

Monitor

Euro area deflation monitor

Inflation outlook

Euro inflation increased to 0.7% in April. Hence, it has stayed far below the ECB's target. Inflation undershot the ECB's projection and we expect it to lower its forecast in June. Governor Draghi recently said *'there is consensus about being dissatisfied with the projected path of inflation'* and we expect more easing, see *'ECB promises to cut in June'*, 8 May 2014.

In the coming months, we forecast inflation to stay around current levels, but in Q4 14 we expect an increase to around 1%. This should partly follow as higher global food prices put upward pressure on food consumer prices. We continue to forecast average inflation at 0.7% in 2014, but we have revised our projection for 2015 slightly up to 1.1%.

The lower inflation does not contradict stronger growth in the euro area. Lower commodity prices have increased purchasing power and real wage growth was above 0.5% in H2 13. This is a clear improvement from its previous decline in 2011-12.

Deflation index

In Danske Bank's **Euro Area Deflation Index**, all countries are placed at or below zero, but the overall euro index has moved up to -5 from -6. Germany has moved up in the index, but France and the Netherlands are still placed among the periphery countries.

- The score of the **core countries** is low but is generally held up by activity indicators. Inflation should slowly increase as the recovery puts upward pressure on wages, but due to slack in the economy the pressure should be limited.
- The **periphery countries** are at the low end of the index and inflation is set to remain low as high unemployment limits wage pressure. This is partly a result of an adaptation of competitiveness, which is necessary to restore sustainable economic growth. However, the risk is that the economies end up in a low inflation equilibrium.

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Danske Bank's Euro Area Deflation Index

	HICP					Activity				Deflation Index	
	Overall	Core	Energy	Food	Ex.taxes	PMI man	GDP growth vs.potential	Unemployment vs.NAWRU	Wage growth	[-10;10]	
										Now	Previous
Euro area	0,7	1,0	-1,2	0,7	0,5	53,4	-0,1	2,7	1,6	-5	-6
Germany	1,1	1,4	-1,3	2,0	1,2	54,1	0,5	-3,0	2,1	0	-1
Austria	1,6	1,8	-1,3	2,4	1,5	51,4	-0,1	0,7	2,1	-2	-2
Belgium*	0,9	1,8	-6,9	2,0	1,1	54,3	0,0	0,8	2,0	-2	-3
Finland*	1,3	1,8	-1,1	0,5	0,8	47,8	-0,8	1,1	2,0	-3	-3
Ireland	0,4	0,9	-2,2	-0,1	na	56,1	1,0	3,7	-3,8	-4	-5
Italy	0,5	1,1	-2,8	0,1	0,2	54,0	-0,2	4,4	1,2	-5	-5
Spain	0,3	0,1	1,6	0,4	0,3	52,7	-0,2	11,2	2,1	-5	-6
France	0,8	1,2	-0,6	0,2	0,3	51,2	-0,4	1,2	1,8	-5	-5
Portugal*	-0,1	0,1	-0,6	-0,4	-0,2	51,7	-0,9	5,6	3,5	-6	-5
Netherlands	0,6	0,9	-0,8	0,4	0,4	53,4	-1,7	3,4	1,3	-6	-6
Greece**	-1,6	-2,2	1,4	-1,2	-0,7	51,1	-0,6	14,9	-6,9	-7	-8

High
inflation



Deflation

Note: Sorted by Danske Bank's Deflation Index, which is a weighted average of the indicators in the table.

*A standardised industrial confidence indicator is used instead of PMI

**GDP and wages are not seasonally adjusted

Source: Macrobond, Danske Bank Markets

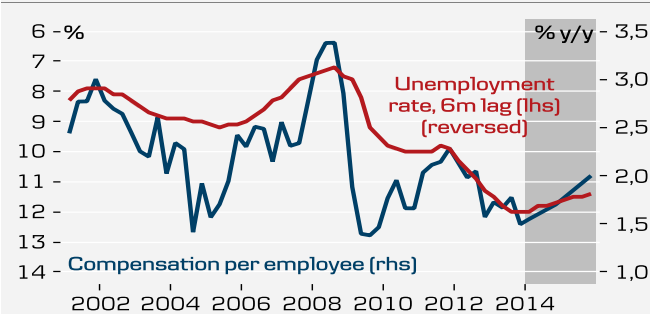
Inflation outlook details

Core inflation went up from 0.7% in March to 1.0% in April. Looking ahead, we expect it to remain around the current low level in 2014 largely due to weak price pressure from the labour market as a result of high unemployment. In 2015, it should slowly increase as economic growth should pick up further, implying that the unemployment rate will decline. However, slack in the economy is likely to result in moderate wage growth, which should limit the pressure on core inflation. Moreover, core inflation will be affected negatively by a drop out of the impact from tax hikes, which now adds around 0.2pp. Since 2010, average core inflation has been very low at 1.2% and excluding taxes it was even lower at 1.0%.

Inflation in food prices decreased to 0.7% in April, which is the lowest rate since March 2010. Although global food prices increased at the beginning of 2014, the yearly change is still below the historical average of 5.6%. Additionally, there is a longer lag from a change in global food prices to food price inflation. In H2 14, we expect food price inflation to increase due to a combination of positive base effect and a spill-over from the higher global food prices.

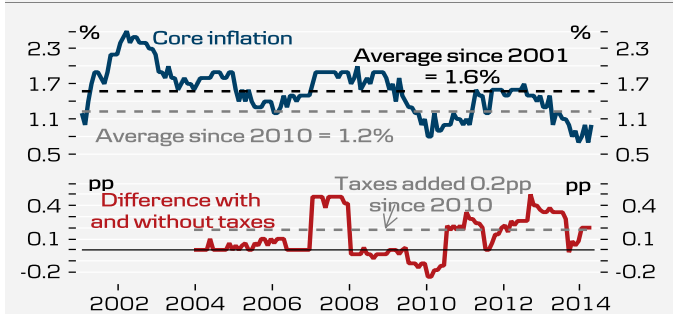
Energy price inflation was still very low and negative at -1.2% in April. We expect it to be less negative for the rest of Q2 due to temporary upward pressure from base effects. Even though energy price inflation should decline at a more moderate rate in coming months, it should remain negative in 2014 and 2015. The forecast of negative energy price inflation follows as oil supply is boosted by new technology to make the most of shale formations, while growth in demand is slowing as growth in China is less energy intensive.

Weak price pressure partly due to high unemployment rate



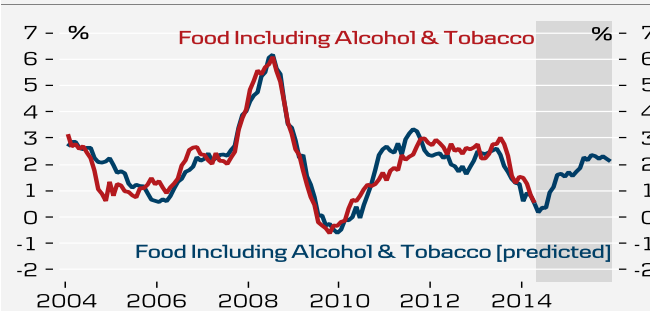
Source: Eurostat, Danske Bank Markets

Average core inflation 1.2% since 2010 (taxes added 0.2pp)



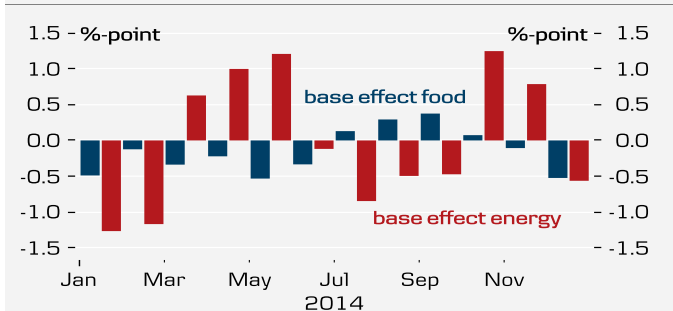
Source: Eurostat, Danske Bank Markets

Our food price model points to higher inflation in H2 14



Source: Eurostat, Bloomberg, Danske Bank Markets

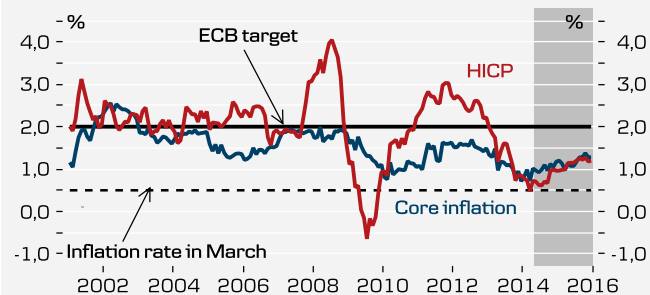
Base effect should lead to higher energy price inflation in Q2



Source: Eurostat, Danske Bank Markets

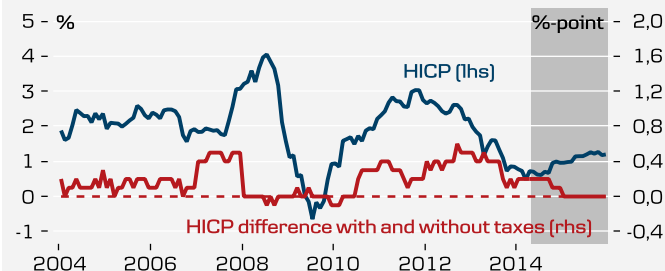
Euro area

We expect inflation to remain around current level until Q4



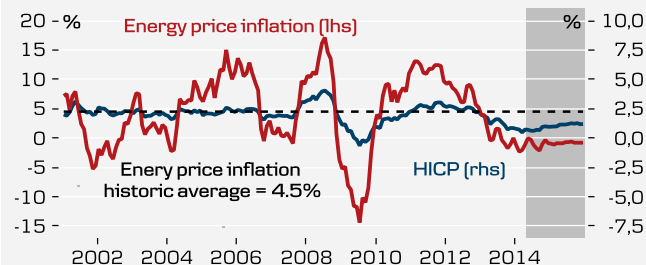
Source: Eurostat, Danske Bank Markets

Tax hikes continue to keep inflation up, but it will fall out



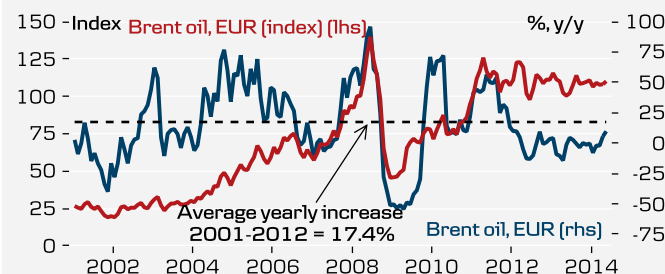
Source: Eurostat, Danske Bank Markets

Inflation in energy prices set to stay around zero



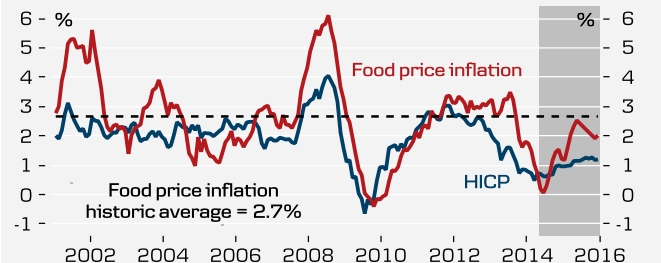
Source: Eurostat, Danske Bank Markets

The yearly oil price increase from 2001-12 was 17.4%



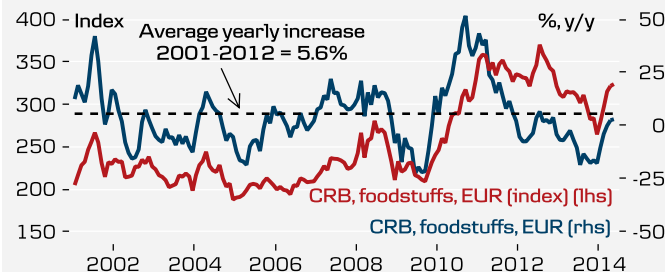
Source: Eurostat, Danske Bank Markets

Food price inflation to pick-up due to higher global food prices



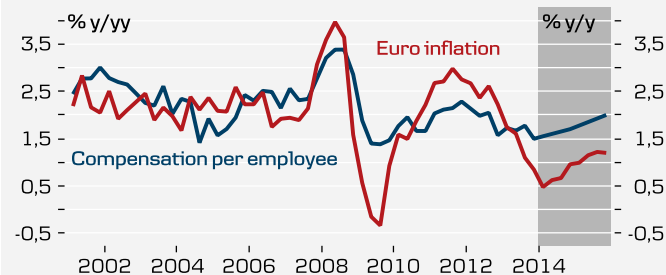
Source: Macrobond Financial

The yearly change in global food prices is still below average



Source: Macrobond Financial, Danske Bank Markets

Nominal wage growth set to remain subdued...



Source: Macrobond Financial, Danske Bank Markets

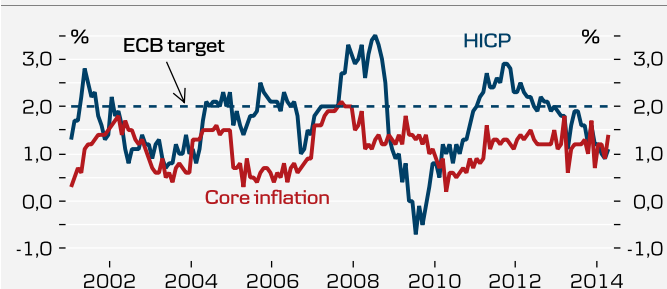
...but real wage growth is helped up by lower inflation



Source: Macrobond Financial, Danske Bank Markets

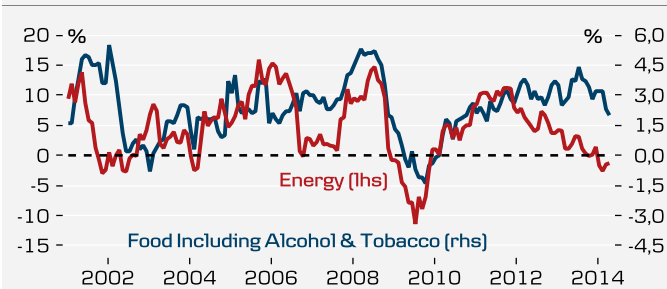
Germany

Inflation remains low and was 1.1% in April



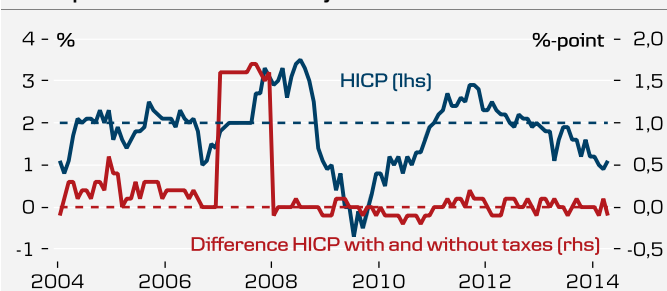
Source: Eurostat

Food price inflation declined in March and April



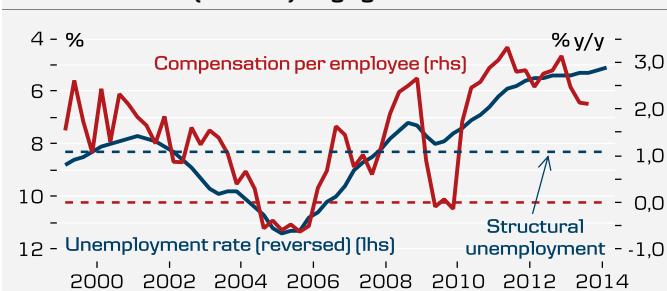
Source: Eurostat

No impact from taxes recently



Source: Eurostat

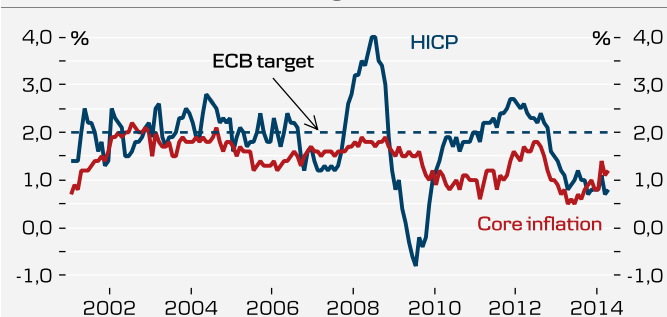
Positive nominal (and real) wage growth



Source: Macrobond Financial

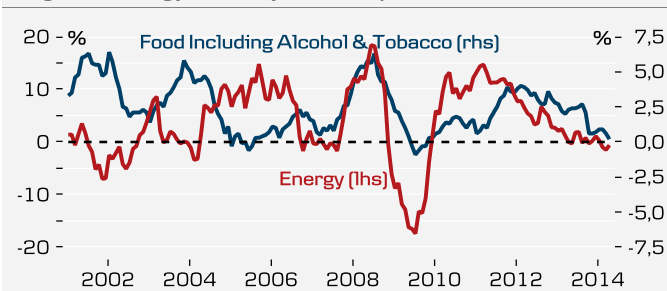
France

French inflation well below target but core inflation increases



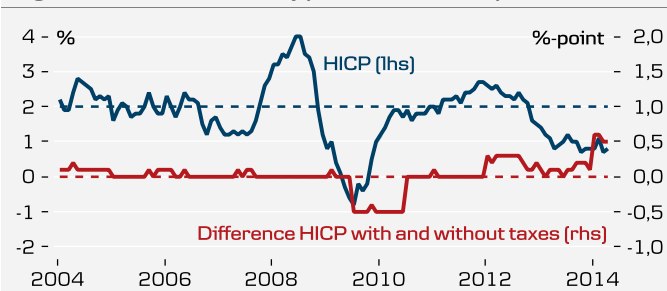
Source: Eurostat

Negative energy and very low food price inflation



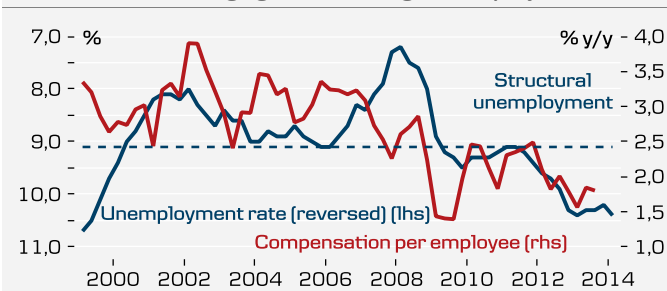
Source: Eurostat

Higher VAT rate in January pushes inflation upwards



Source: Eurostat

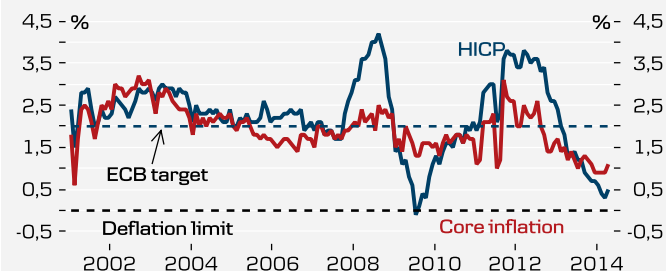
Positive nominal wage growth, but high unemployment rate



Source: Macrobond

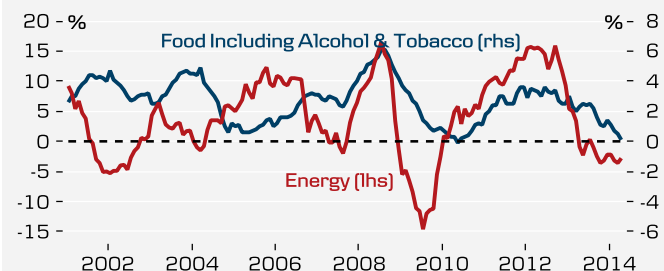
Italy

Inflation a bit higher in April, but still not far from deflation



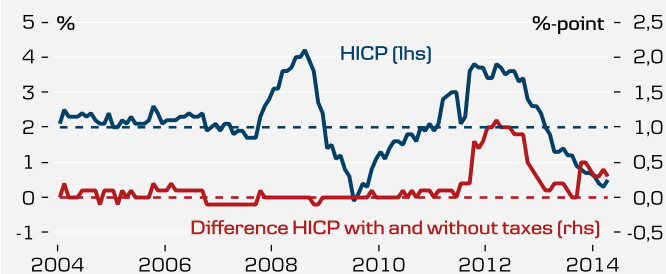
Source: Eurostat

Very low energy and food price inflation



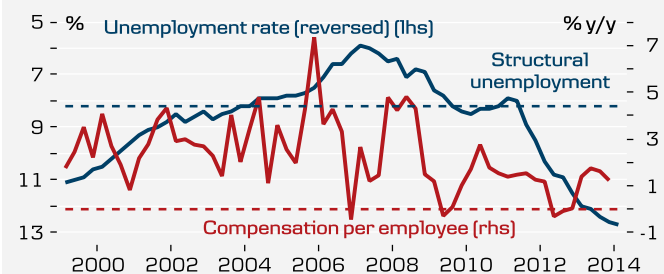
Source: Eurostat

VAT hike in October pushes inflation up



Source: Eurostat

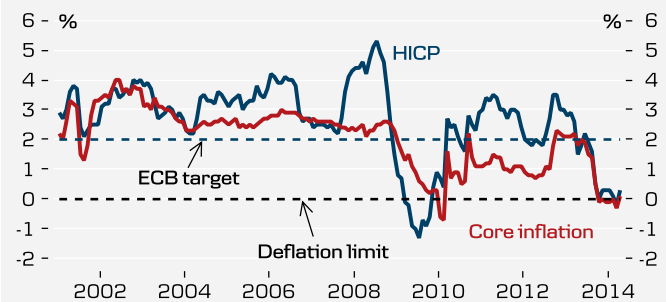
Unemployment rate shows first signs of stabilisation



Source: Macrobond

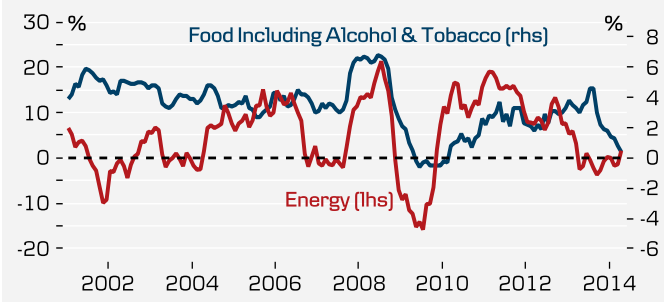
Spain

Positive inflation in April, but still around deflation limit



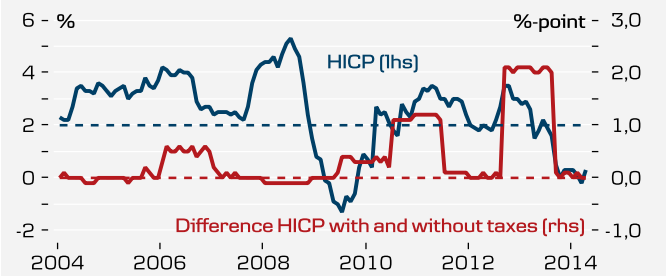
Source: Eurostat

Energy and food price inflation around zero



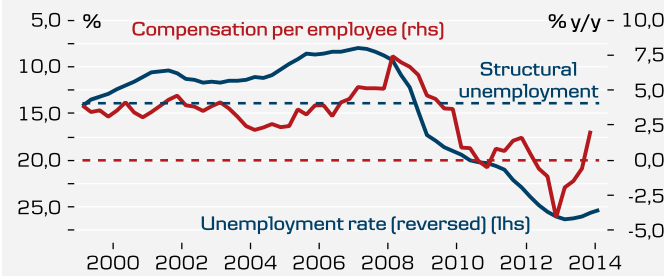
Source: Eurostat

Impact of tax hikes dropped out in 2013



Source: Eurostat

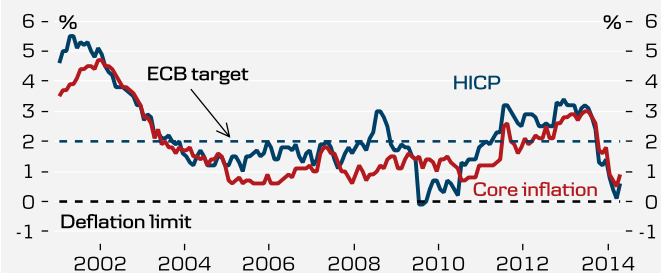
Nominal wage growth was positive in Q4



Source: Macrobond

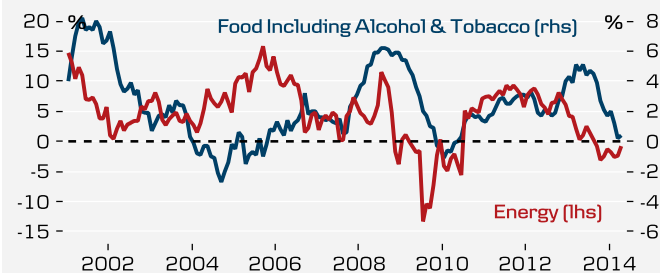
The Netherlands

Inflation higher in April, but not far from the deflation limit



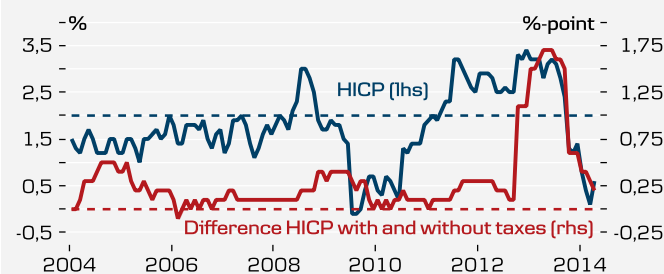
Source: Eurostat

Inflation in energy and food price inflation close to zero



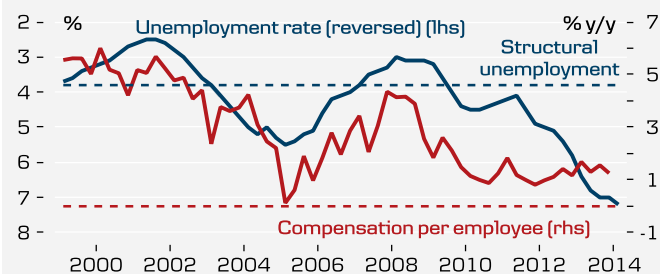
Source: Eurostat

Excluding taxes inflation is even lower



Source: Eurostat

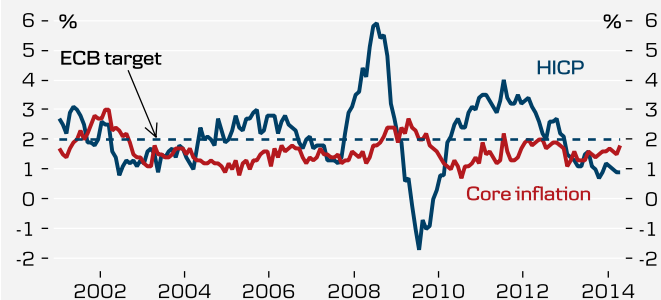
Positive but low wage growth and high unemployment rate



Source: Macrobond

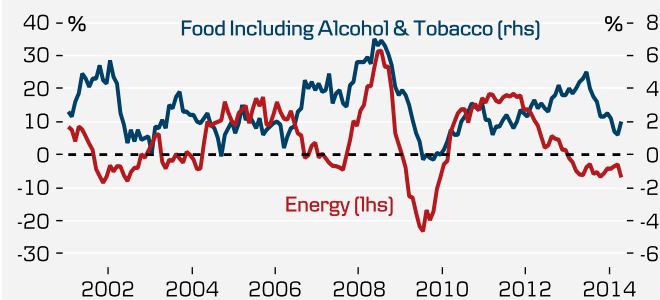
Belgium

Inflation remains close to 1.0%



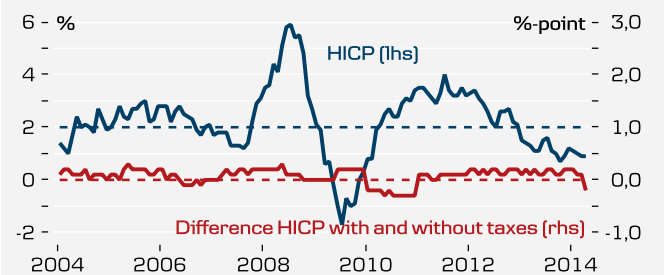
Source: Eurostat

Decline in headline a result of lower food and energy prices



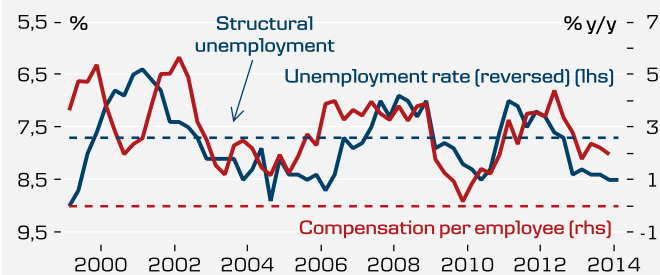
Source: Eurostat

Negative impact from taxes in April



Source: Eurostat

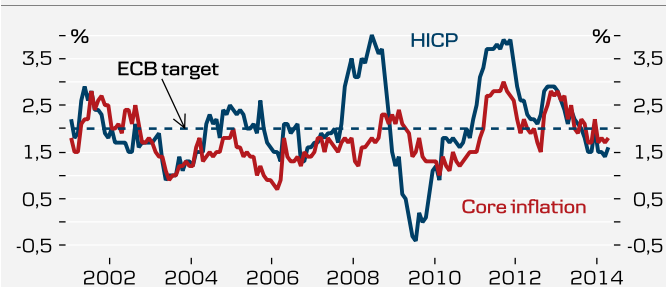
Nominal (and real) wage growth above zero



Source: Macrobond

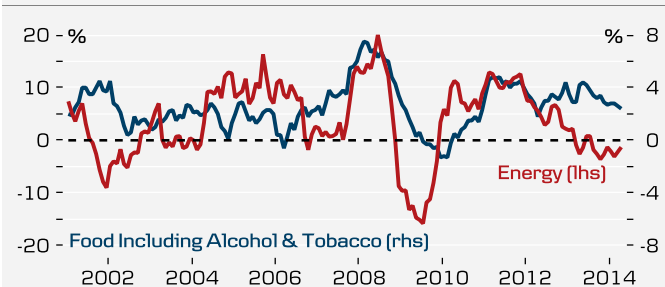
Austria

Inflation was 1.6% in April after it declined during 2013



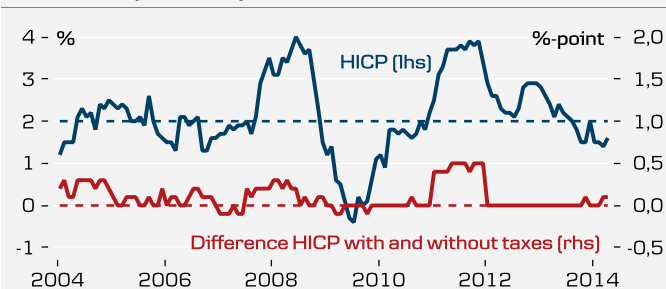
Source: Eurostat

Inflation in food prices has slowly trended down recently



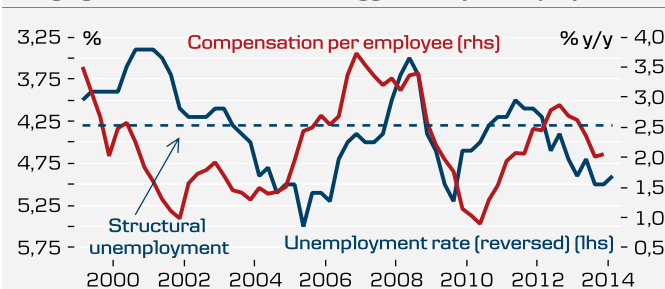
Source: Eurostat

Taxes have practically not affected inflation since end-2011



Source: Eurostat

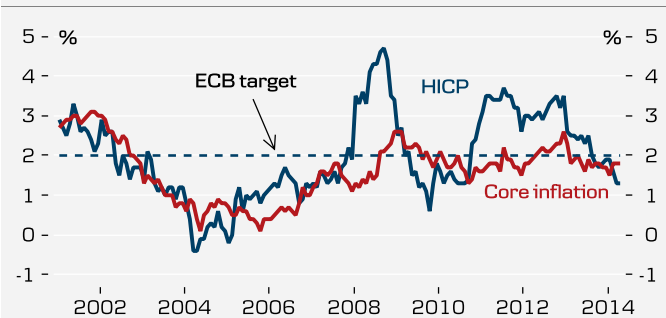
Wage growth has declined as suggested by unemployment



Source: Macrobond

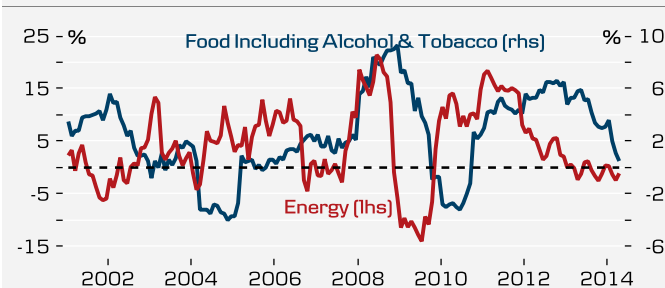
Finland

Inflation at 1.3% in April



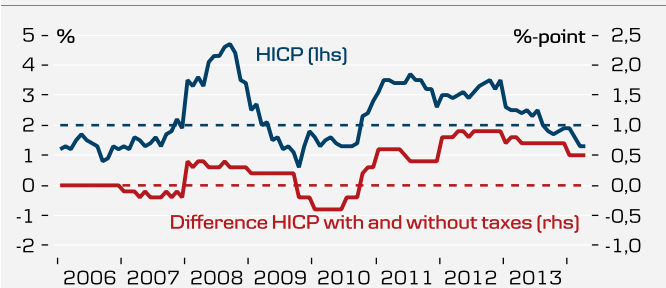
Source: Eurostat

Inflation in food prices has moved down fast



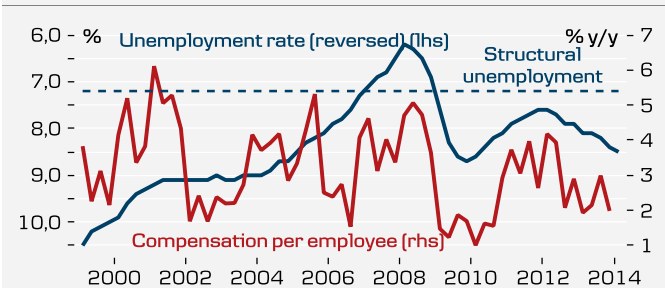
Source: Eurostat

Inflation is held up due to taxes



Source: Eurostat

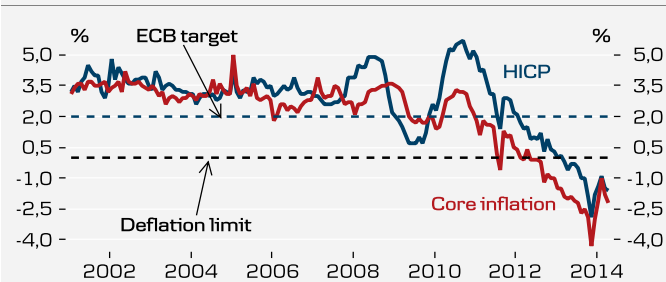
Unemployment rate increases but wages more stable



Source: Macrobond

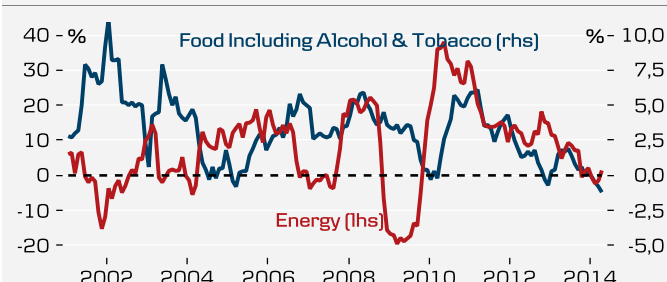
Greece

Deflation at 1.6% in April but core inflation has improved



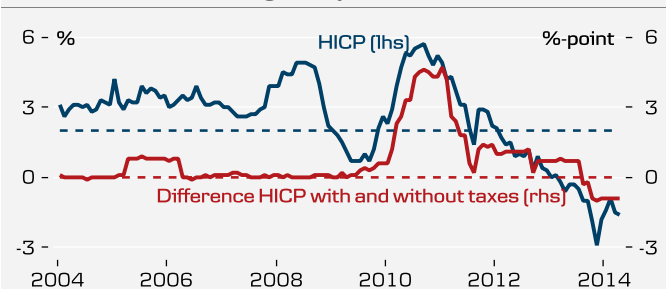
Source: Eurostat

Energy and food price inflation around zero



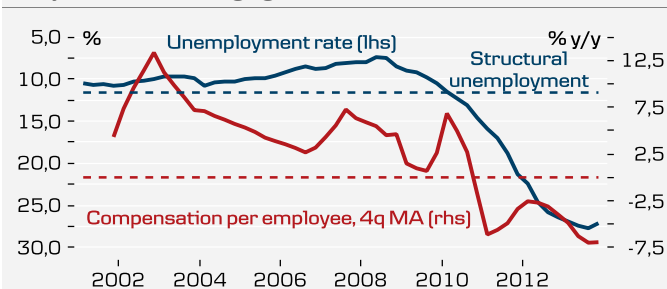
Source: Eurostat

Taxes affect inflation negatively



Source: Eurostat

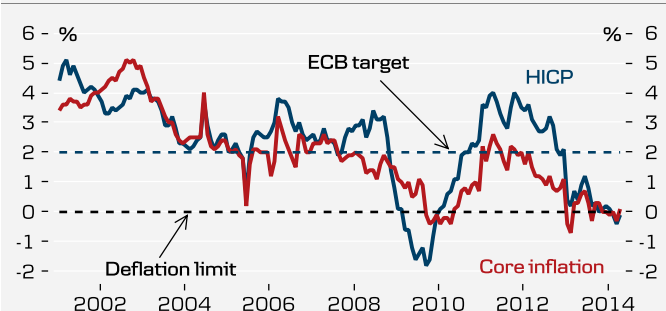
Very low nominal wage growth



Source: Macrobond

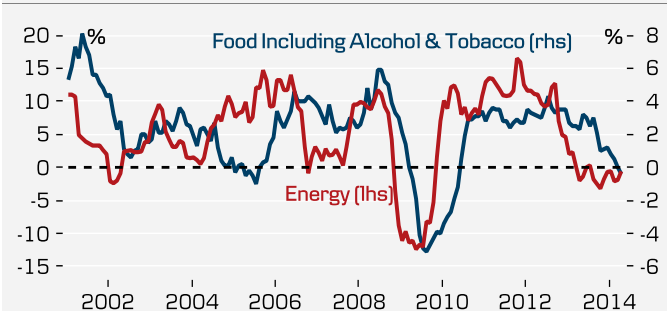
Portugal

Portugal remained in deflation in April



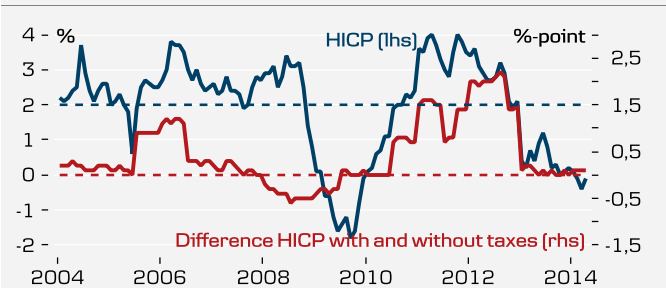
Source: Eurostat

Negative food and energy price inflation



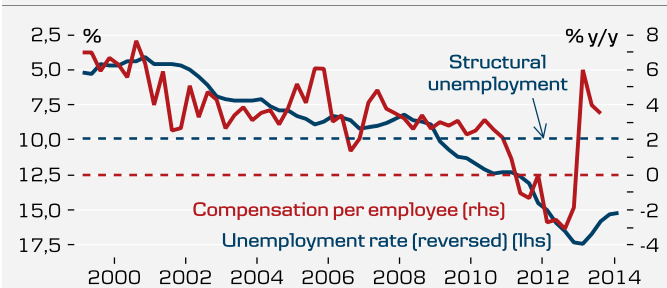
Source: Eurostat

Fall in inflation at beginning of 2013 due to taxes



Source: Eurostat

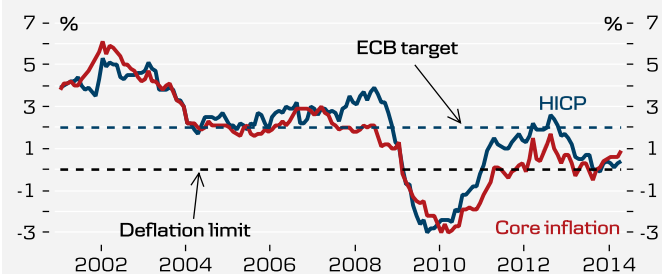
The unemployment rate has started to decline



Source: Macrobond

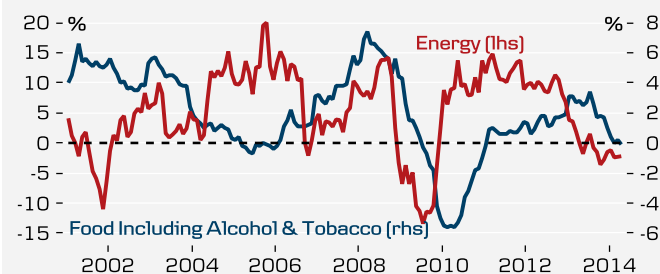
Ireland

Inflation remains around deflation limit, but core increases



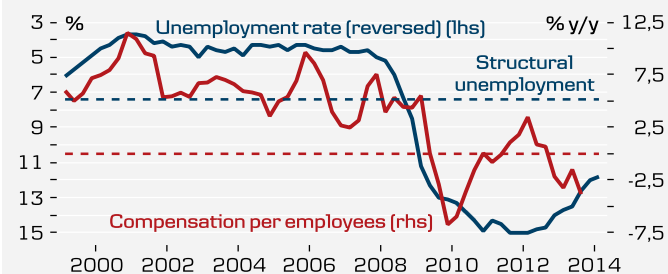
Source: Eurostat

Negative food and energy price inflation



Source: Eurostat

The unemployment rate continues to decline



Source: Macrobond

Disclosure

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