Czech National Bank preview: Hawkish in all scenarios

The May decision will depend on the inflation figure published the day before the meeting. We expect a 25bp rate cut accompanied by a hawkish tone and some votes for a pause. However, an upside surprise in inflation would mean another pause in the cutting cycle. Overall, our forecast remains on the hawkish side of the market

The Czech National Bank cut rates by 25bp, but the end of the rate-cutting cycle is near

Rate cut to be decided by April inflation print the day before the meeting

The Czech National Bank will hold its third meeting this year on 7 May. In addition to the decision itself, the focus will also be on the central bank's new forecast and forward guidance on inflation risks and the impact of trade wars on the Czech economy. We expect the CNB to cut rates by 25bp to 3.50%, but the latest numbers from the economy and the Board's communication clearly show that the probability of leaving rates unchanged is high. In any case, we should see some votes for no change, to make the decision as hawkish as possible.

Although most of the new data from the economy in recent weeks are surprising to the upside, the main number, April inflation, will be released on Tuesday, 6 May, the day before the CNB meeting which will decide the central bank's next move. We expect a drop from 2.7% to 2.2% year-on-year, which should probably be enough for a rate cut, but any upside surprise could tip the central bank's view to the no change side. However, further inflation developments are more complicated given the almost certain rise in inflation in May due to the TV fee hike (0.1-0.2pp) and base effect from last year. And the upside risk to inflation remains housing and food prices. Record-high new mortgage originations in March and continued growth in agricultural prices indicate continued growth in imputed rents and food prices in CPI in the months ahead.

3.50%

CNB key rate

25bp rate cut expected

We should see this in the new CNB forecast and revisions compared to the February version. While core inflation was in line with the central bank's forecast, headline inflation, especially in January and February, was higher. On the other hand, the economy was stronger in 4Q24 and 1Q25 by about 0.4-0.5pp in YoY terms and EUR/CZK was lower by roughly 0.5% vs the CNB forecast.

Foreign assumptions have also changed significantly from the February forecast. EURIBOR and oil prices are likely to see a downward revision, on the other hand EUR/USD up, which would support a dovish case for the CNB. However, the main question will be how the CNB incorporates the impact of US tariffs on the economy. This will likely be most visible in the GDP estimate, which despite better data and German fiscal expansion, will be revised slightly down from the current 2%.

We remain on the hawkish side of the forecast and the market

Our forecast has been on the hawkish side for a long time with stronger economic growth and higher inflation compared to the CNB forecast. This has so far been confirmed by incoming data from the economy with stronger domestic demand and inflationary pressures than the central bank had expected. The key question is how sensitive the CNB will be to the global environment or whether domestic conditions will remain a major factor in decision-making. We have downgraded domestic economic growth from 2.4% to 2.1% (still above consensus) due to US tariffs, but our inflation forecast points to a rebound close to 3% in June and core inflation should see some rebound as well. Therefore, it appears that the potential May rate cut may be the last. For now, we are keeping the August rate cut in our forecast, but this will be subject to revision depending on central bank communication next week, which would move the terminal rate from 3.25% to 3.50% in our forecast, in both cases well above market pricing. Overall, we can say that the CNB will decide between a hawkish local story and a dovish foreign story.

Our market views

Given our hawkish view on the CNB we have been bullish on the koruna for quite some time and this remains our view. The market has moved significantly to the dovish side on CNB policy rates after the US 'Liberation Day' and we think next week's hawkish meeting will be a good opportunity for market repricing. Already since early April, the CZK has shown the biggest recovery within the CEE region and we think this trend will continue, outperforming peers. In the event of a rate cut accompanied by hawkish rhetoric and some voice for no change, we see EUR/CZK in the 24.800-900 range. In the event of a no rate cut, we see EUR/CZK falling into the 24.600-700 range.

In the rates space, the story is a bit more interesting due to aggressive market bets on CNB rate cuts. The priced terminal rate has fallen from around 3.25% to 2.75% at its lowest point in mid-April. After hawkish comments from the Board we saw some repricing up to somewhere between 2.75-3.00%, if we assume PRIBOR above the CNB rate at the end of the cycle. We believe both scenarios discussed would lead to hawkish repricing, especially at the front of the curve and some flattening. From this perspective, we see an attractive risk-reward given the very low chance of a dovish sounding CNB meeting next week.

In the bond space, we continue to see a positive issuance story and relatively cheap valuations for Czech government bonds. Since the March Bund sell-off, CZGBs remain cheap in our view, underperforming the IRS curve. Thus, it is ASW that should benefit most from the hawkish CNB and positive fiscal story. Therefore, the long end of the bond curve remains our favourite within the CEE region.

Author

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

Disclaimer