

## Czech PMI flips into expansion zone

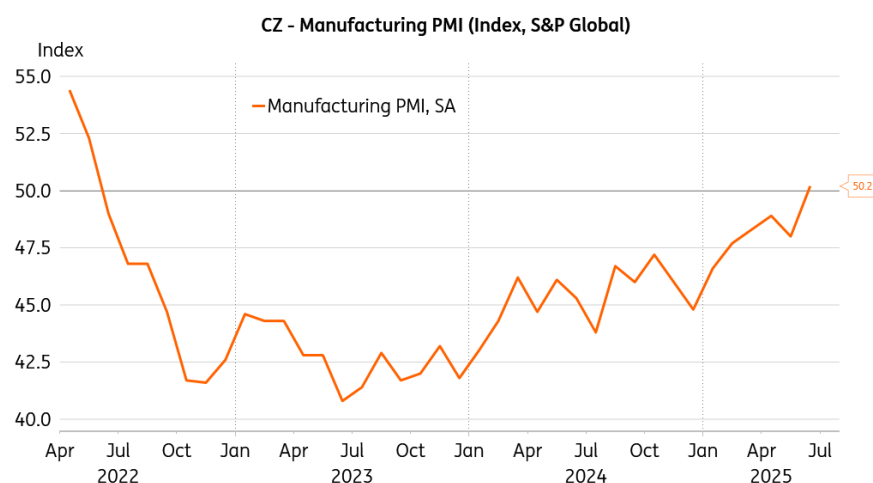
The manufacturing PMI entered expansion territory in June, coming in stronger than market participants had expected. This is a welcome change, as the index had remained below the neutral threshold for three consecutive years. We see potential implications for rate-setters if the rebound gains pace and proves sustainable, as the economy picks up speed



### Czech manufacturing bottoming out eventually

The manufacturing PMI jumped to 50.2 in June, recording the sharpest gain since February last year and entering the expansion zone after three years of decline. The renewed expansion in new orders, meanwhile, underlines hopes for a more fundamental turnaround.

## Land! After three years in rough seas



Source: S&P Global, Macrobond

The overall PMI pickup was driven by both increased output and new orders. While new export orders continued to soften due to competitive pressures and waning interest in key markets, a marked improvement in domestic demand led to an overall stronger inflow of new orders. This supported business confidence, which rose to the highest level since early 2022. That said, for more substantial traction, we would like to see a rebound in demand from the Czech exporters' main European trading partners.

Indeed, employment and input purchases continued to decline. Employment has now fallen for 33 consecutive months, but the latest drop was the mildest in that sequence. Some respondents attributed the staff reductions to earlier declines in new orders, while others pointed to broader cost-cutting measures.

Input prices increased at a subdued pace, namely in the context of sturdy international competition, while selling prices dropped as firms sought to encourage export orders.

## The CNB sees the economy firing on all cylinders

Should this prove to be a substantial and sustainable bottoming out of industry, the Czech economy could shift into high gear, powered by a confident consumer, booming construction, a government prone to more defence spending, and a rebounding industrial sector. Combined with resilient core inflation - which has upward potential due to robust property price growth and rising rents - such conditions are not conducive to any further monetary policy easing.

We view a stable base rate as the most likely scenario. However, if the residential market overheats further, upward pressure on imputed rents would be significant, implying a gradual upward shift in core inflation. In such a case, policymakers may begin to question whether the current policy stance remains sufficiently restrictive given the evolving conditions.

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