Czech inflation briefly hits 3% threshold

Headline inflation hit the upper bound of the Czech National Bank's tolerance band in December yet came in below both the market and CNB expectations. A softer price dynamic in the food segment was the main surprise. The inflation reading makes a February rate cut more likely. Consumers continue to spend, but stagnant investment is a risk to the recovery

Source: Shutterstock

Prices in the housing segment drive annual inflation

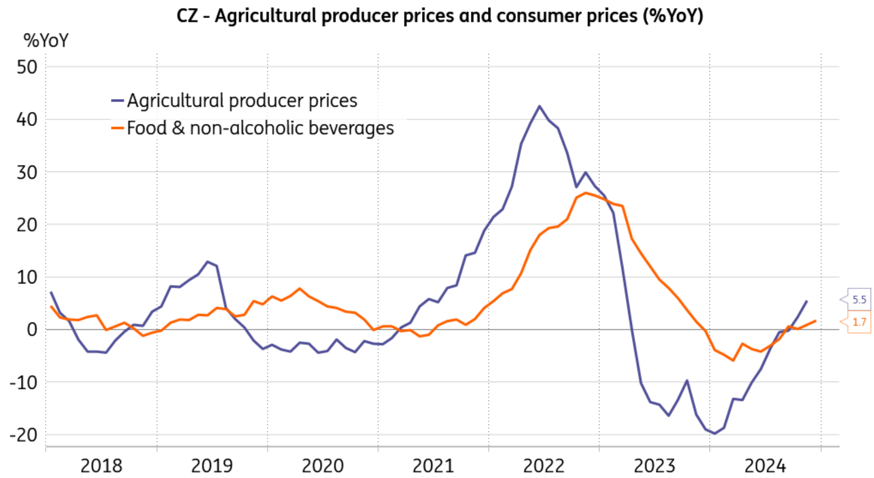
Czech consumer inflation increased to 3.0% year-on-year in December, coming in 0.2ppt above the previous reading. Meanwhile, the reading is below both the market and CNB expectations. Consumer prices shed 0.3% month-on-month, mainly dragged down by lower prices in the food, alcoholic beverages, and tobacco sections.

The acceleration in headline yearly inflation was mainly driven by more potent annual dynamics in the food section and in the transport division. Prices in the housing section significantly impacted the annual price level growth in December, with market rents increasing by 6.2% YoY, imputed rents by 1.7% YoY, water charges by 10.9% YoY, and electricity by 8.0%. Prices of goods rose by 1.7% YoY in aggregate, while prices of services added 5.0% from the preceding year. Core inflation, excluding the volatile food and fuel items, remained unchanged at 2.3% in December. The average headline inflation rate for the full year 2024 was 2.4%.

Food prices are full of surprises

The monthly decline in the overall price level was mainly driven by food prices shedding 0.7% MoM and alcohol and tobacco prices declining by 1.3% MoM. In the food section, the most prominent price declines were recorded for fruit, vegetables, and meat. Food is considered a volatile item, with the possibility of price reductions driven by temporary pre-Christmas discounts. In the residential section, natural gas prices fell by 2.4% MoM.

Food price growth is set to gain pace



Source: CZSO, Macrobond

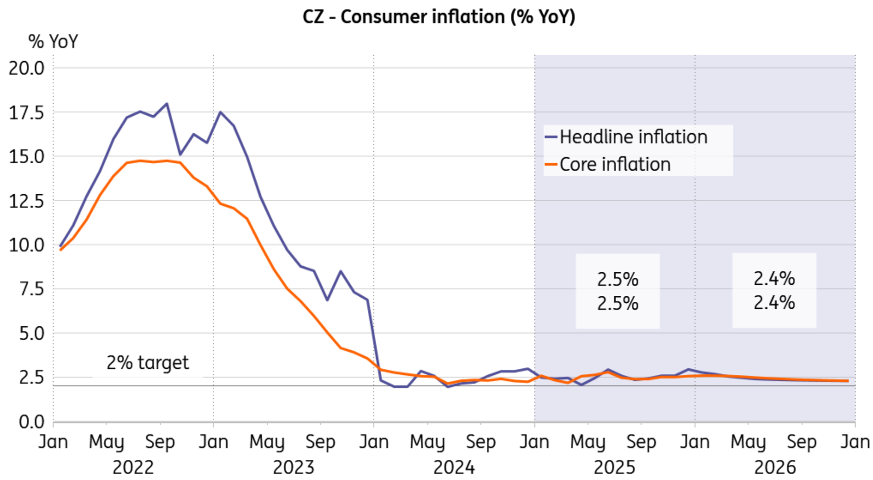
The fundamentals for food prices point in a rather upward direction, with producer prices in agriculture on the rise. The recent increase in Brent crude prices, global natural gas prices, and a weaker koruna vis-à-vis the dollar, also represent an upward risk for domestic food prices over the coming months. The CZSO publishes its food price survey on a monthly basis, but the correlation with consumer food prices as released in the CPI reading is 0.5 when calculated over the past 10 years for monthly variations. This shows a relationship between the two series which is not bad, but not great for forecasting purposes. So forecasting food prices is a dicey business indeed. Still, we believe that food price growth will gain strength over the course of the year.

Further easing amid wobbly manufacturing outlook

The softer reading for both headline and core inflation compared to the CNB's expectations will stir discussion about further rate cuts, with the forecast suggesting space for additional easing. Given the stagnant domestic investment, deteriorating sentiment in industry, and mounting risks to growth prospects in the eurozone, there are viable reasons to support the hesitant economic rebound. On the other hand, price growth in the service sector remains elevated, though below the previous reading.

Overall, with the January CPI flash estimate available in early February, the odds for the easing to carry on in the same month have increased. Rate cuts could resume at the next CNB meeting if the preliminary inflation estimate in January brings no nasty upward surprises, with the flash reading and the decision running on the same day. As Eva Zamrazilova, the deputy governor, admitted: "… it's increasing the likelihood that monetary policy easing will be able to continue early this year."

Headline inflation will return to the tolerance band



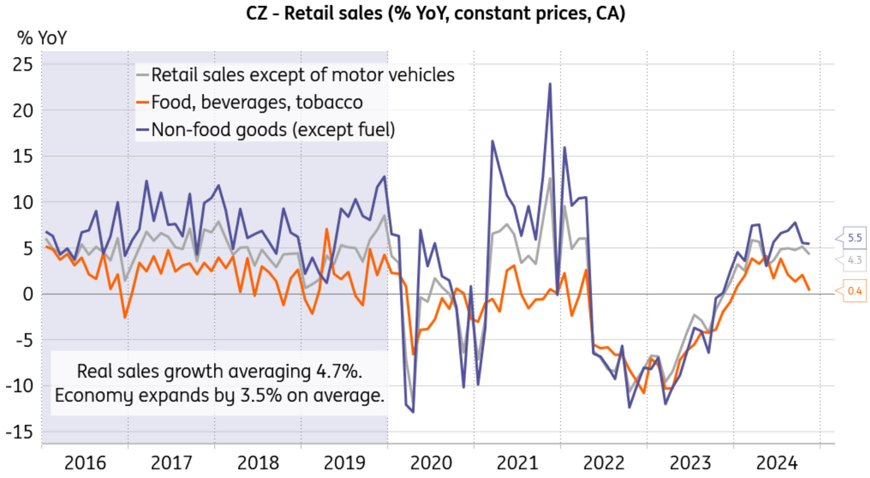
Source: CNB, ING, Macrobond

January inflation is set to slow down to 2.5%, returning back into the tolerance band around the inflation target. Both headline and core inflation are expected to remain above the inflation target throughout the year if the economic rebound gains pace as foreseen. That said, food prices and imputed rents represent an upward risk for January's reading. This time, the decision-makers will see whether some of those risks have materialised when going ahead with their decision.

Real retail sales slow down mainly in the food segment

Czech retail sales gained 4.3% YoY in November, coming in marginally below market expectations and somewhat softer than in the preceding month. A slowdown in sales dynamics of foodstuffs was the main reason for the overall deceleration in real terms, with elevated food prices likely limiting the quantity of what buyers can afford for their money. Meanwhile, real sales of non-food goods maintained a robust dynamic of 5.5% annually.

Non-food real retail sales dynamics remain solid



Source: CZSO, Macrobond

This outcome is well reflected in the type of stores breakdown, with sales in specialised food stores shedding 3.1% YoY in November and sales in non-specialised stores with a predominance of food adding a soft 0.7% YoY. Meanwhile, real sales in non-food-dominated stores gained 14.5% YoY, and internet order sales picked up by 14.1% from the preceding year. Revenues from sales and repairs of motor vehicles increased by 2.8% from the previous November, adding 0.3% MoM in real terms.

Consumers still fuel the rebound, yet limping industry poses a threat

The Czech consumer continued to fuel the economic rebound over the last quarter of the year, contrasting with the lacklustre industrial performance. An annual growth rate of over 4% in real retail sales is consistent with the economy gaining momentum. However, with industry shedding staff and likely not being able or willing to boost wages, aggregate household budgets might come under pressure by the middle of the year. It is essential that the export-oriented industrial base gets the blood flowing in its veins so that the softish economic rebound can gain pace. Such a turnaround, however, seems in the realm of mere desire, as European manufacturing grapples with restrictive institutional and regulatory frameworks on one hand, and fierce overseas competition on the other. Whether a more accommodative monetary policy stance can improve such a situation is the key question. We expect the Czech base rate to decline further to reach 3.25% within the first half of the year.

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