

Czech inflation likely moderated in March

Czech inflation should show a further decline but the main focus will be on core inflation. Although both numbers are pointing down, it is still not enough for the central bank. The Czech koruna remains our favourite currency in the region but the scope for further appreciation is getting smaller



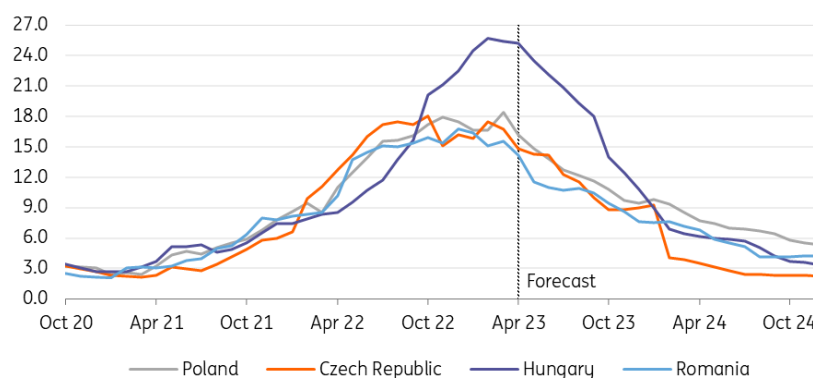
The food and non-alcoholic beverages section saw the most significant negative contribution to Czech annual inflation in June

Headline and core inflation heading lower again

Czech CPI likely slowed in March to the lowest level since April 2022. We expect headline inflation to decelerate to 14.8% year-on-year from 16.7%, in line with the Czech National Bank's forecast. This should include a 0.3% month-on-month decline in food prices and a 0.8% MoM decline in fuel prices. Still, for the CNB, it is the performance of core inflation that is most important. Here, we expect a gentle decline to 11% YoY from 12.1%. This is still not a comfortable level for the CNB, which has a CPI target of 2%.

The last CNB minutes sounded quite hawkish, mentioning risks from a potential wage-inflation spiral and tight labour market. Therefore, the expected decline in headline inflation should not be assumed as a signal for any CNB monetary policy loosening. We expect the CNB to keep interest rates unchanged until it is clear that not only headline inflation but also housing prices are contained.

Headline inflation in CEE (% YoY)



Source: Macrobond, ING estimates

What to expect in rates and FX markets

The Czech koruna has been our favourite currency in the region for some time now, but we see that the room for another rally is getting smaller. Although the direction of travel is still positive, current drivers are running out of steam. At the global level, a higher EUR/USD is positive news for the koruna but we will have to wait until the second half of the year for another significant move higher. The elevated risk premium for emerging markets has almost evaporated in recent weeks and even the energy story has little to offer anymore. At the domestic level, a hawkish CNB and decent FX carry are playing into the hands of the koruna. However, positioning is becoming crowded in our view and the room for further appreciation is getting smaller. Over the coming weeks, getting below 23.30 EUR/CZK should not be a problem. However, we see the path to 23.00 as complicated, without some sell-off to clear positioning.

In rates, the market is still on the dovish side and pricing in around 100bp of CNB rate cuts by the end of this year. While this is a far cry from our forecast, we do not see a catalyst to reassess these expectations anytime soon. Moreover, a weaker inflation print may add fuel to the market's dovish expectations. Only the May CNB meeting can change this, in our view, which should again serve as a reminder that the central bank is not planning to change interest rates anytime soon.

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