

# Financial Market Inflation Expectations

— 3/2020



Czech National Bank — Financial Market Inflation Expectations — 3/2020

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## I. SUMMARY

Although Europe is currently in the midst of a battle with the new coronavirus and is taking the strictest of measures, contributions of twelve domestic and one foreign analysts have been provided for the CNB's traditional survey of financial market expectations. Unfortunately, the cut-off date of the survey was in a period when global central banks were gradually taking measures to mitigate the negative impacts of the spreading pandemic. This period was also characterised by an extremely high degree of volatility. Contributions by some respondents were produced at the start of this process, while others already take into account some events (including an extraordinary decrease in key interest rates by the CNB) which occurred during these very changing developments. (The cut-off date was on 15 March but some respondents sent their contributions in the following week.) Moreover, most analysts are pointing out that the estimates may change radically even in a relatively short period of time due to the high degree of volatility. It is thus better to take the values obtained in the current survey rather as directions in which estimates might go in the months ahead. The respondents are namely pointing out that they will, with high probability, prepare brand new predictions, or revise the current ones, in the next survey after the situation on the market and in the economy stabilises.

The survey results paint a picture of future economic developments that is not at all optimistic. The analysts expect GDP to record a significant fall, the growth rate of nominal wages to slow considerably, monetary policy to ease further in the form of a decline in the key 2W repo rate, and inflation to return below the inflation target at the one-year horizon. The latest developments have also shifted the expected outlook for the koruna's exchange rate to weaker levels. At the same time, the balance of risks is tilted towards less favourable developments.

<b>DOMESTIC ANALYSTS</b>	<b>I.</b>	<b>II.</b>	<b>III.</b>	<b>IV.</b>	<b>V.</b>	<b>VI.</b>	<b>VII.</b>	<b>VIII.</b>	<b>IX.</b>	<b>X.</b>	<b>XI.</b>	<b>XII.</b>
J. Polanský, Česká spořitelna	+	+	+									
David Marek, Deloitte Czech Republic	+	+	+									
Jan Vejrnělek, 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	+	+	+									
<b>FOREIGN ANALYSTS</b>												
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 in this very difficult situation.

Prague, 20 March 2020

## II. INFLATION

### FORECAST FOR Y/Y CPI GROWTH

March 2020	CPI	
	1Y	3Y
<b>minimum</b>	1.3	1.7
<b>average</b>	1.9	1.9
<b>maximum</b>	2.6	2.2

### 1Y AND 3Y FORECAST FOR CPI GROWTH

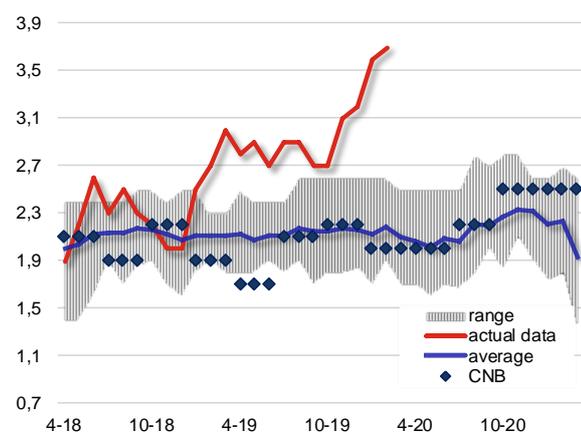
Date of Prediction	ANALYSTS		CNB (%)
	1Y	3Y	1Y
3.19	2.1	1.9	
4.19	2.1	2.0	2Q: 2.0
7.19	2.1	2.0	
9.19	2.2	2.0	3Q: 2.2
10.19	2.3	2.0	
12.19	2.3	2.0	4Q: 2.5
2.20	2.2	2.0	
3.20	1.9	1.9	1Q: 2.3

The annual growth rate of the consumer price index rose again, by 0.1 pp to 3.7% in February. However, the analysts' average forecast was revised downwards due to the recent developments. Although not all respondents managed to fully reflect the dramatic developments in March into their estimates, their average forecast dropped below the CNB's 2% inflation target both at the one-year and three-year horizons. The last time the analysts' average forecast deviated from the inflation target at the three-year horizon was in May 2019; it has remained firmly at 2% since. While the range of three-year forecasts was unchanged, it widened significantly at the one-year horizon due to a greater decline in the minimum.

The analysts originally expected inflation to peak in the coming months and slow gradually afterwards. Due to the recent developments, however, this scenario has been corrected and a more dramatic slowdown in price inflation is expected in the Czech Republic. Highly likely, this will be due not only to a shock fall in economic growth, which will later spill over to the labour market, higher unemployment, nominal wages and household consumption, but also to the recent drop in oil prices, which will be reflected mainly in fuel prices at filling stations. However, these effects will be dampened by the koruna's exchange rate, which weakened significantly due to an increase in global risk aversion and persisting long positions by foreign investors in the Czech koruna dating back to the exchange rate commitment.

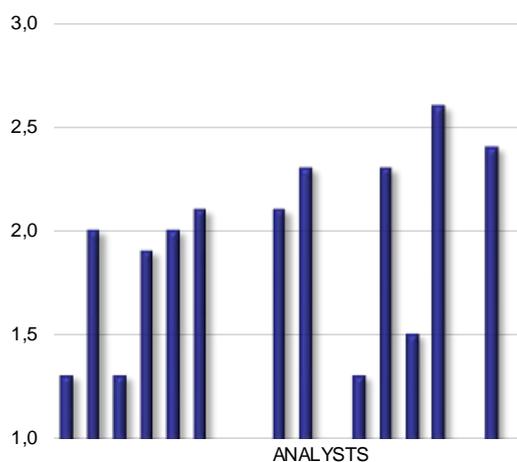
### CONSUMER PRICE INDEX

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

(%)

March 2020	end of year	
	current	current + 1Y
minimum	-1.0	1.0
average	0.7	2.2
maximum	2.3	4.2

#### FORECAST FOR GDP GROWTH

(%)

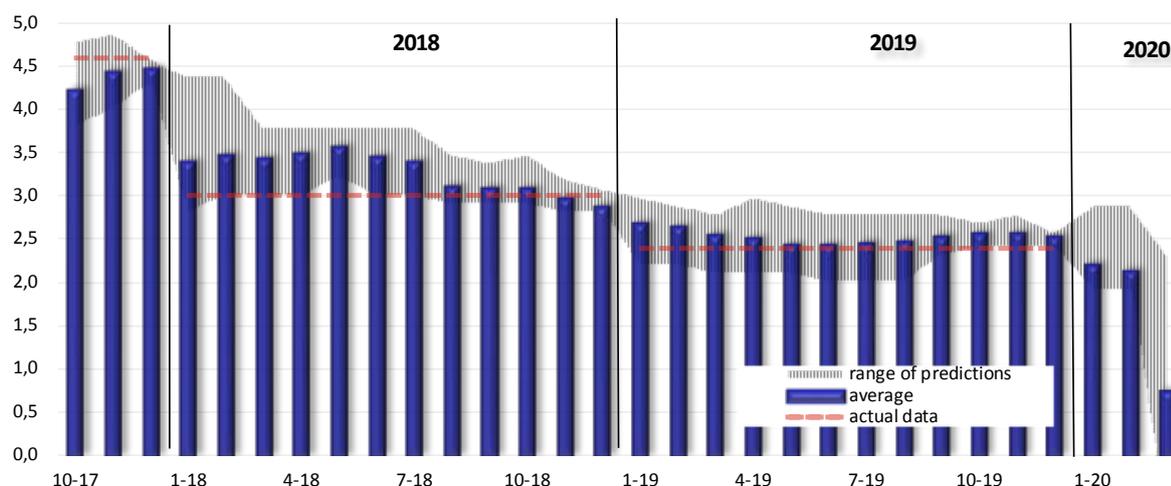
Date of Prediction	end of year	
	current	current+1Y
3.19	2.5	2.5
4.19	2.5	2.5
7.19	2.5	2.4
9.19	2.5	2.3
10.19	2.6	2.3
12.19	2.5	2.1
2.20	2.1	2.3
3.20	0.7	2.2

Although the analysts will need more time and data to be able to fully analyse and reflect the current situation in their forecasts, the available data show that the domestic economy will at least slow its growth rate significantly. Many respondents even expect the GDP to record an annual fall of 0.5–1% in the Czech Republic for 2020 as a whole. At the time of the survey, nevertheless, the analysts were mostly optimistic that this situation would not last long and the economy would return to more than 2% growth next year after the pandemic subsides, yet from a lower base due to weaker performance this year.

Although the first two months of 2020 were relatively favourable, the analysts believe that the impact of the spread of the coronavirus pandemic will have a negative shock impact on aggregate supply and demand especially in March and 2020 Q2. Many respondents believed that economic activity might gradually renew later, which might also continue into 2021. Nevertheless, over time, as little encouraging news appeared in the media, comments have emerged indicating the coronavirus pandemic might have a much deeper impact on the real economy than originally thought. So a more pessimistic rhetoric is heard and according to some respondents, the risks are rather tilted to less favourable economic growth.

#### 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

(%)

March 2020	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
<b>minimum</b>	1.25	0.05	1.35	0.65	0.80	1.10	0.80	0.50
<b>average</b>	1.90	1.37	2.17	1.68	1.32	1.59	1.17	1.43
<b>maximum</b>	2.25	2.25	2.40	2.55	1.80	2.10	1.65	1.95

### 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
3.19	1.85	2.18	2.27	2.51	2.05	2.30	1.99	2.31
4.19	1.87	2.17	2.27	2.48	2.03	2.28	1.97	2.29
7.19	2.00	2.03	2.29	2.24	1.73	1.91	1.65	1.92
9.19	2.00	1.93	2.19	2.07	1.55	1.67	1.39	1.66
10.19	2.00	1.99	2.24	2.15	1.64	1.73	1.35	1.69
12.19	2.00	2.00	2.28	2.25	1.81	1.89	1.52	1.75
2.20	2.25	2.15	2.47	2.32	2.00	2.06	1.72	1.98
3.20	1.90	1.37	2.17	1.68	1.32	1.59	1.17	1.43

### ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE

(%)

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
<b>15.3.</b>	1.75	2.26	1.34	1.21

Despite the fact that the Fed had eased its monetary policy in an emergency move in early May, a similar step by the CNB<sup>1</sup> almost two weeks later was surprising for many analysts. As suggested by the above data, before the CNB's extraordinary measures, some analysts assumed that the regular Bank Board meeting in March would not produce any change in the key rate setting. The analysts who provided their contributions after the CNB's extraordinary meeting could only speculate whether the CNB Board would continue to decrease the 2W repo rate at its regular meeting in March. At least two respondents believed that the 2W repo rate would be cut further by 50 bps to 1.25% at the next CNB Board meeting. No respondent expected it to decrease to 1.00% at the time of the survey. But this may not be the end of the CNB's monetary policy easing cycle as, according to some analysts, the key rates might decrease further in the next twelve months. One analyst even believes that the 2W repo rate might be cut to technical zero (0.05%) where it stood in 2012–2017.

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

(%)

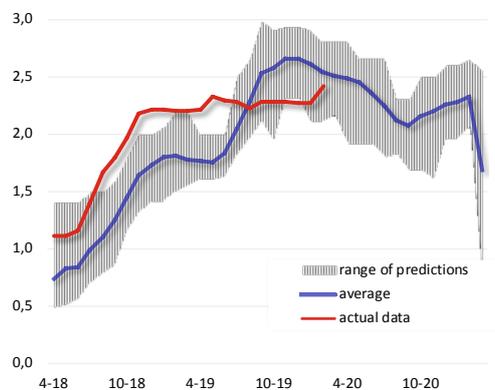
2W repo rate level in 1Y (%)	0.05	0.5	1.25	1.5	1.75	2	2.25	2.5	2.75
number of analysts - current survey	1	2	3	1	3	2	1	0	0
-previous survey	0	0	0	0	2	6	7	1	1

The decrease in the 2W repo rate combined with adverse global economic developments, which led to a decline in interest rates and government bond yields on the global financial market, was also reflected in lower domestic interbank reference rates and swap rates. The analysts have so far reduced the outlook for the 12M PRIBOR by 29 bps and 64 bps at the one-month and one-year horizons, respectively. The expected decline in the 2W repo rate arising from reference interbank interest rates is thus now more pronounced than in the previous survey, despite monetary policy easing adopted at the extraordinary CNB Board meeting in March. The forecasts for IRS rates shifted to significantly lower levels by 46–68 bps. The curve compiled of swap rates continues to have an inverted and even steeper slope between the 5Y and 10Y maturities than in the February survey.

<sup>1</sup> At its extraordinary monetary policy meeting on 16 March 2020, the Bank Board of the Czech National Bank unanimously adopted measures to mitigate the impacts of the situation caused by the coronavirus epidemic on Czech firms, businesses and households. This measure included a decrease in key interest rates of 50 bps.

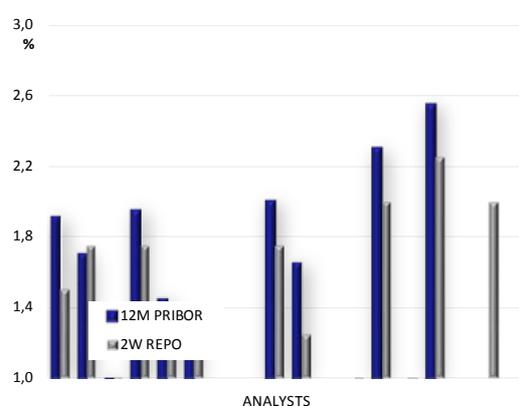
**12M PRIBOR AT 1Y**

ACTUAL DATA, AVERAGE AND RANGE OF PREDICTIONS



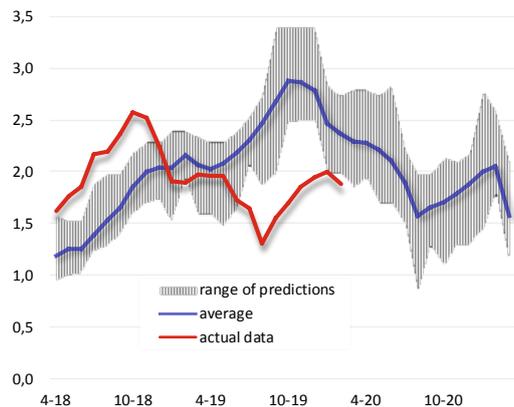
**2W REPO AND 12M PRIBOR AT 1Y**

PREDICTIONS OF INDIVIDUAL ANALYSTS



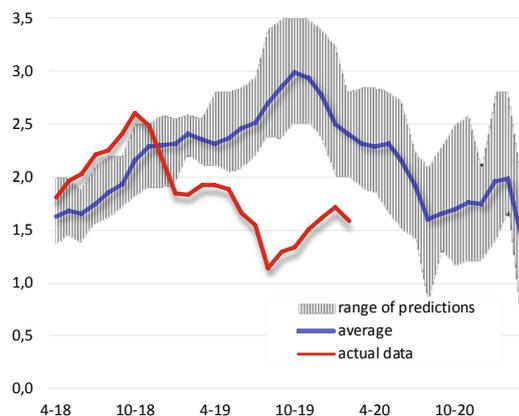
**5Y IRS AT 1Y**

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
3.19	25.61	25.03
4.19	25.61	25.34
7.19	25.59	25.33
9.19	25.74	25.47
10.19	25.78	25.50
12.19	25.57	25.36
2.20	25.05	24.93
3.20	26.20	25.48

### EXCHANGE RATE FORECAST

March 2020	EUR/CZK	
	1M	1Y
minimum	25.50	24.70
average	26.20	25.48
maximum	27.50	26.50

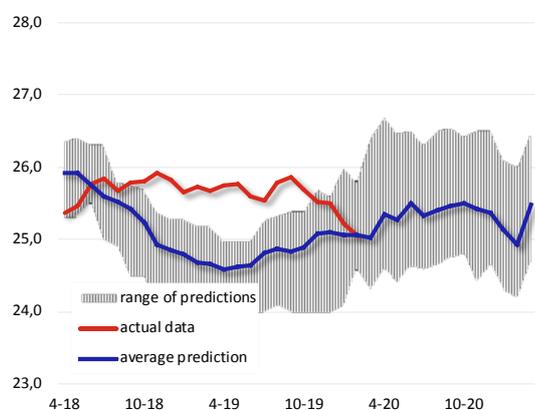
### ACTUAL EUR/CZK AS OF FORECAST DEADLINE

15.3.	26.04
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The last few weeks have brought increased volatility to almost all financial markets, but the exchange rate of the koruna has been much more turbulent than the other currencies in the CEE region, despite the relatively favourable fundamentals of the Czech economy. There was a view that this might have been fostered by expectations of a decline in the CNB's key interest rates, i.e. narrowing of the interest rate differential vis-à-vis the ECB. However, more frequently mentioned are open positions which foreign investors have been maintaining in the koruna since the exchange rate commitment. Due to this foreign capital, the Czech currency is more vulnerable and sensitive to external shocks. The sharp increase in risk aversion related to the negative impacts of the new coronavirus pandemic has thus resulted in a dramatic depreciation of the domestic currency, even above the minimal level maintained during the exchange rate commitment, i.e. CZK 27 to the euro. The data obtained from the analysts around mid-March show that the analysts regarded major depreciation as possible but also regarded the sharp depreciation of the koruna as temporary, assuming appreciation to CZK 25.48 to the euro at the one-year horizon. This is close to the levels they assumed on average at the one-year horizon in our surveys in 2019 Q4. However, in their opinion, the risks are tilted towards weaker levels; for example, in the event of extended production shutdowns. In addition to the traditional arguments related to higher risk aversion and adverse global economic developments, the koruna may lose its attractiveness due to potentially weakening performance in the automotive industry, in which the Czech economy largely specialises.

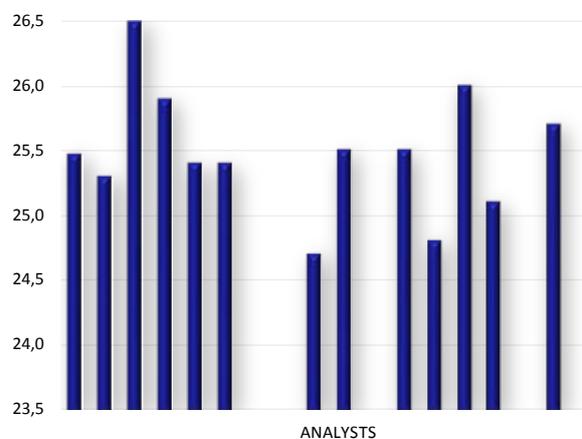
### EUR/CZK

ACTUAL DATA, 1Y PREDICTIONS AND THEIR RANGE



### EUR/CZK AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



## VI. NOMINAL WAGES

### FORECAST FOR NOMINAL WAGE GROWTH

(%)

March 2020	year end	
	current	current+1Y
minimum	3.50	1.50
average	5.15	4.09
maximum	6.80	5.90

### FORECAST FOR NOMINAL WAGE GROWTH

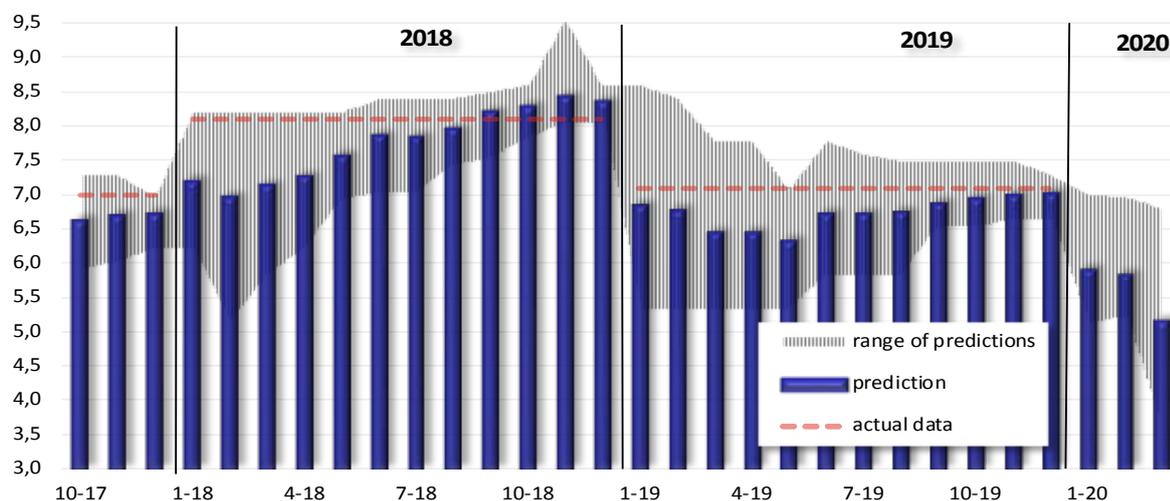
(%)

Date of Prediction	year end	
	current	current+1Y
3.19	6.4	4.7
4.19	6.4	4.9
7.19	6.7	5.2
9.19	6.9	5.4
10.19	6.9	5.5
12.19	7.0	5.7
2.20	5.8	4.9
3.20	5.1	4.1

The fall in economic activity is also likely to affect the labour market. Despite the calls by the Czech prime minister, complications related to the protective measures against the spread of the coronavirus lead many entrepreneurs to reduce the number of their employees. However, demand will not be as high as at the start of 2020 after the contagion subsides and employers will have to adjust their production capacity and reduce the costly labour force. The unemployment rate is thus very likely to rise, which will, on the one hand, ease the previously very tight labour market conditions in the Czech Republic (which had the lowest unemployment rate of all the EU), but on the other hand, the bargaining power of employees when submitting their wage growth requirements will decline to some extent and firms' room for payments of the movable components will be limited. The average forecast for nominal wage growth in 2020 thus decreased by 0.7 percentage point to 5.1%. Wage growth is expected to decline further to 4.1% next year, 0.8 pp less than in the February survey.

### NOMINAL WAGE GROWTH

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



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