Eurozone inflation increased less than expected in December

The inflation rate went up from 2.4 to 2.9%, mainly due to fading energy base effects. The increase serves as a reminder that interest rate cuts in the first quarter are unlikely but this shouldn't dispel expectations of cuts later in the year. We stick to our expectation of a first cut in June

The increase in headline inflation was mainly driven by energy base effects in Germany. The core inflation rate dropped from 3.6 to 3.4%, indicating that the underlying trend in inflation remains relatively benign for the moment. Food inflation also continued to trend down rapidly.

Inflationary pressures made way for disinflation over the course of 2023 as demand weakened and supply shocks faded. This has brought inflation down more than expected at the start of last year. Currently though, base effects from easing supply shocks are moderating and some new inflationary concerns are surfacing. Think of the increased supply chain concerns related to the Red Sea. Besides that, German government measures are also adding to inflation for 2024. The European Central Bank's mantra has always been that the last leg is the hardest. Is this what we are currently witnessing?

Don't overestimate the inflationary pressures for now though. Demand remains weak, which is a very important disinflationary driver right now. Also, inventories are high, making current supply chain concerns much less inflationary than the ones from 2021. And even though energy price shocks related to the Middle East are a clear risk to the outlook, oil prices are currently still below US$80 per barrel. So overall, the outlook for inflation continues to be quite benign and we expect eurozone inflation to be around 2% again by the end of the year.

Current inflationary developments therefore seem to support our view that recent market expectations of a first-quarter hike are premature, but don't think that we're back to 'higher for longer' either. We expect the ECB to start cautiously cutting rates from June onwards, with 75bp in total for 2024.

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