

Europe Flash

Both headline and core inflation remained stable in June

Bottom line: Inflation remained stable in June at 2.4% y/y, interrupting the downward trend observed in the previous months. Energy inflation slowed further, even somewhat more than anticipated, but this was completely offset by the acceleration observed in fresh food inflation, which surprised on the upside. Core inflation remained broadly stable, though is subject to downward pressures from domestic demand. Looking forward, we continue to expect a slow deceleration of headline inflation in coming months, remaining above the ECB target over the next quarter and reverting to around 2% by the end of the year. Core inflation is likely to ease slightly to remain hovering around 1.7% y/y during the second half of the year. Risks to this scenario remain balanced.

- **Energy inflation slowed to 6.1% y/y in June from 7.3% in May, somewhat more than expected, but offset by the acceleration in fresh food inflation**

Underlying the moderation of energy inflation (6.1% y/y; BBVA Research: 6.5% y/y) was a positive base effect after the sharp increase in energy prices a year ago, combined with lower oil prices observed in June. This moderation was somewhat larger than anticipated, but it was offset by the upward surprise observed in inflation of fresh food (from 1.8% to 3.1% y/y) that could be reflecting unfavorable weather conditions, which are likely to continue pushing up food prices in coming months. Overall, the evolution of prices of the more volatile components continues to explain more than one-third of the annual rate of headline inflation.

- **Core inflation remained stable at 1.8%**

This was against our expectations of a slight moderation (BBVA Research: 1.7% y/y). Underlying this positive surprise was mainly a more moderate slowdown of inflation in services (from 1.8% to 1.7% y/y, vs BBVA Research: 1.6% y/y), while prices of the rest of components evolved as expected. In particular, inflation of non-energy industrial goods remained stable at 1.3% y/y for the third month in a row, while inflation of processed food slowed by 0.2pp to 3.2% y/y. Overall, the performance of core inflation in recent months suggests that retailers could be absorbing the past increases in input prices, especially those related to commodities, due to the weakness of domestic demand and poor expectations for coming months.

- **Headline inflation is expected to ease further in July**

Our updated forecasts suggest that headline inflation could decline again in July by around 0.1pp to 2.3% y/y driven mainly by lower energy inflation, although this may partly be offset by a further acceleration in fresh food inflation. Regarding core inflation, we expect it to remain stable at 1.8% y/y.

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

Headline inflation is expected to moderate slowly in coming months, remaining above the ECB target over the next quarter and reverting to around 2% at the end of the year. Core inflation is likely to ease slightly to remain hovering around 1.7% y/y during the second half of the year. We think that risks to this scenario remain balanced, as upside pressures from tax hikes and commodity prices (especially food) should be offset the downwards risks associated with a deeper activity contraction in coming months combined with a larger slowing in oil prices than previously anticipated.

Table 1

Eurozone. Annual HICP inflation rate

	% y/y		% m/m	
	May 2012	June 2012	May 2012	June 2012
HICP	2.4	2.4	-0.1	-0.1
Energy	7.3	6.1	-1.4	-1.7
Fresh Food	1.8	3.1	0.2	0.8
Core excluding Fresh Food and				
Energy	1.8	1.8	0.0	0.1
Services	1.8	1.7	-0.1	0.3
Non-Energy Industrial Goods	1.3	1.3	0.0	-0.3
Processed Food	3.4	3.2	0.1	0.0

Source: Eurostat and BBVA Research

Table 2

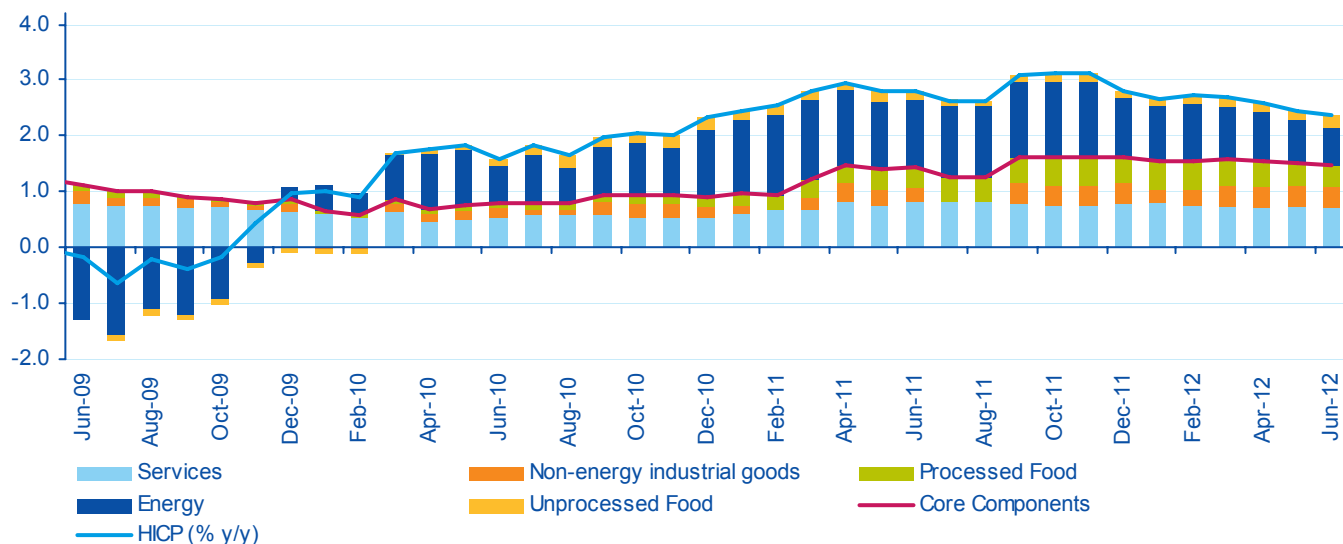
HICP: Forecast evaluation

June 2012	Weight %	Forecast %	Observed %	Confidence Interval Forecast (*)
Headline	100.0	2.3	2.4	(2.1 ;2.5)
Energy	10.99	6.5	6.1	(6.1 ;7.0)
Unprocessed food	7.22	2.0	3.1	(1.4 ;2.5)
Excluding energy and				
unprocessed food	81.79	1.7	1.8	(1.5 ;1.9)
Services	41.47	1.6	1.7	(1.4 ;1.7)
Non-energy industrial				
goods	28.47	1.2	1.3	(1.0 ;1.5)
Processed food	11.85	3.3	3.2	(3.2 ;3.5)

(*) 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

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