

| Czech National Bank |

CNB Focus

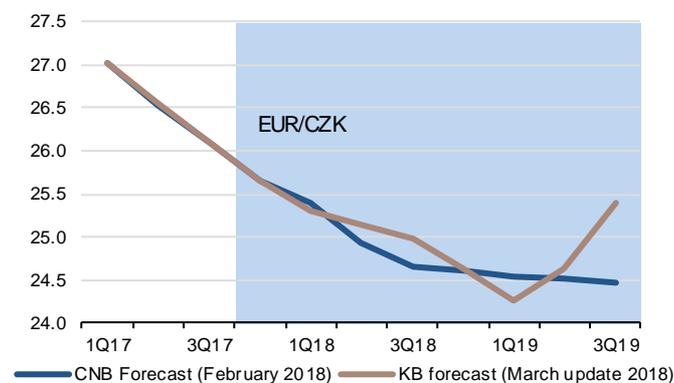
CNB to sound dovish amid weaker inflation readings


Viktor Zeisel
 (420) 222 008 523
 viktor_zeisel@kb.cz

The CNB forecast released in early January met with disappointment in the markets which expected the swift normalisation of monetary policy to continue. CNB expects only one hike at the very end of the year with CZK set to appreciate rapidly as early as the second quarter. We do not expect a rate hike to be announced at Thursday's meeting. The risks to the forecast are likely to be assessed as balanced or even slightly negative, as the figures from the real economy slightly disappointed and current inflation eased more than expected. Only CZK refuses to appreciate and thus represents a pro-inflationary risk. We expect inflation to recover on the back of strong economic conditions and CNB to hike twice in the second half of the year.

Inflation down, but only temporarily

The last CNB meeting was very dovish and was followed by a very disappointing headline inflation figure, showing inflation had eased below the 2% target to reach 1.8% in February. These figures will be the main reason why Governor Rusnok is likely to assess the risks to the forecast as somewhat negative. Moreover, various other data readings disappointed; real wage growth printed slightly below CNB's expectation and GDP growth was also slightly weaker. By contrast, the activity data showed that the beginning of the year was strong and even suggested that wage growth had accelerated and was boosting private consumption. While this might be modestly pro-inflation, most of the attention will be drawn to the exchange rate which has refused to appreciate as the CNB depicted in its last forecast. FX therefore represents the biggest upside risk to the inflation forecast. We believe that neither relative CZK weakness nor the very good monthly data will persuade the governor to adopt a more hawkish tone and that he will most likely stick to the current forecast which suggests only one more hike this year.

Koruna set to fight longer at the EURCZK25 level


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

CNB set to deliver two more hikes this year


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

We remain very positive for the economy as we believe GDP growth will stay solid this year (3.8%) and there are signs that wage growth could even accelerate. The recent drop in inflation is mainly due to volatile food prices which normalised earlier than we expected after last year's surge. Core inflation will be supported by strong wage growth and favourable base effects which should push headline inflation back above the 2% mark by the summer. CZK seems unlikely to move below EURCZK25 quickly, as its appreciation will be curbed by the ongoing dividend season and the dovish CNB stance. To tighten monetary policy conditions, CNB will have to raise rates more quickly than is currently planned. We assume two hikes in the second half of the year, with one at the August meeting and the other probably in November.

KB ECONOMIC & STRATEGY RESEARCH

Chief Economist and Head of Research
Jan Vejmelek, Ph.D., CFA
 (420) 222 008 568
 jan_vejmelek@kb.cz

<p>Economists Viktor Zeisel (420) 222 008 523 viktor_zeisel@kb.cz</p>	<p>Marek Dřimal (420) 222 008 598 marek_drimal@kb.cz</p>	<p>Monika Junicke (420) 222 008 509 monika_junicke@kb.cz</p>	<p>Jana Steckerová (420) 222 008 524 jana_steckerova@kb.cz</p>
<p>Equity Analysts Miroslav Frayer (420) 222 008 567 miroslav_frayer@kb.cz</p>	<p>Jiří Kostka (420) 222 008 560 jiri_kostka@kb.cz</p>	<p>Sectors David Kocourek (420) 222 008 569 david_kocourek@kb.cz</p>	

SG IN CENTRAL AND EASTERN EUROPE

<p>Chief Economist of SG Poland Jaroslav Janecki (48) 225 284 162 jaroslav.janecki@sgcib.com</p>	<p>Head of Research of Rosbank Yury Tulinov, CFA (7) 495 662 13 00 (ext. 14836) yury.tulinov@rosbank.ru</p>	<p>Chief Economist of BRD-GSG Florian Libacor (40) 213 016 869 florian.libacor@brd.ro</p>
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<p>Head of Fin. Markets Research BRD-GSG Carmen Lipara (40) 213 014 370 carmen.lipara@brd.ro</p>	<p>Economist Ioan Mincu (40) 213 014 472 george.mincu-radulescu@brd.ro</p>	<p>Equity Analyst Laura Simion, CFA (40) 213 014 370 laura.simion@brd.ro</p>
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SG GLOBAL ECONOMICS RESEARCH

Head of Global Economics
Klaus Baader
 (852) 2166 4095
 klaus.baader@sgcib.com

<p>Euro area Anatoli Annenkov (44) 20 7762 4676 anatoli.annenkov@sgcib.com</p>	<p>Michel Martinez (33) 1 4213 3421 michel.martinez@sgcib.com</p>	<p>Yvan Mamalet (44) 20 7762 5665 yvan.mamalet@sgcib.com</p>	<p>United Kingdom Brian Hilliard (44) 20 7676 7165 brian.hilliard@sgcib.com</p>
<p>North America Stephen Gallagher (212) 278 4496 stephen.gallagher@sgcib.com</p>	<p>Omair Sharif (1) 212 278 48 29 omair.sharif@sgcib.com</p>	<p>Latin America Dev Ashish (91) 80 2802 4381 dev.ashish@socgen.com</p>	<p>Ankur Shukla (91) 80 6731 4432 ankur.shukla@sgcib.com</p>
<p>China Wei Yao (852) 2166 5437 wei.yao@sgcib.com</p>	<p>Japan Takuji Aida (81) 3 5549 5187 takuji.aida@sgcib.com</p>	<p>Kiyoko Katahira (81) 3 5549 5190 kiyoko.katahira@sgcib.com</p>	<p>Arata Oto (81) 3 6777 8064 arata.oto@sgcib.com</p>
<p>Korea Suktae Oh (82) 2195 7430 suktae.oh@sgcib.com</p>	<p>India Kunal Kumar Kundu (91) 80 6716 8266 kunal.kundu@sgcib.cz</p>	<p>Inflation Vaibhav Tandon (91) 80 6731 9449 vaibhav.tandon@sgcib.com</p>	

SG CROSS ASSET RESEARCH - FIXED INCOME & FOREX GROUPS

Global Head of Research
Brigitte Richard-Hidden
 (33) 1 42 13 78 46
 brigitte.richard-hidden@sgcib.com

Head of Fixed Income & Forex Strategy
Guy Stear
 (33) 1 41 13 63 99
 guy.stear@sgcib.com

<p>Fixed Income Bruno Braizinha (1) 212 278 5296 bruno.braizinha@sgcib.com</p>	<p>Jean-David Ciotteau (33) 1 42 13 72 52 jean-david.ciotteau@sgcib.com</p>	<p>Cristina Costa (33) 1 58 98 51 71 cristina.costa@sgcib.com</p>	<p>Jorge Garayo (44) 20 7676 7404 jorge.garayo@sgcib.com</p>
<p>Head of Euro Area Rates Strategy Ciaran O'Hagan (33) 1 42 13 58 60 ciaran.ohagan@sgcib.com</p>	<p>Shakeeb Hulikatti (91) 80 2802 4380 shakeeb.hulikatti@sgcib.com</p>	<p>Rates Derivative Strategy Adam Kurpiel (33) 1 42 13 63 42 adam.kurpiel@sgcib.com</p>	
<p>Head of US Rates Strategy Subadra Rajappa (1) 212 278 5241 subadra.rajappa@sgcib.com</p>	<p>Jason Simpson (44) 20 7676 7580 jason.simpson@sgcib.com</p>	<p>Marc-Henri Thoumin (44) 20 7676 7770 marc-henri.thoumin@sgcib.com</p>	

<p>Foreign Exchange Kit Juckes (44) 20 7676 7972 kit.juckes@sgcib.com</p>	<p>FX Derivatives Strategy Olivier Korber (33) 1 42 13 32 88 olivier.korber@sgcib.com</p>	<p>Alvin T. Tan (44) 20 7676 7971 alvin-t.tan@sgcib.com</p>
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Head of Emerging Markets Strategy
Jason Daw
 (65) 6326 7890
 jason.daw@sgcib.com

<p>Amit Agrawal (91) 80 6758 4096 amit.agrawal@sgcib.com</p>	<p>Régis Chatellier (44) 20 7676 7354 regis.chatellier@sgcib.com</p>	<p>Phoenix Kalen (44) 20 7676 7305 phoenix.kalen@sgcib.com</p>
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