

THE FACTORS UNDERLYING THE RECENT INCREASE IN INFLATION IN SPAIN

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In recent months, inflation has soared both in Spain and in the vast majority of European economies, beyond analysts' consensus expectations. Thus, for example, headline inflation in Spain rose for the sixth consecutive month, to stand at 3.3% year-on-year in August, the highest rate recorded since October 2012 (see Chart 1). Core inflation increased to 0.6% in August, 0.7 pp higher than that observed at end-2020. Other advanced economies and, in particular, the whole of the euro area experienced similar inflation dynamics, albeit of varying intensity (see Chart 2).

This box describes the main factors behind the recent inflation developments in Spain and analyses the extent to which these and other aspects may influence price behaviour in the coming quarters. Looking ahead, also examined is the question of how persistent the high inflation rates observed in recent months may be in the future. This aspect is particularly significant in terms of future developments in household disposable income and, at the euro area level, for the conduct of monetary policy.

The rise in inflation in Spain in recent months can be explained by a number of factors. First, the hike in electricity prices, which appears to be mostly associated with the rising cost of gas (which, in turn, is linked to specific supply distortions and higher demand from Asia) and, to a lesser degree, of CO₂ emission allowances, as a result of the European Union's more ambitious greenhouse gas emission reduction targets in place since December 2020.¹ Notably, of the 3.9 pp increase observed in the HICP between December 2020 and August 2021, 0.6 pp and 0.2 pp, respectively, would be attributable to the direct impact of the rising cost of gas and emission allowances on the price of electricity.

Second, the path of non-electrical energy prices has also significantly contributed to the rise in the HICP, reflecting, in part, a genuine hike in energy prices associated with the strong recovery of global demand in recent quarters.

However, the recent increase in this component can be largely explained by the marked deceleration of energy prices from the onset of the pandemic to the summer of 2020. This generated substantial base effects² in the spring of 2021, which will continue to play a key role in headline inflation developments over the rest of the year (see Chart 3). Specifically, the base effect of the non-electrical energy component accumulated since February 2021 accounts for 0.8 pp of the year-on-year increase in headline inflation recorded in August 2021. In any event, the impact of these effects on inflation will gradually diminish in the closing months of 2021, fading almost entirely by early 2022.

Another factor that also seems to have contributed to the recent increase in inflation in Spain has been the steep drops in the prices of many services activities requiring a high degree in social interaction, such as hospitality and recreation, over the summer of 2020. As with energy prices, these developments have also led to highly significant base effects, pushing up this inflation component in the last two months (see Chart 4).³

Looking ahead, the recent inflationary spike is expected to be essentially temporary as a significant part of the increase is linked to base effects, and the current high rates of change in consumer prices would therefore foreseeably decrease gradually over the coming quarters.

That said, the existence of some channels that could contribute to making the current bout of inflation more persistent should be noted. Specifically, it cannot be ruled out that the price rises observed in recent months may ultimately prompt further (and possibly longer-lasting) increases via indirect and second-round effects. As regards indirect effects, the recent hike in electricity prices may end up affecting the prices of those goods and services that are produced by firms that use this input more intensively, especially if said price increase proves to be long-lasting.⁴

1 See M. Pacce, I. Sánchez and M. Suárez-Varela (2021) "Recent developments in Spanish retail electricity prices: the role played by the cost of CO₂ emission allowances and higher gas prices", *Occasional Paper* No 2120, Banco de España.

2 The year-on-year rate of change in a given month is affected by the month-on-month changes, be they abnormally low or high, observed in the same month a year earlier. For a more detailed explanation of the base effects, see Box 3 'The recent rise in inflation in Spain and the short-term outlook', "Quarterly report on the Spanish economy", *Economic Bulletin*, December 2016, Banco de España.

3 The time profile of these base effects has also been influenced to some extent by the imputation, in April-June 2020, of a significant proportion of the shopping basket prices used to estimate the HICP, given the enormous data-collection difficulties.

4 Gas price futures have risen significantly between April and September. One of the factors behind this has been the supply difficulties faced by some producing countries relating to infrastructure maintenance, in addition to the prospects of geopolitical tensions in other supply countries potentially affecting output in the medium term. Moreover, gas storage levels in Europe remain at low levels following the decrease attributable to weather-related reasons last winter.

THE FACTORS UNDERLYING THE RECENT INCREASE IN INFLATION IN SPAIN (cont'd)

Chart 1
HEADLINE INDEX

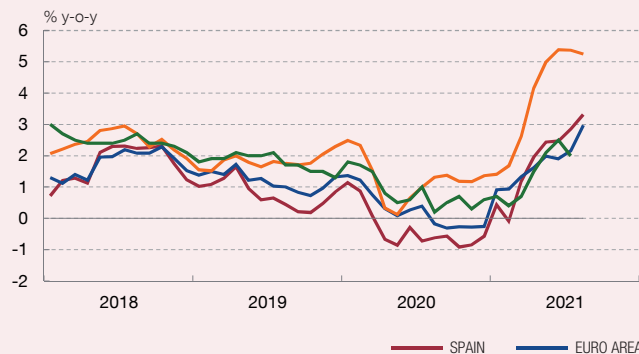


Chart 2
HEADLINE INDEX, EXCLUDING ENERGY AND FOOD

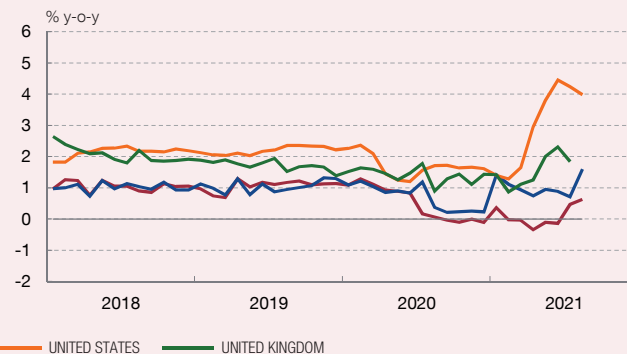


Chart 3
CUMULATIVE IMPACT OF BASE EFFECTS FROM ENERGY AND FOOD

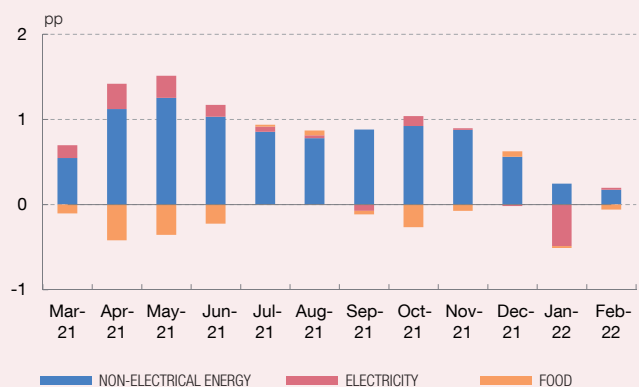


Chart 4
HICP SERVICE PRICE INDICES

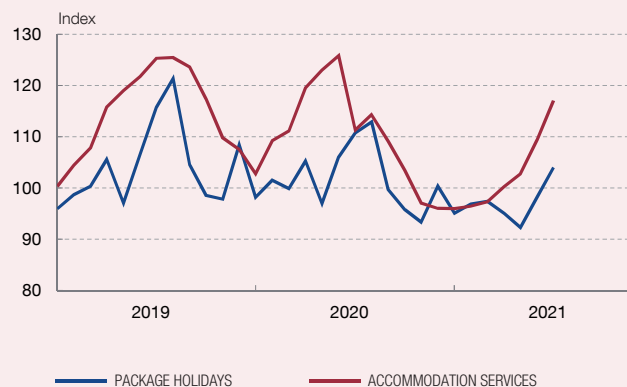


Chart 5
COMMODITY PRICES AND PPI FOR INTERMEDIATE GOODS

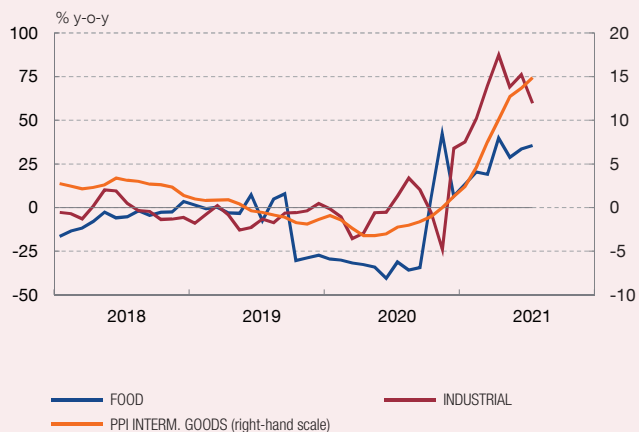
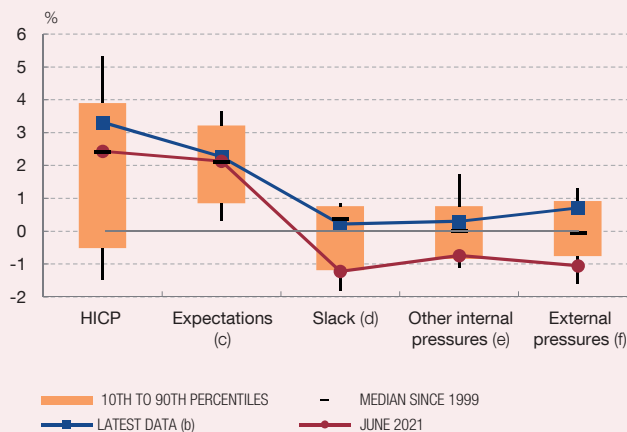


Chart 6
INDICATORS OF INFLATION PRESSURES (a)



SOURCES: European Commission, Eurostat, INE, Reuters and Banco de España.

- a See L. J. Álvarez and I. Sánchez (2018) "Composite indicators of inflationary pressures", Analytical Articles, *Economic Bulletin* 4/2018, Banco de España, for a description of the composite indicators of inflationary pressures.
- b Monthly: August 2021; Quarterly: 2021 Q2; Daily: 14 September 2021.
- c Inflation expectations of professional forecasters, firms, consumers and inflation swaps.
- d Including output gap, capacity utilisation, unemployment rate, quarter-on-quarter change in the unemployment rate, measurement of unemployment gap (recession gap) and quarter-on-quarter change in GDP and private consumption.
- e Including labour costs, profit margins and domestic producer prices.
- f Prices of imported goods: end-products, intermediate goods and commodities.

THE FACTORS UNDERLYING THE RECENT INCREASE IN INFLATION IN SPAIN (cont'd)

Further, some significant bottlenecks have developed in global supply chains since late 2020, which appear to have limited the capacity of firms (particularly those in manufacturing) to meet growing global demand within the timeframes required.⁵ The impact of such supply and demand mismatches has seemingly already been reflected in a notable increase in certain intermediate goods prices. Thus, throughout 2021, industrial producer prices have quickened sharply in Spain, particularly so in the case of manufacturing prices of some intermediate goods in the basic metals and basic chemicals sectors and in the paper industry (see Chart 5). So far, these inflationary pressures have not been significantly reflected

in consumption basket prices, although the empirical evidence available would suggest that a relatively small part of such pressures could end up passing through, with some lag, to the HICP.⁶ In addition, the frictions observed to date in global supply chains could potentially prove to be more persistent than expected.

Turning to second-round effects, the recent price developments may potentially trigger an increase in consumers' and firms' future inflation expectations (see Chart 6). Were this to put upward pressure on labour costs, for example, the inflationary spike may be more persistent and pronounced.⁷

5 See Box 3 "Euro area manufacturing bottlenecks" in this Economic Bulletin.

6 A recent analysis for the euro area estimates that the pass-through of prices of intermediate goods to those of non-energy industrial goods takes between 12 and 18 months (see the box entitled "Recent developments in pipeline pressures for non-energy industrial goods inflation in the euro area", *Economic Bulletin* 5/2021, ECB).

7 However, in the short term, the strength of these second-round effects could be relatively limited, owing both to the low number of agreements with indexation clauses in Spain and to the fact that there is still a high degree of slack in the country's labour market.