Short HUF/CZK

Thesis

In the wake of an intensifying Ukraine-Russia conflict, Eastern Europe has experienced significant capital flight. As a result, currencies like the zloty, forint, and koruna have dropped considerably in the last several days. However, some EEU central banks are more prepared to defend their currency's strength moving forward. Given the CNB's vast FX reserve advantage over the MNB, I expect the koruna to perform better than the forint in the near-term.

Hikes

While other regional central banks intervened directly in the FX market to prop up their currencies, the MNB hiked its key rate. Accelerating domestic inflation means that the MNB does have lee-way in further hikes. However, given >300bp hikes already over the past year, the central bank has indicated that further hikes will be restrained around 30bps a month, which reduces the bank's ability to provide support to the forint. Previously, MNB hikes have done little to calm systemic inflationary pressures and strengthen the currency.

On the CNB side, inflation is at an even greater level. While the CNB has indicated it is drawing its tightening to a close soon, it is not unlikely that the CNB will follow through with further hikes in the next one-to-three meetings. This does not bring it on par with the MNB on key-rate-driven currency support, but it's not far off, either.

FX reserves

Due to a history of weakening the koruna by selling the currency, the CNB has accumulated over $160bn (or over a year's worth of imports) of FX reserves – the highest level in the region. Meanwhile, the MNB has much lower FX reserves at less than 4 months' of imports. As import prices rise with global commodities, this level will further decline. The CNB's massive advantage in terms of FX reserves, which it has already deployed to successfully prop up the currency, means that it has a much wider toolkit to deal with currency depreciation.

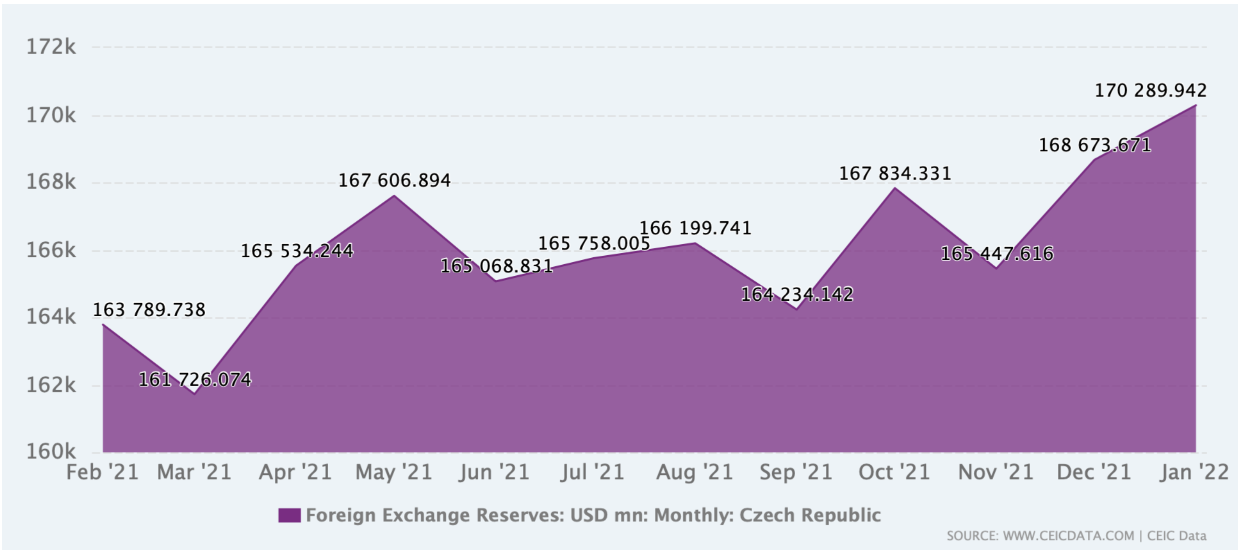
Willingness to intervene

A policy-maker at the CNB noted that, while current levels do not warrant excessive intervention in the FX market, the bank may be willing to intervene aggressively if it sees the currency depreciating considerably and adding to inflation woes. Czech inflation is expected to reach its peak over the next month or two. High commodity prices have already led to upward inflation rate revisions and I expect further revisions to these figures, which should support some more hikes. Beyond that, the CNB is drawing its hiking cycle to a close due to fears of precipitating an H2 recession, so its key means of intervention moving forward will be primarily FX reserves.

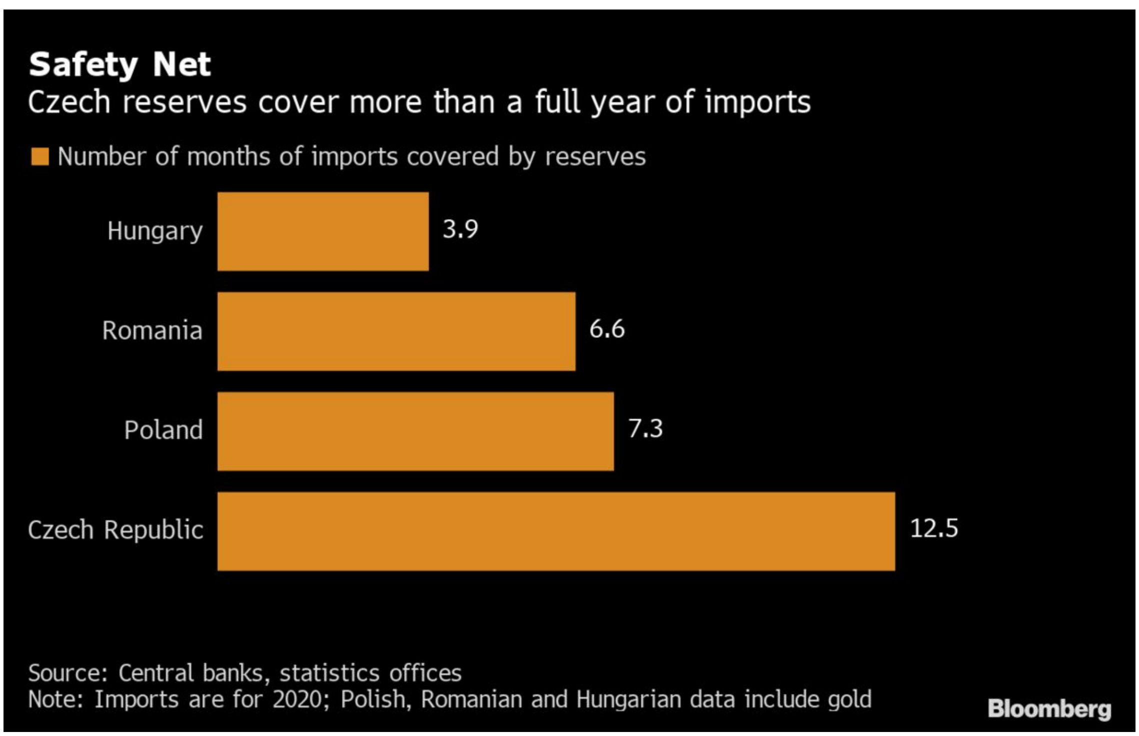
At the same time, the MNB lacks similar stocks of foreign currency and will not be willing to intervene considerably using its current FX reserves. Elevated Hungarian inflation does give the MNB lee-way in hikes (though Hungarian inflation still remains below Czech inflation). Yet, as we have seen this past week - during which the MNB hiked while other EEU CBs sold foreign currency - pure policy-rate support cannot match direct FX intervention. Further, there is a limit to how much the MNB will be able to hike, which is ~1pp higher than the additional 25-50bps I expect from the CNB over its next two or three meetings.

Appendix

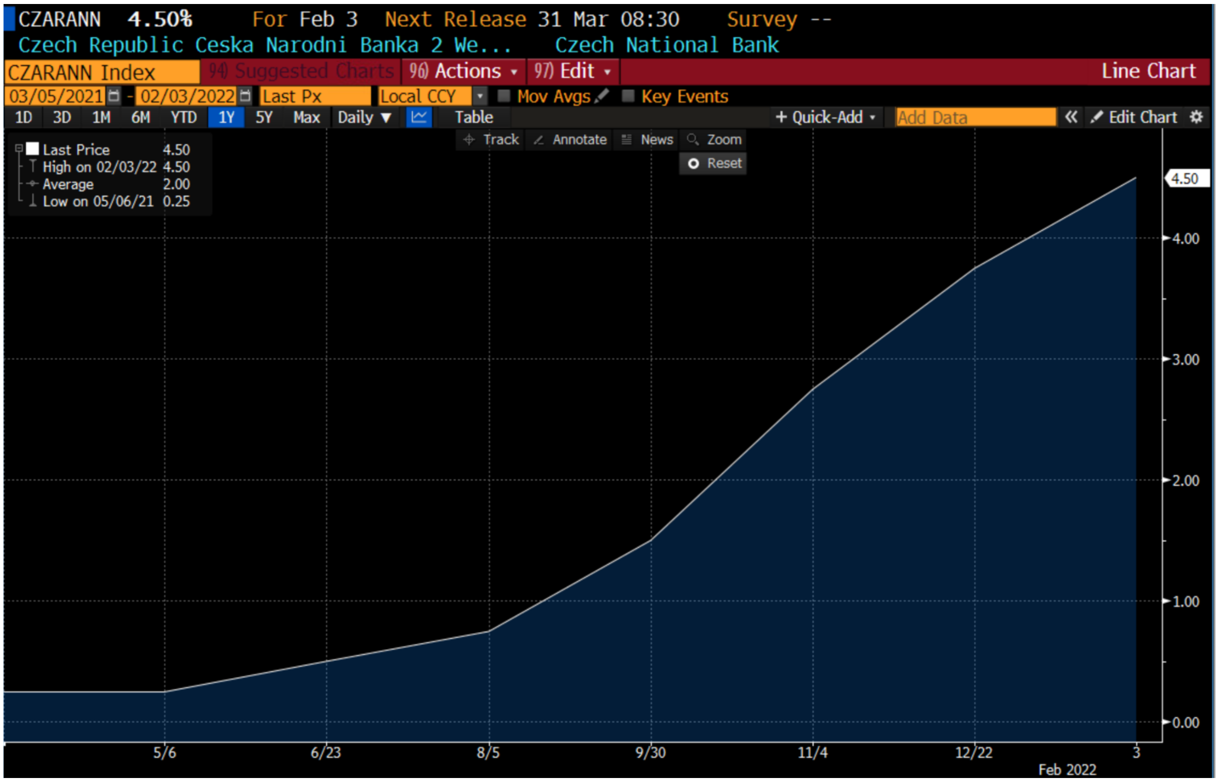
A. CNB FX reserves



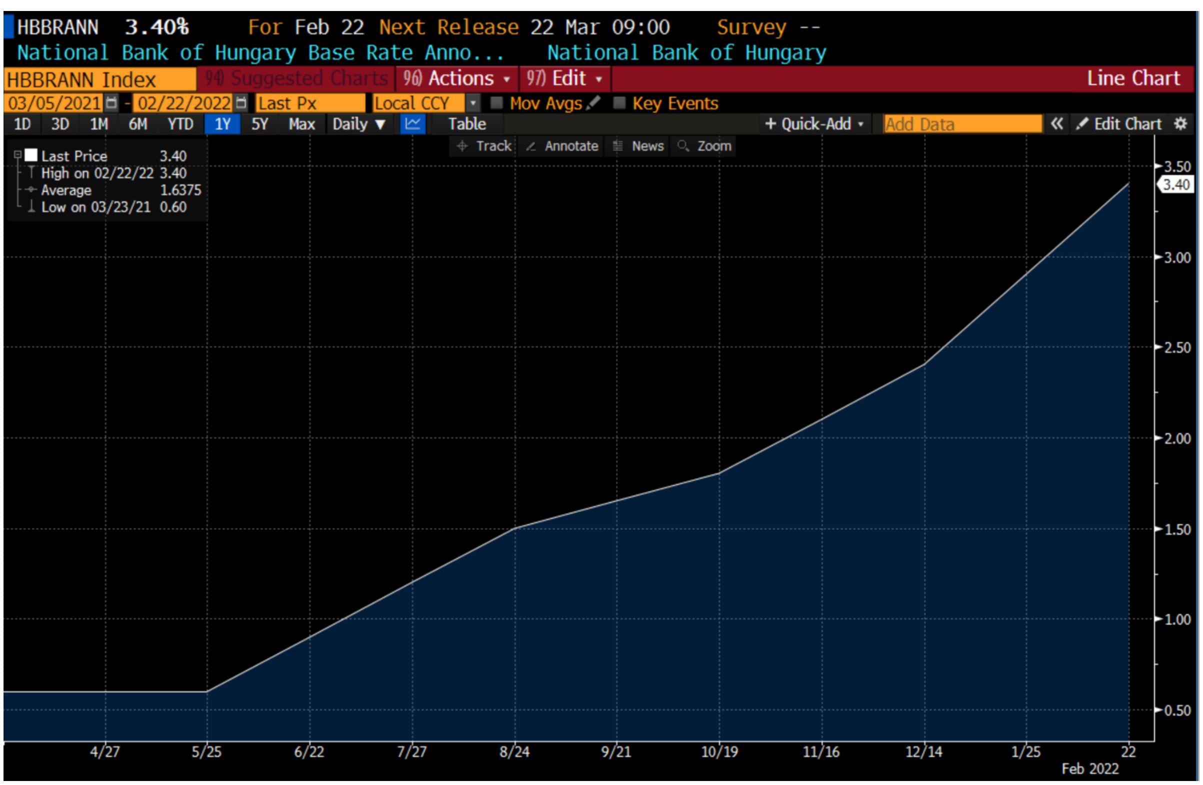
B. Regional FX reserves



C. Czech Key Rate



D. Hungarian Key Rate

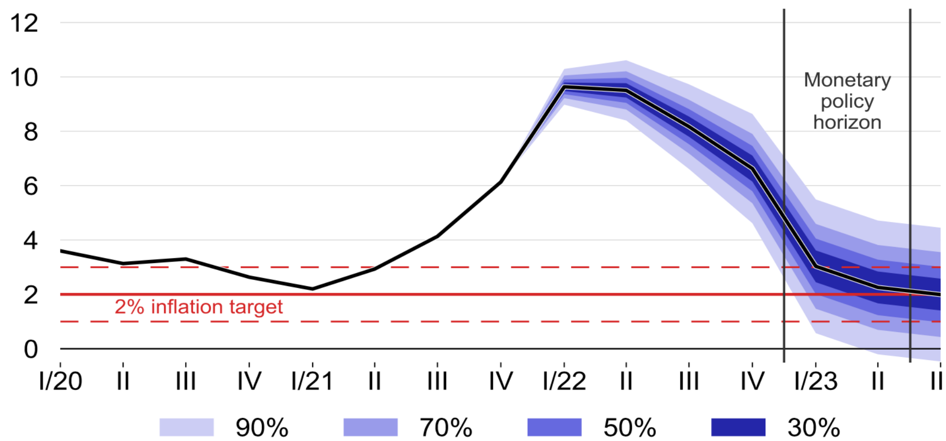


E. CNB inflation projections

Headline inflation (in %)

Headline inflation in 2022 Q1 and at the monetary policy horizon (in %)				
Jan 2022	Feb 2022	Mar 2022	2023 Q1	2023 Q2
9.4	9.7	9.8	3.0	2.3

Inflation will rise significantly further at the start of this year and exceed 9%. This will be due to a further increase in core inflation and sharp growth in administered prices. Inflation will peak in 2022 H1 and then fall gradually. This will be aided by an appreciating koruna and the stabilising effect of monetary policy manifesting itself via domestic demand. Inflation will fall close to 2% over the monetary policy horizon.



F. Hungarian inflation (in %)