



FINANCIAL MARKET INFLATION EXPECTATIONS – JUNE

Financial Markets Department
Operations Analyses Division

2014

Twelve domestic and two foreign analysts took part in the August survey. The annual inflation forecast edged down compared to the previous survey, reaching the level of the CNB's inflation target. Despite flat GDP in Q2, the forecasts for domestic economic growth in 2014 and 2015 increased, with a greater change being recorded for the forecast for this year. None of the respondents expects the key interest rates to rise in the next 12 months. The forecasts for swap rates continue to follow a downward trend. The analysts' predictions for the EUR/CZK exchange rate were affected by the recent depreciation of the koruna in the foreign exchange market. The overwhelming majority of the analysts believe that the CNB will exit from its exchange rate commitment in 2016. Nominal wages are expected to increase slightly less this year.

DOMESTIC ANALYSTS	I.	II.	III.	IV.	V.	VI.	VII.	VIII.	IX.	X.	XI.	XII.
David Navrátil, Česká spořitelna	+	+	+	+		+	+	+				
David Marek, Deloitte Czech Republic	+	+	+	+	+	+		+				
Jan Vejmělek, Komerční banka	+	+	+	+	+	+	+	+				
Pavel Sobišek, Unicredit Global Research	+	+	+	+	+	+	+	+				
Michal Brožka, Helena Horská, Raiffeisenbank	+	+	+	+	+	+	+	+				
Petr Dufek, ČSOB	+	+	+	+	+	+	+	+				
Petr Sklenář, J&T Banka	+	+	+	+	+	+	+	+				
Radomír Jáč, Generali PPF	+	+	+	+				+	+			
Jaromír Šindel, Citi	+			+	+				+			
Tomáš Holinka, Moody's Analytics	+	+	+	+	+	+	+	+				
Jan Kudláček, AXA	+	+	+	+	+	+	+	+				
Jakub Seidler, ING									+			
FOREIGN ANALYSTS												
Magdalena Polan, Goldman Sachs	+	+		+	+		+					
Alex Nice, 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, August 21 2014

FORECAST FOR Y/Y CPI GROWTH (%)

August 2014	CPI	
	1Y	3Y
minimum	1.00	1.50
average	1.97	2.10
maximum	2.70	2.90

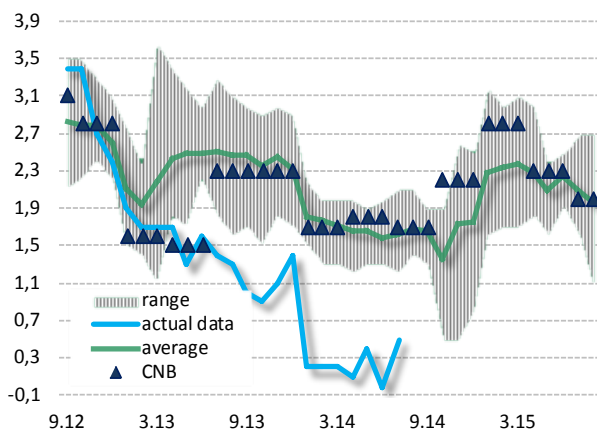
1Y AND 3Y FORECAST FOR CPI GROWTH (%)

Date of Prediction	ANALYSTS		CNB (%)
	1Y	3Y	1Y
8.13	1.7	2.0	
10.13	1.4	2.1	3Q: 1.7
12.13	1.7	2.1	4Q: 2.2
2.14	2.3	2.1	1Q: 2.8
4.14	2.3	2.1	
6.14	2.2	2.0	2Q: 2.3
7.14	2.1	2.0	
8.14	2.0	2.1	3Q: 2.0

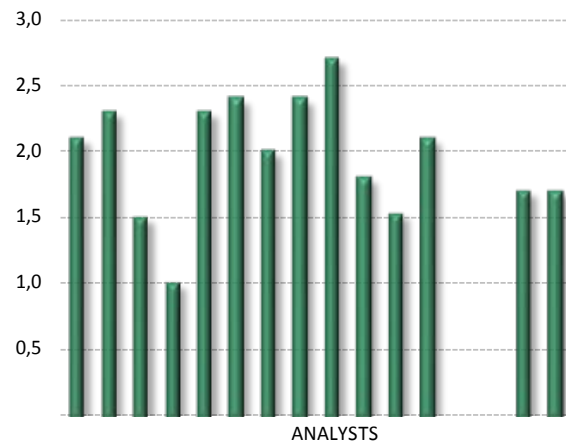
The annual inflation forecast continues to show a very gradual downward trend (down by 0.1 pp compared to the previous survey), reaching the CNB's 2% inflation target. By contrast, it increased by 0.1 pp to 2.1% at the three-year horizon. The range of the one-year forecasts widened considerably due to a decrease in the minimum value (see the chart below), while the range of the three-year forecasts widened owing to an increase in the maximum value.

The decline in the annual inflation forecast seems to stem from cost factors, especially administered prices and food prices, and the related surprising stagnation of the consumer price index in June. However, the question remains whether the analysts have fully included the subsequent rise in consumer prices in July in their forecasts or whether this will be done in the next survey.

CPI: ACTUAL DATA AND 1Y PREDICTIONS OF ANALYSTS (AVERAGE) AND OF CNB (%)



CPI AT 1Y: PREDICTIONS OF INDIVIDUAL ANALYSTS



FORECAST FOR GDP GROWTH (%)

August 2014	end of year	
	current	current+1Y
minimum	2.4	2.4
average	2.7	2.8
maximum	3.5	4.0

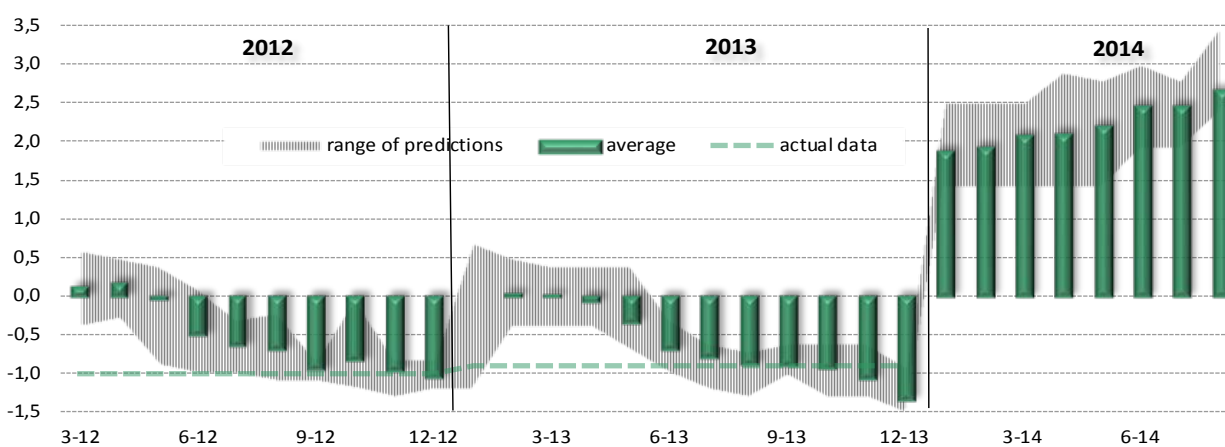
FORECAST FOR GDP GROWTH (%)

Date of Prediction	end of year	
	current	current+1Y
8.13	-0.9	1.8
10.13	-0.9	1.8
12.13	-1.3	1.9
2.14	1.9	2.5
4.14	2.1	2.5
6.14	2.5	2.7
7.14	2.5	2.7
8.14	2.7	2.8

According to the CZSO's preliminary estimate, the domestic economy was flat in 2014 Q2 compared to the previous quarter. Despite that, the analysts increased the average estimate for GDP growth this year by 0.2 pp to 2.7%. The forecast for economic growth next year was also revised upwards, by 0.1 pp to 2.8%. The range of the extreme forecasts for both this year and the next widened due to a greater increase in the maximum estimates.

The analysts' greater optimism about domestic economic growth this year is due mainly to the excellent performance in Q1. They expect a larger fiscal expansion and more robust growth in fixed investment next year, which should foster an increase in the potential output of the Czech economy. External factors, i.e. the rate of recovery in export markets and potential negative impacts of the crisis in Ukraine with the related trade sanctions, are considered the main risks to this scenario.

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
8.13	0.05	0.10	0.76	0.90	1.48	1.78	2.10	2.40
10.13	0.05	0.07	0.73	0.87	1.48	1.94	2.11	2.46
12.13	0.05	0.05	0.60	0.73	1.21	1.71	2.02	2.44
2.14	0.05	0.14	0.56	0.73	1.17	1.61	1.96	2.46
4.14	0.05	0.12	0.57	0.80	1.20	1.74	1.90	2.41
6.14	0.05	0.12	0.53	0.70	0.83	1.43	1.52	2.08
7.14	0.05	0.07	0.51	0.74	0.76	1.39	1.44	2.09
8.14	0.05	0.05	0.51	0.60	0.74	1.11	1.33	1.75

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

August 2014	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
minimum	0,05	0,05	0,50	0,50	0,68	0,78	1,20	1,40
average	0,05	0,05	0,51	0,60	0,74	1,11	1,33	1,75
maximum	0,05	0,05	0,55	1,00	0,80	1,60	1,40	2,35

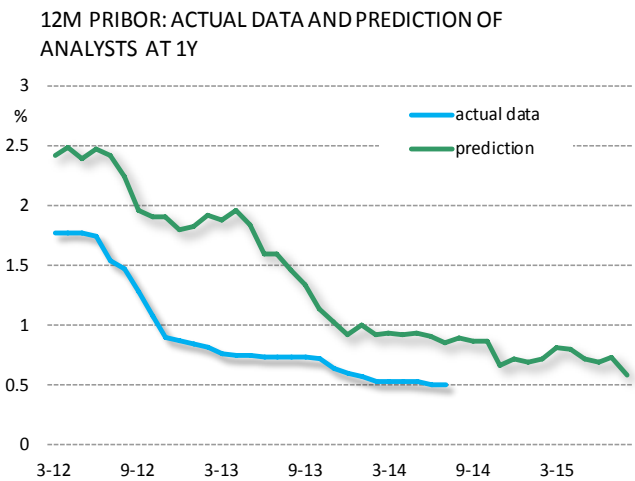
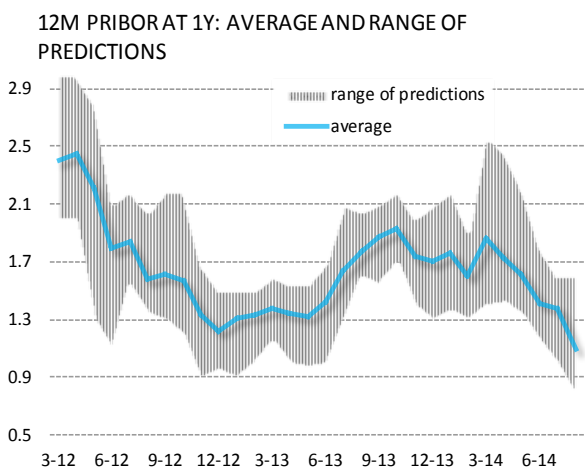
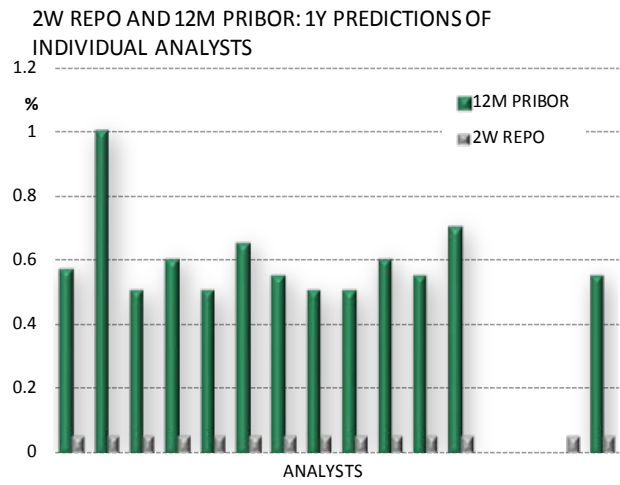
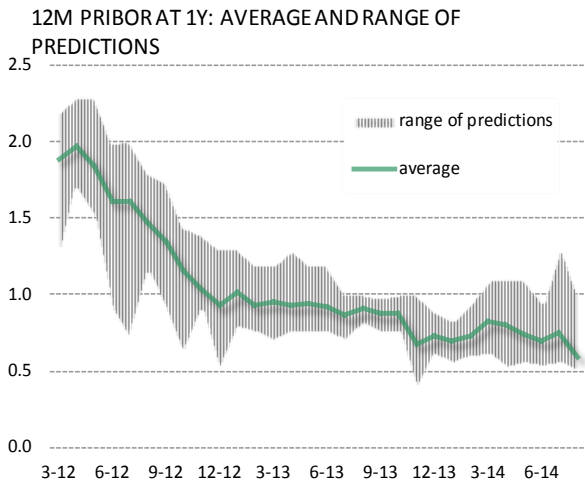
ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE (%)

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
14.8.	0.05	0.52	0.73	1.29

The number of respondents which expect the 2W repo rate to increase in the next 12 months gradually decreased in the previous surveys and none of them currently assumes monetary policy tightening over this horizon.

The 12M PRIBOR reference rate for the domestic interbank market remains flat. Similarly, its average monthly forecast has not changed since July, but it decreased at the one-year horizon, possibly in connection with the postponement of the expected monetary policy tightening.

The forecasts for 5Y and 10Y swap rates (IRS) continue to decline, at the one year horizon in particular. This is due not only to the prospect of a later increase in key interest rates in the Czech Republic but also to the ECB's approach (liquidity provision and possible asset purchases), i.e. the assumed developments in European IRS rates, which largely affect Czech swap rates.



1M AND 1Y EXCHANGE RATE FORECAST

Date of Prediction	EUR/CZK	
	1M	1Y
8.13	25.91	25.31
10.13	25.71	25.06
12.13	27.45	26.94
2.14	27.42	26.95
4.14	27.40	26.96
6.14	27.41	26.98
7.14	27.42	27.10
8.14	27.73	27.33

EXCHANGE RATE FORECAST

August 2014	EUR/CZK	
	1M	1Y
minimum	27.50	27.00
average	27.73	27.33
maximum	27.90	27.70

ACTUAL EUR/CZK AS OF FORECAST DEADLINE

14.8.	27.845
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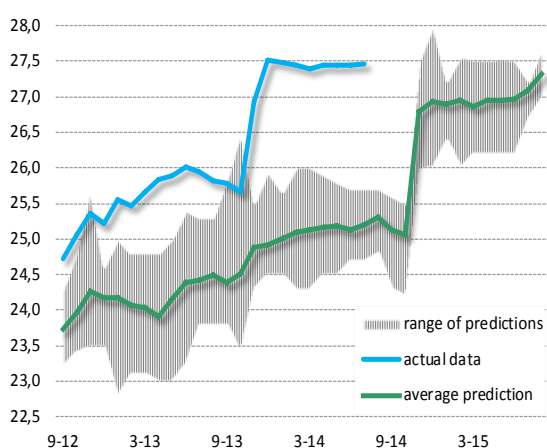
The exchange rate of the koruna against the euro has weakened from CZK 27.4 to the euro to above CZK 27.8 to the euro since mid-July. This has also affected the analysts' forecasts, which have shifted to weaker levels. The exchange rate of the koruna to the euro is expected at around CZK 27.7 in mid-September and close to CZK 27.3 in August 2015.

EXPECTED EXIT FROM EXCHANGE RATE COMMITMENT

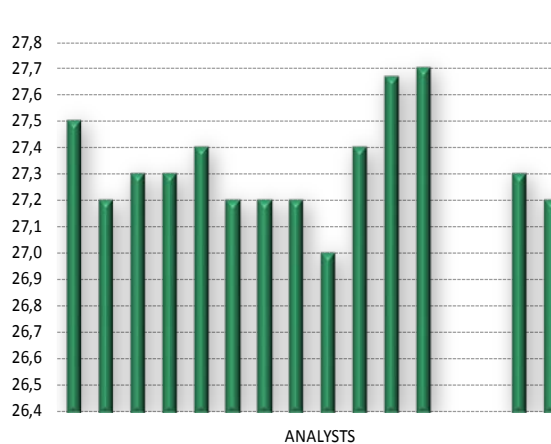
Expected exit	Number of analysts
2015 4Q	2
2016 1Q	8
2016 4Q	2
2016 (Q not specified)	2

With regard to the CNB's communication, the analysts' view of the date of the expected exit from the commitment to prevent excessive appreciation of the koruna below CZK 27 to the euro has shifted significantly. Two analysts still believe that this step will be taken in 2015, whereas all the other analysts expect it in 2016. However, two of them did not specify the quarter (see the table above).

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



EUR/CZK AT 1Y: PREDICTIONS OF INDIVIDUAL ANALYSTS



FORECAST FOR NOMINAL WAGE GROWTH (%)

August 2014	year end	
	current	current+1Y
minimum	2.0	1.5
average	2.5	3.0
maximum	3.3	4.0

FORECAST FOR NOMINAL WAGE GROWTH (%)

Date of Prediction	year end	
	current	current+1Y
8.13	1.0	2.5
10.13	0.7	2.5
12.13	0.8	2.3
2.14	2.1	2.8
4.14	2.2	3.1
6.14	2.4	2.9
7.14	2.6	3.0
8.14	2.5	3.0

The average estimate of wage growth this year was corrected downwards by 0.1 pp to 2.5% compared to the previous survey. Thanks to improving labour market conditions and the promised 3.5% wage increase in the public sector, which will also affect wages in the private sector, wage growth is expected to pick up to 3.0% next year (as in July). Given low inflation, the change in real wages is expected to return to positive figures.

The analysts who made a distinction between the forecast for wage growth in the business sector and that in the non-business sector now estimate that wages in the business sector will grow by 2.9% in 2014 and by 3.6% in 2015, while wages in the non-business sector will rise by 1.8% in 2014 and by 3.6% in 2015.

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

