

## CNB minutes show a gradual rebound as inflationary risks persist

All Czech National Bank board members but one voted for a soft cut, perceiving some inflationary risks as still relevant to consider when maintaining a cautious approach to rate reductions. Mounting challenges to global growth represent a clear risk to the Czech economic rebound, bolstering the case for further easing

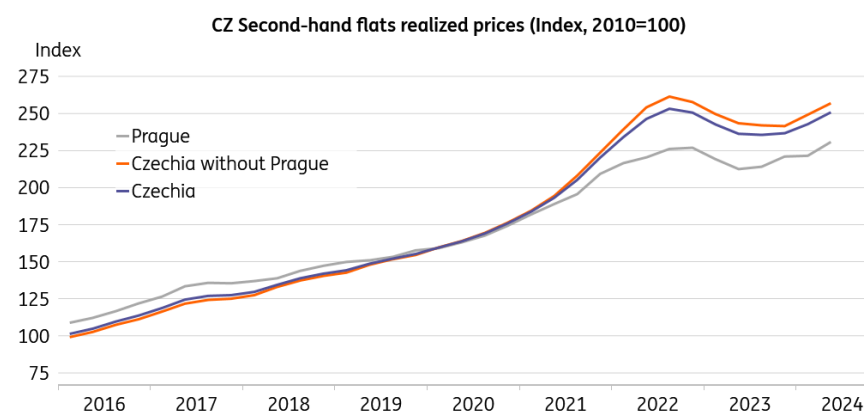


We think the CNB could be set to cut rates once more before pausing to assess incoming data

### Potential price pressures warrant a cautious approach to easing

The CNB reduced rates another 25bp to 4.25% in late September, with all but one board member voting in favour. Tomas Holub voted for a 50bp rate cut, seeing the monetary policy-relevant inflation below target and the economy operating below its potential. Overall, the Board assessed the risks and uncertainties to the outlook as broadly balanced. The governor, Ales Michl, stated that inflation had been higher in recent months than the CNB and financial markets had expected. The fight against inflation doesn't appear to be entirely over, so it is necessary to only reduce interest rates gradually.

## Residential prices started to recover



Source: CZSO, Macrobond

Most of the inflationary risks identified at the August meeting were assessed by the majority of the Bank Board as being unrelenting. Those are predominantly linked to persistent price growth in the service sector and the continued tightness in the labour market. The renewed rise in real estate prices and its potential impact on both market and imputed rents is to be taken seriously when it comes upward to inflation pressures. An unexpected increase in the fiscal deficit also represents the potential for upward price pressures, as stressed by the central bank's governor.

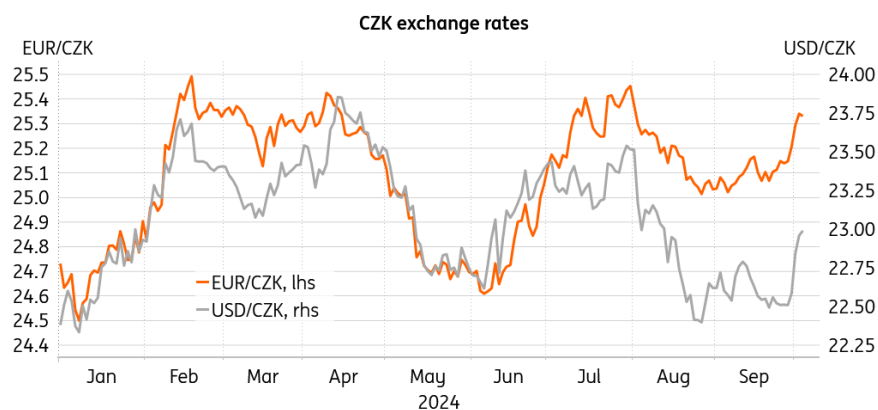
## Deteriorating growth outlook abroad is a drag

On the contrary, the deterioration of global economic conditions and the weaker performance of the German economy were identified as significant anti-inflationary risks. The subdued foreign demand from main European trading partners reflects a combination of cyclical and structural factors, which could warrant more pronounced monetary policy easing from the European Central Bank.

With respect to a cautious approach towards monetary easing, most of the Board members see inflationary pressures as still being rooted in the economy. Jan Prochazka added that maintaining positive real interest rates would contribute to pressure on higher productivity and limit the passthrough of rising labour costs to consumer prices. Some members admitted that the easing process may be interrupted in future meetings as the interest rate approaches the long-term neutral value. Eva Zamrazilova reiterated that she perceives the possible undershooting of the inflation target to be a less serious problem than overshooting.

In contrast, Tomas Holub assessed the medium-term risks as slightly anti-inflationary amid the country's gradual economic rebound and the backdrop of a worsening global outlook. He showed a preference for easing monetary policy conditions to a larger extent, a view that resonated with the medium-term considerations of Jan Frait – although he opted for the milder reduction, due to the potential pressure on a weaker exchange rate once financial markets could reassess the long-term growth potential of the Czech economy.

## Koruna came under pressure recently



Source: Macrobond

## Wait and see, or hit and run?

We still see the risks for elevated core inflation as relevant, especially due to persistent price dynamics in the service sector. The price growth of non-tradeable items, excluding regulated prices, increased to 4.4% in August, interrupting the previous slowdown. The potential for a hike in market and imputed rents would likely manifest itself mainly at the beginning of the next year, following the historical pattern.

Overall, we expect the bank board to reduce rates by 0.25pp at its November meeting to 4%, followed by a pause to consider the state of consumer prices in January. The real interest rate could go down to only 1% in December if headline inflation picks up to 3% as per our projections. Still, the pause in December is a close call, especially if the economic recovery comes under more pressure. If January's inflation reading shows no ugly surprises, rate cuts should be set to resume at a soft pace early next spring, bringing the policy rate to 3.25% by mid-year.

## Author

### David Havrlant

Chief Economist, Czech Republic

420 770 321 486

[david.havrlant@ing.com](mailto:david.havrlant@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.