



Flash

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Koruna after the end of interventions

The Czech National Bank has ended the koruna intervention regime and ceased to defend the level of 27.00 EUR/CZK. We review the prospects for the koruna under the new, free floating system.

Koruna may remain under pressure in the short and medium term...

We expect the koruna to be volatile in the coming weeks and months, possibly in both directions. The main reason is the relatively 'overbought' position of the koruna before the end of interventions.

"Too" many bets on a stronger koruna were opened before the interventions were stopped. The total cumulative inflow of capital was according to our estimate approximately EUR 45 billion at the end of February, and in March (no figures for the March balance of payments are available) it increased by an estimated additional 10-15 billion euros.

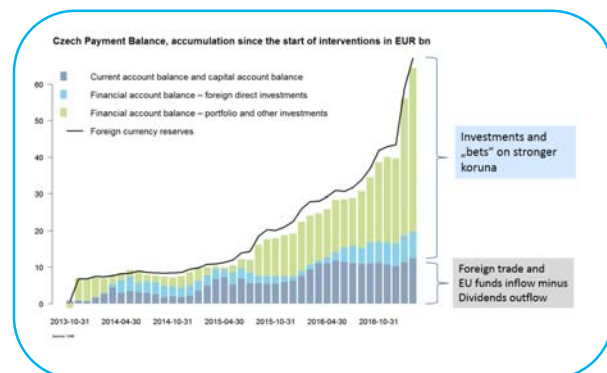
Overall, the long koruna positions could reach up to 50-60 billion euros at the end of the intervention regime. This is much more than the estimated surplus of the current account of the balance of payments (for 2017 € 3 billion) and the estimated external trade surplus (€ 13 billion). According to these measures, the Czech crown was simply 'overbought' before the end of interventions.

If some of the players on the markets want to reduce their long koruna positions, they may not always find strong enough counterparties. **Missing counterparty problems can cause losses for the Czech koruna in the coming weeks and months.**

We believe the outflow of the capital from the koruna can be triggered especially in case of elevated tension in the eurozone – such as before the first round of the French elections.

From this point of view the French (second round of presidential and parliamentary) elections, another Greek

rescue program (installments due in July) and the Italian election (no later than 2018) may turn out to be interesting moments. The Czech autumn elections, in our opinion, won't bring any significant earthquakes in Czech economy nor on the markets.



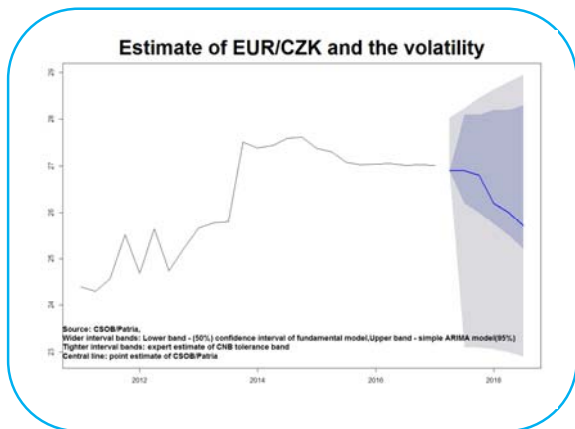
As we do not exclude more pronounced volatility in both directions, **we also publish our expert estimates of the volatility and CNB's "tolerance" band** (see the graph below) next to the average estimates for the following quarters. However, the Central Bank would, in our opinion, actively mitigate the koruna's volatility only in case the Czech currency stayed at significantly weaker levels for a prolonged period (at least one to two weeks). We believe the tolerance band for short term volatility is more or less "unlimited".

The koruna to strengthen in the long run

In the long term (12-month horizon), we expect that (perhaps with the help of the CNB) part of the "hot money" may flow away from the koruna and part may stay for longer-term. Hence the attention could gradually turn to long-term positive fundamentals.

Looking at the development of long-term fundamentals behind the Czech crown (relative growth, relative inflation, external equilibrium), it is clear that they have improved

significantly since the start of the interventions. **According to our estimates, the Czech economy could, on the basis of long-term fundamentals, theoretically live with koruna levels which are approximately 10% stronger.** Nevertheless the uncertainty associated with the estimate of the koruna's long-term-fundamental value is high.



first year after leaving the intervention, we believe the CNB would not tolerate more than 5% gains of the koruna and in the coming years 2-3% per annum (assuming the real convergence of the Czech economy goes on) - see our tolerance band chart. Therefore, we are only betting on gradual gains of the **Czech currency. In a 12 months horizon we see the koruna at 26.00 EUR/CZK.**

It is hard to accurately estimate when the koruna resumes its long term appreciation trend. But we believe that gains will systematically be realized only after some long speculative positions have been removed. At the same time, the expectations of the first rate hike could help with the return to the appreciation trend. We don't expect the hiking cycle to start earlier than until mid-2018 though.

Jan Bures, KBC-CSOB Prague

In addition, as we have said, in the months and quarters immediately after the end of interventions, the koruna may dampen short-term negative factors (as being 'overbought'). Even if the koruna starts to gain significantly, it is likely to face resistance from the central bank. In the

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