AIB Group Treasury
Economic Services Unit

Irish Consumer Price Index – July 2001

Key figures

%	Month	Year
Headline CPI:	**-0.3%**	**4.8%**
Ex-Mortgages:	**-0.3%**	**4.3%**
HICP:	**-0.3%**	**4.0%**

Prices fell by 0.3% in July causing the annual headline CPI rate to decline to 4.8% from 5.3% in June. A similar fall in the core (ex-mortgages) index saw the core annual rate decelerate to 4.3% from 4.5%. The HICP rate also fell by 0.3%, pushing its annual rate down to 4% from 4.3%. Inflation is now well below the 7% and 6% peak levels registered last November for the headline CPI and HICP rates respectively.

The marked decline in inflation in July reflects falling oil prices and also a positive basis effect. In July last year, rising mortgage rates and fuel costs added 0.3% and 0.2% respectively to the CPI. Mortgages were unchanged this July while fuel costs fell. The decline, though, was not quite as big as our forecast fall of 0.5% as fuel prices did not decline by as much as we had expected. Furthermore, the summer sales impact on prices was not as pronounced as last year.

The main features of the July data were as follows:

⇨ The impact of the summer sales, which saw clothing prices fall by 8% in the month, while durable goods prices declined by 1.8%. These falls depressed the CPI by 0.37%, some 0.1% less than last year.

⇨ The energy component of the index fell by 1.5% on declining petrol prices in marked contrast to the same month last year. The fall in energy prices depressed the CPI by close to 0.15%.

⇨ Offsetting these falls was a rise in food prices of 0.3% that was mainly due to higher prices for meat, potatoes and meals out.

⇨ Other price increases included an 0.7% rise in the services component of the index. This reflected increases in the cost of package holidays, childcare, telephone charges and hairdressing.

Further Deceleration In Inflation Likely In August

The main feature of August CPI data is the unwinding of the summer sales effect with a consequent increase in the clothing and durable goods components of the index. The last couple of years have seen the index rise by some 0.5% in the month. However, the rebound in prices may be less this year because of smaller discounting in the July sales.

Further, there have been significant reductions in petrol prices in recent weeks which could depress the index by 0.3%. Upward pressure on meat prices also seems to have started to reverse. Overall, we look for the index to rise by 0.1% this August, resulting in a further deceleration in both headline and core inflation. The headline rate is projected to fall to 4.4% while ex-mortgages, the rate could drop to 3.9%.

CPI Rate To Fall To Close On 3% By End Year

As we have been forecasting for some time, inflation is again falling sharply. We would highlight that factors which pushed up inflation in H2 2000, such as higher mortgage rates, energy costs and food prices, are now abating or reversing which will cause inflation to fall further over the balance of the year.

Meat prices should ease back now that normal trade has resumed in livestock following the ending of foot and mouth disease restrictions. Sharp rises in vegetable and potato prices should also begin to unwind. Petrol prices have already declined following the rebuilding of oil inventories. High home heating oil inventories also suggest that oil prices should not spike sharply upwards again as happened last autumn.

Meanwhile, the marked weakening of the Euroland economy and declining inflation point to an easing of policy by the ECB and thus lower mortgage rates in the months ahead. Finally, distinct signs of weakening domestic demand in Ireland should help to depress domestic inflationary pressures. For the year as a whole, headline inflation is forecast to average 4.6%, while the core rate is expected to average 4%. By end year, though, inflation is expected to be down to close on 3%, averaging 3.3% in Q4.

IRISH INFLATION GAP NARROWS WITH EUROZONE

The inflation gap between Ireland and the rest of the Eurozone has narrowed significantly this year. The gap stood at 1.3% in June down from 3.3% in October 2000. The gap may have narrowed a bit further in July with the Irish HICP rate falling to 4% in the month and the EU-12 average HICP forecast at 2.8%. Furthermore, Ireland's HICP rate is no longer the highest in the Eurozone. Greece, Portugal and Holland all had higher HICP rates than Ireland's in June.

Meantime, it is worth noting that inflation in eurozone clearly peaked in May at 3.4%. It fell to 3% in June with a further fall likely to around 2.8% in July. Lower oil prices have been a significant factor in the decline and could push inflation lower in August while a positive basis effect is likely to see a further significant fall in the annual inflation rate in September, possibly to 2.5% or below. This downtrend in inflation, along with accumulating evidence of quite a sharp weakening of activity in the eurozone economy, should prove sufficient for the ECB to loosen monetary policy soon after it returns from its summer break at the end of August.