

EEMEA Strategy Watch

Easing cycle in Czechia: receive front end on spikes

The market consistently underprices monetary cycles

The market consistently underprices cutting and hiking cycles. The best strategy is to receive into the cutting cycle. This cycle is unlikely to be an exception. We have recently closed our 1y1y receiver in Czechia vs 1y1y Poland payer as it has hit the target (see [EM Alpha: Target hit – close 1y1y receive in Czechia vs 1y1y payer in Poland 02 January 2024](#)). We will be looking to re-enter a receiver trade in Czechia when valuations become more attractive. For more detailed discussion of monetary cycles in CEE, please see:

BofA Global Research Reports

Title: Subtitle	Primary Author	Date Published
Emerging Insight: Front-end rates: the most inefficient market in EEMEA	GEMs FI Strategy & Economics	16 August 2022
Emerging Insight: Wait for receivers in CEE + Israel	GEMs FI Strategy & Economics	07 February 2022

Valuations of Czech front end are not attractive...

The market pricing of cuts is more dovish than our baseline forecast for the policy rate (Exhibit 1). This is the main reason why we do not have a Czech receiver on right now. Stretched valuations and positioning increase the risk of rates going higher in the very short term.

...but the front end should ultimately go lower

Previous cutting cycles suggest that the Czech front end should ultimately reprice lower. As a result, the best strategy for this cycle is to receive on spikes. To show that, we analyse all previous cutting cycles in Czechia. In Exhibit 3 and Exhibit 6, we show the price of a 1y swap entered 14 days after the first cut. Effectively, it is the price of a 1y swap net of carry and roll. We choose 14 days as this is the amount of time that has passed since the CNB's cut in late December 2023.

Czech receiver trade should continue after the first cut

In all cases, except for the August 2008 cutting cycle, the 1y swap (entered 14 days after the first cut) dropped to even lower levels 1 month, 2 months and 3 months after it was entered. In 2008, it took around 4 months for the 1y swap to drop below the entry level. This is related to the spike in the 1y swap in October 2008, which itself was driven by a financial bankruptcy event that has low probability of being repeated in this cycle, in our view. Risks are global rates increasing.

Spikes are an opportunity to enter receivers in Czechia

Having said that, the repricing was not a straight line, with the occasional increase in front-end rates, which is also likely to happen in this cycle. We think this offers an attractive opportunity to enter a receiver trade again. Fading the amount of cuts priced in can only be a very tactical and short-term trade, which also involves a lot of risk given the historical evidence from previous cycles.

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For a list of open trade recommendations and trade recommendations closed in the last 12 months, see [Global Emerging Markets Weekly: 1,000 investors – no consensus 08 December 2023](#)

Abbreviations

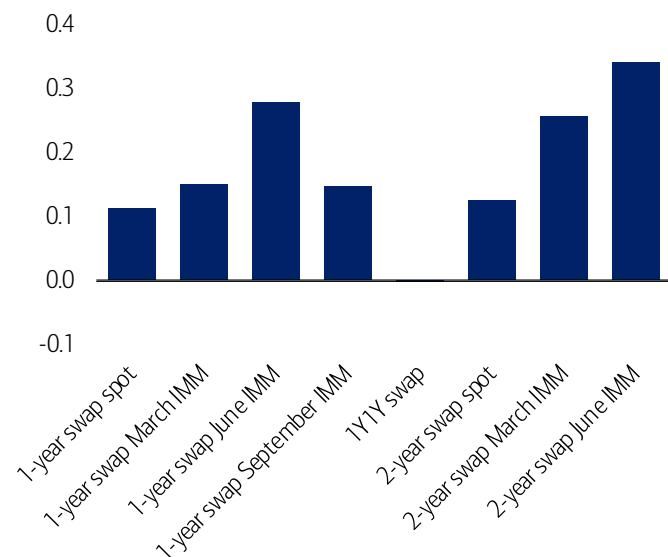
CEE is Central and Eastern Europe

CNB is Czech National Bank



Exhibit 1: Czech front-end valuations are not attractive

Positioning also seems to be stretched. We wait for a better entry point

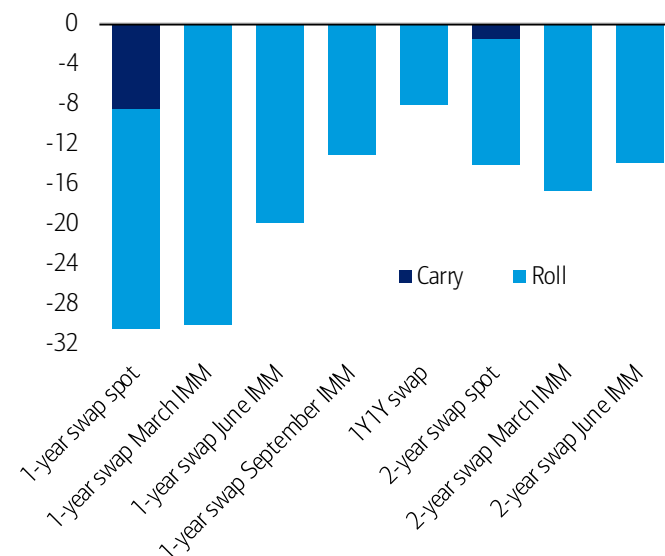


Source: Bloomberg, BofA Global Research

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Exhibit 2: Carry and roll of Czech front end is deeply negative

But it should not prevent the front end from repricing lower



Source: Bloomberg, BofA Global Research

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Exhibit 3: 1y swap performance in 2005 cutting cycle

Receiving on spikes was the best strategy even after the first cut



Source: Bloomberg, BofA Global Research

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Exhibit 4: 2008 easing cycle was an exception due to Lehman

It took around 4 months for the 1y swap to start falling decisively



Source: Bloomberg, BofA Global Research

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Exhibit 5: 1y swap repriced lower in almost a straight line in 2012

The starting point of the 1y swap is 14 days after the first cut



Source: Bloomberg, BofA Global Research

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Exhibit 6: 1y swap repriced lower fast in 2020 cutting cycle

The starting point of the 1y swap is 14 days after the first cut



Source: Bloomberg, BofA Global Research

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