The euro and prices: changeover-related inflation and price convergence in the euro area

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Structure of the Study

- Part a) Extraordinary price developments
- Part b) Analyze household-specific inflation effects (poor, rich, elderly, young, single households ...)
- Part c) Perception jumps: household-specific experience(s), behavioural explanations (kinked perception curve, out-of-pocket-consumption), illiteracy and innumeracy, media effects
- Part d) Convergence in prices and the euro introduction
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Part a
Extraordinary price developments

- In general: inflation rates were not significantly higher during the period of the euro cash changeover than usual.
- Disaggregated data at the product level: some product groups, mainly in the service sector, exhibit significant price increases during the euro introduction.
  - “Catering services”
  - “Cleaning, repair and hire of clothing”
  - “Hairdressing salons and personal grooming establishments”
  - “Repair of audio-visual, photographic and information processing equipment”
  - “Operation of personal transport equipment”
- In line with earlier contributions we can emphasize that the small service firms like restaurants and hairdressers revealed unusual price movements related to the introduction of the euro.
- The largest impact of euro induced inflation can be observed for Finland, where unusual price movements increased the inflation rate by 0.26 percentage points and the lowest in Italy with only 0.004 percentage points.
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Household-specific inflation

- Structure of consumption baskets according to socio-economic characteristics available via HBS
  - by employment status of the reference person
  - by number of active persons (0, 1, 2, 3 and more)
  - by income quintile (1 to 5)
  - by type of households (single person, single parent with dependent children, ...)
  - by age of reference person

- combination of 1999 weights and chain weights (aggregate)
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Figure: Differences in Basket Weights
Part b
Household-specific inflation

Figure: Distribution of Distance to HICP

Certain household types were affected more
But not clear if this was due to cash changeover!
In general, the differences of household-group specific rates to the overall HICP rate are small - in the range 0.1 to 0.2 for rates against the previous year.

In general, inflation affected low-income households, single households and elderly people somewhat harder than the median consumer on average and in 2002. This effect is however not limited to euro area countries.

Econometrics:
- Certain household-specific rates are statistically different from HICP regarding mean and variance.
- Distance to HICP: stationary – no persistent deviations.
- Factor analysis: one dominating factor in all countries, all the idiosyncratic variance is very small and stationary, therefore no evidence for systematic inflation effects on certain groups.
- Clustering procedure: no systematic clustering evident.

Interestingly, countries with real-estate price booms (United Kingdom, Ireland, Spain) seem to deviate in some tests. That indicates that house-price booms via effects on expenditures in the category “Housing...” are more important in explaining differences across the income distribution than possible cashover-related effects.
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**Figure:** Inflation perceptions, November 2007, Germany, Source: GfK presentation
We are interested in how people get official government information about the rate of unemployment, the rate of change in prices, and the rate of change in the Gross Domestic Product. Do you get most of this type of information from television, the radio, newspapers, magazines, the internet, your family, friends, or co-workers, your own personal experiences, from some other sources, or do you never get any official government information on these topics? What is your second most common source of official government information about these topics? What is your third most common source of official government information about these topics?

Figure: Sources of information, Source: Curtin (2007)
Figure: Media reporting, Germany, Source: MediaTenor
Mixture of several effects:
- ex-ante expectations,
- conversion rates,
- macroeconomic “illiteracy and innumeracy” (Curtin, 2007; Blanchflower and Kelly, 2008)
- media reporting (tone and volume)

Calls for a well-designed “changeover” strategy if one believes that “ordinary people’s expectations” matter:
- ex-ante expectations should be considered,
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