

## Czech National Bank preview: the end of a hawkish era

22 June will be the last meeting of the board in its current hawkish composition. We expect an interest rate hike of 125bp. We see risks balanced on both sides. After 1 July, the new board will change communication to rate stability and wait for a signal to cut rates. In our view, FX interventions will continue regardless of the view of the new board



We believe that the depreciation pressure on the koruna will continue

**+125bp** Change in the key rate  
ING forecast

### What to expect from the hawks at their last meeting

On 22 June, the Czech National Bank (CNB) Board will hold its last meeting in its current

composition. Things have changed dramatically since the May meeting, both in terms of economic conditions and at the CNB itself. From a macroeconomic perspective, 1Q GDP showed 0.9% quarter-on-quarter growth, while the central bank had expected 0.0% in its May forecast. EUR/CZK is 2.5% stronger than CNB expectations for 2Q and inflation deviation from forecast came in at 1.1pp (16% year-on-year) in May. Thus, the overall picture of the economy is better than expected while inflationary pressures are visibly rising further.

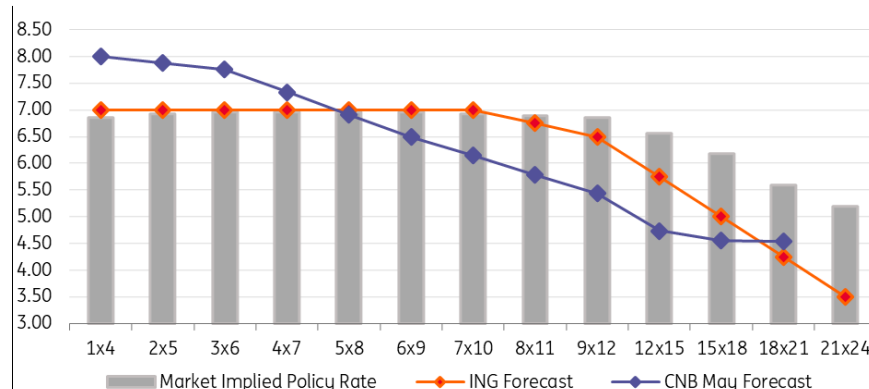
The June meeting will thus, in our view, bring another 125bp hike in the key interest rate to 7.0%. We see the risks to our call balanced on both sides this time. The significant slowdown in the mortgage market in recent months (new mortgages dropped by 40% month-on-month in April) argues for a smaller move. On the other hand, given the changes in the CNB board and the last meeting with the current composition, the frontloading aspect may support a bolder move. Still, the May forecast expects interest rates to rise above 8%. And as we enter the blackout window for CNB communication, some of the last words come from board member Tomas Holub. Today he described the market pricing of a 100bp hike at the June meeting as 'rational'.

## What comes after 1 July?

The new composition of the board seems, according to the first indications, to be a clear dovish shift in the CNB's monetary policy. In his first speech, the new governor pledged to propose interest rate stability at the first meeting under his leadership on 4 August. On the one hand, the new dovish board has good timing for its starting point, as the CNB expects inflation to peak in these months and a drop in the headline number would thus allow for an easy change in communication. On the other hand, as we mentioned before, we are increasingly skeptical about a peak in inflation due to the new announcements of energy price hikes from major suppliers in the country and the continued rise in fuel prices despite the excise tax cut since early June.

Thus, given the lag in data releases, we expect that the initial dovish tone of the new board may be replaced by a wait-and-see mode later on. At the same time, however, we must keep in mind that the current forecast already implies a CNB interest rate cut this year. Inflation will one day peak and this will mean the beginning of interest rate cuts for the central bank's model. Then it will just be a question of how long the new board will delay in following the CNB staff's recommendations. Given the near-zero insight the market has into the new board members, it is impossible to draw a clear conclusion now. However, we continue to believe that the market is still underestimating the current CNB transformation to a dovish stance and that the first rate cut will come earlier than the middle of next year, as the market currently expects. For now, it seems to us that the turn of the year may be an opportunity to show the full force of this dovish shift for the first rate cut, given that the full effect of the comparative base from this year will already be showing up in inflation.

## Czech FRA curve expectations



Source: Refinitiv, ING

## What to expect in FX and rates markets

We expect that the June meeting may be the last signal for interest rate payers, and the first market clash with the new board in August may be a reason to reprice expectations to the downside, which will result in a steepening of the curve. On the other hand, the later peak in inflation is likely to make the road to the downside bumpy and difficult for the market to find a new direction, especially in a low summer liquidity environment.

On the FX side, we expect the new CNB board to be more open to FX interventions and more market activity. However, regardless of the new board's view, we believe that the depreciation pressure on the koruna will continue. So FX interventions are inevitable if the CNB is serious about inflation targeting. Therefore, we continue to expect the koruna below EUR/CZK 25.0 and we cannot rule out that the central bank will try to move the koruna closer to EUR/CZK 24.50 due to the higher and later peak of inflation. However, we do not see much reason why the koruna should naturally appreciate given the peak in the interest rate differential.

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