CNB Monetary Policy: What Will Determine the Future Steps?

Vojtěch Benda
CNB Board member

Prague, 28 February 2018
Monetary policy normalisation: steps 1–4

- FX commitment terminated in April 2017.
  - First step towards MP normalisation.
- Interest rate increases followed – three times so far.

CZK/EUR and monetary policy interest rates

- Lombard rate
- 2W repo rate
- Discount rate
- FX commitment (27 CZK/EUR)
- CZK/EUR (right axis)
The overall economic outlook is positive

Forecasts of selected variables
(annual percentage changes unless otherwise indicated)

<table>
<thead>
<tr>
<th></th>
<th>2016 actual</th>
<th>2017 forecast</th>
<th>2018 forecast</th>
<th>2019 forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headline inflation</td>
<td>0.7</td>
<td>2.5</td>
<td>2.3</td>
<td>1.9</td>
</tr>
<tr>
<td>GDP</td>
<td>2.5</td>
<td>4.5</td>
<td>3.6</td>
<td>3.2</td>
</tr>
<tr>
<td>Average nominal wage</td>
<td>3.7</td>
<td>6.9</td>
<td>7.4</td>
<td>4.9</td>
</tr>
<tr>
<td>Exchange rate (CZK/EUR)</td>
<td>27.0</td>
<td>26.3</td>
<td>24.9</td>
<td>24.5</td>
</tr>
<tr>
<td>3M PRIBOR (in %)</td>
<td>0.3</td>
<td>0.4</td>
<td>0.9</td>
<td>1.7</td>
</tr>
</tbody>
</table>

Note: Headline inflation, GDP, exchange rate and 3M PRIBOR are actual for 2017.
Economic growth is robust

GDP growth forecast
(annual percentage changes; seasonally adjusted)

Economy will continue to be supported by
- growth in external demand,
- robust consumption of Czech households,
- strong domestic investment activity.

- Growth of Czech economy will slow compared to last year, but will still exceed 3%.
- Czech economy will grow in line with its potential growth; output gap will remain slightly positive.
• Upswing in private investment is fostering labour efficiency.
• Fall in government investment (EU-related investment cycle) has faded away.
The labour market is close to its capacity

- Labour market tightness is highest since 2002.
- Labour demand continues to rise.
  - Coupled with labour shortage, it will channel into continued rapid wage growth.

Note: Index; vertical axis shows standard deviations.
Inflation forecast: sustainable fulfilment of target

- Total inflationary pressures remain strong.
  - Increasing wage dynamics and domestic economic growth.
- Domestic inflation will remain above 2% target this year.
- Will return to target at MP horizon.

Headline inflation forecast
(year on year in %)
Monetary policy normalisation: further steps?

- Consistent with forecast is rise in domestic market interest rates this year and especially next year.

- Tendency towards rate normalisation.

- vs. ECB quantitative easing.

- At its February meeting, CNB Board unanimously increased two-week repo rate and Lombard rate.
Czech National Bank is returning to publication of numerical forecasts for koruna-euro exchange rate.

Return to previous level of transparency.

Exchange rate forecast (CZK/EUR, quarterly averages)

Fan chart form = emphasis on uncertainty and non-committal character of trajectory.

Exchange rate forecast is conditional on assumptions of forecast, including outlooks for developments abroad.

- It is FX trajectory consistent with CNB macro forecast.
- Gives market useful guide to future monetary policy stance.
Summary

• CNB has taken initial steps towards monetary policy normalisation.

• Inflation will return to target thanks to strengthening of monetary policy conditions via both channels.

• Consistent with new forecast is rise in domestic market interest rates this year and especially next year.

• CNB has returned to publishing its CZK/EUR forecast.
Thank you for your attention

www.cnb.cz

Vojtěch Benda
CNB Board member
vojtech.benda@cnb.cz