



FINANCIAL MARKET INFLATION EXPECTATIONS - JANUARY

Financial Market Department
Operations Analyses Division

2019

Fourteen domestic and three foreign analysts took part in the first survey of 2019. The results reveal that a larger proportion of the respondents expect the 2W repo rate to be raised at the CNB Bank Board's February meeting. The analysts also predict lower economic growth and inflation one year ahead. Nonetheless, despite an economic cooling, the labour market remains tight and is forcing employers to raise wages in order to retain staff, according to the analysts. This is reflected in slightly higher wage growth forecasts. The opinion about the exchange rate over the coming weeks largely reflects recent movements on the foreign exchange market, while the one-year forecast for the koruna recorded an only slight shift to stronger levels.

DOMESTIC ANALYSTS	I.	II.	III.	IV.	V.	VI.	VII.	VIII.	IX.	X.	XI.	XII.
J. Polanský, Česká spořitelna	+											
David Marek, Deloitte Czech Republic	+											
Viktor Zeisel, Marek Dřímál, Komerční banka	+											
Patrik Rožumberský, Unicredit Global Research	+											
František Táborský, Helena Horská, Raiffeisenbank	+											
Petr Dufek, ČSOB	+											
Petr Sklenář, J&T Banka	+											
Radomír Jáč, Generali Investments CEE	+											
Jaromír Šindel, Citi	+											
Martin Janíčko, Kamil Kovář, Moody's Analytics	+											
Jan Kudláček, Tomáš Lébl, AXA	+											
Jakub Seidler, ING	+											
Lukáš Kovanda, Czech Fund	+											
Michal Šoltés, RoklenFin	+											
FOREIGN ANALYSTS												
Timon Dreyer, Kevin Daly, Goldman Sachs	+											
Shivaan Tandon, The Economist Intelligence Unit	+											
Jose A. Cerveira, JP Morgan	+											

We would like to thank everyone who contributed to this survey of financial market inflation expectations.

Prague, 25 January 2019

FORECAST FOR Y/Y CPI GROWTH (%)

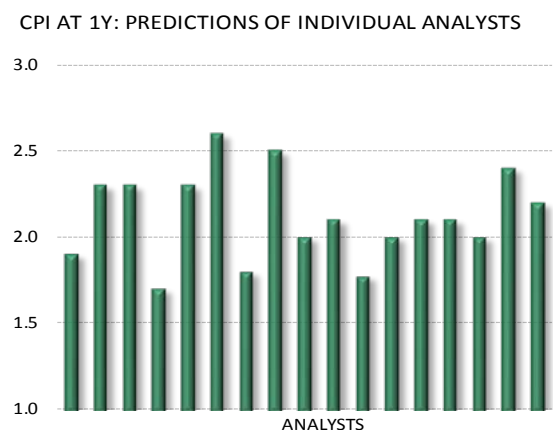
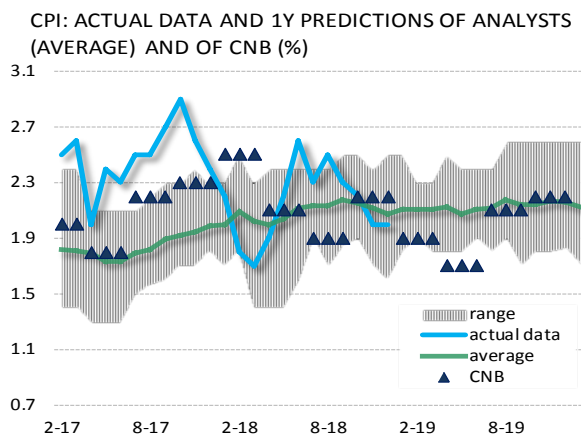
January 2019	CPI	
	1Y	3Y
minimum	1.7	1.7
average	2.1	2.0
maximum	2.6	2.3

1Y AND 3Y FORECAST FOR CPI GROWTH (%)

Date of Prediction	ANALYSTS		CNB (%)
	1Y	3Y	1Y
1.18	2.1	1.9	1Q: 1.9
4.18	2.1	2.0	
6.18	2.1	2.0	2Q: 1,7
9.18	2.1	2.0	3Q: 2,1
10.18	2.1	2.0	
11.18	2.2	2.0	4Q: 2.2
12.18	2.2	2.0	
1.19	2.1	2.0	

Although the consumer price index (CPI) recorded the same year-on-year growth as in November, i.e. 2.0%, the analysts' average one-year forecast moved downwards by 0.1 pp to 2.1%. At the three-year horizon, however, their inflation expectations remain anchored at the CNB's 2% target. The range of the estimates widened at the one-year horizon owing to a decrease in the minimum value, while narrowing at the three-year horizon because of an increase in the lowest value.

For some of the analysts, the December rise in the CPI was surprisingly small, and although the overall trend in actual inflation is anti-inflationary, the analysts still see strong inflationary pressures emanating from the domestic economy in the structure of the CPI. The persisting tight labour market will generate rapid growth in wages and – via strong demand and higher wage costs passing through to prices of final production – growth in the consumer price level. In addition, energy prices will rise as usual in January, and this time the distribution fee will go up as well. On the other hand, the opinion was expressed that inflation could stay below the CNB forecast given the low price of crude oil. For this reason, it is relatively unlikely to approach the upper boundary of the tolerance band around the CNB's inflation target (i.e. 3%).



FORECAST FOR GDP GROWTH (%)

January 2019	end of year	
	current	current+1Y
minimum	2.2	2.0
average	2.7	2.5
maximum	3.0	3.0

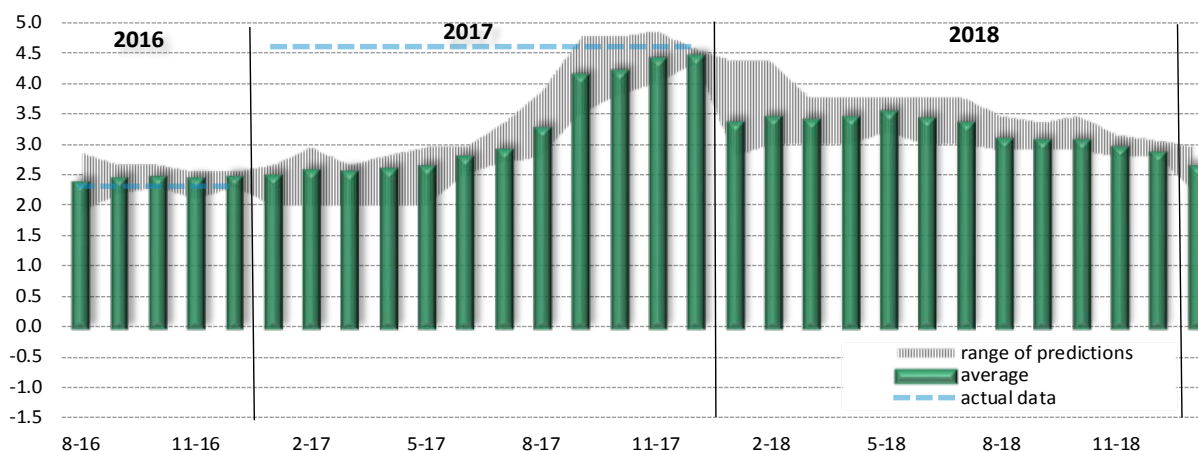
FORECAST FOR GDP GROWTH (%)

Date of Prediction	end of year	
	current	current+1Y
1.18	3.4	2.9
4.18	3.5	2.9
6.18	3.4	3.0
9.18	3.1	2.9
10.18	3.1	3.0
11.18	3.0	2.9
12.18	2.9	2.8
1.19	2.7	2.5

The analysts are rather less optimistic about economic growth and have further lowered their GDP growth forecast for the Czech Republic this year. In August last year they were predicting that the economy would grow by 3.0% in 2019, but they have gradually trimmed their estimate to a current 2.7%. This is 0.1 pp lower than in the December survey. According to the analysts, the trend of slowing economic growth will continue into 2020, when they believe GDP could grow by 2.5% year on year. The range of the estimates for 2019 was unchanged, with the minimum and maximum values declining to the same extent.

The slowdown of the Czech economy, which some of the analysts regard as a healthy return of economic growth to its potential and a closing of the inflation gap, will be due to several factors. One of them will undoubtedly be tighter CNB monetary policy. Labour and capacity shortages are another domestic fundamental greatly constraining the economic recovery in the Czech Republic. External factors will also play a very big role. These include a decline in external demand resulting from a slowdown of the global economy, which may also be hit hard by international trade disputes.

GDP GROWTH IN CURRENT YEAR: AVERAGE AND RANGE OF PREDICTIONS



FORECAST FOR 2W REPO, 12M PRIBOR AND 5Y AND 10Y IRS (%)

Date of Prediction	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
1.18	0.71	1.32	1.16	1.79	1.67	2.05	1.88	2.31
3.18	0.75	1.34	1.14	1.76	1.67	2.04	1.88	2.32
6.18	0.81	1.40	1.22	1.83	1.86	2.19	2.05	2.46
9.18	1.45	2.16	1.89	2.53	2.34	2.68	2.40	2.86
10.18	1.71	2.25	2.05	2.57	2.63	2.89	2.65	3.00
11.18	1.75	2.29	2.20	2.66	2.59	2.87	2.63	2.94
12.18	1.75	2.30	2.20	2.65	2.43	2.79	2.42	2.78
1.19	1.91	2.28	2.30	2.61	2.04	2.48	2.00	2.50

FORECASTS: MINIMUM, AVERAGE AND MAXIMUM 2W REPO, 12M PRIBOR, 5Y AND 10Y IRS (%)

January 2019	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
minimum	1.75	2.00	2.10	2.10	1.80	2.00	1.75	2.00
average	1.91	2.28	2.30	2.61	2.04	2.48	2.00	2.50
maximum	2.00	2.50	2.45	2.90	2.38	2.85	2.40	3.25

ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE (%)

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
15.1.	1.75	2.21	1.77	1.70

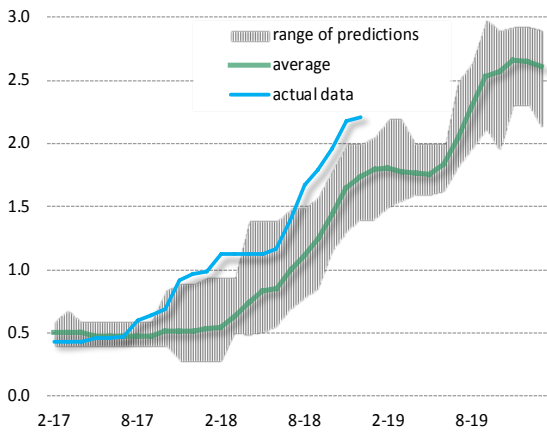
The analysts' differing opinions on inflation in the immediate future probably largely determine their views on what will happen to interest rates at the CNB Bank Board's February meeting. On the one hand, a majority of the analysts feel that an inflation acceleration in January coupled with strong wage growth could induce the CNB to raise policy rates. On the other, there is an opinion that the inflation pick-up will not be so strong and the CNB, given external political and economic factors (especially the form of Brexit) and weakening external demand, will adopt a wait-and-see strategy and leave policy rates unchanged in February. This is understandably conditional on a stable koruna exchange rate. Were the koruna to depreciate, the likelihood of a rate hike would naturally rise. Overall, 11 of the 17 respondents expect a 25 bp increase in the 2W repo rate at the February meeting. The remaining six foresee no change. The one-year outlook is little changed and the expected 2W repo rate has moved only slightly downwards. One of the analysts has revised his opinion and is now forecasting a monetary policy tightening of only 25 bp instead of 50 bp (see the table below).

ANALYSTS FORECAST - 2W REPO RATE LEVEL IN 1Y (%)

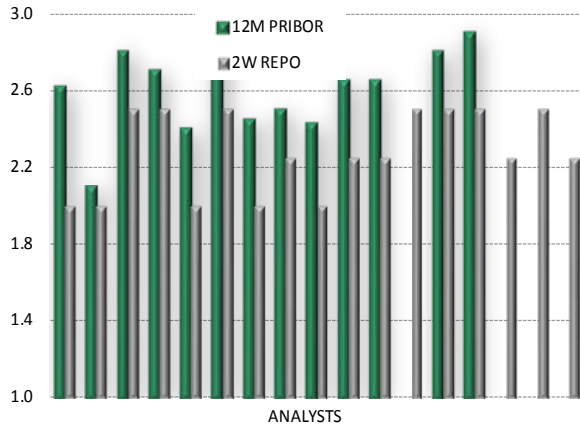
2W repo rate level in 1Y (%)	1.75	2.00	2.25	2.50	2.75
number of analysts - current survey	0	5	5	7	0
-previous survey	0	4	6	7	0

The forecast for 12M PRIBOR reference rates shifted up at the one-month horizon (owing to the prevailing expectations of a policy rate hike at the February meeting), but fell modestly one year ahead, as a slightly slower pace of CNB monetary policy tightening is expected over the rest of this year. The swap rate forecasts reflect the recent sharp drop in IRS rates on the market, but given the resulting levels the analysts expect a rapid correction.

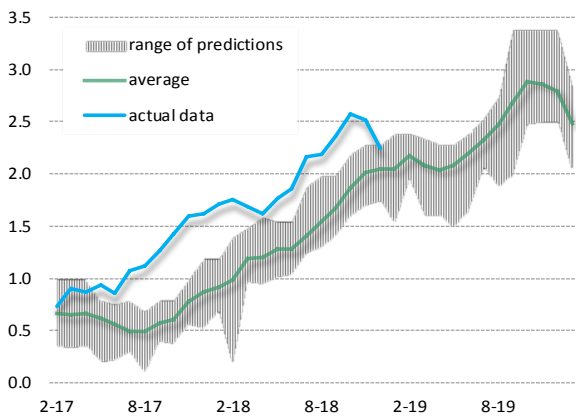
12M PRIBOR AT 1Y : ACTUAL DATA, AVERAGE AND RANGE OF PREDICTIONS



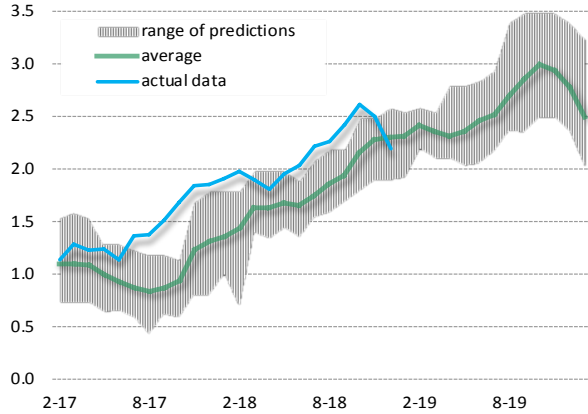
2W REPO AND 12M PRIBOR: 1Y PREDICTIONS OF INDIVIDUAL ANALYSTS



5Y IRS AT 1Y: AVERAGE AND RANGE OF PREDICTIONS



10Y IRS AT 1Y: AVERAGE AND RANGE OF PREDICTIONS



1M AND 1Y EXCHANGE RATE FORECAST

Date of Prediction	EUR/CZK	
	1M	1Y
1.18	25.43	24.80
4.18	25.29	24.59
6.18	25.51	24.64
9.18	25.53	24.82
10.18	25.62	24.89
11.18	25.86	25.07
12.18	25.78	25.09
1.19	25.55	25.05

EXCHANGE RATE FORECAST

January 2019	EUR/CZK	
	1M	1Y
minimum	25.20	24.10
average	25.55	25.05
maximum	25.70	26.00

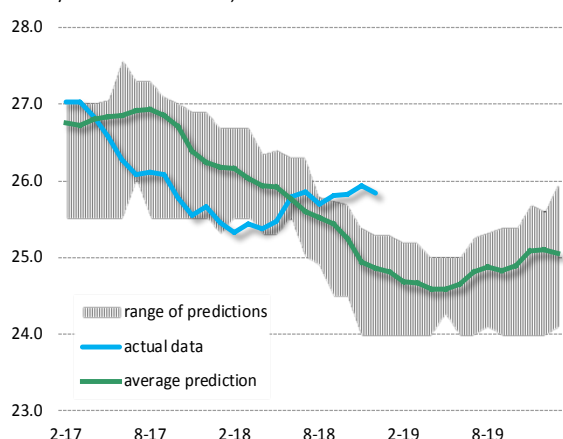
ACTUAL EUR/CZK AS OF FORECAST DEADLINE

15.1.	25.57
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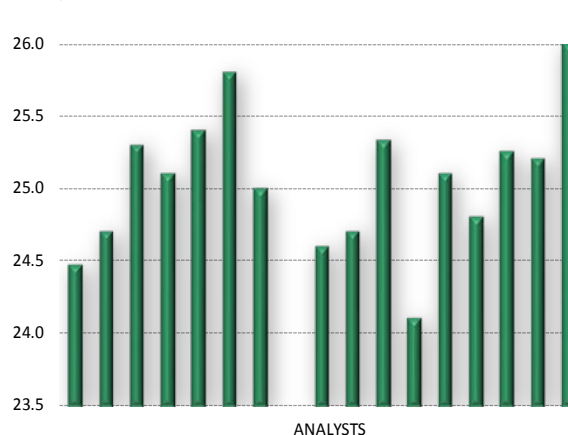
The koruna has strengthened from CZK 25.80 to CZK 25.57 against the euro since the last survey. This was reflected in the analysts' one-month forecast. As the average figure indicates, many of the respondents were expecting the koruna to continue appreciating in the very near future, to CZK 25.2 against the euro in the extreme case. The one-year forecast also moved to a stronger level, but in this case the change – of CZK 0.04 to CZK 25.05 to the euro – was only cosmetic.

The analysts are sticking to a long-term appreciation scenario, but it has an ever decreasing slope, or rate of gradual appreciation, based on the convergence scenario and the interest rate differential. External factors and perceived uncertainties make the exchange rate highly changeable and hard to predict in the short term. Nonetheless, its level is regarded as a key input to the decision on policy rates. According to the analysts, if the koruna stays weak or significantly far from the CNB forecast, the central bank will have a greater tendency to raise policy rates, thereby further increasing the interest rate differential and fostering a stronger koruna.

EUR/CZK: ACTUAL DATA, 1Y PREDICTIONS AND THEIR RANGE



EUR/CZK AT 1Y: PREDICTIONS OF INDIVIDUAL ANALYSTS



FORECAST FOR NOMINAL WAGE GROWTH (%)

January 2019	year end	
	current	current+1Y
minimum	5.3	2.7
average	6.8	5.2
maximum	8.6	8.0

FORECAST FOR NOMINAL WAGE GROWTH (%)

Date of Prediction	year end	
	current	current+1Y
1.18	7.2	5.0
4.18	7.2	5.2
6.18	7.8	5.6
9.18	8.2	6.3
10.18	8.3	6.4
11.18	8.4	6.5
12.18	8.3	6.7
1.19	6.8	5.2

According to the latest figures, the general unemployment rate fell again in November (to 1.9%). The analysts also see continued labour market overheating in the distribution of non-financial corporations' incomes, where the amounts paid in wages and salaries are still rising at the expense of profits. In their view, therefore, it is apparent that employers cannot afford to skimp on their employees despite the slowing economic growth. Firms are being forced to raise wages in order to retain quality staff. This is reflected in the analysts' forecasts, which for 2019 were increased again slightly on average – by 0.1 pp to 6.8%. Wage growth is expected to slow to 5.2% next year

WAGE GROWTH - END OF CURRENT YEAR: AVERAGE AND RANGE OF PREDICTIONS (%)

