

Europe Flash

Energy prices pushed inflation up in August, but core inflation slowed more than expected

- **Underlying August's rebound was mainly the sharp increase in energy prices, but also higher prices of fresh food**

Energy inflation increased sharply to 8.9% y/y in August from 6.1% y/y in the previous month, and thus its contribution to headline inflation rose by 0.3pp to 1pp. In addition, inflation of fresh food also increased again in August by 0.6pp to 3.5% y/y, after remaining broadly stable in the previous two months, and thus showing further evidence that severe weather conditions end up pushing food prices up. As a result, the evolution of prices of the more volatile components continues to explain more than one-third of the annual inflation rate and will be the key determinant of its performance in coming months.

- **Core inflation slowed by 0.2pp to 1.7% y/y in August, against our expectation of stabilization, offsetting partly higher prices of more volatile components**

Underlying this positive surprise was mainly the significant slowdown in inflation of non-energy industrial goods that declined by 0.4pp to 1.1% y/y, more than reversing the sharp rebound observed in the previous month (+0.3pp to 1.5% y/y). This could be a temporary effect, although it could also reflect a disinflationary process due to the weakness of domestic demand such that non-energy industrial prices revert to more moderate levels. Regarding the other components of core inflation, they evolved as expected, with service inflation remained stable at 1.8% y/y, while inflation of processed food declined by 0.2pp to 2.7% y/y. As a result, the decline in core inflation (-0.1pp) partly offset the rebound in the residual component. Overall, August's figures did not show evidence about second-round effects, while the gloomy economic prospects for coming quarters combined with the continuing deterioration of labour market must put the brake on them in the short-term.

- **Both headline and core inflation are expected to remain stable in September**

- **Looking forward, we expect inflation to hover around 2.5% y/y during Q4**

Higher prices of oil Brent than previously anticipated, combined with inflationary pressures stemming from higher indirect taxes in the periphery, suggest that inflation will not slow steadily to revert to ECB's target by end-year, as projected previously, but will remain relatively stable at current levels in coming months.

Table 1

Eurozone. Annual HICP inflation rate

	% y/y		% m/m	
	July 2012	August 2012	July 2012	August 2012
HICP	2.4	2.6	-0.5	0.4
Energy	6.1	8.9	0.9	2.4
Fresh Food	2.9	3.5	-1.1	-0.3
Core excluding Fresh Food and Energy	1.9	1.7	-0.7	0.2
Services	1.8	1.8	1.0	0.3
Non-Energy Industrial Goods	1.5	1.1	-3.4	0.0
Processed Food	2.9	2.7	0.1	0.1

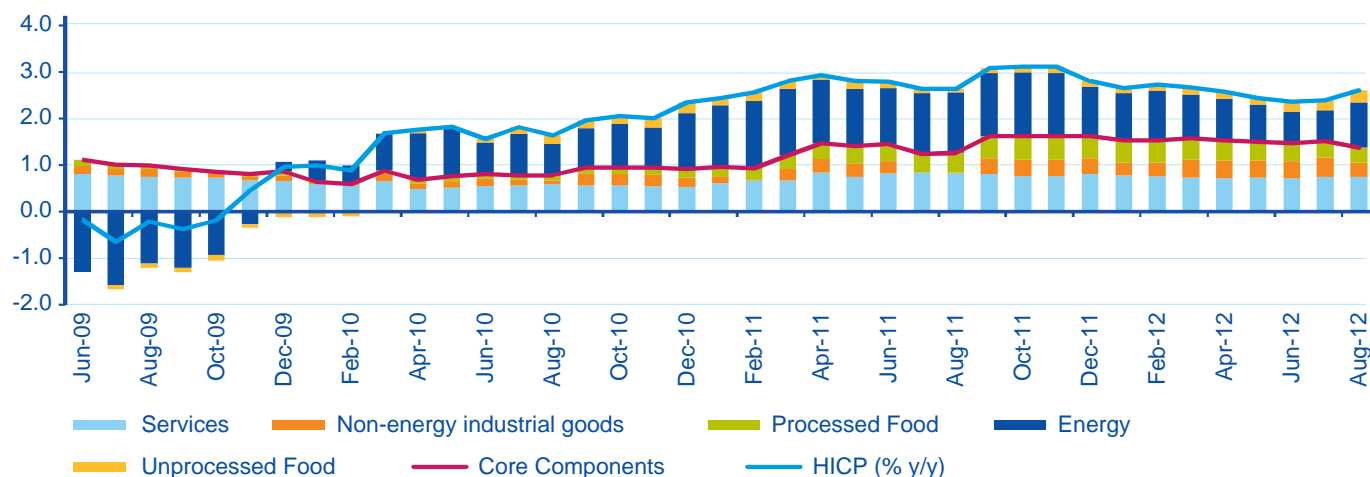
Source: Eurostat and BBVA Research

Table 2
HICP: Forecast evaluation

August 2012	Weight %	Forecast %	Observed %	Confidence Interval Forecast (*)
Headline	100.0	2.6	2.6	(2.4 ; 2.8)
Energy	10.99	8.1	8.9	(7.7 ; 8.6)
Unprocessed food	7.22	3.0	3.5	(2.5 ; 3.6)
Excluding energy and unprocessed food	81.79	1.9	1.7	(1.7 ; 2.0)
Services	41.47	1.8	1.8	(1.6 ; 1.9)
Non-energy industrial goods	28.47	1.6	1.1	(1.4 ; 1.8)
Processed food	11.85	2.7	2.7	(2.6 ; 2.8)

(*) 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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