Eurozone inflation ticks down as weak demand curbs price increases

Headline inflation fell from 2.5 to 2.4% and core inflation dropped from 2.7 to 2.6%. The weak economic environment seems to trump an increase in reported input costs for the moment. For the ECB, this is a dovish sign as the governing council mulls over how low it should bring rates

Amsterdam, the Netherlands. Today's soft reading will contribute to views that the inflation threat in the eurozone is now fairly benign

After quite a strong January reading, February eurozone inflation came in soft. Core inflation ticked down after having been stable at 2.7% since September. The first decline comes despite businesses indicating that input costs have been increasing and their intentions to price these through to the consumer. But for the moment, this proves challenging given weak domestic demand. Consumers have regained purchasing power, but remain worried about the general economic situation, which has contributed to a higher savings rate.

Over the course of the year, we expect the eurozone to slowly move away from stagnation as domestic demand strengthens a bit on the back of further purchasing power improvements and lower rates. That should make for an environment in which inflation remains somewhat above 2%. But then again, geopolitical developments are making the inflation outlook highly uncertain at the moment. Think, for example, of uncertainty surrounding a trade war and energy prices.

For the European Central Bank, the big question is how low it will go. Concerns among hawks in the governing council about lowering rates too much have made headlines in recent weeks. Today's soft inflation reading will contribute to views that inflation is now fairly benign, but will not provide firm evidence on how low rates should be set. We expect another 0.25ppt cut later this week to be accompanied by a fiercer debate on when the ECB will reach its terminal rate.

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