

## Czech Republic Watch

## Lower CPI not enough to trigger cuts soon

**CPI in single digits, but 2% target too far to be comfortable**

Investors have been focusing on the strong disinflation trend in Czechia, emboldened by June CPI back to single digits (9.7%), but we do not think this is the trigger for the Czech National Bank (CNB) to consider easing any time soon. We continue to expect the first cut in February 2024, with YE2024E base rate at 4%. The Board is in a defensive mode against strong domestic criticism about inflation staying too far for too long above the 2% target. This suggests the central bank would rather refrain from cutting rates when the case still appears ambiguous for the public (i.e., inflation in high single digit rates), and the ability to sustainably meet the 2% target is still under question.

The current market pricing of rate cuts this year looks overdone in our view. Even in a risk scenario of a rate cut in November, it is very unlikely that the CNB does more than 25bp per meeting this year, implying only 50bp of cuts possible in 2023.

**Dovish CPI details**

June CPI details may be viewed as strengthening the case for rate cuts, but we think that the headline rate is an important constraint. Inflation slowed to 9.7% yoy from 11.1% in May, 0.4pp below the CNB's expectations. The moderation was driven by both core and non-core components: food (-0.44pp), energy (-0.19pp), imputed rent (-0.2pp), furnishing (-0.1pp) recreation (-0.09pp), and restaurant (-0.07pp). Core CPI undershot the CNB's forecast even more than the headline, slowing to 7.5% yoy vs 8.3% expected and 8.6% in the previous month. Price growth momentum continues to slow across tradables and non-tradables, with the 3m/3m annualised rate down to 3.5% and 5.0%, respectively.

However, given the Board's concerns over unanchored inflation expectations and a wage-price spiral, we think headline inflation matters more than the core for the CNB, and year-on-year rate more than month-on-month annualised trend. A 0.4pp of downside surprise for a high single-digit inflation rate may not bring as much comfort for the CNB Board as the market thinks.

**No longer need to hike, but no strong reasons to rush cuts**

The June CNB meeting minutes noted upside risks from "inflation expectations becoming unanchored" and "a wage-price spiral", and downside risks from a "further stronger-than-forecasted downturn in domestic consumer and investment demand". So far, we have seen upside risks retreating but not substantially, while downside risks are not rising in any material way to call for imminent CNB cuts. Inflation expectations by analysts and corporates have been easing, but the latter is still at an elevated 7.9%. The renewed tightening in the labour market is problematic. This would bolster pay pressures when employees will want to demand some compensation for the lost in real income, and while nominal unit labour costs have already reached at a record high (10%).

Meanwhile, retail sales have stopped declining as consumer confidence stabilizes...

14 July 2023

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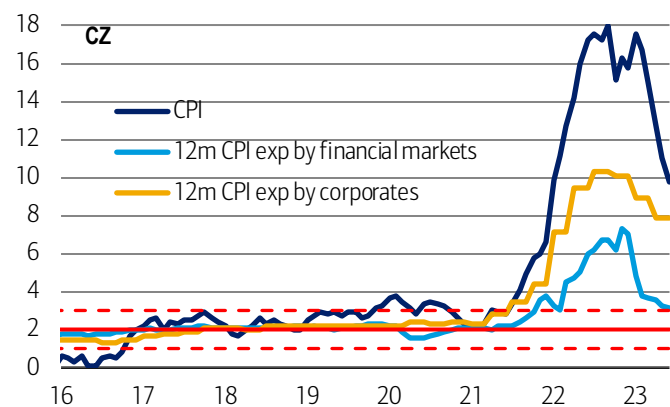
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... Households' deep savings and improving in real income growth likely support private consumption. Credit growth has also tentatively recovered for both households and corporates. Industrial activities have been on a slightly improving trend, though business surveys have been less upbeat recently, but not suggesting any major stress.

### Exhibit 1: Inflation and inflation expectations

Declining trends welcome but far from comfortable for CNB

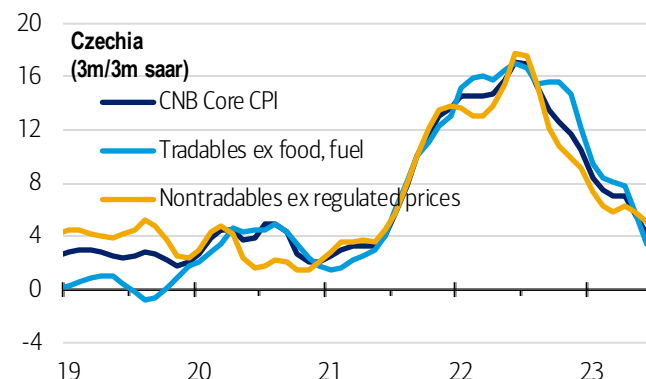


Source: CNB, Haver

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### Exhibit 2: CPI underlying momentum

Sequential inflation falling quickly, breeding market expectations for CNB material cuts in 2023

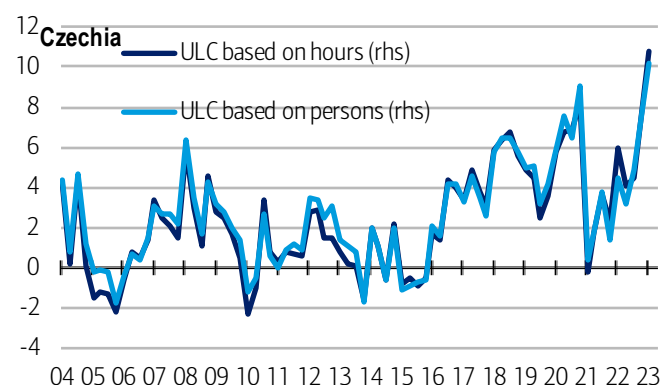


Source: CNB, Haver, BofA Global Research

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### Exhibit 3: Unit labour costs reaching all time high

Cost pressures remain elevated for firms

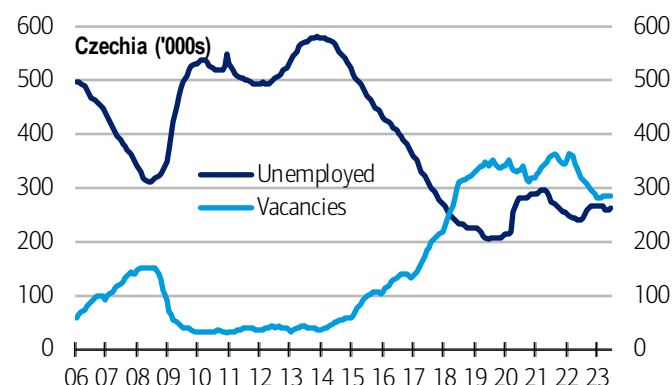


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### Exhibit 4: Unemployment vs vacancies

Labour market is starting to tighten again

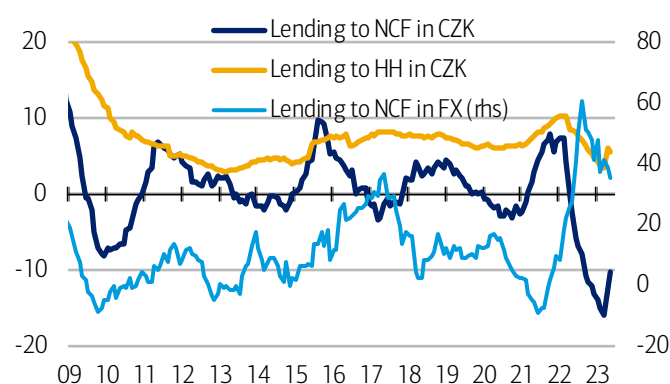


Source: Haver, BofA Global Research

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### Exhibit 5: Lending to households and corporates

Credit growth is picking up again

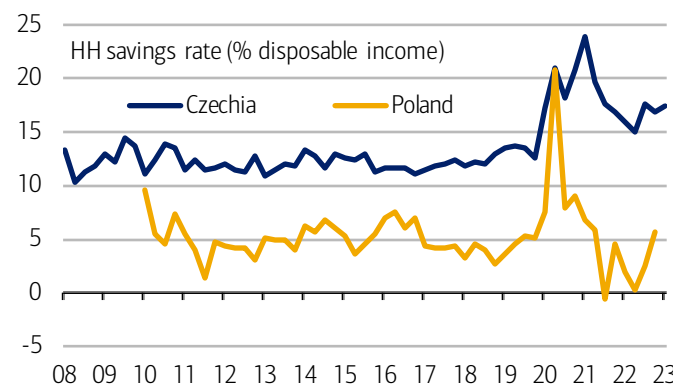


Source: Haver, BofA Global Research

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### Exhibit 6: Households' savings rate

Czech households have deep pocket



Source: Haver, BofA Global Research

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