

Financial Market Inflation Expectations

— 6/2020



Czech National Bank — Financial Market Inflation Expectations — 6/2020

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I. SUMMARY

Fourteen domestic and three foreign analysts sent in their contributions to the June survey within the set deadline. The results show that the average view of the extent of this year's downturn and inflation remains unchanged at the one-year horizon. However, the prospect of an economic recovery next year is slightly less optimistic and the expected inflation has again shifted just below the 2% inflation target set by the CNB. The opinion on monetary policy settings after the June meeting of the CNB Bank Board is unchanged, with most of the respondents expecting the 2W repo rate to remain at 0.25%. The analysts are also consistent in their outlook for key interest rates at the one-year horizon, as nine out of the 17 respondents are expecting the 2W repo rate to drop to 0.05%. The predictions of swap rates and the exchange rate of the koruna virtually reflect the recent market movement. The IRS rate outlook thus shifted higher and the expected koruna exchange rate moved to a stronger level. Nominal wage growth should be less strong this year compared to the data in the previous survey. The forecast for next year is unchanged.

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	+	+		+	+	+						
Alessandro Cugnasca, The Economist Intelligence	+	+	+	+	+	+						
Jose A. Cerveira, JP Morgan	+			+	+	+						

We would like to thank everyone who contributed to this survey of financial market inflation expectations.

Prague, 23 June 2020

II. INFLATION

FORECAST FOR Y/Y CPI GROWTH

June 2020	CPI	
	1Y	3Y
minimum	0.5	0.0
average	1.6	1.9
maximum	2.8	2.6

1Y AND 3Y FORECAST FOR CPI GROWTH

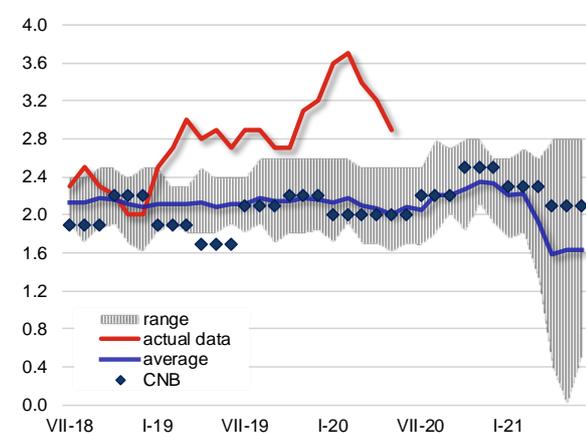
Date of Prediction	ANALYSTS		CNB (%)
	1Y	3Y	1Y
VI.19	2.1	2.0	2Q: 2.0
VII.19	2.1	2.0	
IX.19	2.2	2.0	3Q: 2.2
X.19	2.3	2.0	
XII.19	2.3	2.0	4Q: 2.5
II.20	2.2	2.0	1Q: 2.3
V.20	1.6	1.9	
VI.20	1.6	1.9	2Q: 2.1

Inflation in the Czech Republic is slowing further, returning to the CNB's tolerance band. The consumer price index grew by 2.9% year-on-year in May, 0.3 pp less than in April. According to the CZSO, a slowdown in year-on-year price growth was recorded mainly for food and non-alcoholic beverages, clothing and housing. However, these new data had virtually no impact on the analysts' one-year outlook and the average forecast remains at 1.6%, the same as in the previous survey. By contrast, the three-year forecast fell slightly again below the CNB's inflation target and its average level is now 1.9%. The range of individual forecasts narrowed distinctly at both horizons monitored. This was due to growth in the minimum values in the case of one-year forecasts, and to growth in the minimum values and a drop in the maximum values in the case of the three-year ones.

The dramatic economic downturn observed in 2020 Q2 in the Czech Republic (as well as in other countries) led to a slowdown in inflation. In the following period, consumer demand is expected to weaken, which will also dampen inflation. However, some analysts believe that the anti-inflationary effect of quarantine measures and weaker demand might not be as strong as it might appear at first glance. Moreover, this effect might feed through to inflation with a lag. According to some respondents, a weaker koruna and the current fast growth in prices of selected food products will prevent a faster slowdown in inflation. They thus believe that inflation will not decelerate at a faster pace until 2021 H1. However, inflation is, like overall economic developments, subject to a large degree of uncertainty. Its prediction is currently greatly complicated by, for example, package holiday prices, which are usually seasonal to a great degree and difficult to predict. A potential change in households' buying behaviour, which could lead to a change in the consumer basket, is also very difficult to assess, according to some respondents.

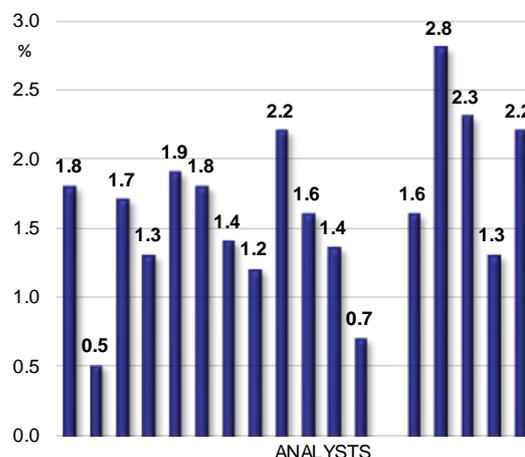
CONSUMER PRICE INDEX

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

(%)

June 2020	end of year	
	current	current + 1Y
minimum	-10.3	3.0
average	-7.9	5.6
maximum	-6.3	7.9

FORECAST FOR GDP GROWTH

(%)

Date of Prediction	end of year	
	current	current+1Y
VI.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
V.20	-7.9	5.8
VI.20	-7.9	5.6

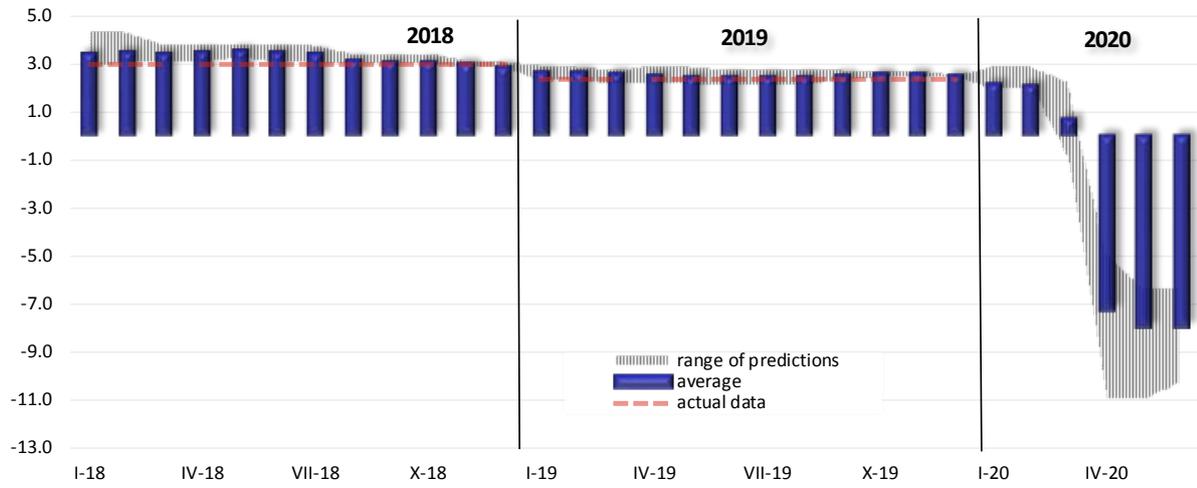
According to a revised CZSO estimate, the Czech economy recorded the largest year-on-year contraction in Q1 since the start of 2010, with GDP falling by 3.3% compared to the previous quarter. Compared to the same quarter of last year, the economy declined by 2.0%. Manufacturing, wholesale and retail trade, transport and hotel and restaurant services were hit the hardest, while construction grew despite an adverse situation in most other sectors. From the demand side perspective, the year-on-year drop was most of all due to investment expenditure and external demand, whereas general government expenditure made a positive contribution and dampened the economic fall.

The analysts have not changed their view of the extent of this year's economic decline, which they estimate to reach 7.9% on average. However, the outlook for next year offers a slightly less optimistic view, as the average forecast for the expected recovery was lowered by 0.2 pp to 5.6%. As regards views of future GDP, the range of individual forecasts also narrowed (as in the case of inflation). This was due to growth in the minimum values in the case of the outlook for this year and, conversely, a drop in the maximum values in the outlook for next year.

The statistics for 2020 Q1 were affected by the government's restrictive measures only briefly (roughly from mid-March), while the data for Q2 will reflect them much more. In 2020 H2, the economy is largely expected to recover. However, this will heavily depend on external demand. The car industry, which is highly cyclical, very sensitive to economic sentiment and has a large share in the Czech economy, will probably be crucial. Support fiscal measures in the form of increased government spending will continue to play an important role. The risks to future economic developments tilt more in the pessimistic direction, as a resurgence in the coronavirus pandemic would undoubtedly lead to an even deeper economic downturn despite better preparedness (smart quarantine, for example, etc.).

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

(%)

June 2020	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
minimum	0.05	0.05	0.30	0.20	0.38	0.36	0.41	0.56
average	0.20	0.14	0.41	0.41	0.55	0.67	0.76	0.92
maximum	0.25	0.25	0.50	0.77	0.70	1.11	1.10	1.30

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
VI.19	2.00	2.08	2.35	2.35	1.90	2.12	1.81	2.16
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
V.20	0.19	0.16	0.41	0.42	0.44	0.60	0.56	0.74
VI.20	0.20	0.14	0.41	0.41	0.55	0.67	0.76	0.92

ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE

(%)

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
15.6.	0.25	0.43	0.61	0.79

The analysts have not changed their view of the outcome of the June meeting since May and, in the June survey, most of them (13 out of 17) expected that the 2W repo rate would remain at 0.25%. The remaining four analysts still expected its drop by 20 bp to 0.05%. A sharper cut in monetary policy rates at the May CNB Bank Board meeting (even if compared to the CNB forecast) and the subsequent communications by Bank Board members were mentioned as an argument for leaving the 2W repo rate unchanged. By contrast, the proponents of a decline in the 2W repo rate point to a strengthening koruna, a confirmed deep decline of the domestic economy and rather weak macroeconomic data from the external environment. The analysts' view at the one-year horizon is also unchanged. Nine respondents expect the 2W repo rate to drop to 0.05% and eight expect it to remain stable. However, even these admit that the CNB would probably cut the 2W repo rate to technical zero in the event of a long-lasting recession or a resurgence of the pandemic.

Besides maintaining their view of the path of the key interest rates, the analysts also kept virtually unchanged the average forecast for the PRIBOR reference interest rates at both one-month and one-year horizons, at which the outlook fell by just 1 bp. By contrast, the outlook for swap rates shifted 7–20 bp higher in line with the growth in the corresponding market rates, which have increased by 19 bp (5Y IRS) and 22 (10Y IRS) since the previous survey. The positive slope of the expected swap curve thus increased further.

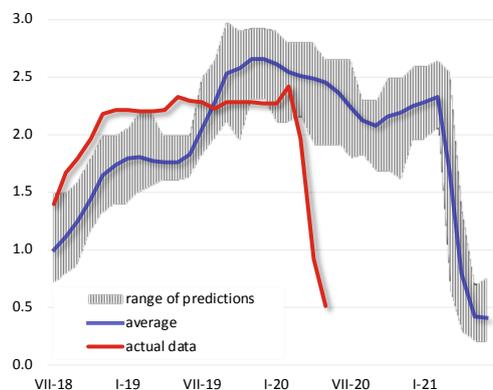
ANALYSTS' FORECAST – 2W REPO RATE LEVEL IN 1Y

(%)

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

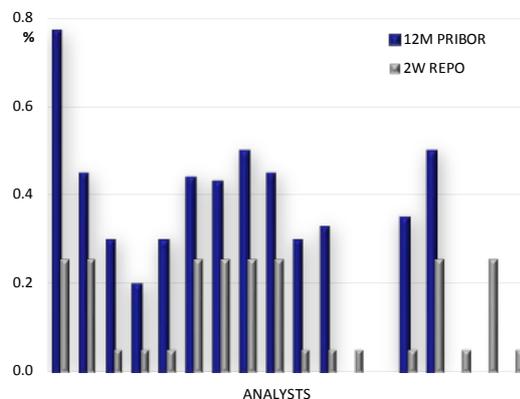
12M PRIBOR AT 1Y

ACTUAL DATA, AVERAGE AND RANGE OF PREDICTIONS



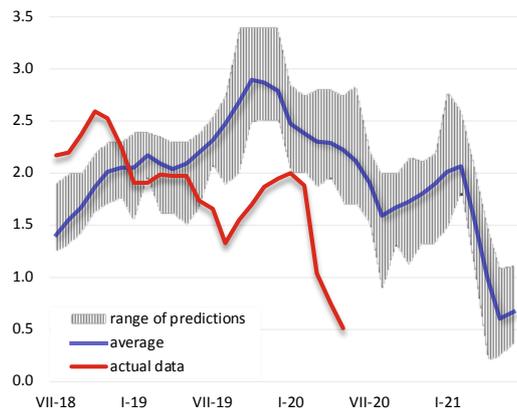
2W REPO AND 12M PRIBOR AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



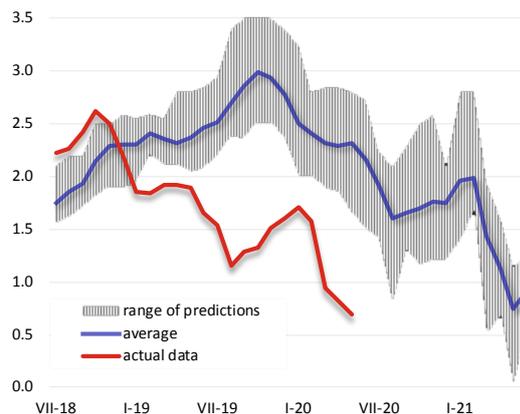
5Y IRS AT 1Y

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.I.19	25.65	25.49
V.II.19	25.59	25.33
V.IX.19	25.74	25.47
V.X.19	25.78	25.50
V.XII.19	25.57	25.36
II.20	25.05	24.93
V.20	27.28	26.20
V.I.20	26.67	26.01

EXCHANGE RATE FORECAST

June 2020	EUR/CZK	
	1M	1Y
minimum	26.50	25.00
average	26.67	26.01
maximum	27.00	26.75

ACTUAL EUR/CZK AS OF FORECAST DEADLINE

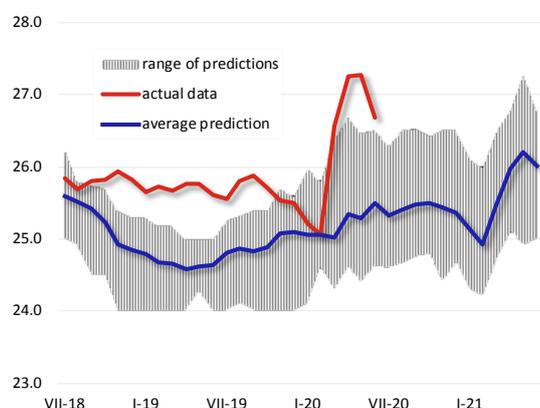
15.6.	26.68
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Improved sentiment on the global market and outflows of investors from very safe (particularly dollar) assets was also reflected in the exchange rate of the koruna, which has appreciated by 91 hellers to CZK 26.68 to the euro since the May survey. Such a change in the exchange rate could not but affect the analysts' one-month forecast, which also shifted to a stronger level – by 61 hellers to CZK 26.67 to the euro – corresponding more to the current exchange rate. A stronger level than in the May survey is also expected at the one-year horizon, although the size of this correction (20 hellers) is not as significant as in the one-month forecast. According to the analysts, the koruna will stand very close to the level of CZK 26 to the euro on average in mid-June 2021.

It will thus, in their opinion, very slowly appreciate. This will be due to an economic recovery which should come after the fall in production unwinds. This will feed through to higher inflation pressures with a lag and start to create room for raising interest rates in the medium term. According to some analysts, the prospect of higher interest rates and a widening of the interest rate differential will increase investors' interest in the koruna and lead to its appreciation against the euro. Another important factor is the assumption of a continued improvement in financial market sentiment, which could lead to a return of capital from safe havens, to which it fled from koruna assets after the outbreak of the pandemic. This scenario is, of course, also extremely dependent on the future evolution of the coronavirus pandemic. The koruna will depreciate if the situation worsens, whereas a rapid disappearance of the pandemic would open up the path to faster appreciation.

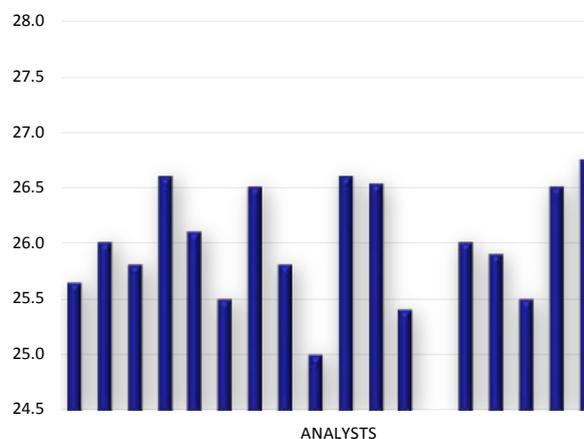
EUR/CZK

ACTUAL DATA, 1Y PREDICTIONS AND THEIR RANGE



EUR/CZK AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



VI. NOMINAL WAGES

FORECAST FOR NOMINAL WAGE GROWTH

(%)

June 2020	year end	
	current	current+1Y
minimum	1.24	1.50
average	3.20	2.83
maximum	4.40	5.30

FORECAST FOR NOMINAL WAGE GROWTH

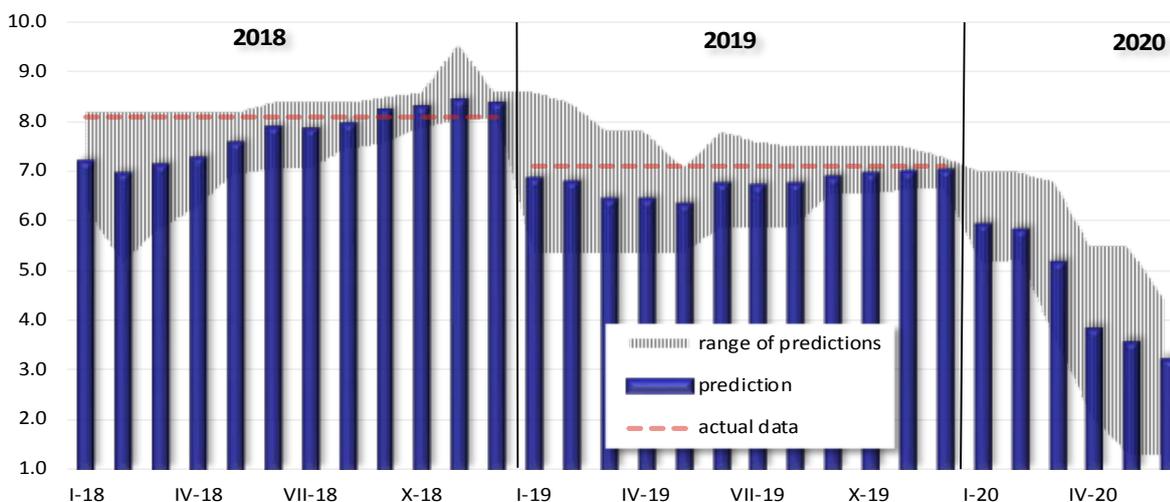
(%)

Date of Prediction	year end	
	current	current+1Y
VI.19	6.7	5.1
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
V.20	3.5	2.8
VI.20	3.2	2.8

The analysts further revise their outlook for future nominal wage developments in the course of time as new macroeconomic data and news come in from the real economy. According to the CZSO, the nominal wage rose by 5.0% year on year in 2020 Q1. Given the inflation rate of 3.6%, the real wage grew by 1.4% compared to 2019 Q1. Nominal wage growth is thus probably slowing. According to some analysts, the slowdown is even more pronounced than they expected. However, this is due largely to a downward revision of previous data. Wage growth would probably slow even if the pandemic had not occurred. Nevertheless, the recession induced by the spread of the new disease is strongly amplifying the slowdown. As wages show little downward flexibility, some respondents are of the opinion that they will reflect the recession with a substantial lag. Flexible components will thus be affected first. As pay rises had been agreed on long before the pandemic broke out, wage growth will be driven mainly by the public sector this year. In the private sector, wage growth will only occur in exceptional cases, particularly in sectors with labour shortages such as IT or construction. Overall, the analysts expect nominal wages to rise by 3.2% this year, which is 0.3 pp less than in the May survey. The outlook for next year remains unchanged at an expected growth rate of 2.8%.

NOMINAL WAGE GROWTH

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



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