

Measuring financial market inflation expectations – Results of the 49th measurement (May 2003)

In the May survey, the predictions for inflation increased appreciably at the shorter-term horizon. On the other hand, the expected interest rate levels and the predictions for the koruna exchange rate remained largely unchanged.

1. Inflation

IV-03	annual CPI (%)	
	1 year	3 years
min.	2,0	2,0
average	3,7	2,8
max.	4,9	3,4

The analysts raised their inflation forecasts at the one-year horizon in line with an analogous move made by the CNB. This was due in particular to a forecast turnaround in the food price trend and an expected change to certain taxes prior to the Czech Republic's accession to the EU. However, not all the analysts share this view – some of them consider the CNB's forecast too pessimistic. They expect a less drastic tax increase, a limited secondary impact of that increase on prices (owing to

the persisting output gap), and also continuing global deflationary pressures. In both groups of analysts (domestic and foreign) there was a sizeable upward shift in the predicted consumer price index, although the increase was larger among the domestic analysts.

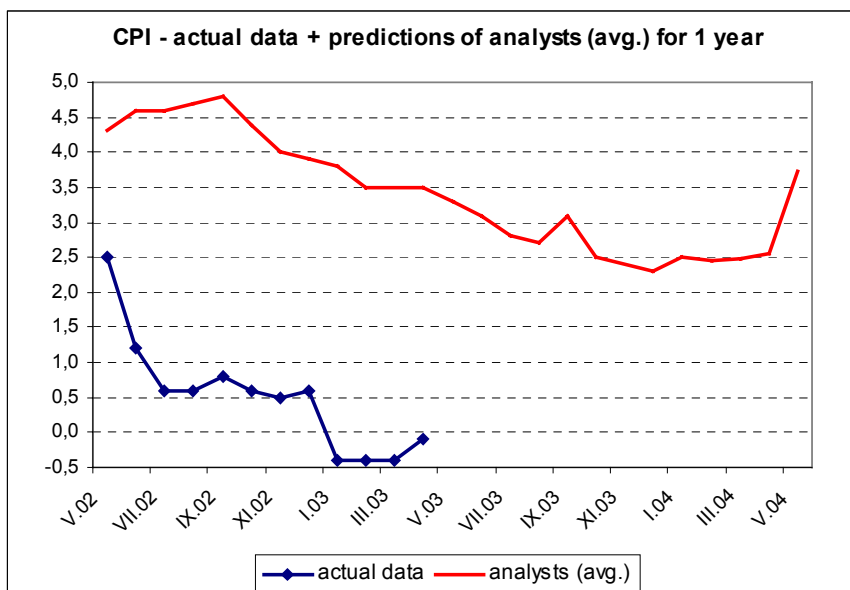
According to the analysts' forecasts, average expected annual CPI inflation in May 2004 should be around 3.7%, with domestic analysts expecting a slightly higher figure (domestic analysts: average 3.9%, range 2.5%–4.9%; foreign analysts: average 3.4%, range 2.0%–4.2%).

Turning to the medium-term outlook, the average prediction for the CPI is 2.8% (compared to 2.7% in April). In May, the difference in opinions between the two groups of analysts widened somewhat: the foreign analysts decreased their prediction, while the domestic analysts adjusted their estimate slightly upwards. As in recent months, the range of the estimates at this longer horizon remains much narrower than for the one-year forecast (domestic analysts: average 2.9%, range 2.5%–3.2%; foreign analysts: average 2.6%, range 2.0%–3.4%). The intensity of the forecast world economic recovery still remains the determining factor at this horizon.

The main inflation factors and risks:

- Food prices
- Increases in certain taxes
- Deregulation of prices (gas, rents, electricity)

Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
V-02	3,3	3,1
VI-02	3,1	3,0
IX-02	3,1	2,9
XII-02	2,3	2,8
III-03	2,5	2,9
IV-03	2,6	2,7
V-03	3,7	2,8



2. Interest rates

IV-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	2,1	2,3	2,4			3,0	2,5	3,6	3,4	2,00
average	2,4	2,7	2,4	3,0	0,0	0,2	3,3	3,8	3,8	4,3	2,36
max.	2,5	3,0	2,5	3,5			3,5	4,3	4,0	5,0	2,75

The predictions for both short-term and long-term rates remained virtually unchanged. The analysts still characterise the inflation outlook as positive, as the CNB can apply its escape clauses to the expected rise in inflation caused by the tax changes and hence will not have to increase its rates. In their opinion, the CNB's chief concern is pass-through of this inflation growth into inflation expectations, which would further accelerate the rise in consumer prices. Most of the respondents believe that a fairly long period of interest rate stability can now be expected, followed by a rise next year. However, given the weakness of the global economy some analysts still see some room for a further decrease in CNB rates. This opinion is more prevalent among the foreign analysts. Long-term rates and bond yields should take their lead from German bond prices. The negative spread should decrease or even disappear, depending on how the ECB's interest rates stabilise below those of the CNB.

The predicted level of short-term rates at the one-month horizon in May remains 10 basis points below their current market level. The predictions of long-term rates and yields at one month are meanwhile virtually identical to the current market level at the time of the survey. The forecasts of the two groups are very close to each other and the prediction range is relatively narrow.

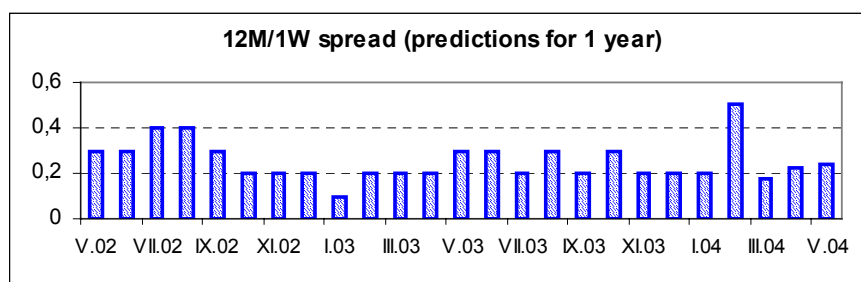
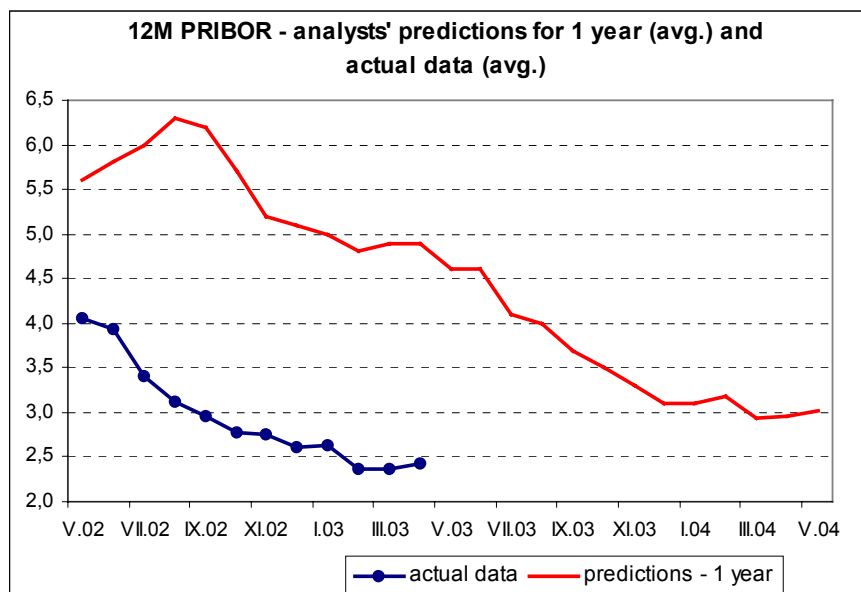
In May 2004, the analysts expect rates and yields to be around 20–60 basis points higher than the current levels. The foreign analysts' predictions remain at the lower end of the range, in line with their view that there is room for further easing of CNB monetary policy (1W PRIBOR – foreign analysts: average 2.5%, range 2.1%–3.0%; domestic: average 2.8%, range 2.6%–3.0%; 1Y PRIBOR – foreign: average 2.8%, range 2.4%–3.5%; domestic: average 3.1%, range 3.0%–3.3%; 5Y IRS – foreign: average 3.4%, range 2.5%–4.0%; domestic: average 4.0%, range 3.6%–4.3%; CR 6.55/11 yield – foreign: average 4.1%, range 3.4%–4.6%; domestic: average 4.5%, range 4.0%–5.0%).

The average “appropriate setting” of the two-week repo rate showed a very slight increase, from 2.31% in April to 2.36% in May. The domestic analysts' expectations continue to range between 2.25% and 2.75% (average within the group 2.46%), whereas the foreign analysts again see a lower level as optimal (average within the group 2.19%, 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
V-02	3,8	4,3	4,0	4,6	0,2	0,3	5,1	5,5	5,3	5,7
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
III-03	2,4	2,7	2,3	2,9	-0,1	0,2	3,0	3,8	3,6	4,3
IV-03	2,4	2,7	2,4	3,0	0,0	0,2	3,3	3,7	3,9	4,3
V-03	2,4	2,7	2,4	3,0	0,0	0,2	3,3	3,8	3,8	4,3

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
13.5.2003	2,50	2,45	-0,05	3,31	3,84	2,36



3. Exchange rate

IV-03	EUR/CZK	
	1 month	1 year
min.	31,20	29,80
average	31,50	30,65
max.	32,00	32,50

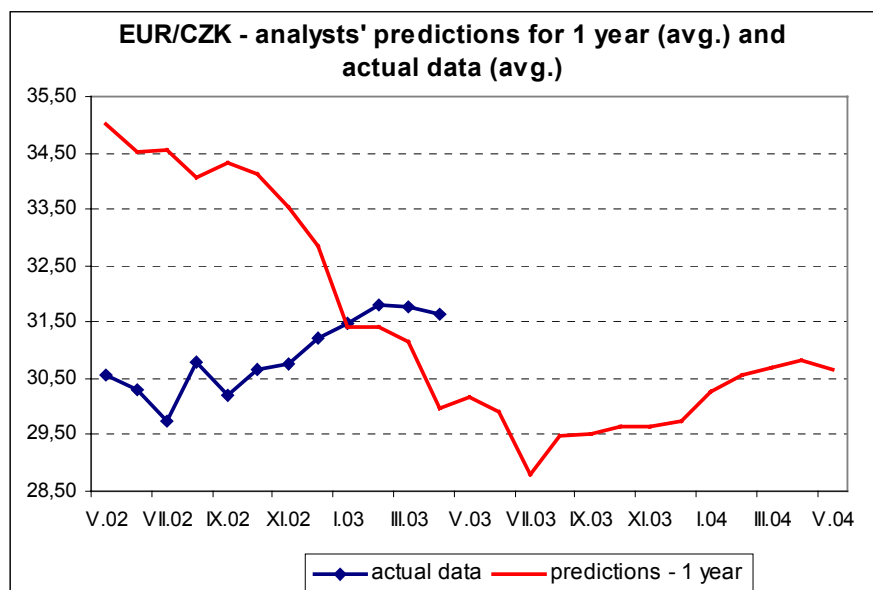
Exchange rate - fixing on the day of deadline for forecasts

13.5.2003	31,49
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Prediction for Month of prediction	exchange rate EUR/CZK	
	1 month	1 year
V-02	30,73	30,18
VI-02	30,64	29,90
IX-02	30,19	29,51
XII-02	30,94	29,74
III-03	31,74	30,70
IV-03	31,67	30,82
V-03	31,50	30,65

The analysts continue to expect the CZK/EUR rate to oscillate within the range 31.20–32.00 at the one-month horizon. Data from the real economy data speak in favour of the koruna, whereas the balance of payments figures speak against it. A successful June referendum on the Czech Republic's accession to the EU is expected to generate an appreciation of the koruna. By contrast, the potential government crisis in the autumn could bring about a temporary depreciation.

The average expectation for the exchange rate at the one-month horizon is CZK 31.50/EUR. The difference between the two groups of analysts amounts to 20 hallers. The foreign analysts' average estimate is CZK 31.63/EUR (range: 31.30–32.00), whereas that of the domestic analysts is CZK 31.43/EUR (range: 31.20–31.60).



Turning to the long-term outlook, expectations of appreciation predominate. The main reason for the renewal of the appreciation trend should be higher FDI inflow associated with the global economic recovery and the imminent full accession of the Czech Republic to the EU. However, this long-term trend is conditional on a fiscal reform that would stop the current unsustainable trend of rising debt.

The average estimate for the exchange rate at the one-year horizon is CZK 30.65/EUR. Again in May, there is a large difference between the expectations of the foreign and domestic analysts. Appreciation expectations continue to prevail among the domestic analysts, while the predictions of the foreign analysts are much more varied and clearly more pessimistic. The average prediction of the foreign analysts for May 2004 is CZK 31.30/EUR (range: 30.70–32.50). The domestic analysts' average is CZK 30.27/EUR (range: 29.80–30.80).

Prague, 16 May 2003