

Measuring financial market inflation expectations – results of the 29th measurement (September 2001)

As in the previous two months, the analysts' CPI predictions have increased slightly at the one-year horizon. Unlike in August, however, they have also increased at the three-year horizon. The analysts have decreased their estimates of the interest rate level relative to the last measurement. The estimates of the koruna's future exchange rate level have shifted slightly towards depreciation. FDI inflow remains the key factor for their predictions of the koruna's exchange rate. The public finance trend, wage growth and an acceleration in consumer demand continue to be the main inflationary risks.

1. Inflation

IX-01	annual CPI (%)	
	1 year	3 years
min.	4,0	2,8
average	4,8	3,6
max.	5,6	4,7

Although the CNB at the end of August increased its inflation forecast for the end of 2001, concerns about the impact on the Czech economy of the world economic slowdown together with the comments made by CNB representatives and the release of the August inflation figures are allaying concerns about a sharp tightening of monetary policy. The GDP figures for Q2 represent a significant piece of

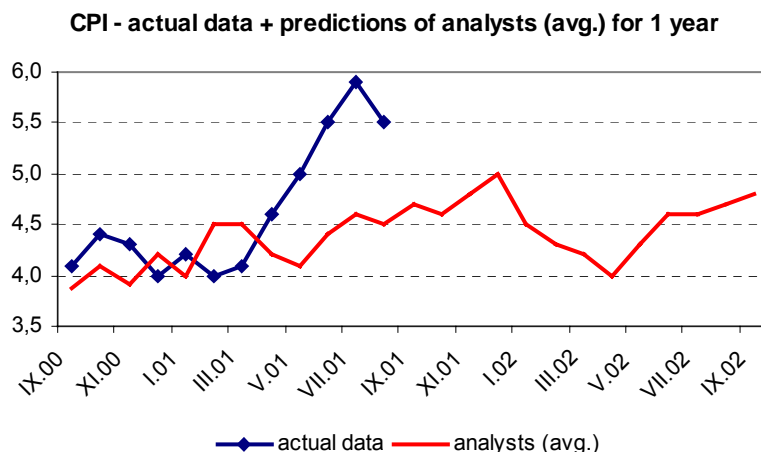
information clarifying the trend in consumer demand and to what extent it is necessary to fear demand-pull inflationary pressures. One question remains the impact of Tuesday's terrorist attack on the USA on the American and other world economies.

In September, the average CPI level expected at the one-year horizon is 4.8%. The analysts have increased their estimates at the three-year horizon to 3.6% (the increase of 0.1% compared with August at both time-horizons reflects in the short term a surprisingly large increase in prices of volatile items over past months, especially food prices, and in the longer run a strengthening of inflation risks). The analysts agree that the CNB will raise interest rates this year, in October or November, although most probably by only 0.25%. If we compare the two groups of analysts (domestic and foreign), the domestic agents remain more optimistic at the one-year horizon (the difference being 0.2%). The two groups' predictions at the three-year horizon are the same again this time.

The decline in inflation in August was due to falls in prices of food, clothing and footwear and in world prices of oil. In contrast, prices of package holidays abroad, water and medicines have increased. A stagnation or slight decline in inflation is expected in the months ahead. The risks going forward are fiscal developments, possible excessive wage demands due to rising inflation expectations, an acceleration in consumer demand and a strengthening of the euro against the dollar.

The main inflation factors and risks:

- Excessively relaxed fiscal policy
- Strengthening consumer demand
- Accelerating inflation expectations
- Rising wage demands



Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
IX-00	4,7	4,1
XII-00	5,0	4,0
III-01	4,2	3,4
VI-01	4,6	3,8
VII-01	4,6	3,6
VIII-01	4,7	3,5
IX-01	4,8	3,6

2. Interest rates

IX-01	1W PRIBOR (%)		12M PRIBOR (%)		12M/1W spread (%)		5Y IRS (%)		CR 6,40/10 yield	
	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year
min.	5,2	5,0	5,5	5,5			5,8	6,1	6,3	6,5
average	5,4	5,9	5,8	6,2	0,4	0,3	6,4	6,7	6,7	7,0
max.	5,7	6,3	6,2	6,5			6,9	7,3	7,0	7,5

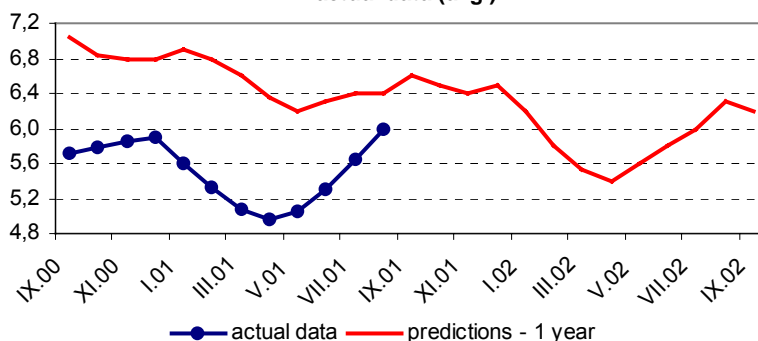
The economic pick-up, higher inflation, the widening budget deficit and new issues of government bonds are the main factors that can be expected to cause growth in the interest rate level and domestic bond yields.

However, in September the analysts corrected August's sharp rise in expected short-term and, in particular, long-term interest rates. The prediction of both short and long-term interest rates at the one-month horizon is very slightly above the current level and is down by 0.3%–0.5% at 1Y and longer maturities compared with the last measurement. Associated with this is a 0.3% decrease in the expected slope of the PRIBOR curve. The predicted slope of the 1W PRIBOR at the one-month horizon is the same as in August. At the one-year horizon, the correction of the August expectations is more moderate (a decline of 0.1%–0.4%). The average prediction for the 1W PRIBOR is 5.9%. However, the individual predictions vary significantly (with a spread of 1% in the case of the domestic analysts and of 1.3% in the case of the foreign analysts).

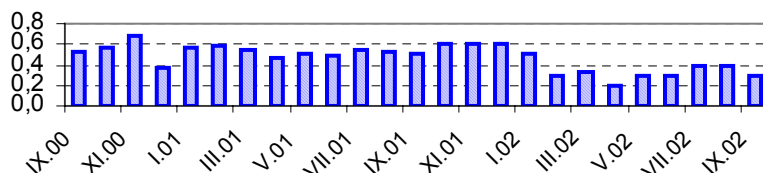
The market's opinion on changes in the CNB's interest rates (up to the end of the year) is relatively unified, although differences emerge in the longer term. The decrease in the long-term interest-rate prediction reflects expectations of a slowdown in economic growth. No signs of recovery in the USA are visible and the tragic events over the last few days provoke fears of a recession. The outlook for the eurozone is none too bright either, and an impact on the domestic economy is very likely. The yield on government bond SD 6.40/10 should, say the analysts, increase by 0.05% at the one-month horizon and by 0.35% at the one-year horizon compared with the current level. The average predictions for both short and long-term interest rates in September are virtually the same for both groups of analysts.

Prediction for Month of prediction	1W PRIBOR		12M PRIBOR		12M/1W spread		5Y IRS		CR 6,40/10 yield	
	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y
	%		%		%		%		%	
IX-00	5,3	6,0	5,8	6,6	0,5	0,5	6,9	7,5		
XII-00	5,3	5,9	5,9	6,5	0,6	0,6	7,1	7,4		
III-01	5,0	5,2	5,2	5,5	0,2	0,3	5,9	6,4		
VI-01	5,0	5,5	5,2	5,8	0,2	0,3	6,2	6,7		
VII-01	5,1	5,6	5,4	6,0	0,3	0,4	6,4	6,9	6,8	7,2
VIII-01	5,4	6,0	6,1	6,3	0,7	0,4	6,9	7,1	7,1	7,3
IX-01	5,4	5,9	5,8	6,2	0,4	0,3	6,4	6,7	6,7	7,0

12M PRIBOR - analysts' predictions for 1 year (avg.) and actual data (avg.)



12M/1W spread (predictions for 1 year)



3. The exchange rate

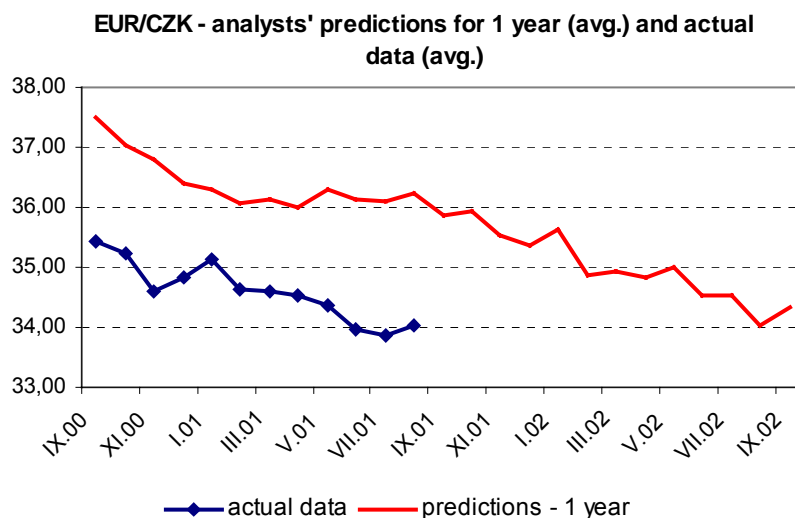
IX-01	EUR/CZK	
	1 month	1 year
min.	33,90	33,25
average	34,05	34,32
max.	34,25	35,25

Prediction for Month of prediction	exchange rate	
	1 month	1 year
EUR/CZK		
IX-00	35,36	35,86
XII-00	34,87	35,35
III-01	34,69	34,95
VI-01	34,02	34,52
VII-01	34,03	34,39
VIII-01	33,93	34,05
IX-01	34,05	34,32

The September predictions of the koruna's average exchange rate level also recorded a modest correction compared with August. Following a long period of an expected strengthening of the domestic currency (the last seven measurements) September saw a modest shift towards depreciation at the one-year horizon.

The average estimates for the koruna's exchange rate at the one-year horizon (34.05) are, with regard to the present level (34.15), clearly being affected by expectations of the payment for Komerční banka. The predictions for September next year lie within a relatively wide band; the average of 34.32 represents a weakening of 15 hellers from the present level.

The inflow of foreign direct investment speaks in favour of a strong koruna. The reasons given for a weakening of the koruna are the growing trade deficit, delays with privatisation, the threat of a makeshift budget arrangement and the strengthening of the euro against the dollar.



In the September measurement, the average predictions of the exchange rate level at both time horizons are virtually the same for both groups of analysts. At both horizons, the estimates of the group of foreign analysts have a slightly wider spread (of 15 hellers at the one-month horizon and of 50 hellers at the one-year horizon compared with the group of domestic analysts).

Prague 13 September 2001