

Measuring financial market inflation expectations – Results of the 56th measurement (December 2003)

The December survey of analysts' expectations reflected the latest data releases, indicating a faster upturn in inflation and persisting high household consumption. Their predictions for consumer price inflation and short-term and long-term rates rose slightly.

Six domestic and one foreign analyst participated in this survey.

1. Inflation

XII-03	annual CPI (%)	
	1 year	3 years
min.	2,7	2,5
average	3,3	2,8
max.	3,9	3,0

The average of the inflation expectations again shifted slightly upwards. The analysts expect inflation to rise further during the course of next year. Up to the end of 2003 inflation should continue be driven by food prices. However, the start of next year will see the first major across-the-board increase in prices due to an increase in excise duty on cigarettes, alcoholic beverages, petrol and diesel oil and also to the shifting of numerous goods and services from the lower to the basic rate of VAT. Further changes in

VAT will occur in May 2004. Oil price developments on world markets and strong domestic consumption remain upside risks to inflation. However, the analysts say that the combination of higher growth in prices due to the tax adjustments and lower growth in real wages next year should lead to some cooling of the currently strong consumer demand in the domestic economy.

The average annual consumer price inflation expected for December 2004 is 3.3%. The domestic analysts' forecasts range between 2.7% and 3.9%.

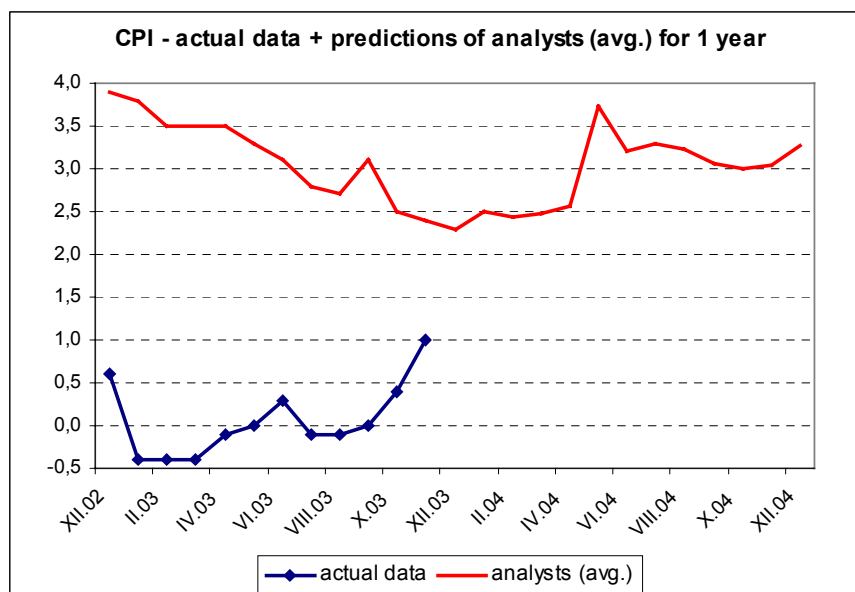
According to the analysts prices should calm in 2005 as the tax adjustments disappear from the statistical bases. At the three-year horizon the inflation predictions remain stable, the domestic analysts' average estimate being 2.8%.

At the close of next year, the CNB expects annual consumer price inflation of 3%, i.e. slightly below the analysts' average prediction.

The main inflation factors and risks:

- Oil prices
- Tax adjustments next year

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



2. Interest rates

	1W PRIBOR (%)		12M PRIBOR (%)		12M/1W spread (%)		5Y IRS (%)		CR 3,70/13 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
XII-03											
min.	2,0	2,4	2,1	2,9			3,9	4,2	4,8	5,0	2,00
average	2,1	2,5	2,3	3,1	0,1	0,3	4,0	4,5	5,0	5,4	2,04
max.	2,3	2,7	2,4	3,4			4,1	4,8	5,1	6,2	2,25

There is a clear conviction among the respondents that domestic rates have bottomed out and that the CNB will start to tighten monetary policy next year owing to high domestic demand and a high growth rate of consumer and mortgage loans, an upturn in inflation and the expected upward trend in rates in the leading world economies.

The basic scenario of most of the respondents envisages the first repo rate increase occurring in the summer months. According to the respondents' estimates, the repo rate could rise by 25–75 basis points by the end of next year. Long-term rates and bond yields should be affected both by the expected continuing growth of the world economy (which from roughly the middle of the year should bring about a gradual increase in rates) and by a relatively large volume of government bond issues. However, this basic scenario could change in either direction. If there is a fast upturn in inflation, the CNB may raise interest rates earlier. Conversely, if the euro continues to appreciate rapidly against the dollar and the dollar remains at low levels for a longer period of time, the ECB – and to some extent the CNB as well – may increase rates later.

The level of rates and the ten-year bond yield expected by the analysts at the one-month horizon is as usual very close to the market level at the time of survey. One of the domestic respondents, who feels the repo rate could rise as early as at the start of 2004, submitted markedly higher estimates (around 20–30 basis points above the current level).

The average prediction for rates and the ten-year bond yield at the one-year horizon is 20–60 basis points higher than in the last survey. The shift in the predictions is greater at longer maturities.

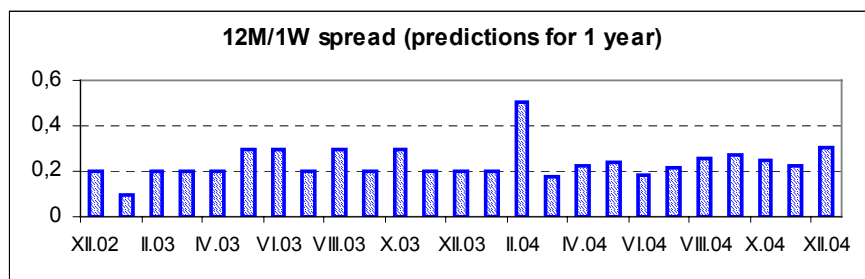
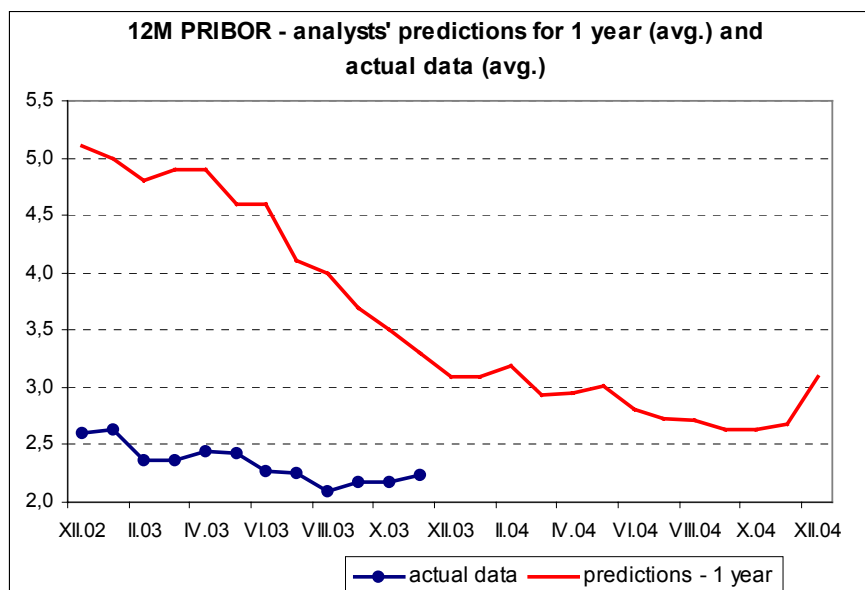
The average “appropriate setting” of the two-week repo rate corresponds to its present level of 2%. According to just one analyst it should be 2.25%.

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
	%		%		%		%		%	
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
IX-03	2,0	2,3	2,1	2,6	0,1	0,3	3,6	3,8	4,3	4,4
X-03	2,0	2,3	2,1	2,6	0,1	0,2	3,6	3,8	4,4	4,6
XI-03	2,0	2,3	2,2	2,7	0,2	0,2	3,9	4,1	4,8	4,8
XII-03	2,1	2,5	2,3	3,1	0,1	0,3	4,0	4,5	5,0	5,4

*/ 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
10.12.2003	2,02	2,31	0,29	3,99	4,91	2,04



3. Exchange rate

	EUR/CZK	
	1 month	1 year
XII-03		
min.	31,50	30,50
average	31,79	30,94
max.	32,00	31,60

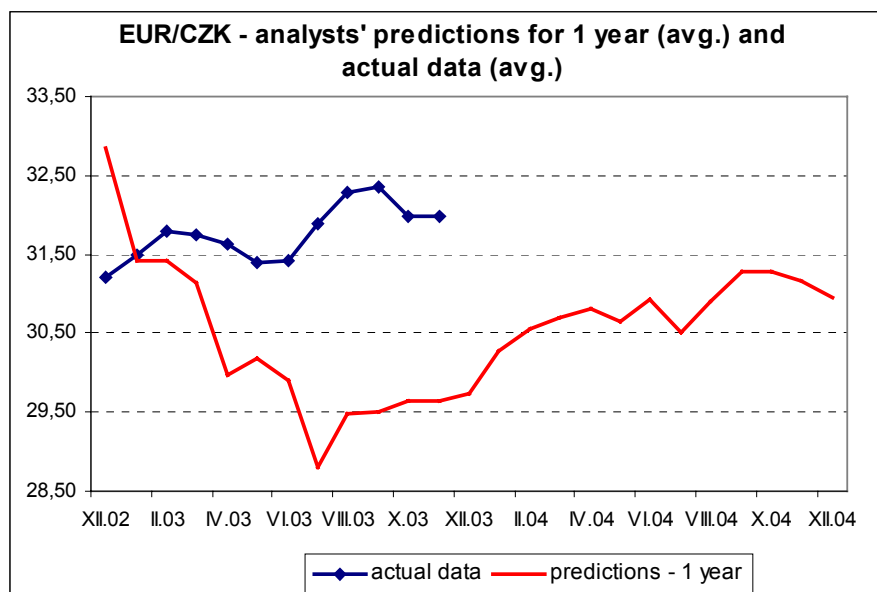
Exchange rate - fixing on the day of deadline for forecasts

10.12.2003	32,115
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Prediction for Month of prediction	exchange rate 1 month 1 year EUR/CZK	
	1 month	1 year
XII-02	30,94	29,74
III-03	31,74	30,70
VI-03	31,39	30,92
IX-03	32,70	31,27
X-03	31,92	31,28
XI-03	31,75	31,16
XII-03	31,79	30,94

The analysts expect the CZK/EUR rate to be within the range of 31.50–32.00 at the one-month horizon, the average being CZK/EUR 31.79. The analysts' expectations remained almost unchanged from the previous month. The individual predictions show only minimal deviations, these being towards a stronger koruna.

According to the analysts' comments the slightly optimistic short-term outlook for the koruna is based on fading political risks, satisfactory data from the real economy and signals of an improving situation in the European economy, which, in conjunction with the weaker koruna, should favourably affect Czech export growth.



All the respondents believe that the koruna will appreciate over the course of next year. This is due mainly to the expected increased FDI inflow associated with the Czech Republic's accession to the EU. The gradually recovering European economy should also lead to higher demand for Czech products.

On the other hand, the analysts point out that the domestic currency will at certain times be weakened by payments of dividends from the earnings of domestic firms to their foreign owners.

The average estimate for the exchange rate of the domestic currency at the one-year horizon is CZK 30.94/EUR (range: 30.50–31.60).

Prague, 18 December 2003