

## Czech National Bank Preview: Time to catch up

We expect the pace of cutting to accelerate to 50bp, which will push the CNB key rate to 6.25%. The main reasons will be low inflation in the central bank's new forecast, which should allow for more cutting in the future. For year-end, we see the rate at 4.00% but the risk here is clearly downwards



CNB headquarters in Prague

### Optimistic forecasts could speed up the cutting pace to 50bp

The Czech National Bank will meet on Thursday next week and will present its first forecast published this year. We are going into the meeting expecting an acceleration in the cutting pace from 25bp in December to 50bp, which would mean a cut from the current 6.75% to 6.25%. This means a revision in our forecast, which previously saw an acceleration taking place in March. Still, it's certain to be a close call given the cautious approach of the board – and that could bring a 25bp cut.

# 6.25%

## Key rate

50bp rate cut expected

The board will have a new central bank forecast, which is likely to be a key factor in decision-making. Here we see the need for revision in a few places, but overall everything points in a dovish direction. On the global side, compared to the November forecast, we expect the CNB to revise down both GDP growth, rates and oil prices.

On the domestic side, inflation has surprised downwards only slightly in the past three months for both headline and core inflation. Still, we expect some downward profile shift due to a better outlook for food, energy and oil prices. As for GDP, the CNB was the most pessimistic forecaster in the market in November and the incoming data was rather mixed in this regard, so we expect only modest changes here.

The CZK was 0.35% stronger than the central bank's expectations in the fourth quarter of last year. On the other hand, it was slightly weaker in January. Overall, we do not see any significant impact on the new forecast here, but the lower EURIBOR profile after the revision may indicate a stronger CZK in the new forecast, or allow for faster rate cuts in the CNB model. The November forecast indicated roughly a 50bp cut in the fourth quarter last year and reaching 3.50% by the end of this year, delivering a total 350bp of rate cuts. As we know, the CNB delivered only 25bp last year, which will need to be reflected in the new forecast.

Overall, we expect a slightly steeper rate path again with a 3.00% level at the end of 2025, which should have a dovish outcome for the market in our view. As always these days, we can also expect several alternative scenarios, one of which will be the board's preferred scenario, showing a slightly slower rate cuts profile than the baseline.

## **Inflation nowcast will be key to the decision**

We see from public statements that the dovish wing of the board (Frait, Holub) will push for a faster pace of rate cuts given inflation numbers indicating a quick return to the 2% inflation target this year and will be open to more than 50bp of rate cuts. For the rest of the board, we think the inflation indication for January and beyond in the central bank's new forecast is key. We are currently expecting 2.7% for January headline inflation, with room for it to come in lower if the anecdotal evidence of January's repricing is confirmed. This, in our view, will give the rest of the board the confidence to accelerate the pace of cutting as early as this meeting.

## **4% at the end of the year or lower depending on core inflation**

Looking forward, we believe the favourable forecast for the coming months will allow the 50bp pace to continue. Here, our forecast remains unchanged and we think core inflation will still prevent the board from going faster later. We therefore still assume a 4% key rate at the end of this year. But if core inflation continues to surprise to the downside, we find it easy to imagine lower levels here.

## What to expect in FX and rates markets

The CZK has weakened in recent days following comments made by Deputy Governor Jan Frait and touched 24.90 EUR/CZK, which is basically the weakest level since early 2022. If the CNB delivers a 50bp rate cut, it's obviously negative news for the CZK. But on the other hand, we believe that the market positioning is already heavy short and rates are already pricing in the vast majority of CNB rate cuts. That's why we see the cap at 25.20 EUR/CZK. A minor cut, however, could bring a temporary strengthening towards 24.70 given heavy dovish expectations. In our base case scenario, we think that after the 50bp rate cut and January inflation, the market should have hit the limit of what can be priced in and the CZK should start appreciating again later this year thanks to the economic recovery, good current account results and falling EUR rates improving the interest rate differential.

The rates market fully priced in a 50bp move recently and expects another 50bp move for the next meeting, which is close to our forecast. However, the terminal rate is already priced in at 3% at the end of this year, which we don't have on paper until next year – but we still see this as a possible scenario if inflation remains under control. If we do see the CNB's forecast, the market can easily get excited for a lower terminal rate and overshoot market pricing. Therefore, we expect the combination of the 50bp cut and the dovish forecast to push market rates further down, resulting in further steepening of the curve. In the bond space, we maintain our positive view here going forward. Czech government bond supply has fallen significantly as we expected and, combined with the inflation profile and central bank cutting rates, offers a perfect combination in the CEE region. Here, we continue to prefer belly curves and see more steepening.

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