

Eurozone inflation drops below 2% ahead of June ECB meeting

A strong drop in core inflation in May to 2.3% and headline to 1.9% serves as a clear sign that undershooting the inflation target is still a possibility for the ECB. Expect the ECB to lower the deposit rate to 2% on Thursday



Pictured: ECB President Christine Lagarde. Falling eurozone inflation means the ECB can comfortably lower the deposit rate on Thursday

The eurozone inflation rate dropped markedly in May, mainly on the back of services inflation dropping from 4% to 3.2%. This brings inflation back below the ECB target of 2% for the first time since September last year. Overall, inflation has been hovering around the target for a while now and ECB forecasts have put medium-term inflation around the target for some time.

Recent trade war developments have so far had a downward impact on inflation in the eurozone. Global commodity prices have fallen, the euro has strengthened against the dollar, uncertainty has muted economic activity in the eurozone, and the European Commission has so far refrained from introducing retaliatory tariffs on the US, which would result in higher prices.

The sharp drop in services inflation may not be structural. Recent survey data corresponds to a somewhat higher trend than the 3.2% seen in May, but overall the downward trend seems significant. Despite unemployment still coming in at 6.2% in April, an all-time low, wage growth

has fallen quickly. This limits core inflation for the medium term.

For the ECB, this means it can comfortably lower the deposit rate to 2% on Thursday and have a good debate about whether it should move rates below neutral to become accommodative for the economy.

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