Rising inflation in France adds to the ECB's reasons to hike

While most European countries are starting to see inflation fall, the inflation peak has not yet been reached in France. In January, inflation rose again, increasing to 6% from 5.9% in December. While the economy is escaping recession for now, peak inflation is yet to come

Demonstration of French bakers against inflation and sharp increase in energy prices. Paris, France

Inflation is on the rise again

Inflation in France rose again in January, increasing to 6% from 5.9% in December. The harmonised index, which is important for the ECB, stands at 7% compared to 6.7% the previous month.

Over one month, consumer prices increased by 0.4% (compared to -0.1% in December) due to the rise in food prices (+13.2% over one year) and the rebound in energy inflation. The end of the fuel rebate at the pump and the revision of the tariff shield, which has led to a 15% increase in household gas bills (compared to a 4% increase in 2022), are pushing up energy inflation, at a time when it is falling in other countries. While government measures on energy prices brought down inflation in France by 3 percentage points in 2022, French households and companies are finally facing higher energy bills, well after their European neighbours. Electricity bills will also increase by 15% in February. On the other hand, inflation in manufactured goods is stable at 4.6% thanks to the winter sales. The good news is that services price inflation remains surprisingly low, even falling to 2.6% in January from 2.9% in December. For the time being, services prices seem to be little affected by cost increases, including minimum wage indexations.

Inflation in France will soon be above the European average

Headline and core inflation could continue to rise in France in February. Indeed, the 15% rise in electricity bills will push up energy inflation further, and hence overall inflation. At the same time, energy will start contributing negatively to inflation in most other European countries. As a result, French inflation will soon be higher than in neighbouring countries.

Beyond the developments in energy inflation, core inflation should continue to rise as well. January PMI surveys indicate that, while production cost inflation is finally starting to fall, businesses' pricing intentions are still on the rise. This is particularly the case in the services sector – where forecast prices, according to the January INSEE survey, are at their highest level since 1988 – and in retail trade. Many companies are facing the first upward revision of their energy bills, which will continue to push costs upwards. In addition, the four indexations of the minimum wage to inflation in 2022 will continue to lead to increases in all wages. As the French economy is doing better than expected and escaping recession for the moment, it is easier for companies to pass on past cost increases to customers. Add to this the fact that a series of annual price reviews (notably in transport) are due to take place in February, and we can expect core inflation to rise further in the coming months. This should encourage the ECB to continue its tightening cycle. The ECB will probably want to see clear signs of a permanent decline in core inflation before it softens its tone and stops raising rates.

Ultimately, average inflation in 2023 in France will probably be higher than in 2022 (we expect 5.5% for the year, and 6.3% for the harmonised index), but the annual profile will be fundamentally different, with a peak that could reach 6.5% in the first quarter, and then a gradual decline from the summer onwards. At the end of 2023, inflation will probably still be above 4%, a level higher than the European average. The deceleration of price developments should continue in 2024, but will still be slow, averaging 2.6% over the year (3.5% for the harmonised index).

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