

Czech Republic: Inflation decelerated as expected to 2.4%

Czech inflation continues to decelerate after its October peak. But this is no game changer for the central bank



Deceleration in inflation due to higher base effects

December price growth slowed down as expected to 2.4% from 2.6% in November, while prices increased slightly by 0.1% in MoM terms. This development was in line with market expectations but was slightly below the Czech National Bank's estimate of 2.5%. The annual slowdown was mainly due to a higher statistical base at the end of 2016. Indeed, inflation accelerated in December 2016 to the CNB's 2% target for the first time in four years, mainly due to higher food prices and higher prices in restaurants, supported by the introduction of online sales.

2.4%

December CPI

(% YoY)

As expected

Highest inflation in the last 5 years

For the whole year 2017, inflation reached 2.5%, which is almost two percentage points more than in 2016 (0.7%) and the highest rate of inflation in the last five years. Food prices contributed the most to the YoY inflation dynamics in 2017 (5.2% YoY, +0.9ppt), together with higher prices in transport (3,7% YoY, +0.4ppt) and prices in restaurants and hotels (5,7% YoY, +0.3ppt). Excluding oil and food prices, prices of services accelerated by 2.9% YoY in 2017, confirming solid demand-driven inflationary pressures.

Inflation should remain close but above 2% CNB target this year

Despite the effect of a higher statistical base, inflation should remain in the 2-2.5% range this year.

The slowdown in December inflation was mainly related to a higher base. It is no game changer for the forthcoming CNB hike at the beginning of February.

The risk to that forecast lies in the direction of oil prices, which are hard to predict. Crude has recently increased to more than \$69 per barrel--the highest level since the end of 2014-- due to geopolitical risks in Iran. If this elevated level persists, it would mean double-digit growth in fuel prices in forthcoming quarters, potentially contributing around 0.5ppt to YoY inflation growth, although the increase in the koruna's oil price would be moderated by a gradually appreciating CZK against the USD. Still, as a supply factor, this would not change the CNB's attitude towards gradual monetary tightening.

February hike ahead

From the CNB's point of view, today's slowdown in YoY CPI was expected and it was mainly related to a higher base effect. Despite that, prices of services were still growing by a solid 2.8% in YoY terms and as such, this is no game changer for the forthcoming CNB hike expected during the next monetary meeting at the beginning of February.