Economic Perspectives

September 2024

Highlights

- Oil prices declined over the summer months, even dropping below 70 USD per barrel in early September. Low oil demand in both the US and China was the prime driver of this decline. Supply problems in the Gulf of Mexico, Libya, Kazakhstan and Norway, along with OPEC+'s decision to delay the unwinding of voluntary cuts by two month, failed to halt the descent of oil prices. Most recently, oil prices edged up mildly against the backdrop of increased tensions in the Middle-East and the risk of further escalation of the military conflict. In contrast to oil prices, gas prices increased in August, almost reaching 40 EUR per MWh, due to the fall-out of Ukraine's incursion into Kursk Oblast.

- Euro area inflation fell sharply in August from 2.6% to 2.2%. The drop is almost entirely attributable to a sharp drop in energy inflation. Food inflation increased slightly. In contrast, core inflation declined only slightly (from 2.9% to 2.8%), as an uptick in services inflation compensated for a decline goods inflation. We now expect 2.5% and 2.2% inflation in 2024 and 2025, respectively.

- US headline inflation continued its descent in August, declining from 2.9% to 2.5%, thanks to a big drop in energy prices and soft food price inflation. In contrast, core inflation stagnated at 3.2% on the back of stronger shelter price inflation. Goods inflation declined for the third time in a row, while services inflation (ex. Shelter) was also mild. We thus we downgrade both our 2024 and 2025 forecast by 0.1 percentage points to 2.9% and 2.3%, respectively.

- Euro area growth remains sluggish. Final Q2 GDP show that investments and household consumption were almost flat last quarter, as savings rates edged higher. However, there is substantial heterogeneity across member states. In the southern economies, consumption continued to grow modestly. In contrast, consumers in Germany and the Netherlands were cautious while German investment is on a downward path. We now expect euro area growth of 0.7% and 1.2% in 2024 and 2025, respectively.

- A rise in the US unemployment rate over the summer caused a panic in financial markets, as a new recession indicator (the Sahm-rule) was triggered. Nonetheless, as the rise in unemployment was to a large extent caused by an increased labour supply, the August panic seems overblown. Nonetheless, we still expect the US economy to eventually soften. Hard data on the housing market and net export have disappointed. Meanwhile, consumer spending should soften in later quarters. Though we still expect growth to average 2.6% in 2024, we expect growth to slow to 1.7% in 2025.

- As inflation risks are fading and employment risks are gaining more attention, many central banks have initiated an easing cycle. This month, the Fed cut its policy rate by 50 basis points, and we expect additional cuts (75 basispoints in total) by the end of this year. The Fed is likely to continue easing by 25 basis points at each meeting in the first half of next year until it reaches our forecasted cycle low of 3.125% (mid-range). The ECB already cut its policy rate twice this year (by 50 basis points in total). However, it has less room to cut rates than the Fed. We thus expect it to make only one extra rate cut this year. Next year, we expect two more rate cuts, bringing our projected cycle low to 2.5%.

- The Chinese economy remains sluggish according to the latest activity indicators, with growth currently forecast at 4.7% for 2024 and 4.2% for 2025. More substantial and targeted fiscal support will likely be necessary to help the economy reach the government's 5% target this year, and more importantly, grow at a more sustainable demand-supported pace going forward.

Global Economy

Introduction

Central banks have shifted their focus in the past few months. The inflation targets of 2% seem to come within reach in both the US and the euro area, as energy prices have dropped significantly, and wage growth seems over its peak. As inflation worries are receding, the focus shifts to the labour market, where signs of weakening are emerging (especially in the US). Fears of an imminent recession, however, seem overblown. Central banks have acted accordingly, as both the ECB and Fed cut their policy rates by 50 basis points already this year and hinted at more rate cuts to come. The other major economic bloc, China, is living a different economic reality. There, a continuing real estate crisis and persistently low consumer confidence is holding back consumption and is keeping inflation very low.

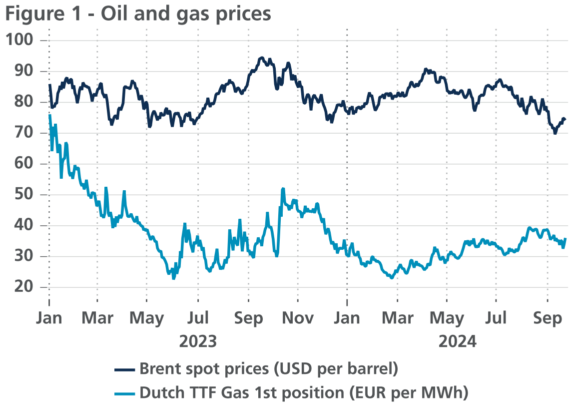
Oil prices on the descent

Oil prices have declined quite markedly over the summer months (see figure 1). Oil prices even dropped (temporarily) below 70 USD per barrel in early September (down from 85 USD end of June). The decline is primarily demand-driven, especially in China and the US. In China, lower activity along with rapid EV adoption caused oil consumption to decline by 280k barrels per day year-on-year in July. Oil demand is also tepid in the US, as gasoline deliveries dropped in June. The International Energy Agency now expects oil consumption this year to be 2 million barrels below pre-pandemic levels.

Several problems on the supply side do little to stop the decline in oil prices. In the US, hurricane Francine is disrupting oil and gas production in the Gulf of Mexico. In Libya, a political quarrel over the appointment of a new central bank governor caused production to drop by 60% during the summer. Yet a compromise has now been found, causing a rebound in oil supply. Maintenance works in Norway and Kazakhstan also strained oil supply in August. OPEC+ also announced they would postpone the unwinding of their voluntary cuts by two months (now starting in December). Nonetheless, the market still expects oil to be oversupplied in the second half of this year. This also explains why recent escalations between Israel and the Iran-backed militia Hezbollah have had limited upward effect on oil prices.

In contrast to oil prices, European gas prices increased markedly over the summer, reaching almost 40 EUR per MWh early August. The Ukrainian capture of Sudzha, which is a major terminal for EU exports, sent prices to their highest level this year. Russia is still supplying 8% of

Figure 1 - Oil and gas prices



Source: KBC Economics based on ICE

the EU's natural gas (via pipelines). That said, as EU gas reserves are well-filled (93% of total capacity), prices remain well below 2022 records.

Further cooling of inflation in the euro area

In the euro area, inflation fell quite sharply in August to 2.2%, down from 2.6% the month before. Especially the new fall in energy price inflation (-3%) contributed to this. The fall in core inflation by 0.1 percentage points to 2.8% was much more modest. Only industrial goods inflation (excluding energy and food products) declined (from 0.7% in July to 0.4% in August). In contrast, services inflation rose from 4.0% in July to 4.1% in August, the same level as in May and June. It illustrates the - as expected - bumpy path to sustainably lower inflation.

Nevertheless, the near-term dynamics of services inflation remain downward-sloping (on a three-month moving-average basis) and the underlying inflation drivers are also moving in the right direction. This is evidenced by the year-on-year increase in the GDP deflator in the second quarter (see figure 2). It slowed from 3.6% in the first quarter of 2024 to 3.0% in the second quarter. A slight slowdown in the growth of nominal wage bill per worker and improving productivity gains cause the contribution of unit labour costs to inflation to decline. Meanwhile, profits per unit of product - which were a source of inflation in the 2021-2023 period - declined slightly. Higher indirect taxes have a slight inflationary effect, probably the result of fading support measures from during the energy crisis.

Inflation will remain on a bumpy path in the next few months. The September figure is likely to be slightly lower than the August figure, and could possibly fall slightly below 2%. In the final months of 2024, however, adverse base effects will most likely push inflation back up. We expect the fundamental trend of gradually cooling inflation to prevail again in the course of 2025. This would bring the average inflation rate for the euro area to 2.2% in 2025, after 2.5% in 2024.

US inflation on a downward path

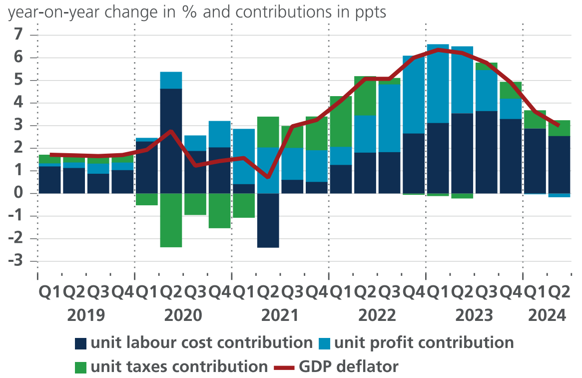
US headline inflation softened again in August, declining from 2.9% to 2.5%. The drop was primarily from energy prices which dropped by 0.8% last month and are now 4% lower than a year ago. As the recent drop in oil prices has yet to filter through to gasoline prices, we expect further drops in energy prices in the coming months. Food prices also remained under control, increasing by only 0.1% last month.

In contrast to headline inflation, core inflation remained stable at 3.2%. The most important contributor to core inflation was shelter inflation, which firmed in August, rising 0.5%. Though this was partly due to a big increase in hotel prices, owner equivalent rents also increased markedly last month.

Excluding shelter, US CPI inflation is already below 2% (see figure 3). Forward-looking indicators suggest shelter inflation will eventually soften. Notably, new tenant rents (which typically lead shelter inflation by 6 to 12 months) are 1.1% lower than a year ago.

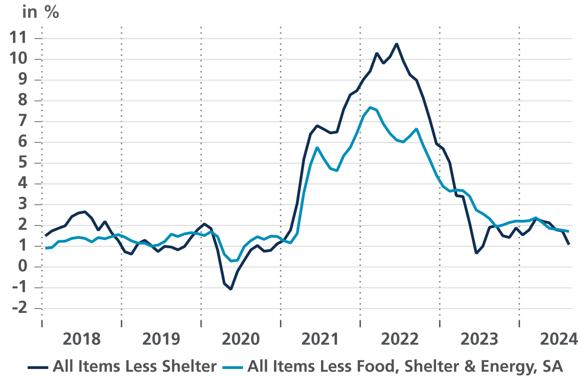
Other components of core inflation were quite soft last month. Core goods prices declined by 0.2% last month, thanks in large part to a 1% drop in used cars and trucks

Figure 2 - GDP deflator euro area



Source: KBC Economics based on Eurostat

Figure 3 - US CPI ex.shelter



Source: KBC Economics based on BLS

prices, the third drop in a row. Industry data suggest that these drops might reverse somewhat in the coming months, however.

Core services (ex. shelter) increased by only 0.2% last month, the fourth soft reading for this key component in a row. This was notwithstanding a big increase of 3.9% in airline fares, a volatile component.

Average hourly earnings, a leading indicator of services inflation, firmed somewhat in August, increasing by 0.4% month-on-month (following a 0.2% increase in July). That said, at 3.8% year-on-year, wage inflation seems beyond its peak and is likely to decline further as the labour market loosens.

Overall, we downgrade both our 2024 and 2025 forecast by 0.1 percentage points to 2.9% and 2.3%, respectively.

ECB in easing mode but remains data-dependent

As expected, on September 12, 2024, the ECB cut its policy rate, the deposit rate, by 25 basis points to 3.50%. Also in September, the ECB's new operational policy framework came into effect. This means, among other things, that the spread between the refinancing rate (MRO) and the deposit rate (DFR) is set at 15 basis points. The marginal lending facility rate will be set 25 basispoints above the MRO rate.

The quantitative policy decisions taken earlier remain in place. For example, the ECB is shrinking its PEPP portfolio by an estimated average of EUR 7.5 billion per month by not reinvesting all assets at maturity. As of 2025, reinvestments will be completely discontinued.

The resumption of the rate easing cycle by the ECB in September was expected by financial markets and in line with our interest rate scenario. The ECB's decision is consistent with, in particular, the drop in headline inflation to 2.2% in August. While that decline was driven largely by the temporary effect of a negative year-over-year change in energy prices, the overall disinflationary trend toward the ECB's 2% target remains broadly intact.

In its new September macroeconomic projections, ECB staff, expect inflation to reach the 2% target in the second half of 2025. Specifically, annual average inflation expectations remain unchanged at 2.5%, 2.2% and 1.9% in 2024, 2025 and 2026, respectively. Behind this is a slightly higher path for underlying core inflation. Nevertheless, according to ECB staff, annual average core inflation will also fall back to 2% in 2026.

Against this background, the ECB remained vague about the further timing and order of magnitude of the next steps in its easing cycle. It stressed that its further decisions remain fully data-dependent and will be (re) considered from meeting to meeting.

That pragmatic data dependence remains a sensible strategy against the backdrop of still stubborn core inflation (mainly driven by the services component), which reached 2.8% year-on-year in August. However, as mentioned above, that core inflation is likely to cool further in the relatively near term.

Fed decided on a jumbo rate cut

A week after the ECB’s second cut, the Fed also began its easing cycle, with a hefty 50 basis point rate cut. Like the ECB, the Fed stated that this is perfectly consistent with the ongoing quantitative tightening (balance sheet deleveraging).

The motivation for the rate cut is primarily found in the new Fed economic projections in September. As indicated by the downward revision of its (PCE) inflation projection to just above 2% by 2025, the Fed now believes that inflation is getting under control and that it will soon reach the first part of its dual mandate (price stability along with maximum employment).

As inflation concerns fade, the Fed’s focus turns to the weakening economy. After the September policy meeting, the Fed pointed out that for them, the risks to both parts of its mandate are roughly symmetrical. In order not to fall behind the curve, the Fed considered it appropriate to start easing its interest rate policy to protect the labour market, especially since the impact of monetary policy changes only show up with long and variable lags.

In its September projections, the Fed gave three signals. First, the September rate cut was the start of an easing cycle. For the two remaining policy meetings in 2024, the Fed expects (at least) another 50 basis points of rate cuts. Given favorable inflation developments and the moderating trend of the US labour market (see further), KBC Economics expects a slightly more substantial easing by a cumulative 75 basis points by the end of 2024.

Second, the Fed raised its expectation for the "neutral" policy interest rate to 2.9%. That level is still slightly below our expectation for the neutral rate. Nevertheless, by raising its expected neutral rate, the Fed signaled that it does not anticipate any meaningful deterioration in the economic environment that would bring down the neutral rate.

Finally, the Fed expects to gradually reach its neutral interest rate in 2026 without undershooting. This fits with Fed Chairman Powell's assessment that (for now) he sees no real signs that the risk of a meaningful cyclical slowdown is higher than normal at this time.

More rate cuts to come

Based on the overall moderating growth and inflation environment and the forward guidance from the ECB and the Fed, we now assume faster and more substantial monetary easing in our interest rate scenario, in initially larger steps of 50 basis points in the case of the Fed. A key driver of this is the downwardly revised inflation outlook over our forecast horizon.

Bond yields have already largely priced in that lower short-term interest rate path. The stronger decline in short-term interest rates will ensure an end to the inversion of the yield curve by 2025. That is expected to happen a little faster in the US than in the euro area.

The US dollar is likely to continue to hover around current levels for the remainder of 2024 and early 2025. Around the time of the US presidential election, the safe-haven dollar may possibly benefit slightly temporarily from increasing geopolitical uncertainty. Starting in late 2025, at the end of the easing cycles, the dollar is expected to resume its gradual depreciation path. This will be driven by the fundamental overvaluation of the dollar at its current rate. However, the expected depreciation over the forecast horizon is expected to remain very limited.

Meanwhile, intra-EMU government bond spreads against Germany remain subdued. We still expect them to rise slightly by the end of 2024 as part of the painstaking progress of the required budget consolidation efforts.

Waiting for the European consumer

In the euro area, real GDP grew 0.2% in the second quarter of 2024 versus the previous quarter. This was slightly less than initial estimates indicated, but in line with our expectations. Nevertheless, the aggregate figure masks some surprises. For example, the expected resumption of household consumption has not yet materialised. This was mainly due to the decline in that spending in Germany and the Netherlands. Rather modest spending growth by Italian and Spanish consumers was insufficient to neutralize this decline (see figure 4). The lukewarm development of household consumption is particularly disappointing against the background of the ongoing recovery in the purchasing power of wages and the overall resilient labour market. While it is true that the decline in the vacancy rate indicates a reduction in the acute tightness of the labour market, the unemployment rate also fell to a new historic low of 6.4% of the labour force.

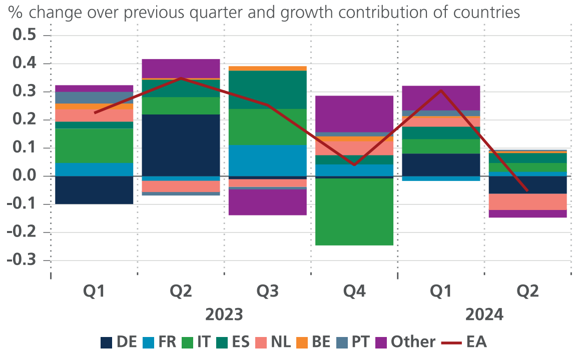
Investment dynamics also remain weak, particularly in buildings and equipment. In contrast, investment in intellectual property is more dynamic. The weak development of business confidence does not immediately set the stage for a strong imminent investment recovery, but the development and outlook for both corporate and residential credit suggest that some improvement may be on the way, especially as the ECB is expected to continue easing interest rates.

A second disappointment behind the aggregate growth figure for the euro area is the new, albeit slight contraction of the German economy (down 0.1% from the previous quarter). Virtually all spending components, with the exception of government consumption, are failing in Germany (across most sectors) without the leading indicators immediately announcing improvement. Against the backdrop of weak demand, structural adjustments in the German economy are also beginning to translate into weakening labour market indicators, such as an increase in short-time employment and slightly rising unemployment. The risks of a further prolonged period of weak German economic activity there are thus increasing.

On the other hand, employment continues to increase also in Germany and households' purchasing power is rising. Thus, as elsewhere in the euro area, the fundamentals for a gradual strengthening of domestic demand remain in place. We therefore maintain our scenario of a gradual, mainly private consumption demand-led slight strengthening of growth throughout the euro area. However, given the recent disappointing

Figure 4 - Final household consumption expenditure in the euro area

% change over previous quarter and growth contribution of countries



Source: KBC Economics based on Eurostat

indicators, we have lowered our growth forecast for real GDP in the third quarter of 2024 from 0.3% to 0.2% (versus the second quarter). This results in a slight downward revision to the expected annual growth rate for 2025 (from 1.3% to 1.2%). The expected average year-on-year growth rate of euro area real GDP in 2024 remains unchanged at 0.7%, as the downward impact of somewhat weaker growth over the course of 2024 is offset by a larger spillover effect from 2023 to 2024 due to a revision of the 2023 GDP figures.

US economy unlikely to enter a recession in the near term

Softer-than-expected US labour market data have rattled financial markets over the summer. Indeed, labour market data have been relatively soft lately. The US only added 231k jobs in July and August combined and there were very big revisions to prior months. Job openings also declined markedly, while the number of people working part-time for economic reasons increased by 610k in July and August combined. Most worrying for financial markets, the unemployment rate stood at 4.2% in August, up from 3.7% in January. This triggered the so-called Sahm-rule, a historically reliable predictor of recessions (see our brief on this topic). Yet this time might be different, as the increase in unemployment is to a large extent driven by a positive labour supply shock. Indeed, higher migration and to a lesser extent higher participation rates have driven up the labour force (see figure 5). As it takes time for new entrants to the labour market to find a job, increases in labour supply can temporarily drive up the unemployment rate.

Aside from the labour market, hard data on the US economy provide a mixed picture. On the positive side, consumption remains healthy. US Q2 GDP growth was revised upwards from 2.8% to 3%, thanks to stronger consumption growth. Consumption contributed almost 2% to US GDP growth in Q2. Consumption is likely to remain the key driver of economic growth in Q3, as retail sales grew by a healthy 1.2% over summer months.

On the negative side, residential investment is a drag on the economy. Nominal construction spending declined 0.3%m/m in July, the first drop in almost two years. Housing starts and permits also dropped sharply in the same month (though they partially bounced back in August). Net exports are also likely to make a negative contribution to GDP this quarter, as the goods trade deficit increased by 6.3% in July.

Business surveys also provide a mixed picture. While manufacturing surveys remain in recessionary territory, non-manufacturing surveys remain in expansionary territory (especially in the S&P Global Survey).

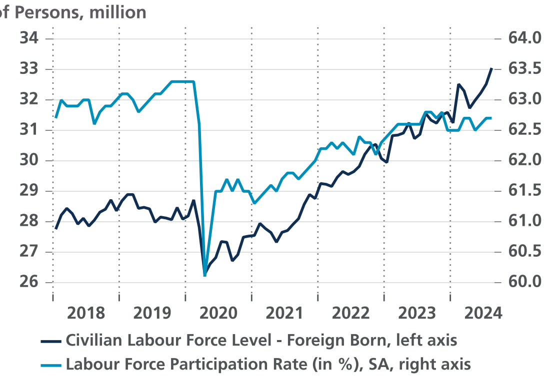
Overall, we still expect GDP growth to weaken as the labour market is loosening and monetary conditions will remain restrictive (Fed cuts notwithstanding). Given the better than expected Q2 GDP figure and the decent Q3 hard data, we upgrade our 2024 forecast from 2.5% to 2.6%, while maintaining our 1.7% 2025 forecast.

Chinese growth unlikely to reach the 5% target

The Chinese economy continues to show signs of slack, with activity indicators like retail sales and industrial

Figure 5 - US labour statistics indicate a supply shock

No. of Persons, million



Source: KBC Economics based on BLS

production weakening in year-over-year terms in August (to 2.1% and 4.5%, respectively). This suggests that Q3 GDP growth is on track to decelerate further from the already disappointing 4.7% year-over-year recorded in Q2.

Other indicators, such as weak consumer confidence and high household savings point to still weak domestic demand. While this may be partially offset by solid export growth (8.7% year-over-year in August), slack in the domestic economy is contributing to weak inflation that risks becoming entrenched (in August, core CPI: 0.3% year-over-year; producer prices: -1.8% year-over-year).

One overarching issue remains the yet-to-stabilise situation in the real estate market, where prices continue to slowly correct while the supply of unsold projects remains large. This uncertainty continues to undermine confidence, puts pressure on local governments' financing, and keeps demand for credit (particularly real estate loans) weak. Recent monetary policy easing measures, including a 20 basispoints cut to the seven-day reverse repo rate from 1.7% to 1.5% and a 50 basispoints cut to the reserve requirement ratio (currently 7% on average) are therefore welcome measures. But more substantial and targeted fiscal support will likely be necessary to help the economy reach the 5% target this year, and more importantly, grow at a more sustainable demand-supported pace going forward.

We therefore maintain our current forecast of 4.7% real GDP growth in 2024, slowing to 4.2% in 2025, with upside potential if the government follows up its monetary easing with important fiscal easing. On the inflation side, while headline inflation has ticked up to 0.6% year-over-year, mostly on higher food prices, the weakness in core inflation led us to revise down our 2025 forecast for headline inflation to 1.6% (from 1.8% previously) while maintaining expectations for inflation of only 0.5% in 2024.

Belgium

The earlier flash estimate for Belgium's Q2 2024 real GDP growth was confirmed at 0.2% qoq, a slight deceleration from the 0.3% growth recorded in the previous quarters. Viewed from the production approach to GDP, growth in value added in the services sector continued to slow, to a quarterly rate of just 0.2%. In construction, value added returned to positive growth (1.1%), after the decline in Q1. In the manufacturing industry, activity fell by 0.3%, so the return to a positive growth rate in Q1 was not repeated (see figure BE1). According the NBB, part of the deceleration in production in Q2 was due to a hit on Belgian vehicle manufacturing, as consumers have been shifting away from electric car models produced in Belgium (i.e., Audi in Vorst and Volvo in Ghent) and a large company in the sector (i.e., bus manufacturer Van Hool) was declared bankrupt. A more "normal" production in vehicle manufacturing would have resulted in an overall quarterly GDP growth of 0.3%.

Looking at GDP components, household consumption grew moderately (0.2%) in Q2, while investment in housing turned negative again (-1.8%). Business investment jumped by 4.4%, largely explained by a sale of ships in Q1 followed by a large investment in information and communication services in Q2. Corrected for all exceptional factors, underlying business investment growth was even negative in Q2, as was communicated in the NBB's Business Cycle Monitor. Government consumption expenditure and public investment rose by 0.6% and 0.5%, respectively. Imports and exports fell by 1.5% and 1.7%, respectively. Hence, net exports made a negative contribution to growth (-0.2 percentage points).

Big impact of changes in inventories

Remarkably, changes in inventories again heavily weighed on growth in Q2 (-0.4 percentage points) after already a large negative contribution in Q1 (-0.6 percentage points, see figure BE2). Consequently, in our scenario their contribution to real GDP growth for the full year 2024 is estimated to be as big as -0.7 percentage points. This illustrates that this GDP component can have a substantial impact on the economic cycle. Despite its importance, little attention has generally been paid to this component. One reason is that the pattern of inventory changes by businesses is harder to explain than the other GDP components. This in turn is partly due to the fact that what we refer to as inventory formation is actually an adjustment variable. Alongside genuine inventory movements, this also comprises statistical discrepancies, which cannot be explained logically.

Meanwhile, conditions in manufacturing remain weak. In September, business sentiment in the sector worsened for the fourth consecutive month. Moreover, after the upward trend which began in March, export orders have taken a hit again during the summer months. As a result, and in line with changes to the euro area scenario, we slightly downgraded quarterly growth of the Belgian economy in Q3, from 0.3% to 0.2%. Our view on the next quarters has been kept unchanged, as we still see improvement in the international business cycle ahead. Belgian growth for the year 2024 as a whole is now seen at 1.1%, down from 1.2% previously. Our growth outlook for 2025 stays at 1.2%.

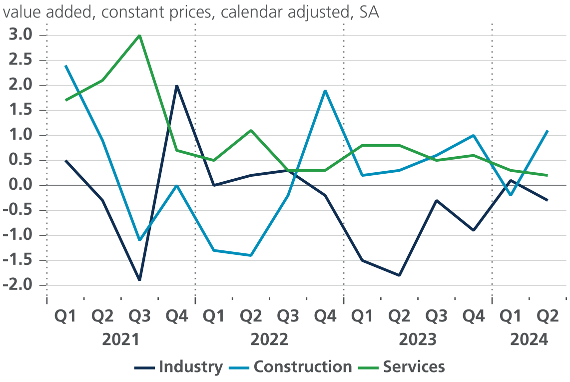
Downside and upside risks to the short-term scenario are balanced. On the downside, we see weakened fundamentals for consumption (i.e., a slowdown in job growth, a normalisation of indexation-driven wage growth, consumer confidence falling below its long-term average in September), weak underlying business investment (due to a lack of expansionary investment activity) and the challenging external environment as the main risks to growth. On the upside, the gradual improvement in cost competitiveness could support Belgian export growth somewhat more than expected. Also, the contribution from changes in inventories to quarterly GDP growth could well prove more favourable in the second half of 2024, after the two negative contributions in Q1 and Q2 (see above).

Inflation reversal

Belgian harmonised inflation (HICP) stabilised at 5.4% in July and declined to 4.3% in August, which is still among the highest figures in the EU. The downward reversal in headline inflation in August followed the sharp fall in energy inflation, from 23.8% to 11.2%. Core HICP inflation, which does not take into account price evolutions of energy products and food, fell from 3.3% to 3.1%. As the downward move in headline inflation over the summer has been somewhat weaker than we had expected, we upwardly revised the outlook for 2024 annual HICP inflation, from 3.8% to 4.0%.

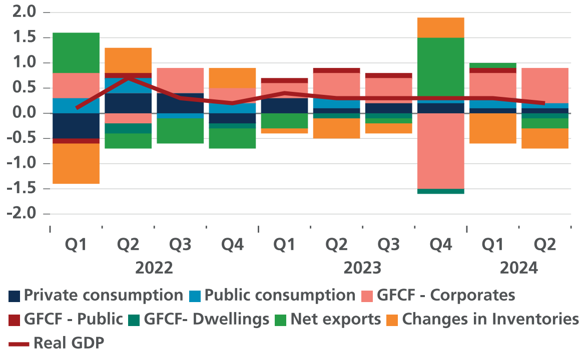
Once again, past data for Belgium's harmonised unemployment rate were revised by Eurostat. While the

Figure BE1 - qoq growth in the three main sectors
value added, constant prices, calendar adjusted, SA



Source: KBC Economics based on NBB

Figure BE2 - Breakdown of Belgian growth by components
quarter-on-quarter, in percentage points



Source: KBC Economics based on NBB

previous Eurostat-series showed an upward movement, the updated data combined with new recent data now have a decline in the rate, reaching 5.4% in July, down from 5.7% in March. In our scenario, we still think the unemployment rate will rise again toward year-end, albeit slightly to 5.6% (5.7% previously). After all, several soft and hard data indicate that the situation on Belgium's labour market has weakened gradually in recent months (e.g., worsening employment outlook of businesses as reflected in the NBB indicator, continuing declines in interim labour, upward move in the July and August unemployment rate based on administrative data).

Central and Eastern Europe

Central and Eastern Europe faces flood-related damages

The Central and Eastern European region was hit by the worst floods in two decades. While the floods were as heavy as in 1997/2002 in many places, the regional countries appeared better prepared thanks to a combination of more accurate weather forecasts and more robust flood protection systems. Still, flood-related costs will impact government spending, adding some strains on public finances at a time when CEE economies continue to deal with several shocks, including the pandemic, the war in Ukraine, and the energy crisis, pushing budget deficits well above the Maastricht limit of 3% of GDP.

In the Czech Republic, the flood damages are preliminarily estimated at around 70 billion CZK, or 1% of GDP. That is significantly below the costs of 3% of GDP during the 1997 and 2002 floods. The Czech government has already announced emergency fiscal support amounting to 40 billion CZK (0.5% of GDP) with 75% distributed already this year. As a result, the government is set to amend the 2024 budget, implying a larger deficit of 282 billion CZK. For next year, government will propose a budget deficit of 240 billion CZK (previously 230 billion CZK).

It is, however, likely that the final government flood-related expenditure will be lower. Looking back, the government typically covered around one-quarter of the total damages. Meanwhile, private insurance companies covered as much as 50% of total costs. The first estimate of the insured damages stands at around 17 billion CZK, with half going to households and the other half to businesses.

In addition, enough financial resources to finance flood damages are available at the region and municipality level. Both are in unusually good financial conditions – in the first half of the year alone, regions and municipalities reached an all-time high surplus of 83 billion CZK (1% of GDP). In total, almost 530 billion CZK is deposited at their account in banks. A needed reconstruction of regional infrastructure is precisely the moment to (finally) start investing heavily in projects with relatively high multiplier effects. These are particularly important in structurally-weakened regions such as the flood-hit Moravian-Silesian region.

Finally, regional economies will significantly benefit from EU financing. In the past, the Czech Republic usually received support of around one billion CZK, however, this time it will receive 50 billion CZK (0.6% of GDP) from the European Solidarity Fund. In total, the EU support to the CEE economies is 10 billion euro. The form of the support is also important – without the standard co-financing by the Member State in order to ensure an easy and fast disbursement.

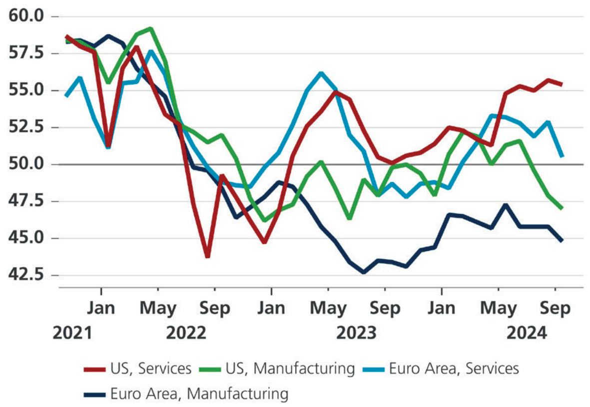
Despite the increased financing needs of around 0.3% of GDP, we estimate that this year's Czech budget deficit will fall moderately below the Maastricht limit of 3% of GDP. Assuming the one-off character of the adopted measures, we do not expect any negative impact on the long-term sustainability of public finances. In fact, as the Czech Fiscal Council has noted recently, the health of domestic public finances has improved and a possible hit to the debt brake (55% of GDP) is no longer imminent in 2028 but only in 2038. These estimates should be taken with a grain of salt, but what is important is that, thanks to the stabilisation of public debt, the Czech government has sufficient fiscal capacity to deal with natural disasters such as floods. Looking forward, this will remain crucial as climate-related events have been becoming more severe lately, and economic losses related to climate are on the rise in the EU.

Figures

Real GDP
yearly change in %

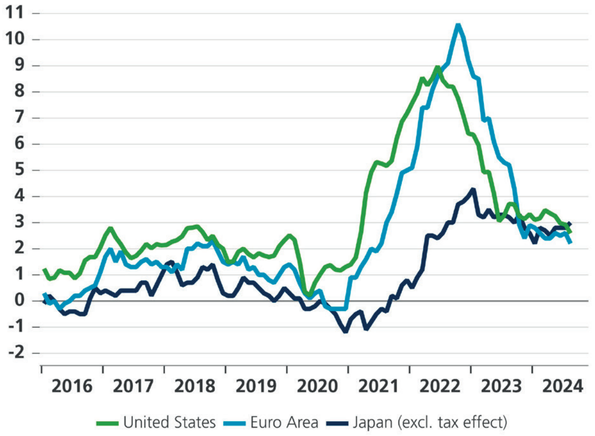
Source: KBC Economics based on Eurostat, BEA, NBS

Business confidence indicators
index, above 50 = expansion



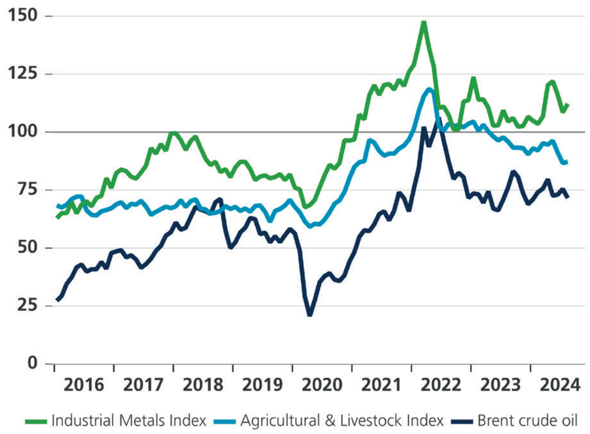
Source: KBC Economics based on S&P Global

Headline inflation
yearly change consumer price index, in %



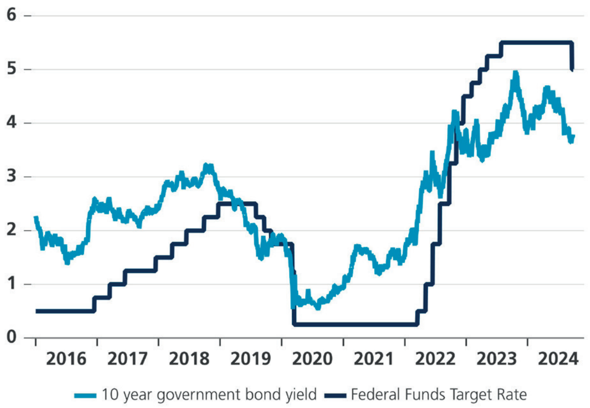
Source: KBC Economics based on Eurostat, SBJ, BLS

Commodity prices
index, January 2013=100, in USD



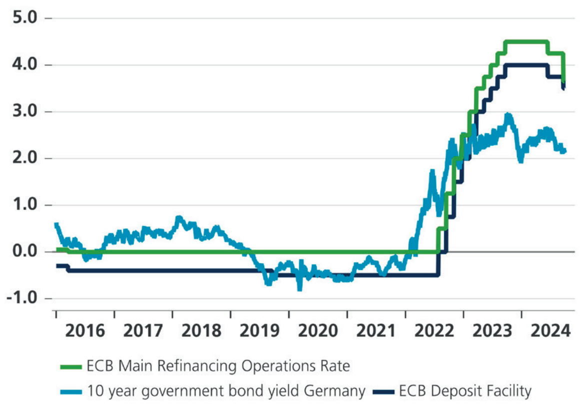
Source: KBC Economics based on World Bank, S&P Global

United States interest rates
in %



Source: KBC Economics based on Fed, U.S. Treasury

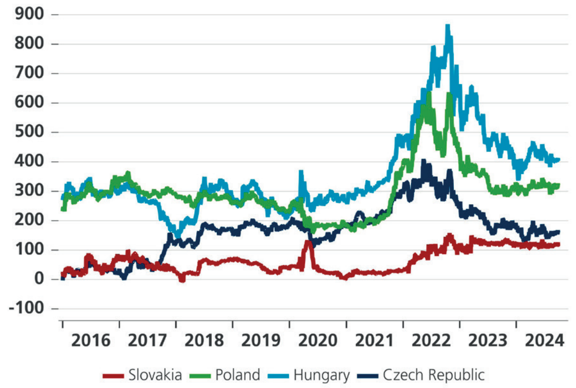
Euro area interest rates
in %



Source: KBC Economics based on Macrobond, ECB

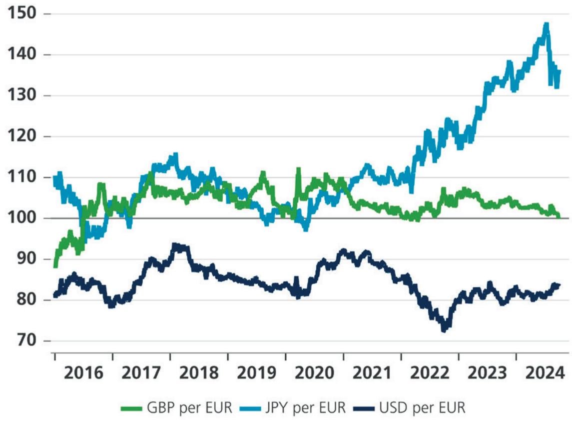
Figures

10 year government bond yield spreads to Germany
in basis points



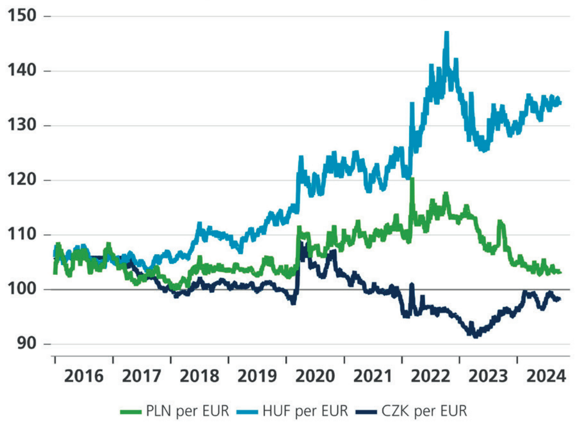
Source: KBC Economics based on Macrobond, AKK, Eurostat

Exchange rates
index, January 2013=100, increase = stronger EUR



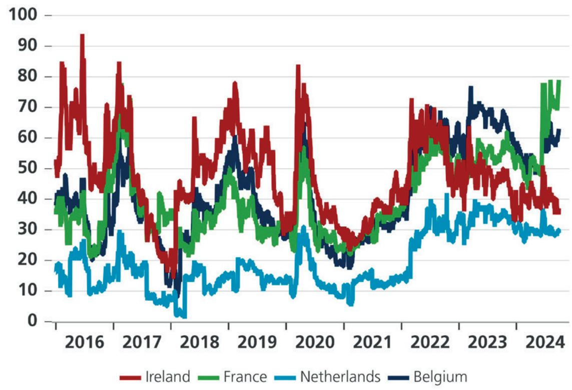
Source: KBC Economics based on Macrobond

Exchange rates
index, January 2013=100, increase = stronger EUR



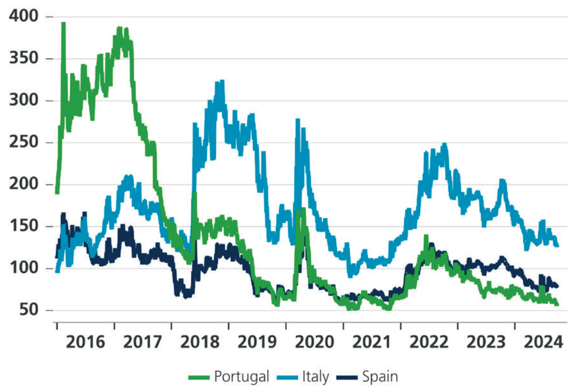
Source: KBC Economics based on Macrobond

10 year government bond yield spreads to Germany
in basis points



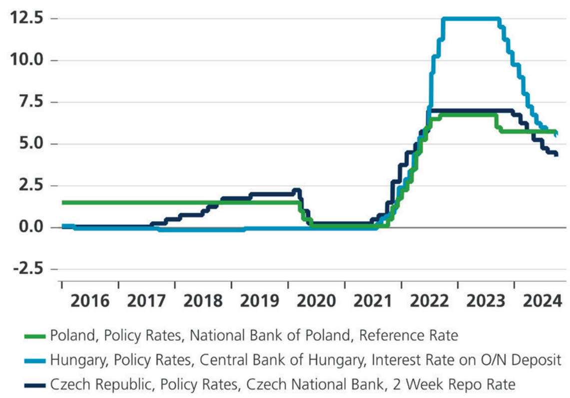
Source: KBC Economics based on Macrobond

10 year government bond yield spreads to Germany
in basis points



Source: KBC Economics based on Macrobond

Monetary policy rates Central Europe
in %



Source: KBC Economics based on CNB, MNB, NBP

Outlook main economies in the world

		Real GDP growth (period average, based on quarterly figures, in %)			Inflation (period average, in %)		
		2023	2024	2025	2023	2024	2025
Euro area	Euro area	0.5	0.7	1.2	5.4	2.5	2.2
	Germany	-0.1	0.1	1.2	6.1	2.7	2.7
	France	1.1	1.1	1.1	5.7	2.7	1.9
	Italy	1.0	0.8	0.8	5.9	1.0	1.5
	Spain	2.5	2.4	2.1	3.4	3.1	2.1
	Netherlands	0.1	0.6	1.3	4.1	3.1	2.3
	Belgium	1.4	1.1	1.2	2.3	4.0	2.2
	Ireland	-3.2	1.8	4.4	5.2	1.7	2.0
	Slovakia	1.6	2.3	2.0	11.0	2.8	5.2
Central and Eastern Europe	Czech Republic	0.0	1.0	2.7	12.1	2.5	2.5
	Hungary	-0.7	1.5	3.0	17.0	3.9	4.0
	Bulgaria	2.0	2.2	2.6	8.6	3.1	3.0
	Poland	0.1	2.9	3.3	10.9	4.0	3.9
	Romania	2.1	3.2	3.0	9.7	6.5	5.0
Rest of Europe	United Kingdom	0.1	0.8	1.1	7.1	2.6	2.3
	Sweden	-0.1	0.8	2.0	5.9	3.1	1.6
	Norway (mainland)	1.1	0.8	1.4	5.7	3.5	2.4
	Switzerland	0.7	1.4	1.5	2.1	1.3	1.1
Emerging markets	China	5.2	4.7	4.2	0.2	0.5	1.6
	India*	8.2	6.5	6.1	5.4	4.6	4.9
	South Africa	0.7	0.9	1.6	6.1	4.8	4.7
	Russia	Temporarily no forecast due to extreme uncertainty					
	Turkey	5.1	3.0	3.3	53.9	44.2	25.5
	Brazil	2.9	3.1	2.1	4.6	4.3	3.9
Other advanced economies	United States	2.5	2.6	1.7	4.1	2.9	2.3
	Japan	1.7	0.1	1.3	3.3	2.5	2.1
	Australia	2.0	1.2	2.1	5.6	3.4	2.8
	New Zealand	0.9	0.7	2.2	5.7	3.2	2.2
	Canada	1.2	1.0	1.8	3.6	2.5	2.1
*** fiscal year from April-March**						26/9/2024	

Policy rates (end of period, in %)						
		26/9/2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025
Euro area	Euro area (refi rate)	3.65	3.65	3.40	3.15	2.65
	Euro area (depo rate)	3.50	3.50	3.25	3.00	2.50
Central and Eastern Europe	Czech Republic	4.25	4.25	3.75	3.50	3.50
	Hungary	6.50	6.50	6.00	5.50	5.00
	Bulgaria	-				
	Poland	5.75	5.75	5.75	5.75	5.50
	Romania	6.50	6.50	6.50	6.50	6.50
Rest of Europe	United Kingdom	5.00	5.00	4.50	4.25	4.00
	Sweden	3.25	3.25	2.75	2.50	2.50
	Norway	4.50	4.50	4.25	4.00	3.75
	Switzerland	1.00	1.00	0.75	0.75	0.75
Emerging markets	China (7-day r. repo)	1.50	1.50	1.50	1.50	1.50
	India	6.50	6.50	6.25	6.00	6.00
	South Africa	8.00	8.00	7.75	7.50	7.25
	Russia	Temporarily no forecast due to extreme uncertainty				
	Turkey	50.00	50.00	45.00	40.00	35.00
	Brazil	10.75	10.75	10.75	10.75	10.75
Other advanced economies	United States (mid-target range)	4.875	4.875	4.125	3.625	3.125
	Japan	0.25	0.25	0.30	0.40	0.40
	Australia	4.35	4.35	4.10	3.85	3.60
	New Zealand	5.25	5.25	4.50	4.00	3.75
	Canada	4.25	4.25	3.50	3.25	3.00

Outlook main economies in the world

10 year government bond yields (end of period, in %)		26/9/2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025
Euro area	Germany	2.16	2.25	2.25	2.30	2.30
	France	2.96	2.98	3.00	3.05	3.05
	Italy	3.50	3.62	3.85	3.90	3.90
	Spain	2.97	3.06	3.25	3.30	3.30
	Netherlands	2.45	2.61	2.65	2.70	2.70
	Belgium	2.80	2.87	2.95	3.00	3.00
	Ireland	2.54	2.62	2.75	2.80	2.80
	Slovakia	3.26	3.34	3.50	3.55	3.55
Central and Eastern Europe	Czech Republic	3.72	3.70	3.90	4.00	4.10
	Hungary	6.29	6.20	6.00	5.90	5.60
	Bulgaria*	3.90	3.95	3.75	3.80	3.80
	Poland	5.34	5.20	5.10	5.00	4.80
	Romania	6.74	7.60	8.00	8.15	8.15
Rest of Europe	United Kingdom	4.00	3.85	3.85	3.90	3.90
	Sweden	1.99	2.00	2.00	2.05	2.05
	Norway	3.35	3.45	3.45	3.50	3.50
	Switzerland	0.47	0.50	0.50	0.55	0.55
Emerging markets	China	2.07	2.15	2.15	2.20	2.20
	India	6.71	6.75	6.55	6.55	6.55
	South Africa	8.84	8.90	8.90	8.95	8.95
	Russia	15.13	Temporarily no forecast due to extreme uncertainty			
	Turkey	26.71	27.00	25.50	24.00	24.00
	Brazil	12.26	11.95	11.85	11.80	11.80
Other advanced economies	United States	3.78	3.75	3.75	3.80	3.80
	Japan	0.83	1.00	1.15	1.15	1.25
	Australia	3.95	3.95	3.95	4.00	4.00
	New Zealand	4.26	4.25	4.25	4.30	4.30
	Canada	3.01	3.00	3.00	3.05	3.05

***Caution: very illiquid market**

Exchange rates (end of period)	26/9/2024	Q3 2024	Q4 2024	Q1 2025	Q2 2025
USD per EUR	1.11	1.10	1.11	1.11	1.12
CZK per EUR	25.14	25.10	24.90	24.60	24.40
HUF per EUR	395.49	395.00	398.00	400.00	402.00
PLN per EUR	4.27	4.28	4.25	4.25	4.23
BGN per EUR	1.96	1.96	1.96	1.96	1.96
RON per EUR	4.97	5.10	5.20	5.25	5.25
GBP per EUR	0.83	0.84	0.84	0.85	0.86
SEK per EUR	11.32	11.30	11.30	11.25	11.20
NOK per EUR	11.81	11.60	11.50	11.40	11.30
CHF per EUR	0.94	0.95	0.95	0.95	0.95
BRL per USD	5.47	5.50	5.48	5.48	5.45
INR per USD	83.70	84.23	83.85	83.85	83.48
ZAR per USD	17.18	17.54	17.46	17.46	17.38
RUB per USD	92.35	Temporarily no forecast due to extreme uncertainty			
TRY per USD	34.15	34.54	36.50	38.20	39.28
RMB per USD	7.02	7.10	7.15	7.17	7.20
JPY per USD	144.86	140.00	138.00	137.00	136.00
USD per AUD	0.69	0.68	0.70	0.71	0.71
USD per NZD	0.63	0.61	0.62	0.63	0.63
CAD per USD	1.35	1.36	1.35	1.35	1.34

Outlook KBC markets

	Belgium			Ireland		
	2023	2024	2025	2023	2024	2025
Real GDP (average yearly change, based on quarterly figures, in %)	1.4	1.1	1.2	-3.2	1.8	4.4
Inflation (average yearly change, harmonised CPI, in %)	2.3	4.0	2.2	5.2	1.7	2.0
Unemployment rate (Eurostat definition, in % of the labour force, end of year)	5.6	5.6	5.6	4.5	4.5	4.5
Government budget balance (in % of GDP)	-4.4	-4.6	-5.0	1.7	1.8	1.8
Gross public debt (in % of GDP)	105.2	105.8	107.9	42.7	39.0	35.7
Current account balance (in % of GDP)	-1.0	-0.5	-1.0	9.8	7.2	7.1
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	2.3	2.8	3.0	3.1	3.0	4.0

	Czech Republic			Slovakia		
	2023	2024	2025	2023	2024	2025
Real GDP (average yearly change, based on quarterly figures, in %)	0.0	1.0	2.7	1.6	2.3	2.0
Inflation (average yearly change, harmonised CPI, in %)	12.1	2.5	2.5	11.0	2.8	5.2
Unemployment rate (Eurostat definition) (in % of the labour force, end of year)	2.7	3.2	3.2	5.5	5.5	5.5
Government budget balance (in % of GDP)	-3.7	-2.7	-1.9	-4.9	-5.8	-4.9
Gross public debt (in % of GDP)	42.4	43.4	44.1	56.0	58.2	59.2
Current account balance (in % of GDP)	0.3	0.9	1.0	-1.6	-2.0	-2.8
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	-1.7	2.7	3.8	-0.2	0.2	2.5

	Hungary			Bulgaria		
	2023	2024	2025	2023	2024	2025
Real GDP (average yearly change, based on quarterly figures, in %)	-0.7	1.5	3.0	2.0	2.2	2.6
Inflation (average yearly change, harmonised CPI, in %)	17.0	3.9	4.0	8.6	3.1	3.0
Unemployment rate (Eurostat definition) (in % of the labour force, end of year)	4.2	4.0	3.6	4.4	4.2	4.1
Government budget balance (in % of GDP)	-6.7	-4.8	-4.1	-1.9	-2.9	-2.8
Gross public debt (in % of GDP)	73.5	74.1	73.6	23.1	24.3	25.8
Current account balance (in % of GDP)	0.3	1.5	1.3	-0.2	-0.7	-0.9
House prices (Eurostat definition) (average yearly change in %, existing and new dwellings)	7.0	4.5	4.5	9.9	9.9	4.0

Outlook Belgian economy

National accounts (real yearly change, in %)	2023	2024	2025
Private consumption	1.4	1.0	1.1
Public consumption	1.6	1.9	0.8
Investment in fixed capital	3.6	1.2	2.9
Corporate investment	6.0	1.9	3.8
Public investment	6.3	6.9	2.0
Residential building investment	-5.7	-5.0	-0.1
Final domestic demand (excl. changes in inventories)	2.0	1.3	1.4
Change in inventories (contribution to growth)	0.1	-0.7	0.1
Exports of goods and services	-3.3	-2.1	1.4
Imports of goods and services	-2.6	-2.8	1.8
Gross domestic product (GDP), based on quarterly figures	1.4	1.1	1.2
Household disposable income	3.8	1.6	0.9
Household savings rate (% of disposable income)	14.5	15.0	14.7

Equilibrium indicators	2023	2024	2025
Inflation (average yearly change, in %)			
Consumer prices (harmonised CPI)	2.3	4.0	2.2
Health index (national CPI)	4.3	3.3	2.2
Labour market			
Domestic employment (yearly change, in '000, year end)	25.5	19.2	30.0
Unemployment rate (in % of labour force, end of year, Eurostat definition)	5.6	5.6	5.6
Public finances (in % of GDP, on unchanged policy)			
Overall balance	-4.4	-4.6	-5.0
Public debt	105.2	105.8	107.9
Current account balance (in % of GDP)	-1.0	-0.5	-1.0
House prices (average yearly change in %, existing and new dwellings, Eurostat definition)	2.3	2.8	3.0

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