

Czech National Bank

CNB Focus

CNB unexpectedly cuts interest rates



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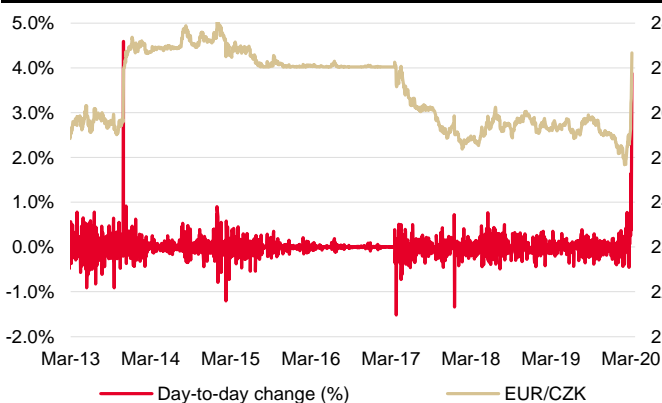
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The Czech National Bank unexpectedly cut interest rates by 50bp at today's meeting, with all seven board members voting in favour of the cut. We expect the key rate to remain unchanged for the rest of the year. However, the door remains open to other instruments. The governor admitted that the central bank is ready to react to any excessive fluctuations in the koruna. Although the CNB currently perceives no shortage of liquidity in the banking system, the board also, as a preventive measure, softened the rules of governing liquidity-providing operations.

The Czech National Bank (CNB) decreased the key repo rate by 50bp to 1.75% today. It did so at today's extraordinary meeting. The decision was made mainly as a result of the escalating situation with respect to the spread of the coronavirus in the Czech Republic. The CNB expects a strong hit to the real economy and is reacting preventively. The Czech koruna started declining early this morning and continued to do so after the decision. Now the CZK/EUR is over 27 vs roughly 26.20 in the morning.

Weakening of the Czech koruna poses another problem in terms of meeting the CNB's inflation target. Headline inflation remains above the upper bound of the tolerance range of the 2% target. Moreover, core inflation exceeded the 3% threshold in February. The governor said during the press conference that the bank's board is aware of current inflation but that it has now decided to support the real economy. The CNB expects the lower demand caused by the coronavirus crisis to gradually slow the increase in price rises. The slowdown in price inflation should also be supported by lower oil prices. The governor mentioned that the CNB is prepared to manage the CZK/EUR exchange rate to prevent excessive volatility. He added that the CNB operates under a managed float regime and that consequently it has enough foreign currency reserves. But he did not cite a trigger value that would lead to intervention in the FX market.

The koruna saw the biggest day-to-day decline since the beginning of the CNB's exchange rate commitment in 2013



Source: Bloomberg, Economic & Strategy Research, Komerční banka

The market is pricing in another significant interest rate cut



Source: Bloomberg, Economic & Strategy Research, Komerční banka

Interest rate cut is only one of the emergency measures adopted by the CNB at today's meeting. The bank also decided to ease conditions for a liquidity provision. With respect to that, it

decreased the rate on reverse repo operations by 10bp. Moreover, there will be a higher number of auctions per week, from one to three. The governor emphasised that there is enough liquidity in the Czech banking sector for now, so this measure should therefore be taken as precautionary. In order to further support commercial banks, the CNB also reversed its previous decision to require an increased capital buffer.

We expect no more changes to rates this year. While the CNB has expressed its willingness to cut rates further (regular monetary policy meeting is scheduled for 26 March), it will still fight with strong inflation. The situation will probably be much difficult if the Czech koruna continues to weaken.

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