Czech inflation moderates but there's still risk from a tight labour market

March Czech CPI softened in line with expectations and marks the lowest year-on-year reading since April 2022. However, the Czech National Bank may still be worried about wage growth exceeding 10% YoY

The building of the Czech National Bank in Prague

CPI moderates, but wage growth remains strong

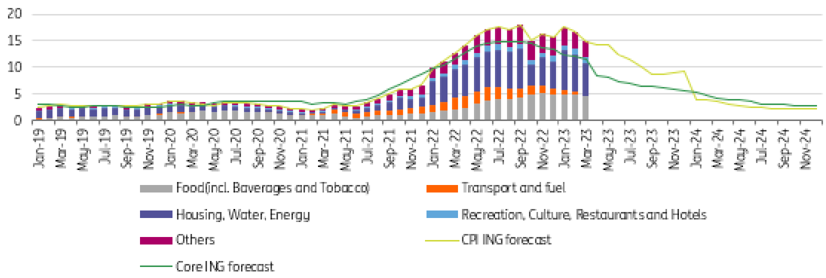
It is clear that the moderation of Czech headline inflation continues. In March, Czech CPI increased by 0.1% month-on-month and headline inflation moderated from 16.7% to 15% (in line with consensus, ING estimate was 16.8%). This is the lowest year-on-year inflation reading since last April.

The main contribution to the March decline came from base effects. Fuel prices declined 1.8% MoM which resulted in their YoY decline of almost 20%. The additional contribution to the decline of headline inflation came from gas prices, which fell 1.4% MoM, and YoY growth moderated from 74% to 60%. It is worth mentioning the softer decline of owner-occupied housing costs which some Czech National Bank (CNB) board members observe as an extension of the price stability environment.

What may worry the CNB board, however, is the still hefty growth of wages in industry at the beginning of the year. This exceeded 10% YoY and hence remained above the critical threshold mentioned by, for example, Vice Governor Eva Zamrazilova. The tightness of the labour market was also confirmed by the recently-published decline in the unemployment rate by 0.2bp to 3.7% in March.

The relatively hawkish comments made recently by Jan Kubicek, the newest member of the CNB board, show that the central bank remains quite cautious about possible monetary policy normalisation. And if the labour market were to develop towards a more pro-inflationary direction, even a debate about another rate hike cannot be ruled out.

Czech inflation and ING forecasts



Source: ING, Macrobond

A normalisation debate could start in August

The Czech Finance Ministry yesterday published its new inflation outlook, with a view of headline inflation falling gradually below 10% YoY in July and further declining to 8% YoY by the year-end. ING's view is a bit less optimistic, expecting headline inflation to remain a touch above 9% by the year-end. Nevertheless, this is still unlikely to open debate about CNB rate cuts anytime soon. On the contrary, the growth of wages in industry above 10% YoY at the beginning of the year is above the CNB's comfort level.

We see the CNB only starting the debate on the possible normalisation of monetary policy when inflation moderates close to the current level of interest rates (7%). The first possibility for such a debate about a symbolic 25bp interest rate reduction could possibly be in August when the new summer inflation outlook will be discussed. But given the prevailing risks from tightness in the Czech labour market, we do not expect more than a 50bp rate reduction by the year-end.