

Measuring financial market inflation expectations – Results of the 50th measurement (>1 bY 2003)

The expected rate of inflation decreased in the June survey. The predicted interest rate and bond yield levels reflect mounting expectations of a further easing of monetary policy by the CNB. The prediction for the koruna-euro exchange rate at the one-year horizon is more pessimistic.

1. Inflation

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

The analysts slightly decreased their expectations for inflation in the months ahead, shifting their average annual CPI inflation forecast at the one-year horizon down by 0.5%. This was due mainly to the weakening of the dollar (which is making imports of strategic raw materials cheaper), a fall in oil prices, and imported disinflation. These factors should reduce the inflation generated by rising food prices and tax changes.

As for the individual forecasts, however, it should be said that the analysts who raised their predictions relatively considerably in May have this time made slight corrections and, conversely, those who last time predicted slower CPI growth (owing to a slower forecast rise in indirect taxes) have now shifted their predictions upwards slightly.

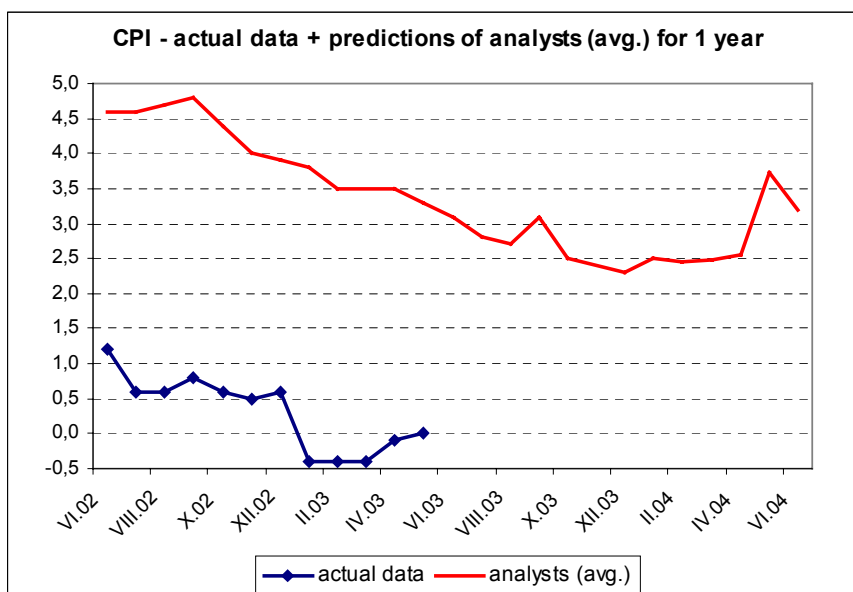
According to the analysts' forecasts, average expected annual CPI inflation in June 2004 should be around 3.2%, with the domestic analysts again expecting a higher figure. The difference this time is fairly substantial, owing to very low expectations on the part of one of the foreign analysts (domestic analysts: average 3.6%, range 3.1%–4.3%; foreign analysts: average 2.6%, range 0.5%–4.2%).

Turning to the medium-term outlook, the average prediction for the CPI remained relatively stable in June, at 2.7% (compared to 2.8% in May). The moderate decline is the result of a lower estimate from the foreign analysts, who expect lower inflation in the Czech Republic at this longer time horizon too. The range of the estimates at this horizon remains narrow compared to the one-year forecast (domestic analysts: average 2.9%, range 2.7%–3.0%; foreign analysts: average 2.5%, all estimates the same at 2.5%). The intensity and speed 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

Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
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
VI-03	3,2	2,7



2. Interest rates

VI-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.	2,1	1,8	2,0	2,1			2,7	2,5	3,4	3,2	2,00
average	2,4	2,6	2,2	2,8	-0,1	0,2	2,9	3,5	3,5	4,1	2,28
max.	2,5	2,8	2,4	3,1			3,0	4,3	3,9	5,0	2,75

The predictions for both short-term and long-term rates shifted downwards, owing to mounting expectations of a further easing of the CNB's monetary policy by about 25 basis points at the three-month horizon. These were fostered by statements made by the CNB's representatives that the risks to inflation were now lower. Developments in other countries are also playing quite a significant role. A statement by the Fed that the risks of harmful disinflation were higher than the likelihood of a pick-up in inflation led among other things to expectations of a reduction in the Fed's interest rates in June. So far there have been no signs of any turnaround in the business cycle in Europe. On the contrary, the situation has deteriorated substantially owing to the euro's appreciation against the US dollar. After the 50 basis point reduction in ECB rates in June, ECB representatives have admitted the possibility of a further reduction by the end of the year. Moreover, if the koruna starts appreciating more rapidly after the referendum on the Czech Republic's accession to the EU, the market expects the CNB to lower rates as early as at the end of June. Long-term rates and bond yields should take their lead from German bond prices. Czech yields are expected to stabilise above the level in Europe.

The predicted level of rates at the one-month horizon remains about 10 basis points below their current market level in June. The predictions for the CR 6.55/11 yield are meanwhile virtually identical to the current market level at the time of the survey. The foreign analysts' average forecast is 10–20 basis points lower than the average for the domestic respondents.

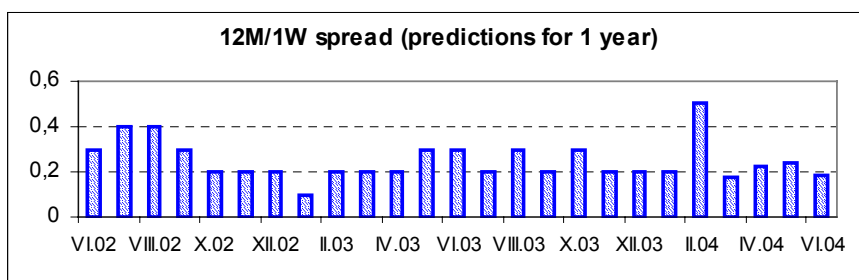
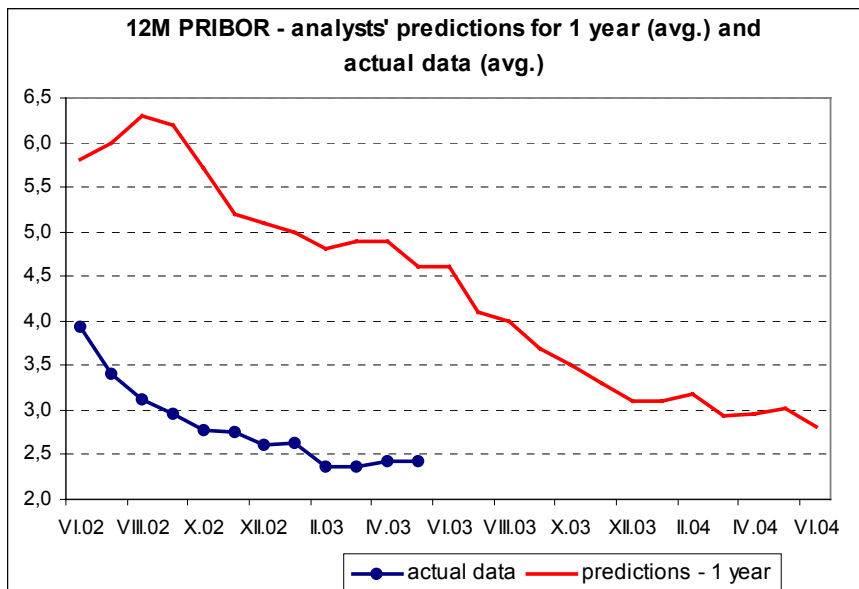
In June 2004, the predictions for the one-year horizon are 10–30 basis points lower than in May, with the foreign analysts still expecting lower rates and yields (1W PRIBOR – foreign analysts: average 2.4%, range 1.8%–2.8%; domestic: average 2.7%, range 2.3%–2.8%; 1Y PRIBOR – foreign: average 2.6%, range 2.1%–2.9%; domestic: average 3.0%, range 2.7%–3.1%; 5Y IRS – foreign: average 3.1%, range 2.5%–3.6%; domestic: average 3.7%, range 3.5%–4.3%; CR 6.55/11 yield – foreign: average 3.9%, range 3.2%–4.3%; domestic: average 4.2%, range 3.8%–5.0%).

Following a temporary increase in May, the average “appropriate setting” of the two-week repo rate showed a very slight decrease (from 2.36% in May to 2.28% in June). The domestic analysts' expectations continue to range between 2.25% and 2.75% (average within the group 2.38%), whereas the foreign analysts again see a lower level as optimal (average within the group 2.13%, range 2.00%–2.25%).

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
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
VI-03	2,4	2,6	2,2	2,8	-0,1	0,2	2,9	3,5	3,5	4,1

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
10.6.2003	2,50	2,29	-0,21	3,01	3,51	2,28



3. Exchange rate

VI-03	EUR/CZK	
	1 month	1 year
min.	31,20	30,00
average	31,39	30,92
max.	31,90	32,50

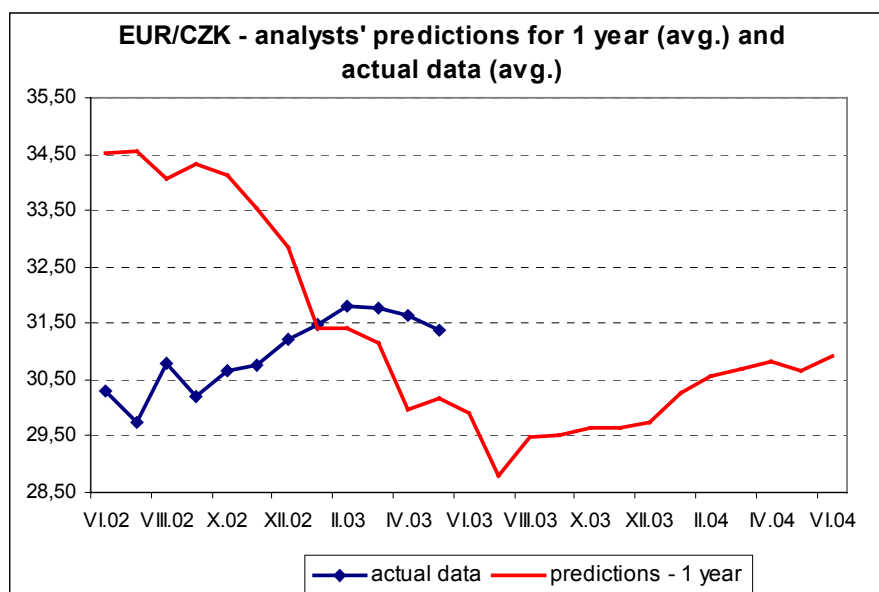
Exchange rate - fixing on the day of deadline for forecasts

10.6.2003	31,29
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Prediction for Month of prediction	exchange rate 1 month 1 year EUR/CZK	
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
VI-03	31,39	30,92

The analysts expect the CZK/EUR rate to oscillate within the range 31.20–31.90 at the one-month horizon. A temporary, rather moderate, appreciation of the koruna could take place in response to a positive result in the June referendum on the Czech Republic's accession to the EU. By contrast, the market's reaction to a negative result would probably generate a dramatic depreciation of the koruna.

The average expectation for the exchange rate at the one-month horizon is CZK 31.39/EUR. The difference between the two groups of analysts again amounts to around 20 hellers. The foreign analysts' average estimate is CZK 31.53/EUR (range: 31.20–31.90), whereas that of the domestic analysts is CZK 31.29/EUR (range: 31.20–31.40).



The koruna could see a temporary depreciation in the autumn as a result of a government crisis. In addition, transfers of dividends to foreign company owners, Český Telecom's payment to current owners Verizon and AT&T for a 49% share, and transfers for purchases and sales of stakes in regional energy-distribution companies between ČEZ, E.ON and RWE can be expected in the weeks and months ahead. Turning to the long-term outlook, expectations of a moderate appreciation predominate. The main reason for the renewal of the appreciation trend should be higher FDI inflow associated with the expected global economic recovery and the imminent full accession of the Czech Republic to the EU.

The average estimate for the exchange rate at the one-year horizon is CZK 30.92/EUR. Again in June, 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 June 2004 is CZK 31.53/EUR (range: 30.60–32.50). The domestic analysts' average is CZK 30.52/EUR (range: 30.00–31.00).

Prague, 17 June 2003