Financial Market Inflation Expectations

7/2020

CNB CZECH NATIONAL BANK

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I. SUMMARY

All respondents participated in the July survey, i.e. fifteen domestic and three foreign analysts sent in their contributions. The results show that the average rate of expected inflation shifted upwards at the one-year and three-year horizons, while the estimated contraction of the economy is expected to be even bigger this year than the analysts expected in June. Most of the respondents do not expect the key interest rates to change at the next CNB Board meeting. The exchange rate forecast shifted towards a stronger koruna at the one-month and one-year horizons, and the scenario of a very gradual appreciation trend remains relevant. According to the analysts, growth in unemployment and firms' efforts to cut costs will lead to slower wage growth this year, but on the other hand, they believe that the economic recovery expected next year will foster slightly faster wage growth than suggested by the figures in the previous survey.

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 Janíčko, 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, 22 July 2020

II. INFLATION

FORECAST FOR Y/Y CPI GROWTH

(%)

July 2020	CPI 1Y	CPI 3Y
minimum	0.5	0.8
average	1.7	2.0
maximum	2.8	2.6

1Y AND 3Y FORECAST FOR CPI GROWTH

(%)

Date of Prediction	ANALYSTS 1Y	ANALYSTS 3Y	CNB (%) 1Y
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
VII.20	1.7	2.0	3Q:

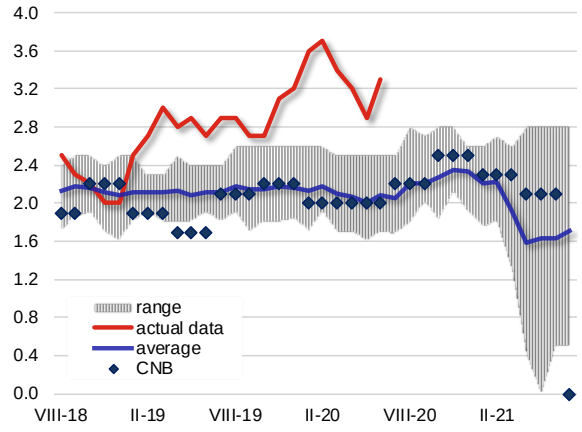
The June inflation rate came as a surprise, with the monthly consumer price index increasing from 0.4% in May to 0.6%, and from 2.9% to 3.3% in year-on-year terms. The upswing in inflation was due mainly to a rise in prices of tobacco products, beer and wine. Increasing prices of fuels and food also played a role. As regards tobacco, the analysts believe this may have involved a lagged pass-through of higher excise duty as sellers sold off their old stocks and gradually put newly stamped cigarettes on sale.

The analysts' one-year forecast also shifted upwards, albeit to a lesser extent. The annual consumer price index is expected to be at 1.7% in July 2021, 0.1 pp higher than in the previous survey. The three-year forecast rose by the same amount, returning to the CNB's 2% inflation target. The minimum and maximum values of the one-year forecasts were unchanged, so their range remained the same. The range of the three-year forecasts narrowed significantly due to an increase in the minimum value.

The analysts estimate that the still low unemployment rate is not yet discouraging consumers from spending. Solid household consumption, which is at the pre-crisis level, is significantly boosting core inflation. According to some of the respondents, core inflation remained at record-high levels, accounting for much of total consumer price inflation. However, weak demand in the production sector will slow inflation. This is expected to be reflected in a higher unemployment rate and subsequently in slower wage growth and ultimately in consumer prices. However, inflation pressures could gradually resurge during 2021 as the economy recovers.

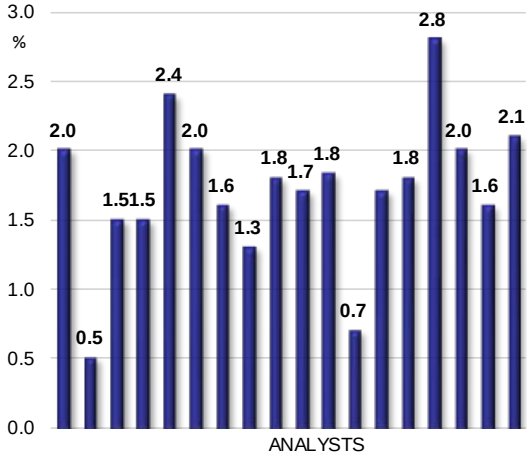
CONSUMER PRICE INDEX

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

(%)

July 2020	end of year	
	current	current + 1Y
minimum	-10.3	3.0
average	-8.0	5.6
maximum	-6.5	7.8

FORECAST FOR GDP GROWTH

(%)

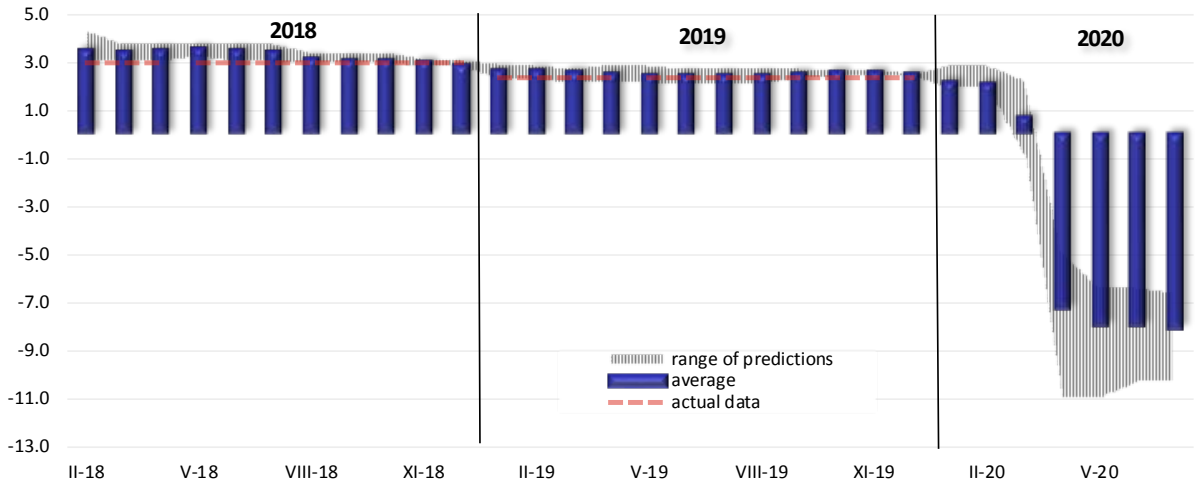
Date of Prediction	end of year	
	current	current+1Y
VII.19	2.5	2.4
IX.19	2.5	2.3
X.19	2.6	2.3
XII.19	2.5	2.1
II.20	2.1	2.3
V.20	-7.9	5.8
VI.20	-7.9	5.6
VII.20	-8.0	5.6

According to the CZSO's latest revision, the Czech economy recorded a quarter-on-quarter contraction of 3.4% in 2020 Q1, i.e. 0.1 pp more than in the previous estimate. The year-on-year decline remains unchanged at 2.0%. Although the analysts worsened their view of the size of the year-on-year contraction by 0.1 pp to 8.0% in 2020, the outlook for 2021 remains the same as in the June survey (growth of 5.6%). The range of the estimates for this year and the next narrowed due to a fall in the maximum (most optimistic) values.

The analysts expect the 2020 Q2 data to show an even greater fall in economic activity than in Q1, fully reflecting the negative impacts of the anti-coronavirus measures. Domestic and external demand is expected to rise gradually, and GDP to record a quarter-on-quarter increase, in Q3. An improvement is also signalled by leading indicators. However, this cannot fully offset the downturn in Q1, and the economy will record a deep decline throughout the year. The recovery that started in 2020 H2 might continue into 2021 and the economy might gradually return to its pre-crisis level, but according to some of the analysts it will not do so until 2022. Further potential waves of the pandemic, which would undoubtedly again have significant negative macroeconomic impacts despite the experience gained, remain a risk to this scenario.

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

(%)

July 2020	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
minimum	0.05	0.05	0.35	0.30	0.38	0.36	0.41	0.56
average	0.24	0.18	0.43	0.45	0.56	0.71	0.76	0.94
maximum	0.25	0.25	0.50	0.83	0.65	1.12	1.00	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
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
VII.20	0.24	0.18	0.43	0.45	0.56	0.71	0.76	0.94

ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE

(%)

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
15.7.	0.25	0.43	0.61	0.84

With the exception of one analyst, all the respondents estimate that the key (2W repo) interest rate will stay at the current level (0.25%) at the CNB Board meeting on 6 August. Moreover, two-thirds of the respondents expect the 2W repo rate to still be at 0.25% in June 2021. Only six respondents, three less than in the previous survey, expect the 2W repo rate to decrease to 0.05% at the one-year horizon. The analysts give the following arguments for an unchanged rate at the one-year horizon: the latest interest rate cut, which went beyond the CNB forecast, a further expected improvement in the economic situation, and also the high inflation rate, which is currently above the upper boundary of the tolerance band around the CNB's inflation target. Of course, the analysts are closely monitoring the CNB's communications, which clearly indicate that some of the board members, including Governor Rusnok, are pointing to the potential negative impacts of a possible reduction of key interest rates on financial sector stability. However, the risks are on both sides. Another wave of the contagion and a deterioration in the economic situation would necessitate monetary policy easing, and cutting key interest rates is not the only option. The analysts do not rule out the deployment of unconventional monetary instruments. By contrast, a faster-than-expected economic recovery could lead to an earlier interest rate hike. The first key interest rate increases are currently estimated for 2021 H2.

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

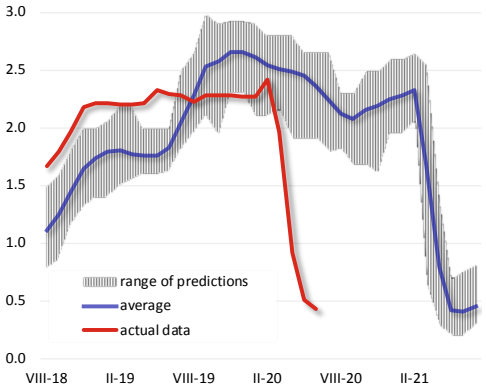
(%)

2W repo rate level in 1Y (%)	0.05	0.25	0.5	0.75	1	1.25
number of analysts - current survey	6	12	0	0	0	0
-previous survey	9	8	0	0	0	0

The almost unchanged view of future key interest rates, combined with minimal changes in PRIBOR reference interbank rates and swap rates on the market, did not generate any need to significantly revise the forecasts. Their movements were thus limited to growth of 4 bp.

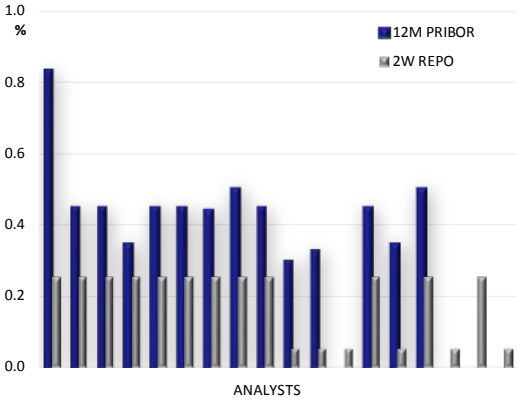
12M PRIBOR AT 1Y

ACTUAL DATA, AVERAGE AND RANGE OF PREDICTIONS



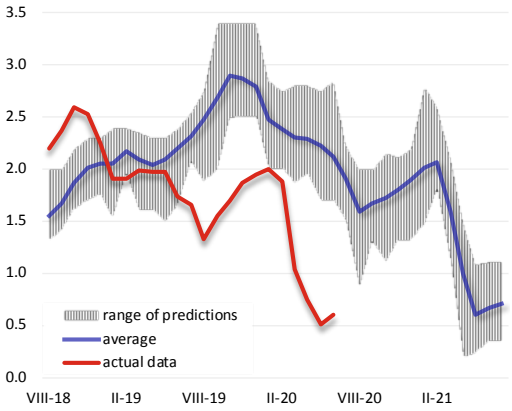
2W REPO AND 12M PRIBOR AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



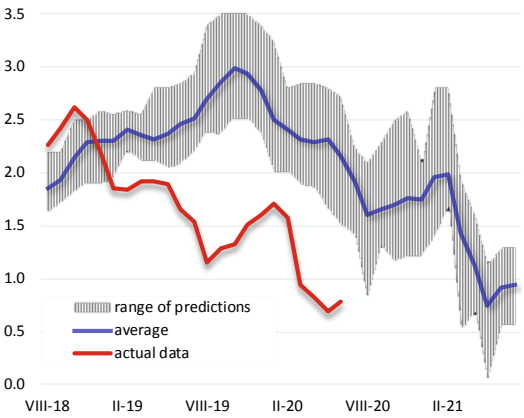
5Y IRS AT 1Y

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
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
V.20	27.28	26.20
VI.20	26.67	26.01
VII.20	26.64	25.93

EXCHANGE RATE FORECAST

July 2020	EUR/CZK	
	1M	1Y
minimum	26.50	25.00
average	26.64	25.93
maximum	27.00	26.55

ACTUAL EUR/CZK AS OF FORECAST DEADLINE

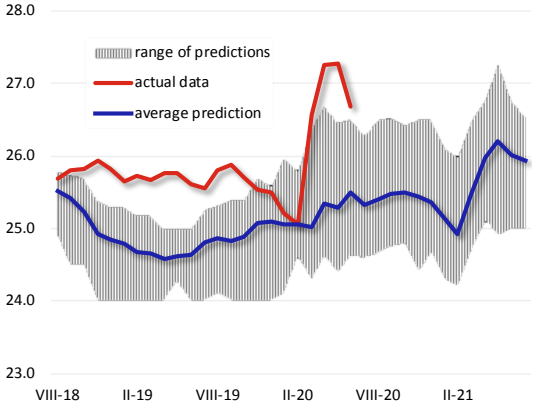
15.7.	26.59

After appreciating to CZK 26.60 to the euro in May, when the domestic currency benefited from improved sentiment on the global market, the koruna has been fluctuating around this level since then. The rate appreciated by 9 hellers between the June survey and the cut-off date of the July survey. The analysts revised their forecasts slightly upwards. In their view, the koruna could be close to CZK 26.64 to the euro in mid-August and appreciate to CZK 25.93 to the euro over the following 11 months, i.e. until mid-July 2021.

The analysts do not expect any major movements in the exchange rate of the koruna in the near future, unless the macroeconomic data, both for the Czech Republic and other countries, bring a surprise. Political events (such as the approval of the EU's fiscal package to support the economy) naturally have the potential to affect sentiment on the global market and the exchange rate of the koruna to some extent, but in the baseline scenario the analysts are sticking to the outlook for a very slowly appreciating exchange rate, based on an improving global situation and the prospect of a gradual increase in the CNB's interest rates. The analysts do not expect interest rates – and the interest rate differential vis-à-vis the euro area – to grow too quickly, so the return of the koruna to its pre-crisis levels will take some time.

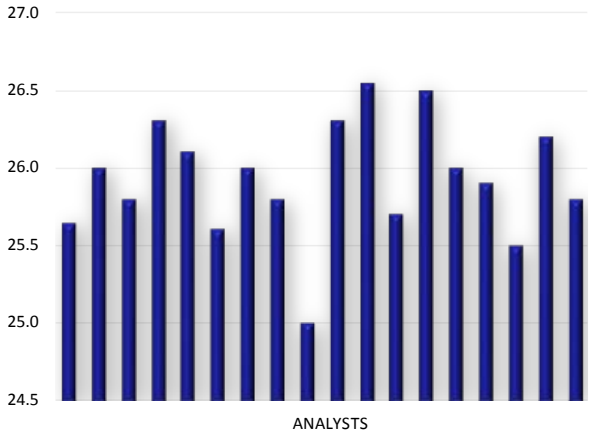
EUR/CZK

ACTUAL DATA, 1Y PREDICTIONS AND THEIR RANGE



EUR/CZK AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



VI. NOMINAL WAGES

FORECAST FOR NOMINAL WAGE GROWTH

(%)

July 2020	year end	
	current	current+1Y
minimum	1.76	1.50
average	3.13	2.94
maximum	4.70	5.50

FORECAST FOR NOMINAL WAGE GROWTH

(%)

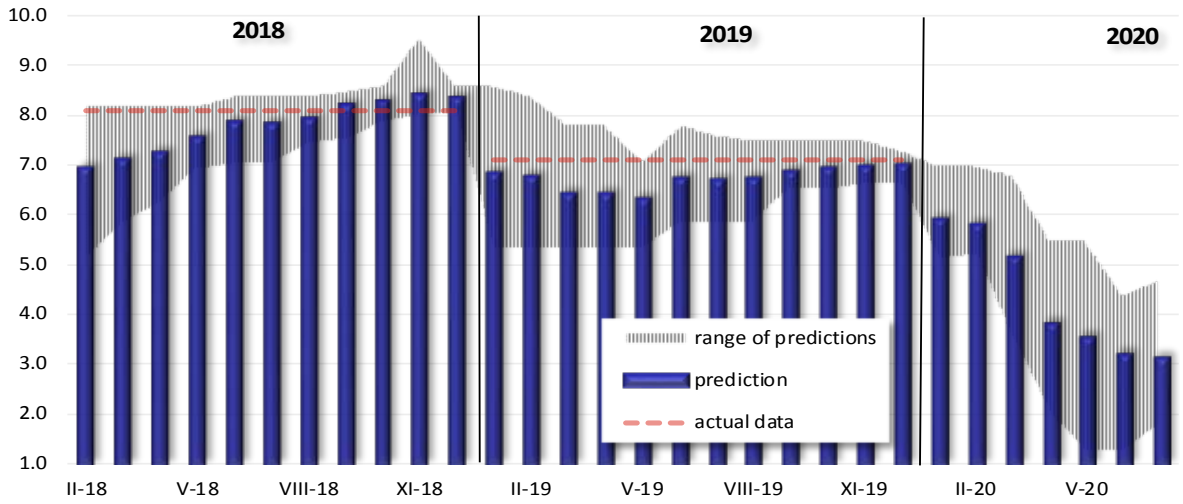
Date of Prediction	year end	
	current	current+1Y
VII.19	6.7	5.2
IX.19	6.9	5.4
X.19	6.9	5.5
XII.19	7.0	5.7
II.20	5.8	4.9
V.20	3.5	2.8
VI.20	3.2	2.8
VII.20	3.1	2.9

Weak demand for goods and services is starting to be reflected in falling employment and rising unemployment – the share of the unemployed rose by 0.1 pp to 3.7% in June according to the MLSA. However, the analysts had feared a much faster rise in unemployment, which is probably being prevented by lower labour market flexibility and also by government support measures. The respondents believe unemployment will continue to grow at least for the rest of this year, with the services sector accounting for the largest share of job losses. In addition to reducing their workforces, firms will try to cope with the difficult situation by cutting wage expenditure. This led the analysts to further adjust their forecast for nominal wage growth this year. The July figure is 0.1 pp lower than the 3.2% reported in the previous survey. Without the contribution of public sector pay growth, the estimated rate of wage growth would probably have been even lower.

The economic recovery expected to occur next year might improve the labour market conditions, lower the unemployment rate and create space for a slightly better forecast for nominal wage growth than expected by the analysts in the June and May surveys. Expected wage growth in 2021 has therefore gone up by 0.1 pp to 2.9%.

NOMINAL WAGE GROWTH

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



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