Research Denmark

Danish CPI and euro area HICP inflation set to move closer in coming years

- In recent years, primarily rent increases have pulled Danish CPI above euro area HICP.
- Rent increases lag overall inflation. This will keep Danish CPI inflation down compared with euro area HICP inflation.
- The decrease in oil prices has weighed more heavily on euro area HICP compared with Danish CPI inflation.
- Increasing oil prices should also induce a larger pickup in European compared with Danish inflation.

CPI (consumer price inflation) in Denmark has been higher than in the euro area in recent years. Technical factors can explain some of the divergence and if you measure Danish inflation by HICP (harmonised index of consumer prices), it has actually tracked euro area inflation quite well this year, until recently. In September, base effects from falling energy prices last autumn disappeared from the inflation figures; however, Danish inflation decreased nonetheless, due primarily to falling clothing prices.

The difference between the HICP and CPI inflation measure is related only to a larger weight on housing in the CPI. This larger weight consists of imputed rent on primarily owner-occupied housing, which is not included in the HICP. On top of actual rent (on rental housing) this means rent constitutes 20.3% of the total Danish CPI but only 6.4% of euro area HICP. In Denmark, the rent component is (by and large) updated just once a year, in February. That means it serves as a stabilising factor on aggregate inflation because of the low frequency of updates. In years with low aggregate inflation such as previous ones, it pulls CPI significantly above HICP inflation.

Because of the large share of CPI, the annual increase in rent in February has a considerable effect on the level of inflation throughout the year in Denmark. Part of the rent increase can be forecast, as rent regulation prevents landlords from increasing rents by more than the growth in the NPI (net price index) in the year running up to the previous summer. Although only part of the rental market is regulated this way, in recent years the NPI has been a fairly good indicator of predicting whether rent increases will be higher or lower. Based on this, we expect the rent contribution to CPI to decrease further in 2017.

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Technical factors can account for some of the difference in Danish CPI and euro area HICP. However, several components have contributed very differently to inflation in Denmark compared with the euro area recently. Since 2014, clothing has been weighing on the inflation rate in Denmark relative to the euro area as Danish clothing prices have been falling. The same goes for telephone and telefax services, which have been falling generally in Europe but more rapidly in Denmark. On the other hand, prices on books and restaurants and hotels have increased significantly more in Denmark.

A key factor behind the low inflation globally over the past couple of years has been the falling oil prices. This has different impacts on Danish and European inflation for two reasons. First, transport fuel and heating oil makes up a relatively small share of Danish consumption. It comprises 3.3% of the Danish CPI but 5.4% of euro area HICP. That is, a 1% decrease in Danish energy prices has a smaller impact on overall Danish inflation compared with the euro area. Second, taxes and markups on fuel are relatively high in Denmark and thus raw material expenses constitute a smaller share of the final price. That is, consumer prices are less sensitive to changes in the oil price in Denmark. Thus, the big decrease in oil prices has had a smaller effect on Danish CPI than on euro area HICP, and when oil prices start to pick up again, we can expect this to induce a larger pickup in the euro area compared with Danish inflation. This is also what we forecast for the coming months – higher euro area compared with Danish inflation.
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None.

Date of first publication

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