

## Measuring financial market inflation expectations – Results of the 60th measurement (April 2004)

The April survey of financial market expectations revealed that the majority of respondents expect a slower inflation growth and a slower rate of tightening the CNB's monetary policy. Some respondents predict a stronger koruna's appreciation, while estimates of GDP growth remained virtually unchanged.

Ten domestic and one foreign analysts participated in this survey.

### 1. Inflation

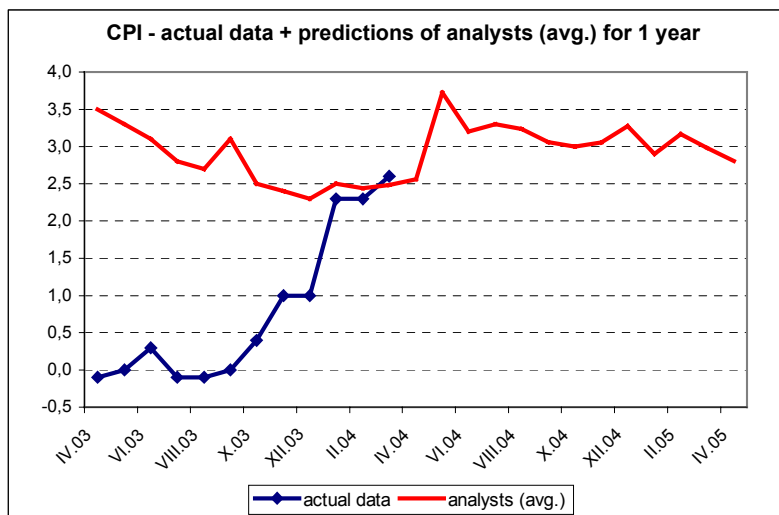
IV-04	annual CPI (%)	
	1 year	3 years
min.	2,0	2,4
average	2,8	2,9
max.	4,0	4,0

The average of the predictions for consumer price inflation at the one-year horizon continued to decline slightly. For April 2005 it is 2.8%. The forecasts of the individual analysts range between 2.0% and 4.0%.

The analysts justify the expectations of lower consumer price inflation at this horizon mainly by further clarification of tax adjustments as of 1 May this year (their effect should be smaller than originally expected) and by a repeated postponement of rent deregulation. However, the issue regarding the tax adjustments is still opened, due to the President's veto, although the analysts expect it to be outvoted.

Inflation in forthcoming months should be fostered in addition to administrative adjustments also by food prices and crude materials prices on world markets. According to the analysts, demand-pullinflationary pressures should be somewhat more moderate this year in comparison with previous years, but on the other hand, all testifies to a revival of cost-push inflation. The question remains, if, and to what extent the price level will reflect the secondary effects of tax changes. The inflation rate expressed as the annual increase in the consumer price index should accelerate until the end of Q3 and stabilise at below 4% at the end of the year. Due to a high base from 2004, annual CPI growth should slow down during 2005 and stabilise roughly in the centre of the CNB's targeted range. At the three-year horizon, the inflation predictions remain more or less stable, the analysts' average estimate being 2.9%.

Prediction for Month of prediction	annual CPI	
	1 Y	3 Y
	%	
IV-03	2,6	2,7
VI-03	3,2	2,7
IX-03	3,1	2,7
XII-03	3,3	2,8
II-04	3,2	2,8
III-04	3,0	2,8
IV-04	2,8	2,9



### 2. Gross domestic product

Prediction for Month of prediction	GDP growth at the end of	
	this year	next year
	%	
I-04	3,2	3,6
II-04	3,2	3,6
III-04	3,3	3,7
IV-04	3,3	3,6

IV-04	GDP growth at the end of	
	current year	next year
min	3,0	2,9
average	3,3	3,6
max	3,8	4,5

All respondents foresee a slight pick-up in GDP growth for 2004 as well as a change in the growth structure. Slackening household consumption due to slower real wage growth and high unemployment, should be offset by increasing investment activity. A positive contribution from net exports, connected with a recovery of demand in EU member states, can also be gradually counted on. The services balance should also improve.

According to the estimates, economic growth should exceed the 3% level this year (average of the predictions for 2004: 3.3%) and pick up even further next year (average of the predictions for 2005: 3.6%).

The risks to this scenario are a slower recovery of the world economy and weaker inflow of foreign investment.

### 3. Interest rates

IV-04	2W repo rate (%)		12M PRIBOR (%)		5Y IRS (%)		CR 3,70/13 yield	
	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year
min.	2,0	2,3	2,2	2,3	3,7	4,0	4,6	4,5
average	2,0	2,6	2,3	2,9	3,8	4,3	4,7	5,1
max.	2,0	3,0	2,4	3,4	3,8	4,6	4,8	5,6

A modest lowering of the expected levels of short-term and long-term rates is a result of changing market opinions on the timing of the first increase in the CNB's rates and the current situation on world markets. A tightening of the CNB's monetary policy is not expected soon which is documented by the analysts' expectations of setting the 2W repo rate at the one-month horizon. According to some analysts, the earlier widely expected increase of 25 basis points in July could be postponed until the end of this year. Although inflation has been increasing recently and real interest rates are negative, the fact that the pick-up in consumer price inflation is markedly affected by the administrative changes speaks in favour of leaving the interest rates at the current level. According to the analysts, further development in inflation expectations and possible secondary effects of the tax adjustments will be important for the CNB's decision-making. The May and June inflation outturns could lead the central bank to increase repo rate slightly around the middle of the year. If the economic growth is weaker than expected and the secondary effects of tax adjustments do not show up, the analysts foresee the prolongation of the period of stability in the setting of interest rates. The estimates of setting the CNB's 2W repo rate at the one-year horizon range between 2.25% and 3.00% (one respondent at 2.25%, five respondents at 2.50%, four respondents at 2.75% and one respondent at 3.00%).

According to the analysts' comments, the outlook for medium-term rates and long-term bonds will be determined primarily by developments on European markets and the prospects for the Czech economy. The expected lowering of ECB rates should slow yield growth in the euro area which, together with a postponement of the expected date of increasing CNB interest rates, should be reflected also by the yield curve. Sufficient liquidity should have stabilising effect on the yield curve's short end. By contrast, the curve's long-end should show a modest growth.

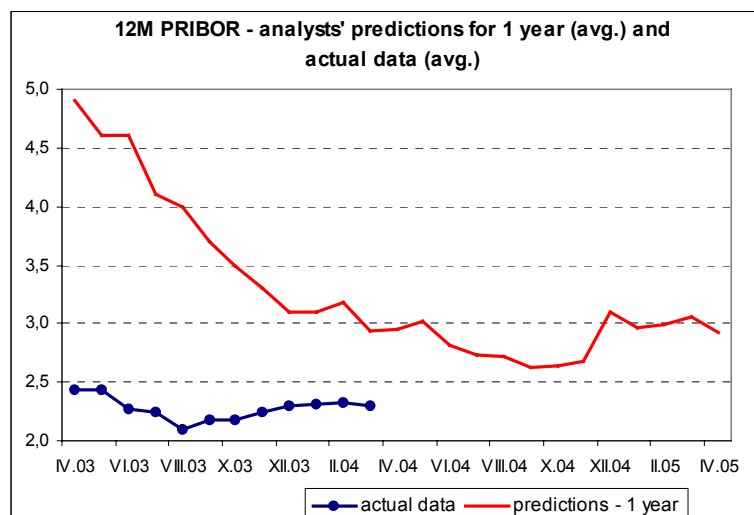
Prediction for Month of prediction	2W repo rate		12M PRIBOR		5Y IRS		CR 3,70/13 yield	
	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y
	%		%		%		%	
IV-03	2,4	2,7	2,4	3,0	3,3	3,7	3,9	4,3
VI-03	2,4	2,6	2,2	2,8	2,9	3,5	3,5	4,1
IX-03	2,0	2,3	2,1	2,6	3,6	3,8	4,3	4,4
XII-03	2,1	2,5	2,3	3,1	4,0	4,5	5,0	5,4
II-04	2,0	2,6	2,3	3,0	4,0	4,4	4,8	5,2
III-04	2,0	2,7	2,4	3,1	3,8	4,4	4,7	5,2
IV-04	2,0	2,5	2,3	3,0	3,8	4,3	4,7	5,2

/\* expected level of 1W PRIBOR

\*/ CR 6,55/11 yield

#### Actual values of indicators on the day of deadline for forecasts

	2W repo rate	12M PRIBOR	5R IRS	CR 3,70/13 yield
13.4.2004	2,00	2,28	3,66	4,65



#### 4. The exchange rate

IV-04	EUR/CZK	
	1 month	1 year
min.	31,80	30,50
average	32,28	31,65
max.	32,60	34,00

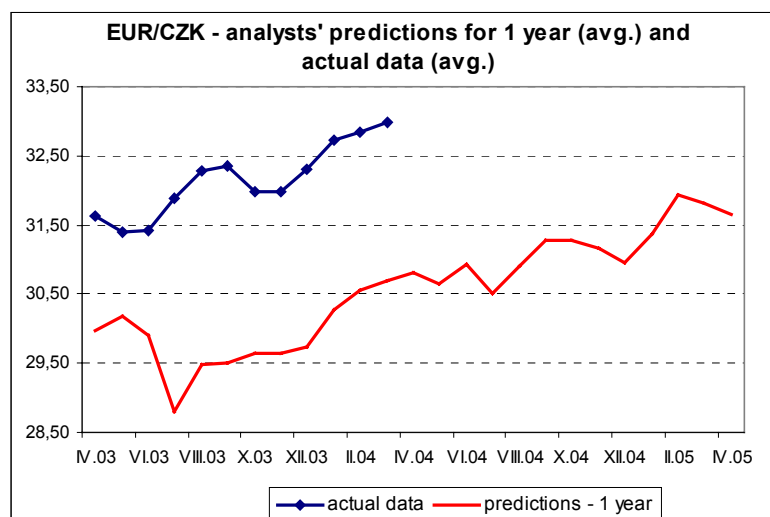
#### Exchange rate - fixing on the day of deadline for forecasts

13.4.2004	32,165
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Prediction for Month of prediction	exchange rate	
	1 month	1 year
IV-03	31,67	30,82
VI-03	31,39	30,92
IX-03	32,70	31,27
XII-03	31,79	30,94
II-04	32,96	31,93
III-04	32,81	31,81
IV-04	32,28	31,65

The respondents expect the koruna's exchange rate to be within the range of CZK 31.80 - 34.00/EUR at the one-month horizon, the average expectation being CZK 32.28/EUR. According to the analysts, a relatively striking shift of the koruna-euro exchange rate and short-term predictions toward the koruna's appreciation is given mainly by the change in the central bank's stance, which admitted a possibility of dissolving the income from international reserves through the market. Although insignificant volumes are in question, the change in the central bank's stance is an important signal for the market.

In the longer-term outlook, the foreign and domestic analysts' predictions differ even more considerably. The foreign analysts expect the koruna to depreciate (range of the estimates: CZK 33.50–34.00/EUR), whereas the domestic analysts tend to foresee an appreciation of the koruna. However, their opinions on the speed of appreciation differ, as can be seen from the range of their estimates (CZK 30.50–32.30/EUR). According to the domestic analysts, a change in trend should be fostered in the course of the year by foreign direct investment, an expected slight improvement in the balance of payments this year and a rise in yields on the bond market. The koruna's exchange rate will also be affected by the euro-dollar exchange rate and temporarily weakened by repatriation of earnings and outflow of dividends. However, by comparison with the past, the domestic analysts, too, are further reducing their opinion on the pace of the appreciation, pointing to negative sentiment in the region, the negative interest rate differential and fiscal instabilities.



The average estimate for the exchange rate of the domestic currency at the one-year horizon is CZK 31.65/EUR, whereas the range of estimates remains wide (30.50 – 34.00). Weakening of the koruna is traditionally expected by one foreign respondent, while the domestic analysts unanimously expect the koruna to appreciate. Underlying these expectations is a foreseen improvement in the balance of payment's structure and in particular a more favourable development on the financial account. In addition to stable FDI inflow, some proceeds from privatisation can be expected. Also, a lower pressure on portfolio investment outflow is predicted. It is necessary to continue to expect a temporary weakening of the domestic currency due to dividend payments.

Prague, 19 April 2004