

Czech Republic: CNB cuts and is ready to intervene

The Czech National Bank delivered a 50bp emergency rate cut today. This makes the already under-pressure CZK more vulnerable. CNB FX interventions are now a question of when rather than if. Should CZK see another abrupt move lower, we expect the CNB to step in around the 28.00 level



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The CNB decided not to wait till next Thursday, when the regular monetary meeting is planned, and delivered a 50bp emergency cut today as a result of the coronavirus outbreak and its negative impact on the global and domestic economy.

With the CNB starting the process of removal of the key koruna anchor – the yield advantage – and communicating its readiness to cut more should it be necessary, the outlook for the overbought koruna is bleak. EUR/CZK is likely to head higher, to/above the 28.00 level. As the recent CZK decline was rather abrupt, the CNB announced today it is ready to react to “any excessive fluctuations of the koruna exchange rate”.

1.75% Main CNB repo rate
-50bp lower

Interventions to support koruna are being more likely now

As the CNB's aim is to "react to any excessive fluctuations", we expect interventions to be of reactive nature to the pace of the CZK decline, rather than the CNB defending a EUR/CZK level per se. Should the koruna see another excessive decline in the coming days, we think the near-term intervention level is close to 28.00. Indeed, Governor Rusnok said in the press conference that he sees "no urgent need to correct CZK moves now". We interpret this as another large one day move in EUR/CZK being necessary (with EUR/CZK close to 28.00) for the CNB to react. The CNB has ample room to smooth the CZK decline as FX reserves amount to €135bn (60% of GDP).

CNB's EUR/CZK action threshold might change in time

However, this does not mean the EUR/CZK cannot go above 28.00. Rather the opposite. If there is a further deterioration in global sentiment, global growth outlook and EM FX (with CEE FX under pressure), we don't think putting a hard ceiling on EUR/CZK (at 28.00 for example) would be desirable as the CNB would lose the optionality of allowing a natural delivery of looser monetary conditions via weaker FX (while other central banks in the region would enjoy such an option). Indeed, such view was indicated by Governor Rusnok who pointed at the need "to see things in the context" (of global environment). We thus expect further CZK weakness (the next near-term realistic target EUR/CZK is 28.00) accompanied/fuelled by further CNB rates cuts. The CNB may then start intervening to smooth the pace of CZK decline.

Other preventive measures introduced

The CNB also introduced further measures, which are more preventive, as the Czech banking sector is not in a liquidity or capital shortage. Firstly, the CNB enhanced liquidity-providing measures, which were active during the global financial crisis. Also, the CNB reversed the increase of the countercyclical capital buffer rate (CCyB), which was supposed to increase to 2% from July 2020. As such, the CNB keeps the CCyB at 1.75%, but is ready to lower it further if needed. The CNB also made a recommendation to Czech banks to postpone dividend payouts until epidemic risks fade away, so as not to jeopardise banking sector resilience. However, based on CNB stress-tests, the domestic banking sector is resilient to highly adverse scenarios, so the steps introduced today towards the banking sector are highly preventive.

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