

The Evolution of Prices of Goods and Services in Economic Crisis

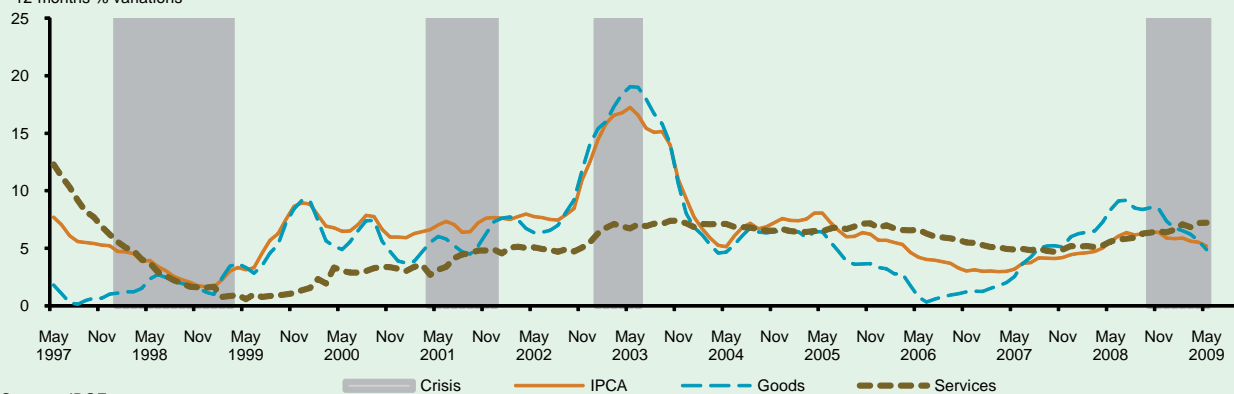
The analysis of changes in relative prices in periods of crisis makes it possible to assess the behavior of the relevant mechanisms of transmission, such as the impacts of the downturn in the economic activity, movements of exchange rate pass-through and the presence of inertial components of inflation. In general, prices of items of services, vis-à-vis those of other products, tend to respond with greater delay and lower intensity and volatility to marked temporary changes that are typical of periods of crisis. This aspect is partly explained by the greater influence of the rigidity of contracts and the lower mobility of factors in this segment.

According to the Economic Cycles Dating Committee (Codace), an entity linked to the Getulio Vargas Foundation (FGV), the current economic crisis was preceded by three other recessive cycles over the past thirteen years: in 1998, when the maintenance of the exchange rate prevailed and there was also the coping with the Russian crisis; in 2001, due to the supply shock caused by energy restriction; and in 2003 in response to the crisis of investors' confidence due to the uncertainty surrounding the presidential election. In all these periods, prices of services followed the behavior of prices of goods, but with less volatility, as illustrated in Figure 1. This behavior, however, has not been observed in the present moment, which shows the trajectory of relative detachment groups.¹ In this scenario, this box assesses the determinants of this change in pattern, drawing parallels between the current crisis and the other recession periods.

1/ The price breakdown in this box regards the items of the IPCA nonemarked price segment, weighting 23.80% in the case of services and 46.65% in the case of goods.

Figure 1 – IPCA – Goods and Services

12-months % variations

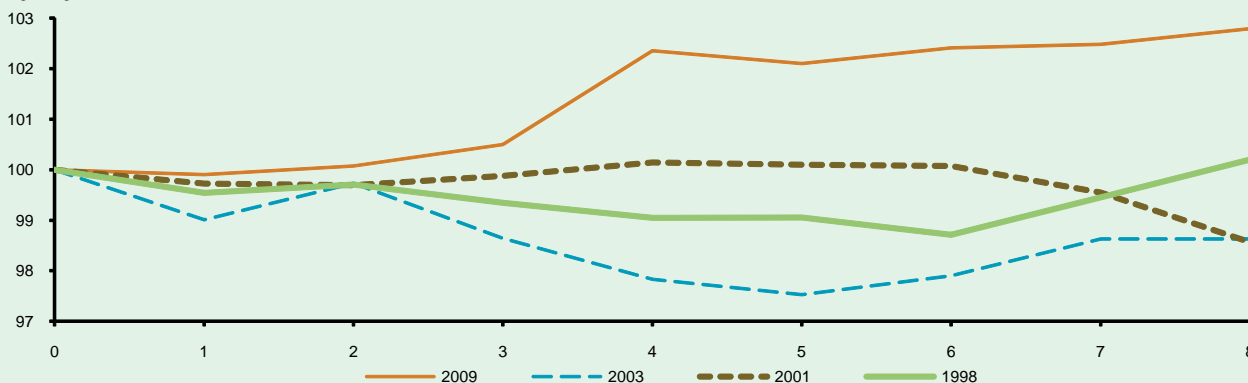


Source: IBGE

The separate behavior of relative prices in the current period is shown in Figure 2, which shows the evolution of the parity price of services and goods in the various crises. In the recent situation, parity evolves all the time above the base level (100) and, –reflecting the rise in prices of items in the service sector and the cooling of prices of other products –increases the level from the sixth month. This trajectory is markedly different from those observed in the crises of 2003 and 1998. In the first case, it was due to the sharp exchange depreciation in the period, and, in the second, due to the impact of the long periods of recession on prices. The evolution of parity in 2001 initially displays a behavior similar to the current crisis, reflecting, as expected, the lagged impact of lower activity on the deceleration of prices of services, which is six months in that specific case. In the seventh and eighth months, however, the behavior differs in the two crises, with the relative price of services slowing in 2001 and continuing to increase in the current crisis.

Figure 2 – Relative prices in economic crisis – Services/Goods

Beginning of the crisis = 100



Source: IBGE

The recent downturn in the prices of goods, in which case twelve-month cumulative variation decreased from 8.37%, in September 2008, to 4.89%, in May 2009, mainly reflected the impact of recession in major developed economies on international prices, which, in other recession periods, recorded a significant acceleration in response to processes of exchange depreciation observed on those occasions. According to the same basis of comparison, the prices of services have accelerated from 6.27% to 7.23%. This development is associated partially to the lagged adjustment of the segment to the variation in the economic activity, to the minimum wage real increase, and to the impact of high inflation during the period preceding the crisis – the 12-month change of the General Price Index – Market (IGP-M) reached 12.3 % in September 2008 – on the adjustments in various services, also highlighting the presence of indexation mechanisms.

The opening of the group of services, as shown in Table 1, favors the identification of the mechanisms underlying the behavior of prices in that segment. It is worth mentioning that only on the item personal service that responds more readily to the activity level a sharp deceleration in prices was recorded in the current crisis, as demonstrated by the reduction of their cumulative 12-month change, from 7.14% in September 2008, to 5.24% in May 2009. These

Table 1 – IPCA – goods, services and regulated – and IGP-M

Itemization	Weights May-2009	12-month variation							
		Period prior to the outset of the crisis				Eight months after the outset of the crisis			
		Crisis I Dec-1997	Crisis II Mar-2001	Crisis III Dec-2002	Crisis IV Sep-2008	Crisis I Aug-1998	Crisis II Nov-2001	Crisis III Aug-2003	Crisis IV May-2009
IPCA	100.0	5.2	6.4	12.5	6.3	2.6	7.6	15.1	5.2
Goods	46.6	1.0	4.7	14.1	8.4	2.2	6.2	16.7	4.9
Services	23.8	6.2	3.6	5.5	6.3	2.2	4.8	7.1	7.2
Repairs	1.3	-1.7	6.2	8.5	5.4	0.0	5.9	7.3	8.8
Domestic help	3.3	7.1	11.0	8.7	10.2	8.3	8.1	8.3	12.3
Personal	2.1	0.9	2.6	5.4	7.1	-0.1	1.7	6.6	5.2
Health	1.6	6.3	0.2	4.3	6.7	3.0	1.5	6.0	6.6
Education	6.1	12.1	5.5	7.9	4.9	7.0	6.4	10.0	5.7
Housing	4.8	8.8	-0.7	1.9	5.8	1.4	2.9	4.3	6.8
Transportation	2.2	6.0	3.8	5.6	6.5	1.1	4.5	8.6	8.5
Leisure	2.5	5.1	4.8	6.9	5.1	2.7	6.1	7.8	5.6
Regulated	29.6	18.3	12.7	15.3	3.0	4.4	12.8	18.4	4.1
IGP-M	100.0	7.7	9.6	25.3	12.3	4.0	10.8	22.9	3.6

Sources: IBGE and FGV

prices displayed a similar performance in other crises, except for the 2003 crisis when, in general, all price indicators showed acceleration.

The segments of domestic help and repairs and alterations, with joint participation of 19% in the group showed accelerations, respectively, from 3.38 p.p. and 2.10 p.p. on the same basis of comparison. This movement reflected, in particular, the impact of minimum wage increase and the maintenance of purchasing power due to the process of reducing inflation. The transmission channel of real income to the prices in the two segments mentioned had exerted a corresponding effect in previous crises.

In the case of the spending on education and housing, accounting for 46% in the service sector, prevails the effect of high inflation prevails in the period preceding the crisis, which serves as a reference for indexing contracts, particularly in residential rents and school fees, usually based on the IGP-M. The remaining segments, health services, leisure and transportation, which accounts for 26% of the service sector, are more dependent on movements in demand but they tend to react with some lag to changes in economic activity.

In broader terms, inflation in services presents relative rigidity and responds with a lag to the pace of activity and to the process of slowing inflation. Moreover, key segments such as education, have annual adjustments rules that are the transmission mechanism of inflation recorded in prior periods. In this scenario, the perspective is that the prices of services remain at a relatively high level in 2009, particularly when considering the 12-month variations. However, such prices outline a gradual cooling throughout this year and even more intensely in 2010. The explanation for the difference in the behavior of relative prices of services in this episode of contraction is probably due, on one hand, to the warming of the labor market in the period prior to the crisis and, on the other, to the effect of the global economic downturn on prices of tradable goods.