

Box 3

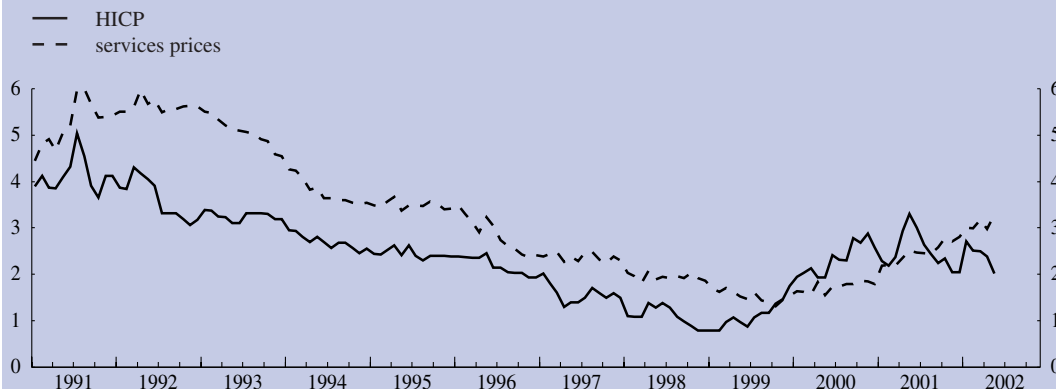
Recent developments in services prices in the euro area

By contrast with the other main sub-components of the HICP, the annual rate of change in services prices has continued to increase in recent months. Although services prices, as included in the HICP, comprise a heterogeneous range of items, most activities in the services sector have a sufficiently homogeneous economic structure for price dynamics in services to be considered a meaningful economic concept. Indeed, as services prices account for approximately 40% of the overall HICP and tend to be less volatile than some other components, they are important in the assessment of the medium-term outlook for prices.

Chart A depicts the evolution of services prices and the overall HICP in the euro area from the early 1990s. Although the same broad pattern of falling year-on-year rates of change during most of the 1990s and rising rates around 1999/2000 is observed in both series, there are some important differences. First, during most of the 1990s the annual rate of change in services prices was above that of total HICP inflation. This was due

Chart A: Overall HICP and services prices in the euro area

(annual percentage changes; monthly data¹⁾)



Source: Eurostat.

1) Data up to December 1994 are estimates based on national CPIs.

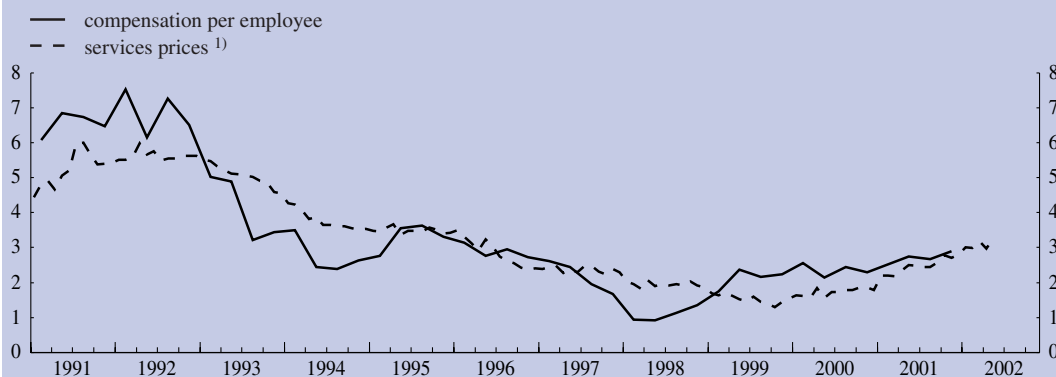
primarily to lower rates of productivity growth in the services sector compared with the goods-producing sector, which – given comparable nominal wage increases in the two sectors – results in higher unit labour cost growth in the services sector. Second, the annual rate of change in the total HICP started to rise before that in services prices, reflecting the more immediate direct impact of oil and exchange rate shocks on the energy component of the HICP, whereas the indirect effects of these shocks on services prices were observed with a lag.

This pattern of falling rates of change in services prices throughout most of the 1990s and rising rates of change from 1999 is observed across most euro area economies and most services sub-sectors. For example, while price levels have fallen in the telecommunications sector as a result of productivity gains stemming from technological advances and market deregulation, the rate of decline has slowed significantly over the past two years. Similarly, while the rate of change in services prices varies to some extent across euro area countries, reflecting, inter alia, convergence in productivity levels and the position of the business cycle, an increase in the rate of change was nonetheless observed in all countries over the past two years. This pattern across sectors and countries suggests that some common factors lie behind recent developments.

The year-on-year rate of change in euro area services prices increased steadily from 1.3% in October 1999 to 3.3% in May 2002. In addition, an upward movement was also observed in the annual rate of change in non-energy industrial goods prices, which increased from 0.5% to 1.7% over the same period. These

Chart B: Services prices and compensation per employee in the euro area

(annual percentage changes; monthly and quarterly data)



Source: Eurostat.

1) Data up to December 1994 are estimates based on national CPIs.

developments suggest that some of the increase in these two components is due to common factors such as the indirect effects of previous oil and exchange rate movements as well as wage developments. Nonetheless, the fact that services prices have accelerated more than goods prices suggests that these factors may have played different roles. In particular, there has been some acceleration in wages since around 1999, which seems to have particularly affected services prices. Chart B depicts the annual rate of change in services prices alongside wage developments in the euro area. Given the relatively large weight of labour costs in the cost structure of service providers, wages (adjusted for productivity growth) are expected to play a major role in the determination of future services price developments. Profitability also plays an important role in explaining price developments in the services sectors. Thus continued product and labour market reform would further contribute to containing price increases in these sectors.

Another factor behind the recent rise in the annual rate of change in services prices appears to be some impact from the cash changeover. This impact seems to be most evident in a number of specific sectors, including restaurants, hairdressing and dry cleaning. Nonetheless, the extent of the cash changeover effect has been relatively limited, and should be temporary.

Looking forward, the annual rate of increase in services prices may ease slightly over the second half of 2002, as the indirect effects of previous shocks unwind. Barring further oil or other price shocks, the outlook thereafter will depend to a large extent on wage developments.