Snap | 7 January 2025

Eurozone inflation increases for the third month in a row

Eurozone headline inflation rose to 2.4% in December, with core inflation stabilising at 2.7%. A further increase in the first quarter looks likely. This will keep the European Central Bank on a cautious easing path, diminishing the validity of the "behind the curve" statements

Energy will be a significant upward risk to eurozone inflation in the first quarter

Energy prices are driving inflation higher

According to the flash estimate, eurozone HICP inflation increased to 2.4% in December from 2.2% in November, while core inflation stabilised at 2.7%.

Examining the drivers of the higher inflation rate, it's important to note that the downward impact of energy prices is now petering out. While energy prices declined by 6.1% year-on-year in September and by 4.6% in October, the decline was only 2% in November, moving to a positive inflation rate of 0.1% in December. This upward trend isn't over yet. Natural gas prices are now more than 50% higher than a year ago, and oil prices are no longer falling. As such, energy will be a significant upward risk to inflation in the first quarter.

Unprocessed food price inflation was 1.7% in December. Agricultural commodity prices, which declined significantly in 2024, are now rising again year-on-year. This suggests that food prices will contribute less to the disinflationary process in 2025.

Goods inflation remains relatively low at 0.5%, the fifth consecutive month that it has hovered close to that level. However, the impact of a potential trade war remains a significant unknown.

ECB will remain on a cautious easing path

Services inflation remains a concern, accelerating to 4% from 3.9% in November. Both the PMI survey and the European Commission's sentiment indicator suggest that upward price pressure in services remains significant due to still-strong wage increases and higher price setting by services companies. While we expect wage growth to decelerate in the second half of the year due to a weakening labor market, services price inflation is likely to remain above 3.5% in the first half of the year.

All of this indicates a high likelihood that the eurozone inflation rate will increase further in the first quarter of this year. The ECB is predicting a decline in headline inflation to 2.3% in the first quarter, with negative energy inflation as a key driver. However, given current trends, this seems optimistic. While the central bank might argue that the current inflation increase is temporary, the hawks in the Governing Council are now less willing to "look through" a supply-side-driven inflation shock than they were a few years ago. We still expect the ECB to continue cutting interest rates, but it is unlikely that the pace of loosening will accelerate. Those claiming that the ECB is "behind the curve" may therefore be further disappointed.

Author

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com