KOMERČNÍ BANKA’S MACROECONOMIC FORECAST

There was a RECESSION? WHEN?

Prague, 25 January 2023

**The Czech economy went through a shallow recession in the second half of last year. Nevertheless, we expect that the period of economic downturn is over, primarily thanks to the German economy’s resilience and the robust economic performance in the euro area overall. Compared with last year, this year should see lower inflation although the disinflation process will be relatively slow. We will probably report a double-digit growth of prices for this year again. In our opinion, the CNB will therefore keep the key rate at 7% until August, when it will start a series of rate cuts. The labour market will remain almost unaffected.**

**The recession in the last two quarters of 2022 was really a technical matter only.** The country’s economy posted only slight QoQ declines in the second half of the year. Thanks to the successful first half it therefore reports a solid economic growth of 2.5% for FY 2022. “*But we can talk about consumer recession. In particular because of last year’s high inflation, we saw the deepest fall of real income for the last three decades. This means, naturally, that real household consumption has been decreasing, in fact continuously since 4Q 2021,”* notes Jan Vejmělek, Komerční banka’s Chief Economist. The other component of internal demand, investments, was also weak, mainly in 2H 2022. The sluggish investment activity reflects the generally prevailing economic uncertainty; the higher costs of financing resulting from the rate hikes also played their role in this.

**Its key trade partners, i.e. external demand, helped the Czech Republic.** In this respect, improvements in the global supply chains played an important role and were positively reflected in automotive production. “*The external environment really helped us. Despite all the concerns, Germany did not fall into recession at all, and we believe that it will not fall into it now*,” Jana Steckerová, Komerční banka’s economist, completes the positive picture. It is external demand that will rev up the Czech economy this year, and internal demand will also be progressively felt. But the recovery will be very gradual; for FY 2023, we expect the Czech GDP to rise by an insignificant 0.3% in real terms (versus the 0.5% expected in our preceding forecast). The country will achieve its pre-pandemic level of real output only towards the end of this year. The forecast expects that last year’s recession will have only a minimal impact on the labour market. The slight increase in the rate of unemployment, which will not exceed seasonally adjusted 4% this year, will change nothing in the tense labour market. Unfortunately, due to high inflation real wages will decline this year too; following last year’s 7.2%, we expect them to drop by 2.7%.

**The year 2022 was marked by inflation, and this year will be only slightly better.** Following last year’s average inflation of 15.1% we expect it to be again a double-digit rate this year, at 12.9% on average. “*This year’s FY result will be significantly affected by the January figure, which, however, is marked by a high level of uncertainty. On the one hand, compensation for energy advance payments has ended, on the other hand the government’s caps on electricity and gas prices are now applicable. A big question mark hovers over the traditional updates of energy price lists in January*,” Martin Gürtler, Komerční banka’s economist, clarifies some of the uncertainties. We will only see single-digit inflation in 2024 when it should stand at 2.5% on average. The slow trend of disinflation will be felt in the CNB’s policy; it will keep the rates at the current levels until August, when we expect it to start a series of rate cuts.

**The Czech koruna has stepped into this year successfully; its ever strongest level against the euro is within reach.** We see risk aversion subsiding globally and the country’s external trade recovering in 4Q 2022 behind the koruna’s currently strong position. The CNB continues to protect the country’s currency. Since November, it apparently has not had to intervene and so continues to hold considerable forex reserves. “*We consider that the koruna will probably not retain the significant gains that it recorded earlier this year and will correct them, particularly in connection with the interest differential continued narrowing*,” Jaromír Gec, Komerční banka’s strategist, reveals the expected forex rates.

**The national budget has not yet been disentangled from the crisis mode.** Last year, the national budget posted a deep deficit similar to that in the pandemic year 2020. We expect public finance consolidation to continue at a slow pace only against the backdrop of dampened economic growth and the deep structural deficit. *“We consider that the deficit may fall below CZK 300 billion this year again, although the approved deficit is CZK 295 billion,”* Jaromír Gec opines. Another extraordinary indexation of old-age pensions, which will require CZK 20-25 billion and was not included in the originally proposed budget, would mainly contribute to the deeper deficit. The high inflation will continue to retard the rising of the public debt relative to the nominal GDP.

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| **Macroeconomic forecast**  |  |  |  |
|   | 2021 | **2022** | **2023** |
| **GDP** (real growth, yoy in %)  | 3.5 | **2.5** | **0.3** |
| **Household consumption** (real growth, yoy in %)  | 4.1 | **-0.6** | **-1.9** |
| **Fixed investment** (real growth, yoy in %)  | 0.8 | **5.4** | **1.2** |
| **External trade balance** (CZK bn) (\*)  | -9.0 | **-223.6** | **-109.7** |
| **Industrial production** (real growth, yoy)  | 8.0 | **2.1** | **1.7** |
| **Retail sales** (real growth, yoy in %)  | 4.2 | **-2.8** | **-1.3** |
| **Wages** (nominal growth, yoy in %)  | 4.8 | **6.7** | **9.9** |
| **Unemployment rate** (MPSV, in %)  | 3.7 | 3.4 | **3.9** |
| **Inflation** (yoy in %)  | 3.8 | 15.1 | **12.9** |
| **3M PRIBOR** (average)  | 1.1 | 6.3 | **6.8** |
| **2W Repo** (average)  | 0.9 | 5.9 | **6.6** |
| **EUR/CZK** (average)  | 25.6 | 24.6 | **24.2** |

Source: CSO, CNB, Ministry of Labour and Social Affairs, Macrobond, Economic and Strategic Research, Komerční banka

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