Financial Market Inflation Expectations

8/2020

Czech National Bank —— Financial Market Inflation Expectations —— 8/2020

CNB CZECH NATIONAL BANK

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I. SUMMARY

Fourteen domestic and two foreign analysts sent in their contributions to the CNB's traditional survey. Although some pandemic-affected macroeconomic data had been published, the analysts continued to draw attention to the high level of risk and uncertainty associated with their forecasts due to the scale of the restrictive measures and the lack of experience with such a situation.

Compared with the previous survey, expected annual inflation increased slightly, while the depth of the estimated economic decline in 2020 was adjusted and the intensity of the recovery in 2021 was reduced. Most of the analysts believe that key interest rates will remain at the current level for at least the next 12 months and the koruna will appreciate somewhat further below CZK 26 to the euro. The less pessimistic outlooks for the depth of the economic decline this year and surprisingly slow growth in unemployment allowed the analysts to increase their forecast for nominal wage growth for both this year and the next.

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, Trinity Bank	+	+	+	+	+	+	+	+				
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, 27 August 2020

II. INFLATION

FORECAST FOR Y/Y CPI GROWTH

(%)

August 2020	CPI 1Y	CPI 3Y
minimum	0.6	1.3
average	1.8	2.0
maximum	2.6	2.5

1Y AND 3Y FORECAST FOR CPI GROWTH

(%)

Date of Prediction	ANALYSTS 1Y	ANALYSTS 3Y	CNB (%) 1Y
VIII.19	2.2	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	
VII.20	1.7	2.0	3Q: 2.2
VIII.20	1.8	2.0	

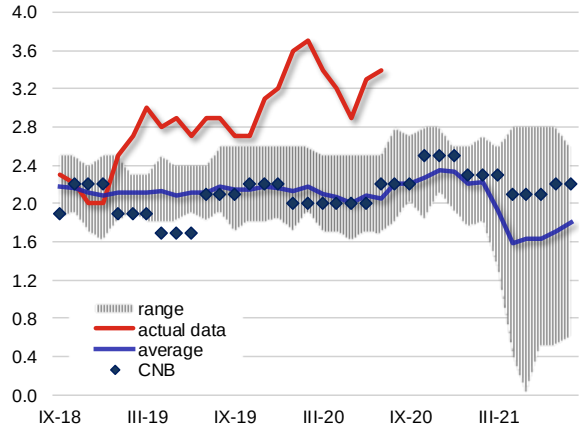
Inflation surprised again in July, exceeding market estimates. According to the CZSO, the annual consumer price index increased by 0.1 pp to 3.4%. This was largely due to prices of alcoholic beverages and tobacco. The price level increased by 0.4% month on month, mostly on the back of holiday prices. The analysts' average annual forecast in our survey also shifted up by 0.1 pp to 1.8%. By contrast, the three-year forecast was unchanged and remains anchored at the CNB's 2% inflation target. The range of the forecasts narrowed. At the one-year horizon this was due primarily to a decline in the maximum value, while the three-year forecasts were more affected by a rise in the minimum value.

Some of the respondents believe that annual inflation currently does not really reflect the impacts of the current crisis and is still being strongly affected by the labour market situation and strong domestic demand prevailing before the crisis. This is suggested by record-high core inflation, which is at its highest level since 2007. According to the analysts, this is due not only to the economic recovery, but also to government programmes to protect employment.

Consumer price inflation is expected to fall gradually in the months ahead. After the summer holidays end, and due to the current crisis, unemployment is highly likely to increase. This will be reflected in weaker consumer demand and subsequently also lower inflation. However, a rapid economic recovery might act in the opposite direction.

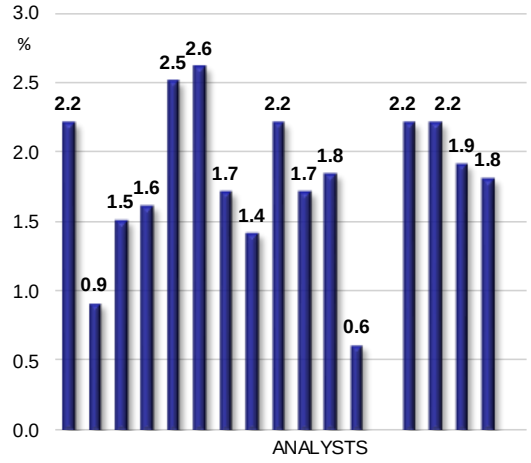
CONSUMER PRICE INDEX

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

(%)

August 2020	end of year	
	current	current + 1Y
minimum	-10.3	3.0
average	-7.2	5.0
maximum	-4.9	7.8

FORECAST FOR GDP GROWTH

(%)

Date of Prediction	end of year	
	current	current+1Y
VIII.19	2.5	2.3
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
VII.20	-8.0	5.6
VIII.20	-7.2	5.0

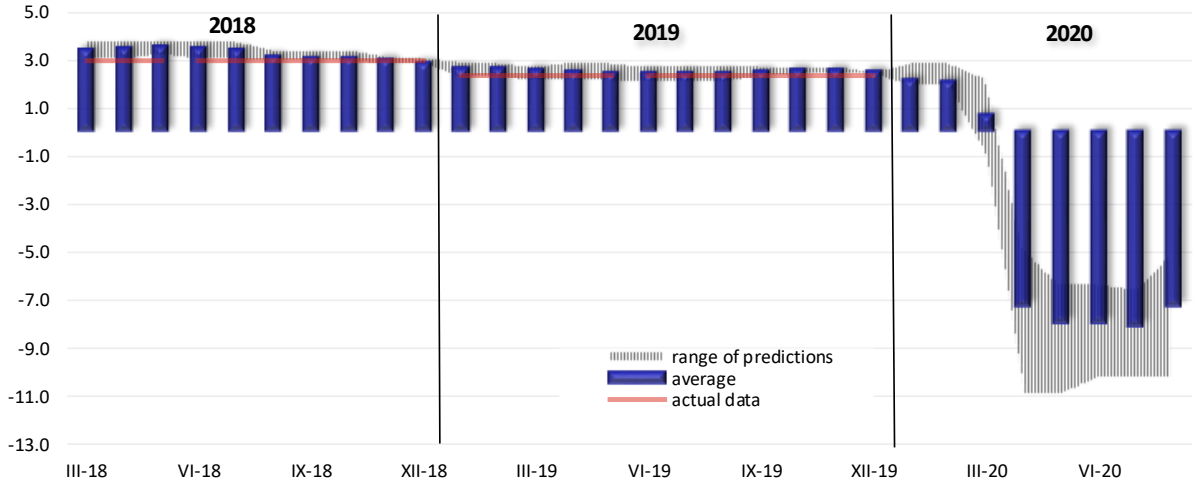
The CZSO's preliminary estimate confirmed that the pandemic and the related measures had had a severe impact on the Czech economy. While 2020 Q1 had still included the favourable economic situation seen before the introduction of across-the-board restrictions, in Q2 the restrictive measures manifested themselves to a much greater extent. The negative impacts of the April freezing of economic activity outweighed the nascent recovery in May, and GDP recorded a quarter-on-quarter fall of 10.7%. This implies a year-on-year contraction of 8.4%, the worst figure ever. The analysts overall seem to have been expecting an even deeper decline, as they adjusted their June forecast for this year from -8.0% to -7.2%. On the other hand, the outlook for next year is less optimistic, with the analysts now expecting GDP to grow by a mere 5.0% instead of 5.6%. The range of the estimates for this year increased due to a rise in the maximum value, while the minimum and maximum values of the forecasts for next year are unchanged.

All components except government consumption contributed to the decline in GDP in 2020 Q2. The government was forced to significantly increase its expenditure to mitigate the negative impacts of the anti-pandemic measures. According to the analysts, the foreign trade figures undoubtedly reflected the restrictions associated with the closure of borders, household consumption was negatively affected by the lockdown and business shutdowns, and investment, which is very sensitive to the economic cycle and sentiment, reflects the sizeable economic downturn and the related uncertainty and unclear prospects.

There is a view among the analysts that, in light of the leading indicators and data from industry and retail, a slight economic recovery should occur in 2020 Q3. Nevertheless, a more pronounced rise in economic activity is not likely until next year, when external demand – especially for car production – might strengthen. However, everything is surrounded by a high degree of uncertainty associated with the potential resurgence of the coronavirus, which could have a disastrous impact on the economy if firms were to be shut down again en masse.

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

(%)

August 2020	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
minimum	0.25	0.25	0.40	0.40	0.38	0.36	0.41	0.56
average	0.25	0.27	0.43	0.50	0.69	0.85	0.88	1.07
maximum	0.25	0.50	0.50	0.87	0.85	1.22	1.05	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
VIII.19	2.00	1.94	2.23	2.12	1.36	1.59	1.20	1.61
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
VII.20	0.24	0.18	0.43	0.45	0.56	0.71	0.76	0.94
VIII.20	0.25	0.27	0.43	0.50	0.69	0.85	0.88	1.07

ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE

(%)

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
15.8.	0.25	0.43	0.76	0.91

All the respondents believe that the key interest rate (the 2W repo rate) will remain unchanged at the current level (0.25%) after the regular CNB Board meeting on 23 September. Most of the analysts also expect key interest rates to be unchanged at the one-year horizon, with only one respondent estimating that there might be room for an increase in the 2W repo rate of 25 bp to 0.50% next summer. Unlike in the previous survey, when one-third of the respondents had been expecting rates to be reduced in July, no analyst expects a rate cut now.

Despite the accelerating annual inflation, which is above the upper boundary of the tolerance band, the analysts mostly believe – in line with the CNB's communications – that, given the substantial uncertainty about future economic growth, the CNB Bank Board considers the current monetary policy settings to be consistent with the current economic situation and will leave its key rates unchanged for at least a year. However, the risks are significant and could act in either direction. A resurgence of the contagion would bring about easier monetary policy, including the potential use of unconventional instruments, whereas a faster-than-expected recovery could cause interest rates to be raised earlier.

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

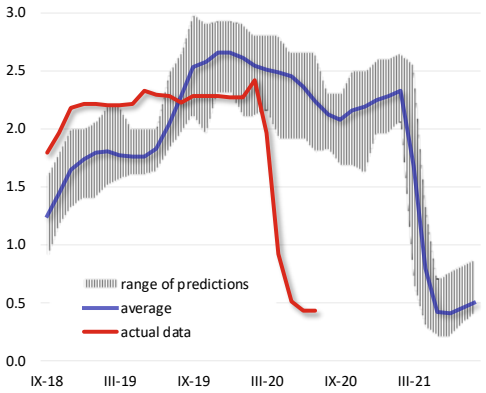
(%)

2W repo rate level in 1Y (%)	0.05	0.25	0.5	0.75	1	1.25
number of analysts - current survey	0	15	1	0	0	0
-previous survey	6	12	0	0	0	0

The fact that the analysts no longer expect key interest rates to decline further and even feel they may rise at the one-year horizon, might have fostered a negligible increase in the average one-year forecast for the 12M PRIBOR. However, the one-month forecast remains unchanged. A slight upward shift (of 12–14 points) in the outlook for swap rates probably also reflects the above argument of a change in expectations about the future level of key interest rates, a slight increase in corresponding market rates and a better economic situation abroad, to which domestic swap rates also tend to react.

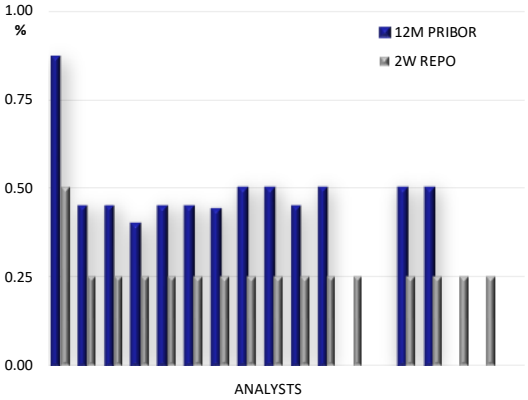
12M PRIBOR AT 1Y

ACTUAL DATA, AVERAGE AND RANGE OF PREDICTIONS



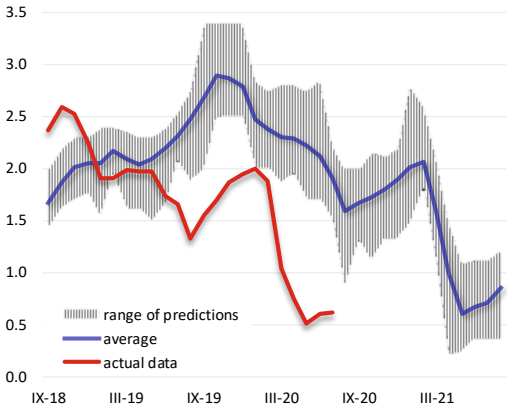
2W REPO AND 12M PRIBOR AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



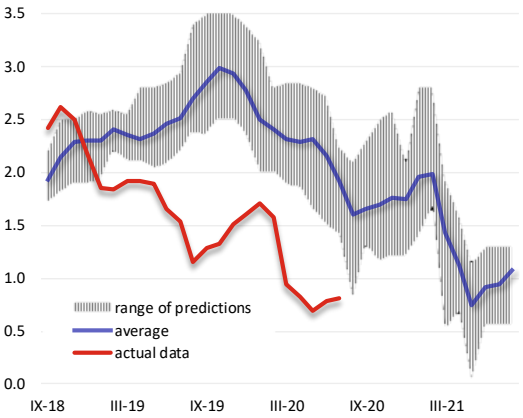
5Y IRS AT 1Y

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
VIII.19	25.68	25.41
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
VII.20	26.64	25.93
VIII.20	26.17	25.76

EXCHANGE RATE FORECAST

August 2020	EUR/CZK	
	1M	1Y
minimum	26.00	25.50
average	26.17	25.76
maximum	26.50	26.00

ACTUAL EUR/CZK AS OF FORECAST DEADLINE

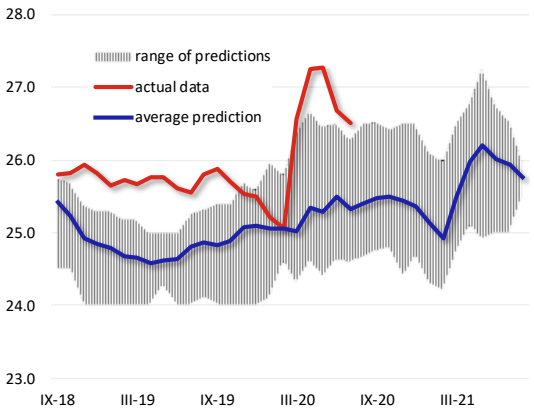
15.8.	26.12

The koruna's exchange rate against the euro on the forex market has appreciated by almost 50 hellers since mid-July. The analysts' one-month forecast has likewise moved to stronger levels; on average, they do not expect the trend to continue and conversely expect a slight correction to CZK 26.17 to the euro. Over the one-year horizon, however, the koruna is expected to continue to appreciate very slowly, reaching CZK 25.76 to the euro in August 2021.

According to the analysts, the recent appreciation of the koruna stems from better macroeconomic data from the real economy (most notably higher inflation), related expectations of a slight rise in interest rates, and financial markets' generally positive sentiment about emerging market currencies. In the baseline scenario, the analysts do not expect these conditions to change and therefore expect the koruna to appreciate gradually in the quarters ahead. In addition to the CNB's less dovish rhetoric and a further improvement in the macroeconomic data, this might be due to a weakening the dollar as investors start to leave the safe havens they moved their funds into at the beginning of the pandemic.

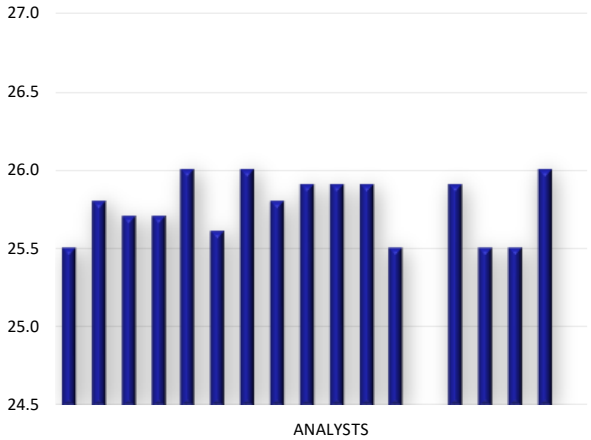
EUR/CZK

ACTUAL DATA, 1Y PREDICTIONS AND THEIR RANGE



EUR/CZK AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



VI. NOMINAL WAGES

FORECAST FOR NOMINAL WAGE GROWTH

(%)

August 2020	year end	
	current	current+1Y
minimum	1.76	1.50
average	3.46	3.15
maximum	4.70	5.30

FORECAST FOR NOMINAL WAGE GROWTH

(%)

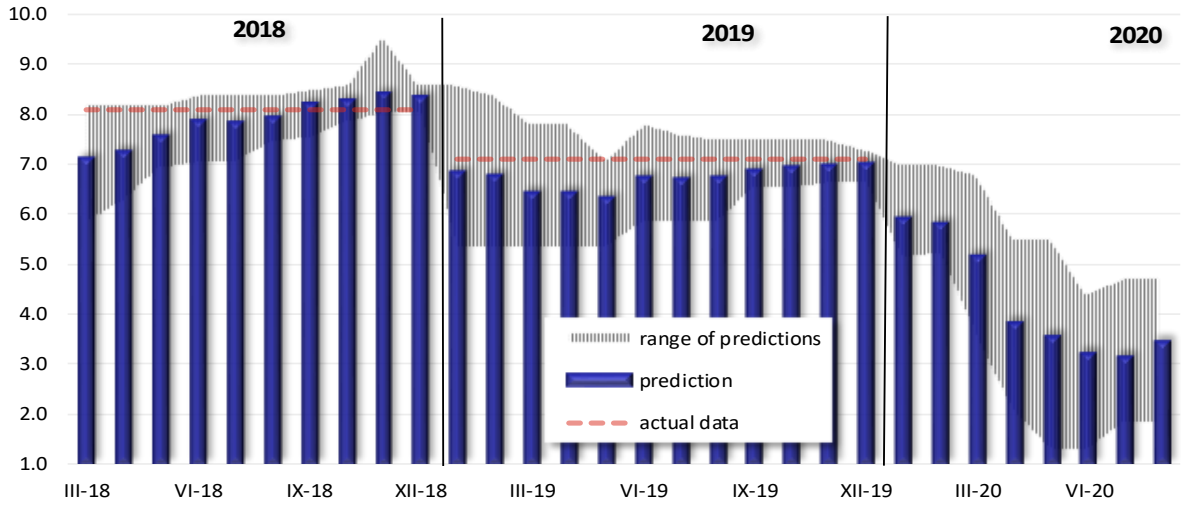
Date of Prediction	year end	
	current	current+1Y
VIII.19	6.7	5.2
IX.19	6.9	5.4
X.19	6.9	5.5
XII.19	7.0	5.7
II.20	5.8	4.9
V.20	3.5	2.8
VII.20	3.1	2.9
VIII.20	3.5	3.2

According to the MLSA, the share of unemployed persons is increasing, reaching 3.8% in July. This is a significantly lower pace of increase than was expected after the pandemic broke out and restrictive measures were introduced. The analysts believe that faster growth in unemployment was prevented by the extremely tight conditions prevailing on the labour market before the pandemic started. Another reason is firms' efforts to retain their employees so that they do not have to find new staff if the crisis eases soon. Government economic policy is also a crucial factor significantly limiting the layoff rate. Although unemployment is expected to rise further, the analysts' outlook for future unemployment and nominal wage growth is a little more optimistic due to the lower-than-estimated fall in GDP.

Although firms' situation is not good in many cases and the analysts expect many of them to cut costs, including wage and personnel costs, they increased their wage growth forecast for 2020 by 0.4 pp to 3.5%. The forecast for next year also recorded an upward shift. A rate of 3.2% is now expected, as compared to 2.9% in the July survey.

NOMINAL WAGE GROWTH

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



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