Czech National Bank likely to confirm end of hiking cycle

As in August, we expect the CNB to leave rates unchanged at the September meeting. Although the economic data has surprised on the upside, inflation has been below the central bank's forecast for the past two months. This provides an ample buffer for the central bank and we believe this rate hiking cycle is over

The Czech National Bank in Prague

No change in views, no change in rates

Next Thursday (29 September), the second monetary policy meeting will be held under the leadership of the new CNB board. Nothing has changed in our forecast since the last meeting and we expect rates to remain unchanged this time again. This is indicated by both the statements of the board members and the latest inflation numbers, which were well below the CNB forecast in July and August, and the same result can be expected from the September number (our preliminary forecast is 17.6% year-on-year). On the other hand, the GDP and wage numbers were higher than the CNB's forecast, but we still believe that lower-than-expected inflation provides an ample buffer for the current board. Thus, we do not see a significant risk of a change in the current CNB view for the coming months either.

7.00%

CNB's key policy rate

We expect no change next week

Although we do not expect another significant rise in inflation and the base effect should cover the potential increase in energy prices, a jump above 20% year-on-year still cannot be ruled out. However, in such a scenario, the reason would likely be the jump in energy prices, which the board would choose to ignore. Moreover, the CNB is also safe on the FX side at the moment. The depreciation pressure on the koruna has eased and the last significant central bank market activity was seen after the August meeting, according to our estimates. Thus, we do not expect anything to change in the board's current approach to FX intervention.

Okay, we're done here but what's next?

Given that we believe this rate hiking cycle ended in June, the question is what happens next, i.e. when should we expect the first rate cut and what is the new 'normal' level of rates? We expect this topic to come increasingly to the fore. We believe that just as the CNB was the first in the region to hike rates, it may be the first to cut rates. We believe this will be a theme for the first half of next year despite inflation still being around 10% year-on-year by then. The last three meetings of the year, however, could give us more clarity on the conditions in which the Board will be willing to cut rates and what level it sees as the new 'normal'.

What to expect in rates and FX markets

Markets have recently given up any bets on an additional CNB rate hike and at this point do not expect any change in the six-month horizon. The first rate cut is currently priced in for the second quarter of next year, close to our forecast. At the two-year horizon, the market expects CNB rates to still be above 4%, which we see as fair pricing at this point. Therefore, we consider the short end of the interest rate swap (IRS) curve done for now. On the other hand, the long end of the curve is trading well below its peak from June and below regional peers. At the same time, the entire region is getting significant support from rising core rates, which we believe will drive the long end of the curve higher. Hence, we have moved from the curve trades and now like the outright payers at the long end of the curve, which also offer a more favourable carryroll.

Czech government bonds (CZGBs) have cheapened a lot in recent weeks, and we are seeing buyers coming back. However, we believe that the strong supply will persist in October and furthermore, as with the IRS curve, CZGBs should follow the sell-off in developed markets. On the other hand, asset swaps are already indicating very wide levels. Therefore, we believe CZGBs yields are near local highs.

In the FX space, the koruna has returned to the CNB's intervention band of 24.60-70 EUR/CZK after the recent news from Russia, but so far there are no signs of much pressure for further depreciation or problems for the CNB's intervention regime. The falling interest rate differential does not indicate that the koruna will return to stronger levels. On the other hand, the relationship with the gas price remains strong, which may benefit the koruna if the geopolitical situation calms down. Thus, at the moment we see current levels as the peak, which may offer high carry for the koruna and a fixed base for cross-trades against the forint or zloty, which have more potential for losses.

Author

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