

Eurozone inflation drops to 2.2% in August

The drop in eurozone inflation from 2.6 to 2.2% was mainly because of energy inflation but does confirm the view that the inflation environment is slowly getting more benign. The ECB has arrived on a long home straight when it comes to bringing inflation back to target



French services inflation ticked up on the back of the Olympics

Quite the decline in headline inflation ahead of the September meeting. Still, the drop in inflation in August was mainly due to energy inflation coming down, with core inflation still stubbornly high. With energy inflation moving around on oil and gas price developments, core inflation remains much more relevant for ECB policy than headline.

Core inflation dropped slightly from 2.9 to 2.8%. This was mainly because goods inflation fell while services inflation ticked up from 4 to 4.2%. In part, the increase was because of French services inflation, which ticked up on the back of the Olympics in August. In any case, services inflation is not yet moving down much for the moment.

At this point, eurozone inflation is not moving much outside of energy price fluctuations. Selling price expectations are moving slowly in the right direction for services, which generally is a decent predictor of where services inflation moves in the coming two quarters. For goods, price

expectations have slightly trended up on higher input cost developments in recent months. Overall, we expect a continued deceleration but don't expect core inflation to drop below 2.5% in the rest of the year.

For next year though, weak domestic demand and expectations of falling wage growth should bring inflation down further. However, the pace of the decline of wage growth remains clouded in uncertainty. The same holds good for energy and transport cost developments related to geopolitical events.

For the ECB, the modest progress in core inflation and wages now and expectations for next year seem enough to cut by 25bps in September. But this remains a slow and gradual process of releasing the brakes on the economy as the ECB continues to be concerned about upside risks to the inflation outlook.

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