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Eurozone inflation back in the single digits

Inflation fell back to 9.2% in December, but rising core inflation means that not much will sway the European Central Bank from the hawkish path it set out late last year

Inflation fell in December on the back of slowing energy price rises

A combination of price caps and lower oil and natural gas prices have caused a significant dip in energy inflation (from 34.9% to 25.7%), which was the main driver of the decline in headline inflation. The decline was broad-based by country, with all the major eurozone economies showing significant drops in price growth. It is likely that the peak in inflation is behind us now, but far more relevant for the economy and policymakers is whether inflation will structurally trend back to 2% from here on.

Core inflation continues to show little sign of relief for now. It increased from 5% to 5.2% and saw sizable increases for both goods and services. The next two months will be critical as many businesses traditionally change prices at the start of the year. It could therefore be that core inflation rises further from now. While consumption remains under pressure and retail sales have been trending down for quite some time now, businesses continue to adjust their prices to the supply-side shocks of 2021 and 2022.

So while supply-side shocks are fading – not just energy, but also think of container prices and various production inputs – core inflation is still adjusting with a lag. The ECB has taken a very hawkish stance towards this development and has indicated that it will hike through a mild recession to bring inflation structurally down to 2%. With energy inflation dropping quickly and energy supply forecasts improving, 2% could be reached much sooner than expected. Still, rising core inflation will be enough for the ECB to continue to hike by 50bp in February and March.

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