

EDITORIAL

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BAD INFLATION CLOUDS OUTLOOK

When the pick-up in inflation during a growth upswing is driven by the demand side, inflation is considered to be good. However, inflation can also be bad. In that case, higher prices do not follow from e.g. higher wages due to a tight labour market. Bad inflation rather reflects supply-side shocks. This is, to some degree, the situation that is unfolding in the Eurozone and other economies due to the recent huge increase of oil and gas prices. Bad inflation weighs on households' real disposable income and hence spending. The impact is expected to be larger for households at the lower end of the income distribution, considering that a bigger portion of their expenditures goes to fuel and in particular heating, and that they also have a lower savings rate.

Inflation tends to evolve procyclically over the business cycle. A pick-up in inflation during a growth upswing is welcome news, at least initially. It signals that policy stimulus – monetary and/or fiscal – when activity was subdued has been effective in boosting activity and demand, that the re-emergence of labour market bottlenecks is creating upward pressure on wages, that companies, faced with solid demand, reflect these higher wages in their sales prices, etc.

In such a world of a demand-side driven acceleration of price increases, inflation is good, at least initially. However, inflation can also be bad. In that case, higher prices do not follow from higher wages due to a tight labour market or companies, faced with strong demand, trying to charge higher prices. Bad inflation rather reflects supply-side shocks. This is, to some degree, the situation that is unfolding in the Eurozone and other major economies due to the recent huge increase of oil and gas prices, with a knock-on effect on electricity prices. Although this is in part related to strong demand, supply-side factors also play a role, leading to a huge increase in prices¹. Bad inflation weighs on households' real disposable income – higher prices have not been preceded by wage increases – and company profits. This may cause a slowdown of demand, triggering a countercyclical relationship between inflation and growth.

Eventually, bad inflation can end up causing stagflation, in which growth is disappointingly low and inflation too high. Judging by the number of references in Bloomberg articles, stagflation worries have been on a rising trend for several years, but, with the exception of short-lived spikes, have remained low. Recently however, the topic has been skyrocketing (see chart) reflecting fears that elevated input price pressures would end up dealing a blow to the growth outlook. In this respect, increased uncertainty can play a role, e.g. due to a reduced visibility about the monetary policy outlook. Bad inflation confronts central banks with a dilemma: do nothing thereby running the risk of inflation staying high for longer or tighten policy, which could weigh on growth. If the pick-up in inflation is temporary, it is justifiable not to react. This is the line taken by the ECB as explained by Christine Lagarde: "Our new forward guidance on interest rates is well-suited to manage supply-side risks. This guidance ensures that we will only react to

1. For a recent analysis of the drivers of higher gas prices, see Tagliapietra, S. and G. Zachmann (2021) 'Is Europe's gas and electricity price surge a one-off?', Bruegel Blog, 13 September

improvements in headline inflation that we are confident are durable and reflected in underlying inflation dynamics."² Another source of uncertainty which follows from the jump in gas prices are the knock-on effects on other sectors.³ To what extent will this weigh on investment and hiring decisions? A direct and potentially more important influence is on household spending, whereby the impact differs depending on the income level. In France in 2017, 6% of spending of households in the lowest two income deciles went to heating and 4% to fuel. The average for the top two deciles was respectively 4.2% and 3.5%⁴. Considering that the savings rate of lower income households is significantly lower than for the rest of the population, there is a higher likelihood that a big increase in energy prices would crowd-out other types of spending and weigh on GDP growth.

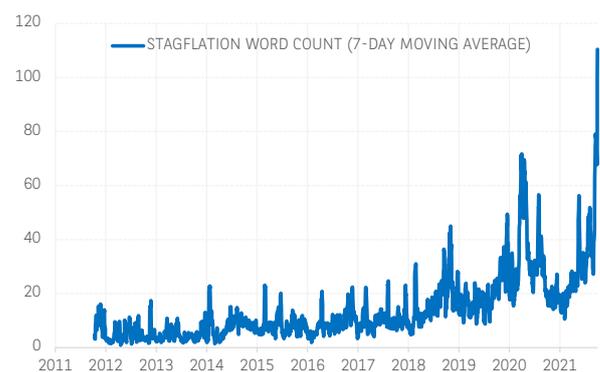
William De Vijlder

2. Source: *Monetary policy during an atypical recovery*, Speech by Christine Lagarde, President of the ECB, at ECB Forum on Central Banking "Beyond the pandemic: the future of monetary policy", Frankfurt am Main, 28 September 2021.

3. "Soaring natural gas prices have forced closures of fertiliser plants, the UK's main source of CO₂ to make drinks fizzy, stun animals for slaughter and cool nuclear power plants". Source: CO₂ crisis set to spread to Europe, big distributor warns, FT, 22 September 2021

4. Source: The expenditures of households in France in 2017, INSEE.

STAGFLATION



SOURCE: BLOOMBERG, BNP PARIBAS

Considering that the savings rate of lower income households is significantly lower than for the rest of the population, there is a higher likelihood that a big increase in gas, or, more broadly, energy prices, would crowd-out other types of spending and weigh on GDP growth.



BNP PARIBAS

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MARKETS OVERVIEW

OVERVIEW

Week 24-9 21 to 1-10-21

▼ CAC 40	6 638	▶ 6 518	-1.8 %
▼ S&P 500	4 455	▶ 4 357	-2.2 %
↗ Volatility (VIX)	17.8	▶ 21.2	+3.4 pb
↗ Euribor 3M (%)	-0.54	▶ -0.55	-0.4 bp
↗ Libor \$ 3M (%)	0.13	▶ 0.13	+0.1 bp
↗ OAT 10y (%)	0.04	▶ 0.05	+0.6 bp
↗ Bund 10y (%)	-0.23	▶ -0.22	+0.9 bp
↗ US Tr. 10y (%)	1.46	▶ 1.47	+0.5 bp
▼ Euro vs dollar	1.17	▶ 1.16	-1.0 %
↗ Gold (ounce, \$)	1 752	▶ 1 756	+0.2 %
↗ Oil (Brent, \$)	75.2	▶ 78.6	+4.4 %

MONEY & BOND MARKETS

Interest Rates	highest 21	lowest 21	Yield (%)	highest 21	lowest 21
€ ECB	0.00	0.00 at 01/01	0.00 at 01/01	€ AVG 5-7y	-0.17
Eonia	-0.50	-0.47 at 26/01	-0.50 at 01/01	Bund 2y	-0.70
Euribor 3M	-0.55	-0.53 at 07/05	-0.56 at 06/01	Bund 10y	-0.22
Euribor 12M	-0.49	-0.47 at 20/04	-0.52 at 02/02	OAT 10y	0.05
\$ FED	0.25	0.25 at 01/01	0.25 at 01/01	Corp. BBB	0.67
Libor 3M	0.13	0.24 at 13/01	0.11 at 09/09	Treas. 2y	0.27
Libor 12M	0.23	0.34 at 01/01	0.22 at 06/09	Treas. 10y	1.47
£ BoE	0.10	0.10 at 01/01	0.10 at 01/01	High Yield	4.83
Libor 3M	0.08	0.09 at 24/03	0.03 at 01/01	£ gilt. 2y	0.23
Libor 12M	0.37	0.38 at 30/09	0.07 at 11/01	£ gilt. 10y	1.00

At 1-10-21

EXCHANGE RATES

1€ =	highest 21	lowest 21	2021
USD	1.16	1.23 at 06/01	1.16 at 30/09 -5.2%
GBP	0.86	0.91 at 06/01	0.85 at 10/08 -4.3%
CHF	1.08	1.11 at 04/03	1.07 at 17/08 -0.3%
JPY	128.68	133.97 at 28/05	125.22 at 18/01 +1.9%
AUD	1.60	1.64 at 20/08	1.53 at 18/03 +0.8%
CNY	7.49	8.00 at 01/01	7.49 at 30/09 -6.3%
BRL	6.25	6.95 at 03/03	5.88 at 24/06 -1.7%
RUB	84.43	92.47 at 20/04	84.35 at 30/09 -6.7%
INR	85.96	90.39 at 23/04	85.30 at 27/03 -3.9%

At 1-10-21

COMMODITIES

Spot price, \$	highest 21	lowest 21	2021	2021(€)
Oil, Brent	78.6	79.5 at 27/09	51.2 at 04/01	+51.4%
Gold (ounce)	1 756	1 947 at 05/01	1 682 at 08/03	-7.5%
Metals, LME	4 161	4 429 at 10/09	3 415 at 01/01	+21.9%
Copper (ton)	9 135	10 449 at 11/05	7 749 at 01/01	+17.9%
wheat (ton)	238	2.9 at 07/05	223 at 10/09	-3.9%
Corn (ton)	202	2.9 at 07/05	188 at 04/01	+0.7%

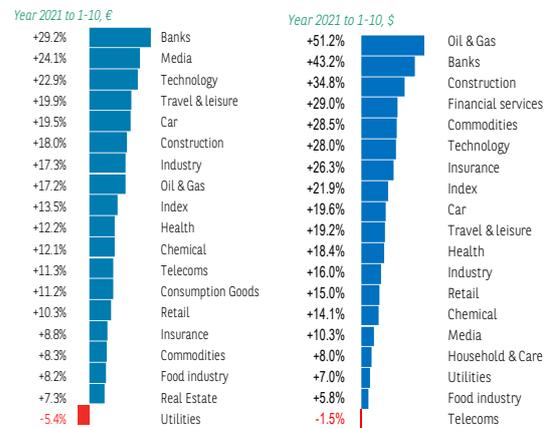
At 1-10-21

EQUITY INDICES

Index	highest 21	lowest 21	2021
World			
MSCI World	3 023	3 170 at 06/09	2 662 at 29/01 +12.4%
North America			
S&P500	4 357	4 537 at 02/09	3 701 at 04/01 +16.0%
Europe			
EuroStoxx50	4 035	4 246 at 06/09	3 481 at 29/01 +13.6%
CAC 40	6 518	6 896 at 13/08	5 399 at 29/01 +1.7%
DAX 30	15 156	15 977 at 13/08	13 433 at 29/01 +10.5%
IBEX 35	8 800	9 281 at 14/06	7 758 at 29/01 +0.9%
FTSE100	7 027	7 220 at 11/08	6 407 at 29/01 +0.9%
Asia			
MSCI, loc.	1 132	1 196 at 14/09	1 044 at 06/01 +0.8%
Nikkei	28 771	30 670 at 14/09	27 013 at 20/08 +4.8%
Emerging			
MSCI Emerging (\$)	1 247	1 445 at 17/02	1 221 at 20/08 -0.3%
China	89	130 at 17/02	87 at 20/08 -17.8%
India	847	869 at 23/09	659 at 29/01 +27.2%
Brazil	1 612	2 098 at 24/06	1 561 at 09/03 -10.9%
Russia	842	846 at 30/09	647 at 01/02 +24.2%

At 1-10-21

PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)



SOURCE: REFINITIV, BNP PARIBAS,

