

## Measuring financial market inflation expectations – results of the 25<sup>th</sup> measurement (May 2001)

Following the higher inflation outturns in April, analysts have increased their estimates of CPI and net inflation and have correspondingly adjusted their rate estimates modestly upwards. The koruna's exchange rate continues to be affected by FDI. Public finances remain a pro-inflationary risk.

### 1. Inflation

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

The higher inflation figures in April, which were attributable mainly to food and fuel price inflation, led analysts to increase their estimates both for May 2002 and at the three-year horizon, despite the previous relatively favourable data. The increases in the estimates vary between 0.2% and 0.3% for both the CPI and net inflation indicators. According to most of the analysts, prices should not continue to rise so markedly. Their predictions for the end of the year vary around 4%, and their average estimate for May 2002 is 4.3%. Inflationary pressures should thus remain under control. However, some analysts are warning of likely further growth in food prices at least until May (among other things because of the linkage between food prices in the Czech Republic and developments in Germany; the rise in prices in Europe is connected with the cattle epidemic). The increase in food prices may then feed through into higher growth of headline consumer price inflation (food prices account for 20% of the consumer basket). Public finances also remain a pro-inflationary risk at the medium-term horizon.

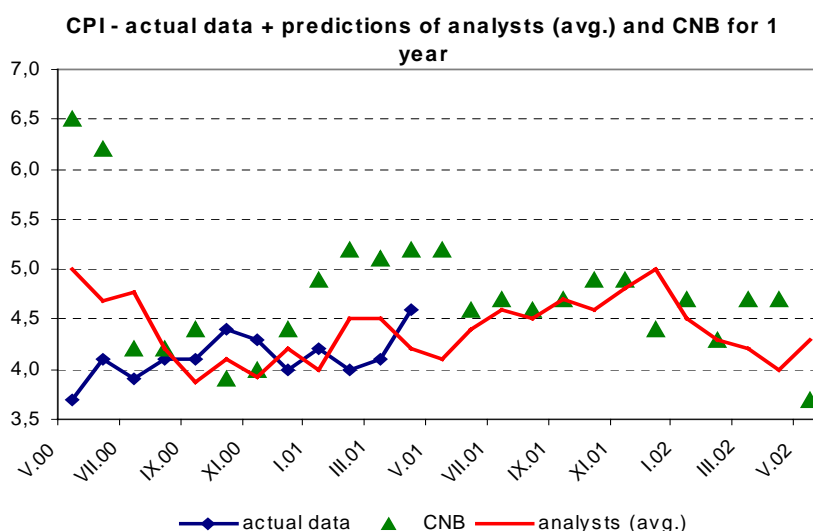
Compared with the CNB's estimates, the analysts' predictions for May are, unlike in previous months, substantially higher (by 0.6% for CPI inflation and by 0.4% for net inflation). This is due to a modest upward adjustment in analysts' predictions in line with the price developments in April, and conversely a considerable lowering of the CNB's predictions (see table).

Comparing the two groups of analysts (domestic and foreign), the predictions of domestic agents are again more optimistic for both indicators and at both horizons (the differences are 0.5%, and 0.2% respectively for CPI inflation and 0.6% and 0.3% respectively for net inflation).

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

- Public finances
- Food prices

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



## 2. Interest rates

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

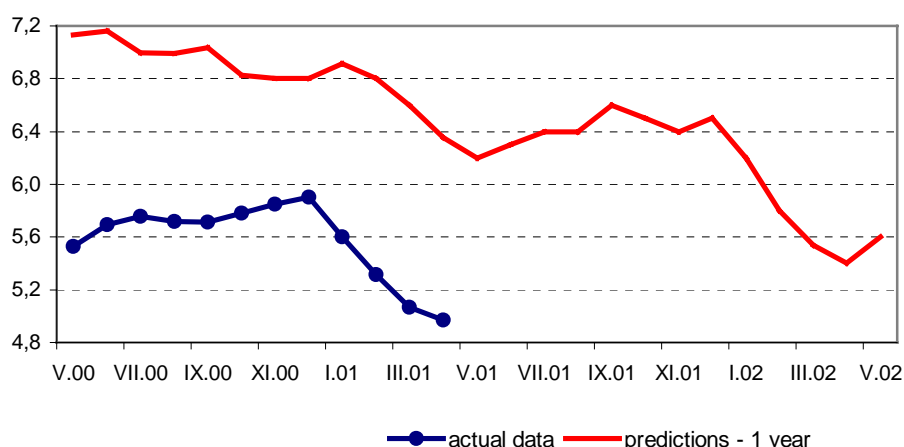
In line with the modest increase in inflation estimates, the analysts also increased their rate predictions (see table). Compared with the current level, though, rates should remain stable and the yield curve flat at the short-term horizon. At the one-year horizon, the increase in rates should be around 0.3% at the short end of the curve and up to 0.5% at longer maturities (1Y, 5Y). The yield curve slope should therefore modestly increase at the one-year horizon.

According to some analysts, the rise in rates is not attributable to inflationary pressures, which remain relatively subdued, but rather to the worsening trend in the fiscal area and partly also to the fact that rates are at historical lows. On the other hand, the risk of a slowdown in the world economy persists, so some of the analysts are not ruling out a modest lowering of rates.

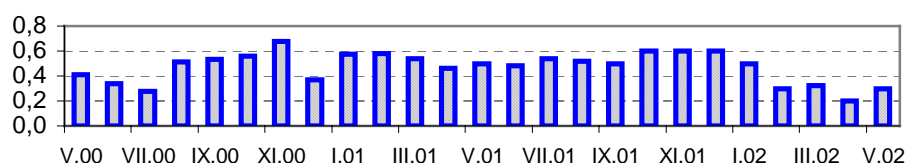
As in previous months, and in contrast to the inflation forecast, the forecasts of the individual groups of analysts differ negligibly (by no more than 0.1%). Both groups of analysts also expect the curve to be the same (modestly upward sloping for one year and flat in the near future).

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
	%		%		%		%	
V-00	5,3	5,7	5,5	6,2	0,2	0,5	6,6	7,0
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

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



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



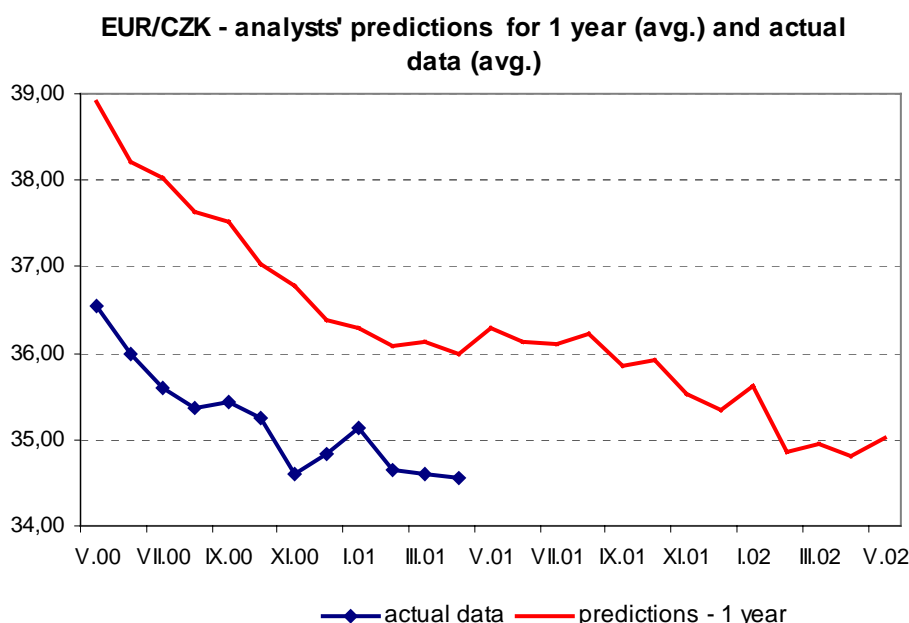
### 3. Exchange rate

V-01	EUR/CZK	
	1 month	1 year
min.	34,10	34,00
average	34,43	35,01
max.	34,75	36,00

Prediction for Month of prediction	exchange rate	
	1 month	1 year
EUR/CZK		
V-00	36,55	36,30
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

For the first time in several months, the analysts' average estimates for the koruna's exchange rate for one year reached 35.000 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, however, the koruna should continue to move around 34.400 CZK/EUR, i.e. at the current level.

FDI inflow remains a significant factor affecting the exchange rate, but according to some comments the analysts do not foresee further appreciation pressures on the exchange rate.



At the one-month horizon, unlike in previous month, the average predictions of the domestic analysts are moderately lower than those of the foreign analysts (by around 25 hellers). This is due, among other things, to a low estimate from one of the domestic agents (close to 34.000 CZK/EUR) and, conversely, to a higher estimate from one of the foreign analysts. At the one-year horizon, the average predictions of the two groups do not differ and are grouped closely around 35.000 CZK/EUR, although the difference between the minimum and maximum values of the individual predictions is CZK 2 (see table).

Prague, 16 May 2001