

## Eurozone | Inflation increased in January but will fall

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### Minor drop in energy prices and rising core inflation, which surprised slightly to the upside

While we have yet to know the final data, Eurostat's flash estimate was in line with expectations, considering that inflation increased by 0.2pp to 0.4% YoY in January (BBVA Research and consensus 0.4% YoY). The smaller decline in energy prices was one of the determinants of this increase, although it was slightly less than expected, which, in the light of national data, could be largely explained by falling electricity prices. The positive surprise was the 0.1pp increase in core inflation to 1% YoY (BBVA Research: 0.9% YoY) and, in particular, the higher growth in the prices of non-energy industrial goods (0.7% YoY from 0.5% YoY in December), while processed food inflation remained stable (0.7% YoY) and services increased slightly (+0.1pp to 1.2% YoY), in line with expectations (Table 1).

### Inflation may moderate slightly in February and record negative rates from March onwards, which could be extended into the second quarter

The evolution of oil prices will continue to be the main determinant of the behaviour of inflation in the coming months, such that we now expect headline inflation to moderate in February (to 0% YoY) and record slightly negative rates from March on (around -0.2% YoY), which could extend into the second quarter (when we expect oil prices to reach their lowest levels) and to rebound only slightly during the second half of the year (to around 0.8 % in 4Q16).

Regarding core inflation, our models estimate that it will remain relatively stable in the coming months, since the strength of domestic demand appears to be limiting any possible second-round effects of falling energy prices. However, the January confidence surveys suggest that companies may be passing on to consumers the falling commodity prices in the euro area, but with differences between countries. In France, this behaviour seems more obvious, although in part already expected by the need to stimulate demand, while German companies do not seem to be passing them on and might be using it to improve their business margins.

For 2016 as a whole, we expect headline inflation to be at 0.2% and core at 1%. Regarding this scenario, the extreme uncertainty on the prices of raw materials means that we continue to foresee downside risks this year (if the fall in oil prices continues without bottoming-out), but also upside risks in 2017 from a possible rebound in oil prices or increased strength of domestic demand

Figure 1

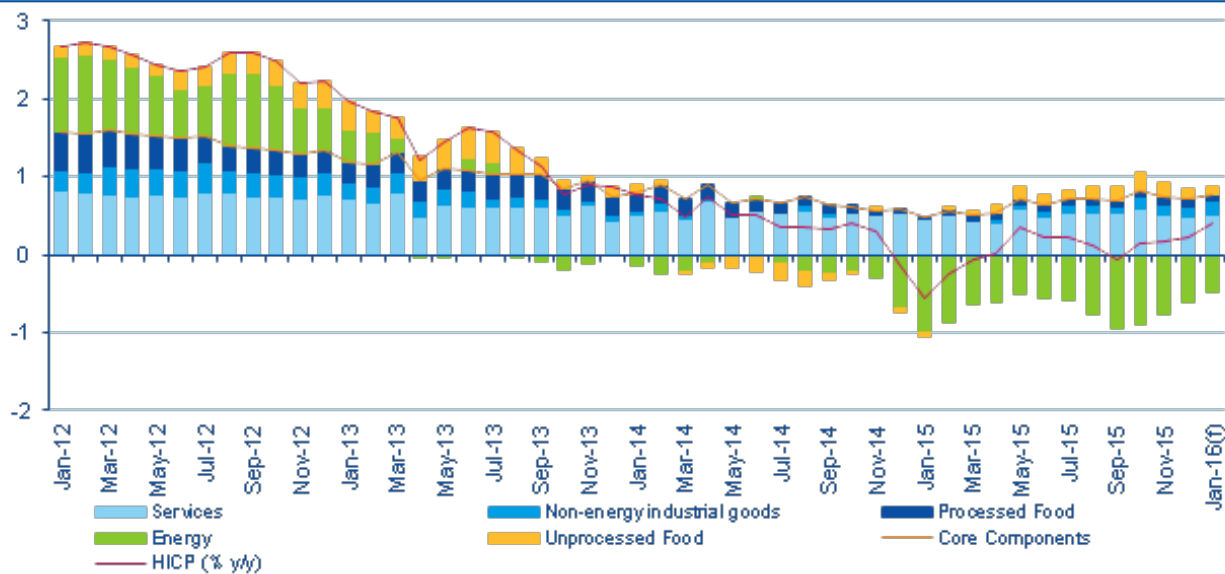
Eurozone. HCPI inflation (% YoY)

	Observed		January 2016	
	November 2015	December 2015	Flash Estimate	BBVA Research
HCPI	0,1	0,2	0,4	0,4
Energy	-7,3	-5,8	-5,3	-4,5
Fresh Food	2,7	2,0	1,8	1,4
HCPI excluding energy and food	0,9	0,9	1,0	0,9
Core excluding Fresh Food and Energy	0,9	0,9	1,0	0,9
Services	1,1	1,1	1,2	1,2
Non-Energy Industrial Goods	0,5	0,5	0,7	0,6
Processed Food	0,7	0,7	0,7	0,8

Source: BBVA Research

Figure 2

Eurozone. Annual HICP inflation rate. Contribution by component



Source: Eurostat and BBVA Research

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