HSBC Global Research

21 May 2024

Eurozone inflation briefing

Disinflation intact despite the volatility

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Economics - Eurozone

- Eurozone inflation was in line with expectations in April but core was a little firmer despite service inflation easing
- Volatility remains high causing swings in near term inflation …
- … but overall the disinflationary trend remains intact and should give the ECB plenty of confidence to cut rates in June

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Eurozone inflation was flat in April, at 2.4% y-o-y, in line with consensus expectations (although it fell a bit, from 2.43% to 2.37% to 2dp). Core inflation, though, surprised a tad to the upside, easing from 2.9% to 2.7% (consensus 2.6%, although also in this case the final print was 2.66% on 2dp. Services inflation fell to 3.7% after five consecutive months at 4.0%. Meanwhile, energy deflation eased (-0.6% after -1.8%) while core industrial goods disinflation continued but at a slower pace (0.9% after 1.1%) and food prices bounced back up (unprocessed food inflation was 1.2% after -0.5%). In Germany and Spain HICP rose 0.1ppt to 2.4% and 3.4%, respectively, while it was flat at 2.4% in France, and eased 0.3ppt to 0.9% in Italy.

Even though the volatility of inflation prints has declined in absolute terms relative to recent years, we are still seeing quite a lot of volatility in relative terms (inflation has never come out in line with consensus so far this year). This reflects many elements, including: the different timing of the phasing out of energy measures across countries; food price volatility; and an earlier Easter relative to last year. For instance, even though we had anticipated a boost to tourism-related prices in March, somewhat surprisingly we did not get a payback in April. Indeed, package holiday prices were still up 5.8% y-o-y. That might have been partly because Easter fell right at the end of March, and partly because school holidays in many countries extended well into April. Whatever the reason, a payback in May – or June at the latest, given many holidays in France and Germany in May – still seems likely to us.

The recent swings in energy prices add to the volatility of inflation. The oil price is down nearly 10% in EUR terms in a month (Chart 5). Based on typical ECB elasticities, this should knock 0.2-0.3ppt off inflation, and with a quick passthrough (a bigger impact could be seen in the medium term, if the move is sustained). We expect inflation to remain flat, at 2.4% in May – albeit a high 2.4% to 2dp, despite the phasing out of last May's travel discount in Germany – before falling further from June. Core inflation should edge down to 2.6%. We see headline inflation averaging 2.4% this year and 2.1% next, with core averaging 2.6% and 2.1%.

Looking at the bigger picture, momentum in services inflation is still high (Chart 2) on the back of rapid unit labour cost growth – productivity was flat in Q1 2024 as employment grew in line with GDP (0.3% q-o-q). Meanwhile, the recent drop in energy prices – if sustained – could even push core industrial goods into deflation. So overall, the deflationary trend seems intact, as also shown by the ECB's preferred measures of underlying inflation (Chart 3). This should make the ECB feel even more confident about its forecasts and look through the near-term volatility – as noted in the account of the April meeting – and cut rates in June.

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Issuer of report: HSBC Bank plc

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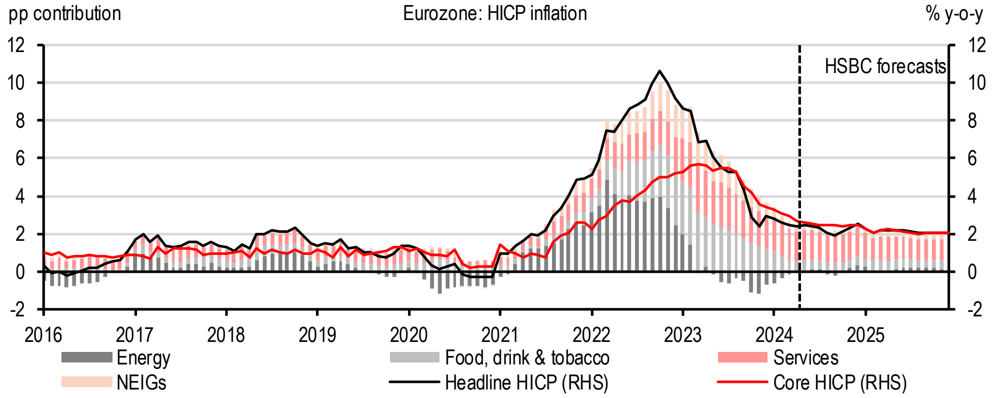
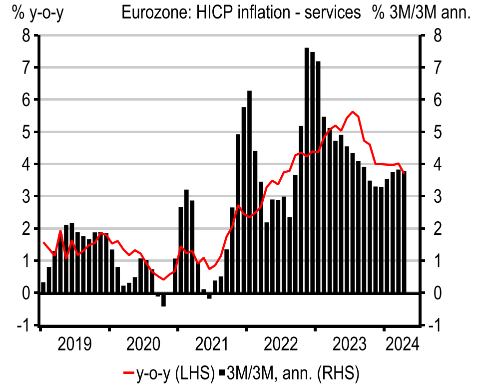
1. Eurozone inflation was flat in April, while core inflation fell but less than anticipated



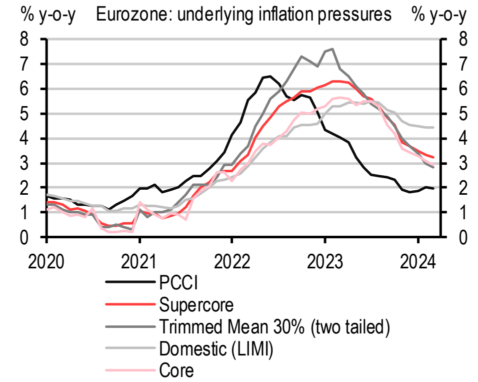
Source: Macrobond, HSBC forecasts.

2. Service sector inflation eased a little even though momentum remains elevated



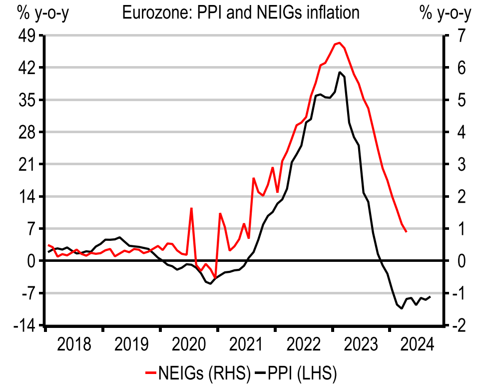
Source: Macrobond, Eurostat, HSBC

3. Most of the ECB's underlying inflation gauges remain on a downward path



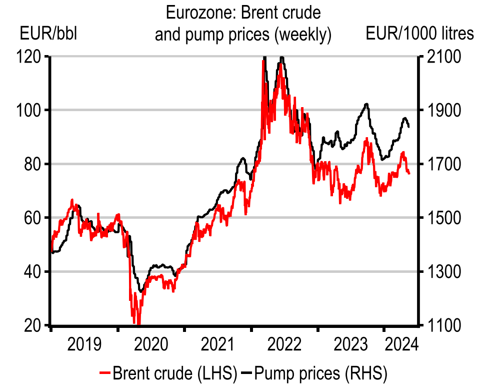
Source: Macrobond, Eurostat, ECB, HSBC. NB: LIMI = Low Import Intensity

4. Core industrial goods could move into deflation as factory goods prices fall …



Source: Macrobond, Eurostat, HSBC

5. … and the downward trajectory could be supported by the recent fall in oil prices



Source: Macrobond, European Commission, HSBC

France: marked upside surprise in April led by services prices

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On the EU harmonised measure (HICP), French inflation was steady at 2.4% y-o-y in April, surprising markedly on the upside (HSBC: 2.1%, consensus: 2.2%). Regarding the national measure (CPI), inflation eased from 2.3% y-o-y in March to 2.2% in April, which was closer to expectations (HSBC: 2.1%, consensus: 2.2%).

The upside surprise relative to our forecasts was entirely driven by services inflation, which was steady at 3.0% y-o-y (we were waiting for a slowdown due to base effects). In particular, prices rose more sharply than we expected for package holidays (12.5% m-o-m after 7.3% in March) and for hotels and restaurants (1.0% m-o-m after 0.2%). Both categories have a higher weight in HICP (10.0% in total) than in CPI (9.1%), which may explain the more pronounced upside surprise on the former. These developments point to no payback from the earlier Easter weekend, with the calendar of school holidays in April (spread between 6 April and 6 May across the different French regions) being seemingly a more important driver.

Excluding services, other components were more in line with our expectations. Disinflation continued for food prices (1.2% y-o-y after 1.7% in March, on the back of non-fresh food) and manufactured goods prices (-0.1% y-o-y after 0.1%). Conversely, energy inflation was a bit firmer (3.8% y-o-y after 3.4% in March), a move driven by petroleum products (-0.7% y-o-y after -2.0%) due to the rise in oil prices (in average) during the month.

In May, we expect French inflation to edge up to 2.6% y-o-y for HICP and 2.3% for CPI. This would reflect base effects on energy prices, given their large fall (-3.0% m-o-m) in May 2023. That said, the marked drop in oil prices since early May means that the upward move on energy inflation should be more limited than what we anticipated a month ago. Besides, we expect services inflation to ease by 0.2ppt to 2.8% in May but this evolution remains very uncertain given the high number of public holidays falling on weekdays this year (which may encourage French workers to take additional days off and, in the end, support demand for tourism).

Given the upside surprise seen in April, we raise slightly our annual inflation forecast on HICP for 2024, to 2.5% instead of 2.4% (the recent drop in oil prices partially offset the impact of this upside surprise). However, our forecast for 2025 remains unchanged at 2.2%. As for CPI, the more limited upside surprise in April leads us to leave our annual forecasts unchanged at respectively 2.3% in 2024 and 2.0% in 2025.

Germany: Something for both the doves and the hawks

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The German inflation print for April offered something for the doves and the hawks. Those favouring a quick succession of ECB rate cuts will have looked towards the downside surprise in the national annual measure, which remained stable at 2.2%. Those more concerned with inflation stickiness will point towards the 0.1ppt uptick in the HICP to 2.4%.

On a month-on-month basis, in April, most upward inflation pressure stemmed from goods as the VAT rate on gas and district heating returned to 19% (from 7%), and stronger global demand facing tight supply saw the Brent oil price rise by 6.5% m-o-m in EUR terms and thereby pushed up motor fuel prices as well as costs for heating oil. Prices for food and non-alcoholic beverages also added to inflation, rising by 0.4% m-o-m. This caused the y-o-y rate to increase for the first time after 12 consecutive declines (+1.1% compared to +0.2% in April).

On the other hand, services price growth lost momentum in April, posting a small rise (+0.4% m-o-m) on the month relative to the seasonal trend. This was due to an earlier timing of the Easter holiday this year, which saw firms move some of the typical hikes in travel and restaurant prices forward into March. However, the anticipated reversal of the Easter distortion in April came in less strongly than anticipated. As package holidays and restaurant services have a larger weight in the HICP compared to the CPI, this resulted in a stronger monthly increase in the harmonised compared to the national inflation measure (0.5% vs 0.6%).

The core inflation rate, which strips out the volatile food and energy components, rose 0.3% on the month in April. The annual rate declined to 3.0%, the lowest rate since March 2022. Momentum nevertheless remains strong, at an annualised rate north of 2.5% over the past few months.

In May, the downward trend in the annual inflation rate will be temporarily interrupted as the base effect of last year's rail travel discount ('Deutschlandticket') fades, pushing up transport services inflation. On a monthly basis, price impulses will likely stem from package holidays and travel-related categories due to public holidays such as Ascension Day and Pentecost falling into that month. A higher tax on airfares will also marginally contribute.

Energy on the other hand is expected to moderate the monthly uptick. Brent in EUR terms has reversed most of its April gains and as of mid-May trades at 76.4 EUR/bl due to a combination of a lower oil price in USD, amid demand uncertainties, and a stronger euro. This is expected to translate into lower motor fuel prices (Diesel is already down 4.6% m-o-m as of mid-May) and to push down heating oil prices, which together should hold back monthly CPI growth by around 0.15pts.

Overall, the annual inflation rate will likely have troughed in April for now, but could fall to the 2% mark in late summer. In May, we expect national CPI to increase by 0.13% m-o-m (HICP +0.16% m-o-m), which would see the annual rate rise to 2.4% (HICP 2.7% y-o-y). For 2024 as a whole, we retain our forecast that national CPI will average 2.3%, meanwhile we push up our projection for the HICP by 0.1pts to 2.5% in response to the higher-than-expected April print.

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