

Snap | 29 June 2023

SPAIN

Spanish inflation falls below 2% for the first time in two years

Spain's inflation outlook improved further in June. Headline inflation fell below 2% for the first time since March 2021. However, inflation is expected to pick up in the second half of the year due to several factors, including higher oil prices and the fading of favourable base effects



Prices in hotels and restaurants are starting to stabilise due to cooling food inflation

Spanish inflation reaches 2% target

The downward trend in Spanish headline inflation continues, falling to 1.9% year-on-year in June from 3.2% YoY in May. This month's sharp fall in inflation was expected given the jump in June last year. This marks the first time in about two years, since the start of the spike in inflation, that inflation is back in line with the ECB's 2% target.

Headline inflation has now fallen to 1.9% YoY, after peaking at 10.8% in July 2022, while the HICP gauge stands at 1.6% YoY, down from its peak of 10.7% in July last year. Core inflation fell further to 5.9% in June from 6.1% in May, showing that disinflationary pressures are broadening.

Falling fuel prices is another force pushing inflation downwards

Several factors are fuelling disinflationary pressures in Spain. First, the significant fall in gas and electricity prices since their peak last summer. Lower fuel prices are also exerting strong downward pressure on inflation. Cooling oil prices on the international market mainly affect the transport component of the CPI, which has a weight of 14% in the overall inflation basket. Moreover, falling transport costs gradually spill over into other sectors of the economy, further reducing inflationary pressures.

Finally, cooling food inflation, which accounts for 22% of the overall inflation rate, is crucial in easing overall inflationary pressures in Spain. This fall in food inflation has a direct impact on inflation and a cascading effect on other sectors of the economy. In particular, prices in hotels and restaurants, which account for 14% of the overall inflation rate, are starting to stabilise despite strong tourist arrivals. In essence, slower growth in food prices also causes operating costs in the hospitality industry to rise more slowly.

Spanish inflation is likely to rise again in the second half of the year

Spanish inflation reached its 2% target this month for the first time since March 2021. However, it is premature to assume that the inflation peak is over. Several factors are at play that are likely to push inflation back above the ECB's target during the coming winter season. The favourable base effects due to higher energy prices will gradually fade in the second half of this year. In addition, we expect an increase in oil prices in early 2024, which will further contribute to the rise in inflation. Add to that the discontinuation of certain government measures which will also put upward pressure on inflation. For the whole of 2023, we expect an average inflation rate of 4.1% and a rate of 2.5% in 2024.

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