

Financial Market Inflation Expectations

5/2020



Czech National Bank — Financial Market Inflation Expectations — 5/2020

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I. SUMMARY

Despite the prevailing state of emergency, we once again managed to obtain contributions from all the respondents. Fifteen domestic and three foreign analysts took part in the CNB's May survey. However, as the obtained data suggest, the analysts' view on future economic developments is even less optimistic than a month ago. The estimated drop in GDP this year increased further, approaching -8%. The one-year inflation outlook is unchanged on average. At the three-year horizon, however, the expected consumer price inflation edged down to just below the CNB's inflation target of 2%. Most of the respondents are not expecting the 2W repo rate to be changed at the June Bank Board meeting. However, more than a quarter predict its cut by a further 20 bps. The koruna exchange rate forecast again reflects the movement on the forex market and has shifted to a slightly weaker level. And the labour market might see an increase in unemployment, which will reduce the room for wage growth. The rate of wage growth expected for both this year and the next has thus been revised downwards.

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, Luboš Růžička, 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 Janičko, 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, 21 May 2020

II. INFLATION

FORECAST FOR Y/Y CPI GROWTH

(%)

May 2020	CPI	
	1Y	3Y
minimum	0.0	-0.2
average	1.6	1.9
maximum	2.8	2.8

1Y AND 3Y FORECAST FOR CPI GROWTH

(%)

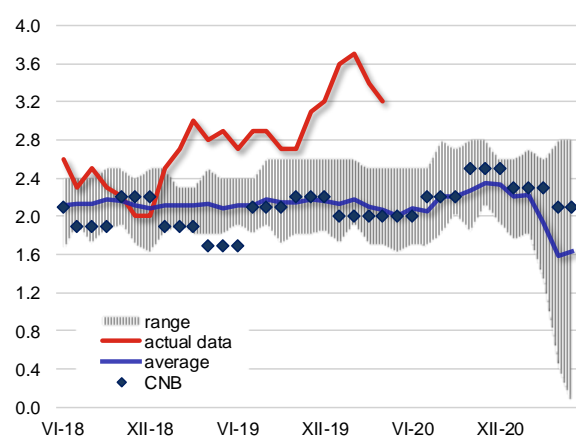
Date of Prediction	ANALYSTS		CNB (%)
	1Y	3Y	1Y
V.19	2.0	1.9	2Q: 2.0
VII.19	2.1	2.0	
IX.19	2.2	2.0	3Q: 2.2
X.19	2.3	2.0	
XII.19	2.3	2.0	4Q: 2.5
II.20	2.2	2.0	1Q: 2.3
IV.20	1.6	2.0	
V.20	1.6	1.9	2Q: 2.1

Inflation continues to slow in the Czech Republic. The year-on-year consumer price index increased by 3.2% in April, 0.2 pp less than a month earlier. This was due largely to the transport segment and a record-high drop in fuel prices at filling stations. By contrast, food prices are raising inflation. Despite that, the analysts' forecasts have not changed dramatically. At the one-year horizon, the average inflation rate is unchanged and remains at 1.6%. By contrast, the average rate in the three-year forecasts shifted slightly down (by 0.1 pp) to 1.9%, i. e. just below the 2% inflation target. The range of individual forecasts widened significantly due to a drop in the minimum values at both horizons monitored. At the three-year horizon, one of the respondents even expects moderate deflation. This scenario is based on economic output being below the potential output level and on the deflationary effects of a strengthening koruna.

According to the analysts, several opposing factors will continue to affect inflation in the future. In addition to low fuel prices, the pre-crisis inflationary trend will unwind gradually. Conversely, the impact of a broad-based decline in aggregate demand, stemming from the economic recession triggered by the coronavirus pandemic and strict government measures aiming to prevent its spread, will intensify. This will happen not only in the Czech Republic, but also abroad. Growth in food prices, caused, among other things, by harvest problems, is acting in the opposite direction. The weaker koruna is also having a significant inflationary effect. According to some respondents, the May data may also reflect a hike in excise duty, which has yet to fully feed through into the consumer price index.

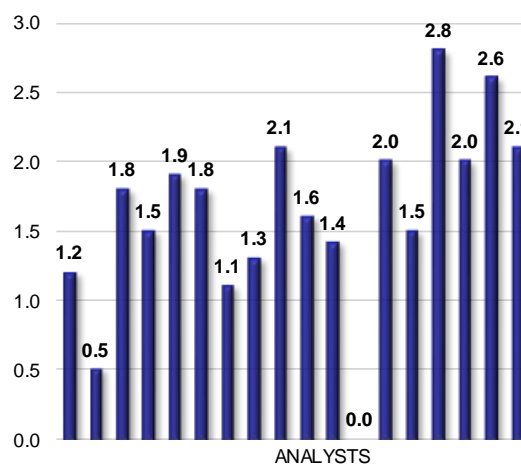
CONSUMER PRICE INDEX

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

(%)

May 2020	end of year	
	current	current + 1Y
minimum	-11.0	2.9
average	-7.9	5.8
maximum	-6.3	9.7

FORECAST FOR GDP GROWTH

(%)

Date of Prediction	end of year	
	current	current+1Y
V.19	2.4	2.4
VII.19	2.5	2.4
IX.19	2.5	2.3
X.19	2.6	2.3
XII.19	2.5	2.1
II.20	2.1	2.3
IV.20	-7.2	5.8
V.20	-7.9	5.8

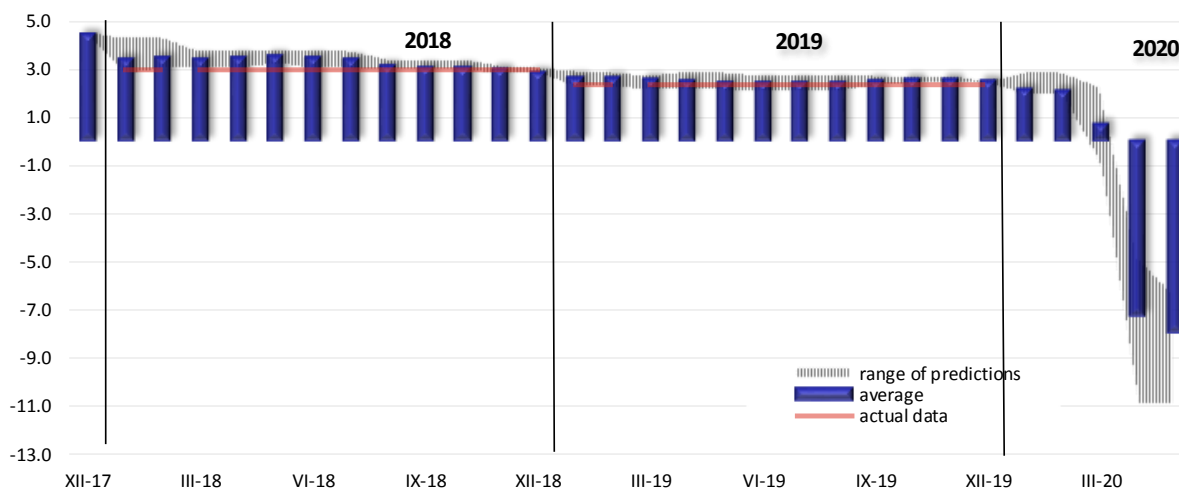
The preliminary economic growth estimate for 2020 Q1 already clearly shows the negative impact of the coronavirus pandemic and the related restrictive measures. The Czech economy contracted by 2.2% year on year, while in quarter-on-quarter terms it declined by as much as 3.6%. According to some respondents, these figures might be even worse in the revised estimate after the CZSO receives retrospective data fully capturing the drop in economic activity. The adverse GDP trend was due mainly to a drop in external demand and lower capital formation. By contrast, general government expenditure had a positive effect. As households made efforts to stock up well after the pandemic broke out in the Czech Republic, the negative impact on household consumption may be felt with a delay, i.e. in 2020 Q2.

The analysts' opinion on economic developments this year worsened further, also probably in view of new data. They are now on average expecting the economy to decline by 7.9%, 0.7 pp more than in the April survey. However, the outlook for the intensity of the recovery next year is unchanged and the expected rate thus remains at 5.8%. The range of the extreme values narrowed in both years of the forecast due to a marked drop in the maximum estimates.

The analysts believe that the weak economic performance reflects not only the government restrictions such as, for example, blocked borders and the corresponding decline in foreign trade activity, or closed shops and the related shortfall in household consumption. A fundamental factor is also increased uncertainty, which dampens investment activity and, owing to fear of loss of employment, also household consumption. Next year, the economy is expected to recover. However, the intensity of the recovery will naturally depend not only on the course of the pandemic and any further waves of its resurgence, but also on the effectiveness of monetary and fiscal measures and the number of preserved jobs.

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

(%)

May 2020	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
minimum	0.05	0.05	0.40	0.20	0.38	0.23	0.01	0.02
average	0.19	0.16	0.41	0.42	0.44	0.60	0.56	0.74
maximum	0.25	0.50	0.50	0.70	0.61	1.09	0.80	1.15

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
V.19	2.00	2.14	2.32	2.45	2.03	2.22	1.98	2.32
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
II.20	2.25	2.15	2.47	2.32	2.00	2.06	1.72	1.98
IV.20	0.61	0.44	0.76	0.79	0.75	1.00	0.83	1.12
V.20	0.19	0.16	0.41	0.42	0.44	0.60	0.56	0.74

ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE

(%)

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
15.5.	0.25	0.41	0.42	0.57

The opinion on the future path of the CNB's key interest rates has adapted to the outcome of the May Bank Board meeting, at which the 2W repo rate was cut substantially (by 75 bps, to 0.25%). Most of the respondents (13 out of 18) do not expect the CNB key rate to be changed at the Bank Board's next (June) monetary policy meeting. The remaining five analysts expect the 2W repo rate to decrease by 20 bps to technical zero, i.e. to 0.05%. However, even some advocates of interest rate stability point out that a further deterioration in the economy might force the Bank Board to reduce the key rates further. At the one-year horizon, most of the analysts (nine out of 18) believe that the key rate will drop to technical zero. Eight respondents expect rates to be stable and only one thinks that an improvement in economic conditions will open up space for a hike in the 2W repo rate to 0.50%.

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

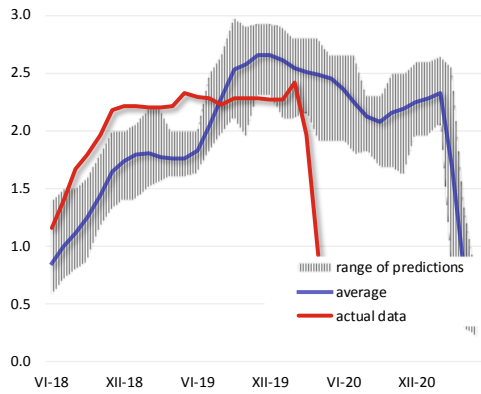
(%)

2W repo rate level in 1Y (%)	0.05	0.25	0.5	0.75	1	1.25
number of analysts - current survey	9	8	1	0	0	0
-previous survey	4	2	9	1	2	0

The May cut of the key interest rates, the extent of which was a surprise for many analysts, and the latest movements of market rates led to a significant downward revision of the average forecasts for both the PRIBOR reference interest rates and swap rates. The average forecast for the 12M PRIBOR was lowered by 34 bps at the one-month horizon and by 37 bps at the one-year horizon. The forecasts for swap rates were reduced by 27–40 bps, with the one-year forecasts always recording a bigger change. At the same time, the positive slope of the swap curve between the 5Y and 10Y maturities also increased slightly.

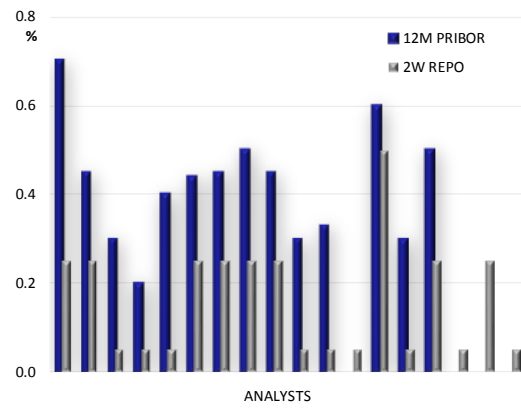
12M PRIBOR AT 1Y

ACTUAL DATA, AVERAGE AND RANGE OF PREDICTIONS



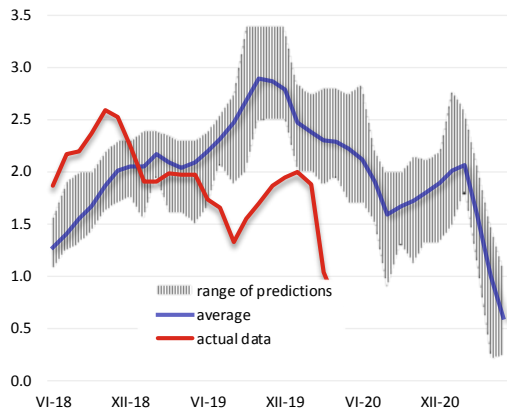
2W REPO AND 12M PRIBOR AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



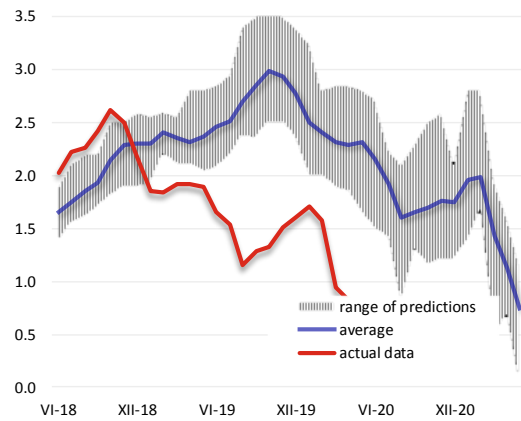
5Y IRS AT 1Y

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
V.19	25.68	25.28
VII.19	25.59	25.33
IX.19	25.74	25.47
X.19	25.78	25.50
XII.19	25.57	25.36
II.20	25.05	24.93
IV.20	26.98	25.98
V.20	27.28	26.20

EXCHANGE RATE FORECAST

May 2020	EUR/CZK	
	1M	1Y
minimum	26.75	24.90
average	27.28	26.20
maximum	27.90	27.30

ACTUAL EUR/CZK AS OF FORECAST DEADLINE

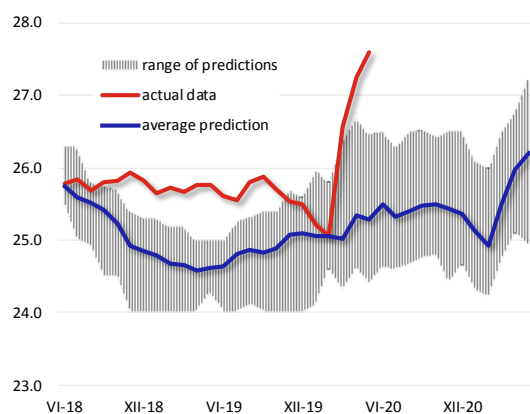
15.5.	27.59
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The persisting high degree of global uncertainty also continues to be reflected in the koruna-euro exchange rate, which has experienced a period of above-average volatility. The koruna depreciated by 60 hellers to CZK 27.59 to the euro from mid-April to mid-May. The analysts naturally incorporated this depreciation in their outlooks and their average forecast shifted to weaker levels, though to a slightly smaller extent. The exchange rate of the koruna is expected to be close to CZK 27.28 to the euro in mid-June and strengthen gradually to CZK 26.20 to the euro over the next few months.

In their comments, the analysts most often attribute the depreciation of the koruna on the forex market to negative global sentiment and considerable uncertainty, which is related to the spread of the new coronavirus and has caused an outflow of capital to the USA. Some analysts now also mention the CNB monetary policy settings and the surprisingly large cut in the key interest rates at the May Bank Board meeting (noting that the CNB forecast implied only a 50 bp reduction in the 2W repo rate). Their comments also contain speculations about further monetary policy easing and a subsequent long period of low interest rates. A gradual return of the economy to more normal conditions and an improvement in global economic sentiment (which could attract part of the capital back into the Czech Republic) should return the koruna on a slight appreciation path. The analysts believe that this will be also supported by favourable domestic fundamental factors, i.e. stable economic growth, a current account surplus and prudent fiscal policy in an environment of a widening interest rate differential vis-à-vis the euro area, as time progresses. However, the future course of the pandemic is a risk. If a second wave of the pandemic resurges, a depreciation of the koruna – or at least a slowdown in its return to an appreciation path – cannot be ruled out.

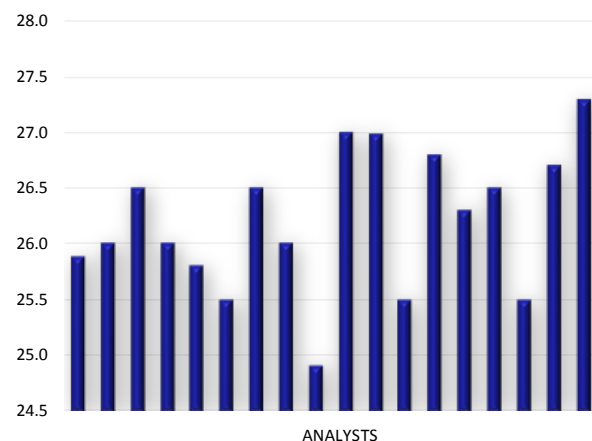
EUR/CZK

ACTUAL DATA, 1Y PREDICTIONS AND THEIR RANGE



EUR/CZK AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



VI. NOMINAL WAGES

FORECAST FOR NOMINAL WAGE GROWTH

(%)

May 2020	year end	
	current	current+1Y
minimum	1.24	1.50
average	3.54	2.82
maximum	5.50	5.30

FORECAST FOR NOMINAL WAGE GROWTH

(%)

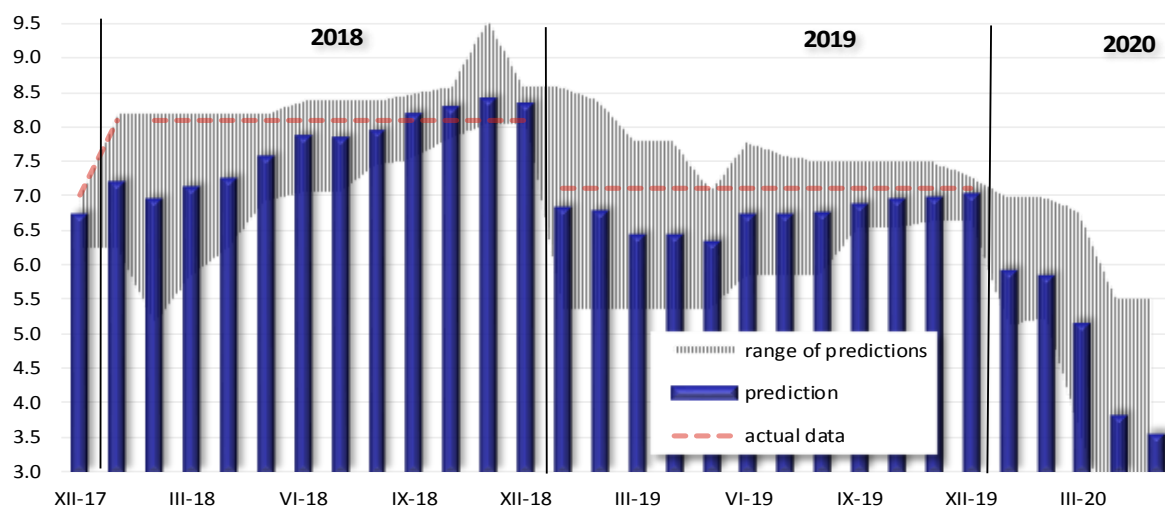
Date of Prediction	year end	
	current	current+1Y
V.19	6.3	4.8
VII.19	6.7	5.2
IX.19	6.9	5.4
X.19	6.9	5.5
XII.19	7.0	5.7
II.20	5.8	4.9
IV.20	3.8	3.2
V.20	3.5	2.8

Against the backdrop of the ever-worsening forecasts for economic growth, the analysts revised the expected rate of nominal wage growth downwards. Unemployment is highly likely to increase despite government support programmes aimed at maintaining employment at a maximum level. Although the analysts expect the domestic economy to grow by 5.8% next year, the growth will be largely due to statistical base effects and the very important pickup in consumer and business confidence may not be as fast. As a result, the recovery from the negative impacts of the pandemic on unemployment will also be only very gradual, which is creating less favourable conditions for rapid wage growth.

Nominal wages are thus expected to increase by 3.5% on average this year, 0.3 pp less than estimated in the April survey. The outlook for wage growth in 2021 is still less optimistic, as the estimated growth is just 2.8%, a slowdown of 0.4 pp from a month earlier.

NOMINAL WAGE GROWTH

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



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