

## Spain: core inflation down for the first time in 23 months

Spain's CPI fell strongly in March after a slight uptick in February. Core inflation also fell in March for the first time since April 2021



### Spanish inflation falls sharply in March due to lower energy prices

Spanish inflation cooled in March, according to Spain's statistics office INE. Headline inflation stood at 3.3% year-on-year, down from 6% in February. The HICP came in at 3.1% year-on-year, down from 6% in February. The decline in headline inflation was mainly due to the fall in gas and electricity prices this month, after the sharp rise in the same month last year.

Also encouraging is that core inflation fell slightly to 7.5% from 7.6% in February, the first drop in 23 months. This shows that despite the sharp fall in headline inflation, inflationary pressures in the economy remain very high, but it is also a sign that the pass-through of higher energy prices into higher consumer prices is starting to lose strength. Moreover, pressures on global supply chains have further eased in recent months to pre-pandemic levels, which is also dampening inflation.

## Downward trend to continue in coming months

We expect headline inflation to cool further in the coming months, mainly thanks to a reduced contribution from the energy component. Energy inflation has been negative since the beginning of the year and will continue to put downward pressure on inflation rates.

Gas stocks in Europe are still well-filled, although the heating season is coming to an end. As a result, the starting position for the new injection season is much more favourable, greatly improving the outlook for energy prices this year.

Inflationary pressures in the pipeline have also eased considerably in recent months. Both producer and import prices are well below their peak levels. Finally, ECB interest rate hikes will also increasingly dampen inflation dynamics in the coming months. Interest rates are now well into restrictive territory, which will increasingly slow down economic activity. This will make it more difficult for companies to pass on new price increases, which will push inflation rates lower.

## Hope for cooling food inflation as agricultural commodity prices fall

Although we don't have the details by component for March yet, there is optimism around food inflation also coming down. Food prices, which rose 16.6% year-on-year in February, were recently a major contributor to headline inflation in Spain. However, the significant decrease in agricultural commodity prices will soon start to decelerate the pace of food inflation. The surge in agricultural commodity prices during the Covid-19 pandemic and the onset of the war in Ukraine were the primary reasons for high food inflation. Fortunately, agricultural commodity prices have declined significantly in recent months. Typically, there is a delay of nine to 12 months before changes in commodity prices translates into changes in food prices. This would mean that food inflation would start to lose momentum from the summer onwards.

## Core inflation more sticky

Core inflation will also gradually lose momentum, although we expect it to be much stickier. Rising energy prices are typically passed on to sales prices faster than when energy prices fall. When energy prices fall, the pass-through into consumer prices is expected to be much more gradual. Another reason is high services inflation, which still shows little sign of cooling. The services PMI accelerated further in February. Strong activity makes it easy for companies to raise prices further. The share of services companies planning to implement new price increases in the coming months is still very close to record highs. Services inflation will therefore remain high for some time to come.

We expect average inflation to reach 3.8% in 2023 and 3.1% in 2024. In early 2024, inflation could go higher again because many government measures to offset inflation and high energy prices will expire, making energy a positive contributor to the inflation rate again from 2024 onward. Therefore, there is a risk that inflation will rise again in 2024, despite a further cooling in underlying core and food inflation.