

Czech National Bank

CNB Focus

The CNB continues to tighten monetary policy

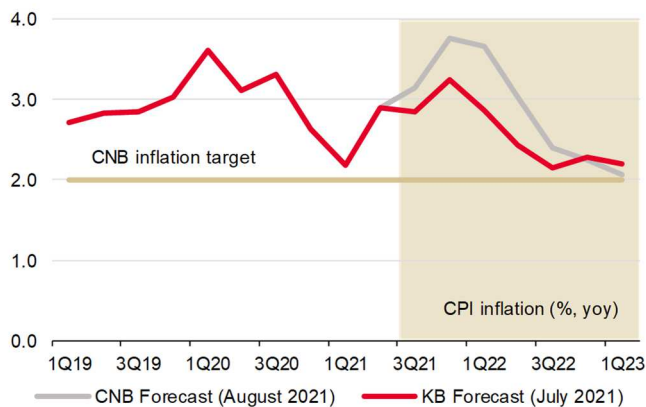


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As expected, the central bank raised its key repo rate from 0.50% to 0.75% at its August meeting. Although the bank board discussed a 50bp hike, as proposed by the new CNB forecast, in the end it preferred a gradual normalisation of monetary policy. According to Governor Rusnok, the CNB should continue to pursue gradual normalisation for the rest of the year. While the CNB forecast calls for a repo rate of 1.50% at year-end, we expect 1.25% due to the cautious approach of central bankers. However, we already expect a repo rate of 2.25% for end-2022, while the CNB expects 2%. The difference is mainly our expectation of a stronger economic recovery, with a slightly weaker koruna.

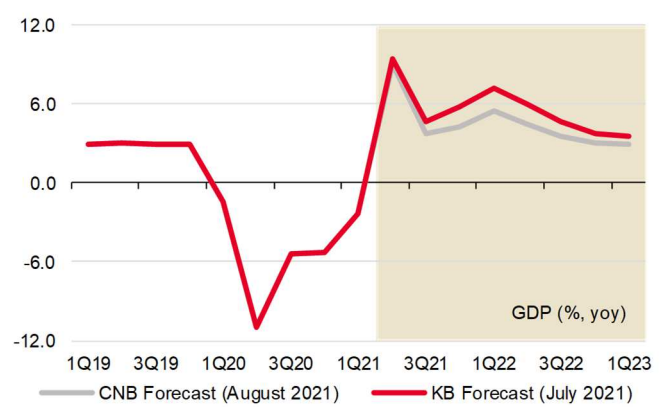
As expected, the Czech National Bank (CNB) raised the key repo rate from 0.50% to 0.75% at its August meeting. This was due to a significantly improved pandemic situation, the ongoing economic recovery and elevated inflation. The central bank also decided to further increase the Lombard rate from 1.25% to 1.75% and to keep the discount rate unchanged at 0.05%. The 25bp hike in the repo rate was enforced by the votes of four board members, while one other preferred a 50bp increase and the remaining two were for interest rate stability. The vote therefore ended with the same result as in June, as the central bankers likely voted as they did a month ago. At that time, Governor Rusnok, Vice Governors Mora and Nidetzky, and board member Holub were for 25bp increase; Benda voted in favour of 50bp and Dedeck and Michl wanted to keep rates unchanged.

Inflation above the CNB target until 2H22



Source: CZSO, CNB, Economic & Strategy Research, Komerční banka

Pre-crisis levels of production at the turn of 2021 and 2022

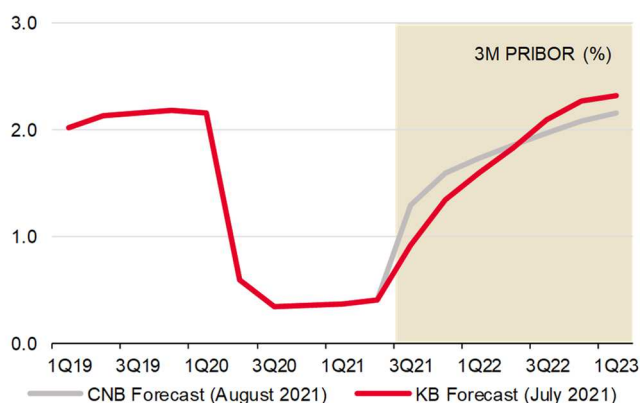


Source: CZSO, CNB, Economic & Strategy Research, Komerční banka

Governor Rusnok said the CNB's new forecast assumed a 50bp hike in the repo rate at the August meeting. This forecast envisages three hikes for the whole of 3Q and one more in 4Q. It is two more than in the previous CNB forecast, which is likely a reaction mainly to the rapid rise in producer prices and to a better performance by the Czech economy in 1Q than the central bank had forecast. The CNB revised this year's GDP growth forecast (from 1.2% to 3.5%) and inflation forecast (from 2.7% to 3.0%). At end-2021, the CNB expects a repo rate of 1.50%. Rusnok admitted that the CNB is ready to raise interest rates at each subsequent

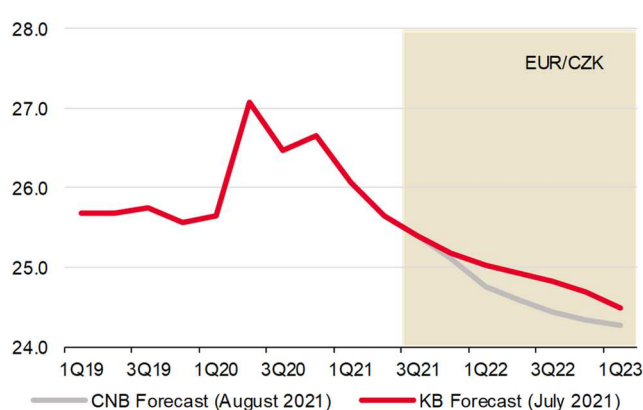
meeting, but at the same time added that the rise in rates is unlikely to be as fast as the new forecast assumes. The bank board is still aware of the risks associated with the pandemic, although it no longer expects significant negative effects on the economy. **According to Rusnok, the central bank does not want to take strong action and would rather go the way of gradually tightening monetary policy, where there is less of a chance of making a mistake.**

Interest rates to rise sharply



Source: CNB, Economic & Strategy Research, Komerční banka

Stronger koruna to help tighten monetary conditions



Source: CNB, Economic & Strategy Research, Komerční banka

We expect a slower rise in interest rates in 2021 and a faster rise in 2022 than the CNB forecasts. In our opinion, there will be two more 25bp hikes in the repo rate this year, at the meetings in September and November. We therefore expect a repo rate of 1.25% at year-end. Due to the Christmas holidays, the December CNB meeting always takes place at an earlier date, so the board does not have a full set of information regarding economic trends. This meeting thus rarely brings changes to monetary policy stance. **We expect another four increases in interest rates next year, while the CNB forecasts only two.** Our forecast assumes a repo rate of 2.25% at end-2022 and the CNB expects 2%. The central bank is more pessimistic about the pace of economic recovery. We forecast growth in Czech GDP of 5.3% in 2022 (after the 4.2% increase this year), but the CNB expects only 4.1%. The stronger koruna – with the CNB forecasting an average EUR/CZK rate of 24.50 for 2022 – vs our EUR/CZK forecast of 24.90, could also have an effect. **Overall, decisions made at the August meeting may further strengthen the inversion of the koruna's yield curve.** Governor Rusnok stated that the majority of the voting board – which was ultimately in favour of a 25bp hike – also considered a 50bp increase, and that could be an especially strong signal for the market.

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