

Europe Flash

Eurozone HICP inflation, both headline and core, remained unchanged in October

Bottom line: Inflation stabilized in October instead of falling, primarily because energy and food prices did not slowed as expected. Despite this, we continue to see a slowdown in headline inflation at the end of the year, to fall below the ECB target late in the first quarter of 2012. Still, several factors have appeared in recent weeks that could put a brake to this deceleration path. One is depreciation of the euro as a result of the weakness of the eurozone economy. The other are the potential hikes in both taxes and administered prices introduced to sustain public finances in some member states.

- **Core inflation remained unchanged at 2% y/y in October,**
in line with our forecasts (BBVA Research: 2.0% y/y), as lower inflation in services was clearly offset by higher prices in processed food and non-energy industrial goods. The former was mainly due to the increase in prices of alcohol and tobacco, while the latter was the result of higher inflation in clothing. Overall, core inflation remained at 2% y/y, after the strong effect of the methodological change in September, pushing it up by around 0.5pp. We see core inflation to remain broadly stable in November, moderating somewhat afterwards, although there is still high uncertainty around the forecast of industrial inflation this year, and thus around core inflation, given the limited information available on the new model to assess the seasonality of the series.
- **Energy inflation remained unchanged at 12.4% y/y, while fresh food prices increased faster,**
explaining partly the slight surprise to our previous headline inflation forecast (BBVA Research: 2.9% y/y). In particular, still high energy inflation continues to explain about half of the annual headline inflation, while recent events, as the depreciation of the euro and the slow decline in oil prices, add more uncertainty to the materialization of positive base effects of energy prices. Nevertheless, according to our baseline scenario forecast for both euro and Brent, we continue to see a markedly slowdown in energy inflation by end-year.
- **Despite the fact that HICP inflation remained stable at 3% y/y, we continue to see inflation to slow down by end year,**
due to the weakness of domestic demand along with favourable base effects in energy prices, reverting below the ECB target by the beginning of 2012. Regarding core inflation, we expect it to hover around current rates for the remainder of the year, moderating somewhat afterwards..

Table 1

Eurozone. Annual HICP inflation rate. Contribution by component

October 2011	y/y		m/m	
	Current %	Previous %	Current %	Previous %
HICP	3.0	3.0	0.3	0.8
Energy	12.4	12.4	0.6	0.9
Fresh Food	1.8	1.4	0.5	0.2
Core excluding Fresh Food and				
Energy	2.0	2.0	0.3	0.8
Services	1.8	1.9	-0.1	-0.8
Non-Energy Industrial Goods	1.3	1.2	0.7	3.3
Processed Food	4.3	4.0	0.5	0.3

Source: Eurostat and BBVA Research

Table 2

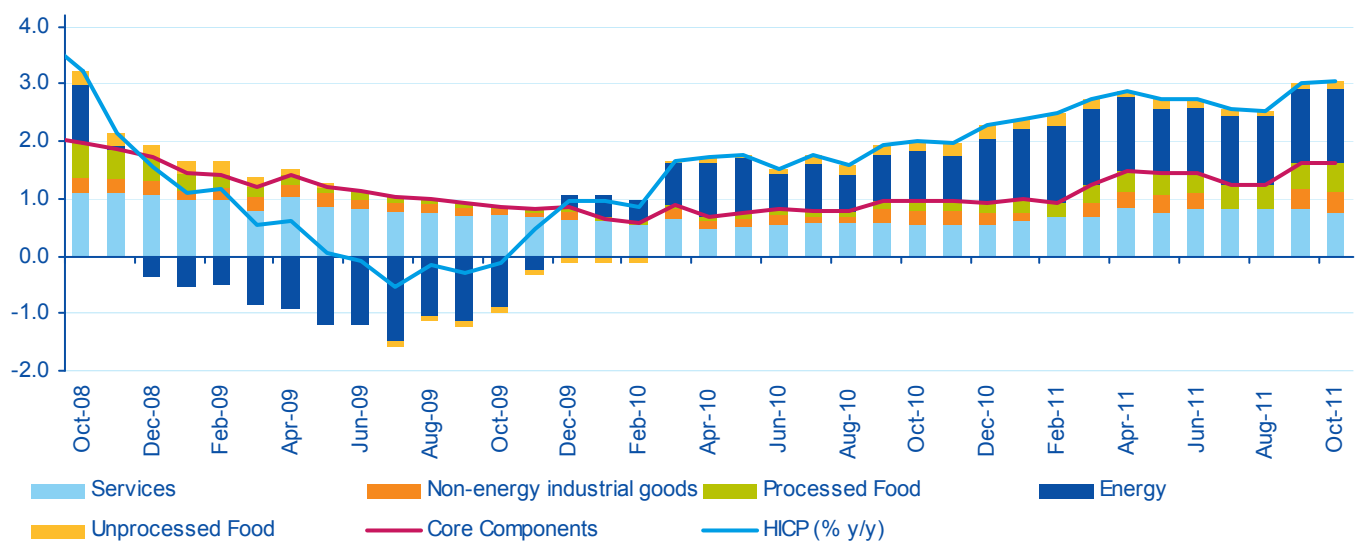
HICP IN THE EMU: Forecast evaluation

	Weight %	Forecast %	Observed %	Confidence Interval Forecast (*)
October 2011				
HICP Headline	100.0	2.94	3.03	(2.7 ; 3.1)
HICP Energy	10.33	11.60	12.44	(11.1 ; 12.0)
HICP Unprocessed food	7.35	1.50	1.82	(0.9 ; 2.0)
HICP excluding energy and unprocessed food	82.29	2.01	1.99	(1.8 ; 2.2)
HICP Services	41.43	1.94	1.83	(1.8 ; 2.1)
HICP Non-energy industrial goods	28.91	1.31	1.27	(1.1 ; 1.5)
HICP processed food	11.95	3.93	4.28	(3.8 ; 4.1)

(*) 80% confidence

Source: Eurostat and BBVA Research

Chart 2

Eurozone. Annual HICP inflation rate. Contribution by component

Source: Eurostat and BBVA Research

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