Lower energy prices amid global turmoil make Czech rate cuts more likely

Headline inflation in the Czech Republic was confirmed at 2.7% in March, unchanged from the previous month. This was driven by rising food prices and declining fuel prices. Meanwhile, less volatile items saw steady annual gains. The global trade landscape, shaken by elevated uncertainty, is likely to make further rate cuts easier

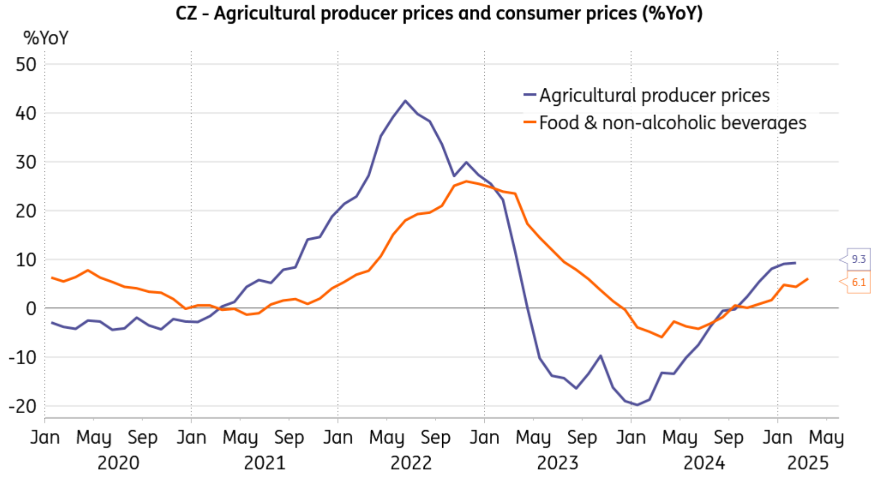
Prague's Old Town Square

Food prices rise while fuel prices drop

Czech annual inflation was confirmed at 2.7% in March, an increase of 0.1% from the previous month. The monthly price gain was mainly driven by the food category, with higher prices for eggs (up 15.7% month-on-month), fruit (up by 2.7% MoM), and poultry (up by 2.0% MoM).

By comparison, prices were lower in the transport section, where prices of fuels and oils fell by 3.2% MoM. The price of full-package holidays fell 2.8% MoM in March, with the winter season coming to an end. Prices of goods gained 0.1% MoM and prices of services rose 0.2% MoM in March.

Food price hikes remain on the table

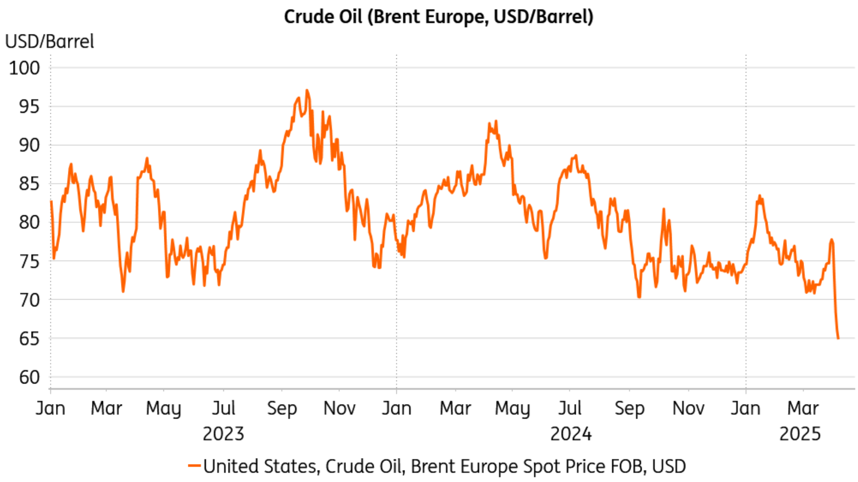


Source: CZSO, Macrobond

The annual price dynamic remained unchanged in March at 2.7%, with the increase in food prices almost entirely offset by a fall in fuel prices. Prices of milk increased by 11.1%, eggs by 46.0%, butter by 27.3%, chocolate by 33.9%, coffee by 22.5% and cocoa by 27.1%. In the housing section, the rents added 6.3%, water charges picked up by 4.2%, and heat charges by 4.5%. Imputed rents gained 3.6% in March (3.1% previously), reflecting the rise in new house prices. Meanwhile, electricity prices shed 4.8% and natural gas prices 8.5%. Prices of goods rose by 1.6% and prices of services by 4.5% from a year earlier.

Food and energy prices, the two sections of the consumer basket usually deemed volatile, are going against each other right now. However, accelerating food prices are perceived as more troublesome from the perspective of households and likely have a more profound effect on inflation expectations. The continued price gains of agricultural producers suggest that there are still some price hikes for consumers in the pipeline. That said, the annual dynamic in the segment is expected to be somewhat erratic over the coming months, as is the case with last year's profile of the food price index.

Lower energy prices mitigate future food price growth



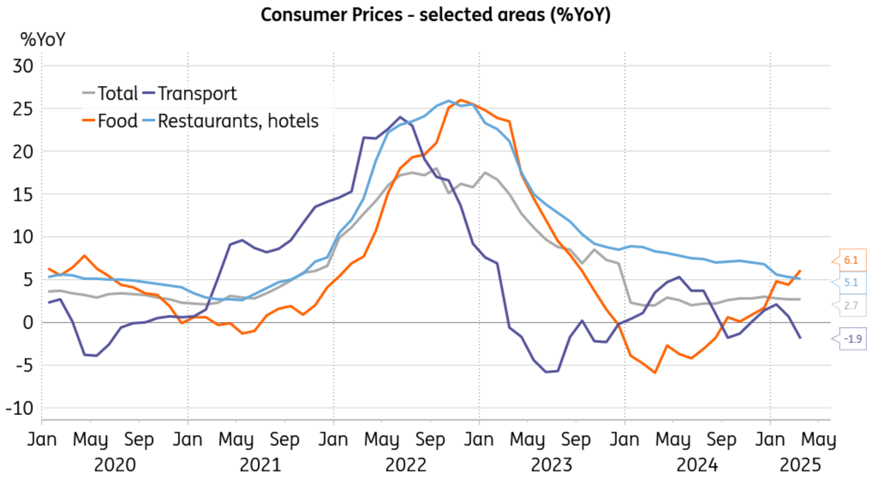
Source: Macrobond

At the same time, the recent fall in Brent crude and natural gas prices represents a downward risk for food price inflation, as the transport and fertiliser costs could be substantially reduced should subdued global energy prices prevail. Such an outcome may relieve household budgets and shape the Czech National Bank's (CNB's) decision when considering future price gains and rate reductions.

Global trade reshuffle makes growth outlook less certain

Core inflation marginally softened to 2.4% YoY in March, according to our calculation, in line with the CNB winter projection. That said, the dynamic of more resilient parts of core inflation, such as rents and prices in restaurants, remained potent, and we expect annual core inflation to pick up again in April. Headline inflation remains 0.1pp above the CNB outlook, being held on a short lead by the heavy decline in fuel prices, the most volatile part of the basket.

Food and transport prices head in opposite directions



Source: CZSO, Macrobond

Headline inflation is set to slow in April due to an elevated comparison base from the preceding year on account of food prices, yet it will gain pace in the subsequent months and fly close to the upper bound of the tolerance band. Still, we believe there is some scope for a rate reduction in the coming months to help the Czech economy reach its full potential in terms of growth and get the monetary easing cycle finished.

Amid the ongoing reshuffle in global trade and the uncertain outlook for global economic expansion, now is the opportune time to create conditions that enable the Czech economy to escape the fixed investment stagnation and secure its place in the evolving global landscape.

In such a situation, we see two more rate reductions in May and August as an appropriate way forward, bringing the base rate to 3.25% as a terminal level for the base case scenario of a continued economic rebound.

Author

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

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