

## Measuring financial market inflation expectations – results of the 45<sup>th</sup> measurement (January 2003)

The January survey brought an increase in the expected CPI growth at the shorter time horizon, a moderation of the expectations of a further easing of CNB monetary policy at the end of January (which had been quite strong up until a few days before), and also a confirmation of a change in sentiment on the koruna market towards a weakening of the Czech currency.

**It should be said, however, that the questionnaires were gathered before the revised foreign trade figures for July–August 2002 were released. For this reason, the predictions for some indicators cannot be considered fully relevant to the present situation.**

### 1. Inflation

I-03	annual CPI (%)	
	1 year	3 years
min.	1,5	2,0
average	2,5	2,7
max.	3,2	3,4

The analysts' opinions on the ongoing low-inflation environment are little changed. They still expect that the January decrease in electricity prices and the postponement of deregulation will probably shift prices into deflation. The latest inflation figures slightly reduce the danger of such a scenario, but they do not rule it out. Oil price developments, however, bring a considerable degree of uncertainty into the predictions.

Oil prices should start growing in April owing to a change in excise duties and to the withdrawal of 10 and 20 heller coins from circulation. Around the middle of the year, agricultural producer prices can also be expected to show a gradual turnaround towards growth. In addition to food prices, this development should be attributable to prices of housing and non-tradable goods. That period, however, should see strengthening counter-pressure from a renewed nominal appreciation of the koruna, which should depress prices of tradables. The CPI should return to the CNB's target band roughly at the end of 2003.

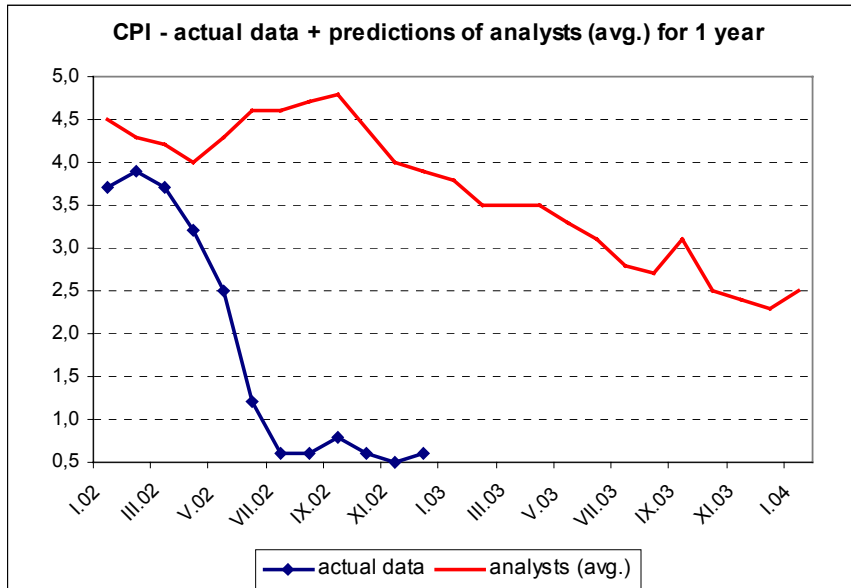
In the longer term, it can be expected that, given a gradual recovery of the global economy, growth in the Czech Republic will approach its potential and inflation will fluctuate above the level in the eurozone.

The average prediction for annual consumer price inflation at the one-year horizon slightly increased in January in both groups of analysts, although more so in the group of foreign analysts. The foreign analysts' average expectation increased from 2.0% in December to 2.1% in January. Their predictions range between 1.5% and 2.7%. By contrast, the average prediction of the domestic analysts increased from 2.5% to 2.7%, ranging between 2.3% and 3.2%.

The estimate of annual consumer price inflation at the three-year horizon fell slightly, to 2.7%. Unlike in the previous measurement, the foreign analysts shifted their average prediction slightly upwards (from 2.7% in December to 2.9% in January, the range of their estimates being 2.5%–3.4%) whereas the domestic analysts moved their average prediction slightly downwards (from 2.9% to 2.6%, the range being 2.0%–3.0%).

### The main inflation factors and risks:

- A jump increase in oil prices in the event of a US attack on Iraq.



Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
I-02	3,8	3,4
III-02	3,5	3,3
VI-02	3,1	3,0
IX-02	3,1	2,9
XI-02	2,4	2,8
XII-02	2,3	2,8
I-03	2,5	2,7

## 2. Interest rates

I-03	1W PRIBOR (%)		12M PRIBOR (%)		12M/1W spread (%)		5Y IRS (%)		CR 6,55/11 yield		analysts' opinion 2W repo rate
	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year	
min.	2,4	2,6	2,4	2,7			3,5	3,4	4,0	3,7	2,00
average	2,7	2,9	2,6	3,1	0,0	0,2	3,7	4,1	4,2	4,6	2,54
max.	2,8	3,1	2,9	3,6			4,0	4,5	4,4	5,0	2,75

The publication of the Minutes of the December Bank Board meeting on monetary issues – and to a lesser extent the Government's stalling on fiscal reform and the change in sentiment about the koruna – dampened speculation of further rate cuts by the CNB at the end of January. Nevertheless, some of the analysts believe that the CNB will reduce rates, although the expectations of this step are being pushed back to later months of this year. In the opinion of most analysts, the CNB would then tighten monetary policy again at the end of this year or the start of the next.

The predictions of short-term rates at the one-month horizon reflect the mixed opinions of the analysts regarding how the CNB will act at its January Board meeting on monetary issues. They therefore lie within a relatively wide range (2.4%–2.8% for the 1W PRIBOR and 2.4%–2.9% for the 1Y PRIBOR). The predictions for long-term rates in one month's time roughly correspond to the current situation on the market at the time of the survey.

The average predictions for short-term rates at the one-year horizon remained at their December levels. This means that the CNB is still expected to start a phase of rate increases towards the end of the year (1W PRIBOR – foreign analysts: average 2.8%, range 2.6%–3.0%; domestic: average 3.0%, range 2.8%–3.1%; 1Y PRIBOR – foreign: average 2.9%, range 2.7%–3.0%; domestic: average 3.2%, range 3.0%–3.6%). Long-term rates and bond yields will be affected by the speed and intensity of the economic recovery in the USA and the eurozone. The long end of the curve may be adversely affected by the high volume of issues this year and the potential weakening of the koruna. The average prediction for the five-year koruna swap at one year is down by 10 percentage points from December, while the average prediction for the ten-year government bond yield at one year remains unchanged (5Y IRS – foreign: average 3.9%, range 3.4%–4.3%; domestic: average 4.3%, range 4.0%–4.5%; CR

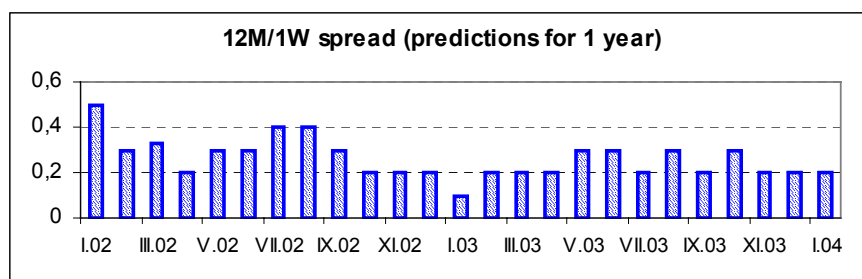
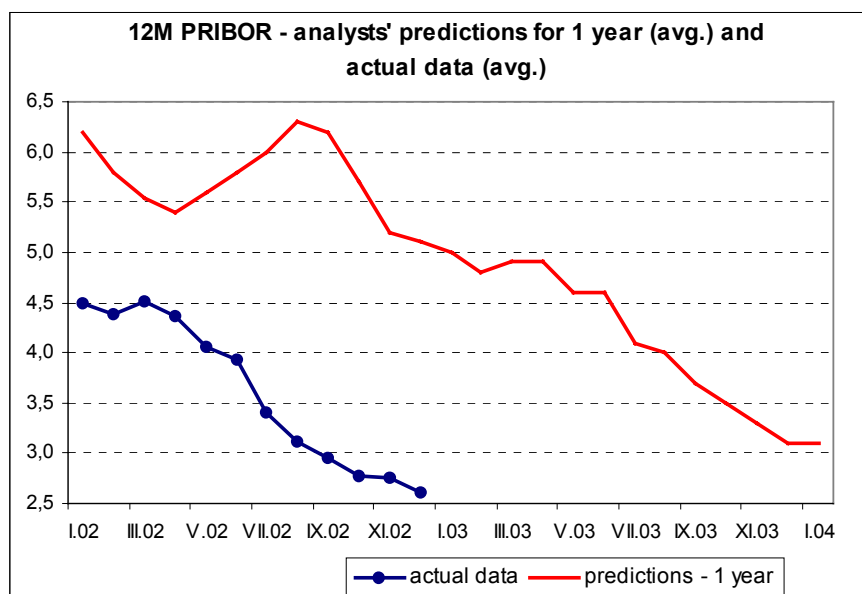
6.55/11 yield – foreign: average 4.3%, range 3.7%–4.6%; domestic: average 4.7%, range 4.4%–5.0%).

The average two-week repo rate setting deemed appropriate shifted from 2.48% in December to 2.54%. The group of domestic analysts is divided between the 2.50% and 2.75% levels (average within the group 2.63%, with four analysts favouring 2.50% and four analysts 2.75%), whereas the foreign analysts see a lower level as optimal, as they have for several consecutive months (average within the group 2.38%, range 2.00%–2.75%).

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-02	4,6	4,8	4,5	5,0	-0,2	0,1	5,1	5,7	5,3	5,8
III-02	4,3	4,6	4,5	4,9	0,2	0,2	5,3	5,7	5,5	5,9
VI-02	3,8	4,2	4,0	4,6	0,2	0,3	5,0	5,5	5,3	5,8
IX-02	2,9	3,5	3,0	3,7	0,0	0,2	3,9	4,6	4,6	5,2
XI-02	2,7	3,0	2,7	3,3	0,0	0,2	3,6	4,2	4,2	4,7
XII-02	2,6	2,9	2,6	3,1	0,0	0,2	3,6	4,2	4,2	4,6
I-03	2,7	2,9	2,6	3,1	0,0	0,2	3,7	4,1	4,2	4,6

**Actual values of indicators on the day of deadline for forecasts**

	1T PRIBOR	12M PRIBOR	spread 12M/1T	5R IRS	výnos CR 6,55/11	analysts - avg. 2W repo rate
10.1.2003	2,76	2,63	-0,13	3,68	4,16	2,54



### 3. Exchange rate

I-03	EUR/CZK	
	1 month	1 year
min.	31,30	29,00
average	31,67	30,28
max.	32,00	32,00

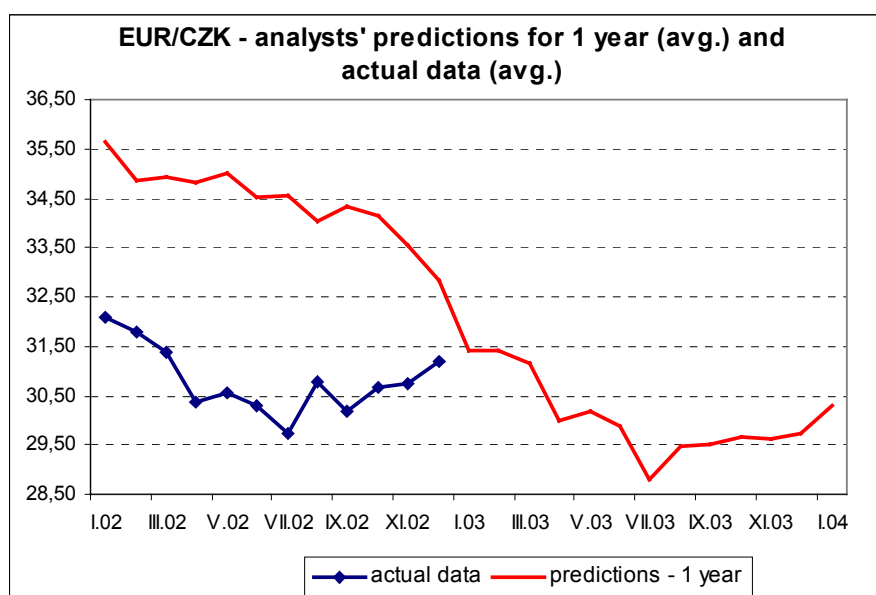
Exchange rate - fixing on the day of deadline for forecasts

10.1.2003	31,76
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Prediction for Month of prediction	exchange rate	
	1 month	1 year
EUR/CZK		
I-02	32,23	31,42
III-02	31,62	31,15
VI-02	30,64	29,90
IX-02	30,19	29,51
XI-02	30,63	29,64
XII-02	30,94	29,74
I-03	31,67	30,28

The prediction of the CZK/EUR rate at the one-month horizon is slightly below the current market rate recorded at the time of the survey. According to the analysts, the reasons for the current weakening are the weaker figures on Czech export performance, concerns about a fall in the inflow of non-privatisation FDI due to the weak performance of Western European economies, and also the low interest yield on koruna holdings. In the short term, the analysts expect the exchange rate to be stable, with a possible trend towards a further depreciation of the koruna.

The average estimate for the exchange rate at the one-month horizon is CZK 31.67/EUR. The foreign analysts are more pessimistic, with an average estimate of CZK 31.90/EUR (range: 31.80–32.00), whereas the average estimate of the domestic analysts is CZK 31.56/EUR (range: 31.30–31.80).



Turning to the long-term outlook, most analysts expect appreciation of the domestic currency, although the rate of appreciation should be much slower than it was last year. The koruna should return to a growth trajectory roughly in the middle of the year owing to the predicted economic recovery in Europe (which should lead to increased activity on the part of direct investors) and to the expected convergence towards the EU. The CNB's efforts to curb an excessive appreciation will have a long-term counter-effect on the koruna.

The average estimate for the exchange rate at the one-year horizon is CZK 30.28/EUR in January. The foreign analysts' estimate again remains the more pessimistic. Their average prediction for January 2004 is CZK 30.60/EUR (range: 29.70–31.20). The average in the group of domestic analysts is CZK 30.11/EUR (range: CZK 29.00–CZK 32.00).

Prague, 20 January 2002