

Europe Flash

Eurozone inflation down in January driven by favourable base effect in energy prices and to the moderation in core inflation

Bottom line: Inflation slowed in January by 0.1pp to 2.6%, instead of the 2.7% anticipated by Eurostat's flash estimation. We continue to see inflation moderating in coming months, but both the minor slowdown in oil prices and the depreciation of the euro will put a break on its downward trend, thus keeping inflation from reverting below 2% in Q2 as previously projected. Still, the moderation of core prices provides further evidence of disinflationary pressures in Europe.

- **Energy inflation slowed in January, but at a slower pace than anticipated, thus posing some upside risks to the reversion below the ECB target in the short-run**

Energy inflation decelerated by around 0.5pp to 9.2% y/y (BBVA Research: 8.6% y/y), as higher oil prices ended up moving to prices of both fuel and gas, and only with annual inflation in electricity falling. The energy component contributed about half a tenth of the observed slowdown in annual headline inflation last month. In addition, inflation in non-processed food remained stable at 1.6% y/y in January, confirming the interruption of the upward trend observed in previous months.

- **Core inflation declined by 0.1pp to 1.9% in January, driven by lower prices growth of both services and non-energy industrial goods**

The slowdown in core inflation was somewhat larger than anticipated (BBVA Research: 1.96% y/y), driven by the bigger fall in inflation of non-energy industrial goods than projected (-3.6% m/m; BBVA Research: -3.4% m/m), reflecting loud discounts at the beginning of the year to encourage subdued domestic demand. In particular, slowing growth in prices of these products explain 0.07pp of the deceleration observed in headline inflation in January. Finally, the inflation of both services and processed food remained broadly stable at 1.9% y/y and 4.1% y/y, respectively, in line with expectations.

- **Headline inflation is expected to decline slightly in February, driven by lower core inflation, which should offset a timid rebound in energy prices**

Eurostat will release the flash estimation of February headline inflation tomorrow. We expect it to decline further by around 0.1pp to 2.5%, although a 2.6% y/y could not be ruled out due to rounding effect.

- **We expect inflation to slow further in coming months, but at a slower pace than previously projected**

Both the minor slowdown in oil prices and the depreciation of the euro will put a brake on the moderation of inflation in the short-term. We now expect inflation to slow further in March (2.2% y/y) and stabilize afterwards, hovering around rates slightly above the ECB's target until Q3 12. Only in Q4, we now see inflation slightly below 2%. As a result, the annual inflation rate could be around 2% in 2012 as a whole.

Table 1

Eurozone. Annual HICP inflation rate

January 2011	% y/y		% m/m	
	December 2011	January 2012	December 2011	January 2012
HICP	2.7	2.6	0.3	-0.8
Energy	9.7	9.2	-0.1	2.6
Fresh Food	1.6	1.6	0.4	0.5
Core excluding Fresh Food and Energy	2.0	1.9	0.4	-1.4
Services	1.9	1.9	0.9	-0.4
Non-Energy Industrial Goods	1.2	0.9	-0.2	-3.6
Processed Food	4.1	4.1	0.1	0.4

Source: Eurostat and BBVA Research

Table 2

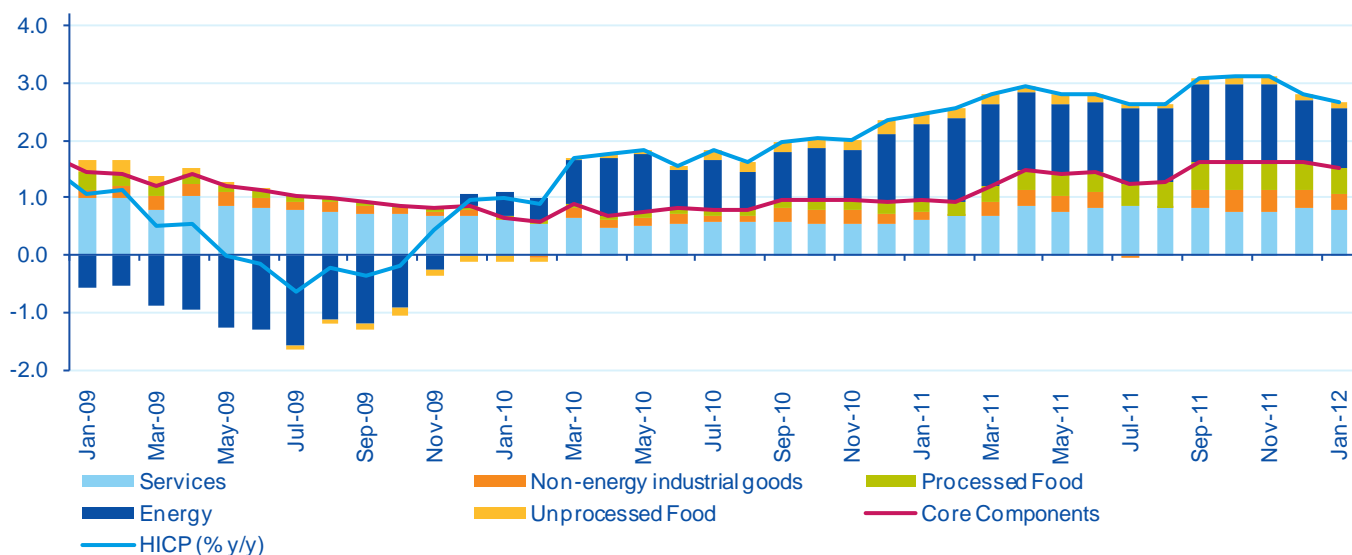
HICP: Forecast evaluation

January 2011	Weight %	Forecast %	Observed %	Confidence Interval
				Forecast (*)
Headline	100.0	2.68	2.64	(2.5 ; 2.9)
Energy	10.99	8.57	9.23	(8.1 ; 9.0)
Unprocessed food	7.22	2.26	1.59	(1.7 ; 2.8)
Excluding energy and unprocessed food	81.79	1.96	1.89	(1.8 ; 2.1)
Services	41.47	1.94	1.89	(1.8 ; 2.1)
Non-energy industrial goods	28.47	1.15	0.95	(0.9 ; 1.4)
Processed food	11.85	3.97	4.07	(3.8 ; 4.1)

(*) 80% confidence

Source: Eurostat and BBVA Research

Chart 1

Eurozone. Annual HICP inflation rate. Contribution by component

Source: Eurostat and BBVA Research

Miguel Jiménez
mjimenezg@bbva.com
+34 91 537 37 76

Agustín García Serrador
agustin.garcia@bbva.com
+34 91 374 79 38

Elvira Prades
elvira.prades@bbva.com
+34 91 537 79 36

Katerina Deligiannidou
aikaterini.deligiannidou@bbva.com
+34 91 537 79 36

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document is based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.