

Czech inflation surprised on the upside

August CPI accelerated to 2.5% on the back of higher electricity and food prices. In our view, given the development of the domestic economy and the persisting weak koruna, the central bank will continue hiking this year, and two more hikes are becoming the most likely scenario



Source: Shutterstock

August inflation accelerated from 2.3% to 2.5% and price growth slightly exceeded market expectations of 2.4%.

The rise in inflation compared to July was mainly due to higher prices of electricity and gas for households. Moreover, despite a month on month fall in food prices, their annual dynamics accelerated due to a base effect, contributing 0.1ppt more to YoY growth in inflation compared to the last month.

2.5% YoY August inflation

above the market consensus of 2.4%

The breakdown

	YoY (%)	Cont (ppt)	MoM (%)	Cont (ppt)	YoY(t-1) (%)	Cont (ppt)
Total	2.5	2.5	0.1	0.1	2.3	2.3
Food and non-alcoholic beverages	0.6	0.1	-0.1	0.0	-0.1	0.0
Alcoholic beverages, tobacco	2.3	0.2	-0.5	0.0	2.9	0.3
Clothing and footwear	-1.4	-0.1	-1	0.0	-1.3	-0.1
Housing, water, energy, fuel	3.2	0.8	0.6	0.2	2.9	0.7
Furnishings, households equip.	2.1	0.1	0.1	0.0	1.7	0.1
Health	3.8	0.1	0.4	0.0	3.6	0.1
Transport	4.8	0.5	-0.5	-0.1	5.4	0.5
Post and telecommunication	-1.5	0.0	0	0.0	-1.6	0.0
Recreation and culture	3	0.3	0.2	0.0	3.1	0.3
Education	1.6	0.0	0	0.0	1.6	0.0
Restaurants and hotels	3.6	0.2	0.2	0.0	3.6	0.2
Miscellaneous goods and services	3.8	0.3	0.4	0.0	2.9	0.2

Source: CZSO, ING Bank

Inflation will remain close 2.5% in forthcoming months

Inflation should stay close to 2.5% for the remainder of the year, so its average level will be 2.2% this year.

However, inflationary pressures will step up not only due to the perceptible wage acceleration but also due to the rise in energy prices, especially electricity and gas for households. At the same time, the acceleration in food prices is expected as a result of the weaker harvest due to drought this year.

These effects will probably lead to inflation exceeding the 3% threshold in the first half of 2019, but also prices excluding volatile food and energy prices will accelerate, which is a more important indicator for the Czech central bank. For example, annual growth in services prices accelerated further from 3.5% to 3.7% in August.

August CPI below the CNB is no game changer

Although August inflation ended below the central bank's estimate of 2.6%, it isn't a game changer for the current monetary policy outlook indicated in the last central bank forecast.

Indeed, when preparing the forecast, the CNB did not have preliminary data regarding July food prices decline which means its estimate of inflation for the first months of the forecast was slightly overestimated. But the CNB was aware of it already during the August monetary meeting.

Two more hikes likely this year

In the context of the current development of the domestic economy, there is a continuing

need for tightening monetary policy.

In our view, another increase in rates this year is a done deal and given the persisting weak koruna, which does not slow the inflationary pressure as expected, the scenario of two rate increases of 0.25 ppt becoming the most likely.