# CNB's Forecast (Monetary Policy Report Summer 2021)

## Erste CEE Investor Roadshow

21 September 2021

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CZECH NATIONAL BANK

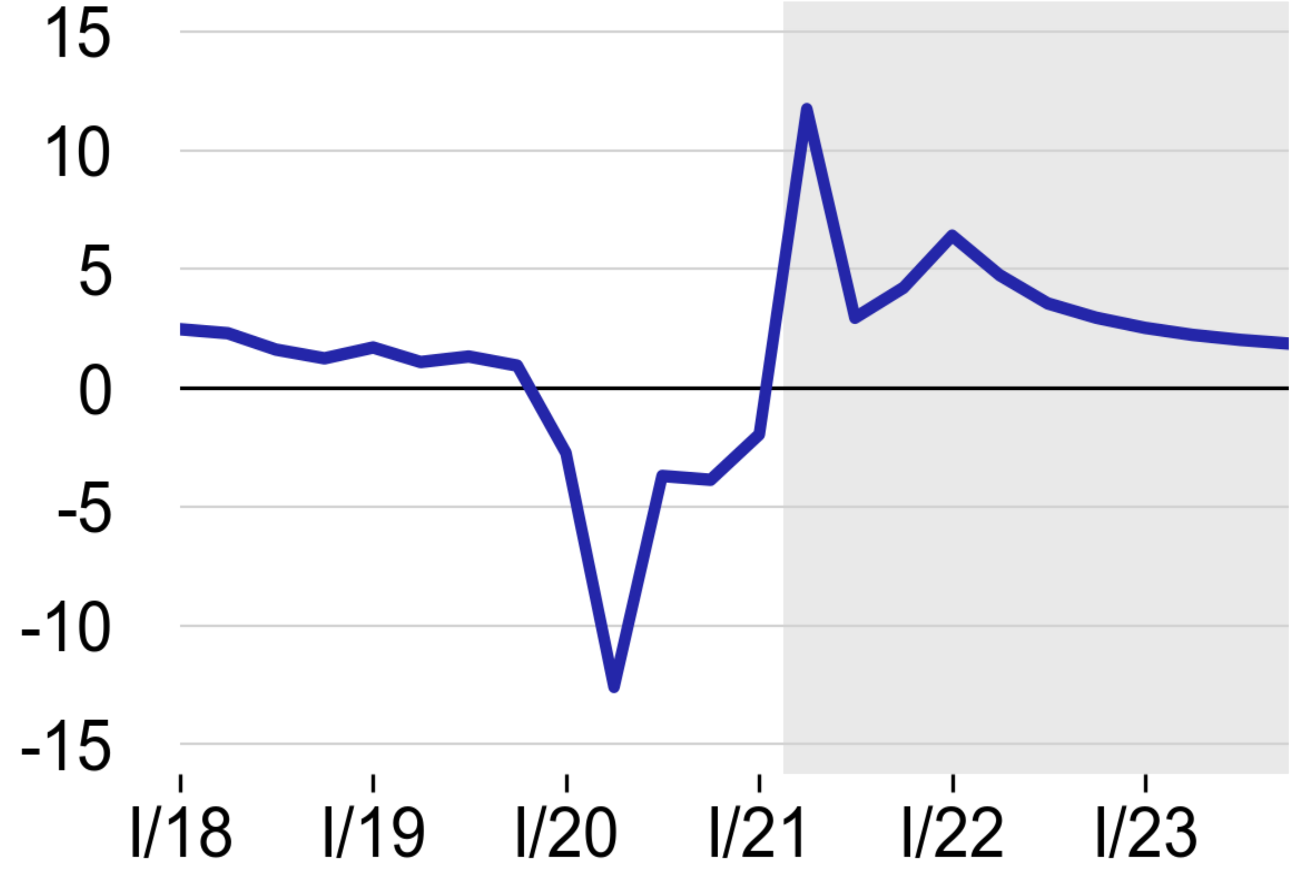
# Presentation Outline

1. **Assumptions of the Forecast**
2. The Macroeconomic Forecast
3. Monetary Policy Simulations, Decision and Communication
4. New Data

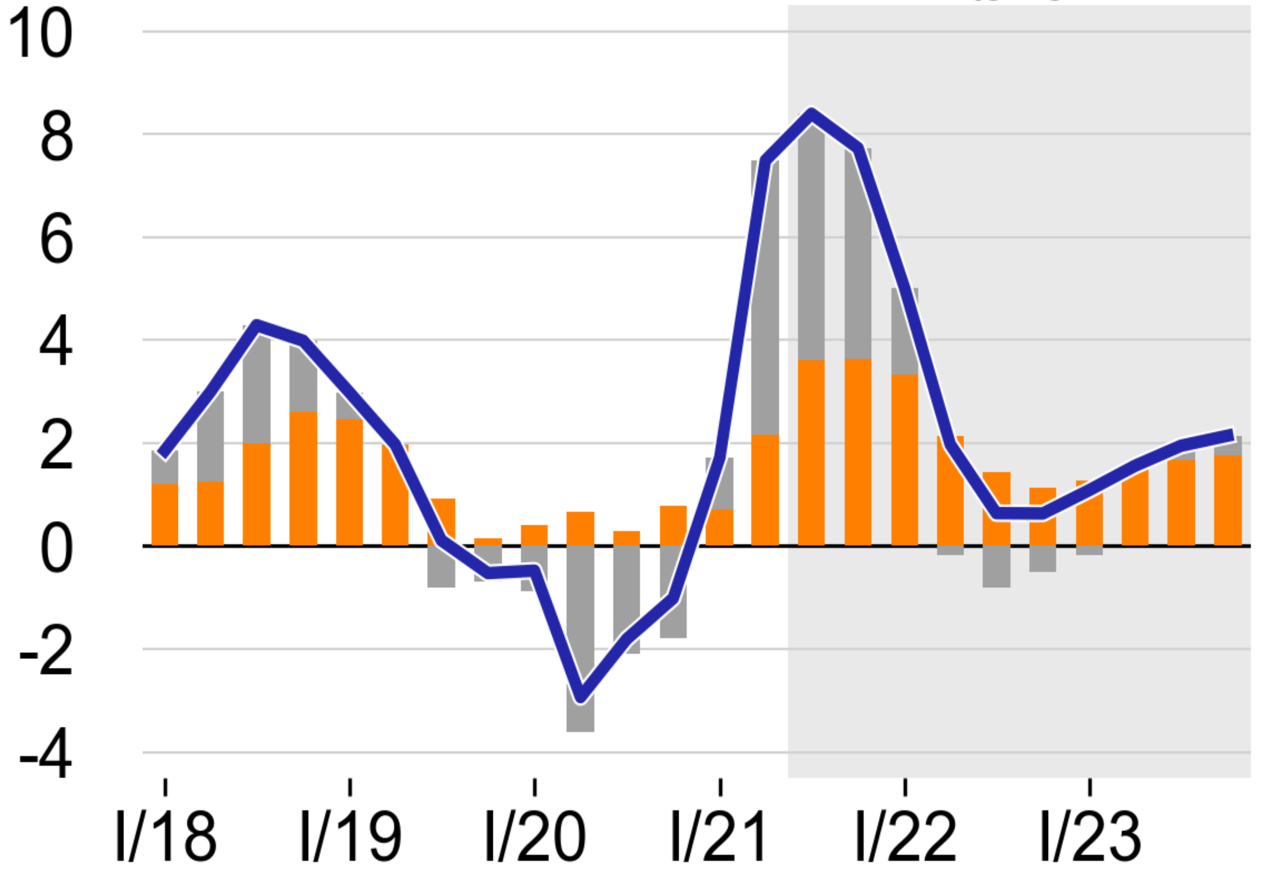
# External Environment Outlook



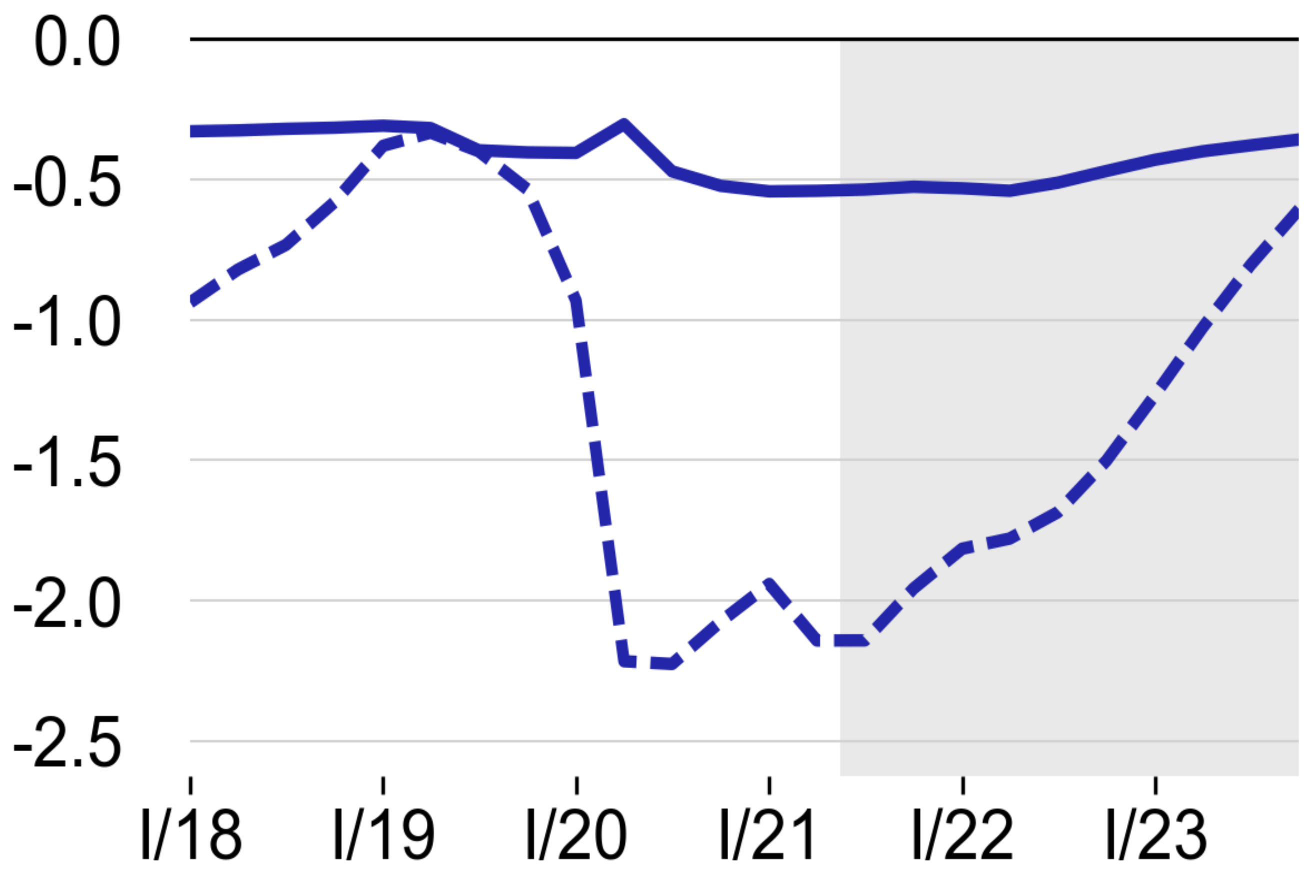
GDP - effective euro area (y/y, in %)



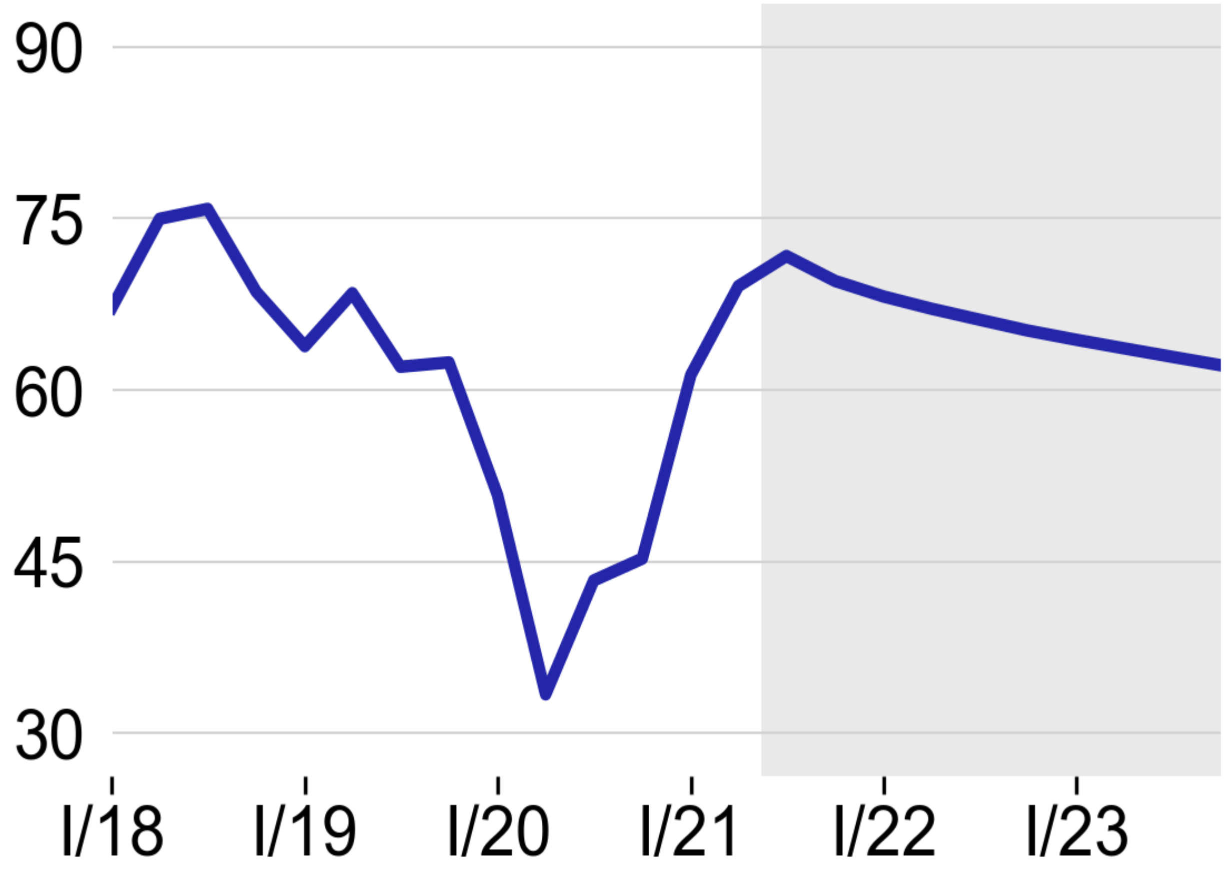

PPI - effective euro area (y/y, in %)




3M EURIBOR (%, p. a.)




Brent oil price (USD/b)




Core component  Energy component  Shadow rate

- The recovery of **economic activity** in the effective euro area will be driven by a reopening of services supported by spending of part of the forced savings created during lockdowns.
- The **price pressures in industrial production** are exceptionally strong at the moment. Both components – core and energy – will contribute to a sharp rise in foreign producer prices this year.
- The pressures on industrial producer prices reflect growth in prices of **crude oil** and other commodities as well as strong demand for industrial goods.
- The **3M EURIBOR** outlook remains negative. The effect of unconventional monetary policy on the **shadow interest rate** is gradually diminishing.

# Domestic Developments

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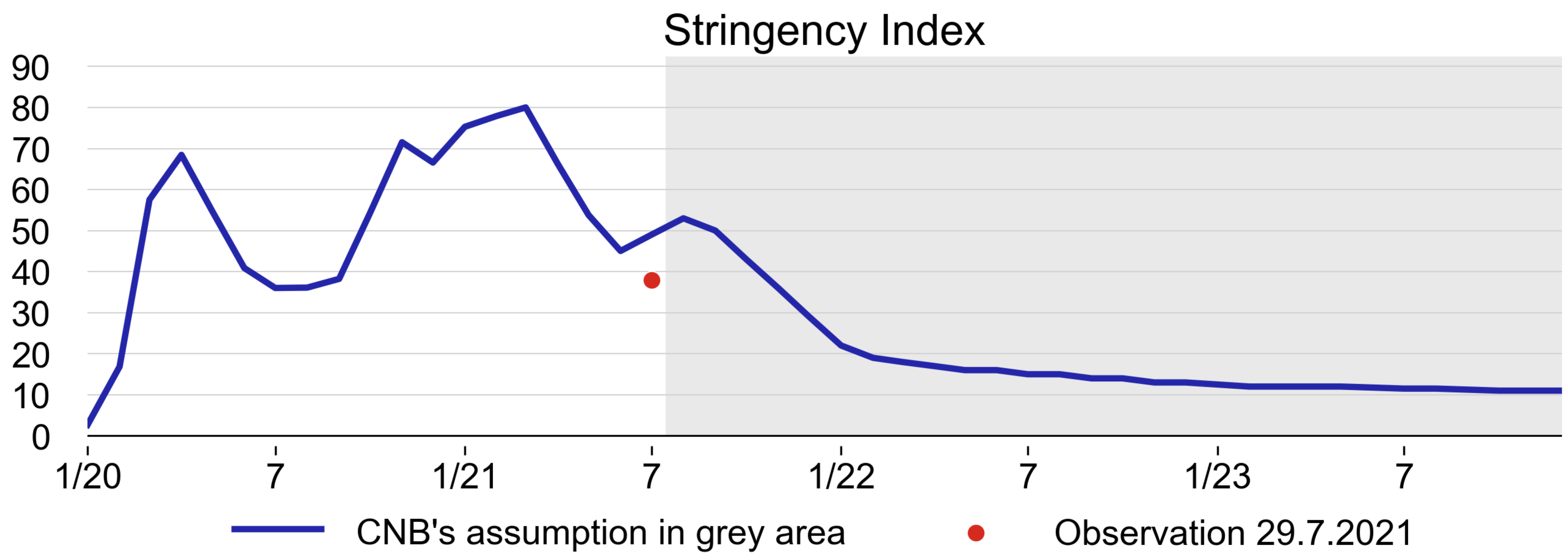


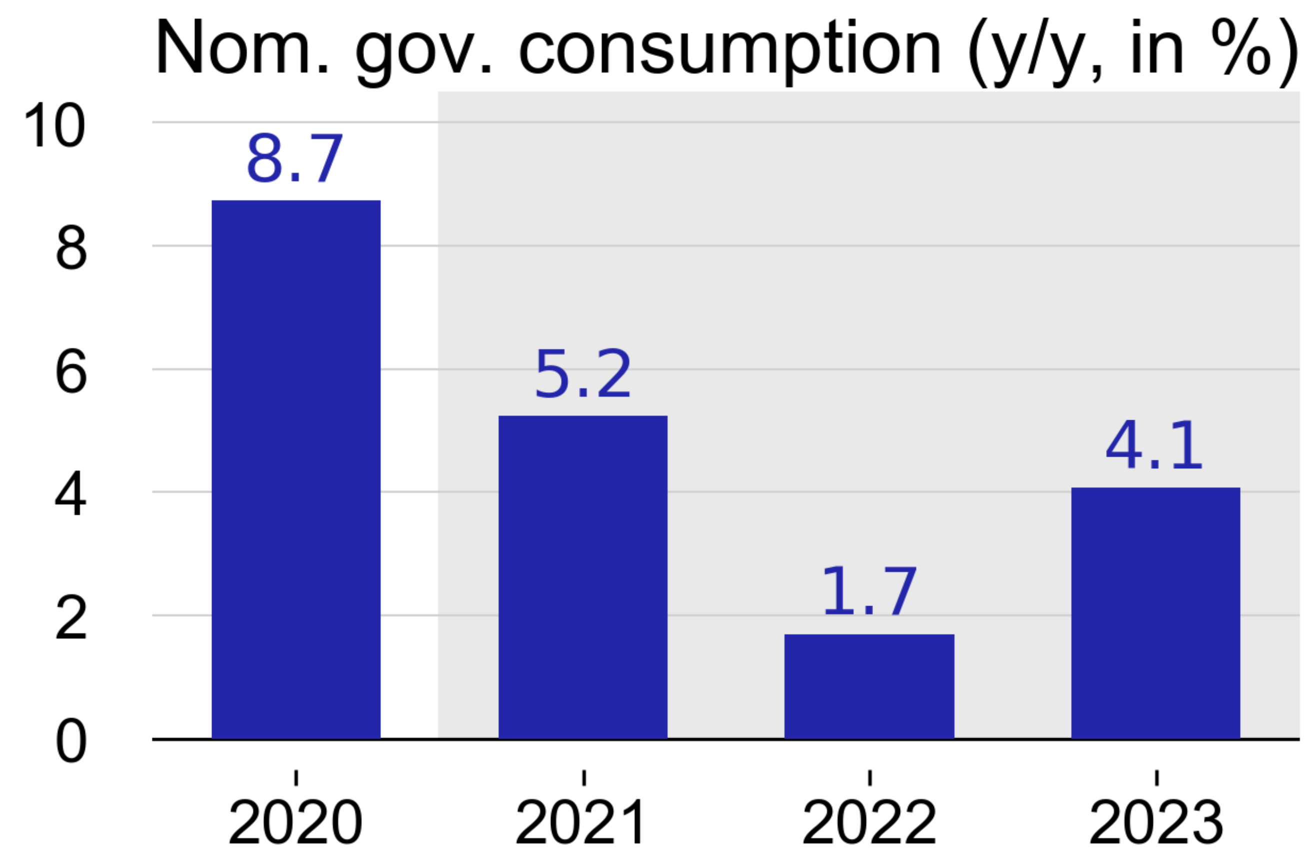


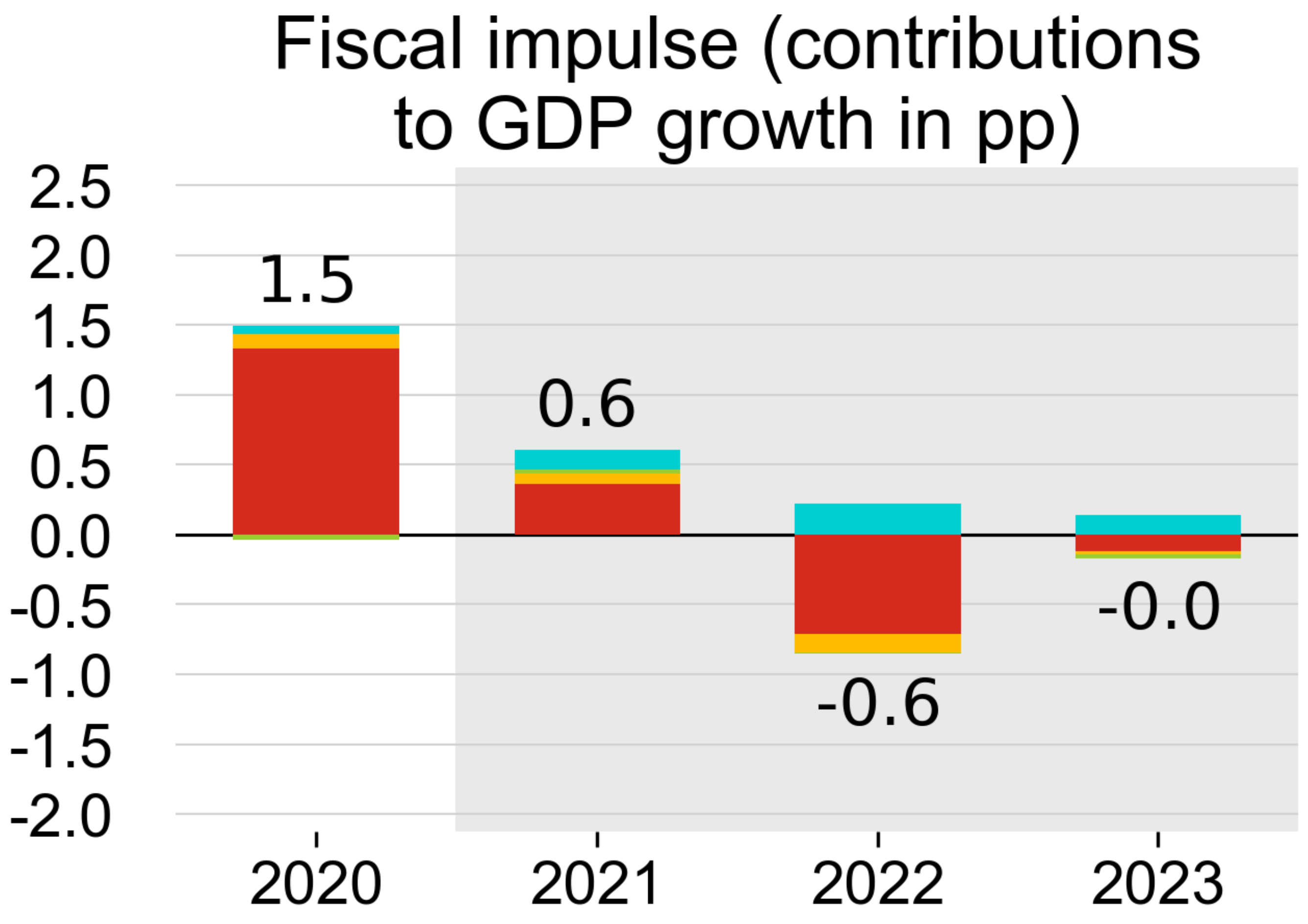


- After an upward summer episode, the **Stringency Index** will fall rapidly again in the coming months. This summer episode should have no major impacts on the consumption of households. Next year, the Stringency Index will be at levels that will not have tangible effects on the economy.
- **Government consumption** will rise this year, albeit more slowly than before due to last year's high expenditure.
- Fiscal policy is increasing GDP growth this year mainly via support for household income and consumption; the **fiscal impulse** will be negative in 2022. Its restrictive effect stemming from the phasing out of support measures will be softened by an extraordinary increase in pensions.

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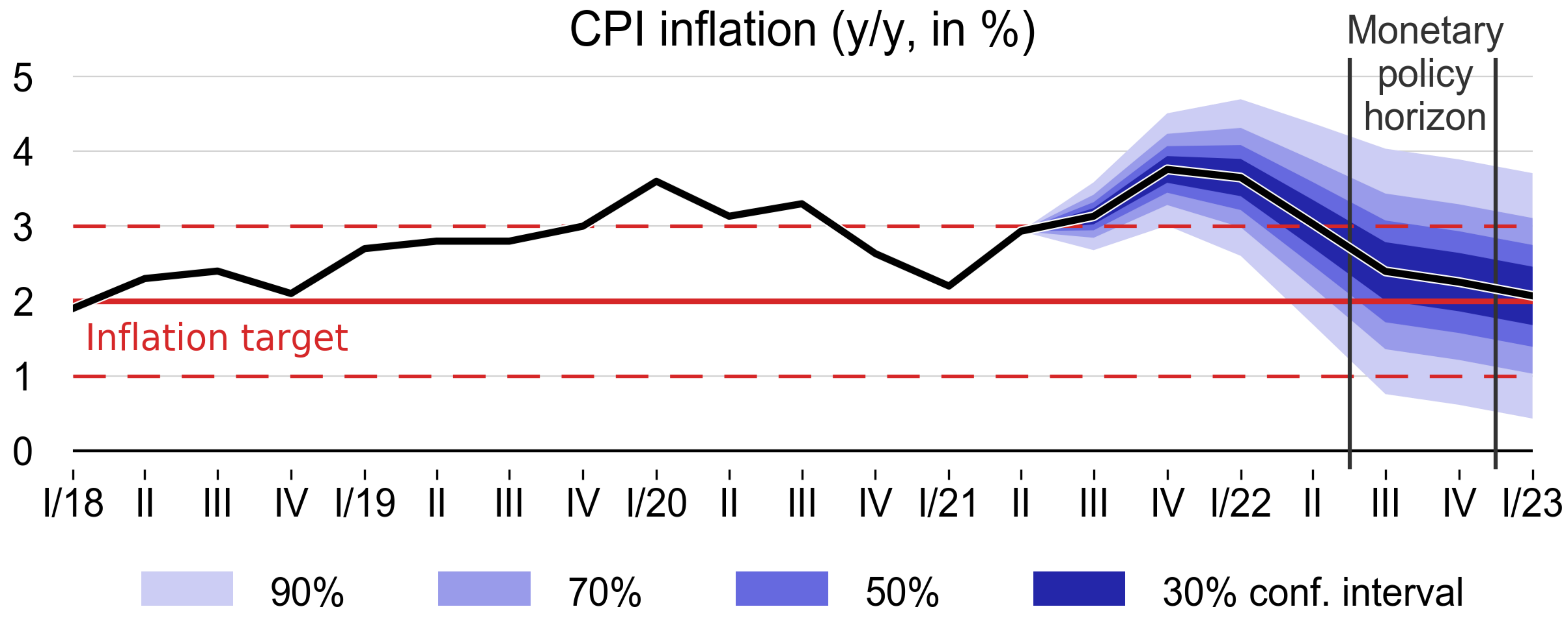
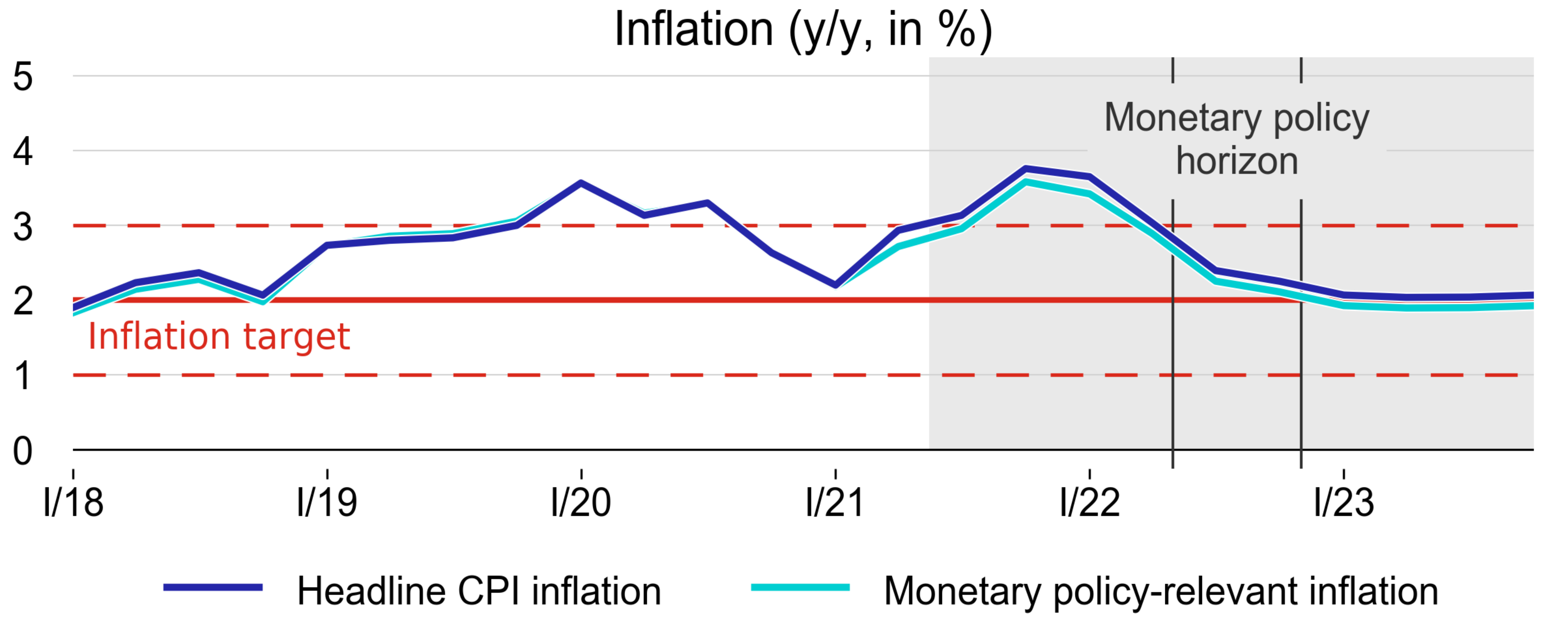
# Headline and Monetary Policy-Relevant Inflation

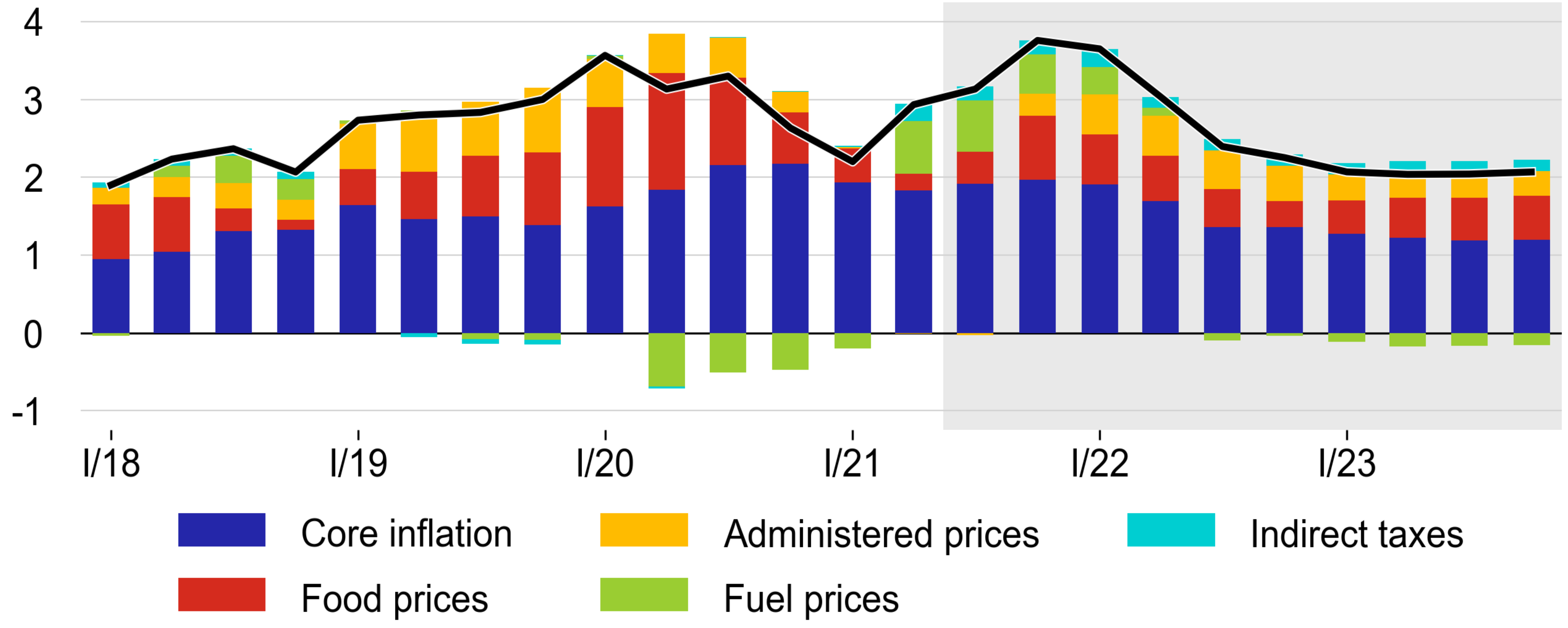


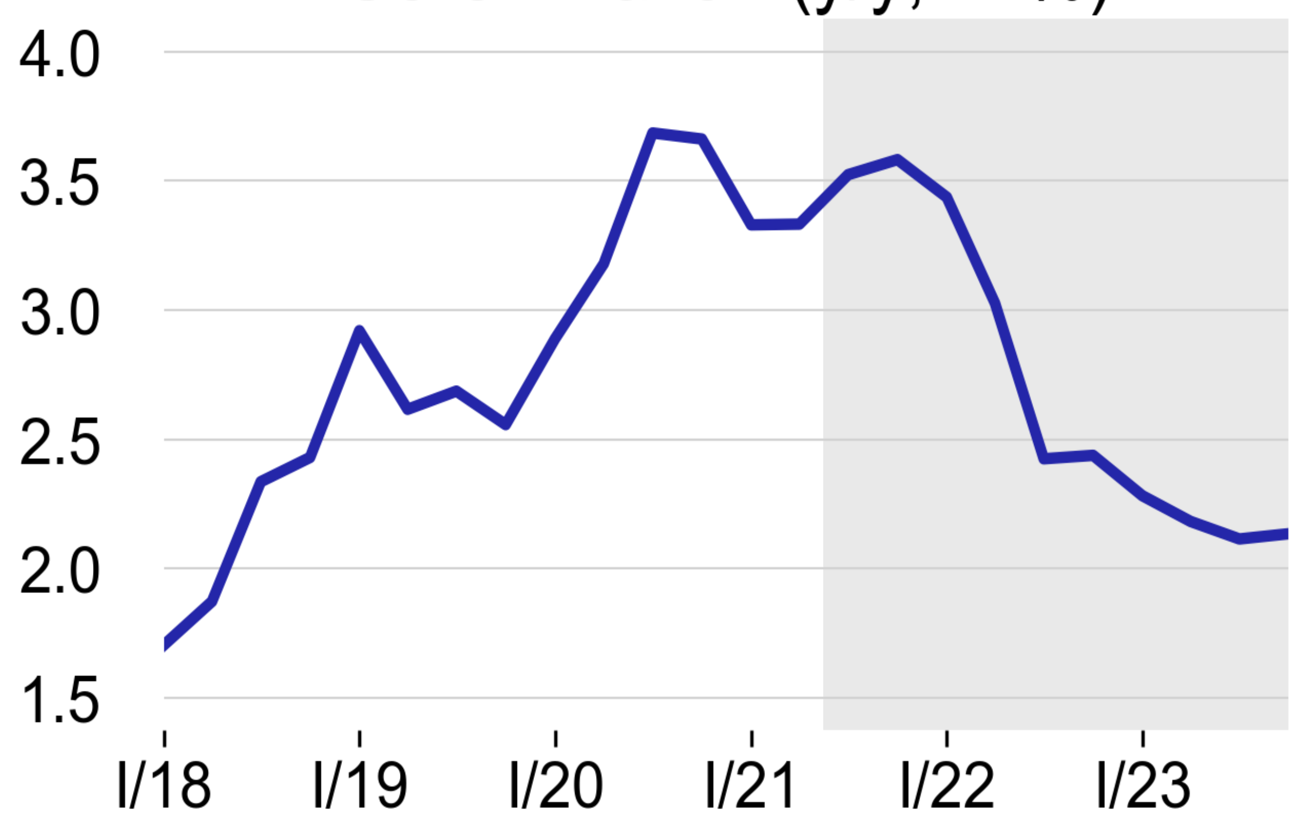

- **Inflation** will rise well above the upper boundary of the tolerance band in the second half of the year and slow towards the 2% target next year.
- Headline inflation will accelerate initially due to a pick-up in **food price** inflation and later also renewed **administered price** inflation. In addition, **core inflation** will remain strong and **fuel prices** will continue to rise apace.
- Next year, inflation will start to return to the target, aided by this year's significant tightening of monetary conditions.
- Headline inflation will be slightly above monetary policy-relevant inflation due to changes in excise duties.

# Inflation

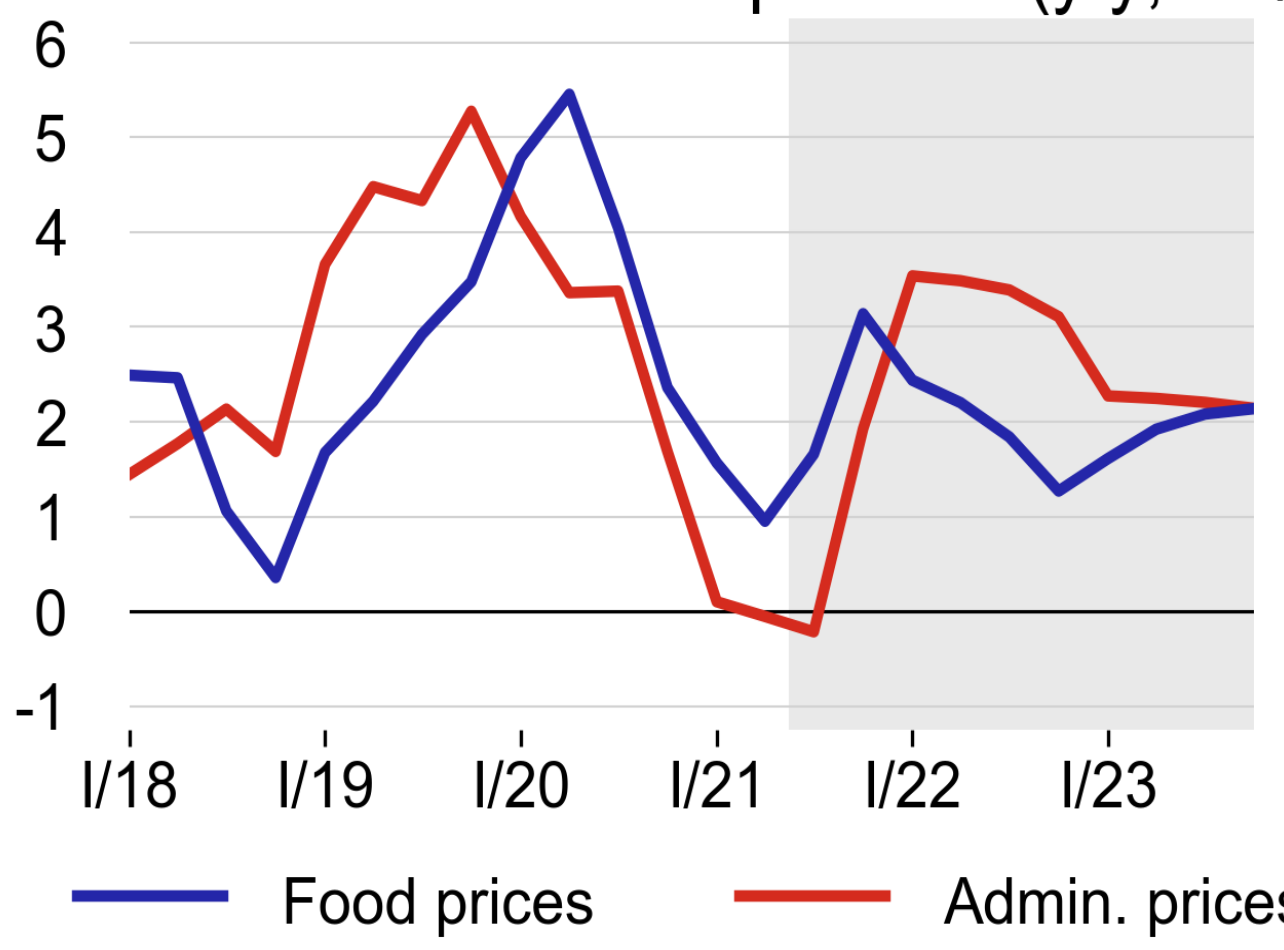
CPI inflation (y/y in %, contributions in pp)




Core inflation (y/y, in %)

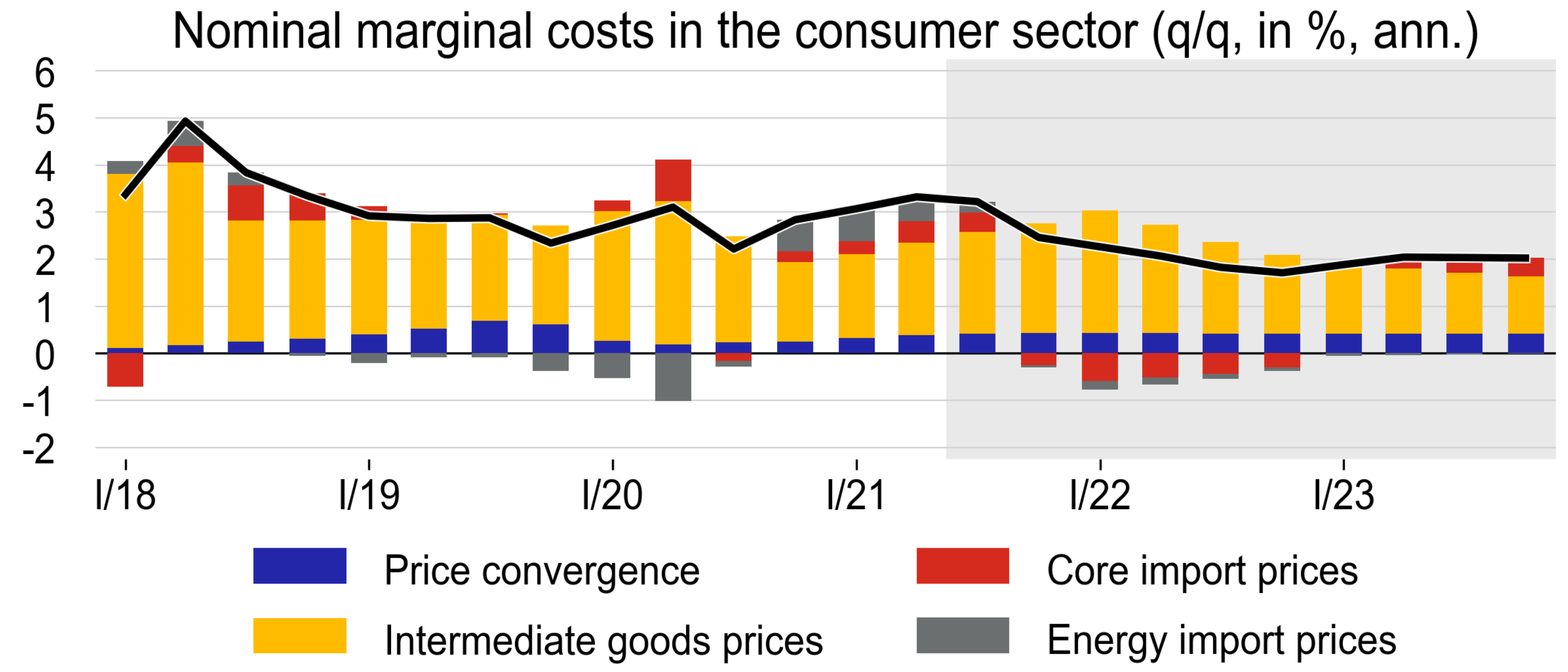


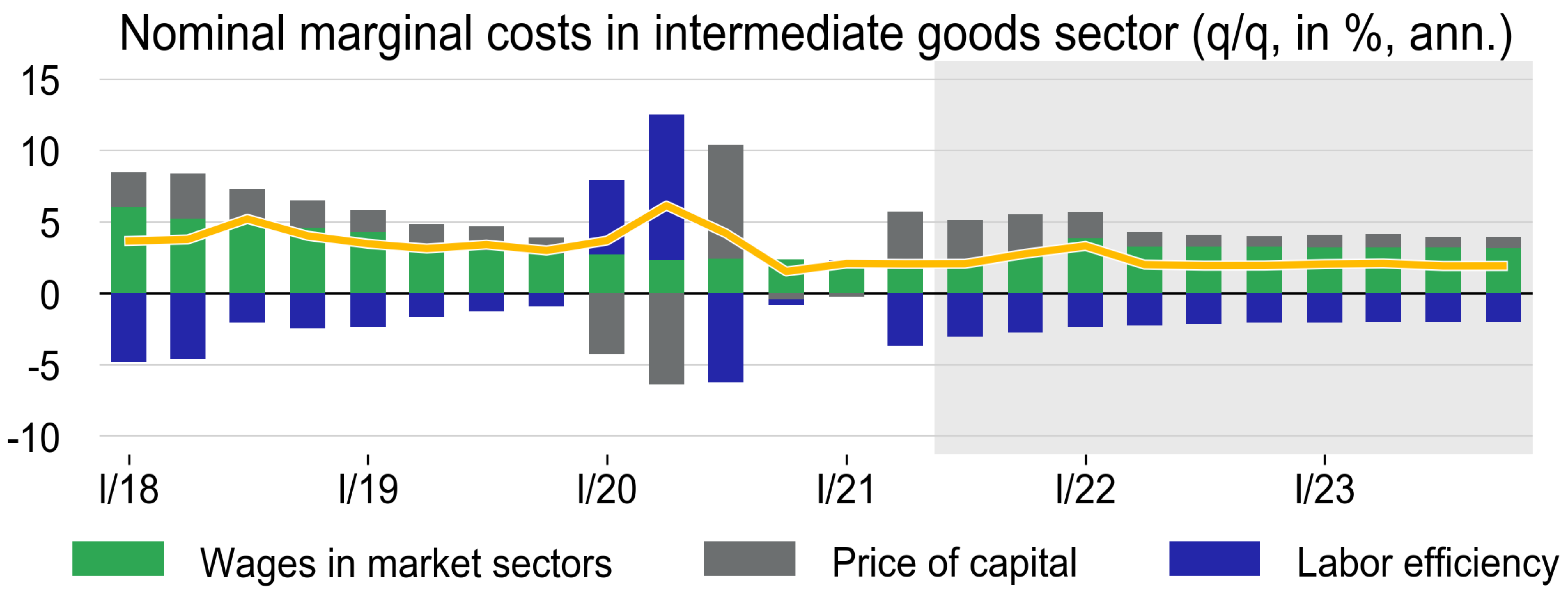

Selected CPI infl. components (y/y, in %)




- Inflation will continue to be dominated by core inflation; the temporarily subdued contributions of food prices and administered prices will soon intensify again.
- Observed rapid growth in **fuel prices** reflects both last year’s low base and the recent sharp rise in oil prices.
- Growth in **core inflation** is being driven largely by cost factors and strong domestic demand.
- The temporarily muted growth in **administered prices** will start to rise sharply at the end of the year due to growing energy prices.
- **Food price** inflation is volatile; it will start to rise from its currently subdued levels and peak at the end of this year.

# Inflation Pressures




- The currently strong **overall inflation pressures** will ease at the end of the year as the high growth in import prices fades away.
- Distinctly positive contributions of the **energy and core components** will turn anti-inflationary at the end of this year owing to appreciation of the koruna, coupled with slower growth in foreign producer prices. The currently elevated overall inflation pressures will therefore ease.
- **Domestic cost** pressures will strengthen temporarily in the quarters ahead owing to increased consumer demand and a recovery in wage growth supported by a further increase in the minimum wage.

# Labour Market

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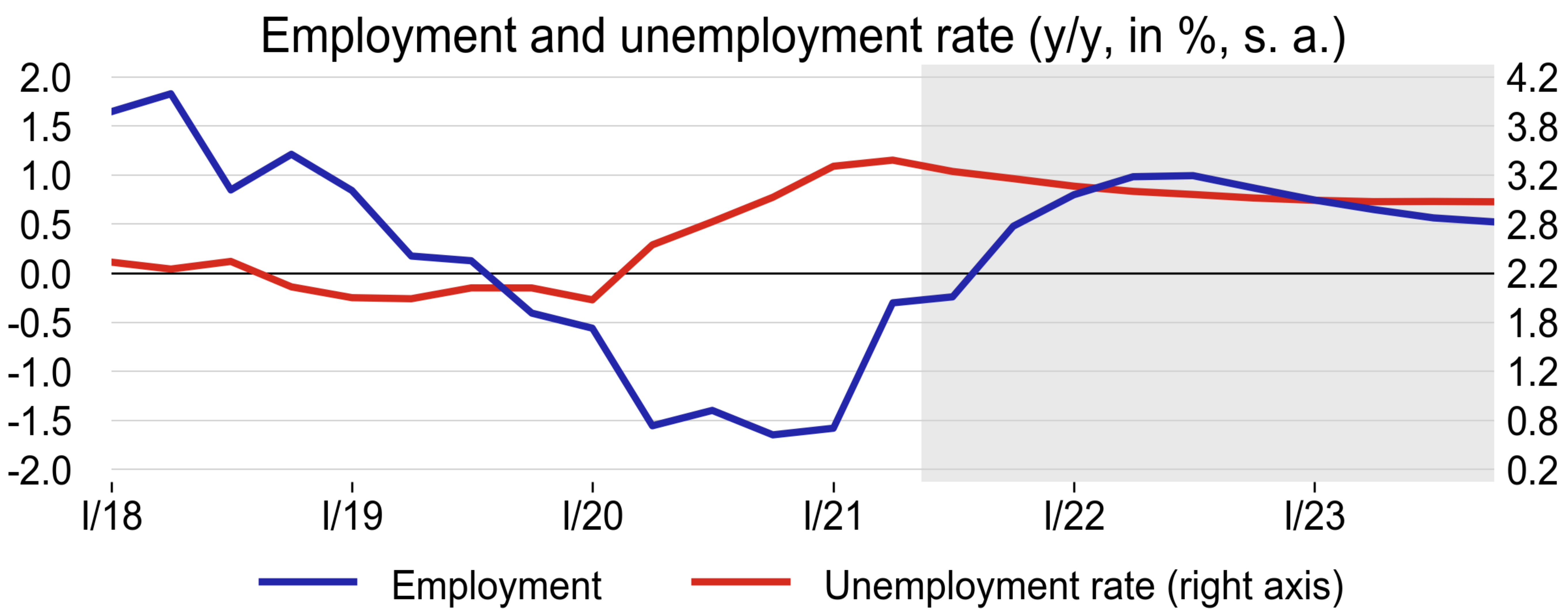
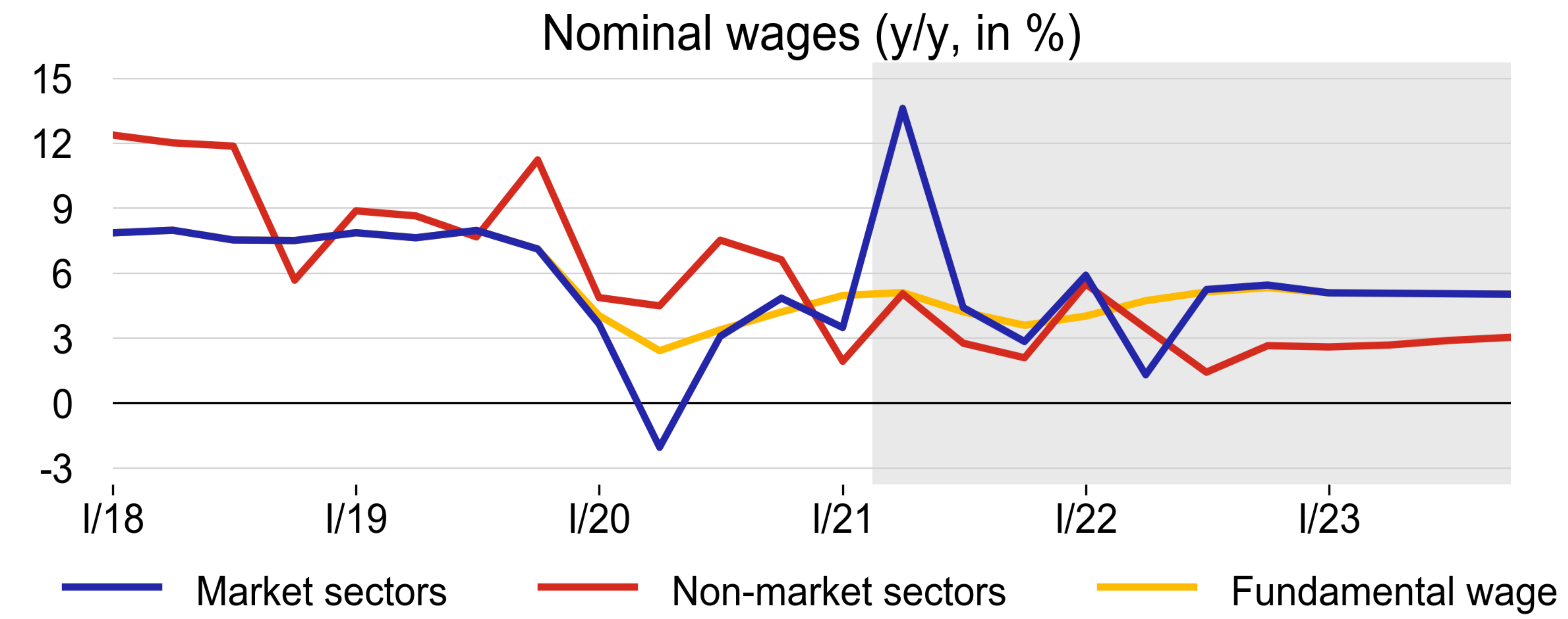
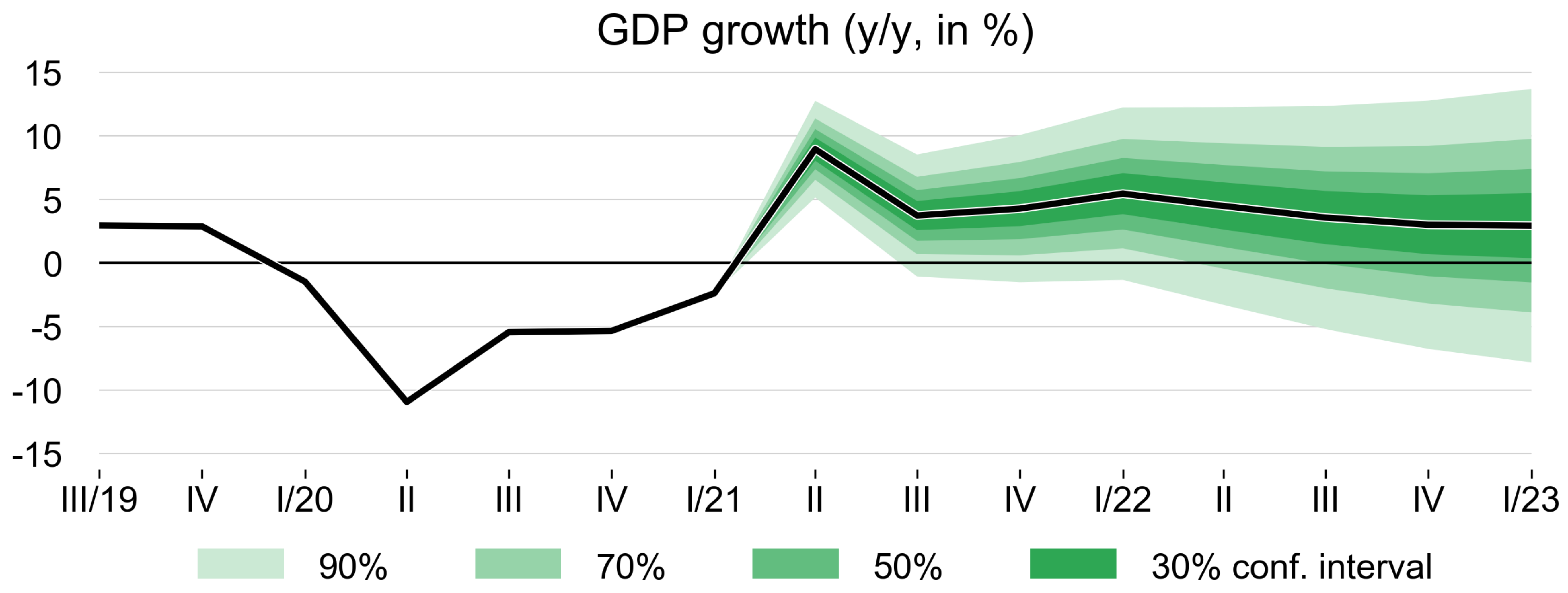
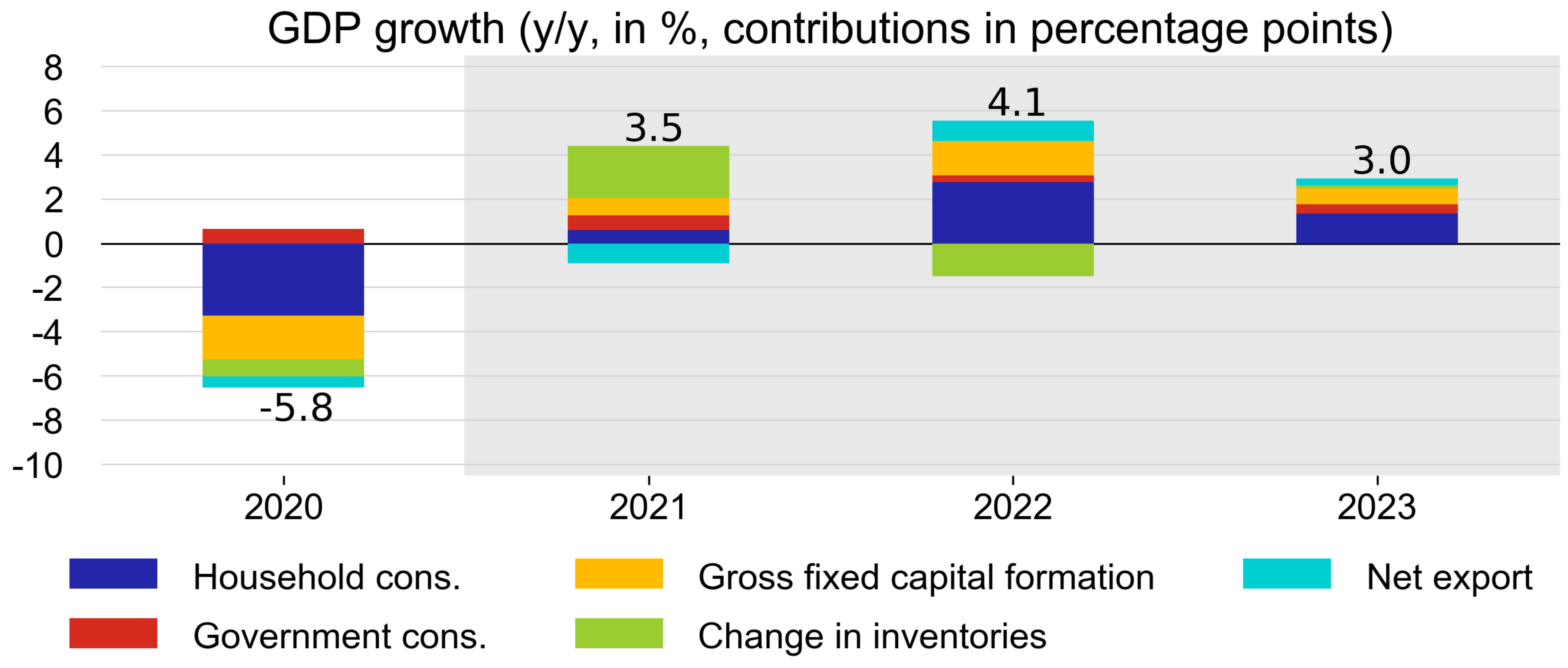



- The **labour market** will see a turnaround in the second half of this year and will gradually overheat again.
- The decline in **employment** will subside at the end of the year, subsequent growth in overall employment will be driven mainly by a rising number of employees.
- The general **unemployment rate** will fall slightly for the rest of this year on the back of the reopening of the economy.
- **Fundamental wage growth** will initially slow further and then start to recover gradually at the end of this year, while **wage growth in non-market sectors** is expected to be rather muted on average.
- **Statistical effects** will cause wage growth in both sectors to fluctuate.

# GDP Growth Forecast




- Annual **GDP growth** will remain highly volatile. Owing to the reopening of the economy in Q2, growth will briefly leap to 9% according to the forecast. This is due mostly to the low base of last year, when a record plunge was recorded during the first wave of the pandemic. Subsequently, the economy will grow at a more stable rate overall.
- In whole-year terms, the Czech economy will grow by **3.5 %** this year. In 2022, GDP growth will exceed **4 %**.
- The current **overloading of production and supply chains**, which is hindering the production and export performance of Czech industry, will persist temporarily. This will also lead to building up of inventories.

# Exchange Rate CZK/EUR

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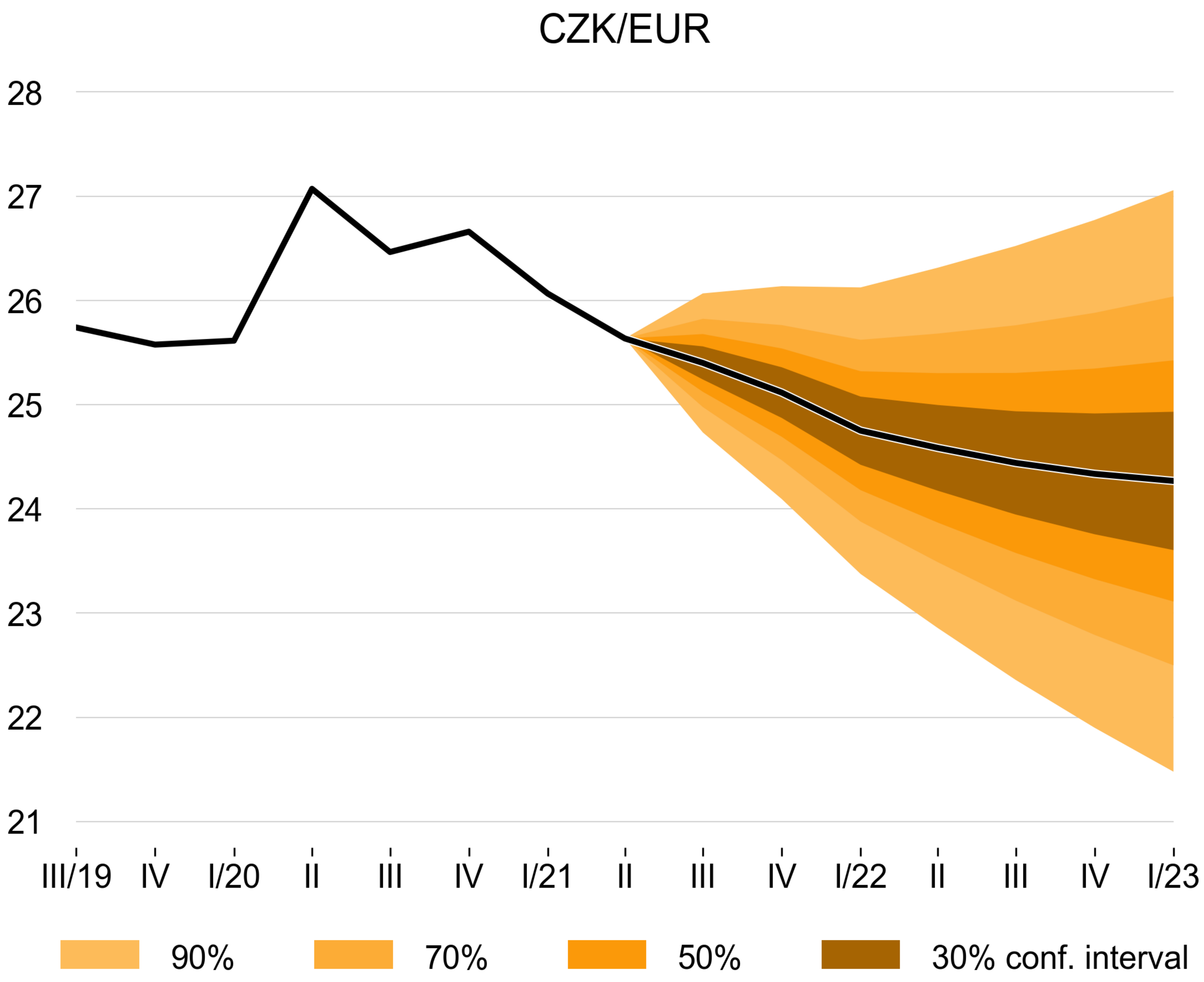
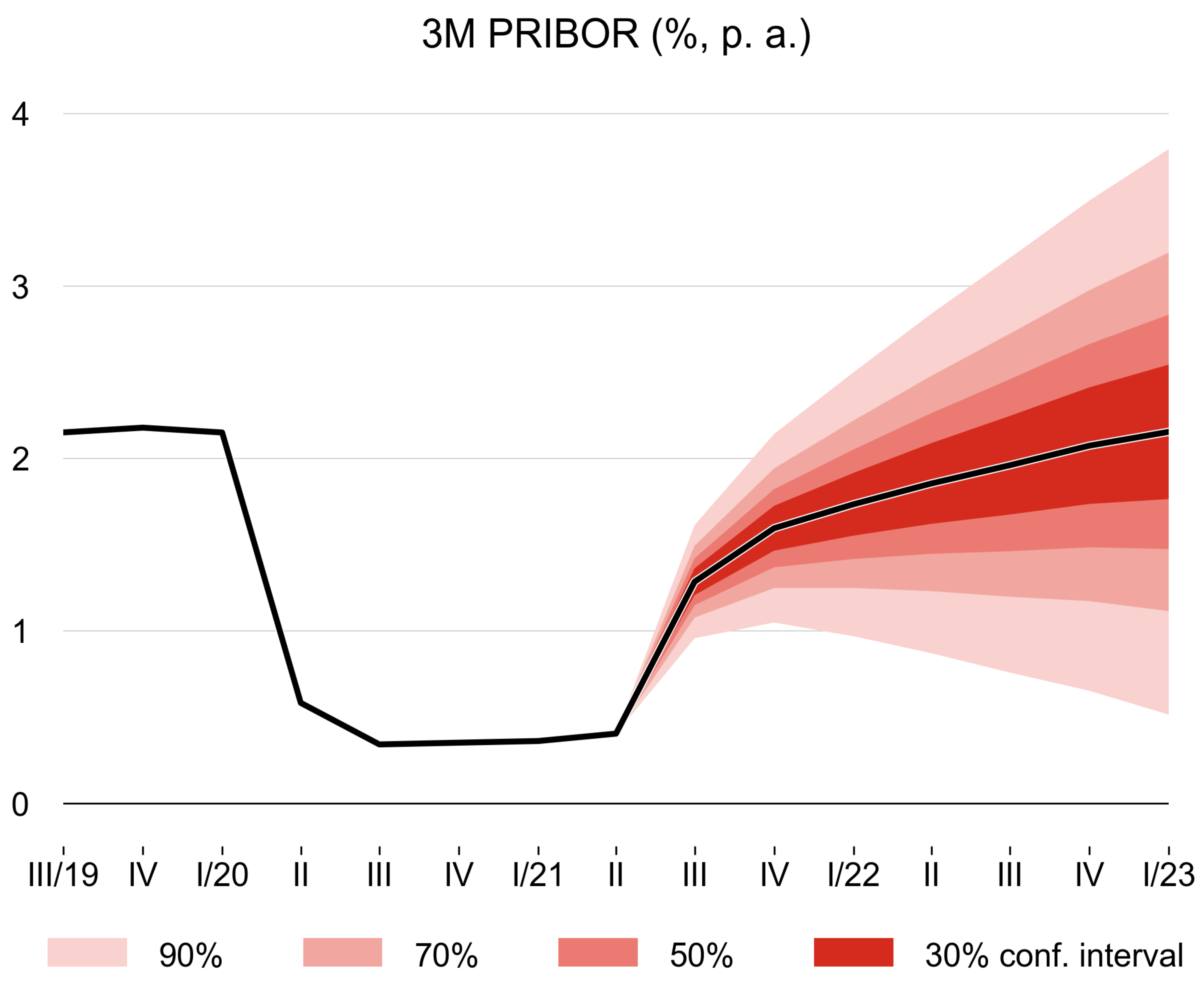



- The **koruna** will appreciate further.
- The exchange rate forecast for **2021 Q3** is set at **CZK 25.4 to the euro**. This reflects an improvement in economic fundamentals and positive sentiment in global markets.
- A recovery in aggregate demand, the export of as yet unfinished products, and an inflow of foreign capital due to improved sentiment will lead to continued appreciation of the koruna over the forecast horizon
- This will also be strongly fostered by a widening interest rate differential vis-à-vis the euro area due to a rise in domestic market rates.
- The exchange rate will thus appreciate towards CZK 24 to the euro by the end of 2023.

# Interest Rate Path (3M PRIBOR)




- Consistent with the forecast is **a rise in market interest rates** from the middle of this year onwards.
- The Czech economy is facing increased price pressures from the foreign and domestic economies (recovering domestic demand, strengthening wage growth, buoyant growth in foreign producer prices).
- The fulfilment of the inflation target at the monetary policy horizon requires a monetary policy tightening and a gradual return of market interest rates to pre-pandemic levels.
- The initial sharp response of domestic interest rates will cause inflation to decline close to the 2% target in the course of 2022. The interest rate component of the monetary conditions will continue to tighten next year.

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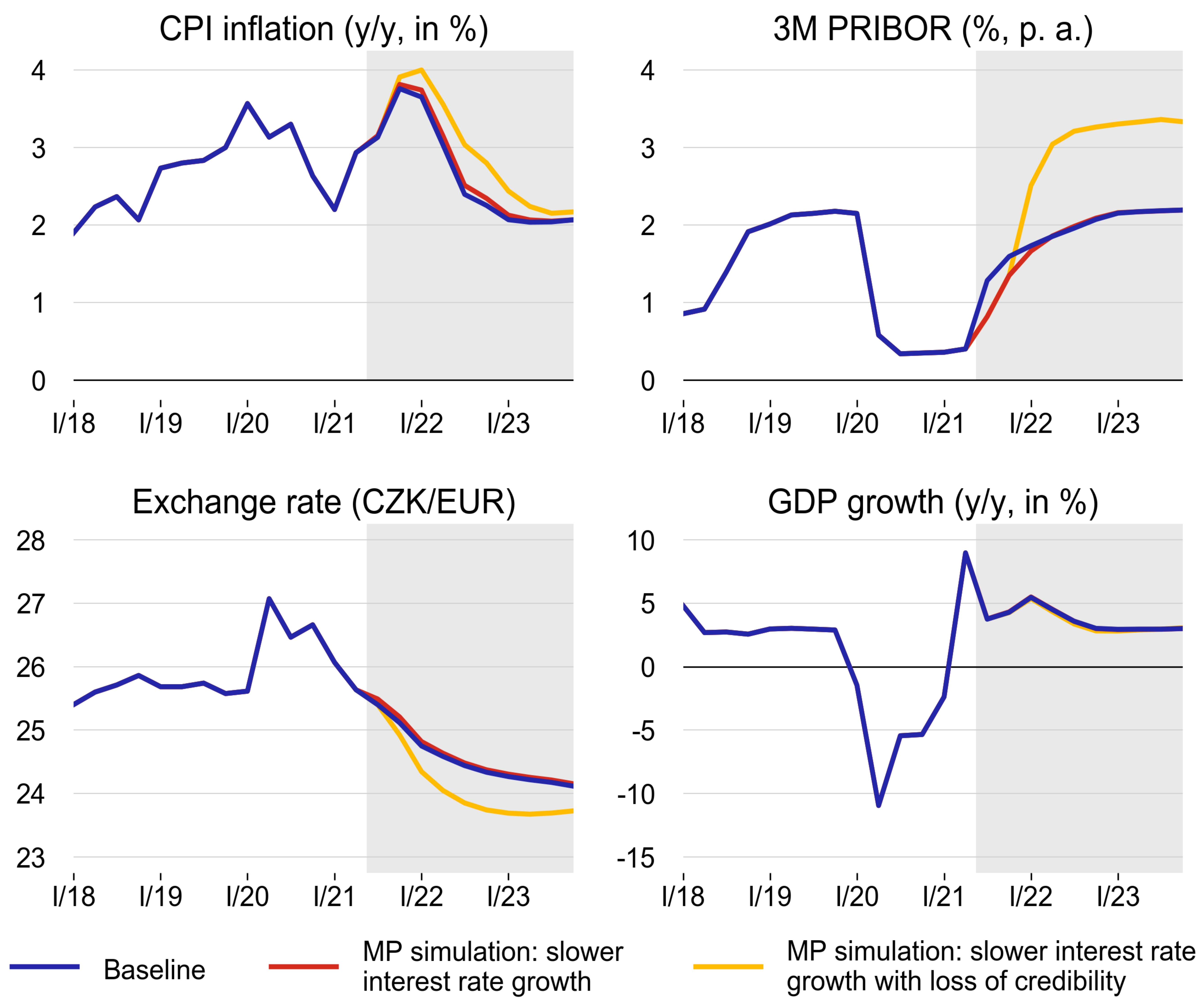
# MP Simulations: Slower Interest Rate Growth




- The two monetary policy simulations illustrate the situation of the central bank increasing interest rates by 0.25 pp at each monetary policy meeting in 2H 2021.
- The first simulation (the red line) describes the situation where **the central bank's lag behind the baseline rate path will not jeopardise its credibility to fulfil the inflation target**. The simulation results only in slightly higher inflation as the interest rate path deviation from the baseline is only temporary and inflation expectations are well-anchored.
- The second simulation (the yellow line) assumes that **the central bank's target loses credibility**. The deviation of the perceived inflation target from 2% creates gradually mounting additional price pressures in the economy leading to appropriate MP tightening at the start of 2022.

# August Monetary Policy Decision

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**At its meeting on August 5, the CNB Bank Board increased the 2W repo rate by 25 basis points to 0.75%.** At the same time it decided to increase the Lombard rate to 1.75% and kept the discount rate unchanged at 0.05%.

**0.75%**
2W repo rate

**0.05%**
discount rate

**1.75%**
Lombard rate

**Four members voted in favour of this decision**, one member voted for raising the 2W repo rate by 50 basis points, and two members voted for keeping interest rates unchanged.

**FOR INCREASE OF 25 BP**

**FOR INCREASE OF 50 BP**

**FOR NO CHANGE**

Consistent with the summer forecast was **a rise in market interest rates from the middle of this year onwards. The Bank Board assessed the uncertainties and risks of the summer forecast as being slightly anti-inflationary overall.**

<u>Inflationary risk:</u> potential greater or lengthier overloading of global supply chains, which could result in even stronger growth in producer prices;

<u>Anti-inflationary risks:</u> possible faster-than-forecasted appreciation of the koruna due to larger capital inflows and uncertainties related to the evolution of domestic economic activity.

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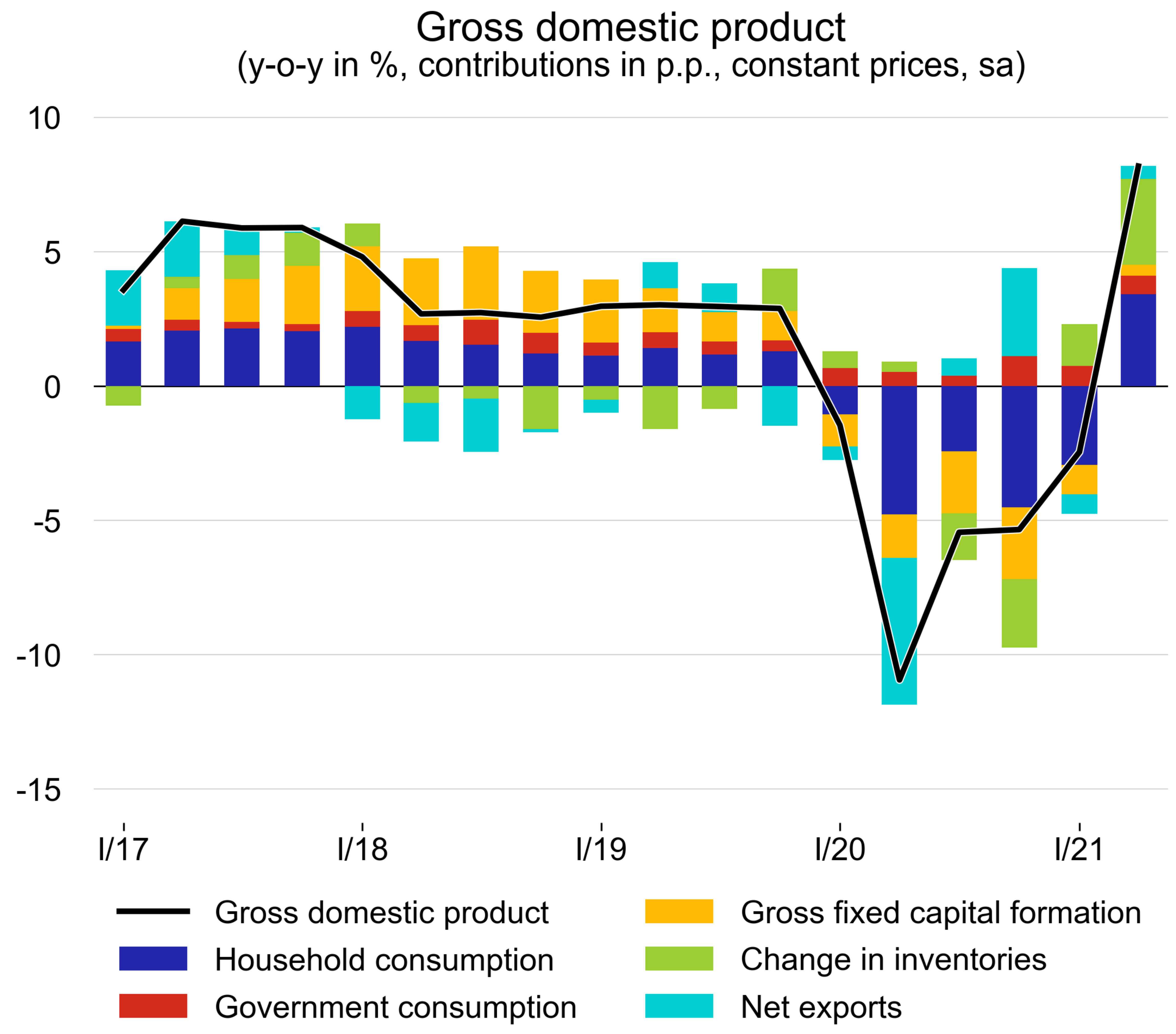
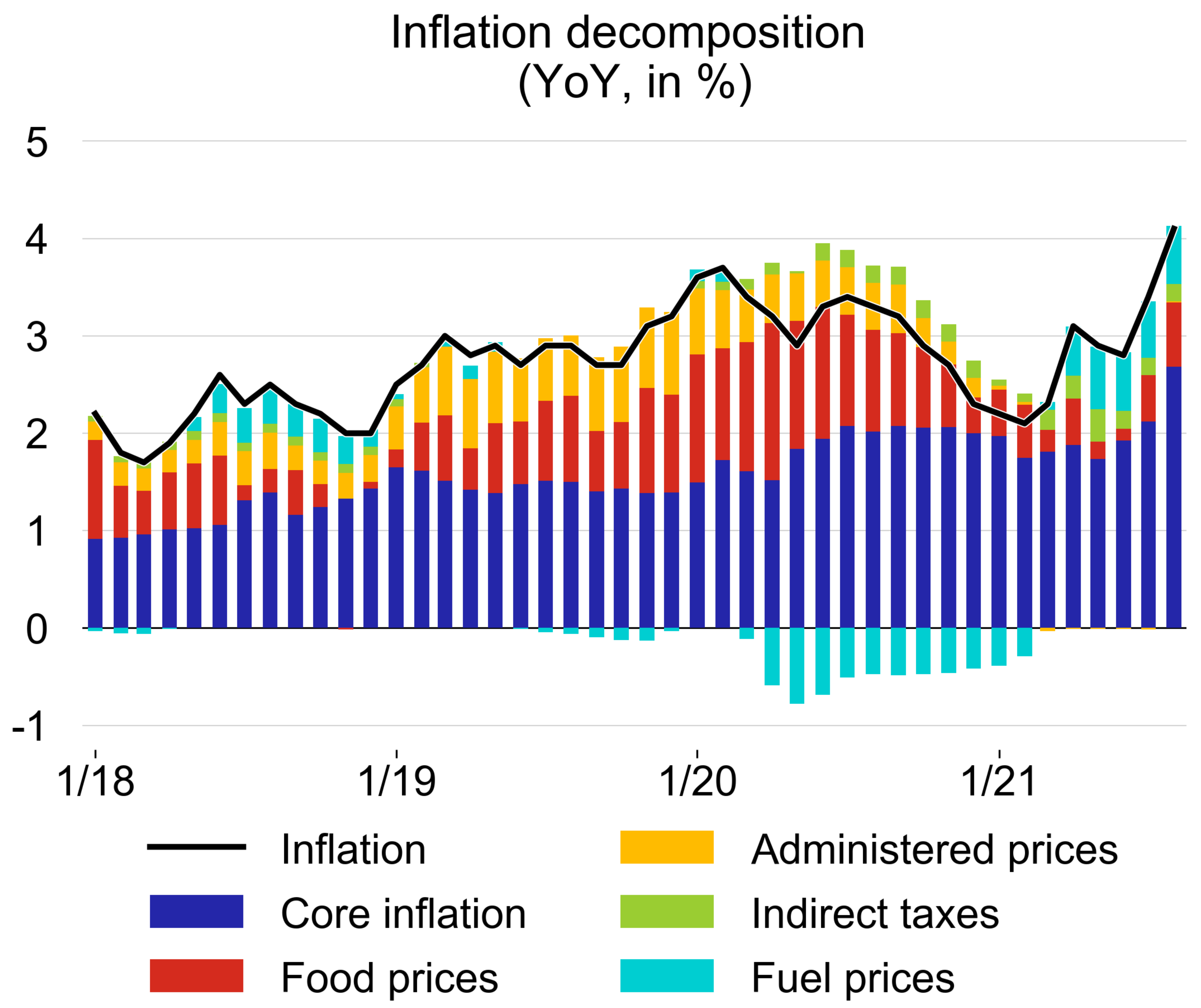
# Gross Domestic Product





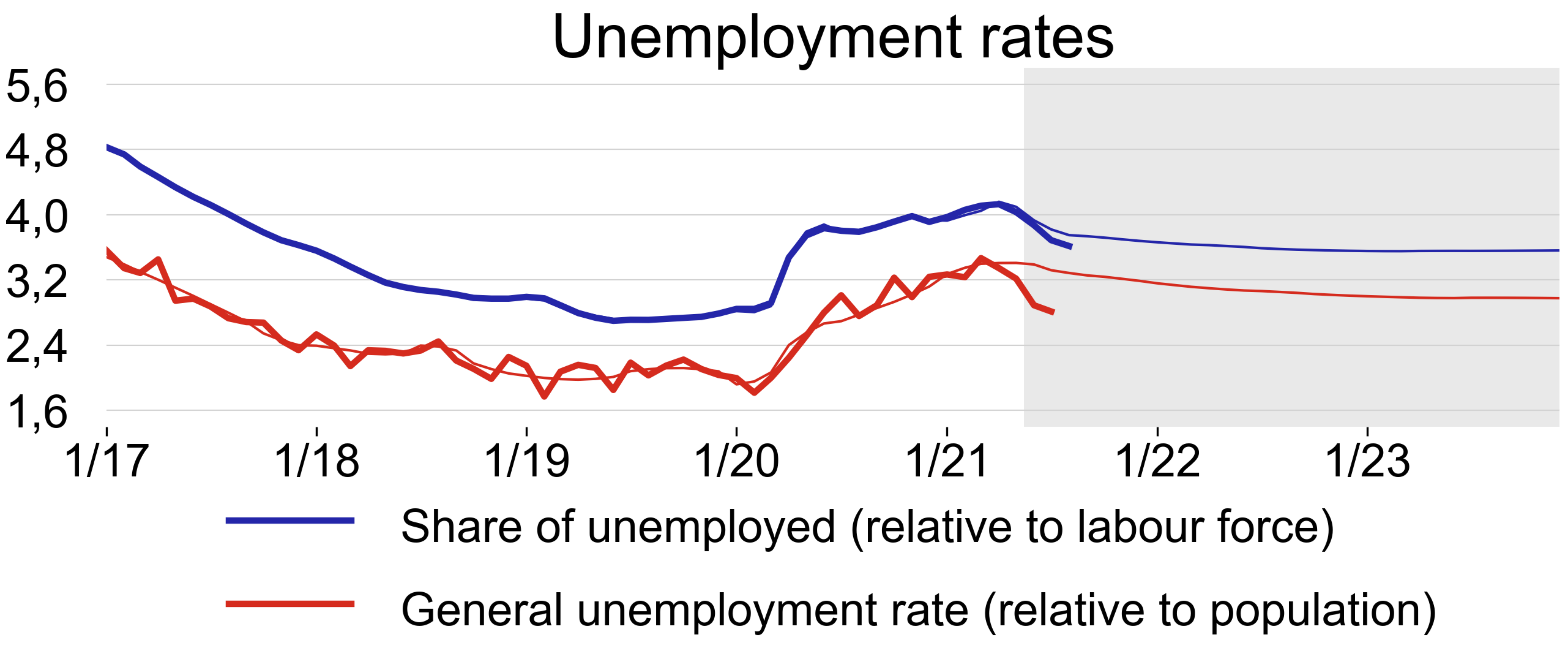

- **Gross domestic product** reached its historically highest growth in Q2/21 due to base effect and spring easing of government restrictions.
- Main driver of the economic recovery was **household consumption**. Besides the re-opening of the economy, it was fuelled by deferred consumption (spending of forced savings) and improved financial situation of households.
- Contribution of **change in inventories** was also high, which is caused by current issues in GVC. Nevertheless, improving business sentiment lead to recovery of fixed investment.
- The problems in GVC had negative impact on export performance of domestic firms which in addition with recovery of the domestic demand dampened the contribution of **net exports**.
- **Government** support of the economy remained substantial.

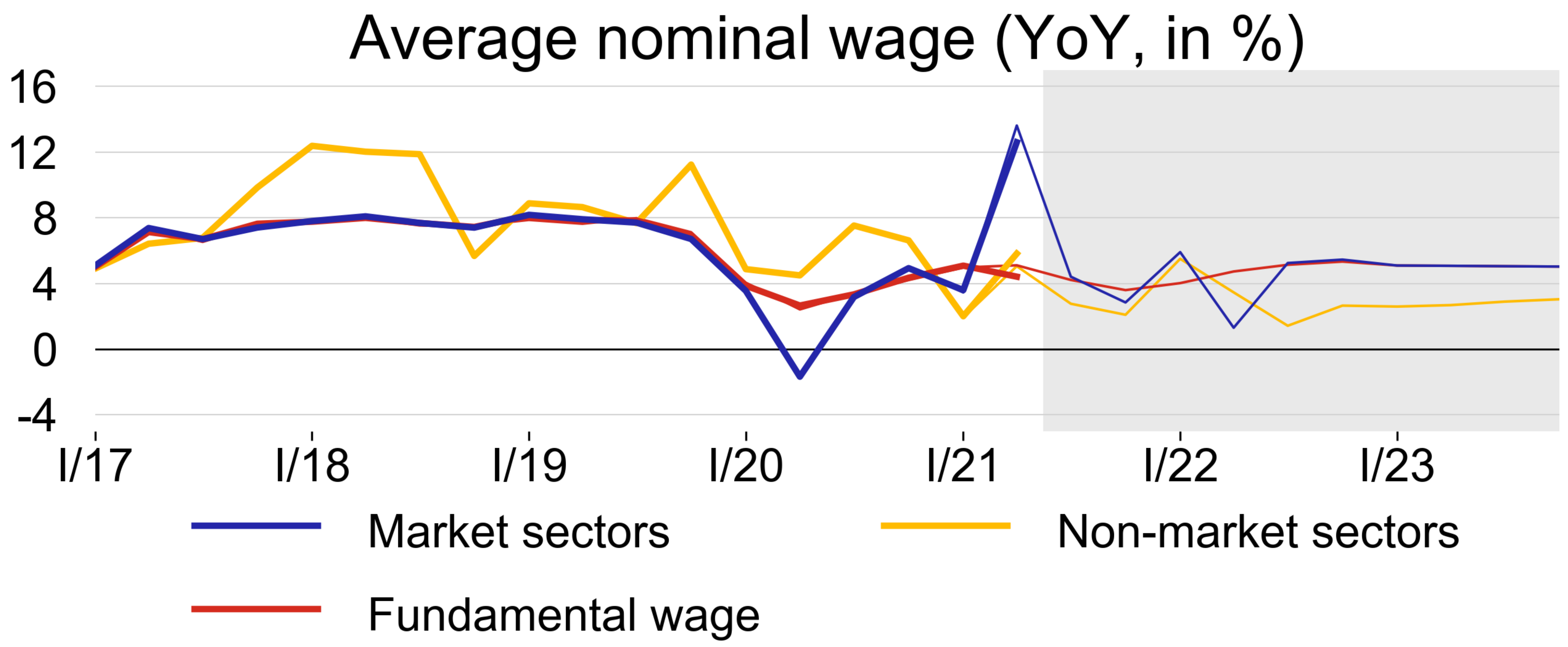
# Inflation




- **Inflation** in August exceeded 4% and continues to be dominated by core inflation; the recently subdued contribution of food prices started to recover.
- Following the reopening of the economy, the **price growth** accelerated especially in services, although prices of goods grew strongly as well.
- Stronger than expected domestic demand, higher growth of foreign prices and extraordinary speed up of imputed rent led to high forecast error during the summer (1 p.p. in August). This was concentrated predominantly in core inflation.

# Labour Market




- **Labour market** exhibited gradual recovery in recent months leading to an increase in its pro-inflationary stance.
- Following the reopening of the economy, the **unemployment rate** started to decrease, even at slightly higher pace than expected.
- The development of **wages** in 2Q21 was roughly in line with the latest forecast. In the following quarters the growth of **fundamental wage in market sectors** will recover and start to accelerate at the beginning of 2022 resulting in an enlarging contribution of domestic demand to overall inflationary pressures.
- Official wage statistics will be more volatile due to **statistical effects** reflecting extraordinary pandemic measures.

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**Current assessment:**

The published figures represent a significant inflationary risk to the CNB’s current forecast, which is tilted to a more pronounced increase in interest rates compared to the outlook so far.

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# Thank you for your attention

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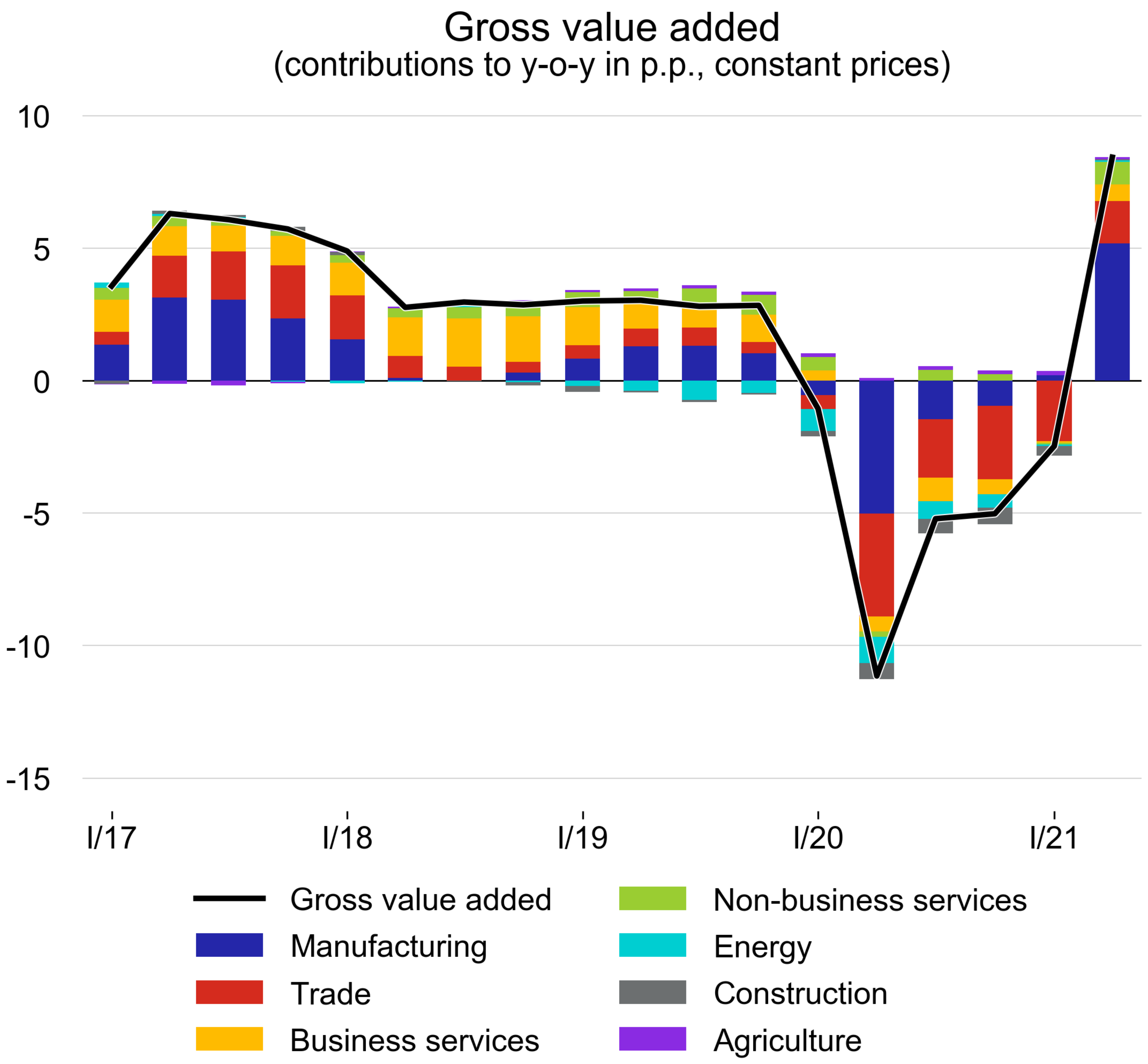
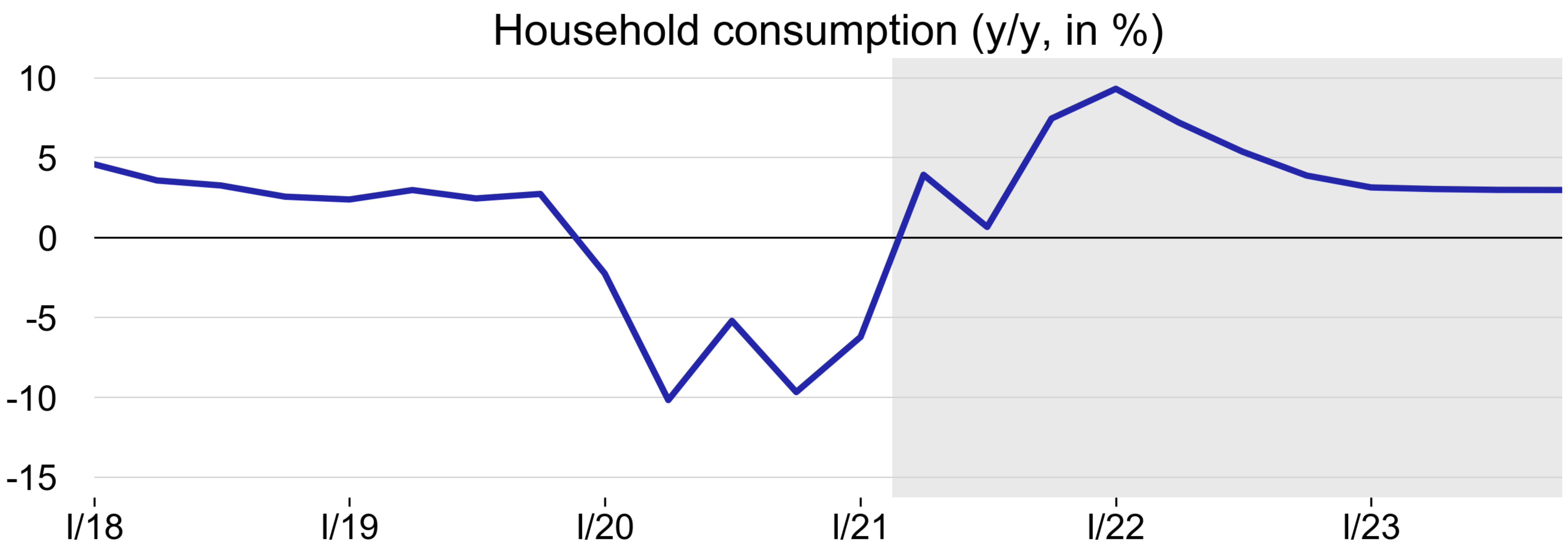
# Back-up slides

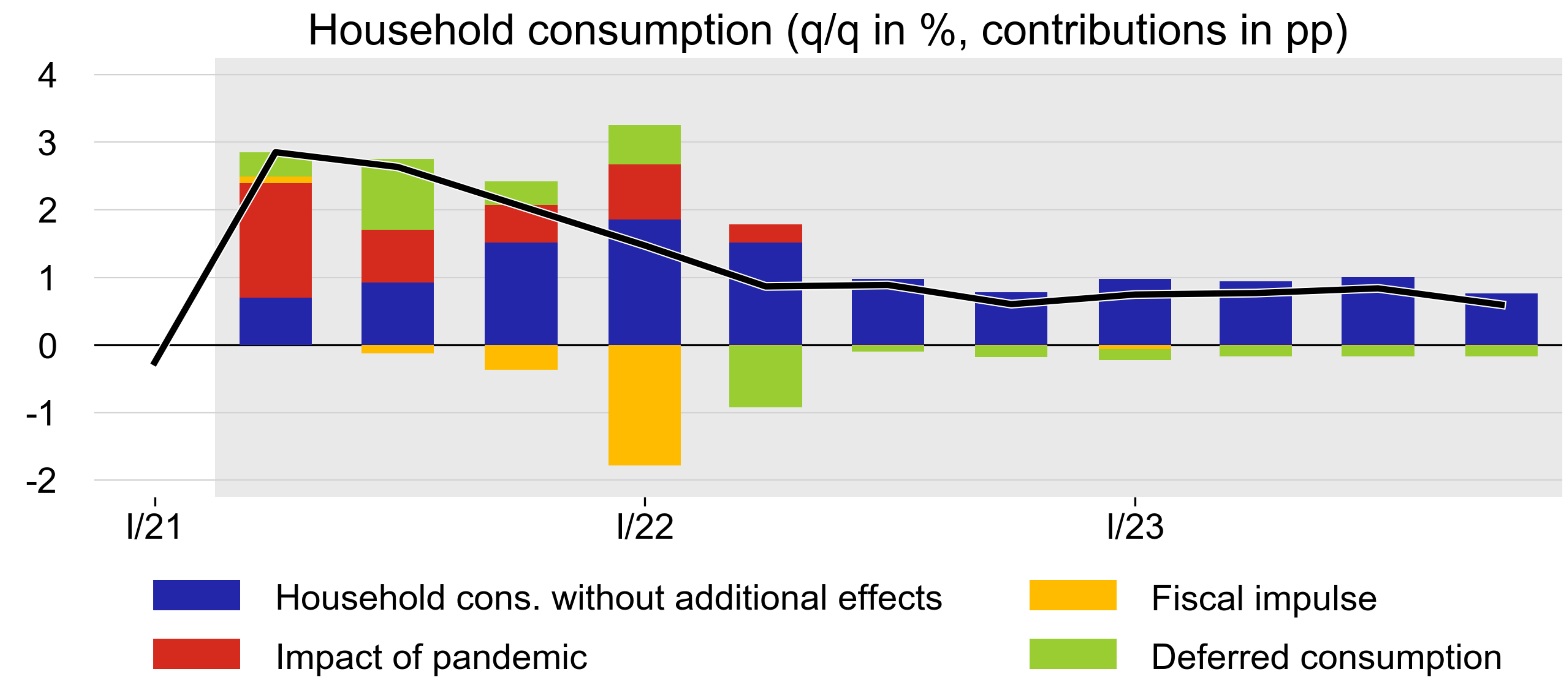
# Gross Value Added




- Growth of **gross value added** was the highest in history as well.
- The biggest was the contribution of **manufacturing**. Its production was growing q-o-q, but the problems in GVC led to piling up in inventories (especially unfinished production in automotive industry).
- Contribution of **trade** and **services** was also substantial due to base effect and spring easing of restrictions.
- Contributions of other sectors remained low.

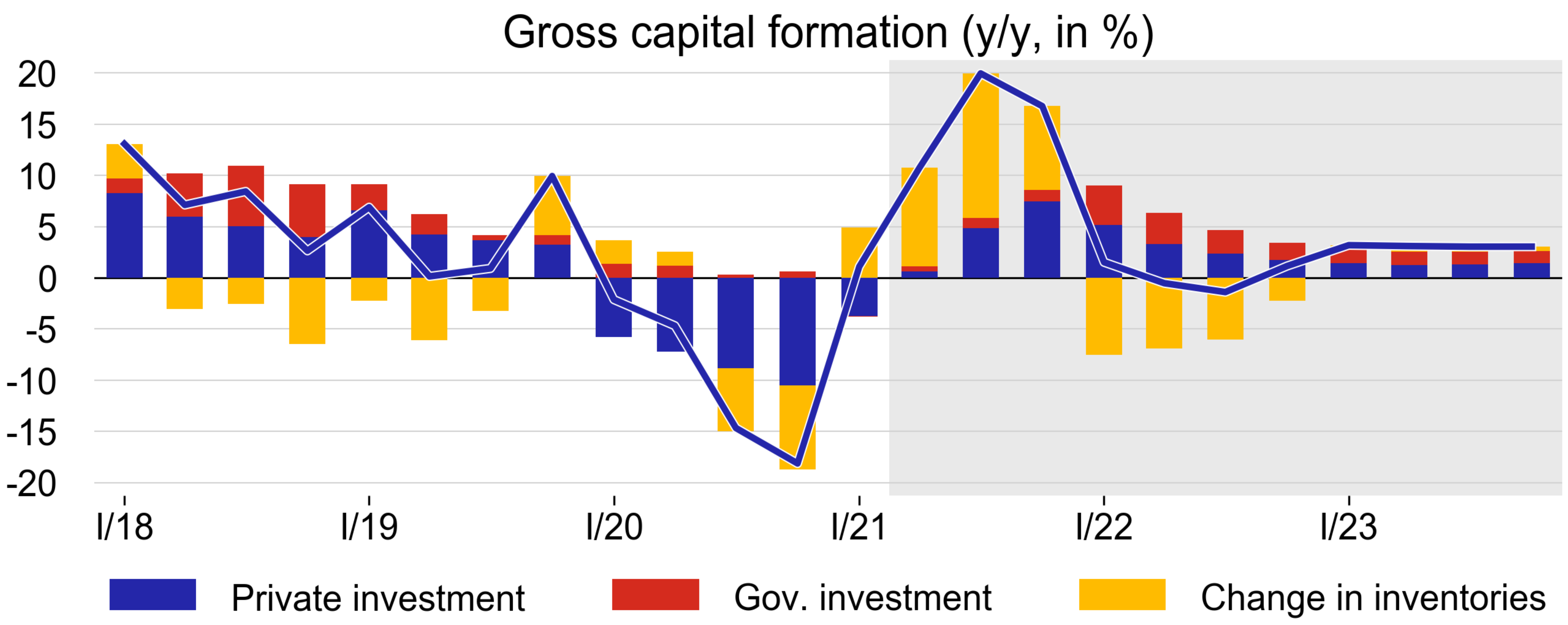
# Household Consumption

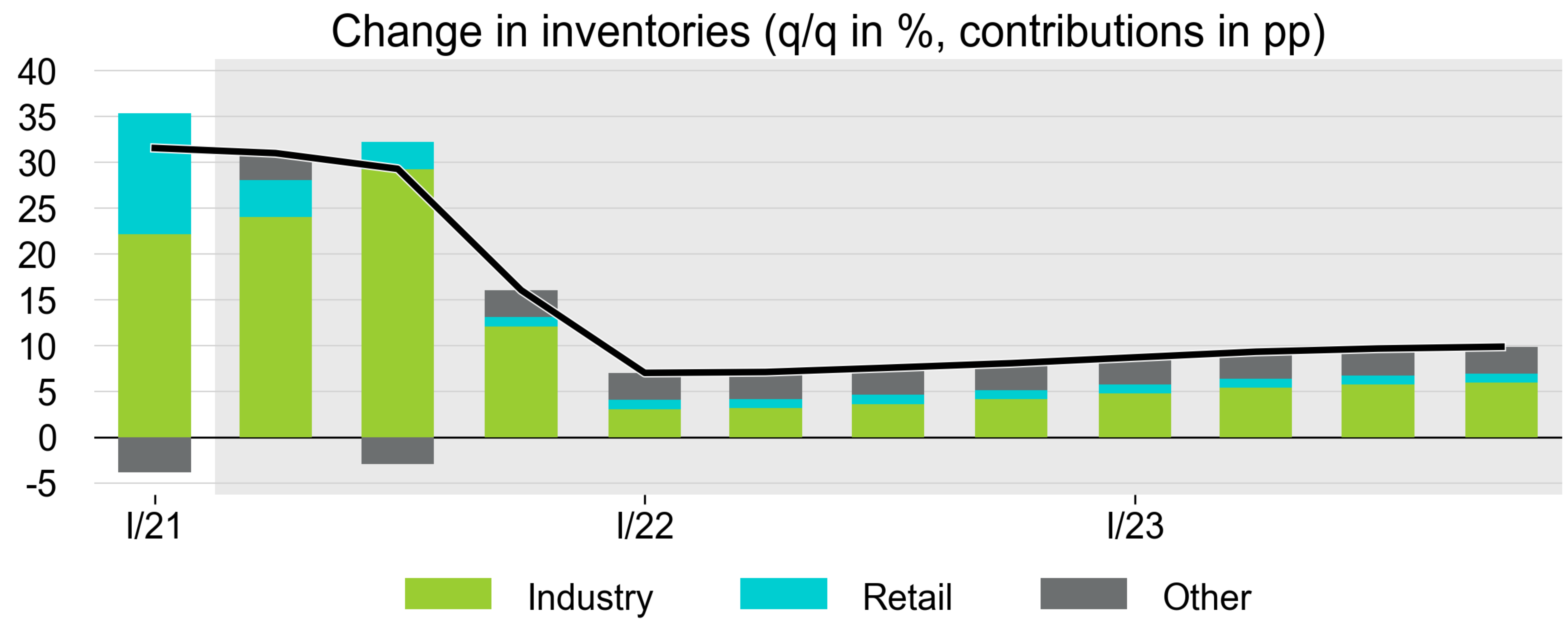



- **Household consumption** recovered after the spring easing and will start to rise quickly again this year.
- The **reopening of the economy due to the fade-out of the pandemic** will support growth in household consumption in the second half of the year. Household consumption will therefore become the main driver of the domestic economic recovery.
- It will be aided by spending of part of the forced savings created during lockdowns (**deferred consumption**).
- The termination of numerous **fiscal support measures** will have the opposite effect.
- Household consumption will reach its pre-pandemic level at the end of 2022.

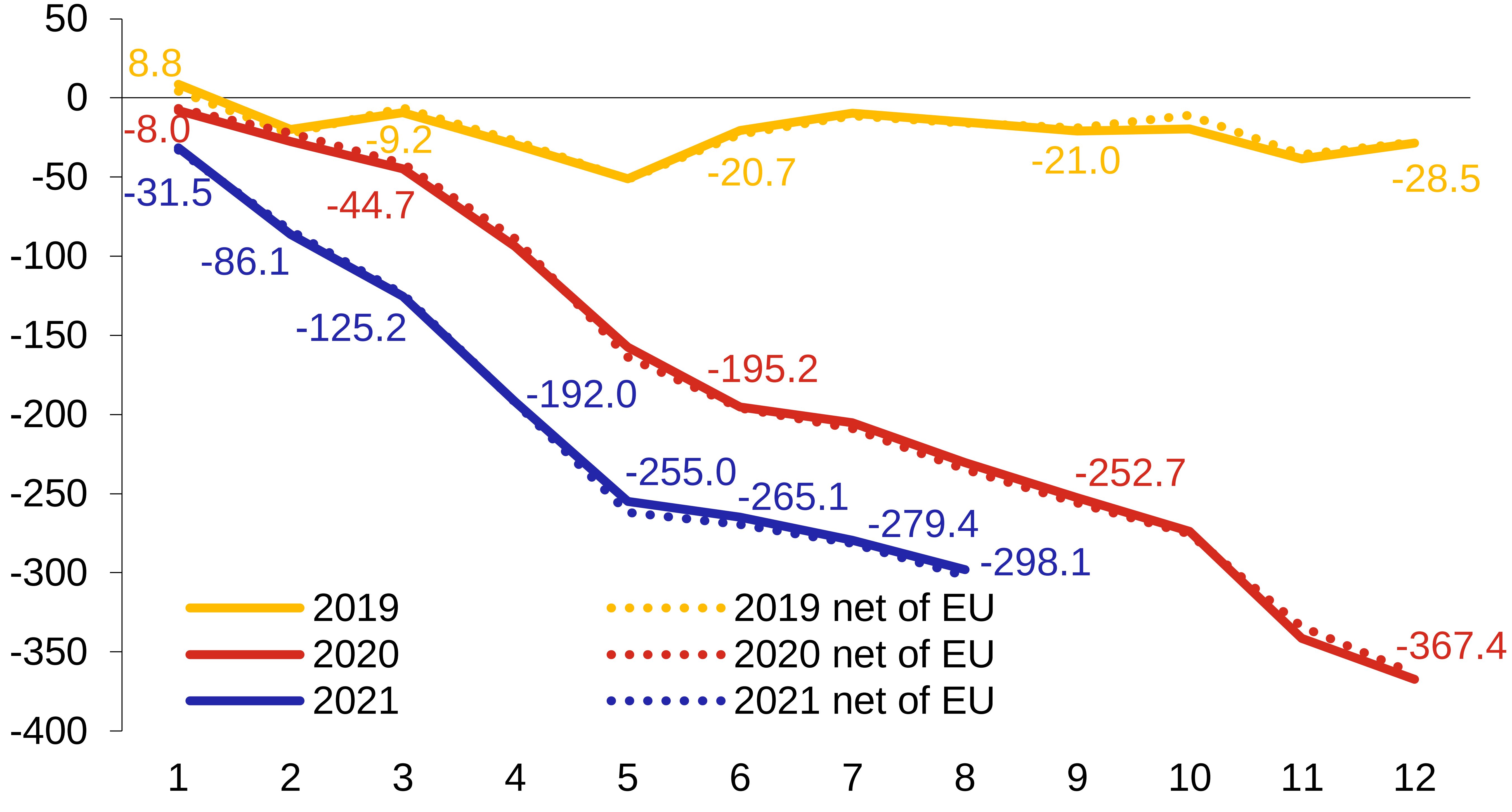
# Gross Capital Formation




- **Investment activity** is recovering as the economy reopens, despite the issues in production and supply chains.
- **Fixed investment** will increase only slightly this year despite last year's low base, amid recovering year-on-year growth in **private investment** and continued growth in **government investment**.
- Growth in gross capital formation will additionally be supported this year by continued high additions to **inventories**.
- **Inventories in industry** are building up because of overloaded production and supply chains. In **retail**, by contrast, we assume high additions to inventories seen at the start of 2021 to be only temporary and will diminish as demand rises.

# Cash Fulfilment of State Budget (in CZK bn)




| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| GOVERNMENT BUDGET BALANCE (CZK in bn) | -348.0 | -455.7 | -339.9 | -345.8 |
| GOVERNMENT BUDGET BALANCE (% of GDP) | -6.1 | -7.5 | -5.3 | -5.1 |
| GOVERNMENT DEBT (CZK in bn) | 2153.0 | 2586.8 | 2917.1 | 3244.3 |
| GOVERNMENT DEBT (% of GDP) | 37.8 | 42.6 | 45.4 | 48.2 |

- The planned **state budget deficit** of CZK 500 billion should not be exceeded in 2021.
- The decline in the state budget balance has slowed in recent months, reflecting both the recovery in tax revenues and the fading of stabilization fiscal measures.
- The CNB **forecast** expects a government deficit of 7.5% of GDP this year. The CNB's fiscal forecast covers the entire government sector, and is recorded in accrual terms.