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CZECH REPUBLIC

Czech economy set to operate below its potential

Real GDP growth has been revised marginally downwards in 2Q26, yet mostly due to changes in inventories. Household income remains robust though corporate profitability is under pressure. We expect the Czech National Bank to raise rates despite mediocre growth, as prolonged conflicts have pushed the equilibrium rate higher than widely assumed



Czech real GDP rose 0.3% in 2Q from the previous quarter and was up 1.8% from a year earlier

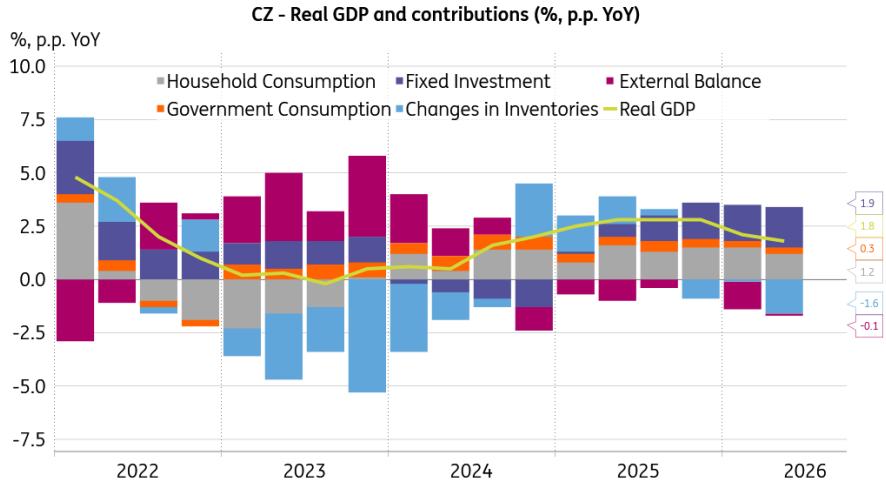
Robust household income vs pressured profitability

Regarding households, real income gained 0.7% quarter-on-quarter, real consumption per capita added 0.6% QoQ, and the savings rate increased by 0.4ppt in 2Q26. On an annual basis, real income rose 3.1%, while consumption per capita increased by 2.5% in 2Q26. The household savings rate was 19.9% in 2Q26, which is 0.1ppt higher than a year ago. The investment rate in the household sector increased 10.9%, adding 0.4ppt QoQ and 0.8ppt year-on-year, signalling a still-strong housing market.

In the corporate sector, the profit rate stood at 42.4% in 2Q26, down 0.5ppt from the previous quarter and 1.8ppt from the previous year. The investment rate was 28.3% in 2Q26, edging down by 0.1ppt on a quarterly basis but up 1.3ppt from a year earlier. Total wage costs surged

6.7% from a year earlier, while the average monthly income from employment rose by 4.2% YoY.

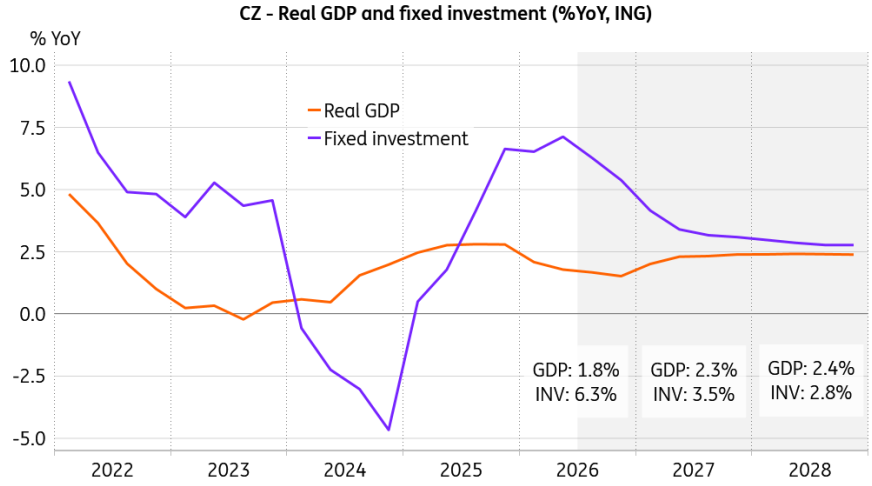
Inventories transformed into fixed investment



Source: CZSO, Macrobond

The more precise estimate of real GDP shows a rise of 0.3% QoQ and a 1.8% YoY gain, while both are 0.1ppt below the previous release. The downward revision was solely driven by changes in inventories. In contrast, we saw somewhat stronger government consumption in 2Q26. Accumulated inventories clearly contributed to the strong growth in fixed investment. That said, given the heightened uncertainty from the ongoing conflicts, we expect further restocking to be pushed out to the second half of next year.

Uncertainty may sour investment appetite



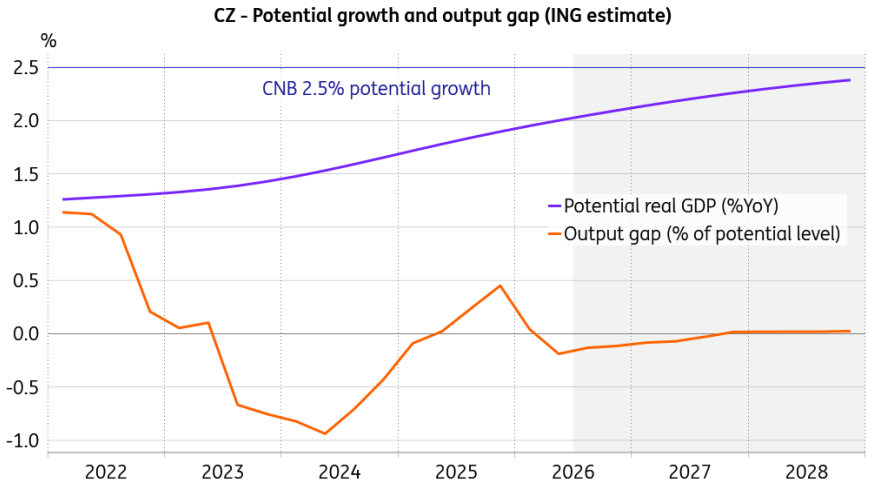
Source: CZSO, ING, Macrobond

Taking the latest figures and innovations on board, we peg this year's expansion at 1.8%, while next year looks better at 2.3%. That said, we expect some slowdown in fixed investment over the coming quarters, as corporate profitability is pressured. And with potentially dwindling profits, wages and investment plans are the first things to take a hit. Nevertheless, as the old saying goes, *epistula non erubescit* (some thoughts are easier to write down than to voice). Despite the heightened uncertainty surrounding the outlook, we may yet see continued strong investment appetite over the forecast horizon, representing an upside risk to our GDP forecast. Well, this would be welcome news for the Czech economy, signalling that Czech firms are confident and doing something right.

Equilibrium rate must adjust to the brave new world

Overall, real household income remains robust, which will likely keep the economic expansion just below 2% this year. At the same time, corporate profitability seems to be under pressure from both surging input costs and fierce competition. Households will face renewed growth in food and energy prices over the next year, which will dampen real purchasing power. Indeed, the protracted Hormuz conflict is starting to bite into real economic activity, while quarterly GDP gains at the turn of the year are subject to downward risks in our view.

Output gap set to remain negative for some time

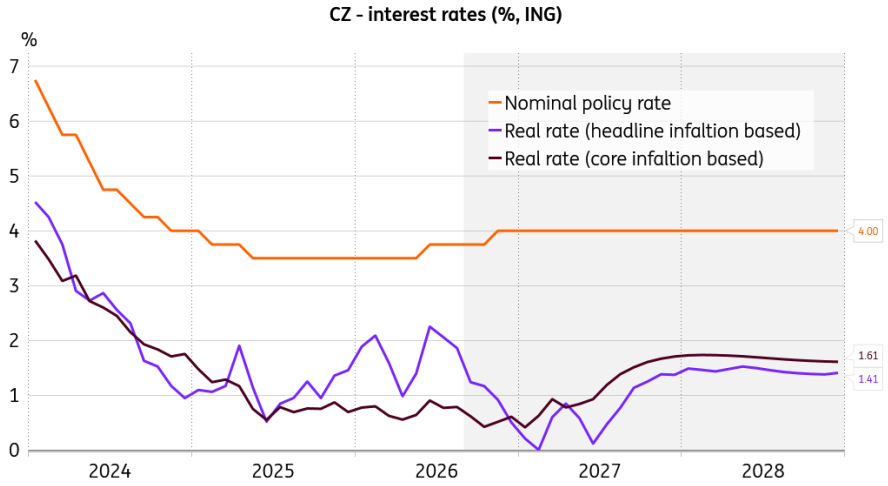


Source: ING, Macrobond

Regardless, we expect the CNB to raise rates despite the mediocre economic performance ahead. Even if we get more than one hike over the coming months, we would not describe it as a traditional hiking cycle, in which policy rates are raised to cool an overheating economy and inflation driven by excessive demand. Based on our output gap estimates, the Czech economy could operate slightly below potential until late 2027 and is therefore far from overheating. So why would central banks raise rates anyway?

In my view, the world is entering a new *modus operandi*, where protracted conflicts become the norm, making all resources increasingly scarce. As supply gets tighter and resources become costlier, the cost of capital must adjust to ensure that inflation does not systematically get out of hand.

Rates pushed up by structural changes; not only for CNB



Source: CNB, ING, Macrobond

And here we stand with fundamental upward pressures on long-term equilibrium interest rates. What is the new level of such a rate in this brave new world? I mean, it's too hard to guess, so I proceed with the classical 2-2-4 framework: 2% inflation, a 2% real interest rate and a 4% nominal interest rate.

This would come amid 2% real economic growth and, if we're lucky, a 1% increase in labour productivity, making nominal wage growth of around 5% compatible with stable inflation. In any case, policymakers and time will provide the answer. To be sure, if our estimate of the equilibrium rate proves correct, the CNB may raise the policy rate above 4% should inflation become too persistent next year, before drifting back once conditions allow. Stay tuned.

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