CZECH CNB NATIONAL BANK

Measuring financial market inflation expectations – Results of the 70th measurement (February 2005)

Twelve domestic and one foreign analyst took part in the CNB's February survey.

The analysts revised their inflation forecasts downwards and significantly changed their expectations of the Bank Board's steps in the monetary policy area. The latest figures on the real economy raise hopes for higher economic growth and faster appreciation of the domestic currency than previously expected.

1. Inflation

II-05	annual CPI (%) 1 year	3 years
min.	2,0	2,3
average	2,6	2,7
max.	3,0	3,0

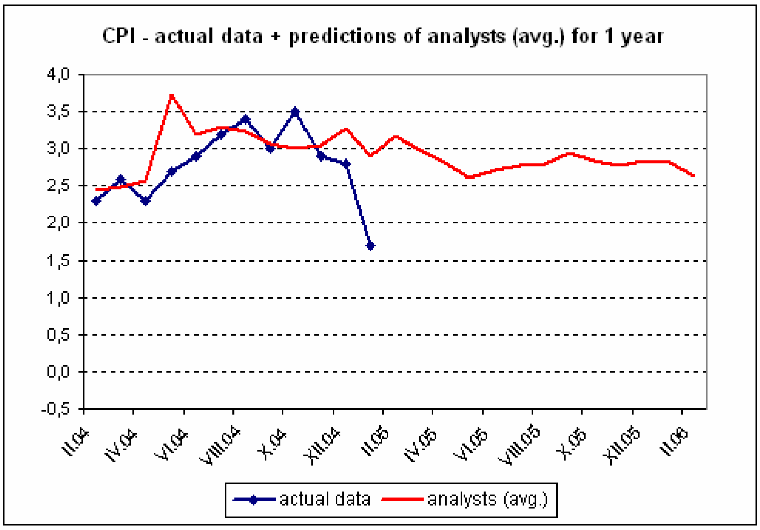
Inflation in January remained below the expectations of both the market and the CNB. The analysts expect inflation to fluctuate below the lower boundary of the CNB's inflation target band at least until the middle of this year. According to their comments, prices are falling particularly in areas where there is strong competition or where the koruna's exchange rate has a stronger effect. The strengthening koruna is making imports of consumer goods, food, electronic goods and fuels cheaper. The demand in the economy is not increasing the pressure on inflation, either.

In the first few months of this year, inflation will be kept down primarily by an unwinding of the effect of last year's tax changes and by a slowdown in food prices, due among other things to last year's good harvest.

According to the analysts, inflation should pick up in the second half of this year, mainly because of administrative measures (excise duty on tobacco, a rise in regulated rents). However, annual consumer price inflation should remain well below 3%. Oil prices and a potential higher increase in rents pose risks.

At the three-year horizon, the inflation prediction remains broadly stable, fluctuating just below 3.0%. The average estimate in the February survey is 2.7%.

Prediction for Month of prediction	**annual CPI 1 Y %**	**3 Y %**
II-04	3,2	2,8
III-04	3,0	2,8
VI-04	2,7	2,7
IX-04	3,0	2,9
XII-04	2,8	2,8
I-05	2,8	2,7
II-05	2,6	2,7



2. Gross domestic product

Prediction for Month of prediction	GDP growth at the end of this year %	 next year %
II-04	3,2	3,6
III-04	3,3	3,7
VI-04	3,4	3,6
IX-04	3,6	3,8
XII-04	3,8	4,0
I-05	3,9	3,9
II-05	4,0	3,9

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

The recent concerns of some analysts about lower economic output last year were replaced by the opposite reaction, i.e. an increase in expected growth, after the release of the foreign trade figures for November and December 2004.

The Czech economy should profit from past foreign direct investment and accession to the EU in 2005 as well. Net exports will remain one of the most significant motors of economic growth this year. The analysts also mention the effect of the launch of car production at TPCA Kolín. Investment growth should remain relatively buoyant, despite an expected slowdown. This year's faster real wage growth and continuing rise in household indebtedness are expected to lead to a recovery in consumer demand. Czech GDP growth is estimated at around 4% this year, and the analysts' average estimate for 2006 is only slightly lower. The analysts say that despite the higher growth potential of the Czech economy, structural problems on the labour market continue to put the brakes on growth.

3. Interest rates

II-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.	2,0	2,0	2,0	2,2	2,7	3,0	3,2	3,5
average	2,2	2,3	2,2	2,7	2,9	3,7	3,5	4,2
max.	2,3	2,8	2,4	3,2	3,4	4,1	4,3	4,7

The reduction in interest rates to 2.25% at the CNB's monetary meeting in January took the market completely by surprise. Despite the CNB's justification for this step (the revision of the GDP time series for 2003 and the resultant downward revision of the assumptions regarding the future growth of the domestic economy, the restrictive effect of fiscal policy in 2004, the stronger exchange rate and the worse outlook for economic growth in the euro area), the analysts believe that the persisting strong exchange rate of the koruna was the primary reason. However, the koruna responded to the rate reduction with only a temporary slight weakening and appreciated again in the days that followed.

According to some of the analysts, there is a very high likelihood of a further reduction in interest rates in February or March, owing to the evolution of the exchange rate of the koruna and the prevailing downside risks of the inflation forecast.

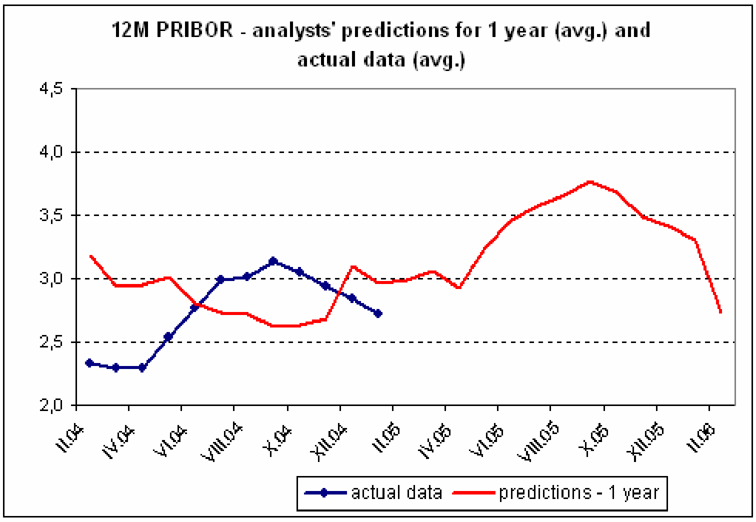
As regards the settings of key rates in the remainder of the year, the analysts' opinions differ. The repo rate estimates for the end of 2005 range between 2.00% and 2.75%, and the estimates at the one-year horizon are similar. The results of the February survey are as follows: repo rate at one year at 2.00% – two respondents, 2.25% – five respondents, 2.50% – five respondents, and 2.75% – one respondent. By comparison with the previous surveys this represents a marked reduction in the estimates, as is clear from the following table.

The average estimate for the long end of the yield curve at the nearest horizon is very close to the level at the time of the survey. In the longer term (one-year horizon), expected domestic interest rates and the situation on global markets should be the deciding factors. The respondents on average expect the yield curve to shift upwards by around 70–80 basis points compared to the levels at the time of the survey.

Prediction for	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
Month of prediction	%	%	%	%	%	%	%	%
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
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
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
II-05	2,2	2,3	2,2	2,7	2,9	3,7	3,5	4,2

Actual values of indicators on the day of deadline for forecasts

	2W repo rate	12M PRIBOR	5R IRS	CR 3,70/13 yield
10.2.	2,25	2,23	2,96	3,44



4. The exchange rate

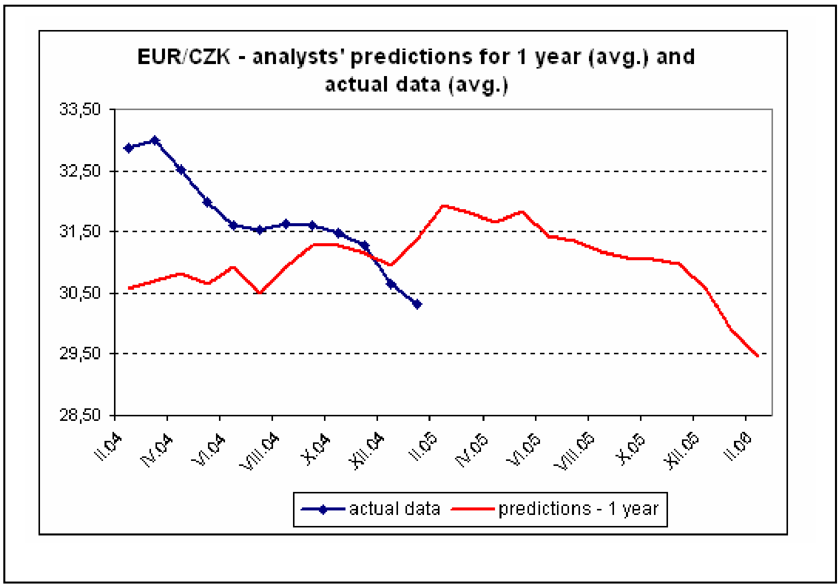
II-05	EUR/CZK 1 month	EUR/CZK 1 year
min.	29,70	28,50
average	29,97	29,46
max.	30,20	30,30

Exchange rate - fixing on the day of deadline for forecasts

10.2.	29,985

Prediction for	exchange rate	
	1 month	1 year
Month of prediction	EUR/CZK	
II-04	32,96	31,93
III-04	32,81	31,81
VI-04	31,63	31,44
IX-04	31,66	31,07
XII-04	30,89	30,56
I-05	30,36	29,90
II-05	29,97	29,46

The koruna has in recent days gone below 30.00 CZK/EUR. Some of the analysts expect the domestic currency to appreciate even further, justifying their expectations by the planned privatisations of state property this year, rising export activity by domestic corporations and the positive sentiment regarding the Central European region on the financial markets. Roughly the same number of analysts, however, tend towards a stagnation or correction of the exchange rate. The respondents' estimates for the exchange rate at the one-month horizon range from 29.70 to 30.20 CZK/EUR. According to their comments, a greater weakening is likely in connection with the repatriation of earnings of foreign-owned corporations in the spring and summer months.



As for the long-term outlook, most of the analysts incline towards the scenario of further gradual appreciation of the koruna. The average estimate for the one-year horizon is 29.46 CZK/EUR. The individual forecasts range from 28.50 CZK/EUR to 30.30 CZK/EUR.

According to the analysts, the expected long-term appreciation of the koruna is based on faster productivity growth and catch-up with the euro area economic level. The koruna should be supported by positive trends in the balance of payments. A declining current account deficit – thanks to the favourable evolution of the trade balance – should be accompanied by a growing financial account surplus, as EU membership and the lower risk premium will stimulate portfolio investment. In addition, significant privatisation revenues are expected (Český Telecom, Unipetrol, Vítkovice).

Prague, 15 February 2005