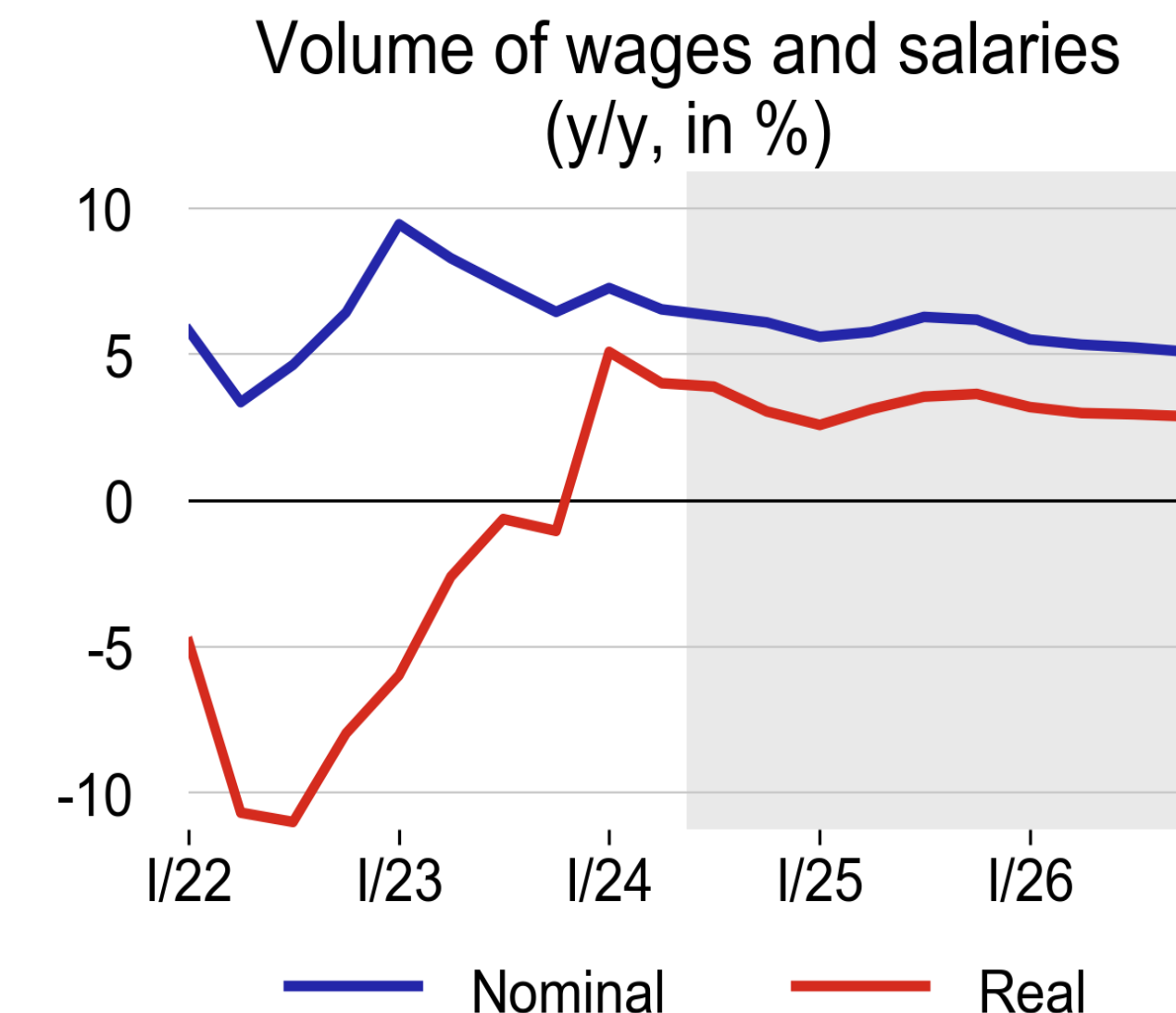
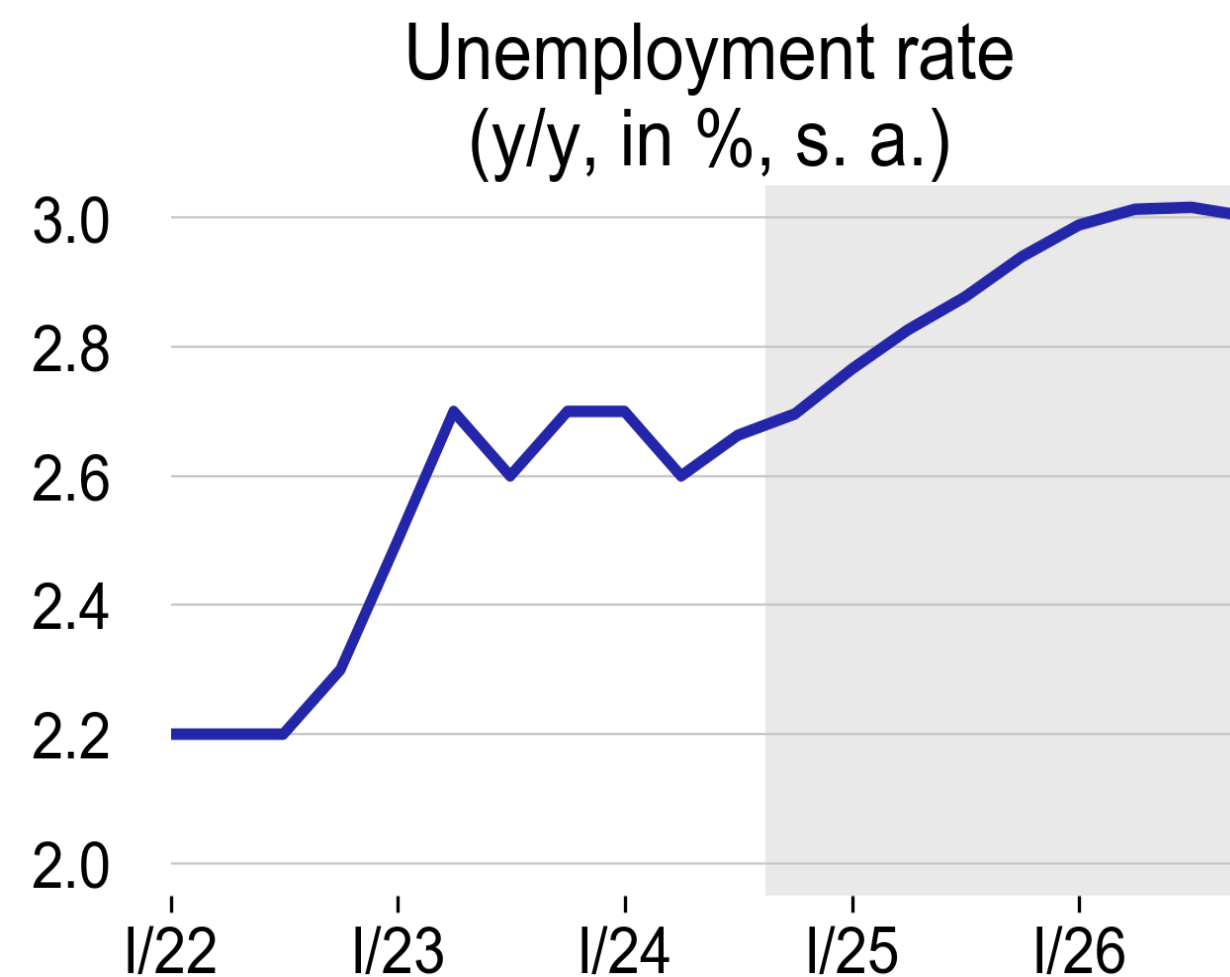
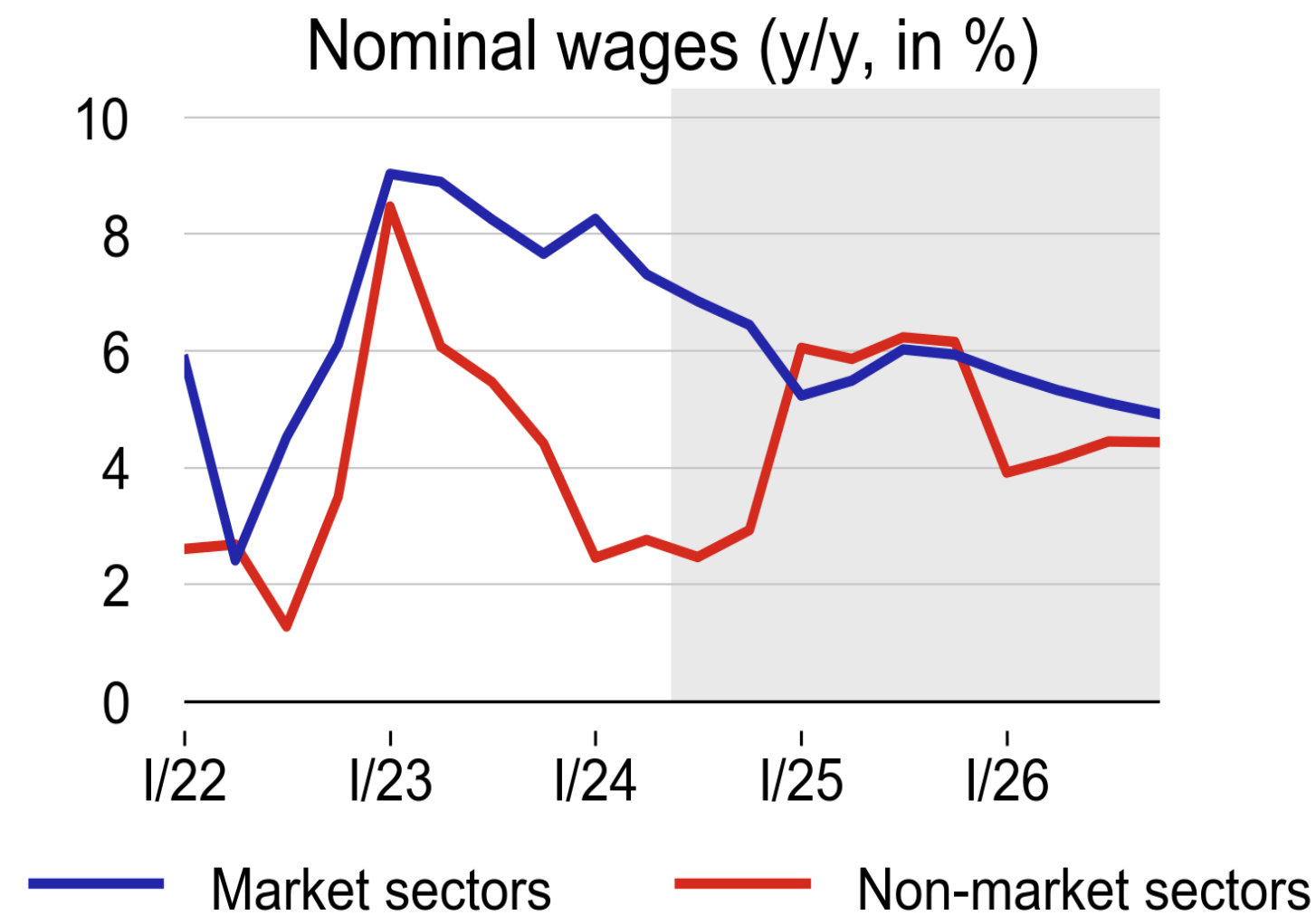
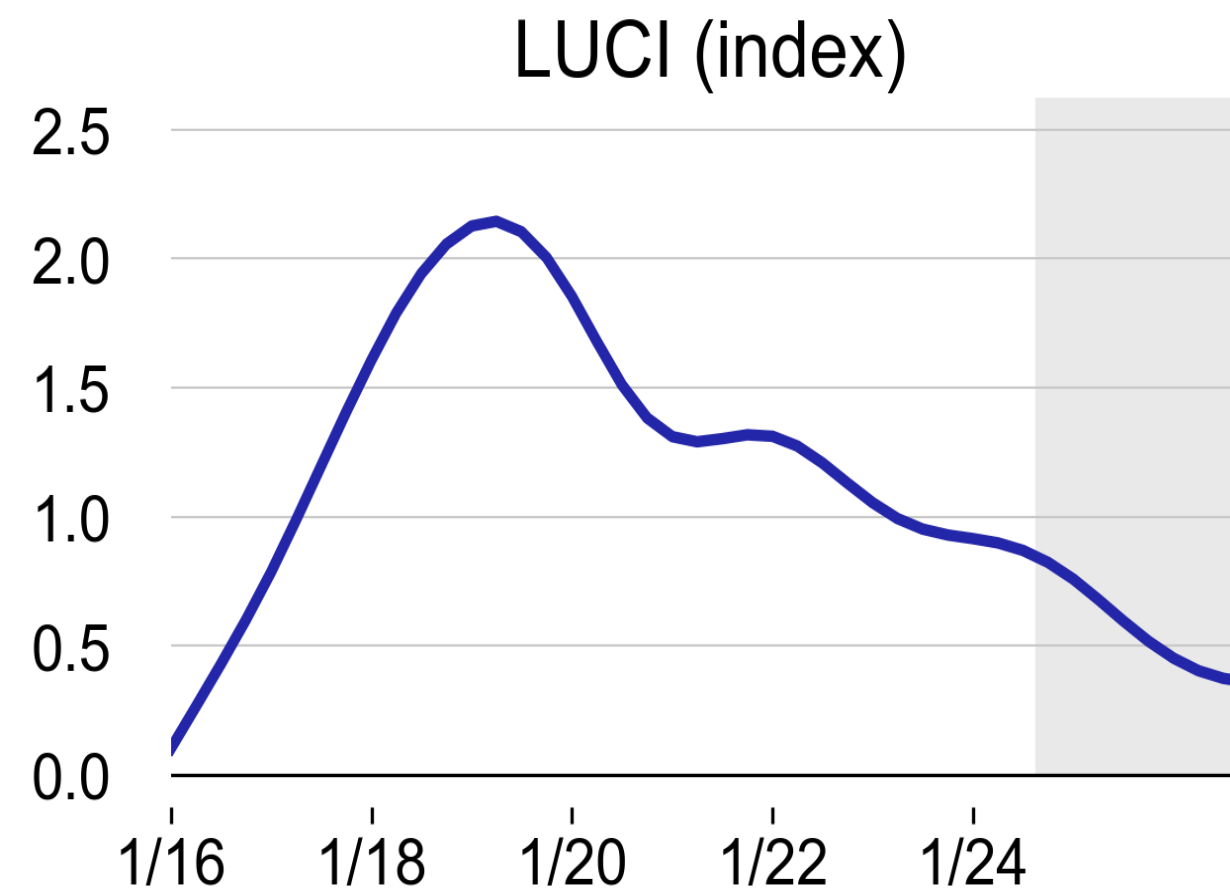
# Cost Pressures and Profit Mark-ups



- Persisting elevated growth in **costs** will foster further market price growth, while a decreasing **surcharge on costs** will dampen it.
- The positive and decreasing **gap in mark-ups** will close at the start of 2026 due to the still tight monetary policy.
- The elevated **overall cost pressures** will decline next year amid a gradual decline in the inflationary effect of the **domestic economy** and **import prices** (incl. agricultural commodities).
- A slowdown in quarter-on-quarter **wage growth**, along with gradual renewed growth in **labour efficiency**, will be reflected in a decline in **domestic cost pressures** from the start of next year.

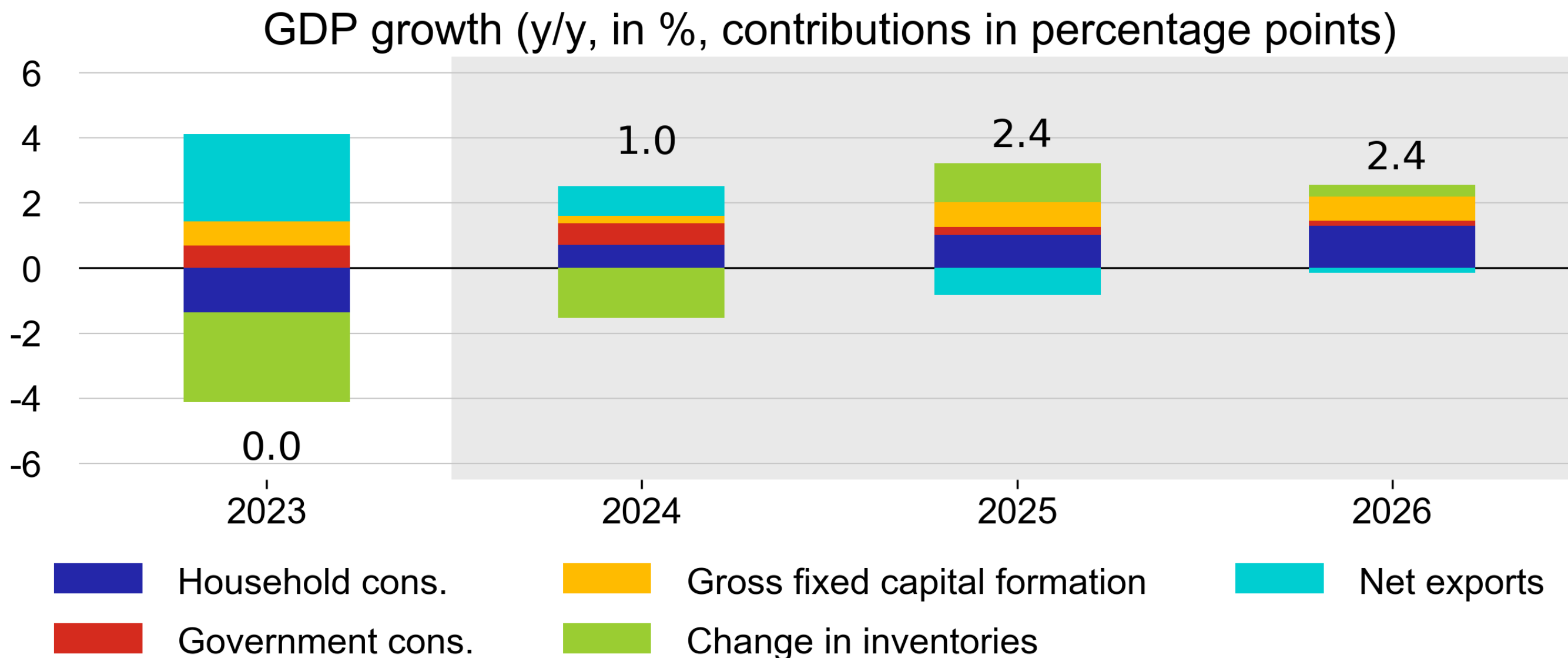
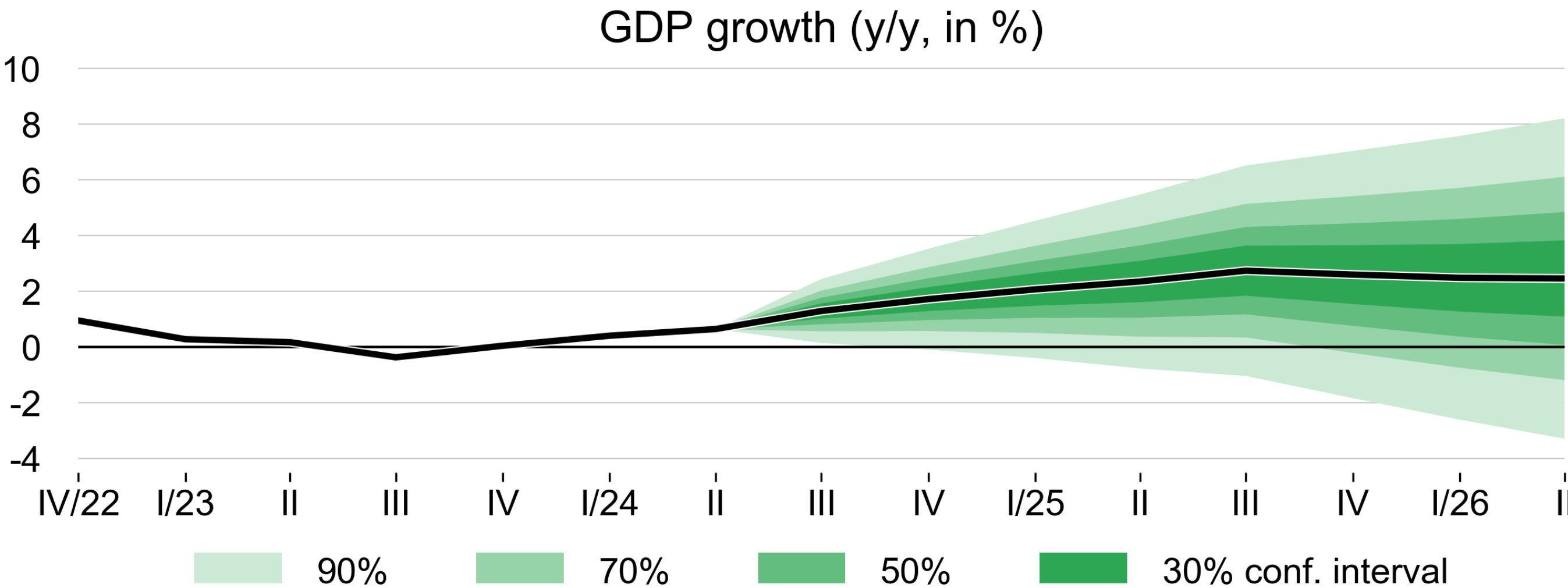


# Labour Market



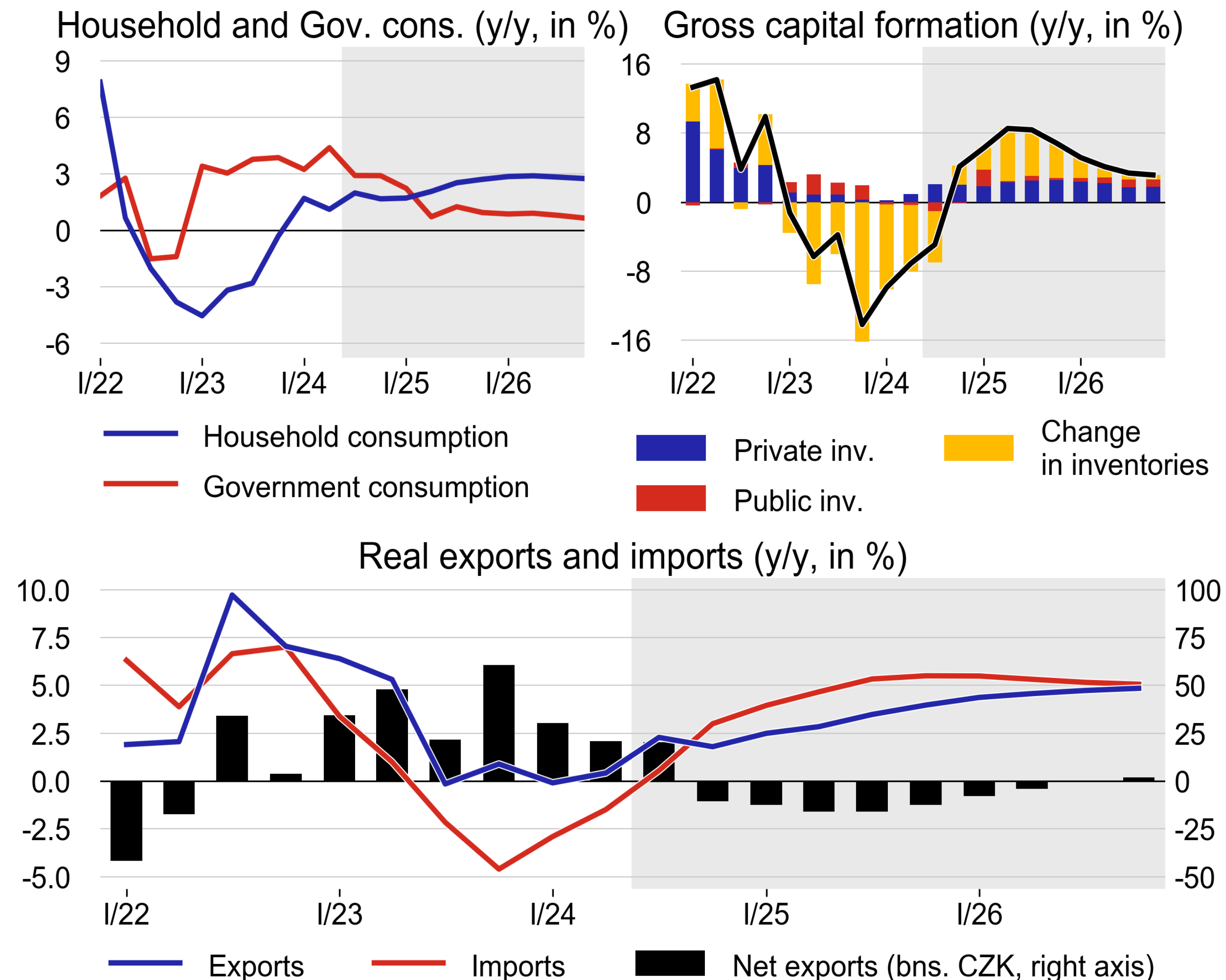
- From the perspective of the **LUCI**, the tightness in the labour market will decrease further.
- Year-on-year average **nominal wage growth in market sectors** will remain high from a historical perspective for the rest of this year and will thus continue to reflect earlier inflation. It will then gradually return to its long-term average.
- The forecast includes a significant rise in public sector pay in **non-market sectors** in January 2025, as well as legislative changes to the cascade of guaranteed salaries.
- **Unemployment** will increase only slowly till the beginning of 2026.
- Growth in the **real wage bill** will remain elevated and will thus help the positive growth rate of household consumption return to the long-term average.

# GDP Growth Forecast



- **Economic growth** is resuming this year and will pick up markedly next year.
- In whole-year terms, **GDP** will grow by **1%** this year and the economy will still operate below its potential. The growth will pick up to **2.4%** in 2025 and stay at that level in 2026.
- According to the CZSO's flash estimate, Czech GDP increased by **0.3%** quarter on quarter and by **1.3%** year on year in 2024 Q3. This is fully in line with the new CNB forecast.

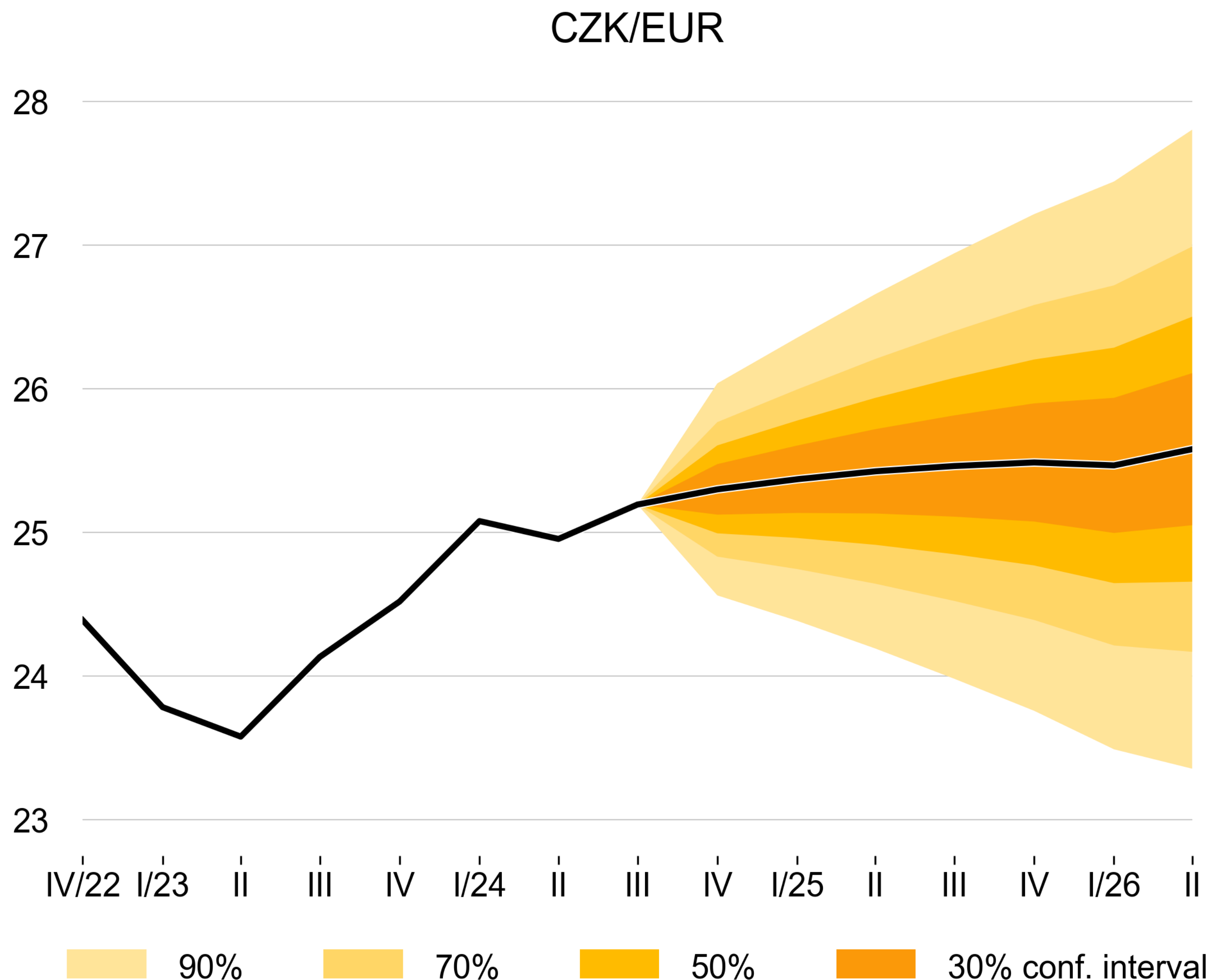
# GDP Components



- Growth in **household consumption** will gain momentum gradually. The recovery in household consumption is being supported by renewed growth in real household income due to falling inflation, and by a decline in interest rates.
- **General government consumption** will slow for the rest of the year and continue to grow at a subdued pace.
- Growth in **total gross capital formation** will be volatile due to **inventories**, while growth in **private fixed investment** will accelerate gradually. **Public investment** will start to grow again in 2025, aided by expected faster absorption of EU funds and funds from the NRRP.
- **Export** and **import** growth will gradually accelerate this year and the next as external and domestic demand gradually recovers.

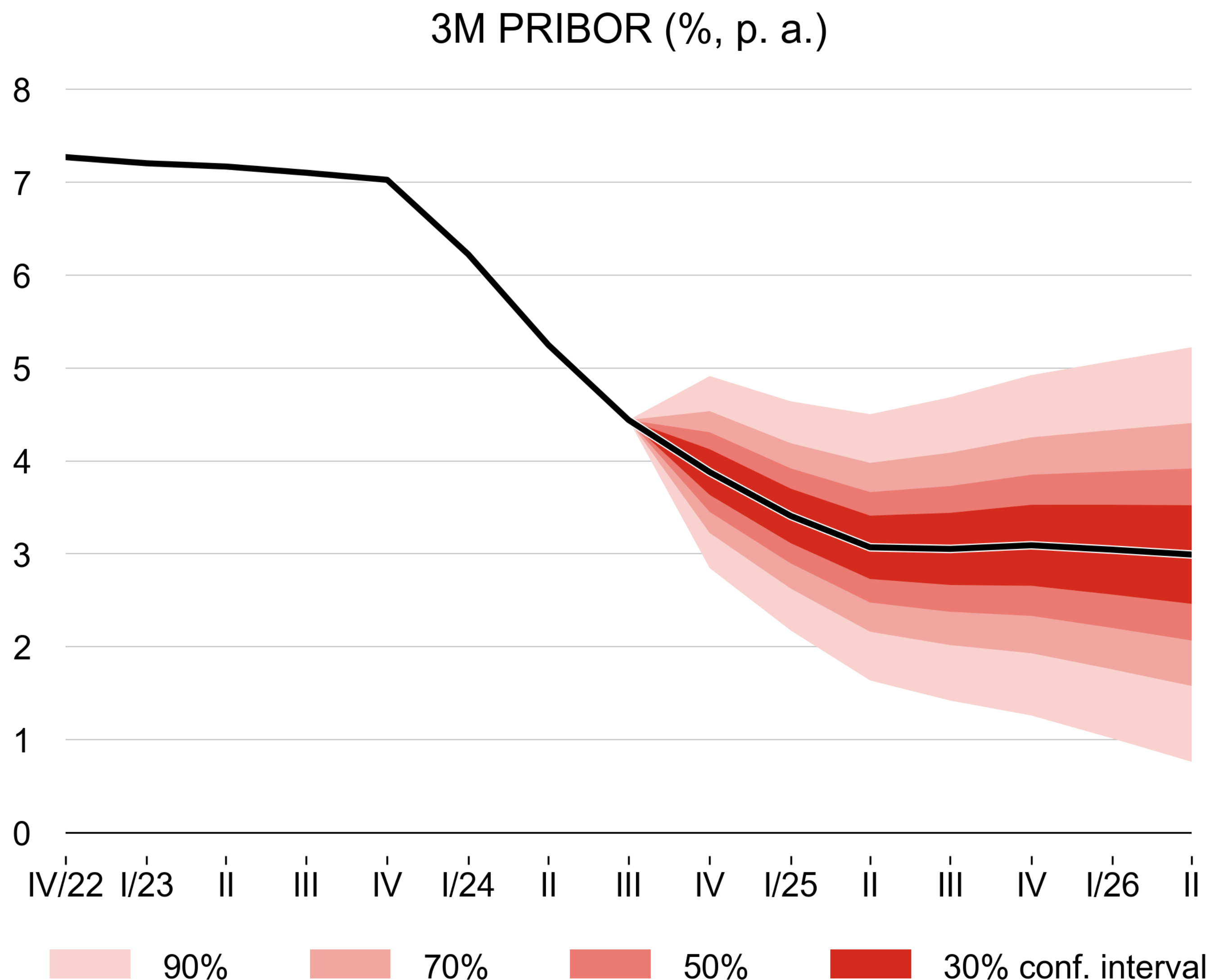


# Exchange Rate CZK/EUR



- The forecast expects the koruna to average **CZK 25.3** to the euro in 2024 Q4.
- The koruna weakens gradually to CZK 25.6 to the euro over the outlook horizon, due mainly to an only gradual improvement in the currently subdued **labour productivity** amid a falling **trade surplus** (current account of BoP) and slowed pace of real equilibrium appreciation.
- A narrowing **interest rate differential** vis-à-vis the euro area will also foster the weaker koruna in the first half of 2025.

# Interest Rate Path (3M PRIBOR)



- Consistent with the forecast is a continued decline in **short-term market interest rates** initially, followed by broadly stable rates from mid-2025 onwards.
- Although growth in costs will remain slightly elevated for the rest of this year and in the first half of next year this will not eliminate the space to ease (decrease tightness of) monetary policy further.
- The inflationary effect of the growth in costs will be partly offset by a decline in firms' profit margins, which will continue to dampen growth in prices, and inflation will thus fall to close to the 2% target at the monetary policy horizon.
- Continued monetary easing by the ECB is also creating room for a decline in domestic interest rates.

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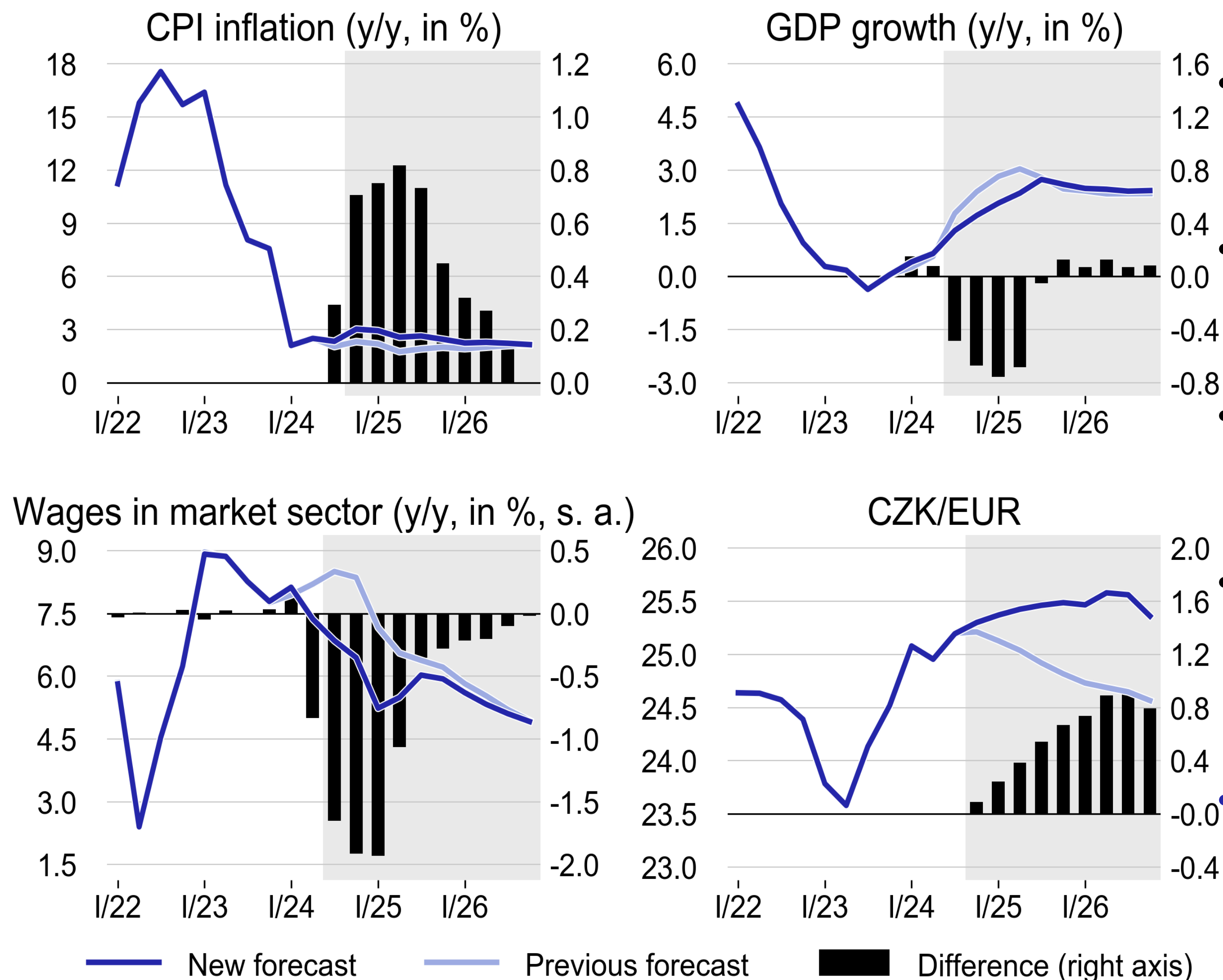
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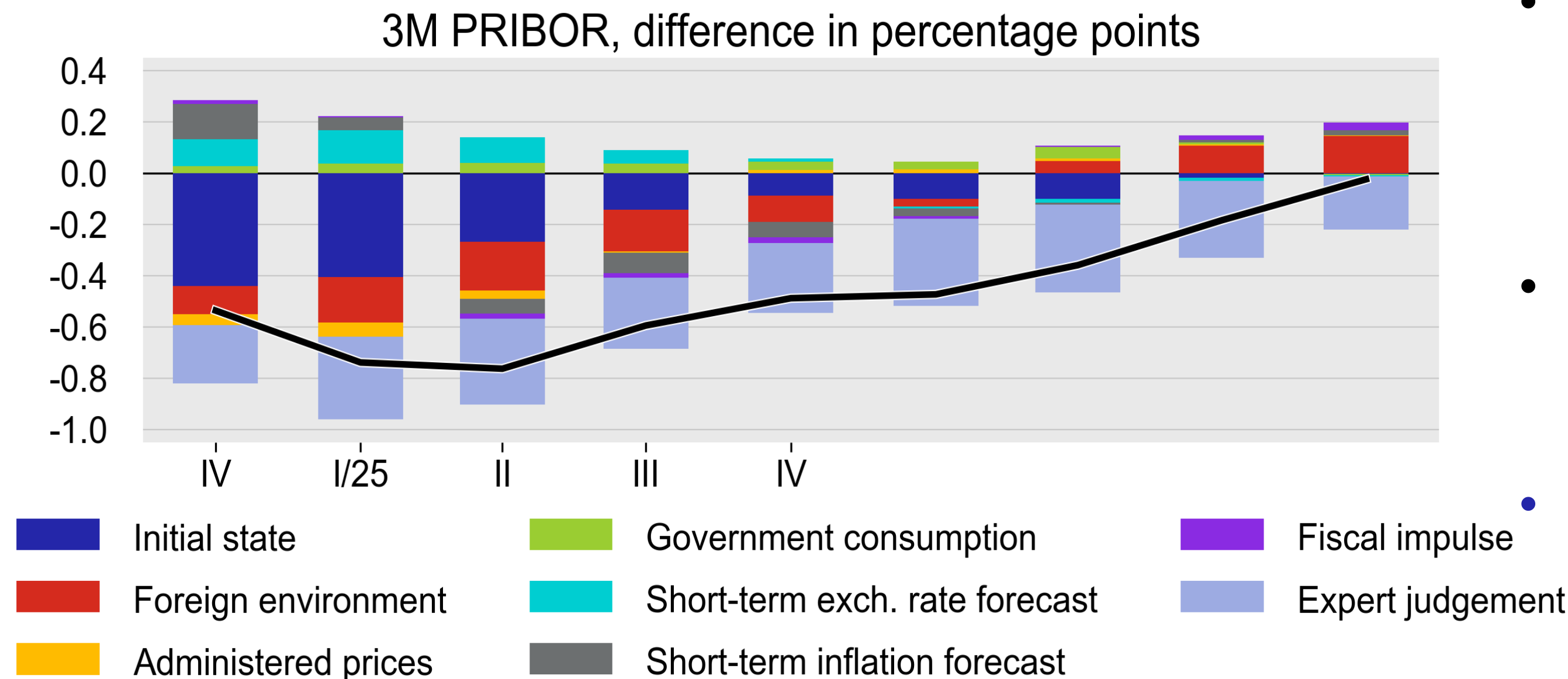
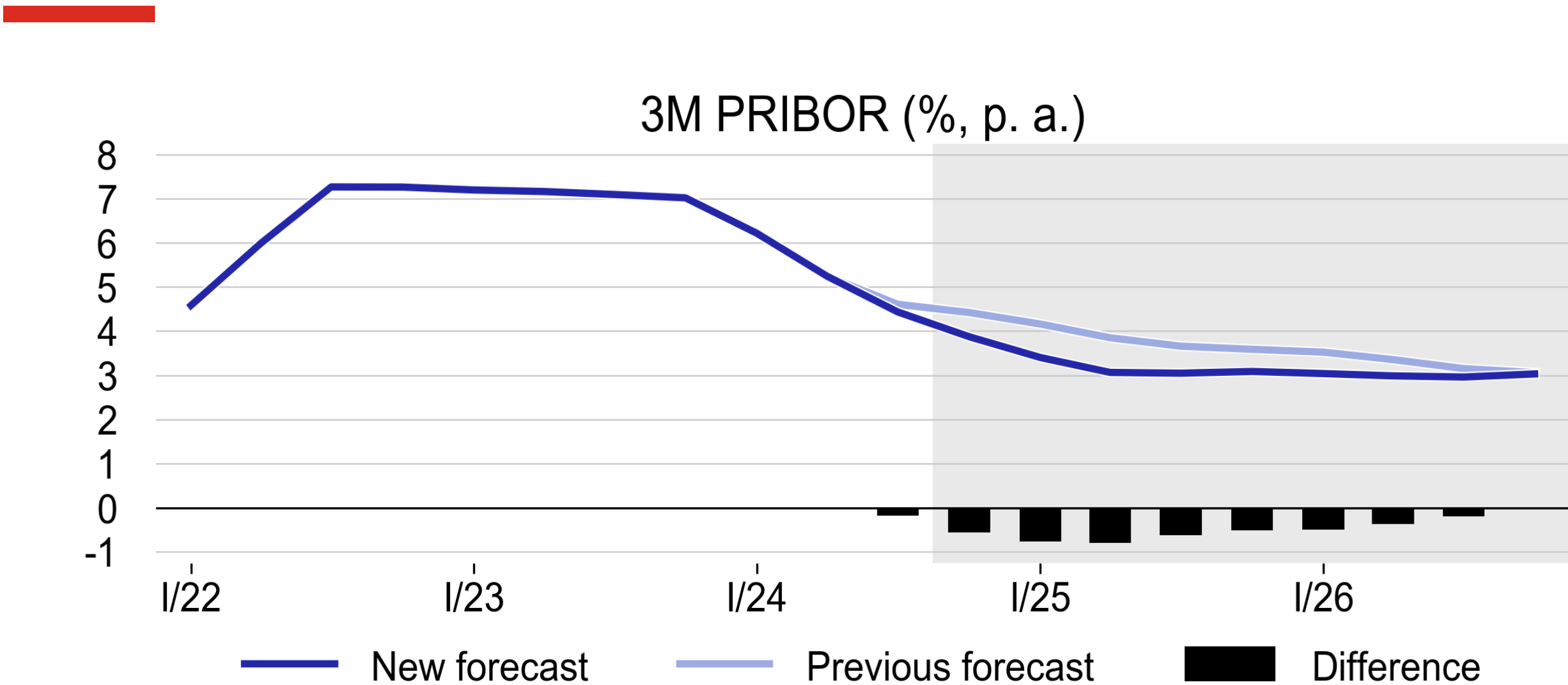


# Comparison of the Forecasts: Domestic Economy



- The **inflation** forecast has shifted upwards mainly because of stronger food price inflation.
- The **GDP outlook** for this year and the next is lower due to weaker external demand and a more gradual recovery in HH consumption.
- The slower **wage growth** in a situation of a lowered outlook for GDP is due also to lower observations recently.
- The **koruna** outlook is weaker due to domestic and foreign factors (lower outlook for interest rates and worse prospect for foreign demand).
- The weaker koruna is also fostered by the incorporation of a **lower pace of equilibrium real exchange rate appreciation** into the forecasting model in a structural way.
- **The exchange rate in the past is now seen as stronger**, implying tighter monetary conditions. This creates room for a faster decline in interest rates, which will offset the previous restrictive effect of the exchange<sup>18</sup> rate.

# Comparison with the Previous Forecast: 3M PRIBOR



- The **interest rate** path is lower.
- The **initial state** fosters lower rates. This is due to slower wage and GDP growth in 2024 Q3. The negative contribution also reflects the incorporation of a **lower equilibrium rate of appreciation of the koruna exchange rate** into the forecasting model in a structural way including a revised interpretation of the CZK previous effect in the economy.
- The negative contribution of the **foreign environment** mainly reflects a lower outlook for ECB interest rates (despite the expert shift from the market outlook).
- The **short-term exchange rate forecast** for 2024 Q4 is set at a slightly weaker level than implied by macroeconomic developments.
- **Expert adjustments** foster lower rates overall (partial elimination of previous adjustments leading to higher wage growth and more pronounced household consumption).



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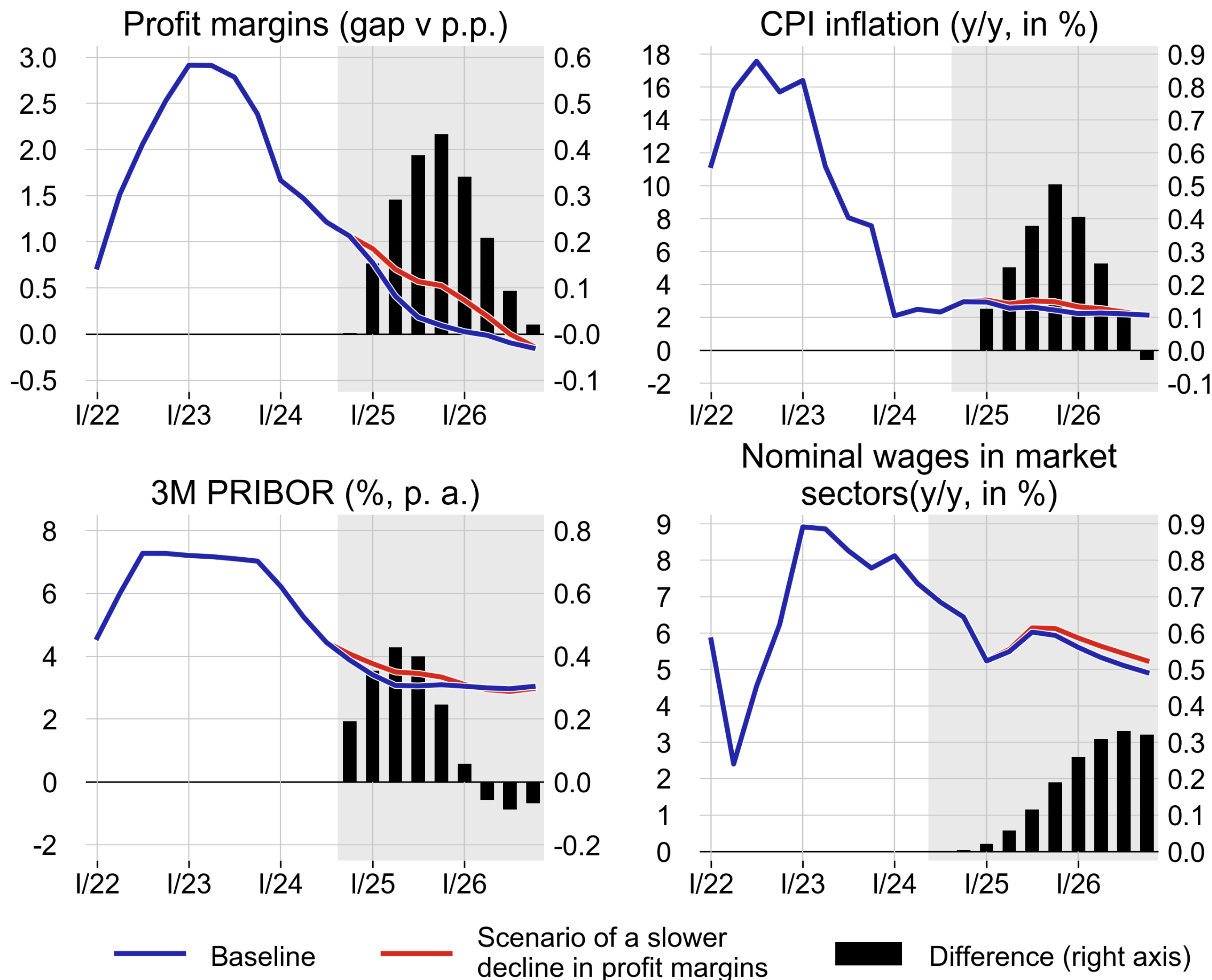
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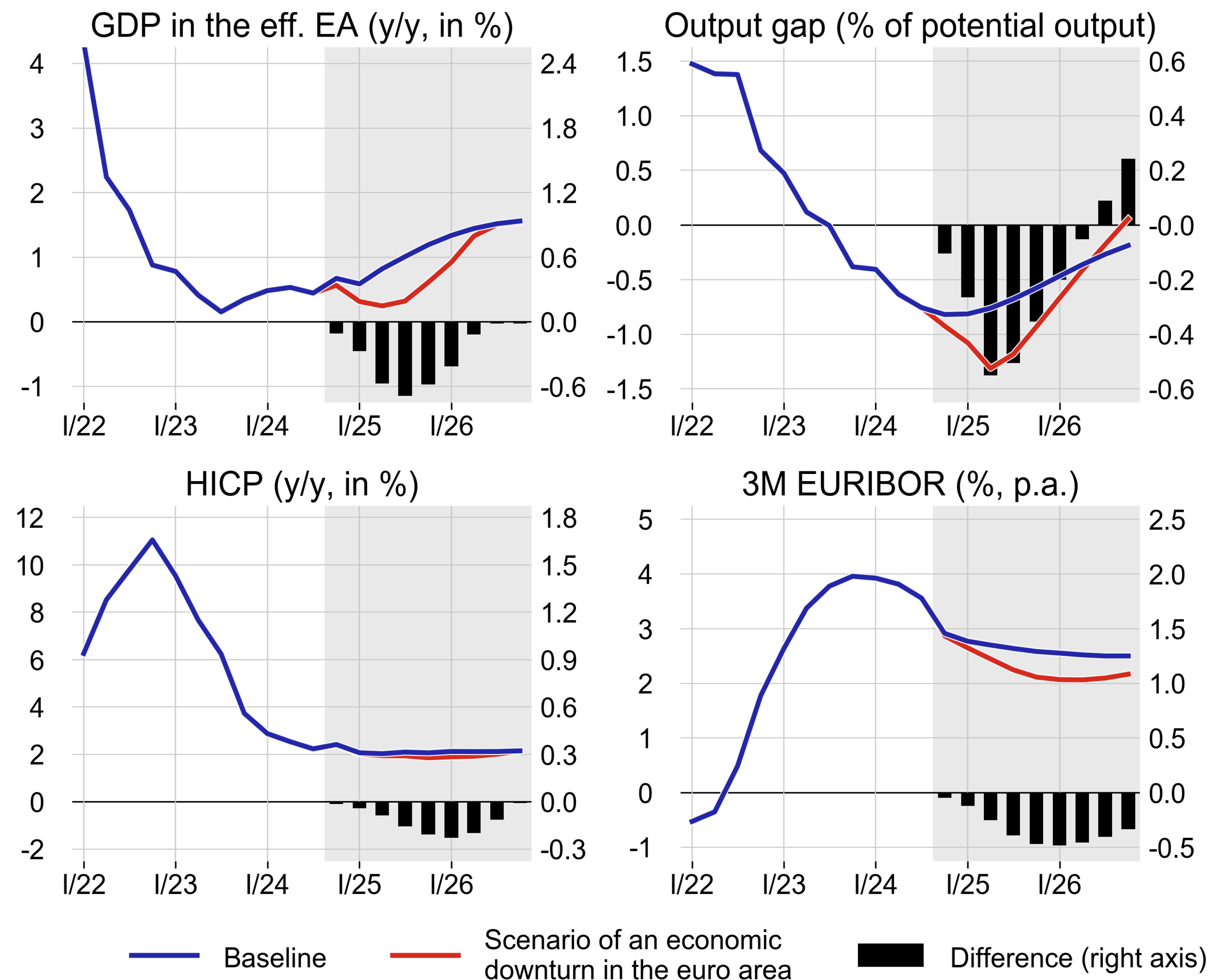


# Scenario of Slower Decline in Profit Margins



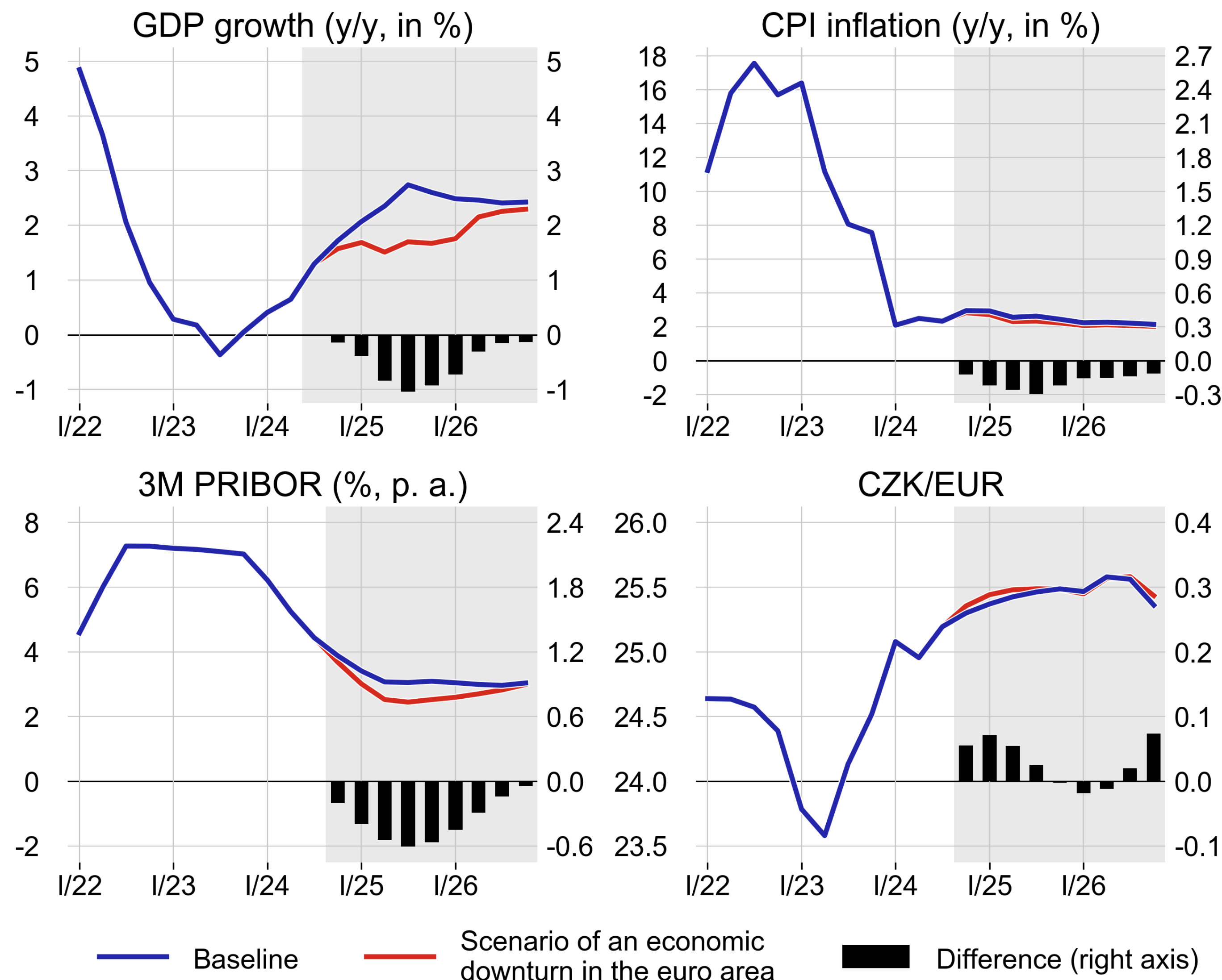
- The scenario describes a situation where, in an environment of elevated inflation in late 2024 and early 2025, service providers resort to greater repricing in an effort to keep their **profit margins** higher for longer.
- This is reflected in 1.5 pp higher **annualised quarterly services inflation** in each quarter of next year compared with the baseline scenario of the forecast. As a result, year-on-year **headline consumer price inflation** is 0.5 pp higher than in the baseline scenario at the end of next year.
- The central bank reacts to this higher inflation with more moderate decline in **interest rates**.
- In spite of that, the higher inflation is partly reflected in faster **nominal wage growth** compared with the baseline scenario.

# Scenario of an Economic Downturn in the EA: Assumptions



- The global NiGEM model was used to construct an alternative euro area outlook consistent with a **market 3M EURIBOR outlook** that is lower than in the baseline scenario.
- The simulation assumes a deeper **cyclical slowdown** over the entire forecast horizon than in the baseline scenario. Beyond this negative demand shock, the scenario also assumes gradually increasing negative (stagflationary) **structural supply effects** in the later quarters of the outlook.
- The scenario thus leads to only slightly lower **inflation** in the euro area.
- The negative demand and supply impacts together result in a greater downturn in **real economic activity** in the euro area over the entire forecast horizon.

# Scenario of an Economic Downturn in the EA: Implications

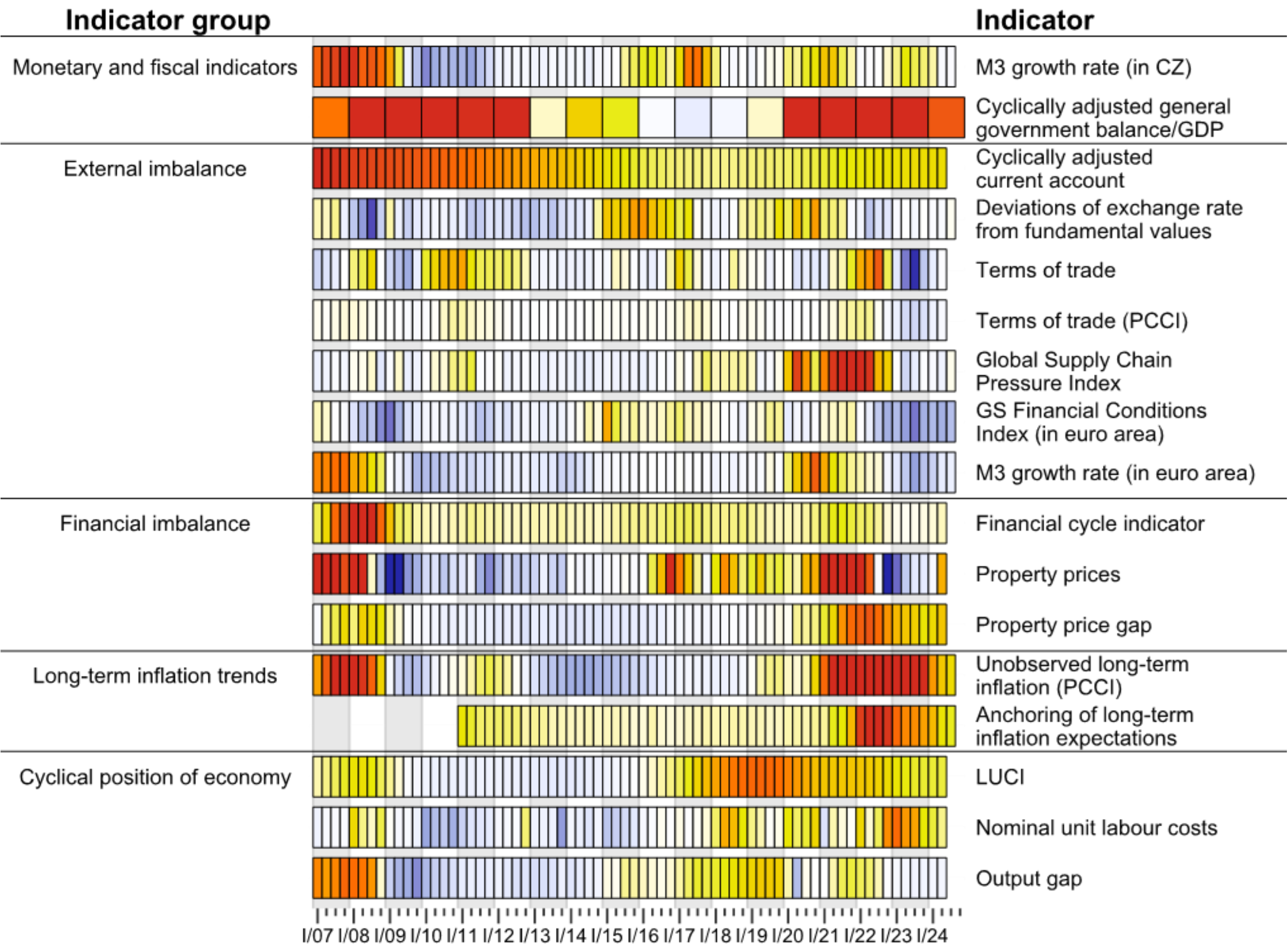


- The slower economic growth in the euro area implies a significantly lower outlook for **domestic economic activity** than in the baseline scenario.
- The more subdued demand pressures from the foreign and domestic economy are reflected in lower **domestic inflation**.
- In response to this, along with a lower outlook for ECB interest rates, domestic **monetary policy rates** are lowered more forcefully than in the baseline scenario to below their neutral level.
- The **koruna** is slightly weaker in the following quarters due to lower external demand.

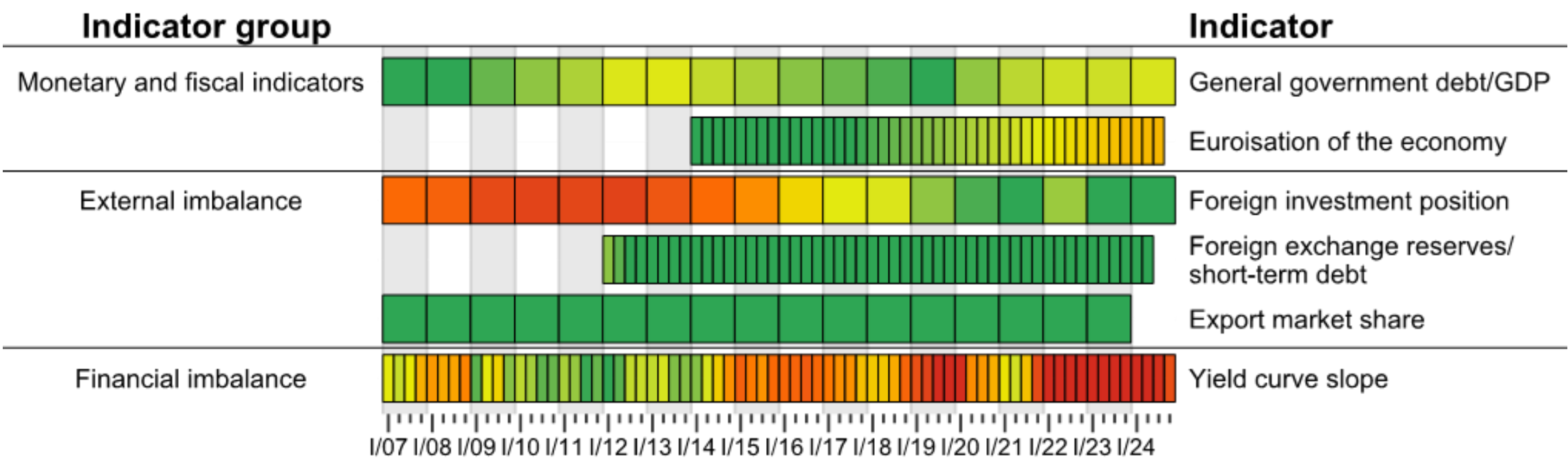


# Risks Identified by the Scoreboard

## Inflation risks

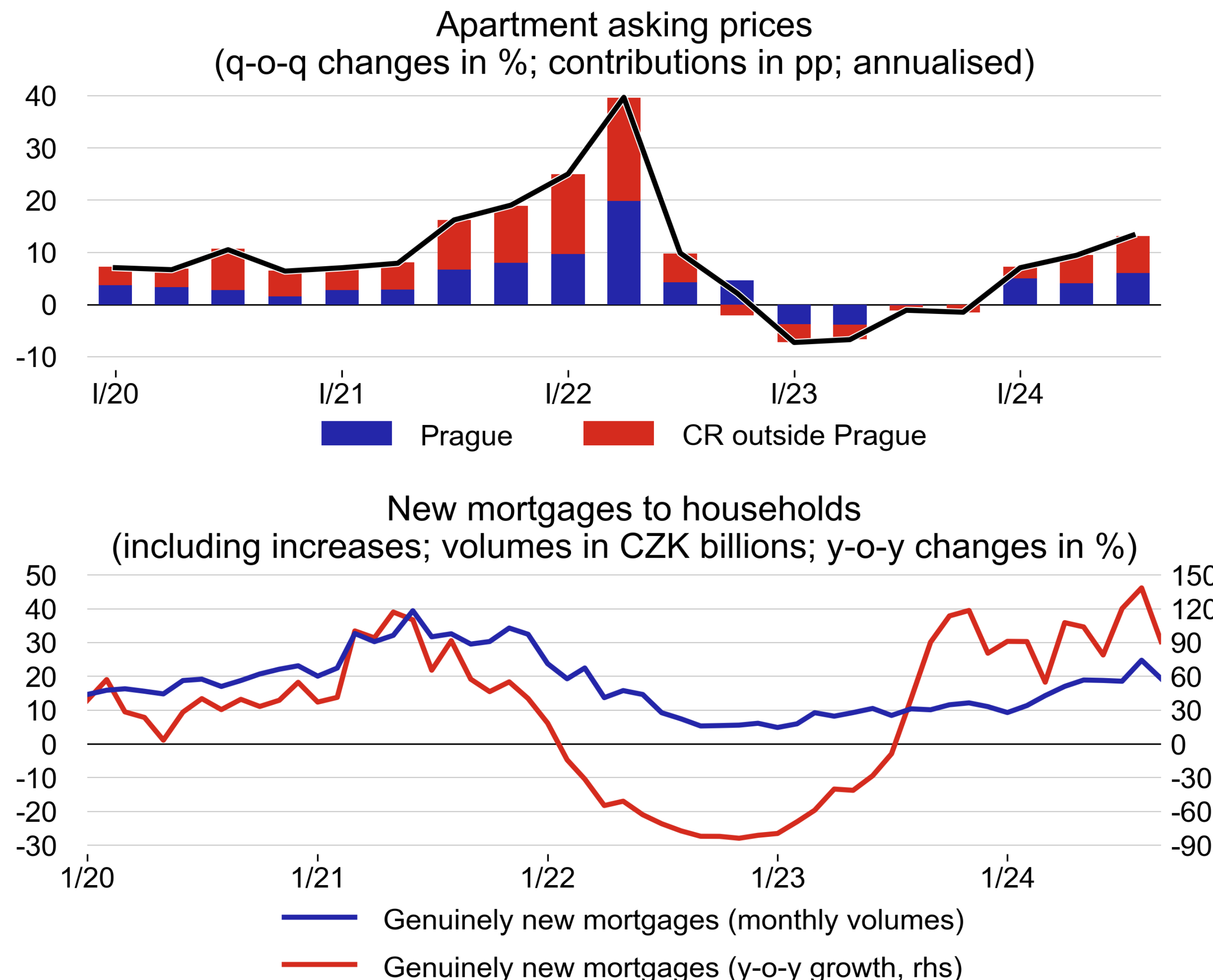


## Other monetary policy risks



- The Inflation and Monetary Policy Risks **Scoreboard** is also identifying several upside risks to inflation.
- The **property price indicator** saw a shift in risk from neutral to inflationary in 2024 Q2.
- By contrast, the **financial conditions index** for the euro area continues to point (almost exclusively) to lower inflation, there is also an easing of inflationary risks in the area of the **Czech government deficit** and **domestic labour market indicators**.

# Main Scoreboard Risks



- Any growth in the **price disequilibrium on the housing market** could greatly increase distortions across the economy, create an underlying inflationary environment and have a significant lagged effect on consumer prices.
- The relevance of this risk is further highlighted by recent developments in **asking prices of apartments**. Their quarter-on-quarter growth has been rising since the start of 2024 and exceeded 13% in annualised terms in Q3.
- In recent months, the **volume of genuinely new mortgages** in real terms has also been around that in the pre-Covid period, which was characterised by a rapid activity of the housing market.



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# Thank you for your attention



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# Autumn 2024 Forecast – Summary

- **Inflation** will be close to the upper boundary of the tolerance band around the target at the turn of the year and will then start to decline gradually towards the 2% target.
- **Economic growth** is recovering gradually, aided not only by **household consumption** amid renewed **growth in real wages**, but also by **general government consumption**. **Inventories** and subdued **external demand** are having the opposite effect.
- Despite slowing, **nominal wage growth** will remain high from the long-term perspective.
- Consistent with the autumn forecast is a continued decline in **short-term interest rates** initially, followed by broadly stable rates from mid-2025 onwards.

	2024	2025	2026
<b>Headline inflation (%)</b>	<b>2.5</b>	<b>2.6</b>	<b>2.2</b>
	(0.2)	(0.7)	(0.2)
<b>GDP (%)</b>	<b>1.0</b>	<b>2.4</b>	<b>2.4</b>
	(-0.2)	(-0.3)	(0.1)
<b>Average nominal wage (%)</b>	<b>6.4</b>	<b>5.7</b>	<b>5.1</b>
	(-1.0)	(-0.7)	(-0.1)
<b>3M PRIBOR (%)</b>	<b>4.9</b>	<b>3.2</b>	<b>3.0</b>
	(-0.2)	(-0.7)	(-0.3)
<b>Exchange rate (CZK/EUR)</b>	<b>25.1</b>	<b>25.4</b>	<b>25.5</b>
	(0.0)	(0.5)	(0.8)