MACROECONOMIC FORECAST

energY PRICES: FROM VILLAIN TO HERO

Prague, 25 April 2023

**Last year’s stagflation picture is over. In the second half of 2022, the Czech economy went through a slight and only technical recession, which was basically not felt at all in the labour market, and thus neither in the development of inflation. This year will be marked by economic growth; it has been visible since the beginning of this year. In particular the development in Germany is encouraging. We expect the Czech pre-pandemic maximum to be surpassed as early as the third quarter. Inflation will decline this year, which will be significantly helped by lower energy prices. Working in favour of significantly greater price hikes last year, energy prices will be a major disinflation factor this year. Inflation will therefore already drop to levels within the inflation corridor early next year. However, core inflation will decline at a slower pace. This is why the CNB will keep unchanged rates for most of this year and will continue to prefer a strong Czech koruna.**

**Last year’s stagflation picture is fading.** Komerční banka’s forecast has been improved for this year, since it currently expects the Czech economy to grow by 0.6% in real terms compared with the 0.3% expected in the January forecast. On the other hand, inflation prospects for this year have been revised downwards from the original 12.9% to the current 11.8%. “*The key variable that has influenced the formulation of the current macroeconomic forecast was energy prices,”* discloses Jan Vejmělek, Komerční banka’s Chief Economist, adding: *“While last year the extreme surges in energy commodity prices significantly contributed to both inflation and recession, it will be the very opposite this year. In short, a villain has turned into a hero.”*

**The Czech economy will keep growing for the whole of 2023. The growth will accelerate, slowly but surely.** For the first quarter, the QoQ dynamics will be 0.2% and the figure will rise to 0.5% by the end of this year. In terms of structure, the development in the country of our key trade partners will be felt positively. “*The results of German industrial production are excellent for the first few months of this year. Lower energy prices have helped; the hitches in the global supply chains seem to be over; and, equally importantly, a strong recovery of the Chinese economy following the end of pandemic lockdowns can be felt,”* Jana Steckerová, Komerční banka’s economist, comments on the strong external environment. Internal demand will gradually come into play, supported by money from EU funds on the investment side. “*Following the earlier deep plunge, household consumption is poised to increase throughout this year. Consumers’ concerns about the impacts of high energy prices have subsided, inflation seems to have peaked, and the accelerating wage growth should gradually help to improve households’ income,”* notes Martin Gürtler, Komerční banka’s economist.

**Year-on-year inflation has peaked and will continue to decline; nevertheless, it will average at 11.8% for the whole of this year anyway as our forecast indicates. Inflation will fall to 2% next year.** Energy prices at wholesale markets have dropped to the pre-war levels and the various suppliers operating in the Czech Republic have begun reflecting this development in their prices for final consumers; up to now, most of those prices have been set at the level of the government’s price caps. “*We expect the lower wholesale energy prices to cascade into consumer prices only gradually this year and will see a stronger seepage into them only at the beginning of next year. But overall, the significantly lower energy prices will help to push inflation down, and even to the CNB’s target next year,”* Martin Gürtler describes the expected structure of the development of consumer prices.

**The Czech central bankers continue making clear their unwillingness to change the rates in any of the two directions.** Combined with the still observed and expected persistence of core inflation, this has prompted us to defer what we expect is the beginning of the CNB’s rate cuts, while reducing in our forecast the estimated pace at which the rate cuts will take place. “*We expect the first rate cut in September. We consider that the basic repo rate should be at 6.25% at the end of this year and it will reach its 3% equilibrium by the end of 2025,”* says Martin Gürtler, adding that “*core inflation will decline only very slowly, also because of the stronger growth of nominal wages, which will exceed 10% on average this year*”.

**Investors’ continuing return to the Central European region combined with the recovery of external trade in the first quarter of this year has helped the koruna to grow stronger.** The CNB continues to protect the Czech currency. However, in our view the koruna will not keep this significant strengthening trend, in particular in connection with the interest differential continued narrowing and the koruna’s appreciable strengthening in real terms so far. “*We expect it to slightly weaken to EUR/CZK 23.80 within a year,*” Jaromír Gec, Komerční banka’s strategist, reveals the expected forex rates.

**The national budget has not yet been disentangled from the crisis mode.** A CZK 166.2 billion deficit for the first quarter is the worst ever entry into a new year in the history of the independent Czech Republic. However, certain extraordinary measures and the timing difference between the income and expenditure flows have contributed to this to some extent. “*But this year’s deficit will probably exceed CZK 300 billion, specifically by at least CZK 20 billion, although the deficit was approved at CZK 295 billion*,” Jaromír Gec opines. The additional extraordinary indexation of old-age pensions, which was not included in the originally proposed national budget, together with the relatively dampened economic growth are expected to play a part in this.

**Households’ borrowing activity had already cooled down significantly by the end of last year.** The business sector is also set to slow down markedly this year. The increased interest rates will cause the mortgage market to remain depressed this year. “*A rather significant recovery can be expected only next year as the rates gradually decline, with the market supported by this year’s good wage growth,”* adds Kevin Tran Nguyen, Komerční banka’s economist. The mortgage market’s slow thawing will be accompanied by only slight corrections to the prices in the property market.

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| **Macroeconomic forecast**  |  |  |  |
|   | 2022 | **2023** | **2024** |
| **GDP** (real growth, yoy in %)  | 2.5 | **0.6** | **1.8** |
| **Household consumption** (real growth, yoy in %)  | -0.9 | **-1.7** | **3.3** |
| **Fixed investment** (real growth, yoy in %)  | 6.2 | **1.8** | **4.9** |
| **External trade balance** (CZK bn)  | -200.1 | **-26.3** | **74.1** |
| **Industrial production** (real growth, yoy)  | 2.6 | **1.7** | **4.2** |
| **Retail sales** (real growth, yoy in %)  | -3.3 | **-1.5** | **3.7** |
| **Wages** (nominal growth, yoy in %)  | 6.5 | **10.4** | **6.6** |
| **Unemployment rate** (MPSV, in %)  | 3.4 | **3.7** | **3.7** |
| **Inflation** (yoy in %)  | 15.1 | **11.8** | **2.0** |
| **3M PRIBOR** (average)  | 6.3 | **7.1** | **5.4** |
| **2W Repo** (average)  | 5.9 | **6.8** | **5.1** |
| **EUR/CZK** (average)  | 24.6 | **23.7** | **23.8** |

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

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