

## PRICE STABILITY

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### ABSTRACT

We can talk about price stability when not seen as inflation or deflation phenomena. Thus the European Central Bank defines price stability as an increase of up to 2% per annum of the harmonized index of consumer prices. The lowest inflation rates were recorded in countries such as Greece and Sweden, and the highest in Hungary, followed by Romania, according to recent data provided in November 2012 by the European Central Bank. Overall, most countries faced with low and relatively stable levels of inflation, explained that although individual prices of products in some sectors have seen a substantial increase in overall they were compensate of price reductions in other sectors and finally reached a relatively stable general price level.

**Keywords:** *stability of prices, HICP, deflation, inflation.*

### 1. INTRODUCTION

As defined by the Central European Bank stability of prices represents an increase of 2% per annum of the harmonized index of consumer prices (HICP) of the medium term.

Therefore we can talk about price stability in the absence of deflation or inflation. These two notions are economic phenomena that negatively affect the economy of any state, characterized by decreased, respectively generalized increase in prices in the long term, affecting the purchasing power of money.

Given the major influence of inflation on price stability, its modification is an essential element. Is there when inflation is rising prices, especially taking into account the dynamics of prices in a market economy.

Inflation for the euro area is determined by "the Harmonized Index of Consumer Prices" (HICP) representing an indicator by which to determine changes in consumer prices over time. Through it can be compared data from different countries, this is suggested by the name "harmonized" indicating that all Member States apply the same methodology.

The introduction of this indicator was essential considering that in the past, before the euro became the common currency; inflation was determined by each country using methods and techniques, this frequently

causing variation of some major overlaps, thus limiting comparisons between countries.

### 2. ANALYZING THE INFLATION IN THE EUROPEAN UNION AND ROMANIA

Determination HICP is critical to maintaining price stability, increase economic welfare, global economic growth and creating new jobs. Thus it is necessary for compliance with a set of rules legally binding, and completion of certain steps by which to determine the variation of prices of consumer goods and services at both the country and the entire euro area:

- Collecting monthly prices of different goods and services by trained observers.
- Calculating the share of product groups according to their importance considering all consumers (rich and poor, young and old).
- Calculate the weight of each country in proportion to total consumption expenditure in the euro area.

In the 90's, the inflation rate reached values significantly lower values (due to two important elements: the European Central Bank monetary policy and preparing the country for the launch of euro) compared with the 70 - 80's when inflation reached very high values in many EU countries.

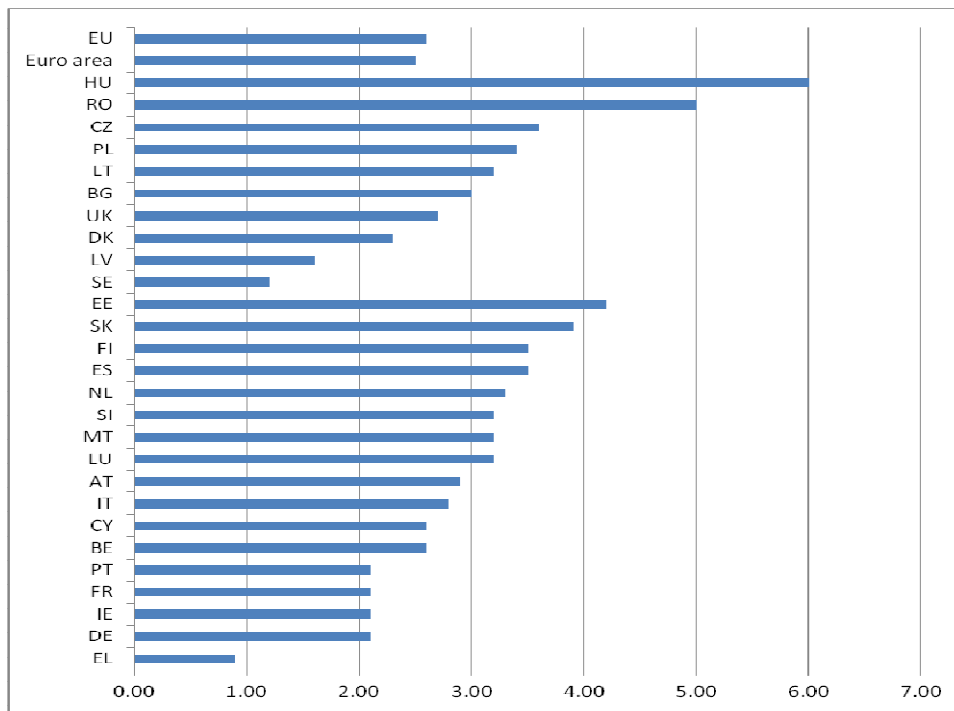


Figure 1 Inflation rates by countries

Sources: Eurostat

Based on calculations using the "Harmonized Index of Consumer Prices" (HICP) in October 2012, the lowest inflation rates were recorded in countries such as Greece (0.9%), Sweden (1.2%) and Latvia (1.6%). At the opposite pole are situated countries like Hungary (6.0%), Romania (5.0%) and Estonia (4.2%). Inflation has had a fluctuating trend in the European Union compared to September of the same year, so that it fell in 13 Member States at the same time increased in 10 and remained stable in 4 of them.

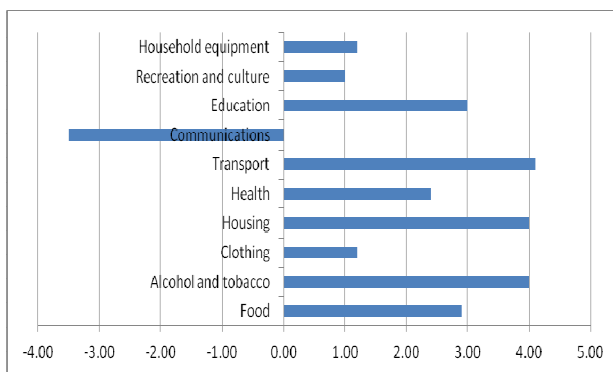


Figure 2 Inflation rates by countries

Sources: Eurostat

Items that have had a major contribution in increasing inflation in October 2012 were transport (Name Rank has a growth rate of 4.1%) and alcohol & tobacco (both an increase of 4%), unlike communications (rate 3.5%), recreation and culture (1.0% rate), clothes and household goods (each at a rate of 1.2%) who had the lowest growth rate.



Figure 3 Highlights the inflation rate based on "Harmonized Index of Consumer Prices" (HICP)

Sources: Eurostat

The figures shows the annual percentage change in the general level of prices of consumer goods and services, since 1996, considering the percentage change compared with the same month last year. The graph shows data in the euro area. Inflation peak was reached in July 2008 and bottomed out in July 2009.

Among factors influence price level we can mention:

- Changes in interest rates influencing short-term consumption, i.e. savings, and thus the supply of products and services on the market;
- The change in market liquidity affects changes in the general level of prices and not the unemployment and real income, the latter depending on the population, technology, fiscal and social policies etc.

As stated above the annual inflation rate in Romania has increased substantially above previously recorded value by about 3%, it managed to exceed the amount projected in the "Inflation Report" with a rate of about 2%. Increasing inflation rate was based on accelerated growth in prices, resulting from a plurality of supply-side shocks that affected a large part of the consumer basket components [6]. Most variable elements that contributed significantly to register a rate of 5% inflation in Romania were: fuel (oil on evolution), excise duties on tobacco products, food products (vegetables, fruits, eggs) and food products (due to bad weather conditions).

Objective of price stability refers to the general price level in the economy and implies avoiding both prolonged inflation and deflation. The benefits of price stability can include:

- Increase living standards, generated by increased pricing transparency mechanism (easy identification of changes "relative prices") taking right decisions on consumption and investment that we can make;

- Price stability makes people recognize changes in relative prices. This allows businesses and consumers to be better informed decisions on consumption and investment, enabling more efficient allocation of resources on the market, this leading directly to increase the productive potential of the economy;

- Lack of price stability involves a request from investors "inflation risk premium" to compensate for the risks associated with holding nominal assets long term. Price stability leads obviously to reduce these premiums, automatically leading to increased incentives to invest, which supports economic prosperity;

- Increase social welfare generated by reducing distortion effects of taxation and social security systems, and avoiding the unnecessary use of protection against risks that may arise due to inflation that will eventually stimulate investment that will lead to lower unemployment and consequently to economic prosperity;

- Improving economic efficiency and consequently the welfare population through efficient use of available inputs;

- Increasing the possession of wealth in the form of cash basically involves reducing transaction costs that would be needed from a lack of liquidity;

- Maintaining stability and social cohesion: price stability prevents arbitrary and significant redistribution of income and wealth, which is common in both inflationary and deflationary at the features. Therefore, an economic environment characterized by stable prices contribute to stability and social cohesion;

- Strengthening financial stability by not affecting the amount of wealth or income sources if the economy is not experiencing deflation or inflation phenomena;

In short, price stability is in sight to achieve three important elements considered at both economic and population level:

- Make monetary policy more transparent;
- Provide a clear evaluation criteria and measures against which Europeans can excoriate the European Central Bank;
- Provide useful information to the public regarding the formation of expectations about future price developments.

### 3. CONCLUSIONS

Overall, most industrialized countries have experienced in recent years, with low levels of inflation and stable realtor explained that although individual product prices in certain sectors (eg fuel, energy) saw a substantial increase this per compensate total were decreases in prices in other sectors (e.g. telephone, TV, etc.) and finally reached a relatively stable general price level.

By achieving price stability can achieve objectives such as:

- Maintaining a low unemployment by creating jobs;
- Maintaining a high standard of living of the population;
- Steady increase in economic activity, i.e. rapid economic growth.

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