

Czech National Bank

CNB Focus

As expected, CNB has lifted key repo rate to 0.50%

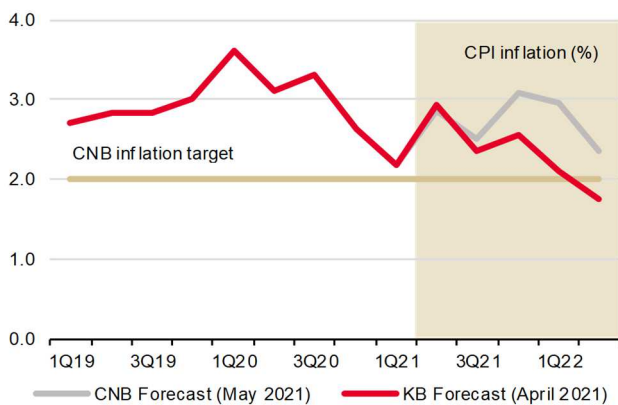


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As expected, the CNB raised its two-week repo rate by 25bp to 0.50% at its June meeting, with four of the bank's board members voting in favour, another calling for a 50bp increase and the remaining two preferring continued rate stability. Persistently high inflation and significantly reduced uncertainty around the pandemic were the main reason for the rate hike. Inflation has remained above the CNB's 2% target for more than two years, which could have an adverse effect on inflation expectations. Moreover, current economic trends are pro-inflationary. Governor Rusnok said at the press conference that, if necessary, the CNB is ready to increase interest rates at each subsequent monetary policy meeting. However, he currently does not think this will be the case. We expect two more hikes this year pushing the repo rate up to 1% at the year-end.

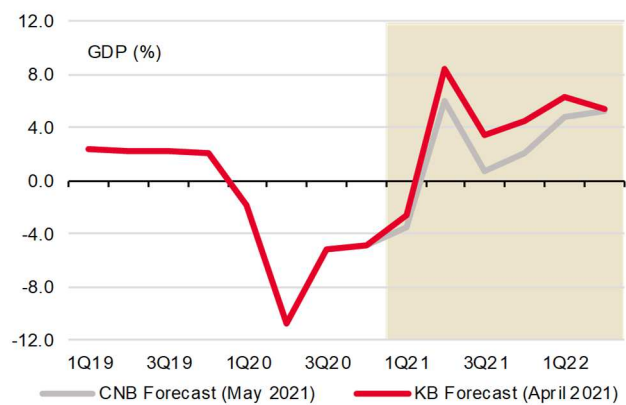
The Czech National Bank (CNB) decided to lift the key repo rate from 0.25% to 0.50% at its June meeting. This was in line with market expectations and the analyst consensus. The Lombard rate has been raised as well, from 1% to 1.25%, while the discount rate remains unchanged at 0.05%. Four of seven of the CNB's board members voted in favour of a 25bp hike. On the other hand, one other board member, Tomáš Holub in our view, was for a larger 50bp increase and the remaining two members favoured flat rates. We think Oldřich Dědek and Aleš Michl were the two doves on the board, which would be in line with what we wrote before the meeting here <https://bit.ly/3gA8Qlq>.

Inflation is forecast to remain above the CNB target all year



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

The second half is likely to bring a strong economic rebound

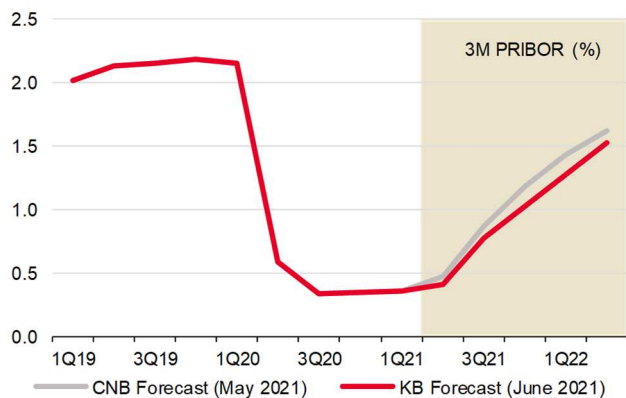


Source: CZSO, CNB, Economic & Strategy Research, Komerční banka

With its June hike, the CNB joined a growing number of central banks that are raising interest rates shortly after the pandemic. In the CEE region, the Hungarian central bank increased interest rates the day before. The CNB is especially worried about inflation, which remains close to 3% in the Czech Republic and has been hovering above the central bank's 2% target for more than two years. Governor Rusnok admitted that the risks of inflation moving above the CNB's current forecast of 2.7% for this year are tilted to the upside. Rapid growth in commodity prices and some production inputs, together with a tight domestic

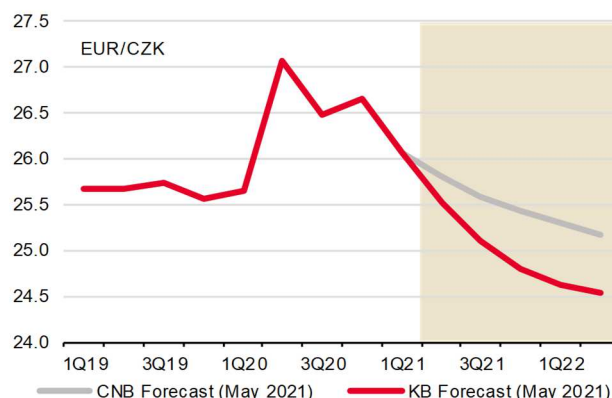
labour market and robust consumer demand are the main reasons. While the CNB still considers a large part of the current inflationary pressures to be temporary, Rusnok said these could persist for longer than was previously thought. He also emphasised the unambiguous legal mandate of the CNB (in contrast to some other banks with dual mandates) which is to maintain price stability. **According to the governor, a faster-than-expected easing of virus-related measures and the better development of the economy in 1Q21 also supported the board's decision to increase interest rates.** Czech GDP declined by 0.3% qoq in 1Q, while the CNB had forecast a much deeper economic decline of 1.7% qoq.

We expect interest rates to increase by a total 75bp this year



Source: CNB, Economic & Strategy Research, Komerční banka

Koruna should be stronger than the CNB expects



Source: CNB, Economic & Strategy Research, Komerční banka

By adding real action to the board's hawkish rhetoric, the increase in interest rates should signal that the CNB is ready to move inflation back to the 2% target. In line with our expectations, Governor Rusnok said the June hike has started the cycle of rate tightening, with further hikes very likely in 2H21. **Rusnok even stated that in case of need the CNB is prepared to increase interest rates at each subsequent monetary policy meeting.** However, he then tempered this statement by adding that, in his view, such a sharp rise in rates would probably not be necessary. Four more such meetings are to be held before the end of the year. The financial markets responded to the governor's words by increasing koruna interest rates, mostly on two- to three-year tenors. The EUR/CZK exchange rate has moved from 25.44 to 25.37, which is about 0.3%.

We expect the CNB to make two more 25bp hikes in 2H21 and the repo rate is thus likely to reach 1% at the end of 2021. At the moment the financial markets have a similar view. According to the governor, the central bank is not worried that the recent easing of restrictions will result in further tightening measures this autumn. This is due to the high vaccination rate and the large number of people who have already had the disease. **We forecast Czech monetary policy rates to continue to rise next year, leading the repo rate to reach 2% at the end of 2022.**

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