

Europe Flash

Eurozone

Madrid, October 16, 2013
Economic Analysis

Europe Unit

Miguel Jiménez González-Anleo

Chief Economist

mjimenezg@bbva.com

Agustín García Serrador

Senior Economist

agustin.garcia@bbva.com

Francisco José Ortega Castaño

franciscojose.ortega.castaño@bbva.com

Diego Torres Torres

diego.torres.torres@bbva.com

Massimo Trento

massimo.trento@bbva.com

Energy and food prices lowered headline and core inflation in September

Inflation is projected to hover around 1.3% y/y over next year

- **Eurozone headline and core inflation slowed by 0.2pp and 0.1pp to 1.1% y/y and 1.2% y/y in September, respectively**

Underlying this month's decline were mainly falling energy prices (-0.9% y/y after -0.3% y/y in August), as expected, but also the slowing inflation in unprocessed food (2.9% y/y from 4.4% y/y), much more than expected. This could be reflecting the reversion in food prices after the sharp increase observed by mid-year due to temporary factors. Overall, these two components equally explained the reduction of 0.2pp in headline inflation. Regarding core components, inflation in both services (1.4% y/y) and in non-energy industrial goods (0.4% y/y) remained broadly stable, while the prices of processed food grew at a moderate pace (2.4% y/y after 2.5% y/y). As a result, core inflation declined by less than a tenth to 1.2% from 1.3% y/y by rounding effects (see tables and graph below).

- **Headline inflation is likely to decline further in October, rising again later this year to around 1.2% y/y in December**

We expect inflation to slow again in October by 0.2pp to 0.9% y/y, somewhat lower than projected last month mainly due to a larger drop in energy prices (in line with recent gasoline prices information) as well as a more moderate growth in prices of unprocessed food. We continue to see inflation increasing slightly by year-end to 1.2% y/y in December (1.4% y/y expected last month), partly reflecting a lower base effect of energy prices. In contrast, we continue to expect core inflation to remain broadly stable at 1.2% y/y over the last quarter, being this performance widespread across its components. Overall, this month's negative surprises in more volatile components could pose some downside risks to our forecast for headline inflation for both 2013 and 2014, implying an annual average inflation of around 0.1pp lower to 1.4% and 1.3%, respectively. Regarding core inflation, it is likely to average 1.3% in both years.

- **Across countries, HICP inflation remained stable in Germany and France, but slowed in Italy and, especially, Spain**

Country by country, both headline and core inflation remained broadly stable in Germany (1.6% y/y and 1.5% y/y, respectively) and France (1.0% y/y and 0.9% y/y), reflecting mainly the lower energy dependence as well as lower weight in the overall index. However, headline inflation declined by 0.3pp to 0.9% y/y in Italy, while core inflation remained broadly stable at 1.3% y/y. Finally, both headline (0.5% y/y from 1.6% y/y) and core (0.9% y/y from 1.7% y/y) inflation slowed sharply in Spain driven by the fading of the base effect of VAT hike last year.

Table 1

Eurozone. HICP inflation rate

| | % y/y | | % m/m | |
|--------------------------------------|-------------|----------------|-------------|----------------|
| | August 2013 | September 2013 | August 2013 | September 2013 |
| HICP | 1.3 | 1.1 | 0.1 | 0.5 |
| Energy | -0.3 | -0.9 | 0.5 | 0.5 |
| Fresh Food | 4.4 | 2.9 | -0.9 | -1.1 |
| Core excluding Fresh Food and Energy | 1.3 | 1.2 | 0.1 | 0.6 |
| Services | 1.4 | 1.4 | 0.3 | -0.9 |
| Non-Energy Industrial Goods | 0.4 | 0.4 | 0.0 | 3.4 |
| Processed Food | 2.5 | 2.4 | 0.1 | 0.0 |

Source: Eurostat and BBVA Research

Table 2

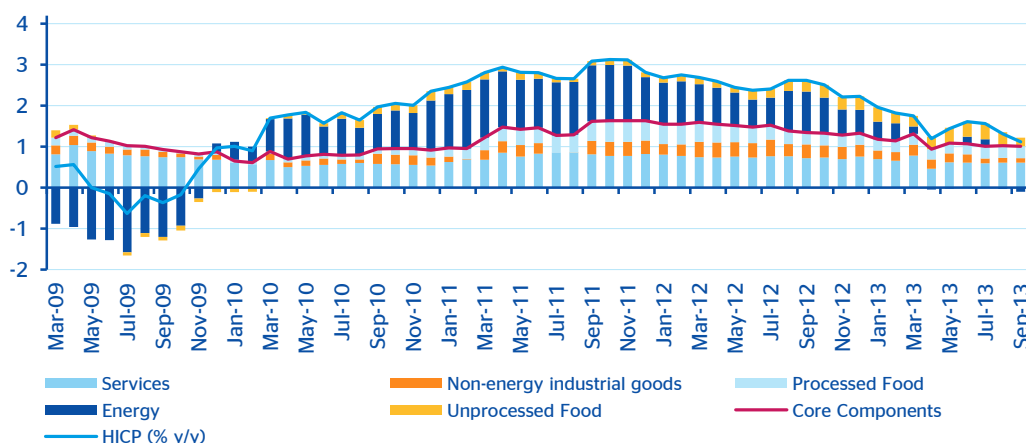
Annual HICP inflation rate: forecast evaluation

| September 2013 | Weight % | Forecast % | Observed % | Confidence Interval Forecast (*) |
|---------------------------------------|----------|------------|------------|----------------------------------|
| Headline | 100.0 | 1.2 | 1.1 | (1.0 ; 1.4) |
| Energy | 10.96 | -1.1 | -0.9 | (-1.6 ; -0.7) |
| Unprocessed food | 7.35 | 4.0 | 2.9 | (3.5 ; 4.6) |
| Excluding energy and unprocessed food | 81.69 | 1.3 | 1.2 | (1.1 ; 1.5) |
| Services | 42.30 | 1.5 | 1.4 | (1.4 ; 1.7) |
| Non-energy industrial goods | 27.36 | 0.5 | 0.4 | (0.3 ; 0.7) |
| Processed food | 12.03 | 2.4 | 2.4 | (2.3 ; 2.6) |

(*) 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 has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.