Financial Market Inflation Expectations

4/2020

CNB CZECH NATIONAL BANK

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I. SUMMARY

Although the coronavirus pandemic is not yet completely over and there are still many restrictive measures in effect, we have succeeded in obtaining contributions from all respondents, i.e. fifteen domestic and three foreign analysts. As the analysts themselves note, authorities' efforts to prevent the coronavirus from spreading and mitigate its negative impacts give rise to many uncertainties regarding, for example, the timing of the end of the adopted measures. These uncertainties are subsequently reflected in our respondents' economic outlooks. This is then naturally mirrored in an unusually wide range of the individual forecasts.

The obtained data suggest that the analysts predict a deep recession overall despite an expected further cut in the 2W repo rate by the CNB. However, the dramatic fall in economic activity could be replaced by an economic recovery as early as at the end of this year or during next year. The current conditions will also probably result in a drop in demand, which will be reflected in lower inflation pressures. Combined with very low commodity prices, this could also lead to a lower rate of consumer price inflation at the one-year horizon. At the three-year horizon, however, inflation expectations are anchored at the CNB's 2% target despite the current adverse developments. The koruna should not weaken significantly further. According to the analysts, in the extreme case, this should be prevented by the CNB's interventions. After the situation on global financial markets calms and sentiment turns positive again, the koruna could return to an appreciation scenario. The deterioration in conditions will also be reflected in the labour market and distinctly slower nominal wage growth both this year and the next. According to the survey, wage growth in 2021 will be even slower than this year.

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 in this very difficult situation.

Prague, 24 April 2020

II. INFLATION

FORECAST FOR Y/Y CPI GROWTH

(%)

April 2020	CPI 1Y	CPI 3Y
minimum	0.4	0.4
average	1.6	2.0
maximum	2.8	2.7

1Y AND 3Y FORECAST FOR CPI GROWTH

(%)

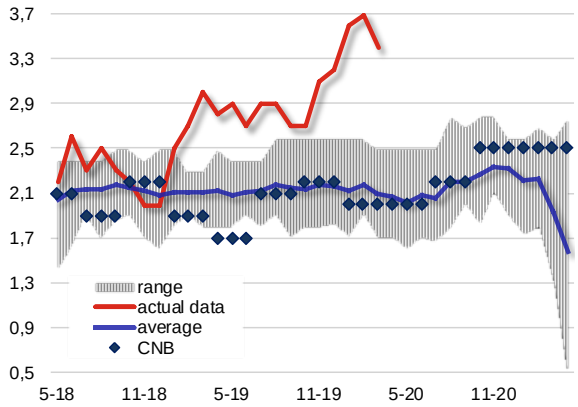
Date of Prediction	ANALYSTS 1Y	ANALYSTS 3Y	CNB (%) 1Y
4.19	2.1	2.0	2Q: 2.0
7.19	2.1	2.0	
9.19	2.2	2.0	3Q: 2.2
10.19	2.3	2.0	
12.19	2.3	2.0	4Q: 2.5
2.20	2.2	2.0	
3.20	1.9	1.9	1Q: 2.3
4.20	1.6	2.0	

The March growth in the consumer price index confirms a slowdown in inflation in the Czech Republic, with its annual rate reaching 3.4% compared to 3.7% in February. As regards month-on-month statistics, the index even declined – by 0.1 pp. This slowdown was due largely to the impact of the spreading pandemic, manifesting itself especially through extremely low oil demand and oil prices which pass through to fuel prices at filling stations. The analysts who took part in our survey responded to the latest events and revised their inflation forecasts considerably. One year ahead, they expect inflation to be even further below the inflation target than they estimated in the previous survey – at 1.6%. This is 0.3 pp less than in March. A high degree of uncertainty, to which the analysts themselves point, is manifested in a significant widening of the range of their one-year forecasts. Due to a large fall in the minimum value, the difference between the highest and lowest value (see the table above) increased by 1.1 pp to 2.4 pp, which is the second-highest value since 2008. Medium-term inflation expectations are anchored at the CNB's 2% target despite very unfavourable economic outlooks.

Already before the outbreak of the disease in the Czech Republic, the analysts had estimated that inflation would peak in the spring and then slow. However, this is now amplified by the expectation that the Czech economy will not be spared a pandemic shock in the form of a dramatic fall in demand, which will be reflected in a considerable weakening of inflation pressures. In addition, inflation will also be affected by the currently extremely low prices of oil and other commodities. Not even a weaker koruna, which will conversely increase the costs of exports, will probably prevent the slowdown in consumer price growth. At the same time, some respondents point out that consumer price volatility may be higher in the period ahead due to the destabilised economic conditions.

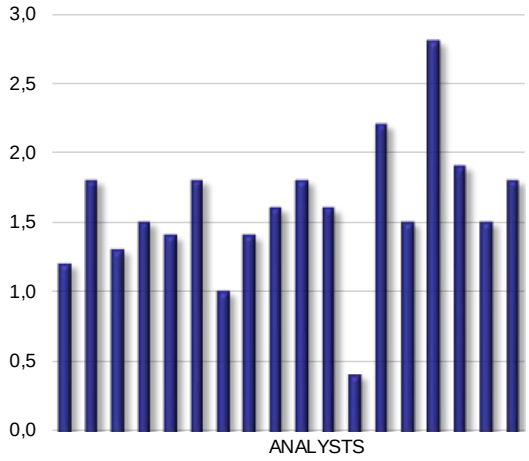
CONSUMER PRICE INDEX

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

(%)

April 2020	end of year	
	current	current + 1Y
minimum	-11.0	2.0
average	-7.2	5.8
maximum	-4.8	11.0

FORECAST FOR GDP GROWTH

(%)

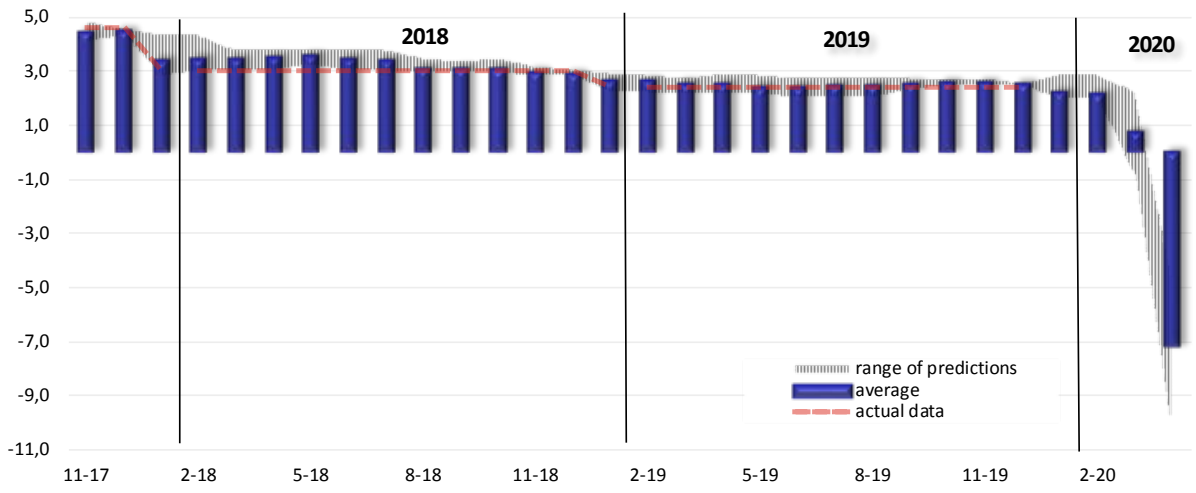
Date of Prediction	end of year	
	current	current+1Y
4.19	2.5	2.5
7.19	2.5	2.4
9.19	2.5	2.3
10.19	2.6	2.3
12.19	2.5	2.1
2.20	2.1	2.3
3.20	0.7	2.2
4.20	-7.2	5.8

Although the CZSO improved the estimate of GDP growth in the Czech Republic for 2019 in its second revision (to 2.5%), this has virtually no effect on the economic outlook due to the impacts of the pandemic. Even though the analysts do not have the necessary information and data which they need for their forecasts, they have a unanimous opinion that the Czech economy will slide into a deep recession. However, they differ as to its extent again due to the large degree of uncertainty. According to the most optimistic scenario, GDP will drop by 4.8% in the Czech Republic this year, whereas the most pessimistic scenario expects a drop of up to 11%. The range of the forecasts is thus (due to the markedly bigger drop in the minimum value) huge – the highest in history. Economic activity is expected to decline by 7.2% on average in 2020. However, the respondents believe overall that there should be a relatively strong recovery of 5.8% next year. Despite that, economic activity in 2021 will remain far bellow the level recorded in 2019.

The economic downturn both in the Czech Republic and abroad will have a significant impact on both demand and supply sides. According to some analysts, a return to the usual production level will be complicated due to the persisting general concern about the new disease and overall negative sentiment of both businesses and consumers. The possibility of a full-fledged renewal of interrupted supplier-customer trade links is also being argued about. Nevertheless, supported by the right expansionary and monetary policies, the economy could gradually pick up again and gain relatively rapid momentum. However, the external environment may hinder this recovery, at least at the beginning.

GDP GROWTH AT END OF CURRENT YEAR

AVERAGE AND RANGE OF PREDICTIONS



IV. INTERESTRATES – 2W REPO, PRIBOR, IRS

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

(%)

April 2020	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
minimum	0.25	0.05	0.47	0.28	0.52	0.20	0.60	0.68
average	0.61	0.44	0.76	0.79	0.75	1.00	0.83	1.12
maximum	1.00	1.00	1.10	1.37	1.10	1.50	1.40	1.60

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
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
4.20	0.61	0.44	0.76	0.79	0.75	1.00	0.83	1.12

ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE

(%)

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
15.4.	1.00	0.93	0.76	0.80

The respondents' views on the setting of the key interest rates after the upcoming CNB Bank Board meeting in May also differ more than is usual. Two analysts estimate that the key interest rate (2W repo) will remain at the current level. However, all the others believe that a further easing of the CNB's monetary policy is inevitable due to adverse economic developments and expect the CNB's key rates to fall. This should facilitate credit financing of the private sector and accelerate the recovery of the Czech economy. The extent of the estimated cut in the 2W repo rate ranges from 25 to 75 bps, with most respondents (precisely ten) expecting a drop of 50 bps to 0.5%. Some analysts believe that the CNB may not even wait with the change in the key rates until the Bank Board's regular May policy meeting but can cut them at an extraordinary meeting again. In its decision-making, the Bank Board will probably take into account particularly the impacts of the government's measures to contain the spread of the coronavirus and the estimated speed of return to normal conditions, not only in the Czech Republic, but also abroad. The actual koruna exchange rate, which is currently much weaker than before the outbreak of the pandemic, could also be relevant.

Most respondents are also expecting the 2W repo rate to be set at 0.50% at the one-year horizon. Nevertheless, the number of analysts who believe that the CNB could ease its monetary policy even more is higher than in the previous survey. Four analysts are now expecting the CNB's key rate to fall to technical zero again (see the table below).

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

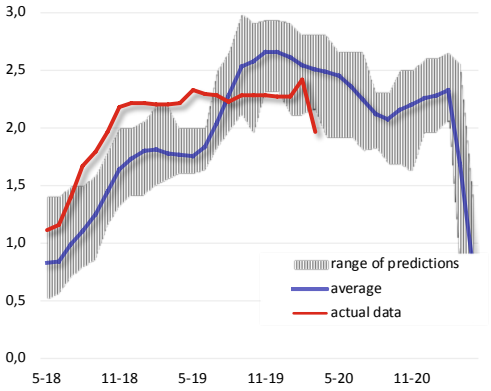
(%)

2W repo rate level in 1Y (%)	0.05	0.25	0.5	0.75	1	1.25	1.5	1.75	2	2.25
number of analysts - current survey	4	2	9	1	2	0	0	0	0	0
-previous survey	1	0	2	0	0	3	1	3	2	1

As many respondents had not managed to project the results of the CNB Bank Board's extraordinary meeting (held on 16 March) to the March survey, the forecasts for both PRIBOR interbank reference rates and swap rates are markedly lower now. PRIBOR rates, which take the expectations of a further easing of the CNB's monetary policy more into account, recorded a significant drop. As regards long-term swap rates, some respondents even expect a gradual increase in the rates in the months (but not weeks) ahead in their comments, with the potential curve implied by the average forecasted rates taking on a slightly positive slope.

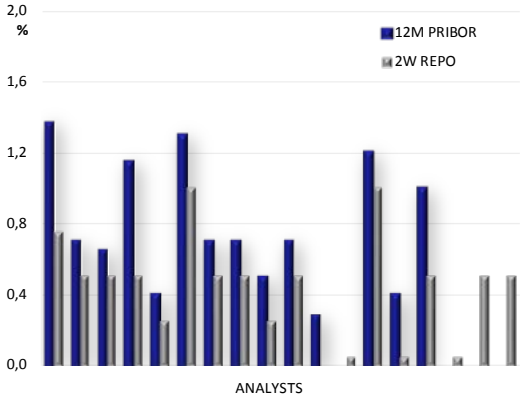
12M PRIBOR AT 1Y

ACTUAL DATA, AVERAGE AND RANGE OF PREDICTIONS



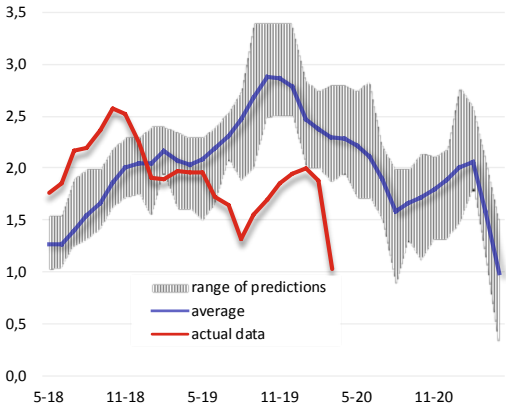
2W REPO AND 12M PRIBOR AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



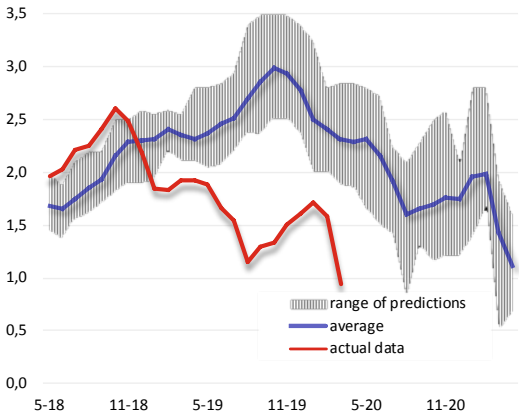
5Y IRS AT 1Y

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
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
4.20	26.98	25.98

EXCHANGE RATE FORECAST

April 2020	EUR/CZK	
	1M	1Y
minimum	26.50	25.10
average	26.98	25.98
maximum	27.50	26.80

ACTUAL EUR/CZK AS OF FORECAST DEADLINE

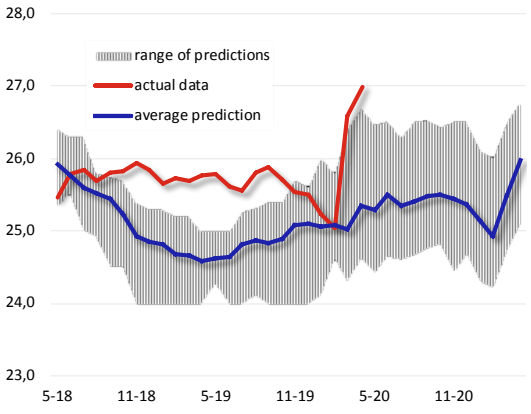
15.4.	26.99

Persisting uncertainty and negative sentiment on the global financial market is unfavourable for the koruna, which weakened again and stood at CZK 27 to the euro as of the cut-off date. Although some analysts acknowledged the possibility of its further depreciation over the one-month horizon (to CZK 27.5 to the euro, though just one), the respondents expected the koruna to remain close to CZK 27 to the euro on average. There were opinions that a further cut in the key interest rates might lead to a weakening of the koruna, but the analysts (in line with the Czech central bank's communications) also admit that this could trigger the CNB's response in the form of interventions on the foreign exchange market.

After the current nervousness eases and investors see hope of an economic recovery again, the koruna could also return to the appreciation path and strengthen gradually. This, however, might be hindered by the low interest rate differential vis-à-vis euro area rates until the next hike in key interest rates. Nevertheless, there was also a view that the appreciation could be stronger than that recorded after the exit from the exchange rate commitment in 2017, as the weakening in recent week is to a large extent attributed to a closing of long koruna positions by foreign investors, where these open positions were regarded as the main obstacle to appreciation of the koruna in recent years. In any case, the analysts expect on average that the koruna might stand at CZK 25.98 to the euro at the one-year horizon.

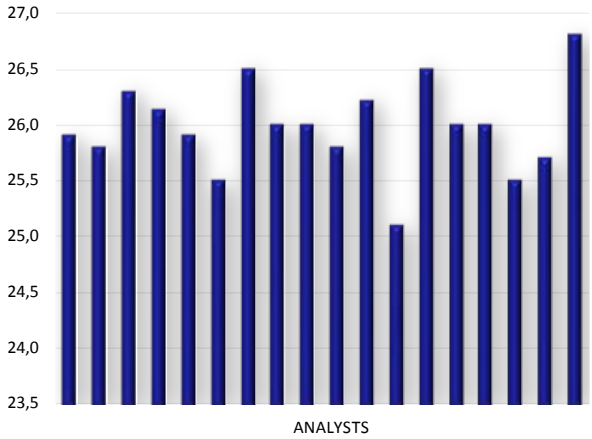
EUR/CZK

ACTUAL DATA, 1Y PREDICTIONS AND THEIR RANGE



EUR/CZK AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



VI. NOMINAL WAGES

FORECAST FOR NOMINAL WAGE GROWTH

(%)

April 2020	year end	
	current	current+1Y
minimum	2.00	1.50
average	3.81	3.17
maximum	5.50	5.30

FORECAST FOR NOMINAL WAGE GROWTH

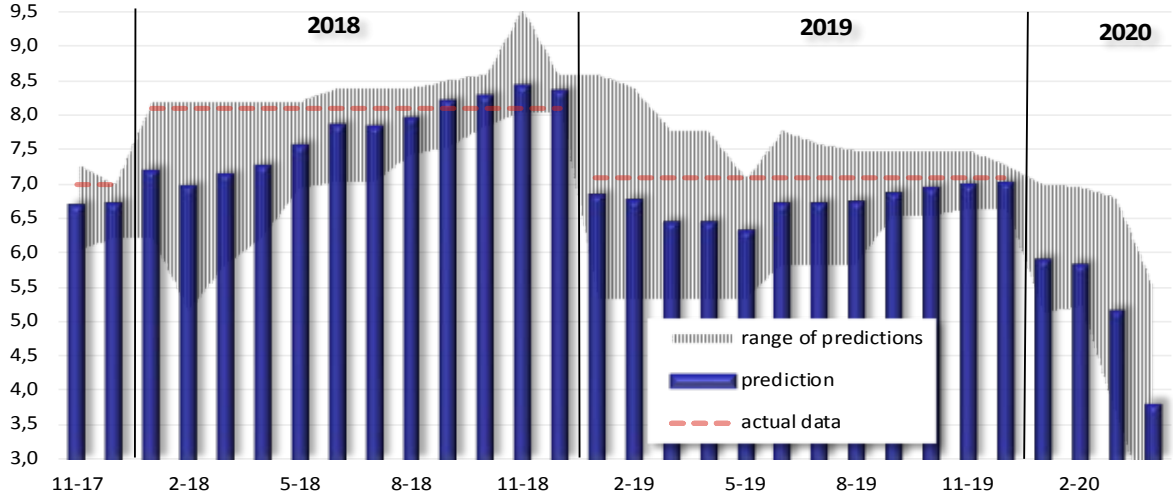
(%)

Date of Prediction	year end	
	current	current+1Y
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
4.20	3.8	3.2

It is clear that the negative impacts of the pandemic and the prospect of a deep recession will probably not allow wages to grow at such a pace as last year when the nominal wage rose by 7.1% and the real wage by 4.2%. Only new macroeconomic data will show how business entities will manage to overcome difficult economic times, how successful the government's effort to maintain the maximum number of jobs will be and how deep an impact this will have on labour market and wages. The analysts expect wage growth to decline markedly this year on average. The growth will fall to 5.5% in the most optimistic opinion and 2.0% in the most pessimistic one. Employees' nominal wages will thus rise by just 3.8% in 2020 on average. Neither do the estimates for next year indicate that wage growth should start to increase thanks to the expected economic recovery. On the contrary, it could slow further to 3.2%.

NOMINAL WAGE GROWTH

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



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