

Snap | 29 June 2018

Eurozone inflation at 2%, but core inflation should worry the ECB

Headline inflation is on target, but the drop in core inflation to just 1% in June reveals there is still plenty for the ECB to chew on in the months ahead



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With the energy price index increasing 8% year on year, the increase in headline inflation was once again mainly due to higher oil prices.

This masks the continued sluggish performance of core inflation, which dropped from 1.1% to 1% in June. A few one-off factors have impacted the core reading over the past months, making especially services inflation more volatile than it usually is. The increase to 0.4% in non-energy goods inflation must have been a silver lining to a weak inflation release for hawks.

Even though the July meeting hasn't become more exciting because of this, the drop in core inflation should be a little unsettling for the ECB

The higher oil price will keep the headline inflation rate higher over the summer months, after which it is likely to converge towards the lower core inflation rate. Core inflation is set to improve slowly over the second half of the year. With wage growth improving at a snail's pace, it still seems unlikely that there are significant upside surprises to the underlying inflation rate.

While inflation is now on the mark, the drop in core inflation must leave the ECB slightly unsettled with the exit of QE in mind. Don't expect anything exciting at the July meeting because of this though, the ECB macro projections for this year's core inflation are not that ambitious at 1.1% on average. That means that the weakness in core is part of the baseline scenario for the ECB and the drop to 1% does not change much to that.

Even though the July meeting hasn't become more exciting because of this, the drop in core inflation should be a little unsettling for the ECB as the move towards a sustained inflation rate of just under 2% has yet to start.

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