

## Czech National Bank preview: How to change the market's mind

A change in rates is not on the table but the CNB will present a new forecast, which we believe is the last chance to change the market's dovish expectations. Looking ahead, we expect the first cut to come in November, but the inflation profile complicates things. The koruna is above the pain threshold of the central bank



The building of the Czech National Bank in Prague

### New forecast is the centre of attention

The Czech National Bank's monetary policy meeting will take place on Thursday next week and a rate change is not on the table this time either, in our view. However, we think it should be one of the most interesting sessions this year. Firstly, rapid disinflation opens up the question of a first rate cut; secondly, the record weak koruna in turn raises the question of intervention and postponement of rate cuts; and thirdly, the CNB will release a new forecast that may be the central bank's last attempt to reverse very dovish market expectations.

Since the decision itself does not have much potential to surprise, the main focus will be on the governor's press conference and the new CNB forecast. While it cannot be ruled out that some members will still vote for a rate hike, our baseline scenario assumes a unanimous leave rates unchanged decision.

# 7.00%

CNB 2W repo rate

No change

The outlook for the economy should be revised down given that economic and wage growth surprised to the downside in the first quarter. On the other hand, headline inflation surprised to the downside in the second quarter by 0.4 percentage points on average and core inflation by 0.5pp. So together these should imply a slightly downward change in the inflation profile. The koruna on average was broadly in line with the CNB's forecast in the second quarter and we assume that the current record weaker levels will not be included in the new forecast due to the data cut-off. We can also see a big change in the forecast on the assumptions for the external environment, particularly on producer prices to the downside and the European Central Bank rate to the upside.

This mix should result in a big revision to the interest rate path in our view. The current forecast implies roughly 150bp of rate cuts this year. We expect the forecast to continue to imply rate cuts but in significantly smaller volumes. We can also expect alternative scenarios, which the board has been keen to show its preference for over the official staff forecast in recent months.

## First cut in November but inflation profile makes it complicated

The current inflation trend opens the question of the first rate cut, which will be the main topic of the CNB meeting for the markets next week. Our forecast remains unchanged, i.e. a first rate cut of 25bp in November. However, the inflation profile is very tricky and in addition, the current weakness in the CZK may also be a problem for the board. Thus, we see a risk of delaying this move until the first quarter of next year.

Inflation is expected to fall close to 7% year-on-year in September, according to our forecast, however, the base effect will turn against the CNB in October due to the government measures last year. Thus, we could see prices jump back to 9% in October despite essentially month-on-month price stability, and remain around 8% by year-end. On the other hand, for January, we expect inflation to fall into the 2-3% range thanks to the base effect from this year and the significant repricing of energy prices. In addition, newly, the energy companies in the Czech Republic will allow fixed contract customers to switch to lower prices below the government's cap in January, which should facilitate the transmission of lower energy prices into the CPI.

## What to expect in FX and rates markets

The Czech koruna touched its weakest level since the beginning of the year above 24.0 EUR/CZK following comments by the CNB deputy governor on the expected weakening of the koruna. We generally believe that at the moment the 24.0 level is a pain threshold for the CNB and may actually be a reason to delay cutting rates. As FX has become a main pillar of monetary policy, we may hear some comments in support of the CZK. We also still have a view that the CNB may intervene at lower EUR/CZK levels than we have seen in the past year if the koruna continues to weaken.

The rates market has fully switched into a cutting-cycle mode and is steadily boosting bets

for a rate cuts and is currently pricing in roughly a 120bp cut this year. By the end of next year, the market expects the CNB base rate to hit 3.50%, so we can say that almost the entire cutting cycle is already priced in within a year and a half. We expect the CNB to try to send a hawkish signal and move expectations from this year to next year. The central bank doesn't have much ammunition up its sleeve at the moment, but we still rather prefer the payers side of the market ahead of the meeting.

## Author

**Frantisek Taborsky**

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).