

## Czech Republic: CNB Preview - Tossing a coin

We still look for no change in CNB policy rate this Thursday, though we fully recognize the 50:50 odds of a rate hike. Yet, with the CNB communication being quite unclear, with hawkish comments from some board members vs the very dovish interest rate forecast, we stick to our no-hike view on the margin.



Source: Czech National Bank

### Macroeconomic data in line with the CNB forecast

**GDP growth in 3Q17 was confirmed at 5% YoY**, in line with the CNB November forecast. The structure of GDP was only slightly less inflationary, as the CNB expected stronger consumption from households and the government.

**CPI decelerated to 2.6% after its peak in October when it hit 2.9%**. The deceleration was caused mainly by the higher base effect, as food prices started to accelerate more rapidly in Nov-16. This was, however, in line with the CNB forecast, though core inflation lagged CNB expectations somewhat.

**Wage dynamics in 3Q17 ended below the CNB consensus - at 6.8% YoY vs the 7.5% forecast.**

The dynamics decelerated in both non-market and market segments. Still, due to the very tight labour market, wage dynamics are expected to accelerate further next year. This is also evident in the unemployment rate, which declined by more than the CNB expected in 4Q17.

**All in all, economic developments were broadly in line with the latest CNB forecast, confirming the favourable economic outlook - this demands further monetary tightening. Therefore, we see a further 25bp rate hike over the next two months as a done deal (during either the December or the February meeting).**

On the margin, we favour a hike in the February meeting. This is because this is an Inflation Report meeting, bringing a new set of forecasts and enabling an enhanced communication from the CNB. Also, the end-of-the-year period is not often popular for interest rate changes due to very low liquidity in the market.

## December hike might be already pre-agreed, however

**However, Governor Rusnok's statement about a 50/50 chance of a December hike was hawkish and suggests that the CNB Board might have already discussed the possibility of a December hike during the previous November monetary meeting.** In our view, the CNB Board was most likely seriously considering a 50bp hike in November, but probably decided to hike just by the traditional 25bp to keep the hiking cycle more gradual - but with the possibility of another hike during the next meeting, if needed. This would explain why Governor Rusnok recently hinted at the 50/50 chance of backing the December hike, even very soon after the November hike. Also, other board members (Benda, Hampl) have already hinted at their support of a December hike in their latest media comments. **As such, the chance of a December hike is clearly non-negligible, very close to 50%.**

## Keeping rate unchanged will not impact CZK significantly

We see only limited downside to CZK stemming from an "on hold" decision given (a) an eventual rate hike possible in February; (b) already non-negligible CZK weakness recently. Any CZK weakness should be only temporary as the CNB should eventually push the currency higher via its tightening cycle. The very short-end implied CZK FX yields should remain heavily negative, as we approach year-end due to the resolution fund consideration. Compared to the previous year-end, we expect implied yields to decline even more this year, reflecting the greater excess liquidity in the system (due to excessive 1Q17 CNB FX interventions).