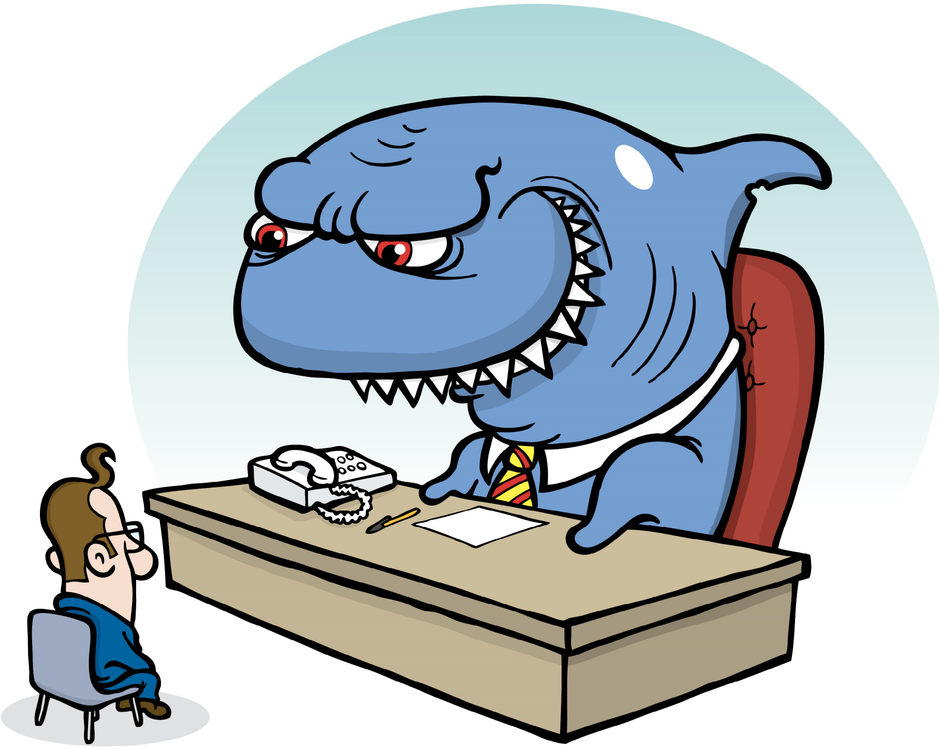
Quarterly report

Czech Economic Outlook

Tariffs Bite off a Chunk of Growth



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- **Czech economic growth to be hit by US tariffs** We forecast GDP to grow by 1.5% this year, before slowing to 1.2% next year. We expect US tariffs to reduce Czech GDP by 1.0-1.5% in total and the economy to suffer a mild recession in 2H25. The negative impact should be reflected in lower fixed investment and net exports, as well as a decline in industrial production. Household consumption is likely to continue growing, but at a much slower pace.

- **Inflation set to return to target as economy slows** We forecast inflation to average 2.2% in 2025, and then fall to 1.8% in 2026. We expect the decline to stem from lower commodity prices, including energy prices, and a continued downturn in industry. However, food prices are likely to be an offsetting factor. We see core inflation averaging 2.4% this year and slowing to 1.9% next year. We expect the high services inflation to decelerate on the back of tight monetary policy and a subdued economy.

- **Gradual CNB rate cuts to continue** We expect the CNB to cut the repo rate by 25bp per quarter, bringing it to a terminal level of 3% by year-end. As the economy slows, we expect to see downward pressure on rates, including market rates. Government bond yields could fall by slightly more than market rates this year, also supported by the Czech Republic's relatively good fiscal position.

- **CZK strengthening unlikely near term** Given risk aversion and likely recession in the Czech economy, we do not expect the koruna to strengthen significantly. Continued tight policy from the CNB could, however, provide support. Overall, we expect EURCZK to remain above 25 on average until the end of the year.

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SOCIETE GENERALE GROUP

Covid, war, energy… and now Trump

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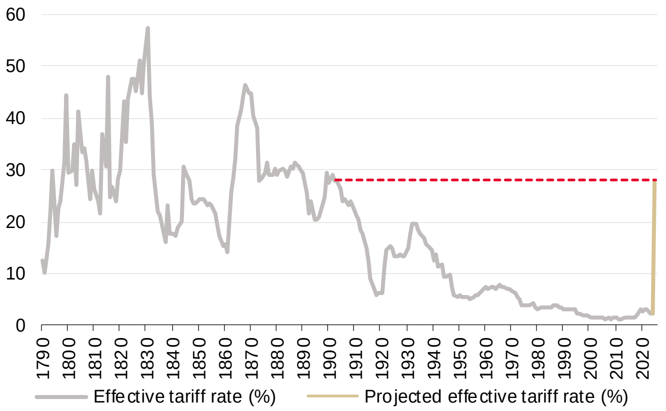
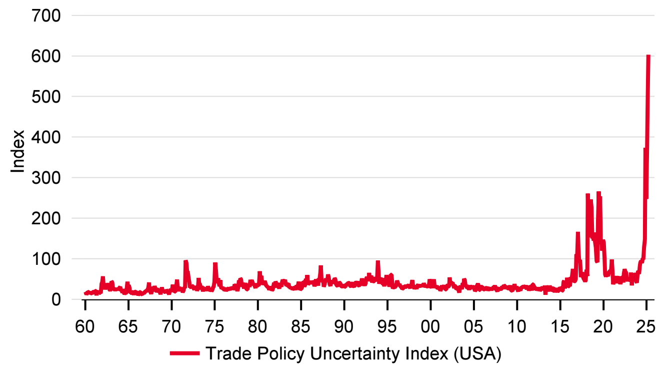
We are not even halfway through the decade, yet we are facing another highly turbulent period in the wake of the coronavirus pandemic, the onset of war in Ukraine and the energy crisis. **On stepping into the Oval Office, US President Donald Trump, has unleashed a tariff tornado.** Raising custom duties constitutes Mr Trump's main instrument for eliminating bilateral external trade deficits, but it seems that the tariffs are also being used as leverage to achieve other, geopolitical objectives. However, it has become abundantly clear that these protectionist measures are not helping to solve the key fundamental problem behind America's chronic current account deficit: Americans simply do not have enough savings to invest, which means their investments are basically being financed by the rest of the world.

The US tariff policy is changing fundamentally



Source: The Budget Lab at Yale, Economic and Strategy Research, Komerční banka

Trade Policy Uncertainty Index for the US is record-breaking

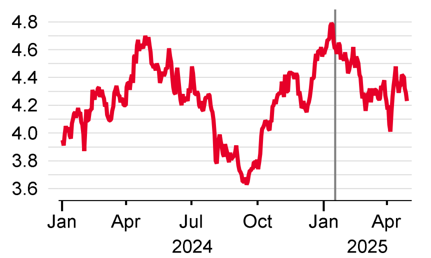


Source: Macrobond, Economic and Strategy Research, Komerční banka

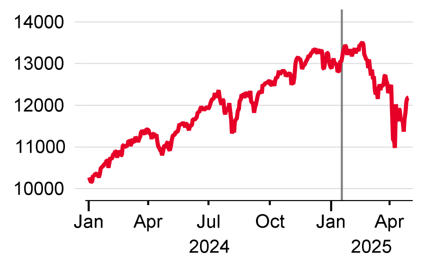
The increase in import tariffs is really massive. The effective tariff rate for imports to the US has climbed to its highest level since 1901. According to *The Budget Lab at Yale's* calculations, it has surged to the current 28% (without the 90-day suspension of the 'reciprocal' tariffs), while in 2024 it was 2.4%. In addition, **the anticipated adverse impact has been exacerbated by the chaos surrounding the tariff announcements**, with the situation in terms of tariff rates and affected countries or products changing almost every day. The result is huge volatility in the financial markets.

EURUSD

10-year yield of US government bond (%)



S&P 500 equity index (points)



Source: Bloomberg, Economic and Strategy Research, Komerční banka
Note: The vertical line indicates the beginning of Donald Trump's second term.

Investors had relatively strong hopes for President Trump. This is reflected in the financial market performance last autumn when the US equity indices were hitting historical highs one by one. The US dollar strengthened significantly and government bond yields also climbed in anticipation of faster economic growth, underpinned by fiscal stimulus and climbing inflation expectations. **However, just over two months into President Trump's new term, we are seeing quite the reverse:** the dollar has been deprived of all of its earlier gains, the US equity indices are in the red – in contrast to the European indices – and government bond yields have fallen. And it's not due to lower inflation expectations but to rising concerns surrounding weaker US economic growth.

One major impact of Mr Trump's policy so far is a change in Europe's geopolitical thinking. The old continent has finally jumpstarted the efforts to invest in its defence capabilities. In addition, Germany has eased its debt brake rule after the recent elections to the Bundestag, and it seems that the country's fiscal policy will be more relaxed in the coming years. At the same time, it remains to be seen whether the increased public spending will be used effectively to boost Europe's potential, and what longer-term impacts this spending will have on growth and inflation. Jana Steckerová discusses German fiscal policy in more detail in a special *box*.

Central bankers are essentially now grappling with a third shock following Covid and the energy crisis, and are again facing the dilemma of how to respond to the situation. To gauge the right response, it is important to assess the strength of demand and decide whether higher tariffs will be passed on to consumers or whether producers/importers will absorb them, at least in part. While higher inflation and lower growth is the threat facing the US this year, we believe recession rather than stagflation is the main scenario for Europe, including the Czech Republic.

Preparing any macro-economic forecast is a complicated exercise in this situation of extreme uncertainty, emanating from the external environment and, in particular, Donald Trump's chaotic and unpredictable behaviour. Global economic uncertainty is now much more acute than at the time of the assault on Ukraine and the subsequent energy crisis, and is reaching its highest level since the pandemic.

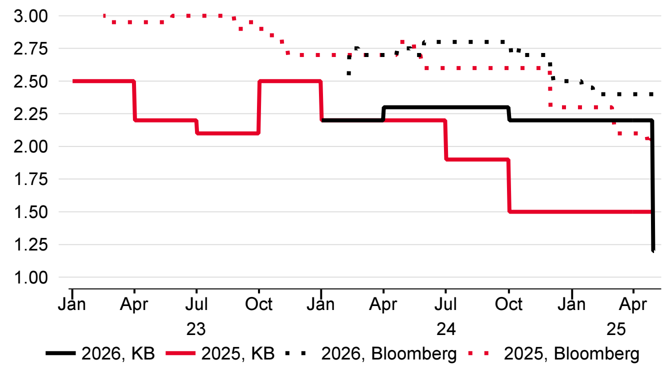
Global economic uncertainty soars to historical highs

Source: Macrobond, Economic and Strategy Research, Komerční banka

Thus, our latest macroeconomic forecast should be viewed from the perspective of the assumptions that we have formulated and on which it is based. They mainly concern the effective tariff rate implied by the currently applicable US measures against imports from the EU. Martin Gürtler quantifies the impacts of the different tariffs on the Czech economy in his special report (available here: https://bit.ly/US_tariffs_Czech_economy_EN). Thus, we now have to focus in more detail on identifying and discussing the various risks to our forecast.

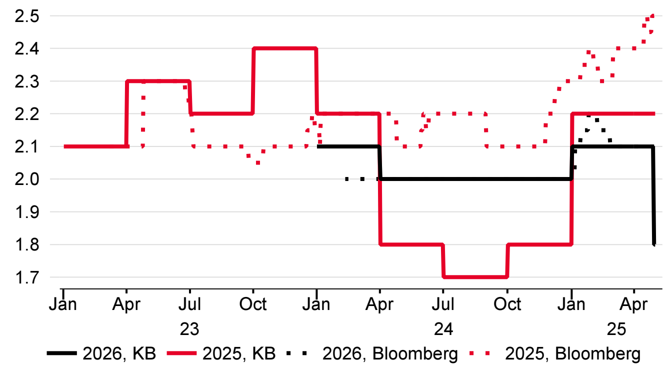
Naturally, sky-rocketing global economic uncertainty is bound to affect the open Czech economy. We believe that exports and investments will be the primary channel; on the production side, industry will continue to suffer. We expect the heaviest adverse impact to fall on the Czech economy in the second half of this year. Nevertheless, in view of last year's strong second half and a solid first quarter this year, we are leaving our full-year GDP growth forecast unchanged at 1.5%. However, next year is likely to be much weaker than previously expected; we have reduced our FY26 forecast from 2.2% to 1.2%. The economy should be sustained by household consumption, which should continue to be supported by growing real wages thanks to inflation being close to the 2% target. The Czech National Bank should continue to cut rates in anticipation of economic deterioration. We still expect the monetary policy rate to be 3% at the end of this year.

Growth prospects for the Czech economy (GDP, %, yoy)



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Inflation prospects for the Czech economy (CPI, %, yoy)



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Enjoy reading the spring edition of Komerční banka's *Czech Economic Outlook*!

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External environment and assumptions

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Tariffs will determine the development of the world economy

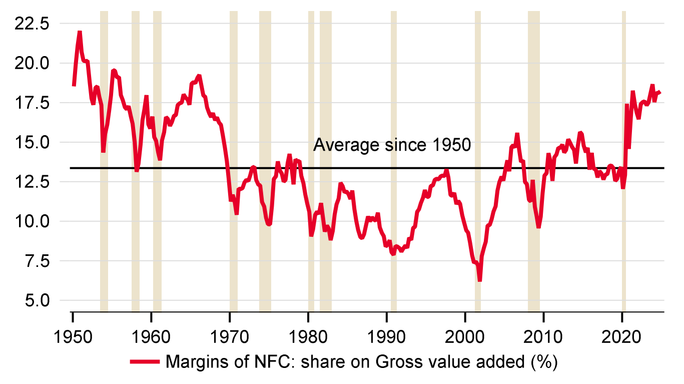
The US economy has been in good shape so far. Profit margins, one of the key indicators of an impending recession, have reached their highest level in a decade last year. There have been no signs of a recession in the labour market or in the real economy. Further developments will depend on the extent of the tariffs to be introduced. If only the 10% universal tariffs remain in place, we put the probability of a recession in the US at 30%. If full 'reciprocal' tariffs are introduced (as announced on 2 April), we see a 70% risk. At this point, we are more inclined to believe that Donald Trump will not want to push the domestic economy into recession and that the measures will ultimately be more muted. In the eurozone, we expect the economy to follow a J-curve. While we forecast GDP growth will only reach 0.5-0.8% this year, in the coming years, the pace of growth will be faster. In the short term, concerns about slowing economic growth and inflation will outweigh fears of a one-off price shock. We therefore expect the ECB to cut rates again in June and July, with the risk of further monetary easing. We expect the first rate hike as early as the end of next year, given that we anticipate looser fiscal policy, higher inflation and faster GDP growth.

US: indicators don't point to recession yet, tariffs will decide

The drive to front load is pushing the US trade balance into deeper deficits.

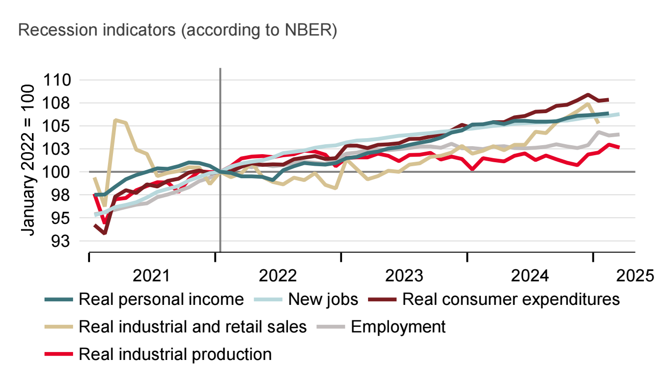
On 2 April, US President Donald Trump imposed 'reciprocal' tariffs on almost all imports into the United States, only to suspend them for 90 days with immediate effect and apply an universal rate of 10% instead. The exception is China, where additional tariffs reached 125% on most items. At the same time, 25% tariffs on aluminium, steel and automobiles (incl. parts from 3 May) remain in place. Negotiations between the US and individual countries will take place over the 90-day period. At the same time, US companies will continue their efforts to replenish inventories. Moreover, despite the tariffs, the US still needs Chinese products. Nearly 30% of US consumer goods (56% in the case of electronics) are imported from China. Chinese exporters will therefore try to get their goods imported into the US despite the tariffs, ideally through other countries that are not as burdened by tariffs. This should mitigate the shock of the tariffs, at least in the short term. At the same time, the push for front-loading is putting significant pressure on the US trade balance. The deficit in the first two months of this year was almost double that of the same period last year ($253 billion). This, in turn, will be reflected in GDP growth. While the US economy grew at an annualised rate of 2.4% qoq in the final quarter of last year, we expect growth of 0.5% qoq in the first quarter of this year.

Profit margins do not indicate a recession



Source: Macrobond, Economic and Strategy Research, Komerční banka, beige color = recession

US economy is in a good condition



Source: Macrobond, Economic and Strategy Research, Komerční banka

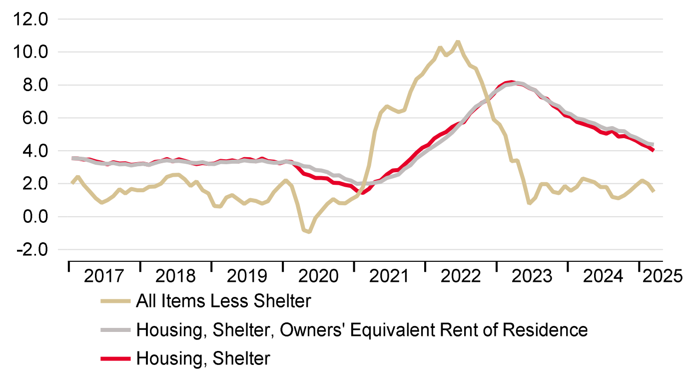
Neither the trend in profit margins nor the situation in the labour market points to a recession.

Whether or not the US economy faces a recession will depend on how the tariff wars play out. If full-blown 'reciprocal' tariffs are imposed (as announced on 2 April, i.e. 20% tariffs on the EU, 24% on Japan, 31% on Switzerland, etc.), we estimate the probability of a recession at 70%. In particular, the tariffs on imports of cars and car parts, to sales of which the US economy is very sensitive, will be significant. If only 10% tariffs are imposed, we estimate the risk of recession is reduced to 30-35%. Profit margins are a key indicator of an impending recession in the US. They reached their highest level in a decade in 2024 and do not indicate a risk of in imminent recession at all. Neither do labour market conditions nor consumer income and spending. Weekly jobless claims remain relatively low, while job creation surprised to the upside with 228,000 new positions added in March (NFP). This is reflected in the willingness of households to stock up on goods ahead of the introduction of tariffs. If a recession were to occur, it would be solely as a result of the imposition of tariffs, in our view.

Inflation level should allow the Fed to cut rates by further 25bp in June.

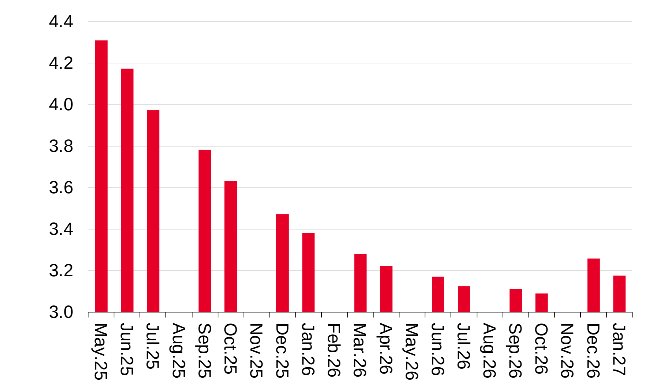
US inflation surprised on the downside in March with a marked slowdown (from 2.8% yoy in February to 2.4% yoy in March). Its core component also eased from 3.1% yoy to 2.8% yoy. Within core services, growth in weighted imputed rents accelerated by a tenth (to 0.4% mom), but this was offset by subdued price pressures in other items (mainly a decline in goods prices). This should allow the Fed to cut rates by a further 25bp in June. We expect another such move in September. The risk is skewed towards more significant monetary easing. Financial markets are now pricing in nearly four Fed rate cuts by 25bp for this year.

Inflation in the US has slowed considerably (%, yoy)



Source: Macrobond, Economic and Strategy Research, Komerční banka

Market expects Fed to cut rates to 3%



Source: Bloomberg, Economic and Strategy Research, Komerční banka

China: the fiscal package will help the economy

We have revised down our GDP growth forecast for China.

Meanwhile, the Chinese economy remains one of the most exposed to tariff wars. Exports to the United States account for 3% of China's GDP, with 15% of total exports going to the US. If tariffs were to end up being 100% or more, it would effectively take Chinese exports out of the game. It would simply be too much for importers, consumers, or the weakening of the domestic currency to absorb. China is growing at a trend rate of about 4%. A fiscal stimulus of 1.5% of GDP has already been announced for this year. The introduction of 100% tariffs would be a 3% shock to GDP, requiring a fiscal stimulus of 2.5% of GDP, or RMB3.5tn, to offset it. Given the introduction of tariffs and the high level of uncertainty, we have lowered our GDP growth estimate for this year and next from 4.7% and 4.5% to 4.0% for both 2025 and 2026.

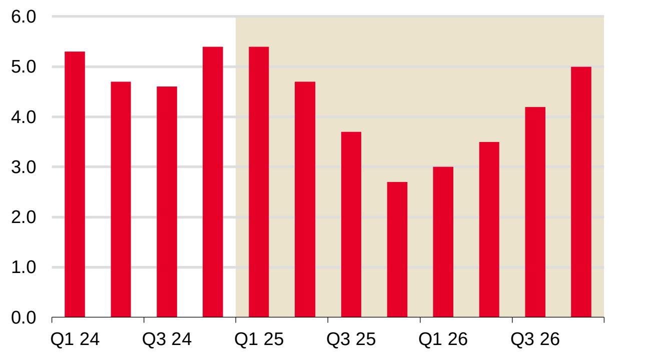
We expect the fiscal impulse to reach RMB3.5tn.

How high the tariffs will ultimately be is difficult to estimate at this point. In any case, the Chinese government can be expected to try to help the domestic economy. In our view, the fiscal stimulus will reach RMB3.5tn. The Chinese central bank is likely to react rapidly to the introduction of tariffs by cutting the benchmark interest rate and the reserve requirement ratio. Additional fiscal stimulus is also likely to be introduced very soon. The main priority will clearly be domestic consumption. In our view, this will be supported by an increase in subsidies, which could be extended to more goods or even to the service sector. Investment is likely to focus on human capital. We expect to see the introduction of childcare subsidies and the establishment of childcare and elderly care centres. There will also continue to be large investments in technology, artificial intelligence and robotics. At the same time, there may be an acceleration in the resolution of problems in the real estate market (support for the completion and sale of projects under construction). Last but not least, we expect targeted support for exporting companies. This could include greater tax breaks, temporary loan extensions, help in finding new customers, or training programmes to prevent large-scale layoffs.

China likely to prefer only gradual depreciation of the RMB.

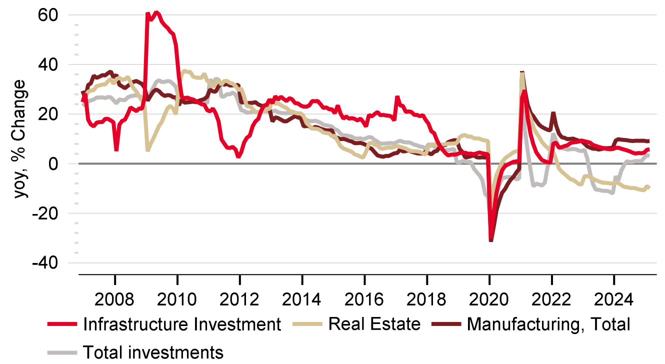
Given the major shock that the tariff war represents, China's central bank may begin to play a greater role in stabilising the stock market, by lending to state-owned enterprises or by buying government bonds to provide sufficient liquidity for their further issuance. At the same time, we do not expect China to undertake a significant devaluation of its domestic currency, as it did in 2015. Given the importance of investor confidence in Chinese assets and the fact that the scale of the tariffs is already so large that it cannot be offset by a depreciation of the exchange rate anyway, we expect China to prefer only a moderate and gradual depreciation of the RMB.

Chinese GDP (%, yoy)



Source: SG Cross Asset Research/Economics

Chinese investment: the property market is still frozen



Source: Macrobond, Economic and Strategy Research, Komerční banka

Box 1: German constitutional amendment unblocked

The CDU/CSU emerged victorious from February's snap elections. However, together with the SPD and the Greens, it failed to win the two-thirds majority in the German Bundestag needed to pass off-budget funds or changes in the debt break rule. The ruling parties decided to resolve the situation by submitting these amendments to the outgoing parliament before the end of the old mandate, which passed them by 513 votes to 207.

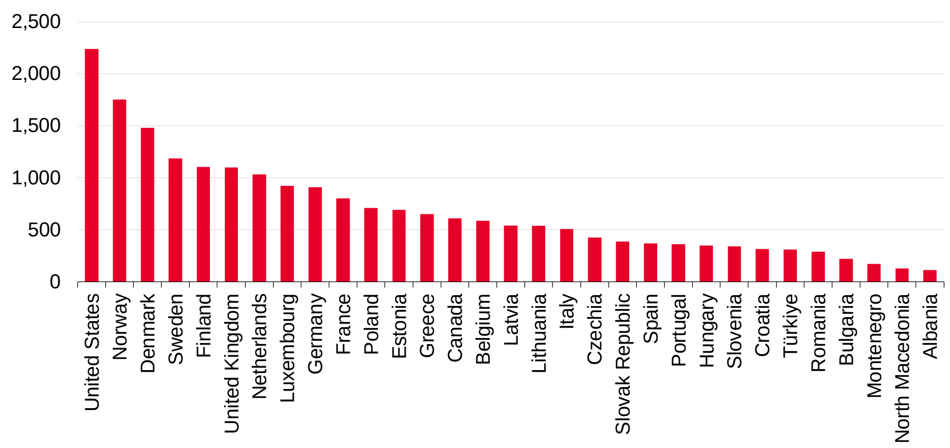
What was approved?

The exclusion of military spending above 1% of GDP from the debt brake rule, which de facto means that defence spending can be unlimited. The definition was also changed to include spending on civil defence, intelligence, cybersecurity and support for Ukraine. In addition, a EUR500bn fund has been set up to be used for infrastructure investment over the next 12 years. Of this amount, EUR100bn will be earmarked for climate change projects, and another EUR100bn will go to regional and local budgets. In addition, the budgets of Germany's 16 States (Länder) will no longer have to be balanced and will be able to run deficits of up to -0.35% of GDP.

What are the risks and challenges of the approved programme?

Ideally, the infrastructure fund should be spent on investments that increase the potential growth of the economy, i.e. not on bailing out uncompetitive industries. In the case of defence spending, it will be important whether the investments are made within the EU or through imports from the United States. In the latter case, the positive impact on the real economy would be roughly halved. However, there are growing calls for Europe to participate as much as possible in arms investments, which could then be reflected in technological progress, innovation and thus higher potential growth, both in Germany and in the EU as a whole. At the same time, it will be important to see how the new government handles the funds that have so far been earmarked for investment in the current budget. The worst-case scenario would be to replace it with money from the approved fund and use the savings to finance expensive election promises (tax cuts, electricity subsidies, minimum wage increases). Other risks include labour shortages, which could hamper the realisation of investments. It is also uncertain whether the centre-right CDU/CSU and the centre-left SPD will reach a consensus on project preparation.

Defence spending per capita (USD, constant 2015 prices)



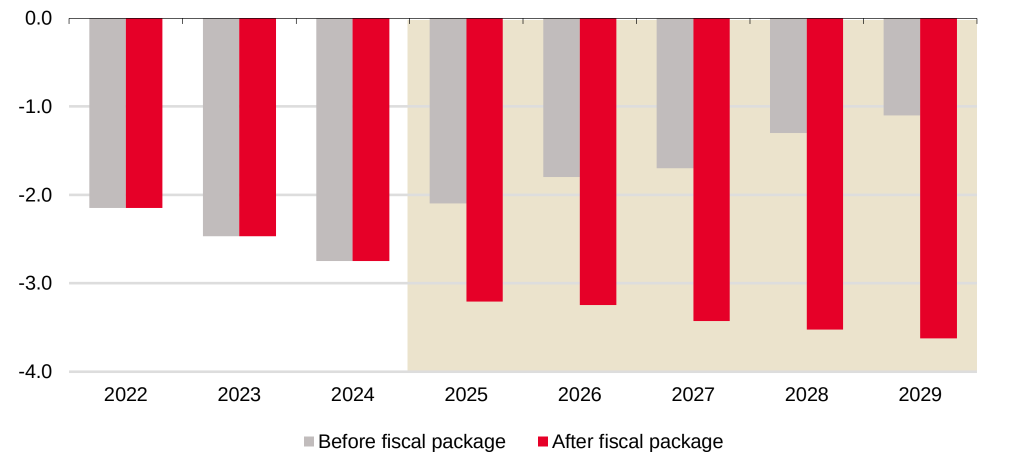
Source: NATO, Economic and Strategy Research, Komerční banka

How will this affect the real economy?

In the final quarter of last year, the German economy contracted by 0.2% quarter-on-quarter. For the whole of last year it was -0.2% vs -0.3% in 2023. The impact of the stimulus package on GDP will be clearly positive. However, it will be offset by the negative impact of the tariffs. We estimate that their impact will be strongest in the third quarter of this year and should gradually decline thereafter. If 'reciprocal' tariffs were imposed at the originally planned level of 20% on the EU, the German economy would most likely fall into recession this year. Starting next year, however, we expect the effects of the fiscal package to be felt and GDP growth to return to around 1% and remain around that level in 2027-2029.

The infrastructure package and higher defence spending should then contribute to higher potential output growth. We estimate that this is currently low at below 1%. We are positive on the EUR100bn earmarked for climate change, which could help Germany increase the efficiency of energy use. As for defence spending, we expect it to increase gradually from the current 2% of GDP to 3% of GDP. Higher spending will lead to a widening of the public deficit. While Germany's budget deficit reached 2.8% of GDP in 2024, we estimate it will be 3.6% of GDP in 2029. The debt-to-GDP ratio is 64% now and is set to rise to 70% by 2029.

Budget deficit (% of GDP)



Source: Macrobond, SG Cross Asset Research/Economics

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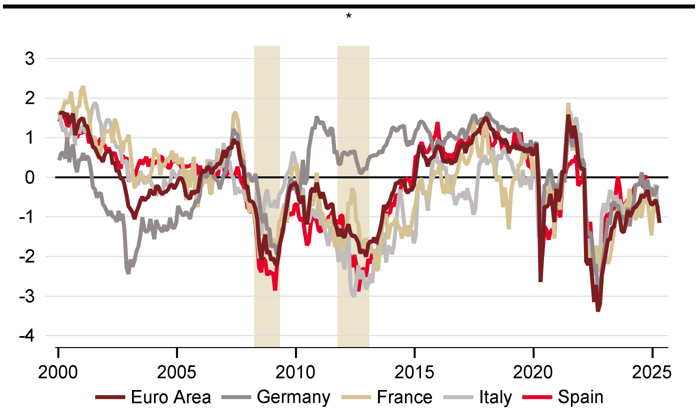
Eurozone: a J-curve recovery

We forecast GDP growth to reach 0.5-0.8% this year.

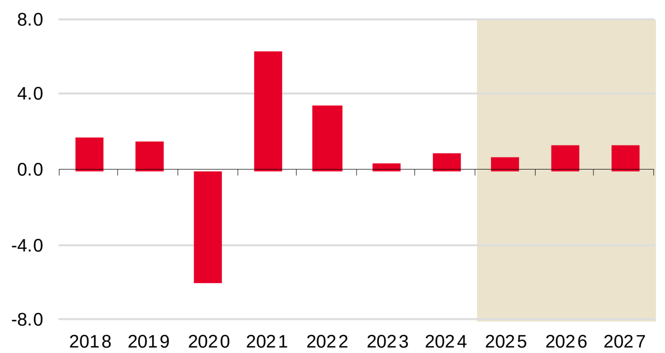
The European Union sends €530bn worth of goods to the US. Excluding pharmaceuticals and semiconductors, which are currently exempt from tariffs, 72% of European exports to the US are subject to 'reciprocal' tariffs. This corresponds to about 3.1% of GDP. If we consider a scenario in which the tariffs are not increased after the 90-day delay and the EU does not take major retaliatory measures, the impact on GDP would be around 0.5-0.6pp for this year and 0.4pp for next year. Taking into account the tariff wars and their negative impact on consumer and business confidence, as well as lower oil prices, the strengthening of the euro and the development of public finances, we expect euro area GDP growth to reach 0.5-0.8% this year and an acceleration above 1% next year.

Tariff wars will be reflected in consumer confidence (LTA = 0)



Source: Macrobond, Economic and Strategy Research, Komerční banka
Note: LTA=long term average

GDP set growth to slow this year, and accelerate next year (%)



Source: Macrobond, Ekonomický a strategický výzkum, Komerční banka

We expect more buoyant growth in 2026-2027

We forecast a J-curve recovery for the euro area: slower growth this year (depending on the extent of the tariffs introduced), followed by more buoyant growth in 2026-2027 (with the risk to the downside). These growth rates would be well above potential output growth. The J-curve recovery would then be reflected in our outlook for wages and inflation.

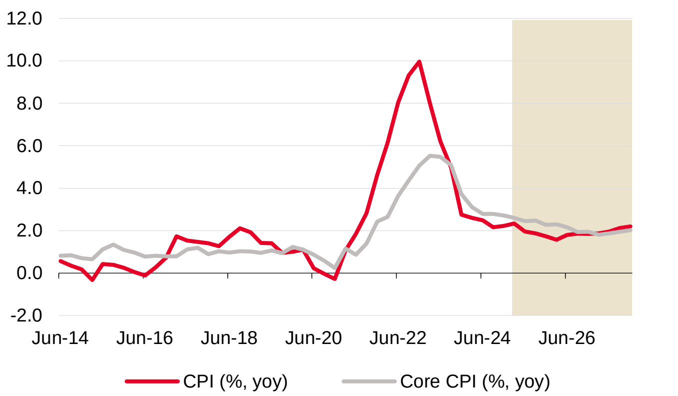
Inflation should fall below 2% by year-end, on our forecasts.

Inflation in the euro area slowed from 2.3% yoy in February to 2.2% yoy in March. Core inflation, which had been near 3% for most of last year, slowed from 2.6% yoy in February to 2.4% yoy in March. Services inflation also slowed, to 3.4% yoy. Given the weaker consumer sentiment, we expect price growth in services to slow down in the coming months. Oil prices, which have fallen by USD10/bbl (to USD65/bbl) during April, will also act in the direction of lower inflation. At the same time, there is a risk that China will redirect its goods from the US to Europe, which would also push down prices. Finally, weaker global economic growth and a stronger euro against the US dollar are also likely to be anti-inflationary. We therefore expect inflation to come down to 1.8% at the end of this year.

We expect further interest rate cuts from the ECB in June and July.

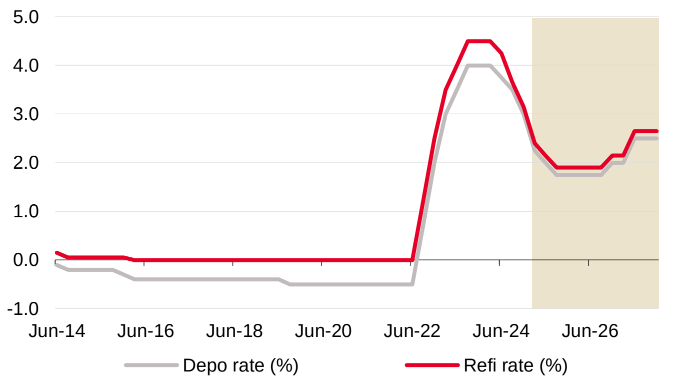
In the coming months, the threat of lower economic growth and inflation will, in our view, outweigh concerns about a one-off increase in price level due to the introduction of tariffs. Therefore, following the ECB's 25bp rate cut in April, we have included two further 25bp rate cuts in our outlook, in June and July. Given the uncertainty stemming from the tariff wars, the risk is skewed towards even more monetary easing.

Eurozone inflation at target (%, yoy)



Source: Macrobond, SG Cross Asset Research/Economics

ECB looks set to continue cutting rates (%)



Source: Macrobond, SG Cross Asset Research/Economics

We expect the first rate hike late next year.

However, in our view, inflationary pressures will intensify in the medium term, due to looser fiscal policy, labour shortages and subsiding uncertainty associated with tariff wars. For these reasons, we expect a first interest rate hike late next year, with a further such move to follow in mid-2027. We do not foresee a change in the quantitative tightening stance at this time. We would only expect the parameters to be amended, or the whole process suspended, if nervousness in financial markets deepens.

CEE region: rates likely to go down significantly in Poland

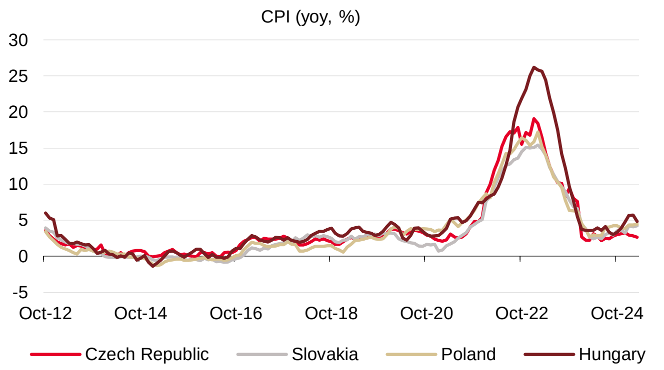
Polish central bank looks set to cut rates sharply this year.

National Bank of Poland Governor Glapinski, who until recently said he did not foresee rate cuts until 2026, changed his rhetoric in April, saying that monetary easing could come as early as the May meeting. He cited slowing inflation, weak retail sales and industrial production, and lower expected inflation due to changes in consumer basket weights. With inflation likely to ease further in April (our estimate is 4.3% after 4.9% in March), we expect a 50bp rate cut at the May meeting. Given Governor Glapinski's very dovish rhetoric, we have added another 25bp cut to our forecast for June, a 50bp cut for July and two 25bp cuts for September and November. This would bring the policy rate to 4% by the end of the year. The Polish zloty reacted to the monetary policy reversal by depreciating sharply (from around EURPLN 4.17 to EURPLN 4.30). We expect it to stabilise in the EURPLN 4.25-4.35 range in the coming period. Monetary easing and possible verbal interventions should prevent a significant appreciation, while the inflow of EU funds should protect the Polish zloty from depreciation. Next year, we expect the Polish economy to benefit from the German fiscal package through higher exports of goods and services. In our view, the central bank will react by raising interest rates by 25bp in July and November, which would bring the key rate to the upper end of the central bank' range for the neutral rate (4-4.50%).

Stability of the currency is the priority for the MNB.

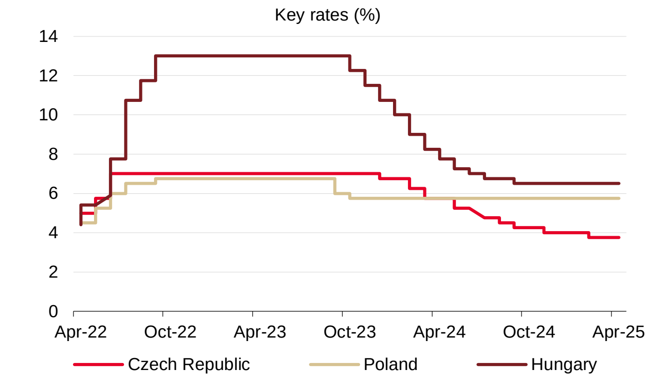
Inflation in Hungary seems to have peaked (5.6% yoy in February) and should slow down in the coming months. We expect it to fall below 4.5% yoy in April. Nevertheless, we think the Hungarian central bank will keep monetary conditions tight. The stability of the domestic currency remains key for the central bank. A period of tariff wars does not bode well for risk assets. Moreover, Hungary has relatively low FX reserves and, unlike Poland or the Czech Republic, cannot rely too much on EU funding inflows. As a result, in April the Hungarian forint fell to its weakest level since the beginning of the year. Nevertheless, we expect the exchange rate to remain around EURHUF 410 for most of this year. We do not anticipate any change in interest rates this year.

Inflation in the region (%, yoy)



Source: Macrobond, Economic and Strategy Research, Komerční banka

After a long period of stability, the Polish central bank is likely to cut rates



Source: Macrobond, Economic and Strategy Research, Komerční banka

Macroeconomic forecast

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Barriers to trade, barriers to growth

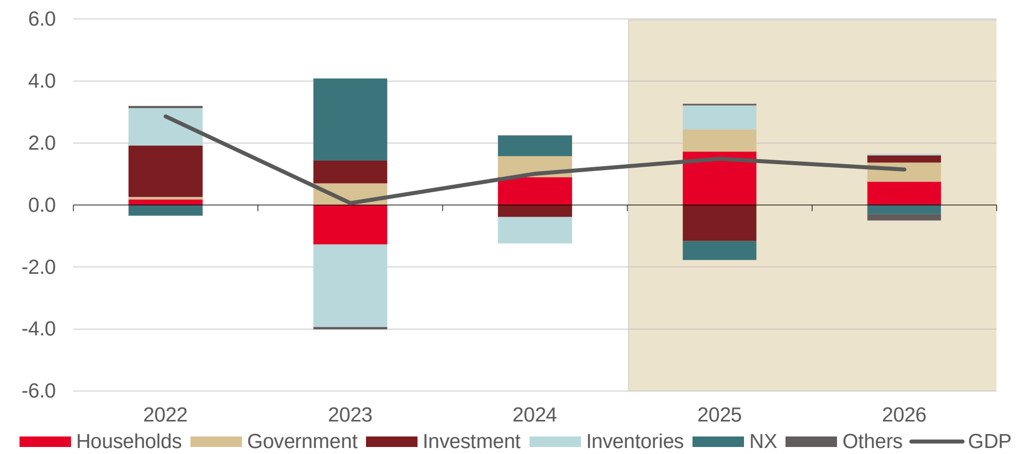
The Czech economy has grown strongly in recent quarters. This has been supported by a recovery in household consumption, although it remains below pre-pandemic levels. We also expect industrial production to have increased at the beginning of this year, after falling throughout last year. However, this is likely to be a temporary effect as US producers and consumers frontloaded ahead of the introduction of import tariffs. We expect the US tariffs to have a negative impact on the economy from 2Q25, leading to a mild recession in 2H25. We forecast economic growth of 1.5% in 2025, slowing to 1.2% in 2026. The economic weakness should be reflected in higher unemployment and lower wage growth. We expect headline and core inflation to be slightly above the 2% target this year and slightly below next year.

Major changes

GDP:
We leave our estimate for economic growth this year unchanged at 1.5%. This is due to stronger GDP growth at the turn of the year than in our January forecast. This offsets the negative impact of the mild recession we now expect in 2H25. However, the recession will be fully reflected in GDP growth in 2026, which we expect to be only 1.2% vs 2.2% in our previous forecast.

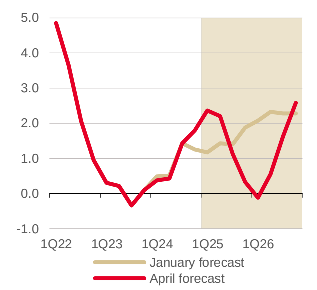
Inflation:
Our inflation forecast of 2.2% for this year also remains unchanged. However, we have raised our forecast for core inflation from 2.3% to 2.4%. By contrast, we expect lower price growth next year. We have lowered our forecast for headline inflation in 2026 from 2.1% to 1.8% and for core inflation from 2.2% to 1.9%. Weaker economic growth and lower commodity prices are the main drivers.

Household and government consumption to drive GDP growth in 2025 and 2026 (%, pp, yoy)



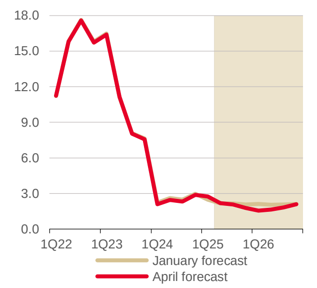
Source: CZSO, Economic & Strategy Research, Komerční banka

Changes to GDP forecast (%, yoy)



Source: CZSO, Economic & Strategy Research, Komerční banka

Changes to CPI forecast (%, yoy)

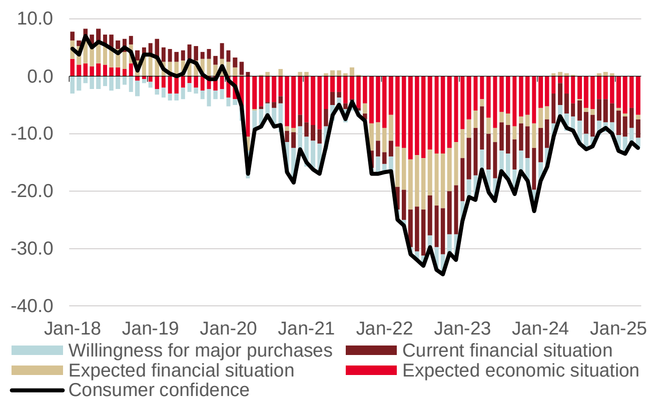


Source: CZSO, Economic & Strategy Research, Komerční banka

Czech economy to grow just above 1% this year and next

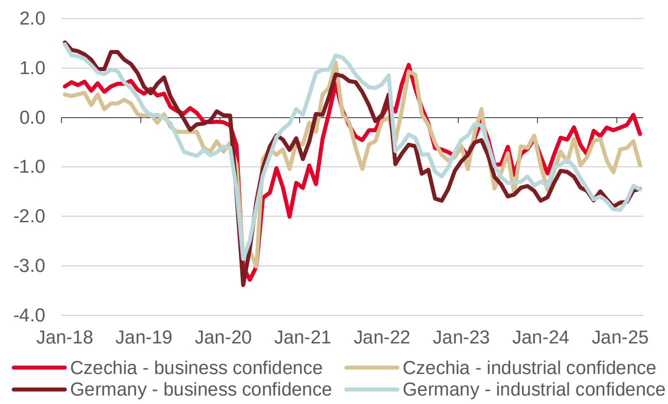
The economy rebounded in 2H24 and grew at a surprisingly strong pace. GDP growth reached 0.6% qoq in 3Q24 and accelerated slightly to 0.7% qoq in 4Q24 vs our forecast of +0.1%. In 1H24, growth was 0.2-0.3% qoq. The economic recovery was mainly driven by household consumption, which rose by 0.9% qoq in 3Q24 and 1.5% qoq in 4Q24. The continued growth in real wages and the improvement in consumer sentiment, which was close to its long-term average in 4Q24, had a positive impact. Nevertheless, household consumption in 4Q24 was still 3% below its pre-pandemic level in 4Q19. Government consumption also increased rapidly, as it has done for several quarters. This may partly reflect higher government spending on military ammunition. In contrast, investment and net exports performed poorly in 2H24. After growing by 0.7% qoq in 3Q24, fixed investment registered a sharp decline of 2.4% qoq in 4Q24. This may have been due to increased political uncertainty, which at the time was probably mainly related to the collapse of the German government and the uncertain future of the German economy. However, the weakness of the manufacturing sector, which in the Czech Republic saw output decline in all quarters of last year, also had an impact. The contribution of net exports to qoq GDP growth was clearly negative in 3Q24 (-0.9pp) and only slightly positive in 4Q24 (+0.1pp). Gross value added then painted a more pessimistic picture of the economy, growing by only 0.1% qoq in 4Q24. This was more in line with our expectation for weak economic growth. A similar difference can be seen in the figures for 2024 as a whole, with GDP rising by 1.0% compared with 0.3% growth in gross value added. GDP growth was probably boosted by the effect of the end of government subsidies for expensive energy.

Consumer confidence fell again after seeing an improvement in 4Q24 (balance of answers in %, SA)



Source: CZSO, Economic & Strategy Research, Komerční banka
Note: While the expected economic situation refers to the performance of the economy as a whole, the expected and current financial situation assesses the state of household finances. Expectations always refer to the next 12 months.

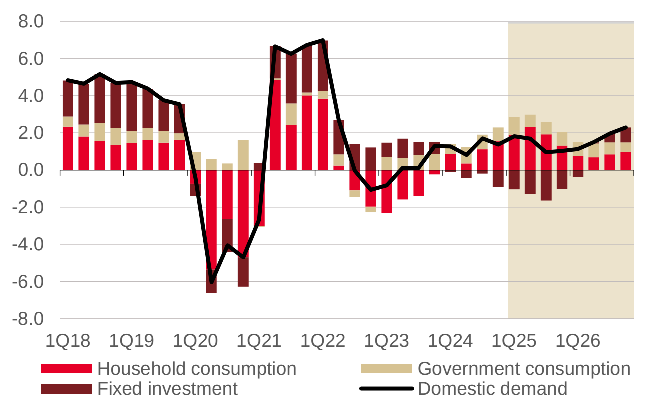
German business confidence remains stubbornly low, while Czech confidence deteriorated sharply in April (z-score, SA)



Source: CZSO, Ifo, Economic & Strategy Research, Komerční banka
Note: Indicators for Czechia are based on the CZSO business survey, while those for Germany are based on data from the Ifo Institute. Z-scores are calculated using time series from 2005 onwards.

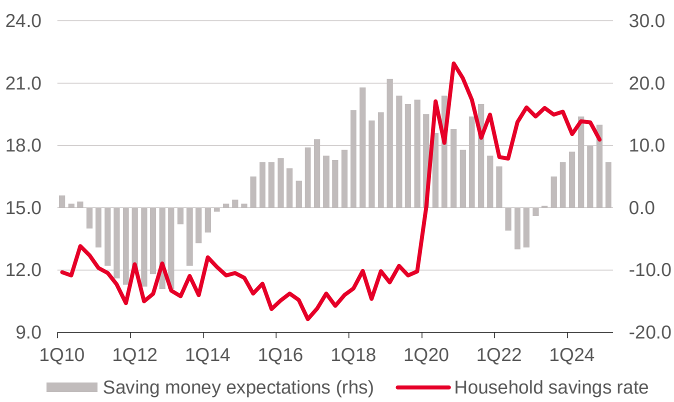
The US frontloading effect should have provided a temporary boost to the Czech economy. We estimate that GDP grew by a strong 0.9% qoq in 1Q25. We expect that the rebound in industrial production and higher net exports were the main reasons for the further acceleration in GDP growth. US manufacturers and consumers appear to have bought imported goods before the tariffs introduced by President Trump significantly increased their prices. This supported struggling European industry and – indirectly – Czech industry. We expect household consumption to have continued to grow rapidly in 1Q25, despite a renewed decline in consumer sentiment. However, monthly sales data for retail trade and services show that the strong growth in consumer demand was mainly concentrated around the turn of the year and may have weakened in the following months. By contrast, fixed investment is likely to have continued its downward trend. The outcome of the German general election and the early agreement on a plan to significantly increase government spending initially led to increased optimism about the prospects for the German and European economies. However, this quickly faded following US President Trump's decision in early April to impose almost flat import tariffs. Uncertainty over the economic impact of the tariffs has been exacerbated by Trump's chaotic communication, with the scope and level of the tariffs subject to frequent changes.

Domestic demand driven by household and government consumption, while fixed investment declines (%, pp, yoy)



Source: CZSO, Economic & Strategy Research, Komerční banka

Household saving rate and expectations for saving money remain high (%, SA)



Source: CZSO, Economic & Strategy Research, Komerční banka
Note: Expectations for saving money during the next 12 months are expressed as a balance of answers in % based on a survey by the Czech Statistical Office.

In our forecast, we assume that the US tariffs will reduce the Czech GDP by a total of 1.0-1.5% and that this will lead to a mild recession in 2H25.

The current US measures against EU imports imply an effective tariff rate in the range of 10-15%, which we estimate would lead to a 1.0-3.0% decline in Czech GDP. The original version, with a zero tariff on pharmaceuticals, a higher tariff of 25% on cars and a flat tariff of 20% on most other goods, would imply a total effective tariff of around 15%. We calculate that this would lead to a reduction in Czech GDP of 1.5-3.0%. For a lower flat tariff of 10% on other goods, to be applied during the 90-day moratorium, the total effective tariff would be around 10% and GDP would fall by 1.0-2.0%. In addition to these two scenarios, the table below also considers tariffs on pharmaceuticals, which President Trump also plans to implement. Pharmaceuticals are the largest category of EU exports to the US, ahead of machinery and cars. We estimate that around 85% of the impact of the US tariffs on the Czech economy is mediated through the EU market. This is the destination for 78% of Czech goods exports, while direct exports to the US account for only 3%. However, the share of the US in EU exports is much higher, at 20.6% in 2024. We calculate the impact of different levels of US tariffs on the Czech economy in our Special Report: https://bit.ly/US_tariffs_Czech_economy_EN.

Effective tariff rate on European imports to the US and the impact on Czech GDP for different scenarios

US import tariffs, implied total effective rate and estimated impact on Czech GDP	Original version	Moratorium	Moratorium + 10% on pharma	Moratorium + 25% on pharma
Pharmaceuticals	0%	0%	10%	25%
Motor vehicles (including parts)	25%	25%	25%	25%
Flat tariff on other goods	20%	10%	10%	10%
Approximate effective rate for EU	15%	10%	10%	15%
Estimated reduction of Czech GDP	1.5-3.0%	1.0-2.0%	1.0-2.0%	1.5-3.0%

Source: Economic & Strategy Research, Komerční banka

We forecast the Czech economy to enter a shallow recession in 2H25 and to grow by just over 1% in both 2025 and 2026. Our forecast assumes that the US tariffs will lead to an overall decline in Czech GDP of 1.0-1.5%. This is consistent with an effective tariff rate on EU imports of 10-15%, as implied by the current US measures. However, it is at the lower end of our estimated impact range in the table above (1-3%). We expect the economy to be flat qoq in 2Q25 and then to contract by 0.4% qoq in 3Q25 and 0.2% qoq in 4Q25. The decline in GDP will also be driven by the fading of the frontloading effect from the beginning of the year. Despite a mild recession in 2H25, we forecast economic growth of 1.5% in 2025, unchanged from our January forecast. This is because GDP growth at the turn of the year was much stronger than we had expected. The recession in 2H25 will be fully reflected in the economic outcome for 2026, for which we now expect GDP growth of only 1.2%, compared with 2.2% in our previous forecast. However, in terms of qoq GDP growth, we expect a gradual recovery in 2026. The main channel for the negative impact of US tariffs on the economy is likely to be lower fixed investment and net exports. Among various sectors, industry will be particularly affected and we expect it to contract for a third consecutive year in 2025. We expect growth in household consumption to continue, but the pace should slow significantly in 2H25 due to the recession. Continued growth in household consumption should be supported by high savings and the catch-up to pre-pandemic levels, which we expect to only be reached in 1Q26.

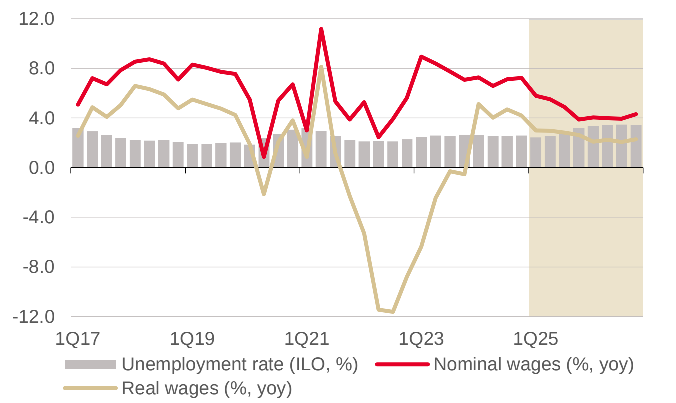
Our forecast is highly uncertain. It depends mainly on the level of US tariffs on imports from the EU. A significant deviation from our assumed effective rate of 10-15%, or the complete removal of tariffs, would likely undermine the forecast. At the same time, however, we think that the mere uncertainty surrounding the tariffs, whether they ultimately remain in place or not, will have a negative impact on economic growth. The enormous uncertainty and the sharp increase in the tariff burden are the reasons why we expect the negative effects to materialise relatively quickly. A rapid onset of economic slowdown is also part of the external assumptions of our forecast, both for Germany and for the euro area. On the other hand, the external assumptions also include the positive impact of expected higher government investment in infrastructure and defence, which will partly offset the negative impact of the US tariffs. This contributes to our forecast that the recession will be shallow.

Higher unemployment to hamper wage growth

Although the economic slowdown will partially cool the labour market, it will remain tight.

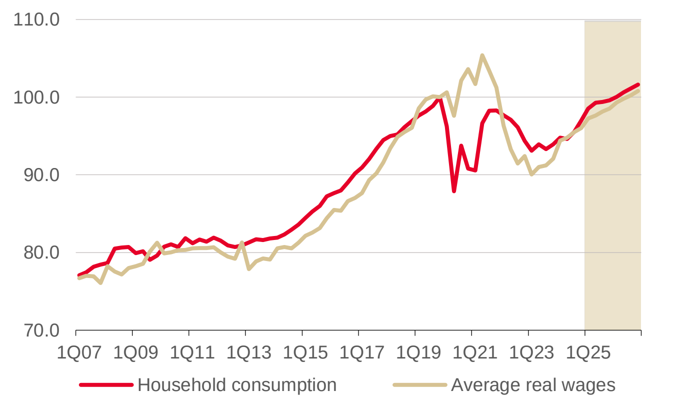
After 7.1% last year, we expect nominal wage growth to slow to 5.0% this year and to 4.1% in 2026. This is lower growth in both years than in our January forecast (5.4% and 4.6%, respectively). The downward revision reflects a more pessimistic outlook for the economy as a whole. In real terms, we expect wages to grow by 2.9% this year and 2.2% next year, but not to return to pre-pandemic levels until the end of 2026. Workers' efforts to compensate for the earlier decline in real wages should keep wage growth at a higher level, despite the expected cooling of the labour market. We forecast the ILO unemployment rate to rise from 2.6% last year to 2.8% in 2025 and 3.4% in 2026. As with other macroeconomic variables, the impact of the recession in 2H25 will therefore be more evident in the 2026 figure. In line with a mild recession, we forecast only a slight increase in unemployment, so the labour market should remain tight. This should contribute to further increases in wages and household consumption. We expect employment to grow by a substantial 1.7% this year, as suggested by the monthly data at the beginning of the year. This is likely to be a technical effect of the ongoing gradual inclusion of workers from Ukraine in the labour market statistics.

Wage growth to slow, dragged down by a weak economy and higher unemployment



Source: CZSO, Economic & Strategy Research, Komerční banka

We do not expect real wages and household consumption to return to pre-pandemic levels until 2026 (4Q19=100)



Source: CZSO, Economic & Strategy Research, Komerční banka

Economic slowdown and lower commodity prices to bring inflation to target

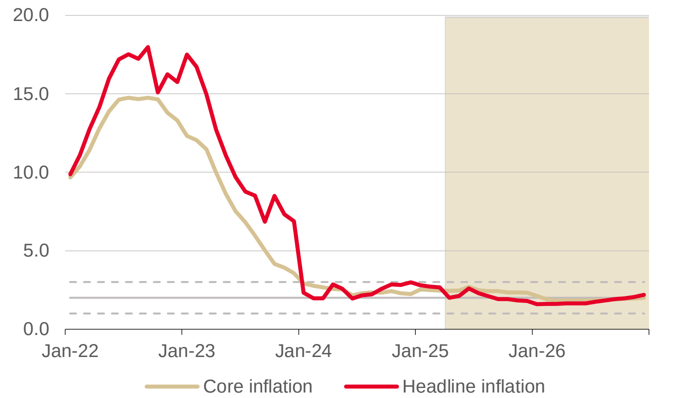
Headline and core inflation to remain close to or slightly below the central bank's 2% target this year and next.

The decline in inflation has been slower than we expected at the beginning of the year. Inflation fell from an average of 2.9% yoy in 4Q24 to 2.7% yoy in 1Q25 vs our forecast of 2.5%. Regulated prices exceeded our forecast the most, with household energy prices falling at a slower pace. Core inflation was also higher. It accelerated from 2.3% yoy in 4Q24 to 2.5% in 1Q25, while we had expected it to remain unchanged. The impact of higher excise duties on tobacco and alcohol was also stronger than we had expected. In contrast, the decline in fuel prices reached 4.4% yoy in 1Q25, faster than we had assumed. Food prices (including beverages and tobacco) rose by 4.2% yoy in 1Q25, broadly in line with our January forecast.

We expect inflation to average 2.2% this year and to fall to 1.8% next year. Compared with our previous forecast, the estimate for this year is unchanged, while that for next year is slightly lower than the original 2.1%. After more volatile annual inflation in 1H25, which should still remain within the CNB's tolerance band, we expect inflation to stabilise around or slightly below the 2% target in 2H25. We expect the impact of the recession on price developments to be felt mainly in 1H26, when we expect annual inflation to be more clearly below 2%. Growth in goods prices is likely to remain subdued, in line with the weak situation in the global industrial sector. The recent decline in commodity prices in response to the deteriorating global economic outlook should also have a positive impact. Energy prices edged down, including a significant drop in crude oil prices. As a result, we expect fuel prices to fall sharply and regulated prices to rise only slightly this year and next. Prices for some imported goods should also be pushed down by the weaker dollar against the euro. By contrast, prices for some agricultural commodities remain at higher levels, so food prices are likely to remain an inflationary factor. We expect consumer food prices to rise by an average of 3.4% this year and 2.2% next year.

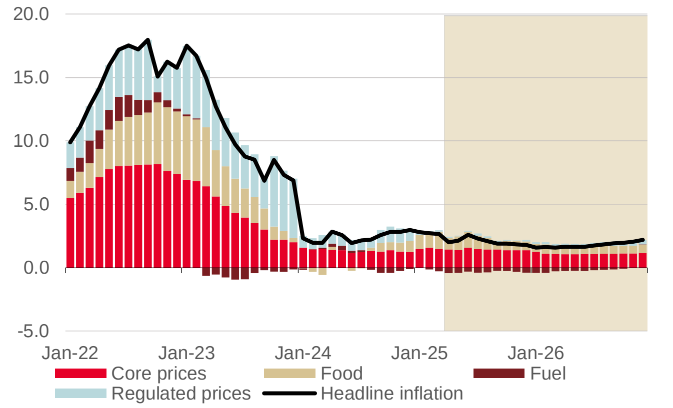
We expect core inflation to be 2.4% this year and to slow to 1.9% next year. This is higher in 2025 and lower in 2026 compared with our January forecast (2.3% and 2.2%, respectively). Core inflation is likely to remain above the 2% target this year, driven by services prices, including imputed and paid rents. These should reflect the strong recovery in the housing market amid the limited supply of flats and houses for sale. Although services price growth is likely to remain elevated for some time, we expect it to decelerate gradually as a result of the lagged effects of monetary tightening and the economic slowdown. Moreover, goods prices should offset the elevated services inflation. An upside risk to both core and headline inflation is the possibility of retaliatory tariffs by the EU, which would make imports more expensive. On the other hand, a stronger spillover of the economic slowdown into wages and household consumption than we expect would push core and headline inflation lower. The same applies to a possible redirection of Chinese exports from the US to Europe.

Inflation to remain within the CNB's tolerance band and to fall slightly below the 2% target next year (%, yoy)



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

Food and services price increases to remain elevated, while energy and goods prices to drag on inflation (%, pp, yoy)



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

Monetary policy

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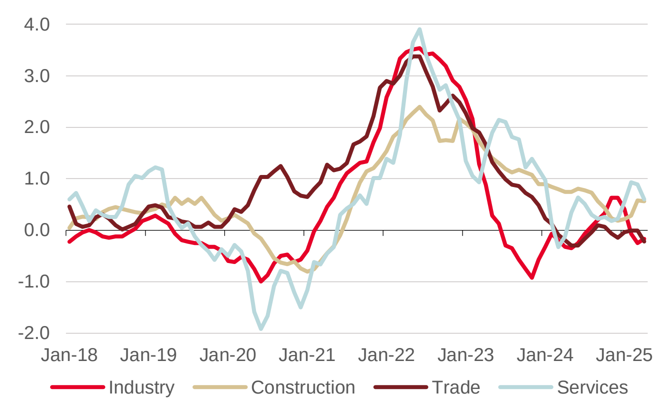
CNB to cut rates under the pressure of US tariffs

The central bank's previous steps and communication confirm the board's cautious stance on monetary easing. This is reflected in our interest rate forecast, which expects that the CNB will cut the repo rate by 25bp once a quarter. This should bring it to 3% by the end of the year. The economic slowdown caused by the US tariffs and the return of inflation to the 2% target should support this view. We now see the risks to our forecast as balanced. If the impact of the US tariffs is more significant, then the central bank is likely going to have to switch to an expansionary monetary policy.

We expect the CNB to cut rates by 25bp once a quarter, bringing the repo rate to 3% by the end of the year.

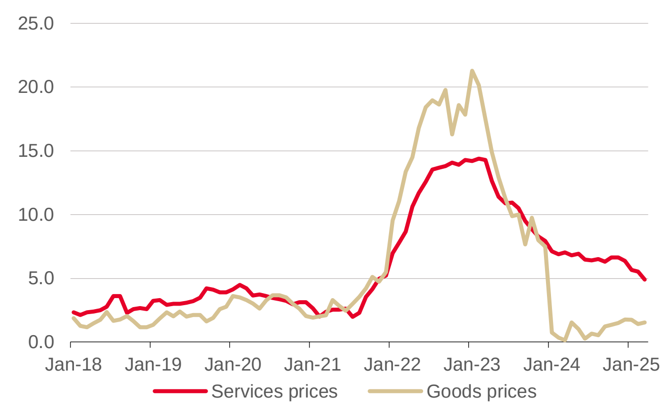
The Czech National Bank continues to lower interest rates only gradually. Although it cut rates by 25bp at its February meeting, it left them unchanged in March. In our January forecast, we had expected a 25bp cut at both meetings. The key repo rate now stands at 3.75%. The stability of interest rates in March was due to increased global uncertainty about the impact of US tariffs and the inflationary risks to the CNB's February forecast. These risks are mainly related to stronger economic growth. Like us, the central bank expected only weak GDP growth of 0.2% qoq in 4Q24, while the actual figure was 0.7%. Wage growth of 7.2% yoy in 4Q24 was only slightly higher than the CNB forecast (7.0%). The same is true for inflation, which averaged 2.7% yoy in 1Q25 vs the CNB forecast of 2.6%. However, core inflation was in line with the central bank's expectation of 2.5% yoy. Among the inflationary risks highlighted by the bank board, elevated services inflation continues to play an important role. According to CPI data, services price growth slowed from 4.7% to 4.5% yoy in March, while HICP data showed a deceleration from 5.5% to 4.9% yoy.

Inflation expectations are elevated in services and construction, but subdued in industry and trade (z-score, SA, 3MA)



Source: CZSO, Economic & Strategy Research, Komerční banka
Note: Price expectations for a specific economic sector based on the CZSO survey. Z-scores are calculated using time series from 2003 onwards and the graph shows their three-month moving averages.

Services prices continue to rise at a fast pace, while goods price growth remains below the 2% target (HICP, %, yoy)



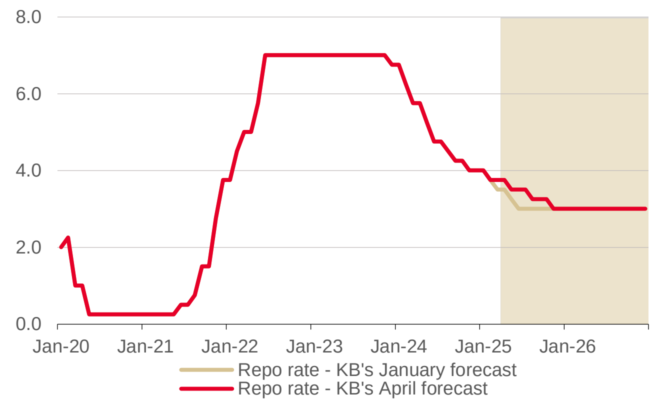
Source: Eurostat, Economic & Strategy Research, Komerční banka

We still expect the repo rate to reach 3% by the end of the year, but the pace of its decline is likely to be more gradual than in our January forecast. We now expect the CNB to cut interest rates by 25bp once a quarter, at the May, August and November meetings. In our January forecast, we had expected the terminal level of 3% to be reached in June. The CNB board's cautious stance, with its continued emphasis on inflationary risks, suggests only a gradual easing of policy. This is likely to be supported by the current high level of global uncertainty. We believe that our expected 25bp cut at the upcoming CNB meeting in May is associated with minimal risk of a policy error, which should convince the board to take this step. Even after a cut in the repo rate to 3.5%, monetary policy is likely to remain slightly restrictive. At the same time, the CNB would be better prepared to react if significant downside risks to the economy materialise. We expect that the negative economic trend will already be visible in a significant deterioration in qoq GDP growth in 2Q25. The CNB will see this in the data published before its August meeting, at which we expect it will cut rates again. Before the November meeting, the CNB will receive the 3Q25 GDP estimate, which we expect to show a qoq contraction in GDP, leading the repo rate to fall to its terminal level of 3%.

The CNB board's communication remains hawkish, but the US tariffs pose a significant negative risk to the economy.

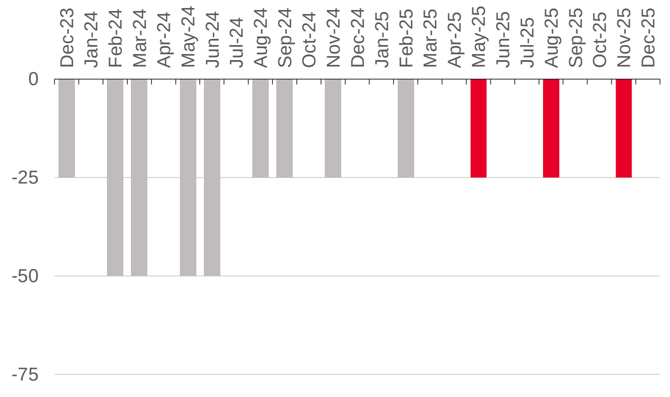
We currently see the risks to our interest rate forecast as balanced. In several previous forecasts, we have always stated that the balance of risks was skewed towards higher for longer rates due to hawkish communication from the board. However, this is now offset by the risk of an economic slowdown due to the impact of US tariffs. Our forecast incorporates the impact of US tariffs at the lower end of our estimates. If the more pessimistic scenarios materialise, the CNB would probably have to cut its repo rate below 3%. This will also depend on the extent to which household consumption is affected. In our forecast, it remains resilient, which is why inflation does not fall much below 2% in 2026 and the repo rate ends up at 3%, which we consider neutral. However, the question remains what level of repo rate the CNB board considers to be neutral. So far, it has tended to favour a level above 3%. Therefore, for some central bankers, a level of 3% may already represent a slightly expansionary monetary policy.

Repo rate to reach terminal level of 3.0% by year-end



Source: CNB, Economic & Strategy Research, Komerční banka

Repo rate cuts to continue at a pace of 25bp per quarter



Source: CNB, Economic & Strategy Research, Komerční banka

Fiscal policy

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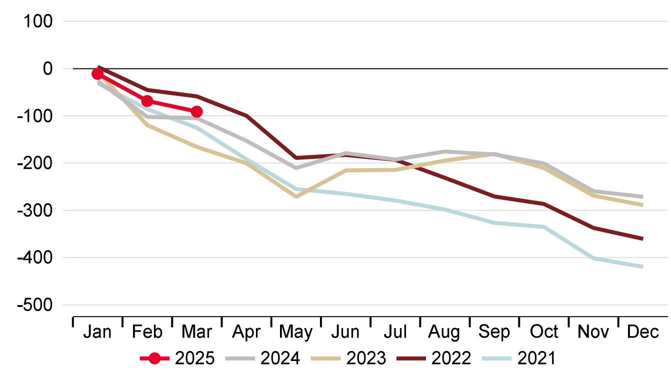
Consolidation is losing momentum

Additional defence spending should newly be exempt from domestic budget rules in the coming years. We therefore assume a slightly slower pace of consolidation than in our previous forecast. Nevertheless, we believe that the Czech Republic should continue to meet the Maastricht criteria for government deficit and debt. The state budget deficit should narrow to CZK240.0bn this year from CZK271.4bn last year. As a share of GDP, we expect the public finance deficit to remain close to last year's level of 2.2% this year. We expect the impact of fiscal policy on the economy to be roughly neutral this year. However, given the trend towards looser fiscal rules in Europe and the still relatively low level of overall debt in the Czech Republic, we see a medium-term risk that domestic rules could eventually be revised even further towards a looser fiscal policy. The risk of a more deficit-oriented fiscal stance is also skewed by the increasing likelihood of a more pronounced economic downturn associated with a rise in tariff barriers to global trade.

Budget fulfilment indicates continued recovery of the Czech economy

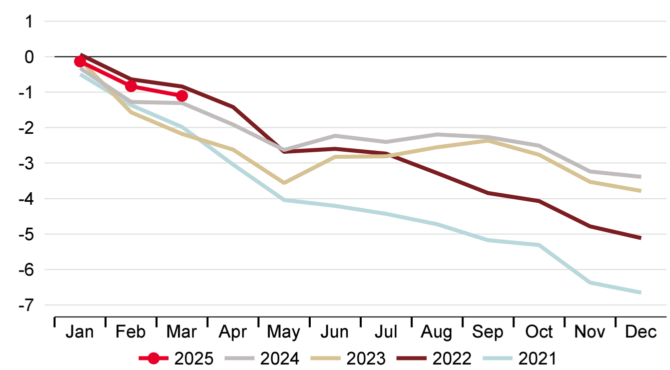
The cash deficit of the state budget reached CZK91.2bn in the first quarter of this year. Overall, in our view, the data on the implementation of the state budget to date do not signal an additional risk of not meeting the planned deficit of CZK241bn beyond the negative factors discussed in more detail below.

State budget balance (CZKbn, ytd cumulative)



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

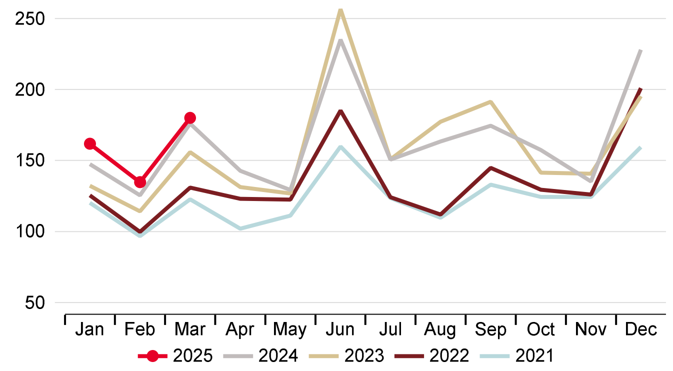
State budget balance (% GDP, ytd cumulative)



Source: Ministry of Finance, CZSO, Macrobond, Economic & Strategy Research, Komerční banka
Note: Nominal GDP in 2025 according to the KB forecast.

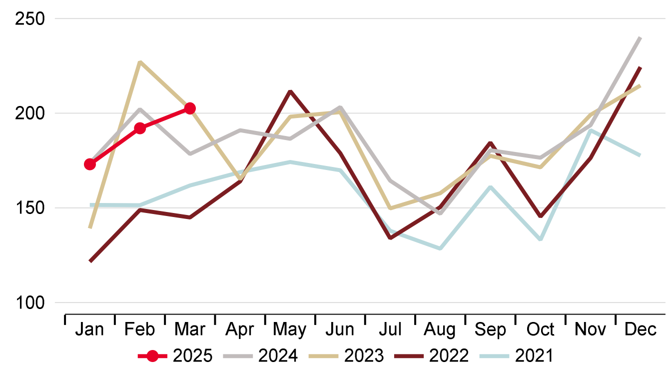
Expenditures in 1Q25 were CZK13.6bn (+2.4%) higher than a year earlier. Compared to the previous year, the increase was mainly due to transfers to local government budgets (+CZK8.2bn), especially related to the financing of education. Expenditures for servicing the public debt also increased significantly (+CZK5.1bn yoy). There was also an increase in investment transfers to the State Fund for Transport Infrastructure. The increase in expenditure (not only) in these chapters was partly offset by lower transfers to enterprises compared to the previous year, mainly due to the end of the cap on electricity prices. **Revenues increased by CZK27.4bn (+6.1%) yoy by the end of March,** with the largest contributions coming from social contributions (+CZK13.3bn) and VAT (+CZK6.1bn). The dynamics of both items suggest that solid wage growth, which is reflected in the recovery of consumer demand, is likely to have continued in 1Q25.

State budget revenue (CZKbn, non-cumulative)



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

State budget expenditure (CZKbn, non-cumulative)



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

This year, the state budget deficit should ease to CZK240bn

In our view, year-on-year growth in the revenue side of the government budget this year will be driven mainly by social contributions, but also by higher personal income tax and VAT collections, reflecting continued solid growth in nominal wages and consumption and, in the case of personal income tax, some legislative changes adopted as part of the consolidation package that took effect from the beginning of 2025. Investment is expected to be the main contributor to expenditure growth this year, but the increase in the volume of social benefit payments, especially old-age pensions, should also be noticeable. The cost of servicing public debt will also remain at a high level and will continue to rise this year, reaching about CZK100bn. In the following years, we forecast the state budget deficit to gradually decline to CZK170bn in 2029.

The risk to the state budget is skewed to the downside over the entire horizon. This year, in addition to uncertainties on some items (emission allowance revenues, education and renewable energy expenditures), this direction is also indicated by economic growth, which we estimate to be significantly lower than the MinFin's August 2024 forecast, on which the budget was based (MinFin: 2.7%, KB: 1.5%). On top of the growing risk of a more pronounced downturn in the global economy in the coming years, the possible loosening of domestic fiscal rules beyond the gradual increase in defence spending at a rate of 0.2pp of GDP from 2026 (included in the baseline scenario) also works in the same direction. In fact, EU fiscal rules are less stringent than Czech legislation, requiring 'only' a public deficit of up to 3% of GDP. Moreover, in recent months there has been a tendency to further relax EU fiscal rules in the context of rising defence spending. The possible provision of repayable financial assistance by the state for the construction of nuclear units could also lead to a higher deficit. On the other hand, the possible use of other sources of financing (savings in other areas, increased tax revenues or use of EU funds) could offset these factors.

Public finance deficit safely below 3% of GDP

In our view, this year's public finances will end with a deficit of 2.2% of GDP, the same as last year.

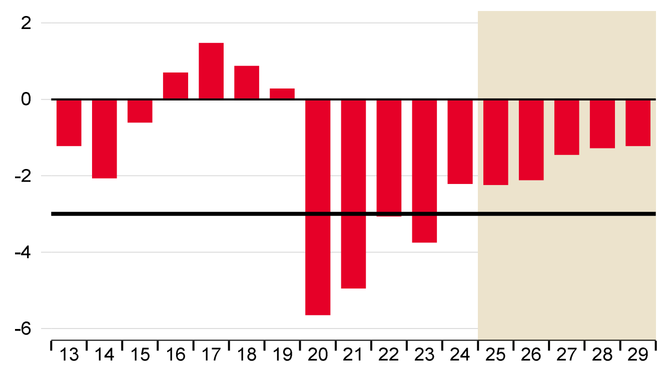
This year, we expect the general government deficit to remain at 2.2% of GDP. Last year's deficit in the ESA accrual methodology ended up being a positive surprise compared to the cash flow signals. This could be due to an increase in defence spending at the end of last year. In fact, this expenditure may show up in the accrual statistics with a time lag. Compared to the central government or state budget, the deficit of the public finance as a whole was reduced by the positive balance of local governments, which have been in surplus since 2013. At the same time, the accumulation of their bank balances continued. At the end of last year, according to the MinFin, municipalities and regions had a total of CZK527.4bn (+9.9% yoy) in their accounts, while their debt amounted to CZK89.5bn (-0.6% yoy). The deficit of public finances in relation to the state budget as a share of GDP is also expected to be lower on the projection horizon, as we expect the surpluses of local governments to continue. Thus, the main driver of the deficit reduction in 2027 is the reduction of the state budget deficit in line with the law. We estimate that the public sector debt-to-GDP ratio will increase by an average of 0.4pp per year in 2025-2029, reaching 45.5% of GDP in 2029. As a result, the Czech Republic is likely to remain among the third least indebted countries in the EU.

Public finance forecasts

	2024	2025f	2026f	2027f	2028f	2029f
Balance (% GDP)	-2.2	-2.2	-2.1	-1.5	-1.3	-1,2
Fiscal effort (pp of GDP)	0.6	0.1	0.5	0.2	0.0	0.0
Public debt (CZKbn)	3 491.9	3 731.9	3 961.9	4 136.9	4301.9	4471.9
Debt ratio (% GDP)	43.6	45.2	46.5	46.2	45.9	45.5

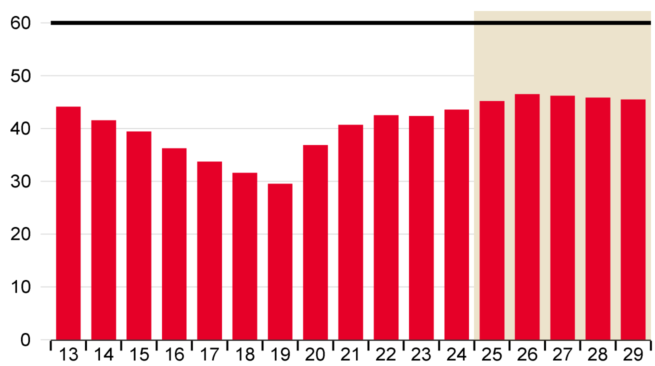
Source: CZSO, Macrobond, Ministry of Finance for published data, Economic & Strategy Research, Komerční banka
Note: fiscal effort is measured as the yoy change in the public finance balance, adjusted for the economic cycle and one-off operations on GDP in pp.

Public finance balance (% of nominal GDP)



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

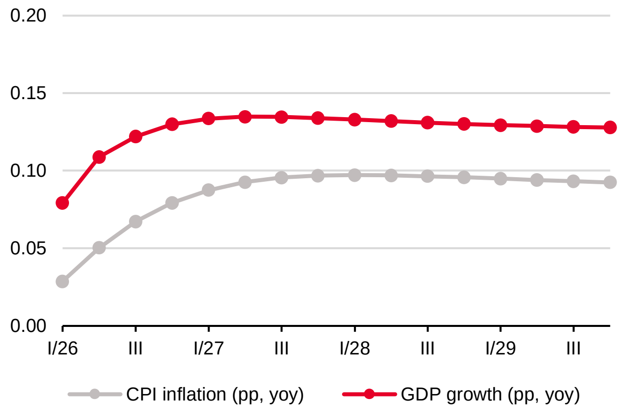
Public debt (% of nominal GDP)



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

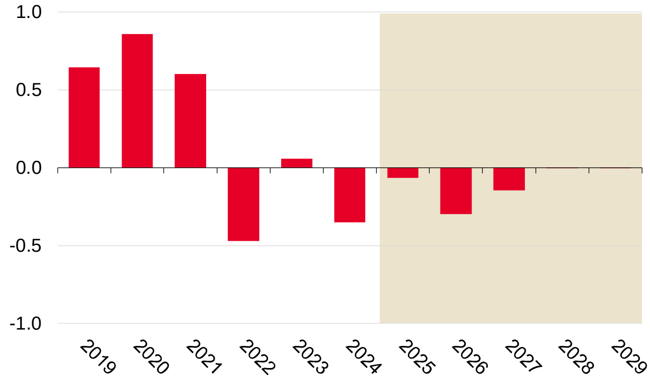
The impact of discretionary fiscal measures on the economy is likely to be broadly neutral this year. Following last year's visible reduction in the structural deficit of public finances, to which the so-called consolidation package also contributed, we estimate that the fiscal constraint, as measured by the approximate aggregate fiscal impulse, will disappear completely this year. The slightly restrictive effect of fiscal policy on economic growth will then resume in 2026-2027, in line with the consolidation path set by the law, although this will be partly offset by higher defence spending. This is expected to increase by 0.2 percentage point per year to reach the 3% of GDP target in 2030. We estimate the partial impact of an across-the-board increase in public spending of this magnitude to be around +0.1pp on average for GDP growth and inflation per year over the forecast horizon. This is therefore not a very significant change in the fiscal assumptions of our macroeconomic forecast.

Impact of a gradual increase in public spending at 0.2pp of GDP per year in 2026-2029



Source: Economic & Strategy Research, Komerční banka
Note: Estimate of the impact of the increase in public spending based on the BVAR model on GDP growth and the price level. Structural shocks to the general government revenue/expenditure ratio to GDP were identified based on sign restrictions.

Fiscal impulse (contribution to GDP growth in pp)



Source: CZSO, Ministry of Finance, Macrobond, Economic & Strategy Research, Komerční banka
Note: The fiscal impulse captures the estimate of the impact of a change in the structural balance (fiscal discretion) on GDP dynamics. Calculated on the basis of the top-down method with a uniform fiscal multiplier of 0.6.

Summary forecast table

	Q3 24	Q4 24	Q1 25	Q2 25	Q3 25	Q4 25	Q1 26	Q2 26	2024	2025	2026	2027	2028	2029
GDP and its breakdown														
GDP (real, yoy, %)	1.4	1.8	2.4	2.2	1.1	0.3	-0.1	0.6	1.0	1.5	1.2	2.8	2.5	2.4
Household consumption (real, yoy, %)	2.4	3.2	4.0	4.9	4.0	2.7	1.5	1.4	2.0	3.9	1.7	2.3	2.4	2.2
Government consumption (real, yoy, %)	3.4	3.3	4.2	2.9	2.9	3.2	3.2	3.2	3.3	3.3	2.8	1.7	1.8	1.6
Fixed investment (real, yoy, %)	-0.6	-3.1	-3.5	-4.4	-5.6	-3.5	-1.3	0.2	-1.4	-4.3	0.9	3.9	3.5	3.3
Net exports (contribution to yoy)	0.5	-1.1	-0.5	-0.7	-0.3	-0.9	-1.2	-0.7	0.7	-0.6	-0.3	0.2	0.2	0.2
Inventories (contribution to yoy)	-0.7	1.6	1.1	1.2	0.5	0.3	0.3	0.1	-0.9	0.8	0.1	0.2	0.0	0.1
Monthly data from the real economy														
Foreign trade (CZKbn)	28.2	43.4	96.9	62.4	5.9	27.1	82.4	53.1	227.1	192.4	176.4	201.5	235.3	252.2
Exports (nominal, yoy, %)	10.5	4.6	6.0	2.2	3.5	-1.2	-0.5	1.5	4.7	2.6	3.1	6.2	5.4	5.5
Imports (nominal, yoy, %)	7.6	5.1	5.2	3.1	5.6	0.1	0.8	2.4	2.4	3.5	3.6	5.9	4.9	5.4
Industrial production (real, yoy, %)	0.7	-2.2	0.4	-0.2	-1.9	-1.8	-2.7	-0.6	-1.0	-0.9	1.1	4.0	2.6	2.7
Construction output (real, yoy, %)	0.3	3.1	0.0	4.5	4.0	-0.4	-0.2	0.0	-1.6	2.0	0.7	4.9	3.5	3.1
Retail sales (real, yoy, %)	4.9	4.8	3.2	3.2	2.4	1.7	1.4	1.4	4.4	2.6	1.5	2.5	2.7	2.2
Labour market														
Wages (nominal, yoy, %)	7.1	7.2	5.8	5.5	4.9	3.9	4.0	4.0	7.1	5.0	4.1	4.4	4.6	4.3
Wages (real, yoy, %)	4.7	4.2	3.0	3.0	2.8	2.6	2.1	2.3	4.5	2.9	2.2	2.3	2.5	2.2
Unemployment rate (MLSA, %)	3.8	3.9	4.3	4.1	4.4	4.8	5.2	4.9	3.8	4.4	5.1	4.8	4.6	4.5
Unemployment rate (ILO 15+, %)	2.6	2.5	2.6	2.5	2.9	3.1	3.5	3.4	2.6	2.8	3.4	3.2	3.0	2.9
Employment (ILO 15+, yoy, %)	2.3	2.3	1.7	2.2	1.8	1.3	-0.8	-0.6	2.6	1.7	-0.4	0.6	0.5	0.3
Consumer and producer prices														
CPI Inflation (yoy, %)	2.3	2.9	2.7	2.2	2.1	1.8	1.6	1.6	2.4	2.2	1.8	2.1	2.0	2.0
Taxes (contribution to yoy inflation)	0.1	0.1	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.2	0.1	0.1	0.0	0.0
Core inflation (yoy, %) (*)	2.3	2.3	2.5	2.5	2.4	2.3	1.9	1.8	2.5	2.4	1.9	2.0	2.1	2.2
Food prices (yoy, %) (*)	1.1	2.8	4.2	3.9	3.1	2.5	2.3	2.1	0.7	3.4	2.2	2.1	1.9	1.9
Fuel prices (yoy, %) (*)	-3.9	-7.4	-4.4	-11.1	-9.4	-8.9	-10.3	-6.9	-0.9	-8.4	-5.4	0.3	0.6	0.6
Regulated prices (yoy, %)	5.8	7.4	1.2	0.5	0.7	0.4	1.1	1.6	6.3	0.7	1.7	2.1	2.1	2.0
Producer prices (yoy, %)	1.2	1.8	0.0	-0.6	-1.3	-2.3	-0.5	0.6	0.8	-1.0	0.7	1.7	1.8	1.8
Financial variables														
2W Repo (%, average)	4.6	4.1	3.9	3.6	3.4	3.1	3.0	3.0	5.1	3.5	3.0	3.0	3.0	3.0
3M PRIBOR (%, average)	4.5	4.0	3.8	3.6	3.5	3.3	3.3	3.3	5.0	3.5	3.3	3.3	3.3	3.3
EUR/CZK (average)	25.2	25.2	25.1	25.1	25.2	25.1	25.0	25.0	25.1	25.1	24.9	24.6	24.5	24.3
External environment														
GDP in EMU (real, yoy, %)	1.0	1.2	1.1	0.7	0.1	0.1	0.1	0.7	0.8	0.5	0.8	1.3	1.2	1.1
GDP in Germany (real, yoy, %)	-0.3	-0.2	-0.2	-0.4	-0.7	-0.2	-0.1	0.8	-0.2	-0.3	0.9	1.2	1.0	1.1
CPI in EMU (yoy, %)	2.1	2.2	2.4	2.0	1.8	1.7	1.6	1.8	2.4	2.0	1.8	2.0	2.0	2.1
Brent oil price (USD/bbl, average)	82.0	73.1	75.0	62.5	61.0	60.0	62.5	61.4	80.8	64.6	62.2	63.6	64.9	65.8
EUR/USD (quarter eop, year average)	1.10	1.07	1.05	1.10	1.12	1.13	1.15	1.16	1.08	1.10	1.17	1.19	1.21	1.23

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

Czech IRS market and government bonds

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Slight decline in rates and yields

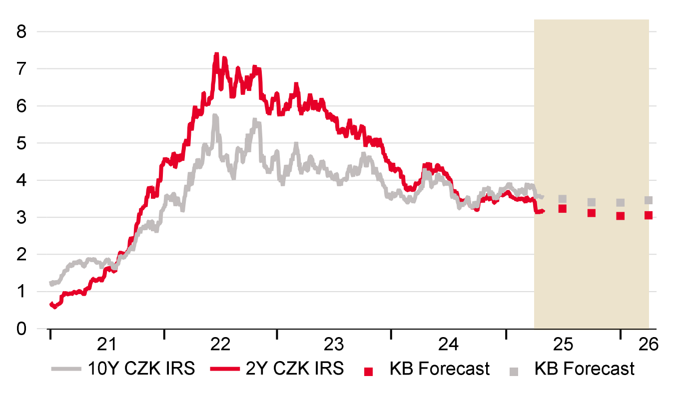
The CZK market interest rates should gradually decline this year due to the economic downturn caused by rising tariff barriers in global trade. In our view, the shorter CZK IRS will only be temporarily protected from a more significant decline by the CNB's cautious stance on further monetary policy rate cuts. A mild economic recession should also contribute to a gradual narrowing of the spread between CZGB yields and CZK market interest rates this year. Gross issuance of CZGBs is expected to increase this year and next, mainly as a result of higher maturing instruments outweighing an easing government budget deficit. In net terms, however, we estimate 2025 and 2026 issuance to be comparable to last year, at 2.6-2.7% of GDP.

The Czech IRS market: the economic downturn will push rates down further

The cooling of the domestic economy following the increase in tariff barriers should contribute to a decline in the koruna market interest rates this year.

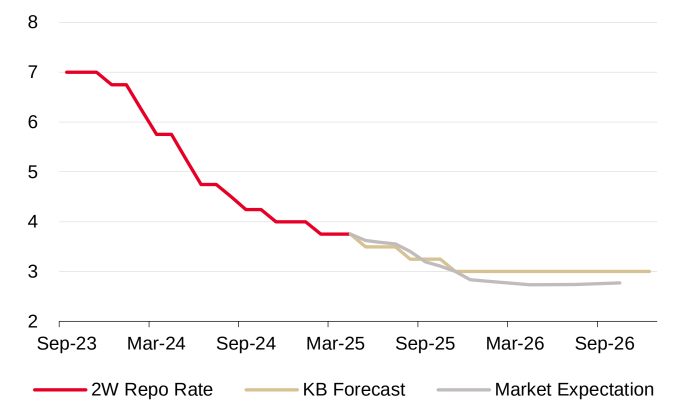
The decline in foreign interest rates following the announcement of new US tariffs has been reflected in the CZK curve. Increased concerns about a global economic slowdown have led the markets to price in more monetary easing, and even move into expansionary territory in the case of the euro area. Despite the CNB's continued hawkish stance, external developments have altered the projected path of the CNB's key repo rate, which, according to the koruna money market, will fall below 3% later this year. In our baseline scenario, however, we do not anticipate such significant monetary easing. We expect a temporary stabilisation at the shorter end of the CZK curve. However, the weakening of the domestic economy, which we believe will experience a mild recession this year due to an increase in protectionist measures in global trade, should gradually affect all maturities. The materialisation of the risk of rising tariffs is also the main reason for the downward revision of our koruna market interest rate forecasts.

IRS forecast (%)



Source: Bloomberg, Economic & Strategy Research, Komerční banka

Expected CNB key interest rate path as of 29 April 2025 (%)



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

CZK IRS outlook (end of period, %)

	2Q25f	3Q25f	4Q25f	1Q26f
2y	3.25	3.10	3.05	3.05
5y	3.25	3.15	3.15	3.20
10y	3.50	3.40	3.40	3.45

Source: Economic & Strategy Research, Komerční banka

Euro market consistently offers lower interest rates

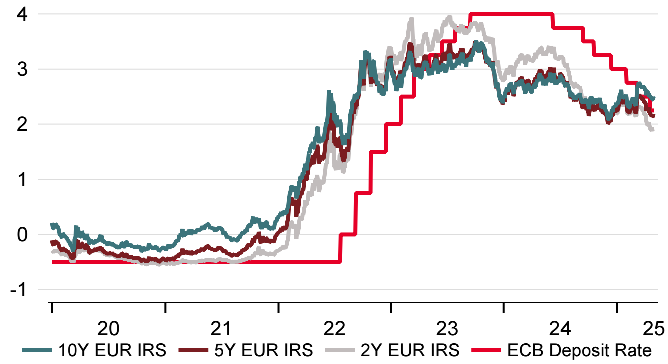
Interest rate hedging conditions in the koruna market have improved slightly across all maturities as foreign interest rates have fallen. The forward market offers lower rates at shorter maturities than spot IRS. Euro area interest rates remain significantly lower than koruna rates.

CZK forward interest rate swaps (%, p.a., vs 6M Pribor)

Forward	Maturity 1Y	2Y	3Y	5Y	10Y
Spot	3.38	3.21	3.20	3.26	3.52
3M	3.23	3.15	3.16	3.25	3.54
6M	3.09	3.10	3.14	3.25	3.55
9M	3.05	3.09	3.15	3.27	3.58
1Y	3.02	3.08	3.16	3.30	3.60
2Y	3.14	3.23	3.29	3.44	3.70
3Y	3.33	3.37	3.45	3.60	3.80

Source: Bloomberg, Economic & Strategy Research, Komerční banka, as of 29 April 2025

Euro area rates (%)



Source: Bloomberg, Economic & Strategy Research, Komerční banka

Gross CZGB issuance to rise visibly this year, net issuance more moderately

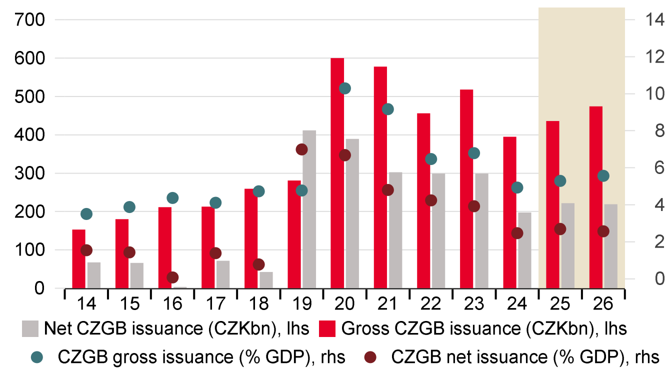
We expect the cash deficit related to the state budget to reach CZK240bn this year, down from CZK271.4bn last year. Combined with other financing needs, in particular repayments of maturing bonds and treasury bills, we estimate that gross CZGB issuance will reach CZK436.2bn this year, in the upper half of the range indicated by the Czech finance ministry (MinFin), which expects issuance of CZK350-450bn. For both 1Q25 and 2Q25, the MinFin has set the indicative volume of CZGBs offered in primary auctions at CZK85.0bn. At the same time, it has already issued CZK130bn of bonds on the primary market and CZK10.4bn on the secondary market in the first four calendar months. The MinFin is also allowing the issuance of a euro-denominated bond this year (we estimate the volume at EUR1bn), although it traditionally prefers to use the domestic market to cover foreign currency funding needs. So far this year, foreign currency issuance has been limited to the secondary market, with a volume of EUR250m. **Next year, we expect net issuance to remain close to the current level**, but higher maturing bond repayments should lead to a year-on-year increase in gross issuance.

Funding programme and issuance activity (CZKbn)

	2025		2026	
	MinFin	KB	MinFin	KB
State budget deficit	241.0	240.0	225.0	230.0
Transfers and other operations of state financial assets	7.4	7.4	2.5	2.5
T-bonds denominated in local currency redemptions	214.2	214.2	255.0	255.0
T-bonds denominated in foreign currency redemptions	0.0	0.0	0.0	0.0
Redemptions and early redemptions on savings bonds	19.0	19.0	16.0	16.0
Money market instrument redemptions	81.3	81.3	0.0	70.0
Redemption of T-bills		81.3		60.0
Redemption of other money market instruments		0.0		10.0
Repayments on credits and loans	0.6	0.6	26.5	26.5
Total financing needs	**563.5**	**562.5**	**525.1**	**600.0**
Money market instruments		70.0		60.0
T-bills		60.0		50.0
Other money market instruments		10.0		10.0
Gross issuance of CZK T-bonds on domestic market		436.2		473.9
Gross issuance of EUR T-bonds on domestic market/eurobond		25.0		25.0
Gross issuance of government savings bonds		1.3		1.1
Received credits and loans		15.0		20.0
Financial asset and liquidity management		15.0		20.0
Total financing sources		**562.5**		**600.0**
Gross borrowing requirement		**547.5**		**580.0**
Net CZGB issuance		**222.0**		**218.9**

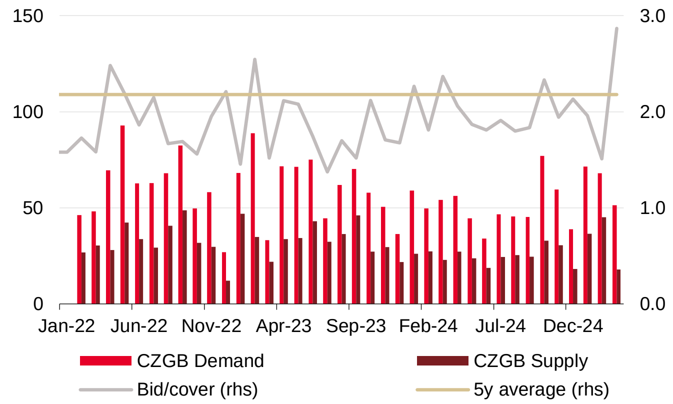
Source: MinFin, Economic & Strategy Research, Komerční banka

CZGB issuance



Source: MinFin, Economic & Strategy Research, Komerční banka

CZGB primary market (CZKbn)



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

CZGB yield forecast (end of period)

	2Q25f	3Q25f	4Q25f	1Q26f
2y CZGB yield (%)	3.30	3.05	2.95	2.90
5y CZGB yield (%)	3.60	3.35	3.25	3.30
10y CZGB yield (%)	4.00	3.85	3.75	3.80
10y CZGB ASW (bp)	50	40	40	30

Source: Economic & Strategy Research, Komerční banka

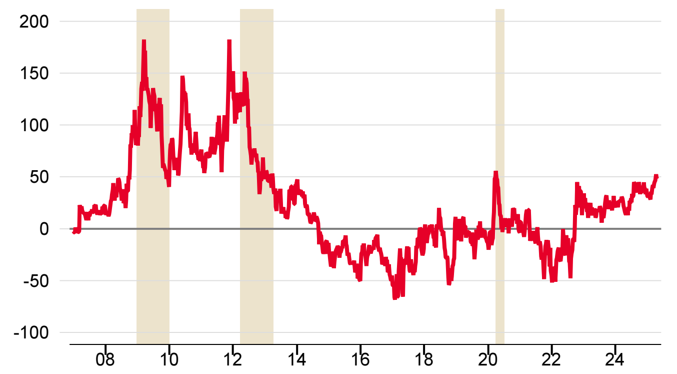
Fiscal developments and a cooling economy could benefit bonds

As CZGB yields lagged the recent decline in IRS, ASW spreads widened and bonds became relatively cheaper. This probably reflected strong risk aversion and an aversion to emerging market assets in general. However, the general government deficit is expected to remain at last year's level of 2.2% of GDP, and at the same time we expect the domestic economy to experience a mild recession this year. Such periods have historically been associated with relatively strong demand for CZGBs, which has been reflected in narrowing spreads to market rates. As with market interest rates, we expect bond yields to tend to come down gradually, with the decline accentuated by their relative appreciation against the IRS.

CZGB yield forecast (%)

Source: Bloomberg, Economic & Strategy Research, Komerční banka

10y CZGB ASW (bp)



Source: Bloomberg, Economic & Strategy Research, Komerční banka
Note: ASW= 10y CZGB yield - 10y CZK IRS; shading indicates recessionary period

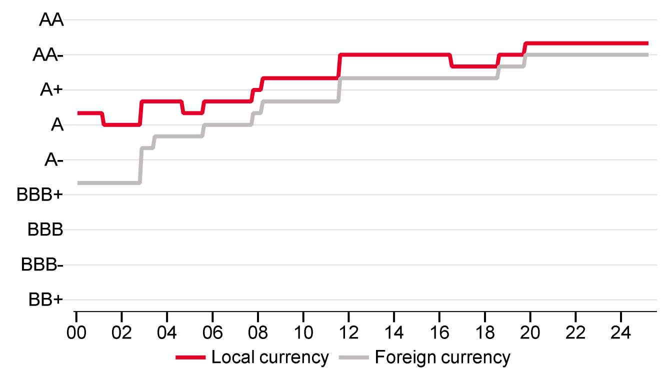
The Czech Republic's sovereign rating remains unchanged, with all major agencies showing stable outlooks. The last change occurred in February 2024, when Fitch, like Moody's in November 2023, upgraded its outlook for the Czech Republic's rating from negative to stable. The agencies linked the 2022 outlook downgrade mainly to the energy crisis, dependence on Russian energy and deteriorating public finances, all areas that have since seen improvement. The Czech Republic therefore still has the best credit rating of all CEE countries.

Sovereign rating overview

	Local currency	Outlook	Foreign currency	Outlook
S&P	AA	STABLE	AA-	STABLE
Moody's	Aa3	STABLE	Aa3	STABLE
Fitch	AA-	STABLE	AA-	STABLE

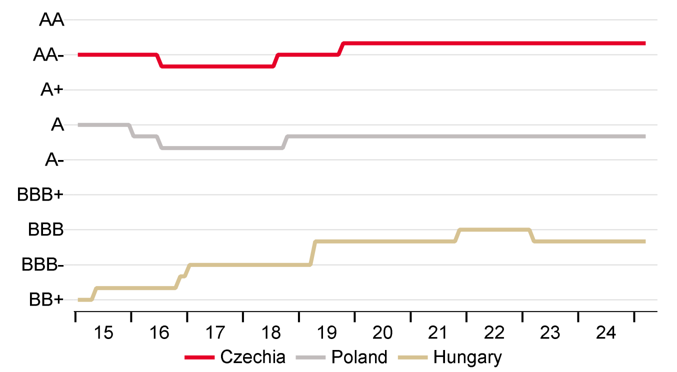
Source: Bloomberg, Economic & Strategy Research, Komerční banka

Czech Republic's rating (average of Fitch, S&P and Moody's)



Source: Bloomberg, Economic & Strategy Research, Komerční banka

Rating in CE3 – local currency (avg. of Fitch, S&P and Moody's)



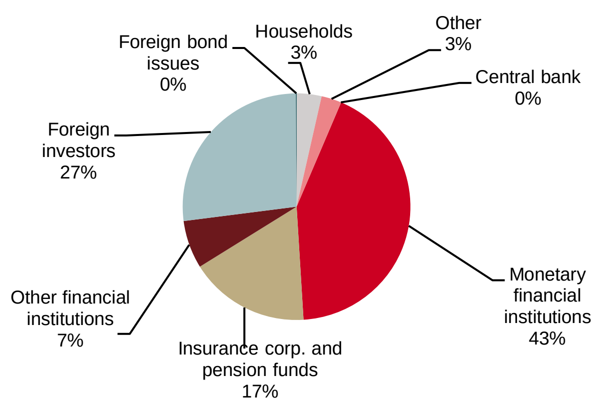
Source: Bloomberg, Economic & Strategy Research, Komerční banka

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
2.40 Sep-25	0.4	0.0	85%	3.40	-2	-1	2.03	-21	-7	-3	-42		-15	0.8	23	-9.9	1	-55.2	24
6.00 Feb-26	0.8	0.0	71%	3.22	-6	-10	1.93	-23	0	10	-81		-12	1.0	21	8.3	23	-22.2	23
1.00 Jun-26	1.1	0.0	100%	3.33	1	5	2.07	-7	1	28	-33		-3	1.4	13	-2.4	10	-11.1	22
0.25 Feb-27	1.7	0.0	112%	3.33	1	-7	2.18	2	1	22	-15		11	0.8	24	-0.5	14	-5.8	21
2.50 Aug-28	3.1	0.0	94%	3.35	-2	-25	2.42	9	-3	10	-7		19	0.9	22	5.1	20	-1.8	20
5.50 Dec-28	3.2	10.3	81%	3.34	-1	-25	2.48	10	-2	11	-11		22	1.3	15	8.6	24	-1.3	19
5.75 Mar-29	3.5	0.0	123%	3.38	-2	-26	2.56	14	-3	9	-10		27	1.2	18	7.0	21	-0.7	18
2.75 Jul-29	3.8	0.0	100%	3.47	0	-24	2.63	18	-1	12	-6		31	1.0	19	0.3	16	0.3	16
0.05 Nov-29	4.4	0.0	62%	3.52	-1	-22	2.67	18	-2	13	-5		29	1.0	20	-1.4	13	1.0	15
0.95 May-30	4.8	0.0	100%	3.57	1	-24	2.75	23	-1	11	0		32	1.3	16	-2.8	8	1.5	13
5.00 Sep-30	4.6	0.0	101%	3.60	-2	-22	2.87	30	-2	13	-2		39	1.6	12	-1.9	12	1.8	12
1.20 Mar-31	5.5	0.0	100%	3.67	1	-23	2.84	27	-1	10	4		37	1.3	17	-4.4	3	2.3	11
6.20 Jun-31	4.9	4.9	100%	3.68	0	-23	2.98	38	-1	12	0		43	2.0	9	-2.4	9	2.4	10
1.75 Jun-32	6.4	0.0	100%	3.81	0	-23	2.98	33	-1	9	7		39	1.4	14	-4.2	5	3.1	9
4.50 Nov-32	6.2	21.5	95%	3.84	1	-23	3.11	42	-1	9	18		45	2.2	6	-3.3	6	3.2	6
3.00 Mar-33	6.8	11.2	55%	3.90	0	-23	3.10	40	-1	8	18		44	1.8	11	-5.0	2	3.4	4
2.00 Oct-33	7.4	0.0	100%	3.96	3	-16	3.10	39	0	10	17		42	1.8	10	-4.4	4	3.5	1
4.90 Apr-34	7.2	4.6	108%	3.95	0	-23	3.22	46	1	11	23		48	2.4	3	2.3	17	3.5	2
3.50 Jun-36	8.3	15.7	102%	4.04	-1	-22	3.24	44	1	8	22		48	2.1	7	4.6	19	3.5	3
3.60 Dec-36	8.7	0.0	32%	4.11	0	-20	3.34	46	0	7	24		49	2.3	4	7.8	22	3.3	5
4.20 Jul-37	8.9	5.8	100%	4.19	3	-18	3.45	55	2	10	25		55	2.6	2	3.8	18	3.2	7
1.95 Apr-40	10.2	4.1	60%	4.30	3	-14	3.39	48	2	11	26		49	2.2	5	-2.1	11	3.1	8
1.50 Apr-44	12.6	4.1	64%	4.41	0	-10	3.39	45	3	15	27		49	2.0	8	-2.9	7	1.4	14
4.00 Apr-44	12.8	4.1	10%	4.56	-1	-8	3.64	69	1	17	42		69	2.6	1	0.0	15	0.0	17

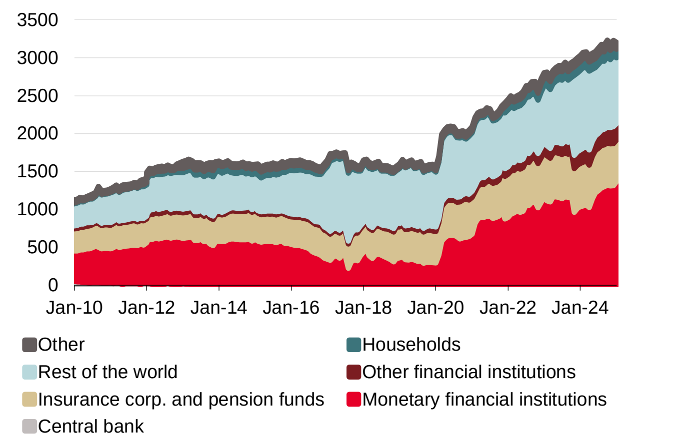
Source: Economic & Strategy Research, Komerční banka; Note: more details in CZGB Auction Alerts

Holdings of CZK government debt (February 2025)



Source: MinFin, Economic & Strategy Research, Komerční banka

Holdings of CZK government debt



Source: MinFin, Economic & Strategy Research, Komerční banka

Czech FX market

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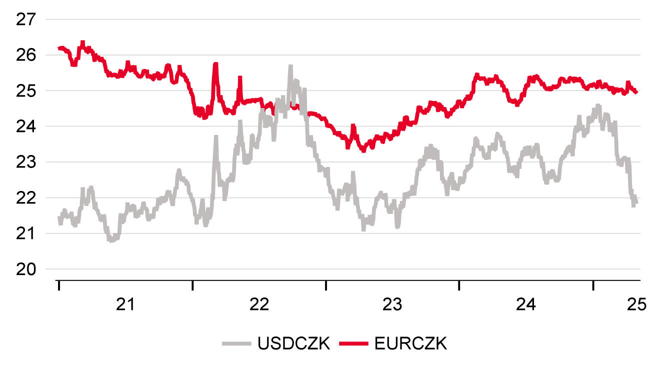
CZK strengthening is postponed

In our view, the aversion to risky assets and the slowdown in the Czech economy due to the increase in tariff barriers will not allow the koruna to significantly strengthen. On the other hand, the interest rate differential remains widened, supported by the CNB's continued restrictive policy, and capital outflows from the United States may continue. However, even this is unlikely to be enough to offset the negative factors. Overall, we expect that the EURCZK could remain above 25 on average until the end of the year. However, uncertainty remains high, while the pronounced volatility on the global currency markets has not yet fully spilled over to the Czech FX market.

Markets are beginning to challenge the US dollar as a safe haven

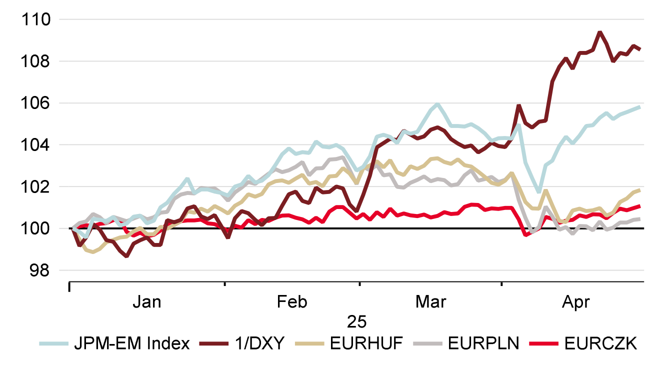
The EURCZK has been relatively stable around EURCZK 25 so far this year. The increased aversion to risky assets (and EM currencies) has been roughly offset by a still widespread interest rate differential and a significant surplus in domestic foreign trade (the current account of the balance of payments respectively), which may have reflected efforts to frontload before the introduction of new tariff barriers. The koruna firmed significantly against the US dollar. However, this was primarily due to capital outflows from overseas assets accompanied by a weakening of the US dollar, whose position as a traditional safe haven is beginning to be questioned by the markets. Moreover, in our view, risks are skewed towards an even more significant depreciation of the greenback than the EURUSD 1.15 level over the one-year horizon that is part of the external assumptions in our forecast. Indeed, the degree of monetary easing by the Fed might be even more pronounced than we assumed in the baseline scenario (we write more on this in the *External Environment* chapter).

CZK exchange rates



Source: Bloomberg, Economic & Strategy Research, Komerční banka

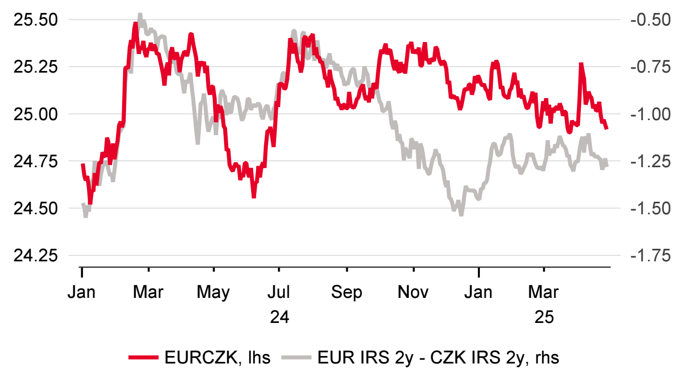
Performance of CE currencies (1 January 2025 = 100)



Source: Bloomberg, Economic & Strategy Research, Komerční banka
Note: a value above 100 indicates an appreciation of the CZK, PLN or HUF against the EUR or the Emerging Market Currency Index (JPM-EM), or a weakening of the Dollar Index (DXY) from 1 January 2025.

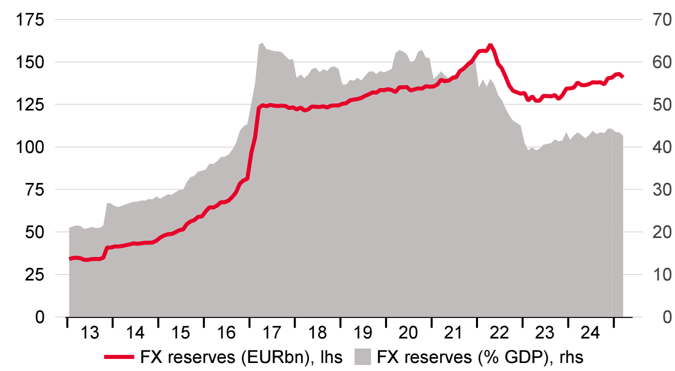
The CNB should continue to protect the koruna from significant weakening. A cautious approach to further monetary easing (see the *Monetary Policy* chapter for more details), which in our view is likely to be milder than what the koruna money market is pricing in, should keep the koruna market interest rate differential relatively wide. A possible increase in the volume of sales from the CNB's foreign exchange reserves, which has been close to EUR300m per month since September 2023, could also have a stabilising effect on the exchange rate. The central bank's foreign exchange reserves stood at EUR140.9bn at the end of March this year. Relative to the size of the economy, FX reserves amount to more than 40% of annual nominal GDP and remain one of the largest in the world in this respect.

EURCZK and interest rate differential



Source: Bloomberg, Economic & Strategy Research, Komerční banka

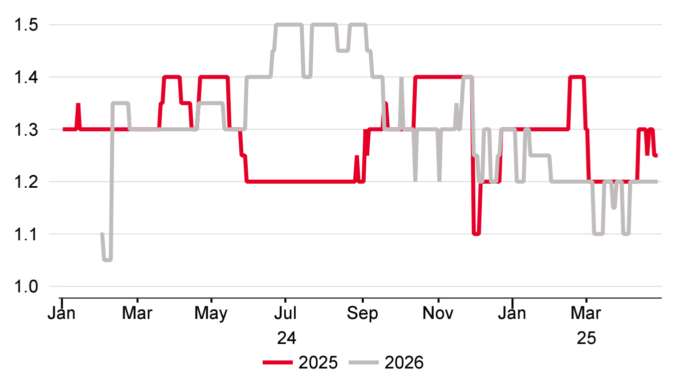
CNB's FX reserves



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

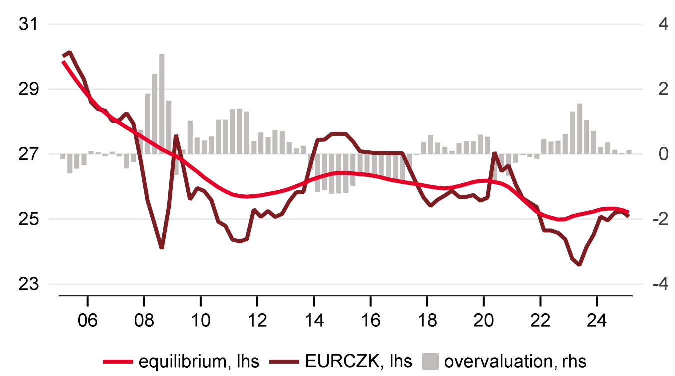
Economic activity will not support the koruna in the short term. Although we estimate that the exchange rate is close to its fundamental equilibrium, which is around EURCZK 25, a mild recession triggered by the increase in tariff barriers in global trade will push the koruna to weaken. The positive growth differential vis-à-vis the euro area should persist, but we expect it to be much lower than the Bloomberg analyst consensus. Moreover, the impact on the exchange rate will be muted by the fact that domestic demand is expected to drive growth. In our view, a more significant resumption of the Czech economy's real convergence with the euro area is unlikely before 2027.

GDP growth differential between the Czech Republic and the euro area – Bloomberg consensus (pp)



Source: Bloomberg, Economic & Strategy Research, Komerční banka

Equilibrium EURCZK exchange rate

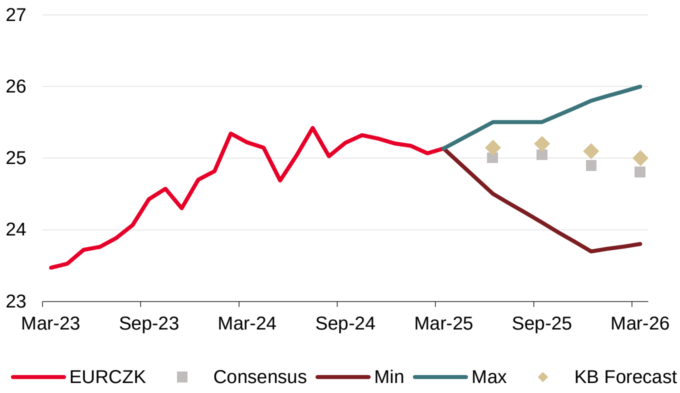


Source: Macrobond, Economic & Strategy Research, Komerční banka
Note: the estimated equilibrium exchange rate is based on a model of the economy's internal (output gap) and external (net export-to-GDP gap) equilibrium.

We have revised our EURCZK forecast to slightly weaker levels due to the worsened outlook for the expected dynamics of the Czech economy as a result of tariff barriers.

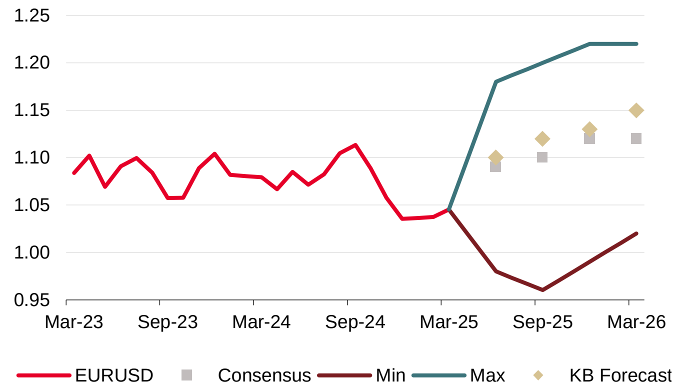
Overall, we expect the EURCZK to remain above 25 on average for the rest of the year. After an initial depreciation, some of the losses could be reversed at the turn of the year, when the gradual recovery of the European economies from the initial tariff shock and the decline in risk aversion should be evident. Nevertheless, we expect the subsequent appreciation of the koruna to be only gradual, while also taking into account the lower growth rate of the domestic economy's potential compared to the pre-pandemic period.

Expected EURCZK path, Bloomberg consensus (as of 29 April 2025)



Source: Bloomberg, Economic & Strategy Research, Komerční banka

Expected EURUSD path, Bloomberg consensus (as of 29 April 2025)



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

Koruna exchange rate forecast (end of period)

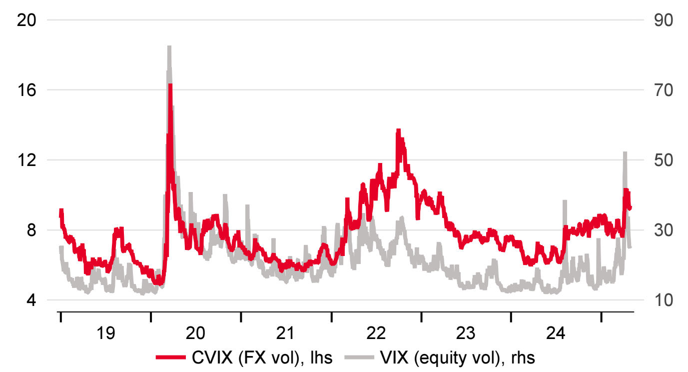
	2Q25f	3Q25f	4Q25f	1Q26f
EURCZK	25.15	25.20	25.10	25.00
USDCZK	22.90	22.50	22.20	21.75
EURUSD	1.10	1.12	1.13	1.15

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

Further developments are associated with significant uncertainty

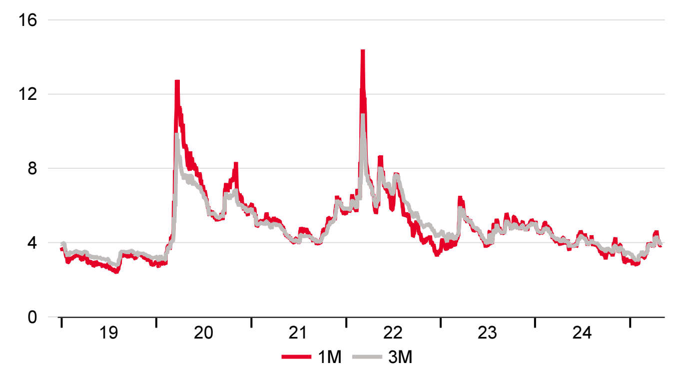
Risks are two-sided compared to our baseline scenario. This is mainly related to the general uncertainty about the final effective level of tariffs in global trade and their impact on the Czech economy and the euro area. The further development of the war in Ukraine also remains a general uncertainty with a potential impact on market perceptions of all Central European currencies. Overall, however, the increased nervousness in global currency markets (CVIX index) seems to have had only a limited impact on the koruna market so far. In addition to the relatively stable exchange rate of the koruna against the euro this year, implied volatility, which is close to last year's level, has not increased significantly.

Implied volatility in the global foreign exchange (CVIX) and US equity (VIX) markets



Source: Bloomberg, Economic & Strategy Research, Komerční banka

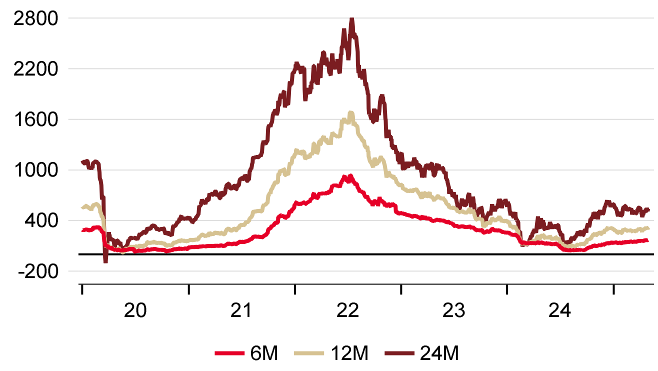
EURCZK implied volatility



Source: Bloomberg, Economic & Strategy Research, Komerční banka

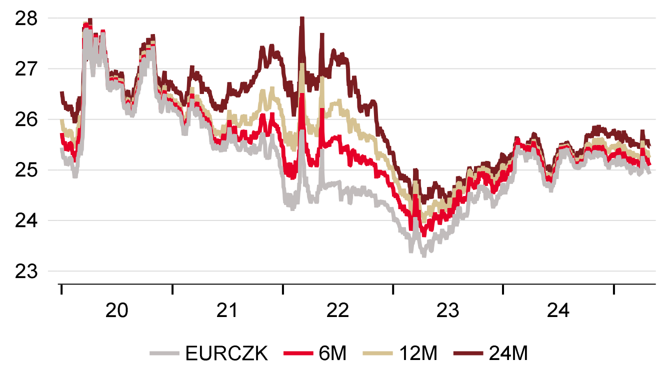
Potential market volatility could create attractive opportunities for currency hedging. In our baseline scenario, conditions for euro-exposed exporters should temporarily improve slightly as domestic activity slows and the spot exchange rate weakens later this year.

Forward points



Source: Bloomberg, Economic & Strategy Research, Komerční banka

Forward vs spot exchange rate: EURCZK



Source: Bloomberg, Economic & Strategy Research, Komerční banka

Banking sector

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Credit impulse for the economy put on ice amid uncertainty

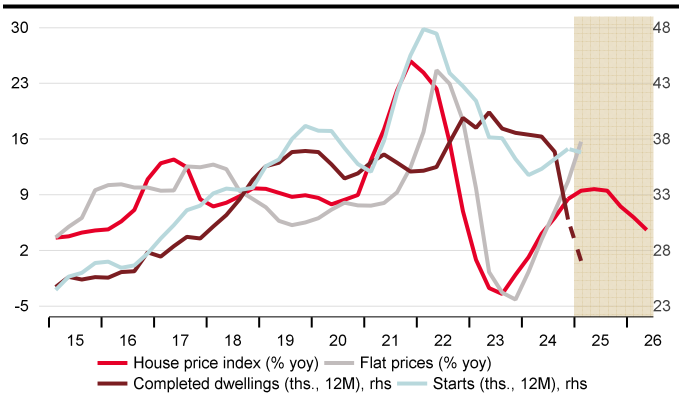
The slowdown in the domestic economy is likely to curb the strong recovery in household credit impulse. However, mortgage lending should prove more resilient, supported by the gradual easing of the strong housing market expansion and lower interest rates. High levels of uncertainty and a weak economy are likely to dampen corporate credit appetite again, which has been picking up slowly. Despite the easing of financial conditions, businesses are likely to put investment decisions on hold due to murky expectations. In contrast, we expect deposit expansion to gain momentum, boosted by uncertainty and growing concerns about the economy. It is likely to outpace credit growth once again, deepening the deposit overhang over credit and bolstering banks' deposit base. This should put more pressure on declining deposit rates, especially for the stickier household deposits. The weak performance and recession of the Czech economy is likely to heighten risks on banking portfolios, especially through an increase in Stage 2 loans (increased credit risk), while sector-specific risks linked to international trade exposures may invite regulatory scrutiny.

Housing and mortgage markets' ongoing strong expansion set to taper off

Housing and mortgage market boom should fade slowly, even amidst a worsened economy. They should draw support from lower interest rates and deferred demand. House prices continue to represent a major inflationary force.

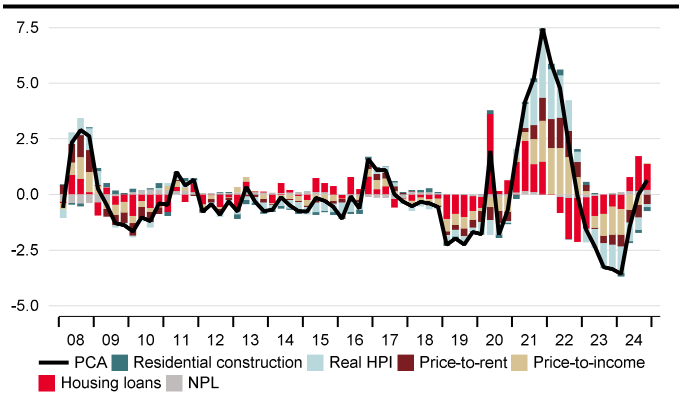
The rapid house price growth is likely to continue this year, but it should gradually taper off. However, it should remain a major inflationary force. The House Price Index (HPI) shows house prices up 8.5% yoy in 4Q24, as qoq growth accelerated to 2.9% qoq from 2.1% in 3Q24. This may have partly reflected higher transaction prices in Prague. Other house price metrics point to continued buoyant growth. Asking prices of flats were up 15.7% yoy in 1Q25, while *Flat Zone* data shows realised prices for new Prague flats up 13.9% yoy. After HPI growth averaged 5% last year, we expect it to accelerate to 9% in 2025. We expect qoq momentum to slow in 2H25 as the weak economy and household confidence take hold, although demand triggered by lower interest rates could partly offset this. The contracting economy and cooling labour market should lead to HPI growth slowing towards 4% in 2026, in our view. However, we still see risks to the upside, given the structural imbalance between strong demand for owner-occupied housing – partly crowded out by investment demand – and insufficient housing supply. Strong house price growth should further deteriorate housing affordability in Czechia, but we expect it to stabilise in 2026. Nevertheless, its low level is likely to shift demand to rentals in the medium term, while further marked house price growth despite the weak economy in 2026 would support this view.

House-price growth to remain high this year



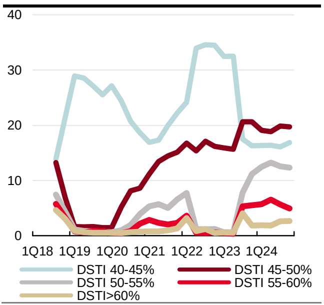
Source: CZSO, Macrobond. Economic & Strategy Research, Komerční banka
Note: data on dwelling completions and starts (as of February 2025) is extrapolated and only indicative for 1Q25. 12M denotes the 12-month trailing sum.

The housing market is expanding mainly thanks to demand



Source: Economic & Strategy Research, Komerční banka
Note: own calculations; PCA = principal component analysis vector. The composite housing index is the result of Principal Component Analysis (PCA). Construed as per Cár, M., & Vrbovský, R. (2019, March). *Composite index to assess housing price development in Slovakia.* https://www.nbs.sk/_img/documents/_publik_nbs_fsr/biatec/rok2019/03-2019/05_biatec19-3_car.pdf.

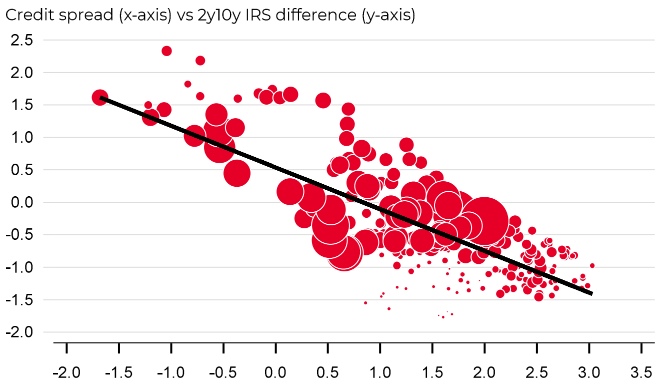
Share of loans by DSTI (%)



Source: CNB, Economic & Strategy Research, Komerční banka

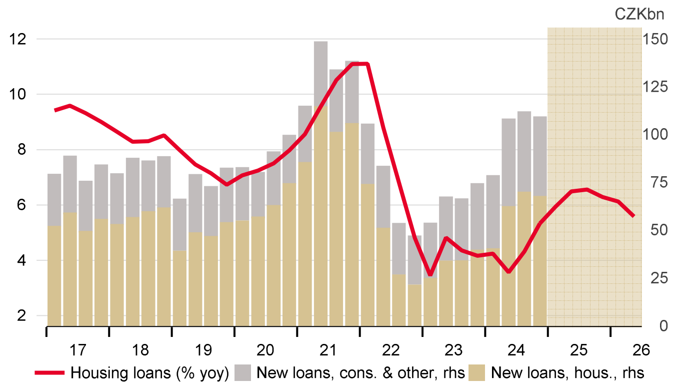
Mortgage lending should remain strong, but the scope for more exuberance is limited. Compared to the 2024 full-year volume of (pure) new housing loans (CZK241bn), we expect an increase of about 15-20%, which would imply volumes above CZK280bn in 2025. In February, volumes amounted to CZK52bn ytd (+83% ytd). Based on our assumptions, we estimate housing loan stock growth at 6.3% in 2025.[1] Expanding housing and mortgage activity brings the risk of reintroducing DSTI and DTI limits into view. However, concerns about the overvaluation of house prices and the inflation impact may be offset by low credit risk accumulation from a financial stability view. Moreover, they could amplify the downturn in the financial cycle borne by the economic slowdown. At the same time, the reintroduction of the 50% DSTI affects 20% of all housing loans and could largely cripple the mortgage market.

Mortgage credit spreads over IRS and IRS curve inversion (pp)



Source: CNB, Bloomberg, Macrobond, Economic & Strategy Research, Komerční banka
Note: The size of the bubbles represents the volume of new loans. Credit spread is computed as the difference between the realised interest rate on housing loans and the weighted average of corresponding market IRS (only an approximation).

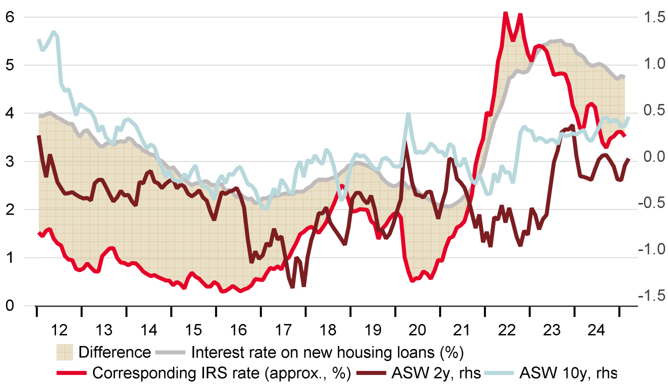
Housing loans stock reflects the previous rise in new loans



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

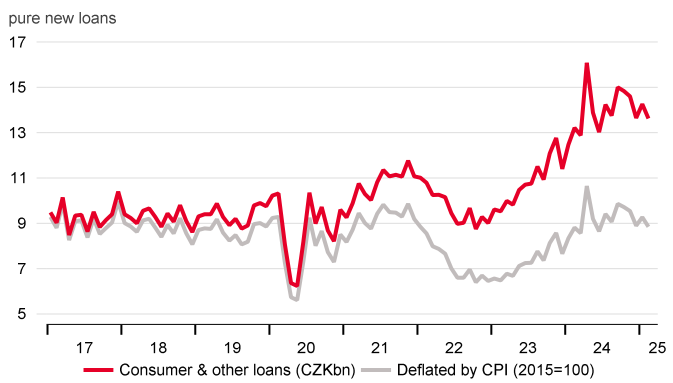
Mortgage rates should continue to fall gradually. In 1Q25 they fell to 4.7%, and we see room for them to fall below 4.5%, closer to 4%, opened up by the decline in market IRS, which may continue at the longer end. Given the shape of the IRS curve and the weak economy (higher risk), we see little chance of a visible decline below 4%. Moreover, banks' refinancing concerns should keep the spread between short and long interest rate fixings low. Higher repricing of mortgages due to the shift to short fixings boosts monetary policy transmission.

Mortgage rate spreads over IRS (%, pp)



Source: CNB, Bloomberg, Macrobond, Economic & Strategy Research, Komerční banka
Note: ASW (CZGB-IRS) of corresponding CZGBs.

Higher consumer loan volumes reflected earlier inflation



Source: CNB, Macrobond, Economic & Strategy Research, Komerční banka
Note: Pure new loans are loans or extensions to loans which enter the economy for the first time.

[1] Unless stated otherwise, values refer to the end of period yoy growth.

Concerns about the economy to cool demand for consumer financing

Slowing wage growth and a cooling labour market should reduce demand for consumer finance. Still, the growth of the retail segment lending should exceed the corporate segment.

The slowdown in household consumption and wage growth is likely to curb consumer financing. The strong household credit impulse foreshadowed a gradual strengthening of household consumption. Notwithstanding the mortgage segment, high levels of uncertainty, a cooling labour market and consumer spending restraint should affect consumer finance in particular, as households postpone some large purchases. Accordingly, we have lowered our estimates for consumer credit growth in 2025 and 2026 by 1-1.5pp to 7.7% and 5.6%, respectively. The weak domestic economy is likely to feed through into a rise in consumer credit default rates, which stood at 4.2% in 1Q25 (+0.13pp yoy). We expect the household debt ratio – as the ratio of household credit to nominal GDP – to rise to 29.4% of GDP by end-2025 (+1pp yoy), still below its peak in 2021 (30.9% of GDP). We continue to expect the growth in bank credit to be driven mainly by the retail segment, especially mortgages, while consumer credit should adjust more significantly and quickly to the weak economy.

Bank loans and deposits (%, yoy)

	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	1Q26	2Q26	2024	2025	2026	2027	2028	2029
Bank loans														
Total	5.5	5.3	5.1	5.7	6.0	5.4	5.3	5.0	6.1	5.5	5.1	5.5	5.7	5.5
Households - real estate loans	4.3	5.3	5.9	6.5	6.6	6.3	6.1	5.6	4.4	6.3	5.5	4.8	5.1	4.8
Households - consumer loans	8.8	9.6	8.6	8.8	8.2	7.7	7.2	6.1	8.7	8.3	6.1	6.6	6.8	6.1
Corporate loans	6.8	5.2	4.3	4.9	5.3	4.4	4.3	4.4	7.5	4.7	4.8	6.3	6.2	5.9
Deposits														
Total	6.8	7.8	5.4	7.1	6.2	5.5	7.9	7.0	7.4	6.0	6.7	4.9	4.7	4.7
Households	7.8	7.1	6.3	5.8	6.0	6.3	6.5	6.7	8.0	6.1	6.4	5.2	4.7	4.6
Non-financial corporations	6.3	8.7	3.1	5.6	6.3	4.0	7.5	6.1	5.4	4.8	6.0	4.1	4.2	4.1
Others	5.7	8.2	5.5	10.4	6.3	5.0	10.5	8.2	8.0	6.8	7.6	4.9	5.1	5.2
Ratios														
Loans/GDP	57.3	57.3	57.5	57.7	58.4	58.6	59.1	59.3	57.3	58.0	59.5	59.9	60.4	60.8
Deposits/GDP	93.7	90.2	93.7	95.4	95.8	92.3	98.6	100.0	92.6	94.3	98.1	98.3	98.1	98.0
Loans/deposits	61.1	63.5	61.4	60.5	61.0	63.5	59.9	59.3	61.9	61.6	60.7	61.0	61.6	62.1
Interest rates														
Real estate loans	4.9	4.7	4.7	4.6	4.5	4.3	4.2	4.2	5.0	4.5	4.2	4.1	4.1	4.1
Consumer loans	8.7	8.6	8.3	8.1	7.9	8.0	8.2	8.5	8.8	8.1	8.5	8.8	8.8	9.0
Corporate loans	6.0	5.7	5.5	5.3	5.2	5.0	5.0	5.1	6.3	5.3	5.1	5.1	5.0	5.0
Share of NPL														
Real estate loans	0.7	0.7	0.7	0.7	0.8	0.8	0.9	1.0	0.7	0.8	1.0	1.3	1.5	1.7
Consumer loans	4.2	4.1	4.2	4.5	4.9	5.4	5.7	5.8	4.2	4.8	6.1	7.3	7.7	8.1
Corporate loans	2.4	2.5	2.6	2.6	2.6	2.8	3.1	3.4	2.5	2.7	3.5	4.2	4.5	4.9

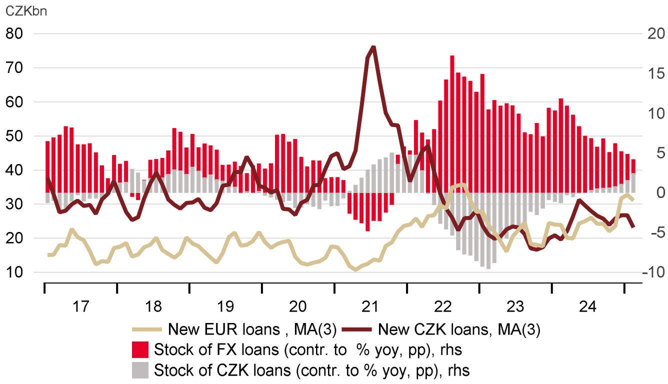
Source: CNB, CZSO, Macrobond, Economic & Strategy Research, Komerční banka
Note: quarterly values are end of period, full-year values are averages.

Tangible rise in corporate investment appetite put on hold amid trade wars

Radical uncertainty is likely to force corporates to reassess investment plans and curb lending. Despite lower interest rates, the credit impulse should remain weak.

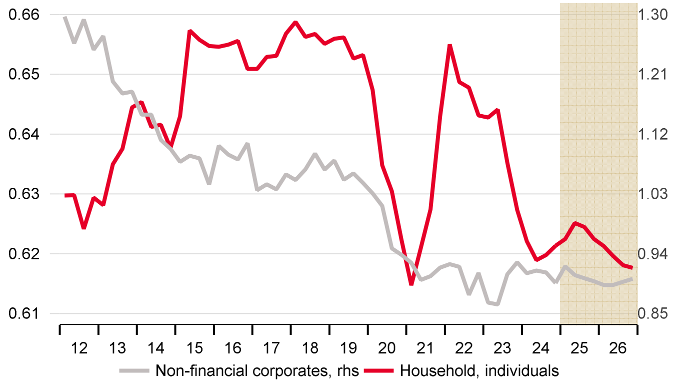
Corporate investment decisions are likely to be put on hold amid the tariff turmoil and a dramatic rise in uncertainty. This is likely to limit the credit appetite of non-financial corporates (NFCs). After a gradual rise in credit demand due to the improving economic outlook and lower interest rates, it is likely to experience a new setback. The share of new euro (EUR) and koruna (CZK) loans fluctuates around 50%. While demand for EUR loans is high compared to pre-2022 levels and the strengthening demand was evident throughout 2024, the volume of CZK loans remains muted by comparison, even with the higher price level. The volume of new EUR loans to NFCs was up 17% ytd in February, while CZK loans grew by 23% ytd.

NFC credit showed modest signs of strengthening



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

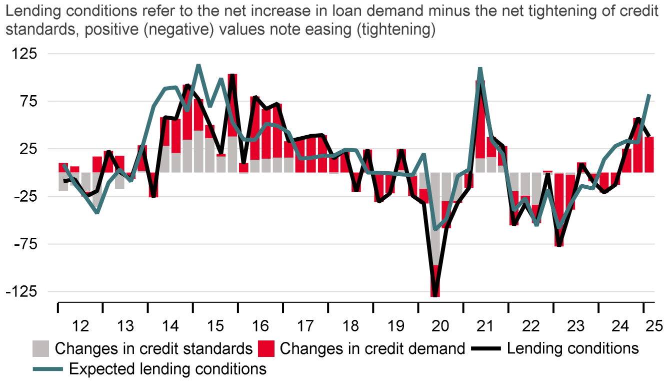
Loan-to-deposit ratios



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

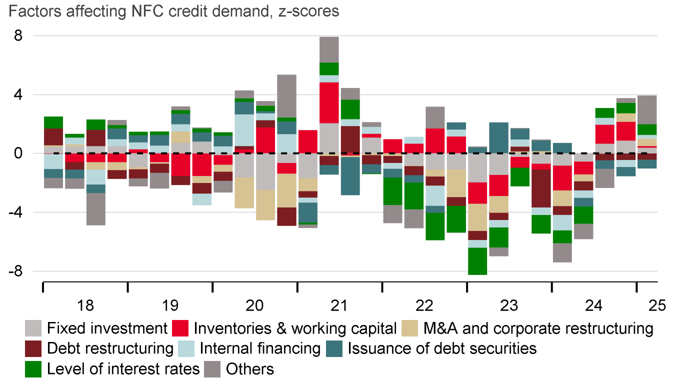
The recession in the domestic economy should be reflected mainly in lower credit demand from industry and export-oriented sectors. While sectors that are more reliant on domestic demand may benefit from easing financial conditions, especially those with higher leverage, such as residential construction, which is making up for the shortfall of previous years due to limited construction and now strong housing demand. However, the bank lending channel is likely to be constrained by non-bank financing and the growing share of domestic investment funds in real estate financing. Given the gloomy economic outlook and the radical uncertainty paralysing investment decisions, we revise our estimates for NFC credit growth down by 1.2pp and 0.8pp to 4.4% and 5.4% in 2025 and 2026, respectively.

Lending conditions indicate higher credit demand



Source: CNB, Macrobond, Economic & Strategy Research, Komerční banka
Note: Bank lending survey (CNB, 1Q25), loans to NFCs. Expected lending standards refer to questions regarding banks' expectations for the next three months.

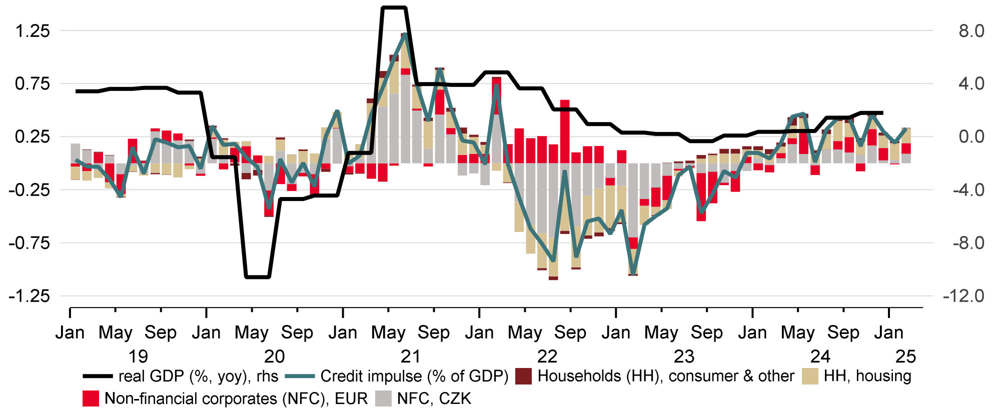
Factors affecting NFC credit demand according to banks



Source: CNB, Macrobond, Economic & Strategy Research, Komerční banka
Note: Stacking the z-scores in the bar chart is for presentation purposes only. *Others* refers to loans from other banks and non-bank institutions, issuance of equity and other.

The decline in market IRS and the increasing likelihood of CNB monetary easing contributed to the easing of financial conditions. In addition, banks expect lending standards to ease, although this may not necessarily materialise in view of the adverse economic situation. Given the CNB's more cautious approach, the current PRIBOR-EURIBOR spread could widen modestly from 145bp currently to 160bp in a 1y horizon, in our view, thus increasing the appeal of EUR funding, but this may be reduced by the prospect of a weaker CZK.

Credit impulse remains positive, but has not given the economy a major boost yet



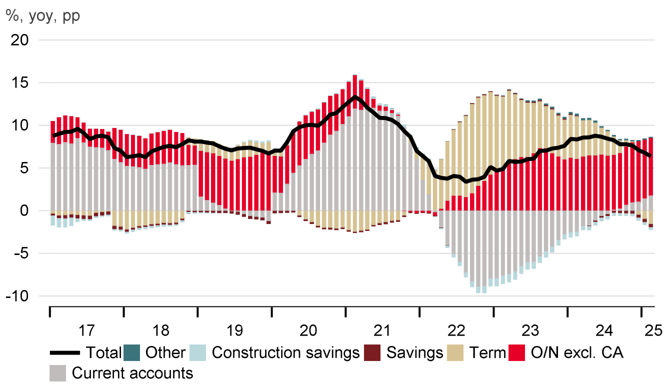
Source: CNB, CZSO, Macrobond, Economic & Strategy Research, Komerční banka
Note: credit impulse is defined as the change in the volume of new borrowing, often given as a % of annual GDP. The presented credit impulse represents the yoy change in new borrowing of the non-financial private sector to trailing 12m nominal GDP. It is further broken down according to the use of the loan for households and the currency denomination for firms. As opposed to monthly credit indicators (as of February 2025), GDP (as of 4Q24) is a quarterly indicator.

Deposit growth boosted by savings accumulation and investment deferrals

Higher savings and investment being put on ice should drive deposit expansion. This should exacerbate the overhang of deposits over loans.

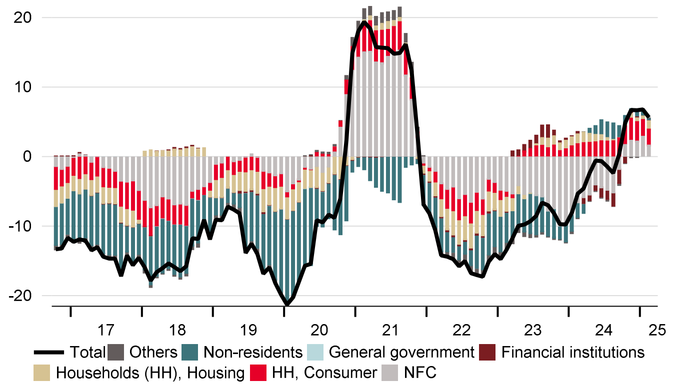
Despite lower interest rates, deposits accumulation is likely to be boosted by growing concerns about the economy. The negative impact of lower credit activity should be offset by higher savings, mostly precautionary as low interest rates offer less appeal. The overhang of deposits over loans is likely to widen from 2H25 onwards. Restrained household consumption and higher savings should boost household deposit balances. Higher corporate liquidity buffers and investment postponements should also contribute, as should the government, especially local governments. Banks' funding base should thus expand further, while the scope for lending will be limited. This could translate into a higher absorption capacity for bonds by residents. The easing monetary policy and high excess liquidity in the banking sector are likely to put pressure on the decline of deposit interest rates, especially for households, which have fallen by 0.3pp for non-term and 2.4pp for term deposits since February 2024. We expect deposit growth to average 6.0% in 2025. The outlook is subject to a greater degree of uncertainty due to the high volatility of corporate deposits and stronger outflows due to the increased interest rate sensitivity.

Household deposit growth has slowed, but fears may boost it



Source: CNB, Macrobond, Economic & Strategy Research, Komerční banka
Note: O/N = overnight; O/N excl. CA also includes non-term savings deposits.

Small rise in NPL volumes did not yet raise any alarms (%, yoy)



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

Economic slowdown to incur more risks to banks' loan portfolios

The deterioration in the economy should increase the risk on bank portfolios. However, we do not expect a major wave of defaults, but sector-specific risks should increase materially.

The accumulation of risks in banks' portfolios remained moderate despite the expanding financial cycle. Credit risks have increased slightly, but payment morale remains robust. However, a further negative shock in the form of trade wars is likely to increase the non-performing loan (NPL) ratios and require higher provisioning. To some extent, default rates on consumer loans have already shown some deterioration. In contrast, the mortgage segment remains solid. The situation in the corporate segment also remains remarkably stable, especially for large corporates, while SMEs are likely to be more affected by tight monetary policy. As the economic situation worsens due to trade wars, sector-specific risks are likely to increase – probably in proportion to international trade exposures. Such exposures may therefore come under regulatory scrutiny.

Key economic indicators

Macroeconomic indicators – long-term outlook

		2022	2023	2024	2025	2026	2027	2028	2029
GDP	real, %	2.9	0.1	1.0	1.5	1.2	2.8	2.5	2.4
Inflation	average, %	15.1	10.8	2.4	2.2	1.8	2.1	2.0	2.0
Current account	% of GDP	-4.7	-0.1	1.8	0.4	0.2	0.4	0.5	0.6
3M PRIBOR	average, %	6.3	7.1	5.0	3.5	3.3	3.3	3.3	3.3
EUR/CZK	average	24.6	24.0	25.1	25.1	24.9	24.6	24.5	24.3
USD/CZK	average	23.4	22.2	23.2	22.8	21.4	20.7	20.2	19.8

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

FX & interest-rate outlook

		28-04-2025	Jun-25	Sep-25	Dec-25	Mar-26	Jun.26
EUR/CZK	end of period	24.9	25.15	25.20	25.10	25.00	24.95
EUR/USD	end of period	1.14	1.10	1.12	1.13	1.15	1.16
USD/CZK	end of period	21.9	22.90	22.50	22.20	21.75	21.50
3M PRIBOR	end of period, %	3.64	3.55	3.45	3.20	3.25	3.25
10Y IRS	end of period, %	3.53	3.50	3.40	3.40	3.45	3.55

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

Monthly macroeconomic data

		VII-24	VIII-24	IX-24	X-24	XI-24	XII-24	I-25	II-25	III-25
Inflation (CPI)	%, yoy	2.2	2.2	2.6	2.8	2.8	3.0	2.8	2.7	2.7
Inflation (CPI)	%, mom	0.7	0.3	-0.4	0.3	0.1	-0.3	1.3	0.2	0.1
Producer prices (PPI)	%, yoy	1.7	1.1	0.6	0.8	1.7	2.8	0.5	-0.1	-0.3
Producer prices (PPI)	%, mom	0.6	-0.4	-0.2	0.1	0.4	0.6	0.2	-0.1	-0.3
Unemployment rate	% (MLSA)	3.8	3.8	3.9	3.8	3.9	4.1	4.3	4.4	4.3
Industrial production	%, yoy, c.p.	7.6	-1.1	5.0	-1.6	-2.4	-2.7	-0.8	-1.4	n.a.
Industrial sales	%, yoy, current.p.	9.7	2.2	7.5	0.8	0.5	0.0	1.0	-3.2	n.a.
Construction output	%, yoy, c.p.	1.5	0.3	-5.6	-1.9	2.8	9.3	7.2	0.7	n.a.
External trade	CZKbn (national met.)	11.6	37.8	19.5	15.5	18.0	21.9	15.8	20.0	n.a.
Current account	CZKbn	-6.9	13.8	-8.7	13.0	30.0	14.1	34.1	43.8	n.a.
Financial account	CZKbn	-31.5	14.7	4.9	43.7	-23.5	53.9	24.2	20.9	n.a.
M2 growth	%, yoy	5.3	5.8	5.4	6.0	5.3	7.4	4.5	4.0	n.a.
State budget	CZKbn (YTD cum.)	-192.3	-175.8	-181.8	-200.7	-259.2	-271.4	-11.2	-68.6	-91.2
PRIBOR 3M	%, average	4.61	4.41	4.30	4.13	3.95	3.91	3.88	3.76	3.72
EUR/CZK	average	25.3	25.2	25.1	25.3	25.3	25.1	25.2	25.1	25.0
USD/CZK	average	23.3	22.8	22.6	23.2	23.8	24.0	24.3	24.1	23.1

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

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