

# CNB's New Forecast

## Monetary Policy Report – Winter 2025

### Meeting with Analysts

7 February 2025

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# Presentation Outline

## 1. Assumptions of the Forecast

2. The New Macroeconomic Forecast

3. Comparison with the Previous Forecast

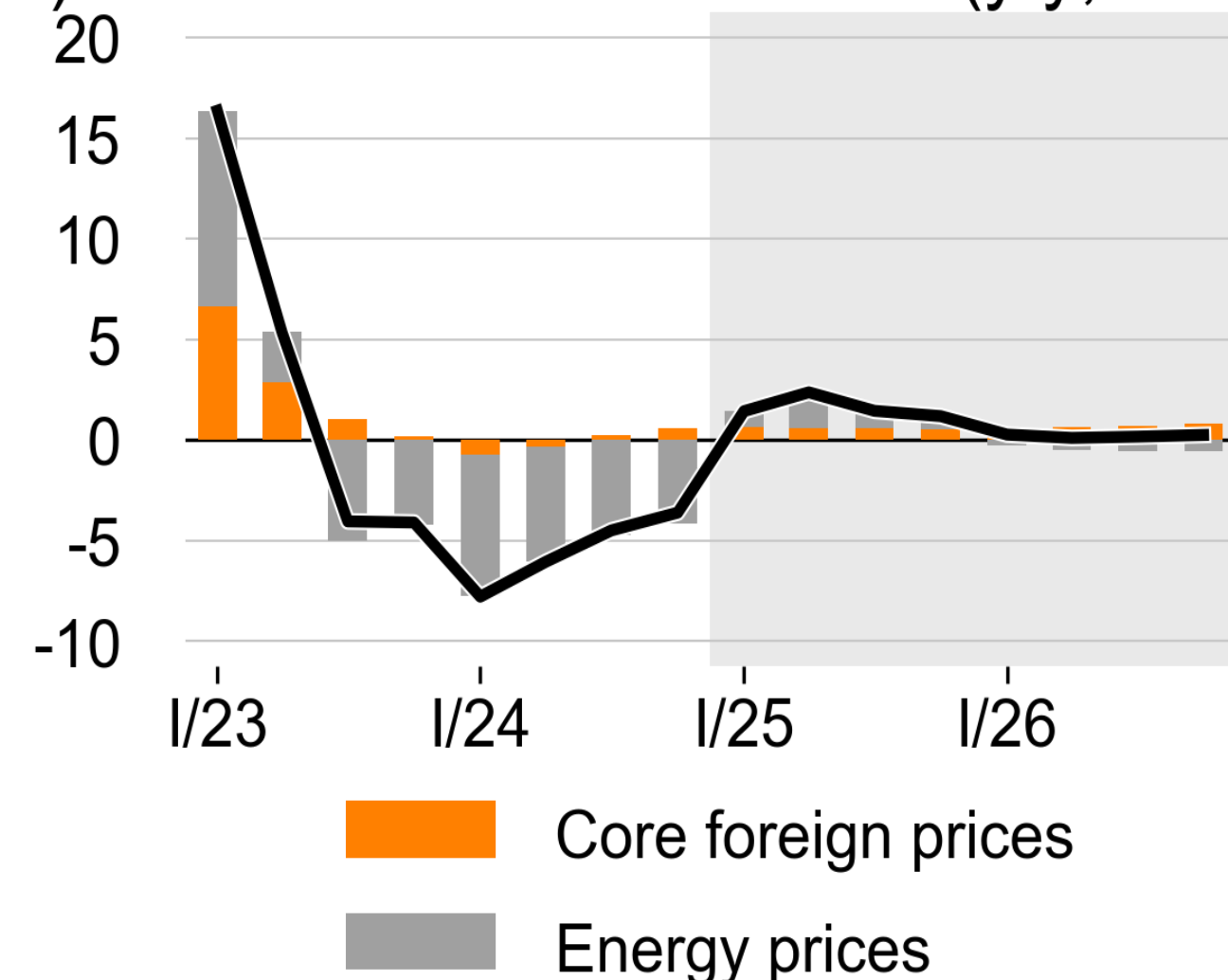
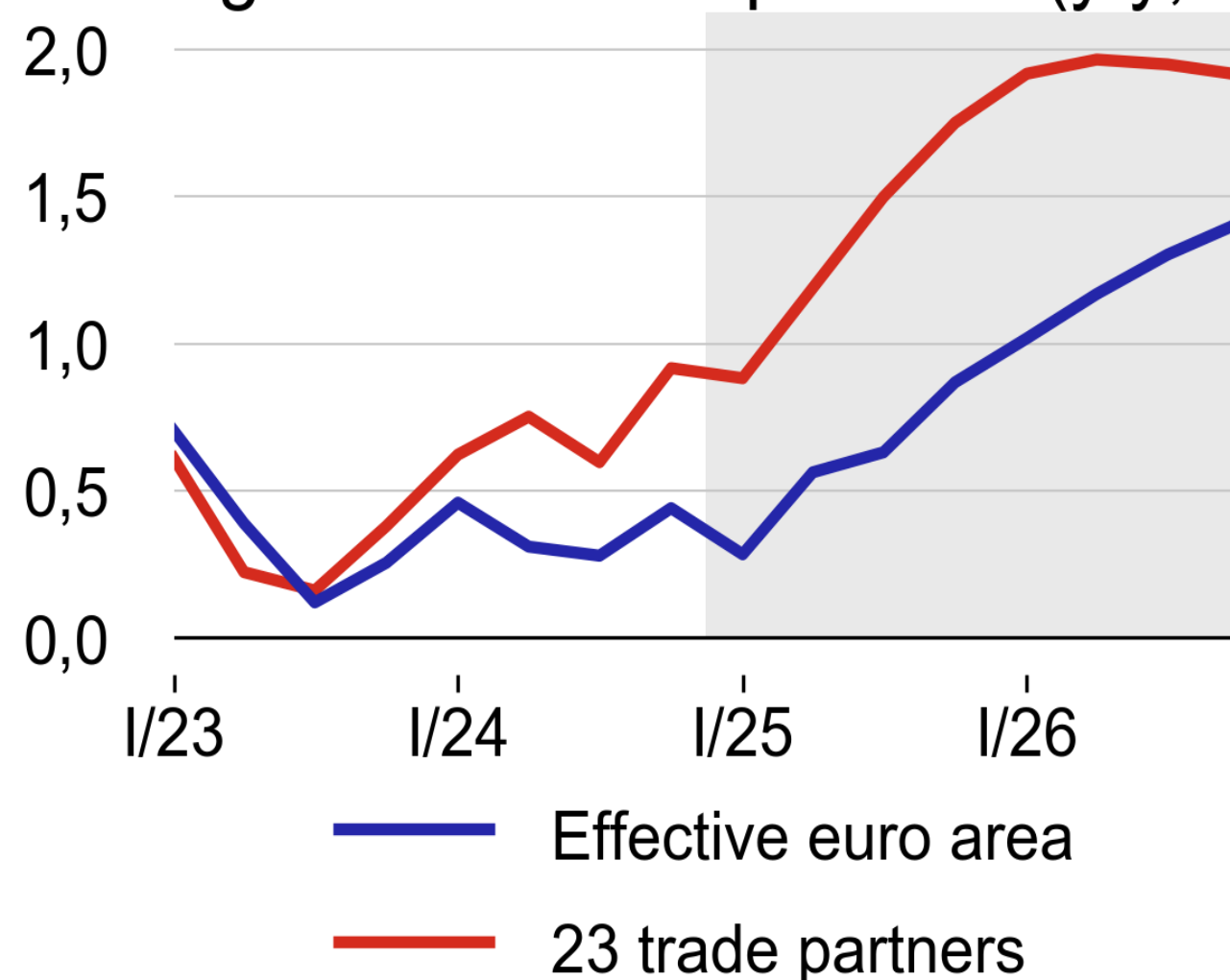
4. Scenarios and Scoreboard Risks

5. Core Prediction Model Upgrade and the Shadow Forecast

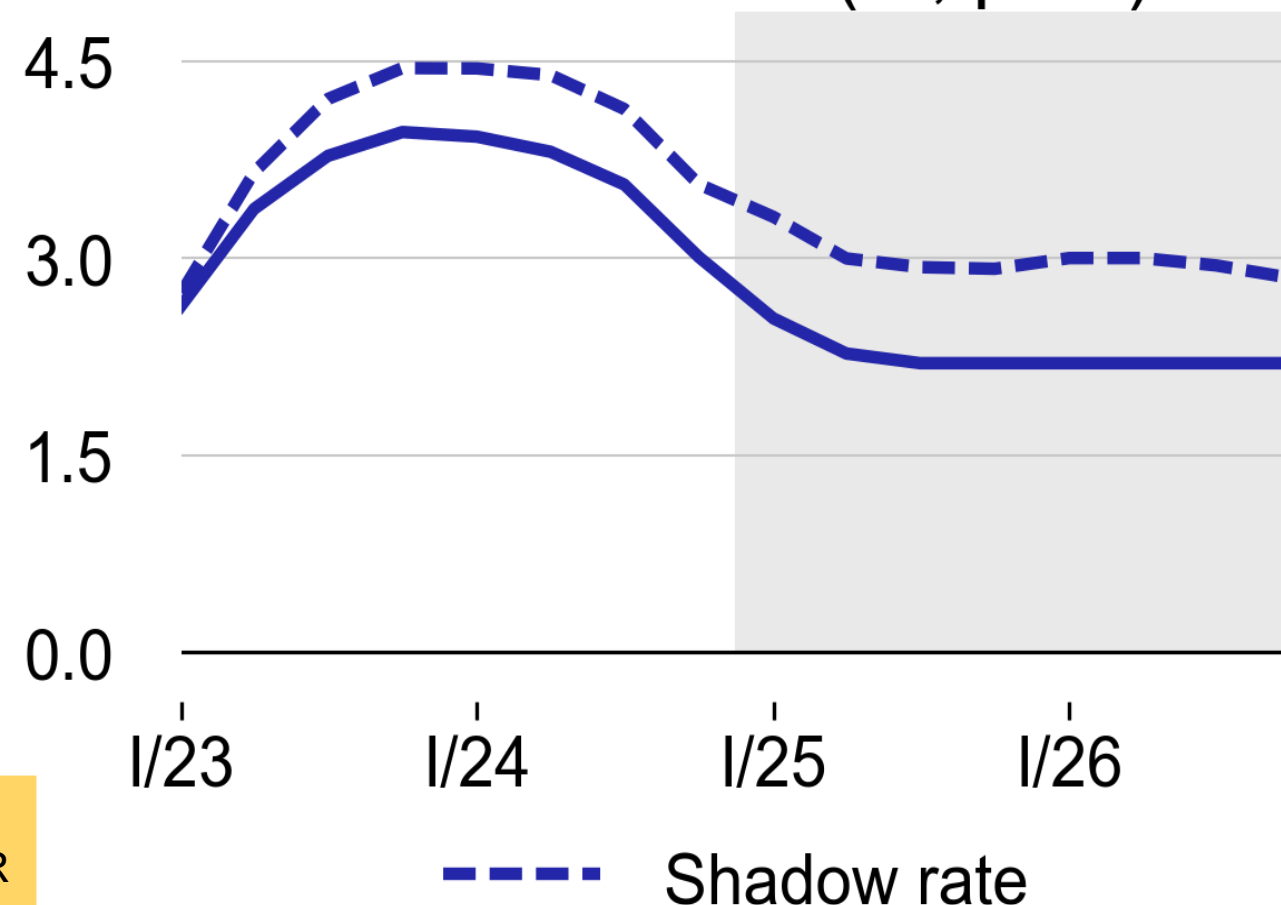


# Foreign Environment Outlook

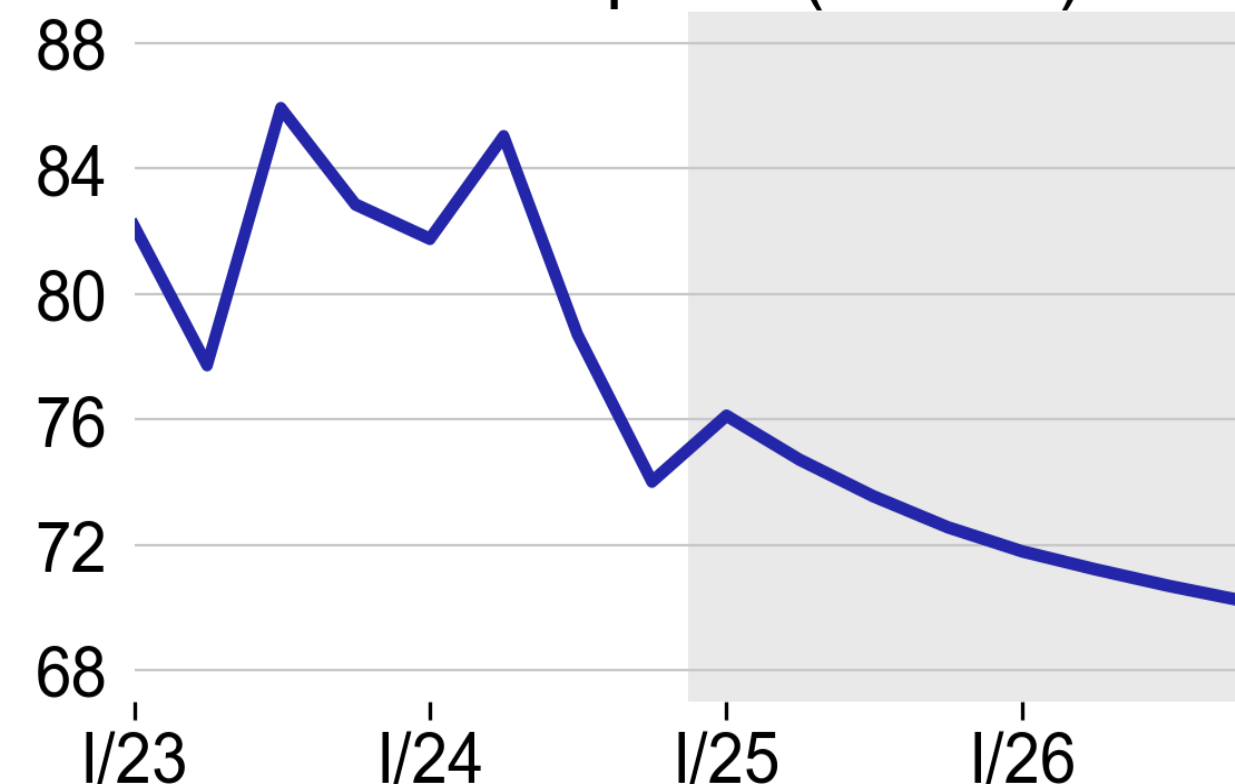
GDP growth of trade partners (y/y, in %) PPI - effective euro area (y/y, in %)



3M EURIBOR (% p. a.)

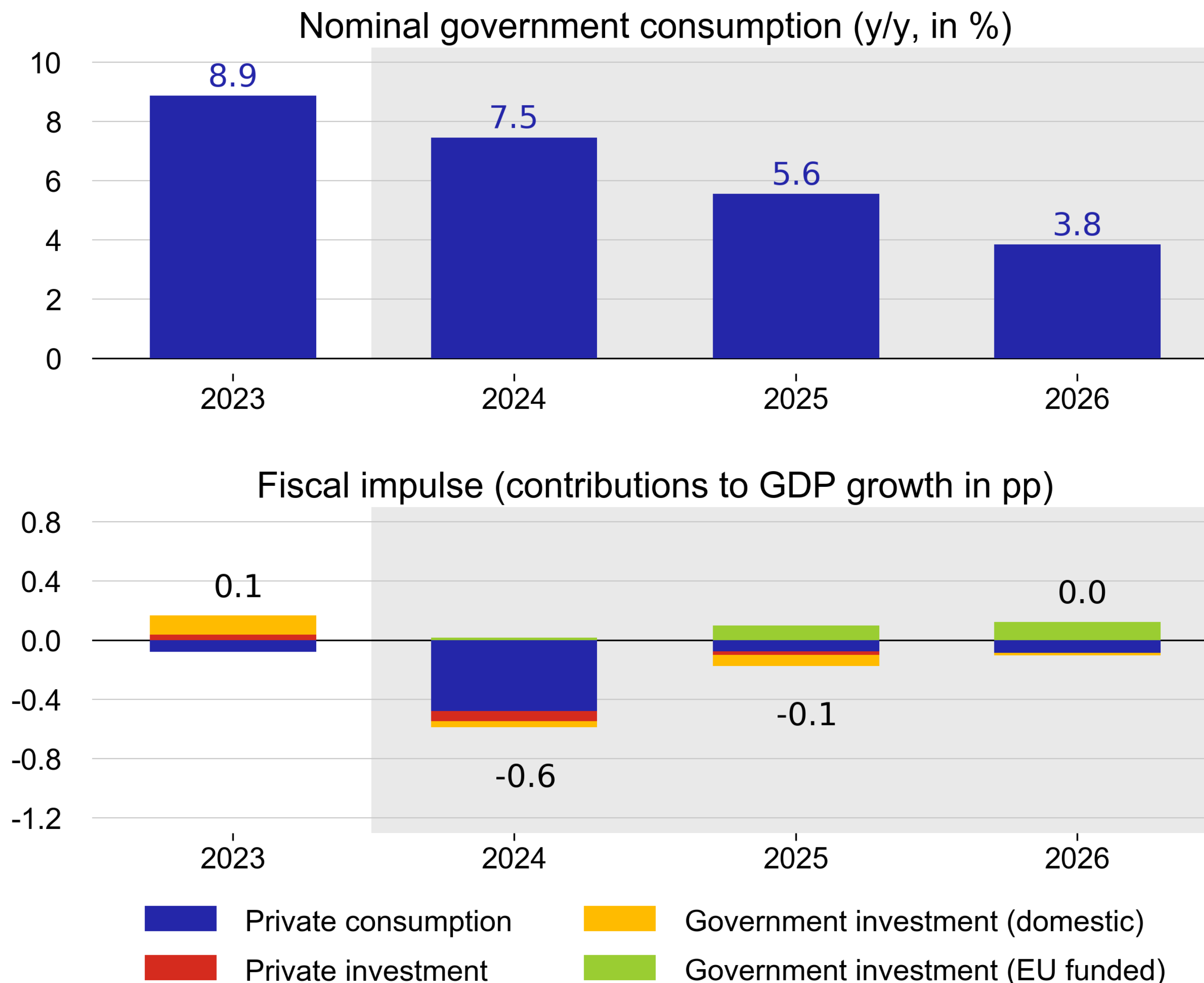


Brent oil price (USD/b)



- The **effective euro area** is expected to recover only gradually starting from the half of 2025, when the headwinds in the German economy will start to abate. In annual terms, the growth is expected to increase up slightly to 0.6% in 2025 and reach 1.2% in 2026.
- In contrast, the **GDP of other trade partners** of Czechia will grow faster.
- **Industrial producer prices** are expected to return to moderate growth this year, owing mainly to energy prices.
- **Euro area interest rates** will continue to decline in the first half of 2025.
- The market outlook for the **Brent crude oil price** remains falling towards USD 70 a barrel at the end of next year.

# 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. The forecast also reflects the public sector pay rises.
- **Fiscal policy** will have a broadly neutral effect on GDP growth this year, as the ongoing moderating effect of the fiscal consolidation package will be offset by the expected faster absorption of EU funds.
- The forecast assumes that fiscal policy will have a neutral effect also next year.

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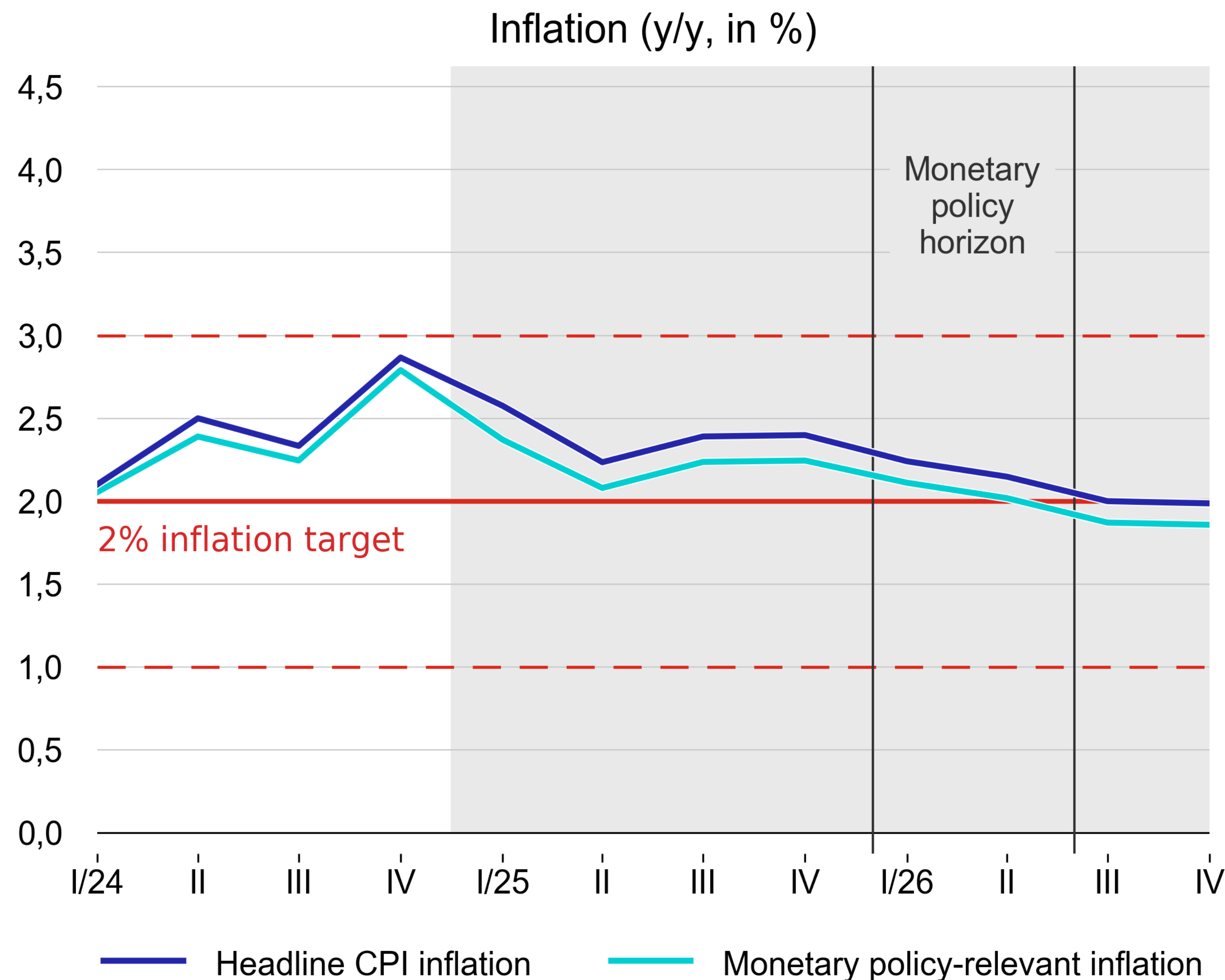
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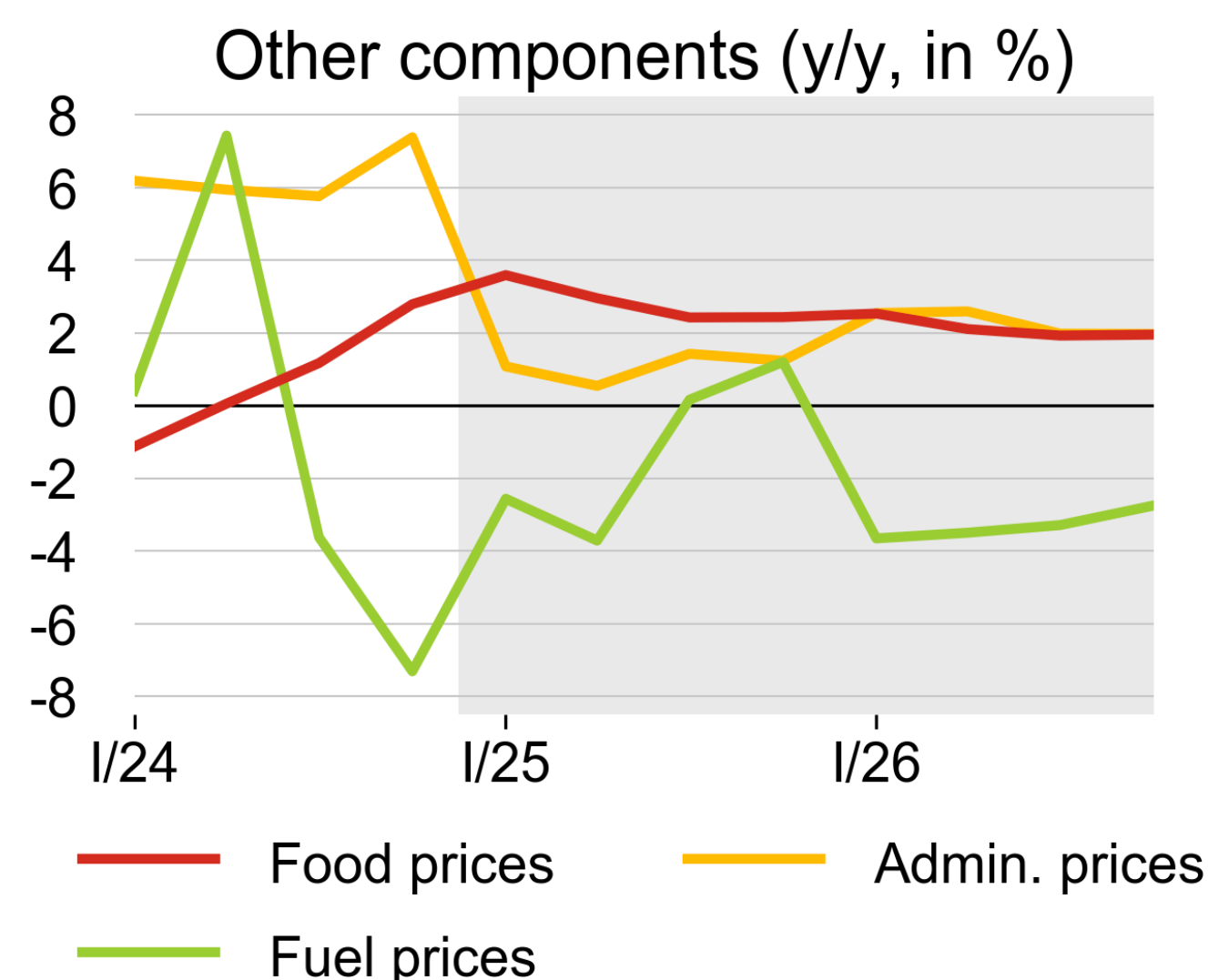
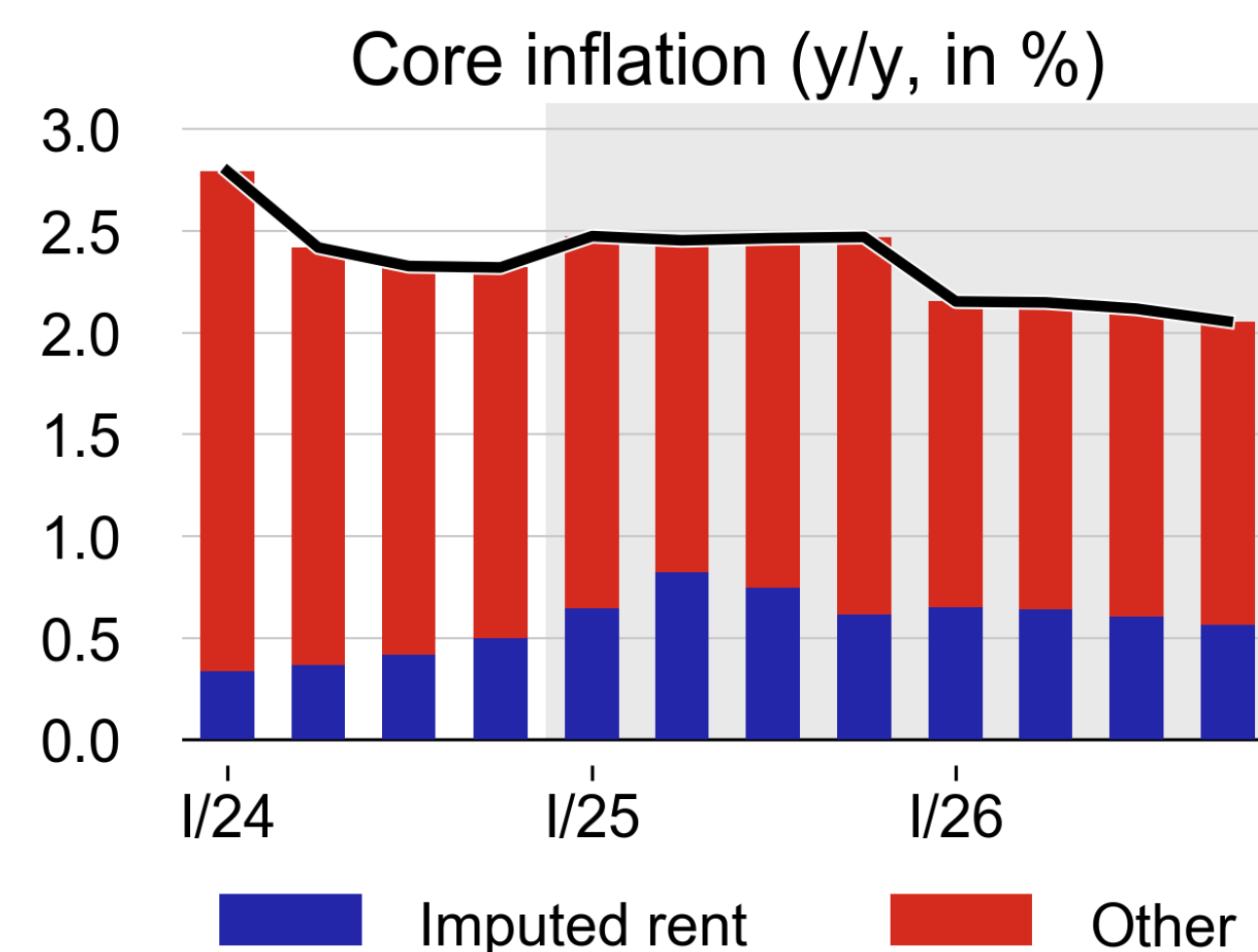
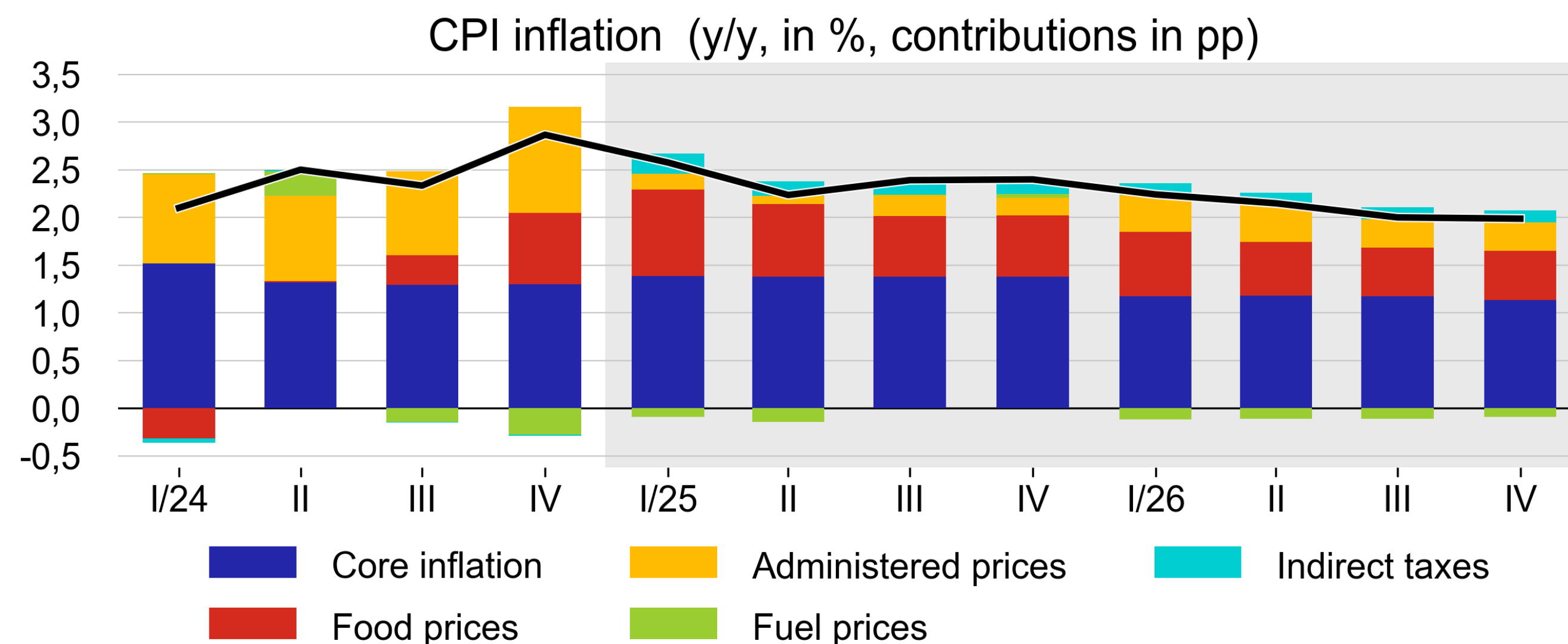


# Headline and Monetary Policy-Relevant Inflation



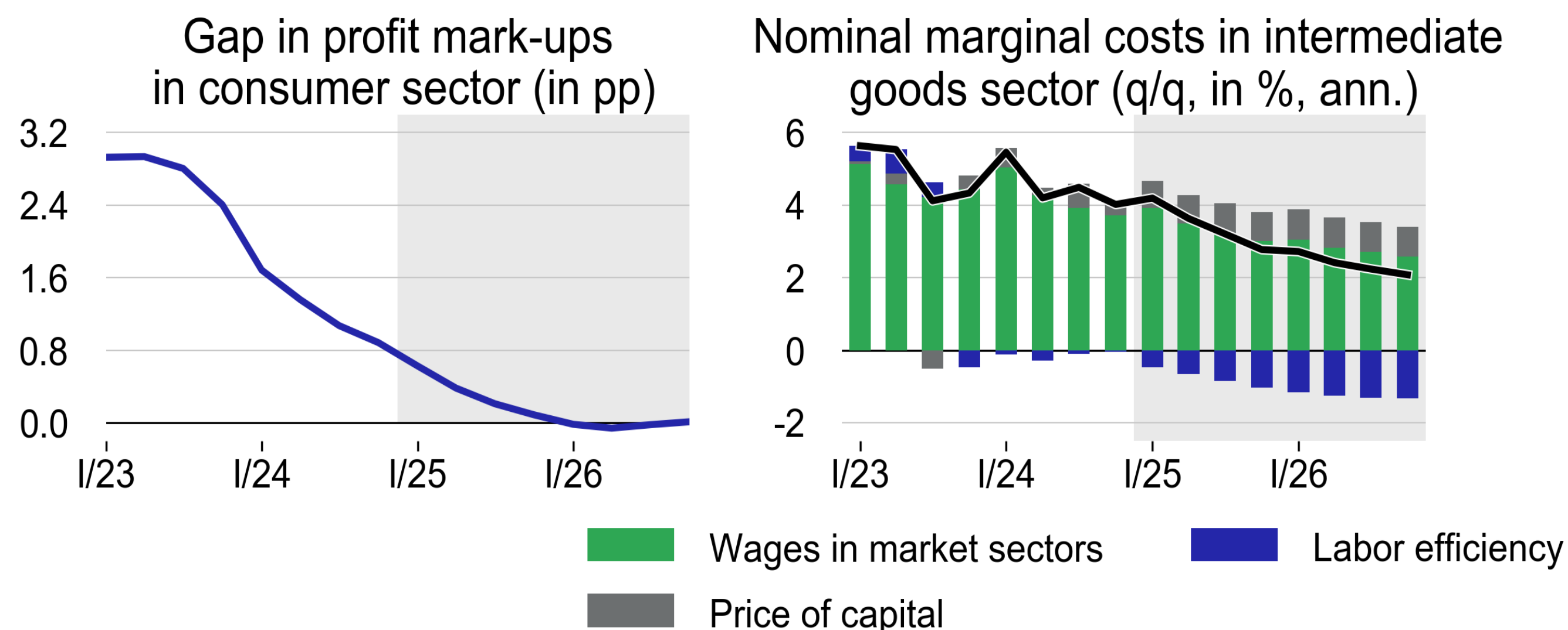
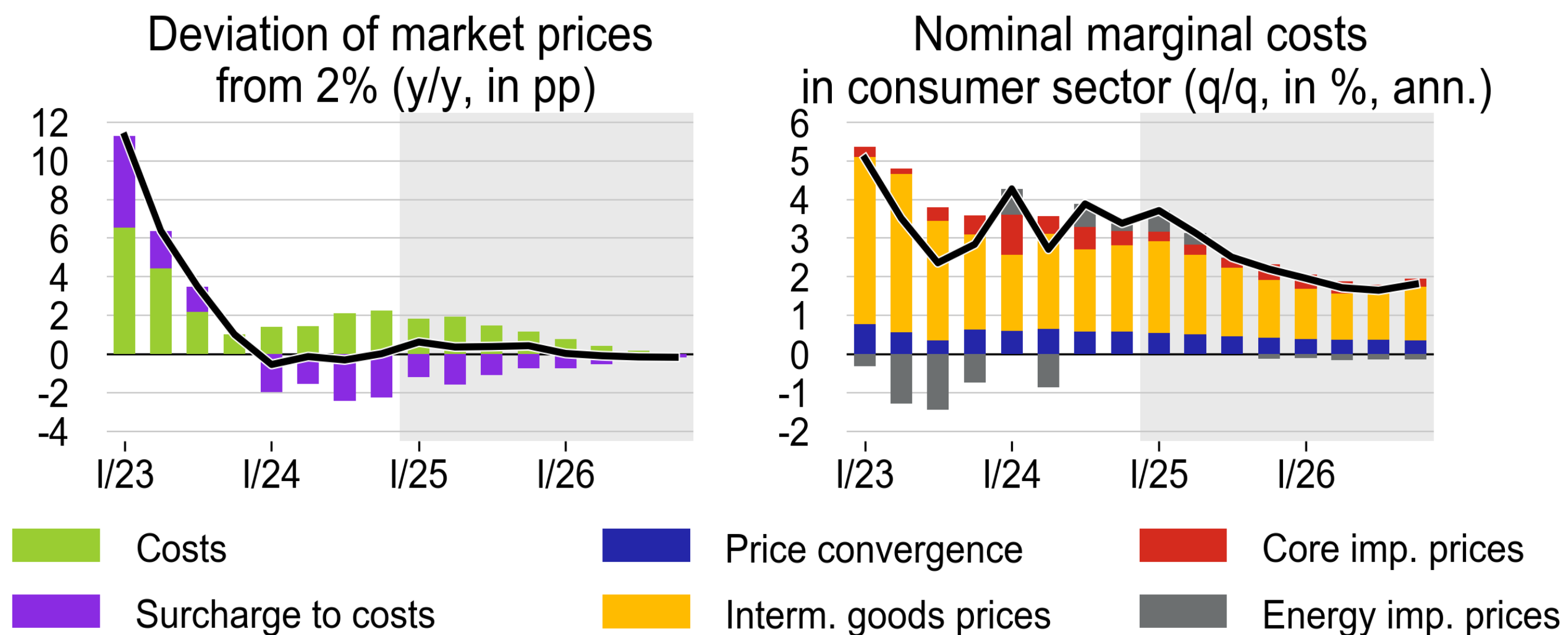
- **Inflation** is expected to slow at the start of 2025, still staying in the upper half of the tolerance band. By 2026, it will be close to the 2% target.
- Flash estimate of inflation at 2,8 % creates a mild pro-inflationary risk.
- Headline inflation will be slightly above **monetary policy-relevant inflation** (excluding primary effects of indirect taxation changes) due mainly to slightly inflationary effect of increases in excise duty on tobacco and alcohol.

# Core Inflation, Administered, Food and Fuel Prices



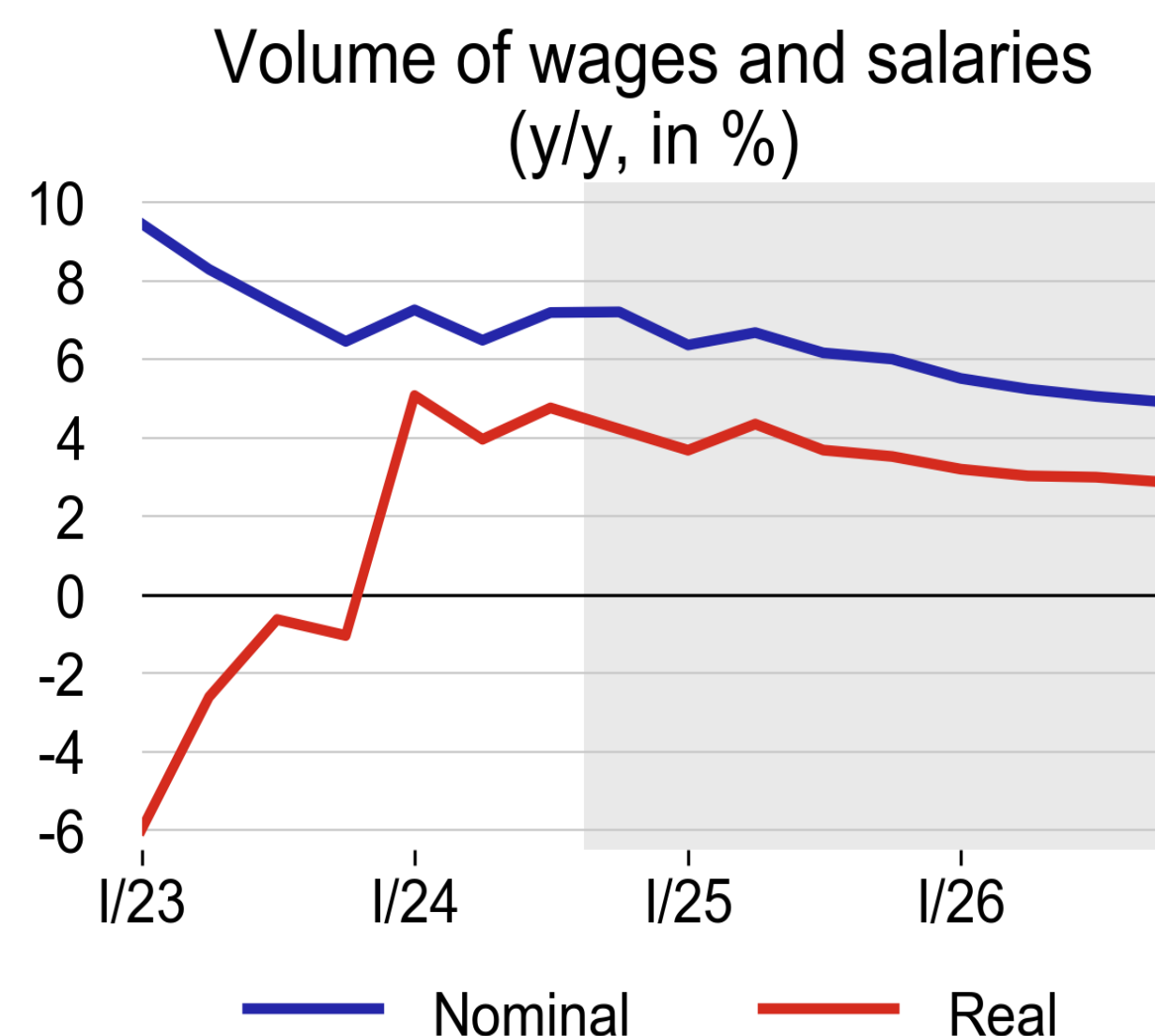
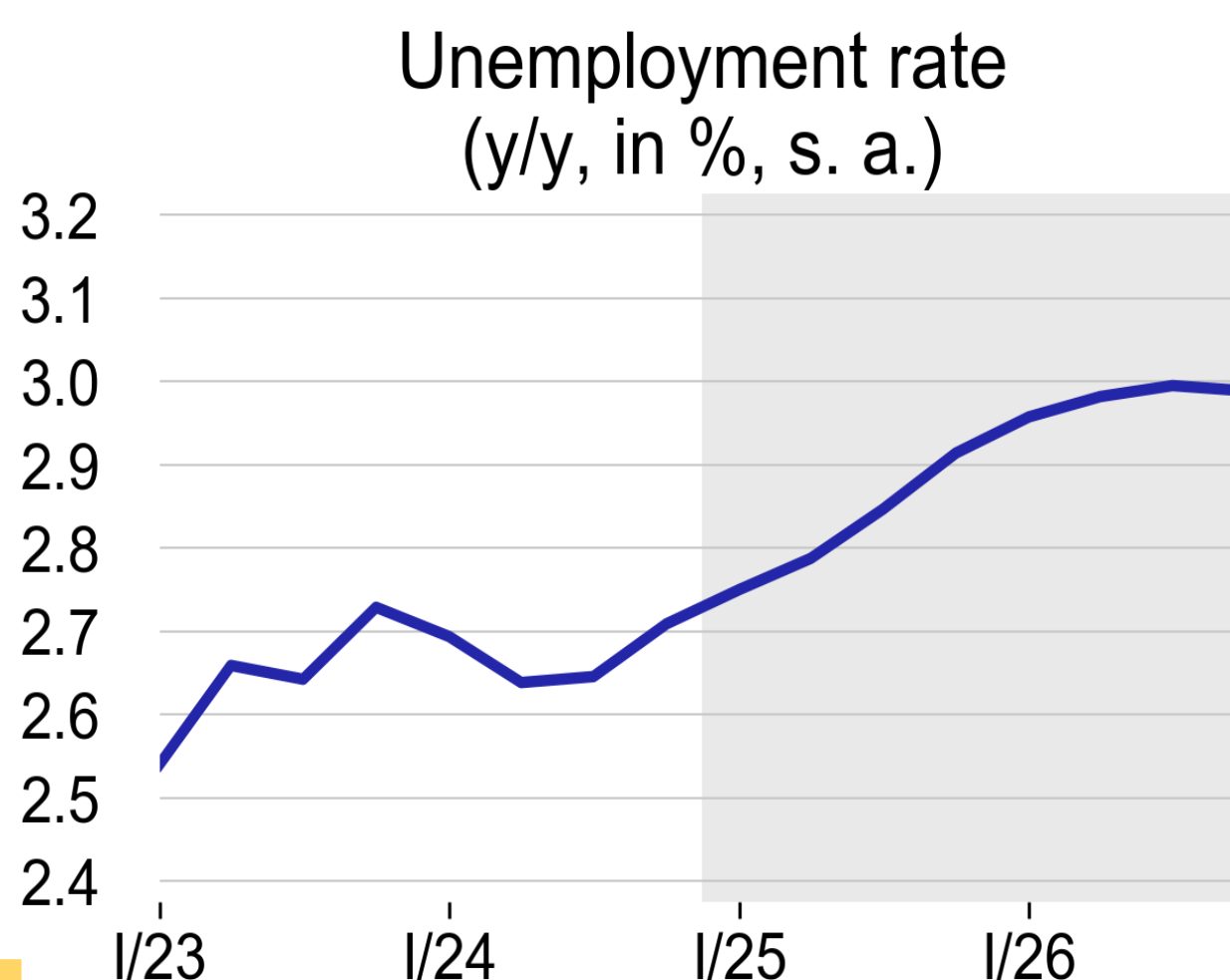
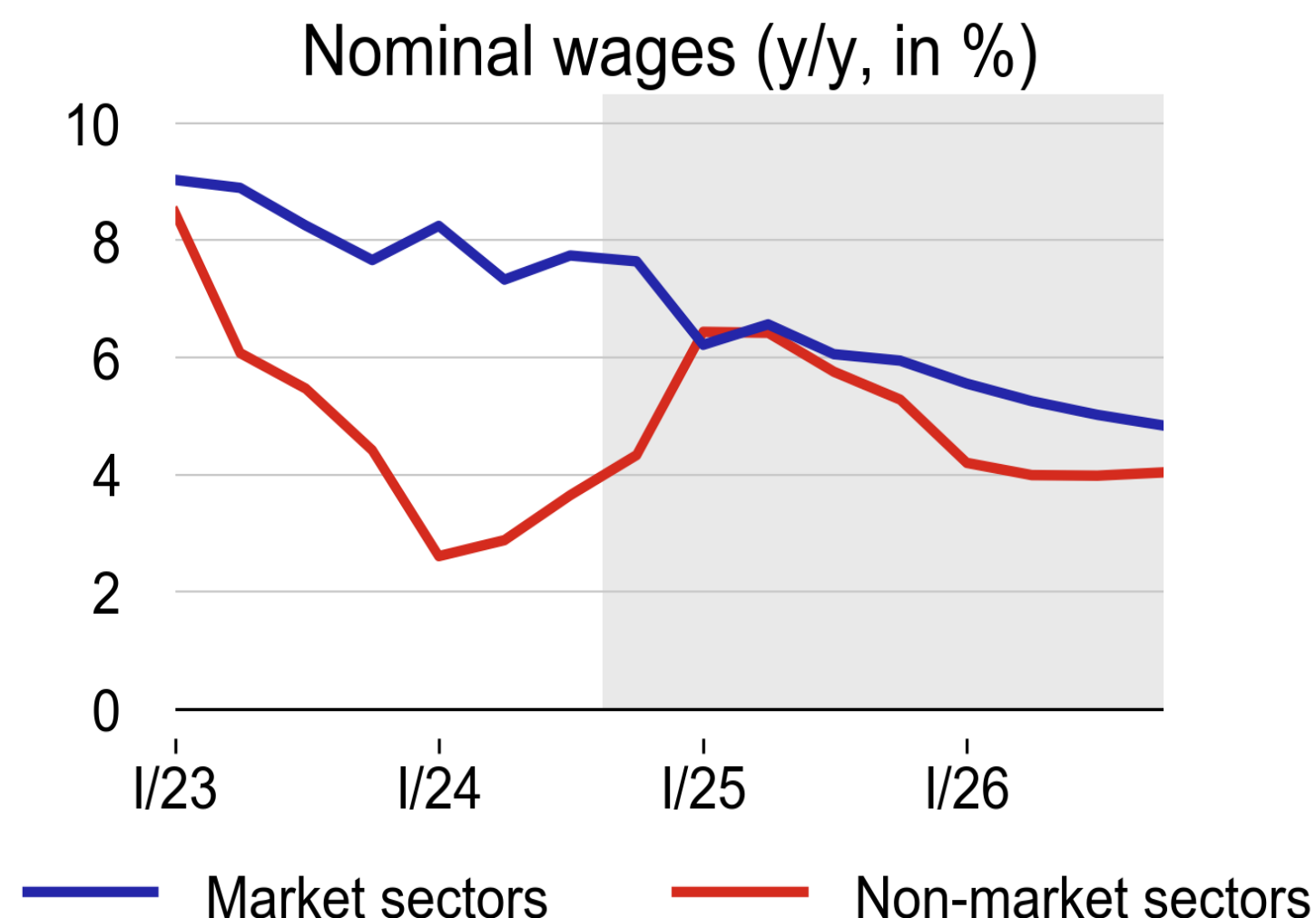
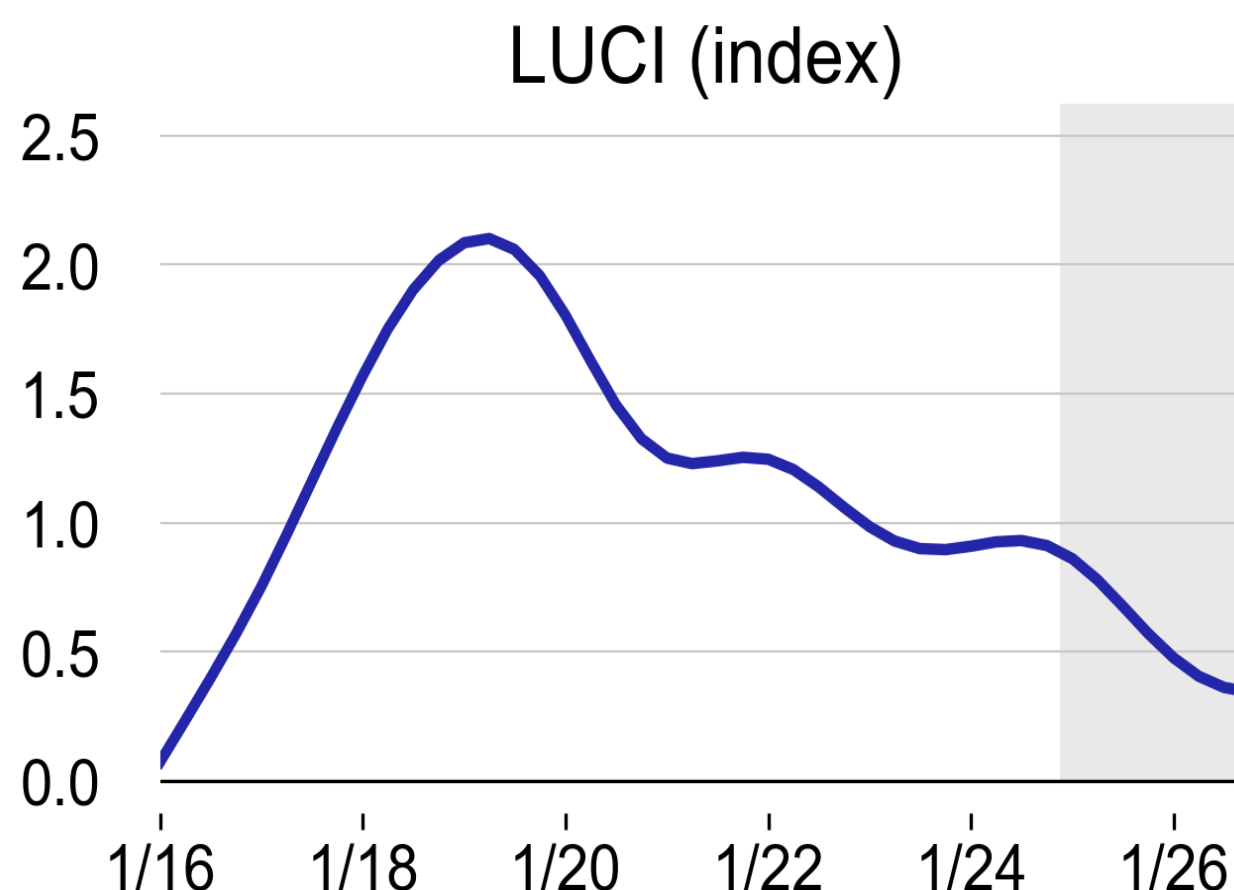
- **CPI inflation** moderates at the start of this year and is expected to stay in the target tolerance band, before coming down towards the target next year.
- **Administered price** inflation is expected to fall below 2% at the start of 2025 and to stabilise close to 2% in 2026.
- **Food price inflation** will remain elevated in the coming quarters due to both renewed growth in agricultural producer prices and a continued rise in prices of some food commodities.
- **Core inflation** will stay just above 2% amid a slightly increasing contribution of imputed rent in the first half of this year.
- **Fuel prices** will continue their y-o-y decline in the first half of 2025.

# Cost Pressures and Profit Mark-ups



- Persisting elevated growth in **costs** create price pressures, while a decreasing **surcharge on costs** (model mark-ups) will dampen it.
- The elevated **overall cost pressures** will decline during 2025 amid a gradual decrease in the inflationary effect of the **domestic economy** and **energy import prices**.
- 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** over the next two years.
- The positive and decreasing **gap in mark-ups** will close at the start of 2026 due to the still tight monetary policy.

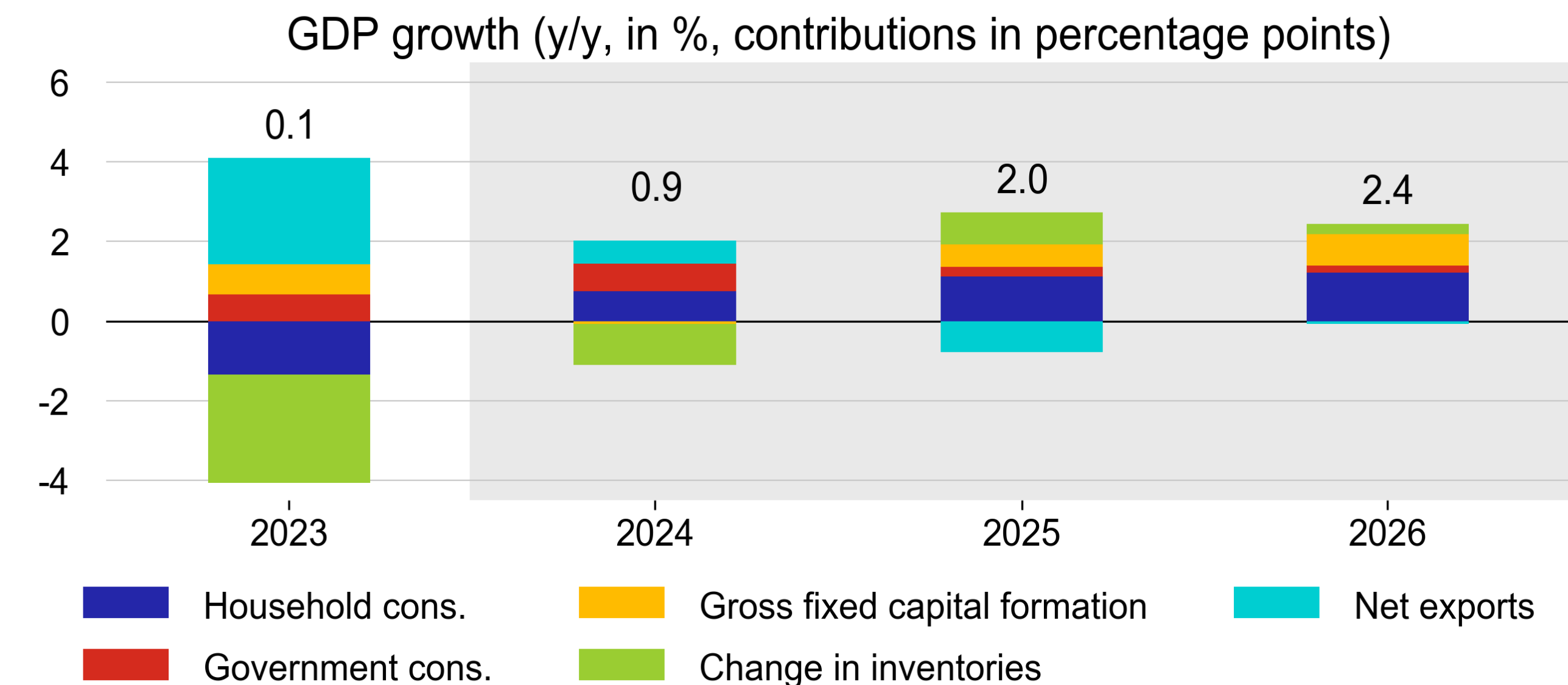
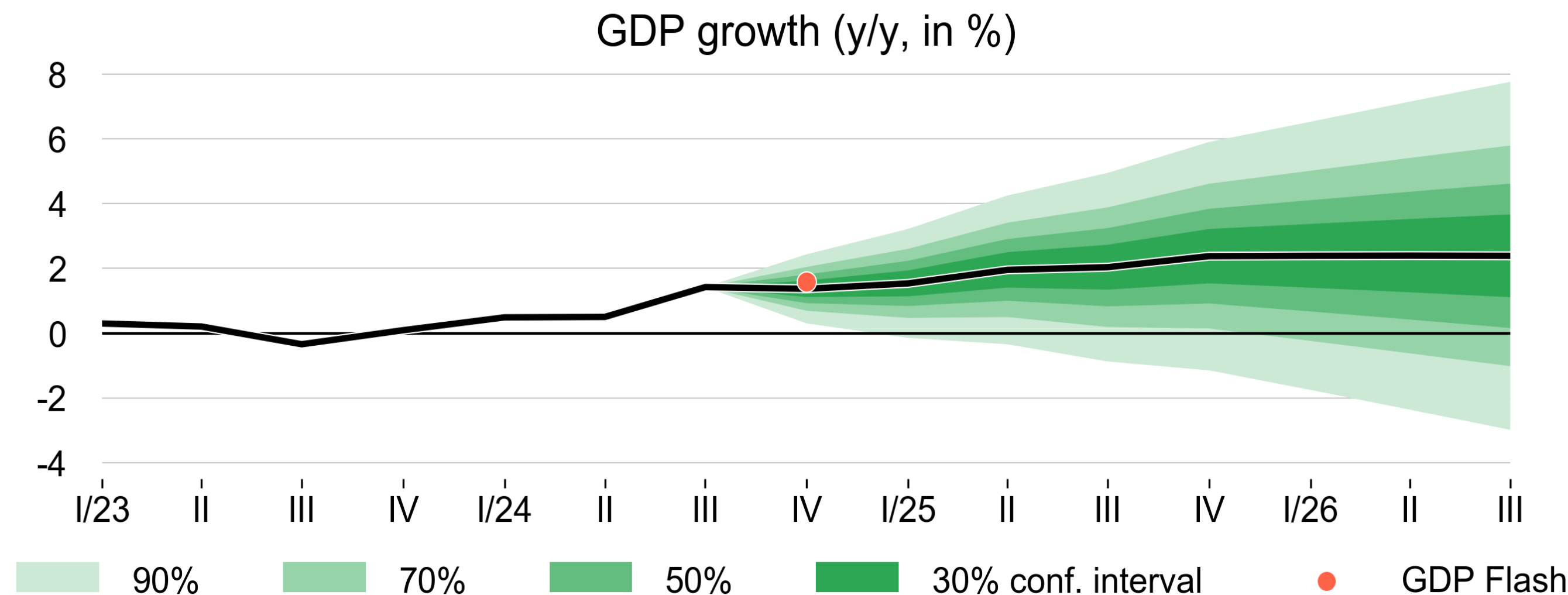
# Labour Market



Net wage  
levels

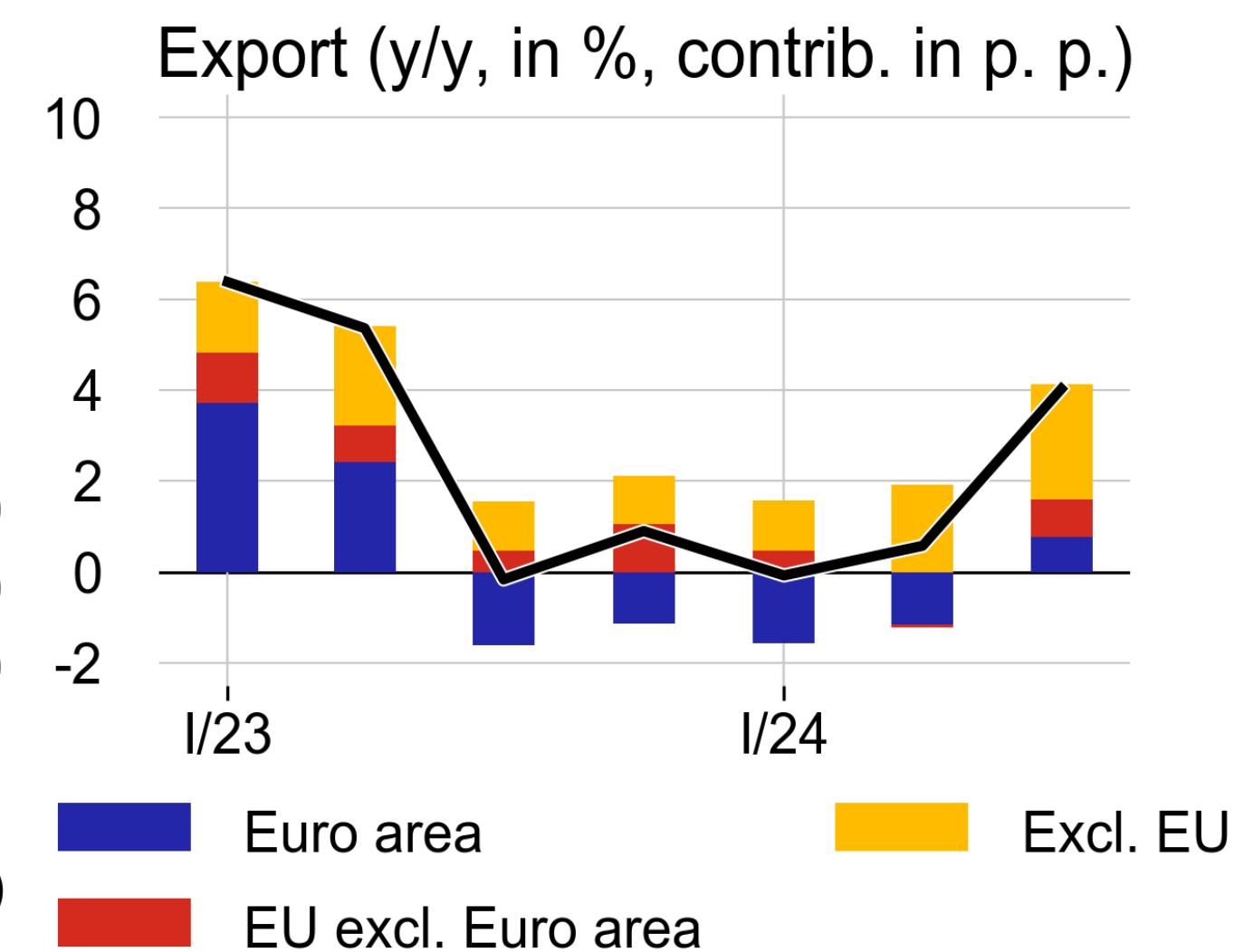
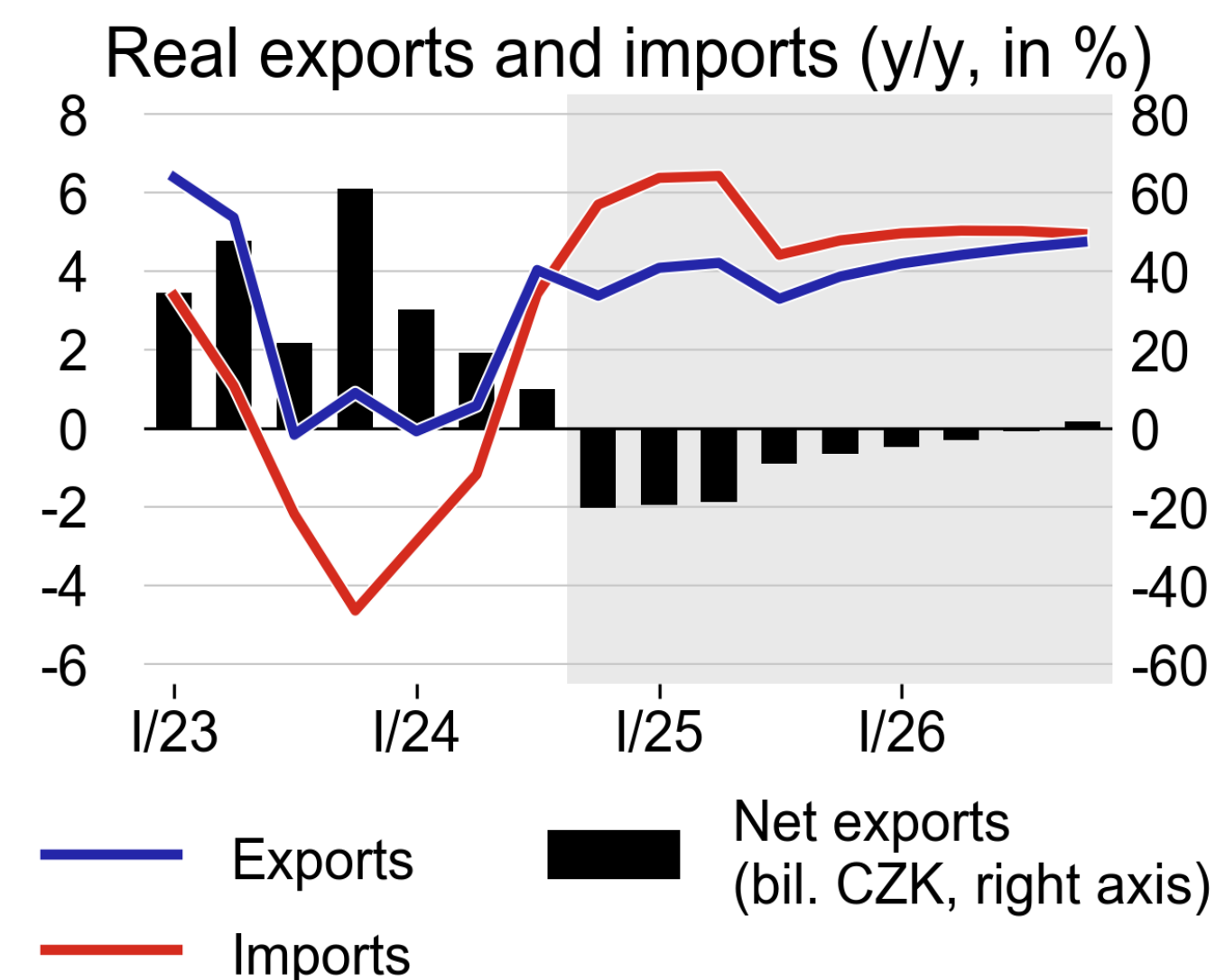
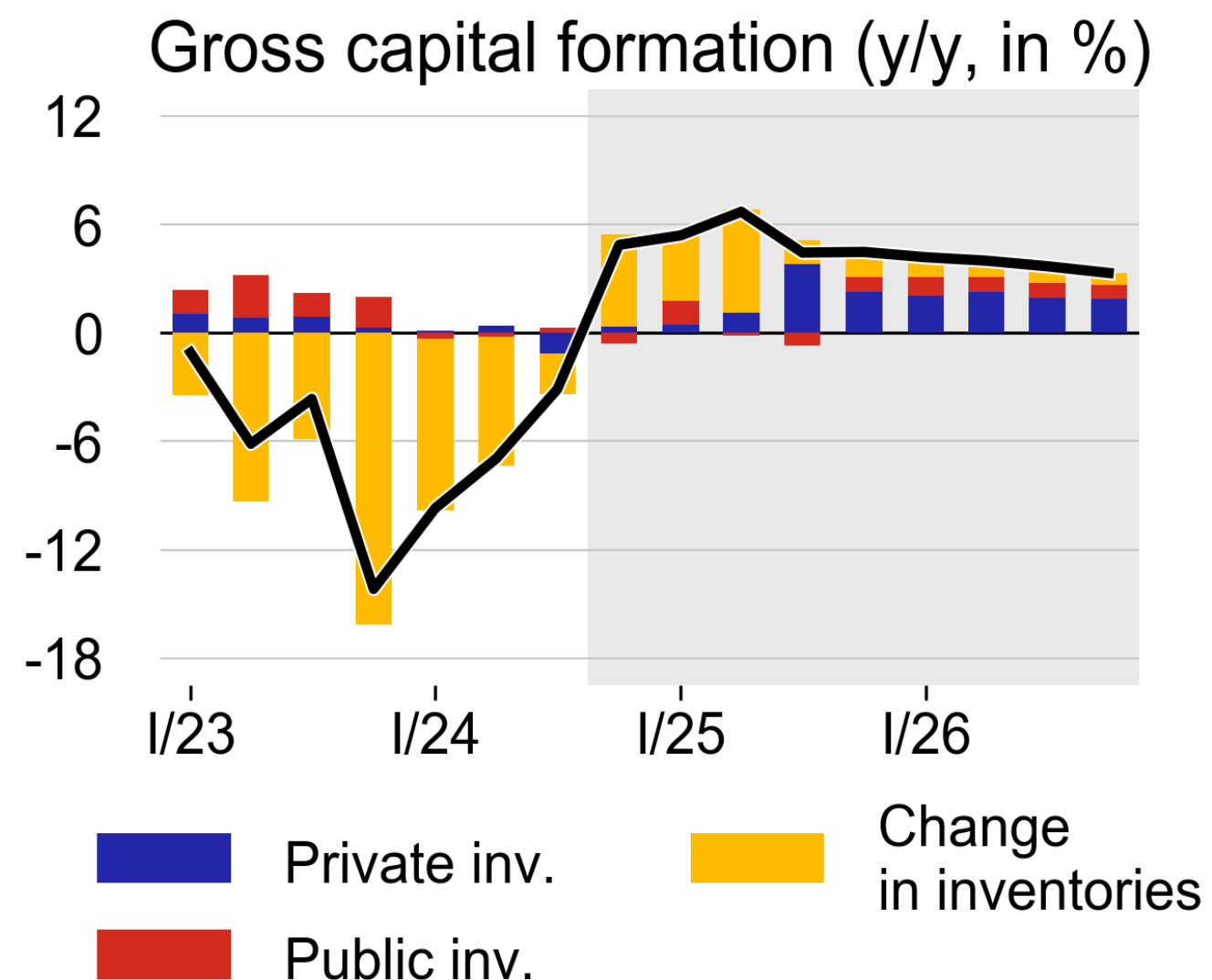
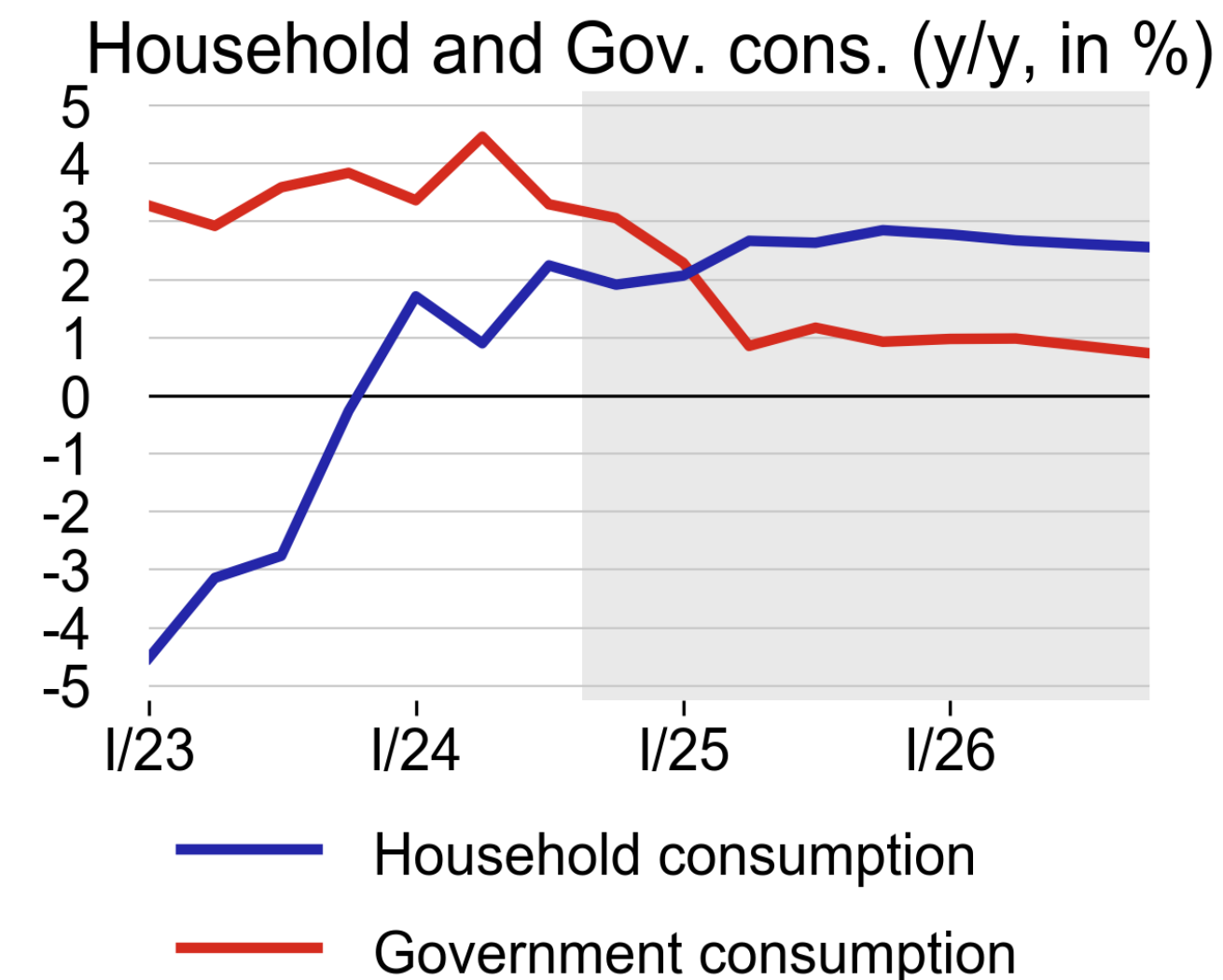
- From the perspective of the **LUCI**, the tightness in the labour market will gradually decrease further.
- Nominal wage growth in market sectors** will remain above-average from a historical perspective this year. Due to
  - gradual economic recovery;
  - compensation for high-inflation period.
- The forecast includes a significant rise in public sector pay in **non-market sectors** in January this year, and legislative changes to the cascade of guaranteed salaries.
- Unemployment** will increase gradually mainly related to layoffs in industry.
- Growth in the **real wage bill** will remain elevated and fuel the growth of household consumption.

# GDP Growth Forecast



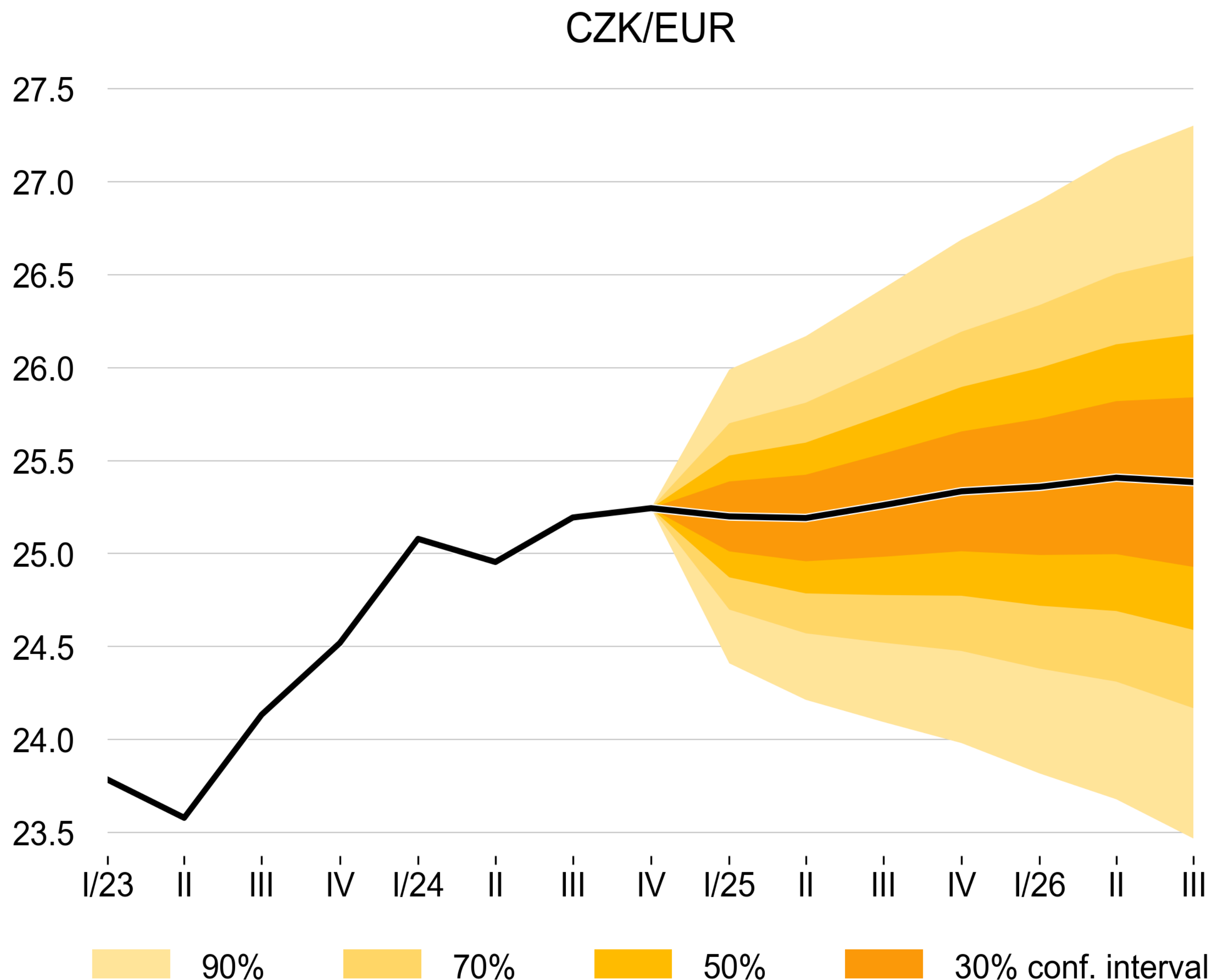
- **Economic growth** will accelerate visibly this year due mainly to recovery in household consumption and also fixed investment.
- In annual terms, **GDP** will grow by **2%** this year and the economy will still operate below its potential. The growth will pick up to **2.4%** in 2026.
- According to the CZSO's flash estimate, Czech GDP increased by **0.5%** quarter on quarter and by **1.6%** year on year in 2024 Q4. This is slightly higher than the presented CNB forecast.

# GDP Components



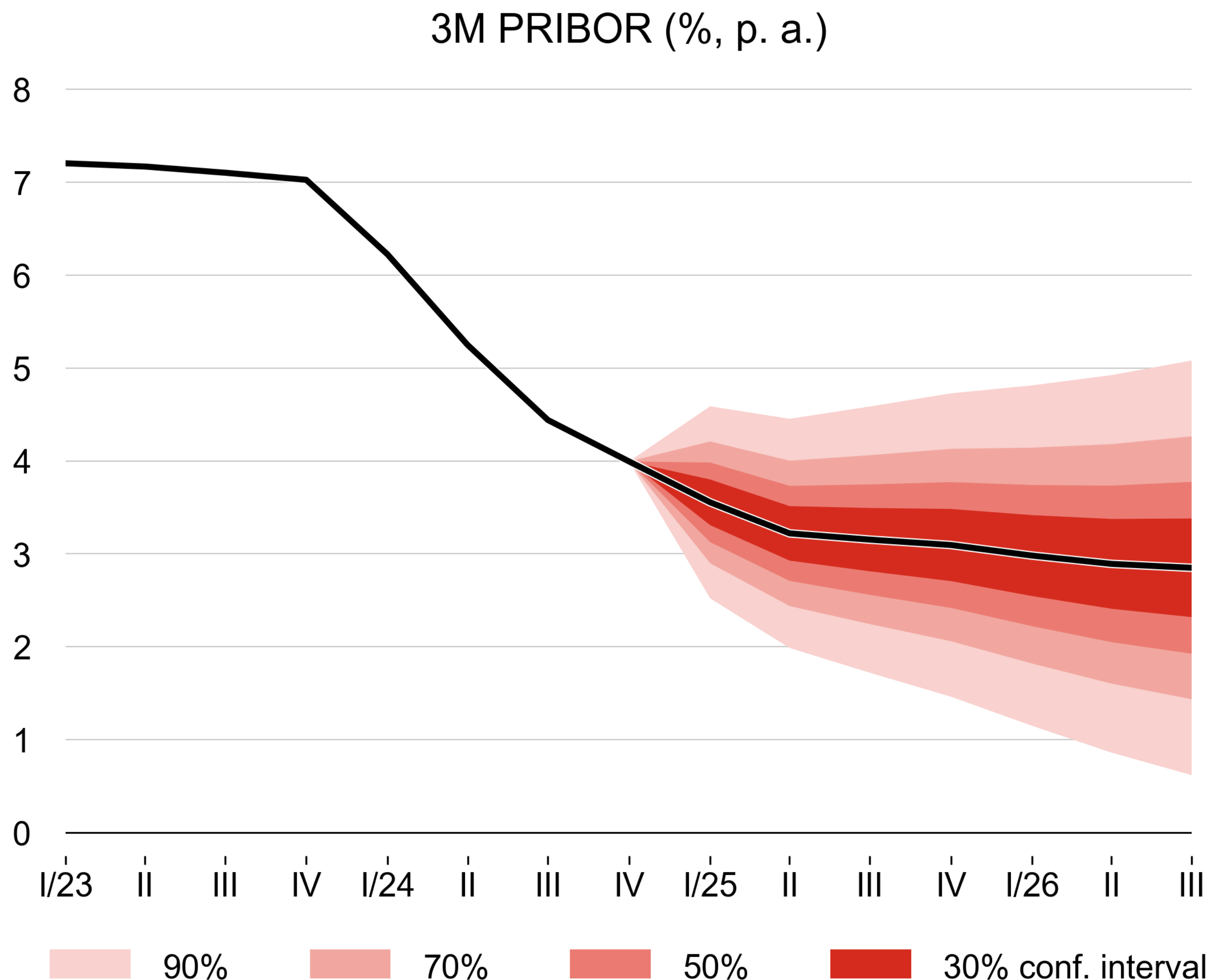
- **Household consumption** will grow this year on the back of swift growth in real wages. It will reach its pre-pandemic level in 1H 2026.
- **Government consumption** growth will decrease this year due to additional savings stemming from the government's consolidation package.
- **Investment** will grow swiftly this year, driven by:
  - **Formation of inventories**;
  - recovery of **private investment** in response to rising demand from EA countries and other trading partners;
  - **public investment** which will be supported by faster expected absorption of EU funds and resources from the NRRP.
- **Export** and **import** growth will be solid over the next two years, due in part to the ability of Czech firms to find new export markets.

# Exchange Rate CZK/EUR



- The forecast expects the koruna to average **CZK 25.2** to the euro in 2025 Q1.
- The koruna will then be broadly stable at close to CZK 25.3 to the euro. This level stems from subdued growth in **labour productivity** and a reduction in the previous large **trade surplus**.

# Interest Rate Path (3M PRIBOR)



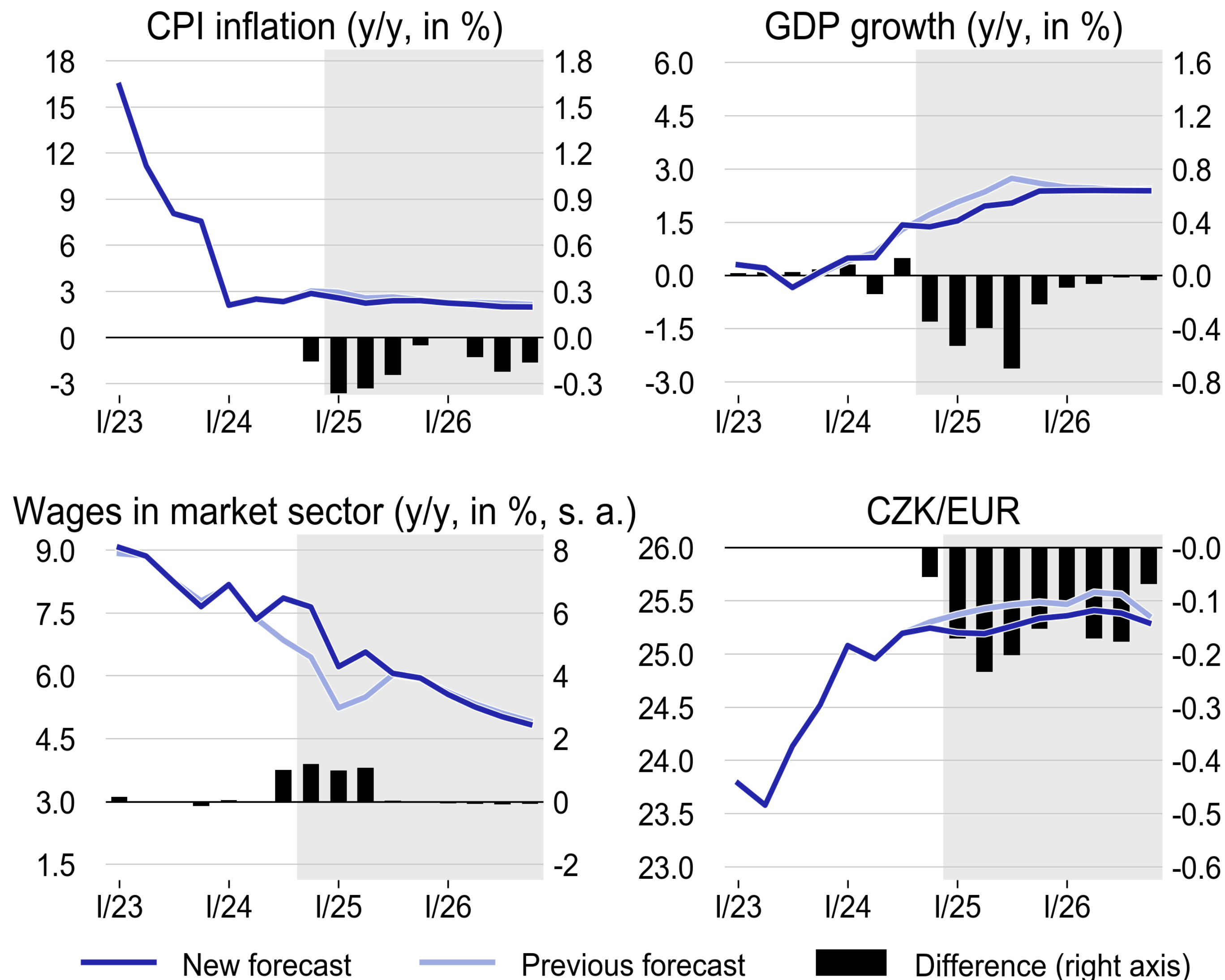
- Consistent with the forecast is a continued decline in **short-term market interest rates**, followed by broadly stable rates from mid-2025 onwards.
- **Growth in costs** will remain slightly elevated this year. However, it does not eliminate the need to ease monetary policy further.
- The inflationary effect of the growth in costs will be partly offset by a **decline in firms' profit margins**, which will continue to dampen inflation.
- 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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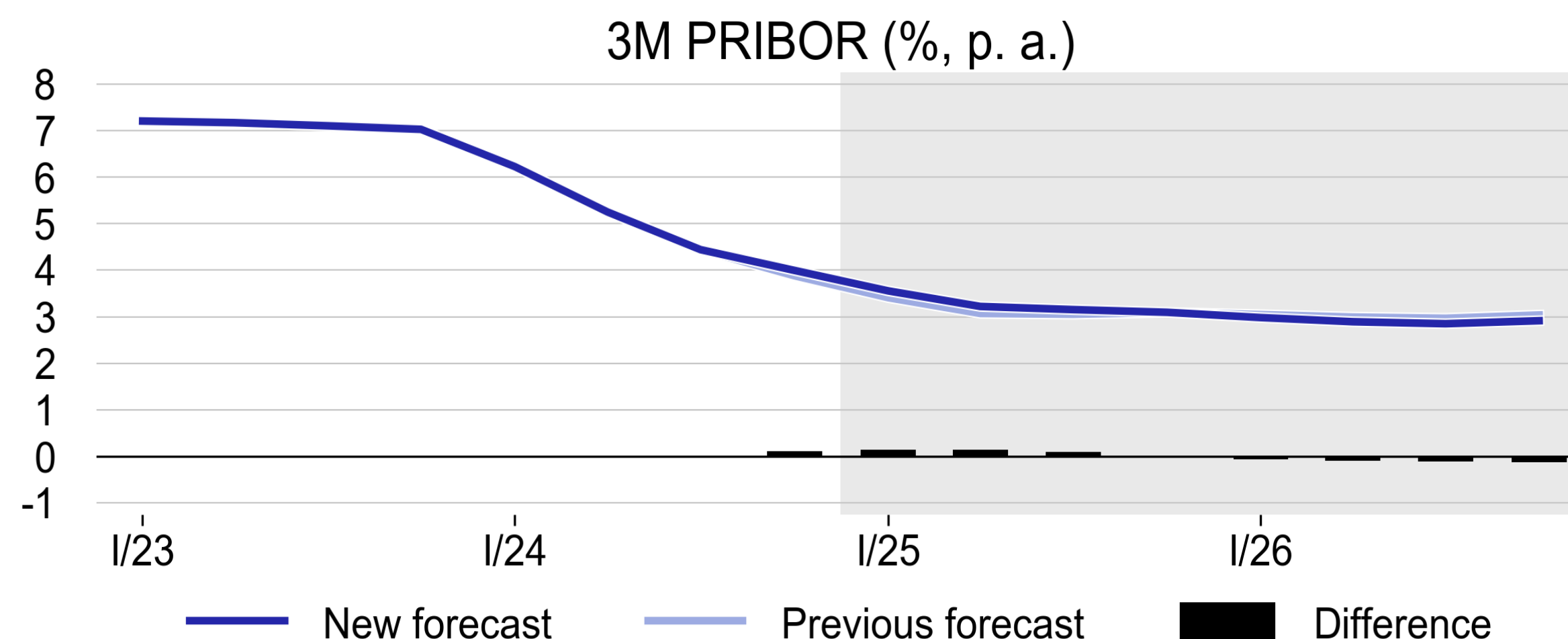


# Comparison of the Forecasts: Domestic Economy

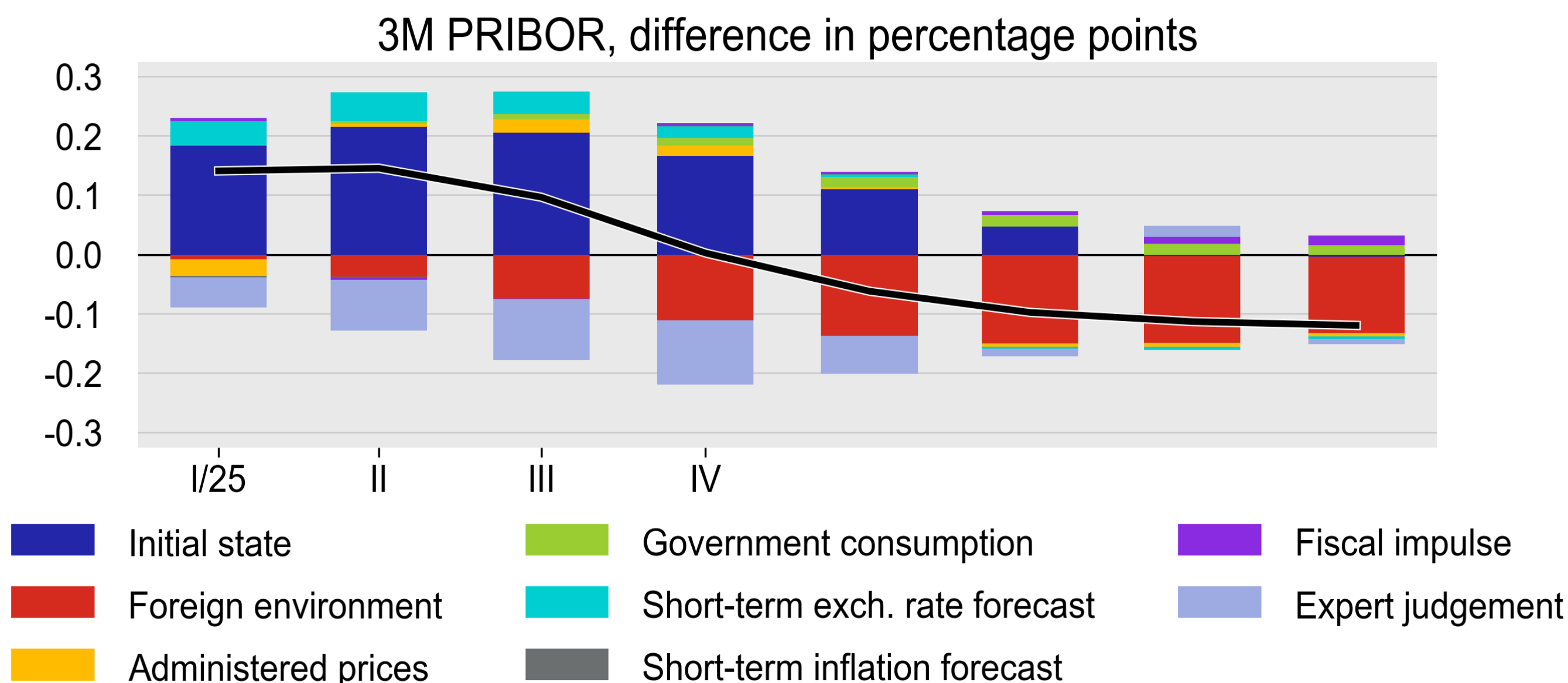


- The **inflation** forecast has shifted slightly downwards (combination of factors).
- The **GDP outlook** for this year is lower than in the previous forecast due to weaker growth in gross capital formation.
- The faster **wage growth** this year is due mainly to higher observations in 2024 Q3 and a slightly higher estimate for 2024 Q4.
- The **koruna** is slightly stronger than in the autumn forecast, due mainly to a wider interest rate differential vis-à-vis the euro area.

# Comparison with the Previous Forecast: 3M PRIBOR



- The **interest rate** path is only marginally higher this year.
- The **initial conditions** foster higher rates, due to faster wage growth and worse labour productivity in the 2H 2024.
- **Expert adjustments** contribute to slightly lower rates.
  - Reduction of autumn forecast adjustments that went towards faster wage and HH consumption growth for the end of 2024.
  - Subsequently published data showed that wage and GDP growth were stronger (as indicated in initial state contributions), reducing the need for these expert adjustments.



- The negative contribution of the **foreign environment** mainly reflects a lower outlook for ECB interest rates.

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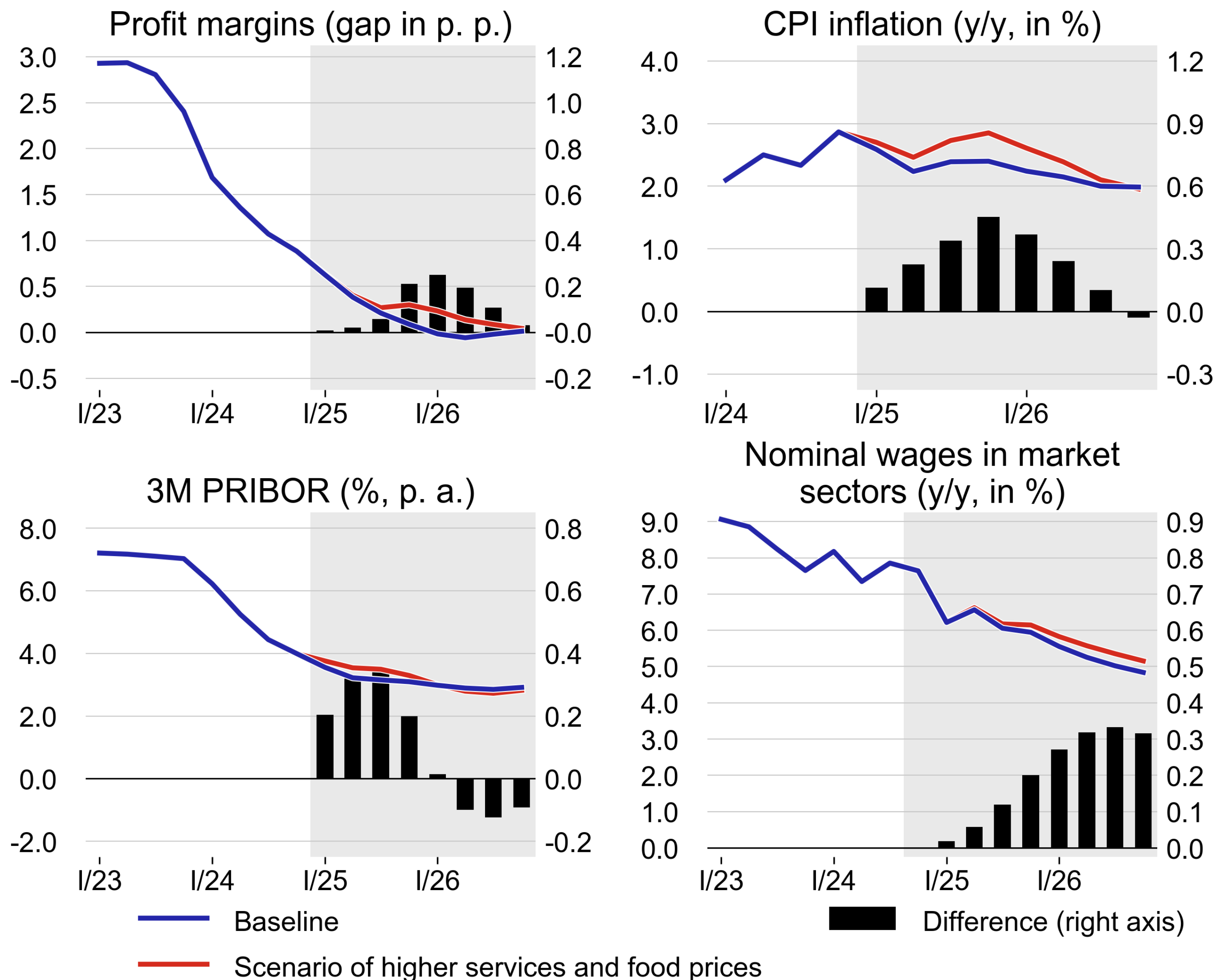
# Risks and Uncertainties

- The risks to the baseline scenario (meeting the inflation target) are **slightly inflationary**.

	Probability of risk materialization	Impact on domestic inflation	Monetary policy response
<b>Forecast risks</b>			
Higher growth in service and food prices	medium	high	⬆️ tighter MP
Impacts of imbalanced developments in the real estate market	high	low-medium	⬆️ tighter MP
Deepening economic difficulties in the euro area	medium	medium	⬇️ looser MP
<b>Key risks from the scoreboard</b>			
Persistently deep government deficit	high	low	⬆️ tighter MP

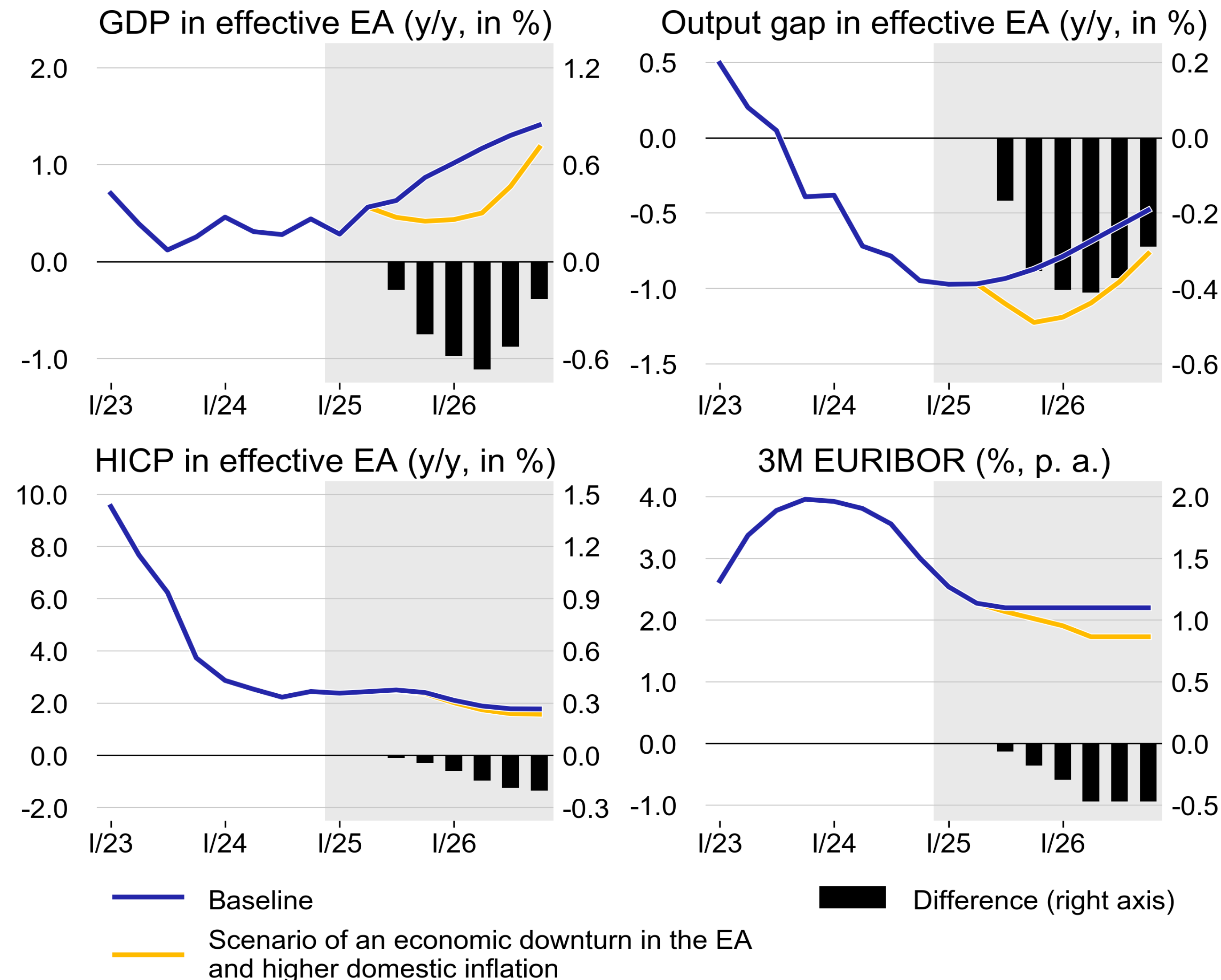
- The main uncertainty of the forecast is the **impact of the announced policies of the new U.S. administration**.

# Scenario of higher services and food prices



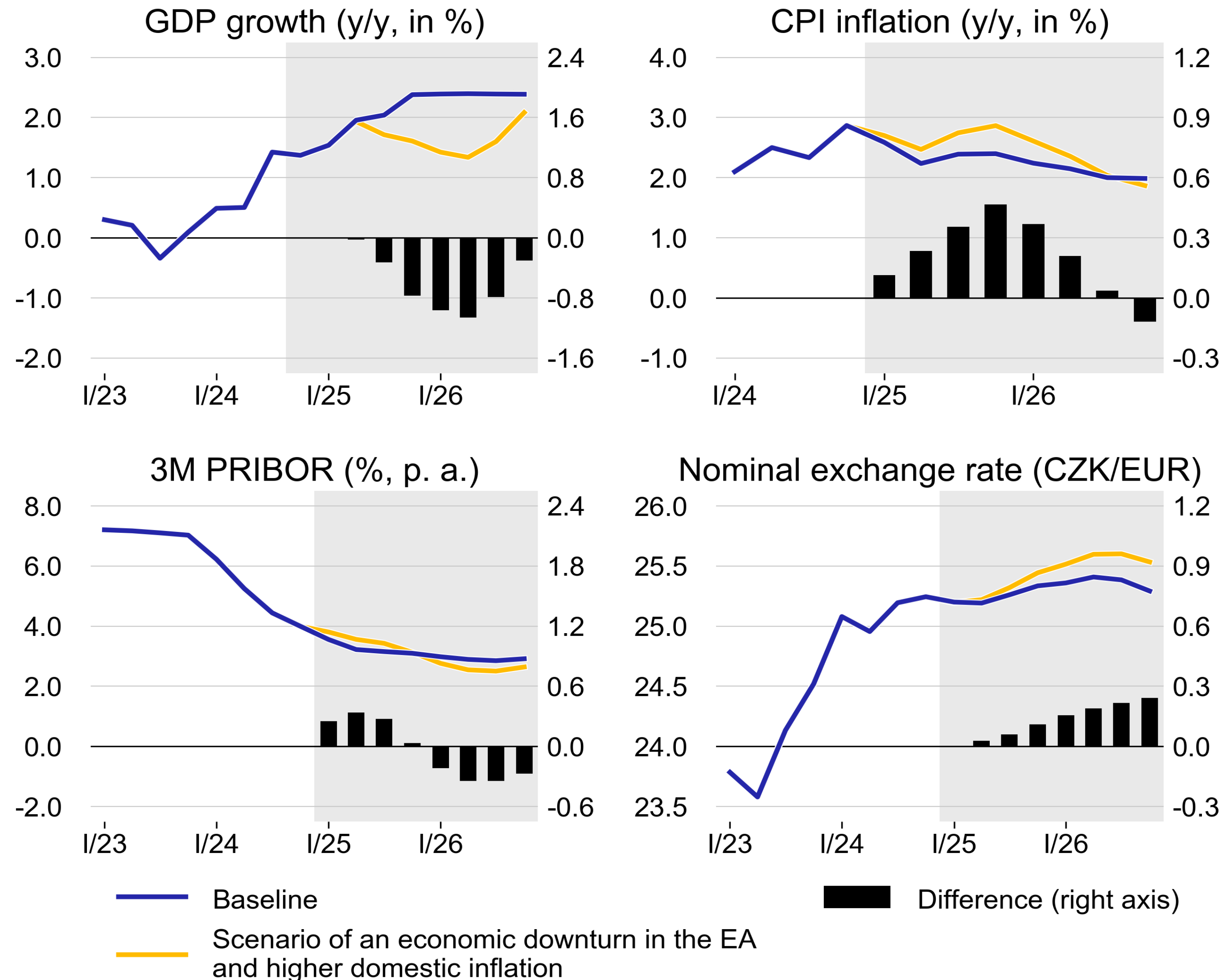
- This scenario assumes that **inflation** will remain elevated this year compared to the baseline scenario, for two reasons:
  - retailers might take advantage of the current strong **demand for services** to reprice more significantly (fostering higher profit margins);
  - potential stronger **cost pressures** stemming from food commodity imports (fostering lower profit margins).
- Overall, **profit margins** narrow more slowly this year and **CPI inflation** is almost 0.5 pp higher at the end of this year.
- The central bank reacts with a smaller reduction in **interest rates**.
- Despite that, the higher inflation is partly reflected in faster **nominal wage growth** compared with the baseline scenario.

# Scenario of higher domestic inflation and economic downturn in the EA: external assumptions



- On top of the previous one, this scenario assumes stagnation in Germany, which subsequently spills over to the other euro area countries.
- The **cyclical component of the slowdown** dominates, starting from mid-2025 onwards, leading to:
  - Slightly **lower inflation** in the EA, as the anti-inflationary effect of weaker demand, reflected in a **deeper negative output gap**, outweighs the inflationary effect of a supply weakness and a **weaker euro against the dollar**;
  - longer downturn in **real economic activity** in the EA;
  - **looser monetary policy** of ECB.

# Scenario of higher domestic inflation and economic downturn in the EA: implications

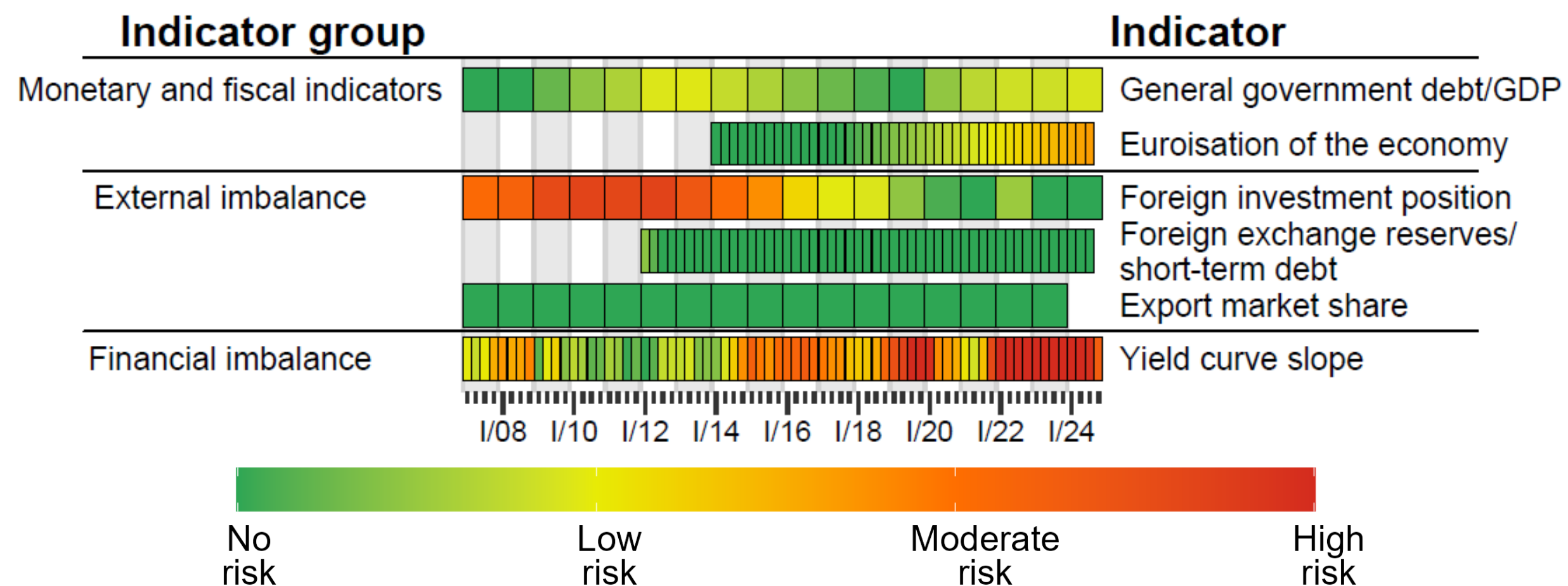
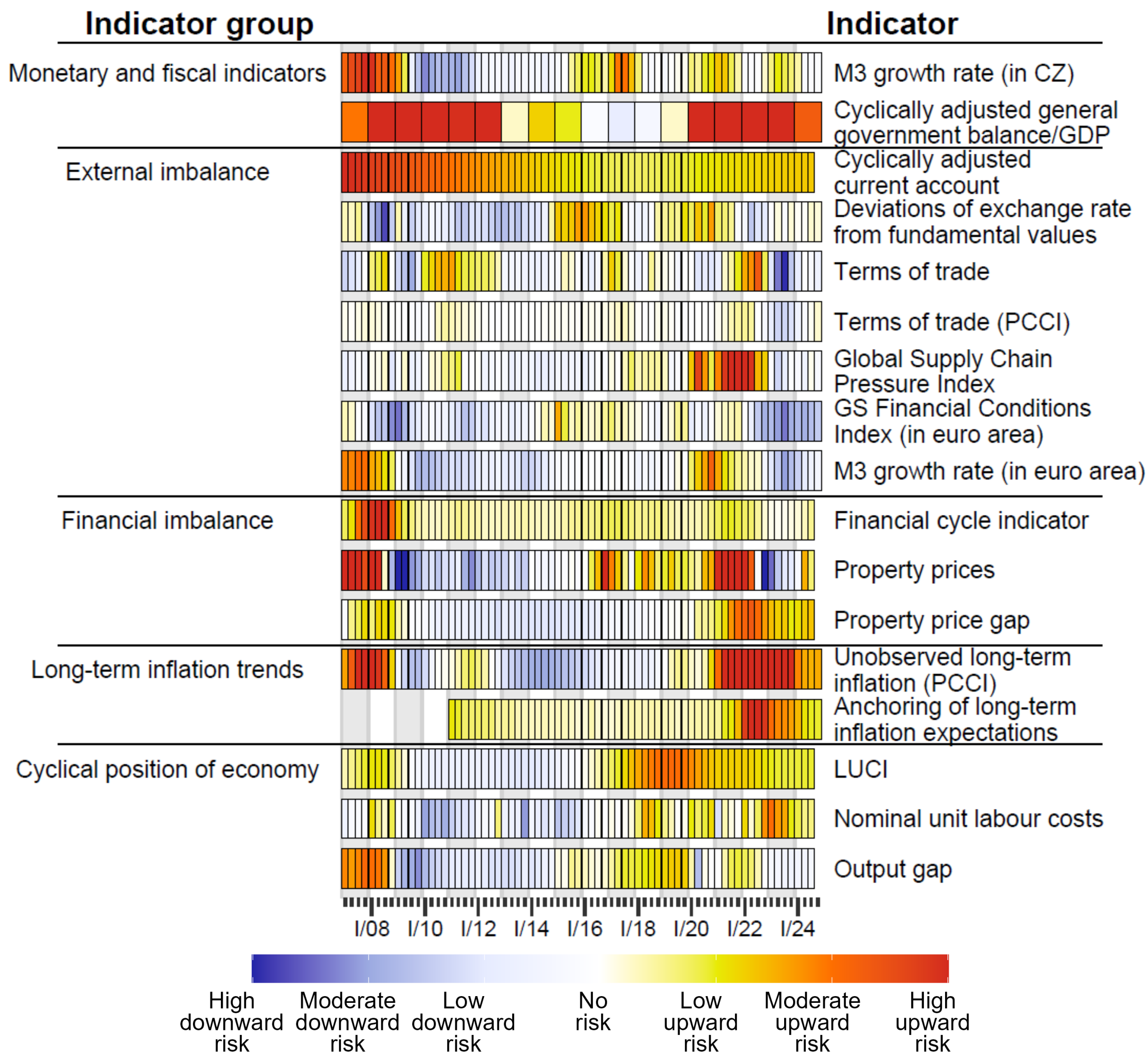


- The slower growth in the EA is reflected in **lower output of the domestic economy** than in the baseline.
- The worse foreign trade with the EA fosters a **weaker koruna**.
- Despite the lower demand in the EA, the simultaneously considered higher inflation implies the simulation has a **stagflationary direction**.
- The **initially tighter monetary policy** responds to higher inflation. As the effects of subdued foreign demand, combined with lower ECB interest rates dominate, a **looser domestic monetary policy** is implied, compared to the baseline.

# Risks Identified by the Scoreboard

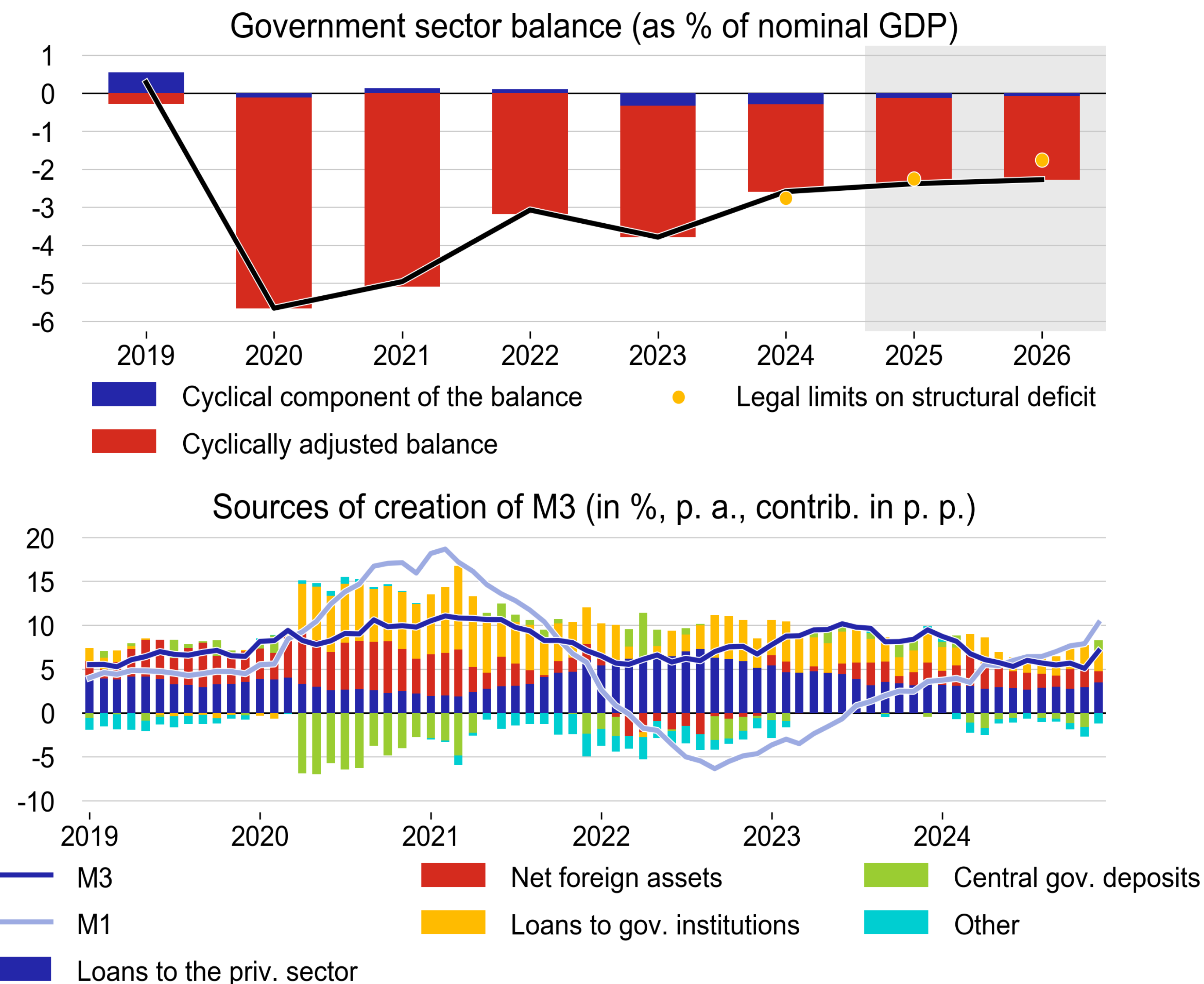
## Inflation risks

## Other monetary policy risks



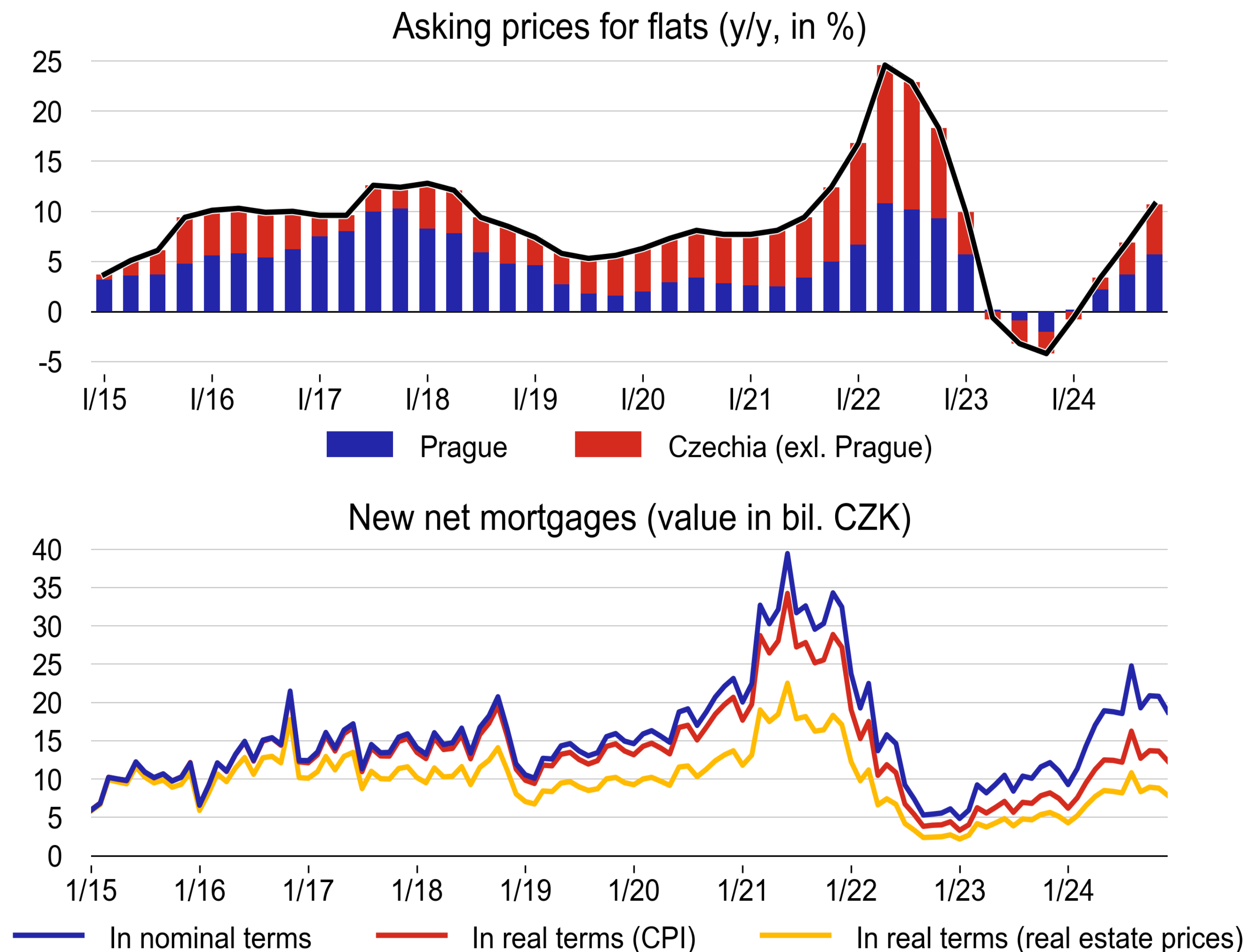
- The Inflation and Monetary Policy Risks **Scoreboard** identifies several upside **risks to inflation**, mainly:
  - wide general government deficits;
  - swiftly growing property prices.
- By contrast, the tight **financial conditions** for the euro area continues to point (almost exclusively) to lower inflation.

# Main Scoreboard Risks I.



- Persistently wide **general government deficits** can have the potential to foster a long-term underlying inflationary pressures in the economy.
- The dominant channel is money creation from government debt issuance.
- The amount of money in the economy, measured by the **M1 and M3 aggregates**, has risen by the end of 2024, mainly due to the withdrawal of central government deposits.

# Main Scoreboard Risks II.



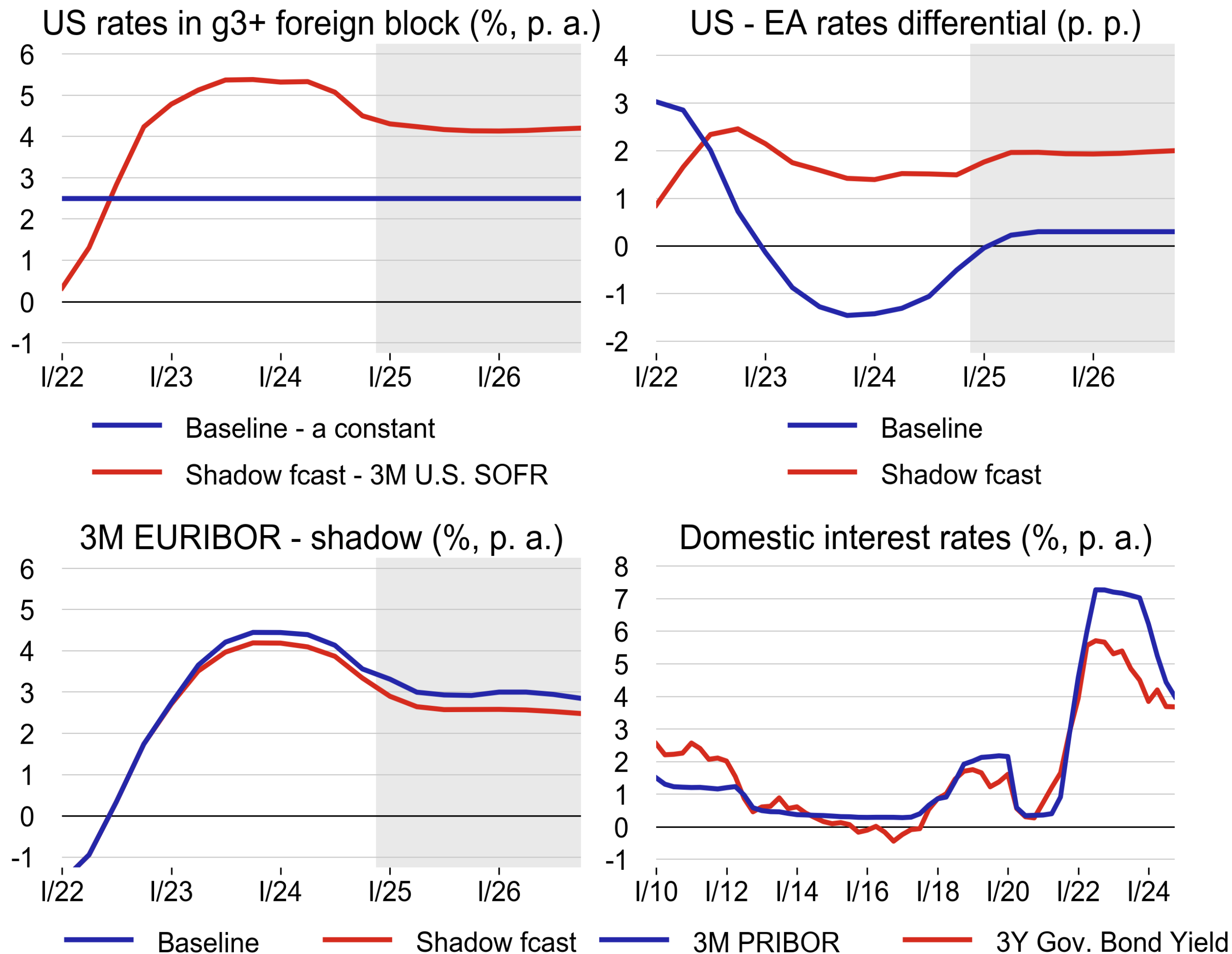
- A significant price and mortgage growth in the **on the housing market** could increase distortions and create an underlying inflationary environment beyond its direct effect on imputed rent.
- The relevance of this risk is highlighted by recent developments in **offer prices for flats**, which grew by above 10% year-on-year in 2024 Q4.
- In recent months, the **volume of new net mortgages** in has reached close to pre-Covid values in real terms. That period was characterised by overheating of the housing market.

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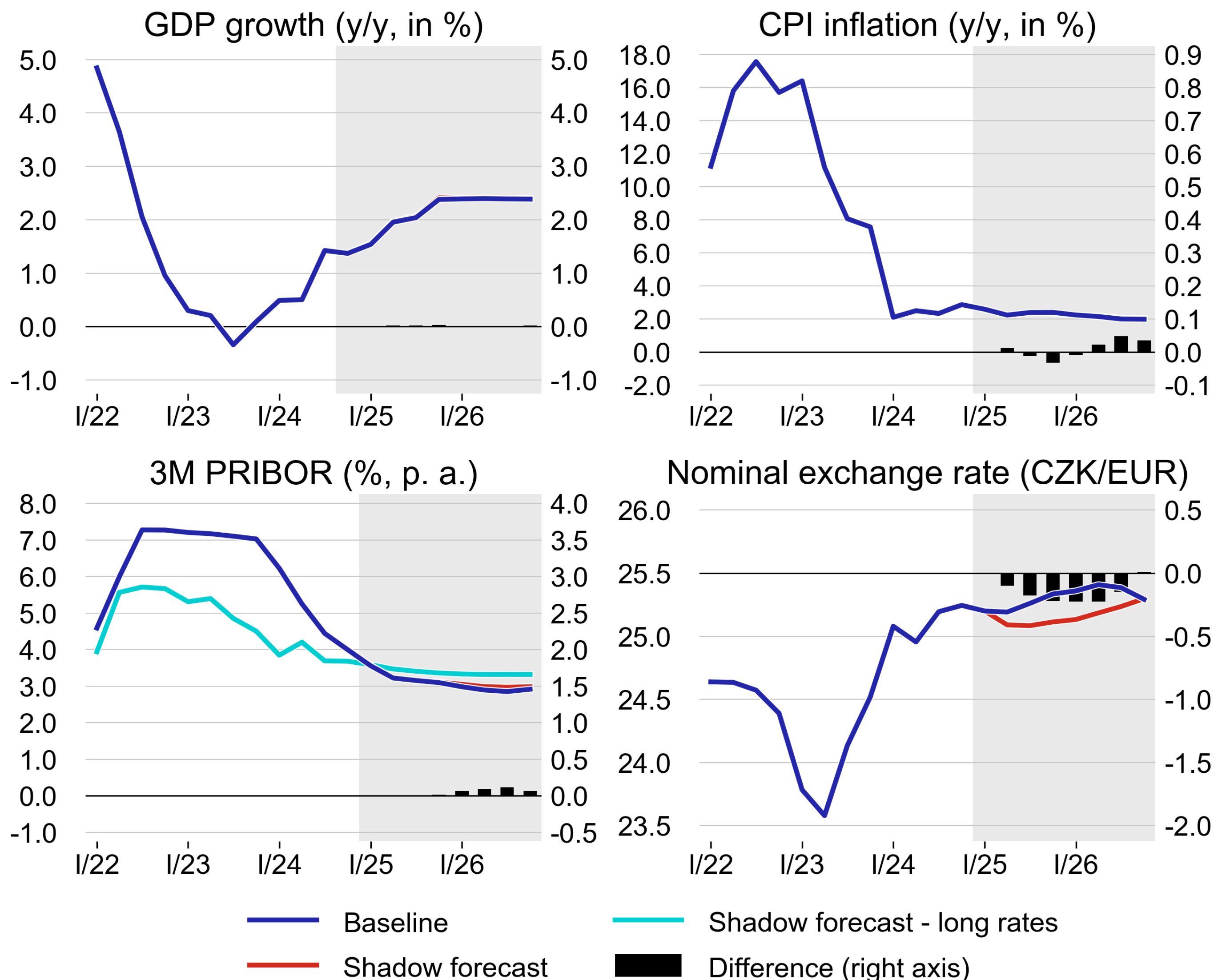


# Upgrades in the Core g3+ Model



- The new model incorporates several upgrades, including:
  - a link between the foreign block and **US rates** via the 3M SOFR, previously approximated only by a constant equilibrium EA interest rate;
  - the assumption of **assymetric effects** between increases and decreases in the ECB's balance sheet modeled using the concept of **3M EURIBOR shadow rate**;
  - the incorporation of long-term (3Y) domestic rates to the domestic block;
  - the shortening of the LIRE (limited information rational expectations) schemes for foreign outlook from 9 to 7 quarters, improving accuracy.
- For details, see Appendix 1 of the Monetary Policy Report – Winter 2025.

# Shadow Forecast



- The forecast produced by the extended g3+ model interprets the current phase of the economic cycle similarly to the baseline scenario and additionally provides a projection for interest rates with longer maturities.
- However, a difference is visible in the **CZK/EUR rate path**, which mostly reflects the changes in the foreign block of the model (primarily wider US - EA interest rate differential).

# Winter 2025 Forecast – Summary

- **Inflation** will slow at the start of 2025 and will be in the upper half of the tolerance band of the inflation target.
- **Economic growth** will accelerate this year and will be driven by **household consumption, additions to inventories** and later also growth in **fixed investment**. By contrast, **net exports** will have a negative effect on the economy.
- Despite slowing, **nominal wage growth** will remain high from the long-term perspective.
- Consistent with the baseline scenario of the winter forecast is a continued decline in **short-term market interest rates**, followed by broadly stable rates from mid-2025 onwards.

	2024	2025	2026
<b>Headline inflation (%)</b>	<b>2.4</b>	<b>2.4</b>	<b>2.1</b>
	(-0.1)	(-0.2)	(-0.1)
<b>GDP (%)</b>	<b>0.9</b>	<b>2.0</b>	<b>2.4</b>
	(-0.1)	(-0.5)	(-0.1)
<b>Average nominal wage (%)</b>	<b>6.9</b>	<b>6.1</b>	<b>5.0</b>
	(0.6)	(0.4)	(-0.1)
<b>3M PRIBOR (%)</b>	<b>5.0</b>	<b>3.3</b>	<b>2.9</b>
	(0.0)	(0.1)	(-0.1)
<b>Exchange rate (CZK/EUR)</b>	<b>25.1</b>	<b>25.2</b>	<b>25.4</b>
	(-0.0)	(-0.2)	(-0.1)

# Thank you for your attention



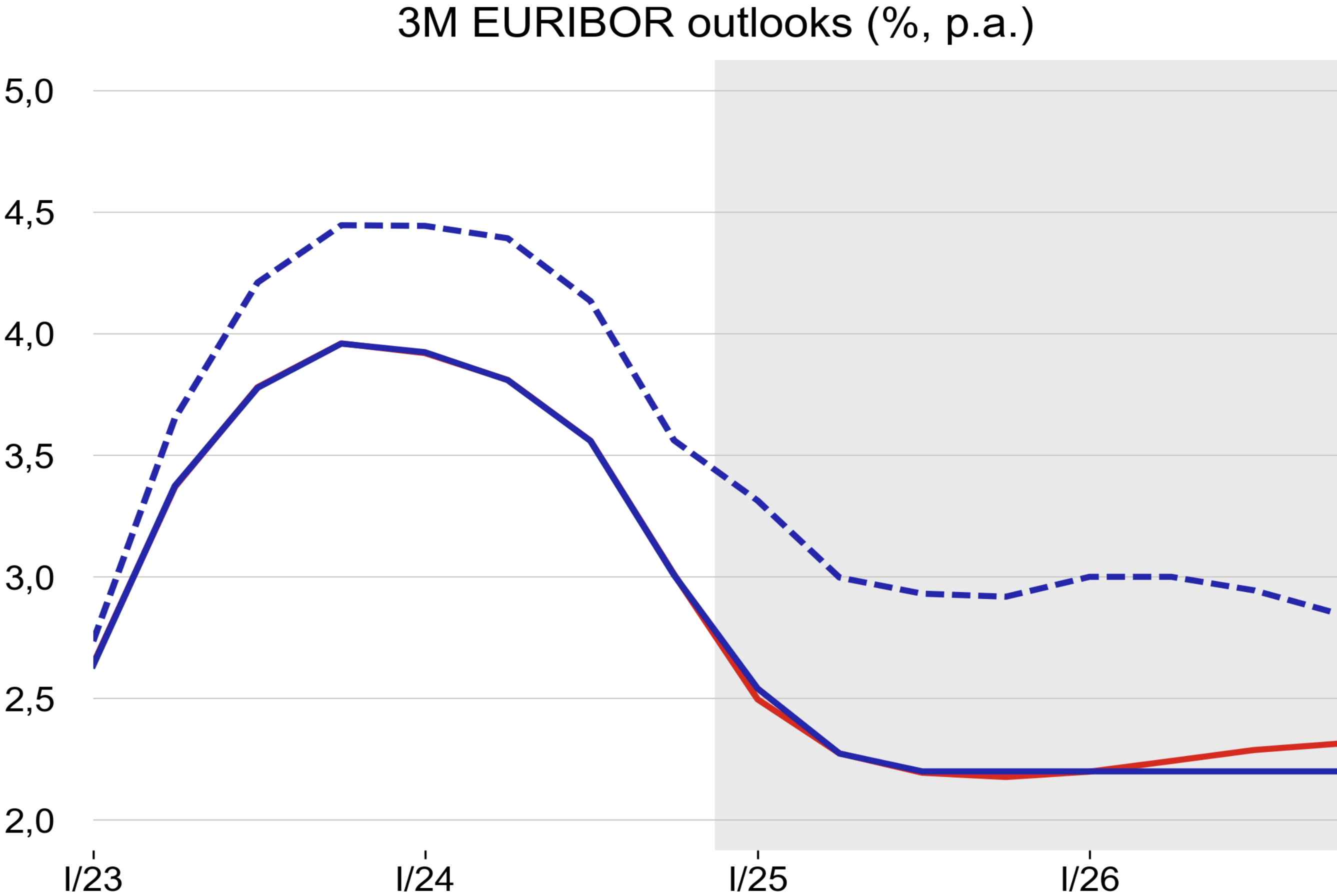
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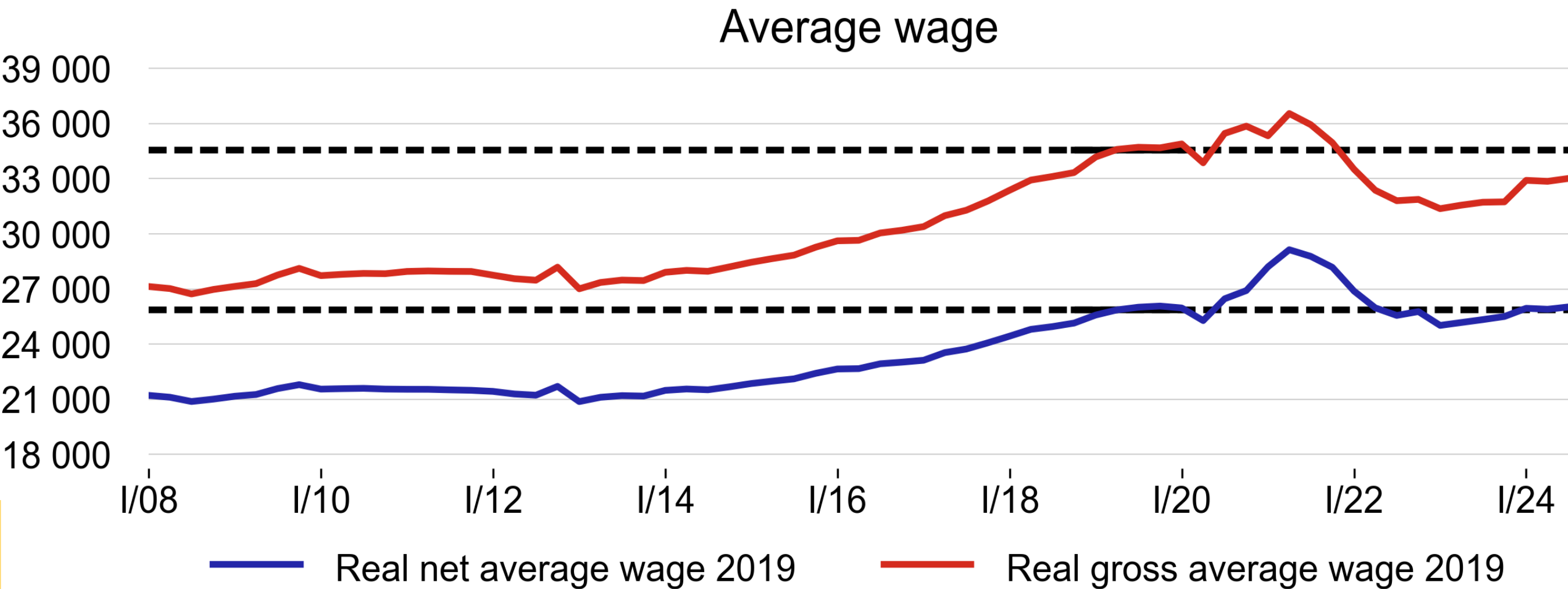
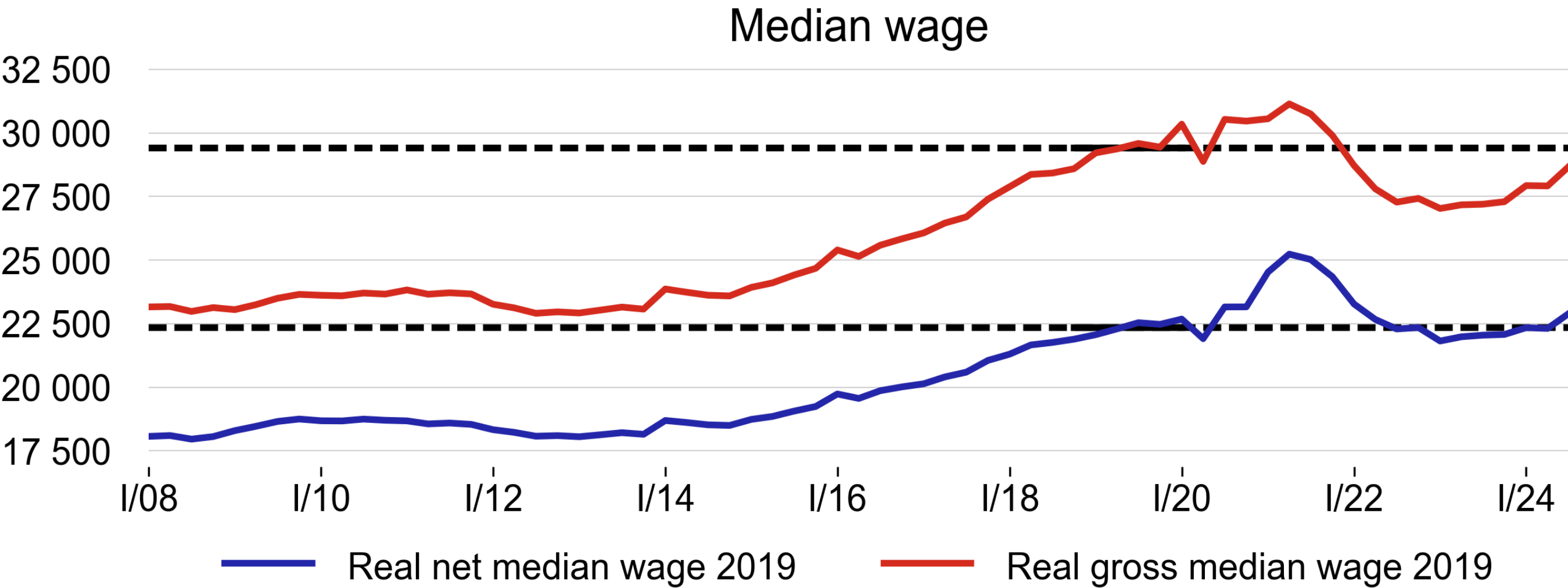


# 3M EURIBOR Outlooks



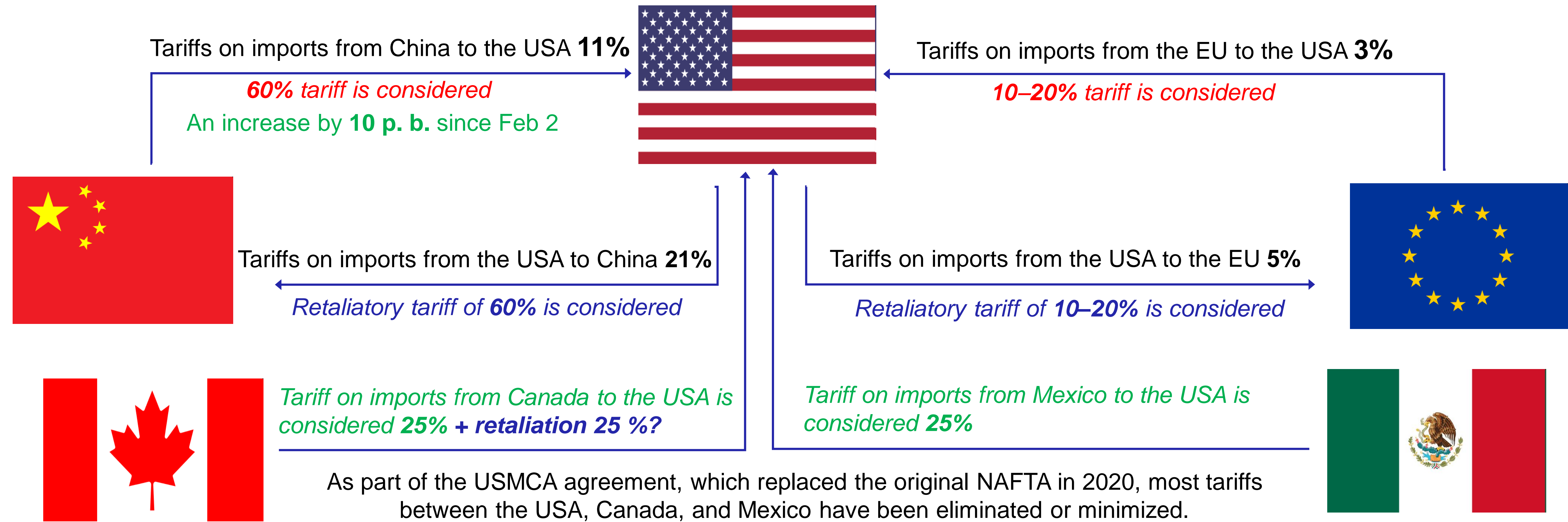
- 3M EURIBOR (MPR Winter 2025)
- 3M EURIBOR (Financial Markets Outlook, 10d average as of February 4)
- Shadow rate

# Nominal and Real Net Wage



# Potential Tariff Changes with the New U. S. Administration

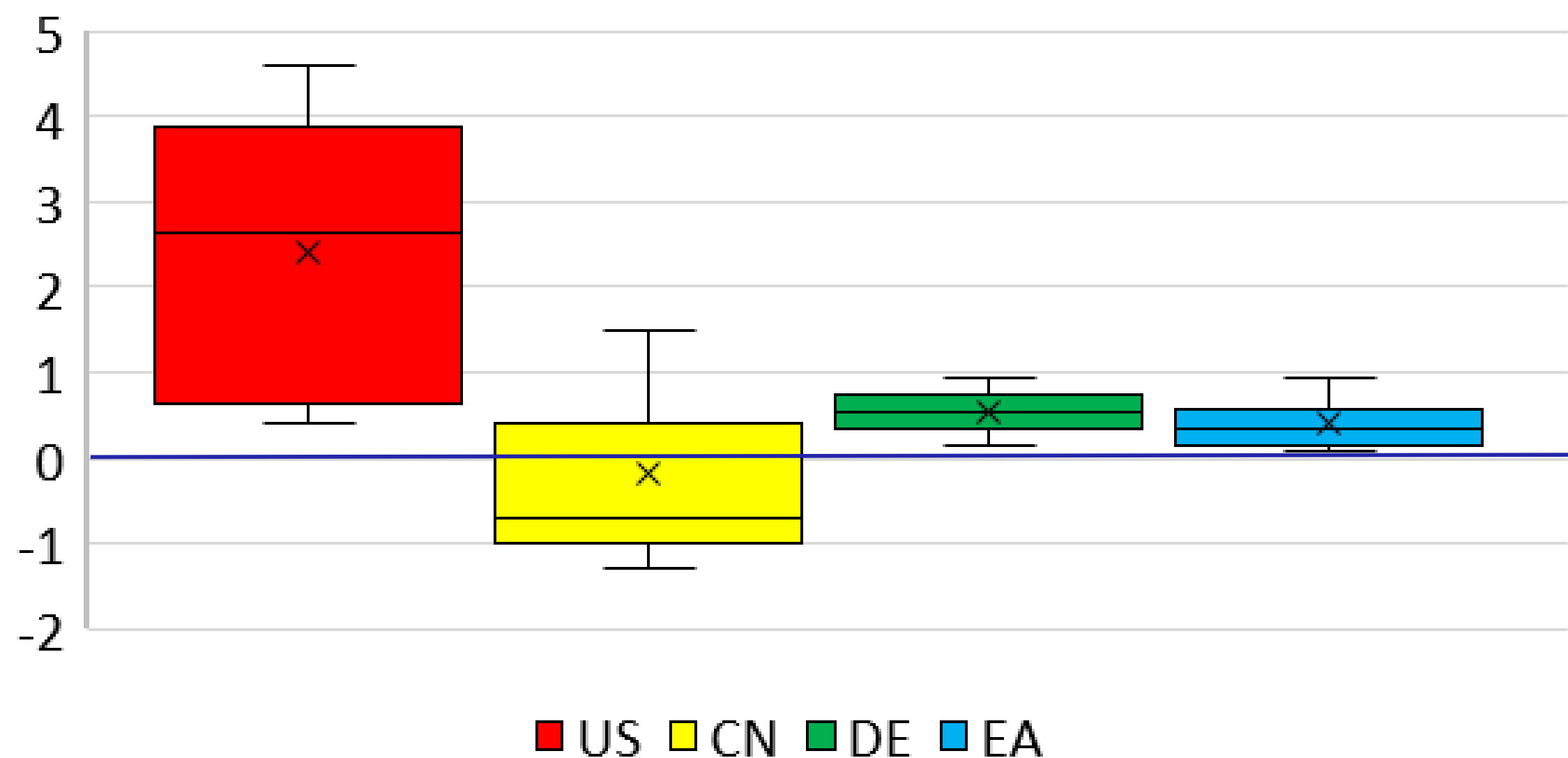
- Average Import Tariff Rate in 2024 and Its Considered / Adopted Level in 2025 (%).



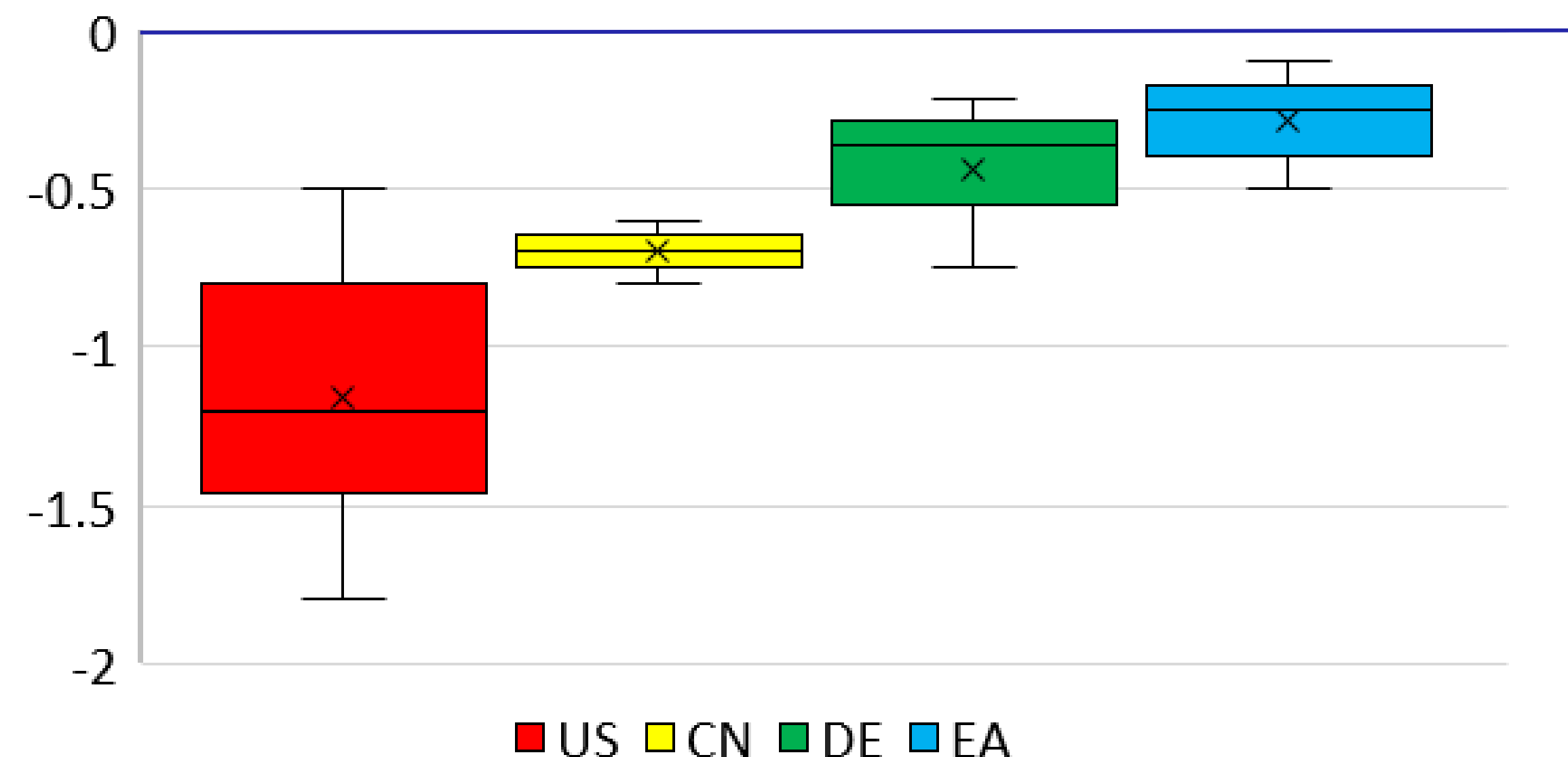
- The current world is burdened with tariffs, but imports to the USA less than imports to EU or China.

# Expected Tariffs impact

Impact on y/y CPI inflation (p. p.)



Impact on y/y real GDP growth (p. p.)



- **These are summary results from more than 20 studies:** tariffs on imports from China (60%) and the EU (10–20%) to the USA.
- Some studies suggest that the introduction of US tariffs on Chinese goods could lead to the **redirection of Chinese exports to European markets**. This development could initially cause increased **downward pressure on prices in Europe**.
- Tariff Barriers  $\Rightarrow$  restriction of global trade  $\Rightarrow$  reduction in exports to the USA  $\Rightarrow$  stronger USD (weaker other currencies).
- Higher Inflation in the USA  $\Rightarrow$  higher interest rate levels  $\Rightarrow$  stronger USD (weaker other currencies).