

Eurozone inflation stickier than expected in February

Inflation decreased from 8.6 to 8.5% in February with core inflation rising to 5.6%. While some forward-looking indicators for inflation are improving, the faster pace of underlying inflation means the European Central Bank has no reason to stop hiking anytime soon



The small decline in headline inflation mixed with a jump in core inflation is far from what the ECB had been hoping for. The increase in food inflation stands out, jumping from 14.1 to 15% in February. Services inflation is also a clear worry, which increased from 4.4 to 4.8%. With wage growth on the rise, concerns are that services inflation could prove sticky at high levels. But also energy inflation did not drop in line with the market price developments, thanks in part to French changes in the tariff shield.

The silver lining is that core inflation increases were mainly due to base effects. Using our own seasonal adjustment, we find that the monthly increase in core prices was in fact slightly down from January. So perhaps not as alarming as it looks at first sight, but then again, at 0.5% month-on-month, core inflation is still growing at an annualised pace above 6%. So still nowhere near the ECB target for the moment.

How bad is this exactly?

The February reading is a clear setback, but forward-looking indicators show that the declining trend in inflation is set to continue. March will show a much faster drop in headline inflation as the huge jump from last March will fall out of the year-on-year comparison. Energy inflation is set to turn negative soon, possibly already in March. But the question is how fast other price categories will see declines and if inflation proves to be stickier than expected.

We do see producer prices for food showing smaller increases and outright declines in food commodity prices, which should lead to slower consumer food inflation over the course of the year. Goods inflation is also set to fade in the months ahead as input costs have improved markedly and selling price expectations from manufacturers are falling quickly. The big worry to us is around services inflation as faster wage growth could make services inflation sticky.

Still, the smaller-than-expected decline in inflation in February is important as the ECB takes current underlying inflation seriously as a factor for determining policy. That was not lost on markets this week as yields surged on the back of the higher inflation readings from Spain, France and Germany already released earlier. At the same time, it is also important not to put too much emphasis on this one figure. A rate hike at the March ECB meeting is more or less a given at 50 basis points and May is still quite some time away.

There is a clear risk of the ECB having to do more, but ECB Chief Economist Philip Lane also indicated earlier this week that a lot is pointing in the right direction for inflation to come under control. The difference between disappointing current inflation and optimism about forward-looking indicators will likely bring about more debate between hawks and doves ahead of the post-March meetings. Before May, we will have quite some data to judge as to whether February was a blip or inflation does indeed remain stickier than expected.

Author

Bert Colijn

Senior Economist, Eurozone

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 <http://www.ing.com>.