The Czech economy remains on solid ground

Real GDP growth in the third quarter was revised up in the Czech Republic, with strength across spending components. Fixed investment rebounded solidly, signalling confidence ahead. Inflation should stay near target over the next year. For now, rate stability remains the prudent choice amid the double-edged risks

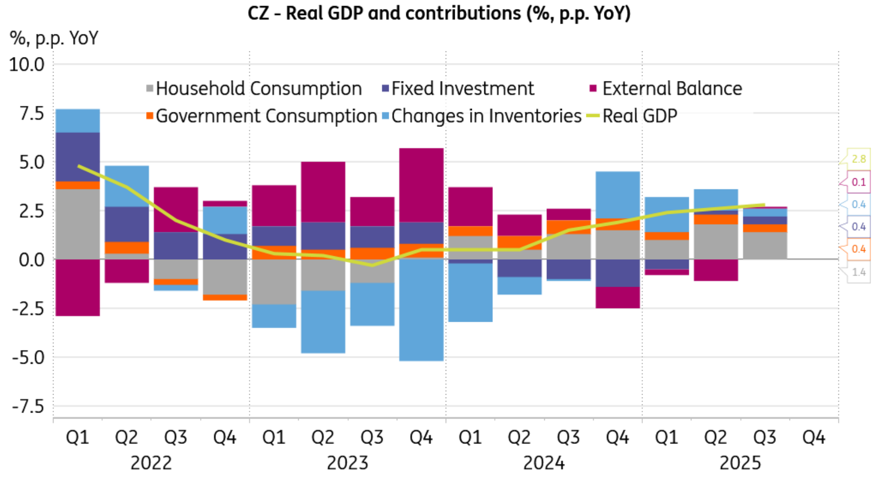
The Czech economy has a warm glow, unlike the current weather

Economy is in a good position now and on the outlook

Czech GDP growth in 3Q was revised upwards to 0.8% QoQ and 2.8% YoY, supported by both domestic and foreign demand. Household consumption made the largest contribution to overall growth. Household final consumption expenditure rose by 0.3% QoQ and by 3.0% YoY, government consumption expenditure added 0.1% QoQ and 2.0% YoY, and fixed investment picked up by 0.4% QoQ and by 1.7% YoY.

Real exports gained 1.0% QoQ and 3.4% YoY, while real imports stagnated QoQ and rose by 3.7% YoY. Considering value-added gains from the previous quarter, most sectors performed well: construction and communication activities were the outperformers, while the industry remained flat.

All expenditure components in decent shape

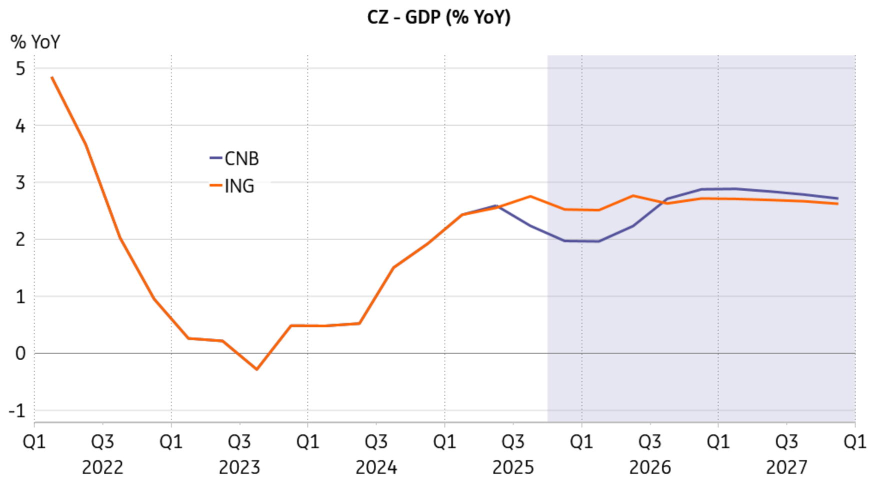


Source: CZSO, Macrobond

So the Czech economy is not just in a good position now, it's looking positive for the future, too. Households have enough resources to maintain solid spending, while ample savings and demand exceeding supply in the housing market will provide solid ground for the construction sector. The Czech industrial base has stabilised this year, also on the back of continued gradual decoupling from its troubled German counterparts.

Stagnant industrial output provides a bit of a dampener, with continued pressure on staffing and costs, but it is not too dismal either. For the Czech economy to enter a sweet spot performance, a bottoming out of demand from the eurozone is needed, which is far from certain.

Solid performance when looking ahead



Source: CNB, ING, Macrobond

Taking the latest GDP figures and breakdowns on board, we reiterate our base case scenario, in which we see the Czech economy expanding by 2.6% this year and by 2.7% in each of the next two years. Household consumption and fixed investment are set to drive next year's expansion, contributing around 1.1ppt each. In contrast, net exports will likely have a negative contribution next year, as any upward surprises from the eurozone's demand are not yet very likely.

Rate stability walks the line of twofold risks

The pleasant economic rebound so far and positive growth outlook imply no need for a change in monetary policy setup for some time.

The risks for a tighter monetary policy are:

1. double-digit house price growth,
2. a 7% and stronger increase in wages, and
3. core inflation flying above 2.7% supported by a potential liftoff in industry.

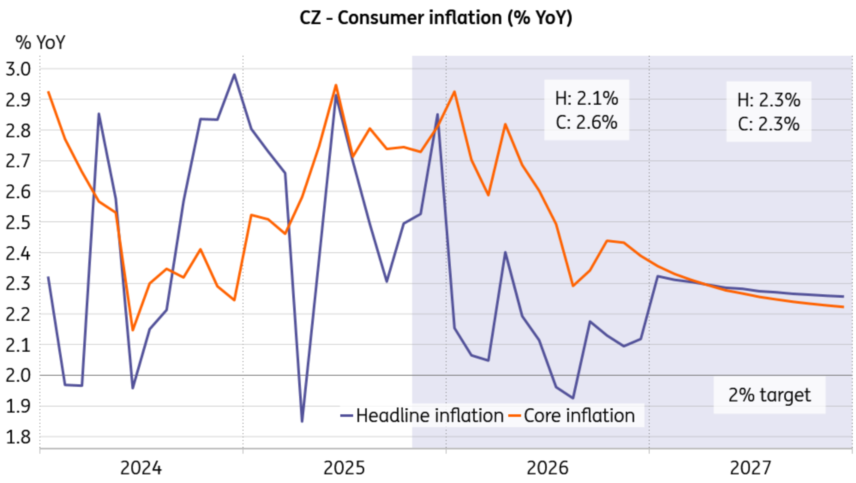
The risks for a looser monetary policy are:

1. more trouble for the German, French, and eurozone economies,
2. low external demand due to other global factors, and
3. iia standby mode in domestic investment.

This year's headline inflation is about to average 2.6%. Meanwhile, it will hover around the inflation target over the next year at 2.1% on average, dragged down by announced declines in electricity and natural gas end prices in January. That said, the government intends to reduce the regulated part of energy prices rather swiftly, which would shave another 0.3ppt to 0.4ppt from headline inflation.

Core inflation is set to remain somewhat elevated next year, driven by discretionary spending given the relative strength of household budgets and expected solid nominal and real wage gains, averaging 2.6%.

Headline inflation close to the target while core rate remains elevated



Source: CZSO, ING, Macrobond

For the next year and a half, we see a 65% likelihood of stable rates, 20% of cuts to foster waning economic expansion mostly for external reasons, while observing subdued inflation, and 15% in favour of a rate hike in conditions of an overheating economy, swiftly re-tightening labour market and wage-price spiral becoming a risk. More oomph for the German economy would boost the odds for tighter monetary policy in Czechia. However, we don't see the German economy turning into a phoenix any time soon; rather, it will remain in the ashes for a little longer. But as we all know: dum spiro spero. **[-** ***The editor didn't; it means, 'while I breathe, I hope'***].

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