CNB's Forecast

(Monetary Policy Report, Winter 2023 – update)

IMF/WB Annual Meetings

April 2023

Parameters of the MP Regime

The baseline scenario of the winter forecast assumes that the central bank sets interest rates in order to fulfil the 2% target at a **monetary policy horizon 12–18 months ahead**.

The previous strong external cost pressures have recently been easing greatly and will largely fade out before the end of this year. The need to exempt major price movements caused by external factors is no longer relevant. Monetary policy has returned to the standard framework, in which the MP horizon is 12–18 months ahead and covers the first half of 2024.

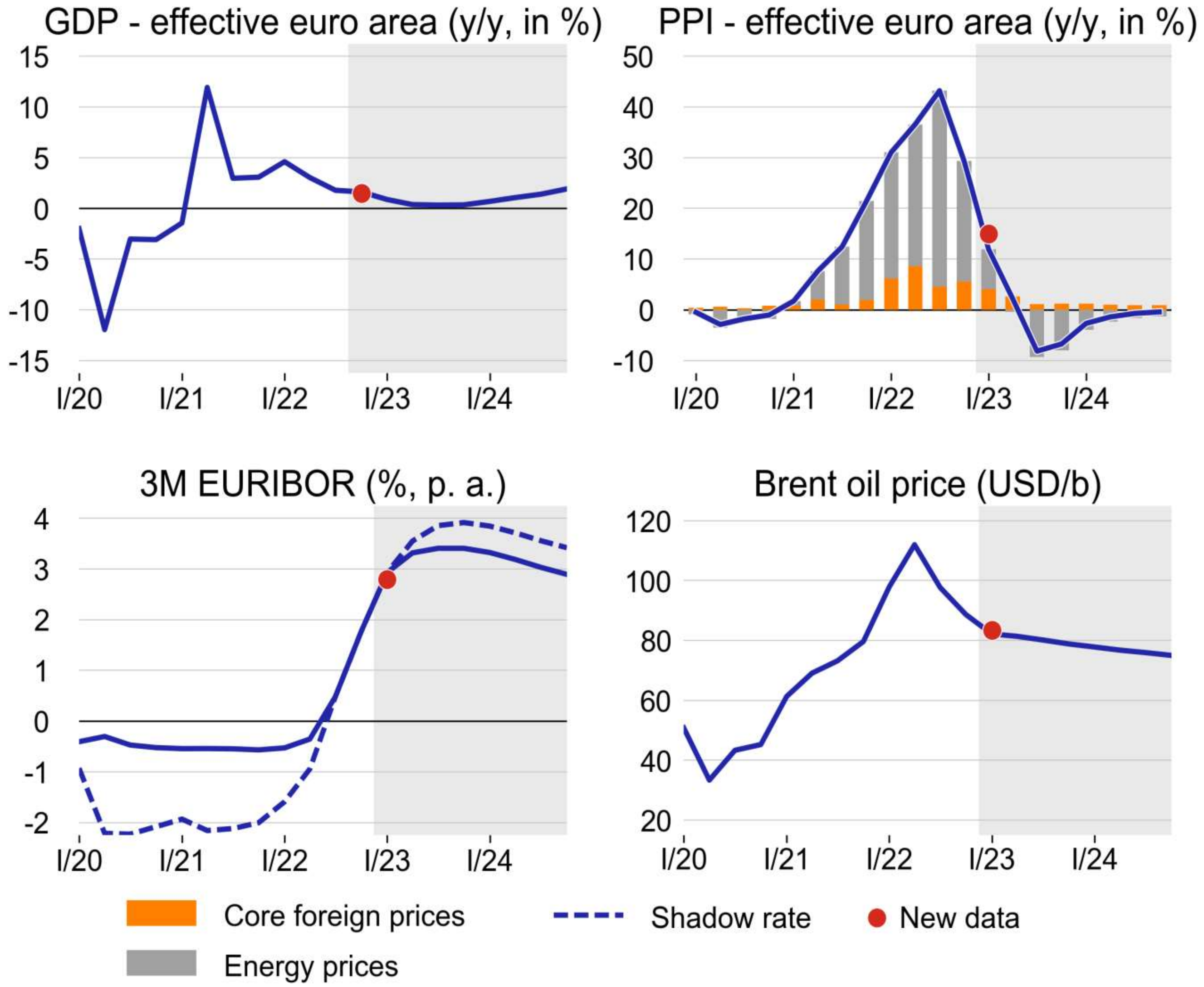
Presentation Outline

1. **Assumptions of the Forecast**

2. Winter Macroeconomic Forecast – update

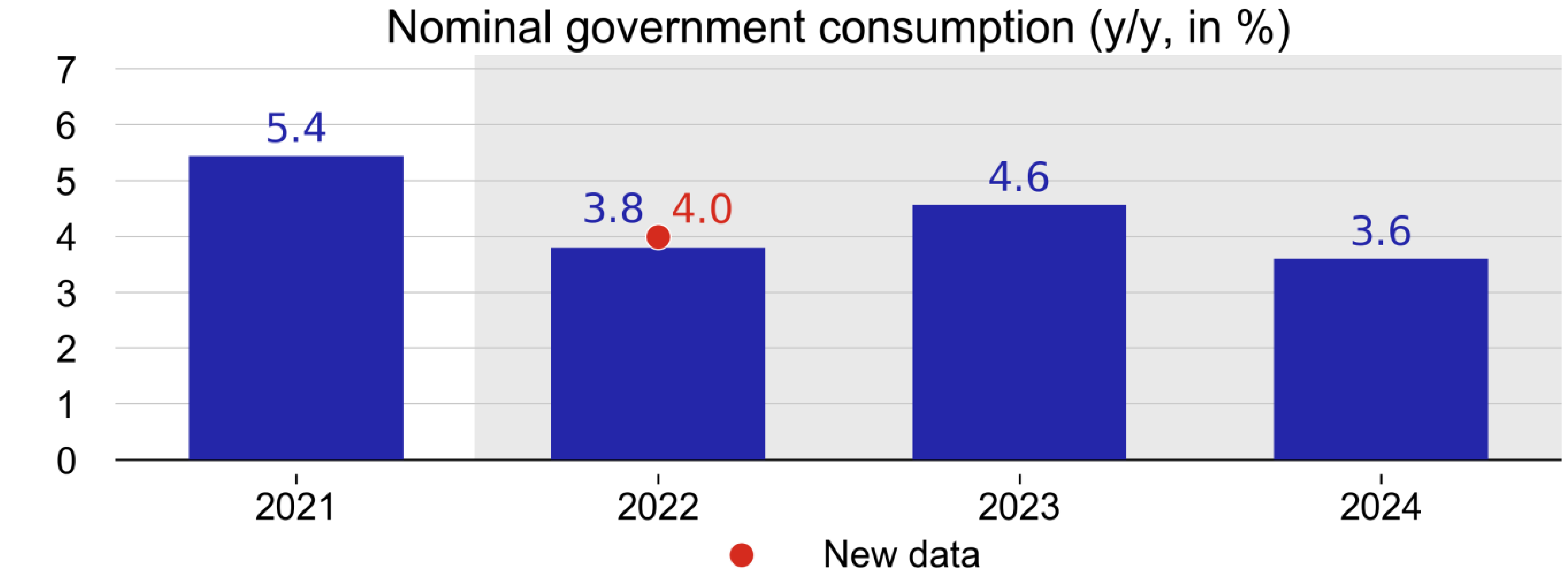
3. Monetary Policy Simulations

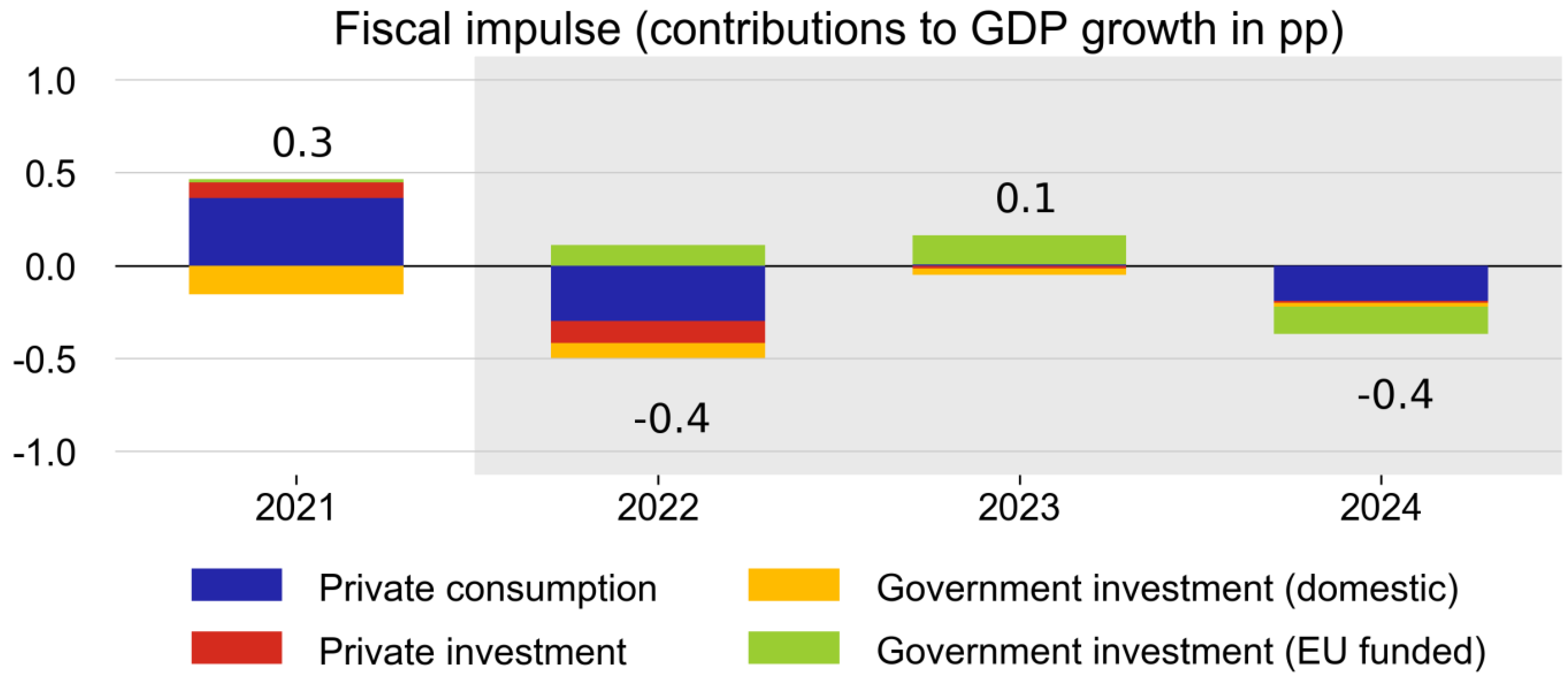
External Environment Outlook



- This year, the **effective euro area** will grow only slightly due to slowdown in global demand growth, tightening monetary conditions and a decline in households' real income. The economy will recover in autumn 2023 as supply chain disruptions ease and international trade recovers.
- The **effective euro area PPI** started to decline at the close of last year. The outlook for this year is strongly affected by an expected sizeable correction of gas and electricity prices. The easing of supply chain stress will foster a reduction in the pressure on core inflation.
- The outlook for the **Brent crude oil price** remains falling in expectation of a global economic downturn.
- The market outlook for rising interest rates reflects the **ECB's** expected monetary policy tightening to return inflation to the target.

Fiscal Policy





- **Nominal government consumption** grew a bit than expected last year. This year it will grow by about 4.5% due to an increase in wages and salaries in the non-market sector and an increase in public expenditure, linked to the arrival of Ukrainian refugees. It will slow down slightly next year.
- The **fiscal impulse** will be roughly neutral this year, with the effects of individual revenue and expenditure measures offsetting each other (e.g. energy compensations, windfall tax and levy on excess profits).
- An unwinding of temporary support measures and a slow start of absorption of EU funds from the new programme period will dampen GDP growth in 2024.

CZECH NATIONAL BANK

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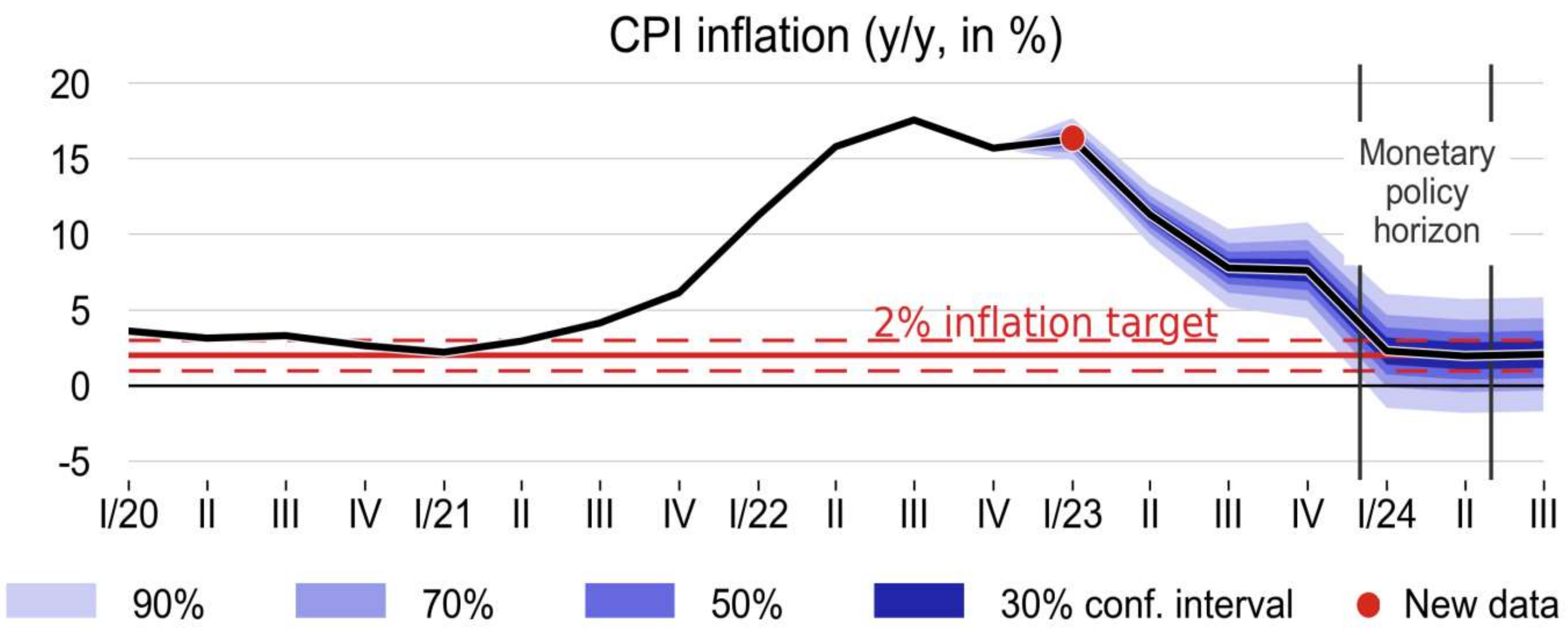
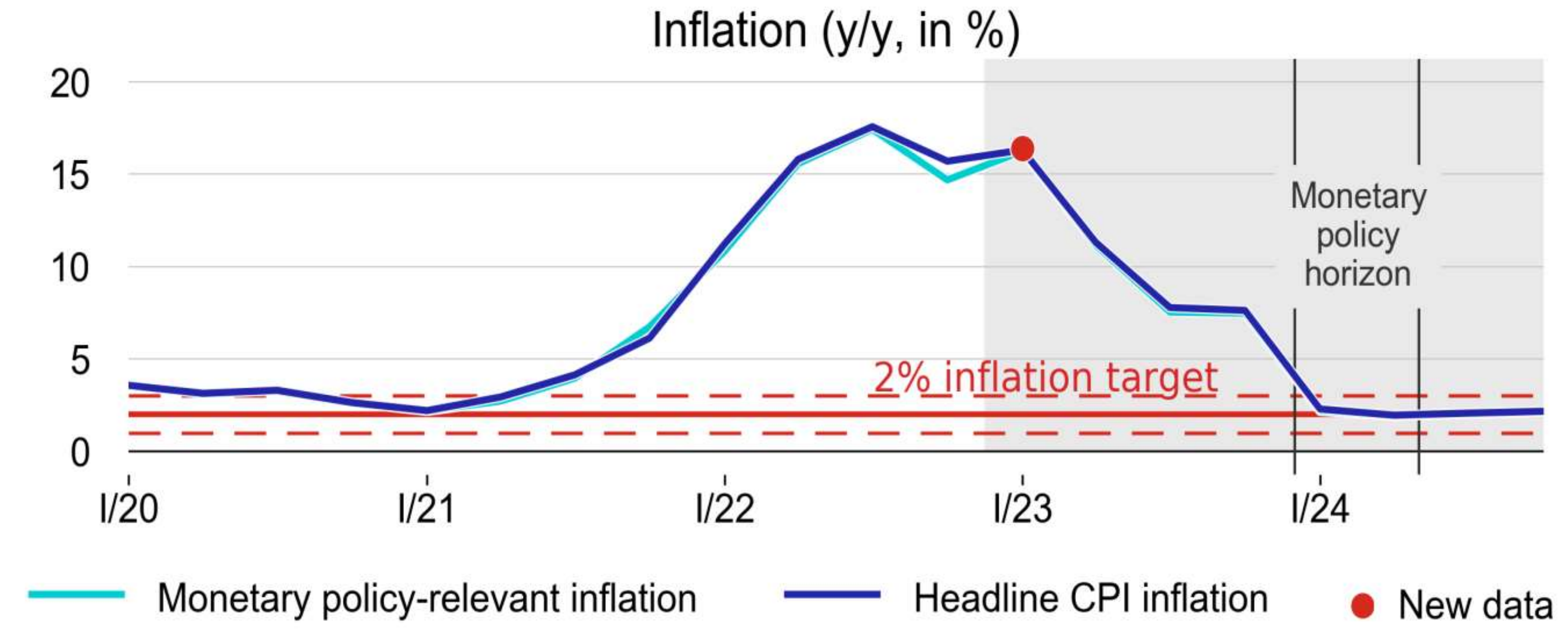
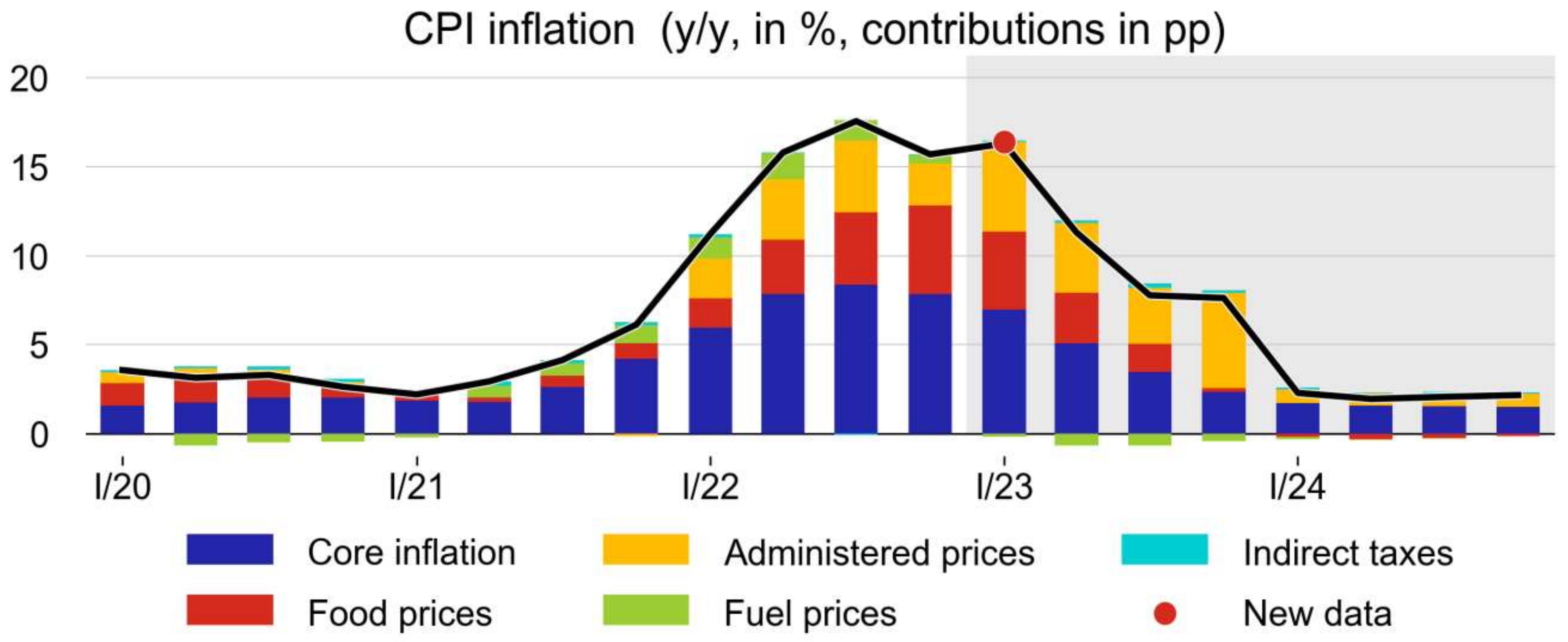
Headline and Monetary Policy-Relevant Inflation

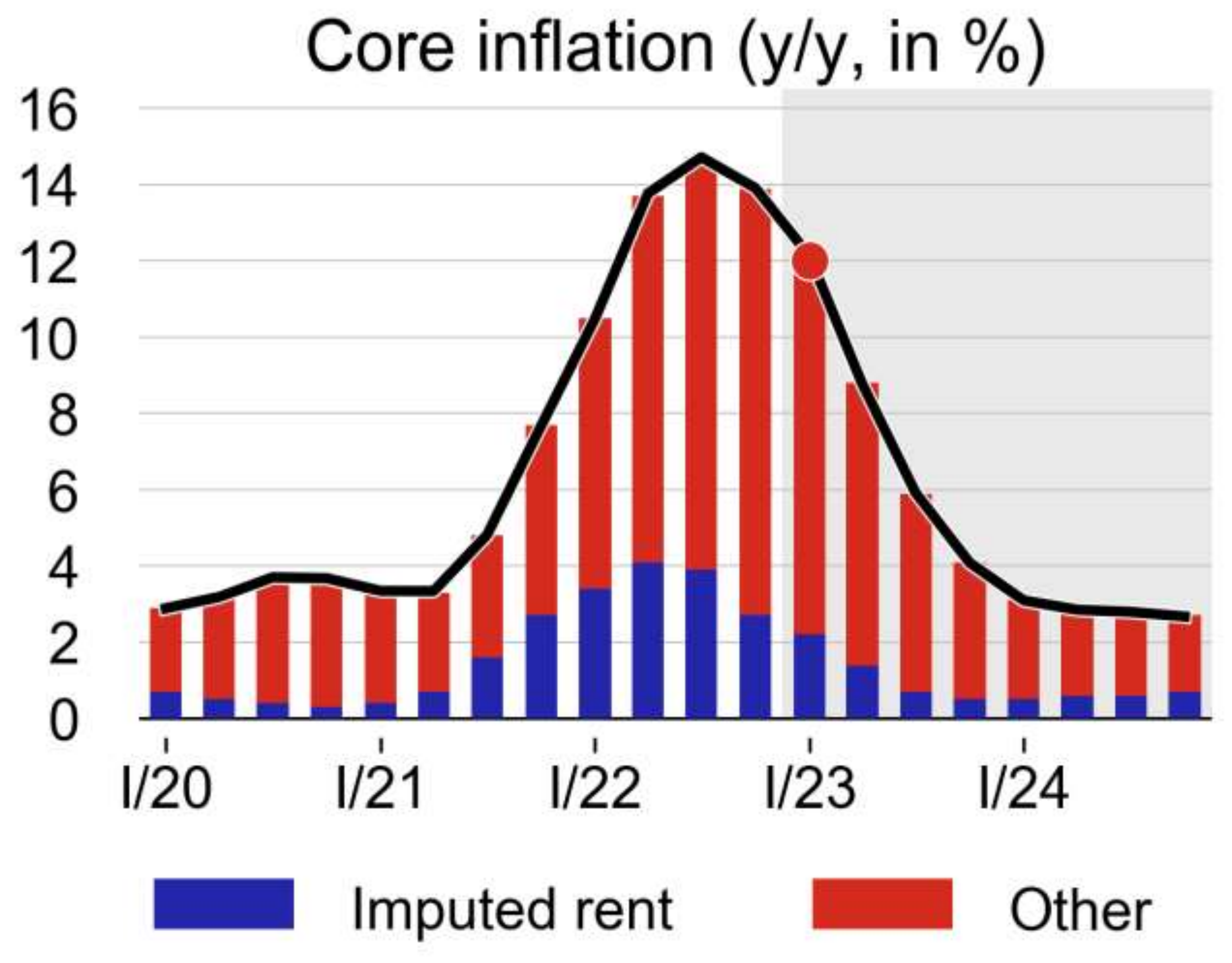


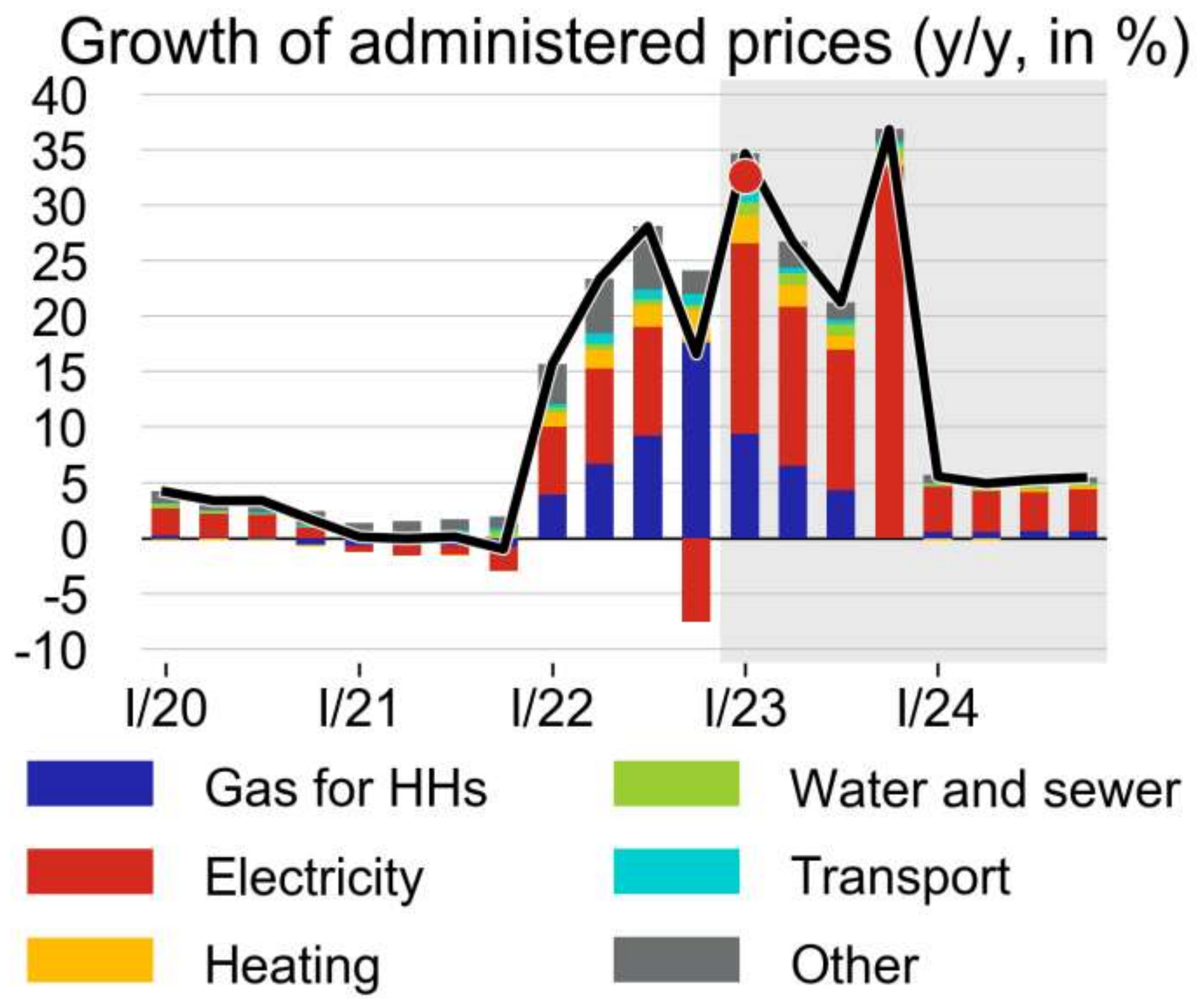


- **CPI inflation** will rise temporarily above 17% in 2023 Q1 and drop to single digits in the second half of the year. It will return close to the 2% target in the first half of 2024.
  - The market components of inflation will decline due to decreasing cost pressures from the foreign and domestic economies.
  - The currently peaking profit margins of domestic producers, retailers and service providers will undergo a gradual correction.
  - Tighter monetary policy will contribute to this decline.
- Headline inflation will be above **monetary policy-relevant inflation** over the entire outlook.

Inflation Components, Core Inflation and Admin. Prices

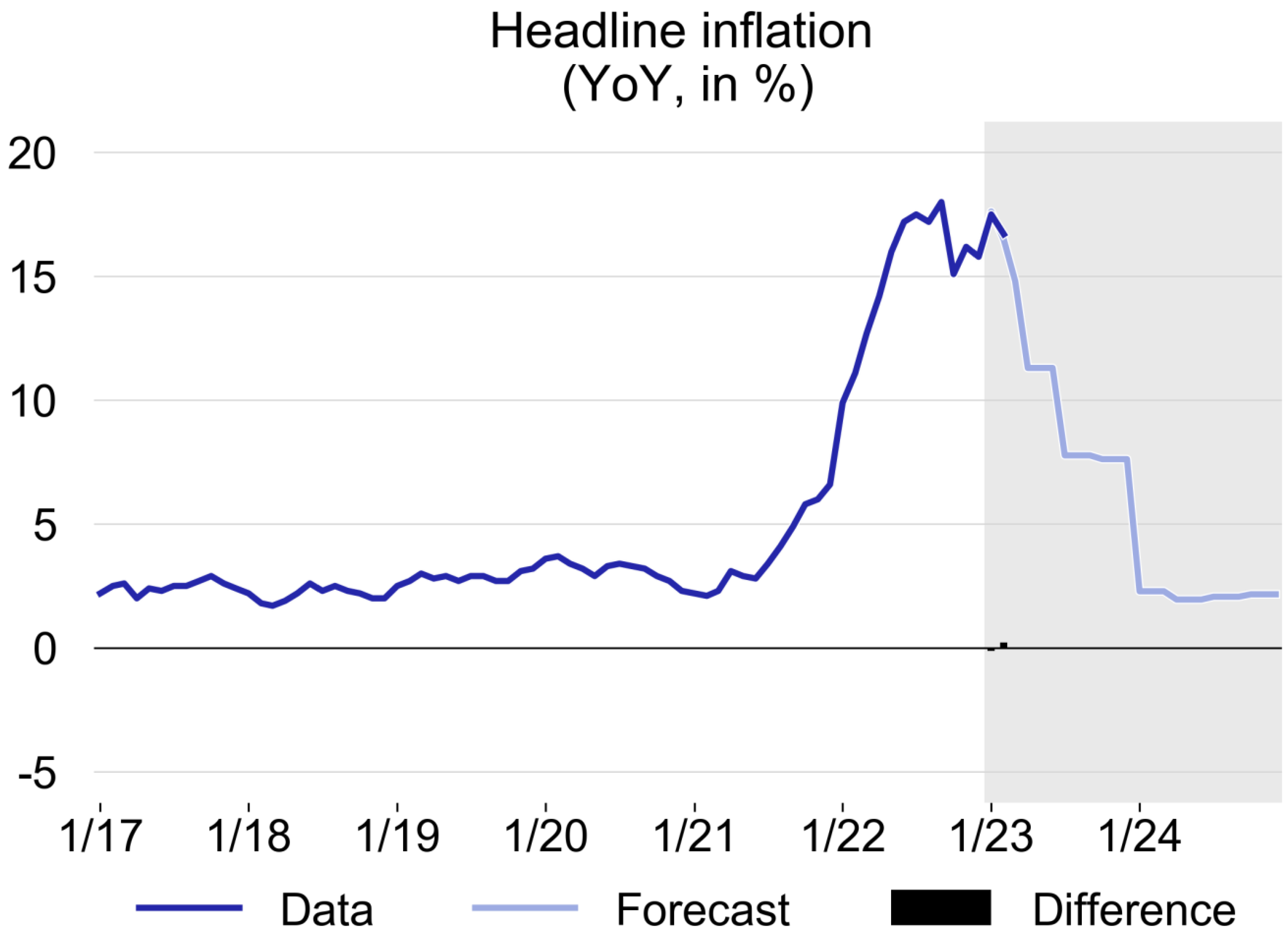






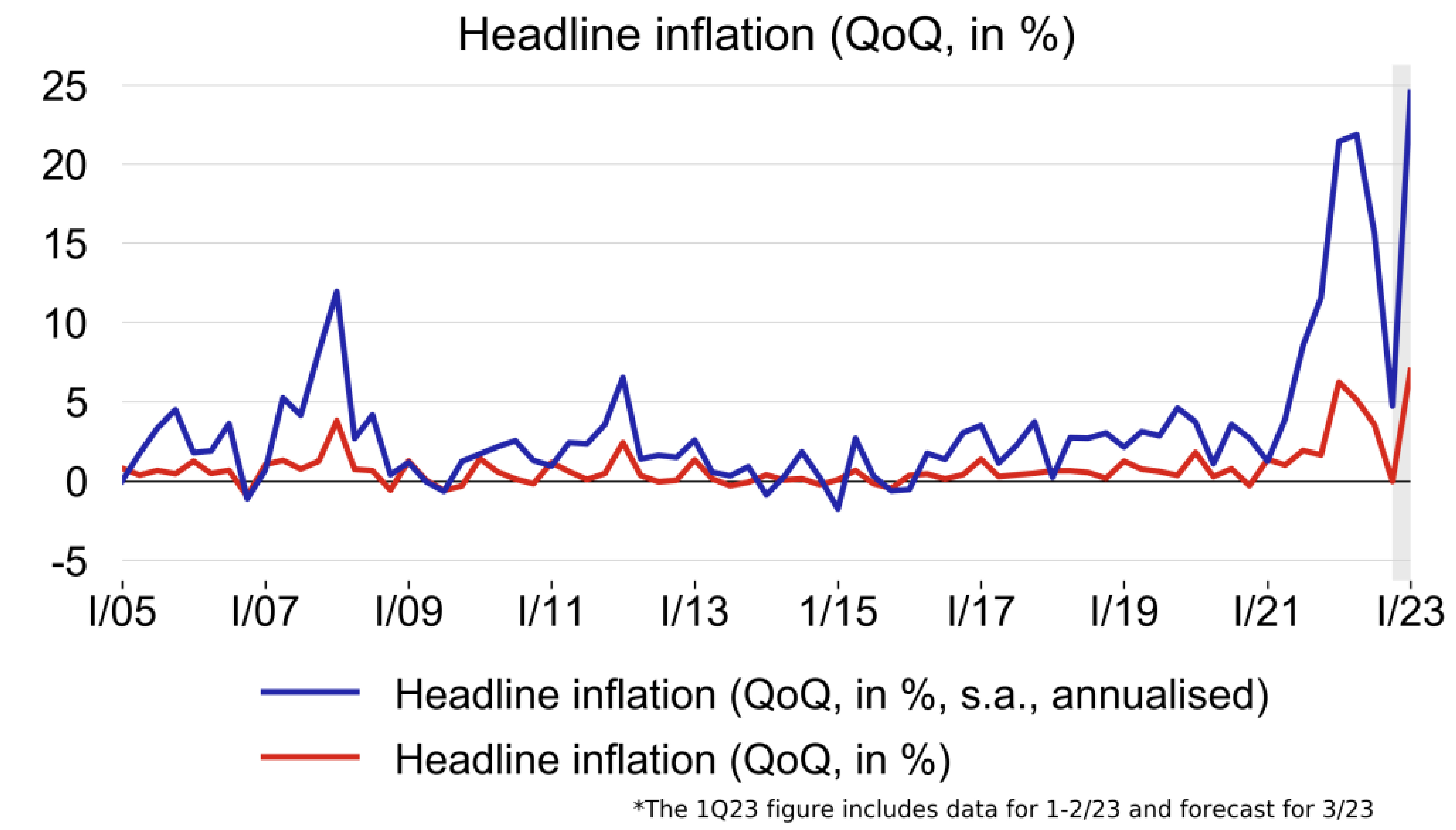
- **CPI inflation** will remain broad-based at the start of 2023; in addition to core inflation, it will be driven by a marked increase in the contribution of administered prices and still high food price inflation.
- Within **core inflation**, growth in tradables and non-tradables prices has started to slow. The drop in core inflation will be fostered by the declining contribution of **imputed rent** in the quarters ahead.
- **Administered price inflation** will be extremely high and simultaneously very volatile this year due mainly to an unprecedented rise in electricity prices and discontinuation of the energy savings tariff. It will not fall markedly until next year.

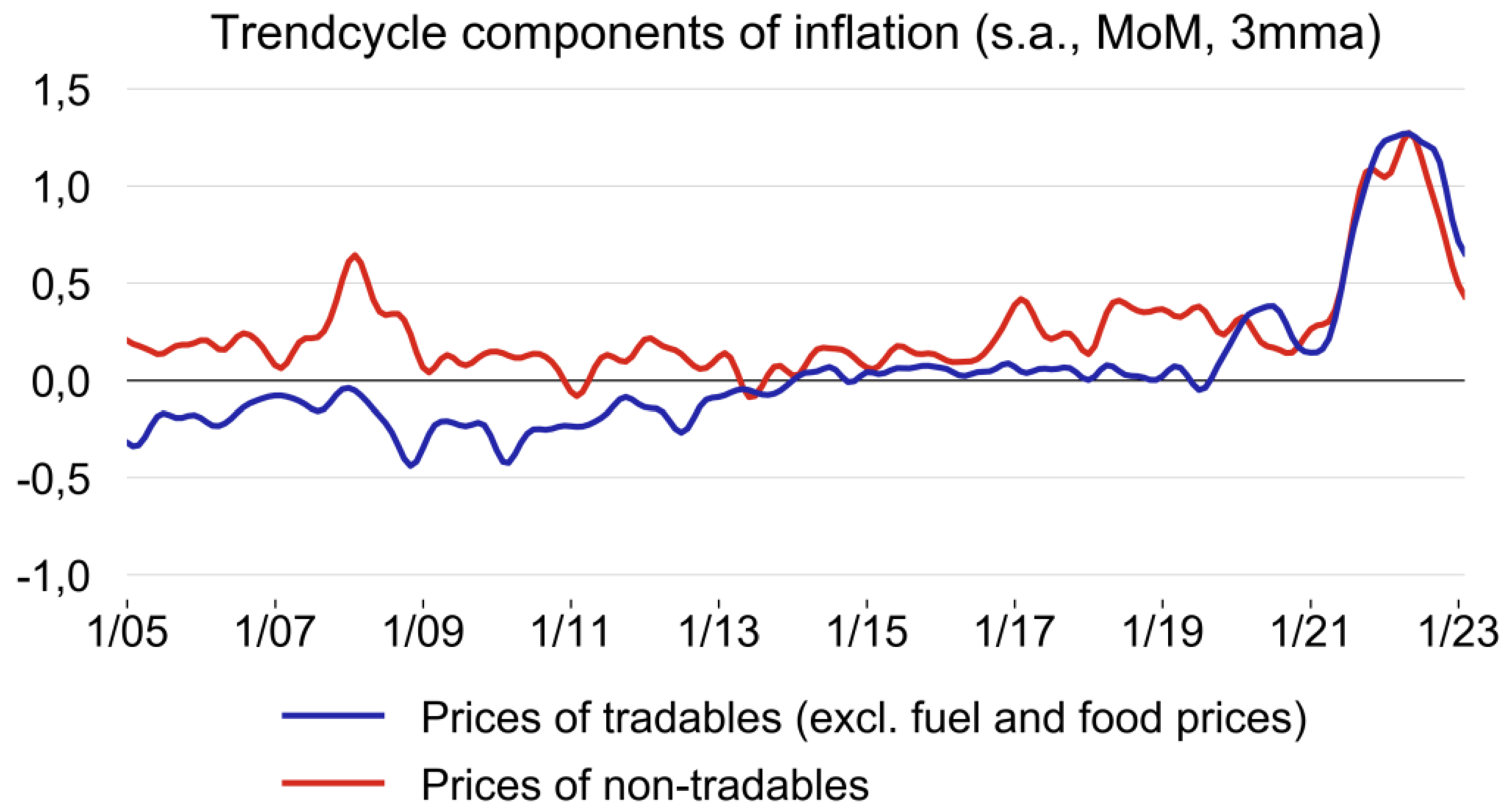
CPI – Winter Forecast and Reality



- The evolution of inflation in 2023 Q1 signals **inflation peaking in line with the winter forecast**.
- **A moderation of price growth** will be fostered in the subsequent period by an easing of the dynamics of production costs, a decline in households' purchasing power, and the stabilising effect of the previous monetary policy tightening helping to cool domestic demand.

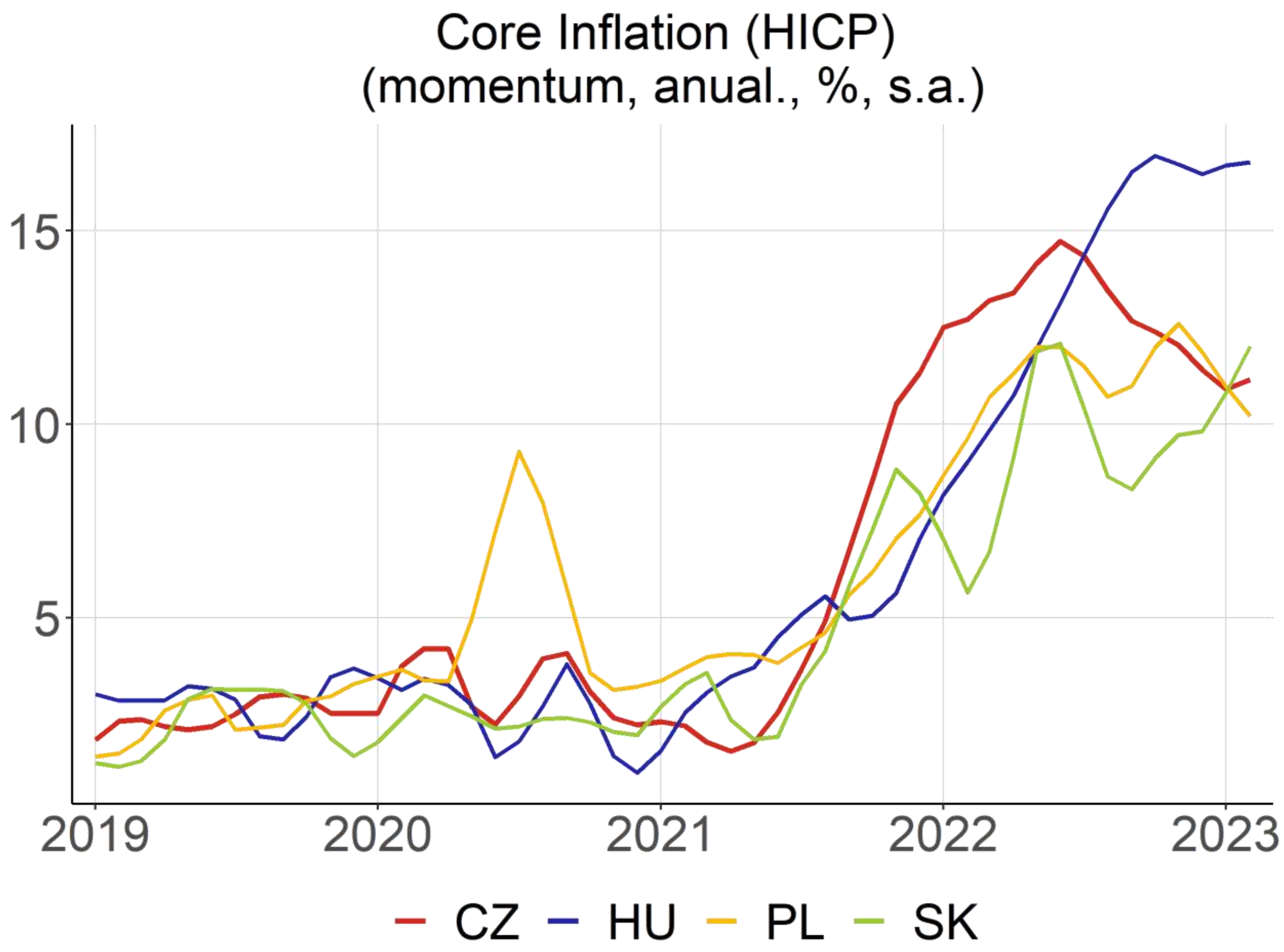
CPI – Winter Forecast and Reality





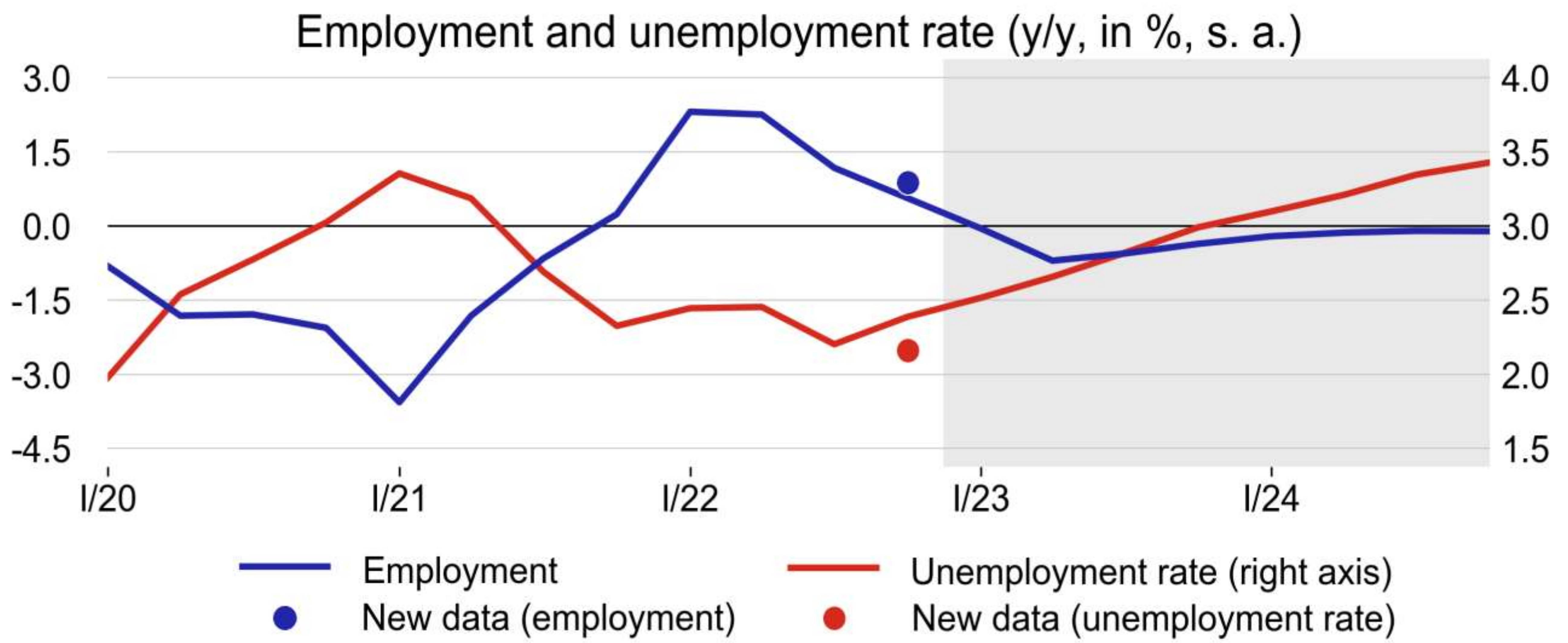
- The observed data **confirm a peak in inflation**, which the CNB forecast predicted in the second half of 2022 and in early 2023.
- The effect of the fading post-Covid recovery of domestic demand is especially visible in **tradable goods** prices, which decelerated more slowly than services.
- The contribution of the cost of **owner-occupied housing** in the form of imputed rent, which had previously been exceptionally high, declined during 2022 Q4 and 2023 Q1.

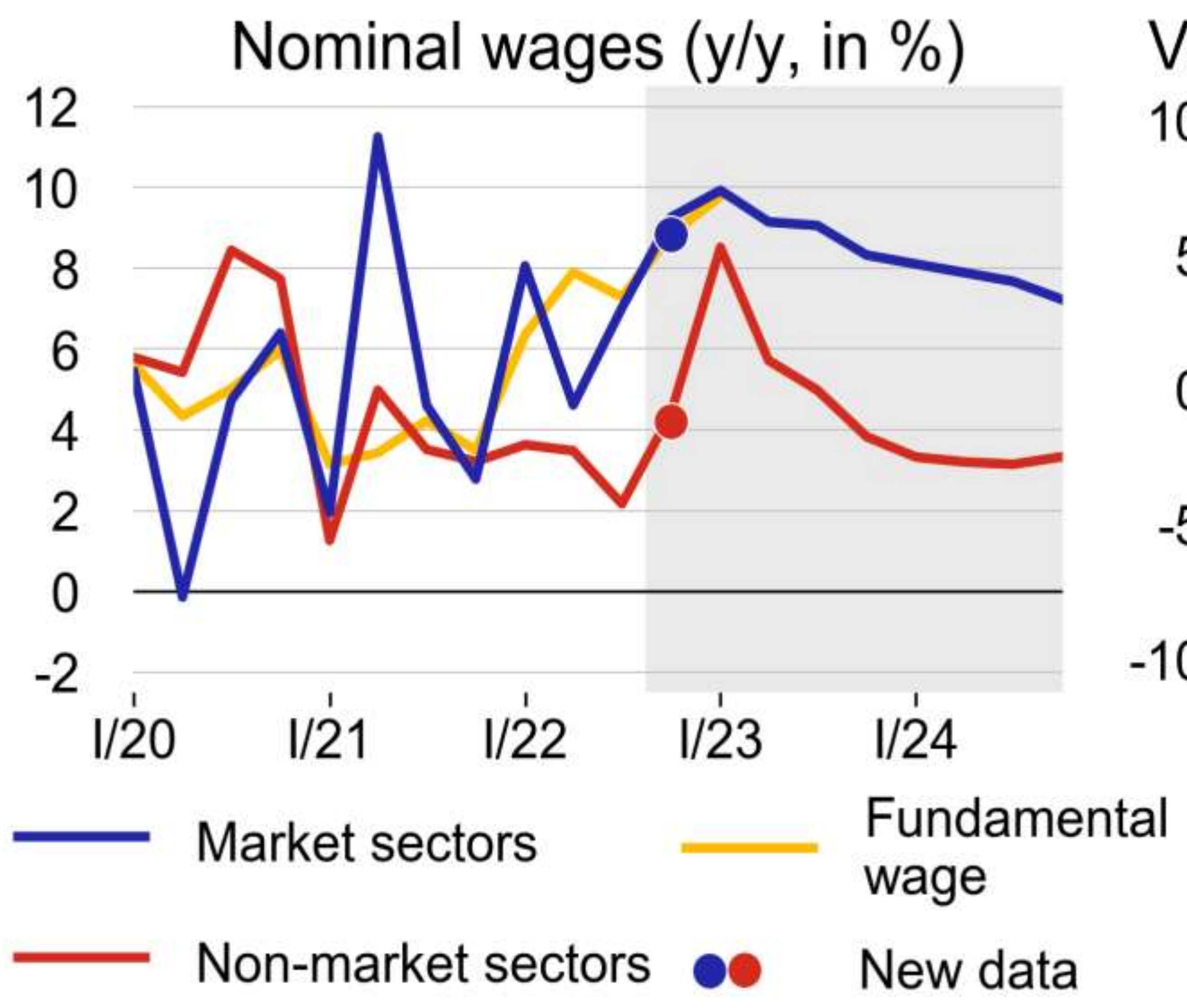
Core Inflation Among V4 Countries

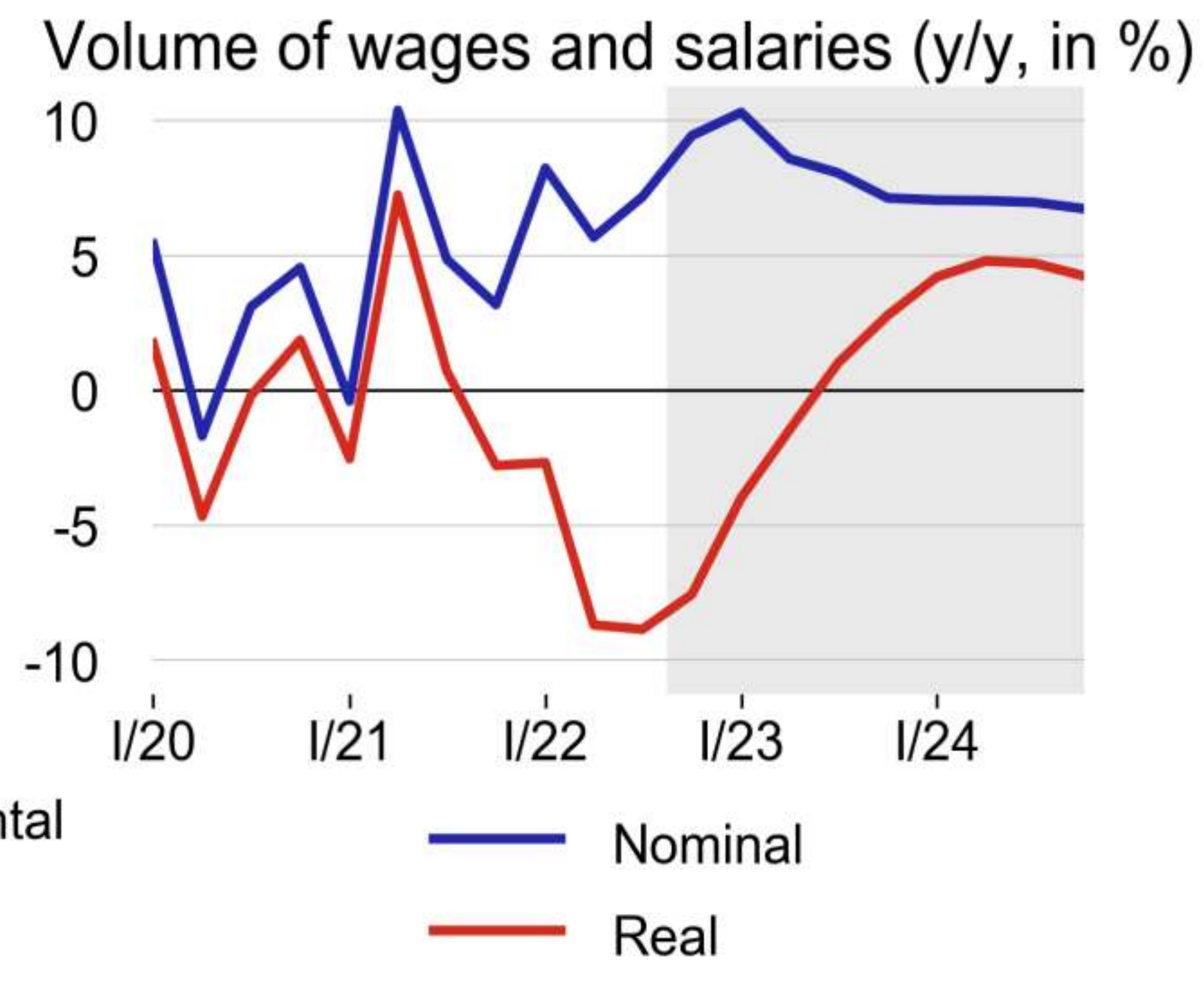


- **Core inflation** in CZ and PL is slowing down in contrast to SK and HU.
- It is still very high in all V4 countries.
- Last observation February 2023.
- Momentum = percentage change in last 3m over previous 3m.

Labour Market

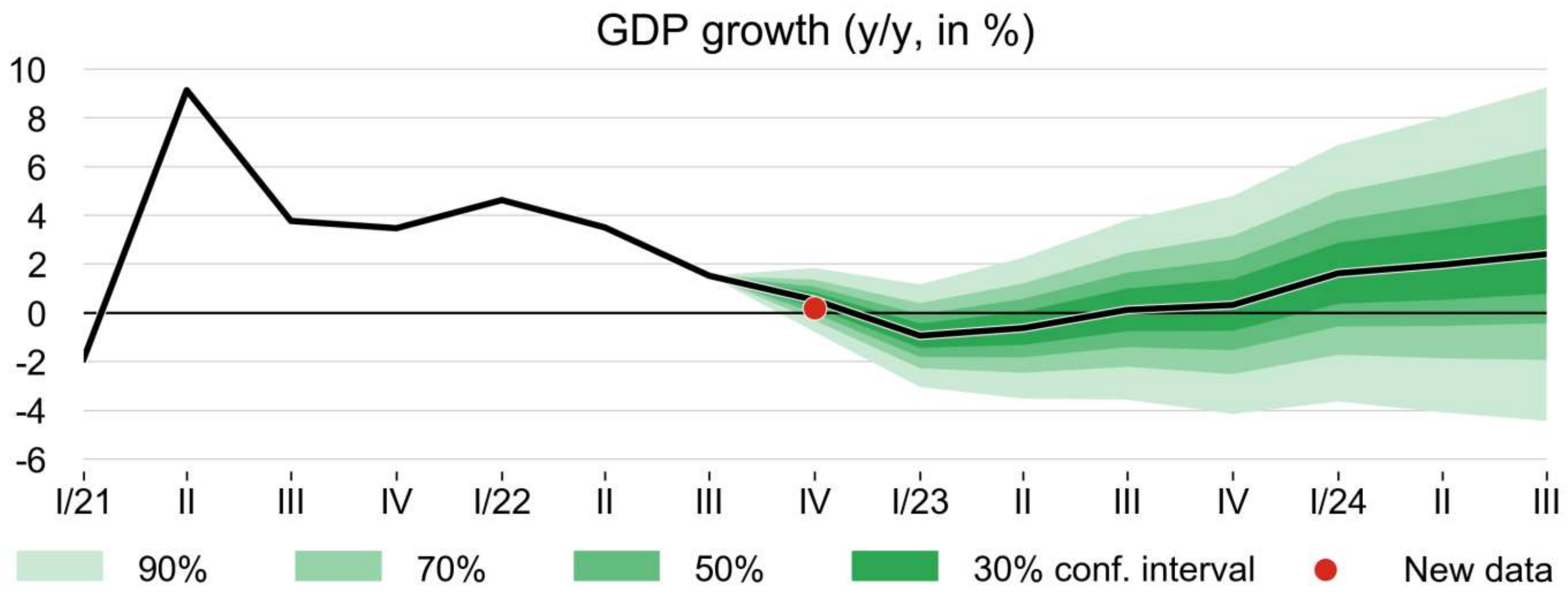


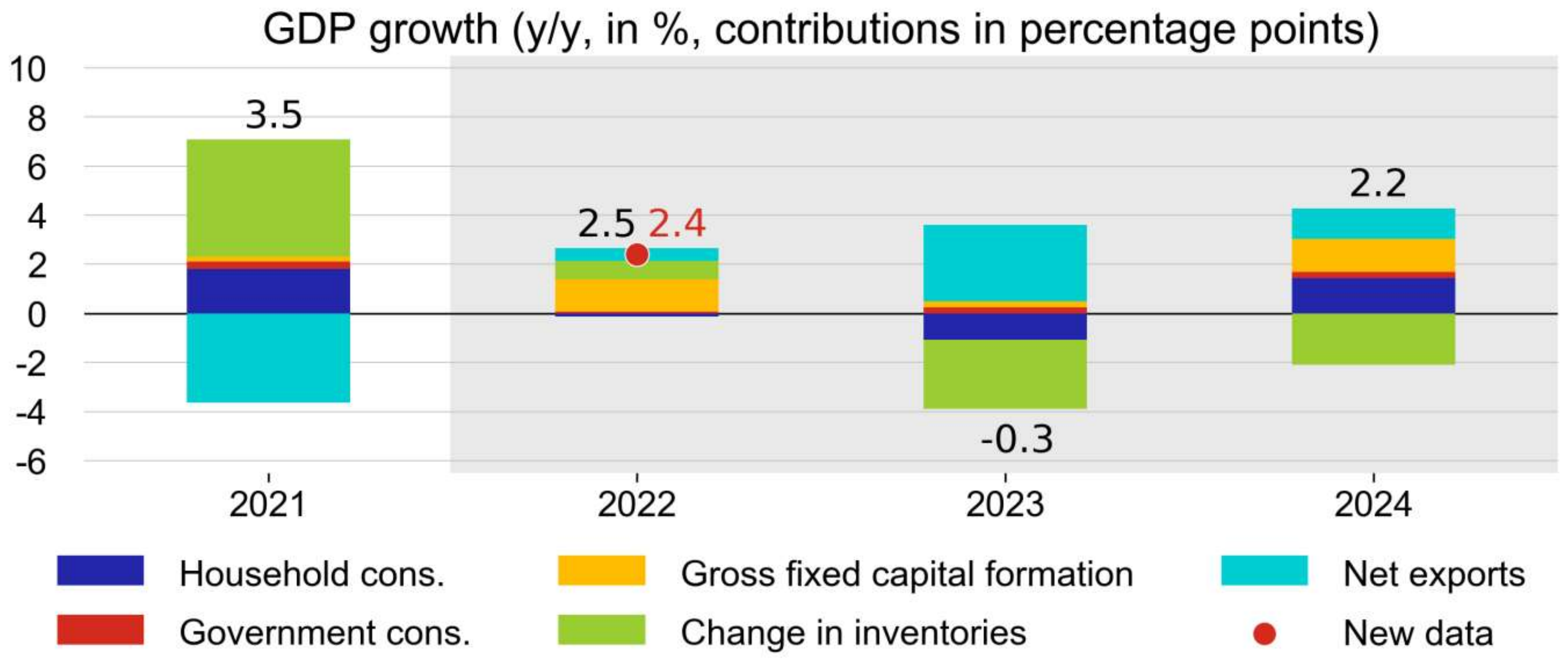




- **Employment** peaked in 2022 and started to decline moderately in the second half of the year. This decline will continue into 2023. The **general unemployment rate** switched to modest growth at the end of last year and will continue to rise this year. This will be due to a temporary worsening of the macroeconomic situation.
- **Nominal wage growth** will accelerate sharply in market and non-market sectors at the start of 2023. It will remain elevated over the forecast horizon as firms will compensate employees for the decline in real wages.
- **Growth in the real volume of wages and salaries** will be negative over the next few quarters due to high inflation and will thus lead to a decline in household consumption.

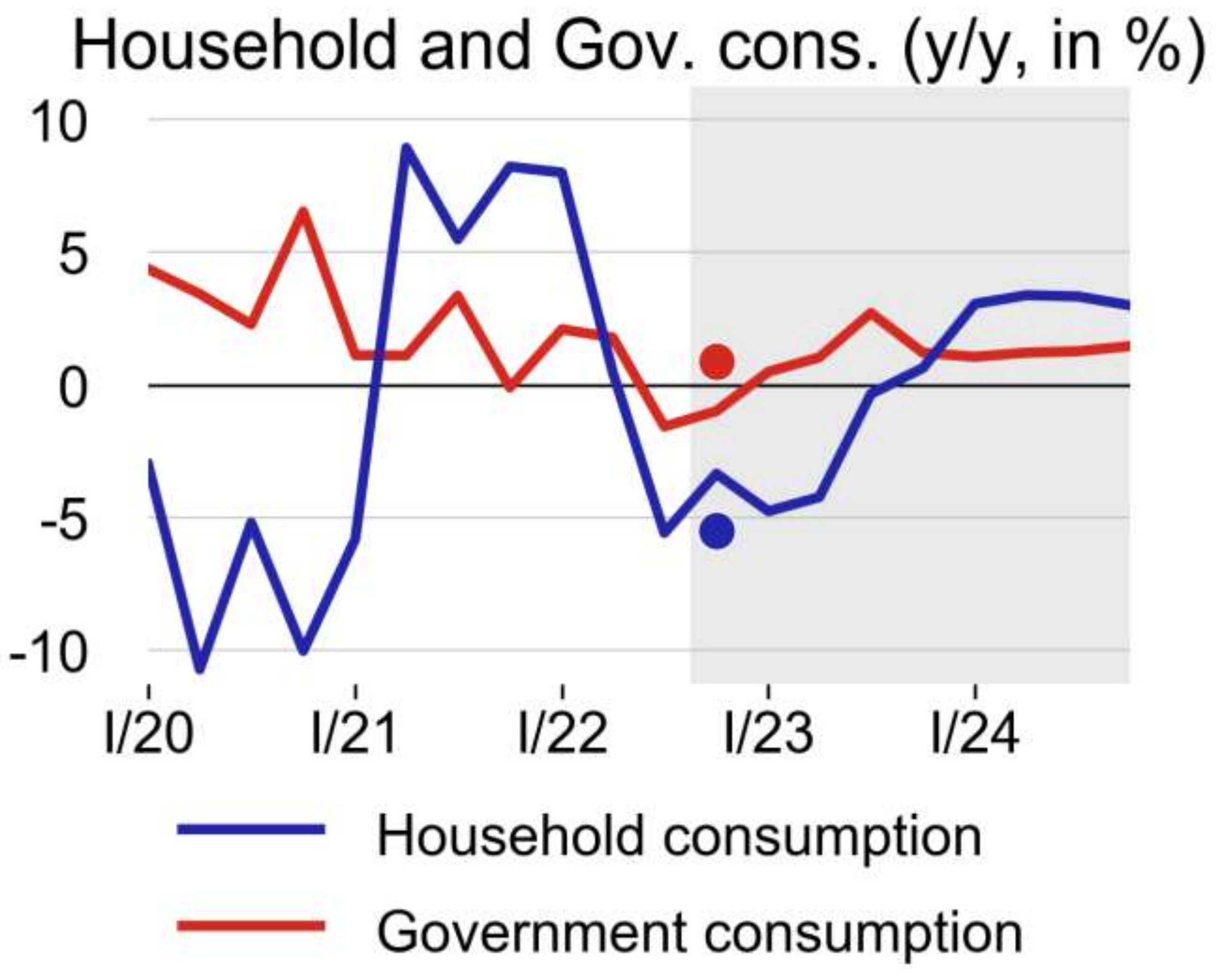
GDP Growth Forecast

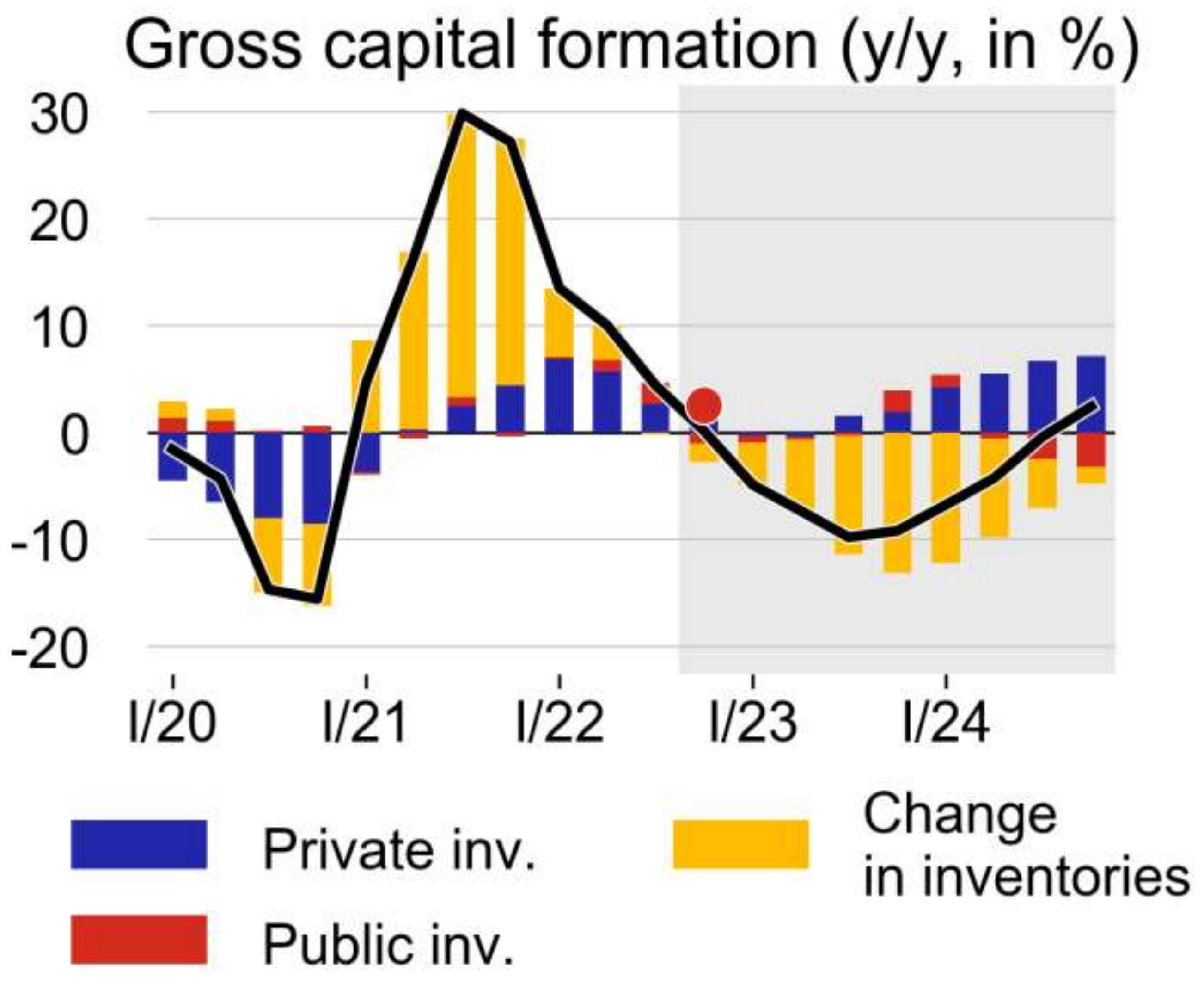


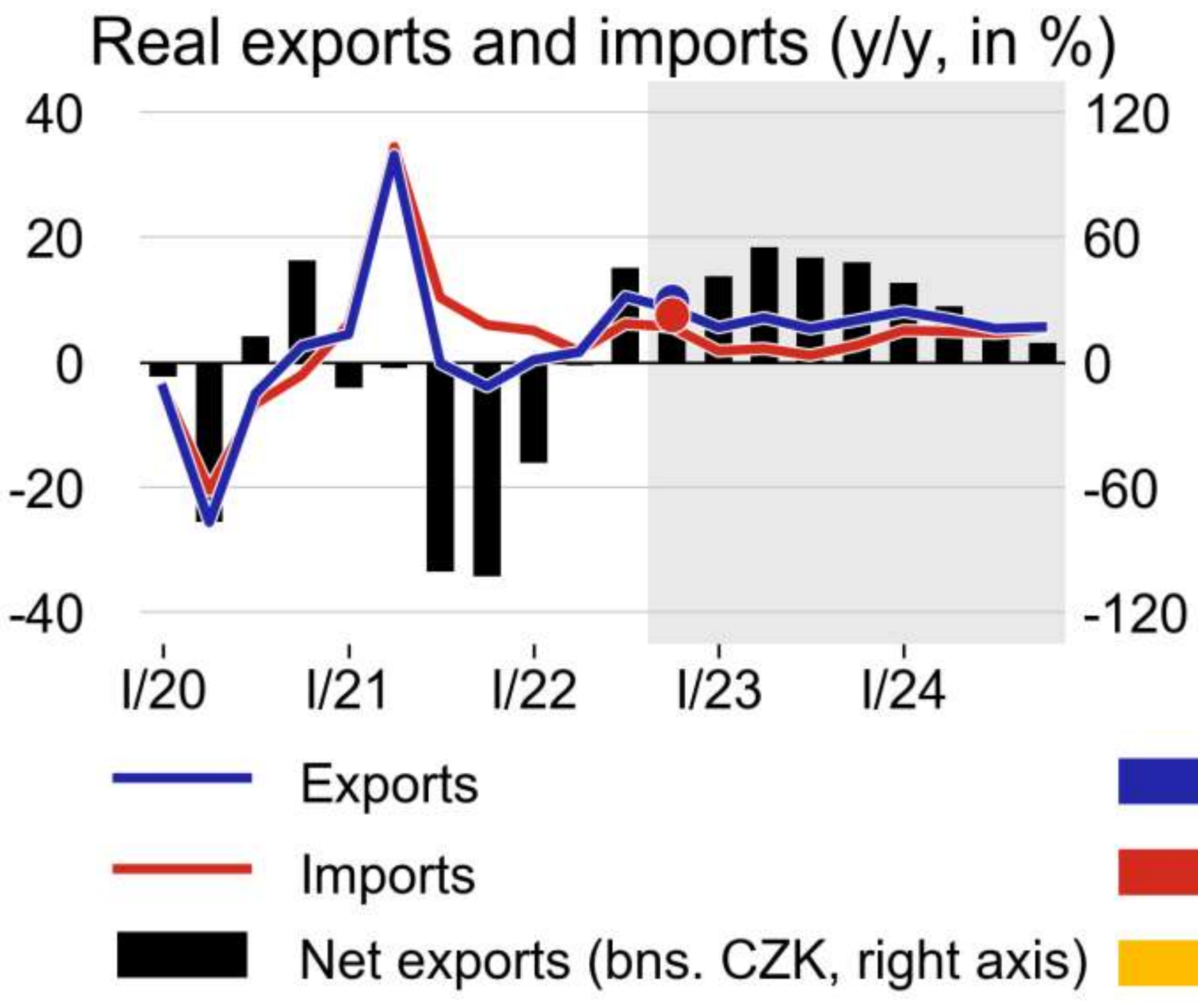


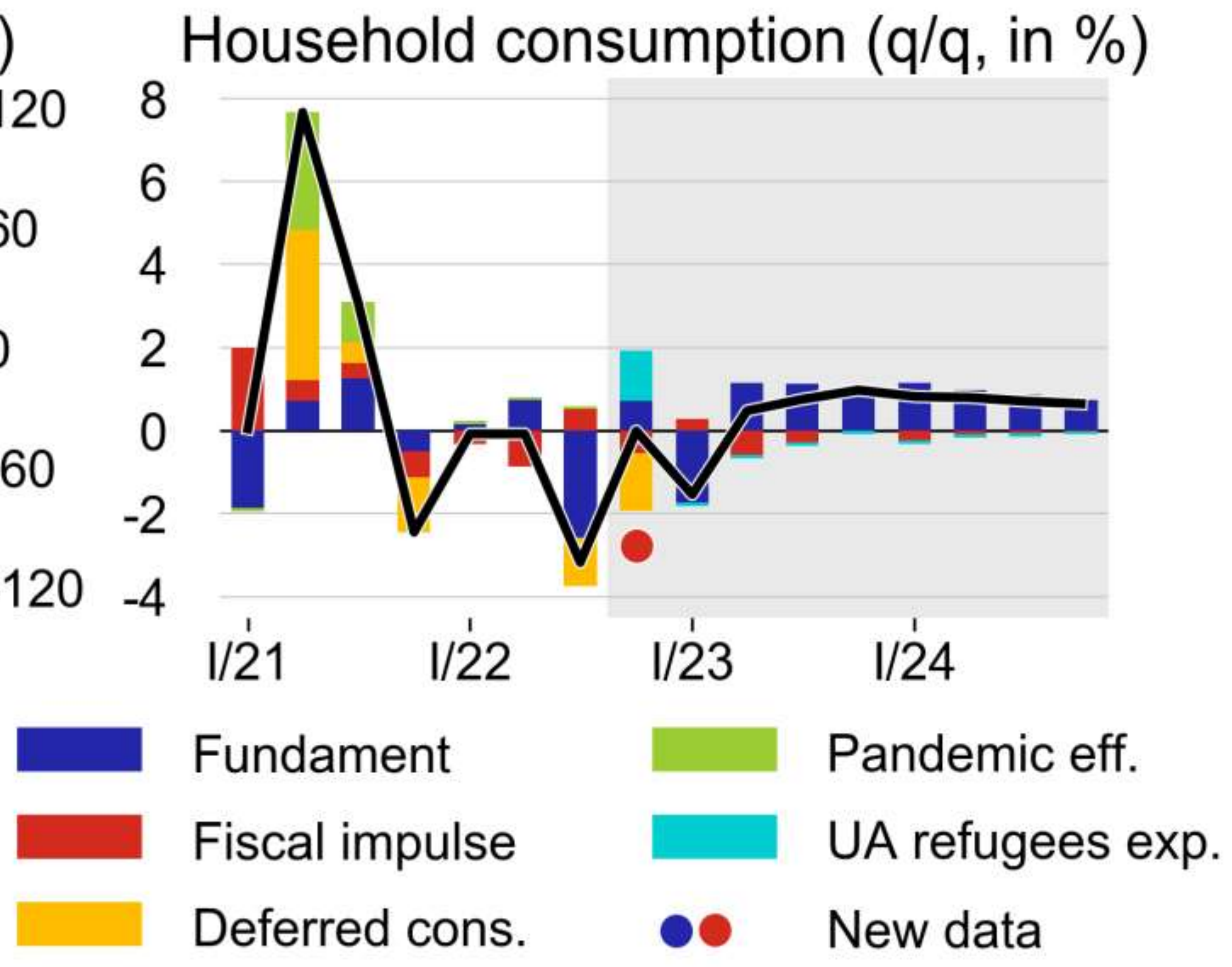
- **Economic activity** will fall slightly due mainly to further deterioration in the financial situation of Czech firms and households, a cooling of external demand and receding problems in global value chains.
- This year, GDP will decrease slightly in **whole-year terms**. It will return to growth of around **2%** in 2024.
- According to a **preliminary CZSO estimate**, Czech GDP **increased** by **0.4%** y/y in 2022 Q4 and **decreased** by **0.3%** q/q, which is slightly lower than the CNB forecast.
- The domestic economy fell below its **potential** at the end of last year with the onset of the recession and will remain there until mid-2024.

GDP Components



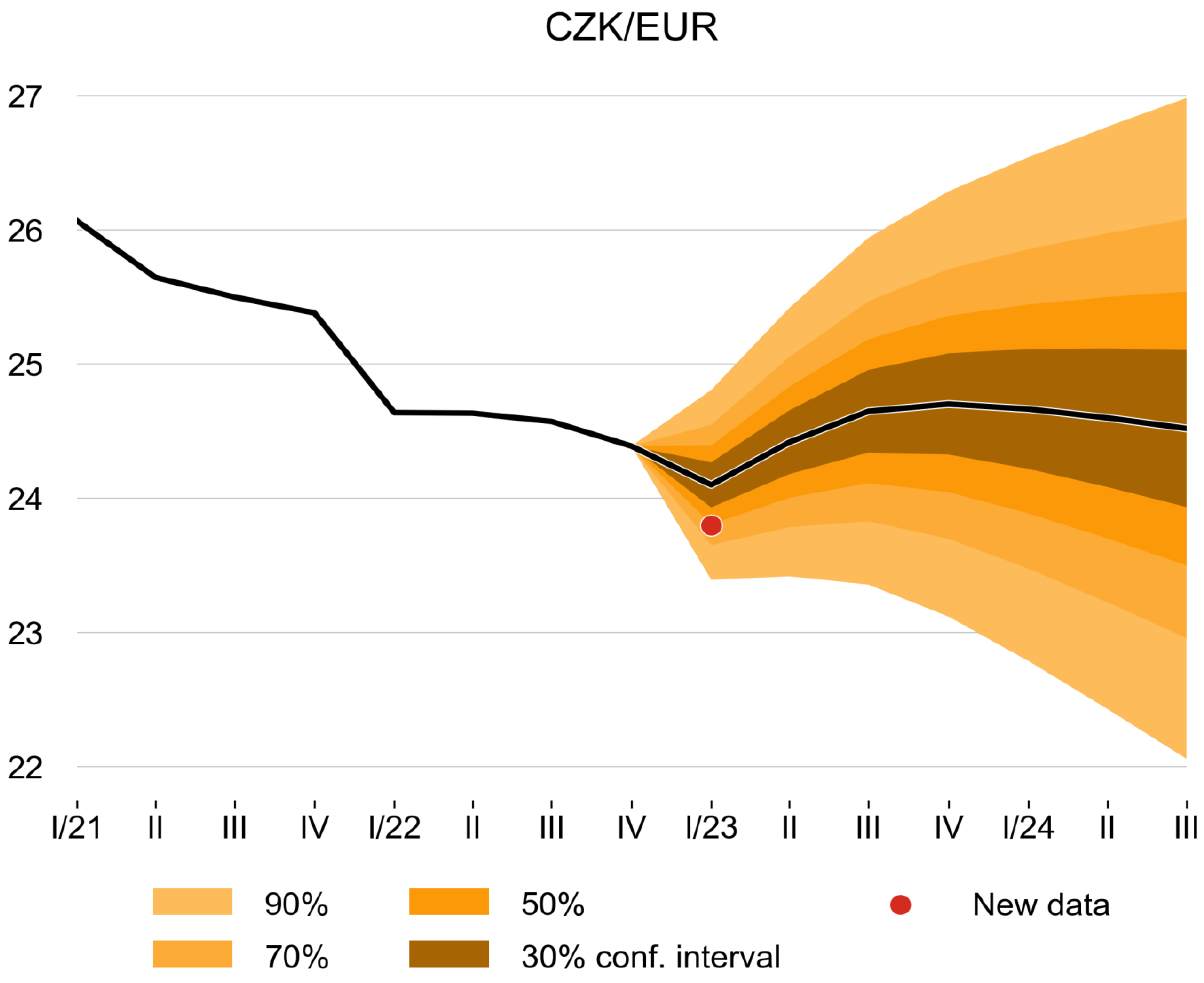






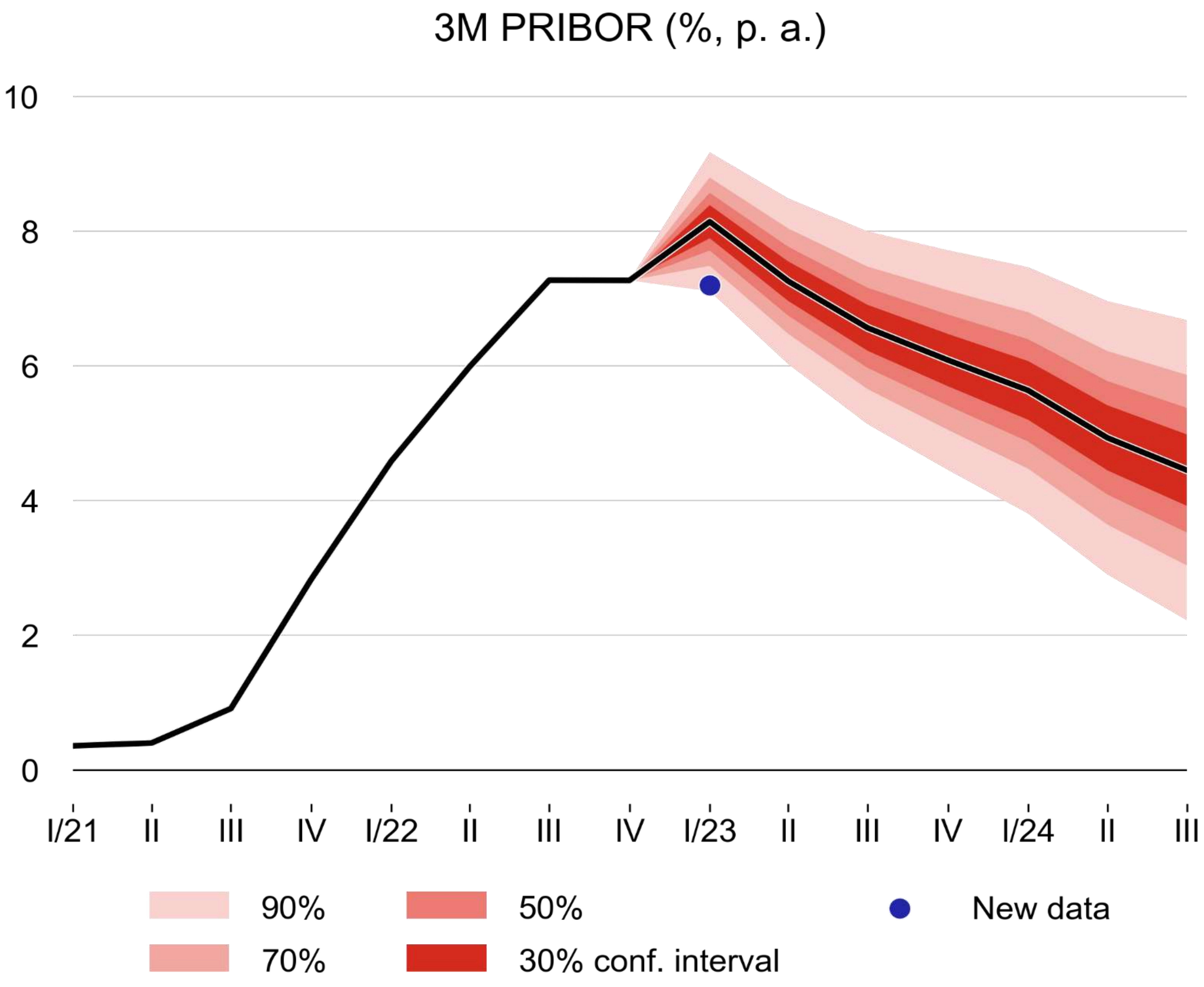
- **Household consumption** will be adversely affected by a sharp fall in real income and negative sentiment, but this fall will be partly offset by government assistance. As a result, household consumption will decline in y-o-y terms for most of this year.
- Households' purchasing power will later improve as inflation drops significantly. Renewed real wage growth will then trigger growth in private consumption.
- **Government consumption** will start to grow again.
- **Growth in total gross investment** will be affected predominantly by **additions to inventories**.
- **Export** and **import growth** will slow slightly this year due to a downturn in external and domestic demand.

Exchange Rate CZK/EUR



- The forecast expects the **koruna** to average CZK 24.1 to the euro in 2023 Q1 and gradually weaken to around CZK 24.5 to the euro in the following quarters.
- The exchange rate will be affected by a **narrowing interest rate differential** vis-à-vis the euro area, which will have a weakening effect.
- After the negative impacts of disrupted global value chains and the impacts of the war in Ukraine fade out, the balance of trade will return to a surplus and global sentiment will improve. This will in turn be reflected in gradual **appreciation** of the koruna during 2024.

Interest Rate Path (3M PRIBOR)



- Consistent with the winter forecast is a rise in **market interest rates** initially, followed by a gradual decline.
- The interest rate reaction reflects the central bank's efforts to fulfil the 2% target robustly at the **monetary policy horizon 12–18 months** ahead, i.e. in the first half of 2024.
- The initial monetary policy tightening will foster a desirable deferral of current consumer and investment demand and reduce the price impacts of the previous excess demand. Fading cost price pressures will result in inflation falling to the target in the 2024 H1. Interest rates will thus be able to start coming down in the course of this year.

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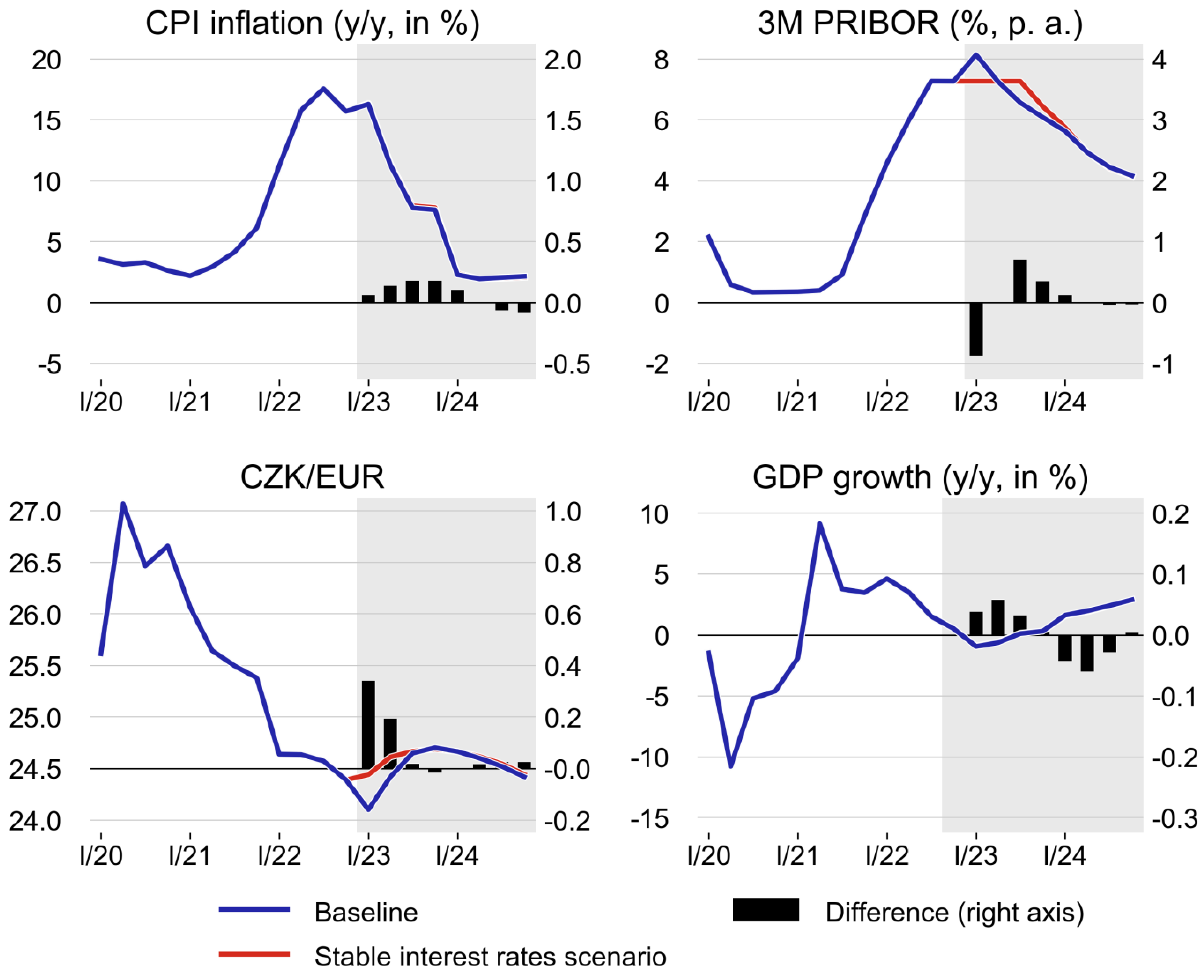
Stable Interest Rates Scenario (Winter Forecast)



- In this simulation, interest rates are kept at their current levels for three quarters.
- The **market interest rate** path is lower than in the baseline scenario in 2023 Q1. This leads to a weaker **koruna** at the start of the outlook than in the baseline scenario.
- Subsequently, the interest rate path is higher than in the baseline scenario, making room for the exchange rate to return to the baseline scenario path.
- In 2023, **inflation** will stay higher than in the baseline scenario, mainly because of the weaker koruna.
- Inflation will return close to the 2% target at the monetary policy horizon due to a more restrictive effect of interest rates in the second half of this year.

Thank you for your attention

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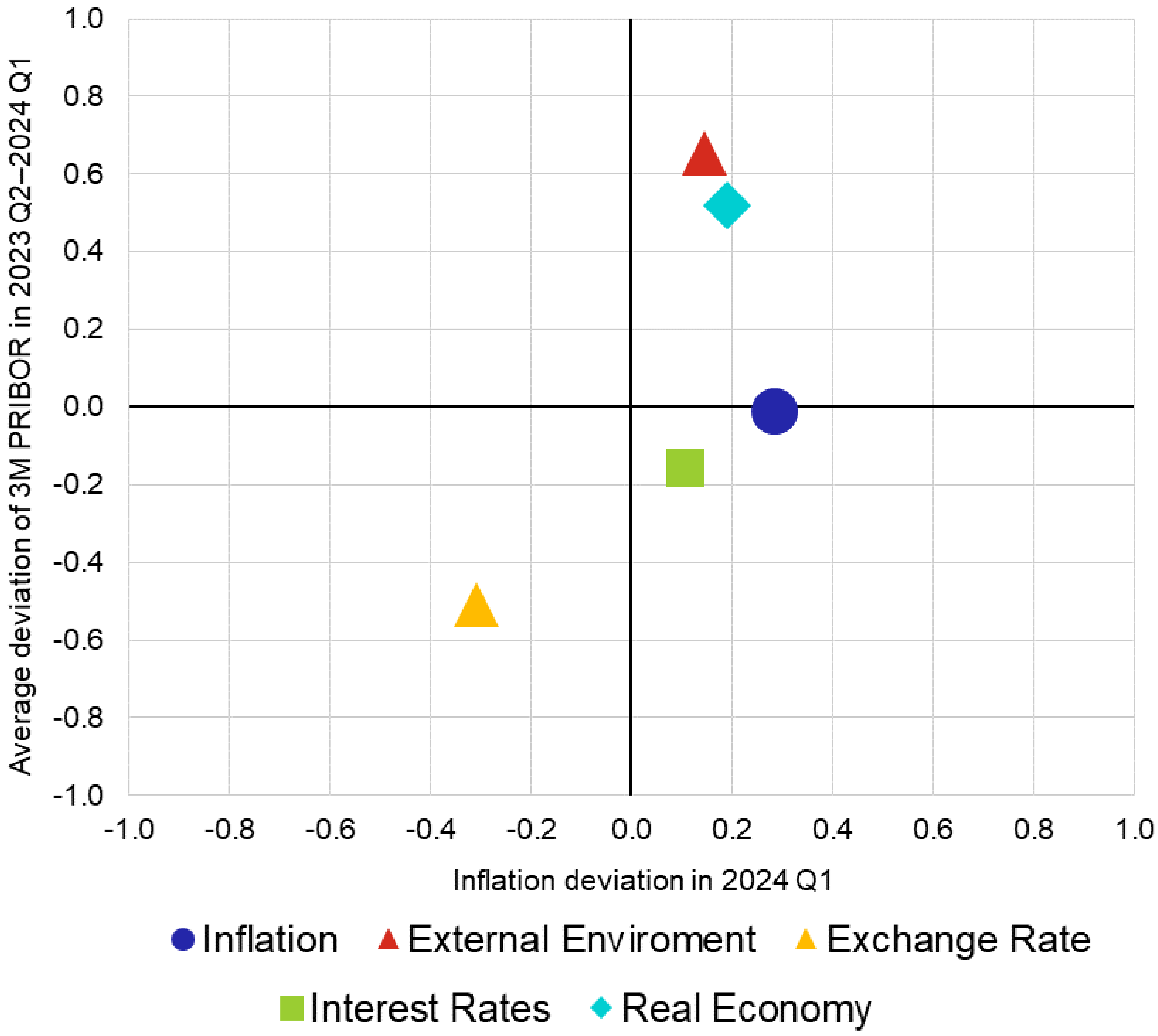
Monetary Department

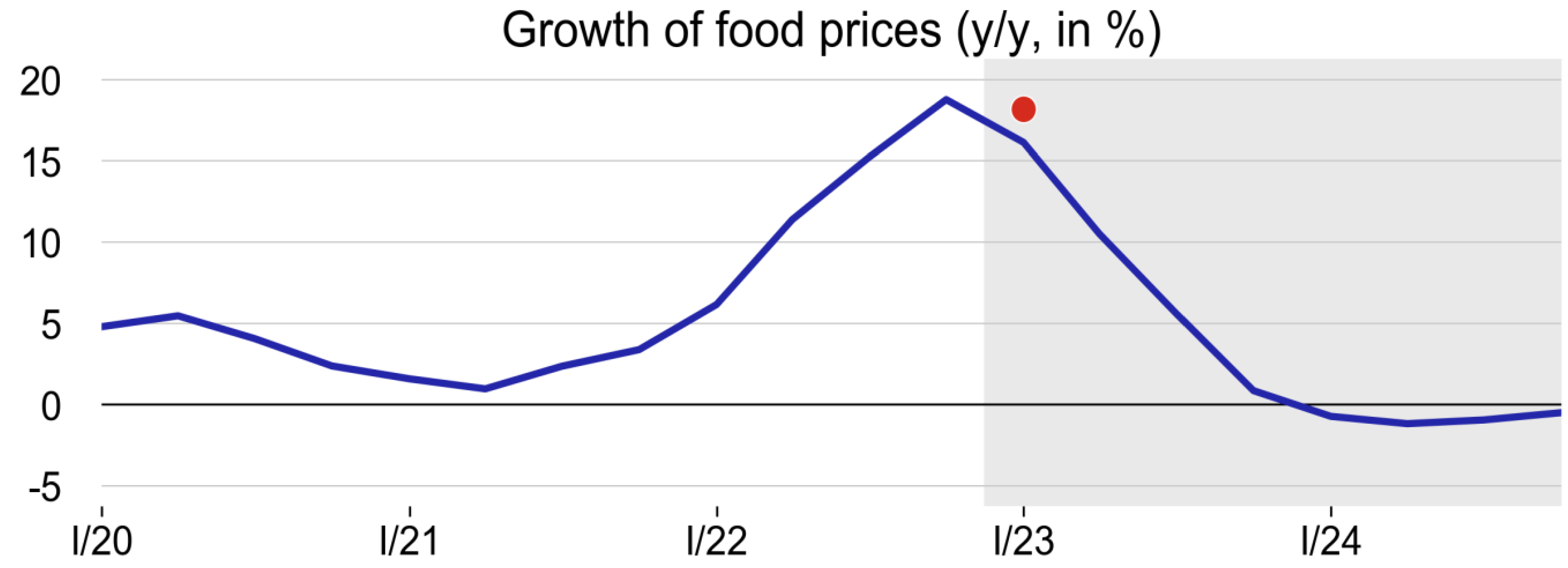
Deputy Executive Director

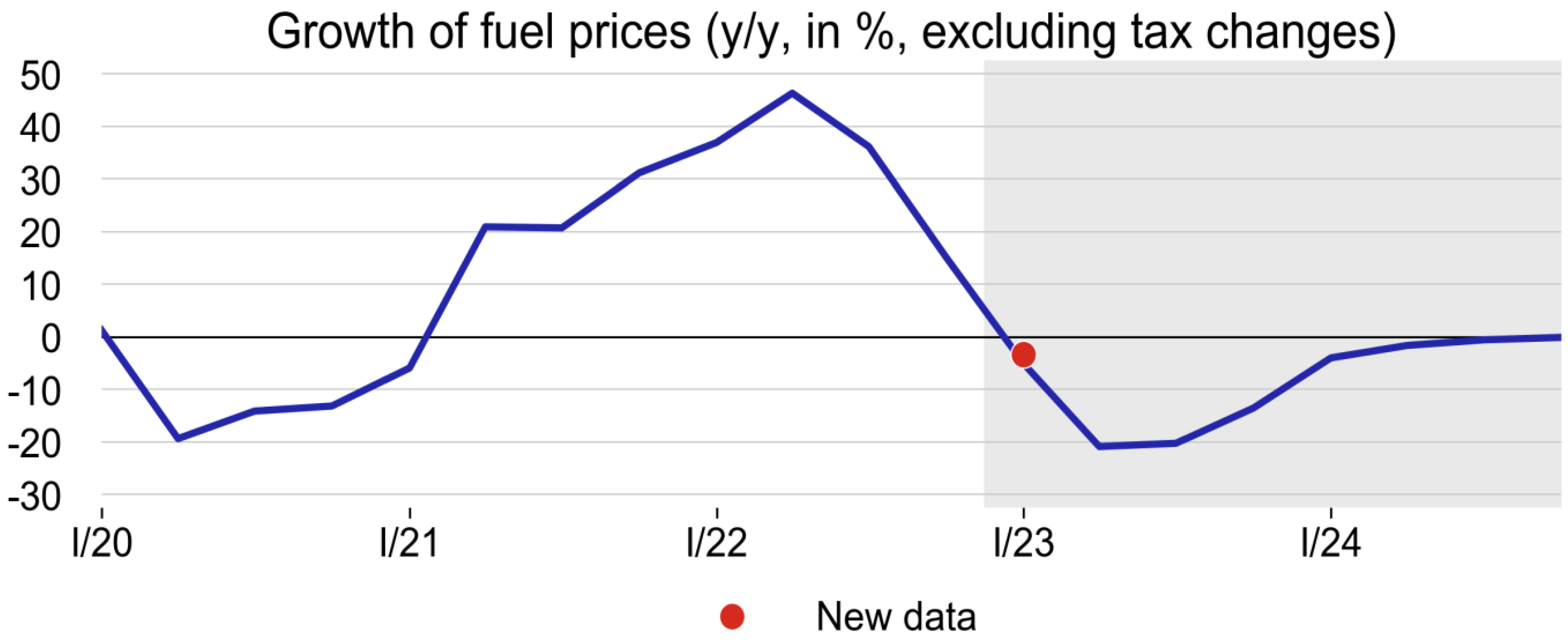
GRIP



- The sharp growth in **food prices** is being driven mainly by still high world agricultural commodity prices and soaring domestic agricultural producer prices. This is going on amid rising energy costs.
- A significant rise in prices can be expected across all food categories in the summer months. It will be fostered in part by the situation in Ukraine.
- The surging **food price inflation** will peak at the turn of summer and autumn. It will slow distinctly in 2023, owing to an expected correction of world agricultural commodity prices.
- **Fuel price inflation** will be high throughout this year, but it will decrease gradually as global oil prices fall. Prices at filling stations will decrease year on year in the second half of 2023.

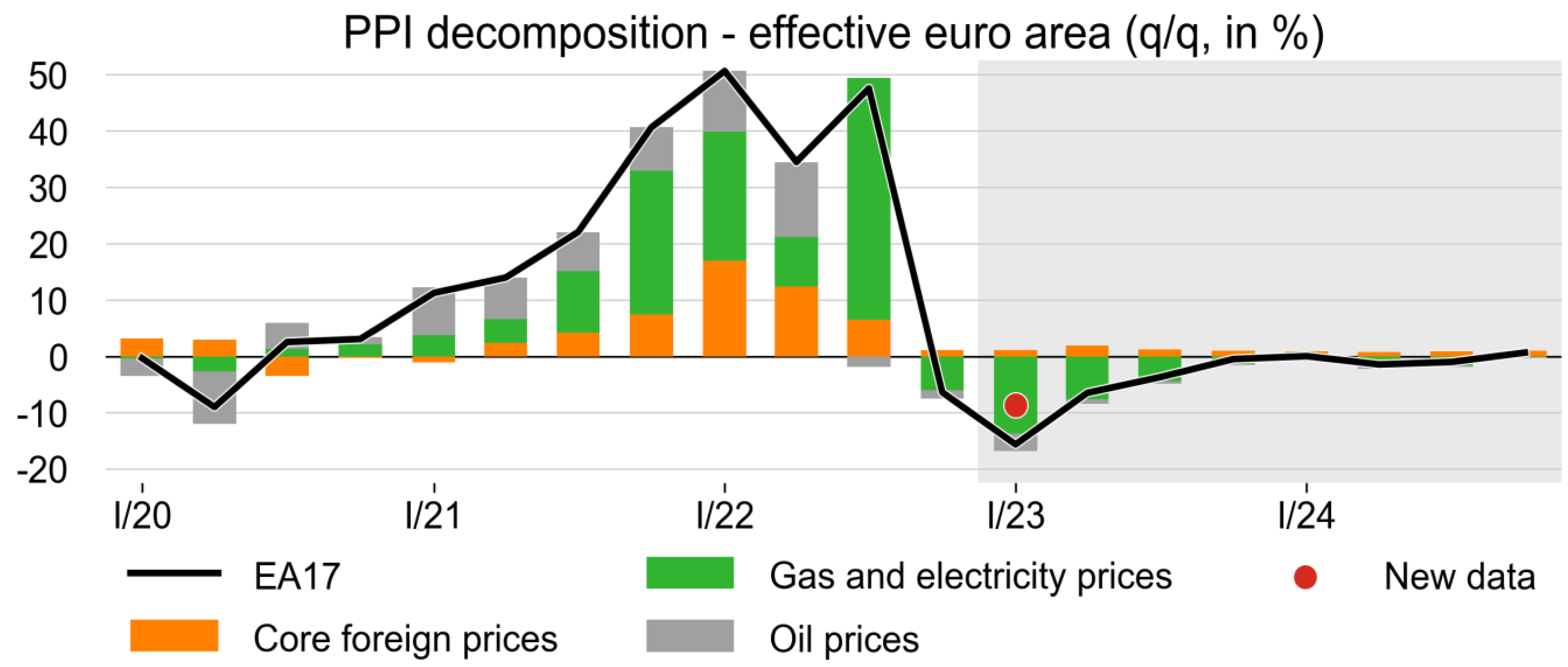
Food and Fuel Prices

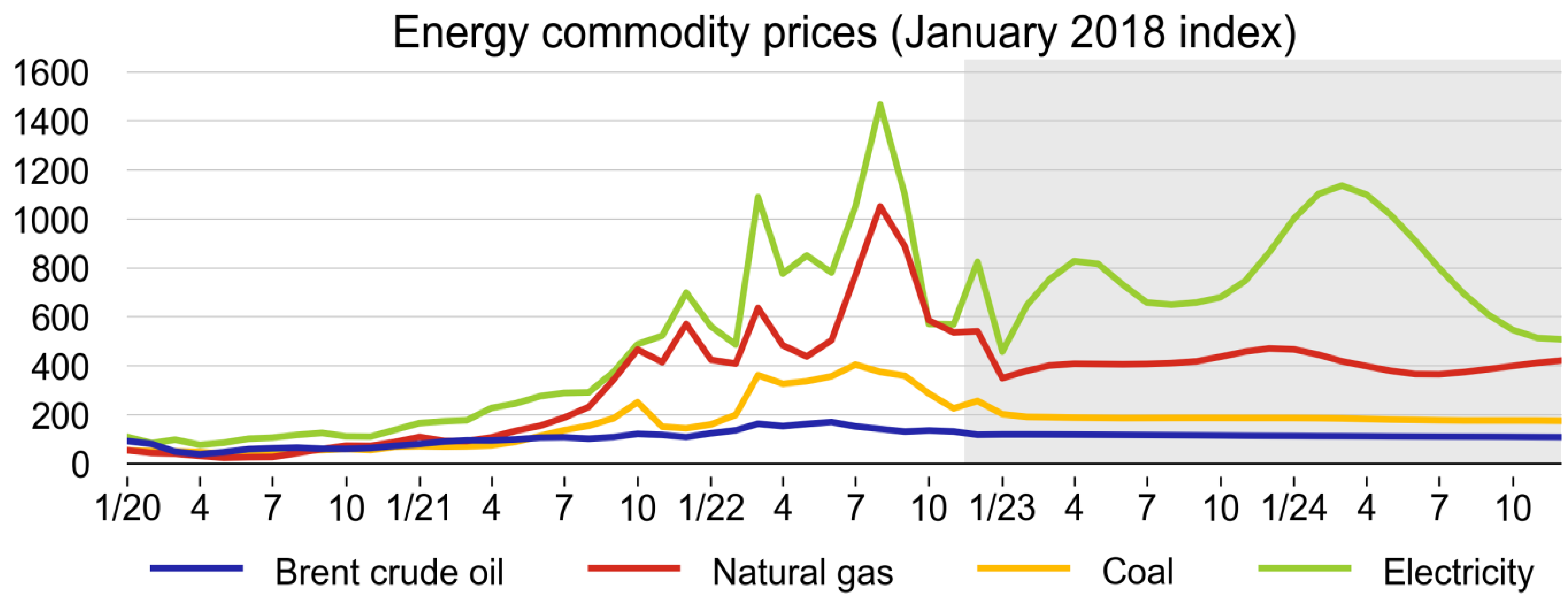




- **Food price inflation** will continue to come down in 2023 Q1 partly because of falling world agricultural commodity prices and domestic agricultural producer prices.
- Over the rest of this year, food price inflation will drop distinctly. At the end of 2023, food prices will begin to fall in year-on-year terms.
- **Fuel price inflation** will start to decline in 2023 Q1 owing to a drop in oil prices and margins along the entire value chain. Prices at filling stations will decrease year on year in 2023 Q1, due mainly to a high base, and will continue to fall for the rest of this year.

Energy Price Outlook

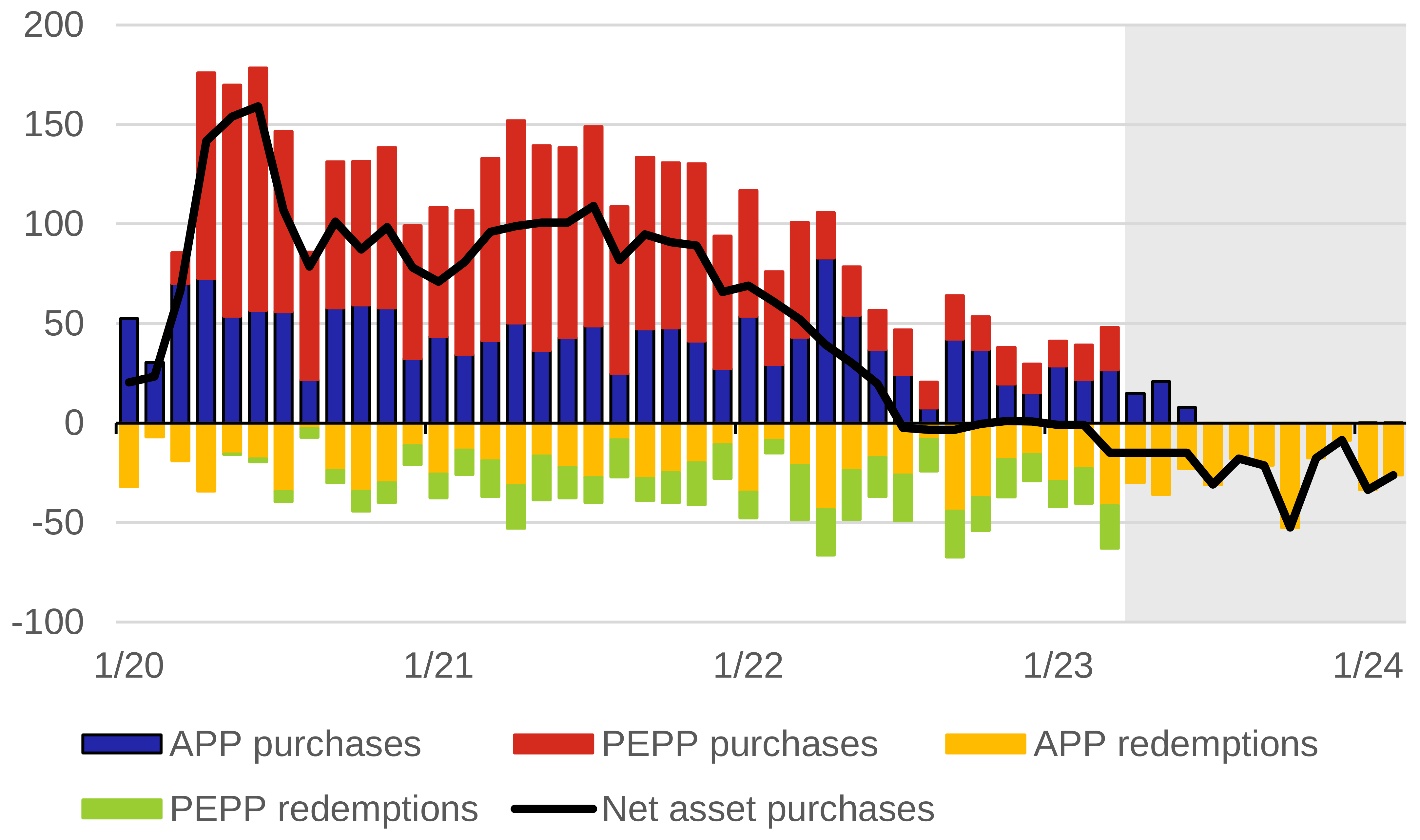




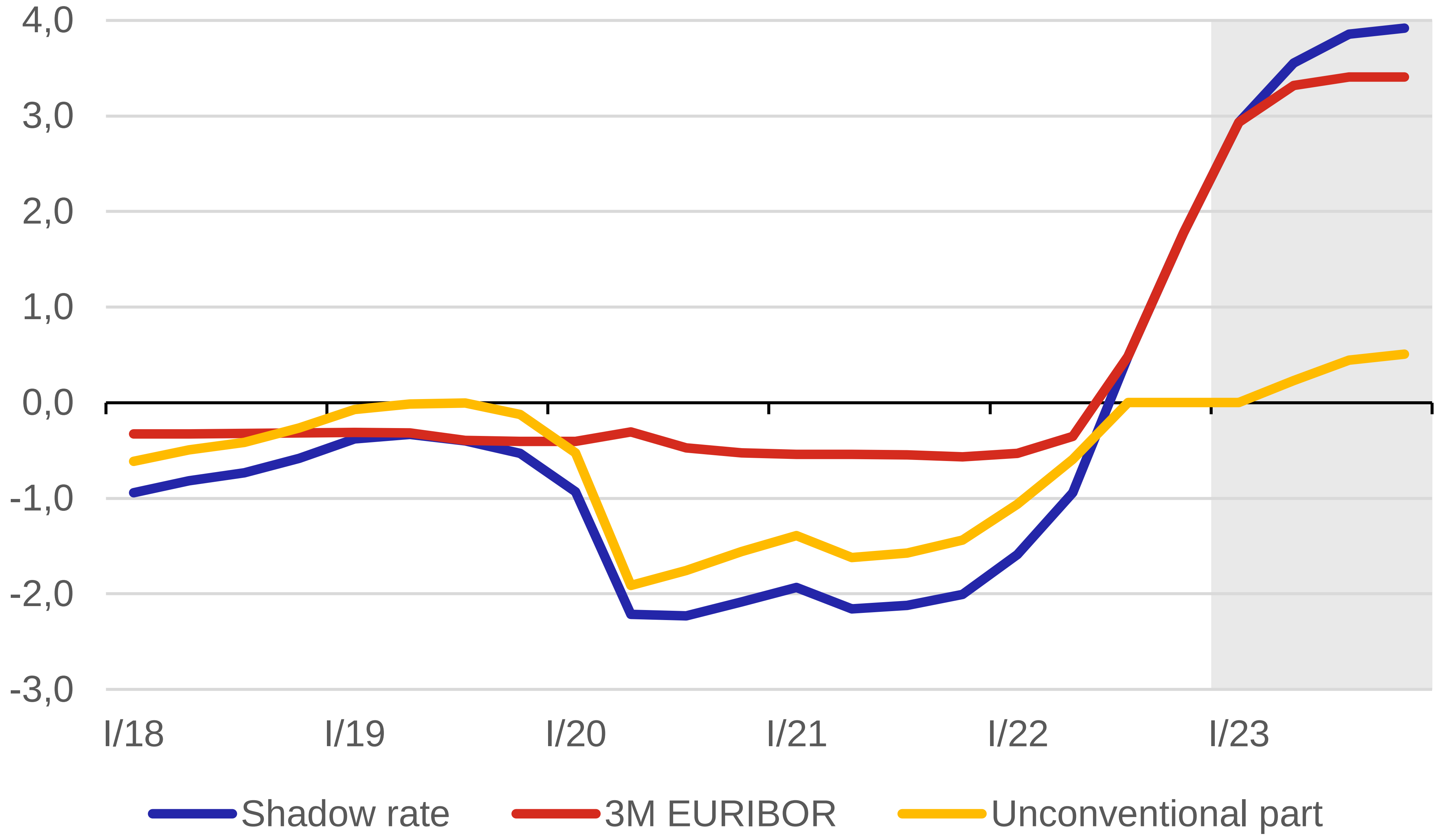
- A drop in effective **euro area PPI** in 2023 will be predominantly driven by gas and electricity prices.

Balance Sheet Operations of ECB

ECB‘s asset purchases (bil. EUR)



3M EURIBOR and shadow rate (%, p.a.)



- The volume of financial **assets purchased by the ECB** will start falling in spring 2023, causing the euro area **shadow rate** to move above the 3M EURIBOR due to the unconventional part.