

## Measuring financial market inflation expectations – Results of the 47<sup>th</sup> measurement (March 2003)

The March survey showed a stagnation of expectations. The analysts' data are only slightly different from February. The market's opinion has thus not changed over the past month.

### 1. Inflation

III-03	annual CPI (%)	
	1 year	3 years
min.	1,5	2,4
average	2,5	2,9
max.	3,5	3,4

The main reasons for the current trend, i.e. low inflation at the one-year horizon, are still expected stable food prices and the strengthening exchange rate of the koruna. The outlook surrounding price deregulations and energy prices is still unclear, primarily in connection with the Iraq crisis. The foreign analysts' are more optimistic in their outlook, while the domestic analysts reflect these concerns in their expectations much more significantly. This is also visible in the predictions, with foreign analysts expecting inflation of

2.1% at the short-term horizon, and domestic analysts being more sceptical (with expectations of 2.7%).

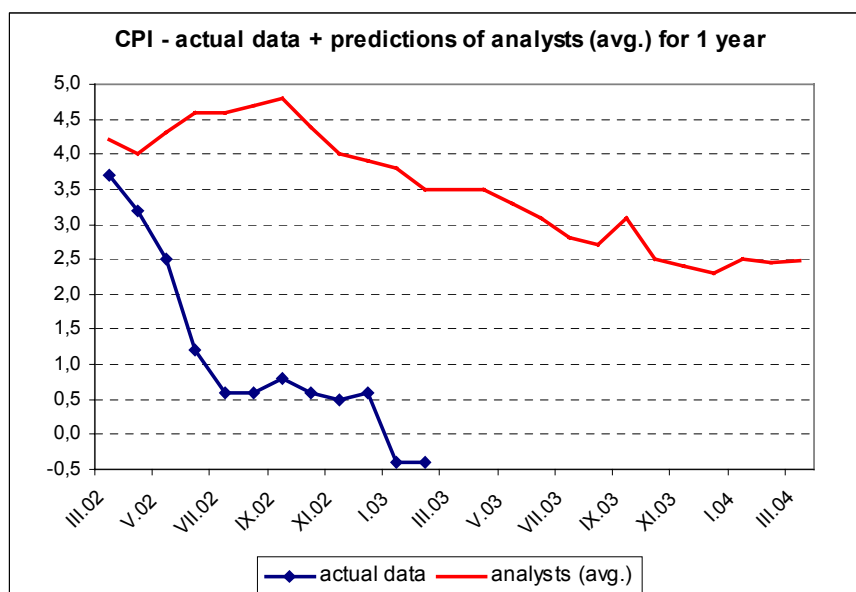
As regards the medium-term outlook, both groups are expecting a rise to 2.9%. A recovery of the world economy is still considered one of the determining factors at this horizon. A new important factor is the response of oil prices and their evolution after a potential attack on Iraq. In the analysts' opinion, this should, however, be partly offset by an expected appreciation of the exchange rate.

The opinions within each group remain mixed. The predictions of the domestic analysts range between 2.1% and 3.5% at the one-year horizon and between 2.4% and 3.2% at the three-year horizon, whereas the ranges of the foreign analysts' predictions are 2.1%–2.8% (ignoring one very optimistic prediction of 1.5%) and 2.5%–3.4% respectively.

#### The main inflation factors and risks:

- A step increase in oil prices in the event of a US attack on Iraq.
- Domestic price deregulation (gas, housing etc.).

Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
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
III-03	2,5	2,9



## 2. Interest rates

III-03	1W PRIBOR (%)		12M PRIBOR (%)		12M/1W spread (%)		5Y IRS (%)		CR 6,55/11 yield		analysts' opinion
	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year	2W repo rate
min.	2,0	2,3	2,2	2,3			2,7	2,5	3,5	3,3	2,00
average	2,4	2,7	2,3	2,9	-0,1	0,2	3,0	3,8	3,6	4,3	2,36
max.	2,5	3,0	2,4	3,4			3,2	4,3	3,8	5,0	2,75

Given the low inflation, the weak economic growth and the reductions in interest rates around the world, and in particular in the context of an expected further rate lowering by the ECB, the market is not ruling out further reductions in key rates by the CNB and subsequent falls in market rates. Potential conditions for rate increases – including within-potential GDP growth – are expected at a horizon beyond that of the survey, i.e. roughly in Q2 of next year.

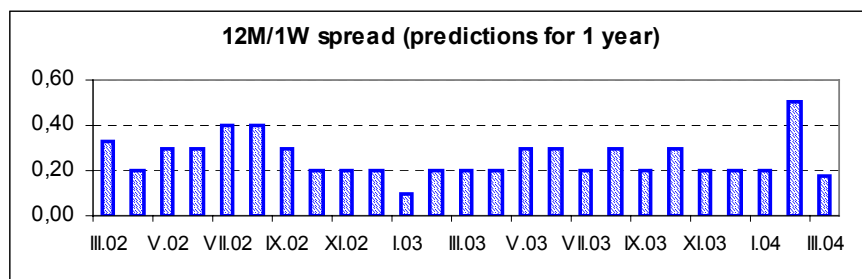
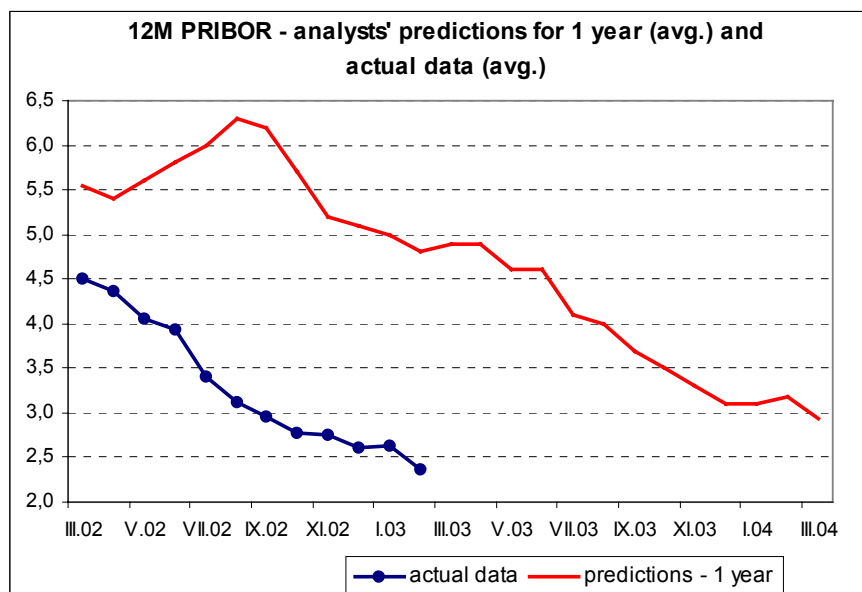
Given these expectations, all segments of the interest-rate, or yield, curve thus recorded a further downward shift in March, especially at longer maturities.

The predictions for the 1W PRIBOR at the one-month horizon thus decreased on average by 10 basis points (range: 2.0%–2.5%), the same as those for the 1Y PRIBOR (range: 2.2%–2.4%). The short-term prediction for the 1W rate is below the current market level and that for the 12M rate roughly corresponds to the current market level at the time of the survey. The respective predictions for rates in one year's time are about 20 basis points and 63 basis points higher than the rates recorded at the time of the survey.

The predictions of the individual groups at the short-term horizon show no great differences (1W PRIBOR – foreign analysts: average 2.3%, range 2.0%–2.5%; domestic: average 2.5%, range 2.3%–2.5%; 1Y PRIBOR – foreign: average 2.2%, range 2.2%–2.3%; domestic: average 2.2%, range 2.2%–2.4%), whereas at the longer-term horizon the foreign analysts' forecasts are about 0.5% lower. The average prediction for the five-year koruna swap at one year shifted downwards to 3.8%, as did the average prediction for the ten-year government bond yield at one year, to 4.3% (5Y IRS – foreign: average 3.4%, range 2.5%–3.8%; domestic: average 4.0%, range 3.5%–4.3%; CR 6.55/11 yield – foreign: average 3.9%, range 3.3%–4.2%; domestic: average 4.5%, range 4.0%–5.0%).

The average “appropriate setting” of the two-week repo rate showed a further significant decrease, from 2.46% in February to 2.36% in March. The domestic analysts are more or less equally divided between the 2.25% and 2.75% levels (average within the group 2.43%), whereas the foreign analysts still see a lower level as optimal (average within the group 2.25%: the range is 2.00%–2.50%, but the majority of the analysts are around the average).

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
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
III-03	2,4	2,7	2,3	2,9	-0,1	0,2	3,0	3,8	3,6	4,3



### 3. Exchange rate

III-03	EUR/CZK	
	1 month	1 year
min.	31,40	30,00
average	31,74	30,70
max.	32,10	32,00

Prediction for Month of prediction	exchange rate EUR/CZK	
	1 month	1 year
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
III-03	31,74	30,70

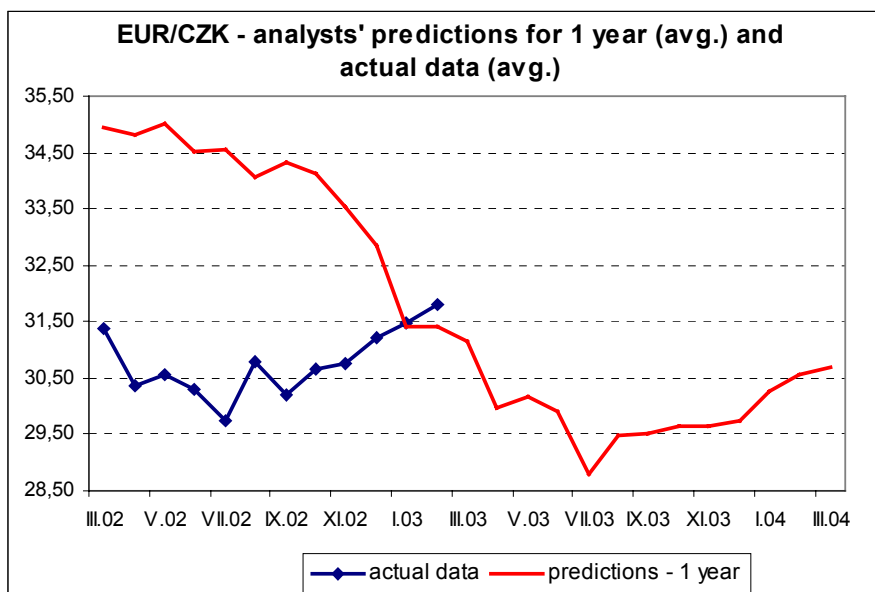
Exchange rate - fixing on the day of deadline for forecasts

11.3.2003	31,78
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Most analysts expect a stable CZK/EUR rate at the one-month horizon, with no clear trend. Given the absence of any impulses, the exchange rate will oscillate around the current level looking for somewhere to go.

The average expectation for the exchange rate at the one-month horizon is CZK 31.74/EUR, showing no marked difference between the groups of analysts. The foreign analysts' estimate is CZK

31.78/EUR (range: 31.50–32.00), whereas the average estimate of the domestic analysts is CZK 31.71/EUR (range: 31.40–32.10).



Turning to the long-term outlook, most analysts are more optimistic, still expecting economic recovery and higher FDI inflow in connection with the Czech Republic's accession to the EU. However, the opinion is far from undivided. Some analysts no longer foresee a substantial appreciation, expecting a decline in interest in the Czech currency once the interest rate differential between the koruna and the euro is eliminated. However, most analysts are still optimistic.

The average estimate for the exchange rate at the one-year horizon is CZK 30.70/EUR. There is a great difference, however, between the expectations of the foreign and domestic analysts: appreciation expectations tend to be the internal opinion, while the foreign analysts are much more pessimistic. The average prediction of the foreign analysts for March 2004 is CZK 31.20/EUR (range: 30.11–32.00). The domestic analysts' average is CZK 30.41/EUR (range: 30.00–31.20).

Prague, 17 March 2003