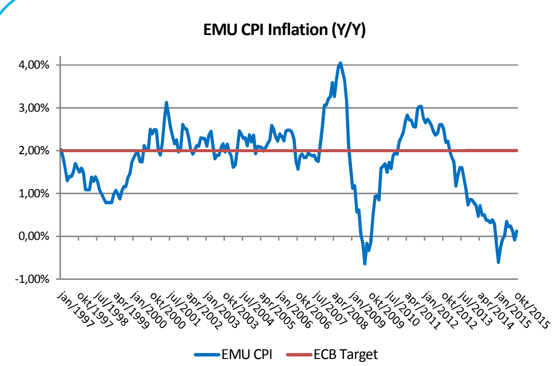
Monday, 23 November 2015

Inflation turns higher, components encouraging

Headline inflation again above 0% Y/Y

Headline inflation eased since May and dropped back below zero in September, notably to -0.1% Y/Y from +0.1% Y/Y in August. The fall in energy prices is an important factor in the decline of overall inflation. In October inflation turned higher again. Headline inflation jumped by 0.2%-points to 0.1% Y/Y, while core inflation held up better already for longer. It reached an all time low in April at 0.6% Y/Y and trended very gradually higher to 0.9% Y/Y in September and now even to 1.1% Y/Y.



In October, euro zone HICP inflation increased to 0.1% Y/Y from -0.1% Y/Y in September.

Services and goods inflation higher

Looking at the breakdown, the **details show a positive picture** with prices of goods rising to -0.85% Y/Y in October from -1.02% Y/Y in September. Overall, deflationary pressures remain based in energy-related sectors, like transport and housing, water, electricity & gas. Clothing and footwear prices went up to 0.45% Y/Y from flat, but prices in this sector are too volatile to draw already firmer conclusions. Furnishing prices showed little variation as did alcohol & beverage. Food price inflation on the contrary is clearly rising, up to 1.45% Y/Y in October from 1.16% Y/Y in September.

Services inflation stabilized at 1.2% Y/Y in the period from June to September, **but rose to 1.35% Y/Y October**. It reached a record low around 1% Y/Y in the period January-March 2014. **The uptick in October services prices is encouraging, probably a consequence of the recovery of domestic demand over the last few quarters.** A warning: the increase in services was located especially in education and recreation & culture sectors, where administrative pricing often plays a large role. Interestingly, for the first month in many years communication prices stabilized on Y/Y basis. **It seems that the deflationary trend in communication is finally over,** which is from the point of view of the ECB, who wants higher inflation, a positive feature.

Looking at the **number of product groups,** those with negative annual inflation rates fell rather sharply to 19% from 26% in September and 34% at the start of the year. **So, there is no sign of deflation, i.e. being a generalized decline in goods and services prices.**

The breakdown by country shows an improvement too with 9 of the 11 countries in our sample reporting higher Y/Y inflation and only Portugal reporting declining inflation. Of the 11 countries only three had negative inflation rates (Spain, Greece and Finland) versus 6 in September

Market-based measures of inflation expectations rose a bit. The ECB's closely-watched 5yr/5yr forward rate stabilized around 1.75%, well below the ECB's 2%-target, but 10 bps higher versus previous month**. Survey-based inflation expectations (business and consumers) are still downwardly oriented.**

No time for complaisance

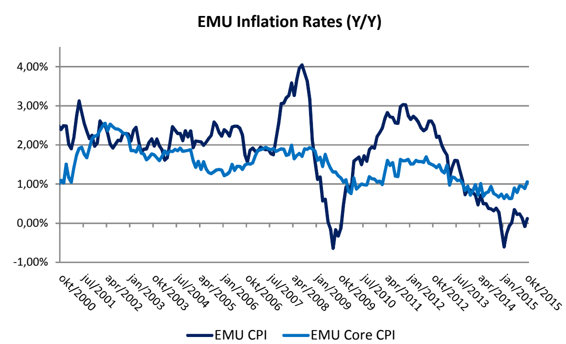
The October inflation scoreboard clearly improved in most aspects. The Euro zone is clearly not in deflation, which is a generalized fall in prices. Upcoming ECB measures will help inflation move higher. The weaker euro is another positive for inflation and the basis effect coming from earlier declining energy prices will gradually lose its impact on inflation.

However, there is no room for complaisance. **Global growth** is still fragile and deflationary pressures are exported from China and commodities towards advanced economies (see PPI and import prices). No extra slack is absorbed, meaning that **supply exceeds demand**. **Even if risks for genuine deflation may be very low, inflation will remain well below the ECB 2% target**. In a context of **too high debt levels**, low inflation hampers the gradual decline of debt and especially the debt to GDP metric. It constraints demand for goods and services from overburdened households, governments and/or firms. **Therefore, the ECB won't be satisfied by the inflation status quo and will be looking for measures to stimulate inflation. The expected modest rise in inflation in 2016 as a consequence of basis effects won't withhold the ECB from taking further action.**

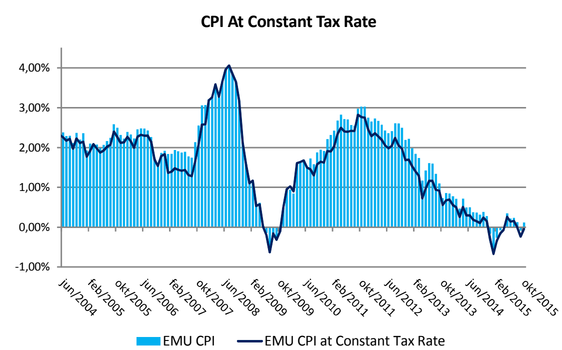
On the contrary it may convince them to bring extra stimulus forward to December. If the inflation picture improves in a couple of months, it strengthens the hand of those inside the ECB that don't belief that these extra-ordinary measures are needed in a context of low but positive inflation rates with little to no deflation risk.

Piet Lammens, KBC Dealingroom

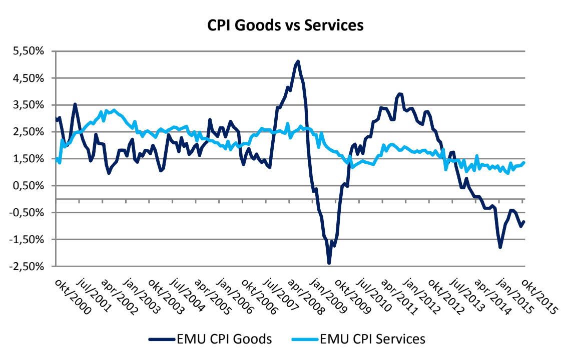
Special aggregates



While headline inflation moved again above zero in October (0.1% Y/Y), also ***core inflation increased by 0.2%-point to 1.1% Y/Y.*** *In the period Januari/April 2015, core CPI reached a new historical low at 0.6% Y/Y, stoking deflation fears.* ***So core inflation remains low too, but no second round effects coming from lower energy prices noticeable.***



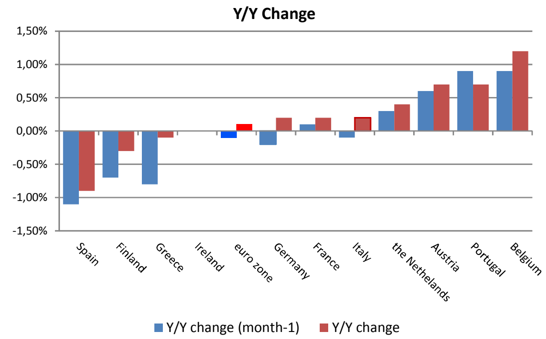
Over the previous years, governments took austerity measures including tax increases, which supported headline inflation. The effect from the tax increases has however faded significantly since. In October, ***CPI at constant tax rate rose to -0.04% from -0.23% Y/Y in September.***

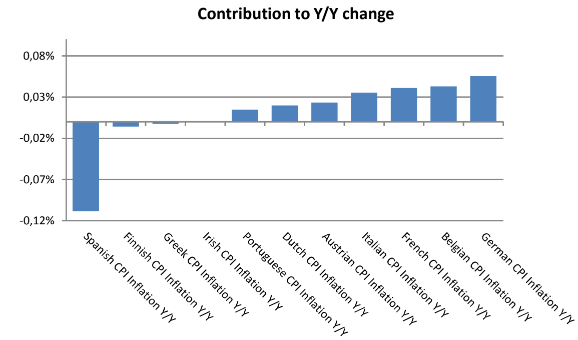


In October, ***goods deflation lessened to -0.85% Y/Y from -1.02% Y/Y previously, but services inflation increased to 1.35% Y/Y from 1.24% Y/Y in September.*** *The global slowdown keeps goods inflation under downward pressure, but the weaker euro may mitigate the effects to some extent. In the more sheltered (domestic) services sector, inflation stays up well, also as domestic growth picked up.*

	m/m	y/y
Core CPI (Ex. Food & Energy)	0,18%	1,06%
CPI Ex. Energy	0,26%	1,21%
CPI Goods	0,26%	-0,85%
CPI Services	-0,10%	1,35%
CPI at Constant Tax Rate	0,14%	-0,04%

Inflation by country



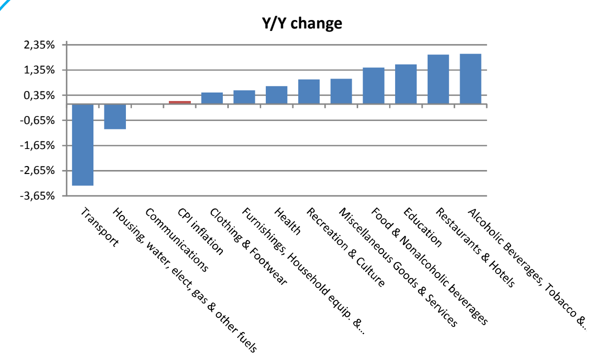


*The national data show that 3 countries **observe negative inflation,** while in September 5 countries reported falling prices.Belgium has the highest inflation rate as several taxes and administrative prices were raised to help trim the government deficit*

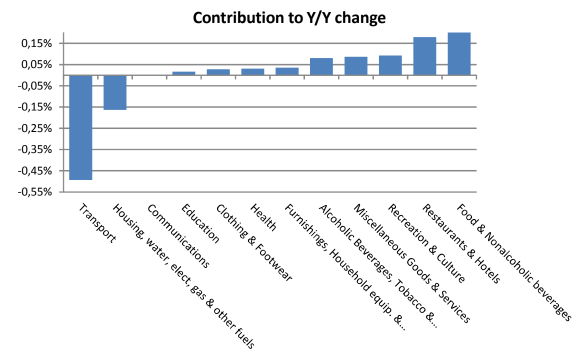
The graph above shows the contribution of each member state to the 0.1% Y/Y inflation rate (annual rates of growth multiplied by their weight in the EMU inflation reading). As Spanish prices fell rather sharply into deflationary territory, it weighed on the overall outcome

	Weight	Y/Y Change (month-1)	Y/Y Change (month)	Contribution to Y/Y Change
EMU CPI Inflation Y/Y	**1**	**-0,10%**	**0,10%**	**0,10%**
German CPI Inflation Y/Y	0,27744	-0,20%	0,20%	0,06%
French CPI Inflation Y/Y	0,20551	0,10%	0,20%	0,04%
Italian CPI Inflation Y/Y	0,17662	-0,10%	0,20%	0,04%
Spanish CPI Inflation Y/Y	0,12019	-1,10%	-0,90%	-0,11%
Dutch CPI Inflation Y/Y	0,04953	0,30%	0,40%	0,02%
Belgian CPI Inflation Y/Y	0,03585	0,90%	1,20%	0,04%
Austrian CPI Inflation Y/Y	0,03338	0,60%	0,70%	0,02%
Greek CPI Inflation Y/Y	0,02572	-0,80%	-0,10%	0,00%
Portuguese CPI Inflation Y/Y	0,02132	0,90%	0,70%	0,01%
Finnish CPI Inflation Y/Y	0,01912	-0,70%	-0,30%	-0,01%
Irish CPI Inflation Y/Y	0,01357	0,00%	0,00%	0,00%

Inflation by product group

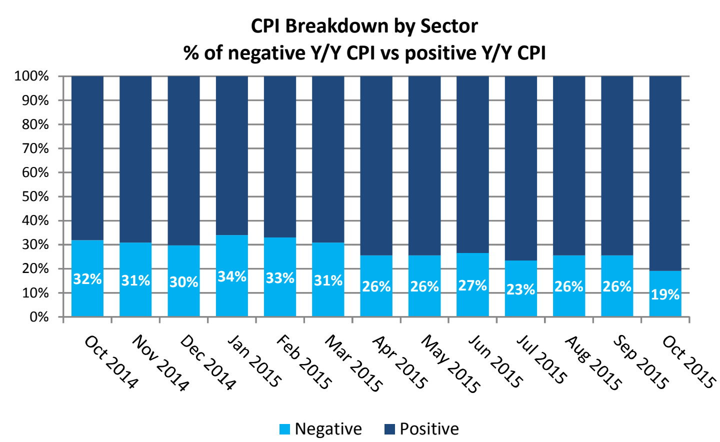


Euro zone CPI inflation rose from -0.1% Y/Y in Septembert to 0.1% Y/Y in October. Month-on-month figures show a sharp drop in prices of transport, an energy price effect, and housing, water & electr. & gas. All other sectors showed flat or positive inflation.



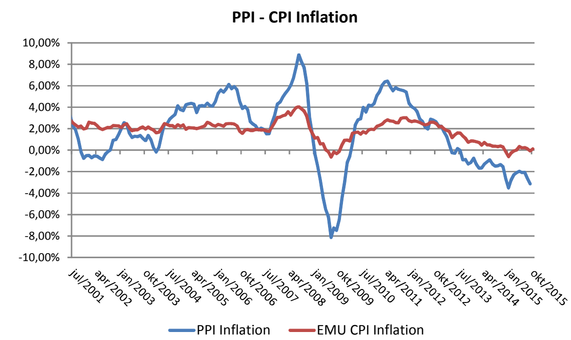
*The graph above shows the contributions of several categories of products to the 0.1% Y/Y inflation rate (annual rates of growth multiplied by their weight in the EMU inflation reading). **Food & beverages and Restaurants & hotels are the biggest positive contributors to the annual inflation rate**, while lower transportation prices and prices for housing, water, electricity and gas weigh significantly on headline inflation.*

	Weight	M/M change	Y/Y change	Contribution to Y/Y change
CPI inflation	**1**	**0,14%**	**0,12%**	**0,12%**
Food & Nonalcoholic beverages	0,1571	0,45%	1,45%	0,23%
Alcoholic Beverages, Tobacco & Narcotics	0,0404	0,01%	1,99%	0,08%
Clothing & Footwear	0,0634	1,90%	0,45%	0,03%
Housing, water, elect, gas & other fuels	0,1632	-0,08%	-1,00%	-0,16%
Furnishings, Household equip. & maintenance	0,066	0,18%	0,54%	0,04%
Health	0,0436	0,09%	0,71%	0,03%
Transport	0,1522	-0,33%	-3,24%	-0,49%
Communications	0,0306	0,00%	0,00%	0,00%
Recreation & Culture	0,0948	-0,19%	0,98%	0,09%
Education	0,0105	0,86%	1,58%	0,02%
Restaurants & Hotels	0,0914	-0,08%	1,97%	0,18%
Miscellaneous Goods & Services	0,0869	0,08%	1,00%	0,09%

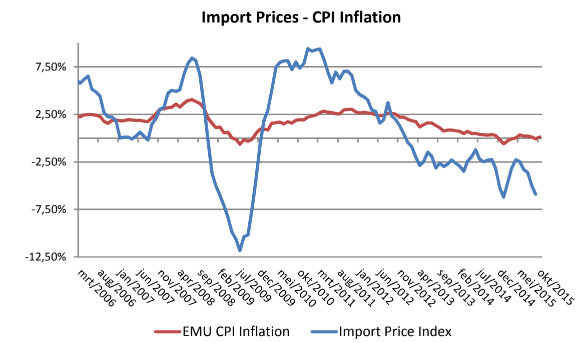


*This graph represents the percentage of product groups with positive annual CPI rates (blue) versus negative CPI rates (light blue). **The number of product groups with negative inflation rates declined rather sharply in October and are well below the highs reached in January.***

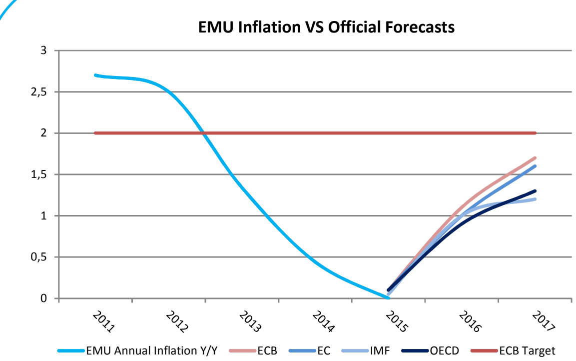
Forward-looking indicators



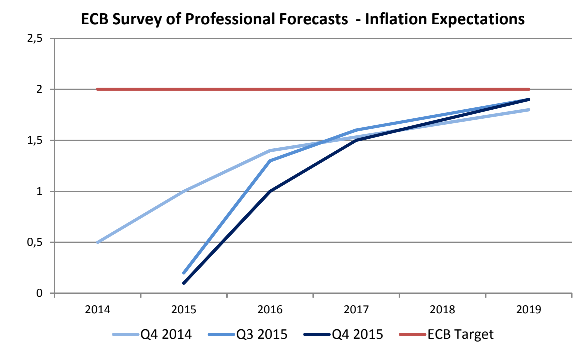
EMU PPI inflation is often seen as leading somewhat on CPI inflation. PPI (only goods) is on a downward path since early 2011 and in deflationary territory since May 2013. CPI good prices followed with a lag PPI into deflation, even if the decline in good rices is modest. PPI fell by 3.13% Y/Y in September, down from -2.63% Y/Y in August.



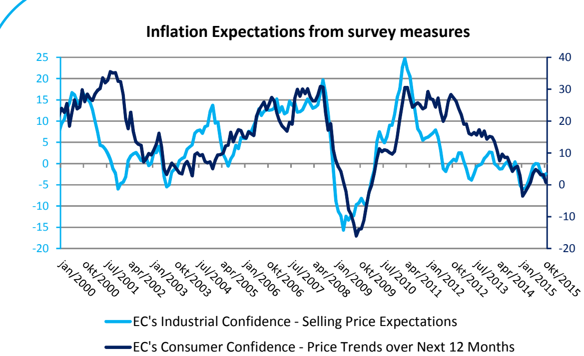
*After a sharp uptick in January-March (still negative rates), **the decline in import prices re-accelerated (to -5.89% Y/Y in September).** This shows how important it is for the ECB that the euro weakens as it mitigates more deflationary pressures from China and EM.*



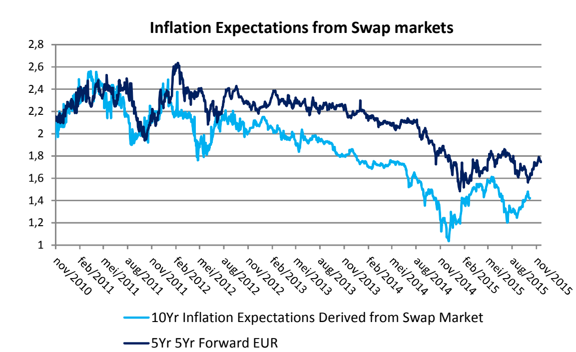
*EMU inflation rose by 0.44% Y/Y in 2014, the slowest rate of inflation since 0.3% Y/Y in 2009. **This year, inflation may be even lower,** perhaps about flat. In 2016, base effects should push headline inflation higher, although remaining well below the ECB's 2% target. No international organisation puts inflation back to 2% in 2017 either.*



***ECB professional forecasters downgraded their inflation forecasts in the fourth quarter.** For 2019, inflation expectations were revised up to 1.9% Y/Y, broadly in line with the ECB's target of below but close to 2%. For 2015 and 2016, forecasts were revised to 1% and 1.5% respectively versus 1.3% and 1.6% last quarter.*



***Survey measures of inflation expectations were mixed in October, but still in downtrend.** Consumers' price expectations fell to 0.7 from 3.2 previously, but firms' selling price expectations improved marginally to -2.4 from -3.3 previously.*



*Inflation expectations derived from the swap markets increased recently,maybe due to signs the ECB will ease policy further. **We are still somewhat above the all-time lows and tentatively the downtrend seemed to have stopped, but at levels that suggest the ECB won't reach its 2% inflation target anytime soon** The ECB's closely-watched **5yr/5yr forward trades at 1.75%; 10-yr inflation expectations at 1.435%.***

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