

Europe Flash

Slower inflation in October thanks to energy prices, while core inflation remains stable

- **HICP inflation eased by 0.1pp to 2.5% y/y in October, but somewhat less than expected, as higher prices in fresh food offset lower energy inflation**

The growth in energy prices declined to 8% y/y in October from 9.1% y/y in the previous months, reducing its contribution to annual inflation rate by somewhat more than 0.1pp to 0.9pp. This slowing in energy inflation was somewhat less than what we marked in our forecast, mainly due to higher prices in both electricity and gas in France and Italy. Inflation in fresh food increased for the third month in a row more than expected, to 4.3% y/y from 3.7%, offsetting the positive effect of energy inflation and confirming that inflationary pressures in coming months will stem from commodity prices.

- **Core inflation remained stable at 1.6% y/y in October, as expected**

Across its components, inflation in services increased slightly, although due to rounding effect remained stable at 1.7%, as expected, and compensated the marginal lower growth in prices of both non-energy industrial goods (1.1% y/y after 1.2%) and processed food (2.4% after 2.5%). Evidence of second-round effects stemming from higher commodity prices continues to be absent, and we expect it to be the case also for the coming quarters.

- **Headline inflation is expected to decline in November, due again to lower increases in energy prices**

Our updated forecasts, incorporating the latest information of fuel prices, suggest that energy inflation is likely to decline further next month, while core inflation is set to remain relatively stable at 1.6% y/y. As a result, headline inflation is likely to decline by around 0.2pp to 2.3%.

- **Looking forward, we expect inflation to hover around 2.3% by year end, slowing more rapidly at the beginning of next year**

Still high prices of oil Brent, combined with inflationary pressures stemming from higher indirect taxes in the periphery, suggest that inflation will slow sluggishly in the remainder of the year, while core inflation is expected to remain broadly stable at 1.6% y/y. As a result, headline inflation will average 2.5% and core inflation 1.8%. For 2013, we expect headline inflation to slow markedly at the beginning of the year as a result of a significant base effect in energy prices after increasing sharply a year ago, remaining slightly below the ECB's target during the second quarter. Thereafter, slowing both core and headline inflation will be more sluggish.

Table 1

Eurozone. Annual HICP inflation rate

	% y/y		% m/m	
	September 2012	October 2012	September 2012	October 2012
HICP	2.6	2.5	0.7	0.2
Energy	9.1	8.0	1.1	-0.5
Fresh Food	3.7	4.3	0.4	1.0
Core excluding Fresh Food and Energy	1.6	1.6	0.7	0.3
Services	1.7	1.7	-0.9	0.0
Non-Energy Industrial Goods	1.2	1.1	3.5	0.6
Processed Food	2.5	2.4	0.1	0.1

Source: Eurostat and BBVA Research

Table 2

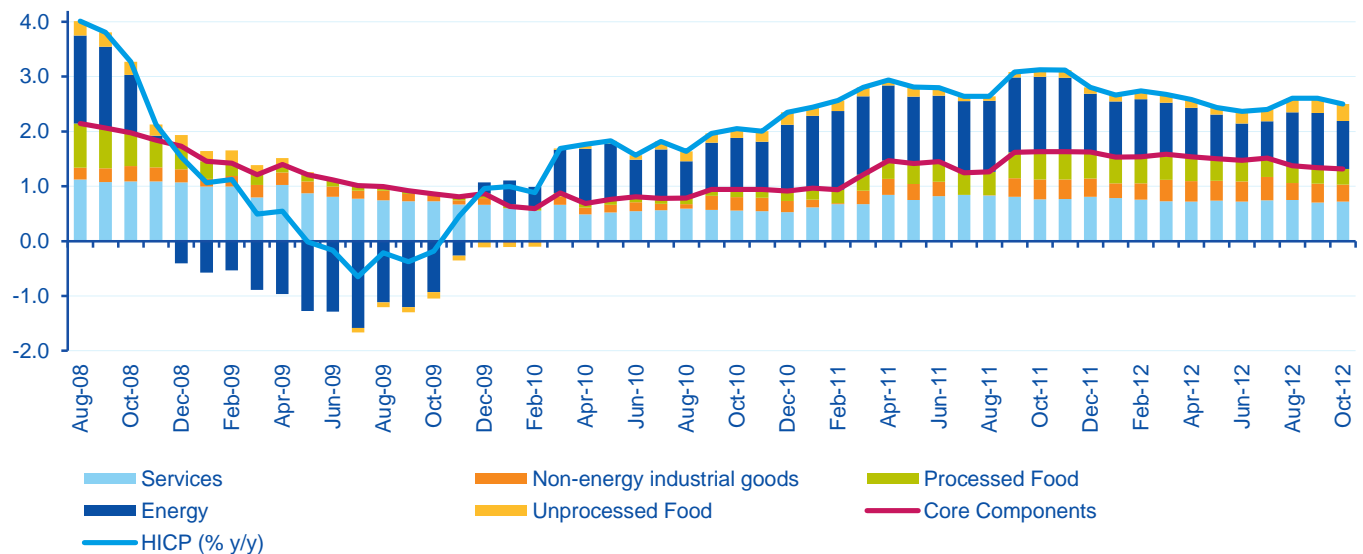
HICP: Forecast evaluation

October 2012	Weight %	Forecast %	Observed %	Confidence Interval Forecast (*)
Headline	100.0	2.4	2.5	(2.2 ; 2.6)
Energy	10.99	7.6	8.0	(7.1 ; 8.0)
Unprocessed food	7.22	3.7	4.3	(3.1 ; 4.2)
Excluding energy and unprocessed food	81.79	1.6	1.6	(1.4 ; 1.7)
Services	41.47	1.7	1.7	(1.6 ; 1.9)
Non-energy industrial goods	28.47	1.0	1.1	(0.8 ; 1.2)
Processed food	11.85	2.2	2.4	(2.1 ; 2.3)

(*) 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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