

## EDITORIAL

# THE INCREASE IN INFLATION IS OIL DRIVEN

### NET OF ENERGY PRODUCTS INFLATION IS AROUND 1.5%

Consumer price inflation (Italian general NIC index) has risen to 2.2% in recent months. The rise was led by the increase in energy products: fuels, heating oils, electricity and gas.

Inflation for non energy product goods remained below 1% and a slowdown was observed for some private sector services prices. More specifically there was good news for hotel and restaurant services where the increases over the last twelve months were just a little over 2% and care to persons and recreation services increased by around 1.5% per annum. Inflation remained high in other services sectors: transport and financial services increased by approximately 4% over the last twelve months.

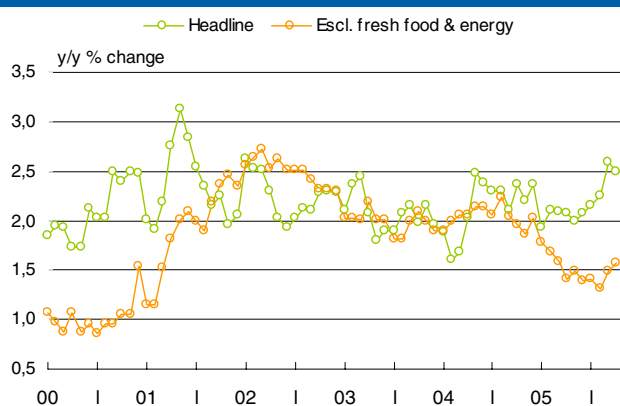
Net of increases in energy products, inflation has remained steady at 1.5% since the start of the year. All measures of core inflation indicate that the rise in inflation is not permanent. One of the special focus sections in this edition investigates the causes of the divergence between general and core measures of inflation. Like that of other economies in the euro area, the Italian economy was subject to a series of shocks in 2005. Domestic inflation has remained high if one considers the absence of indirect oil price impacts, which are destined to manifest in 2006, the removal of import quotas on textiles, the competition from goods from emerging countries on consumer electronics markets and the far from flourishing trends in consumer demand. If we take the case of clothing goods for example the fall in supply costs has not been sufficient to produce a decrease in consumer prices. This is because commercial distribution is still too fragmented, characterised by the still marginal presence of chains of shops and of the big international players.

The price gap at pumps between petrol and Diesel oil almost halved from 20 to 10 cents over the last year, against a background of falling petrol consumption and growing Diesel oil consumption. The producer price of Diesel oil in Italy is the dearest in the EU even though Italy continues to be the principal refiner and exporter. Pump prices for Diesel oil were loaded by an increase in the distribution mark up (destined to pay the petroleum company and retail distributors) of around 30%. Petroleum companies and/or retail distributors could have offset the fall in sales volumes for petrol with an increase in the profit margin on Diesel oil.

A recent survey conducted by the Statistics Office of the City of Rome analysed

how price changes were transmitted down the supply chain. The survey, conducted in the capital, found inefficiencies and rigidities. Distribution companies show little flexibility in both their supply and their pricing policies. Price lists are reviewed sporadically and a substantial proportion of firms tend not to change prices even when there is a substantial increase in costs.

EURO AREA: HEADLINE AND CORE INFLATION



SOURCE: REF CALCULATIONS ON EUROSTAT DATA



# DOMESTIC PRICES

## INCREASES NET OF OIL DO NOT EXCEED 1.5%

Recent trends in consumer inflation are driven by energy products which were rising at close to 13%, year-on-year, in October. Net of energy products inflation is moving at an annual rate of around 1.5%

For non energy goods, the slight acceleration in foodstuff prices has been offset by the slowdown in non foodstuff goods. As concerns services, the gradual deceleration in free market prices has been offset by the return, year-on-year, of public sector tariffs to positive rates of inflation.

Nevertheless inflation remains high in two services sectors: transport and financial services have increased by more than 4% over the last twelve months. Increases in financial services have been driven by current account banking charges, which rose by 11% over twelve months.

### ITALY: BREAKDOWN OF INFLATION

ANNUAL % CHANGE					
	Avg. 2002	Avg. 2003	Avg. 2004	Aug.05/ Aug.04	Oct.05/ Oct.04
<b>Food</b>	<b>3,6</b>	<b>3,1</b>	<b>2,2</b>	<b>0,0</b>	<b>0,4</b>
Processed food	2,1	2,6	2,3	0,6	0,5
Fish and seafood	4,5	4,5	1,6	1,7	2,2
Fruit and vegetables	9,8	5,3	2,0	-3,9	-1,0
<b>Industrial goods</b>	<b>2,1</b>	<b>1,9</b>	<b>0,8</b>	<b>1,0</b>	<b>0,9</b>
Medical products	-1,2	0,4	1,7	1,3	1,1
Clothing	2,4	2,8	2,2	1,6	1,3
Footwear	3,5	2,9	1,8	1,6	1,3
Furniture and furnishings	1,9	1,9	2,2	2,1	2,1
Household appliances	0,3	0,2	-0,3	-0,8	-0,9
Radio, Tv, etc.	-2,9	-4,1	-13,3	-11,1	-11,2
Photog. equip., optical instr.	1,1	1,2	1,4	0,6	0,6
Household goods	2,1	2,2	1,7	0,9	0,9
Tools and equip. for house	2,2	2,8	2,6	2,3	2,2
Products for personal care	2,1	2,3	1,8	0,4	0,2
Newspapers, books	4,3	2,4	2,0	1,8	2,0
CD, magnetic tape	0,9	0,8	0,6	0,0	0,0
Games, toys, sport equip.	1,5	1,8	1,0	0,6	0,5
Miscellaneous goods	2,7	2,7	2,6	2,1	2,6
Motor cars and access.	2,5	1,6	-0,1	2,8	2,1
<b>Energy</b>	<b>-2,8</b>	<b>3,0</b>	<b>2,4</b>	<b>9,9</b>	<b>12,6</b>
Heating oil and fuels	-1,5	2,4	5,8	11,5	14,6
Electricity and gas	-4,2	3,9	-1,7	7,8	9,8
<b>Services</b>	<b>3,9</b>	<b>3,6</b>	<b>3,3</b>	<b>2,8</b>	<b>2,7</b>
Personal care, recreation	2,8	2,3	2,2	1,7	1,8
Housing	2,6	2,9	2,7	2,5	2,5
Transport	3,7	3,5	4,9	4,5	4,3
Health	3,9	3,6	2,9	2,0	1,7
Financial and n.e.c.	5,9	7,7	2,9	4,3	4,5
Restaurants and hotels	4,7	4,1	3,4	2,4	2,4
<b>Regulated prices</b>	<b>1,5</b>	<b>0,2</b>	<b>1,5</b>	<b>-0,6</b>	<b>0,2</b>
Nationally	1,2	-1,3	0,6	-2,4	-1,3
Locally	2,7	3,1	3,1	2,5	2,6
<b>Rents</b>	<b>2,3</b>	<b>2,8</b>	<b>2,8</b>	<b>2,4</b>	<b>2,4</b>
<b>Tobacco</b>	<b>1,8</b>	<b>8,4</b>	<b>9,8</b>	<b>10,0</b>	<b>9,7</b>
<b>All-items</b>	<b>2,5</b>	<b>2,7</b>	<b>2,2</b>	<b>2,0</b>	<b>2,2</b>

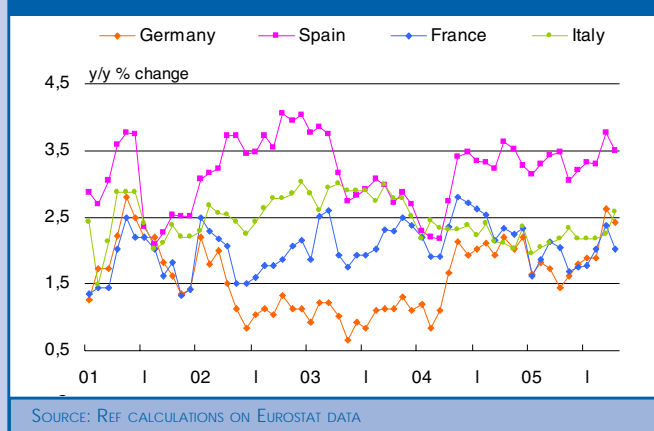
SOURCE: REF CALCULATIONS ON ISTAT DATA

## INTERNATIONAL PRICES

# CRUDE OIL PRICES DRIVE EUROPEAN INFLATION

Inflation in the euro area accelerated sharply rising from 2.2% in August to 2.6% in September. There was, however, a slowdown between October and November. The rise was seen in almost all the major European countries and was caused by the prices of oil and its derivatives. Core inflation, on the other hand, remained at around 1.5% indicating that the overall index is being influenced by the transitory effects of the prices of the more volatile components of the basket. Nevertheless, the average difference between the two measures of total and core inflation broadened from 0.1% last year to 0.7% between January and October 2005. However, careful analysis of the nature and duration of the current price shocks suggest that caution should be

INFLATION IN SOME EURO AREA COUNTRIES



employed in considering the ability of core inflation to forecast general inflation accurately.

## SPECIAL FOCUS

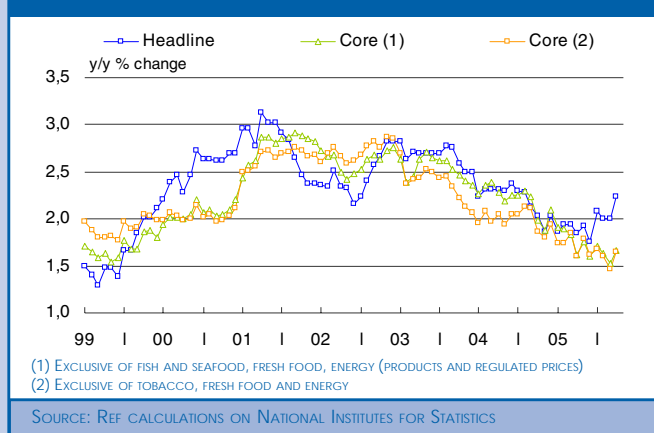
# DIFFERENT MEASURES OF CORE INFLATION: THE LESSONS

A new gap opened up in the second half of 2005 between general and core measures of inflation.

An analysis of the outlook for inflation is inadequate if it does not include careful assessment of shock impacts: the appreciation of the euro, the fall in consumer electronics prices, the increase in oil prices and the removal of import quotas on textile and clothing products.

These are closely connected factors; oil prices of more than 50 dollars per barrel are destined to persist in coming years because of the strong growth in energy requirements by China and India. Economic growth in those same Asian economies is driven by exports to western countries, consisting mostly of textile and consumer electronic products.

HEADLINE AND CORE INFLATION

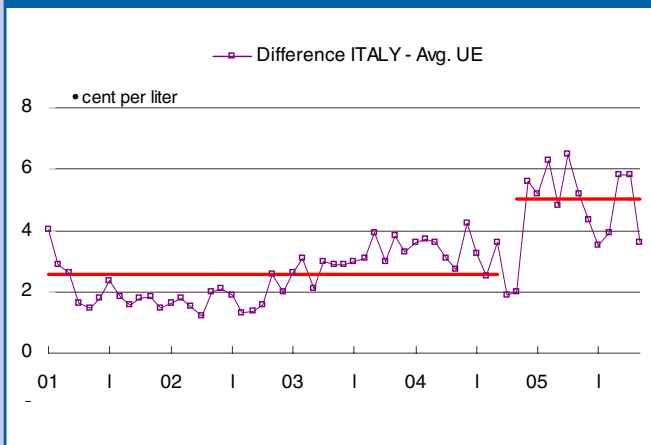




# FUEL FUEL PRICES ARE RISING: NOT JUST CRUDE OIL

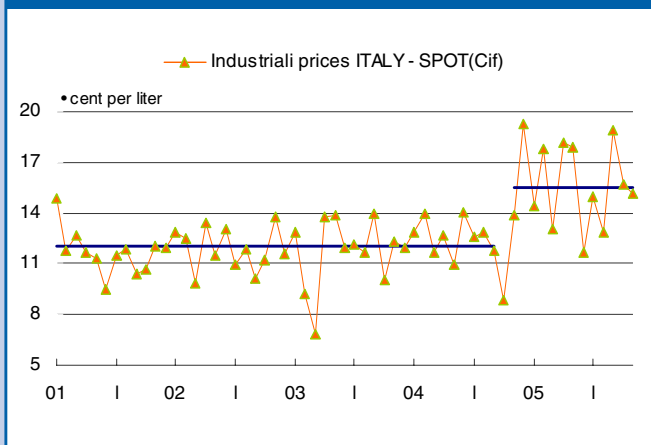
Fuel prices have increased considerably over the last year. The increases are the result of the rise in crude oil prices and of refinery bottlenecks. The gap between petrol and Diesel oil prices at the pump has practically halved in a context of falling petrol consumption and growth in Diesel consumption. The producer price of Diesel oil in Italy has become the highest in the EU even though Italy continues to be the main refiner and exporter. Pressures from international markets on the pump price of Diesel oil has been added to with a substantial increase in the retail mark up (destined to pay petroleum companies and final retailers) which rose from an average of 12 cents per litre over the four year period 2001-2004, to 16 cents per litre in 2005, an increase of around 30%. Petroleum companies and/or retail distributors could have offset the fall in sales volumes for petrol with an increase in the profit margin on Diesel oil.

## DIESEL: INDUSTRIAL PRICES



SOURCE: REF CALCULATIONS ON ISTAT AND MINISTERO DELL'ECONOMIA E DELLE FINANZE DATA

## DIESEL: DISTRIBUTION MARGIN



SOURCE: REF CALCULATIONS ON ISTAT AND MINISTERO DELL'ECONOMIA E DELLE FINANZE DATA