

## MNI Czech National Bank Preview: March 2024

### Details:

Monetary Policy Decision	March 20 <sup>th</sup>	13:30GMT/14:30CET
Press Conference	March 20 <sup>th</sup>	14:45GMT/15:45CET
Minutes	April 2 <sup>nd</sup>	08:00BST/09:00CEST

### MNI Point of View: Keeping Pace

Last-minute comments from Bank Board members, just ahead of the CNB's media blackout period, inspired reflection on market wagers, with remarks from Eva Zamrazilová and Jan Kubíček reducing the perceived odds that the push for a faster pace of rate cuts could muster sufficient support. Consensus (i.e. almost all analysts polled by major news wires) looks for another 50bp reduction in the two-week repo rate, possibly coupled with cautious rhetoric from Governor Aleš Michl. We think that the sentiments of individual policymakers verbalised in their recent communications, persistent koruna weakness, and concerns about lingering risks to the inflation outlook limit the probability of faster monetary easing.

Czech inflation surprised to the downside in February, hitting the CNB's +2.0% Y/Y point-target and undershooting both market consensus (+2.1%) and the central bank's projection (+2.8%). Admittedly, the CNB's forecast was somewhat outdated when the publication crossed the wires – the January reading (+2.3%) fell short of the estimate in the winter forecast (+3.0%), implying a lower starting point for inflation and raising the odds of further misses in the following months. However, the long-awaited return to the target has certain psychological and symbolic importance, marking a milestone in the process of bringing price pressures under control. Furthermore, data from the first two months of the year showed that the effect of annual repricing of goods and services was less acute than many had feared, rebutting one of the key hawkish arguments.

Nonetheless, benign headline readings masked some potentially worrying details. Core CPI remains above headline, printing at +2.8% Y/Y in February, with sequential data (+0.5% M/M) raising a red flag over core inflation momentum. Against this backdrop, lingering price pressures in the services sector remain a source of concern. The CNB repeatedly stressed that it wants to anchor inflation sustainably around the target, which underpins its cautious bias. As the economy starts to recover, while the labour market remains very tight, the sustainability of the recent return to the inflation target will undoubtedly feature in this week's debate on monetary policy. Given the central bank's inherent forward-looking approach, upside risks to inflation place a constraint on dovish calls.

Another factor reducing the urgency to cut interest rates is the depreciation of the koruna exchange rate, which accelerated after the previous Bank Board meeting, as Governor Michl played down its importance in the panel's deliberations. As the koruna depreciated after his comments, Board members appeared to have switched to damage control mode, with several of them making references to the koruna's performance. This has helped stabilise the exchange rate, which has now moved away from new cyclical lows, but EUR/CZK continues to operate comfortably above the CNB's forecast for 1Q2024 (24.7).

All in all, recent comments from Czech central bankers amounted to a preference for gradualism and a relatively hawkish longer-term stance. Last week's remarks from Zamrazilová and Kubíček, who pointed to lingering price pressures in the services sector and the performance of the koruna, provided most interest, as the officials revealed their voting preferences. While Kubíček said that he would likely back another 50bp rate cut this week, Zamrazilová said she would decide between a 25bp and 50bp cut. Considering the cautious tone of comments from other officials, this suggests that that February's dovish dissenter Jan Frait is unlikely to be joined by a sufficient number of colleagues to tip the balance of the vote this week.

In the current conditions, this will likely result in a 50bp rate cut. The CNB remains in an early phase of its monetary easing cycle, after keeping rates at elevated levels for a relatively long period of time. We think that this week's 50bp cut will likely be followed by further cuts of that magnitude, until the Board deems it suitable to move to the next phase of the cycle, that is fine-tuning. The exact trajectory of interest rates further down the road may depend on the results of analytical efforts to determine the policy-neutral level of interest rates, with officials signalling that it might be higher than the pre-pandemic estimate of 3%. If this proves to be the case, then the rate-cutting cycle may stop earlier than currently assumed.

## Sell-Side Views

### BNY Mellon: CNB Likely To Opt For Another 50bp Cut

- In BNY Mellon's view, the only uncertainty surrounding the CNB decision is whether policy board members will continue with aggressive 50bp moves or revert to 25bp moves.
- They think that the former is favoured for now given February inflation surprised to the downside but activity numbers have rebounded strongly, which suggests that confirming full price stability will require some more time.
- They note that the CNB will also need to take note of the ECB's current trajectory, whereby significant policy space may not open up for CEE economies until after the first ECB cut, which is most likely in June.

### ČSOB: 50bp Cut Expected This Time, Further Path Depends On Neutral Rate Estimate

- They write that the CNB must have been satisfied with inflation outturns for January and February, with headline CPI back to the +2.0% Y/Y target. However, they still expect the central bank to strike cautious notes this week while trimming the repo rate by another 50bp.
- First, they note that part of the Board is concerned about the structure of inflation, with price momentum in the services sector still quite strong. Second, they note that services inflation may prove sticky if higher wage pressures and inflation expectations remain elevated. Third, they point to the exchange rate, which is notably weaker compared to the latest forecast.
- In addition, some Board members think that the neutral rate in the post-pandemic era may be slightly higher than 3%. The analytical "check" of the natural interest rate should be completed by the May meeting of the CNB. ČSOB write that if those central bankers' fears are confirmed, the May forecast may indicate a more cautious rate cut than February's. Conversely, if everything remains the same, a more significant rate cut of 75bps may occur in May.

### Goldman Sachs: Central Case Assumes 50bp Cut

- They view the decision as being a close call between a 50bp and 75bp cut but their central case is that the CNB Board will opt for a 50bp reduction. They see the choice as being primarily tactical in nature and, given weak underlying inflation dynamics, they remain relatively dovish on medium-term rate prospects in Czechia.
- Inflation hit the CNB's target and surprised its expectations sharply to the downside, which came after a much more benign annual repricing effect in January and reflected, in Goldman's view, the underlying weakness of price dynamics in the Czech economy. On the other hand, (1) the annual CPI re-weighting contributed 0.3pp to the fall; and, (2) the composition of the surprise was less dovish than headline.
- In addition, relative to the CNB's February forecast, other economic developments have been more hawkish: the Czech Koruna is 1-2% weaker than the CNB expected, ECB rates have re-priced materially higher, and growth appears stronger than the CNB's (admittedly pessimistic) forecasts. In addition, the CNB's analysis implies that the economic costs of moving in 50bp increments is small relative to larger moves.
- On balance, they expect that the Board will continue to cut at a 50bp pace, rather than accelerating to -75bp. However, with two members indicating that they will vote for -75bp, they expect the decision to be relatively close and they maintain a relatively dovish view on Czech rates by year-end and beyond.

**HSBC: At Least 50bp Cut In Pipeline, 75bp Warranted**

- The rate setters guided for a steady and cautious pace of rate reduction which firmly supports at least 50bp cut this week, in HSBC's view, after 50bp in February.
- But with inflation surprising to the downside and pushing real rate above 400bp, they think a bigger cut of 75bp is warranted (which is their entry in the Bloomberg survey of sell-side analysts).
- That said the latest comments from Board members were mixed and it remains unclear if a bigger cut – 75bp vs 50bp – could be supported by the majority.
- The latest Monetary Policy Report did, however, indicate that delayed policy easing raises the risk of deeper cuts down the line with an outright loose policy stance in 2025; they understand the rate setters seek a soft landing, returning policy rate to its neutral level.

**JP Morgan: 50bp Camp To Prevail**

- In their view, the CNB meets for another hard-to-call rate decision. They write that the arguments for moving faster are the downside CPI surprises of January and February mainly, while arguments for moving slower are concerns that beyond the optics of low Jan/Feb prints lies a much less benign inflation picture, hawkish push-back from some board members and pressures for weaker FX in recent months.
- They recall that although in the press conference Governor Michl argues FX was not a big topic in the decision, what followed was a flurry of commentary by board members reassuring markets that the CNB will not ease aggressively and that the CZK weakness implied an upside risk to the CPI forecast. This allowed for stabilisation and even some strengthening in the currency lately, which, in their view, hinges on the board delivering on this prudent message.
- They note that if the pace of rate cuts accelerates again, the market will price in more near-term rate cuts and the Crown would likely come under renewed pressure. Furthermore, even if the currency stays flat forever, it is far from clear that inflation can sustainably fall to +2.0% Y/Y given a tight labour market and strong services CPI. But if the currency is allowed to persist in gradual depreciation, then they believe reaching the target is quite unlikely.
- They expect a divided vote, with some board members like Deputy Governor Jan Frait pushing for a faster rate cut cycle, possibly together with Tomáš Holub, or even a third member. On the more hawkish side, they expect to see Deputy Governor Zamrazilová, who stated to Bloomberg that she was considering either a 25bp or a 50bp cut, board members Kubiček, and Kubelková, together with Governor Michl.
- They expect the CNB to cut rates by 50bp, although this is not a done deal and they see high risks of a 75bps move. This would also be a divided vote they think, and they would expect opposition from at least two board members. In their view, a quick front-loaded easing cycle likely makes no meaningful difference to growth (the CNB even produced a scenario illustrating this), would risk FX weakness at a time of ECB/Fed high rates, and with core CPI demonstrating plenty of stickiness, could prove a premature celebration of disinflation success.

**Komerční banka: CNB To Cut Rates By 50bp/Meeting Until August, Then Slow To 25bp/Meeting**

- They expect the Bank Board to reduce the two-week repo rate by 50bp to 5.75%, trimming their earlier call for a 75bp cut, following last week's comments from several members, who expressed preference for more gradual policy moves.
- Komerční expect the CNB to deliver further 50bp rate cuts in May, June and August. At all subsequent meetings, they expect 25bp cuts, until March 2025, when the repo rate will reach its neutral rate of 3%.
- They flag uncertainty around the terminal level of the repo rate, citing comments from Czech central bankers, who suggested that the neutral rate could in fact be higher than 3%.

**mBank: 50bp Cut Expected**

- They expect the CNB to cut the repo rate by 50bp but do not rule out a more dovish scenario, while noting that koruna weakness is an argument against it.

**Société Générale: Revising Call To 50bp**

- They have revised their call to 50bp from 75bp following the CNB's comments just before the upcoming meeting, with Eva Zamrazilova set to decide between a 25bp and 50bp cut and Jan Kubicek mentioning that he would likely support another 50bp cut.

- SocGen note that by cutting rates by only 50bp in March, the central bank is likely to remain behind the curve. The economy has been weak and is the only one in the EU bloc to remain below pre-pandemic levels. Moreover, the pace of recovery in household purchasing power has been slower than expected, with real wages growing only marginally in 2H23.
- They now pencil in a series of 50bp cuts at the March, May, June and August meetings. At each subsequent meeting until March 2025, they foresee a standard 25bp cut. As a result, they expect the repo rate to be at 3.5% by the end of the year and the policy-neutral level of 3% to be reached in March 2025.
- However, the CNB board continues to state that it considers the policy-neutral level to be higher than the 3% used by the CNB staff in its forecasts. Therefore, it is possible that the CNB will eventually stop cutting interest rates at 3.5% or even 4.0%.

#### **Unicredit: 50bp To Be Chosen Over 75bp Again**

- They continue to believe that a 50bp cut will be the most likely outcome on Wednesday, despite market consensus for the size of the CNB rate cut shifting towards 75bp.
- On the one hand, February headline inflation dropped to 2.0% yoy, well below the ČNB's forecast of 2.8% from January. On the other hand, recent disinflation was brought about largely by food, tobacco and administered prices, whereas core inflation stood at a still slightly elevated level of 2.8%.
- In addition, FX is viewed as a clear inflationary risk, as noted by several policymakers lately. In fact, several central bank members have recently urged for a cautious approach in policy easing, while no one has signalled newly leaning towards faster cutting.
- On balance, they expect a 75bp cut to be proposed (as was the case in February) but for it not to win a majority of votes. That said, they think that the ongoing low inflation may allow the CNB to cut by 50bp at least twice more at the coming meetings. They project the repo rate will drop to 4.75% by the end of June.