

Measuring financial market inflation expectations – results of the 46th measurement (February 2003)

In the February survey, unlike in January, inflation expectations decreased at the one-year horizon and slightly increased at the medium-term horizon.

1. Inflation

II-03	annual CPI (%)	
	1 year	3 years
min.	1,5	2,3
average	2,4	2,8
max.	3,0	3,4

The main reasons for the low inflation expectations at the one-year horizon are – as regards domestic factors – stable food prices and the strong exchange rate and – and as for external factors – the weak economic development in Germany. Deregulated items, most notably gas, might be pro-inflationary this year. The analysts also mention rent prices and tax adjustments in this connection. Nevertheless, the analysts do not rule out deflation over the next few

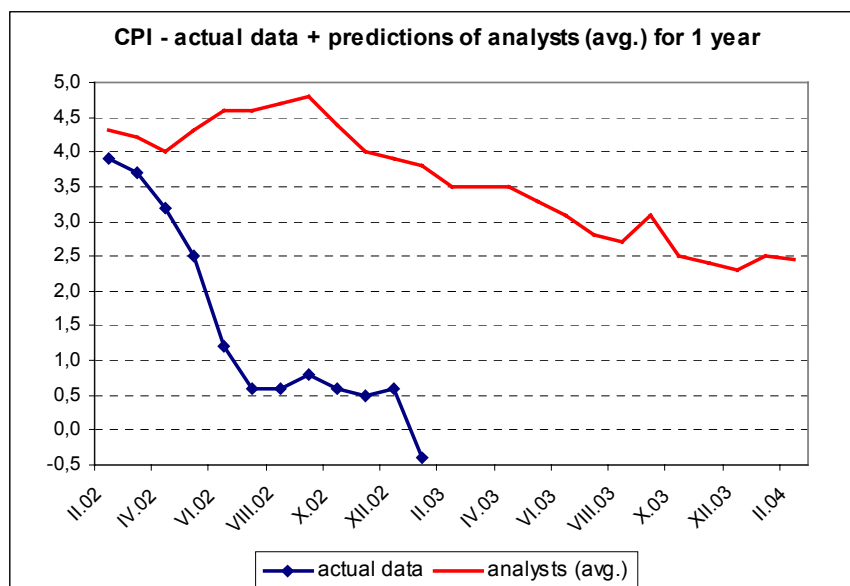
months. As usual, the foreign analysts were more optimistic than their domestic colleagues, expecting inflation of around 0.5% lower (figures of 2.2% and 2.6% respectively).

In the medium term, both groups of analysts expect very moderate inflation. This will depend on economic growth in Europe and on the exchange rate against the euro.

Turning to the differences in opinion within each group of analysts, the forecasts of the domestic analysts are much more homogeneous than those of the foreign analysts. The domestic analysts expect a shift at the one-year horizon within the range 2.5%–3.0% and at the three-year horizon within 2.3%–3.2%, whereas the ranges of the foreign analysts' predictions are 1.5%–2.7% and 2.5%–3.4% respectively.

The main inflation factors and risks

- A jump increase in oil prices in the event of a US attack on Iraq
- An unexpected fast recovery in Europe



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
XII-02	2,3	2,8
I-03	2,5	2,7
II-03	2,4	2,8

2. Interest rates

II-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.	2,3	2,5	2,2	2,6			3,2	2,8	3,8	3,5	2,00
average	2,5	2,8	2,6	3,2	0,3	0,5	3,5	4,1	4,1	4,6	2,46
max.	2,6	3,0	4,4	5,0			5,8	6,1	6,1	6,3	2,75

The analysts make a clear distinction between the short-term and longer-term horizons. In the short term, they expect a further decline in interest rates, due mainly to the disinflationary trend and the weak economic development abroad, especially in Europe. They do not rule out further rate cuts by the CNB, although only if the ECB does likewise.

At the one-year horizon, however, they expect some growth, particularly in long-term rates, depending on how the world economic recovery proceeds. If, as a result of this recovery, the Czech economy grows so that GDP approaches its potential, some analysts do not exclude a rate increase by the CNB.

At the one-month horizon, the market lowered its average prediction for the 1W PRIBOR by 20 basis points (range: 2.3%–2.55%) and that for the 12M PRIBOR by 5 basis points (range: 2.2%–3.0%, with just one foreign analyst predicting a level of 4.4%). The short-term prediction for the 1W rate roughly corresponds to the current level at the time of survey. The forecast level of long-term rates in one month's time are around 15 basis points lower than the market rates recorded at the time of the survey.

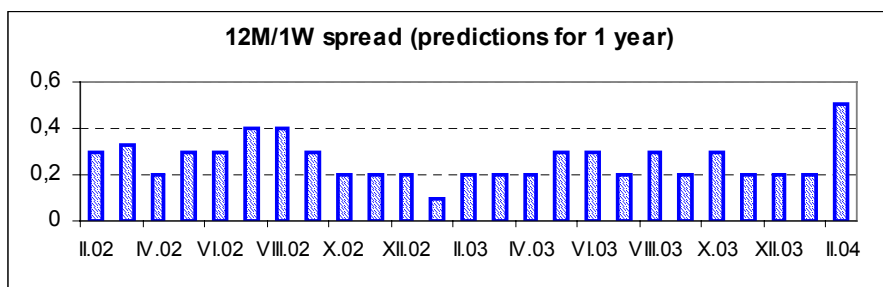
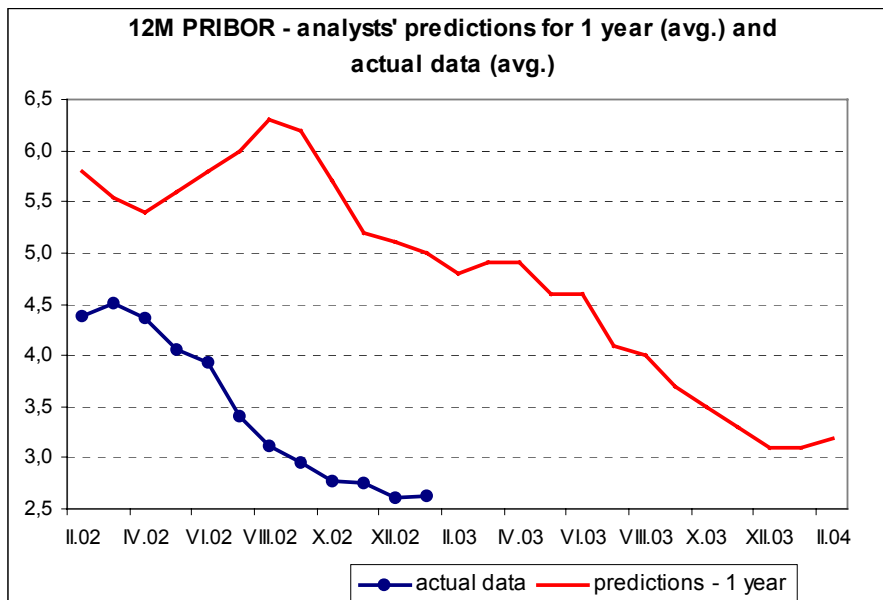
There were some changes in the average predictions for short-term rates at the one-year horizon in month-on-month comparison. Short rates – represented by the 1W PRIBOR – continued falling (1W PRIBOR – foreign analysts: average 2.8%, range: 2.6%–3.0%; domestic analysts: average 2.83%, range: 2.5%–3.0%; 1Y PRIBOR – foreign analysts: average 3.4%, range: 2.7%–5.0%; domestic analysts: average 3.1%, range: 2.6%–3.4%). Long-term rates and bond yields will continue to depend on the speed and intensity of the world economic recovery. The average prediction for the five-year koruna swap at one year remains at the January level (4.1%), as does that for the ten-year government bond yield at one year (4.6%). The figures are as follows: 5Y IRS – foreign analysts: average 4.1%, range 2.8%–6.1%; domestic analysts: average 4.1%, range: 3.8%–4.3%; CR 6.55/11 yield – foreign analysts: average 4.6%, range: 3.5%–6.3%; domestic analysts: average 4.6%, range 4.3%–5.0%.

The average “appropriate setting” of the two-week repo rate fell from 2.54% in January to 2.46%. The domestic analysts are still divided between the 2.50% level and the 2.75% level (average within the group: 2.57%, with five analysts favouring 2.5% and two preferring 2.75%). The foreign analysts continue to see a lower level as optimal (average within the group: 2.30%, range: 2.00%–2.50%).

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
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
II-03	2,5	2,8	2,6	3,2	0,3	0,5	3,5	4,1	4,1	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
10.2.2003	2,52	2,48	-0,04	3,38	3,92	2,46



3. Exchange rate

II-03	EUR/CZK	
	1 month	1 year
min.	31,43	29,50
average	31,74	30,56
max.	32,00	31,50

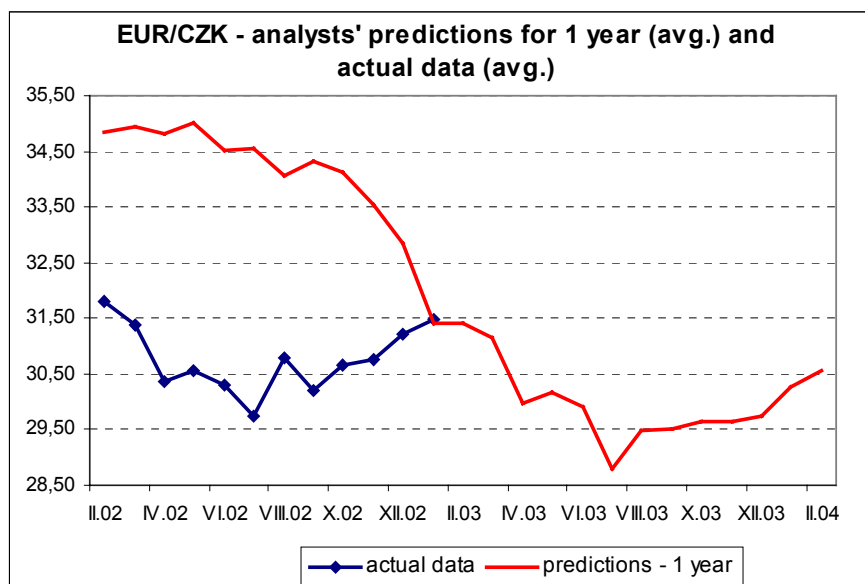
Exchange rate - fixing on the day of deadline for forecasts

10.2.2003	31,78
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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
XII-02	30,94	29,74
I-03	31,67	30,28
II-03	31,74	30,56

The EUR/CZK exchange rate expected at the one-month horizon is below the current market rates recorded at the time of survey. The analysts expect it either to stay at the current level or even to weaken towards EUR 32.00/CZK, although they do not foresee such a weakening lasting very long. However, if the world's economies do not show a recovery, the market does not expect any significant appreciation of the koruna.

The average expectation for the exchange rate at the one-month horizon is EUR 31.74/CZK. The foreign analysts are slightly more pessimistic, with an average estimate of EUR 31.81/CZK (range: 31.65–32.00). The average of the domestic analysts' expectations is EUR 31.69/CZK (range: 31.43–32.00).



Turning to the long-term outlook, optimism prevails on the market, with the majority of the analysts expecting the koruna to appreciate further (although the estimated nominal exchange rate is higher than in January this year and in December last year). The koruna is expected to start appreciating sometime in the second half of the year, when the economic recovery is expected to begin and when some analysts also expect the FDI inflow to pick up, owing to the Czech Republic's accession to the EU (the June referendum will be an important milestone).

The average estimate for the exchange rate at the one-year horizon is CZK 30.56/EUR. The foreign analysts' estimate is again the more pessimistic. Their average prediction for February 2004 is EUR 31.07/CZK (range: 30.15–31.50). The domestic analysts' average is CZK 30.20/EUR (range: 29.50–31.20).

Prague, 18 February 2003