

Box 4

MEASURING AND ASSESSING THE IMPACT OF ADMINISTERED PRICES ON HICP INFLATION

Although inflation in the medium term is ultimately determined by monetary policy developments, conjunctural economic analysis and forecasting require an understanding of the factors behind short-term disaggregate HICP dynamics. Two prominent channels through which governments can have a direct impact on price-setting are indirect taxes and administered prices.

Statistical developments

Over the past two years work has been ongoing in Eurostat and the national statistical institutes of the EU Member States to calculate an auxiliary HICP index with a view to removing the direct impact of changes in indirect taxes from the overall HICP. At the same time, the ECB, with the cooperation of the NCBs of the ESCB, has been compiling HICP-based estimates of administered prices. These experimental estimates for the euro area are now published for the first time in this issue of the Monthly Bulletin (see Table 5.1 of the “Euro area statistics” section). The analysis given in this box aims to present the newly available information on administered prices and assess their direct influence on euro area inflation.

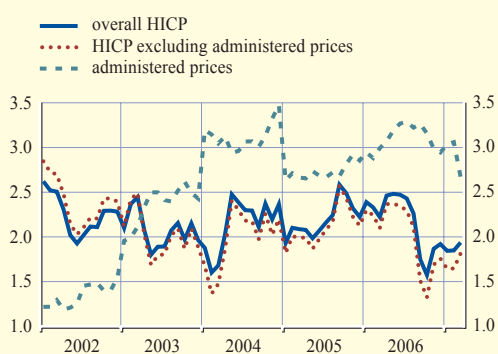
The new ECB estimates of administered prices aim to show the development of a subset of prices in the HICP basket that are either directly set or significantly influenced by the government (including central, regional and local government, as well as national regulators) via measures other than changes in indirect taxes. Examples for administered prices include local transportation charges, education fees, regulated rents and telephone tariffs that may, depending on national practices, require approval by regulatory authorities. The estimates are compiled by the ECB based on the HICP sub-indices and weights for euro area countries as published by Eurostat. The euro area results are based on an assessment of national price administration practices for the goods and services contained in each of the 93 detailed HICP sub-indices.¹ A breakdown is also compiled for fully administered prices (i.e. those prices directly set by the government) and mainly administered prices (i.e. those prices on whose development the government or any national regulator has a very significant influence).² It should be noted that, owing to the difficulty in isolating the impact of government decisions from other influences on price-setting, the estimates can only provide an approximation of price changes due to administrative decisions and should therefore be interpreted with caution.³

Impact of administered prices on HICP inflation

According to the new estimates of the HICP-based administered prices index, in the period from January 2002 to March 2007⁴ the year-on-year rate of change in administered prices was, on average, 2.5%. It rose from a low of 1.2% towards the beginning of the period to

Chart A Overall HICP and administered prices

(annual percentage changes)



Sources: Eurostat and ECB estimates based on Eurostat data.

1 The fact that the new estimates take account of differences in national price administration practices in the euro area countries is a major improvement compared with previously published estimates (see, for example, the box entitled “The impact of developments in indirect taxes and administered prices on inflation” in the January 2004 edition of the Monthly Bulletin).

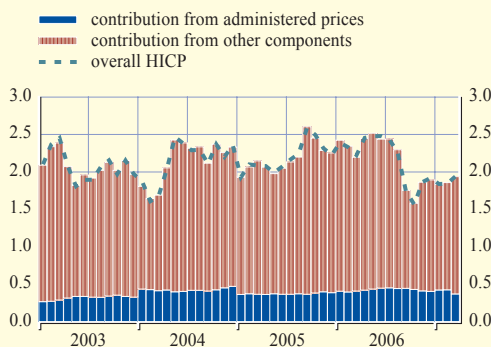
2 The administered price estimates (including these sub-indices) can be downloaded from the website of the ECB’s Statistical Data Warehouse at <http://sdw.ecb.int/browse.do?currentNodeId=2120778>

3 For further details of the methodology used in the compilation of this indicator see <http://www.ecb.int/stats/prices/hicp/html/index.en.html>

4 The new HICP-based administered prices index starts from January 2001.

Chart B Contribution of changes in administered prices to overall HICP inflation

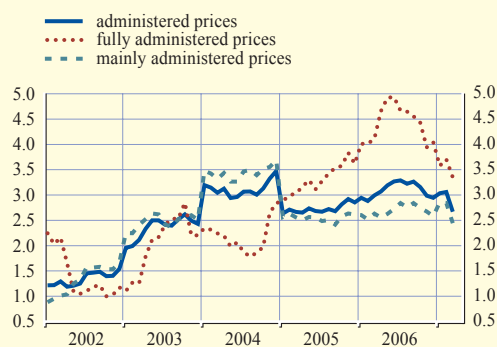
(annual percentage changes; contributions in percentage points)



Sources: Eurostat and ECB calculations based on Eurostat data.

Chart C Administered prices and components

(annual percentage changes)



Sources: Eurostat and ECB estimates based on Eurostat data.

a high of 3.5% in December 2004, and stood at 2.7% in March 2007 (see Chart A). As of May 2003 administered prices grew faster than the overall HICP. Administered prices have therefore been adding to upward price pressures, which is also visible when comparing the actual annual HICP inflation for the euro area with a synthetic index that excludes such prices.

The total share of administered prices in the overall HICP is 13.9% in 2007. Over the past few years the contribution of changes in administered prices to aggregate annual HICP inflation has been significant and does not seem to be correlated with the overall inflation rates (see Chart B). In March 2007 the contribution was 0.4 percentage point, in line with its average since 2003. Starting from its lowest level of 0.3 percentage point at the beginning of 2003, the contribution of administered prices to the annual inflation rates in the euro area peaked at nearly 0.5 percentage point during 2004, mainly driven by the healthcare reform in Germany.

Focusing on administered prices that are classified as fully administered (see Chart C), changes in their annual rates are considerably more volatile than those of the administered component taken as a whole. Fully administered prices recorded their lowest growth rate of 1% in October and November 2002 and their highest growth rate of 4.9% in May and June 2006, while their current rate of 3.3% in March 2007 is still high. However, this component has a relatively low weight of 3.5% in the overall HICP.

It is important to keep in mind that the precise quantification of the impact of administered prices on HICP inflation is subject to a number of uncertainties. For example, although the newly compiled administered price index offers more precise information than previously available, inevitably it is not possible to distinguish perfectly between price changes that have occurred due to government intervention and those driven by market developments, such as price pressures stemming from imperfect competition on certain product markets, underlying costs and other factors outside government control. Border-line cases and decisions in the classification of certain items are therefore unavoidable.

An assessment of the overall direct impact of government measures on inflation developments should also take into consideration the influence of indirect taxes. According to the latest ECB staff projections⁵, indirect taxes are expected to contribute 0.5 percentage point to euro area HICP inflation in 2007. This is significantly above the average contribution of about 0.2 percentage point in previous years. Further information will be available after Eurostat and the national statistical institutes complete their project to calculate an auxiliary HICP index that maintains indirect taxes constant over time, assuming a full and immediate pass-through of changes in tax rates. The first results from this index are expected to be published by Eurostat by the end of 2007.

Overall the impact of government policies on euro area inflation through price administration and indirect taxation generally appears to be non-negligible and has increased over recent years. This has to be taken into account when assessing overall price pressures in order to maintain inflation rates below, but close to, 2% over the medium term.

⁵ See the box entitled “ECB staff macroeconomic projections for the euro area” in the March 2007 issue of the Monthly Bulletin.