Ebury What borders?

CNB November Meeting Reaction: CNB keeps rates unchanged, expects a recession in 2023

Written by:

Enrique Díaz-Alvarez, Matthew Ryan, CFA, Roman Ziruk, Itsaso Apezteguia & Eduardo Moutinho

4th November 2022

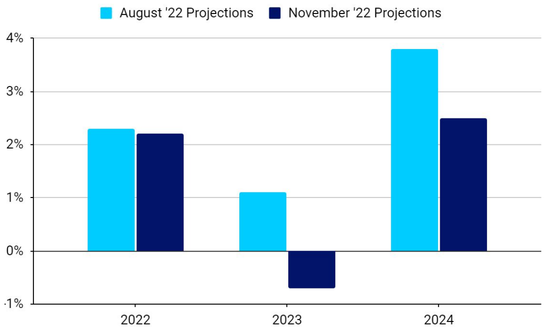
CNB keeps rates unchanged, expects a recession in 2023

The Czech National Bank kept rates unchanged for the third meeting in a row, with the two-week repo rate held at 7%. The vote followed the usual 5-2 pattern, with two members opting for a 75 basis point increase. The decision was broadly expected and, in itself, had little potential to influence markets. Attention among market participants was, instead, on the bank's communication and, in particular, its updated forecasts.

The new forecasts imply somewhat lower inflation in 2022 and 2023 than previously expected. The peak is also lower – at around 19% in December this year. At the same time, the CNB now anticipates a GDP contraction of 0.7% in 2023 (vs. a 1.1% increase expected in the summer) and weaker growth in the following year (2.5% vs. 3.8%). The forecast for market interest rates (3M PRIBOR) were, however, revised higher – the difference is particularly pronounced in 2023 and 2024 (7% vs. 5.2% and 5.3% vs. 3.1%). These new forecasts also assume a stronger koruna than previously envisioned, not far from current levels.

If the Bank Board was to follow the forecast, it would mean rates would need to rise sharply in December. This does, however, seem unlikely. It appears that the decisionmakers prefer rate stability to any significant changes. While governor Michl suggested that the decision at the upcoming meeting will be between stable rates and an increase, barring significant data surprises, we think we're most likely to see the CNB stand pat on rates through the end of the year and into early-2023.

Figure 1: CNB GDP Growth Forecast (Nov '22 vs. Aug '22)



Source: Czech National Bank Date: 03/11/2022

Furthermore, the bank confirmed its willingness to intervene in the FX market in order to prevent an excessive weakening of the koruna. Considering the use of the tool doesn't seem to be much of an issue in the current environment (pressure on the exchange rate appears low and FX reserves remain vast), we think that this will remain the preferred option in near term.

Figure 2: CNB Forecast table (Nov '22 vs. Aug '22)

	2022	2023	2024
Headline inflation	15.8% (16.5%)	9.1% (9.5%)	2.4% (2.4%)
GDP growth	2.2% (2.3%)	-0.7% (1.1%)	2.5% (3.8%)
3M PRIBOR	6.6% (6.2%)	7.0% (5.2%)	5.3% (3.1%)
EUR/CZK	24.6 (24.8)	24.8 (25.7)	24.7 (25.5)

Source: Czech National Bank Date: 03/11/2022

The reaction in the koruna to yesterday's announcement from the Czech National Bank was limited. The currency did appreciate against the euro following the decision, albeit only modestly (+0.3%) and its closest regional peers ended the day with similar gains.

The markets seem to have focused on the higher rate trajectory forecast, rather than the gloomier economic outlook. Even though additional rate hikes seem unlikely to us, a possibility that rates will be kept high for longer is a positive signal for the koruna.

We think the attention in the coming months will turn towards the timing for interest rate cuts in Czechia. The Bank Board stressed that 'interest rates will remain relatively high for some time', albeit the beginning of rate cuts around mid-2023 wouldn't be surprising to us, as this is in line with the bank's forecast. A reversal in policy tightening could present a risk for the koruna, albeit we think that the currency shouldn't come under too much downward pressure in an event of gradual rate adjustments. This would be particularly the case should policy tightening in the main economies (notably the US) be drawn to a halt by that time.

Ebury
100 Victoria Street, London SW1E 5JL

+44 (0) 20 3872 6670 | info@ebury.com | ebury.com