The Czech economy and CNB monetary policy

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- Weakening of koruna contributed to economic recovery and gradual rise in inflation in 2014–2016
- Inflation pressures accelerated in late 2016/early 2017
- Exchange rate commitment was ended on 6 April 2017
  - Condition of sustainable fulfilment of inflation target was met
  - Continuation of exchange rate commitment was no longer necessary to fulfil CNB's primary objective of maintaining price stability

The exit from the commitment was the first step towards normalising monetary policy, i.e. towards using interest rates as the main instrument again
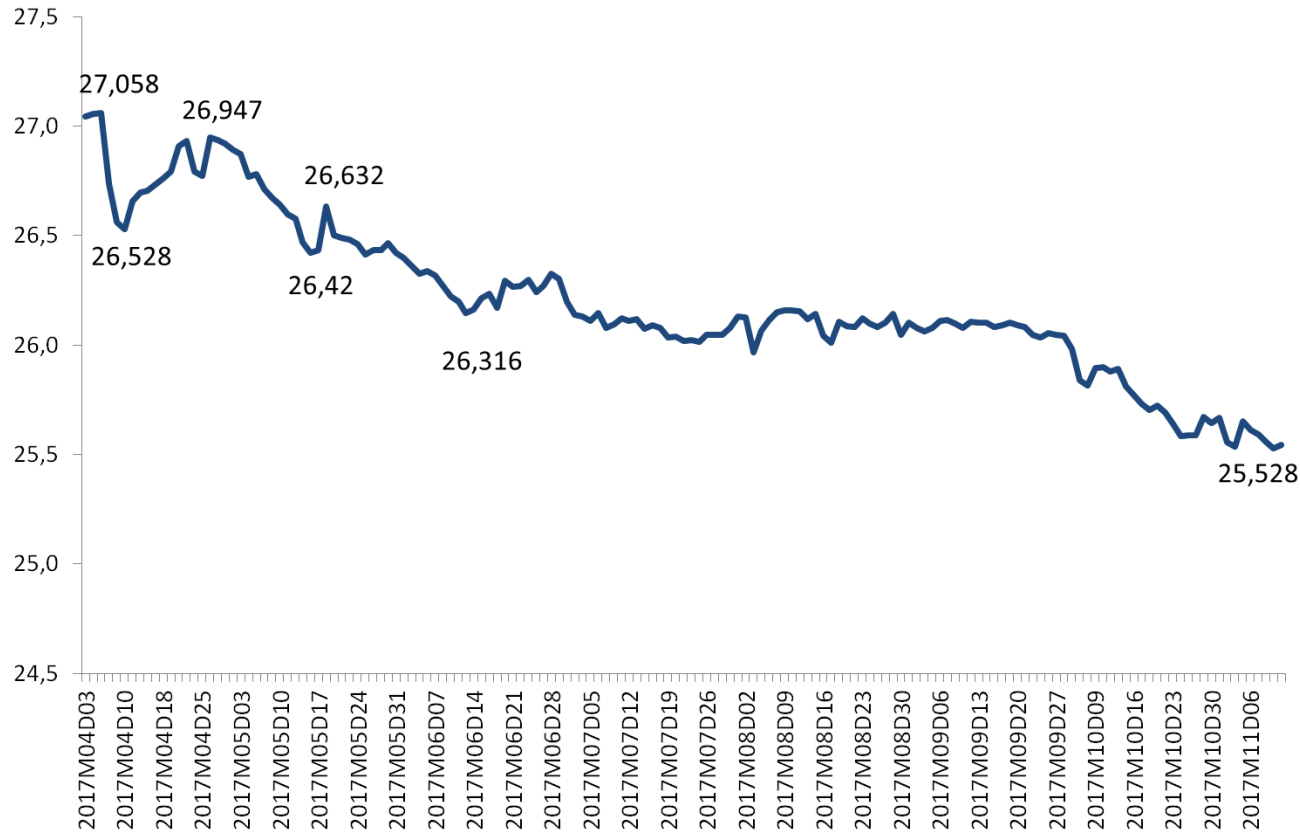
(in %; 1 January 2013–13 November 2017)
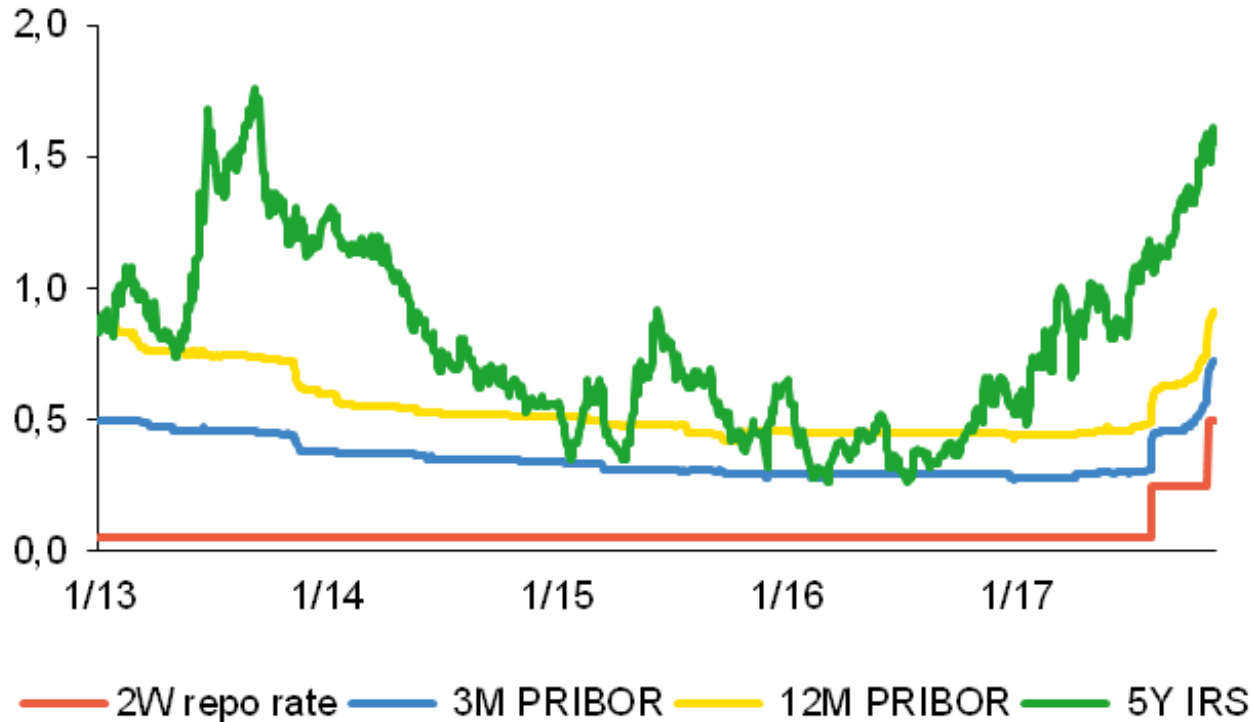
Source: CNB

The normalisation of monetary policy continued with repo rate increases at the start of August and November (by 0.25 pp each time); financial market interest rates went up at all maturities
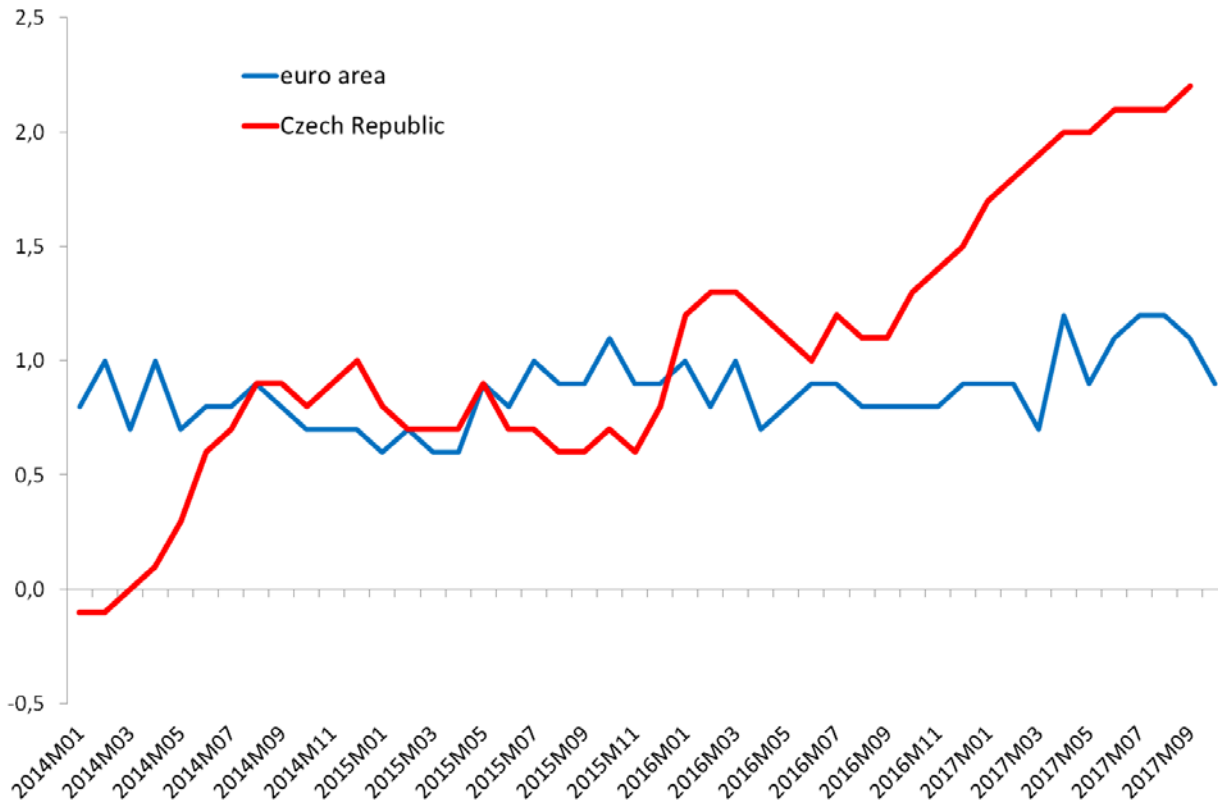
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(1 April–10 November 2017)

Source: Eurostat

The koruna has mostly been gradually appreciating; the rate is currently just above CZK 25.50 to the euro; the koruna is now around 5.5% stronger than the commitment level of CZK 27 to the euro

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(January 2014–October 2017)
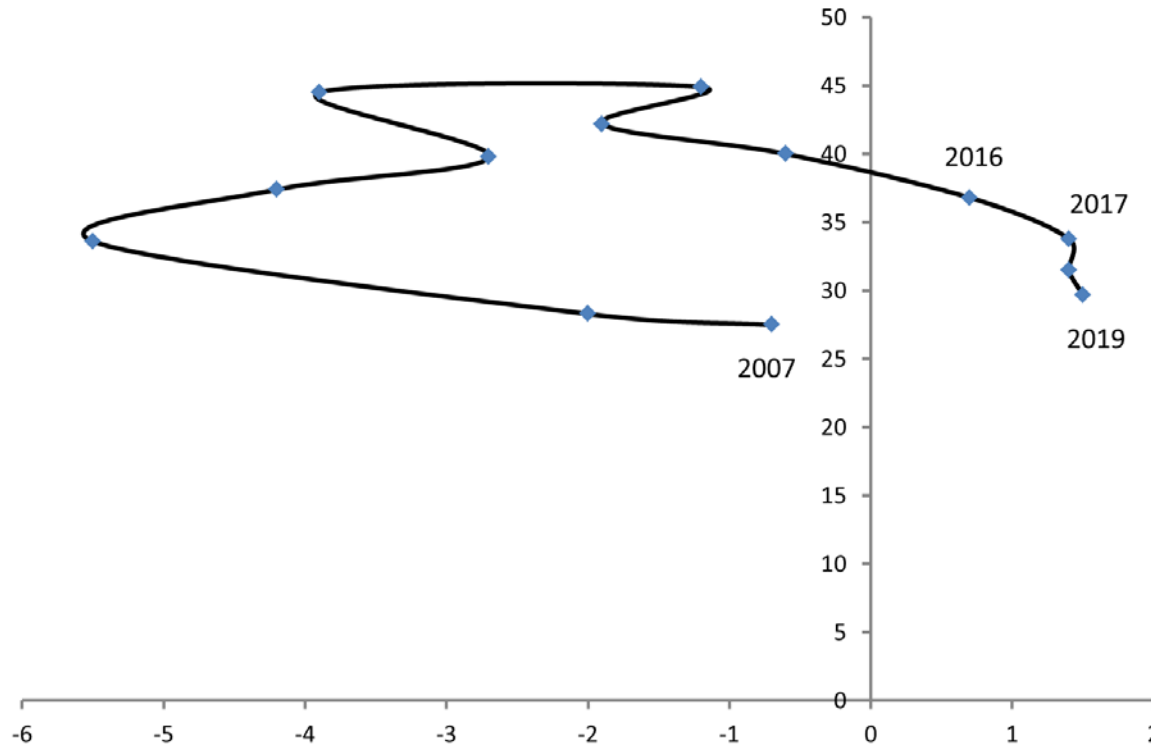

Source:
Eurostat

Note: Core inflation = annual HICP excluding energy, food, alcohol and tobacco prices

In the euro area core inflation has been fluctuating around 1% for four years now, while in CZ it has been steadily rising over the same period; this illustrates some disconnect between the euro area and CZ cycles

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- Economic growth has risen sharply this year: from 3% in Q1 to 4.7% in Q2 and 5% in Q3 (flash estimate)
  - Economy outpacing potential (over 3%) ⇨ overheating
  - Growth being driven by (manufacturing) industry
- Unemployment is breaking one hist. record after another
- Tight labour market is stimulating wage growth (2017 Q2: 7.6% nominal and 5.3% real) ⇨ rising consumption
- Credit growth remains high, especially for housing loans
- Public finances are in surplus
- Trade balance and current account also remain in surplus
- Inflation is peaking near upper limit of CNB inflation target: went up from 2.7% in Sep to 2.9% in Oct

The CZ business cycle is ahead of the euro area cycle

(2007–2019)

Note: Figures for 2017–2019 are CNB forecast

Source: Eurostat, CNB

Govt debt to GDP ratio was 27.5% in 2007 and peaked at 45% in 2013; it is projected to fall to 30% in 2019; this is much better than in the euro area and indicates that public finance can act as a shock absorber in the future

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- Enhancing the resilience of the banking sector:
  - Capital conservation buffer: 2,5% (2014)
  - Systemic risk buffer: 1-3% in place for 4/5 banks since 2014/16
  - Countercyclical buffer activated in 4Q2015: 0,5% applicable as of 1/2017 and 1% from 7/2018
  - 7 O-SII identified, no O-SII buffer applied (substituted by SRB)
- Mitigating the risks of residential real estate credit exposures:
  - LTV limits for mortgages applied since 2015
    - Upper LTV limit on individual loans of 90% and aggregate limit of 15% of new loans with an LTV of 80%–90% (4/2017)
    - Institutions should apply an LTV of 60% to an investment type of loan (buy-to-let mortgage) should it bear characteristics of a higher riskiness
    - Institution that do not comply materially can be (and in some cases are) subject to Pillar 2 add-on
  - Providers should monitor the DTI and DSTI ratios, set internal limits for them (DTI ratio of over 8; DSTI ratio of over 40%)

Macro-prudential policy is moving into line with monetary policy: it is gradually getting more restrictive

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