Eurozone inflation sharply down to 6.1% in May

All broad categories of inflation trended down in May, with core inflation dropping to 5.3%. This confirms the downward trend in inflation and sends a dovish message to the European Central Bank

Quite a bit of relief on inflation in May as the downward trend in price growth was resumed quite forcefully. Good news all around as both headline and core fell more than expected. A lot of key drivers of inflation have turned for the better in recent months, which is starting to be reflected in the data.

With energy prices close to pre-2021 levels, it is no surprise that energy inflation was negative again in May. Expect a more significant spell of disinflation in energy in the months ahead as base effects over the summer will make year-on-year data fall markedly. Also, food inflation is now rapidly turning for the better. While the annual rate is still elevated at 12.5%, monthly contributions are down sharply in April and May.

Core inflation was down more than expected, falling from 5.6 to 5.3% in May. A downward trend in goods inflation is widely expected given falling producer prices, easing input shortages and weak demand, which resulted in a drop from 6.2 to 5.8%. Services inflation also fell from 5.2 to 5%, which was more of a surprise given the better performance of the service sector.

The main concern around inflation at the moment is that wage growth is trending up. In the first quarter, negotiated wage growth increased to 4.3% year-on-year and more collective agreements on higher wage growth are still in the pipeline, especially as the labour market continues to run hot despite GDP broadly stagnating. Unemployment fell again in April from 6.6 to 6.5%, meaning that wage pressures are continuing. This could add to a situation where inflation trends back to 2% at a slower pace than previously foreseen.

The ECB has more or less committed to a June hike but from there on, things get more uncertain. More so than in normal times, incoming data will be key for the July and September decisions. The May inflation data brings some relief on the inflation front, while economic data has disappointed and monetary developments show fast transmission from previous rate hikes. Those will no doubt embolden the doves in the ECB's governing council, but concerns around higher wage growth bolster the hawkish view. Clearly, it will be a heated summer in Frankfurt concerning the ECB's peak in rates.

Author

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