

Box 7

Decomposing overall HICP developments since early 1999

Over recent years, the annual rate of change in overall HICP in the euro area has experienced a significant increase. Standing at a low of 0.8% in February 1999, HICP inflation has increased since then to reach 3.0% in April 2001, i.e. a rise of 2.2 percentage points. This box decomposes overall HICP developments using the breakdown of HICP into its main components.

An important factor behind the observed increase in inflation has been *import price developments*, in particular oil price and exchange rate movements which affected HICP inflation either directly via the energy price component or indirectly via the domestic chain of production. In February 1999 the year-on-year rate of change in *energy prices* was -4.4%, reflecting mainly the sharp decline in oil prices that occurred between end-1997 and early 1999 (when they stood at a low of about €9 per barrel). Beginning in early 1999, oil prices started to increase strongly, reaching a high of almost €40 per barrel in November 2000 before declining somewhat. In April 2001 the year-on-year increase in energy prices stood at 7.9%. Overall, they contributed 1.2 percentage points to the 2.2 percentage point rise in overall HICP inflation between February 1999 and April 2001 (see table below).

HICP inflation in April 2001 compared with February 1999

(percentage points, unless otherwise indicated)

	Weights ¹⁾	Change in year-on-year rates	Contribution to the change in year-on-year rate of overall HICP
Overall HICP	100.0	2.2	-
<i>of which:</i>			
Energy	9.5	12.3	1.2
Unprocessed food	8.0	5.4	0.4
Processed food	12.3	1.3	0.1
Non-energy industrial goods	32.1	0.6	0.2
Services	38.1	0.7	0.3
<i>Memo item:</i>			
HICP excluding unprocessed food and energy	82.5	0.7	0.6

Sources: Eurostat and ECB calculations.

1) 2001 weights. Since 1999 the coverage of the HICP has been extended and the weights have been updated twice.

Unprocessed food prices have also contributed to the rise in overall HICP inflation since February 1999, albeit to a lesser extent than energy prices, i.e. 0.4 percentage point. While the annual rate of change in unprocessed food prices fell during most of 1998 and 1999, mainly reflecting a decline in meat and fruit prices, it has been moving upwards since then. There was a considerable rise in the level of unprocessed food prices in the first half of 2000 and its impact on the annual rate of change was reinforced by base effects. From late 2000 onwards, these prices also have been significantly affected by health concerns regarding meat in the context of BSE and by the outbreak of foot-and-mouth disease (see also Box 3 in the May 2001 issue of the Monthly Bulletin). In total, the volatile components, i.e. energy and unprocessed food, accounted for 1.6 percentage points of the 2.2 percentage point increase in HICP inflation between early 1999 and April 2001.

The remaining 0.6 percentage point increase over the period from February 1999 to April 2001 is attributable to a rise in the annual percentage change in *HICP excluding unprocessed food and energy*. All the main components of this narrower measure of consumer price inflation, i.e. processed food, non-energy industrial goods and services prices, have experienced some increase in their year-on-year rates since early 1999. Several underlying factors can be identified, although they are difficult to quantify with a sufficient degree of precision. First, there is evidence that companies have – to some extent – passed on higher costs from past rises in import prices. These indirect effects probably account for the bulk of the contribution from HICP excluding unprocessed food and energy. In addition, strong economic growth in the euro area, in particular

when it was well above potential between late 1999 and mid-2000, may have exerted some upward pressure on consumer prices. More recently, part of the increase in the annual rate of change in HICP excluding unprocessed food and energy is also attributable to one-off movements linked to an increase in administered prices and indirect taxation in several countries of the euro area, which mainly affected services prices. Furthermore, as in the case of unprocessed food prices, the recent problems in the agricultural sector may also have had an impact on prices of some processed food items such as dairy products. Finally, it may be noted that wage developments remained moderate during the period under review while competitive forces also acted to contain price increases.

Looking ahead, direct inflationary pressure from energy and unprocessed food prices is expected to remain temporary in nature, assuming that no new shocks occur. Indirect effects of past import price increases are likely to continue for some months to come, but should gradually fade out. This would allow a decline in overall HICP inflation in the course of 2001. Looking beyond 2001, the maintenance of price stability depends on a number of conditions, among which wage moderation in particular will play an important role (see the “Eurosysteem staff macroeconomic projections for the euro area” section).