Czech National Bank Preview: February 2023

Details:

Monetary policy decision: 1330GMT/1430CET/0830ET, Thursday, 2nd February 2023.
Forecast presentation for analysts: 1000GMT/1100CET/0500ET, Friday, 3rd February 2023.

MNI Point of View: Repo Rate On Hold Before Board Rejig

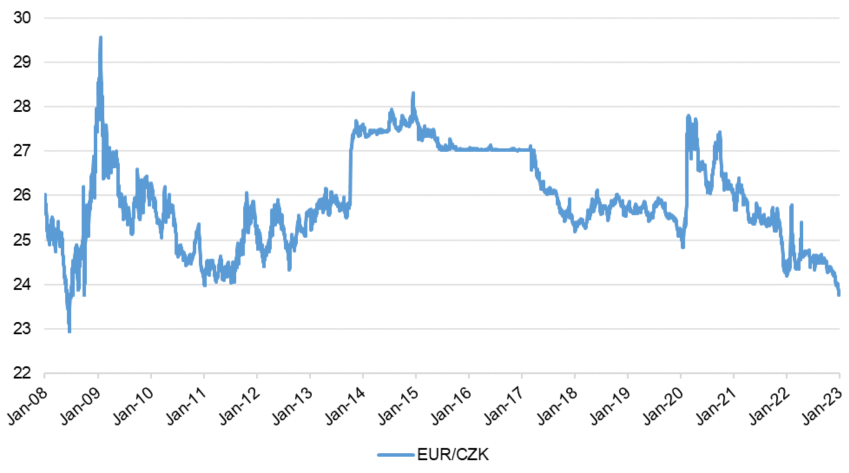
Recent communications from the CNB's Bank Board members suggest that the overall sentiment has not shifted and interest rates will in all likelihood remain unchanged this week. The Board is expected to replicate the familiar 5-2 vote split, with known hawks Tomas Holub and Marek Mora dissenting in favour of tighter monetary policy settings. The focus will be on the updated set of economic forecasts, with little potential for major surprises on that front.

Consumer inflation data for December played into the hands of the "rate-stabilisation" camp as headline CPI growth unexpectedly slowed to +15.8% Y/Y, with prices staying flat on a monthly basis. At the same time, economic activity has cooled, with advance GDP data for 4Q2022 providing preliminary evidence that Czechia entered a technical recession. Particularly weak in the GDP report was household spending, which testifies to the impact elevated interest rates have on domestic demand, backing the doves' argument that prior hikes are working.

The central bank's interpretation of recent data is that the disinflationary impulse is here to stay, which is an assumption shared by all Bank Board members. While some have outlined scenarios which could tilt the panel's collective approach in the hawkish direction, such as the emergence of an evident wage-price spiral, the odds are low that these dynamics take hold in the near-term. However, members remain divided on the pace at which they should bring inflation towards the +2% Y/Y target.

The latest comments from Bank Board members suggest that the familiar division in the panel remains the same. While the two hawks, Tomas Holub ("desirable to raise interest rates a little further") and Marek Mora ("risks of tightening policy further now are smaller than the risks of losing control"), have reaffirmed their calls for tighter monetary policy, the other five members led by Governor Ales Michl have maintained their support for keeping interest rates steady in anticipation of a sharp slowdown in inflation.

Figure 1. The Czech Koruna has appreciated to its best levels since 2008.



A stand-pat decision is fully baked in and would match a unanimous sell-side consensus call. While some analysts flag the risk of renewed rate hikes if inflation unexpectedly spikes higher, most seem to believe that the tightening cycle is effectively over and already discuss the most likely timing of policy loosening. Based on the latest data signals and central bank communications, we also expect the CNB to keep the repo rate unchanged at 7.00% this Thursday, in a split decision, as the Bank Board remains in a wait-and-see mode.

In addition, the central bank will likely stick with its current FX regime, even as there has been no need to prop up the Czech Koruna in the recent weeks. Data from the CNB showed that the central bank did not step into FX markets in November, which was its first month without interventions since December 2021. The turn of the year saw further Koruna appreciation, keeping the CNB and its interventions at bay. That said, with recessionary concerns doing the rounds, the Koruna may face renewed

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pressure in the months to come. Hence, the CNB will likely reaffirm its readiness to intervene, in order to maintain a key buffer against imported inflation while rates remain stable.

The outlook for interest rates is somewhat more complicated, which is reflected in rhetoric from Bank Board members. Governor Ales Michl and his dovish-leaning colleagues have repeatedly warned that interest rates may have to remain higher for longer in order to prevent elevated inflation from becoming embedded in the mindsets of price-setters. In addition, Jan Frait explicitly pushed back against market bets on policy loosening this year, noting that he “wouldn’t want to promise or signal anything like that” amid a “slightly overheated” labour market.

As we look to future meetings, this week’s decision will be the last one for outgoing policymakers Oldrich Dedek (dove) and Marek Mora (hawk), whose mandates expire on February 12. They will be replaced by Jan Prochazka and Jan Kubicek, who do not have any substantial experience in monetary policy and little is known about their views. Given President Milos Zeman’s dovish leanings manifested in last year’s overhaul of the rate-setting panel’s composition, we do not expect these new appointments to tip the balance in the Bank Board to the hawkish side.

CNB Forecast – Autumn 2022

	2022	2023	2024
Headline inflation (%)	15.8	9.1	2.4
Monetary policy-relevant inflation (%)	15.3	8.9	2.3
Gross domestic product (annual changes in %)	2.2	-0.7	2.5
Interest rates 3M PRIBOR (%)	6.6	7.0	5.3
Exchange rate (CZK/EUR)	24.6	24.8	24.7

This forecast was published on 3 November 2022 and (with some exceptions) is based on the data available as of 21 October 2022.

Sell-Side Views

Barclays: Risk Of CNB Dropping FX Stability Commitment

- After front loading the tightening cycle in late 2021 and early 2022, the new CNB governor viewed CZK stability as a better anti-inflationary tool than further rate hikes, highlighting the external nature of the inflationary shock.
- Given that CZK now trades significantly stronger than intervention levels and Barclays believe Czech inflation has passed its peak, they see a risk that the CNB could drop its commitment to EURCZK stability at the upcoming board meeting. This could inflate implied EURCZK vols.

Goldman Sachs: CNB To Keep Rates Unchanged This Year

- They expect that the Board will continue to vote 5-2 in favour of an unchanged policy rate at 7.00%, as the recent commentary from CNB Board members suggests that the main fault lines between hawks and doves remain unchanged.
- Goldman note that in addition to the existing Board members, two new members have been announced – Jan Kubicek and Jan Prochazka – and are due to replace Mora (hawkish) and Dedek (dovish) in March 2023. Little is known about their views on monetary policy but, given President Zeman’s dovish tilt, Goldman expect the new appointments to maintain the dovish majority on the Board.

- In addition to the rate decision, the CNB will also publish revised forecasts. The November Monetary Policy Report implied that policy rates should be 1.5 percentage points higher than their current level – 8.5% vs. 7.0% – but then begin to decline in 2023.
- All else equal, factoring in a significantly lower starting level of rates will result in a downward revision to the near-term rate projection vs. the previous forecast. However, other changes are possible, including a return to a more 'standard' forecast horizon.
- Goldman note that their views are closer to the hawkish camp on the Board, in that they are worried by the evidence of de-anchored inflation expectations but remain comfortable with their forecast for no rate change in rates this year.

ING: Focus On Forecasts This Week, Debate On Rate Cuts May Start In Q3

- According to recent statements by board members, everything is pointing towards the same outcome as we saw in the second half of the year; five votes for stable interest rates and two votes for a rate hike. Thus, the main focus will be on the central bank's new forecast, especially on expected inflation for January and February.
- The CNB forecast suggests interest rates should be 100bp higher now, and then start to decline gradually as of the second quarter, in order to bring inflation back to the target by the end of 2024. The reluctance of the bank board to follow the recommendation of staff forecast suggests the board will maintain the current level of interest rates for an extended period, instead of the recommended temporary shift, followed by gradual cuts thereafter.
- Given the upside risk due to the new year repricing, the tone of the meeting should remain the same: "higher rates for longer" and "don't rule out a rate hike at the next meeting".
- ING expect rates to remain unchanged throughout the first half of the year and the topic of rate cuts to be open in the third quarter.

JP Morgan: Bank Board To Vote 5-2 In Favour Of Stable Rates, Cuts May Start From August

- They think the CNB will eventually shift dovish, but for now will keep the hawkish pose at this week’s policy meeting.
- JPM expect the CNB’s messaging to stay unchanged, with the Bank Board still highlighting the threat of wage-price spirals and remaining divided between more hikes and unchanged policy (the likely vote split is 5-2 in favour of keeping rates unchanged).
- If core inflation keeps falling the way JPM predict (core CPI falling from 13.3%oya to 6.4% in 3Q23, and running sequentially at 3.5%-4% ar), they expect the CNB will begin cutting rates cautiously from August, delivering a total of 100bp this year.

Société Générale: CNB To Stand Pat Until August, Gradual Cuts To Follow

- SocGen expect the Czech National Bank’s base repo rate to remain at the current 7% until August this year, after which it could decline gradually.
- They expect the repo rate to reach 5% by end-2023 and a policy-neutral 3% by end-2024, albeit the timing of the first rate cut is associated with a large degree of uncertainty, as it will likely depend on the economy and inflation, and possibly also on foreign central bank policies.
- They now assess the risks to their CNB interest rate forecast as roughly balanced, whereas previously they highlighted a risk of further hikes. This is mainly due to the CNB’s current wait-and-see policy which has led the board to miss the ideal moment to hike rates further and bring inflation back to its 2% target sooner.
- They also continue to expect the CNB to counter any excessive weakening in the koruna, even though developments in the FX market at the turn of the year did not require its intervention.

Unicredit: CNB To Stand Pat, Further Hikes Unlikely In This Cycle

- The upcoming CNB meeting will be the last for two policymakers, one hawk and one dove, whose mandates come to an end mid-February.
- Unicredit don’t expect any change to the CNB’s overall stance compared to the past several meetings, when five board members voted to keep rates on hold while two favoured a hike.
- With rates unchanged, the focus will be on new quarterly forecasts but even there, they only expect some fine tuning.

- Whether there is a chance of another hike in this cycle will become clearer in March. In Unicredit's view, continued hiking is unlikely.

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