CZECH NATIONAL BANK

Macroeconomic Forecast and Monetary Policy of the CNB

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JP Morgan CEEMEA Opportunities Conference - Czech Republic Roundtable

January 14, 2021

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Macroeconomic Forecast and CNB’s Policy Decision

- **Current forecast** published on November 5, 2020.
- **CNB’s last policy decision meeting** on December 17, 2020.
- **New forecast along with monetary policy meeting** due on February 4, 2021.

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Monetary Policy Decision

At its meetings on November 5, 2020 and December 17, 2020, the CNB's Board unanimously kept 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%.

Consistent with the forecast is **stability of market interest rates initially, followed by a gradual rise in rates in the course of 2021.**

The Bank Board assessed **the risks and uncertainties of the forecast in the context of the ongoing second wave of the pandemic as remaining very substantial.**

0.25% 2W repo rate

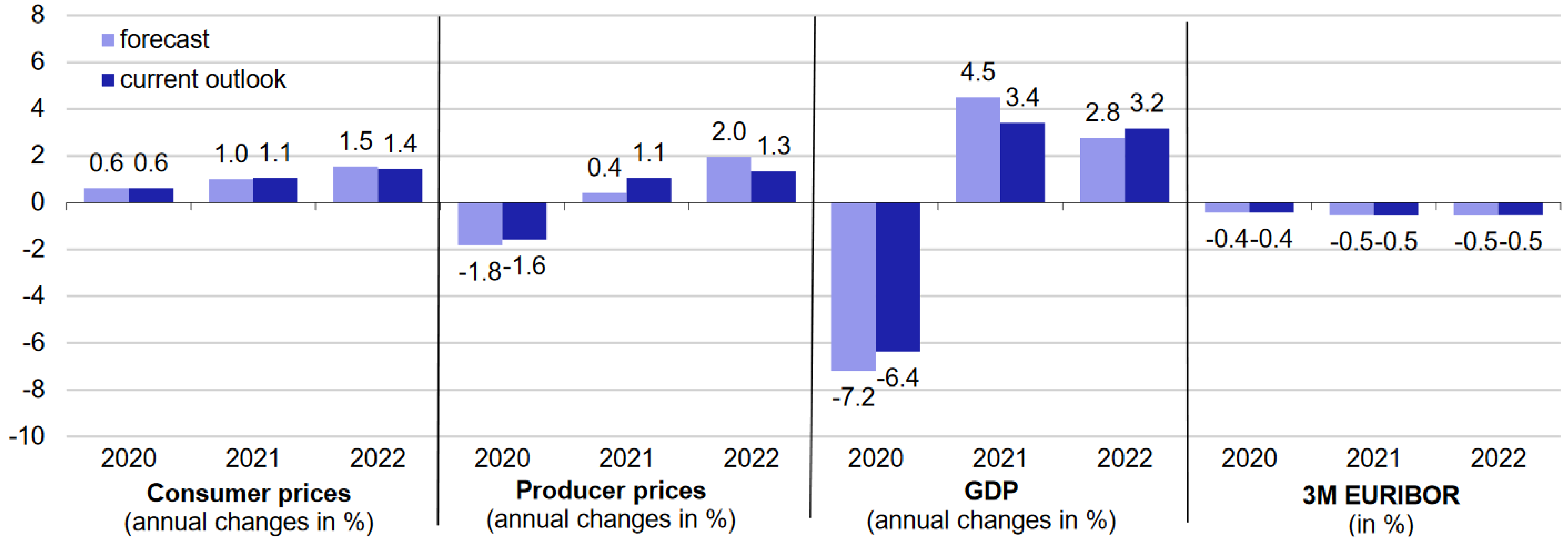
0.05% discount rate

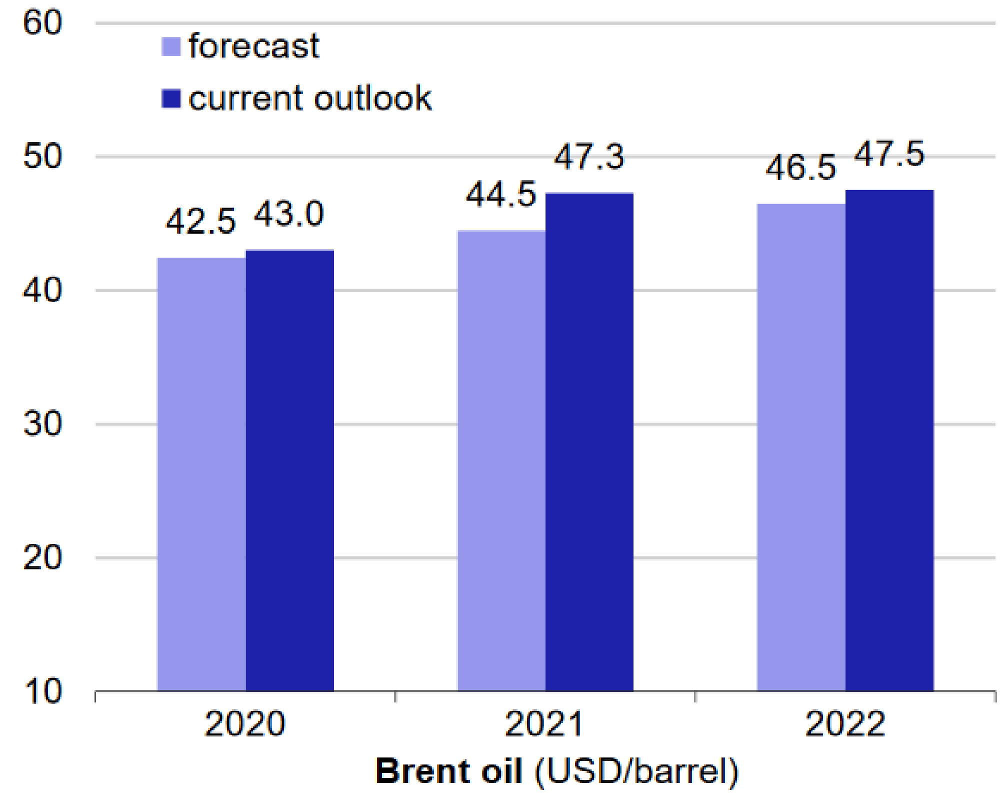
1.00% Lombard rate

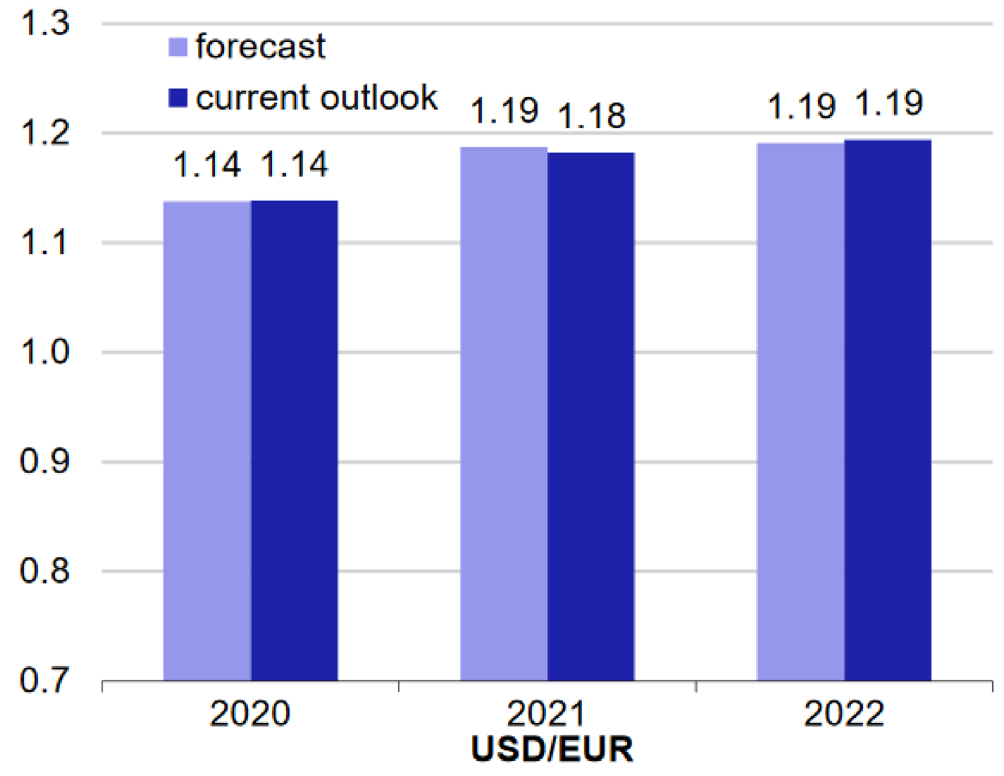
FOR NO CHANGE

Current Forecast – External Assumptions

External Assumptions







Current forecast

- The **effective euro area** is assumed to have declined by more than 7% last year and to grow by about 5% this year.
- Foreign **PPI** declined last year on the back of low energy prices; it will rise again as this effect fades out and the currently subdued core component picks up.
- The **3M EURIBOR** will remain negative over the entire forecast horizon.

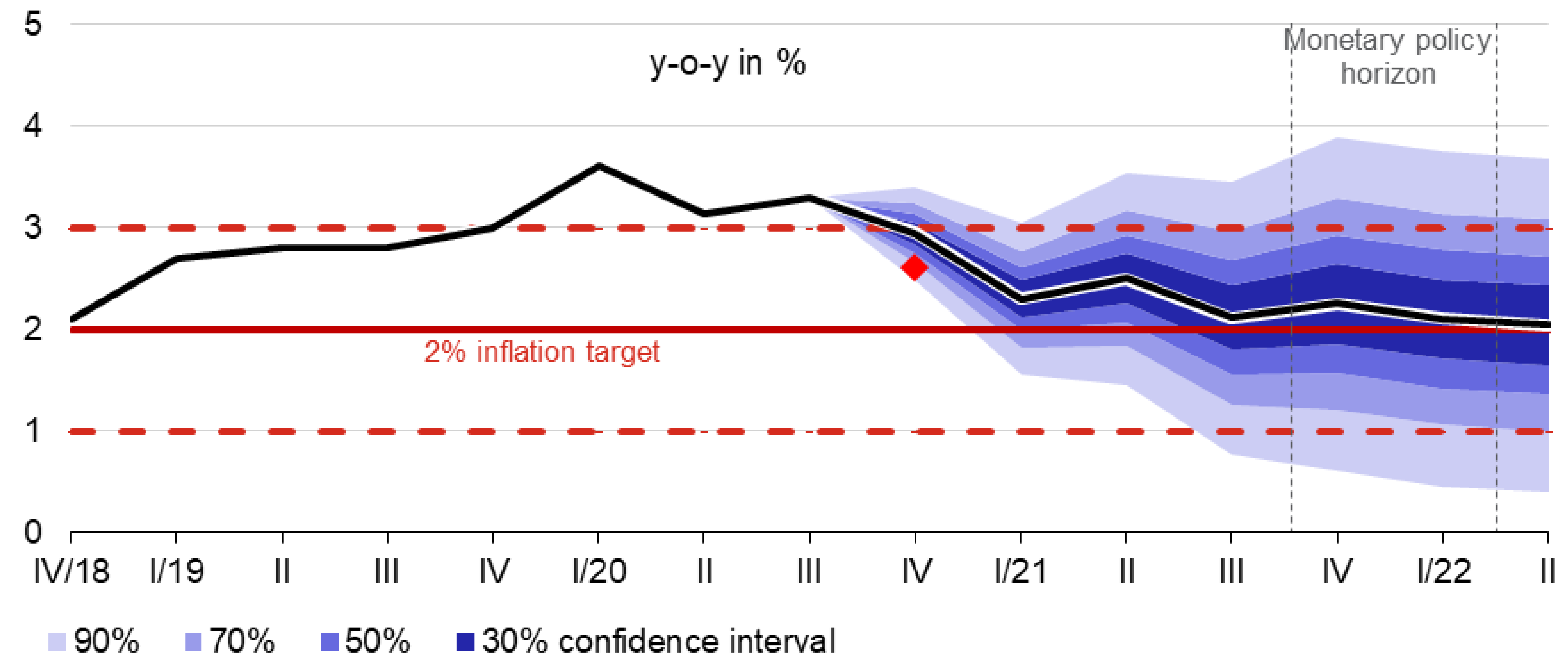
Recent update

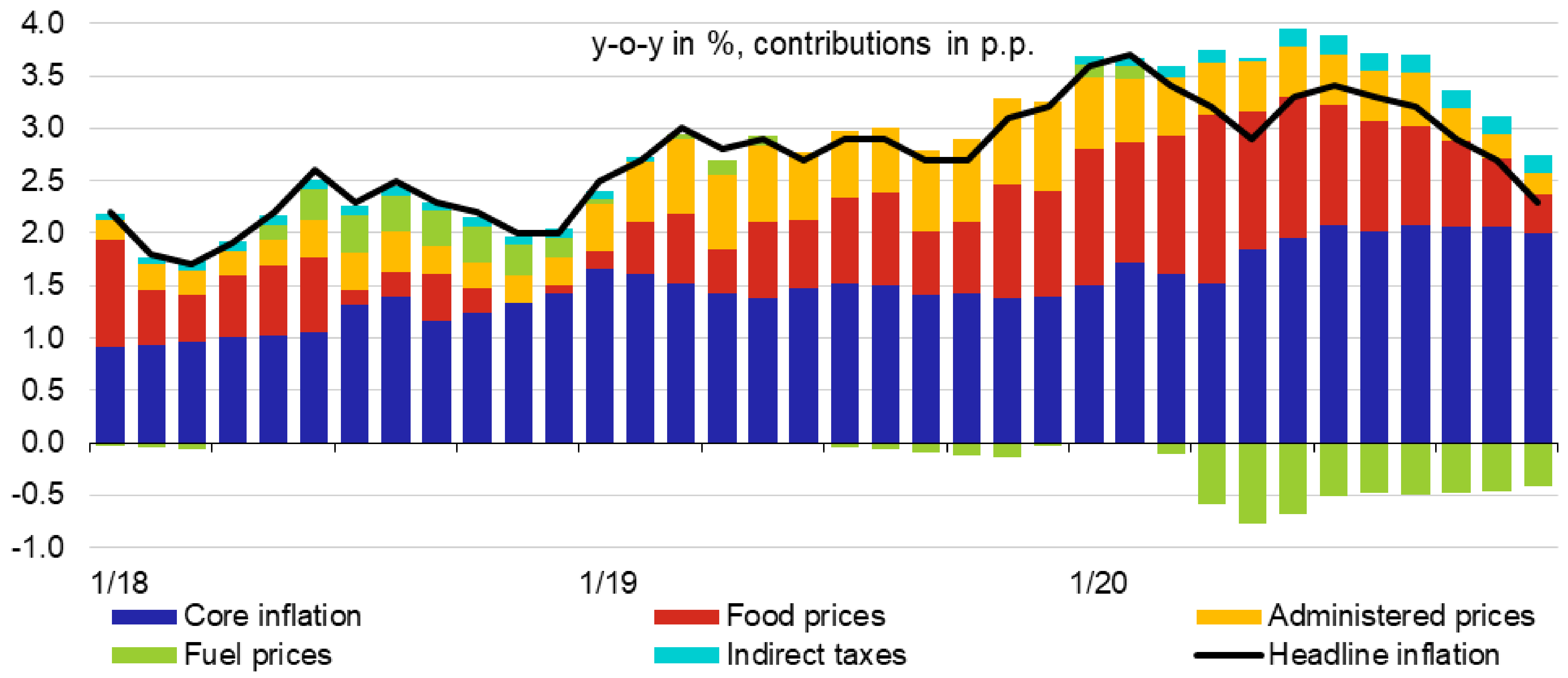
- The drop in economic activity in the effective euro area last year is estimated to have been marginally less deep than expected. However, growth will be renewed at a lower pace.
- The outlook for foreign PPI has been increased this year on the back of its lower decline last year and an increase in world oil prices at the end of last year.

Current Forecast – Domestic Variables

14 January 2021

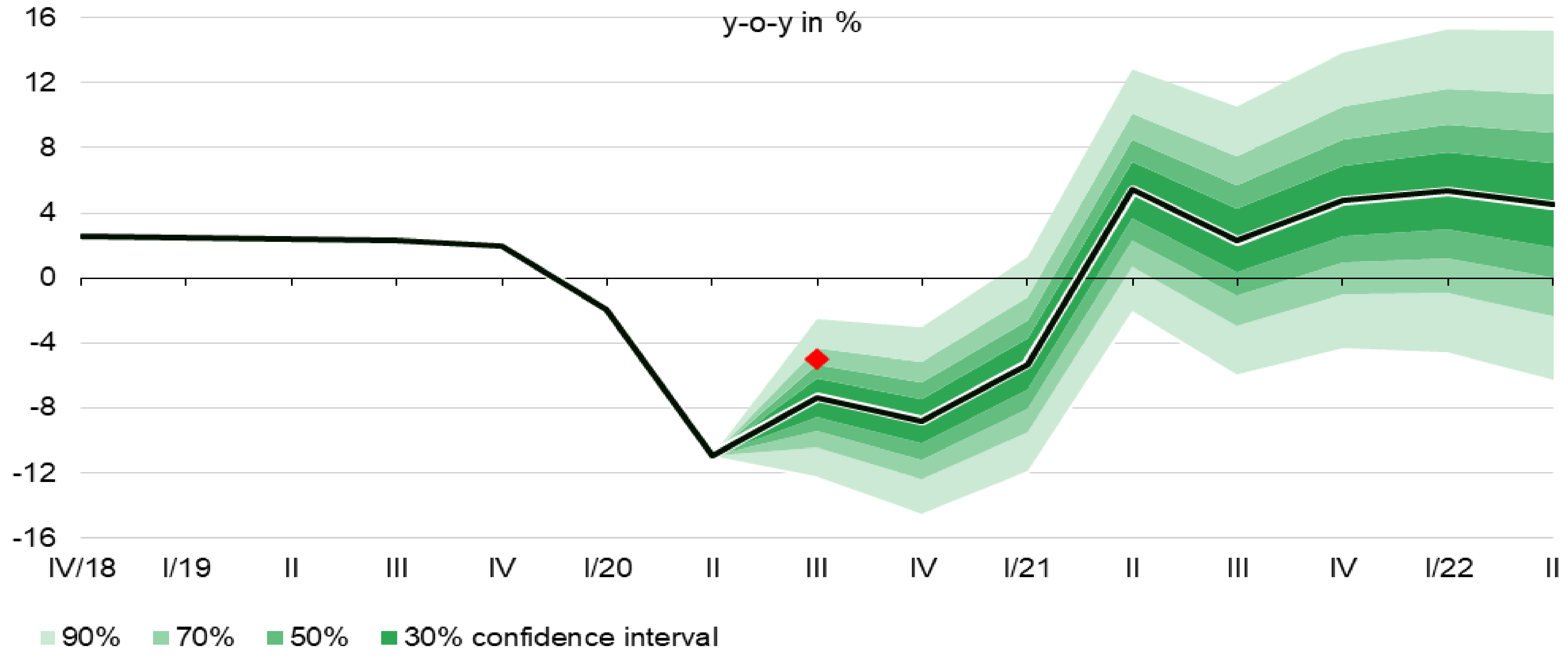
Headline Inflation Forecast

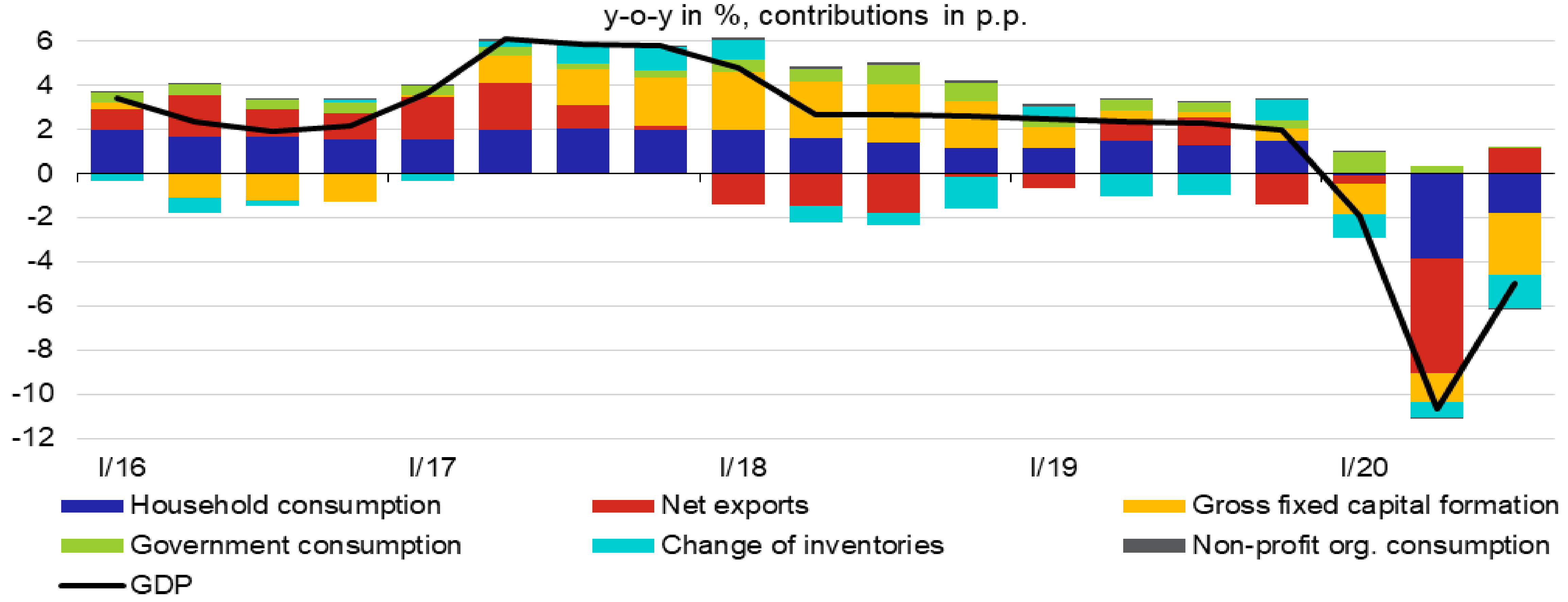




- **Headline inflation** will decrease close to the target early this year, as the second wave of the pandemic will bring deflationary demand pressures.
- In particular, a reduction in **core inflation and food price growth** will contribute to the return of headline inflation close to the target over the next year.
- Inflation reached 2.6% in 2020Q4, 0.3 pp below the November forecast, mainly due to lower food prices and core inflation.
- **Core inflation remained elevated** at the end of 2020 but did not accelerate further. Core inflation was slightly below the current forecast.
- The recent high growth in **food prices slowed** in 2020. The slowdown was slightly faster than forecasted.

Real GDP Forecast





GDP growth will recover this year and accelerate slightly further next year. However, the economy will not reach its pre-crisis level even by the end of 2022.

The renewed economic growth (by less than 2%) will be driven mainly by **household consumption and net exports**.

The depth of the **decline in 2020Q3 was smaller** than expected, reaching -5% compared to -7.4% in the November 2020 forecast.

- **Exports** were supported by a stronger recovery in external demand. **Imports** meanwhile lagged behind exports, owing partly to an unexpectedly deep downturn in domestic private investment, which is highly import-intensive.

- The **household consumption** forecast broadly materialized. By contrast, **government consumption** growth surprisingly halted.

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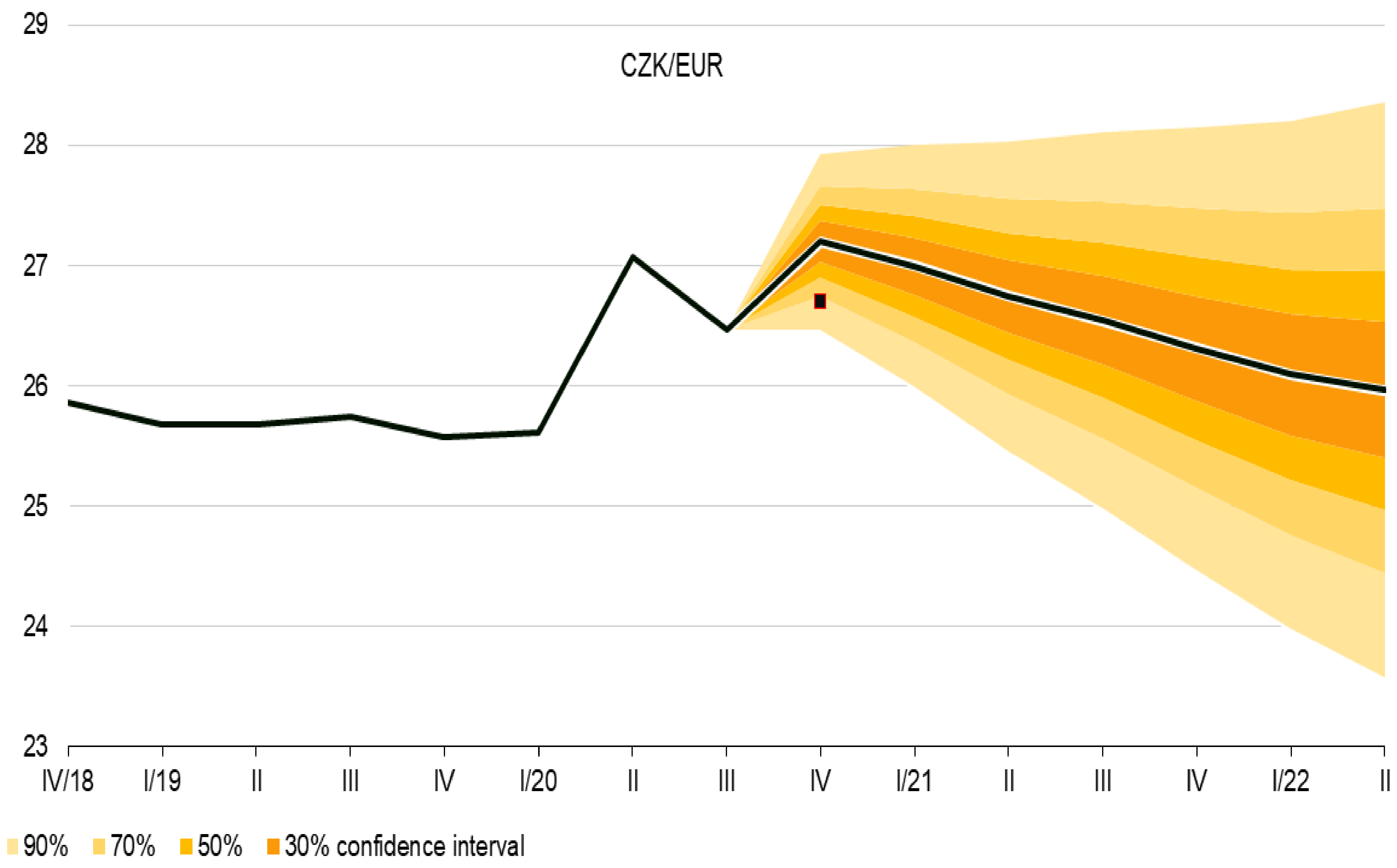
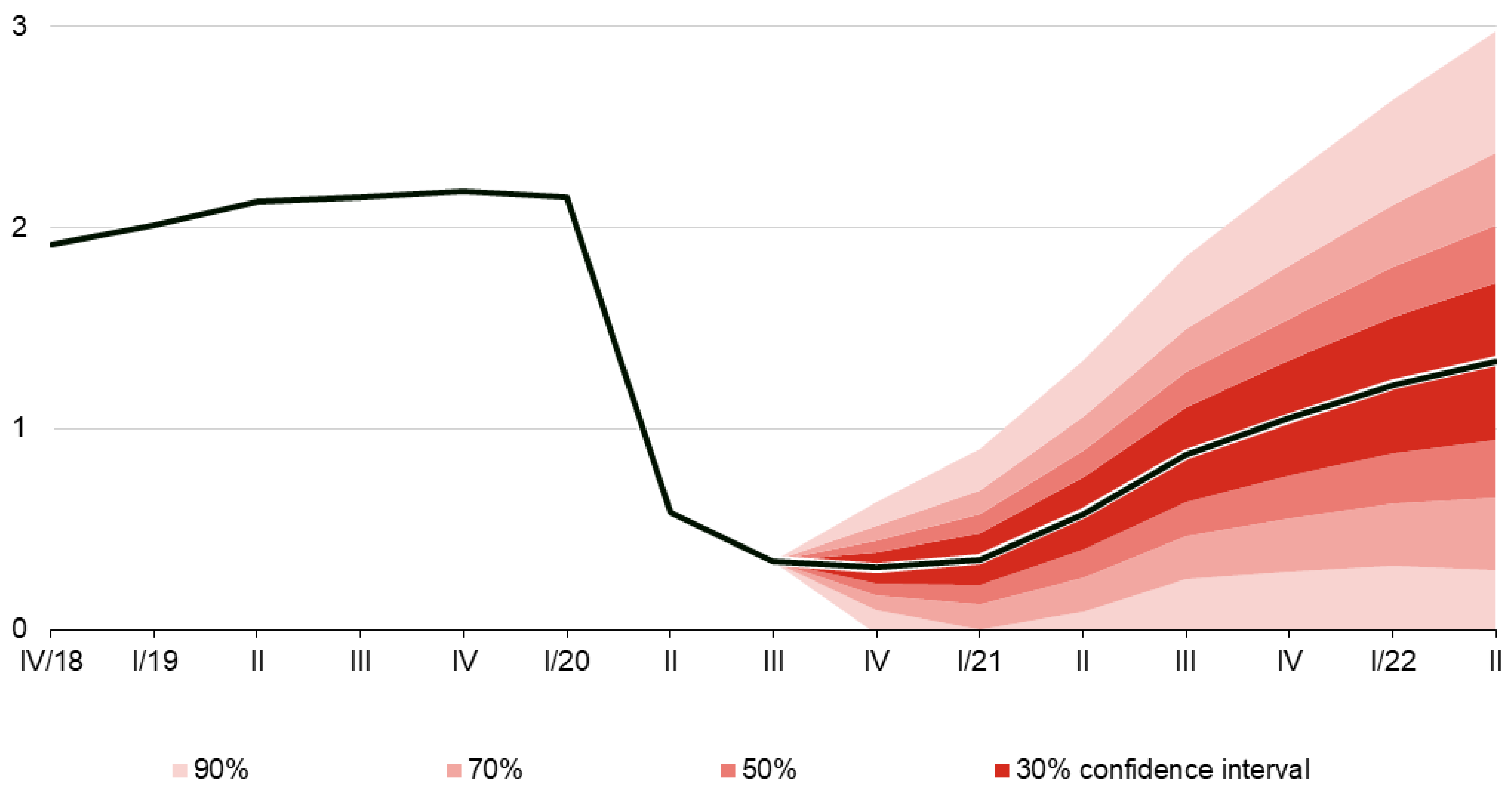
Koruna Exchange Rate



- The current forecast assumes a return to a gradual strengthening of the **nominal exchange rate**.
- **The koruna will strengthen** on the back of a positive interest rate differential in the context of a gradual recovery in foreign and domestic demand.
- The strengthening exchange rate of **the koruna will contribute to the return of inflation** to the 2% target over the next year.
- The average **exchange rate in 2020Q4** was 26.7 CZK/EUR, which is about 50 hellers lower than assumed in the forecast.
- So far in 2021Q1, the koruna has hovered around 26.2 CZK/EUR, compared to 27 CZK/EUR assumed in the forecast.

Interest Rate Path (3M PRIBOR)



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

- The expected fading of the negative effects of the second wave of the pandemic in the coming quarters, inflation stabilizing subsequently close to the target, and a continued return of domestic and foreign economic activity towards pre-crisis levels will then allow for a gradual increase later this year.

- This interest rate path is conditional on assumptions about the course of the epidemic situation and the anti-pandemic measures.

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Risks and uncertainties

- **The Bank Board assessed the risks and uncertainties** of the current forecast in the context of the ongoing second wave of the pandemic **as remaining very substantial.**
    - The risk of easier fiscal policy this year is materializing, given the approved tax package.
    - The risk of a worse course of the pandemic is not materializing fully so far, but a deterioration of the situation cannot be ruled out given recent developments.
    - The structure of supply and demand factors at home and abroad and their impact on inflation remains a general uncertainty of the forecast.

In light of these significant uncertainties, the Bank Board considered it likely (at its November meeting) that interest rates will be left at a low level for longer than assumed in the baseline scenario of the forecast.

Two sensitivity scenarios in the current forecast: (i) worse pandemic and (ii) less restrictive fiscal in 2021

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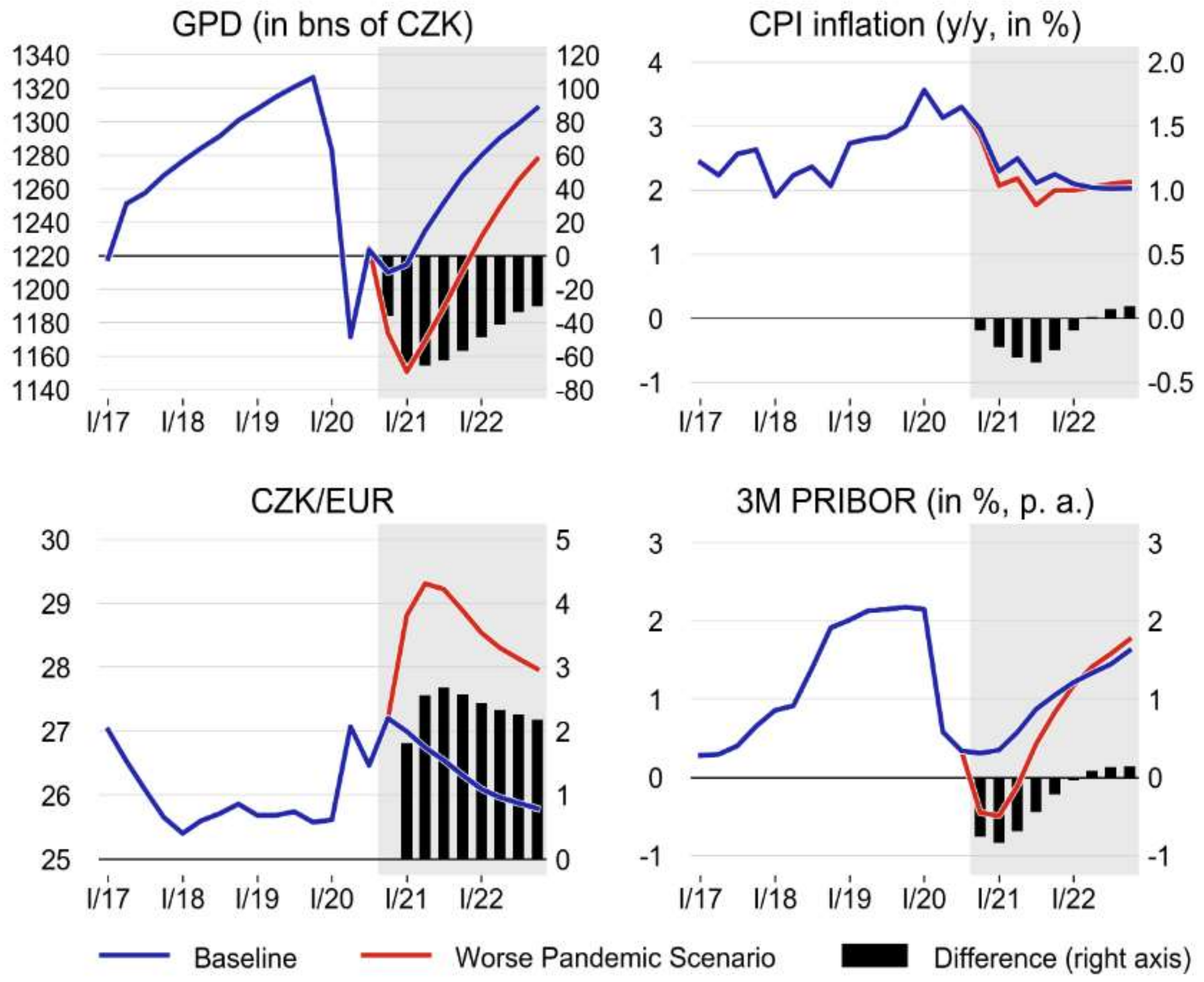
Worse Pandemic Scenario: Domestic Developments



- **Economic activity in the effective euro area is markedly lower** in this scenario, causing stronger deflationary pressures. The ECB responds by easing further.

- **Domestic activity** weakens due to deteriorating net exports and lower private investment activity. The longer-lasting second wave and period of high uncertainty would also lead to **lower household consumption** and to a more pronounced cooling of the labor market.

- Temporarily highly subdued demand would feed into **lower inflation** than in the baseline.

- A significantly **weaker exchange rate** and further easing of monetary policy would support the gradual recovery of economic activity and the subsequent stabilization of inflation at the target.

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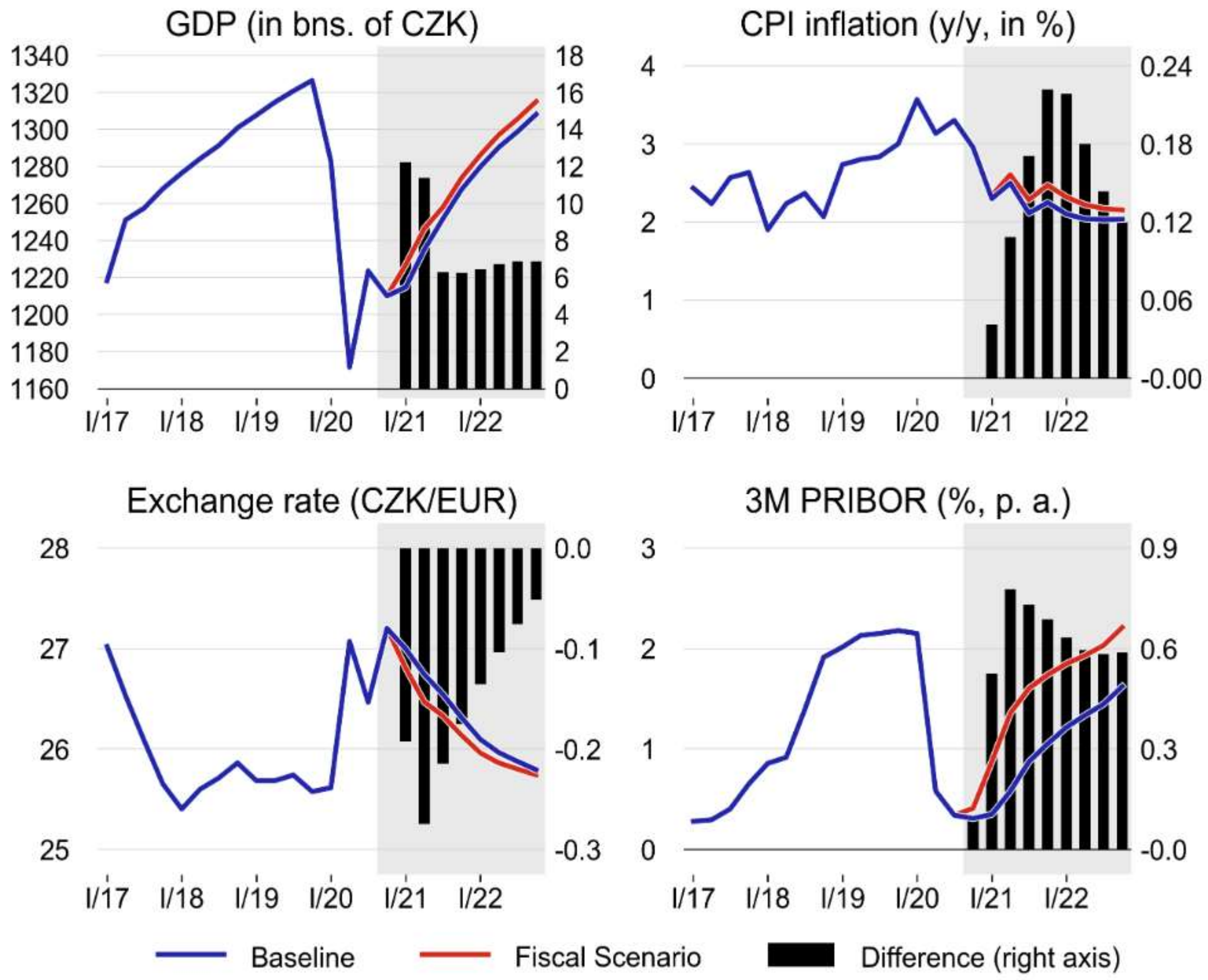
Fiscal Scenario: Neutral Fiscal Impulse in 2021



- The scenario assumes **a neutral fiscal stance** in 2021, mainly through measures supporting private consumption:
    - The abolition of the super-gross wage and a 15% personal income tax rate for two years,
    - An increase in the minimum living level and minimum subsistence level, and child allowances,
    - Further support for self-employed persons and employers with a small number of employees,
    - A VAT reduction for selected services affected by the government measures in the second wave of the pandemic, and a faster start to NGEU drawdown.

- The additional fiscal measures compared to the baseline scenario will lead to **faster GDP growth** this year and to **stronger domestic inflationary pressures**.

Thank you for your attention

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