

## Czech National Bank Review: The governor delivered what he promised

The CNB delivered exactly what it promised, the first stable rate decision since the middle of last year. Although the new governor has not completely ruled out additional rate hikes, we believe the hiking cycle ended in June. Only a global sell-off in EM currencies would push the CNB to raise rates additionally, in our view



The Czech National Bank in Prague

# 7.00%

CNB's key policy rate

No change

### CNB confirmed its dovish shift

The CNB left interest rates unchanged today, in line with [our expectations](#). Five members voted in favour of the decision, with two voting for a 100bp rate hike. The details of the vote will be released next week; however, from previous statements it is almost certain that Marek Mora and Tomas Holub voted for the rate hike.

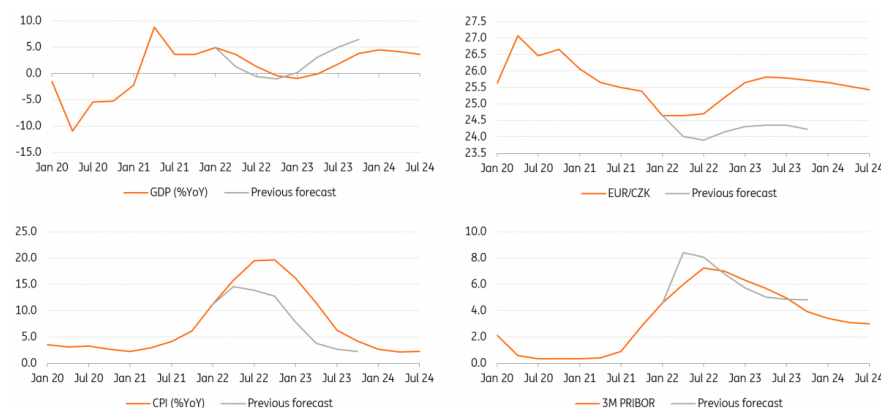
During the press conference, for the first time led by new governor Ales Michl, the CNB's summer forecast was presented. It brought an extension of the monetary policy horizon from 12-18 months to 18-24 months in its baseline scenario as we could only see in May an alternative scenario. With no surprises, inflation moved up in the CNB forecast and is expected to peak in September at 20.4% year-on-year. However, the main shift was in inflation for next year, moving from 4.1% to 9.5% on average. GDP growth was improved from 0.8% to 2.3% this year and downgraded from 3.6% to 1.1% next year. However, under these conditions, the CNB sees the key rate lower than previously forecast, with the peak at the current 7.0% and the first cut implied by the forecast in the fourth quarter of this year. For the koruna, this scenario should imply a depreciation above the 25.00 EUR/CZK level in 4Q and remain around the 25.60 EUR/CZK level throughout the forecast horizon.

In addition to the stability of rates, this time the Board's statement also included a sentence on the CNB's continued intention to "prevent excessive fluctuations of the koruna exchange rate". The Governor did not want to comment more on FX interventions during the press conference, but it is clear that the exchange rate has become the main tool of monetary policy.

*"It is almost certain that annual inflation will reach around 20% by the end of this year. However, the central bank can no longer influence that now."*

CNB governor

## CNB summer forecast



Source: CNB, ING

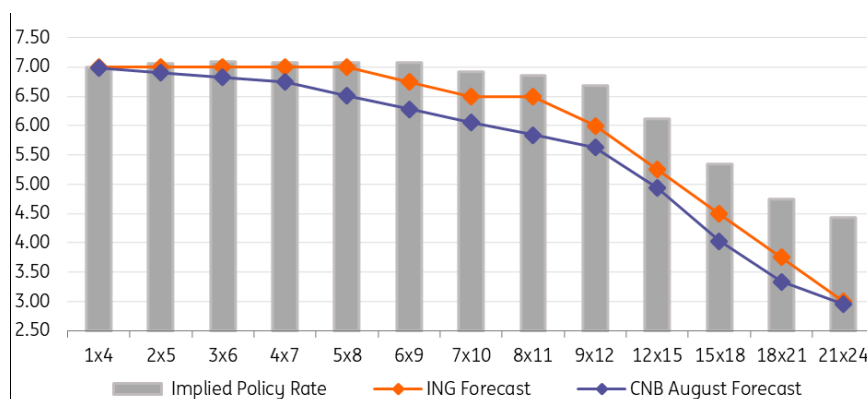
## Rate hike possible only if global risks materialise

Today's CNB meeting confirmed the transformation from hawk to dove and, in our view, showed that the new board is not willing to hike rates now or in the future. Thus, we see no change in our forecast and continue to expect the CNB to no longer raise rates. Although the governor mentioned during the press conference that further rate hikes are not out of the question and will depend on incoming data from the economy, we believe that global developments and pressure on the koruna are key at the moment.

The CNB expects inflation to reach 20% YoY and we believe the pain threshold is high enough to accommodate any upside surprises. Therefore, in our view, only the excessive cost of FX intervention may push the CNB to hike rates again. So the right question is where is the pain threshold of the new board for spent FX reserves. We think it is above 30% of all FX reserves, which is far from current levels (according to [our calculation](#) 12% of FX reserves since mid-May).

We can expect pressure on the koruna to increase in the coming days, however, we think sufficient pressure would be sparked by an EM-wide sell-off triggered by global events. Otherwise, we think the CNB can weather the period of record inflation and short koruna speculation in peace and start talking about rate cuts next year, motivated by the weak performance of the economy.

## Czech FRA curve expectations



Source: Refinitiv, ING

## What to expect in rates and FX markets

Short-term expectations within a year dropped by about 20-30bp in response to the decision and the long end of the curve to a lesser extent, resulting in a strong bull steepening. We expect this trend to continue and therefore continue to like the 2s10s steepener. After the CNB revealed the new cards it wants to play, we see that the risk of a rate hike is lower. At the same time, inflation rising to 20% is becoming a market view. Thus, an outright receiving position at the short end of curve also make sense.

Czech government bonds will get a boost from the ongoing rally in our view, but given the recent buying momentum across the Central and Eastern European region and the all-time record August supply, we see limited space for improvement. Asset spreads of the belly and long end of the curve indicate extremely tight market conditions, which may not allow a significant move lower in yields.

The koruna briefly looked towards 24.550 EUR/CZK just after the decision, likely due to closing short positions as hopes of a near end to the CNB intervention regime faded. However, after the press conference the koruna returned to just below 24.600 and we expect it to remain in this area. Later next week, we will have the first estimate of CNB FX reserves costs for this week, which could reveal how realistic it is that the central bank's new main policy tool becomes too painful.

## Author

**Frantisek Taborsky**

EMEA FX & FI Strategist

[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.