



EXPAT ADVISORS



Czech Koruna Outlook

The Czech National Bank is expected to terminate its intervention in the trading of its currency. There has been much speculation as to when this will occur and how it will affect the Koruna's exchange rate with other major currencies. The public is necessarily left in the dark as to the details of these types of actions, but we can look to the signs in the market and the results of a new Bloomberg survey which was released on March 26th to gain more insight.

In the survey of 22 economists conducted from March 20 to March 23:

- 95% see Koruna cap exit in 2017 vs 71% in prior survey (May seen as most likely month by 59%)
- Koruna seen strengthening to 26.2 per euro by end-2017; Compared to current limit of 27 per euro (Details Below)

What is your estimate for EUR/CZK exchange rate at the end of 2017?

Median estimate:	26.18	korunas per euro
Average estimate:	26.10	korunas per euro
High estimate:	26.80	korunas per euro
Low estimate:	25.00	korunas per euro
Previous estimate:	25.00	korunas per euro

Source: Bloomberg survey

It would appear that the free float of the currency is going to happen sooner rather than later, and that the expected result will be a strengthening of the CZK by about 3% versus the Euro. If we look to the financial markets for confirmation, we can examine the forward exchange rates for both the CZK/EUR and CZK/USD. With a forward contract, traders can lock in a specific exchange rate at a future point in time, essentially expressing their view on expected movement in the rate. We will plot where both exchange rates are currently trading one and two years forward in time.

	SPOT RATE (CURRENT)	1 YEAR FORWARD	2 YEARS FORWARD
CZK/EUR	27.00	26.75 (+0.92%)	26.73 (+1.00%)
CZK/USD	25.00	24.25 (+3.00%)	23.70 (+5.20%)

The difference between the interest rates in the Czech Republic and the Euro zone are minimal, but interest rates are significantly higher in the US, which accounts for the greater move in the USD exchange rate. It can be inferred that almost all of the expected change in the EUR rate is directional speculation, while about half of the expected move in the USD rate is attributed to the interest rate equalization effect and half is explained by directional speculation.

Current activity in the market confirms the surveys findings that a major move is not widely expected when the currency floats freely. Yes, there will most certainly be an increase in volatility, but the CNB has been incited to wait until this point to have an orderly result, because a significant strengthening would harm the competitiveness of their export heavy economy.

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