

Monitoring consumer prices | the HICP

A consumer price index is an economic indicator designed to measure changes in the prices that households pay for goods and services. There is a Harmonised Index of Consumer Prices (HICP) for the euro area. Every month, the national statistical offices in the euro area use 'harmonised' methods to record consumer prices for a range of goods and services – known as the 'basket'. Over one million monthly price observations are collected, for a basket including more than 100 items, each with a weighting that reflects its contribution to monthly household expenditure; examples are given in the table. Eurostat, the Statistical Office of the European Communities, uses the data from national statistical offices to compile the HICP for the whole euro area. Consumer price indices have many uses – for example, to adjust the level of pensions, social protection benefits and housing rents (known as indexation). The HICP plays an important role in guiding monetary policy, as it is the main measure used by the European Central Bank to assess price stability in the euro area.

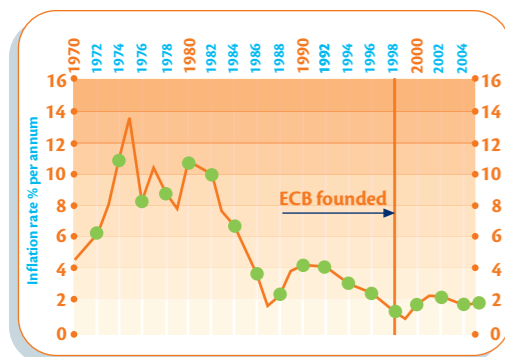
| Main groups in the HICP | which include | weighting % |
|----------------------------------|--|--------------------|
| Food and non-alcoholic beverages | Bread and cereals, vegetables, etc. | 15.4 |
| Alcohol and tobacco | Wine, beer, etc. | 4.1 |
| Clothing and footwear | Clothing accessories, shoe repair, etc. | 7.4 |
| Housing | Housing rent, electricity, etc. | 15.0 |
| Household equipment | Carpets, household appliances, etc. | 7.7 |
| Health | Medicines, dental services, etc. | 4.1 |
| Transport | Car parts, train tickets, etc. | 15.3 |
| Communications | Telephone bills, etc. | 2.8 |
| Recreation and culture | Musical instrument repair, garden plants, etc. | 9.5 |
| Education | Books, etc. | 1.0 |
| Hotels and restaurants | Restaurants and cafés, etc. | 9.5 |
| Miscellaneous | Hairdressers, house insurance, social protection, etc. | 8.2 |
| | | Total 100,0 |

The European Central Bank | targeting inflation

The ECB guides monetary policy in the euro area and acts independently to maintain price stability. Using the monthly HICP to monitor price inflation, the ECB and the national banks control the base interest rates in the euro area, which determine the cost of borrowing and thus has a strong but delayed influence on prices and inflation.

The ECB targets an annual price inflation rate, as measured by the HICP, of close to, but below 2%. This is the optimum rate to allow the euro area economy to reap the full benefits of stability. The success of economic and monetary union and the ECB in controlling price inflation is seen in the stable inflation rate since the ECB started operations in January 1999, around 2%, much less than in the preceding decades (see graph 2).

The euro also brings other, more direct benefits to citizens. A single currency allows price comparisons across the euro area, which increases competition and keeps prices down. Travel is also much easier and cheaper, as the costs of exchanging currencies have disappeared.



Source: adapted from Eurostat/ECB data

Graph 2
Inflation in the euro area since the 1970s
After the high inflation of the 1970s, preparation for EMU helped inflation to fall over the next decades, reaching the optimum level of around 2% per year.



Further info at:

European Commission Directorate-General for Economic and Financial Affairs

http://europa.eu.int/comm/economy_finance/index_en.htm

Eurostat – The Statistical Office of the European Communities

<http://europa.eu.int/comm/eurostat/>

The European Central Bank

<http://www.ecb.int/>

The European Commission

http://europa.eu.int/comm/index_en.htm/

The euro

<http://europa.eu.int/euro>



Did the euro
cause prices
to rise?
Perceptions
and reality



one currency  many opportunities

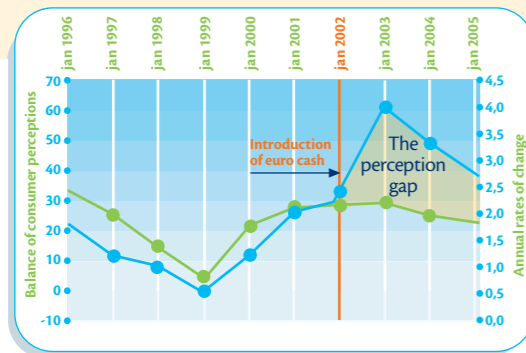
Low inflation that brings price stability is important to us because it encourages the long-term investment that leads to economic growth. It also enhances social cohesion by preventing growing disparities in wealth. For these reasons, the EU Treaty sets maintaining stable prices as a key objective of economic and monetary union (EMU). Therefore, to keep prices stable, the European Central Bank targets an inflation rate close to, but below 2% as the optimum for the euro area (see paragraph **The European Central Bank | Targeting inflation** on the last page).



Monitoring the HICP basket before and after the introduction of euro banknotes and coins shows that a few items displayed unusual price increases. For example, some restaurants, cafés and hairdressing salons showed significant price rises, as did car and house repair, and sports and recreation. These price rises were concentrated in local, neighbourhood services that have little competition. They can be attributed to the euro as it seems that some small retailers took the opportunity to raise their prices at the same time that euro banknotes and coins were introduced. In contrast, many other prices remained steady or, in the case of a lot of manufactured products like computers, photographic and stereo equipment, continued to fall, partly because the technology became cheaper.



These unusual price increases affected a number of small items we buy frequently. Everyday, small, cash purchases determine our perceptions of price inflation more than less frequent purchases, such as a new computer, insurance or rental costs. However, their influence on the cost of living is less – they only form a small part of the HICP basket. But our perception of price rises during the euro changeover corresponds more closely to the price inflation of these more frequently bought items than to that of the whole basket. This shows that while people have good reasons for the impression of widespread price increases during the switch to the euro, in reality these were limited and had only a small effect on the total cost of living.



Source: Commission Services

Graph 1
The perception gap

—●— Our perception of inflation
—●— Actual inflation

Is life more expensive in euro? five frequently asked questions

1 So, did prices rise when we started paying in euro?



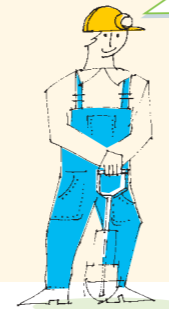
Yes, some did, but prices rise most years due to current inflation not linked to the money changeover. Average price inflation in 2002, the year euro banknotes were introduced, was 2.3%, the same as the year before. This means a broad basket of goods that cost €100 in a supermarket in 2001 would cost, on average, €102.3 in 2002.

2 Did the switch to the euro contribute to the higher prices we pay today?



Yes – but only by a small amount. In fact, the average consumer price increase due to the euro changeover was estimated to be only 0.1 to 0.3 % out of the 2.3 % normal inflation for the year. So if the average price rise was 2.3 euros for a €100 basket we buy in the supermarket, then no more than thirty euro cents of this increase was due to the euro. The remainder was due to other factors.

3 These are averages! What happened to the real prices that we all pay?



A few individual prices rose by quite a lot – but most did not and others fell. The price changes we can attribute to the euro changeover vary according to the sector, for example food prices and taxes did not rise because of the euro. But the costs of car repairs, a haircut and some other services did. These price rises were concentrated in smaller, local shops and services that could take advantage of the new euro to raise their prices, despite the calls not to do so. The important point is that the introduction of euro cash **added little to inflation and the cost of living** for most citizens in the euro area.

4 So why does everyone seem to believe that the euro brought higher prices?



These everyday purchases influence our perceptions more than less frequent, but often much larger purchases, which showed few or no price increases. It is paying for small items, with the money in our pockets, which forms our impressions about inflation.

5 What steps were taken to prevent unjustified price rises and what can be done in the future?



In preparing for the cash changeover, the European Commission and national authorities took **measures to ensure exact price conversion**, working with central banks, consumer organisations and the retail industry to prevent abusive price rises. For example, the one and two euro cent coins were distributed widely to retailers to discourage the abusive rounding up of prices. These measures were very effective and unjustified price rises were limited to local shops and services not covered by nationwide or industry-wide agreements and with little local competition. As other Member States adopt the euro, particular attention will be given to these problematic sectors to avoid abusive price rises.



Did the euro cause prices to rise? Perceptions and reality



The European Commission regularly monitors consumer prices for the same range of household items – known as ‘the basket’. Eurostat, the Statistical Office of the European Communities, compiles an averaged index of consumer price for the euro area, the ‘HICP’ (see paragraph **Monitoring consumer prices | the HICP** on the last page). Changes in the HICP show changes in consumer price inflation. In 2002, the year we started using euro banknotes and coins, consumer price inflation was 2.3%, as measured by the HICP basket. But most of this rise was due to higher imported oil prices, higher taxes on tobacco, and the effect of bad weather and animal health scares on some food prices. Of the 2.3% price rises in 2002, only 0.1 to 0.3% was due to the euro changeover.



As well as actual prices, the Commission also monitors our perceptions of price inflation. Each month, 20 000 EU consumers are asked for their impressions on how prices for everyday goods have risen or fallen. Comparing this ‘harmonised consumer survey’ to real price inflation, as shown in graph 1, shows that for many years, consumer perceptions of inflation followed actual price inflation quite closely. However, when we started using euro cash, a ‘perception gap’ between actual and perceived price changes appeared, with consumers systematically overestimating actual inflation.



Other measures include: displaying shop prices in both the national currency and euro before and after the changeover, to let consumers make price comparisons; agreements with industry on consumer-friendly pricing practices; and running extensive information campaigns for the general public. These measures were effective, but it was mainly large distributors and supermarket chains who responded well. It proved more difficult to reach local shops and services.