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ECB DOVISH TUNE STILL IN PLAY AFTER INFLATION UPSIDE SURPRISE

Berenberg Macro Flash

Eurozone inflation, June, in %, yoy

	Headline	Core
Actual:	**1.2**	**1.1**
Previous:	1.2	0.8
Consensus:	1.2	1.0
Berenberg	1.2	1.0

While the inflation print for June came in slightly higher than expected, it will not change the ECB's dovish tune much. The June number is partly distorted by ongoing monthly volatility that was caused by the late Easter this year. Still, at the margin, the upside surprise takes some pressure of the ECB to cut rates at as early as its 25 July meeting and wait until September when it is likely to announce QE, too. That is, of course, providing the economic data does not tank badly in the next four weeks.

A significant pick up in services price inflation offset the drag from the drop in oil prices. As a result, the headline yoy CPI rate was unchanged at 1.2% in June, while core inflation surprised a little on the upside at 1.1% (1.05%), versus expectations of 1% and May's 0.8% print. From March until May, the late Easter made the yoy inflation rate volatile. Spending on expensive package holidays was lower in March, higher in April and again lower in May. In June, it seems that effect had not fully dissipated. German inflation data – published yesterday – showed that package holidays made a big positive contribution to overall inflation in June.

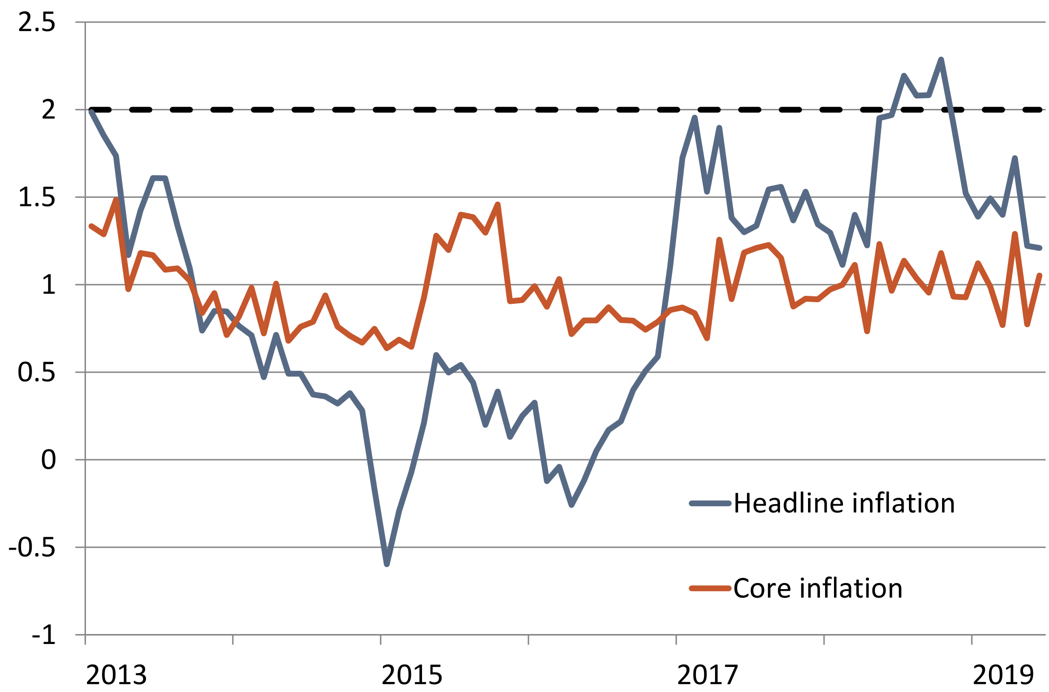
Going forward, if oil prices evolve in line with largely stable future prices, energy base effects will pull headline inflation lower, possibly to 1% yoy in Q4.

Final inflation print before ECB meeting: The inflation reading for June is the last one before the Governing Council meeting 25 July – the final estimate with more details on the components is due 17 July. Eurostat will publish a first estimate of the July print on 31 July. Exactly how the ECB will evaluate this reading relative to its own projections and how much weight it will put on it remain open questions. To hit the ECB's projected 1.1% average for core inflation in 2019, the yoy rate would have to edge just a little higher from the current 1.1% to 1.2% in Q4. While that looks absolutely possible, we see two reasons why inflation may still miss the ECB's core inflation call: First, after the big positive contribution from package holidays in June, a likely correction in July will weigh on the core inflation rate for that month. Second, the core rate has been sticky at c1% over the past five years which is unlikely to change much soon amid the current slowdown in demand growth.

Guidance change in July, easing package in September: We still think the weak survey data recently (Eurozone sentiment, German Ifo, Eurozone PMIs) will push the ECB in July to adjust its guidance and vow to keep rates at "present or lower" rather than just at "present" levels. If industrial production for May published on 12 July and the next Survey of Professional Forecasters published late July shows a significant drop in inflation expectations, the ECB may be inclined to act more forcefully in a few weeks. Today's reading suggest the ECB will wait until its September meeting with a deposit rate cut by 10bp and a new asset purchase programme announcement.

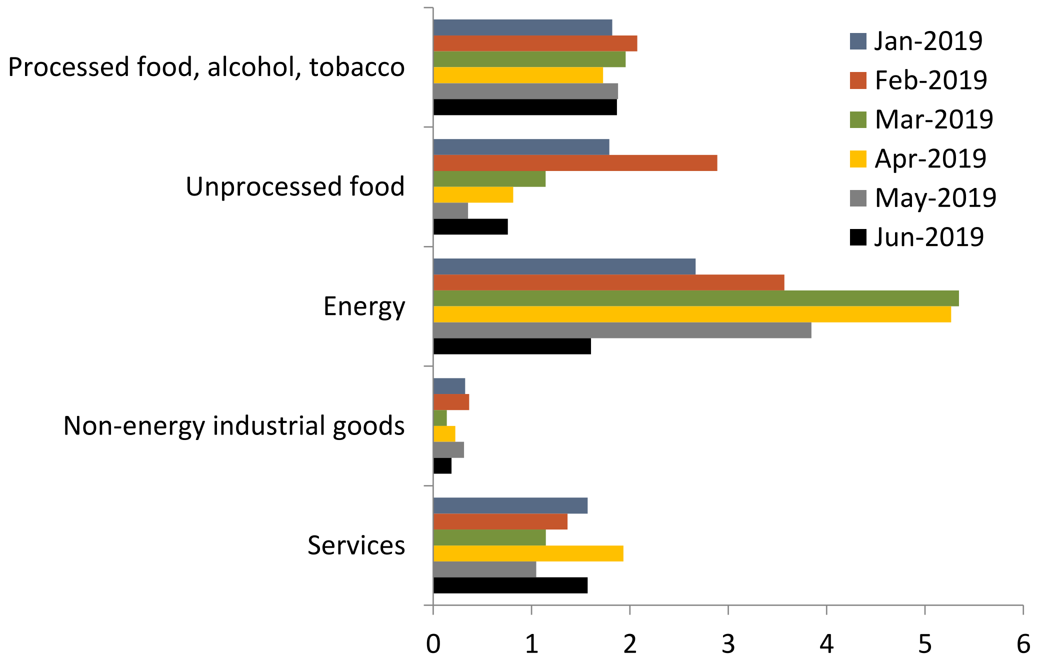
See further reading on the ECB's likely next steps:
[ECB: doing whatever it can]
[Eurozone: bottoming out amid the storm]
[ECB: Draghi: new version of "whatever it takes"]
[ECB: to QE, or not to QE]

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



Sources: Eurostat, Berenberg calculations

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



Source: Eurostat

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