

Czech central bank preview: No change to its wait-and-see stance

The Czech central bank is set to retain its wait-and-see stance and keep rates unchanged as external uncertainties offset domestic price pressures



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- Despite weaker global growth, escalating trade wars and manufacturing industry slowdown, the Czech economy remains solid. 2Q19 GDP growth of 2.7% was in line with the CNB forecast. Wage growth slightly surprised on the upside at 7.2% YoY (vs. the 6.9 in the CNB forecast) and inflation was above CNB expectations for the third month in a row – due to higher core inflation and food prices.
- The domestic economy should warrant tighter monetary conditions as inflationary pressures are mounting on an overheated labour market, solid household consumption and CZK weaker than forecast. The CNB model pencilled in a hike at the last August meeting, but the CNB board decided to wait and see due to persisting risks abroad. We expect more of the same from the September meeting, as the Board will still need to take the uncertainty abroad into consideration.

2.0%

2-week CNB repo rate

unchanged

- We expect unchanged rates this week. In fact, since the Aug QIR, the foreign environment has deteriorated and the assumption of 1.5% growth in the effective eurozone assumed in the latest CNB forecast seems overoptimistic. Current developments point to the adverse sensitivity scenario the CNB introduced in the last inflation report, expecting growth of 0.7% in the effective eurozone in 2020.
- Even if the CNB model assumes three cuts in 2020 in this adverse scenario, it also assumes a relatively strong koruna around EUR/CZK 25.30. This doesn't look likely to materialise as, under a meaningful German slowdown, CZK weakness would deliver easing of monetary conditions and thus take away the need to cut rates, particularly when pronounced cuts would lead to a risk of a sharp sell-off in the overbought CZK.

Given the risks abroad, which remain elevated, longer-term stability of rates seems the most likely scenario.

We can imagine an "insurance" cut in 3Q20 if the global economy continues to slow, but positioning for earlier and more aggressive CNB cuts seems premature in our view. Such a message makes sense from a central bank, trying to persuade the market that cuts are not on the table at this point.