Surprising drop in Czech inflation opens the door to rate cuts in November

Inflation fell faster than expected in September, but base effects mean that inflation could rise again throughout the rest of the year. However, headline and core inflation are below the central bank's forecast and we think this opens the door to a rate cut in November

The food and non-alcoholic beverages section saw the most significant negative contribution to Czech annual inflation in June

6.9%

Headline inflation

year-on-year

Lower than expected

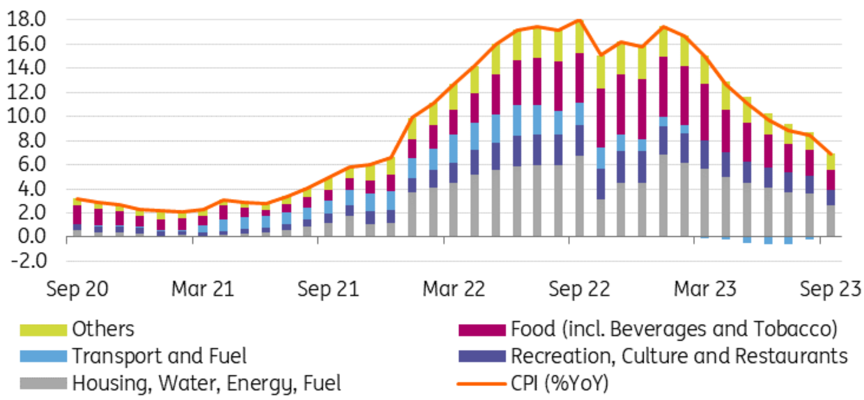
Inflation falling faster than expected

Consumer prices fell 0.7% month-on-month in September, which translates into a decline from 8.5% to 6.9% year-on-year, three-tenths below our forecast. The market was expecting 7.5%, and the Czech National Bank had projected 7.2% in its August forecast. In YoY terms, this number should be this year's low given the base effect in the coming months, but it confirms that inflationary pressures are fading very quickly.

The main downward drivers were food, housing and recreation prices. On the other hand, clothing, fuel and education prices rose. This was all expected, however, there were surprises in the detail and dynamics. Food prices fell 1.6% MoM, the fastest since April. September's reduction in energy prices was more pronounced in the CPI than we expected and the seasonal movement in recreation prices was much larger than in previous years. On the other hand, the increase in fuel prices was lower than indicated by the weekly surveys.

Core inflation fell from 6.0% to 5.4% according to our calculations. This should confirm a third quarter below the central bank's forecast (6.0% vs 6.2%). The official numbers will be published later today as always.

Breakdown of annual inflation (bp)



Source: Macrobond, ING

November rate cut in play despite rising inflation in months ahead

Looking ahead, the base effect from last year comes into play in the next three months due to government measures to reduce energy prices for consumers. Our fresh nowcast indicator shows an increase in the headline number to 8.2% YoY for October, but this is less than we had previously expected given the earlier drop in energy prices. And it should also be safely below the CNB's current forecast. Inflation should then remain around 8% or below until the end of the year, and in January, in turn, the base effect should help inflation move into the 2-3% YoY range.

For the CNB, today's number is clearly good news that should support the case for cutting rates as early as November, as mentioned in the latest CNB minutes.

Author

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Disclaimer