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Eurozone inflation jumps but don't get excited just yet

Despite a strong increase in inflation and retail sales in December, it's premature for hawks to get excited. This is not an environment in which core inflation pressures are increasing



Vasco da Gama shopping center in Lisbon, Portugal

The inflation rate jumped on energy price effects. As the oil price jumped in December and base effects played a role, headline inflation increased from 1 to 1.3%. Depending on oil price developments- which are likely to be volatile as Middle East tensions have spiked recently- it is expected that inflation could trend somewhat higher than the 1% range for the coming months. The real story though is in core inflation, which has been at 1.3% for two months in a row now. This is higher than expected and could encourage hawks at the European Central Bank to seek some clawback of the monetary stimulus provided in the second half of last year.

November's retail sales numbers may also give rise to some excitement, coming in higher-than-expected at 1% month-on-month growth. It's important to remember, however, that the rise of Black Friday across the eurozone will play an important role here.

Predictions for a sustained rise in core inflation still seem premature, as wage pressures have been moderating recently thanks to the sluggish and uncertain economic environment. The same holds for selling price expectations which have been trending down, indicating that more modest price

growth is in the making in the months ahead.

While the higher core inflation reading will be on the ECB's radar, continued sluggish growth and subsiding wage pressures make a quick rise to the 1.5-2% range an upside risk scenario, rather than a base case. Without material improvement in business confidence and the growth outlook, continued modest price growth seems the most likely scenario for the moment.

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