

Czech inflation below the target due to volatile food prices

Inflation dropped below the target in April, with food prices being the decisive drag factor. However, food prices are subject to significant volatility, so policymakers might discount the drop. In contrast, the price dynamic in the service sector remained potent. The softer headline figure might tilt the Czech National Bank decision toward a cut

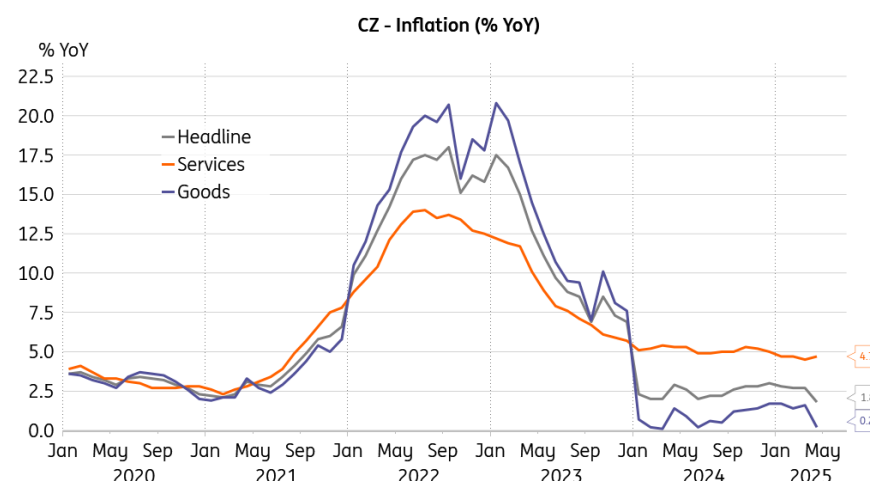


Inflation was below target in April on a big drop in food prices, but it may be transitory

Inflation dragged down by food prices

Czech consumer prices dropped by 0.1% month-on-month and rose by 1.8% year-on-year in April, according to the preliminary estimate. The inflation reading came in below market expectations. The main drag was the substantial monthly drop in prices of processed foods, alcohol, and tobacco. That said, food prices are generally hard to predict, as there is quite some variation in the seasonal pattern, especially in the segments of fruits and vegetables. Energy prices also contributed to a softer CPI figure.

Services and goods prices take a different path



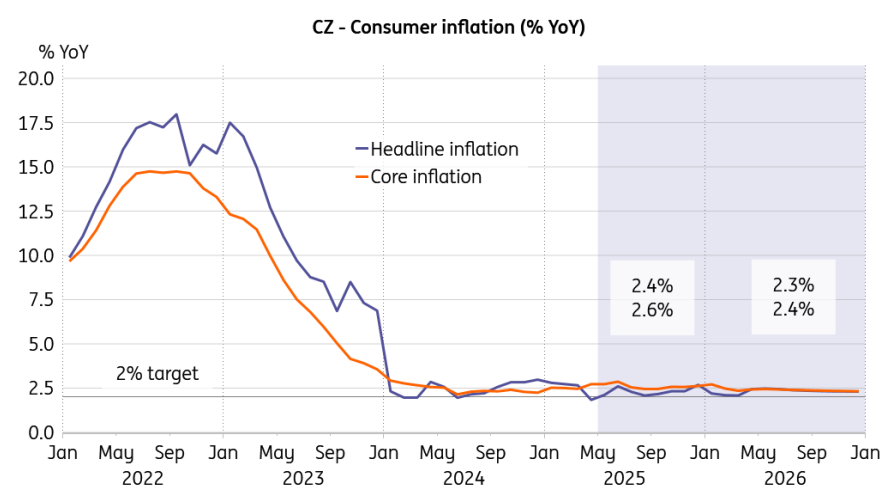
Source: CZSO, Macrobond

Meanwhile, the annual growth of services prices picked up in April to 4.7% from 4.5% previously, signalling that core inflation picked up and remains potent. The prices of unprocessed food maintained a strong dynamic, suggesting that the softer annual growth in the overall food segment in April might only be a blip.

Global energy prices put a lid on the inflation outlook

We revise our inflation forecast lower, mainly on account of lower Brent crude oil prices and a stronger koruna against the dollar. Both have a direct impact on domestic fuel prices, and a delayed effect on food prices and regulated prices. Meanwhile, as household budgets get some boost from lower energy bills, the extra resources directed toward discretionary purchases would foster core inflation that is foreseen to remain robust.

Core inflation to remain above the target



Source: CZSO, ING, Macrobond

Still, the downward surprise in April's headline inflation may tilt tomorrow's Czech National Bank vote toward a 25bp rate reduction, as is our base case scenario. The economy still operates below its potential, fixed investment has been stagnant for over two years, and the global growth outlook has become less certain. We see a good opportunity for policymakers to set the conditions right for investments to gain solid ground and for the industrial base to get back on track. At the same time, the downward surprise in food prices may be deemed transitory, while the price growth inertia in the service sector perceived as unshattered, so we expect a continued hawkish stance.

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