

Eurozone inflation breaches 2% target

August price increases of 2.1% damp hopes for an interest rate cut this year

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Eurozone inflation rose to 2.1 per cent last month — the first time it has gone above the European Central Bank's 2 per cent target since April.

The flash estimate of the annual inflation figure for August was above the 2 per cent forecast by economists in a Reuters poll. By contrast, inflation for June and July was 2 per cent — in line with the ECB's medium-term target.

Diego Iscaro, head of European economics at S&P Global Market intelligence, said the August data was “likely to damp down talk of a December interest rate cut” as “rates are likely to remain on hold for the rest of the year”.

The euro, which was weak ahead of the data release, was little moved, down 0.6 per cent on the day at \$1.164.

Traders in swaps markets kept their bets largely unchanged following the data, continuing to price in a roughly 50-50 chance of a quarter-point rate cut by the ECB's March meeting. There is consensus among economists and traders that the central bank will keep rates on hold at its first meeting after the summer break, on September 11.

Traders have scaled back expectations of further interest rate cuts since the EU struck a trade deal with the US in late July. ECB president Christine Lagarde said at the central bank's last meeting that month that policymakers had entered “wait-and-watch” mode as they kept rates unchanged at 2 per cent.

Policymakers previously halved borrowing costs in eight steps, starting in June 2024. They have recently given different signals about inflation risk.

Finnish central bank governor Olli Rehn told the Financial Times at the weekend that inflation risks were “tipped to the downside”, pointing to “cheaper energy, a stronger euro and contained service inflation”.

But ECB governing council member Isabel Schnabel told Reuters yesterday — ahead of the inflation data release — that “the balance of risk” was “tilted to the upside”.

She argued that trade tariffs were “net inflationary”: “If you have an increase in input prices globally due to tariffs, and these propagate through global production networks, this will increase inflationary pressures everywhere.”

The uptick in Eurozone inflation in August was driven by higher prices for food, alcohol and tobacco, which were 3.2 per cent higher than a year ago.

Core inflation, excluding food, alcohol and tobacco, hovered at 2.3 per cent for the fourth month in a row. Services inflation, a metric closely watched by the ECB, came down to 3.1 per cent, the lowest level since March 2022.

Schnabel had pointed to rising food inflation as one of several areas of concern, at its “highest level since March of last year, partly driven by the occurrence of extreme weather events”. Food prices played a big role in households' perception of inflation, she warned.

“The ECB will be comfortable with the August inflation data,” ABN Amro economists said, adding that while food inflation was “somewhat of a concern, trends elsewhere continue to look more benign, and consistent with inflation modestly undershooting the 2 per cent target as we move into 2026”.