Czech National Bank Review: Rates higher for longer

The Czech National Bank keeps rates unchanged at 7.0%. The CNB's new winter forecast suggests headline inflation accelerating from 15.8% to 17.4% year-on-year, then a gradual moderation to 7.6% in the fourth quarter this year. The CNB is likely to keep rates at 7% for a longer period

The Czech National Bank in Prague

7.00%

CNB's key policy rate

No change

As expected

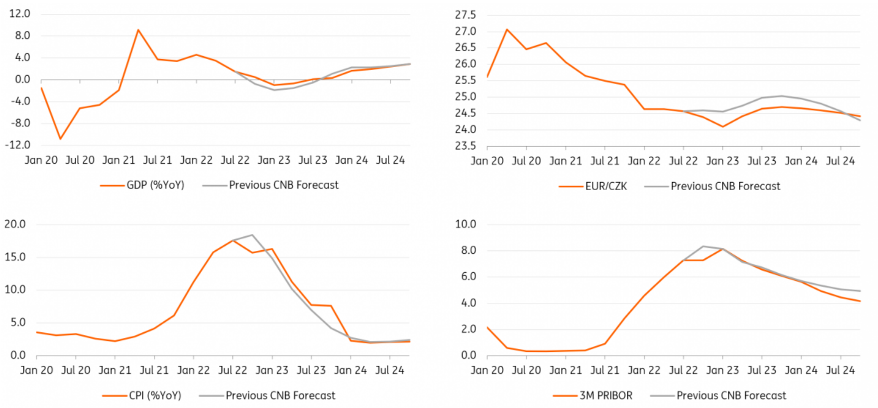
CNB on hold, inflation to pick up to 17.6%

Unsurprisingly, the Czech National Bank kept its interest rate unchanged in its February monetary policy meeting. Two board members voted for 50bp (very likely Tomas Holub and Marek Mora). The previous hiking cycle finished last June, when the hawkish bank board of CNB Governor

Rusnok hiked by 125bp to 7%. Since the start of dovish Governor Michl's term, the new bank board has kept interest rates unchanged.

The new CNB outlook forecasts inflation to pick to 17.6% in January and to decline relatively swiftly from spring towards 7.6% in the last quarter of this year. After a market drop of headline inflation to 2.3% in the first quarter of 2024 the CNB forecast suggests it being mostly flat throughout the whole remainder of the next year. The CNB forecast of GDP shows a shallow recession to end in the second quarter, followed by soft recovery thereafter. Hence the overall GDP growth in 2023 is expected at 0.3%.

New CNB forecast



Source: CNB

Board diverges from rate forecast on hawkish side

The forecast implies additional hikes by roughly 100bp in the first quarter followed by 200bp cuts until year-end. According to Governor Michl, however, the board preferred to keep key interest rates unchanged for longer, having regard to the sensitivity scenario which will be presented on Friday, 3 February. In this simulation, inflation falls close to the inflation target in the first half of next year as well. The Governor said the risk of current FX strength for export performance and economic recovery is given lesser weight compared to the priority to slash inflation back to the target.

The outcome of today's CNB board meeting is an interesting mix of dovish/hawkish stance. Refusing a rate hike suggested by the new forecast on the one hand, and a resolution to keep rates rather higher compared to forecasts on current already high levels for longer period. It seems the possible reduction in interest rates is limited this year, maybe 50bp or less, while the first possible cut could be delivered in August, a symbolic 25bp, while in the fourth quarter we may see another 25bp in November.

What to expect in rates and FX markets

Today's meeting gave the koruna another reason to maintain its current record strong values. The intervention regime seems to be here to stay for a longer period of time, and its abolition is out of the question at the moment. Although the CNB last intervened in September last year in our view, the central bank's presence in the market will continue to play a key role. However, as we mentioned in our preview, the main driver at the moment, in our view, are global factors – falling gas prices and a higher EUR/USD. Thus, the CNB is more of a complementary factor why to be positive on the koruna. Moreover, the koruna still offers decent and stable carry. Thus, the main enemy at the moment is the market positioning, which was already the most long in CEE before the CNB meeting in our view. Thus, the koruna may test stronger levels in the short term but the EUR/CZK move lower is limited in our view and the koruna will be rather stable compared to CEE peers.

The premature dovish expectations we highlighted in our preview got a direct hit after today's meeting from the CNB governor saying that market expectations are wrong and rates will be higher than the market expects. In addition, next week we will see January inflation which should be on the higher side and support a reassessment of current expectations. On the other hand, the long end of the IRS curve is being pulled down by core rates, which leads us to flatteners as the best positioning for the coming weeks.

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