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Eurozone: pockets of inflation in a low inflation world

■ Despite an increase in June, core inflation in the eurozone remains stubbornly low ■ The dispersion is significant between countries and between the expenditure components of the price index. Inflation is low for clothing and footwear, furnishings and household equipment, transport and communications. It is higher for housing-related items, restaurants and hotels, miscellaneous goods and services and recreation and culture ■ Non-energy industrial goods price inflation is very low. Should this continue, it would imply that the acceleration of inflation which is the ECB is pursuing by renewed policy easing, has to come from services. However, research shows that it takes more time for services prices to respond to monetary policy and economic activity. Monetary accommodation is here to stay.

In June, the annual inflation rate for the eurozone was 1.3%. Core inflation –which excludes energy, alcohol, food and tobacco- rose to 1.1%, from 0.8% in May. Since the start of the year, it has been fluctuating between 0.8% and 1.3%. Both inflation measures remain well below the objective of the ECB, which is to have, over the medium term, a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) below but close to 2%.

Yet, the average hides considerable dispersion, which has a large impact on national real interest rates. As shown in chart 1, five countries have inflation of 2% or more but five countries, among which France and Italy, are below 1.0%. In Germany, despite massive bottlenecks, core inflation is only 1.5%. The dispersion is also considerable when looking at the expenditure items per country. The highlighted cells in chart 2 show inflation higher than 1.5%. In most countries, inflation is low for clothing and footwear, furnishings and household equipmentⁱ, transport and communications. The picture on education is mixed, but it only represents 1% of HICP. Housing-relatedⁱⁱ items, restaurants and hotels, miscellaneous goods and servicesⁱⁱⁱ and, to a lesser extent, recreation and culture, have inflation of 1.5% or more, sometimes significantly so. Inflation well above average for restaurants, hotels, recreation and culture doesn't come as a surprise at this point of the business cycle: a low unemployment rate, low interest rates and good growth in compensation support consumer spending, which creates room for companies to raise prices. Housing-related inflation is explained by higher energy bills and bottlenecks in the construction sector.

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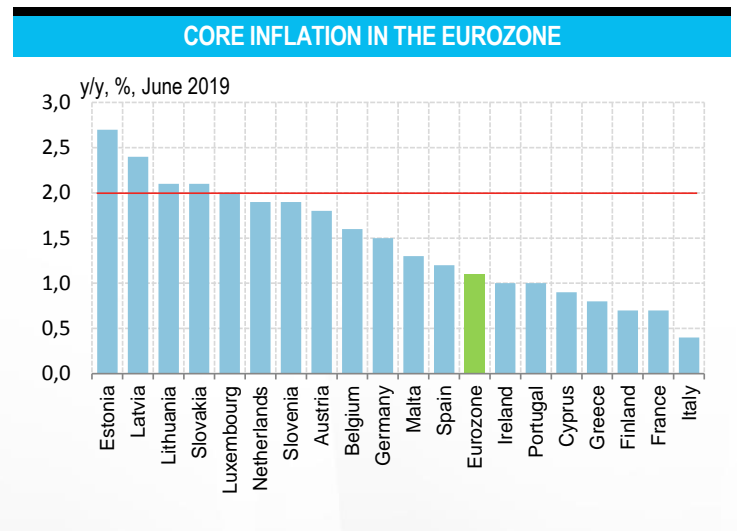


Chart 1

Source: Eurostat

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Economic scenario

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Another measure of dispersion is the difference between services and goods prices (chart 3). Whereas services price inflation ranges between 1.4% and 3.4%, goods price inflation is very low at 0.3%. There is virtually no inflation for a long list of items (bicycles, clothing and footwear, watches, household textiles, medical products, furnishings, refrigerators, freezers, toys, etc.) and inflation is even negative for a broad range of items (mobile telephone equipment, personal computers, cameras, household appliances, lighting equipment, etc.). This reminds us of the usual explanations for the structural decline of inflation: globalisation and increased competition via internet, which facilitates price comparisons.

The charts also illustrate the challenges faced by the ECB. Food including alcohol and tobacco has a weight of 19% in HICP, energy 10%, so monetary policy tries to influence the remaining 71%. The weight of non-energy industrial goods is 26.4%, but for structural reasons goods price inflation remains stubbornly low. Moreover, a slowing economy and persistently high uncertainty restrain the eagerness of companies to raise prices. This implies, for inflation to move closer to the ECB's target on a lasting basis, services inflation needs to accelerate further from an already satisfactory level. Against this background, Benoît Coeuré's comment in a recent speech^{iv} that "prices in the services sector change much less frequently than in other sectors and are less sensitive to exchange rates" which implies that "it takes longer for inflation to respond to changes in monetary policy and economic activity than it did a few decades ago" reminds us that patience will be necessary. Monetary accommodation is here to stay.

EUROZONE INFLATION: GOODS VERSUS SERVICES



Chart 3

Source: Eurostat

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ⁱ This concerns items such as household furniture, lighting equipment, carpets, repair of furniture, household textiles, household appliances, cleaning and maintenance products, domestic services, etc.
ⁱⁱ Items consist of actual rentals for housing, maintenance and repair of the dwelling, services of plumbers, electricians, painters, carpenters, cost of water, electricity and gas supply, etc.
ⁱⁱⁱ This covers personal care, jewellery, social protection, insurance, charges by banks and post offices, legal services and accountancy, etc.
^{iv} The rise of services and the transmission of monetary policy, Speech by Benoît Coeuré, Member of the Executive Board of the ECB, at the 21st Geneva Conference on the World Economy, 16 May 2019

INFLATION DISPERSION: SERVICES AND GOODS PRICES

June 2019	HICP	Core inflation	Clothing and footwear	Housing, water, electricity, gas and other fuels	Furnishings, household equipment and routine household maintenance	Health	Transport	Communications	Recreation and culture	Education	Restaurants and hotels	Miscellaneous goods and services
Germany	1,5	1,5	2,2	2,2	0,6	1,1	2,1	-1,2	1	-3,6	3	2,3
Austria	1,6	1,8	-0,4	3,1	1,4	1,5	0,6	-2,5	1,5	2,4	3	2
Belgium	1,3	1,6	0,4	0,5	0,6	1,1	1	0,1	2,1	1,3	3,2	2,1
Cyprus	0,3	0,9	-4,2	5,3	0,1	0	0,1	-2,8	2	1,9	0,2	1,2
Spain	0,6	1,2	1,7	-1,4	0,6	0,7	0	0,1	-0,5	1	2,4	1,7
Estonia	2,6	2,7	0,8	2,9	1,7	2,2	-0,5	-2,7	6,2	4,4	5,7	2,5
Finland	1,1	0,7	-1,6	3,3	1	0,8	0,2	0,2	-1	1,2	2,1	1,4
France	1,4	0,7	-0,8	2,5	0,2	-0,8	0,8	-2,5	0,6	2,4	1,6	1
Greece	0,2	0,8	-0,1	-0,1	-1,9	0,7	0,4	3,7	-0,7	-0,8	1,4	-0,9
Ireland	1,1	1	-1	4,5	-3,5	0,4	1,1	-6,6	0,3	1,7	3,2	-0,4
Italy	0,8	0,4	0,2	3,2	-0,1	0,6	0,8	-9,4	-0,3	0	1,5	1,6
Latvia	3,1	2,4	1,4	4,2	2,6	2	0,8	2	3	2,7	4,6	1,7
Lithuania	2,4	2,1	-1,1	3,2	1,9	4,6	0,4	-2,8	2,3	1,9	4,5	2,7
Luxembourg	1,5	2	1,3	2	1	1,4	-0,4	0,9	1,2	9,1	3,1	2,5
Malta	1,8	1,3	1,4	2,1	0,1	1,5	0,8	1,6	1,1	-4,6	2,1	2,5
Netherlands	2,7	1,9	-0,7	5,9	0,2	2,6	2,5	-4,9	2,3	-3,2	5,5	1,5
Portugal	0,7	1	-3,8	0,6	0,3	1	0,9	-3,8	-0,6	1,4	3,4	1,6
Slovakia	2,7	2,1	1	5,1	1,3	2,1	-2,3	3	1,6	1,4	4	3
Slovenia	1,9	1,9	1,1	5,5	1,2	2,7	-1	-1,4	1,6	3,1	3,9	1,7
Eurozone	1,3	1,1	0,4	2,3	0,4	0,7	1,1	-2,6	0,7	-0,6	2,4	1,6

Chart 2

Source: Eurostat

