

Dear Colleagues,

Financial reports and news have recently been of enough crucial importance to regularly fill the front pages of newspapers. The double-digit inflation, a sharp increase in interest rates and, most recently, the appointment of Aleš Michl as the Governor of the Czech National Bank. Particularly after the President's choice of the country's top guardian of finances, dozens of comments and speculations immediately sprang up, especially regarding the further development of interest rates, as the future Governor is known to have recently voted in the Bank Board against raising them.

I am of the opinion that the Governor, whoever he or she may be, should address the real problems of our economy. And in this respect, Aleš Michl has exactly the same cards on the table as Jiří Rusnok, his predecessor: high inflation, strong inflation expectations and the ever-fading hope that double-digit figures are here merely for a short time. Fiscal policy in the tow of deficits and under pressure to increase them further. The koruna weaker than the CNB would like it to be and unemployment still extremely low.

The decisions not only of the new Governor, but more importantly the statements of the entire Bank Board, based on majority consensus, are necessarily determined by these factors. The CNB is the guardian of the stability of the currency, and I hope and trust that its decisions will always comply with its mandate.

I wish you all the best!

Monika Zahálková, Managing Director



News of the Day

The CNB raised rates, expecting weaker growth and inflation of up to 15 %



The Czech National Bank has raised the base interest rate to its highest level in more than 20 years and expects lower economic growth and higher inflation this year than it did in its previous forecast. The 0.75 percentage point increase in the base rate, to 5.75 per cent, was a surprise for the market.

It was the sixth time in a row that the CNB had raised the rate by more than 0.25 percentage point. Analysts had expected the rate to go up by only 0.5 per cent. The last time the rate was this high was in 1999. The reason for the increase is the continuing rise in inflation, exacerbated by the war in Ukraine, and the central bank's efforts to dampen inflation expectations.

According to Jakub Seidler, the Chief Economist of the Czech Banking Association, it appears that the CNB still considers it more important to tame inflation than to worry about the negative impact of higher rates on

the real economy. *"However, this rate hike will not reverse this year's double-digit inflation; it is the next year's inflation that is at stake,"* Jakub Seidler warned. Meanwhile, analysts expect rates to peak at about 6.5% this year.

At the same time with taking the monetary decision, the CNB published a new, updated forecast of macroeconomic indicators. In its new forecast, it expects consumer price growth to average 13.1 percent this year, rising to nearly 15 percent during the year. Inflation is expected to fall to 4.1 percent next year. In its previous forecast in February, before the outbreak of war in Ukraine, the bank had expected average inflation of 8.5 percent this year and 2.3 percent next year. The CNB Board described the risks and uncertainties of the new forecast as being significant.

The CNB worsened its economic forecast for this year and slightly improved it for next year. It expects the gross domestic product to grow by 0.8 per cent this year and by 3.6 per cent next year. GDP growth will slow down significantly this year and economic activity will even decrease slightly year-on-year in the second half of the year.



CBA Hypomonitor: interest rates rose to 4.4%

In April, banks and building societies provided mortgage loans totaling over CZK 17.5 billion. Compared to March, the volume and number of mortgages granted dropped significantly, by about 40%. The year-on-year decline also became bigger, exceeding 60%. The noticeable drop in new mortgages in April was probably caused by the CNB's new stricter rules. Their expected entry into force also led to some "frontloading" in earlier months, which was also reflected in the weaker April figures. The interest rate on actual new mortgages, excluding refinancing, rose to 4.4% in April from 4.15% in March. As expected, mortgage rates continue to rise and we will see this trend continue in the coming months as market interest rates continue to rise. The above information comes from [the CBA Hypomonitor data](#), which captures data from all domestic banks and building societies providing mortgage loans on the domestic market.

Inflation in April exceeded 14%

Continued inflation growth exceeds analysts' and the central bank's expectations. In April, [inflation accelerated further](#) to 14.2%, from 12.7% in March. The market estimate was 13.2%, while the CNB's estimate was 13.8%. The key reason for the acceleration in the y-o-y inflation in April was attributable to housing-related prices. The price of electricity rose by 30% year-on-year (24.7% in March), while the price of gas increased by 44.2% (37.7% in March). These factors contributed to a year-on-year price acceleration of approximately 0.3 percentage point, similar to the previous month. Furthermore, imputed rentals accelerated again, from 16.3% to 17.7% y-o-y, contributing less than 0.2 percentage points to year-on-year inflation. Overall, housing prices accelerated inflation by about 0.6 percentage points in April. Price growth in the housing category reached 20% year-on-year, the highest since the end of 1998 (it was above 30% at the beginning of 1998). Food prices were another strong inflationary factor, with the annual growth of 10.7%, the highest since the end of 2008. April's figures push the inflation outlook for this year towards 14%.

CBA Focus focused on energy prices

The next episode of the CBA Focus roundtable focused on inflation at a level not seen for years. How long can it take the central bank to tame inflation? And where are the limits to helping households and firms that are threatened by the constant rise in the price of key commodities and especially of energy? Should aid be targeted or across the board? These are the main questions discussed by Petra Grmelová, the presenter, and by Mojmír Hampl, member of the Czech Fiscal Council and former CNB Vice-Governor, Jakub Seidler, the Chief Economist of the CBA, and Pavel Cyriani, Vice-Chairman of the Board of Directors of ČEZ. You can watch the CBA FOCUS on [YouTube](#), or listen to it on [Spotify](#).

Aleš Michl becomes the CNB Governor

President Miloš Zeman appointed [Aleš Michl as the Governor of the Czech National Bank](#). The current member of the Bank Board will take up his duties in July. He will replace Jiří Rusnok, whose second mandate terminates in June and who cannot run again. Aleš Michl previously worked, among other things, at Raiffeisenbank and was an external adviser to former Prime Minister Andrej Babiš (ANO). He has been a member of the CNB Bank Board since the end of 2018. Aleš Michl and Oldřich Dědek, another Board member, were the only ones of the seven-member Board who repeatedly voted against raising interest rates. They

believe that raising rates will not work with the current inflation, but will harm exports and the economy. Aleš Michl also said after his appointment at Prague Castle that he would propose leaving interest rates at the present level at his first Board meeting in August and said that it would take two years for inflation to return to the 2 % threshold.

Bankers discussed sustainable economy

In early May, the Czech Banking Association, in cooperation with the European Investment Bank (EIB), organized a conference *„Geopolitical uncertainty: how can we finance a faster and safe green transition in the Czech Republic?”*. In her opening remarks, the EIB Vice President Lilyana Pavlova first presented European initiatives to promote green investments to not only slow down climate change but also improve energy security. Jan Juchelka, Vice President of the CBA and CEO of Komerční banka, outlined the approach of the CBA and banks to financing the Czech economy's transition to greater sustainability. René Neděla, a Deputy Minister of Industry and Trade explained the political strategy. Jakub Seidler, the CBA's Chief Economist, followed with an analysis of the Czech macroeconomic environment as a complicated entry point for energy transition, while Debora Revoltella, the EIB Chief Economist, outlined potential barriers to “green” investments in the Czech Republic and in the EU. The panel, facilitated by Petr Procházka, the CBA's support for the Sustainable Finance Commission, focused on approaches to supporting investment in energy efficiency, energy savings and green innovation. The panel discussed these topics with Shiva Dustdar, Head of Innovation Finance Advisory at the EIB, Vladislav Nožička, Managing Director of Specialized Finance at ČSOB Group, Jiří Novotný, Innovation and Development Manager at ČEZ ESCO, and Petr Vítek, Founder and Partner at Tilia Impact Ventures.

Banking Identity enables registration to the National Library

The possibilities of using the Banking Identity continue to increase. Most recently, it can be used for remote registration to the [National Library of the Czech Republic](#). The registration to the National Library allows you to activate your reader account in a few minutes and thus gain access to digitized works not available on the market or, to the licensed database. Remote registration is valid for one year for a fee of 100 crowns. However, the registered readers do not receive a traditional library card and cannot use some library services. In order to obtain it, you should visit Klementinum in person, and complete the registration. The reader can then borrow books and documents or use the study rooms.



The Number of the Week

14.2 %

inflation in April 2022

From Legislature

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Opportunities to break banking secrecy will be increased

The Ministry of Finance should now have the possibility to break bank secrecy if it comes to cooperation with the European Anti-Fraud Office (OLAF). According to the draft [law](#) on the Czech Republic's cooperation with OLAF and amendments to the laws on banks, credit unions and the Central Register of Bank Accounts, the Ministry would be able to request a list of transactions from banks and credit unions and obtain information from the Central Register of Bank Accounts. The proposed legislation is required in order to designate the competent authority with the power to obtain the information requested by OLAF in the context of its investigations and to transmit it to OLAF. In general, cooperation with OLAF, which, among other things, investigated the Stork' Nest case, means that the Office, through the MoF, forwards its recommendations from the audit to the managing authority in the Czech Republic. On the basis of these recommendations, the latter will assess whether to launch its own audit, which may result, for example, in the withdrawal of the subsidy, or whether to disagree with OLAF's recommendation.

Financial Education

European Money Quiz 2022 winners known



In the pan-European final of the fifth edition of the [European Money Quiz](#), which focuses on the financial literacy of 13 to 15-year-old students, the most successful teams were teams from Norway, Italy, Ireland, Serbia and Malta. The top three teams will receive a cash prize from the European Banking Federation (EBF), while the five most successful teams will also be awarded a two-day trip to Brussels to visit selected European institutions. The competition is part of the EBF's financial literacy initiatives to highlight the importance of financial education for young people. In the Czech Republic, the Czech Banking Association has traditionally been the coordinator of the competition. In the online final, a total of 29 two-person student teams competed in their financial knowledge, whose task was to answer a total of 20 quiz questions on, among other things, sustainability, internet fraud, budgeting and cryptocurrencies as quickly and correctly as possible.

Topic

The Banking Association downgrades the economic growth estimate

Experts at the Czech Banking Association have agreed on an [updated economic forecast](#), which assumes a deterioration in most of the macroeconomic data. The Czech economy will slow down to 1.8% this year, the risks of stagflation are growing and real wages

will markedly drop this year. However, analysts have also pointed to extreme uncertainties due mainly to the development of the conflict in Ukraine.

The post-pandemic recovery of the global economy was disrupted at the end of February by the launch of the Russian military aggression in Ukraine. This completely changed the previous relatively favorable expectations for future economic developments. The conflict in Europe has brought a number of adverse economic consequences in addition to huge human tragedies. *"Russia's aggression in Ukraine turned the course of the world economy earlier this year and has caused the economy to face an equally difficult situation this year after two pandemic years. High energy prices, disruptions in supply-chains and significant price increases will undermine economic growth throughout this year,"* said Jakub Seidler, the CBA's Chief Economist.

Growth will not exceed 2%

According to the CBA's forecast, the growth of domestic economy will slow down to half this year compared to the original estimates. While the previous forecast from the beginning of February predicted growth of 3.7%, the current one estimates it at 1.8%. The estimate is thus slightly more optimistic in this respect than the latest CNB or finance ministry forecast. However, this is also due to the fact that the CBA forecast already knew the growth estimate for the first quarter when it was made. Despite the more favorable outcome of Q1, the forecast assumes a quarter-on-quarter decline in the economy in Q2 and Q3. The y-o-y economic growth will thus be close to zero in the second half of this year and some bank forecasts also expect a slight decline.

Inflation is being driven by housing prices

The price growth continues to surprise, accelerating to 14.2% in April, higher than the market and the central bank's expectations. This also poses risks to this year's inflation estimate, which the forecast sees at 12.5%. The acceleration in inflation this year has been driven mainly by housing-related prices, rising food prices as well as by fuel prices. The economists on the prognosis panel generally agreed that there are risks to inflation in upwards rates, both for this year and next. In particular, energy prices have risen appreciably for long-term contracts next year and beyond, which will pose further upside risks to inflation if the market situation does not calm down. The panel expects average inflation of 4.5% next year, with the highest estimate of 7%.

Employees will be left worse off

Average wages are expected to grow by around 6% this year, similar to

last year. This will not compensate for the rapid rise in prices and real wages will therefore decrease by more than 6%. The prognostic panel expects real wage growth to return to 1.5% next year. Although for next year, the consensus of estimates expects a similar rate of around 6%, increased pressure from unions and employees to compensate for the high inflation of this year cannot be ruled out.

Rates will still go slightly up

Faster-than-expected price growth was also reflected in a much faster rise in interest rates on the part of the CNB. In the last few quarters, the CNB has raised interest rates to the current 5.75%. According to the CNB's latest forecast, interest rates could rise further, supported by rising inflationary pressures. The prognostic panel thus expects a further increase in interest rates at the end of June. For now, it expects the CNB base rate to be 6% at the end of this year and at 4% next year.

Despite the noticeable rise in interest rates and the koruna's greater attractiveness in the eyes of foreign investors, the CBA's forecast panel does not foresee any significant appreciation of the koruna. According to the consensus, the koruna should move around the level of CZK 24.3 per euro at the end of this year and at CZK 24 per euro next year.

Pressure on higher deficit is growing

The CBA forecast estimates the state deficit for this year to reach 4.9% of GDP, which is a deterioration from the previous forecast due to the adverse effects of the war in Ukraine. Although collection of tax revenues has so far surprised rather positively, the consolidation of public finances will proceed more slowly due to the extraordinary circumstances, as it will entail a number of non-standard expenditures. According to the median estimates, the total public sector debt will reach 45% of GDP next year. *"The necessary fiscal austerity and the energy crisis are likely to reduce political capital and resources for the much-needed structural reforms,"* said Jaromír Šindel, Citibank's Chief Economist.

