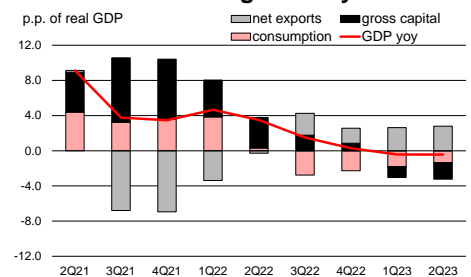


## Breathing space

- In 2Q23, real GDP ticked up in qoq terms (0.1%), leaving the pace of yoy contraction unchanged (-0.4%). Private consumption added 0.2% qoq. Government consumption maintained its momentum, expanding by 0.3% qoq. Fixed capital formation posted the first sequential rise in four quarters (3.4% qoq). The inventory change stayed deeply negative (-2.5pp of GDP yoy). Exports and imports started to shrink in qoq terms with their yoy expansion easing to 4.5% and 0.8%, respectively.
- The period started on poor footing, with major monthly macroeconomic indicators declining yoy in July. We suspect that poor July data could stem from the timing of company-wide holidays. In August, retail sales probably picked up substantially, as our payment card transaction indicator suggests. Also manufacturing PMI moved in September further away from its July bottom, helped by future output and export orders components. We predict 2Q23 GDP up 0.3% qoq (0.2% yoy).
- Domestic demand is seen playing a much bigger role as a GDP driver in 2024 than in 1H23. From the start of 2024, household real income will be rendered a boost via the decline of inflation to an estimated 3%-4% band. The government's fiscal package will raise short-term uncertainty among lower-income households but may not change their whole-year spending habits. In total, GDP is projected to rise 0.6% yoy in 2H23, accelerating to 2.1% in 2024.
- The chance for a ČNB rate cut in November looks extremely slim. We expect the policy easing to start only next year, when the ČNB will be able to evaluate year-turn consumer price adjustments. The process of rates cutting will stay cautious even thereafter, with the repo probably not dropping below 5.25% by the end of 2024.

### Breakdown of GDP growth by demand\*



\*/ Contributions to real GDP growth in percentage points  
Sources: CZSO, UniCredit Research.

Destocking gathered momentum in 2Q23, extending the occurrence of gross capital's negative contributions to yoy growth by another quarter. Consumption remained in a yoy decline for the fourth quarter running, although the pace of private consumption's contraction moderated. Of the three major GDP components, net exports were again the only one supporting GDP growth.

### REAL GDP (CONSTANT PRICES OF 2015, ADJUSTED)

	2Q23		1Q23 revised	
	YoY change	% of change in GDP*	YoY change	% of change in GDP*
<b>GDP total</b>	<b>-0.4</b>	<b>-0.4</b>	<b>-0.4</b>	<b>-0.4</b>
Household consumption (%)	-4.5	-2.0	-5.4	-2.5
Government consumption (%)	3.3	0.7	3.4	0.7
Fixed capital formation (%)	2.5	0.7	-0.8	-0.2
Change in inventories	-	-2.5	-	-1.1
Net exports	-	2.8	-	2.6

Source: Czech Statistical Office. Calculations: UCB CZ.

\*/ Real GDP in the same period of previous year

Remark: The national accounts are based on chain-linked data, which introduces a discrepancy between GDP and real demand components.

#### Authors:

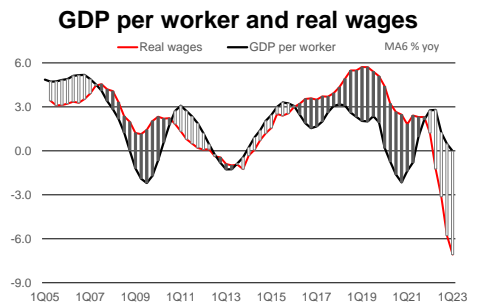
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### 2Q23: BREATHING SPACE FOR DOMESTIC DEMAND

In 2Q23, real GDP ticked up in qoq terms (0.1%), leaving the pace of yoy contraction unchanged (-0.4%). Private consumption added 0.2% qoq, moderating the yoy decline to a still deep -4.5%. Government consumption maintained its momentum, expanding by 0.3% qoq and 3.3% yoy. Fixed capital formation posted the first sequential rise in four quarters (3.4% qoq), turning to growth also in yoy terms (2.5%). All types of investment except for construction turned up, with transport equipment showing a double-digit increment (14.5% qoq, 16.2% yoy). The inventory change stayed deeply negative (-2.5pp of GDP yoy). Foreign trade started to shrink with exports and imports showing qoq -0.5% and -1.2%, respectively, and their yoy expansion easing to 4.5% and 0.8%, respectively. From the production side, yoy growth was maintained in the sectors of manufacturing, ICT and business services, whereas yoy declines continued in financials, trade & transport, industry outside manufacturing, construction and agriculture. Nominal GDP slowed an expansion to 9.7% yoy with GDP deflator slightly retreating from its 4Q22 high to 10.2% yoy. Total employment was higher by 0.8% yoy, with increments registered in all sectors but manufacturing. Hours worked saw a 0.9% yoy increase spreading over all sectors except for trade & transport and 'other services'. Gross operating surplus (GOS) and mixed income expanded by 14.0% yoy, almost twice as fast as compensation to employees (7.6% yoy). GOS and nominal GDP dynamics were helped by an all-time-high terms of trade gain in 2Q23 (2.4% of GDP in yoy terms).



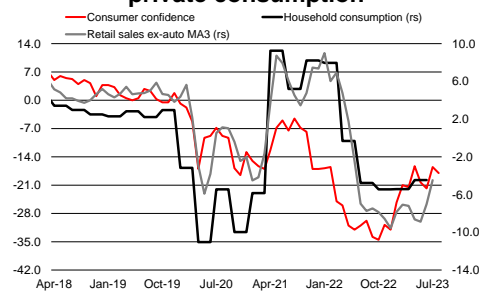
Sources: HIS Markit, UniCredit Research.

The scale of real wages contraction from 2022-2023 is unprecedented. One reason behind may be a legacy from the 2017-2020 spell when real wages were growing much faster than labor productivity.

### 3Q23: LEADING INDICATORS COUNTER HEADWINDS

The period started on poor footing, with July industrial output posting (SA yoy) -2.8%, construction output -2.1% and ex-auto retail sales -1.8%. In the same vein, the broad sector of services displayed in July yoy decreases in sales (-4.3%) and output (-3.5%), with both indicators deteriorating from 2Q23. The number of highway toll transactions, an indicator of transport intensity, was also rather weak, dropping by 2% yoy in August after being broadly flat in July. On the other hand, car sales and repairs increased by 4.9% yoy in July, while new car registrations added 12.9% yoy in August. Also manufacturing PMI moved in September further away from its July bottom, helped by future output and export orders components. We suspect that poor July data was affected by the timing of company-wide holidays, which more people spent abroad than during the 2022 summer. In August, retail sales probably picked up substantially, as our payment card transaction indicator suggests. An additional factor to consider are new supply-chain disruptions in the car manufacturing. These appear to be resolved much faster than in the previous chip crisis, but they may still drag on 3Q23 GDP. All in all, we expect the consumer spending upturn to prevail over other factors, pushing the 2Q23 GDP up 0.3% qoq (0.2% yoy).

### Consumer confidence, retail sales and private consumption



Sources: CZSO, UniCredit Research.

With consumer confidence picking up from the bottom and the contraction of retail sales moderating, private consumption is hoped to start performing better from 3Q23.

## 2024: GRADUAL PICK-UP OF HOUSEHOLD SPENDING

Indications are mounting that the external environment will not be much supportive for the Czech economy in short-term, with GDP forecasts in Europe decreasing, demand in China still depressed and, newly, the oil price spike threatening to slow the global economy. Subsequently, we expect Czech exports to just stagnate in 2H23, reverting to meaningful growth only later in 2024. By then, the export growth could also be supported by the global value chains relocating their output away from Asia to Europe, including Czechia.

In terms of GDP structure, the inventory rundown will be ongoing, as the inventory stock remains excessive by historical standards, which is a legacy of the supply-side crisis from 2021-2022. In terms of GDP, an inventory change may broadly net off with lower imports, keeping net exports slightly supportive of growth in 2024.

However, domestic demand is seen playing a much bigger role as a GDP driver in 2024 than was the case in 1H23. Of the GDP domestic components, private consumption is set to become a leader. In 2H23, real wages are expected to stay broadly flat after their continuous decline for seven quarters. This would probably not be sufficient to turn private spending to growth, had it not been for excessive household savings from the Covid era. Nevertheless, there is evidence that part of households used that financial source to restore purchasing goods for recreation in a larger scale in the summer. We expect the trend of boosting purchases other than that of basic needs to extend through the rest of 2023 which, considering the severely depressed 2022 levels, may boost real private spending in 2H23 by 2% yoy.

From the start of 2024, household real income will be rendered an additional boost via the decline of inflation to an estimated 3%-4% band. With the dynamic of nominal wage growth lagging behind the inflation momentum, resources of households to boost spending should jump particularly in 1H24. Admittedly, this will occur at the same time as effects of the government's fiscal package set in. The package is hoped to ease imbalance in the government finances by CZK 95 billion (1.2% of GDP) in 2024. That said, only a smaller part of the savings should come from the household sector and hence, we expect the measure to raise short-term uncertainty among lower-income households but not to change their whole-year spending habits.

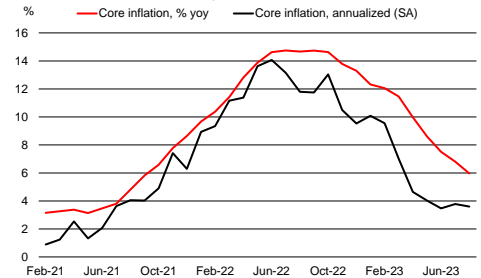
Fixed capital formation is projected to grow only marginally over the period. In terms of financial restraints for capital spending, bank credit interest rates will be viewed as prohibitive by some corporates in both CZK and EUR, but many of them can still rely on sufficient own sources.

In total, GDP is projected to rise 0.6% yoy in 2H23, accelerating to (a still unimpressive dynamic of) 2.1% in 2024.

## POLICIES: RATE CUTS TO START MOST LIKELY IN MARCH, FISCAL TIGHTENING WILL BE LIMITED

The ČNB decision makers were in favor of keeping the repo rate unchanged at 7% unanimously for the first time in August and we have no

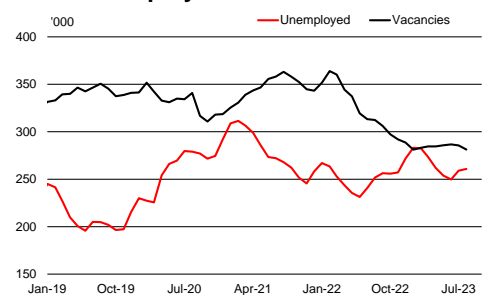
### Czech core CPI – year-on-year versus monthly annualized



Sources: CZSO, Macrobond, UniCredit Research.

A traditional view on inflation via the year-on-year price comparison may delay spotting abrupt changes in the price development, as those could be masked by a previous year's base. Our alternative indicator – core monthly annualized CPI – removes the disadvantage. It shows that inflation has been lately moving just below 4% without a tendency to decline further.

### Unemployment and vacancies



Sources: Czech Ministry of Labor, UniCredit Research.

Despite recent poor performance of the Czech economy, the number of vacant job positions continues to exceed the number of unemployed. Admittedly, the gap has turned narrower, which is attributed to a smaller number of new jobs opening as well as the employment of refugees from Ukraine.

doubt to see the same outcome in September. Further down the road, the chance for a cut in November looks extremely slim. We expect the policy easing to start only next year, when the ČNB will be able to evaluate year-turn consumer price adjustments. With CPI, in our forecast, hovering above the 1% to 3% tolerance band of the ČNB for most of 2024, the process of rates cutting will stay cautious even thereafter and the repo may not drop below 5.25% by the end of 2024.

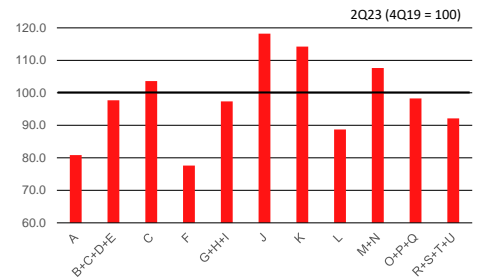
Fiscal policy is likely to play only a marginal role in the central bank's decision making. The government's package of measures, aimed to ease the state budget imbalance by CZK 95 billion in 2024, is still in the legislative process, but no major changes from an initial draft are assumed. However, we expect the government budget deficit to narrow only by CZK 40-50 billion, as one-off income sources were targeted in 2023, reducing the base for deficit. Thus, structural imbalance may remain above 2% of GDP beyond 2024, urging for more fiscal measures in future.

### FOCUS: WHY CZECH ECONOMY UNDERPERFORMS

In 2Q23, Czechia was the only EU-27 country with GDP not yet attaining to its pre-pandemic 4Q19 level. Looking at GDP demand side components, it is almost exclusively private consumption to blame, with its level below the respective peak by 8.3%. The consumption slump corresponds to the spell of real wage contraction, lasting already for seven quarters. However, it remains non-trivial to explain why the typical adjustment of nominal wages to inflation has been incomplete or delayed in Czechia. We submit two reasons, with each of them possibly adding to the overall story. Firstly, companies offered their employees (and they accepted it) a sub-standard pay rise in 2021 in exchange for a permanent tax base reduction called "cancelling the super-gross wages". However, low-income households benefited disproportionately little from the measure, which dragged the overall consumption. Secondly, Czechia's lagging in the real wage dynamic behind the others followed a period of its record-high real wage growth that was not justified by labor productivity and was set to terminate in 2020 anyway. Thus, we may conclude that Czechia is now paying the price for policy mistakes from the past.

From the production side of GDP, what may hinder economic growth could be a sticky sectoral structure, preventing an optimal allocation of resources - human or financial. Our preferred indicator to help identify this is real gross value added (GVA) per worker. Indeed, staggering differences among sectors can be found. Four out of the 11 sectors in the basic breakdown managed to boost the indicator since 4Q19. The list includes ICT, financials, business services and manufacturing. Growth in the first two mentioned sectors was even double-digit. By contrast, GVA per worker in three other sectors – real estate services, agriculture and construction - dropped by more than 10% over the same period. Combining this relative metric with an information on the actual size of GVA per worker may exclude real estate services from our focus due to its low employment. However, construction stands out among sectors, with real GVA declining and employment (including hours worked) rising over time. A hypothesis emerges that the shadow economy excels there.

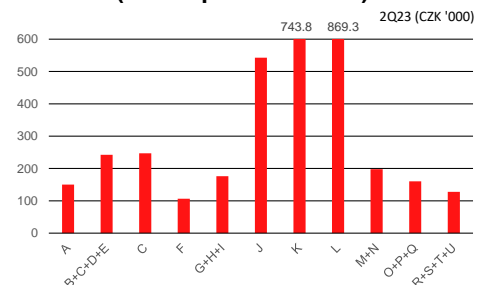
Index of real GVA per worker by sector since 4Q19



Sources: UniCredit Research, CZSO  
Breakdown of sectors: see below

In 2Q23, gross value added per worker remained by 2.9% below the level of 4Q19 for the whole Czech economy. While some sectors defied this negative trend, construction saw a drop by a whopping 22.4%.

Real GVA per worker by sector in 2Q23 (const. prices of 2015)



Sources: UniCredit Research, CZSO  
Breakdown of sectors: see below

In 2Q23, real gross value added per worker by sector at constant prices of 2015 varied eightfold among basic sectors, ranging from CZK 106.5 thousand for construction to CZK 869.3 thousand for real estate services. These huge gaps should be utilized to define a sectoral policy focus, from which the whole economy would benefit.

A – agriculture; B – mining; C – manufacturing; D – electricity, gas, climate air; E – water, waste; F – construction; G – wholesale, retail sale; H – transport, storage; I – hotels, restaurants; J – information, communication; K – banking, insurance; L – real estate; M – professional, scientific activities; N – administration; O – public services; P – education; Q – healthcare; R – culture, recreation; S – other; T – households' activities; U – extraterritorial organizations

# Czechia Macroeconomic Outlook

	2020	2021	2022	2023 forecast	2024 forecast
GDP growth (real yoy change, %)	-6.4	3.5	2.4	0.1	2.1
Household consumption (real yoy change, %)	-7.2	4.1	-0.7	-1.8	3.0
Gross fixed capital formation (real yoy change, %)	-6.0	0.7	3.0	1.2	1.8
Industrial output (real yoy change, %)	-7.2	6.9	2.5	-0.5	3.0
Unemployment rate (average, %)	3.6	3.8	3.4	3.7	3.6
Inflation rate (CPI yoy change, average, %)	3.2	3.8	15.1	11.1	3.8
Average wages (nominal yoy change, %)	4.6	4.8	6.5	8.8	7.0
Interest rates (3-M PRIBOR, end of period, %)	0.35	3.50	7.26	7.10	5.35
Interest rates (3-M PRIBOR, average, %)	0.86	1.13	6.28	7.17	6.40
EUR/CZK exchange rate (end of period)	26.25	24.86	24.12	24.30	24.60
EUR/CZK exchange rate (average)	26.44	25.65	24.57	23.95	24.40
Current account balance (% of GDP)	2.0	-2.8	-6.1	-1.7	-0.2
FDI net inflow (% of GDP)	2.6	0.5	2.5	2.3	2.1
General government balance (% of GDP)*	-5.8	-5.1	-3.6	-4.8	-3.6
Public debt (% of GDP)	37.7	42.0	44.1	45.2	46.0

Remarks:

\*/ ESA 2010 definition.

Sources: Czech National Bank, Czech Statistical Office.

Forecasts: UniCredit Bank CZ.

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