



Czech National Bank |

CNB Focus

Slower inflation represents the biggest threat to CNB forecast

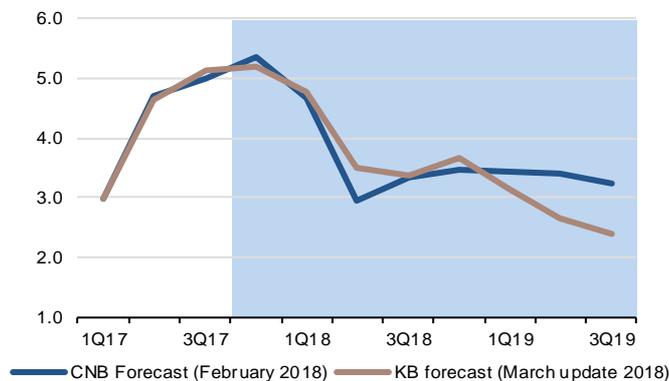


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Today's Czech National Bank (CNB) meeting was a rather boring event. The bank board unanimously decided to keep rates unchanged. The risks to the forecast were evaluated as slightly anti-inflationary, but the projected rate hike at year-end does not seem to be in danger. Our in-house view is that the CNB will conduct two more hikes in 2H18, after inflation returns above the 2% target in summer.

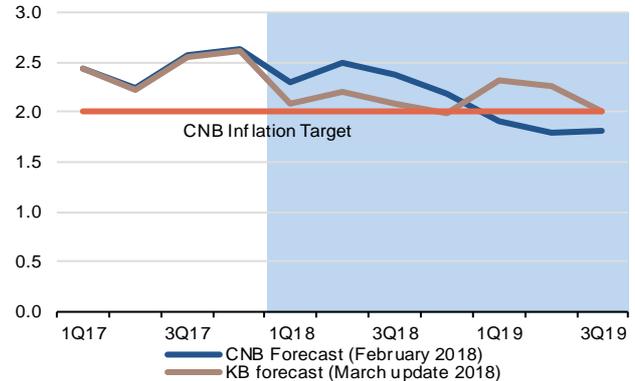
The bank board unanimously decided to keep monetary policy unchanged, in line with market expectations. The evaluation of risks to the February forecast was a bit more interesting. The forecast called for a slight easing of inflation and rapid CZK appreciation. However, we saw a strong drop in inflation figures, while the CZK refused to strengthen. The CNB thus sees risks, both on upside and downside. In the end, weak inflation outweighed the exchange rate, and the overall risk was evaluated as slightly anti-inflationary, though Governor Rusnok admitted that the main reason inflation eased was a dramatic slowing of food price inflation.

Economic trends remain sound, according to CNB (%)



Source: CNB, CZSO, Macrobond, Economic and Strategy Research KB

Inflation set to accelerate in 2Q18 (%)



Source: CNB, CZSO, Macrobond, Economic and Strategy Research KB

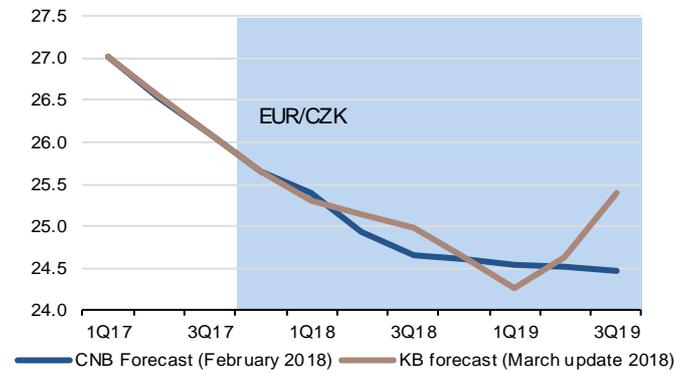
In the Q&A session, we heard some hawkish remarks. According to Governor Rusnok, the debate was lively and some board members mentioned an overheating of the economy. Those members might have a tendency push for quicker policy tightening than what is suggested by the current forecast. Moreover, Mr Rusnok repeated that if the currency does not appreciate in line with the forecast, it would give the board more room for rate hikes.

Inflation expected to return above 2%, CNB to hike twice in 2H

The CNB expects only one rate hike by year-end. Our forecast is somewhat more aggressive. The economic statistics from the beginning of the year show that the economy continued to perform well. Preliminary figures about industrial wages suggest that remuneration growth even accelerated in the beginning of the year. That should propel core inflation, while the easing in food inflation has probably stopped for the time being. Sound economic trends, together with strong wage growth, should create more inflationary pressures. Moreover, we do

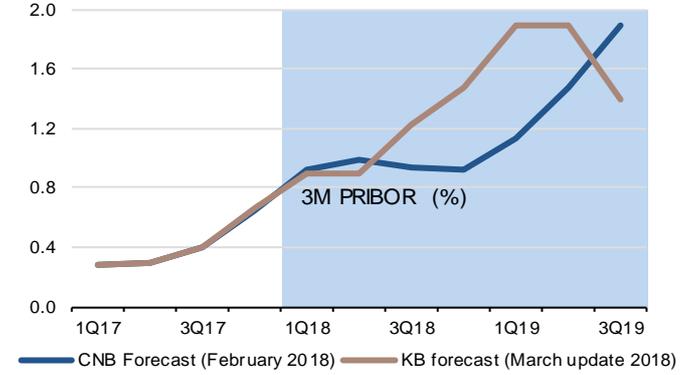
not expect the CZK to appreciate as much as the CNB expects in its current forecast, as it will likely be impeded by the CNB's dovish talk and ongoing dividend payments.

We see the koruna weakening a bit in 2018...



Source: CNB, Bloomberg, Economic and Strategy Research KB

... allowing the CNB to hike more



Source: CNB, Bloomberg, Economic and Strategy Research KB

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