

Czech inflation returns to target after three years

Inflation surprised to the downside in January, a win for the Czech central bank given the seasonal volatility we see at the start of the year. The focus now shifts to core inflation, which remains above target, and weak FX may threaten further CNB rate cuts. However, today's numbers pave the way for 75bp of rate cuts at the next meeting



A market in Prague. Food prices in the Czech Republic have remained stable

2.3%

Czech headline inflation

% YoY

Lower than expected

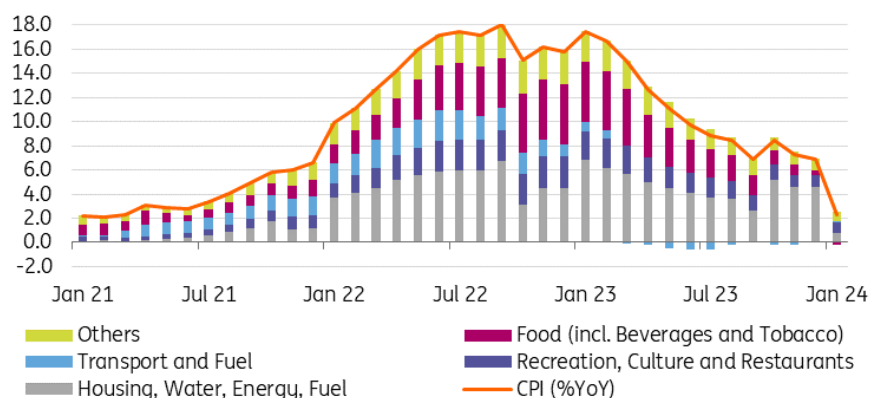
Key January number surprises to the downside

January Inflation in the Czech Republic fell from 6.9% to 2.3% YoY, well below the CNB (3.0%) and

market expectations (2.9%). The headline number dropped to its lowest level since March 2021 and is very close to the 2% central bank inflation target. Month-on-month inflation was 1.5%, driven by alcohol & tobacco, and housing costs associated with energy prices. Imputed rents fell significantly. Food prices were stable.

The surprise is the slight increase in fuel prices, which surveys had suggested were falling in January. However, they did fall by more than expected in December.

Headline inflation breakdown



The estimate of core inflation is particularly tricky here because of weighting and tax changes. The Czech National Bank was expecting 3.9% YoY in January, and we were expecting 3.6%. We think it'll be 3.5% once the numbers are released later today, but we don't have a great deal of confidence here. With headline inflation now close to the central bank's target, core inflation will take centre stage in the coming months.

Inflation stays near CNB target, paving the way for 75bp of rate cuts

Our fresh forecast for headline inflation now stands at 2.1% for February and 2.2% for March while the CNB expects 2.8% and 2.9%. And the main message here is that with this January reading, even if inflationary pressures return, we're unlikely to see the number go about 3%. And today's news clearly paves the way for 75bps of rate cuts. FX seems to be the main deciding factor here. It may be too early to predict accurately, but we expect a higher EUR/CZK with a higher inflation estimate. Thus, short CZK positioning and aggressive rates dovish pricing seem to create a limit for further EUR/CZK upward movement.

On the other hand, it's good to mention that the CNB is indicating much bigger cuts in the new forecast. So overall, this still leaves room for 75bps to keep the same monetary conditions in the CNB forecast despite weaker FX compared to central bank expectations.

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