Czech Economic Developments

Monetary Policy Perspective

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European Economics and Financial Centre, online seminar

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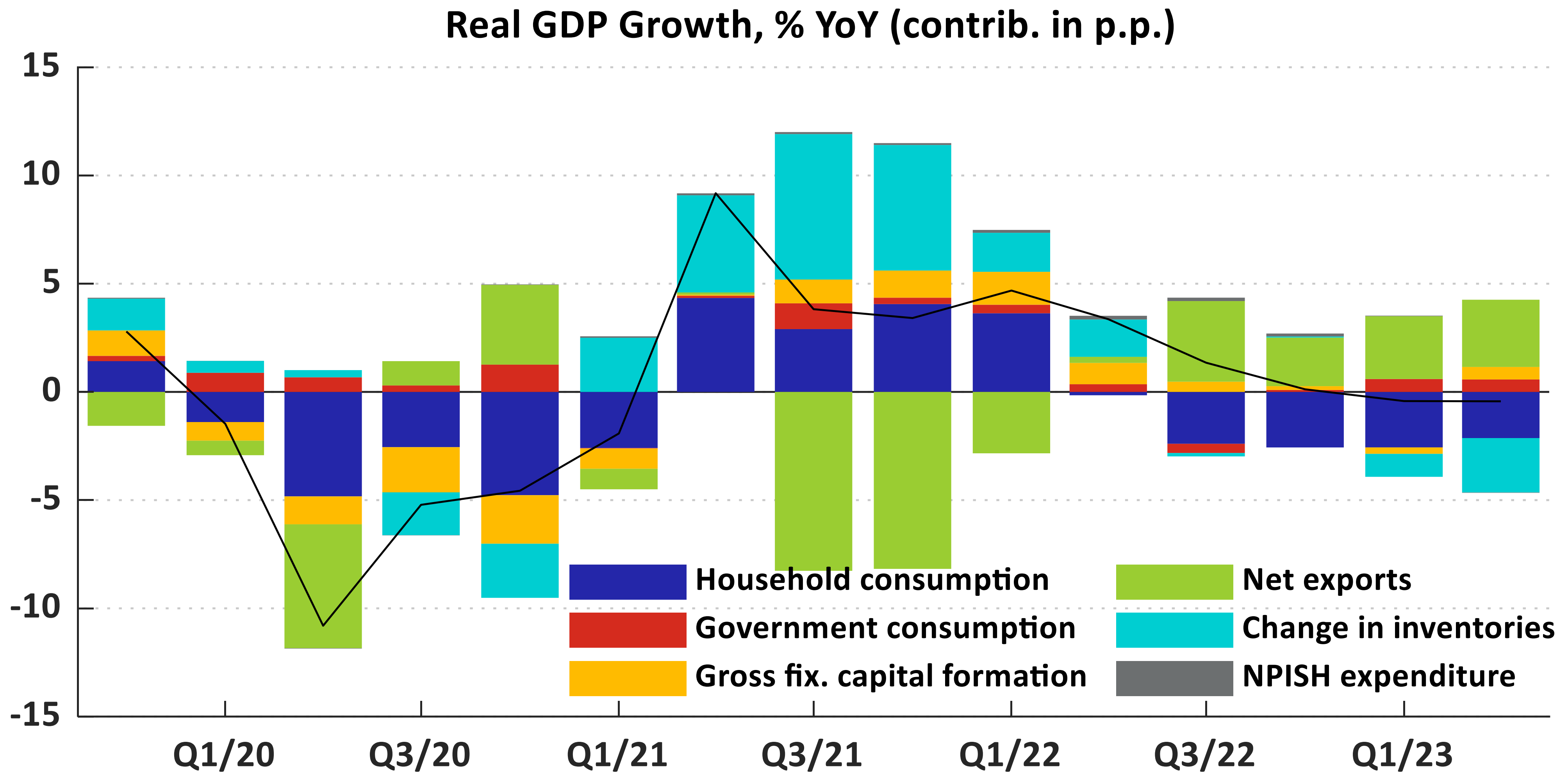
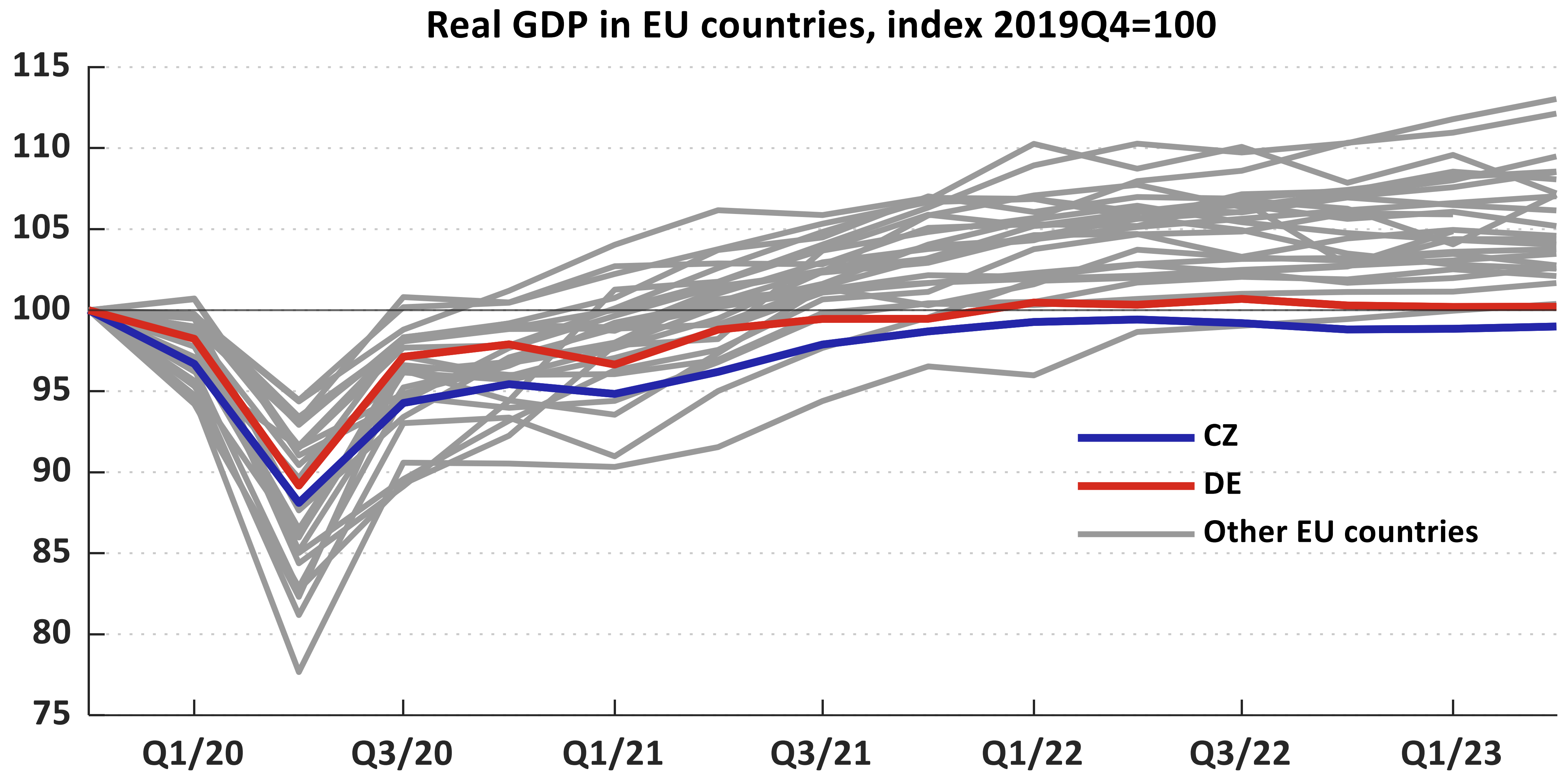
Real Economic Developments





Source: CZSO and Eurostat

A **mild recession** experienced in the first half of this year was driven by declining household consumption, which was only partly offset by net exports benefiting from a recovery in foreign demand and improved supply chains.

Declining **household consumption** reflected mainly a drop in real wages and worsening sentiment on the back of tight monetary policy (high households' savings rate).

Compared to most other EU countries, **Czech real GDP** has not reached the pre-Covid level yet. Similarly, Germany has been struggling with low real GDP and industrial production growth.

External developments pose a downside risk to the expected economic recovery.

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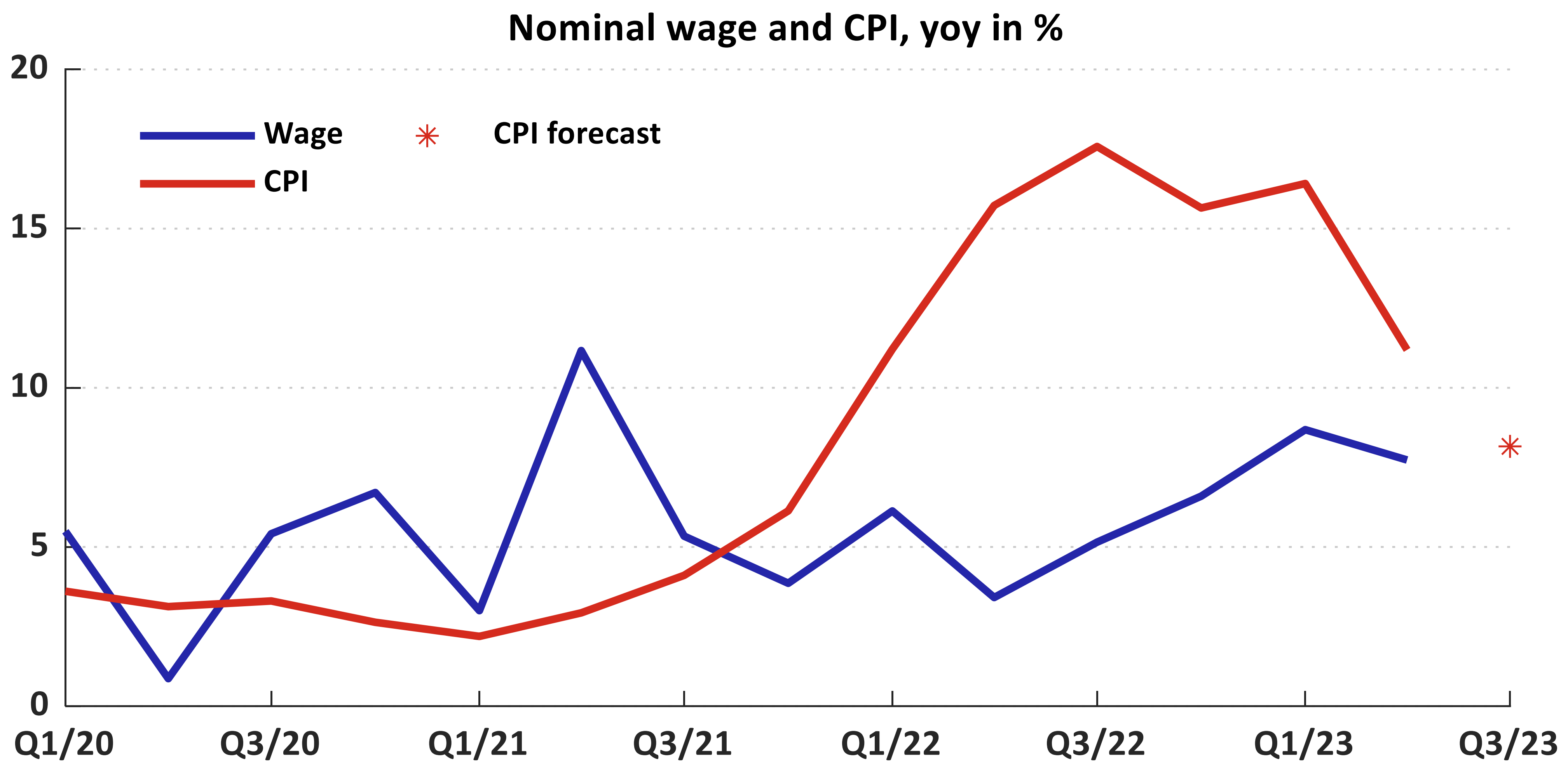
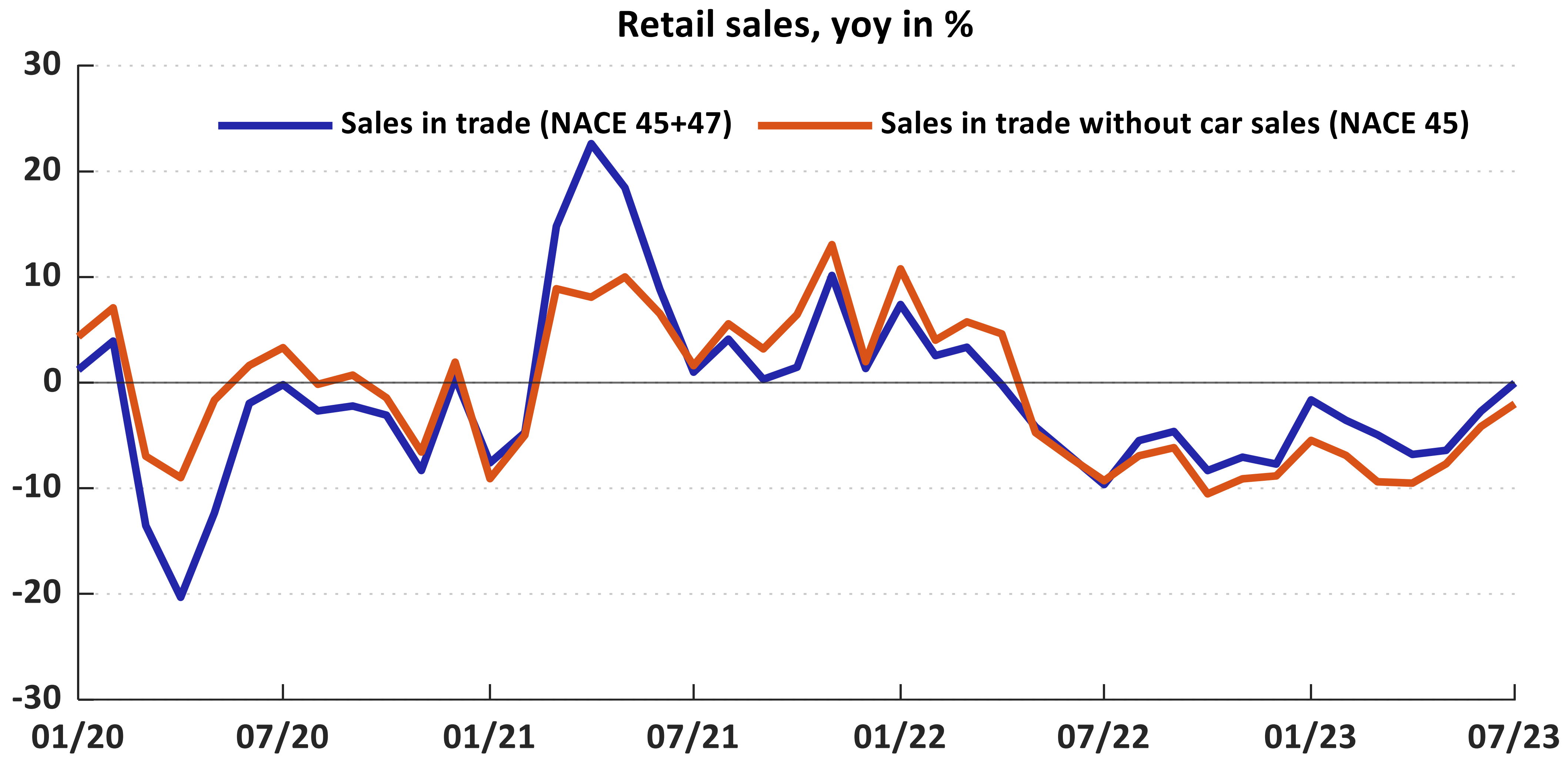
Real Economic Developments (cont.)



Note: CPI forecast for 2023 Q3 uses actual data for July and August along with the CNB's Summer 2023 inflation forecast for September.



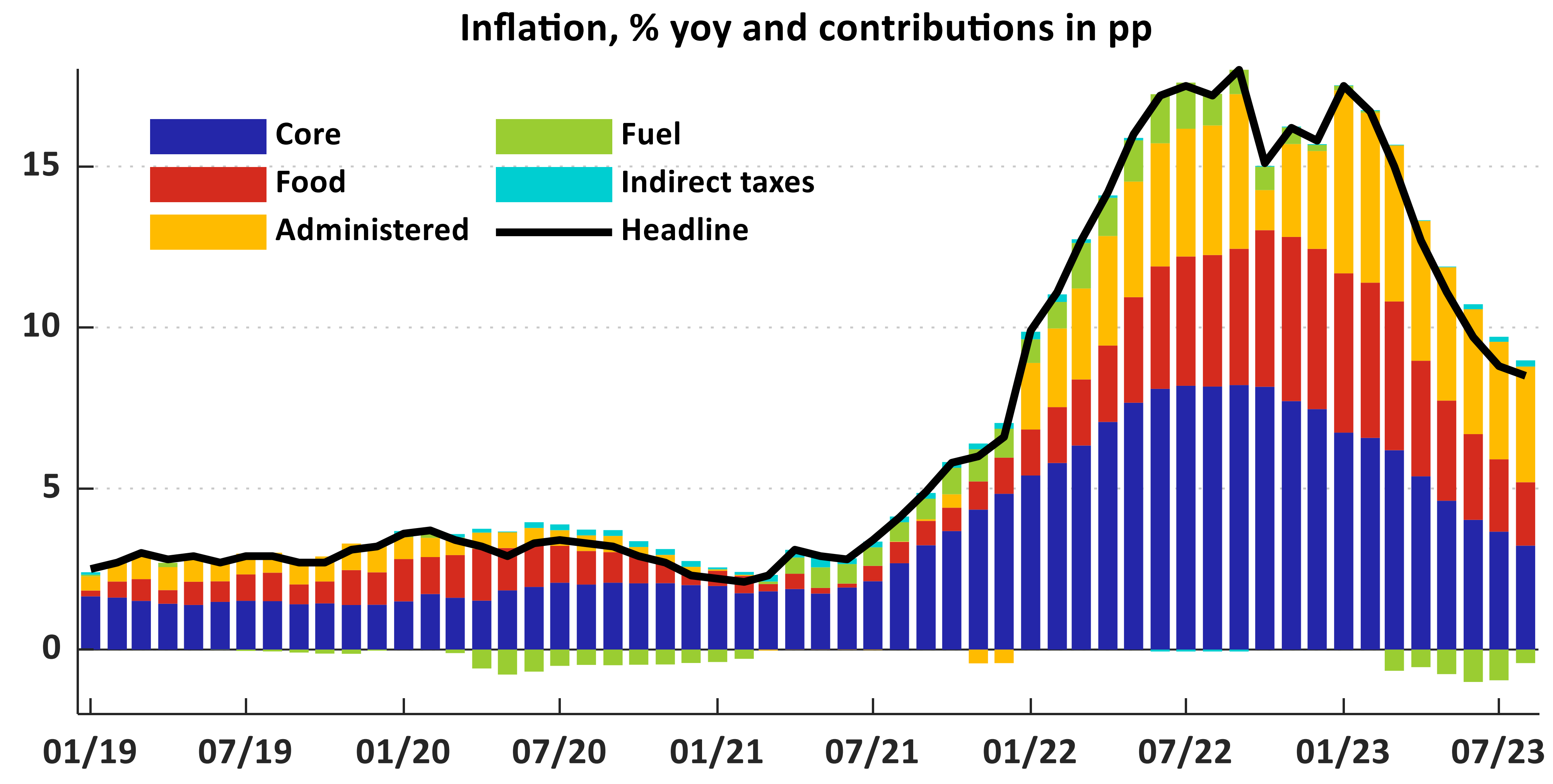
Source: CZSO

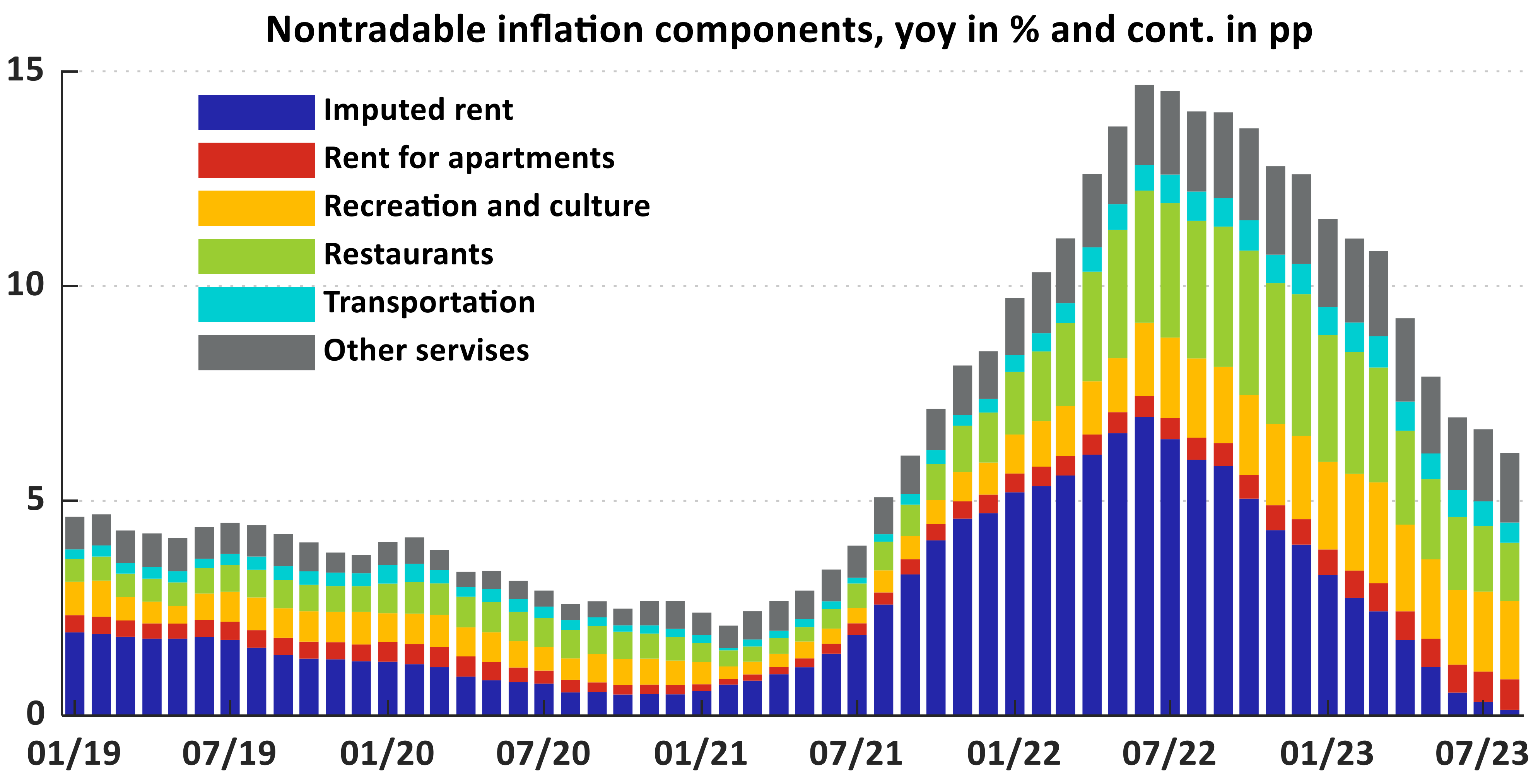
Wage growth speeded up early this year, but stayed in single digits despite a tight labour market and strong profitability of enterprises. Risks of a wage-price spiral, and related persistence of inflation, are still present but declining.

Real wages are expected to renew their growth at the end of this year, lifting **household consumption**.

Retail sales are returning to last year's levels, indicating a recovery in household consumption in the rest of this year.

Inflation





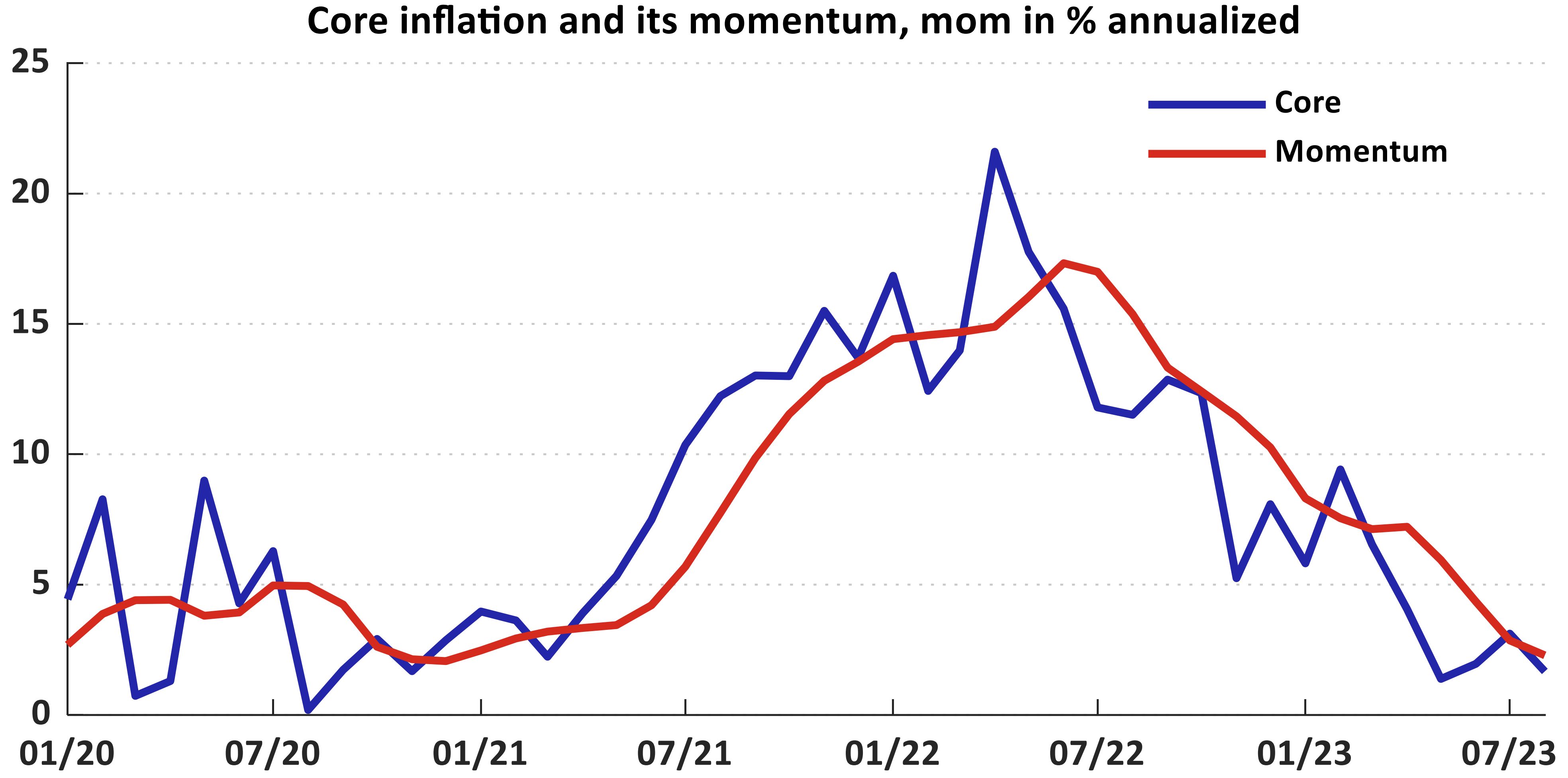
Source: CZSO and CNB computations

Headline inflation continues to slow, reaching 8.5% in August, which is in line with the CNB's summer 2023 forecast.

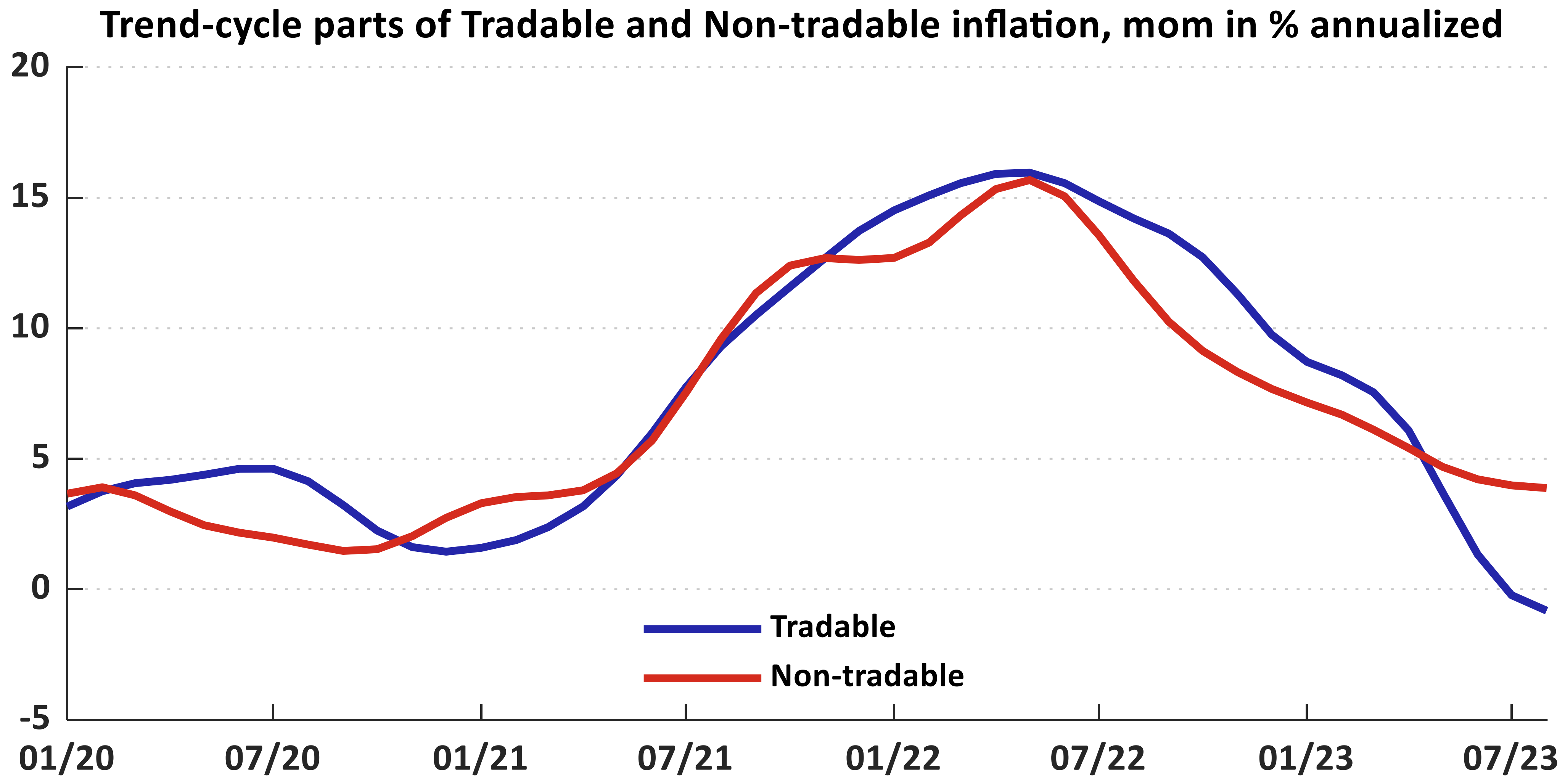
All inflation subcomponents have contributed to this slowdown. Only the year-on-year decline in **fuel prices** moderated significantly in August due to the renewal of the excise duty on diesel and rising global oil prices.

Core inflation is decelerating owing to both tradable and non-tradable price developments. Declining growth in imputed rent and prices in restaurants are the main factors behind decreasing non-tradable price inflation.

Inflation (cont.)



Note: Momentum is defined as moving quarterly changes of the price index



Note: Trend-cycle components derived using LUCI indicator.

Source: CZSO and CNB computations

The **momentum** of core inflation is declining, suggesting that inflation will further decelerate in year-on-year terms (except for the temporary base effect in October related to energy-price measures introduced by the government last year).

Cost pressures observed in the past are also fading (PPI, energy and commodity prices).

However, over the medium-term horizon, the recent drop in **real wages** poses a risk of faster nominal wage growth which might feed through to inflation in the future (unless absorbed by the currently quite high corporate profit margins).

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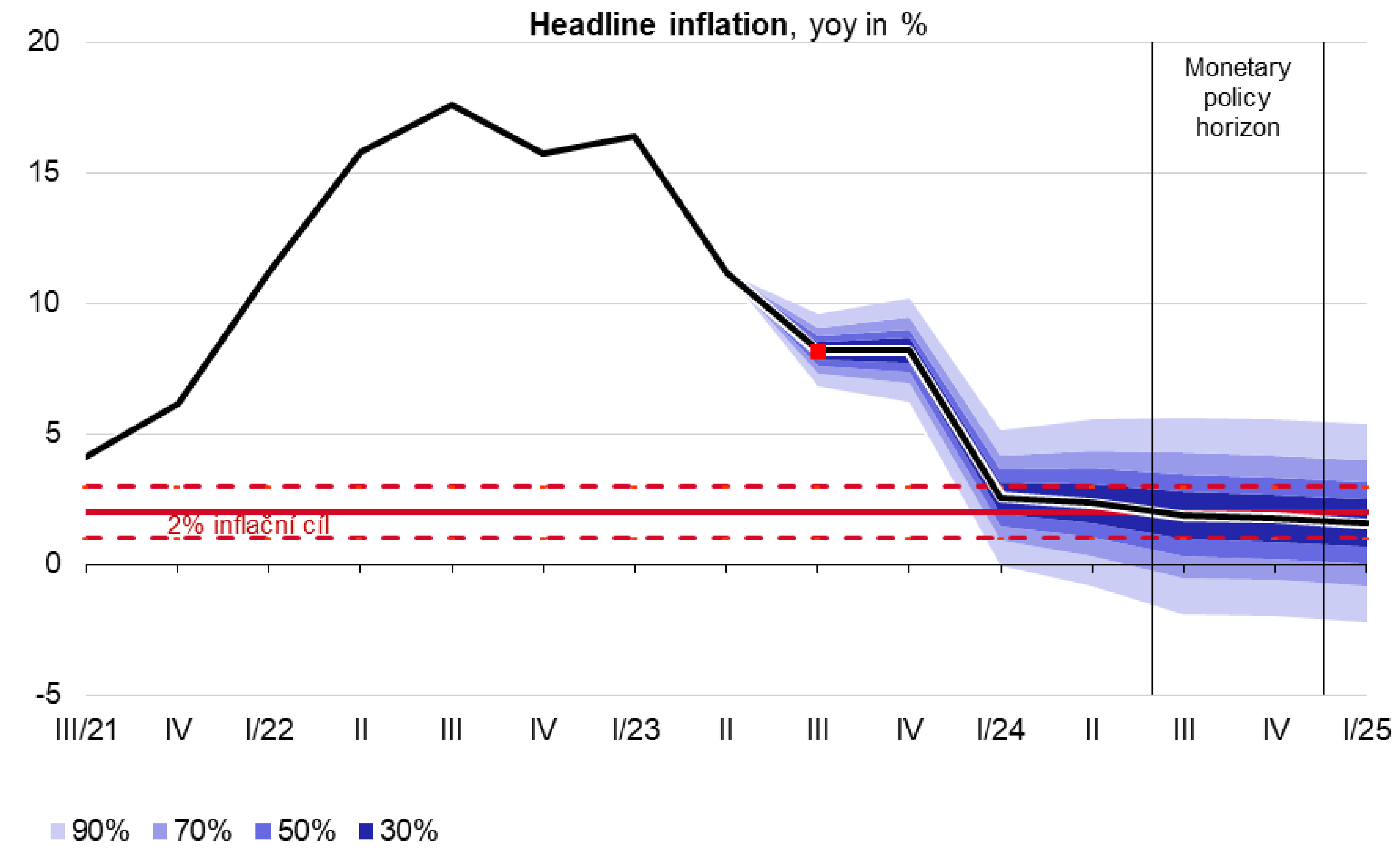
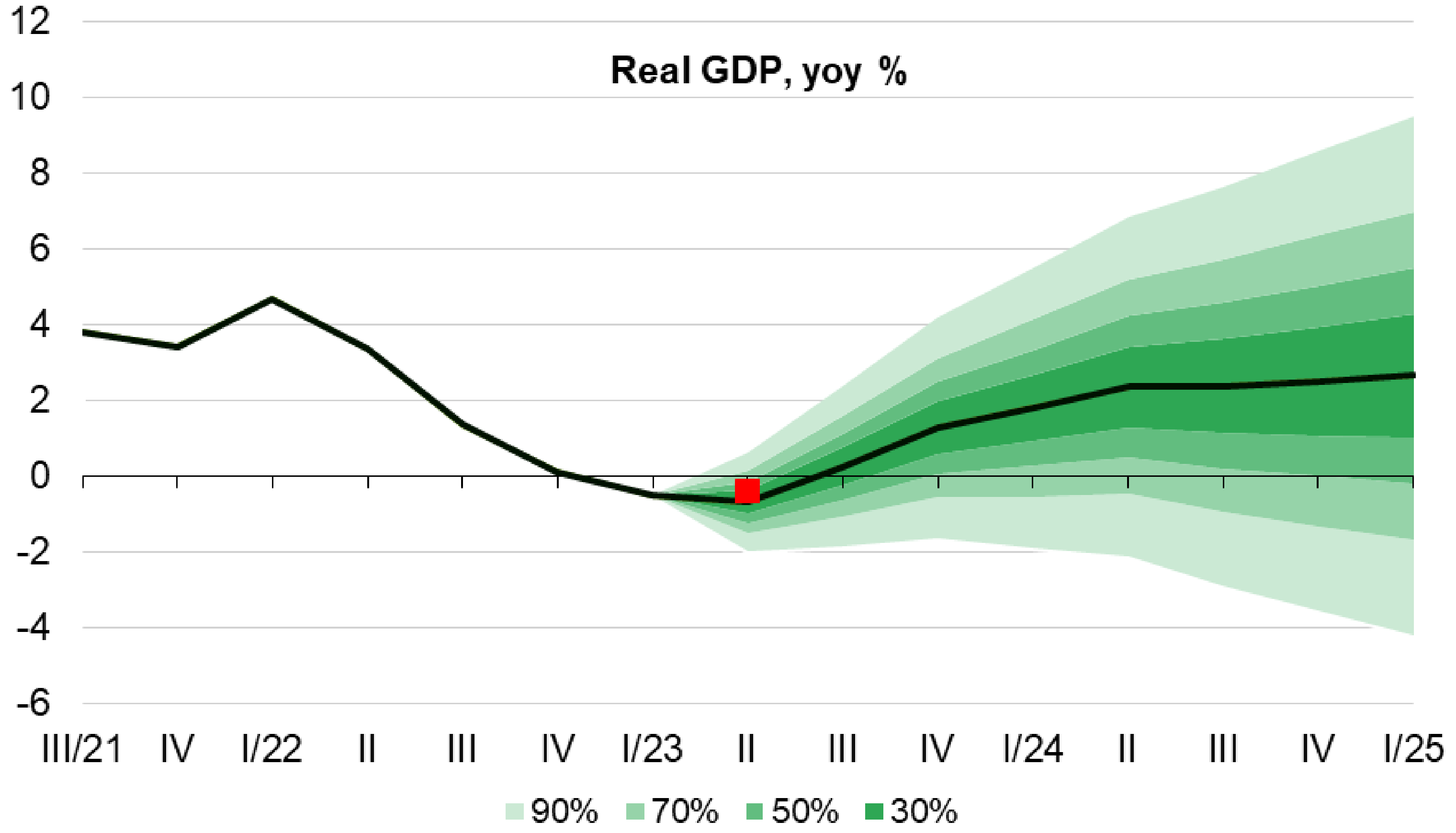
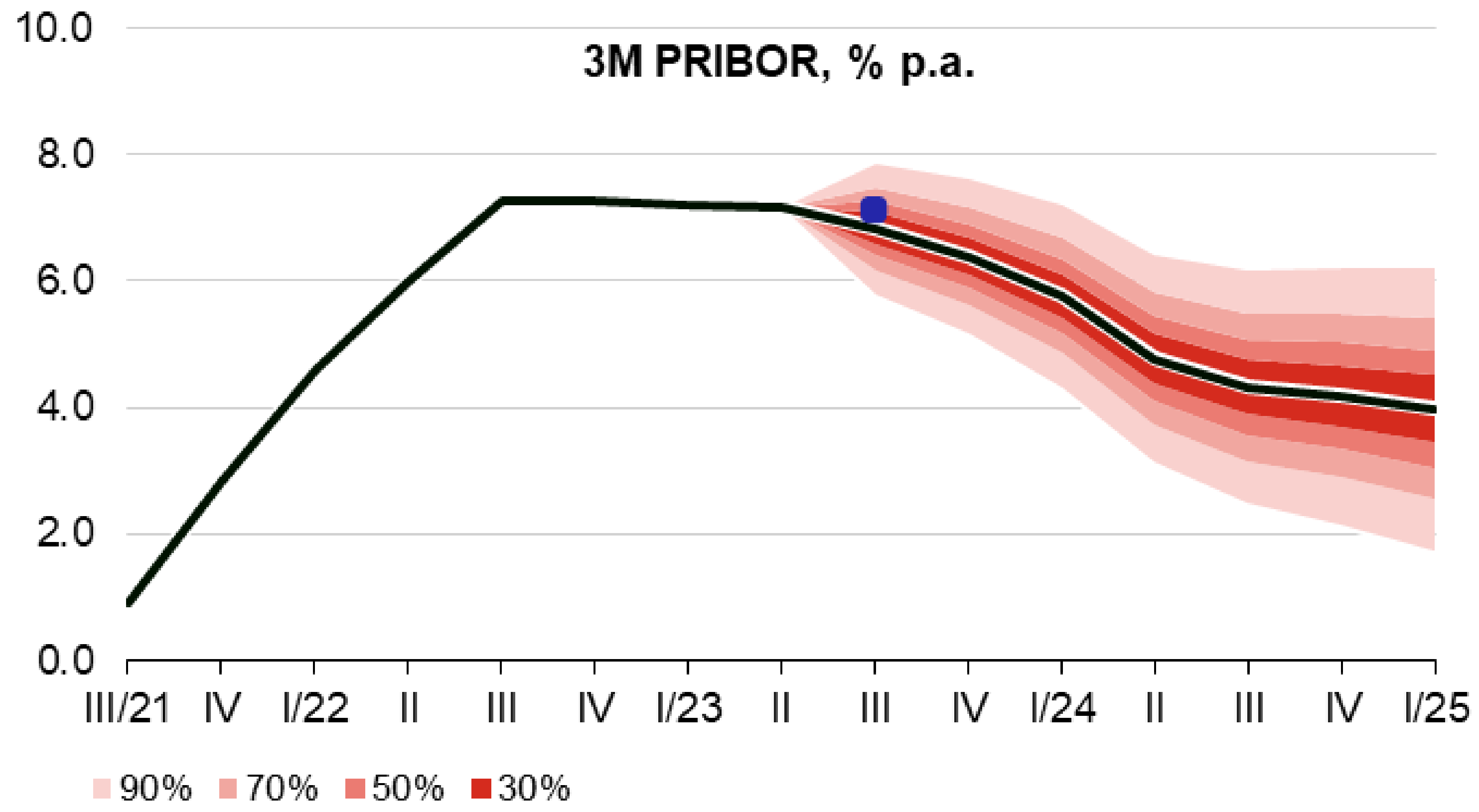
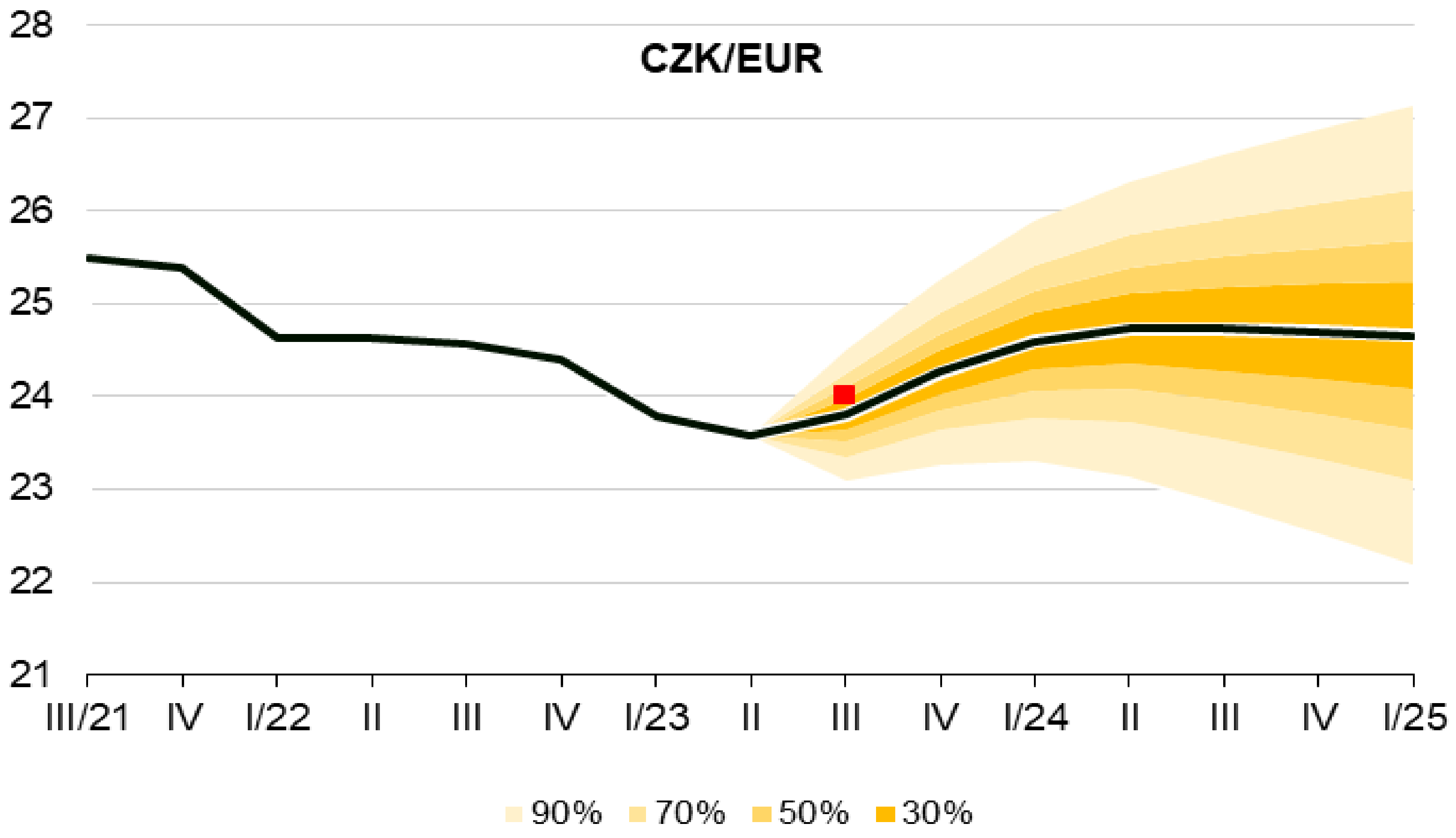
Summer 2023 forecast









Source: CNB's Summer 2023 Forecast

At the latest policy meeting on 3 August 2023, **the Board decided to keep the policy rate at 7%**, formally ended the intervention regime and resumed sales of part of the income on international reserves.

Consistent with the **baseline scenario** of the forecast is a decline in market interest rates over the entire outlook.

The Bank Board assessed the **risks** of the baseline as being significant and **tilted to the upside** given the threat of inflation expectations becoming unanchored, risks of a wage-price spiral, and longer effects of expansionary fiscal policy.

Recent data is broadly in line with the summer 2023 forecast (slightly more **disinflationary** external developments and slower wage growth vs. higher oil prices and a weaker exchange rate).

Next policy meeting on 27 Sep. will assess the risks of the current forecast in detail.

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Monetary policy challenges

Given the falling inflation and its outlook but inflationary risks, monetary policy tightness needs to be carefully considered

- ensuring **robust fulfilment of the inflation target** at the monetary policy horizon,
- taking into account the **risks and the likelihood of their materialisation** by acting in a prudential way,
- but **avoiding excessively tight monetary policy** (including its autonomous tightening) incurring unnecessary real economic losses.

Inflationary risks

- High mark-ups given the oligopolistic structure and price setting power in some segments of the economy
- Recent drop in real wages along with a tight labour market which might lead to faster nominal wage growth, implying renewed demand-pull pressures and persistent inflation
- Still elevated, even though declining, inflation expectations

Disinflationary risks

- Declining real economic activity abroad
- Autonomous tightening of monetary policy if rates are kept too high for too long

Thank you for your attention

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