MNI Czech National Bank Review: March 2023

Executive Summary:

- **The CNB kept interest rates, FX regime and forward guidance unchanged, in line with expectations.**
- **The accompanying statement explicitly pushed back against excessively dovish market pricing.**
- **Governor Ales Michl doubled down on FX rhetoric, noting that the Koruna could be even stronger.**

Key Links:

- **For full statement click here.**
- **For Governor Ales Michl's presentation click here.**
- **For the transcript of the Q&As click here.**

Key Takeaways: Pushing Back Against "Premature" Rate-Cut Bets

In line with virtually universal expectations, Bank Board voted to keep interest rates unchanged and maintain its commitment to prevent excessive fluctuations in the Koruna exchange rate, while sticking with a formal neutral to hawkish bias. The vote split suggests that new members toed the line of the majority camp and backed the strategy of keeping interest rates stable. However, the Bank Board doubled down on the importance of a strong Koruna exchange rate and tuned up its hawkish rhetoric, as it continues to wrestle with market participants betting on the easing cycle starting as soon as this year.

The decision to stick with the current monetary policy settings was taken by an increased majority of 6-1, which suggests that the two new Board members – Jan Prochazka and Jan Kubicek – toed the line of the majority camp and can be expected to support the central bank's well-documented strategy of smoothing out the interest rate path. The lone dissenter, who voted for a 25bp rate hike, was likely Tomas Holub. His hawkish leanings are well-known after he consistently called for raising interest rates at the previous monetary policy meetings and in multiple interviews. For the record, the hawkish dissenter moderated his rate-hike call to 25bp from 50bp at the February meeting, albeit the Board's general approach remains dictated by the Governor-led majority.

The on-hold decision was widely expected and keeping formal neutral to hawkish guidance ("the Bank Board will decide at its next meeting whether rates will remain unchanged or increase") was not a surprise either. However, the accompanying rhetoric was replete with firmly hawkish overtones as the CNB is trying to reassure market participants about its determination to keep monetary conditions tight and bring inflation under control. Most notably, the central bank explicitly pushed back against market bets on rate cuts by the end of this year, calling them "premature," as "market expectations that rates have peaked may not materialise." Furthermore, the Bank Board warned that it could still raise interest rates if it sees signs of a wage-price spiral, while Deputy Governor Jan Frait later told public TV that policymakers "are not even thinking" about rate cuts now.

In addition, the CNB reasserted the importance of a strong Koruna exchange rate as a key tool to curb inflation. Members noted that the domestic currency "could be even stronger than it is now," even as EUR/CZK was sitting just 1.3% above its 15-year lows when the statement crossed the wires. The CNB's confidence in the exchange-rate channel of monetary policy is well known and Bank Board members have hardly missed any opportunity to reiterate this view in the recent months. However, doubling down on this rhetoric may have taken some by surprise. After all, prior to the February meeting some sell-side desks had been suggesting that the CNB might abandon its FX regime. Hawkish language on FX reaffirmed the CNB's core message that it is ready to keep monetary conditions tight in pursuit of its inflation mandate.

We interpret the CNB's statement and press conference as raising the risk of a delay to the beginning of the rate cut cycle relative to market expectations. Already in our preview, we flagged that the CNB might continue pushing back against "overdone" rate-cut bets in the wake of Deputy Governor Zamrazilova's recent comments to that effect. The

CNB's rhetoric sets the bar high for commencing the rate-cut cycle. In line with Zamrazilova's comments, we may have to wait until the autumn release of Q2 wage data to get more clarity on its timing, as most Bank Board members see a potential wage-price spiral as a key risk to the interest-rate outlook.

Analyst Views (Alphabetical Order)

Commerzbank: Hawkish Surprise In Rhetoric

- What makes Michl's remarks sound more hawkish than usual from the market's standpoint is that Michl himself was the big dove last year, whose nomination as governor injected big controversy into CNB matters, and big volatility into the exchange rate. Michl forwarded many unconventional arguments at the time about why rate hikes were unnecessary or inappropriate as inflation was accelerating towards its highs last year.
- Since then however, Czech core inflation dynamics have distinctly improved (one has to examine things using month-on-month changes to appreciate this). Hence, for the same Michl to now remind markets, that CNB could always choose to resume rate hikes, is a particularly hawkish signal – also because few other board members would probably oppose him if this situation were to arise – many of the members voting for unchanged rates now are doing so because they fell in line with Michl's dovish views last year within a politically strange environment within CNB.
- Whether Michl would really pull the trigger easily or not remains to be seen, but for now his verbal intervention will support the koruna.

Goldman Sachs: CNB Won't Hike But Bar To Easing Is High

- This was the first meeting with the Board's new line-up after Jan Kubicek and Jan Prochazka replaced Mora (hawkish) and Dedek (dovish). The split shifted from 5-2 to 6-1, implying that both new members voted for unchanged policy (on the assumption that Holub continued to vote for higher rates).
- The CNB continued to push back against the rate cuts priced in by the market by the end of the year, stating that the market's expectation of easing is premature. The accompanying press release indicated that the decision at the May meeting will likely be between stable rates and a hike, as the Board will thoroughly assess wage developments after it noted the significant rises in nominal wages in January.
- Given that the CNB views the current monetary policy stance as materially restrictive and enough to bring down inflation if rates are kept higher for longer, Goldman do not expect a rate hike going forward. Equally, however, they think the bar to cutting rates is also high.
- The CNB remains committed to preventing excessive exchange rate fluctuations, ruling out rate cuts until inflation slows below 10% and the Q2 wage data shows some easing in the labour market. Furthermore, the impact of the recent banking sector stresses in the US and in Europe on Czechia remains limited given the strong capital bases of Czech banks and limited exposure to the affected banks abroad. Therefore, the CNB's monetary outlook is largely unaffected by the events.

ING: Hawkish Rhetoric To Continue In Coming Months

- The board said that intends to keep interest rates high and will again decide at its next meeting whether to leave rates unchanged or raise them. From this perspective, today's meeting is essentially a carbon copy of the February meeting.
- On the other hand, almost two months have passed since the February meeting, during which time much has changed in the global story. Thus, in our view, the board has been gradually increasing a hawkish tone if we take into account the global context, which cannot be ignored.
- The governor during the press conference commented on market expectations of a peak in interest rates at current levels and a significant rate cut this year (roughly 125bp in cuts priced in before the meeting). However, according to the governor, a rate hike cannot be ruled out and rate cut expectations are premature at this point.
- ING do not expect the board to decide on an additional rate hike, even as the monthly data for January indicates strong wage momentum, which may push the board to make further hawkish statements. They don't expect any change in rhetoric for the coming months and expect no change until at least the end of June, when the board might already have enough numbers in hand and ease off the gas from the hawkish rhetoric.

JP Morgan: Extremely Hawkish Message Pushes Back Against Market Pricing

- Given the predictability of the rate decision, today the main focus was on communication, which JP Morgan expected to be hawkish (in line with the recent public narrative). The message was indeed hawkish, but, even more so than anticipated.
- The first key highlight is the effort made to push back against market pricing of rate cuts from later in the year. This was done in as-clear-as-possible-terms in the press release: “We consider the market expectations regarding the timing of the first decrease in CNB rates to be premature”, a message which was reiterated by Governor Michl in the press conference. Not only no cuts, but the message challenges the idea that rates have peaked at all: “market expectations that rates have peaked may not materialize”, and revives the case for potential rate hikes in the case of a wage-price spiral arising.
- The second key message was on FX. Looking beyond the recent volatility (induced by heightened risk-off sentiment globally), the Czech Koruna has been trading at its strongest historically vs the Euro, which could be a sign for concern in a hyper export-oriented economy with a poor growth record in the past few years. Instead, the governor reiterated the message that FX strength is welcome by the CNB. Not only that, it appeared to double down, and wishes for more “Czech Koruna could be even stronger than it is”.
- Upon nomination, markets read the current CNB board as dovish-leaning, not unreasonably so, given the information at the time. But the message from the board is as hawkish as could be; we would hazard a guess that it is even more hawkish than Rusnok’s board would have been in similar circumstances.
- Given stickier CPI and hawkish CNB, they see risks to their call for rate cuts starting from August as severely skewed for a later start. They will wait for the March CPI data (April 13), where we need to see some encouraging renewal of disinflation dynamics, before reassessing.

NatWest: Pushback Against Rate-Cut Expectations

- At today's Czech central bank decision, the Governor pushed back strongly against expectations of coming rate cuts. However, beyond the rhetoric, the policy statement acknowledged easing inflation and the CNB's most hawkish member voted for a reduced pace of tightening.
- The CNB's last remaining hawkish reduced his rate hike call to only a 25bps hike. T Holub was the only dissenter calling for a 25bps rate hike. Back in June, he was calling for 125bps of rate increases, reducing his vote to 100bps, 75bps and 25bps rate hikes at subsequent meetings.
- The Governor's explicit reference to rates market pricing saw the CZK strength almost 0.5% against the EUR, though it has since partially retraced some of those gains. Rates markets reacted, paring expectations for rate cuts by 3bps over the next 12 months.
- However, NatWest deems the outright level, 100bps of rate cuts still priced over the next 12 months, to be to much. They continue to recommend paying the 9x12mth FRA. They remain bullish the currency given that CZK assets offer a yield premium to the euro area with limited FX and political risk.

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