

## CNB Preview: Wait-and-see approach continues

The Czech National Bank (CNB) should not surprise this Thursday, remaining on hold due to global economic uncertainty. A new forecast will be introduced, this time using an adjusted CNB model but we're not expecting any major shocks given recent signals



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### Core inflation to slow down

Czech average inflation reached 2.8% in 2Q19, 0.1ppt above the CNB forecast. However, the difference was due to slightly higher-than-expected fuel and food prices, while core inflation was in line with the central bank's estimate of 2.6%. Inflation should decelerate slightly to 2.5% in 2H19 due to a base effect. Next year, inflation might remain above 2% due to expected tax increases for tobacco and alcoholic beverages, but core inflation should get to the 2% CNB target by mid-2020.

**2.0%** 2-week repo rate  
No change expected

## Real economy so far so good

The real economy has performed relatively well in recent months despite the global economic slowdown. Industrial production grew by more than 3% YoY in the past two months after stagnation in 1Q. However, the manufacturing industry in Europe remains under pressure due to the US-China trade wars. Together with the slowdown in the automotive sector, this, in our view, will all become more visible sooner or later in the domestic industry sector. As such, we expect the Czech economy to slow further in 2H19, in line with recent declines in confidence indicators (which hit multi-year lows in recent months).

## CZK weaker than assumed by the CNB

The CNB assumes a 25.2 EUR/CZK average for 3Q19, and we don't think that's likely to materialise. Although CZK has strengthened and hit the EUR/CZK 25.50 threshold in June and July, this has been driven by a significant change in market expectations of Fed policy. Although the Fed should cut rates this week, this is already priced in by the market and the impulse for the koruna to appreciate should be muted. However, compared to the previous year, the non-strengthening CZK vs the CNB forecast may not lead to an increase in policy rates as weaker developments abroad will counteract this.

## Longer-term stability of the CNB rates most likely

The environment has not changed much since the June meeting. Given the current global uncertainty, the best strategy for the CNB seems to be 'wait-and-see'. The market expects the CNB to deliver a partial cut this year and two full 25bp cuts by end-2020 given the slowing global economy and an easing bias from both the ECB and the Fed. In our opinion, however, this is premature in the case of the CNB and not in line with recent data from the domestic economy. Longer-term stability of the CNB rate is thus probably the most likely scenario.