

Czechia Watch: CNB delivered expected rate stability

Same as at its August meeting, the CNB bank board voted to keep rates stable. The decision was in line with analysts' unanimous expectations. There was also no change in the FX interventions strategy; the CNB will continue to prevent excessive FX fluctuations. At the press conference, Governor Ales Michl was brief, but some of his answers were surprisingly hawkish.



<i>Rates stable or higher, discussion about cuts is not on the table</i>	1
<i>Pro-inflationary and anti-inflationary risks</i>	1
<i>Markets barely reacted to the expected decision</i>	1
<i>Risks both ways for our outlook, no change for now</i>	2
<i>Disclaimer</i>	3
<i>Analyst</i>	5

Rates stable or higher, discussion about cuts is not on the table

The question of a possible rate cut was not raised at all at the meeting and rates will thus "remain stable or rise" in the future. The Board would lean towards a rise in the event of rising budget deficits or high wage growth - both of which are currently feasible risks. In his comments on interventions, Governor Michl said that the CNB has no threshold below which it would be unwilling to let foreign exchange reserves fall, but he avoided any further comments on this subject. Some more information could theoretically be found in the CNB minutes released next Friday.

Pro-inflationary and anti-inflationary risks

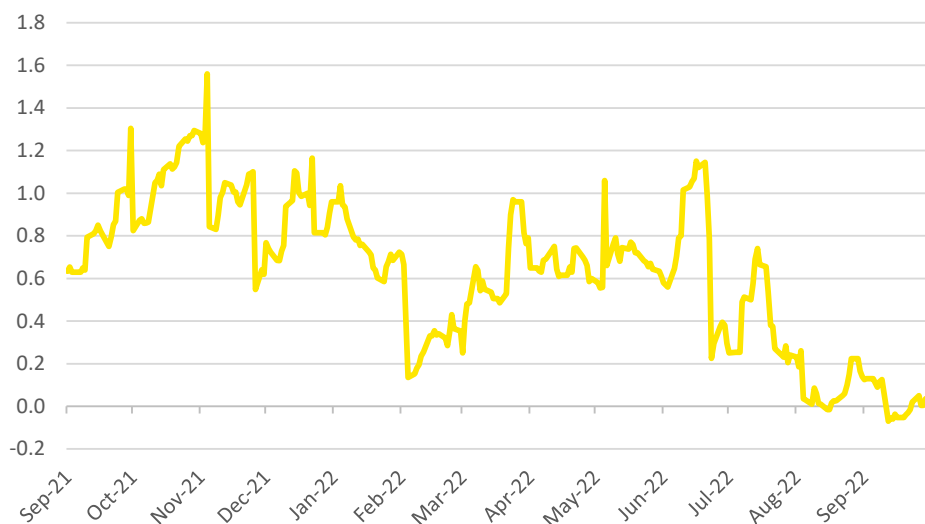
As at the last meeting, five members voted for rate stability, two for a (75bp) hike. The only change is that at the last meeting the two hawkish votes were for a 100bp hike. The CNB sees risks in both directions, where the mentioned wage growth combined with more expansionary fiscal policy, but also a higher outlook for foreign output prices or a loss of anchoring of inflation expectations, could act as a pro-inflationary factor. Conversely, the rising likelihood of a recession abroad, a higher-than-expected slowdown in domestic demand and the introduction of measures to curb energy price growth could be anti-inflationary. The CNB's forecast does not rule out the possibility of annual inflation still rising towards 20% despite the August y/y decline. The CNB expects a return to the 2% target in about a year and a half. Our forecast assumes a slower retreat.

Markets barely reacted to the expected decision

Financial markets did not react to the decision itself and major movements occurred only during the press conference. The koruna strengthened sharply from 24.70 to 24.55 EUR/CZK, probably as a result of interventions, as the domestic currency was at its weakest levels since July and in the range where the CNB has been entering the market in recent months.

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Market sees rates stability as the most likely scenario FRA 3x6 spread over Pribor 3M (in pp)



Source: Bloomberg, Raiffeisen Research/RBI

Risks both ways for our outlook, no change for now

In our forecast, we do not rule out a rate hike in the final quarter of this year. The lower inflation dynamics, along with some comments by Board members, are the main risks to this forecast, where the CNB could lean rather towards longer-term stability without future hikes. On the other hand, today's meeting made it clear that the CNB is willing to discuss a hike even in its new more dovish composition, and if it happens, rates could rise even more than our forecast assumes (+25bps). This is especially so if a price-wage spiral were to emerge. Thus, we will continue to assess the latest data (led by September inflation numbers), but for now we leave our forecast unchanged. From the koruna's perspective, we continue to expect ongoing interventions and so koruna should stay around 24.80 EUR/CZK until approximately the middle of next year.

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