

Measuring financial market inflation expectations – results of the 31st measurement (November 2001)

As in October, the analysts' CPI predictions have decreased at the one-year horizon and this time they have also slightly decreased at the three-year horizon. In this connection the analysts have also lowered their expected short-term and long-term interest rate levels. Although public finances and wage demands for next year remain risk factors, the inflation outlook for the Czech economy is improving. Compared with previous expectations the Czech Republic will probably be affected more strongly by the slowdown in the major world economies.

The predictions of the koruna's future exchange rate against the euro reflect the long-term appreciation trend. The assumptions of a continued strong domestic currency are again based primarily on an expected ongoing inflow of FDI.

1. Inflation

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

The analysts justify the decrease in their forecasts for annual CPI inflation with both internal and external factors. The October CPI figures confirmed a calming and unwinding of the seasonal step increases in consumer prices. The moderation in annual inflation in October was due mainly to a slowdown in food price inflation and an annual decline in fuel prices. The original assumptions that the

slowdown in economic growth in the USA and the sizeable cooling in Europe would not have a quick and too severe impact on the Czech economy are now proving to be over-optimistic, judging from the signs of a downturn in construction and industry. Expansionary fiscal policy and excessive wage growth are still considered inflation risks, although some analysts feel that given the present situation in the most advanced economies these risks are also decreasing. The Czech Republic should profit from the global decline in inflation. Falling oil prices, the expected price decline in the eurozone and the koruna's continuing appreciation are improving the inflation outlook for the Czech economy.

The average expectations of the CPI level at the one-year horizon fell from 4.4% in October to 4.0% in November. The estimates at the three-year horizon meanwhile dropped by 0.1% to 3.5%.

If we compare the two groups of analysts (domestic and foreign), the foreign analysts' forecasts are lower at both horizons, unlike in previous months. The difference is 0.1% at the one-year horizon and 0.2% at the three-year horizon.

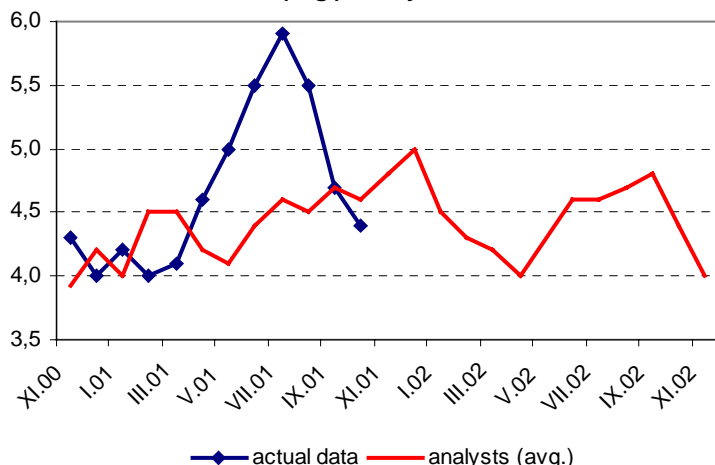
According to the analysts' comments, the domestic economy is starting to show signs of cooling. Consequently, they expect that the CNB might follow other central banks and lower rates by 0.25% by the year-end and again during the first half of next year.

The main inflation factors and risks:

Tab

- Expansionary fiscal policy
- Wage demands

CPI - actual data + predictions of analysts
(avg.) for 1 year



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

2. Interest rates

XI-01	1W PRIBOR (%)		12M PRIBOR (%)		12M/1W spread (%)		5Y IRS (%)		CR 6,55/11 yield	
	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year
min.	5,0	4,5	4,6	4,4			4,9	4,7	5,0	4,6
average	5,2	5,1	4,8	5,2	-0,3	0,2	5,2	5,7	5,3	5,9
max.	5,3	5,8	5,0	5,8			5,5	6,3	5,5	6,4

The continuing reductions in Fed and ECB rates and the economic situation in the USA and the eurozone, together with the domestic slowdown in construction and industry and the changes in the GDP and inflation forecasts of the CNB and other institutions, resulted in expectations of CNB rate cuts.

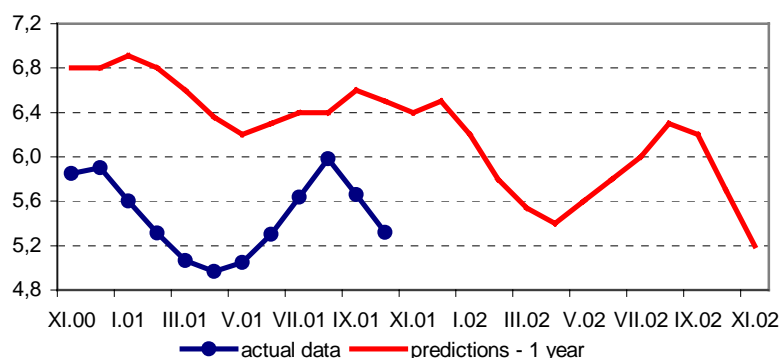
Consequently, the analysts lowered their forecasts of both short-term and long-term interest rates more radically in November than in September and October. The average predictions of the level of the monitored rates at the one-month horizon are virtually identical to the market level at the time the questionnaires were dispatched, when the longer PRIBOR and FRA rates reflected market expectations of a CNB rate cut of 50 basis points and when long-term rates and bond yields achieved historical lows. The predicted level of the 1W PRIBOR at the one-month horizon decreased by 0.1% compared with October. A more marked fall in the predictions (of 0.6%–0.9%) is again visible at 12M and longer maturities. The expected 12M/1W spread changed by 0.4% compared with the previous measurement and now stands at -0.3% (at the time the predictions were dispatched, the curve was downward-sloping with a spread of around -0.4%).

At the one-year horizon, the analysts lowered their predictions of the interest rate level by 0.5%–0.7% compared with the last measurement, the reduction being larger for long-term rates. Comparing the domestic and foreign analysts, we can see a marked difference, particularly for the forecasts of long-term rates and ten-year government bond yields, where foreign analysts expect levels 0.5%–0.6% lower than domestic analysts. This is due to the foreign analysts' more optimistic view of the CPI at both time horizons.

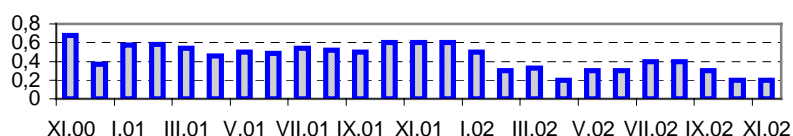
Prediction for Month of prediction	1W PRIBOR		12M PRIBOR		12M/1W spread		5Y IRS		CR 6,55/11 yield	
	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y
	%		%		%		%		%	
XI-00	5,3	5,9	5,8	6,4	0,5	0,6	7,1	7,4		
XII-00	5,3	5,9	5,9	6,5	0,6	0,6	7,1	7,4		
III-01	5,0	5,2	5,2	5,5	0,2	0,3	5,9	6,4		
VI-01	5,0	5,5	5,2	5,8	0,2	0,3	6,2	6,7	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
X-01	5,3	5,6	5,4	5,7	0,1	0,2	5,8	6,3	6,2	6,6
XI-01	5,2	5,1	4,8	5,2	-0,3	0,2	5,2	5,7	5,3	5,9

*/ In italics - expected yield of CR 6,40/1

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



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

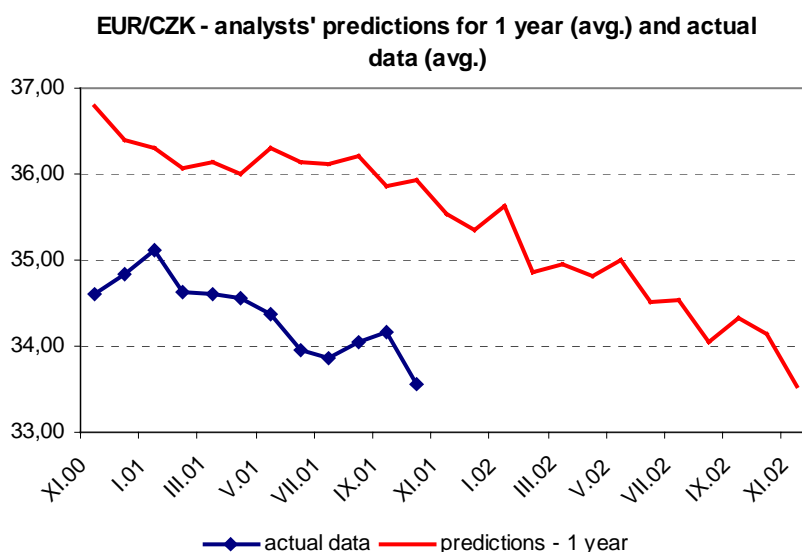


3. Exchange rate

XI-01	EUR/CZK	
	1 month	1 year
min.	33,00	32,86
average	33,52	33,54
max.	33,80	35,00

Prediction for Month of prediction	exchange rate 1 month 1 year EUR/CZK	
	1 month	1 year
XI-00	34,83	35,53
XII-00	34,87	35,35
III-01	34,69	34,95
VI-01	34,02	34,52
IX-01	34,05	34,32
X-01	33,78	34,13
XI-01	33,52	33,54

The predictions of the koruna's exchange rate reflect expectations of a continuing appreciation trend for the domestic currency. Compared with the October measurement the analysts predict a strengthening of about 25 hellers at the one-month horizon (CZK 33.52/EUR). This prediction, however, corresponds broadly with the koruna's exchange rate at the time the questionnaires were dispatched. The strong expectation of a continuing appreciation trend is quite obvious when looking at the longer horizon. The forecast average exchange rate of the domestic currency in one year is CZK 33.54/EUR, compared with the average estimate of CZK 34.12/EUR in October. The market opinion that the koruna will appreciate in the long run is also reflected by the present situation – at the end of October, following a CNB intervention against the strong koruna, the rate depreciated slightly from 33.200 to 33.800, but it returned to CZK 33.200/EUR within a fortnight. The predictions of a strong domestic currency are still based primarily on expectations of a continuing strong inflow of FDI. According to the analysts, the factors that might act against the koruna in the medium-term horizon include the widening deficit in public finances and weakening exports associated with the slowdown in economic growth in the eurozone.



In the October measurement, the average exchange rate predictions at the one-month horizon differ little between the individual groups (the domestic analysts predict CZK 33.57/EUR, whereas foreign analysts estimate CZK 33.47). At the one-year horizon, the average expectations of domestic and foreign analysts show bigger differences (CZK 33.36 and CZK 33.75 respectively). As in previous months, this difference is due to two foreign analysts with estimates at or just below 35.00. The foreign analysts' estimates thus again have a wider spread than those of the domestic analysts (of 60 hellers at the one-month horizon and of 50 hellers at the one-year horizon).

Prague, 14 November 2001