CNB preview: no more cuts likely as inflation risks dominate

Inflationary pressures mount as the economic rebound continues amid a relatively tight labour market. The effects of a buoyant housing market and persistent price growth in services are not fully offset by a stronger koruna and lower energy prices. The cutting cycle is likely over, also given brighter growth prospects from the external environment

Czech National Bank headquarters in Prague

A new CNB forecast arrives with a more upbeat rate trajectory

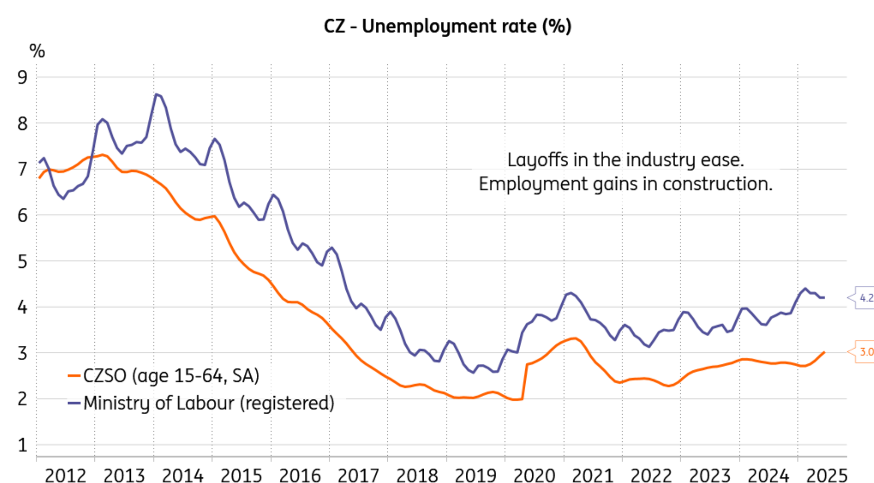
We expect headline inflation to hover in the upper tier of the Czech National Bank's tolerance band for the remainder of the year, provided that restrictive monetary policy conditions persist. This means no further rate reductions when looking ahead, consistent with our base-case scenario. Such a standpoint is also supported by recent comments from Deputy Governor Eva Zamrazilova. We expect the CNB to keep the base rate at 3.5% at its meeting on 7 August.

Relative to the CNB's spring projection, the stronger koruna is dampening imported inflation (July average of EUR/CZK at 24.6 vs. 25.2 CNB 3Q forecast) while Brent crude has exerted somewhat

stronger upward pressure. June's annual inflation rate of 2.9% is only a tick above the CNB's spring view, reflecting a more buoyant annual price dynamic for regulated items and a less pronounced decline in fuel prices. Real GDP growth of 2.4% in 2Q was only 0.1ppt stronger than the CNB had expected, while nominal wage dynamics at 6.7% in 1Q landed a tiny bit below the expectation. So, are there any incentives for the CNB to adjust the projection for the summer edition?

Well, we believe there are, namely when looking at the projection from 4Q25 onward. The CNB spring forecast assumes noticeable softening in the pace of economic expansion, along with inflation starting to ease toward the 2% target. Several new factors have emerged recently that support the economy's continued upward trajectory; i) The German infrastructure and defence package may trickle down to the real economy sooner than expected, and ii) the recent trade deals - not limited to the EU - may significantly reduce uncertainty and promote global growth.

The unemployment rate trends upward for now



Source: CZSO, Ministry of Labour, Macrobond

Both would imply stronger Czech economic growth amid a relatively tight labour market. That said, the unemployment rate typically adjusts with a considerable lag to changes in economic performance, especially across Europe. We note that unemployment trends appear somewhat contradictory when comparing the ILO-defined rate with registered figures from labour offices.

Still, we see a discernible upward trend in unemployment since 2022. That said, the rate remains moderate compared to historical highs of more than 7% and 8%, respectively. With the Czech economy gaining real traction from mid-2024 following a period of stagnation in 2022–23, this negative trajectory may begin to reverse over the coming year.

Stronger economic expansion would imply upward pressure on wages, given the general scarcity of skilled and experienced workers, which in turn, would potentially halt any further disinflationary trend in the services segment - a key concern for rate-setters. Add in the buoyant housing market, which affects core inflation via increasing rents, and you arrive at a broad-based set of domestic inflationary pressures when looking ahead. All in all, we see the new CNB forecast as painting a picture of both stronger GDP growth and more potent inflation - and yes, the price tag includes higher interest rates and a stronger koruna.

Food prices are hard to predict during summer

We see July's inflation print softening to a decent rate of 2.6% annually, with core inflation also coming in milder than in the previous month at 2.7%. However, the food inflation forecast is especially challenging during the summer months, as fruit and vegetable prices can be erratic. The July food inflation print will depend on the extent to which the bumpy path of potato prices is reflected in the CPI statistics, with a preliminary price survey showing a 25% rise in potato prices in June and a 31% decline in July. We take the position that the drop in July's potato prices will be visible in July's CPI reading.

Food price prediction is a dicey business

Jul-25	%MoM	%YoY
Headline	0.3	2.6
Core	0.8	2.7
Food	-0.5	4.0
Regulated	-0.2	1.2
Fuels	1.1	-9.5

Source: ING

Electricity prices represent another risk, as the reduction in electricity prices by major distributors might be measured with a delay in the CPI. This is the reason why we foresee a mild monthly decrease in regulated prices for July. That said, we see both headline and core inflation increasing to above 2.7% over the last quarter of the year, requiring restrictive monetary policy in both the exchange rate and interest rates.

The trade deal reduces uncertainty, but it will take its toll

In a way, the external environment has turned more growth-friendly for the Czech economy. The US-EU trade deal resulted in a 15% tariff on EU goods imports, while steel and aluminium remain at a 50% rate. All in all, significantly lower uncertainty is generally positive news for Czech businesses, except for the steel and aluminium exporters. For those types of Czech industries, a 25% rate marks a borderline where it is still possible to make some profit when exporting to the US, while 50% indicates a no-go zone.

Ultimately, the United States now applies the same tariff rate on steel and aluminium to its ideological ally as it does to its strategic rival, which was not the case beforehand. Should such conditions prevail, compounded by Europe's higher energy and labour costs and dense regulatory spider web, it may be the case that neither of the two strategic materials will be exported from Europe in the future. Such a scenario would increase the external dependency and reduce the resiliency of the European and Czech economies.

It seems that the EU opted for a more concessionary stance while keeping its demands relatively modest. For instance, the digital tax for US tech giants was not mentioned at all. Some consider the outcome as the best deal achievable under the circumstances. The upper bound was set by the US at a 30% rate. However, the UK set the lower bound at a 10% rate. In the end, Europe walked away with a Japan-style 15% rate deal, despite having the largest market, which should be one of the crucial metrics for such a type of negotiation. Look at it from any angle – the EU-based firms will face a five percentage point comparative disadvantage to businesses based in the UK. That makes the deal hard to justify, even as a minimisation of maximal loss; let's conclude that the

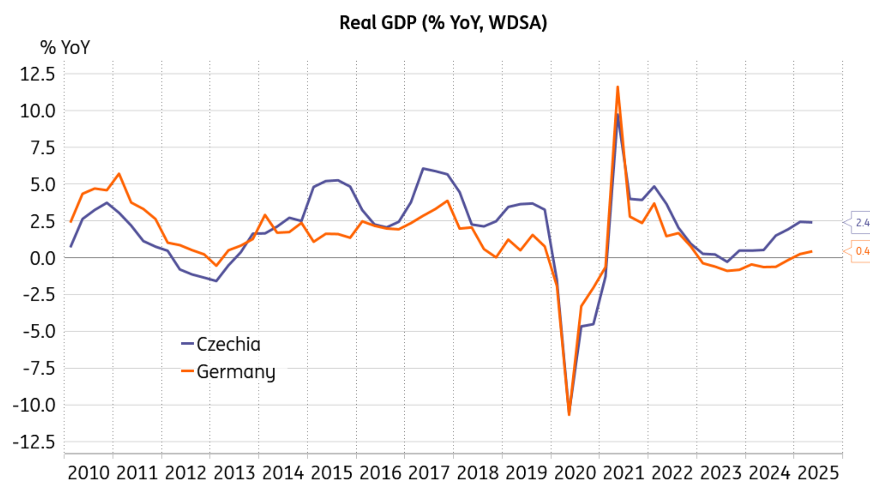
deal is not an optimal outcome for EU-based companies.

Meanwhile, selected Czech firms are intensifying their strategic plans to transfer some of their production capacity to the US. Those who already did so previously to avoid prohibitively high and uncertain energy prices, along with burdensome regulatory costs, may now feel vindicated about their earlier decision and are planning to bolster their production facilities across the Atlantic. The puzzling fact remains that what would have been assessed as a disaster a year ago now seems to be met with relief in some circles. Despite the adverse effects of the US tariffs, we see the Czech economy expanding 2.3% this year and 2.5% the next as our baseline.

Germany turns around as the package takes effect

There are persistent and deeply rooted structural growth hurdles embedded in the German economy, such as a lagging energy strategy, dense regulation that creates an extra burden for firms, an inflexible labour market, and a social benefits system that disincentivises long-term unemployed individuals from joining the labour force. Still, it is obvious that if you throw a substantial amount of money at a long-term problem, you can significantly suppress some of its manifestations, at least in the short term.

And who knows, maybe the structural changes to the German economic and social model will follow suit, also pushed forward by the momentum induced by the experience of a growing economy after three years of stagnation. A cyclical turnaround could then be transformed into something more durable, such as economic expansion underscored by a structurally revamped economy that could serve Germany for a couple of years or a decade.



Source: Macrobond

Even given the disappointing Q1 GDP figure for Germany, we see a case of a simultaneous economic rebound of the German and Czech economies as a viable option. Still, the German locomotive scenario remains in the realm of vague possibilities, as the clear turnaround in sentiment needs to be confirmed in reality, such as upward-trending industrial production and a series of upbeat real GDP growth figures. Together with John Maynard Keynes, we all know that the animal spirits can change sides just like that.

Anyway, stronger German performance would imply more potent expansion for the Czech economy and earlier closing of the output gap, along with repercussions for labour market tightness, wage growth, and the rate path. Should such a scenario materialise, we would start

thinking about when the new hiking cycle might take off in 2026, and mid-next year would be our best guess.

Our market view

The market shifted significantly in our direction during June and July, and the end of the CNB's cutting cycle basically became the base case. The Czech koruna thus gained a good shield from external influences, and even the recent sell-off in the EUR did not affect the CZK too much, while CEE peers sold off. The CZK has been our favourite currency in the region for some time, but it will be harder to see further gains from current levels. EUR/CZK touched 24.550, the lowest level since early 2024. At the same time, the market has already priced in all the cuts, and the positioning squeeze has pushed the front end of the curve above the fixing in the two-year. Although the CNB will remain hawkish and continue to support a stronger CZK, the scope from current levels is limited, and we will see a rather slow grind lower. Thus, reaching 24.500 may take more time than before.

In rates, we have seen significant hawkish repricing in recent weeks, which we believe has been caused by a positioning squeeze of earlier receiving flow. Therefore, arguably, the current aggressive high levels may not faithfully reflect the current market view, and the market will likely look for chances to receive rates again here from these levels. While the CNB's messaging offers limited justification for such positioning, we maintain a contrarian view, seeing any dip in rates as a good opportunity to pay rates at better levels.

Still, the very front-end FRAs up to a 12-month horizon are still a few points below PRIBOR fixing. At the same time, the fixing should be above the CNB rate of 3.50% and the spread should start widening after the August meeting. So there is still room for some flattening against the belly curve as well.

Author

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

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