Financial Market Inflation Expectations

2/2020

Czech National Bank —— Financial Market Inflation Expectations —— 2/2020

CNB CZECH NATIONAL BANK

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I. SUMMARY

Fifteen domestic and two foreign respondents sent in their contributions to the February survey of financial market inflation expectations. The change in the CNB's 2W repo rate led the analysts to revise the forecast for short-term interest rates upwards. At the one-year horizon, the view that the CNB will cut the key interest rate in line with its forecast is now slightly predominant. The inflation forecast is unchanged at both the one-year and three-year horizons despite a fast rise in the price level in January. The estimates of economic growth and nominal wage growth this year are slightly less optimistic. The expected path of the koruna exchange rate reflects appreciation after the February meeting of the CNB Bank Board.

DOMESTIC ANALYSTS	I.	II.	III.	IV.	V.	VI.	VII.	VIII.	IX.	X.	XI.	XII.
J. Polanský, Česká spořitelna	+	+										
David Marek, Deloitte Czech Republic	+	+										
Jan Vejmělek, Komerční banka	+	+										
Patrik Rožumberský, Unicredit Global Research	+	+										
Helena Horská, Eliška Jelínková Raiffeisenbank	+	+										
Petr Dufek, ČSOB	+	+										
Petr Sklenář, J&T Banka	+	+										
Radomír Jáč, Generali Investments CEE	+	+										
Jaromír Šindel, Citi	+	+										
Kamil Kovář, Moody's Analytics	+	+										
Jan Kudláček, Tomáš Lébl, AXA	+	+										
Jakub Seidler, ING	+	+										
Lukáš Kovanda, Czech Fund	+	+										
Michal Šoltés, RoklenFin	+	+										
Martin Janíčko, MND	+	+										
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, 24 February 2020

II. INFLATION

FORECAST FOR Y/Y CPI GROWTH

(%)

February 2020	CPI 1Y	CPI 3Y
minimum	1.8	1.7
average	2.2	2.0
maximum	2.7	2.2

1Y AND 3Y FORECAST FOR CPI GROWTH

(%)

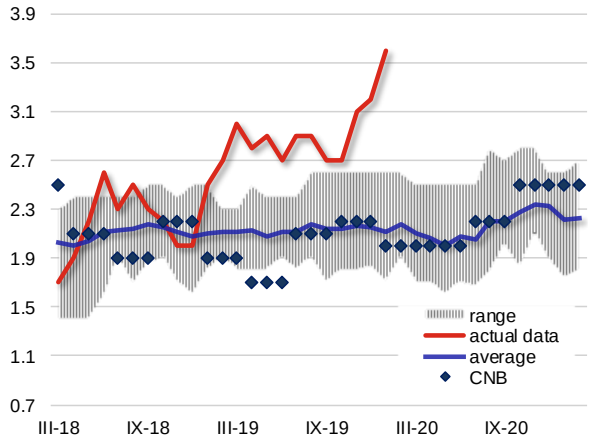
Date of Prediction	ANALYSTS 1Y	ANALYSTS 3Y	CNB (%) 1Y
II.19	2.2	2.0	
IV.19	2.1	2.0	2Q: 2.0
VII.19	2.1	2.0	
IX.19	2.2	2.0	
X.19	2.3	2.0	
XII.19	2.3	2.0	
I.20	2.2	2.0	
II.20	2.2	2.0	

The annual growth rate of the consumer price index rose again, this time by 0.4 pp to 3.6%, which is the highest level since March 2012. However, the results of our survey show that the analysts expect inflation to slow significantly over the next 12 months. As in the previous survey, they expect annual CPI inflation of 2.2% in February next year. Even the three-year inflation forecast is unchanged and remains anchored at the CNB's 2% target. The range of the one-year estimates is unchanged due to an equal increase in the minimum and maximum values, while the range of the three-year forecasts widened slightly due to a drop in the minimum value.

The annual increase in the price level in January was driven primarily by prices of housing, food, alcohol and tobacco. The analysts expect inflation to continue to rise in the months ahead. In 2020 Q2, however, they predict a marked slowdown in consumer price growth. This will probably be due to weakening performance of the domestic economy and slower growth in real wages and the related household consumption. A decline in inflation will also be supported by a stronger koruna and, according to some analysts, the expected slowdown in housing and food prices. Finally, inflation should also be affected by the CNB's monetary policy restrictions. Indirect taxes, and a possible recovery of economic growth in the euro area in 2020 H2, will have an upward effect on inflation.

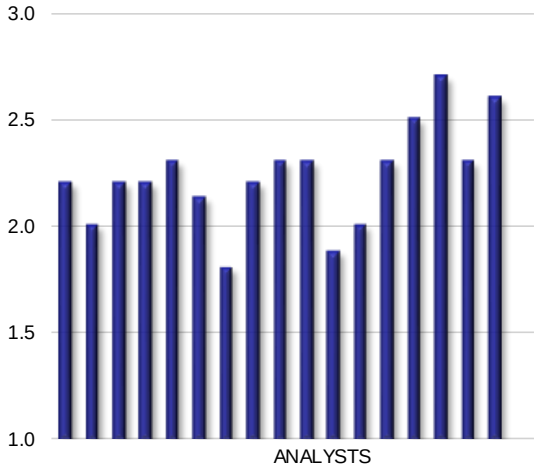
CONSUMER PRICE INDEX

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



CONSUMER PRICE INDEX AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS (%)



III. GROSS DOMESTIC PRODUCT

FORECAST FOR GDP GROWTH

(%)

February 2020	end of year	
	current	current + 1Y
minimum	1.9	1.8
average	2.1	2.3
maximum	2.9	3.1

FORECAST FOR GDP GROWTH

(%)

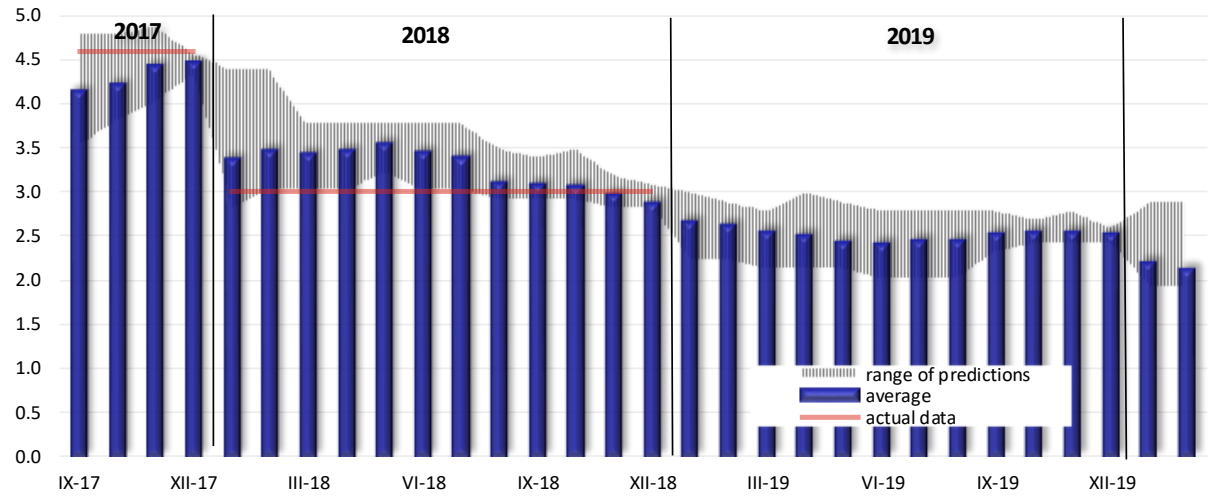
Date of Prediction	end of year	
	current	current+1Y
II.19	2.6	2.6
IV.19	2.5	2.5
VII.19	2.5	2.4
IX.19	2.5	2.3
X.19	2.6	2.3
XII.19	2.5	2.1
I.20	2.2	2.3
II.20	2.1	2.3

According to the CZSO's preliminary estimate, Czech gross domestic product grew by 1.7% year on year in 2019 Q4 (compared with 2.5% in 2019 Q3) and by 2.4% in 2019 as a whole (compared with 2.9% in 2018). The analysts' average short-term estimate was also revised downwards, albeit to a much lesser extent. The Czech economy is thus expected to grow by 2.1% this year, which is 0.1 pp less than the analysts estimated in the previous survey. The outlook for 2021 is unchanged and the expected economic growth remains at 2.3%. The range of the forecasts for this year remains unchanged, as do the minimum and maximum values.

The analysts' overall view on the Czech economy is unchanged. According to the analysts, the economy is driven mainly by household consumption, which is fuelled by a strong labour market and external demand. Looking at economic growth from the perspective of gross value added formation; the main drivers are services and construction. By contrast, subdued corporate investment, which is weakened by concerns about global economic developments, is seen as a factor hampering growth by the analysts. From the perspective of gross value added, manufacturing (which is crucial in the Czech Republic) stopped contributing to growth. This year, domestic economic activity will slow, the labour market situation will ease and wages will not rise as quickly. The slowdown of the Czech economy is already visible in employment, which dropped by 0.3% compared with the previous quarter. However, the expected recovery of the euro area economy could increase external demand and investment growth in the Czech Republic over time. Nevertheless, a great uncertainty is the coronavirus epidemic, whose spread to other countries may negatively affect both the external economic environment and domestic investment.

GDP GROWTH AT END OF CURRENT YEAR

AVERAGE AND RANGE OF PREDICTIONS



IV. INTEREST RATES – 2W REPO, PRIBOR, IRS

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

(%)

February 2020	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
minimum	2.25	1.75	2.39	2.05	1.80	1.80	1.62	1.68
average	2.25	2.15	2.47	2.32	2.00	2.06	1.72	1.98
maximum	2.25	2.75	2.55	2.65	2.28	2.60	1.90	2.80

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
II.19	1.81	2.22	2.25	2.54	1.99	2.38	1.96	2.41
IV.19	1.87	2.17	2.27	2.48	2.03	2.28	1.97	2.29
VII.19	2.00	2.03	2.29	2.24	1.73	1.91	1.65	1.92
IX.19	2.00	1.93	2.19	2.07	1.55	1.67	1.39	1.66
X.19	2.00	1.99	2.24	2.15	1.64	1.73	1.35	1.69
XII.19	2.00	2.00	2.28	2.25	1.81	1.89	1.52	1.75
I.20	2.01	2.07	2.28	2.27	1.99	2.02	1.75	1.96
II.20	2.25	2.15	2.47	2.32	2.00	2.06	1.72	1.98

ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE

(%)

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
15.2.	2.25	2.45	1.99	1.68

The February increase in key interest rates came as a big surprise, as it had been expected by just one respondent. The analysts thus had to incorporate the new fact in their forecasts and revise the expected path of the CNB's key interest rate upwards, at least in the very near term. None of the analysts expects a change in the monetary policy settings in the Czech Republic at the March meeting. All of them thus predict the 2W repo rate to remain at 2.25%. In their comments, the analysts say that the Bank Board's February decision was affected mainly by higher inflation. Concerns about a loss of the CNB's credibility also played a role according to the analysts. Some of them believe that the Bank Board will now debate stability of interest rates or their cut, which is a move expected by the CNB's forecast. A further monetary policy tightening is thus not expected in the near future, probably due to the slowing economic activity. However, the chances of an interest rate cut is dampened by high inflation, so the move will very much depend on new data from the economy, for which the CNB might wait. However, the number of respondents who expect the 2W repo rate to be lowered at the one-year horizon is slightly predominant. Two of them even still predict the rate to drop to 1.75%. The number of analysts who expect stability of the key rate is slightly smaller. Only two respondents expect its growth (to as high as 2.75% in one case).

ANALYSTS' FORECAST – 2W REPO RATE LEVEL IN 1Y

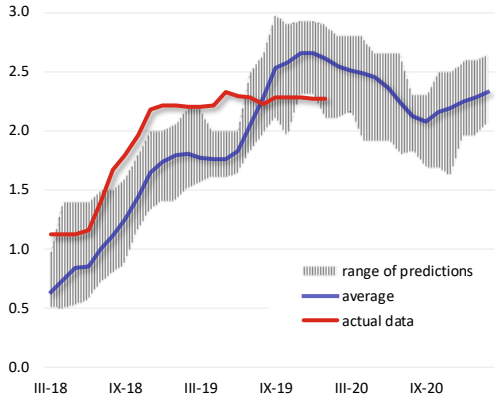
(%)

úroveň 2T repo sazby za 1Y (%)	1.75	2	2.25	2.5	2.75
počet analytiků - aktuální šetření	2	6	7	1	1
- minulé šetření	3	10	3	1	1

The growth in the 2W rate was reflected only in shorter maturities on the market. By contrast, the swap rates under review declined. The analysts' forecasts were revised similarly. The forecast for 12M PRIBOR interbank reference rates shifted higher (the shift in the one-month PRIBOR forecast was naturally higher than that in the one-year forecast due to expectations of a drop in key interest rates at the one-year horizon) and the forecast for swap rates recorded mixed movements of up to ±4 pp. The inverted slope of the expected swap curve increased imperceptibly in the 5–10Y range at both the one-month and one-year horizons.

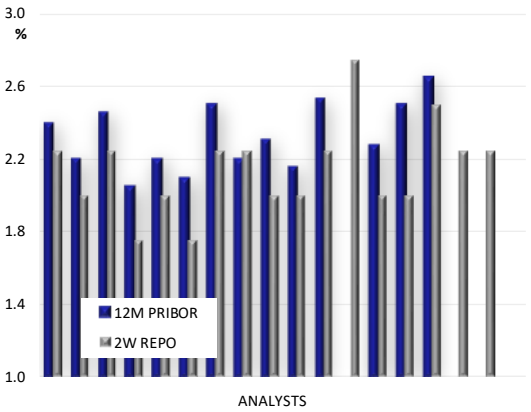
12M PRIBOR AT 1Y

ACTUAL DATA, AVERAGE AND RANGE OF PREDICTIONS



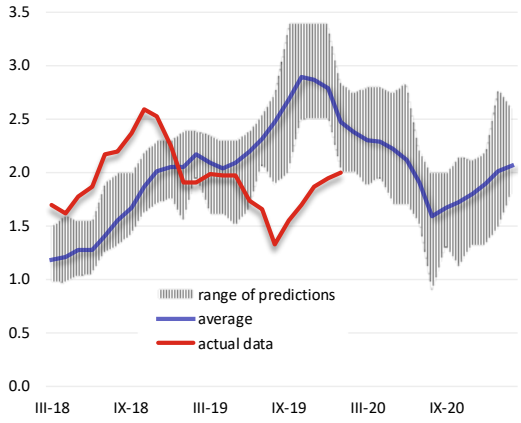
2W REPO AND 12M PRIBOR AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



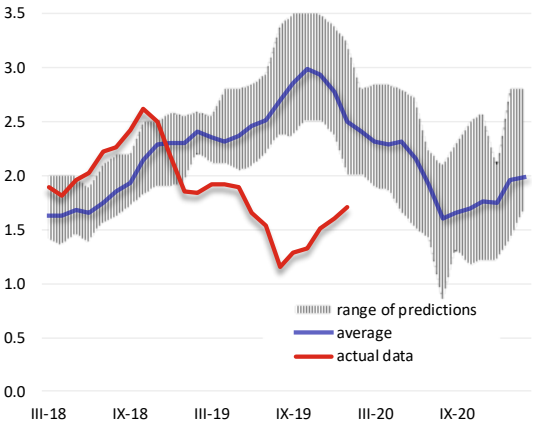
5Y IRS AT 1Y

AVERAGE AND RANGE OF PREDICTIONS



10Y IRS AT 1Y

AVERAGE AND RANGE OF PREDICTIONS



V. EXCHANGE RATE

1M AND 1Y EXCHANGE RATE FORECAST

Date of Prediction	EUR/CZK	
	1M	1Y
II.19	25.63	25.07
IV.19	25.61	25.34
VII.19	25.59	25.33
IX.19	25.74	25.47
X.19	25.78	25.50
XII.19	25.57	25.36
I.20	25.26	25.14
II.20	25.05	24.93

EXCHANGE RATE FORECAST

February 2020	EUR/CZK 1M	EUR/CZK 1Y
minimum	24.80	24.20
average	25.05	24.93
maximum	25.80	26.00

ACTUAL EUR/CZK AS OF FORECAST DEADLINE

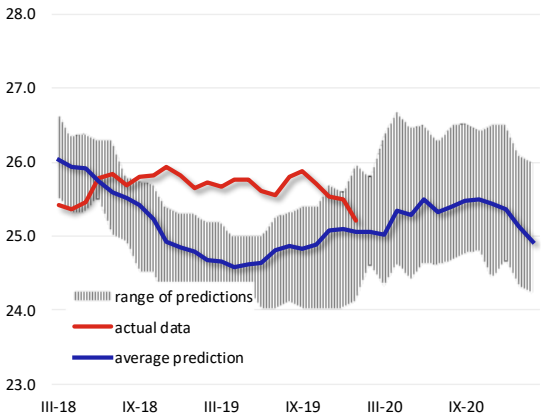
15.2.	24.83

The CNB's latest monetary policy decision was followed by increased volatility of the koruna, which shifted, at least temporarily, below the psychological level of CZK 25 to the euro. The analysts' views on its future path are diverse. They fall within a relatively wide range even at the one-month horizon (from CZK 24.80 to CZK 25.80 CZK to the euro), with the average at CZK 25.05 to the euro. This shows that the analysts consider the current appreciation of the koruna below CZK 25 to the euro to be temporary overall. However, they expect the koruna to return to that level next year.

On the one hand, there is a view in the analysts' comments that the tightening of the CNB's monetary policy and the related widening of the interest rate differential relative to the euro area makes the Czech koruna attractive to buy and has contributed fundamentally to its recent appreciation. Moreover, easing nervousness on the global financial market is also fostering appreciation of the koruna, which is also sensitive to the level of risk aversion in the external environment. On the other hand, there are opinions considering the current koruna exchange rate to be overvalued and predicting its weakening. On average, however, the koruna is expected to return (at the same pace as in the previous survey) to a very gradual appreciation path towards CZK 24.93 to the euro over the one-year horizon after a correction to just above CZK 25 to the euro.

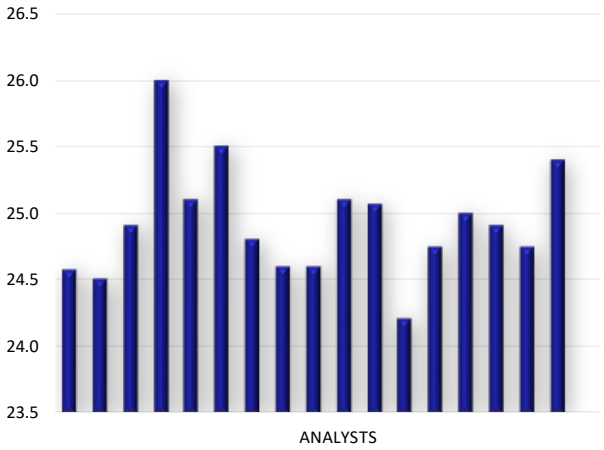
EUR/CZK

ACTUAL DATA, 1Y PREDICTIONS AND THEIR RANGE



EUR/CZK AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



VI. NOMINAL WAGES

FORECAST FOR NOMINAL WAGE GROWTH

(%)

February 2020	year end	
	current	current+1Y
minimum	5.20	4.00
average	5.82	4.88
maximum	6.98	5.80

FORECAST FOR NOMINAL WAGE GROWTH

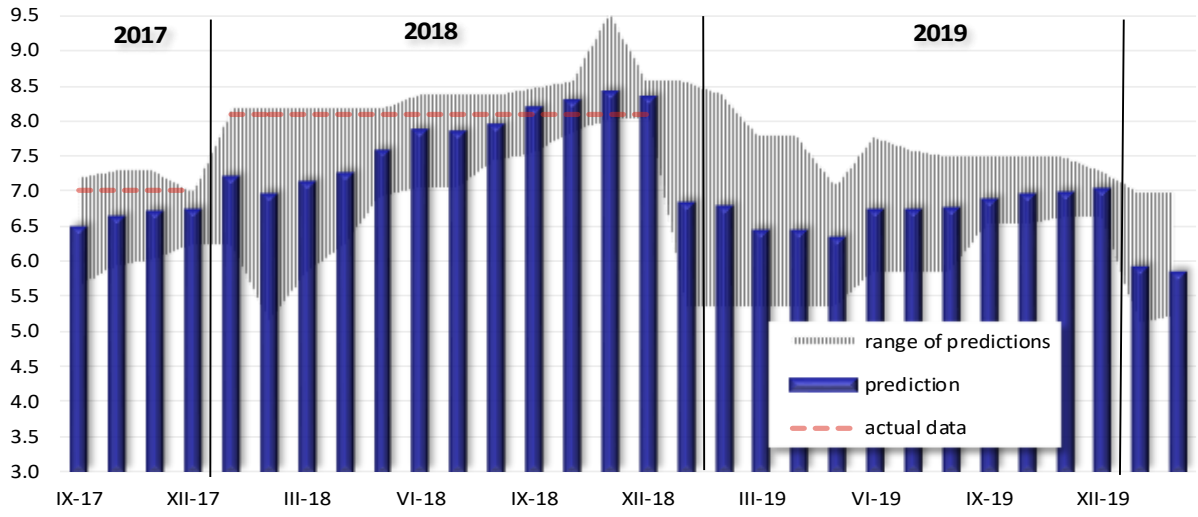
(%)

Date of Prediction	year end	
	current	current+1Y
II.19	6.8	5.3
IV.19	6.4	4.9
VII.19	6.7	5.2
IX.19	6.9	5.4
X.19	6.9	5.5
XII.19	7.0	5.7
I.20	5.9	4.9
II.20	5.8	4.9

According to the analysts, tightness on the labour market will ease only very slowly. However, a strong economic shock is not expected and labour market conditions will thus reflect a gradual economic slowdown. This should be visible mainly in production sectors such as industry, where employment is already falling. For now, however, dismissed industry employees seem to find jobs in other sectors or in services very quickly and the general unemployment rate is thus not growing rapidly. Nevertheless, lower economic growth will also become gradually visible in the services sector. This will be reflected in weakening wage growth. Many private companies find it difficult to maintain the high rate of wage growth seen in recent years. The analysts' average forecast thus dropped by 0.1 pp to 5.8% compared to the previous survey. However, growth remains strong. It should be fostered significantly by a rise in the wage scales in the public sector, which, according to some analysts, works as a discretionary macroeconomic stabiliser from the fiscal policy perspective. The outlook for nominal wage growth in 2021 is unchanged and remains at 4.9%.

NOMINAL WAGE GROWTH

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



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