

Czechia Watch: A final 50 bp cut?

At its fourth meeting this year, the CNB cut interest rates by 50 bp, which aligned with our forecast. However, the decision came as a surprise as the market and most analysts were leaning towards a more cautious approach and a rate cut of only 25 bp.

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Five board members voted for a 50 bp rate cut, while two others opted for a 25 bp cut. Consequently, the **key rate is currently at 4.75%**. We expect a slowdown in monetary easing at the next meetings.

Today's meeting was **marked by uncertainty**, as the board members indicated that both variants - a 25 bp or a 50 bp rate cut - were equally likely. According to a Bloomberg poll, the vast majority of analysts expected the board would take the more cautious approach and cut rates by only 25 bp. These predictions did not materialise when the board eventually cut rates from 5.25% to 4.75%, which we projected as one of the few. As the decision was also surprising to the market, the koruna immediately broke the level of 25 EUR/CZK, which translated to a weakening of 0.5% and stabilised around that level. Subsequently, yields on Czech government bonds and interest rate swaps also fell across maturities.

The subsequent **press conference** by Governor Ales Michl was interesting, mainly from the perspective of the future direction of monetary policy. When asked, the Governor said that this was probably the last rate cut of 50 bp and that monetary easing would slow down or stop altogether at subsequent meetings, especially if inflation persisted at the upper bound of the CNB's tolerance band. Indeed, the bank board assesses the inflation risks leaning to the upside, mainly in the form of persistently faster growth in services, an interruption in the favourable trend in goods prices, the government's deficit spending and a tight labour market. Demands for wage increases in the public sector may spill over to the private sector and represent one of the inflation risks. However, the materialisation of a wage-inflation spiral has not yet occurred. The board did not discuss year-end rates; instead, they will assess incoming data and make decisions at each meeting accordingly. However, monetary policy will remain restrictive as real interest rates are significantly positive.

The board cut rates by 50 bp today and signalled that rates would go down more slowly at subsequent meetings. **Our forecast anticipates that rates will be cut by 25 bp at all remaining monetary policy meetings, bringing the key rate to 3.75%** by the end of the year. However, we cannot rule out the possibility of a halt in the monetary easing cycle, with rates starting at 4% at the end of the year.

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