

Macroeconomic Forecasts

EcoAlert

Monthly forecast – June 2021



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The economy is booming and inflation looks for a ceiling

Data published in June will confirm a slight decline of the Czech economy at the beginning of the year and a moderation in average wage growth. At the same time, monthly data for April will show a rapidly growing economy due to the easing of anti-pandemic measures. The reopening of services will likely lead to faster inflation in May. We expect the Czech National Bank to raise interest rates at its meeting in August. However, financial markets expect a hike as early as the June meeting.

Upcoming indicators

		Period	Previous figure	KB forecast	Release date
GDP second reading	%, qoq	1Q21	-0.3	-0.3	1.6.
GDP second reading	%, yoy	1Q21	-2.1	-2.1	1.6.
Purchasing Managers' Index	points	May	58.90	59.00	1.6.
Avg real monthly wage	%, yoy	1Q21	1.7	2.8	4.6.
Industrial production	%, yoy, swda	April	14.9	52.6	7.6.
Construction output	%, yoy	April	-3.1	-1.1	7.6.
External trade	CZKbn	April	18.5	3.6	7.6.
Share of unemployed	%	May	4.1	4.0	8.6.
Retail sales	%, yoy	April	13.0	28.5	8.6.
Retail sales ex auto	%, yoy	April	6.6	12.0	8.6.
Inflation (CPI)	%, mom	May	0.5	0.5	10.6.
Inflation (CPI)	%, yoy	May	3.1	3.2	10.6.
Current account	CZKbn	April	11.8	2.5	14.6.
Producer prices (PPI)	%, mom	May	0.8	0.4	16.6.
Producer prices (PPI)	%, yoy	May	4.58	4.59	16.6.
CNB Repo rate	%		0.25	0.25	23.6.

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

GDP: According to the advance estimate, the Czech economy shrunk 0.3% qoq in 1Q21 after growing 0.6% in 4Q20. In year-on-year terms, the decline eased from -4.8% to -2.1%, mainly due to the lower base from 1Q20, which had already been affected by the pandemic. We expect the refined estimate to confirm these numbers. Net exports and household consumption were likely the main drags on growth in 1Q. Household consumption likely decreased in response to a significant tightening of virus-related measures, with a ban on movement between regions adding to the closure of shops and services. The lower net exports surplus was related to lower exports due to the problems with production input supply in industry as well as increased imports of inventories. Due to increased uncertainty, fixed investment likely remained very weak, but we think volumes didn't fall much further. On the other hand, the economy was likely supported by still-buoyant government consumption. We expect the Czech economy to grow 3.4% in 2021 and 4.7% next year.

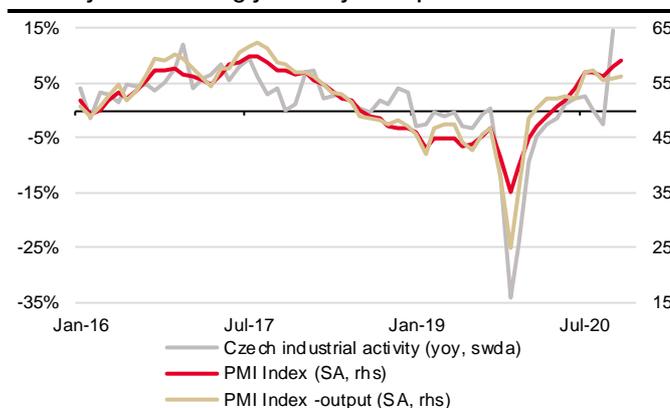
Average wage: Growth in average nominal wages likely eased in 1Q from 1.7% in 4Q to 0.5% qoq and from 6.5% to 5.0% yoy. This was likely due to a lower increase in the public sector, especially in health services, where the effect of one-off pandemic payments in 4Q20

has faded. However, similar payments to healthcare workers were made by the government in 2Q21, and so public wages are likely to go up again. In the private sector, we expect wage growth remained subdued in 1Q as the economy remained depressed by the pandemic. Despite the GDP decline in 1Q, inflation has accelerated. As a result, we expect real wages to have decreased slightly quarter on quarter, with year-on-year growth slowing from 3.8% to 2.8%.

Industrial output: Industrial production broke a series of month-on-month declines in March, rising 3.2%. The expansion should continue in April. Further improvements in leading indicators and confidence in the industry speak in favour of continued growth. On the contrary, the decline in production in neighboring Poland is an argument for a more gradual expansion. A reduction in the level of anti-pandemic measures could also have some positive effect on production output, in particular due to labour constraints.

In April, we expect month-on-month growth in industrial production of 1.5%. This corresponds to a year-on-year jump of an incredible 52.6%, which is naturally due to industry closures last year. The effect of a low base effect will weaken rapidly in the coming months as the economic

Industry shows strong year-on-year expansion



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

shutdown quickly disappeared last spring. Importantly, however, on a month-on-month basis, we could see continued expansion, especially with regard to demand growth, which is evidenced by both domestic developments and, in particular, the expansion of foreign demand and foreign leading indicators. The missing components for production have become a significant limit in the industry, which will limit its performance this year. Problems with labour shortages are gradually returning roughly to outlines comparable to the pre-pandemic situation. Our forecast for this year assumes industry will grow around 9%, but the latest development rather suggests the full-year result could be in slightly double-digit numbers.

Retail sales: We expect solid growth from retail sales in April. In addition to the greater possibility of spending and the end of restrictions on the movement of the population, this is also indicated by the growth of consumer confidence. Evidence of increased consumer appetite also includes growing card transactions, which recorded year-on-year growth of less than 20% in April. For this month, we expect an increase in retail sales excluding car sales and repairs (which also reflects the purchases of companies) by a strong 3.4% month-on-month. Given last year's low base effect, this would mean a year-on-year jump of 12%. In the case of car sales, the year-on-year low base effect will be even more pronounced. Here, we expect month-on-month growth of only 0.8%, given weaker car registrations. However, this still corresponds to the extremely high year-on-year rate of 62.8%. We expect year-on-year growth of 28.5% for total retail trade, including the automotive segment. Due to the high pace of the spread of epidemic measures, a strong expansion of retail sales can be expected in the coming months. Already in May, the level of retail sales (excluding car sales) could be higher than before the pandemic. Our April forecast for this year expected retail growth excluding car sales to be around 1%, but the pace of anti-pandemic measures suggests it could be more than 2-3%.

CPI inflation: The reopening of the economy brings price fluctuations. In May, measures were further relaxed, including services, which may have a significant impact on price developments. Already in April, it brought an average month-on-month increase of 0.5%, while the market expected 0.2%. In May, we expect only a slight increase in prices at gas

stations and a similar increase in food prices. A smaller increase in prices could be observed for tobacco and alcohol. However, a key issue is the development of core inflation, which reflects the evolution of items in most consumer baskets, especially services, where anecdotal evidence points to a rise in prices after services such as restaurants and hairdressers have reopened.

Yoy inflation to rise in the near term



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

To some extent, this effect can be compared with previous pandemic measures disintegrations, but the uncertainty of the estimated development is high. We anticipate that core prices rose 0.5% month-on-month in May and year-on-year core inflation slowed to 3.2% from a previous rate of 3.4%. For headline inflation, this would mean a further slight acceleration to 3.2% from the previous 3.1%. **We believe that in the case of month-on-month dynamics, inflation will be at its peak in the period from May to July. In that case, annual inflation could fall slightly in June but still remain close to 3.0% in the second half of the year. The inflation result for May could provide important guidance for the CNB's June decision on rates. Although the CNB can do nothing with current inflation, the argument may be the effect on inflation expectations.**

Czech National Bank: We expect the Czech National Bank (CNB) to make the first rate hike in August, but there is a risk of an earlier June increase. With the improving epidemic situation and higher vaccination rate of the population, the CNB board speaks more optimistically, thanks to which the money market is now mostly betting on interest rates being raised as early as June. Central bankers have been cautious, saying they would rather delay than rush policy tightening. We therefore think they will prefer to wait for the new CNB forecast and monthly indicators confirming an economic rebound. The exchange rate of the koruna, being about 1% stronger to the euro than the CNB expected, plays an important role, as well. The first hike in the key repo rate by 25bp in August is likely to kick off the gradual normalisation of monetary policy, which will come as a result of the recovering economy and continuing tightness on the labour market. We expect a total increase in the repo rate of 50bp this year as a rate hike likely to occur in November. Policy tightening should continue in the next year, with a repo rate of 1.5% at its end.

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