

Box 6

THE IMPACT OF RECENT CHANGES IN INDIRECT TAXES ON THE HICP

Indirect taxes form part of final consumer prices. Consequently, increases in value added tax rates, for example, have a direct upward impact on HICP inflation. The necessary fiscal consolidation measures that are currently being implemented in a number of euro area countries have meant

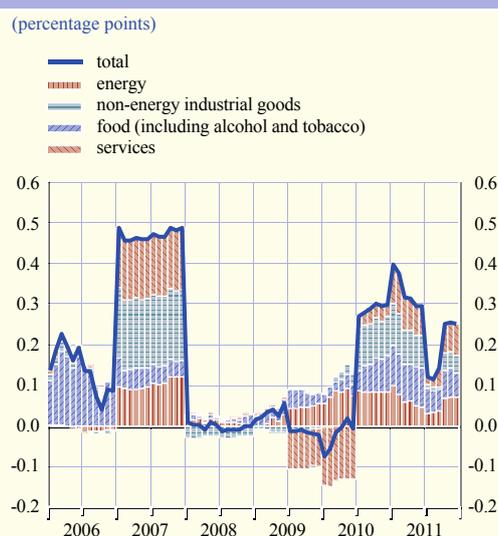
that indirect taxes had a strong impact on inflation in 2011. This box reviews this impact on inflation in both the euro area as a whole and the individual countries, using Eurostat's monthly data for the HICP at constant tax rates (HICP-CT).¹

HICP-CT data show how the HICP would have evolved had tax rates remained constant and assuming that any changes were passed on to consumer prices fully and immediately.² Given this assumption, the implied "mechanical impact" of changes in indirect taxes can be viewed as the likely upper bound for the actual direct impact, which is typically lower, depending on a number of factors related to the cyclical situation and competitive environment of the price-setting firms. The mechanical upward impact of changes in indirect taxes on the annual rate of overall HICP inflation in the euro area was, on average, ¼ percentage point in 2011, which was slightly higher than in 2010 (see Chart A).

The figures for the euro area as a whole conceal differences in the impact across both the HICP components and the individual euro area countries. For instance, in 2007 the large and significant upward impact on inflation originated almost entirely from a general increase in VAT in Germany. From mid-2009 to mid-2010 the slight downward impact was due to reductions in the VAT rates for certain services in some euro area countries, which were partly offset by hikes in taxes on energy and tobacco (included in the food component) in other countries.

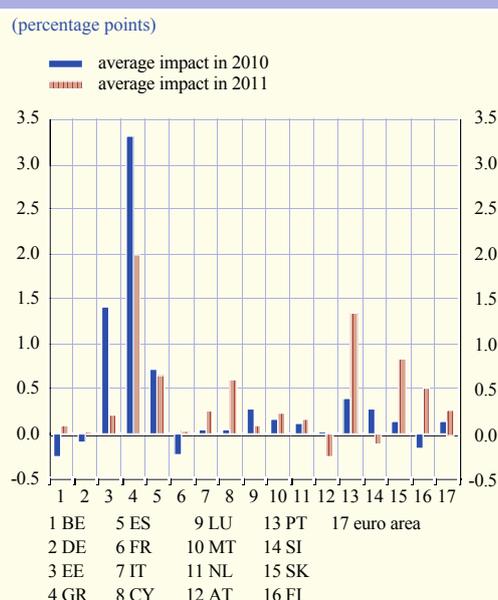
Compared with earlier years, the impact on HICP inflation in the euro area as a whole in 2010 and 2011 was spread across a larger number of countries, with some sizeable impacts in individual countries. In both years, the mechanical impact was the largest in Greece, amounting to 3.3 percentage points in 2010 and 2.0 percentage points in 2011. Other

Chart A Mechanical impact¹⁾ of changes in indirect taxes on the annual rate of HICP inflation in the euro area



Sources: Eurostat and ECB calculations.
1) Calculated as the difference between annual HICP and annual HICP-CT inflation rates.

Chart B Mechanical impact¹⁾ of changes in indirect taxes on the annual rate of HICP inflation in the euro area and euro area countries



Sources: Eurostat and ECB calculations.
Note: HICP-CT data are not available for Ireland.
1) Calculated as the difference between annual HICP and annual HICP-CT inflation rates.

1 See the box entitled "Gauging the impact of indirect taxation on euro area HICP inflation", *Monthly Bulletin*, ECB, March 2011.
2 For further details on the construction of the HICP-CT and caveats with regard to its interpretation, see the box entitled "New statistical series measuring the impact of indirect taxes on HICP inflation", *Monthly Bulletin*, ECB, November 2009.

countries with significant impacts included Portugal, Slovakia, Spain and Italy. In the latter country, although the VAT increase was only introduced in September 2011, it still led to a mechanical impact of 0.2 percentage point for 2011 as a whole (see Chart B).

Looking ahead, a number of countries have implemented or announced VAT increases that will have an impact in 2012, including Ireland, Cyprus, Italy, France and Portugal. This will result in continued upward pressure on inflation rates this year (see Box 10, entitled “ECB staff macroeconomic projections for the euro area”).