

Measuring financial market inflation expectations – Results of the 69th measurement (January 2005)

Fourteen domestic and two foreign analysts took part in the CNB's January survey.

The Czech Republic's inflation outlook remains positive, say the analysts. The respondents again moved back the expected timing of this year's first interest rate increase, mostly to the summer months. As in the previous surveys, the expected CZK/EUR exchange rate moved quite markedly towards appreciation.

1. Inflation

I-05	annual CPI (%)	
	1 year	3 years
min.	2,4	2,3
average	2,8	2,7
max.	3,2	3,2

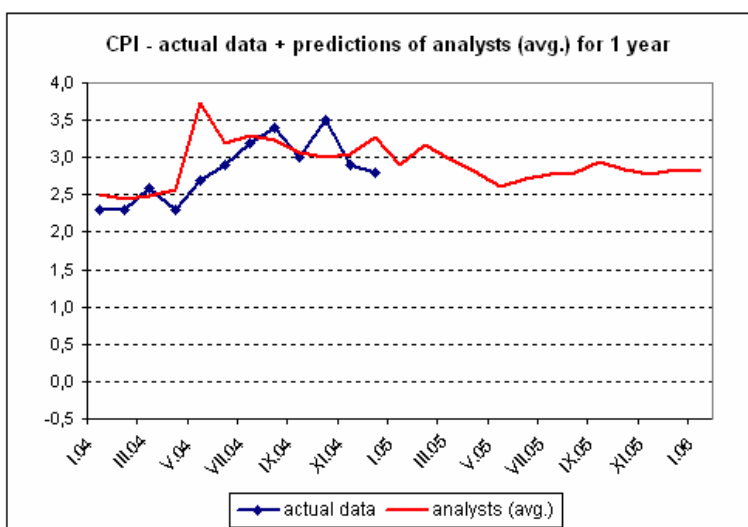
According to the respondents, the fall in inflation from its peak last October should continue. The upcoming months should see only moderate price growth of around 2%. The slowdown in inflation will be due mainly to a strong koruna, an unwinding of the effect of last year's tax changes and falling oil prices. The decline in the prices of electronics, textiles, footwear and furnishings should continue. By contrast, regulated prices of electricity, gas

and water supply and sewerage collection charges will increase. Prices are also expected to continue rising in the categories of hotels and restaurants and recreation and culture. Food prices are expected to record moderate growth as well, as the fall in crop product prices due to last year's good harvest is being offset by a rise in livestock product prices. Some analysts therefore expect a faster balancing-out of price levels in the Czech Republic and Western Europe as a result of the greater openness of EU markets to our farmers. Tobacco and alcohol prices will probably rise again in June. As in previous years, rent deregulation remains uncertain.

The inflation rate is expected to increase to around 3% in H2. Demand-pull inflationary pressures are expected to emerge in the Czech economy in this period, owing to faster wage growth this year and solid growth of the domestic economy.

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

Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
I-04	2,9	2,9
III-04	3,0	2,8
VI-04	2,7	2,7
IX-04	3,0	2,9
XI-04	2,8	2,7
XII-04	2,8	2,8
I-05	2,8	2,7



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
III-04	3,3	3,7
VI-04	3,4	3,6
IX-04	3,6	3,8
XI-04	3,9	3,9
XII-04	3,8	4,0
I-05	3,9	3,9

I-05	GDP growth at the end of	
	current year	next year
min	3,6	3,0
average	3,9	3,9
max	4,5	4,5

In their comments, some analysts say that owing to the revision of the data for 2004 Q2 and the whole of 2003, and also because of lower-than-expected consumption, they have further slightly reduced their estimates for the whole-year growth of the domestic economy.

This year, growth should continue to be driven chiefly by investment (although a slowdown in investment can be expected compared to 2004) and the improving export performance of the Czech economy. Faster wage growth and increasing household indebtedness are expected to lead to a recovery in consumer demand. Czech GDP growth is estimated at around 4% in both 2005 and 2006. According to the comments of one respondent, partial indicators suggest that the Czech economy has a higher growth potential, but its many rigidities (labour market, labour taxation, social benefits, etc.) prevent a more marked pick-up.

3. Interest rates

I-05	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	2,0	2,5	2,6	3,2	3,1	3,7	3,9
average	2,5	3,0	2,8	3,3	3,5	4,1	4,0	4,6
max.	2,5	3,3	2,9	3,6	3,9	4,5	5,1	5,3

According to the analysts, the strong koruna and the lower-than-expected household consumption growth have reduced the originally foreseen modest inflation risks to a minimum. The respondents say that the favourable inflation outlook and slower economic growth thus reduce the scope for interest rate rises in the near future. The analysts are now awaiting the last January meeting of the CNB Bank Board, and they agree that its forecasts for growth and inflation will probably be downscaled. In February, the Inflation Report will be published and four members of the Bank Board will be appointed. External factors, namely the strong euro and the second-round effect of expensive oil on the euro area economy, also indicate that interest rate rises may be postponed.

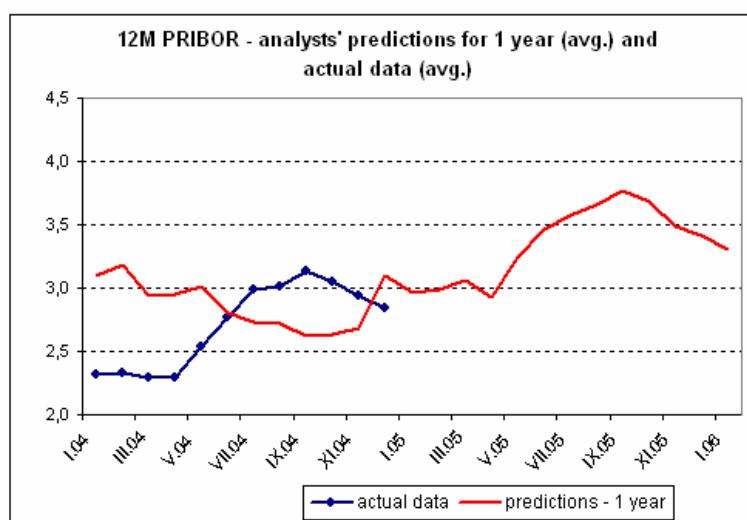
The financial market does not expect an interest rate rise in Q1, and the analysts hold the view that it might take place in April at the earliest. In their opinion, the summer months are the most probable time for the first increase. Some respondents incline towards an even later date. One of the foreign analysts has long had fairly pessimistic expectations regarding the world economy (and therefore also the Czech economy) and foresees a reduction in the CNB's repo rate back to 2%. According to the results of the survey, the repo rate at the one-year horizon could be as follows: 2.00% (one respondent), 2.75% (two respondents), 3.00% (nine respondents) or 3.25% (three respondents).

According to the comments of one respondent, the low liquidity in December, the need to close out short positions before the end of the year and the favourable fundamentals led to a marked rise in bond prices. However, most of the analysts believe that the current prices of these instruments are artificially low and the yield curve can be expected to shift upwards despite the lower supply of domestic debt and the strong demand. They expect a moderate increase of 10–15 basis points at the horizon of one month. Turning to the longer-term outlook (one year), expectations regarding the evolution of domestic interest rates and the situation on global markets should be the key factors. The respondents mostly forecast the yield curve to shift upwards by around 70 basis points compared to the levels at the time of the survey.

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
	%	%	%	%	%	%	%	%
I-04	2,0	2,5	2,3	3,0	3,8	4,3	4,7	5,2
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
XI-04	2,5	3,1	3,0	3,5	4,1	4,5	4,8	5,2
XII-04	2,5	3,0	2,9	3,4	3,7	4,3	4,2	4,8
I-05	2,5	3,0	2,8	3,3	3,5	4,1	4,0	4,6

Actual values of indicators on the day of deadline for forecasts

	2W repo rate	12M PRIBOR	5R IRS	CR 3,70/13 yield
12.1.	2,50	2,75	3,43	3,90



4. The exchange rate

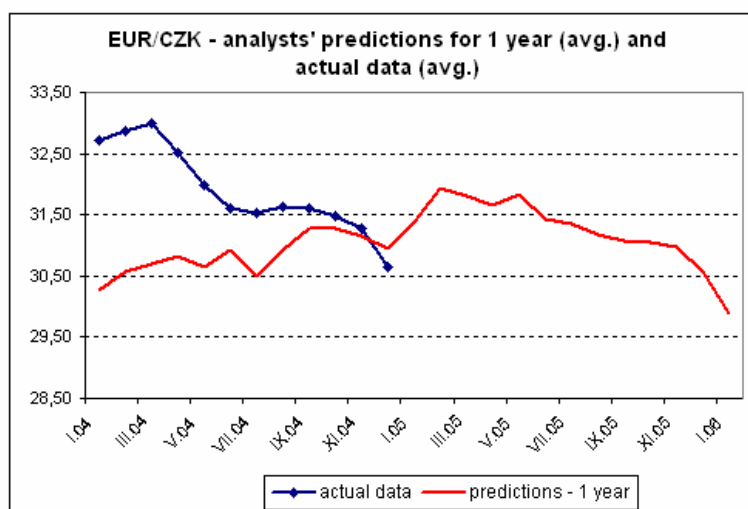
I-05	EUR/CZK	
	1 month	1 year
min.	30,00	28,50
average	30,36	29,90
max.	30,90	30,50

Exchange rate - fixing on the day of deadline for forecasts

12.1.	30,485
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Prediction for Month of prediction	exchange rate 1 month 1 year EUR/CZK	
	1 month	1 year
I-04	32,34	31,37
III-04	32,81	31,81
VI-04	31,63	31,44
IX-04	31,66	31,07
XI-04	31,47	30,97
XII-04	30,89	30,56
I-05	30,36	29,90

The analysts' estimates for the exchange rate of the koruna at the one-month horizon range from 30.00 to 30.90 CZK/EUR, with the majority forecasting further moderate appreciation of the domestic currency. They observe, however, that the koruna appreciated at the end of last year above levels consistent with fundamentals. The analysts say that the appreciation of the koruna was driven by the interest of foreign investors in regional assets (including Czech ones), which, in turn, is due partly to the persisting negative outlook for the US dollar. Speculation regarding the privatisation of Český Telecom was another reason, but its effect on the koruna should have unwound by now, according to the analysts.



The estimates for the koruna for the next few months vary, but a slight correction of the current level is generally expected. In the long run, however, the koruna is forecasted to continue appreciating moderately. The improving export performance of the Czech economy (to be boosted this year by the launch of automobile production at TPCA in Kolín) and the expected increase in the CZK/EUR yield spread will benefit the koruna. The expected further weakening of the dollar should also foster appreciation of Central and Eastern European currencies. By contrast, repatriation of earnings to foreign owners will act against the koruna. The estimates for the koruna at the one-year horizon range from 28.50 to 30.50 CZK/EUR, the average estimate being below 30.00 CZK/EUR.

Prague, 19 January 2005