Inflation in EMU at the end of 2001 averaged about 2%, a percentage masking inflation rates as divergent as 1.5% in France to approximately 5% in the Netherlands. The weights of these countries, as measured by their contribution to the eurozone’s overall GDP, differ though. Just as is the case for the other member states with relatively high inflation rates, the weight assigned to the Netherlands is modest. Consequently, the effect of high inflation rates in countries like Ireland, Portugal, and the Netherlands on overall eurozone inflation cannot compare to that of the relatively low inflation rates in, e.g., Germany and France. Clearly, the ECB’s common monetary policy notwithstanding, the inflation differentials between the member states will as yet persist insofar as they have no monetary cause but arise from, notably, differences in economic structure and development as well as in market flexibility.

Figure 1 reflects the average inflation rates recorded in the period 1997–2001 for three EMU member state groups, arranged by size. Four details stand out. First, the inflation differentials between the various country groups are wide and systematic. Second, as of mid-1999 parallelism starts to increase, possibly as a result of the common monetary policy adopted in 1998. Third, the three largest countries – Germany, France, and Italy – invariably register lower inflation rates than the four medium-sized countries (Spain, the Netherlands, Belgium, and Austria) plus Ireland and those of the smallest category (Finland, Portugal, and Luxembourg, leaving aside the new member Greece for the moment). Fourth, average inflation in each of the country groups was invariably higher after the start of EMU than before. This likewise holds for the standard deviations, which for brevity have been omitted here. These simple observations raise the question whether the various statistical patterns have elements in common and, if so, by what economic grounds these are underlain. This brief article aims to answer this question as well as ascertaining the extent to which the inflation differentials may be attributed to monetary causes or to real convergence not having been realised as yet. It is certain, though, that inflationary and production gaps between countries influence their competitive position and, hence, their mutual flow of goods and
Explanatory note Figure 1: Inflation figures are harmonised and annualised averages.

Figure 1 – Average inflation rates of EMU country groups (1996-2001)