

Snap | 31 August 2018

Eurozone core inflation declines to 1% and becomes a bigger worry for ECB

Headline inflation drops to 2%, but the real story is core inflation falls back to 1%. The ECB will monitor this carefully in the coming months as core inflation needs to pick up for the conditional path of monetary tightening



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Headline inflation remains elevated due to the energy price jump in the first half of the year, causing energy price growth to be 9.2% in August. This effect has started to slowly fade out of the inflation rate, meaning that inflation will slip below target in the months ahead. Core inflation is therefore much more interesting to look at. For a sustained higher inflation rate, it needs to move up, and the much-anticipated acceleration has so far failed to happen.

There is hope for higher core inflation though. Perhaps the most interesting data point to come out this summer was Eurozone negotiated wage growth, which jumped from 1.7% to 2.2% year on year in Q2. This significant acceleration brings wage growth to a pace last seen in 2012 and gives the first indication that the long labour market recovery is starting to lead to increasing wage pressures. Still, while concerns about the ECB being behind the curve have already been voiced, today's core inflation reading suggests the contrary.

In the coming months, the question remains whether businesses will dare to increase prices on the back of higher wage growth in times of weakening business confidence. Surveys indicate slower expected price growth in the months ahead as global economic uncertainty has impacted the business outlook.

The European Central Bank needs improved core inflation to stay on track for its conditional path towards the end of quantitative easing in December and a rate hike at the end of summer 2019.

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