CNB Monetary Policy and Macro Outlook

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COVID-19 Pandemic: the Expected Impact on the Economy

- The impact is measured by the **Stringency Index** of epidemiological measures.
- The restrictive effects of the autumn measures peaking in Nov 2020.
- Substantial **negative impact** on GVA mainly through disrupted trade (retail) and services.
• **Headline inflation** returned in Oct 2020 to the tolerance band of the inflation target. The easing of price growth owed to the decline in electricity and natural gas prices, while core inflation stayed robust.

• Weaker demand resulting from the second wave of the pandemic, together with stronger currency, will lead to a decline in core inflation and a convergence of headline inflation towards the target in 2021 H2.
Inflation Components

- **Core inflation** will remain elevated until the end of this year, but ease in 2021.
- Slowing food import prices and lower domestic demand pressures will foster a decline in **food price inflation** early next year.
- The **administered price inflation** has weakened with fall in electricity and natural gas prices.
- The decline in **fuel prices** will fade out next year.
The forecast expects the impacts of the second wave on economic activity to fade away in mid-2021 after that, gradual recovery closing the output gap.

- GDP growth of just below 2% next year driven by household consumption and net exports.
- GDP growth will pick up further in 2022.
Aggregate Demand Components in Levels: W-shape

- **Household consumption** will drop this year as a result of the pandemic and a cooling of the labour market. Household consumption will reach its pre-coronavirus level in 2022.

- **Private investment activity** will be adversely affected by the impacts of the pandemic and a repeated decline in business confidence.

- **Exports and imports** will drop sharply this year, but rebound fast.
The exchange rate will appreciate gradually on the back of global recovery and improving sentiment, supported by the widening of IR differential.

Nominal convergence has been realized mainly through inflation differential in recent years.
• Consistent with the forecast is the initial stability of market interest rates, followed by a gradual rise in rates in 2021.

• The expected fading of the negative effects of the second wave, inflation stabilising close to the target, and a gradual return of domestic and foreign economic activity towards pre-crisis levels will allow the normalisation of interest rates to start during 2021.
Worse Pandemic Scenario: Deeper Second Wave Impact

• The drop in domestic and external demand will be reflected mainly in more subdued domestic activity, lower investment and NX.

• The longer-lasting second wave and period of constant uncertainty will also lead to lower household consumption and to faster cooling of the labour market.

• Lower growth in domestic costs and subdued demand pressures reflect in the lower inflation outlook.

• A temporary drop in market interest rates to slightly negative levels combined with a distinctly weaker exchange rate will support a gradual recovery of domestic economic activity and maintain inflation close to the target.
Fiscal Scenario: Higher Willingness to Spend in Election Year

- Additional measures amounting to almost 2.2% of GDP.
  - Temporary income tax cut
  - Increase insubsistence wage and child allowances
  - Continued pandemic support as in 2020
  - Further VAT cuts on selected items
- Govt unlikely to restrict spending in election year
- Suggests even faster normalisation of rates
Thank you for your attention

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