

Eurozone inflation looks encouraging, but be careful interpreting the data

Headline inflation continues its fast decline and dropped to 8.5% in January, while core inflation remains stubbornly high at 5.2%. Lacking German inputs, these numbers are tricky to interpret, but for the ECB high core inflation will be enough to hike by another 50bp tomorrow



January's eurozone inflation data does not include Germany's numbers

Tread carefully with these January inflation figures. A day ahead of a crucial ECB rate decision, January inflation data have been released but are hard to interpret as German inputs have been postponed. A model has been used to infer German data, making it more prone to revision than in other months. Besides that, we have the annual item weights revision influencing the data, already making it a difficult month to interpret. It's also a month the ECB has put a lot of emphasis on as President Christine Lagarde mentioned in the Q&A of the December press conference that she expected January to have higher inflation as it is a traditional month for passthrough of energy to reach retail prices.

If we take the data at face value – and we'll see on 23 February when final data are released if we were right to do so – we see that core inflation did not show the feared increase. The core inflation rate was flat at 5.2%, but monthly seasonally-adjusted data show another cautious decline to 0.4% growth compared to December. While this is still far too high – annualised this makes 5.3%

core inflation – it does mark the fourth month of consecutive declines.

While it's all about core from here on, we do of course see an encouraging trend in headline inflation. The drop from 9.2% to 8.5% is faster than expected. Food inflation remains stubbornly at 14.1%, but energy drives the rate down at the start of the year. A decline from 25.5% to 17.2% reflects lower market prices and significant negative base effects.

In recent days, both the Brent oil price in euros and natural gas market prices have declined year-on-year, which will put more downward pressure on consumer prices in the coming months. Price ceilings for energy also have their effect of course, which does work both ways in January. From here on, energy contributions are set to decline substantially given the relatively low market prices we are currently seeing.

All in all, the data looks decent as a jump in core inflation has been avoided but uncertainty remains without final German figures. For the ECB, the muddled picture of inflation is annoying, but don't expect it to throw it off course for tomorrow. The jump in core inflation in some key countries will be enough for the central bank to confirm its current hawkish stance and add another 50 basis points to policy rates.

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