

25 January 2023

Euro inflation notes

January surprises

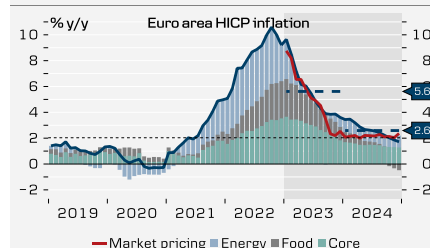
The uncertainty surrounding the January HICP release is larger than usual, as a range of different economic and technical factors loom with the turn of the year. Below we discuss some of the most important issues to be aware of and how they could influence price developments this year:

- HICP component weights:** The flash figures will bring the new component weights for 2023. Just like under the Covid-19 pandemic in 2020, 2022 saw big changes to ‘traditional’ consumption patterns and households on balance spent a larger share of their income on energy consumption during 2022 than in previous years. We expect the new HICP energy weight to rise to ca. 13.8% (compared to 10.9% in 2022), thereby magnifying the impact of energy developments on the HICP dynamics. Core and especially services could in contrast see its weight declining (see chart), but with a readjustment of weights in favour of recreational services. On balance, the higher weights for volatile items such as food and energy could further increase the volatility in HICP and increase inflation risk premiums.
- HICP country weights:** With the turn of the year, the euro area has also gotten a new 20th member state. Croatia’s HICP share will probably be sufficiently small not to be a game-changer for the HICP dynamics, but with its inflation rate standing at 12.7% in December 2022 (above the euro area average), it could on balance be another pro-inflationary factor for 2023.
- Menu cost adjustments:** Firms are still in the process of passing-on higher input costs to consumers and many companies will likely use the turn of the year as an excuse to adjust prices to a new input cost reality. With the economy holding up better than expected, the environment for price hikes remains unusually benign, as also illustrated by continued high selling price expectations. This is especially the case for services, where increasing wage demands have yet to be fully reflected in prices.

However, not only core goods and services face menu cost adjustments. We expect that also many energy providers could seek another round of contractual price increases in light of the new reality in energy markets. This implies that the rise in wholesale prices observed in 2022 is set to exert continued upward pressure on retail gas and electricity prices throughout 2023 year as well, and the drop in HICP energy inflation could therefore lag the decline indicated by spot commodity prices in the market.

- Fiscal measures:** While government support measures succeeded in cushioning the blow from the energy crisis for consumers and firms, they also remain a distorting influence for the inflation dynamics. France, which froze gas bills in October 2021 and capped electricity price increases at 4% in 2022, will allow bigger price rises of up to 15% in 2023 and could therefore see another uptick in energy inflation in January. German energy inflation saw a significant decline in December 2022 due to a one-off government-backed discount on energy bills. That effect will drop out in January, meaning energy inflation could revert sharply, before the German gas and electricity price brake takes full effect in March and the decline in energy inflation repeats.

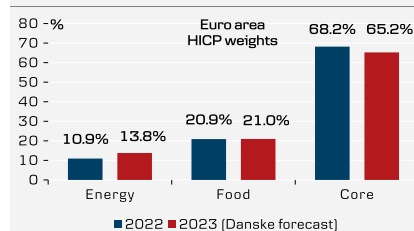
Markets are underestimating euro inflation risks in 2023/24



Source: Eurostat, Macrobond Financial, Danske Bank

Note: Past performance is not a reliable indicator of current or future results.

Higher weight for energy, lower weight for core in 2023



Source: Eurostat, Macrobond Financial, Danske Bank

Menu cost adjustments loom in light of still high selling price expectations



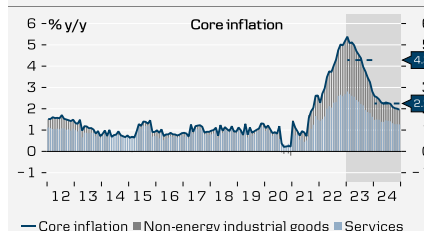
Source: European Commission, Macrobond Financial, Danske Bank

Senior Euro Area Analyst
Aila Mihr
+45 45 12 85 35
amih@danskebank.dk

Overall, we look for an uptick in euro area headline inflation to 9.6% in January (from 9.2% in December), as menu cost adjustments trigger another increase in core inflation to 5.4% (from 5.2% in December). An inflation upside surprise could bring a setback to the European fixed income rally, adding to the risk of more ECB hikes to come.

For the time being, lower energy prices and base effects, as well as government interventions are pushing down headline inflation. However, with a tight labour market and still elevated selling price expectations, high core inflation will likely remain a worry for ECB for some time yet. **We still think markets are underestimating the ‘stickiness’ in underlying inflation and forecast HICP inflation to average 5.6% in 2023 and 2.6% in 2024, but with core inflation not returning to the ECB’s 2% target before H2 24.**

High core inflation will remain a worry for ECB for some time yet



Source: Eurostat, Macrobond Financial, Danske Bank

Euro area HICP heatmap

	Weight	12/2022	11/2022	10/2022	9/2022	8/2022	7/2022	6/2022	5/2022	4/2022	3/2022	2/2022	1/2022
All-Items	100	9.2	10.1	10.6	9.9	9.1	8.9	8.6	8.1	7.4	7.4	5.9	5.1
Food & Non-Alcoholic Beverages	17	16	16	15.5	13.8	12.4	11.5	10.4	8.7	7.4	5.7	4.7	3.9
Food	15	16.3	16.4	15.9	14.1	12.7	11.8	10.7	8.9	7.7	5.8	4.8	4
Non-Alcoholic Beverages	1.5	12.5	11.8	11.1	10.1	9.4	8.5	7.4	6.6	5	4.2	3.4	2.8
Alcoholic Beverages, Tobacco & Narcotics	4.3	5.2	4.6	4.2	4.1	3.8	3.5	3.2	2.7	2.2	2.3	2.2	2.2
Alcoholic Beverages	1.8	7.4	6.9	6.6	6	5.3	4.7	4.3	3.3	2.3	1.7	1.3	1.4
Tobacco	2.4	3.5	2.8	2.4	2.6	2.7	2.5	2.4	2.2	2.1	2.7	2.9	2.9
Clothing & Footwear	5.3	3.7	3.4	3.8	3.2	2.1	0	0.6	1.7	2	2.1	2.1	-0.2
Clothing	4.2	3.9	3.6	4	3.4	1.9	-0.4	0.4	1.7	2.1	2.2	2	-0.5
Footwear	1.1	2.8	2.4	2.9	2.7	2.5	1.6	1.3	1.9	1.5	1.6	2.5	1
Housing	18	16.3	20.6	23.2	21.1	19.7	17.7	16.9	16.3	15.9	17.2	13.4	11.9
Actual Rentals for Housing	7.1	2.3	2.2	2	1.9	1.8	1.8	1.6	1.5	1.3	1.2	1.2	1.2
Maintenance & Repair of the Dwelling	1.3	10.2	10.4	10.4	9.4	9.4	9.4	8.6	8.4	7.7	7.1	6.6	5.8
Water Supply & Misc. Dwelling Services	2.9	2.8	2.7	2.7	2.4	2.3	2.2	2.2	2.1	2.1	2	1.9	1.6
Electricity, Gas & Other Fuels	6.6	38.4	50.9	59.2	55.5	51.9	46.5	44.9	43.5	42.8	47.5	36.3	32.1
Furnishing	6.7	9.1	8.6	8.5	7.8	7.4	6.9	6.5	5.9	5	4.2	3.8	2.8
Furniture & Furnishings	2.3	9.5	9.2	9.4	8.7	8.7	8.7	8.5	7.6	6.4	6.1	5.7	4.5
Household Textiles	0.44	7.7	6.4	7.2	6.1	6	5.5	5.3	4.8	4.8	3.4	3.6	2.1
Household Appliances	1.1	8.2	7.5	7.5	7	6.1	5.5	4.9	4.5	3.5	2.4	1.9	1
Glassware, Tableware & Household Utensils	0.55	7.7	7.6	6.6	6.6	6.2	5.7	5.6	5.3	4.5	3.5	3.2	2.5
Tools & Equipment for House & Garden	0.56	5.2	5.4	5	4.7	4.4	4.1	3.9	4.2	3.9	3.2	2.6	1.8
Goods & Services for Routine Maintenance	1.8	11.1	10.5	9.9	8.8	8	7.2	6.2	5.6	4.8	3.8	3.3	2.2
Health	5.1	1.8	1.7	1.8	1.4	1.2	1.3	1.1	1.3	1.1	1	0.9	0.8
Medical Products, Appliances & Equipment	2.1	2.2	2.1	2.1	1.6	1.4	1.4	1.1	1	0.5	0.6	0.4	0.2
Out-Patient Services	2.2	1.2	1.2	1.5	1.2	0.9	1	1	1.4	1.5	1.2	1.1	1.1
Hospital Services	0.74	2	2	1.9	1.8	1.8	1.7	1.6	1.7	1.8	1.8	1.7	2
Transport	15	6.9	8.7	10	10.9	9.9	12.7	14.4	14	13	14.6	10.3	9.4
Purchase of Vehicles	3.9	8.7	8.7	8.5	8.4	8.5	8.1	7.7	7.4	6.9	6.2	5.9	5
Operation of Personal Transport Equipment	8.8	6.2	8.9	11.1	12.9	12.6	17.3	21.1	18.5	17	21.2	14.3	13.2
Transport Services	1.9	6.8	7.4	7.5	7.3	1.1	1.6	-2	7.1	7.9	2	2.2	2
Communications	3.1	-0.9	-1	-0.9	-0.8	-0.7	-0.8	-0.3	-0.4	0.1	0	-0.4	-0.4
Postal Services	0.15	4.2	4.1	4.1	4	4.4	4.3	3.9	4	4.1	4.1	3.5	3.5
Telephone & Telefax Equipment & Services	2.9	-1.1	-1.3	-1.2	-1	-1	-1.1	-0.5	-0.6	-0.1	-0.2	-0.6	-0.6
Recreation & Culture	7.9	5.5	4.7	4.9	4.6	4.8	4.4	4.4	3.6	3.6	3.1	3.1	2.8
Audio-Visual & Photographic	1.3	-0.5	-0.7	-0.1	0	0.1	-0.3	0.2	0.2	0.1	0.7	0.5	0.5
Other Major Durables for Recreation & Culture	0.38	8.5	8.5	8.7	8.1	9.2	8.5	7.6	7.7	6.4	6.2	4.6	4
Other Recreational Items, Gardens & Pets	2.3	8	7.2	6.4	6	5.3	5.3	5.7	4.7	4.6	4	3.8	3.2
Recreational & Cultural Services	1.8	3.7	3.4	3.6	3.4	3	2.3	2.2	3	2.8	2.3	2.3	2
Newspapers, Books & Stationery	1.3	6.3	6	5.4	4.9	4.4	4.5	4.5	4	3.9	3.2	3	2.7
Package Holidays	0.7	9.6	7	9.7	9.2	12.4	10.7	11.5	5.3	8.8	6.7	9.2	11.6
Education	0.98	4.1	4.1	4.1	3.8	-0.8	-0.9	-1	-0.9	-0.9	-0.9	-0.9	-0.9
Restaurants & Hotels	8	8.3	8.1	8.4	8.5	8.1	8.3	7.9	7.1	5.9	5.1	4.4	4.1
Catering Services	6.6	7.8	7.6	7.1	6.8	6.4	6.1	5.7	5.4	4.6	4.1	3.7	3.3
Accommodation Services	1.5	10.1	10.5	13.7	15.1	13.4	16.1	17.2	13.8	11.2	10	7.5	8.2
Miscellaneous Goods & Services	9.7	4.2	4.1	3.8	3.4	3.2	3	2.7	2.6	2.4	2.2	2.1	1.9
Personal Care	2.9	7.4	6.8	6.2	5.4	4.9	4.1	3.6	3.4	2.9	2.3	2.2	1.9
Personal Effects N.E.C.	0.88	4.8	4.8	4.7	4.5	4.4	4.1	3.8	3.9	3.6	3.1	2.7	1.5
Social Protection	1.8	3.3	3.2	2.9	2.7	2.3	2.1	1.9	1.9	1.8	1.8	1.8	2
Insurance	2.4	1.4	1.6	1.5	1	1.3	1.7	1.7	1.9	1.7	1.8	1.8	1.8
Financial Services N.E.C.	0.62	5.1	5.1	5	5.1	5.1	5	2.9	3	3.1	3.1	2.8	3.2
Other Services N.E.C.	1.1	3	2.9	2.8	2.6	2.6	2.5	2.4	2.3	2.2	2	1.8	1.6

Source: Eurostat, Macrobond Financial

Disclosure

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Aila Mihr, Senior Analyst.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and regulated by the Danish Financial Services Authority (Finanstilsynet). Danske Bank is authorised by the Prudential Regulation Authority in the UK and subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Danske Bank's research reports are prepared in accordance with the recommendations of Capital Market Denmark.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Ad-hoc.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank A/S. It is provided for informational purposes only and should not be considered investment, legal or tax advice. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

This research report has been prepared independently and solely on the basis of publicly available information that Danske Bank A/S considers to be reliable but Danske Bank A/S has not independently verified the contents hereof. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation or warranty, express or implied, is made as to, and no reliance should be placed on, the fairness, accuracy, completeness or reasonableness of the information, opinions and projections contained in this research report and Danske Bank A/S, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts and reflect their opinion as of the date hereof. These opinions are subject to change and Danske Bank A/S does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom (see separate disclaimer below) and retail customers in the European Economic Area as defined by Directive 2014/65/EU.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank A/S's prior written consent.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank A/S is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank A/S who have prepared this research report are not registered or qualified as research analysts with the New York Stock Exchange or Financial Industry Regulatory Authority but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Disclaimer related to distribution in the United Kingdom

In the United Kingdom, this document is for distribution only to (I) persons who have professional experience in matters relating to investments falling within article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the 'Order'); (II) high net worth entities falling within article 49(2)(a) to (d) of the Order; or (III) persons who are an elective professional client or a per se professional client under Chapter 3 of the FCA Conduct of Business Sourcebook (all such persons together being referred to as 'Relevant Persons'). In the United Kingdom, this document is directed only at Relevant Persons, and other persons should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the European Economic Area

This document is being distributed to and is directed only at persons in member states of the European Economic Area ('EEA') who are 'Qualified Investors' within the meaning of Article 2(e) of the Prospectus Regulation (Regulation (EU) 2017/1129) ('Qualified Investors'). Any person in the EEA who receives this document will be deemed to have represented and agreed that it is a Qualified Investor. Any such recipient will also be deemed to have represented and agreed that it has not received this document on behalf of persons in the EEA other than Qualified Investors or persons in the UK and member states (where equivalent legislation exists) for whom the investor has authority to make decisions on a wholly discretionary basis. Danske Bank A/S will rely on the truth and accuracy of the foregoing representations and agreements. Any person in the EEA who is not a Qualified Investor should not act or rely on this document or any of its contents.

Report completed: 25 January 2023, 09:00 CET

Report first disseminated: 25 January 2023, 10:00 CET