



Fall in Eurozone Inflation Won't Hasten Rate Easing

Eurozone inflation dropped to 3.0% (y-on-y) in May, easing back from the 3.4% eight year high that it reached in May and reversing the rising trend seen since February. On a month-on-month basis consumer prices rose by 0.1%. The data showed an easing in energy price rises, which have pushed up inflation in recent months. The rise in the energy component dipped to 5.5% from May's 8.6%. Despite the dip in the headline rate, it still is one full percentage point above the ECB's 2.0% preferred ceiling. Also, the closely watched core or underlying inflation rate (excludes energy, food, alcohol and tobacco) was unchanged at 2.1%.

Eurozone CPI <i>Year-on-Year % Change</i>	Weight (%)	Jun '01	May '01	April '01	Mar '01
All Items	100	3.0	3.4	2.9	2.6
- ex energy	90.5	2.8	2.8	2.5	2.3
- ex food/engy/tobacco	70.2	2.1	2.1	1.9	1.8
- energy	9.5	5.5	8.6	7.8	5.6
- food	16.3	6.0	5.9	4.8	4.4
- alcohol/tobacco	4.0	3.0	2.9	2.9	2.4
- transport	15.6	2.0	3.9	3.0	1.8

The numbers have not changed our view that the ECB will leave interest rates on hold until after its summer recess which begin after the meeting on 2 August. The ECB's 2.0% goal is unlikely to be reached this year and according to Duisenberg will "only just" be reached sometime in 2002 if rates remain at their current levels. At the ECB's last press conference Duisenberg signaled that, not only are rates at an appropriate level, but that he expects them to remain there for some time to come. The fact that the core inflation rate remained above 2.0% in June will have been a disappointment to the ECB. Monetary easing is unlikely to resume until a clear downtrend emerges in inflation, despite the pronounced weakening in the pace of economic activity.

Further deceleration in the headline rate is unlikely until September in the absence of an unwinding of the increases in food and energy prices year to date. By the fall, though, the HICP rate should have fallen to around 2.5%. However, it looks like it will be 2002 before inflation falls below the ECB's 2% ceiling level. ECB officials have put the emphasis on the need to dampen down inflation in their recent statements suggesting that a rate cut is unlikely over the summer. By the autumn, though, the expected fall in the HICP rate to around 2.5% should create the scope for a 0.25% rate cut. A further reduction in interest rates may occur at around end year if, as is expected, inflation still looks set to fall to under 2% in 2002.

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