

SEMINAR

Inflation Measures: Too High - Too Low - Internationally Comparable? Paris, 21-22 June 2005

11. Dispute around inflation since Euro changeover in France

Dominique Guédès (INSEE)

Dispute around inflation since Euro changeover in France

Dominique Guédès, INSEE

What happened in 2002?

On the first of January 2002, the Euro became a reality for all consumers of the Euro zone countries. This event, end of a long and complex process, had consequences in a lot of domains, a lot of them foreseen, and some more unexpected ones. The domain of consumer price statistics was obviously concerned by this major change. As many other activities, collection of prices and production of the indices had to be adapted. But the true challenge for the statisticians of the prices and the economists was to determine the influence of the passage from a currency to another on the inflation. More than three years after, the question does not seem closed, for if the statisticians and the economists do agree to say that Euro changeover impact on the inflation was small, the public opinion, the media, the federations of consumers and certain politicians are strongly convinced of the opposite. The goal of this paper is to analyze that perception divergence of the same event and to try to determine the role that the price statistician must have in this debate.

Institutional preparation: INSEE, Banque de France, DGCCRF.

In France, the official follow-up on the evolution of the prices at the time of the Euro changeover implied three organisms: the Banque de France (national central bank), INSEE (statistical office) and the “direction générale de la consommation, de la concurrence et de la répression des fraudes” (DGCCRF, control office belonging to the Ministry of the economy and finances).

The DGCCRF has centered its action on the detection of eventual abuses notably in the application of conversion rules or of prices posting. Its action was also macroeconomic, aiming to detect eventual issues in sensitive sectors. For that, it carried out many price checks in the field (about 21.000 collected prices every three weeks from June 2001). In collaboration with INSEE, a sub-basket of the CPI (called witness basket) was constituted and centered on the sectors judged the most risky at the time of transition (products of small value, with round or psychological prices, products sold by automatic coin machines ...). The conclusions of this follow-up were very reassuring. Of course, abuses took place, certain sectors being more particularly concerned, but globally the conversion rules were respected.

The Banque de France and the INSEE also set up some tools aiming to measure the impact of the currency change on the inflation.

The Banque de France, of course strongly implied in the Euro changeover, studied different aspects of that event. It especially took investigations with the businesses (industries, services and trades) on the costs of the Euro changeover and the eventual consequences on prices. Studies also exploited the elementary data of the CPI, looking at the evolution of the rotation rate of the prices and amplitude of the price changes. The results were also very clear there: « the impact of the Euro changeover appears very limited [...] a little less than 0,20 points ».

INSEE followed two specific axes: on the one hand the study of the processes of rounding at the time of the price conversions between franc and euro and the convergence towards the psychological prices in the new currency, on the other hand the macroeconomic analysis of the inflation aiming to isolate the Euro changeover effects among others explanations. Those studies, begun in 2001, were followed for the whole year 2002. The results were regularly published: in February 2002 with the publication of the index of the January, and with the “Note de conjoncture” of June and December 2002. The results of all those studies gave the same conclusions, coherent with the DGCCRF’s and the Banque de France’s one.

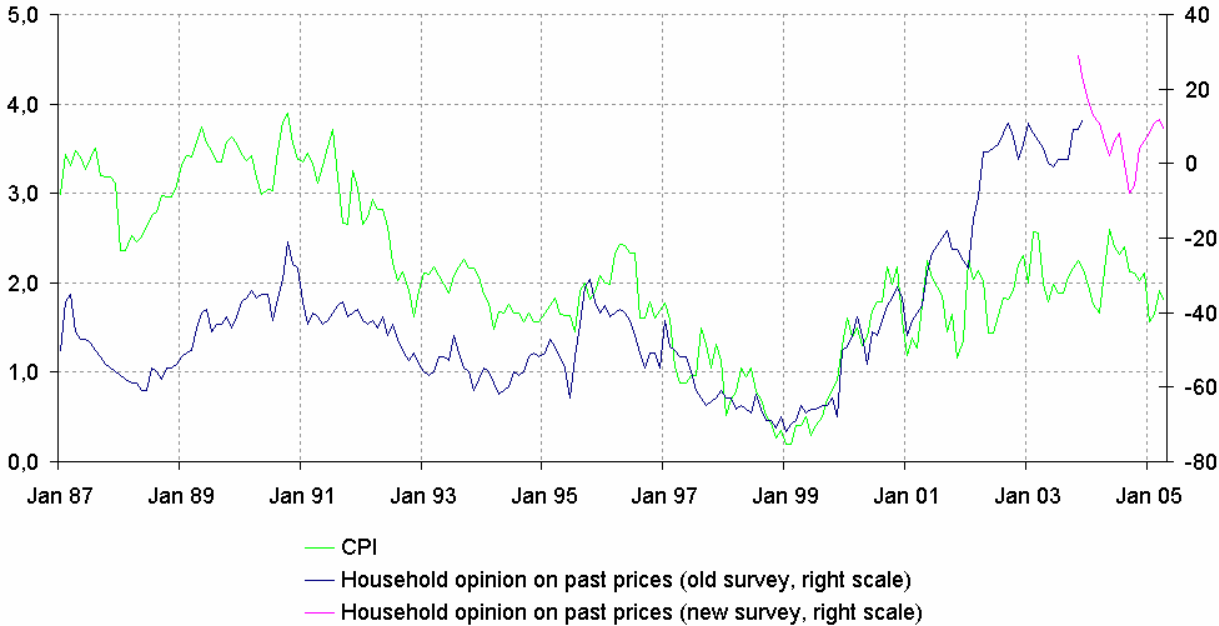
Inflation perception.

Despite this unanimous speech of the institutions, the public opinion very quickly evolved in an unfavorable manner. Two signs illustrate this evolution: appearance of the inflation theme in the press and the situation in households’ opinion surveys.

The possible drift of the prices at the period of the Euro changeover was evoked as early as 2001. The press echoed this worry. But it was in the first months of 2002 that the theme really came in the foreground.

The households’ opinion surveys showed a very strong climb of the inflation perceived by the households in the beginning of 2002, even though the CPI showed a stable inflation.

Graph 1: Perceived inflation and CPI



In fact, the increase of household perceived inflation began as early as 1999. Nevertheless, this perception corresponds to a real increase of annual growth rate of the CPI at that period after a low point at the end of 1998. Up to 2001, the two curves are comparable. The rise of the perceived inflation in mid 2001 is partially erased by the end of the year. But in the first months of 2002 a break occur, with a perceived inflation that flies away without compensation in CPI. From April 2002 the two series stabilize themselves, perpetuating an unprecedented divergence.

Indeed, another question of the household opinions surveys showed that that split between perceived inflation and CPI was predictable because households had anticipated price increases with the Euro changeover.

Do you think that Euro set up will have an effect on prices levels?

	June 99	dec 99	june 00	dec 00	june 01	Sept 01
No, that will have no effect on prices	44	47	43	38	28	16
You think that prices will increase.....	38	40	40	47	60	78
You think that prices will decrease.....	5	3	2	1	2	0
Don't know	13	10	15	14	10	6
Total	100	100	100	100	100	100

The opinion of the households on the inflation they felt at the moment of the Euro changeover seems therefore to be some perception partially constructed before the arrival of the fiduciary Euro.

Why people disbelieved official CPI?

Econometric model of perceived inflation.

The perception of the inflation by the households never totally corresponds with what the CPI measures. For psychological reasons, the perception of the households of their own consumption is distorted. It is known that certain sectors, for which the purchases are frequent, are over-weighted, and that, conversely, the weight of the durable goods is generally under estimated. To attempt to understand the formation mechanisms of the opinion, models of regression were elaborated.

At the autumn of 2001 the selected model was:

EQUATION

$$\text{OPP} = 4,05 \times \text{AHPF} + 2,90 \times \text{O_MANUF} + 0,71 \times \text{ENERGY} + 0,58 \times \text{O_SERV} - 63,19$$

(7,75) (3,53) (5,64) (1,97) (-52,76)

Estimation period: jan. 87 - sept 2001

OPP : opinion about past prices

AHPF : food (without fresh products)

O_MANUF: others manufactured goods

ENERGY : energy

O_SERV : "other services" (services other than rents, water, garbage collection, health, transport and communication); in particular, maintenance of housing, repair of the cars, hotels, coffees, restaurants, insurances...

AHPF, O_MANUF, ENERGIE et O_SERV are measured with annual rate of change.
Student statistic is under each coefficient.

This model, published in the “Note de conjoncture” of December 2002, showed that “the opinion balance studied appears more specifically linked to four groups of the price index: food (without fresh products), other manufactured products, energy and other services”.

A year after, the same modeling type was attempted. Nevertheless, the results were disappointing. Even while modifying the choice of the product indices and while introducing a self-regressive factor, the explanatory strength of the models failed on the end of the period, the year 2002. Finally models kept, published in June 2003 in “L’économie française, édition 2003-2004” is:

EQUATION

$$\begin{aligned}
 \text{OPP} = & 0,90 \times \text{OPP}(1) + 0,54 \times \text{AHPF} + 0,09 \times \text{ENERGY} + 1,01 \times \text{O_SERV} + 7,28 \times \text{IND} - 4,26 \\
 & (31,74) \qquad (2,88) \qquad (1,96) \qquad (2,77) \qquad (4,24) \qquad (-3,44)
 \end{aligned}$$

Estimation period: jan. 88 - dec 02

OPP : opinion about past prices

AHPF : food (without fresh products)

ENERGY : energy

O_SERV : "other services"

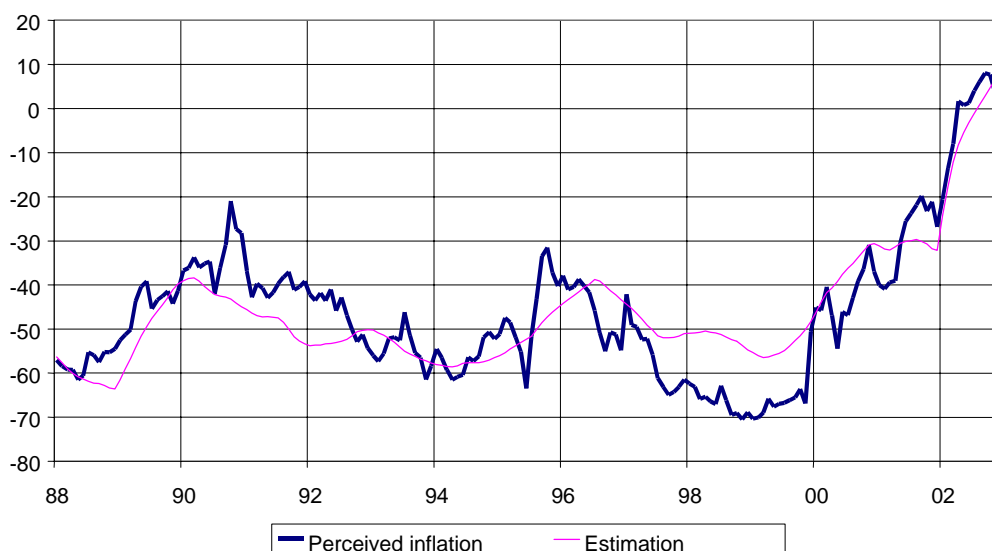
IND : indicatrice de valeur nulle avant 2002 et égale à un en 2002

AHPF, ENERGIE et O_SERV are measured with annual rate of change.

OPP(1) : opinion about past prices one month before

Student statistic is under each coefficient.

Graph 2: estimate of perceived inflation



The appearance in the model of an indicator value of year 2002, showing a significant “Euro effect” in the perception of the households, cannot be explained by a simple distorted vision of the consumer structure.

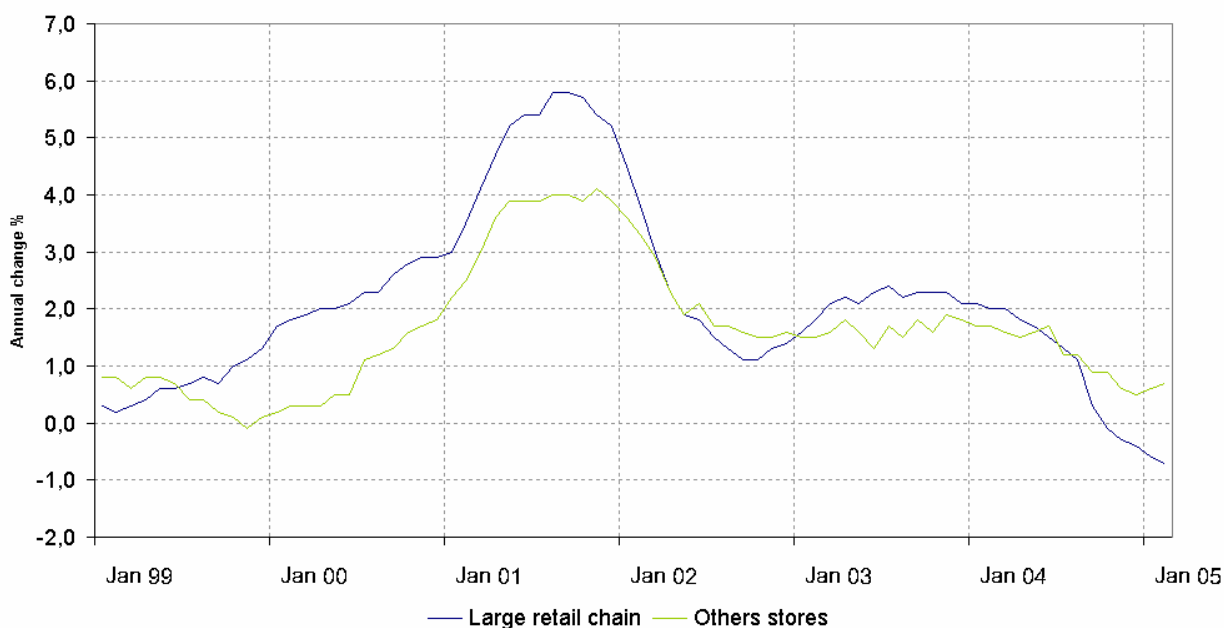
Prices in large retail chains and euro changeover.

Among the factors pointed at by many analysts, the large retail chains often looked like an accused in this file. With a major market share in food and other daily consumer goods, the large retail chains play, without any doubt, an important role in the daily life of the French consumers. If the accusations of drifting of prices in this distribution channel are true, the effects on the inflation perceived could be important.

It is therefore interesting to try to understand what actually append. So much more than the principal chains of large retail stores participated in a “freezed prices” operation between November 2001 and the March 2002 aiming to avoid any excess at the time of the passage to the fiduciary Euro.

A toll allowing that analysis was set up in France last year. This toll is a set of sub-indices of the CPI on a reduced field of often purchased products: food, cleaning products for house and personal care products. These indices have been computed from the elementary data of the CPI since 1998, last base year in France CPI. The results, presented on the graph 3, shows a strong inflationary rise, but before the Euro changeover, with a maximum in 2001 near + 6% in annual shift in August and September. The “freezed prices” period that begins just after is respected: the index has the same value in October 2001 and in April 2002. The annual shift returns thus to + 2% as early as the month of May 2002.

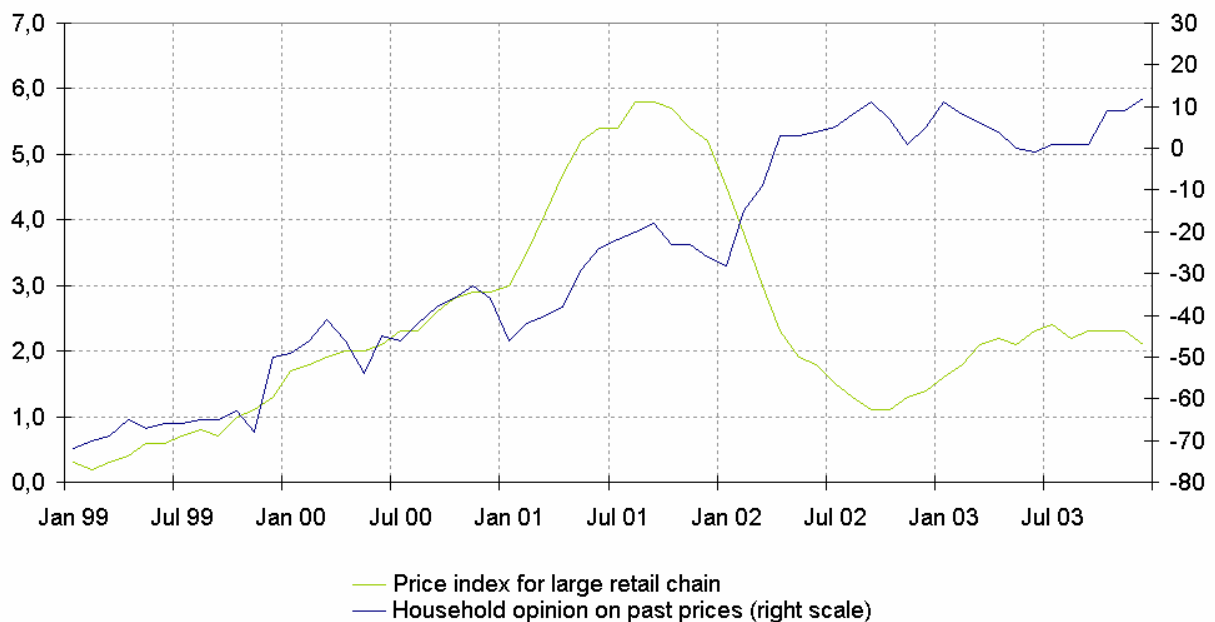
Graph 3: large retail chain index (often purchased goods)



The inflationary episode thus made obvious does not appear in the overall index, of which the annual shift remains around + 2% on all the year 2001. It affects nevertheless directly the consumer in his daily life and has to step in his perception of the evolution of the prices.

But the parallel between perceived inflation and index in the large retail chains is not straightforward: if the two curves show an important climb, these climbs are shifted in time. As if households had been aware at the moment of the Euro changeover of the accumulated inflation that previously happened.

Graph 4: Inflation in large retail chains and perceived inflation



New actors in the dispute: consumers associations and mass media

Not only the official organisms followed up the Euro changeover. Consumers associations were also very attentive at the time of this very delicate event for many consumers. The federal union of the consumers (UFC), the most important French organization, conducted an active campaign with the set up of a « reference basket » of which the prices has been followed from November 2000. The publication in August 2002 of the first results after the passage to the fiduciary Euro and the end “frozen prices” period in the large retail chains, received a very wide cover by media and, in a way, was the trigger of a public debate of which is not yet ended.

The UFC is a powerful organization perfectly trained in communication. The timing of publication was perfect: end of August, after holidays for most of consumers (period with habitual price excess), but before the new political and social season to benefit from a maximum media cover. The speech was simple and effective: « the prices increase again... we pointed out the most bad students » with spectacular and nominative examples.

Arriving in a context of a very strong inflation feeling and of an official speech reassuring, this campaign met a very favorable echo in the public opinion and in the non-

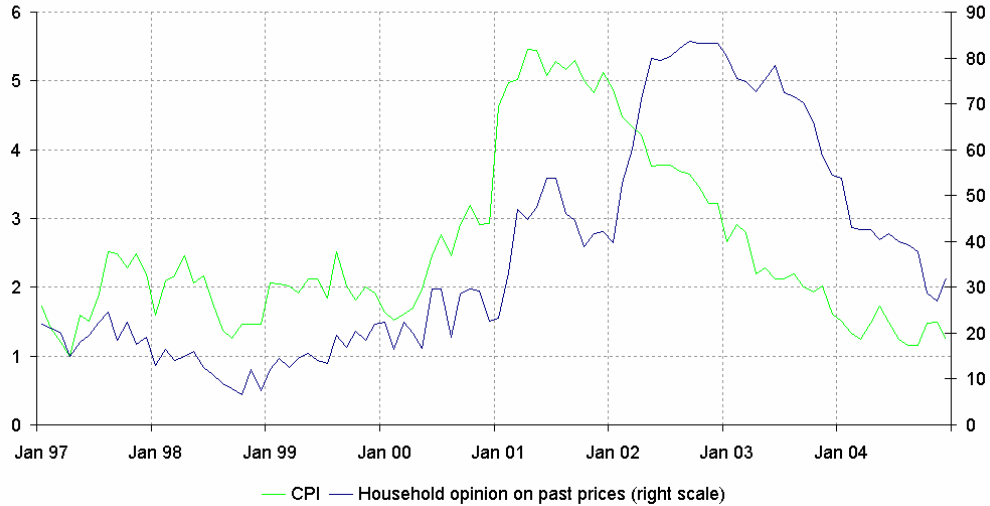
specialized press. Besides, the UFC did not try to attack the CPI by a methodological or technical critic, but rather attempted to present “real” and simple indicator, more in phase with the real-life of the consumers, against a “technocratic” official statistic.

The UFC published again an article in the end of 2002, also at a favorable moment for a maximum cover by media: hollow period for the politics but where the consumption and the prices are traditionally evoked. Again, this new publication was abundantly taken up in the written and broadcasting press.

Those publications fuelled debate in France and lined up with the persistence of an important gap between the perceived and measured inflation. A year after the Euro changeover, the new currency remains accused of provoking a return of the inflation.

The position in of other countries of Euro zone was quite similar to the one met in France in 2001 and 2002, with an important rise in the inflation felt by the households.

Graph 5-1: Perceived inflation and CPI : Netherlands



Graph 5-2: Perceived inflation and CPI : France



Nevertheless, different evolutions occurred. In fact, felt inflation strongly decreased in certain countries as Germany or the Netherlands (graph 5-1) from the beginning of the year 2003.

The perceived inflation being measured by a question concerning the 12 past months, that is coherent with a shock on the prices linked to the Euro changeover at the beginning 2002. In France, the perception of a high increase of the prices does not modify itself with the remoteness in time of the fiduciary Euro big-bang (graph 5-2).

Dispute in France began to evolve step by step. If the Euro changeover was at the origin of the debate and remains a central subject, other arguments appear from the second half of 2003. Also there, the actors are not usual actors, but newcomers, sometimes unexpected.

For example:

- In October 2003, the magazine LSA¹ published a study of International Panel on “the masked inflation”. From scanner data of large retail store, the study showed that an important part of the price increases intervenes at the time of model changes. CPI, with the systematic application of quality adjustments, is accused to mask this inflation source of which the study estimates the impact on inflation to 1,2%.

- In January 2004, the leader of a large retail chain, Edouard Leclerc, launches a big campaign denouncing the purchasing power decrease with a shocking slogan: « Those that say that the purchasing power increases must live on another planet ».



This last case is emblematic. In fact, the study at the basis of this campaign, made by the private office BIPE (Bureau d'Informations et de Prévisions Economiques = Office of economic information and forecast), concerned the measure of the purchasing power and of its evolution. But, paradoxically, even if the technical divergences between INSEE and the BIPE were not on the measure of the prices evolutions, but on the measure of the standards of living, the media took up to present that new campaign as a new attack on the CPI.

¹ LSA is a professional magazine for retail trade and distribution

In fact, this kind of campaign , that may appear esoteric for a non-French public, has its origin in the specific aspect of the commercial organization in France. Some of the laws framing the large retail chains are strongly protested, notably by Mr. Leclerc who uses the public debate around inflation (and purchasing power) as an instrument in his own fight.

New type of communication

Global communication and specific action

INSEE has for general policy not to directly participate in debates but rather to develop a communication centered on its own productions without commenting on the competing sources or studies. In the case of the Euro changeover, INSEE, in complement of the normal monthly publication of the CPI, published specific studies. When the debate amplified itself, notably after the UFC's publications, INSEE put forward its own works in order to support the weakness of impact Euro on the inflation but did not directly discussed or criticized the validity of the investigation of the consumer association.

Nevertheless, the INSEE had to adapt its communication because it faced at the same time on the one hand a dispute periodically fuelled again and again by criticisms on CPI and on the other hand a persistent divergence between the perception of the inflation by the households and the measure of that inflation by the index.

This adaptation went through a better reactivity, aiming, without entering into a direct controversy, to reply to each criticism leveled at us by specific studies or by setting up new statistical tools.

Some examples.

Quality effect

The study published by the magazine LSA, entitled « the masked inflation », asked the question of the treatment of the changes of the products and impact of the quality adjustments done by the statisticians in the production of CPI. The study in question announced average increases of + 8,8% of price at the time of the replacement of an old product by a new product. This phenomenon, allegedly under estimated by the CPI, have, according to the computation of the study, an impact of + 1,2% on the global inflation.

INSEE, using under way works on the implicit quality indices (IQI) initiated with Eurostat and others European CPI offices, published a study showing that all quality adjustments made had only an impact downwards of about 0,3% on the annual shift of the index in 2003. This study was announced as early as the original publication of the study in LSA in October 2003 and widely broadcast at the time of his publication in April 2004². Later, the continuations of the study of International Panel on the same theme were published in the same magazine. This publication nevertheless had less cover in the press.

² This study is available in french at :
http://www.insee.fr/fr/nom_def_met/methodes/doc_travail/docs_doc_travail/F0404.pdf

Indices by household categories

A recurrent argument against the CPI is that it is not representative of certain categories of households, notably the modest or even poor households. In fact, the products often put forward as examples of decreasing (or very slowly increasing) prices are durable goods such as microcomputers, hi-fi, photographic equipment... viewed as non-essential or luxury goods, and of which decreasing prices will not benefit to the more modest households. This critic was notably relayed by the trade-union representatives in the CNIS (Conseil national de l'information statistique), discussion instance on the political orientations regarding public statistics.

INSEE made a study with data from the last household budget survey in order to estimate impact of the differences of consuming patterns for different type of households in terms of inflation. This study, decided and announced at the time of a meeting of the CNIS in the spring 2004, was presented as early as September of the same year and published in October in "France portrait social". The study shows that criteria of age, socio-professional category or composition of the household are not differentiating. Income by consumer-unit is the only dimension that shows a light divergence between the first decile and the last decile: the households with the smaller income undergo a superior inflation to the average of about 0,13% per year while the wealthiest households see an inflation inferior to the average by 0,08% per year (a gap of 0,21% between the two extreme deciles). Nevertheless the study showed also that this difference is largely attributable to the tobacco that has known very important price increases on the recent period. Out of tobacco, the difference in the two deciles is not more than 0,03% (by the way in France the law imposes the usage of the indices out of tobacco for the indexations). The study therefore globally shows that the overall index is well representative, not only of the whole population, but also of principal sub-populations.

Index of the prices in the large retail chains

The media campaign of Edouard Leclerc, evoked previously, supplied the debate on the role of the large retail chains on the evolution of the prices. In reaction to this debate, the Minister of Economy obtained from professionals of distribution and from producers an agreement on prices decrease for the often-purchased products. This agreement, signed in June 2004, foresaw an average decrease of 2% for prices of products of major brands between the signature and the end of September 2004. The item 11 of the agreement foresaw also the creation of a new index of the prices specifically carrying on the often-purchased products in the large retail chains. This new index was constructed by INSEE while exploiting the data of the CPI and publishes monthly from November 2004. That is presented in the graph 3.

Conclusion

The Euro changeover had a strong impact on the consumer's daily life. It deeply influenced their perception of the state of the economy. The perception of the inflation by the households has known a break at the beginning of 2002; break far away from what the CPI or the official studies recorded. Nevertheless, to the difference of other countries as Germany or the Netherlands, this ditch between perception and measures about the inflation persists in France more than three years after the arrival of the new currency. The initial event appears as a trigger of a debate that was since uniformly fuelled. Particularly active actors as the consumers association heavily weighed and continue to weigh on the opinion.

INSEE have adapted his communication, but remains attacked. The initial discourse on the impact of the Euro changeover, doubtless too complex in the technical explanation of the measure methods and too simplistic in the result (slight impact), did not be very effective. This battle is lost and in the opinion of the French (and others Europeans) the Euro changeover will remain as an inflation cause. Nevertheless debates evolved and we had to react to others attacks less predictable. That enriched us. The studies that we undertook reinforced our methods and completed our measure tolls with new indices. Nevertheless, if we were able to reply to the critics on the CPI and if the last months seem quieter, the perception by the households of the inflation remains high and the distrust to the official index remains strong. We must follow our explanation work and remain reactive in the public debate.