

Measuring financial market inflation expectations – Results of the 83rd measurement (March 2006)

Twelve domestic and two foreign analysts sent in their predictions for inflation and other financial market indicators to the CNB's March survey. The analysts newly expect faster GDP growth in both 2006 and 2007, despite higher expected interest rates. The forecast for the exchange rate and consumer price inflation at the one-year horizon remained unchanged from the February survey. According to the analysts, the fast GDP growth (driven in particular by exports) will continue without any demand-pull inflationary pressures. The analysts expect faster GDP growth compared to the February survey despite relatively tighter monetary conditions: the expected interest rate path has shifted slightly upwards, while the koruna's nominal exchange rate against the euro at the one-year horizon is unchanged.

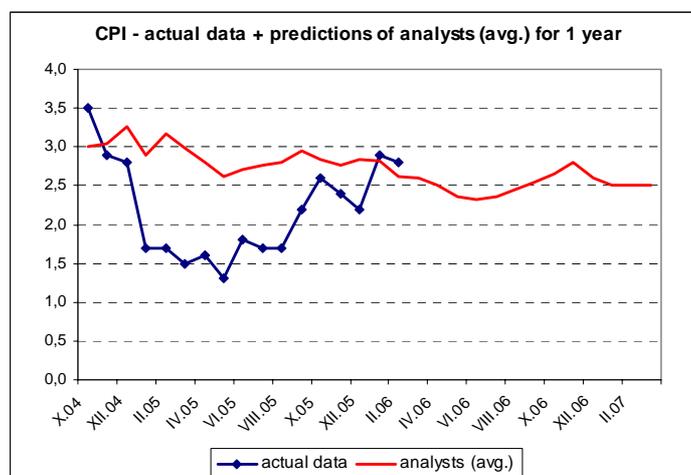
Inflation

III-06	annual CPI (%)	
	1 year	3 years
min.	1,8	1,9
average	2,5	2,4
max.	3,2	2,8

The inflation forecast was unchanged from February. The analysts expect annual inflation of 2.5% at the one-year horizon and 2.4% at the three-year horizon. The primary inflation factor in 2006 remains growth in regulated prices, although the analysts expect the sharp increase in January to gradually unwind. They took a similar view of the February inflation figures. During 2006, the increase in excise duties on cigarettes should continue to pass through to cigarette prices, and as from 2007 the partial deregulation of rents also needs to be taken into account. The current depreciation of the koruna's exchange rate is viewed by the analysts as a correction of the previous appreciation trend with no major impact on import prices. The stabilisation of oil prices is also assessed positively.

The interval of the estimates for the one-year horizon moved slightly upwards compared to February, although their range remained virtually unchanged. The slight increase in the upper limit of estimates might be linked with the pick-up in GDP growth and faster closure of the output gap.

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



Gross domestic product

Prediction for Month of prediction	GDP growth at the end of	
	this year %	next year %
III-05	4,0	3,9
IV-05	4,0	3,9
VII-05	4,2	4,0
X-05	4,7	4,3
XII-05	4,9	4,4
I-06	4,6	4,4
II-06	4,5	4,4
III-06	5,1	4,6

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

The forecast for GDP growth increased compared to February. The analysts expect GDP growth of 5.1% this year and 4.6% next year. The change in the forecast was due to the strong economic growth both in

2005 Q4 and in 2005 as a whole. Although many of the analysts are only now reviewing the latest CZSO figures, it is already clear that exports (the car industry) will continue to be the main factor of growth, followed by slowly rising household consumption (growth in disposable income due to a cut in personal income tax) and private investment. In addition to the expected recovery in Germany and FDI inflow, investment will profit from a pick-up in the flow of money from the EU.

According to the analysts, a slight slowdown in growth could be caused in 2007 by a decline in net exports, due to higher imports as a result of growing consumer demand and the strong koruna.

The range of the estimates for 2006 widened considerably compared to February. This may be due to revisions made to the estimates by the analysts. The effect of fiscal policy in the election year remains an upside risk.

Interest rates

III-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	2,25	2,20	2,50	3,10	3,35	3,50	3,50
average	2,00	2,50	2,33	2,77	3,24	3,52	3,63	3,80
max.	2,00	3,25	2,40	3,00	3,39	3,80	3,78	4,30

The interest rate path expected by the analysts rose compared to February. This is due to the depreciation of the koruna in March. According to some of the analysts, the exchange rate is near to the level predicted by the CNB's January forecast. Given the evolution of the exchange rate, the central bank will thus not have to change its inflation forecast and the implied interest rate path. An interest rate reduction also seems unlikely in the light of the CNB's latest communication (...there should not be frequent contrary movements in interest rates...). The market expects the first increase in interest rates to come at the turn of 2006 Q3 and Q4 (FRA rates). At the one-year horizon, the 2W repo rate, according to the analysts, should be around 2.50%. Another factor underlying the sharper increase in koruna interest rates, say the analysts, will be interest rates in the euro area. One of the foreign analysts expects growth in the 2W repo rate to 3.25% at the one-year horizon, although this is conditional on ECB rates rising to 3.50%.

All the respondents expect stable monetary policy rates in March. The expected slope of the money market yield curve at the one-year horizon – as measured by the 12M PRIBOR minus the 2W repo rate – fell slightly to 27 basis points. The range of the estimates of the 12M PRIBOR at the one-year horizon narrowed markedly compared to February. This may be due to greater certainty about future monetary policy. The koruna’s exchange rate and lower growth in euro area interest rates may pose a downside risk.

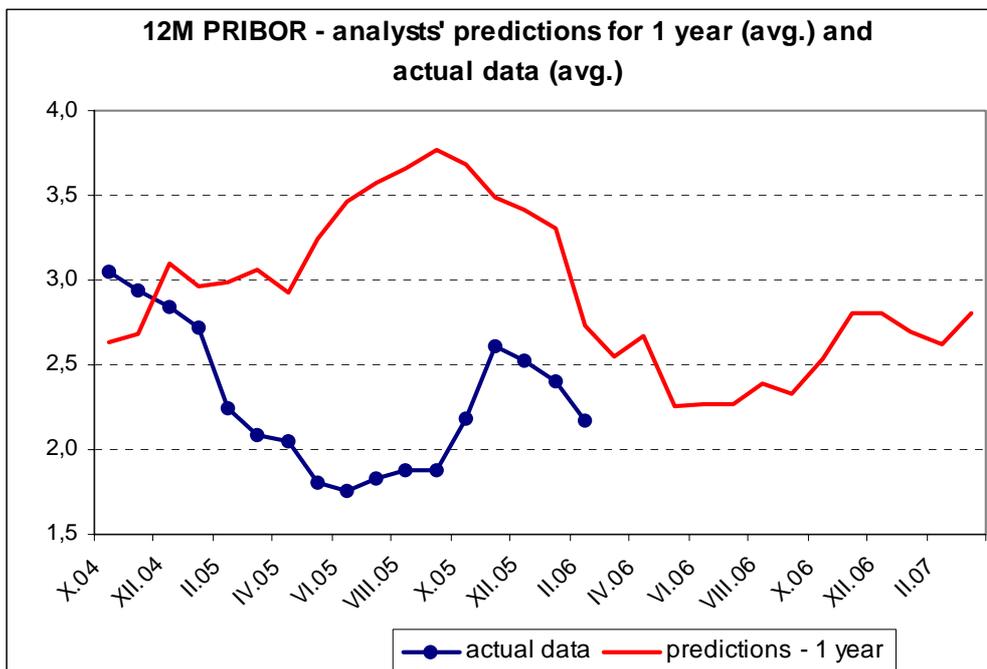
The expected ten-year interest rates rose slightly compared to February. This is due to a revision of the CNB’s future monetary policy owing to the depreciation of the koruna and the expected rise in euro area yields. According to one of the analysts, growth in koruna yields should be faster in 2006 H1 and should later unwind with the expected end to the increases in interest rates by the Fed and the ECB and the koruna’s return to an appreciation trend. The rising issuance of government bonds should be covered by increased demand for longer-term bonds from abroad and also from domestic funds and building societies.

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
	%		%		%		%	
III-05	2,02	2,26	1,99	2,55	2,90	3,58	3,49	4,08
IV-05	1,98	2,32	2,08	2,68	3,02	3,64	3,73	4,30
VII-05	1,76	1,94	1,78	2,31	2,58	3,21	3,29	3,84
X-05	1,75	2,25	2,06	2,54	2,95	3,36	3,43	3,88
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
II-06	2,02	2,32	2,18	2,62	3,06	3,42	3,46	3,69
III-06	2,00	2,50	2,33	2,77	3,24	3,52	3,63	3,80

**/ 10Y benchmark yield*

Actual values of indicators on the day of deadline for forecasts

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
14.3.	2,00%	2,34%	3,28%	3,67%



The exchange rate

III-06	EUR/CZK	
	1 month	1 year
min.	28,40	27,30
average	28,82	28,02
max.	29,10	29,02

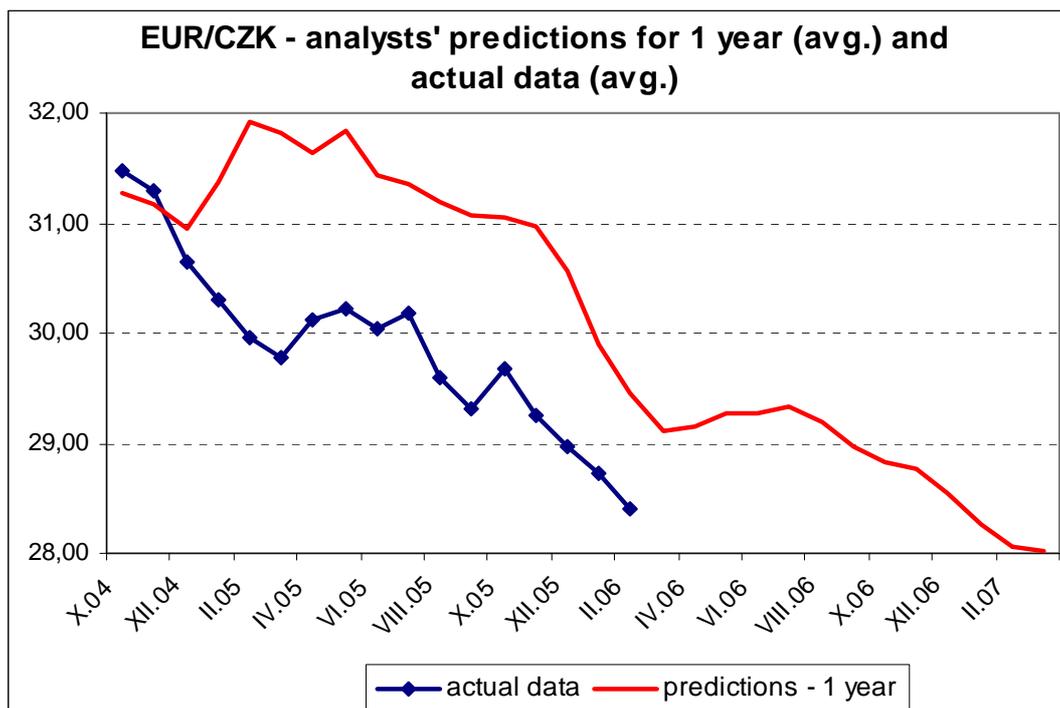
Exchange rate - fixing on the day of deadline for forecasts

14.3.	28,800
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Prediction for Month of prediction	exchange rate EUR/CZK	
	1 month	1 year
III-05	29,48	29,11
IV-05	29,89	29,15
VII-05	30,09	29,34
X-05	29,43	28,83
XII-05	29,06	28,55
I-06	28,85	28,26
II-06	28,56	28,07
III-06	28,82	28,02

In March, the analysts expect a nominal koruna exchange rate of around 28 CZK/EUR at the one-year horizon, the same as in February. The expected nominal appreciation of the koruna hence picked up from 0.7% to 2.7% at the one-year horizon, owing to the depreciation of the koruna in March. According to one of the analysts, the koruna's faster nominal appreciation is also more consistent with the assumption of an equilibrium real appreciation rate of around 3% (assuming a slight inflation differential of 0.5 percentage point).

The positive outlook for the koruna at the one-year horizon thus persists. The reasons are well known: expectations of faster GDP growth than in the euro area countries, favourable trade balance figures (thanks mainly to rising car exports), convergence of the Czech economy towards the EU countries, continuing inflow of FDI and depreciation of the dollar. At the shorter horizon, however, the analysts believe that the koruna could depreciate slightly, to 29 CZK/EUR. The reasons remain the following: growth in yields on global markets causing an outflow of assets from the CEE region, a widening negative interest rate differential, political instability in the region prior to the parliamentary elections (CZ, SK, HU), and also the outflow of dividends expected especially in 2006 H2.



Compared to the February survey, the range of the estimates for the koruna's exchange rate was unchanged at the one-month horizon, but widened at the one-year horizon. The risks are thus concentrated more at the longer horizon. The most often mentioned include uncertainty about yields on global markets and political uncertainty in the Central European region.

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

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