

EA OUTLOOK AND EXPECTED EURO ADOPTION SURVEY OF ANALYSTS' OPINIONS

Financial Markets Department
Operations Analyses Division

2018

Summary

Seven respondents took part in this year's survey of the views of analysts from leading financial institutions on selected topical EU issues and on euro adoption in the Czech Republic.

According to the respondents, the EU is laden with many problems complicating its smooth functioning. They include, for example, the unclear direction of future political developments, growing populism and Euroscepticism, misalignment of the Member States' economies and high levels of government debt in some cases. For instance, almost all the respondents consider the fiscal situation in Greece to be unsustainable and debt restructuring to be unavoidable.

The prevailing view of the future arrangement of the EU is that the UK will ultimately leave. This might have a negative impact on the negotiating position of non-euro area countries. Brexit is not expected to have a major impact on the functioning of the Czech financial market. At the same time, it is not generally expected that any of the Member States will follow the UK out of the EU.

As regards monetary policy, inflation in the euro area is expected to be below the 2% inflation target in the coming quarters. The ECB is expected to move gradually away from unconventional instruments towards conventional ones. Most of the respondents expect the ECB's QE programme to be ended in 2018 Q4, naturally with continuing reinvestment of the assets purchased into the ECB's balance sheet. When choosing its QE exit strategy, the ECB might be inspired by the Fed.

The analysts have conflicting and often very diverse views on deepening integration, for example in the form of a common European minister of finance or the issuance of common financial instruments.

Although most of the analysts are of the view that the economic cons of the Czech Republic joining the euro area currently outweigh the pros and there is no need to hasten the euro preparations, all of the respondents concede that the euro will one day become the currency in the Czech Republic. This moment is expected to come in 2025 at the earliest, at an average exchange rate of around CZK 21.2 to the euro. However, these data are surrounded by considerable uncertainty and only a few of the analysts ventured to make such an estimate, as there are many economic and political factors which could postpone the Czech Republic's entry to the euro area.

The participants in this year's survey were:

Jan Vejmělek, Komerční banka

František Táborský, Raiffeisenbank

Petr Dufek, ČSOB

Petr Sklenář, J&T

Jan Kudláček and Ondřej Kurečka, AXA investiční společnost

Michal Šoltés, Roklen

Patrik Rožumberský, UniCredit Bank

We would like to thank everyone who contributed.

Prague, 15 May 2018

The views expressed in this document are based on a survey among the participating analysts and do not necessarily reflect the official views of the CNB.

1. EU RISKS AND OPPORTUNITIES

The biggest risks to the functioning of the EU

The key risks seen in the political area are unfinished integration, the unclear direction of further integration, the absence of political priorities at euro area level and non-compliance with the rules. Attention was also drawn to the growing influence of populist movements and Eurosceptic parties (for example in Italy), which might gain even greater importance at a time of slowing economic growth in the EU.

Insufficient alignment of the Member States' economies and business cycles is viewed as the key macroeconomic issue. According to some of the analysts, the widening divergence and external shocks are even giving rise to conflicting policy responses. The absence of adjustment mechanisms in the form of a common fiscal policy, i.e. a single European budget and national debt consolidation, is then felt in these situations. The centrally pursued monetary policy of the ECB cannot alone meet the individual economies' needs. However, there are some objections to the ECB and the way it is conducting monetary policy, in particular QE, i.e. extremely easy monetary policy, at a time of economic growth. No less important economic problems concern the overindebtedness of some EU Member States, especially those in the south of Europe. Opinions were also expressed that the causes of the European debt crisis have yet to be resolved.

Although concerns of increasing barriers to international trade are a topical issue in the media, this issue was addressed by only one respondent, who said he did not expect any major negative impacts on the EU given the general lack of interest in escalating the situation.

The sustainability of Greek government debt. Will this debt have to be restructured?

All but one of the analysts consider Greece's current debt level to be unsustainable and believe a restructuring of Greek debt will be unavoidable if another recession occurs. Postponing the debt maturity seems to be an insufficient solution. If the debt really were restructured, there are concerns that political factors would again be given preference over economic aspects.

Against this, the opinion was expressed that restructuring efforts might come at the cost of political uncertainty, which could ultimately cause greater complications than continued debt rolling and maintaining the status quo. Moreover, the latest results show a clear improvement in the Greek government's financial situation, as evidenced by renewed issuance of Greek government bonds. Some of the analysts regard the Greece's current political leaders as far more conscientious than their predecessors.

What FinTech opportunities and risks do you see for the development and stability of the EA/EU financial market?

The responses to this question were relatively brief. Blockchain technology, which may help store data on financial market transactions, was mentioned as an opportunity. On the other hand, the absence of regulation and the inability to perform effective supervision, which in the extreme case may lead to future crises, are viewed as risks. The high volatility of FinTech-related assets and its spillover to the rest of the financial market are also seen as a danger.

2. BREXIT

Will the EU and UK manage to sign a Brexit agreement under Article 50 of the EU treaty this year? What is the probability that the UK will ultimately not leave the EU?

The political negotiations about Brexit are very unclear, but most of the respondents agree that the UK is highly likely to leave the EU in the end. By contrast, the chances of a yes vote in another referendum on the UK staying in the EU are considered very low (only 15% according to some estimates). Despite recently observed efforts made by various organisations to convince the British of the pros of remaining in the EU, the opposition to the referendum result is not strong enough to reverse it.

There is also a prevailing view that an Article 50 Brexit agreement will be signed this year, probably towards the year-end. According to two of the respondents, due to the complexity of the entire process, efforts to prolong the negotiating period can be expected and the agreement might not be signed until next year. This notwithstanding, all the respondents are convinced that Brexit will take place at some future point.

Could the influence of non-euro area EU Member States on the future form of the EU decrease after the exit of the UK from the EU?

The prevailing view among the analysts is that the influence of non-euro area EU Member States will be reduced after the UK's exit from the EU, and not solely because of the purely arithmetic reason of an increase in the weight of euro area countries. There was concern that the UK would be missed as a counterpart in negotiations with large countries such as France and Germany. At the same time, the political will to unify and restrict the influence of national governments in favour of centralising power in Brussels might tend to win out in decision-making in an EU without the UK.

On the other hand, mention was made of the argument that the UK has gradually and voluntarily been curbing its efforts to influence the running of the EU of late, so there may be no major changes in decision-making after Brexit.

Impacts of the UK's potential departure from the EU's internal market on the Czech Republic and the domestic financial market and on cross-border provision of financial services

The prevailing view is that Brexit will have only a negligible impact on the Czech financial market and the cross-border provision of its services. The UK is not a significant market for domestic banks, and barriers to the cross-border provision of financial services would probably affect UK financial institutions more.

A small negative effect might arise in the form of a slight decline in liquidity in the financial market or a marginal drop in competitive pressures in the provision of financial services. There is not a strong belief that the UK will retain the option of free provision of financial services in the EU. However, the UK's separation from the single market might have larger negative consequences for Czech exporters, as the UK is the Czech Republic's fourth biggest export partner.

Will any of the EU Member States will follow the UK?

Six of the seven respondents do not expect any other EU Member State to leave the EU in the coming years. Nevertheless, not even they completely rule out the possibility of another country leaving the EU, drawing attention to growing Euroscepticism, which will keep relations in the EU tense. According to the analysts, another issue is how the EU will deal with the "problematic" Hungary and Poland.

3. MONETARY POLICY

Price and financial stability developments in the EU and the EA in the next few years

The responses suggest that growth in the price level, with the exception of asset prices, will fall short of the inflation target in the coming quarters. Inflation might near to 2% in the second half of 2019. Although lending activity will not significantly exceed nominal GDP growth, the cooling of economic activity might be reflected in an increase in bad loans. On the other hand, financial stability is expected to improve overall in the event of an economic recovery.

The analysts are also concerned about widening divergence and misalignment of EA countries. A gradual change in monetary policy instruments is expected, with the ECB moving away from QE towards interest rates. A change in the ECB's management might lead to faster tightening of monetary conditions than under the leadership of Mario Draghi. While risks are not expected to accumulate in the banking sector, problems might emerge in the public finances of southern European countries (such as Greece and Italy) in the event of a recession. In Italy, a problem might arise from an increase in government debt funding costs after the ECB ends QE.

When do you think the ECB's asset purchase programme will end?

The same as a year ago, most of the analysts expect the current asset purchase programme to end during 2018. This time, however, the estimated QE end dates are more concentrated in 2018 Q4. One analyst believes QE will be prolonged until 2019 H1. The ECB will naturally continue to reinvest funds from maturing financial assets, but it will not further increase their size or expand its balance sheet.

What form do you think the ECB will choose for ending its asset purchase programme and normalising its monetary policy?

Most of the analysts agree that the ECB will be inspired by the Fed when ending QE. However, greater emphasis will be placed on making the process more gradual. Most of the analysts believe that the purchases will be tapered out in 2018 Q3, although one respondent expects a sudden termination in October 2018. However, reinvestment of maturing assets should be maintained and the balance sheet should be reduced only in 2019. The rate normalisation process might be launched in the same year. Unless inflation surges significantly in the euro area, the analysts expect the ECB to adhere to its previous rhetoric and increase rates for the first time some time after ending QE.

What is the monetary-policy-neutral level of nominal interest rates in the EA?

As in last year's survey, the analysts estimate that the monetary policy-neutral level of nominal rates lies in the range of 2%–3%. The median estimate is also the same (2.5%). Conversely, the mean rose slightly from 2.2% last year to the current 2.3%.

4. INTEGRATION AND REGULATION

What is your view of the EC's proposals to deepen integration, especially the proposal to establish a European ministry of finance and a European monetary fund, the considerations about establishing a macroeconomic stabilising function, and a strengthening of support for structural reforms?

The analysts' responses to this issue are very diverse. Some view the establishment of the above institutions as a necessary and logical step towards integration in the euro area. On the other hand, there are strong critical voices questioning the ability of such authorities to respond with sufficient speed and flexibility to locally specific challenges, especially in the heterogeneous states making up the EU. Some of the respondents regard such steps as a further expansion of a bureaucracy with many powers but minimal responsibility. There are also concerns that these measures will not resolve the real structural problems of overindebted European countries anyway. There was even a comment that such integration efforts might bolster Euroscepticism and antagonise those who have not previously been active opponents of deepening integration.

Mention was also made of related political difficulties arising from the fact that the representatives of EU-wide authorities are only representatives of national states, not independent EU representatives. This may cause ineffectiveness or be a source of major conflicts within the EU. Last but not least, the willingness of representatives of individual countries to cede powers to the EU's central authorities was questioned.

Joint issues of European government bonds or similar instruments, for instance the ESRB's latest proposal to develop SBBS through the securitisation of EU countries' government bonds

The responses to this issue are also naturally very mixed. Some see great potential in joint European issues, especially as regards reducing the costs of raising funds for EU Member States viewed as "more risky". On the other hand, others see clear potential for free rider and moral hazard effects in such instruments. Nevertheless, joint issues found more supporters among the analysts than last year.

Do you consider regulatory support for securities/investment instruments regarded as sustainable finance, i.e. environmentally or socially responsible investments, to be desirable?

Regulatory support for environmentally or socially responsible investment instruments gained distinctly less favour among the analysts. Although some of them support it, they ask whether there are more effective ways of intervening in markets and whether such support can help achieve the declared objective. Others flatly reject such regulation and assess these proposals as a misconception of the regulatory role in the financial sector. They strongly question the benefit of such interventions in market mechanisms and ask whether it would be more appropriate to use, say, state guarantees or subsidies to achieve economically unprofitable objectives.

5. THE CZECH REPUBLIC'S ACCESSION TO THE EA

Do the economic pros of the Czech Republic joining the EA currently outweigh the cons?

Most of the analysts believe that the economic cons of the Czech Republic joining still outweigh the pros. The number of respondents with the opposite view decreased by one compared to last year, with only one analyst now seeing a preponderance of pros.

Should the Czech Republic step up its preparations for euro adoption?

According to most of the analysts, the Czech Republic need not rush to introduce the euro, especially since the future arrangement of the EU is unclear and because fixing the koruna exchange rate close to current levels would clearly and unfavourably set the level of wealth of domestic households and firms. On the other hand, two of the responses were positive (compared to three last year). Preparations should be stepped up in the area of public education policy, for example, as the euro adoption process itself may be relatively fast and the main problem at the moment lies in the public's attitude to the euro. It will thus be necessary to change the public's aversion to the euro and, above all, to address the lack of knowledge about the functioning and impacts of the single European currency.

What do you see as the main benefits of fast euro adoption?

Since the Czech economy is currently highly dependent on the euro area economy, it is considered important for the Czech Republic to be able to contribute directly to the monetary policy of the euro area, alongside other benefits.

Will the CNB ultimately become a euro area Member State?

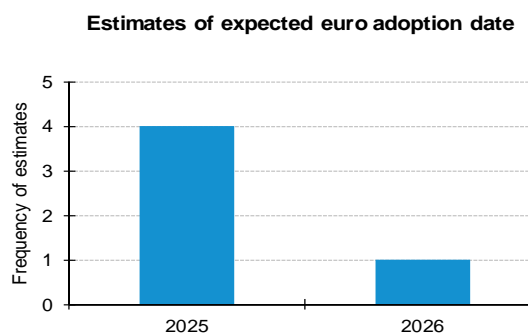
Five of the respondents believe that the euro will ultimately become the currency in the Czech Republic. The remaining two analysts do not expect this to happen in the near future, pointing to a preponderance of economic disadvantages, adoption costs and insufficient public support. As the current growth phase comes to an end, problems relating to the fact that the EMU is not an optimum currency area may worsen. This might bolster Euroscepticism and postpone the Czech Republic's euro area entry. Nevertheless, even these two respondents do not completely rule out euro adoption in the Czech Republic.

Expected euro adoption date

The estimated euro adoption date in the Czech Republic is little changed from last year's survey and remains focused on 2025. A slight postponement compared to last year's results is only visible if the average is calculated to one decimal place. The interval between the survey date and the expected euro adoption date in the Czech Republic is thus another year shorter and back at the seven years indicated by the results in 2014–2016. It should again be noted that this is the most optimistic and hence the nearest possible date; a realistic average would probably be much further in the future.

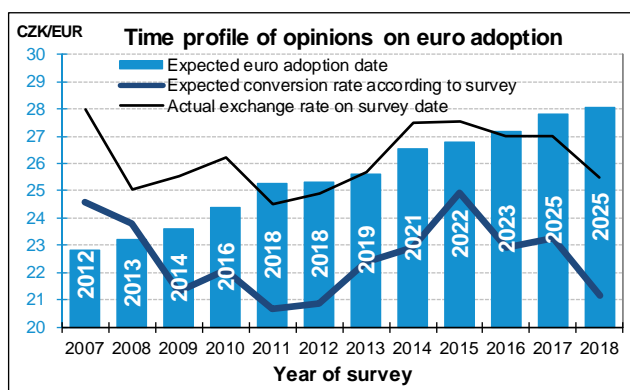
Nearest expected euro adoption date	
min	2025
average	2025
max	2026
Expected conversion rate (EUR/CZK)*	
min	20,00
average	21,17
max	22,00

* min conversion rate = strongest expected EUR/CZK rate



Expected CZK/EUR conversion rate

Only three of the respondents ventured to speculate about the future conversion coefficient upon the Czech Republic's entry to the euro area. Their average estimate reflected the koruna's rate on the foreign exchange market and also shifted to a stronger level. Last year it was CZK 23.25 to the euro, whereas now it is CZK 21.17.




What factors might jeopardise euro adoption on the expected date?

The potential problems that the analysts see as possible causes of a postponement of the Czech Republic's entry to the euro area can be divided into two groups – political and economic. The political causes include increasing populism, the long-running decline of the pro-Western domestic political parties and the unwillingness of domestic political representatives to meet the commitment to adopt the euro. The position in the business cycle was mentioned as an economic argument. The end of the current period of economic growth and a fall into recession might also delay the moment when the euro becomes legal tender in the Czech Republic. Persisting problems in the euro area, both political and economic, stand at the interface between these two groups.

Would it be beneficial for the Czech Republic to join the banking union before EA entry?

The analysts are against the Czech Republic joining the banking union earlier than it has to and see no major pros in doing so. On the contrary, they would prefer supervisory powers to stay with the CNB and not be transferred to a central EU authority, as the latter would probably not be in a better position to identify risks than a locally operating supervisory authority. Moreover, the quality of the domestic banking sector relative to the euro area attests to the high quality of domestic supervision and does not suggest any need to play by European rules. According to some of the analysts, the banking union's potential scope of competence, such as the issue of deposit insurance, is also unclear. According to one respondent, however, voluntary accession to the banking union might have a political dimension as a signal that we take the Czech Republic's entry to the euro area seriously.

	
SELECTED EUROPEAN TOPICS AND EURO ADOPTION IN THE CZECH REPUBLIC - SURVEY OF ANALYSTS -	
Date:	<input type="text"/>
Name of organisation:	<input type="text"/>
1. EU RISKS AND OPPORTUNITIES	
<i>What do you see as the greatest risks to the functioning of the euro area?</i>	
<input type="text"/>	
<i>Might the problems in Southern European banks result in a banking crisis?</i>	
<input type="text"/>	
<i>Do you consider Greece's current fiscal policy stance to be sustainable and its debt situation to be stabilised?</i>	
<input type="text"/>	
<i>Do you expect the new US president to have any impacts on the euro area? If so, what impacts?</i>	
<input type="text"/>	
<i>What FinTech opportunities and risks do you see for the development and stability of the euro area/EU financial market?</i>	
<input type="text"/>	
2. BREXIT	
<i>When and in what form do you expect the future post-Brexit relationship between the EU and the United Kingdom to be clarified?</i>	
<input type="text"/>	
<i>What do you think the trade and economic-policy agreements between the UK and the EU will look like?</i>	
<input type="text"/>	
<i>What impact will Brexit have on the euro area and on the non-euro area states?</i>	
<input type="text"/>	
<i>Do you think that any other EU member states will follow the UK?</i>	
<input type="text"/>	
3. MONETARY POLICY	
<i>What price and financial stability developments do you expect to see in the EU and the euro area in the next few years?</i>	
<input type="text"/>	
<i>How will the euro area be affected by the divergence between the ECB's and Fed's monetary policies?</i>	
<input type="text"/>	
<i>When do you think the ECB's asset purchase programme will end?</i>	
<input type="text"/>	
<i>What form do you think the ECB will choose for ending its asset purchase programme and returning to the normalisation of its monetary policy?</i>	
<input type="text"/>	
<i>What do you think the monetary-policy neutral level of euro area nominal interest rates is?</i>	
<input type="text"/>	
4. INTEGRATION AND REGULATION	
<i>Do you expect a stronger impetus for further deepening the economic/fiscal integration of the EMU this year? In what area?</i>	
<input type="text"/>	
<i>Do you see any potential in joint issues of European government bonds or similar instruments?</i>	
<input type="text"/>	
<i>What are/will be the impacts of strengthening banking regulation? What do you expect from the new proposals for mitigating risks in the banking sector?</i>	
<input type="text"/>	
5. THE CZECH REPUBLIC'S ACCESSION TO THE EMU	
<i>Do the economic pros of the Czech Republic joining the EMU currently outweigh the cons?</i>	
<input type="radio"/> Yes <input type="radio"/> No	
<i>Should the Czech Republic step up its preparations for euro adoption?</i>	
<input type="radio"/> Yes <input type="radio"/> No	
<i>If yes, what do you see as the main benefits of fast euro adoption?</i>	
<input type="text"/>	
<i>Do you believe that the Czech Republic will ultimately become an EMU member?</i>	
<input type="radio"/> Yes <input type="radio"/> No	
<i>If NO, why not?</i>	
<input type="text"/>	
<i>If YES, when do you expect the Czech Republic to adopt the euro?</i>	
<input type="text"/>	
<i>What exchange rate do you expect for the conversion of koruna into euro?</i>	
<input type="text"/>	
<i>What factors might jeopardise adoption of the euro on your expected date?</i>	
<input type="text"/>	
<i>Would it be beneficial for the Czech Republic to join the banking union before EMU entry? Why?</i>	
<input type="text"/>	