

Czechia Watch: February inflation is a bittersweet moment

Consumer prices grew by 0.6% in February due to the absence of another energy price shock. Still, price pressures remain robust with elevated price growth in services. We have revised our inflation outlook upward and expect now a slower-paced rate-cutting cycle.



More subdued price growth, but services inflation still robust 1

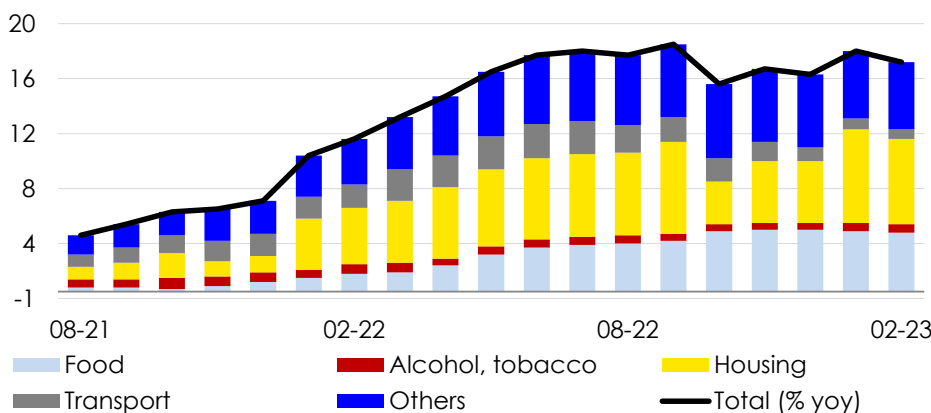
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More subdued price growth, but services inflation still robust

Consumer prices grew by 0.6% compared to January during which they surged by 6% driven by a significant upward correction in energy prices after government measures expired. From a year-on-year perspective, the inflation rate fell from 17.5% to 16.7%, finally being aligned with market consensus (16.6%).



pp contributions to yoy% headline inflation

Source: Macrobond, Raiffeisen Research

As widely expected, the previous energy price impulse is missing in the February data due to the since January active energy price caps. Any significant energy price moves are thus unlikely for the rest of the year. Naturally, this creates room for a price hike in 2024 (price caps no longer active) especially given our expectation of an increase in natural gas prices later this year.

The decline in inflation aligned with market consensus is a much-welcomed development from the perspective of households. However, **details of the CPI statistics reveal that price-pressure is still broad**, especially in the services sector, which generally exhibits a tendency to remain persistent. Particularly in the segment of recreation and culture, prices came in hot at 2.6% compared with January. Given our outlook of unemployment rate remaining close to 4% (3.9% in Feb) and the pace of nominal wage growth increasing,

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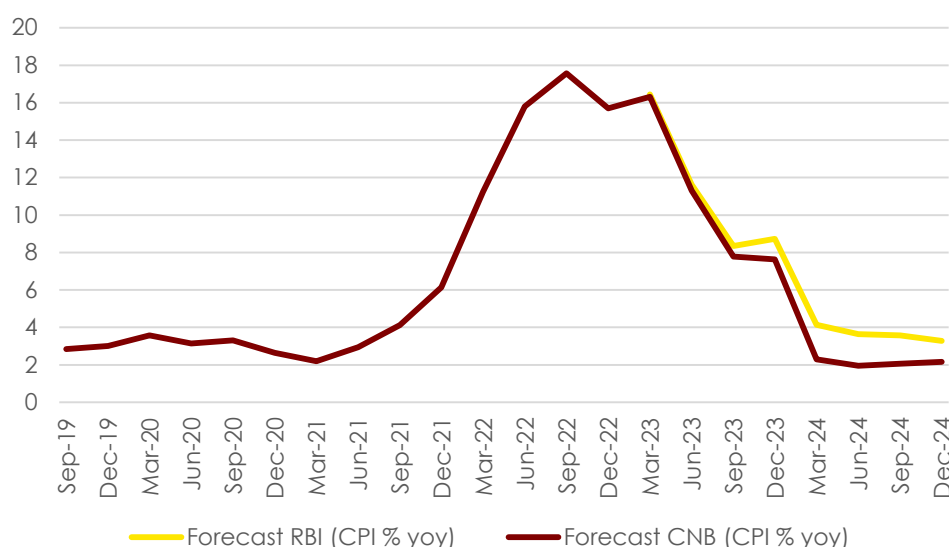
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we fear that services inflation is going to decrease only slowly. Local factors aside, we also think that global development will add to inflation pressure, such as demographics (aging population), the changing nature of global trade (geopolitical risks) or green energy transition.

Forecast revision - higher CPI and slower-paced rate cuts

In light of the remarks above, together with the above-expectations January CPI print, **we are revising our inflation outlook up** to 11.3% for 2023 (vs. 8.8% previously) and to 3.7% in 2024 (vs. 3.2% previously). The upward revision is mostly due to higher energy and food prices, while core inflation outlook has increased only marginally to 9.3%, due to higher persistency. The trajectory of inflation remains similar, though, gradually declining reaching single digits by mid-2023.

Inflation outlook of declining but "sticky" inflation



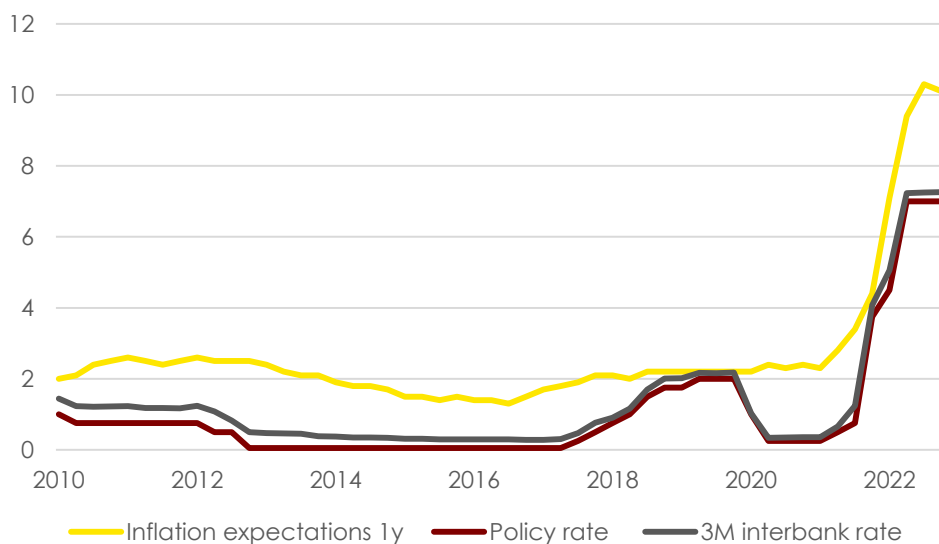
Source: Macrobond, CNB, Raiffeisen Research

With inflation projected to continue in its descent while being rather persistent, we **have kept our call of interest rate cuts starting this summer but reduced the subsequent pace of the rate-cutting cycle**. Thus, we continue to expect the key rate at 6% by the end of 2023 (currently at 7%), while at 4% by the end of 2024 (vs. previously expected 3.5%).

The rationale for rate cuts in 3Q23 is as follows. The charts below show forward-looking real interest rates, which the CNB views as being restrictive enough. If the following months bring a series of declining inflation prints with the headline number back to single digits by mid-2023, the historically flexible inflation expectations should follow suit. At constant nominal rates, this would imply rising real rates and thus tightening of financing conditions at a time when the economy is undergoing a fragile recovery. Therefore, for the CNB to remain consistent with their current stance, we view rate cuts this summer as a plausible move.

How restrictive is monetary policy?

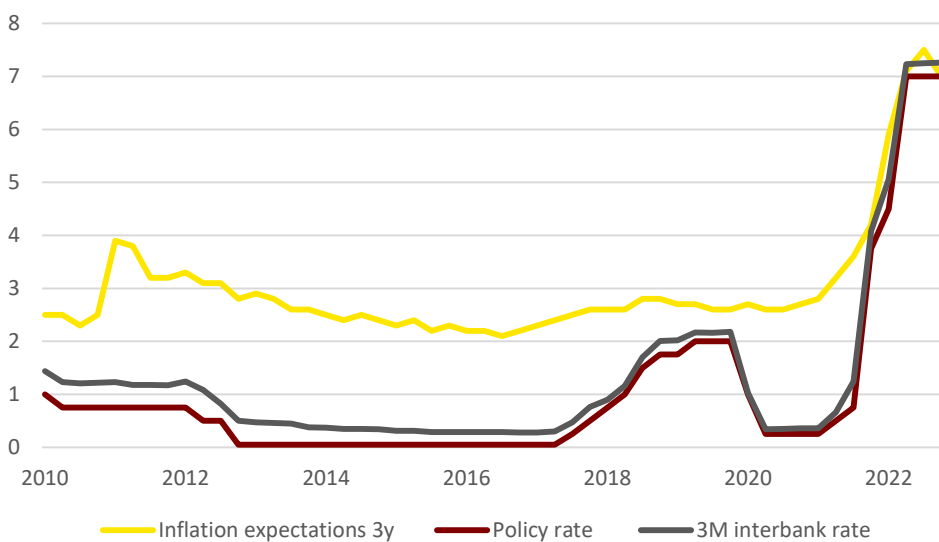
in %



Inflation expectations one year ahead based on CNB survey among non-financial corporations

Source: Macrobond, CNB, Raiffeisen Research

in %



Inflation expectations three years ahead based on CNB survey among non-financial corporations

Source: Macrobond, CNB, Raiffeisen Research

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CZ	30.12.2022	Under Revision	Czech Republic
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Symbol	Date	Recommendation	Company
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CZ	07.06.2022	Not rated	Czech Republic

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Producer of this publication Raiffeisen Bank International AG Am Stadtpark 9, A-1030 Vienna

Creation time of this publication: 10/03/2023 12:34 P.M. (CET) ;

First Dissemination of this publication: 10/03/2023 12:34 P.M. (CET)