# Czech National Bank Preview: The magnificent seven

We do not expect any further CNB interest rate hikes. The new forecast should show lower inflation but also higher wage growth. The cost of FX intervention is low enough to continue to play a major monetary policy role. However, together with high wage growth, they remain for us as the main risk of a potential additional rate hike


The Czech National Bank in Prague

## Lower inflation gives doves enough buffer

The third monetary policy meeting under the new CNB leadership will take place on Thursday next week. We expect interest rates to remain unchanged. Thus, the central bank's new forecast will be the main focus. Compared to the August forecast, we see the biggest deviation in inflation, which surprised to the downside. In September, this deviation came in at 2.4 percentage points. Therefore, here we can expect the biggest downward revision in the new forecast. The government's new energy measures should also come into play to bring inflation down artificially. However, given the statistical office's unclear approach, the question is how the CNB will take into account this change. On the other hand, wage growth surprised to the upside by 1.7pp in the second quarter compared to the CNB forecast. Moreover, the monthly numbers show a further acceleration in the third quarter. In doing so, wage growth has become the main focus of the board as a reason for a potential additional interest rate hike.

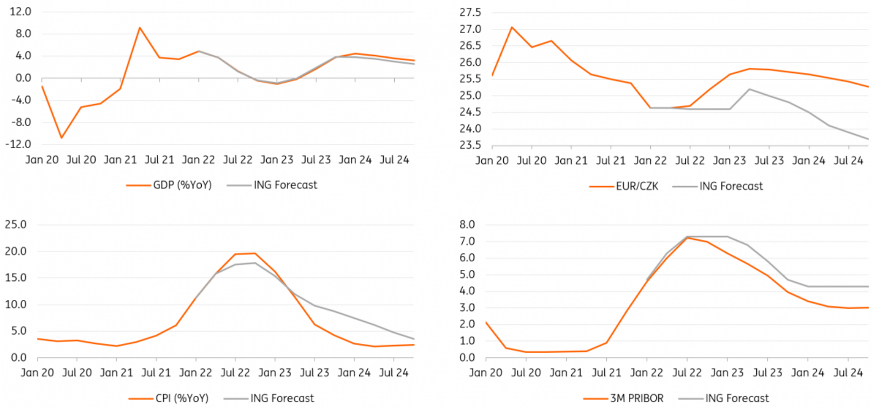
7.00%

CNB's key policy rate

We expect no change next week

Nevertheless, the interest rate forecast can be expected to remain roughly similar to the CNB's summer version, indicating a rate cut already in the next quarter due to the nature of the central bank's model. On the FX side, we don't expect much change in the forecast weakening trajectory of the koruna under the pressure of the declining interest rate differential. However, we don't see much implication for FX interventions, which are fully decoupled from the CNB forecast and depend only on the discretionary decision of the board. But, at the moment, we see the CNB in a comfortable position with no reason to change anything about the current regime.

## CNB summer forecast

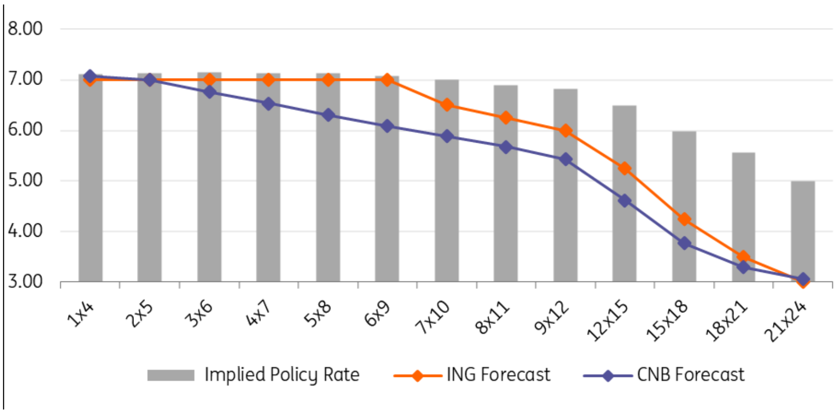



Source: Macrobond, ING forecast

## We see little risk of a rate hike in the future, but remain vigilant

In the long run, we do not expect any further CNB rate hikes. Despite the board's highlighting of the wage-inflation risk, we believe that the stability or decline in annual inflation combined with a weaker economy will be enough in coming months for the CNB to confirm the end of the rate hike cycle at future meetings. In the meantime, the main monetary policy tool will remain FX intervention, the cost of which we believe is low enough for now (around 19% of FX reserves). However, while we see the risks of additional rate hikes as low, we think the key will be the further development of wage growth and the cost of FX intervention, which we will monitor closely in the coming months.

## Czech FRA curve expectations




Source: Refinitiv, ING

## What to expect in rates and FX markets

The market retains a small chance (less than 50%) of a rate hike at the next meeting or possibly at subsequent meetings until the end of the first quarter of next year. Market expectations are that the CNB should then start cutting rates in the second half of 2023, later than we expect. However, given the CNB's current limited communication regarding next year, we do not see much opportunity at the short end of the curve. Therefore, we prefer to look at the long end, which we believe reopens the opportunity for ratepayers thanks to the current global rally, and next week's CNB meeting could bring tempting levels due to the central bank's dovish tone.

On the bond side, Czech government bonds (CZGBs) have cheapened significantly, but we see that there is still a need to cover high financing needs this year and recent fiscal headlines are also not supporting buyers. Moreover, we expect the global sell-off to continue after the temporary current pause, which will bring further pain to the Czech bond market. However, we remain constructive and believe that the moment for buyers will come when funding strategy becomes clearer in the deluge of budget changes. In addition, the risk of a sovereign rating downgrade has been averted for this year, which may attract investors back into CZGBs at the end of the global sell-off.

On the FX side, the CNB remains the main driver, remaining active in the 24.60-70 EUR/CZK levels according to our estimates. The market can be expected to build short koruna positions again ahead of next week's meeting in anticipation of changes in the FX regime. However, we do not expect any changes and anticipate a similar scenario after the CNB meeting as in the case of the last two meetings, i.e. liquidation of short positions and a stronger koruna.

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