

## CNB Review: Catching the market off guard

The Czech National Bank surprised the market today with a cautious hike (0% probability of a hike was priced in). We looked for a hike in May but the move came earlier than expected. Today's hike is likely to end the CNB tightening cycle. The dilemma now shifts towards whether to stay on hold or cut in the second half of 2020. On the margin, we favour the former



Source: Czech National Bank

- By a narrow majority of 4:3, the Bank Board decided to raise interest rates by 25bp. For some board members, concerns about higher inflation and loss of CNB credibility prevailed over fears of a slowing domestic economy and other foreign risks.
- Indeed, inflation in the new CNB forecast has been revised up. The CNB expects average inflation of 3.2% this year, compared to 2.7% in the previous forecast. In March, the CNB expects inflation at 3.6% year on year. Inflation is also higher over the monetary policy horizon (1H21), which for some board members could also be an argument to back a hike. As Governor Rusnok mentioned in the press conference, the CNB is primarily an inflation targeter with no dual mandate (compared to the Fed). As such, the inflation outlook is thus

the main argument for setting monetary policy.

**2.25%** The main CNB 2-week repo rate  
after February monetary meeting

Higher than expected

- The EUR/CZK path remains similar to the previous forecast as well as the interest rate path. The latter still shows cuts in 2H20 - we still think this is premature for the time being. If the developments abroad would indeed further significantly worsen, it is possible to imagine a renewed minor rate cut at the end of the year, but the stability of rates is more likely, in our view.
- If CNB Board members backing a hike thought that the rate cut was in the pipeline, as the forecast suggests, they would probably not vote to hike today, in our view. But what is clear is that the up-to-now the CNB's dilemma about the rate hike or stability is to change towards the decision whether to stay on hold or cut rates later in the year. Stability of rates seems as the most likely scenario for now, however.