

EUROZONE: WHAT DRIVES COMPANIES' ELEVATED SELLING PRICE EXPECTATIONS?

An exceptionally high number of Eurozone companies plan to raise selling prices. It is unlikely that, at this stage, unit labour cost growth would already be a key driver. Rising input costs and strong demand are playing a crucial role, whereby well-filled order books make it easier for companies to increase their prices. Selling price expectations of euro area companies are much higher than what would be expected based on their historical relationship with input prices and order book levels. It seems that when more companies are raising prices, others will be inclined to do the same. This broad-based nature of the increase of inflation could slow down the reaction of inflation to slower demand growth.

The latest business survey of the European Commission shows that the net balance of industrial companies planning to raise their selling prices continues to increase and, at 58, is at the highest level ever¹. Understanding the drivers behind this development is important for the assessment of the outlook for producer and consumer prices. Companies will be inclined to charge higher prices when wage costs are growing in excess of productivity gains, when they are confronted with rising input costs (commodities, intermediate inputs), or strong demand, which increases their pricing power. It is unlikely that at this stage and at the aggregate level, the first factor would already be an important driver behind the intentions to raise prices. The annual growth of negotiated wages was 1.6% in the fourth quarter of 2021², although, considering the labour market bottlenecks in various sectors and anecdotal evidence³, one would expect wage growth to pick up going forward. Rising input costs are a key driver. The purchasing managers' indices show that a vast majority of survey participants in the manufacturing sector continue to face higher input prices, month after month. Finally, strong demand, as reflected in well-filled order books, makes it easier for companies to increase their prices⁴.

Chart 1 shows the close correlation between the assessment of order book levels in industry and the selling prices expectations of companies. Recently, both series have reached record-high levels. As shown in the table, a regression analysis reveals that input prices and order book levels are highly significant in explaining selling price expectations in industry. However, the quality of the statistical fit has declined as of late, as reflected in exceptionally large and positive regression residuals (chart 2): the observed selling price expectations are significantly higher than their estimated value based on the historical relationship. Given the current tensions on input prices and the level of order books, even more companies than normal plan to raise their selling prices. A possible explanation is that an exceptionally large number of companies are very confident about their pricing power. However, it could also reflect that inflation has become very broad-based. When more companies are raising prices, others will be inclined to do the same.

ASSESSMENT OF ORDER-BOOK LEVELS (X-AXIS) VERSUS SELLING PRICE EXPECTATIONS (INDUSTRY) (Y-AXIS)

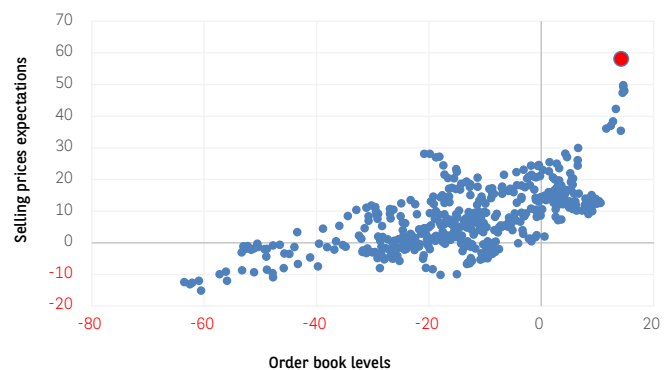


CHART 1

SOURCE: S&P GLOBAL (MARKIT), EUROPEAN COMMISSION, BNP PARIBAS

1. Records start in January 1985. The wording of the question is "How do you expect your selling prices to change over the next 3 months? They will + increase/= remain unchanged/-decrease". Source: *The Joint Harmonised EU Programme of Business and Consumer Surveys, User Guide* (updated October 2021), European Commission.

2. Source: ECB, statistical data warehouse.

3. This is illustrated by the result of exchanges, mainly between 10 and 19 January 2022, between ECB staff and representatives of 74 leading non-financial companies operating in the euro area. "Typically, contacts said they expected average wage increases to move from around 2% in the recent past to 3% or possibly more this year. Significantly higher rates of wage inflation were described or anticipated in relation to those jobs for which it was a challenge to recruit and retain staff, for example in the fields of construction and road haulage and for IT experts and software engineers." Source: ECB, *Economic Bulletin*, 01/2022, February 2022.

4. "The effect of the surge in the prices of many raw materials and of logistics costs in 2021 was still feeding through the value chain, and the demand environment for passing these costs through to prices remained very favourable in most sectors... Many contacts said that prices were being adjusted more frequently than in the past to avoid margins being squeezed". Source: see footnote 3.

Selling price expectations of euro area companies are exceptionally high, even when taking into account the pressure on input prices and the well-filled order books. It seems that when more companies are raising prices, others will be inclined to do the same.



An interesting indicator in this respect is the ‘persistent and common component of inflation’ (PCCI)⁵. This measure of underlying inflation that is calculated by the ECB shows that in recent months, the pick-up in inflation has indeed become very widespread (chart 3). Moreover, its recent evolution is highly correlated with the regression residuals discussed before, which suggests that the exceptionally high selling price expectations are related to the broad-based increase of inflation. This may lead to a certain inertia in price developments and hence a delayed reaction of inflation when demand growth eventually slows down.

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5. Based on an analysis of around 1000 monthly time series for 12 euro area countries, this indicator seeks to capture the underlying inflation dynamics that are common across euro area countries. Source: *PCCI – a data-rich measure of underlying inflation in the euro area*, ECB, Statistics Paper Series, October 2020.

SELLING PRICE EXPECTATIONS: ESTIMATED VERSUS OBSERVED

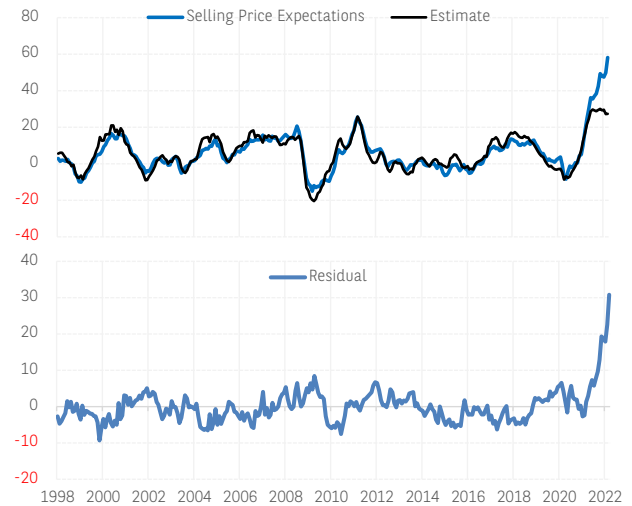


CHART 2

SOURCE: S&P GLOBAL (MARKIT), EUROPEAN COMMISSION, BNP PARIBAS

REGRESSION RESIDUAL OF SELLING PRICE EXPECTATIONS VERSUS UNDERLYING INFLATION

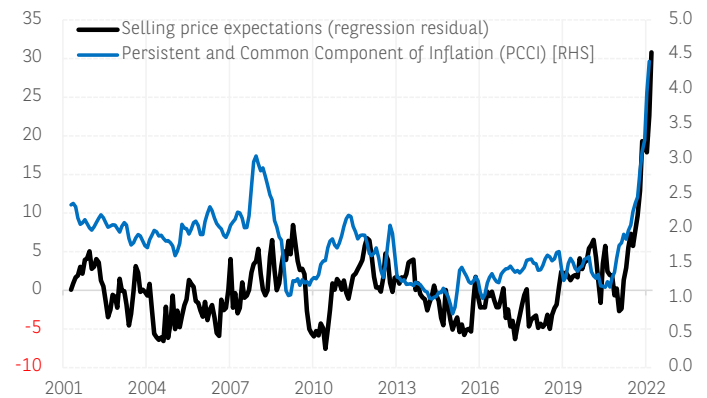


CHART 3

SOURCE: S&P GLOBAL (MARKIT), EUROPEAN COMMISSION, BNP PARIBAS

REGRESSION RESULTS FOR SELLING PRICE EXPECTATIONS ESTIMATION PERIOD: 1998 - 2022

Variable	Coefficient	t-Stat
<i>Dependent Variable: Selling Price Expectations</i>		
Order book	0.1751	7.5620
PMI Input Prices (-1)	0.6126	20.5349
Brent in euro (m/m)	0.0795	2.6774
C	-27.2721	-14.1029
R2	0.8162	

TABLE 1

SOURCE: S&P GLOBAL (MARKIT), EUROPEAN COMMISSION, BNP PARIBAS

