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Article

Czech Republic: Hike is a done deal, but rates forecast to be dovish

The February hike is a done deal following the recent CNB communication. However, the dovish tilt may come from the CNB interest rate forecast, which is likely to signal only two hikes in 2018

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February hike is a done deal

As a hike was most likely in play during the last December meeting and the latest economic figures did not bring any unexpected negatives, the 1 February CNB decision should be relatively clear. The CNB will hike by 25bp, raising the policy rate from 0.5% to 0.75%.

Economic activity continues to develop favourably. Inflation remains safely above the 2% threshold, and despite a slight deceleration at the end of 2017 due to a base effect, it will remain above the target (yet close to 2%) over the monetary policy horizon. The labour market has been performing exceptionally well, breaking its record in recent months, both in terms of low unemployment rates and high job vacancies.

0.75%

CNB 2-week repo rate
after the CNB meeting this Thursday

New forecast will be released

The CNB Board will have a new forecast in hand. Market attention will turn to (1) a newly published EUR/CZK path; and (2) the interest rate projections.

We believe that the EUR/CZK forecast might be close to / modestly below the 25.00 level in 4Q18. The interest rate projection might signal only two hikes for 2018, however. The latter is driven by the CNB's model assumption of the ECB's accommodative policy, which does not enable a faster hiking cycle due to the increasing interest rate differential.

At least three hikes in 2018 are likely

Still, we assume that at least three hikes will be delivered by the CNB this year, even if the ECB will continue in lowered QE in 4Q18. This was confirmed also by recent comments of the CNB Board members, who admitted more than two hikes in 2018 as an option. As such, we see the 2-week

repo rate at 1.25-1.5% at the end of 2018. The CNB deposit rate is most likely to remain at its current zero level, as Governor Rusnok suggested in his latest interview.

February hike is priced in

We also note that this week's expected rate hike is priced in, meaning that the impact of the hike itself should be muted. Dovish signals might be sent by the interest rate forecast, as we look for the CNB interest rate forecast for 2018 to show two rate hikes only, while the market is pricing three hikes in 2018. This dovish sign should be partly offset, however, from the newly published CNB CZK forecast, particularly if the year-end EUR/CZK forecast is below 25.00, as we expect.

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