CZECH NATIONAL BANK

Czech Inflation and Macroeconomic Developments

CNB’s Winter 2023 Forecast

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Recent inflation dynamics

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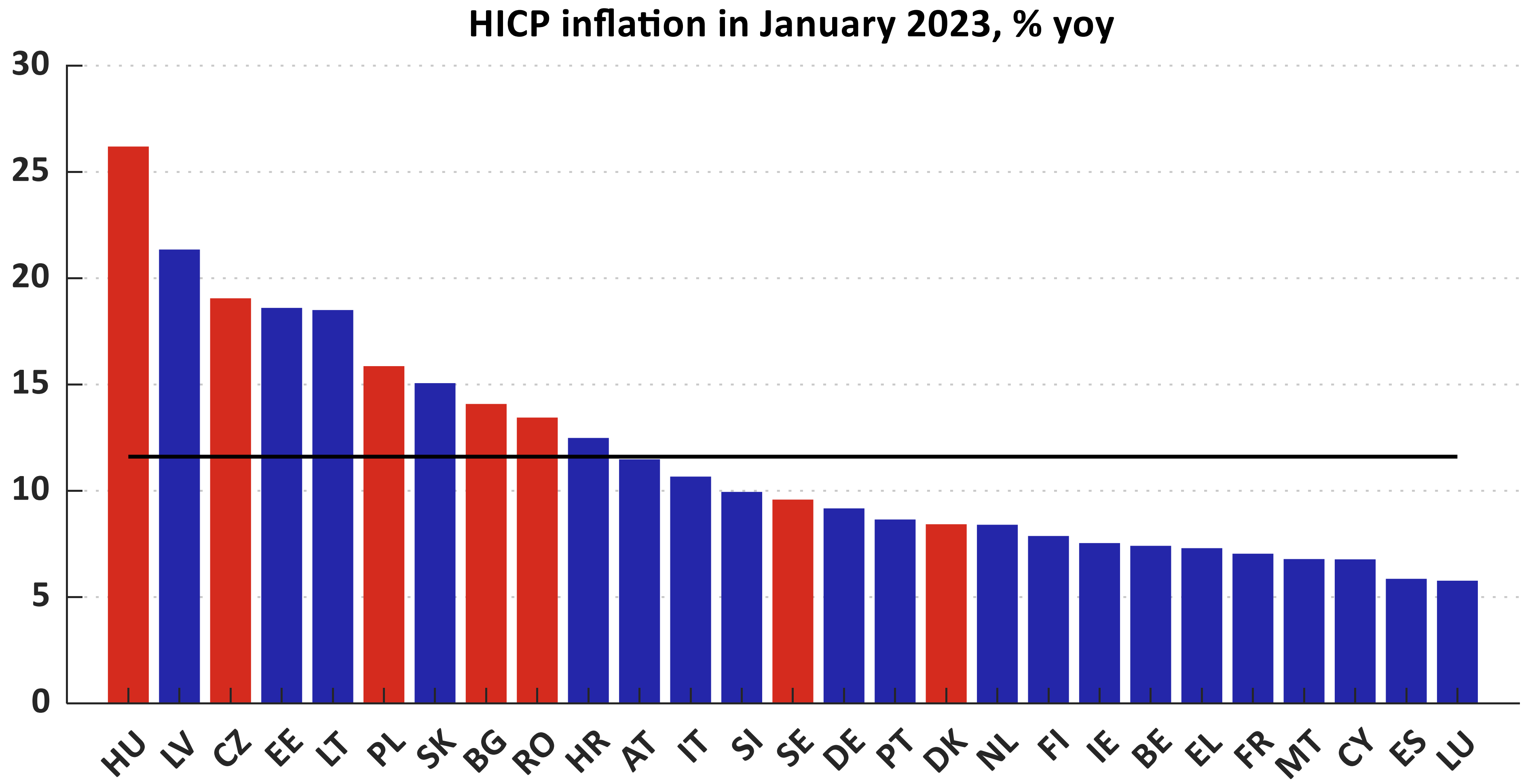
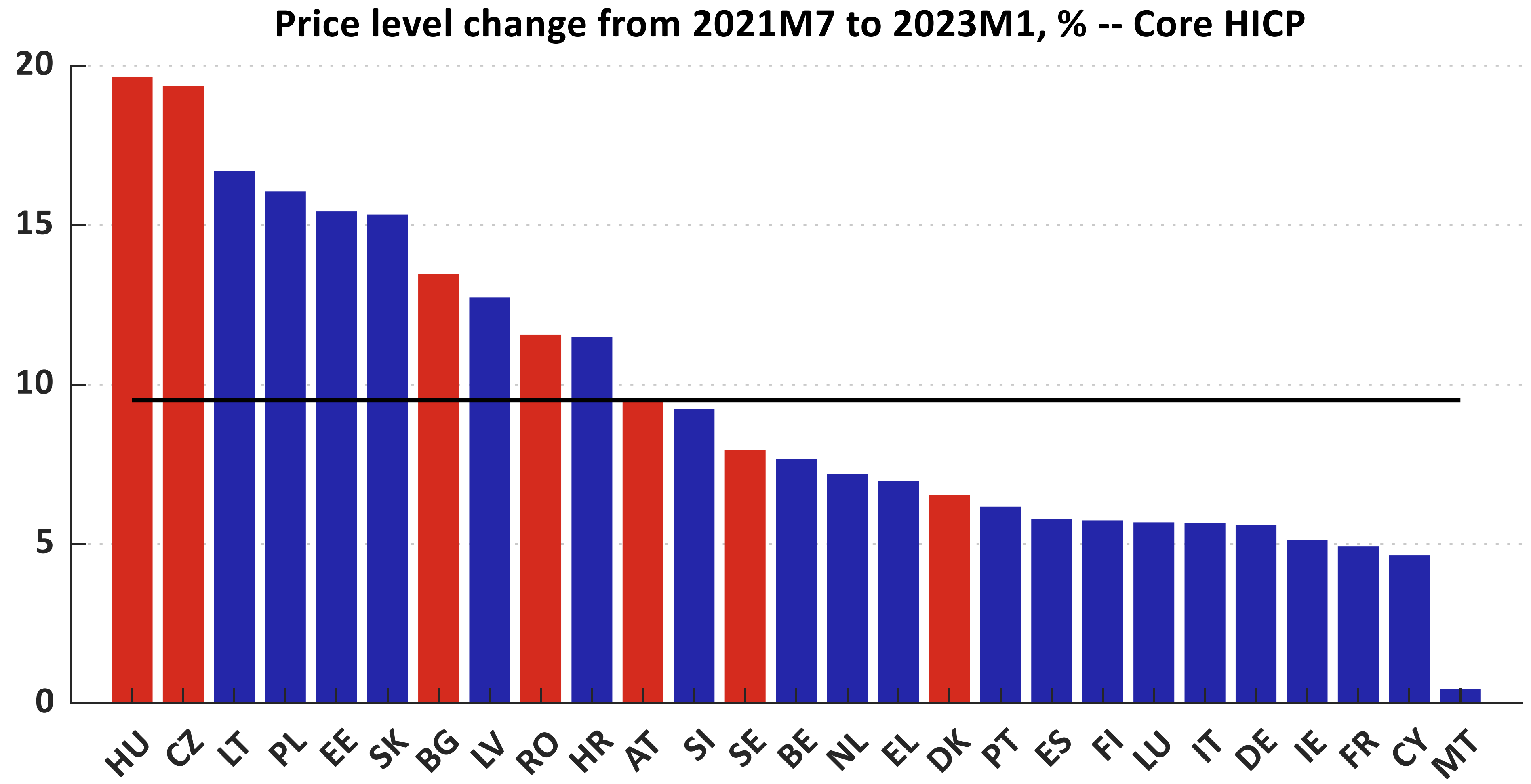
Inflation dynamics – EU comparison



Source: Eurostat and computations



Note: Blue bars denote eurozone countries while red bars stay for non-euro countries. The starting point 2021M7 is chosen as first central banks started to hike interest rates after the Covid shock. Solid black line denotes EU average.

Czech headline HICP inflation in January 2023 remained one of the highest in the EU. However, January inflation was affected heavily by the effects of government programs and caps on energy prices.

Czech core prices increased substantially from July 2021 to January 2023. The increase in core prices was the second highest among the EU countries.

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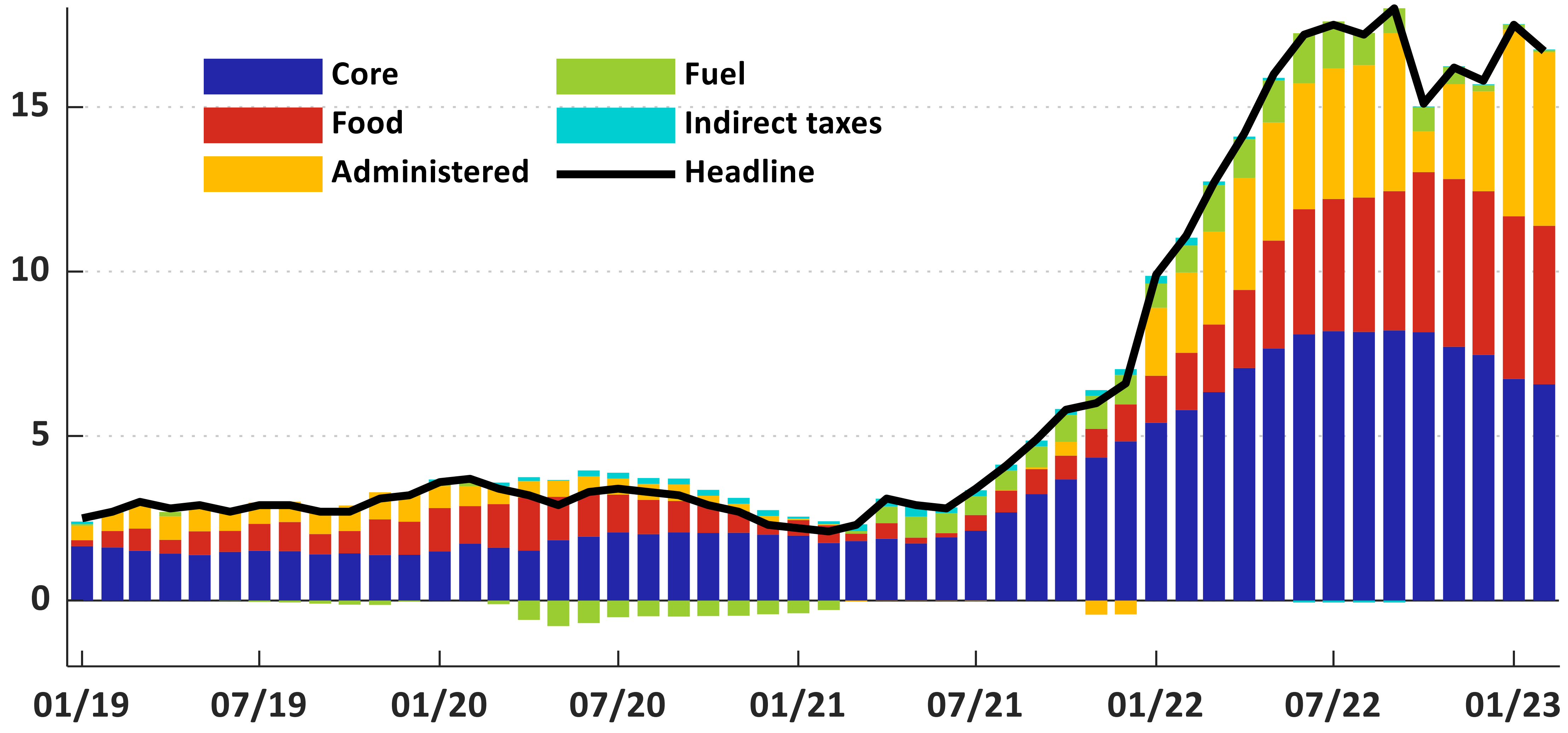
Headline inflation

Inflation, % yoy and contributions in pp



Source: Czech Statistical Office

Headline inflation accelerated temporarily to 17.5% in January (CNB forecast 17.6%) before declining to 16.7% in February (CNB forecast 16.5%). The higher-than-forecasted February inflation was due to faster food price growth, which was only partly offset by lower administered price growth. Core inflation in February was in line with the CNB projection.

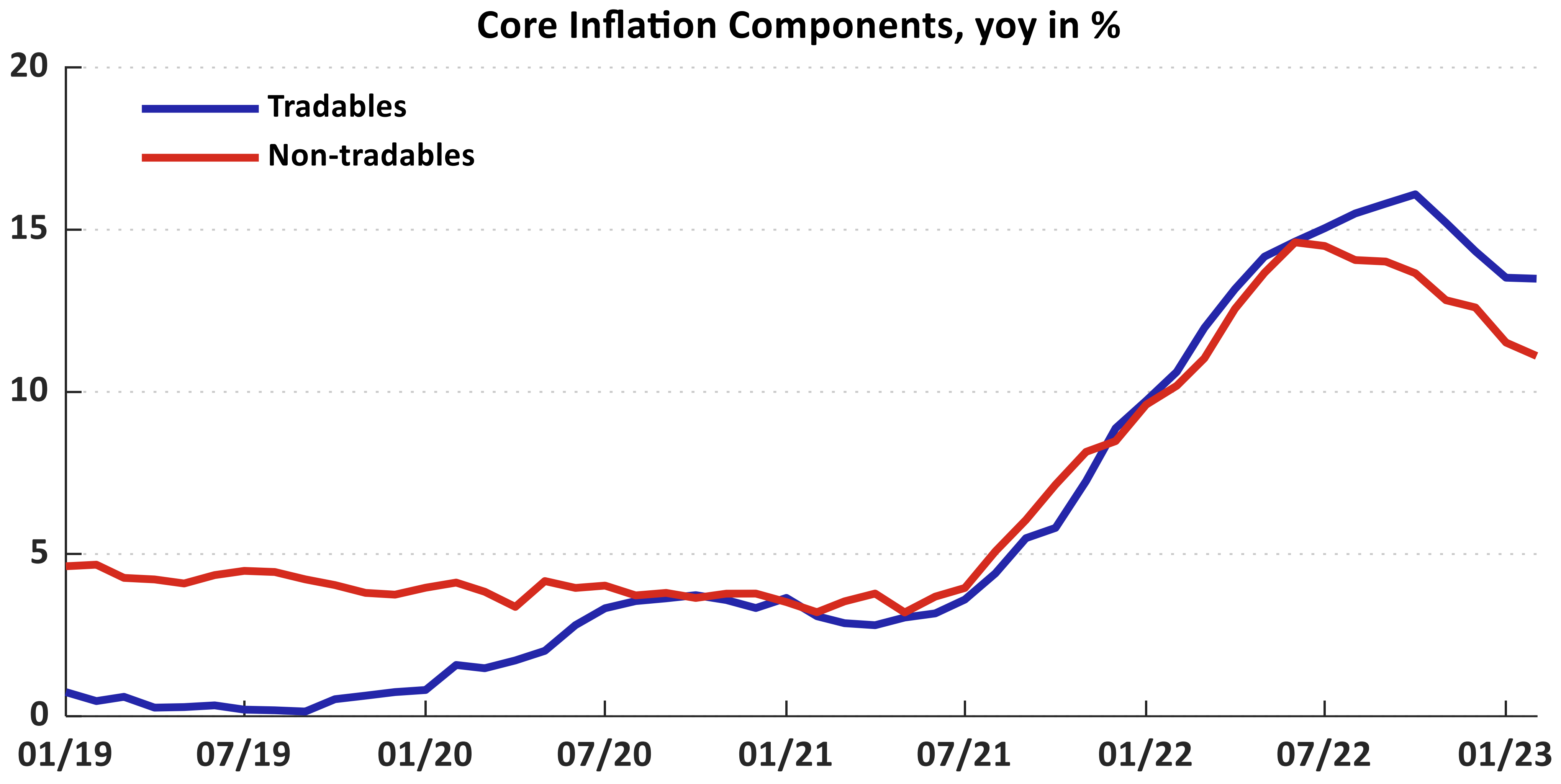
Inflation has remained **broad-based**.

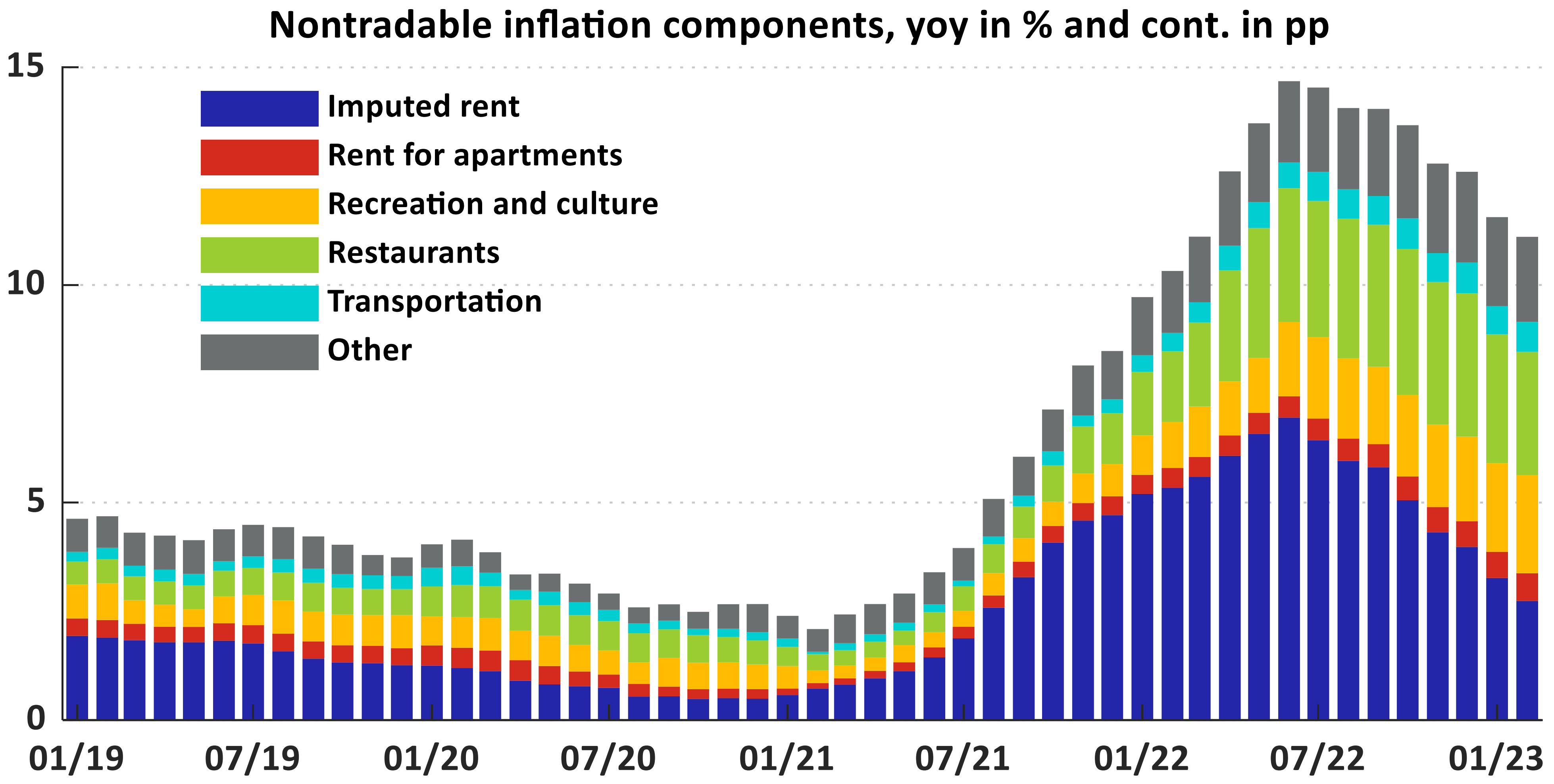
Its temporary acceleration early this year was driven mainly by **administered prices** – the end of the “energy savings tariff” and an increase in the price of electricity to the price ceiling.

Core inflation, which peaked in the second half of last year, has continued to slow down, while **fuel price** growth has almost faded.

Food price growth has remained high and roughly stable.

Core inflation





Both tradable and non-tradable core prices have continued to slow down since the second half of last year.

The declining contribution **of imputed rent** to non-tradable core price inflation reflects a combination of weakening growth in new **residential real estate prices** on the back of sharply falling demand for new mortgages and moderate growth in **prices of construction materials**.

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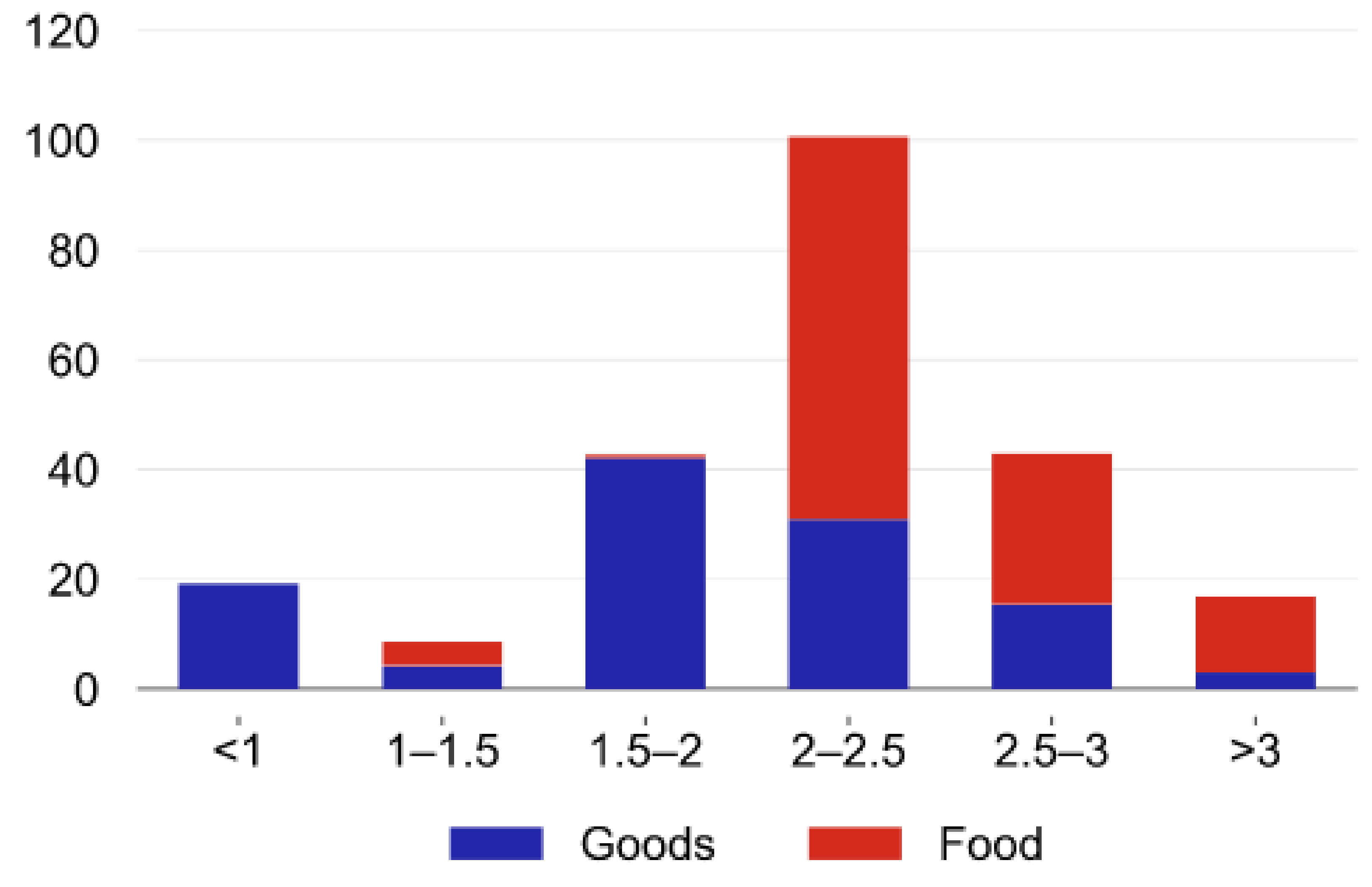
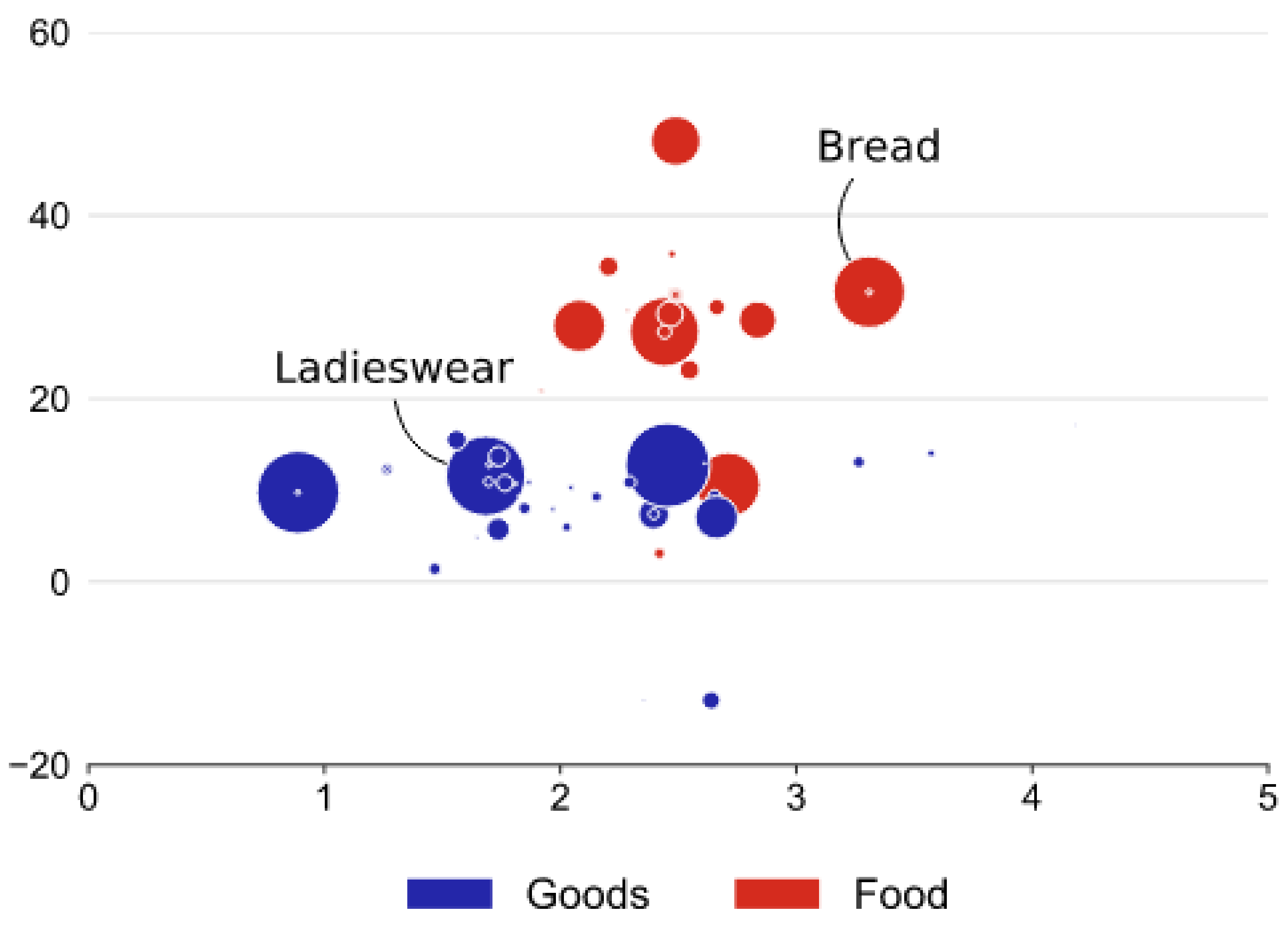
Energy intensity of production

x-axis: energy intensity in %; y-axis: weight of items in consumer basket in ‰



data for December 2022; x-axis: energy intensity in %; y-axis: annual producer price inflation in %; size of bubble corresponds to weight of related item in consumer basket



Source: CNB's Winter 2023 Monetary Policy Report

Direct effects of energy prices are given by their weights in the CPI: electricity 4%, gas 2% and fuel 3.1% (gasoline 2.1%, diesel 1%). **Indirect effects** reflect the energy intensity of production and distribution affecting the final price of goods and services.

The energy intensity of **industrial consumer goods** is relatively homogeneous and low between 2% and 2.5%. Compared to industrial consumer goods, the energy intensity of **food** is somewhat higher.

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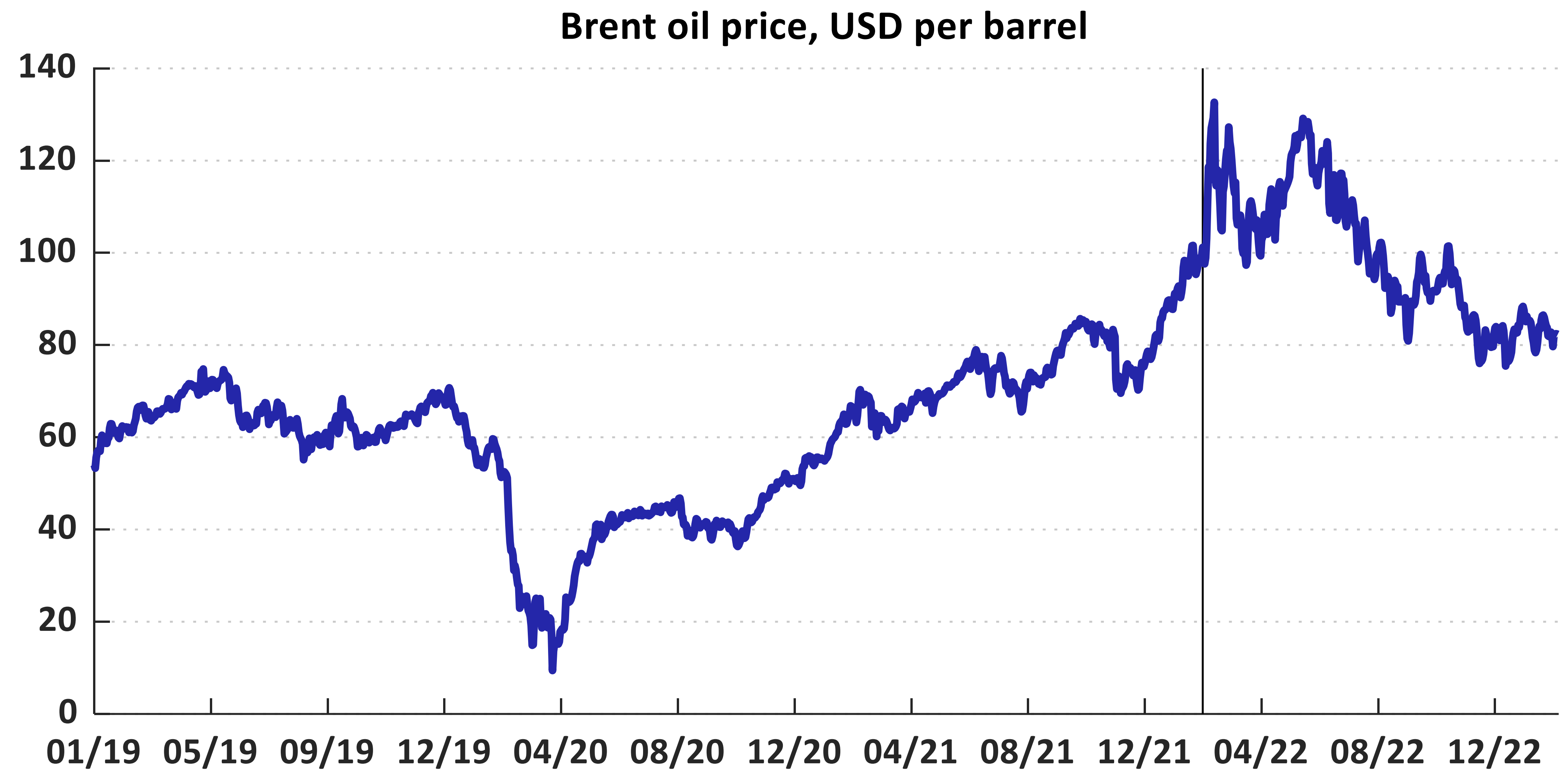
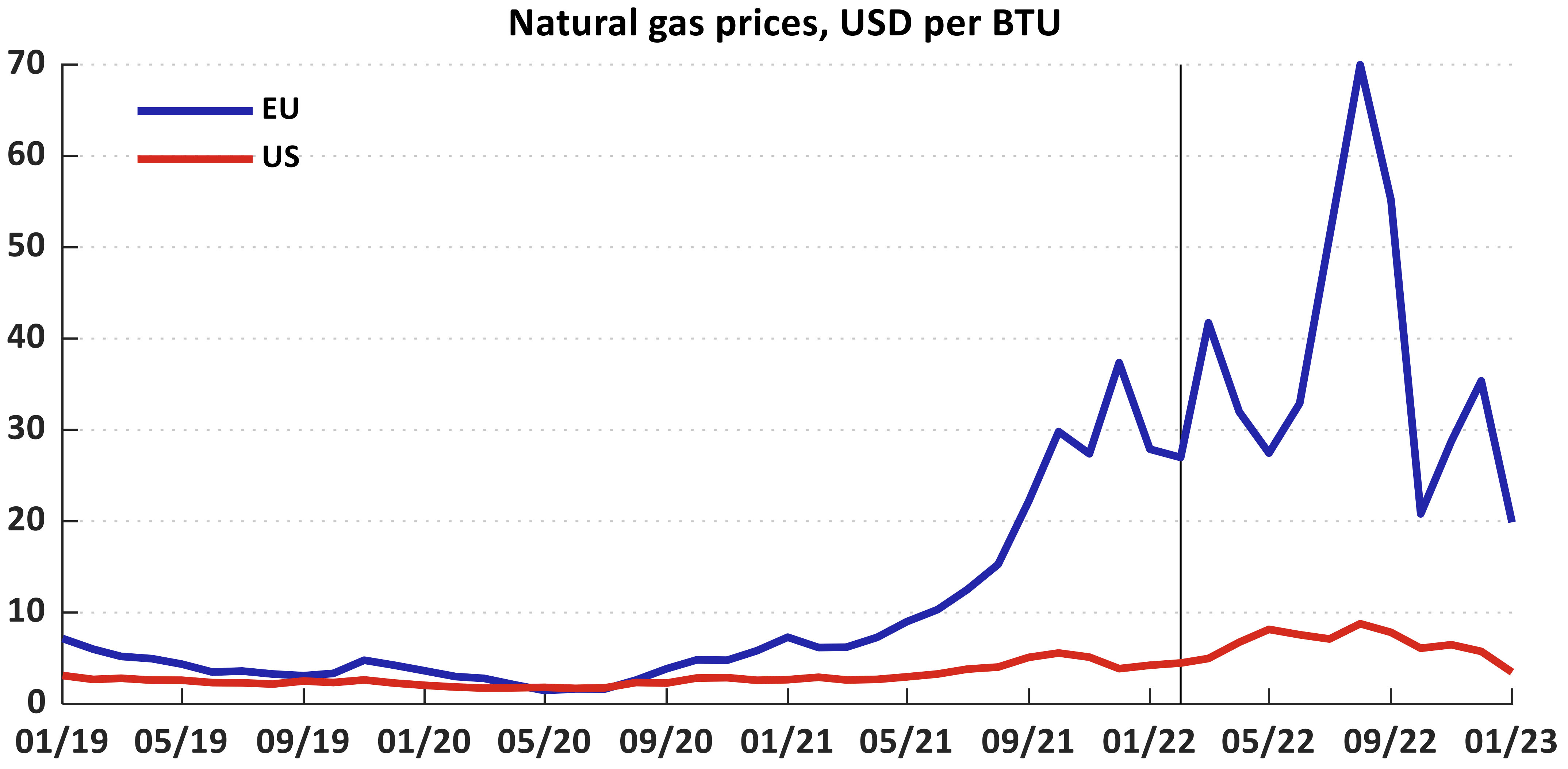
Energy commodity prices





Source: FRED

LNG imports and a **warm winter** along with **consumption savings** have left gas storage tanks filled above average in Europe, pushing down **natural gas prices** to levels seen before the war.

Electricity prices in Europe and world oil prices have also fallen to pre-war levels, reflecting resumed operation of French nuclear power plants, windy weather and an abundance of natural gas.

The CNB’s current forecast assumes that **energy prices** will remain at approximately the current levels and thus also have a neutral cost effect in the future.

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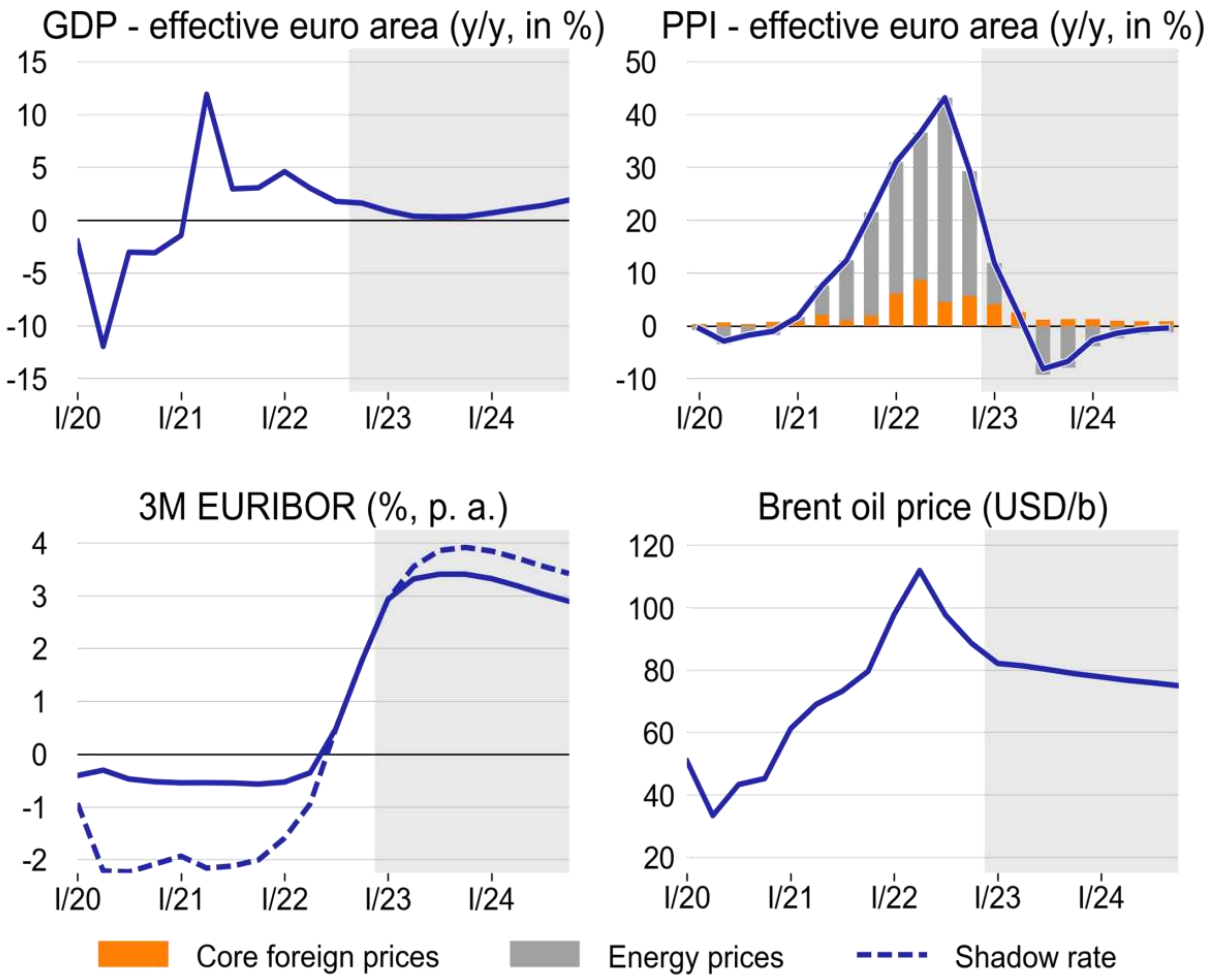
Winter 2023 forecast

External outlook



Effective euro area real growth will be hindered by weak global demand growth, tightening monetary conditions and falling households' real income. Real growth will revive later this year and in 2024 as supply chain disruptions ease and international trade recovers.

Real growth in the effective eurozone reached 1.6% yoy in 2022Q4, which was in line with the forecast.

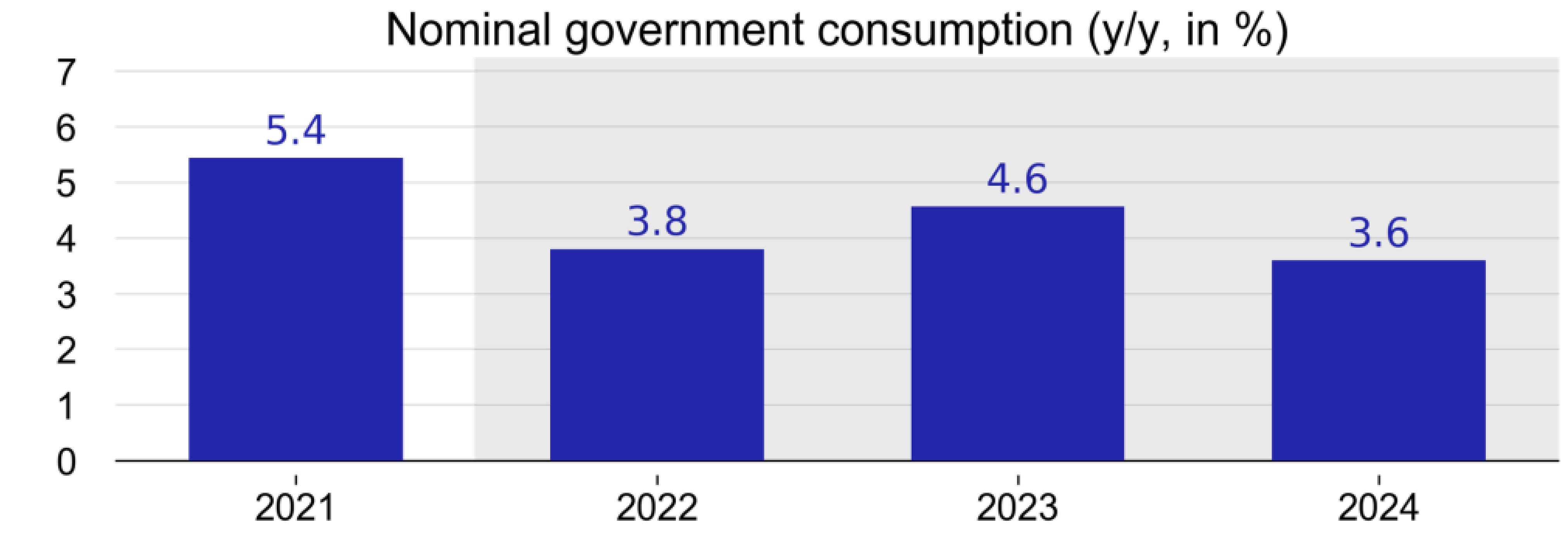
Effective euro area PPI started to decline at the end of last year and its outlook assumes subdued gas and electricity prices. Also, an easing of supply chain stress will foster a reduction in the pressure on core inflation.

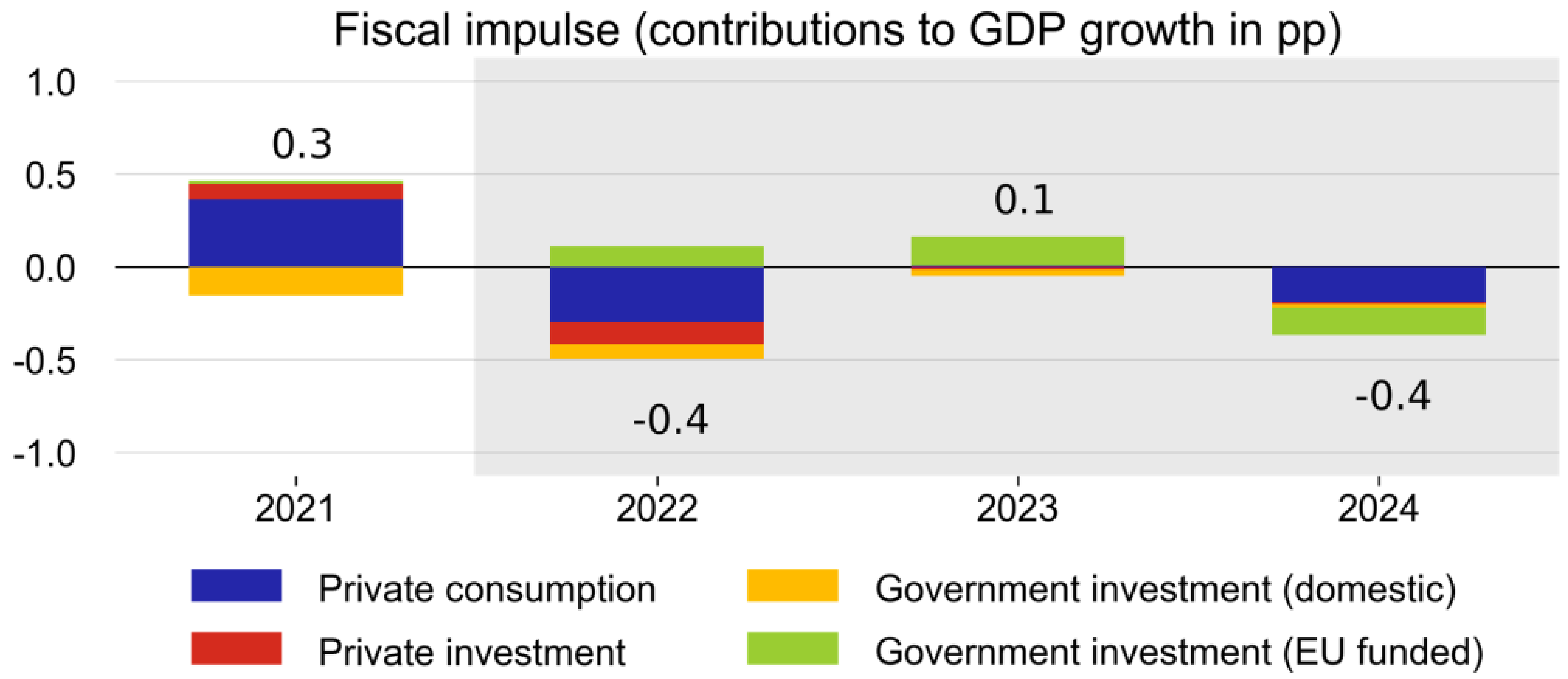
PPI growth in the effective eurozone reached 20.7% yoy in January 2023 versus 16.2% in the forecast.

The outlook for the **Brent 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**.

Fiscal assumptions



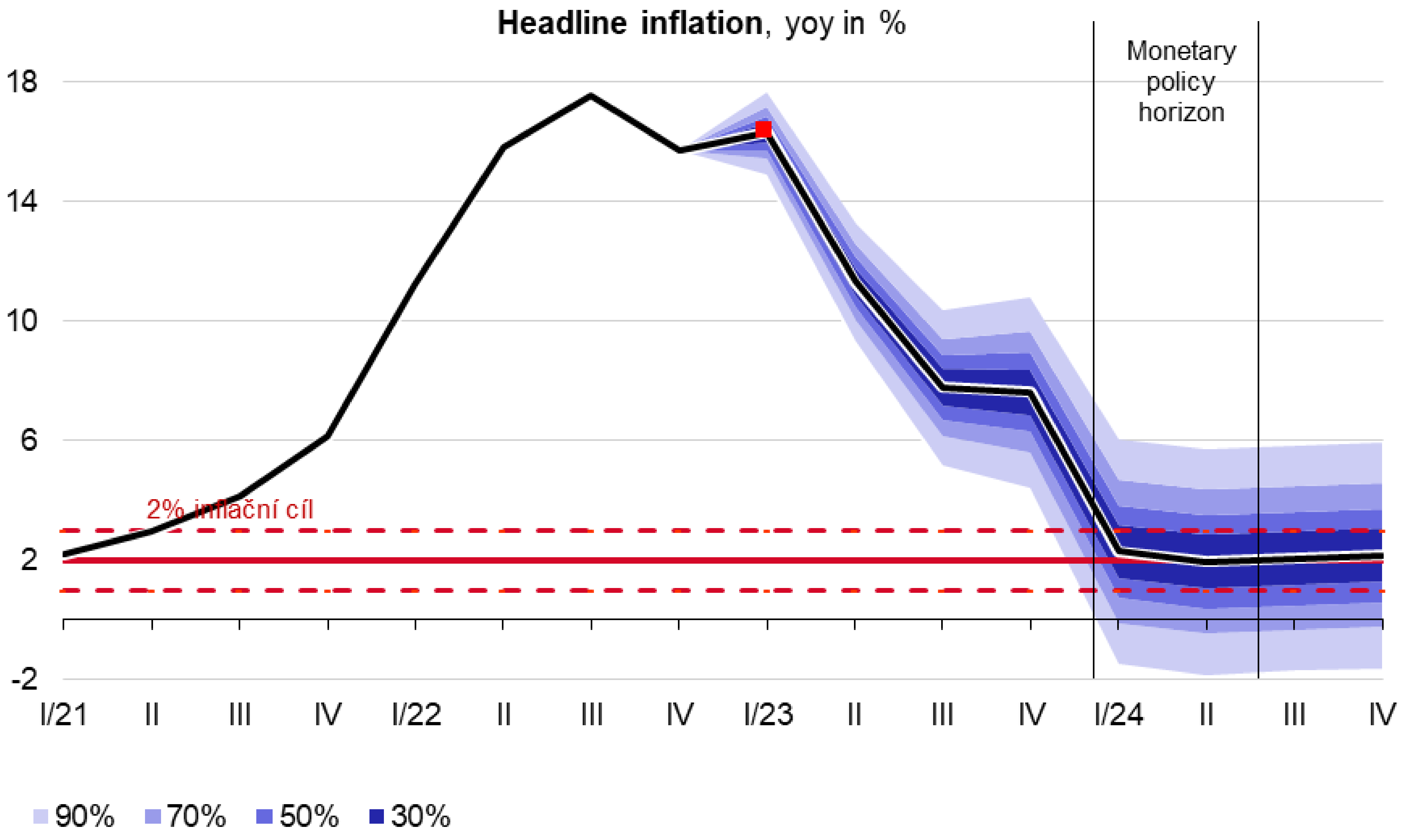


Nominal **government consumption** will grow by about 4.5% this year reflecting increasing salaries in the non-market sector and public expenditure, linked with the arrival of Ukrainian nationals. It will slow down slightly next year.

Fiscal impulse will stimulate GDP growth slightly this year due to the continuation of support measures to fight high energy prices.

The fading of **support measures** and a temporary **fall in absorption of EU funds** due to a slow start to the new program period will significantly dampen GDP growth in 2024.

Inflation forecast



Headline inflation will be temporarily above 16% in 2023 Q1 and drop to single digits in the second half of this year.

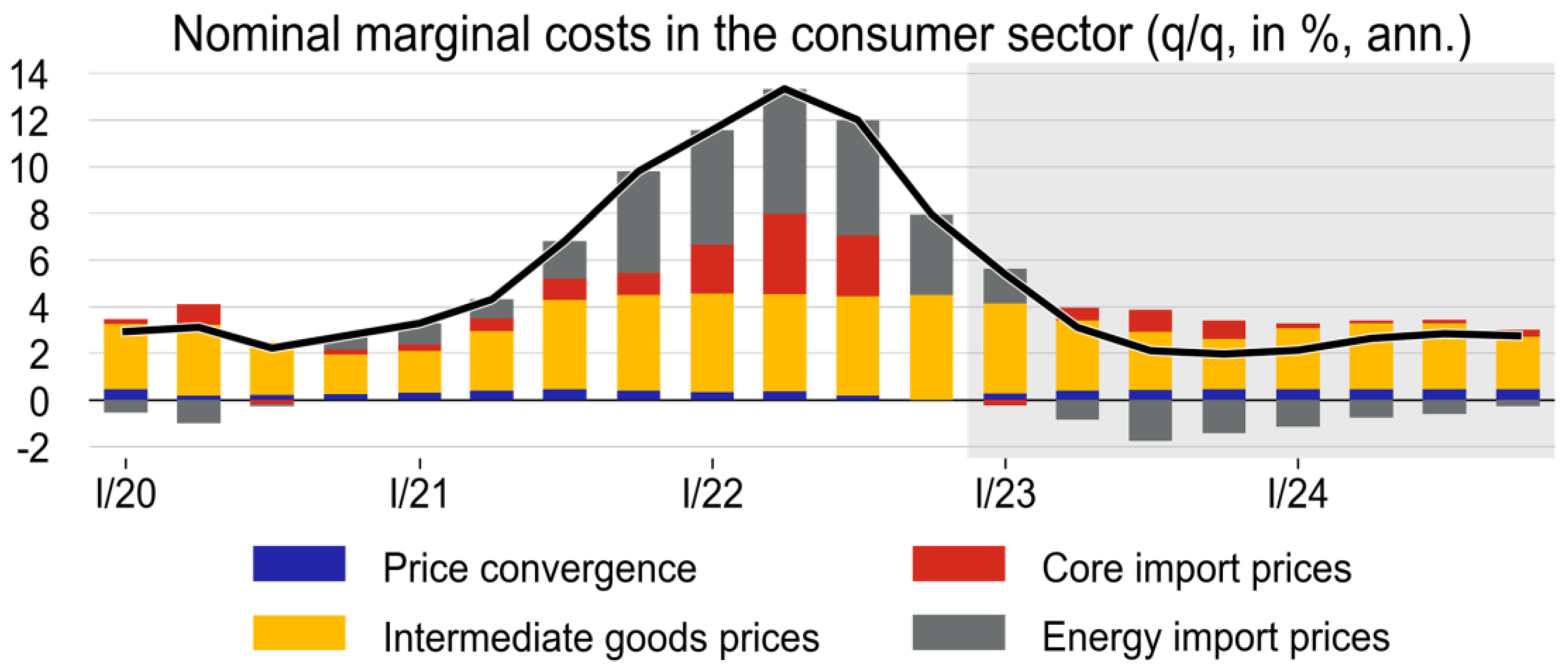
Inflation will **return close to the 2% target in the first half of 2024,** reflecting decreasing cost pressures from both the foreign and domestic economies.

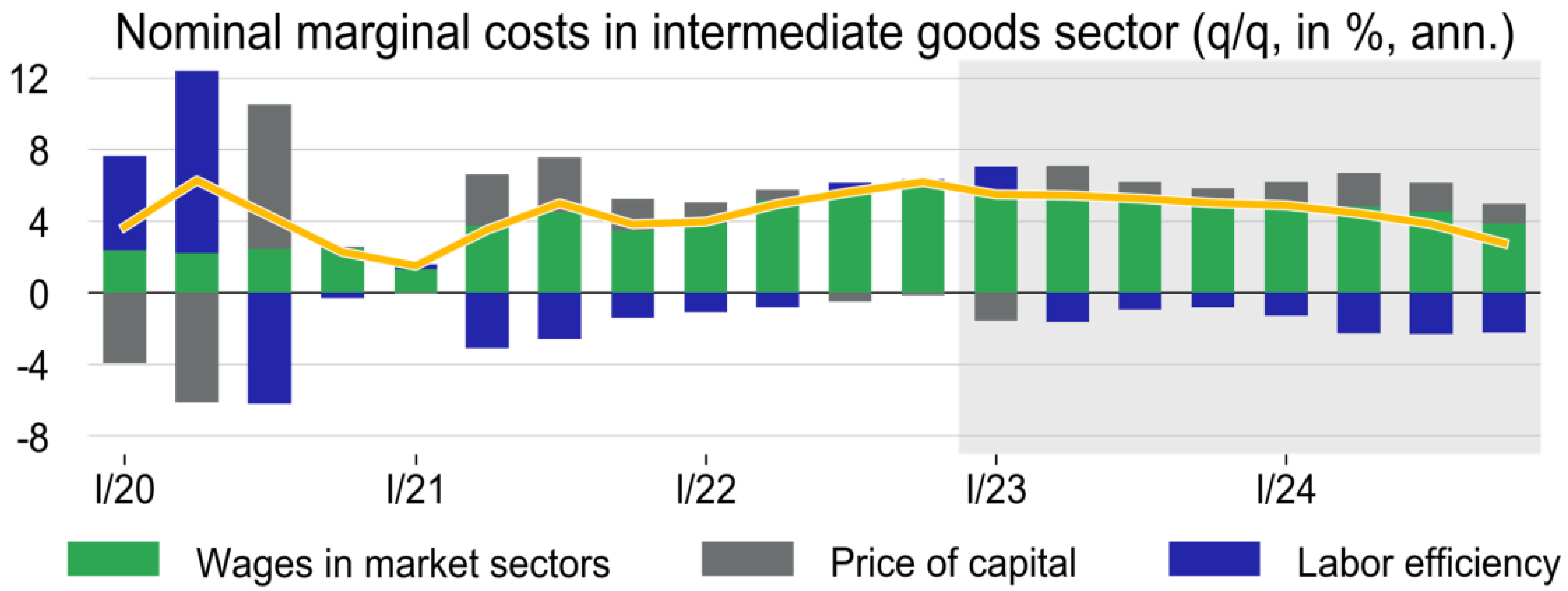
The currently **peaking profit margins** of domestic producers, retailers and service providers will undergo a gradual correction.

Tight monetary policy will contribute to this decline.

The January and February inflation figures were close to the forecast, implying approximately 16.4% for 2023Q1 so far.

Cost pressures



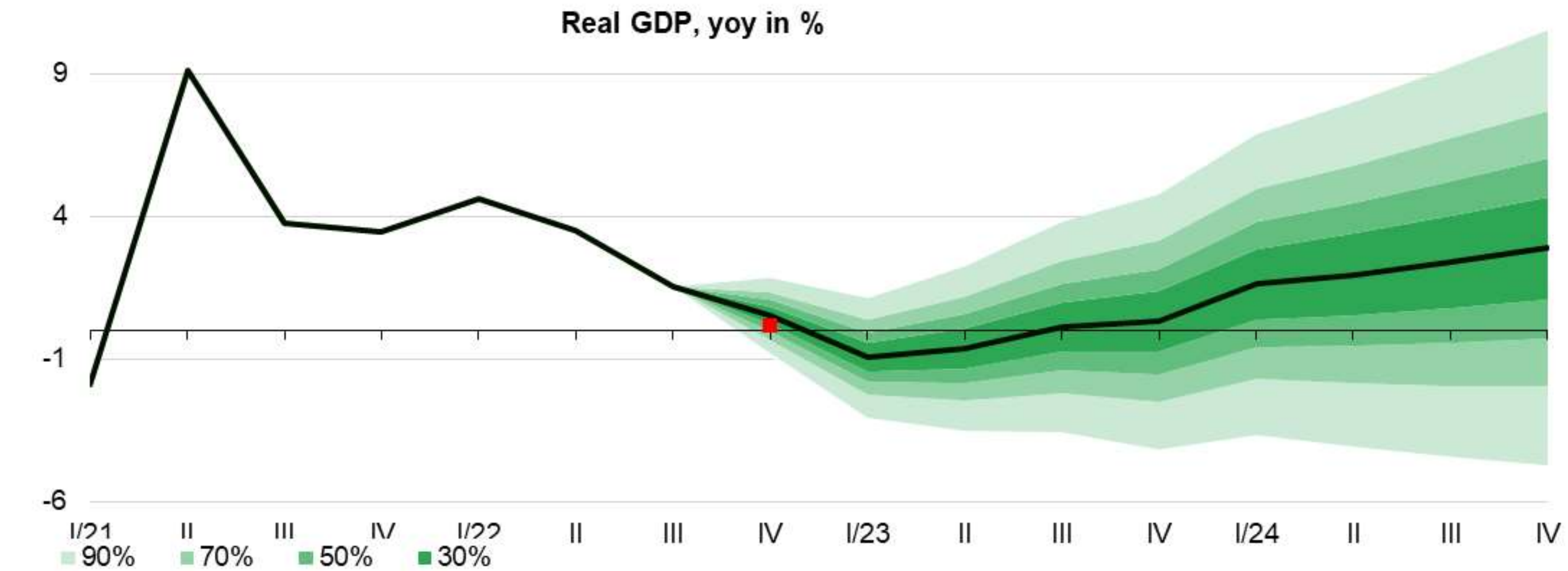


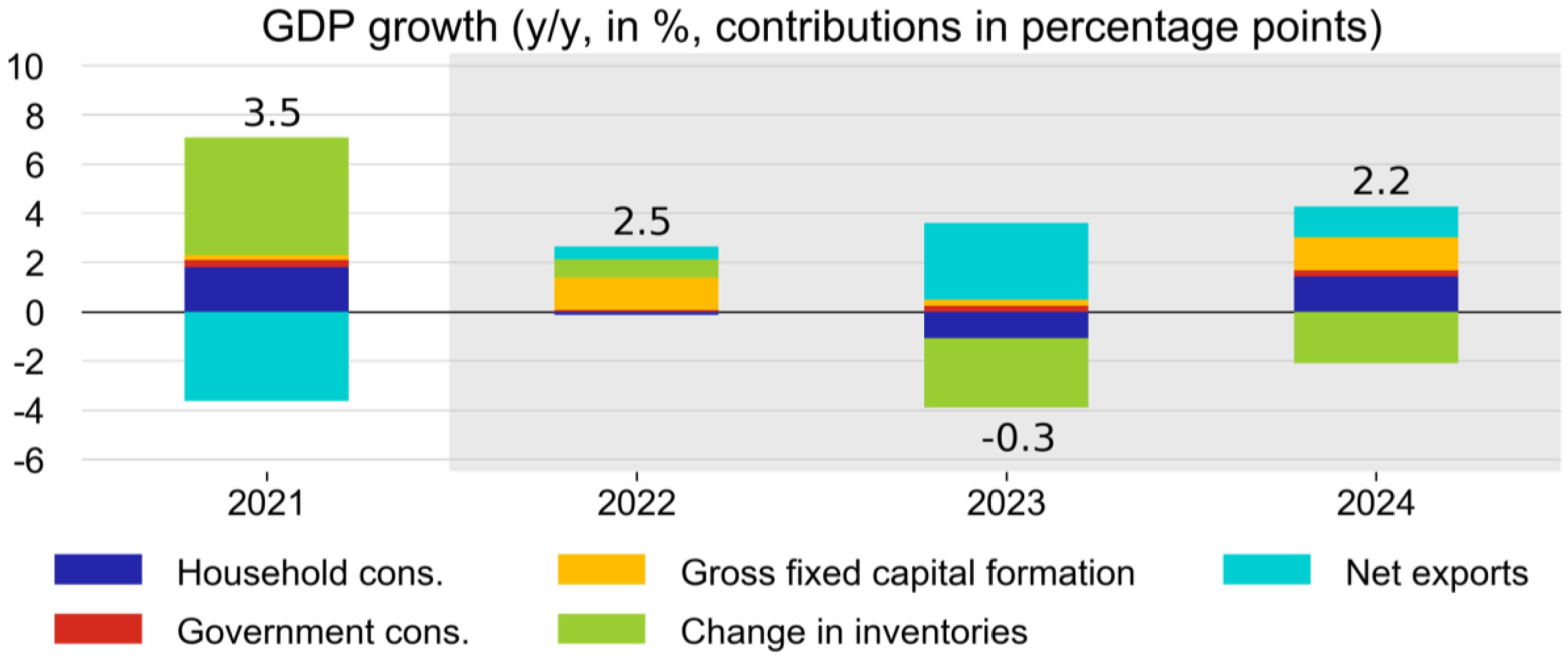
Costs pressures eased at the end of last year due to a slowdown in import price dynamics.

The overall cost pressures will continue to weaken this year reflecting mainly a drop in **energy import prices** and decreasing growth in **domestic intermediate goods prices**.

The **domestic cost pressures** will ease slightly early this year but remain elevated. They will be driven mainly by brisk wage growth, which will fade out only gradually.

Real GDP





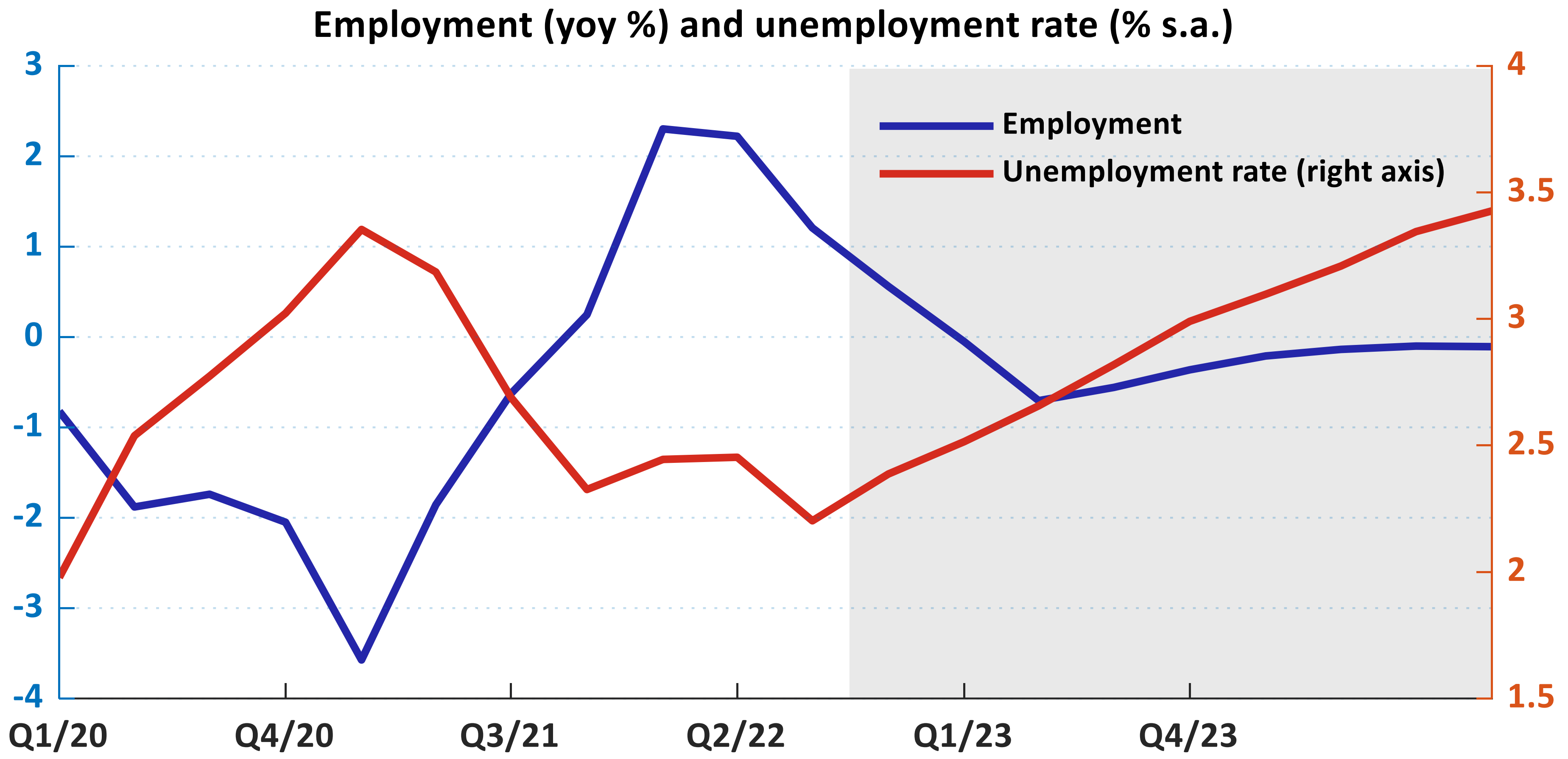
Real GDP will decline slightly given a further deterioration in the financial situation of Czech households and firms, cooling external demand and ongoing – though gradually receding – problems in global value chains.

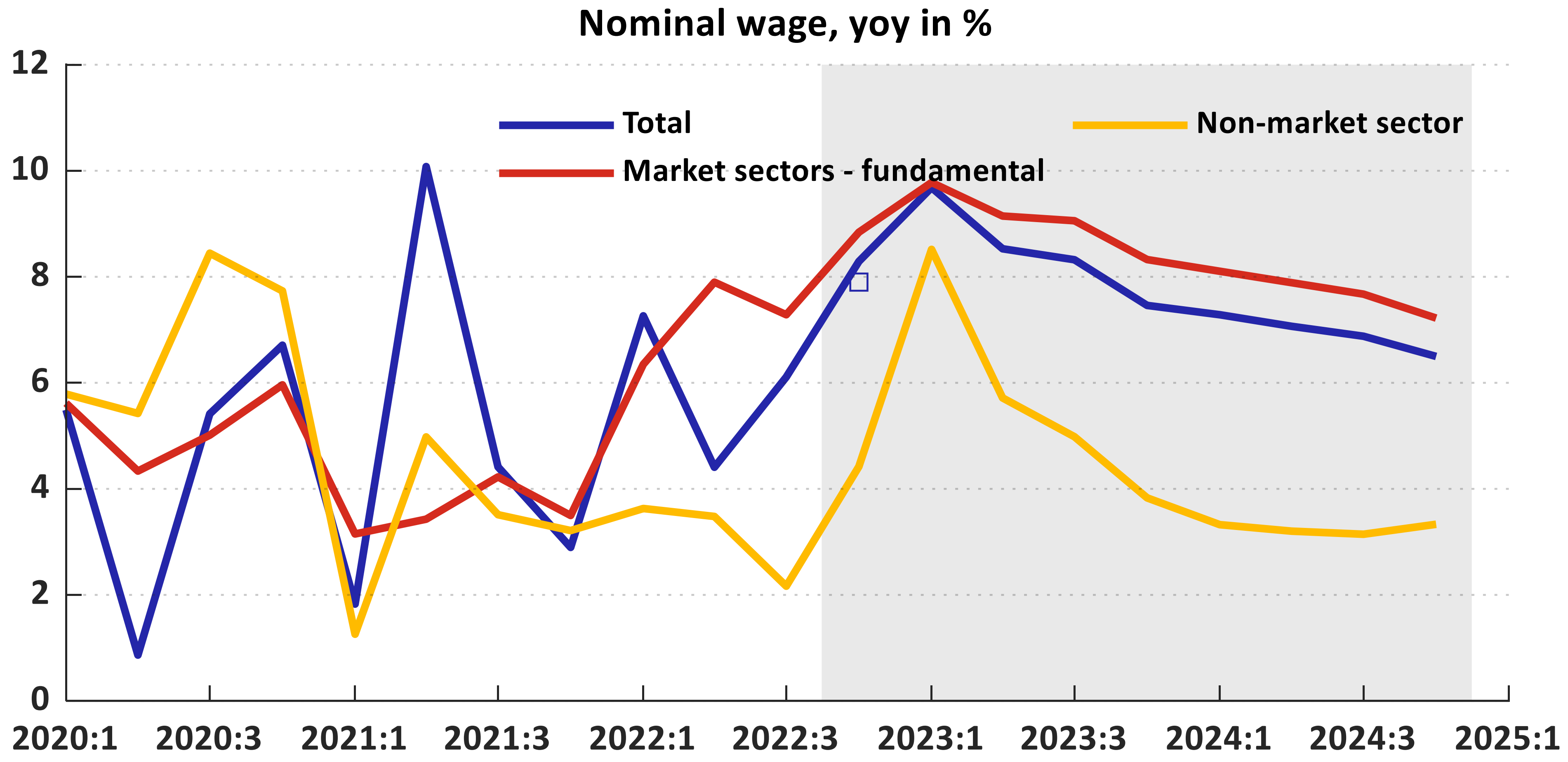
But the recession will be mild and short-lived. The economy will return to **growth of more than 2% in 2024**.

Real GDP growth in 2022Q4 reached 0.2% yoy, which is lower than in the forecast (0.5%). Lower-than-forecasted figures were recorded by **household consumption** (-5.5% versus -3.3% yoy) and **net exports** (2.2% versus 1.7% yoy) despite faster growth in exports and imports. On the contrary, **capital formation** and **government consumption** grew faster than forecasted.

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.

Labor market





Employment peaked in 2022 and started to decline moderately afterwards. The decline will continue in 2023.

The general **unemployment rate** started to increase modestly at the end of last year and will continue to rise due to the mild decline in real GDP. The unemployment rate reached 3.9% in January.

Nominal wage growth will accelerate visibly in both **market and non-market sectors** at the beginning of 2023. It will remain elevated over the forecast horizon as firms will partially compensate employees for the decline in **real wages** in the still-tight labour market.

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**.

Nominal wage growth reached 7.9% yoy in 2022Q4, which was slightly below the forecast (8.3%).

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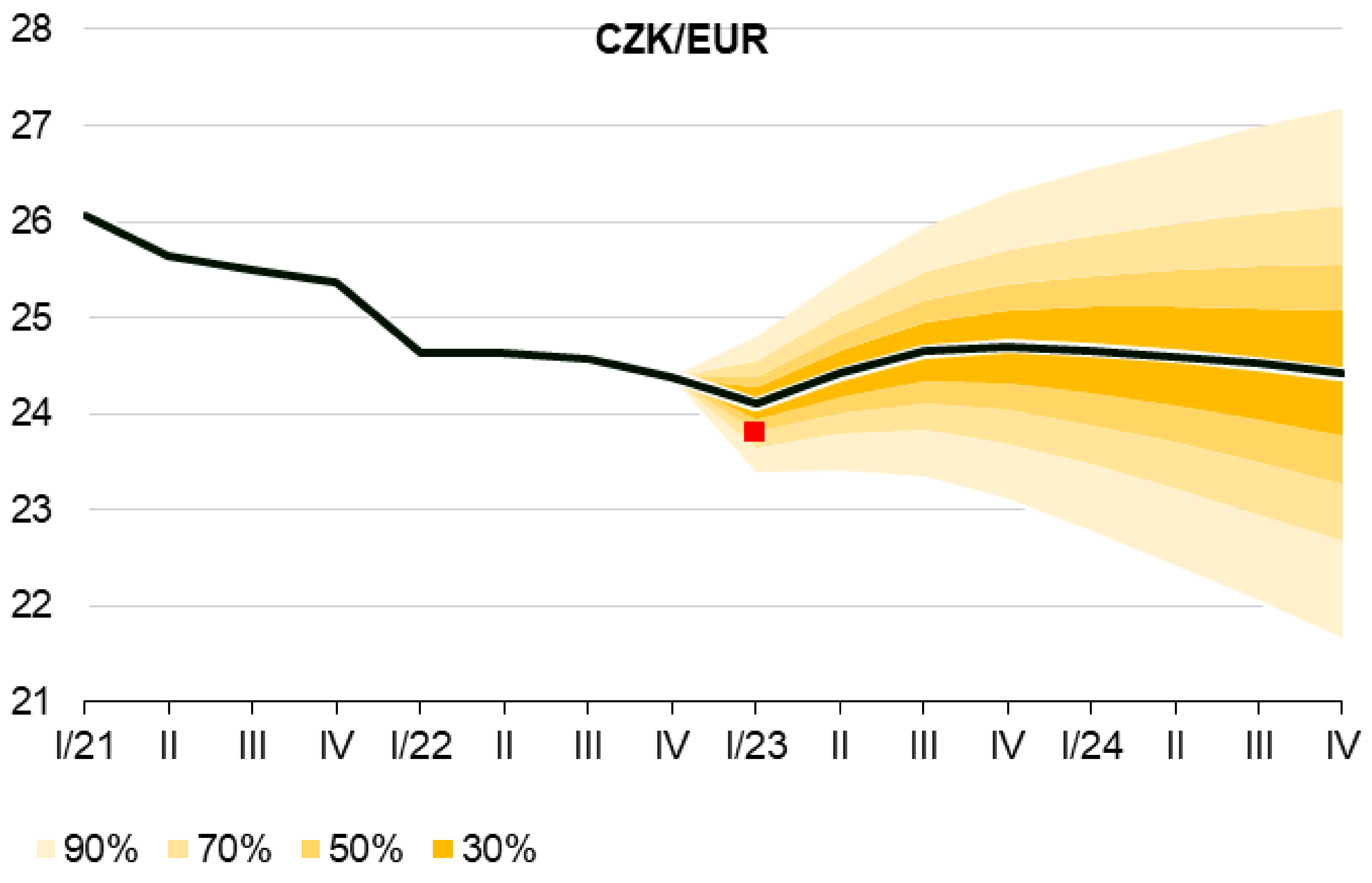
CZK/EUR exchange rate



The **nominal appreciation** of the koruna – 23.8 CZK/EUR so far on average in 2023Q1 – is a slightly anti-inflationary factor compared to 24.1 CZK/EUR in the forecast.

The koruna is expected to depreciate slightly later this year given a **narrowing interest rate differential** vis-à-vis the euro area.

Gradual appreciation of the koruna expected in 2024 reflects fading global value chain disruptions, improving global sentiment, and thus an improving trade balance.

The CNB **will continue to prevent excessive fluctuations of the koruna.**

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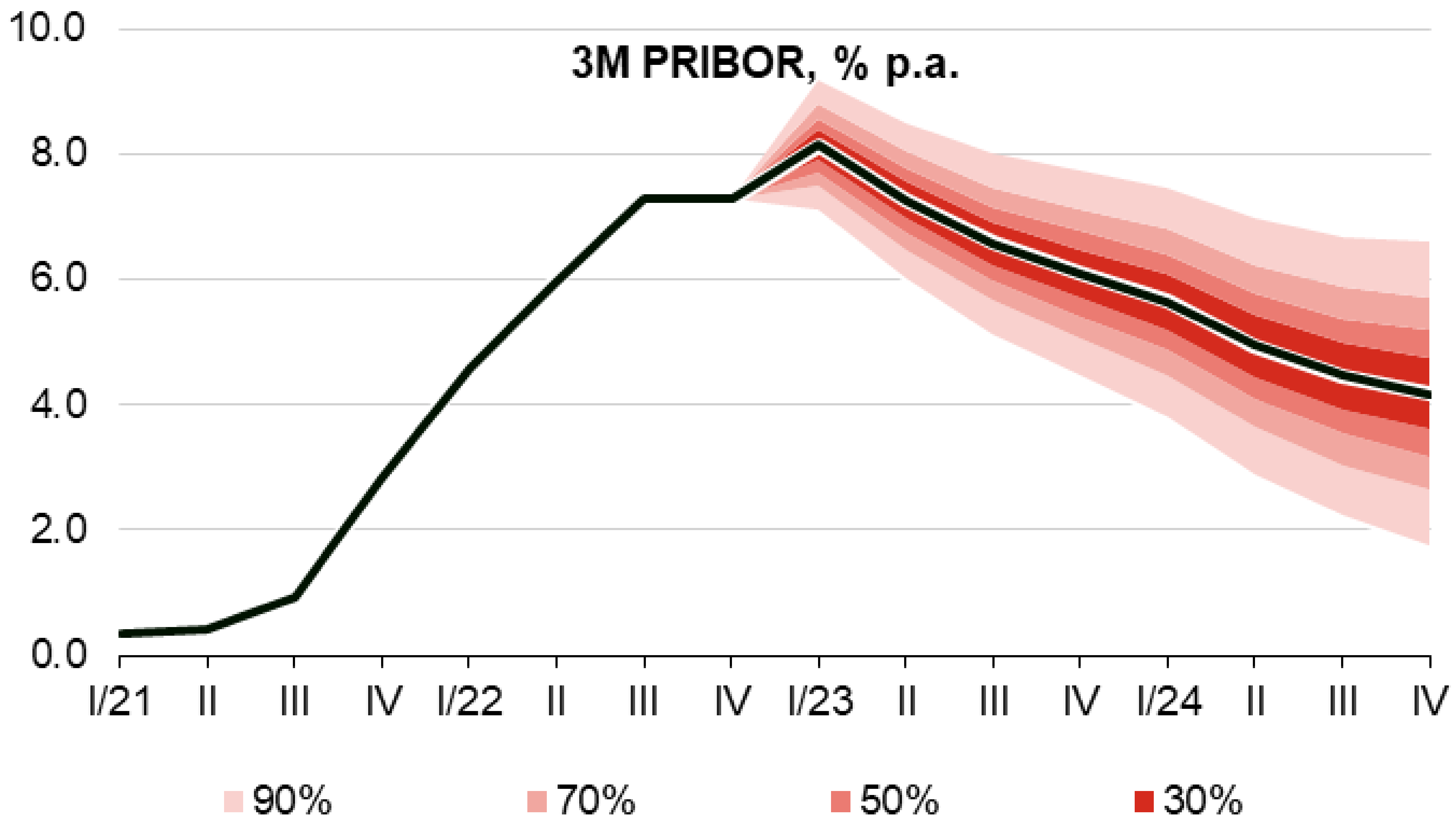
Interest rate



Consistent with the 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 standard **monetary policy horizon** (12–18 months ahead), i.e. in the first half of 2024.

In the forecast, the initial monetary policy tightening is assumed to foster a **desirable deferral of current consumer and investment demand** and to further reduce the price pressures. Fading cost pressures will result in inflation returning back to the target in 2024H1. Consistently with the expected return of inflation back to the target, the policy rates will decline gradually.

Will inflation return to the 2% target or stay elevated above the target in 2024?

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Risks and uncertainties of the forecast

The Bank Board assessed the risks and uncertainties of the baseline scenario of the forecast as being significant and going in both directions.

Inflationary risks:

- more expansionary fiscal policy
- threat of inflation expectations becoming unanchored from the CNB's 2% target and the related risk of a wage-price spiral

Anti-inflationary risks:

- stronger-than-forecasted downturn in domestic consumer and investment demand
- faster-than-expected decline in core inflation

Uncertainties:

- extent of repricing of goods and services in January
- future course of the war in Ukraine
- availability and prices of energy
- future monetary policy stance abroad

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Last monetary policy decision

6.00%	7.00%	8.00%
discount rate	2W repo rate	Lombard rate

VOTING ON 2W REPO RATE

LEAVE UNCHANGED at 7.00%

INCREASE to 7.50%

The CNB Board kept the 2W repo rate at 7% at its last meeting on February 2, 2023. **Five members** voted in favor of this decision and **two members** voted for an increase of the rate by 50 bp.

Consistent with the baseline scenario is a rise in market interest rates initially, followed by a gradual decline.

The Board also discussed a **scenario** in which policy rates remain at the current level for a longer period of time.

The next policy meeting on March 29, 2023 will evaluate forecast fulfilment and risks based on the actual data since the forecast publication.

Thank you for your attention

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CNB Board Member

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