Instant Reaction

EcoAlert

Production is weakening due to stifling components subcontracting

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

Industrial output, foreign trade, construction (February 2021)

	Current	KB forecast	Consensus (Bloomberg)
Industrial output (% yoy)	-2.6	0.5	0.4
Industrial new orders (% yoy)	6.7		
Foreign trade balance (CZK bn)	22.5	28.8	26.2
Construction output (%, yoy)	-11.0	-8.3	

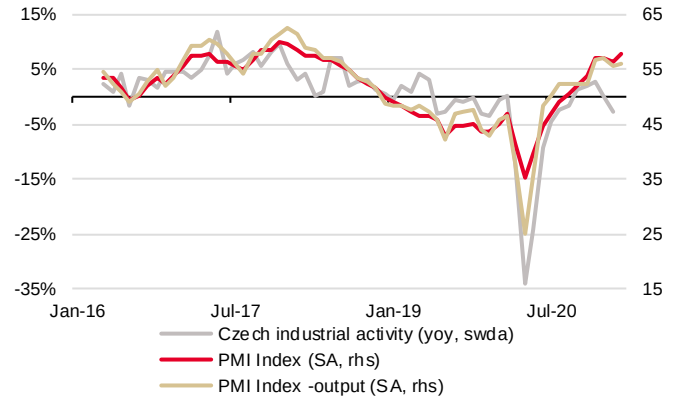
Source: Bloomberg, CZSO, Economic & Strategy Research, Komerční banka

Industrial production accelerated its decline in February, negatively surprising analyst estimates. Orders are growing, but there are missing components for production and partial shortages of manpower. The foreign trade surplus fell in line with weaker industry. Unsurprisingly, construction remains subdued.

In February, adjusted industrial production in the Czech Republic fell 2.0% month-on-month (SWDA). Given the continuing problems in subcomponent deliveries, we expected a smaller decrease of 0.3% mom after a decrease of 0.8% in January. In year-on-year terms, industrial production fell 2.6%, which was below all analytical estimates that in the median showed growth of 0.4%.

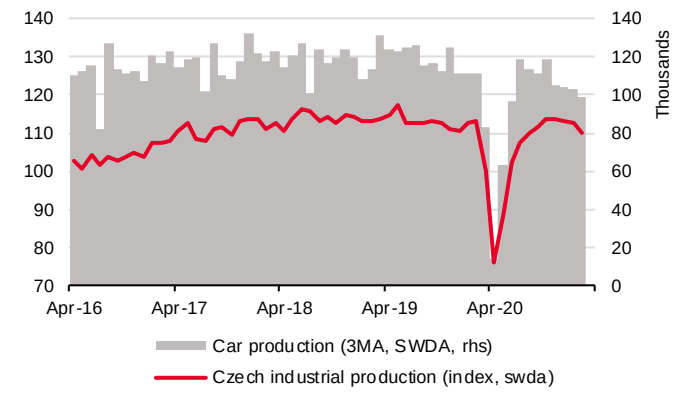
Leading indicators and new orders growing 6.7% yoy show that the reason for the decline in production is not weak demand but rather problems in the subcontracting of components that affect the Czech automotive industry.

Leading indicators still show production expansion



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

Car production is limited by subcomponents deliveries



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

The year-on-year decline in motor vehicle production deepened to 8.0% in February from a decline of 1.6% in January. Without car production, the year-on-year decline in industrial production would not be 2.6% but 1.0%. The production of beverages also decreased significantly (-17.9% yoy), which is related to closed restaurants, as well as the production of non-metallic mineral products (-8.8% yoy, mainly building materials) and furniture (-9.5% yoy).

Year-on-year growth of almost 25% is reported by pharmacies. The production of chemicals (4.2% yoy), metal structures (2.2% yoy), paper (3.9% yoy) and wood processing (2.8% yoy) is also growing.

Supply problems continue and some carmakers are reporting production cuts. In March, we can expect weak numbers from industry again. In addition to problems with the supply of components, manufacturing companies also have a problem with labour shortages, which is exacerbated by the anti-pandemic measures.

In a year-on-year comparison, however, industry will start comparing from March with the period when the pandemic first began. Even if industry declines on a month-on-month basis, we will see very high numbers year-on-year, especially in April, when a large part of production was closed last year.

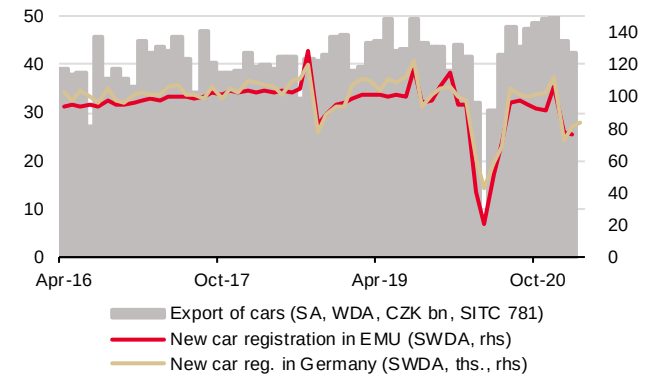
After last year's 8% decline in industrial production, our forecast for this year assumes growth of 9.8%. This may look like rocket growth; however, the main recovery has already taken place and this year's growth is high due to a low base effect. The development itself in the first quarter shows a rather weaker result, but the recovery in the second half of the year may be strong. This will depend on the development of the pandemic, the immunisation of the population and the availability of components.

Data for February also showed a relatively weak year-on-year increase of 0.9% in the average wage in industry after stagnation in January. The year-on-year decline in employment decreased slightly to 3.5% from the previous 3.3%.

Foreign trade is also weaker

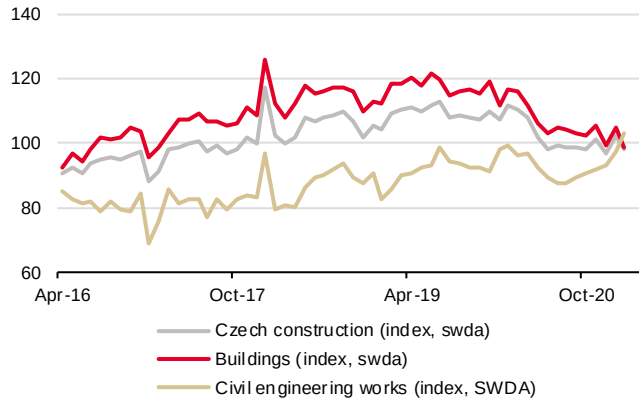
The foreign trade balance reached a surplus of CZK22.5bn in February. The year-on-year improvement in the surplus thus fell further to CZK2.2bn. For comparison, the year-on-year improvement in December was CZK8.4bn and in December even CZK24.1bn. As is the case in industry, the foreign trade balance lagged behind estimates, which counted on a surplus of around CZK26bn. **While imports increased 0.4% mom (SA), exports decreased 0.8% mom (SA).** Compared with last year, total February exports increased 3.8% and imports 3.3%.

Weakened car production also affects foreign trade



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

The construction industry remains subdued



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

The foreign trade balance was favourably affected mainly by a lower deficit in oil products of CZK1.1bn and CZK1.0bn in oil and natural gas. The negative balance was also lower in the balance of clothing, which shows the closure of Czech retailers. Compared to last year, the

balance with machinery and transport equipment deteriorated by CZK2bn, which corresponds to lower production.

In the coming months, exports will be weaker due to lower expected industrial production. Higher oil prices will eliminate the improvement in the commodity balance. In a year-on-year comparison, however, in the balance sheet, as in industry, there will be a significant improvement due to the extremely low base from the time after the outbreak of the pandemic. Last year, the Czech Republic's foreign trade reached a record surplus of CZK190bn. For this year, we expect a more significant economic recovery in the second half of the year, which will gradually be reflected in accelerated import growth. This should lead to a reduction in the foreign trade surplus below CZK160bn.

Construction remains subdued

Construction output in the Czech Republic fell 11.0% yoy in February, after a previous decline of 5.2%. We expected a decrease of 8.3%, but in the context of the uncertainty of monthly data from construction, we cannot speak of a significant surprise. Compared to January, construction output decreased 3%. It is still weak, especially in the building construction sector, where the year-on-year decline in production deepened to 13.8%. The main culprits are continued anti-pandemic restrictions and increased uncertainty about further developments. This leads to companies, in particular, limiting investment in expanding production. In the field of civil engineering, where a large part of projects are commissioned directly by the state, on the other hand, production increased 0.8% yoy.

The outlook for the coming months remains relatively pessimistic, as the number of newly issued building permits continued to decline (3.3% yoy in February). Although the approximate value of building permits increased 30%, according to information from the CZSO, this growth was mainly driven by several infrastructure projects, for which it usually takes longer for their implementation to begin. We could observe a rather slight recovery in the construction sector in the second half of the year, when the current restrictions could ease, and due to the higher share of the vaccinated population, the uncertainty about further development should also decrease. In the coming years, domestic construction production would also be significantly helped by funding from EU funds. However, the brake on further development may be the lack of workers from abroad, on which the Czech construction industry has long relied. They travelled to their home countries after the outbreak of the pandemic and the question is whether or when they will return.

In terms of monetary policy, data from the manufacturing sector published today indicate a wait for interest rates future increases. At the moment, we are counting on this happening in the fourth quarter. On the contrary, previously published retail data pointed in the opposite direction. The key variable will be the development of the pandemic and the vaccination coverage of the population.

KB ECONOMIC & STRATEGY RESEARCH

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

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

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

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

Strategist
František Táborský
(420) 222 008 598
frantisek_taborsky@kb.cz

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

SG IN CENTRAL AND EASTERN EUROPE

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

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

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

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

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

SG GLOBAL ECONOMICS RESEARCH

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

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

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

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

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

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

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

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

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

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

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

Japan
Takuji Aida
(81) 3-6777-8063
takuji.aida@sgcib.com

Japan Rates Strategist
Tomoya Narita
(81) 3 6777 8065
tomoya.narita@sgcib.com

SG CROSS ASSET RESEARCH – FIXED INCOME & FOREX GROUPS

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

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

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

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

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

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

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

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

Kevin Ferret
(44) 20 7676 7073
kevin.ferret@sgcib.com

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

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

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

Head of Emerging Markets Strategy
Jason Daw
(65) 6326 7890
jason.daw@sgcib.com

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

Phoenix Kalen
(44) 20 7676 7305
phoenix.kalen@sgcib.com

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

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

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

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