Eurozone inflation jumps above target as unemployment drops further

Inflation jumped on food and energy prices, while core inflation ticked down despite German VAT effects kicking in. Not much evidence of overheating in this release. Unemployment continues to come down on the reopening of economies, providing more upside for medium-term inflation

The inflation rate for July ticked back up above the European Central Bank's target, but remember, President Christine Lagarde made it very clear that the central bank won't act on temporary inflation. This release didn't provide much evidence of more structural inflation as core inflation fell back from 0.9% to 0.7%. While it ticked up strongly in Germany on the back of VAT effects, other countries have seen a drop that more than offset this effect.

Non-energy industrial goods inflation, which had been rising over recent months, fell back from 1.2% to 0.7%, which indicates that the price pressures related to transport costs and input shortages are not yet translating into soaring consumer goods prices. Services inflation only increased from 0.7% to 0.9%, which shows a modest increase but certainly does not give the impression of broad price hikes on the reopening of economies.

Still, this doesn't mean that the inflation concern is over. We expect both services and goods inflation to trend higher in the coming months and food and energy prices have outperformed our expectations so far. This adds to upside inflation risk for the months ahead.

Also important is that the labour market performs very well. Today's release showing that unemployment declined to 7.7% confirms the labour market is getting tighter on reopening. We are cautious about drawing longer term implications from this, because furlough schemes ending and additional slack outside of the labour force could well cause wage growth to remain modest in the recovery phase. But nevertheless we do like to note that the job market improvements so far add to some additional medium-term inflation risk.

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