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# CNB's Forecast and Current Developments

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# Presentation Outline

1. CNB's Board decision
2. Forecast assumptions
3. CNB's forecast and current developments
4. Risks and uncertainty



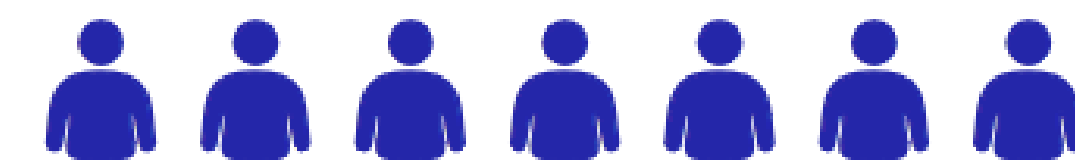
## Monetary policy decision

At its meeting on August 6, 2020, the CNB Bank Board unanimously kept the interest rates unchanged.

The two-week repo rate thus remains at 0.25%, the discount rate at 0.05% and the Lombard rate at 1%.

|                 |                  |                 |
|-----------------|------------------|-----------------|
| <b>0.25%</b>    | <b>0.05%</b>     | <b>1.00%</b>    |
| 2W repo<br>rate | discount<br>rate | Lombard<br>rate |

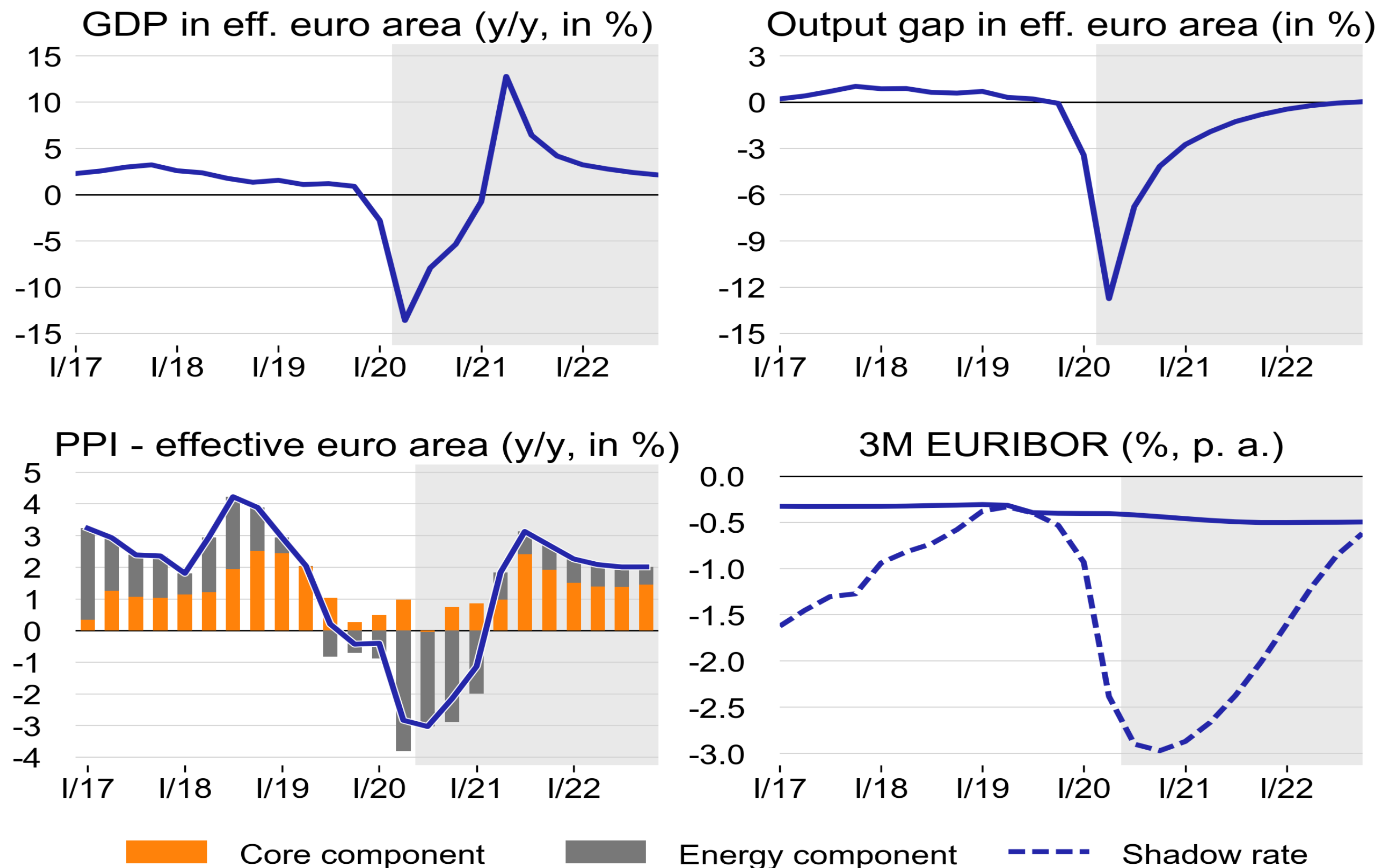
**FOR NO CHANGE**



The decision adopted by the Bank Board is underpinned by the **CNB's macroeconomic forecast** prepared by the staff in July.

Consistent with the forecast is **stability of domestic market interest rates until mid-2021, followed by a gradual rise in rates.**

## External assumptions



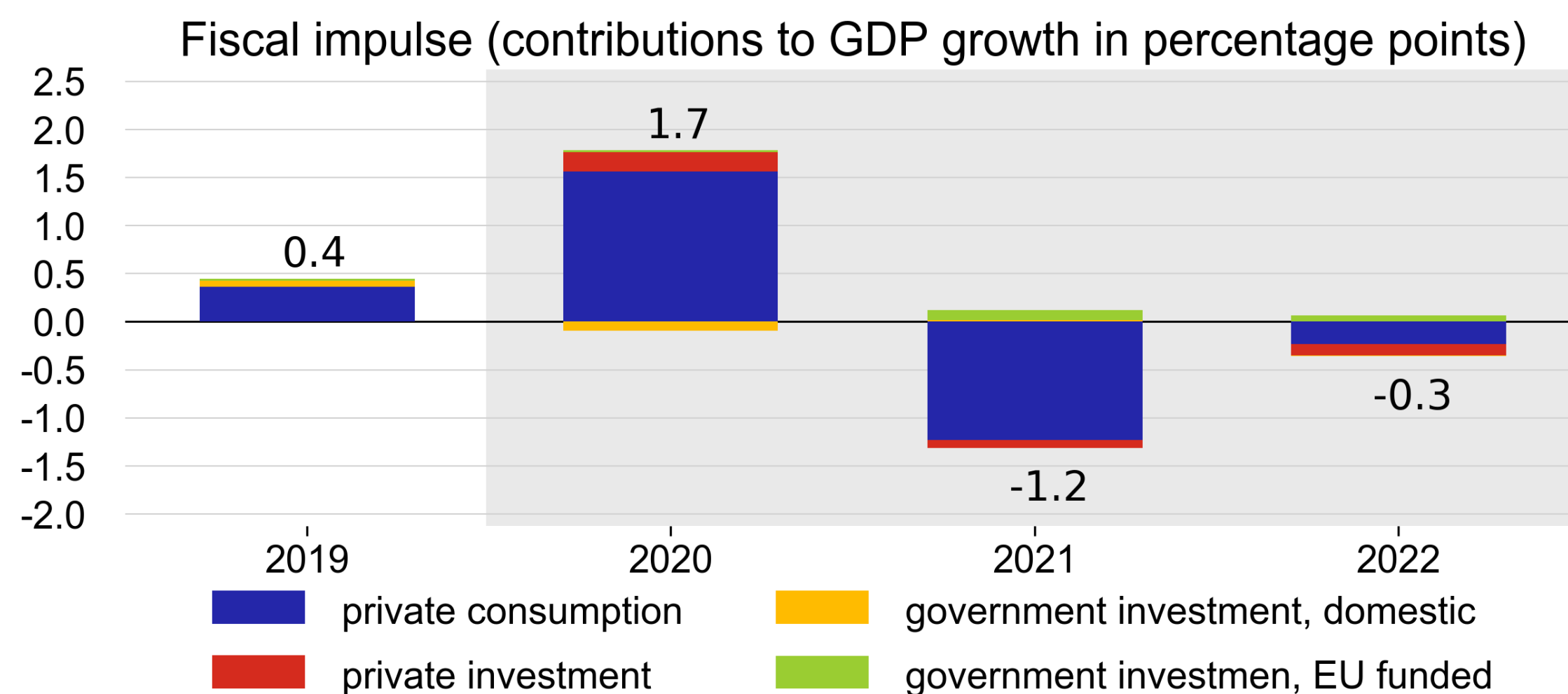
The **effective euro area** economy will decline by more than 7% this year. The currently highly **negative output gap** is assumed to close in **2022**.

Observed **drop of energy prices** will lead to a sizeable decline in producer prices on the back of the fall in economic activity.

**The 3M EURIBOR will remain negative over the entire forecast horizon.** The forecast takes into account expectations regarding the ECB's asset purchase program (via a shadow interest rate concept). The shadow rate is significantly lower than market rates.



# Fiscal assumptions



(% of nominal GDP unless otherwise indicated)

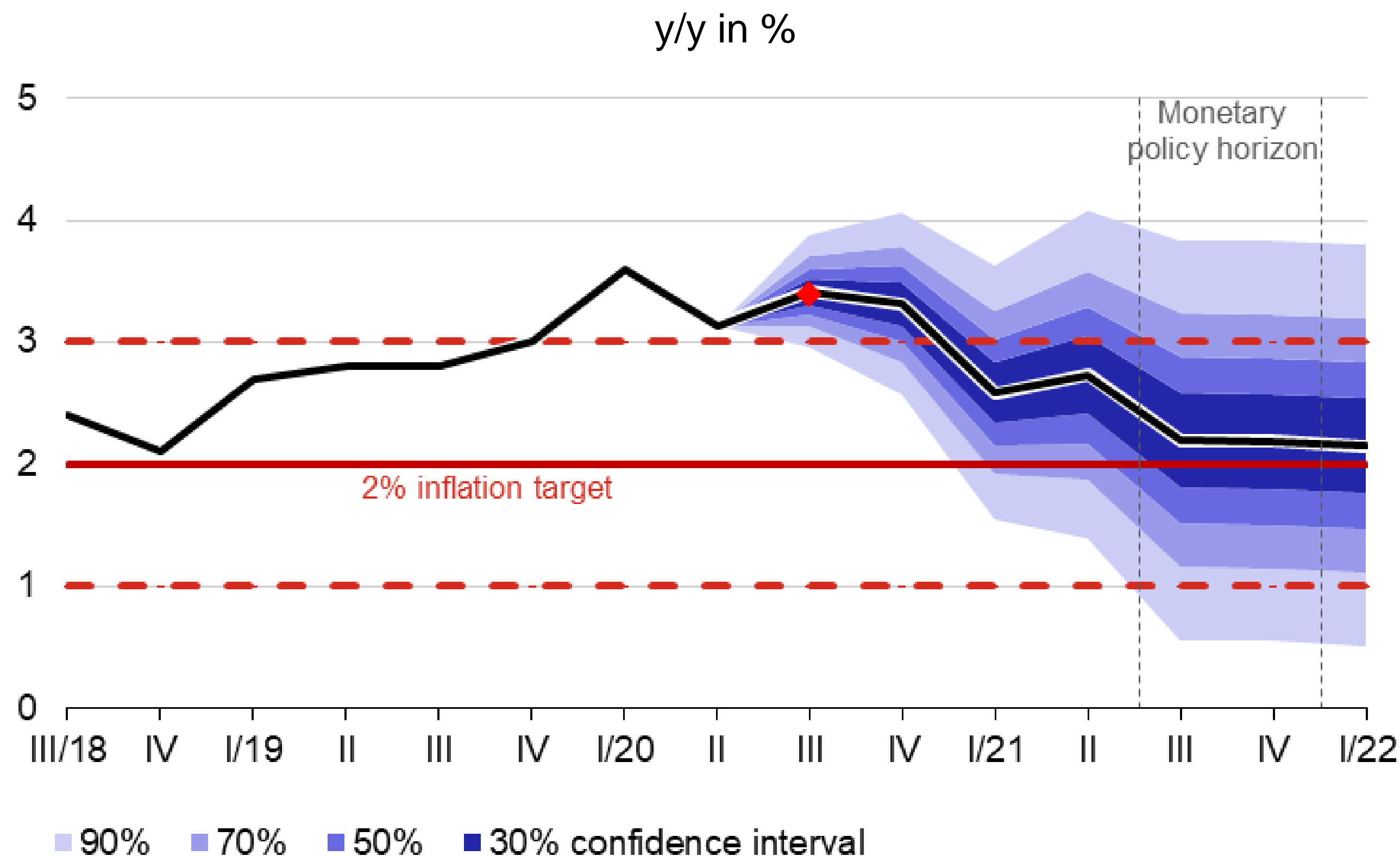
|  | 2019<br>actual | 2020<br>forec. | 2021<br>forec. | 2022<br>forec. |
|--|----------------|----------------|----------------|----------------|
| Government revenue                                       | 41.4           | 41.6           | 42.5           | 42.6           |
| Government expenditure                                   | 41.2           | 47.4           | 46.8           | 46.5           |
| of which: interest payments                              | 0.7            | 0.7            | 0.7            | 0.7            |
| GOVERNMENT BUDGET BALANCE (CZK in bn)                    | 15.4           | -320.7         | -249.0         | -239.5         |
| GOVERNMENT BUDGET BALANCE                                | 0.3            | -5.8           | -4.3           | -3.9           |
| of which:  |                |                |                |                |
| primary balance <sup>a)</sup>                            | 1.0            | -5.1           | -3.6           | -3.3           |
| one-off measures <sup>b)</sup>                           | 0.2            | 0.2            | 0.2            | 0.1            |
| ADJUSTED BUDGET BALANCE <sup>c)</sup>                    | 0.0            | -6.0           | -4.5           | -4.0           |
| Cyclical component (disaggregated method) <sup>d)</sup>  | 1.6            | -1.1           | -1.1           | -0.6           |
| Structural balance (disaggregated method) <sup>d)</sup>  | -1.6           | -4.9           | -3.4           | -3.4           |
| Fiscal stance in pp (disaggregated method) <sup>e)</sup> | -0.9           | -3.3           | 1.5            | 0.0            |
| Cyclical component (aggregated method) <sup>d)</sup>     | 0.3            | -1.4           | -0.6           | 0.1            |
| Structural balance (aggregated method) <sup>d)</sup>     | -0.3           | -4.6           | -3.9           | -4.1           |
| Fiscal stance in pp (aggregated method) <sup>e)</sup>    | -0.8           | -4.3           | 0.7            | -0.2           |
| GOVERNMENT DEBT (CZK in bn)                              | 1738.7         | 2072.6         | 2327.0         | 2567.9         |
| GOVERNMENT DEBT  | 30.2           | 37.5           | 40.1           | 42.1           |

The forecast assumes a **deficit** at 5.8% this year due to a drop in tax revenues and fiscal stabilization measures. The general **government debt will rise** to 42.1% of GDP in 2022 from 30.2% in 2019.

**The fiscal stabilization measures amount to about 3.1% of GDP this year:** the employment support program (Antivirus), support for the self-employed, payment of attendance allowance while schools were closed, the tax loss carryback, cancellation of real estate transfer tax, the payment of 50% of rents by the government and the support for accommodation facilities, ...

There will be a **strongly positive fiscal impulse** this year given the extraordinary measures taken to support the economy, but **negative fiscal impulses** are assumed in 2021 and 2022 together with declining structural deficits.

## Headline inflation



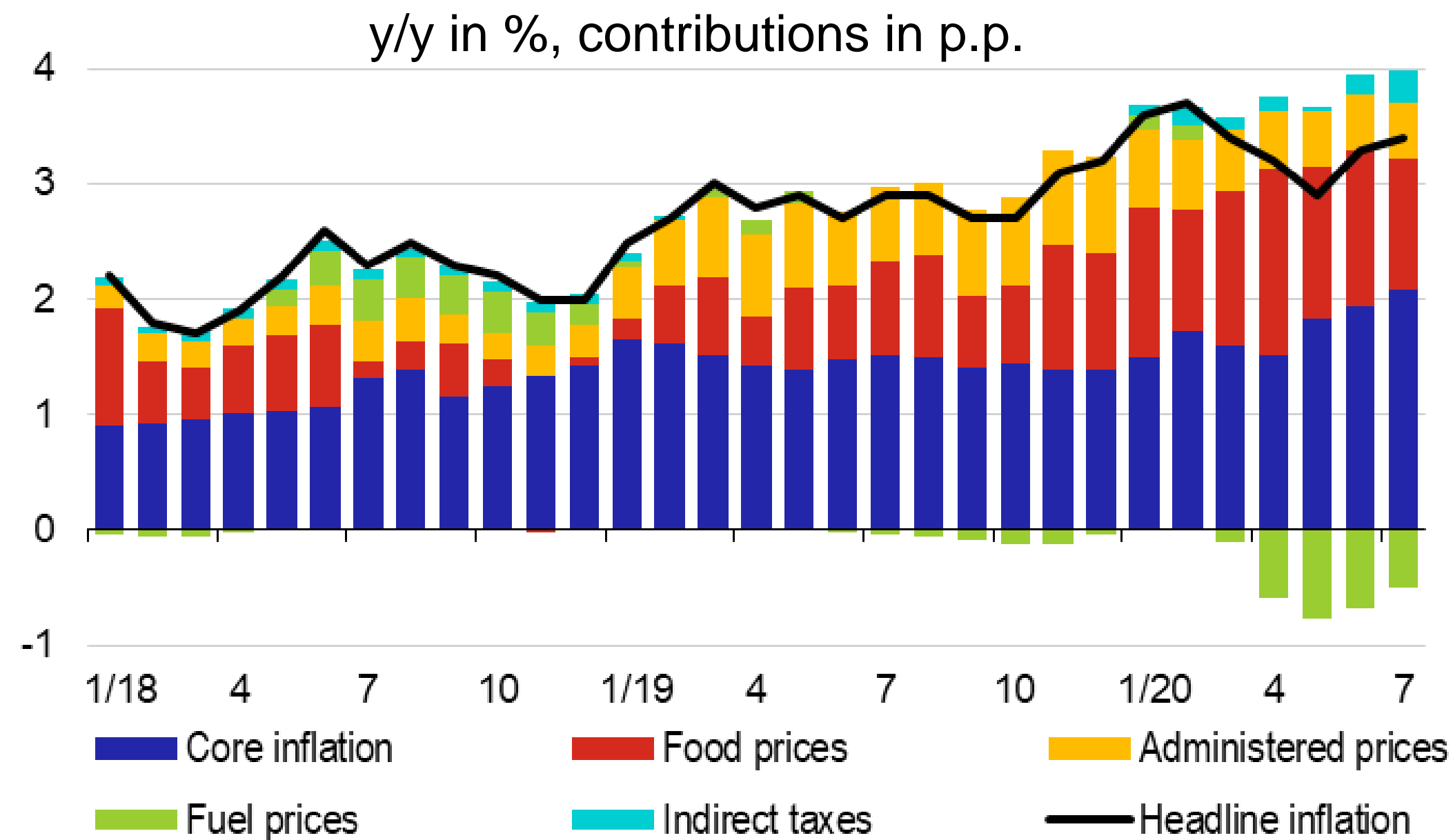
**Headline inflation** will stay **above the upper bound** of the tolerance band **for the rest of this year** and return close to the target next year.

**Firms' falling revenues and rising production costs will fuel inflation** this year, despite a deep decline in demand and overall economic activity.

**Inflation will fall** at the beginning of **2021** in line with lower growth in domestic costs, slightly appreciating koruna, and cooling of the domestic labor market.

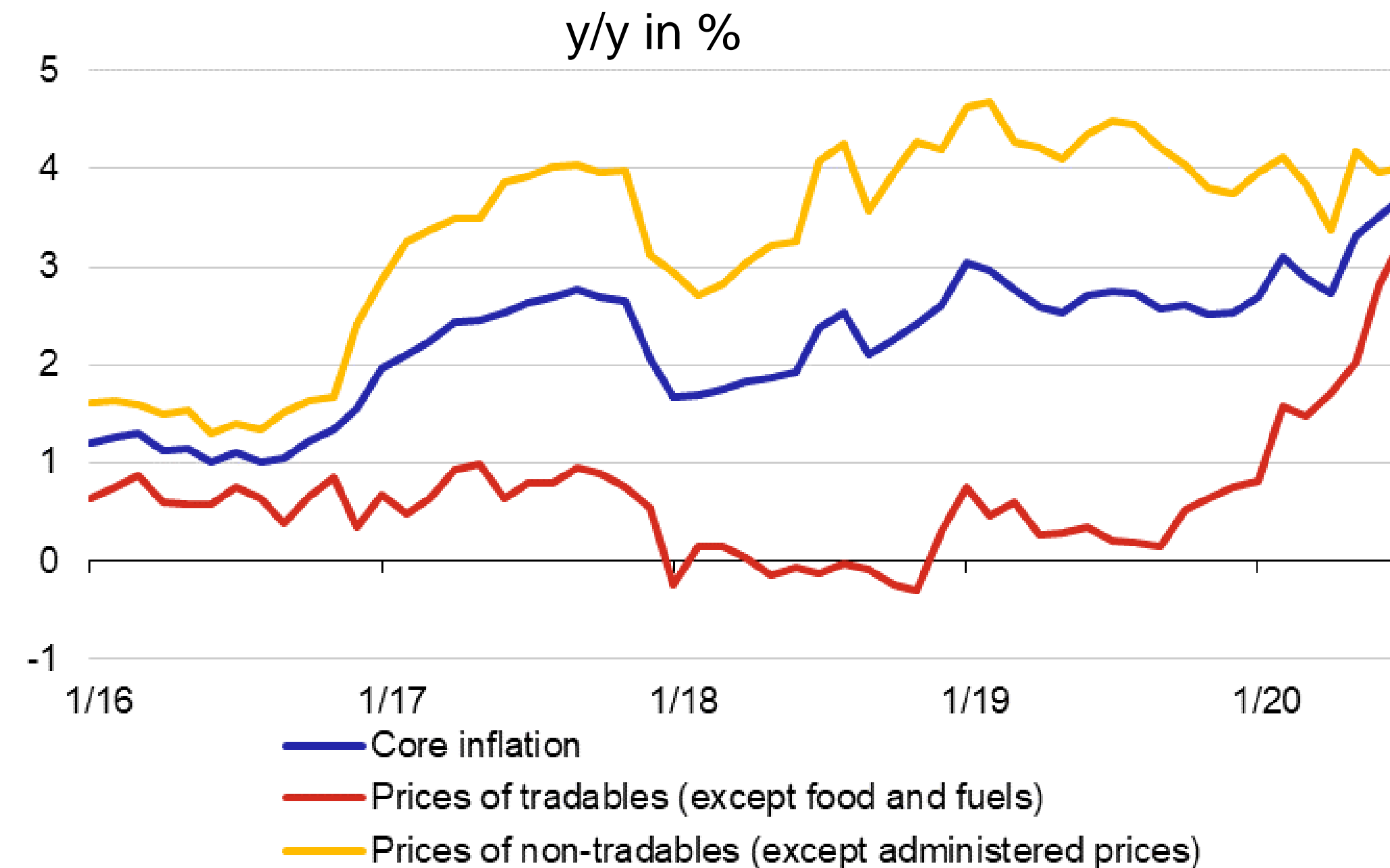
**In July headline inflation reached 3.4% y-o-y and was in line with the forecast.** Higher than forecasted core inflation, reflecting previously strong domestic demand and temporarily elevated corporate costs, was offset by lower food price growth.

## Structure of inflation



**Core inflation continues to contribute to high inflation** along with **food price inflation** which has probably peaked. By contrast, consumer price inflation was dampened by a significant **fall in fuel prices**.

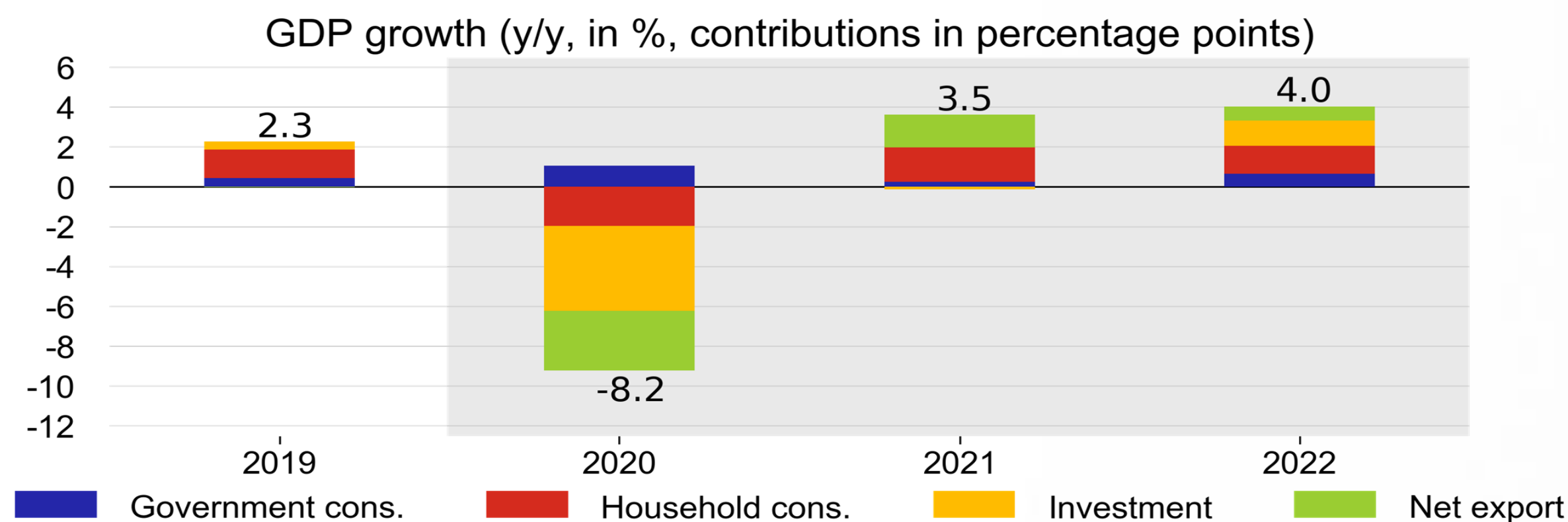
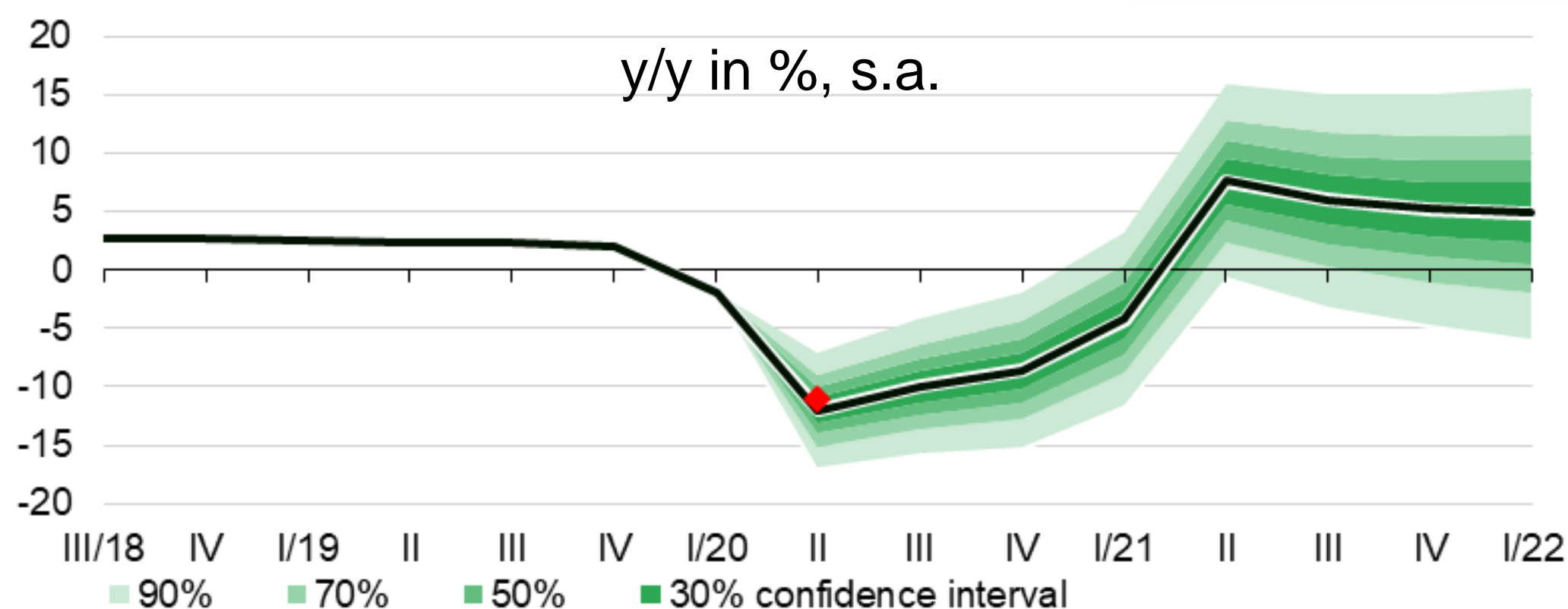
## Core inflation



**Rising tradable inflation** – mostly prices of used cars and household equipment given the weak koruna early this year. Continued buoyant price growth in restaurants has kept **non-tradable inflation high**. Moreover, the cut in VAT did not pass through to consumer prices of selected services.



## Real GDP Growth



**Domestic economic activity** will fall sharply this year given the coronavirus pandemic. Mainly **private investment** sharply declines, but also net exports and household consumption.

Conversely, **government measures** help reduce the negative impacts of the coronavirus pandemic this year.

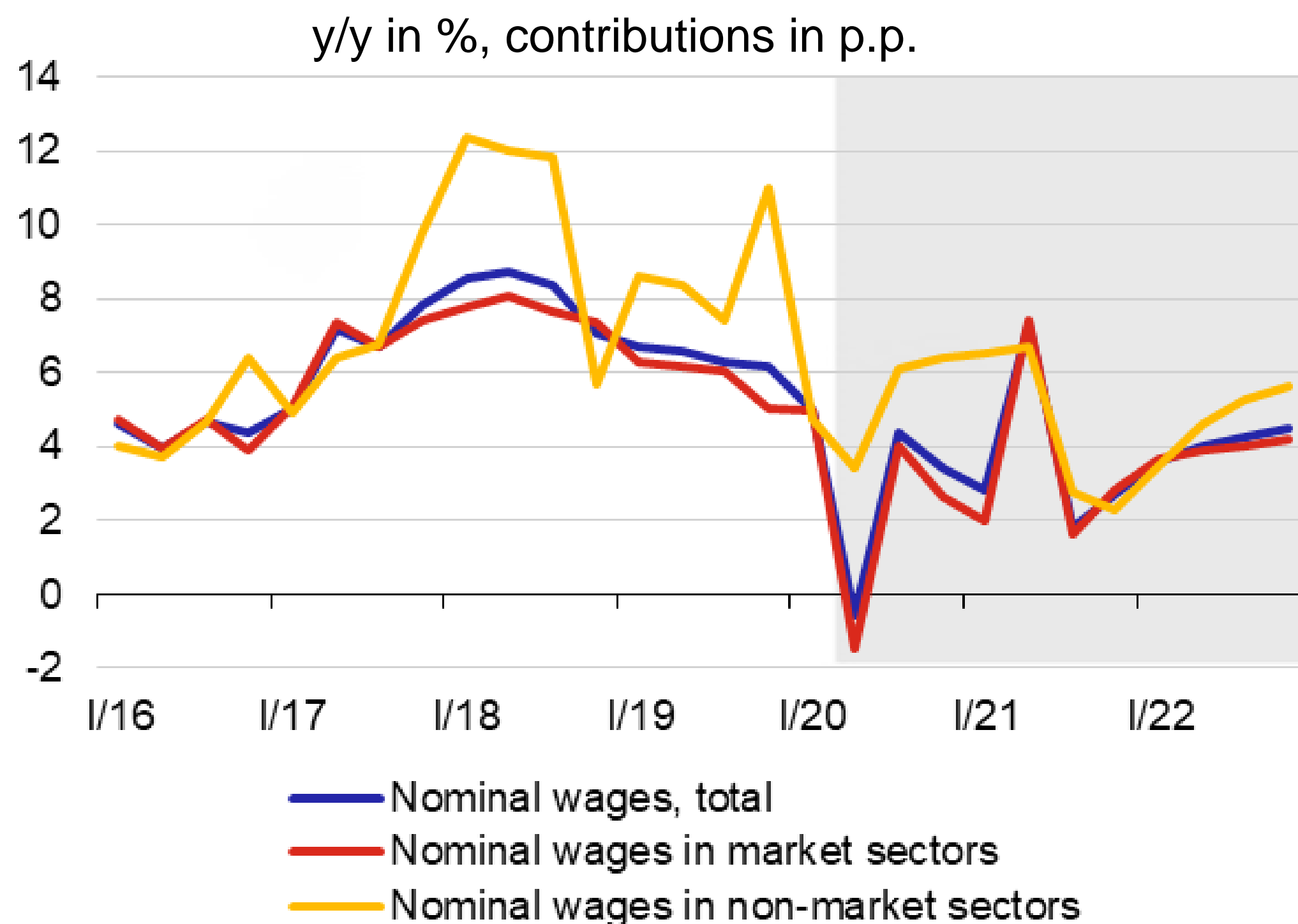
As a result, **GDP will drop by around 8% this year**. Economic growth will renew next year driven mainly by household consumption and net exports.

**GDP for Q2** broadly in line with our forecast: -11.0% y/y versus -12% in the forecast.

The forecast assumes that the potential **second wave of pandemic will not lead to wide-spread shut-downs** in economies.

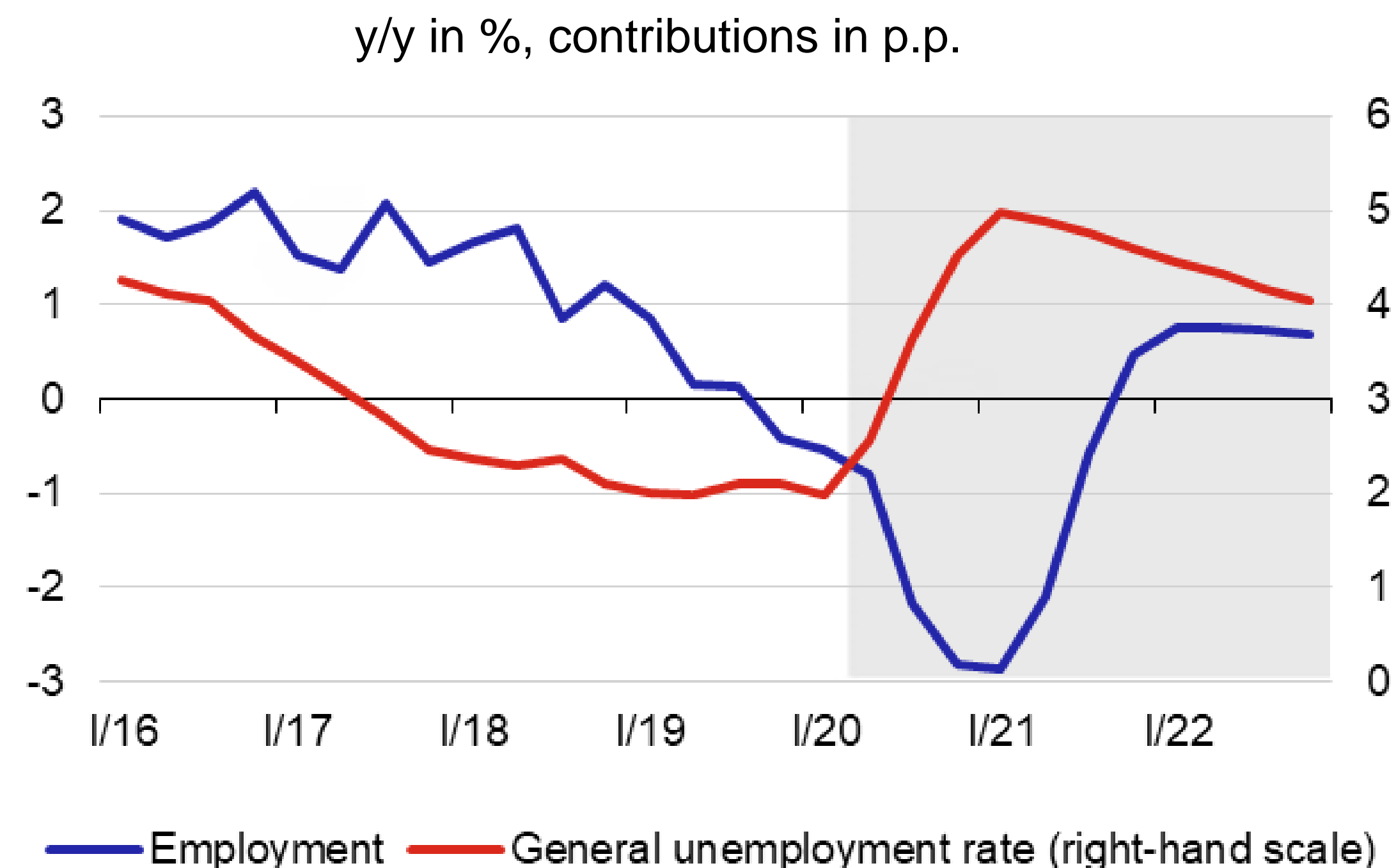


## Average nominal wages



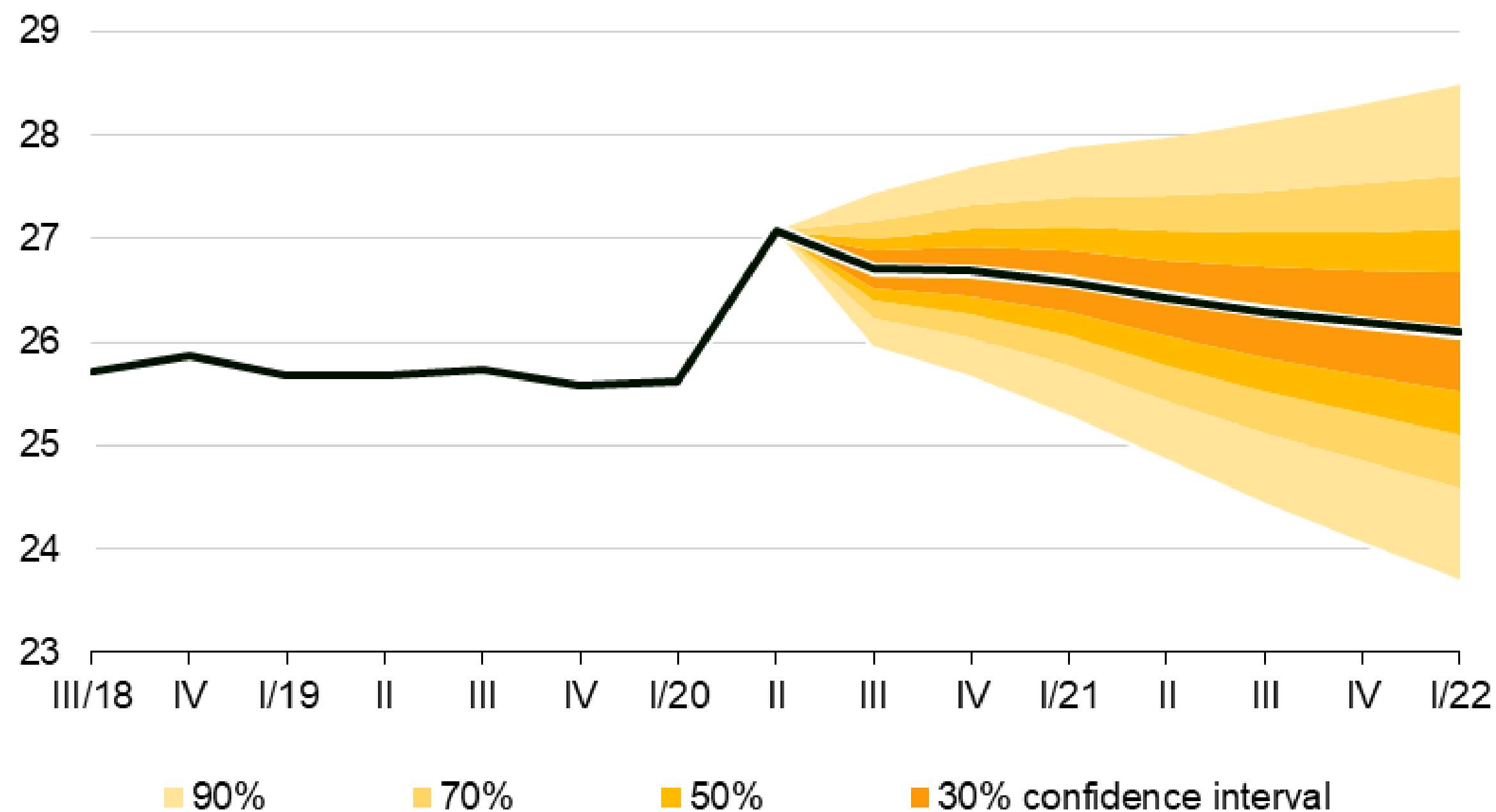
**Wage growth will slow** significantly in both market and non-market sectors this year. The one-off deceleration in Q2 (actual figure is +0,5% vs. -0.6% in the forecast) reflects quarantine measures.

## Labor market



**Total employment** will decrease this year and the next while the unemployment rate will increase markedly in the near future despite the government's employment protection measures.

## Exchange rate CZK/EUR

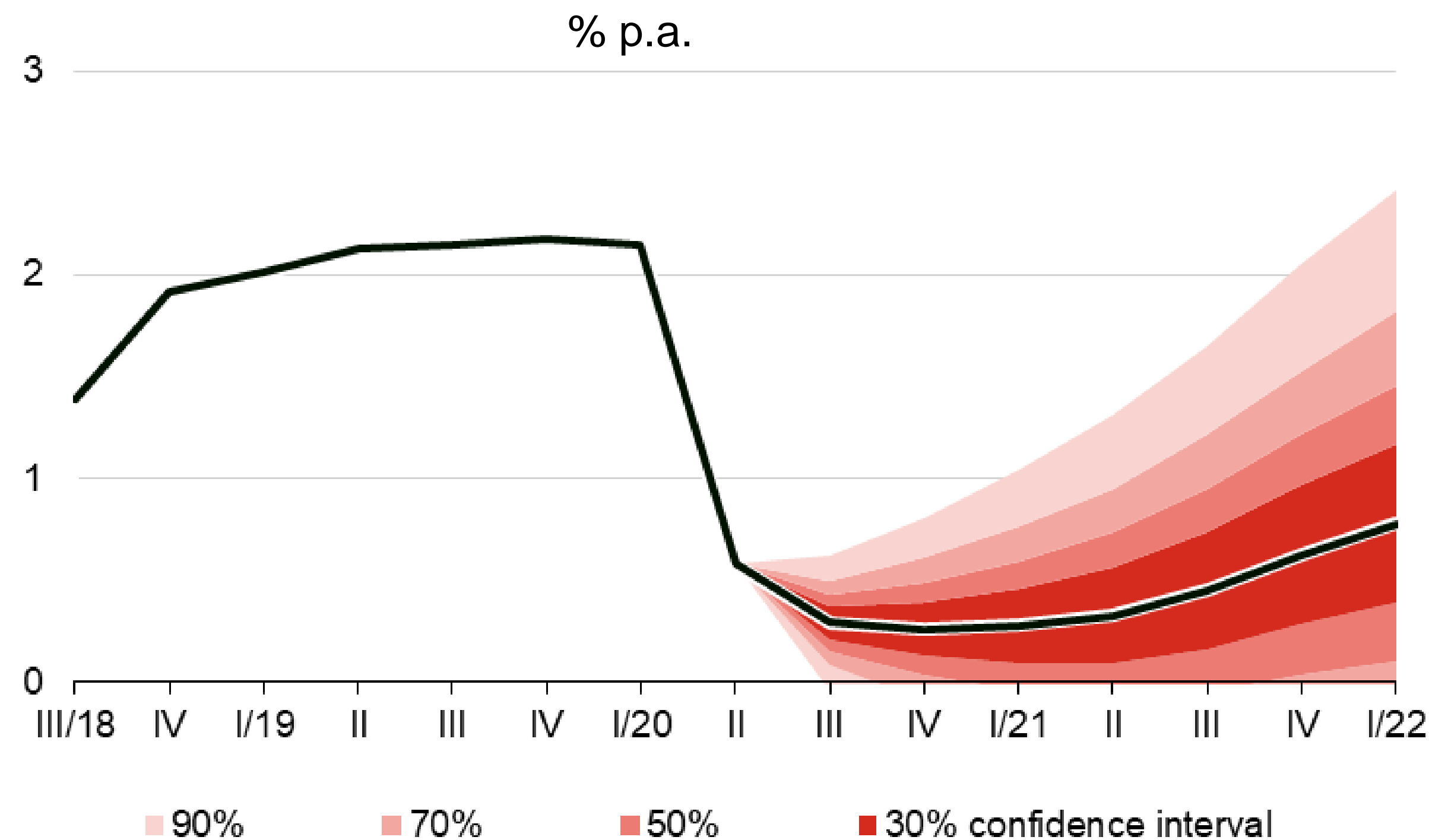


**The koruna** will gradually **appreciate** over the entire forecast horizon.

Depreciation of the koruna in the first half of this year mirrored worsening of the global sentiment. However, the trend has been reverted in May/June given successful measures fighting against the pandemic.

Further appreciation over the forecast horizon reflects renewed growth in external demand and domestic economic activity.

## Interest rate path (3M PRIBOR)



Consistent with the forecast is **stability of domestic market interest rates** until mid-2021, followed by a gradual rise in the rates.

The baseline forecast **does not indicate a need for unconventional policy measures**.

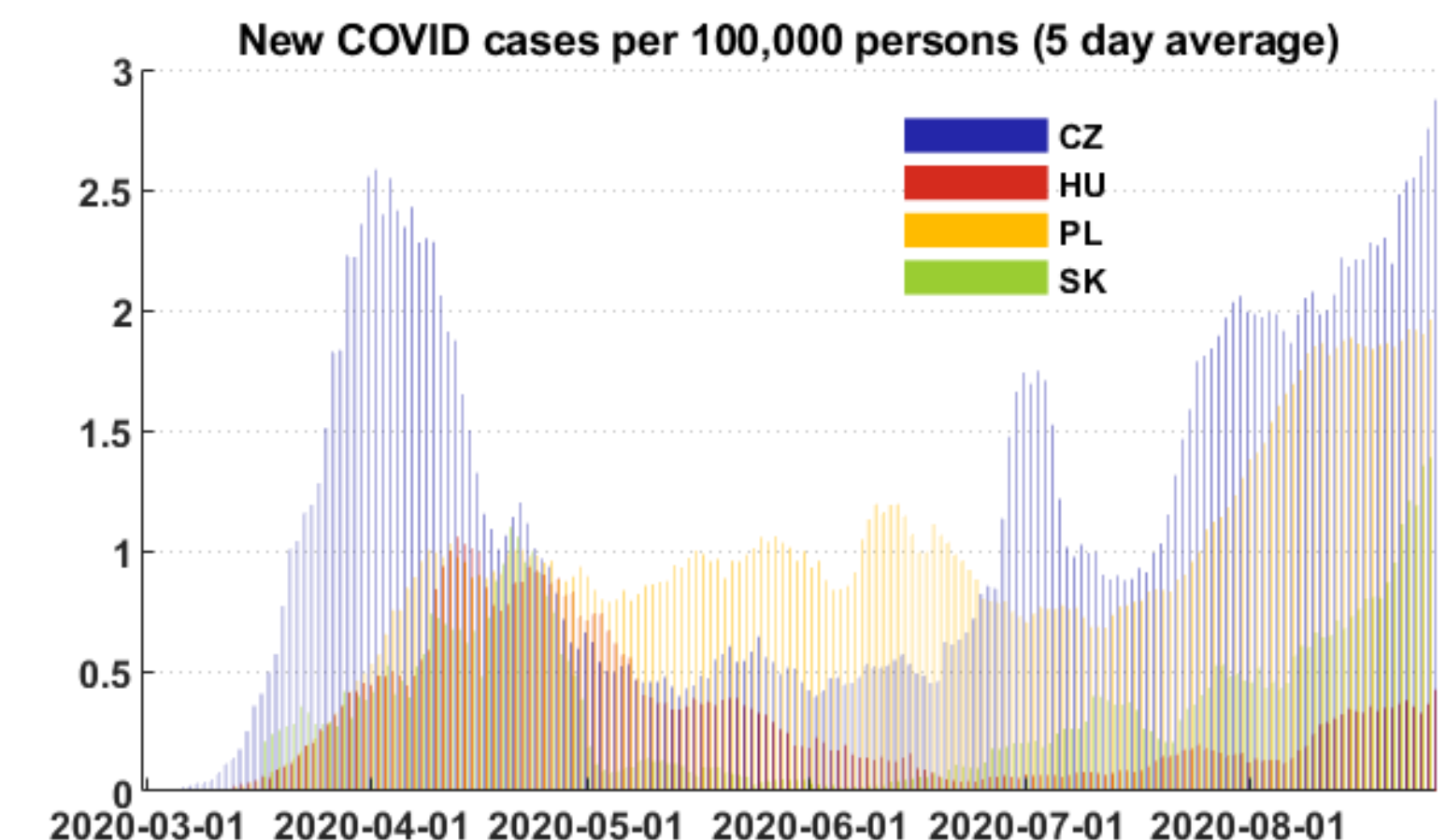
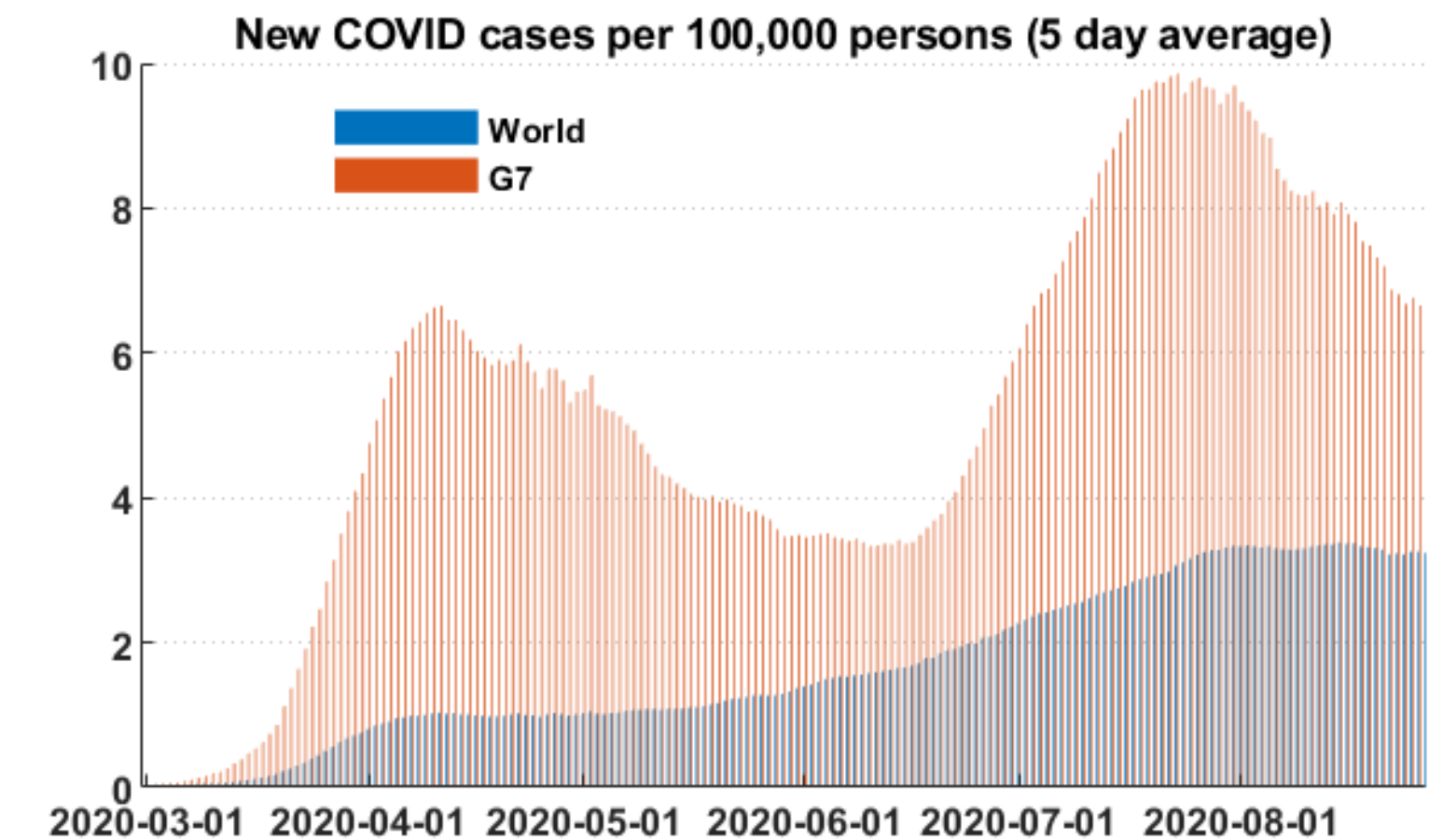
- Unconventional monetary policy measures are discussed only hypothetically as the choice depends highly on circumstances.
- Initial strong policy response helped mitigate the downside risks for price stability, making the need of using unconventional policy measures less likely.

## Risks and uncertainty of the forecast

The Bank Board assessed the risks to the forecast as being significant but not tilted in either direction overall.

### Risks and uncertainties:

- Course of the pandemic, and the duration and size of the impacts of the quarantine measures on the global and domestic economies
- Current evolution of the koruna exchange rate
- Fiscal policy support for the domestic economy
- Structure of the supply and demand factors underlying growth in domestic consumer prices





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Thank you for your attention

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