Czechia | Macro Outlook

Surprisingly positive growth in 1H22
Another interest rate hike is less likely
Yield curve affected by market expectations
The koruna remains stable

Economy (%)	2022e	2023e	2024e
GDP (real, y/y)	2.3	0.9	3.7
Unempl. Rate	2.6	3.3	3.4
CPI (y/y)	15.8	7.0	2.1
Retail Sales (y/y)	-2.1	-0.3	3.7
Ind. Prod. (y/y)	0.6	0.2	3.8
Public Debt/GDP	43.3	44.0	44.6

Source: Erste Group Research

Market	Spot	22Q4	23Q1	23Q2
EUR/CZK	24.50	24.50	24.36	24.29
USD/CZK	24.31	23.33	22.98	22.28
Target Rate (%)	7.00	7.00	6.00	5.25
3M Rate (%)	7.26	7.07	6.04	5.27
2Y Bond (%)*	5.86	5.23	4.43	3.82
5Y Bond (%)*	4.99	5.14	4.87	4.57
10Y Bond (%)*	4.47	4.37	4.16	3.89

Source: FactSet, Erste Group Research

Rating	Current	Outlook
Moodys	Aa3	stable
S&P	AA-	stable
Fitch	AA-	neg

Source: Erste Group Research

General	2022
Population mn	10.5
GDP/Capita EUR	26,198

Source: Erste Group Research

Spot Rates as of:
12th Sep. 2022

All Research on Czechia:
erstegroup.com/research

Analysts:

David Navratil
DNavratil@csas.cz
+420 956 765 439

Jiri Polansky
JPolansky@csas.cz
+420 956 765 192

Note:
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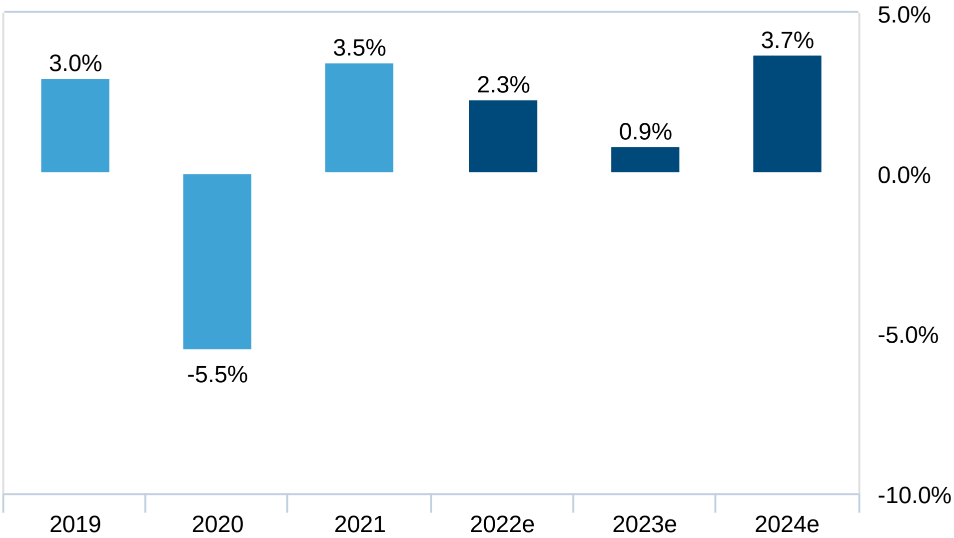
In the rest of this year, the development of the Czech economy will probably worsen, due to both lower domestic as well as foreign demand. In this respect, we expect a mild recession, but both-sided uncertainty remains high, due to external factors. Although a slight increase in the unemployment rate is expected, the labor market worsening during this year goes mainly through decreasing real wages affected by high inflation. Next year, economic recovery should take place, which will also be supported by a gradual reduction in inflation, improved foreign demand and lowering the CNB rates.

We expect the CNB to keep rates stable until the beginning of the next year. However, the probability of an earlier cut (e.g. November) has been increasing, mainly due to the recent shift of the MP horizon, the lower than expected August inflation figure, price caps on electricity and gas and the expected economic worsening. The koruna has been relatively stable, and we expect such a development to continue in the coming months. The koruna could start appreciating again in the next year, although its pace will probably be mild, in our view.

GDP (real,y/y)



Source: Erste Group Research

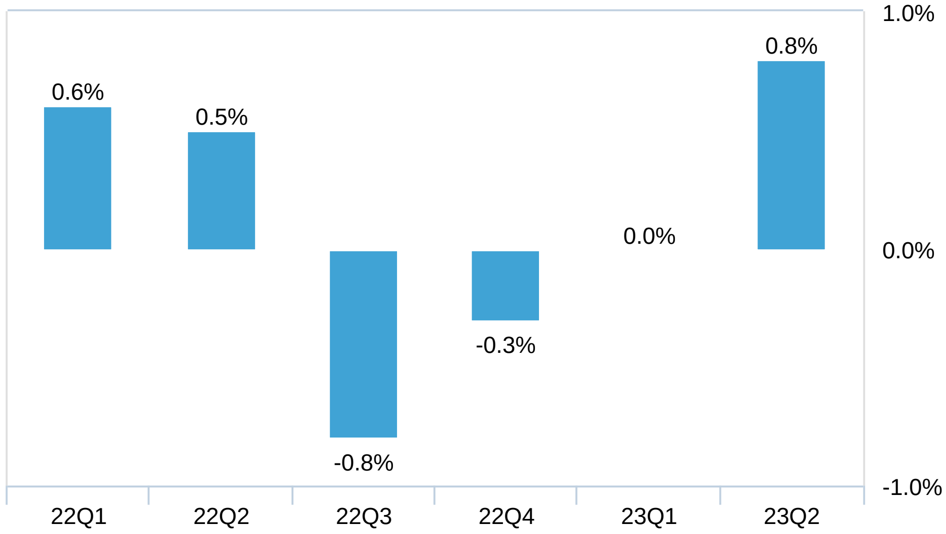
GDP

Surprisingly positive growth in 1H22

GDP growth in the first half of this year was surprisingly strong, as the Czech economy reached positive q/q growth in both quarters, and thus showed resistance to adverse external shocks. Investments, both fixed and inventory, contributed significantly to this. However, we see the current inventory stocks as too high, and thus their deaccumulation could slow down GDP growth in the coming years. In 1H22, GDP growth was negatively influenced by net exports, mainly due to supply-side problems in the automotive sector and relatively high domestic demand positively affecting imports.

Given the surprisingly favorable development in 1H22, we expect GDP growth to be slightly above 2% in 2022. The expected deterioration of economic development in the next few quarters will thus become more pronounced in the data for 2023, when GDP growth may remain slightly below 1%. Uncertainty remains high, especially as external factors will be key. In our view, a recovery could already take place during the next year, and GDP could thus grow by almost 4% in 2024, mainly due to the improved investments and foreign trade. Household consumption is likely to recover more slowly.

GDP (real, s.a., q/q)



Source: Erste Group Research

Annual	2020	2021	2022e	2023e	2024e
GDP real	-5.5%	3.5%	2.3%	0.9%	3.7%
CPI (y/y)	3.2%	3.8%	15.8%	7.0%	2.1%
Private Consumption	-7.4%	4.0%	0.8%	0.3%	2.9%

Source: Erste Group Research

Inflation

Pro-inflationary effects of demand are already weakening

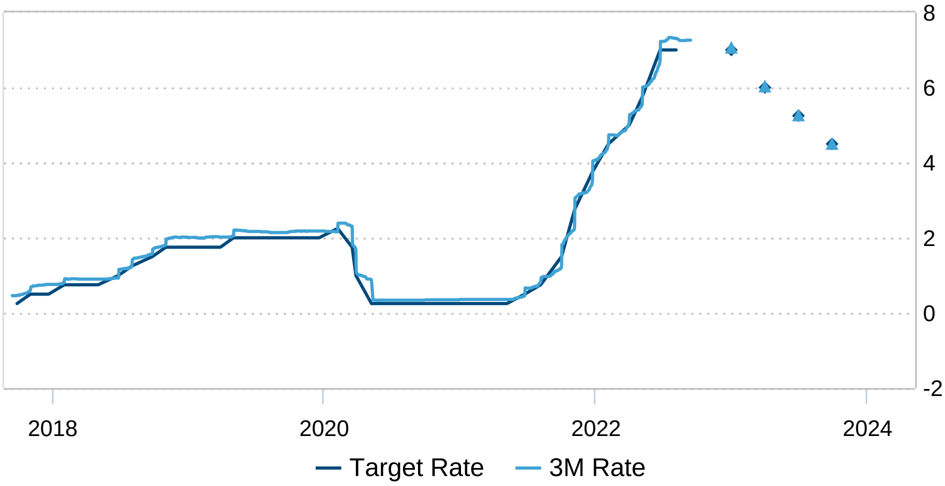
Although annual inflation unexpectedly slowed down in August, we expect it to strengthen in the 3Q/4Q turn with a peak around 19%, mainly due to a further rise in energy prices and partly also in food prices. In contrast, the pro-inflationary effects of demand are already weakening. From this year's peak, inflation should gradually return to the inflation target, which will take a little over a year. On September 12, the government approved caps on electricity and gas prices. This could contribute to a relatively quick slowdown of inflation over the next year.

Monetary Policy

Another interest rate hike is less likely

As the most likely scenario, we expect stability of policy rates until February, followed by a relatively quick policy loosening, due to a gradual return of inflation towards the target. Risks are both-sided. On one hand, we still cannot rule out a hike, although the probability of such a move is decreasing considerably, in our view. On the other hand, and much more importantly, the CNB could cut rates already this year (e.g. in November), which could be a consequence of the economic worsening, recent shift of the MP horizon or current inflation figures, which are below the CNB forecast.

Short Term Yields



Source: FactSet, Erste Group Research

Market (%)	Spot	22Q4	23Q1	23Q2	23Q3
Target Rate	7.00	7.00	6.00	5.25	4.50
3M Rate	7.26	7.07	6.04	5.27	4.51

Source: FactSet, Erste Group Research

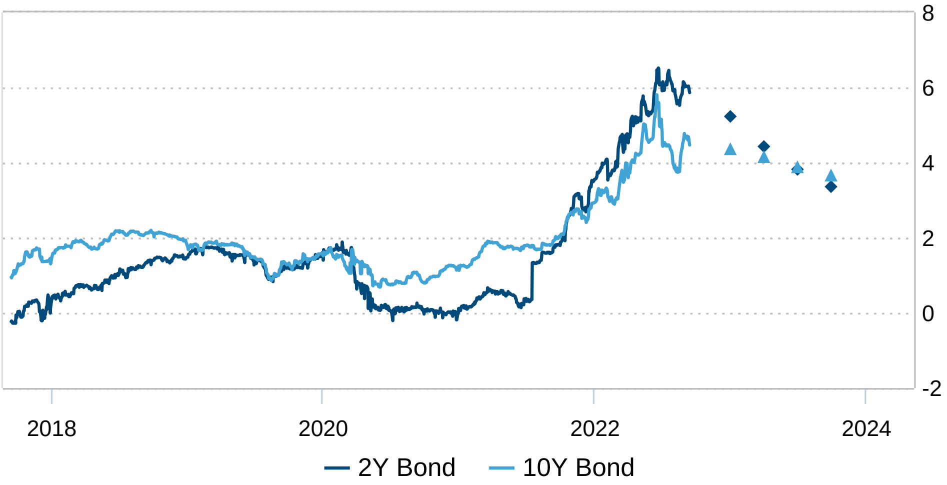
Bond Yields

Yield curve affected by market expectations

The yield curve remains relatively high, and its slope continues to be negative. This is influenced by high CNB rates, which are more pronounced at the short end of the curve, while the longer end is more affected by low rates in the Eurozone. According to our estimates, the curve is now higher compared to the economic fundamentals, which is probably also influenced by market expectations, which suppose a further increase in CNB rates and then a longer period of their stability.

For the rest of this and the next two years, we expect a gradual downward movement in the yield curve and its flattening. If the CNB does not raise rates this year and starts to announce their first rate cut to come, the market will relatively quickly adjust its expectations downwards. In the next two years, the curve will be pulled down by falling CNB rates and lower emission activity of the government. Rising rates in the Euro Area will act in the opposite direction.

Generic Bond Yields (%)



Source: FactSet, Erste Group Research

Market	Spot	22Q4	23Q1	23Q2	23Q3
2Y Bond*	5.86	5.23	4.43	3.82	3.36
5Y Bond*	4.99	5.14	4.87	4.57	4.30
10Y Bond*	4.47	4.37	4.16	3.89	3.67

Source: FactSet, Erste Group Research

Note:

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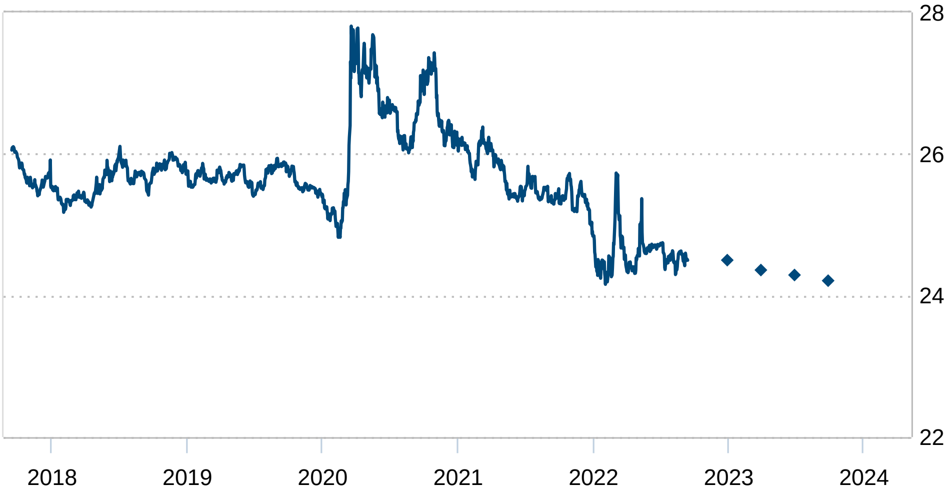
Czech Koruna

The koruna remains stable

The koruna remains relatively stable, due to a slight calming down of sentiment in the markets and the CNB's readiness to use FX interventions to prevent significant fluctuations in the koruna. We do not expect the koruna to move much in the coming weeks, as the CNB will probably not allow it to weaken; however, it is also not likely that there would be some reason for a significant strengthening of the koruna, as the CNB will not hike, and the development of the Czech economy will worsen.

For the next two years, we expect only a relatively moderate appreciation of the koruna. On the strengthening side, the koruna will be driven by an improvement in market sentiment (although this is unlikely to happen in the short term) and a renewed convergence of the Czech economy towards more developed European countries. Falling CNB rates will have the opposite effect. The risks are significant and skewed towards a weaker koruna, mainly due to global uncertainties.

EUR/CZK



Source: FactSet, Erste Group Research

	Spot	22Q4	23Q1	23Q2	23Q3
EUR/CZK	24.50	24.50	24.36	24.29	24.21
vs. Spot		*0%*	*-0.6%*	*-0.9%*	*-1.2%*
USD/CZK	24.31	23.33	22.98	22.28	22.01
vs. Spot		*-4%*	*-5.5%*	*-8.4%*	*-9.5%*

Source: FactSet, Erste Group Research

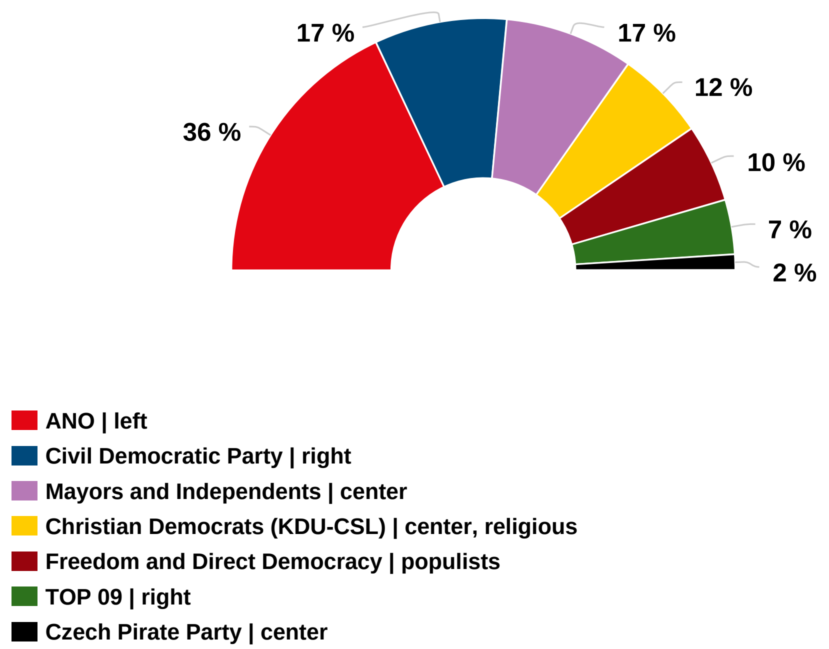
Politics

Relatively strong parliamentary majority

The result of the October parliamentary election meant that five parties formed a government coalition with a (by Czech standards) relatively strong parliamentary majority of 108 seats out of 200. Thus, the risk of political instability should be lower during this election term, although we cannot rule out some tensions, given the recent development with energy prices. The government is center-right and pro-European.

Among its key plans, the new government included budget responsibility after its appointment. As a first step, the planned deficit for this year was decreased, with a further reduction in the coming years. Although the current situation implies higher than expected expenditures, the government still aims for a gradual improvement of public finances in the coming years. From a longer-term perspective, however, an increase in taxation cannot be ruled out, given the high structural deficit.

Parliament Seats



Source: Erste Group Research

Last Election:
2021, October

Next Election:
2025, October

Forecasts

Annual	2016	2017	2018	2019	2020	2021	2022e	2023e	2024e
Real GDP growth	2.5	5.3	3.2	3.0	-5.5	3.5	2.3	0.9	3.7
Inflation (CPI, avg)	0.7	2.4	2.2	2.8	3.2	3.8	15.8	7.0	2.1
Unemployment rate (avg)	4.0	2.9	2.3	2.0	2.6	2.9	2.6	3.3	3.4
Retail sales growth	4.7	5.9	5.0	4.8	-0.8	4.2	-2.1	-0.3	3.7
Industrial output growth	3.0	6.7	3.1	-0.4	-6.9	6.2	0.6	0.2	3.8
Private consumption growth	3.7	4.0	3.3	2.6	-7.4	4.0	0.8	0.3	2.9
Fixed capital formation growth	-3.1	5.1	10.0	5.9	-6.0	0.6	4.3	1.2	4.1
Percent of GDP									
Trade balance	3.4	3.1	1.8	2.5	3.2	-0.1	-2.5	1.1	2.0
Current account balance	1.8	1.5	0.4	0.3	2.0	-0.8	-2.8	0.3	1.1
Foreign direct investment	78.0	77.3	76.4	75.5	80.6	80.8	80.0	79.3	n.a.
Budget balance	0.7	1.5	0.9	0.3	-5.8	-5.9	-4.7	-3.7	-2.8
Public debt	36.6	34.2	32.0	30.0	37.6	42.0	43.3	44.0	44.6
External debt, gross	72.9	85.5	80.5	75.0	75.5	76.5	76.1	75.5	n.a.
FX, money market									
USDLCY average	24.44	23.38	21.74	22.93	23.22	21.68	23.38	22.34	20.64
EURLCY average	27.03	26.33	25.65	25.67	26.46	25.64	24.61	24.27	23.88
EURLCY eop	27.02	25.51	25.72	25.42	26.24	24.89	24.50	24.15	23.70
(percent)									
CB policy rate (avg.)	0.05	0.17	1.06	1.92	0.77	0.88	5.95	5.27	3.21
3m interbank offer rate (avg.)	0.29	0.41	1.27	2.12	0.86	1.13	6.26	5.21	3.23
2Y Yield (average)*	-0.31	-0.20	1.06	1.57	0.59	1.59	5.41	3.83	2.53
5Y Yield (average)*	-0.05	0.20	1.48	1.42	0.87	1.85	4.78	4.54	3.71
10Y Yield (average)*	0.44	1.06	2.02	1.61	1.18	1.96	4.25	3.88	3.25

Source: Erste Group Research

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Contacts

Group Research

Head of Group Research
Friedrich Mostböck, CEFA®, CESGA® +43 (0)5 0100 11902
CEE Macro/Fixed Income Research
Head CEE: Juraj Kotian (Macro/FI) +43 (0)5 0100 17357
Katarina Gumanova (Fixed income) +43 (0)5 0100 17336
Katarzyna Rzentarzewska (Fixed income) +43 (0)5 0100 17356
Croatia/Serbia
Head: Alen Kovac (Fixed income) +385 62 37 1383
Mate Jelic (Fixed income) +385 72 37 1443
Ivana Rogic (Fixed income) +385 62 37 2419
Czech Republic
Head: David Navratil (Fixed income) +420 956 765 439
Jiri Polansky (Fixed Income) +420 956 765 192
Michal Skorepa (Fixed income) +420 956 765 456
Hungary
Orsolya Nyeste (Fixed Income) +36 1 268 4428
Janos Nagy (Fixed Income) +36 1 272 5115
Romania
Head: Ciprian Dascalu +40 3735 10108
Eugen Sinca (Fixed income) +40 3735 10435
Dorina Ilasco (Fixed Income) +40 3735 10436
Vlad Nicolae Ionita (Fixed Income) +40 7867 15618
Slovakia
Head: Maria Valachyova, (Fixed income) +421 2 4862 4185
Matej Hornak (Fixed income) +421 902 213 591
Major Markets & Credit Research
Head: Gudrun Egger, CEFA® +43 (0)5 0100 11909
Ralf Burchert, CEFA® (Sub-Sovereigns & Agencies) +43 (0)5 0100 16314
Hans Engel (Senior Analyst Global Equities) +43 (0)5 0100 19835
Margarita Grushanina (Economist AT, Quant Analyst) +43 (0)5 0100 11957
Peter Kaufmann, CFA® (Corporate Bonds) +43 (0)5 0100 11183
Stephan Lingnau (Global Equities) +43 (0)5 0100 16574
Heiko Langer (Financials & Covered Bonds) +43 (0)5 0100 85509
Bernadett Povazsai-Römhild, CEFA®, CESGA® (Corporate Bonds) +43 (0)5 0100 17203
Carmen Riefler-Kowarsch (Financials & Covered Bonds) +43 (0)5 0100 19632
Elena Statelov, CIIA® (Corporate Bonds) +43 (0)5 0100 19641
Gerald Walek, CFA® (Economist Euro, CHF) +43 (0)5 0100 16360
Rainer Singer (Senior Economist Euro, US) +43 (0)5 0100 17331
CEE Equity Research
Head: Henning Eßkuchen +43 (0)5 0100 19634
Daniel Lion, CIIA® (Technology/Industrial Goods&Services) +43 (0)5 0100 17420
Michael Marschallinger, CFA +43 (0)5 0100 17906
Nora Nagy (Telecom) +43 (0)5 0100 17416
Thomas Unger, CFA® (Banks, Insurance) +43 (0)5 0100 16314
Christoph Schultes, MBA, CIIA® (Real Estate) +43 (0)5 0100 11523
Vladimira Urbankova, MBA (Pharma) +43 (0)5 0100 17343
Martina Valenta, MBA +43 (0)5 0100 11913
Croatia/Serbia
Head: Mladen Dodig (Equity) +381 11 22 09 178
Anto Augustinovic (Equity) +385 62 37 2833
Magdalena Basic (Equity) +385 72 37 1407
Davor Spoljar, CFA® (Equity) +385 62 37 2825
Czech Republic
Head: Petr Bartek (Equity) +420 956 765 227
Jan Safranek (Equity) +420 956 765 218
Hungary
Head: Jozsef Miro +361 235 5131
Andras Nagy (Equity) +361 235-5132
Tamas Pletser, CFA® (Equity) +361 235-5135
Poland
Head: Cezary Bernatek (Equity) +48 22 257 57 51
Piotr Bogusz (Equity) +48 22 257 57 55
Lukasz Janczak (Equity) +48 22 257 57 54
Krzysztof Kawa (Equity) +48 22 257 57 52
Jakub Szkopek (Equity) +48 22 257 57 53
Romania
Caius Rapanu (Equity) +40 3735 10441
Editor Research CEE
Brett Aarons +420 956 711 014

Treasury - Erste Bank Vienna

Head of Group Markets
Oswald Huber +43 (0)5 0100 848901
Group Markets Retail Sales
Group Markets Retail and Agency Business
Head: Christian Reiss +43 (0)5 0100 84012
Group Markets Execution
Head: Kurt Gerhold +43 (0)5 0100 84232
Retail & Sparkassen Sales
Head: Uwe Kolar +43 (0)5 0100 83214
Markets Retail Sales AT
Head: Markus Kaller +43 (0)5 0100 84239
Corporate Treasury Product Distribution AT
Head: Christian Skopek +43 (0)5 0100 84146
Fixed Income Institutional Sales
Group Securities Markets
Head: Thomas Einramhof +43 (0)5 0100 84432
Institutional Distribution Core
Head: Jürgen Niemeier +49 (0)30 8105800 5503
Institutional Distribution DACH+
Head: Marc Friebertshäuser +49 (0)711 810400 5540
Bernd Bollhof +49 (0)30 8105800 5525
Andreas Goll +49 (0)711 810400 5561
Mathias Gindele +49 (0)711 810400 5562
Ulrich Inhofner +43 (0)50100 85544
Sven Kienzle +49 (0)711 810400 5541
Rene Klasen +49 (0)30 8105800 5521
Christopher Lampe-Traupe +49 (0)30 8105800 5523
Karin Rattay +43 (0) 5 0100 84118
Michael Schmotz +43 (0)5 0100 85542
Klaus Vosseler +49 (0)711 810400 5560
Slovakia
Sarlota Sipulova +421 2 4862 5619
Monika Smelikova +421 2 4862 5629
Institutional Distribution CEE & Insti AM CZ
Head: Antun Buri? +385 (0)7237 2439
Jaromir Malak +43 (0)50100 84254
Czech Republic
Head: Ondrej Cech +420 2 2499 5577
Milan Bartos +420 2 2499 5562
Jan Porvich +420 2 2499 5566
Institutional Asset Management Czech Republic
Head: Petr Holecek +420 956 765 453
Petra Maderova +420 956 765 178
Martin Perina +420 956 765 106
Petr Valenta +420 956 765 140
Blanka Weinerova +420 956 765 317
David Petracek +420 956 765 809
Croatia
Head: Antun Buri? +385 (0)72 37 2439
Natalija Zujic +385 (0)72 37 1638
Zvonimir Tukac +385 (0)72 37 17 87
Hungary
Head: Peter Csizmadia +361 237 8211
Gabor Balint +36 1 2378205
Adam Szönyi +36 1 237 8213
Romania and Bulgaria
Head: Octavian Florin Munteanu +40 746128914
Group Fixed Income Securities Markets
Head: Goran Hoblaj 43 (0)50100 84403
FISM Flow
Margit Hraschek +43 (0)5 0100 84117
Christian Kienesberger +43 (0) 5 0100 84323
Ciprian Mitu +43 (0)50100 85612
Bernd Thaler +43 (0) 5 0100 84119
Zsuzsanna Toth +36 1 237 8209
Poland
Head: Aleksandar Doric +43 (0)5 0100 87487
Pawel Kielek +48 22 538 6223
Michal Jarmakowicz +43 50100 85611
Group Fixed Income Securities Trading
Head: Goran Hoblaj 43 (0)50100 84403
Group Equity Trading & Structuring
Head: Ronald Nemec +43 (0)50100 83011
Business Support
Bettina Mahoric +43 (0)50100 86441

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Erste Group Bank AG
Group Research
1100 Wien, Am Belvedere 1
Head Office: Wien
Commercial Register No: FN 33209m
Commercial Court of Vienna
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