

## INFLATION BOOST, AMERICAN STYLE?

Would inflation rates in the Eurozone increase, if owner-occupied housing costs were introduced? We doubt it. We put more faith in service wages.

Is inflation in the Eurozone finally getting off the ground? Until recently, it didn't seem like it. Inflation rates below 1% were the norm. But now there is hope for at least a moderate upward trend. Mind you, we are not referring to erratic prices or prices that are difficult to control, such as those for energy (which are formed on the world market), food (which are weather-dependent) or even rents (which depend on regulatory provisions or supply shortages). Instead, we're talking about wages, which play an important role in the price of services (excluding rents). They've been rising at an annual rate of more than 2.5% since 2018.<sup>1</sup> It's only a matter of time before companies pass on the wage pressure to consumers. While service expenditures only account for roughly a third of the basket used for determining inflation, they have substantially reduced the downside risks to inflation. To the European Central Bank (ECB), this serves as confirmation that its monetary policy is having an impact – albeit slowly – on inflationary developments.

"Perceived" inflation rates, on the other hand, vary considerably. The ECB, too, wonders whether the current basket of

goods and services correctly reflects the actual price pressure. Their "strategic review" is supposed to tackle this. Rents play an important role in this quest. In the Eurozone consumer price index (HICP) their weight is only 6.5%. In Spain, where the home ownership rate is 77%, rents only account for 3.1%. Costs incurred due to home ownership (purchase, renovation, interest) are not included in the inflation calculation.

So why not include owner-occupied housing costs in the price index as it's done in the U.S.? Assuming rent and owner-occupied housing made up 33% of the basket of goods and services in the Eurozone, too, the inflation rate would have fluctuated much more since 2010 and in some cases would have been 0.2 to 0.5 percentage points above the reported rate. From 2011 to 2013, on the other hand, it would have been lower. And on average it would have produced a similar value. "Such an index would thus better reflect the price reality of consumers, but it would not necessarily have led to a different monetary policy over the past decade," Ulrike Kastens, DWS economist, concludes.

<sup>1</sup>Source: Bloomberg Finance L.P. as of 2/17/2020



Sources: Eurostat, Haver Analytics, DWS Investment GmbH as of 2/17/20

\* OOH = owner occupied housing

\*\* the ECB's inflation target is "below but very close to 2%," so we are using 1.9% to adequately reflect this

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Source: DWS Investment GmbH

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## GLOSSARY

The **European Central Bank (ECB)** is the central bank for the Eurozone.

The **Eurozone** is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

The **Harmonized Index of Consumer Prices (HICP)**, a list of the final costs paid by European consumers for the items in a basket of common goods, is produced by each European Union member

state to help measure inflation and to guide the European Central Bank in formulating monetary policy.

**Inflation** is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

**Monetary policy** focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

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