Eurozone inflation reaches new highs, driven by supply

Food and core inflation continue to trend higher while the gas crisis is keeping energy inflation elevated. Supply, rather than demand, remains the main driving force behind rising inflation. Don't rule out another 50 basis point hike from the ECB in September

Another ugly inflation reading for July. Both supply-side problems causing high inflation and the second-round effects resulting from this show no imminent sign of relief. Energy inflation was only slightly down at 39.7% as gas supply concerns are keeping prices elevated. The market prices for natural gas reached new peaks this month, translating into high consumer prices once again.

Food inflation also continues to trend up as higher transport costs, shortages and uncertainty around Ukrainian supply have pushed up producer prices which are still being priced through to the consumer. With market prices trending lower for food commodities, some relief could be seen over the course of the second half though.

Core inflation is also still on an upward trend and at 4% is well above the European Central Bank's target. While a smaller percentage of businesses have indicated that they are increasing prices at this point, we do expect the core rate to continue its upward trend in the months to come as input costs for businesses remain elevated in a large number of sectors, which is putting pressure on margins. Goods inflation increased from 4.3 to 4.5% and services inflation from 3.4 to 3.7% in July, which shows that businesses are still passing higher costs onto the consumer.

Even though GDP growth was still slightly positive in the second quarter, demand is already cooling significantly at this point. This confirms our view that despite rising core inflation, very little of this is demand-driven. High input costs are therefore likely to be the main driver behind the rapidly rising consumer prices with some service sectors like tourism perhaps being the exception.

Ultimately, this makes the impact of the ECB's rate hike on current inflation very limited, although it does add to a further cooling of demand in the eurozone. With a recession looming and inflation reaching new highs, the question is how the ECB will respond to an economy which is already cooling down. Don't rule out the ECB front-loading hikes, so 50 basis points in September is definitely still on the table.

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