EcoFlash

February inflation: sharp drop expected in France, stability in the rest of the Eurozone

Inflation has probably eased in February, particularly in France due to the marked cut in the regulated electricity price. However, this overall movement masks divergent trends. Although disinflation is becoming more widespread (two-thirds of the components in Insee's index show inflation below 2% y/y in January in France), prices continue to rise rapidly in services, in France as well as elsewhere in the Eurozone. In the short term, a return of energy price inflation is possible in the Eurozone, but this is likely to be short-lived. The ECB is likely to continue to cut rates at its 6 March meeting, but the persistence of core inflation (below but close to 3% y/y) could change the pace of cuts thereafter.

1. French inflation likely to be around 1.1% year-on-year in February on the harmonised index (1% on the Insee figure). The big cut in the regulated electricity price (down 15% on average in February 2025, compared to a 10% hike in February 2024) will explain the whole of this marked fall in inflation (from 1.8% y/y in January on the harmonised index and 1.7% on the Insee figure). This will take inflation back to a level not seen since February 2021. Although the core inflation will still be at 2% in January (harmonised, against 1.4% for Insee), disinflation is becoming increasingly widespread. Prices for nearly two-thirds of the components in the Insee index rose by less than 2% y/y (prices for accommodation, hotels and restaurants, alcohol and tobacco continued to rise by over 2%), compared to half of the components in October 2024.

2. Eurozone inflation trending towards the 2% target. Inflation is likely to ease in Germany in February (-0.1 of a point to 2.7%), but will increase in Spain (up 0.3 of a point to 3%) and Italy (up 0.1 of a point to 1.8%). Overall Eurozone inflation for February is likely to be similar to its January level of 2.5% y/y. From now until the summer, energy prices and those for food and industrial goods are likely to put upward pressure on inflation, but a fall in services inflation, even limited, would allow core Eurozone inflation to fall in the spring and headline inflation to stabilise at around the 2% target.

3. … but upside risks are emerging. In the short term, the recent increase in the cost of energy, including gas (but more generally an increase in energy production prices in the Eurozone of 9% between September and December), is also creating some inflationary pressures in the manufacturing sector, particularly in Germany and Spain. However, these factors look set to dissipate. They were linked to winter weather conditions and we expect the fall in the TTF (€46/MWh on 25 February, from a peak of €59) to firm up. However, service sector inflation is likely to persist throughout 2025, in France as well as the rest of the Eurozone. The latest PMI survey suggests that pressure on input prices has continued to increase in this sector during February.

4. Monetary policy: towards a pause? Recent statements from Isabel Schnabel[1] and the Governor of the Bank of Belgium, Pierre Wunsch, arguing for greater caution in monetary easing, can be justified on a number of counts. In addition to PMI surveys, median household expectations of inflation (published by the ECB) reached 2.8% in December 2024, the highest level since last July. The policy rate is no longer very far from the upper bound of the neutral rate that the ECB estimates is between 1.75% and 2.25% (our estimate is 1.5% to 2.5%). On top of this there are external factors, such as the potential inflationary effects of protectionist measures from the US. **We are still expecting the ECB to make three further consecutive 25bp cuts to its policy rates. Although a cut on 6 March seems relatively certain, subsequent moves might be spread over time** with the risks to our scenario seeming, in the short term, more symmetrical than previously.

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[1] See Isabelle Schnabel's interview in the Financial Times (link **here**).