Eurozone inflation eases to 2.6 percent

DAVID McHUGH - AP Business Writer - Associated Press

Europe got more downbeat economic news Monday as inflation remained higher than expected and European Central Bank data showed only anemic growth in credit to businesses — despite its massive infusion of cheap money into the financial system.

Inflation in the 17 countries that use the euro fell to an annual 2.6 percent in April, down from 2.7 percent in March but higher than the 2.5 percent expected by market analysts.

Rising prices have been a consistent headache for the ECB — the chief monetary authority for the 17-country eurozone. The annual rate has remained stuck well above the central bank's goal of just under 2 percent, a target that it now says won't be reached until early 2013.

The stubborn inflation rate — which the ECB blames on higher oil prices and taxes in some countries — is important to the eurozone debt crisis because it discourages the ECB from cutting its 1 percent benchmark interest rate further. Lower central bank interest rates can spur growth, but can also worsen inflation. ECB President Mario Draghi has stressed that fighting price rises is the bank's top priority.

Lack of flexibility on interest rates could become more of an issue as worries increase about the depth of the eurozone's economic downturn. The economy of the 17-country group that uses the euro shrank 0.3 percent in the fourth quarter of last year. Recent economic indicators — such as a disappointing survey of purchasing managers showing lower economic activity — have raised fears the dip may be deeper.

Persistently high inflation adds to those growth worries as it hits European consumers' purchasing power.

"Stubborn inflation will only add to household's financial problems in the nearer term and supports the view that the eurozone economy will fall deeper into recession," Ben May, European economist at Capital Economics in London, wrote in a note to investors.

Additionally, high oil prices are squeezing companies' profits, with oil a key cost factor both in the form of energy and as a raw material. Chemical company BASF SE reported lower earnings last week in part because it was unable to pass on all its raw materials costs to customers.

Analyst Howard Archer at IHS Global Insight said that with inflation "disappointingly sticky" — and in spite of weak forward-looking data putting pressure on Draghi — the ECB appears reluctant to take interest rates lower and would likely not change rates at its meeting Thursday.

The ECB added to the gloom with news that loans to the private sector rose by a meager 0.6 percent in March from the same month a year ago, another sign of weak economic activity.

The ECB has said that its €1 trillion ($1.32 trillion) injection of cheap, 3-year emergency loans to commercial banks in December and February have improved financial institutions access to funding — but that businesses are not asking banks for loans because of shaky economic prospects. Commerzbank analyst Michael Schubert said that the weak demand should reinforce expectations that the ECB for the time being will not resort to further emergency measures such as more longer-term loans to the banks.