

## Czech Republic Watch

## CNB – hawkish signals, dovish substance

**CNB on hold, hawkish tone likely intended to support FX**

In holding the policy rate at 7% as expected on Wednesday, the Czech National Bank's (CNB) rhetoric was outright hawkish in its guidance on rates and FX. The central bank was explicit that "market expectations regarding the timing of the first decrease in CNB rates are premature" and added that "market expectations that rates have peaked may not materialise". This is consistent with our view that the CNB will not rush into near-term rate cuts. But we continue to believe there is no major intention to resume hikes in the coming months. The hawkish signals on rates are most likely intended to prop up the CZK, which is probably the easiest way for the Board to speed up the disinflation process in our view. We expect a 50bp reduction this year, starting with 25bp in November, conditional on a stable/stronger CZK. See our report: [CEE: no inflation complacency](#).

**CNB wants stronger CZK but likely no intervention lately**

The CNB is likely sticking to verbal intervention for now – we don't think it has been active in the FX market during the recent bouts of global risk aversion. Governor Michl stated in Wednesday's press conference that: "A strong koruna remains essential. It makes imports cheaper. We welcome a strong koruna. It could actually be even stronger than now." But he also added that the central bank "didn't discuss it beyond this", which likely suggests to us no active decisions by the new Board on the intervention level since it was last set by the previous Board in May 2022.

The 10-day CNB balance sheet data for March does not suggest any major CNB intervention activities when EUR/CZK spiked above 24. The change in liabilities between 10 and 20 March was CZK33.5bn (EUR1.4bn). This was mostly due to changes in "loans received from abroad", rather than to domestic banks' liquidity, which would be closely related to the CNB's intervention (Exhibit 1). The central bank's current assumption of EUR/CZK is 24.1 for 1Q – despite some volatility in March, EUR/CZK did not deviate much to call for central bank's intervention. In general, the Board does not want to commit to defending any particular level in EUR/CZK. The bar is likely to be high for a decision to signal a lower intervention level from the current market perception of around 24.5 to around 24.

**Macro assessments sound net dovish**

The CNB's assessment of the domestic macro is more dovish compared to February, which suggests that the hawkish guidance on the peak in rates may not be a reflection of the Board's true intention. On the dovish side, the statement noted:

(1) "The demand pressures from the domestic economy continue to weaken". There was a material deviation to the downside in GDP vs CNB forecasts (-0.4% qoq vs -0.1% expected), particularly for private consumption, which is crucial for the demand-pull inflation outlook. The CNB added that private consumption "decline in 2022 Q4 was 2.8% (qoq), the deepest decline ever, with the exception of the COVID pandemic".

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Timestamp: 30 March 2023 08:21AM EDT

30 March 2023

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(2) “a major slowdown in the property and mortgage markets”, which “will gradually help reduce core inflation further”.

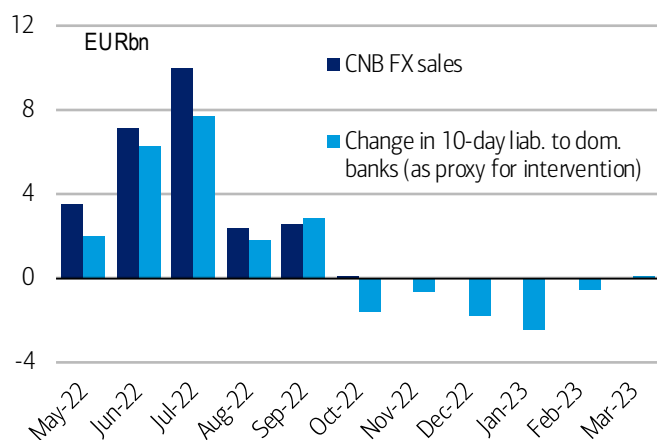
(3) an unfavourable environment for firms who are facing “increased costs of energy and commodities”, remaining “supply chain problems”, and weaker “external demand” as financial conditions tighten. These in turn are “slowing investment growth” and “constrain production”.

On the hawkish side, the key risk comes from the labour market with the CNB noting “relatively significant increases in nominal wages in industry (11.9% year on year) and construction (14.9%)”. Caution is indeed needed and pay negotiations in the auto sector are being closely monitored. For example, Hyundai recently agreed an 11.7% wage hike. Skoda, the main auto producer, has yet to announce its plan. The CNB’s current forecast for wages in the business sector is 9.9% yoy in 1Q 2023 and 9.1% for the whole year. Therefore, any outcome close to 10% would not be a huge deviation to motivate rate hikes consideration.

We believe the wage outlook is more relevant for the CNB’s decision on the start and pace of the easing cycle, rather than renewing a genuine rate hike debate. Deputy Governor Frait’s comments on Wednesday after the decision likely support our view. He said that most Czech central bankers consider current monetary policy settings as sufficiently tight to cool the economy and tame inflation.

#### Exhibit 1: CNB FX intervention

CNB did not intervene in Oct-Janu according to official data. 10-day balance sheet data suggest no activities in Feb-March either



Source: CNB, BofA Global Research. Notes: Dec and Jan data are smoothed out to avoid year-end large volatility in liquidity situation.

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