Quarterly report

Czech Economic Outlook

Economy revving up

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- **The economy is rising sharply** Growth has so far been driven by high inventories this year, but investment in fixed capital and household consumption should now take the lead. We expect the economy to grow by 4.2% this year and 5.3% in 2022.

- **Inflation should have reached a peak** Core inflation has been running faster since onset of the pandemic and will probably take time to slow down. We estimate inflation to reach 2.8% this year and slow down to 2.4% next year.

- **CNB likely to continue to raise interest rates** With the economy starting to recover and inflation staying above the 2% target, we expect further hikes. The repo rate is likely to rise from 0.5% to 1.25% by year-end, and to above 2% by end-2022.

- **A complicated path to higher interest rates and government bond yields** Short-term declines look set to continue, but an upward trend is inevitable, in our view.

- **Global developments limit the potential of the koruna** We expect the CZK to continue to appreciate, but further fluctuations are likely. Compared to the previous forecast, we expect a more moderate pace of appreciation for the koruna.

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GROUP

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The economy is experiencing a breath of fresh air

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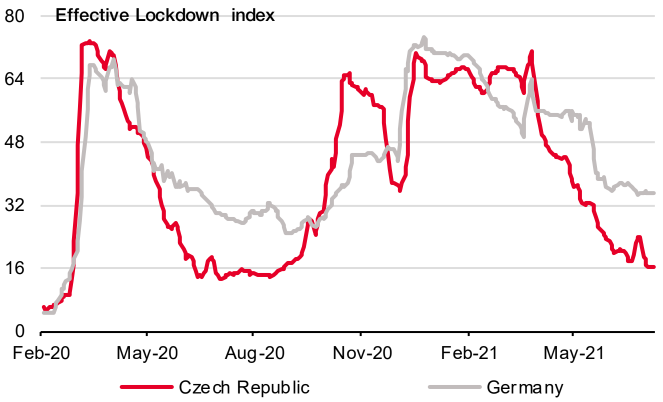
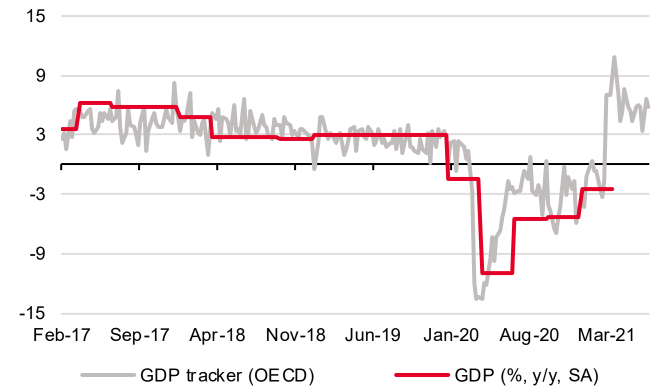
The first half of this year is over. Two quarters that differed more than night and day. The first months of the year were marked by another wave of the pandemic, which necessitated heavy restrictions on – but not only – economic life. On the contrary, the second quarter saw a significant improvement in the pandemic situation and hence also the easing of the restrictive measures, which were much faster than expected. This also resulted in a turnaround in the real economy's development. **The recovery of economic activity started to yield impressive macroeconomic data in the second quarter. In addition, this data is being inflated by the 'magic' of a low statistical base**, especially in comparison with the same period last year. The reason is that the comparative base is extremely low due to the anti-pandemic measures seen in 2020.

Anti-COVID restrictions significantly reduced



Source: Economic and Strategy Research, Komerční banka, Macrobond

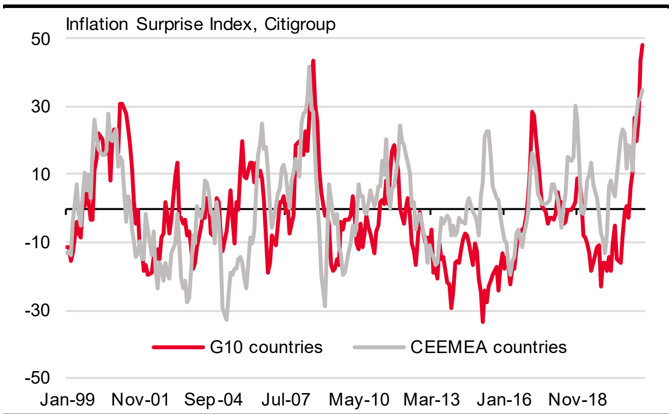
Macro-data supported by a low statistical base



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

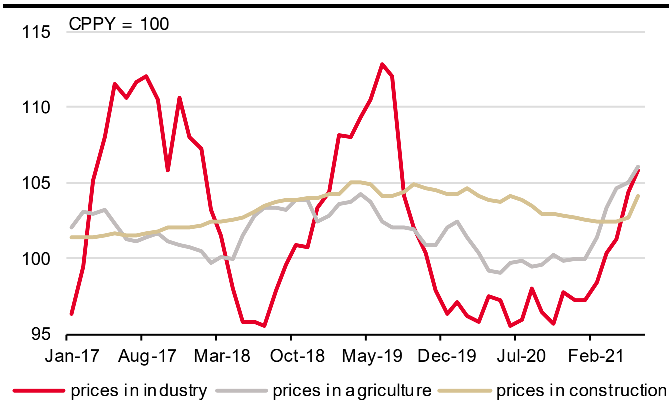
The April issue of our *Czech Economic Outlook* was subtitled *The Hawks Are Returning*. And indeed, they did return to the board of the Czech central bank – and in numbers hitherto unseen. **As early as June, the CNB was unafraid to sound its retreat from its position of an extremely relaxed monetary policy.** However, their Hungarian colleagues who had hiked the rates one day prior to that deprived the Czech central bankers of their primacy in the region. In any case, the trend of rising monetary policy rates was triggered, and the **next stage will probably come at the following meeting in early August**. Retreating from zero rates will not only help with the recovery of economic activity, which will reach its pre-crisis level in the fourth quarter of this year according to our new forecast, but is even necessitated by persistent higher inflation which poses a risk to inflation expectations.

Inflation Surprise Index jumps to highest level since 2008



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

In Czechia, prices in the primary areas are rising fast

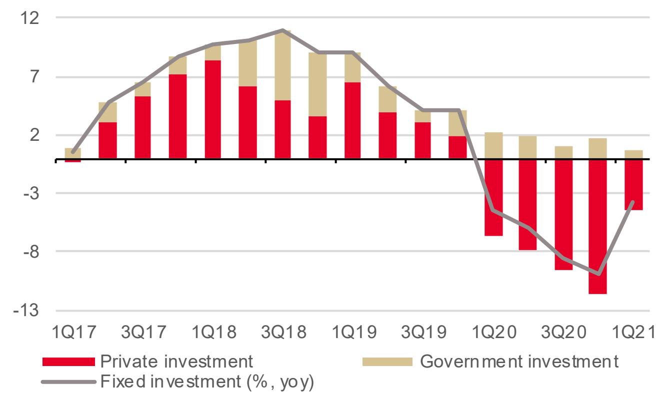


Source: CZSO, Economic and Strategy Research, Komerční banka

The currently visible increase in inflation is surprising to a certain extent only. Today, we are obviously reaping the fruits of an extremely easy monetary policy combined with the fiscal policy during the pandemic. Their purpose was to prevent an economic or financial crisis, which they have managed to do. However, a significant portion of today's inflationary pressures arises from the problems on the supply side, most of which stem from the effects of the pandemic. It is apparent in the service sector that the companies and businesses are using the reopening of their service operations for price hikes, which otherwise could have been spread over the year. The production chain, most notably the automotive industry, is coping with a shortage of components needed for production, mainly chips in the case of the automotive sector. In general, the recovery across the global economy is felt in the higher prices of commodities that are used as feedstock for production. In addition, restricted mobility and the shortage of seasonal workers are resulting in higher costs in farming and the higher prices of foodstuffs. Nevertheless, we expect that **within the monetary policy horizon (i.e. the end of 2022) the problems on the supply side will be resolved and that as interest rates grow, inflation will return to around its target.**

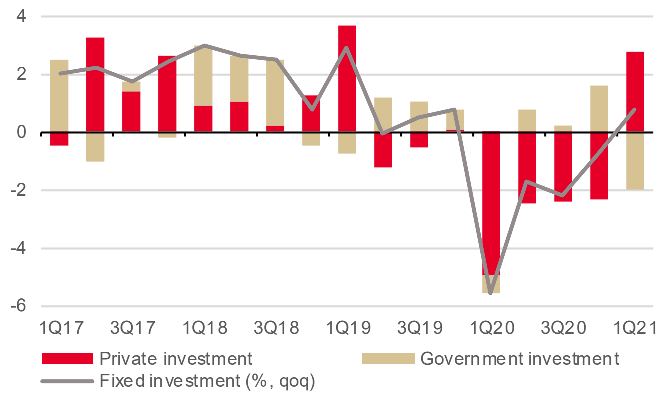
We are now able to assess the pandemic recession and its impact on the economy's structure now that a fair distance of time has passed. In the editorial of the preceding *Czech Economic Outlook* we reflected on the different nature of this pandemic-induced recession. It is also different, *inter alia*, in that it has not been accompanied by such a dramatic slump in investments as the earlier recessions were. **The pandemic has accelerated structural changes in the economy in favour of digitalisation and automation**, which was evident during last year. Investment activity data for 1Q21 is a pleasant surprise in light of the lockdown, particularly in regards to private investment. **The engine of the economy has been started again.** It therefore seems that during the period of strong economic restrictions, companies were already watching out for a recovery of demand for production – and the recovery actually did come in the second quarter of this year. Equally importantly, the investment appetite of companies continues to be stimulated by the persistent shortage of labour, which the pandemic-led recession has definitely not eliminated.

Growth in government investments cushioned the overall slump last year



Source: CZSO, Economic and Strategy Research, Komerční banka

The private sector this year has seen higher investment activity



Source: CZSO, Economic and Strategy Research, Komerční banka

Although we are currently facing the increasingly predominant delta variant of the coronavirus, in the light of the continuing vaccination and immunisation of the population **we do not expect, in the main scenario of our forecast, a repetition of economic restrictions.** Thus, the second half of this year should be marked by accelerating growth in the economy, driven by internal demand. Investment activity, on the part of the private as well as the public sector, should also contribute to this internal demand. For the next several years, the economy will receive a strong injection of funds from the new programming period for the EU's structural funds and the recovery plan that the European Commission has recently approved for the Czech Republic. The green investment wave, as Jana Steckerová describes in her box, constitutes both a challenge and an opportunity for the Czech economy in the coming years.

To conclude, we wish that you enjoy reading the current edition of *Czech Economic Outlook* which brings, after quite a long time, some hopefully rather optimistic forecasts. And a beautiful summer!

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External environment and assumptions

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Extremely loose monetary policy is nearing an end

The global economy is quickly recovering from the pandemic crisis. Leading indicators in the US, euro area and Central Europe are reaching record levels, while inflation is climbing to multi-year highs. So the extremely accommodative monetary policy stance is nearing an end. The topic of the coming months will be the eventual gradual reduction of asset purchases in the US and euro area. In the US, interest rate hikes may now come sooner than we and the market had expected, which will likely mean a significantly stronger US dollar. The Hungarian and Czech central banks appear set to continue hiking rates. Monetary policy tightening may also be near in Poland. The only central bank unlikely to hike in the near future is the ECB – we don't see it happening there until 2024.

US: inflation at highest level since 2008

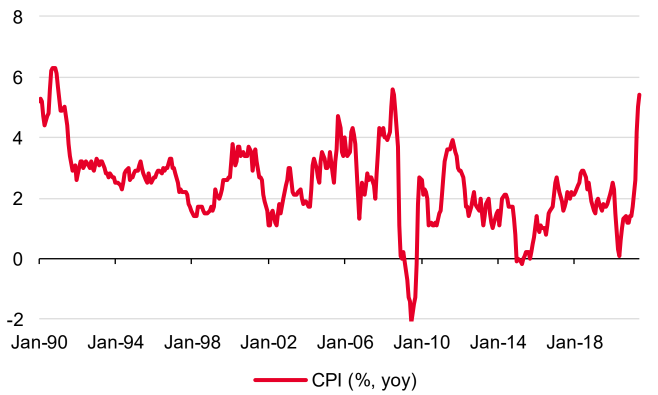
Inflation driven by used-car prices.

US inflation skyrockets. In June last year, inflation fell to 0.6% yoy as a result of the first wave of the pandemic. It recovered to 5.4% in June this year, the highest level since 2008, while core inflation at 4.5% reached its highest level since 1991. To a large extent, however, this was due to last year's low base and used-car prices, which were up by almost 30% in the preceding three months amid a shortage of new car production due to problems with the supply of components. However, in our opinion, these effects will weaken in the coming months and inflation will start to slow again. The Fed too sees the rise in inflation as temporary. In addition, after adjusting for transport prices, inflation would have been only 2.1% in June, in line with previous years' trends.

Rental prices, the biggest part of consumer basket, are not rising fast.

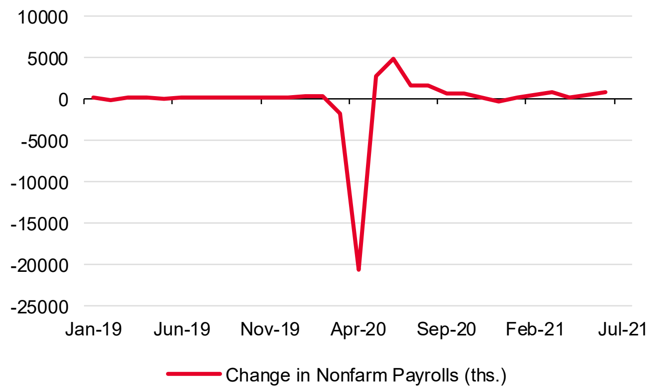
For inflation to see sustained growth, rental prices, the largest item in the consumer basket, need to rise. However, we are not seeing price pressures in this category. This is due to developments in the labour market, with which rental prices are strongly corelated. Although the US payrolls number is growing rapidly (up 850,000 in June), the economy is still down 6.8 million jobs compared to pre-pandemic levels. Growth in rental prices will probably remain moderate in the coming months as well, providing no impetus for inflation.

US inflation at highest level since 2008



Source: Bloomberg, SG Cross Asset Research/Economics

Change in non-farm payrolls ('000s)



Source: Macrobond, SG Cross Asset Research/Economics

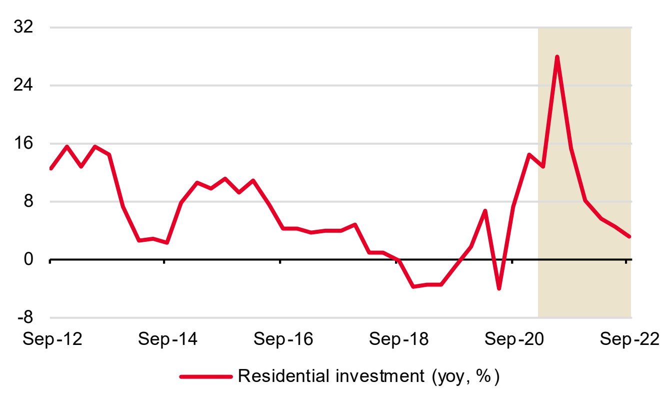
Tapering details to be announced in 4Q21.

Despite rising inflation, Fed chair Jerome Powell said in his semi-annual speech to the House of Representatives that it is still too early to back away from aggressively supporting the economy through asset purchases. We assume that tapering will start at the beginning of next year. A preliminary announcement could come around the Jackson Hole conference in late August, with concrete details to be announced in 4Q21. We estimate that the whole process should be completed in the second half of 2023, allowing interest rates to rise by the end of 2023. It when asset purchases end that the Fed expects to start hiking rates. However, given inflation developments and, in particular, the rapid economic recovery, the Fed may start reducing asset purchases in October already, or it may proceed faster than we currently anticipate. This would mean the possibility of earlier rate hikes. The June dot plot came as a surprise, reflecting expectations of a double rate increase by end-2023, with 7 of the 18 federal reserve bank governors expecting a rate hike by end-2022 already.

Markets not pricing in much yet in the way of rate hikes.

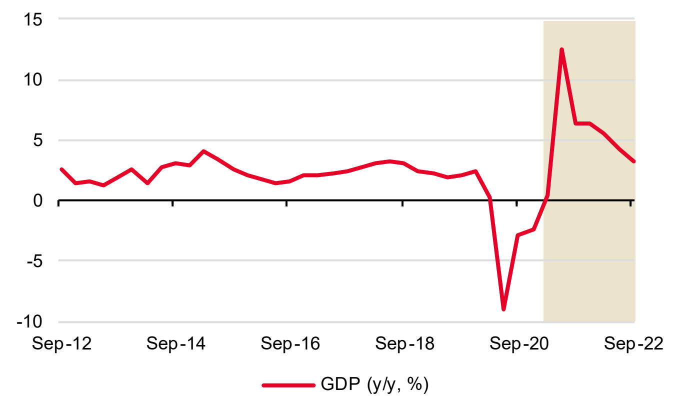
Decision about QE tapering is therefore also a decision about the possibility to hike rates. The market does not expect rates to move much higher yet. At the two-year horizon, it is pricing one hike, and at the three-year horizon, two hikes. However, we assume that these expectations will gradually increase, which should subsequently be reflected in the dollar strengthening against the euro. We have thus significantly weakened our outlook for the single European currency. In the middle of next year, we see EUR/USD at 1.14.

US residential investment (%, yoy)



Source: SG Cross Asset Research/Economics

GDP growth set for a record year (%, yoy)



Source: SG Cross Asset Research/Economics

Eurozone: Rise in inflation should be temporary

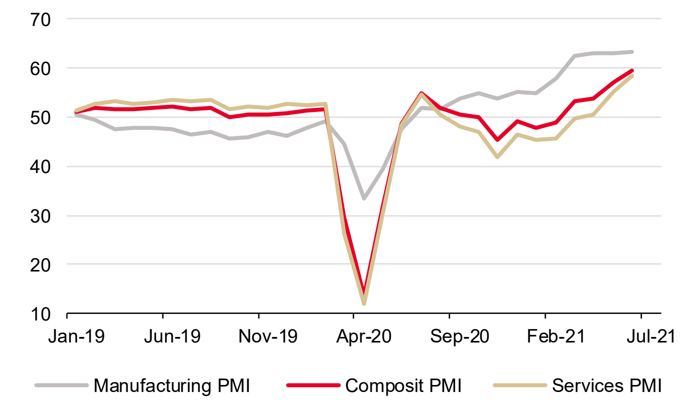
Leading indicators at historical highs.

Leading indicators suggest that the euro area economy might have a bright future. The PMI indicators for industry have reached historical highs in recent months, with confidence in services at its highest level in 15 years thanks to the easing of virus-related restrictions. However, the real data lag the leading indicators. Due to problems with component supply, industrial production probably fell in 2Q21. Export activity also remains below pre-crisis levels.

We expect a strong economic rebound in 3Q21 and 4Q21.

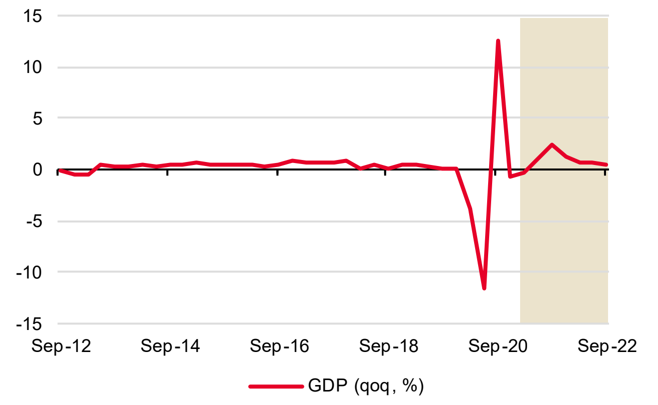
On the other hand, retail sales surprised in May with strong growth, confirming the willingness of households to spend accumulated savings. Even so, GDP for 2Q21 may disappoint – our estimate is 1.1% qoq. In 3Q and 4Q, however, we expect a significant rebound. Supply chain problems should gradually diminish, although they will probably not completely disappear before year-end. The restart of services (tourism, entertainment, leisure) will also be key to the strength of the recovery. We expect GDP growth of 4.4% in 2021 and 4.1% in 2022. The euro area economy should regain pre-crisis levels in 1Q22.

Euro area PMIs at record highs



Source: Macrobond, SG Cross Asset Research/Economics

GDP might disappoint in 2Q (%, qoq)



Source: SG Cross Asset Research/Economics

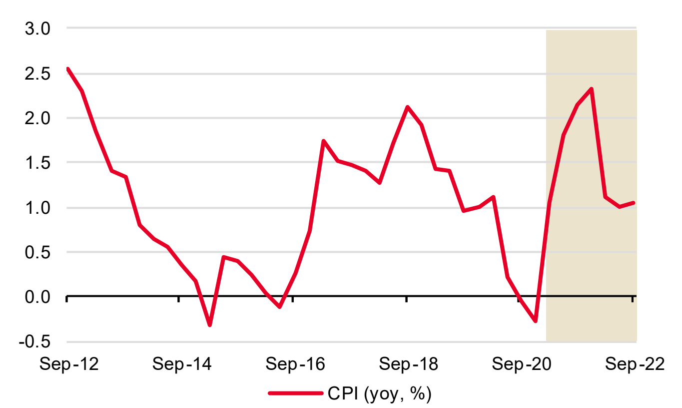
Inflation will likely return to close to 1% next year.

Inflation slowed slightly in the euro area in June, falling below 2% yoy. In the second half of this year, however, base effects, especially from the VAT reduction in 2H20 in Germany, will push core inflation to 1.5%, according to our forecasts. This, together with higher energy prices, should see headline inflation rise from 2.0% in July to 2.5% in August. We then see inflation remaining close to this level until year-end. However, given supply problems and rising input prices, inflation may eventually come in even higher. Next year, however, the base effect and fuel-price effect will fade, and inflation should quickly return to levels slightly above 1%.

ECB rhetoric looks set to remain dovish.

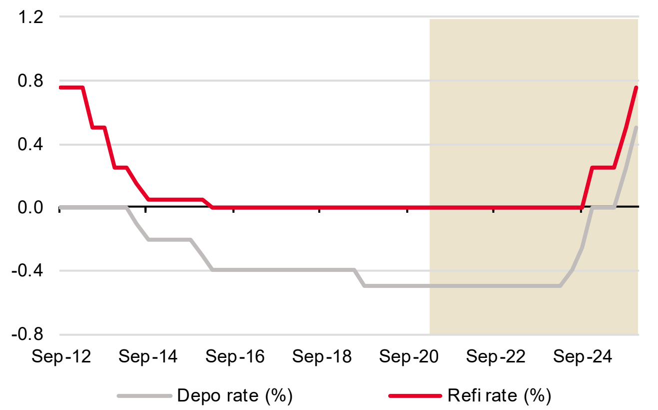
The ECB's problems do not end with this year's rise in inflation. One of the results of the bank's strategy review was a change in the inflation target from "close to or below 2%" to 2%. This is a cosmetic change that could still however mean an even more dovish stance. For the time being, we still assume that the pandemic emergency purchase program (PEPP) will end in March next year, as planned, or slightly later.

Inflation growth will likely be temporary



Source: Macrobond, SG Cross Asset Research/Economics

ECB: We expect rate hikes in 2024



Source: Macrobond, SG Cross Asset Research/Economics

End of pandemic program will be smoothed by higher asset purchases.

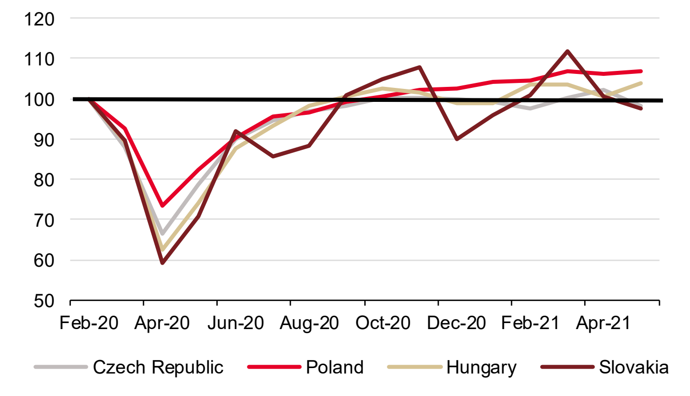
We believe that to ensure a smooth end of the PEPP, the ECB will increase its (current) asset purchase program (APP). It currently runs at EUR20bn per month, but we think it will be increased to EUR50bn per month in 2Q22, reduced to EUR30bn per month in 3Q and reduced further to EUR15bn in the final quarter of next year. We also assume that the TLTRO4 program will be launched in June 2022. We expect the APP program to end in June 2023. But we will still have to wait for all these announcements – most likely they will not arrive until the end of this year. Our forecast does not anticipate an increase in interest rates until 2024.

CEE: Inflation gathering pace

PMI at historical highs.

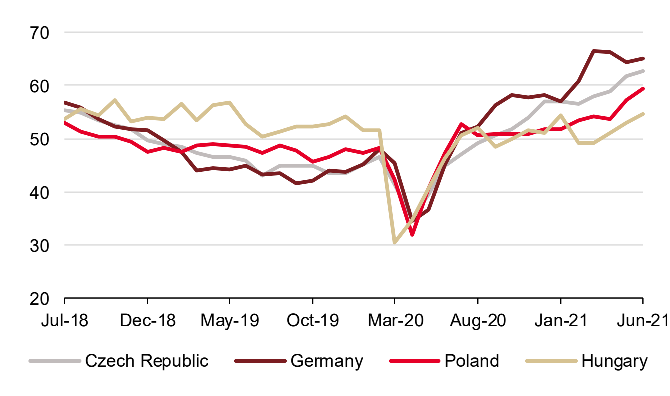
First-quarter trends in the region deepened in the second quarter. Confidence in the manufacturing industry, as measured by the PMI index, reached the highest levels ever recorded in Poland and the Czech Republic in June. In all CEE countries, production and new orders, domestic and foreign, grew strongly. On the other hand, supply problems deepened. This in turn was reflected in rising input prices, which producers then passed on to customers. Price growth in Poland and the Czech Republic was the highest ever seen. According to a PMI survey, manufacturing industry employment grew at the fastest rate since 2017 in both countries.

Industry stays around pre-crisis levels (February 2020 = 100)



Source: Macrobond, Economic & Strategy Research, Komerční banka

PMIs at historical highs (points)

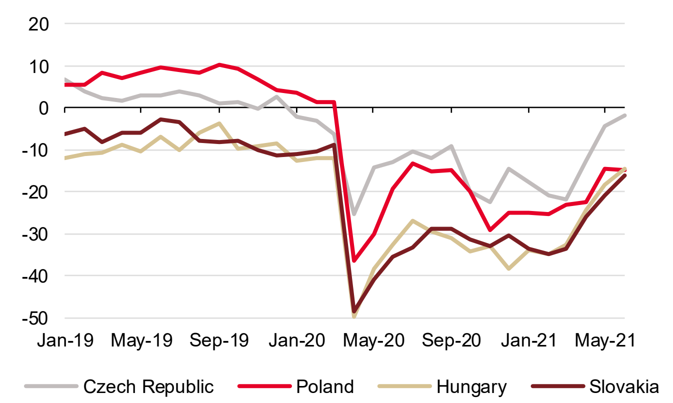


Source: Macrobond, Economic & Strategy Research, Komerční banka

CEE industry around pre-pandemic levels.

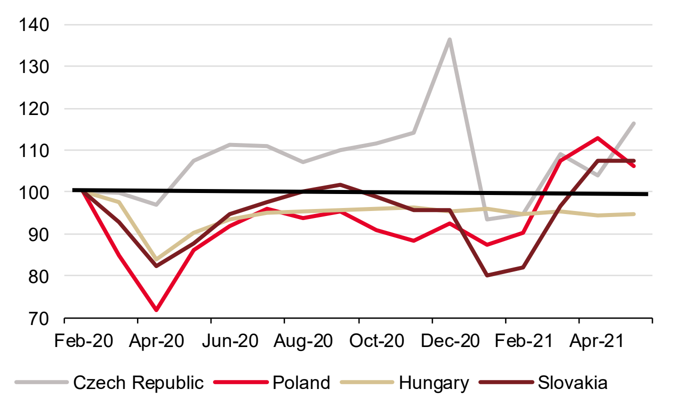
According to the PMI indicators, Central European industry is on track for a solid performance this year. Output, except in Slovakia, remains above pre-crisis levels, which should remain the case in the coming months. We do not anticipate another virus wave that would lead to the lockdown of the industrial sector, as in 2020. However, subcontracting problems are likely to persist in the coming months.

Consumer confidence growing quickly (points)



Source: Macrobond, Economic & Strategy Research, Komerční banka

Retail sales (February 2020 = 100)



Source: Macrobond, Economic & Strategy Research, Komerční banka

Spending of savings and strong labour market should support household consumption.

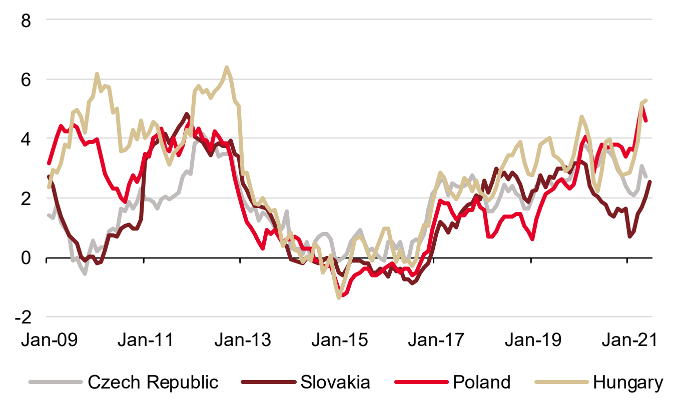
Retail sales are diverging within CEE. While retail sales in Poland, the Czech Republic and Slovakia are already above pre-crisis levels, they are still below this threshold in Hungary despite restrictive measures having been lifted. It is the services sector that is benefiting most in Hungary. Consumer confidence in the region is growing rapidly. Saving rates are high, while the labour market is also doing well, with the unemployment rate already starting to fall.

Household consumption should thus be the main driver of CEE GDP growth this year. However, investment, supported by the inflow of EU funds, should revive as well.

Inflation is above the targets of the Hungarian and Polish central banks.

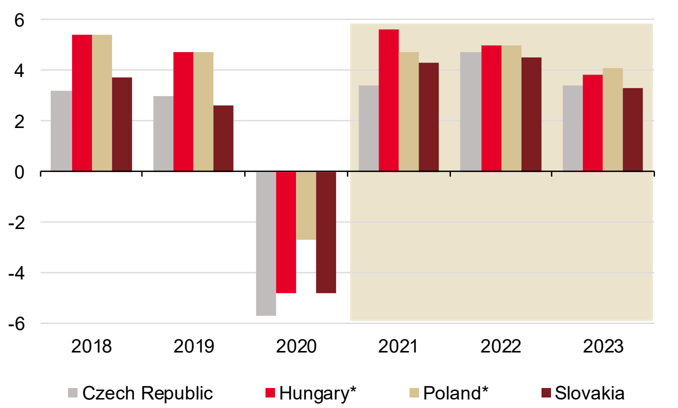
Inflation in the region is gathering pace. In Hungary and Poland, it is already well above central bank targets due to a low comparison base and high core inflation amid rising service prices. In Hungary, inflation reached 5.3% yoy in June, the highest level since 2012, while the central bank's target stood at 3%. Core inflation then rose to 3.8% in June. In Poland, inflation slowed in June from 4.8% in May to 4.4% but is still above the upper band of the Polish central bank's target (2.5% +/-1pp). Due to demand pressures associated with the lifting of coronavirus measures, rising input prices and their subsequent pass-through to end-customer prices, the inflation risks are now skewed toward faster price growth, in our opinion.

Inflation jumps in the region (%, yoy)



Source: Macrobond, Economic & Strategy Research, Komerční banka

GDP in the region (%, yoy)



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

Polish central bank likely to retain dovish rhetoric.

According to the Polish central bank (NBP), inflation should return to target in 1Q22. It sees inflation averaging 4.1% this year (mid-point of NBP's forecast range) and slowing to an average of 3.25% next year. However, according to Governor Glapinsky, current price developments are due to factors beyond the control of the NBP (base effect, supply problems, regulatory factors) and the central bank thus will not react. The rhetoric of most members of the Monetary Policy Committee remains dovish despite the NBP's new forecasts showing higher inflation and much higher GDP growth (5% this year, 5.25% next year). We expect a first hike only in March 2022, but due to inflationary developments, the risks are skewed toward earlier tightening. This could come as soon as November, when the NBP will discuss the new forecasts. The central bank will probably continue its QE program until the first rate hike, according to Governor Glapinsky. In our view, it may take even longer given the need to smooth the process of normalising bond yields.

Hungarian central bank will likely tighten monetary conditions at quick pace.

The Hungarian central bank has already started its tightening cycle. At the June meeting, it raised the key three-month deposit rate by 30bp to 0.9% and the weekly deposit rate by 15bp to the same level (0.9%). At the same time, it stated that it will evaluate interest rate settings on a monthly basis according to economic developments. We and the market think that a July rate hike is certain due to June inflation developments. We expect the key three-month deposit rate to be increased to 1.5% by the end of the year and to 2.25% next year (March, June, September). The Hungarian forint, which we see at EUR/HUF 325 in the middle of next year, should benefit from the tightening of monetary policy. We see the Polish zloty strengthening as well. Our forecast for the end of 2H22 is EUR/PLN 4.25.

Macroeconomic outlook

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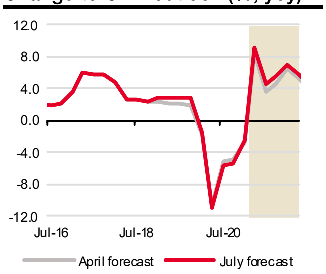
Main changes

GDP:
For 2021, we have increased the GDP forecast to 4.2% from the previous estimate of 3.4%. In 2022, we expect the economy to grow by 5.3%.

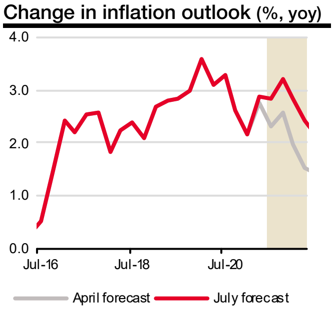
Inflation:
For 2021, we raised the inflation estimate to 2.8% from the previous 2.5%. In 2022, we expect it to average 2.4%.

Change to GDP outlook (%, yoy)



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

Change in inflation outlook (%, yoy)

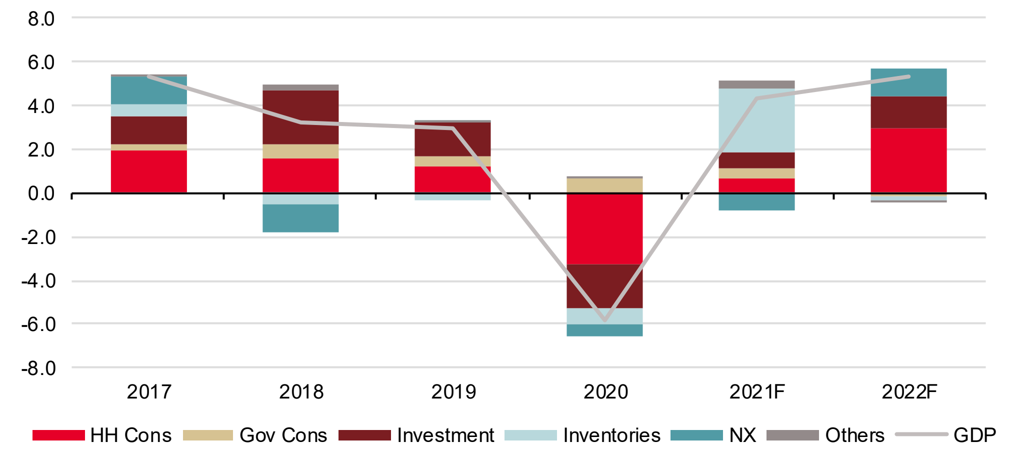


Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Economy will soon catch up with last year's slump

The domestic economy began to expand strongly in the second quarter of this year and growth should accelerate further in the second half. In the wake of the pandemic, inflation remains high and its dynamics are likely to weaken only slowly. We expect the CNB's inflation target to be reached at the beginning of 2023, as interest rates are expected to rise up until then. Pandemic-related risks have weakened significantly, but the uncertainty is still relatively high.

This year, GDP growth will be driven mainly by investment in inventories, as the household consumption driver will be delayed (%)

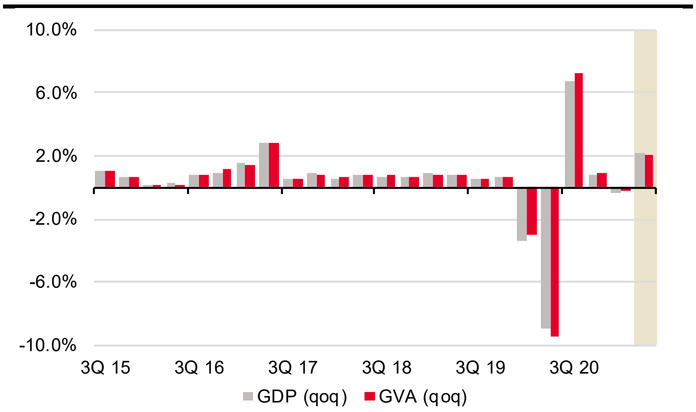


Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

The economy is growing rapidly

The pandemic restrictions were eased approximately 2-4 weeks sooner than we predicted in our April forecasts. This mainly led to significant expansion in the market services sector. On the other hand, the higher rate of economic growth was hindered by a lack of production components. Despite a faster deterioration, we expect approximately 2% qoq GDP growth in 2Q, in line with our previous forecast. However, it is worth noting that the economy developed slightly better than we expected in the first quarter, when it fell by only 0.3% qoq. This is favourable result considering the scope of anti-pandemic measures, as travel between districts was also restricted in this period. In summary, the GDP performance in the first half calls for an increase in the full-year estimate. Importantly, the industrial plants were not closed which, in the context of growing foreign demand, enabled the continued expansion of production. Meanwhile, on the demand side, the main driver of GDP was investment, especially in inventories. Household consumption continued to decline qoq in 1Q,

GDP will expand strongly from Q2



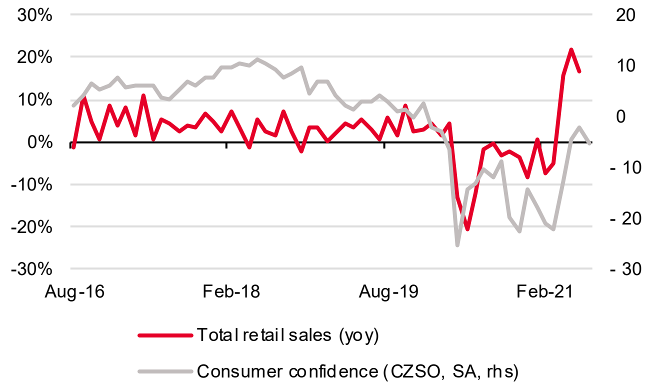
Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

although the pace of decline has already decreased significantly to -0.3%. The inventory and investment-led growth surge that started at the beginning of the year is natural in the initial phase of a recovery, but this time it is being held back by a shortage of components and materials for production.

The economy has been growing strongly but is hampered by supply chains disruptions.

Volatility of real data remains high, as the economy is exposed to favourable but very turbulent conditions due to the lifting of anti-pandemic measures. Significant uncertainty also prevails due to the risk of further pandemic waves, and although this risk has decreased significantly, there are still uncertainties, especially in the form of delayed deliveries of production components and materials. For this year, we anticipated that the main economic driver would be household consumption, however, the recovery did not begin until the middle of the second quarter, so in a year-round comparison, it will be only a weak driver of GDP. In addition, consumption growth will be dampened by shortages of some goods and/or price increases, and therefore by the possible postponement of consumption (due to expectations of future price declines).

Consumer confidence grew strongly



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

The main impetus for growth this year will be provided by investment in inventories. This was the main driver of GDP in the first quarter. We believe that this factor, while decreasing in intensity, will persist for the rest of the year. The shortage of components is leading to high inventory creation as companies accumulate stocks of unfinished products. In addition to anecdotal reports from companies, this development is also evidenced by survey data, indicating that stocks of unfinished products are reaching historical highs. For this reason, purchasing manager indices in many countries, including the Czech Republic, have also reached new highs. The current levels indicate that production should increase further strongly, although we believe that such an increase is unlikely to be achieved. Overcrowded order books do not only reflect growing demand, but also delayed work in progress due to problems in supply chains. Nevertheless, the economy is heading upwards, as reflected by a strong recovery in confidence in virtually all sectors.

In addition to leading indicators, the growth of the economy is clearly evidenced in the "hard" monthly data. The standard yoy change in GDP should of course be extremely strong with solid quarter-on-quarter expansion expected throughout the second half. Our estimate is 2.1% per quarter, which corresponds to a yoy rate of 9.4%. Starting in the second quarter, the main driver until the end of the year should be household consumption. However, the previous decline means that the full-year increase will be relatively limited. Inventory change is typically a highly volatile component of the GDP, and therefore uncertainty over this year's GDP estimate remains considerable. We do not expect the sharp inventory recovery recorded in the first half of the year to be repeated, but we also do not expect inventories to decline in the coming quarters.

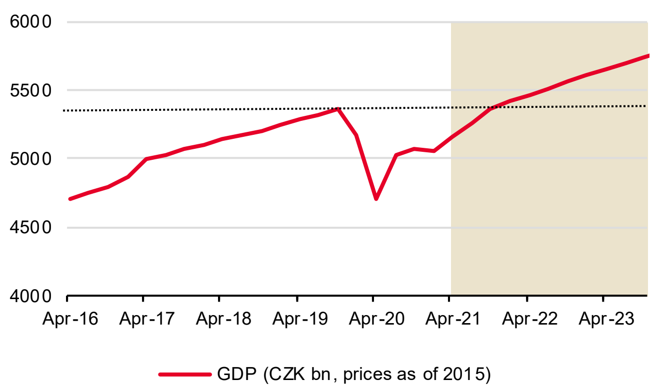
The lifting of anti-pandemic measures should increase potential growth of the economy.

GDP to return to pre-crisis levels in 2021

Most anti-pandemic measures were lifted in the second quarter. While a considerable amount of uncertainty persists, we do not expect any measures to be re-introduced

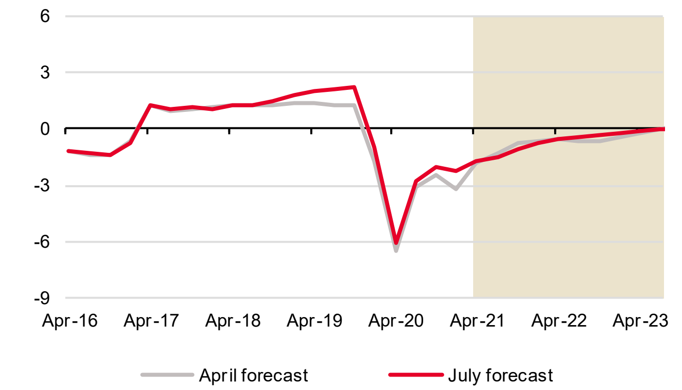
given the significant level of immunisation in the population. Rapid growth should continue in the third quarter, allowing the economy to make up for the previous slump. The rapid lifting of anti-pandemic measures at home and abroad has led us to increase our economic growth forecast for this year to 4.2% from a previous estimate of 3.4%. In addition, the higher pace of economic growth during 2021 and the assumption of the rapid expansion of the foreign economy, as well as the expected growth in public investment supported by EU funds, should lead overall domestic GDP growth to accelerate in 2022 to 5.3%. Following a recession of 5.8% last year, the pre-crisis level of real GDP should therefore be reached in the fourth quarter of this year. This is about a quarter of a year earlier than predicted in our previous forecast, as restrictions were eased earlier than we expected, in the second quarter of this year. However, this loosening in our model also points to stronger GDP growth potential, so the development of the GDP output gap is similar to the previous forecast. We continue to expect the gap to close next year. The negative output gap is a factor which, in our forecast, works in the direction of lower inflation. However, as discussed in the next section, we believe inflation is only likely to slow down gradually.

GDP to return to pre-crisis level at the end of 2021 (CZKbn)



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

Output gap to close at the end of 2022 (%)



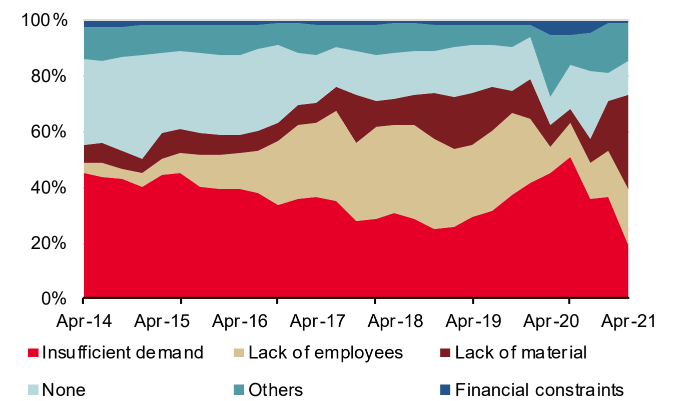
Source: Economic & Strategy Research, Komerční banka

Supply chain difficulties are growing

The industry is increasingly constrained by delayed deliveries of components.

Industrial production was hit by closed plants and demand setbacks last year, but things are moving in a much more positive direction this year. While in the first quarter, there was a real threat that some operations would have to be closed due to a strong pandemic wave in the Czech Republic, in the end this did not happen. The exacerbation of the pandemic situation at the beginning of the year reduced the availability of free labour, but industrial production was able to continue. In the end, the main limitation to expansion was the shortage of production components, especially semiconductors. In the case of Czech industry, which is heavily exposed to the automotive sector, this is a significant limitation. The chip shortage was also largely caused by the pandemic, as carmakers cut orders

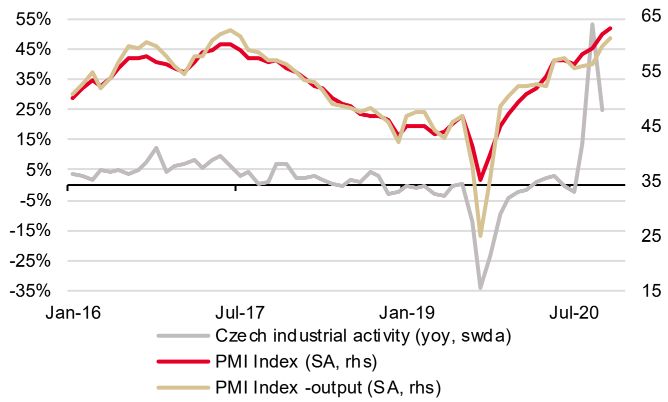
Barriers to industrial output growth



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

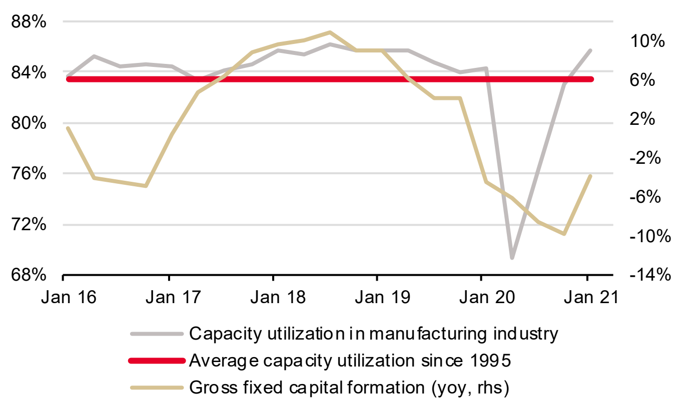
last year on expectations of declining production, but an unexpectedly strong resurgence in demand this year meant that production was unable to meet demand. The production of Hyundai cars represented a relative advantage for the Czech market as Hyundai had counted on a growing market and secured more components. However, if semiconductor shortage continues into next year, then Hyundai's production will probably also be limited. It should be noted that other manufacturers also have problems with the supply of components and materials, but we observe large fluctuations in production between car manufacturers, which is reflected in the statistics for the entire industry. Industrial production grew decently in March, slowed down in April and declined by significant 3.6% mom in May, in parallel to a decline in car production. Given last year's low base effect, production has remained strong, with yoy growth rates of over 30% in May and over 50% in April. However, the mom trend is not at all clear. For the rest of the year, we expect industrial production data to remain volatile. Component shortages are likely to lead to production restrictions and partial plant closures. On average, we expect only a slight increase in industrial production over the rest of the year due to missing components. Nevertheless, based on the current development and outlook for the domestic and global economy this year, we have slightly increased our industrial growth estimate to 10.8%. The high number again reflects last year's low base effect. Bearing in mind the shortage of components, we estimate industrial growth of close to 20% to be achievable this year. Meanwhile, the issue of insufficent demand, which was the dominant barrier to growth last year, should also recede this year. **Subsequently, in 2022, we expect the component supply problems to subside, enabling industrial production to grow at a relatively lively pace of close to 7%.**

Leading indicators show the expansion of manufacturing



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

Capacity utilisation is growing

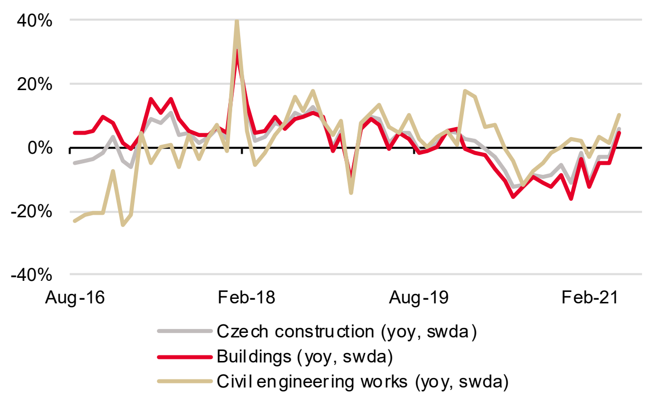


Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

The construction industry already has a chance to show growth this year.

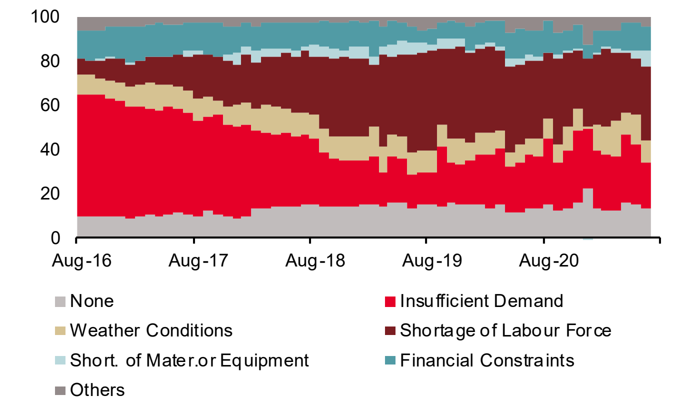
In our previous forecast for this year we expected the contstruction industry to stagnate. However, the development in the first half of the year was more favourable than we expected. Investment demand is increasing and the easing of the pandemic situation and the associated restrictions on the workforce are also having a positive effect. The restoration of tornado-affected areas in South Moravia will also have a positive impact on the construction industry. For the whole year, we expect the construction industry to grow by around 4%. The recovery in the construction sector has fallen significantly behind the rest of the economy, but we expect a more significant expansion in 2022-2023, when, in addition to private investment, public investment, especially infrastructure investment, should grow strongly thanks to EU funds (see *Box 1*). The main constraint to the construction industry remains the shortage of workers, as the problem of insufficient demand is easing. At the same time, the industry is also increasingly being affected by materials shortages. While the situation is not as complicated as it is in other industries, such as automotives, it is becoming is clearly evident, notably in the form of rising prices. The price of construction work increased by 4.1% yoy in June, but in the case of materials the rise was 9.5%. The shortage of materials and higher prices are likely to put a significant brake on construction production this year. **We think some smaller projects could be speculatively postponed in anticipation of a price correction in the future. In 2022, we expect construction to expand by around 9%.**

The construction industry is slowly returning to growth



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

Barriers to output growth in construction



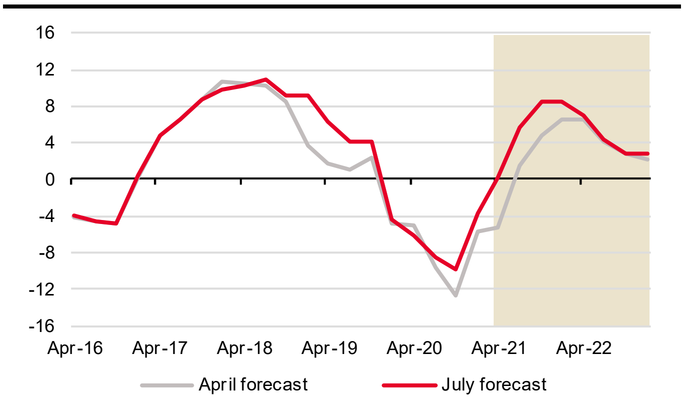
Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

Economy driven first by investment then household consumption

This year inventories will be restored and investment in fixed capital will grow. Later in the year, household consumption should accelerate.

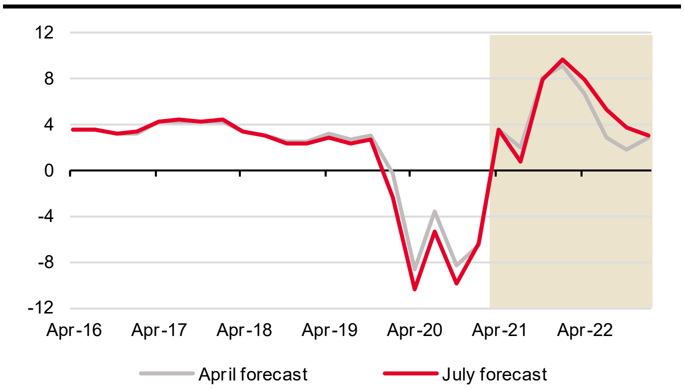
In terms of demand, last year's economic decline was driven first by household consumption and then by fixed capital investment. After that, declining investment in inventories weighed on GDP, and foreign trade also made a small negative contribution. The exception was government spending. The improving outlook for the economy at the beginning of this year led to a resumption of growth in fixed capital investment. However, investments in inventories increased even faster. In the current environment of growing demand and missing components, we expect strong inventory creation to continue for the rest of the year. While household consumption and fixed investment should become the main drivers of the economy in the coming quarters, in a year-round comparison, the recovery of inventories is likely to be the biggest driver. We expect household consumption to grow by a modest 1.3% over the full year, as the weakness seen in the first quarter should only be partially offset by higher consumption in the remaining three quarters. This delayed rise in household consumption will thus prevent it from being the main driver of the economy until 2022, when we expect it to expand by 6.6%. **However, in terms of qoq rates, household consumption should register its fastest expansion in the second half of this year.**

Investments return to growth (%, yoy) ...



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

... followed, with a slight delay, by household consumption (%, yoy)



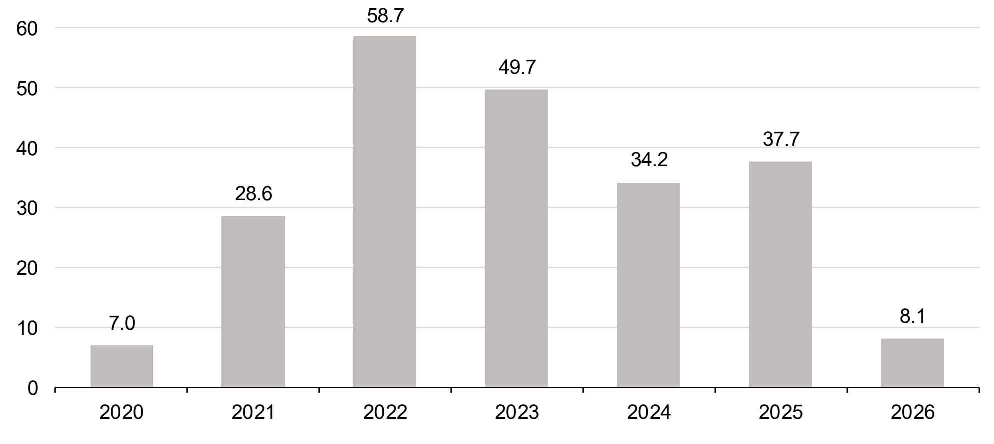
Source: CZSO, Macrobond, Economic & Strategy Research, Komerční banka

The expected strong growth in household consumption combined with strong investment corresponds to a weak contribution from foreign trade. Despite the relatively favourable development in the foreign trade balance in the second half of last year, the contribution of net exports was slightly negative over the whole of 2020. We expect the picture to be similar this year as well, although this time we should see strong growth in the structure, instead of year-round declines in imports and exports. The main argument for a favourable development of foreign trade is the foreign demand outlook, as we expect GDP growth of over 4% for the euro area this year and next. In the national methodology, we expect the Czech Republic's foreign trade surplus for this year to be close to CZK180bn, i.e. close to last year's result.

Box 1: Green investment gets the green light

The Czech Republic can look forward to a massive inflow of funds from the European Union in the coming years. In total, close to CZK1tn is expected to flow into the country. This is the largest amount in the history of the Czech Republic. In addition, the drawdown should start relatively quickly, which is due to the strict rules regarding the use of funds from the *Recovery Plan*. According to these, 70% of funds must be committed (which does not mean invested) by the end of 2022, and the remaining 30% by the end of 2023. While this year will be mainly marked by preparations, next year, the drawing of money should be in full swing. The National Plan assumes that by the end of 2022, more than 40% of the funds will have been transferred to the final beneficiaries through the state budget in connection with the financing of projects approved by the *Recovery Plan*, with 2022 being the most active year in this respect. We believe that the transfer of funds will be a bit slower than the government expects and that 2023 will see the largest amount of transfers. We assume that in 2022 and 2024, funds from the *Recovery Plan* will increase the volume of investments by close to 3%, and in 2023, by 4.5%. This year, they will contribute 0.4pp to the year-on-year investment growth, and 0.8pp next year. 2023 will be extraordinary also because the country will have to draw all of its funds from the REACT-EU programme (approximately CZK30bn) and the remaining money from the programming period 2014-2020 (at the end of May, of the CZK641bn allocated, 66% had been transferred to final beneficiaries). From an investment point of view, 2024 will also be strong, as the government will have to fulfil the n+3 rule for the first time within the new programming period 2021-2027.

Expenditures anticipated by the government related to the Recovery Plan (CZKbn)



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

More and more funds from the EU are directed to projects related to the preservation and restoration of the environment. According to the *Recovery Plan*, over 40% of the allocated amount, i.e. CZK76.7 billion, should go to green investment. Note, though, that the change in the structure of investments will not be dramatic. Funds will continue to flow into the renovation of buildings, and the purchase of machinery and equipment. It is just that greater emphasis will be placed on making these investments more environmentally friendly.

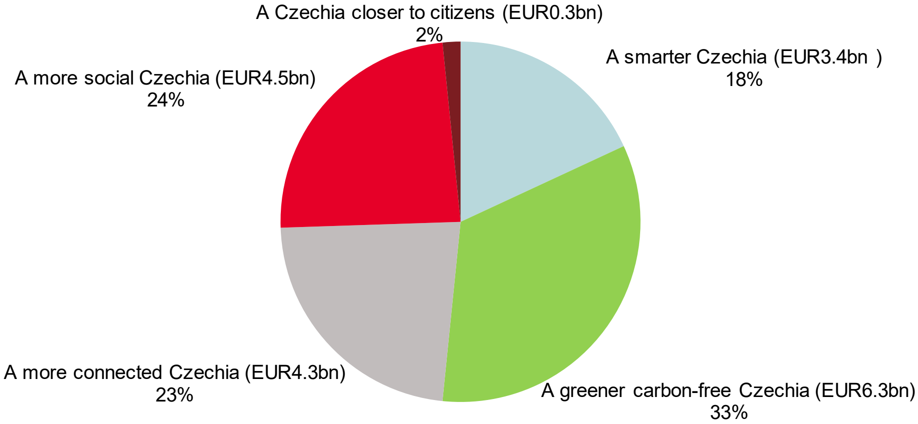
Recovery plan: funds allocated for green investments in individual categories (CZKmln)

Investment area	CZKmln.	Investment area	CZKmln.
Sustainable and safe transport	13,989	Investment support for revitalisation	1,333
Reduction of public sector energy consumption	8,265	Promotion of biodiversity and drought issues	1,789
Transition to cleaner energy sources	6,660	Innovation in education and labour market	8,579
Developing clean mobility options	4,934	Systemic support for public investment	49
Building renovation and air protection	15,671	New instruments to support entrepreneurship	400
Nature protection and climate change adaptation	12,473	Support for research and development	200
Circular economy and water recycling	2,400		

Source: Economic & Strategy Research, Komerční banka, National recovery plan

Even from the classic EU funds, a considerable amount will be directed to green investments. Of the total funds allocated to the Czech Republic (€21bn), €6.3bn, i.e. 33%, should be used to help build a green, carbon-free Czechia.

Priorities in the new programming period 2021-2027



Source: Economic & Strategy Research, Komerční banka, National recovery plan

Green investments will also be financed by the EU's *Modernisation Fund*. Its goal is to reduce dependence on coal combustion and accelerate the transition to clean energy sources. The amount of money in this fund should reach at least CZK150bn. However, due to the rising prices of emission allowances, the sale of which generates cash for the fund, the fund's total will probably exceed CZK200bn. Funds under the *Modernisation Programme* are divided into nine categories. Most of the money should go toward the development of new renewable energy sources (38.7%) and to the modernisation of thermal energy supply systems (26%). However, drawing of money will start very slowly. This is also due to there being no strict time limits, unlike with the *Recovery Plan* and *EU funds*. There is only a timeframe of ten years.

Companies will be pushed into green investments not only by the volume of allocated funds but also by regulation, which will gradually become stricter. The European Commission wants to reduce EU greenhouse gas emissions by at least 55% by the end of 2030 compared to 1990. This should make it possible to achieve climate neutrality by 2050. Regulatory changes in the financial sector have already begun to be introduced by the European Central Bank and the European Banking Authority. In November last year, the ECB issued a guide for banks to climate and environmental risks. Banks will have to use it to create their business strategy and to evaluate how exposed they are to environmental risks. In 2022, the ECB will evaluate the situation and it might call for redress. However, the pressure for greater environmental responsibility is also evident in the corporate sphere, not only from regulators, but also from investors themselves, who are increasingly interested in how companies are positioned in this field.

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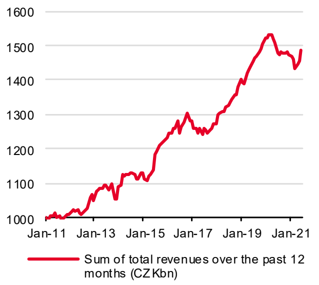
Fiscal policy: Growing the economy for better results

Our April forecast is gradually materialising, so our new one has seen only cosmetic changes. We think that the state budget is heading for a deficit of CZK400bn (6.5% of GDP) this year, the highest ever but lower than the Ministry of Finance's expectation. Direct tax collection exceeded the government's expectation in 1H, and we expect it be higher again in 2H. On the other hand, coronavirus-related spending will likely not reach the level approved in the budget. Next year's state budget is still in the legislative process, but for the same reasons we expect a better result than projected by the Ministry of Finance. Municipalities and health insurers will continue to help lower the public deficit. Overall, we expect the deficit to widen to 6.2% of GDP this year and to only show signs of consolidation next year. Public debt should rise to 41.7% of GDP this year and further grow to 44.1% of GDP in 2023.

State budget revenues

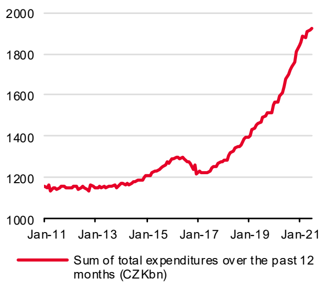


Source: Finance Ministry, Economic & Strategy Research, Komercni banka

State budget on track to deliver better result than planned for by MinFin

In the first six months of this year, the government ran a deficit of CZK265.1bn (4,3 % of GDP). Total state revenues grew by 1.9% yoy and expenditures by 9.3% yoy. After a sharp deterioration in April and May, the state budget was under less pressure in June, as expected. This was mainly due to improved revenues, led by direct taxes. A key item was the half-year advance corporate income tax payment, which exceeded the Ministry of Finance's expectation and reached 90% of the full-year plan. Personal income tax and insurance premiums also helped increase revenues. In contrast, VAT and excise collection continue to lag significantly. Overall, however, revenues exceeded the figure approved by the government by CZK16.2bn.

State budget expenditures



Source: Finance Ministry, Economic & Strategy Research, Komercni banka

On the expenditure side, transfers to the business and municipal sectors, including COVID programmes to support the economy, remained burdensome. However, these are largely over and will not be repeated in the second half of the year. On the other hand, government investment, which traditionally lags in the first half of the year, should pick up. So far, less than CZK60bn of the planned CZK187.5bn (3.1 % of GDP) has been spent. For now, the pace of spending is in line with the average of previous years, so we assume that the government's ambitious target can be achieved. Overall, expenditure is ahead of the FinMin's plan by CZK31.2bn.

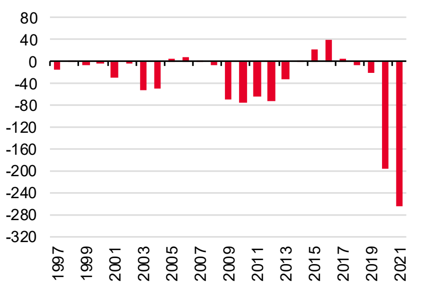
We leave our forecast for this year's state budget deficit at CZK400bn, below the market consensus. We assume that tax revenues will increase beyond the figure budgeted for during the year and that COVID expenditures will be lower as a result.

As we expected, the pressure on the state budget has eased in the middle of the year. Although our forecast assumed higher tax collection than the Ministry of Finance did, corporate income tax in particular was a positive surprise. **Our forecast for the 2021 state budget deficit remains CZK400bn (6.5% of GDP).** This is based on: (1) in line with our expectations, direct tax collection to date is higher than in the MinFin plan, and this additional revenue should continue to grow; (2) indirect taxes, especially VAT, should increase in the second half of the year due to the re-opening of the economy and higher household consumption than envisaged by the MinFin; and (3) interim data show significantly reduced interest in COVID compensation, which according to our estimates will save CZK10-15bn compared to the figure budgeted for. In our view, the state budget this year will continue the trend of undervaluing revenues and, like last year, savings on COVID programs. Thus, we expect a lower state budget deficit than foreseen by the government.

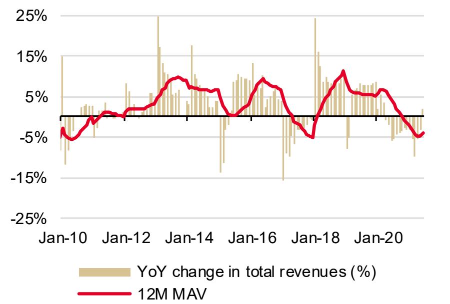
The risks have diminished since our last forecast. Pandemic developments do not suggest the need for more lockdowns and the associated additional spending and lower tax revenues. At the same time, in advance of the October election, the government is focusing more on next year's budget, and investment this year is picking up at a pace similar to recent years.

The state budget for next year is still at the beginning of the legislative process. In early June, the government approved the draft state budget with a deficit of CZK390bn (6.4% of GDP), which is higher than we expected in our April forecast. The final draft has to be sent to the Chamber of Deputies by the end of September, but the discussions so far do not suggest significant changes. The draft budget will be submitted by the current government but must be approved by the new Chamber of Deputies. However, there will be little room for adjustment after the election. In our view, the reasons for the lower deficit this year compared to the Ministry of Finance's plan will be valid next year too. **Thus, we are keeping the forecast for the state budget deficit at CZK300bn (4.9% of GDP) for 2022.**

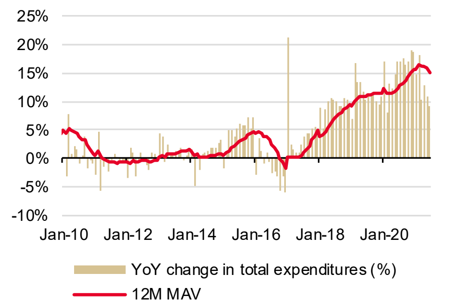
June state budget results since 1997 (CZKbn)



Revenues should be higher this year compared to the approved plan



Expenditure growth is slowing and should help reduce the deficit

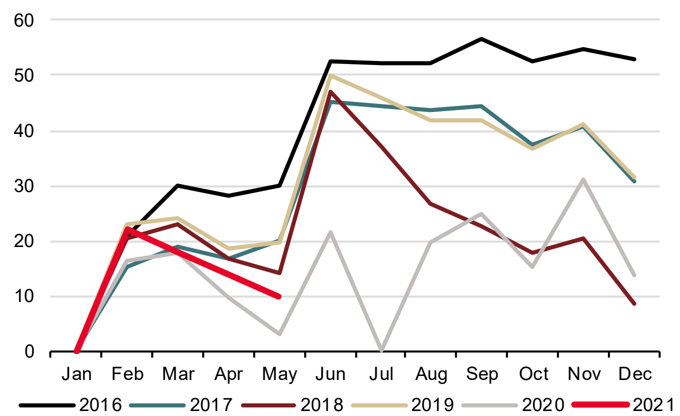


Source: Finance Ministry, Economic & Strategy Research, KB

Other sectors to continue to help reduce the general government deficit

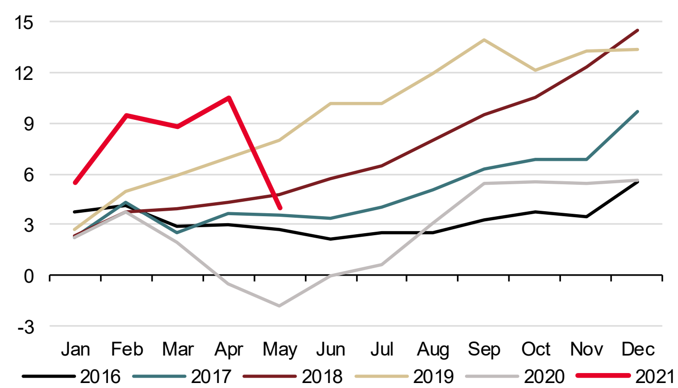
The first five months of this year showed a surplus of CZK10bn for municipalities, almost returning to the usual trajectory after a year of pandemic. Moreover, the June state budget showed surprisingly high corporate tax collection, which we estimate will support the municipal economy by around CZK25bn. Investment activity slowed by 3% after a surprisingly strong year 2020. On the other hand, municipal current account balances have risen by almost CZK50bn to CZK277bn since the beginning of the year. **Like with the state budget, we expect a better result for municipalities this year than the Ministry of Finance** at CZK20bn vs CZK0.3bn. Next year, higher tax revenues should also support municipalities, for which we expect a surplus of CZK30bn.

Municipal finances back pre-pandemic pattern (CZKbn)



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

Health insurers have come under cost covid pressure (CZKbn)



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

Health insurers have come under cost covid pressure in recent months, and the surplus has halved after an optimistic start to the year. Costs are likely to continue to rise in the coming months. However, the situation should start to improve by the end of the year. In particular, thanks to repeatedly increased payments for the state insured, we expect health insurers to maintain a solid surplus, of CZK8bn this year. In the following year, the surplus should rise to CZK15bn in the absence of pandemic-related costs. Moreover, a further increase in payments for the state insured is in play, which is a positive risk to our forecast.

Public finance forecasts

	2019	2020	2021f	2022f	2023f	2024f
Balance (% GDP)	0.3	-6.1	-6.2	-4.0	-2.7	-1.6
Fiscal effort (pp GDP)	-0.8	-3.8	-0.7	1.7	1.3	1.1
Public debt (CZKbn)	1,739.9	2,153.0	2,553.0	2,853.0	3,078.0	3,228.0
Debt ratio (% GDP)	30.0	37.8	41.7	43.3	44.1	44.0

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

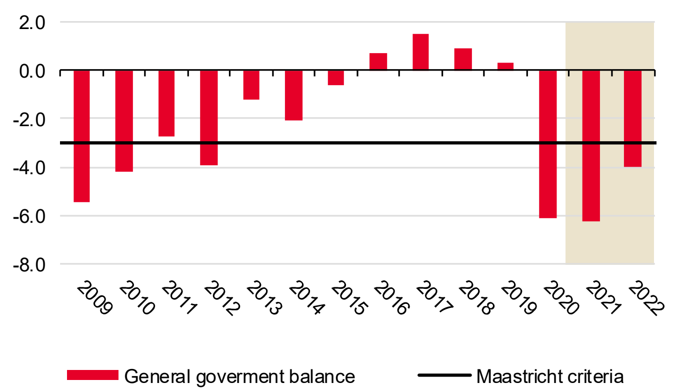
Public finances to widen deficit to record levels this year

Public finances saw a record deficit last year. We expect a further increase this year. Public debt has reached its highest level since 2015 and should continue to grow.

Our April forecast for the state budget is gradually materialising and therefore our outlook for the public finances as a whole has seen only cosmetic adjustments. We expect the overall deficit to reach 6.2% of GDP this year, based on ESA2010 methodology, one tenth higher than in 2020 and the highest in modern history. The main reason for this is our expectation of a higher government budget deficit than last year. On the other hand, the performance of municipalities and social security funds should continue to point in the direction of a lower deficit for overall public finances this year (+0.5 pp). Next year, we expect the deficit to fall to 4.0% of GDP. Public sector debt is expected to rise further to 41.7% of GDP this year and peak at 44.1% in 2023.

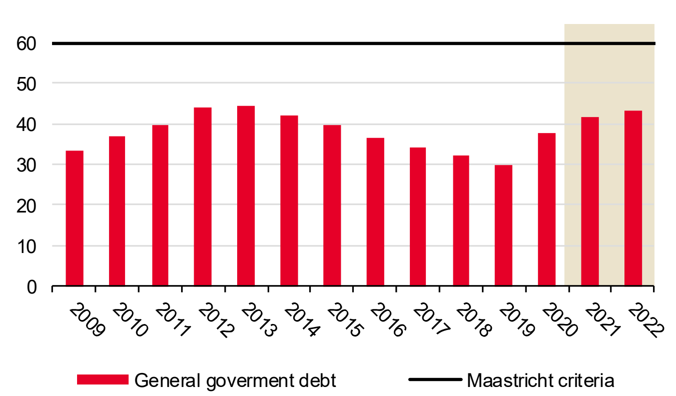
The Ministry of Finance's April forecast envisages a deficit of 8.8% of GDP this year. Although we assume a similar pace of economic recovery as the MinFin, our expected structure of economic growth, with much higher household consumption, also supports higher tax revenues. On the other hand, spending targets will not be met again, in our view. We therefore consider it unlikely that the debt brake will be reached at 55% in the next two years.

Public finance balance (% of GDP)



Source: CZSO, Economic & Strategy Research, Komerční banka

Public debt (% of GDP)



Source: CZSO, Economic & Strategy Research, Komerční banka

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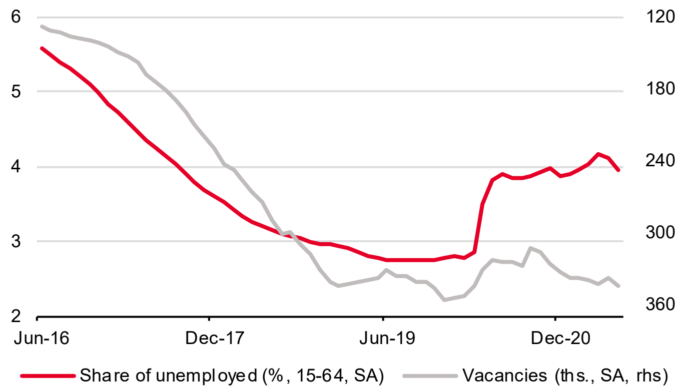
Labour market is getting tighter

The government's labour market support programmes are ending at a time when the economy is growing rapidly. The number of vacancies is growing. We believe that the unemployment rate is close to its peak and will start to gradually decline from next year. Wage growth will be driven by the public sector this year, with increased uncertainty about the timing of extraordinary health care payments. We anticipate economic recovery in the coming years and a gradual acceleration of wage growth in the private sector as well.

We are expecting only a minimal increase in the unemployment rate.

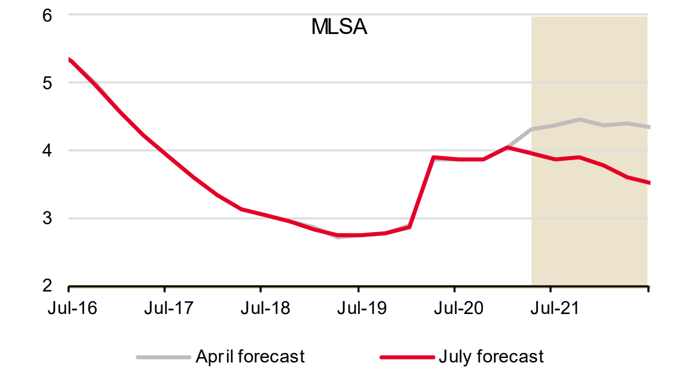
The unemployment rate in the middle of this year reached 3.7% (based on the MLSA methodology). This is a year-on-year deterioration of exactly one percentage point. June already shows a decline in the unemployment rate after seasonal adjustment. Whether this is the beginning of a trend of declining unemployment cannot be judged with certainty. On the one hand, it is true that companies are hiring new employees and there is a shortage of people in many places. On the other hand, with the return of the economy to normal functioning, programmes maintaining largely artificially low unemployment have been terminated. Thus, a fast-growing economy will face the release of some employees. According to the Ministry of Labor and Social Affairs (MLSA), the number of vacancies nevertheless increased to almost 356,000 in June. This is even slightly above the level of 2019, when staff shortages and a tight labour market were a major issue, which, incidentally, contributed to the tightening of monetary policy by the central bank. **In summary, we expect an approximately stable unemployment rate in the second half of the year and a gradual decline next year; in the previous forecast we had expected a slightly higher level for the same period. Based on our model, the unemployment rate is close to equilibrium value and will fall slightly below this level next year.**

Number of vacancies rising again



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

We do not expect a further increase in unemployment (%, SA)



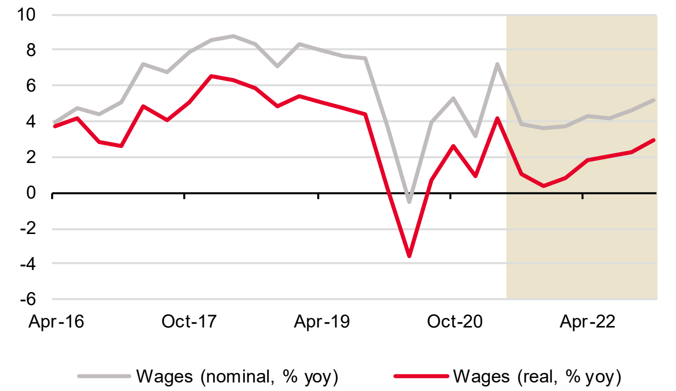
Source: MLSA, Macrobond, Economic & Strategy Research, Komerční banka

While wage growth surprised to the upside in Q4, it was slower than expected at the beginning of the year. Data for the fourth quarter of last year show year-on-year growth in the average nominal wage of 5.3%, which slowed to 3.2% at the beginning of this year. In real terms, the average wage increased by 1.0% year-on-year in Q121 after a previous increase of 2.6%. The slowdown was due to a fading effect of the extraordinary wages in health and social care, which were paid during the fourth quarter and led to a significant increase in the average wage. The abolition of the super-gross wage may also have played a role, which was reflected in the growth of net incomes and in lower pressure to increase wages in the private sector. This was counteracted only in part by the pre-announced growth in tariff wages since the beginning of the year in the public sector, especially in health care and education.

The year-round growth of the average wage will be supported mainly by the public sector.

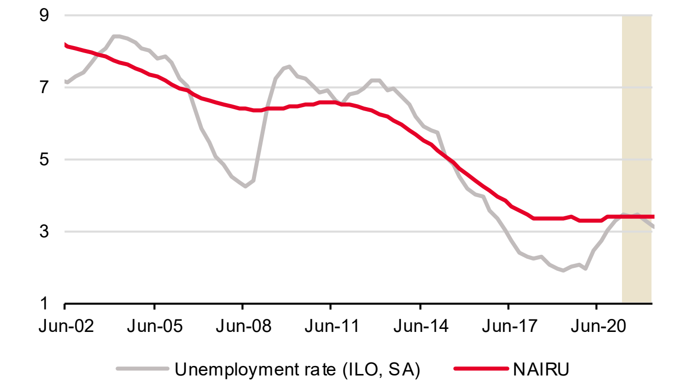
For the second quarter of this year, we expect an acceleration in the rate of wage growth, which will also be helped by a low base effect from last year in the year-on-year comparison. We estimate the year-on-year rate to be slightly above 7%. However, the driving force is likely to be the public sector again, mainly due to other extraordinary payments in healthcare. However, there is a question mark here, as these bonuses were not paid out everywhere in the second quarter, and this effect could therefore rather be felt in the next quarter. Wages probably also rose in the private sector, albeit at a more moderate pace. However, in view of the above developments in the labour market, pressures for higher growth can be expected in the coming quarters. Our forecast has not changed significantly in this respect from the previous one. **For this year, we expect the average wage to increase by 4.5%, next year by 4.2% and then to accelerate again in line with the tightness of the labour market. In real terms, this would mean an average wage increase of a modest 1.6% this year, and 1.7% in 2022.**

We expect a slowdown in average wage growth (%, yoy)…



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

… but upward pressure on wages could rise by end-2021 (%)



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

Inflation still high

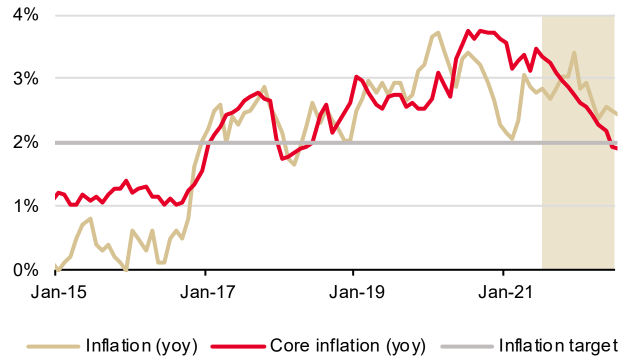
The rise in consumer prices is likely to reach 2.8% this year. In our view, core inflation has peaked, but will slow down more gradually as domestic price pressures resume and producer prices rise rapidly. Gas station prices are rising due to more expensive oil and, given the expected strengthening of the dollar, they will have a pro-inflationary effect next year as well. In contrast, we continue to expect moderate developments in the case of food. Next year, we expect inflation to slow to 2.4% on average.

Core inflation will subside slowly.

Year-on-year growth in consumer prices in the second quarter was 2.9%. This was in line with our April forecast. However, the structure was different, with core prices rising faster and food prices slower. From a monetary policy perspective, such a composition points to stronger demand pressures. The impact of demand on food prices is limited and thus has less weight from the central bank's point of view. Core inflation was 3.5% yoy in the middle of the year, and even in terms of month-on-month growth, it still does not show a slowdown. **The problem is that after the loosening of anti-epidemic measures, a number of one-off price adjustments could have taken place, which may only be of short duration. On the other hand, we can find reasons why this might not be the case.** A strong argument for it is that subcontracted producers may have increased their prices, and these may only be gradually spilling over into consumer prices. Although these problems could disappear next year, it is not certain. Year-on-year growth in producer prices is already 6.1%. We are inclined to believe that the current accelerated wave of inflation will weaken only gradually in the second half of the year, and in the case of year-on-year growth in core prices, which do not include food, energy and taxes, we expect a rate slightly below 3% at the end of the year.

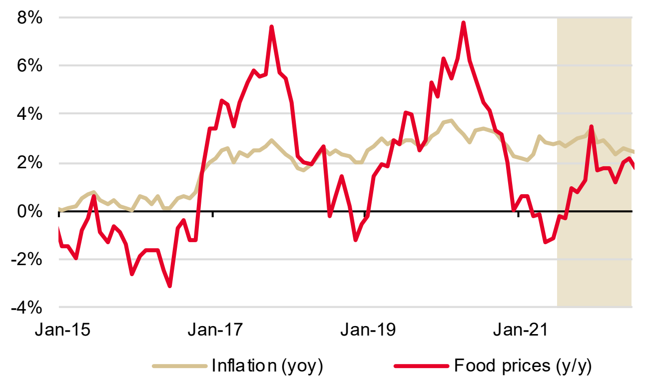
Next year, we expect a slowdown in core inflation to 2.1% on average. This will be helped by a further slight strengthening of the koruna, a rapid rise in CNB interest rates and a slowdown in inflation abroad. While we expect inflation in the euro area to be around 2% this year, we expect it to slow down again to 1.1% next year, which implies a decline in import prices with the expected strengthening of the koruna.

Year-on-year inflation will be above 3% by the end of this year



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

This year, food prices have a slightly disinflationary effect



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

After the previous rise, we expect the oil price to be stable in the range of $70-75/barrel.

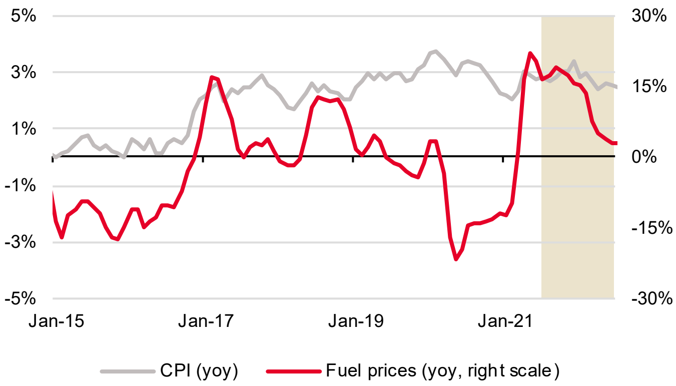
Compared to our April forecast, the price of oil rose by approximately 15% in the second quarter, while we expected its stability. The rise in prices at petrol stations was higher at the beginning of the year and has a pro-inflationary effect. Prices are rising from low levels, so in the year-on-year comparison, the prices at petrol stations were significantly higher by about 20% year-on-year in the middle of the year. In our forecast, we assume that Brent oil prices will remain in the range of $70-75/barrel until the end of 2022 and then rise slowly. However, given the assumption of a strengthening dollar against the koruna, gas station prices will continue to be pro-inflationary next year.

This year, food prices are rising only very moderately and thus have a disinflationary effect. With regard to the currently expected development of agricultural commodity prices, we expect a slight acceleration of their growth from the second half of this year; however, we expect their moderate growth to be slightly below 2% for next year as well.

The rise in the excise tax increases inflation. Lower energy prices are holding it back this year, but they will accelerate from next year.

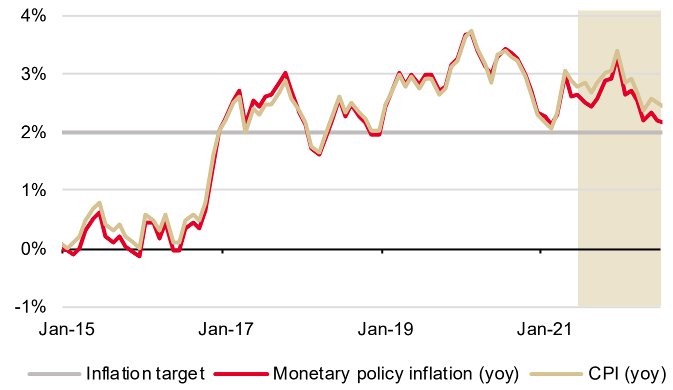
The increase in excise duties is gradually becoming an evergreen in rising inflation. The vast majority of this took place in the first half of the year, and we estimate the total contribution of the tax change to overall inflation to be 0.2 percentage points. We expect a similar effect for next year. **Regulated energy prices for this year have fallen, working significantly in favour of lower inflation.** We expect a turnaround in the coming years. This is already indicated this year by the strong rise in the prices of electricity and allowances on the stock exchange. What could dampen the growth of regulated prices are other components, such as water and sewage. In the next two years, due to rising energy prices, we expect growth in regulated prices to be just below 3%. With regard to the transformation of the European electricity market, we perceive increased uncertainty here.

Prices at gas stations have risen sharply



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

Monetary policy inflation is still above 2%



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

Uncertainty about price developments in the near future is still significant. In terms of month-on-month dynamics, we believe that inflation is now past the peak, as a number of price adjustments have already taken place. However, in summary, compared to the previous forecast, we perceive a growing number of arguments indicating a rather slower decline in inflation. When reporting year-on-year inflation in this scenario as well, we expect inflation to be close to 3.4% at the end of the year and to start falling below 3% at the beginning of the year. Such a development may have a further impact on inflation expectations, which often react late and we are now seeing an increase. The rise in inflation expectations would then be another argument against the decline in inflation, and on the contrary a reason for a greater tightening of monetary policy.

In summary, we expect inflation to slow only gradually, averaging 2.8% this year. Next year, it will slow to 2.4%, with core inflation reaching 2.1% after an estimated rate of 3.2% this year.

Risks: Fears of a pandemic have subsided

Due to the vaccination rollout and natural immunisation of the population, the perceived risks of a pandemic rise have dropped sharply. However, in terms of impact on the economy, we still consider it the main risk. The specific risks include:

- **Other waves of pandemics and mutations.** We do not anticipate the re-closure of various sectors of the economy. However, given the existing and potential mutations of COVID-19, the risk of such a development is still significant, which would significantly limit economic growth.

- **Capital outflows from emerging markets.** The period of withdrawal from the Fed's strongly relaxed monetary policy may bring significant changes in global capital flows and higher volatility in foreign exchange markets, which could also affect the exchange rate of the Czech koruna with an impact on interest rates and inflation.

- **Problems in supply chains.** We assume that the problem in the supply of components and materials for production will decrease over the next year. However, there is a significant risk that the problems will persist for longer, which would lead to lower economic growth and, conversely, higher price growth.

- **Price development after the pandemic.** We expect the current global inflation wave to be largely transient in nature. The risk is that global and domestic price increases persist, to which monetary policy would probably respond with a rise in interest rates.

Key economic indicators

	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	2020	2021	2022	2023	2024	2025
GDP and its breakdown														
GDP (real, yoy)	-5.3	-2.4	9.4	4.6	5.7	7.2	6.0	4.7	-5.8	4.2	5.3	3.5	2.8	2.6
Household consumption (real, yoy)	-9.9	-6.4	3.6	0.8	7.9	9.8	7.9	5.3	-7.1	1.3	6.6	3.2	3.2	2.3
Government consumption (real, yoy)	5.7	3.8	3.4	3.6	-0.4	-0.8	-0.8	-0.9	3.4	2.6	-0.5	1.6	2.0	2.4
Fixed investments (real, yoy)	-9.9	-3.8	0.1	5.6	8.5	8.6	6.9	4.3	-7.2	2.5	5.6	2.8	2.9	3.0
Net exports (contribution to yoy)	3.6	-0.8	3.4	-1.7	-4.2	0.9	1.3	1.0	-0.5	-0.8	1.2	1.0	0.4	0.5
Inventories (contribution to yoy)	-2.5	1.4	3.7	3.2	3.5	0.0	-0.5	0.5	-0.8	2.9	-0.2	-0.2	-0.1	-0.3
Monthly data from the real economy														
Foreign trade (CZK bn)	79	65	63	32	21	62	58	36	181	180	183	181	183	190
Exports (nominal, yoy)	10.6	10.8	41.2	7.9	4.8	5.4	5.2	8.4	-4.4	14.7	6.2	4.6	5.2	4.1
Imports (nominal, yoy)	3.5	8.1	34.3	11.4	11.4	6.0	6.0	8.2	-5.6	15.5	6.4	4.8	5.3	4.1
Industrial production (real, yoy)	1.7	3.2	31.1	4.6	4.2	6.7	7.5	7.8	-7.1	10.8	7.3	5.9	5.0	3.2
Construction output (real, yoy)	-8.4	-5.6	4.7	8.0	9.3	4.9	6.6	10.3	-5.1	4.1	9.1	8.8	6.8	3.8
Retail sales (real, yoy)	-2.0	-1.7	6.7	1.2	5.8	9.4	2.7	3.5	-0.6	3.0	4.9	4.6	3.9	2.1
Labour market														
Wages (nominal, yoy)	5.3	3.2	7.2	3.9	3.7	3.7	4.2	4.2	3.1	4.5	4.2	5.8	5.7	4.1
Wages (real, yoy)	2.6	1.0	4.2	1.0	0.4	0.8	1.8	2.0	0.0	1.6	1.7	3.7	3.7	2.1
Unemployment rate (MLSA)	4.0	4.2	3.7	3.8	4.0	4.0	3.4	3.4	3.6	3.9	3.6	3.3	3.4	3.4
Unemployment rate (ILO 15+)	3.0	3.3	3.4	3.5	3.4	3.4	3.0	3.2	2.6	3.4	3.1	2.9	2.9	3.0
Employment (ILO 15+, yoy)	-1.6	-1.5	-1.4	0.0	0.3	0.8	1.3	0.4	-1.3	-0.7	0.8	0.3	0.0	-0.1
Consumer and producer prices														
CPI Inflation (yoy)	2.6	2.2	2.9	2.8	3.2	2.9	2.4	2.2	3.2	2.8	2.4	2.0	2.0	2.0
Taxes (contribution to yoy inflation)	0.0	0.0	0.2	0.3	0.3	0.2	0.1	0.1	0.0	0.2	0.2	0.3	0.1	0.0
Core inflation (yoy) (*)	3.7	3.3	3.3	3.2	2.8	2.5	2.1	1.8	3.4	3.2	2.1	2.0	2.0	2.0
Food prices (yoy) (*)	1.7	0.3	-0.8	0.5	2.0	2.0	2.0	1.7	4.5	0.5	1.8	0.7	1.3	1.8
Fuel prices (yoy) (*)	-13.1	-7.2	19.5	17.8	17.0	13.5	5.8	3.1	-11.4	11.8	6.5	1.1	0.5	0.3
Regulated prices (yoy) (*)	1.8	0.2	0.1	-0.1	1.7	2.0	2.8	2.9	3.2	0.5	2.7	2.9	2.8	2.7
Producer prices (yoy)	0.1	1.5	5.3	6.6	6.9	5.3	2.9	1.9	0.1	5.1	2.9	1.2	1.6	2.0
Financial variables														
2W Repo (%, average)	0.3	0.3	0.3	0.7	1.2	1.4	1.7	1.9	0.8	0.6	1.8	2.3	2.3	2.3
3M PRIBOR (%, average)	0.4	0.4	0.4	0.9	1.3	1.6	1.8	2.1	0.9	0.8	1.9	2.3	2.4	2.4
EUR/CZK (average)	26.7	26.1	25.6	25.4	25.2	25.0	24.9	24.8	26.5	25.6	24.9	24.1	23.8	23.2
External environment														
GDP in EMU (real, yoy)	-4.7	-1.3	12.7	2.4	4.3	5.5	5.0	3.3	-6.7	4.4	4.1	2.1	1.9	1.7
GDP in Germany (real, yoy)	-3.3	-3.1	9.2	2.7	3.4	6.1	4.9	3.2	-5.1	3.1	4.2	1.9	1.6	1.4
CPI in EMU (real, yoy)	-0.3	1.1	1.8	2.4	2.6	1.3	1.1	0.9	0.3	2.0	1.1	1.3	1.5	1.5
Brent oil price (USD/brl, average)	44.3	60.9	66.8	75.0	72.0	72.5	73.0	74.0	42.4	68.7	73.6	75.8	77.0	78.2
EURIBOR 1Y (%, average)	-0.5	-0.5	-0.5	-0.4	-0.3	-0.3	-0.2	-0.1	-0.3	-0.4	-0.2	0.1	0.4	1.0
EUR/USD (quarter eop, year average)	1.19	1.20	1.20	1.18	1.18	1.16	1.14	1.12	1.14	1.19	1.14	1.15	1.17	1.16

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

CNB Focus

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Central bank to continue raise rates

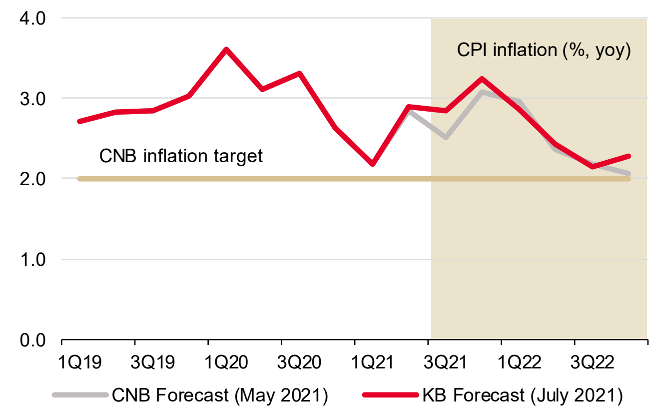
The CNB lifted the key repo rate from 0.25% to 0.50% in June, its first rate hike since the COVID pandemic began. The spread of the virus has slowed significantly in recent months, and the vaccination rate is on the rise. This supported a rapid, almost complete easing of restrictions, which likely led to a strong economic rebound in 2Q. Moreover, we expect the economy to reach pre-crisis levels by year-end. With the economy returning to normal, the CNB is determined to bring interest rates back to more typical levels. Rates are also being pushed higher by inflation, which has been above the central bank's 2% target for more than two years, and the bank board is thus worried about an adverse impact on inflation expectations. Current economic developments are associated with inflationary risks. In our opinion, the June rate hike was not the last; we expect another three this year to bring the repo rate to 1.25% at year-end, followed by a further rise to 2.25% by end-2022.

June rate hike the first in more than a year

After being cut by 2pp in 1H20, the repo rate remained unchanged until the June hike from 0.25% to 0.50%.

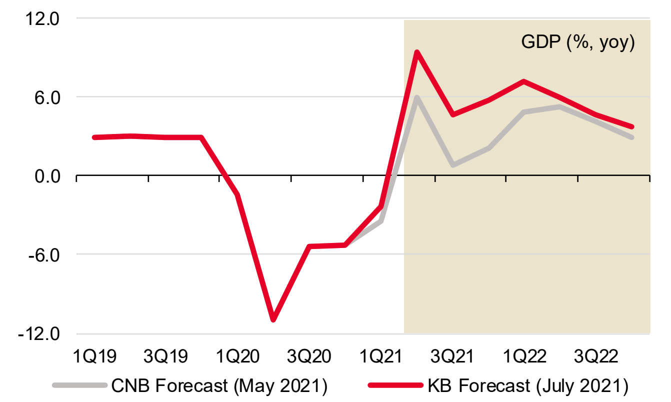
At its June meeting, the Czech National Bank (CNB) raised interest rates for the first time in more than a year. It increased the key repo rate to 0.50% from 0.25%, where it had been since the central bank cut it by 2pp in May 2020 in response to the COVID pandemic. After previous statements by the bank board, the June decision was fully anticipated by the market. **The CNB said higher rates were justified by significantly reduced uncertainty about the pandemic due to the growing vaccination rate.** The rapid easing of virus-related measures likely led to a strong economic rebound and contributed to the return of inflation to the upper limit of the CNB's tolerance band, where it has been hovering for more than two years. Governor Rusnok, vice governors Mora and Nidetzký and board member Holub voted in favour of raising rates by 25bp, while Benda preferred an increase of 50bp. The remaining two members, Dědek and Michl, were for keeping interest rates stable.

Inflation to approach the CNB target in 2H22 at the earliest



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

Economy likely to reach pre-crisis levels by end-2021



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

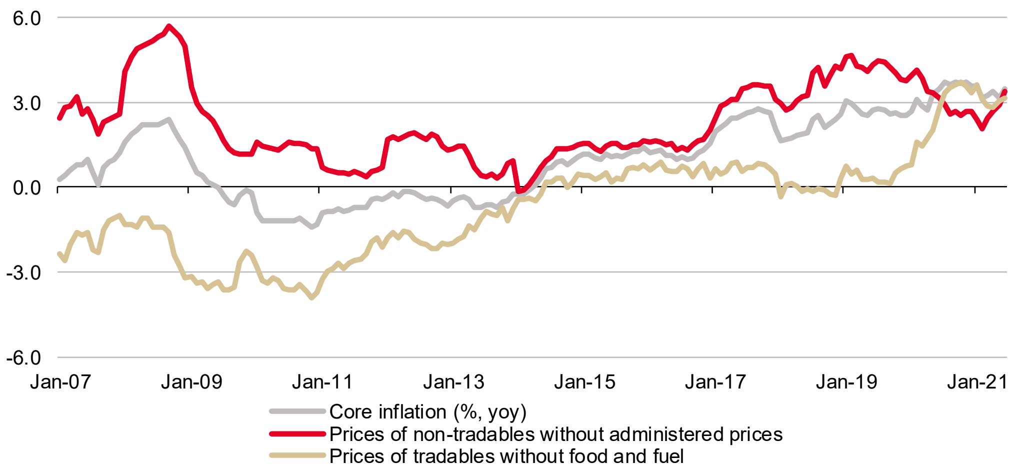
Higher price dynamics can elevate inflation expectations

After reopening, services became more expensive. According to data from June, a price increase was recorded by 60% of them. Core inflation remains above 3%.

Inflation accelerated from 2.2% yoy in 1Q to 2.9% in 2Q, just one-tenth above the central bank's estimate. In particular, core inflation was higher than forecast, remaining at 3.3% on average, while the CNB expected it to fall to 3.0%. Fuel prices rose slightly faster as well. On the other hand, the increase in food prices was smaller than in the CNB forecast. **In May and June, there was a significant increase in the prices of services**, which rose by a total of 1.4% during these two months. In contrast, prices of goods increased by 0.3%. Service sector prices were supported by the partial reopening of the economy in May, while in June the economy was functioning almost without restrictions. Given strong consumer demand, sellers were likely able to offset higher costs and lost profits from the pandemic. In June in particular, the price increase in services was relatively broad based. **Of those items that can be classified in the CPI consumer basket as non-tradables (basically market services), a mom price increase occurred for 60%, and about 35% rose by more than 1%.** As a result, yoy growth in the prices of non-tradables accelerated from an average of 2.3% in 1Q to 3.0% in 2Q. On the other hand, inflation in tradables (excluding food and fuels) eased slightly, from 3.2% to 3.0%.

We expect inflation to remain close to 3%, at least until the year-end, but the risks continue to be skewed towards the upside. A sharp rise in industrial prices, which reached 6.1% yoy in June, is a significant risk, as is the rapid opening of the economy combined with a tight labour market and robust household income growth. However, growth in raw material prices slowed in June and July, and in some cases even stopped. **Moreover, the CNB is concerned less with short spikes and more with inflation remaining above the 2% target for a prolonged period, as this could have an adverse impact on inflation expectations.** This is one of the main reasons it has cited in recent months when talking about the need to start raising interest rates. The tightening of monetary policy should help inflation to gradually return close to its target, and we expect consumer prices to rise 2.4% next year.

Growth in service prices accelerated after the economy reopened



Source: CNB, Economic & Strategy Research, Komerční banka

CNB's pessimistic GDP forecast does not materialise

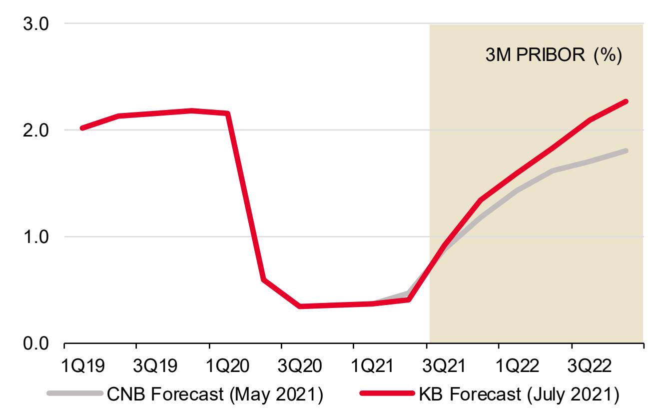
Czech GDP fell by only 0.3% qoq in 1Q, while the CNB had forecast much deeper downturn of 1.7%.

While inflation was roughly in line with the CNB forecast, the real economy performed much better. In May, the central bank presented an unusually pessimistic GDP forecast of -1.7% qoq in 1Q. However, the economy fell only 0.3%. **Its forecast for 2Q is also pessimistic, in our view, implying roughly stagnant aggregate output at the 1Q level.** Given the abovementioned widespread easing of restrictions, we expect strong economic growth of 2.1% qoq. We think this will prompt the CNB to raise its 2Q GDP forecast in August. Given the economic improvement already seen in 1Q, we think the CNB is also likely to raise its GDP estimate for the full year from the very modest 1.2%. We expect the economy to grow 4.2% this year.

CNB rates above 2% at end-2022

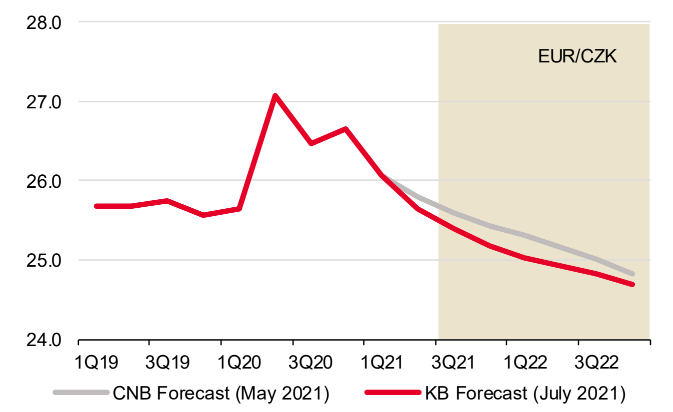
The CNB's current forecast envisaged the June hike in interest rates and includes another two for the rest of the year. The bank board was wary of such a rapid rise in interest rates a few months ago, but according to recent statements, it seems to have changed its mind. Some board members have even suggested that policy tightening could be faster. This is also illustrated by the Graph of Risks to the Inflation Projection (GRIP) published by the central bank, which evaluates the extent to which the newly published data are in line with the CNB forecast. **According to this assessment, the risks to the current CNB forecast are skewed towards higher inflation and create a need for faster policy tightening than it currently anticipates.** In addition to slightly higher inflation in recent months and the significantly better economic performance in 1Q, developments abroad are also working in this direction. While the CNB originally expected GDP growth in the effective euro area of 3.1% this year, the updated assumptions in its forecast from June is 3.6%. There is an even bigger forecast revision for producer prices in the euro area, which serves as the main measure of imported inflation in the CNB's core forecasting model. While the bank's May forecast assumed euro area PPI growth of 3.5% this year, the updated outlook is 5.2%. This is only partly offset by the Czech koruna, which has appreciated almost 1% more against the euro than the CNB anticipated.

Interest rates to rise sharply



Source: CNB, Economic & Strategy Research, Komerční banka

Stronger koruna to help tighten monetary conditions



Source: CNB, Economic & Strategy Research, Komerční banka

We forecast another three 25bp hikes this year to bring the repo rate to 1.25%. Interest rates should continue to increase to slightly above 2% in 2022.

For the rest of this year, we expect another three hikes, bringing the repo rate to 1.25% at end-2021. Specifically, we forecast a 25bp increase each at the monetary policy meetings in August, September and November. Statements from the bank board point to a preference for gradual policy tightening. However, we cannot rule out a 50bp hike at one or more of these meetings, especially in August, though this is not our base case. This could happen if the CNB significantly raises its inflation forecast. **Regardless, this is much faster tightening than we expected when we published our previous quarterly in April, when we projected only one hike this year.** There are two main reasons we have been revising our forecasts upwards since June. One is the significant improvement in the pandemic situation in recent months, followed by a rapid easing of restrictions, which likely led to a strong economic rebound. **In fact, we now expect the economy to reach pre-crisis levels by end-2021.** At the same time, the growing vaccination rate (at least one dose of the vaccine has already been given to 50% of the population) gives us hope that there will be no further economic lockdown. The second reason is the very hawkish communication of the bank board, which makes it clear that, with the return of the economy to normal and with inflation above the target for a prolonged period, the CNB is ready to bring interest rates back to more typical levels. **We thus expect the CNB to continue raising rates next year, and we expect the repo rate to reach 2.25% by end-2022.**

Czech IRS market and government bonds

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Complicated path to higher levels

Interest rates and government bond yields stabilised in the second quarter and saw a series of corrections. Short-term declines will continue in our view, but an upward trend is inevitable. For the coming weeks, we see the greatest upside potential for the short end of the curve owing to the CNB's monetary policy. However, we believe longer maturities in particular should rise over the rest of the year on the back of global developments, which should put the IRS curve back on an upward trajectory. In the meantime, however, current conditions could be used to hedge temporarily lower levels. A better-than-planned state budget will likely limit supply for the rest of the year, prompting further increases in government bond prices. We expect this to keep government bond yields from rising, driven by market expectations.

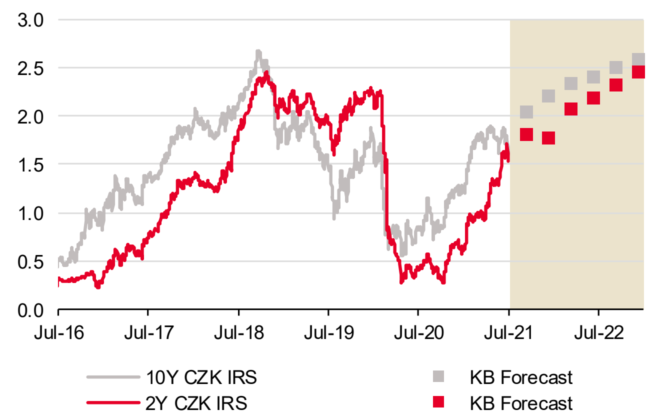
The Czech IRS rate market: a return to an upward trajectory

The recent correction in the region and global developments have pushed the koruna curve to lower levels and into an inverse shape. However, for the coming months, we expect growth and the rising shape to return.

CZK interest rates continued to rise in the second quarter, especially at the shorter end of the curve, on the back of the CNB's aggressive monetary policy. The earlier initiation of the central bank's interest rate hiking cycle and the prospect of further monetary tightening moved the short end up significantly. Conversely, the long end remains trapped in the 1.50-2.00% range. These factors have pushed much of the curve into an inverted shape last seen prior to the start of the coronavirus pandemic (see *Box 2*).

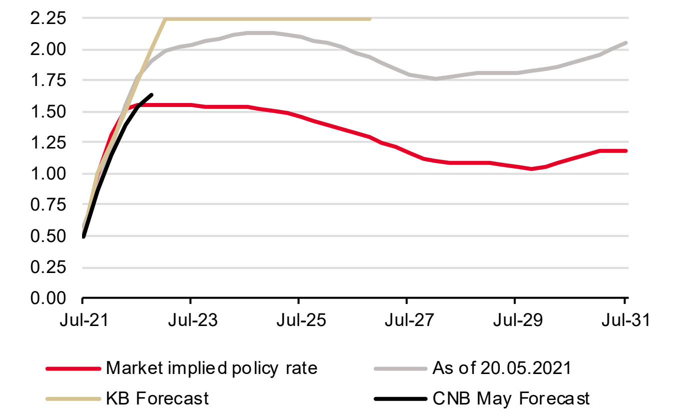
In recent weeks, however, the entire region has seen a strong correction in interest rate hike expectations, which has pushed some maturities to their lowest levels in several months. However, the reason for the correction was more likely to be global concerns about the further evolution of the coronavirus pandemic and the associated economic recovery. In our view, **the August CNB meeting should bring market interest rates back to higher levels** and central bankers' new forecast should confirm that market expectations of rising rates were justified.

IRS forecast (%)



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Expected CNB key interest rate path (%)



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

For the coming weeks, we expect the short end of the curve to have the most room to grow. However, the long end in particular should be set in motion by developments abroad. US central bank rhetoric will, in our view, kick-start a rise in dollar rates again, which will also provide impetus for the koruna curve to move up in the longer maturities and break out of its inverse shape. Thus, for the end of this year, we expect only a weaker rise at the short end of the curve, while the 10-year IRS should move from the current 1.60% to 2.20%. We recommend *Pay CZK 10y IRS.*

CZK IRS outlook (end of period, %)

	3Q21f	4Q21f	1Q22f	2Q22f	3Q22f
2Y	1.80	1.80	2.10	2.20	2.35
5Y	2.15	2.15	2.35	2.40	2.50
10Y	2.05	2.20	2.35	2.40	2.50

Source: Economic & Strategy Research, Komerční banka

Box 2: Is inversion the new normal for the CZK IRS curve?

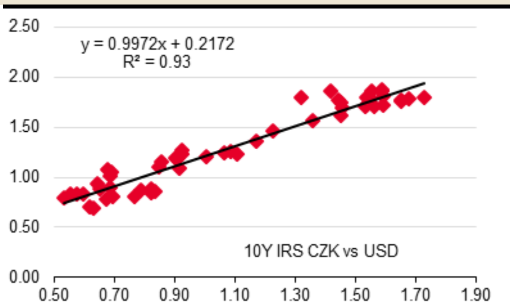
Global financial markets entered this year massively reassessing inflation expectations and central bank interest rate forecasts. This led to a sharp rise in long-term market rates, including on the CZK curve, which reached its steepest level in late March and early April. Since then, long rates have been in the 1.50-2.00% range, while the short end has moved higher amid aggressive CNB monetary policy. Along with the drop in core rates, the result is an inversion of the curve from the belly to long end.

The spread between the 10y and 5y rate reached -14bp in recent days, meaning that investors expect the CNB to cut interest rates in the long run. However, in our view, there is little justification for this expectation, and we think it is more of a one-off anomaly. However, this is nothing new for the koruna market. The interest rate swap curve was even more inverted from the beginning of 2019 until the pandemic began last year (in October 2019, the 5y10y spread reached -41bp). However, the reasons were different. German industry and the eurozone as a whole were teetering on the edge of recession, and Europe was tipping into deflation. On the other hand, the CNB was raising rates.

In the current situation, the domestic central bank is playing a similar role, hiking rates recently, but developments abroad are different. The global economy is recovering from a series of lockdowns, and it is only a matter of time before monetary policy is tightened abroad as well. However, the risks to the economy from coronavirus and question marks over the nature of the rise in inflation have put the brakes on the rise in long-term rates. Moreover, the belly of the curve is being supported by flows from domestic banks, which are hedging clients' mortgage loans in the financial markets while squeezing the long end of the curve by hedging interest rate risk on long-term deposits. The combination of these factors has prompted an inversion of the koruna curve.

Long end of CZK curve being driven by core rates (%)

Waiting for dollar rates to rise again (%)

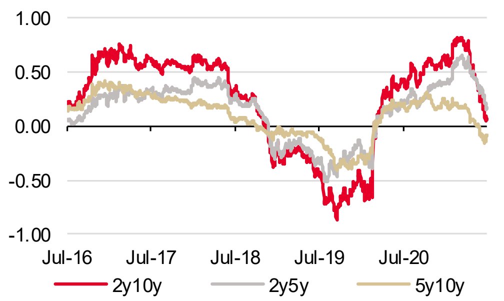


Source: Economic and Strategy Research, Komerční banka, Bloomberg

Long-maturity foreign interest rates are the main driver of CZK rates. In recent years in particular, the dollar curve and related Fed rate expectations have played a key role in this relationship. This is not a hot topic for the time being, but discussions about the start of tapering and rising inflation will in our view lead to a further rise in long-term rates in particular. Thus, the Fed's July and September meetings and the annual meeting of central bankers in Jackson Hole at the end of August will be key.

The outcome should in our view also provide impetus to the long end of the CZK IRS curve, which we see regaining a rising shape. The SG forecast calls for the 10y USD rate to rise to 1.95% by year-end. Based on a simple regression relationship, this implies the koruna rate rising from the current 1.75% to 2.15%, only slightly below our interest rate swap forecast (see more in the *The Czech IRS rate market*).

Inverse slope of CZK IRS curve (%)



Forward below spot for first time since pandemic (%)

Source: Economic and Strategy Research, Komerční banka, Bloomberg

In the meantime, however, from the perspective of hedging low interest rates, we see an opportunity arising from the current inversion of the swap curve. For longer horizons or pre-hedging, it may be better to avoid hedging the near-term horizon, thereby achieving a lower hedging interest rate in the future (see more in *The current rate correction and curve inversion as an opportunity to hedge*).

IRS forecast (%, end of the period)

	3Q21f	4Q21f	1Q22f	2Q22f
EUR 2y	-0.68	-0.65	-0.60	-0.55
EUR 5y	-0.15	-0.08	0.00	0.10
EUR 10y	0.30	0.40	0.50	0.62
USD 2y	0.28	0.33	0.38	0.43
USD 5y	0.97	1.16	1.29	1.40
USD 10y	1.75	1.95	2.10	2.30

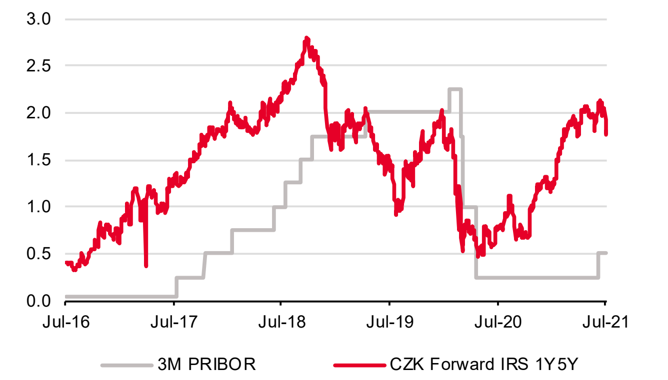
Source: SG Cross Asset Research

The current rate correction and curve inversion as an opportunity to hedge

We believe that the current low interest rates over the past few months can be used as an opportunity to hedge interest rate risk. Longer maturities are most interesting from this perspective. This is supported by the inverted shape of the curve (see *Box 2*), which improves the conditions for hedging with forward swaps, i.e. with a delayed start. The first CNB interest rate hike came a few months earlier than initially expected, and current developments confirm that further rate hikes have already been decided. Prices on the financial markets are largely counting on this, which is why **we recommend taking advantage of short-term corrections, as was the case in mid-June or in recent weeks.**

Global markets are nervous about further coronavirus variants and discussions by the ECB and Fed central bankers about possible monetary policy tightening. This will likely also cause greater volatility in koruna rates, amplified by low liquidity in the summer months. Further corrections of similar magnitude are thus very likely. However, the CNB has already confirmed that the next wave of the pandemic will not force it to cut interest rates again. **The question is therefore how fast and how far CNB interest rates will rise** (more in *CNB Focus*). The financial markets are aware of this, which is why the hedging conditions of last year are no longer achievable, but any correction could at least offer more interesting levels.

Interest rate hedging conditions are deteriorating (%)



Source: Bloomberg, Economic & Strategy Research, Komerční banka

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

Forward \ Maturity	6M	1Y	18M	2Y	3Y	5Y	10Y
Spot	0.88	1.29	1.45	1.55	1.66	1.71	1.62
3M	1.35	1.57	1.66	1.71	1.77	1.77	1.65
6M	1.62	1.74	1.77	1.81	1.83	1.79	1.66
9M	1.78	1.82	1.83	1.85	1.85	1.80	1.66
1Y	1.84	1.85	1.86	1.87	1.86	1.79	1.65
18M	1.84	1.87	1.88	1.87	1.85	1.76	1.64
2Y	1.89	1.90	1.87	1.87	1.83	1.72	1.62
3Y	1.83	1.84	1.81	1.80	1.74	1.61	1.63

Source: Bloomberg, Economic & Strategy Research, Komerční banka, as of 27/7/2021

Low CZGBs supply despite revised MinFin projection

In line with our expectations (https://bit.ly/3xagZo8), the MinFin revised forecasted financing needs (https://bit.ly/2TMGmxr) up to CZK740.7bn (12.1% of GDP). However, we estimate that **this year's needs will be only slightly higher than last year's** (CZK640.3bn vs CZK610.2bn; 10.5% of GDP vs 10.0%) and that net CZGB issuance will be the roughly same (CZK381.0bn vs CZK384.5bn).

Funding programme and issuance activity (CZKbn)

	2021		2022	
	MinFin	**KB**	**MinFin**	**KB**
State budget deficit	500.0	400.0	390.0	300.0
Transfers and other operations of state financial assets	0.0	0.0	0.0	0.0
T-Bonds denominated in local currency redemptions	156.2	156.2	165.8	165.8
T-Bonds denominated in foreign currency redemptions	52.9	52.6	74.3	67.9
Redemptions and early redemptions on savings bonds	0.1	0.1	0.0	0.0
Money market instruments redemptions	25.4	25.4	0.0	20.0
Redemption of T-bills		25.4		20.0
Redemption of other money market instruments		0.0		0.0
Repayments on credits and loans	6.0	6.0	3.2	3.2
Total financing needs	**740.7**	**640.3**	**633.3**	**556.9**
Money market instruments		20.0		15.0
T-bills		20.0		15.0
Other money market instruments		0.0		0.0
Gross issuance of CZK T-bonds on domestic market	Min. 500	537.2		455.2
Gross issuance of EUR T-bonds on domestic market		0.0		67.9
Gross issuance of T-bonds on foreign market		0.0		0.0
Gross issuance of savings government bonds		12.0		10.0
Received credits and loans		52.3		3.2
Financial asset and liquidity management		18.8		19.2
Total financing sources		**640.3**		**570.5**
Gross borrowing requirement		**621.5**		**551.3**
Net CZGB issuance		**381.0**		**289.4**

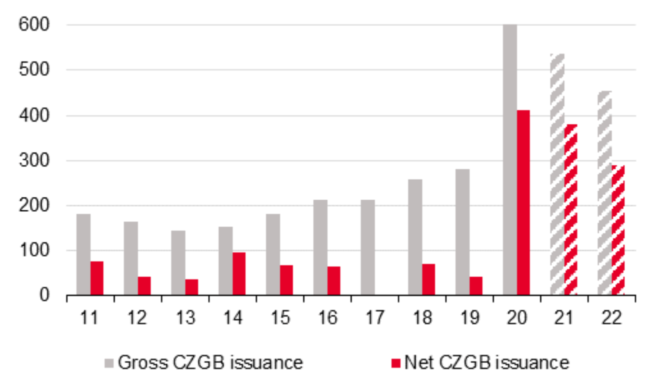
Source: Economic and Strategy Research, Komerční banka, MinFin

The supply of government bonds will be limited for the rest of the year, which will hamper yield growth driven by the IRS curve.

On our calculations (based on a CZK400bn deficit), the MinFin has covered around 70% of all needs in 1H21, creating a comfortable situation for the second half of the year. Increased supply earlier this year was met with above-average demand. Since May, the MinFin has returned to its original practice of two auctions per month, which we expect to continue until at least September, depending on state budget needs. Demand for CZGBs (bid/cover ratio) in the first half of the year was above the five-year average, and given limited supply in the coming months, it should remain decent.

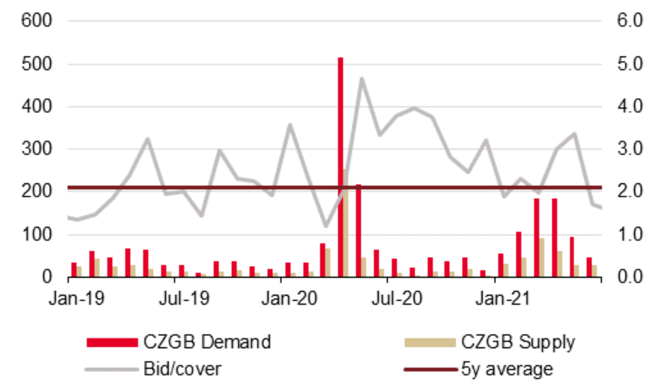
We expect the MinFin to be more active in the secondary market to pre-finance its needs for next year, as it did in 2020. So far, it has cut its needs via CZK19bn in switch operations (vs CZK71.2bn last year). Prefinancing is likely to include a €2.75bn Eurobond maturing in May 2022. The MinFin's preferred instrument is a euro-denominated bond under domestic law introduced in 2019. These should become eligible as collateral with the ECB this year, which should increase their appeal with foreign investors. However, there are other options, including drawing on euro-denominated EU programmes.

CZGB issuance (CZKbn)



Source: Economic and Strategy Research, Komerční banka, MinFin

CZGB primary market (CZKbn)

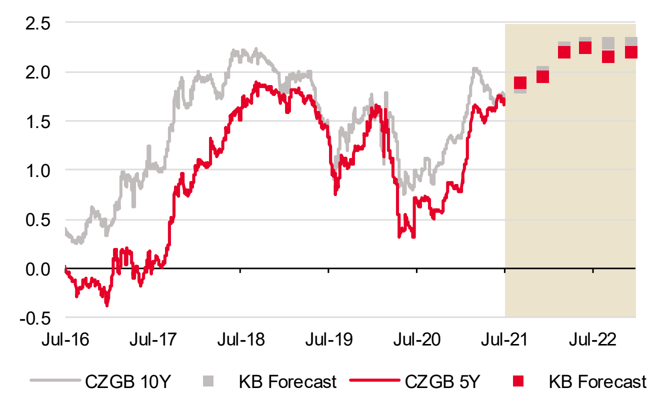


Source: Economic and Strategy Research, Komerční banka, MinFin

Further yield growth held back by strong demand

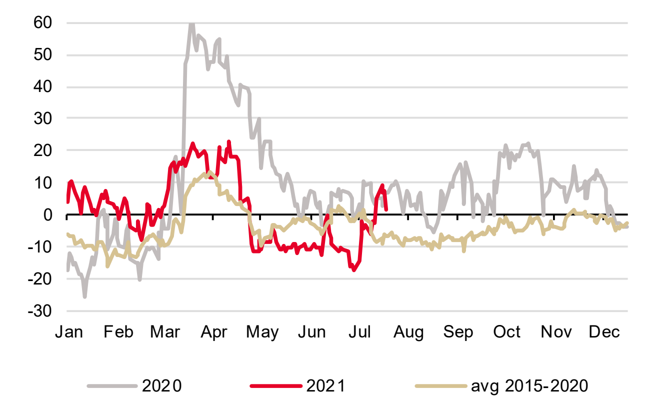
The combination of aggressive CNB monetary policy (see CNB Focus) and stagnant to lower core rates has resulted in a strong bear flattening of the yield curve. Given the short-term expectations that currently are priced in, we believe there is limited room for further upside at the short end in the coming weeks. However, **the long end of the curve is still waiting for a summer boost to yields from core rates,** in line with our G10 rates strategists' expectations.

CZGB yield forecast (%)



Source: Economic and Strategy Research, Komerční banka, Bloomberg

10y CZGB ASW (bp)



Source: Economic and Strategy Research, Komerční banka, Bloomberg

In line with our expectations, the MinFin delivered the majority of CZGB supply in the first half of the year, amplifying ASW seasonality (widening in 1H21). In our view, good excess demand amid limited supply will hamper further yield growth, resulting in further ASW richening in 2H21. We see space especially at the long end of the curve, but most of the story is already behind us. However, we also see the summer's low liquidity, higher volatility and declining rates as an opportunity to take advantage of ASW richening.

CZGB yield forecast (end of period)

	3Q21f	4Q21f	1Q22f	2Q22f	3Q22f
2y CZGB yield (%)	1.50	1.55	1.85	2.05	1.95
5y CZGB yield (%)	1.90	1.95	2.20	2.25	2.15
10y CZGB yield (%)	1.85	2.00	2.25	2.30	2.30
10y CZGB ASW (bp)	-20	-18	-10	-10	-22

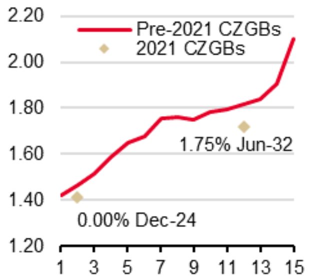
Source: Economic & Strategy Research, Komerční banka

CZGBs to remain in GBI-EM for at least three more years

Contrary to our expectations (https://bit.ly/2RQOZ93), JPM announced that CZGBs would remain in GBI-EM the index family. The Czech Republic met the GNI per capita growth criterion for inclusion among developed markets (GBI index family), but not the purchasing power parity criterion. This means that the whole process is back to square one, and **a reclassification of CZGBs as 'developed market' bonds is possible only in three years at the earliest.** Until then, partial changes in the index will be important from this perspective. Since the beginning of the year, in line with our expectations, we have seen several CZGB additions to the GBI-EM, closing the weight gap with peers. The first CZBG bond to exit the index will be the 4.7% Sep-22, and an announcement will be made in January-February 2022. The space for adding new CZGBs has been significantly reduced, but further announcements cannot be ruled out. In that case, our best guess is the addition of the short-end bonds (0.00% Dec-24 and 1.25% Feb-25).

New tax regime supports domestic bondholders

CZGB yield curve by date of first issuance



Source: Economic and Strategy Research, Komerční banka, Bloomberg

The CZGBs first issued this year fall under a new tax law that exempts domestic entities from income tax. This change aims to support domestic bondholders and thus reduce the share of foreign bondholders, which has increased significantly in recent years. The tax exemption relates to the coupon and primary discount of the bond. However, the interpretation of the law is uncertain in terms of the secondary market, and the Czech Banking Association is still awaiting clarification from the MinFin. Since the beginning of the year, three CZGBs (0.00% Dec-24, VAR% Oct-31, 1.75% Jun-32) have been introduced that trade below the curve of bonds issued in previous years. If the new tax law gets a clear interpretation, we could see a greater deviation of newly issued bonds from the curve. However, one political group (centre-left coalition of the Pirates and STAN party) that is currently popular in the polls has the abolition of the tax exemption in its manifesto for the October 2021 general election.

Sovereign rating: little risk of a downgrade

Despite the significant deterioration in the public finance outlook and the economic downturn, which was more pronounced than for peers, **the Czech Republic's rating has been reaffirmed by all major rating agencies** since the beginning of the year. Most recently, Fitch, which adopted the most pessimistic view during the coronavirus crisis, announced its rating review last week. Our public finance forecast is optimistic, thus we expect the rating agencies to revise their expectations upwards, and we think that the risk of a downgrade has passed.

Sovereign rating overview

	Local currency	Outlook	Foreign currency	Outlook	Next rating review
S&P	AA	STABLE	AA-	STABLE	29-Oct
Moody's	Aa3	STABLE	Aa3	STABLE	6-Aug
Fitch	AA-	STABLE	AA-	STABLE	10-Dec

Source: Economic and Strategy Research, Komerční banka, Bloomberg

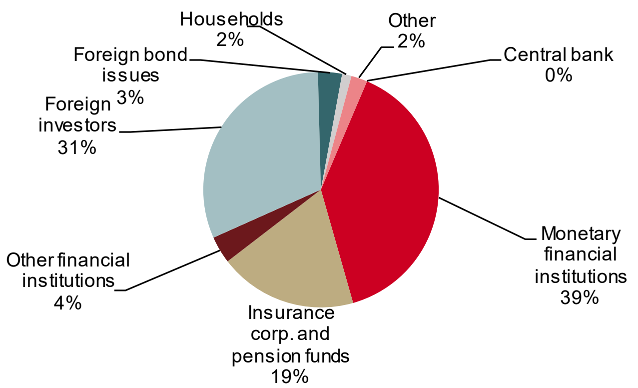
Government bond overview

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
0.00	Feb-22	0.6	0.0	6%	0.51	1	11	-0.71	-52	4	-6	-52		-24	-2.2	19	-4.8	8	-5.1	19
0.10	Apr-22	0.7	0.0	100%	0.67	-1	16	-0.66	-46	-1	1	-50		-3	-1.5	18	-14.8	3	7.8	7
4.70	Sep-22	1.1	0.0	100%	0.41	3	10	-1.14	-94	2	-1	-104		-18	-1.3	17	27.4	19	0.5	18
0.45	Oct-23	2.2	0.0	80%	1.29	1	6	-0.43	-27	-3	9	-47		-10	0.4	16	-23.7	1	14.6	1
5.70	May-24	2.6	0.0	100%	1.24	4	3	-0.50	-42	-3	13	-63		-24	0.8	11	-3.4	9	11.6	2
0.00	Dec-24	3.3	8.5	34%	1.45	0	4	-0.32	-23	1	17	-42		-12	1.1	5	-11.0	5	11.2	3
1.25	Feb-25	3.4	0.0	100%	1.49	-1	-3	-0.28	-22	-2	8	-41		-12	1.0	6	-11.6	4	11.1	4
2.40	Sep-25	3.9	0.0	76%	1.53	0	-7	-0.22	-20	-4	7	-43		-5	0.6	14	-5.5	7	9.7	5
1.00	Jun-26	4.7	0.0	100%	1.59	-2	-8	-0.14	-15	-4	9	-33		-2	0.6	15	0.3	10	7.9	6
0.25	Feb-27	5.4	0.0	83%	1.61	-2	-8	-0.09	-12	-4	8	-30		0	0.8	10	4.8	13	6.6	9
2.50	Aug-28	6.5	6.1	84%	1.63	-5	-10	0.06	-6	-5	5	-26		7	0.6	13	11.2	18	4.4	10
2.75	Jul-29	7.2	0.0	83%	1.67	-3	-9	0.16	1	-4	9	-23		12	0.9	8	9.3	17	3.5	12
0.05	Nov-29	8.2	5.0	53%	1.67	-4	-9	0.14	3	-4	9	-21		11	1.0	7	8.9	16	2.9	13
0.95	May-30	8.3	0.0	100%	1.69	-4	-7	0.20	5	-5	11	-16		16	0.9	9	6.2	14	2.6	14
1.20	Mar-31	8.9	0.0	100%	1.71	-4	-8	0.27	6	-6	7	-13		19	0.7	12	3.3	12	2.2	15
1.75	Jun-32	9.8	32.4	31%	1.67	-4	-3	0.32	4	-5	14	-19		12	2.0	1	3.1	11	1.6	17
2.00	Oct-33	10.6	3.6	87%	1.77	-4	-6	0.49	13	-5	11	-13		21	1.2	4	-10.8	6	1.8	16
4.20	Dec-36	11.7	4.0	100%	1.86	-3	-5	0.72	18	-3	21	-12		25	1.3	3	-17.3	2	3.6	11
1.50	Apr-40	15.9	4.6	30%	2.05	-2	-4	0.77	29	-2	21	0		33	1.4	2	8.8	15	7.7	8

Source: Economic & Strategy Research, Komerční banka

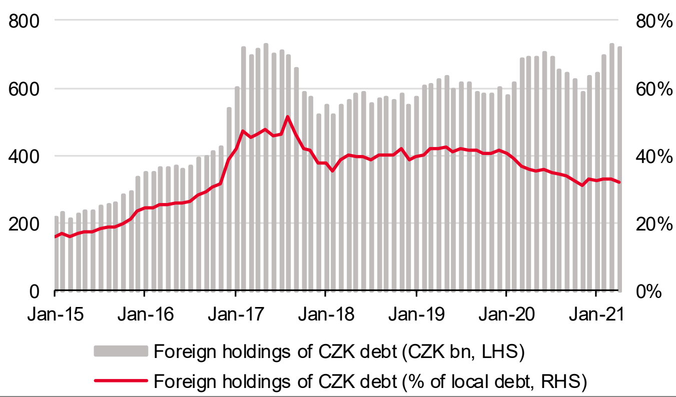
Note: More details in CZGB Auction Alert

Holdings of CZK government debt (May 2021)



Source: MinFin, Economic & Strategy Research, Komerční banka

The share of non-resident bondholders declines further



Source: MinFin, Economic & Strategy Research, Komerční banka

Czech FX market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Global developments limit the koruna's appreciation potential

The summer months traditionally bring lower liquidity and higher volatility to financial markets. This year, this is compounded by a closely watched debate among central bankers about the pace and timing of monetary policy tightening. We expect the koruna to strengthen further, but temporary swings to weaker levels remain likely. Compared to our previous forecast, we expect the koruna to appreciate at a more moderate pace, mainly due to the complete revision of the euro-dollar forecast. According to our colleagues at SG, the US dollar has already reached its weakest levels and its appreciation will have a negative impact on the EM currencies, including the Czech koruna. However, the CZK will continue to benefit from the CNB's aggressive monetary policy and higher interest rates. By the end of this year, we expect it to appreciate to EURCZK25.10, back in line with our April forecast. A slower pace of appreciation should follow next year. We see the summer volatility of the koruna and its temporary shifts towards weaker values as an opportunity to hedge better conditions for exporters.

Higher rates and a strengthening dollar pulling koruna in opposite directions

The second quarter brought a post-pandemic calm and the first interest rate hikes by the Czech and Hungarian central banks. This supported the currencies of both countries on their way to significant gains, and the prospect of earlier interest rate hikes also helped the Polish zloty. However, the start of the summer holidays broke this trend and the **combination of traditionally low liquidity, global fears of further coronavirus mutations and a strengthening dollar made life significantly more difficult for CEE currencies** and the entire emerging market currency sector.

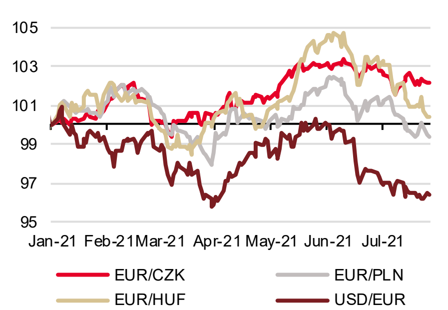
The coming weeks will be marked by low summer liquidity, higher volatility and central banker speeches. The new forecast is for a slower rate of appreciation of the koruna, mainly due to a change in the eurodollar forecast.

We expect higher volatility for the koruna in the months ahead. On the global scene, the views of central bankers at the Fed and ECB on the pace and timing of monetary policy tightening will be a major factor for the Eurodollar. The latter has fully dominated the direction of emerging markets in recent weeks. In addition, **domestic factors, led by market interest rates, are contributing to higher volatility.** Global uncertainty and lower summer liquidity are exacerbating fluctuations in market prices, and the testing of investor confidence in the CNB's interest rate hikes is also supporting higher volatility in the koruna. It should continue to appreciate in the second half of the year. But **we have had to revise our forecast towards a slower rate of appreciation for the first time since the coronavirus pandemic broke out** due to a radical change in the trajectory of the Eurodollar expected by our colleagues at SG.

CZK exchange rates

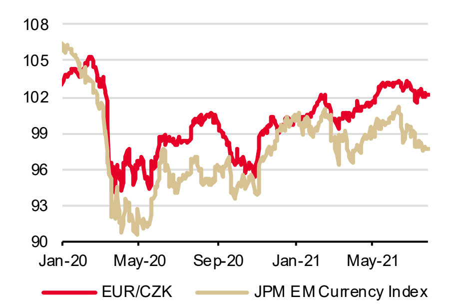
Source: Bloomberg, Economic and Strategy Research, KB

Performance of CE currencies



1.1.2021 = 100

The koruna resists global developments



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The euro has probably already peaked, and an earlier start of monetary tightening by the Fed will lead to an earlier appreciation of the dollar than we had anticipated (see more in the

External environment chapter). This has had an impact on our EURCZK forecast, particularly at the one-year horizon, when the US dollar is expected to peak.

EUR/CZK and interest rate differential

Source: Economic and Strategy Research, Komerční banka, Bloomberg

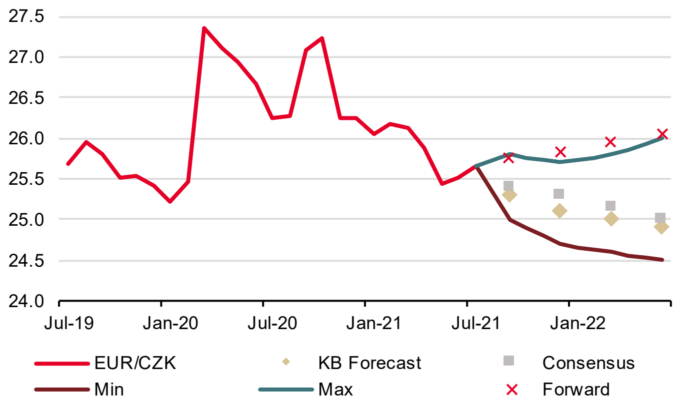
In the second half of this year, however, the koruna should continue to be strongly supported by rising market interest rates. In our view, current market expectations still underestimate the extent of the CNB's monetary policy normalisation and thus have room to rise. However, **they will not offer the potential for appreciation that they did in the first half of the year.** Another, weaker headwind is global sentiment, which has already fully digested the post-COVID economic recovery and are now considering whether the initial optimism was overdone. Given that the euro is gradually weakening against the US dollar, the koruna should thus also slow its pace of appreciation. **We are expecting a level of 25.10 per euro for the end of this year, which brings us back to our April forecast.** Next year should see a further slowdown in the pace of appreciation owing to the effects of the CNB interest rate hikes and the strengthening of the dollar against the euro, which traditionally has a negative impact on EM currencies.

Koruna exchange rate forecast (end of period)

	3Q21f	4Q21f	1Q22f	2Q22f	3Q22f
EUR/CZK	25.30	25.10	25.00	24.90	24.80
USD/CZK	21.45	21.35	21.55	21.85	22.15
EUR/CZK	1.18	1.18	1.16	1.14	1.12

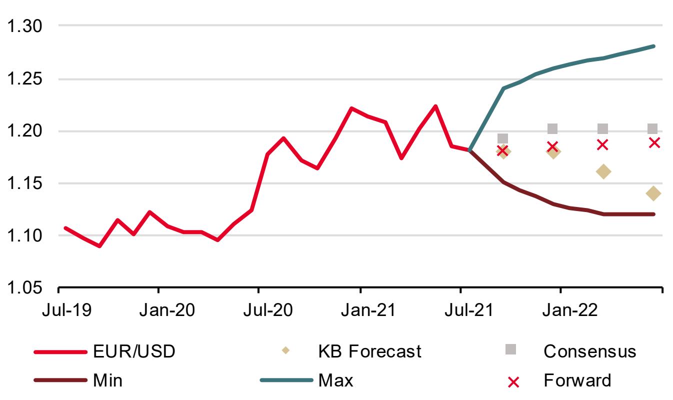
Source: Economic and Strategic Research, Komerční banka

Expected EUR/CZK path, market consensus by Bloomberg (as of 27 July 2021)



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Expected EUR/USD path, market consensus by Bloomberg (as of 27 July 2021)



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Risks remain the same, but their intensity is decreasing

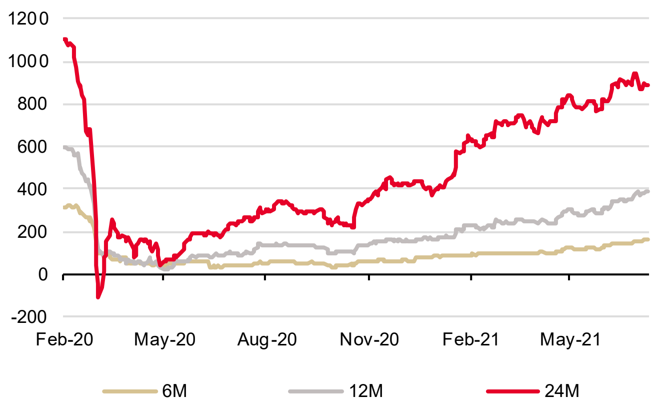
The pandemic and the CNB's monetary policy remain the main risks to the koruna, but their intensity has declined since the last forecast. Potential further waves of the coronavirus will have a much smaller and shorter impact on financial markets in general. We estimate that the March wave had a 0.35-0.40 depreciation effect on the koruna, above the global trend. Thus, any depreciation should be of a lower magnitude, serving as a good opportunity to rebuild speculative positions or hedges. Closely related to the development of the pandemic is the CNB's monetary policy, which we believe will bring a rapid series of interest rate hikes that are largely not priced in at present. **However, if the CNB's approach were to change and rate hikes were to stop, this would mean the loss of a major driver for the CZK to stronger levels.** In such a situation, the impact of a strengthening US dollar against the euro would be fully felt, leading to a weakening of the koruna. On the other hand, a weaker currency opens a greater opportunity for the central bank to raise interest rates, which in turn will again support the koruna. A change in the central bank's approach would thus have to be underpinned by a significant slowdown in inflation. Another risk is the trajectory of the

Eurodollar, which has seen the biggest change in our forecast. It will be dependent upon discussions between the Fed and ECB central bankers regarding the timing and pace of monetary policy tightening, which is currently the main focus of financial markets.

Summer volatility as a hedging opportunity

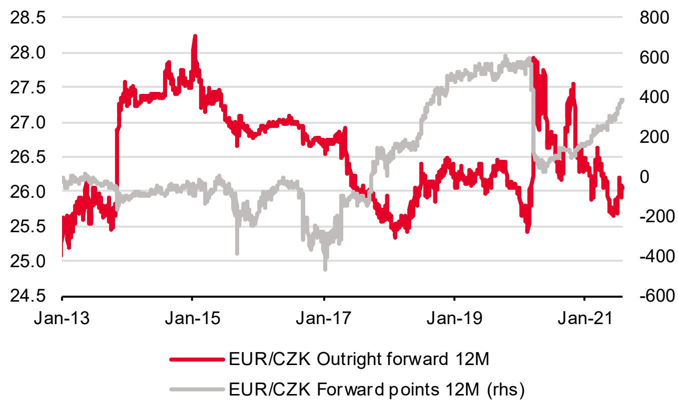
Current global financial market concerns about excessive pandemic-related optimism combined with a regional correction in market interest rates have pushed the koruna to weaker levels. Although we expect the koruna to strengthen further, **similar declines are likely to recur during the summer months. From the perspective of exporters, we recommend taking advantage of such a situation to hedge better exchange rate conditions.** We expect the koruna to appreciate by less than 3% from current levels over the annual horizon. However, even though our new forecast assumes a more moderate pace of appreciation, the difference between the annual forward rate and our expected level on the spot market is still close to CZK1.20. Despite the fact that the forward market has already surpassed pre-COVID levels, it is still an attractive hedging option. Moreover, we expect the CNB's aggressive monetary policy (see more in the *CNB Focus* chapter) to bring market interest rates back to at least recent highs and the koruna to stronger levels later in the summer. However, the rise in forward points will not be able to fully compensate for the higher interest rate differential and the appreciation of the koruna, which will lead to a further deterioration in forward rates or hedging conditions.

Forward points follow the rise in the interest rate differential



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Forward exchange rate reaches pre-COVID levels



Source: Bloomberg, Economic and Strategy Research, Komerční banka

Banking Sector

The expansion of loans is growing, the growth of deposits is slowing down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A further increase in our estimate of economic growth is positive news for the banking sector. Housing loans will continue to expand strongly, and real estate price growth will slow down rather reluctantly. Loans to corporations expanded in the first half of 2021, and this growth is expected to accelerate significantly as the economy recovers. A similarly positive picture should be seen in consumer credit. Deposit growth is extremely fast, but is already slowing, and this trend should continue. The development of non-performing loans is relatively favourable, and we expect only a slight increase in their share.

The real estate market continues to grow rapidly

So far this year real estate prices have continued to rise rapidly and contribute to the growth in the volume of mortgages.

Housing prices rose by 7.2% in 2020, and developments in the first half of this year do not suggest that there will be any changes soon. Demand remains strong and while interest rates are rising sharply, they are still relatively low, and the thought of their further increase is motivating people to take out housing loans. For this year, we expect a further increase in the price of apartments of more than 7%, but from next year, their growth rate should slow down. **Year-on-year growth in housing loans accelerated to 9.8% in the first quarter and will be close to 11% in the second quarter.** We believe that expectations of future growth in interest rates and rising house prices for the rest of the year will maintain the high growth rate of mortgage loans. We were afraid that the CNB would start communicating the possibility of an early tightening of mortgage rules this year and that the tightening could take place later this year. It has not happened yet but given the risk reduction and the rapidly growing mortgage market, the tightening still seems relatively likely this year. **After last year's growth in housing loans of 7.4%, we expect a further strong increase of 9.4% this year and a slowdown to 6.4% in 2022.**

Bank loans and deposits (% yoy)

	Q4 20	Q1 21	Q2 21	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	2020	2021	2022	2023	2024	2025
Bank loans														
Total	4.2	4.5	6.2	5.3	6.9	7.1	5.1	6.9	5.2	5.7	6.4	5.9	5.8	5.5
Households - real estate loans	8.0	9.8	10.9	8.8	9.1	8.7	6.0	7.4	7.4	9.7	7.1	5.8	5.2	5.1
Households - consumer loans	0.8	0.2	1.0	2.3	4.6	5.9	7.1	7.5	3.8	2.0	7.0	7.2	6.6	6.2
Corporate loans	0.3	0.8	-1.9	2.1	5.1	6.0	8.9	7.0	3.5	1.5	7.1	5.1	5.5	5.6
Deposits														
Total	8.9	13.4	7.6	10.7	13.5	7.1	12.4	5.3	9.9	11.3	7.6	5.8	5.7	5.4
Households	12.1	13.3	11.5	13.1	11.3	9.1	8.7	5.8	10.2	12.3	7.3	5.6	5.9	5.7
Non-financial corporations	11.2	12.9	9.2	7.3	10.5	6.6	7.5	5.8	11.7	10.0	6.3	5.9	4.9	4.8
Others	-0.5	13.9	-0.1	9.3	22.2	4.3	23.0	4.2	7.7	11.3	9.2	5.9	5.8	5.2
Ratios														
Loans/GDP	63.1	65.6	64.6	63.6	62.8	64.1	62.5	62.7	62.7	64.2	62.8	62.7	62.9	63.2
Deposits/GDP	90.6	105.1	98.9	102.6	95.7	102.7	102.3	99.6	93.3	100.6	99.6	99.3	99.4	99.9
Loans/deposits	69.7	62.4	65.3	62.0	65.6	62.4	61.0	63.0	67.2	63.8	63.2	63.2	63.3	63.4
Interest rates														
Real estate loans	2.1	2.1	2.2	2.3	2.4	2.6	2.7	2.8	2.3	2.2	2.7	3.0	3.1	3.1
Consumer loans	7.7	7.4	7.3	7.5	7.8	8.1	8.2	8.4	8.0	7.5	8.3	8.7	8.8	9.0
Corporate loans	1.9	2.5	1.5	2.3	2.7	3.0	3.3	3.6	2.2	2.2	3.4	4.1	4.1	4.1
Share of NPL														
Real estate loans	1.1	1.2	1.2	1.2	1.3	1.3	1.4	1.4	1.1	1.2	1.4	1.4	1.4	1.5
Consumer loans	5.1	5.5	5.8	6.3	6.7	7.0	7.2	7.5	4.4	6.1	7.3	7.9	8.3	8.4
Corporate loans	4.2	4.3	4.4	4.4	4.4	4.3	4.2	4.2	3.4	4.4	4.2	4.2	4.6	4.6

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

The currently slow growth of consumer credit should accelerate from the second half of this year.

Consumer credit is growing slowly

Given the strong economic recovery this year, we expect consumer loans to increase. In the first half of 2021, however, their growth was small, which corresponds to a slower rise in household consumption (see the chapter *Macroeconomic outlook*). We have thus reduced our estimate of consumer credit growth this year to 2%. However, we expect an acceleration from the second half of this year, so we expect consumer credit to grow by a strong 7% next year.

For the time being, the growth rate of corporate loans is slightly slower than we previously expected.

The growth of corporate loans should accelerate

Loans to non-financial corporations began to grow at the beginning of this year. After a quarter-on-quarter increase of 0.7% (SA) in Q121, their pace in the second quarter is likely to be similar. However, we expect the growth of corporate lending to accelerate from the third quarter due to the rapid expansion of the economy. This should continue next year. For the whole of this year, we estimate the growth rate of loans to non-financial corporations to be 1.5% and next year 7.1%. The main change from our previous forecast is the reduction of our estimate for this year from the original estimate of 2.3%, due to a weaker increase in loans in the first half of the year.

Deposit volumes continue to grow rapidly.

The pace of accumulation of deposits past the peak

In terms of quarter-on-quarter dynamics, corporate deposits are still growing relatively rapidly, but have slowed down. In a year-on-year comparison, growth was approximately 9% in the second quarter. In the case of retail deposits, quarter-on-quarter growth is even faster, with the year-on-year growth rate rising above 11% in the second quarter. The end of anti-pandemic measures and the improved economic outlook speak in favor of a significant slowdown in deposit growth. The total growth of deposits last year reached almost 10% and for this year we expect an even higher rate of above 11%. However, in terms of quarter-on-quarter dynamics, deposits probably peaked in the first quarter.

The share of non-performing loans is likely to grow only slightly.

Non-performing loans are developing favourably

We anticipated that the share of non-performing loans (NPLs) would grow relatively little and with a lag, especially given the magnitude of the previous shock. However, developments to date, and in particular the outlook for the economy, paint an even more favorable picture. In all monitored groups of loans, we have significantly reduced the estimated future growth of NPLs, so that in the case of loans for housing purposes and corporate loans, we expect only a minimal increase.

Key Economic Indicators

Macroeconomic indicators – long-term outlook

		2018	2019	2020	2021	2022	2023	2024	2025
GDP	real, %	3.2	3.0	-5.8	4.2	5.3	3.5	2.8	2.6
Inflation	average, %	2.1	2.8	3.2	2.8	2.4	2.0	2.0	2.0
Current account	% of GDP	0.4	0.3	3.6	1.6	0.8	1.3	1.1	1.1
3M PRIBOR	average, %	1.3	2.1	0.9	0.8	1.9	2.3	2.4	2.4
EUR/CZK	average	25.6	25.7	26.5	25.6	24.9	24.1	23.8	23.2
USD/CZK	average	21.7	22.9	23.2	21.4	21.8	20.9	20.3	20.0

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

FX & interest-rate outlook

		27-07-2021	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
EUR/CZK	end of period	25.7	25.30	25.10	25.00	24.90	24.80
USD/EUR	end of period	1.18	1.18	1.18	1.16	1.14	1.12
CZK/USD	end of period	21.8	21.45	21.25	21.55	21.85	22.15
3M PRIBOR	end of period, %	0.71	1.20	1.45	1.70	1.95	2.20
10Y IRS	end of period, %	1.59	2.05	2.20	2.35	2.40	2.50

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

Monthly macroeconomic data

		X-20	XI-20	XII-20	I-21	II-21	III-21	IV-21	V-21	VI-21
Inflation (CPI)	%, mom	2.9	2.7	2.3	2.2	2.1	2.3	3.1	2.9	2.8
Inflation (CPI)	%, yoy	0.2	0.0	-0.2	1.3	0.2	0.2	0.5	0.2	0.5
Producer prices (PPI)	%, mom	0.3	-0.1	0.0	0.0	1.4	3.3	4.6	5.1	6.1
Producer prices (PPI)	%, yoy	0.4	-0.5	0.2	1.3	0.7	1.4	0.8	0.9	0.8
Unemployment rate	% (MLSA)	3.7	3.8	4.0	4.3	4.3	4.2	4.1	3.9	3.7
Industrial sales	%, yoy, c.p.	-1.5	-0.3	8.0	-5.2	-2.3	17.4	55.1	32.3	n.a.
Industrial production	%, yoy, c.p.	3.0	1.8	8.5	-4.9	-0.7	20.3	63.6	38.3	n.a.
Construction output	%, yoy, c.p.	-10.5	-8.4	-11.4	-5.2	-11.0	-3.3	-3.9	5.8	n.a.
Retail sales	%, yoy, c.p.	-3.7	-8.3	0.4	-7.6	-4.9	15.6	21.6	16.5	n.a.
External trade	CZKbn (national met.)	31.1	32.0	15.6	25.2	21.8	18.0	20.9	6.3	n.a.
Current account	CZKbn	2.8	19.7	-4.4	32.3	14.1	33.8	37.3	7.2	n.a.
Financial account	CZKbn	-17.9	-9.8	17.6	50.5	1.3	58.2	30.9	-8.8	n.a.
M2 growth	%, yoy	10.8	10.7	10.5	11.0	11.9	11.0	10.9	10.7	n.a.
State budget	CZKbn (YTD cum.)	-274.0	-341.5	-367.4	-31.5	-86.1	-125.2	-192.0	-255.0	-265.1
PRIBOR 3M	%, average	0.35	0.35	0.35	0.36	0.36	0.36	0.36	0.37	0.48
EUR/CZK	average	27.2	26.5	26.3	26.1	25.9	26.2	25.9	25.5	25.5
USD/CZK	average	23.1	22.3	21.6	21.5	21.4	22.0	21.7	21.0	21.1

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

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