Czech National Bank review: Board discusses a rate cut but its forecast sees a hike

The CNB's forecast signals stronger growth, lower inflation and tighter conditions, yet the Board struck a dovish tone, discussing cuts with headline inflation well below the CNB target. We now expect the first rate cut in May. However, a downside February inflation print could be a deciding factor for an earlier rate cut

Czech National Bank Governor Ales Michl

New CNB forecast shows strong economy and return of inflation later

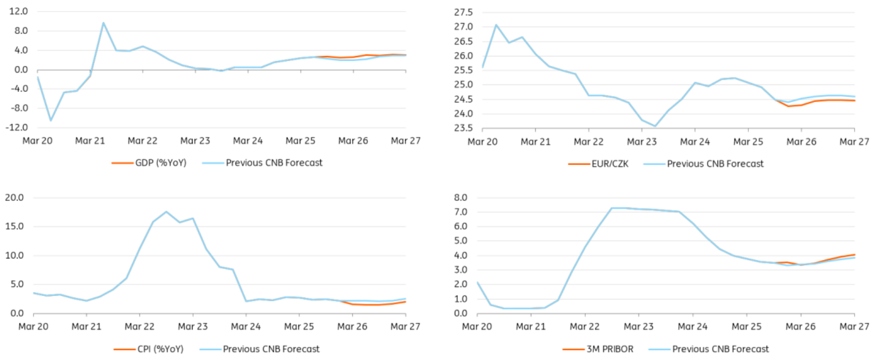
The Board of the Czech National Bank (CNB) left rates at 3.50% today, as expected. The new forecast sees a significant upgrade of the GDP forecast to 2.9% this year and next year from 2.4% and 2.8%, above ING expectations. With this step, the CNB returns to the view of the most bullish forecaster out there. At the same time, the inflation forecast has moved 60-70bp lower this year and 40-50bp next year due to energy prices and ETS2 presumably. This seems to be an issue for the CNB model and we see a revision of EUR/CZK down and, at the same time, rates up by 22bp on average next year. Overall, monetary conditions are tightening while inflation is below target all year and on target for most of next year in the new CNB forecast.

More interesting from the market point of view is that the CNB expected 1.6% inflation for January, which is in line with the actual number, and expects 1.6% for February and March as well. If food prices were the main reason for inflation pressure and if energy prices continue to fall, we could see a downside surprise in February.

3.50% CNB key rate

As expected

New CNB forecast compared to November



Source: CNB, Macrobond

The Board discussed the possibility of rate cuts

However, the press conference was in the exact opposite style to the forecast. Governor Michl confirmed that the Board had discussed the possibility of a rate cut today. At the same time, he mentioned that the Board would like to see a slowdown in the momentum of core inflation, which would make it more comfortable to cut rates. Although, according to the governor's words, we should not expect large rate cuts, fine-tuning is on the table and the governor's bias was clearly in the direction of rate cuts.

May seems like the best opportunity for a rate cut

We have changed the rate cut call from March to May after this morning's inflation report, which seems like the best possible expectation at this point. However, we wouldn't say that a March cut is off the table completely if headline inflation surprises to the downside in February due to a correction in food prices and further disinflation in energy prices. But we believe it is a safer case for the CNB to wait for more data prints and a new forecast in May, where core inflation should also fall somewhat in the meantime.

Our market view

On the markets side, the front of the rate curve saw significant repricing up this morning after the market was positioned for a lower number. At the same time, the market initially viewed the press conference as hawkish due to the new forecast, but we saw some market reversal in the end. Still, the market ended today pricing in one rate cut, which may seem fair at this point.

EUR/CZK peaked in the range 24.350-400, which has been our target since the beginning of the year and, given that we cannot expect the market to go for two cuts in the near future, this can be considered a peak and a reversal down again. For now, 24.250-300 seems fair, in line with the reaction in rates. We will wait for more details from the CNB analyst meeting tomorrow.

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