Czech price growth surprised in April; pace of rate cuts likely to slow down

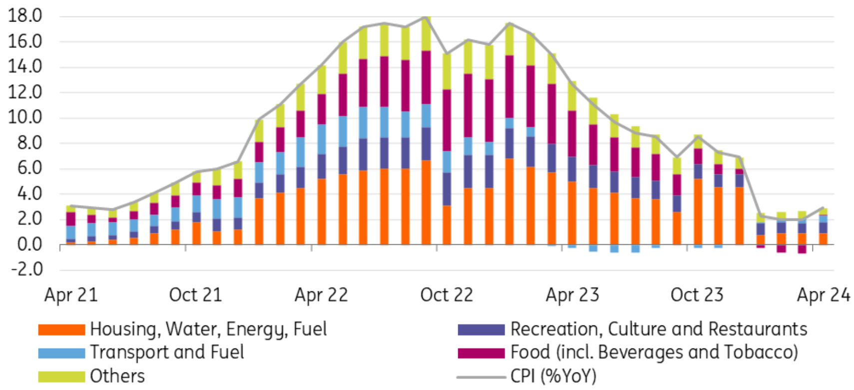
Headline inflation in April jumped to 2.9% year-on-year, significantly higher than both the Czech National Bank forecast and market expectations. This confirms the Bank Board's reasons for caution in cutting interest rates, with monetary easing likely to slow down

Rising food prices will bite into household budgets

Prices of food and alcohol have driven overall inflation higher. Food prices increased by a significant 1.7% in April from the previous month, with the growth being broad-based across groups presented in the consumer basket. Prices of confectionery, vegetables, meat, and fish showed the highest rate of growth, while price increases of bakery and dairy products were a bit milder. Fuel prices have also contributed to overall hot inflation, growing by 2.7% on a monthly basis. Czech households will, of course, feel these changes hitting their budgets, as the rise in mandated spending leaves less for discretionary spending.

In the year-on-year comparison, price growth in the service and housing segment continued to contribute significantly to headline inflation. Rents increased by 7.2%, water charges by 10.9%, and electricity prices by 12.0% from a year earlier. The elevated and persistent price growth in the service sector represents one of the main concerns for the Bank's Board, as the disinflation process in this segment has hardly even started.

Consumer prices have picked up in April (YoY %)



Source: Czech Statistical Office

Inflation still in tolerance band but close to headache territory

Headline inflation crept above the CNB's inflation target in April but remained within its tolerance band. At the same time, the acceleration in overall inflation was driven by food prices, which are considered a relatively volatile item. As such, it occasionally can be discounted in the decision function of the Bank Board. Year-on-year core inflation, which represents price developments of a more persistent nature, slowed to 2.6%. By this preferred measure, the disinflationary process is still intact. However, overall inflation came in well above the CNB's expectations of 2.5%.

Even so, consumer price inflation is getting to a point where the Board will have to consider carefully the next steps for setting monetary policy conditions. The risk that the rise in food prices will continue cannot be ignored. Tightness in the labour market is still pronounced, and relatively high nominal wage growth could continue to feed through into an acceleration in services prices in the coming months. The case for a slowdown in the pace of base rate cuts is thus growing. Overall, the likelihood that the Board will cut rates by only 25bp at its next meeting in June or take a pause is increasing. Governor Ales Michl has already stressed that interest rate cuts could be paused at any time to keep monetary policy sufficiently restrictive.

There will be one more observation on consumer prices available before the CNB's June meeting. The upward price pressures could be mitigated by the koruna remaining at appreciated levels and even strengthening in the quarters ahead. A slower pace of monetary easing in the Czech Republic and the start of the European Central Bank's rate cut cycle would contribute to such developments.

Elevated price growth may again threaten the emerging recovery

High inflation in recent years was also behind the cooling of household spending, well reflected in poor economic performance. Czech GDP still has not exceeded pre-pandemic levels. Czech households have recently regained their appetite for spending and have contributed to the emerging economic recovery. However, households' sensitivity to price developments remains considerably elevated. If headline inflation were to move above the 3% threshold in the coming months, consumers could switch back into a rather cautious mode and squeeze discretionary spending once again.

If there is not another upward surprise in food prices, we believe that inflation will likely remain below the 3% threshold in the coming months, i.e. within the CNB tolerance band. Still, inflationary pressures might accumulate in the coming quarters, on the back of the expected pick-up in economic activity, more steam in household spending following two years of subdued consumption, and continued tightness in the labour market.

Author

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com