

# Czechia Watch: CNB raised rates again, but another hike is unlikely

The CNB decided on Wednesday to raise rates by another 125 basis points to 7.00%. From July, the forces in the Board will turn more in favour of the doves, and we expect rates to remain stable. However, a cosmetic August hike cannot be completely ruled out.



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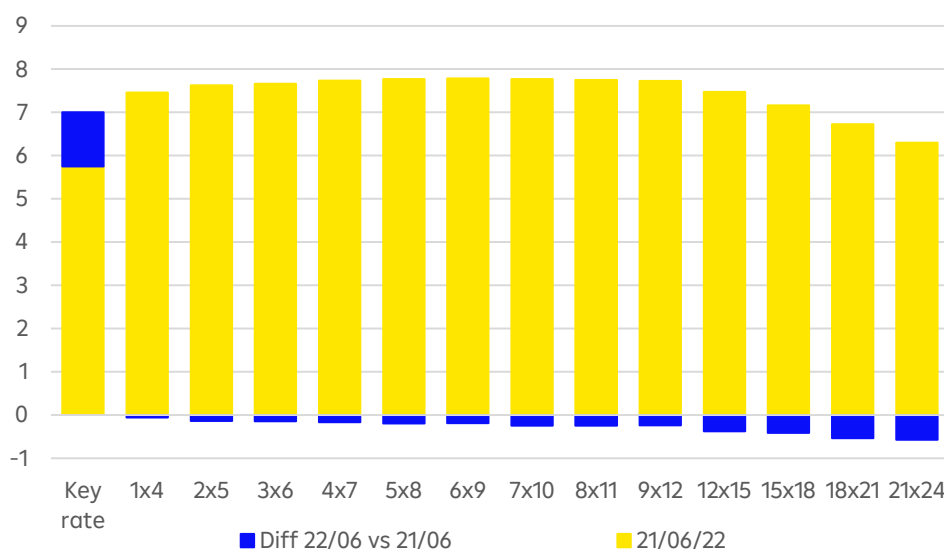
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## Interventions continue, changes await the Bank Board

Before the meeting, the market started betting on a possible hike of 150bps and as a result the central bank did not surprise with the announcement. The koruna weakened slightly after the decision but continues to hold in a narrow band around 24.7 EUR/CZK. The main contributing factor to this development is the CNB itself, which has been intervening against the weakening koruna since mid-May. This was also confirmed at a press conference by Governor Jiří Rusnok. According to him, **the interventions have no given end-date and will continue until further notice**. It was the last meeting for Governor Rusnok and two other (hawkish) members of the Bank Board, **so the forces will turn more in favour of the doves. As a result, we expect rates to remain stable**. However, a cosmetic August hike cannot be completely ruled out if inflation does not show signs of stabilization and there is a threat of continued unwinding of inflation expectations. But it would mean that the slimmed-down camp of the hawks would have to possibly mobilize 2 out of the 3 new Board members for a chance of a rate increase.

## CZ FRA curve slightly lower after CNB meeting, especially at the longer end (in %)



Bloomberg, Raiffeisen Research/RBI

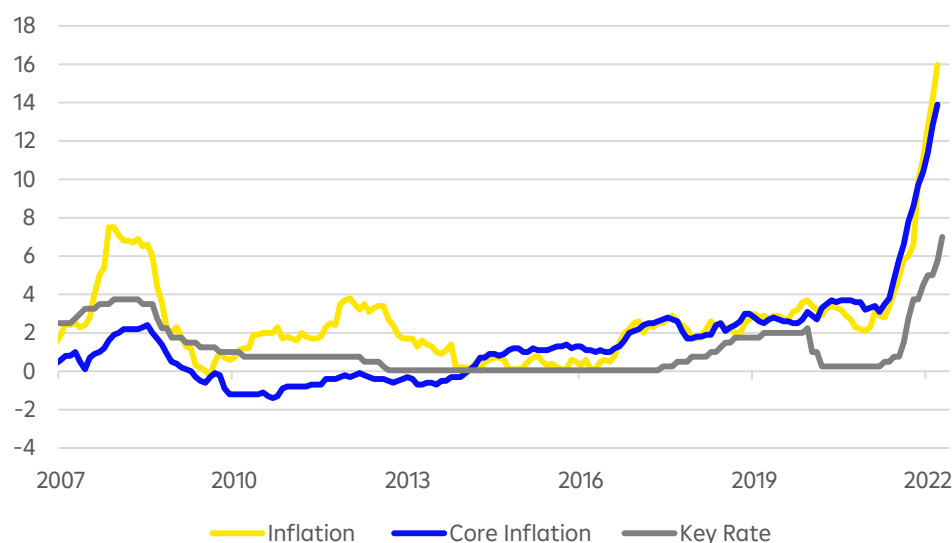
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## Reasons for another sharp increase

Wednesday's decision represents a response to the continued significant increase in inflationary pressures in the Czech economy. May's 16% inflation ended more than a percentage point above the CNB's forecast and the weaker exchange rate of the koruna vis-a-vis the euro is also an inflationary factor. Thus, **the Bank Board's decision showed once again that price stability is its absolute priority, even at the cost of negative implications to economic growth.** Governor Rusnok also communicated again that price growth is not coming only from abroad, but that a substantial part of price pressures is generated within the domestic economy, which was reflected in the rise of core inflation — also above the CNB's spring forecast. The less restrictive fiscal policy, which is not in line with the restrictive monetary policy, may also have an inflationary effect, and the consolidation of the state budget has been slower than initially expected.

## Core inflation still running strong (inflation rates in % yoy, key rate in %)



CNB, Macrobond, Raiffeisen Research/RBI

## Stability is expected but not certain

Overall, the CNB delivered a largely expected move and Governor Rusnok did not prepare any major surprises at his last meeting. **Markets will now eagerly assess the views of the three new members of the Board.** They are generally expected to adopt a more dovish stance, reflected by the stability of rates and pressure for faster cuts. The question is whether this stance would hold true even with a significantly higher June inflation reading or with even more detached inflation expectations. **The most likely scenario continues to be rate stability, with the first cut not coming until Q1'23.** However, as in previous months, there will still be some level of uncertainty around the CNB's actions in the wake of significant price increases. The new governor, Ales Michl, had previously announced his plan to keep rates stable at the current level. However, the board members will have to take into account the most up-to-date economic data and will also have a new forecast at their fingertips. And as the past has shown, the situation can change quickly. Period of stability seems to be the most likely scenario, but it is by no means a 100% outcome.

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