

EUROZONE INFLATION: MORE NOISE THAN SIGNAL

The preliminary estimation for euro area inflation surprised to the upside, with annual core inflation reaching 1.4% in January. Monthly inflation was negative however, at -0.5%. Due to the Covid-19 pandemic, inflation data have become very noisy and hence more difficult to interpret. Survey data show rising input prices and lengthening of delivery times, which could exert some upward pressure on inflation. These factors should dissipate during the course of the year. Given the economic slack, any lasting pick-up in inflation should be a very gradual process

The preliminary estimate for euro area inflation surprised to the upside, with annual core inflation reaching 1.4% in January. Monthly inflation was negative however, at -0.5%. This may explain why the bond market was unimpressed. 10-year Bund yields hardly reacted to the news. Another reason could be that investors are very much aware that, due to the pandemic, inflation data have become very noisy and hence more difficult to interpret.

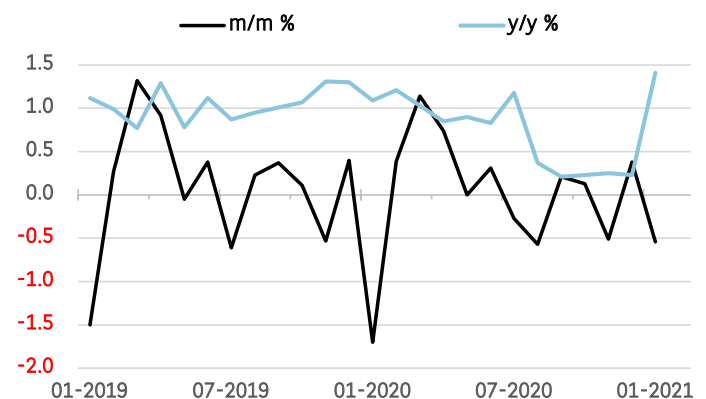
Several factors play a role. One, lockdown means that for certain items, new price sources need to be used. Certain prices may even be missing, because shops, hotels and restaurants are closed or services are no longer provided. Statistically, this is addressed by imputing the price changes observed for similar products for which data are available. In January, prices for 18% of services are imputed. Admittedly, it is well below the level of April last year when 41% of services and 43% of non-energy industrial goods had imputed prices, but it remains significant¹. Two, changes in taxation created base effects. In Germany, the temporary reduction in the VAT rate first caused a decline in prices, but, having ended in December, it triggered a price increase in January. Three, shop closures in certain countries meant less discounting than usual during the sale season, which is reflected in an increase of annual inflation. Four, due to restrictions and working-from-home, the household spending basket changes, which may also influence inflation dynamics². Finally, supply-side factors may cause a temporary increase in inflation. Sectors that have been under lockdown could see a jump in demand when restrictions are lifted, creating room to raise prices when price elasticity of demand is low.

Generally speaking, supply/demand-imbalances are already manifesting themselves in the purchasing managers' survey which point towards rising input prices and lengthening delivery times. This shows the delayed effects of supply side disruption but also the sudden acceleration of demand when restrictions are dropped. It is doubtful this will trigger a significant increase of consumer price inflation. The

PMI surveys show that output prices have increased less than input prices. Moreover, the influence of these factors should wane during the course of the year, as producers are better able to gauge the level of demand. It would imply that the more traditional inflation drivers would gain the upper hand, like inflation expectations and, in particular, economic slack. Given the ongoing concern about the employment outlook and the absence of labour market bottlenecks, any lasting pick-up in inflation should be a very gradual process.

William De Vijlder

EUROZONE: CORE HICP INFLATION RATE



SOURCE: EUROSTAT, BNP PARIBAS

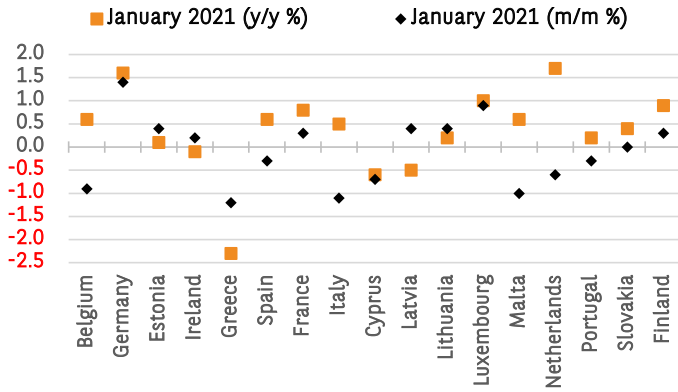
1. Source: Eurostat. <https://ec.europa.eu/eurostat/web/hicp/publications>.

2. Eurostat has written a special note on the updating of the HICP weights: <https://ec.europa.eu/eurostat/documents/10186/10693286/Guidance-on-the-compilation-of-HICP-weights-in-case-of-large-changes-in-consumer-expenditures.pdf>

Due to the Covid-19 pandemic, inflation data have become very noisy. Supply disruption may cause temporary increases, but given the economic slack, any lasting pick-up in inflation should be a very gradual process.



EUROZONE: HICP INFLATION RATE (EUROSTAT FLASH ESTIMATE)



SOURCE: EUROSTAT, BNP PARIBAS

EUROZONE: HICP INFLATION AND ITS COMPONENTS, %

	2021 weights	January 2021 annual rate	January 2021 monthly rate
All-items HICP	1000	0.9e	0.2e
All-items excluding:			
energy	905.1e	1.5e	-0.2e
energy, unprocessed food	854.5e	1.4e	-0.3e
energy, food, alcohol & tobacco	687.4e	1.4e	-0.5e
Food, alcohol & tobacco	217.6e	1.5e	0.8e
Processed food, alcohol & tobacco	167.0e	1.3e	0.7e
Unprocessed food	50.6e	1.9e	1.1e
Energy	94.9e	-4.1e	3.8e
Non-energy industrial goods	267.7e	1.4e	-1.5e
Services	419.7e	1.4e	0.0e

e Eurostat estimate

SOURCE: EUROSTAT, BNP PARIBAS

