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.

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.

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.

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
Low inflation is good because it encourages people to spend rather than save. However, the long-term benefits of low inflation are significant, as well as the positive effects on the economy. Inflation is defined as the increase in the general price level of goods and services over time. It is usually measured as the annual change in the consumer price index (CPI).

### Monitoring the CPI basket

The CPI basket is a measure of the cost of living. It is used to calculate inflation and is calculated by comparing the prices of a fixed basket of goods and services over time. The CPI basket includes a wide range of goods and services, including food, clothing, housing, and transportation. The CPI basket is used to measure the cost of living for different income groups and to compare the cost of living between different countries.

### Is life more expensive in euro?

The Commission monitors the price level of the euro area. The information is available on the last page. For more details, please refer to the Commission's economic and financial report (EFSR).

### Monitoring the HICP basket

The HICP basket is a measure of the cost of living for a household. It is used to calculate inflation and is calculated by comparing the prices of a fixed basket of goods and services over time. The HICP basket includes a wide range of goods and services, including food, clothing, housing, and transportation. The HICP basket is used to measure the cost of living for different income groups and to compare the cost of living between different countries.

### Is life more expensive in euro?

Yes, some did, but prices rose 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 that a household with a budget of 100 euro in a supermarket in 2001 would need 103 euro in 2002.

### Did the switch to the euro cause prices to rise?

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 2002. The euro changeover was therefore not the cause of the price increase in the supermarket, but it was a factor in the increase in the cost of living. The remainder was due to other factors.

### Why did prices rise?

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 perceptions of price rises due to the euro changeover correspond more closely to the price inflation of these more frequently bought items than that of the whole basket. This shows that people have good reasons for the impression of widespread price increases during the switch to the euro.

### How much did prices rise?

The price rises were concentrated in smaller, local shops and services that could take advantage of the new opportunity to raise their prices at the same time that euro banknotes and coins were introduced. In contrast, many other prices remained steady or even fell because the technology became cheaper.

### Is life more expensive in euro?

Yes, we did see some price rises when we switched to the euro. But these were limited and had only a small effect on the total cost of living.

### As well as actual prices, the Commission also monitors our perceptions of price inflation.

People’s perceptions of price inflation are important because they determine how much they are prepared to pay. The European Commission regularly monitors consumer prices for a range of household items – known as the basket. Eurostat, the Statistical Office of the European Communities, compiles an average index of consumer prices for the euro area, the HICP (see paragraph Monitoring the HICP basket). 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 the rise was due to higher import prices, higher taxes on tobacco, and the effect of bad weather and animal health scares on some food prices. Of the 2.3% price rise in 2002, only 0.1 to 0.3% was due to the euro changeover.

### Why did prices rise?

A few individual prices rose by quite a lot, but most did not and others fell. The price change we can attribute to the euro changeover vary according to the sector: for example food price increases and taxes did not rise because of the euro. But the costs of car repairs, haircuts 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.

### 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 hairdressers charged more than they had previously. But this was mainly because large distributors and supermarket chains responded well to the changeover. It proved more difficult to reach local shops and services.

### Conclusion

In conclusion, the euro changeover did not cause prices to rise. The average consumer price increase due to the euro changeover was 0.1% to 0.3% out of the 2.3% normal inflation for 2002. The euro changeover was therefore not the cause of the price increase in the supermarket, but it was a factor in the increase in the cost of living. The remainder was due to other factors.