MACROECONOMIC forecast

Looking for growth impetus

Prague, 25 October 2023

**The Czech economy seems to be unable to emerge from the lethargy that started with a shallow recession in the second half of last year. Following stagnation in the first two quarters of this year, the Czech economy then apparently slightly declined in the third quarter on a quarter-to-quarter basis. It is also likely to post a drop in the real GDP for full year 2023, and then return to growth, although not exactly strong, in 2024. Everything will depend on how quickly household consumption recovers. However, that is not possible without wages rising in real terms. Both the tense labour market and the deflating inflation are working in favour of wages. Despite the uncertainty as to the level of inflation at which the country steps into 2024, we expect the rate of inflation to return to the CNB’s tolerance zone during the first quarter of 2024. And it is only a matter of the coming months when the central bank starts to cut its rates.**

**The Czech economy will post a decline in real terms for 2023.** According to Komerční banka’s updated forecast, the decline will be 0.3%. Thus, this year’s growth outlook now drops by almost 0.5 pp compared with the July forecast. “*The main reason is the disappointment brought by the summer holiday months,”* Jan Vejmělek, Komerční banka’s Chief Economist, clarifies the reason for the downward revision. “*Contrary to our expectations of household consumption recovering hand-in-hand with rising real wages, we consider that real consumption expenditure was flat in the third quarter on a quarter-to-quarter basis. On the production side, the recurring problems in supplier chains had an adverse impact on automotive manufacturing,”* adds Jan Vejmělek. The growth outlook for 2024 has also been slightly revised; compared with the original 1.8% the forecast now envisages 1.6%.

**Economic growth in 2024 should primarily be associated with stronger internal demand** despite the restrictive effects of the fiscal package which is expected to enter into force at the beginning of next year. “*Recovery in household consumption appears to be critical: no way without growth of consumption expenditure in real terms*,” notes Martin Gürtler, Komerční banka’s economist. One of the key preconditions is reviving the growth of real wages, for which very good prerequisites exist. Next year, average inflation will hover just below the 2% inflation target while we expect nominal wages to rise by 7.6%. Even so, this will offset the earlier deep plunge in real wages only partly. In mid-2023, real wages were at the level of the end of 2017. But the labour market remains tight. The rate of unemployment is staying and most probably will continue to stay the lowest across Europe. The current economic stagnation will be reflected only in a cosmetic increase in unemployment.

**Following its temporary rise in the last months of this year, inflation will quickly decline in the early months of next year.** Because of the low statistical base from Q4 2022, when the government’s compensation for energy advance payments helped to reduce energy prices, in October inflation will jump from September’s 6.9% into the 8-9% range and will not drop under 7% until the end of the year. But, come January, it will plummet dramatically. In 2024, average inflation in this country should be 1.9% following this year’s expected 10.8%. “*The rate of inflation for next year will be fundamentally affected by the January number, which, however, is burdened by great uncertainty. The uncertainty relates to the degree of the traditional New Year repricing of goods and services and to changes in regulated prices,”* warns Martin Gürtler.

**Looking at the monetary policy, the launch of the rate cut cycle is approaching.** It is only a matter of the coming weeks or months when this takes place. We believe that central bankers will continue to be prudent and begin rate cutting only next year. *“From the communication perspective, the temporary increase in year-on-year inflation in Q4 will make any rate cuts more difficult. Also the degree of the traditional January repricing is a great unknown for central bankers,”* says Martin Gürtler, adding: “*The 2024 calendar of the CNB Board’s monetary policy meetings has not yet been published and so nothing stands in the central bank’s way to slightly move the date of the February meeting and wait for the publication of January inflation, and make the first rate cut only then.”*

**Koruna is free now.** The formal termination of the intervention mode by the central bank at its August board meeting against the backdrop of the Czech economy’s continuing slowdown and the US dollar’s strength resulted in a notable weakening of the Czech koruna, which, according to our estimates, has wiped out most of its overvaluation in relation to the euro. For a short term, the factors on the depreciation side may continue to predominate, but we believe that they will be suppressed by, *inter alia*, the too aggressive pricing reflection of the pace of the rate cuts triggered by the Czech monetary policy. “*We expect the trend of the koruna’s appreciation to the euro in connection with the Czech economy’s recovery and the US dollar’s weakening only from the second half of next year,”* Jaromír Gec, Komerční banka’s strategist, unveils the forex prospects.

**Public finance set on a more sustainable track.** Our estimates suggest that the approved national budget deficit of CZK 295 billion may actually be achieved this year in the end. “*The consolidation package combined with the phase-out of certain extraordinary measures and the Czech economy’s recovery will, in our estimate, reduce the public finance deficit to visibly under 3% GDP in the coming years, which should also underpin the attraction of the Czech government bonds,”* opines Jaromír Gec. However, on the other hand, the structural deficit continues to be close to 2% GDP and without changes, in particular in the pension system, it may begin deteriorating significantly in the following decade.

**Lending activity will remain relatively low this year** due to the high interest rates and the Czech economy’s weak performance. Only lowered interest rates will bring a stronger impetus. The more appreciable recovery of mortgage lending should also result in a revived growth of property prices next year following this year’s slight decline, which is expected to be 4.5% at the end of this year. Despite the current tight monetary policy, payment discipline remains resistant in the country’s economy. *“The delinquency rate in Q3 stayed close to the lowest levels ever and so reflected households’ and companies’ good financial situation,”* notes Kevin Tran Nguyen, Komerční banka’s economist.

|  |  |  |  |
| --- | --- | --- | --- |
| **Macroeconomic forecast** |  |  |  |
|   | 2022 | **2023** | **2024** |
| **GDP** (real growth, yoy in %)  | 2.4 | **-0.3** | **1.6** |
| **Household consumption** (real growth, yoy in %)  | -0.8 | **-3.2** | **3.7** |
| **Fixed investment** (real growth, yoy in %)  | 3.0 | **2.8** | **6.1** |
| **External trade balance** (CZK bn)  | -204.8 | **100.3** | **112.7** |
| **Industrial production** (real growth, yoy)  | 2.6 | **-0.5** | **4.0** |
| **Retail sales** (real growth, yoy in %)  | -3.3 | **-4.5** | **4.0** |
| **Wages** (nominal growth, yoy in %)  | 5.3 | **7.7** | **7.6** |
| **Unemployment rate** (MPSV, in %)  | 3.4 | **3.7** | **3.8** |
| **Inflation** (yoy in %)  | 15.1 | **10.8** | **1.9** |
| **3M PRIBOR** (average)  | 6.3 | **7.1** | **5.5** |
| **2W Repo** (average)  | 5.9 | **7.0** | **5.3** |
| **EUR/CZK** (average)  | 24.6 | **24.0** | **24.8** |

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

**Jan Vejmělek**, Komerční banka’s Chief Economist, tel.: +420 222 008 568, jan\_vejmelek@kb.cz