

Eurozone inflation jumps to a 10-year high

Inflation is well above target in August, but don't expect this to make a huge impression on the European Central Bank. Yes, price pressures are increasing, but this dramatic move does overstate the underlying inflation developments



Core inflation was subdued in July due to a shift in the sales period last year and some other, more minor statistical factors. The data is showing its true colours in August with a reading of 1.6%. The change in last year's sales period and German VAT increase were the main drivers behind the jump in non-energy industrial goods prices from 0.7 to 2.7%. These effects are temporary and the increase in services inflation was much smaller, from 0.9 to 1.1%. Yes, price pressures are increasing, but August's dramatic move does overstate the underlying inflation developments.

Headline inflation at 3% has not been seen since 2011. The elevated headline rate was due to the higher core rate and continued year-on-year growth in food as well as energy prices. The latter has been somewhat of a surprise in recent months, related to higher gas prices and continued growth in petrol prices despite Brent oil prices starting to level off. This has the potential to push headline inflation higher towards year end.

Despite the jump in core inflation and the further rise in headline inflation, this is not set to sway the ECB towards a more hawkish stance ahead of the September meeting next week. These were widely expected moves, although the magnitude is larger than most would have expected. Remember July though? ECB President Christine Lagarde repeatedly mentioned that the ECB would not act on temporary inflation. Today's release will cause some sweaty palms but has not given much evidence of more structural high inflation. The macro projections presented at next week's meeting will likely not have seen too much extra upward pressure yet.

This is not to say that there is no upside risk to the inflation outlook. The one big question mark is around the passthrough of the higher input and transport prices for goods, which has been moderate so far but the price pressures have become abnormal in recent months. The other is whether service sector reopenings will still cause price jumps like we saw for hairdressers after the first wave. We're starting to see some evidence of that in restaurants and hotels, but not yet in package holidays. There is some evidence that this effect will start to become more prominent towards the end of the year, so hold tight: inflation has the potential to go higher from here.

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