

## Measuring financial market inflation expectations – results of the 26<sup>th</sup> measurement (June 2001)

Following the higher-than-expected inflation outturns in April and May, analysts have again increased their estimates of consumer price inflation and have correspondingly adjusted their interest rate estimates modestly upwards. Their predictions of the koruna's exchange rate continue to be affected by FDI inflow. Public finances and the economic recovery remain pro-inflationary risks.

### 1. Inflation

VI-01	annual CPI (%)	
	1 year	3 years
min.	3,9	2,5
average	4,6	3,8
max.	5,5	5,0

***In view of the CNB's switch to targeting headline inflation as from 2002, we have discarded the net inflation prediction and in future measurements we will deal with the CPI forecast only.***

The higher-than-expected inflation figures for the second consecutive month led analysts to further increase their estimates at both the one-year and three-year horizons. The

May rise in the inflation figures was attributable mainly to higher food, fuel and holiday prices. The increases in the CPI estimates vary between 0.2% and 0.3%. The analysts expect a slower rate of price growth in the months ahead, but their predictions for the end of the year have increased to around 4.5%. Their average estimate for June 2002 is 4.6%. The case of BSE found in the Czech Republic is a new risk factor for food price inflation. Inflation is also being affected by the euro's depreciation against the dollar, the effects of the inflation in Western European countries on the domestic economy, rising consumer demand and, at the medium-term horizon, still also by public finances.

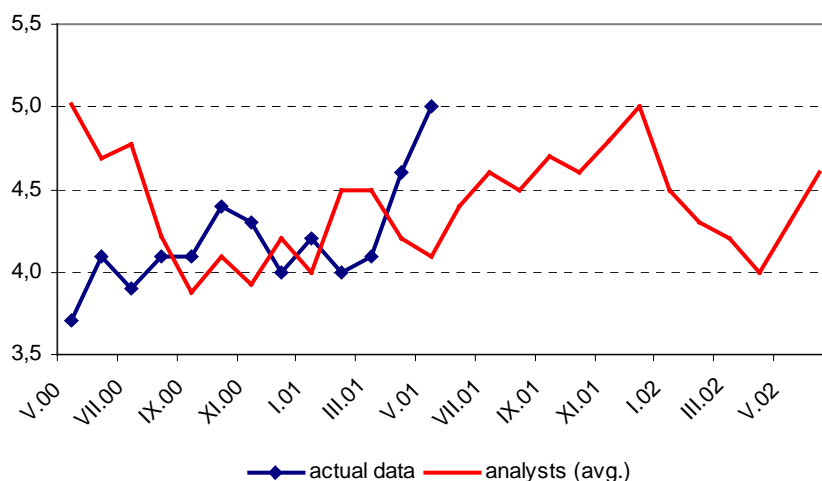
Comparing the two groups of analysts (domestic and foreign), the predictions of domestic agents are again more optimistic for the one-year horizon (where the difference is 0.4%; the predictions of the two groups at the three-year horizon are identical).

#### ***The main factors and risks which might affect inflation:***

- Public finances
- Food prices
- The euro's depreciation against the dollar

Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
VI-00	4,4	3,9
IX-00	4,7	4,1
XII-00	5,0	4,0
III-01	4,2	3,4
IV-01	4,0	3,4
V-01	4,3	3,6
VI-01	4,6	3,8

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



## 2. Interest rates

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

As in May, in line with the increase in inflation estimates, the analysts also increased their interest rate predictions. The current rate developments – faster growth at the longer end of the curve (1Y, 5Y) – also played a role, passing through into an increased curve slope (from flat to slightly positive). This reflects the moderate increase in inflation expectations. At the one-year horizon, the increase in rates should be around 0.5% at both the short and long (1Y, 5Y) ends of the curve (in May, the analysts had predicted lower growth at the short end). The slope of the curve at the one-year horizon should not change significantly compared with the current level.

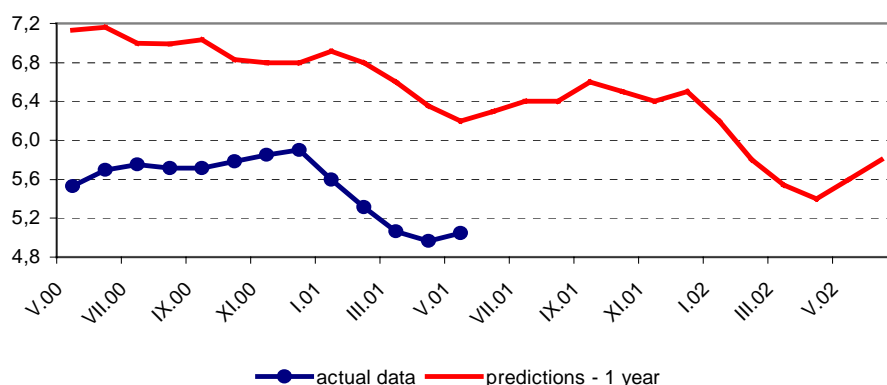
**Starting from June, so as to cover the long (10Y) end of the curve, the questionnaires also include the yield on the ten-year government bond (SD 6,40/10).** According to the analysts, the yield on this bond should also increase at the one-year horizon (by about 0.5%).

The analysts' comments are starting to reflect the reasons for the moderate raising of rates by the CNB owing to the slight increase in inflation expectations (food and fuel prices and the economic recovery) and to the trend in the fiscal area. Moreover, with respect to government bond yields, the expanding bond supply linked with the financing of the fiscal deficit is playing a role as well.

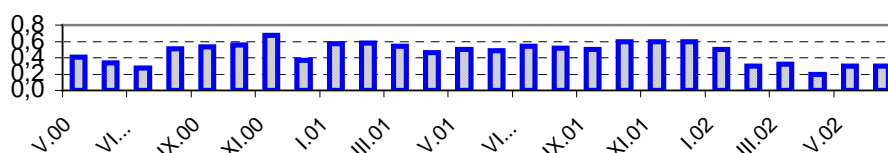
As in previous months, the forecasts of the individual groups of analysts differ negligibly (by 0.2% at the most). Both groups of analysts also expect the same curve slope (slightly positive).

Prediction for Month of prediction	1W PRIBOR		12M PRIBOR		12M/1W spread		5Y IRS	
	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y
	%		%		%		%	
VI-00	5,3	5,8	5,6	6,3	0,3	0,5	6,8	7,3
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
IV-01	5,0	5,2	5,0	5,4	0,0	0,2	5,8	6,2
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

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



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



### 3. The exchange rate

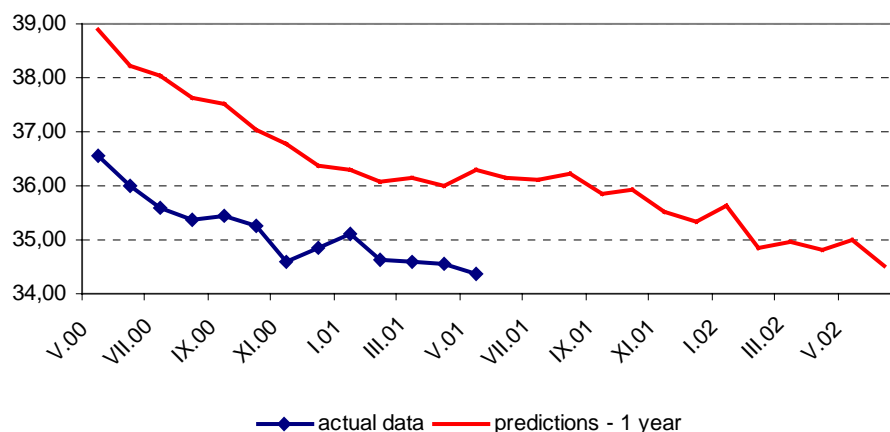
VI-01	EUR/CZK	
	1 month	1 year
min.	33,50	33,50
average	34,02	34,52
max.	34,30	35,50

Prediction for Month of prediction	exchange rate	
	1 month	1 year
EUR/CZK		
VI-00	36,23	36,14
IX-00	35,36	35,86
XII-00	34,87	35,35
III-01	34,69	34,95
IV-01	34,60	34,82
V-01	34,43	35,01
VI-01	34,02	34,52

Owing probably to the current appreciation of the koruna beyond 34.000 CZK/EUR, the analysts' estimates shifted toward appreciation of the domestic currency. The average estimates for the koruna's exchange rate at the one-year horizon reached 34.500 CZK/EUR, or just above it. Compared with the current level, then, the exchange rate should weaken by approximately 50 hellers. At the one-month horizon, the koruna should continue to move around 34.000 CZK/EUR, i.e. just above the current level.

FDI inflow remains a significant factor affecting the exchange rate. At the longer time horizon, however, the influence of the widening trade deficit is expected to predominate. The risk of a double deficit is being mentioned more and more often, too. Another reason for the koruna's weakening against the euro is the expected strengthening of the euro against the dollar compared with the current level.

**EUR/CZK - analysts' predictions for 1 year (avg.) and actual data (avg.)**



At the one-month horizon, unlike in the previous measurement, the predictions of the domestic analysts are moderately higher than those of the foreign analysts (by around 10 hellers). This is due to a low estimate from one of the foreign agents (33.500 CZK/EUR). At the one-year horizon, the average predictions of the two groups do not differ and are grouped closely around 34.500 CZK/EUR, although the difference between the minimum and maximum values of the individual predictions is CZK 2 (see the table).