# FINANCIAL MARKET INFLATION EXPECTATIONS – OCTOBER

Financial Markets Department
Operations Analyses Division

2012

CNB CZECH NATIONAL BANK

Eleven domestic and three foreign analysts sent in their contributions to the October survey. The results show that the inflation forecast decreased slightly at both the one-year and the three-year horizon. The fall in GDP is expected to be somewhat smaller this year. Next year, the economy should grow noticeably more slowly than expected in September. Most of the analysts expect key interest rates to remain unchanged in November. The forecast for the koruna's exchange rate shifted slightly towards weaker levels at both horizons. According to the analysts, nominal wages will grow more slowly both this year and the next.

| DOMESTIC ANALYSTS | I. | II. | III. | IV. | V. | VI. | VII. | VIII. | IX. | X. | XI. | XII. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Martin Lobotka**, Česká spořitelna | + | + | + | + | + | + | + | + | + | + | | |
| **David Marek**, PATRIA Finance | + | + | + | + | + | + | + | + | + | + | | |
| **Jan Vejmělek, Komerční banka** | + | + | + | + | + | + | + | + | + | + | | |
| **Pavel Sobíšek, Unicredit Global Research** | + | + | + | + | + | + | + | + | + | + | | |
| **Michal Brožka, Helena Horská, Raiffeisenbank** | + | + | + | + | + | + | + | + | | + | | |
| **Petr Dufek, ČSOB** | + | + | + | + | + | + | + | + | + | + | | |
| **Petr Sklenář, J&T Banka** | + | + | + | + | + | | + | + | + | + | | |
| **Radomír Jáč, Generali PPF** | + | + | + | + | + | + | + | + | + | + | | |
| **Jaromír Šindel, Citi** | | | | | | + | | | + | + | | |
| **Vojtěch Benda, ING Commercial Banking** | + | + | + | + | + | | | + | + | + | | |
| **Tomáš Holinka, Moody's Analytics** | + | + | + | + | + | + | + | | + | + | | |
| **FOREIGN ANALYSTS** | | | | | | | | | | | | |
| **Magdalena Polan, Goldman Sachs** | | + | + | | + | | | + | | + | | |
| **Katya Kocourek, The Economist Intelligence Unit** | + | + | + | + | + | + | + | + | + | + | | |
| **Nicolaie Alexandru, JP Morgan** | | | | | + | | | | + | + | | |

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

Prague, 24 October 2012

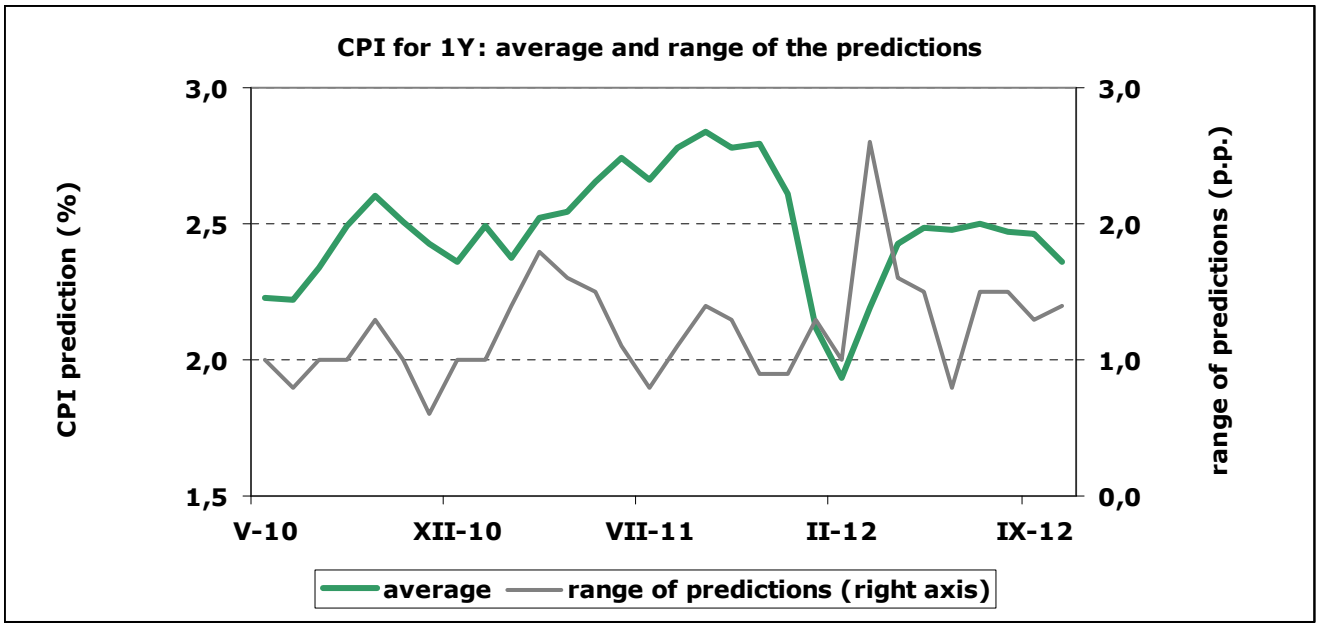
| October 2012 | 1R CPI y/y % | 3Y CPI y/y % |
|---|---|---|
| minimum | 1,5 | 1,7 |
| average | 2,4 | 2,2 |
| maximum | 2,9 | 2,6 |

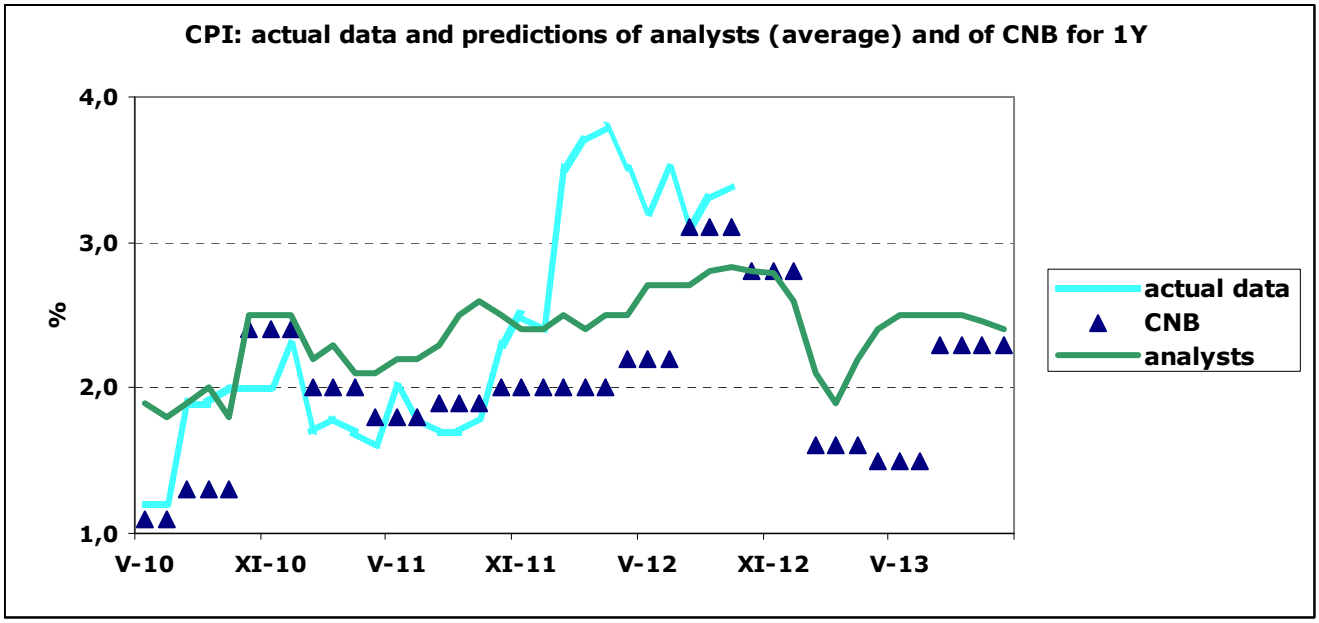
| Prediction Horizon / Date of Prediction | 1Y y/y CPI % | 3Y y/y CPI % | 1Y CNB % |
|---|---|---|---|
| X-11 | 2,8 | 2,2 | 3Q: 3,1 |
| XI-11 | 2,8 | 2,2 | 4Q: 2,8 |
| II-12 | 1,9 | 2,1 | 1Q: 1,6 |
| IV-12 | 2,4 | 2,2 | |
| V-12 | 2,5 | 2,2 | 2Q: 1,9 |
| VIII-12 | 2,5 | 2,2 | |
| IX-12 | 2,5 | 2,3 | 3Q: 2,3 |
| X-12 | 2,4 | 2,2 | 4Q: 2,3 |

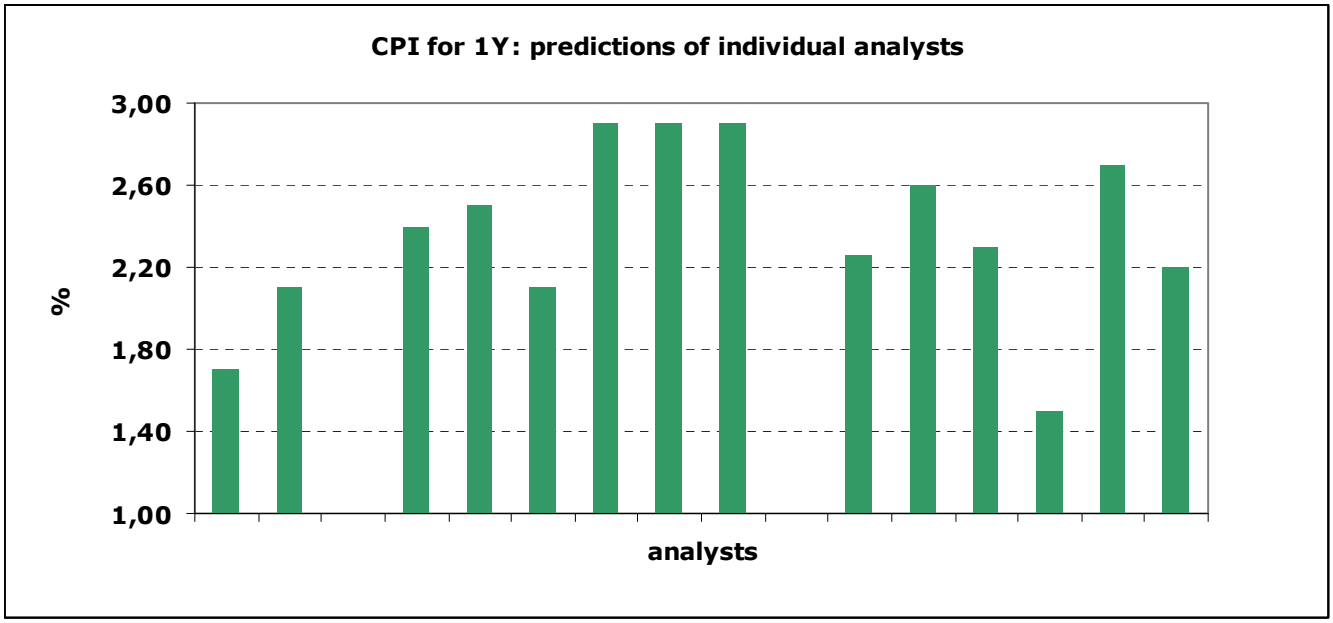
Although the consumer price index increased modestly year on year in September (to 3.4%), both the one-year and three-year inflation forecasts declined slightly. The analysts thus on average expect the CPI to be up by 2.4% next October and by 2.2% two years later. The range of both the one-year and three-year forecasts widened owing to a decline in the minimum estimates.

In the coming period, headline inflation should be driven mainly by rising administered prices (rents in particular) and a change to indirect taxes (VAT). Although VAT should push inflation upwards by exactly 1 pp, the analysts expect the overall impact to be slightly lower, for example at the expense of retailers' margins. In addition, the VAT changes will adversely affect household consumption. This, in turn, will have a negative impact on demand-pull inflation, which will thus remain negative.

Owing to the dissatisfaction of several Civic Democratic Party (ODS) deputies, however, there is still considerable uncertainty surrounding the approval of the increase in VAT rates. If it is not approved, inflation in 2013 will rise more slowly than the analysts currently expect on average. By contrast, faster growth in food prices is considered an upside risk to inflation.




CPI: actual data and predictions of analysts (average) and of CNB for 1Y
4,0
3,0
2,0
1,0
%
V-10
XI-10
V-11
XI-11
V-12
XI-12
V-13
actual data
CNB
analysts

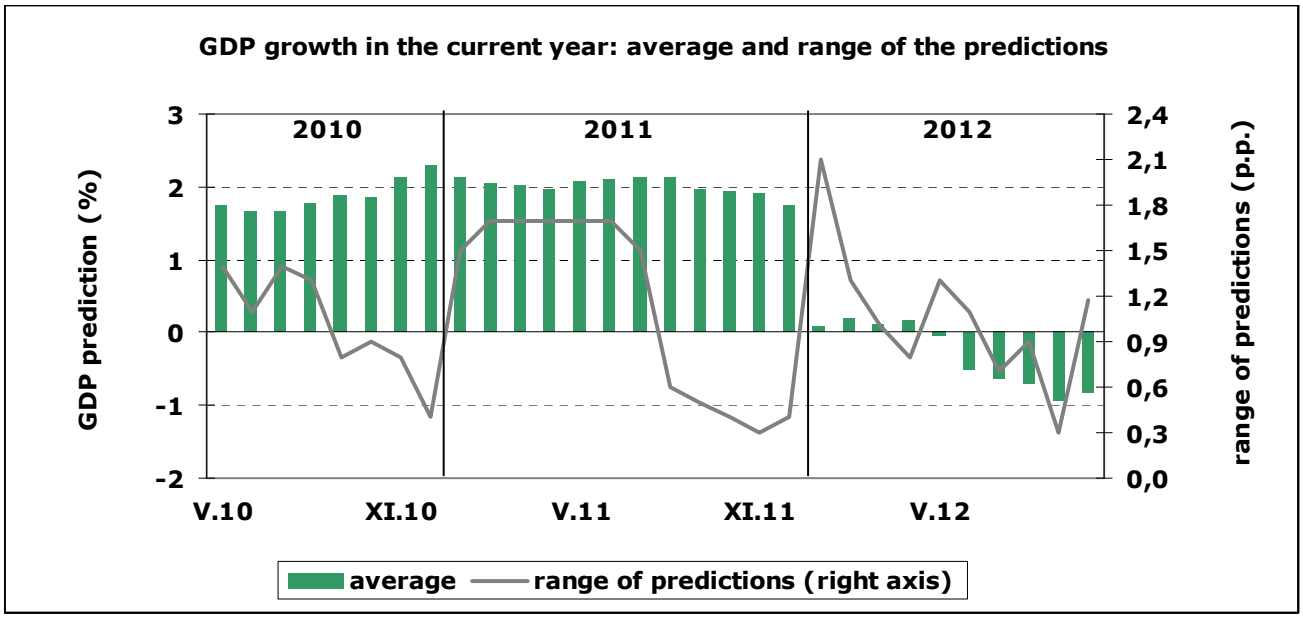

CPI for 1Y: predictions of individual analysts
3,00
2,60
2,20
1,80
1,40
1,00
%
analysts

| October 2012 | end of year current | +1Y |
|---|---|---|
| | GDP % | |
| minimum | -1,2 | -1,2 |
| average | -0,8 | 0,6 |
| maximum | 0,0 | 2,0 |

| Prediction Horizon / Date of Prediction | end of year current | current+1Y |
|---|---|---|
| | % GDP Growth | |
| X-11 | 1,9 | 1,3 |
| XI-11 | 1,9 | 0,9 |
| II-12 | 0,2 | 2,1 |
| IV-12 | 0,2 | 1,9 |
| V-12 | 0,0 | 1,8 |
| VIII-12 | -0,7 | 1,2 |
| IX-12 | -0,9 | 1,1 |
| X-12 | -0,8 | 0,6 |

The analysts' opinion on Czech GDP growth this year improved slightly, whereas the forecast for next year shifted noticeably downwards. The Czech economy is expected to contract by 0.8% in 2012 (compared to 0.9% in the previous survey) and expand by just 0.6% in 2013 (compared to 1.1% in September). The range of the forecasts widened for both monitored years due to a rise in the maximum estimate for this year and a decrease in the minimum estimate for next year.

The revision of the forecast for domestic economic growth in 2013 was partly a result of a decline in the consumer confidence index, but was mainly due to a more pessimistic view among the analysts regarding future economic growth in the EMU. Despite the revision, some analysts are afraid that the scenario may even be worse and still consider economic developments in the EMU as the key factor skewing the risk of non-fulfilment of the forecast towards slower domestic economic growth.



| October 2012 | 1M 2W Repo Rate % | 1Y 2W Repo Rate % | 1M 12M PRIBOR % | 1Y 12M PRIBOR % | 1M 5Y IRS % | 1Y 5Y IRS % | 1M 10Y IRS % | 1Y 10Y IRS % |
|---|---|---|---|---|---|---|---|---|
| **minimum** | 0,10 | 0,05 | 1,00 | 0,60 | 1,00 | 1,20 | 1,60 | 1,80 |
| **average** | 0,24 | 0,23 | 1,07 | 1,15 | 1,10 | 1,58 | 1,67 | 2,13 |
| **maximum** | 0,25 | 0,50 | 1,20 | 1,45 | 1,30 | 2,20 | 1,75 | 2,40 |

| Prediction Horizon / Date of Prediction | 1M 2W Repo Rate % | 1Y 2W Repo Rate % | 1M 12M PRIBOR % | 1Y 12M PRIBOR % | 1M 5Y IRS % | 1Y 5Y IRS % | 1M 10Y IRS % | 1Y 10Y IRS % |
|---|---|---|---|---|---|---|---|---|
| X-11 | 0,75 | 0,84 | 1,68 | 1,91 | 1,79 | 2,48 | 2,32 | 2,93 |
| XI-11 | 0,75 | 0,80 | 1,71 | 1,91 | 1,74 | 2,38 | 2,23 | 2,84 |
| II-12 | 0,75 | 0,85 | 1,74 | 1,92 | 1,71 | 2,32 | 2,20 | 2,75 |
| IV-12 | 0,75 | 0,88 | 1,78 | 1,97 | 1,81 | 2,46 | 2,23 | 2,83 |
| V-12 | 0,69 | 0,71 | 1,74 | 1,84 | 1,58 | 2,22 | 2,01 | 2,63 |
| VIII-12 | 0,45 | 0,31 | 1,44 | 1,47 | 1,16 | 1,59 | 1,73 | 2,18 |
| IX-12 | 0,33 | 0,29 | 1,24 | 1,34 | 1,17 | 1,63 | 1,75 | 2,23 |
| X-12 | 0,24 | 0,23 | 1,07 | 1,15 | 1,10 | 1,58 | 1,67 | 2,13 |

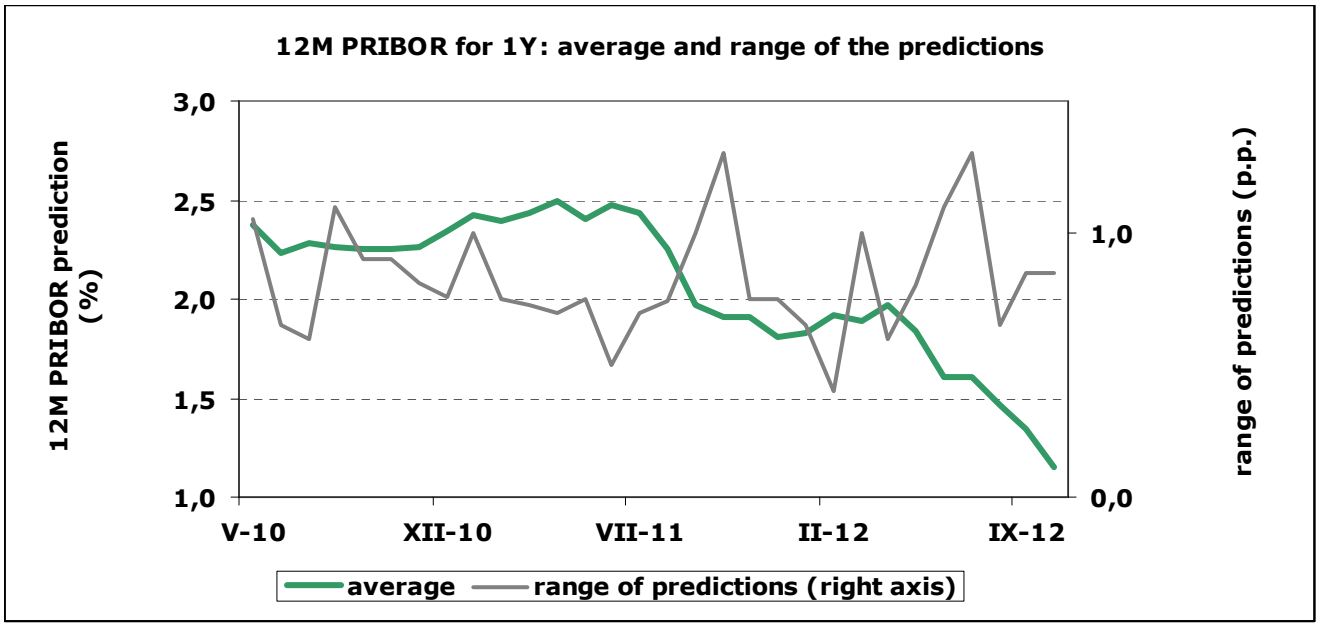
**Actual indicator values as of forecast deadline**

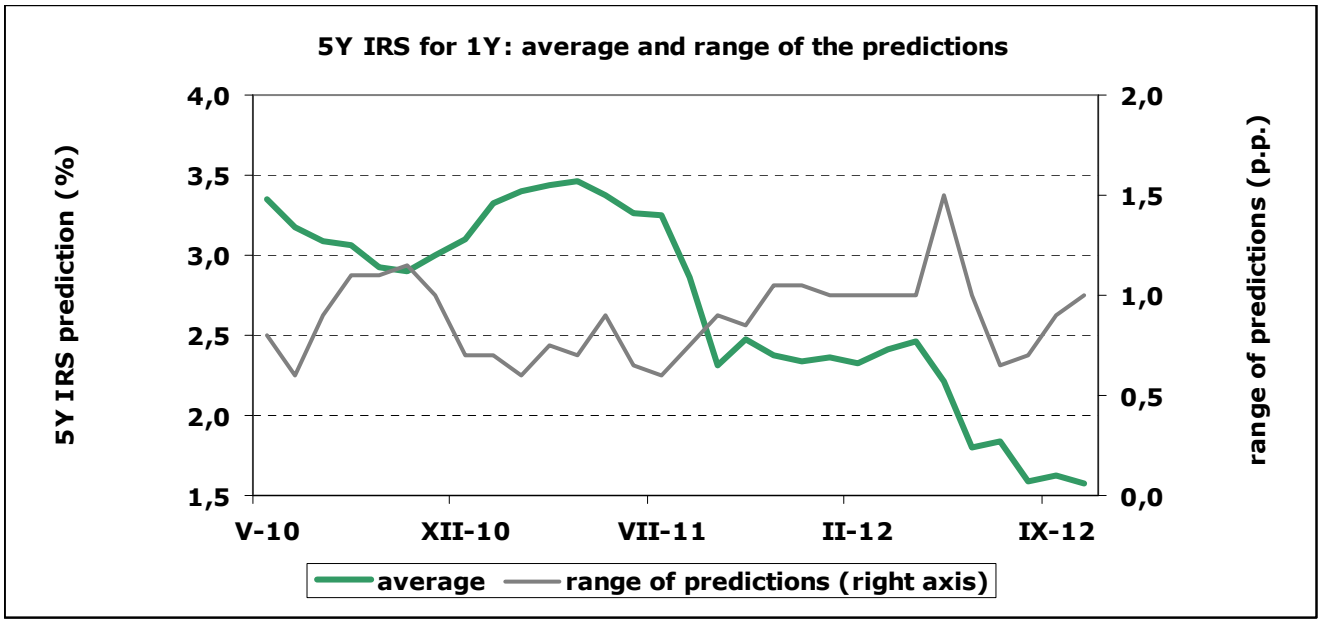
| | 2W Repo Rate | 12M PRIBOR | 5Y IRS | 10Y IRS |
|---|---|---|---|---|
| **12.10.** | 0,25% | 1,08% | 1,05% | 1,62% |

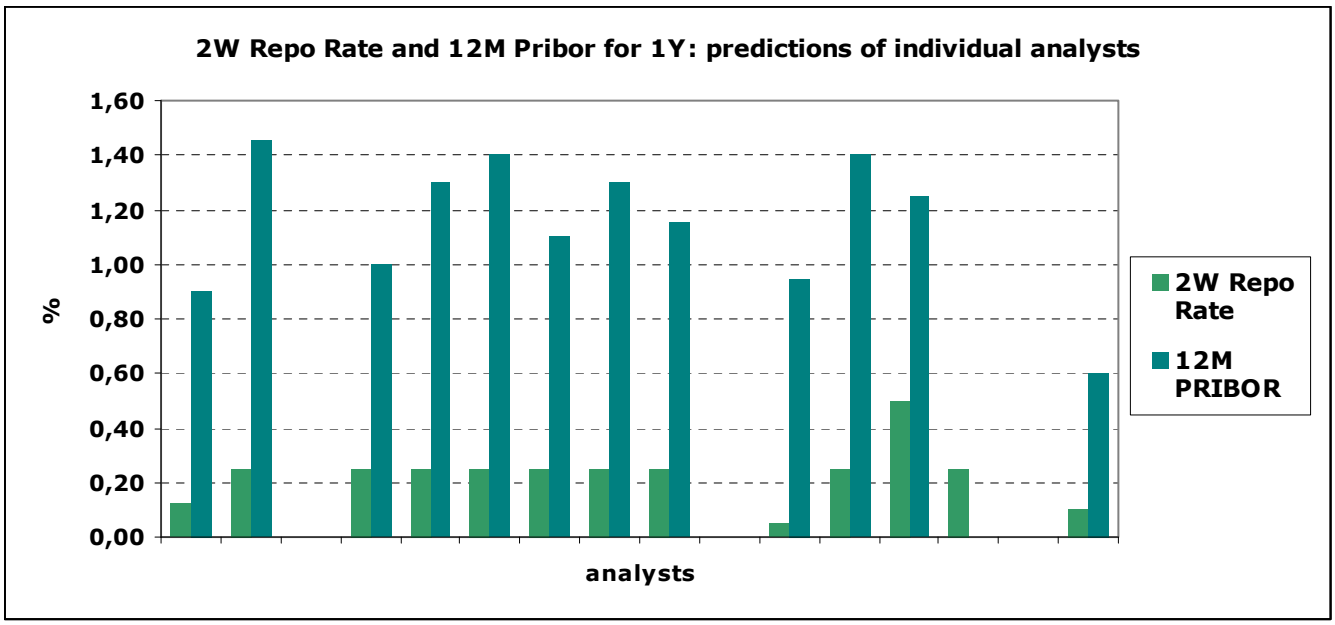
Almost all of the respondents predict that key interest rates will remain unchanged at the CNB Board's meeting in November. Only one of the analysts thinks that the CNB will lower the two-week repo rate further (to 0.10%). Most of the analysts believe that the two-week repo rate will remain at 0.25% at the one-year horizon. Three expect it to fall to zero or close to zero, whereas one analyst predicts that it will rise to 0.50%.

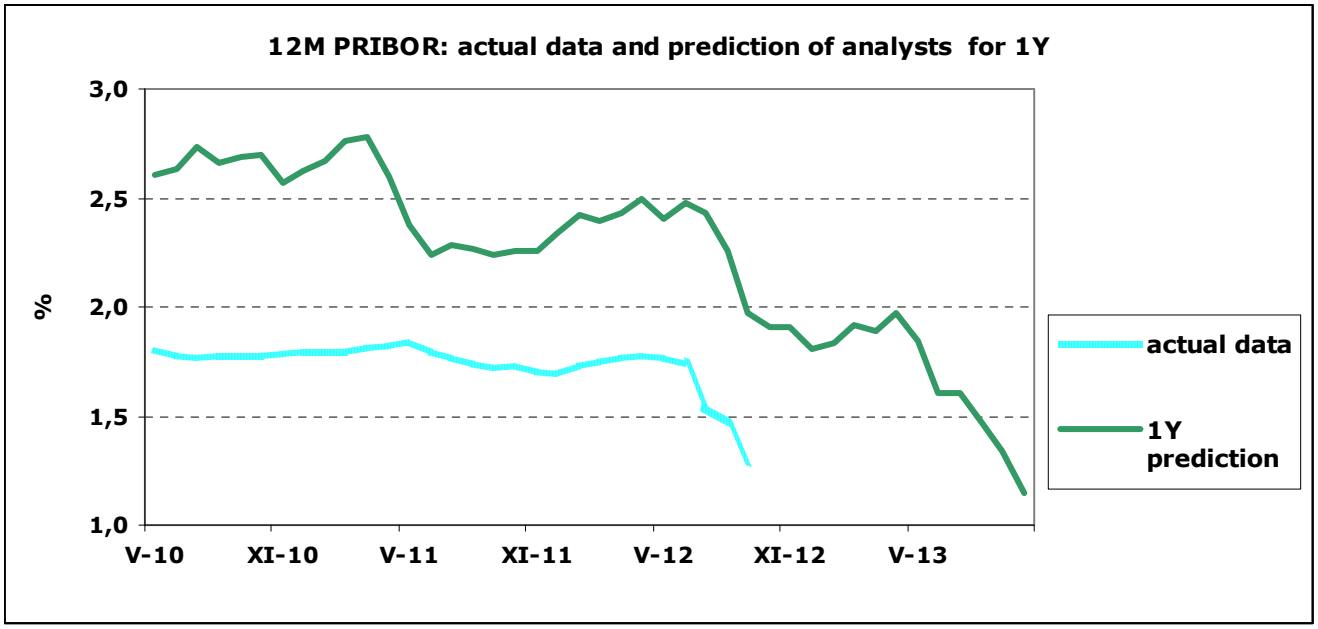
The 12M PRIBOR rate on the interbank market dropped by 20 bp in response to the September monetary policy easing. The forecast for the 12M PRIBOR at the one-month horizon recorded a similar downward shift (of 17 bp). The analysts' one-year forecast reflected the change in market rates even better and is now 19 bp lower than in the previous survey.

The sensitivity of the IRS forecasts to market rate changes was somewhat smaller. The 5Y IRS on the financial market dropped by 13 bp, while the 5Y IRS forecast fell by 7 bp at the one-month horizon and by only 5 bp at the one-year horizon. As for the 10Y IRS, the market rate decreased by 18 bp, whereas the one-month forecast shifted downwards by only 8 bp and the one-year forecast by 10 bp.


12M PRIBOR for 1Y: average and range of the predictions
12M PRIBOR prediction (%)
3,0
2,5
2,0
1,5
1,0
1,0
0,0
range of predictions (p.p.)
V-10
XII-10
VII-11
II-12
IX-12
average
range of predictions (right axis)


5Y IRS for 1Y: average and range of the predictions
5Y IRS prediction (%)
4,0
3,5
3,0
2,5
2,0
1,5
2,0
1,5
1,0
0,5
0,0
range of predictions (p.p.)
V-10
XII-10
VII-11
II-12
IX-12
average
range of predictions (right axis)


2W Repo Rate and 12M Pribor for 1Y: predictions of individual analysts
1,60
1,40
1,20
1,00
0,80
0,60
0,40
0,20
0,00
%
analysts
2W Repo Rate
12M PRIBOR


12M PRIBOR: actual data and prediction of analysts for 1Y
3,0
2,5
2,0
1,5
1,0
%
V-10
XI-10
V-11
XI-11
V-12
XI-12
V-13
actual data
1Y prediction

| Prediction Horizon / Date of Prediction | 1M Exchange Rate EUR/CZK | 1Y Exchange Rate EUR/CZK |
|---|---|---|
| X-11 | 24,72 | 23,96 |
| XI-11 | 25,52 | 24,27 |
| II-12 | 25,15 | 24,08 |
| IV-12 | 24,79 | 23,91 |
| V-12 | 25,44 | 24,17 |
| VIII-12 | 25,20 | 24,50 |
| IX-12 | 24,74 | 24,39 |
| X-12 | 24,89 | 24,51 |

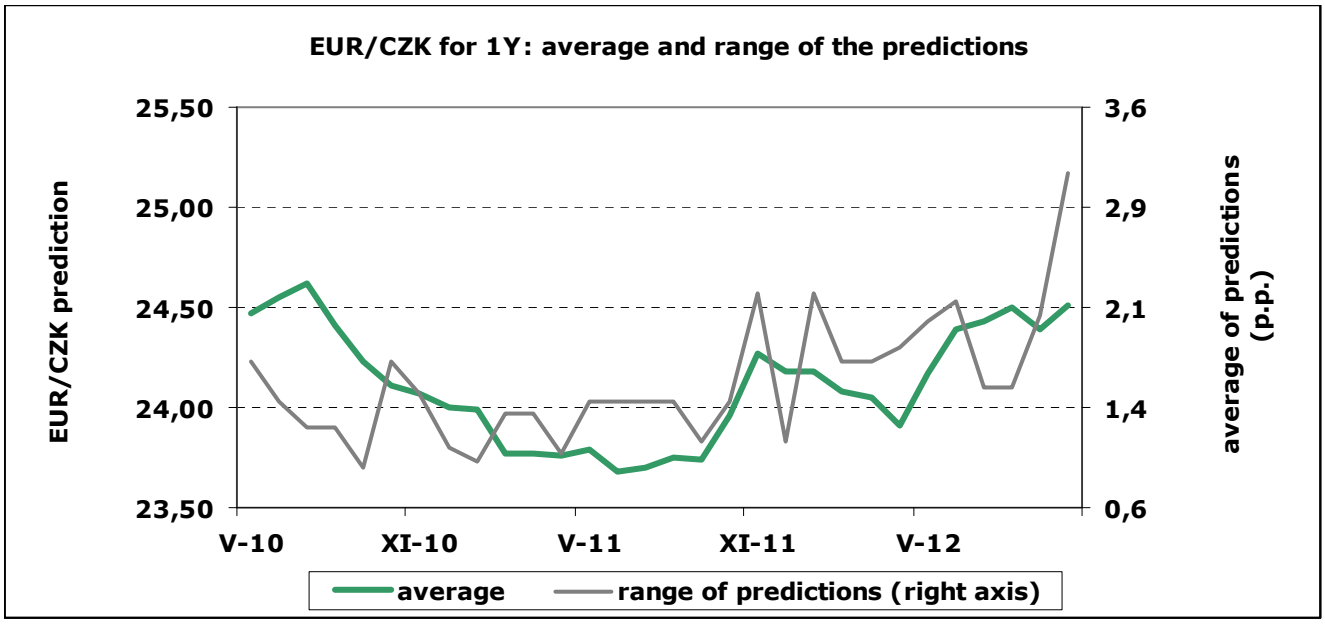
| October 2012 | 1M Exchange Rate CZK/EUR | 1Y Exchange Rate CZK/EUR |
|---|---|---|
| **minimum** | 24,70 | 23,40 |
| **average** | 24,89 | 24,51 |
| **maximum** | 25,00 | 26,50 |

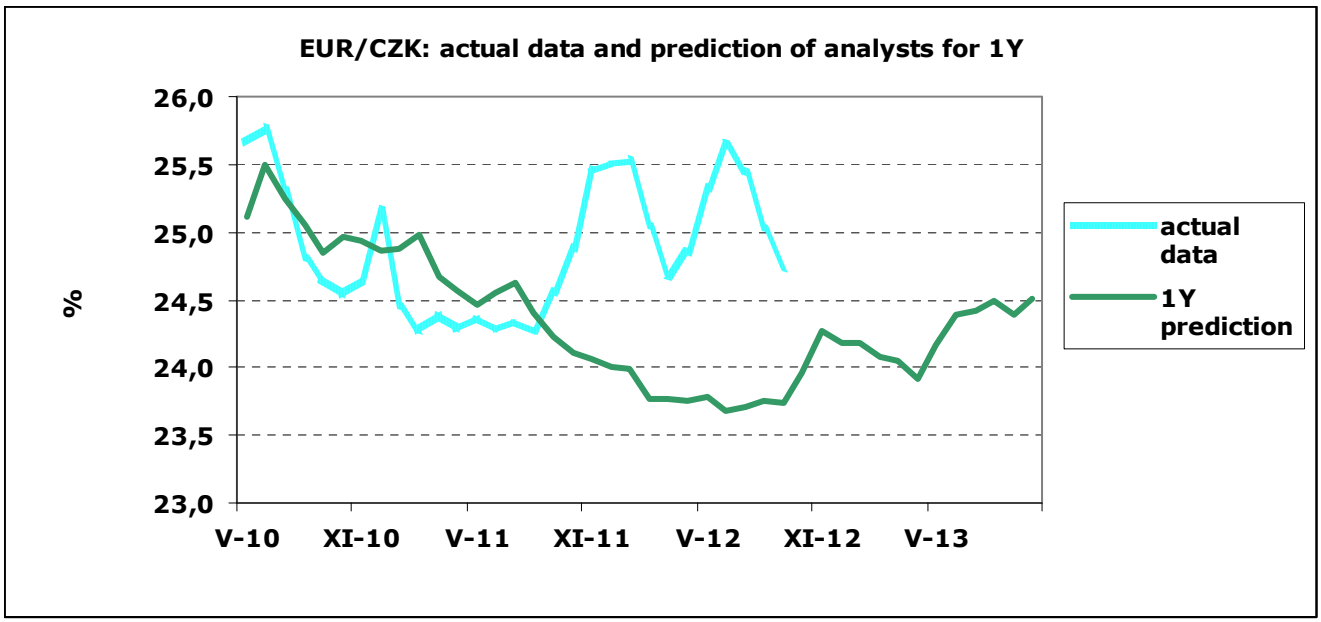
**Actual EUR/CZK as of forecast deadline**

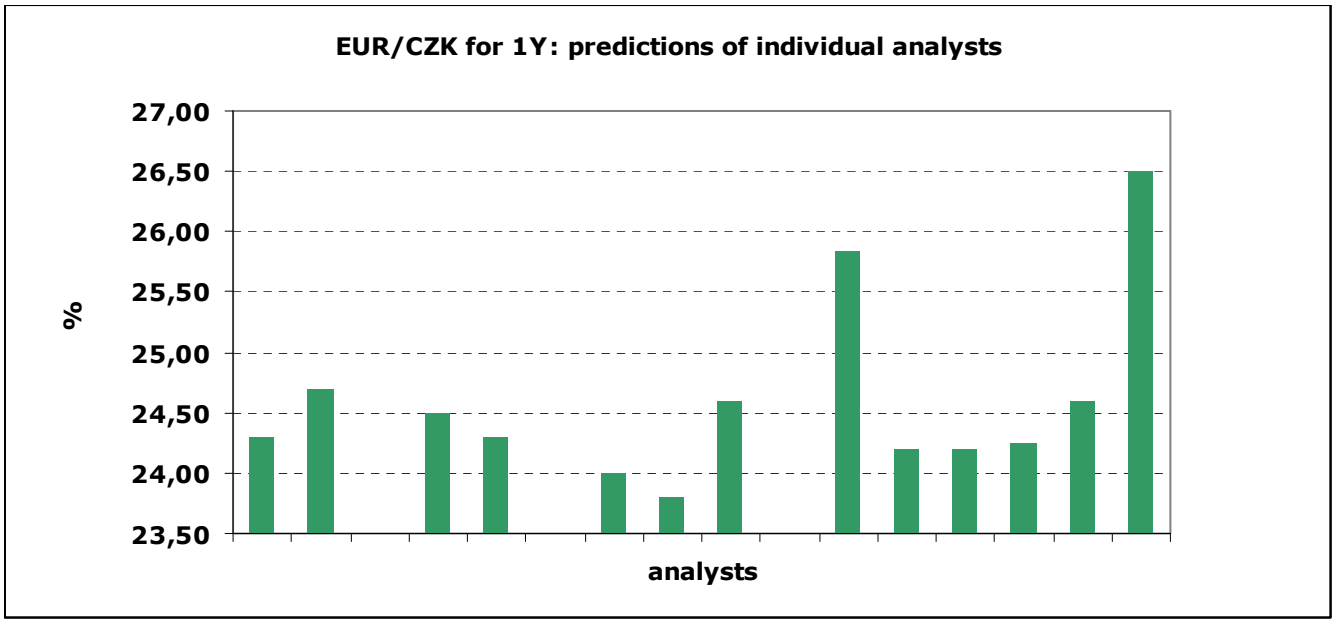
| | |
|---|---|
| **12.10.** | 24,96 |

The koruna's exchange rate depreciated by CZK 0.52 to CZK 24.96 against the euro compared to the September survey. This again affected the analysts' forecasts, which also mostly shifted towards weaker levels, albeit to a lesser extent. The one-month forecast fell by CZK 0.15 to CZK 24.89 and the one-year forecast by just CZK 0.12 to CZK 24.51. The average monthly forecast thus broadly corresponds to the current koruna exchange rate on the foreign exchange market as of the cut-off date of the survey and the analysts therefore expect the koruna to be practically flat against the euro at least until mid-November.

In the longer term, the koruna is expected to appreciate very slowly, reaching CZK 24.51 against the euro in October 2013. The speed of expected appreciation at the one-year horizon, however, is somewhat slower than in past years. This is due to a lower growth differential between the Czech and European economies and hence slower real convergence. In addition, the koruna's appreciation tendency could, according to some analysts, be limited by exchange rate interventions by the CNB. The koruna may deviate from the expected trend because of further unexpected developments in the EMU debt crisis.

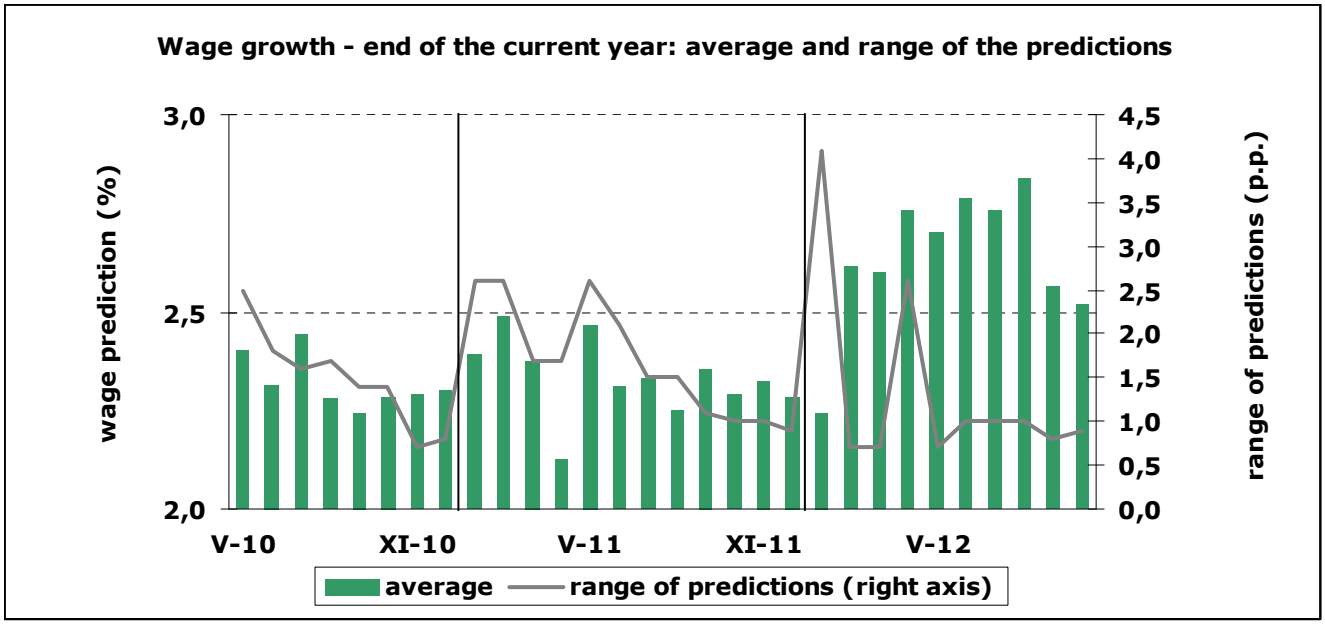



EUR/CZK: actual data and prediction of analysts for 1Y
%
26,0
25,5
25,0
24,5
24,0
23,5
23,0
V-10
XI-10
V-11
XI-11
V-12
XI-12
V-13
actual data
1Y prediction


EUR/CZK for 1Y: predictions of individual analysts
%
27,00
26,50
26,00
25,50
25,00
24,50
24,00
23,50
analysts

| October 2012 | end of year current | +1Y |
|---|---|---|
| | Wages % | |
| minimum | 2,00 | 2,10 |
| average | 2,52 | 2,84 |
| maximum | 2,90 | 4,00 |

| Prediction Horizon / Date of Prediction | end of year current | current+1Y |
|---|---|---|
| | % Wage Growth | |
| X-11 | 2,3 | 3,1 |
| XI-11 | 2,3 | 2,9 |
| II-12 | 2,6 | 3,3 |
| IV-12 | 2,8 | 3,4 |
| V-12 | 2,7 | 3,6 |
| VIII-12 | 2,8 | 3,3 |
| IX-12 | 2,6 | 3,0 |
| X-12 | 2,5 | 2,8 |

The bleak economic outlook and the still strained situation on the labour market are reflected in expected nominal wage growth, which was again lowered for this year and the next. Wages are thus predicted to grow by 2.5% on average in 2012 (compared to 2.6% in the last survey) and to pick up to only 2.8% in 2013 (compared to 3.0%).

The analysts who made a distinction between the forecast for wage growth in the business sector and that in the non-business sector believe that wages in the business sector will grow by 2.6% this year (compared to 2.4% in September) and wages in the non-business sector by 2.1% (compared to 2.4 %). In 2013, wages are now expected to grow by 2.5% in both sectors.