Financial Market Inflation Expectations

10/2020

CNB CZECH NATIONAL BANK

Czech National Bank —— Financial Market Inflation Expectations —— 10/2020

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I. SUMMARY

Fourteen domestic and three foreign analysts sent in contributions to the October survey. The data obtained suggest that renewed growth in the number of new confirmed cases of Covid-19 and the outbreak of another – much more serious – wave of the pandemic will affect economic performance. This is expected to lead to a deeper drop in GDP in 2020 as a whole than predicted by analysts in September. This decline in GDP will be accompanied by slower growth in nominal wages this year and a weaker koruna. Consumer price inflation should be at the CNB's 2% inflation target at both the one-year and three-year horizons. Most of the respondents believe that the CNB's key interest rate – the 2W repo rate – will remain at the current level at least until October 2021. However, the unpredictable course of the pandemic increases the range of unknowns and uncertainties regarding future developments. Reliable economic forecasts are very difficult to produce without a clear idea as to the approximate date on which the economic restrictions implemented to curb the spread of the disease in the Czech Republic will be lifted. According to the analysts, it is therefore possible that current data will also be revised significantly, with risks being strongly tilted towards a less optimistic scenario.

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, 26 October 2020

II. INFLATION

FORECAST FOR Y/Y CPI GROWTH

(%)

October 2020	CPI 1Y	CPI 3Y
minimum	1,1	1,6
average	2,0	2,0
maximum	2,5	2,5

1Y AND 3Y FORECAST FOR CPI GROWTH

(%)

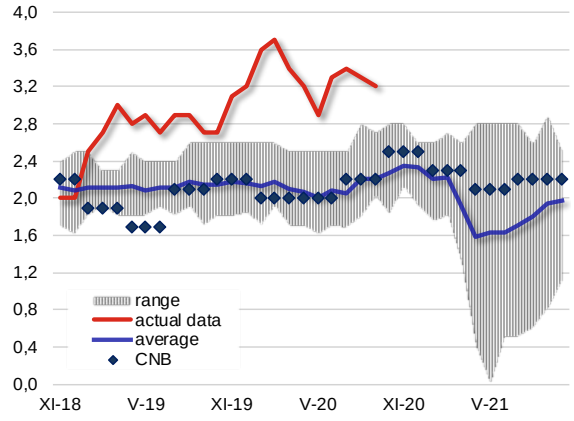
Date of Prediction	ANALYSTS 1Y	ANALYSTS 3Y	CNB (%) 1Y
X.19	2,3	2,0	3Q: 2.2
XII.19	2,3	2,0	4Q: 2.5
II.20	2,2	2,0	1Q: 2.3
V.20	1,6	1,9	2Q: 2.1
VII.20	1,7	2,0	
VIII.20	1,8	2,0	3Q: 2.2
IX.20	1,9	2,0	
X.20	2,0	2,0	

The consumer price index fell by 0.6% month on month in September, representing a slowdown in annual growth of 0.1 percentage point to 3.2%. This was due mainly to lower food prices and a seasonal drop in holiday prices. Although the depth of the month-on-month decline is surprising to many, the analysts raised the average one-year inflation forecast by 0.1 percentage point compared to the September survey. The three-year forecast was unchanged. The analysts' one-year and three-year forecasts are thus both exactly at the CNB's 2% inflation target for the first time since 2017. The range of individual estimates for this year narrowed considerably due to an increase in the minimum values and a decrease in the maximum values, while the minimum and maximum values of the forecast for next year were unchanged and their range thus remains the same.

According to the analysts, future inflation will reflect the planned drop in energy prices, but only marginally. The key factor will be the current resurgence of the pandemic. The expected slowdown in the economic recovery in Q2 should generally reduce inflation pressures. However, extensive government measures that will both moderate the economic slowdown and the drop in households' disposable income also come into play. At the same time, supplier-customer relations may become disrupted again. A disruption of these relations and supply-side constraints would, in turn, lead to a rise in the price level. Inflation will also reflect the current exchange rate of the koruna, which has weakened noticeably since mid-September.

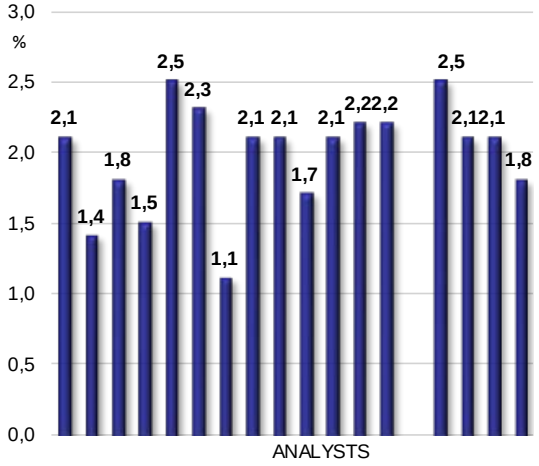
CONSUMER PRICE INDEX

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

(%)

October 2020	end of year	
	current	current + 1Y
minimum	-10,5	0,6
average	-7,1	4,3
maximum	-5,0	7,5

FORECAST FOR GDP GROWTH

(%)

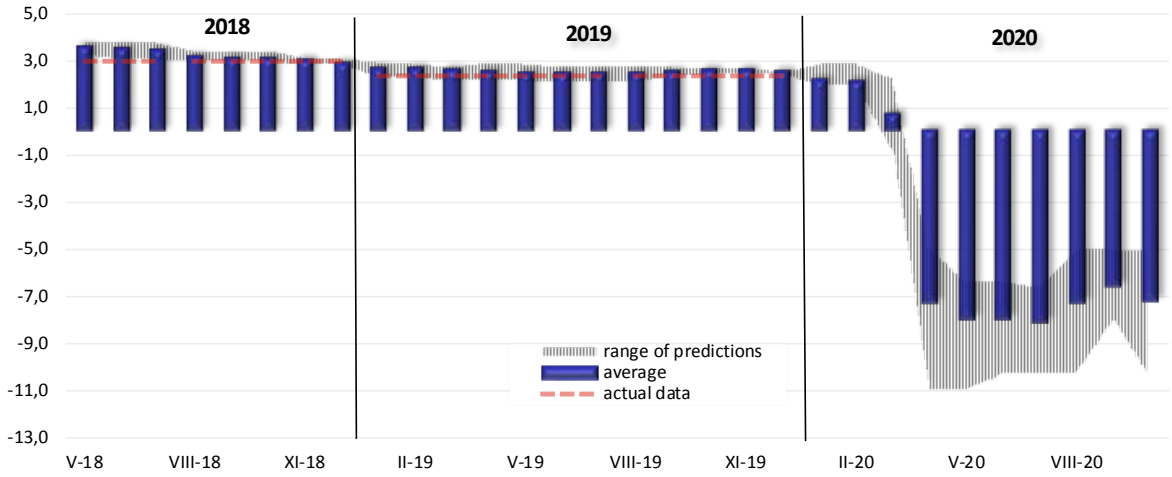
Date of Prediction	end of year	
	current	current+1Y
X.19	2,6	2,3
XII.19	2,5	2,1
II.20	2,1	2,3
V.20	-7,9	5,8
VII.20	-8,0	5,6
VIII.20	-7,2	5,0
IX.20	-6,5	4,5
X.20	-7,1	4,3

The CZSO revised slightly the extent of the drop in GDP. The Czech economy contracted by 10.9% year on year in 2020 Q2. The quarter-on-quarter figure is unchanged and remains at 8.7%. However, this is not decisive for the analysts' forecasts which are much less optimistic than in the September survey. Overall, the economy should decline by 7.1% this year. The figure is 0.6 p.p. worse than expected a month ago. The outlook for next year also expects lower growth, which is expected to reach only 4.3% instead of 4.5%. A significant drop in the minimum value led to a widening of the range of individual estimates for this year. The range of the forecasts for next year widened owing to a decrease in the minimum value and an increase in the maximum value.

The current epidemiological situation is the clear reason behind the deterioration in the estimated decrease in GDP. The Czech Republic has again entered a state of emergency, with a dramatic increase in Covid-19 cases also being observed abroad. The related measures aimed at slowing the spread of the coronavirus will undoubtedly affect economic performance again. So far restrictions have not applied much to industry, which is a very important part of the Czech economy. Nevertheless, the analysts point to the risk of a "spontaneous" halt of production, due, for example, to a shortage of subcontracting, a lack of interest on the part of buyers or concerns regarding employees' health. However, consumer confidence and demand will also probably weaken due to efforts to maintain social distancing. Some analysts believe that if closures last only until 3 November, the negative impact on GDP could amount to only to several tenths of a percentage point. However, many anticipate – based on the latest available information – that the lifting of the measures will be postponed.

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

(%)

October 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	0,40	0,45	0,60	0,70	0,95
average	0,24	0,24	0,42	0,52	0,60	0,90	0,85	1,15
maximum	0,25	0,25	0,44	0,86	0,72	1,19	0,94	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
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
IX.20	0,25	0,25	0,42	0,51	0,74	0,94	0,96	1,18
X.20	0,24	0,24	0,42	0,52	0,60	0,90	0,85	1,15

ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE

(%)

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
15.10.	0,25	0,43	0,57	0,80

Most of the respondents do not expect the 2W repo rate to change (from the current level of 0.25%) at the CNB Bank Board November meeting (on 5 November). Only one domestic respondent is of a different opinion, expecting the Bank Board to cut this key interest rate to 0.05% due to the latest developments. As regards one-year forecasts, only one analyst – this time a foreign analyst – believes that the 2W repo rate will be cut by 25 basis points to 0.05%. All the others expect the CNB's 2W repo rate to remain at 0.25% at least until October.

Even a month ago, the analysts were strong in their conviction that the CNB would undoubtedly take a wait-and-see approach and leave its interest rates unchanged for an extended period. However, they are now remarking that part of the money market has started to speculate on a further drop in the CNB's 2W repo rate owing to the unfavourable pandemic situation and also to the larger-than-expected slowdown in inflation in September (including core inflation, according to some estimates). Despite this, most of the analysts believe that not even these arguments will lead to a cut in key interest rates given the latest communications from the CNB. A more likely development is a delay in the return of a more robust economic recovery and thus in the growth in interest rates (of about three months, according to some analysts).

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

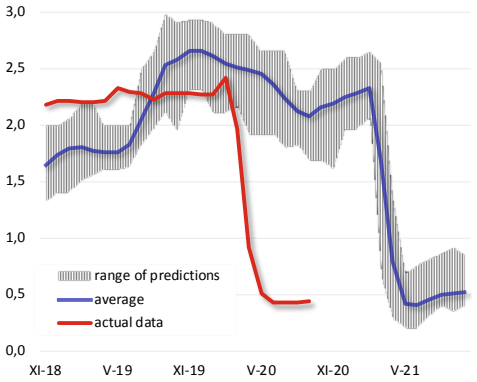
(%)

2W repo rate level in 1Y (%)	0,05	0,25	0,5	0,75	1	1,25
number of analysts - current survey	1	16	0	0	0	0
-previous survey	1	15	1	0	0	0

The PRIBOR reference rates did not respond much to the latest events and remained very stable. This is also true of their forecasts in our survey. By contrast, the 5Y and 10Y IRS swap rates have fallen on the market by 20 basis points since mid-September, as have the analysts' average forecasts of the rates. Monthly estimates recorded a larger drop, of 14 basis points for 5Y IRS and 11 basis points for 10Y IRS. The analysts probably expect the drop in swap rates to be only temporary, as their average forecasts at the one-year horizon have shifted lower by just 3 basis points for both 5Y and 10Y IRS.

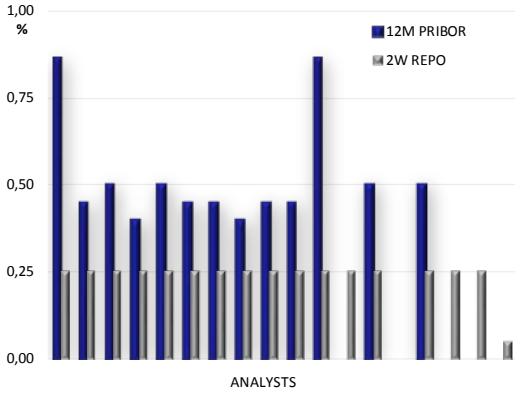
12M PRIBOR AT 1Y

ACTUAL DATA, AVERAGE AND RANGE OF PREDICTIONS



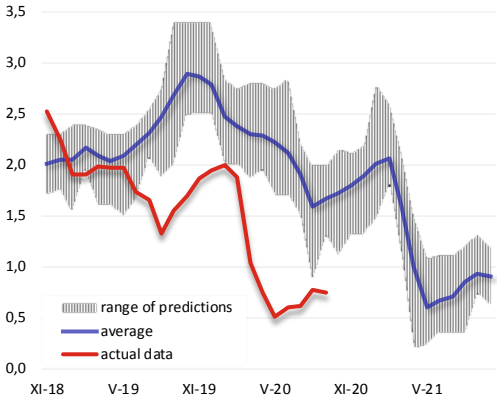
2W REPO AND 12M PRIBOR AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



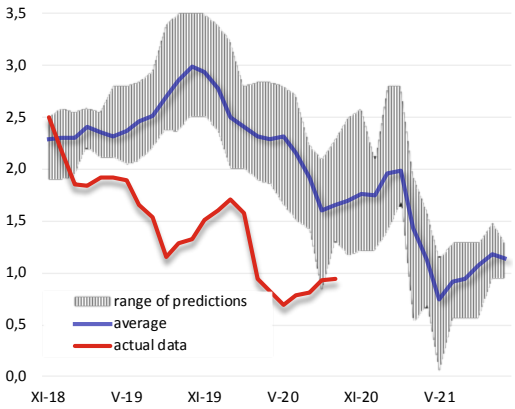
5Y IRS AT 1Y

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
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
IX.20	26,48	25,77
X.20	27,11	25,88

EXCHANGE RATE FORECAST

October 2020	EUR/CZK 1M	EUR/CZK 1Y
minimum	26,70	25,00
average	27,11	25,88
maximum	27,60	26,80

ACTUAL EUR/CZK AS OF FORECAST DEADLINE

15.10.	27,34

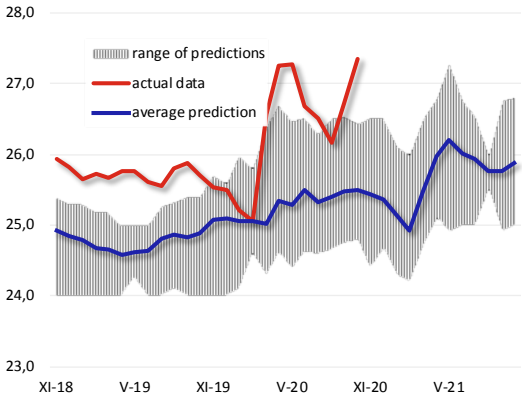
The exchange rate of the koruna against the euro depreciated from CZK 26.83 to CZK 27.34 last month. As a result of this and the latest events, the analysts have revised their views and increased their average monthly forecast to above CZK 27 to the euro. They are now expecting the koruna to stand close to CZK 27.11 to the euro in mid-November 2020 and strengthen gradually to CZK 25.88 by October 2021.

The analysts believe that the depreciation is due mainly to the unfavourable course of the pandemic, the related introduction of tighter measures and a global increase in risk aversion. According to some analysts, slowing inflation and a drop in market interest rates could also play a role, reflecting speculations of part of the market on a drop in key interest rates owing to worse economic outlooks following a dramatic escalation of the epidemiological situation in the Czech Republic.

Given that there has been no change in the epidemiological situation and it is yet unclear when the economy will return to normal, the analysts do not rule out that the koruna will remain at weaker levels. Nevertheless, the depreciation is not expected to be permanent, and the koruna should start to appreciate gradually again once the coronavirus crisis ends and the economy recovers.

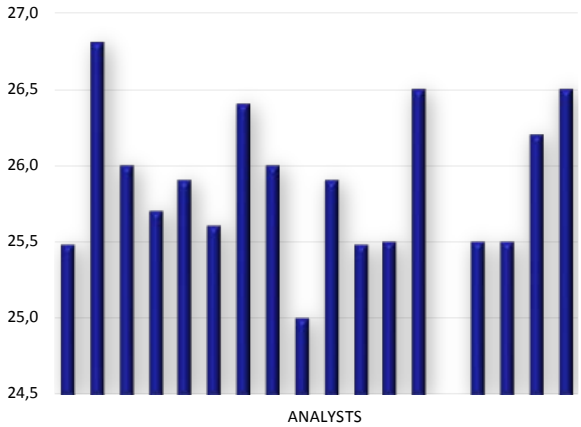
EUR/CZK

ACTUAL DATA, 1Y PREDICTIONS AND THEIR RANGE



EUR/CZK AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



VI. NOMINAL WAGES

FORECAST FOR NOMINAL WAGE GROWTH

(%)

October 2020	year end	
	current	current+1Y
minimum	0,90	1,60
average	2,66	2,85
maximum	4,70	5,30

FORECAST FOR NOMINAL WAGE GROWTH

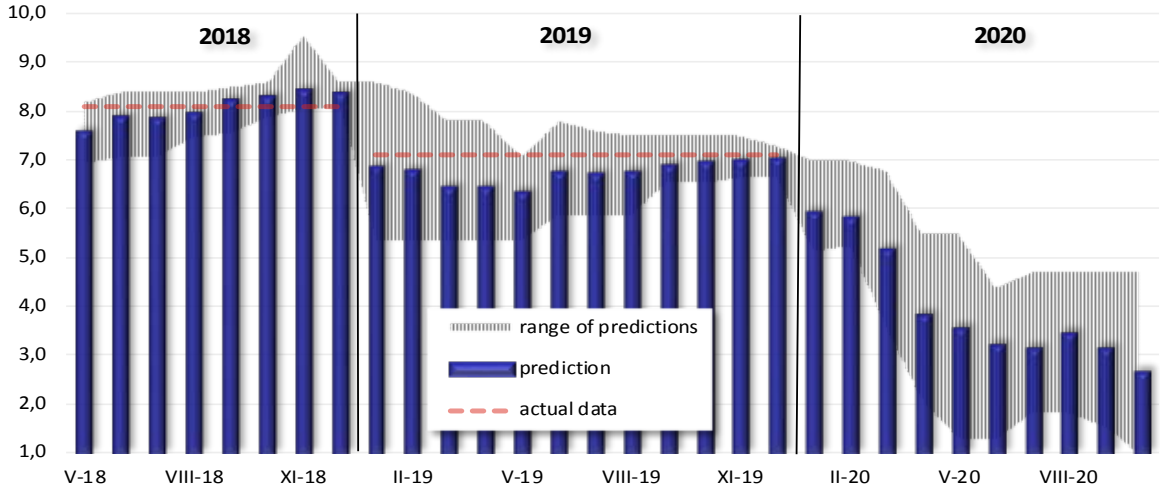
(%)

Date of Prediction	year end	
	current	current+1Y
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
IX.20	3,1	2,9
X.20	2,7	2,9

The sharp deterioration in the fight against the coronavirus in the Czech Republic and the related revision of the economic outlook is also inevitably reflected in the nominal wage forecast which has been revised downwards for 2020. The analysts expect the nominal wage to grow by 2.7% this year, which is 0.4 basis point less than in the September survey. Such a pace could still be close to the inflation rate and therefore, despite the current extremely unfavourable economic situation, does not imply a change in real wages which will fall deep into negative territory. Wage growth in 2021 is expected to accelerate slightly to 2.9% as the economy recovers. This corresponds to the figure in the previous survey.

NOMINAL WAGE GROWTH

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



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