

## Czech central bank: Cautioned but likely to hike rates in 4Q

The Czech central bank is expected to reiterate that frontloaded tightening in the second quarter is unlikely given the deteriorating Covid-19 situation. But with higher-than-expected inflation and the expected improvement of the pandemic in 2H21, the case for tightening this year remains intact. We look for two hikes in the fourth quarter



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### Better 4Q20 figures vs. latest forecast

Recent macroeconomic developments have been somewhat better compared to the Czech central bank's February forecast.

Fourth-quarter GDP increased by 0.6% quarter-on-quarter (-4.7% YoY) amid stronger net exports while the central bank assumed QoQ stagnation (-5.4% YoY).

Wage growth in 4Q was also strongly above the central bank's expectations (2.2% vs 6.5%) though a positive surprise was driven by several one-off factors and bonuses for healthcare workers. The

central bank expected weaker 4Q20 wage dynamics due to tax-optimization followed by a strong 1Q21 (5.8% YoY), which didn't really materialise.

## Higher inflationary outlook for 2021

The CPI outlook is now more pro-inflationary as January CPI was higher than central bank and market expectations amid higher food prices (2.2% vs 1.7% expected by the CNB). In February, CPI reached 2.1%, prices of services decelerated from 2.6% to 2.3%, and core CPI according to the central bank's definition fell from 3.6% to 3.2%.

Still, the recent spike in commodity prices is pro-inflationary, moving the 2021 CPI outlook higher towards 2.5% vs 2.0% as the central bank forecast in February.

# 0.25%

Main CNB rate

should get to 0.75% till end-21 in our view

## Despite the pandemic, hikes in 2H21 likely

Although the deteriorating pandemic situation in 1Q21 has delayed the start of the recovery, recent rhetoric from central bank board members suggests that rate hikes in 2021 remain very likely, though more likely to shift to the second half of the year.

We continue to expect two 25bp hikes in 4Q21 as the most likely scenario. We also don't rule out a one-off 50bp hike - most likely in November. An earlier hike (in August) is still possible, but only if the pandemic situation improves significantly in 2Q, accompanied by a strong pace of vaccinations

### A stronger koruna

The Czech central bank remains fundamentally hawkish and points to the tightening of monetary conditions (both via interest rate and FX channels). Should the Czech koruna fail to recover in the second quarter, the case for even more aggressive tightening is likely to build and, in turn, strengthen CZK.

The positioning squeeze exaggerated the CZK sell-off in February, as CZK was the favourite CEE long among investors. Less stretched positioning points to CZK upside.