Czech Republic: Wait-and-see stance to continue

The Czech National Bank faces an unpleasant dilemma. The reduced foreign uncertainty and high CPI (above 3%) are countered by visibly weakening domestic economic activity. Still, no change in rates at this week's non-Inflation Report meeting is likely.

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Domestic economic activity remains solid, but some signs of weakening becoming more visible. 3Q GDP data printed somewhat below CNB expectations (2.5% vs 2.7% YoY) and the structure of growth was less inflationary, as household consumption slowed to just 2.3% YoY and lagged CNB expectations of 2.9%. Also wage growth slightly disappointed in 3Q, at 6.9% YoY vs. 7.2% expected by the CNB. Real wage growth came at 3.9% vs. 4.4% in the central bank forecast.

CPI above the tolerance band

On the other hand, CPI breached the 3% upper tolerance band in November, reaching 3.1% (vs 2.7% in Oct). The increase was driven mainly by higher than expected food prices, while core inflation in the CNB definition slowed slightly, from 2.6% to 2.5% in November, as did prices of services, from 3.8% to 3.7% YoY.

2.0 %

The main CNB's interest rate

most likely stable after the meeting on Wednesday

Monetary policy dilemma continues

The dilemma for the CNB Board has thus increased. On the one hand, the foreign risks that held the CNB back most of this year, have diminished (US-China trade deal, UK elections' market-friendly outcome) and inflation is above 3%. On the other hand, the Czech economy started slowing by more than expected. Some board members might be more sensitive to such developments. But inflation above the 3% level should be relatively short-lived, as current estimates suggest. Also, some tightening of monetary conditions was delivered by EUR/CZK, which was weaker than the CNB had estimated – by c.0.5% in 4Q19 (25.6 vs. 25.7).

Recent signals from the CNB supports stability

Recent signals from the CNB Board point to rates stability. Governor Rusnok indicated stability of rates as the most likely scenario and Nidetzky mentioned that a hike would not impact current inflation anyway. But both interviews were before inflation hit 3%. Holub suggested that his support for a hike is higher than 50%, but he doesn't want to be "locked" in this position. We expect him and Benda to support a hike this week, but other board members should prefer rates stability. However, if foreign data improves and inflation does not slow as expected in the months ahead, a hike in the first half of the year is on the table, in our view.