Eurozone inflation pushes higher but keep structural weakness in mind

Up, up, and away! Eurozone inflation continues to increase and will be above 2% for a large part of 2021. Don't expect it to remain there much beyond the end of the year, which will test the ECB's communication seriously in the months ahead

Shoppers in Turin, Italy

Eurozone headline inflation increased from 0.9 to 1.3% in March, mainly on the back of energy price inflation. Gasoline prices continued to climb throughout March despite oil prices falling from the middle of the month, spurring energy inflation higher while base effects from last year also inflate the figure for the moment. Energy inflation increased from -1.7 to a whopping 4.3% in March and will continue to push up the headline index in the months to come.

Core inflation fell back from 1.1 to 0.9% thanks to a much lower goods inflation reading. Expect this to be temporary though as goods inflation is actually expected to rise substantially over the coming months on the back of surging input prices. With supply chains disrupted and commodity prices rising, goods producers have indicated an expected rise in selling prices for the months ahead.

Still, with wages weak, fiscal stimulus set to fade and growth expectations slower than in the US, overheating in the eurozone is really not an issue for the moment. Most factors pushing up inflation are temporary or statistical in nature: energy inflation, the German VAT increase and the changes in weights in the inflation basket are important ones to name a few key ones.

Perhaps some elements could result in inflation not coming down all the way to 1% again; think of global inflation pressures causing spillovers through higher commodity prices or small second-round effects. But still, we expect inflation to fall back below 1.5% in the first half of 2022 again.

The European Central Bank will be challenged in terms of its communication by this inflation path expected for 2021 and 2022. Perhaps it seems evident that the ECB is not yet behind the curve on inflation now with the economy still contracting and lockdowns extended into 2Q. But come summer when economies are expected to have reopened and show rapid rebound growth it could be more of a challenge when inflation exceeds 2%. For an ECB that has been struggling with providing clarity on the strategy regarding rising yields, this will become a hot summer.

Author

Bert Colijn
Senior Economist, Eurozone
bert.colijn@ing.com

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