

Short Note

Inflation - October 2013

November 11, 2013

Czech inflation below 1 % in October

In October consumer price inflation in the Czech Republic dipped to 0.9% yoy from September's 1%, the lowest value since March 2010. The figure was in line with our forecast and market consensus. Compared to September, the consumer prices went up by 0.2% driven by alcoholic beverages, tobacco, clothing and footwear.

The year-on-year inflation fell below the lower boundary of the tolerance band of the inflation target from the central bank and at the beginning of 2014 it is likely to hover just above the zero mark.

It is clear that inflation in the Czech Republic is subdued because of **a lack of any demand impulses**. The weaker CZK will not generate demand-driven inflation until the Czech companies will start to raise real wages. Without raising real wages households will not generate higher expenditures (rather the opposite). And who might increase labor cost under current intensive global price competitiveness?

Last Thursday, the Czech National Bank (CNB) unexpectedly decided to intervene against the CZK in effort to keep the exchange rate close to the EUR/CZK 27 level for an unspecified period of time. This unconventional measure means that the central bank is going to "target" the foreign exchange rate for a transition period. The central bank does not sterilize the CZK purchases, at least for the time being, boosting not only FX reserves but also CZK liquidity. In our view, **it will continue with it at least until mid-2014**. Then the central bank has to adopt an **exit strategy from the "currency targeting"** as otherwise a rapid CZK appreciation with dampening effects on domestic inflation and economic growth could be the consequence. The currency target or the timing of the exit strategy might be, however, adjusted during next year in line to changes in economic forecast of the central bank.

Our FX forecast is now under revision and in days to come we publish new forecast.

Helena Horská, chief economist Raiffeisenbank a.s., Prague +420 221 141 413