

Measuring financial market inflation expectations – results of the 33rd measurement (January 2002)

The January measurement saw a continuation of the trend of previous months, namely a decrease in the predictions for annual CPI inflation at the one-year horizon and this time also at the three-year horizon. The rates foreseen at the one-month horizon reflect analysts' expectations of a further moderate easing of CNB monetary policy. However, the difference in the levels at the one-year horizon is negligible, particularly in the case of long-term rates. This is due to the global economic recovery expected this year. The koruna's pronounced depreciation in December and the assumption of further steady appreciation have considerably shifted the CZK/EUR exchange rate predictions at both time horizons.

1. Inflation

I-02	annual CPI (%)	
	1 year	3 years
min.	3,0	2,5
average	3,8	3,4
max.	4,5	4,0

Compared with the previous month, the average estimate for annual CPI inflation was 0.1% down at the one-year horizon (3.8%) and 0.2% down at the three-year horizon (3.4%). According to the analysts' comments, the slackening of inflationary pressures is continuing, fostered by a similar trend abroad and by the strong appreciation of the koruna.

Prices are also falling in industry, where the economic slowdown and increasing competition are being felt most strongly. The situation on the labour market is also becoming more difficult.

The lower CPI and PPI have been strongly affected in recent months by the fall in oil prices. This was true again in December, when the decline resulting from falling fuel prices was offset in part by rising food and recreation prices.

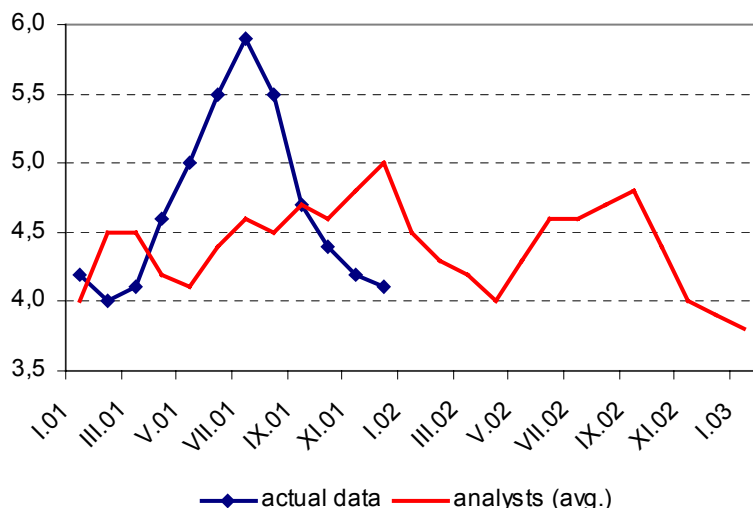
The CPI predictions are based on GDP growth of just above 3% in 2002 (owing to the global economic slowdown; on the other hand the trend to date gives no reason for pessimism – the positive effect of the foreign investment is now being felt and domestic demand has not so far been hit by the situation in the USA and eurozone) and on the assumption that the current oil price level will be maintained. Referring to the comments of the CNB Governor, Zdeněk Tůma, following the last Board meeting on monetary issues, the analysts expect the CNB to review its latest forecasts when discussing the quarterly Inflation Report towards the end of January.

A comparison of the two groups of analysts (domestic and foreign) reveals that, as in November and December, the foreign analysts' forecasts are lower at both horizons. The difference is 0.3% at the one-year horizon and 0.2% at the three-year horizon. The predictions within this group also show a greater range.

The main inflation factors and risks:

- Expansionary fiscal policy

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



Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
I-01	4,5	3,7
III-01	4,2	3,4
VI-01	4,6	3,8
IX-01	4,8	3,6
XI-01	4,0	3,5
XII-01	3,9	3,6
I-02	3,8	3,4

2. Interest rates

I-02	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.	4,5	4,5	4,3	4,4			5,0	5,0	5,0	5,1
average	4,6	4,8	4,5	5,0	-0,2	0,1	5,1	5,7	5,3	5,8
max.	4,8	5,3	4,7	5,5			5,2	6,4	5,8	6,8

The analysts believe that the decline in inflationary pressures is opening up more room for an easing of CNB monetary policy. Expectations prevail of a 0.25% reduction in key interest rates at the end of January and again during the course of 2002 H1. Owing to the expected recovery of the economy in the USA and subsequently in Europe in Q2 or Q3 this year, the analysts predict a further moderate increase in CNB rates at the end of this year or at the start of next year.

The predictions for short-term rates are based on the above expectations – see the following table.

The predictions for long-term rates at the one-month horizon correspond broadly with the market situation on the date the predictions were dispatched. The analysts do not see any room for a further decline. At the one-year horizon, the recovery in the world economy should bring about a rise in euro rates and also drive koruna yields upwards. The average estimate of the 5Y IRS level at the one-year horizon is modestly higher than in the last measurement, whereas the average estimate of the yield on government bond SD 6,55/11 remains unchanged.

The average predictions in the two groups of analysts differ minimally. A wider range in the predictions is again visible within the group of foreign analysts, particularly in the case of longer rates.

The CNB has introduced into its monitoring of market inflation expectations a question regarding each analyst's personal opinion of the repo rate setting that, at the time the prediction is dispatched, he or she would view as being consistent with both the current and expected development of the economy. The average of the individual answers is 4.6%. However, this figure is somewhat biased by the opinion of one of the foreign analysts (who cited 5.5%). The opinions of all the other analysts range between 4.25% and 4.75%, the average being 4.5%.

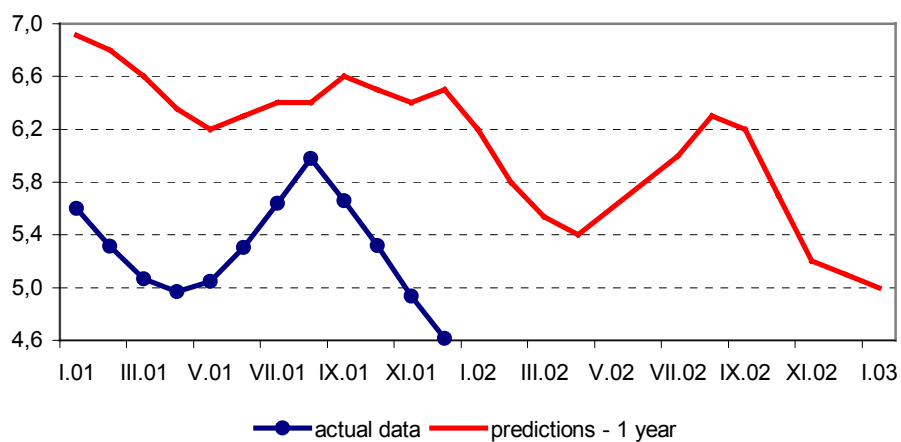
Prediction for Month of prediction	1W PRIBOR		12M PRIBOR		12M/1W spread		5Y IRS		CR 6,55/11 yield	
	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y
	%		%		%		%		%	
I-01	5,3	5,8	5,6	6,2	0,4	0,5	6,6	7,0		
III-01	5,0	5,2	5,2	5,5	0,2	0,3	5,9	6,4		
VI-01	5,0	5,5	5,2	5,8	0,2	0,3	6,2	6,7	6,8	7,2
IX-01	5,4	5,9	5,8	6,2	0,4	0,3	6,4	6,7	6,7	7,0
XI-01	5,2	5,1	4,8	5,2	-0,3	0,2	5,2	5,7	5,3	5,9
XII-01	4,7	4,9	4,7	5,1	0,0	0,2	5,3	5,6	5,6	5,8
I-02	4,6	4,8	4,5	5,0	-0,2	0,1	5,1	5,7	5,3	5,8

note: in blue - expected yield of CR 6,40/10

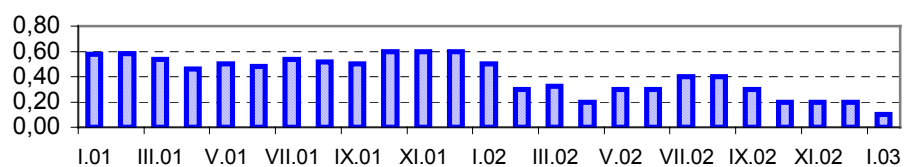
Actual values of indicators on the day of deadline for forecasts

	1T PRIBOR	12M PRIBOR	spread 2M/1T	5R IRS	výnos CR 6,55/11	analysts - avg. 2W repo rate
11.1.2002	4,79	4,49	-0,3	5,07	5,24	4,6

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



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



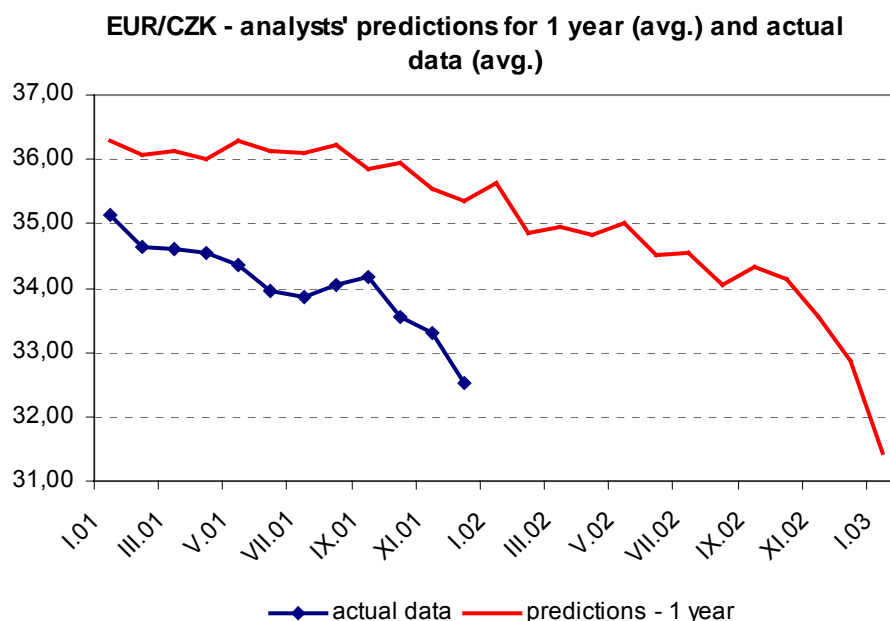
3. Exchange rate

I-02	EUR/CZK	
	1 month	1 year
min.	32,00	30,00
average	32,23	31,42
max.	32,50	33,00

Prediction for Month of prediction	exchange rate EUR/CZK	
	1 month	1 year
I-01	35,23	35,63
III-01	34,69	34,95
VI-01	34,02	34,52
IX-01	34,05	34,32
XI-01	33,52	33,54
XII-01	32,94	32,85
I-02	32,23	31,42

The strong appreciation of the koruna against the euro at the end of last year caused the analysts to review their predictions considerably. While the prediction at the one-month horizon as usual reflects the exchange rate current at the time the questionnaires were collected (around CZK 32.2/EUR), a shift in expectations is clearly visible in the forecasts for one year. The average forecast at the one-year horizon is CZK 31.42/EUR, a shift of approximately CZK 1.40 compared with the December measurement (CZK 32.85/EUR).

The joint resolution of the Government and the CNB to adopt measures to limit the effect of privatisation proceeds on the koruna's exchange rate helped to weaken the koruna from December's record level of around CZK 31.3/EUR back to CZK 32.0/EUR. Nevertheless, the analysts feel that early implementation of these joint measures may weaken the koruna only temporarily and will not stop its appreciation, as they believe that part of the privatisation proceeds would probably have to be exchanged on the market anyway. In addition, more large greenfield investments have been announced (Toyota and Peugeot being the biggest). Also playing a role is an assumption that the completion of the privatisation of the remaining state holdings will trigger an inflow of further capital.



In the medium term, the analysts view the deteriorating state of public finances as a risk factor for the koruna. According to their comments, another significant risk is the negative impact of the excessively strong currency on Czech exporters in conditions of declining foreign demand. A political risk – in the form of the elections scheduled for June of this year – is mentioned in passing.

The estimates at the one-month horizon do not differ very much with respect to group of analysts (domestic: CZK 32.32/EUR on average; foreign: CZK 32.10/EUR on average). At the one-year horizon the estimates differ more strongly (domestic: CZK 31.62/EUR; foreign: CZK 31.13/EUR). The foreign analysts' estimates of the CZK level at the one-year horizon in January again show a wider range (of CZK 3, compared with CZK 1.80 for the domestic analysts).

Prague, 16 January 2002