Economic Research

Economic Insight

Euro area – “supply chain effect” on inflation diminishes

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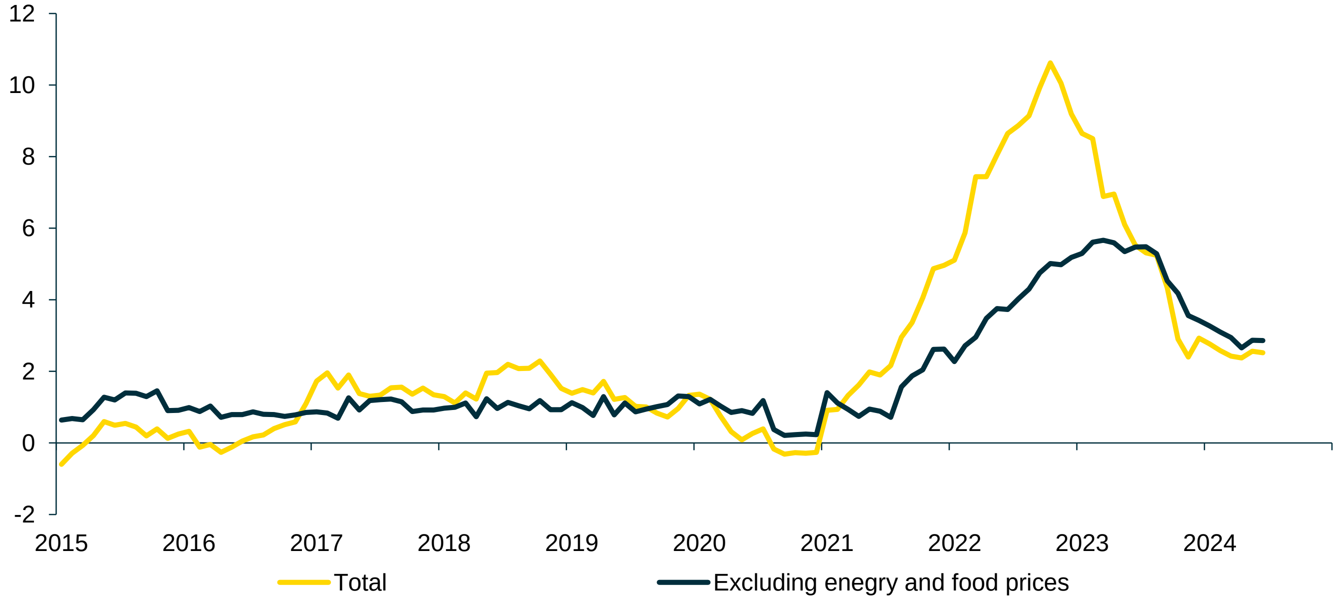
Table of contents

The core inflation rate in the euro area has stabilized at just under 3% in recent months. While the inflation rate for services has probably trended slightly upwards due to the sharp rise in wage costs, the inflation rate for goods has fallen until recently. The main reason for the latter is that the supply bottlenecks have eased and the price-increasing effect of higher energy prices has also weakened noticeably. However, the trend of producer prices in recent months suggests that this effect is gradually coming to an end and that the lowest point in the inflation rate for goods is not far off, especially as wage costs are also rising significantly for goods producers. This suggests that the core inflation rate will stabilize well above the ECB's 2% target in the coming months.

Will the inflation rate in the euro area fall back to 2% (or below) permanently by the end of next year or will it stabilize above the ECB's inflation target? For a long time, there were several arguments for the first scenario. This is because the inflation rate fell significantly throughout 2023. This was partly due to falling energy prices and much weaker increases in food prices. But even if these two often very volatile sub-components were factored out, the core inflation rate was clearly pointing downwards (Chart 1). Recently, however, both rates have stabilized.

Chart 1 - Will the downward trend in the inflation rate soon come to an end?
Harmonized Index of Consumer Prices (HCPI), year-on-year change in percent

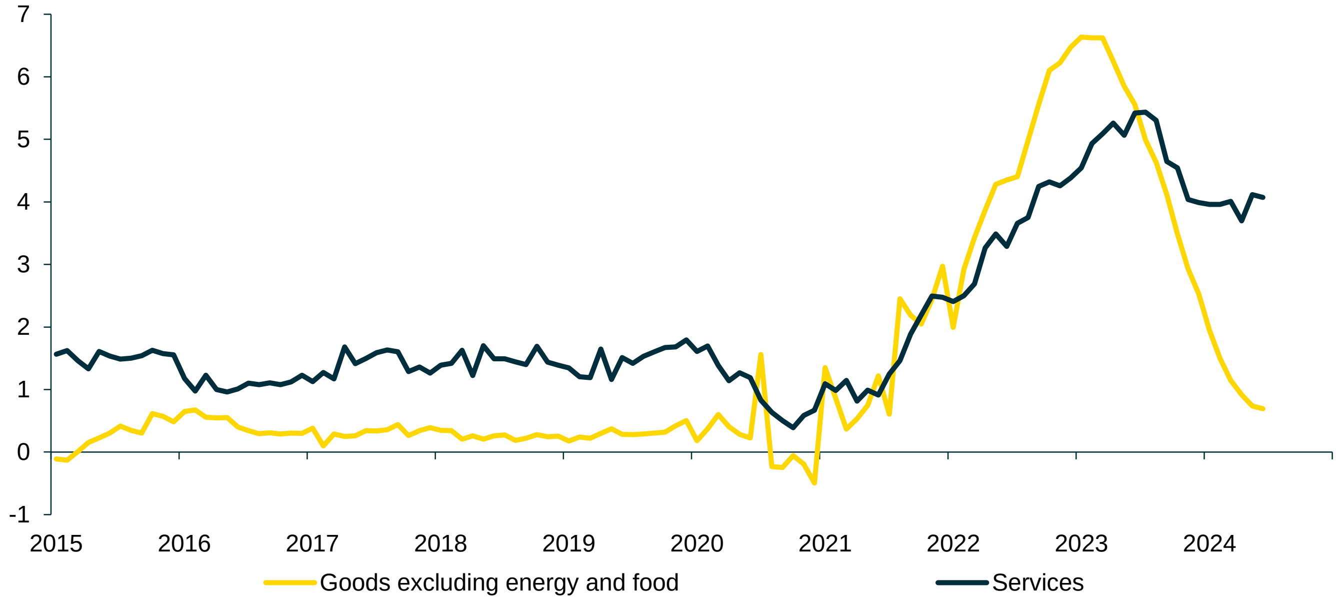


Source: Eurostat, S&P Global, Commerzbank Research

Lower inflation for goods depresses the core rate

A look at the details shows that inflation rates have developed very differently in the two major sub-groups of the core inflation rate, i.e. services and goods prices excluding energy and food. While the year-on-year rate for services has stabilized at around 4% since last autumn, the rate for goods has fallen until recently, although the decline has slowed noticeably as of late (Chart 2).

Chart 2 - Inflation for services remains stable, for goods still declining
Subcomponents of the harmonized index of consumer prices for the eurozone (HICP), year-on-year change in percent



Source: Eurostat, S&P Global, Commerzbank-Research

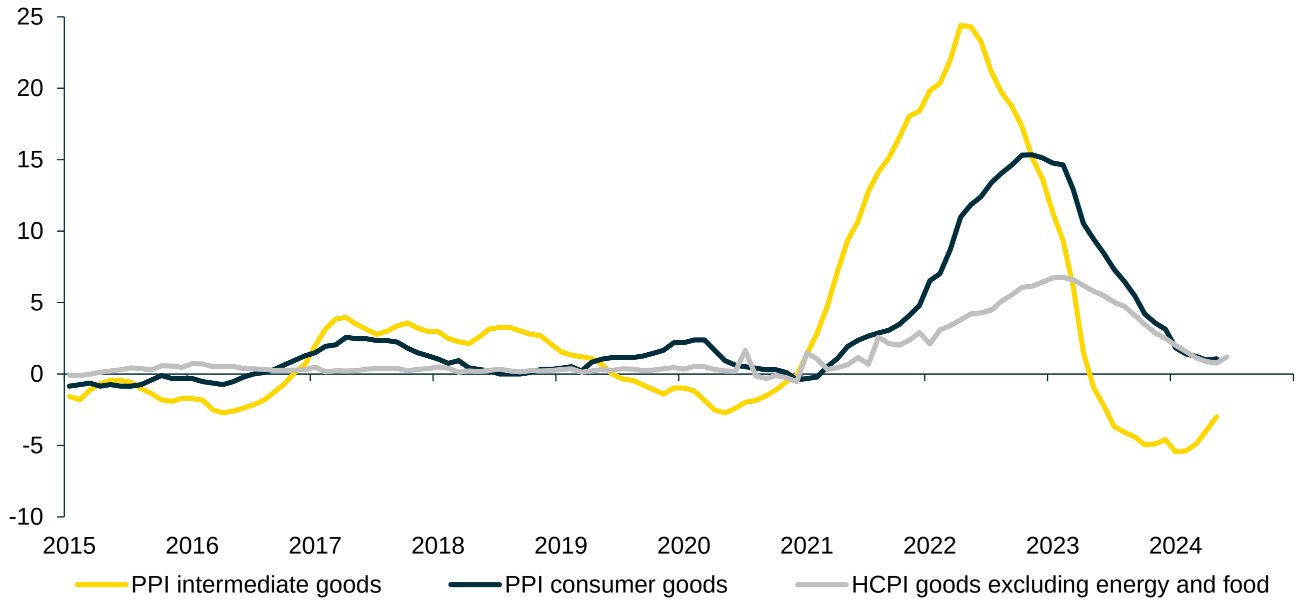
Eurostat, S&P Global, Commerzbank-Research

Goods prices driven by supply bottlenecks and more expensive energy, ...

However, there are some indications that the inflation rate for goods will at least stabilize in the coming months. The pronounced ups and downs in the inflation rate for goods prices observed over the past three years were primarily due to the supply bottlenecks that occurred during the pandemic and the significantly higher prices for energy and raw materials. These initially drove up producer prices for intermediate goods and then consumer goods, before prices for final consumers also increased (Chart 3). This sequence was also observed when these effects subsided: First, the year-on-year comparison peaked for producer prices of intermediate goods, then for producer prices of consumer goods and finally for consumer prices of goods, and then fell significantly for all three groups.

Chart 3 - "Supply chain effect" comes to an end

Subcomponents of the producer price index for industrial goods (PPI) and the harmonized consumer price index (HCPI), year-on-year change in percent



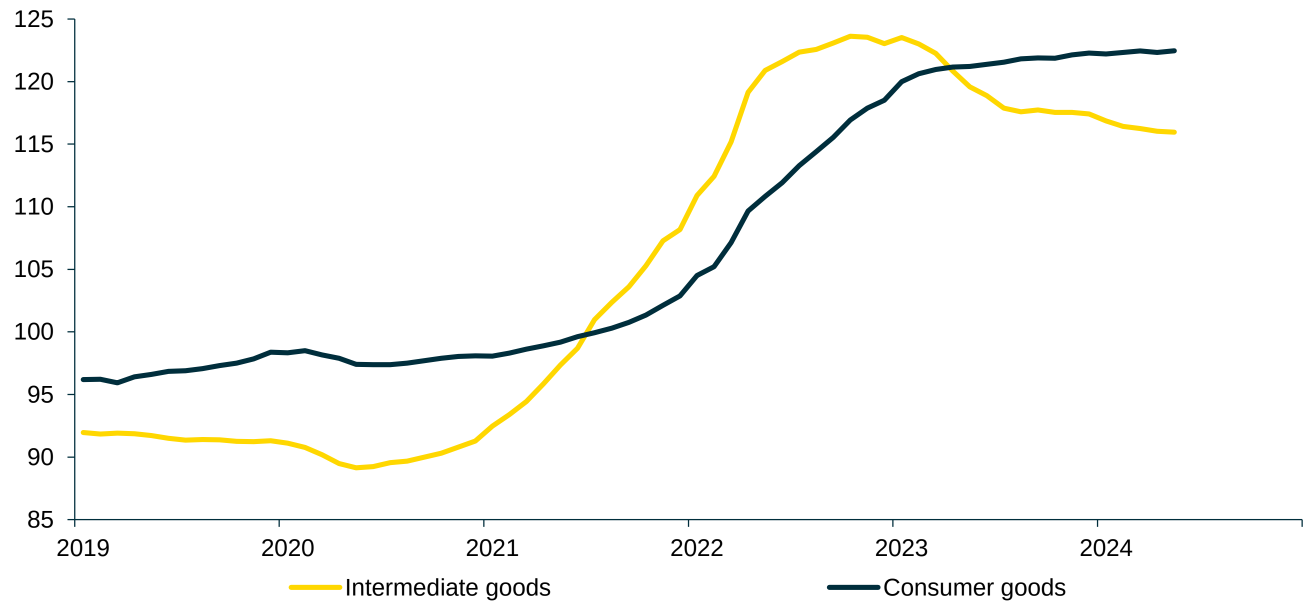
Source: Eurostat, S&P Global, Commerzbank-Research

... and these effects seem to be coming to an end

It appears that these effects, which first boosted inflation and then reduced it, have now largely run their course. For example, the year-on-year comparison for intermediate goods appears to have bottomed out. Prices for intermediate goods are still lower than a year ago. However, a look at the (seasonally adjusted) levels shows that they are barely falling on a monthly basis. Producer prices for consumer goods have even been rising slightly again for some months now (Chart 4).

Chart 4 - PPIs for consumer goods remain stable

Subcomponents of the producer price index, seasonally adjusted monthly values, 2015=100



Source: Eurostat, S&P Global, Commerzbank-Research

Higher wage costs should also cause goods prices to rise

This means that there should at least no longer be any downward pressure on goods prices in the consumer price index stemming from the price of intermediate goods. In contrast, the higher wage costs of companies are likely to have an impact on the prices of goods, even if their provision is not as labor-intensive as that of services. For this reason, the inflation rate for goods is unlikely to fall substantially in the coming months and is more likely to rise again later this year.

In view of the recent sharp rise in wage costs, inflation in services is also unlikely to slow down in the coming months. Looking at the trend over the last three or six months, service prices have even risen noticeably recently.

This means that the core inflation rate is also unlikely to fall any further in the coming months. Instead, it is likely to remain at just under 3% by the end of this year, which would be well above the ECB's target of 2% and limit the scope for interest rate cuts by the ECB.

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