

Europe Flash

Inflation to remain above 2% during 2012

Bottom line: Inflation remained stable at 2.7% y/y in February for the third month in a row, with an upward revision of January's reading by 0.1pp. We now expect a slower moderation in inflation in coming months as a result of recent increases in oil prices along with milder than expected slowdown of activity which has been apparent over Q1. As a result, HICP inflation should remain slightly above the ECB target during 2012.

- Energy inflation increased slightly in February, but higher oil prices than previously anticipated point to slower moderation in headline inflation over 2012**

Energy inflation rose by around 0.3pp to 9.5% y/y (BBVA Research: 9.9% y/y), as higher oil prices pushed up prices of fuel, but not those of gas and electricity. The downward trend observed in energy inflation was interrupted in February, explaining almost 40% of the annual headline inflation rate. In addition, prices of non-processed food increased sharply to 2.2% y/y from 1.6% y/y in January, much more than expected, due to unfavorable weather affecting fresh vegetables and fruit prices.

- Core inflation remained stable at 1.9%, against our expectation of a slight deceleration**

Inflation in services declined by 0.1pp to 1.8% in February, as expected, but this was more than offset by the higher inflation of non-energy industrial goods (from 0.9% to 1.1% y/y; BBVA Research: 0.9% y/y) after the effect of January's sales. Inflation of processed food remained broadly stable at 4.1%, as projected.

- Headline inflation is expected to ease in March, driven by lower growth of energy prices**

Despite higher oil prices, we continue to expect a favorable base effect in March after the strong energy inflation rates observed a year ago (around 13% y/y). As a result, headline inflation might slow by 0.1pp to 2.6% y/y. Regarding inflation of other components, our forecast suggest that they should remain at broadly unchanged, resulting in the stabilization of core inflation at 1.9% y/y.

- We now expect a more sluggish moderation in inflation in coming months**

Recent increases in oil prices combined with the milder slowdown in activity recently observed point to somewhat higher inflation in the short-term. As a result, headline inflation should remain slightly above the ECB target during 2012; while core inflation is likely to remain hovering around 1.9% y/y. Upside risks continue to come from geopolitical tensions related to oil prices, as well as potential tax hikes to meet fiscal targets. In addition, the significant upside surprise in food inflation in February also reveals potential, though marginal, upside pressures on HICP inflation in coming months resulting from bad weather over past months.

Table 1

Eurozone. Annual HICP inflation rate

	% y/y		% m/m	
	January 2012	February 2012	January 2012	February 2012
HICP	2.7	2.7	-0.8	0.5
Energy	9.2	9.5	2.6	1.1
Fresh Food	1.6	2.2	0.5	1.2
Core excluding Fresh Food and				
Energy	1.9	1.9	-1.4	0.3
Services	1.9	1.8	-0.4	0.5
Non-Energy Industrial Goods	0.9	1.1	-3.6	0.2
Processed Food	4.1	4.1	0.4	0.3

Source: Eurostat and BBVA Research

Table 2

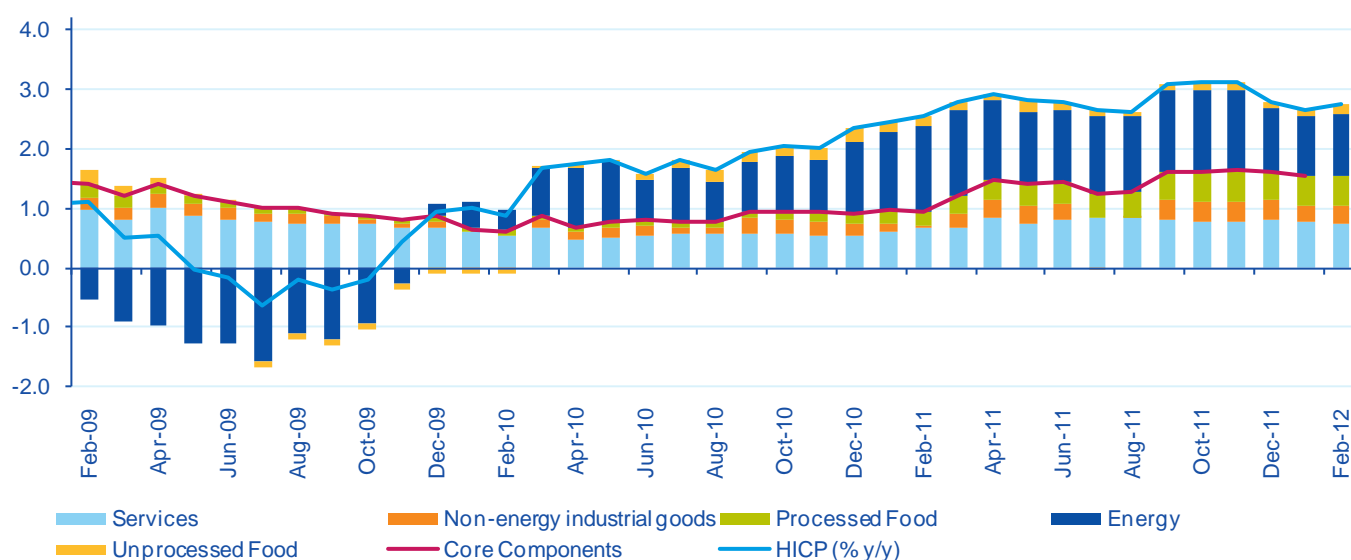
HICP: Forecast evaluation

February 2012	Weight %	Forecast %	Observed %	Confidence Interval Forecast (*)
Headline	100.0	2.6	2.7	(2.4 ;2.8)
Energy	10.99	9.9	9.5	(9.5 ;10.4)
Unprocessed food	7.22	0.7	2.2	(0.2 ;1.3)
Excluding energy and unprocessed food	81.79	1.8	1.9	(1.7 ;2.0)
Services	41.47	1.8	1.8	(1.7 ;2.0)
Non-energy industrial goods	28.47	0.9	1.1	(0.6 ;1.1)
Processed food	11.85	4.0	4.1	(3.9 ;4.1)

(*) 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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