

Measuring financial market inflation expectations – Results of the 84th measurement (April 2006)

Twelve domestic analysts and one foreign analyst sent in their predictions for inflation and other financial market indicators to the CNB’s April survey. Owing to the unexpectedly strong data for 2005 Q4, the analysts continued revising upwards their expectations of GDP growth in 2006 and 2007. However, the faster GDP growth will increase the demand-pull inflationary pressures only minimally (most of the growth will pass through to an increase in potential output). With additional help from a stronger exchange rate of the koruna at the one-year horizon, the CNB will thus not be forced to raise its interest rates. The analysts expect the 2W repo rate to increase to 2.50% at the one-year horizon, the same as in March. The expected monetary conditions tightened slightly compared to the March survey: the expected 12M PRIBOR and the nominal koruna-euro exchange rate shifted upwards at the one-year horizon.

Inflation

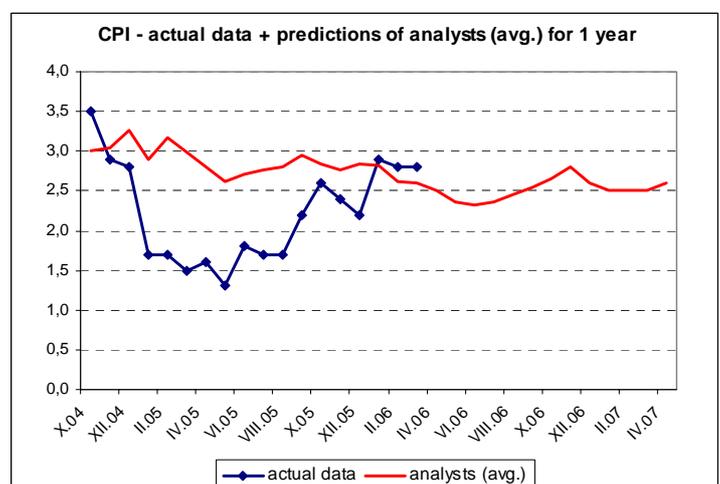
IV-06	annual CPI (%)	
	1 year	3 years
min.	2,1	1,9
average	2,6	2,4
max.	3,3	2,8

The inflation forecast shifted upwards slightly. The analysts expect annual inflation of 2.6% at the one-year horizon, as against the 2.5% expected in March. Nevertheless, long-term inflation expectations remain well anchored. The month-on-month increase in the inflation forecast may have been caused by a slight rise in demand-pull inflationary pressures stemming from faster

closure of the output gap. Nonetheless, the demand-pull inflationary pressures in the economy should remain under control, since the faster GDP growth will pass through rather to an increase in potential output. The primary inflation factor in 2006 therefore remains growth in regulated prices, which should, however, slowly abate.

The interval of the estimates for the one-year horizon moved slightly upwards compared to March, but their range narrowed. This narrowing might be linked with the reduced uncertainty associated with the future direction of consumer price inflation. The higher estimates might be due concerns about the faster closure of the output gap. The koruna’s appreciation trend, conversely, could pose a downside risk to inflation.

Prediction for Month of prediction	annual CPI	
	1 Y %	3 Y %
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
IV-06	2,6	2,4



Gross domestic product

Prediction for Month of prediction	GDP growth at the end of	
	this year %	next year %
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
IV-06	5,3	4,8

IV-06	GDP growth at the end of	
	current year	next year
min	4,5	3,6
average	5,3	4,8
max	6,3	6,3

The forecast for GDP growth continued to rise compared to March. The analysts expect GDP growth of 5.3% this year and 4.8% next year. Over the past two months, during which the analysts have been revising their forecasts on

the basis of new data from the CZSO, the GDP growth expected in 2006 has increased by 0.8 percentage point and that in 2007 by 0.4 percentage point. However, the structure of the growth remains unchanged. Exports and incoming investment remain the main factors and will profit, in addition to the expected recovery in Germany and FDI inflow (Hyundai), from a rise in the inflow of money from the EU. The favourable growth structure has led the analysts to revise potential output growth. Whereas the growth rate of potential output was 4% in 2003 and 2004, according to one of the analysts it should rise to 5% in 2005 and even 6% in 2006.

The range of estimates for 2006 narrowed considerably compared to March. This may be linked with the completion of revisions made to the estimates by most of the analysts. The effect of fiscal policy in the election year remains an upside risk to growth.

Interest rates

IV-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	2,30	2,70	3,30	3,50	3,70	3,60
average	2,00	2,52	2,40	2,85	3,42	3,69	3,81	3,93
max.	2,00	2,75	2,50	3,00	3,50	3,95	3,90	4,15

The interest rate path expected by the analysts continued to rise modestly compared to the March survey. This was due to the faster GDP growth, which may generate slight demand-pull inflationary pressures, and higher euro rates. However, higher growth, particularly in short-term rates, is being hindered by the stronger exchange rate. One of the analysts therefore believes that the message of the CNB's April inflation forecast could be identical to the January forecast, i.e. a modest upswing in rates. The market expects the first increase in interest rates to come as early as 2006 Q3. According to the analysts, the 2W repo rate should be around 2.50% at the one-year horizon, the same as in March.

The range of the short-term rates expected at the one-year horizon narrowed significantly compared to March. The uncertainty regarding the future direction of monetary policy thus decreased. The sizeable reduction in the maximum estimate for the 2W repo rate at the one-year horizon from March's 3.25% to 2.75% is due to the absence of one foreign analyst from the April survey.

All the respondents expect stable monetary policy rates in April. 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 – rose by 6 basis points to 33 basis points due to faster growth at longer maturities. The koruna’s exchange rate and lower growth in euro area interest rates remain a downside risk to rates.

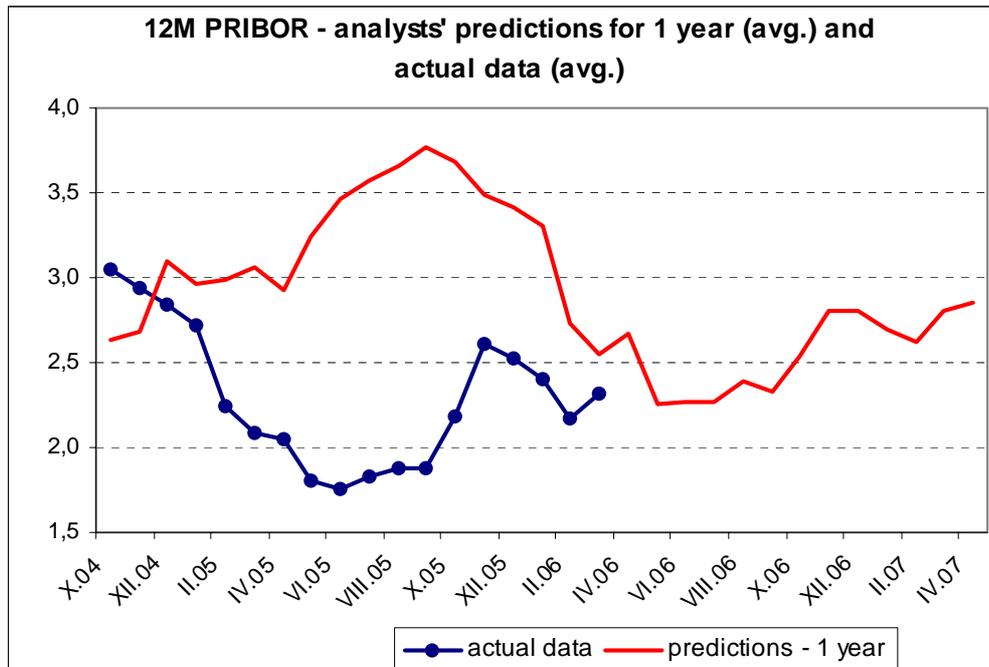
The expected medium and long-term yields increased more significantly compared to March. This is due to similar yield movements in the euro area and the US. A correction of koruna yields cannot be expected until the Fed finishes raising interest rates and the outflow of funds from the CEE region stops. In contrast, political factors (the elections in the Czech Republic, the Slovak Republic and Hungary and the political uncertainty in Poland) will push yields upwards. The range of the estimates for the 5Y and 10Y maturities either remained flat or narrowed.

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
	%		%		%		%	
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
IV-06	2,00	2,52	2,40	2,85	3,42	3,69	3,81	3,93

**/ 10Y benchmark yield*

Actual values of indicators on the day of deadline for forecasts

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
13.4.	2,00%	2,41%	3,44%	3,85%



The exchange rate

IV-06	EUR/CZK	
	1 month	1 year
min.	28,50	27,20
average	28,71	27,87
max.	29,00	28,30

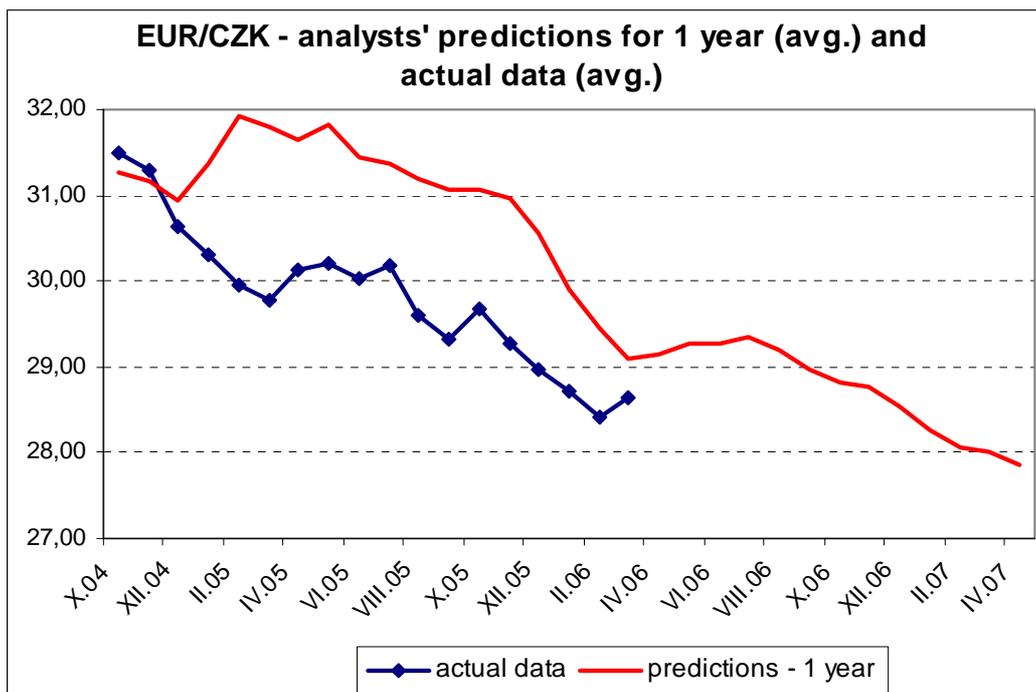
Exchange rate - fixing on the day of deadline for forecasts

13.4.	28,645
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Prediction for Month of prediction	exchange rate EUR/CZK	
	1 month	1 year
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
IV-06	28,71	27,87

In April, the analysts expected a nominal appreciation of the koruna against the euro of 2.7% at the one-year horizon, the same as in March. Due to the appreciation over the past month, the analysts revised the expected nominal exchange rate to 27.90 CZK/EUR at the one-year horizon. The reasons for the expected appreciation remain the same: expectations of faster GDP growth than in the euro area countries (confirmed by the 2005 Q4 and the 2005 whole-year data), favourable trade balance figures and continuing inflow of FDI (confirmation of the Hyundai car plant investment). According to one of the analysts, the favourable growth structure only emphasises the annual rate of equilibrium real appreciation of the koruna at around 3%.

At the shorter horizon, however, the analysts believe that the koruna could depreciate slightly to 29 CZK/EUR. One of the analysts expects the international factors (the expected monetary policy tightenings by the Fed and the ECB) to subside, but these could be replaced by domestic effects (the outflow of dividends expected particularly in 2006 H2) together with nervousness prior to the parliamentary elections in the Czech Republic, the Slovak Republic and Hungary.



Compared to the March survey, the range of the estimates for the koruna's exchange rate narrowed at both the one-month and one-year horizons. The sizeable reduction in the maximum estimate for the exchange rate at the one-year horizon from March's 29 CZK/EUR to 28.30 CZK/EUR is due to the absence of one foreign analyst from the April survey. The main risks mentioned include uncertainty about yields on global markets and political uncertainty in the Central European region.

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