

CHART OF THE WEEK

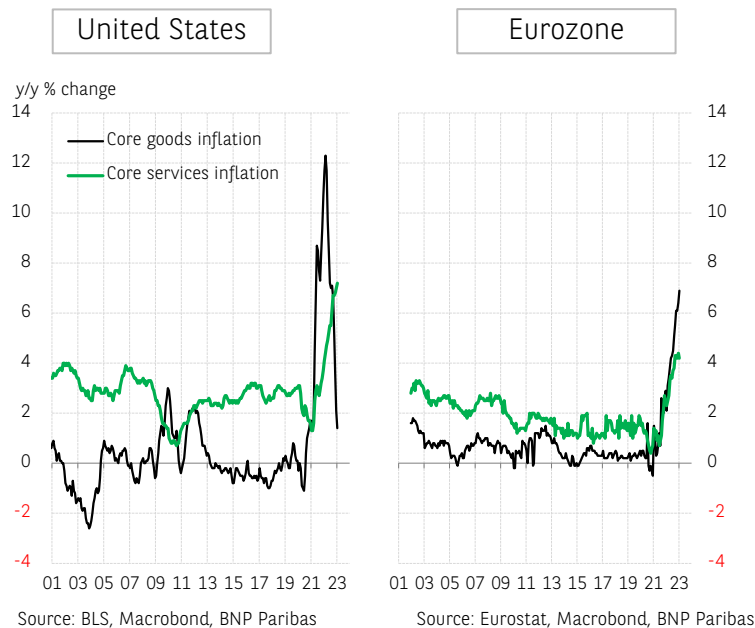
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15 February 2023

DISINFLATION: IT IS A MATTER OF SCALE

Hélène Baudchon

United States vs Eurozone: core goods and services inflation



According to Jerome Powell, Chairman of the US Federal Reserve (Fed), the process of disinflation has begun in the US. In January 2023, US inflation (measured by the CPI) fell for the seventh month in a row, dropping 2.7 percentage points since its peak of 9.1% in June 2022 (year-on-year). Core inflation has also been on a downward trend, but to a lesser extent (-1 percentage point since its later peak of 6.6% in September 2022). In the euro area, the disinflation process is not yet fully underway. While headline inflation seems to have passed its peak - it has been falling for three months and has lost 2.1 points - this is not the case for core inflation, which was stable at 5.2% in January 2023 according to Eurostat's preliminary estimate.

More than the number of months of falling inflation, it is the extent of the disinflation and its broad-based (or not) character that matters. However, it is enough to look at the evolution of the two main items of core inflation (goods and services prices) to see that the current disinflation in the United States relies on a very narrow base. Indeed, only goods prices are decelerating, albeit very sharply, but they weigh less heavily in the CPI (21%) than services prices (58%), which continue to accelerate. In the euro area, neither metric is falling yet.

While goods disinflation is expected to increase, or even turn into deflation in the coming months, services inflation is expected to show more inertia (due in particular to the shelter component), slowing the overall decline in inflation. It is only when services inflation falls sharply, or at least shows convincing signs of doing so (provided that the other components of the CPI (goods, energy and food) do not resume their upward momentum, which cannot be ruled out), that we can consider that victory against inflation is close at hand. This is not the case at the moment and it will not be for several months. The Fed and the ECB will stop raising their policy rates when they anticipate this moment with sufficient conviction.

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