Czech inflation confirmed above target as service price inertia lingers

Czech annual inflation was confirmed at 2.7% in February, ticking below the previous reading. Service price inertia doesn't seem to have faded just yet, and we think that this – alongside a potential increase in military spending – could trigger a more hawkish stance among policymakers

Czech food prices had the largest impact overall

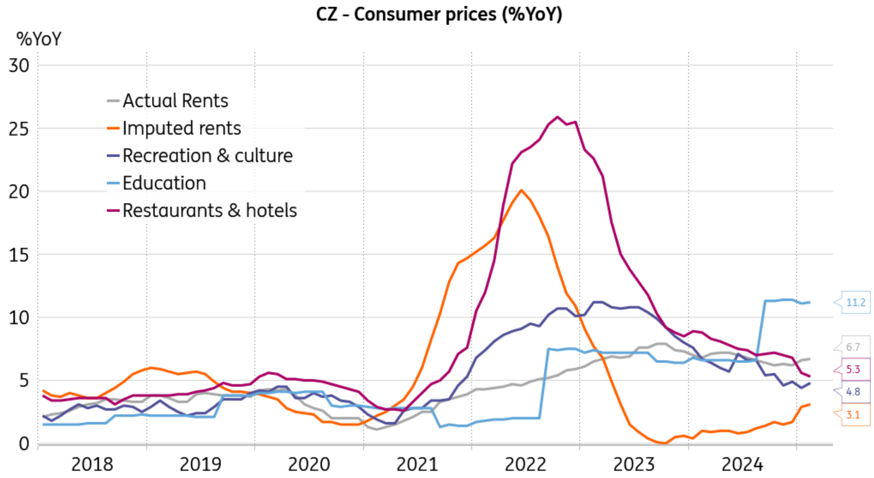
Annual food price dynamics elevated despite monthly relief

Czech annual inflation reached 2.7% in February, with annual price increases recorded in all sections of the consumer basket except clothing and footwear. Prices in the food section again had the largest impact on the annual price level increase, with prices of milk rising by 12.3%, eggs by 18.6%, butter by 41.6%, and chocolate by 30.5%. That said, there was some relief as food prices dropped overall. In the housing section, rent increased by 6.7%, and water and heat charges increased by more than 4%. Meanwhile, electricity prices shed 4.8% and natural gas prices 7.9%. Imputed rent growth increased to 3.1% in February from 2.9% previously, reflecting the rise in new house prices.

Price growth in goods decelerated to 1.4% in annual terms, while price dynamics in services remained unchanged at 4.7% in February. According to our estimate, annual core inflation remained unchanged at 2.5% in February, in line with the Czech National Bank's expectations.

On a monthly basis, consumer prices added 0.2% in February. Among the main drivers were prices of full-service holidays (+5.0%), prices of recreation and cultural services (+0.9%), and household equipment (+1.9%). In contrast, prices in the food section, as well as alcohol and tobacco, were 0.6% below their January price level. Goods prices shed 0.2% from the previous month in aggregate, while services prices added 0.7% month-on-month in February.

Price growth in services isn't backing off



Source: CZSO, Macrobond

We see the persistence in service price growth as the main worry for policymakers; it remains well above 3.5%, the rate considered to be in line with the inflation target. Both nominal and real wage growth surprised on the upside, suggesting that continued disinflation in the service segment is not a *fait accompli*. We see the board maintaining a hawkish stance and waiting for a fresh fully-fledged forecast before the next rate cut, which we see coming in May. Such prudence will also be fostered by the discussions over plans to boost defence spending, with the bank board regarding potential fiscal expansion as a clear pro-inflationary risk.

Author

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

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