Food, services and rent drive rising Czech inflation

The uptick in Czech inflation was largely attributed to food prices and an increase in core inflation. The disinflationary process in the service sector appears to have come to a halt, while imputed rents have accelerated in line with the overheated property market. Both will likely foster a hawkish stance from the CNB, with no rate cut expected this month

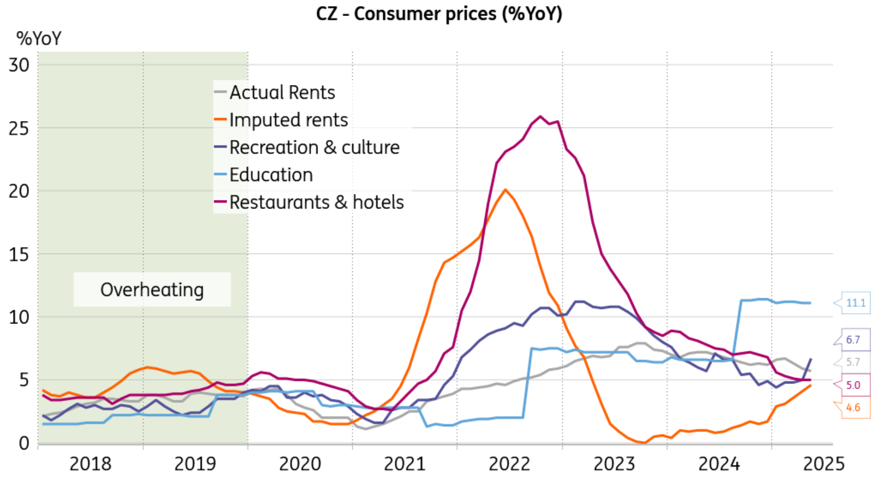
Services prices linked to restaurants and accommodation, along with a continued acceleration in imputed rents, have driven Czech core inflation higher recently

Imbalances in the property market foster core inflation

Czech headline inflation was confirmed at 2.4% year-on-year and 0.5% month-on-month in May, with higher prices in the food section being the main growth driver. That said, services prices also contributed noticeably to the rebound in the overall price growth, mainly via services linked to restaurants and accommodation. These drove core inflation higher, along with a continued acceleration in imputed rents. Core inflation is estimated to have quickened to 2.8% YoY, adding 0.3% MoM. The prices of goods and services increased by 0.5% MoM each. In annual terms, goods prices increased by 0.9%, and services by 4.9%, both more potent than seen previously.

The excessive demand for housing is heating up the property market, and prices have continued to rise swiftly, resulting in an increase of imputed rents to 4.6% YoY (4.1% previously) and 0.8% MoM, with the monthly dynamics doubling from the previous reading. Market rents added 5.7% YoY, marginally less than in the previous month. The imbalances in the residential market and their implications for imputed rents and core inflation aren't likely to recede any time soon, and will therefore play an increasingly important role in the Czech National Bank's decision function, along with the stalled disinflation in the services segment.

Lofty services price dynamic does not recede



Source: CZSO, Macrobond

The CNB's decision will be shaped by a trilemma consisting of: a) persistent services price growth and quickening imputed rents, b) lukewarm fixed investment under elevated uncertainty, and c) potent rates differential vis-à-vis the European Central Bank. We see no change in rates for the June meeting, while the upcoming data on the real economy will suggest where the industry is, in fact, heading.

We see the surprisingly strong first-quarter GDP figure being driven by three one-offs: the election outcome in Germany, exports fostered by tariffs-induced front-loading, and the positive wave from a brief focus on improving European competitiveness. We would like to see a sustainable pickup in Czech industrial production and fixed investment before calling the situation a full-fledged economic rebound. Until then, we still see scope for a rate reduction, likely scheduled for August, to bring the rate to its 3.25% landing zone.

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