

Europe Flash

Headline inflation eased by 0.1pp to 2.6% y/y in April, while core inflation remained stable at 1.9% y/y, as expected

Bottom line: Inflation eased to 2.6% y/y in April, as expected, after remaining broadly stable at 2.7% y/y in the first quarter. Underlying April's slowing was not only a lower growth of prices of more volatile components, but also those of the core index, as the stabilization observed in the latter was due to a rounding effect. Looking forward, recent increases in oil prices combined with the continuous depreciation and a milder slowdown in activity point to a slower moderation of headline inflation in coming months. As a result, it should remain above the ECB target during 2012, although reverting towards 2% at the end of the year. Core inflation is likely to remain hovering around 1.9% y/y in coming months and to moderate timidly in the second half of the year.

- **Energy inflation slowed to 8.1% y/y in April from 8.5% in March, less than expected, but offset by a slight slowing in fresh food inflation**

Underlying the moderation of energy inflation (8.1% y/y; BBVA Research: 7.5% y/y) was a positive base effect after the sharp increase in energy prices a year ago, although this was lower than anticipated mainly due to an increase in administered prices of both gas and electricity. However, the positive surprise observed in energy inflation was offset by the negative one observed in inflation of fresh food (from 2.2% to 2.1% y/y), after the sharp increase registered in the previous month. Overall, the evolution of prices of the more volatile components continues to explain about half of the annual headline inflation.

- **Core inflation remained stable at 1.9%**

Core inflation remained stable but only due to a rounding effect, as the index slowed by 0.06pp driven by lower inflation in all its components. In particular, inflation in services eased to 1.7% y/y (BBVA Research: 1.8% y/y), slowing by around 0.2pp over Q4 2011, partly reflecting the weakness of domestic demand. Prices of processed food grew in April at a more moderate pace than in previous months (3.7% y/y after 3.9% y/y; BBVA Research: 3.7% y/y), thus continuing the downward trend observed since end-2011. Finally, non-energy industrial inflation also declined by 0.1pp to 1.3% y/y in April (BBVA Research: 1.4% y/y), after the strong rebound observed in March (increasing by 0.3pp to 1.4% y/y), confirming that the latter was explained by more aggressive and durable discounts at the beginning of the year, along with the methodological changes in the treatment of some seasonal products, as clothing. Overall, core inflation performance in April suggests that retailers could be absorbing the recent increase in input prices, especially those related to energy, due to the weakness of domestic demand and poor expectations for coming months, limiting risks on the resurgence of indirect effects.

- **Headline inflation is expected to remain relatively stable in May**

Our updated forecasts suggest that headline inflation could decline marginally in May, likely to 2.5%, although inflation of all components is expected to remain broadly stable. This slight decline could be driven by lower inflation in more volatile components, while core inflation should remain stable at 1.9% y/y.

- **We expect a slower moderation of inflation in coming months**

Recent increases in oil prices combined with the continuous depreciation of the euro and a milder slowdown in activity point to somewhat higher inflation in the short-term. As a result, headline inflation should remain above the ECB target during 2012, although returning to the target at the end of the year. Core inflation is likely to remain hovering around 1.9% y/y in coming months and to moderate timidly in H2 2012. Upside risks continue to come from geopolitical tensions related to oil prices, as well as potential tax hikes to meet fiscal targets, while the depressed domestic demand could partly offset these effects.

Table 1

Eurozone. Annual HICP inflation rate

	% y/y		% m/m	
	March 2012	April 2012	March 2012	April 2012
HICP	2.7	2.6	1.3	0.5
Energy	8.5	8.1	1.6	1.1
Fresh Food	2.2	2.1	0.5	-0.1
Core excluding Fresh Food and Energy	1.9	1.9	1.3	0.4
Services	1.8	1.7	0.1	0.3
Non-Energy Industrial Goods	1.4	1.3	3.6	0.7
Processed Food	3.9	3.7	0.2	0.2

Source: Eurostat and BBVA Research

Table 2

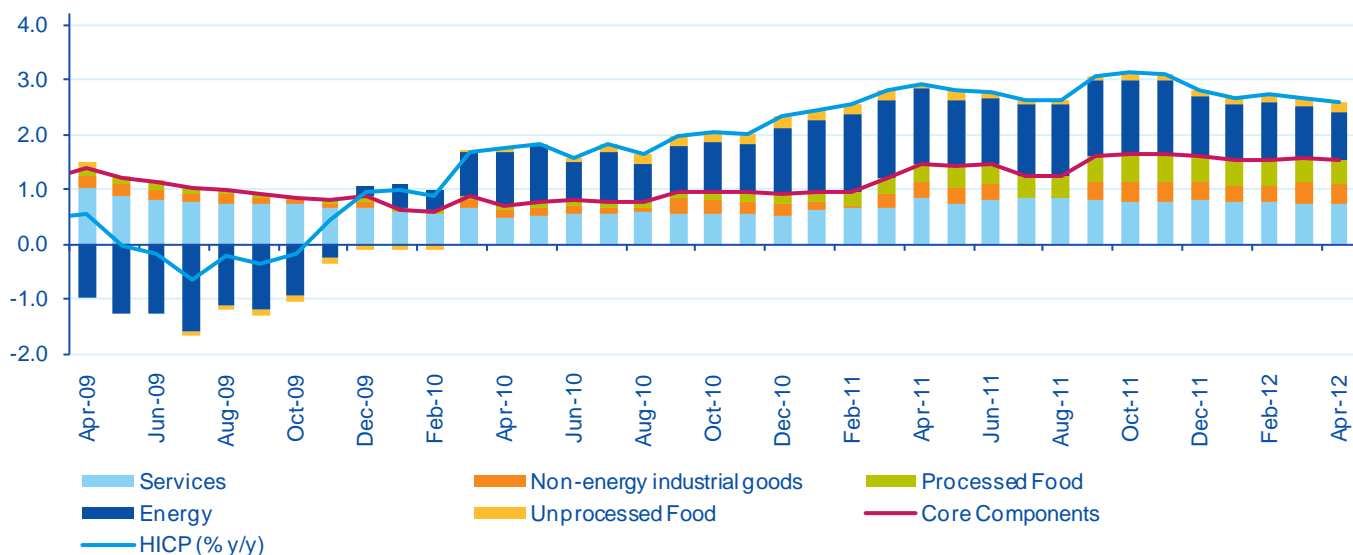
HICP: Forecast evaluation

April 2012	Weight %	Forecast %	Observed %	Confidence Interval Forecast (*)
Headline	100.0	2.6	2.6	(2.4 ;2.8)
Energy	10.99	7.5	8.1	(7.1 ;8.0)
Unprocessed food	7.22	3.1	2.1	(2.5 ;3.6)
Excluding energy and unprocessed food	81.79	1.9	1.9	(1.8 ;2.1)
Services	41.47	1.8	1.7	(1.6 ;1.9)
Non-energy industrial goods	28.47	1.4	1.3	(1.2 ;1.6)
Processed food	11.85	3.7	3.7	(3.6 ;3.8)

(*) 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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