



COMMERZBANK

Economic Research

Economic Briefing

A warning shot for the ECB

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The inflation rate in the eurozone has not fallen for two months. In May, it even rose again from 2.4% to 2.6%. More importantly, the core rate also halted its downward trend in May, rising from 2.7% to 2.9%. For the ECB, this data, like the surprising stronger rise of negotiated wages in the first quarter, comes at an inopportune time, as it has already announced a cut in key interest rates for June. At the press conference, ECB President Lagarde will probably justify the rate cut primarily on the basis of the medium-term inflation outlook. However, according to our forecast, this is not very rosy either, as the core rate is likely to settle at 3% rather than 2% towards the end of the year.

According to preliminary data from Eurostat, the inflation rate rose from 2.4% in April to 2.6% in May, ending the downward trend of the last year and a half. This is above the average expectations of the economists surveyed in advance (Table 1). The increase was largely due to the fact that the core inflation rate, i.e. the inflation rate excluding energy and food, surprisingly rose from 2.7% in April to 2.9% in May. By contrast, the year-on-year rate for food prices fell from 2.8% in April to 2.6%. The effect of energy prices, which had dampened inflation in previous months, had hardly any effect on inflation in May, with a rate of 0.3%.

In recent months, falling energy prices compared to the previous year and decreasing pressure on food prices had dampened inflation overall. Energy prices had been falling year-on-year for around a year – in some cases very significantly. Partly because a weak monthly figure was excluded from the year-on-year comparison, the rate of change for energy was around zero at 0.3% in May. However, the rate of change for food and beverages fell only slightly from 2.8% in April to 2.6% in April. Fresh food in particular, such as fruit and vegetables, appear to be driving up prices at the moment.

The core rate rises surprisingly

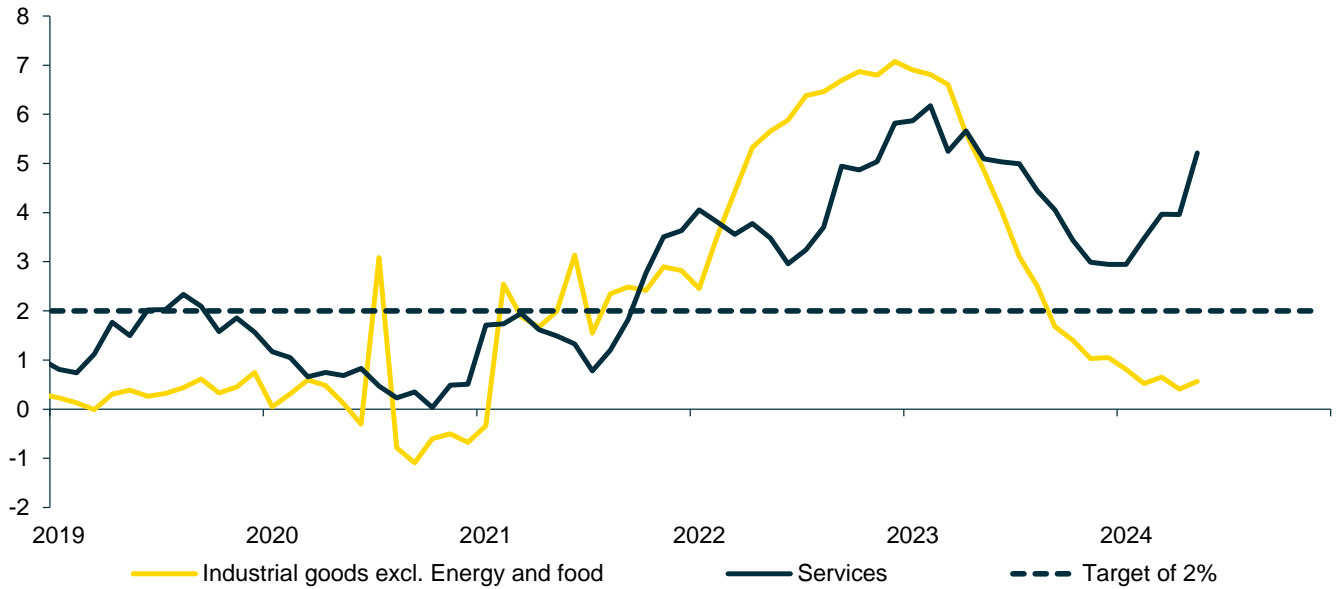
The inflation rate excluding energy, food and beverages had fallen since its peak in March 2023. In May, it has now risen from 2.7% in April to 2.9%. Underlying inflation has already picked up again since the start of the year, particularly in services (Chart 1). As these are particularly labor-intensive, the recent high wage settlements have had a particularly strong impact on them. According to Eurostat, wages increased by 4.7% in the first quarter of 2024 compared to the same period of the previous year. The short-term momentum for goods (excluding energy and food) has recently stabilized (Chart 1).

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Chart 1 - Services pushing up core rate

Subcomponents of the harmonized consumer price index, seasonally adjusted monthly figures, annualized 6-month rates of change in percent, May 2024: estimated by Commerzbank on the basis of the year-on-year rates



Source: Eurostat, S&P Global, Commerzbank Research

Warning shot for the ECB

Both the inflation rate and the core rate have stabilized with the latest figures well above the ECB target of 2.0%. Due to the sharp rise in wage costs, this price increase appears to be becoming increasingly entrenched. Ahead of the next ECB meeting next week, these figures are therefore a warning shot for the ECB. An initial interest rate cut at this meeting appears to be a done deal. However, the surprisingly high core rate in May should give food for thought regarding the number and speed of further cuts.

Table 1 - Euro area HICP

changes year-over-year in %

Indicator		May-24	Forecasts		Apr. 24	Mar-24
		preliminary	CB	Consens		
Consumer prices	%, y-o-y	2.7	2.5	2.4	2.4	2.4
Core rate 1)	%, y-o-y	2.9	2.7	2.7	2.7	2.9

Source: Eurostat, Commerzbank Research

1) excl. energy, alcohol, food and tobacco



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