

Measuring financial market inflation expectations – results of the 28th measurement (August 2001)

The analysts' CPI prediction at the one-year horizon has increased slightly relative to the last measurement. At the three-year horizon, conversely, their prediction has decreased somewhat. The analysts have also raised their estimates of the interest rate level. FDI inflow remains the key factor for their predictions of the koruna's exchange rate. The main inflationary risks are an acceleration of inflation expectations, which may pass through into wage growth; the growing public finance deficit; the balance of payments trend; and the emergence of demand-pull inflationary pressures.

1. Inflation

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

The CNB's revision of its inflation forecast for the end of 2001 and 2002 and the higher-than-expected growth in inflation in July generated a further increase in the analysts' CPI prediction at the one-year horizon. In August, the average CPI level expected at the one-year horizon is 4.7% (an increase of 0.1% compared with July). The analysts reduced their estimates at the three-year horizon by a further 0.1% to 3.5%. The expectation is that the CNB's 0.25% hike in key rates in July was only the first step and

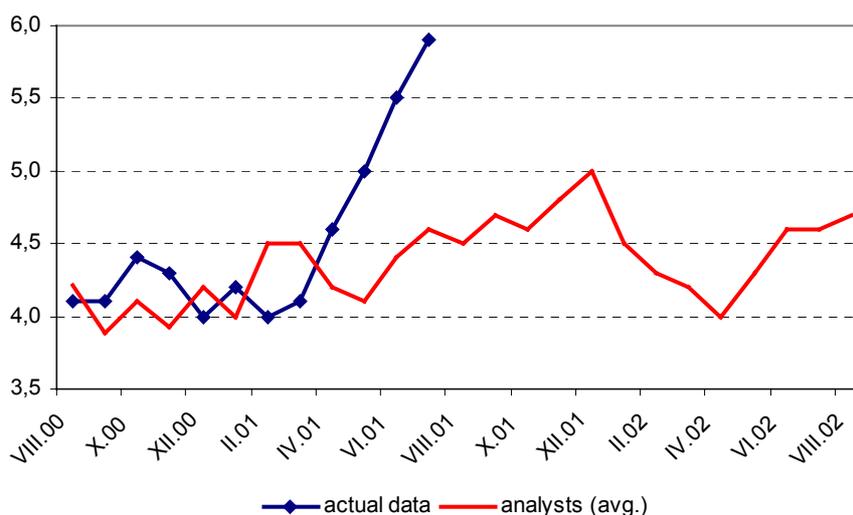
that a further tightening of monetary policy will follow within the foreseeable future. The continuing weakening of the eurozone economy and its expected impact on Central and Eastern European countries is cited by the analysts as the key factor preventing a more considerable tightening of monetary policy. The rise in inflation in July was chiefly due to growth in prices of package holidays abroad and to adjustments to regulated prices. This was offset by falls in prices of food and fuels and by seasonal discounts on clothing and footwear. A moderate rise in inflation is still expected in the months ahead, followed by a fall at the year-end. The risks going forward are as follows: the first signs of demand-pull inflationary pressures; the danger of an acceleration of inflation expectations and pass-through of those expectations into wage growth; and developments in public finances and the balance of payments. If we compare the two groups of analysts (domestic and foreign), the domestic agents are as usual rather more optimistic at the one-month horizon (the difference being 0.1%). The two groups' predictions are the same at the three-year horizon.

The main inflation factors and risks:

- Growth in the public finance and balance of payments deficits
- An acceleration of inflation expectations
- An acceleration of wage growth
- The risk of demand-pull inflationary pressures.

Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
VIII-00	4,5	4,1
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

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



2. Interest rates

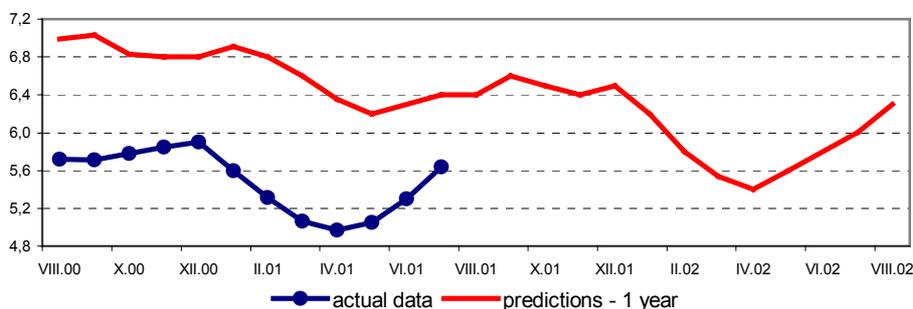
VIII-01	1W PRIBOR (%)		12M PRIBOR (%)		12M/1W spread (%)		5Y IRS (%)		CR 6,40/10 yield	
	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year
min.	5,3	5,5	5,5	5,8			6,8	6,7	6,9	6,8
average	5,4	6,0	6,1	6,3	0,7	0,4	6,9	7,1	7,1	7,3
max.	5,6	6,5	6,8	7,0			7,2	7,5	7,5	7,8

With inflation rising, the analysts are further increasing their expected level of both short-term and long-term interest rates. A further tightening of monetary policy by the CNB is now clearly present in the predictions (predicted 1W PRIBOR at the one-year horizon: 6.0%). Sizeable growth in the predictions is visible at the one-month horizon at all maturities, with the biggest rise recorded at 1Y maturity (compared with July, the 1Y was up by 0.7% and the others by 0.3%–0.5%). Associated with this is an expected major change in the slope of the PRIBOR curve, from 0.3% in July to 0.7% in August. The predicted values at the one-month horizon are virtually the same as the current market situation. At the one-year horizon, the biggest rise in rates relative to the current level should be at 1W maturity (with an increase of 0.7%). At longer maturities, the predictions vary between 0.2% and 0.4% higher than in July. The yield on government bond SD 6,40/10 should, say the analysts, also increase – by around 0.1% at the one-month horizon and 0.3% at the one-year horizon compared with the present level. The expected flattening of the yield curve at long maturities is linked with EMU convergence.

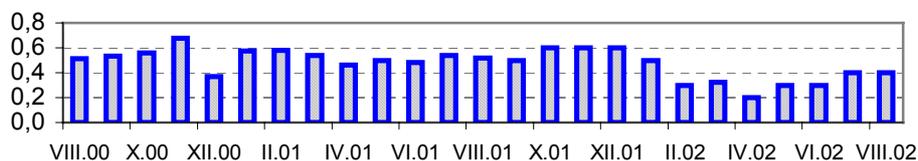
The predictions of the domestic analysts are for the most part around 0.1%–0.2% lower than those of the foreign analysts. The exception is the 1W PRIBOR level expected in one year, which is affected by a significantly higher estimate from one of the domestic analysts. In this connection, the expected 12M/1W spread at the one-month horizon is the same for both groups, but at the one-year horizon the domestic analysts' estimate is 0.2% higher.

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
	%		%		%		%		%	
VIII-00	5,3	5,9	5,7	6,4	0,5	0,5	7,1	7,4		
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	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
VIII-01	5,4	6,0	6,1	6,3	0,7	0,4	6,9	7,1	7,1	7,3

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



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



3. The exchange rate

VIII-01	EUR/CZK	
	1 month	1 year
min.	33,80	33,00
average	33,93	34,05
max.	34,25	35,25

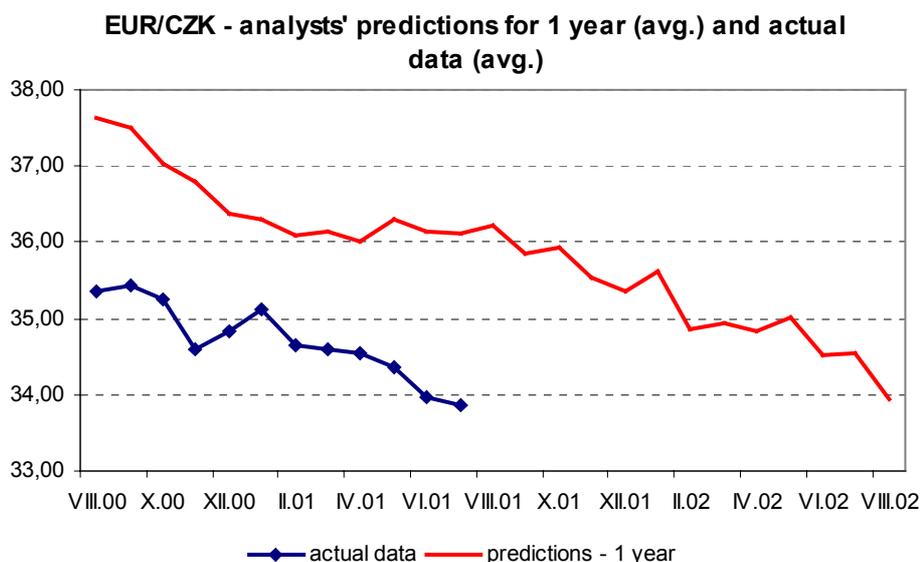
Prediction for Month of prediction	exchange rate EUR/CZK	
	1 month	1 year
VIII-00	35,39	36,22
IX-00	35,36	35,86
XII-00	34,87	35,35
III-01	34,69	34,95
VI-01	34,02	34,52
VII-01	34,03	34,39
VIII-01	33,93	34,05

The firming and stabilisation of the koruna's exchange rate to below CZK 34.000/EUR generated a further shift in the forecast koruna/euro rate towards appreciation of the koruna at the one-year horizon.

The average estimates for the koruna's exchange rate at the one-year horizon in the August measurement are just above CZK 34.000/EUR, which represents a forecast weakening of the Czech currency of only around 20 hellers from its present level. At the one-month horizon, the koruna should continue to move around CZK 33.900/EUR, i.e. essentially at the current level.

The analysts expect the inflow of foreign direct investment to be sufficiently large for the koruna to remain strong, despite lower-than-expected privatisation proceeds.

The possibility of a weakening of the koruna is mentioned in connection with the current account deficit and the imbalance in public finances.



At the one-month horizon, as in the previous measurements 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 August prediction of the foreign analysts is CZK 33.740/EUR, whereas the average in the group of domestic analysts is CZK 34.300/EUR. The difference between the minimum and maximum values of the individual predictions is CZK 2.25 in the case of the foreign analysts and CZK 1.50 in the case of the domestic analysts.