7 May 2020
Snap

Czech Republic: CNB delivered frontloaded easing

As last time, the Czech National Bank delivered a higher-than-expected cut, 75 bp versus 50bp expected by the market. The new central bank forecast sees the Czech economy contracting by 8% this year. The CNB was not specific about preferred tools in the case of rates reaching zero

The CNB surprised the market today by delivering a 75bp cut vs 50bp expected. As revealed during the press conference, it was a 5:2 decision, where the minority supported just a 50bp cut. However, 50bp was recommended by the new forecast. As such, the CNB Board members decided to frontload monetary easing today, as the new forecast indicated more lowering of rates in the second half of the year.

0.25%

2-week repo rate

from 2.25 in March

Lower than expected

New forecast introduced

The new forecast expects Czech GDP to fall by 2% year on year in 1Q20, followed by an almost 12% YoY decline in 2Q, which should be the bottom. For the whole year, the economy is expected to fall by 8%, and in 2021 it is expected to grow by 4.2%. EUR/CZK should remain stable at around 27.5 till the end of 2021. Inflation is gradually slowing down close to 2% next year. A more detailed forecast will be published next week.

New liquidity measures in the pipeline

The CNB plans to introduce a new instrument for providing liquidity to non-banking institutions, in the form of a short-term loan pledged by the same securities as in the liquidity-providing repo operations. For credit institutions, including banks, the CNB plans to extend possible collateral used in liquidity-providing repo operations to include mortgage-backed securities. Liquidity-providing operations with a three-month maturity will also be introduced for credit institutions.

Bond buying not on the table now

Governor Rusnok did not want to anticipate what other tools the CNB could use if rates hit the zero-lower bound, and only mentioned that the CNB will always have room to deliver more. He mentioned it is necessary to wait for economic developments after the relaxation of restrictive measures. However, the CNB does not see the need to supply liquidity to banks; ie, move closer to quantitative easing, which is backed by the legislation, but apparently is not a preferred option for the CNB right now.

The CNB probably hopes to weather the situation with standard tools

All in all, today's CNB decision to frontload rates lower beyond the forecast recommendation provides some chance that rates will remain stable for some time, at least in June, if economic developments will not disappoint the CNB forecast. Still, getting to a technical zero level in the second half of the year looks as a likely scenario now. However, the CNB probably hopes to weather the situation by keeping rates low for a longer period accompanied by a relatively weak koruna also delivering solid monetary easing, ie, without the need to launch QE or other non-standard or more controversial measures like an FX-floor regime. This explains why the CNB does not want to be too specific about the next steps if the zero-lower bound is hit.

Jakub Seidler
Chief Economist, Czech Republic
+420 257 47 4432
jakub.seidler@ing.com

Petr Krpata, CFA
Chief EMEA FX and IR Strategist
+44 20 7767 6561
petr.krpata@ing.com

Disclaimer