

Europe Flash

Eurozone

Madrid, February 28, 2013
Economic Analysis

Europe Unit

Miguel Jiménez González-Anleo
Chief Economist
mjimenezg@bbva.com

Agustín García Serrador
Senior Economist
agustin.garcia@bbva.com

Sonia López Senra
Economist
sonia.lopez.senra@bbva.com

Diego Torres Torres
Economist
diego.torres.torres@bbva.com

Core inflation slowed in January

Inflation is likely to moderate again in February, but at a slower pace

- **HICP inflation declined by 0.2pp to 2% y/y in January, as expected, although the detailed breakdown showed some surprises**

The growth in energy prices declined to 3.9% y/y in January from 5.2% in the previous month, reducing its contribution to annual inflation rate by around 0.1pp to 0.4pp. This moderation in inflation of energy prices was somewhat lower than anticipated (3.2% y/y), partly explained by higher increases of administered prices of both electricity and gas. Inflation in fresh food increased for the second month in a row, by 0.4pp to 4.8% y/y, against our expectation of stabilization. Nonetheless, these upward surprises were completely offset by the moderation in core inflation.

- **Core inflation also slowed by 0.1pp to 1.5%, against our expectation of stabilization**

The decline in core inflation was widespread across components, but was particularly noticeable the moderation in non-energy industrial goods (0.8% y/y from 1% y/y in December; BBVA Research: 1.2% y/y), which can be attributed to a larger discount sales than previously anticipated resulting from the weakness of domestic demand. This was also reflected in a slowing inflation of services by 0.2pp to 1.6% y/y (BBVA Research: 1.7%). Finally, inflation in fresh food remained relatively stable at 2.3% y/y, as expected. As a result, core components also contributed with -0.1pp to the moderation of the annual headline inflation rate in January.

- **Headline inflation is expected to slow again in February to 1.9% y/y**

Eurostat will release tomorrow the flash estimate of HICP inflation for February. Energy inflation is expected to moderate slightly again mainly due to the base effect from the increase in energy prices a year ago, despite the rise in fuel prices observed over last weeks. In addition, we also expect core inflation to have remained broadly stable.

- **Looking forward, inflation is likely to slow further and more rapidly until April, falling below the ECB's target during 1Q13**

Thereafter, inflation could increase slightly again but would hover around 1.6% during the second half of the year. Core inflation is likely to remain more stable, fluctuating around the current rates along this year.

- **The moderation of HICP inflation in January was also widespread across countries, with a particularly sharp decline in Portugal**

Country by country inflation also reflected not only a lower growth of energy prices, but also a moderation in core inflation (in Germany from 1.5% to 1.3%; in France from 1.2% to 1.0%), except in Italy where it increased by 0.1pp to 1.8% y/y, while remained stable in Spain at 2.3% y/y. More surprising were Portugal's figures that

showed a slump in inflation from 2.1% to 0.4% y/y, driven by the strong fall in prices of non-energy industrial goods (-3.9% y/y after -2.6% in December), while inflation of the rest of components moderated again, especially in services (1.7% in January after 3.4% in the previous month), reflecting the sharp contraction of domestic demand.

Table 1

Eurozone. Annual HICP inflation rate

	% y/y		% m/m	
	December 2012	January 2013	December 2012	January 2013
HICP	2.2	2.0	0.4	-1.0
Energy	5.2	3.9	-0.5	1.3
Fresh Food	4.4	4.8	0.7	0.8
Core excluding Fresh Food and Energy	1.6	1.5	0.5	-1.5
Services	1.8	1.6	1.1	-0.5
Non-Energy Industrial Goods	1.0	0.8	-0.3	-3.8
Processed Food	2.4	2.3	0.1	0.3

Source: Eurostat and BBVA Research

Table 2

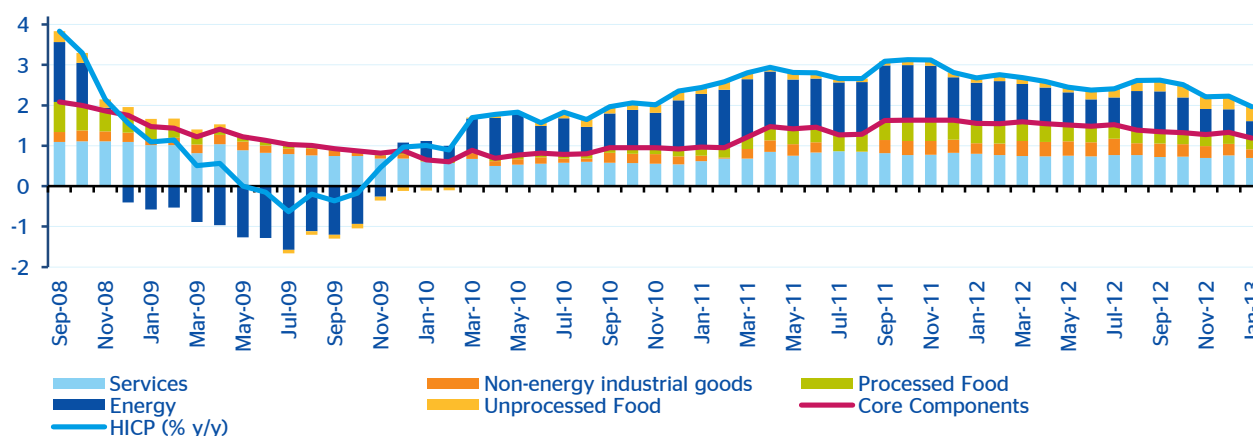
HICP: Forecast evaluation

November 2012	Weight %	Forecast %	Observed %	Confidence Interval Forecast (*)
Headline	100.0	2.0	2.0	(1.8 ; 2.2)
Energy	10.96	3.2	3.9	(2.8 ; 3.7)
Unprocessed food	7.35	4.4	4.8	(3.8 ; 4.9)
Excluding energy and unprocessed food	81.69	1.7	1.5	(1.5 ; 1.8)
Services	42.30	1.7	1.6	(1.6 ; 1.9)
Non-energy industrial goods	27.36	1.2	0.8	(1.0 ; 1.4)
Processed food	12.03	2.4	2.3	(2.3 ; 2.5)

(*) 80% confidence

Source: Eurostat and BBVA Research

Chart 1

Eurozone. Annual HICP inflation rate. Contribution by component


Source: Eurostat and BBVA Research

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances; investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.