Eurozone inflation jumps to 8.6% on food and energy effects

Another ugly inflation reading as energy and food prices push inflation to a new high. Core inflation moderated slightly, in part due to domestic support packages. For the European Central Bank, this adds pressure to act quickly

Today’s record inflation was mainly caused by energy and food. Importantly, the oil embargo and gas supply squeeze that unfolded over the month of June have caused energy prices to soar. Increasing food prices remains a key theme for the inflation outlook as it now adds well above 1ppt to total inflation. This month, price growth accelerated from 7.5 to 8.9%.

The positive note in the release is that core inflation fell from 3.8 to 3.7% in June on the back of slightly weaker services inflation than last month. Goods inflation still increased from 4.2 to 4.3% though.

At this point, the inflation picture is starting to muddy a bit. Domestic support packages are important drivers of diverging inflation paths at this point, think of Germany's cheap public transport and petrol tax rebate. We also see a surprise decline in core inflation in France while Spain saw continued higher core inflation.

Peak inflation?

The big question for the second half of the year is when peak inflation will be reached. This is a very tough question to answer at this point because of the volatility around energy price developments and uncertainty around the persistence of second-round effects. We do see more disinflationary pressures ahead as recessionary pressures are building in the eurozone, and global commodity prices – excluding energy - have been coming off their peak.

Surveys suggest that price pressures are easing somewhat for both services and industry, but are still close to all-time highs. While government support packages can temporarily bring down core inflation readings now, we expect underlying price pressures to persist over the summer months. Starting in the autumn, negative base effects and rapidly cooling demand should start to have more of a dampening effect on the inflation rate.

Still, for the ECB this is another upside surprise to the inflation rate and will add pressure to act forcefully. The drop in core inflation is impacted by fiscal support and therefore not a reliable measure of underlying inflation in the eurozone. Hawks will push further for a 50bp hike in July on the back of this given the uncertain inflation outlook at this point.

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