ERSTE
Asset Management

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World's Biggest Currency Rally Not Over for $12 Billion Investor

- **Erste's Rezac sees longer-term koruna gains of 2%-3% per year**
- **Czech money market 'still a great deal' for foreign capital**

By Krystof Chamonikolas

(Bloomberg) -- Foreign investors came to the Czech Republic for a quick speculative payoff and stayed for an upswing in the economy and interest rates.

After staging the world's biggest currency rally, the koruna still has more room for gains, according to the second-biggest Czech money manager. Although some investors from abroad have taken profit after the central bank scrapped its 27-per-euro limit on appreciation a year ago, others are sticking around.

"I've been positively surprised by many foreigners' patience," Martin Rezac, the head of Erste Asset Management GmbH's Prague-based unit, said in an interview in Prague. "While foreign capital will keep trickling out of the country, the generous rate premium has significantly reduced the earlier risk of a mass exodus."

One of Europe's fastest-growing economies and resurgent inflation have prompted Czech policy makers to raise rates three times, becoming the continent's first central bank to turn to monetary tightening last year. That's made local assets more attractive and drove a 6.8 percent koruna rally against the euro since the Czech currency was allowed to trade freely.

Appealing Yields

Meanwhile, Czech government bond yields, among the world's smallest in late 2016, have risen to levels above lower-rated euro area members Spain and Portugal. Erste's Rezac, who oversees an equivalent of about $12 billion in assets, predicts the exchange rate will keep gaining about 2 percent to 3 percent per year in the longer term.

The koruna traded little changed at 25.319 against the euro as of 11:53 a.m. in Prague. The Czech National Bank says the exchange rate will average 24.9 per euro in the second quarter and 24.6 in the fourth.

Before the currency-intervention regime ended in April 2017, Rezac was among investors, analysts and central bankers who warned that foreigners might try to wind down their positions soon after the end of the policy shift, leading to a period of high volatility and preventing sustainable koruna appreciation.

Indeed, the share of foreigners has declined from a record 51 percent last September. But in a sign that capital outflows have been gradual, the proportion of non-residents holding koruna-denominated government notes has declined to only 38 percent at the end of February, remaining well above the roughly 10 percent before the central bank's interventions began in 2013.

Rezac says that instead of leaving the country, some foreigners are selling government bonds only to switch to more liquid, koruna-denominated assets.

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'Great Deal'

"The Czech money market now offers a yield of 0.5 percent to 0.7 percent plus a prospect of moderate koruna appreciation, which is still a great deal for foreign investors compared with what they can earn in euros," he said.

The call isn't completely without risks. The central bank has repeatedly said the koruna remains "overbought" and could weaken if a surge in global risk aversion prompts foreigners to dump the currency. But Rezac agrees with policy makers that such threats have diminished.

"The prospect of gradually rising Czech rates is attractive enough to keep some non-residents parked in koruna-denominated assets," Rezac said.