

## Measuring financial market inflation expectations – Results of the 67<sup>th</sup> measurement (November 2004)

Eleven domestic and two foreign analysts took part in the November survey.

The Czech Republic's inflation outlook is little changed, according to the analysts. Concerns regarding the effects of oil prices on the world economy have increased somewhat. The expected rise in CNB interest rates has shifted to the first quarter of next year. The predictions for the koruna's exchange rate do not show any substantial changes.

### 1. Inflation

XI-04	annual CPI (%)	
	1 year	3 years
min.	2,4	2,3
average	2,8	2,7
max.	3,0	3,2

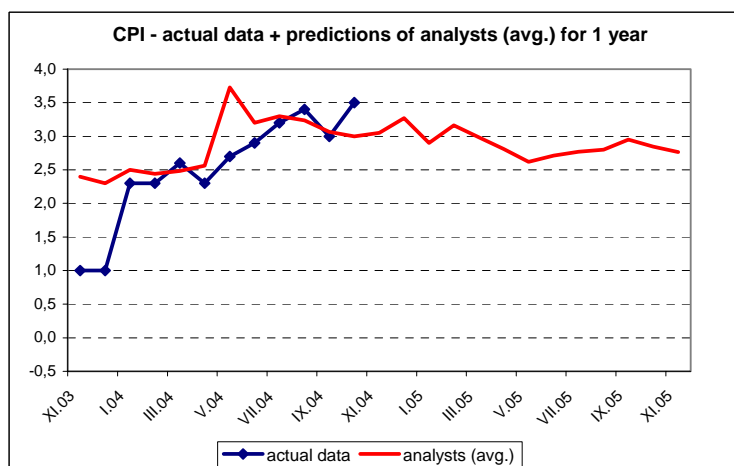
In line with the analysts' expectations, inflation in the Czech Republic picked up in October. It is expected to decline in the months ahead, owing to lower food prices and a smaller contribution of regulated prices and tax adjustments in 2005 compared to this year. The price of petrol should also gradually stabilise, or even decrease slightly. The opposite trend is expected for gas prices – after

the October price increase further growth is likely in January 2005. Some analysts point out that, despite the good harvest, food prices may not fall as significantly as originally expected, owing to rising prices of livestock products. According to the respondents, the evolution of the price level will depend on prices of raw materials, particularly oil.

Inflation should decrease gradually, staying above 2% in the first half of 2005. In the second half, however, demand-pull inflationary pressures are expected to emerge in the Czech economy, owing to faster wage growth next year and satisfactory growth of the domestic economy.

At the three-year horizon, the inflation prediction is broadly stable, fluctuating just below 3.0% in the long run. The average estimate in the November survey is 2.7%. Inflation in the Czech Republic at this horizon should be subject to the same effects as that in the euro area.

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



## 2. Gross domestic product

Prediction for Month of prediction	GDP growth at the end of	
	this year %	next year %
III-04	3,3	3,7
VI-04	3,4	3,6
VII-04	3,4	3,7
VIII-04	3,4	3,6
IX-04	3,6	3,8
X-04	3,8	3,9
XI-04	3,9	3,9

	GDP growth at the end of	
	current year	next year
<b>XI-04</b>		
min	3,7	2,7
average	3,9	3,9
max	4,5	4,5

The analysts remain more pessimistic than the CNB in their forecasts of domestic economic growth. They mention that the data released in October and November reflect the negative effect of high oil prices on the world economy and in particular on expectations of world economic growth. Concerns are particularly apparent in the euro area, whose growth depends strongly on exports. According to the analysts, domestic economic growth should be driven chiefly by investment, the improving export performance of the Czech economy and, thanks to faster wage growth next year, by domestic consumption.

The risks to the majority scenario of a pick-up in domestic GDP growth next year are still a slower recovery of the world economy and a weaker inflow of foreign direct investment.

## 3. Interest rates

<b>XI-04</b>	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.	2,4	2,4	2,9	2,7	4,0	3,8	4,7	4,4
average	2,5	3,1	3,0	3,5	4,1	4,5	4,8	5,2
max.	2,5	3,5	3,1	3,8	4,2	4,9	5,1	5,5

As in the previous survey, the expectations of a further increase in CNB rates have shifted back in November to a later period. Most analysts believe that the fundamental inflation risks in the Czech economy are small for the time being. The higher prices are due not to economic growth, but to inflation imported via expensive oil and gas. Consequently, more and more analysts are saying that the Czech National Bank will probably leave rates at their present level until February 2005, when the mandates of four current Bank Board members are to end.

The estimates for the repo rate at the one-year horizon range between 2.4% and 3.5%. Four respondents predict the repo rate at 3.00% and seven at 3.25%. The estimates of 2.4% and 3.5% are each represented by only one analyst. The scenario of a future rate reduction to 2.4% is again considered probable by one foreign respondent, who has long been rather pessimistic about the sustainability of the global economic recovery and therefore also expects a slowdown in the Czech economy, a new easing of monetary policy and a weakening of the Czech koruna against the euro.

The analysts expect only a very slight movement in medium-term rates and the ten-year bond yield at the one-month horizon, with most respondents predicting a moderate increase. In the near future, this market segment might be affected by the Q3 GDP figures and the publication of the planned volume of government bond issues for 2005.

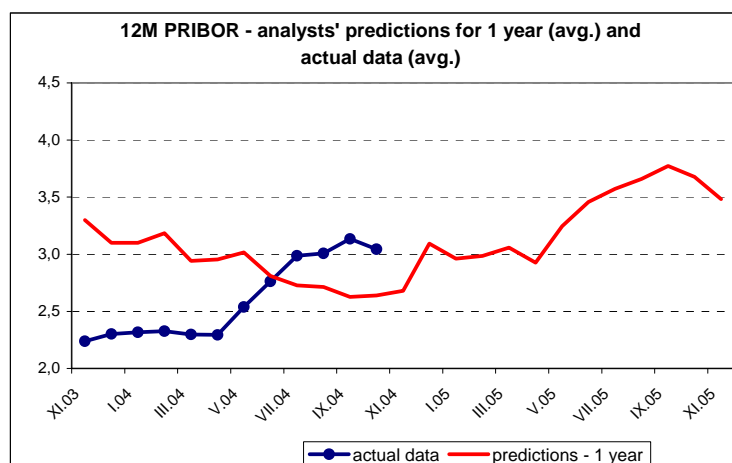
As to the longer-term outlook, expectations regarding the evolution of CNB rates and the situation on global markets should be the key factors. The respondents mostly forecast the yield curve to shift upwards slightly, thanks to global economic growth.

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
	%	%	%	%	%	%	%	%
XI-03	2,0	2,3	2,2	2,7	3,9	4,1	4,8	4,8
XII-03	2,1	2,5	2,3	3,1	4,0	4,5	5,0	5,4
III-04	2,0	2,7	2,4	3,1	3,8	4,4	4,7	5,2
VI-04	2,1	2,9	2,7	3,5	4,2	4,8	5,1	5,5
IX-04	2,5	3,4	3,1	3,8	4,5	4,9	5,2	5,6
X-04	2,6	3,3	3,1	3,7	4,3	4,7	5,0	5,3
XI-04	2,5	3,1	3,0	3,5	4,1	4,5	4,8	5,2

*/\* expected level of 1W PRIBOR*

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

	2W repo rate	12M PRIBOR	5R IRS	CR 3,70/13 yield
10.11.	2,50	2,99	4,03	4,69



#### 4. The exchange rate

XI-04	EUR/CZK	
	1 month	1 year
min.	31,30	30,60
average	31,47	30,97
max.	31,60	32,50

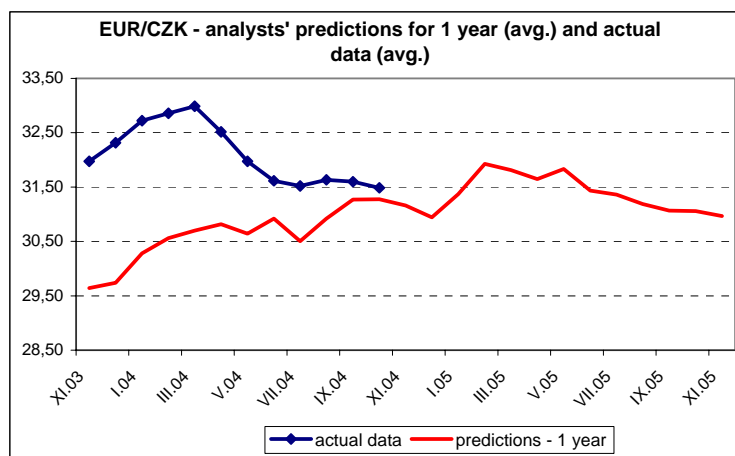
#### Exchange rate - fixing on the day of deadline for forecasts

10.11.	31,420
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Prediction for Month of prediction	exchange rate 1 month 1 year EUR/CZK	
XI-03	31,75	31,16
XII-03	31,79	30,94
III-04	32,81	31,81
VI-04	31,63	31,44
IX-04	31,66	31,07
X-04	31,51	31,06
XI-04	31,47	30,97

The analysts expect the koruna to move within a relatively narrow range of CZK 31.30–31.60/EUR, stating that the koruna started to appreciate after the government coalition agreed on the draft budget for next year at the end of September and the budget bill was subsequently passed in the Chamber of Deputies (the lower house of the Czech parliament).

At the end of the year, however, the koruna might depreciate to CZK 32.00/EUR, reflecting unfavourable seasonal factors – a widening trade deficit and repatriation of earnings of foreign investors. The koruna is expected to fluctuate around this level in the first few months of next year.



In the medium term, the koruna's exchange rate will be affected by the ratio between the current account and financial account balances, and in particular by the volume of foreign direct investment. In the longer term, the koruna should be supported by a favourable balance of trade combined with expectations of a moderate rise in interest rates. The volume of repatriation, which was extraordinarily high this year due to the Czech Republic's accession to the EU, should not recur. Therefore, the analysts forecast a trend of modest appreciation interrupted by seasonal effects. One of the foreign respondents maintains a more pessimistic view (a weakening of the koruna to CZK 32.50/EUR at the one-year horizon).