

Measuring financial market inflation expectations – Results of the 51st measurement (July 2003)

The July survey brought no substantial changes in the analysts' expectations of future inflation and interest rates. The prediction for the koruna-euro exchange rate at the one-year horizon shifted towards appreciation.

1. Inflation

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

Inflation expectations remained virtually unchanged from June. As for the individual forecasts, the expectations recorded only sporadic shifts, both upward and downward. The analysts agree that the inflation outlook remains favourable, the reasons being a substantial income gap and imported disinflation. In addition, the koruna should start strengthening again in the final quarter. The expected inflation trend is also being affected by the increasingly clear

nature of the public finance reform and tax changes. The reform should reduce household and government consumption and is therefore considered an important anti-inflationary factor.

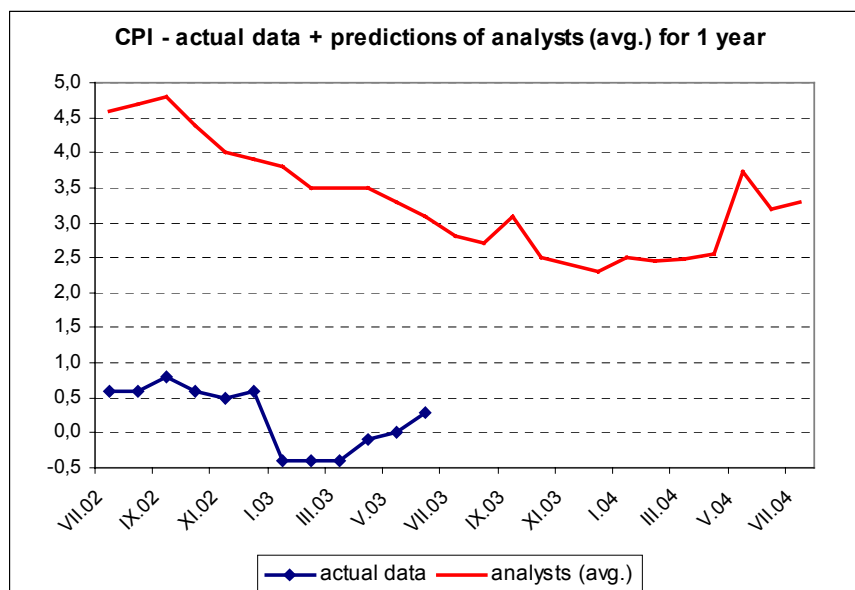
Average expected annual CPI inflation for July 2004 is 3.3%, with the domestic analysts again expecting a higher figure. The marked difference between the groups in July is again the result of very low expectations on the part of one of the foreign analysts (domestic analysts: average 3.6%, range 3.1%–4.3%; foreign analysts: average 2.5%, range 0.5%–4.2%).

Turning to the medium-term outlook (three-year horizon), the average prediction for the CPI remained stable in July, at 2.8% (compared to 2.7% in June). The forecasts of both groups are identical for this time horizon. The range of the estimates at this horizon remains relatively narrow compared to the one-year forecast (domestic analysts: average 2.8%, range 2.5%–3.0%; foreign analysts: average 2.8%, range 2.5%–3.3%). 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 %
VII-02	2,8	3,0
IX-02	3,1	2,9
XII-02	2,3	2,8
III-03	2,5	2,9
V-03	3,7	2,8
VI-03	3,2	2,7
VII-03	3,3	2,8



2. Interest rates

VII-03	1W PRIBOR (%)		12M PRIBOR (%)		12M/1W spread (%)		5Y IRS (%)		CR 3,70/13 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.	2,0	1,5	2,1	1,8			2,7	2,0	3,5	3,0	1,50
average	2,2	2,4	2,2	2,7	0,0	0,2	3,1	3,5	3,9	4,1	2,18
max.	2,5	2,8	2,3	3,1			3,4	4,3	4,3	5,0	2,50

The predictions for rate and yield levels, as with inflation, showed no substantial changes. Short maturities reflect the 25-basis-point reduction in the CNB's repo rate in June. The analysts differ in their expectations regarding the CNB's future monetary policy actions. The foreign analysts in particular expect a further lowering of the CNB's key rates, justifying their assumptions primarily with the gloomy situation in the global economy, the expected deflation in Germany this year and in 2004, the expected marked decrease in ECB rates (by up to 125 basis points) over the next 12 months and an expected appreciation of the koruna to CZK 31/EUR. Other analysts (mostly domestic) do not see the future scenario so unambiguously. They believe that the robust growth in consumer credit and the risk of an upturn in inflation expectations due to the tax adjustments will cause the CNB to be careful and not reduce rates further. However, they do not rule out the possibility of the CNB repo rate falling to two per cent in the event of a further deterioration of the world economy and too rapid an appreciation of the koruna. 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 and yields at the one-month horizon in July again remains slightly below their current market level. The foreign analysts' average forecast is still 10–20 basis points lower than the average for the domestic respondents.

The predictions for rates at the one-year horizon are 10–20 basis points lower than in June, while the predictions for medium-term and long maturities are unchanged. The foreign analysts are still expecting lower rates and yields (1W PRIBOR – foreign analysts: average 2.0%, range 1.5%–2.8%; domestic: average 2.6%, range 2.3%–2.8%; 1Y PRIBOR – foreign: average 2.2%, range 1.8%–2.8%; domestic: average 2.9%, range 2.7%–3.1%; 5Y IRS – foreign: average 2.7%, range 2.0%–3.5%; domestic: average 3.8%, range 3.3%–4.3%; CR 6.55/11 yield – foreign: average 3.5%, range 3.0%–4.3%; domestic: average 4.4%, range 3.9%–5.0%).

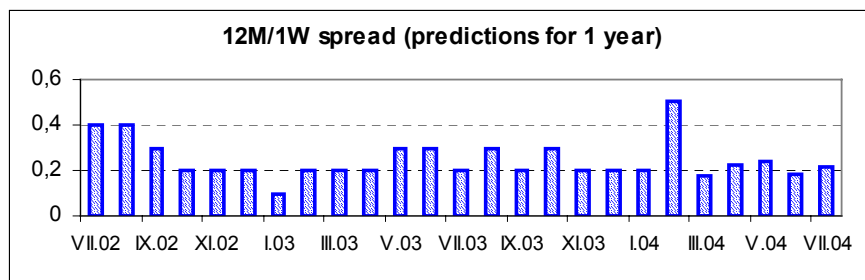
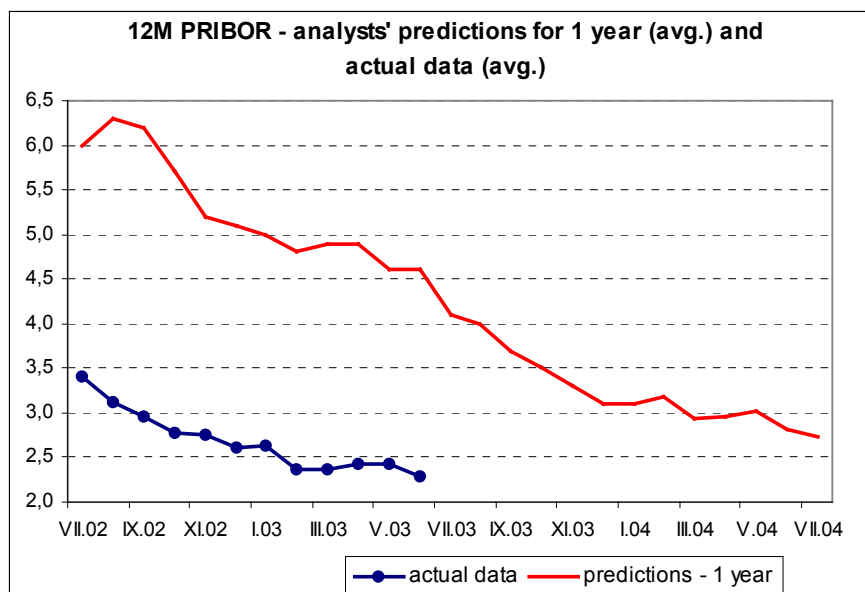
The average “appropriate setting” of the two-week repo rate decreased further compared to the previous survey, to 2.18% (2.28% in May). The domestic analysts' expectations range between 2.25% and 2.50% (average within the group 2.25%), whereas the foreign analysts as usual see a lower level as optimal (average within the group 2.00%, range 1.50%–2.25%).

Prediction for Month of prediction	1W PRIBOR		12M PRIBOR		12M/1W spread		5Y IRS		CR 3,70/13 yield	
	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y
	%		%		%		%		%	
červenec 2002	3,4	3,9	3,5	4,1	0,1	0,2	4,3	5,0	4,9	5,5
září 2002	2,9	3,5	3,0	3,7	0,0	0,2	3,9	4,6	4,6	5,2
prosinec 2002	2,6	2,9	2,6	3,1	0,0	0,2	3,6	4,2	4,2	4,6
březen 2003	2,4	2,7	2,3	2,9	-0,1	0,2	3,0	3,8	3,6	4,3
květen 2003	2,4	2,7	2,4	3,0	0,0	0,2	3,3	3,8	3,8	4,3
červen 2003	2,4	2,6	2,2	2,8	-0,1	0,2	2,9	3,5	3,5	4,1
červenec 2003	2,2	2,4	2,2	2,7	0,0	0,2	3,1	3,5	3,9	4,1

*/ CR 6,55/11 yield

Actual values of indicators on the day of deadline for forecasts

	1T PRIBOR	12M PRIBOR	spread 12M/1T	5R IRS	CR 3,70/13 yield	analysts - avg. 2W repo rate
9.7.2003	2,27	2,24	-0,03	3,15	4,08	2,18



3. Exchange rate

VII-03	EUR/CZK	
	1 month	1 year
min.	31,20	29,80
average	31,48	30,51
max.	31,60	32,50

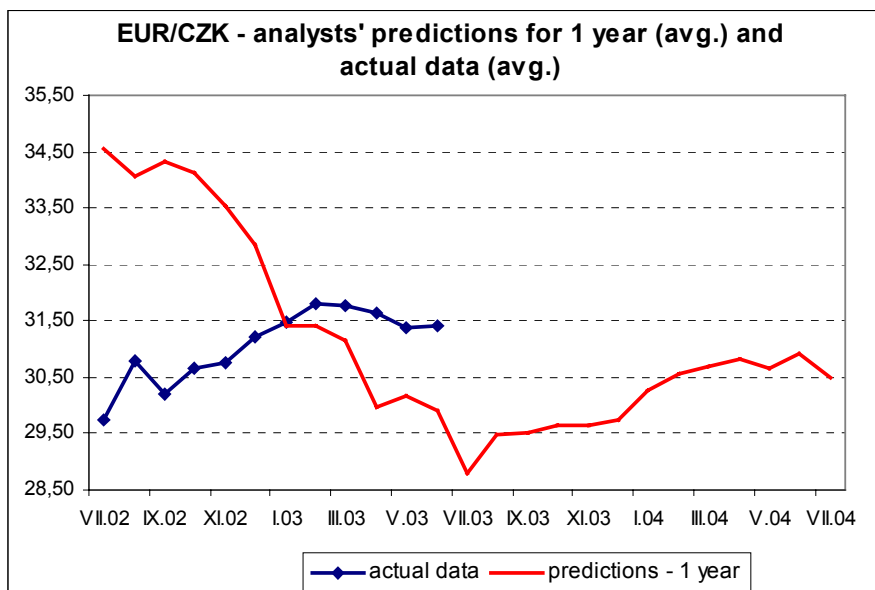
Prediction for Month of prediction	exchange rate 1 month 1 year EUR/CZK	
	1 month	1 year
VII-02	29,10	28,80
IX-02	30,19	29,51
XII-02	30,94	29,74
III-03	31,74	30,70
V-03	31,50	30,65
VI-03	31,39	30,92
VII-03	31,48	30,51

Exchange rate - fixing on the day of deadline for forecasts

9.7.2003	31,60
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The analysts expect the CZK/EUR rate to be within the range 31.20–31.60 at the one-month horizon. The current pressure on the koruna will probably continue in the days that follow and the exchange rate could gradually reach 32.0. After speculation on repatriation of dividends eases, the exchange rate should again strengthen relatively quickly back to the aforementioned range.

The average expectation for the exchange rate at the one-month horizon is CZK 31.48/EUR. The difference between the two groups of analysts again amounts to around 20 hellers. The foreign analysts all estimate a rate of CZK 31.60/EUR at one month, whereas the average estimate within the group of domestic analysts is CZK 31.42/EUR (range: 31.20–31.50).



The koruna is currently being affected by counteracting factors. The data from the real economy are having a favourable effect, while the slowing investment activity, outflow of portfolio investment and increased political risk in connection with the public finance reform are acting against it. Turning to the long-term outlook, however, a moderate appreciation trend is expected, driven by a combination of FDI inflow, an improving foreign trade balance and price and labour productivity convergence to the EU average. Accession to the European Union and successful handling of the fiscal reform should reduce the political risks.

The average estimate for the exchange rate at the one-year horizon is CZK 30.51/EUR. Again in July, there is a large difference between the expectations of the foreign and domestic analysts. Appreciation expectations continue to prevail among the domestic analysts, but the predictions of the foreign analysts are distorted both by a low number of forecasts in July on the part of foreign analysts and by one of the estimates within this group. The average prediction of the foreign analysts for July 2004 is CZK 31.15/EUR (range: 30.40–32.50), while the domestic analysts' average is CZK 30.23/EUR (range: 29.80–30.80).

Prague, 16 July 2003