Financial Market
Inflation Expectations

—— 9/2020

CNB CZECH
NATIONAL
BANK

Contents

I. SUMMARY

Fourteen domestic and three foreign analysts took part in the CNB's September survey. The results reveal that the one-year inflation forecast shifted slightly upwards, while the three-year forecast remains anchored at the CNB's 2% target. The estimated downturn in the Czech economy might be less pronounced this year than expected in August. But this also implies a lower expected recovery rate next year. According to most of the respondents, an increase in the CNB's key interest rates is not expected in the current economic conditions at the one-year horizon. The exchange rate forecast is in response to the koruna's depreciation on the forex market, which is related to a deterioration in the course of the pandemic in the Czech Republic. Nevertheless, this depreciation is viewed as somewhat temporary and is expected to be replaced by a return to a gradual long-term appreciation trend over the next 12 months. The analysts' optimism regarding future wage developments decreased, as did the forecast for nominal wage growth this year and 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, 24 September 2020

II. INFLATION

FORECAST FOR Y/Y CPI GROWTH

(%)

September 2020	CPI	
	1Y	3Y
minimum	0.8	1.6
average	1.9	2.0
maximum	2.9	2.5

1Y AND 3Y FORECAST FOR CPI GROWTH

(%)

Date of Prediction	ANALYSTS		CNB (%)
	1Y	3Y	1Y
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	1Q: 2.3
5.20	1.6	1.9	
7.20	1.7	2.0	3Q: 2.2
8.20	1.8	2.0	
9.20	1.9	2.0	

According to the CZSO, inflation in the Czech Republic recorded an annual decline of 0.1 pp to 3.3% in August, while the consumer price index remained flat month on month. Lower prices of food and non-alcoholic beverages were largely offset by an increase in prices in the transport sector, most notably an increase in car and fuel prices. The analysts' forecasts changed only negligibly overall at the one-year horizon. While consumer prices were expected to rise by 1.8% in August, they are now expected to increase by a further 0.1 percentage point. The range of the individual forecasts widened owing to a larger increase in the maximum value. The average forecast remains unchanged at the three-year horizon, remaining at the 2% inflation target set by the CNB. Conversely, the range of the individual estimates narrowed owing to an increase in the minimum value.

Generally, the unprecedented drop in economic activity is expected to start to translate to a slowdown in price growth in the months ahead. The growth rate is expected to decline gradually below 3%. This will probably be also fostered by lower commodity prices, especially oil prices. However, inflation will slow only gradually as the decline to lower levels will be dampened by a weaker koruna-euro exchange rate. According to the analysts, it is unlikely to approach the 2% target until 2021.

Some respondents believe that there is a prevailing risk of undershooting the inflation target due to weaker domestic demand. In a pessimistic scenario, this effect might be exacerbated by an introduction of additional quarantine or other restrictive measures if the coronavirus pandemic continues to spread dramatically.
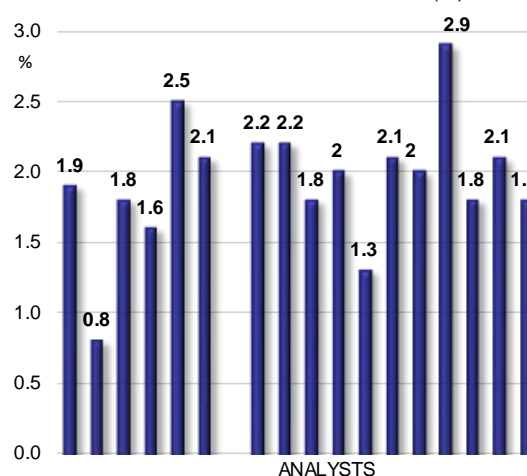
CONSUMER PRICE INDEX

ACTUAL DATA AND 1Y PREDICTIONS OF ANALYSTS (AVERAGE) AND OF CNB (%)
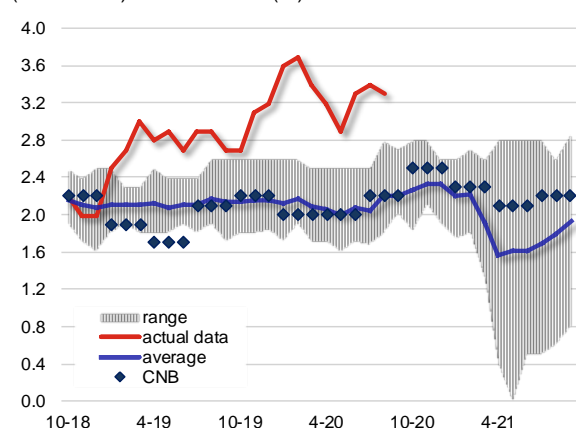
CONSUMER PRICE INDEX AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS (%)

III. GROSS DOMESTIC PRODUCT

FORECAST FOR GDP GROWTH
(%)

September 2020	end of year	
	current	current + 1Y
minimum	-8.0	2.0
average	-6.5	4.5
maximum	-4.9	6.8

FORECAST FOR GDP GROWTH
(%)

| Date of Prediction	end of year	
	current	current+1Y
9.19	2.5	2.3
10.19	2.6	2.3
12.19	2.5	2.1
2.20	2.1	2.3
5.20	-7.9	5.8
7.20	-8.0	5.6
8.20	-7.2	5.0
9.20	-6.5	4.5

According to the CZSO's revised estimate, the drop in GDP was more pronounced in 2020 Q2 than estimated initially. The economy fell by 8.7% quarter on quarter and by 11.0% year on year. On the demand side, the annual figure was due mainly to much weaker foreign demand but also lower household consumption and a decline in investment activity. General government expenditure alone made a positive contribution to GDP growth. Gross value added was most affected in year on year terms by a drop in manufacturing and negative developments in wholesale and retail trade, transport, hotels and restaurants.

Despite the above revision, the analysts' average forecast for this year shifted upwards, with the recovery next year expected to be less dynamic than indicated in the August survey. The range of individual estimates for this year narrowed considerably owing to an increase in the minimum value, while the minimum and maximum values in the outlooks for next year recorded the same decline and their range thus remains the same.

The Czech economy is expected to recover following a deep decline as a result of the pandemic, which came as no surprise in light of the measures taken. According to the analysts, this has been apparent since May, not only in the data for retail trade and industrial production, but also in the leading indicators. Nevertheless, the analysts are aware that there are still difficult times ahead, with the beginning of autumn and the growing numbers of new cases of coronavirus infections. The next wave may result in further lockdowns of the economy, albeit only local ones, which would have serious, negative economic impacts. Although governments are rejecting this scenario, the analysts believe it cannot be fully ruled out. Moreover, concerns alone about renewed lockdowns of the economy may dampen economic recovery as people will be reluctant to use many services, and enterprises facing uncertainty will cut costs and curb investment as much as possible. By contrast, both groups will have a tendency to create cash reserves. There is thus a great risk that the economy will stagnate as the number of infected increases. Finding a solution to the current pandemic will thus be essential for the economic outlook.

GDP GROWTH AT END OF CURRENT YEAR
AVERAGE AND RANGE OF PREDICTIONS
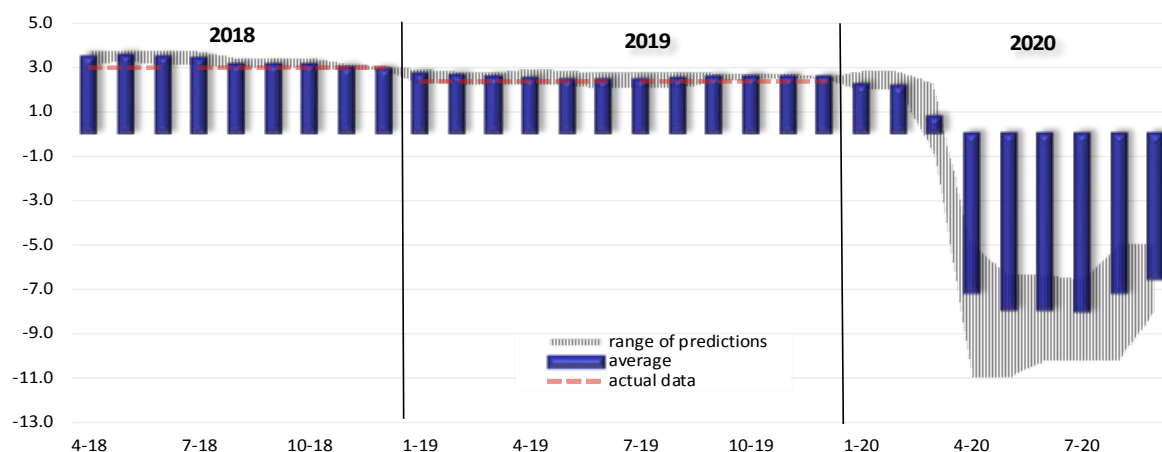
IV. INTEREST RATES – 2W REPO, PRIBOR, IRS

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

(%)

September 2020	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
minimum	0.25	0.05	0.33	0.35	0.60	0.73	0.80	0.95
average	0.25	0.25	0.42	0.51	0.74	0.94	0.96	1.18
maximum	0.25	0.50	0.45	0.93	0.91	1.33	1.12	1.50

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
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
5.20	0.19	0.16	0.41	0.42	0.44	0.60	0.56	0.74
7.20	0.24	0.18	0.43	0.45	0.56	0.71	0.76	0.94
8.20	0.25	0.27	0.43	0.50	0.69	0.85	0.88	1.07
9.20	0.25	0.25	0.42	0.51	0.74	0.94	0.96	1.18

ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE

(%)

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
15.9.	0.27	0.44	0.77	1.00

All respondents assumed that the key interest rate (the 2W repo rate) would remain unchanged at the current level (0.25%) after the regular CNB Board meeting in September (23 September). Most of the analysts continue to expect key interest rate stability at the one-year horizon. Only one of the respondents expects a decline in the 2W repo rate of 20 bp to 0.05%. On the other hand, another respondent, also alone in his view, estimates that there might be room for an increase in the CNB's 2W repo rate of 25 bp to 0.50% next summer.

The analysts continue to believe that the CNB, in line with its previous communications, considers the monetary policy settings in the Czech Republic to be appropriate and will maintain a wait and see approach. Above all, the course of the pandemic will play a dominant role. In the negative scenario, the next wave of infections (resulting in a deterioration of the economic situation) might force the CNB to lower the 2W repo rate to 0.05%. In this case, the use of unconventional monetary policy instruments, which are currently not under consideration, might come back into play.

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	1	15	1	0	0	0
-previous survey	0	15	1	0	0	0

A slight increase in the PRIBOR reference interbank rates and IRS swap rates on the market was also reflected in the analysts' forecasts. They followed the trend observed in previous surveys and shifted upwards by 2–11 bp, except the one-month forecast for the 12M PRIBOR, whose average value dropped by 1 bp.
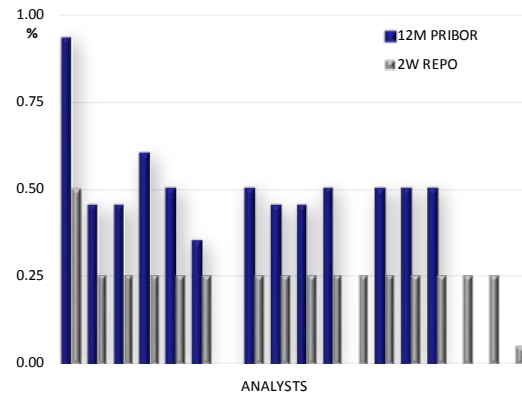
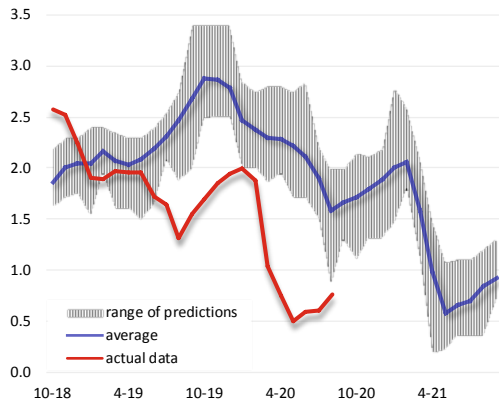## 12M PRIBOR AT 1Y
ACTUAL DATA, AVERAGE AND RANGE OF PREDICTIONS
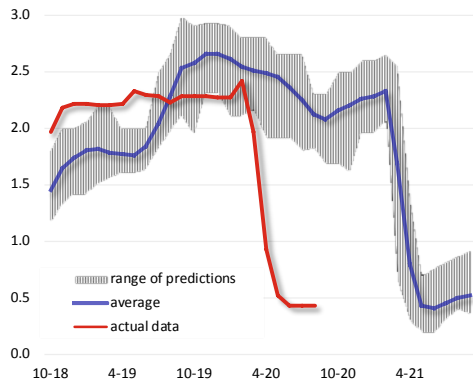
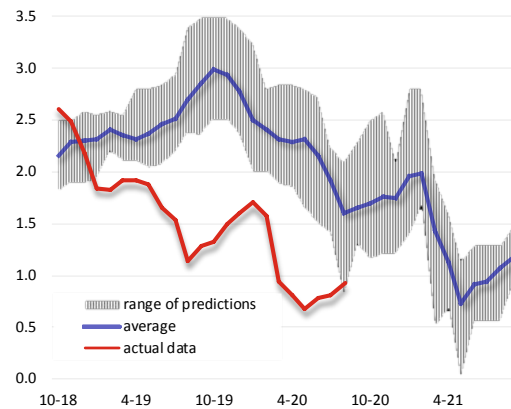## 2W REPO AND 12M PRIBOR AT 1Y
PREDICTIONS OF INDIVIDUAL ANALYSTS

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
9.19	25.74	25.47
10.19	25.78	25.50
12.19	25.57	25.36
2.20	25.05	24.93
5.20	27.28	26.20
7.20	26.64	25.93
8.20	26.17	25.76
9.20	26.48	25.77

EXCHANGE RATE FORECAST

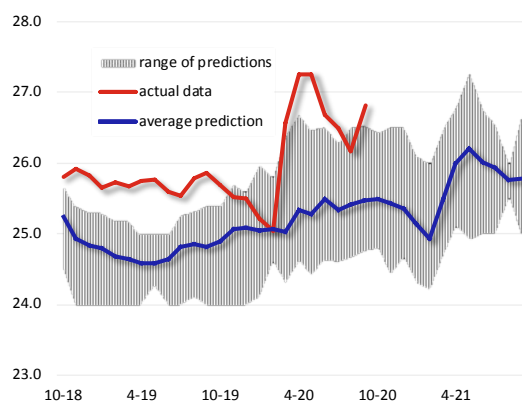| September	EUR/CZK	
2020	1M	1Y
minimum	26.20	24.90
average	26.48	25.77
maximum	27.00	26.75

ACTUAL EUR/CZK AS OF FORECAST DEADLINE

15.5.	27.59

The koruna-euro exchange rate has depreciated noticeably since the August survey, shifting from CZK 26.12 to the euro to CZK 26.83 to the euro. However, on average the analysts assume that this is a temporary fluctuation, which will be corrected to CZK 26.48 to the euro within a month. This view remains virtually unchanged at the one-year horizon, with the koruna exchange rate expected to move to the same level as was expected a month ago, i.e. CZK 25.77 to the euro.

The analysts are still convinced that a long-term trend appreciation will be fostered by the convergence story, which might also be supported by some recently published macroeconomic data. Although the rapid introduction of measures against the spread of the epidemic led to a dramatic drop in economic activity, the subsequent easing of restrictions restarted the Czech economy fairly quickly. The downturn in the Czech economy was thus not as pronounced as in some other European countries. This notwithstanding, the koruna may deviate from the long-term convergence scenario due to unexpected events. These undoubtedly include the level of risk aversion on the global financial market, to which the koruna's exchange rate is very sensitive, and also the risk assessment of the Czech Republic as such. In September, nervousness on the markets was sparked again and, most significantly, the Czech Republic lost its standing as a model country that had coped very well with the spread of COVID-19. According to the analysts, the rapid rise in the spread of infection in the Czech Republic has led to reduced interest on the part of investors in the koruna, which in turn may keep the exchange rate at weaker levels. Nevertheless, once the unfavourable pandemic situation subsides, the analysts expect a return to an appreciation trend.
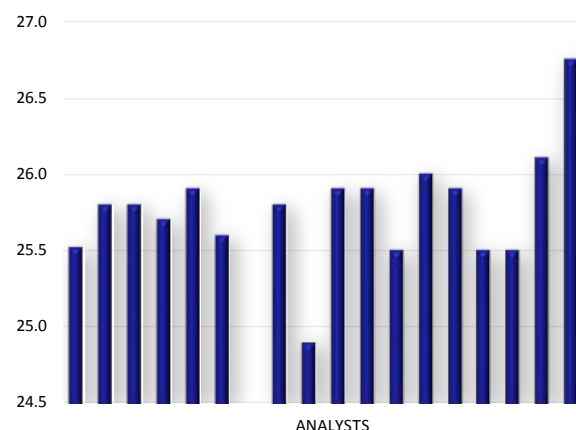
EUR/CZK
ACTUAL DATA, 1Y PREDICTIONS AND THEIR RANGE

EUR/CZK AT 1Y
PREDICTIONS OF INDIVIDUAL ANALYSTS

VI. NOMINAL WAGES

FORECAST FOR NOMINAL WAGE GROWTH
(%)

September 2020	year end	
	current	current+1Y
minimum	1.50	1.60
average	3.14	2.88
maximum	4.70	5.30

FORECAST FOR NOMINAL WAGE GROWTH
(%)

Date of Prediction	year end	
	current	current+1Y
9.19	6.9	5.4
10.19	6.9	5.5
12.19	7.0	5.7
2.20	5.8	4.9
5.20	3.5	2.8
7.20	3.1	2.9
8.20	3.5	3.2
9.20	3.1	2.9

Although the gross nominal wage in the Czech Republic still recorded a slight annual increase in 2020 Q2 (up by 0.5%), it showed a decline of 3.1% quarter on quarter after seasonal adjustment. Given the inflation rate, it also declined year on year in real terms (down by 2.9%). Some analysts point out that the above macroeconomic figures clearly suggest the end of a period of high wage growth in the Czech Republic. This also takes into account that flexible pay elements, which were probably first to be reduced, may increase again relatively soon after the worst of the pandemic, and that the latest data on nominal wage growth may be significantly distorted, as a substantial section of the workforce did not receive their actual salaries in Q2, but instead wage compensation.

The unemployment rate published by the Labour Office of the Czech Republic remained at 3.8% in August. The analysts believe that in view of the current level of unemployment, the situation on the labour market has not been badly affected so far. Despite a slight increase, the proportion of the labour force that is unemployed is still relatively low, while remaining close to a steady-state level. However, as seasonal work and the Antivirus support programme subside, the number of unemployed is set to grow more quickly. This has the potential to limit wage growth which – in addition to wage increases in the public sector – is based on very fragile and (due to the current pandemic) vulnerable economic growth. The analysts thus assume that wage growth will be subdued in the near future and in line with this, lowered their forecasts on average. The nominal wage is thus expected to increase by 3.1% this year (compared to 3.5% expected in August) and slow to just below 2.9% next year (compared to 3.2% in the previous survey).

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