Czech National Bank review: A wave of inflationary risks

Policymakers unanimously decided to make no change in the policy rate, leaving it at 3.75%, which aligns with market expectations. The overall stance and tone are hawkish, emphasising inflationary risks coming from all directions, with all possibilities opened for the next move. We still see space for some easing, but the terminal rate is close by

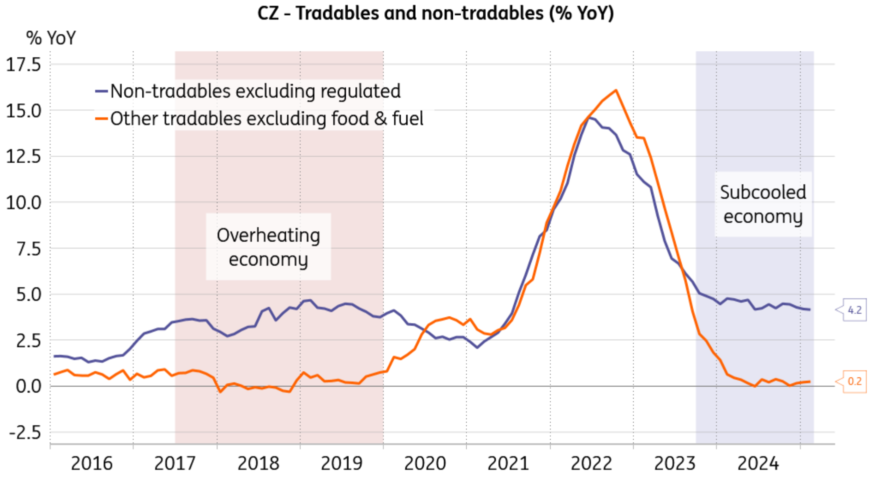
The Czech National Bank kept the policy rate unchanged at 3.75%

Stronger expansion brings additional inflationary risks

The Czech National Bank clearly perceives overall risks as inflationary, be it from robust household spending, a tight labour market and solid wage growth, persistent services price dynamic, or recently the potential for a more relaxed fiscal situation in a boost to defence spending. The economy is doing better than expected, with more potent expansion and, thus, price pressures ahead.

At the same time, the recently agreed German fiscal package reduces the risk of the continued weakness of the German economy, which is the main trading partner for Czechia. At the same time, external demand remains subdued for the time being. Potential trade wars and tariff escalation are perceived as a pro-inflationary risk in the near term, yet may carry anti-inflationary factors in the medium term. The reviving credit growth, also linked to the revival of the residential market, is to be perceived as another inflationary risk, according to Governor Ales Michl. Excessive growth of money in the economy has to be understood as a source of long-term troubles for maintaining price stability.

Price growth of non-tradables gets sticky



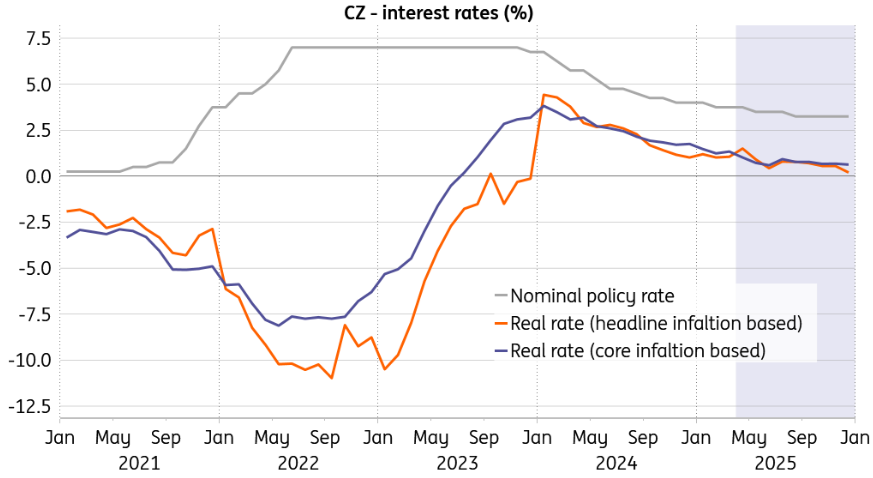
CZSO, Macrobond

Overall, the large number of pro-inflationary risks leaves no doubt that the communication and general setup are hawkish. At the same time, no option was excluded when looking ahead, be it a rate reduction, stability, or increase. We perceive the communication as a confirmation of our take that the easing phase is coming to an end. What the landing runway will be is hard to determine, as every board member may have their own specific view. It all comes to the next inflation prints and the potential comeback of fixed investment and revival of conditions in the industry.

Some room for cuts but space is limited

We see a no-change inflation print at 2.7% annually in March, with a marginally softer core rate and a more potent food price dynamic. That said, food prices are rather hard to predict, likely due to numerous discounts and other temporary distortions that make even the measurement a tough job. The price dynamic in non-tradable items, a good services proxy, remains solid. However, with the economy still operating below its potential, our take is that there is still room for some rate reduction, though limited. Substantial growth barriers of a structural nature are still present in Europe and are waiting to be tackled. And yes, all the Europe-wide fiscal spending enthusiasm and propensity to boost defence spending are much appreciated, especially considering the ongoing war for a third year in a row. However, it may prove a long track for all this to trickle down through the economy.

Real rates may get close to the zero-bound



Source: CNB, ING, Macrobond

Therefore, we see one more cut as highly likely, bringing the rate to 3.5% during the upcoming May meeting. There is still space to help the economy in terms of its actual fitness in getting back to where it belongs, i.e., to its potential. The Governor mentioned that the equilibrium rate is estimated somewhere above 3%, though he does not have a personal number in favour. So, whether the policymakers will decide to continue to 3.25%, which we see as an optimal landing zone, is less sure right now and remains to be seen.

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