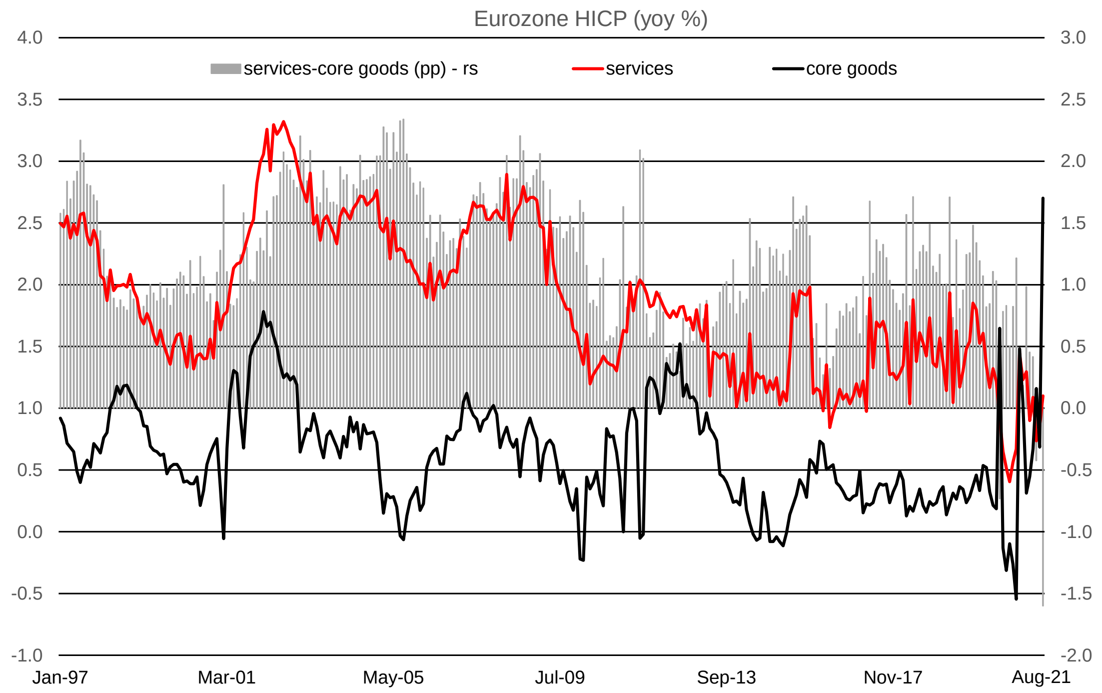
# Eurozone inflation will rise further, but monetary policy should look through this




Source: Eurostat, UniCredit Research

- The August flash estimate of eurozone inflation published on Tuesday surprised to the upside, showing a sizeable acceleration in the headline rate to 3.0% yoy from 2.2%. This is its highest level since late 2011. Core inflation rose strongly, to 1.6% yoy from 0.7%, explaining most of the jump in headline inflation. Our *Chart of the Week* breaks down core inflation into its two main components: services and core goods. It shows that the August acceleration was almost totally driven by a huge spike in the prices of goods. The gap between services and goods inflation, which had always been positive in the two and a half decades before the pandemic, has turned negative by an unprecedented 1.6pp (services: 1.1%, core goods: 2.7%).
- Several temporary factors explain this unusual pattern. First, goods inflation was artificially inflated by the late start last year of summer sales on apparel in France and Italy, among other eurozone member states. This is a purely statistical effect, which reversed weakness recorded in the yearly change in apparel prices for July and which should fade over the next one or two months. Second, it is highly likely that manufacturers have continued to pass on some of the cost increases caused by supply bottlenecks and rising commodity prices. To the extent that higher production costs largely reflect the global ramifications of the pandemic, this should also be considered as a temporary factor, although available indicators suggest that its effects will last longer than expected, most probably into 2022. Third, services inflation was dampened during the summer months by lower weights (compared to 2020) for travel, leisure and hospitality expenses in the HICP basket. This explains why the reopening of several tertiary activities and a rebound in demand have been accompanied by weak services inflation until now. This effect will likely reverse in the fall, when these price categories typically record large seasonal price declines. We expect services inflation to rise more meaningfully over the coming months.

- Overall, transient factors have played a key role in driving inflation in the euro area, and we expect they will continue to do so at least until the end of the year. These factors also include a 15.4% yoy increase in energy prices (which alone accounted for half of the headline inflation rate in August) and changes in Germany's VAT rate. We expect that headline and core inflation will rise further in the coming months, before probably peaking in November. A clear slowdown is likely to start at the beginning of 2022, helped by the fading of the VAT effect in Germany, and to continue in subsequent months. This deceleration might push headline inflation back below 1.5% in about a year's time, amid a strong base effect on energy prices. Monetary policy should remain patient and persistent.

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