

Food and services prices drive Czech inflation

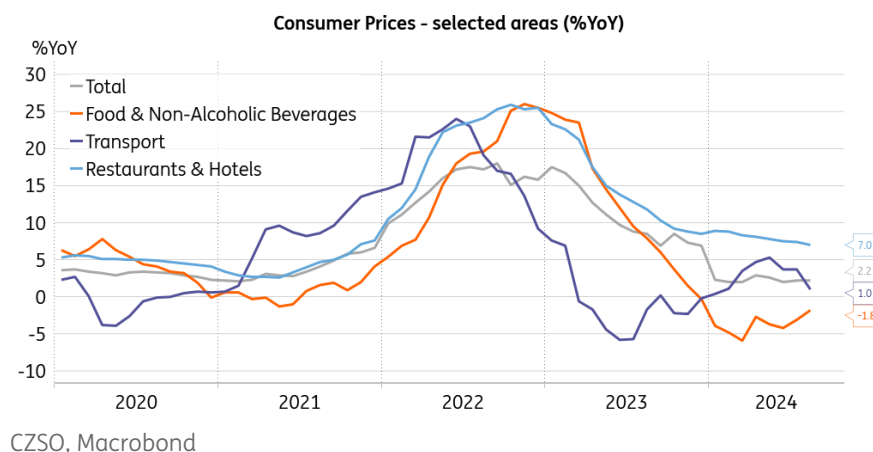
Annual consumer inflation in Czechia stalled at 2.2% in August, coming in stronger than markets expected. Price increases in the food and services segment were the main sources of the surprise. Still, the inflation print will likely not prevent a further reduction in policy rates later this month



Headline inflation is close to the target, but service inflation flies high

Czech annual inflation remained unchanged at 2.2% in August, confounding market expectations for a return to the 2% target. Consumer prices rose by 0.3% month-on-month, mainly driven by higher prices in the alcoholic beverages, tobacco, and food sections. Considering the monthly dynamics in the food segment in August, price increases were mainly tangible for fish (4.1%), oils and fats (3.1%), and fruit (2.2%). Lower prices were recorded primarily in transport, where prices of fuel dropped by 2.2% and prices of cars by 0.7%. Prices of goods increased by 0.1%, while prices of services added 0.5% from a month earlier.

Prices in restaurants remained elevated

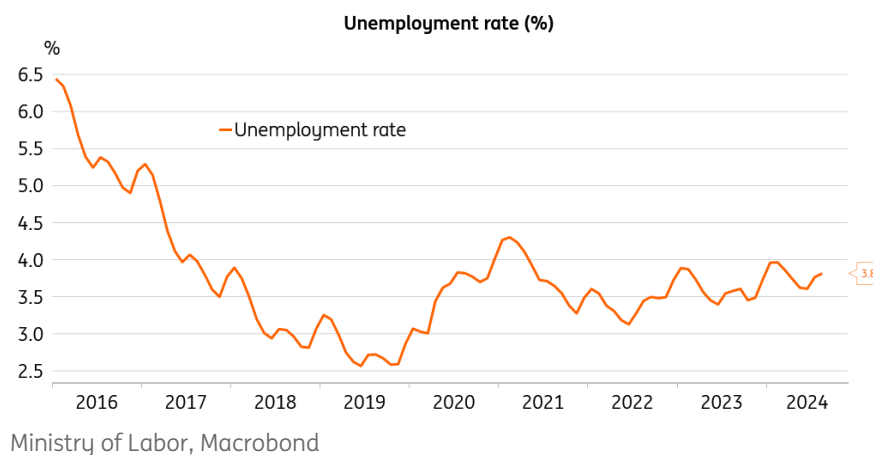


Annual consumer inflation was considerably affected by food and fuel prices, with a softening decline in food prices and a renewed annual decline in fuel prices partially offsetting each other. Prices in the housing segment continued to significantly impact the overall annual price change in August, with a 6.6% increase in rents and a 10.9% increase in water charges. Prices of goods rose by 0.5% in aggregate, while prices of services added 5.0% from a year earlier.

Shortages of skilled labour can further feed into services prices

Annual core inflation has increased by 0.1 percentage points to 2.4%, as recorded in August, predominantly due to the items from the service segment. The persistence in the elevated price growth in services seems to be hard to break and could continue due to the impact of increasing wage costs. This linkage represents a recurring reason for the Czech National Bank's caution when it comes to rate cuts. Average nominal wage growth decelerated to 6.5% in the second quarter, sliding below the CNB estimate of a 7.2% annual wage increase. However, the labour market is still tight, as the unemployment rate remained unchanged at 3.8% in August, according to the Czech Ministry of Labour.

The unemployment rate is low, skilled labour is scarce resource

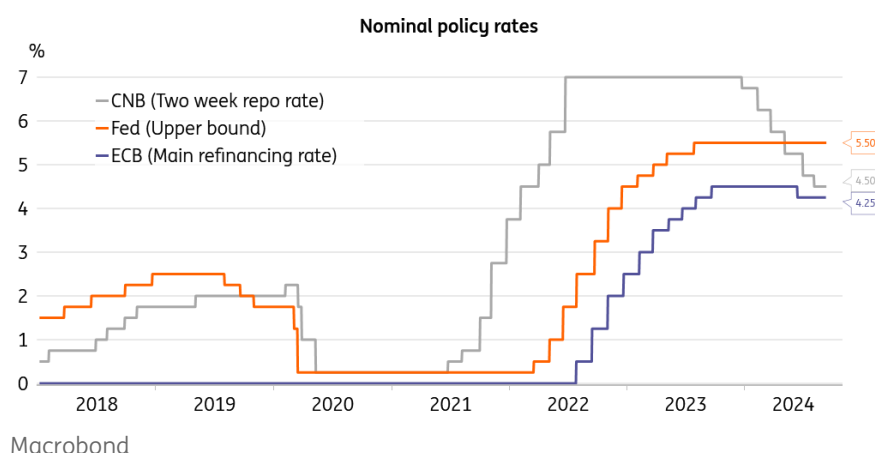


Companies report a shortage of skilled employees and are ready to retain or hire an experienced workforce, accepting solid wage increases despite the uncertain growth outlook. This is confirmed by the lower median wage growth of 5.8%, with low-wage workers receiving a less buoyant wage rise. The average wage growth in the first half of this year was 6.9%, which is comparable to the 6.8% historical average recorded between 2016 and 2019 when the Czech economy was firing on all cylinders. That said, the CNB does not have to be afraid of an evolving wage-price spiral, though robust wages could keep services prices elevated for some time.

Uncertain growth prospects call for less restrictiveness

Steady consumer inflation supports the CNB's hawkish tone and the Board's call for caution. However, the monetary policy stance seems tight as measured by the elevated real interest rate of 2.3%, which seems to discourage the expansion of medium-sized firms along with the tepid foreign demand. Also, the lower Brent crude price, stronger koruna, and announced reductions of electricity and natural gas end-prices by major energy distributors will contribute to lower inflation pressures in the coming months. We see a 25bp cut at this month's CNB meeting as the most likely outcome. A gentle cut would reduce the restrictiveness of monetary policy in light of weak foreign conditions and the performance of Czech industry, while still maintaining the leitmotiv of caution due to high retail sales and sustained price growth in the service sector.

Monetary easing fashion month



CNB policymakers will already know what the Federal Reserve and the European Central Bank have done with their main policy instruments and how these institutions think about the economic outlook and the adequate monetary policy setup. With only a gradual recovery in the eurozone and inflation close to the target, another rate reduction from the ECB side is highly likely. With the cooling US jobs market and inflation prints trending downwards, the Fed is also expected to cut rates at the September meeting. Dovish signals from the major players have to be taken into account by the CNB, as the interest rate differential is one of the crucial drivers for the domestic currency. Overall, the likely rate cuts by other major monetary institutions, the weaker data from abroad, the mediocre performance of Czech industry, and uncertainty about the recovery in the year ahead point toward reducing the current restrictiveness of the Czech monetary policy mix.

Author

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.