

CZECHIA : MACRO OUTLOOK

Economic recovery expected to continue

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Economy Czechia - Analyses and Forecasts | Erste Group Bank AG
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Spot Rates as of: December 13, 2024
Note: Information on past performance is not a reliable indicator for future performance.
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The CNB likely to be cautious

The Czech economy is undergoing a gradual recovery, expected to strengthen over the next two years. In addition to continued favorable consumption trends, this will be supported by a gradual improvement in foreign demand and the stabilization of current inventory declines. The labor market outlook remains positive. Although the unemployment rate may rise slightly, it will remain very low overall, and real wages, which returned to growth this year, are expected to continue rising over the next two years. Despite month-to-month volatility, inflation has returned close to the target this year, and a similar trend is anticipated in the coming years.

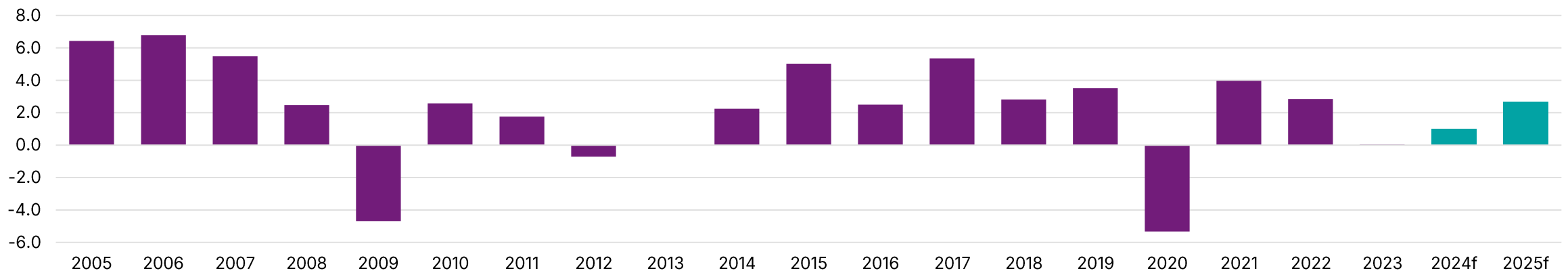
The CNB will continue its gradual rate cuts, facilitated by low inflation and weak economic growth that does not generate significant inflationary pressures. However, compared to this year, we expect a much slower pace of monetary easing, as the CNB is likely to be cautious, due to service price developments, wage growth, and ongoing fiscal expansion. Therefore, we anticipate rate stability for December and expect three 25-basis point cuts in 2025. We believe the koruna is currently close to its fundamentals, and we do not foresee significant movements in the near term. Over the next two years, we expect a slight strengthening of the koruna in our baseline. However, we see risks as highly asymmetric, skewed towards weaker side, primarily due to global and geopolitical factors.

GDP growth

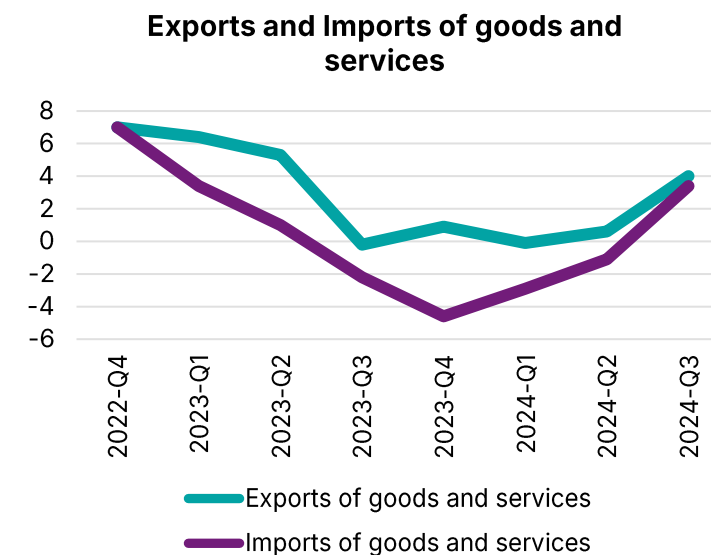
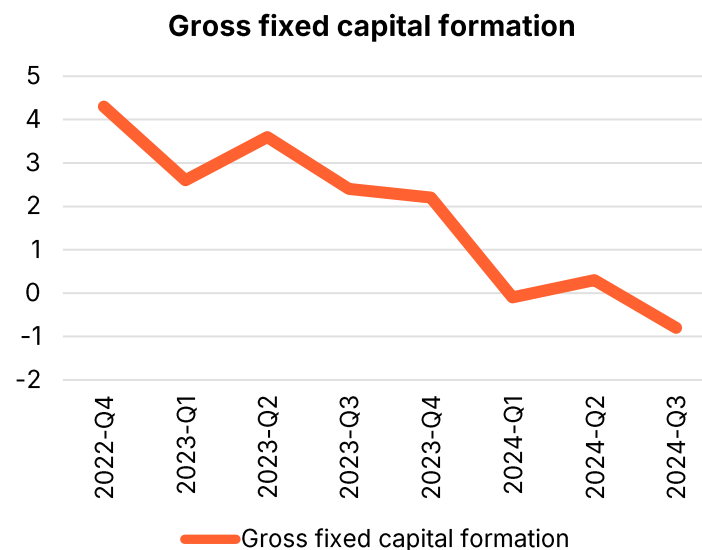
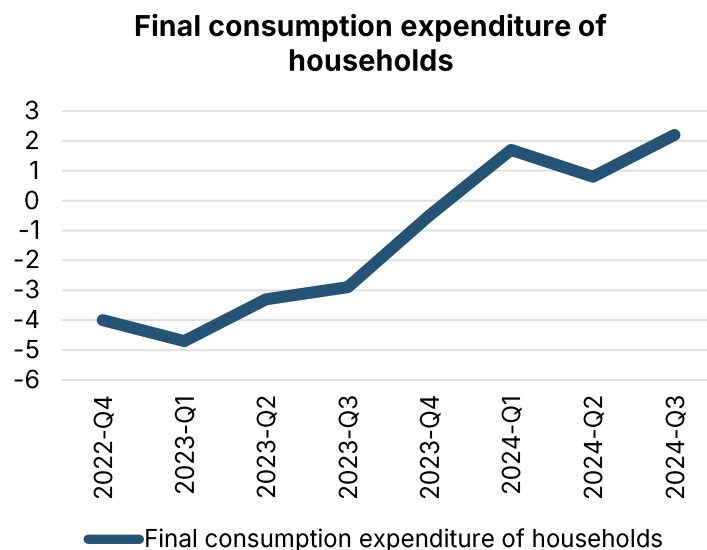
The Czech economy continues its gradual recovery, which began at the end of 2023. We expect GDP growth of 1% in 2024, as the subdued performance of the German economy remains a drag. A more significant acceleration in Czech economic growth is likely next year, with GDP projected to rise by 2.3%. In addition to domestic demand, driven by favorable labor market conditions, positive household sentiment and an expansionary fiscal policy, a gradual recovery in foreign demand is expected to contribute more significantly in comparison to this year.

Risks remain elevated and are skewed to the downside. The first is uncertainty surrounding the German economy, particularly the automotive industry. This is linked to the second risk, which involves the potential introduction or increase of high tariffs on European exports to the US, depending on their level and scope. However, even if these risks materialize, the Czech economy should manage them, albeit at the cost of weaker growth. Thus, even in this situation, we see the risk of recession as relatively small.

GDP growth, percent



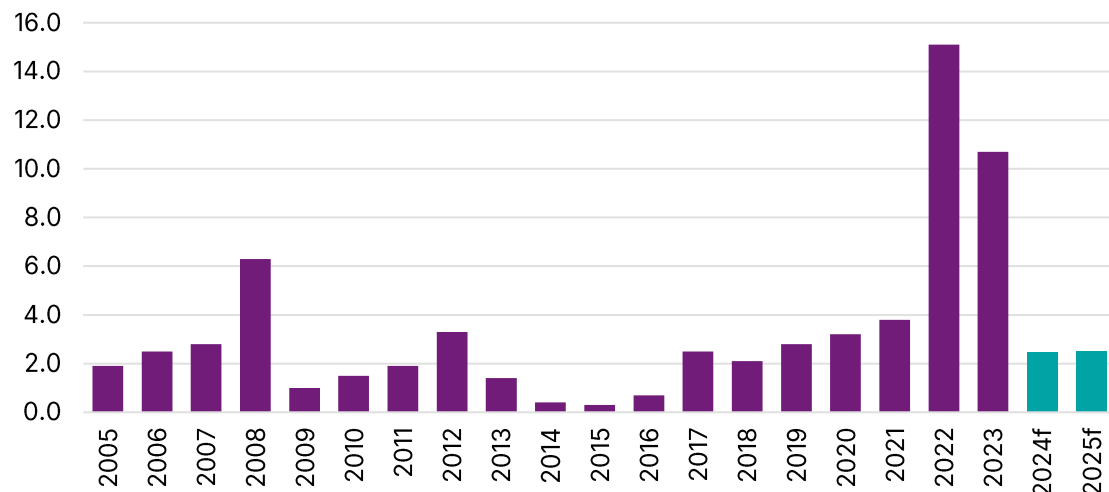
GDP structure



In terms of GDP structure, recent quarters have shown relative stability. Growth is primarily driven by household consumption, positively influenced by declining inflation, rising real wages, and improved sentiment. Government consumption also contributes positively, with significant growth. Foreign trade adds to the growth, although its contribution is gradually diminishing. This reflects weak demand from Germany on one hand and a recovery in imports for consumption on the other. Inventories have a notably negative impact, having been excessively accumulated in previous years and now gradually decreasing, despite quarter-to-quarter volatility. In this regard, however, we expect the decline in inventories could halt as early as next year.

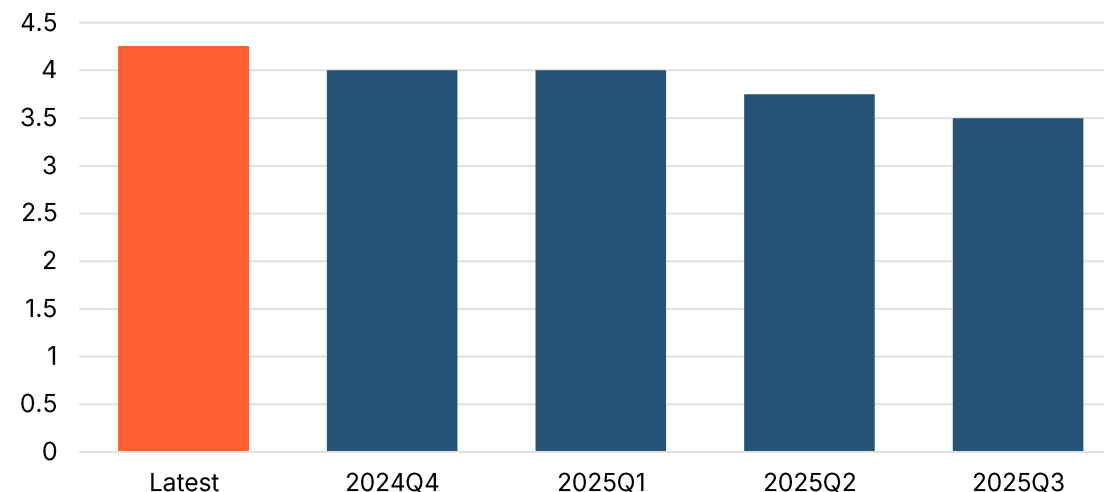
Inflation and monetary policy

Inflation, percent



During the autumn, inflation strengthened closer to the 3% level, which is the upper limit of the CNB's tolerance band. Pro-inflationary pressures are primarily driven by a strong labor market with low unemployment and renewed real wage growth, rising service sector prices, the recent weakening of the koruna, and fiscal policy. Additionally, food price developments have contributed to this trend. We expect a similar pattern over the next two years, with inflation averaging slightly above 2%. The CNB's monetary policy, characterized by cautious rate cuts and a slight strengthening of the koruna, should prevent a significant increase in inflation. Food and energy prices will remain a major uncertainty in both directions.

Key Interest Rate, percent



The Czech National Bank continues its gradual reduction of interest rates, facilitated by low inflation and relatively weak economic growth that does not generate significant inflationary pressures. We currently anticipate the next rate cut at the May meeting, while the market expects February. We anticipate three rate cuts next year, as the CNB is likely to remain cautious given the expected economic recovery and certain pro-inflationary risks.

Yields and spreads

The yield curve has remained relatively stable recently. Upward pressure on yields comes from market expectations shifting towards a later CNB rate cut (from December to February). Conversely, expectations of a quicker rate reduction in the Eurozone and a more gradual rate decline in the US (where the curve has shifted upwards) exert downward pressure. We do not anticipate significant movements in the Czech yield curve in the near term.

From a medium-term perspective, we expect a further gradual decline in the yield curve. This will primarily be driven by falling CNB rates. The decline in yields will continue to be restrained by the Ministry of Finance's issuance activity, which will remain high in the medium term. Overall, this movement is unlikely to be significant, as the extent of future monetary policy easing is already largely priced into the curve.

10Y yield development and forecast



FX Market

The koruna is currently slightly above EUR/CZK 25.0, influenced by several opposing factors. Supporting a stronger koruna is the shift in expectations regarding the CNB's future policy, which has moved towards a more gradual expected pace of rate cuts. Conversely, the continued subdued macroeconomic performance in Germany and market sentiment, which shifted following the US election results, due to heightened concerns about the European economy's outlook for next year, exerts downward pressure on the koruna.

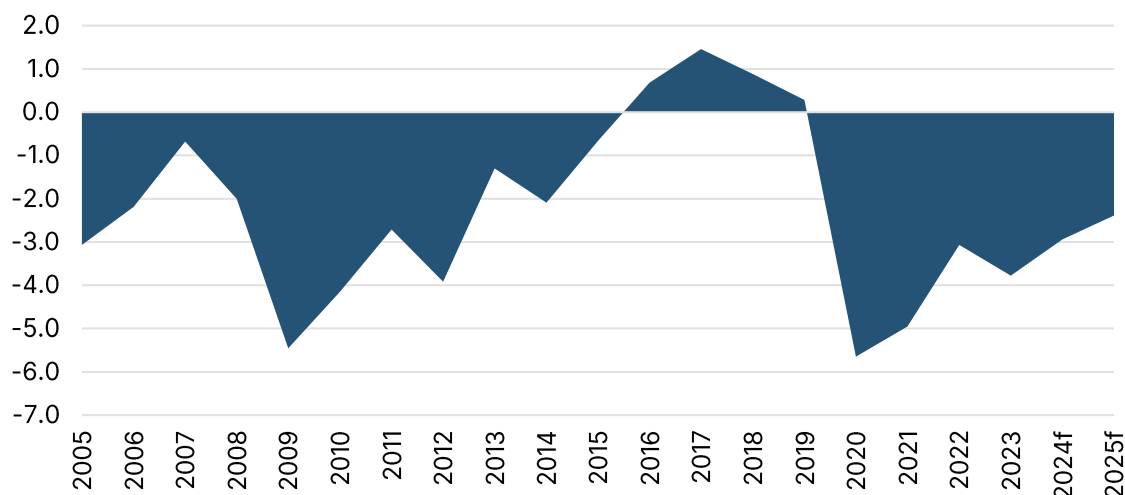
We have revised our forecast for the koruna to a weaker level compared to our previous forecasts. Nonetheless, we expect a slight strengthening of the koruna over the next two years in our baseline, driven by the CNB's cautious monetary policy and improved macroeconomic conditions, including foreign trade. However, we see risks as highly asymmetric, skewed towards weaker side, primarily due to global and geopolitical factors.

FX market development and forecast

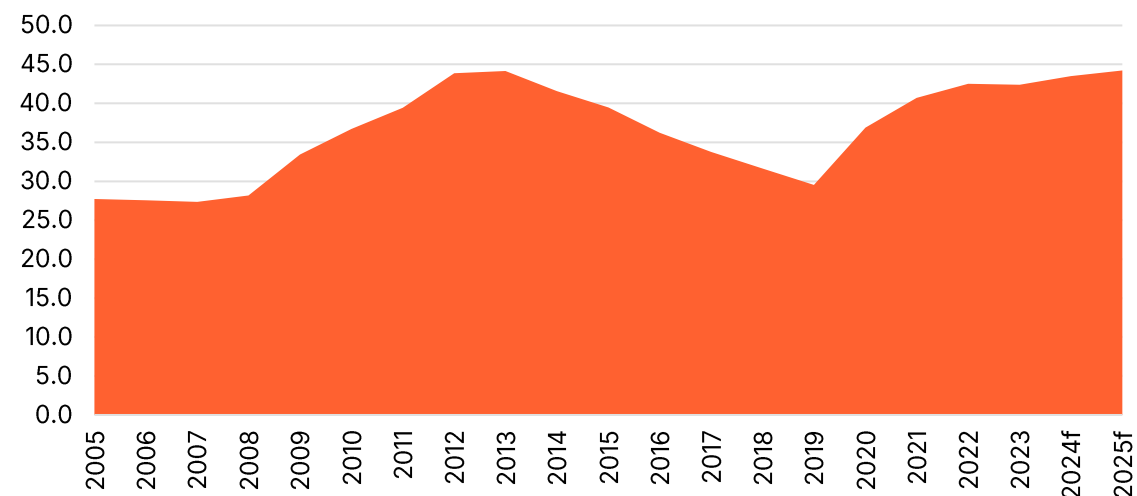


Fiscal Situation

Budget balance, percent of GDP



Public debt, percent of GDP



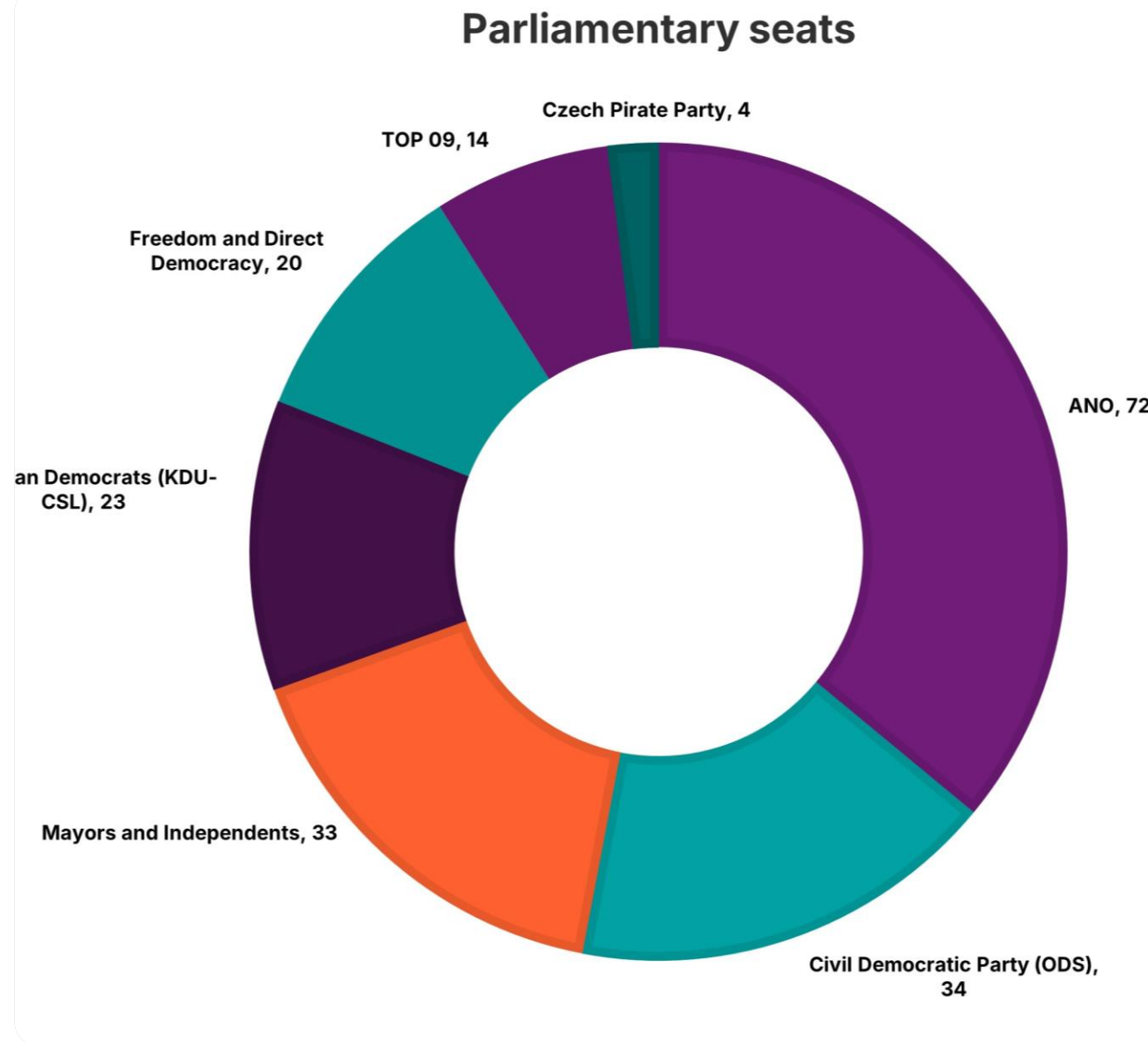
In January 2024, the government launched a fiscal consolidation package, with early indicators pointing to an improvement in public finances. The enhanced economic climate is also expected to positively influence public finances over the next two years. Thus, the general government deficit is projected to decrease from 3.8% in 2023 to 2.9% in 2024 and 2.4% in 2025. However, comprehensive measures addressing both revenue and expenditure will likely be required for the reduction of the structural balance. With elections approaching, further significant actions in this cycle are improbable and may be postponed.

The debt of the government sector is increasing, a trend expected to continue in the coming years. However, its overall share of GDP remains low, and the recent annual changes are relatively modest. This has been aided by high inflation of recent years, and the anticipated economic recovery next year is expected to further curb the debt-to-GDP ratio.

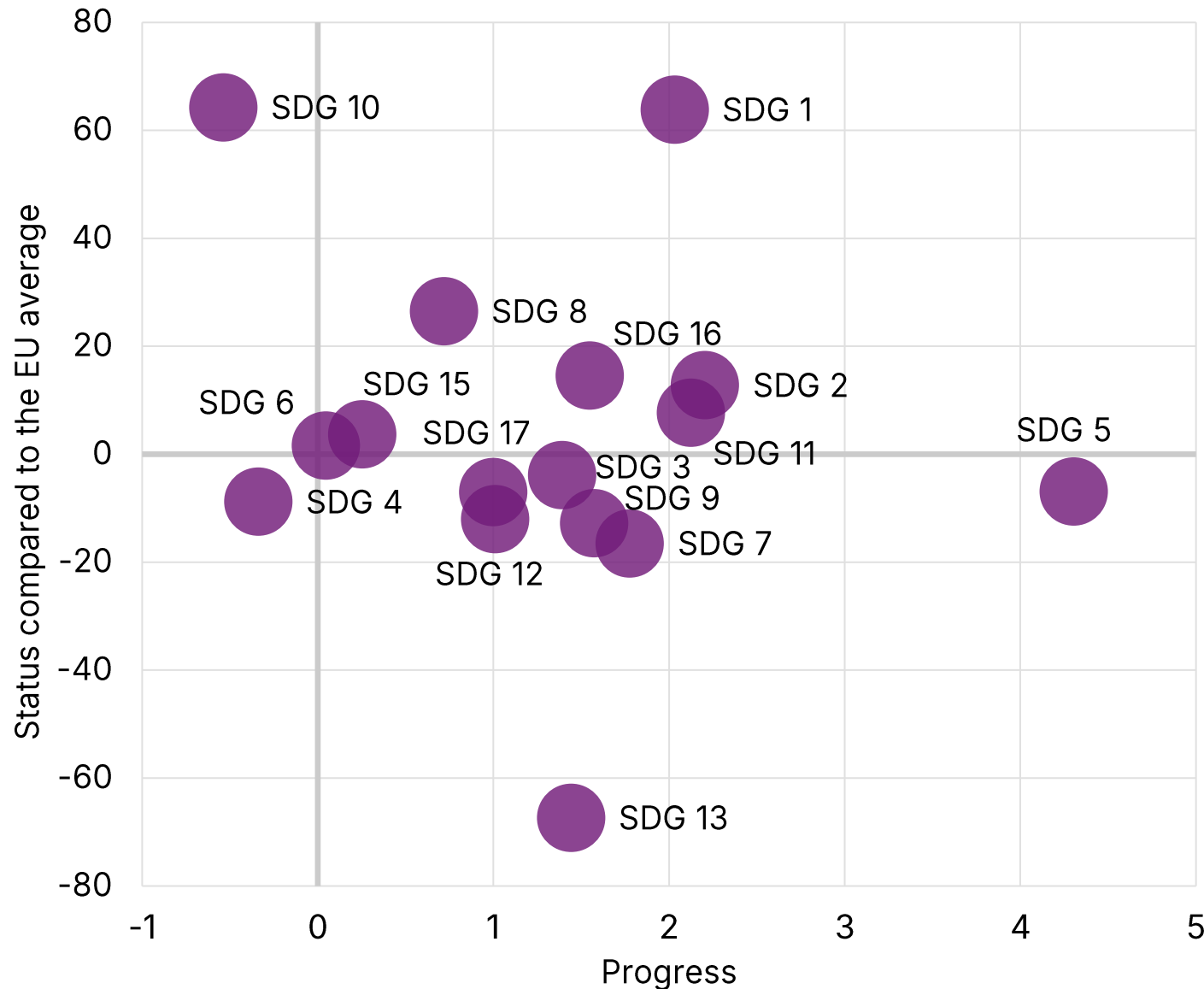
Political landscape

Despite minor changes in the government, with the Pirate Party leaving the coalition, the current pro-European government coalition still holds a sufficient majority in parliament with 104 out of 200 seats. The risk of political instability is thus moderate, and the government is expected to remain in its current form until the next parliamentary elections scheduled for October 2025.

Given the government's current low popularity and the upcoming elections, further reforms are unlikely, and the ruling parties will likely focus on improving their standings.



Social Development Goals



Among the social development goals, Czechia continues to excel in areas related to poverty, boasting one of the lowest poverty rates within the OECD. Additionally, there has been a notable improvement in institutional quality. However, due to the significant contribution of industry to GDP, further efforts are needed to reduce energy consumption and carbon emissions. There is also room for enhancing gender equality, despite the considerable progress already achieved in this area.

Czechia: Forecasts

	2018	2019	2020	2021	2022	2023	2024f	2025f	2026f
Percent				Annual average					
Real GDP growth	2.8	3.5	-5.3	4.0	2.9	0.0	1.0	2.3	2.6
Private consumption growth	3.4	3.0	-6.6	4.1	0.4	-2.9	1.8	2.9	2.8
Fixed capital formation growth	8.9	7.4	-4.8	6.7	6.3	2.7	0.4	2.6	3.0
Inflation	2.1	2.8	3.2	3.8	15.1	10.7	2.5	2.5	2.3
Unemployment rate	2.2	2.0	2.6	2.8	2.2	2.6	2.7	3.2	3.5
Percent of GDP									
Budget balance	0.9	0.3	-5.6	-5.0	-3.1	-3.8	-3.1	-2.5	-2.2
Public debt	31.6	29.5	36.9	40.7	42.5	42.4	43.5	44.4	44.7
Current account balance	0.4	0.3	1.9	-2.7	-5.9	1.2	0.5	0.8	1.0
				End of year					
EURLCY	25.72	25.42	26.24	24.89	24.16	24.70	25.20	24.85	24.60
Central bank policy rate	1.75	2.00	0.25	3.75	7.00	6.75	4.00	3.25	3.00
3M interbank offer rate	2.01	2.18	0.36	4.08	7.26	6.77	4.07	3.32	3.07
2Y Yield	1.50	1.77	0.14	3.65	5.58	5.40	3.64	3.08	2.96
5Y Yield	1.76	1.46	0.84	3.30	5.30	4.24	3.58	3.25	3.20
10Y Yield	1.94	1.63	1.30	2.86	5.10	4.28	3.70	3.42	3.38

Czechia : Country overview

Official EU language: Czech

Capital: Prague

Geographical size: 78 871km²

Population: 10 900 555

GDP per capita: EUR 34 200, below the EU average

Currency: Czech koruna CZK

Credit Ratings:

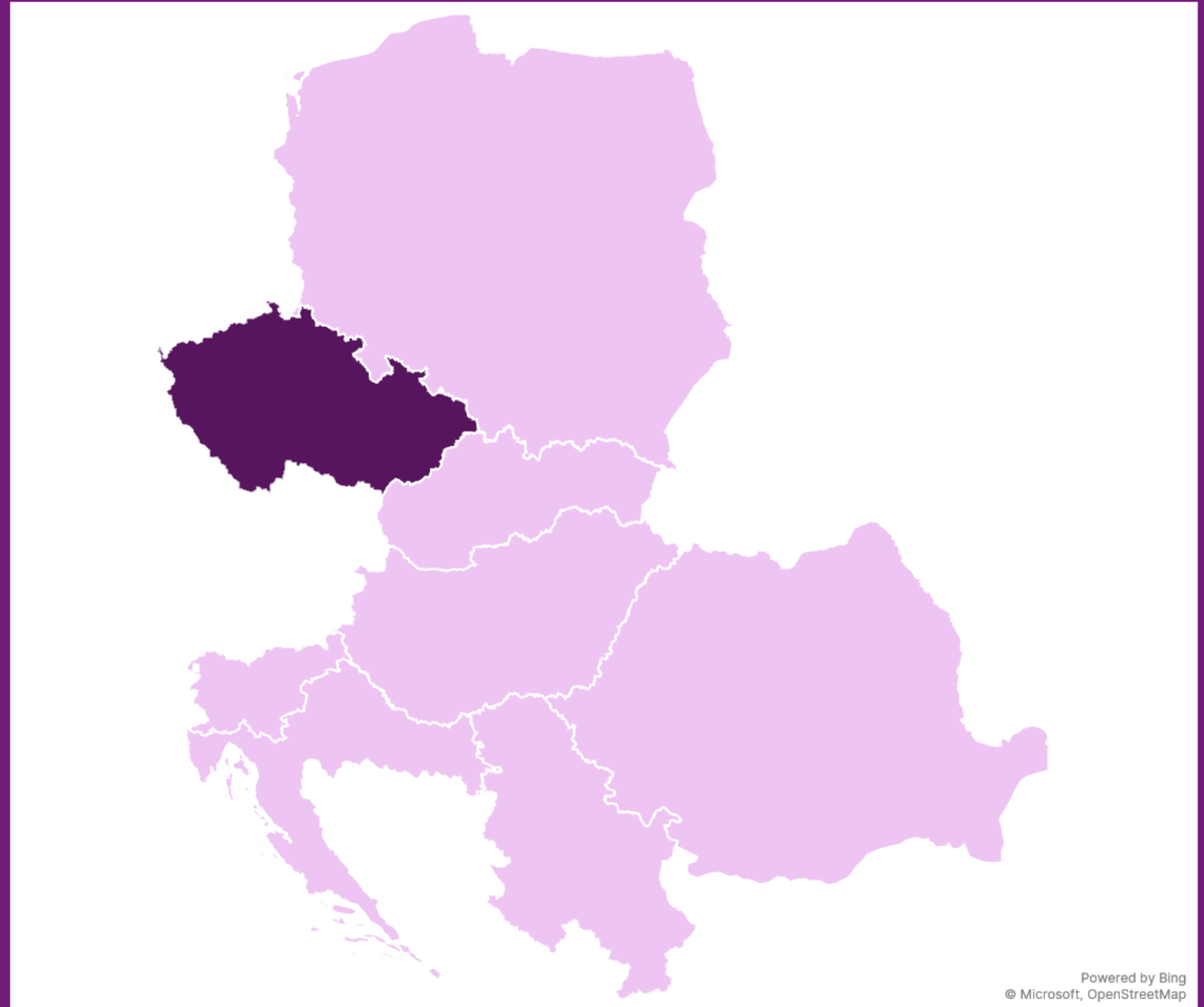
Moody's: Aa3, outlook stable

S&P: AA-, outlook stable

Fitch: AA-, outlook negative

EU member state: since 1 May 2004

Schengen: member since 21 December 2007



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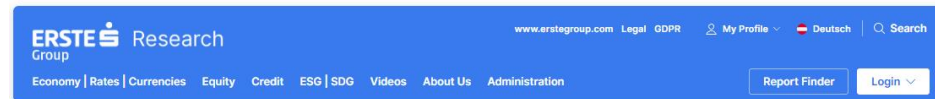
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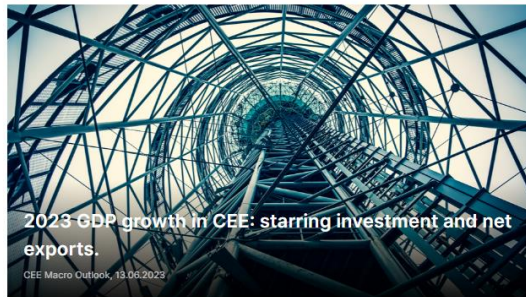


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