

## The Czech National Bank is sounding more hawkish

The CNB kept interest rates unchanged at 7%. However, the bank stresses the risks are skewed to the upside



### Unsurprisingly, the Czech central bank decided to keep interest rates unchanged

As expected, the CNB kept rates unchanged but there is a clear shift in the CNB's approach to the inflation environment. It is worth mentioning that the CNB improved its economic outlook for this year, expecting GDP to increase by 0.5%, compared with a -0.3% decline anticipated in its February forecast. Unlike in previous cases, this time three board members voted for a 25bp hike. In our view this can be assumed rather as support for the currency than a willingness to increase interest rates.

In a new forecast, the CNB raised its inflation forecast for this year upwards (from 10.8% to 11.2%) and remains unchanged at 2.1% on average for next year. GDP was raised from -0.3% to +0.5% for this year and from 2.2% to 3.0% for next year. Pribor's new interest rate forecast no longer assumes a rate hike but otherwise the path remains unchanged. However, the Governor mentioned that the Board is not looking to follow the rate forecast. The EUR/CZK forecast has been adjusted to the current stronger levels but otherwise, as in February, the CNB expects a return to

24.50. At the same time, however, the CNB also raised its estimate of full-year inflation to an average of 11%. The central bank also improved its forecast for the average exchange rate of the Czech koruna to EUR/CZK 23.70 this year, compared with EUR/CZK 24.5 in January. Next year, the koruna should weaken to an average of 24.30/EUR, according to the CNB's forecast.

The key element to follow will be wage development. Industrial wages grew more than 10% year-on-year in the beginning of the year. In addition, the CNB is concerned with a widening public deficit, which represents an imminent threat to inflation development. We assume the CNB will keep rates unchanged until August. A swift decline of core inflation can play a crucial role in the decision to cut interest rates in the summer. In our view, it is unlikely that a majority of the CNB board will vote for a rate hike. On the contrary, rate cuts are out of question until August, when the new summer forecast will be published and discussed.

## What to expect in FX and rates markets

The Czech koruna reacted with a slight strengthening after the end of the press conference. However, we expect the dust to take a while to settle and expect further strengthening of the koruna in the coming days. The interest rate differential has fallen by around 30bp at the short end of the curve versus eur rates and global conditions with a higher EUR/USD also supporting a further rally in the koruna. For now, we expect the koruna to settle in the 23.30-40 EUR/CZK band with the possibility of a further rally if global conditions allow.

Interest rates jumped up across the curve after the strong hawkish report from the CNB, but especially at the short end, resulting in bear flattening. As with FX, we expect the dust to take a while to settle. Tomorrow the full CNB forecast will be released and we will see the central bank meeting with analysts. Overall, we could see even a higher curve in the coming days. On the other hand, April inflation will be released next week on Thursday, which could again bring a dovish tone to the market and push back the current rates paying flow.

### Author

#### Frantisek Taborsky

EMEA FX & FI Strategist

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

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