Flash Economics

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The ECB's monetary policy is likely to be disrupted by the gap between the increases in service prices and those in industrial prices, as well as by the differences in inflation rates across countries

Usually, the ECB responds only to:

- The overall inflation rate (for all goods and services) in the euro zone;
- Average inflation in the euro zone, not that observed in individual countries.

Since inflation in January 2026 is 1.7%, if the ECB maintains this overall euro zone approach to inflation, it could potentially lower its interest rates (currently 2% for the deposit rate).

However, in reality, can the ECB ignore that:

- Inflation excluding food and energy is 2.2%, above 2%;
- Inflation in services is 3.2%;
- In the major euro zone countries, year-on-year inflation (Harmonised Index) ranges from 0.4% in France to 1% in Italy, 2.1% in Germany, and 2.5% in Spain?

The heterogeneity of inflation across various goods and services is likely to prevent a rate cut, given the high level of inflation in services. Conversely, the heterogeneity of inflation across countries could push the ECB to lower interest rates in order to avoid plunging low-inflation countries into deflation.

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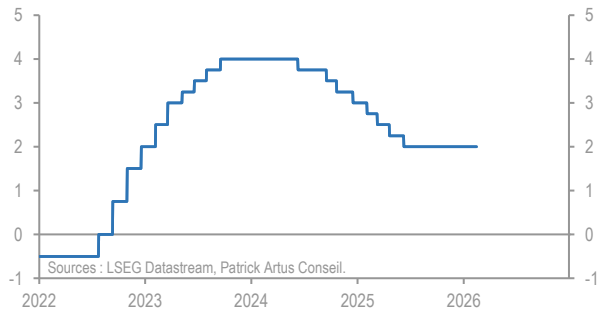
Usually, the ECB only considers average inflation

The **ECB typically bases its monetary policy decisions on overall inflation, calculated across all goods and services** and for all euro zone countries. **Chart 1** shows that this overall inflation is currently 1.7% (January 2026), **which would normally give the ECB some room to lower interest rates** (**Chart 2**).

Chart 1
Euro zone: Inflation (HICP, Y/Y as %)



Chart 2
Euro zone: European Central Bank deposit facility rate (as %)

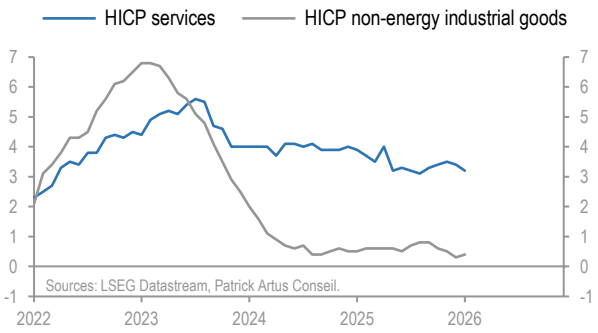


There is significant heterogeneity in price increases across various goods and services

In January 2026, total inflation stood at 1.7%, inflation excluding food and energy was 2.2%, energy prices were falling by 4.2%, industrial goods prices rising by 0.4%, and service prices increasing by 3.2%.

Focusing on inflation excluding food and energy, **the gap between the rise in industrial goods prices and that in services is particularly pronounced** (**Chart 3**).

Chart 3
Euro zone: Consumer price indices of services and non-energy industrial goods (Y/Y as %)



Industrial goods prices are being weighed down by foreign competition, weak activity in the euro zone manufacturing sector (**Chart 4**), and the appreciation of the euro (**Chart 5**).

Chart 4
Euro zone: Manufacturing PMI (index)

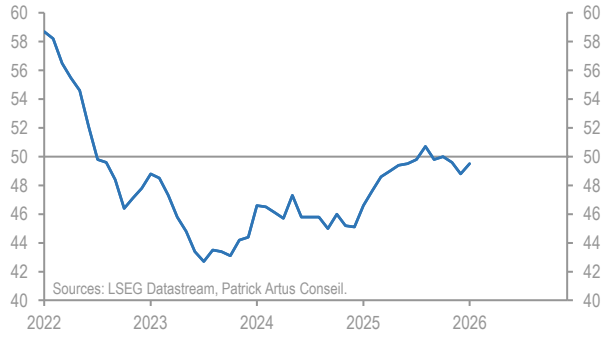
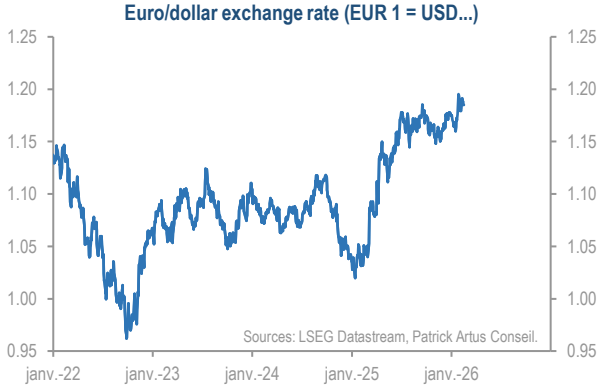


Chart 5
Euro/dollar exchange rate (EUR 1 = USD...)



Service prices are being driven higher by growth in wages per capita (**Chart 6**) and by the absence of productivity gains (**Chart 7**).

Chart 6
Euro zone: Nominal per capita wage (Y/Y as %)

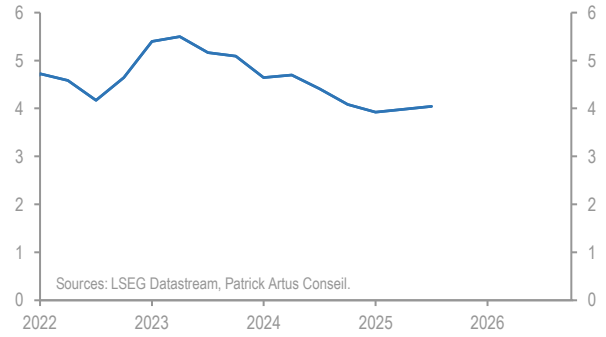
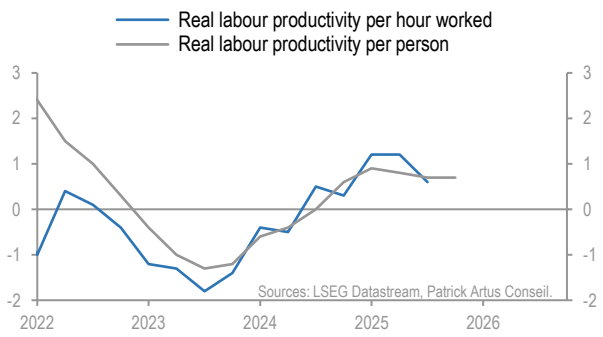


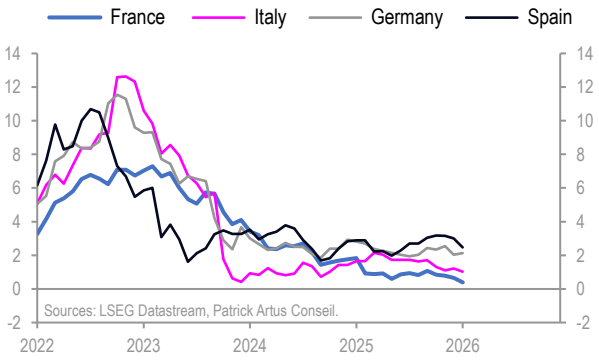
Chart 7
Euro zone: Real labour productivity per hour worked and per person (Y/Y as %)



There is also significant heterogeneity in price increases across major countries

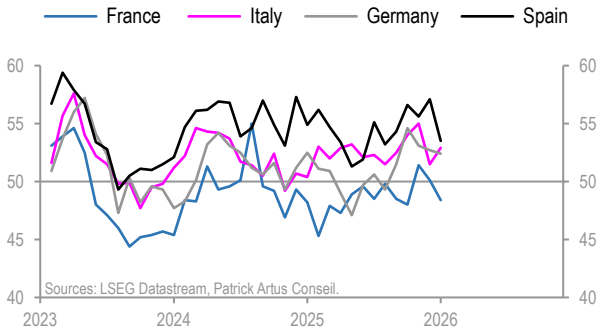
Year-on-year total inflation in January 2026, according to the Harmonised Index of Consumer Prices, ranges from 0.4% in France to 1.0% in Italy, 2.1% in Germany, and 2.5% in Spain (**Chart 8**).

Chart 8
Inflation (HICP, Y/Y as %)



Inflation in France is being held down by weak activity in the services sector (Chart 9).

Chart 9
Services PMI (indices)

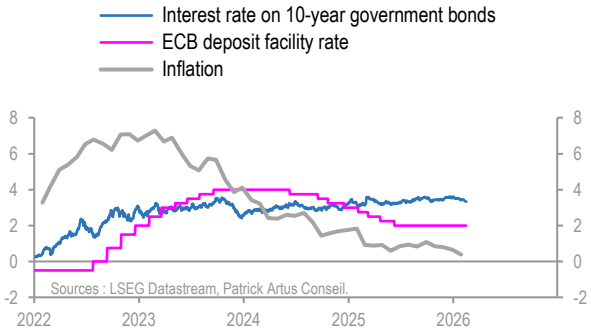


Summary: how could this dual heterogeneity affect monetary policy decisions?

The differences in price increases between goods and services, with services prices rising much faster than those of industrial goods, may lead the ECB to refrain from cutting interest rates, as the increase in services prices mostly match inflation owing to higher wages.

Conversely, differences in inflation across countries could encourage the ECB to lower interest rates in order to prevent low-inflation countries from slipping into deflation due to high real interest rates. Chart 10 illustrates this with the example of France.

Chart 10
France: ECB deposit facility rate, interest rate on 10-year government bonds and inflation (as%)



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