

Czech National Bank Preview: QE is coming

We expect the Czech central bank to announce QE and deliver a 50 basis point cut this Thursday. The CNB's intention to embark on Czech government bond purchases was confirmed by the ministry of finance in an interview overnight. QE should add even more pressure to the struggling CZK



Source: Shutterstock

Another rate cut on Thursday?

Given the current extraordinary developments in both domestic and global economies as Covid-19 spread, the Czech central bank is likely to cut rates again this week.

Although lowering rates alone will not be a very effective tool in these extraordinary times, the central bank must join the fight against the negative consequences of the spread of Covid-19. We are expecting a 50bp cut.

Start to QE?

As for additional measures, the ministry of finance Schillerova confirmed (possibly by mistake) the

central bank's intention to start QE in an interview overnight. Apparently, the MinFin will try to finalise the needed legislation in an emergency mode today. We don't know the details yet, but we know asset purchases are coming.

The CNB may also come with further measures such as reducing its countercyclical capital buffer rate below 1.75%, as many other regulators have done recently.

Economy set to contract sharply this year

According to our estimates, the domestic economy is currently operating at around 70%. The economy will be most affected in the second half of March and the first half of April, after which we expect a gradual easing of restrictions.

However, the return to normal will be significantly hampered by weak foreign demand due to the spread of Covid-19 globally. The domestic economy could thus fall by c.3.5% this year (with clear downside risk). The Czech government has announced a -5.1 % YoY GDP outlook for this year.

QE is negative for the koruna

CZK has already been under a lot of pressure in the recent weeks and the upcoming announcement of QE is likely to be a further CZK negative. Up until recently, the central bank has been perceived as the least likely CEE central bank to embark on such measures.

With the CNB already signalling a readiness to intervene and to tame the unwarranted koruna volatility and weakness, we expect FX interventions to start very soon - QE should be seen as CZK negative. The CNB's firepower is immense (FX reserves around 60% of GDP vs around 20% for other central banks in the region) and the central bank may credibly lean against the weakness of the overbought koruna. We expect the intervention to start once EUR/CZK moves above the 28.00 level.

With the CNB set to embark on QE with policy rates being well above zero, it remains to be seen whether there is an appetite to move rates closer to the zero lower bound in the weeks to come (i.e, similar to NBP, which also announced QE but may not cut rates significantly).

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