

Europe Flash

Eurozone

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Economic Analysis

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EZ inflation to decline further over the first quarter

December inflation confirmed at 0.8%, dragged down by technical changes in German inflation

- **Both headline and core inflation declined in December, by 0.2pp to 0.8% y/y and 0.9% y/y, respectively**

Underlying this month's decline was mainly the slowing inflation in services (1% y/y after 1.4% y/y in November; BBVA Research: 1.5% y/y) and this explains basically all the downward surprise to our forecast (around 0.2pp). This performance of service prices reflects the changes in seasonality in holiday packages and hotels in Germany, resulting in a sharp decline in German service inflation of 1.3pp to 1% y/y, while the moderation in growth of service prices was much more moderate in other countries (around 0.1pp/0.2pp). Regarding the rest of core components, inflation of non-energy industrial goods increased slightly by 0.1pp to 0.3% y/y, while processed food remained stable, in line with expectations (Table 2). As a result, core inflation slowed by 0.2pp to 0.9% y/y (BBVA Research: 1.1% y/y). Finally, energy inflation remained flat, while inflation in unprocessed food accelerated again (Chart 1).

- **Across countries, inflation slowed sharply due to technical reasons in Germany and remained broadly stable in other countries**

As stressed above, the reduction in the eurozone inflation was mainly due to the sharp decline in German figures (1.2% y/y after 1.6% y/y in November) stemming from service prices. Inflation remained broadly stable in other countries (0.8% y/y in France, 0.7% in Italy and 0.3% y/y in Spain), though the slight reduction in core inflation was also widespread across countries (around 0.2pp to 0.8% y/y in France, 0.9% y/y in Italy and 0.2% y/y in Spain), partly offset by higher prices in both energy and food products.

- **The significant moderation in inflation over 2013 was mainly due to lower energy prices**

All in all, the eurozone HICP inflation averaged 1.4% in 2013 as a whole, slowing from 2.5% in previous years due mainly to lower growth in energy prices, as they explained around 0.8pp of this slowing, while lower core prices growth took the remaining 0.3pp. This performance was widespread across countries. Core inflation remained relatively stable during the first three quarters of the year, but slowed slightly by year-end, especially in the periphery due to fading temporary effects (tax hikes) (Chart 2).

• **Inflation is projected to slow down slightly over 1Q14**

We expect inflation to decline slightly over the first quarter (to rates around 0.7% y/y), partly reflecting a lower base effect from energy prices, not only the moderation in oil prices but the strength of the euro. In addition, we see a more volatile performance of core inflation in coming months resulting from methodological changes, though on average we expect it to remain relatively stable. Still, we think that the slow but positive growth numbers expected for coming months imply that a strong disinflationary process is unlikely to last, with inflation rates below 1% y/y in coming months but then recovering gradually.

Table 1
Eurozone. HICP inflation rate

	% y/y		% m/m	
	November 2013	December 2013	November 2013	December 2013
HICP	0.9	0.8	-0.1	0.3
Energy	-1.1	0.0	-0.8	0.6
Fresh Food	0.9	1.5	0.1	1.3
Core excl. Fresh Food and Energy	1.1	0.9	0.0	0.2
Services	1.4	1.0	-0.1	0.6
Non-Energy Industrial Goods	0.2	0.3	0.1	-0.3
Processed Food	2.0	2.0	0.1	0.0

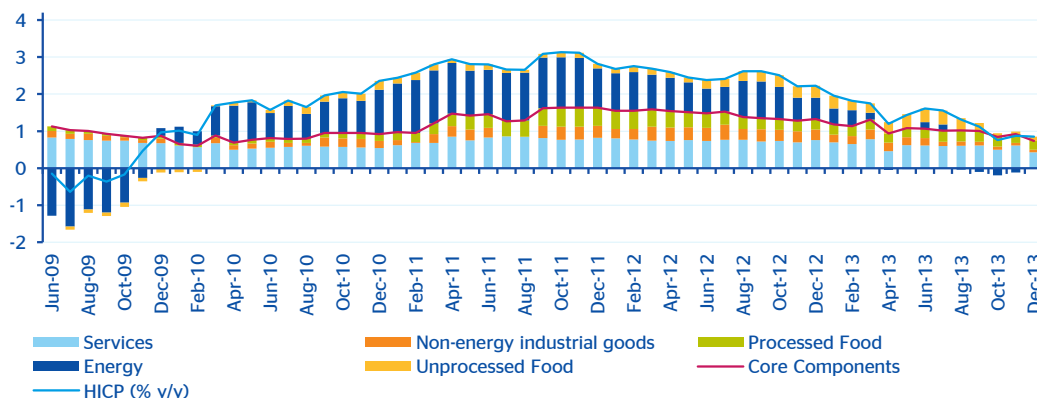
Source: Eurostat and BBVA Research

Table 2
Annual HICP inflation rate: forecast evaluation

December 2013	Weight %	Forecast %	Observed %	Confidence Interval Forecast (*)
Headline	100.0	1.0	0.8	(0.8 ; 1.2)
Energy	10.96	0.0	0.0	(-0.4 ; 0.5)
Unprocessed food	7.35	0.6	1.5	(0.1 ; 1.2)
Excluding energy and unprocessed food	81.69	1.1	0.9	(1.0 ; 1.3)
Services	42.30	1.5	1.0	(1.4 ; 1.6)
Non-energy industrial goods	27.36	0.3	0.3	(0.0 ; 0.5)
Processed food	12.03	2.0	2.0	(1.8 ; 2.1)

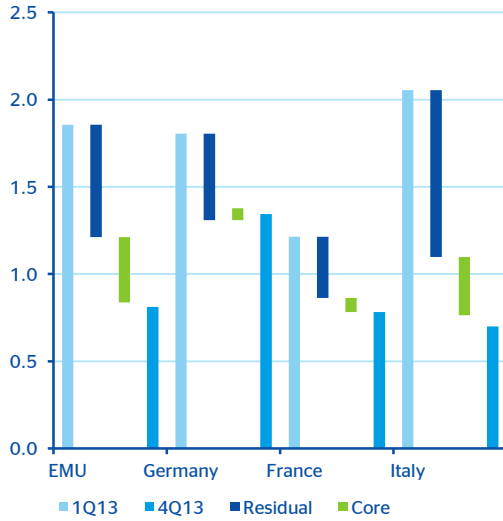
(*) 80% confidence.
Source: Eurostat and BBVA Research

Chart 1
Eurozone. Annual HICP inflation rate. Contribution by component



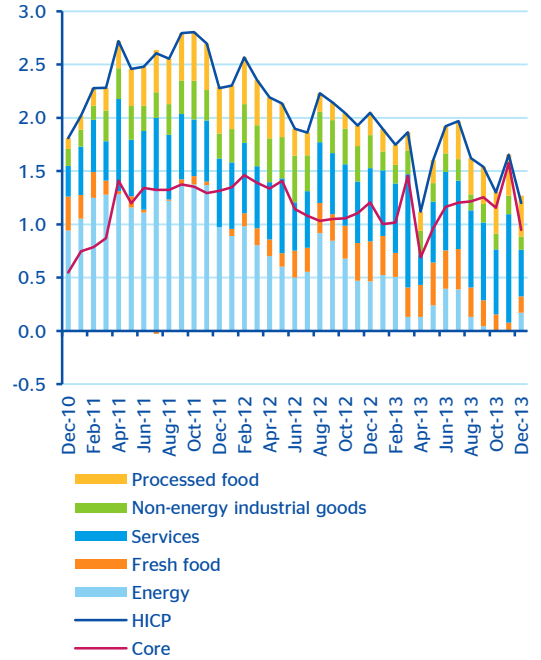
Source: Eurostat and BBVA Research

Chart 2
HICP inflation. Quarterly average (% y/y)



Source: Eurostat and BBVA Research

Chart 3
Germany. Annual HICP inflation rate. Contribution by component



Source: Eurostat and BBVA Research

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