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Article

Czech Republic: Inflation weakens further

Czech inflation continued to decelerate in January, falling to 2.2%, the lowest rate since April 2017. Still, this is mainly a statistical effect relating to one-off factors

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Inflation deceleration driven by statistical effect

Annual price growth slowed down in January as expected to 2.2% from 2.4% in December, while prices picked up by 0.6% in monthly terms. The slowdown in annual inflation was mainly driven by a higher base from last year. At the turn of 2016 and 2017, prices began to accelerate as a result of faster growth in food, fuel prices and also an acceleration in restaurant prices due to the introduction of the online registration of sales.

2.2%

January CPI in YoY terms
after 2.4% in December-17

As expected

The statistical office changed weights in the consumer basket in January...

January consumer price inflation is usually affected by a number of administrative effects such as tax changes or changes in regulated prices or even methodological changes in CPI computation. As such, it is not unusual for January inflation figures to differ from the initial estimates. Though January inflation was in line with the market estimate, partially new methodological changes helped this time. The Czech Statistical Office updated weights in the consumer basket in January.

...which slightly pushed up inflation

Some changes were anti-inflationary, for example, the lower weighting of energy and food in the CPI basket. Prices of these items are growing and so their reduced weighting resulted in a lower contribution to the YoY CPI.

Other changes were pro-inflationary. The most significant one was caused by a higher weight of the imputed rent item, which increased from 8.7% to 10.4% of the basket. This change pushed YoY inflation up by almost 0.1ppt, as imputed rent partially reflects accelerating property prices in the Czech Republic. If we total all the changes given by the new weights, the impact on the annual CPI

was roughly 0.1ppt, suggesting that January inflation would otherwise have been 2.1%.

Structure of the inflation in the Czech republic

Structure of the inflation in the Czech republic

	YoY (%)	Cont (ppt)	MoM (%)	Cont (ppt)	YoY(t-1) (%)	Cont (ppt)
Total	2.2	2.2	0.6	0.6	2.4	2.4
Food and non-alcoholic beverages	4.5	0.8	0.6	0.1	5.6	1.0
Alcoholic beverages, tobacco	3.2	0.3	2.5	0.2	2.0	0.2
Clothing and footwear	-0.5	0.0	-3.3	-0.1	-1.0	0.0
Housing, water, energy, fuel	2.3	0.6	0.7	0.2	2.1	0.5
Furnishings, households equip.	0.6	0.0	0.2	0.0	0.7	0.0
Health	4	0.1	0.7	0.0	4.3	0.1
Transport	1	0.1	0.4	0.0	2.1	0.2
Post and telecommunication	-1.2	0.0	0	0.0	-1.3	0.0
Recreation and culture	0.4	0.0	1.7	0.1	0.6	0.1
Education	1.5	0.0	0	0.0	1.6	0.0
Restaurants and hotels	3.8	0.2	0.4	0.0	4.1	0.2
Miscellaneous goods and services	0.8	0.1	0.7	0.0	1.1	0.1

Source: CZSO, ING Bank

Inflation should remain above, yet close to the 2% target this year

Despite the effect of a higher benchmark base, inflation should continue to remain in the 2-2.5% band this year. The anti-inflationary effects stemming from a stronger koruna will be compensated by inflationary pressures from an overheated labour market, which will push up wage growth. For the whole of 2018, we expect average price growth similar to the Czech National Bank's estimate of 2.3%, though oil and food prices represent usual uncertainty.

January inflation below the CNB forecast

From the CNB's point of view, January inflation remained slightly below its forecast of 2.3%, driven by lower core-inflation. Although the CPI might slightly decelerate next month due to the high base from last year and a stronger CZK, it should accelerate further in 2Q18. Also, Czech economic conditions remain favourable and require further tightening of monetary conditions. Though the CNB has forecast that tightening this year will come from a stronger koruna rather than higher rates, we consider it all part of the communication strategy and expect more even distribution of tightening via rates and FX. Therefore, we still see room for another two hikes to be delivered by the CNB this year.

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