

Czech central bank: Another hike, but limited support for koruna

For the Czech national bank, a 25bp rate hike next Wednesday seems like a done deal, with one more likely to follow later this year. Given this is fully priced in, we have a hard time seeing how the press conference will deliver a more hawkish signal. So the positive impulse for the koruna should be muted



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Inflationary pressures are mounting

The Czech economic performance remains solid. The labour market is overheated, wages are growing by more than 8% year on year and inflationary pressures are mounting. The latter is most visible in core inflation, which touched 2.5% YoY in August and prices of services are growing by 3.7% YoY.

Pro-inflationary risks are rising, partially on the back of supply factors such as higher electricity, gas and food prices given a weak harvest. But also demand-driven inflation is supported by an insufficient workforce and new government measures confirming 8% public wage growth next year.

We expect inflation to most likely exceed the 3% tolerance band in 1H19, supporting the central bank hawks to continue with rate normalisation.

1.5% 2-week repo rate after next meeting
In line with market consensus

Central bank models signal a need to tighten via rates in 2H18

While the central bank is forecasting EUR/CZK 25.80 on average in 3Q18, the reality will most likely be 25.70.

This is a negligible difference, given that the 3Q18 repo average assumed in the last forecast was at 1.48%, while the reality will be below 1.2% - even with a September hike.

Assuming the Bank's rule of thumb that a 1% koruna appreciation is equal to a 25bp hike, a slightly stronger CZK in 3Q18 doesn't wipe out the need to tighten monetary policy via rates.

Even with a hike, upside potential for CZK is limited

Although we see the central bank as a big hawkish outlier in the wide European central banking space and look for two rate hikes this year, these are already priced in by the market in addition to two more in 2019.

Given these high market expectations and the fact that we don't expect the CNB to verbally pre-commit to meaningful tightening next year - (note the current CNB forecast shows no rate hikes for 2019), we have a hard time seeing how the central bank will deliver a more hawkish signal versus what is already priced in.

As such, we see limited upside potential to CZK after the hike will be delivered as expected.