

Snap | 31 May 2018

Eurozone inflation soars to target, putting the ECB in an awkward spot

As this jump in inflation just thinly masks underlying core weakness and uncertainty about the economy is high, it is unlikely to convince the ECB to normalise policy more quickly



Source: Shutterstock

As prospects of a trade war with the US loom and euro-risk returns, Eurozone inflation jumps to 1.9%. Core inflation improves from 0.7% to 1.1%. After distortions to the inflation rate because of the timing of holidays, the May rate should provide a somewhat fairer view of how strong price growth is at the moment although there was still some holiday impact. The services inflation reading is still quite volatile as it jumped from 1% to 1.6%. Non-energy goods production remained weak though and fell back from 0.3% to 0.2% in May.

This core inflation reading is still below where we would expect it to be with the improving labour market and increased selling prices indicated in business surveys. And, as selling price expectations have been weakening in the recent soft patch of economic data, it does not seem like we are at the start of a marked increase in inflation.

The understatement of recent months was also helped by a weakening euro, which dampened some of the effects from the higher oil price. Petrol prices jumped significantly in May, on the back

of an oil price of around \$80 per barrel for most of the month and a weakening euro.

Be careful what you wish for, ECB. After years of pushing for inflation to return to just under 2%, it could not have come at a more difficult time. Eurozone financial market turmoil has returned because of Italian politics this week and it is very difficult to see how the Italian political situation is going to play out. Economic data has been weakening over the past months, and the ECB is eager to determine whether this is just a soft patch. Finally, the US seems on the brink of announcing tariffs on European steel and aluminium, which clouds the exports outlook and could have an additional inflationary impact if the trade conflict gets out of hand.

The ECB therefore now has to decide whether it will provide certainty straight away by announcing an extension to QE or take a “wait and see” approach at the June meeting. Then it could just hint at an extension while taking another six weeks to see how the political situation in Italy and the trade conflict with the US play out, and take in more economic data. As this jump in inflation just thinly masks underlying core weakness, it is unlikely to convince the ECB to normalise policy more quickly.

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.