

Czech Economy in 2025: Risks and Policy Responses

Jan Procházka, CNB Bank Board Member

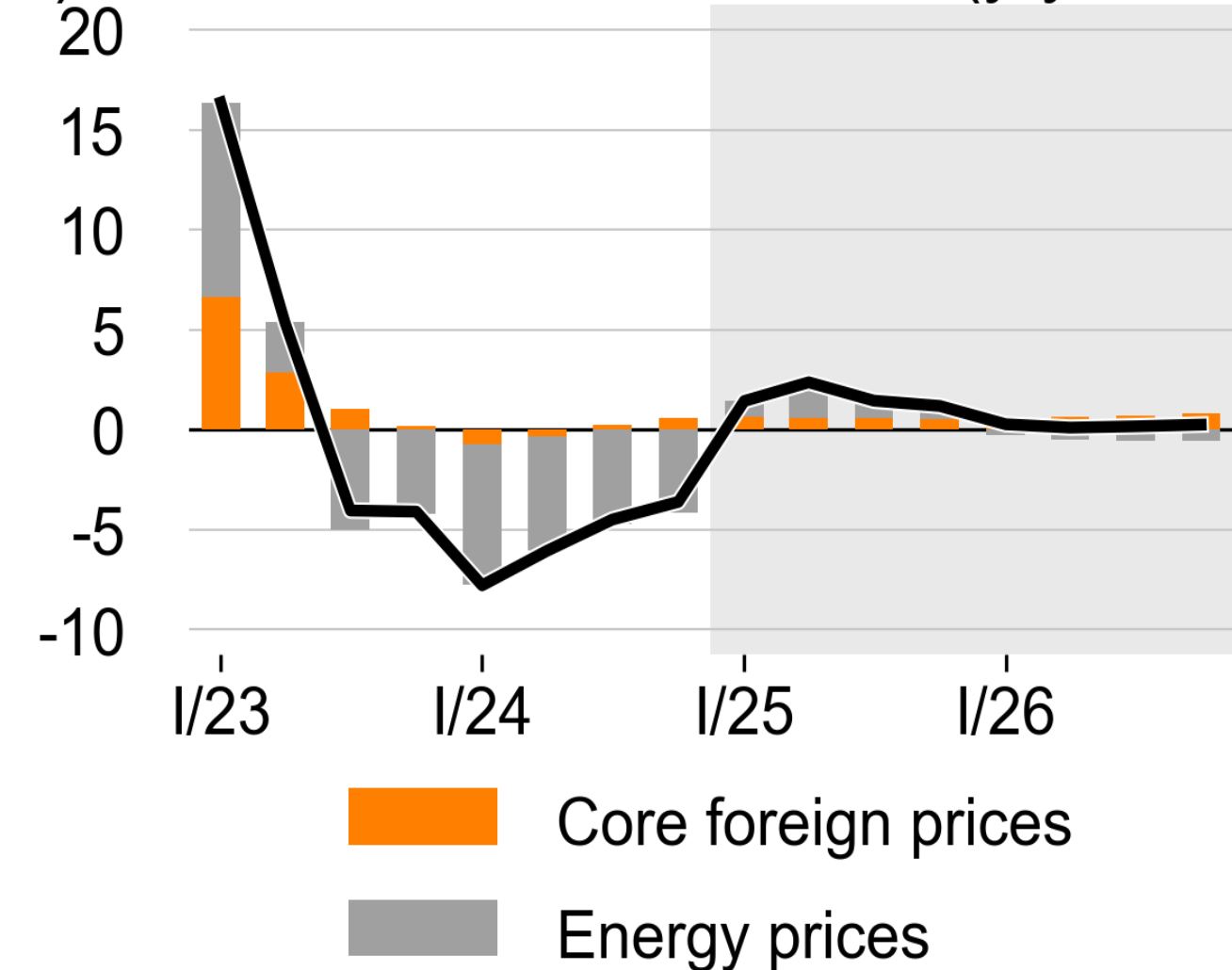
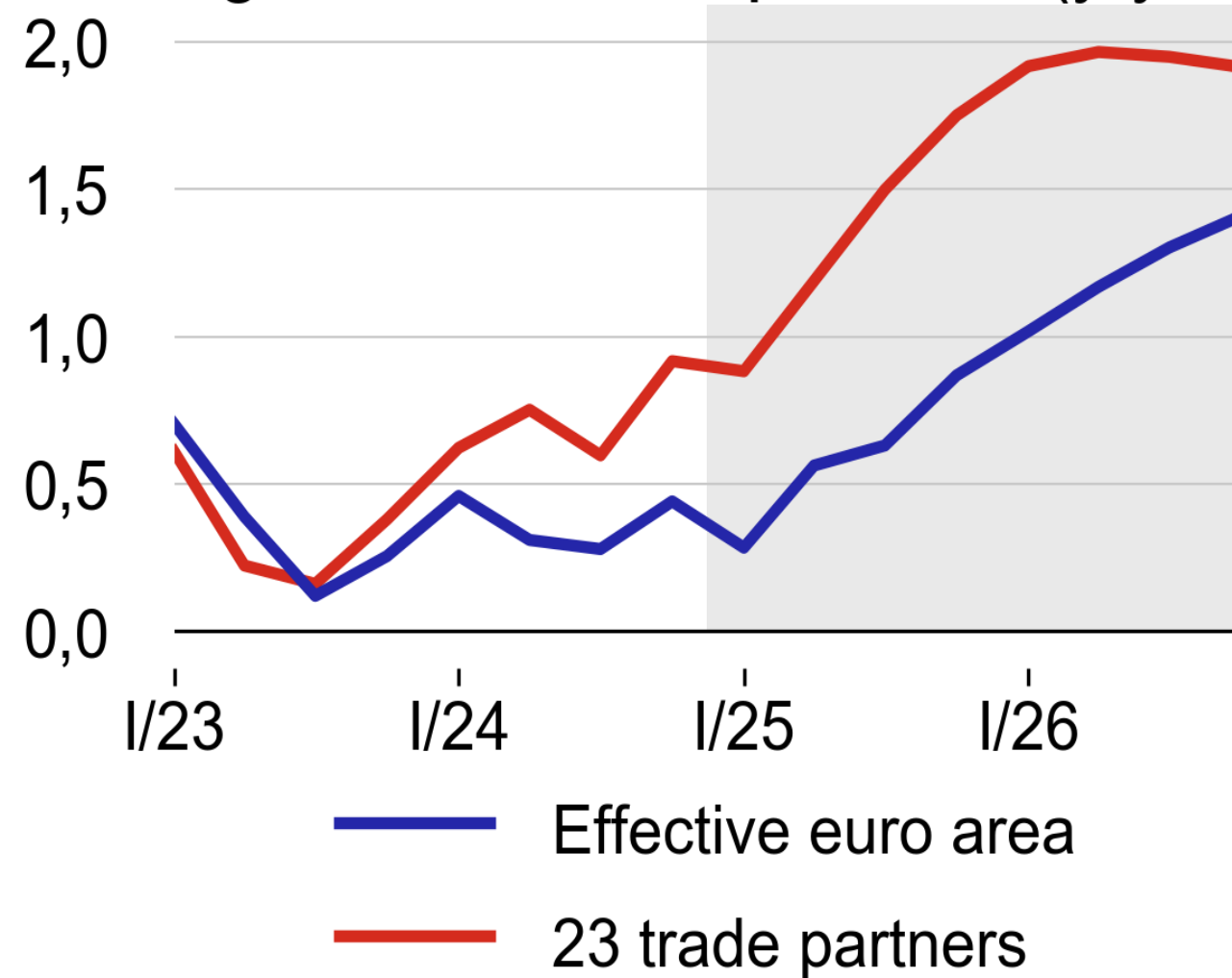
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Quo Vadis 2025

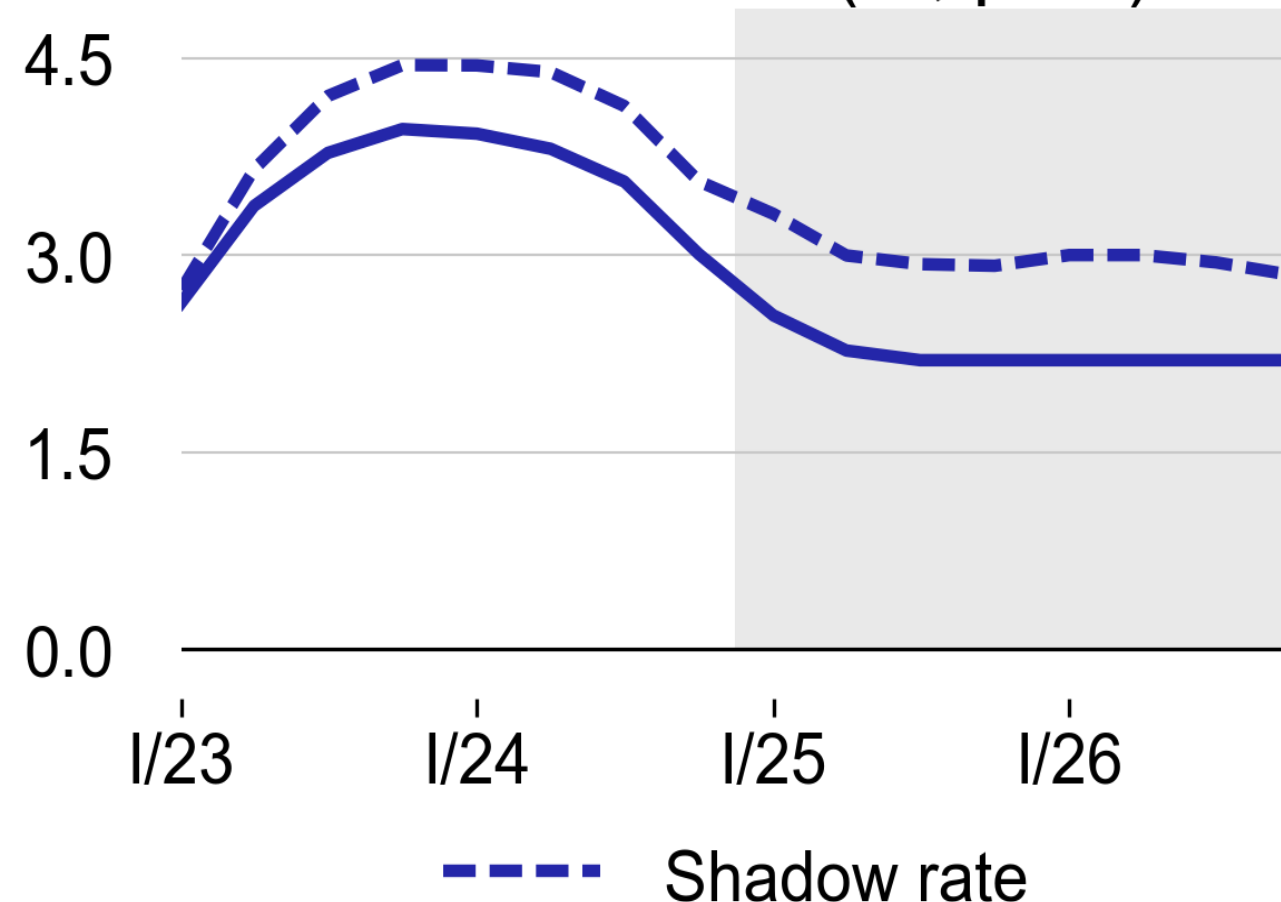


Foreign Environment Outlook

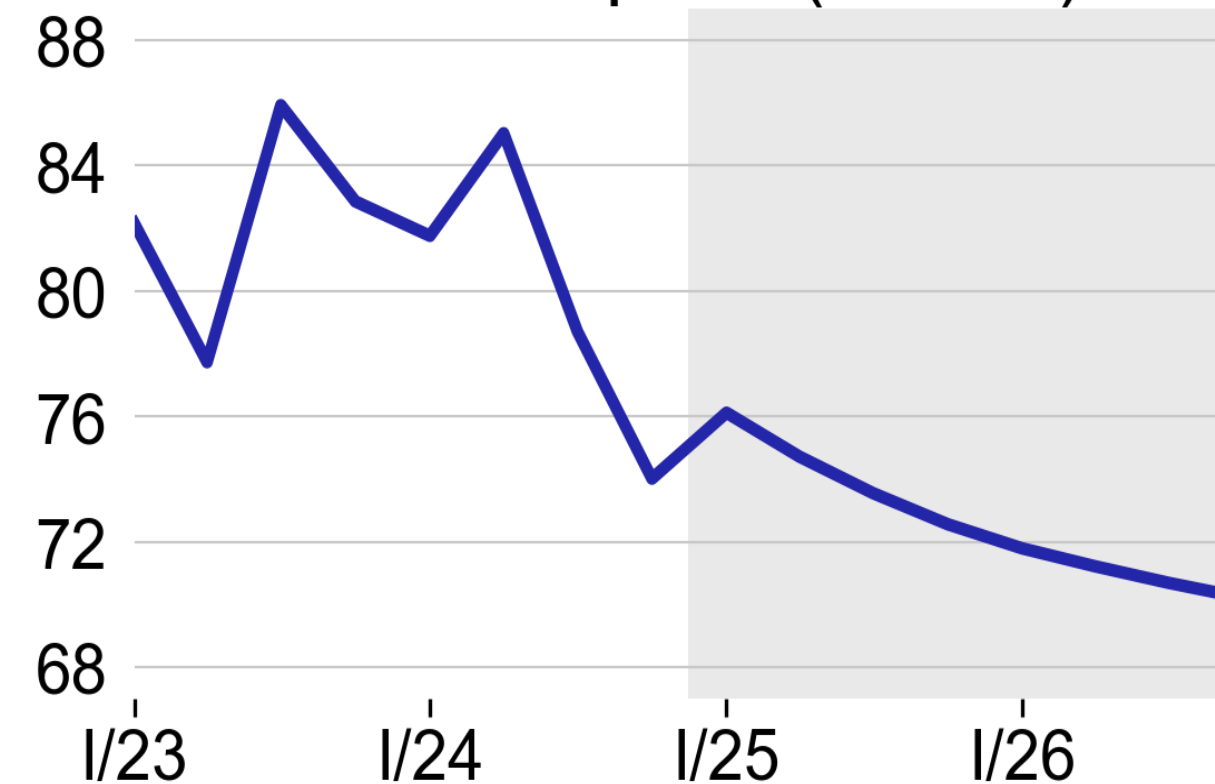
GDP growth of trade partners (y/y, in %) PPI - effective euro area (y/y, in %)



3M EURIBOR (% p. a.)

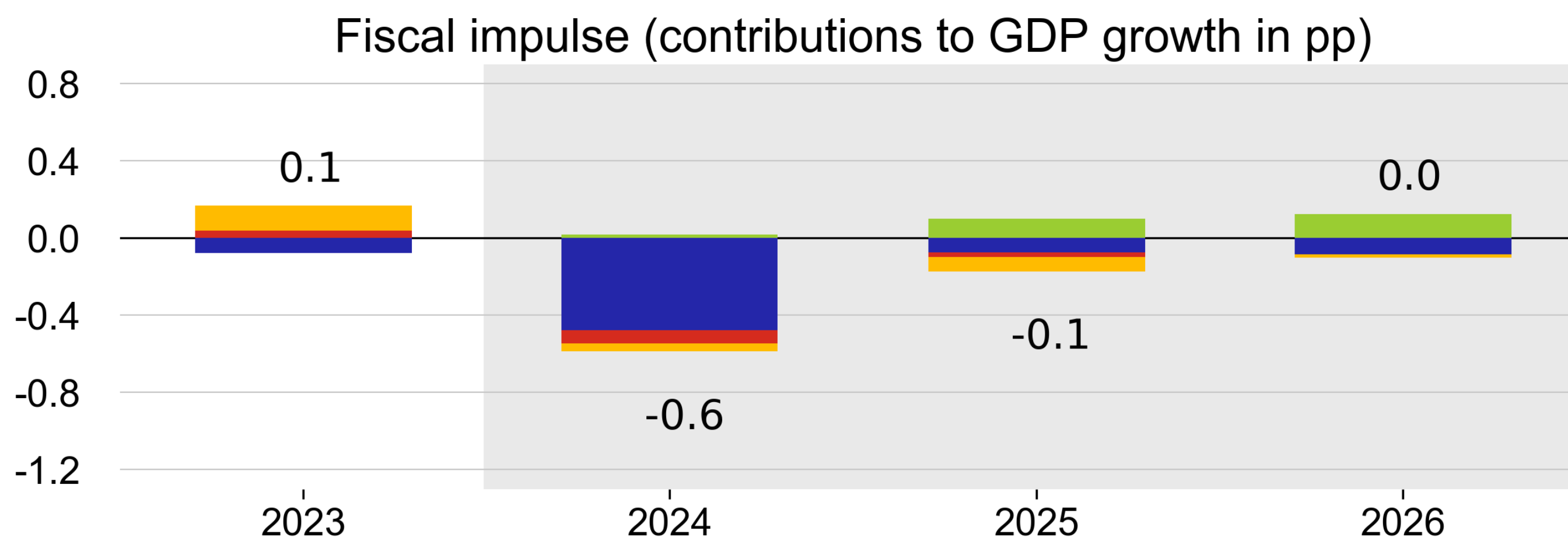
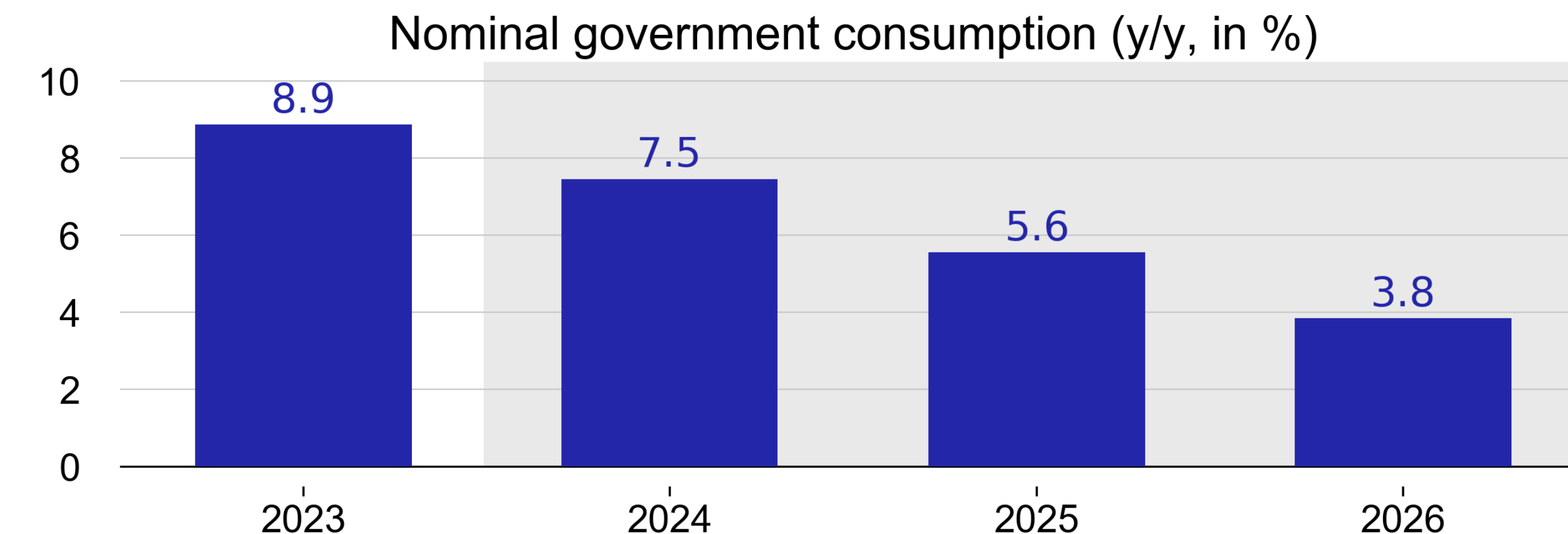


Brent oil price (USD/b)



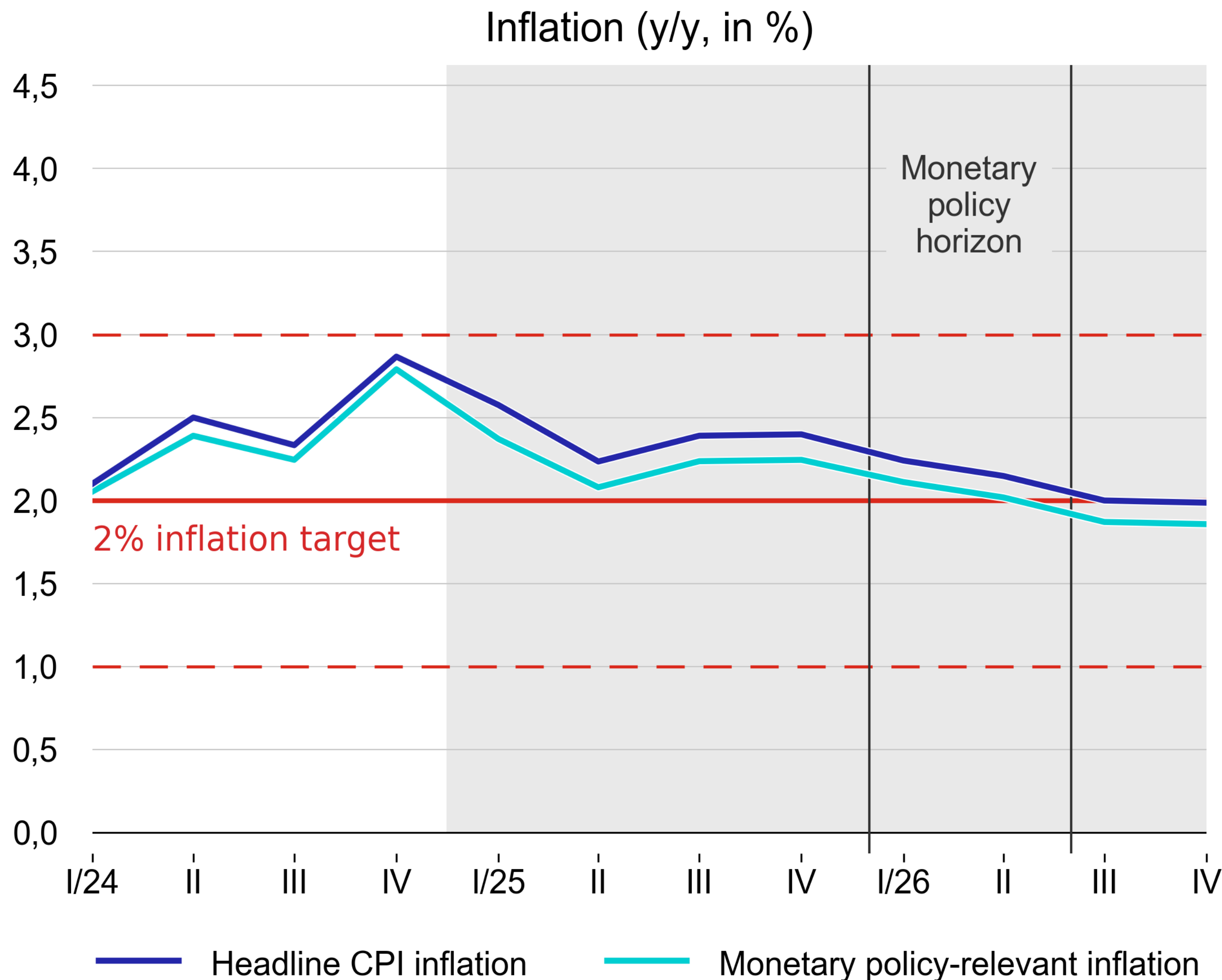
- The **effective euro area** is expected to recover only gradually starting from the half of 2025, when the headwinds in the German economy will start to abate. In annual terms, the growth is expected to increase up slightly to 0.6% in 2025 and reach 1.2% in 2026.
- In contrast, the **GDP of other trade partners** of Czechia will grow faster.
- **Industrial producer prices** are expected to return to moderate growth this year, owing mainly to energy prices.
- **Euro area interest rates** will continue to decline in the first half of 2025.
- The market outlook for the **Brent crude oil price** remains falling towards USD 70 a barrel at the end of next year.

Fiscal Policy



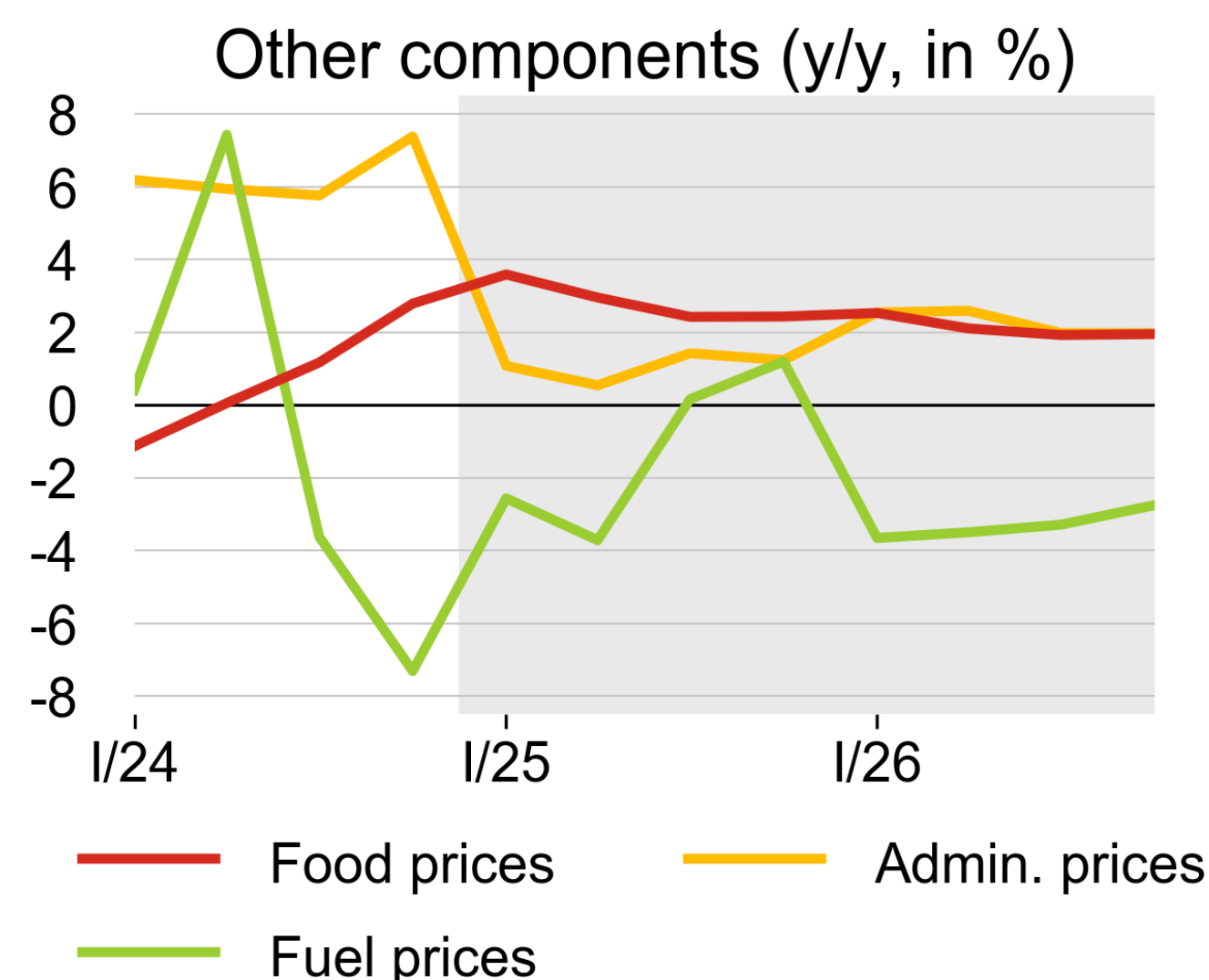
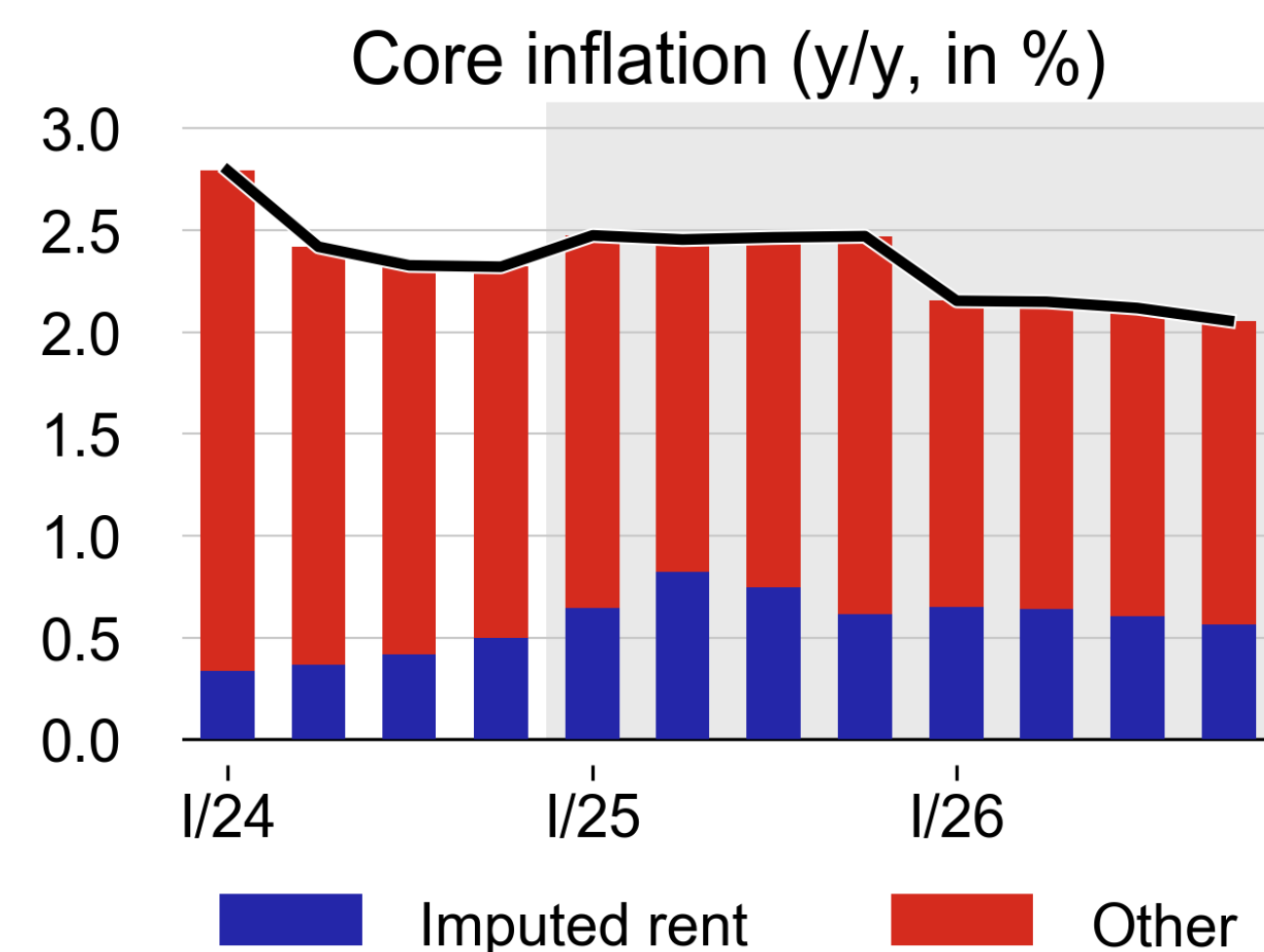
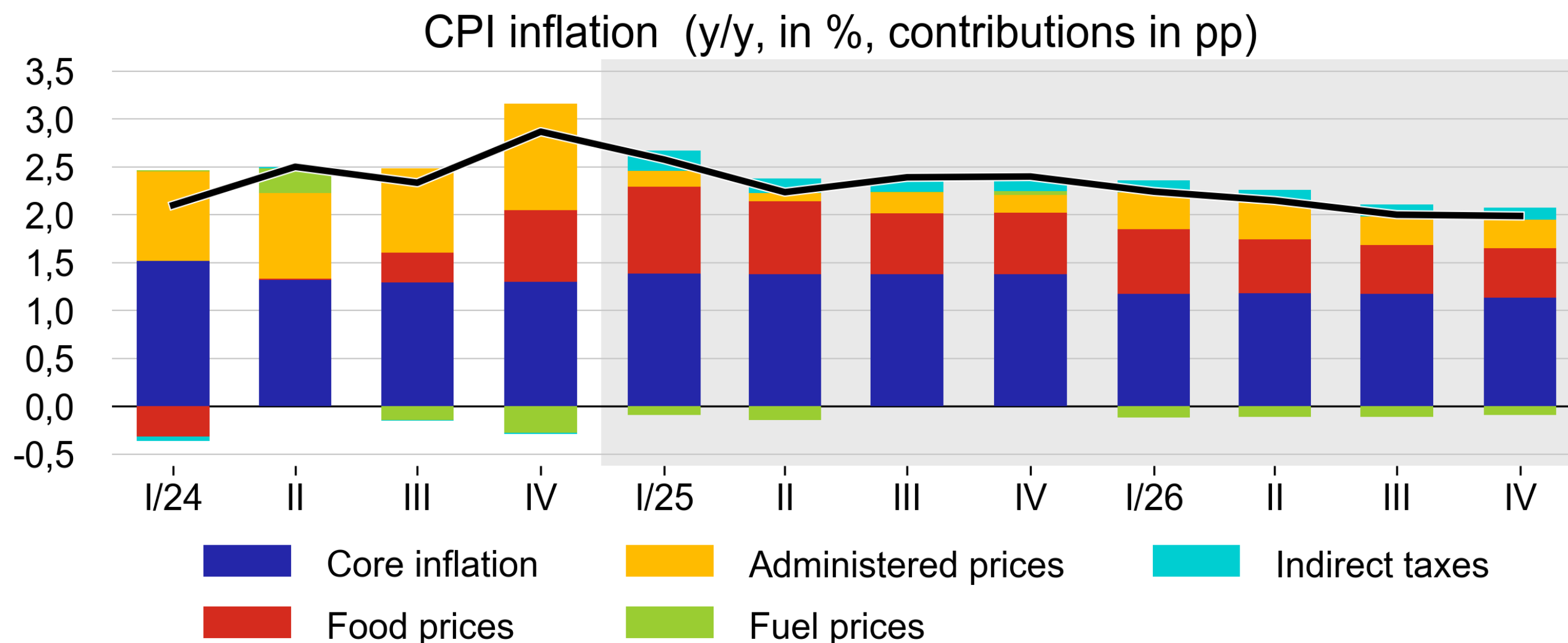
- Growth in **nominal government consumption** will slow gradually, due mainly to cuts in operating expenditures and the declining effect of extraordinary expenditures after the floods. The forecast also reflects the public sector pay rises.
- **Fiscal policy** will have a broadly neutral effect on GDP growth this year, as the ongoing moderating effect of the fiscal consolidation package will be offset by the expected faster absorption of EU funds.
- The forecast assumes that fiscal policy will have a neutral effect also next year.

Headline and Monetary Policy-Relevant Inflation



- **Inflation** is expected to slow at the start of 2025, still staying in the upper half of the tolerance band. By 2026, it will be close to the 2% target.
- Flash estimate of inflation at 2.8% creates a mild pro-inflationary risk.
- Headline inflation will be slightly above **monetary policy-relevant inflation** (excluding primary effects of indirect taxation changes) due mainly to slightly inflationary effect of increases in excise duty on tobacco and alcohol.

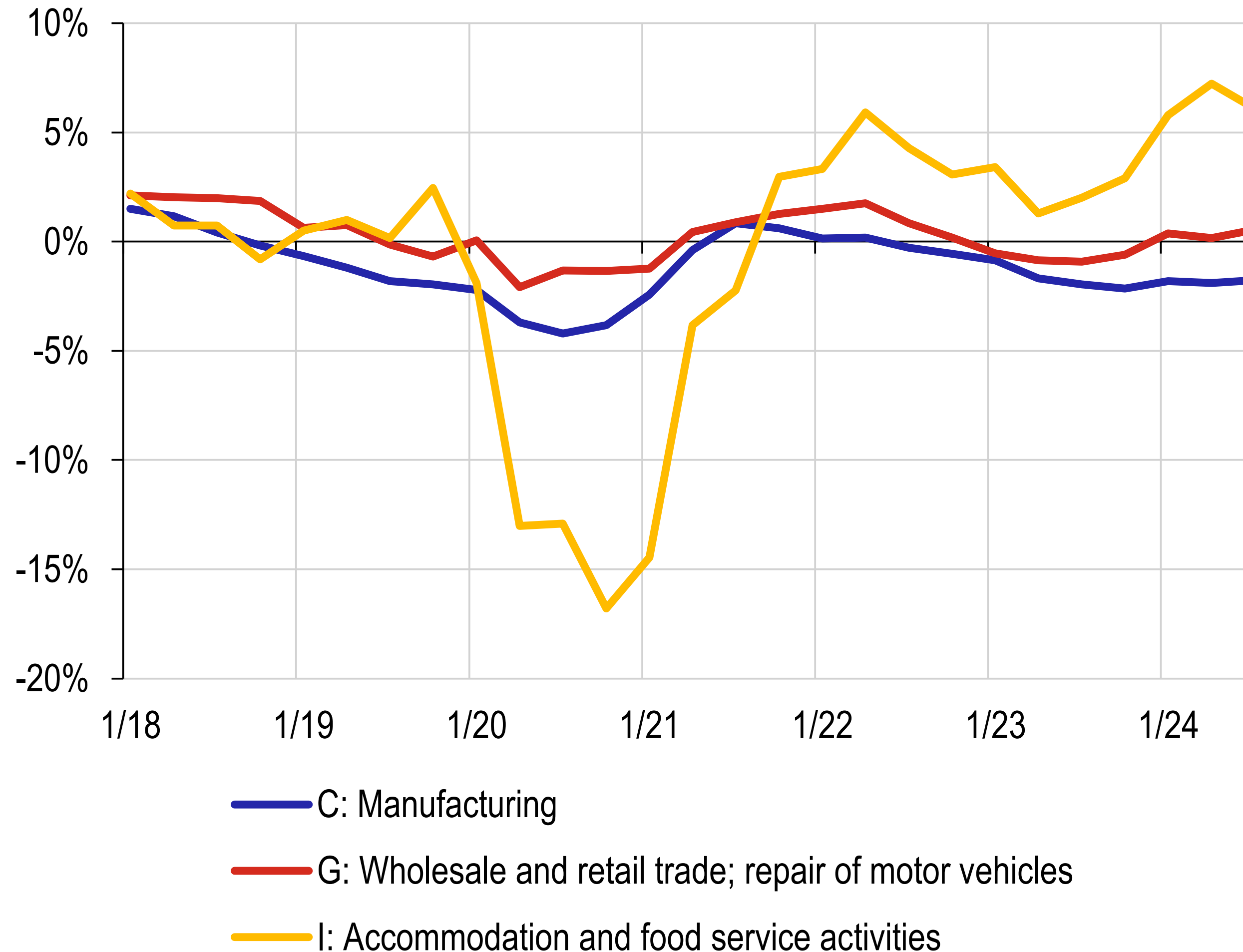
Core Inflation, Administered, Food and Fuel Prices



- **Core inflation** will stay just above 2% amid a slightly increasing contribution of imputed rent in the first half of this year.
- **Food price inflation** will remain elevated in the coming quarters due to both renewed growth in agricultural producer prices and a continued rise in prices of some food commodities.
- **Administered price** inflation is expected to fall below 2% at the start of 2025 and to stabilise close to 2% in 2026.
- **Fuel prices** will continue their y-o-y decline in the first half of 2025.

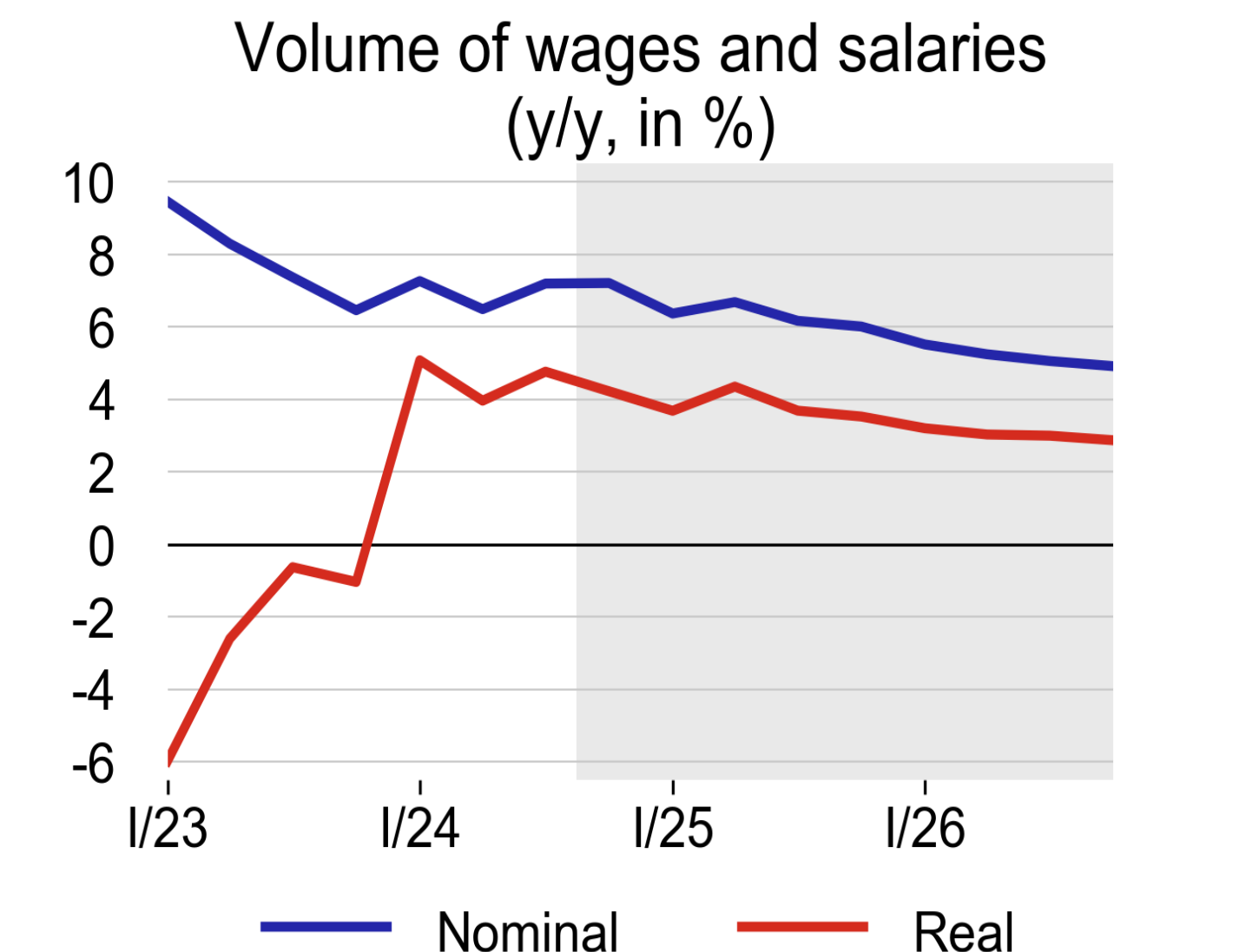
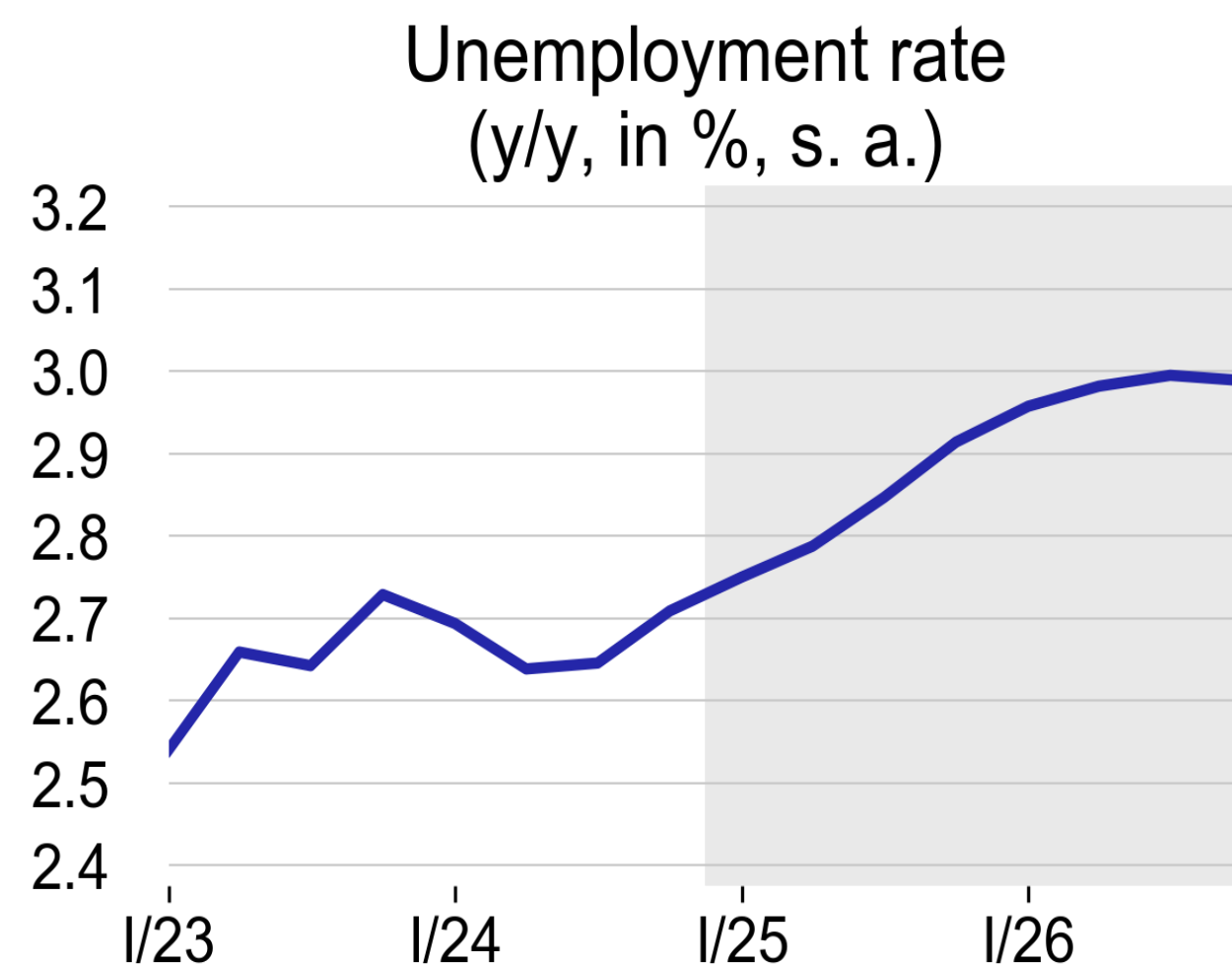
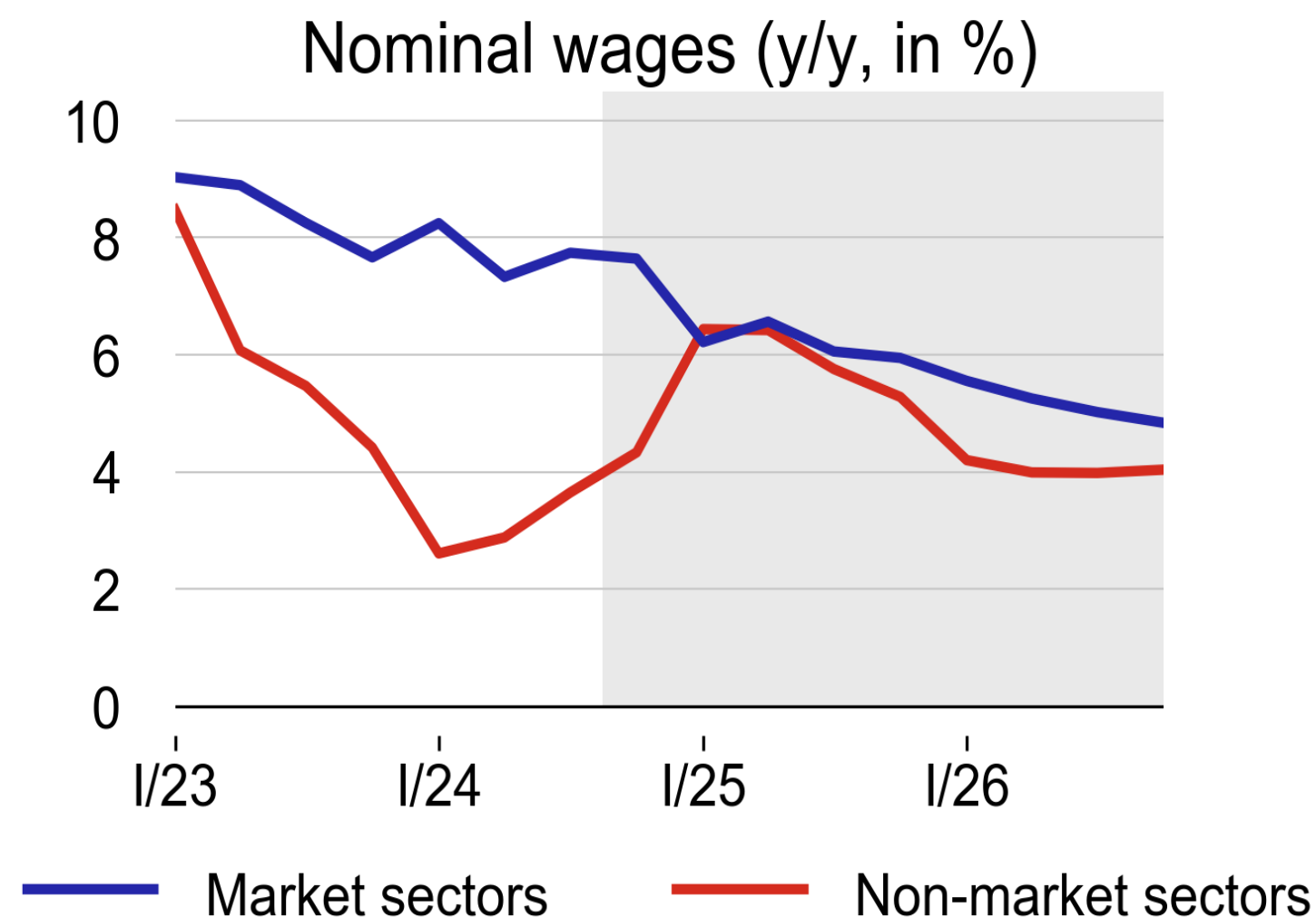
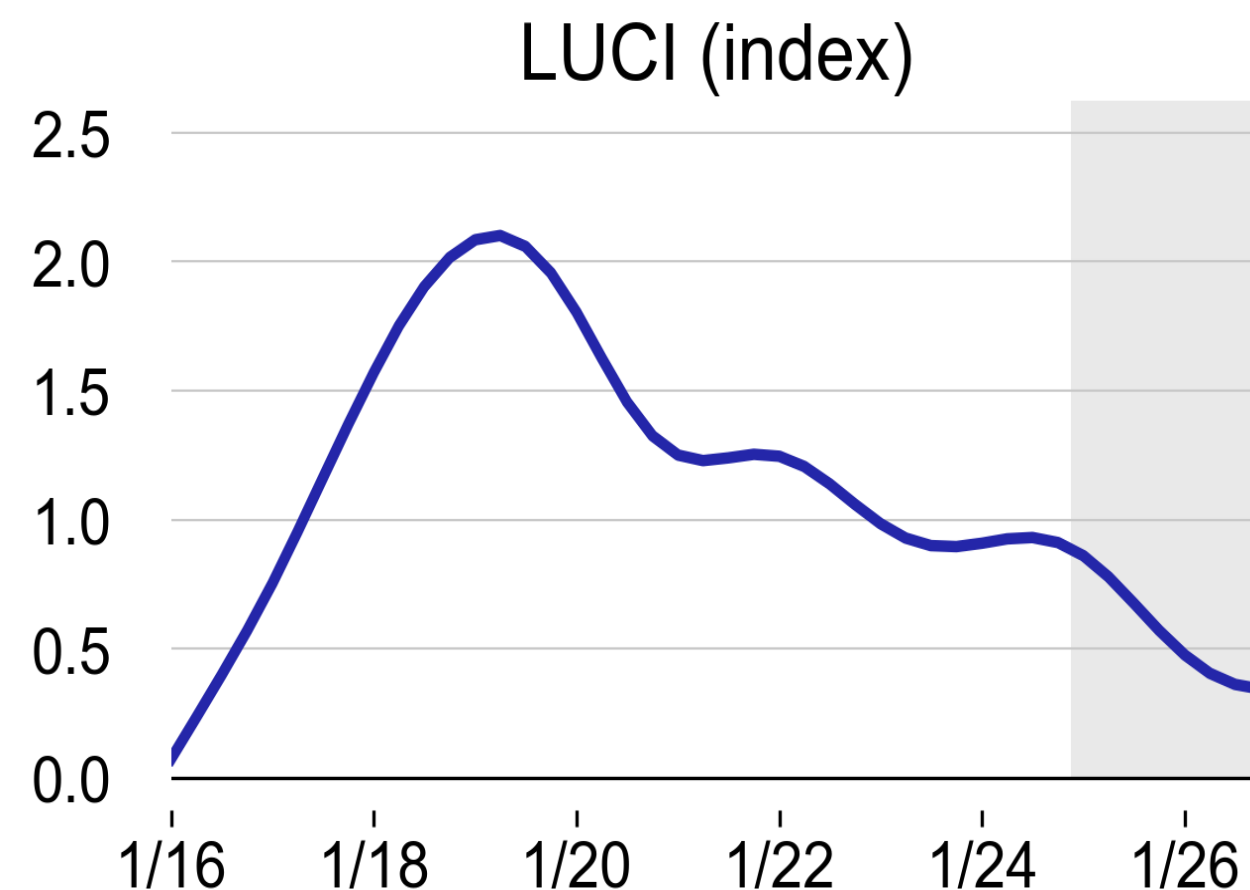
What is Happening in Core Inflation? Services!

Number of employees in selected sectors (y/y, in %)



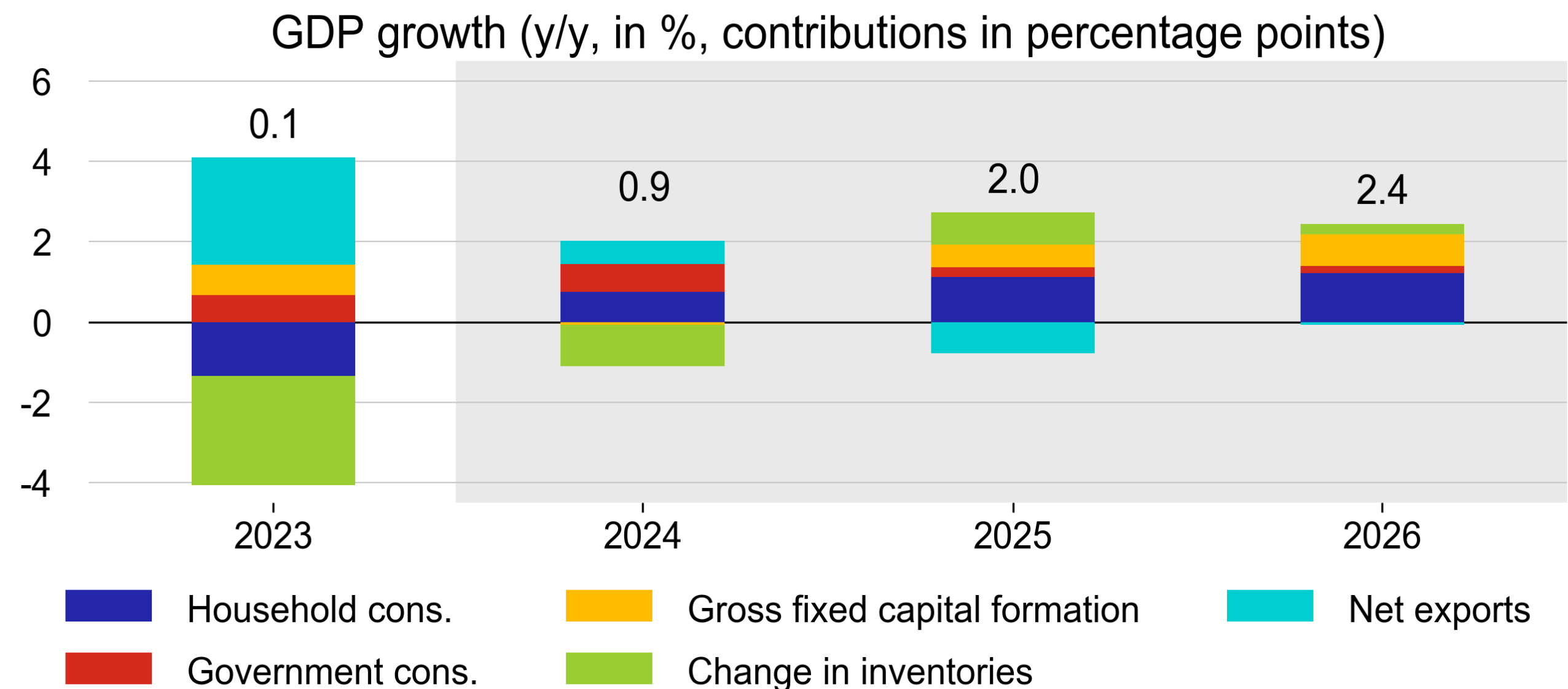
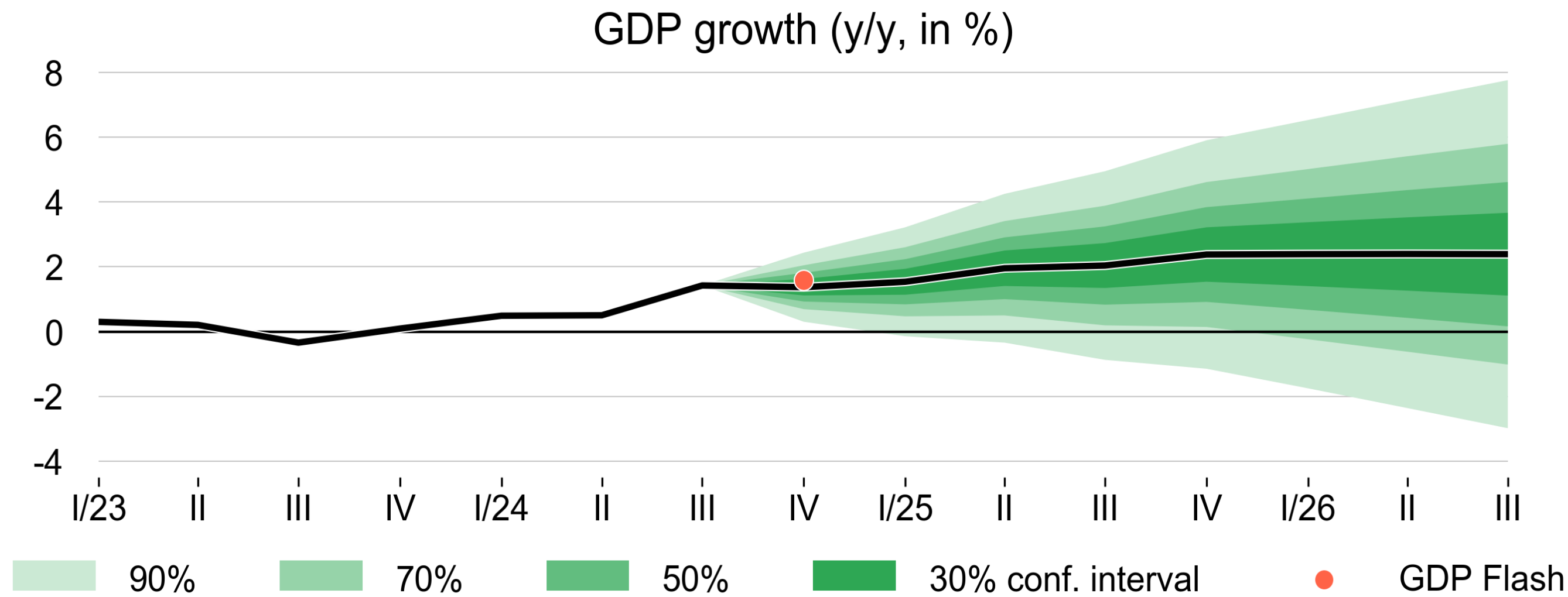
- **Structural changes of demand:**
1. From goods to services, 2. From quantity to quality
- Accommodation and food services still have **5% fewer employees** than before COVID.
- Demand for services is increasing; there is a **shortage of workers** who left the industry during COVID.
- **Wages in services often below average**, so their growth is not surprising; rising demand will allow higher cost increases to be passed on to prices this year as well.
- The nature of service consumption is changing: **higher quality, more expensive, less frequent.**

Labour Market



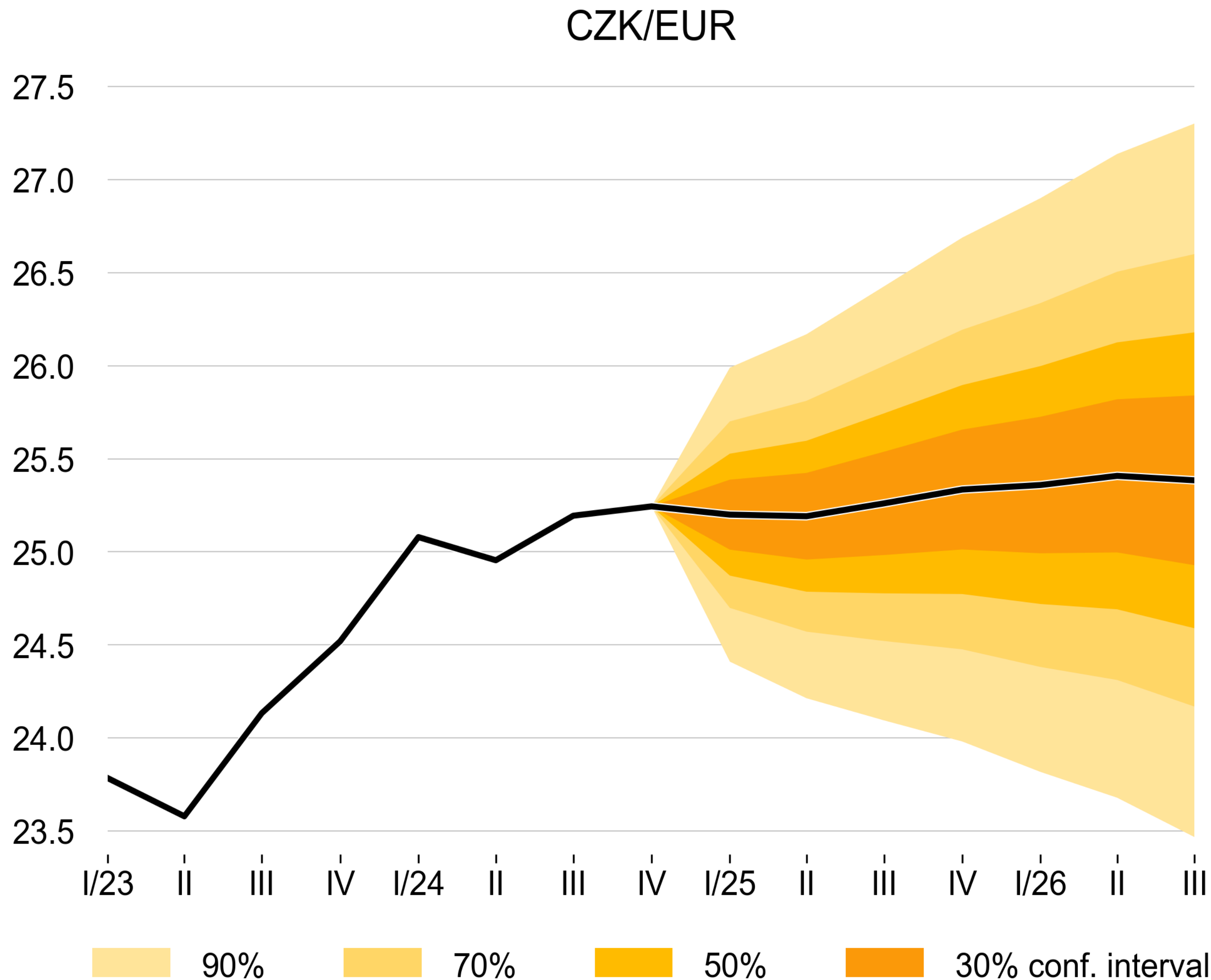
- From the perspective of the **LUCI**, the tightness in the labour market will gradually decrease in 2025.
- **Nominal wage growth in market sectors** will remain above-average from a historical perspective this year. Due to
 1. gradual economic recovery;
 2. compensation for high-inflation period;
 - 3. structural changes.**
- The forecast includes a significant rise in public sector pay in **non-market sectors** in January this year, and legislative changes to the cascade of guaranteed salaries.
- Growth in the **real wage bill** will remain elevated and fuel the growth of household consumption.

GDP Growth Forecast



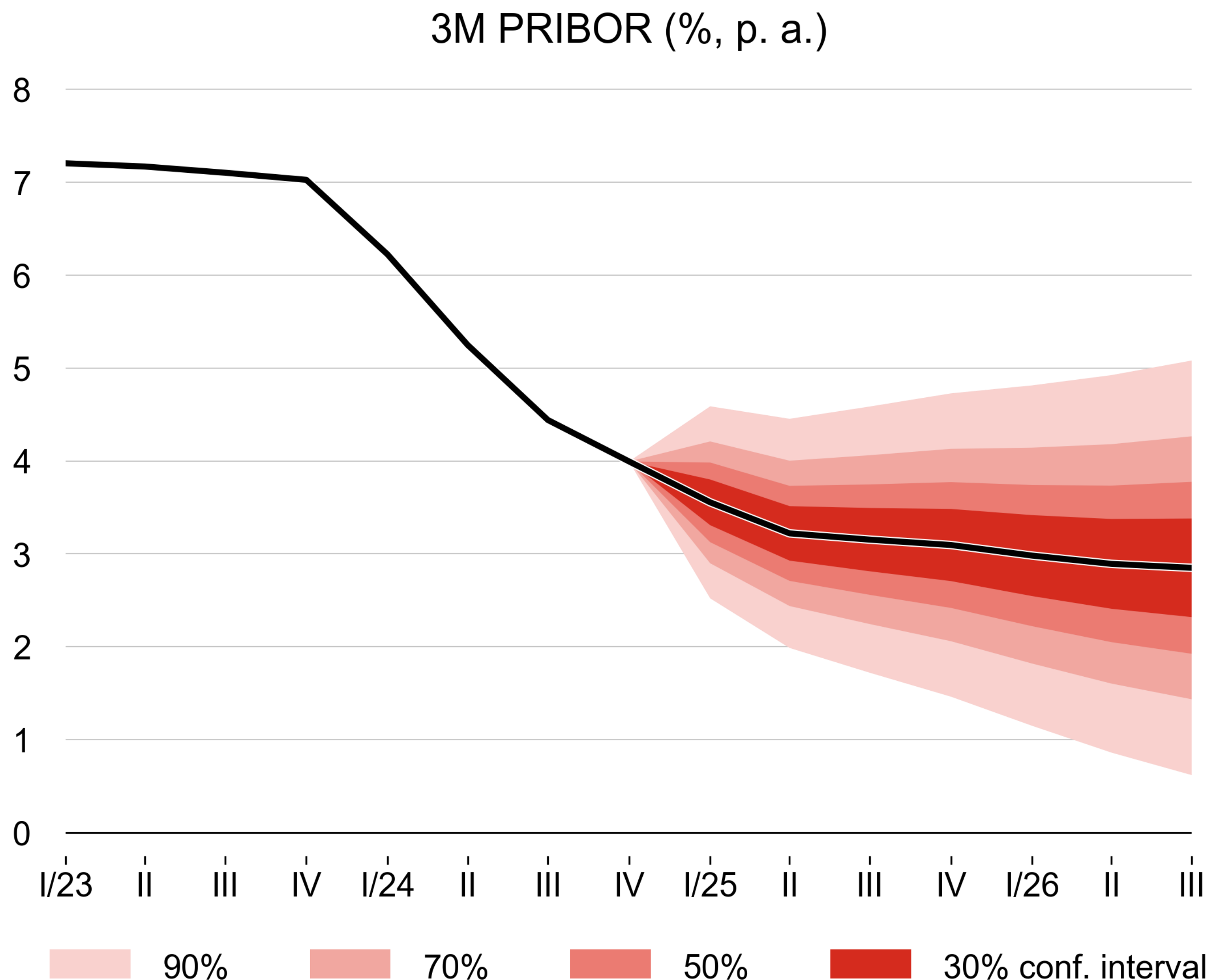
- **Economic growth** will accelerate visibly this year due mainly to recovery in household consumption and also fixed investment.
- In annual terms, **GDP** will grow by **2%** this year and the economy will still operate below its potential. The growth will pick up to **2.4%** in 2026.
- According to the CZSO's flash estimate, Czech GDP increased by **0.5%** quarter on quarter and by **1.6%** year on year in 2024 Q4. This is slightly higher than the presented CNB forecast.
- **Bad mood** seems to be gone.

Exchange Rate CZK/EUR



- The forecast expects the koruna to average **CZK 25.2** to the euro in 2025 Q1.
- The koruna will then be broadly stable at close to CZK 25.3 to the euro. This level stems from subdued growth in **labour productivity** and a reduction in the previous large **trade surplus**.

Interest Rate Path (3M PRIBOR)



- Consistent with the forecast is a continued decline in **short-term market interest rates**, followed by broadly stable rates from mid-2025 onwards.
- **Growth in costs** will remain slightly elevated this year. However, it does not eliminate the need to ease monetary policy further.
- The inflationary effect of the growth in costs will be partly offset by a **decline in firms' profit margins**, which will continue to dampen inflation.
- Inflation will thus fall to close to the **2%** target at the monetary policy horizon.
- Continued monetary easing by the ECB is also creating room for a decline in domestic interest rates.

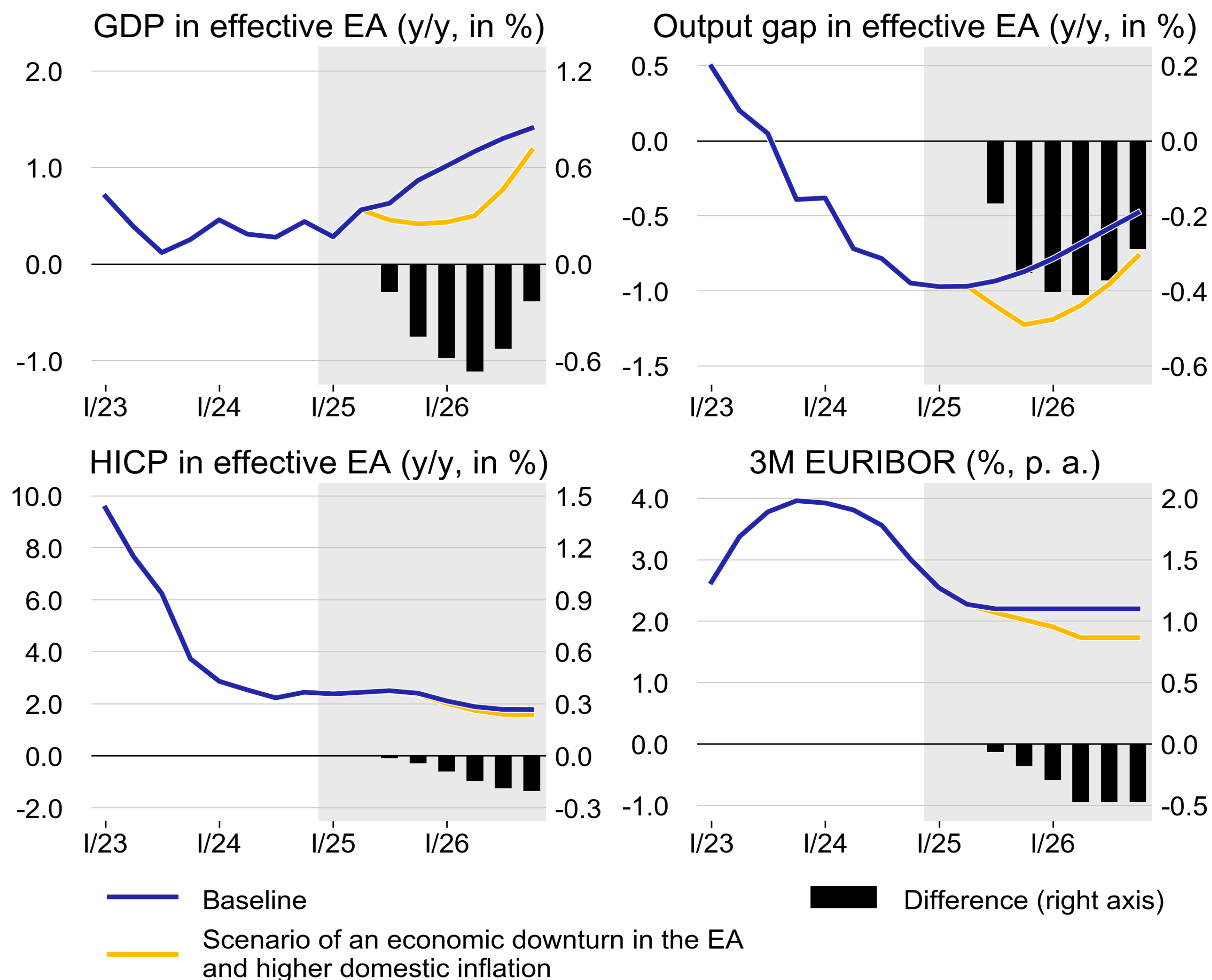
Risks and Uncertainties

- The risks to the baseline scenario (meeting the inflation target) are **slightly inflationary**.

	Probability of risk materialization	Impact on domestic inflation	Monetary policy response
Forecast risks			
Higher growth in service and food prices	medium	high	↗ tighter MP
Impacts of imbalanced developments in the real estate market	high	low-medium	↗ tighter MP
Deepening economic difficulties in the euro area	medium	medium	↘ looser MP
Key risks from the scoreboard			
Persistently deep government deficit	high	low	↗ tighter MP

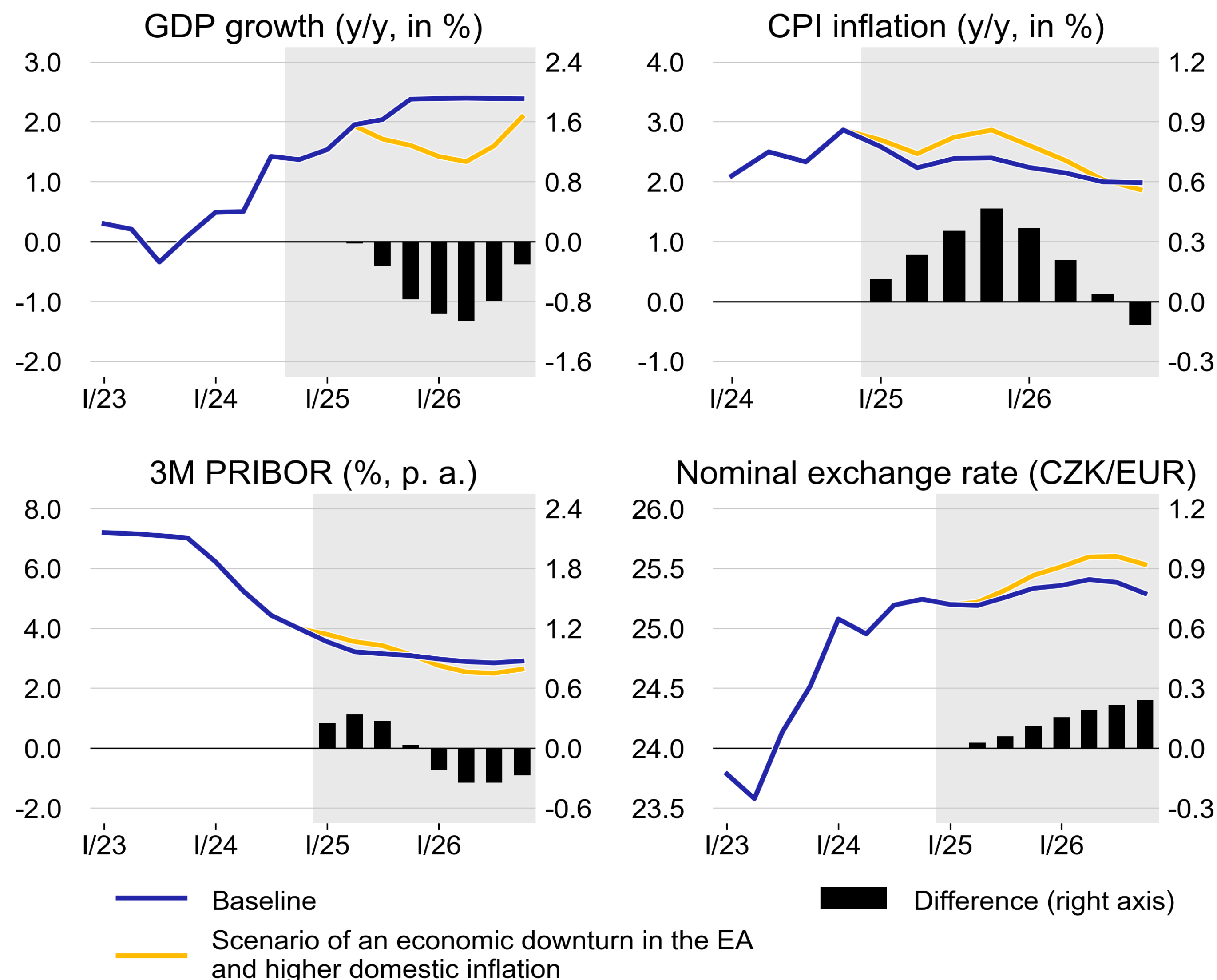
- The main uncertainty of the forecast is the **impact of the announced policies of the new U.S. administration**.

Scenario of higher domestic inflation and economic downturn in the EA: external assumptions



- This scenario assumes that inflation will remain elevated this year compared to the baseline scenario mainly due to **stronger cost pressures** (food) and **higher margins in services** + it assumes **stagnation in Germany**, which subsequently spills over to the other euro area countries.
- The **cyclical component of the slowdown** dominates, starting from mid-2025 onwards, leading to:
 - Slightly **lower inflation** in the EA, **deeper negative output gap**, and a **weaker euro against the dollar**;
 - longer downturn in **real economic activity** in the EA;
 - **looser monetary policy** of ECB.

Scenario of higher domestic inflation and economic downturn in the EA: domestic implications



- The slower growth in the EA is reflected in **lower output of the domestic economy** than in the baseline.
- The worse foreign trade with the EA fosters a **weaker koruna**.
- Despite the lower demand in the EA, the simultaneously considered higher inflation implies the simulation has a **stagflationary direction**.
- The **initially tighter monetary policy** responds to higher inflation. As the effects of subdued foreign demand, combined with lower ECB interest rates dominate, a **looser domestic monetary policy** is implied, compared to the baseline.

Winter 2025 Forecast – Summary

- **Inflation** will slow at the start of 2025 and will be in the upper half of the tolerance band of the inflation target.
- **Economic growth** will accelerate this year and will be driven by **household consumption, additions to inventories** and later also growth in **fixed investment**. By contrast, **net exports** will have a negative effect on the economy.
- Despite slowing, **nominal wage growth** will remain high from the long-term perspective.
- Consistent with the baseline scenario of the winter forecast is a continued decline in **short-term market interest rates**, followed by broadly stable rates from mid-2025 onwards.

	2024	2025	2026
Headline inflation (%)	2.4	2.4	2.1
	(-0.1)	(-0.2)	(-0.1)
GDP (%)	0.9	2.0	2.4
	(-0.1)	(-0.5)	(-0.1)
Average nominal wage (%)	6.9	6.1	5.0
	(0.6)	(0.4)	(-0.1)
3M PRIBOR (%)	5.0	3.3	2.9
	(0.0)	(0.1)	(-0.1)
Exchange rate (CZK/EUR)	25.1	25.2	25.4
	(-0.0)	(-0.2)	(-0.1)

Thank you for your attention

