CNB's Winter Forecast, Recent Economic Developments and Monetary Policy

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30 March 2021

Presentation Outline

1. Winter Macroeconomic Forecast
2. Recent Economic Developments
3. Decisions of the CNB Bank Board

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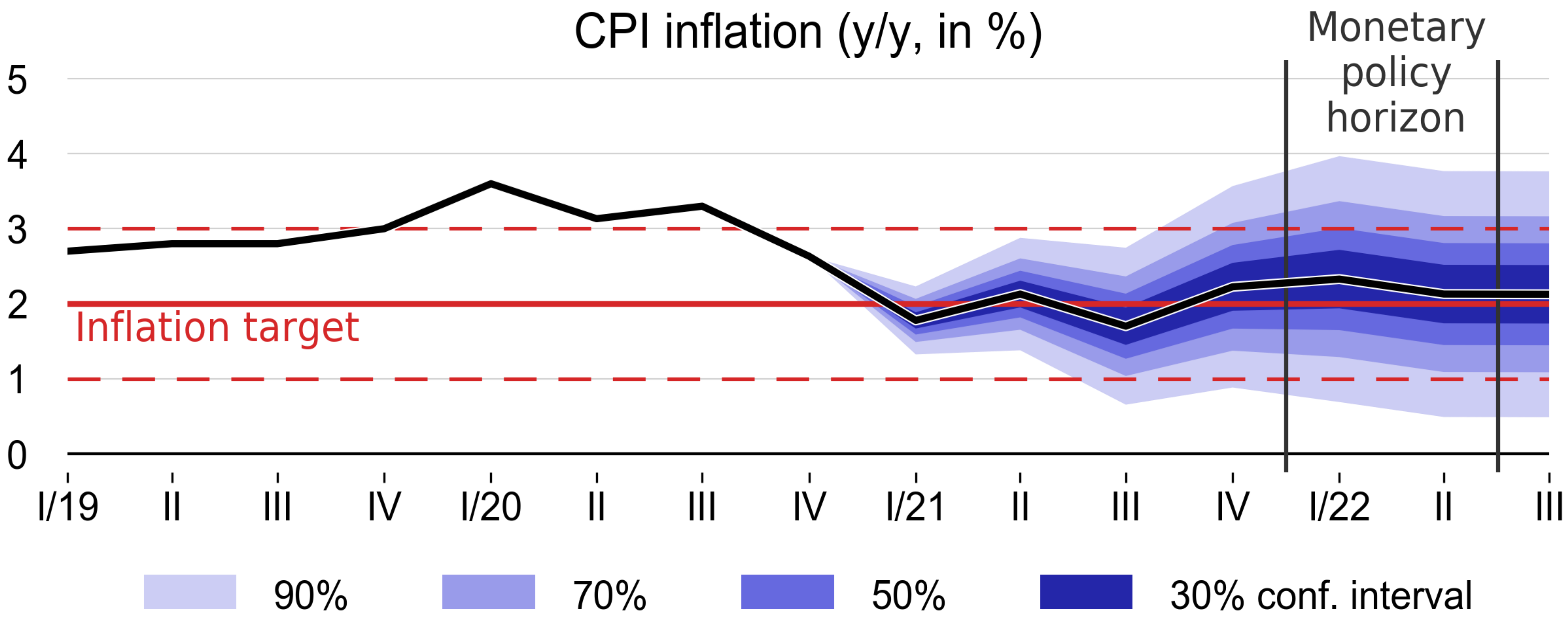
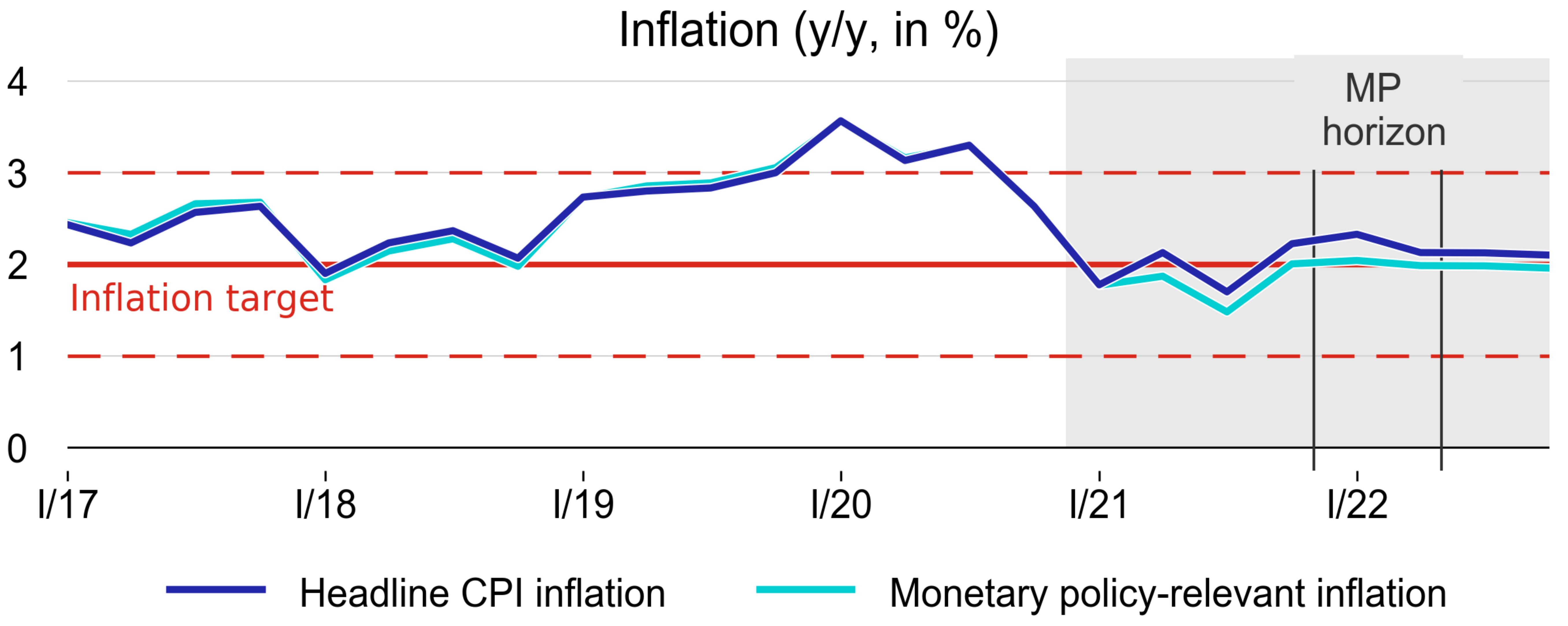
Winter Forecast - Inflation

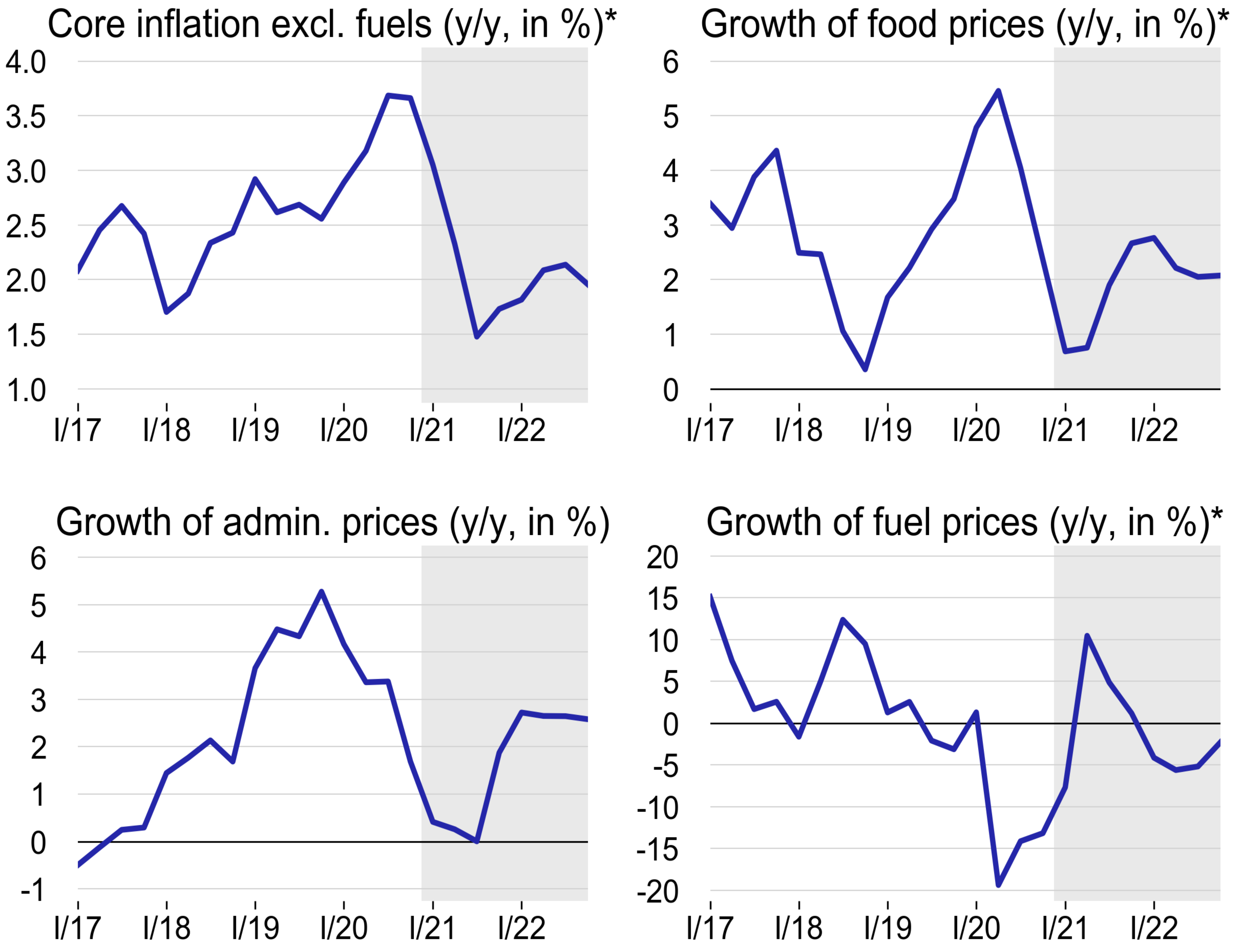




- **Inflation** is forecast to decline in early 2021 and to fluctuate around the CNB's 2% target during the year.
- In **2022**, it will remain slightly above 2%, due to the positive first-round effects of increase in excise duties, to which monetary policy does not react

- **Monetary policy-relevant inflation** will thus lie slightly below headline inflation, and it will stabilise at the inflation target over the monetary policy horizon.

Winter Forecast - Inflation Components

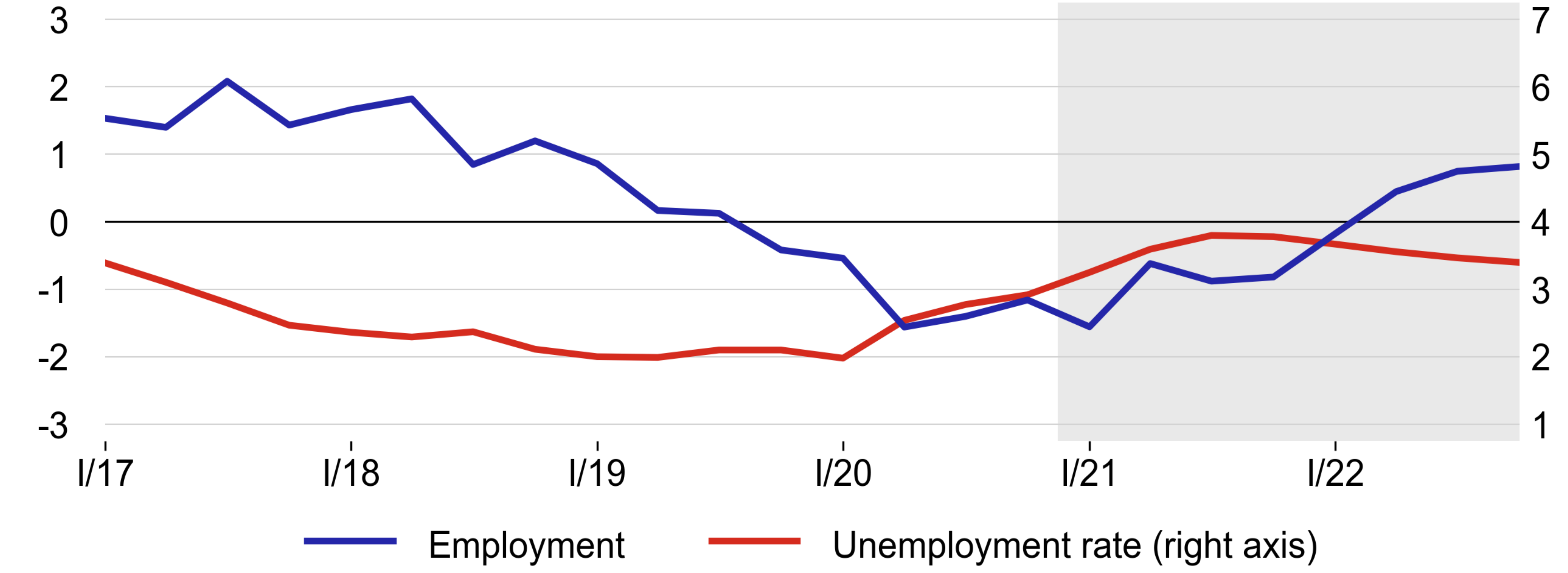


* excluding tax changes

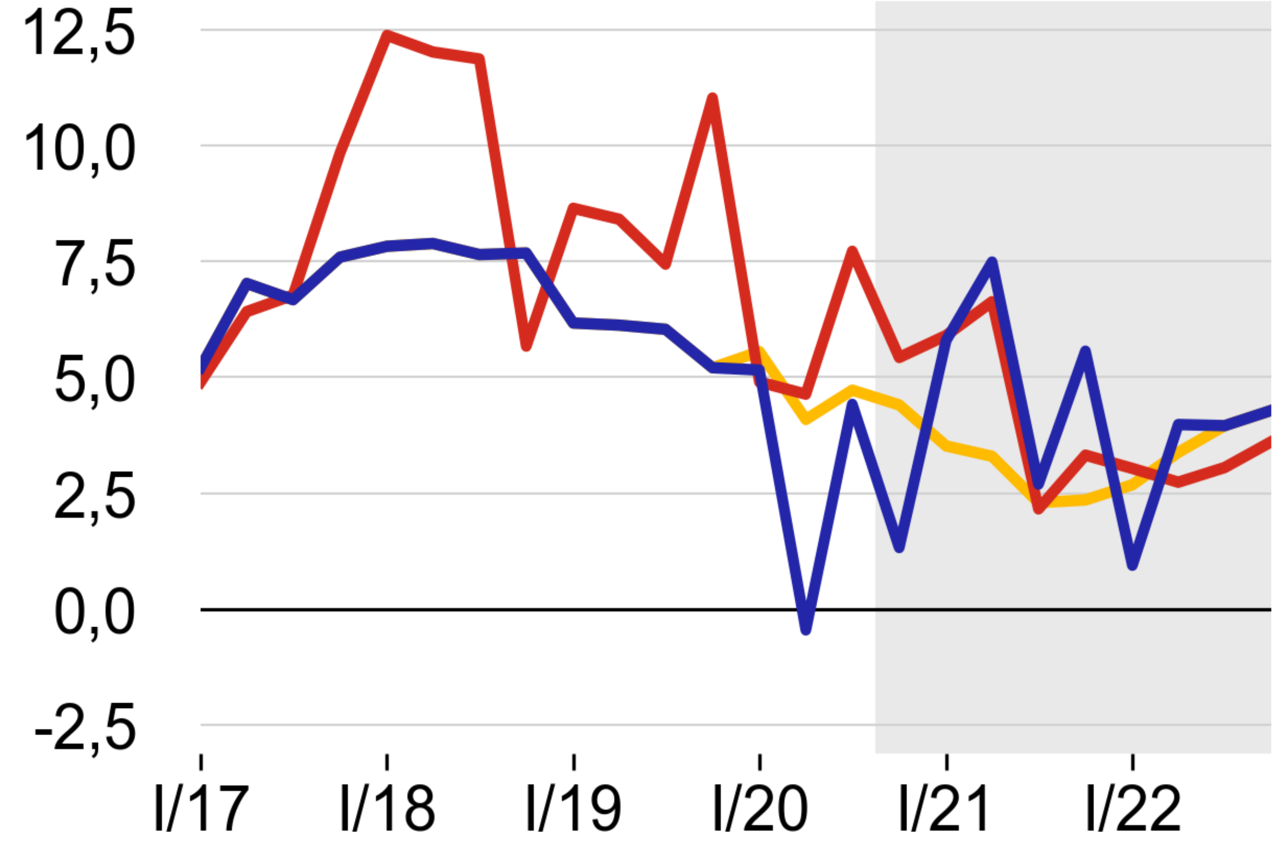
- **Core inflation** will drop during the coming quarters reflecting the development in import prices and further easing of domestic demand pressures. It will subsequently resume with the recovery of the economy.
- The dip in **food price inflation** will only be temporary. Food prices will start rising again in mid-2021 on the back of recovery of agricultural producer price inflation.
- The muted growth in **administered prices** will pick up at the close of this year, as the decline in energy prices will only be temporary.
- **Fuel prices** will increase sharply as the drop in oil prices observed last spring fades out.

Winter Forecast - Labour Market

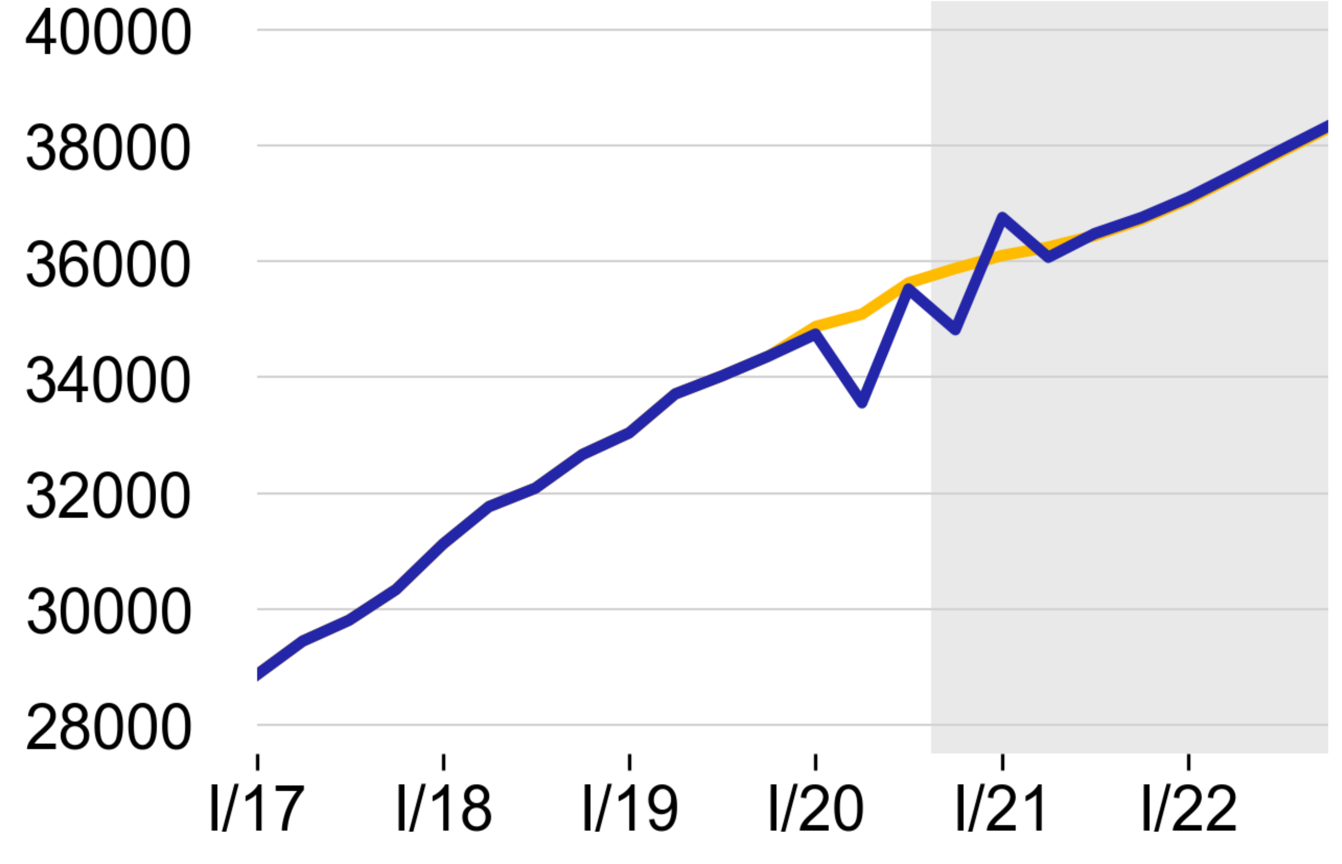
Employment and unemployment rate (y/y, in %, s. a.)



Nominal wages (y/y, in %)



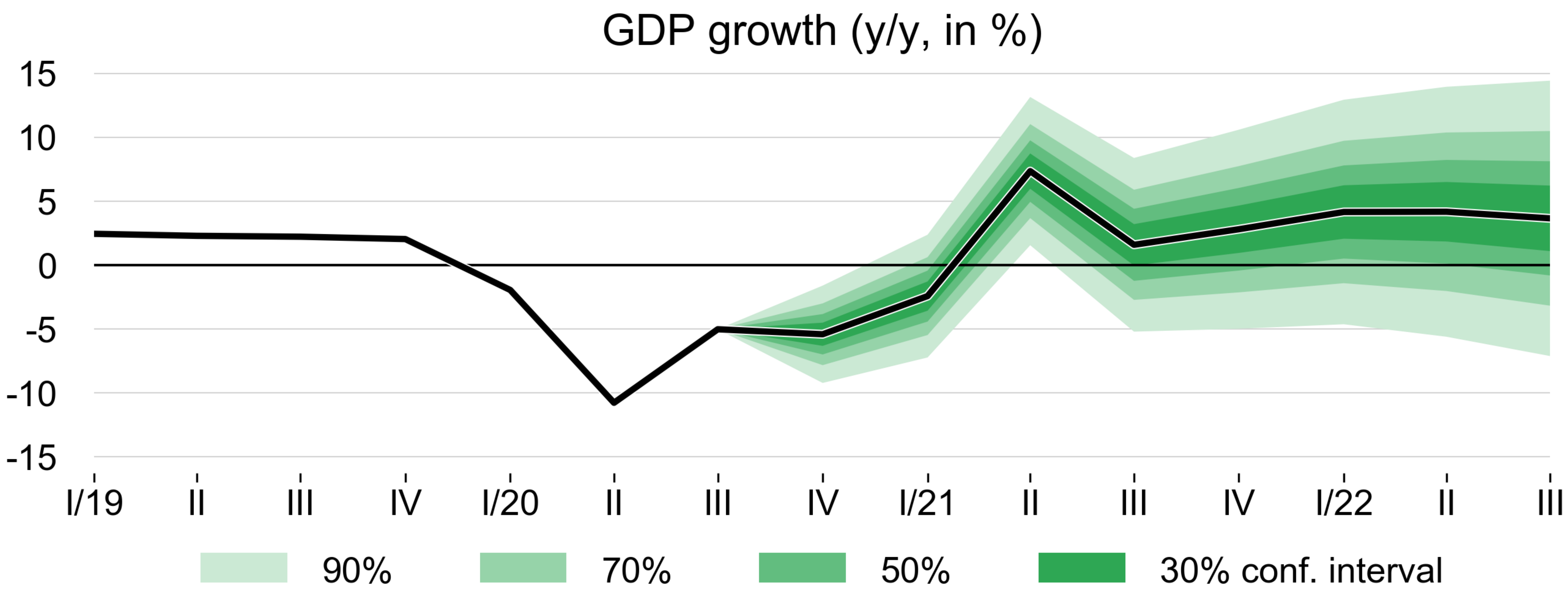
Nom. wage in market sectors (in CZK)

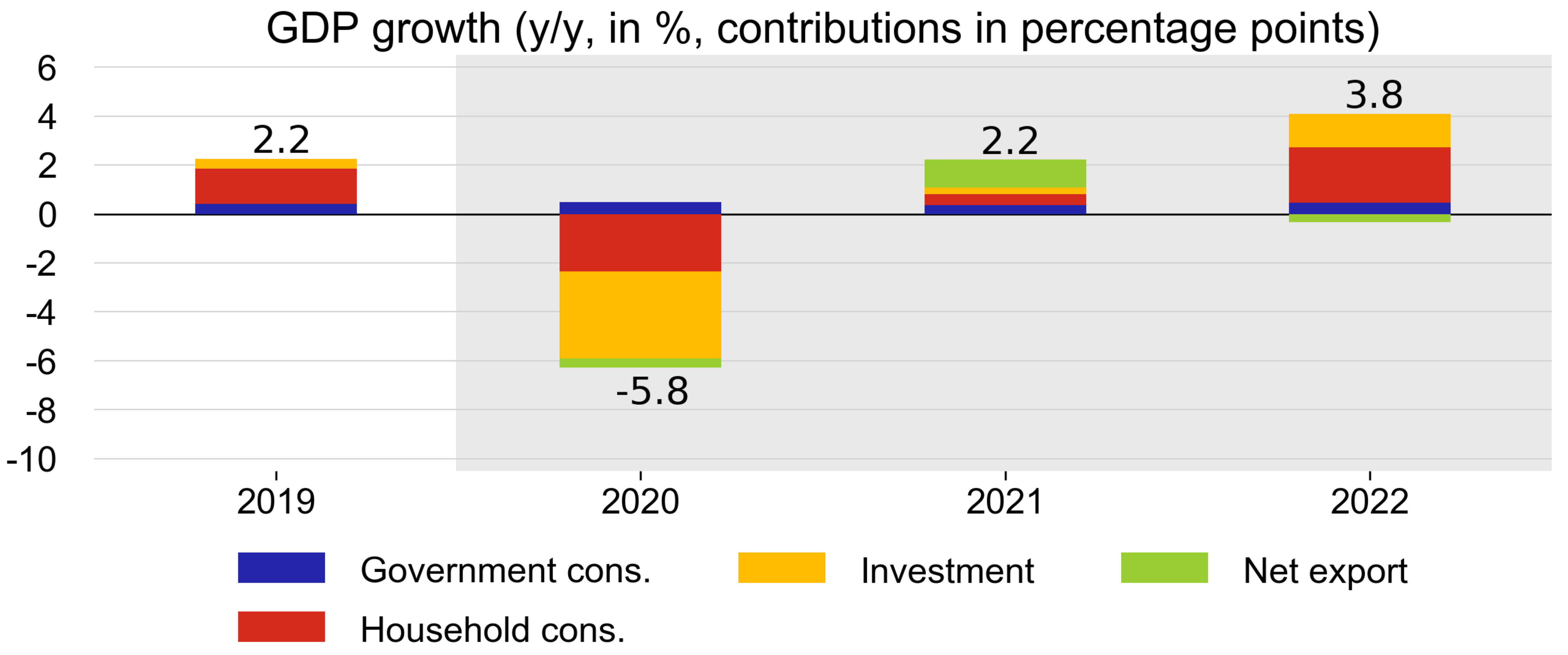


Market sectors | Non-market sectors | Fundamental wage

- Although **employment** has so far been protected by government support programmes, it will decline further in 2021.
- **Unemployment rate** will rise until the second half of 2021 due the pandemic-related economic downturn.
- **Wage growth** was affected at the turn of the year by a number of one-off factors going beyond the fundamental trend (statistical effects of a drop in the wages of employees drawing attendance allowance or wage compensation in the event of quarantine). This will cause wage growth in both market and non-market sectors to fluctuate.
- **Growth in fundamental market wages** will slow initially, reflecting the negative impacts of the pandemic. It will recover only slowly in the second half of 2021.

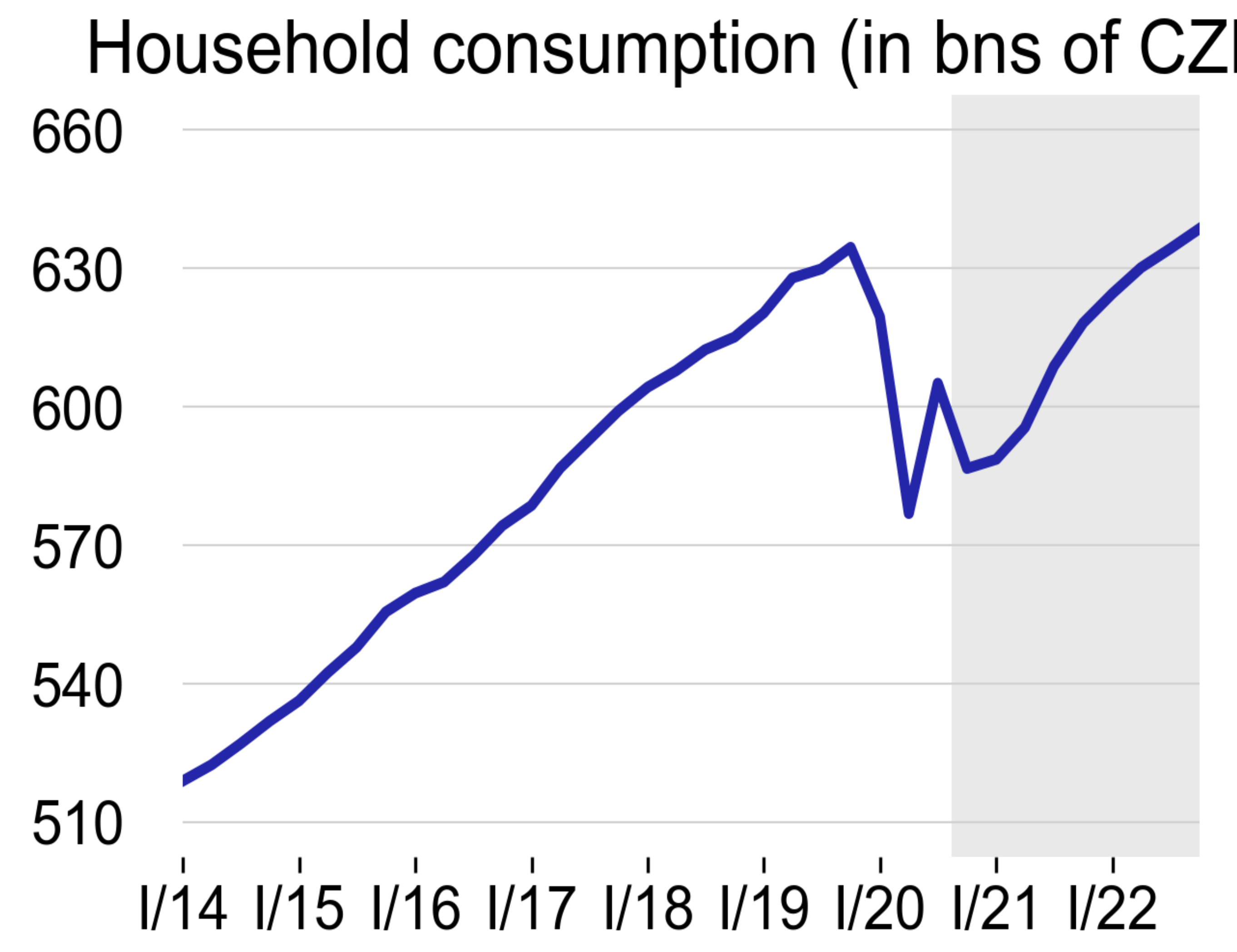
Winter Forecast - GDP Growth

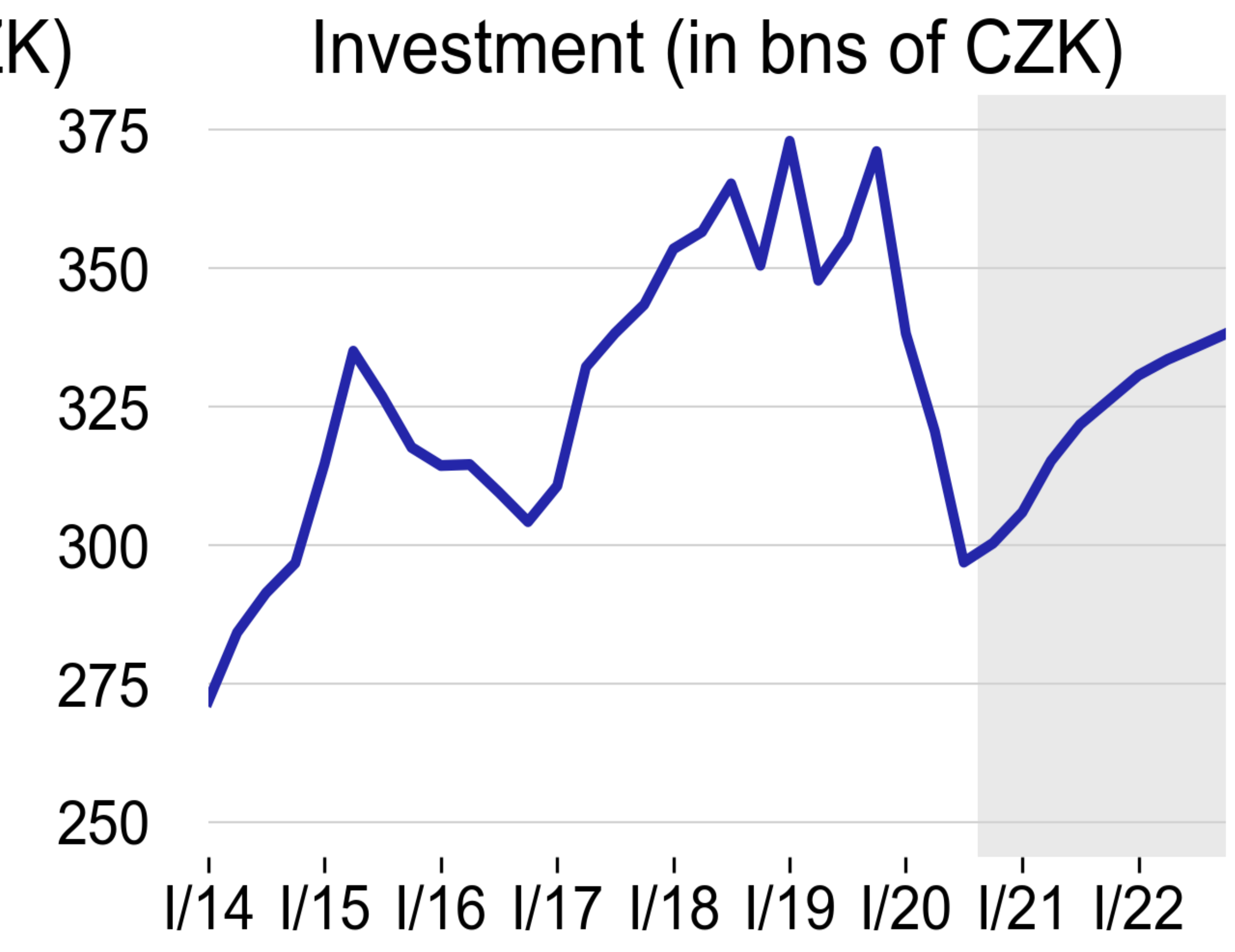


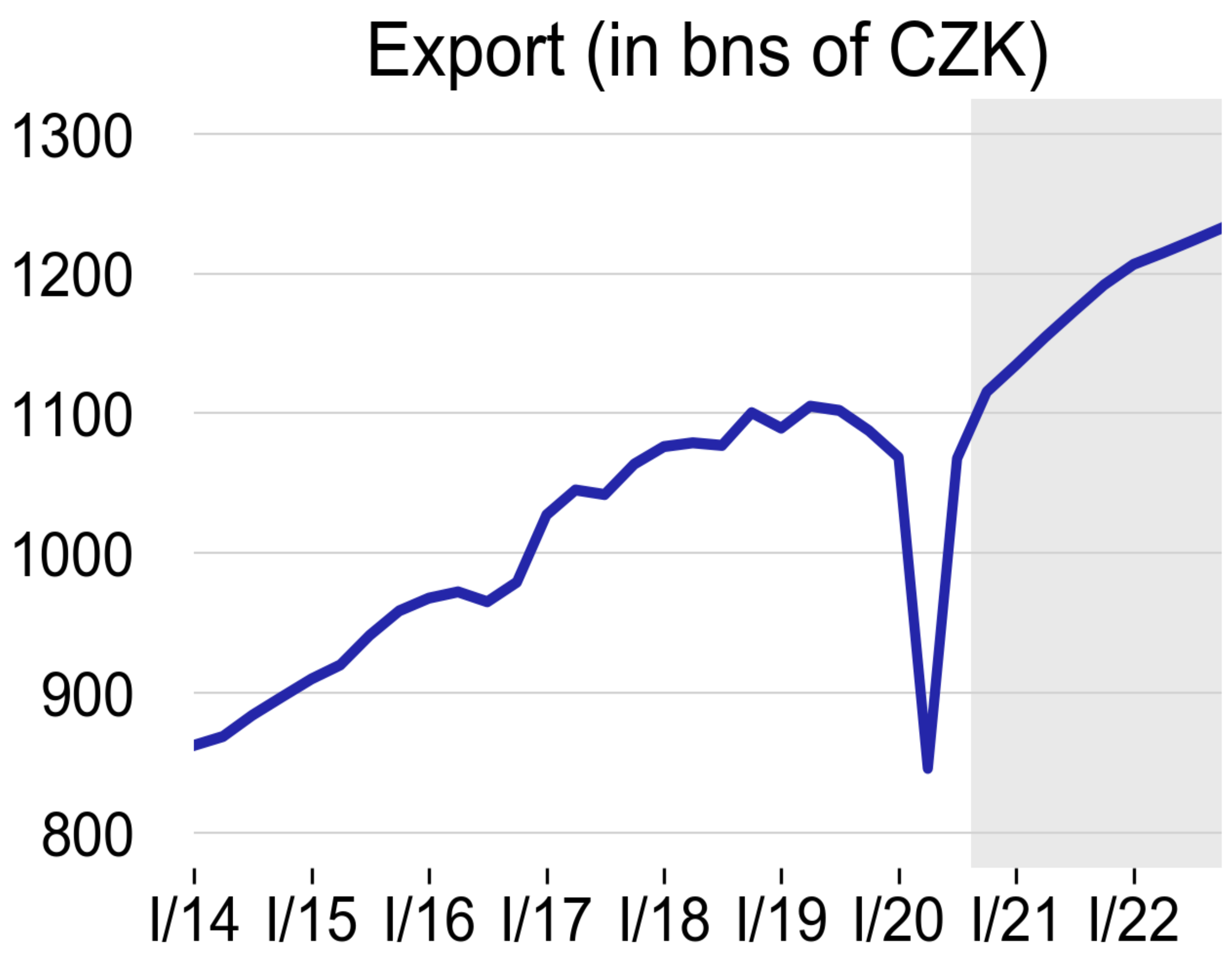


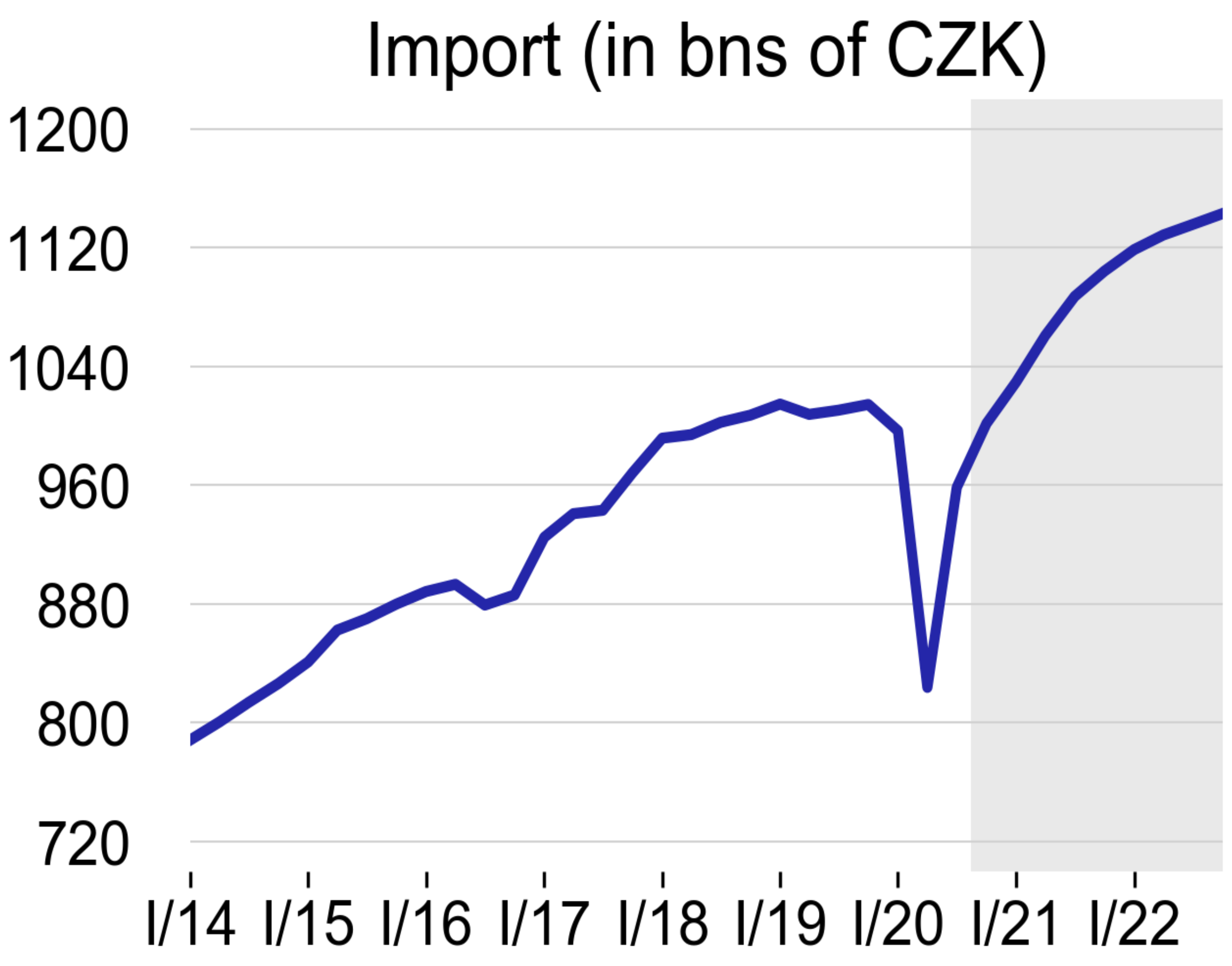
- **The worsening epidemic situation in the second wave of the pandemic** led to renewed shutdowns in the domestic economy in the autumn and winter. The closures mainly concern wholesale and retail and services, and are assumed to be removed during the first half of 2021.
- By contrast, export-oriented industry and some related services will be hit to only a small extent.
- The **economy will grow** by more than 2% overall this year and pick up further next year, leading to a return of domestic economic activity to the pre-pandemic level.
- **GDP growth** will be driven in the near future by net exports. Household consumption will become the main driver of economic growth next year.

Winter Forecast - Aggregate Demand Components





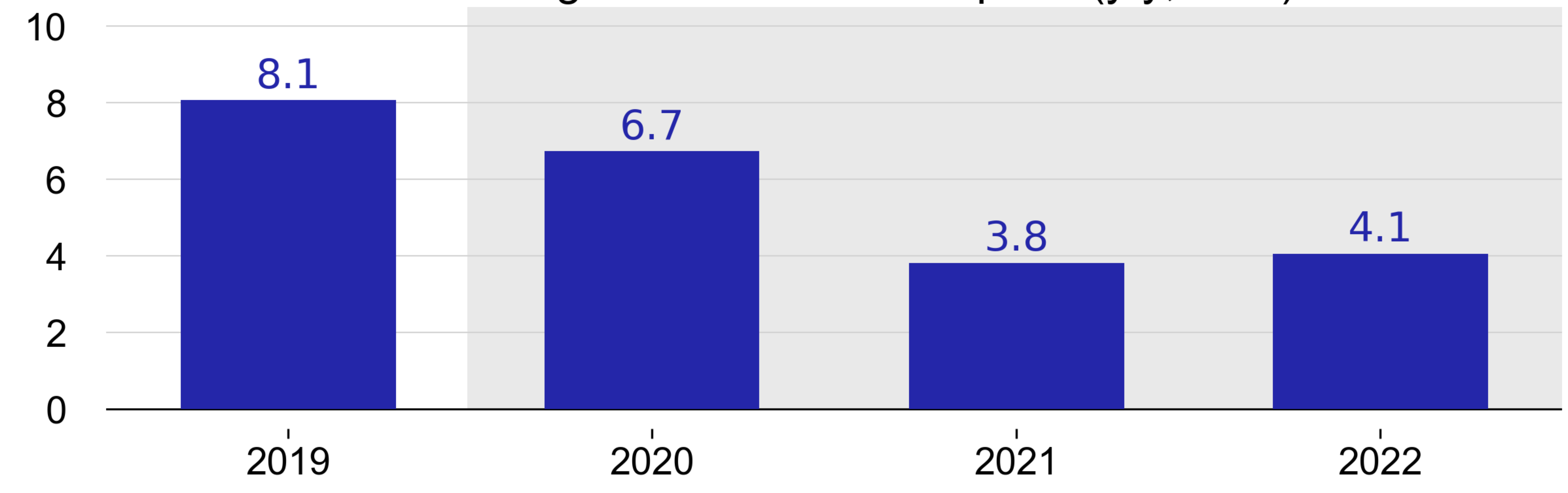




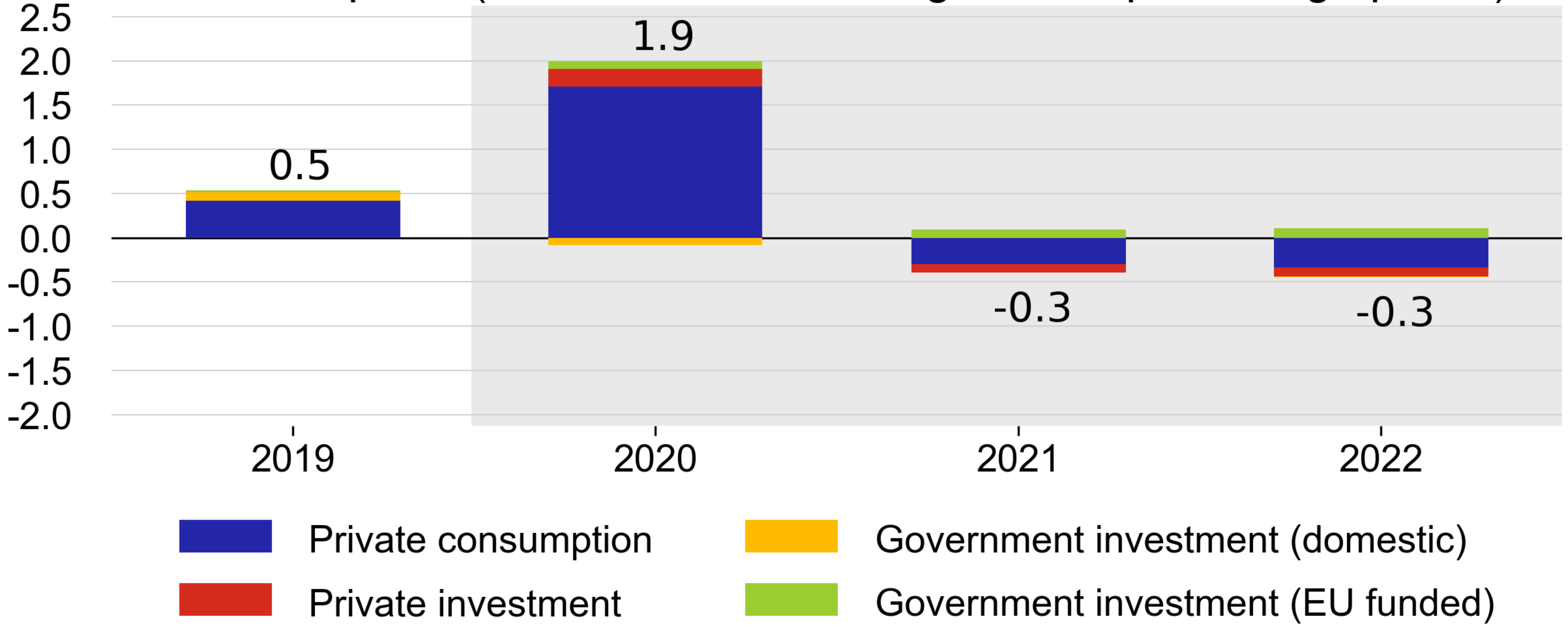
- **Household consumption** will return to sustained, robust growth this year as the adverse economic impacts of the pandemic will start to fade in the second half of the year. Household consumption will reach its pre-pandemic level in 2022.
- **Private investment** activity is also affected by shutdowns and worsening business sentiment, and will remain subdued in the near future. Improving sentiment, recovery abroad and EU funds will help total investment activity to rise gradually.
- **Exports** will improve over the forecast horizon, as the second wave of the pandemic has only had a marginal effect on demand for Czech exports.
- **Import growth** will outpace export growth in the second half of this year due to a surge in aggregate domestic demand.

Winter Forecast - Fiscal Policy

Nominal government consumption (y/y, in %)



Fiscal impulse (contributions to GDP growth in percentage points)



- **Budgetary policy**, implemented through government consumption and fiscal impulse, has played an important role in countering the income impacts of the pandemic so far.
- **Fiscal discretion** had a strongly stabilising contribution to GDP growth in 2020.
- The forecast assumes a slightly negative **fiscal impulse** for this year, which reflects the temporary character of most of the support measures.
- Lowered wage taxation (the abolition of the super-gross wage), which will partially boost private consumption, thus acts against the negative growth effects of discontinuation of support measures.
- Government support for businesses in areas of activity hit by the downturn also remains significant.

Winter Forecast - Exchange Rate CZK/EUR

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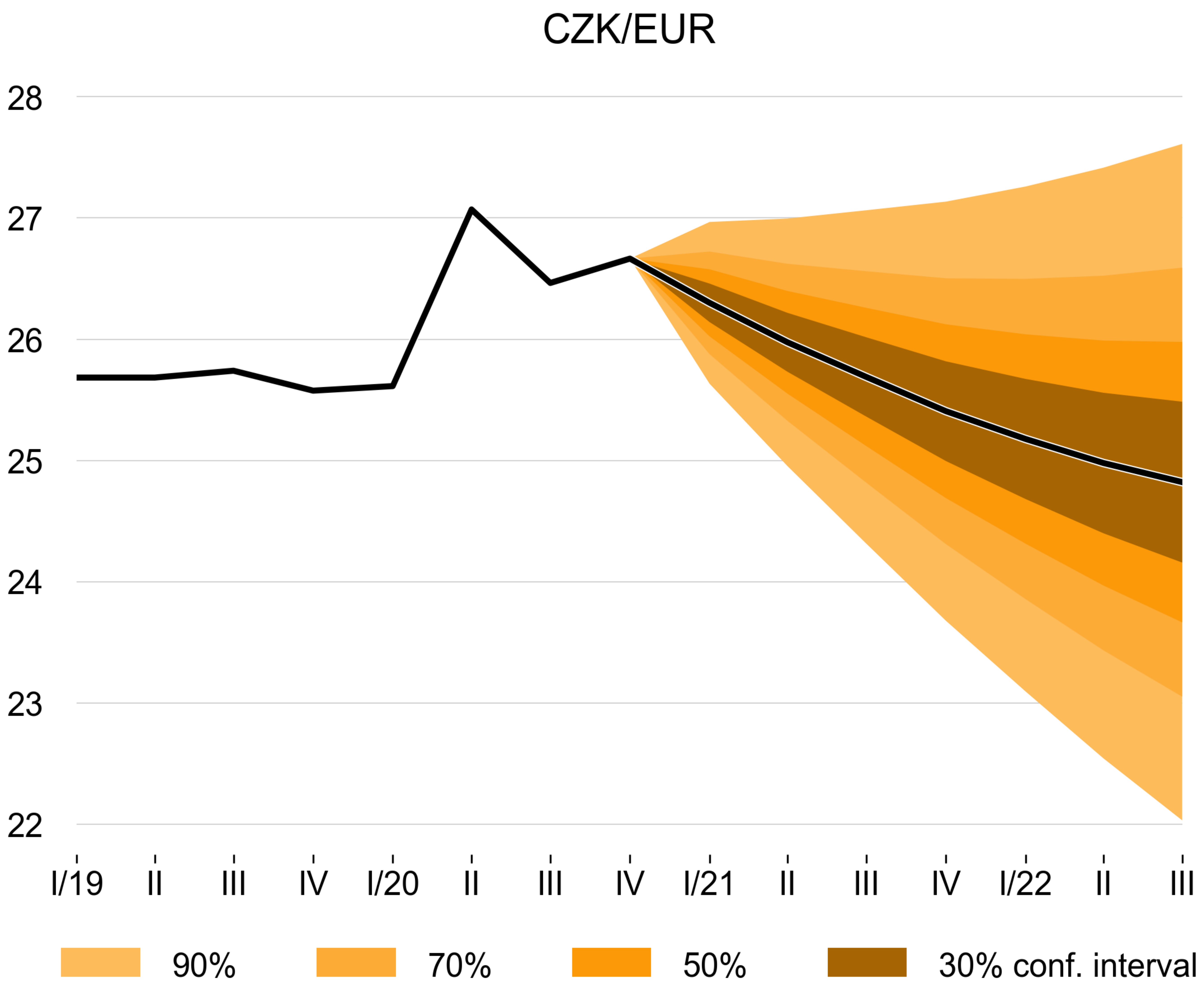
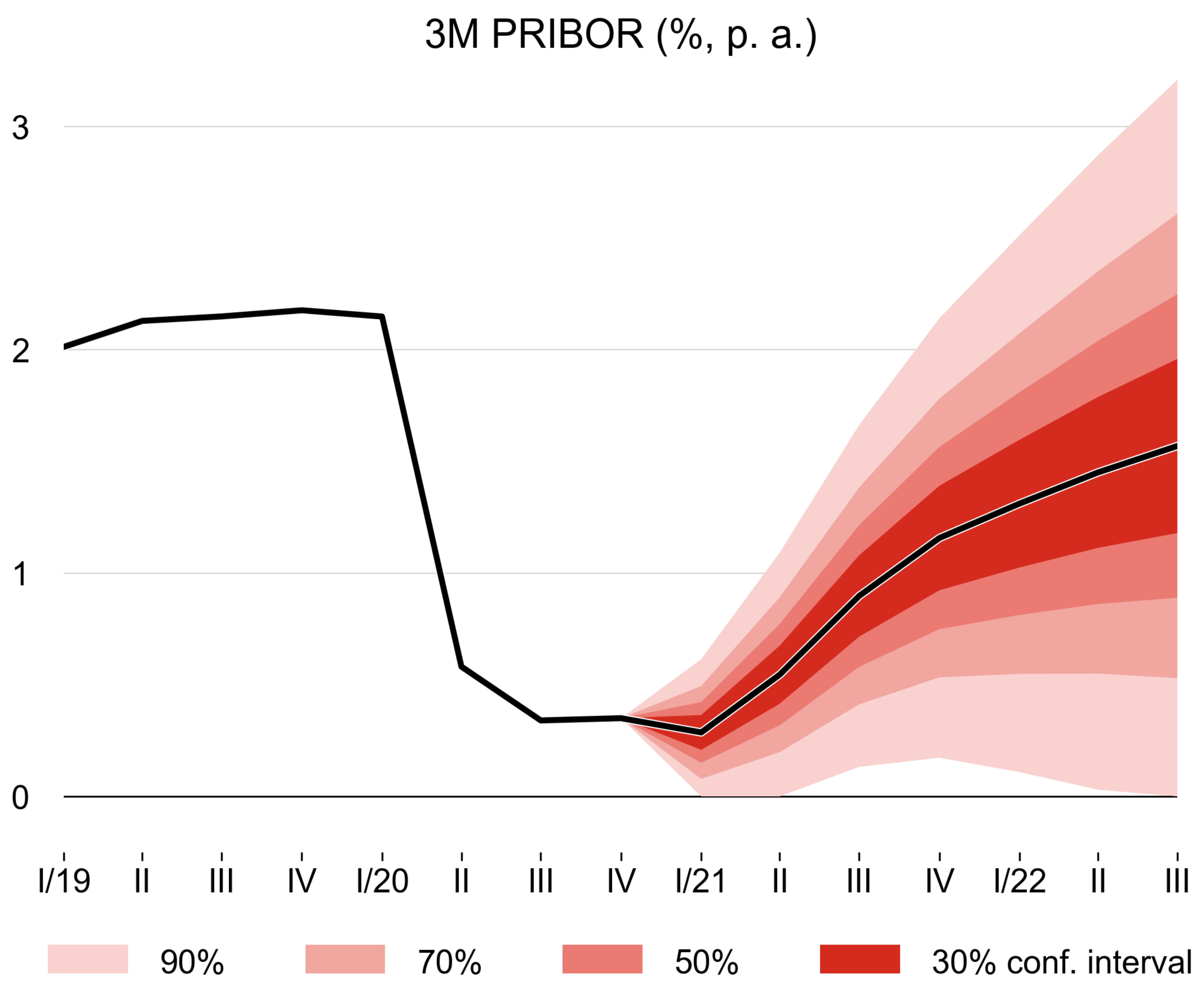


- The **koruna** will appreciate over the entire forecast horizon.
- The exchange rate forecast for **2021 Q1** was set at **CZK 26.3 to the euro**. This reflects the resilience of Czech export-oriented industry up to now despite the continued adverse epidemic situation.
- The receding of the pandemic together with the reopening of the economy and improved financial market sentiment this year will lead to continued appreciation of the koruna.
- A strengthening koruna will also be fostered by a gradually widening positive interest rate differential vis-à-vis the euro area.

Winter Forecast - Interest Rate Path (3M PRIBOR)



- Consistent with the winter forecast is **stability of market interest rates initially**, followed by a gradual rise in rates from roughly the middle of this year onwards.
- The initial stability of market interest rates reflects the need to keep monetary policy easy in a situation where the pandemic is having negative impacts on the domestic economy.
- The subsequent gradual increase in (normalisation of) interest rates stems from the expected recovery of the Czech and foreign economy with domestic inflation anchored at the target.

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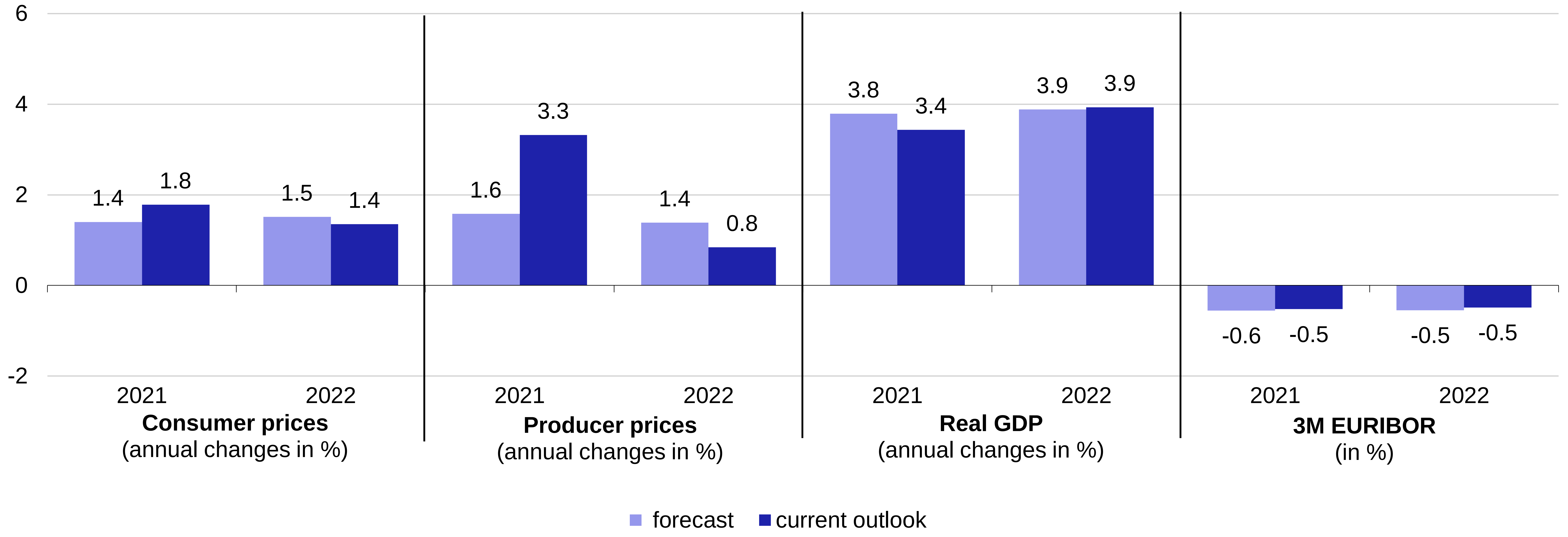
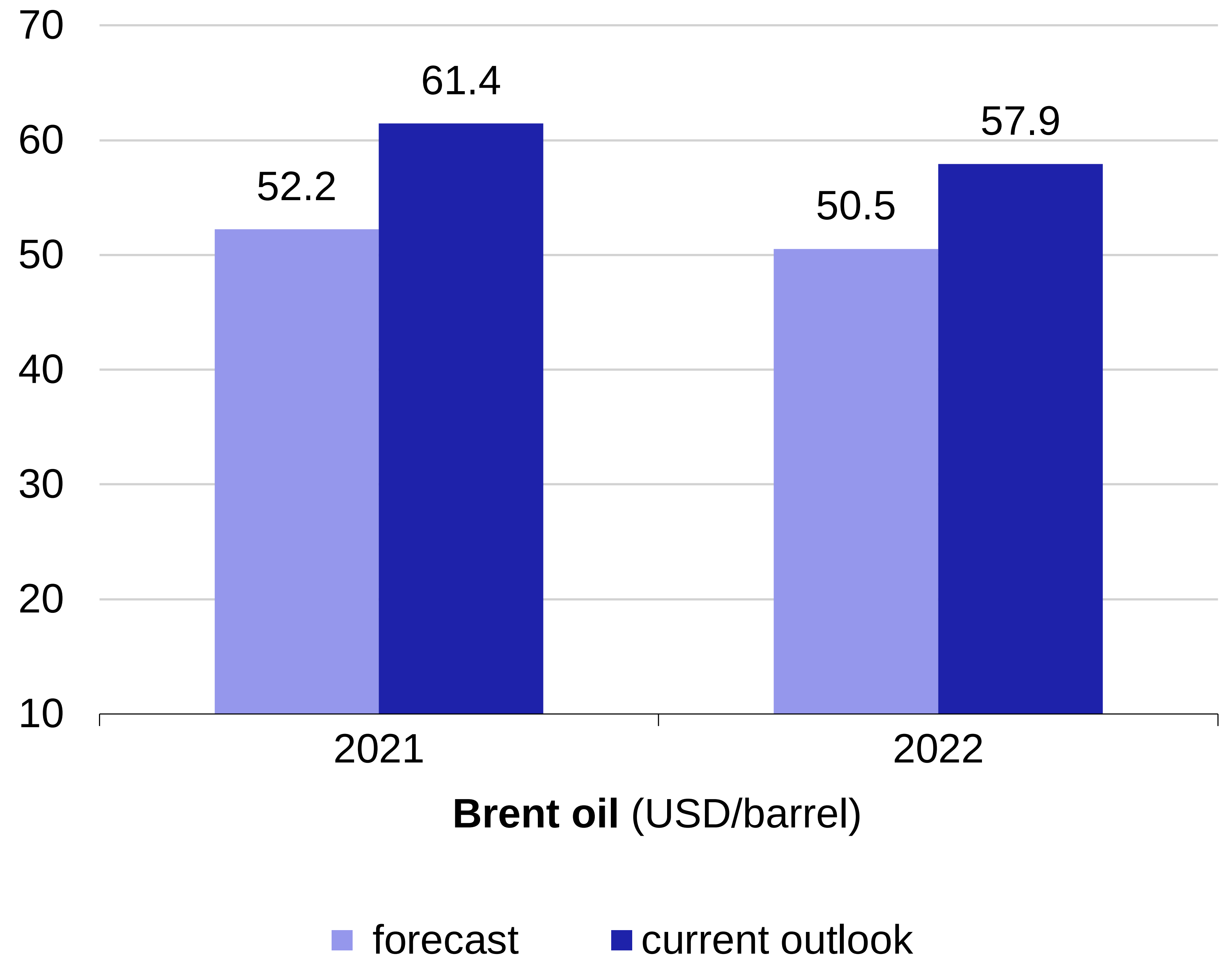
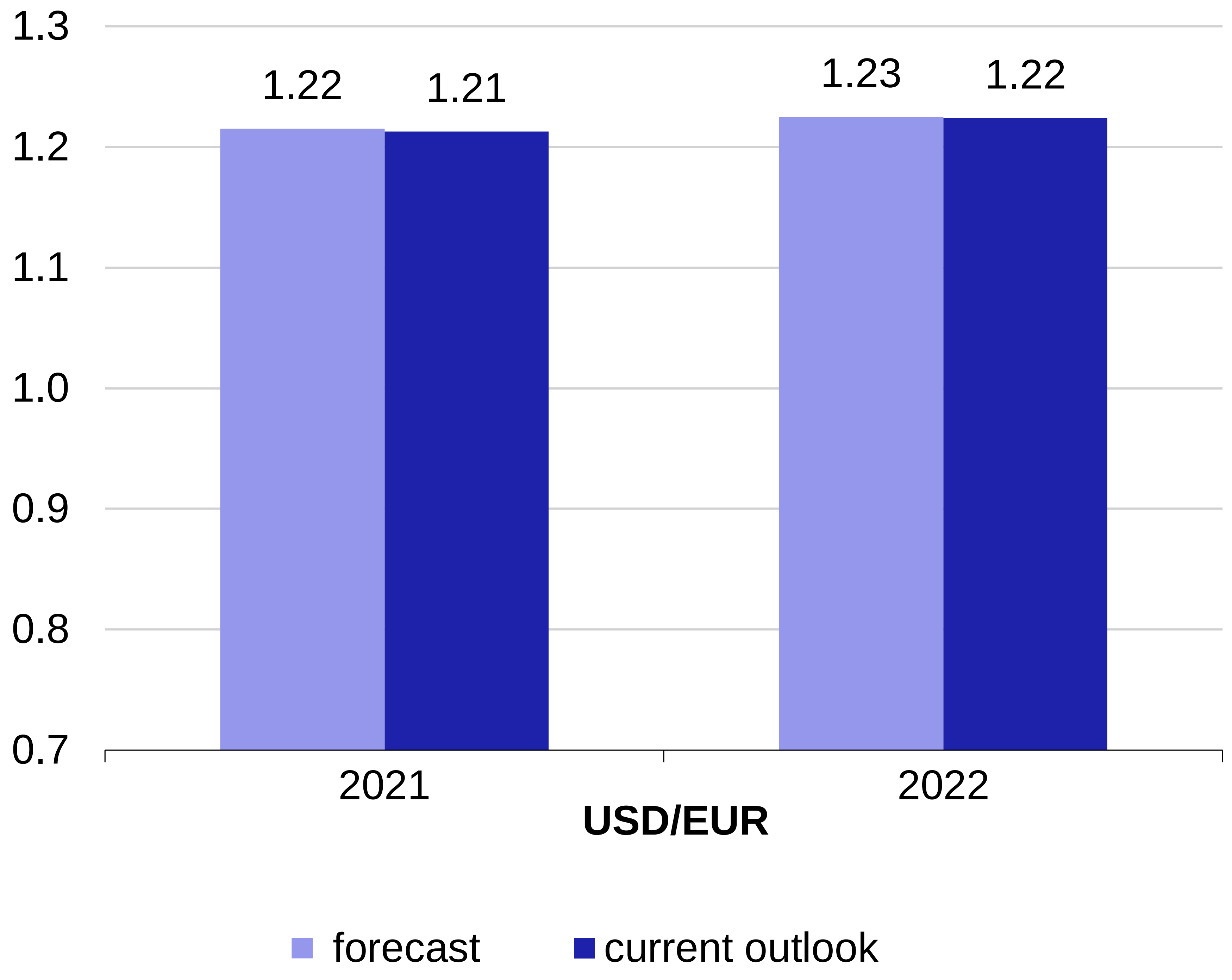
Current outlook for the effective euro area



- **Consumer prices** in the euro area will grow faster this year due to their surprisingly strong increase at the start of the year and higher oil price outlook.
- Outlook for **producer prices** is markedly higher this year due to higher outlook of oil prices and the resilience of euro area industry to the pandemic so far.
- Current outlook for **euro area GDP** is slightly lower this year than the forecast owing to a deterioration of the epidemic situation and an extension of lockdowns.
- The outlook for **3M EURIBOR** interest rates remains broadly in line with the forecast.

Oil price and the USD/EUR exchange rate

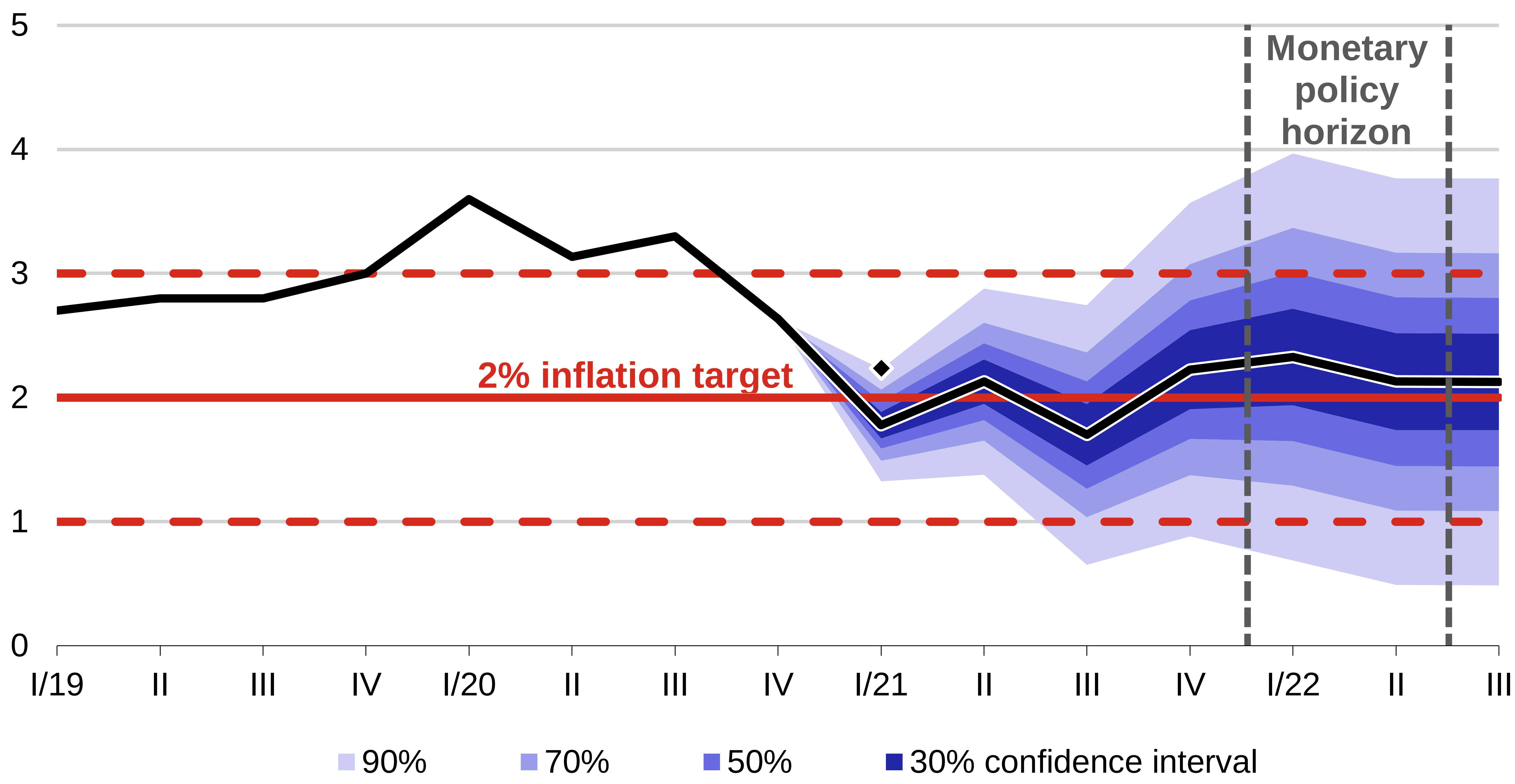




- The **Brent crude oil price** rose significantly during February and March, with its outlook shifting appreciably above the assumptions of the forecast.

- The outlook **EUR/USD** exchange rate is broadly in line with the forecast.

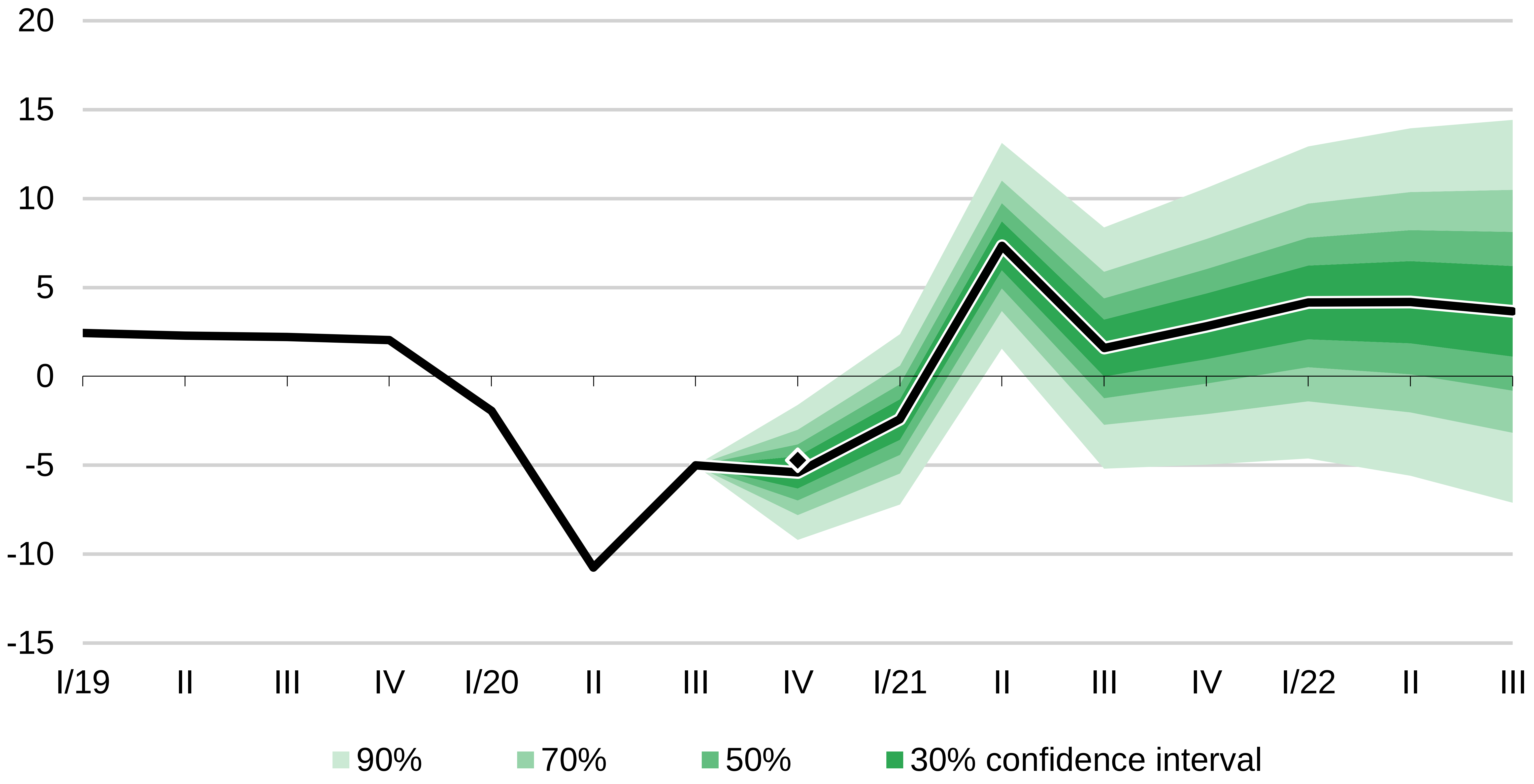
Inflation Forecast and Expected Outcome in 2021 Q1



Note: y-o-y changes in %.

- **Inflation** continued in returning to the target in the course of 2021 Q1, while being a bit higher than expected in the forecast.
- The deviation from the forecast was due mainly to **food price inflation**, which accelerated unexpectedly at the start of the year.
- **Core inflation** was also slightly higher than forecasted in the beginning of the year, moderating rather more slowly than expected.

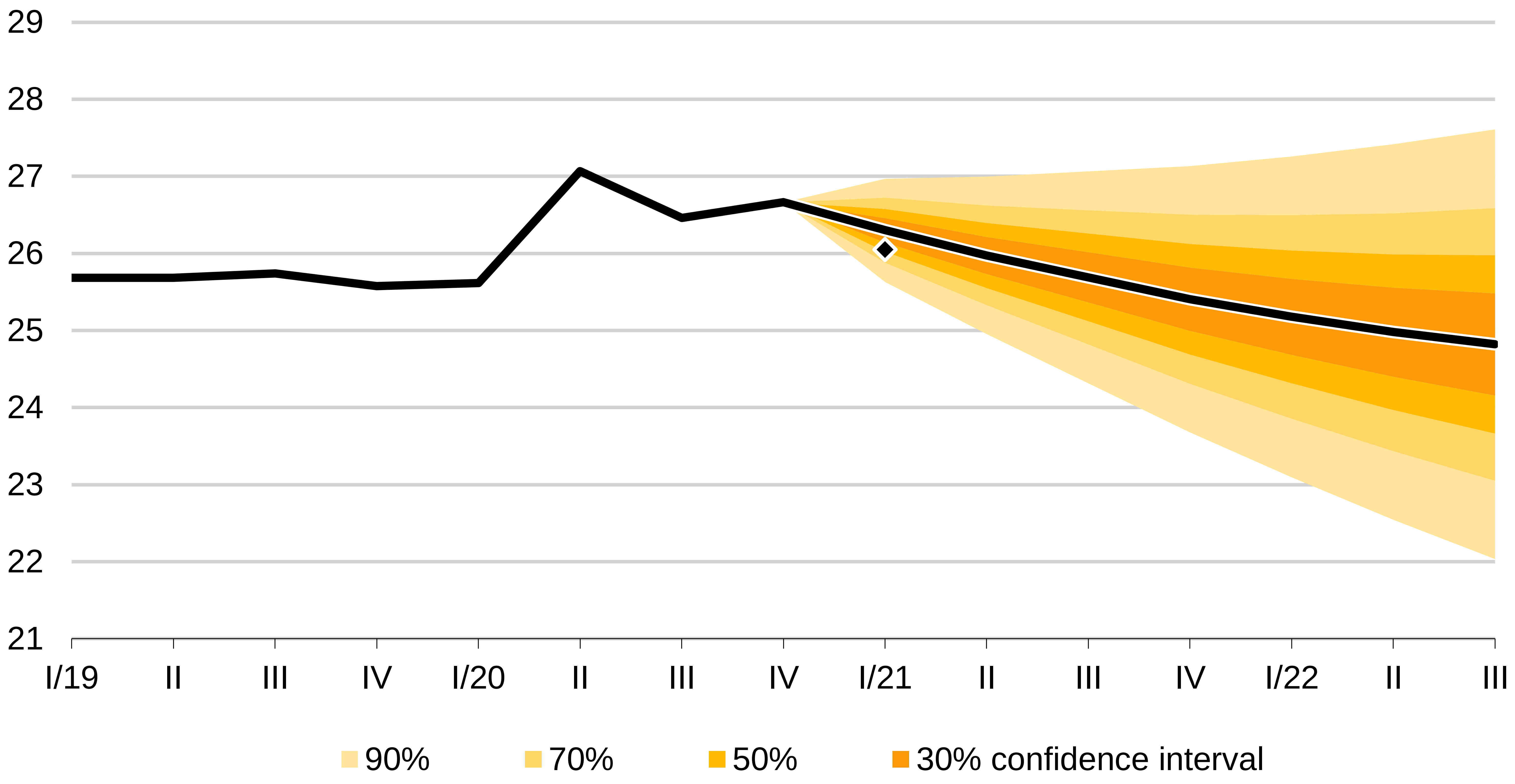
GDP Forecast and Outcome in 2020 Q4



- The **GDP** rose by 0.6% quarter-on-quarter in 2020 Q4, and the year-on-year decline of the Czech economy was smaller than forecasted.
- The deviation was partly due to a larger positive contribution of **net exports** and faster growth in **government consumption**.
- Conversely, the downturn in **household consumption** was slightly larger than expected.
- **Gross capital formation** was broadly in line with the prediction.

Note: y-o-y changes in %; contributions in pp; constant prices; seasonally adjusted.

CZK/EUR Forecast and Outcome in 2021 Q1



- The **koruna** appreciated against the euro in the first half of February but then weakened somewhat as a result of a deterioration in the domestic pandemic situation.
- So far in Q1, the koruna has been 20 hellers on average stronger than forecasted.

Comparison of Current Domestic Data with the Forecast

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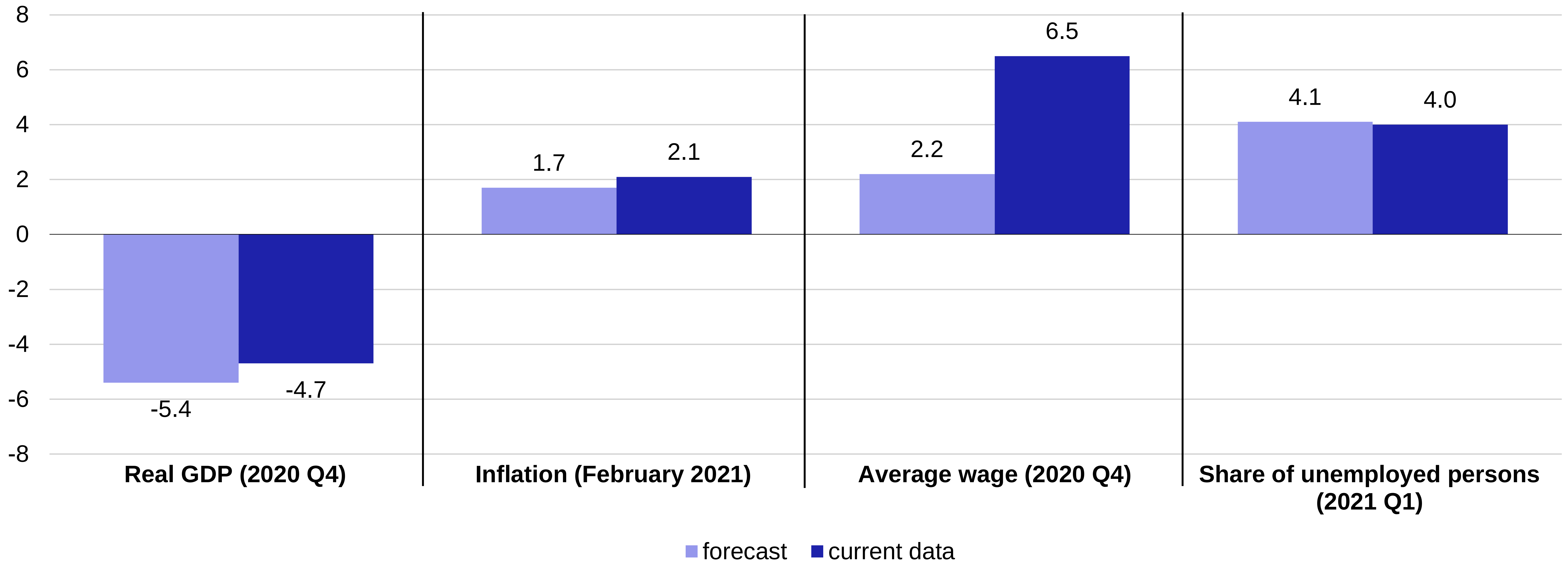

Note: Annual changes in %, the share of unemployed persons in % (comparison of s.a. outcomes in January and February with the forecast for 2021 Q1).

- In a situation of **unprecedented uncertainty** affecting both economic life itself and the way it is captured by the statistical data, the winter forecast is materialising in a fairly satisfactory way so far.
- The **share of unemployed persons** has been roughly as forecasted in 2021 Q1 so far.
- The unexpectedly sharp acceleration of the **average wage** at the close of last year was largely due to non-fundamental factors.

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Decisions of the Bank Board

At its **February and March meetings**, the CNB Bank Board kept **interest rates unchanged**.

The two-week repo rate remains at 0.25%, the discount rate at 0.05% and the Lombard rate at 1%.

0.25%	**0.05%**	**1.00%**
2W repo rate	discount rate	Lombard rate

Consistent with the forecast is stability of market interest rates initially, followed by a gradual rise in rates from roughly the middle of this year onwards.

At its March MP meeting, the Bank Board assessed **the risks and uncertainties** of the forecast in the context of the ongoing second wave of the pandemic **as remaining very substantial**.

A slower fading out of the unfavourable epidemic situation, and thus slower opening of the domestic and European economies could lead to a need to keep the monetary conditions accommodative for rather longer than in the forecast.

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Thank you for your attention

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