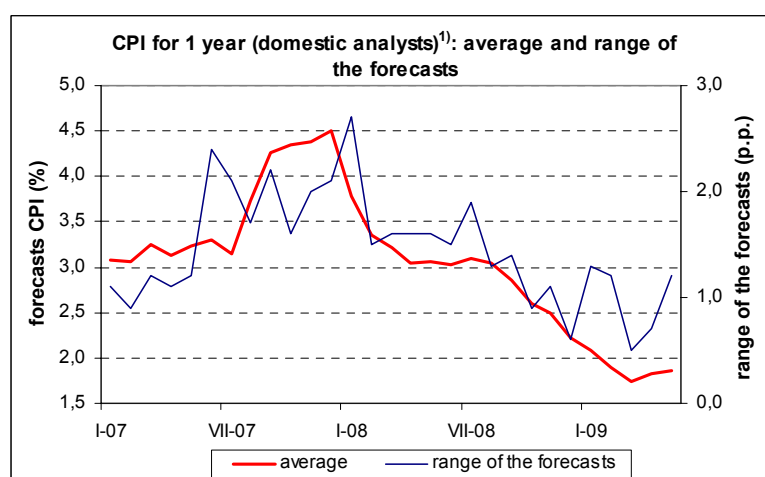


Measuring financial market inflation expectations – Results of the 121st Measurement (May 2009)

Nine domestic and one foreign analysts sent in their predictions for inflation and other indicators to the CNB's May survey. While the expected increase in the price level remained unchanged at the one-year horizon, a worse economic outlook had a negative effect on forecasts for GDP and nominal wages. According to the analysts, the Czech economy is currently close to the bottom of its economic cycle. A gradual regeneration should be observed in the second half of the year, to which the current record-low monetary policy rates should respond. In addition, the amount of interest rate swaps might be affected by a greater need to finance the state budget deficit in future.

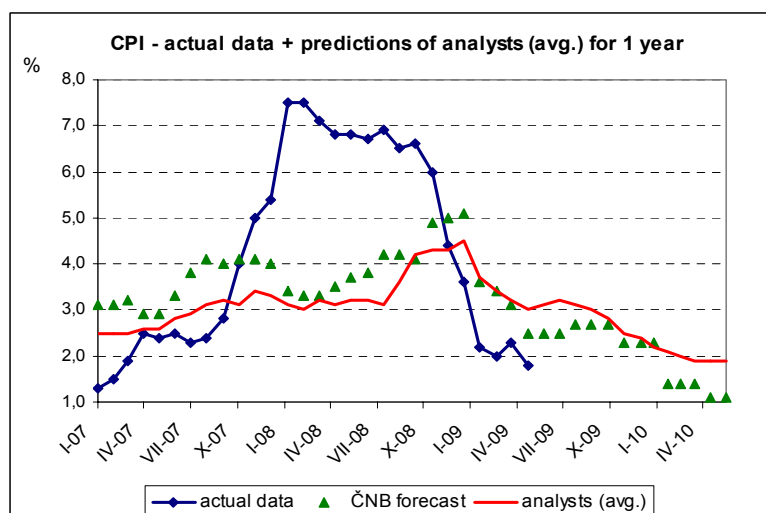
1. Inflation

V-09	annual CPI (%)	
	1 year	3 years
min.	1,1	1,9
average	1,9	2,5
max.	2,3	4,0



The inflation forecast remained unchanged at the one-year horizon (*see the table below*), while it increased slightly at the three-year horizon. There was a slight increase at the one-year horizon in the narrower set of domestic analysts (*see the chart above*), while the average value remained unchanged at the three-year horizon. Expected inflation should remain just below the CNB's new inflation target of 2% in May 2010. It should be maintained low by weak aggregate demand and low commodity prices which are reflected in both market prices and regulated prices (e.g. gas and electricity prices). On the other hand, a weaker exchange rate of the koruna remains an upside risk to inflation. The range of extreme forecasts widened at the one-year horizon, owing to an increase in the maximum value and a decline in the minimum value. By contrast, it narrowed at the three-year horizon due to an increase in the minimum value.

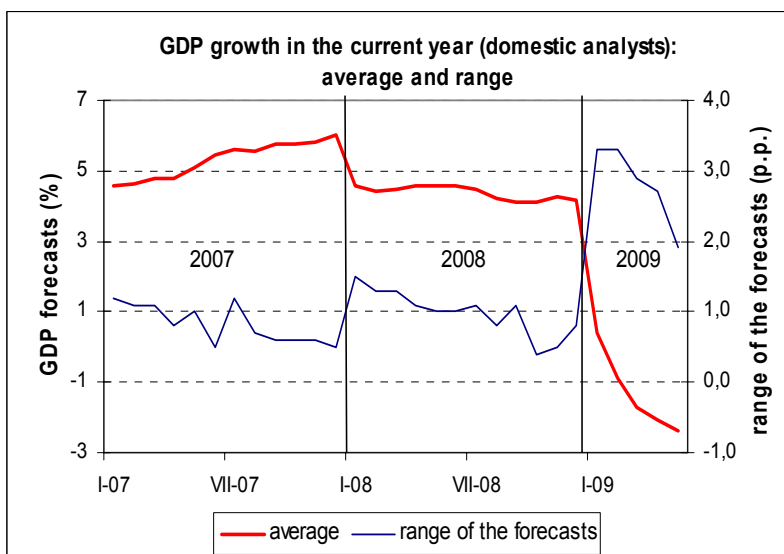
Prediction for Month of prediction	annual CPI		CNB 1 Y %
	1 Y %	3 Y %	
V-08	3,2	2,7	2Q: 2,5
VII-08	3,1	2,6	
VIII-08	3,0	2,6	3Q: 2,7
X-08	2,5	2,5	
XI-08	2,2	2,5	4Q: 2,0
II-09	2,0	2,4	1Q: 1,4
IV-09	1,9	2,4	
V-09	1,9	2,5	2Q: 1,1



¹ Reduced approach on average and the difference between the maximum and minimum estimate via the domestic analysts is due to a more stable data base.

2. Gross domestic product

V-09	GDP growth in	
	current year	next year
min	-3,5	0,2
average	-2,4	1,5
max	-1,6	2,0



Prediction for Month of prediction	GDP growth in	
	current year	next year
	%	
V-08	4,6	4,8
VII-08	4,5	4,5
VIII-08	4,3	4,2
X-08	4,2	3,2
XI-08	4,2	2,4
II-09	-0,9	1,8
IV-09	-2,2	1,2
V-09	-2,4	1,5

The expected decline in GDP in 2009 deepened somewhat again in 2009 (from -2.2% in April to -2.4% in May). It takes into account a negative impact of a decrease in external demand on domestic industry and, subsequently, its pass-through to other sectors (e.g. IT, transport, finance, consultancy, construction). A faster increase in unemployment, a low rise in nominal wages and a lower growth rate in consumer credit will weaken domestic demand. According to the analysts, investment activity will remain significantly subdued, owing to the adverse effect of higher real market interest rates and the unfavourable economic environment. Economic growth is expected to return in 2010; its pace is higher than in the previous survey (1.5% against 1.2% in April). This should be fostered by a recovery in external demand and the effect of the anti-crisis government package. By contrast, economic growth will be slowed by the adverse developments on the labour market.

3. Interest rates

V-09	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.	1,50	1,25	2,48	2,30	3,00	3,30	3,50	3,40
average	1,50	1,80	2,62	2,60	3,28	3,58	3,79	4,10
max.	1,50	2,25	2,82	3,05	4,10	3,85	4,90	4,60

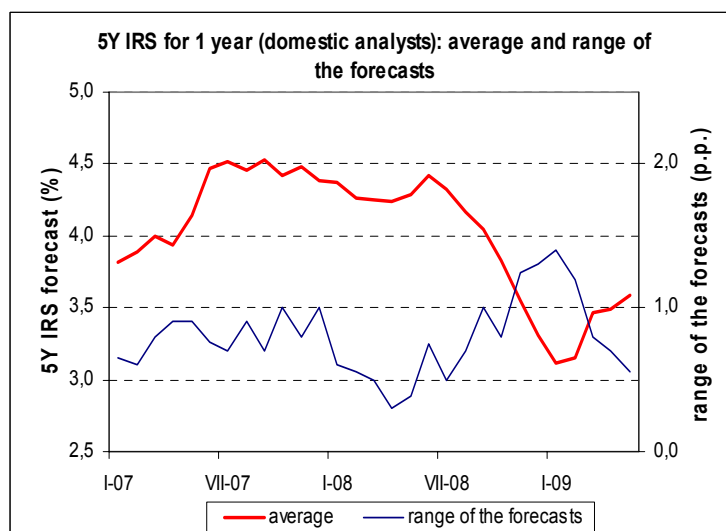
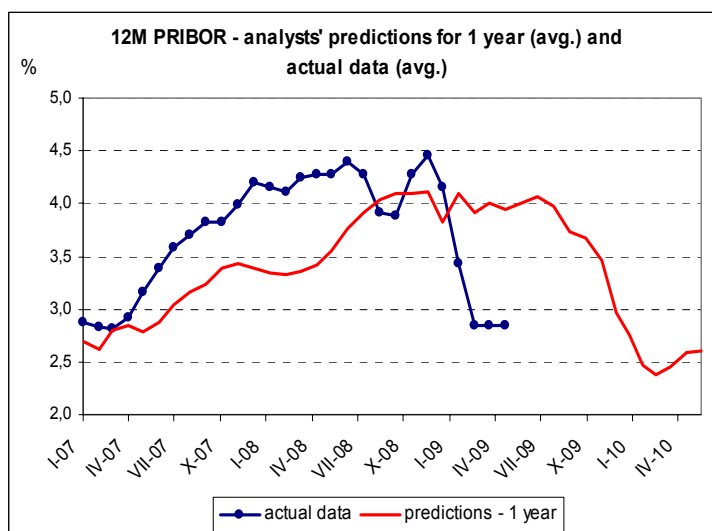
The average forecasts for interest rates and IRS income shifted upwards. According to the analysts, the key monetary policy rates have reached their bottom. Nevertheless, imperfect transmission prevents a greater decline in market rates. By contrast, government bond yields and interest rate swap income increase due to the crisis, the rising risk premium and particularly the need for a more extensive financing of state finances. Given the improving economic situation, the analysts expect a return of the monetary policy tightening in the second half of this year. In addition to the rising risk premium (due to a large state debt), this should increase upward pressures on market rates and, naturally, swap income.

Main risks for key interest rates remain the same. They may decline owing to much worse economic growth than currently assumed, while a faster monetary policy tightening may be due to an excessive depreciation of the koruna exchange rate. As has been said, the analysts assume that income may be also largely affected by the acute need to finance a deeper state budget deficit.

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
	%		%		%		%	
V-08	3,83	3,79	4,32	4,07	4,59	4,42	4,78	4,65
VII-08	3,73	3,66	4,26	3,97	4,34	4,33	4,59	4,57
VIII-08	3,50	3,34	3,78	3,74	3,88	4,17	4,32	4,34
X-08	3,22	2,89	3,91	3,46	3,25	3,83	3,71	4,16
XI-08	2,53	2,06	4,19	2,96	3,17	3,55	3,41	4,03
II-09	1,69	1,48	2,52	2,38	2,86	3,15	3,33	3,63
IV-09	1,64	1,77	2,79	2,59	3,26	3,49	3,77	4,06
V-09	1,50	1,80	2,62	2,60	3,28	3,58	3,79	4,10

Actual values of indicators on the day of deadline for forecasts

	2W repo rate	12M PRIBOR	5Y IRS	10Y IRS
15.5.	1,50%	2,63%	3,23%	3,72%

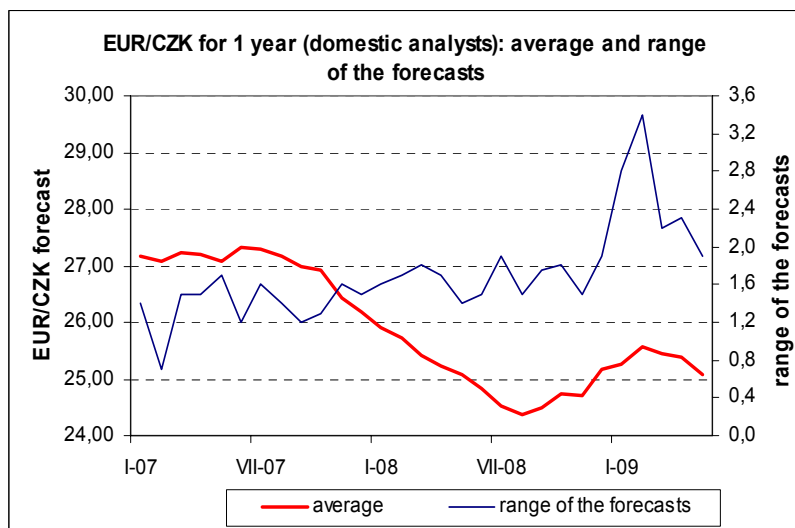


4. The exchange rate

V-09	EUR/CZK	
	1 month	1 year
min.	26,40	23,90
average	26,99	25,12
max.	27,50	25,80

Actual exchange rate

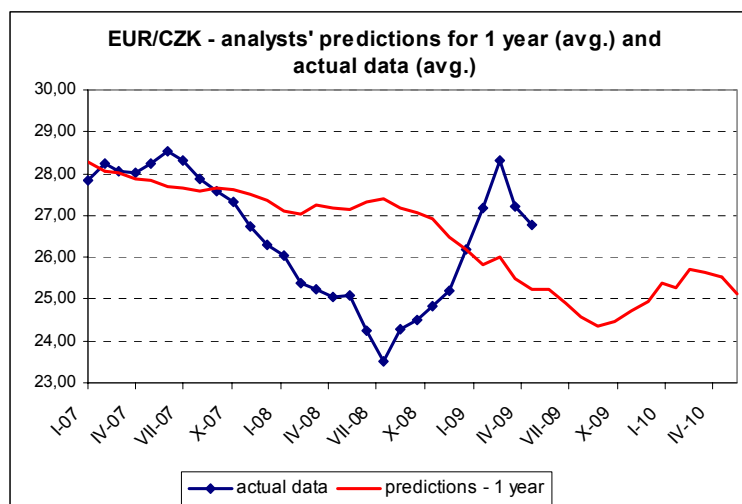
15.5.	26,88
-------	-------



The average forecast for the exchange rate has been shifted again towards stronger levels at both the one-month and one-year horizon. The analysts still expect the exchange rate to be volatile in the next few months, before returning gradually to the convergence scenario, thus to the appreciation trend. However, this is subject to stabilisation and a gradual recovery in the domestic and European economy. The koruna exchange rate should appreciate to the average CZK 25.12/EUR in May next year.

The range of the maximum values narrowed at both the one-month and one-year horizon owing to a greater decline in maximum, i.e. the weakest, forecasts.

Prediction for Month of prediction	exchange rate	
	1 month	1 year
V-08	24,85	24,90
VII-08	23,53	24,56
VIII-08	24,31	24,36
X-08	24,90	24,72
XI-08	25,50	24,96
II-09	28,64	25,71
IV-09	27,12	25,52
V-09	26,99	25,12

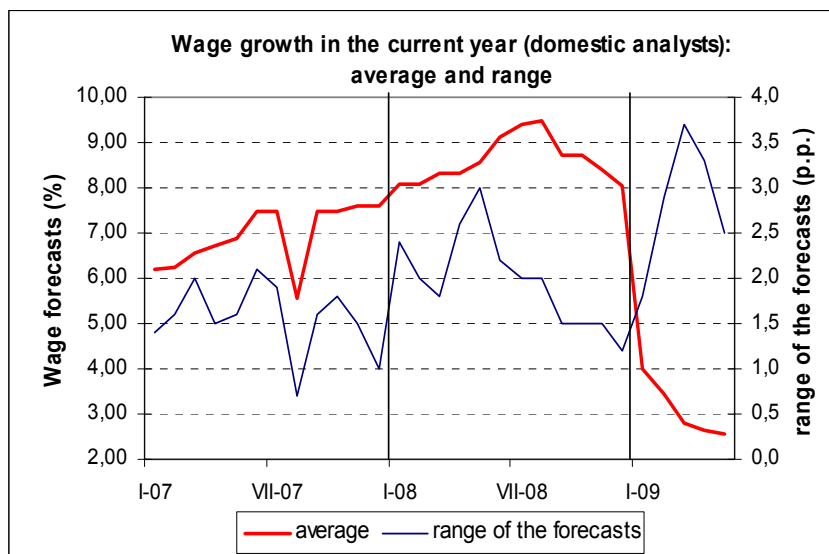


According to the analysts, the koruna may depreciate in the near term, for instance due to a deteriorating trade balance of the Czech Republic (a further sharp fall in external demand) or owing to a renewed increase in the risk premium (problems regarding the financing of the trade balance of some of the CEE countries or a decline in optimism about economic recovery stemming from the United States). On the other hand, good regional news or a more intensive distinction made between individual countries in the region may foster a temporary appreciation. A quick recovery in the Czech Republic's trading partners and, subsequently, in the domestic economy may bring a faster return to the longer-term convergence scenario.

5. Wages

V-09	Wage growth in	
	current year	next year
min	1,0	3,0
average	2,6	3,6
max	3,5	4,0

Prediction for Month of prediction	wage growth in	
	current year	next year
	%	
V-08	9,1	8,0
VII-08	9,4	7,8
VIII-08	9,4	8,2
X-08	8,8	6,7
XI-08	8,4	6,1
II-09	3,4	4,2
IV-09	2,7	3,8
V-09	2,6	3,6



The adverse current economic situation and the related developments on the labour market (the outlook for a dramatic rise in unemployment) made the analysts revise the expected average increase in nominal wages slightly downwards. Compared to the April survey, a more sizeable slowdown can be observed next year (from 3.8% in April to 3.6% in May). This year's growth rate of wages declined by just 0.1 percentage point to 2.6% (compared to 2.7% in May). The forecasts for wage growth in the business sector and that in the non-business sector remained unchanged. Wages in the business sector should increase by just 1.2% in 2009, while those in the non-business sector should rise by 5.2%. Wages in both the business and non-business sectors should grow by 3.3% in 2010.

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

David Marek, Patria Finance
 Jan Vejmelek, Komerční banka
 Pavel Sobíšek, Unicredit Global Research
 Michal Brožka, Raiffeisenbank
 Petr Dufek, ČSOB
 Petr Sklenář, Atlantik FT
 Radomír Jáč, Generali PPF
 Vojtěch Benda, ING Wholesale Banking
 Radomír Jáč, Generali PPF
 Miroslav Plojhar, JP Morgan

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

Prague, May 26, 2009