Czech inflation slows down as expected

November CPI down to 2.6% but the figures don't help solve the rate hike timing puzzle

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Base effect main culprit behind CPI slowdown

November inflation slowed down to 2.6% mainly on the back of lower food prices. The year-on-year dynamics slowed down from 7.8% in October to 5.7% in November despite the fact that food prices slightly increased in month-on-month terms. Weaker YoY dynamics in November were driven by high base effect from last year's November when food prices picked up by 2.1% MoM – the strongest dynamics in almost last three years.

2.6%

November CPI

after 2.9% growth in prices, in October

As expected

Further slowdown ahead due to high base

On the other hand, prices of services slightly sped up in November, from 3.2% to 3.3%. However, their year-on-year dynamics will also be influenced by the base effect in forthcoming months, as prices of restaurants started to grow more rapidly in December due to the beginning of online sales registration.

Also, the change in the methodology of imputed rents giving higher weight to property prices will push YoY dynamics of services somewhat lower. This means that inflation is about to slow down further in the months ahead.

The CNB hiking cycle will continue

However, the effect of higher base effect is expected, and despite that, CPI should remain safely slightly above the 2% Czech National Bank target next year.

CNB rate will increase again in two 2-month time, with prospect of another 2-3 hikes in one year horizon.

In our view, given the favourable economic prospects, the CNB will further tighten monetary policy. As such, the CNB rates will further increase in the two-month horizon, but today's inflation didn't help much to solve the puzzle, whether rates will increase already in December or at the beginning of February.

Rate hike likely to be followed by more in 2018

The advantage of the February meeting is it will bring a new forecast which is connected with enhanced communication. On the other hand, a December rate hike might increase volatility as 'end-of-year' effects influence the market. However, proponents of a December hike will argue that even the new forthcoming data will not change the rate decision so there is no need to wait.

We see a slightly higher chance for February hike as December brings some technical obstacles, but when Governor Rusnok himself signals 50/50 chance of a December hike, this scenario cannot be wholly excluded.

What is more important, however, is that the CNB will hike again in two-months time, with the prospect of another 2-3 hikes in the one-year horizon.