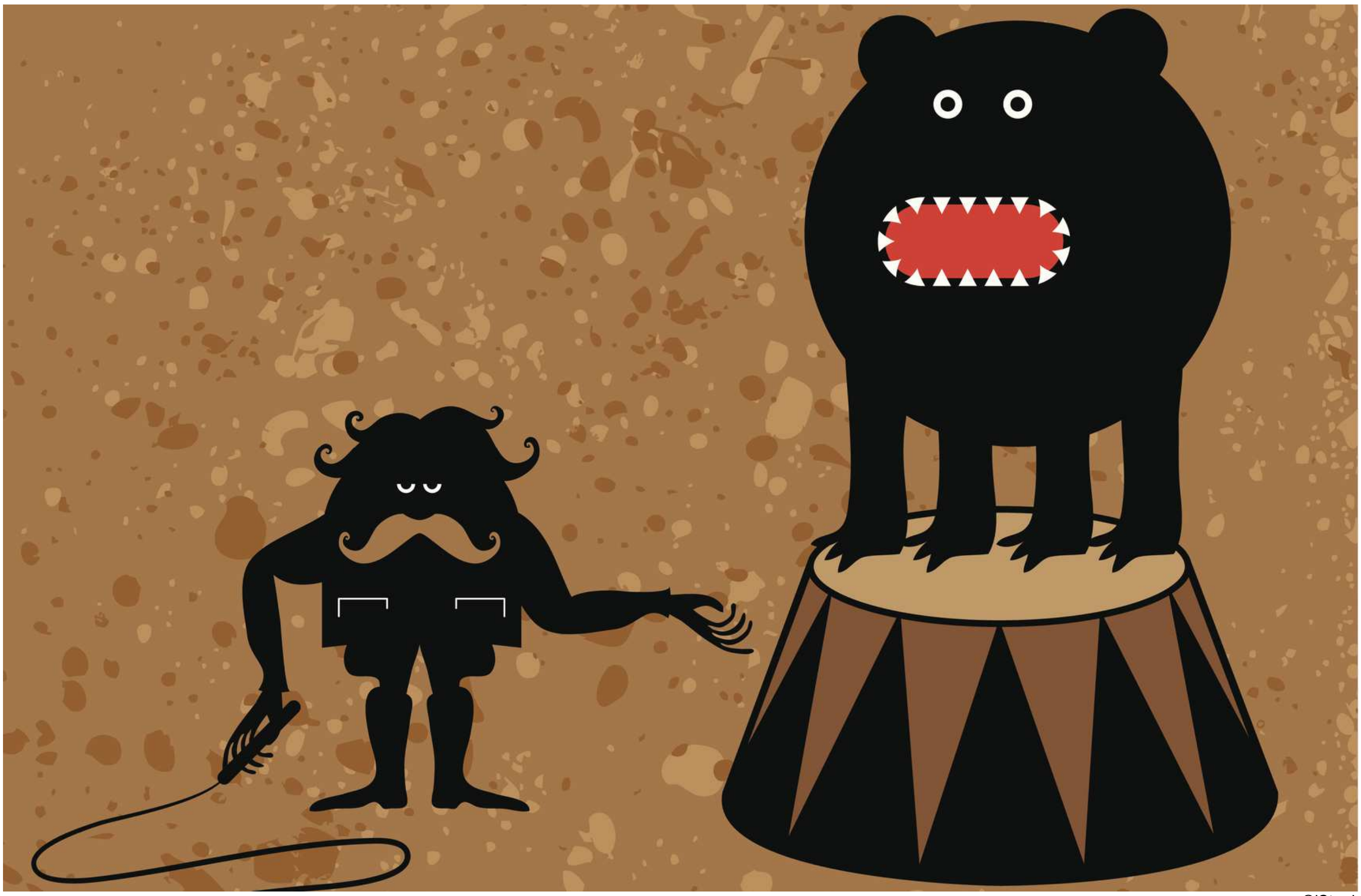
Quarterly report

Czech Economic Outlook

Taming the Inflation Shrew



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■ **Components subcontracting set to boost the economy** We expect an improvement in the supply chain situation, which should support production and help the economy grow at a rate of 4.9% this year, on our forecasts. However, economic policy tightening should gradually slow the growth rate to below 3% in 2023.

■ **Inflation likely to reach double digits** As we start 2022, consumer prices look set to rise rapidly again. We therefore expect annual inflation to peak at slightly above 10% in the first half of the year, before slowing significantly thereafter.

■ **The CNB is likely to raise interest rates to 5%** This peak should be reached in May. As strong inflationary pressures ease, however, we expect the central bank to start cutting rates towards the policy neutral 2.5% level from the end of 2022.

■ **Yields are nearing their peak** We expect the short end of the yield curve to increase in response to the CNB's rate hikes, with a turnaround only in the second half of this year. The supply of bonds is likely to fall this year compared to last year, and their yields will thus remain below the IRS in an environment of persistently strong demand.

■ **USD likely to prevent significant CZK appreciation** While a record-wide interest-rate differential should push the koruna to stronger levels, we expect this to be countered by the US dollar, which we believe will strengthen further vs the euro. Overall, we expect the koruna to give back some of the gains from the beginning of this year, returning to EURCZK25 once the Fed starts its policy normalisation. We then expect the koruna to appreciate towards EURCZK24.80 by end-2022.

Jan Vejmělek
(420) 222 008 568
jan_vejmelek@kb.cz

Jana Steckerová
(420) 222 008 524
jana_steckerova@kb.cz

Michal Brožka
(420) 222 008 569
michal_brozka@kb.cz

Martin Gürtler
(420) 222 008 509
martin_gurtler@kb.cz

Jaromír Gec
(420) 222 008 598
jaromir_gec@kb.cz

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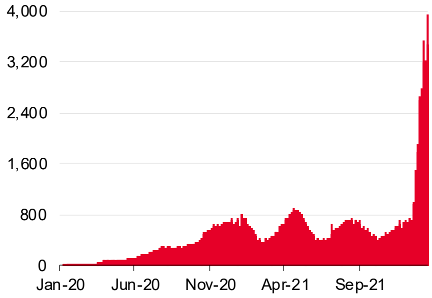
Automotives could surprise on the upside this year

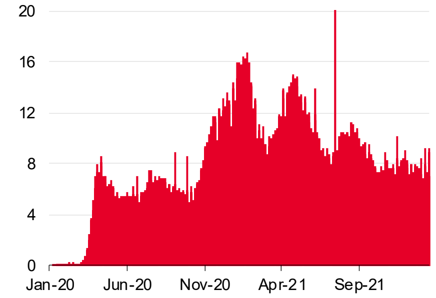
Jan Vejmělek
(420) 222 008 568
jan_vejmelek@kb.cz

Unfortunately, 2022 has so far been marked by a sharp deterioration in the pandemic situation, with dominant variant Omicron, proving to be the most infectious to date. Case numbers are reaching new highs across the globe. Meanwhile, in central Europe, the current wave looks set to peak in February. On the upside, Omicron seem less severe than prior variants and, as a result, combined with a high vaccination rate, the number of deaths does not seem to be rising. This does not mean that there has been no economic impact, however. Restrictions have been tightened in some countries in recent weeks, e.g. in Germany where stringent measures were introduced at the end of last year. But Czech businesses and households have learned to live with COVID over the last two years, as evidenced by economic growth in the second half of last year, which ultimately exceeded our forecasts. As a result, we now expect the Czech economy to return to its pre-pandemic levels a quarter earlier, i.e. in 2Q22 vs 3Q22 previously.

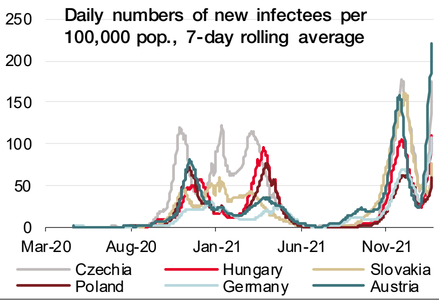
Daily new COVID cases, worldwide (000)



Daily deaths, worldwide (000)



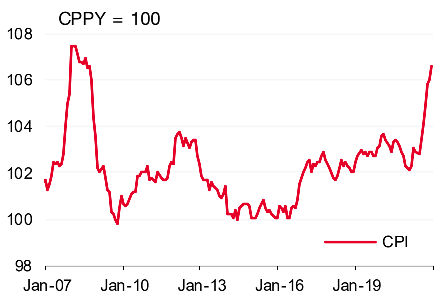
Daily new COVID cases, central Europe (000)



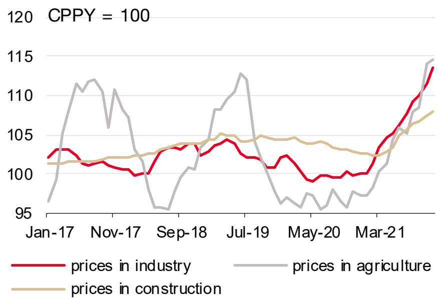
Source: Economic and Strategy Research, Komerční banka, Macrobond

The COVID pandemic has turned out to be a major inflationary factor. Government anti-pandemic measures have left negative imprints on global production chains, as they have made the movement of people and raw materials, production feedstock, and goods across national borders more difficult. Government and central bank expansive policies have also helped to boost demand. Thus, nothing short of a global swelling of inflationary pressures could be the result.

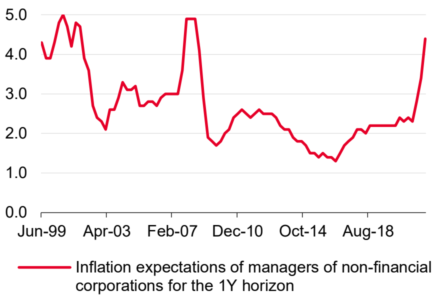
Czech prices rising at their fastest rate since 2008



Prices in primary areas are also increasing quickly



Unfortunately, inflation expectations are rising as well (%)



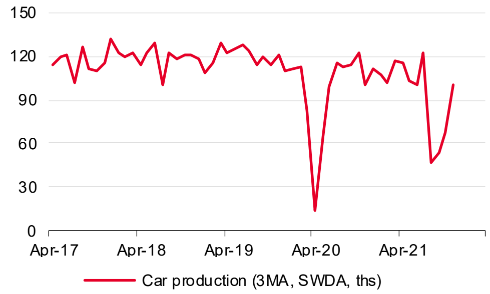
Source: Economic and Strategy Research, Komerční banka, Macrobond

To tackle inflation, measures must be taken quickly to bridge the gap between supply and demand. This should prevent inflation expectations from breaking loose, as were they to do so, this would be far more painful to resolve. However, keeping inflation in check will come at a cost. Meanwhile, inflation is clearly causing economic and social tensions, jeopardising the profitability of long-term investments, and disadvantaging savers, creditors, and fixed income households.

Central banks are likely to adjust their monetary policies fairly quickly. We believe the US Fed is likely to take the plunge and hike its interest rates towards the end of March, thereby launching a series of US dollar rate hikes. Meanwhile the Czech central bank, has been leading the way and already completed its monetary tightening to a large extent. We believe a last major hike of 75bp to 4.50% could well be announced at the CNB's next board meeting in early February, following which, we see scope for only minor adjustments, i.e. two more standard 25bp increases to a final 5.00%.

We firmly believe that the CNB will keep inflation in check by leveraging an unusually strong tightening in monetary conditions. We expect a quick and robust rise in interest rates (and thus also a more resilient koruna rate), statistical base effects, and the gradual easing of friction within global production chains to curb inflation relatively quickly. Our current forecast indicates that the Czech economy should return to the central bank's tolerance zone within a year or so. This means that we should see interest rates start to decline again as early as the end of this year.

Car production is getting its second wind



Source: Economic and Strategy Research, Komerční banka, Macrobond

Industrial economies, including the Czech economy are set to benefit from a stabilisation in the supply side of the economy and a gradual resumption of materials supplies. Thus the automotive sector could well surprise on the upside in 2022. Late 2021 brought the first signs of a gradual reduction in raw materials and production feedstock shortages. Although such issues are unlikely to be entirely resolved this year, we do expect to see marked progress on this front. For example, thanks to renewed chip deliveries, goods-in-progress and unfinished goods in car production plants will likely be rapidly completed and start to satisfy a hungry market in a context of huge demand for automobiles, including low-emission vehicles.

So, although we have not seen a particularly rosy start to the year due to Omicron and accelerating inflation, as our updated macroeconomic forecast shows, **2022 as a whole may ultimately be rated one of the successful ones**. We wish you a successful 2022 and hope you find our 1Q22 *Czech Economic Outlook* an interesting read.

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External environment and assumptions

Jana Steckerová
(420) 222 008 524
jana_steckerova@kb.cz

Inflation should decelerate

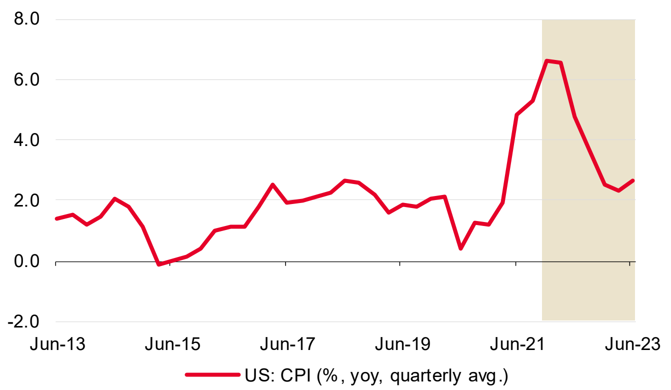
Inflation in both the US and the euro area exceeded all expectations during the last couple of months and was also the trigger for a change in economists' calls on key central banks' policies. Our view is that the Fed will hike rates for the first time as early as the March meeting, with tightening to continue until the key rate reaches 2.00-2.25%. At the same time, we expect the Fed to announce in September how it will normalize the balance sheet. For the first interest rate hike in the euro area, we will have to wait until December 2023, in our view. However, we expect the ECB to end its asset purchases as early as the middle of next year. The pandemic program is due to end in March. While last year the industrial sector was a source of disappointment, this year it could kick off renewed economic growth in the euro area, US and CEE economies. The shortage of production components should gradually diminish and totally disappear towards the end of 2022 or the early part of 2023.

US: first rate hike as early as March

Inflation has already peaked.

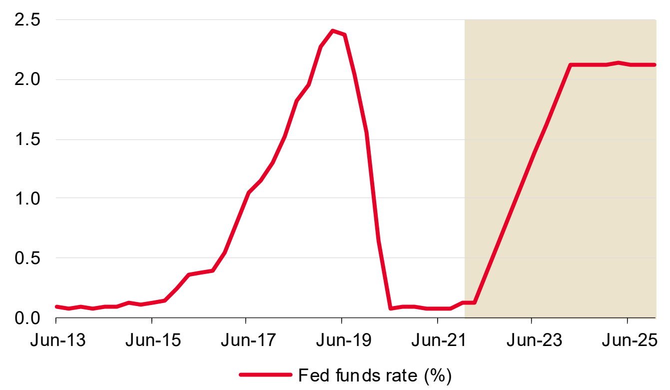
As in many other countries, inflation in the US has been breaking records in recent months. It rose to 7.0% yoy in December, reaching its highest level since 1982. Core inflation reached 5.5% yoy. Price growth was widespread and almost no item in the consumer basket escaped the trend. The price of used cars (up more than 20%), gasoline (+50% yoy), and even food and services were all up. Rents have the highest weight in the consumer basket and are of particular concern: if landlords were to include the current high inflation in longer-term contracts, the current price growth could prove more persistent. However, this is not part of our core scenario. This year, inflation is still likely to stay above 4% on average, but next year it should be only around 2.5%. In the longer term, we expect it to stabilize at 2.2%.

US: inflation should decelerate (%, yoy)



Source: SG Cross Asset Research/Economics

Interest rates to grow to 2.00-2.25%



Source: SG Cross Asset Research/Economics

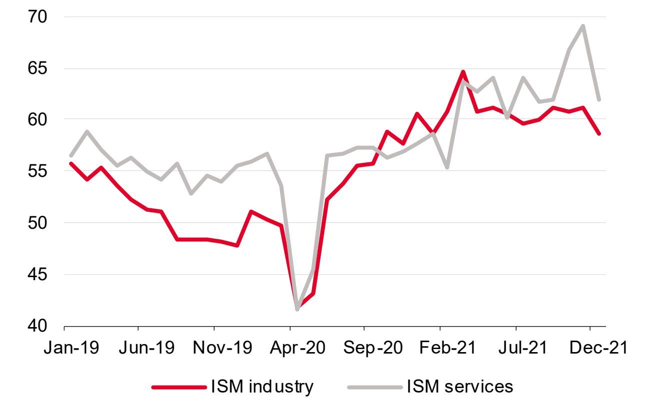
In September, the Fed should clarify how the normalization of the balance sheet will happen.

The US Federal Reserve responded to high inflation by accelerating the reduction in asset purchases (by $30bn per month instead of the original $15bn), and the outlook for interest rates also moved significantly upwards. The Fed's dot plot now assumes a triple hike this year, and in 2023, eight of the eighteen governors see four or more rate hikes, and ten expect three or less. For 2024, the dot plot expects rates to rise to 2.1%, four governors see the key rate even up to 2.9%, and one above 3.0%. So far, our forecast assumes three rate hikes this year. The first should come in March, the next in June and the last one in December. We have left our September meeting forecasts unchanged. We assume the Fed will proceed in the same way as in 2017 and use the September meeting to announce the normalization of the balance sheet – it is almost double the 2017 level (at $8.8tn). At the same time, however, the average maturity of instruments held by the Fed in its portfolio is shorter, which should allow normalization to be faster (we assume twice as fast) than in 2017-2018.

We do not expect rates to rise above the neutral level.

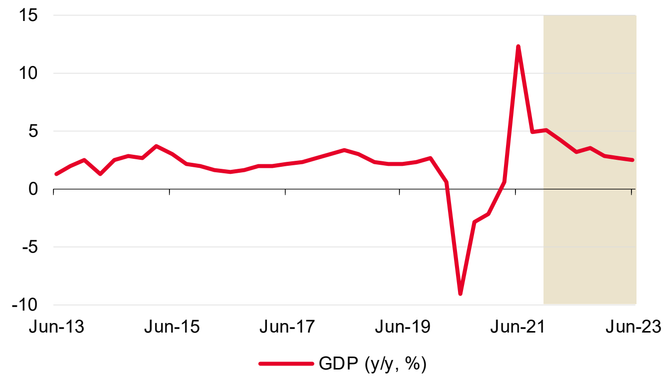
Our estimates have rates growing by 25bp every three months (except in September 2022), to 2.00-2.25%. While the market expects four rate hikes this year, in the longer term its expectations are still lagging behind our forecast and the Fed's forecast. At the same time, we do not yet assume that rates will go beyond equilibrium level (2.5%). This would only happen if current inflationary pressures proved to be more permanent. On the other hand, the effect of the Omicron variant represents a risk to our interest rates forecast. This also poses a risk to our GDP growth estimate (3.4% this year). But a bigger risk would be if Biden failed to secure approval for his infrastructure investment package. Overall, GDP growth should remain above trend this year. The labour market situation should improve further, which would support household consumption. The gradual disappearance of subcontracting problems should be seen in car sales, which have so far been missing on the market.

ISM indexes pointing to further expansion despite correction



Source: SG Cross Asset Research/Economics

GDP is likely to grow by 3.4% this year



Source: SG Cross Asset Research/Economics

Euro area: problems with supply bottlenecks to diminish

SG, January 2022	2021	2022	2023
GDP (%)	5.1	4.2	2.3
Inflation (%)	2.6	3.4	1.5
Core inflation (%)	1.4	1.7	1.5

Source: SG Cross Asset Research/Economics

ECB, Dec 2021	2021	2022	2023
GDP (%)	5.1	4.2	2.9
Inflation (%)	2.6	3.2	1.8
Core inflation (%)	1.4	1.9	1.7

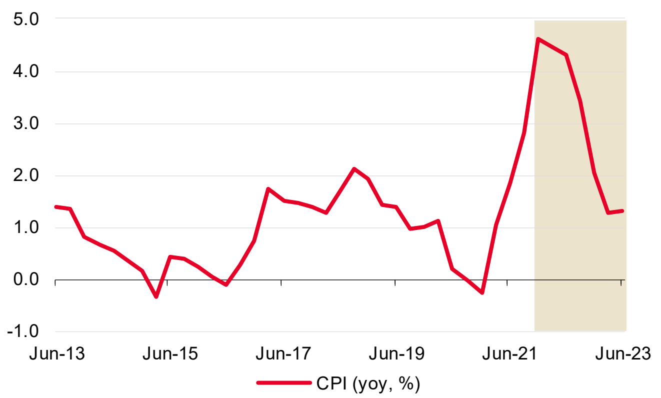
Source: ECB, SG Cross Asset Research/Economics

Inflation in the euro area has probably peaked (5% in December) and we expect it to gradually decelerate in the coming months. In our opinion, the three main factors behind its recent significant acceleration - subcontracting problems, energy prices and the comparison base - should subside. The price of oil, which we expect to average $77.5 per barrel this year, should also stabilize. Even so, in light of the already published data, we have revised our forecast upwards. In our new scenario, inflation should average 4.4% in 1Q and 4.2% in 2Q. It will probably remain above 3% until August this year, which will be a significant communication challenge for the ECB. By 4Q22, however, it should have already contracted to below 2%. It will probably remain below the ECB's target in 2023 and 2024. Core inflation (on average 2.1% in 1H) should be at higher levels in the first half of this year, but it is also likely to slow down. However, the risks are mostly tilted to the upside. Energy prices may not fall as fast as we expect. The Nord Stream 2 pipeline may not be approved, the harsh winter in China may increase demand and thus fuel prices, and OPEC may stop increasing production if it fears that Omicron could lead to a crippling of demand. Energy prices may thus remain under pressure this year as well.

We expect the ECB to raise rates for the first time in December 2023.

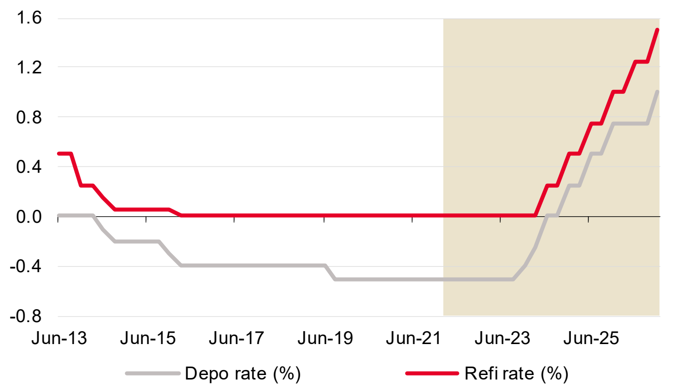
The ECB also published its new inflation forecast in December. It expects consumer prices to grow by an average of 3.2% this year and by 1.8% next year. In our opinion, this opens up room for a 10-point increase in the key deposit rate as early as December 2023 (so far our estimate was for the middle of 2024). In the course of 2024, we expect interest rate hikes by 75bp. The financial markets are already pricing a first increase in interest rates of 20bp this year, while the deposit rate should reach zero by 2023; in 2024, it should be roughly 75bp higher than the current level. This is in line with our expectations, but we see the first increase later, with faster tightening of monetary policy onwards. The ECB has also announced that it will end its pandemic asset purchase program in March, albeit mitigated by an increase in the APP program to €40bn per month (from April 2022, from the current €20bn). It will be reduced to €30bn in June and €20bn in September, and the program is expected to end in mid-2023. The pandemic maturing bonds will continue to be reinvested by the ECB (around €180bn a year).

Inflation should quickly return to below 2%



Source: SG Cross Asset Research/Economics

We expect the ECB to start hike rates in December 2023

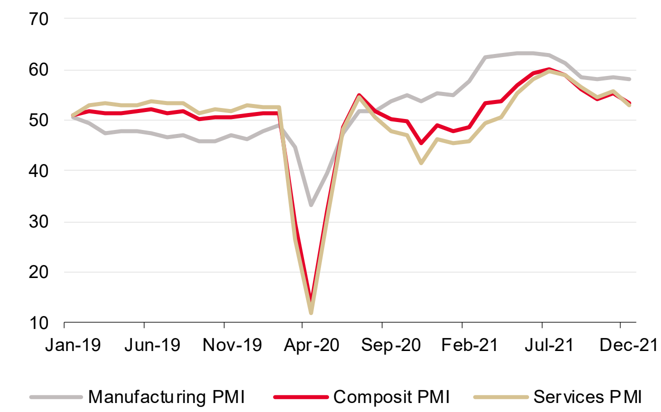


Source: SG Cross Asset Research/Economics

Dollar should benefit from faster monetary policy tightening in the US.

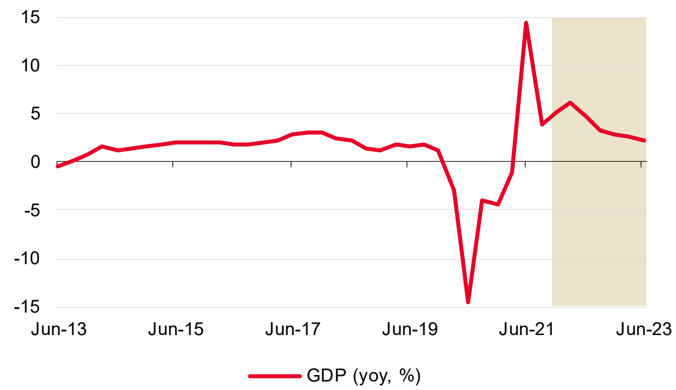
EUR/USD trends are highly correlated to the Fed and ECB's policies. The euro lost 8% vs the US dollar last year. Given the way in which monetary policy in the US and euro area is expected to diverge, the euro is likely to weaken further in the first half of this year. We expect it to fall below 1.10 in 1H. After that, the euro should start to strengthen slightly again.

PMIs corrected but still remain above 50bp threshold



Source: SG Cross Asset Research/Economics

GDP trends should remain solid (%, yoy)



Source: SG Cross Asset Research/Economics

Problems with bottlenecks should ease.

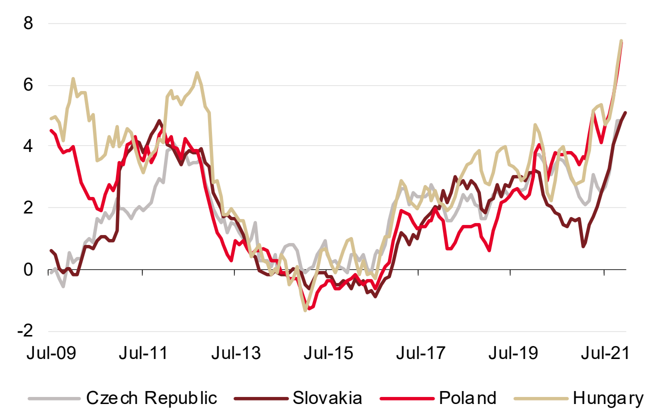
Last year, the euro area industrial sector suffered significantly under the weight of production component shortages. Its output was 1.5pp below the 2019 average. At the end of the year, however, the situation started to improve as car production began to grow again, while delivery times started to gradually shorten, according to PMI readings. Although the bottleneck issues are unlikely to disappear completely this year, but rather by the beginning of 2023, they should gradually ease. In contrast, industry, especially the automotive industry, could be a significant source of growth this year, as evidenced by full order books, deferred demand for cars and excess household savings, which we estimate at 6% of GDP. According to our forecast, GDP growth could reach a solid 4.2% this year and 2.3% next year.

CEE region: central banks should tighten monetary conditions further

Polish central bank set to continue hiking rates.

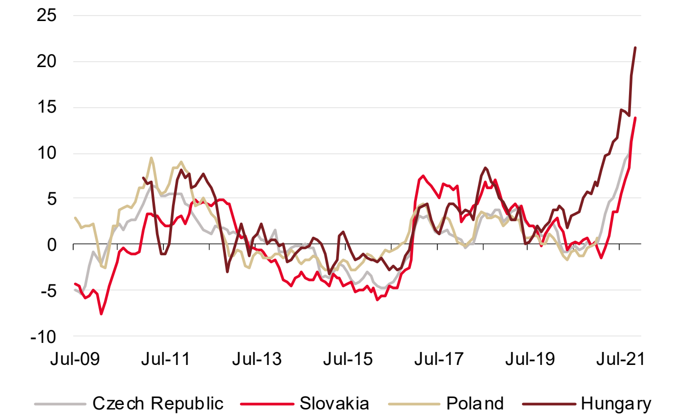
Inflation in the region failed to ease even in the final quarter of last year. Polish inflation rose to 8.6% yoy in December, well above the central bank's 2.5% target, with around 8% likely for the first half of this year. In December, the central bank responded by further tightening monetary policy by 50bp, which pushed the key interest rate to 2.25%. The central bank no longer considers inflationary pressure temporary but fears the pressure could be more permanent and robust. Therefore, we expect a further increase in interest rates of 75bp in February and March and of 25bp in April and May. As inflation risks are concentrated upwards, tightening might even be robust. The market currently expects rates to rise to just below 4%. We currently see them peaking at 4.25%. Either way, the Polish zloty should benefit from monetary policy and robust domestic growth (after GDP growth of 5.2% last year, the market expects 4.7% this year). The exchange rate should move from the current 4.50EURPLN to 4.35EURPLN during the year.

CEE region: inflation accelerated (%, yoy)



Source: SG Cross Asset Research/Economics

Fuel prices (%, yoy)

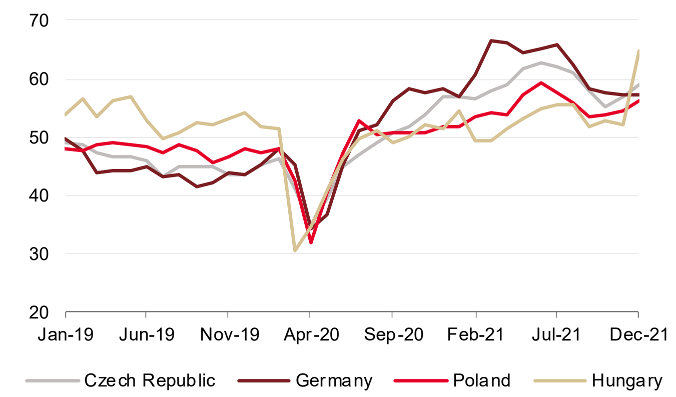


Source: SG Cross Asset Research/Economics

Hungarian forint should strengthen further.

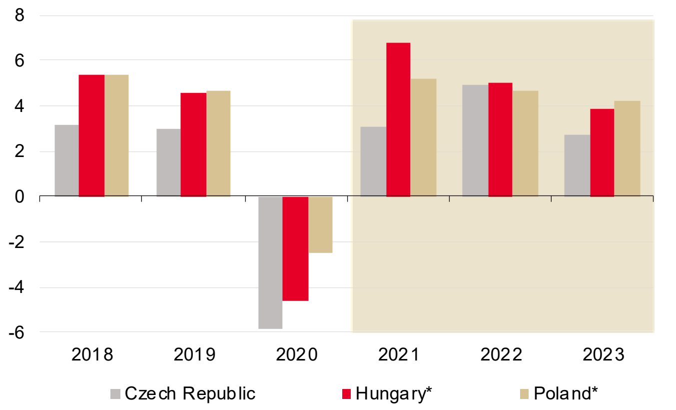
The Hungarian central bank also continues to tighten monetary policy. In December, the bank raised its key three-month deposit rate by 30bp to 2.40%, while announcing its intention to end its asset purchase programme. The bank raised its inflation forecast for this year significantly higher, from the original 3.4-3.8% to 4.7-5.1%. It will thus have to continue tightening monetary policy. During the first quarter of this year, we expect the key 3m deposit rate to rise by 30bp per meeting and in the second quarter it should increase only 15bp. The key rate should thus reach 3.75%. At the same time, the central bank expects solid GDP growth for this year in the range of 4.0-5.0%. This, together with higher interest rates, should help the Hungarian forint reach stronger levels. At the end of this year, according to our forecast, the exchange rate should be around 340EURHUF. The market is more sceptical in this regard and expects 357.5EURHUF.

PMI indices promise further expansion



Source: SG Cross Asset Research/Economics

GDP (%, yoy)



Source: SG Cross Asset Research/Economics, *Bloomberg consensus

Macroeconomic outlook

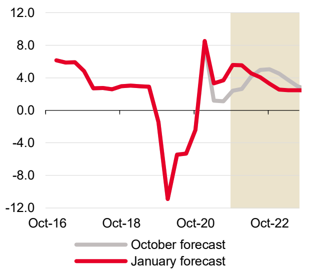
Michal Brožka
(420) 222 008 569
michal_brozka@kb.cz

Main changes

GDP:
For 2022, we have increased the GDP forecast to 4.9% from the previous estimate of 3.5%. In 2023, we expect the economy to grow by 2.7%.

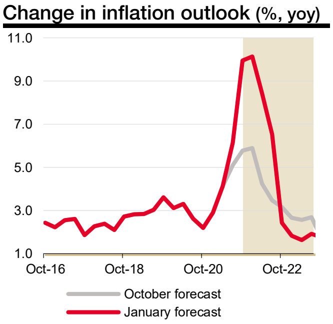
Inflation:
For 2022, we raised the inflation estimate to 8.8% from the previous 4.8%. Next year we expect it to average 1.9%.

Change to GDP outlook (%, yoy)



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Change in inflation outlook (%, yoy)

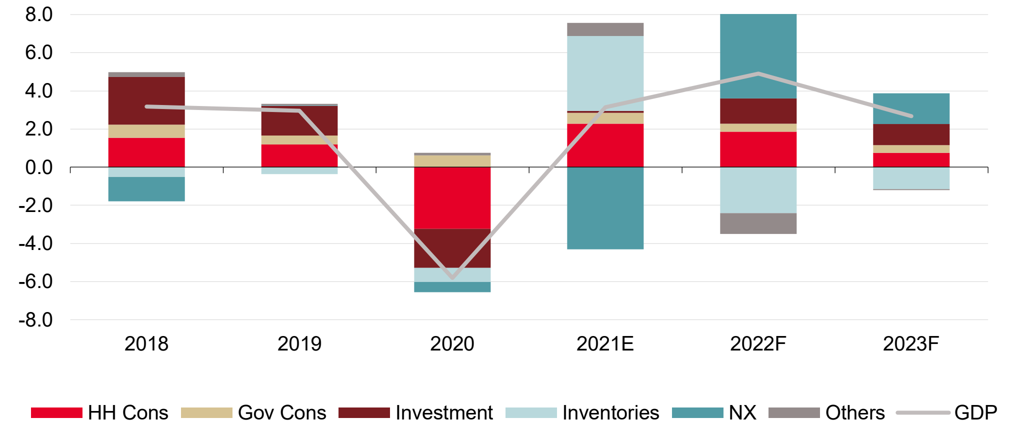


Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Soon to be at its pre-pandemic level

The economy faced a severe shortage of production components in the second half of last year, while fears of another wave of the coronavirus pandemic did not completely disappear. Nevertheless, GDP growth continued at a solid pace. Unemployment has fallen sharply again. Inflationary pressures have intensified, energy prices have rocketed and are now being passed on to consumers. This year's economic growth should be positively affected by the easing of difficulties in the supply of production components. This should, on the contrary, support the expected slowdown in inflation. The tightening of monetary policy will also contribute to this. However, the labour market will probably remain tight.

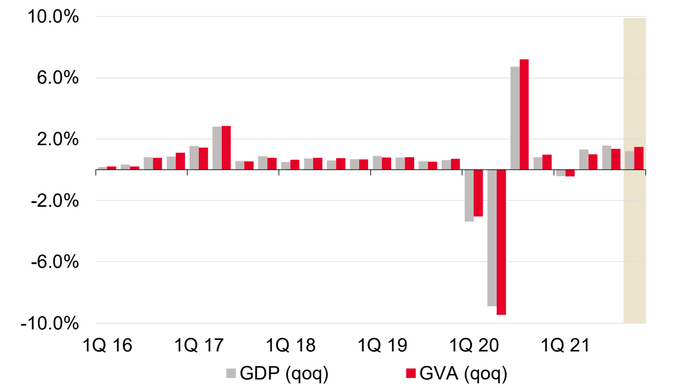
GDP growth will be driven by exports this year, real consumption will grow more slowly, inventories will fall (% yoy)



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

The economy is still facing a shortage of production components

GDP since 2Q 2021 continues to grow solidly



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Economic growth in the third quarter reached 1.6% qoq. Given the weak industry performance, which lacked production components and materials, this was a surprisingly good result. However, in the absence of high inventories, which are also related to missing production inputs, GDP fell nevertheless. Due to the lack of semiconductors, car production fell sharply in August and was less than half that of the previous year. In November, however, there was a strong increase in production inputs and, consequently, growth in industrial production. Therefore, a significant positive impulse to gross value added can be expected for the entire fourth quarter. On the other hand, economic growth may be dampened by lower inventory creation (storage removal of completed cars). **From the expenditure side point of view, consumer confidence declined during the fourth quarter.**

The reason was accelerating inflation, including a jump in energy prices against the background of the collapse of some of its suppliers. At the same time, there were growing concerns about the impact of another wave of the coronavirus pandemic via the Omicron variant. Nevertheless, there was no decline in retail sales until November, which was a real concern and we even observed an increase in the services sector. In summary, we expect quarter-on-quarter economic growth to slow to 1.2% in the fourth quarter, which would mean an acceleration in the year-on-year rate to 3.7% from the previous 3.3%.

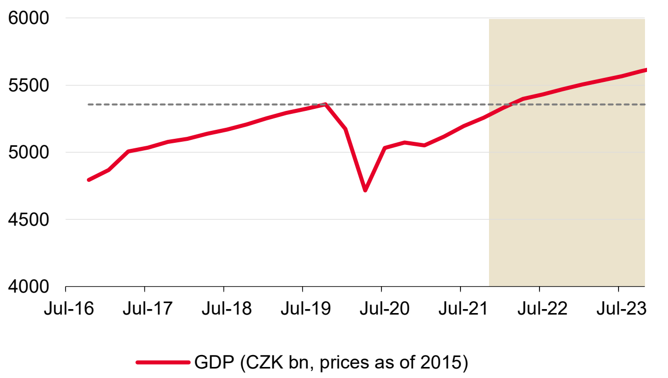
The return of production components and materials to production is a key assumption and a risk to the Czech economy's forecast.

The extent to which the supply of components to production will resume will still be crucial for developments in the coming quarters. In the October 2021 forecast, we assumed that the situation would improve only slowly in the first half of this year, and we did not expect the subcontracting problems to subside until the second half of 2022. This should allow for a significant increase in industrial production, especially car production, which also affects other industries and, in part, services. However, the uncertainty of this assumption is considerable – and the assumption of improved subcontracting is the main risk to this forecast.

Return of GDP to its pre-crisis level in 2Q this year

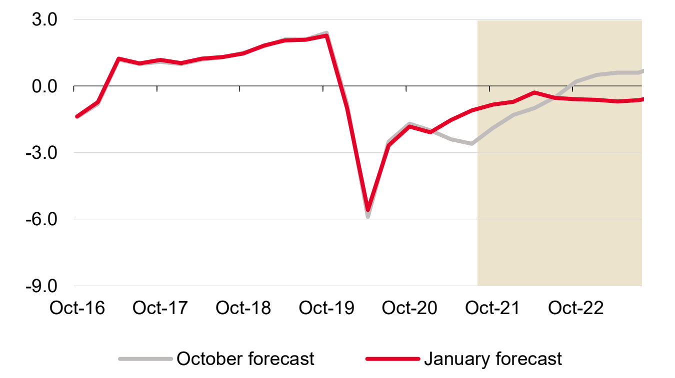
Faster economic growth in the second half of last year and the assumption of faster easing of supply chains should enable the pre-pandemic GDP level to be reached earlier than anticipated. We expect this in the second quarter, which is one quarter earlier than in the previous forecast. For the whole of 2021, economic growth should reach 3.1% and we expect an acceleration to 4.9% this year. The still relatively low comparison base will contribute to the high growth dynamics. In terms of the position of the economy within the cycle, we expect the gradual closing of the negative output gap during the first half of this year. In the previous forecast, however, we subsequently expected a slight opening of the positive output gap, while we now expect a slight opening of the negative output gap again until 2024. A tighter monetary policy in 2022–2023 will contribute to this development.

GDP to return to pre-crisis level in 2Q 2022 (CZKbn)



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Output gap remains slightly negative (%)



Source: Economic & Strategy Research, Komerční banka

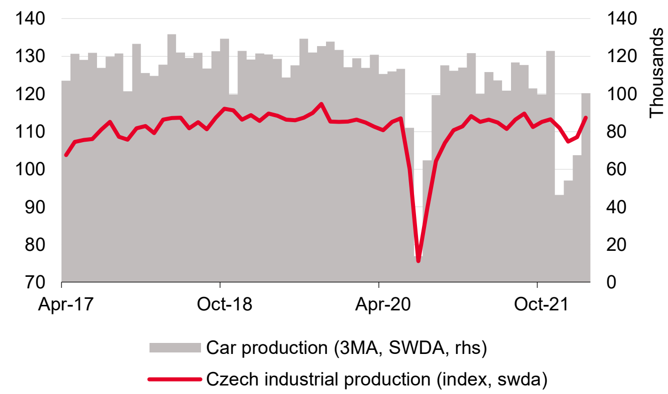
Semiconductor deliveries should give a boost to industry

Chips arrived for carmakers and production rose sharply. However, it is still significantly negative compared with the pre-pandemic level.

In November 2021, there was a sharp increase in industrial production by 4.5% mom. The key reason was the car manufacturing sector. Its production jumped to 6% growth year-on-year. However, compared with November 2019, this level was still almost by 15% lower. In this sense, the automotive sector still has some way to catch up. Overall, in 2022 the production of passenger cars decreased by 4.1% and exports by 4.7% compared with 2021. The decrease between 2020 and 2019 was 19.2% for production and 19.9% for exports. This development indicates how strong the growth could be in this sector, should the supply of materials and components, which are necessary for production – especially semiconductors –

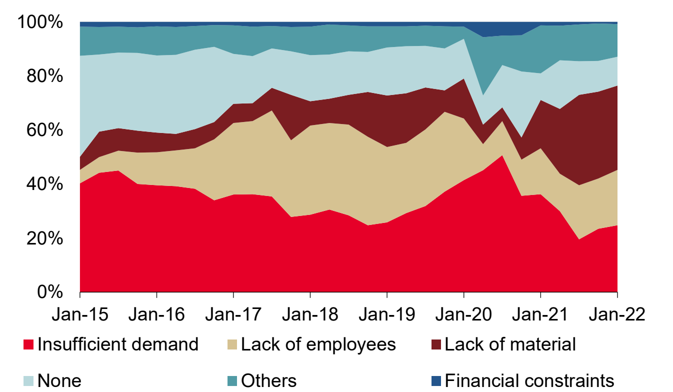
resume again. The largest Czech car manufacturer, Škoda Auto, has already announced the resumption of production and thus the early completion of tens of thousands of cars that have not been waiting in stock. Anecdotal evidence also speak of ample components until February. It is, of course, still very uncertain to predict how the delivery situation will continue in the longer run due to the global effects of the COVID-19 pandemic.

Car production bottoming out



Source: CZSO, Macrobond, AutoSAP , Economic & Strategy Research, Komerční banka

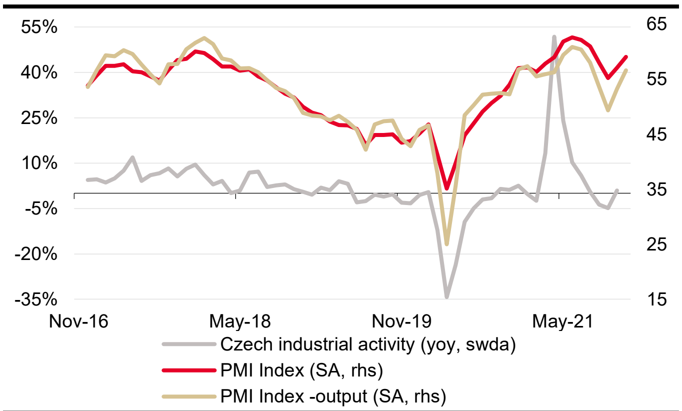
Barriers of growth in industry



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

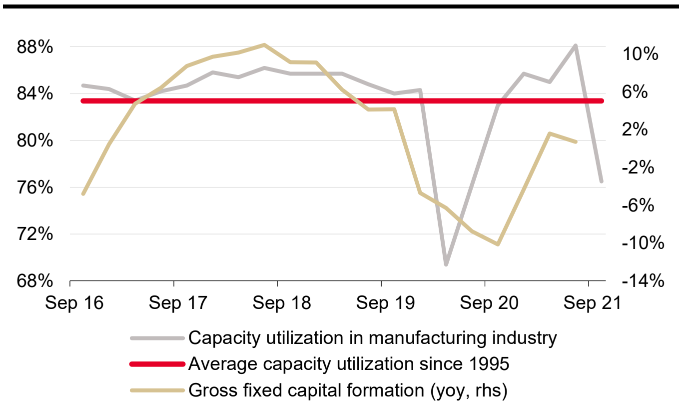
Overall, we estimate industrial production growth of 1.6% qoq in the fourth quarter. In the first quarter, we expect its quarter-on-quarter rate to be 3.4%. We expect expansion in the following quarters, but under conditions of sufficient supplies of production components. For the whole of this year, our forecast expects industrial production to grow by 7.8%. Last year's growth will be close to 8.5%, which at first glance seems like a strong figure, but it is compared against the first year of the pandemic and the general closure of the economy, including that of industry. **Let us recall that the pre-pandemic level of industrial production was reached already in the autumn of 2020. But since then, it more or less stagnated until the summer of last year. This was followed by further decline and strong growth only in November.**

Leading indicators show manufacturing expansion



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Capacity utilisation will draw a W shape

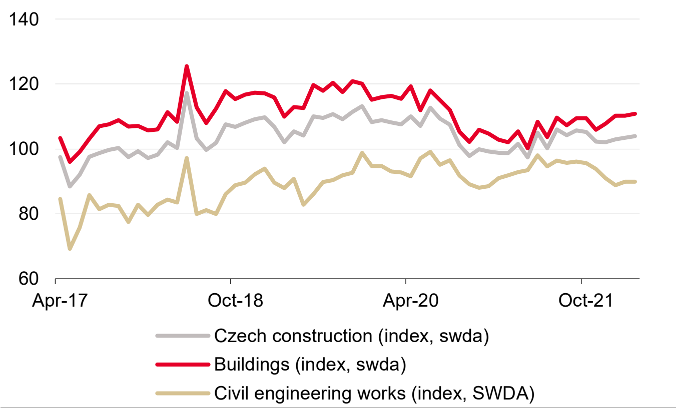


Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

The construction industry should be supported this year via improvement in the supply of materials as well as EU funds.

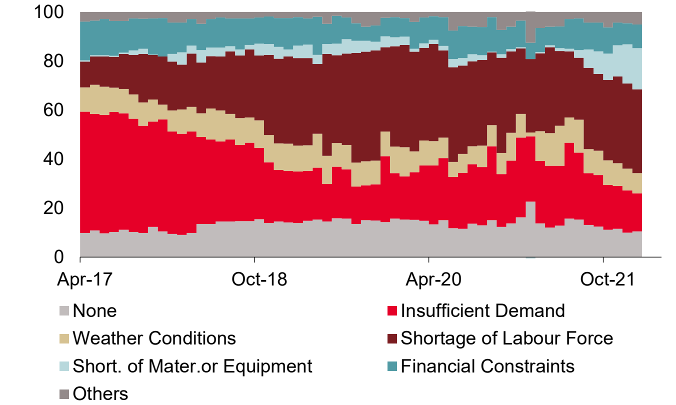
The lack of production materials in the second half of the year also had a negative effect on developments in the construction industry. Here, too, there was a slowdown in the second half of the year, with the prices of building materials rising at the same time. The year-on-year price growth rate of the construction materials at the end of 2021 was a high 17.0%. Meanwhile, the year-on-year increase in construction work prices also accelerated to 8.3%. We estimate that last year's construction output via the national accounts methodology grew at a rate of close to 1%. The expected alleviation of material supply problems should contribute to its faster expansion this year. EU funds and public investment will also make a significant contribution to this, as we described in more detail in the July issue of the forecast. The biggest limit will probably continue to be the shortage of staff. **We expect the growth rate of construction output to be 5.9% this year and more than 9% next year.**

On average, the construction industry has been stagnating



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Barriers to growth in the construction industry



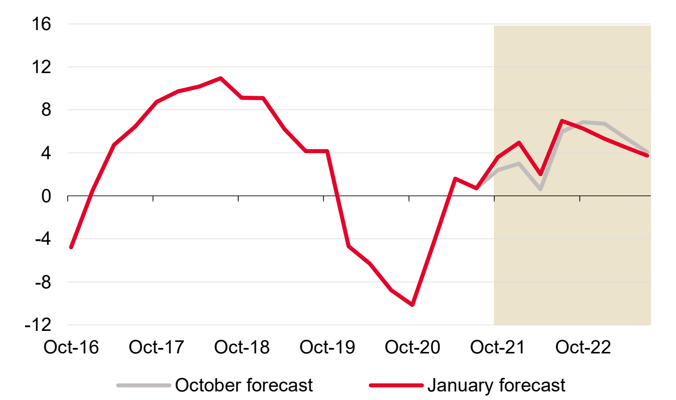
Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Household consumption is hampered by inflation

Growth in household consumption will slow this year.

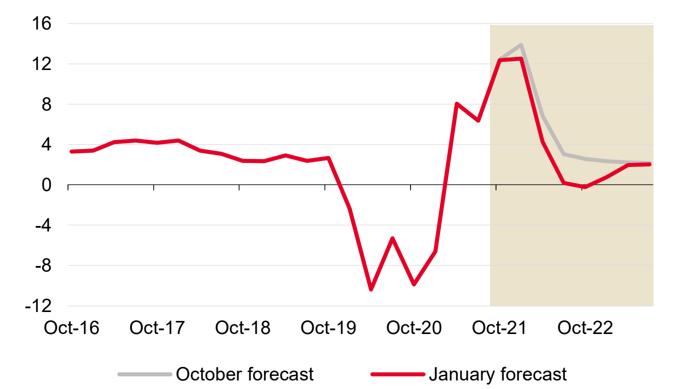
After the easing of anti-pandemic measures in the spring of 2021, household consumption increased rapidly. Its quarter-on-quarter real expansion was 7.2% qoq in the second quarter and 4.3% qoq in the third quarter. The fall in consumer confidence in the autumn of last year in connection with a sharp rise in energy prices and, in part, the increased pandemic risk, indicates a weakening of household spending. However, the development of retail trade and services until November tends to continue their growth at a slower pace. **For the whole of 2021, household consumption was probably the second biggest driver of economic growth, when inventory creation is likely to come first.** During this year, we expect a slower expansion of household consumption, especially in the first half of 2022. In real terms, we expect a slight decline even in 1Q and 2Q on a quarter-on-quarter basis, while households will be negatively affected by increasing inflation and fears of its further growth. Nevertheless, the contribution of households to this year's GDP growth will be the second highest on the expenditure side.

Investment expansion will accelerate (%, yoy)



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Inflation slowing down household consumption (%, yoy)



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

The main driver of GDP on the expenditure side should be net exports this year. The foreign trade balance contracted to almost zero last year, as deficits in its second half tightened the result. Our assumption of loosening supply chains and growing industrial production, including car production, should lead to a renewed increase in the trade surplus and thus make a strong contribution to GDP expansion. In the previous year, on the other hand, the development of exports in terms of contributions to GDP was the main brake on the economy. **In contrast to the weaker year of 2021 and the decline in 2020, we expect significant positive contributions, especially in the case of fixed capital investments.** This should be helped by the disappearance of subcontracting difficulties, as well as the cycle of EU funds, which we discussed in the previous forecasts. We expect investment to grow by 5.0% this year and by 4.2% next year. However, GDP growth compared to the previous year should be significantly limited by weak inventories.

In summary, we have increased the growth estimate of the Czech economy to 4.9% this year from the previously estimated rate of 3.5%. The main reason for this is the stronger development we saw in the economy in the second half of last year and the expected weakening of problems in subcontracting to production. **However, we have also reduced the forecast for 2023 to 2.7% from the previous 4.0%.** This is mainly due to the effects of the expected tighter monetary policy in 2022 and 2023.

Jaromír Gec
(420) 222 008 598
jaromir_gec@kb.cz

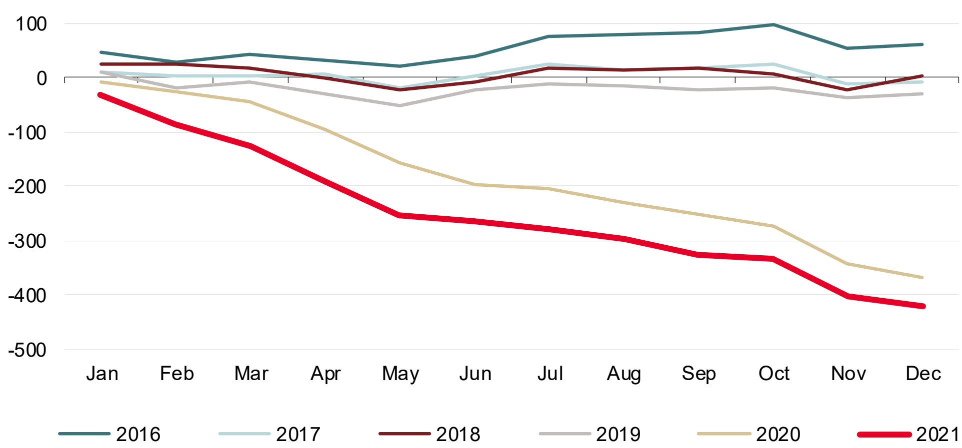
Fiscal policy: towards lower deficits

The state budget ended last year at a record deficit of CZK419.7bn, slightly deeper than we had forecast in October. The municipalities, however, ran a record surplus last year, while health insurers were hit hard by additional pandemic-related spending. For the time being, despite the current provisional budget, we expect a 2022 state budget deficit of CZK300bn. Combined with a continuing surplus at municipalities overall, this should reduce the public finance deficit to 3.9% of GDP this year, and the improvement looks set to continue over the coming years. We expect public debt to peak in 2024 at 43.5% of GDP.

Increased spending last year widened the deficit to a record level

The government ended last year with a deficit of CZK419.7bn (6.8% of GDP). Total revenues increased by 0.8% yoy and expenditures by 3.5%.

The state budget (CZKbn), 2016-21



Source: Finance Ministry, Macrobond, Economic & Strategy Research, Komerční banka

On the revenue side, although the amounts collected in corporate income tax and VAT increased, this was largely offset by lower personal income tax collection due to the abolition of the so-called ‘super-gross‘ salary and an increase in the taxpayer's rebate (MinFin estimates the impact of this change on the state budget to CZK56.7bn). The increase on the expenditures side was mainly due to a rise in social benefits, much higher transfers to health insurance companies, and a significant impact from pandemic-related support programmes.

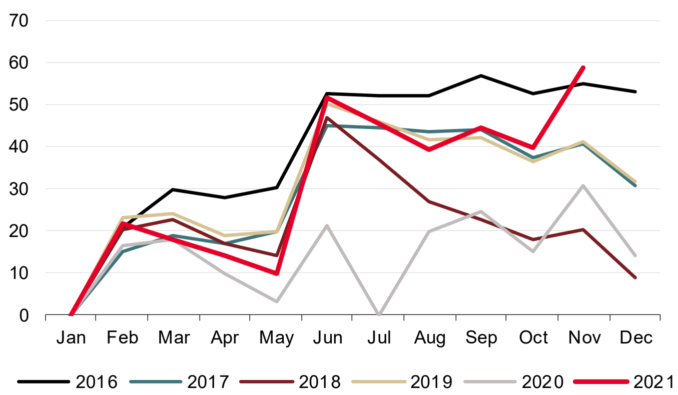
For the time being, we estimate a state budget deficit of CZK300bn this year. This is also in line with the Ministry of Finance‘s current expectations. The draft budget for this year should be presented by the end of February, so the current provisional budget could thus be replaced at the end of March. However, given the size of last year's budget, which is the starting point for the provisional budget, the situation does not pose a significant risk to the economy in our view.

Municipalities in record surplus in 2021, health insurers caught up in COVID

At the end of November, the municipal finances jumped to a record-high surplus of CZK58.6bn. Income tax and transfers from the state budget were the main contributors. At year-end, however, growth in some expenditures, particularly investments, tends to increase. Therefore, for 2021 as a whole, we expect the current surplus of municipalities to deteriorate to CZK50bn. This is CZK10bn higher than the 2021 surplus deficit that we had forecast in October. Next year, we expect the surplus to decrease to CZK40bn.

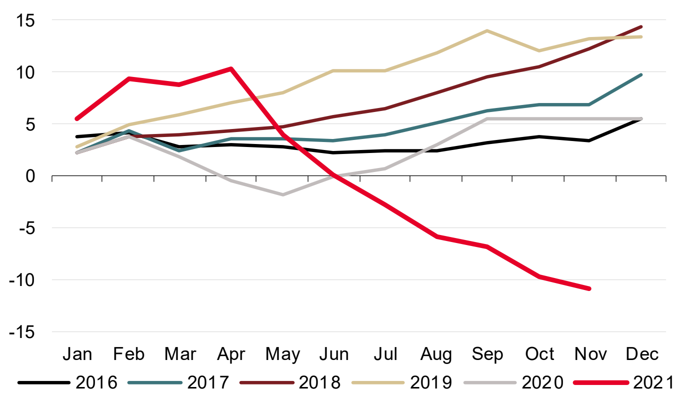
On the other hand, health insurers ran into deep deficit last year, due to increased pandemic-related costs and delays in reimbursement. The November figure showed a widening of the health insurers‘ deficit to CZK10.9bn, which is the worst result in history. We forecast last year's overall deficit at CZK12.5bn. This year, however, as the pandemic subsides, we estimate that health insurance companies should return to a small surplus of CZK5bn.

Municipal finances (CZKbn)



Source: Finance Ministry, Macrobond, Economic & Strategy Research, Komerční banka

Health insurers’ finances (CZKbn)



Source: Finance Ministry, Macrobond, Economic & Strategy Research, Komerční banka

We expect this year's public finances to end with a significantly smaller deficit than last year. And, the improvement in the government's finances looks set to continue in the coming years. We estimate that public debt will peak in 2024.

Public finance forecasts

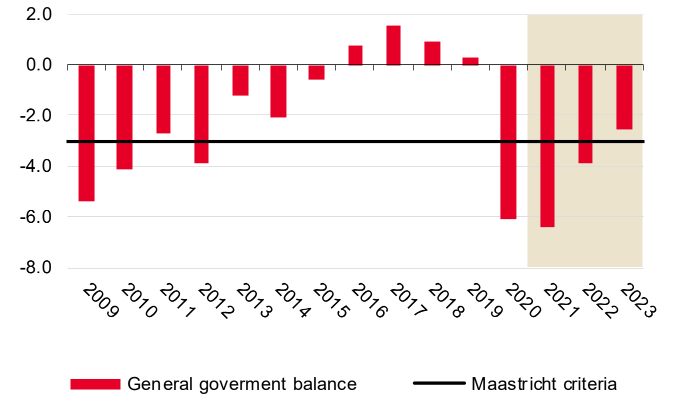
	2020	2021e	2022f	2023f	2024f	2025f
Balance (% GDP)	-6.1	-6.4	-3.9	-2.6	-1.5	-0.8
Fiscal effort (pp GDP)	-3.8	-0.9	1.7	1.0	1.1	1.3
Public debt (CZKbn)	2 153.0	2 572.7	2 872.7	3 097.7	3 247.7	3 347.7
Debt ratio (% GDP)	37.8	42.0	42.1	43.4	43.5	42.8

Source: CZSO, MinFin for published data, Economic & Strategy Research, Komerční banka for estimates

Public finance deficit – we expect 2021 to mark the peak

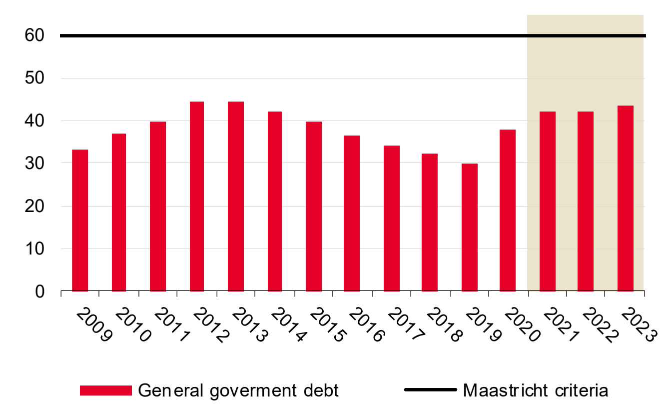
Due to the increased uncertainty associated with the provisional budget, our updated outlook for public finances as a whole reflects only modest adjustments. We expect the total deficit to reach 3.9% of GDP this year, based on the ESA 2010 methodology, which is 2.5pp less than last year. We see the main factor behind this reduction as better macroeconomic developments, leading to higher tax collection. The municipalities' traditional surplus should also continue to drive down the public finance deficit this year. We expect the gradual improvement in public finances to continue in 2023, when the deficit should decrease to 2.6% of GDP, on our estimates. For public sector debt, we forecast a slight increase to 42.1% of GDP this year and a further rise to 43.4% of GDP in 2023.

Public finance balance (% of GDP)



Source: CZSO, Economic & Strategy Research, Komerční banka estimate

Public debt (% of GDP)



Source: CZSO, Economic & Strategy Research, Komerční banka estimates

Michal Brožka
(420) 222 008 569
michal_brozka@kb.cz

The labour market remains very tight

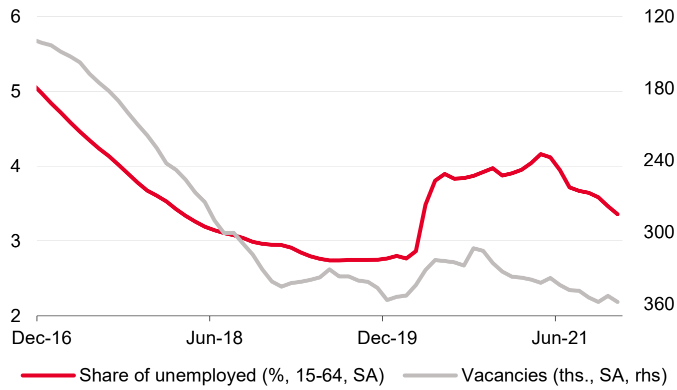
The expansion of the Czech economy has led to a further significant reduction in the unemployment rate and pushed the number of vacancies close to a record high. The unemployment rate is already below equilibrium, in our view, and we expect it to edge down further this year, before increasing slightly as early as 2023. The overheated labour market will probably put upward pressure on the average wage this year. We expect it to rise by a solid 7.5% this year; however, due to high inflation, even such a high nominal growth rate would represent a decline on a real basis.

The labour market is reaching its limits.

The seasonally adjusted unemployment rate in the MLSA methodology was 3.5% in December. On a year-on-year comparison, it was 0.5pp lower. Unemployment peaked at 4.2% in April last year and has fallen steadily since, as the economy has expanded and demand for new employees has risen. The decline in the unemployment rate over the past quarter was again slightly faster than in the previous forecast. After bottoming out in October 2020, the number of vacancies grew to a record 360,000 in September 2021. The reduction since then is only a consequence of the onset of winter, and after seasonal adjustment the level is even up slightly. Based on ILO methodology, the unemployment rate was 2.2% in November. As we estimate the equilibrium unemployment rate at around 3%, this would seem to indicate an overheating labour market. Therefore, aside from the implications this has for wage development and thus inflation, and consequently for monetary policy, we believe that the scope for a decline in the unemployment rate this year is relatively small. **Based on the MLSA methodology, we expect the share of the number of unemployed to be slightly below 3% in the spring months. In contrast, in 2023 we expect a slight increase due to the economic slowdown that we anticipate.**

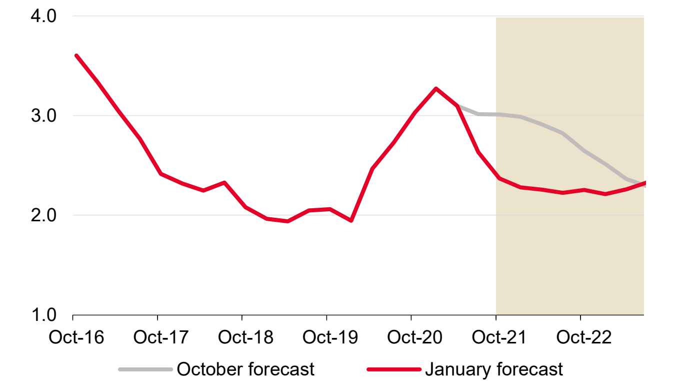
The growth in the average wage slowed to 5.7% year-on-year in 3Q21, from 11.4% in 2Q21. Both the private and public sectors contributed to the growth. However, the quarter-on-quarter wage growth rate accelerated slightly (by 30bp) in 3Q to 1.5%. The reason for the year-on-year slowdown was the higher base effect from the 3Q20, when the economy experienced a significant recovery, as well as the fading effect of the second round of extraordinary bonuses paid during 2Q21 in health and social care. In 4Q21, we expect the increase in the average wage to have slowed slightly qoq. For 2021 as a whole, we estimate the increase in the average nominal wage at 6.4%, i.e. an increase of 2.5% after adjusting for inflation. The main driver was probably the public sector.

Number of vacancies at a record high (MLSA)



Source: MLSA, Macrobond, Economic & Strategy Research, Komerční banka

Little room for further unemployment reduction (%, SA, ILO)

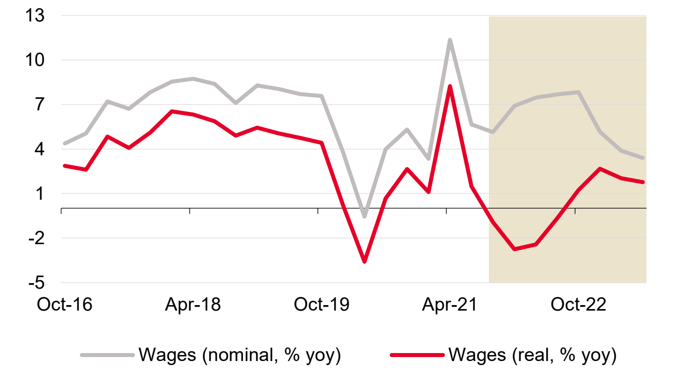


Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

This year, growth in the average wage is likely to be driven mainly by the private sector.

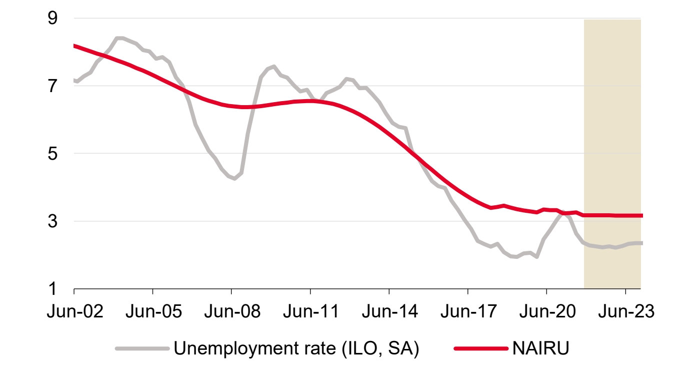
This year, the private sector is more likely to be the main contributor to wage growth, although wage negotiations do carry considerable uncertainty. In the case of the public sphere, the government intends to increase the wages of healthcare workers by 6%, and to give teachers a rise of c.2%. Those employed in other public-sector professions, such as the army and the police, are to receive an additional CZK700, while the salaries of public officials have been frozen. It is thus likely that wage growth will be driven more by the private sector this year, which is facing increased wage demands due to a tight labour market and rising inflation. On the other hand, given the current situation and uncertain outlook faced by many companies, wage growth is unlikely to outpace inflation. Trade unions are also likely to take the difficult situation at companies into account, to some extent, in wage negotiations. The wage differences between sectors are thus likely to increase significantly this year.

Avg. real wage will probably decline in 2022 (%, yoy) ...



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

... while upward pressure on nominal wages is increasing (%)



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

On average, we expect the average wage in the Czech Republic to grow by 7.5% this year, which, with estimated inflation of 8.8%, would mean a real decrease of 1.2%. If this year's nominal wage growth rate was significantly higher, this would imply the need for even tighter monetary policy. Next year, we expect real wage growth to average around 2%, mainly due to a slowdown in inflation.

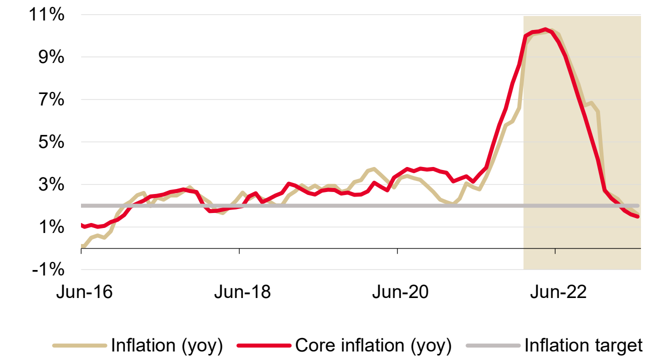
Inflation is heading towards 10%

We expect another significant increase in consumer prices at the beginning of this year. Year-on-year consumer price inflation is likely to be close to 10% in the first half of 2022. The uncertainty of price developments at the beginning of the year is considerable. In the second half of 2022, we expect a significant slowdown in inflation from high levels. The key prerequisite is that the easing of problems with the supply of goods and components to production.

Core inflation accelerated further.

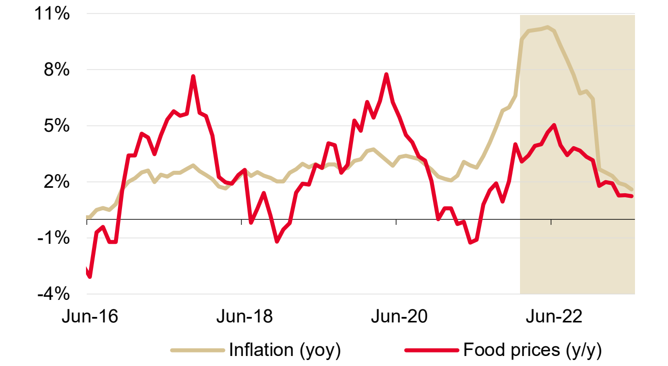
Year-on-year consumer price inflation accelerated to 6.1% in the fourth quarter, from 4.1% in the previous quarter, beating all estimates again. Importantly, growth in core prices, which do not include volatile food and energy items, has accelerated further. Their annualized month-on-month growth reached more than 12% (SA) in the fourth quarter. Year-on-year growth at the end of last year was 8.6%. Given that many companies are changing price lists at the beginning of the year and a large number of them have announced increases, we expect a further increase in the month-on-month annualized dynamics of core inflation in the first months of this year above 15% (SA). The year-on-year rate would thus move above 10%. The prices will be further affected by previous price increases for producers, as companies try to pass on part of the increased costs, as well as by the effect of growing demand due to the tight labour market and nominal income growth. A strong impact from housing costs can still be expected, even without regulated energy prices. So-called imputed rents, whose contribution to year-on-year inflation has been slightly over one percentage point in recent months, will also contribute to this. The uncertainty of price developments at the beginning of the year is very high, and we could easily see large surprises. The dynamics are likely to remain above average in the coming months, but we expect inflation to weaken significantly in the second half of the year. The reasons are the global easing of problems in production chains, which have so far manifested themselves in limited supply, as well as tighter monetary policy and a slowdown in real estate price growth. The risk in the direction of faster growth in consumer prices would be a more pronounced spillover of higher inflation into nominal wage growth.

Year-on-year inflation will rise to 10%



Source: CZSO, CNB, Macrobond, Economic & Strategy Research, Komerční banka

Rise of food prices will also accelerate



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

For the rest of the year, we assume the price of oil to decline below USD80/barrel (Brent).

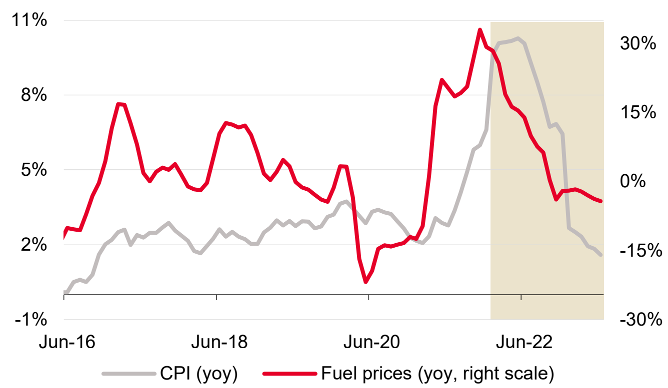
The price of Brent crude oil averaged less than USD80/barrel during the fourth quarter, which was in line with our expectations. Although SG has increased the expected price of oil for this year, a slight reduction to USD75/barrel during the year is still expected, in line with the market consensus. Despite the expected strengthening of the dollar, the oil price trend should gradually begin to have a disinflationary effect. It should be added, however, that at the beginning of January the price of oil rose to near USD90/barrel and indicates a pro-inflation risk, especially in relation to other energy prices (particularly gas), whose supplies may be threatened this winter.

Growth in food prices was relatively weak last year, at less than 1% on average. By the end of the year, however, the rise had accelerated slightly. At the beginning of this year, we anticipate a more significant increase in food prices, which in many cases has already been announced by producers who are responding to rising costs, including higher energy prices. We expect food prices to increase by an average of 4% for the whole year. Recall that food prices are highly volatile, and the reports of some producers from the beginning of the year indicate a pro-inflation risk in the event of a significant rise in prices.

Energy prices will rise more than 20% this year.

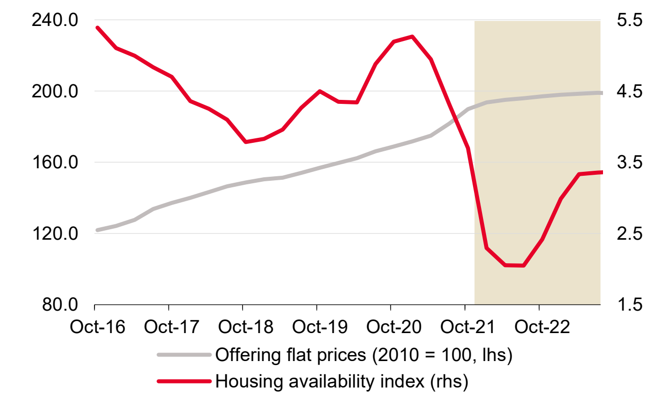
We addressed regulated energy prices in more detail in the previous quarterly forecast in October 2021. Even then, it was clear that strong growth in market energy prices would be passed on to consumers, which would be fully reflected in January. In connection with the policy response at the time, we assumed a temporary switch to a reduced VAT rate after the waiver of VAT payments for energy. That didn't come true. The VAT remission had a negative impact on annual inflation of around one percentage point. For the inflation in January, we will see the exact opposite effect, and in fact suppliers' announcement suggest that there will be increases. Transfers between suppliers may still affect the price development. Overall, however, we have moved in the direction of even higher energy price growth since October, based on announced price lists and trends in market prices. **Before the end of the year, there was another strong increase in energy prices, especially gas. However, the prices of electricity and emission allowances also remain higher.** For this year, the growth of electricity prices could reach 26%, while gas prices could grow as much as 24%. Year-on-year data at the end of the year will be strongly affected by last year's VAT remission. After this year's price jump, we expect slightly lower growth for 2023, but generally we expect a faster upward trend due to the move towards "green" energy, which has a higher price (excluding externalities) and lower reliability. **Another factor that will increase inflation is traditionally higher excise taxes on tobacco and alcohol.** There is a possibility of higher growth for the coming years, which would imply the need for higher interest rates, but considering the above uncertainties, this is currently a secondary effect.

Gas pump prices increased further



Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Slower rise of the real estate prices should contribute to CPI deceleration



Source: CZSO, CNB, Macrobond, Economic & Strategy Research, Komerční banka

In summary, we expect year-on-year inflation to peak in the period from April to May this year at levels slightly above 10%. The loosening of consumer supply chains should lead to lower financial pressures in both the domestic economy and globaly, which also implies low "imported" inflation. For the euro area, we assume an average inflation rate of 3.5% this year and undershooting of the 2% ECB inflation target in 2023. Among domestic factors, a significant deceleration in construction and real estate price growth should also contribute to the slowdown in inflation, which will be reflected in a lower contribution from imputed rents. **The expected easing of price pressures should lead to significant disinflation, especially**

in the second half of this year. At that time, moreover, its year-on-year expression will meet the growing base from this year, and we should see a rapid decline. However, we do not expect a return below 3% yoy before the end of 2022.

Overall, we estimate that inflation will average 8.8% this year and decelerate to 1.9% next year. For core inflation, we estimate a rate of 8.3% this year and 2.0% next year.

Risks: component shortfall still the focus

We assume that with the vaccination of a significant part of the population (63%), plus natural immunity, the risks of a further negative economic impact from the pandemic are significantly reduced. The main risks we see include:

- **Problems in supply chains.** We anticipate that problems in the supply of components and materials to production will weaken over the course of this year. A further deterioration or delay in this development would negatively affect the outlook for the economy and could lead to higher price pressures, and possibly have a negative impact on the Czech koruna.
- **Price development and its effect on economy.** Uncertainty regarding price development has increased. The impact of current high inflation on inflation expectations, wages and the real economy is also a risk. Price developments, especially in the case of gas, could be adversely affected by the looming conflict between Russia and Ukraine.
- **Capital outflows from emerging markets.** The tightening of the US Fed's monetary policy may bring significant changes in global capital flows and contribute to higher volatility in foreign exchange markets. This could affect the exchange rate of the Czech koruna, impacting interest rates and inflation.
- **Fiscal policy.** The new government promises fiscal consolidation. If it pushes through more restrictive budgets for 2023 and beyond than we anticipate, this will imply lower interest rates or a greater strengthening of the Czech koruna against the euro than we anticipate.
- **Price development after the pandemic.** In our baseline scenario, we do not expect sectors of the economy to close again. However, the pandemic remains a risk. Further pandemic waves could exacerbate problems in supply and demand chains, with a negative impact on GDP and a positive impact on inflation.

Summary forecast table

	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	2020	2021	2022	2023	2024	2025
GDP and its breakdown														
GDP (real, yoy)	3.3	3.7	5.6	5.5	4.5	4.0	3.3	2.5	-5.8	3.1	4.9	2.7	2.5	2.5
Household consumption (real, yoy)	6.4	12.4	12.5	4.3	0.2	-0.2	0.8	1.9	-7.0	4.9	3.9	1.7	1.6	2.5
Government consumption (real, yoy)	3.6	1.0	1.7	2.7	2.2	1.7	2.1	2.0	3.4	2.8	2.1	2.0	1.6	1.7
Fixed investments (real, yoy)	0.7	3.6	5.0	2.0	7.0	6.3	5.3	4.5	-7.5	0.4	5.0	4.2	4.4	3.6
Net exports (contribution to yoy)	-8.2	-7.9	0.9	4.7	7.6	6.0	1.9	2.0	-0.5	-4.3	4.8	1.6	0.2	0.1
Inventories (contribution to yoy)	6.6	3.8	-0.9	-1.0	-4.6	-3.1	-1.8	-2.1	-0.7	3.9	-2.4	-1.2	0.1	-0.1
Monthly data from the real economy														
Foreign trade (CZK bn)	-53	-22	35	21	4	12	44	37	180	5	72	120	129	122
Exports (nominal, yoy)	3.6	4.4	3.0	4.1	11.6	4.8	6.6	2.8	-5.7	13.5	5.8	3.9	3.9	3.3
Imports (nominal, yoy)	17.0	15.8	6.5	3.6	5.1	1.5	5.9	1.3	-6.9	19.5	4.1	2.8	3.8	3.6
Industrial production (real, yoy)	-1.3	1.9	4.4	7.0	11.0	8.7	6.8	1.4	-7.1	8.5	7.8	3.1	3.5	2.6
Construction output (real, yoy)	1.3	4.1	-5.2	6.6	10.3	12.1	15.0	9.0	-5.1	0.8	5.9	9.4	4.8	2.1
Retail sales (real, yoy)	3.6	9.5	10.0	1.7	2.1	0.5	2.5	2.7	-0.6	4.8	3.6	2.1	1.6	2.8
Labour market														
Wages (nominal, yoy)	5.7	5.1	6.9	7.5	7.7	7.8	5.2	3.9	3.1	6.4	7.5	3.9	3.5	5.3
Wages (real, yoy)	1.5	-0.9	-2.8	-2.4	-0.7	1.2	2.7	2.0	0.0	2.5	-1.2	1.9	1.9	3.3
Unemployment rate (MLSA)	3.5	3.5	3.5	3.0	3.1	3.4	3.4	3.0	3.6	3.7	3.2	3.3	3.4	3.4
Unemployment rate (ILO 15+)	2.7	2.4	2.3	2.2	2.4	2.2	2.3	2.2	2.6	2.8	2.3	2.3	2.4	2.5
Employment (ILO 15+, yoy)	0.4	0.7	1.7	1.8	0.8	0.9	0.1	0.1	-1.3	-0.3	1.3	0.0	-0.1	-0.1
Consumer and producer prices														
CPI Inflation (yoy)	4.1	6.1	9.9	10.1	8.4	6.5	2.4	1.8	3.2	3.8	8.8	1.9	1.6	1.9
Taxes (contribution to yoy inflation)	0.2	-0.7	0.3	0.2	0.2	1.0	0.3	0.4	0.0	-0.1	0.4	0.4	0.1	0.1
Core inflation (yoy) (*)	4.8	7.7	10.0	10.1	8.2	5.1	2.4	1.8	3.4	4.8	8.3	2.0	2.1	2.0
Food prices (yoy) (*)	1.4	2.3	3.5	4.6	3.6	3.5	1.9	1.3	4.5	0.8	3.8	1.2	0.5	1.3
Fuel prices (yoy) (*)	19.4	29.6	24.6	16.8	9.9	-0.3	-1.3	-3.9	-11.4	15.3	12.8	-2.9	-2.2	-0.6
Regulated prices (yoy)	0.3	-0.9	9.3	10.0	9.7	12.4	2.2	1.6	3.2	-0.1	10.4	1.9	2.1	2.5
Producer prices (yoy)	9.0	12.8	12.2	10.4	7.1	3.4	1.8	1.0	0.1	7.1	8.3	1.3	1.4	1.8
Financial variables														
2W Repo (%, average)	0.7	2.3	4.2	4.8	5.0	4.3	3.6	2.6	0.8	0.9	4.6	2.8	2.5	2.5
3M PRIBOR (%, average)	0.9	2.8	4.6	5.1	5.1	4.3	3.5	2.7	0.9	1.1	4.8	2.9	2.7	2.7
EUR/CZK (average)	25.5	25.4	24.5	24.8	25.0	24.8	24.8	24.7	26.5	25.7	24.8	24.6	24.0	23.8
External environment														
GDP in EMU (real, yoy)	3.9	5.2	6.2	4.8	3.2	2.8	2.6	2.3	-6.5	5.6	4.3	2.3	1.9	1.6
GDP in Germany (real, yoy)	2.5	2.5	5.7	4.9	3.7	3.4	2.7	2.0	-4.9	3.0	4.4	2.0	1.6	1.4
CPI in EMU (real, yoy)	2.8	4.6	4.4	4.2	3.3	2.0	1.3	1.4	0.3	2.6	3.5	1.5	1.5	1.7
Brent oil price (USD/brl, average)	74.8	78.2	80.0	80.0	75.0	75.0	74.9	75.0	42.4	70.2	77.5	75.1	75.9	77.2
EURIBOR 1Y (%, average)	-0.5	-0.5	-0.4	-0.3	-0.2	0.0	0.2	0.4	-0.3	-0.5	-0.2	0.5	1.2	1.8
EUR/USD (quarter eop, year average)	1.18	1.15	1.11	1.09	1.10	1.10	1.12	1.14	1.14	1.18	1.10	1.15	1.20	1.24

Source: CZSO, MLSA, Bloomberg, Macrobond, Economic & Strategy Research, Komerční banka
Note: (*) these parts of inflation are adjusted for the primary effect of indirect tax changes

CNB Focus

Martin Gürtler
(420) 222 008 509
martin_gurtler@kb.cz

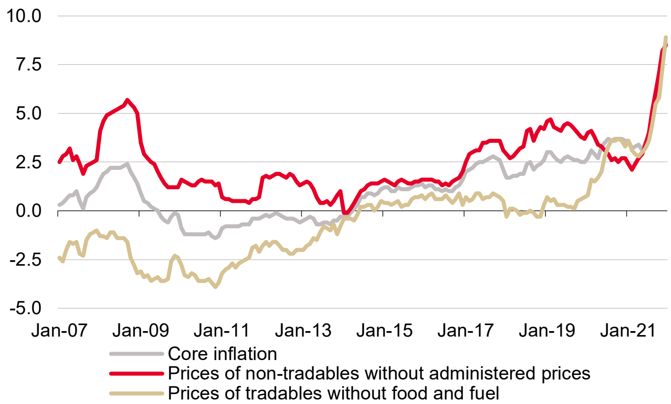
Interest rates at 5% only a matter of time

The central bank is likely to continue raising interest rates in the coming months. At the next meeting in February, we expect it to hike the repo rate by another 75bp. This should be followed by two standard 25bp hikes in March and May, bringing the repo rate from the current 3.75% to a peak of 5%. The reason for further monetary policy tightening is the persisting inflationary pressures. However, we expect these to weaken significantly in 2H22. As a result, the CNB is likely to start cutting rates by the end of this year. In 2Q23, we already foresee a repo rate close to the policy neutral 2.5%. Otherwise, inflation could undershoot the target next year.

At its December meeting, the central bank raised interest rates by 100bp, double its November forecast. The reason was inflation, which in December was one percentage point higher than the CNB expected.

The Czech National Bank continues to raise interest rates rapidly due to elevated inflation. At its last meeting in December, it raised the key repo rate by a full percentage point to 3.75%. This was again above the market consensus. Over 2021, interest rates rose by a substantial 350bp. However, inflation accelerated even faster. In December it reached 6.6% yoy, the highest since 2008, even though at the beginning of 2021 it was close to the central bank's target of 2%. In its latest forecast in November, the CNB expected inflation to increase further in 4Q21, but to a lesser extent. In December, inflation was one percentage point higher than the CNB forecast. This was the main reason why the central bankers raised the repo rate more than indicated by their forecast, which called for a 50bp hike.

Core inflation accelerated further to 8.6% in December, with prices of both services and goods rising rapidly (%, yoy)



Source: CZSO, CNB, Economic & Strategy Research, Komerční banka

Based on the CNB's survey, non-financial corporations expect inflation above 4% at both one and three-year horizon (%, yoy)

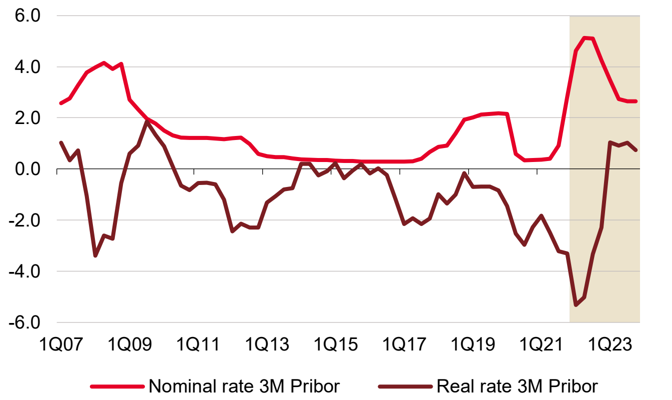
Source: CNB, Economic & Strategy Research, Komerční banka

Inflation expectations continue to rise with inflation. According to the CNB's December survey, non-financial corporations expect inflation of 4.4% yoy at the one-year horizon and 4.2% yoy at the three-year horizon, versus 3.4% and 3.6% in September. There was therefore another significant increase in inflation expectations in 4Q21. This reflected the ongoing rapid growth of production costs and the tight labour market. Producer prices in the euro area, which the central bank uses as the main indicator of imported inflation, have been well above its forecast in recent months. In December, the CNB thus revised its assumption of growth in foreign producer prices from 6.0% yoy to 8.4% yoy this year, with a revision of last year's growth from 9.0% to 10.5%. Compared to the CNB forecast, the weaker Czech koruna has also contributed to higher imported inflation. In 4Q21, the exchange rate averaged EUR/CZK25.37, while the central bank expected EUR/CZK25.00, a 1.5% stronger level. Moreover, the development of import prices remains uncertain due to highly volatile commodity prices, especially electricity and natural gas.

The CNB expects inflation to be close to 10% at the beginning of this year. According to central bank, the yoy growth in consumer prices should reach 9.2% in January and accelerate further to 9.6% in February.

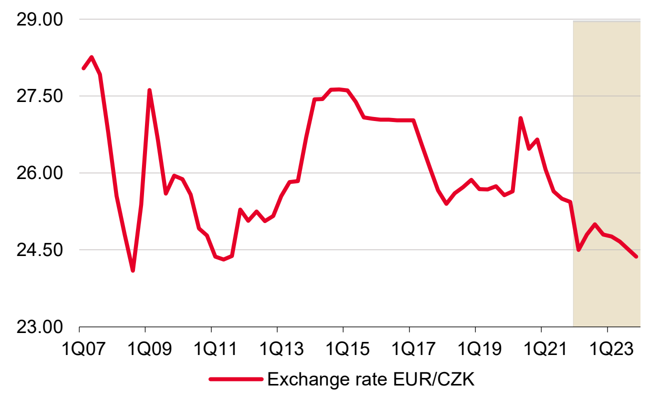
Prior to the publication of the new forecast, the CNB published an estimate of inflation for the first months of this year, putting it close to 10% yoy. The CNB's November forecast had predicted average inflation of 6.9% yoy in 1Q22. The core inflation of 8.6% yoy made up three quarters of overall consumer price growth in December. This includes the impact of higher production costs, but also reflects robust domestic demand. The better-than-expected performance of the economy in 2H21 also contributed to the rise. The central bank expected GDP to grow by 0.8% qoq in 3Q and to decline by 1.1% in 4Q. However, the economy grew 1.6% qoq in 3Q and we estimate that it grew 1.2% qoq in 4Q. The labour market was also more pro-inflationary, with the unemployment rate 0.2pp lower than the CNB forecast in 4Q21. On the other hand, average wage growth was significantly above the CNB forecast. It reached 5.7% yoy in 3Q, about three times the growth in labour productivity, while the CNB expected 4.7% yoy. The fact that both imported and purely domestic price pressures are now reflected in core inflation is evidenced by its structure. Tradable prices (mostly goods) increased by 8.9% yoy in December, while non-tradable ones (mainly services, including a significant contribution from housing costs) rose by 8.5% yoy.

Interest rates are likely to peak at 5% in May, but in real terms they will remain negative until the end of 2022 (%)



Source: CNB, Economic & Strategy Research, Komerční banka

The temporary weakening of the koruna in 2Q and 3Q will be due to an increase in foreign interest rates and market speculation on the reduction in CNB rates



Source: CNB, Economic & Strategy Research, Komerční banka

According to our forecast, interest rates will continue to rise toward 5% in May. However, as strong inflationary pressures subside, they are expected to start returning to a politically neutral level of around 3% from the end of this year.

While the two-week repo rate is likely to rise to 5% in the coming months, it should fall again by the end of the year. At the next meeting in early February, we expect the CNB to continue rapidly tightening monetary policy and raise interest rates by another 75bp. This should be followed by two standard 25bp rate hikes in March and May. We expect that the size of the increase will be sufficient to offset the factors pushing inflation above the CNB's November forecast, which expected rates to peak slightly above 3% in 1Q22. Higher interest rates, which the CNB began to raise in June last year and whose stronger impact is evident in the economy with a delay of about a year, are likely to dampen inflation. The strengthening of the Czech koruna should also be reflected in price developments. Lastly, the gradual easing of supply-side bottlenecks, which according to some indicators is already partially taking place, should also have a positive effect.

We expect that 2H22 will already bring significantly lower inflationary pressures, and thus there will be no need to keep monetary policy so tight. Weaker inflationary pressures should be evident, mainly through lower mom inflation dynamics, especially their core component. After about six months of wait-and-see with rates at 5%, we expect the CNB to start reducing rates again in 4Q22. In terms of policy communication, the central bank should be helped by yoy inflation approaching the tolerance band at end-2022. The effect of higher base from 2H21 will also be beneficial. We anticipate inflation to reach the 2% target in 1H23. Our forecasting model indicates that the CNB will have to cut rates relatively quickly to keep inflation within the tolerance band. Otherwise, the inflation target could be undershot next year. We therefore expect the interest rates to reach a policy neutral level of 2.5% in 2Q23. In real terms, rates are expected to be close to the one-percent equilibrium level throughout next year, after about a decade of negative or zero real rates. However, the more distant development of interest rates is associated with a high degree of uncertainty. A slower easing of inflationary pressures may hamper rate cuts, while a significant restriction on fiscal policy could have the opposite effect.

Czech IRS market and government bonds

Jaromír Gec
(420) 222 008 598
jaromir_gec@kb.cz

Yields are nearing their peak

Market rates have experienced skyrocketing growth over the past few months following the surprisingly sharp rise in CNB rates, and the entire market interest rate curve has thus become even more inverted. In our opinion, the short end of the curve will increase in response to the increase seen in CNB rates, and the turnaround will not take place until the second half of this year. Hedging conditions have deteriorated significantly as rates have risen. However, the inversion of the entire curve offers an opportunity. At the end of 2021, government bonds became significantly more expensive relative to IRS, backed by persistently strong demand and low supply. With higher emission activity, we expect some easing in ASW. However, the overall supply of bonds will fall this year compared with last year and their yields will thus remain below the IRS. Despite the initial provisional budget by the government, during which the budget follows last year's record budget, total borrowing needs will be significantly lower this year.

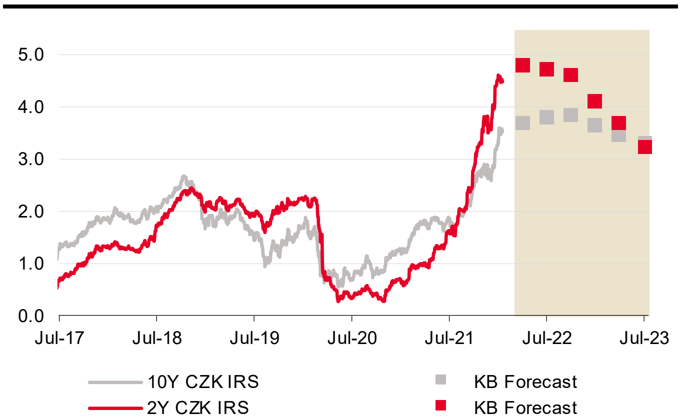
The Czech IRS rate market: short yields following the policy of the CNB

By raising rates rapidly, the CNB has shot the IRS curve well above its pre-COVID highs. We expect rates to rise further, especially at the shorter end of the curve. The inversion of the curve will persist at least through this year until the first CNB rate cut.

Market interest rates rose further sharply in the fourth quarter and earlier this year. Accelerating inflation and the uncompromising and surprisingly strong reaction of the central bank led to a sharp increase in yields on the markets. However, its intensity varied significantly across maturities. Changes in the monetary policy stance have traditionally mainly affected yields with shorter maturities, which is further supported by the expected easing of inflationary pressures in the second half of this year. While the short end of the curve jumped since the beginning of October last year by 230-250bp, the long end increased by 90-170bp.

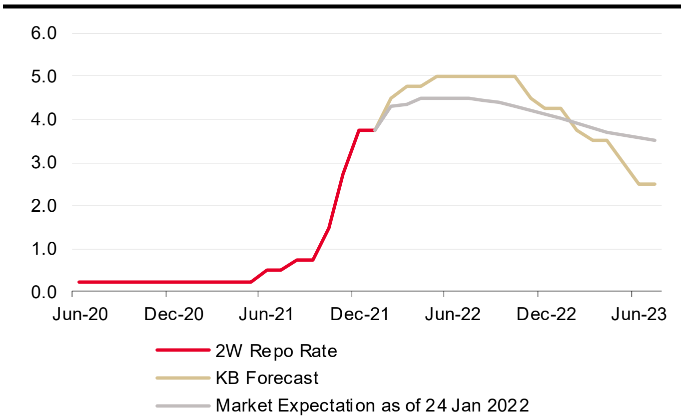
Financial markets currently expect the CNB to raise interest rates at 4.5% over the 3-6 month horizon. Subsequently, rates are expected to move down from their peaks very quickly. According to current expectations, we should see the first rate cut at the turn of this year and next year, followed by another significant easing of monetary conditions. Compared to the market, we expect a need for greater tightening of monetary policy through the interest rate channel during the next few meetings, as we expect smaller koruna gains amid an environment of rising interest rates in the United States. However, due to the easing of inflationary pressures, we expect a sharper reduction in the CNB's reference rates to a level of equilibrium (close to 2.5%) in the longer term compared to the market. In our opinion, the two-week repo rate could reach this level in the middle of next year.

IRS forecast (%)



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Expected CNB key interest rate path (%)



Source: Bloomberg, Economic and Strategy Research, Komerční banka, CNB

The start of the CNB rate cut at the end of this year will help to normalise the shape of the yield curve. We assume that the inverse shape will be maintained at least throughout this year and that it will not be settled until the first half of 2023 in connection with the turnaround in monetary policy rates, which will reduce its short end.

CZK IRS outlook (end of period, %)

	1Q22f	2Q22f	3Q22f	4Q22f	1Q23f
2Y	4.80	4.70	4.60	4.15	3.70
5Y	4.25	4.25	4.25	3.90	3.65
10Y	3.70	3.85	3.85	3.65	3.50

Source: Economic & Strategy Research, Komerční banka

Deepening of the curve inversion as an opportunity for hedging

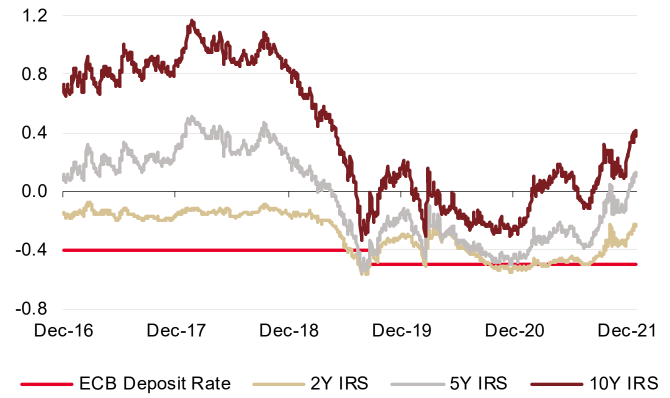
Due to the significant increase in the IRS curve over the past few months, interest rate hedging conditions have deteriorated sharply and for now we do not see much opportunity for a more significant decline from the current levels. Thus, a certain opportunity can currently be seen only in the deepening of the inversion of the entire IRS curve, which improves the conditions on the forward market, i.e. interest rate hedging with a delayed start. Using forward starting IRS allows one to benefit from an inverted curve, and by shifting the start of hedging, one can avoid aggressive pricing at super-short maturities and benefit from the lower long end of the curve. Despite the recent increase in market revenues, the EUR market still offers a certain opportunity. However, EUR yields are expected to increase as well, so the conditions for hedging interest rate risk will deteriorate further in the coming months.

Forward interest rate swaps (%, p.a., vs 6M PRIBOR)

Forward \ Maturity	6M	1Y	18M	2Y	3Y	5Y	10Y
Spot	4.58	4.67	4.49	4.42	4.17	3.91	3.48
3M	4.88	4.70	4.50	4.37	4.12	3.87	3.45
6M	4.79	4.50	4.37	4.20	4.00	3.78	3.39
9M	4.41	4.30	4.16	4.04	3.88	3.69	3.34
1Y	4.10	4.15	3.97	3.90	3.78	3.61	3.28
18M	4.11	3.90	3.80	3.74	3.66	3.49	3.22
2Y	3.61	3.64	3.59	3.58	3.54	3.37	3.15
3Y	3.48	3.51	3.48	3.48	3.40	3.22	3.09

Source: Bloomberg, Economic & Strategy Research, Komerční banka, as of 24 January 2021

Euro rates continue rising (%)



Source: Bloomberg, Economic & Strategy Research, Komerční banka

CZGB supply will be smaller this year – but still significant

Demand for bonds remain high, which will help to keep yields below the IRS curve.

The smaller state budget deficit compared with last year's record will lead to a reduced CZGB supply. We currently assume that the state budget will end in a deficit of CZK300bn this year, which would mean the need to issue bonds worth approximately CZK400bn. At present however, there is considerable uncertainty about this year's budget due to the new government's unclear plan on the matter and the temporary provisional one that has already been introduced. In addition, the degree of fiscal consolidation is a risk in the coming years.

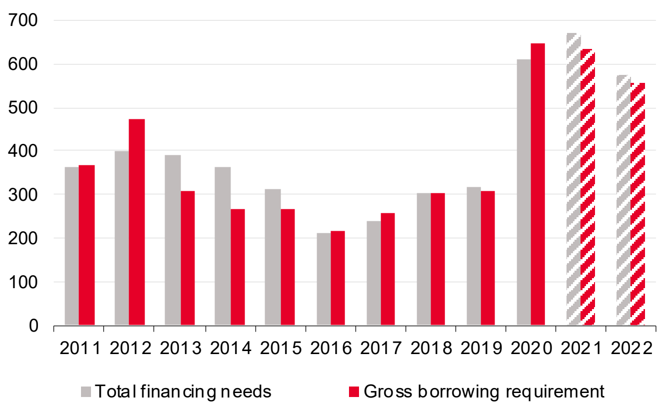
We expect the financing needs for this year to reach CZK573.5bn (8.4% of GDP), which would mean a significant decrease compared with last year's CZK668.4bn (10.9% of GDP). As in previous years, we assume that the offer in primary auctions should revive, especially during the first half of the year, in order to secure funds for, among other things, expenses related to maturing bonds. The increased supply should, at least temporarily, lead to some easing of the pressure on expensive government bonds against the IRS curve.

Funding programme and issuance activity (CZKbn)

	2022	
	MinFin	KB
State budget deficit	300.0	300.0
Transfers and other operations of state financial assets	0.0	0.0
T-Bonds denominated in local currency redemptions	145.4	145.4
T-Bonds denominated in foreign currency redemptions	74.3	74.3
Redemptions and early redemptions on savings bonds	0.0	0.0
Money market instruments redemptions	50.6	50.6
Redemption of T-bills		33.3
Redemption of other money market instruments		17.3
Repayments on credits and loans	3.2	3.2
Total financing needs	**573.3**	**573.5**
Money market instruments		20.0
T-bills		20.0
Other money market instruments		0.0
Gross issuance of CZK T-bonds on domestic market	Min. 350-400	404.3
Gross issuance of EUR T-bonds on domestic market		91.6
Gross issuance of T-bonds on foreign market		0.0
Gross issuance of savings government bonds		41.1
Received credits and loans		0.0
Financial asset and liquidity management		17.4
Total financing sources		**573.5**
Gross borrowing requirement		**556.1**
Net CZGB issuance		**258.0**

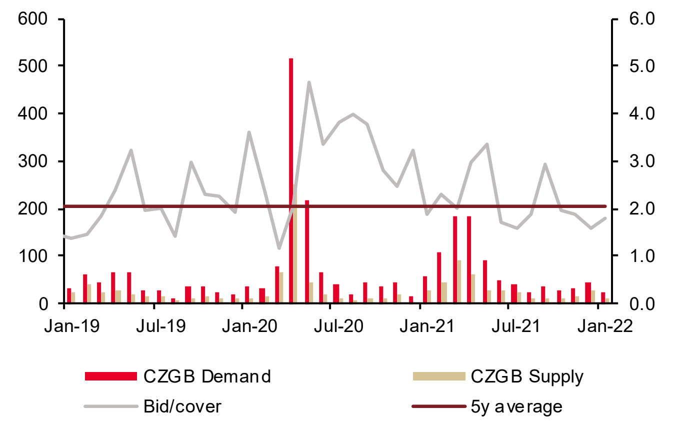
Source: Economic and Strategy Research, Komerční banka, MinFin

Financing needs (CZKbn)



Source: Economic and Strategy Research, Komerční banka, MFCR

CZGB primary market (CZKbn)



Source: Economic and Strategy Research, Komerční banka, MFCR, CNB

CZGB yield forecast (end of period)

	1Q22f	2Q22f	3Q22f	4Q22f	1Q23f
2y CZGB yield (%)	4.10	4.05	3.85	3.35	3.10
5y CZGB yield (%)	3.60	3.65	3.60	3.30	3.15
10y CZGB yield (%)	3.30	3.45	3.50	3.30	3.20
10y CZGB ASW (bp)	-42	-38	-35	-38	-28

Source: Economic & Strategy Research, Komerční banka

We expect CZGB yields to peak in the second half of this year

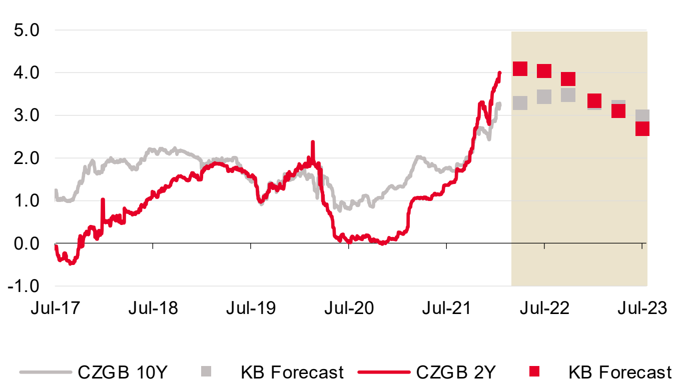
Government bond yields, like the IRS, rose sharply at the end of last year and the beginning of this year. With maturities of up to five years increasing from the beginning of the fourth quarter 2021 in the range of about 130-190bp, while the long end of the curve saw an increase of 100bp. However, due to the relatively low supply of CZGB and the continuing strong demand, the increase was not as much as in the case of the IRS curve, so CZGB thus became significantly more expensive in ASW terms. Although we expect some convergence in bond yields and swaps as a result of the aforementioned higher issuance activity of MinFin during the first half of this year, we believe that CZGB's yields will remain visibly lower than the IRS curve. Apart from temporary movements in asset swap spreads, mainly due to uneven issuance activity during the year, we expect government bond yields to more or less mirror IRS movements for the rest of the year. The former should reach their peak in the second half of this year and then, like the longer-dated IRS, should begin to decline close to long-term equilibrium values.

Sovereign rating overview

	Local currency	Outlook	Foreign currency	Outlook	Next rating review
S&P	AA	STABLE	AA-	STABLE	29-Apr
Moody's	Aa3	STABLE	Aa3	STABLE	4-Feb
Fitch	AA-	STABLE	AA-	STABLE	6-May

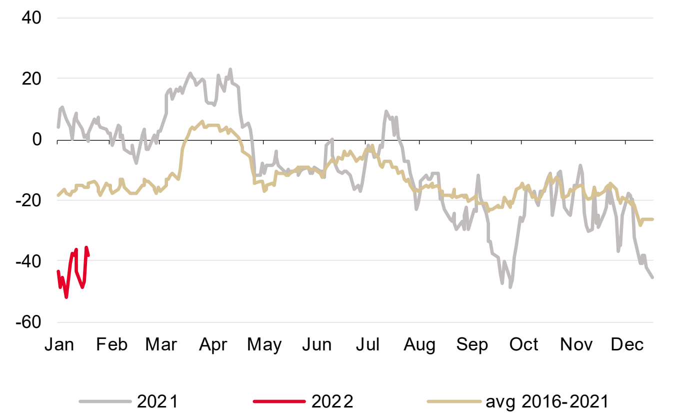
Source: Economic and Strategy Research, Komerční banka, Bloomberg

CZGB yield forecast (%)



Source: Economic and Strategy Research, Komerční banka, Bloomberg

10y CZGB ASW (bp)



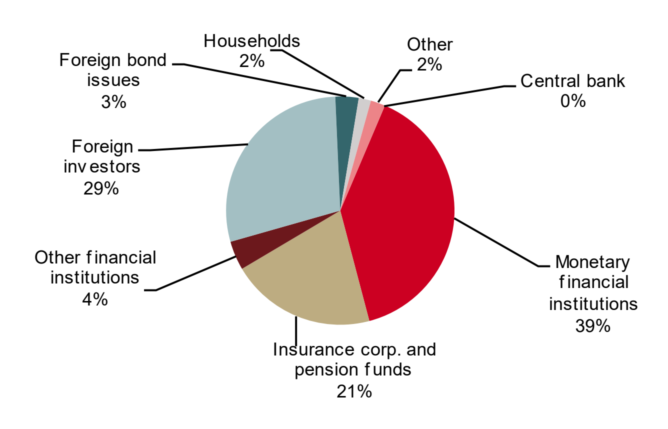
Source: Economic and Strategy Research, Komerční banka, Bloomberg

Government bond overview

Government bond overview									Rich-cheap analysis												
Bond		Dur.	Issued last 90D	Issuance limit	Yield	Δ1W	Δ1M	FX hedged	ASW	Δ1W	Δ1M	Min	90D	Max	Z-Score	Rank	Spline spread	Rank	Carry Roll 90D	Rank
0.10	Apr-22	0.2	0.0	100%	4.48	21	150	-0.13	22	12	47	-65		80	1.2	4	-17.8	1	NA	NA
4.70	Sep-22	0.6	0.0	100%	4.08	20	105	-0.82	-51	23	68	-159		-51	1.6	2	11.3	19	-21.2	18
0.45	Oct-23	1.7	0.0	80%	3.94	17	62	-0.51	-43	14	13	-92		-25	1.6	3	0.4	11	-12.5	17
5.70	May-24	2.1	0.0	100%	3.84	17	70	-0.38	-52	19	29	-110		-38	1.8	1	-1.2	9	-10.9	15
0.00	Dec-24	2.8	0.0	34%	3.64	8	73	-0.30	-53	7	30	-102		-33	1.1	5	9.2	17	-11.1	16
1.25	Feb-25	2.9	0.0	100%	3.66	10	51	-0.24	-58	12	-1	-89		-30	0.2	7	4.3	15	-10.5	14
2.40	Sep-25	3.4	0.0	76%	3.54	15	41	-0.18	-55	12	-11	-78		-22	-0.1	8	6.8	16	-9.9	13
1.00	Jun-26	4.2	0.0	100%	3.53	5	51	-0.02	-46	6	2	-76		-27	0.5	6	-1.7	8	-8.2	12
0.25	Feb-27	4.9	0.0	83%	3.42	6	47	0.00	-53	9	-12	-69		-18	-0.5	18	2.2	12	-7.5	11
2.50	Aug-28	5.9	0.0	94%	3.37	7	53	0.18	-44	15	-8	-61		-13	-0.4	13	-5.3	3	-5.7	10
2.75	Jul-29	6.5	9.9	101%	3.31	8	47	0.24	-45	17	-18	-62		-9	-0.7	19	-3.5	7	-5.2	9
0.05	Nov-29	7.6	0.0	57%	3.30	7	48	0.30	-32	14	-12	-49		-7	-0.3	12	-4.0	6	-4.5	8
0.95	May-30	7.7	0.0	100%	3.29	8	48	0.34	-31	13	-15	-50		-7	-0.3	11	-4.7	5	-4.3	7
1.20	Mar-31	8.3	0.0	100%	3.27	10	52	0.42	-27	13	-14	-46		0	-0.4	16	-5.0	4	-3.7	6
1.75	Jun-32	9.1	8.9	67%	3.18	8	53	0.47	-31	8	-11	-47		-6	-0.4	15	2.7	13	-3.3	5
2.00	Oct-33	10.1	8.1	100%	3.22	9	52	0.61	-23	11	-14	-45		5	-0.4	14	-0.1	10	-2.6	4
4.20	Dec-36	11.1	0.0	100%	3.23	6	54	0.77	-26	8	-16	-49		2	-0.3	10	3.2	14	-2.1	2
1.95	Jul-37	12.8	0.0	10%	3.17	0	55	0.73	-25	1	-15	-45		4	-0.5	17	9.7	18	-2.0	1
1.50	Apr-40	15.0	0.0	40%	3.32	5	58	0.88	-6	6	-11	-31		20	-0.2	9	-6.4	2	-2.1	3

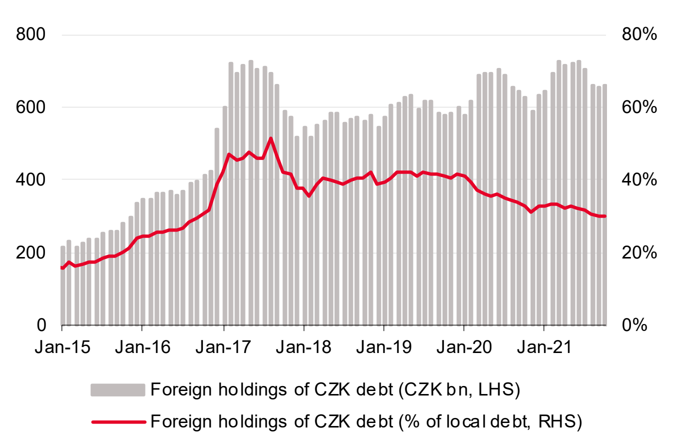
Source: Economic & Strategy Research, Komerční banka
Note: More details in CZGB Auction Alert

Holdings of CZK government debt (November 2021)



Source: MinFin, Economic & Strategy Research, Komerční banka

The share of non-resident bondholders declines further



Source: MinFin, Economic & Strategy Research, Komerční banka

Czech FX market

Jaromír Gec
(420) 222 008 598
jaromir_gec@kb.cz

USD likely to prevent significant CZK appreciation

We expect rising market interest rates and the USD trend to continue to dictate the future direction of the koruna. While a record-wide interest-rate differential should push koruna to stronger levels, we expect this to be countered by the US dollar, which we believe will strengthen further vs the euro. Overall, we forecast a correction in the koruna's gains from the beginning of this year, with the currency returning to EURCZK25.0 once the Fed starts its policy normalisation. We then expect the koruna to start to appreciate slightly towards EURCZK24.80, nearing that level at end-2022. The record-high interest-rate differential is also pushing forward points to new highs. However, significant appreciation in the spot rate has led to a distinct deterioration in hedging conditions for Czech exporters. We expect such conditions to improve following the correction in the koruna. The biggest risk we see is still the future trend in the USD.

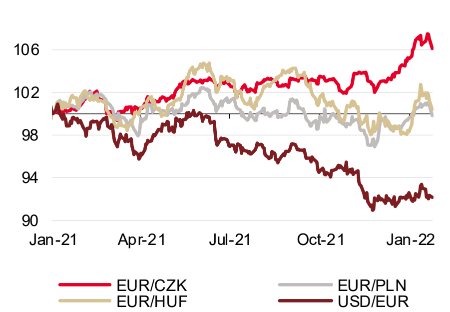
The koruna to strengthen thanks to the record interest-rate differential

A strengthening USD kept CEE currencies under pressure in 4Q21, although this was offset by a robust policy-rate hikes from regional central banks. Such hikes were a key factor in erasing previous losses suffered by the Polish zloty and Hungarian forint due to USD strengthening. The record-high interest-rate differential (IRD) had an even more pronounced effect on the Czech koruna, which continued to appreciate steadily from end-November 2021 and even hit a 10y high against a backdrop of rapid hikes in the CNB's key policy rate. The financial markets are anticipating further interest-rate hikes from the CNB up until mid-2022, followed by a shift in monetary policy, with interest rates gradually returning towards their long-term trends. We believe the CZK will benefit from higher interest rates, especially in 1H22, but that the USD is likely to counter a stronger koruna beginning in 2Q22.

CZK exchange rates

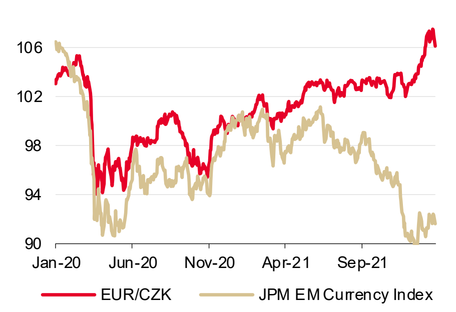
Source: Bloomberg, Economic and Strategy Research, KB

Performance of CE currencies



1.1.2021 = 100

The koruna resists global developments



1.1.2021 = 100

We revise our scenario for the CZK towards stronger levels in 1H22 and weaker levels in 1H22. We expect the koruna to reach EURCZK24.80 at end-2022, then appreciate to EURCZK24.70 in mid-2023. We see US dollar strength as the key driver, along with the Czech IRD.

The same factors are set to play a key role in the coming months. We have revised our koruna exchange rate scenario, since our last reading, to stronger levels, especially in 1Q22 as we now assume CNB policy rates will peak at a higher level within the current tightening cycle. Subsequently, however, we expect the CZK to correct significant gains once the monetary-policy normalisation in the US begins. We believe the persistent but narrowing interest-rate differential, as CNB rates return to equilibrium values and rates gradually increase abroad, will lead to only a slight strengthening in the koruna to EURCZK24.80 at end-2022.

EUR/CZK and interest-rate differential

Source: Bloomberg, Economic and Strategy Research, Komerční banka

The USD remains the main risk for the koruna

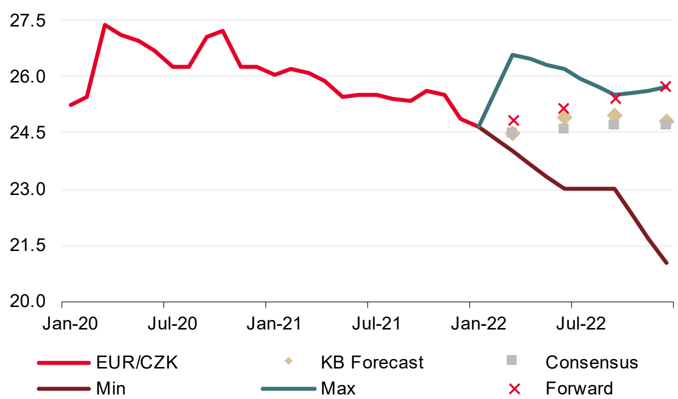
Our forecasts assume a slower strengthening than the consensus in a EURCZK0.00-0.30 range, within a one-year horizon. The main risk in our view is the USD trend, which is in turn contingent on the pace of monetary tightening in the US. In the high-inflationary environment the US interest rates still have plenty of room to normalise their post-COVID levels. This may lead to a faster strengthening in the USD dollar, and as a result, a weakening in EM currencies. In that event, the koruna should be supported by the already record-high IRD. However, its impact should decline over time, the faster the CNB returns the repo rate back to equilibrium (close to 2.5%). How the coronavirus pandemic evolves remains a persistent risk. But we see COVID-19 as less of a risk than a stronger USD, as in our view, any further COVID waves are likely to have a far lower and shorter impact on financial markets in general. Any additional waves should be of a lower magnitude, which would serve as a good opportunity for investors to rebuild speculative positions or hedges.

Koruna exchange rate forecast (end of period)

	1Q22f	2Q22f	3Q22f	4Q22f
EUR/CZK	24.50	24.90	25.00	24.80
USD/CZK	22.07	22.84	22.73	22.55
EUR/USD	1.11	1.09	1.10	1.10

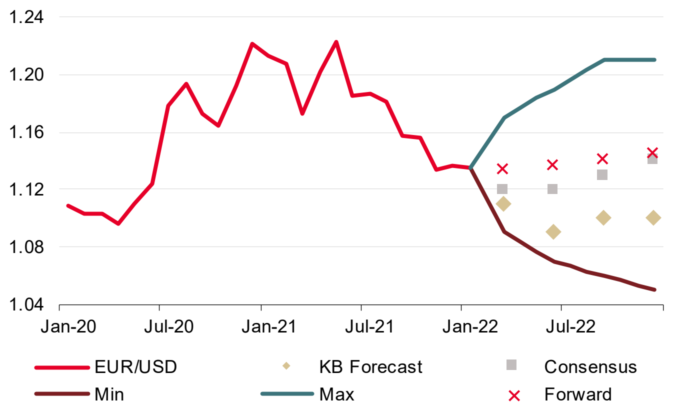
Source: Economic and Strategy Research, Komerční banka, SG Cross Asset Research

Expected EUR/CZK path, market consensus by Bloomberg (as of 24 January 2021)



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Expected EUR/USD path, market consensus by Bloomberg (as of 24 January 2021)

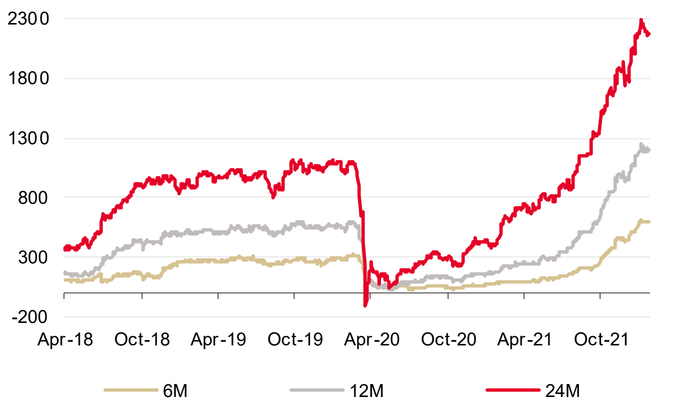


Source: Bloomberg, Economic and Strategy Research, Komerční banka, SG Cross Asset Research

Record interest-rate differential pushes forward points to new highs

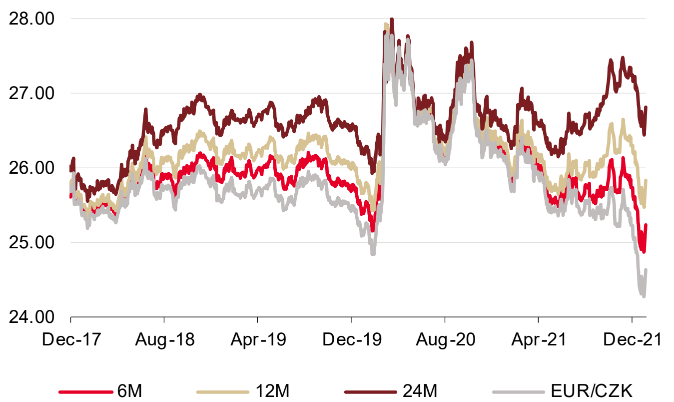
Over a one-year horizon, we expect the koruna to strengthen to EURCZK24.80 after previously weakening temporarily. At the same time, the interest-rate differential vis-à-vis euro rates continues to exceed its previous highs. This is reflected in forward points, especially at longer maturities. However, the significant strengthening in the spot exchange rate at the turn of last year and ytd means that koruna exchange rate hedging conditions have deteriorated significantly vs end-November 2021. **Thus, over a one-year horizon, one could get near the level of EURCZK25.80 and 26.80 on a two-year horizon.** Although we anticipate a further rise in market rates and thus in forward points, the main potential has – at least temporarily – already been exhausted, in our view, especially for maturities of up to one year. Hedging conditions could improve slightly after a prospective correction in regional currencies, based on our expectations of a more pronounced strengthening in the USD compared to current market expectations.

Forward points surpass pre-COVID highs



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Forward vs spot exchange rate EUR/CZK



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Banking sector


Michal Brožka
(420) 222 008 569
michal_brozka@kb.cz

Interest rates on the rise

We expect the improved economic outlook and declining supply chain difficulties to have a positive effect on corporate credit growth this year. On the other hand, an increase in interest rates will work against this. Rising interest rates and tight conditions for mortgages are likely to lead to a gradual slowdown in the still-high growth rate of mortgages as well as real estate prices. Favourable labour market developments and growth in nominal household consumption will support the growth of consumer credit. Deposit growth remains rapid but is likely to slow. The development of non-performing loans is still favourable, and we expect only a gradual increase in their share.

The rapid growth of mortgages and prices will slow this year

Higher interest rates and stricter mortgage rules will lead to a cooling of the real estate and mortgage markets this year.

The rise in prices of residential real estate in the Czech Republic accelerated again, with house prices rising by more than 12% yoy on average in 4Q21. With regard to the achieved price levels and the significant increase in interest rates, we expect a gradual slowdown in the price of real estate prices this year, which we still expect to be on average close to 9%. However, movements in real estate prices tend occur with a considerable lag, and we expect this to be case with mortgages as well. Although the qoq growth rate for mortgages declined in the fourth quarter, those negotiated during the period of rising interest rates (fears of even higher levels) and before the tightening of supply conditions are likely to affect the statistics during 1H22 (as expected, the CNB announced this tightening in November with effect from April this year). The yoy growth in mortgages at the end of last year is likely to have reached a level close to 9%. We expect a significant slowdown in the second half of 2022, as a result of the expected peak in interest rates and stricter regulations. **At the end of this year, we expect yoy growth in mortgages to reach 3.3%, with the pace of growth accelerating slightly next year.**

Bank loans and deposits (% yoy)

	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	2020	2021	2022	2023	2024	2025
Bank loans														
Total	4.4	5.8	3.5	6.7	6.3	5.5	5.3	5.5	**5.2**	**4.6**	**5.5**	**5.6**	**5.6**	**5.7**
Households - real estate loans	10.5	8.7	7.6	5.9	3.4	3.3	2.9	3.3	**7.4**	**9.3**	**5.1**	**4.0**	**5.6**	**5.2**
Households - consumer loans	4.1	2.4	5.2	4.4	3.8	6.9	5.6	5.6	**3.8**	**2.3**	**5.1**	**6.1**	**6.4**	**6.2**
Corporate loans	1.9	2.9	3.7	6.0	4.4	6.2	7.0	6.9	**3.5**	**0.1**	**5.1**	**6.6**	**5.3**	**5.7**
Deposits														
Total	7.2	16.9	12.7	17.2	13.0	5.9	4.8	5.1	**9.9**	**10.9**	**12.2**	**5.2**	**5.2**	**5.4**
Households	10.2	15.0	15.4	14.2	12.4	5.3	3.3	4.4	**10.2**	**12.2**	**11.8**	**4.4**	**5.5**	**5.7**
Non-financial corporations	6.6	10.7	9.7	9.6	7.4	6.4	6.1	5.6	**11.7**	**9.1**	**8.3**	**6.2**	**4.7**	**4.7**
Others	2.7	28.7	10.5	28.6	18.2	6.7	6.3	5.9	**7.7**	**10.9**	**16.0**	**5.9**	**5.0**	**5.3**
Ratios														
Loans/GDP	62.9	62.1	61.5	60.6	60.2	58.9	59.4	59.7	**62.7**	**63.4**	**60.3**	**59.7**	**60.3**	**60.9**
Deposits/GDP	99.0	98.5	105.1	105.4	100.8	93.7	100.9	103.4	**93.3**	**100.0**	**101.3**	**99.8**	**100.3**	**101.0**
Loans/deposits	63.5	63.0	58.6	57.5	59.8	62.8	58.9	57.7	**67.2**	**63.4**	**59.7**	**59.9**	**60.1**	**60.3**
Interest rates														
Real estate loans	2.5	2.8	4.5	5.1	5.1	4.4	3.5	3.2	**2.3**	**2.4**	**4.8**	**3.3**	**3.3**	**3.3**
Consumer loans	7.6	7.7	8.9	9.9	10.2	10.4	10.1	9.7	**8.0**	**7.4**	**9.8**	**9.6**	**9.3**	**9.4**
Corporate loans	1.9	4.3	6.1	6.7	6.6	5.7	5.0	4.2	**2.2**	**2.4**	**6.3**	**4.3**	**4.1**	**4.0**
Share of NPL														
Real estate loans	1.1	1.1	1.1	1.1	1.2	1.2	1.2	1.3	**1.1**	**1.0**	**1.2**	**1.3**	**1.4**	**1.6**
Consumer loans	5.4	5.4	5.7	6.2	6.3	6.3	6.5	7.1	**4.7**	**5.3**	**6.1**	**7.2**	**7.9**	**8.0**
Corporate loans	4.3	4.3	4.3	4.3	4.3	4.3	4.4	4.5	**3.7**	**4.3**	**4.3**	**4.6**	**5.0**	**4.7**

Source: CNB, CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Consumer credit is growing slowly

Rapid nominal economic growth should also support consumer credit.

Due to higher interest rates, we have reduced the estimated growth of consumer loans for this year. On the other hand, the growing economy and favourable labour market, as well as the outlook for nominal growth in personal consumption, which is partly due to higher inflation, speak in favour of increasing credit. In summary, we expect the same average growth rate of consumer loans for this year as for mortgages or loans to non-financial corporations, by 5.1%.

Lending to businesses has been volatile

The growth rate of loans to companies has slowed down but should accelerate this year.

Loans to non-financial corporations increased significantly in 3Q21, by 3.4% qoq (SA) and 1.9% yoy. However, levels slowed down in 4Q21, and for FY21, the average increase in corporate lending is likely to be close to 0.1%. The outlook for 2022 looks more positive. However, the loosening of the bottlenecks within the economy remains an important precondition. Pandemic-related fears are diminishing and the outlook for companies improved by the end of the year. On the other hand, tighter monetary conditions in the form of higher interest rates will mitigate against rising loans. Gradually, more frequent financing through the bond market also contributes to lower estimated rates. For this year, we expect an average growth of loans in the corporate segment of 5.1%.

Deposits are still growing rapidly

Double-digit growth in the volume of deposits should gradually slow down.

The rapid pace of deposit increases continued in 4Q21. According to our estimates, it reached almost 17% yoy. We do not expect a quick change here. The rapid nominal growth of the economy, higher interest rates and also fears of higher inflation speak in favour of deposit growth. However, this could be hampered by a change in behaviour due to fears related to the pandemic. In 2022, we expect a slowdown in deposit growth to level of 11.8%, which would still be double the level we expect for loan growth. Next year, we already expect slightly lower rates on deposits compared to loans.

Higher interest rates will increase the share of NPLs

The share of non-performing loans will continue to grow gradually.

The share of non-performing loans (NPLs) has increased slightly in the case of consumer and corporate loans, but still remains at low levels. In the coming years, however, we expect a further gradual increase in all types of loans due to rising interest rates and a slowdown in economic growth, but to still relatively favourable levels.

Key economic indicators

Macroeconomic indicators – long-term outlook

		2018	2019	2020	2021	2022	2023	2024	2025
GDP	real, %	3.2	3.0	-5.8	3.1	4.9	2.7	2.5	2.5
Inflation	average, %	2.1	2.8	3.2	3.8	8.8	1.9	1.6	1.9
Current account	% of GDP	0.4	0.3	3.6	-0.1	-1.9	-1.0	-1.9	-2.4
3M PRIBOR	average, %	1.3	2.1	0.9	1.1	4.8	2.9	2.7	2.7
EUR/CZK	average	25.6	25.7	26.5	25.7	24.8	24.6	24.0	23.8
USD/CZK	average	21.7	22.9	23.2	21.7	22.5	21.4	20.0	19.2

Source: CZSO, CNB, Macrobond, Economic & Strategy Research, Komerční banka
Note: KB forecasts are in red

FX & interest-rate outlook

		24-01-2022	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
EUR/CZK	end of period	24.5	24.50	24.90	25.00	24.80	24.80
USD/EUR	end of period	1.13	1.11	1.09	1.10	1.10	1.12
CZK/USD	end of period	21.7	22.05	22.85	22.75	22.55	22.15
3M PRIBOR	end of period, %	4.26	4.95	5.15	5.15	4.45	3.70
10Y IRS	end of period, %	3.45	3.70	3.85	3.85	3.65	3.50

Source: CNB, Macrobond, Economic & Strategy Research, Komerční banka, SG Economic Research
Note: KB forecasts are in red

Monthly macroeconomic data

		IV-21	V-21	VI-21	VII-21	VIII-21	IX-21	X-21	XI-21	XII-21
Inflation (CPI)	%, mom	3.1	2.9	2.8	3.4	4.1	4.9	5.8	6.0	6.6
Inflation (CPI)	%, yoy	0.5	0.2	0.5	1.0	0.7	0.2	1.0	0.2	0.4
Producer prices (PPI)	%, mom	4.6	5.1	6.1	7.8	9.3	9.9	11.6	13.5	13.2
Producer prices (PPI)	%, yoy	0.8	0.9	0.8	1.6	1.2	0.7	1.9	1.2	-0.1
Unemployment rate	% (MLSA)	4.1	3.9	3.7	3.7	3.6	3.5	3.4	3.3	3.5
Industrial sales	%, yoy, c.p.	54.2	32.2	11.1	-0.6	1.2	-4.0	-7.4	4.5	n.a.
Industrial production	%, yoy, c.p.	63.3	37.2	15.0	4.3	7.5	-2.1	-6.3	11.8	n.a.
Construction output	%, yoy, c.p.	-3.8	7.0	6.5	-2.3	3.0	3.0	2.3	3.4	n.a.
Retail sales	%, yoy, c.p.	21.6	18.5	9.3	0.5	4.1	0.6	0.7	9.9	n.a.
External trade	CZKbn (national met.)	19.6	3.2	-8.3	-9.2	-27.7	-15.5	-16.3	5.7	n.a.
Current account	CZKbn	31.8	2.2	-13.3	-24.5	-40.2	-12.0	-3.7	-6.0	n.a.
Financial account	CZKbn	26.3	-14.5	17.1	-44.3	-27.7	2.8	1.6	-28.6	n.a.
M2 growth	%, yoy	10.9	10.7	10.7	10.2	9.9	8.8	8.2	8.0	n.a.
State budget	CZKbn (YTD cum.)	-192.0	-255.0	-265.1	-279.4	-298.1	-326.3	-335.0	-401.5	-419.7
PRIBOR 3M	%, average	0.36	0.37	0.48	0.69	0.94	1.11	2.02	2.97	3.50
EUR/CZK	average	25.9	25.5	25.5	25.6	25.5	25.4	25.5	25.4	25.2
USD/CZK	average	21.7	21.0	21.1	21.7	21.6	21.6	22.0	22.3	22.3

Source: CZSO, CNB, MF, MLSA, Macrobond, Economic & Strategy Research, Komerční banka

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KB ECONOMIC & STRATEGY RESEARCH

Chief Economist and Head of Research
Jan Vejmělek, Ph.D., CFA
(420) 222 008 568
jan_vejmelek@kb.cz

Economists
Michal Brožka
(420) 222 008 569
michal_brozka@kb.cz

Jana Steckerová
(420) 222 008 524
jana_steckerova@kb.cz

Martin Gürtler
(420) 222 008 509
martin_gurtler@kb.cz

Strategist
Jaromír Gec
(420) 222 008 598
jaromir_gec@kb.cz

Equity Analyst
Bohumil Trampota
(420) 222 008 560
bohumil_trampota@kb.cz

SG IN CENTRAL AND EASTERN EUROPE

Head of Research of Rosbank
Evgeny Koshelev
(7) 495 725 5637
evgeny.Koshelev@rosbank.ru

Economist Rosbank
Yury Tulinov, CFA
(7) 495 662 1300 (ext. 14-836)
yury.tulinov@rosbank.ru

Economist Rosbank
Anna Zaigrina
(7) 495 662 1300
anna.zaigrina@rosbank.ru

Economist Rosbank
Evgeniy Vertiporokh
(7) 495 662 1300 (ext. 14-263)
evgeniy.vertiporokh@rosbank.ru

Romania
Ioan Mincu
(40) 21 301 4472
george.mincu-radulescu@brd.ro

SG GLOBAL ECONOMICS RESEARCH

Head of Global Economics
Klaus Baader
(44) 20 7762 4714
klaus.baader@sgcib.com

Euro area
Michel Martinez
(33) 1 4213 3421
michel.martinez@sgcib.com

Anatoli Annenkov
(44) 20 7762 4676
anatoli.annenkov@sgcib.com

Yvan Mamalet
(44) 20 7762 5665
yvan.mamalet@sgcib.com

United Kingdom
Brian Hilliard
(44) 20 7676 7165
brian.hilliard@sgcib.com

North America
Stephen Gallagher
(1) 212 278 4496
stephen.gallagher@sgcib.com

Latin America
Dev Ashish
(91) 80 2802 4381
dev.ashish@socgen.com

India
Kunal Kumar Kundu
(91) 80 6716 8266
kunal.kundu@sgcib.cz

Korea
Suktae Oh
(82) 2195 7430
suktae.oh@sgcib.com

China
Wei Yao
(33) 1 57 29 69 60
wei.yao@sgcib.com

Greater China
Michelle Lam
(85) 2 21 66 57 21
michelle.lam@sgcib.com

Japan
Jin Kenzaki
(81) 3 6777 8032
jin.kenzaki@sgcib.com

SG CROSS ASSET RESEARCH – FIXED INCOME & FOREX GROUPS

Global Head of Economics, Cross-Asset & Quant Research
Kokou Agbo Bloua
(44) 20 7762 5433
kokou.agbo-bloua@sgcib.com

Head of Fixed Income & Forex Strategy
Guy Stear
(33) 1 41 13 63 99
guy.stear@sgcib.com

Head of Rates Strategy
Adam Kurpiel
(33) 1 42 13 63 42
adam.kurpiel@sgcib.com

Covered Bonds & SSA
Cristina Costa
(33) 1 58 98 51 71
cristina.costa@sgcib.com

Head of US Rates Strategy
Subadra Rajappa
(1) 212 278 5241
subadra.rajappa@sgcib.com

Shakeeb Hulikatti
(91) 80 2802 4380
shakeeb.hulikatti@sgcib.com

Jorge Garayo
(44) 20 7676 7404
jorge.garayo@sgcib.com

Jean-David Cirotteau
(33) 1 42 13 72 52
jean-david.cirotteau@sgcib.com

Ruben Marciano
(1) 212 278 5129
ruben.marciano@sgcib.com

Rohit Gaurav
(91) 8067318958
rohit.gaurav@sgcib.com

Ninon Bachet
(33) 1 58 98 30 26
ninon.bachet@sgcib.com

Chief Global FX Strategy
Kit Juckes
(44) 20 7676 7972
Kit.juckes@sgcib.com

FX Derivatives Strategy
Olivier Korber
(33) 1 42 13 32 88
olivier.korber@sgcib.com

Head of Emerging Markets Strategy
Phoenix Kalen
(44) 20 7676 7305
phoenix.kalen@sgcib.com

Bertrand Delgado
(1) 212 278 6918
bertrand.delgado-calderon@sgcib.com

Marek Dřímal
(44) 20 7550 2395
marek.drimal@sgcib.com

Kiyong Seong
(852) 2166 4658
kiyong.seong@sgcib.com

Vijay Kannan
(91) 7010445705
Vijay.kannan@sgcib.com