

Czech inflation stagnated in August

Price growth remained close to 3% in August, driven mainly by housing costs, which contributed more than half to inflation growth this year. For the whole of 2019, we expect inflation around 2.8%, the highest figure since 2012. The Czech National Bank should remain on hold for now



Compared to July, average price growth was only marginal, rising by 0.1%, as some price changes cancelled each other out. After prices of alcoholic beverages fell in previous months, they rose in August. By contrast, fuel prices fell slightly by 0.6%. Food prices also fell slightly in August, especially prices of vegetables. However, annual food price inflation remained close to 4% for the second month in a row after hovering around 2% in 1H19, as seasonal declines in vegetable prices over the summer were not as pronounced as they usually are due to a bad harvest. Prices of package holidays increased further- almost 8% more expensive in year-on-year terms.

2.9% YoY

August inflation slightly surprised on the upside

0.1% MoM

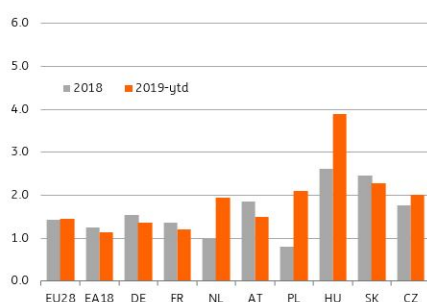
Higher than expected

A few items behind solid price growth

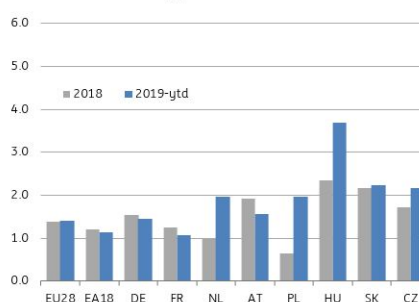
This year, housing prices were largely responsible for pushing YoY inflation higher, driven by double-digit increases in electricity prices, but also higher rents, due to the overheated property market. As such, housing prices accounted for more than half of the growth in inflation this year. In addition, food prices, which were growing by more than 2% on average this year, accelerated to 4% during the summer. These costs, together with a further increase in wages, were reflected in price growth at restaurants. Prices of services, in general, have been growing at a rapid pace, with year-on-year growth in August remaining at 3.8%. Service prices in the summer months were also supported by strong growth in prices for holidays, although as in the previous year, we expect these to slow again in September. Still, Czech price growth this year is not exceptional in the EU context.

Average price growth in the EU countries (% YoY)

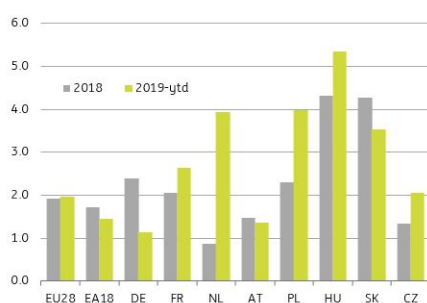
Total inflation (HICP, % YoY)



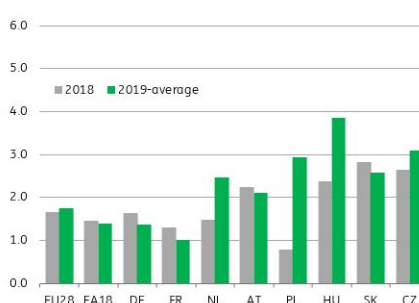
Prices without energy and food (% YoY)



Prices of food (% YoY)



Prices of services (% YoY)



Source: Eurostat, ING

CNB on hold despite higher inflationary pressures

The Czech National Bank expected 2.6% inflation in August, but despite the higher price growth (driven mainly by food prices), we don't expect a reaction from the central bank at the moment. CNB board member Vojtěch Benda said in his presentation yesterday that with the knowledge of today's weaker exchange rate, the CNB should have increased interest rates faster, which would

have brought current inflation closer to the 2% target.

The economy is still inflationary, wages and prices are rising, but he noted that the CNB should not fight yesterday's battles. This means that, looking ahead in the monetary policy horizon, inflationary pressures are falling, but current inflation is a lost battle for the CNB and it makes no sense to hike – mainly because global economic growth is slowing and there is a lot of uncertainty ahead.

If Czech economy decelerates further, CNB reaction can come later

As a result, the CNB will not react to higher inflation and we expect rates to remain at the current level this year, as also highlighted by CNB Board members recently. Given recent global developments, the market is also starting to bet on CNB rate cuts, mainly due to the expected cuts delivered by the Federal Reserve and the ECB. However, in the half-year horizon, this is premature for the domestic economy, in our view. In the case of a faster deceleration of the domestic economy, a possible CNB reaction could be expected in the second half of next year, though this would cause the Czech koruna to depreciate and limit the magnitude of interest rate cuts. This is a scenario where the Czech economy's growth falls below 2% next year, i.e. well below the current consensual expectations of 2.4% (2.9% by the CNB), which has become our baseline view.