

Eurozone inflation provides reality check

Eurozone inflation rate dropped to 1.3% in January, with core inflation slightly up to 1%. However, inflation outlook remains subdued despite the strong economy



Even though the Euroboom has continued into 2018, inflation is showing few signs of picking up. If 2018 is supposed to be the year of inflation returning, it's hiding its start pretty well.

While selling price expectations have recently increased to the highest levels in about seven years, it can take a while before this results in higher inflation rates and we expect core inflation to increase just modestly over the year.

Weak wage growth is an important factor in the subdued inflation outlook. Wages have failed to pick up recently despite increasing labour shortages. Unemployment in December came in at 8.7%, stable at the lowest rate since January 2009. Some recovery in wage growth seems imminent, German unions are pushing for higher wage increases in collective bargaining negotiations for example, but it will likely take at least until 2019 until wage growth is back at pre-crisis levels. Expectations of a swift return of inflation to the Eurozone, therefore, seem premature.

Because of the modest inflation expectations for the months ahead, the ECB's frustration with recent euro appreciation seems understandable. The euro appreciation has offset a large part of the oil price increases over the past months. As currency appreciation often has a lagging effect on

many consumer price categories, expectations for 2018 remain modest in terms of inflation increases.

With Europhoria continuing but inflation not moving towards the target, this makes the ECB's job all the more awkward in 2018.

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