

## Czech National Bank to hold rates steady amid global uncertainty

Despite last month's slightly better data and inflation beating the central bank's expectations, global uncertainty remains elevated amid the ongoing trade war. In such an environment, and with Czech inflation slowing to close to the 2% target in the monetary policy horizon, a wait-and-see approach seems to be the best strategy for the central bank now



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### Inflation higher, but slowdown ahead

Inflation reached 2.9% in May, slightly above the Czech National Bank's forecast of 2.7%. Still, this was mainly due to higher food prices, and we expect inflation to decelerate gradually, mainly due to the base effect. Fuel prices and the cost of housing and energy grew faster in the second half of 2018, which will push year-on-year prices lower in the second half of this year. As such, inflation should fall to close to 2.5% in 2H19, and decelerate further towards 2% by mid-2020 (i.e. the monetary policy horizon).

## Solid data from the real economy in recent months

The real economy has surprised slightly on the upside in recent months, with 1Q19 GDP growth at 2.6% vs the CNB's forecast of 2.5%.

- Household consumption accelerated in 1Q19 (2.7% YoY) after a weaker reading at the end of the year (2.2%) but it remains below the four-year average growth rate. Though wage growth remained solid in 1Q and surprised the CNB positively (7.4% vs 6.3%), it was mainly due to higher public wages. Meanwhile, wage growth for 2018 was revised downwards by around 0.6 percentage points and will likely decelerate this year to close to 6%.
- Industrial production stagnated in 1Q based on monthly data, but contributed solidly to GDP growth in 1Q GDP (0.8ppt). The discrepancy relates to different methodologies but, given the slowdown in German industrial production and new orders, the prospects for Czech industry remain challenging.

# 2.0%

## 2-week repo rate after June meeting

No change expected

## CZK rally related to Fed repricing

We don't expect the early May rally in the Czech koruna to last, as this was associated with the dovish repricing of the Fed and higher EUR/USD. While the Fed may well cut rates in July, we expect the European Central Bank to follow and in turn neutralise the impact on EUR/USD. This, in turn, suggests limited upside to CZK vs EUR. Given our base case of a deteriorating trade war outlook, and the US imposing tariffs on eurozone car exports by 4Q19, we look for a higher EUR/CZK in 2H19.

## Stability of rates seems to be the most likely scenario for now

Given the current foreign uncertainty which is weakening global demand and our forecast of Czech inflation returning to the 2% target in the monetary policy horizon, we expect CNB rates to be stable for some time. Market expectations for CNB rate cuts this year are premature in our view, given the current shape of the domestic economy.