

CNB FX intervention may become a problem sooner than we expected

Preliminary data show that defending the koruna cost the Czech National Bank as much last week as it did in total for May and June. The total cost of FX interventions has thus reached 11% of FX reserves as of mid-May, in our view. The koruna still has room to strengthen, but the cost of interventions will become questionable during August and September



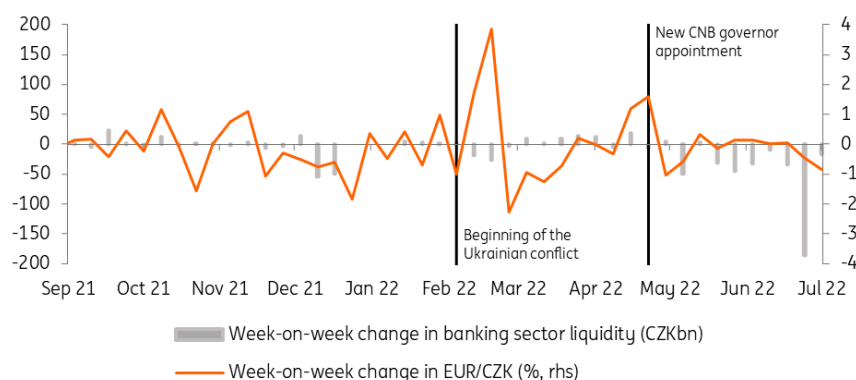
Preliminary data indicate the Czech National Bank spent almost EUR9bn last week in defending the koruna

The beginning of July cost the CNB as much as May and June combined

Unlike the Polish zloty or the Hungarian forint, which went through a massive sell-off last week, the Czech koruna held near its levels and has even been stronger since Friday. Thus, given the pressures coming from EUR/USD, one would think that the cost of the CNB's FX interventions must have risen significantly over the past few days. As we already have the first data for last week, it is thus time to look at the overall account [again](#). Of course, the banking sector liquidity data contains a lot of noise, but the first indication suggests that the CNB spent almost EUR9bn last week, which is as much as the whole of May and June combined. In total, we thus estimate the cost at

EUR17.8bn since mid-May, which is 11% of the FX reserves CNB had at the end of April. Despite the inaccuracies in the data, it is clear that interventions are getting more and more expensive by the day. While this is as we expected, the pace of the acceleration in costs is surprising and could become a problem for the central bank very soon if the sell-off in the CEE region continues. We had previously expected this moment to occur in the fourth quarter, however, based on these numbers, it appears that it may occur as early as August/September, depending on further developments in global markets.

CNB defending the koruna during last week's sell-off



Source: Refinitiv, ING

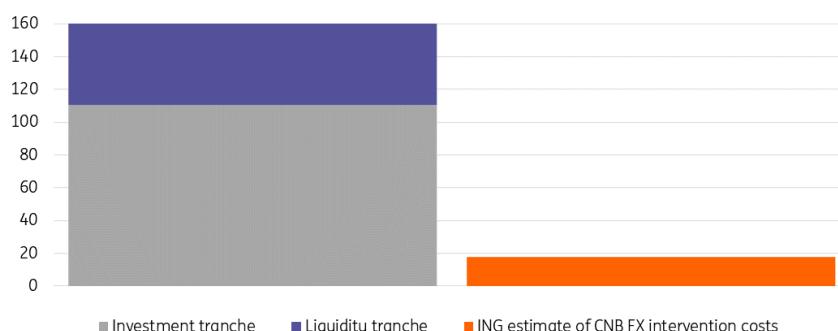
Koruna still has room to strengthen but the August CNB meeting will renew depreciation pressure

June inflation will be published tomorrow, the last number before the CNB's August meeting. We expect a further rise from 16.0% to 17.3% year-on-year, however, [as we mentioned earlier](#), we may see a more significant jump up due to the announced energy price hikes. However, the main focus here will be July and August, for which we expect the biggest move in energy prices, which could push inflation up to 20% YoY.

The key level for the Czech National Bank at the moment is 24.60-70 EUR/CZK

We expect the CNB to see similar numbers, which may lead the central bank to be more aggressive in pushing the koruna lower, which was our base case scenario. The CNB is encouraged to do so this week by low liquidity and liquidation of short positions built up over the past two weeks. Therefore, in our view, the key level for the CNB at the moment is the 24.60-70 EUR/CZK level and the rest of the move is more market driven. This is evidenced by the renewed relationship between the interest rate differential and the koruna in recent days due to growing expectations for a CNB rate hike at the August meeting. Moreover, these expectations may gain additional momentum after an inflationary print and the koruna could go even lower. At the moment we see room for EUR/CZK to get to 24.30. However, we continue to believe that the CNB will not raise rates in August and the koruna will come under pressure again.

Size of CNB FX reserves in April and costs of interventions since mid-May (EURbn)



Source: Refinitiv, ING

What's next?

In our view, the CNB's current cost of FX intervention is within a sustainable range for now, but the pace of cost growth is alarming. Thus, during August and September, we expect to see growing voices at the CNB for an end to FX interventions, or at least an adjustment of parameters or a change in approach from a less commitment-style as we currently see, to a more flexible approach. Overall, the CNB FX intervention story is thus proceeding as we expect but at a faster pace. The last few days may have shaken out short investors, but the current EUR/CZK levels and the rising cost of intervention make this trade idea more attractive these days and makes more sense to us.

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