

Europe Flash

Both headline and core inflation remained stable in Q1 at 2.7% and 1.9% y/y, respectively

Bottom line: Inflation remained stable at 2.7% y/y in March for the fourth month in a row, after being revised upwards by 0.1pp from the flash estimation. Underlying this stabilization was higher inflation of non-energy goods that was not offset by the moderation observed in both energy and non-processed food inflation. As a result, core inflation remained stable at 1.9% y/y. We expect a slow moderation in inflation in coming months, as the reversal of energy price hikes from a year ago will be partially compensated by recent increases in oil prices, along with a continuous euro depreciation and a milder than expected slowdown of activity which has been apparent over Q1. As a result, HICP inflation should remain above the ECB target all through 2012.

- **Energy inflation slowed to 8.5% y/y in March from 9.5% in February, somewhat less than expected**

Underlying the moderation of energy inflation (8.5% y/y, BBVA Research: 8.4% y/y) was a positive base effect after the sharp increase in energy prices a year ago. As a result, the contribution of this component to annual headline inflation declined further to 0.9pp in March, around 0.4pp lower than its contribution in 2011. In addition, inflation of fresh food remained broadly stable at 2.2% in March (BBVA Research: 2.2% y/y), after the significant acceleration observed in the previous month (by 0.6pp), and thus tying down some fears about the upside pressure of this component on HICP inflation resulting from bad weather over past months. 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%, as expected**

Inflation in services remained stable at 1.8% y/y in March, as expected, thus slowing by around 0.2pp over Q4 2011, partly reflecting the weakness of domestic demand. Prices of processed food grew in March at a more moderate pace than in the previous month (3.9% y/y after 4.1% y/y, BBVA Research: 4.0% y/y), which were more than offset by the increase in prices of non-energy industrial goods (1.4% y/y after 1.1% y/y, BBVA Research: 1.2% y/y). This rebound could be explained by a 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 (16% m/m).

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

Despite higher oil prices, we continue to expect a favorable base effect in April 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 suggests that they should remain broadly unchanged, resulting in the stabilization of core inflation 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 reversing to the target at the end of the year. Core inflation is likely to remain hovering around 1.9% y/y in coming months 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 offset partly these effects.

Table 1

Eurozone. Annual HICP inflation rate

	% y/y		% m/m	
	February 2012	March 2012	February 2012	March 2012
HICP	2.7	2.7	0.5	1.3
Energy	9.5	8.5	1.1	1.6
Fresh Food	2.2	2.2	1.2	0.5
Core excluding Fresh Food and Energy	1.9	1.9	0.3	1.3
Services	1.8	1.8	0.5	0.1
Non-Energy Industrial Goods	1.0	1.4	0.2	3.6
Processed Food	4.1	3.9	0.3	0.2

Source: Eurostat and BBVA Research

Table 2

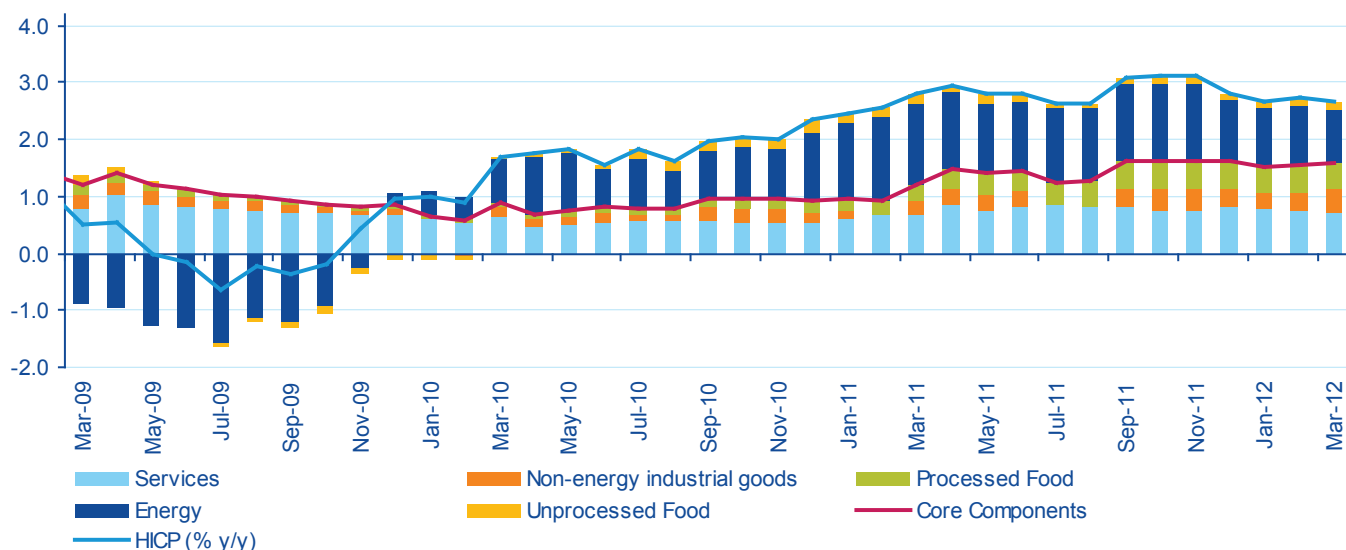
HICP: Forecast evaluation

March 2012	Weight %	Forecast %	Observed %	Confidence Interval Forecast (*)
Headline	100.0	2.61	2.68	(2.4 ;2.8)
Energy	10.99	8.41	8.54	(8.0 ;8.9)
Unprocessed food	7.22	2.18	2.17	(1.6 ;2.7)
Excluding energy and unprocessed food	81.79	1.88	1.94	(1.7 ;2.0)
Services	41.47	1.78	1.76	(1.6 ;1.9)
Non-energy industrial goods	28.47	1.17	1.38	(0.9 ;1.4)
Processed food	11.85	4.01	3.91	(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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