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CZECH REPUBLIC

Czech National Bank hikes rates to keep inflation in check

Policymakers proceeded with a rate hike, which was heralded by hawkish communication. Maintaining a low inflation environment is the central bank's main objective as core inflation and credit growth pose risks. The next steps depend on the domestic and external environment, while core inflation remains the key determinant of another hike.



The Czech National Bank in Prague

Pro-inflationary risks seen on the horizon

The CNB Board voted six-to-one in favour of a base rate increase, taking it to 3.75% from 3.5%. Persistently high core inflation was the primary reason for this move, along with robust credit growth. A potentially expansive fiscal stance is traditionally seen as a source of upward price pressures on the outlook. An overheating housing market remains one of the sources of elevated core inflation, along with strong growth in services prices. The risks have been assessed as pro-inflationary overall, especially considering the tightness of the labour market and solid wage growth.

The resolution of the Middle Eastern conflict will be closely monitored, while second-round effects may still drive price growth. In contrast, weak growth in some of the eurozone's economies remains an anti-inflationary risk, along with lower oil prices. Future decisions will be based on domestic and external economic data, the geopolitical environment and events, as well as steps taken by other central banks.

Core inflation determines what comes next

Our view is that if core inflation softens marginally in the coming months, as is our current forecast, we will not see further monetary policy tightening at the next meeting in August. However, should core inflation continue to float just below 3% or even accelerate, another rate hike would become the more likely outcome. The resilience of the economy to the recent global negative supply shock and the tightness of the labour market will also factor into decision-making, but core inflation will remain the key driver.

Our market view

The press conference did not provide too much guidance on the next meeting, and we did not hear particularly specific reasons why the CNB hiked rates today. Our baseline is that the CNB is now done, but the bar for another hike appears relatively low. Core inflation in June and July will probably be decisive for further policy decisions and for markets, even as headline inflation is expected to fall below 2% in June.

The market reaction was rather muted but if anything, somewhat dovish. The governor was perhaps hawkish compared to recent press conferences but dovish relative to market pricing. The market is still pricing in one more hike in the coming months. However, the entire curve flattened further and we expect this trend to continue. EUR/CZK was driven more by a stronger US dollar today but the koruna still managed to outperform its CEE peers. This outperformance should continue relative to Poland's zloty in the coming weeks.

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