

Czech Republic: Central bank on hold as expected

The Czech National Bank stayed on hold today as expected but surprised with hawkish interest rate projections. We see the signalled three hikes for 2021 as unrealistic, with the board likely preferring a wait-and-see approach. But this shows the bar for rate cuts is set even higher now



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New revisions in forecast

The CNB revised its 2020 GDP forecast upwards to -7.2% from -8.2%. We assumed no meaningful change to 2020 GDP due to the second Covid-19 wave compared to the August forecast, as 3Q20 GDP growth was weaker in the last CNB projection. Though the revision to 7.2% is slightly surprising and below the consensus among local banks (-8% YoY). Still, this is mainly a function of 4Q QoQ dynamics, which is rather uncertain. More importantly, 2021 GDP was revised lower from 3.5% to 1.7%, in line with the market estimates.

Inflation has been revised only slightly to average 2.3% in 2021 from 2.4%, but monetary relevant inflation went slightly higher to 2.3%. The koruna is slightly weaker in the new forecast, however,

the revision was not so significant, especially for the end of next year (26.2 vs 26.3).

0.25% Main CNB rate
unchanged as expected

New interest forecast seems unrealistic

But the most surprising is the new forecast for interest rates, which shows the first CNB rate hike in 2Q21 (ie, one quarter earlier than in the August forecast), and a total of three hikes next year. However, this does not look very realistic in the current perspective, which is why the Bank Board itself mentioned that it expects rates to remain lower for longer compared to the CNB's model, maybe even throughout next year, according to Governor Rusnok.

We see the current aggressive rate forecast for 2021 as unrealistic. But one message from today's meeting is clear – the bar for rate cuts is set even higher. As such, longer term stability of rates seems as the most likely scenario now, in our view.

New CNB forecast

	new f'cast		old f'cast	
	2020	2021	2020	2021
GDP (% yoy, avg)	-7.2	1.7	-8.2	3.5
Inflation (% yoy, avg)	3.2	2.3	3.4	2.4
Inflation (% yoy, eop 4Q avg)	2.9	2.2	3.3	2.2
3M Pribor (% , eop 4Q avg)	0.3	1.1	0.3	0.6
EUR/CZK (eop 4Q avg)	27.2	26.3	26.7	26.2

Source: CNB, ING

CZK benefited from more hawkish meeting

The fairly hawkish CNB forecast (contrasting with the market pricing of cuts) benefited the Czech koruna today, but the near-term effect should be a one-off. This is because the rate forecast is unrealistic, and any near-term tightening is unlikely. Still, with the CNB being the most hike prone central bank in the region, the soft USD outlook for 2021 in place (even in the scenario of a Biden Presidency and a Republican Senate) and expected recovery of Czech and eurozone economies from 2Q21 on, CZK should gain next year.