

## EUROZONE: UPSIDE RISKS TO INFLATION

Although they have eased recently, high Eurozone manufacturing price pressures are fuelling analysts' concerns that inflation could stay high for longer. There is an impression that the ECB is increasingly sympathetic for this view. This is important in the run-up to the December meeting of the governing council. Whether supply bottlenecks and rising input prices will have a longer-lasting effect on inflation depends on the transmission to the rest of the economy. One would expect it to be higher under a combination of strong demand, low inventory levels and long supplier delivery times. This corresponds to the current situation in the sectors producing durable consumer goods, intermediate goods and investment goods. Perhaps, inflation could surprise to the upside after all in the near term.

Eurozone manufacturing price pressures – the average of the readings for input prices, output prices and suppliers' delivery time in the PMI surveys – have eased recently whilst remaining at an elevated level. Historically, increases in this indicator have at times – such as in 2011-2012 – been accompanied by rising core inflation (chart 1) but on other occasions, such as in 2017-2018, this was hardly the case.

Despite this unstable correlation, at the current juncture, the record high level of price pressures is fuelling concerns amongst analysts that inflation could stay high for longer. It seems that the ECB is increasingly sympathetic for this view. Admittedly, despite an upgrade of the inflation projection, Christine Lagarde sounded quite neutral during her press conference of 9 September.

Headline inflation should decline next year but there was acknowledgement of the risk of an upside surprise if certain conditions were met. The latest projections of the Banque de France for the French economy articulate these risks very clearly. The magnitude and duration of the effects triggered by the observed rise in industrial input prices “constitute an upside hazard for our inflation projection.” Although it notes that input prices seem to have stabilised for now, they may increase further due to supply constraints. “Combined with the pressure on recruitment, higher than expected wage increases may occur.”<sup>1</sup> ECB Executive Board member Isabel Schnabel recently stated that three factors warrant particular attention – longer-term supply bottlenecks, wide-reaching reforms and structural change leading to a higher growth path and optimism of households which could boost demand – adding that “we are very diligently monitoring whether the underlying forecast assumptions might not underestimate the possibility of higher inflation over the coming years.”<sup>2</sup> According to Martins Kazaks, governor of the central bank of Latvia, “If Covid does not surprise on the negative side, there is some upside for the inflation outlook over the medium term.”<sup>3</sup> Finally, the FT reported that in the ECB staff's internal medium-term reference scenario, which has a five

year horizon, inflation would reach 2% ECB soon after the end of the three year staff projections that the ECB is publishing.<sup>4</sup>

The impression of a somewhat stronger insistence than before by ECB officials on the upside risk to inflation is important in the run-up to the December meeting of the governing council. On that occasion, updated staff projections will be published – which may influence policy rate expectations – whereas the council should decide on the future of the pandemic emergency purchase programme. Against this background, economic data will, more than ever, be closely monitored, in particular those relating to supply bottlenecks and input prices. Whether they will have a longer-lasting effect on inflation depends to a large degree on the transmission of these impulses to the rest of the economy: to what extent do they cause an increase in output prices and, eventually, consumer prices? Lengthening delivery times tend to lead to higher input prices whereas low stock levels and strong demand will

4. Unpublished inflation estimate raises prospect of earlier rate rise, Financial Times, 17 September 2021. The article mentions that the comments were made by ECB chief economist Philip Lane in a call with German economists, although, according to Reuters, the ECB “disputed the story, calling it inaccurate” (ECB's Lane reveals in private meeting inflation target may be met by 2025, Reuters, 17 September).

### EUROZONE: MANUFACTURING PMI PRICE PRESSURES AND INFLATION

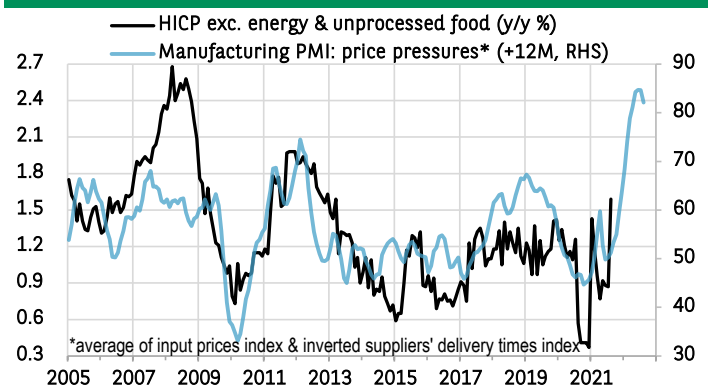


CHART 1

SOURCE: EUROSTAT, IHS MARKIT, BNP PARIBAS

1. Banque de France, Macroeconomic projections, 13 September 2021.
2. New narratives on monetary policy – the spectre of inflation, Speech by Isabel Schnabel, Member of the Executive Board of the ECB, 148th Baden-Baden Entrepreneurs' Talk, Frankfurt am Main, 13 September 2021.
3. ECB's Kazaks Sees Prospect of Faster Inflation Than Forecast, Bloomberg, 17 September 2021.

In the euro area, the sectors producing durable consumer goods, intermediate goods and investment goods are confronted with strong demand, low inventory levels and long supplier delivery times. Such a combination increases the risk of inflation surprising to the upside in the near term.



probably imply low price elasticity of demand, offering the opportunity of producers to raise their output prices in reaction to higher input prices. Thus, one would expect the transmission to be higher under a combination of strong demand, low inventory levels and long supplier delivery times. This corresponds to the situation prevailing in the euro

area in the sectors producing durable consumer goods, intermediate goods and investment goods (charts 2-7). Perhaps, inflation could surprise to the upside after all in the near term.

**William De Vijlder**

**EURO AREA: INDUSTRY SURVEY, CONSUMER GOODS**

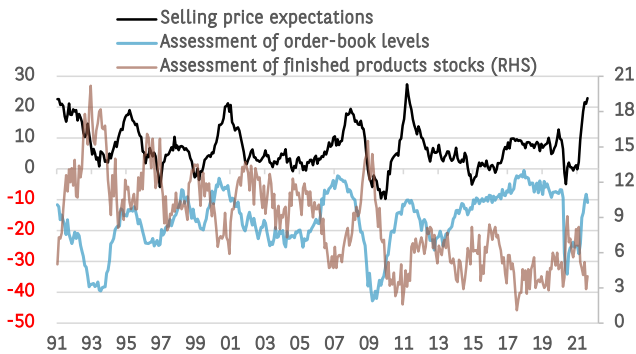


CHART 2 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

**EURO AREA: INDUSTRY SURVEY, DURABLE CONSUMER GOODS**

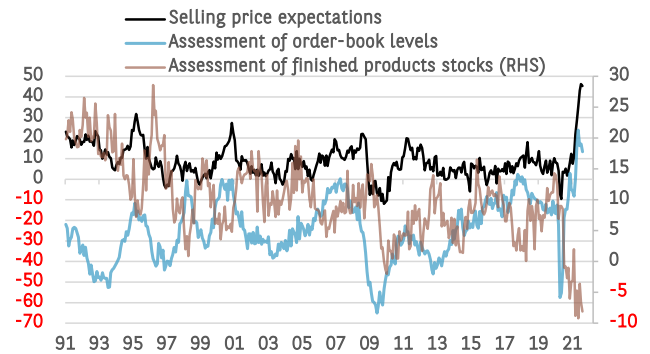


CHART 3 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

**EURO AREA: INDUSTRY SURVEY, NON DURABLE CONSUMER GOODS**

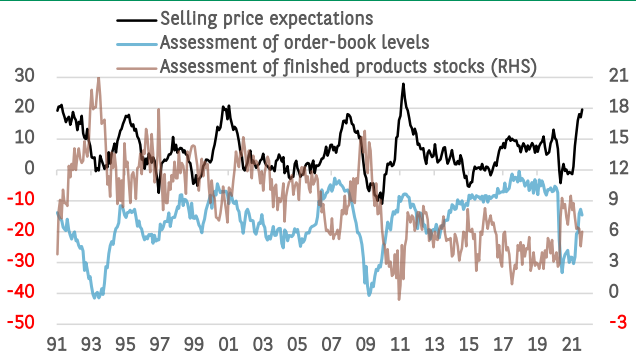


CHART 4 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

**EURO AREA: INDUSTRY SURVEY, FOODS AND BEVERAGES**

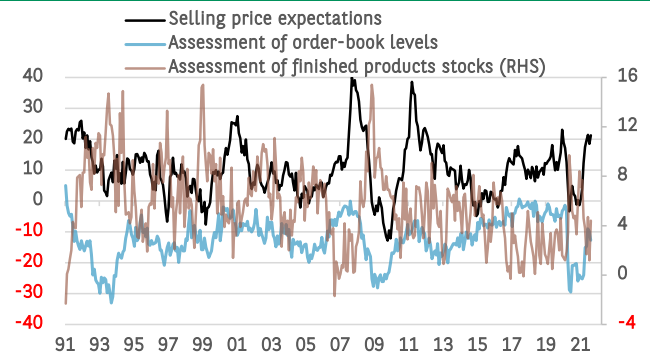


CHART 5 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

**EURO AREA: INDUSTRY SURVEY, INTERMEDIATE GOODS**

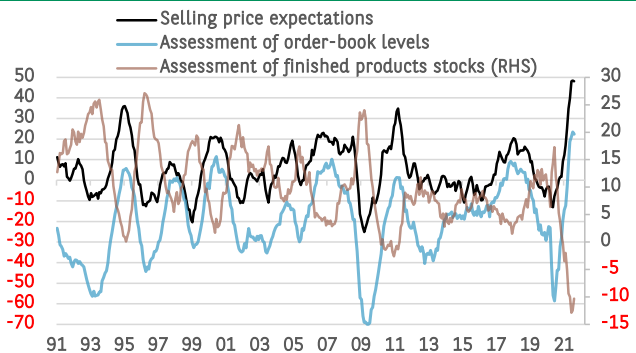


CHART 6 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

**EURO AREA: INDUSTRY SURVEY, INVESTMENT GOODS**

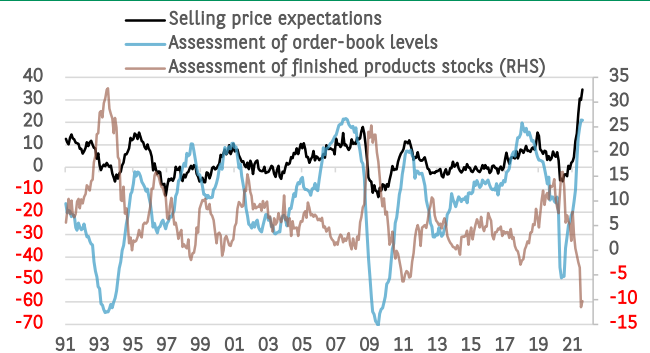


CHART 7 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS