December inflation surprise opens the door to faster rate cuts in the Czech Republic

Inflation has surprised to the downside and disinflationary pressures are visible across the consumer basket. Headline and core inflation is below the CNB forecast. The inflation decomposition also points to an admittedly low number in January. Overall, we think this opens the door for a faster rate cut by the CNB, possibly as early as February

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

6.9%

Headline inflation

YoY

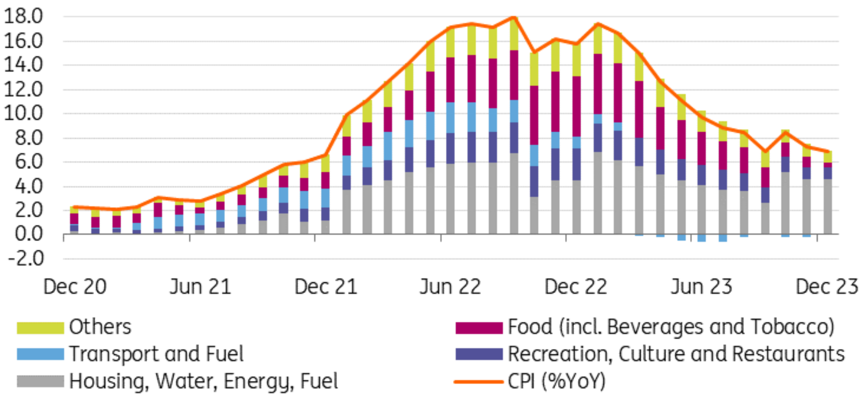
Lower than expected

Prices are falling in almost the entire consumer basket

December headline inflation fell from 0.1% to -0.4% month-on-month, which translates into a drop from 7.3% to 6.9% year-on-year, well below market expectations. The biggest surprise came from food, which fell 1.4% MoM, while surveys suggested an increase. However, the decline is visible across the consumer basket almost everywhere. Fuel prices were down significantly as expected, although a little less than forecast, which could push the effect of lower oil prices into January's numbers. Price declines are also visible in clothing, which usually only gets cheaper in January according to a seasonal pattern. The only surprise to the upside is housing, which rose 0.2% MoM in December. In detail, imputed housing fell again after November's surprise increase, but energy prices rose 0.6% MoM – slightly less than the previous month, despite announcements by energy companies of price cuts.

By our calculations, core inflation is roughly stable at -0.1% MoM, giving us a drop from 3.9% to 3.5% in December. So in both cases, headline and core inflation remain below the Czech National Bank's forecast (7.0% and 3.6%), as in previous months. The downside surprise today also raises the chance that January inflation may be below 3% as we indicated earlier, which would open the door for more aggressive CNB cuts.

Headline inflation decomposition



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That may be enough for the CNB to cut rates more already in February

The central bank will release its commentary later today, as always including official core inflation numbers. However, this morning's numbers already clearly show good news for the CNB. Inflationary pressures appear to have completely disappeared across the consumer basket and we see no sign of frontloading price increases ahead of a sensitive January re-pricing, which has become a political topic in the Czech Republic in recent weeks.

Today's numbers also confirm our positive bias for the January inflation number, which could be below 3.0%. The question mark is therefore how much the CNB needs to see without a January inflation number in hand for the February meeting and a larger than 25bp move. In our view, today's number significantly raises the odds that we could see a 50bp rate cut as early as February.

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