

Czech National Bank: The vaccine game changer

The CNB will stay on hold this week but should confirm a more optimistic outlook for next year, driven by the vaccine news and recent fiscal package approval. This will push GDP and inflation higher and raise the odds of earlier rate hikes. But prudent wording might be chosen to prevent a sharp CZK appreciation. We look for two hikes in 2H21



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No new forecast this time

Recent developments have been somewhat better compared to the CNB's November forecast. 3Q GDP accelerated by 6.9% quarter-on-quarter (-5% YoY) while the CNB assumed 4.4% QoQ (-7.4% YoY). Wage growth in 3Q was above the CNB's expectations (5.1% vs 4.5%). But the most important change is related to the more optimistic outlook for 2021 given the new Covid-19 vaccine. As such, 2021 projections will be gradually revised higher (we now expect growth of around 3.5%), which was not considered in the last CNB forecast, which called for just 1.7% growth in 2021.

Fiscal scenario

Recent developments on a tax package are heading towards strong fiscal easing, impacting government revenues by around CZK100bn. This is very close to the alternative fiscal scenario assumed by the CNB in its last report, assuming two more hikes in 2021 compared to the baseline – with the CNB baseline (with 1.7% GDP growth in 2021) pencilling in three hikes in 2021, ie in total, rates by 1.3 percentage point higher in 4Q21 compared to the last quarter of 2020.

0.25% The main 2-week repo rate
likely unchanged on Thursday

Hikes in 2021 more likely now

As such, recent developments increase the odds of rate hikes, as a more optimistic outlook related to the vaccine news and fiscal easing are pro-inflationary. However, the bulk of the tightening needed was (and should be) delivered by a stronger Czech koruna, which was also highlighted by recent media comments by a few CNB board members. Despite a stronger CZK, we see room for two rate hikes in the second half of 2021.

Press conference prudent to limit CZK appreciation

While Governor Jiří Rusnok's press conference may not be hawkish per se, with an intention to prevent sharp CZK appreciation, the recognition of the improving economic outlook and the ongoing upside risk to CPI should move the balance of risks to rate hikes in the second half of next year, with CZK benefiting. To tame market expectations, it could be argued that the recent CZK strength has already delivered some tightening (and thus lowers the need for imminent hikes in 2021). But this should be looked through as, compared to the last CNB forecast, the need to tighten is higher now given the vaccine news and tax cuts. Hence, there is more scope for CZK gains in 2021. We see CZK as the currency with the highest upside potential in the Central and Eastern European region, as the CNB is (a) tolerant of FX strength; and (b) likely to deliver earlier and more pronounced tightening.