Article | 3 November 2022

Business price expectations show no quick turnaround for eurozone core inflation

Despite falling energy prices and weakening demand, a swift drop in core inflation in the eurozone doesn't seem imminent. Business surveys indicate that selling price expectations to consumers remain near all-time highs

The eurozone's inflation battle is far from won

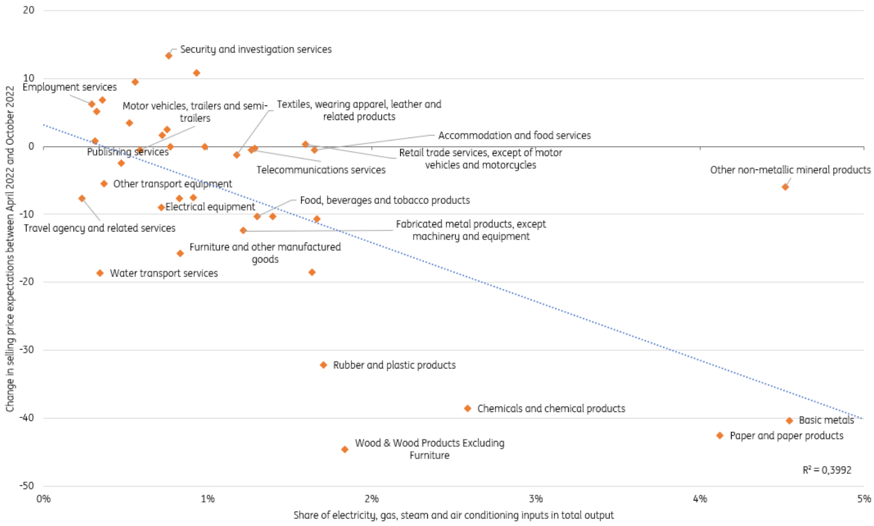
Business inflation expectations still predominantly driven by energy costs

Looking at inflation expectations has become key in this day and age. All the more so now that European Central Bank (ECB) board member Isabel Schnabel explained at Jackson Hole that incoming inflation expectations data are an important input in policymaking as medium-term inflation expectations are harder to forecast right now. So let's look at recent developments.

Since April, we have seen the number of businesses expecting to raise prices in the months ahead decline steadily. But they ticked up again in September according to the economic sentiment survey by the European Commission. What has driven the move? When looking at the development of selling price expectations by sectors since April, we find a strong correlation with the energy-intensiveness of production. Clearly, energy prices continue to be the key driver in determining whether prices need to go up or not.

At the same time though, we do notice that the August price peak has not resulted in a similar jump in selling price expectations that we saw in March. This suggests that weakening demand is starting to have an impact on whether businesses are comfortable pricing through to their consumers.

The drop in selling price expectations correlates with energy intensity of production



Source: Eurostat, ING Research

Energy intensity of production is based on Eurostat input-output tables for 2019

Selling price expectations remain high for businesses selling straight to the consumer

The fact that the peak in selling price expectations seems to be behind us gives the impression that some moderation in core inflation could be around the corner. The question is how fast this will actually start to have an effect. The problem with these business indicators for inflation expectations is that it lumps together companies selling directly to consumers and businesses further down the supply chain, like base metals for example.

To distinguish between sectors fueling pipeline inflation and those directly selling to consumers, we look at the final consumption expenditure by households from different sectors. While those sectors in most cases also sell wholesale, it at least gives an indication of whether consumer prices are currently being raised. We lump the ten sectors that sell most to consumers together to create a view of the selling price expectations among businesses selling to consumers. We also average the indicator for the 20 sectors selling to consumers least, which we count as the pipeline selling price expectations.

It still seems too early to call the peak in core inflation

While we see little difference between the two in selling price expectations historically, they have diverged much more in recent months. The decline in selling price expectations has been much stronger with pipeline sectors. The drop for businesses selling straight to consumers has been far smaller so far. What this tells us is that a quick drop in core inflation is not imminent despite energy price declines and weaker demand. Businesses are still trying to price through a lot of the earlier jumps in energy costs for the moment. This means that despite encouraging signs around prices, with energy costs dropping and weakening demand, it still seems too early to call the peak in core inflation.

Selling price expectations have fallen much more for B2B than B2C

Source: Eurostat, European Commission DCECFIN, ING Research

We have made the distinction between B2B (business-to-business) and B2C (business-to-consumer) sectors based on final consumption expenditure by household per sector using Eurostat input-output tables for 2019. The direct sales to households category includes those sectors having the highest volumes of final consumption expenditure by households, excluding real estate. The pipeline sectors category includes those with the smallest volumes of final consumption expenditure by households.

We included the following sectors in the “direct sales to households” category: retail, food products, motor vehicles, wearing apparel, furniture, land transport and transport via pipelines, telecommunications, travel agency and related activities and computer, electronic and optical products.

We included the following sectors in the “pipeline sectors” category: basic metals, repair & installation of machinery & equipment, wood & wood products excluding furniture, machinery & equipment N.E.C., other non-metallic mineral products, fabricated metal products, paper & paper products, rubber & plastic products, electrical equipment, warehousing & support activities for transportation, rental & leasing activities, security & investigation activities, other professionals, scientific & technical activities, other transport equipment, water transport, architectural & engineering activities, postal & courier activities, printing & reproduction of recorded media, computer programming, consultancy & related activities, employment activities, and advertising & market research.

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