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Eurozone inflation dropped to 5.3% in July as all eyes turn to services

Services inflation remains the main concern for the European Central Bank as inflation moves slowly in the right direction. While base effects muddy the picture, inflation should be materially lower towards the end of the year



Eurozone inflation continues to move in the right direction. As expected, it came in at 5.3% in July, down from 5.5% in June. Energy inflation was sharply negative on base effects from last year at -6.1% while food inflation was lower at 10.8%, down from 11.6% last month. While recent price developments have been less disinflationary, overall headline inflation should continue to trend lower.

Core inflation was flat on the month at 5.5% thanks to diverging developments between non-energy industrial goods and services inflation. Goods inflation is trending down quickly as demand for goods has moderated, supply chain problems have faded and energy input costs are now sharply down from a year ago. Services inflation continues to trend up though as wage growth continues to push input costs for service providers higher. Demand is also much stronger than for goods, allowing stronger price increases.

Overall, the inflation picture looks positive for the coming months. Even though energy prices have been increasing recently, base effects will push energy inflation down further. Selling price expectations look encouraging for core inflation, especially for goods. Services inflation is set to trend higher for longer, but also slowing from here on.

While the summer will see inflation blurred by base effects from government measures, we do expect a much lower reading in inflation by the end of the year. Still, the ECB September meeting will come too early for that, which means that the concern around services inflation will remain key to the Bank's next move.

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