

Eurozone inflation hits a Middle East war high, but core pressures remain contained

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Yes, headline inflation increased from 2.9 to 3.3% in August, but core inflation fell back to 2.4%. Upside risks to inflation remain aplenty but the core rate remains surprisingly benign six months into the Middle East conflict

Inflation jumped in August, driven by higher energy prices as the Gulf conflict intensified once again, with no resolution currently in sight. The increase to 3.3% in headline inflation marks the highest reading since the start of the war. The year-on-year increase in energy inflation is now 14.3%.

Goods inflation has been on the rise as well, now standing at 1.2%. That is up from 0.7% in June. But food inflation remained stable at 1.2% in August and services inflation dropped back to 3% from 3.3% last month.

Six months into the Middle East turmoil, core inflation stands at 2.4%, which is exactly where it was in February, the last month before the conflict started. A significant pass-through of higher energy costs to other prices has not materialised so far. And in August, businesses remained calm about price increases in the months ahead as well. So far, so good.

But of course, upside risks abound and the pass-through of costs can take time. Energy prices could see another leg up, droughts are impacting supply chains, and the economy is still performing reasonably well, which makes the pass-through of higher costs easier. And indicators of wage growth have started to move up. So while it's fine now, do expect core inflation to rise further in the months ahead.

For the European Central Bank, the jump in the headline inflation rate makes a September hike easier to sell. But the stubbornly benign core inflation rate should make for an interesting debate about a possible subsequent hike into restrictive territory.

Source: <https://think.ing.com/snaps/eurozone-inflation-at-middle-east-war-high-but-no-sign-of-core-inflation-moving-up-yet/>