

Czech: Central bank to stay on hold, hike to come in February

We expect the Czech National Bank to stay on hold next Thursday. Although the koruna has been weaker than the CNB projected in 4Q18, the board is likely to see the current CZK softness as related to the year-end effect. Hence, a rate hike is likely to be postponed to February next year, in our view



Source: Shutterstock

Economic activity remains solid

Economic activity slowed to 2.4% in 3Q18, below the CNB's expectations of 2.7%. This was mainly due to weaker net exports and softer household consumption. Still, it remained above 3% year-on-year. The labour market remains tight and wage dynamics are strong (8.5% YoY in 3Q vs 8.2% expected by the CNB). This means that households' spending, as a main pro-inflationary factor, remains in place.

1.75%

2-week CNB repo rate after December meeting

no change expected

Weaker inflation on the back of supply factors...

The recent decline in Czech headline CPI to 2% was mainly on the back of food prices, which surprised on the downside in the last two months. More importantly, core inflation by the CNB definition accelerated further to 2.4% YoY and so did prices of services (3.3% YoY) or non-tradable items, which picked up by 4.3%, with the best YoY growth rate in the last ten years.

...and will accelerate again next year

This illustrates that inflationary pressures remain tangible due to the tight labour market and solid wage growth. We look for Czech CPI to accelerate back above 2.5% by March next year due to strong households' consumption transmitting into core inflation growth, but also an increase in prices of electricity and food prices in 2019 as a result of the weak harvest. Recent oil developments, however, are an anti-inflationary risk, though as a supply shock it is less relevant for the monetary policy decision. Even with Brent oil remaining around 60 USD per barrel, headline CPI will remain above the 2% target next year.

Weaker CZK on the back of end-of-year bias

All this suggests a clear tightening bias from the CNB, especially given the weak CZK, which we hardly see getting to EUR/CZK 25.10 in 1Q19 and 24.4 in 4Q19 as is seen in the latest CNB forecast. EUR/CZK remained above the CNB assumption even in 4Q18 (25.7 vs 25.9). The 0.9% weaker CZK vs the forecast, in theory, suggests possible rate hikes in order to deliver an equivalent monetary tightening. However, the CZK weakness in 4Q18 has partially been driven by the end-of-year effect and resolution fund fee, as the domestic banking sector is penalising CZK liquidity stored over the year-end. As such, we expect the CNB to remain on hold during the December meeting and is more likely to deliver a hike at the beginning of February.