Czech manufacturing sees the light at the end of the tunnel

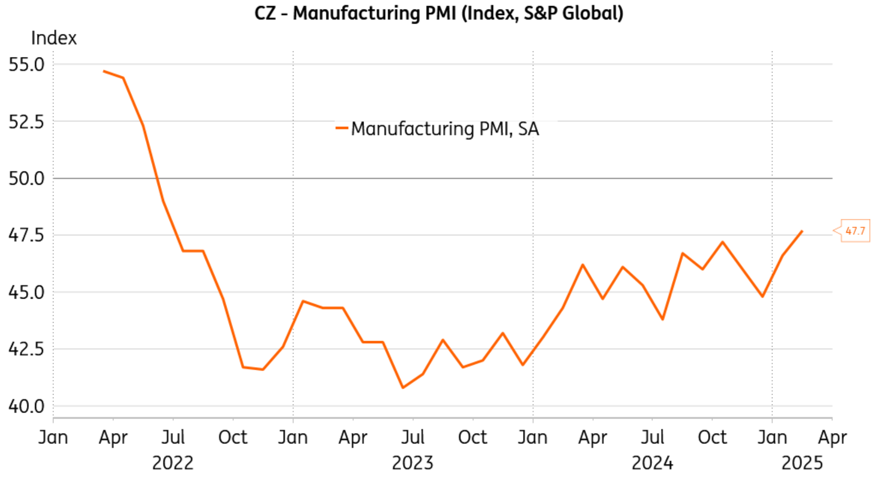
The Czech manufacturing PMI has remained in a contraction zone for almost three years, with employment in the segment taking a hit in February. That said, the worst for the industry seems to be in the past as confidence on the outlook strengthened, pushing the overall index above market expectations

We're optimistic that the worst is now in the past for Czech industry

Weakness in output and new orders softened significantly

The deterioration in Czech output and new orders has slowed significantly, although the overall manufacturing PMI remained in the contraction zone at 47.7 points in February. Still, we see a clear upward trend that leaves the bottom back in 2023. Indeed, the PMI reached its most upbeat point since June 2022 – this was when we saw it drop to the contraction zone, and it has failed to return above the 50-point watermark for expansion ever since.

Czech PMI on an upward trend



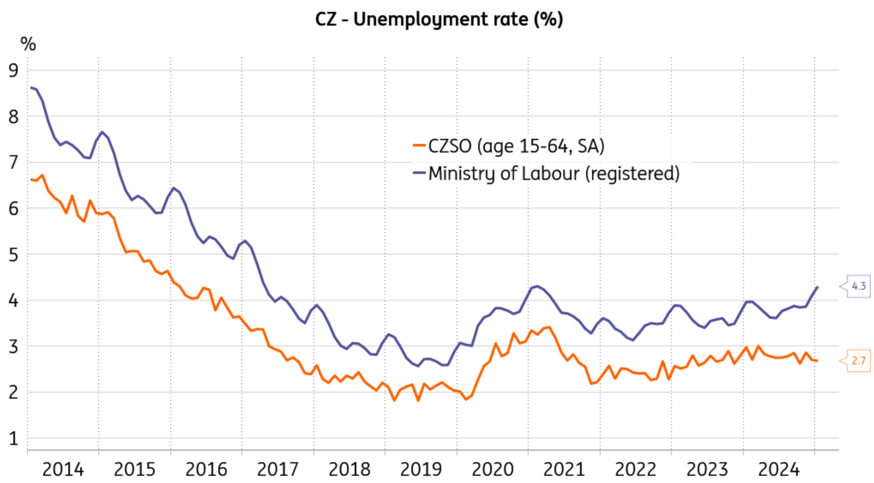
Source: S&P Global, Macrobond

The lukewarm demand from European trading partners remains the main weak point from the perspective of the Czech manufacturers. At the same time, some firms noted signs of revived interest from existing clients. Another encouraging sign was the reduction in delivery times and the subsequent improvement in supply conditions. The rate of cost inflation remained historically subdued, given the weak demand for input. This has eased the pressure on profit margins at a time when the requests for discounts remained vigorous.

Staff reduction accelerates while confidence improves

The layoffs in manufacturing gained traction in February, as the industry has more than two and a half rough years behind it. Despite the tendency to retain the skilled labour force, the demand from European trading partners has been too weak for too long to keep everyone on board. In contrast, business confidence in February was the most upbeat since last March, providing some renewed hope that the worst is in the past for Czech industry.

The labour market remains tight



Source: CZSO, Ministry of Labour, Macrobond

We see the thriving construction sector at least partially compensating for the tough employment situation in industry in the coming quarters. The seasonally adjusted unemployment rate remained unchanged at 2.7% at the beginning of the year, according to the latest survey from the Statistical Office. Meanwhile, as measured by the registered job seekers in the Ministry of Labour statistics, the unemployment rate has accelerated to 4.3% in January – but this increase is heavily affected by a prominent seasonal effect. When putting the relationship of the two series to statistical tests, it can't be clearly decided whether one series precedes the other and provides a more timely signal. In our view, the Czech labour market remains rather tight.

Overall, manufacturing eventually getting out of the woods would be good news for the Czech economic rebound, as households have recently become more worried about the future. Should industry gain more solid ground and receive a boost when it comes to profit margins, robust wage growth could carry on and push the Czech economy further ahead.

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