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ENERGY PRICE GAINS DRIVE EUROZONE INFLATION HIGHER

Berenberg Macro Flash

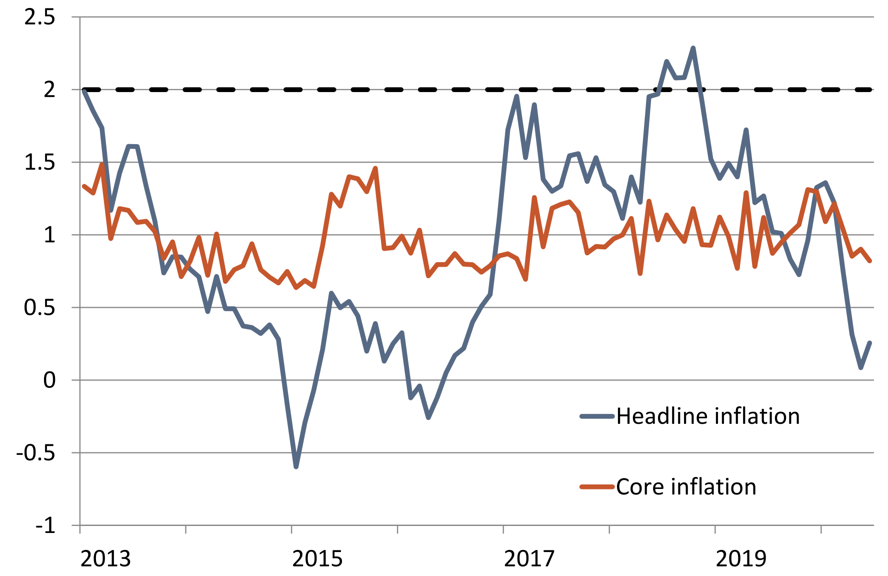
Ignore the headline: Despite a modest acceleration in headline inflation, underlying price pressures are easing in the Eurozone. In June, energy price gains more than offset softer underlying inflation, raising the headline rate from 0.1% yoy in May higher to 0.3% in June. Core inflation, which strips off the volatile energy and food components from the overall price basket, slowed down further to 0.8% yoy in June from 0.9% in April and May and a 1.1% average in Q1 2020 (see Chart 1).

Energy price gains drive headline inflation higher: The yoy rate of the energy component turned less negative from -11.9% in May to -9.4% in June on the back of a 1.7% mom rise in energy prices and some base effects (see Chart 2). This pushed up the yoy headline inflation rate by almost 0.3ppt in June relative to May (see Chart 3). Energy inflation increased for the first time in 5 months. Back in 2019 it had fallen by 1.2% mom between May and June. Brent crude rose by 21% mom in June (in euro terms), which lowered its yoy drop from -52% in May to -35% in June. Super95 pump prices rose by 3.6% mom in June versus a corresponding drop by 2% in 2019, lifting the yoy rate from -19.5% in May to -14.9% in June. Processed and unprocessed food price gains slowed a little from 2.4% yoy in May to 2.3% in June and 6.7% to 5.9%, respectively.

Softer underlying price pressures weigh on core inflation: Service inflation, a proxy for underlying, domestically generated price pressures, fell from 1.3% yoy in May to 1.2% in June (see Chart 2). It shaved off 0.06ppt from the headline inflation yoy rate and also pulled core inflation lower (see Chart 3). The slowdown in services inflation from an average of 1.6% yoy in January/February highlights the disinflationary impact of the Covid-19 recession. Even though supply has shrunk, and remains below its pre-crisis capacity, demand has fallen by more, and will likely not recover as quickly. Contrary to most of supply and production facilities, household consumption and business investment cannot be switched on that easily. Underlying price pressures will reverse only once demand outpaces supply growth. This will unlikely happen before early 2021.

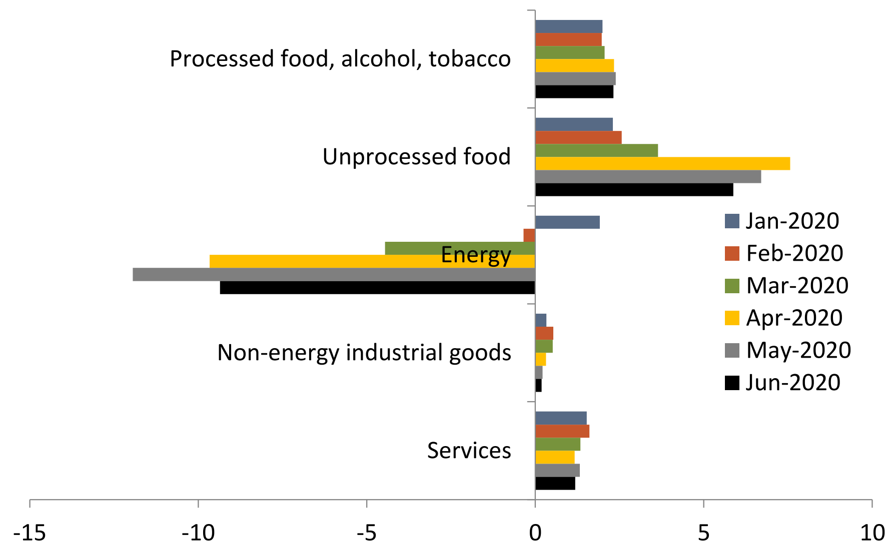
Eventually negative in H2, rising in 2021: Going forward, we expect inflation to slow down modestly. The energy component will keep headline inflation below the core rate, but by less than in May – unless, of course, oil prices were to fall significantly yet again. We expect the contribution from stronger food prices to largely wane as Eurozone governments continue to ease restrictions. At the same time, services inflation and price gains in non-energy industrial goods will probably continue to slow. Germany's 3 point VAT cut during H2 2020 will also add to that temporarily. As a result, headline inflation will probably turn slightly negative at some point during H2 2020, before turning positive in 2021 again.

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



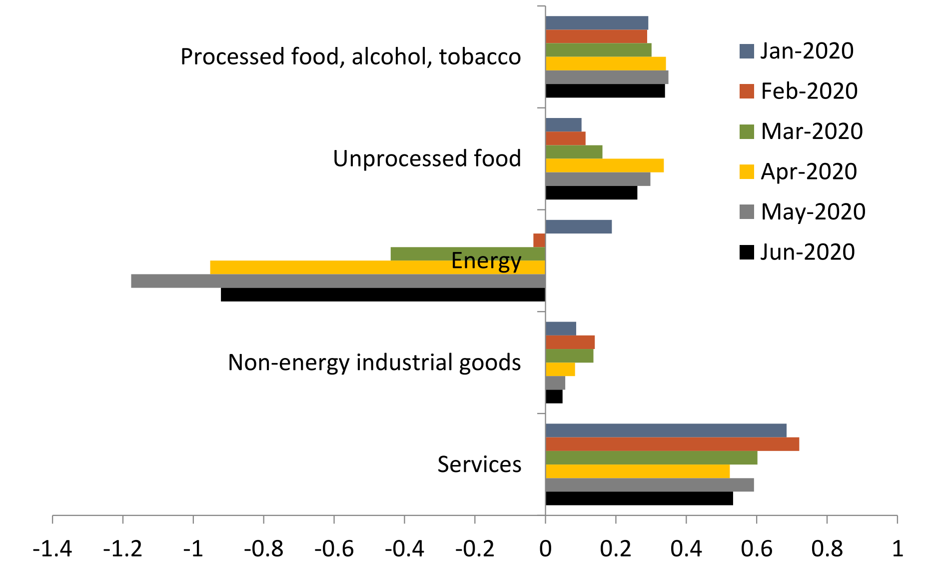
Source: Eurostat, Berenberg

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



Source: Eurostat, Berenberg

Chart 3: Contribution to yoy inflation by component (in ppt)



Source: Eurostat, Berenberg

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