

## Eurozone inflation dropped less than expected in February

Inflation fell from 2.8 to 2.6% and core inflation fell from 3.3 to 3.1%. The small decline in inflation was mainly because of base effects, with recent developments in services giving enough worries for the ECB to comfortably keep the central bank from cutting rates next week



Inflation continues on its slow trend down in the eurozone, but base effects did most of the heavy lifting last month as month-on-month seasonally adjusted inflation rates are not showing much comfort for the European Central Bank to cut rates imminently. Using our own seasonal adjustment, we see that monthly core inflation ticked up for the third month in a row on the back of services inflation accelerating. This trend is something the ECB will be keen to see broken before cutting rates, in our view.

Headline inflation also did not come down as much, which is no surprise given that energy support measures to consumers are currently being ended. Think of France, where an energy tax was reintroduced in February. Given that the eurozone is still only very slowly recovering from a negative real income shock, the unwinding of support measures ultimately curbs demand elsewhere. That in turn results in a dampening impact on underlying inflation later.

Weak demand has also smoothed over the impact of Red Sea disruptions as goods demand is slow and inventories at manufacturers and retailers remain high. That causes the disinflationary process for goods to continue despite disruptions. If demand picks back up again later in the year, this could change again, but for now goods inflation is not a concern for the ECB. The main worries therefore remain around inflation in the service sector.

For the months ahead, the broader inflation picture looks relatively benign. Still, with unemployment at record lows and the economy not in recession, the ECB will not feel rushed towards rate cuts as concerns around services inflation linger. In the coming months, the question remains how fast wage growth retreats and whether demand for services will be limited enough for core inflation to mute. In any case, the ECB will be happy to keep rates unchanged next week as it awaits incoming data.

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