

CNB Preview: interest rate hike on the table next week

Despite some persisting foreign uncertainties, recent central bank Board member comments signal that there is higher support to back an interest rate hike next week. This is due to a higher inflationary outlook, weaker-than-expected koruna and tentatively declining Brexit uncertainty



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Inflation hitting 3% upper tolerance band

March inflation hit the 3% year-on-year threshold, driven mainly by prices of services growing by 3.7% YoY. Although we might see an elevated CPI print even in April, inflation should gradually slow down. However, the recent spike in oil prices could result in an even more gradual CPI slow down. As such, the new Czech National Bank (CNB) CPI forecast should show an upward revision to the average inflation for this year from 2.2% to closer to 2.5%.

Weaker-than-expected CZK

The non-appreciating koruna (CZK) path should be the main factor in the potential policy reaction

as it has become clearer that CZK will not follow the appreciation path projected in February's CNB forecast (25.17 in 2Q19, 24.8 in 3Q19 and 24.5 in 4Q19). Assuming EUR/CZK around 25.65 on average in 2Q19 (ie, 2% weaker than the CNB assumed), this would ceteris paribus require two interest rate hikes. As foreign developments will be revised downwards also, the initial conditions in the forecast will change, but hardly enough not to warrant policy tightening demanded by the CNB forecasting model.

2.0%

Expected 2-week repo rate

after the CNB meeting next Thursday

Uncertainty still remains

We can also imagine a more cautious approach of an “on hold” decision given persisting foreign uncertainties. Mainly recent leading indicators from the manufacturing industry in Germany remained on a weak footing in April, raising questions about the Eurozone economic outlook. Also, some domestic factors are supporting caution. Households consumption decelerated in 4Q18 to 2.2%, wage growth signalled less buoyant dynamics at the end of the last year, and new credit activity has been falling around 25% YoY in recent months due to new stricter CNB macroprudential rules.

Signals from the central bank were relatively hawkish, supporting a hike delivery

However, recent interviews with the CNB Board seemed relatively hawkish. T Holub signalled closing the “opportunity window” for a hike in 1H19, J Rusnok suggested a very narrow line between an “on hold” and a hike decision and M. Mora signalled a willingness to support a hike if forecasts enable that. However, due to the weaker path of CZK and higher inflation trajectory, new forecasts will very likely indicate the need for a hike. Also, a hike will be traditionally supported again by V. Benda, and very likely also by A. Michl, who voted for hikes together with Benda during previous meetings. As such, given all recent signals from the board members, a CNB hike seems like the most likely outcome from the monetary meeting next week, in our opinion.