

Measuring financial market inflation expectations — results of the 44th measurement (December 2002)

The December survey is in line with the long-term trend in the area of inflation expectations and interest rate predictions. Expectations of low annual CPI growth and lower (particularly short-term) interest rate levels still prevail. The rate of the koruna's appreciation at the longer-term horizon will probably be slower than previously expected.

1. Inflation

XII-02	annual CPI (%)	
	1 year	3 years
min.	1,5	2,5
average	2,3	2,8
max.	2,9	3,5

The analysts agree that the inflation outlook for the months ahead is very good. Domestic prices will be affected by a strong koruna, a relatively low degree of deregulation, low import prices, strong competition between the large retail chains and a slow recovery in the European Union. At the start of 2003, consumer prices should – thanks mainly to a decrease in prices of electricity on 1 January 2003 – shift to the deflationary band, where they could remain for several

months. In approximately mid-2003 there should be a recovery in the EU, which will give rise to domestic inflationary pressures. The increase in prices should be attributable chiefly to food, housing and nontradables prices. At that time, however, counter-pressure from a renewed nominal appreciation of the koruna should strengthen. The CPI should return to the CNB target band at the end of 2003. The possibility of a jump increase in oil prices in the event of a US attack against Iraq is considered the main risk factor for inflation going forward.

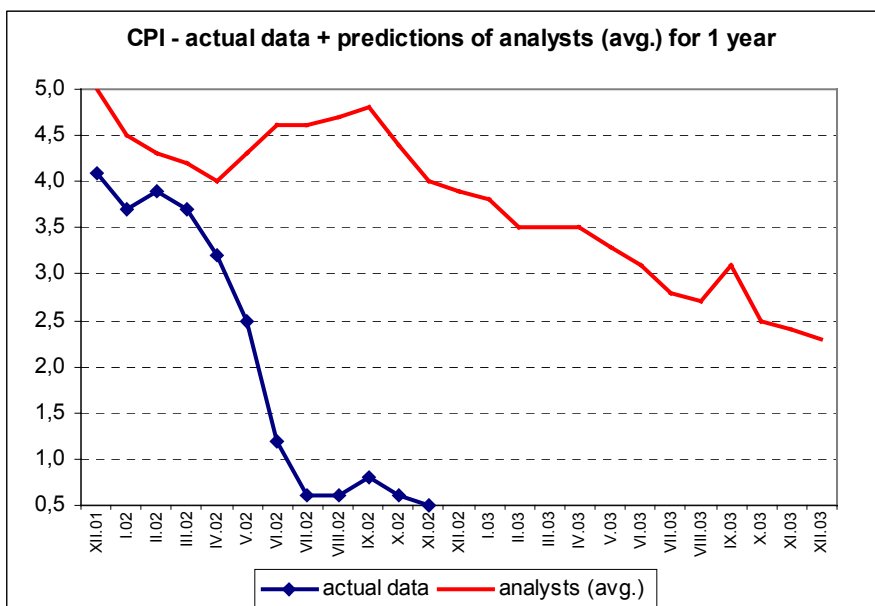
In the longer term, it can be expected that, given a gradual recovery of the global economy, growth in the Czech Republic will approach its potential and inflation will fluctuate above the level in the eurozone.

The average prediction for annual consumer price inflation at the one-year horizon decreased in December, thanks mainly to the opinions of the foreign analysts. Their average expectation decreased from 2.3% in November to 2.0% in December. Their predictions range between 1.5% and 2.6%. By contrast, the average prediction of the domestic analysts increased slightly, from 2.4% in to 2.5%, ranging between 2.3% and 2.9%.

The estimate of annual consumer price inflation at the three-year horizon remained unchanged at 2.8%. As at the shorter horizon, the foreign analysts shifted their predictions slightly downwards (from 2.8% in November to 2.7% in December, the range of their estimates being 2.5%–3.5%) and the domestic analysts slightly upwards (from 2.7% to 2.9%, the range being 2.6%–3.2%).

The main inflation factors and risks:

- A jump increase in oil prices in the event of a US attack on Iraq.



Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
XII-01	3,9	3,6
III-02	3,5	3,3
VI-02	3,1	3,0
IX-02	3,1	2,9
X-02	2,5	2,9
XI-02	2,4	2,8
XII-02	2,3	2,8

2. Interest rates

	1W PRIBOR (%)		12M PRIBOR (%)		12M/1W spread (%)		5Y IRS (%)		CR 6,55/11 yield		analysts' opinion 2W repo rate
	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year	
XII-02											
min.	2,4	2,4	2,4	2,9			3,1	3,3	4,0	3,7	2,00
average	2,6	2,9	2,6	3,1	0,0	0,2	3,6	4,2	4,2	4,6	2,48
max.	2,8	3,1	2,8	3,3			4,0	4,7	4,5	5,3	2,75

The reduction in ECB rates eliminated the negative interest rate differential. Despite the current exchange rate stabilisation, in the opinion of most analysts the low inflation and the risk of weaker economic growth will allow the CNB to cut rates by a further 25 basis points, probably in January 2003. The foreign analysts, however, tend to believe that the reduction could be even bigger. According to this opinion, weak global growth and low inflation will result in a further 50 basis point drop in rates in the USA and the eurozone, which will have an indirect effect on the Czech Republic.

In 2003, a recovery is expected in the American economy, followed with some lag by Europe. At the end of 2003, the CPI should return to the CNB's target band, and it is at this time that the analysts also expect the first moderate tightening of CNB monetary policy. The level of long-term rates and bond yields should be affected primarily by the behaviour of the eurozone markets.

The expected levels of short-term rates at the one-month horizon mostly reflect the aforementioned expectations of a further modest reduction in the CNB repo rate. The prediction of long-term rates beyond one month roughly corresponds to the current situation on the market.

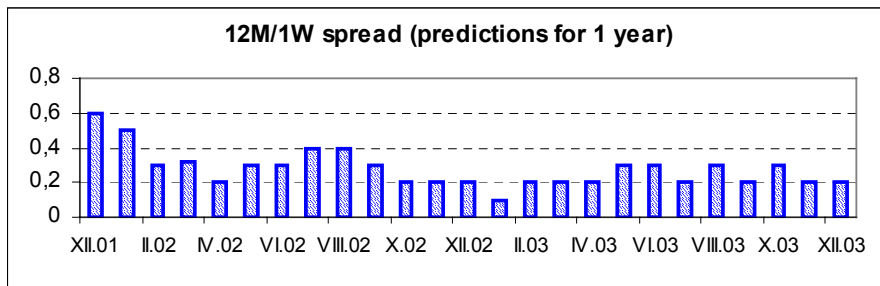
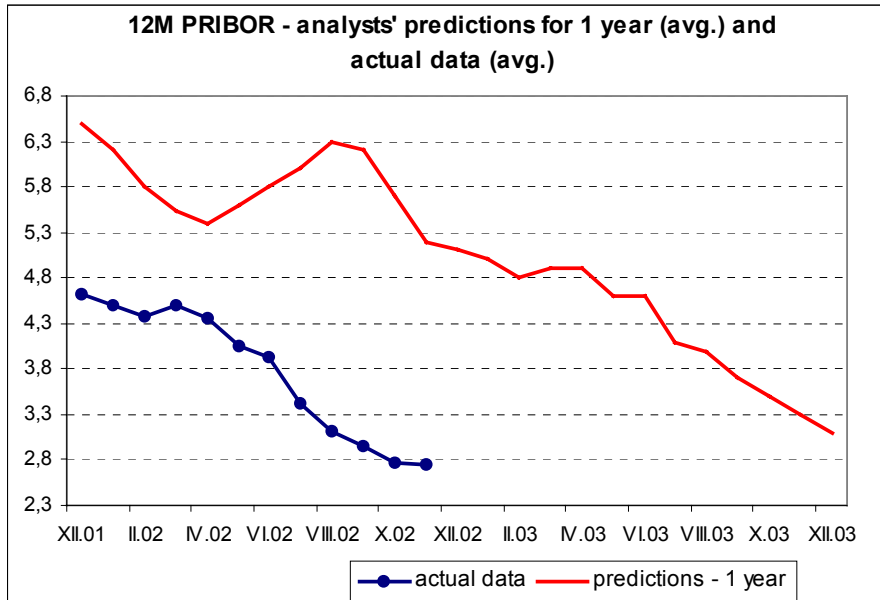
The average predictions for short-term rates at the one-year horizon shifted slightly downwards again in December, reflecting the aforementioned expectations of a moderate rise in CNB rates at the end of next year (1W PRIBOR – foreign analysts: average 2.8%, range 2.4%–3.0%; domestic: average 3.0%, range 2.8%–3.1%; 1Y PRIBOR – foreign: average 3.1%, range 2.9%–3.2%; domestic: average 3.2%, range 2.9%–3.3%). In the months ahead, long-term rates and bond yields will be bolstered by favourable developments in this segment of the market in the USA and the eurozone. In the second half of the year, given a gradual recovery of the global economy, a rise in longer-term rates can be expected in both Europe and the Czech Republic. An increase in the volume of government bonds and a higher government-debt duration may also have negative effects (5Y IRS – foreign: average 4.0%, range 3.3%–4.5%; domestic: average 4.3%, range 4.0%–4.7%; CR 6.55/11 yield – foreign: average 4.5%, range 3.7%–4.9%; domestic: average 4.7%, range 4.3%–5.3%).

The average two-week repo rate setting deemed appropriate has shifted to 2.48%. Most of the domestic analysts are now favouring the 2.50% level (average within the group 2.57%, range 2.5%–2.75%), whereas the foreign analysts see a lower level (average within the group 2.35%, range 2.00%–2.50%).

Prediction for Month of prediction	1W PRIBOR		12M PRIBOR		12M/1W spread		5Y IRS		CR 6,55/11 yield	
	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y
	%		%		%		%		%	
XII-01	5,2	5,1	4,8	5,2	-0,3	0,2	5,2	5,7	5,3	5,9
III-02	4,7	4,9	4,7	5,1	0,0	0,2	5,3	5,6	5,6	5,8
VI-02	4,3	4,6	4,5	4,9	0,2	0,2	5,3	5,7	5,5	5,9
IX-02	3,8	4,2	4,0	4,6	0,2	0,3	5,0	5,5	5,3	5,8
X-02	2,9	3,5	3,0	3,7	0,0	0,2	3,9	4,6	4,6	5,2
XI-02	2,7	3,1	2,7	3,5	0,0	0,3	3,5	4,2	4,1	4,8
XII-02	2,7	3,0	2,7	3,3	0,0	0,2	3,6	4,2	4,2	4,7

Actual values of indicators on the day of deadline for forecasts

	1T PRIBOR	12M PRIBOR	spread 12M/1T	5R IRS	výnos CR 6,55/11	analysts - avg. 2W repo rate
10.12.2002	2,77	2,61	-0,16	3,69	4,14	2,48



3. Exchange rate

XII-02	EUR/CZK	
	1 month	1 year
min.	30,50	28,20
average	30,94	29,74
max.	31,50	31,00

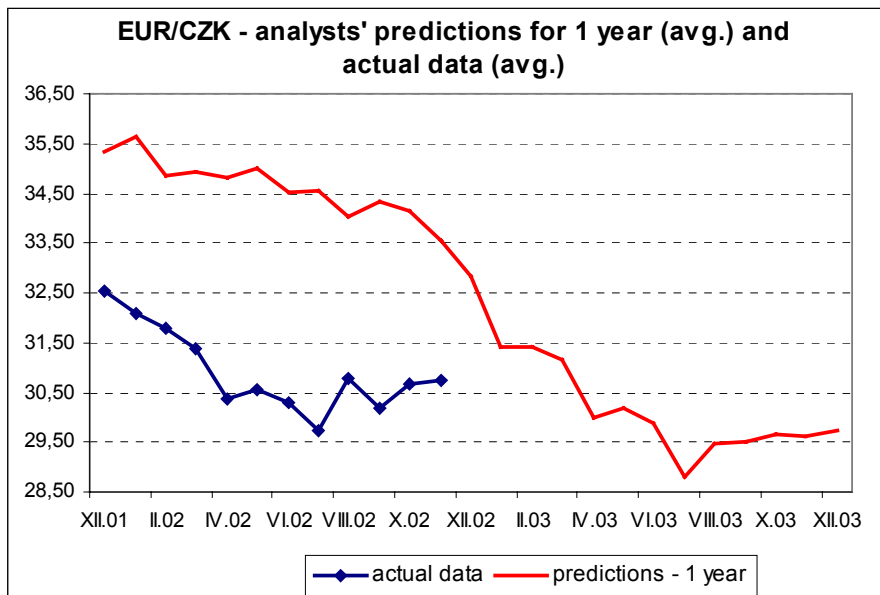
Prediction for Month of prediction	exchange rate 1 month 1 year EUR/CZK	
	XII-01	32,94
III-02	31,62	31,15
VI-02	30,64	29,90
IX-02	30,19	29,51
X-02	30,63	29,65
XI-02	30,63	29,64
XII-02	30,94	29,74

Exchange rate - fixing on the day of deadline for forecasts

10.12.2002	31,16
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The prediction of the CZK/EUR rate at the one-month horizon was slightly below the current market value at the time of the prediction. The analysts believe that because of the low liquidity on the foreign exchange market no significant trend can be expected over the next few weeks and the koruna should remain around its current levels. In the months ahead, the koruna should be in the shadow of other Central European currencies, especially those that are most undervalued and those bearing the largest additional interest yields.

The average estimate for the exchange rate at the one-month horizon is CZK 30.94/EUR in both groups of analysts. The foreign analysts' estimates range between CZK 30.50 and CZK 31.50, whereas those of the domestic analysts range between CZK 30.80 and CZK 31.30.



Turning to the long-term outlook, expectations of appreciation are still prevailing, although the annual rate of appreciation should be much slower. The analysts believe that the koruna will start appreciating rather in the second half of next year, owing to an expected increase in FDI inflow associated with the predicted recovery of the global economy in 2003 H2 and to speculation on the Czech Republic's accession to the EU.

The average estimate for the exchange rate at the one-year horizon is CZK 29.74/EUR in December. The foreign analysts' estimate again remains the more conservative. Their average prediction for December 2003 is CZK 29.90/EUR (ranging between CZK 29.00 and CZK 31.00). The average in the group of domestic analysts is CZK 29.63/EUR (ranging between CZK 28.20 and CZK 30.50).

Prague, 16 December 2002