

| Czech National Bank |

# CNB Focus

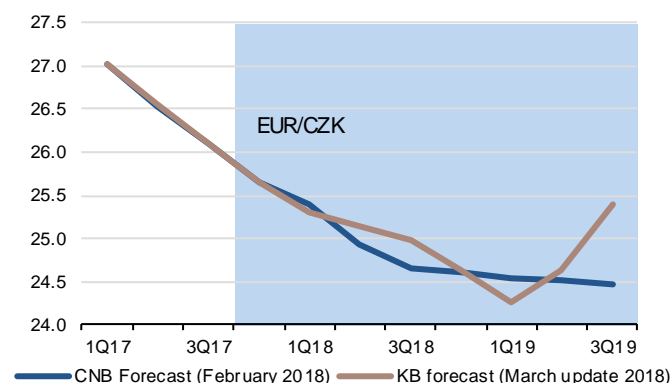
## CNB to sound dovish amid weaker inflation readings


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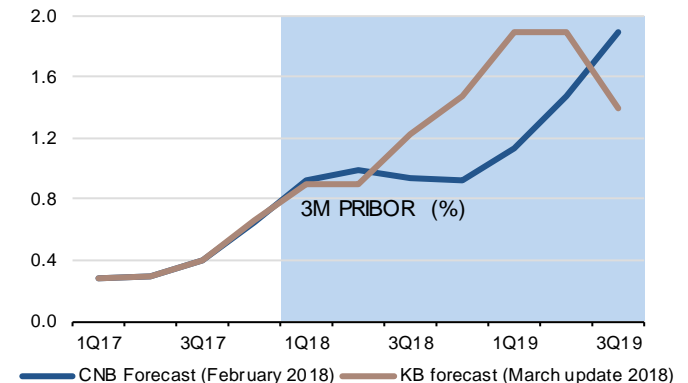
The CNB forecast released in early January met with disappointment in the markets which expected the swift normalisation of monetary policy to continue. CNB expects only one hike at the very end of the year with CZK set to appreciate rapidly as early as the second quarter. We do not expect a rate hike 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 &amp; Strategy Research, Komerční banka

**CNB set to deliver two more hikes this year**


Source: CNB, Bloomberg, Macrobond, Economic &amp; 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.

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