

Czech Republic: Rates to stay on hold amid uncertain global backdrop

We expect the Czech National Bank to remain on hold next Thursday for the same reason it held rates steady in February: an uncertain global environment. The CNB board is likely to wait for a new forecast in May before any policy reaction. This should outweigh the weaker-than-expected Czech koruna and higher core CPI



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Global outlook remains challenging

We could easily copy and paste our CNB preview for the February rate-setting meeting, as external uncertainty remains the main driver for policymakers, pushing the Board towards a more cautious stance and a wait-and-see approach. Globally, manufacturing PMIs are still in contraction territory, new factory orders and industrial production have disappointed in Germany and China's economy has yet to feel the full impact of fiscal and monetary stimulus. Though some weakness can be attributed to one-off factors, it is clear that local policy makers are more cautious after both the European Central Bank and Federal Reserve highlighted the uncertain global environment and turned more dovish.

1.75% 2-week repo rate
no change during March meeting

Domestic factors warrant caution

Some domestic factors also support a more cautious approach. Household consumption decelerated in 4Q18 to 2.2%, wage growth was looking less buoyant at the end of last year, and new credit activity fell 30% YoY in the past three months due to new, stricter CNB macroprudential rules, though some deceleration has been caused by the [frontloading of credit before the rules came into effect](#).

Some room for hikes remains this year, mainly due to weaker koruna

In contrast, the Czech koruna remains weak compared to the central bank's forecast. While this was not the case in 1Q19 (25.7 vs. 25.6), the CNB forecast sees the koruna at 25.17 in 2Q19 – which is unlikely given the current market action. Inflation also surprised on the upside, particularly core prices, which increased to 3% in January-February vs. the CNB's 2.6% forecast for 1Q19. As such, the softer path for the CZK and still solid economic activity argue for further rate hikes.

Why react in March when there is a new forecast one month later?

Given all of the above, however, we see little reason for the CNB to deliver a policy change at the March meeting when there is only one month left to the meeting on 2 May, when new macroeconomic forecasts will be available. We still see scope for two CNB hikes this year, with the first being delivered in May. We don't think the dovish Fed and ECB will take away the prospect of CNB hikes this year, as a less sensitive koruna towards interest rates abroad provides the CNB more independence. Still, an improvement in the global economic outlook is a necessary condition for the CNB to hike again soon, as we expect.

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