

Eurozone inflation gives ammunition to ECB hawks

Preliminary figures come out higher than expected



1.5% Eurozone headline inflation

Slightly higher than expected

Preliminary figures for both headline and core inflation came out higher than expected in August. However, it would be a stretch to see a strong upward trend. Inflation might even fall back again at the start of 2018. Energy inflation increased to 4.0% from 2.2% in July, but this is largely due to a temporary drop in oil prices in August 2016. With crude oil prices likely to continue hovering around \$50 / barrel, and taking on board the stronger euro, the energy component is unlikely to add much to inflation in the second half of this year and will even push it lower in the first half of 2018. Looking at price trends in food commodities, food price inflation is also unlikely to have much of an upward impact; this implies that headline inflation will remain close or even below core inflation for some time to come.

Core inflation has definitely troughed, but it would be a stretch to expect a strong upward trend

Even though surveys signal slowly rising pricing power among European businesses, wage pressures have remained largely absent until now. In that regard, we believe that core inflation will hover around 1.5% throughout 2018, while headline inflation could be even slightly lower next year. The hawks within the Governing Council will argue that deflationary pressures have now clearly disappeared. But given the risk that an overshoot of the euro exchange rate could push inflation back below 1.5%, caution remains warranted in removing monetary policy accommodation. We believe the ECB will announce a “dovish tapering” in October, giving the markets the impression that QE could be lengthened into the second half of next year if need be. At the same time, we think that a deposit rate hike is not to be expected before the end of 2018.

After June's drop, the Eurozone unemployment rate stabilized at 9.1% in July. In the light of the current taper debate it is no surprise that markets rather focused on the preliminary inflation figures for August. Headline inflation actually rose to 1.5% in August, from 1.3% in July. This was slightly above the consensus estimate (1.4%), while core inflation remained stable at 1.3% (consensus at 1.2%).

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