

Snap | 28 September 2018

Eurozone inflation: A soft core picture

Eurozone inflation climbs to 2.1% in September, but core inflation falls back to 0.9%. In these circumstances, the ECB isn't going to speed up its exit strategy



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The flash estimate for Eurozone HICP inflation came out at 2.1% in September, in line with consensus estimates. Core inflation (excluding energy, food, alcohol and tobacco) surprised on the downside, falling back to 0.9%.

The 2% headline inflation remains pretty much an oil story. Energy prices increased 9.5% year on year on the back of higher oil prices and looking at the oil price dynamics over the past 12 months to assess the base effects; it's very likely that energy will continue to keep headline inflation above core inflation for some time. If oil prices don't ease, headline inflation might even remain above 2% until the second quarter of 2019.

However, the European Central Bank looks through these temporary effects and pays more attention to the underlying price dynamics.

Bear in mind that we might see signs of a significant slowdown in

the US towards the end of 2019. And then the question is: can the ECB embark on a tightening cycle when major trading partners are facing a serious slowdown and inflation still isn't going anywhere

Mario Draghi recently mentioned his belief in a “relatively vigorous” pick-up in core inflation on the back of tightening labour market conditions. It's true that annual growth in compensation per employee increased to 2.3% in the second quarter of 2018, compared with 1.9% in the first quarter of 2018.

But at the same time, European household's expectations regarding the labour market have deteriorated over the summer, which is unlikely to boost their wage bargaining power. The fact that services price inflation, which typically has a substantial wage component, remains at only 1.3% is a testimony to the fact that tight labour conditions aren't creating much inflation for the time being.

Non-energy industrial goods inflation was only 0.4% in September. With emerging market currencies under strong downward pressure, keeping non-energy import prices low, we don't expect much change in this situation.

We still believe the ECB will try to get rid of the negative interest rates by the end of 2019. But with the current core inflation figures, it is unlikely that the ECB is going to speed up its exit strategy.

We should also bear in mind the fact that towards the end of next year we might see signs of a significant slowdown in the US. And then the question is: can the ECB embark on a tightening cycle when major trading partners are facing a serious slowdown and inflation still isn't going anywhere.

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