Czech economy and CNB monetary policy: Introductory remarks

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Recent macroeconomic and monetary developments

- Trough is now behind us, economy picked up during summer
- Several year long overheating is still lingering:
  - house prices high
  - labour in short supply in some industries
  - inflation slightly elevated
- Emerging second wave of pandemic is downside risk
- Labour market is cooling: wage growth slowing sharply, unemployment rate rising
- Koruna is relatively stable given high uncertainty, fulfilling shock absorber function
- Massive fiscal and monetary support measures are playing key role in present situation
Beveridge curve illustrates specific nature of current labour market: market is cooling but still well above peak of last cycle; this is consistent with relatively high core inflation.

Source: MLSA, CZSO, CNB
Inflation

Inflation structure (y-o-y changes in %; contributions in pp)

- Core inflation
- Administered prices
- Fuel prices
- Indirect taxes
- Headline inflation

Core and median inflation (y-o-y changes in %)

Source: CZSO

Inflation (CPI) in September: 3.2% – slightly above upper bound of target (2% ± 1 pp); tradables prices accelerating
Core inflation in euro area and Central Europe (Jan 2014 – Sep 2020)

• Core inflation in EMU and Central European countries is diverging: hovering around 1% in EMU but accelerating in CZ, Poland and Hungary over past several years

• Y-o-y core inflation reached all-time low of 0.2% in EMU in September

Source: Eurostat
Interest rates

- CNB cut policy rate three times in quick succession – from 2.25% on 15 March to 0.25% on 7 May
- Has used up almost entire potential of its main instrument to ease interest rate component of monetary conditions
- Does not currently feel need to ease monetary conditions further

Source: CNB
CNB measures for banks and their customers

CNB has:
• reduced CCyB rate from 1.75% to 1.00% (1 April 2020)
• called on banks (+ insurers and pension companies) not to pay dividends
• preventively increased weekly number of liquidity-providing monetary operations
• made 3/6-month loan moratorium available to bank customers (according to specific law)
• softened recommendations for assessing new mortgages on 1 April: LTV raised from 80% to 90%; DTI assessment obligation cancelled; DSTI raised from 45% to 50% (DSTI assessment obligation cancelled on 1 July);
• reduced CCyB rate from 1.00% to 0.50% (1 July 2020)

In CNB’s view, contraction is highly likely to feed through to loan portfolio quality
Future developments are subject to unprecedented risks and uncertainties

- Second wave of pandemic now incoming. How many more to follow?
- Will shock be “temporary” or “permanent”? (hysteresis problem)
- What will happen when fiscal stimulation ends? Has it helped agents overcome worst of crisis (gain time), or has it merely (at great expense) postponed inevitable failures?
- What will happen when fiscal consolidation begins?
- Are there any “safe” limits on fiscal indebtedness?
- Will there be no-deal Brexit?
- Will trade tensions between USA and China increase?
- Special feature of turning points: latest figures from real economy become obsolete faster than usual, reducing their relevance for forecasts
Summary

• Czech Republic still has good starting position:
  • No major macroeconomic and trade (external) imbalances before crisis (only minor imbalances: labour market and housing market)
  • Low public debt (among lowest in Europe) ⇒ lot of room for manoeuvre
  • Own currency and monetary policy (advantage before and after crisis)
  • Sound and resilient banking sector (should be part of solution)

• CNB:
  • currently sees no need to ease monetary conditions further (inflation quite high, expected to drop to target next year)
  • to be on safe side, is analysing options for potential use of unconventional tools
Thank you