Markit Economic Research

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Eurozone

Falling consumer prices pile further pressure on ECB

- **Consumer prices fall 0.2% on a year ago**
- **First annual fall since 2009**
- **Core inflation rises to 0.8%**

Consumer prices fell compared to a year ago across the euro area in December, adding to pressure on policymakers to combat the threat of deflation and bringing the ECB another step closer to full-scale QE. However, further action is by no means a done deal, as core inflation in fact picked up slightly and policymakers may see lower oil prices as helping fuel an economic recovery in 2015.

Consumer prices fell 0.2% compared to a year ago, according to the flash estimate from Eurostat, representing the first negative inflation print since October 2009. The rate of inflation had stood at 0.3% in November and has been below the European Central Bank's target of "below but close to 2%" for much of the past two years.

The inflation rate is also likely to fall further into negative territory in coming months as lower oil prices feed through to the consumer. Oil has more than halved in price over the past six months, which should reduce the cost of fuel as well as many other items bought by households, for example via lower transport and production costs.

Economy near stagnation

Coming hard on the heels of PMI survey data showing the eurozone continuing to more or less stagnate in December, the fall in prices piles further pressure on the ECB to take more aggressive action to revive the economy. The survey data point to the economy having grown by a mere 0.1% in the fourth quarter, with worrying signs of weakness becoming increasingly apparent in the core as well as several peripheral members.

Markit's Eurozone Retail PMI, released today, meanwhile showed retail sales falling for a sixth successive month in December. The decline sends a disappointing signal about consumer confidence and spending after signs of improvement seen earlier in the year.

Eurozone consumer prices, annual % change

Source: Eurostat via Ecowin.

QE no done deal

Expectations are therefore building that the ECB could announce full-scale quantitative easing, including the purchase of government debt, at its next policy meeting on 22 January. Such expectations have also been fuelled by recent remarks from ECB President Mario Draghi that the risks of the central bank failing to fulfil its mandate of price stability had increased, and hinting that preparations were being stepped up for further action.

However, the buying of government bonds by the ECB is by no means a done deal. In particular, the uncertain outcome of the Greek general election on 25th January may cause the ECB to decide to hold off with any purchases of Greek debt, especially if an elected Syriza party would seek to renegotiate existing bail out terms.

One solution may therefore be for the ECB to just purchase sovereign debt of the highest credit ratings, for the time being at least. Action other than sovereign debt purchases should also not be ruled out, such as the buying of AAA-rated corporate debt.

However, expectations of more aggressive stimulus may be dashed by the recent fall in oil prices, which policymakers may see as likely to have a stimulatory effect on the economy in coming months, as lower energy prices boost the amount of money to be spent on other items, and also raise profits outside of the energy sector. After all, core inflation, excluding volatile items such as energy, alcohol, tobacco and food, in fact rose from 0.7% to 0.8% in December.

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