Czech National Bank Review: Hawks sign off with 125bp

The Czech National Bank (CNB) today raised the key interest rate by 125bps to 7.00% as expected. However, today's meeting did not bring any clarity regarding the new board's next steps. Nothing has changed in our view and we continue to believe that the market is underestimating the new board's willingness to cut interest rates earlier.

Source: Shutterstock

7.00% CNB's new policy rate

+125bp

Final meeting of the hawks delivers a sharp rate hike

As expected, the CNB today raised its key interest rate by 125bps to 7.00%, the highest level since

1999. This was also the seventh consecutive above-standard hike, of more than 25bps. Unsurprisingly, five board members voted in favour of the move and two members voted against. Details of the vote will be released on Friday next week, but we assume nothing has changed from previous voting patterns (with Michl and Dedek against the hike).

The press conference did not bring many surprises or news. According to the CNB Governor, today's decision did not "deviate" from the staff recommendation. Higher inflationary pressures simply called for another sharp rate hike. The Board assessed the risks to the forecast as "markedly inflationary". The CNB cited higher domestic and foreign prices, steep energy price increases, a weaker koruna, and a less restrictive fiscal policy as the main risks. The war in Ukraine and monetary policy abroad remain uncertainties for the CNB forecast. During the press conference, the governor did not want to comment much on the next steps given the changes in the CNB board which come into effect July 1.

However, he said the inflationary situation will not deteriorate further but he would not put any ceiling on interest rates just in case. On the other hand, the board decided today that it would not change anything about the central bank's current approach to FX interventions. According to the governor, they assess the situation on a weekly basis and are satisfied with the current situation. Here the market assumes the CNB continues to offer euros near the CZK24.70/75 area.

> *"Restoring price stability soon is now the CNB's absolute priority and is a necessary condition for the long-term prosperity of the Czech economy"*

CNB Board statment

Clean separation between two CNB eras, without any forward guidance

Today's CNB meeting did not tell us anything new about the future steps of the new board and therefore nothing has changed in our outlook and strategy. The new board can afford a dovish shift given the expected peak in inflation in the coming months. On the other hand, due to energy and fuel prices, inflation is likely to peak later or the deceleration in inflation will not be what the CNB expected.

Combined with the change in central bank communication, it will not be easy for the market to find a clear path. We assume that today's rate hike was the last in the current hiking cycle and the pain threshold of the new board for any further rate hikes is high. On the other hand, we expect the approach to FX intervention to remain unchanged despite rising costs. In the longer term, we continue to believe that the market is still underestimating the CNB's 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.

Author

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Disclaimer