

Czechia Watch: CNB sticks to strategy of rates stability and FX interventions

The CNB bank board decided to keep interest rates stable for the sixth month in a row. The Bank Board also decided that the CNB will continue to prevent excessive fluctuations of the koruna exchange rate. Next meeting will be about stability or an increase.

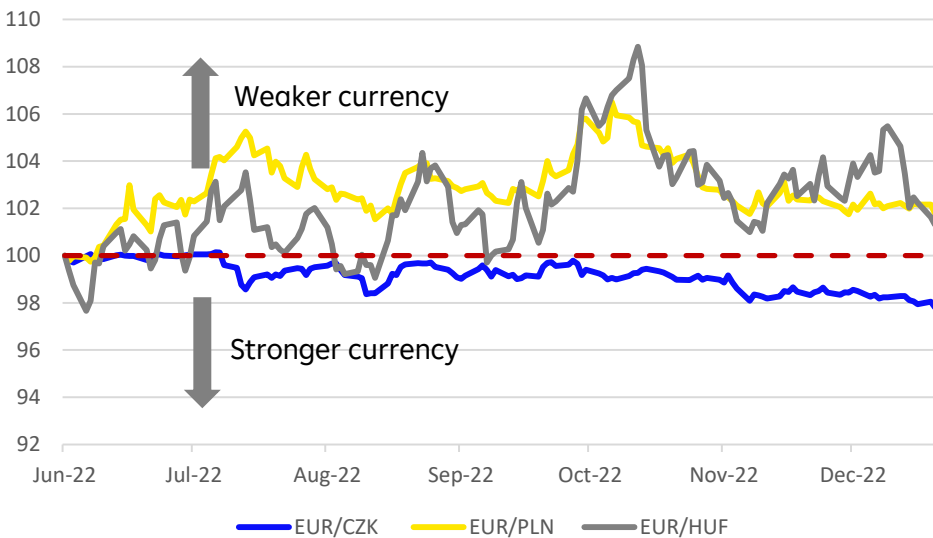
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The CNB bank board decided to **keep interest rates stable** for the sixth month in a row. The 2-week repo rate thus remains at 7%. At the same time, the Bank Board also **decided that the CNB will continue to prevent excessive fluctuations of the koruna exchange rate**. The need to intervene has declined recently with global depreciation forces on the koruna subsiding.

CZK outperforming its CEE peers June 2022 = 100



Source: Bloomberg, Raiffeisen Research

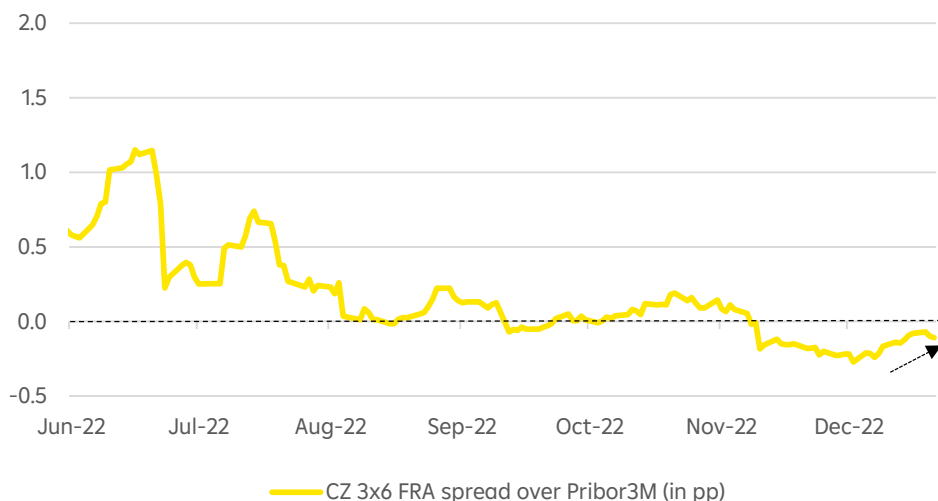
Even though CNB’s model calls for another increase of interest rates by approximately 100bp, the current bank board favours a rather smoothed-out outlook of rates rather than further increases followed by steeper cuts. Currently, the market tries to assess the timing of rate cuts. **Bets on a cut already in 1H23 have decreased recently, as shown in the chart below.**

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**Bets on rate cuts in 1H23 reduced
FRA 3x6 spread over Pribor 3M (in pp)**

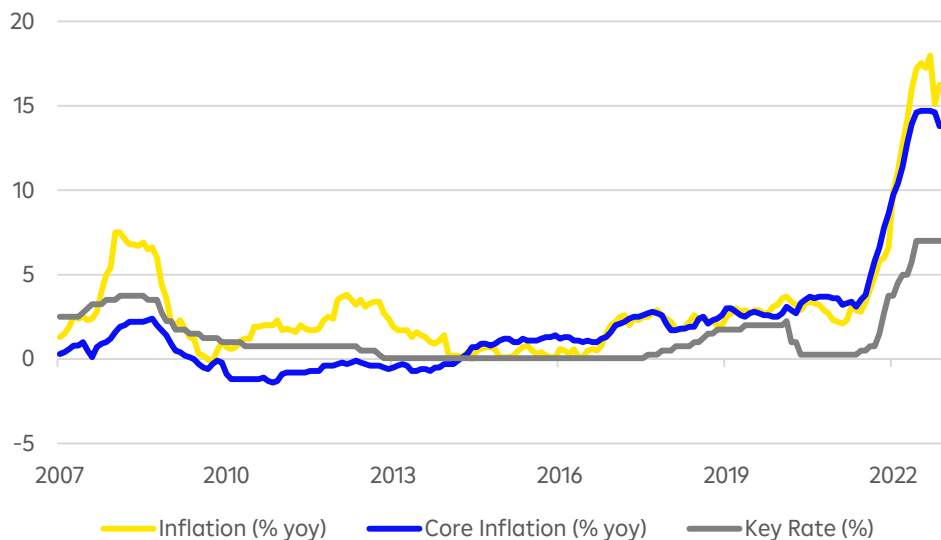


Source: Bloomberg, Raiffeisen Research

Financial market showed no strong reaction neither to CNB’s rate decision nor the press conference, which didn’t last long. Governor Michl stated that there a debate about rate cuts is premature and **next meeting will be about either stability or increase**. He emphasized demand-driven inflation as CNB’s main focus. Among relevant factors, he mentioned wage development and household spending. Regarding wage growth, there might be an upside surprise — we forecast nominal wage growth by 7.2%, on average, in 2022, while CNB only by 6.3%. Regarding household spending, data will be insufficient at the next meeting as the structure of 4Q23 GDP is going to be released March, 3. However, the situation in household demand can be assessed by monthly retail sales data or consumer confidence indicators. Governor Michl commented on slowing domestic demand, which is in line with our forecast suggesting continued deterioration in household spending but also fixed investment. That being said, this doesn’t mean that the fight against inflation is over. The CNB expects average inflation at 14.9% yoy in 1Q23 while market consensus only at 12.9% since it already accounts for how the CZSO calculates the impact of the energy tariff into CPI. This means that January inflation might stay within CNB’s forecast but still surprise the market pushing inflation expectations higher, which are already elevated. Inflation expectations among non-financial firms are between 7-8% on a 3-year horizon. On top of that, a higher January inflation shifts the whole trajectory up for the rest of the year. Coupling this risk with a return of yoy real wages into positive territory next year, on the back of still tight labour market, **we assess risks to the inflation forecast being skewed to the upside**.

Despite the pro-inflationary risks, we think the CNB will not hike further. In our forecast, the 2-week repo rate thus remains at 7%, first rate cut comes in August 2023, thanks to a sufficient slowdown in inflation.

Rates stability as the most likely outcome



Source: CNB, Macrobond, Raiffeisen Research

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