

| Czech National Bank |

CNB Focus

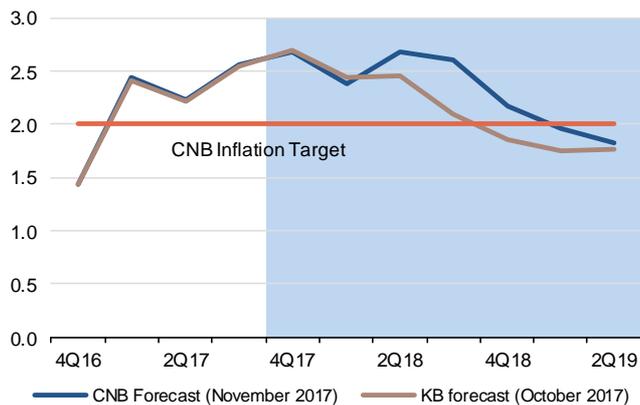
CNB to stay on hold in a close vote


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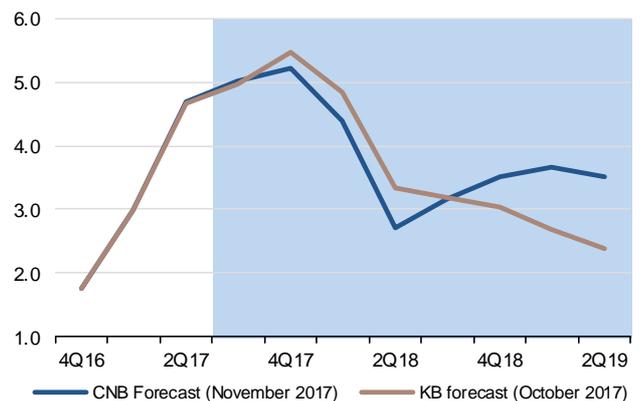
November's bank board meeting was a surprisingly calm event (as all board members raised their hands for a 25bp hike) despite hawkish comments from some members before the meeting who suggested they would vote for a 50bp hike. Also, the forecast released in November had an unexpectedly dovish message. As the economy developed almost exactly in line with the forecast, we believe the bank board will stay on hold, in line with the recent staff prognosis. Yet, some of board members might consider monetary conditions too loose due to the weaker koruna. We thus expect the board to be split, and our call for no hike is a close one.

Data in line with current forecast

The December meeting will not provide the board members with a new macroeconomic forecast. Thus, the board will be evaluating the risk to the November prognosis. The most recent CNB forecast, published in early November, assumes no more hikes this year. Yet, the bank board identified two major pro-inflationary risks in the economy. The first stems from the extremely tight labour market, which creates strong wage pressures. In the annex of the most recent inflation report, the CNB published a 'sensitivity' scenario that assumed stronger wage growth resulting in a steeper hiking trajectory and quicker koruna appreciation. The second risk stems from the elevated CZK positions among foreign investors. If these are unwound, the CZK would depreciate and monetary conditions would relax as a result.

Inflation stays in line with the CNB forecast (%)...


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

... as does GDP growth (%)


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

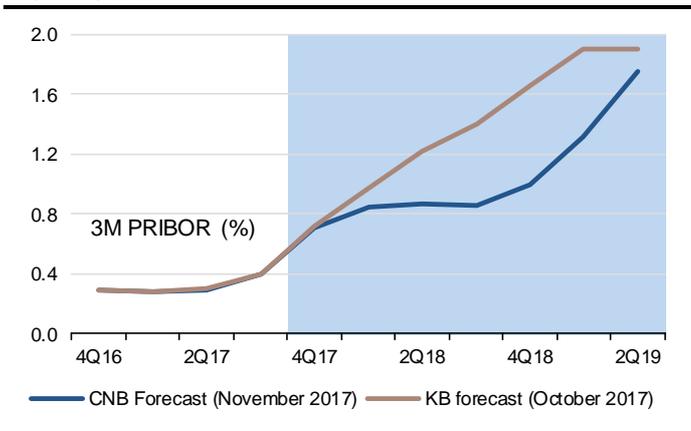
Given the most recent average wage reading (4.2% real wage growth in 3Q17, below the 5.0% CNB estimate), it is apparent that the sensitivity scenario has not materialised thus far. **We therefore believe most board members will base their decisions on the baseline scenario of the staff forecast, which implies no rate hike in December.**

Slow koruna appreciation to provide a reason to hike for some December voting will likely be a close, in our view. The fact that the koruna has not appreciated since the last monetary policy meeting might prompt the hawks on the board to vote for a hike this month. However, we believe that majority of the board will act in line with the recent staff outlook and delay monetary tightening until the next year. We could see a repeat of what happened in September, when three members voted for a hike and the smallest possible majority ensured that rates stayed on hold. So while we expect no hike, the CNB will likely deliver a hawkish message at its 21 December meeting.

Rates normalisation to continue next year

Although the CNB forecast suggests only a c.30bp in rate increases to end-2018 from current levels, we assume that the board will normalise monetary policy. **We think the CNB forecast needs to be taken with a grain of salt.** The bank board probably wants rates to be much higher than they are now at the beginning of 2019, as suggested by the current forecast, but we think the hiking path to be

We believe the bank board will pursue a continuous PRIBOR trajectory (%)



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

much more of a continuous process than the current CNB forecasts suggest. **We expect the bank board to increase rates by 25bp every quarter at its main monetary policy meetings until 1Q19, with the repo rate peaking at 1.75%.**

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