Pricing in Czech manufacturing accelerates across sectors

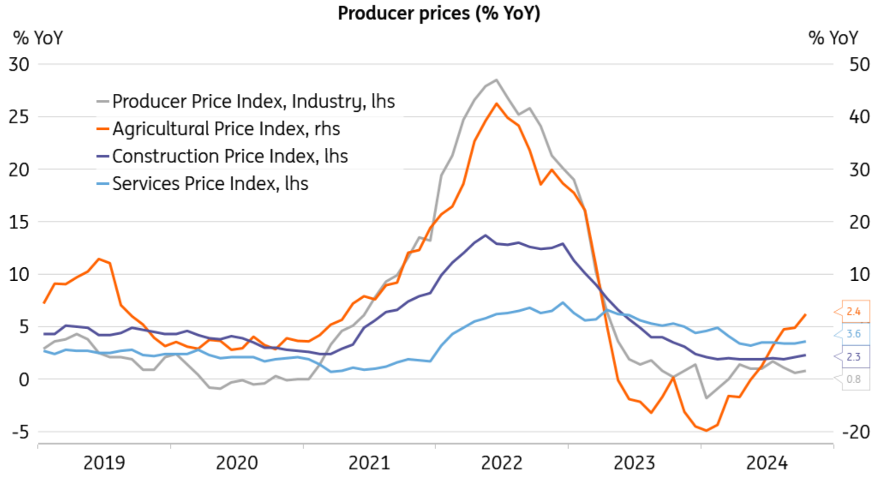
Producer prices in industry accelerated in October, yet the annual dynamic remained soft due to elevated price competition. However, price growth has resumed in the food processing segment, which will likely push up consumer prices in the coming months, increasing the likelihood of inflation crossing the 3% threshold by year-end

Price growth in the food industry will put pressure on consumer inflation

Czech industrial producer prices rose by 0.8% year-on-year in October and increased by 0.1% from the previous month, slightly below market expectations. This occurred despite continued weak foreign demand, indicating high price competitiveness across industrial sectors.

Agricultural producer prices saw a renewed annual growth of 2.4% in October, with a significant 6.9% increase month-on-month. This marks the first annual rise in agricultural prices since April last year, and this renewed growth is likely to be reflected in consumer prices in the coming months.

Price growth strengthened across sectors



Source: CZSO, Macrobond

Annual price dynamics in construction rose to 2.3% in October, up 0.3% from the previous month. The rebound in demand for residential property is reflected in increasing real estate prices and a pickup in the construction sector, while the still-tight labour market is contributing to the upward pressure on wage costs.

Prices of market services for businesses also accelerated in the same month, with a 3.6% annual increase and a 0.5% monthly rise, indicating persistent price inertia in the service sector. Historically, annual growth in this segment averaged just 0.5% in the decade following 2009 and saw an average annual increase of 1.4% between 2016 and 2019, a period when the economy was performing strongly and showing signs of overheating towards the end.

When looking at the main industry groups, prices of capital goods rose by 2.8% YoY in October, energy by 0.3% YoY, and non-durable goods by 1.9% YoY. Meanwhile, prices of intermediate goods decreased by 0.6% from a year earlier. The annual dynamics of industrial producer prices excluding energy quickened to 1.1% in October.

Sub-potential growth amid elevated inflation to shape central bank decision

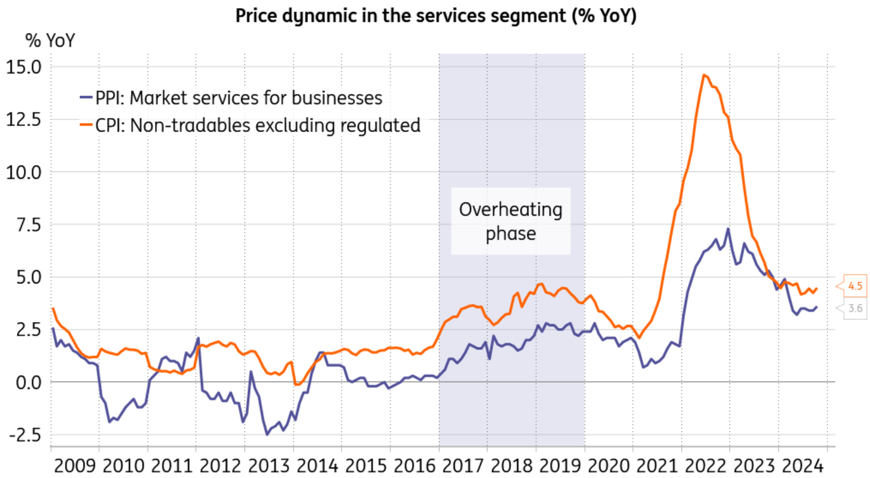
Overall, we see October's renewed annual price growth in agricultural manufacturing and the lofty price increase from the previous month as a source of upward pressure on the consumer price segment over the coming months.

Indeed, food prices mitigated headline inflation until August, but this has changed, and food price increases are going to put household budgets under pressure and add to the chances of inflation crossing the 3% threshold by year-end.

We will see how the central bank board manages the dichotomy between a sluggish recovery and the economy operating below its potential on the one hand, and the headline and core inflation remaining elevated on the other.

Our take is that the concerns about price stability will have the upper hand in the Czech National Bank decision function and that we will likely see a pause in the current cutting cycle in December to judge what is going on in the consumer price segment.

Pricing in the service sector remains robust



Source: CZSO, CNB, Macrobond

When looking at the CPI developments, we see the price inertia in the service segment unbroken, food and fuel prices no longer having a mitigating effect, and the weaker Koruna against the dollar fostering prices of imports. Moreover, the recovery in property prices will likely contribute to solid increase in rents, which represent one of the crucial drivers of core inflation. We see the consumer price growth to peak at 3.4% in December, but to remain above the target throughout the next year under the base case scenario of continued gradual recovery. This setup will drive the cautious approach of the policymakers to further rates reduction.

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