Czech National Bank Review: First in, first out

The central bank confirmed its August decision not to raise rates further but kept the door open if wage growth crosses the pain threshold. We consider the hiking cycle to be over. The CNB is the first in the Central and Eastern European region to stop raising rates, with monetary policy now conducted through FX intervention

The Czech National Bank in Prague

End of hiking cycle confirmed

The CNB left interest rates unchanged at 7.00% today in line with expectations. Five members voted for this decision, while two members voted for a 75bp rate hike (100bp in August). At the press conference, the governor highlighted inflationary pressures from foreign and domestic economies, a strong labour market and resilient industrial production. On the other hand, he also mentioned the negative impact of foreign trade on GDP and negative leading indicators indicating a slowdown in foreign demand.

7.00%

CNB's key policy rate

No change

As expected

The bank board assessed the risks as high but balanced on both sides. The CNB sees faster wage growth, expansionary fiscal policy, higher producer prices abroad and unanchoring inflation expectations as upside risks. On the other hand, the central bank sees as anti-inflationary the rising likelihood of a recession abroad, a stronger-than-expected decline in domestic demand and investment, the introduction of an energy price cap, and a faster-than-expected decline in core inflation. While the list of risks was 3:2 in favour of pro-inflationary risks in August, this time the score is 4:4. In addition, the board sees uncertainties such as the war in Ukraine, energy availability and future monetary policy developments abroad.

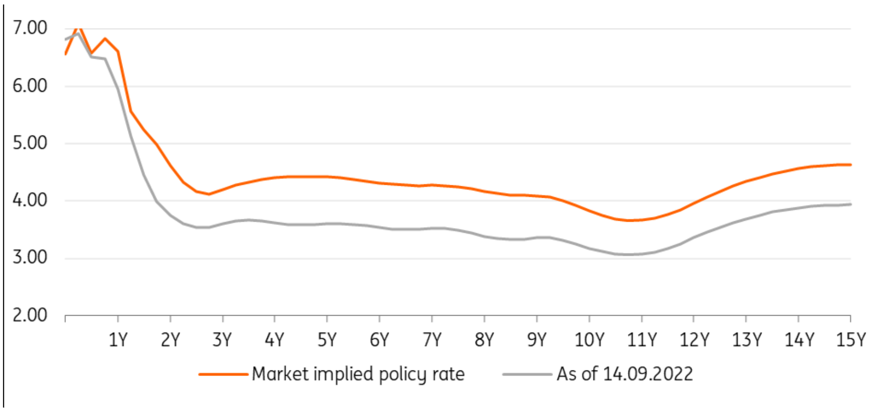
Rates will remain high for longer

As a result, the August rate stability was confirmed with the door open to react if necessary. According to the governor, the main trigger for an additional rate hike would be stronger wage growth stemming from wage negotiations and fiscal policy. However, a specific pain threshold level has not been set and the governor said each board member sees it differently. Compared to the August meeting, we see this as more likely and will need to monitor the incoming numbers closely. However, our baseline scenario of the end of the hiking cycle remains unchanged. Third quarter wage growth will not be released until early December when we should already see inflation slowing, or at least see a clear peak, and the central bank will not react in our view. In the long run, the governor said rates should remain high for longer, but we did not get more details and this topic was not discussed today.

FX intervention continues without blinking an eye

On the FX front, the governor made it quite clear that FX intervention will continue, and declined to comment on any details during the press conference. Thus, our forecast remains unchanged and we expect the CNB to continue with the current regime. Bank liquidity statistics show, according to our calculations, that the central bank returned to the market last week for the first time since the August meeting, spending around EUR0.5bn. This week it was probably several times more, but we will have to wait until the end of next week for the numbers. For now, we see enough buffer to continue the FX intervention.

Long-term market implied CNB rate



Source: Refinitiv, ING estimate

What to expect in rates and FX markets

The IRS curve moved 0-17bp higher today, resulting in a massive bear steepening. However, the larger half of the move is on account of global developments and rising core rates. We also found the FRA curve slightly higher after the press conference given the CNB's indication that rates will stay high for longer. Like the CNB forecast, our strategy remains unchanged: a steeper curve led by the long end higher. The market sees the CNB rate at around 4% in the long run, which we believe still has the potential to go up, supported by rising core rates.

On the bond side, CZGBs yields continue to rise under the pressure of high supply and global events. In asset spread terms, CZGBs at the long end of the curve have reached their widest levels since last March. However, we believe the sell-off is not over and still see a bit of room to move higher. CZGB supply remains strong in October and global conditions are also not helping to stop the pressure. However, we believe we are close to the peak.

The CNB confirmed very clearly that it intends to continue FX intervention, which led to a massive closing of short CZK positions. Shortly after the end of the press conference, the koruna reached its strongest levels since mid-September, repeating the same scenario as in August. Given the global developments, we believe that the koruna will return to weaker levels near the CNB's intervention levels of 24.60-70 soon and the market will test the central bank's patience again. However, we believe the CNB has enough ammunition to fight it for now.

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