

New forecast might persuade Czech central bank to hike again

New forecast prepared by the central bank will show a significant increase in the interest rates path as monetary tightening hasn't come through via the koruna. The fact that it failed to strengthen despite the market pricing this information might just be enough to persuade the CNB to hike again by 0.25ppt next week



Source: Shutterstock

A few weeks ago, we were rather sceptical of the Czech national bank delivering another rate hike after delivering one at the end of the June. However, latest comments from central bank representatives suggest another 25bps hike next week is slightly more likely than staying on hold, which is our new base case.

Hawkish signals from the CNB

Apart from the hawkish signals from the deputy governor Mojmir Hampl and board member Vojtech Benda, the Chief Economist of the bank signalled a significant change in the forthcoming staff-forecast due to a weaker than expected koruna. As the CZK deviated from the May forecast in 2Q18 by 1.6%, and 2H18 deviation is likely to be around 3.5%, this significantly increases the need

to tighten monetary policy via the interest rate channel.

Assuming a weaker path of the koruna in the new central bank forecast and the Bank aiming to deliver a similar amount of cumulative tightening delivered via the mix of the FX and rate channels as in the May forecast, we are likely to see a very hawkish interest rate path. Indeed, the new forecast will most likely project further two to three hikes this year and at least six by the end of 2019.

1.25 2-week repo rate after CNB meeting

Priced in by the market by more than 80%

Muted reaction of koruna is another reason not to postpone

More importantly, the market priced in recent hawkish signals from the CNB and expects a hike next week with more than 80% probability. Also, in the nine-month horizon, three rate hikes are expected by the central bank.

Hawkish forecast and the fact the koruna remains relatively weak, despite market expectations will most likely persuade even less hawkish board members for the August hike as an adequate policy reaction.

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