

Eurozone inflation remains on track for a bumpy ride down

Headline inflation continues to drop quickly on energy price effects, but core inflation ticked back up in June. This is mainly related to base effects from government support and the underlying trend remains disinflationary. Concerns about persistent wage growth remain though as unemployment remained at historic lows in May



The inflation rate dropped from 6.1% in May to 5.5% in June, but the main focus for the European Central Bank is currently on core inflation, which ticked back up from 5.3 to 5.4%. This was mainly due to the effects on services inflation from German government support last year.

Our own seasonal adjustment suggests that both eurozone goods and services inflation saw a modest decline in June, in line with the current disinflationary trend. Non-energy industrial goods inflation dropped from 5.8% in May to 5.5% in June and we expect it to fall further in the coming months, while services inflation could remain elevated on base effects and possibly on wage growth, adding upward pressure to costs.

Headline inflation continues to drive the strong declines though. Food inflation has moderated substantially, although our own seasonal adjustment suggests a monthly uptick between May and

June. Still, the year-on-year inflation rate is coming down at the moment. Energy inflation is strongly negative on base effects as well.

The labour market remains hot, which is a key concern for the ECB. While there are initial tentative signs of cooling - think of vacancy rates having moved past their peak - unemployment remained stable at the historic low of 6.5% in May. For the ECB, this means that the risk of prolonged high wage growth remains in place, which is an important reason why the ECB is not pausing its hiking cycle just yet.

Other forward-looking indicators for inflation are looking benign though, with selling price expectations steadily dropping by the month and cost pressures outside of wages having fallen quickly. The sluggish economic environment is also adding little demand pressure.

So while the improving inflation environment will be encouraging for the ECB, the message coming out of Sintra this week has been pretty clear: there's more work to be done. The ECB thinks it is more costly to do too little in terms of hikes than to do too much, which means that we expect the ECB to continue hiking in July and September. By then, the blurring base effects from government support should largely have faded, which means that a pause will become likely.

Author

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.