

Measuring financial market inflation expectations – results of the 27th measurement (July 2001)

In comparison with the last measurement, the analysts have not changed their CPI prediction at the one-year horizon, but at the three-year horizon their prediction has decreased. The analysts have further increased their estimates of the interest rate level. Inflow of FDI continues to be a key factor for their predictions of the koruna's exchange rate. The main inflationary risks are food and fuel prices, seasonal factors, the double deficit and now also the risk of demand-pull inflationary pressures.

1. Inflation

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

As in the previous two months, the June growth in the CPI surpassed analysts' expectations, this time very considerably. However, the analysts' predictions in July were collected two days before the publishing of the inflation figures. We believe that, had the sending of estimates and publishing of CSO data been timed in the "standard" manner, the large CPI increase would probably have fed through into the long-term predictions. In July, the analysts left their estimates for

the one-year horizon unchanged at 4.6% and lowered their estimates at the three-year horizon by 0.2% to 3.6%.

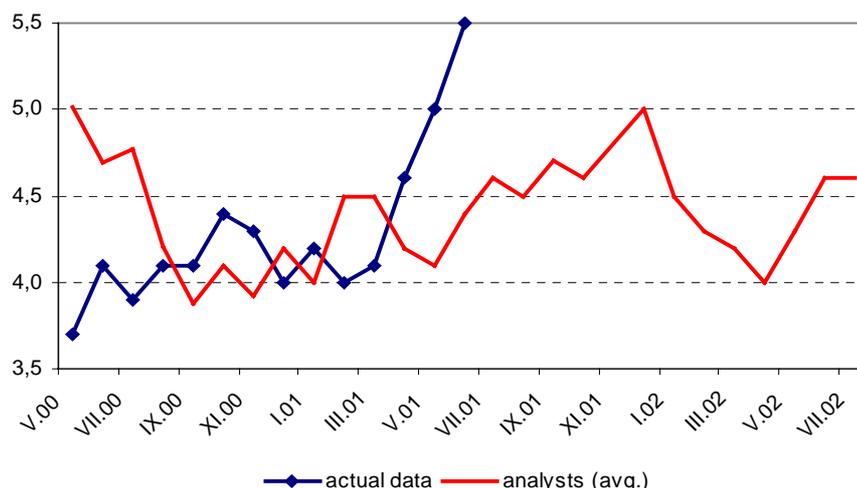
The June rise in inflation was caused mainly by higher meat and potato prices, rising fuel prices and higher holiday prices. The analysts' expectations have up to now tended towards a stabilisation, or even gradual lowering, of inflation (despite the expected deregulation of rent and gas prices in July). However, following the release of the June CPI figures, reactions of a contrary character have emerged indicating that the CNB's year-end inflation target (net inflation of 2%–4%, against the June outturn of 4.4%) and its CPI target for January 2002 (3%–5%, against 5.5% in June) may not be met and suggesting a possible continuing rise in inflation. Other pro-inflationary factors include the depreciation of the euro against the dollar, the rise in consumer demand (the GDP growth in Q1, when household consumption rose by 3.9%), the pick-up in wage growth, and developments in public finances and the balance of payments.

The main factors and risks which might affect inflation:

- Food prices
- Growth in the public finance and balance of payments deficits
- Depreciation of the euro against the dollar
- The risk of demand-pull inflationary pressures.

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
V-01	4,3	3,6
VI-01	4,6	3,8
VII-01	4,6	3,6

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



2. Interest rates

VII-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.	5,0	5,3	5,3	5,7			6,2	6,5	6,4	6,2
average	5,1	5,6	5,4	6,0	0,3	0,4	6,4	6,9	6,8	7,2
max.	5,3	5,8	5,5	6,4			6,4	7,3	7,1	7,8

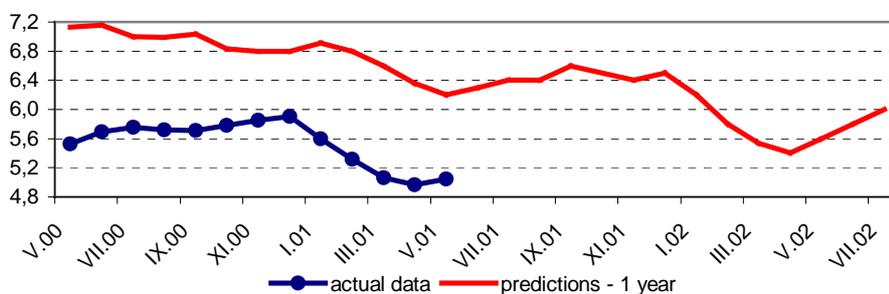
As in the previous two months, the analysts increased their interest rate predictions in July. In line with interest rate developments on the market, where the slope of the curve is rising thanks to a higher growth rate at longer maturities, there occurred a bigger shift in the estimates at longer maturities and a widening of the estimate for the PRIBOR curve spread. At the one-year horizon, the increase in rates relative to the current level should be around 0.5%–0.6% at both the short and long ends of the curve (1Y and 5Y). Compared with June, there is a clear expectation of faster growth at longer maturities (1Y and 5Y) and a related rise of 0.1% in the estimate of the 1Y–1W PRIBOR spread. As with the CPI, knowledge of the June inflation figures might effect the predictions for rates and for the yield on government bond SD 6,40/10, as the current rates on the market responded with a relatively buoyant rise at longer maturities, an increase in spread and a fall in bond prices. According to the analysts, the predicted yield on SD 6,40/10 at the one year-horizon should also increase (by approximately 0.3%).

Up until the publishing of the June inflation figures the analysts had been forecasting a slight rise in CNB rates at the close of the year (due to a modest rise in inflation expectations, the economic recovery and developments in the fiscal area). However, speculation is now emerging that the CNB will take this step significantly earlier. In addition to concerns of a tightening of monetary policy, yields on government bonds are being affected by the rising bond supply linked with the financing of the fiscal deficit.

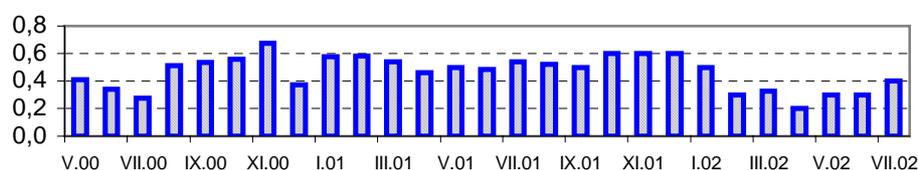
The predictions of the domestic analysts are approximately 0.1%–0.2% lower than those of the foreign analysts; the same also holds true for the curve slope.

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
	%		%		%		%		%	
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		
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
VII-01	5,1	5,6	5,4	6,0	0,3	0,4	6,4	6,9	6,8	7,2

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



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



3. The exchange rate

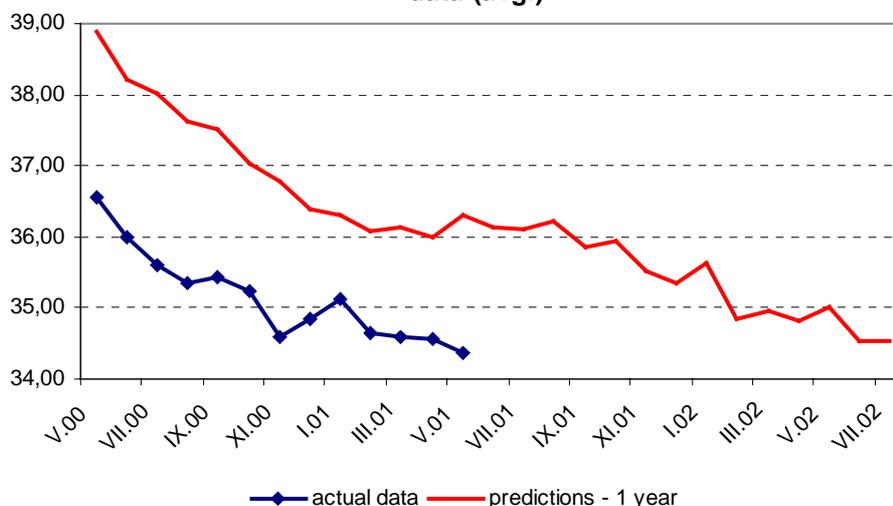
VII-01	EUR/CZK	
	1 month	1 year
min.	33,50	33,20
average	34,03	34,39
max.	34,50	35,50

Prediction for Month of prediction	exchange rate EUR/CZK	
	1 month	1 year
VI-00	36,23	36,14
IX-00	35,36	35,86
XII-00	34,87	35,35
III-01	34,69	34,95
V-01	34,43	35,01
VI-01	34,02	34,52
VII-01	34,03	34,39

The stabilisation of the koruna's exchange rate at around CZK 34.000/EUR continued to shift the analysts' estimates at the one-year horizon towards appreciation of the domestic currency. The average estimates for the koruna's exchange rate at the one-year horizon reached CZK 34.390/EUR, representing a forecast weakening of approximately 40 hellers from the present level. At the one-month horizon, the koruna should continue to move around CZK 34.000/EUR, i.e. essentially at the current level.

FDI inflow remains the determining factor for the exchange rate, since the euro's exchange rate against the dollar is not changing appreciably. At the longer time horizon, the expectations of certain weakening of the koruna from its present level are likely to continue, owing to the growing current account deficit. Another reason for a weakening of the koruna against the euro might be a strengthening of the euro against the dollar compared with the present level. However, given the current forecasts of economic developments in the eurozone and the USA, the likelihood of this scenario is low.

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



At the one-month horizon, as in the previous measurement, the predictions of the domestic analysts are modestly lower than those of the foreign analysts (by around 5 hellers). At the one-year horizon the average predictions of the foreign analysts are around CZK 34.250/EUR, whereas the predictions of the domestic analysts are just below CZK 34.600/EUR. In the case of the foreign analysts, the difference between the minimum and maximum values of their individual predictions is CZK 2.30. For domestic analysts the figure is CZK 1.40.