Eurozone: inflation stable in February, but more increases to come

Inflation was stable at 0.9% in February. We expect inflation to temporarily exceed 2% later in the year, but the only worry for the European Central Bank at the moment is higher bond yields, not higher prices

Core inflation dropped from 1.4% to 1.1% in February, which was driven by slowing goods inflation and to a lesser degree by slowing services prices. This is, in part, because of cancelled winter sales in France, which pushed the January reading higher. With the core rate still at 1.1%, after having been as low as 0.3% until December, core inflation is still trending higher.

Headline inflation was stable as energy inflation has been running less negative due to rising oil prices and favourable base effects. The energy inflation rate improved from -4.2% to -1.7% in February and we can expect it to turn positive in the coming months. This adds to other temporary price pressures like input price increases due to supply chain problems and base effects from services categories that reduced prices over the course of the pandemic.

With all the market jitters about an economy running hot in the US, rising eurozone inflation could give a similar impression at face value. Not much more than that though, as temporary factors are pushing up the rate right now and the economy continues to contract as the second round of lockdowns has been extended well into 1Q. This means that we expect the elevated levels of inflation in 2021 to be largely transitory and that weaker inflation is set to return in 2022.

For anyone in doubt: the ECB is clearly not concerned about being behind the curve at the moment. They will see these inflationary drivers as largely fleeting. The big concern is around the higher bond yields that have been driven by developments in the US. Because of that, we expect the ECB to increase asset purchases and address the rising bond yields at next week's meeting.

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