WEEKLY UPDATE

Inflation driven by wages or profits? Different symptoms but the same response

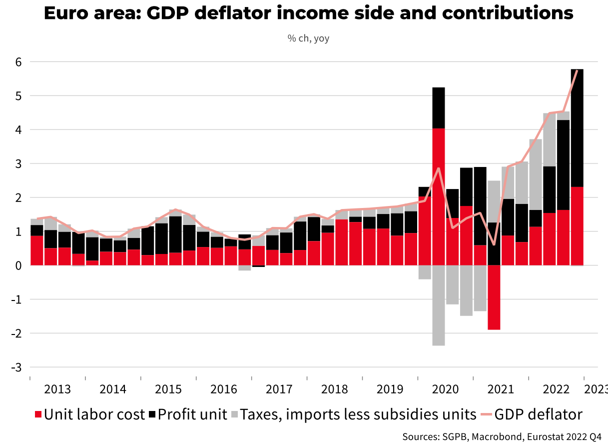
The surge in inflation has raised fears of a 1970s-80s style wage-price spiral. It now seems inflation is being spread through Euro area economies more by profits than price pressures. Either way, bringing down price pressures will mean easing the pull of demand on the limited available supply. The ECB will continue to meet this challenge by tightening monetary policy.

From external to internal inflation. Euro area inflation was initially triggered by a succession of external shocks (Covid, Ukraine war) which drove up import prices (goods, energy, agri-products). Coming on top of a strong post-Covid recovery, these shocks took rapid hold on booming demand and spread gradually through all goods and services prices in the area. In this way inflation became internalised to the region's economies, prompting the European Central Bank to tighten its monetary policy with the prime aim of repressing demand.

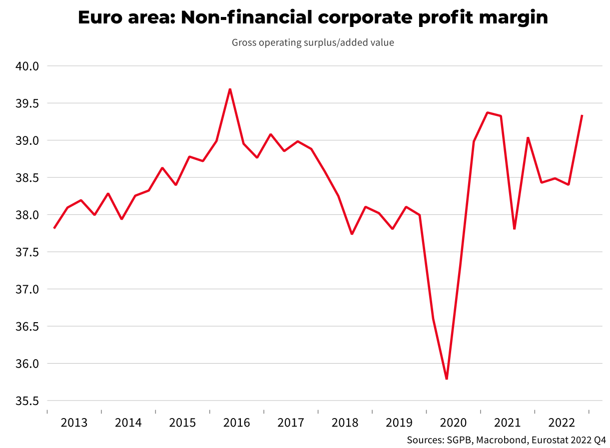
Second round effects work mainly through margins. Now that inflation has spread through the economy, the fear is that it could embed itself for the long term. Inflation is a negative cost, which different types of economic agents try to offset. Their offsetting strategies can have consequences for second round effects and embed the rise in inflation more durably. Workers try to minimise the costs of inflation through their wage demands, making good through higher salaries what they have lost through higher prices, so generating the risk of a wage-price spiral. Meanwhile, companies also try to minimise their share of the pain by hiking their prices to protect margins, again generating the risk of a wage-price spiral. Today, unlike the 1970s and 1980s, barely any salaries are index-linked to inflation, and it is obvious that wage rises across the Euro area are well contained. Company profits however are growing apace, helping explain the stubbornly high inflation we are seeing, and posing a real risk that strong inflation could embed itself for the long term.

Need to depress demand relative to supply, which means monetary tightening whatever the cause. Inflation thus continues to propagate through the Euro area. This represents a cost for economies, with inflation sharply eroding household buying power. This is very unlike the 1970s and 80s when it was companies that bore the brunt of inflationary effects. The symptoms are therefore different. But, while the propagation mechanism may differ, the key short-term response remains the same: to dampen demand so companies find it harder to pass on inflation in their selling prices. The European Central Bank thus has every reason to continue tightening monetary policy through further interest rate hikes. These rises will slow demand by making borrowing more expensive and channelling money into higher-paying savings. Medium term, if the price-profits spiral persists, the authorities are likely to raise taxes on profits or tighten competition rules.

Prices are driven up more by corporate profits than by wages



Corporate margins are on the rise



Past performance should not be seen as a guarantee of future returns.
All data taken from Bloomberg and Macrobond on the 28/04/2023, publication achievement date. In accordance with the applicable regulation, we inform the reader that this material is qualified as a marketing document.

OUR MACRO COMMENTS

Events of the week

In the US, GDP growth increased by 1.1% (annualized) in the first quarter, down from the previous quarter and below expectations. The main reason for this slowdown is a significant reduction in inventories, although private demand growth remains strong. **In the Euro area**, in France, GDP grew by 0.2% (quarterly) in Q1-2023, with a decline in household consumption and investment, business investment still buoyant and exports rising. In Germany, GDP remained stable (0%) in Q1-2023, while in Italy, GDP exceeded expectations by reaching a growth of 0.5%.

Companies have started to publish their results for the first quarter and the trend is generally positive. **In the US**, among the 258 SP500 companies that reported results, sales and revenues surprised to the upside, up 2% and 6.8% respectively. On the revenue side, sales for these companies rose by 4.8% but profits fell by 2.56%. **In Europe**, of the 181 STOXXX 600 companies that reported results, both sales and revenues came in above consensus at 2.3% and 35% respectively. On the revenue side, sales rose by 5.8% and profits by 4.7%.

Figures of the week

	Actual		Forecast	Previous
• Durable Goods Orders (MoM, March)	3.2%	↑	0.7%	-1.2%
• GDP Growth Rate (QoQ at annualised rate, Q1)	1.1%	↓	2%	2.6%
• Inflation Rate (YoY, April)	5.19%	↑	5,7%	5.7%
• GDP Growth Rate (QoQ, Q1)	0.2%	↑	0.2%	0%
• GfK Consumer Confidence (May)	-25.7	↑	-27.9	-29.3
• GDP Growth Rate (QoQ, Q1)	0%	↑	0.2%	-0.5%
• BoJ Interest Rate Decision	-0.1%	→	-0.1%	-0.1%

Sources: Macrobond, 28 April 2023

The week ahead

Monday
ISM Manufacturing PMI (April)
Tuesday
Retail Sales (March) Germany
Inflation Rate (April)
Wednesday
Fed Interest Rate Decision, ISM Services PMI (April)
Thursday
ECB Interest Rate Decision
Friday
Caixin PMI (April)
Unemployment Rate (April)

MARKET PERFORMANCES

Interbank rates	Last.	-1W	-3M	YTD	-12M
€STER O/N	2,90	2,90	1,90	1,91	-0,58
USD SOFR O/N	4,80	4,80	4,31	4,30	0,28
JPY TONAR O/N	-0,03	-0,01	-0,01	-0,02	-0,02
GBP SONIA O/N	4,18	4,18	3,43	3,43	0,69
CHF O/N	0,80	0,80	0,80	0,80	-0,71

Commodities	Last.	-1W	-3M	YTD	-12M
Brent, USD/BL	77,76	-6,1%	-9,8%	-9,5%	-25,8%
Or, USD/oz	1 989	-0,3%	2,2%	8,9%	5,5%
Copper, USD/metric ton	8 585	-3,4%	-7,6%	2,2%	-13,2%
Platinium, USD/oz	1 101	3,7%	5,0%	3,4%	21,0%
Palladium, USD/oz	1 514	-6,5%	-12,4%	-15,3%	-30,5%
Silver, USD/oz	24,85	0,4%	6,1%	3,8%	5,1%

Long term sov. rates	Last.	-1W	-3M	YTD	-12M
10Y OAT	2,89	3,00	2,60	2,98	1,31
10Y Bund	2,38	2,50	2,11	2,44	0,81
10Y BTP	4,25	4,35	3,96	4,55	2,58
10Y JGB	0,48	0,47	0,41	0,41	0,25
10Y Bonos	3,42	3,53	3,11	3,51	1,80
10Y Swiss	1,05	1,09	1,13	1,57	0,79
10Y Gilt	3,70	3,84	3,25	3,66	1,85
10Y USTnote	3,43	3,60	3,46	3,88	2,82

FX rates	Last.	-1W	-3M	YTD	-12M
EUR/USD	1,10	1,0%	1,5%	3,3%	4,3%
EUR/CHF	0,98	-0,1%	-2,0%	-0,3%	-3,6%
USD/GBP	0,80	-0,2%	-0,9%	-3,4%	0,3%
USD/JPY	133,32	-1,0%	2,9%	1,9%	3,9%
USD/BRL	5,05	0,3%	-0,4%	-5,4%	0,4%
USD/CNY	6,93	0,6%	2,1%	0,4%	5,5%
USD/RUB	82,47	0,9%	18,8%	13,0%	11,2%

Credit & EM	Last.	-1W	-3M	YTD	-12M
EUR Corporate Aaa	3,31	3,43	2,90	3,12	1,49
EUR Corporate Baa	4,49	4,54	4,12	4,65	2,23
GBP Corporate Baa	4,73	4,89	4,16	4,59	2,68
USD Corporate Aaa	4,23	4,36	4,25	4,62	3,56
USD Corporate Baa	5,39	5,52	5,22	5,70	4,48
USD EM aggregate	7,34	7,39	7,00	7,52	6,20

Equity indices	-1W	-3M	YTD	-12M
Developped markets	-2,1%	-2,1%	-3,2%	0,5%
Euro area	-1,0%	-1,0%	4,8%	12,7%
Germany	-0,6%	-0,6%	4,7%	12,3%
France	-1,1%	-1,1%	6,0%	13,2%
United Kingdom	-0,6%	-0,6%	1,4%	5,4%
Switzerland	0,0%	0,0%	-0,3%	5,9%
United States	-2,4%	-2,4%	1,0%	5,6%
Japan	-0,8%	-0,8%	2,2%	7,0%
Brazil	-1,5%	-1,5%	-10,5%	-3,8%
Hong Kong	-3,0%	-3,0%	-10,4%	-0,1%
India	1,2%	1,2%	0,2%	-1,4%
China	-4,0%	-4,0%	-5,3%	2,3%

Source: Bloomberg, on 27 April 2023.
-1W = 1-week change, -3M = 3-month change, -12M = 12-month change, YTD = year-to-date change. Equities; total return in local currency. Government bonds = 10-year returns. Figures are rounded.

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