

# 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
<b>HICP</b>	<b>2.7</b>	<b>2.6</b>	<b>0.3</b>	<b>-0.8</b>
<b>Energy</b>	9.7	9.2	-0.1	2.6
<b>Fresh Food</b>	1.6	1.6	0.4	0.5
<b>Core excluding Fresh Food and Energy</b>	<b>2.0</b>	<b>1.9</b>	<b>0.4</b>	<b>-1.4</b>
<b>Services</b>	1.9	1.9	0.9	-0.4
<b>Non-Energy Industrial Goods</b>	1.2	0.9	-0.2	-3.6
<b>Processed Food</b>	4.1	4.1	0.1	0.4

Source: Eurostat and BBVA Research

Table 2

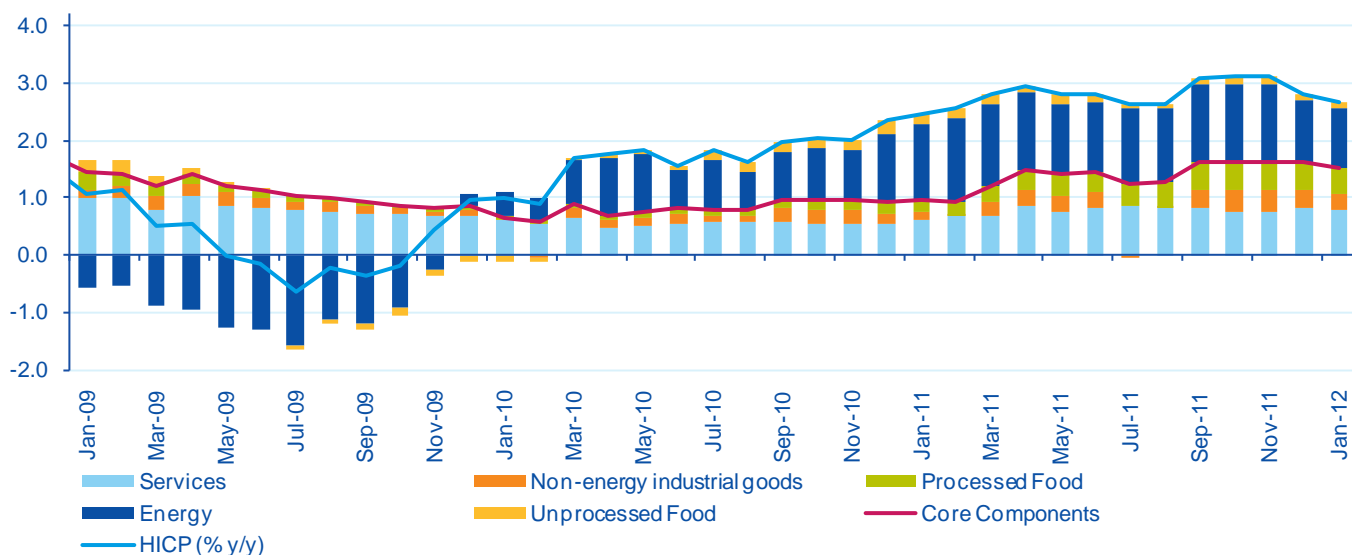
**HICP: Forecast evaluation**

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

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