

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

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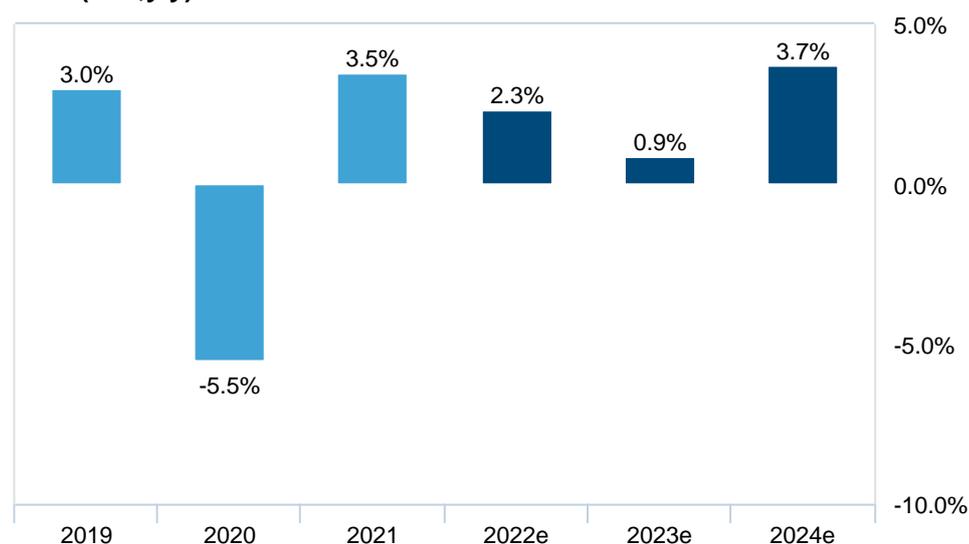
Note:

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Forecasts are not a reliable indicator for future performance.

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

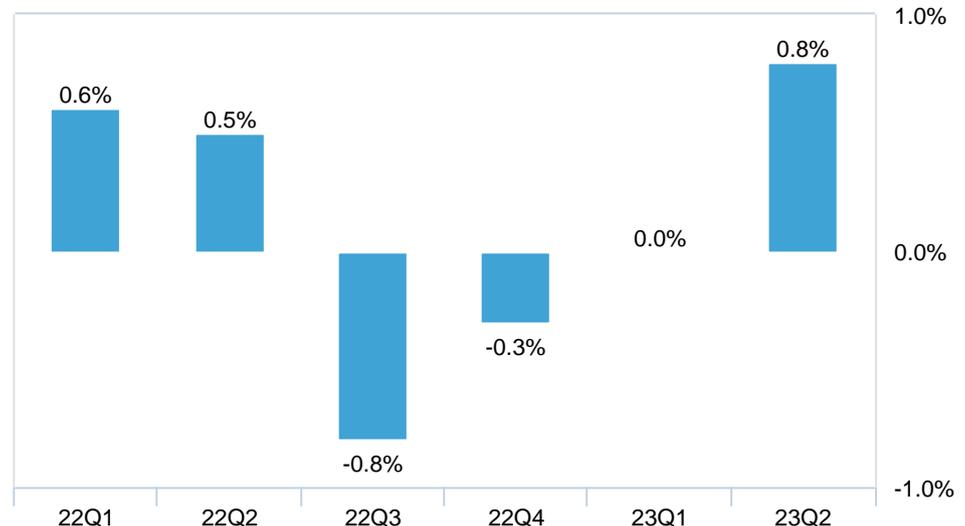
GDP

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

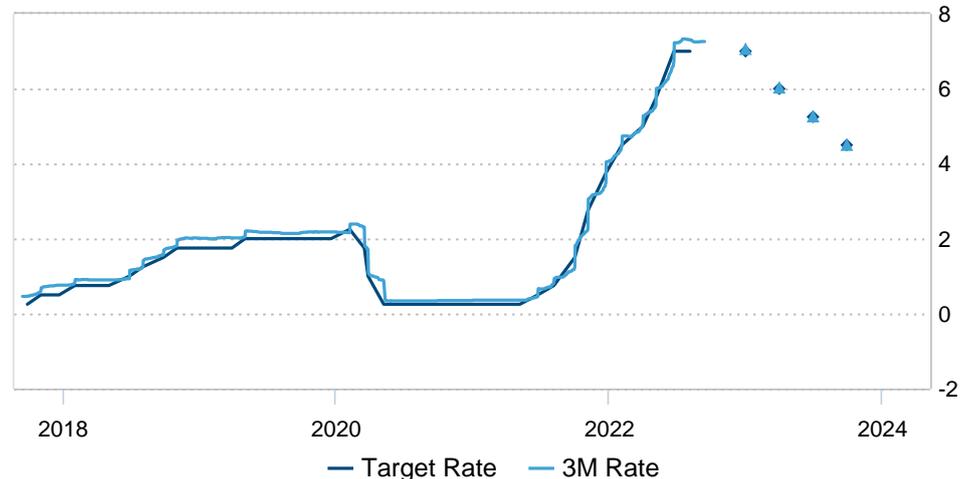
Although annual inflation unexpectedly slowed down in August, we expect it to strengthen in the 3Q/4Q turn with a peak around 19%, mainly due to a further rise in energy prices and partly also in food prices. In contrast, the pro-inflationary effects of demand are already weakening. From this year's 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

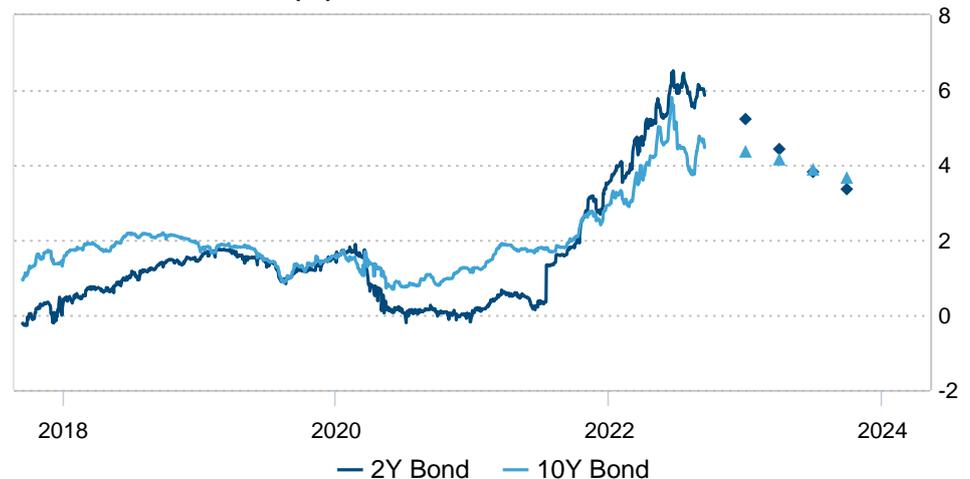
Bond Yields

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

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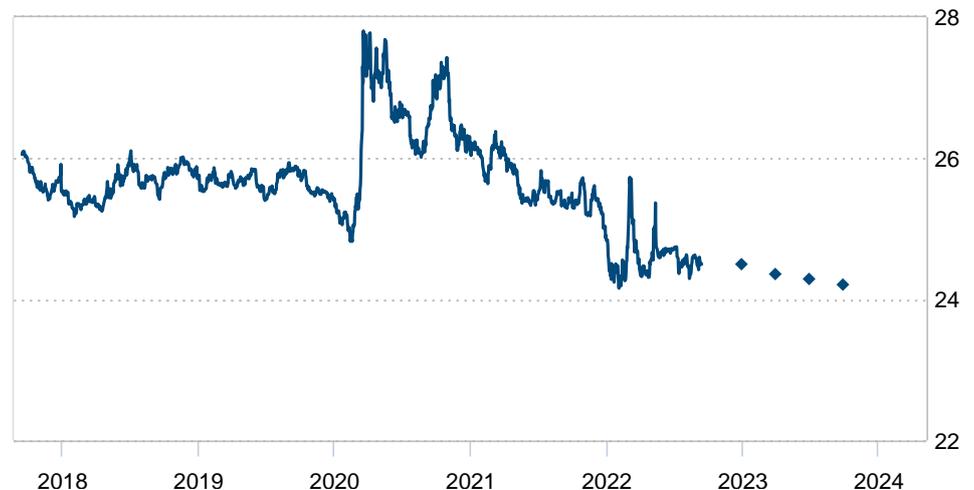
Czech Koruna

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
<i>vs. Spot</i>		0%	-0.6%	-0.9%	-1.2%
USD/CZK	24.31	23.33	22.98	22.28	22.01
<i>vs. Spot</i>		-4%	-5.5%	-8.4%	-9.5%

Source: FactSet, Erste Group Research

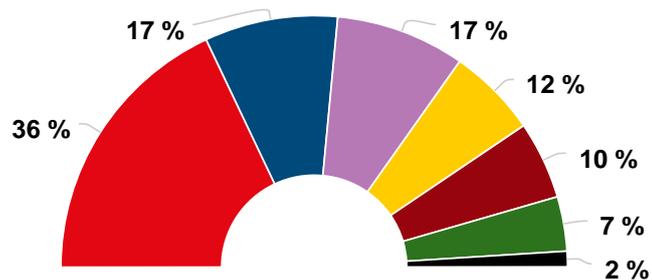
Politics

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



- ANO | left
- Civil Democratic Party | right
- Mayors and Independents | center
- Christian Democrats (KDU-CSL) | center, religious
- Freedom and Direct Democracy | populists
- TOP 09 | right
- Czech Pirate Party | center

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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