MACROECONOMIC FORECAST:   
NO RATE CUTS THIS YEAR BUT MORE IN 2024

Prague, 25 July 2023

**Having gone through a slight recession in the second half of last year, the Czech economy was basically stagnant in the first half of this year. Consumer demand remained sluggish, largely due to the significant drop in real wages registered last year. In combination with the cumulated savings being released the recovery of real wages, starting in the second quarter of this year, should form the basis for household consumption gradually rising again. In addition, higher investment activity will appear towards the end of this year. The implementation of the restrictive fiscal package notwithstanding, stronger internal demand will support economic growth in 2024. The strong disinflationary trend of the first half of this year will slacken in the remaining part of the year but inflation will decline to the 2% target only in the first months of next year. And we expect the CNB to embark upon the series of its rate cuts only in 2024, but the rates will decline all the faster.**

**The Czech economy will experience only minimal improvement in real terms this year.** According to Komerční banka’s updated forecast, real GDP will grow by only 0.1%. Compared with the April outlook, this year’s expected growth has been revised downwards by 0.5 pp. “*Primarily the second quarter has disappointed us,”* Jan Vejmělek, Komerční banka’s Chief Economist, clarifies the reason for the downward revision, adding some more reasons: “*Although net exports generated a significantly positive contribution to economic growth throughout the first half of the year thanks to the resolution of the problems with supply chains and strong automotive production, weak internal demand basically erased its impact.”* Our estimates show that the QoQ decline in households’ real consumption went on throughout the first half of this year. Thus, the decline is continuing for seven quarters in a row, while investments have been decreasing for one year.

**Internal demand will start to rise in the second half of this year but a more visible recovery will come only in 2024** when we expect real GDP to grow by 1.8%. Despite the restrictive effect of the fiscal package, with implementation from the beginning of next year, the growth forecast for 2024 has not been changed, but only because of this year’s lower basis of comparison. Internal demand is set to grow stronger despite fiscal restriction. Household consumption will be helped by the growth in real wages, which we will see from this year’s second quarter on a QoQ basis. It will gradually be underpinned by the release of cumulated savings. Stronger demand will also be felt in livelier investment activity, which will be supported by EU funds. External demand will also strengthen. “*European companies are enjoying fat margins and have considerable financial liquidity cushions while consumers have not yet spent their covid savings and are benefiting from the tight labour market,”* says Jana Steckerová, KB’s economist.

**The situation in the euro area, as our key trade partner, looks encouraging.** The reason is that its demand is still robust in many sectors. This is true for, e.g., the automotive industry, which should contribute to the recovery of European and hence also Czech industry.

**The Czech labour market will remain tense, which will be reflected in the continuing rapid growth of nominal wages.** Our forecast suggests that the average wage will rise by 9.4% this year and by 7.3% next year. Besides the persisting workforce shortage, the deep decline in real wages so far will resound in wage negotiations. “*Employees have shouldered the heaviest burden of inflation as the growth of their earnings significantly lagged behind inflation. On the other hand, companies have been able to pass the increased costs through to consumers, and their profit margins have even increased. In our opinion, this fact will be the main motto of wage negotiations for next year,”* says Martin Gürtler, KB’s economist.

**Motivated by the weakening inflationary pressures the CNB will be cutting rates quite quickly next year.** While the y-o-y growth of consumer prices should be around 8% in the second half of this year, we expect inflation to drop to an average of 1.3% next year. Martin Gürtler believes that this will mainly be attributable to the long expected decline in energy prices for consumers and also the VAT changes proposed by the government. On the other hand, core inflation should stay above the inflation target due to recovered demand. “*Although the inflationary pressures in the economy have already weakened significantly, the CNB Board will probably want to defer the first rate cut to early next year. The rate cuts will therefore most probably come later than the best time would be; nevertheless, rate cuts in 2024 will be all the faster,”* adds Martin Gürtler*.*

**The trend of the koruna’s appreciation has paused.** The narrowing interest differential contributed to the end of its strengthening to the euro in the second quarter of this year. “*Because of the high rates in the euro area, the only very gradual economic recovery, and the hitherto strong appreciation of the koruna in real terms, we expect its rate to reach CZK/EUR 24.10 within a year,”* Jaromír Gec, KB’s strategist, unveils the forex prospects.

**The consolidation package is the first step towards public finance consolidation.** Without additional savings, this year’s national budget deficit will probably exceed the approved CZK 295 billion. “*In the coming years, the proposed consolidation package will not only reduce the national budget deficit but also help to slow down GDP growth and inflation; by reducing the offering of government bonds, it should also accelerate the decline in their yields,”* Jaromír Gec opines. We expect that beginning next year the public finance deficit should gradually return under 3% of the GDP. Thus, total public debt will continue to grow but will roughly stabilise in relation to the nominal GDP in 2025-2026.

**The tightened monetary policy and the Czech economy’s weaker performance will cause the low lending activity to persist until the end of this year.** The mortgage market will continue in only gradual thawing while lending to companies will remain relatively weak. “*Only the easing of the monetary policy early next year will bring a fairly appreciable lending impetus for the economy,”* adds Kevin Tran Nguyen, KB’s economist. The continuing decline, albeit only slight, in property prices, up to -4.5% this year, will accompany the mortgage market’s slow awakening.

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| **Macroeconomic forecast** |  |  |  |
|  | 2022 | **2023** | **2024** |
| **GDP** (real growth, yoy in %) | 2.4 | **0.1** | **1.8** |
| **Household consumption** (real growth, yoy in %) | -0.8 | **-4.0** | **4.5** |
| **Fixed investment** (real growth, yoy in %) | 3.0 | **-1.5** | **5.8** |
| **External trade balance** (CZK bn) | -202.6 | **126.8** | **110.5** |
| **Industrial production** (real growth, yoy) | 2.6 | **1.0** | **4.2** |
| **Retail sales** (real growth, yoy in %) | -3.3 | **-4.0** | **4.8** |
| **Wages** (nominal growth, yoy in %) | 5.3 | **9.4** | **7.3** |
| **Unemployment rate** (MPSV, in %) | 3.4 | **3.6** | **3.6** |
| **Inflation** (yoy in %) | 15.1 | **11.0** | **1.3** |
| **3M PRIBOR** (average) | 6.3 | **7.2** | **5.5** |
| **2W Repo** (average) | 5.9 | **7.0** | **5.3** |
| **EUR/CZK** (average) | 24.6 | **23.8** | **24.1** |

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

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