

Czech Central Bank Preview: August 2022

Details:

Monetary policy decision: 1330BST, 1430CET, 0830ET, Thursday 4th August 2022.

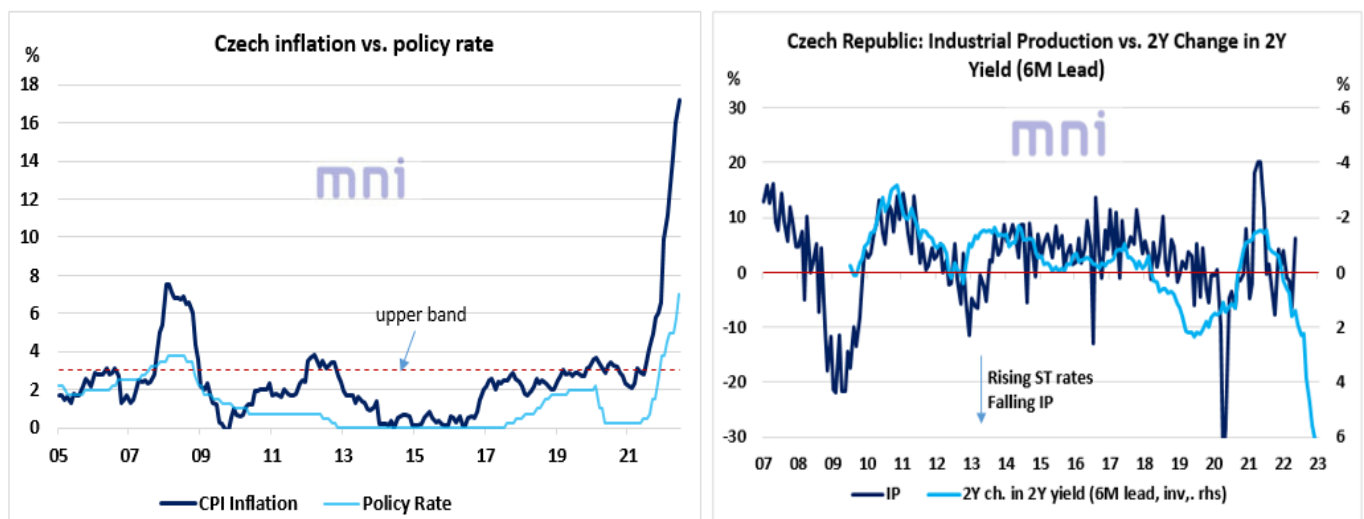
MNI Point of View

CNB Likely To Keep Rates Unchanged

The Czech National Bank is likely to keep its benchmark rate steady at 7% on August 4, marking the first pause since the beginning of the tightening cycle in June 2021. The 'new' CNB board seems to be keener on favouring FX interventions to support the koruna instead of rising rates as the economic outlook keeps deteriorating. Median estimate is standing at 7.25%, with analysts' consensus split between no change and a 25bps hike.

CPI inflation continued to accelerate in June, coming up at 17.2%, slightly above expectations (17.1%) and up from 16% the previous month. Czech inflation is currently standing at its highest level since December 1993 and continues to be driven by the surge in food and energy prices. Even though the significant divergence from the CNB 3-percent upper tolerance band has been pressuring policymakers to intervene by hiking rates aggressively in the past year, inflation is likely to peak this summer (July/August at 20%) and therefore policymakers have started to increasingly attribute more attention to the growth component.

Figure 1



Source: Bloomberg, MNI

Growth Outlook Expected To Fade Sharply in H2

With the global economic outlook constantly being revised to the downside, policymakers have started to comment on the fact that rising rates too aggressively runs the risk of accelerating the downturn. Figure 1 (right frame) shows that the dramatic tightening in financial conditions (i.e. 2Y change in 2Y yield) has been pricing in a significant deceleration in the economic activity in the coming months. Hence, even though inflationary pressures remain elevated, the CNB will have to start considering the growth side of the equation in the near term.

New Board May Favour FX Interventions Over Rate Hikes

- While **Mora** and **Holub** are expected to continue to support rate hikes to counter the inflationary pressures, 'new' members **Frait** and **Zamrazilová** are likely to vote for no change on Thursday given the deterioration in the macro outlook. Even though **Zamrazilová** recently mentioned that she was considering 'all options' for the next meeting, the fall in business surveys with PMI dropping to 46.8 in July should weigh on her decision as the H2 outlook is expected to be continuously revised lower.
- The other new member **Karina Kubelková** has not made any public comment recently; all we know is that she prefers to maintain a more 'cautious' approach regarding monetary policy.
- Dedek** and new Governor **Michl** are also likely to vote for rates stability; the two members have constantly opposed the CNB board view in the past year, as both believe that inflation remains mostly driven by external factors outside of the monetary policy realm.

Interestingly, the new board seems keener on intervening via the FX market to make sure that inflation expectations do not get de-anchored via the FX channel (i.e. CZK depreciation), and could be less favourable for rate hikes going further.

Czech 10Y Consolidates Sharply Lower Despite Inflation at 30Y High

Preference for the traditional safe (LT government bonds) has started to surge in recent weeks, with Czech 10Y yield consolidating sharply lower since the middle of June despite accelerating inflation. The 10Y yield broke below the 3.94% support level this week, which corresponds to the 61.8% Fibo retracement of the 2.79% - 5.79% range and the MT upward trending support line. Next key level to watch on the downside stands at 3.64% (200DMA).

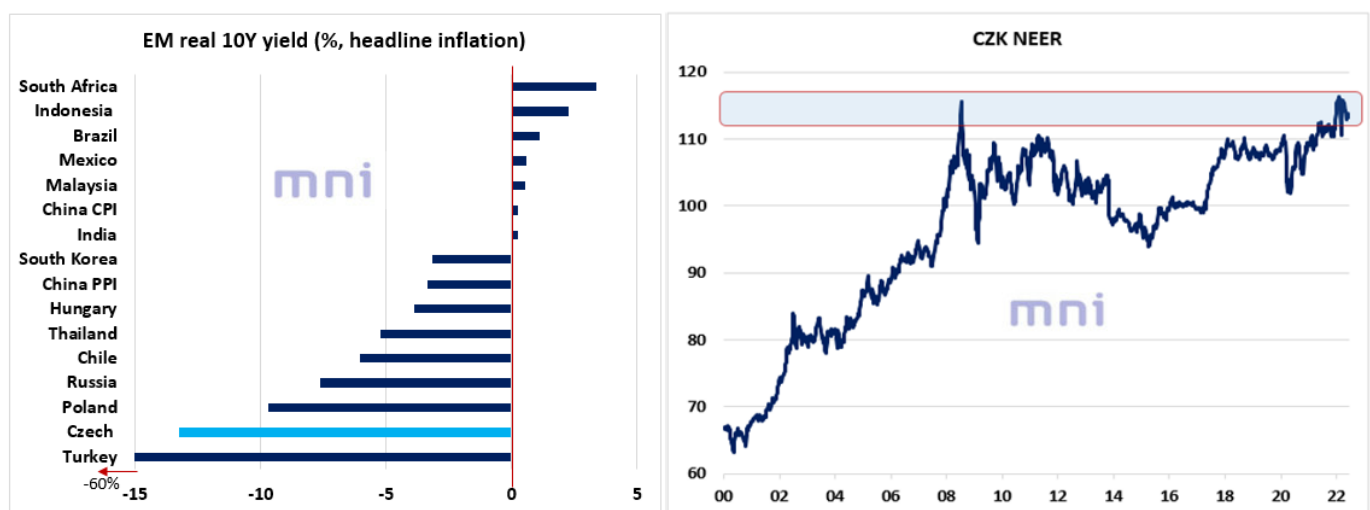
Hence, the 10Y real yield continues to reach new historical lows, currently trading at -13.3%; figure 2 (left frame) shows that Czech Republic offers the second lowest 10Y real yield among the EM world after Turkey.

FX Market

EURCZK has been retracing higher in the past three weeks after reaching a local low at 24.2660 in the middle of July. The pair broke above its 100DMA this week and is gradually approaching its ST resistance at 24.7980, which corresponds to the 61.8% Fibo retracement of the 24.09 – 25.94 range and its 200DMA.

Even though the koruna has been weakening against the USD since the start of the year (down 10% against the greenback), CZK continues to trade close to its historical highs when we look at the LT historical range of the broad index (NEER CZK, figure 2, right frame).

Figure 2



China*: we also use PPI for China as it shows stronger relationship with the 10Y yield

Source: Bloomberg/MNI

Czech National Bank Watch

mni Central Bank Watch - NBH

August 03, 2022

MNI Czech Central Bank Data Watch List											
Inflation		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
CPI	% y/y	17.2	12.7	↑	6.6	↑					2.35
Import Prices	% y/y	20.7	14.0	↑	12.8	↑					1.46
PPI	% y/y	28.5	24.7	↑	13.2	↑					1.08
Economic Activity		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
PMI Manufacturing	Index	46.8	54.4	↓	59.0	↓					-2.12
GDP (Q)	% q/q	0.2	0.9	↓	0.8	↓					-0.60
Industrial Production	% y/y	6.3	-1.0	↑	4.2	↑					1.28
Economic Sentiment	Index	88.3	92.5	↓	95.3	↓					-1.49
Monetary Analysis		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
M0 Money Supply	% y/y	-0.08	3.97	↓	3.46	↓					-1.88
M3 Money Supply	% y/y	5.80	5.54	↑	7.11	↓					-0.75
Consumer Credit	CZKmn	2094872	2081403	↑	2044209	↑					1.46
Consumer / Labour Market		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
Retail Sales	% y/y	4.8	0.7	↑	0.5	↑					0.43
Consumer Confidence	Index	-33.0	-26.0	↓	-16.8	↓					-1.17
Unemployment Rate	%	3.1	3.4	↓	3.5	↓					-1.56
Average Gross Wages	% y/y	-3.6	7.0	↓	2.0	↓					-1.13
Markets		Current	3m ago	3m Chg	6m ago	6m Chg	2Y History	Hit / Miss	Vs Trend	Surprise Index	Z-Score
Prague Stock Exchange	Index	1222	1334	↓	1416	↓					0.29
Czech 10Y Yield	%	3.92	4.22	↓	3.24	↑					0.31
CZK Yield Curve (2s-10s)	bps	629.2	525.1	↑	398.8	↑					1.25
CZK REER	Index	119.55	118.60	↑	119.15	↑					1.25

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: Looking For a 25bps Hike

- This week's CNB rate decision will be important to watch to better understand the reaction function of the new board.
- GS economists are looking for a 25bp hike against a split consensus (between 25bp and on hold), though this is a low conviction view.
- Still, in the event of a dovish surprise, GS thinks the CNB's ability to intervene in the FX market should cushion the blow for the Koruna.
- GS continues to expect CZK to outperform its regional peers given the Czech National Bank's ample reserves and historical institutional credibility.

ING: Expecting no Change This Week

- ING expects no change in CNB interest rates next week.
- However, ING sees a risk that sooner or later the central bank may be pushed to hike rates by the koruna.
- Forward guidance should be dovish, however, its presentation may be tricky for markets.
- INGs expect a steeper curve as a result of the dovish shift.

JP Morgan: Expecting a 50bps Hike

- Better-than-CNB-forecast growth likely not enough to resolve board indecision.
- CNB board members have displayed hesitancy between a small hike and unchanged rates next week.
- Some have expressed their vote as data dependent, with the GDP print one of the elements to be factored in.
- But, although last week's numbers are better than expected by the official forecast, an annualized pace of 0.8%q/q saar is still a poor number, especially for country which is a clear regional laggard in the post-COVID recovery.
- In that sense, the GDP data likely is insufficient to break the uncertainty.
- This week's is the most unpredictable CNB decision in a long while; JPM still expects a final 50bp hike (to 7.5%), but risks are obviously skewed for unchanged rates given the expressed preferences of the new Governor and the dark clouds gathering over the growth outlook.

Morgan Stanley: Expecting No Change This Week

- MS expects the CNB to keep its policy rate unchanged at 7%.

Societe Generale: Expecting Rates To Remain Unchanged

- SocGen expects the CNB to keep its rates unchanged at the new board's first monetary policy meeting on 4 August.
- The three new board members (deputy governor Zamrazilova, members Kubelkova and Frait) will probably join new governor Michl and longstanding dovish member Dedek in supporting stable rates.
- Recent statements by Zamrazilova and Frait indicated their bias toward stable rates.
- At the same time, the CNB is likely to continue with its FX intervention.
- However, this is likely to become increasingly difficult, given unsupportive fundamentals for the CZK and accelerating inflation.
- Therefore, SocGen economists expect the CNB to eventually deliver a 50bp rate hike in November.

UniCredit: Expecting No Change This Week

- UniCredit expects the CNB to keep its policy rate unchanged at 7%.