

Eurozone inflation drops as expected but core continues to rise

Headline inflation fell from 8.5% in February to 6.9% in March, but core inflation ticked up to 5.7% in a sign that the fight against inflation is not over. For the European Central Bank, we expect two more 25bp hikes before a peak is reached



The March decline in inflation was widely expected due to energy price developments

Many of us saw this coming. The March decline in inflation was widely expected due to the energy price developments, which spiked in March last year. The base effect is therefore currently very favourable for energy developments. Energy inflation fell from 13.7% to -0.9% in March, which is the first decline in energy inflation since February 2021.

Because it was so widely known that energy inflation would drop like a stone, the bigger concerns remain around the other components. This is where a lot more work needs to be done. Core inflation increased from 5.6% to 5.7% in March with services inflation increasing from 4.8% to 5% while goods inflation fell from 6.8% to 6.6%.

Food inflation – which has been the largest contributor to headline inflation in recent months – increased from 15% to 15.4%. This indicates that price pressures remain high for the moment, although this should improve in the coming months.

Forward-looking data are starting to become less concerning from an inflation perspective though.

Futures prices for energy look manageable, while producer prices for food have also come off peaks. Transport costs and supply chain problems have eased substantially, which had led to manufacturers seeing a drop in selling price expectations.

The main concern seems to be around wage developments. Wage growth has been rising and with unemployment still at a low of 6.6%, the chances of there being upward pressure on wages remain. This could result in somewhat stickier inflation, mainly on the services side.

So while March has seen a large drop in inflation, core inflation remains a concern for the ECB. The potential for core inflation to remain stickier than hoped will be the main reason for the ECB to continue to hike in the near term. We expect another 25bp hike in May and another in June. As the inflation outlook is starting to look more benign, and recent banking turmoil serves as an illustration that aggressive hikes are not without cost, we expect a peak to be reached thereafter.

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