

Financial Market Inflation Expectations

— 12/2020



Contents

I. SUMMARY	3
II. INFLATION	4
III. GROSS DOMESTIC PRODUCT	5
IV. INTEREST RATES – 2W REPO, PRIBOR, IRS	6
V. EXCHANGE RATE	8
VI. NOMINAL WAGES	9

I. SUMMARY

Fourteen domestic and two foreign analysts took part in this year's final inflation expectations survey. Despite the adverse pandemic situation in recent weeks, the results show that the expected fall in GDP in 2020 has moderated and the pace of projected economic recovery in 2021 has increased since November. This, combined with favourable labour market data, creates conditions for higher wage growth and a slightly faster tightening of monetary conditions through both the exchange rate and interest rate components. The analysts' view of future consumer prices is unchanged and their inflation expectations remain anchored close to the 2% target at both the one-year and three-year horizons.

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 Jách, 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 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, 22 December 2020

II. INFLATION

FORECAST FOR Y/Y CPI GROWTH

(%)

December 2020	CPI	
	1Y	3Y
minimum	1.2	1.5
average	2.1	2.0
maximum	2.4	2.4

1Y AND 3Y FORECAST FOR CPI GROWTH

(%)

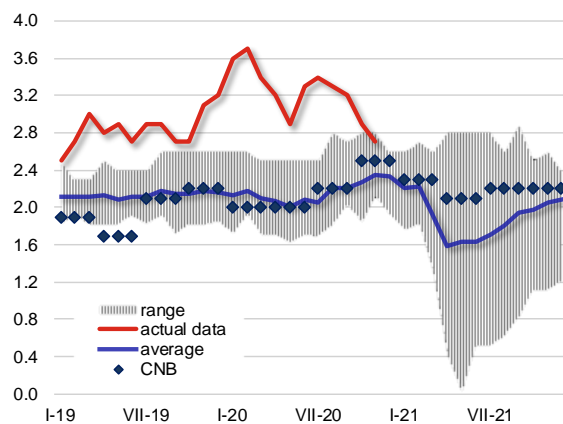
Date of Prediction	ANALYSTS		CNB (%)
	1Y	3Y	1Y
XII.19	2.3	2.0	4Q: 2.5
II.20	2.2	2.0	1Q: 2.3
V.20	1.6	1.9	2Q: 2.1
VII.20	1.7	2.0	
VIII.20	1.8	2.0	3Q: 2.2
X.20	2.0	2.0	
XI.20	2.1	2.0	4Q: 2.2
XII.20	2.1	2.0	

Inflation in the Czech Republic continues to show a downward trend. The consumer price index was flat month-on-month in November, increasing by 2.7% year-on-year, which is 0.2 pp lower than in October. The slowdown in inflation was reflected mainly in the food and non-alcoholic beverages category. However, the analysts contributing to our survey did not change their views on inflation. They left the average forecast at 2.1% at the one-year horizon and at the level of the CNB's 2% inflation target at the three-year horizon. The range of individual one-year estimates narrowed due to an increase in the minimum value and a decrease in the maximum value. By contrast, it widened slightly for three-year forecasts due to a moderate increase in the maximum value.

The analysts continue to expect inflation to slow in 2021 H1 due mainly to a weak economy affected by the adverse impacts of the coronavirus pandemic. Base effects will also play a role after a rise in prices in early 2020. Conversely, a decline in inflation will be mitigated by a further increase in excise duty on tobacco and alcohol and the hotly debated tax package, which will have a positive effect on consumer demand. Inflation pressures might start to grow in the second half of the year, due to the economic recovery after the pandemic subsides.

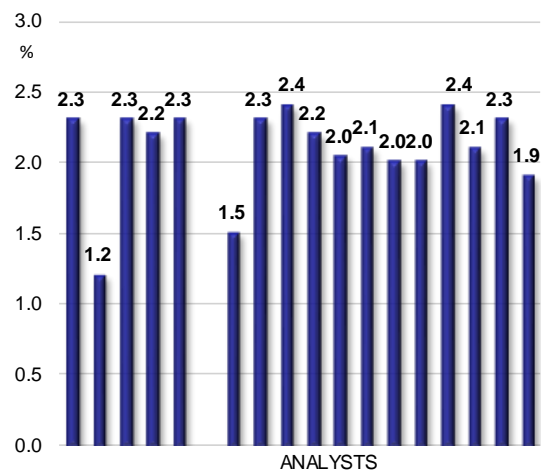
CONSUMER PRICE INDEX

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

(%)

December 2020	end of year	
	current	current + 1Y
minimum	-8.0	2.0
average	-7.0	3.5
maximum	-6.0	6.6

FORECAST FOR GDP GROWTH

(%)

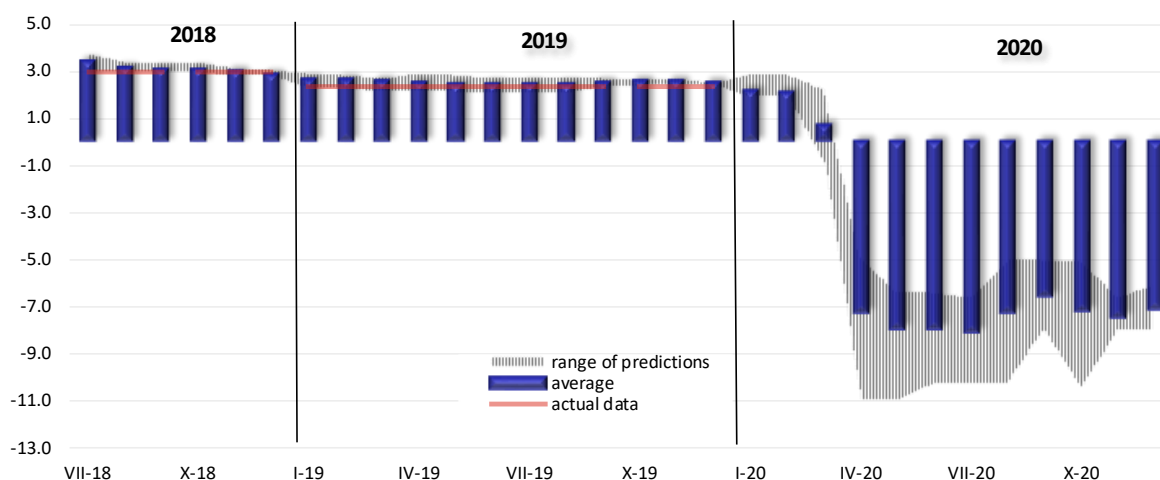
Date of Prediction	end of year	
	current	current+1Y
XII.19	2.5	2.1
II.20	2.1	2.3
V.20	-7.9	5.8
VII.20	-8.0	5.6
VIII.20	-7.2	5.0
X.20	-7.1	4.3
XI.20	-7.4	3.2
XII.20	-7.0	3.5

The CZSO revised upwards its initial estimate for Czech GDP growth in 2020 Q3. The domestic economy declined by 5.0% year on year (compared to the original estimate of 5.8%) and increased by 6.9% quarter on quarter (compared to 6.2%). Household consumption and foreign trade had a pro-growth effect, while a decline in investments, the volume of which is significantly affected by the current marked uncertainty, had a pronounced negative impact. As regards gross value added, a recovery was observed mainly in restaurants, manufacturing and other activities in Q3. The GDP revision likely led the analysts to revise their estimates. Their view is more optimistic than in the previous survey, as they expect the Czech economy to decline by 7.0% this year (compared to -7.4% in November) and believe it could grow by 3.5% next year (compared to 3.2% in the previous survey). The range of individual estimates for 2020 widened due to an increase in the maximum value, while the minimum and maximum values in the forecasts for 2021 narrowed due to a faster increase in the minimum value.

The favourable developments in Q3 stemmed from the economic recovery in the Czech Republic and abroad. However, the feared second pandemic wave arrived in the last quarter, striking again with tremendous force. A wide range of restrictions and renewed closures of a large part of retail and services will inevitably have a far-reaching impact on economic performance. Moreover, corporations have been weakened significantly compared to the first wave. The question remains how the pandemic situation and related restrictions will evolve and how fast customers will return. The restrictions in industry are not as large as they were in spring and thus the decline in Q4 may not as deep as in the first wave. Nonetheless, some respondents believe it could again be close to 10% in year-on-year terms. According to the analysts, there will be a recovery in 2021, with the vaccine in particular bringing hope. The tax package will also provide support. However, there is a view among analysts that the Czech economy may not even return to its 2019 level in 2022.

GDP GROWTH AT END OF CURRENT YEAR

AVERAGE AND RANGE OF PREDICTIONS IN %



IV. INTEREST RATES – 2W REPO, PRIBOR, IRS

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

(%)

December 2020	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1M	1Y	1M	1Y	1M	1Y	1M	1Y
minimum	0.25	0.25	0.33	0.35	0.60	0.80	0.90	1.10
average	0.25	0.35	0.46	0.65	0.92	1.20	1.13	1.40
maximum	0.25	0.75	0.55	1.05	1.04	1.50	1.22	1.70

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
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
ACTUAL INDICATOR VALUES AS OF FORECAST DEADLINE				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
				52	0.60	0.90	0.85	1.15
	2W	12M	5Y	10Y	54	0.69	0.97	1.22
	repo rate	PRIBOR	IRS	IRS	65	0.92	1.20	1.13
15.12.	0.25	0.49	1.04	1.19				

All respondents expected the key interest rates to remain unchanged at the Bank Board meeting in December and the 2W repo rate to enter 2021 at 0.25%. The analysts slightly revised their view of the key interest rates at the one-year horizon, probably due to better global sentiment, which is related to progress in the approval of the coronavirus vaccine and the vaccination programme. Although most analysts still expect the CNB's 2W repo rate to be set at 0.25% throughout 2021, the number of respondents expecting an increase of 25 bps to 0.50% increased from four to five. Moreover, one of the analysts admits that it might even increase by 50 bps to 0.75%. The slightly higher average level of expected interest rates is thus in line with a smaller fall in GDP this year and a faster expected economic recovery in 2021. Inflation pressures, which may arise from tax changes and higher household consumption, could prompt the CNB Bank Board to raise interest rates. However, such a step is not expected before 2021 H2, as also indicated by statements made by some CNB Bank Board members.

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

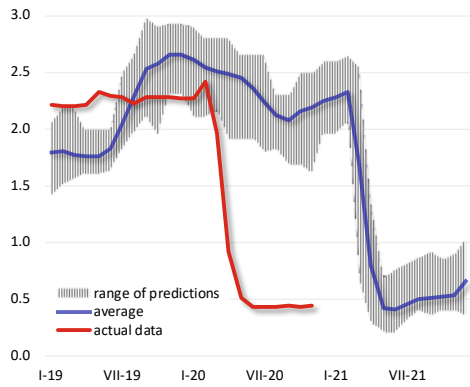
(%)

2W repo rate level in 1Y (%)	0.05	0.25	0.50	0.75	1	1.25
number of analysts - current survey	0	11	5	1	0	0
-previous survey	0	12	4	0	0	0

The analysts' view of reference interest rates on the interbank market (PRIBOR) and swap rates takes largely into account the recent developments in corresponding rates on the market, which stems mainly from global hopes for progress in combating the pandemic through vaccination. The forecast for the PRIBOR rates thus increased by 5 bps and 12 bps at the one-month and one-year horizons respectively. The shift was slightly larger for IRS rates, ranging from 17 to 24 bps.

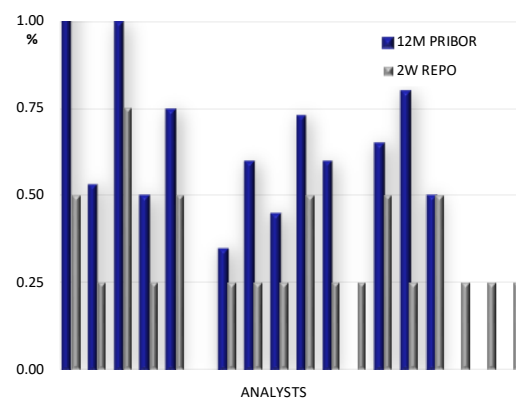
12M PRIBOR AT 1Y

ACTUAL DATA, AVERAGE AND RANGE OF PREDICTIONS



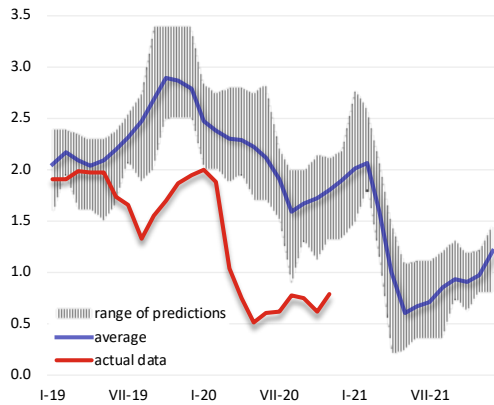
2W REPO AND 12M PRIBOR AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



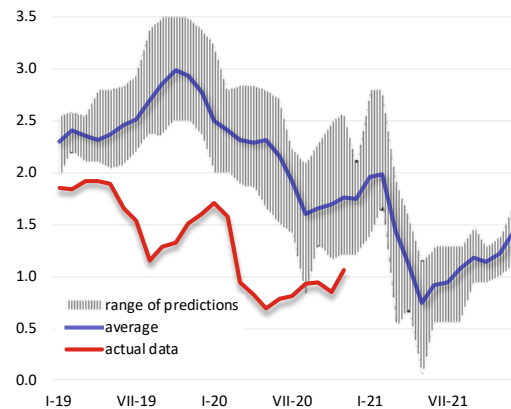
5Y IRS AT 1Y

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
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
X.20	27.11	25.88
XI.20	26.63	25.75
XII.20	26.33	25.63

EXCHANGE RATE FORECAST

December 2020	EUR/CZK	
	1M	1Y
minimum	26.10	25.10
average	26.33	25.63
maximum	26.60	26.00

ACTUAL EUR/CZK AS OF FORECAST DEADLINE

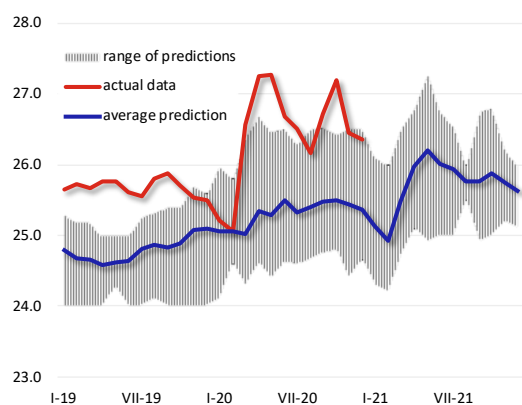
15.12.	26.36
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The exchange rate of the koruna to the euro has appreciated noticeably since the last survey, shifting from CZK 26.47 to the euro to CZK 26.36 to the euro. The analysts have again adjusted their forecasts to stronger levels and to an even greater extent than by how much the koruna has appreciated since November. They thus made the one-month forecast (CZK 26.33 to the euro) broadly equal to the exchange rate at the time of the survey (CZK 26.36 to the euro). They probably have greater faith in the koruna now and do not expect it to return to weaker levels in the near future. The one-year outlook also shifted to stronger levels, albeit to a smaller extent. The analysts therefore expect the koruna to stand close to CZK 25.63 to the euro in mid-December 2021.

The koruna's exchange rate has been very volatile in recent months, which is naturally mostly due to the pandemic and the (un)successful fight against it, but also due to the uncertainty surrounding Brexit and the approval of the EU budget. From the economic perspective, the upward pressure on the koruna should be only moderate. The recent fast appreciation stems from generally more favourable sentiment on the global market but some believe it may to some extent also reflect tax changes, which increase the risk that the CNB will be forced to increase the key interest rates sooner due to an increase in inflation pressures. With the easing of the pandemic and hence increased volatility on foreign exchange markets, the koruna is expected to appreciate again gradually, which will be related to the economic recovery, the CNB's monetary policy tightening and in the longer term the Czech Republic's convergence towards advanced Western European countries. However, the fight against the pandemic is far from over and the risk of renewed above-average volatility on the market and further deviations from the long-term trend thus remains higher.

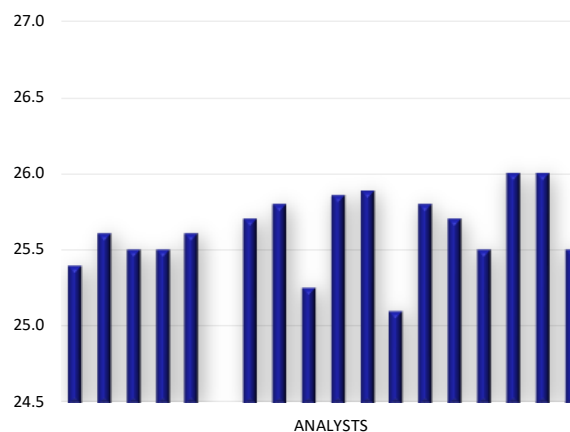
EUR/CZK

ACTUAL DATA, 1Y PREDICTIONS AND THEIR RANGE



EUR/CZK AT 1Y

PREDICTIONS OF INDIVIDUAL ANALYSTS



VI. NOMINAL WAGES

FORECAST FOR NOMINAL WAGE GROWTH

(%)

December 2020	year end	
	current	current+1Y
minimum	0.90	1.60
average	2.51	2.88
maximum	3.90	4.20

FORECAST FOR NOMINAL WAGE GROWTH

(%)

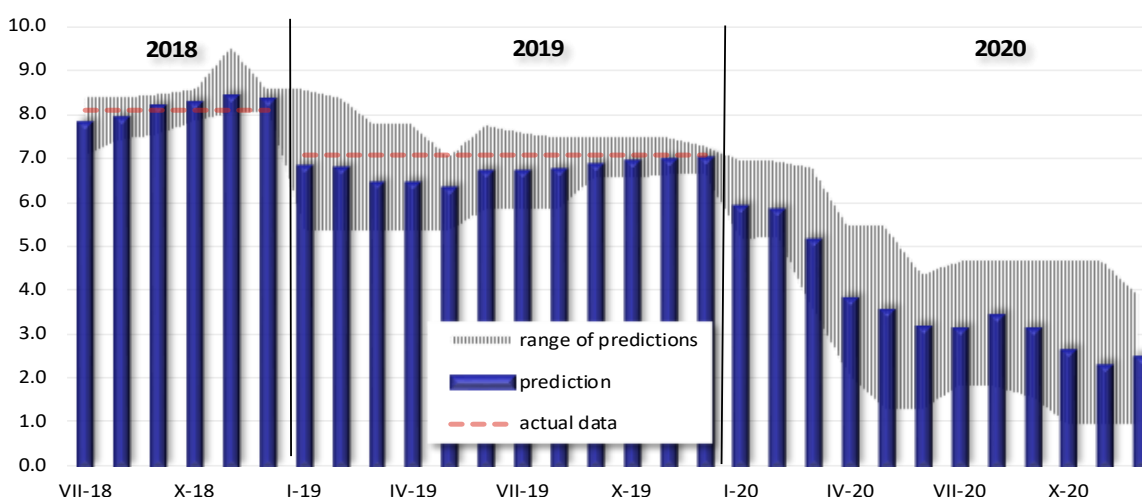
Date of Prediction	year end	
	current	current+1Y
XII.19	7.0	5.7
II.20	5.8	4.9
V.20	3.5	2.8
VII.20	3.1	2.9
VIII.20	3.5	3.2
X.20	2.7	2.9
XI.20	2.3	2.7
XII.20	2.5	2.9

The recovery in economic activity also led to an increase in nominal wages in Q3. According to the CZSO, the average wage in the Czech Republic increased by 5.1% to CZK 35,402 in 2020 Q3 compared with the same period last year (compared to +0.5% in 2020 Q2). This greatly exceeded the estimates. Given the 3.3% rise in consumer prices, this represents real annual growth of 1.7% (compared with a decline of 2.5% in 2020 Q2), while the market tended to expect stagnation. The total volume of wages paid rose by 1.9% in the same period but the number of employees declined by 3.1%.

According to the analysts, rapid wage growth in Q3 may be related to employees returning to work, as the reasons for cutting their wages (for example, shutdowns, lower demand and childcare) no longer existed. The higher wages in Q3 might also have been affected by extraordinary bonus payments to healthcare workers for their efforts during the pandemic and higher wage growth in the public sector. At the same time, the unemployment rate remains very low and many employers find it difficult to fill vacancies even in the current situation. In addition, the analysts' forecasts also reflect a more optimistic GDP outlook. According to the latest data, the average nominal wage will increase by 2.5% in 2020, i.e. by 0.2 pp more than expected in the previous survey. This is despite the fact that the 2020 Q4 data will be negatively affected by the second wave of the pandemic and many firms may reduce annual bonuses, which are usually included in wages in the last quarter or even waive their payment altogether in view of the difficult economic conditions this year. The analysts expect wage growth to increase to 2.9% in 2021, i.e. also by 0.2 pp more than in the November survey.

NOMINAL WAGE GROWTH

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



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