

Measuring financial market inflation expectations – results of the 37th measurement (May 2002)

Introductory note: Since in the past few months some of the foreign analysts have not been returning their questionnaires regularly, starting in May of this year the list of participants in the foreign analysts group has been altered and expanded. This affects (albeit not very significantly) the month-on-month comparisons of the estimates.

In the May measurement, the annual CPI inflation expected at both time horizons continued to fall. The considerable lowering of the CNB's 2W repo rate passed through into the level of short-term rates and, together with the April macroeconomic figures and the trend in long-term rates and yields in the USA and Europe, also affected long-term rates. The predictions of short-term rates, the 5Y interest rate swap and the 10Y government bond yield all fell. The analysts are expecting a slight depreciation of the koruna in the next few weeks and continuing appreciation of the exchange rate in the long-term.

1. Inflation

| V-02 | annual CPI (%) | |
|---------|----------------|---------|
| | 1 year | 3 years |
| min. | 2,8 | 2,5 |
| average | 3,3 | 3,1 |
| max. | 4,0 | 3,5 |

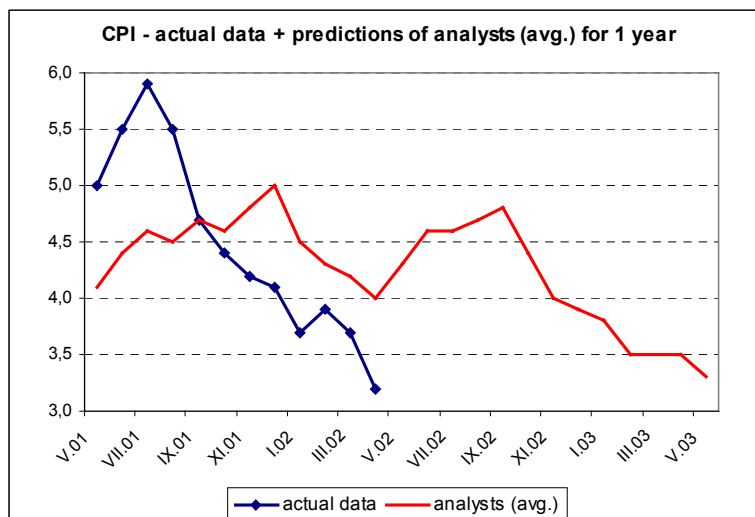
The positive CPI inflation figures in March and April and the lowering of CNB's inflation forecast confirm the analysts' predictions of a low risk of a rise in inflation pressures. In May, following three months of stagnation, the prediction for annual CPI inflation at the one-year horizon decreased further, from 3.5% to 3.3%. The downward trend in expected annual CPI inflation at the three-year horizon continued; as in April, the analysts' average estimate fell by 0.1% relative to the previous month.

Most of the analysts continue to expect inflation to decline in the next few months, to bottom out in the summer and then to rise gradually. The inflation pressures are also continuing to ease in industry. However, in subsequent months the analysts expect a change in trend, chiefly due to growth in oil prices. The expectation persists that the CNB is likely to tighten monetary policy moderately at the close of this year. The estimate of an interest rate rise of 0.25% prevails, yet the market is not ruling out a rise of 0.50%. However, this scenario may change in the event of a slow recovery of the world economy or a stronger-than-expected koruna.

As with the overall consumer price inflation prediction, expectations declined within the two groups of analysts surveyed. The change in the domestic analysts' expectations was very small, whereas that of the foreign analysts was relatively sizeable. The domestic analysts expect average annual consumer price inflation of 3.3% in May 2003 and the foreign analysts 3.4%. For the three-year horizon, the average forecast of the domestic analysts is 3.0% and that of the foreign analysts is 3.2%. For the one-year horizon, the range of the predictions remains greater within the group of foreign analysts (foreign: 2.8%–4.0%; domestic: 2.8%–3.6%). For the three-year horizon the reverse is true (foreign: 3.0%–3.5%; domestic: 2.5%–3.2%).

The main inflation factors and risks:

- Expansionary fiscal policy.
- Growth in prices of raw materials, most notably crude oil



| Prediction for Month of prediction | annual CPI | |
|------------------------------------|------------|-----|
| | 1 Y | 3 Y |
| V-01 | 4,3 | 3,6 |
| VI-01 | 4,6 | 3,8 |
| IX-01 | 4,8 | 3,6 |
| XII-01 | 3,9 | 3,6 |
| III-02 | 3,5 | 3,3 |
| IV-02 | 3,5 | 3,2 |
| V-02 | 3,3 | 3,1 |

2. Interest rates

| V-02 | 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 | |
| min. | 3,7 | 3,7 | 3,8 | 4,0 | | | 5,0 | 5,0 | 5,1 | 5,1 | 3,25 |
| average | 3,8 | 4,3 | 4,0 | 4,6 | 0,2 | 0,3 | 5,1 | 5,5 | 5,3 | 5,7 | 3,96 |
| max. | 3,8 | 4,8 | 4,1 | 5,1 | | | 5,2 | 6,0 | 5,5 | 6,2 | 4,50 |

The unexpected reduction of the CNB's key interest rates by 0.50% shifted short-term rates on the interbank deposit market downwards by a corresponding amount. The decline in long-term rates was around 0.20%. This passed through into the May predictions. The analysts expect that interest rates will remain low in the months ahead and that the tightening of CNB monetary policy will to a large extent follow the similar step by the ECB. The cooling of optimism regarding a fast recovery of the global economy shifted the expectations of an increase in rates by the Fed to August. An analogous step by the ECB is expected in Q4, although concerns are emerging on the market regarding a faster response by the ECB in connection with the inflation risks in the eurozone. On the other hand, there is only marginal mention of the possibility of further cuts in the CNB's rates, mainly in connection with any further rapid appreciation of the koruna.

The short-term and long-term domestic rates and yields expected at the one-month horizon correspond to their current market level.

The predictions for short-term rates at the one-year horizon reflect the expectations of a tightening of CNB monetary policy in this period. The 2W repo rate is expected to rise by 0.50% relative to its present level by May 2003.

The predictions for long-term koruna rates and yields at one year foresee an increase of around 0.4% compared with the present levels. Domestic bonds are expected to continue developing in line with such instruments in the eurozone.

The average predictions within the two groups of analysts differ only very slightly. Those of the domestic analysts for the one-year horizon are mostly around 0.1% higher than those of the foreign analysts.

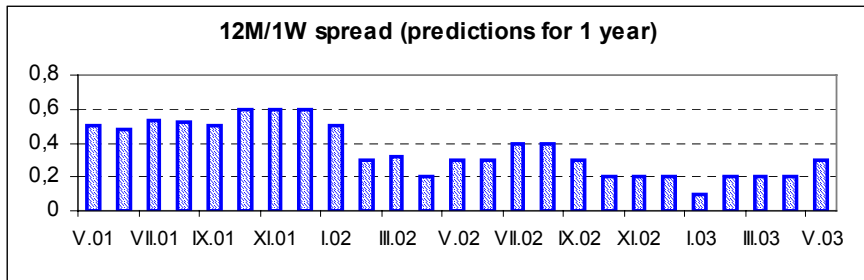
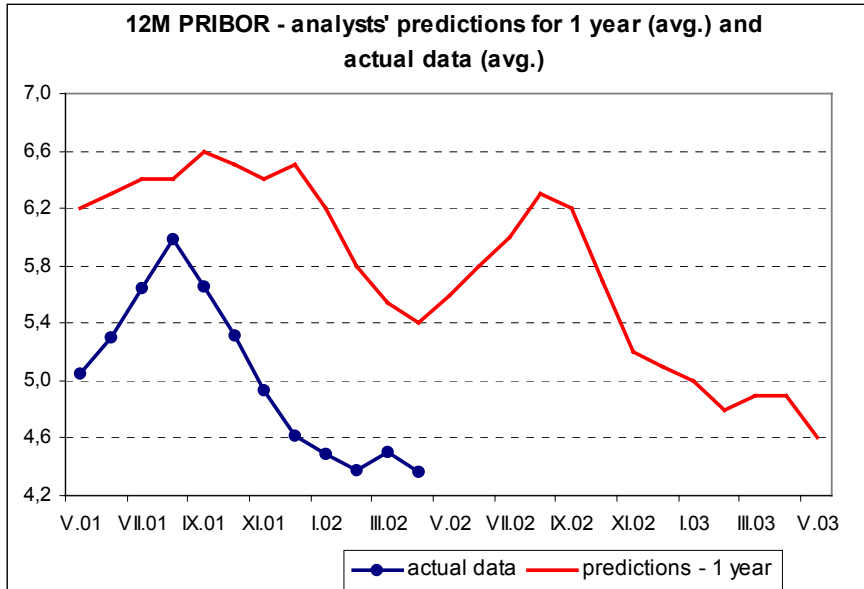
The values of the appropriate 2W repo rate setting again shifted downwards relative to the previous measurements, ranging between 3.25% and 4.5% (compared with 4.0% and 5.0% in April). The average of the responses is 3.96% (4.33% in April). The average for the group of domestic analysts is 4.11% (4.25% in April) and that for the foreign analysts is 3.79% (4.44% in April). The lower figure in the group of foreign analysts is linked with expectations of a more marked appreciation of the koruna by some of the analysts from this group.

| 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 |
| | % | | % | | % | | % | | % | |
| V-01 | 5,0 | 5,3 | 5,1 | 5,6 | 0,0 | 0,3 | 5,9 | 6,5 | | |
| VI-01 | 5,0 | 5,5 | 5,2 | 5,8 | 0,2 | 0,3 | 6,2 | 6,7 | 6,8 | 7,2 |
| IX-01 | 5,4 | 5,9 | 5,8 | 6,2 | 0,4 | 0,3 | 6,4 | 6,7 | 6,7 | 7,0 |
| XII-01 | 4,7 | 4,9 | 4,7 | 5,1 | 0,0 | 0,2 | 5,3 | 5,6 | 5,6 | 5,8 |
| III-02 | 4,3 | 4,6 | 4,5 | 4,9 | 0,2 | 0,2 | 5,3 | 5,7 | 5,5 | 5,9 |
| IV-02 | 4,2 | 4,6 | 4,4 | 4,9 | 0,2 | 0,2 | 5,3 | 5,7 | 5,5 | 5,9 |
| V-02 | 3,8 | 4,3 | 4,0 | 4,6 | 0,2 | 0,3 | 5,1 | 5,5 | 5,3 | 5,7 |

**/ expected yield of CR
6,40/10*

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 |
| 13.5.2002 | 3,8 | 4,04 | 0,24 | 5,05 | 5,3 | 3,96 |



3. Exchange rate

| | | |
|----------------|----------------|--------|
| | EUR/CZK | |
| V-02 | 1 month | 1 year |
| min. | 29,75 | 28,75 |
| average | 30,73 | 30,18 |
| max. | 31,75 | 32,00 |

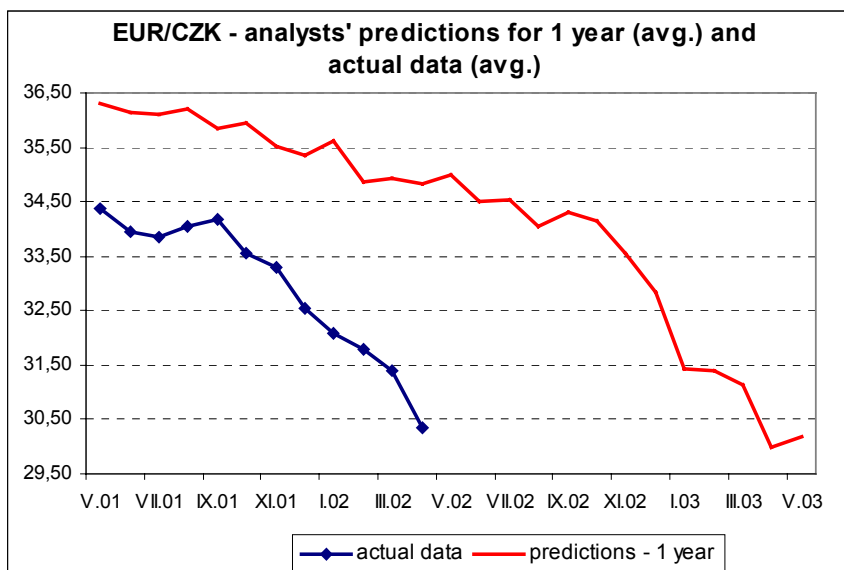
Following seven months of gradual decline, the expected CZK/EUR exchange rate in May increased both at the one-month horizon (which more or less copies the real market trend) and at the one-year

horizon. The average expectation at the one-month horizon is CZK 30.73/EUR (the fixing on 13 May was 30.630). For the one-year horizon, the average prediction is CZK 30.18/EUR.

At the one-month horizon the estimates of the two groups of analysts differ by 50 hellers (domestic: CZK 30.96/EUR on average; foreign: CZK 30.46/EUR on average). The domestic analysts consequently expect a short-term depreciation of the koruna, whereas the foreign analysts expect a continuing gradual appreciation.

For the one-year horizon the predictions are the same: both groups expect the exchange rate to be just below 30.20. The range of the estimates remains traditionally greater for the foreign analysts, especially at the one-year horizon, where their estimates vary between CZK 28.75/EUR and CZK 32.00/EUR (compared with CZK 29.40/EUR and CZK 32.00/EUR for the domestic analysts).

| | | |
|---|---|-------|
| Prediction for Month of prediction | exchange rate 1 month 1 year EUR/CZK | |
| | | |
| V-01 | 34,43 | 35,01 |
| VI-01 | 34,02 | 34,52 |
| IX-01 | 34,05 | 34,32 |
| XII-01 | 32,94 | 32,85 |
| III-02 | 31,62 | 31,15 |
| IV-02 | 30,49 | 29,98 |
| V-02 | 30,73 | 30,18 |



The surpassing of the CZK 30/EUR level during the course of April was followed by verbal and direct interventions by the CNB and a 0.50% reduction of the 2W repo rate. This helped the koruna to return to a level of around CZK 30.60/EUR.

The analysts associate the last unexpected lowering of the repo rate clearly with the CNB's effort to counter the excessive rate of appreciation of the domestic currency. They refer to the fact that the lowering of rates reduces the CNB's losses from interventions and from holding higher international reserves. Although the macroeconomic figures have yet to indicate a noticeable negative impact of the strong koruna on industrial businesses as a whole, the analysts do not expect a rapid recovery of the global economy and a major increase in demand for Czech goods. The export figures in the months ahead will therefore be anxiously awaited. The domestic analysts connect their expectations of a slight depreciation of the koruna at the one-month horizon with the CNB's threat of intervention, a possible rise in the USD/EUR exchange rate and the June elections. At the longer-term horizon, expectations of a continuing appreciation of the koruna prevail in both groups of analysts.

Prague, 16 May 2002