

Measuring financial market inflation expectations – Results of the 77th measurement (September 2005)

Eleven domestic and two foreign analysts sent in their predictions for inflation and other financial market indicators to the CNB's September survey. The respondents' expectations regarding future inflation and rates are essentially unchanged. However, thanks to favourable data, the forecast for domestic economic growth has risen quite significantly, despite the fact that most of the respondents again expect a tightening of the exchange rate component of the real monetary conditions due to a further revision of the koruna's exchange rate forecast towards stronger appreciation.

1. Inflation

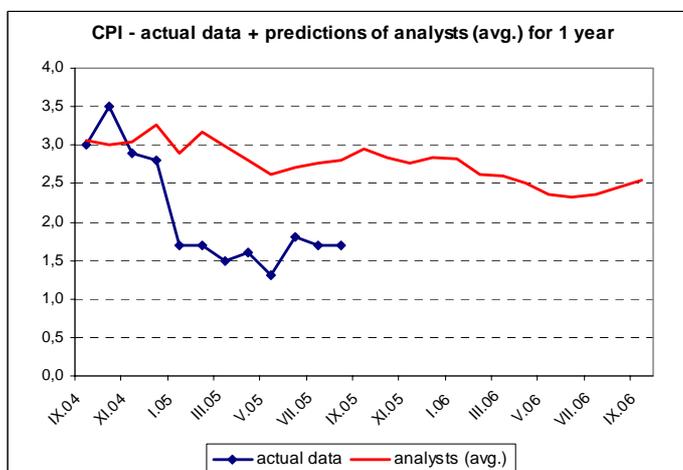
IX-05	annual CPI (%)	
	1 year	3 years
min.	2,0	2,0
average	2,5	2,5
max.	2,8	2,9

The inflation outlook is still relatively favourable, according to the analysts, despite the dramatically growing oil prices. Inflation is expected to rise in the upcoming months and at the turn of 2005 and 2006 might reach 3%, i.e. the CNB's inflation target level. The analysts emphasise that

demand pressures will remain subdued and inflation growth will be driven by cost factors resulting from rising prices of oil, gas and electricity. However, these pressures are being partly offset by the strengthening koruna. Moreover, strong competition will prevent full pass-through of the higher prices of raw materials and energy into producer prices, and competition in the retail sector will prevent these prices from passing on into consumer prices.

Rising oil prices and administered prices (gas, rents, excise duty on tobacco, electricity) are thus the main upside risks to inflation, according to the analysts. Owing to this year's worse harvest they also expect a rise in food prices. The downside risks can be seen mainly in the expected appreciation of the koruna, which will reduce import prices. Only modest demand growth and slower closure of the output gap will continue to curb demand-pull inflationary pressures.

Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
IX-04	3,0	2,9
XII-04	2,8	2,8
III-05	2,6	2,6
VI-05	2,3	2,5
VII-05	2,4	2,5
VIII-05	2,5	2,6
IX-05	2,5	2,5



2. Gross domestic product

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

IX-05	GDP growth at the end of	
	current year	next year
min	4,2	3,8
average	4,7	4,2
max	5,1	4,6

Most of the respondents in the September survey further increased their forecasts for GDP growth this year and the next. Based on the latest data on the trade balance and developments in industry, the analysts revised their estimates of growth this year quite significantly upwards (the average estimate being 0.4% higher than in August). Net exports have clearly become the main engine of growth. In the analysts' opinion, this is largely due to investment growth in previous years and the declining import intensity of Czech industry. The Czech Republic's accession to the EU has at the same time enhanced perceptions of the quality of Czech products abroad. Domestic exporters have thus been more successful on foreign markets, despite the appreciating exchange rate of the koruna. Unlike last year, when the Czech Republic enjoyed a massive inflow of capital and reinvestment of earnings, this year has seen a marked slowdown in investment. In the analysts' opinion, the contribution of domestic consumption will also remain quite weak.

Nonetheless, the Czech economy should continue to grow at a solid rate next year. The analysts are expecting some change in the growth structure, specifically the onset of stronger growth in domestic consumption. A risk to economic growth is the combination of high oil prices, which is raising energy prices, and the rapidly appreciating koruna. A cooling of investor interest in the Czech Republic and a slowdown in the world economy may also provoke concerns.

3. Interest rates

IX-05	2W repo rate (%)		12M PRIBOR (%)		5Y IRS (%)		10Y IRS (%)	
	1 month	1 year	1 month	1 year	1 month	1 year	1 month	1 year
min.	1,75	1,75	1,80	1,90	2,60	2,80	3,20	3,25
average	1,75	2,06	1,86	2,32	2,71	3,15	3,31	3,69
max.	1,75	2,25	1,92	2,65	2,90	3,30	3,60	4,00

The forecast for short-term rates at the one-year horizon decreased slightly, as did the forecasts for medium- and long-term rates. Although about one quarter of the respondents revised their predictions for the CNB's monetary policy measures in one direction or the other, the expectations remain virtually unchanged overall (of the thirteen respondents, four predict the two-week repo rate at the one-year horizon at 2.00%, six at 2.25% and three at the current level).

The fact that the dynamic growth of the Czech economy is sound in structure and that inflation will be driven upwards chiefly by cost factors is not forcing the CNB to consider tightening monetary policy in the near future, say the analysts. Nor is there any reason to fear demand-pull inflationary pressures in the near future. The analysts mention the risk of the rising energy prices being reflected in inflation expectations, but, on the other hand, they think it is likely that consumers will offset the higher petrol and energy prices by reducing their expenditure on other consumer goods, which could create downward pressure on consumer goods prices. They also note that the inflationary effect of oil prices is, to a certain extent, being offset by faster appreciation of the koruna. For this reason, they still expect the CNB to increase interest rates by 25 basis points in 2006 Q2 at the earliest.

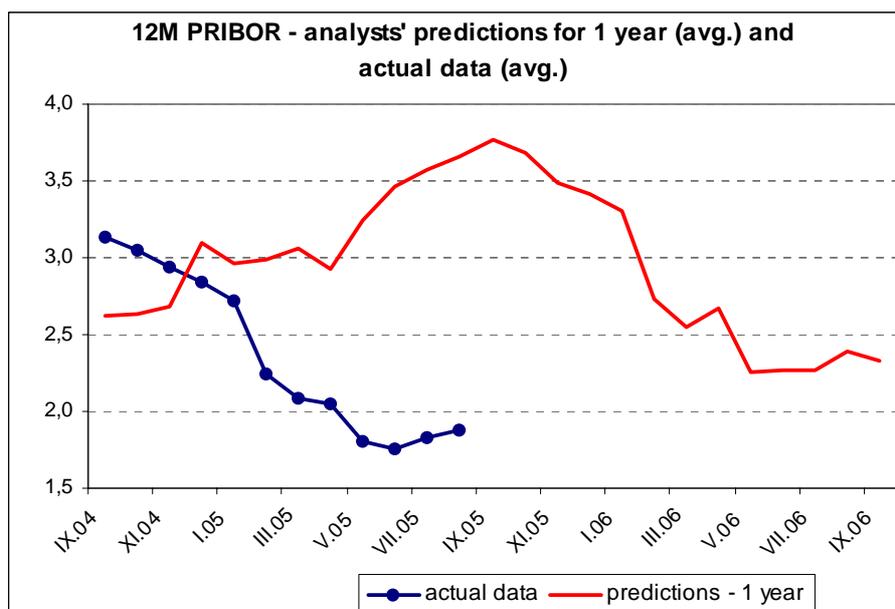
The average estimates for medium-term and long-term rates at the one-month horizon are very close to their current values. At the one-year horizon, the analysts expected the yield curve to shift upwards by around 40–45 basis points from the current level. The expected increase in yields should be affected primarily by the CNB's monetary policy rate settings, the supply of domestic bonds and developments in the euro area.

Prediction for Month of prediction	2W repo rate		12M PRIBOR		5Y IRS		10Y IRS	
	1 M	1 Y	1 M	1 Y	1 M	1 Y	1 M	1 Y
	%		%		%		%	
IX-04	2,52	3,36	3,14	3,77	4,45	4,88	5,17	5,60
XII-04	2,49	3,04	2,91	3,41	3,68	4,27	4,15	4,76
III-05	2,02	2,26	1,99	2,55	2,90	3,58	3,49	4,08
VI-05	1,75	1,93	1,75	2,27	2,59	3,22	3,28	3,85
VII-05	1,76	1,94	1,78	2,31	2,58	3,21	3,29	3,84
VIII-05	1,75	2,09	1,85	2,39	2,71	3,21	3,41	3,80
IX-05	1,75	2,06	1,86	2,32	2,71	3,15	3,31	3,69

**/ 10Y benchmark yield*

Actual values of indicators on the day of deadline for forecasts

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
12.9.	1,75%	1,85%	2,68%	3,23%



4. The exchange rate

IX-05	EUR/CZK	
	1 month	1 year
min.	29,00	28,20
average	29,28	28,97
max.	29,80	30,00

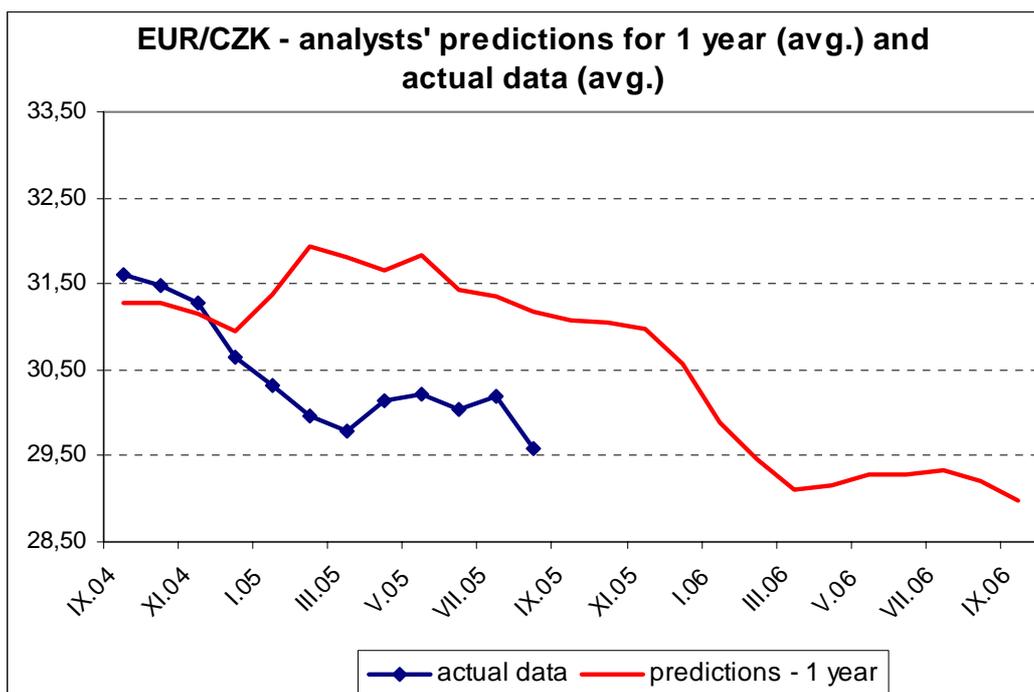
Prediction for Month of prediction	exchange rate 1 month 1 year EUR/CZK	
	IX-04	31,66
XII-04	30,89	30,56
III-05	29,48	29,11
VI-05	30,10	29,27
VII-05	30,09	29,34
VIII-05	29,77	29,20
IX-05	29,28	28,97

Exchange rate - fixing on the day of deadline for forecasts

12.9.	29,195
--------------	--------

Compared to previous months, the short-term forecast for the koruna-euro exchange rate saw a major change connected with the current appreciation of the domestic currency. The analysts on average predict the exchange rate at the one-month horizon at around CZK 29.30/EUR, with the forecasts ranging between CZK 29.00 and CZK 29.80.

Most of the analysts view the recent strengthening of koruna to CZK 29/EUR as an overshooting of the long-term appreciation trend, which is out of line with domestic economic fundamentals. They explain this strengthening by the depreciation of the dollar, optimism regarding Central European currencies, excellent domestic macroeconomic data, hedging against exchange rate risk by domestic firms and lower holiday-period liquidity. According to the analysts, the koruna's exchange rate will be affected in the next few weeks by developments in the region and by indications of the pace and extent of increases in the Fed's key rate.



At the longer horizon, the koruna is expected to appreciate on the back of favourable domestic economic data. The koruna's appreciation is being aided in particular by the Czech Republic's improving trade results. Regional sentiment and investors' interest in dollar assets will remain important for the development of the koruna. The negative interest rate differential is still acting against the koruna. By contrast, the fact that the outflow of dividends has now peaked is a favourable factor. Foreign investors' interest in the shares of domestic companies is also playing a positive role.

In September, the forecast for the koruna-euro rate at the one-year horizon again shifted towards a stronger koruna. The average estimate is CZK 28.97/EUR, with the individual estimates lying within the relatively wide range of CZK 28.20–30.00/EUR.

We would like to thank the following respondents for their contributions to this survey of financial market inflation expectations:

David Marek, Patria Finance
 David Navrátil, Česká spořitelna
 Jan Vejmělek, Komerční banka
 Jana Steckerová, ING Bank
 Pavel Sobíšek, HVB Bank ČR
 Vladimír Pikora, Volksbank
 Helena Horská, Raiffeisenbank
 Markéta Šichařová, Next Finance
 Petr Dufek, ČSOB
 Patrik Rožmberský, Živnobanka
 Radomír Jáč, PPF Asset Management
 Anders Faergemann, AIG International Limited

Gillian Edgeworth, Deutsche Bank London

Special thanks go to the analytical teams at Česká spořitelna, Komerční banka and Raiffeisenbank for their comments on the forecasts.

Prague, 21 September 2005