

## 7. Monetary Conditions

The Czech National Bank continued in loose monetary policy. Sustaining of the exchange rate commitment required active CNB forex interventions on the foreign exchange market. The pressure on the crown appreciation grew by the end of the year.

The overall setting of the monetary policy did not change during the year 2016. Monetary-policy interest rates remained at a constant level since December 2012. Sustaining of the exchange rate commitment, which the Czech National Bank (CNB) uses as a further instrument of easing the monetary conditions, required a series of transactions on the foreign exchange market. The exchange rate of crown against euro thus held just above the level of 27 crowns for the whole year. The exchange rate of crown against dollar mildly fluctuated during the year. The national currency strengthened from the January average of 24.89 crowns per dollar below the 24 crowns boundary during the first half of the year<sup>1</sup>. The exchange rate oscillated in the relatively narrow range around the 24.30 crowns per dollar in Q3. The crown depreciated more noticeably only at the end of the year and it reached an average exchange rate of 25.64 crowns per dollar in December.

Growth of the monetary aggregate M3 was relatively high in the first half of the year, nevertheless slowed down at the end of the year.

Growth of the volume of money in the economy<sup>2</sup> accelerated during the years 2014 and 2015 and the year-on-year addition remained above 9% in the first half of 2016. This rate of growth dropped to the 8% boundary in the second half of the year and it arrived at 6.5% in December, which returned it to the values of the first half of 2015. The volume of deposits with agreed maturity was decreasing throughout the whole year. Growth of the money stock was thus concentrated into the increase of amount of currency and deposits on current accounts. Monetary aggregate M1, which includes just these two items, comprises 89.4% of the total volume of money in the economy.

Interbank interest rates stayed the same during the year. Yields from short-term state bonds fell to record minimums.

Market interest rates remained the same during the year. Three-month interbank rate PRIBOR kept at 0.29% and the one-year PRIBOR was at the level of 0.45% the whole time. The situation on the market with state bonds was different. Yields of medium term bonds (with maturity from 2 to 5 years) got above zero in Q2 2016, but it subsequently fell and oscillated around the value of -0.20% towards the end of the year. Yields of bonds with short-term maturity (up to 2 years) did not climb above zero since July 2015. Similarly to the medium-term bonds, its yields increased in Q2 2016 and reached to -0.04%, it fell down to -0.5% during Q3 and it arrived at historically the lowest value of -0.81% in December 2016. The interest rate on the long-term bonds attained the lowest value in September 2016 and it rose in contrast to the other two types of bonds in Q4 – it was 0.53% in December.

Interest rates on deposits were further falling and they tightly touched zero in case of non-financial businesses.

Interest rates on deposits were decreasing throughout the whole year 2016 or remained at a constant level regardless of the type or deposit or client. Household deposits with agreed maturity up to 1 year represented a partial exception and fluctuated between 1.31% and 0.53% and they finished at the same level at the end of the year as in January. Households had the largest volume of funds deposited on one day deposits (77.6% as of 31<sup>st</sup> December 2016). The average interest rate fell from 0.21% in January to 0.11% in December 2016. The situation was similar for non-financial businesses. The vast majority of their monetary resources (93.9% as of 31<sup>st</sup> December 2016) is deposited as one day deposits, whose interest rates did not have much room any more for the decrease to zero, since they reached 0.08% in January 2016. Their average rate came to 0.04% in December. Rates on the deposits with agreed maturity for non-financial businesses reached the level of current accounts in December.

The long-term outflow of funds from term deposits continues, with their interests falling below the level of inflation.

The practically zero interest rates led to a notable outflow of funds from term accounts of non-financial businesses. The volume of deposits with agreed maturity lowered by 22.8 bn for 2016, which represents a 32.3% fall. The rates on term deposits of households remained slightly above the level of inflation (until November), but even the private savers deposit still larger proportion of their funds on current accounts. The volume of one day deposits of households increased by 221.5 CZK bn (+14.4%) for 2016.

<sup>1</sup> The CNB data. Unless stated otherwise, all data in this chapter are taken from the Czech National Bank database ARAD.

<sup>2</sup> Measured by the monetary aggregate M3.

Rates both on consumer credit and mortgages were falling.

Most of the rates on credit to households were decreasing during the year 2016. The interest rates on consumer credit fell by 1.6 p.p. during the year. The decline manifested mainly for medium and long term fixed rate credit. Interest rates on mortgages were also declining during the year. Rates on medium term fixed rate credit were falling at a stable rate. The most common fixed rate credit with term above 1 year and within 5 years charged on average interest of 2.35% in December 2015 and the rate fell by 0.15 p.p. during the year. The drop of rates for fixed rate credit with term between 5 and 10 years was more pronounced (-0.5 p.p.). The situation on the credit market did not change much for non-financial businesses during the year 2016.

Credit financing for non-financial businesses stayed at the level of the preceding year.

The volume of provided consumer credit markedly rose in the first half of the year. Growth of the volume of mortgages fastened in the last quarter.

With respect to the favourable conditions, the volume of provided consumer credit was growing. The largest increase eventuated in February till May, when these credits swelled by more than 10% rate of growth year-on-year. The increase moderated in Q3 and settled at 6.3%. The year-on-year additions increased to 8.2% in the last quarter of the year. Mortgages formed the largest part of the total volume of provided credit (66.5% as of 31<sup>st</sup> December 2016). Their year-on-year growth was more than 8% throughout the whole year 2016, while it gained pace in the last quarter and crossed 9% in November. The new fixed rate mortgages with term between 5 and 10 years accrued the fastest, having the most advantageous interest conditions in 2016.

Non-financial businesses voted especially credit financing with long-term maturity. Growth of volume of credit was driven mostly by the increase of credit denominated in foreign currencies.

The volume of credit provided to non-financial businesses grew in the first three quarters of 2016 similarly to the year 2015 and it dropped in the last quarter. It increased from 922 CZK bn to 1001 bn during January till November and it fell to 976 CZK bn during December. The volume of long term credit (with maturity longer than 5 years) grew the fastest. These credits comprise more than 50% of the total volume of credit to non-financial businesses already several years and their share stably grows. The currency composition of credits presents a relatively interesting detail. The credits denominated in foreign currency participated in 22.7% from the total volume at the beginning of the year 2016 and this share arrived at 27.8% as of 31<sup>st</sup> December 2016. Practically only these credits contributed to the total growth of credit in Q3 and Q4. From the view of the branch structure<sup>3</sup>, the largest and fastest growing volume of credit was provided to businesses, which operate in the real estate activities. Financial and insurance activities were another branches, where the credits were significantly rising in the last year. On the contrary, the volume of credit provided to businesses in manufacturing stagnated and the volume of credit continued in decline for pro manufacturing and distribution of electricity, gas, heat, air, water and waste water.

Household debt stably increases and mortgages represented the main contribution in 2016.

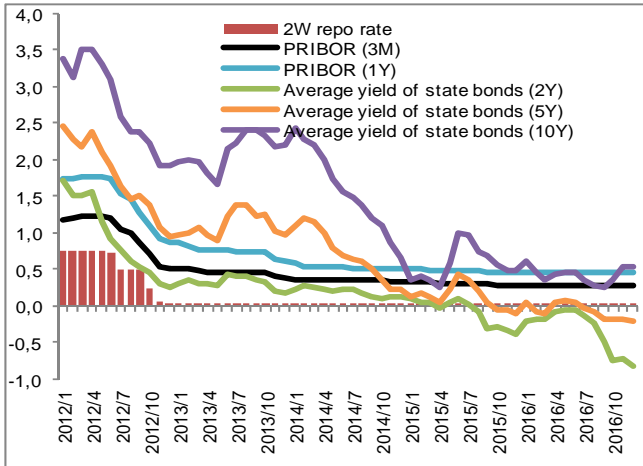
Household indebtedness increased by 96 CZK bn since the beginning of 2016 and arrived at 1428 CZK bn as of 31<sup>st</sup> December 2016. Mortgages comprised the majority of this increase (81.7 bn) and formed 74.2% of the total household debt as of 31<sup>st</sup> December 2016. The year-on-year increase of their volume fastened during the year from 7.7% in Q1 to 8.5% in Q4. Debt for the consumption purposes grew by a year-on-year pace of 10.1% in the first five months of the year, but the rise slowed down in Q3 and Q4 (2.4% and 4.0%).

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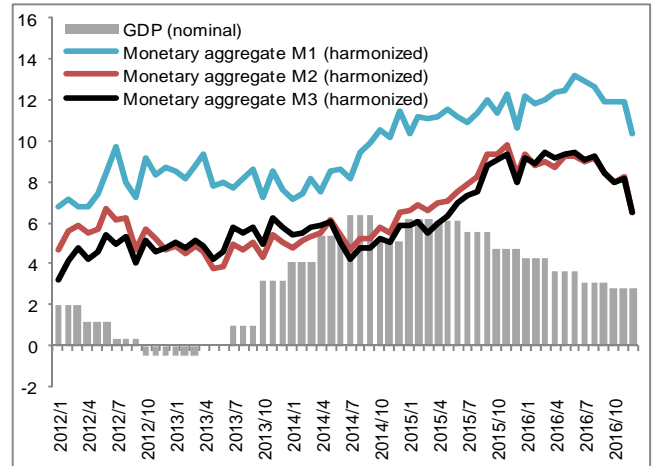
<sup>3</sup> Based on CZ-NACE classification.



**Chart 17** Monetary aggregates and gross domestic product (y/y in %)



**Chart 18** Market interest rates (in %)



Source: CZSO, CNB