Inflation in the Czech Republic on track to hit 2% target

Headline inflation is falling as expected in the Czech Republic and the likelihood of the central bank hitting its 2% target early next year is rising. The inflation profile is tricky for the coming months but we believe it will be sufficient for the Czech National Bank's first rate cut in November

Czech National Bank headquarters in Prague

8.8%

Headline inflation

YoY

As expected

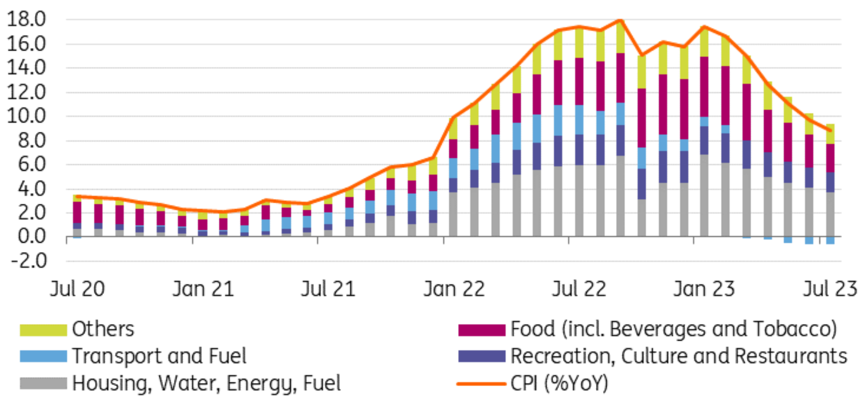
Inflation falling as expected

Consumer prices rose by 0.5% in July, up from 0.3% in the previous month. Year-on-year, this translated into a decline from 9.7% to 8.8%, in line with market expectations and 0.1pp below the

Czech National Bank (CNB) forecast. The main drivers of the decline were food prices (-0.8% month-on-month) and seasonal movements in clothing prices. On the other hand, prices were pushed up by the recreation, fuel and beverages.

Overall, in July, we saw a big gap between the price growth of goods (0.3% MoM) and services (1.6% MoM). Core inflation increased from 0.5% to 1.1% MoM, mainly due to seasonality, and fell further from 7.5% year-on-year to levels around 7.0% YoY, according to our calculations, which we think should be close to the CNB forecast. As always, the official numbers will be released later today.

Breakdown of annual inflation (bp)



Source: Macrobond, ING

Inflation profile is tricky, but reaching CNB target is possible in January

Our fresh nowcast points to headline inflation of 8.4% YoY in August and 7.3% in September. However, we will probably see a jump up above 9.0% in October mainly due to the base effect from last year. And we will remain in the 8-9% range for the rest of the year. However, in January next year, we should be in the 2-3% YoY range, again due to the base effect and the strong seasonal effect in the Czech Republic. The downside risks, in our view, are food prices, which still remain above regional levels, and energy prices, which could fall before the January repricing, based on reports from energy suppliers in recent weeks.

First rate cut in November and the risk of a postponement

Today's number doesn't change the CNB story much. Headline inflation is just a tenth below the central bank's new forecast. However, it still reads like dovish news given that inflation path uncertainty is the main risk according to the board at the moment. Our forecast has remained unchanged for some time, with the CNB's first rate cut in November. We think the condition is to see September inflation near 7% YoY, which is our forecast. This should give the board confidence that the inflation target is achievable in January next year. However, if the picture is not clear, the board may wait for January inflation which would mean delaying the cut until February or March 2024.

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