UniCredit

Czech Economic Quarterly

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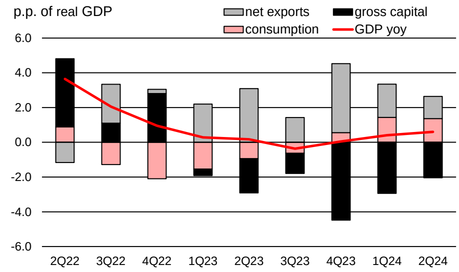
Households hold the key to a GDP rebound

- In 2Q24, real GDP expanded by 0.3% qoq, slowing from the 1Q24 upwardly revised dynamic of 0.4%. In the yoy terms, growth firmed to 0.6%. Private consumption barely increased (0.2% qoq, 1.0% yoy), government consumption accelerated to 4.3% yoy, fixed capital formation was on the brink of stagnation (+0.7% yoy) and the change of inventories subtracted from GDP 2.2pp. Net exports added to GDP 1.3pp on the volume of exports expanding 0.4% yoy and of imports shrinking by 1.5% yoy.
- We are revising downwards our 2024 GDP forecast to 1.0% from the 1.3%, projected three months ago. It is private consumption that contributes the most to our changing call. The September flooding may cause shifts in the structure of demand but should not alter the overall growth. We predict sequential GDP growth at 0.5% for each of the 3Q24 and 4Q24.
- In 2025, household spending will be bolstered by a rise in average real wages, while fixed capital formation and exports will be slower to rebound. All in all, we expect GDP growth to accelerate to 2.6% in 2025, surpassing the dynamics of eurozone and Germany by a wider margin than in 2024.
- We expect inflation to remain well above 2% in 2025, although likely not exceeding 3%. This should allow space for the ČNB to continue cutting the repo rate but not below 3.5%. With the rate projected to reach 4.0% in December, it would mean one 25bp cut arriving in 4Q24 (probably in November) and two final cuts to be delivered in 1H25.

Breakdown of GDP growth by demand*



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

In 2Q24, the structure of GDP growth has shifted from an extreme closer to normal. Consumption and net exports both contributed to growth positively, with the former changing little since 1Q24 while the latter easing somewhat. Gross capital continued to subtract from GDP growth but distinctly less profoundly.

REAL GDP (CONSTANT PRICES OF 2015, ADJUSTED)

	2Q24		1Q23 revised	
	YoY change	% of change in GDP*	YoY change	% of change in GDP*
GDP total	**0.6**	**0.6**	**0.4**	**0.4**
Household consumption (%)	1.0	0.5	1.7	0.8
Government consumption (%)	4.3	0.8	3.2	0.6
Fixed capital formation (%)	0.7	0.2	-0.1	0.0
Change in inventories	-	-2.2	-	-2.9
Net exports	-	1.3	-	1.9

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.

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2Q24: Slower private spending, higher fixed investment

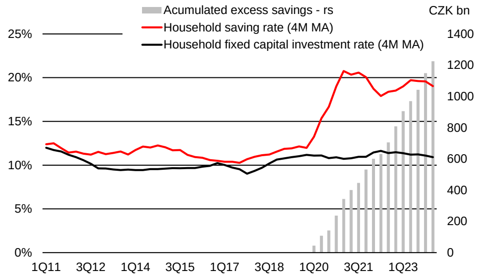
In 2Q24, real GDP expanded by 0.3% qoq, slowing from the 1Q24 upwardly revised dynamic of 0.4%. In the yoy terms, growth firmed to 0.6%. Private consumption barely increased (0.2% qoq), slowing to 1.0% yoy. Government consumption remained the fastest-growing demand-side component, even accelerating to 4.3% yoy. Fixed capital formation was on the brink of stagnation (+0.7% yoy), similar to a 1Q24 reading of -0.1% yoy that was revised from a preliminarily-flagged -2.7% yoy. The change of inventories subtracted from GDP 2.2pp, being a drag on yoy growth for the sixth quarter in a row. Net exports added to GDP 1.3pp on the volume of exports expanding 0.4% yoy and of imports shrinking by 1.5% yoy. Importantly, services helped total exports to expand, as exports of goods fell by 0.8% yoy. From the production side, gross value added (GVA) rose yoy in most service sectors, while contracting in industry (-3.0% yoy) and construction (-2.4% yoy). Nominal GDP expanded by 4.8% yoy on the GDP deflator posting 4.2% yoy. Total employment was higher by 0.2% yoy with hours worked shrinking by 1.0% yoy in seasonal-adjusted terms (but posting only -0.3% yoy unadjusted). The number of self-employed grew yoy faster (0.7%) than employees (0.1%). Labor productivity per worker inched up (0.4% yoy), per hour worked grew faster (1.4% yoy). Gross operating surplus and mixed income in current prices accelerated to 3.7% yoy but remained slower to grow than compensation of employees (5.4% yoy).

The pace of private consumption growth (1.0% yoy) in 2Q24 is regarged surprisingly slow, given that real wages added 3.9% yoy in the same period. One cause preventing households from spending more can be derived from a comparison between the evolution of average and median wages. While the former posted growth of 7.2% and 6.5% yoy in the first two quarters of 2024, the latter added only 5.7% and 5.8% yoy. Hence, wage growth disproportionately favored higher earners whose propensity to spend tends to be lower. However, there is also a more long-term element in the change of households‘ spending behavior. Household savings ratio shot up to 20% in 2020 and has shown few signs of a reversal yet.

2H24: Only limited momentum gathering

We are revising downwards our 2024 GDP growth to 1.0% from the 1.3%, projected three months ago. It is private consumption that contributes the most to our changing call. An immediate change in household spending habits is unlikely to occur. Firstly, the government has delayed the wage adjustment for public workers (most of whom earn close to the median salary), which trade unions were seeking from September, until January. Secondly, we suspect that this summer's heatwaves may have slowed overall household spending by restricting some casual spending and delaying some seasonal purchases. Only 4Q23 may see a partial improvement as seasonal purchases catch up and Christmas shopping looks set to be unhindered by a decline in real wages. Fixed capital formation may continue to stagnate throughout the rest of 2024, while weak eurozone GDP

Household savings rate and excess savings



Sources: CZSO, UniCredit Research.

Spending habits of Czech households changed dramatically in 2020 and have shown no signs of a reversal since. Interestingly, the change only concerned consumption but not investment. Since 2019, the accumulated excess savings have surpassed CZK 1200 billion, an equivalent of 15% of GDP.

Unemployment and vacancies

Sources: MPSV, UniCredit Research.

Since February 2022 when the Russian aggression in Ukraine started, the number of vacant job positions in Czechia have dropped by 100 thousand, while the number of unemployed has risen by only 23 thousand. Apparently, the influx of Ukrainian workforce is having a positive impact on the local labor market, which was extremely overheated until 2022.

growth may leave Czech volume-based exports of goods in marginal contraction for 2024. Overall exports will fare slightly better, though, thanks to rebounding income from tourism, boosting service exports. The September flooding may cause shifts in the structure of demand but should not alter the overall GDP growth. On balance, we predict sequential GDP growth at 0.5% for each of the 3Q24 and 4Q24.

2025: Finally coming a household-driven rebound

From the start of 2025, **household spending** will be bolstered by a 5% to 7% hike in the public sector compensation package and a 10% increase in the minimum (and guaranteed) wage. Along with a standard private sector wage hike, this is set to lift average real wages by 4.8% and do so in a way that should help low earners more than in 2024. As a result, we see private consumption growth accelerating to 2.2% in 2025.

Fixed capital formation looks set to differentiate by the type of capital. Machinery and equipment may be approaching a cyclical trough, meaning that growth may resume there at some point. The upturn may also be bolstered by the recent announcement of a USD 2bn investment by US chipmaker onsemi in new manufacturing capacity in Czechia, although we expect most funds to be invested only in 2026. An upturn in capex is also expected in residential construction. For other construction, private investors may remain rather cautious, while the public sector should speed up the utilization of EU funds. By contrast, transport equipment may enter a cyclical slowdown before long, as new car registrations have started to slow, and a boom in EV equipment installations may come to an end. All in all, only a moderate recovery in fixed capital formation (1.0%) is envisaged for 2025. As is usual for an initial phase of a cycle, the upturn in fixed investment will be preceded by stocks of inventory starting to mount, lifting gross capital more profoundly in 2025 (5.0%). Downside risks for capex are related to manufacturing weakness of external trading partners.

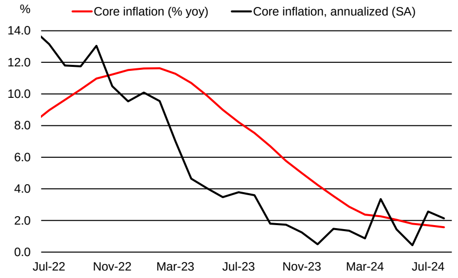
Exports of goods are projected in 2025 to improve alongside the eurozone recovery in line with our baseline forecasts, although a delay in the recovery remains a risk. Interestingly, Czechia has managed to maintain its share of global exports since 2019, outperforming the eurozone. We attribute this to more traditional and cost-efficient automotive manufacturing compared to some German peers. We believe this advantage may provide some protection against downside risks in 2025.

All in all, we expect **GDP growth** to accelerate to 2.6% in 2025, surpassing the dynamics of eurozone and Germany by a wider margin than in 2024.

ČNB policy: 3.5% seen as the terminal rate for the cycle

As to ČNB policy rates, sticky service prices (5.0% yoy for August) may be tested in an environment of accelerating economic growth, while food prices are also a source of upside risk. On balance, we expect inflation to remain well above 2% in 2025, although likely not exceeding 3%. This

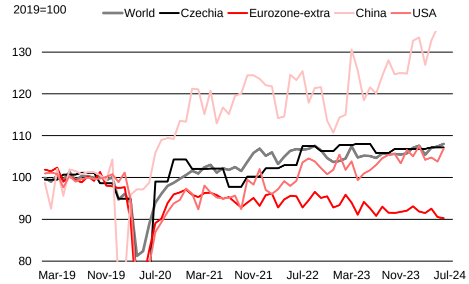
Czech yoy core inflation versus annualized core inflation



Sources: CZSO, UniCredit Research.

Annualized core inflation has been above yoy core inflation for two months now, in a sign that inflation in Czechia has bottomed out.

Export volumes since 2019



Sources: Macrobond, UniCredit Research.

Export volumes from China have been growing rapidly since 2020 while the eurozone has been losing its market share in global exports. The dynamic of Czech export volume is keeping pace with global exports, outperforming eurozone's.

should allow space for the ČNB to continue cutting the repo rate but not below 3.5%. With the rate projected to reach 4.0% in December, it would mean one 25bp cut arriving in 4Q24 (probably in November) and two final cuts to be delivered in 1H25.

Focus: Fading of the European industry

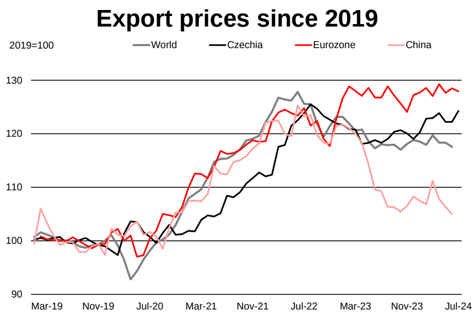
Poor conditions in the European industry are of an increasing concern in Czechia due to a prominent position of Czech manufacturers in the EU value chains. A comparison in real industrial production of the EU with the rest of the world is glaring. From 2019 to mid-2024, global production increased by 8.1%, with China reporting awesome growth of 27.8%. The US showed roughly a stagnation, the same as Czechia. In contrast, eurozone production dropped by 3.2%. Weak demand is usually reported to be the most prominent drag on the European industry. Our aim is to take a closer look into where the weak demand originates.

First, our approach is that final demand (i.e. total consumption and investment into gross capital) controls everything. In this perspective, the domestic demand added a minor 2.0% in eurozone and 2.7% in the whole of EU over last four and half years. (In a further breakdown, household consumption grew moderately whereas gross capital formation stagnated.) So slow growth of domestic demand in Europe is surely an important drag on its industry, as 80% of eurozone's (or 83% of EU's) gross value added (GVA) is finally used there. However, this may not explain fully why industrial output has declined. In addition, final demand in the rest of the world (RoW) grew faster (we estimate 12% for the "effective" RoW from the eurozone's viewpoint, which consists, for instance, of the US growth of 11.3% with a 3.4% share in EU's GVA, China growth of 25% with a 2.0% share, and a similar dynamic in India). Still, eurozone's real exports outside the block fell by 9.7%*, which also contrasts with growth of exports globally (8%), the US (7%), Czechia (7%) and China (36%).

The eye-popping drop in the eurozone's exports momentum is magnified by a divergence in export prices. While since 2019 global (and US) export prices rose by 18% and China prices added only 5%, eurozone exports turned more expensive by 28% (and Czechia's by a not-much-different 24%). The divergence may be partially due to differences in exports commodity-wise, but we believe that structural issues are also to blame - high energy prices, green and other regulations and a high cost of labor.

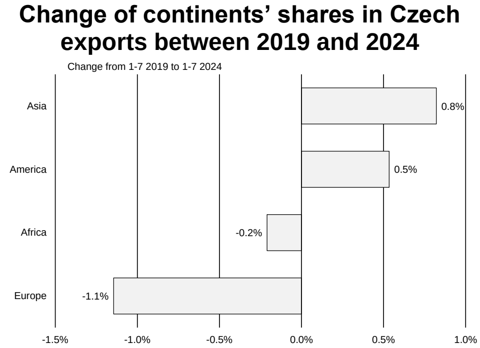
Figures above suggest that the eurozone production is being undermined by poor domestic demand as well as weak foreign demand for eurozone goods due to their deteriorating competitiveness. Czech exports were still able to keep pace with global trade dynamics, partly thanks to a successful focus on faster-growing markets in Asia and America, as well as Poland and in Europe. However, in the long run, Czech exporters will desperately need eurozone demand to improve.

*/ Based on cross-border trade statistics. Balance of payments statistics shows in contrast a rise of export by 6.9%. Both stats have their limitations, but we strongly believe the former one is much more relevant this time. The latter is not adjusted for intra-eurozone flows and may also be distorted by exports of Europe-based corporations having their production outsourced, which is difficult to correctly identify in data.



Sources: Macrobond, UniCredit Research

Economic shocks related to the pandemic in 2020 caused export prices to grow in sync across regions. However, the shocks that followed the Russian aggression in 2022 led to a considerable gap in prices between eurozone (up by 28% since 2019) and China (up only by 5%). The gap may stem from different commodity structures in exports as well as Europe's higher energy prices than elsewhere.



Sources: Czech statistical office, UniCredit Research

Between 2019 and 2024, Czechia managed to partly refocus its direct exports from Europe to Asia and America. The share of Europe dropped by 1.1pp to 89.5%. On the other hand, the share of Asia added 0.8pp to 5.4% and Amerika rose by 0.5pp to 3.8%. The share of Russia fell by 1.9pb to 0.3%, which was partially offset by a rise in Asian proxy-destinations.

Czechia Macroeconomic Outlook

	2021	2022	2023	2024 forecast	2025 forecast
GDP growth (real yoy change, %)	4.0	2.9	0.0	1.0	2.6
Household consumption (real yoy change, %)	4.2	0.5	-2.7	1.3	2.2
Gross fixed capital formation (real yoy change, %)	6.7	6.3	2.7	-0.2	1.0
Industrial output (real yoy change, %)	6.8	2.1	-1.3	-0.3	2.5
Unemployment rate (average, %)	3.8	3.4	3.6	3.8	3.7
Inflation rate (CPI yoy change, average, %)	3.8	15.1	10.7	2.3	2.6
Average wages (nominal yoy change, %)	5.8	4.3	8.0	6.8	7.2
Interest rates (3-M PRIBOR, end of period, %)	3.50	7.26	6.97	3.95	3.60
Interest rates (3-M PRIBOR, average, %)	1.13	6.28	7.13	5.00	3.75
EUR/CZK exchange rate (end of period)	24.86	24.12	24.73	25.00	24.70
EUR/CZK exchange rate (average)	25.65	24.57	24.01	25.10	24.90
Current account balance (% of GDP)	-2.7	-4.7	0.4	1.4	2.3
FDI net inflow (% of GDP)	0.5	1.2	0.2	1.6	1.3
General government balance (% of GDP)*	-5.0	-3.1	-3.5	-2.8	-2.6
Public debt (% of GDP)	40.7	42.5	44.0	43.3	43.4

Remarks:
**/ ESA 2010 definition.*
Sources: Czech National Bank, Czech Statistical Office.
Forecasts: UniCredit Bank CZ+SK.