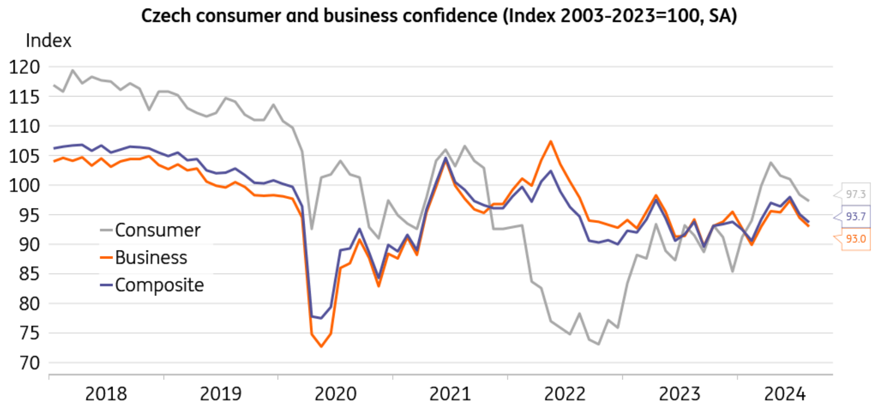
Czech business and consumer confidence deteriorates amid uncertain outlook

Business and consumer confidence in Czechia worsened in August, going against market expectations. The breakdown of the business sentiment shows that the mood improved in industry. However, this was outweighed by the deterioration in services, trade, and construction

Consumers are worried about the uncertain outlook

The consumer confidence indicator dropped by 1.1 points to 97.3 in August, with the share of respondents expecting the overall economic situation in Czechia to deteriorate over the next 12 months increasing significantly from the previous reading. Sentiment among consumers declined for the fourth consecutive month, mainly due to concerns about the uncertain economic outlook and the potential impact on their financial situation. Around a third of households report that they are struggling to make ends meet with their current financial resources, and almost 10 percent have to make do with savings or borrow money.

Economic confidence worsened in Czechia



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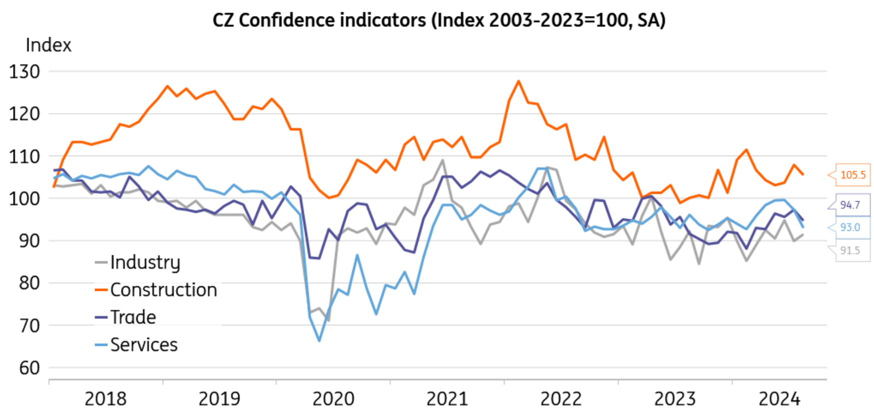
Households are already feeling the consequences of mounting uncertainty around the economic outlook, with the average registered number of employees in industry dropping by 2.1% in June from the previous year. The average annual wage growth in manufacturing decelerated to 3.5% in the same month, from a lofty 7.9% recorded in May, leaving the real wage increase at just 1.5% in June for the workers in industry. We see a similar pattern when looking at construction: reduced staff numbers and softening wage increases in annual terms. Such a development is well perceived by consumers, especially when they consider what may come next and the profound impact on their expected spending budget.

Deteriorating mood in the service sector poses a risk to growth

The business confidence indicator fell by 1.5 points to 93.0 in August, with the mood worsening in all sectors except industry. It fell most sharply in the service sector, including the financial sector, reflecting an expected reduction in demand in the coming months. Meanwhile, the sentiment in industry improved, likely due to the better performance of auto manufacturing, which is suggested by increasing new orders and firmer pricing in this segment in recent months. We will see whether the downward moves in construction and trade remain one-offs or are the onset of a weakening trend.

Mood worsened across sectors accept for industry



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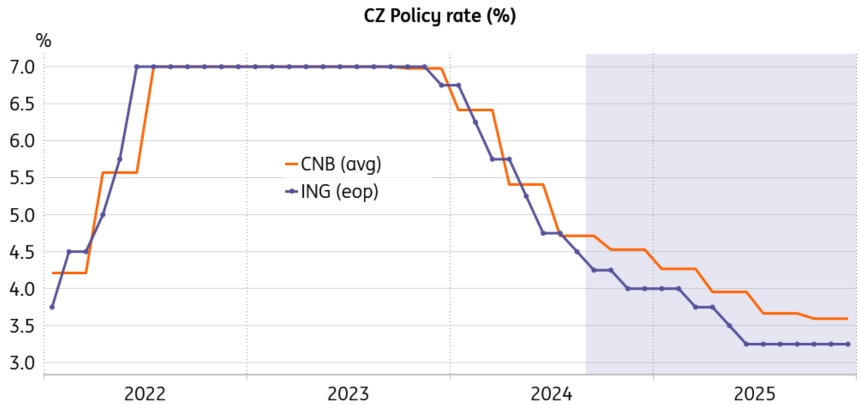
Downward risks in the spotlight

The consumer and business confidence deterioration is worrying news for Czechia's economic recovery. For now, we stick to our 0.9% projection for annual real GDP expansion within the central scenario of a continued, though gradual, economic recovery in the quarters ahead. The weak data from the eurozone also provide little hope for a sharper rebound. Overall, the outcome keeps our conservative growth projection in the right place. Most likely, it still does not represent a major issue for the Czech National Bank (CNB) forecast en bloc, but its economic performance expectations might prove too upbeat.

Policy rate set to trend lower



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That said, the sharp deterioration in the service segment might shift things in the direction of a more pessimistic scenario, such as: i) consumers have played their part well, ii) the industry does not catch up, iii) wage growth decelerates, and iv) consumers pull back. This raises potential hurdles for fourth-quarter growth performance. We have had such an adverse scenario in our minds for a while, but its probability is still relatively low, though it is gaining prominence. The increased uncertainty surrounding the Czech economic recovery leaves us comfortable with our rates path projection below the CNB view, with two more rate cuts for this year during the two consecutive Board meetings, followed by a break toward the year-end.

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