Czech National Bank: On hold with hawkish tilt

The Czech National Bank kept the main rates unchanged, as broadly expected. But the press conference was surprisingly hawkish, indicating that debate about a potential hike was quite serious, and two board members even voted for that. Still, we believe that longer-term stability of rates is the most likely scenario given foreign risks

Source: Czech National Bank

Mentioned during the press conference:

- Inflation has been close to the CNB's tolerance band in recent months and slightly above the forecast, mainly due to higher core inflation and also food prices.
- Current economic data indicate continuing growth of the domestic economy in 3Q. Although industrial production decreased, new orders improved. Wage growth in market sectors slowed slightly, in line with the forecast. However, the dynamics remain high due to the tight labour market.
- The koruna's exchange rate lagged behind the forecast in 3Q by 30 hellers, as the koruna is significantly influenced by global factors.
- To sum up, the forecast is predominantly fulfilling, with the Bank Board assessing the risks

to the August forecast as significant, in both directions, but overall as inflationary.
- The weaker CZK is acting in the direction of higher inflation; on the other hand, the risk of a significant slowdown abroad and the subsequent impact on the domestic economy is the opposite risk.

Inflationary risk become more tangible

Governor Rusnok was asked during the press conference, what changed compared to the June meeting when all Board members backed an on-hold decision. The answer was that apparently upside risks to inflation are increasing, at least for the moment. The weaker exchange rate results in more relaxed monetary conditions. And so far, there is little signal that the domestic economy is slowing down. The CNB's mandate is primarily price stability, so there was a debate as to what is perceived as more risky for the CNB: hike and subsequently cut if an economic slowdown appears, or smooth rate with a risk of not meeting the inflation target, ie, CNB's objective. However, the arguments supporting raising rates were offset by the very uncertain environment abroad, which will sooner or later transmit in the domestic economy.

2.0%

Main rate of the CNB

unchanged after the September meeting

As expected

Most likely scenario - rates on hold

As mentioned by Governor Rusnok, this was not an easy debate for the CNB Board today, discussing quite seriously the possibility of raising rates. They will return to the debate at the November meeting, when they will have a new forecast. Still, we believe that the current CNB August forecast seeing almost 3% GDP growth next year is relatively optimistic in the context of current external developments. The CNB's November forecast should thus bring a downward revision reflecting current weakness in the Germany/Eurozone. As such, it is most likely that the more cautious policy stance will prevail again and rates will remain on hold. As such, stability of CNB rates remains the most likely scenario in a 2-3 quarter horizon. We can imagine some "insurance" cut in 2H19, if the Eurozone economy will continue slowing down, but this will be a function of currently "uncertain" global economic developments.