

Economics

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Czech Republic Macro Flash

CNB: No hike on the horizon, while a cut is still in play

■ Policy rate left at 0.75%, but if koruna intensifies its appreciation, expect cut —

All attending members of the CNB's Bank Board voted for a stable policy rate. The CNB's forecast is consistent with stable policy rate near-term, followed by a 25bp cut in 4Q13. No alternative scenario was published, however, CNB sees several risks to the forecast, but they are evaluated as balanced. The Minutes from the meeting and the Inflation Report with the detailed forecast will be published on 10 Feb, at 8am LDT.

Jaromir Sindel

+420-2-3306-1485

jaromir.sindel@citi.com

■ CNB's forecast expects zero growth in 2012 and flat policy rate in near-term reflects a weaker koruna —

The CNB slashed its GDP growth forecast to zero in 2012 from 1.2% previously. This reflects a cut in expectation on the effective foreign demand growth in 2012 to 0.5% from 1.4% previously. CNB forecast suggests to us a flat policy rate despite a sizeable cut in GDP growth and lower 3M EURIBOR. This reflects a forecast of a weaker koruna, which CNB's expect at 24.9 against the euro in 2012, 7.4% weaker compared to its previous forecast (by 7.9% in 2013).

■ Our forecast points to three risks – further drop in foreign demand, weaker koruna and again lower 3M EURIBOR —

We expect a larger fall in the euro area GDP by -1.5% (consensus by -0.3%). While this has a disinflationary impact on domestic demand, it actually implies around a 25bp hike in CNB's policy rate owing to the weaker koruna, which we expect around 25.6 against the euro in 2012, which is 3.5% weaker than CNB's forecast. By contrast, Citi expects a further cut in ECB's policy rate to 0.5% in mid-2012, which in our view suggests a 30-40bp cut in CNB's policy rate.

■ These risks are accompanied by two risks in CNB's forecast – higher growth in food prices and fiscal consolidaton in 2013 —

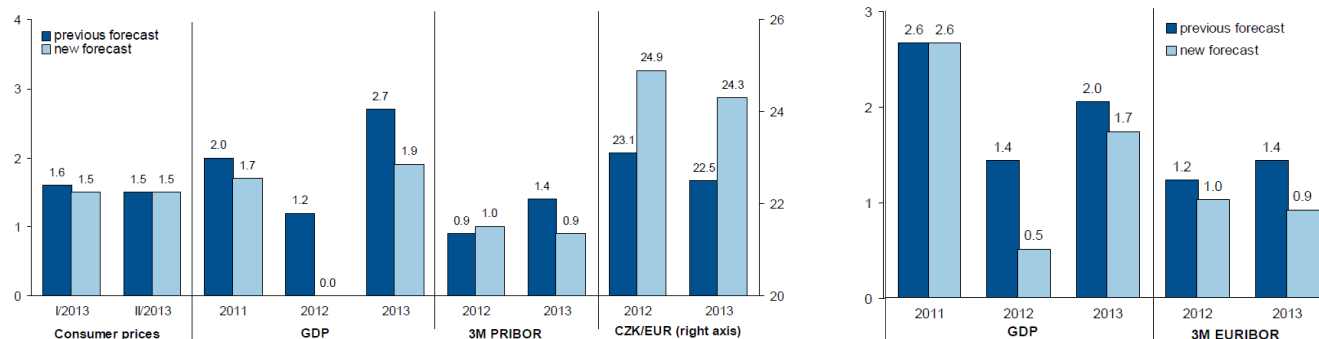
While CNB sees higher food prices as an upside risk, we view this oppositely as it hurts disposable income. We argue that our forecast points to a worse labor market. Hence, higher household price expectations are unlikely to be followed by higher wage growth. CNB perceives downside risk in the fiscal consolidation to meet the fiscal deficit target at 3% of GDP in 2013 as CNB's forecast points to -3.8%. This in our view implies a cut in policy rate by around 15bp. Our forecast envisages the deficit at 3.4%, which suggests a 7bp cut.

■ Policy Implications — Taking into account the recent appreciation of the koruna, we see downside risk to our forecast of a flat CNB policy rate, remaining at 0.75% until 1Q13.

Our forecast mainly reflects a weaker koruna owing to renewed stress from the worsening real economy and euro area fiscal woes, offsetting the impact of a lower EURIBOR. All in all, the comparison of the CNB's and our forecast points to a higher 3M PRIBOR by 25bp compared to the CNB baseline. Hence, it reduces the chance of a 25bp cut in 4Q12. However, this comparison suggests a first hike in late 2013 rather than in 1Q13. Additionally, if koruna returns to stronger levels below CNB's forecast, we would see a cut in policy rate as more likely in late 2012.

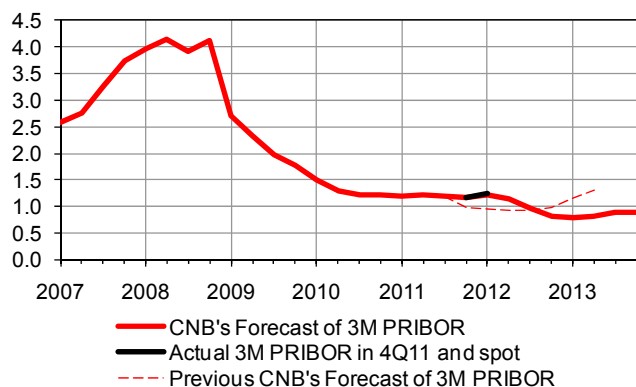
See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Figure 1. CNB's forecast (on left) and assumptions of effective Euro area GDP growth and 3M EURIBOR (on right)



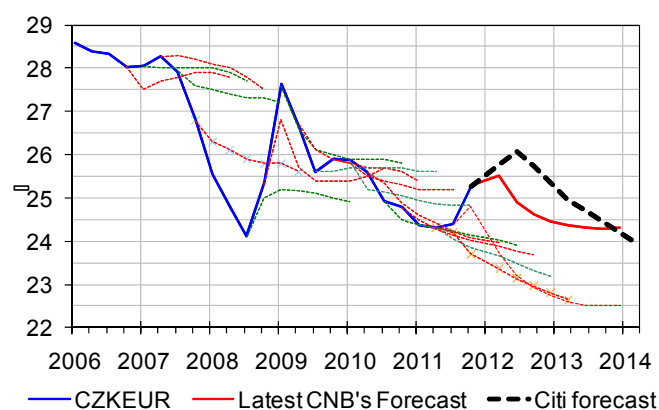
Source: Czech National Bank

Figure 2. CNB's forecast of 3M PRIBOR vs. previous forecast



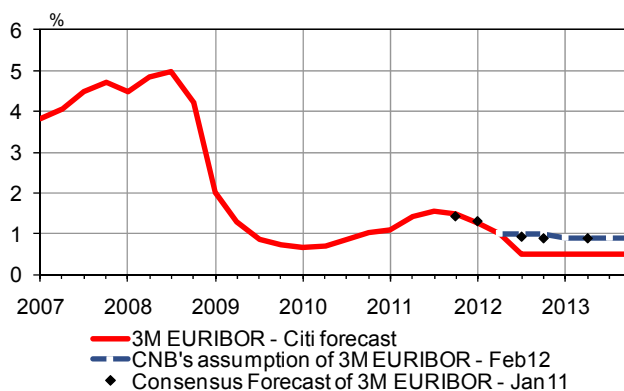
Source: Czech National Bank, Citi Investment Research and Analysis

Figure 4. CNB's forecasts of EURCZK vs. Citi forecast



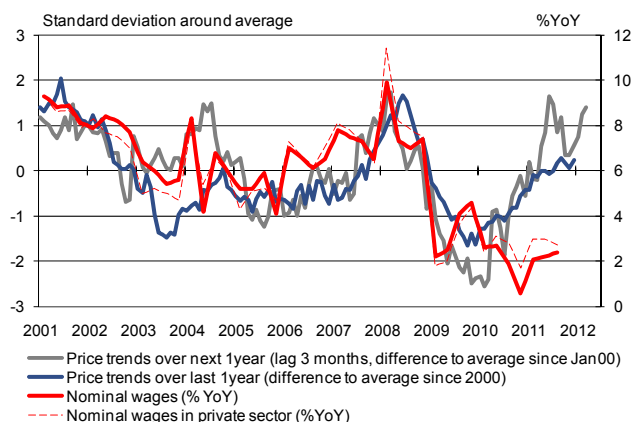
Source: Haver, Czech National Bank, Citi Investment Research and Analysis

Figure 3. CNB's assumption of 3M EURIBOR vs. Citi forecast



Source: Czech National Bank, Citi Investment Research and Analysis

Figure 5. Wage growth has not followed households' price expectations



Source: Eurostat, Czech Statistical Office, Citi Investment Research and Analysis

Appendix A-1

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