Czech National Bank Review: Copy paste but still different

The Czech National Bank confirmed its hawkish tone despite the current global turbulence. The governor considers discussions on rate cuts to be premature. We expect to see the same tone in the coming months, which should support the koruna

Czech National Bank in Prague

Discussions on rate cuts are premature according to the CNB

The CNB board decided today to keep the key interest rate at 7.00%, in line with expectations. Also without surprise, six of the seven members were in favour of the decision, while one voted for a 25bp rate hike. The board also confirmed that it would "continue to prevent excessive fluctuations of the koruna".

7.00%

CNB's key policy rate

No change

As expected

During the press conference, the governor said that the highest interest rates since 1999 had dampened inflationary pressures in the economy and that real interest rates, taking into account inflation expectations over a one-year horizon, had risen to positive levels for the first time in a long time. However, despite seeing signs that inflationary pressures are easing, the board still intends to keep interest rates high and will again decide at its next meeting whether to leave rates unchanged or raise them. From this perspective, today's meeting is essentially a carbon copy of the February meeting.

On the other hand, almost two months have passed since the February meeting, during which time much has changed in the global story. Thus, in our view, the board has been gradually increasing a hawkish tone if we take into account the global context, which cannot be ignored. The governor during the press conference commented on market expectations of a peak in interest rates at current levels and a significant rate cut this year (roughly 125bp in cuts priced in before the meeting). However, according to the governor, a rate hike cannot be ruled out and rate cut expectations are premature at this point.

Hawkish tone to continue until the end of the first half of the year

We do not expect the board to decide on an additional rate hike, however, it is true that the monthly data for January indicates strong wage momentum, which may push the board to make further hawkish statements. On the other hand, March inflation should show the first significant fall in year-on-year terms and very little rise in month-on-month terms, which should reassure the CNB that inflation is indeed starting to fall. However, we cannot expect any change in rhetoric for the coming months and we can expect no change until at least the end of June, when the board might already have enough numbers in hand and ease off the gas from the hawkish rhetoric. However, cutting interest rates is more likely to be a topic for the autumn meeting or the end of the year.

What to expect in rates and FX markets

The Czech koruna visibly welcomed the CNB's hawkish tone and moved below 23.60 EUR/CZK for the first time since the sell-off in global markets two weeks ago. The central bank has confirmed that it is ready to intervene if needed, but current levels are far from where the CNB was last active. On the other hand, the central bank's statement is clearly supportive for the koruna and implies that the koruna is safe in the event of a global sell-off. Moreover, with the prospect of higher rates for a longer period of time, a solid FX carry is also certain. Overall, the koruna thus offers decent risk/reward and we expect it to strengthen further.

The market reacted to the clear hawkish message with a rise in the IRS curve, especially at the short end, and reassessed expectations of rate cuts somewhat. However, the market does not seem to want to completely abandon its bet on rate cuts supported by global sentiment. We expect it will take a few days for the dust to settle and for the market to depreciate more, but we do not expect it to completely change current dovish expectations. Thus, in the short term, we may see the curve flatter and higher, but the medium- and long-term direction is lower and steeper, in our view.

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