

Czech Republic: The CNB on hold, but the cycle is not over

The Czech National Bank (CNB) remained on hold as broadly expected, but we believe the market heavily misinterpreted the CNB press conference. The hiking cycle is not over and the central bank should deliver at least two hikes next year



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The hiking cycle is not over

We don't believe the CNB tightening cycle is over. We expect the central bank to push with the February hike and deliver at least additional one more hike in the rest of 2019 - unless we see a sharp deterioration in the global outlook. The domestic economy still warrants a degree of tightening (as mentioned by Governor Rusnok during the press conference today) and even if the next inflation report in February will show less need for the overall scale of tightening, the environment has not deteriorated so significantly for the CNB to move away from currently 5-6 implied rate hikes signalled for 2019 (combination of FX and interest rates). That's why we have a hard time seeing the CNB delivering less than two hikes next year and we still don't rule out three hikes either.

1.75%

The main 2-week repo rate

remained stable

Market interpreted today's press conference heavily on the dovish side

We believe the market over interpreted today's press conference heavily on the dovish side. Even Governor Rusnok pointed out that the majority of the board was still inclined for further normalisation towards the neutral rate, but they preferred to wait today. As such, pricing cuts for 4Q19 and a large part of 2020 seems unjustified in our view.

Inflationary pressure remain in place

While inflation will be negatively affected by the fall in fuel prices in coming months, we assume it will accelerate gradually next year and be close to 2.5% at the turn of 1Q and 2Q19. The CPI acceleration will not only be driven by the rise in core inflation (due to solid household consumption driven by a strong wage dynamics), but also by higher food prices due to the worse harvest this year and the further rise in energy prices for households.

Gains of CZK next year might be limited

We have a fairly low conviction on scale and sustainability of CZK gains, which could deliver demanded monetary tightening instead of rates. To the extent to which the market will entertain the idea of CNB being at / very close to the end of the tightening cycle, the impetus for CZK to rally is not large and risks are on the downside. Adding to it what we judge is still very saturated CZK positioning, we see a risk of a meaningful CZK fall in the absence of continued CNB hikes.

CNB hiking cycle is not over, as the market prices in

All in all, given the inflationary pressures steaming from the tight labour market and expected CZK weakness not delivering demanded monetary tightening, we do not expect CNB hiking cycle is over and the CNB should deliver at least two hikes next year, in our view.