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EUROZONE INFLATION: THE STICKY CORE

Berenberg Macro Flash

Eurozone inflation, November, in %, yoy

	Headline	Core
Actual:	**2.0**	**1.0**
Previous:	2.2	1.1
Consensus:	2.0	1.1
Berenberg	2.0	1.1

Not only energy drives inflation lower: After hitting a six-year high of 2.2% yoy in October, headline inflation eased to 2% this month owing to slower price gains across the board (see chart 1). All components published by Eurostat with the first inflation print – except for non-energy industrial goods – registered softer inflation (see chart 2). As pump prices fell by 1.7% mom – while much less than the 17% mom slump in Brent crude's price in euros – the energy component's contribution to the headline yoy rate fell from more than 1ppt to less than 0.9ppt (see chart 3). Lower price gains for food and services subtracted another 0.05ppt each versus the previous month.

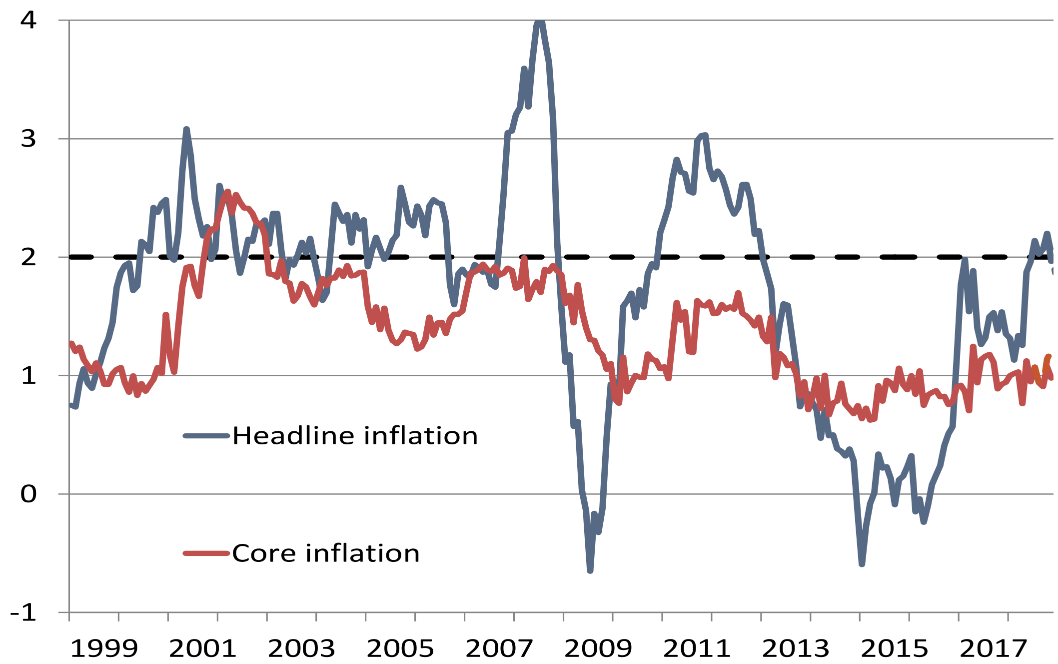
Core inflation sticky around 1%: Services inflation is a good proxy for domestically-generated, and similar to core, for that reason, a better gauge for the underlying price pressures in the economy. The services inflation drop from 1.5% yoy in October to 1.3% in November does not provide much of a clear read, though. The occasional price swing in package holidays likely weighed on services inflation in November, after boosting it in October. According to German regional data, package tours inflation was down from 7.1% yoy September to 0.3% in October. If anything, this month's print suggests that underlying price pressures have not changed much this year and core remains sticky – or comfortably anchored, whichever one may see this – at around its 4-year average of 1%.

2019 outlook: Over the next six to nine months, the trend is down for headline inflation. If the oil price and EUR/US dollar exchange rate were to remain at current levels, and would feed-through 1-to-1 to pump prices and electricity bills, the yoy headline rate could fall to 1.2% yoy in Q1. Of course, that is unlikely to happen, but there is a risk that the rate falls closer to 1.5% yoy than 2%. Similar to the ECB we expect the energy-driven decline in headline inflation to mask a gradual pick-up in services-led core price pressures. A vigorous uptick in core inflation of the sort the ECB's September 2019 projections forecast – from 1.1% in 2018 (probably revised to 1%) to 1.5% in 2019 and 1.8% in 2020 (see chart 4) – is, however, unlikely as the Eurozone's upswing has moderated further in H2.

Impact from slowdown on labour market: Eurozone unemployment stopped falling for the fourth consecutive month in October at 8.1%. The number of persons unemployed rose actually by 12k from September – largely driven by Italy though. Wage growth may, therefore, climb slower over the next 12 months than over the previous ones. As productivity gains look set to accelerate and many businesses continue to face heavy competition, rising input costs for material and labour will translate only slowly into higher charged prices. We look for core inflation of 1.4% in 2019 and 1.7% in 2020, with risks tilted to the downside.

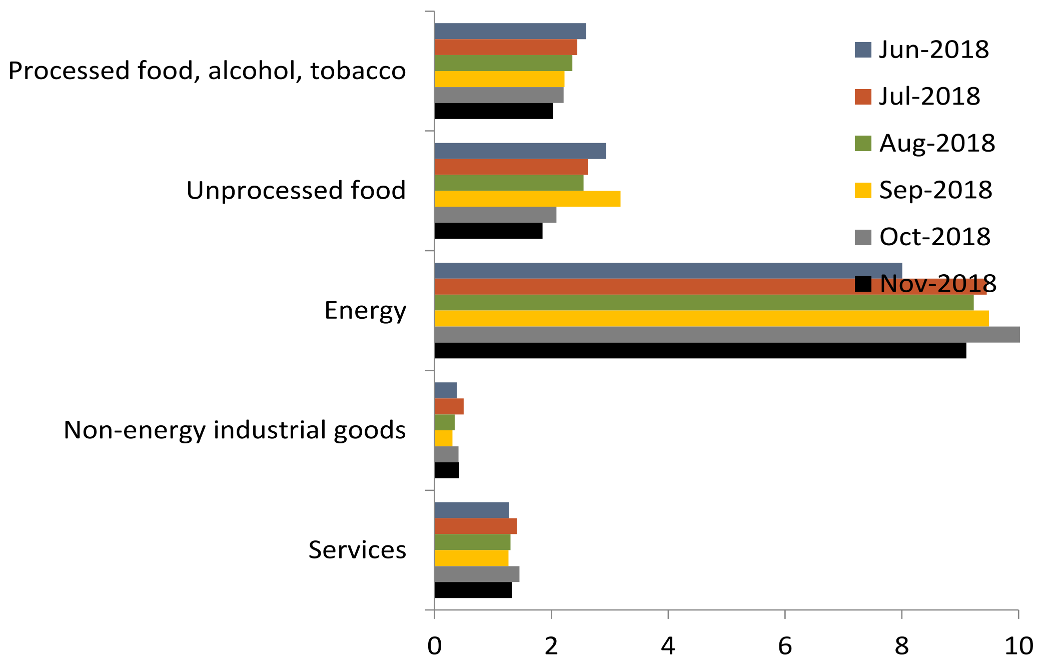
ECB December meeting: We expect the ECB to send a more dovish signal at its next meeting on 13 December. Softer growth will cause the ECB to revise its growth projections down and trigger a debate whether the current commitment to keep interest rates at record-low levels should be extended beyond the summer of 2019. The ECB need not take a decision in December already as it still has time to watch the data. As we look for growth to rebound throughout 2019, we maintain our call that the ECB will start to raise rates very gradually next autumn.

Chart 1: Headline and core inflation (yoy, in %)



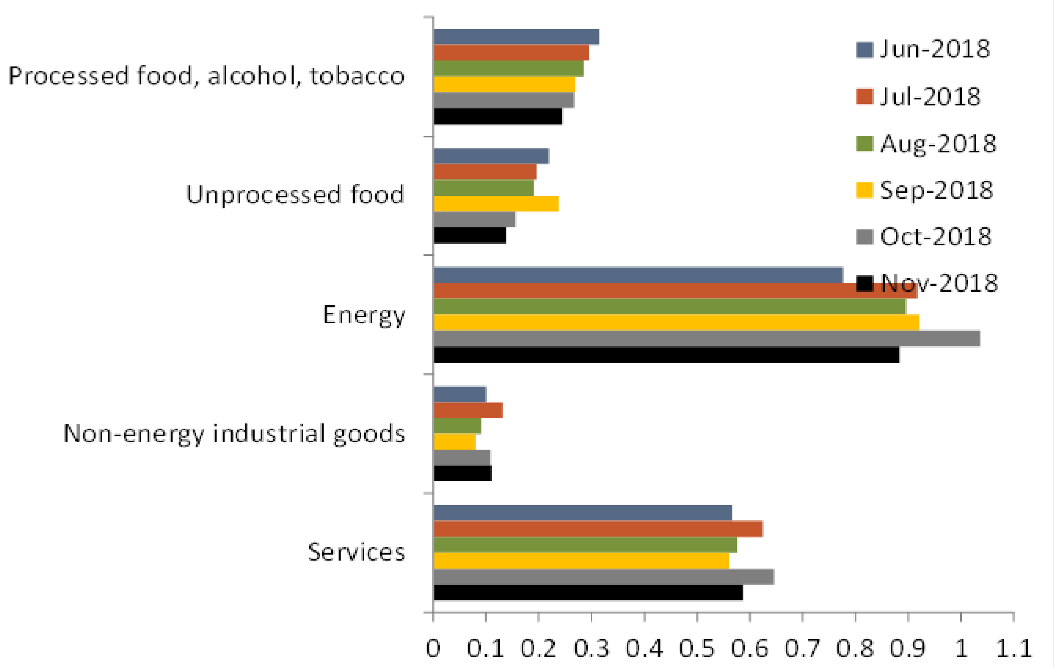
Sources: Eurostat, Berenberg calculations

Chart 2: Inflation by component (yoy, in %)



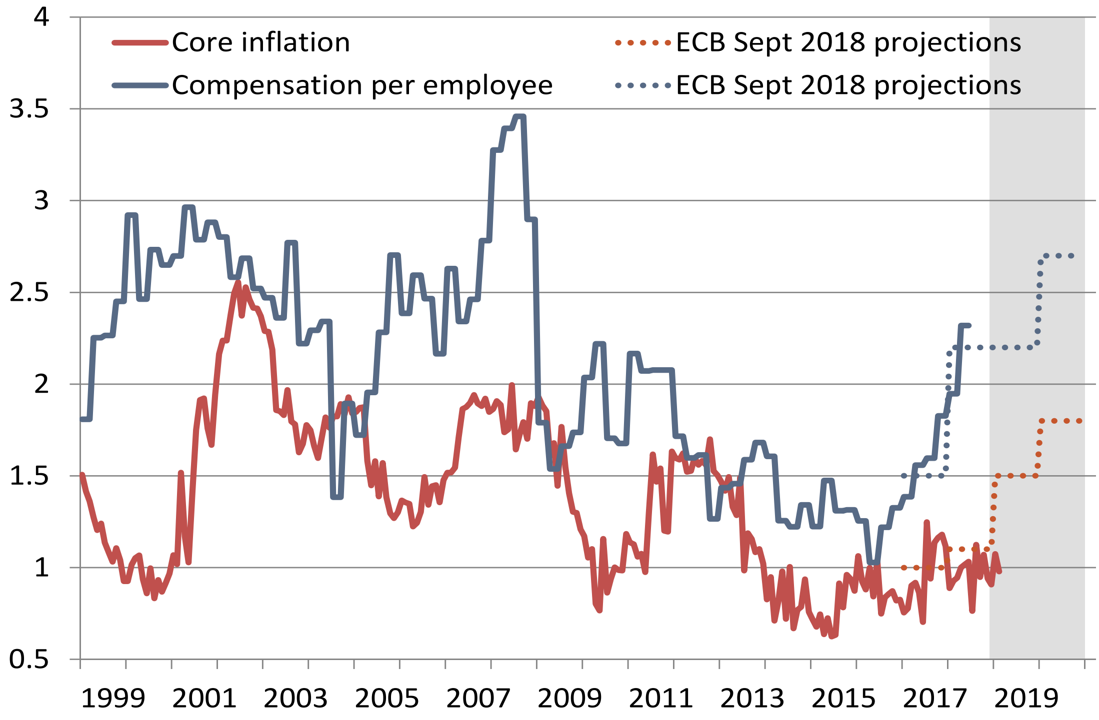
Source: Eurostat

Chart 3: Contribution to headline inflation by components (yoy, in % points)



Source: Eurostat

Chart 4: Core inflation and compensation per employee (yoy, in %)



Sources: Eurostat, ECB

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