

# Czechia Watch: CNB continues its gradual monetary easing

At today's meeting, the CNB Bank Board voted to cut interest rates by 25 basis points, in line with our forecast and market expectations. The new key interest rate will be 4.25%, effective from 26 September.

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This is the second rate cut of this magnitude after the CNB decided to slow down the pace of monetary easing at its August meeting. The central bank has thus confirmed that it intends **to continue easing its restrictive monetary conditions gradually**, should the development in price stability continue to achieve satisfactory results.

Six Board members voted in favour of the 25bp cut, while one member voted for a 50bp reduction. The rationale behind the potential for a more pronounced rate cut was the perceived decline in the risk of future inflation exceeding the central bank's target.

Given the expected nature of the decision, the reaction of the financial markets was limited in the first minutes, with the koruna tending to appreciate slightly as investors positively assessed the prevalence of the Board's cautious approach. Subsequently, however, it weakened again to levels above EUR/CZK 25.15 where the currency pair traded at the beginning of the week.

At the press conference, Governor Ales Michl confirmed the cautious approach of the Bank Board. The central bank will make further decisions based on incoming data. The governor confirmed that the current monetary policy stance is still restrictive and is having a dampening effect on economic activity, given that the Czech economy is recovering at a slow pace and is below its potential output. The recovery in domestic demand is now facing a challenge due to the weaker sentiment among consumers and businesses, which is slightly dampening the positive effect of real wage growth. The Bank Board still identifies upside risks to inflation, which could push inflation up to the upper bound of the tolerance band. These risks include potentially increased wage demands, excessive public spending, and prolonged inertia in service price growth. During the summer months, both headline and core inflation were slightly above the target and above the CNB's expectations. According to Michl, this confirms the correctness of the cautious rate cuts. **In line with our forecast, the CNB anticipates a slight increase in inflation over the coming months**, largely attributable to the fluctuating statistical base from last year. We anticipate that inflation will approach the inflation target again in the new year.

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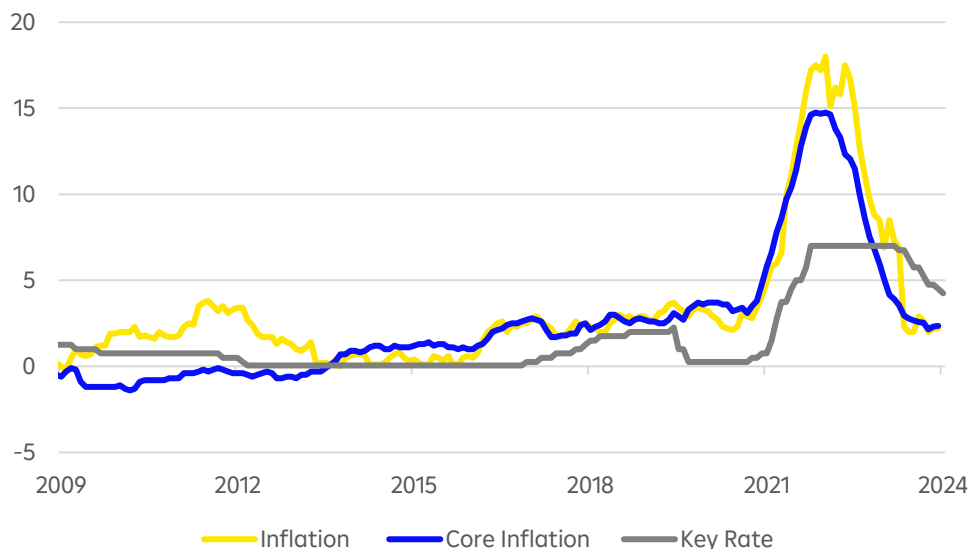
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Real interest rates above inflation rate (in %)



\* Inflation/Core Inflation in %yoy  
Source: CNB, Macrobond, Raiffeisen Research

As anticipated, the Bank Board continues to ease monetary conditions with caution. Despite recent months seeing inflation accelerate slightly above the central bank's target, the risks to future increases remain relatively low. In light of the aforementioned, **we anticipate that the current rate-cutting cycle will continue at the current pace at least until the end of the year when the base repo rate could reach 3.75%.**

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	<b>Column A</b>	<b>Column B</b>
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