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Surging inflation and CNB’s response

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Goldman Sachs Spring Emerging Market Conference

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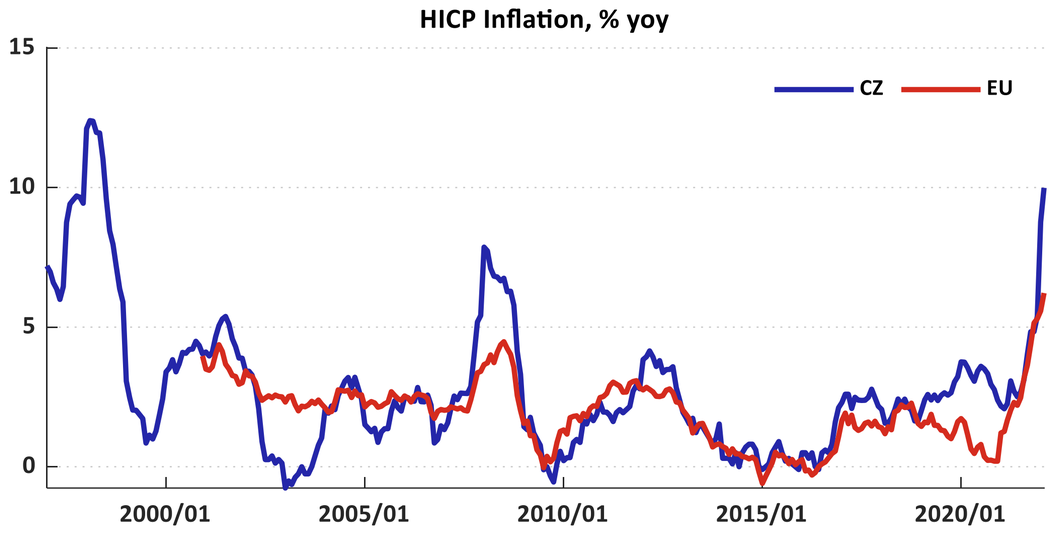
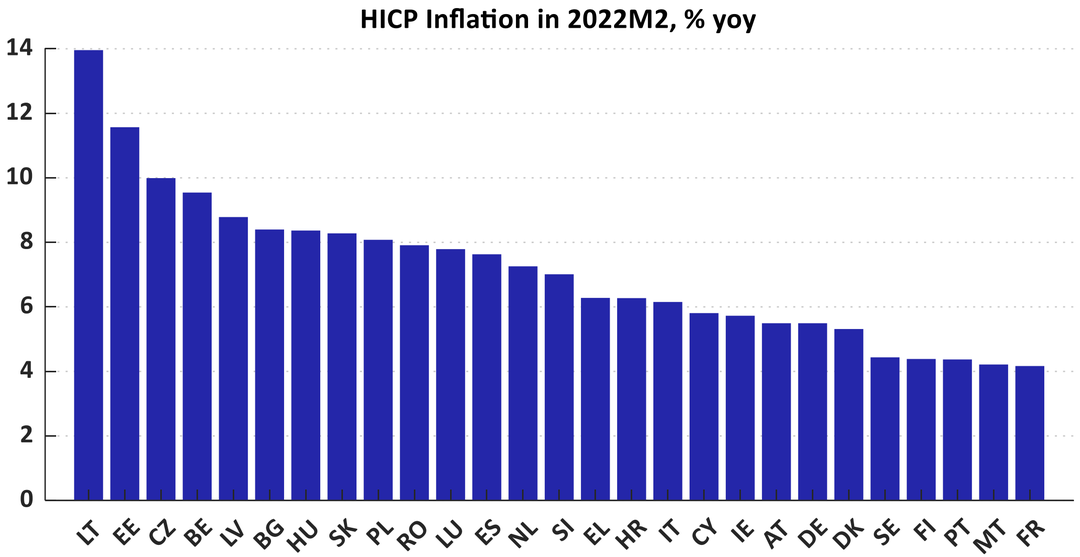
HICP inflation



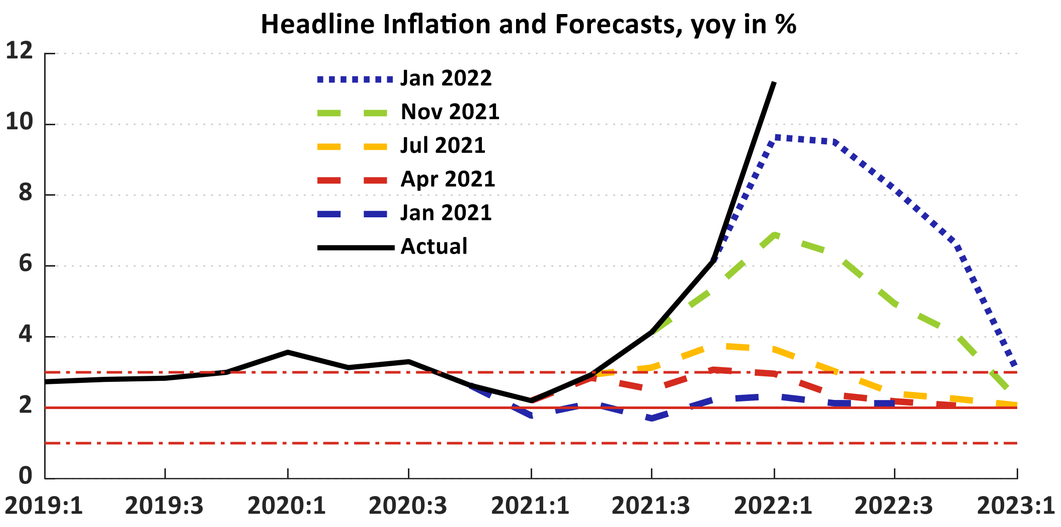


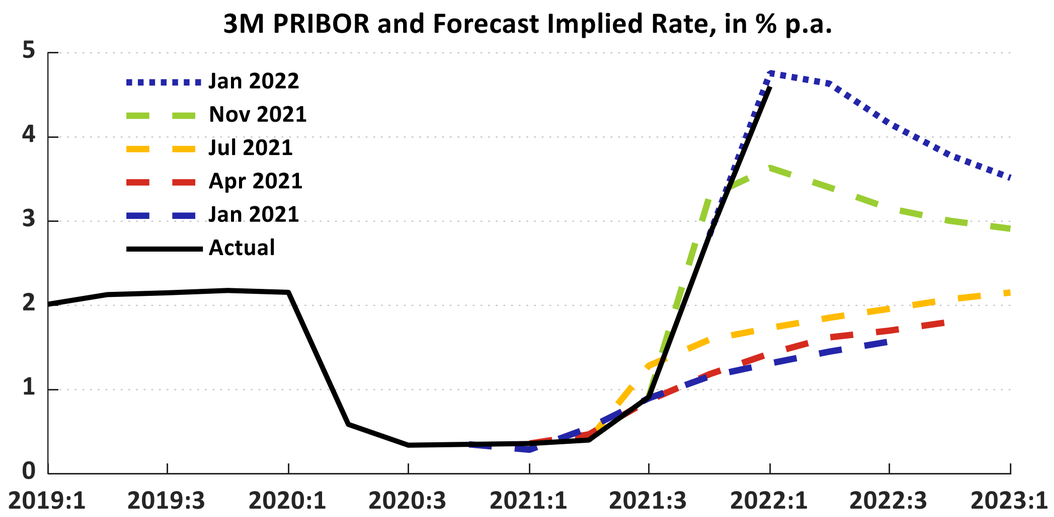
Headline inflation is increasing sharply and reaching the highest levels in many decades in the Czech Republic as well as in other EU countries. Not only energy and food prices are rising, but also **core inflation**.

Czech HICP inflation was the third highest among EU countries in February 2022.

Most **emerging market countries** are experiencing higher inflation compared to advances countries.

CNB forecasts





CNB forecasts have indicated **surging inflationary pressures** and called for normalization of monetary policy interest rates since 2021 H2.

However, there have been significant **upward revisions of inflation forecasts** as observed inflation has moved well above the previous forecasts, suggesting materialization of the **upside risks** of the past forecasts – higher commodity prices and persistent supply chain disruptions.

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Latest monetary policy decision

4%	5%	6%
discount rate	**2W repo rate**	Lombard rate

VOTING ON 2W REPO RATE

INCREASE TO 5%

LEAVE UNCHANGED

The CNB Bank Board increased the 2W repo rate by 50 basis points to 5% at its most recent meeting on March 31, 2022.

The Bank Board assessed the risks and uncertainties of the winter forecast in light of the new information as being **markedly inflationary**, especially in the short run. **These risks require significantly tighter monetary policy compared with the winter forecast, and probably for longer than predicted by the winter forecast.**

The next policy meeting along with a new forecast is scheduled for May 5, 2022.

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Risks to winter forecast

Inflationary risks:

• Higher domestic and foreign inflation in the year to date

• Sharp growth in energy and commodity prices, mainly due to the war in Ukraine

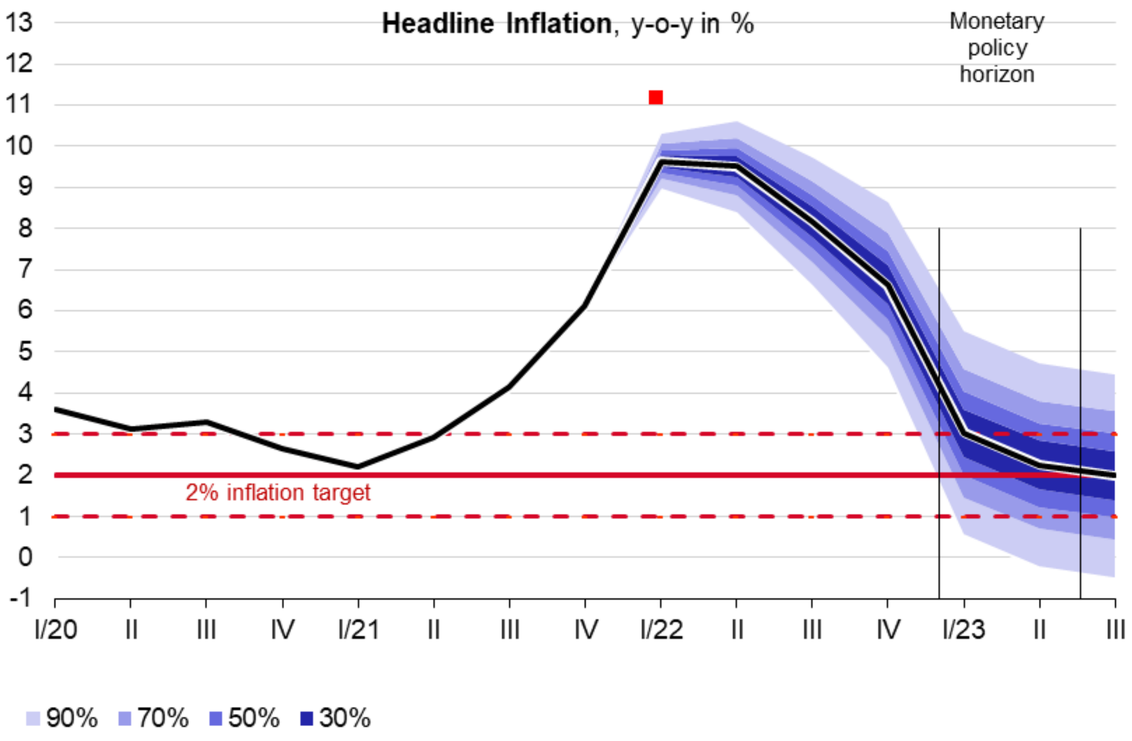
• Weaker anchoring of inflation expectations to the CNB's 2% target

• Less restrictive fiscal policy this year related to the refugee crisis

Anti-inflationary risk:

• Worse future economic developments having an impact on the labor market and related lower demand-driven inflation

Inflation above the winter forecast in 2022 Q1

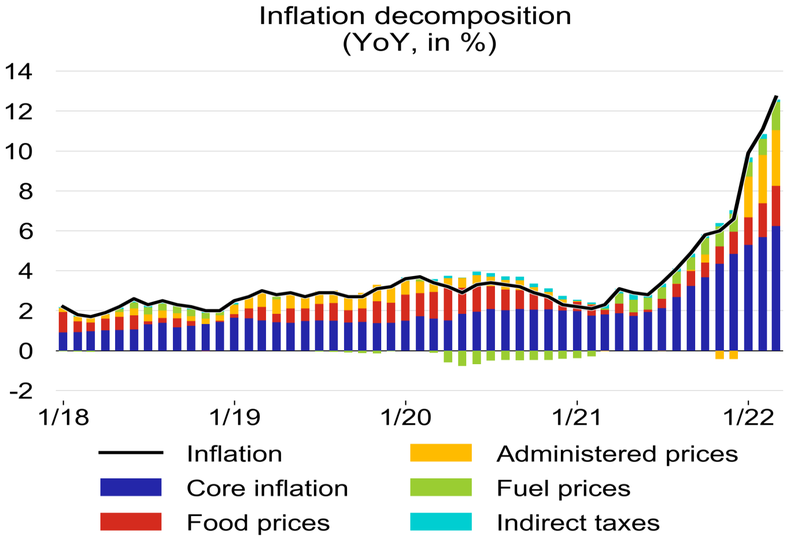


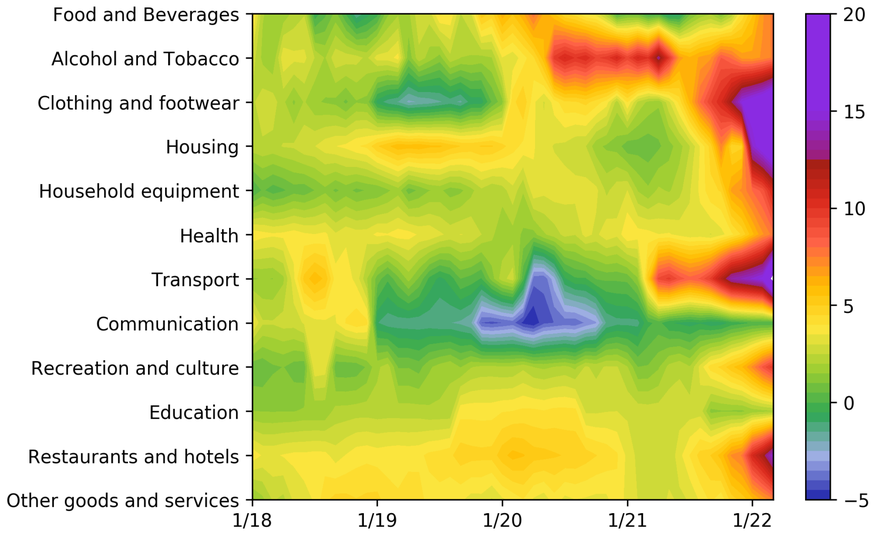
In 2022 Q1 **inflation** reached 11.2%, which was well above the winter forecast (9.6%).

Higher **food and fuel prices** have contributed to higher inflation, as the war in Ukraine further accelerated their growth in March. **Core inflation** was higher, too.

The winter forecast expected inflation to peak in 2022 H1 and decrease close to the 2% target over the monetary policy horizon. According to the current estimate, **inflation will remain very high** for the rest of this year.

Inflation decomposition



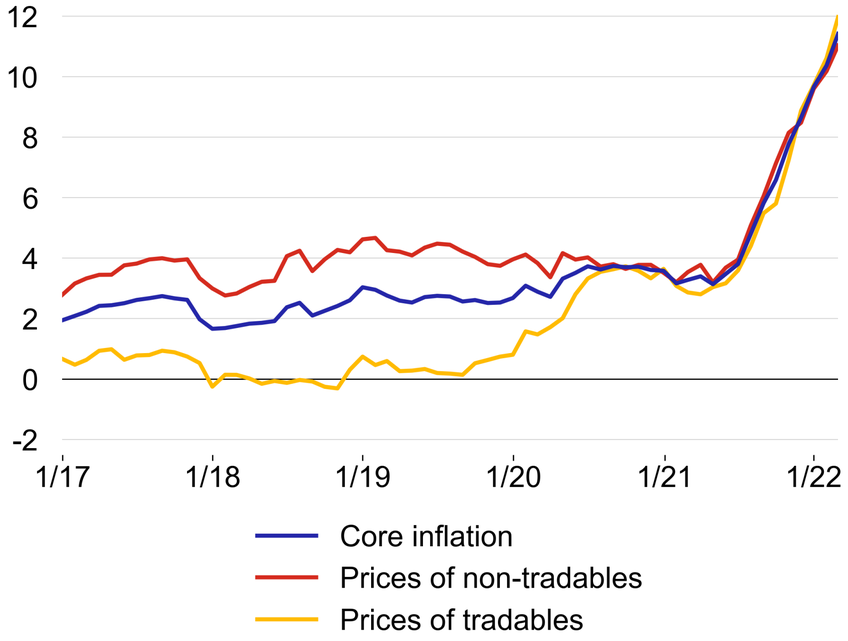


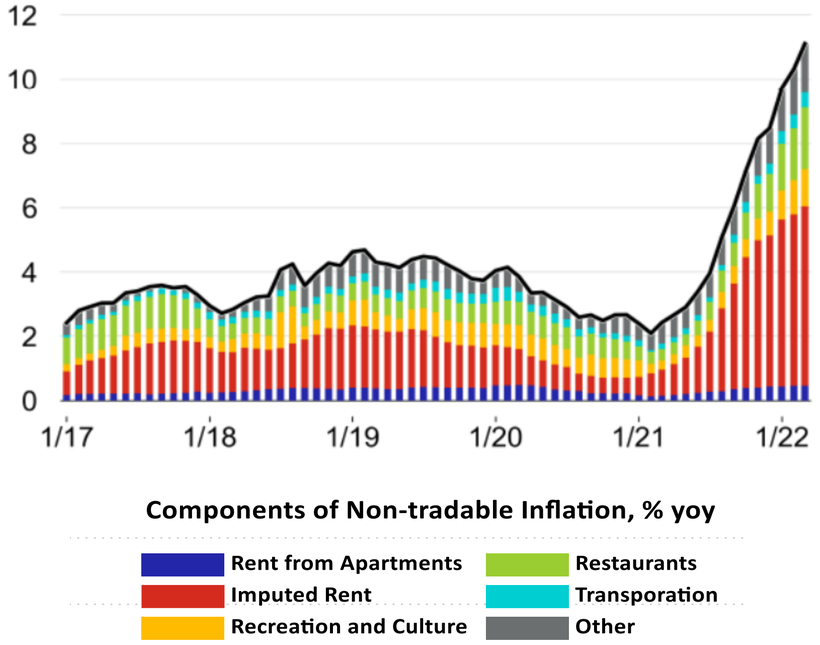
Core inflation continues to accelerate, exhibiting the highest contributions to the inflation surge on the back of strong domestic and foreign demand and supply chain disruptions.

Surging prices of commodities are mirrored in domestic **food** and **fuel prices** and also in a significant increase in **administrative prices** early this year.

The current wave of price increases is a **widespread and relatively intense phenomenon** across most categories of the consumer basket.

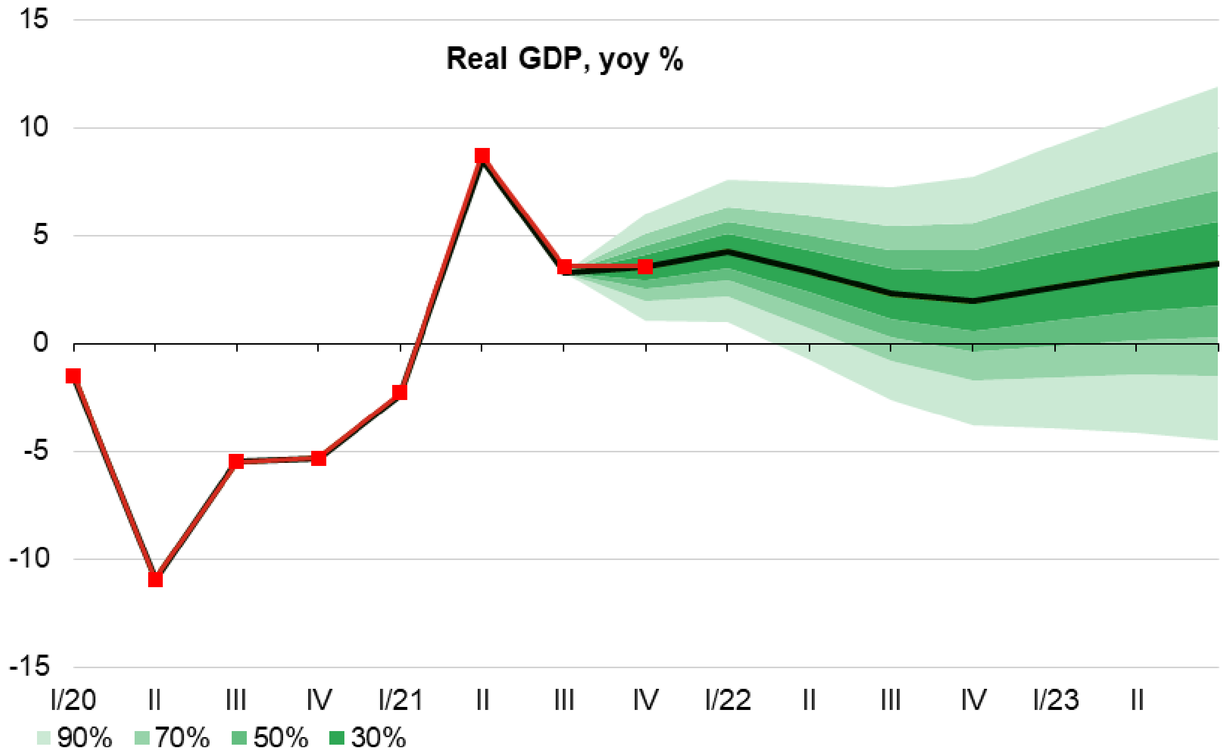
Core inflation components





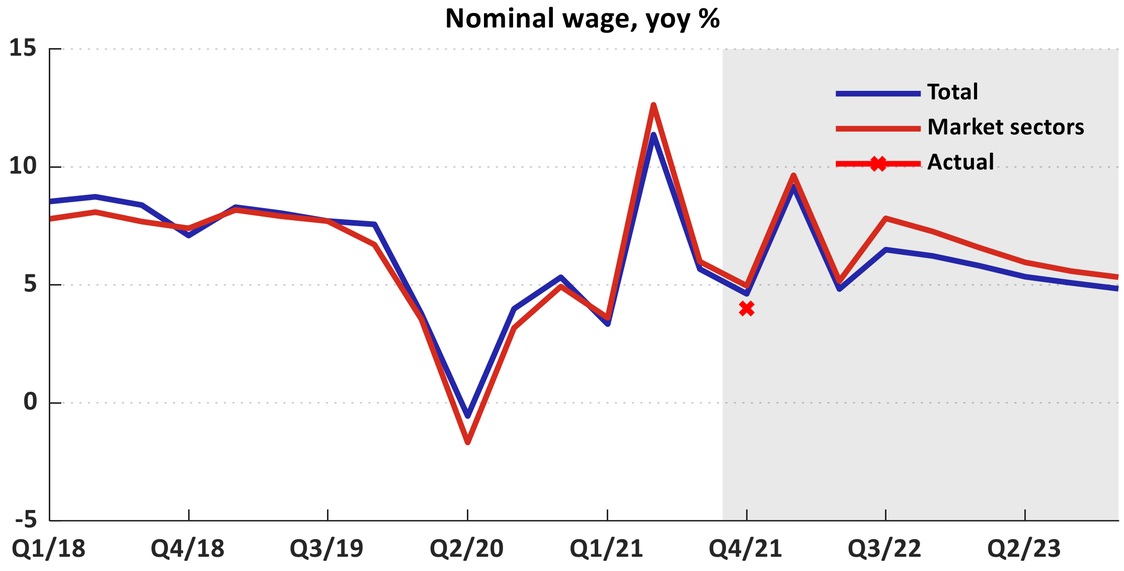
- Tradable and non-tradable price inflation increased, suggesting the presence of both **foreign and domestic inflationary pressures**.
- A significant contribution of **imputed rent to non-tradable price inflation** reflects sharp growth in property prices and increasing construction prices.

Real economy growth



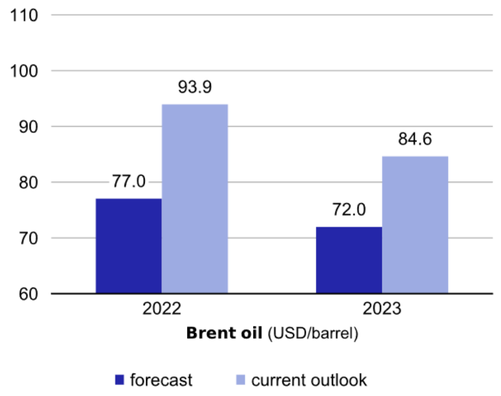
- The **Czech economy continued to grow** at 3.6% y/y in 2021 Q4. Its growth rate corresponded to the forecast.
- The winter forecast expected the Czech economy to grow around 3% this year and the next.
- The **war in Ukraine will reduce expected economic growth** roughly to one-half of that figure (or even less).

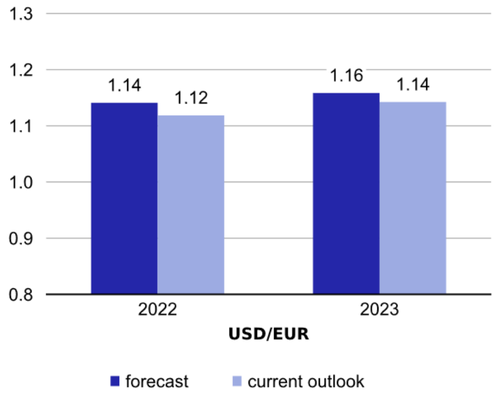
Labor market

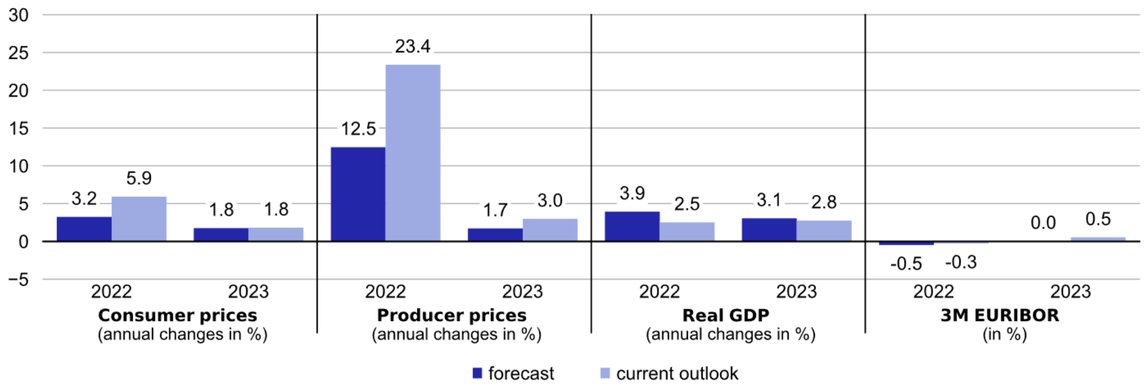


- **Nominal wage** growth reached 4% in 2021 Q4, which is lower than the winter forecast (4.6%).
- **Tightness in the labor market** continues to decline gradually.
- Future labor market developments will be affected by **refugee inflows due to the war in Ukraine.**

External developments







An update of the external outlook suggests higher inflationary pressures.

Inflationary pressures stemming from higher commodity prices and producer prices are only partly mitigated by a somewhat weaker outlook for external demand.

Summary

The risks of the winter forecast are markedly **inflationary**, especially in the short run.

The developments since the publication of the winter forecast call for **significantly tighter monetary policy compared with the current forecast, and probably for a longer period of time**.

Worse future real economic developments might help to cool down the labor market and lead to lower demand-driven inflation in the medium term.

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Thank you for your attention

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