CZECH CNB NATIONAL BANK

Measuring financial market inflation expectations – Results of the 81st measurement (January 2006)

Thirteen domestic analysts and one foreign analyst sent in their predictions for inflation and other financial market indicators to the CNB's January survey. Compared to the December survey there was a modest fall in the inflation forecast. This was due to a more appreciated koruna, the postponement of the increase in regulated rents and the expected lower pass-through of the rise in excise duty on tobacco products and regulated prices to inflation expectations. According to the analysts, thanks to the lower inflationary pressures the CNB will be able to postpone raising interest rates. This, in turn, led to a modest decline in the interest rates expected by the analysts. The relatively biggest change compared to the December survey was seen in the GDP growth estimate. The analysts expect faster growth this year due to the expected lower interest rates, an improvement in the growth prospects for the euro area and the revision of the GDP series by the Czech Statistical Office (CZSO).

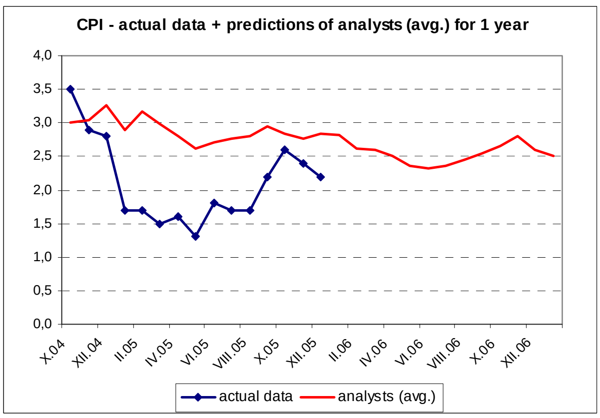
Inflation

I-06	annual CPI (%)	
	1 year	3 years
min.	1,6	2,0
average	2,5	2,4
max.	3,3	2,8

The inflation forecast fell only slightly compared to the December survey. The market expects year-on-year CPI growth of 2.5% at the one-year horizon and 2.4% at the three-year horizon. The main reasons for the lower inflation forecast are the expected lower second-round effects of the higher energy prices, the postponement of the increase in regulated rents until 2007 and the uncertainty regarding the effect of the increase in excise duty on the prices of tobacco products. The anti-inflationary effect of the strong koruna, which is reducing import prices, the lower expected oil prices and the wider output gap, which does not suggest any demand-pull inflationary pressures, are still persisting. After the unwinding of the cost shock, which will push inflation above 3% at the start of 2006, inflation can be expected to return below the inflation target.

The range of the estimates for the one-year horizon was slightly wider than in December. This might be linked with the greater uncertainty regarding the pass-through of the higher excise duty into cigarette prices, or with the higher number of respondents compared to December. By contrast, the range of the estimates for the three-year horizon narrowed to lower values, which might indicate good anchoring of long-term inflation expectations.

Prediction for Month of prediction	annual CPI 1 Y %	3 Y %
III-05	2,6	2,6
VI-05	2,3	2,5
VII-05	2,4	2,5
IX-05	2,5	2,5
X-05	2,7	2,5
XI-05	2,8	2,6
XII-05	2,6	2,5
I-06	2,5	2,4



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Gross domestic product

Prediction for Month of prediction	GDP growth at the end of this year	 next year
	%	
III-05	4,0	3,9
VI-05	4,0	3,9
VII-05	4,2	4,0
IX-05	4,7	4,2
X-05	4,7	4,3
XI-05	4,7	4,3
XII-05	4,9	4,4
I-06	4,6	4,4

I-06	GDP growth at the end of current year	 next year
min	4,1	3,3
average	4,6	4,4
max	5,0	5,4

The analysts revised their forecasts for GDP growth this year upwards, from 4.4% (in the table the December 2005 forecast for the end of next year) to 4.6%. This is due to the revision of the GDP series by the CZSO and the better growth prospects for the euro area economy. Compared to the expected growth of 4.9% last year, the growth should decelerate slightly. However, there should be more striking changes in its structure than the growth in absolute terms. Owing to the expected lower interest rates than in December, falling unemployment and growth in real wages, consumer demand should at least partially offset the lower contribution of net exports. Investment should benefit from the inflow of money from the EU and the public budgets. Overall, however, domestic demand will not succeed in offsetting the modest worsening of net exports caused by the stronger koruna.

The range of the estimates for 2006 remained unchanged from December, but the estimates shifted to higher levels. The effect of fiscal policy in the election year remains a risk.

Interest rates

I-06	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.	2,00	2,00	2,20	1,90	2,95	2,80	3,20	3,30
average	2,02	2,38	2,43	2,70	3,11	3,48	3,41	3,77
max.	2,25	2,50	2,50	3,00	3,30	3,70	3,60	4,00

The interest rate path expected by the analysts declined slightly by comparison with the December survey. However, the decline was more moderate than in December. The lower interest rate path is due to the lower market inflation forecast and also to the stronger koruna than in December. The possibility of a lowering of the CNB’s inflation forecast, and hence also of the expected interest rate path, has also been mentioned by some central bank representatives. Some of the analysts are of the opinion that ECB monetary policy is also a important factor behind domestic rate movements. Given that the ECB has indicated that the December rise in interest rates is not the beginning of a cycle of increases, and if it does not actually raise rates further, there is no reason for the CNB to tighten its monetary policy more strikingly.

Only one of the analysts expects a rise in monetary policy rates in January (25 basis points). At the one-year horizon, the rates should fluctuate between 2.25% and 2.50%. The expected slope of the money market yield curve at the one-year horizon, as measured by 12M PRIBOR – 2W repo rate, remained virtually unchanged.

The range of estimates of the 12M PRIBOR at the one-year horizon remained the same as in December. A higher-than-forecasted impact of the second-round effects of the high energy prices remains an upside risk, whereas a stronger koruna could foster lower rates.

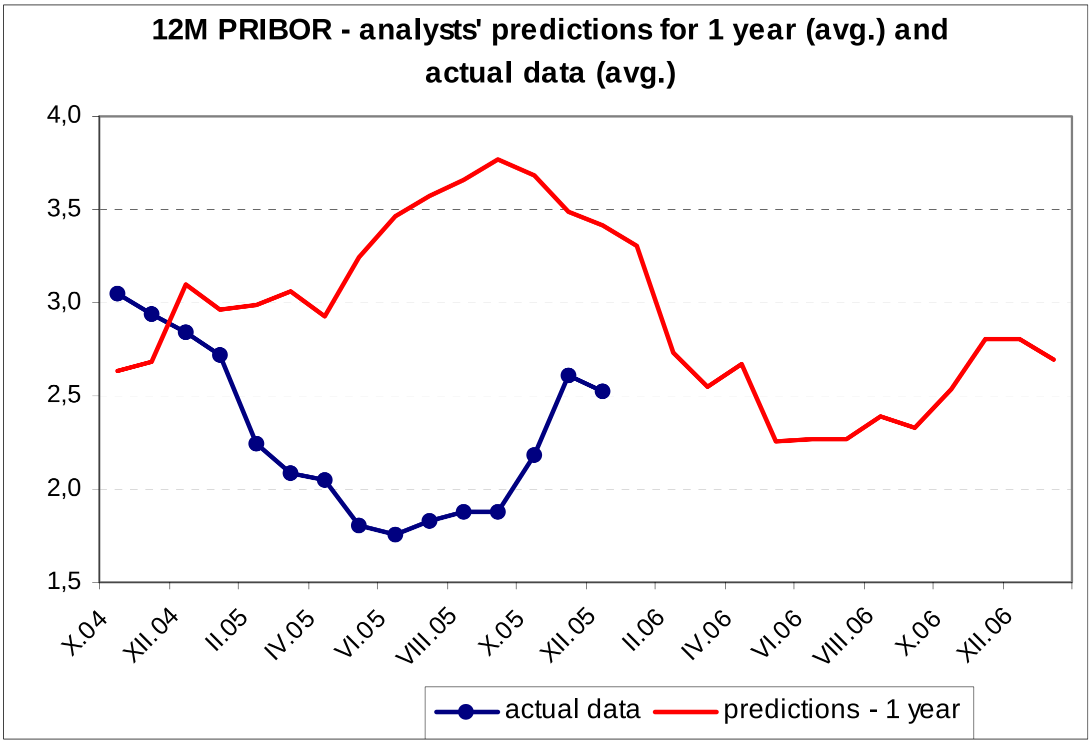
The 10-year interest rates expected at the one-year horizon fell modestly compared to the December survey. Once the cost-push inflation has unwound, yields should fall owing to lower net issuance of bonds, the exchange rate of the koruna and the only moderate second-round effects of the higher energy prices. Growth in euro yields due to expectations of a further tightening of monetary policy by the ECB and nervousness prior to the June parliamentary elections in the Czech Republic could pose an upside risk.

Prediction for	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
Month of prediction	%		%		%		%	
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
IX-05	1,75	2,06	1,86	2,32	2,71	3,15	3,31	3,69
X-05	1,75	2,25	2,06	2,54	2,95	3,36	3,43	3,88
XI-05	2,04	2,46	2,55	2,80	3,32	3,57	3,77	4,00
XII-05	2,00	2,40	2,47	2,75	3,21	3,47	3,62	3,89
I-06	2,02	2,38	2,43	2,70	3,11	3,48	3,41	3,77

**/ 10Y benchmark yield*

Actual values of indicators on the day of deadline for forecasts

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
11.1.	2,00%	2,48%	3,12%	3,41%



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The exchange rate

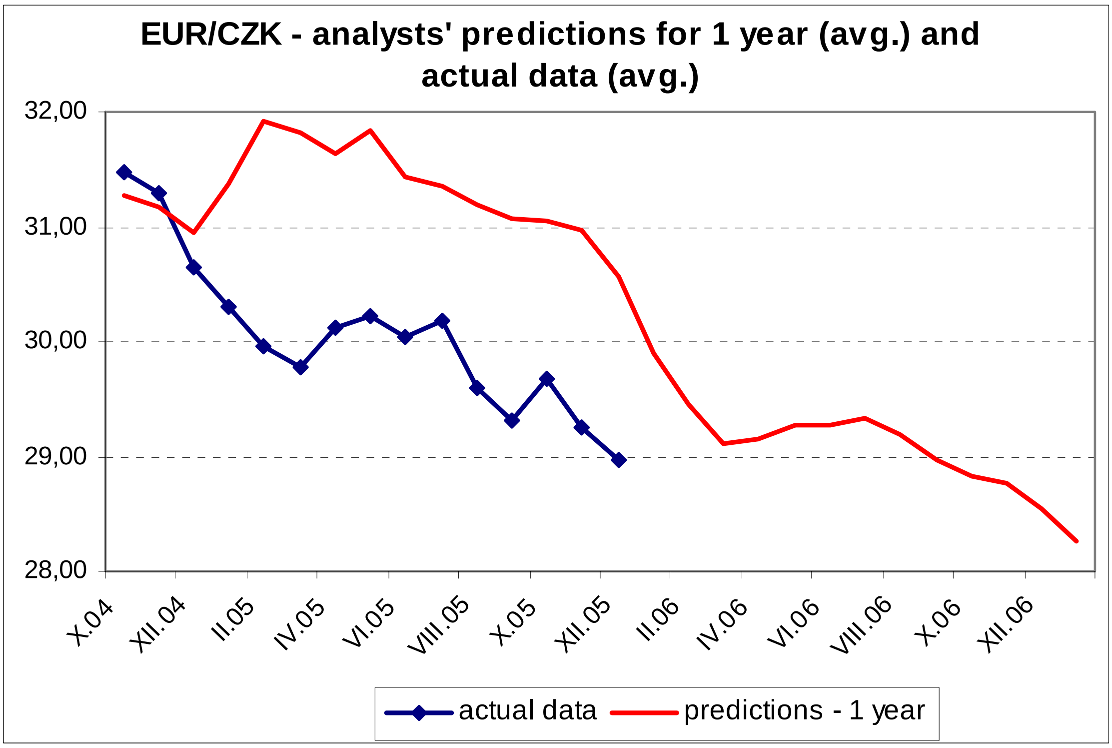
I-06	EUR/CZK 1 month	EUR/CZK 1 year
min.	28,60	27,80
average	28,85	28,26
max.	29,10	29,30

Exchange rate - fixing on the day of deadline for forecasts

11.1.	28,750

Prediction for Month of prediction	exchange rate EUR/CZK 1 month	exchange rate EUR/CZK 1 year
III-05	29,48	29,11
VI-05	30,10	29,27
VII-05	30,09	29,34
IX-05	29,28	28,97
X-05	29,43	28,83
XI-05	29,33	28,76
XII-05	29,06	28,55
I-06	28,85	28,26

The analysts expected a nominal appreciation of the koruna against the euro of 1.7% in January. The expected appreciation of the koruna at the one-year horizon remained unchanged from December. The expected koruna-euro exchange rate changed due to the koruna's appreciation trend so far in January. At the one-year horizon, the analysts expect faster GDP growth than in the euro area countries, convergence of the Czech economy towards the EU countries and continuing inflow of FDI (here the analysts most often mention the expected announcement of the construction of a Hyundai car plant). The favourable trade balance, which will affect the koruna mainly in 2006 H1, will be counteracted by an outflow of dividends, especially in 2006 H2.



The range of the estimates for the koruna's exchange rate narrowed at both horizons compared to the December survey. This may have been due to the unwinding of the uncertainty surrounding the future movement of ECB interest rates. By contrast, some of the analysts mentioned a temporary political risk following the parliamentary elections in the Czech Republic as well as Hungary, and also a possibility of early elections in Poland due to the minority government there. As usual, the weakest exchange rate is expected by the foreign analyst.

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