

Europe Flash

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Economic Analysis

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EZ: final February inflation revised downwards and more in line with forecasts

The unexpected increase in core inflation was not enough to offset lower energy prices and, above all, moderation in food prices

- **The preliminary headline inflation estimate was revised downwards by 0.1pp to 0.7% YoY in February, but core increased by 0.2pp to 1.1% YoY**

Eurostat has revised downwards by 0.1pp the eurozone flash inflation estimate in February, by reducing it to 0.7% YoY from 0.8% YoY in January, more in line with our initial forecast of a slight slowdown. Price variations in the more volatile components were the main factor behind this reduction, together with easier energy prices and moderating inflation on fresh food. This was not fully offset by the positive surprise of core inflation rising by 0.1pp to 1.1% YoY, driven by the rebound in prices of non-energy industrial goods and services (see Figures 1 and 2). However, the VAT hike for final prices in France seems to have been behind this increase in core inflation, as well as the disappearance of the impact of a more aggressive sales season at the beginning of the year.

- **Across countries, the moderation in inflation was widespread, except in France, although core remained stable**

Inflation eased around 0.2pp in Germany (1% YoY), Italy (0.4% YoY) and Spain (0.1% YoY), mainly reflecting the sharp drop in prices of energy (both because of the fall in oil prices vs. a year ago – 6.6% YoY – and the 2.2% YoY appreciation of the euro), but also the moderation in food inflation. However, the stability of core inflation was widespread in these three countries (1.4%, 1% and 0.1% YoY, respectively). The exception to this price behaviour was France, where headline inflation rose by 0.3pp to 1.1% YoY and core 0.6pp to 1.4% YoY, mainly due to the VAT increase in January, while the fall in energy prices was much more moderate, given France's particular energy structure.

- **Inflation will ease again in March and increase slightly for the rest of the year**

Our forecasts continue to indicate inflation falling a little in March (around 0.1pp to 0.6% YoY) because of the calendar effect of the Easter holidays, although partly offset by lower energy prices. In the next few months, inflation should rebound in the second quarter, by around 0.3pp to about 0.9% YoY, and remain relatively stable until the last quarter of the year, when it could return to levels above 1% YoY.

The surprise to the upside in February offset in part the surprises to the downside of previous months, since core inflation was more resilient than expected. This could help to dispel fears about the intensity and nature of the disinflationary process and its possible negative effect on inflationary expectations. We still think it unlikely that disinflation will continue beyond March, and that a scenario of low and stable inflation rates around 0.9% YoY is more likely, given that internal demand recovery is taking hold. These are the values we have seen for inflation, excluding the impact of higher taxes on prices since 2Q13. Nevertheless, we continue to see downside risks, particularly deriving from the euro's strength, while differences between countries will continue, with very low rates of inflation in the periphery and moderate rates in central European countries.

Table 1
Eurozone. Annual changes (HICP, %)

	% YoY		% MoM	
	January 2014	February 2014	January 2014	February 2014
HICP	0.8	0.7	-1.1	0.3
Energy	-1.2	-2.3	0.0	0.1
Fresh food	1.3	0.9	0.6	-0.5
Excluding energy and unprocessed food	1.0	1.1	-1.4	0.4
Services	1.2	1.3	-0.4	0.5
Non-energy industrial goods	0.2	0.4	-3.9	0.4
Processed food	2.0	1.8	0.3	0.1

Source: Eurostat and BBVA Research

Table 2
Annual inflation rate (HICP, % YoY): forecast errors

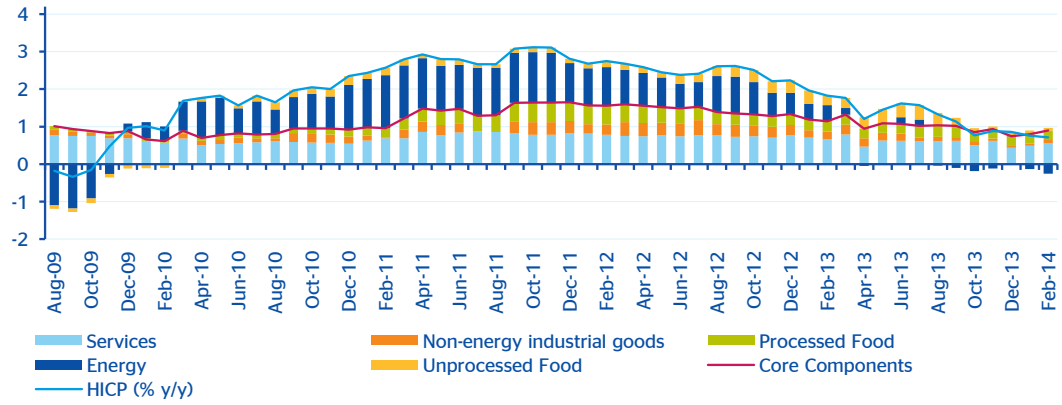
February 2014	Weight %	Forecast %	Observed %	Confidence interval forecast (*)
Headline	100.0	0.6	0.7	(0.5 ; 0.8)
Energy	10.80	-2.4	-2.3	(-2.8 ; -1.9)
Fresh food	7.48	2.4	0.9	(1.8 ; 2.9)
Excluding energy and unprocessed food	81.73	0.9	1.1	(0.7 ; 1.1)
Services	42.81	1.1	1.3	(1.0 ; 1.3)
Non-energy industrial goods	26.67	0.0	0.4	(-0.3 ; 0.2)
Processed food	12.25	2.0	1.8	(1.8 ; 2.1)

(*) 80% confidence.

Source: Eurostat and BBVA Research

Chart 1

Eurozone. Annual HICP inflation rate. Contribution by component



Source: Eurostat and BBVA Research

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