Quarterly report

Czech Economic Outlook

Czech economy losing power

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- **Recession likely at turn of year.** The Czech economy has so far been resilient to the impact of the energy crisis. However, demand for consumer and industrial goods is falling. This should lead to a qoq decline in GDP in 4Q22 and 1Q23, followed by only a gradual recovery. We do not expect GDP to reach pre-pandemic levels until 3Q23.

- **Inflation may have already peaked.** The government's measures on expensive energy should help reduce inflation in 4Q22. However, once this effect subsides, inflation is likely to pick up again slightly at the start of next year and remain in double digits for much of the year. In our view, the 2% target will not be reached until the end of 2024.

- **CNB set to keep rates at 7%.** This is being indicated by the dovish rhetoric of the new bank board. We think the first cut in rates could occur in mid-2023, but the policy-neutral 3% is unlikely to be reached until the end of 2024.

- **Higher rates for longer.** We expect market rates to peak in 1H23 but are likely to remain elevated for most of next year. Only the CNB starting to return rates back to neutral levels may bring a more significant decline.

- **Weakening pressures on koruna to persist.** Despite the CNB's presence in the FX market, we expect the koruna to weaken to EUR/CZK 24.85 by year-end and to EUR/CZK 25.10 on a one-year horizon due to deteriorating fundamentals.

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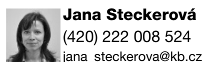
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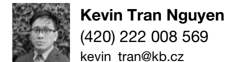
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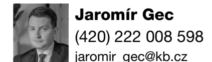
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Natural gas: a heavy-calibre weapon against western sanctions

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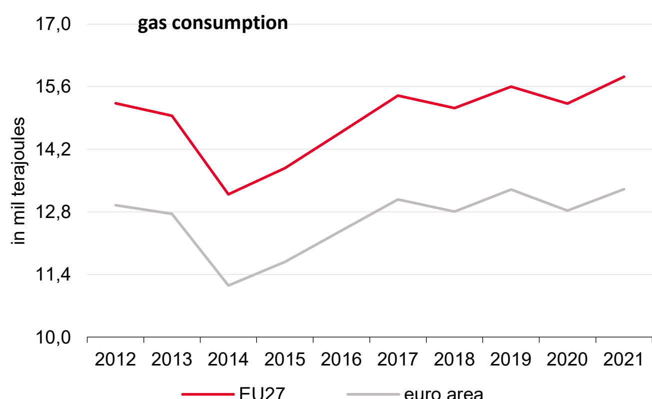
The key theme of this latest edition of our *Czech Economic Outlook* is that *the Czech economy is losing power*. We are referring here to the high energy intensity of the country's output and to the uncertainty over whether it will have enough energy and at what price. In addition, at the turn of the year, we expect the Czech economy to experience a shallow recession, with weaker growth dynamics in the following quarter.

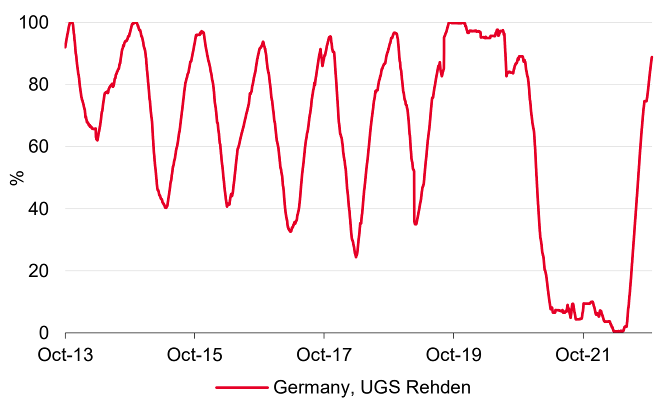
Russia is not waging war against Ukraine with conventional weapons alone; strategic, mostly energy commodities are also playing an important role. Russia has long based its economic and geopolitical model on exporting such commodities. **Europe's dependence on Russian gas supply appears to be the primary critical issue here**. Before the war, Russian gas covered approximately half of Europe's total gas consumption, and the Czech Republic was almost entirely dependent on Russian gas.

Europe's gas consumption hit a record high last year



Source: Eurostat, Economic and Strategy Research, Komerční banka

Gazprom didn't fill German gas-storage facilities at all last year



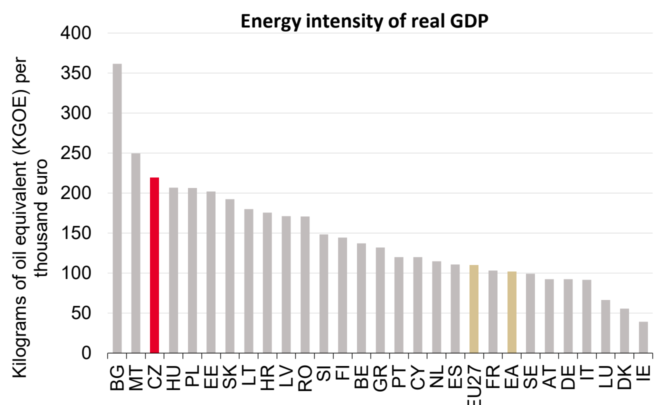
Source: Macrobond, Economic and Strategy Research, Komerční banka

The prospect of Russian gas being used as an economic weapon had been looming for quite some time. In hindsight, the gradual reduction in Russian gas supply to Europe via Ukraine, visible since late 2019, was clearly a warning sign. Contrary to all convention, the German gas-storage facilities leased by Russian gas company Gazprom, were not even filled at all last year. At the same time, gas consumption in Europe has long been rising and reached its highest-ever level in 2021.

Gas prices skyrocketed at the end of the summer holiday season

Source: Bloomberg, Economic and Strategy Research, Komerční banka

The energy intensity of Czech output is one of the highest in Europe



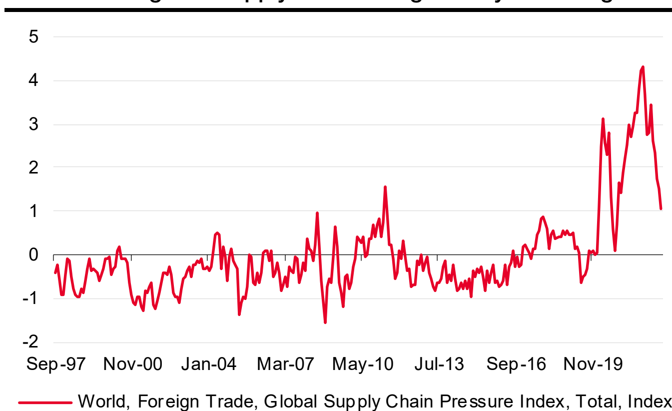
Source: Eurostat, Economic and Strategy Research, Komerční banka

The question of whether or not there will be any gas at all, and at what prices, is therefore one of the most burning issues ahead of the coming winter. Thus, gas and electric power prices have become a key determining factor of the Czech economy's prospects for the coming months and quarters. It was difficult enough to prepare macro-economic forecasts during the initial pandemic waves and at the beginning of the war in Ukraine. And the situation is not much better now for the forecasters; in fact quite the opposite. The reason is that expensive energy clearly is affecting European and Czech industry, while the Czech economy's energy intensity is one of the highest in Europe. Energy is also a major item in the household consumption basket and this is naturally weighing on household budgets and causing consumer confidence to fall to record lows.

It is therefore likely to be the energy crisis that sends the Czech economy into recession in the end. Nevertheless, it is fighting back tenaciously for the time being. And it even seems right now that the country's economy is set to record a qoq decline in GDP in the last quarter of this year alone. How deep and long the recession will be depending on a number of factors, ranging from the severity of the coming winter and the speed at which gas-storage facilities are depleted and then filled again from, say, Russia or under LNG delivery contracts, to the solution that is ultimately be adopted at the pan-European and national levels. For the time being, leaders have yet to agree on any single solution and the ideas and attitudes are changing relatively often. We are moving from price controls and price caps to financial compensations from the public purse. The Czech cabinet has also included both of these elements in its toolkit. The granting of some compensation for energy advance payments until the end of the year and the waiver on renewable energy financing fees for households should help to tame inflation somewhat in the last few months of the year. Martin Gürtler offers a detailed quantification of the effects of the cabinet's measures to combat high energy costs in his analysis (see report https://bit.ly/3rJTT66).

However, the cabinet's help in the fight against high energy costs has its consequences: public finance consolidation has been postponed indefinitely, and the repeatedly large national budget deficits and across-the-board stimulation of demand are seriously undermining the likelihood of the inflation target being met. Apparently the inflation target will not be met again until the end of 2024. We fear that the central bank will not go out of its way to help inflation subside sooner either.

Difficulties in global supply chains are gradually subsiding



Source: Federal Reserve Bank of New York, Macrobond, Economic and Strategy Research , Komerční banka

In our view, the current energy crisis changes nothing with respect to achieving the adopted climate targets; in fact, we believe that on the contrary, it should be a catalyst for the entire process, as Jana Steckerová discusses in detail in her ESG box. This will be, and we have to note that it already is being, positively reflected in solid investment activity, at the moment mainly in the private sector, as the statistics for 1H22 show. Efforts by households to invest in more energy-efficient solutions are also apparent; although they are primarily aimed at overall savings, and this is reflected in declining household consumption. On the other

hand, the improving situation in global supply chains, which is likely to be reflected in higher exports, should have a positive influence on economic development.

The coming winter may therefore be very bleak indeed, but the Czech economy's wheels should not freeze up, in our view. Komerční banka's entire *Economic and Strategic Research* team is hoping this proves to be the case.

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External environment and assumptions

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Central banks to prioritise inflation fight over recession risk

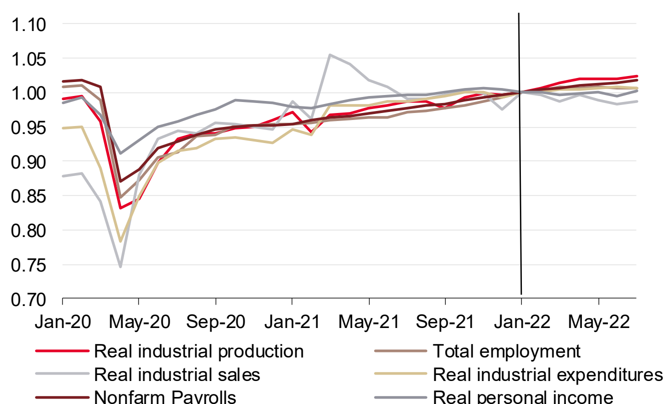
Inflation in the US and euro area may have peaked but will likely only very reluctantly return to central banks' targets. The ECB and Fed will probably have to continue to raise interest rates sharply, even at the cost of plunging both economies into mild recession. The key rate is forecast to climb to 4.6% in the US in January next year and 3% in the eurozone in the first half of the year, but the risks are biased toward even more vigorous tightening. Restrictive monetary policy will likely then result in a shallow recession in the US in early 2024. The eurozone will probably only narrowly avoid one at the end of this year, with quarter-on-quarter GDP growth at zero. However, the German economy should see a recession in the second half of this year.

US: Recession only in 2024

Lower external trade deficit to contribute significantly to GDP growth.

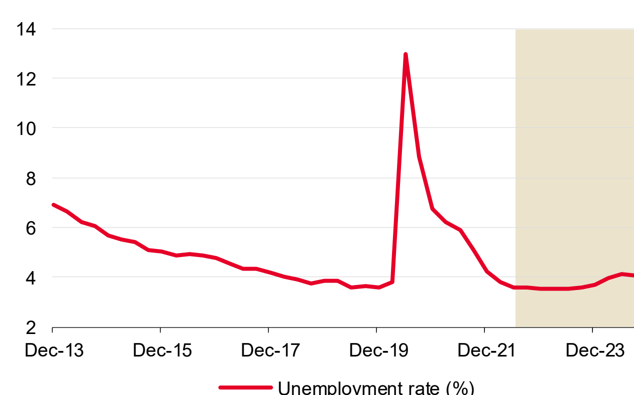
The US economy contracted by 1.6% qoq annualised in 1Q22 (seasonally adjusted) and 0.6% qoq annualised in the second quarter. However, the downturn was largely due to foreign trade developments, especially crowded ports. Due to a lack of subcontracting, companies ordered more goods than they needed at the end of 2021 in the hope that at least part of their orders would be met. This led to a dramatic increase in the number of cargo ships outside ports, congestion and an inability to unload goods. Goods began to be unloaded in greater volume in the first half of this year, leading to a significant increase in imports and thus a deterioration in foreign trade balance. The normalisation of the port situation should lead to a narrowing of the foreign trade deficit in 2H, which we estimate will push GDP growth up to a high 3% qoq annualised in 3Q. Solid economic growth is also being indicated by a tight labour market, with job vacancies still growing briskly (263k in September) and unemployment falling (3.5% in September). Thus, a wage-price spiral rather than a recession is more of an immediate concern, although there is growing speculation that the latter may come earlier than expected. We project a mild recession starting in early 2024 given sharp Fed monetary tightening.

US: Key indicators not signalling recession yet (January 2022=100)



Source: SG Cross Asset Research/Economics

Labour market still tight



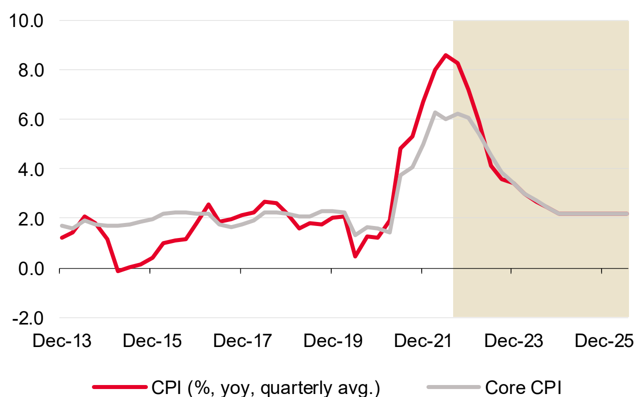
Source: SG Cross Asset Research/Economics

Rates likely to peak at 4.6%.

In October, the Fed raised its key interest rate by 75bp to 3.00-3.25%. It also published its new interest rate forecasts, which foresee a rise to 4.4% by the end of this year and 4.6% next year. This is in line with our forecast: we expect another 75bp hike on 2 November, a 50bp hike on 14 December and a 25bp hike 1 February. This would take the key rate well above the 'neutral' level (2.5%) and would be highly restrictive. Balance-sheet reduction, which has been

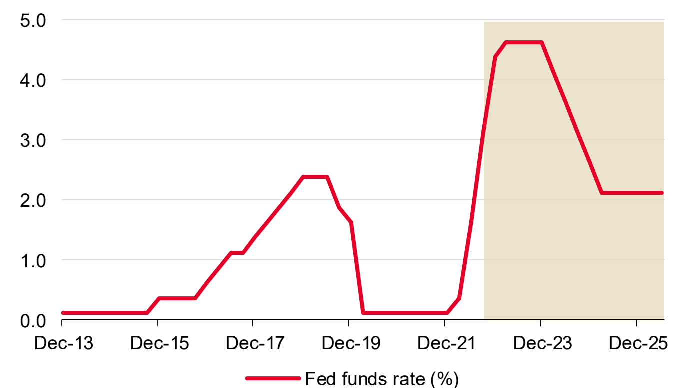
running at USD95bn per month since September, will have the same effect. For this reason, the Fed foresees a mild recession next year, which is evident from its unemployment rate forecast of 4.4% vs 3.8% this year. But the labour market is not yet showing signs of cooling, and it is questionable whether a rise in unemployment to 4.4% would be enough to push inflation down. On the contrary, significantly higher interest rates (up to 7%) would be consistent with the current level of unemployment. Inflation is therefore likely to slow only very reluctantly. Having stood at 8.1% yoy in September, we expect it to average 4.3% next year and 2.6% in 2024. However, the risks are to the upside given rising rental prices and the possibility of a wage-price spiral.

Inflation likely to return to target only in 2024



Source: SG Cross Asset Research/Economics

Fed to raise interest rates aggressively



Source: SG Cross Asset Research/Economics

Euro area: industry to dampen performance of economy

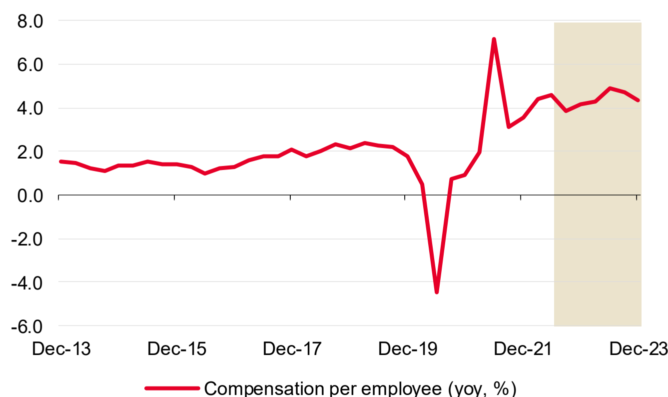
The economy is surprisingly resilient.

The euro area economy has shown solid resilience to the Ukraine war and the consequent inflation shock, growing by 0.7% qoq in 1Q and 0.8% qoq in 2Q. Households benefited from their pandemic savings, government support and historically low unemployment (6.6% in August). These factors should remain in play, albeit to a lesser extent, in the coming quarters, with solid wage growth (4.6% yoy in 2023) adding to the mix. Meanwhile, corporates are benefiting from their strong ability to pass on high input prices to end customers, which in turn is reflected in their historically high margins. In the past, corporates have triggered recession in the euro area by limiting investment, signs of which were generally evident around two years beforehand. We are seeing no such signs at present. On the contrary, companies remain willing to invest and recruit new staff. Subcontracting problems are also disappearing, as seen in the strong recovery of the European car industry in August.

Germany already in recession.

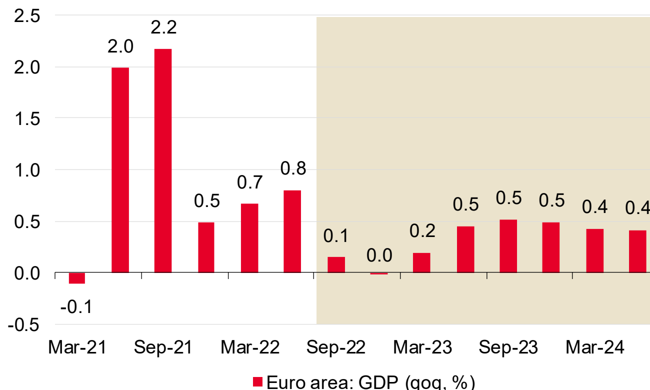
High energy input prices remain a problem, especially for industry-oriented countries such as Germany. There, companies cut back or even closed production in the summer months due to expensive inputs, reflected in a decline in industrial production. The German economy should thus go through a mild recession in the third and fourth quarters of this year. The euro area as a whole should avoid recession for the time being, albeit narrowly, as we expect 0% qoq growth in 4Q. We see GDP growth reaching 3.2% in the euro area in 2022 and 1.1% next year.

Households helped by savings and wage growth



Source: SG Cross Asset Research/Economics

Euro area GDP to grow by a solid 3.2% this year

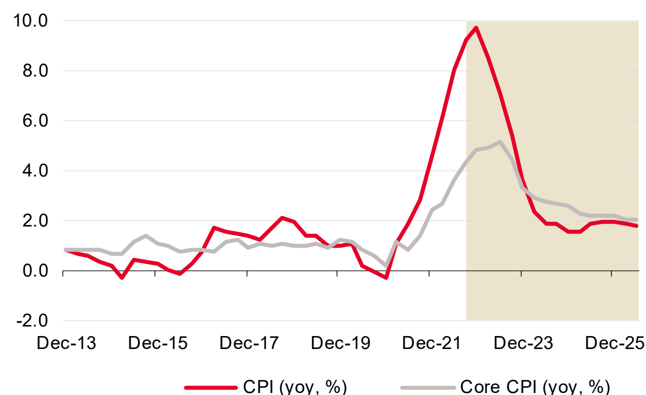


Source: SG Cross Asset Research/Economics

ECB likely to raise interest rates by 125bp in total by year-end.

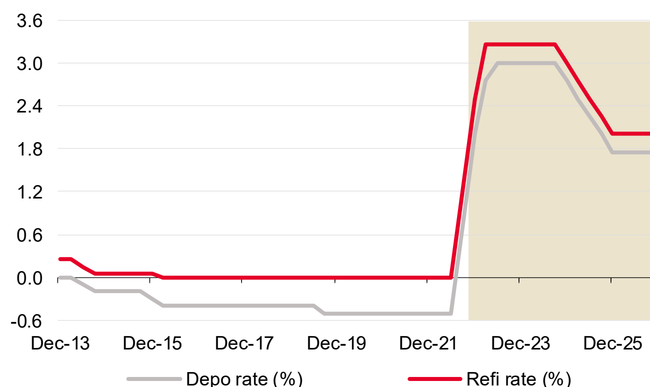
Inflation in the euro area reached a record 9,9% yoy in September. This should be the peak, and it should start to decline in the coming months. Even so, we estimate that it will average 5.9% next year and not fall below 2% until 2024. We see core inflation continuing to rise in the months ahead, not falling below 2% for the next two years (4.4% in 2023, 2.8% in 2024). The ECB will thus likely try to get interest rates quickly above the 'neutral' level, which it estimates at 2%. We therefore expect a further 75bp rate hike at the October meeting and 50bp at the December meeting. By May next year, the deposit rate should rise by another 100bp to 3%. Whether this will be sufficient to get inflation to the target level will depend on the ECB's approach to balance-sheet reduction. We expect it to start this process in the middle of next year through TLRO reductions or reduced reinvestment of maturing bonds.

Inflation at peak (%, yoy, quarterly averages)



Source: SG Cross Asset Research/Economics

ECB to continue raising rates (%)



Source: SG Cross Asset Research/Economics

CEE: Inflation in Poland and Hungary still not at peak

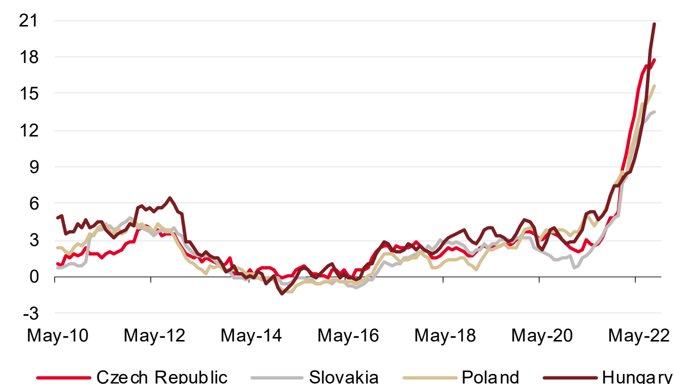
Regional currencies to remain under pressure.

Inflation in the region hit further highs in September. In Hungary, it reached 20.1% yoy, with the core component climbing to 20.7% yoy. Although inflation is likely to peak in the coming months, the first signs of cooling domestic demand are emerging. Retail sales growth has slowed for five months in a row despite exceptionally fast wage growth (wages grew by an average of 18% yoy in 1H). The central bank raised interest rates by 125bp to 13% in September and announced that it would not continue to tighten monetary policy further through rates. However, high inflation forced it to offer an O/N deposit facility at an 18% yield in mid-October, thus supporting short-term bond yields and the forint. At the same time, it announced that it was ready to use FX reserves to cover liquidity needs related to energy imports. Thus, the forint strengthened from historically weakest levels of around EUR/HUF 435

to EUR/HUF 417. Even so, the widening current account deficit, disputes with the EU, and negative sentiment towards emerging markets will lead to renewed forint depreciation in 1Q23, in our view (EUR/HUF 445).

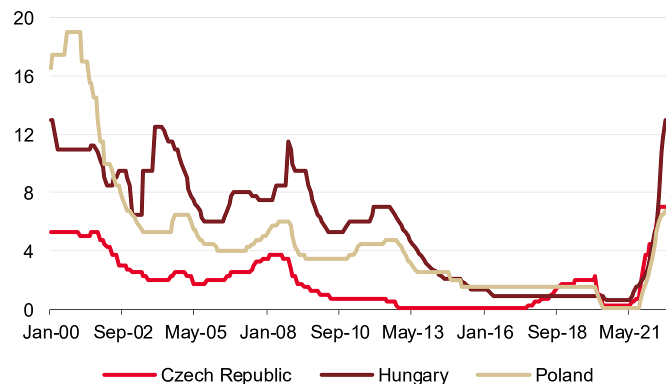
In Poland, inflation surprised with a rise to 17.2% in September. The central bank also surprised by leaving interest rates at 6.75%. Given that inflation has likely not yet peaked in Poland, and with the zloty under pressure, we expect another 75bp rate hike in 1Q to a terminal rate of 7.5%. We expect the zloty to remain subject to negative sentiment and weaken towards EUR/PLN 5.1 in 1Q23.

Inflation in the region at historical highs (HICP, %, yoy)



Source: Macrobond, Economic & Strategy Research, Komerční banka

Monetary tightening likely coming to an end (key rates, %)



Source: Macrobond, Economic & Strategy Research, Komerční banka

Macroeconomic forecast and monetary policy

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Economic growth to face difficulties

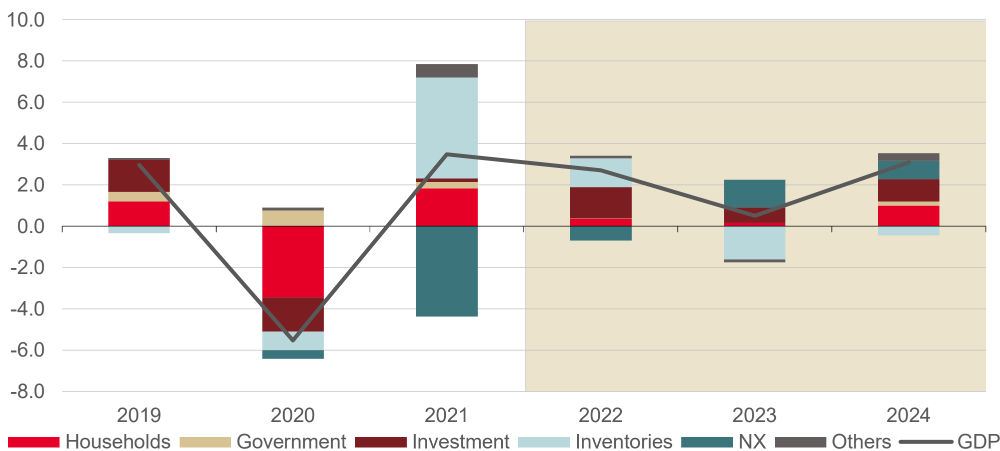
The Czech economy has so far been relatively resilient to the impact of the energy crisis. However, the trend is still negative. Declining demand caused by high inflation and uncertainty should translate into a mild recession at the turn of the year, followed by only a gradual recovery in growth. Despite government measures to tackle expensive energy, we expect inflation to stay in double digits for most of next year and not reach the 2% target until 2024/2025. In our view, the economic recession will lead to only a slight increase in unemployment, and so labour market tensions are unlikely to ease. This should boost nominal wage growth, although we don't expect this to be enough to offset high inflation, leading to a deep fall in real wages this year. The CNB is likely to continue its wait-and-see policy and we expect the repo rate to remain at the current 7% until the middle of next year. According to our estimates, it could fall to 5% by the end of 2023 and reach the policy-neutral rate of 3% by the end of 2024.

Major changes

GDP:
We expect the economy to grow by 2.7% this year, which is only slightly higher than the previous forecast (2.5%). However, we have significantly lowered our GDP growth estimate for next year from 1.7% to 0.5%. This is due to the later occurrence of a recession. While the recession should be milder compared to our July forecast, the subsequent recovery in growth is likely to be more gradual compared to our previous assumptions.

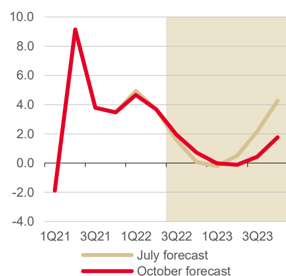
Inflation:
We have reduced our inflation estimate for this year from 16.8% to 15.1%. The reasons for this are lower inflation in 3Q and government measures that should push down electricity prices in 4Q. In contrast, the lower statistical comparative and the continued rise in energy prices push our inflation forecast for next year slightly higher, from 11.2% to 12.0%.

We expect the GDP to grow by 2.7% this year, but we see it slowing to only 0.5% next year (%, yoy)



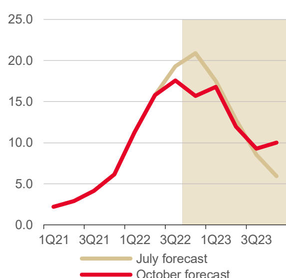
Source: CZSO, Economic & Strategic Research, Komerční banka

Change in GDP forecast (%, yoy)



Source: CZSO, Economic & Strategic Research, Komerční banka

Change in CPI forecast (%, yoy)



Source: CZSO, Economic & Strategic Research, Komerční banka

Mild recession followed by moderate growth in the economy

The Czech economy has so far been relatively resilient to the effects of the energy crisis and high inflation. In 1Q22, it grew by 0.6% qoq, while its growth slowed to 0.5% qoq in 2Q. This was slightly better than we had expected in our last forecast, but with 1Q's figure being revised down. The qoq GDP growth in 2Q was mainly driven by continued inventory build-up stemming from supply chain issues amplified by the war in Ukraine. Inventories of unfinished goods continued to rise due to production input shortages, while net exports declined. Household consumption remained on a downward trend due to persistently high inflation and uncertainty, but its decline was lower, according to the revised data. In addition to inventories, business fixed investment added to economic growth in 2Q, driven by continued labour shortages and increasing pressure on energy savings. Government investment also returned to growth after a previous decline.

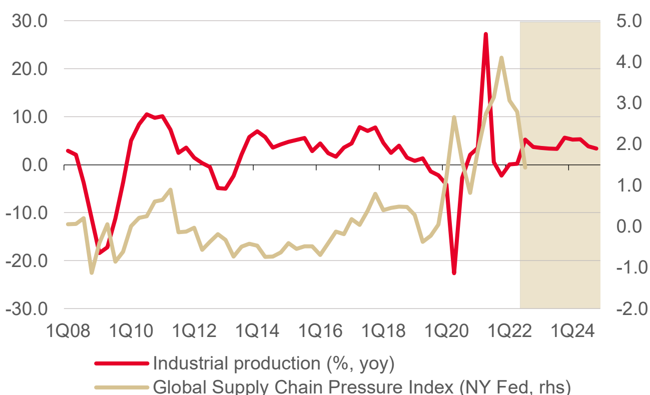
In 3Q, we estimate that the economy stagnated quarter-on-quarter. The negative effects of the energy crisis are materialising more slowly than we had expected, but the negative trend persists. The third quarter was likely marked by two opposing influences. On the one hand, industrial production recovered, helped by a further easing of the problems on the supply side and the associated high order backlogs from previous months. In particular, car

production, which was among the worst affected, increased strongly. In terms of structure, net exports should contribute positively to qoq GDP growth, while inventories should decline. This would be a reversal of the situation in 2Q. What remains, on the other hand, is falling household consumption. Moreover, the pace of its decline has accelerated, in our view, from 0.1% in 2Q22 to 0.6% qoq. While demand for services rebounded in 2Q after the full easing of COVID restrictions, it has mostly declined again in 3Q. This was also the case for restaurant and hotel services. Retail sales have decreased for several months in a row as consumer sentiment reached new lows in 3Q. The fall in household demand is most evident in durable goods such as cars. Demand for these is now likely to be driven primarily by businesses, which we think continued in a brisk investment activity in 3Q.

A decline in domestic and global demand due to high inflation and increased economic uncertainty is set to lead to a mild recession in the Czech economy at the turn of the year.

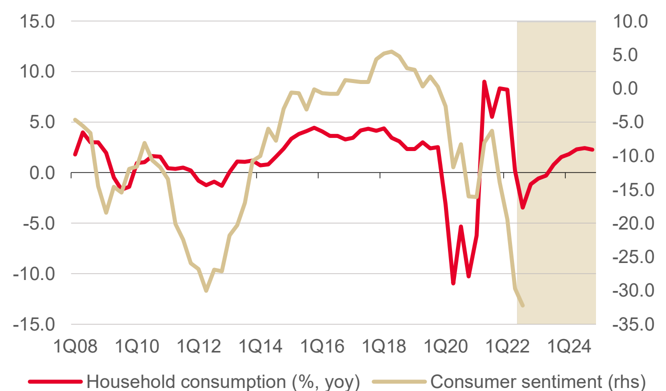
We expect the economy to fall into a mild recession at the turn of the year. We are forecasting a quarter-on-quarter decline in GDP of 0.4% in the last quarter of this year and 0.1% in the first quarter of next year. Compared to our previous estimate, the economic contraction should thus be half as large. In July forecast, we expected economic output to decline by a total of 1% over 3Q22 and 4Q22. Household consumption is likely to fall throughout this year, and industry is also likely to see a decline towards the end of the year. The overall drop in demand, which is linked to the rapid rise in prices, especially for energy, remains the main reason for the recession in the economy in our forecast. The lower demand applies not only to consumer goods but also to industrial goods. Possible gas supply disruptions remain a significant risk. If gas were to flow to the Czech Republic in significantly reduced quantities, or even not at all, and the functionality of industry had to be curtailed as a result, the recession would be much deeper because of the high energy intensity of the Czech economy. However, almost full gas storage and contracted LNG supplies provide a significant chance that this risk will not materialise during the winter.

Tensions in supply chains are easing



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

Consumer sentiment is at historical lows



Source: CZSO, Economic & Strategic Research, Komerční banka

The economy is unlikely to return to pre-pandemic levels (end-2019) until the third quarter of 2023.

According to our forecast, the economy will grow by 2.7% this year and slow to just 0.5% next year. Compared to our previous forecast, we see growth coming in slightly higher this year (2.7% vs 2.5%), but significantly lower next year (0.5% vs 1.7%). This is due to the higher resilience of the economy so far and our expectation of a later recession. The economic downturn should be milder, but we expect the subsequent recovery in economic growth to be more gradual than we had anticipated in the July forecast. We do not expect economic activity to reach pre-crisis levels until 3Q23, a quarter later than in our last forecast. Household consumption growth is likely to be weak both this year and next. We expect it to grow by 0.8% this year and 0.4% next year. The negative effects of high inflation on the decline in real incomes and so household spending are likely to persist for a longer period. The contribution of net exports to GDP growth will be negative this year, for the third year in a row. Next year, however, it should already be contributing positively, as the positive impact of the receding

problems in supply chains becomes fully apparent. We forecast fixed investment to grow in both years. This should be helped by the absorption of EU funds, on which the Czech Republic is still behind schedule.

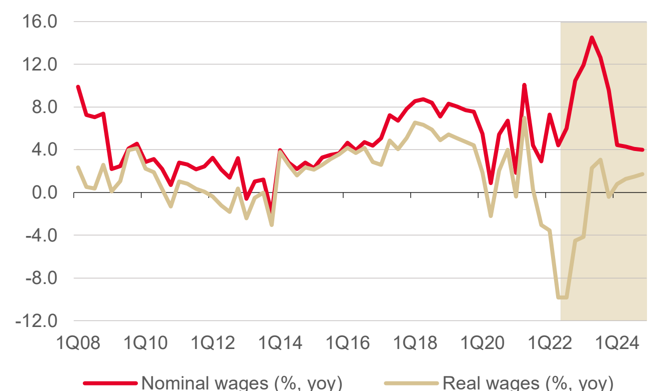
Nominal wage growth should be strong, but not enough to cover inflation

The unemployment rate remains very low and labour market tensions persist. Both the ILO unemployment rate and the share of unemployed persons (MLSA methodology) have returned to pre-pandemic, and therefore record-low, levels. The number of job vacancies still significantly exceeds the number of unemployed registered at the labour offices. Labour markets in neighbouring countries are also becoming increasingly tight. This may, especially in the case of more skilled professions, further increase the demand for domestic workers. In our view, the mild recession we expect will bring only a small increase in unemployment, with the ILO rate rising to close to 3% from around 2.5% at present. This is in line with what we expected in our previous forecast.

Labour market to remain tight despite a rise in unemployment (%)

Source: CZSO, MLSA, Economic & Strategic Research, Komerční banka

Real wages to fall significantly this year due to high inflation



Source: CZSO, Economic & Strategic Research, Komerční banka

The labour market is likely to remain tight despite the economic recession. This would lead to higher nominal wage growth, but we don't expect this will be enough to cover inflation this year.

We estimate that average wage growth will reach 7.0% this year and accelerate to 12.2% next year. Despite the strong nominal growth, we don't expect this to be enough to cover high inflation this year, as we expect real wages to fall by a significant 6.9%. Wage negotiations for next year will then, in our view, take full account of the current highly inflationary environment, leading to double-digit nominal wage growth, we expect. However, inflation is likely to remain in double digits, leaving wages roughly unchanged in real terms, even after the deep drop this year. In both years, even with such nominal growth, real wage developments should fall short of rising labour productivity. In addition to the tight labour market, the fact that firms have so far been able to pass on higher costs to consumers, and that their financial situation should therefore stay favourable, will likely contribute to upward pressure on wages next year. Compared to the July forecast, nominal wage growth is lower in both years (we had previously expected growth of 8.1% this year and an acceleration to 13.0% next year). The lower nominal dynamics is due to slower wage growth in 2Q and a lower inflation estimate for this year.

Inflation is likely to peak at a lower level, but should subside more slowly

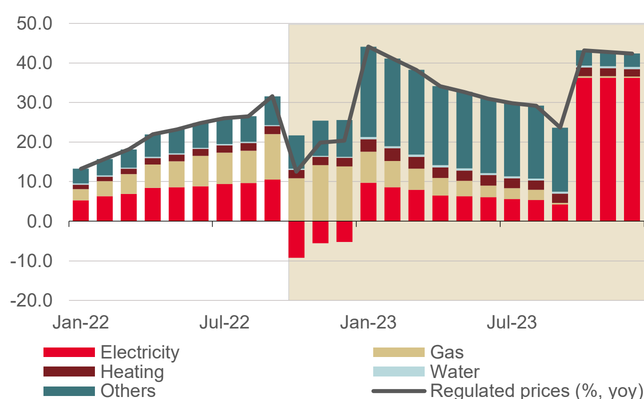
Consumer price inflation was lower than expected in 3Q, mainly due to a more gradual pass-through of high wholesale energy prices to consumer prices. While annual inflation had remained slightly above 17% during the summer holidays, a stronger acceleration due to more expensive energy for households was seen in September, when price growth reached 18.0% yoy. Higher housing costs, including expensive energy, accounted for around a third of September's inflation. The September figure could be the peak of the current inflation rise. Compared to the July forecast, we no longer expect inflation to accelerate to 20% yoy. One

reason for this is the only gradual pass-through of high wholesale energy prices to consumer prices. This is due to a higher share of previously fixed prices or more favourable prices for existing customers for whom suppliers have bought energy in advance and so at better market conditions. We see energy prices as being still the main driver of inflation in the months ahead.

The rise in household energy prices at the end of this year should be curbed by government measures. However, upward pressure will persist, in our view. The government's price caps should be reached at 2022/2023.

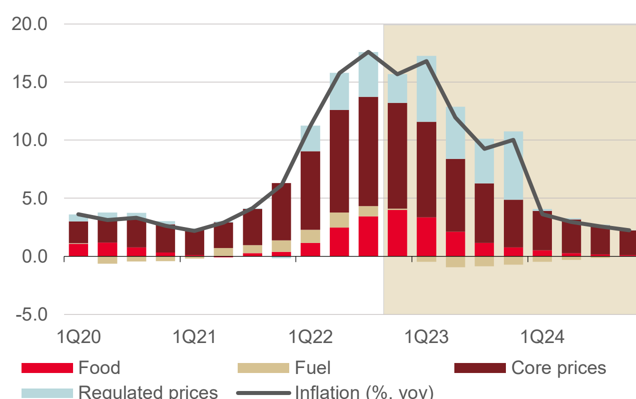
The Czech government's measures on expensive energy should bring inflation down to 16% yoy in 4Q22. Effective this October, the government introduced the so-called *special energy tariff* and also approved a waiver on payments for renewable energy. According to our estimates, which we describe in more detail here: https://bit.ly/3rJTT66, the direct impact of these measures is likely to contribute to a 1-2.5pp reduction in annual inflation in the last three months of this year through lower household electricity prices. Of this, the waiver on renewable energy payments, which will continue next year compared to the special energy tariff, is likely to account for 0.3pp. The effect of the government's measures will be counteracted by the continued rise in electricity and gas prices. Indeed, the end consumer energy prices have so far included only a fraction of the high wholesale prices. According to CZSO data for September, the consumer electricity price was up by around 40% yoy on average, and in the case of gas by around 85%. The same was true in both cases when compared to the start of 2021. Electricity and gas prices on wholesale markets have been very volatile in recent months due to the war in Ukraine. Nevertheless, if we consider the October average of spot prices, despite a recent partial drop, the wholesale price of electricity was four times higher than at the beginning of last year, while for gas it was more than eight times higher. The pass-through of high wholesale prices to consumer prices will not yet be prevented by the government's approved caps on electricity and gas prices, but we estimate that these could be reached for average household prices by the turn of the year. In the case of gas, an earlier date is also possible, with a 15% increase in consumer gas prices during September alone. Many suppliers are going ahead with changes to electricity prices in January. Combined with the fact that the special energy tariff will end at the end of this year, we expect a more significant increase in consumer electricity prices at the beginning of next year.

Measures on expensive energy to affect regulated price growth



Source: CZSO, Economic & Strategic Research, Komerční banka

Government measures to reduce inflation in 4Q22



Source: CZSO, Economic & Strategic Research, Komerční banka

We don't expect inflation to reach the central bank's 2% target until the turn of 2024 and 2025.

According to our forecast, inflation will average 15.1% this year and decelerate to 12.0% next year. In our previous forecast, we expected 16.8% for this year and 11.2% for next year. This year's lower inflation is driven by weaker price growth in 3Q and the aforementioned government measures in 4Q, both of which contribute to higher inflation next year via a lower statistical comparative. Inflation is likely to accelerate slightly again towards 17% yoy early next year due to further energy price increases and the fading of the impact of the special energy tariff. However, its further acceleration will be hampered by the government's price

caps, at which consumer energy prices are likely to remain for a longer period. In our view, annual inflation will gradually decline over the next year, driven by slowing core inflation and fuel price growth, both of which will be lowered by last year's high comparative (this should have an effect as early as 4Q22). Above this, fuel prices are expected to continue to decrease and core inflation is likely to be dampened by falling demand. Food prices should also rise more slowly. In spite of this, headline inflation will remain in double digits for much of next year. At the end of 2023, we expect it to be around 10% yoy, with electricity prices being pushed up by the lower comparative from 4Q22. We don't expect annual inflation to reach the central bank's 2% target until the turn of 2024 and 2025. We assess the risks to our inflation forecast as balanced. The main risk in favour of higher inflation is the potential for a more pronounced pass-through of higher energy prices to other price categories. In the direction of lower inflation, on the other hand, core inflation may be fading faster due to a drop in demand. At the end of this year, our estimate of a slowdown in annual inflation comes with a higher degree of uncertainty, as it is not clear how the Czech Statistical Office (CZSO) will take into account the effect of the special energy tariff in its price statistics.

CNB to keep interest rates unchanged for longer

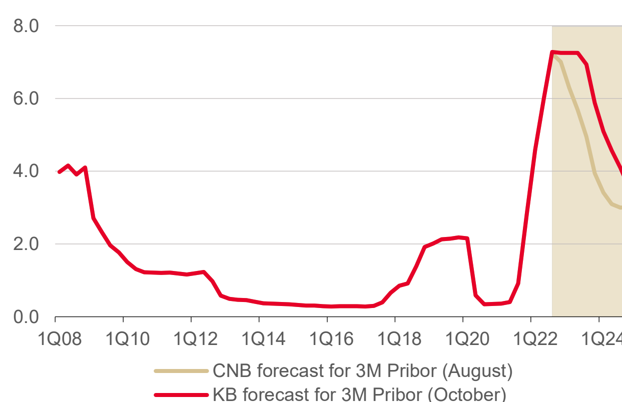
We expect the repo rate to remain at the current 7% until the middle of next year, after which it could start to fall gradually. However, we do not expect it to reach the policy-neutral level of 3% until the end of 2024.

The central bank is likely to keep interest rates at their current levels until the middle of next year, when it could start to reduce them gradually. The new CNB board, headed by Governor Michl, continues to make it clear, either through the last two policy decisions or through statements by its members, that it believes the current level of interest rates is already sufficient to curb inflation. The usual arguments put forward to support this view are declining lending activity, lower money supply growth or a slowing economy. The slower rise in inflation in 3Q also seems to be reinforcing the board's wait-and-see mode. Inflation rose from an average of 15.8% yoy in 2Q to 17.6% yoy in 3Q, while the CNB had expected an increase to 19.5% yoy. On the other hand, producer price growth in the euro area was significantly higher than the CNB forecast, which poses a risk of continued strong pressures on higher domestic inflation from import prices. Unanchored inflation expectations are also a risk to inflation remaining at high levels for a longer period. They continue to trend upwards. According to the latest CNB survey for September, non-financial corporations expect inflation of 10.3% yoy at the one-year horizon and 7.5% yoy at the three-year horizon. The last upside risk to inflation, which is often mentioned by the dovish majority on the CNB board, is wage growth. It had already exceeded the central bank's expectation in 2Q22, when nominal average wages rose by 4.4% yoy vs 2.7% forecast by the CNB. For the full year, the CNB forecasts nominal wage growth of 4.5% and 6.2% next year, which is significantly lower than our estimate.

NFCs' inflation expectations continue to rise significantly (%)

Source: CNB, Economic & Strategic Research, Komerční banka

CNB's interest rates have already peaked



Source: CNB, Economic & Strategic Research, Komerční banka

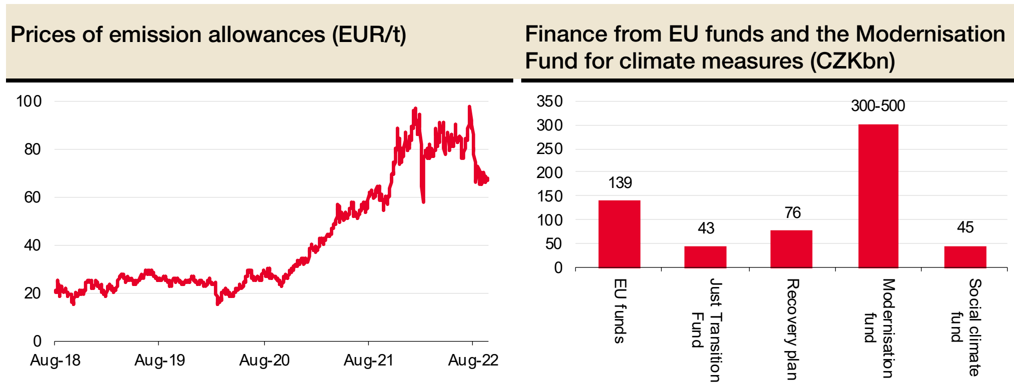
According to our forecast, the repo rate will remain at the current 7% until August next year, will be 5% at end-2023 and will not reach a policy-neutral 3% until end-2024. However, there is huge uncertainty at present as to the start of the reduction in interest rates, as it will likely depend on the development of the economy and inflation, as well as on the policy of foreign central banks. We see the risks to our interest rate forecast, mainly due to our expected wage developments and the unanchored inflation expectations, as skewed towards higher rates. The Czech Government's accommodative fiscal policy and the continued rapid rise in interest rates abroad also continue to act in this direction. Compared to the CNB's August forecast, we expect interest rates to be higher over the entire forecast horizon. The lower monetary policy flexibility associated with the current CNB's wait-and-see strategy is likely to contribute to the persistence of higher inflation for a longer period. Core inflation is likely to fade only very slowly. We expect it to be 13.3% this year and 9.4% next year. In our forecast, we also assume that the CNB will continue to intervene against the weakening koruna.

Box: ESG: The energy crisis will hasten climate change and spur investment

The European Union has already committed to achieving carbon neutrality targets in 2019. However, the current energy crisis and the drive to reduce dependence on Russian fossil fuel imports has intensified efforts to use renewable sources and achieve energy savings. The carbon neutrality commitment aims to reduce greenhouse gas emissions by 55% by 2030 (compared to 1990) and achieve neutrality by 2050. The purpose is to keep the increase in global warming up to 1.5C compared to pre-industrial times. To achieve this, CO2 production will need to be halved globally by 2030. China is the largest CO2 emitter, with almost 30% of global production, followed by the US at 14% and the EU at 8%. On a positive note, 136 countries have already signed up to the climate neutrality pledge, and collectively account for 87% of emissions, including China, which would like to achieve carbon neutrality by 2060.

Within the EU, the Fit for 55 package legislates on climate change. It addresses three main areas. The first is market-based mechanisms, which includes the emissions trading scheme. Other sectors such as road, maritime and air transport should be included from 2026. The proceeds from the allowances should be used exclusively for climate change issues, as only half of the funds raised so far have been used for this purpose. Emission allowance prices are now around EUR70/t, compared to EUR20/t in 2020. However, demand for allowances remains high, as current gas prices make coal-fired power generation cheaper even with more expensive allowances. The European Commission estimates that the price of allowances should be between EUR50-85/t in 2030. Higher allowance prices also mean higher revenues from the sale of such energy. Therefore, the Czech Republic could receive CZK300-500bn from the Modernisation Fund by 2030. In addition, EU funds (25%) or the money from the National Recovery Plan (42%) will also go towards climate change. In total, the Czech Republic could receive up to CZK800bn from the EU for these purposes, which would represent a significant stimulus for domestic investment activity. Market mechanisms addressing the first area of Fit for 55 include a carbon duty to be paid by companies importing non-eco-friendly industrial products into the EU.

Prices of emission allowances (EUR/t) | **Finance from EU funds and the Modernisation Fund for climate measures (CZKbn)**

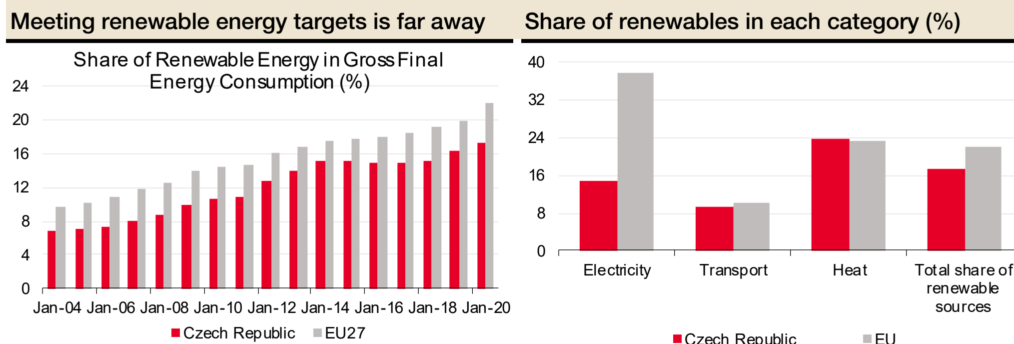


Source: Bloomberg, Economic & Strategy Research, Komerční banka

Source: Bloomberg, Economic & Strategy Research, Komerční banka, Ministry of Industry and Trade

The second area covered by the Fit for 55 package is targets and regulation, which includes the Renewable Energy Directive. Due to the current energy crisis, the European Commission and the Member States have decided to increase the target for the share of renewable energy sources in total consumption to 45% from 40%, whereas initially the target was set at only 32%. This will also mean a significant increase in the targets for the Czech Republic. If the national target is increased proportionally, this would mean increasing the share of renewables (RES) in consumption to 31%. However, the EU recommendation is likely to be even higher. In 2020, the share of renewables in the Czech Republic was 17%, compared to 22% in the EU. The target is set for the electricity, heating and cooling and transport sectors. In transport, the share of RES will be increased through greater use of biofuels (bioethanol, biodiesel), biofuels produced from waste biomass and electric vehicles. The heat generation sector is also expected to increase its use of biomass. However, to meet the overall target, the share of RES in electricity will need to increase significantly. To reach the 31% target, the European Commission's impact study suggests that RES in electricity will need to increase three times (23TWh) compared to the current situation. The share of electricity in the total national RES mix should therefore increase significantly from the current level of approximately one-third. The technical potential for increasing electricity production from RES is not a problem. However, the inflexible regulatory environment poses a problem. In this respect, the amendment to the Czech Energy Act, which foresees a higher limit for energy production without a licence or the installation of a renewable energy source up to a certain capacity without a building permit, should help. However, the amendment does not address a number of areas, such as rules for the operation of community energy and so on.

Meeting renewable energy targets is far away | **Share of renewables in each category (%)**



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

Source: Macrobond, Economic & Strategy Research, Komerční banka

The Fit for 55 package includes a directive on reducing primary energy consumption. In the wake of the energy crisis, the European Parliament has increased the EU's target for reducing final and primary energy consumption. Together, countries must ensure that by 2030, final energy consumption is reduced by at least 40% and primary energy consumption

by 42.5% compared to 2007 projections. The problem is that even when the original limits were set at 32.5% of final consumption, which would have meant an annual saving of 0.8% for the Czech Republic, the cost of reducing consumption was already as high as the cost of building new renewable generation capacity. Therefore, at the current requirement, energy saving measures will be significantly more expensive than building new renewable capacity.

We expect ESG policy to provide a boost to the domestic economy in the coming years. A significant amount of money is allocated to this area, from both EU funds and the sale of emission allowances. A large number of companies are aware of the government's ESG agenda and are actively preparing for its implementation. With mandatory reporting for SMEs from 2027, these trends will intensify. We thus expect an increase in public and private investment in this area. In the longer term, however, this will not be sufficient to meet climate targets. SG economists, who map this area globally based on how GHG-intensive GDP is and on long-term GDP forecasts for individual economies, estimate that the climate targets will not be met by 2030, with global GHG emissions continuing to grow beyond 2030. The targets could only be met at a significant loss of GDP (several tenths of a pp per year), which is something that economic policymakers are not yet willing to allow.[1]

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[1] Global Economic Outlook June 2022: Focus - Update on GHG emissions in 2030 - Still on course to cause 2.4°C of global warming

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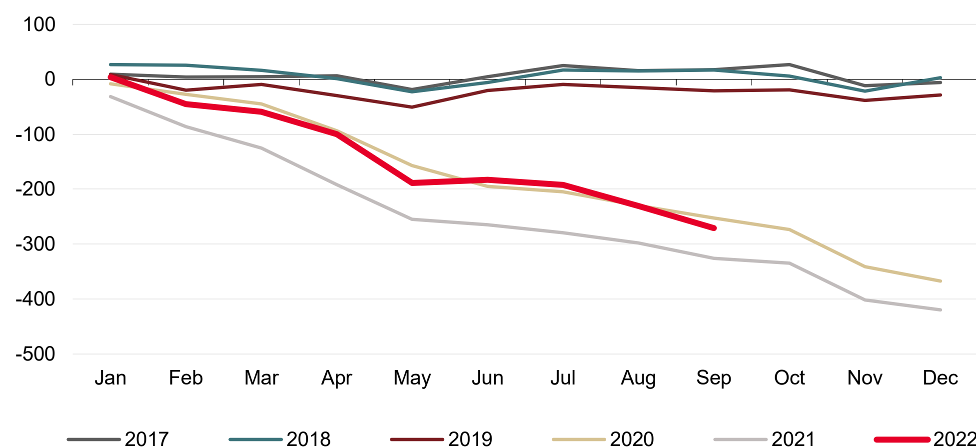
Fiscal policy: deep deficits as the new normal

By the end of the year, we expect high energy prices to require new budget expenditures that likely will outweigh higher tax collection. This year's state budget deficit could thus head towards the planned CZK375bn. Given the negative effects of the expected economic recession, high energy prices and a deep structural deficit, we expect the state budget deficit to continue to narrow at a gradual pace in the coming years. Thus, while overall public debt is set to continue to grow, high inflation should significantly slow relative to nominal gross domestic product. We believe that if higher expenditure from rising energy prices is not fully covered, the 2023 deficit could grow even bigger.

State budget on track for second worst result in history

By the end of September this year, the state was running a deficit of CZK270.9bn. Compared with last year, this is CZK55.4bn lower, mainly owing to higher tax revenues. Expenditure also increased year-on-year, mainly reflecting the triple indexation of old-age pensions this year, but spending related to high energy prices is also starting to show.

The state budget (CZKbn)



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

This year's increase in spending to date (CZK33.5 billion year-on-year) mainly is attributable to an increase in social benefits, capital expenditure, and the introduction of a special energy tariff. Almost CZK50bn more was spent on social benefits year-on-year. The largest item in this category is pensions, which have been re-indexed three times this year, raising spending by CZK36.8bn year-on-year. For 2022 as a whole, roughly CZK56bn more will be spent on pensions than last year. Greater social spending on housing and material need benefits, the one-off child allowance and humanitarian aid also increased total spending. In September, the budget was affected by the introduction of the *special energy tariff* in the amount of CZK17.4bn. There was also a significant year-on-year increase in capital expenditure (by CZK13.2bn), where higher transfers to the State Fund for Transport Infrastructure played a major role. Conversely, the additional expenditure was partly offset by the absence of pandemic aid, which was reflected in a CZK41.2bn lower year-on-year transfer to businesses.

Wage and employment growth as well as higher inflation are helping raise more revenue. The overall year-on-year increase in revenues of CZK88.9bn was mainly attributed to an increase in VAT, social security contributions, corporate and personal income taxes and excise duties collections. Although only 39.7% of the full-year plan had been received from the EU by the end of September (compared with 63.2% at the same time last year), the MoF

said that the uneven flow of EU funds is currently negatively distorting the state budget balance (by CZK14.1bn), which should end up being neutral.

The state budget deficit could end the year at around CZK375bn. This would be the second worst result in the history of the independent Czech Republic since 1993. In our view, the onset of a recession, which would weaken tax revenue dynamics to some extent, would contribute to a widening deficit over the rest of the year. At the same time, we expect expenditures related to compensation for high energy prices for households, firms and public institutions to continue to rise.

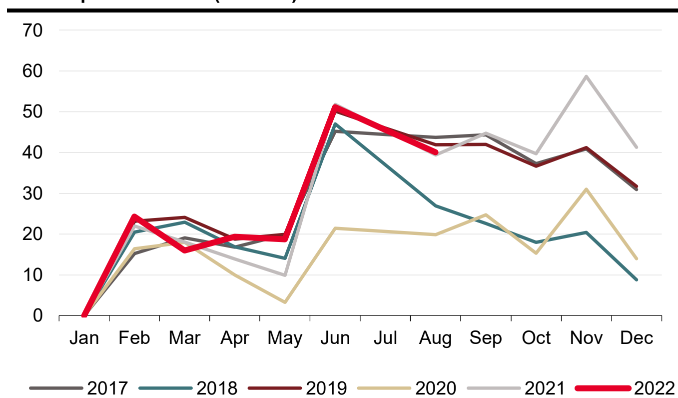
The government has forecast a state budget deficit of CZK295bn for 2023. However, our estimates of tax collections combined with the ministry's expected expenditures point to a deficit of around CZK315bn next year. Moreover, we believe there is a risk that all the expenditures related to compensation for increased energy costs will not be fully covered by additional tax revenues.

The high structural deficit in domestic public finances also persists. We estimate that the structural deficit will remain well above CZK200bn over the next few years. The significant increase over the past few years was due to additional spending, which prompted a permanent deficit. For example, we note the tax package approved during the COVID-19 pandemic resulted in a permanent decline in revenues of more than CZK100bn per year. However, the expenditure side of the balance also significantly worsened owing to a series of supra-legislative indexations of old-age pensions in recent years.

Municipalities remain in surplus

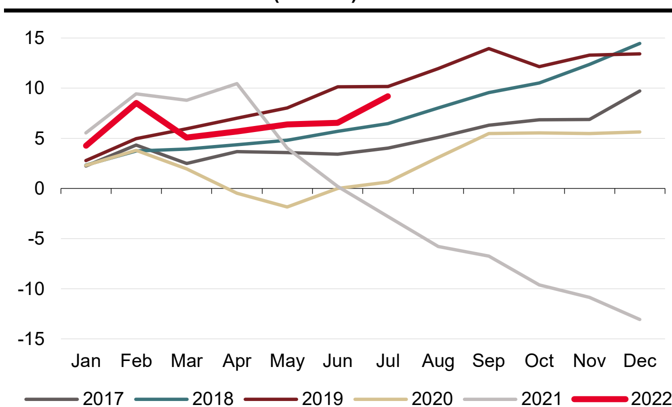
Local government budgets ended August with a surplus of CZK40bn YTD. This was mainly attributable to rising tax revenues, inter alia, owing to higher VAT collections due to high inflation. This was partly offset by an increase in expenditures. For full year 2022, we still expect a surplus of CZK30bn for municipal budgets. We also estimate that health issuers may end this year in a slight surplus based on YTD monthly performance.

Municipal finances (CZKbn)



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

Health insurers' finances (CZKbn)



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

Public finance forecasts

	2021	2022f	2023f	2024f	2025f	2026f
Balance (% GDP)	-5.9	-5.2	-3.9	-3.3	-2.9	-2.6
Fiscal effort (pp GDP)	-0.9	0.4	1.5	0.5	0.4	0.3
Public debt (CZKbn)	2566.6	2941.6	3256.6	3546.6	3816.6	4066.6
Debt ratio (% GDP)	42.0	43.1	43.5	44.1	45.2	46.3

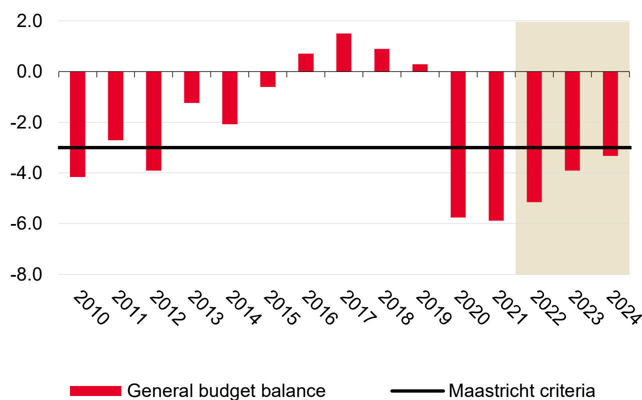
Source: CZSO, Macrobond, MinFin for published data, Economic & Strategy Research, Komerční banka
Note: Fiscal effort is measured as the year-on-year change in the cyclically adjusted general government balance on GDP in pp.

In our view, this year's public finances will end with a slightly smaller deficit than last year. However, the consolidation of the government's budget will be only moderate in the coming years.

Hope is fading for an early consolidation of public budgets

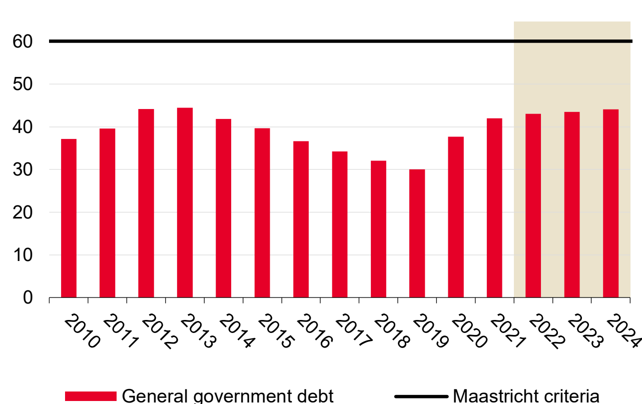
The general government deficit is expected to reach 5.2% of GDP this year, 0.7pp lower yoy. In our view, both higher nominal GDP growth this year vs 2021 and stronger fiscal efforts will contribute to reduce the deficit. The traditional surplus generated by municipalities should also continue to help cut the general government deficit in 2022. We expect public finances to continue to consolidate in 2023, as there is a potential threat of credit rating downgrade and rising government debt servicing costs, thanks to greater efforts to cover additional expenditures by extraordinary revenues. However, the government does not foresee significant savings or revenue increases in the medium term, so we expect only a gradual consolidation of public budgets. Overall, we expect the general government deficit to narrow to 3.9% of GDP next year. On our estimates, nominal public sector debt-to-GDP will grow at an average annual rate of 0.9bp over 2022-2026 to reach 46.3% of GDP in 2026. Going forward, however, significant reforms will be needed on both the revenue and expenditure sides. Indeed, as the National Budget Council points out, on unchanged parameters, the economy would start to deteriorate very rapidly in the 2030s due to adverse demographic developments.[2]

Public finance balance (% of GDP)



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

Public debt (% of GDP)



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

[2] https://unrr.cz/wp-content/uploads/2022/10/Sustainability-report-_2022.pdf

Summary forecast table

	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23	2021	2022	2023	2024	2025	2026
GDP and its breakdown														
GDP (real, yoy, %)	4.6	3.7	1.9	0.7	0.0	-0.1	0.4	1.8	3.5	2.7	0.5	3.1	2.6	2.4
Household consumption (real, yoy, %)	8.2	0.2	-3.4	-1.2	-0.6	-0.3	0.8	1.6	4.0	0.8	0.4	2.2	2.5	2.7
Government consumption (real, yoy, %)	2.1	1.3	-1.3	-1.7	-2.0	-0.2	1.6	0.6	1.5	0.1	0.0	1.1	1.5	2.2
Fixed investments (real, yoy, %)	6.9	6.1	5.3	4.6	2.8	2.7	2.1	3.2	0.6	5.7	2.7	3.9	4.1	3.4
Net exports (contribution to yoy)	-3.8	-0.7	1.6	0.1	0.8	1.4	1.4	1.8	-4.4	-0.7	1.3	0.9	1.2	1.7
Inventories (contribution to yoy)	2.2	2.4	0.9	0.1	-0.8	-2.1	-2.1	-1.4	4.9	1.4	-1.6	-0.4	-0.5	-0.7
Monthly data from the real economy														
Foreign trade (CZK bn)	-11.0	-66.9	-70.1	-63.8	-6.3	-43.5	-56.9	-48.4	-9.0	-211.8	-155.1	-96.2	13.8	94.1
Exports (nominal, yoy, %)	8.0	11.2	24.7	19.4	20.3	17.3	12.3	13.4	13.4	15.7	15.7	8.2	4.8	5.1
Imports (nominal, yoy, %)	16.4	19.4	24.9	22.1	19.7	14.4	10.5	11.6	19.8	20.8	13.8	6.9	2.8	3.8
Industrial production (real, yoy, %)	0.4	0.0	5.4	2.9	4.2	1.9	2.5	5.4	8.0	2.2	3.5	4.8	3.2	3.1
Construction output (real, yoy, %)	10.3	6.6	7.6	-2.4	-2.8	-2.1	3.7	4.4	2.0	5.5	0.8	8.8	5.4	2.0
Retail sales (real, yoy, %)	6.8	-2.8	-8.0	-5.1	-3.8	-0.9	2.5	2.3	4.2	-2.3	0.0	2.1	1.7	1.8
Labour market														
Wages (nominal, yoy, %)	7.3	4.4	6.0	10.4	11.9	14.5	12.6	9.6	4.8	7.0	12.2	4.2	4.4	4.6
Wages (real, yoy, %)	-3.6	-9.8	-9.8	-4.5	-4.2	2.3	3.1	-0.4	1.0	-6.9	0.2	1.3	2.7	3.0
Unemployment rate (MLSA, %)	3.4	3.1	3.5	3.8	4.0	3.8	3.9	4.1	3.7	3.5	3.9	3.6	3.5	3.6
Unemployment rate (ILO 15+, %)	2.5	2.4	2.5	2.4	2.7	2.7	2.9	2.7	2.8	2.4	2.7	2.4	2.3	2.5
Employment (ILO 15+, yoy, %)	-0.5	-0.1	-0.5	0.7	2.3	1.2	1.0	-0.2	-0.4	-0.1	1.1	0.3	0.2	-0.2
Consumer and producer prices														
CPI Inflation (yoy, %)	11.2	15.8	17.6	15.7	16.8	11.9	9.3	10.0	3.8	15.1	12.0	2.8	1.6	1.6
Taxes (contribution to yoy inflation)	0.4	0.2	0.1	1.2	0.0	0.1	0.2	0.1	-0.1	0.5	0.1	0.1	0.0	0.0
Core inflation (yoy, %) (*)	10.5	13.8	14.7	14.1	13.0	9.9	8.0	6.6	4.8	13.3	9.4	4.2	2.3	1.5
Food prices (yoy, %) (*)	6.7	14.6	20.0	22.7	19.9	12.7	6.8	5.3	0.8	16.0	11.2	1.5	0.9	1.7
Fuel prices (yoy, %) (*)	36.8	44.4	31.5	5.2	-8.5	-24.7	-25.1	-17.4	15.3	29.5	-18.9	-7.1	-0.8	2.9
Regulated prices (yoy, %)	15.7	23.3	28.0	17.6	41.2	32.6	27.5	42.6	-0.1	21.2	36.0	0.6	0.0	1.3
Producer prices (yoy, %)	21.8	27.7	25.3	21.6	13.3	6.1	4.8	3.0	7.1	24.1	6.8	2.0	1.9	1.2
Financial variables														
2W Repo (%, average)	4.2	5.6	7.0	7.0	7.0	7.0	6.7	5.6	0.9	5.9	6.6	4.1	3.0	3.0
3M PRIBOR (%, average)	4.6	6.0	7.3	7.3	7.3	7.3	6.9	5.9	1.1	6.3	6.8	4.3	3.3	3.3
EUR/CZK (average)	24.6	24.6	24.6	24.7	25.0	25.1	25.1	25.1	25.6	24.7	25.1	24.9	24.7	24.6
External environment														
GDP in EMU (real, yoy, %)	5.4	4.2	2.1	1.6	1.1	0.8	1.2	1.7	5.5	3.3	1.2	1.8	1.6	1.6
GDP in Germany (real, yoy, %)	3.5	1.7	0.5	0.3	-0.2	0.0	0.8	1.5	2.8	1.5	0.5	1.7	1.5	1.4
CPI in EMU (real, yoy, %)	6.1	8.0	9.3	9.7	8.5	7.1	5.3	3.6	2.6	8.3	6.1	1.9	1.8	1.9
Brent oil price (USD/brl, average)	96.1	113.2	107.1	110.0	105.0	95.0	90.0	85.0	70.2	106.6	93.8	91.3	90.6	84.3
EUR/USD (quarter eop, year average)	1.11	1.05	0.98	0.97	1.00	1.03	1.07	1.10	1.16	1.03	1.05	1.17	1.24	1.29

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

Czech IRS market and government bonds

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Higher for longer

Domestic market interest rates continued to face increased volatility in Q3. Following persistent strong inflationary pressures at home and abroad, they have been rising again since the local low in August, especially at longer maturities. However, the entire market interest rate curve remains significantly inverted. Rates are expected to peak in 1H23. The shorter end of the curve could subsequently start to decline gradually, with the prospect of the CNB rates starting to return to neutral levels against the backdrop of fading inflationary pressures. Conditions for interest rate fixing have deteriorated again as rates have risen. There is still an opportunity to use the inversion of the entire curve or to take advantage of lower rates on the euro market. Government bonds have become significantly cheaper in recent months due to a higher-than-expected increase in their supply in the context of the widening government budget deficit. We expect their yields to remain elevated at least until the middle of next year. Significant issuance activity can be expected next year, which, especially for longer maturities, will keep their yields above the IRS.

Czech IRS market: rates caught between external forces and dovish CNB

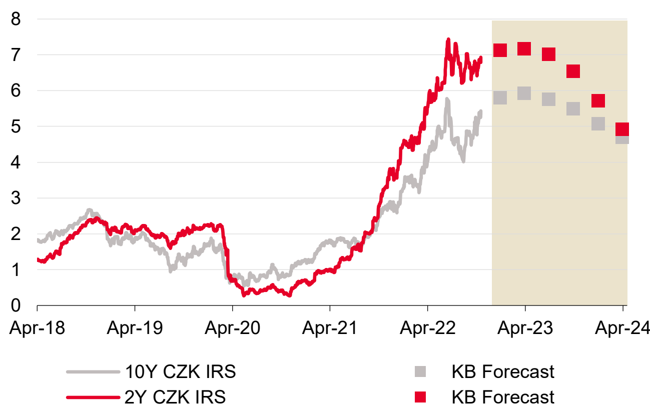
Persistent inflationary pressures at home and abroad have pushed the domestic IRS curve up again, especially at its longer end. We expect rates to peak in 1H23. The curve will maintain a markedly inverted shape for most of next year. It will only straighten out in 1H24, mainly due to the decline in short rates.

Market interest rates witnessed another significant increase in the third quarter of this year. This was helped by persistently strong global inflationary pressures, which raised the stakes for a significant tightening of monetary policy by the world's key central banks. Dramatic increases occurred mainly in shorter euro and dollar rates (up 180bp). The domestic yield curve, however, rose more at the longer end (up to 90bp), partly due to the repricing of expectations of inflation staying above the central bank's target for longer. Financial markets have recently adopted the view of the majority of the CNB's board, which is sceptical of further significant increases in domestic interest rates. Domestic rates with shorter maturities have thus risen much more slowly in the past quarter, unlike euro or dollar rates (two-year swaps "only" by about 50bp).

The market expects the CNB's two-week repo rate to peak at 7-7.25%. In our view, monetary policy rates have already peaked. The subsequent gradual reduction in interest rates may start in 3Q23, we believe. However, given the risks of higher wage growth, looser fiscal policy, a de-anchoring of inflation expectations and continued monetary tightening abroad, we assess the overall risk of our forecast as skewed towards higher monetary policy and market interest rates.

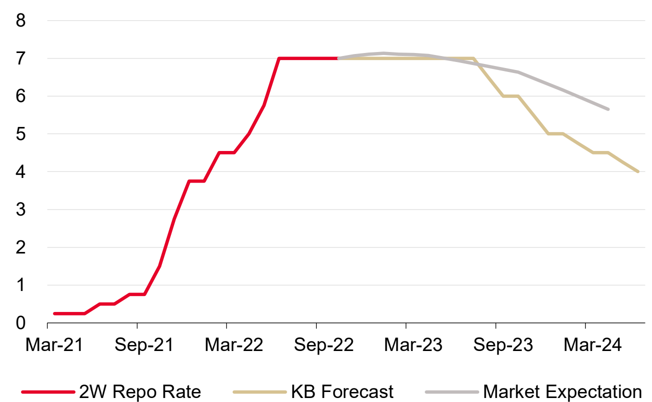
We expect interest rates to remain at elevated levels for most of 2023. Domestic rates will be prevented from falling by further increases abroad. Inflationary pressures also remain robust and we expect them to subside only gradually. In our view, a visible reduction in domestic market interest rates could therefore only occur towards the end of next year as CNB's monetary policy rates start to return to neutral.

IRS forecast (%)



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Expected CNB key interest rate path as of 25 October 2022 (%)



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

The CNB's initiation of rate cuts next year will help to normalise the shape of the yield curve. We expect the curve to maintain its significantly inverted shape for most of next year. It will only straighten out during 1H24, mainly due to a decline in the short end.

CZK IRS outlook (end of period, %)

	4Q22f	1Q23f	2Q23f	3Q23f
2Y	7.10	7.15	7.00	6.55
5Y	6.35	6.50	6.35	5.95
10Y	5.80	5.95	5.75	5.50

Source: Economic & Strategy Research, Komerční banka

Forwards and the euro market still offer an opportunity to hedge interest rate risk

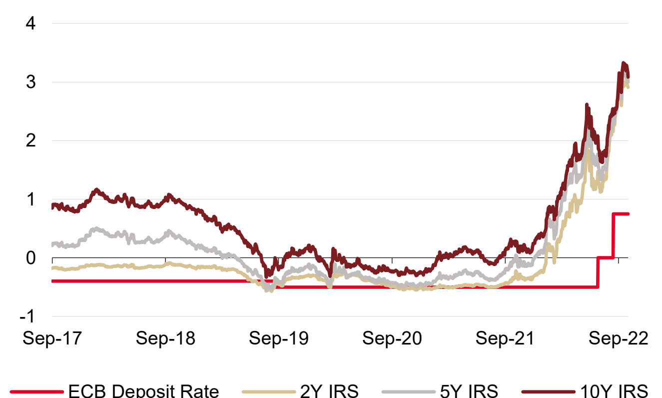
Given the sharp rise in the IRS curve over the past few months, rate-fixing conditions have deteriorated again. The proximity of their peak also does not currently indicate the appropriateness of the timing of domestic interest rate fixing. Some opportunity can still be seen in the persistently high inversion of the entire IRS curve, which brings with it more favourable conditions in the forward market. It is also possible to take advantage of hedging in the euro market, which offers significantly lower interest rates than the domestic market.

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

Forward \ Maturity	1Y	2Y	3Y	5Y	10Y
Spot	7.40	6.98	6.42	5.97	5.54
3M	7.36	6.73	6.23	5.82	5.44
6M	7.17	6.49	6.03	5.70	5.35
9M	7.57	6.53	6.07	5.72	5.36
1Y	6.51	5.89	5.66	5.46	5.20
2Y	5.24	5.20	5.17	5.13	4.99
3Y	5.15	5.14	5.13	5.08	4.95

Source: Bloomberg, Economic & Strategy Research, Komerční banka, as of 25 October 2022

Euro rates continue to rise (%)



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

Significant CZGB issuance likely to continue next year

Large government budget deficits will keep the supply of Czech government bonds high for the rest of this year and throughout next year. We assume that the state budget will end this year in deficit at the approved level, i.e. CZK375bn, which, combined with other financing

needs (mainly repayments of previously issued bonds), would imply a total issuance of CZK482.6bn worth of koruna bonds, of which CZK335.9bn has been issued so far in primary auctions (including the latest auction on 19 October). Another CZK42.7bn was raised by the Ministry through the sale of CZK-denominated bonds on the secondary market and CZK41.1bn through the issuance of the retail bonds at the beginning of the year. The refinancing of EUR2.75bn of euro-denominated bonds issued in 2012, which matured in May 2022, has so far probably been mostly covered by a short-term loan from the Slovak Debt and Liquidity Management Agency (Ardal) for a total amount of EUR2.5bn. EUR1bn of own euro bonds were issued (a combination of primary and secondary market). We estimate that in total around 80.2% of the full-year total financing needs were covered after the last auction on 19 October. We therefore anticipate that stronger supply in primary auctions could persist for the rest of the year, thereby offsetting the upward pressures on government bonds relative to the IRS curve (visible in the second half of previous years).

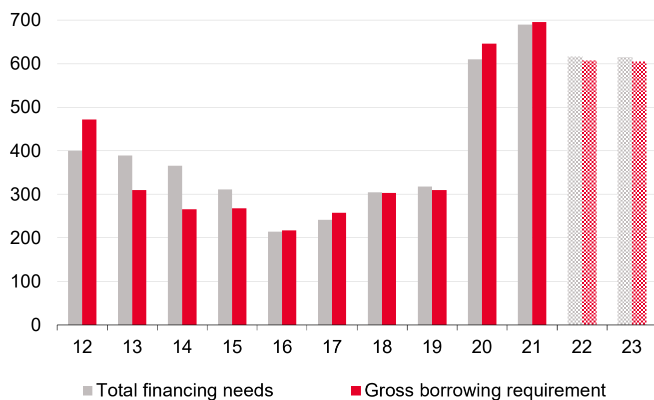
We expect total financing needs to reach CZK614.1bn (8.2% of GDP) in 2023, i.e. slightly lower than this year's level (CZK640.6bn, 9.4% of GDP). Thus, given the absence of significant budget consolidation, and assuming no significant use of other instruments (loans, retail bonds, etc.) to cover the borrowing requirement, the supply of CZGBs may even increase visibly compared to this year (by around CZK30bn).

Funding programme and issuance activity (CZKbn)

	2023	
	MinFin	**KB**
State budget deficit	295.0	315.0
Transfers and other operations of state financial assets	1.5	1.5
T-Bonds denominated in local currency redemptions	208.3	208.3
T-Bonds denominated in foreign currency redemptions	0.0	0.0
Redemptions and early redemptions on savings bonds	0.0	0.0
Money market instruments redemptions	86.7	86.7
Redemption of T-bills		25.0
Redemption of other money market instruments		61.7
Repayments on credits and loans	2.6	2.6
Total financing needs	**594.0**	**614.1**
Money market instruments		25.0
T-bills		25.0
Other money market instruments		0.0
Gross issuance of CZK T-bonds on domestic market		517.4
Gross issuance of EUR T-bonds on domestic market/eurobond		61.7
Gross issuance of savings government bonds		0.0
Received credits and loans		0.0
Financial asset and liquidity management		10.0
Total financing sources		**614.1**
Gross borrowing requirement		**604.1**
Net CZGB issuance		**309.1**

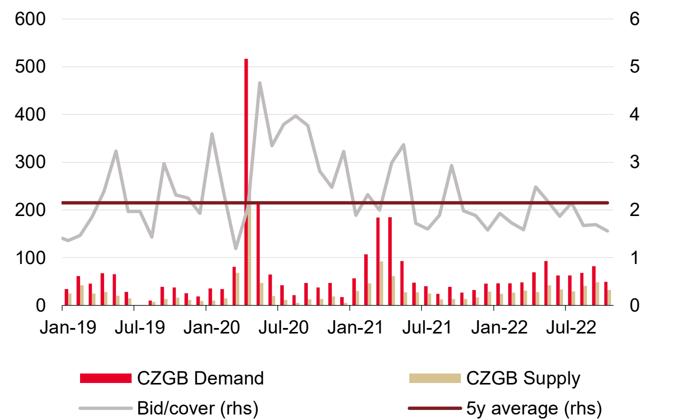
Source: Economic and Strategy Research, Komerční banka, MinFin

Financing needs (CZKbn)



Source: Economic and Strategy Research, Komerční banka, MFCR

CZGB primary market (CZKbn)



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

CZGB yield forecast (end of period)

	4Q22f	1Q23f	2Q23f	3Q23f
2y CZGB yield (%)	6.25	6.40	6.35	5.80
5y CZGB yield (%)	6.45	6.50	6.35	5.90
10y CZGB yield (%)	6.15	6.25	6.00	5.65
10y CZGB ASW (bp)	35	30	25	15

Source: Economic & Strategy Research, Komerční banka

CZGB yields likely to remain elevated until at least the middle of next year

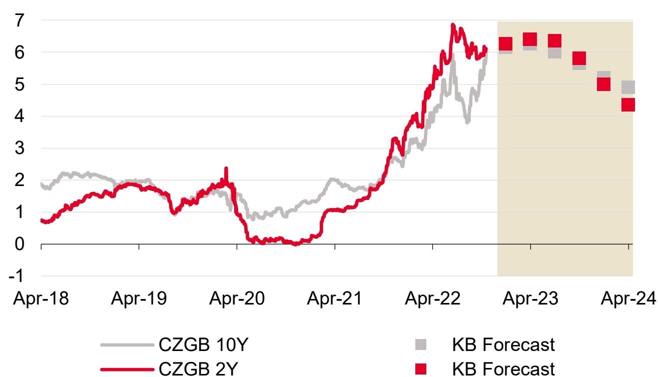
Treasury yields, like the IRS, have risen again since the local low in August, mainly in longer maturities. Over the last quarter, the rise in longer CZGB yields was even slightly more pronounced than in the case of the IRS curve; in ASW terms, these bonds became cheaper by about 30bp. Given the increased supply and lower real yields relative to US Treasuries, we do not see much room for them to get richer in the coming weeks. In our view, Czech government bond yields should be near their peak in the first half of next year, only to begin a gradual decline thereafter, just like the IRS. In our view, the risk of an increase in the risk premium also persists. While both Fitch and Moody's did not resort to changing the domestic rating in their latest revisions, both see the outlook as negative. In the eyes of the rating agencies, the main factors arguing for a possible downgrade are the medium- and long-term (un)sustainability of the current set-up of domestic public finances and the risk of a deepening of the energy crisis.

Sovereign rating overview

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

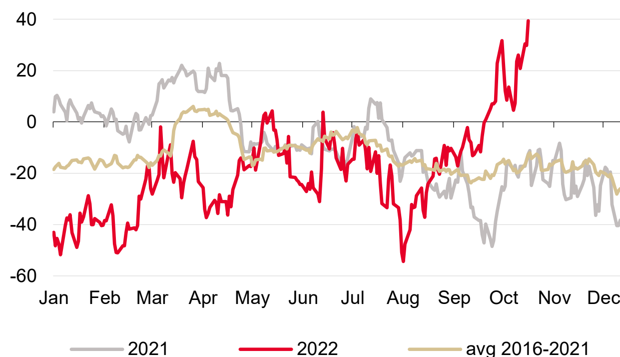
Source: Economic and Strategy Research, Komerční banka, Bloomberg

CZGB yield forecast (%)



Source: Economic and Strategy Research, Komerční banka, Bloomberg

10y CZGB ASW (bp)



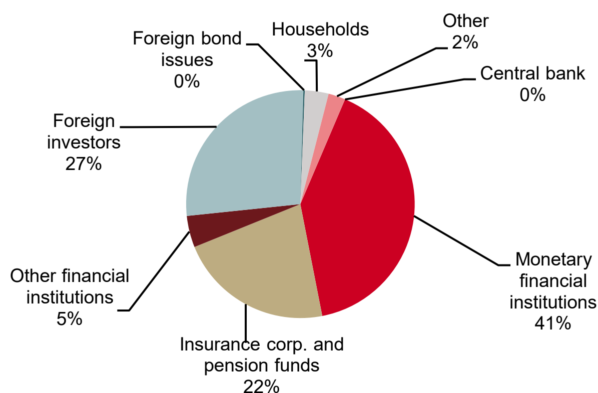
Source: Economic and Strategy Research, Komerční banka, Bloomberg

Government bond overview

Government bond overview									Rich-cheap analysis												
Bond		Dur.	Issued last 90D	Issuance limit	Yield	Δ1W	Δ1M	FX hedged	ASW	Δ1W	Δ1M	Min	90D	Max	Z-Score	Rank	Spline spread	Rank	Carry Roll 90D	Rank
0.45	Oct-23	0.9	0.0	80%	7.01	13	20	2.36	-56	3	-15	-68		-4	-1.0	18	-45.7	1	-30.4	19
5.70	May-24	1.4	0.0	100%	6.16	15	22	2.12	-111	-3	-18	-126		-32	-1.4	19	29.3	19	-33.4	20
0.00	Dec-24	2.0	1.4	34%	5.97	16	33	2.34	-85	2	-5	-102		4	-1.5	20	39.6	20	-25.2	18
1.25	Feb-25	2.1	0.0	100%	6.39	23	70	2.82	-41	0	23	-71		11	0.0	17	-5.2	8	-18.4	17
2.40	Sep-25	2.7	0.0	85%	6.23	25	84	2.97	-28	-2	28	-63		-3	0.9	16	4.0	14	-16.0	16
6.00	Feb-26	2.9	26.9	67%	6.22	34	92	3.14	-17	1	34	-79		-13	1.9	15	0.0	12	-14.6	15
1.00	Jun-26	3.4	0.0	100%	6.21	36	103	3.20	-4	5	41	-61		3	2.2	10	-2.1	11	-12.3	14
0.25	Feb-27	4.0	0.0	83%	6.22	41	109	3.34	9	2	40	-50		9	2.6	6	-6.7	7	-10.0	13
2.50	Aug-28	5.1	0.0	94%	6.13	43	112	3.48	20	10	39	-49		20	2.9	5	-3.5	10	-7.8	10
5.50	Dec-28 *	5.0	34.4	25%	6.13	39	102	3.58	22	13	40	-57		22	2.1	11	-4.4	9	-7.6	9
2.75	Jul-29	5.8	0.0	100%	6.19	46	121	3.60	33	11	48	-53		33	3.1	2	-11.2	3	-6.1	7
0.05	Nov-29	6.7	0.0	57%	6.16	42	120	3.54	35	11	42	-34		35	3.1	3	-7.8	4	-5.4	5
0.95	May-30	6.8	0.0	100%	6.15	40	118	3.58	36	9	40	-33		36	2.9	4	-6.8	6	-5.2	3
5.00	Sep-30 *	6.2	48.5	37%	6.03	30	108	3.62	29	3	41	-50		29	2.0	14	4.6	16	-6.1	6
1.20	Mar-31	7.4	0.0	100%	6.07	40	116	3.58	34	8	37	-33		34	3.1	1	0.3	13	-5.0	1
1.75	Jun-32	8.2	7.7	100%	5.97	34	107	3.60	33	1	32	-46		33	2.5	7	9.5	18	-5.1	2
2.00	Oct-33	9.1	0.0	100%	5.94	34	107	3.67	36	2	28	-41		36	2.5	8	9.3	17	-5.3	4
3.50	May-35	9.3	3.0	33%	5.88	32	101	3.76	38	-2	22	-45		38	2.3	9	4.0	15	-6.7	8
4.20	Dec-36	9.6	0.0	100%	5.79	25	95	3.73	32	-1	20	-40		34	2.1	12	-7.2	5	-8.5	11
1.95	Jul-37	11.6	0.0	10%	5.74	26	91	3.61	26	-4	14	-33		30	2.0	13	-14.0	2	-8.7	12

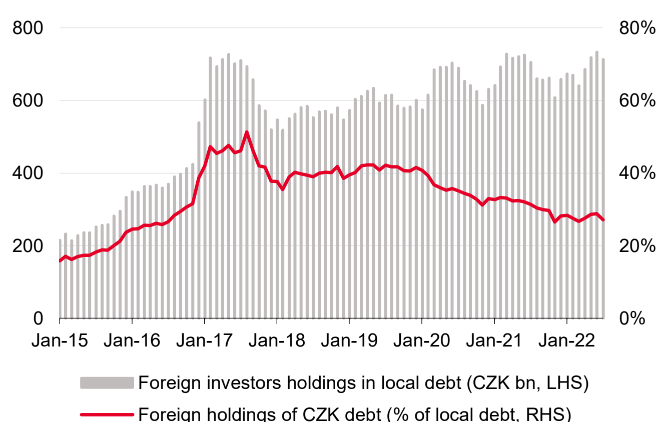
Source: Economic & Strategy Research, Komerční banka
Note: More details in CZGB Auction Alerts

Holdings of CZK government debt (August 2022)



Source: MinFin, Economic & Strategy Research, Komerční banka

The share of non-resident bondholders declines



Source: MinFin, Economic & Strategy Research, Komerční banka

Czech FX market

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Weakening pressures to persist

The CNB has so far succeeded in stabilising the koruna. Since May, the central bank has issued almost a fifth of its foreign exchange reserves to defend the currency from depreciation. This still leaves sufficient room for temporarily keeping the koruna at slightly stronger levels than its long-term equilibrium value implied by the fundamentals. We expect the CNB to gradually abandon targeting a specific exchange rate level and allow the koruna to move closer to its equilibrium value through moderate depreciation. This would arguably minimise the risk of having to intervene in increasing volumes. Thus, the exchange rate could be close to EUR/CZK 24.85 by the end of the year and around EUR/CZK 25.10 on a one-year horizon. The conditions for hedging against koruna appreciation have visibly deteriorated due to the decline in the interest rate differential, which we expect to continue, at least in the short term. The main risk to the koruna is a possible escalation of the geopolitical situation. There is also considerable uncertainty about the CNB's next monetary policy decisions.

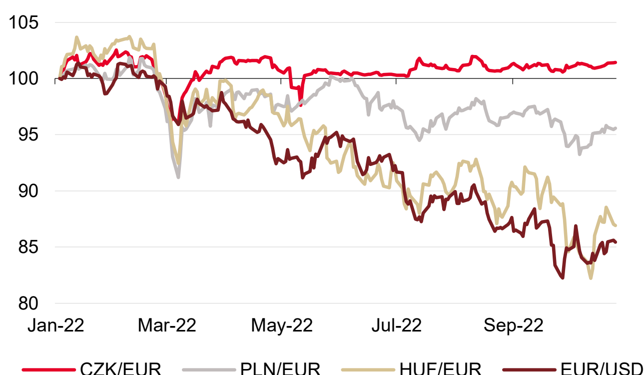
The koruna is the region's best performer, aided by CNB support

The koruna is the only currency in the region showing any resilience. Regional currencies have had a tough time of late, with pressures from multiple sources: the rising probability of recession in Europe, amplified by the high dependence on Russian gas supplies, as well as the deteriorating external trade and current account balances. The koruna has been seemingly unresponsive to these circumstances, but it is greatly supported by the CNB, which has been intervening to limit its depreciation. We estimate that between May and 10 October, the central bank carried out spot operations totalling almost EUR29bn, representing around 18% of foreign exchange reserves (compared to a peak of EUR160.4bn at the end of April 2022).

CZK exchange rates

Source: Bloomberg, Economic and Strategy Research, Komerční banka

Performance of CEE currencies (1. 1. 2022 = 100)



Source: Bloomberg, Economic and Strategy Research, Komerční banka
A value above 100 indicates an appreciation of the CZK, PLN or HUF against the EUR, or an appreciation of the EUR against the USD from 1 January 2022.

We revised our forecast for the koruna to slightly stronger levels due to mildly less pronounced depreciation pressures. We expect the koruna to depreciate to EUR/CZK 24.85 at the end of the year and to EUR/CZK 25.10 at the annual horizon. The CNB's intervention should prevent a more pronounced depreciation.

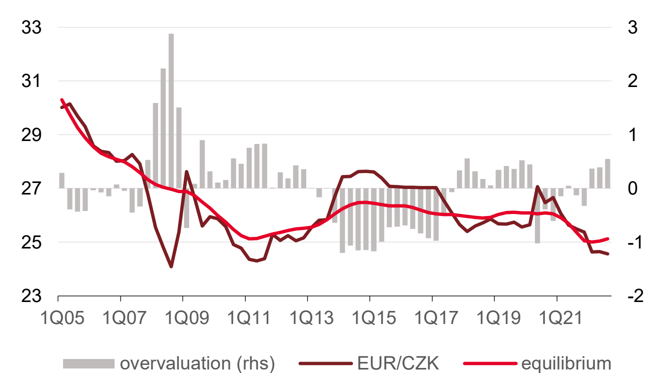
Depreciation pressures on the koruna are likely to remain. The interest rate differential has already fallen by more than a third since its peak in July amid tightening monetary policy abroad and a dovish turnaround of the CNB Board. The koruna's gains, however, are countered by a strong dollar, whose recent appreciation has seen regional currencies visibly weaken (with the exception of the koruna, defended by the CNB). At the same time, USD is expected to remain below parity with the euro until the end of this year. Foreign trade is also unlikely to help the koruna this year. The import side is still inflated by expensive energy. The negative primary income balance, which reflects the outflow of dividends from foreign direct investment, is also contributing to the current account deficit. In addition, we identify a risk of further capital outflows from the domestic banking sector by the end of this year, withheld during the pandemic. Last but not least, we forecast that the domestic economy will face a shallow recession at the turn of the year.

According to our estimates, the koruna was overvalued against its equilibrium value by roughly EUR/CZK0.6 to the euro at the end of 3Q. The hypothetical equilibrium value is based on a model filtration of the real bilateral exchange rate against the euro, which is consistent with the internal and external equilibrium of the economy.

EUR/CZK and interest rate differential

Source: Bloomberg, Economic and Strategy Research, Komerční banka

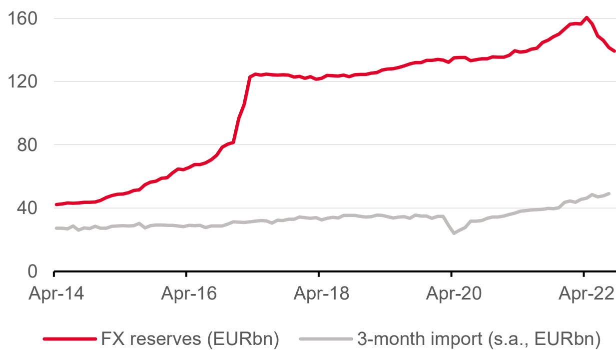
Equilibrium EUR/CZK exchange rate



Source: Macrobond, Economic and Strategy Research, Komerční banka
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.

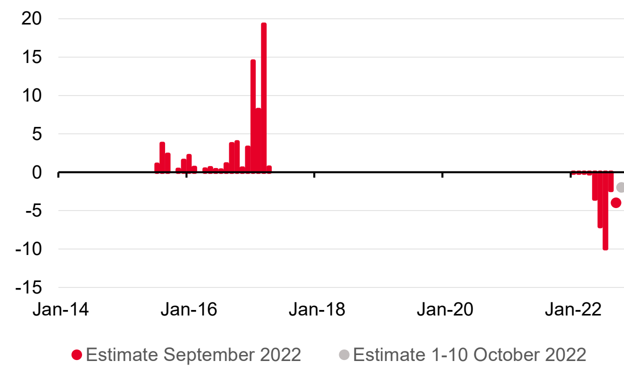
We assume the CNB will maintain its presence on the foreign exchange market and thus prevent the koruna from depreciating significantly. The CNB still has a significant cushion of around EUR85bn to the three-month import limit, which is sometimes simplistically stated as the recommended level of foreign exchange reserves. The recent volumes of foreign exchange interventions are, for the time being, at least temporarily sustainable in terms of the overall "firepower" of the domestic central bank. Given that the economic fundamentals do not favour the appreciation of the koruna this year, we expect the CNB to no longer defend a specific exchange rate level. Instead, we expect the CNB to switch to a mode in which it seeks only to avoid a sharp depreciation that would add fuel to the fire of increased domestic inflationary pressures through more expensive imports. The introduction of a regime of regular interventions of a pre-determined volume could also be in play. Looking at the exchange rate gap to equilibrium, we expect the koruna to remain overvalued, but the degree of this overvaluation will diminish as the koruna depreciates. By the end of the year, we think the koruna could depreciate to EUR/CZK 24.85 despite continued support from the central bank. Further depreciation should follow in the first half of next year, towards EUR/CZK 25.15.

CNB FX reserves



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

CNB spot operations (EURbn)



Source: CNB, Macrobond, Economic and Strategy Research, Komerční banka
Note: a positive value means interventions against koruna appreciation and a negative value against depreciation.

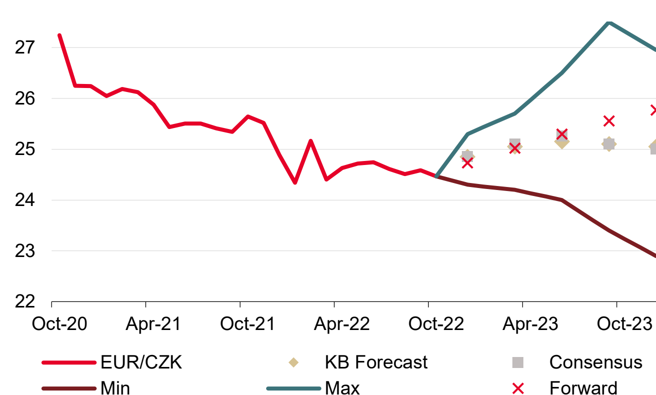
In our view, the gradual appreciation of the koruna could resume in the second half of next year. According to our assumptions, this should be due, among other things, to the weakening of the US dollar from the fading of negative sentiment towards European economies, which will also work in favour of a stronger koruna. The same dynamic should also be influenced by a recovery in foreign trade following the easing of supply chains and of the impact of high inflation on demand. Overall, we expect the koruna to strengthen gradually in 2H23, back towards EUR/CZK 25.05 by the end of 2023.

Koruna exchange rate forecast (end of period)

	4Q22f	1Q23f	2Q23f	3Q23f
EUR/CZK	24.85	25.05	25.15	25.10
USD/CZK	25.60	25.05	24.40	23.45
EUR/USD	0.97	1.00	1.03	1.07

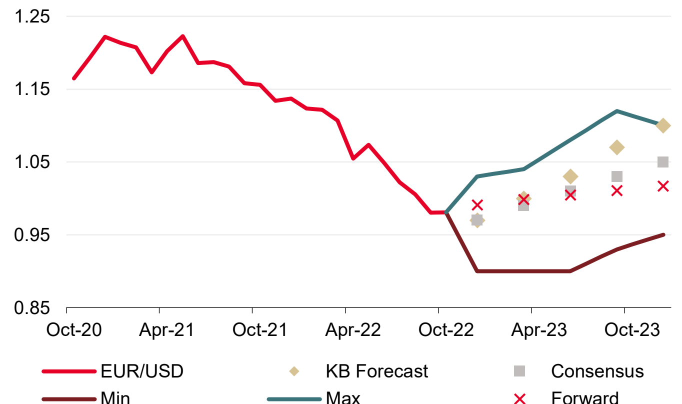
Source: Economic and Strategy Research, Komerční banka, SG Cross Asset Research

Expected EUR/CZK path, market consensus by Bloomberg (as of 25 October 2022)



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Expected EUR/USD path, market consensus by Bloomberg (as of 25 October 2022)



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

Risks to the outlook for the koruna remain considerable

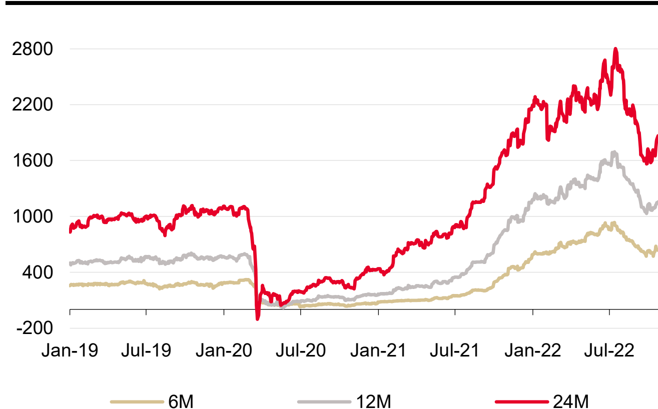
A significant risk is the possible escalation of the geopolitical situation, which could intensify the pressure on Central European currencies. We also identify a risk from further monetary policy actions by the CNB. The Bank Board is reluctant to hike rates further. At the same time, however, there is probably no clear support for foreign exchange interventions within the board, so there is a risk of their abrupt termination. On the other hand, it is still possible that the CNB, under the weight of persistent inflationary pressures,

will decide to support the koruna by raising interest rates. External developments also remain a significant risk, namely a possible deepening of the German recession and the development of the US dollar, or the speed of monetary policy tightening in the US and the euro area.

Decline in interest rate differential knocks down forward points

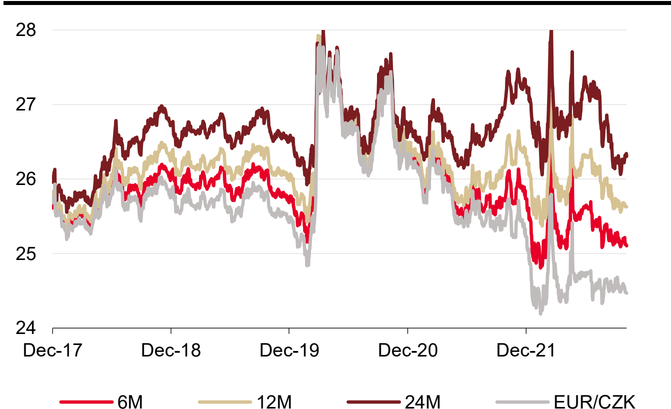
The conditions for hedging the exchange rate against appreciation had visibly deteriorated given the decline in the interest rate differential. In the coming months, we expect a further rise in market interest rates in the euro area, while domestic interest rates will probably no longer be supported by increases in domestic monetary policy rates. The interest rate differential may thus narrow further by the end of the year. The weakening of the spot exchange rate will, in our view, be rather moderate. Overall hedging conditions against appreciation will therefore continue to deteriorate, in our view. To a large extent, however, this depends on how much exchange rate depreciation the CNB allows and whether the materialisation of some upside risks eventually forces it to raise interest rates further.

Forward points



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Forward vs spot exchange rate EUR/CZK



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Banking sector

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Credit cycle slowdown likely to bring only a minor rise of risk

The higher loans growth this year compared to the previous forecast has been driven by loans to non-financial firms. A more protracted recovery of the economy from the shallow recession at the turn of the year, together with higher interest rates on loans, would lead to a cooling of credit activity across segments. The pace of residential property price appreciation should continue to moderate; however, more expensive financing and weak demand are likely to underpin a continued slowdown in mortgage lending. Consumer finance is set to be similarly affected. Deposit expansion should continue to be held back, as high inflation erodes households' savings. Slower economic recovery next year would result in only a limited realisation of risk on the loan portfolios.

Continued cooling down in the mortgage and residential property markets

More expensive financing, worse affordability and a slowdown in economic activity are set to result in further cooling of the property and mortgage markets, in our view.

Following a high rate of price appreciation in residential real estate since late 2020, the price momentum eased significantly in 3Q this year, with prices rising 2.4% qoq on a seasonally adjusted basis (vs 8.8% qoq in 2Q). Nonetheless, yoy prices are still almost 23% higher and housing affordability is still one of the worst in the EU. This, paired with more expensive mortgages, should lead to a continued increase in demand for rentals and hence further rental growth. However, residential property prices should continue to moderate and even fall slightly in the near term before rising only modestly thereafter. The decline should be primarily attributable to energy-intensive and recreational properties, along with the lower segment, due to the reversal of the COVID-driven trend and high energy prices.

Bank loans and deposits (% yoy)

	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	2021	2022	2023	2024	2025	2026
Bank loans														
Total	4.4	6.9	8.2	7.0	6.6	6.2	4.6	4.5	**4.9**	**6.6**	**5.5**	**5.7**	**6.6**	**6.6**
Households - real estate loans	11.1	8.8	6.9	4.9	3.6	3.6	3.3	3.7	**9.9**	**7.9**	**3.5**	**5.4**	**6.7**	**6.9**
Households - consumer loans	8.9	7.0	5.8	4.9	3.6	3.1	3.1	3.3	**3.3**	**6.7**	**3.3**	**5.9**	**6.6**	**6.6**
Corporate loans	7.6	7.7	10.9	9.7	8.9	9.1	4.2	4.3	**0.9**	**9.0**	**6.6**	**6.5**	**6.5**	**6.3**
Deposits														
Total	4.7	8.3	5.4	6.0	7.3	5.6	5.8	5.6	**8.3**	**6.1**	**6.1**	**5.2**	**6.0**	**5.8**
Households	4.1	4.1	3.5	3.4	4.6	3.9	4.1	4.8	**10.2**	**3.7**	**4.3**	**5.6**	**6.5**	**6.2**
Non-financial corporations	8.1	5.6	8.4	8.6	8.0	7.5	6.2	5.8	**8.3**	**7.7**	**6.9**	**5.0**	**5.4**	**5.4**
Others	3.4	18.0	6.7	9.8	11.6	7.1	8.6	7.2	**4.9**	**9.5**	**8.6**	**4.8**	**5.4**	**5.3**
Ratios														
Loans/GDP	62.6	61.6	61.9	60.3	59.7	58.5	58.3	57.5	**63.5**	**61.6**	**58.5**	**57.2**	**57.6**	**58.9**
Deposits/GDP	98.5	98.6	94.9	85.4	94.5	93.1	90.5	82.3	**97.7**	**94.3**	**90.1**	**87.7**	**87.8**	**89.0**
Loans/deposits	63.6	62.4	65.2	70.6	63.1	62.8	64.4	69.9	**65.1**	**65.5**	**65.1**	**65.3**	**65.7**	**66.2**
Interest rates														
Real estate loans	3.8	4.4	4.8	4.9	4.9	4.9	4.8	4.5	**2.4**	**4.5**	**4.7**	**4.1**	**4.0**	**4.0**
Consumer loans	8.2	8.8	10.1	11.2	11.6	12.0	12.2	12.2	**7.4**	**9.6**	**12.0**	**11.0**	**9.8**	**10.0**
Corporate loans	6.2	7.9	8.2	8.2	8.3	8.3	8.0	7.0	**2.4**	**7.6**	**7.9**	**5.3**	**4.1**	**4.1**
Share of NPL														
Real estate loans	0.8	0.8	0.7	0.7	0.9	1.1	1.2	1.3	**1**	**0.7**	**1.1**	**1.5**	**1.6**	**1.7**
Consumer loans	4.3	4.0	4.0	4.2	4.6	5.5	6.3	6.9	**5.2**	**4.1**	**5.8**	**7.9**	**8.2**	**8.0**
Corporate loans	3.7	3.5	3.2	3.2	3.3	3.6	3.8	4.1	**4.1**	**3.4**	**3.7**	**4.2**	**4.4**	**4.4**

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

We expect worse affordability and interest rates lingering at higher levels to contribute to the cooling of the mortgage market. This will mainly be visible next year, as the 2H22 figures still reflect front-loaded mortgages with more favourable terms, unaffected by the stricter limits on their drawdown. After nearly 10% growth last year, we expect a slowdown to 7.9% this year. Mortgage lending activity next year will fully reflect the higher level of interest rates and weak household consumption being a potent drag on economic growth. Thus, we expect mortgage loans to grow by only 3.5% on average in 2023. Notably, we expect to see a significant positive impact from the return of Sberbank's mortgage portfolio to the statistics. The usually delayed reaction of the credit cycle to the developments in the real economy should also lead to lower growth in 2024 (+5.9%).

Weak consumer sentiment signals further slowdown in consumer finance

Households' deteriorating solvency and weakening demand should feed into low growth in consumer finance.

Worsening consumer sentiment and weakening household consumption point to a slowdown in consumer finance. The greater riskiness of consumer credit, coupled with the negative economic outlook and deteriorating household solvency, implies higher rates on consumer credit. While a tight labour market and associated strong wage growth should lead to a solid growth of 6.4% this year, in our view, weak household demand is set to be accompanied by low growth in consumer finance next year (+3.5%). In both years, high inflation, reflected in higher personal expenditures, ought to support growth in nominal terms.

We expect non-financial firms' appetite for leverage to start to wane

Demand for operational and foreign denominated financing should gradually decline and we expect a significant slowdown in firms' overall lending activity next year.

Despite interest rates reaching local maxims, loans to non-financial corporates posted a surprisingly strong growth in 3Q. As a result, growth in this segment is likely to reach 9% on average this year. Since 2Q, however, the growth has been entirely the work of euro-denominated loans due to appealing interest rate spreads, which are however slowly but surely disappearing. Meanwhile, the yoy decline in the volume of koruna loans is deepening. Supply chain constraints and high increases in input prices have favoured operational financing, where the energy sector has played a major part due to margin calls. We expect this trend to continue, particularly at the expense of long-term investment loans, although it should weaken as the turbulence in the commodity markets fades. Given that interest rates will likely stay higher for longer, including foreign ones, coupled with the protracted economic recovery, we estimate that loans to non-financial firms will grow by 6.6% on average next year and total business by 7%. Bridging and other short-term loans are likely to contribute markedly again.

Deposits growth is set to be hampered again by credit activity and inflation

Deposit expansion is likely to continue to hit the brakes but should still outpace loan growth next year.

While better appreciation of deposited funds and nominal wage growth is poised to help deposits expansion, high inflation encourages a search for yield by both households and businesses and thus pivoting to alternative non-bank solutions. The worsening financial solvency of households due to persistently high inflation should further erode accumulated savings. On the other hand, the highly expansionary fiscal policy is likely to contribute in the other direction. Moreover, lower credit activity across segments is set to negatively affect deposit growth. We estimate deposits to grow by an average of 6.1% this year and next year, a significant slowdown from previous years when households inflated their savings balances.

Drawn-out economic recovery likely to result in small credit risk realisation

Weaker economic growth next year should lead to a modest realisation of risk on banks' loan portfolios.

In 3Q, non-performing loans (NPL) ratios continued to decline across segments, nearing record lows. However, due to weak economic growth and higher debt service burden, we see default rates nudging a little higher in the year ahead. Nonetheless, given the delayed response of the credit cycle to macroeconomic developments, the increase in NPLs is likely to be very gradual. Further, the levels reached should be relatively low and do not represent a major risk, i.e., the upcoming provisioning should be sufficient to cover the risk incurred. The increasing exposure to foreign currency denominated positions could potentially present an upside risk, albeit still manageable provided the resilience of the domestic banking sector.

Key economic indicators

Macroeconomic indicators – long-term outlook

		2019	2020	2021	2022	2023	2024	2025	2026
GDP	real, %	3.0	-5.5	3.5	2.7	0.5	3.1	2.6	2.4
Inflation	average, %	2.8	3.2	3.8	15.1	12.0	2.8	1.6	1.6
Current account	% of GDP	0.3	2.0	-0.8	-4.4	-3.2	-2.6	-1.6	-0.8
3M PRIBOR	average, %	2.1	0.9	1.1	6.3	6.8	4.3	3.3	3.3
EUR/CZK	average	25.7	26.5	25.6	24.7	25.1	24.9	24.7	24.6
USD/CZK	average	22.9	23.2	21.7	23.8	24.2	21.3	19.9	19.1

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

FX & interest-rate outlook

		24-10-2022	Dec.22	Mar.23	Jun.23	Sep.23	Dec.23
EUR/CZK	end of period	24.5	24.85	25.05	25.15	25.10	25.05
USD/EUR	end of period	0.99	0.97	1.00	1.03	1.07	1.10
CZK/USD	end of period	24.8	25.60	25.05	24.40	23.45	22.75
3M PRIBOR	end of period, %	7.30	7.30	7.30	7.30	6.40	5.40
10Y IRS	end of period, %	5.53	5.80	5.95	5.75	5.50	5.10

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

Monthly macroeconomic data

		I-22	II-22	III-22	IV-22	V-22	VI-22	VII-22	VIII-22	IX-22
Inflation (CPI)	%, mom	9.9	11.1	12.7	14.2	16.0	17.2	17.5	17.2	18.0
Inflation (CPI)	%, yoy	4.4	1.3	1.7	1.8	1.8	1.6	1.3	0.4	0.8
Producer prices (PPI)	%, mom	19.4	21.3	24.7	26.6	27.9	28.5	26.8	25.2	25.8
Producer prices (PPI)	%, yoy	6.9	2.2	4.2	2.3	1.9	1.4	0.3	-0.1	1.2
Unemployment rate	% (MLSA)	3.6	3.5	3.4	3.3	3.2	3.1	3.3	3.4	3.5
Industrial sales	%, yoy, c.p.	3.9	-1.0	-1.4	-7.3	4.5	2.7	-1.9	10.3	n.a.
Industrial production	%, yoy, c.p.	15.8	8.8	7.2	0.7	18.8	18.2	13.0	30.2	n.a.
Construction output	%, yoy, c.p.	5.4	16.7	8.8	3.4	4.3	1.5	-4.0	1.0	n.a.
External trade	CZKbn (national met.)	7.4	-6.5	-11.9	-27.7	-26.1	-13.1	-21.5	-28.2	n.a.
Current account	CZKbn	9.0	-8.6	-13.9	-2.2	-21.1	-49.4	-24.2	-80.6	n.a.
Financial account	CZKbn	-12.5	-13.1	21.9	-12.7	-42.6	-46.3	-43.7	-106.6	n.a.
M2 growth	%, yoy	6.9	6.1	5.9	5.6	6.3	5.3	5.3	5.3	n.a.
State budget	CZKbn (YTD cum.)	3.9	-45.3	-59.1	-100.1	-189.3	-183.0	-192.7	-231.1	-270.9
PRIBOR 3M	%, average	4.21	4.69	4.86	5.36	5.97	6.64	7.30	7.27	7.25
EUR/CZK	average	24.5	24.5	25.0	24.4	24.8	24.7	24.6	24.6	24.6
USD/CZK	average	21.6	21.6	22.7	22.6	23.4	23.4	24.2	24.3	24.8

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

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