

Eurozone inflation dropped below 1% again in September

Inflation fell from 1 to 0.9% in September, while core inflation moved up from 0.9 to 1%. The overall picture of underlying softness in core inflation should worry the European Central Bank as it could persist due to recession fears



Vasco da Gama shopping center in Lisbon, Portugal

The small movements in inflation in September are indicative of the current pricing environment, which is lacklustre. Sure, energy price base effects are likely to boost inflation over the coming months, but that will not result in a sustainable move towards the ECB's 2% target. The underlying picture for inflation continues to be weak as drivers of inflation have recently started to soften. This is partly driven by weaker producer price developments, but also related to significant declines in selling price expectations of businesses over recent months. Even though services inflation did tick up to 1.5% in September, it is unlikely that we'll see a significant jump in core inflation in the months ahead.

The economic uncertainty means businesses are still very reluctant to increase their margins, and so recent positive wage growth developments are not translating into higher inflation. This has been the case for some time now but as recession fears will likely loom for at least a few months to come, it seems unlikely that core inflation will improve significantly in the months ahead.

Interestingly, this modest inflation environment could in itself be helpful to stave off a recession as it boosts real household incomes which, in turn, helps to keep domestic demand growth in positive territory.

For the ECB, today's figures will not be a surprise, but the underlying picture remains one of concern nonetheless. The smorgasbord of stimulus that ECB President Mario Draghi announced a few weeks ago will need to have quite some impact to see core inflation move out of the 1% range in the course of 2020. If it does not, the ECB's own expectations for core inflation may once again need to be lowered.

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