Czech Central Bank Preview: December 2021

Details:

Monetary policy decision: 1330GMT, 1430CET, 0830ET, Wednesday 22nd December 2021.

MNI Point of View

CNB To Hike Policy Rate Back To Sep 2008 Levels

The Czech National Bank is likely to raise its benchmark rate by 75bps to 3.5% at its next meeting on December 22 to curb the inflationary pressures, which are expected to remain elevated longer than what policymakers previously estimated. Even though the uncertainty over the economic recovery remains elevated, we saw that a rising number of CNB members have mentioned that a bigger rate hike may be necessary to combat inflation.

CPI inflation accelerated to 6% in November (as expected), its highest level since October 2008, up from 5.8% the previous month and continues to be driven by the surge in food and fuel prices. Figure 1 (left frame) shows that inflation has been diverging significantly from the CNB 3-percent upper tolerance band, which has been pressuring policymakers to act. Last month, we saw that the CNB survey showed that the 12-month inflation expectations continued to surge and reached 3.6%, up from 2.9% in October. Sell-side analysts have been constantly increasing their CPI forecasts for 2022 year-end to 4.25% recently, up from 2.75% in the beginning of November.

Figure 1

Source: Bloomberg, MNI

Terminal rate closer to 4%

The constant upward revision in inflation forecasts is likely to result in the CNB prolonging its tightening cycle through 2022, which will bring the terminal rate above the ‘neutral’ rate. CNB Governor Rusnok mentioned in a recent interview that he sees terminal rate closer to 4% (than 3% previously) in 2022, implying that the central bank is ‘far’ from done in hiking rates after Wednesday meeting. It is clear that CEE policymakers seem to be very sensitive to the drastic rise in inflation in the past year and therefore will do whatever is needed to curb inflationary pressures.

As uncertainty over the economic outlook remains elevated, the sharp tightening has led to an inversion of the traditional 2Y10Y yield curve, which is pricing in a sharp deceleration in the economic activity in the coming 6 to 12 months. Figure 1 (right frame) shows that the 2Y10Y yield has strongly led industrial production (proxy for the business cycle) in the past 15 years. Hence, hiking rates too aggressively could result in a significant downward revision in growth expectations in the medium term.
FI/FX Markets

The constant upward revision in inflation expectations have been pressuring LT bond yields to the upside in the past two weeks. The 10Y yield is currently testing its 2.67% resistance after finding support at 2.40% earlier this month; a break above that level would open the door for a move up to 2.74% (September 2012 highs). With an inflation rate of 6%, Czech Republic currently offers the third lowest 10Y real yield (-3.3%) among the EM world after China and Poland. Next key resistance on 10Y yield stands at 3%.

However, the rise in short-term rates amid ‘hawkish’ CNB has been strongly supporting cyclical stocks such as financials, which have been levitating Czech equities to new highs. PX Index recently broke above the 1,400 level (highest since September 2008); the rise in Covid uncertainty in addition to the broad USD strength have not been impacting Czech risky assets in the past two months. Figure 2 (left frame) shows that Czech equities now appear ‘expensive’ relative to other EM equity markets according to our scoring model which ranks EM equities based on price-to-book, PE and price-to-sales ratios.

Even though CZK has been consolidating lower against the US Dollar in recent weeks despite the aggressive CNB hikes, the koruna remains strong broadly relative to historical levels. Figure 2 (right frame) shows that the CZK nominal effective exchange rate (NEER) is still trading at the high of its 11-year range. Monetary policy divergence between CNB and ECB could continue to support the koruna against the Euro and therefore limit the upward revision in inflation expectations.

Figure 2

Source: Bloomberg/MNI
Czech National Bank Watch

Central Bank Watch - CNB

December 21, 2021

MNI Czech Central Bank Data Watch List

<table>
<thead>
<tr>
<th>Inflation</th>
<th>Current</th>
<th>3m ago</th>
<th>1y Chg</th>
<th>6m ago</th>
<th>2Y History</th>
<th>Hit / Miss</th>
<th>Vs Trend</th>
<th>Surprise Index</th>
<th>Z-Score</th>
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<tbody>
<tr>
<td>CPI</td>
<td>6.0</td>
<td>4.1</td>
<td>2.9</td>
<td>2.9</td>
<td>2002-2005</td>
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<td>Bullish</td>
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<td>Import Prices</td>
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<td>PMI Manufacturing</td>
<td>Index</td>
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<td>GDP (%)</td>
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<td>Industrial Production</td>
<td>% y/y</td>
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<td>M3 Money Supply</td>
<td>% y/y</td>
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<td>7.43</td>
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<td>Retail Sales</td>
<td>% y/y</td>
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<td>Unemployment Rate</td>
<td>%</td>
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<td>Average Gross Wages</td>
<td>% y/y</td>
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<td>Prague Stock Exchange</td>
<td>Index</td>
<td>1408</td>
<td>1204</td>
<td>1103</td>
<td>2002-2005</td>
<td>Bullish</td>
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<td>Bullish</td>
<td>1.64</td>
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<tr>
<td>Czech 10Y Yield</td>
<td>%</td>
<td>2.66</td>
<td>1.79</td>
<td>1.63</td>
<td>2002-2005</td>
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<td>Bullish</td>
<td>Bullish</td>
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<td>CZX Yield Curve (2s-10s)</td>
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<td>325.2</td>
<td>194.17</td>
<td>109.5</td>
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<td>Index</td>
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<td>114.27</td>
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<td>Bullish</td>
<td>0.36</td>
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Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

Sell-side Views

Goldman Sachs: CNB to Hike by 75bp to +3.50 % (consensus: +3.50%)

- GS expectation is that the CNB will continue with its hiking cycle, and deliver a further 75bp increase to +3.50% (consensus: 3.50%).
- Inflation remains high and continues to surprise to the upside, with the November print of 6.0% yoy being the highest since 2008 (significantly above the CNB’s forecast of 4.9% yoy).
- While the sequential momentum in inflation decelerated in November, this was predominantly driven by a temporary VAT waiver on electricity and natural gas prices.
- At this stage, the new government has signaled that it will not extend the VAT waiver into 2022 and thus GS expects a big positive contribution from this source in January.
- GS analysts also observe that, although the CNB has already raised rates by a cumulative 225bp from the trough, these increases have not meaningfully translated into a stronger Czech Koruna exchange rate, which reduces the constraint on the CNB hiking further.
HSBC: Expecting a 75bps hike

- HSBC now sees a 75bp hike in December and a 50bp hike in February, taking the policy rate to 4% (2.75% previously).
- CNB raised its policy rate by 250bp so far this year and increased the size of its hikes in each meeting.
- At its last policy meeting in November it surprised with a larger-than-expected hike (125bp vs 75bp expected) and delivered more hawkish guidance compared to our earlier thinking.
- The bank’s forecast interest rate path showed policy rate averaging 3.23% in Q1 22, up from 1.57% in its August forecast.

JP Morgan: Expecting a 75bps hike this week

- JPM expects the CNB will hike rates another 75bp in December to 3.5%.
- Although some intention to slow the pace of tightening has been brewing at the CNB, the inflation data remain too bad to ignore.
- Instead of the 50bp analysts expected prior to the November CPI report, they now see 75bp (to 3.5%) being delivered.
- After that, JPM expects 50bp in February and add a further 50bp between March and May, to a peak rate of 4.5%.

Morgan Stanley: CNB likely to hike by 75bps this week

- MS expects the CNB will hike rates another 75bp in December to 3.5%. MS see risks to its call slightly skewed to the upside.
- On the one hand, forward guidance from MPC members has been more ambiguous than usual with views ranging from a possibility of on hold to a 25bp-75bp hike, but more recently Governor Rusnok’s views have shifted towards a bigger than 50bp hike.
- On the other hand, the November inflation data, the 1% weaker CZK than the CNB’s forecast and deteriorating inflation expectations suggest to us risks for another 100bp-125bp hike are non-negligible, to which MS attributes a 30% subjective probability.
- Such an outcome would put the key policy rate at or above its pre-GFC level of 3.75%.
- Finally, the CNB is clearly conscious of its inability to impact near-term inflation, and prospects are that inflation will continue to overshoot the central bank’s forecast in January.
- Thus MS sees a chance the central bank takes a more patient approach, given that it has delivered substantial rates and macro-prudential tightening already, and opts for a 50bp hike (10% subjective probability), while awaiting the core February meeting to get the new forecast.
- A bit further ahead, MS still see a 25bp hike in February and a terminal rate at 3.75%, while Omicron creates an upside risk to its current call through its potential to disrupt global supply-chains further.

Societe Generale: CNB to raise by 75bps on December 22

- At the upcoming December meeting, SocGen analysts expect the central bank to build on what has been a rapid series of interest rate hikes in recent months and add another 75bp to the current level. This would push the repo rate up to 3.5%.
- SocGen perceives the risks of this forecast as balanced. In their view, the current round of monetary policy tightening is likely to end in February 2022, with a peak repo rate of 4%.
- By front-loading the rise in interest rates, the central bank is primarily responding to inflation, which analysts forecast to increase to above 7% yoy at the beginning of next year.
- With significant inflationary pressures easing, interest rates should begin to return to the policy-neutral level of around 3% - however, SocGen does not think this will start before early 2023.
UniCredit: CNB to raise by 75bps on December 22

- At its last meeting of the year, the CNB is likely to deliver another bold interest rate hike.
- Both the governor Jiri Rusnok and influential board member Tomas Holub have stated recently that they are ready to vote for a hike of more than 50bp on 22 December, while the vice-governor Marek Mora has suggested he would be choosing between increases of 50bp and 75bp.
- The latest economic data have certainly painted a more pro-inflationary picture than the November CNB prognosis assumed. November CPI stood at 6% yoy, outpacing the CNB’s forecast by 1.1pp; both 3Q21 GDP and wage growth also came in higher than expected and EUR-CZK is running higher than had been forecast.
- Hence, we assume a 75bp repo rate hike to 3.50% this week, with the risk to our scenario that the rate will peak at that level now skewed firmly to the upside.