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Czech Presidential Election and the reaction of the markets

Gast-AutorIn / Guest Author

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Guest author: Margarita Sinitsyna, Fund Manager, Czech Republic Branch

With both rounds of the Czech presidential election behind us, we can now take a look back at some of its highlights. Incumbent Milos Zeman reaped a narrow edge over his challenger Jiri Drahos.

The first round of the election, held on January 12-13th, started off with a relatively large number of candidates. Despite that the number remained unchanged from the previous election held in 2013 (nine), this time, the election was dubbed a referendum about the incumbent president, Milos Zeman, whose political course, deemed controversial at times, attracted many supporters, as well as opponents. While the incumbent president has frequently been criticised for his tilt toward the East, his second-round contender, Jiri Drahos, has repeatedly manifested a relatively strong pro-European position. Out of the nine candidates, the two clear first-round winners, Milos Zeman and Jiri Drahos, gained respectively 38.57% and 26.60% of the vote. Most of the remaining candidates encouraged their voters to support Jiri Drahos in the second round.

Apolitical background vs. EU sceptical attitude

For the second round held on January 26-27th, the vote was expected to be relatively tight. Despite Milos Zeman's solid first round result, the incumbent president's challenger seemed to have a good chance of beating his contender. For all the opponents of his political course, the incumbent president had very faithful voters and the skeptical overall attitude towards the EU and migration issues that prevails in the country at this point in time also played in his favour. His challenger, on the other hand, managed to garner many supporters as well, largely thanks to his apolitical background, pro-Western stance, and potential to bring new blood into the political establishment with which many voters feel dissatisfied. Still, a lot of other factors were at play. For instance, the health of the incumbent president which often came into question recently or his contender's background of a political outsider which could make him rely on people or entities heeding their own interests, to name a few.

The strategies that the second-round contenders selected for winning undecided voters were predominantly focused on migration issues. Milos Zeman and Jiri Drahos took advantage of a number of opportunities to put them to work – including television debates as well as meeting the voters directly and featuring in social networks, among others. Although the political scene is usually not a significant market-mover in the Czech Republic and the powers of the president are rather limited, the election overall was a closely followed event as it still determines the future direction of the country. Finally, the second round brought victory to Milos Zeman who reaped a narrow edge over his challenger with 51.37% of the vote. The markets remained largely indifferent to the result.

Reactions of the Czech markets

Although the markets in the Czech Republic are mostly indifferent to politics, they are usually more responsive to the policies of the central bank, as well as to the macroeconomic data. The Czech economy can pride itself on its broad-based GDP growth which reached 5% in Q3 2017 and the lowest unemployment rate in the EU which amounted to a mere 2.5% in November 2017 according to Eurostat. In April 2017, the Czech National Bank (CNB) exited its currency commitment which had been in place since November 2013 and the crown embarked on a solid appreciation path. The economy was doing well and, concurrently, the inflation pressures that were generated helped the CNB reach its inflation target. Some denounced the measure as controversial though and reviled the central bank for doing more harm than good, e.g., promoting "laziness" of exporters with respect to innovation and competitiveness and failing to grasp the opportunity to solidify the economic foundations in high value added products, among others. While such opinions sometimes give rise to endless debates (about "pros" and "contras"), the prosperity did come at a cost.

Above its potential

The central bank quintupled its FX reserves and although there seems to be no immediate issue with that, it is something that should be kept in mind. After all these years under the FX commitment, the economy began operating close to or even above its potential and the CNB, mindful of the risk of overheating, became one of the first banks in the world, and actually the first in the region, to begin monetary tightening. The interest rates were raised twice so far and further tightening, via the exchange rate channel, as well as via the conventional monetary tightening, is expected. The market predominantly expects at least two interest rate hikes in 2018 with the first one deemed very probable already at the February 1st meeting. Government bond yields and the EURCZK exchange rate largely price in the hike at the moment. We therefore estimate that some market reaction may be expected rather in the event that the CNB disappoints at the meeting. Should this happen, the reaction is likely to be relatively weak and short-lived. It is widely expected that the general trends of the crown appreciation and the rise in bond yields will continue.

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Gast-AutorIn / Guest Author

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