Eurozone inflation reached new multi-decade high of 5% in December

Another historic figure, but expect decreasing inflation rates from here as energy inflation moderates. Still, core inflation is set to remain above 2% in the first half of 2022 as high producer costs are priced through to the consumer

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Another slight tick up for eurozone inflation means that the highest rate since 1985 has now been reached. Energy is still the dominant driver of the high rate, but the energy inflation rate did drop from 27.5 to 26% in December as oil price base effects have finally started to drive down year-on-year price growth. The rise was mainly due to higher trending food and goods prices, which have been affected by higher transport costs and shortages.

Is this peak inflation? This depends to a significant degree on gas price developments, which have been incredibly volatile in recent weeks and a dominant driver of the recent inflation surge. Still, at current futures prices for natural gas and oil, energy inflation is likely to have peaked and is set to trend down from here. On top of that, the German VAT effect, which lifted inflation for a final month in December, will shave off about 0.5% from headline inflation from January onwards.

The question is how steep the downward trend will be. Think of the huge build up in pipeline inflation pressures for goods producers for example. Non-energy industrial goods inflation already jumped from 2 to 2.9% in the past two months, showing clear signs of costs being priced through to the consumer at a faster pace. We expect this to continue at the start of the new year. Mild restrictions in place to combat the fourth wave of the virus will curb service sector price growth moderately, but ultimately it is safe to expect core inflation to remain above 2% for the first half of 2022.

This means that real wages remain under pressure at the moment, as second round effects from high inflation on wage growth remain mostly absent for now. This dampens GDP growth somewhat, but also means that the ECB still has time to see how quickly the current supply side inflation declines over the course of the year before it decides on further action.

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