

Inflation and deflation risks: How to recognise them? How to avoid them?

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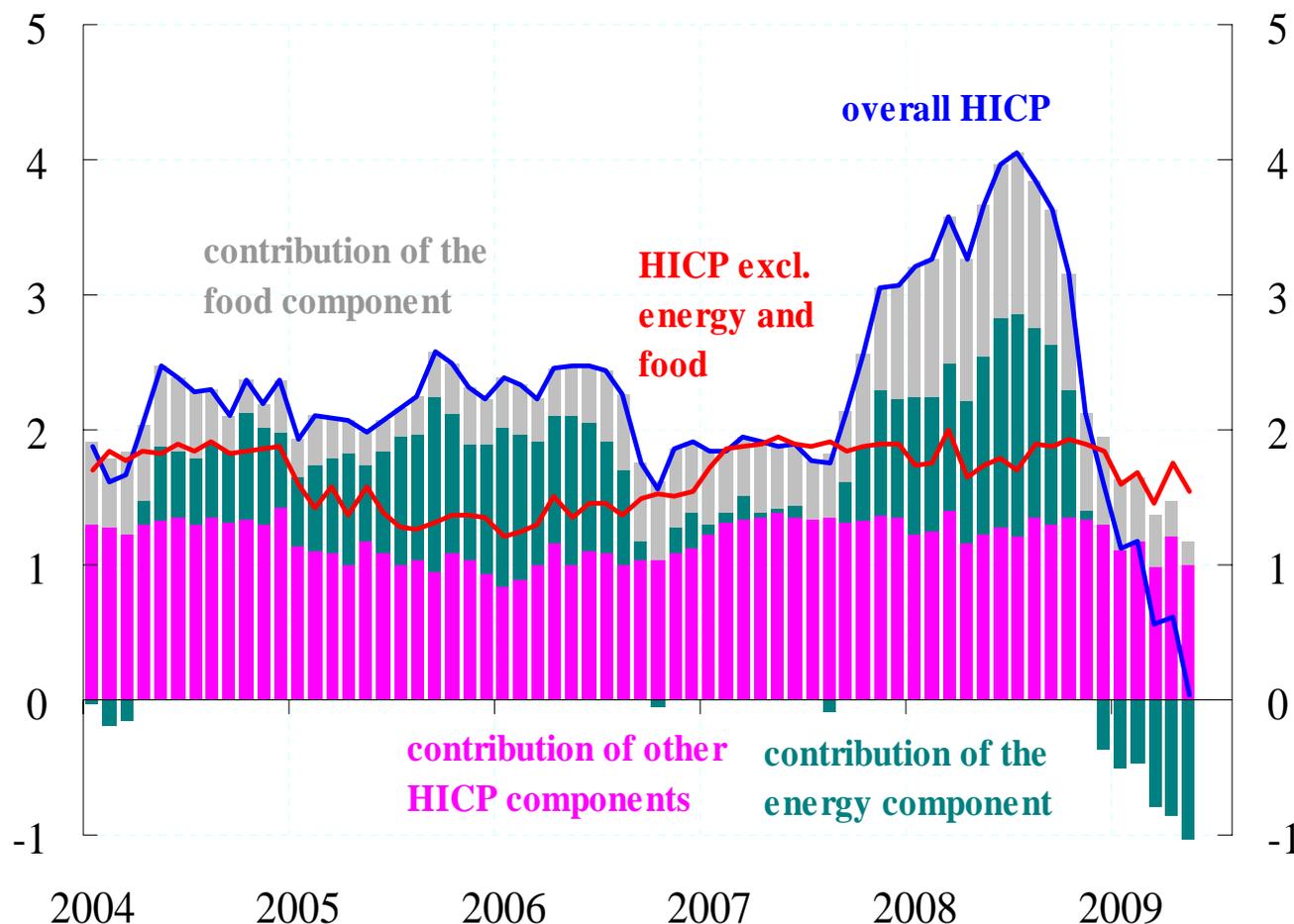
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CEIS – Centre for Economic and International Studies
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The decline in HICP inflation is mainly explained by developments in food and energy items

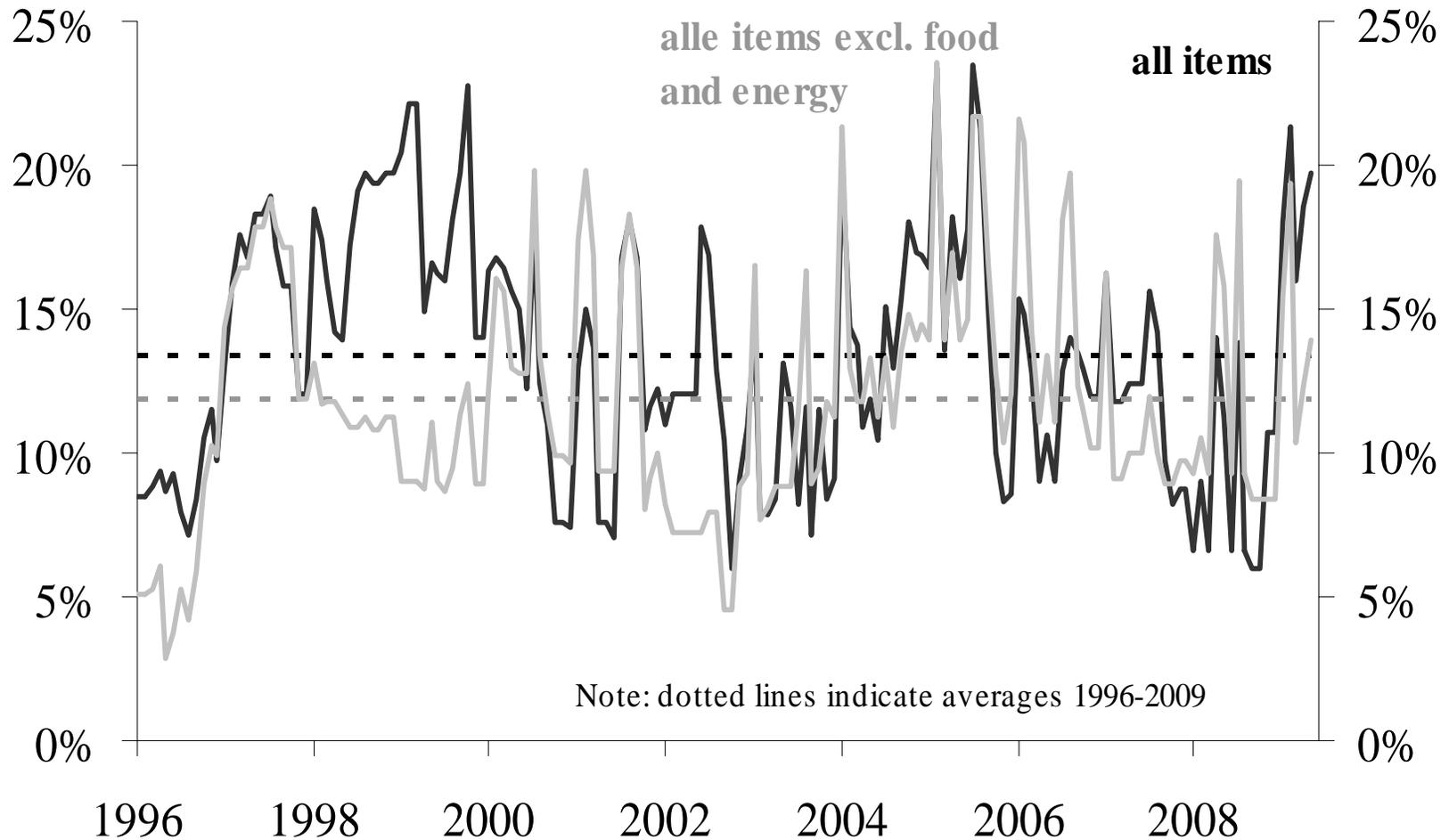
(annual growth rates and percentage point contribution)



Contribution to HICP inflation. Latest observation: May 2009.

Sources: Eurostat and ECB calculations.

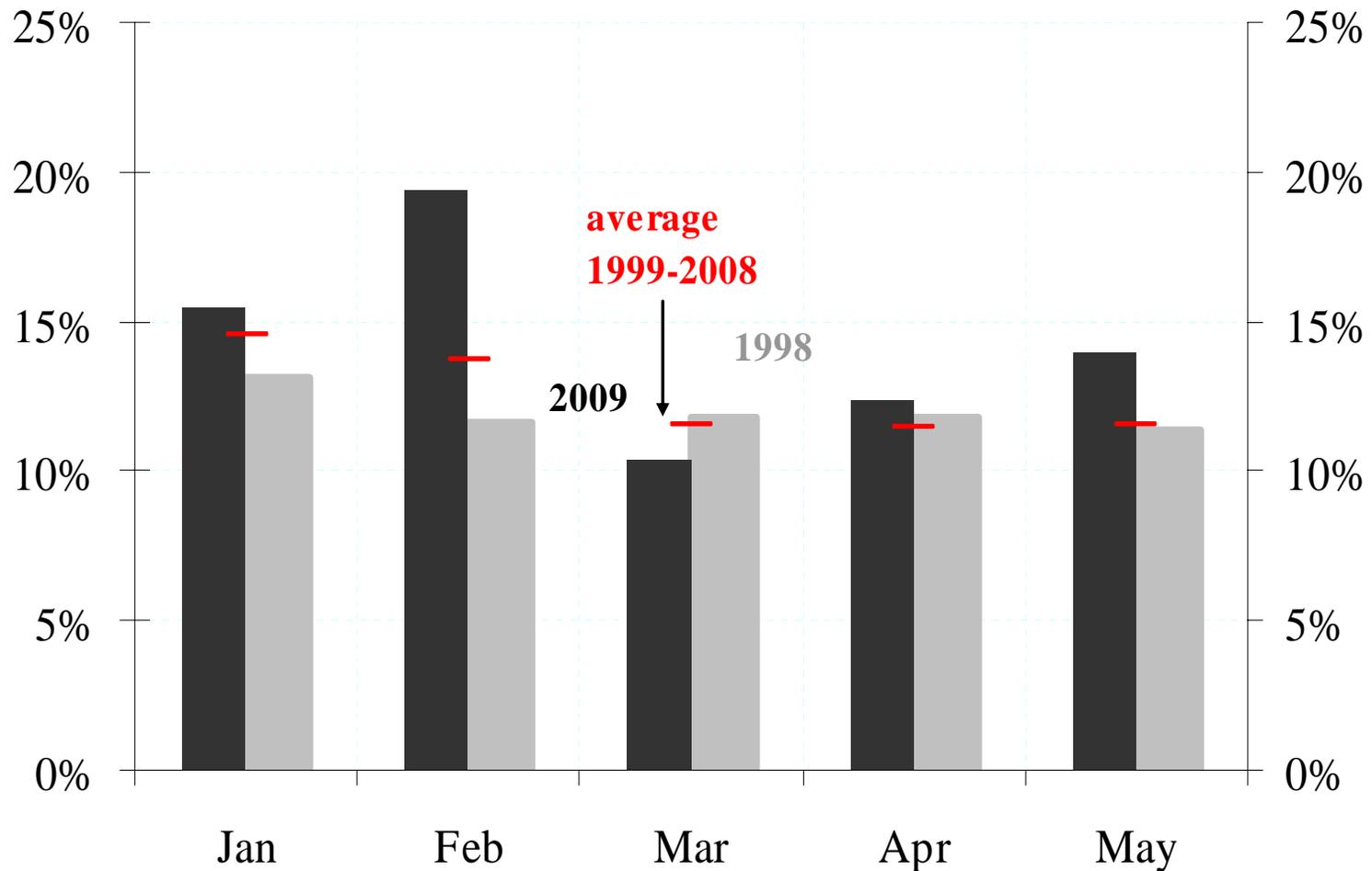
Excluding energy and food, there is little sign of widespread price cuts



Share of HICP items with negative annual inflation rates. Latest observation: May 2009.

Sources: Eurostat and ECB calculations.

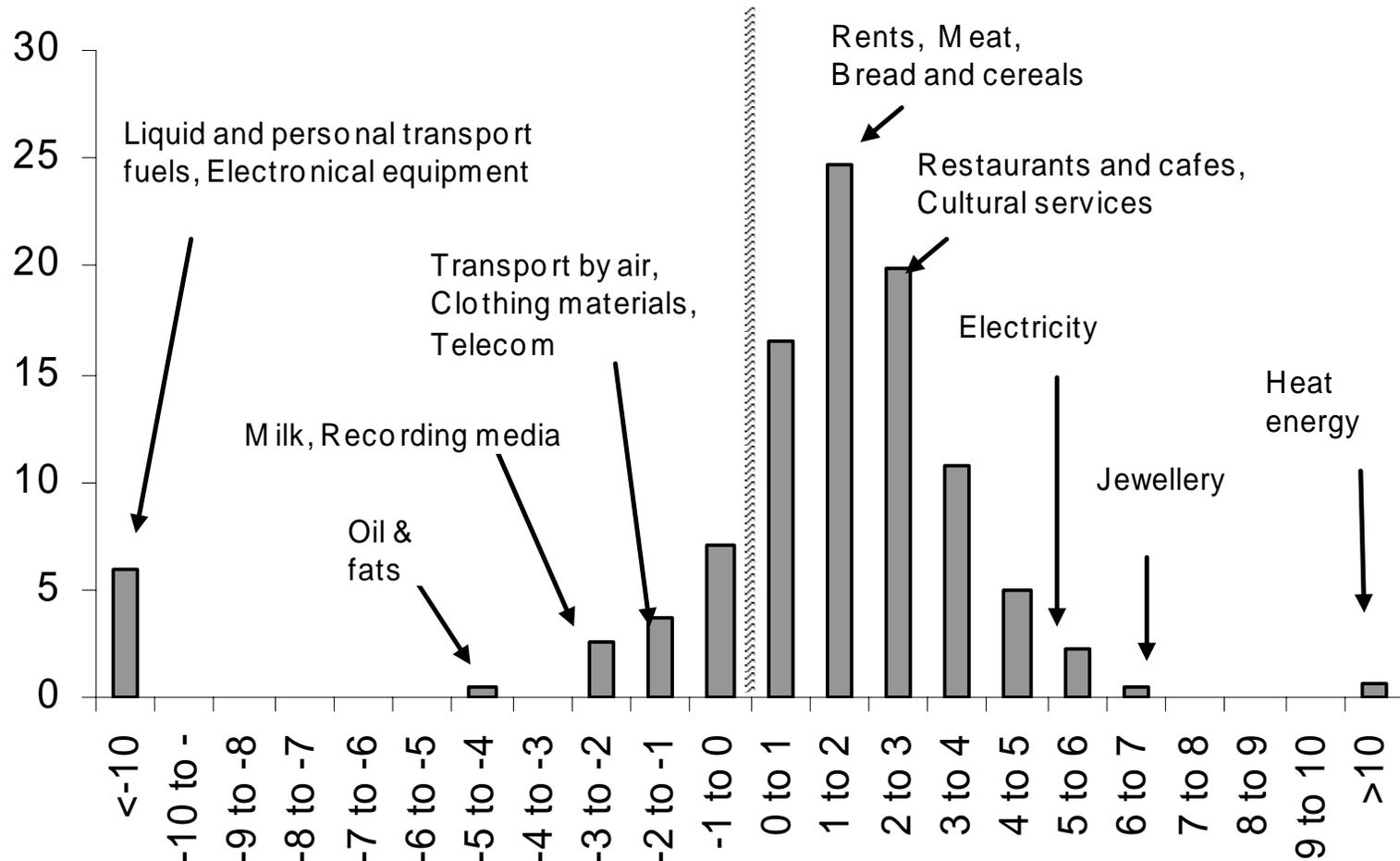
Share of HICP items with negative annual rates of change is broadly in line with historical patterns



*HICP excluding food and energy: share of HICP items with negative annual growth rates.
Sources: Eurostat and ECB calculations.*

Most prices in the euro area are still growing at annual rates of 1% or above

(percentage share)

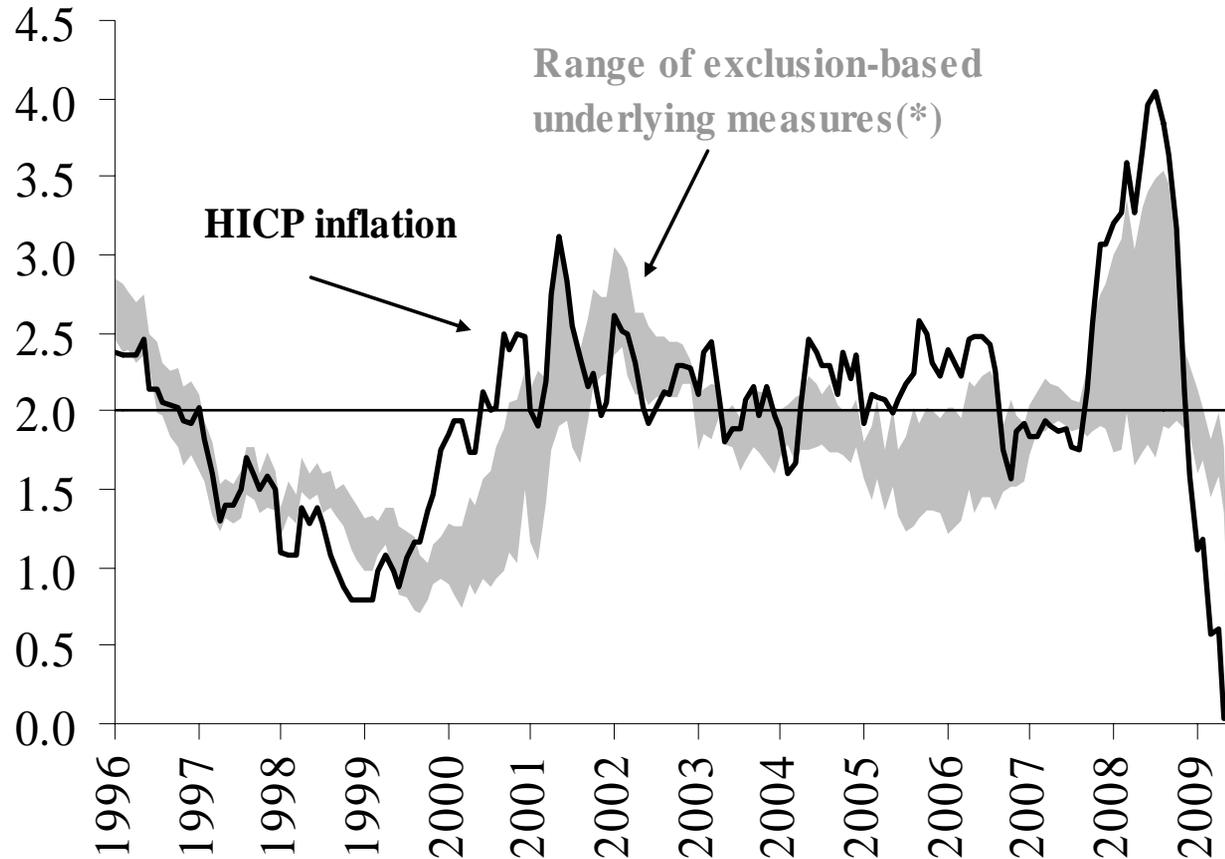


Distribution of weighted annual rates of change of HICP items in May 2009

Sources: Eurostat and ECB calculations.

Measures of underlying inflation have come off their peak but are not exceptionally low

(annual growth rates)



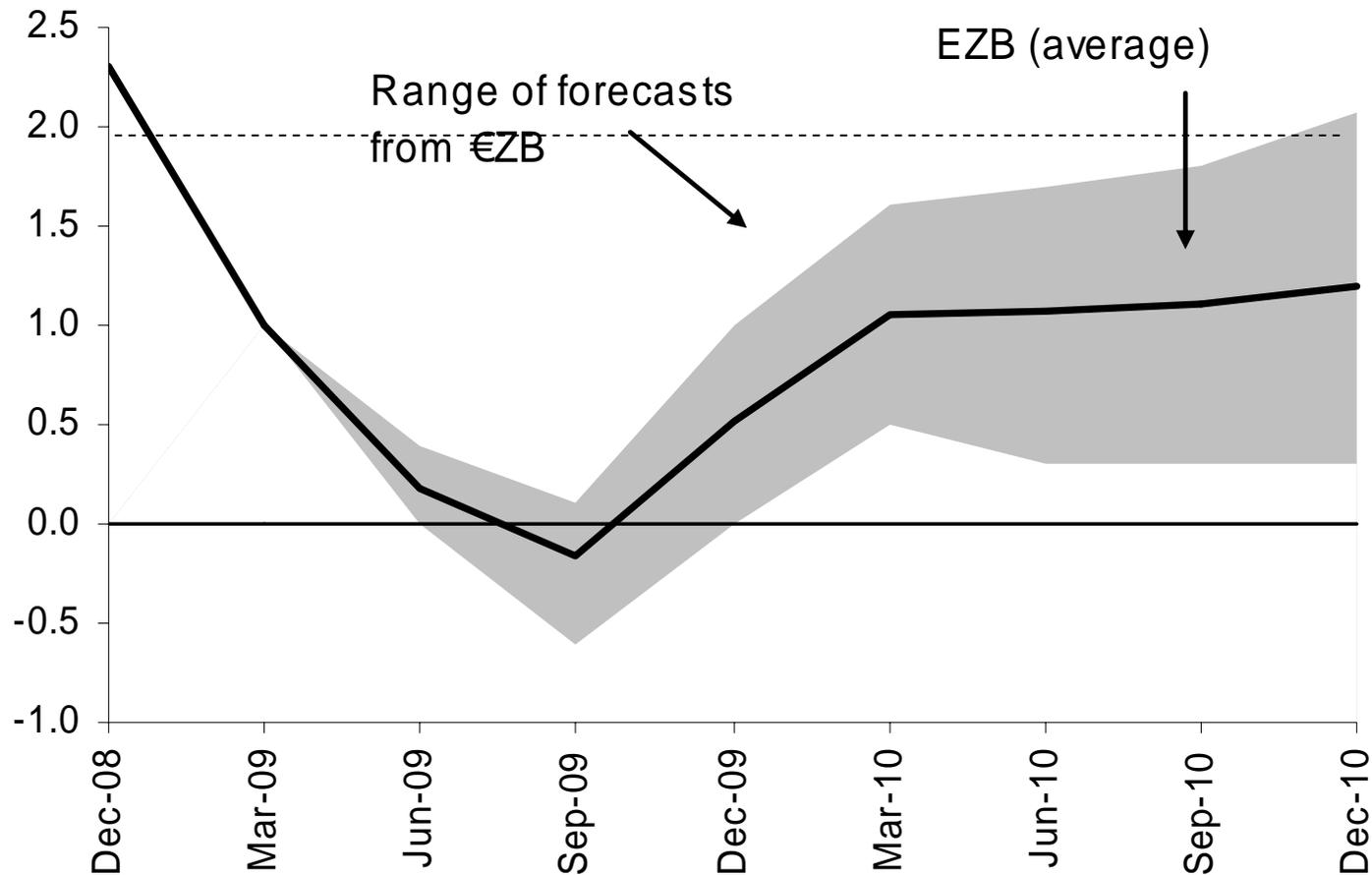
Measures of underlying HICP inflation. Latest observation: May 2009.

Sources: Eurostat and ECB calculations.

Note: (*) Range of permanent exclusion-based (e.g. HICP ex energy, HICP ex energy and food), statistical exclusion-based (trimmed means, weighted median) and econometric (dynamic factor model) measures.

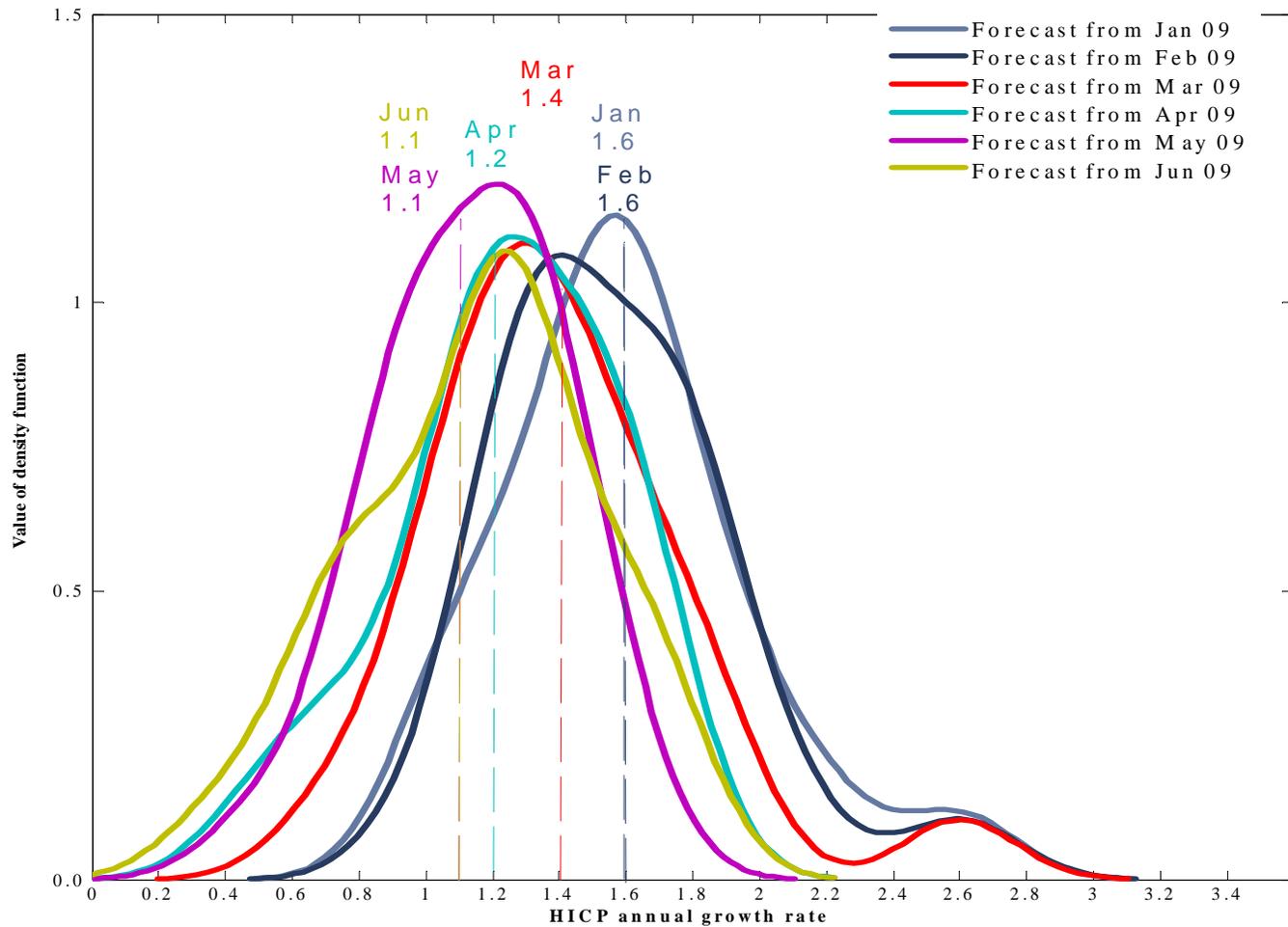
Forecasters in Euro Zone Barometer expect the spell of negative inflation in 2009 to last only a few months

(annual growth rates)



HICP inflation forecasts from EuroZone Barometer (EZB).
Source: EuroZone Barometer (June 2009 issue).

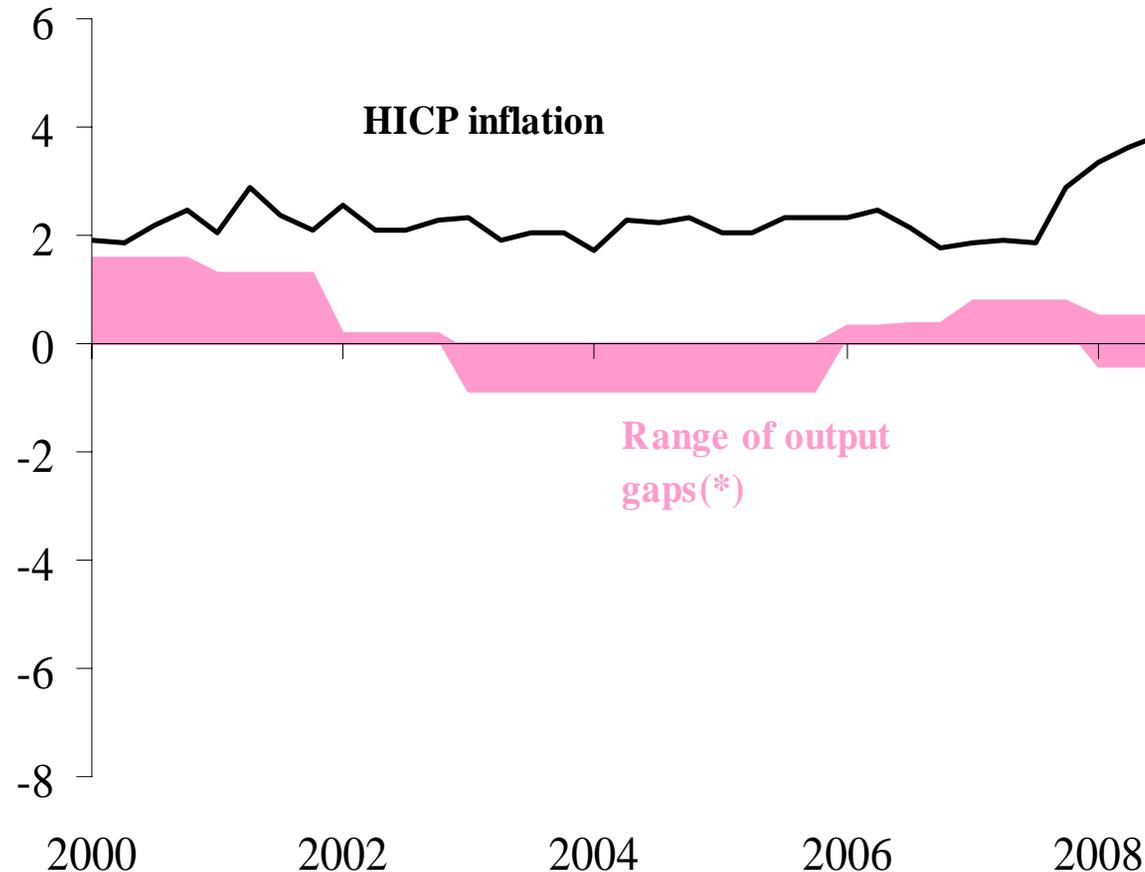
Inflation projections for 2010 revised gradually down recently, but the median is still above 1%



Distribution of EuroZone Barometer HICP forecasts for 2010.
Sources: EuroZone Barometer and ECB staff calculations.

Measures of economic slack have played a fairly modest role in the inflation process in the euro area

(annual percentage change and percentages; quarterly data)



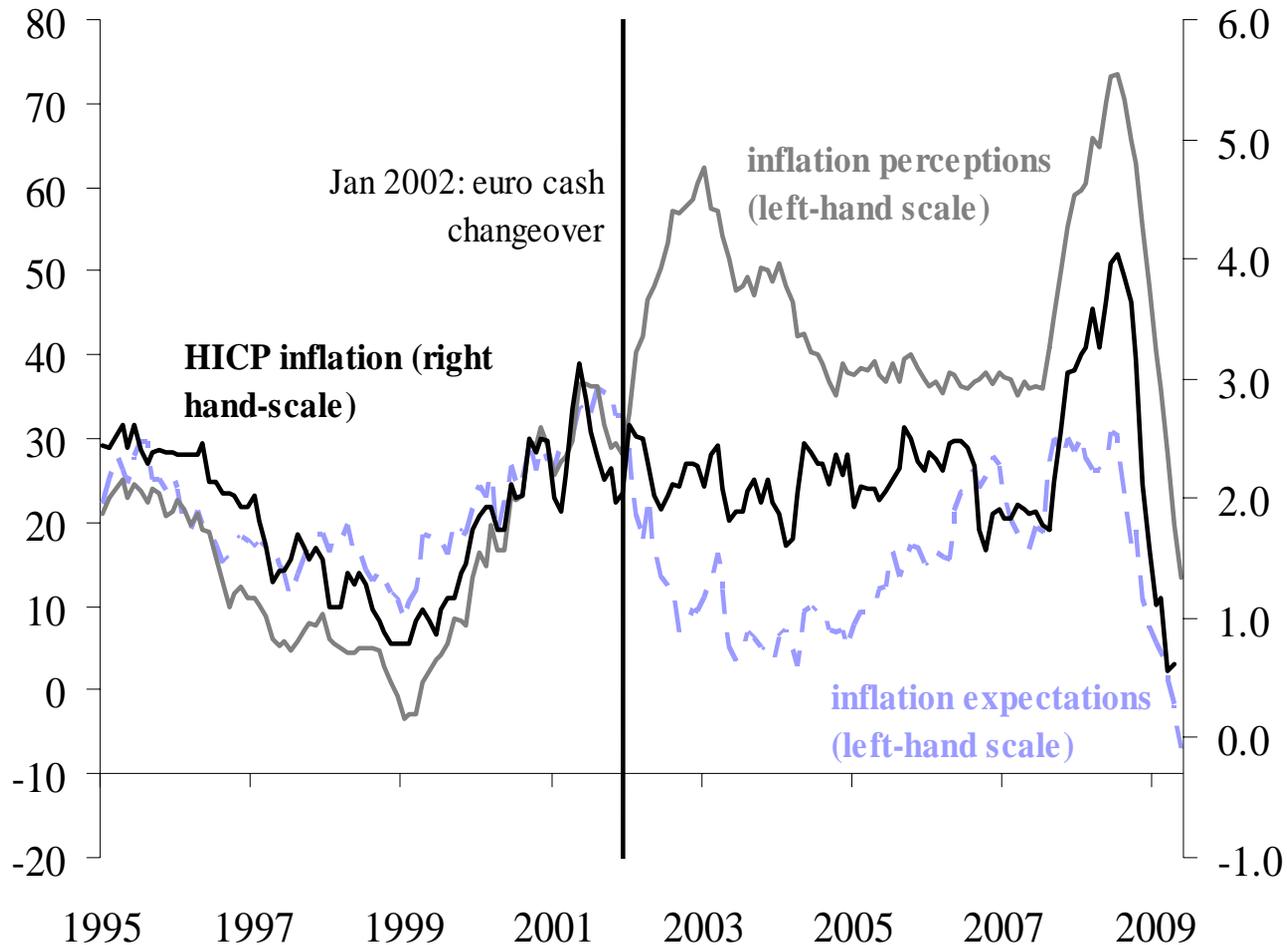
HICP inflation and output gap.

Sources: Eurostat, OECD, IMF and European Commission.

Note: (*) Output gap estimates from the OECD, the IMF and the European Commission.

Expectations based on consumers' survey have declined recently, in line with inflation

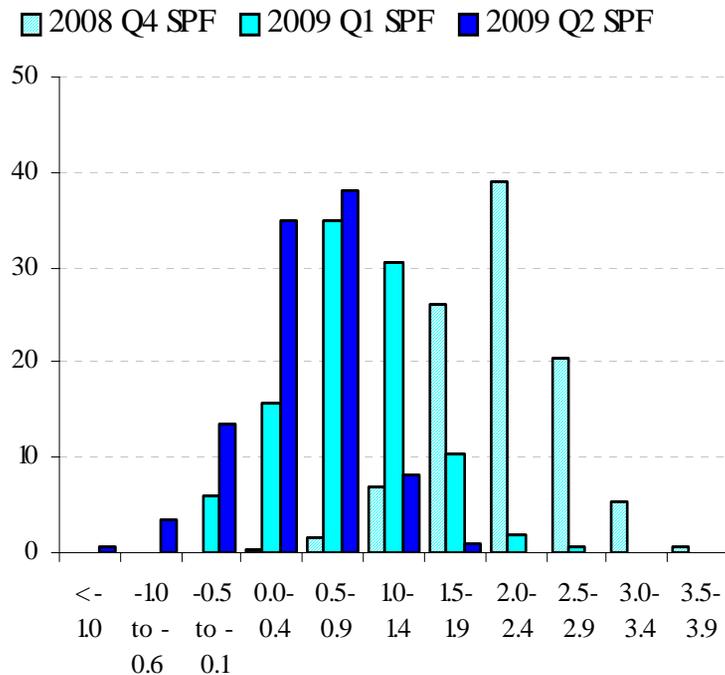
(percentage balance and year-on-year growth rates)



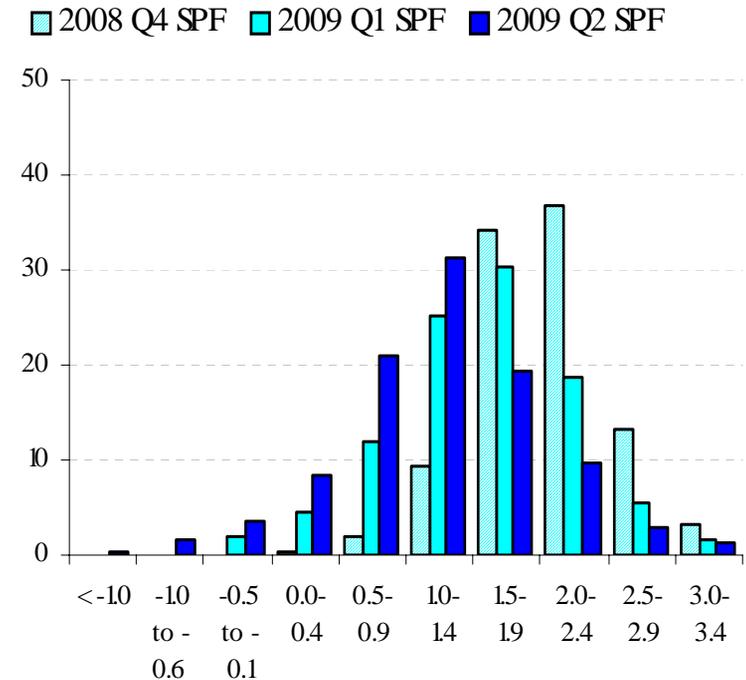
HICP inflation and consumers' qualitative inflation perceptions and expectations. Latest observation: May 2009.
Sources: EC Consumer Survey and Eurostat.

The ECB's Survey of Professional Forecasters (SPF) suggests that deflation is not a likely event

Probability distribution of expected inflation in 2009



Probability distribution of expected inflation in 2010

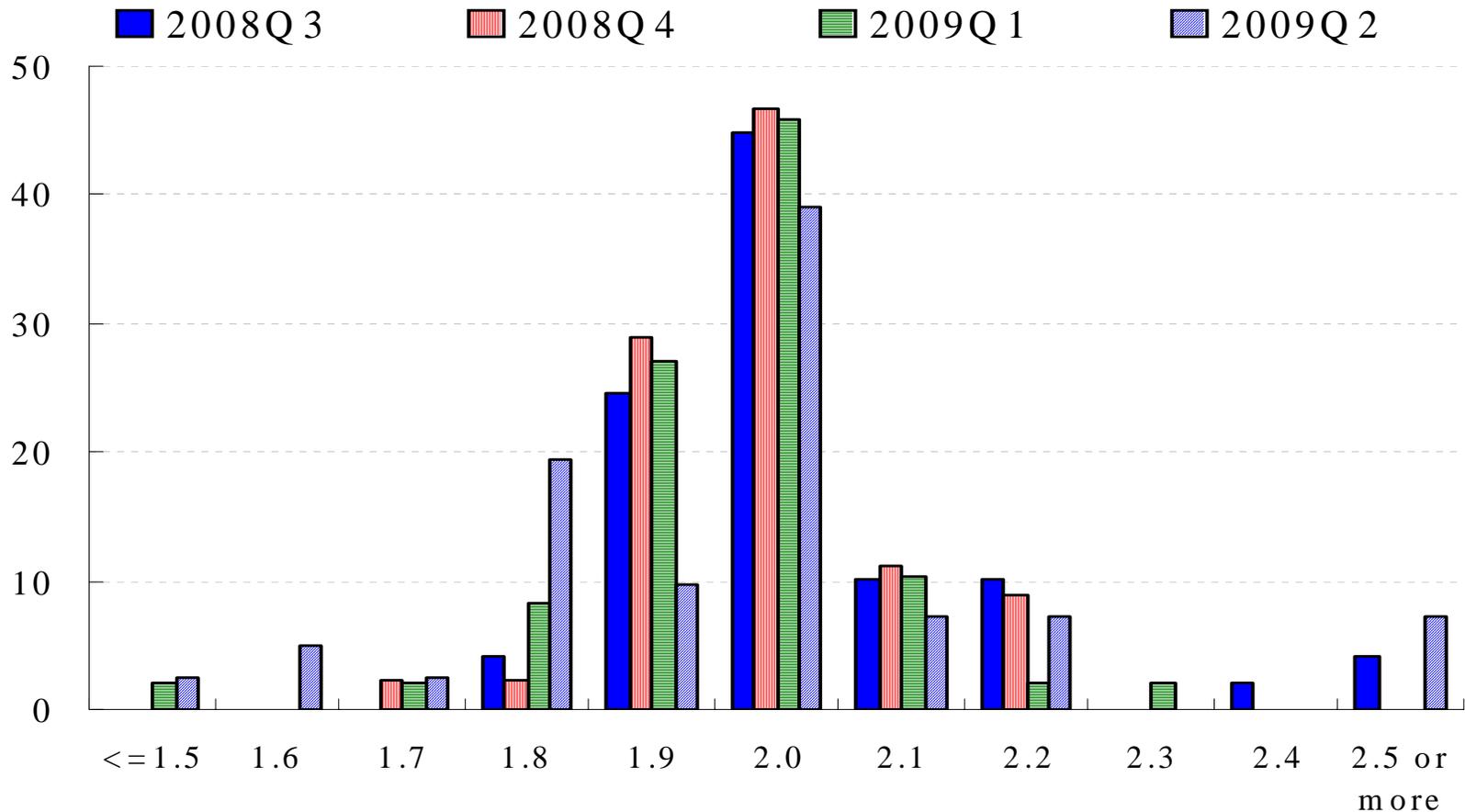


Cross-sectional distribution of 2009 and 2010 inflation expectations among SPF respondents. Various vintages. Latest vintage 2009 Q2.

Source: ECB Survey of Professional Forecasters.

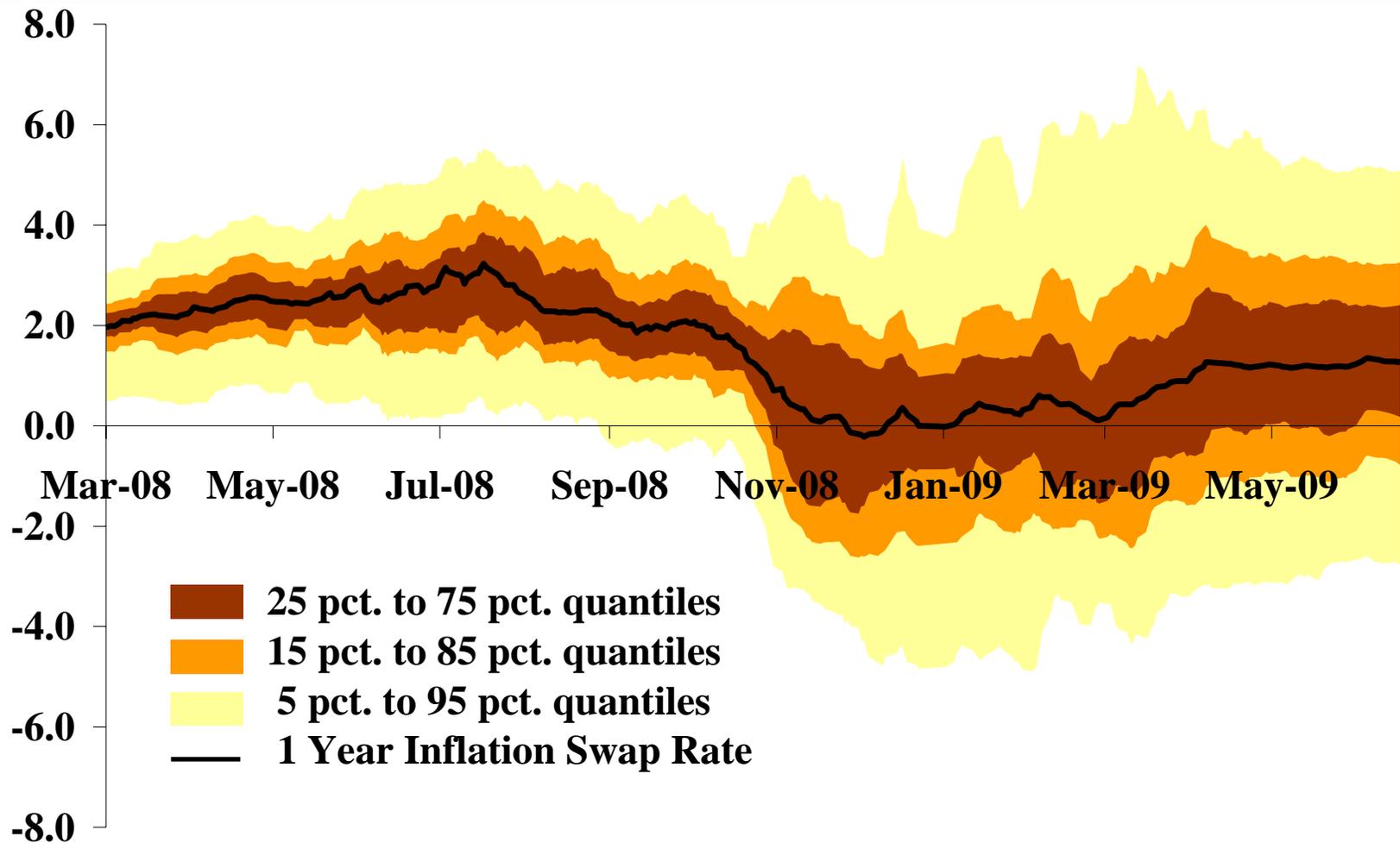
Long-term inflation expectations from ECB's SPF have remained firmly anchored

(percentage of respondents)



*Cross-sectional distribution of longer-term (2013) inflation expectations among SPF respondents.
Source: ECB Survey of Professional Forecasters.*

Deflation fears have abated, but uncertainty remains high

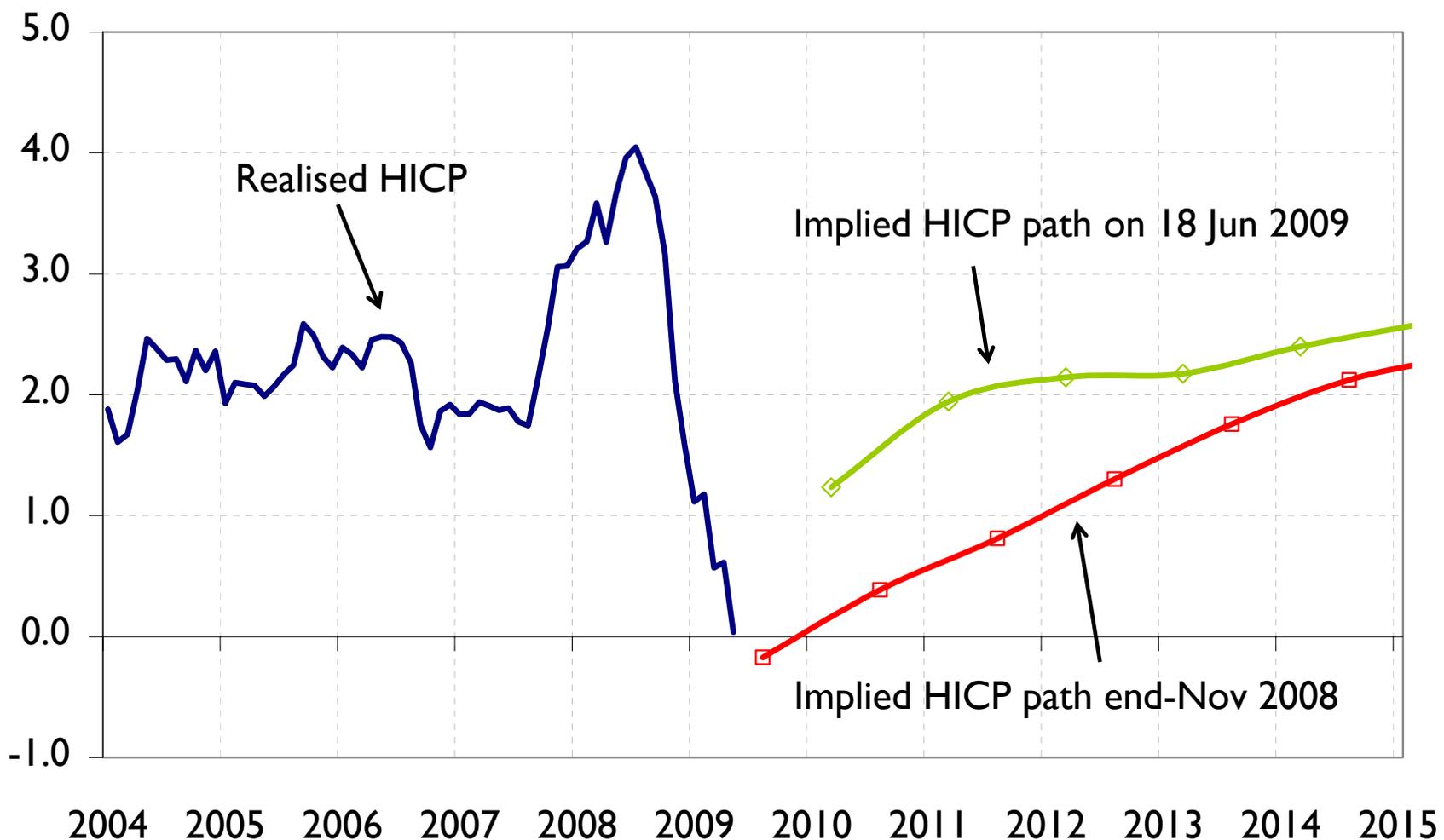


Perceived inflation uncertainty extracted from inflation derivatives

Sources: Bloomberg and ECB calculations.

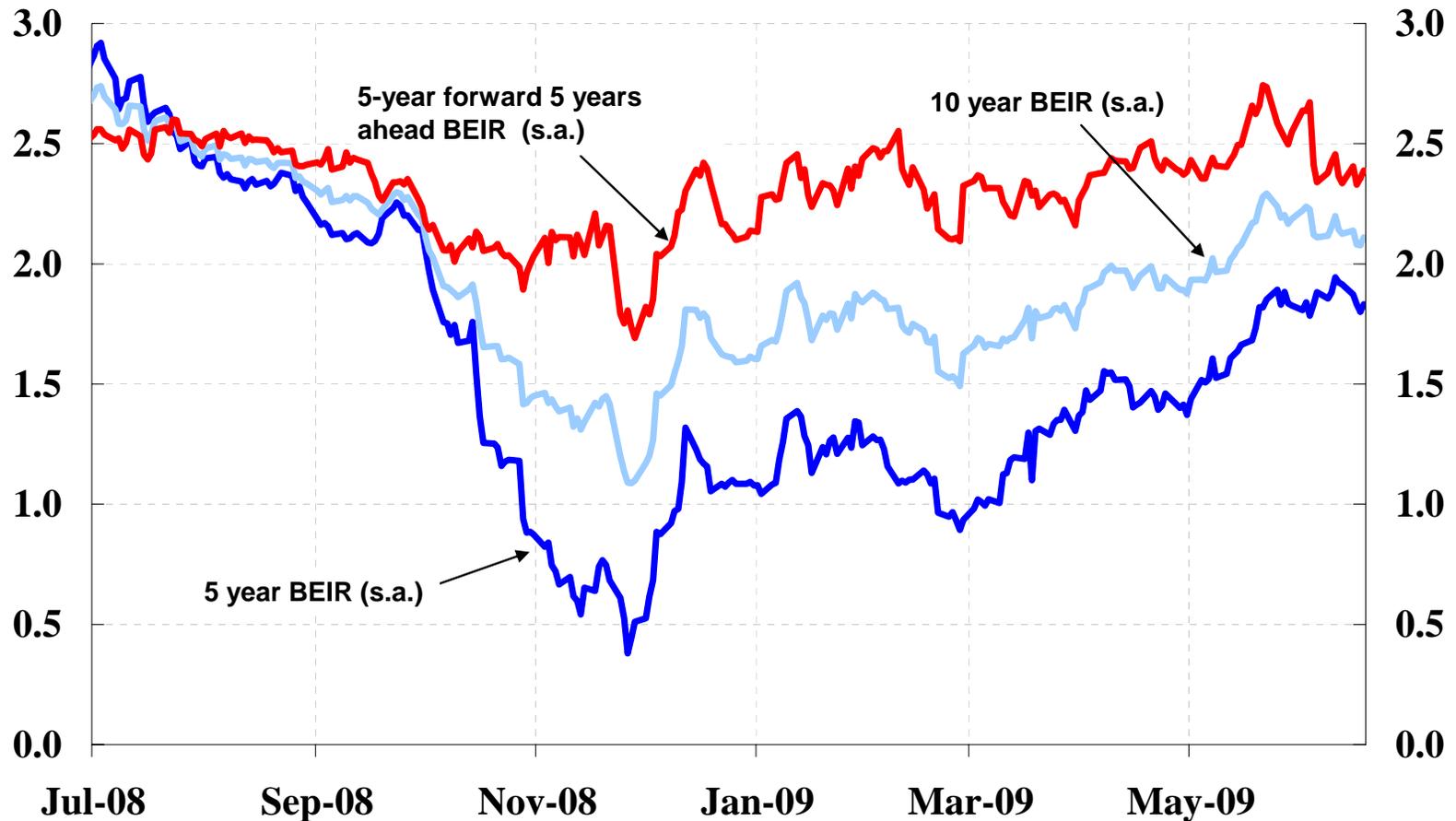
Daily data; Last observation: 17 June 2009

Short-term inflation expectations have shifted up in recent quarters



*Path of year-on-year HICP inflation rates derived from inflation-linked swaps (percent per annum).
Sources: Eurostat, Reuters and ECB calculations.*

Long-term expectations remain well-anchored



Break-even inflation rates for the euro area
Sources: Reuters, ECB calculations.
Daily data; Last observation: 18 June 2009

Negotiated wages: Country breakdown

Negotiated wages

(y-o-y growth rates)

	1999-2008 ^(a)	2008	2008 Q1	2008 Q2	2008Q3	2008Q4	2009Q1
Germany	1.9	2.8	2.6	1.8	3.0	3.7	3.1
France	2.4	3.0	2.7	3.1	3.0	3.0	2.7
Italy	2.5	3.5	2.7	3.2	4.2	3.7	
Spain	3.0	3.5	3.3	3.5	3.5	3.5	2.8
Netherlands	2.7	3.5	3.0	3.5	3.7	3.6	3.5
Belgium	2.4	3.6	3.0	3.3	4.0	4.2	3.8
Austria	2.4	3.1	3.0	3.2	3.2	3.1	3.5
Greece	-	-	-	-	-	-	
Ireland	-	-	-	-	-	-	
Finland	2.6	4.3	3.6	4.5	5.0	4.0	3.9
Portugal	3.1	3.0	3.5	2.7	2.9	2.6	3.8
Slovakia	-	-	-	-	-	-	
Luxembourg	-	-	-	-	-	-	
Slovenia	6.0	9.0	7.6	8.5	10.2	9.7	7.5
Cyprus	-	-	-	-	-	-	
Malta	-	-	-	-	-	-	
Euro Area	2.4	3.2	2.8	2.9	3.4	3.6	3.2

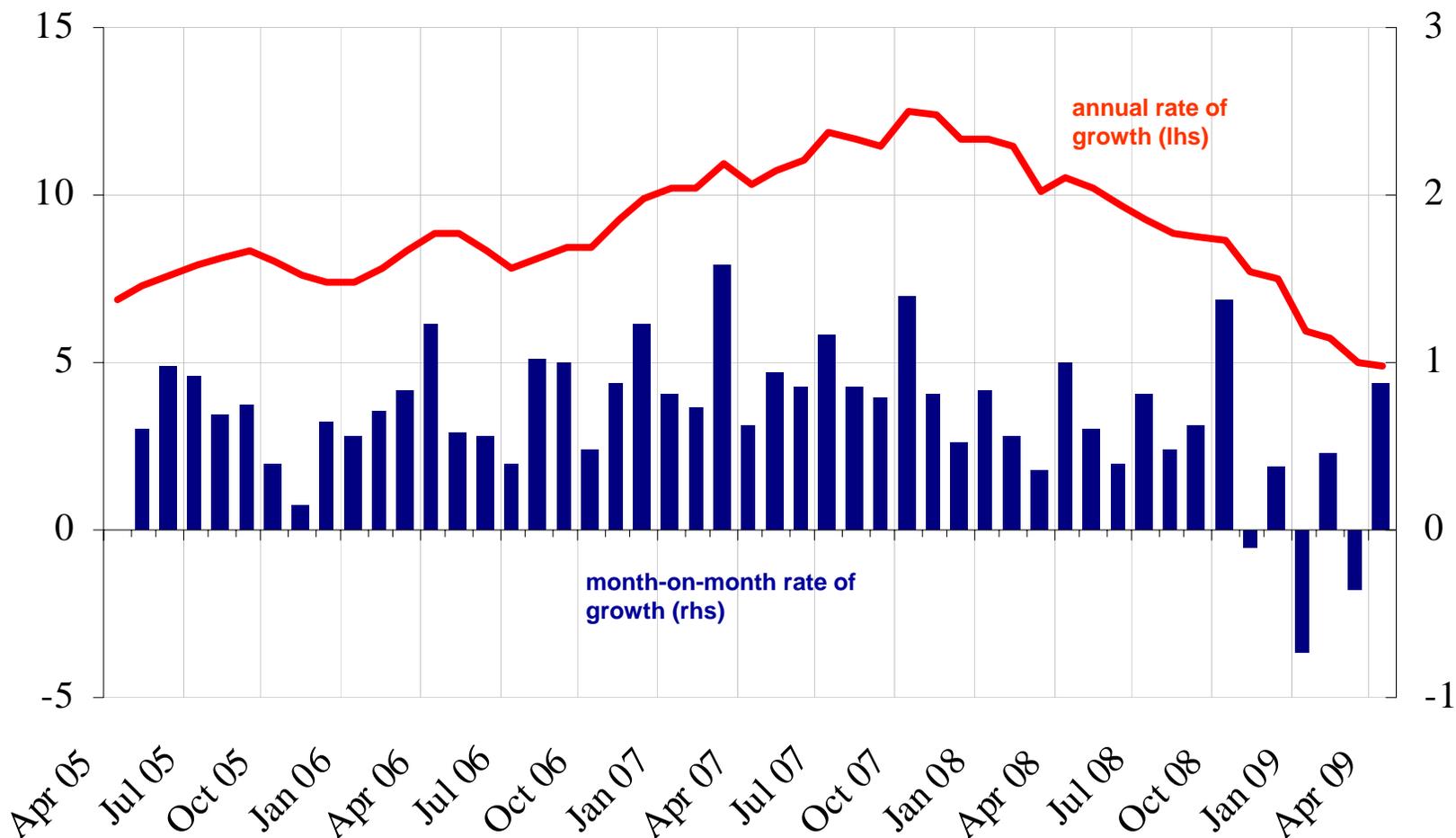
Sources: BIS, European Commission, ECB calculations.

Notes: Negotiated wages reflect the increase in basic pay (excluding bonuses, overtime compensation and so on) agreed between employers and employees, excluding the impact of social security contributions. The exact coverage and definition from one country to another, however, may vary. Data are nsa.

(a) Yearly average over the period.

Annual M3 growth decelerated further in 2009Q1

(percentage changes)



Source: ECB calculations.