

Measuring financial market inflation expectations – Results of the 53rd measurement (September 2003)

The September survey again brought only small changes in the analysts' expectations. There was on average a moderate downward shift in their estimates of the consumer price index and short-term and long-term interest rates at the one-year horizon. The analysts continued to adjust their previous more optimistic predictions for the speed of appreciation of the domestic currency.

Seven domestic and four foreign analysts participated in this survey.

1. Inflation

| IX-03 | annual CPI (%) | |
|---------|----------------|---------|
| | 1 year | 3 years |
| min. | 0,5 | 2,0 |
| average | 3,1 | 2,7 |
| max. | 3,9 | 3,3 |

Inflation expectations remain relatively stable. Some analysts shifted their outlook downwards, probably because the Czech economy remains in the deflation band. In the months to come, inflation will be affected by the withdrawal of the 10- and 20-heller coins, a reduction in gas prices, a gradual return of the koruna to appreciation, the impact of this year's hot and dry summer on food prices, higher oil prices and a recovery of the world economy. Next year, consumer prices will record a

step increase owing to tax changes associated with EU accession.

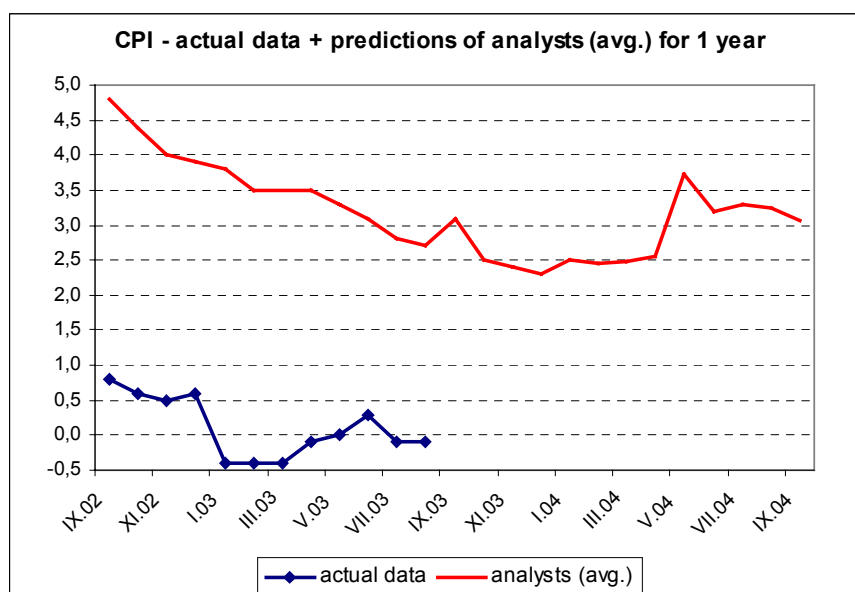
Average expected annual CPI inflation for September 2004 is 3.1%, with the domestic analysts typically expecting a higher figure (domestic analysts: average 3.4%, range 2.7%–3.9%; foreign analysts: average 2.5%, range 0.5%–3.4%).

Turning to the medium-term outlook (three-year horizon), the average prediction for the CPI remains stable at 2.7% (compared to 2.6% in August). The forecasts of the two groups are identical. The range of the estimates remains narrower compared to the shorter time horizon (domestic: 2.7%, range 2.2%–3.2%; foreign: average 2.7%, range 2.0%–3.3%). The intensity and speed of the world economic recovery are considered the determining factor at this horizon.

The main inflation factors and risks:

- Food and oil prices
- Increases in certain taxes
- Fast wage growth

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



2. Interest rates

| IX-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. | 1,9 | 1,5 | 2,0 | 1,8 | | | 3,4 | 2,6 | 4,2 | 3,3 | 1,50 |
| average | 2,0 | 2,3 | 2,1 | 2,6 | 0,1 | 0,3 | 3,6 | 3,8 | 4,3 | 4,4 | 2,00 |
| max. | 2,1 | 2,8 | 2,2 | 3,1 | | | 3,8 | 4,5 | 4,4 | 5,0 | 2,50 |

Most analysts believe that rates have now bottomed out. Owing to strong domestic demand, high wage growth, the present weaker level of the domestic currency, the uncertain outcome of the public finance reform and the expected world economic recovery, the analysts consider the scenario of long-term interest rate stability to be the most probable. The first reduction in CNB rates is expected around the middle of next year at the earliest.

As for bonds, the analysts expect continuing pressure for yield growth, fuelled by better performance of the leading world economies.

Only two of the analysts (both of them foreign) expect further cuts in CNB rates – of 25–50 basis points – and a corresponding downward shift of the entire yield curve.

The predicted level of rates and yields at the one-month horizon is as usual very close to the market level at the time of the survey. The average predictions of the two groups' forecasts are virtually the same at this horizon. In the analysts' opinion, domestic bond yields should continue to correlate with the trends in Europe and gradually stabilise above the German bond curve.

The average predictions for short-term rates at the one-year horizon recorded a downward shift of 10 basis points relative to the previous survey. The situation is similar for the 5Y koruna swap and 10Y bond yield (1W PRIBOR – foreign analysts: average 2.1%, range 1.5%–2.8%; domestic: average 2.4%, range 2.1%–2.5%; 1Y PRIBOR – foreign: average 2.5%, range 1.8%–3.1%; domestic: average 2.7%, range 2.3%–2.9%; 5Y IRS – foreign: average 3.4%, range 2.6%–4.3%; domestic: average 4.1%, range 3.7%–4.5%; CR 3.70/13 yield – foreign: average 4.0%, range 3.3%–4.8%; domestic: average 4.6%, range 4.4%–5.0%).

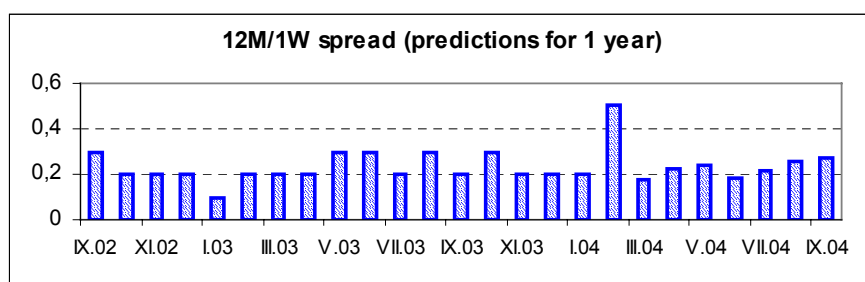
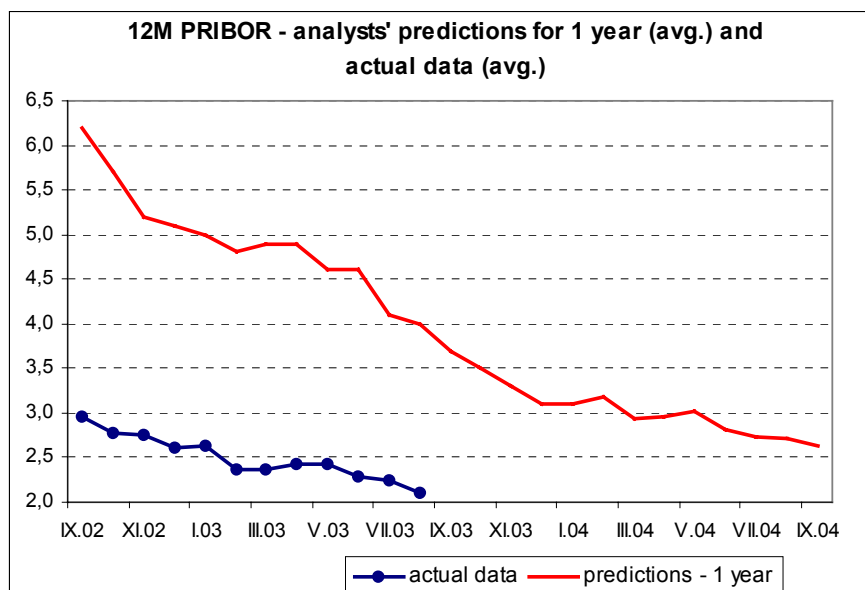
The average “appropriate setting” of the two-week repo rate is 2.00% in September (2.07% in August). The domestic analysts' expectations again range between 2.00% and 2.50% (average within the group 2.07%), whereas the foreign analysts see this rate's optimal setting between 1.50% and 2.00% (average within the group 1.88%).

| 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 |
| 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 |
| VI-03 | 2,4 | 2,6 | 2,2 | 2,8 | -0,1 | 0,2 | 2,9 | 3,5 | 3,5 | 4,1 |
| VII-03 | 2,2 | 2,4 | 2,2 | 2,7 | 0,0 | 0,2 | 3,1 | 3,5 | 3,9 | 4,1 |
| VIII-03 | 2,0 | 2,4 | 2,1 | 2,7 | 0,1 | 0,3 | 3,4 | 3,9 | 4,2 | 4,5 |
| IX-03 | 2,0 | 2,3 | 2,1 | 2,6 | 0,1 | 0,3 | 3,6 | 3,8 | 4,3 | 4,4 |

*/ CR 6,55/11 yield

Actual values of indicators on the day of deadline for forecasts

| | 1T PRIBOR | 12M PRIBOR | 12M/1W spread | 5Y IRS | CR 3,70/13 yield | analysts - avg. 2W repo rate |
|-----------|-----------|------------|---------------|--------|------------------|------------------------------|
| 10.9.2003 | 2,03 | 2,18 | 0,15 | 3,61 | 4,31 | 2,00 |



3. Exchange rate

| IX-03 | EUR/CZK | |
|---------|---------|--------|
| | 1 month | 1 year |
| min. | 32,20 | 30,00 |
| average | 32,70 | 31,27 |
| max. | 33,30 | 34,00 |

Exchange rate - fixing on the day of deadline for forecasts

| | |
|-----------|-------|
| 10.9.2003 | 32,84 |
|-----------|-------|

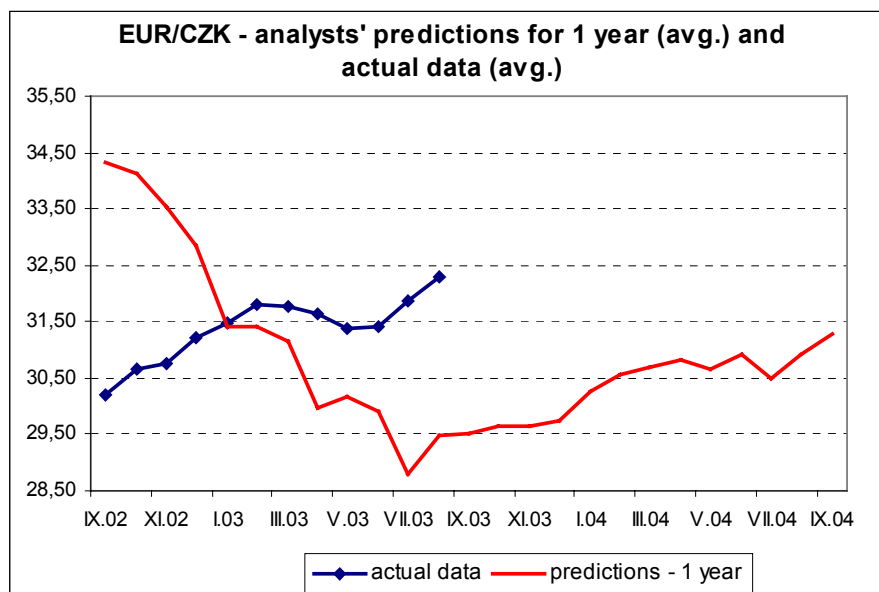
| Prediction for Month of prediction | exchange rate 1 month 1 year EUR/CZK | |
|------------------------------------|--------------------------------------|-------|
| IX-02 | 30,19 | 29,51 |
| XII-02 | 30,94 | 29,74 |
| III-03 | 31,74 | 30,70 |
| VI-03 | 31,39 | 30,92 |
| VII-03 | 31,48 | 30,51 |
| VIII-03 | 32,09 | 30,92 |
| IX-03 | 32,70 | 31,27 |

The analysts expect the CZK/EUR rate to be within the range 32.20–33.30 at the one-month horizon, with an average of CZK 32.70/EUR. The foreign analysts maintain their more pessimistic view, expecting the CZK/EUR rate on average at 32.83 (range: 32.50–33.30), whereas the average estimate within the group of domestic analysts is CZK 32.62/EUR (range: 32.20–33.20).

The analysts see the reason for the current weakening of the koruna primarily in the political uncertainty associated with the discussions on the reform of public finances. Low interest rates, repatriation of dividends and outflow of portfolio investment are the other factors mentioned.

The analysts believe that if the public finance reform fails to go through and the present government falls, the koruna will weaken to CZK 33.00–33.50/EUR. If the Czech Parliament passes the government's proposed reform, the analysts expect a turnaround to a strengthening of the koruna. By

their estimates, the koruna could be somewhere between CZK 31.50 and CZK 32.00/EUR at the end of the year.



Most of the analysts believe that the koruna will see an improvement over the course of next year. They expect the effects of the ongoing inflow of foreign direct investment and the global economic recovery to be felt in the medium term. The koruna should also be bolstered by higher growth in domestic productivity than abroad.

Only one analyst expects a weakening of the koruna at the one-year horizon; another expects a stagnation around the present level (both are from the group of foreign analysts).

The average estimate for the exchange rate at the one-year horizon is CZK 31.27/EUR. The trend of a more pessimistic view of the koruna's development on the part of the foreign analysts has lasted for more than a year. Their average prediction for September 2004 is CZK 31.88/EUR (range: 30.00–34.00), while the domestic analysts' average is CZK 30.93/EUR (range: 30.00–31.78).

Prague, 15 September 2003