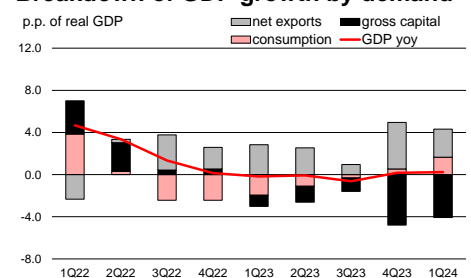


Waiting for a second phase

- In 1Q24, real GDP expanded by 0.3% qoq, maintaining the pace of yoy growth unchanged at 0.2%. Private consumption further accelerated to 1.0% qoq, bringing the yoy momentum to a positive 2.1%. Government consumption reported a rise of 3.5% yoy. Fixed capital formation by contrast posted the first yoy contraction (-2.7%) since 1Q21. Inventories continued to be a drag on GDP, subtracting 3.4pp from yoy growth. Net exports added 2.7pp to GDP growth on real exports accelerating to 2.5% while imports shrinking by 1.1% yoy.
- The economic recovery seems to be ongoing, as most calendar-adjusted real-activity data for April showed improving yoy dynamics versus 1Q24. However, the April data needs to be taken with a pinch of salt due to an unusually large, three working-days addition following the same deduction from March in yoy adjusted series. In our view, the recovery momentum may be somewhat underrated by the circumstance. We predict 2Q24 GDP at 0.7% qoq as well as yoy.
- We reduced our 2024 GDP-growth forecast to 1.3% from 1.5% due to a downward revision in official 1Q24 GDP data as well as our poorer outlook for investment. We have shifted our 2025 forecast upwards by the same amount, to 2.7%. We expect inflation to stay within the 2-3% band for most of 2024-25.
- We expect the pace of ČNB rate cuts to stay reduced to 25bp per policy meeting, in line with the central bank's own assumptions until mid-2025. Where we differ from ČNB's views is for 2H25, as we assume the repo reaching 3.5% in mid-2025 to be the terminal rate for the current rate-cutting cycle.

Breakdown of GDP growth by demand*



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

In 1Q24, gross capital largely subtracted from GDP and net exports highly contributed to it for the second time in a row. What came different from 4Q23 was a positive input from consumption, driven not only by government but also private spending.

REAL GDP (CONSTANT PRICES OF 2015, ADJUSTED)

	1Q24		4Q23 revised	
	YoY change	% of change in GDP*	YoY change	% of change in GDP*
GDP total	0.2	0.2	0.2	0.2
Household consumption (%)	2.1	0.9	-0.5	-0.3
Government consumption (%)	3.5	0.7	3.8	0.8
Fixed capital formation (%)	-2.7	-0.7	6.2	1.7
Change in inventories	-	-3.4	-	-6.4
Net exports	-	2.7	-	4.4

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:

Pavel Sobisek
Tel: +420 605 236 570
E-mail: pavel.sobisek@unicreditgroup.cz

Jiří Pour
Tel: +420 602 937 576
E-mail: jiri.pour@unicreditgroup.cz

UniCredit Bank Czech Republic and Slovakia
Internet: www.unicreditbank.cz

1Q24: Fixed investment becoming a drag

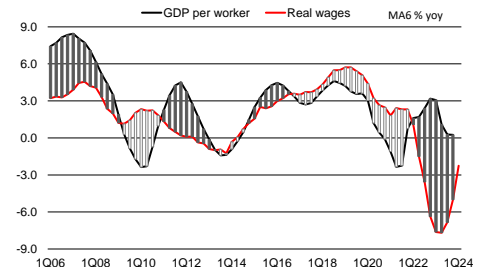
In 1Q24, real GDP expanded by 0.3% qoq, maintaining the pace of yoy growth unchanged at 0.2%. Private consumption further accelerated to 1.0% qoq, bringing the yoy momentum to a positive 2.1%. Government consumption remained the fastest-growing demand-side component with a rise of 3.5% yoy. Fixed capital formation by contrast posted the first yoy contraction (-2.7%) since 1Q21, with all types of investment but transport equipment losing yoy momentum. Inventories continued to be a drag on GDP, subtracting 3.4pp from yoy growth. Net exports added 2.7pp to GDP growth on real exports accelerating to 2.5% yoy due mainly to services while imports shrinking by 1.1% yoy. From the production side, gross value added (GVA) contracted by 0.7% yoy on subsidies being cut by 27.4% yoy from the base period affected by the energy crisis. Most sectors recorded yoy declines in GVA, with exceptions being financials (4.9%) and real estates (flat). Nominal GDP expanded by 3.9% yoy, the lowest pace since 1Q21. GDP deflator slowed to 3.7% yoy. Total employment rose by 0.3% yoy with the number of employees staying almost flat, while the number of self-employed adding 1.4% yoy. Labor productivity per worker fell marginally (-0.1% yoy) but rose per hour worked (+0.8% yoy). Gross operating surplus and mixed income in current prices contracted (-0.8% yoy) for the first time since 3Q20, while compensation of employees grew by 6.1% yoy, showing no slowdown versus the previous dynamic.

Two striking, and possibly interconnected features in the latest data include the poor investment appetite and the declining gross operating surplus. A hypothesis could be that public sector investment tumbled temporarily due to a shift of EU funding from one to another budgeting period. For the moment, we are missing in the data the breakdown of fixed capital formation between public and private sectors. However, the magnitude of the downside in total investment, along with a breakdown by its type, almost excludes the possibility that only government investment is to blame. Rather, financial results of companies added to the observed investment weakness.

2Q24: Working-day-adjustment uncertainty looming

The economic recovery seems to be ongoing, as most calendar-adjusted real-activity data for April showed improving yoy dynamics versus 1Q24. Industrial output eased its decline to -0.4% from -0.9% seen in 1Q24. Construction output improved to -0.3% in April from the 1Q24's -4.3%. Sales in services grew by 2.4% yoy, while in 1Q24 the dynamic was only 1.0% yoy. Retail sales (ex-car) expanded by 5.3% yoy as against 3.9% yoy for 1Q24. The sales expansion may have continued in May at a similar pace, as indicated by figures from payment card transactions. Manufacturing PMI hit 46.1 in May, a level still pointing to a contraction in activity but a more moderate one than in 2023. New car registrations added 6.6% yoy in April before falling by 3.1% yoy in May. Importantly, the April data needs to be taken with a pinch of salt due to an unusually large change in the number of working days. Three days more were counted against last April, following the opposite change of the same magnitude from March. In our view, the recovery momentum in adjusted terms may be somewhat underrated by the circumstance. We predict 2Q24 GDP at 0.7% qoq as well as yoy.

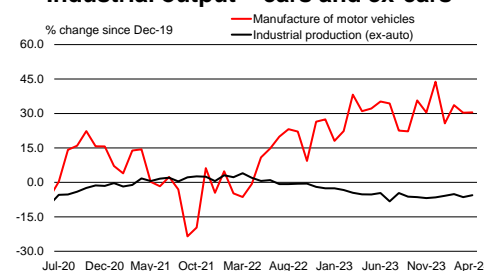
Productivity and real wages in Czechia



Sources: CZSO, UniCredit Research.

Following the sharp adjustment over last two years, real wages have realigned with productivity. This removes one obstacle from a future rise in real wages, although productivity gains remain as a key condition.

Industrial output – cars and ex-cars



Sources: CZSO, UniCredit Research.

The sector of motor vehicles, with its output rising by a third since the end of 2019, prevents the overall industrial output from contracting sharply. Excluding the car segment would leave the overall production 7% below the pre-covid level.

2H24: Waiting for a second phase in the rebound

Three factors have slowed **real spending** in 1Q24. First, income and property tax adjustments have not directly affected inflation but have still reduced household purchasing power. Second, wage increases probably disproportionately favored higher earners who have a lower propensity to spend. Third, servicing of household debt has become more expensive, while interest income from bank deposits has peaked. We think the same mitigating factors will continue to detract from household spending through the rest of 2024, while real wages will have limited space to accelerate further. That said, consumption growth may speed up in 2025 to exceed 3%, unless it is threatened by a fresh inflation surge.

As to the weakening of **fixed-capital formation**, data released thus far do not yet point to an ultimate culprit. However, a breakdown by type of capital almost excludes the possibility that only government investment is to blame. Indeed, gross operating surplus and mixed income ceased to grow in 1Q24, reducing the corporate sector's ability to invest. Going forward, a boost in investment activity will require not only improvement in companies' financial results but probably also improvement in external demand. Government infrastructure projects may gradually gather momentum, employing available EU money, but that will not act as a game changer in terms of activity. Neither will private-housing construction, although we view its 1Q24 upturn as no coincidence. In total, we think fixed-capital formation is set to dip in 2024 and to resume growth only in 2025, launching a second phase of the economic recovery.

With 46% of Czechia's GDP being dedicated to meeting external demand, sustainable economic growth can hardly be reached without an upturn in **demand in key export markets**, notably Germany. Indeed, we expect to see cyclical improvement in 2H24 there, but recent leading indicators suggest that this will be gradual. Therefore, we remain rather cautious with regard to projecting faster real-export growth before 2025.

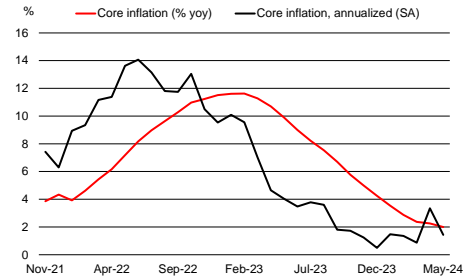
These factors, along with a downward revision in official 1Q24 GDP data, led us to reduce our 2024 **GDP-growth forecast** to 1.3% from 1.5%. We have shifted our 2025 forecast upwards by the same amount, to 2.7%.

We expect **inflation** to stay within the 2-3% band for most of 2024-25. Only December 2024 could be an exception, with inflation expected to overshoot (above 3%) due to an adverse base effect. There seems to be little demand-side inflationary pressure at the moment, while cost factors have been lifting particularly prices for services (5.3% yoy for May). From the FX side, the koruna's firming below EUR-CZK 25.0 in April and May should theoretically help deflate prices, but the effect will remain marginal, not least because we expect EUR-CZK to correct higher before year-end.

ČNB policy: Cuts to stay reduced to 25bp per meeting

The ČNB's outlook on inflation does not appear to be an obstacle to further interest-rate cutting. We nevertheless expect the pace of cuts to stay reduced to 25bp per policy meeting, which is in line with the central bank's own assumptions until mid-2025. Where we differ is for 2H25, as we

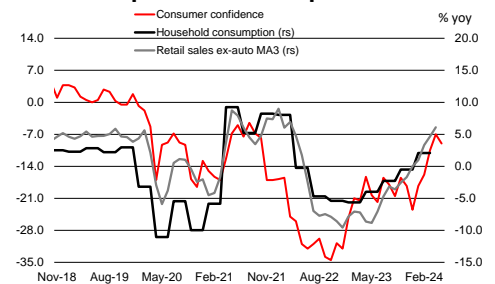
Czech core CPI – yoy versus monthly annualized



Sources: CZSO, UniCredit Research.

Our favorite measure of inflation - the monthly annualized core CPI index – exceeded yoy core inflation for the first time in April before retreating to 1.4% in May. Nevertheless, recent figures suggest that annualized inflation has already bottomed for this economic cycle.

Consumer confidence, retail sales and private consumption



Sources: CZSO, UniCredit Research.

Recent gains in private consumption look consistent with consumer confidence and retail sales. There seems to be a space for an additional moderate acceleration in private spending.

assume the repo will reach 3.5% in mid-2025 and that this will be the terminal rate for the current rate-cutting cycle, while the ČNB expects policy easing to continue in 2H25. Our more-cautious repo-rate outlook is consistent with our stickier-inflation forecast.

Focus: Czechia lagging behind in labor productivity

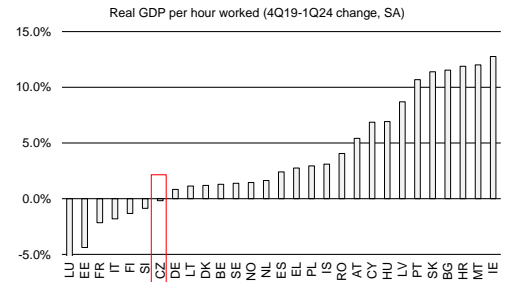
Czechia strongly lags behind most EU economies in the evolution of labor productivity. It wasn't always like that. While in 2008-2019, Czechia's increase in real GDP produced per hour of work was the 11th best out of 31 countries, in the period starting just before the Covid-19 (4Q19-1Q24) Czechia ranked the 7th worst with a decrease of 0.2%. Then, only Luxembourg (-5.4%), Estonia (-4.4%), France (-2.1%), Italy (-1.8%), Finland (-1.3%) and Slovenia (-0.9%) underperformed Czechia. Eurozone countries' productivity increased by 0.7% on average, of which Germany's by 0.8%. Among the countries of the CEE region, an hour of work generated GDP higher versus the base period by 2.9% in Poland, 6.9% in Hungary 6.9% and 11.4% in Slovakia.

How disturbing is poor productivity? Its growth is not only a necessary condition for economic convergence or international competitiveness. We also rely on it in maintaining the living standard of pensioners: if, for example, there is to be a one-third fewer earners (20-66 years) per one pensioner (67+) in 2060 than now, then simply to keep the current real level of pensions we need a 1.1% average annual productivity growth, other parameters staying unchanged. In 2008-2019, productivity grew by 1.4% per year on average, which would be just enough to maintain real value of pensions. But what if the economic model has been already exhausted, with productivity in future struggling to grow?

In a sectoral view, the biggest drag on productivity in 4Q19-1Q24 (considering weights in GDP) came from construction with a decrease of 23.3% (and simultaneously hours worked adding 3.3%), trade and transport (-3.6% and +3.1%) and real estate activities (-7.3% and +4.2%). The key drivers of productivity were IT services with productivity higher by 16.9% (hours worked by 9.3%) and the financial sector (23.9% and -15.9%). Services in total showed productivity growing by an acceptable 2.7% with hours worked adding 1.5%. Productivity in industry rose by a modest 0.4% with hours worked declining 6.1%. However, that was strongly affected by a falling output in the specific segments of electricity, gas and heat, as well as mining, whereas manufacturing alone displayed respectable growth of productivity at 7.3% with hours worked declining by 6.3%.

Good news is that manufacturing, as a pillar of the Czech economy, has been able to maintain productivity growth. Bad news is that some other important sectors have been struggling. One explanation is that many businesses have regarded the recent series of economic shocks as cyclical and have been reluctant to lay off redundant workers. However, the ensuing rigid labor market is a macroeconomic problem, as employees may stay where they are not needed, while being absent elsewhere. Therefore, a more flexible distribution of labor among sectors is seen as the key condition for maintaining economic growth in future.

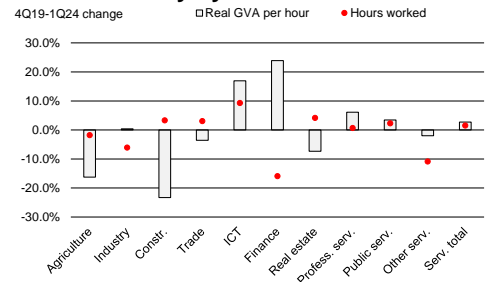
Evolution of productivity by countries



Sources: Eurostat, UniCredit Research

In terms of a productivity change in 4Q19-1Q24, Czechia ranked the 7th worst with a decrease of 0.2%. Only Luxembourg (-5.4%), Estonia (-4.4%), France (-2.1%), Italy (-1.8%), Finland (-1.3%) and Slovenia (-0.9%) underperformed Czechia. Eurozone countries' productivity increased by 0.7% on average, of which Germany's by 0.8%.

Productivity by sectors in Czechia



Sources: Czech statistical office, UniCredit Research

The biggest drag on a productivity change in 4Q19-1Q24 came from construction with a decrease of productivity by 23.3% (and hours worked adding by 3.3%), trade and transport (-3.6% and +3.1%) and real estate activities (-7.3% and +4.2%). Main drivers of productivity were IT services with productivity growing by 16.9% (hours worked by 9.3%) and the financial sector (23.9% and -15.9%).

Czechia Macroeconomic Outlook

	2021	2022	2023	2024	2025
				forecast	forecast
GDP growth (real yoy change, %)	3.5	2.4	-0.2	1.3	2.7
Household consumption (real yoy change, %)	4.1	-0.6	-3.0	2.6	3.2
Gross fixed capital formation (real yoy change, %)	0.7	3.1	4.2	-1.1	3.0
Industrial output (real yoy change, %)	6.8	2.1	-1.3	0.8	2.5
Unemployment rate (average, %)	3.8	3.4	3.6	3.7	3.5
Inflation rate (CPI yoy change, average, %)	3.8	15.1	10.7	2.5	2.5
Average wages (nominal yoy change, %)	5.8	4.3	8.0	7.4	6.5
Interest rates (3-M PRIBOR, end of period, %)	3.50	7.26	6.97	4.05	3.60
Interest rates (3-M PRIBOR, average, %)	1.13	6.28	7.13	5.12	3.72
EUR/CZK exchange rate (end of period)	24.86	24.12	24.73	25.00	25.00
EUR/CZK exchange rate (average)	25.65	24.57	24.01	24.90	25.00
Current account balance (% of GDP)	-2.8	-4.9	0.4	1.4	1.4
FDI net inflow (% of GDP)	0.5	1.2	0.2	1.0	1.2
General government balance (% of GDP)*	-5.1	-3.2	-3.7	-2.8	-3.0
Public debt (% of GDP)	42.0	44.2	44.0	44.9	45.5

Remarks:

*/ ESA 2010 definition.

Sources: Czech National Bank, Czech Statistical Office.

Forecasts: UniCredit Bank CZ+SK.

Disclaimer:

UniCredit Bank Czech Republic and Slovakia, a.s. within developing relationships with its clients and generally informing the public creates and publishes analytical outputs, mostly outputs related to financial markets, currencies and interest rates and stock or investment analyses.

These analytical outputs are meant for informational purposes only, do not represent any offer, or suggestion to buy or sell any investment instrument, they focus only on own and independent investment decision and do not substitute professional investment advice. If not stated otherwise, analytical outputs represent an opinion as of the date of their publishing, whilst can be changed without previous notice.

All information and views used to produce or found in the text of analytical outputs originate or are based on several sources, which UniCredit Bank Czech Republic and Slovakia, a.s. considers to be trustworthy. Despite devoting all care to content and verification of these information and views, UniCredit Bank Czech Republic and Slovakia, a.s. cannot guarantee their correctness, accuracy and completeness.

Rates, prices, yields, appreciations, performances or other parameters achieved by individual investment instruments in the past cannot in any case serve as an indicator or guarantee of future rates, prices, yields, appreciations, performances or other parameters of these or similar financial instruments. Each investment is always connected to the risk of value fluctuation and the return on invested funds is not guaranteed. Financial instruments denominated in foreign currencies are also exposed to fluctuations following the changes in exchange rates, which can have both positive and negative influence particularly on their rates, prices, appreciations or yields. Change in circumstances affecting the derivation of recommendation can result in loss of validity of the respective recommendation.

UniCredit Bank Czech Republic and Slovakia, a.s., is not responsible in any way for potential damages arising from using information in the analytical outputs. UniCredit Bank Czech Republic and Slovakia, a.s., is not responsible for any losses resulting from investment established following any recommendation, forecast or other information contained in the analytical outputs.

Securities, financial instruments or strategies mentioned in analytical outputs do not have to be suitable for every investor. UniCredit Bank Czech Republic and Slovakia, a.s. recommends to all investors to seek professional advice for their investment intentions and decisions prior to their realisation.