

## Eurozone headline inflation falls, but 'core' disappoints

The flash estimate shows a decline in eurozone HICP inflation from 2.9% to 2.8% in January, with core inflation declining to 3.3% from 3.4% in December. However, it's too soon to declare victory in the inflation battle



The eurozone's inflation battle is far from won

### Inflation falls slightly in January, core inflation disappoints

HICP inflation in the eurozone fell to 2.8% in January from 2.9% in December, in line with expectations; that's according to flash estimates. Energy prices remain an important factor in the downward price pressure, with energy prices still falling 6.3% year-on-year in January. At the same time, core inflation, which excludes energy, food, alcohol & tobacco, declined to 3.3% from 3.4% in December. But that decline was smaller than the 3.2% consensus forecast.

As industry and retail are still struggling with excess inventories, non-energy industrial goods price inflation continues to fall and now stands at 2%. Services price inflation, however, remains at a relatively high 4%. The peak in food inflation, caused by the war in Ukraine and the energy price spike, is now behind us. Food inflation (including alcohol & tobacco) declined to 5.7% from 6.1% in December.

## The last mile will be the hardest

Energy remains a disinflationary force, though the effect is petering out and will probably disappear completely in the second quarter, as the base effect will become less advantageous. Remember, too, that in several member states, energy support measures, which kept prices lower than the market price for the consumer last year, are now gradually falling away.

The European Central Bank is especially attentive to the evolution of core inflation. In that regard, the increase in transport prices on the back of the geopolitical tensions in the Middle East remains an inflation risk. Also, higher wage agreements might still filter through in higher selling prices. Let's not forget that both in the PMI survey and the European Commission's economic sentiment survey, selling price expectations have already been rising for several months (for services even five consecutive months), reversing a downtrend that started in the middle of 2022. In other words, a continuation of the downtrend in core inflation cannot yet be taken for granted.

## The first cut will not be the deepest

While today's figure still shows easing price pressures, it is far too soon to give the all-clear on inflation. The ECB hopes that higher wages will be partially absorbed by lower profit margins. But if growth starts to pick up again in the second quarter, companies might have the pricing power to withstand margin compression, so inflation won't come down much further. This is why we continue to believe that the ECB will be very cautious and will not contemplate any rate cut before June.

We also think that, given the structurally tight labour market (the unemployment rate remained at the historically low 6.4% in December), the ECB will refrain from reducing interest rates aggressively. A first cut in June will probably be limited to 25 basis points and the pace of loosening after that might be more gradual than the market is currently pricing in.

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