

Irish consumer prices (June)

Thursday, 8 July 2010

Having peaked at 6.6% last October, the latest consumer price index, released by the Central Statistics Office this morning, showed a continuation of the easing in the annual rate of deflation since then. Overall prices in June were 0.9% lower than in the same month last year, compared with year-on-year rates of deflation of 1.1% in May and 2.1% in April. However, on a monthly basis, prices were 0.1% lower than in May, the first monthly decline since January, suggesting that deflationary rather than inflationary forces continue to be the main price drivers in the economy at the moment despite the recovery in activity since the start of the year.

Headline deflation has predictably decelerated a year on from the large falls in energy prices in late 2008. However, once the energy effects have worked through, and the recent increases in mortgage interest rates are taken into account, the inflation outlook is still in the main dominated by disinflationary pressures. Indeed, the HICP measure of inflation, which excludes mortgage interest repayments, was also down 0.1% month-on-month in June, but that was enough to see the annual rate of deflation on this basis pushing back up to 2.0% from 1.9% in April.

The latest HICP figures for the EU as a whole refer to the month of May, and they show that Ireland is now only one of two countries within the 27-member bloc, along with Latvia to still be in deflationary territory at this point in time. This should be no surprise given that they were the two countries within the EU to implement severe wage/price reductions across the board. While Ireland needs to make significant downward wage/price adjustments to become more competitive and return the economy to sustainable growth, the last thing we need is to get stuck in a deflationary spiral like Japan, which will do more damage than good in the medium- to long-term. Thankfully, we don't think that will be an issue. In fact, we think prices will pick up over the next twelve months as the economy recovers, but Ireland's HICP will still be running below the Eurozone/EU average which will be good news as regards regaining competitiveness.

The main factors contributing to the monthly change in the June consumer price index were decreases in clothing and footwear due to the Summer sales; falls in petrol and diesel prices due to lower global oil prices; and a lower cost for wine sold in off-licences and supermarkets. As regards price increases in the month, home insurance was higher than in May.

Overall inflationary pressures should remain muted during 2010. In particular, challenging labour market conditions and declines in disposable incomes will constrain demand and the pricing power of firms. There is also some negative carryover from 2009. That said, upward base effects will play a prominent role and will eventually push the headline inflation rate back into positive territory before the year is out. Based on these latest CPI figures, we now think we will see the first positive year-on-year change in the CPI since December 2008, in October.

The bottom line is that overall prices in Ireland are likely to be lower on average again in 2010. However, the rate of deflation is set to ease considerably this year. Following an average drop in prices of 4.5% in 2009, we are looking for a much more modest annual average fall in 2010 of around 1.2%.

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	All Items Index (Dec 2006=100)	% Change Month	% Change Year	HICP Index (2005=100)	% Change Month	% Change Year
2009 June	102.1	-0.3	-5.4	107.6	0	-2.2
2010 April	100.7	0.2	-2.1	105.3	0	-2.5
2010 May	101.3	0.6	-1.1	105.6	0.3	-1.9
2010 June	101.2	-0.1	-0.9	105.5	-0.1	-2.0