

Eurozone inflation back at 2% target, confirming ECB's sweet spot

With inflation at 2% and modest softening in price growth expected in the months ahead, the European Central Bank can afford to wait for more direction on the economy before deciding its next move



Headline inflation dropped back to the 2% target in December from 2.1% in November, with core inflation falling from 2.4 to 2.3%. The ECB has referred to the current situation as 'the good place' ad nauseam and is unlikely to change that mantra as current data continues to point to a benign inflation environment.

For the months ahead, drivers of inflation do point predominantly to a softening. Think of the strong euro, low energy prices and the deceleration in wage growth, for example. While that is the case, selling price expectations from businesses for goods have increased in recent months and also ticked up for services in November. Headline inflation could therefore drop more than core inflation.

Still, we don't expect a significant drop below 2% in our base case, although such a scenario is not unimaginable either. Over the course of 2026, however, expect more upward pressure on inflation to return as fiscal spending is set to give a modest boost to economic growth.

The ECB expects inflation to be slightly below target in 2026 and 2027 before returning to 2% in 2028. With expectations like that, expect policy rates to remain stable for the time being. The ECB is in a luxury position where it can afford to wait for more direction on the economy and inflation before deciding its next move.

Author

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

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