Sticky inflation won't alter ECB's rate cut decision

Inflation data across the Eurozone came in slightly higher than expected in May, but are unlikely to alter the ECB's monetary policy decision on Thursday.

As signalled by earlier releases from Spain and Germany, the Eurozone inflation data came in at a slightly higher rate than forecast in May. Annual inflation ticked up to 2.6% in May, from 2.4% in April, slightly above the consensus of 2.5%. Two factors drove this rise in May. First, the base effects from earlier energy price cuts have now passed, with energy prices now adding to annual headline inflation, albeit marginally, for the first time since April 2023. Second, services inflation remained sticky in May, with the annual rate increasing to 4.1% from 3.7% in April. However, this may reflect temporary factors such as the unwinding of public transport discounts in Germany, and the bounce back in prices following the early Easter in March/April.

Near term, there may be some upside risk to energy prices, although earlier oil price rises have reversed significantly in recent weeks, with Brent Crude easing from above $90/barrel at end-April to under $82 by end-May. Longer term, the drivers of services and wider core inflation have lessened significantly in recent month. The supply chain pressures evident post the pandemic in 2021/22, which drove up consumer prices have dissipated, as consumer demand normalised and firms built in resilience to geopolitical and trade disruptions. More importantly, the sharp rise in wages across the Eurozone in recent years, which has underpinned services inflation, appears to be moderating sharply. Surveys such as the Indeed and ECB wage trackers signal a slowdown in pay growth across the Eurozone's major economies.

Nonetheless, still high rates of services inflation may embolden the hawks at the ECB to push for a more gradual decline in rates following the expected 25 basis point cut on Thursday.

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