

Czech National Bank preview: Last meeting before first rate cut

The CNB is starting to discuss the possibility of cutting rates and we believe that conditions will allow the first cut as early as November. In any case, the board will want to stay on the cautious side, and the tone of the press conference will reflect that. However, the CNB has little to offer from its hawkish arsenal given that a cut is only a matter of time now



EUR/CZK is pointing in an inflationary direction

The debate on rate cuts begins

The Czech National Bank (CNB) will hold its monetary policy meeting next Wednesday, which we believe will be the last one before the vote on cutting rates. This time there will be no new central bank forecast and the board will only discuss an internal update on the situation.

For now, it seems that the CNB is happy with the numbers coming out of the economy. Economic growth was slightly above expectations in the second quarter, on the other hand, wage growth and headline and core inflation are below the central bank's forecast. Only EUR/CZK is pointing in an inflationary direction with weakening after the August CNB meeting, and more recently after the National Bank of Poland's (NBP's) surprise decision (of a 75bp rate cut) in early September.

However, the CNB was expecting this direction, and based on recent communication we believe FX is not a game-changer.

7.00% CNB 2W Repo Rate
No change

Board members have already indicated that the September meeting will be used to discuss the rate-cutting strategy, so we could see some details from this discussion. In any case, the CNB will try to sell future rate cuts with a hawkish and cautious tone. However, we doubt that the central bank has anything more to offer from its hawkish arsenal to the markets, especially in the context of the current shift in market expectations towards a later rate cut.

Moreover, the central bank's recent moves – the end of the FX intervention regime and the easing of capital and mortgage requirements – indicate a dovish bias of the board.

First rate cut in November

Our forecast remains unchanged – the first 25bp rate cut in November along with a new central bank forecast. Of course, the risks here are clear. The central bank could wait for the January inflation number and cut rates at the start of next year. However, we believe that the combination of faster-falling inflation, weak economic numbers and FX at current or stronger levels will be a reason for the board to cut rates in November and avoid too much monetary tightening and inflation near the target in January.

Looking ahead, we don't expect there to be more than two 25bp rate cuts (in November and December) before the January inflation number is released (after the February meeting). Further down the line, however, we expect the CNB to gradually increase the pace of cuts if the numbers confirm inflation is near the 2% target.

What to expect in FX and rates markets

In the FX market, the Czech koruna suffered a depreciation after the end of the CNB's exchange rate regime in August and the NBP's surprise rate cut in September. In particular, due to the spillover shock within the region in the last few weeks, we believe EUR/CZK should be lower and are slightly positive on the CZK. This should be supported by the CNB's cautious tone next week. Of course, EUR/CZK levels will play a key role in the November decision and we believe the pain threshold for the CNB to delay rate cuts until the first quarter of next year is 25.0 EUR/CZK.

In the rates market, we see the pricing of rate cuts in the short term, within two years, as more or less fair. If anything, we see less chance of big rate cuts in the first quarter, as the market currently expects. On the other hand, we see the biggest mispricing at the long end of the curve, which has out-priced a CNB return to the 3% equilibrium rate level. Thus, the IRS curve now points to rates above 4% in the long term and we see room for downward repricing here once rate-cutting discussions begin next week.

Czech government bond (CZGBs) yields have moved higher following the sell-off in core markets, which we believe opens up a good opportunity to benefit from a clearly positive outlook. On the supply side, MinFin is already limiting issuance as the year-end approaches and the better-than-expected state budget result. In addition, MinFin is now starting to frontload next year's needs through switches, confirming a comfortable situation with nearly 75% of the CZGBs plan covered.

Thus, we see the current yield as attractive ahead of the materialisation of a massive supply drop next year and by far the best inflation profile in the CEE region followed by the CNB rate cuts. Thus, we like CZGBs both outright and in the spread versus the IRS curve, which should head into negative territory in the coming months, in our view.

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