Eurozone inflation comes down in November, paving way for 50bp ECB hike

Inflation dropped more than expected from 10.6 to 10% in November, mainly on energy price developments. Core inflation remained stable at 5% though. While we're far from out of the woods yet, it does look like the current economic environment could push the European Central Bank to a smaller 50bp hike next month

We were due some good news. The eurozone inflation rate ticked down after a few nasty upside surprises. Energy inflation has been the most important driver of the decline going from 41.5 to 34.9%. Food inflation continues to trend up, while core inflation was stable at 5%. This is still far too high, but tentative signs that we're at or close to a peak are increasing.

Whether this is the peak in inflation remains to be seen. Another episode in the energy crisis could easily push inflation back up again and core inflation usually proves to be sticky after a supply shock.

The question is how relevant the talk about a peak in annual inflation actually is. We think it is far more relevant to focus on month-on-month developments as base effects will become significant in the coming months. Using our own seasonal adjustment, we see that monthly inflation was slightly negative for the first time since April and that food inflation is the largest contributor to monthly headline inflation at the moment.

We also think the focus should be more on what level inflation will trend down to, as opposed to whether this is the peak or not. The big question, therefore, is how core inflation is going to move in the coming months. Don't expect a miracle just yet, core inflation tends to adjust slowly to energy shocks and a lot of the higher costs have not yet been priced through to the consumer.

The tricky thing here is that the effects of the previous supply shock – the pandemic – are also still playing into the numbers. Large inventory increases at retail stores are the result of falling demand for goods and restocking as supply problems improved. That adds some disinflationary pressures for the months ahead. Overall, more volatility in core inflation can be expected as the effects of two massive supply shocks play out but we don't expect a quick drop in core inflation anytime soon.

For the ECB though, tentative signs of inflation peaking are mounting, evidence of a wage-price spiral continues to remain absent and the environment is turning recessionary. In our view, that is likely to sway the ECB from 75 basis point hikes to a smaller hike of 50 basis points in December.

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