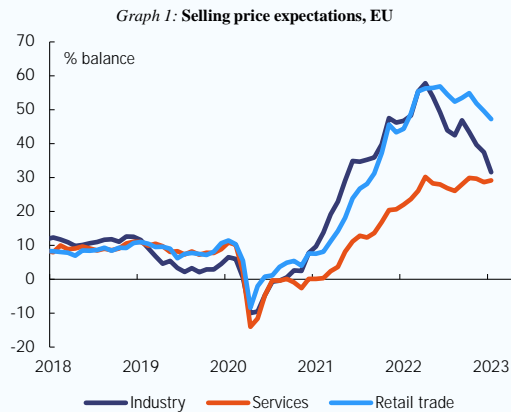


Box 1.2: Selling price expectations and core inflation – insights from the Commission’s business surveys

A key question shaping this forecast concerns the future dynamics of core inflation. Namely, to what extent will recent declines in energy and food commodity prices pass through to retail prices, at what speed, and will countervailing forces – mainly from wages – result in more entrenched inflationary pressures? Information on managers’ pricing intentions for their firms’ output can help answer these questions.

This Box analyses the results of the European Commission’s monthly business surveys until January 2023 regarding managers’ selling price expectations⁽¹⁾. As the surveys do not cover energy utilities⁽²⁾ nor agriculture, they appear particularly well-suited to provide leading indications for core inflation and some of its sub-components.

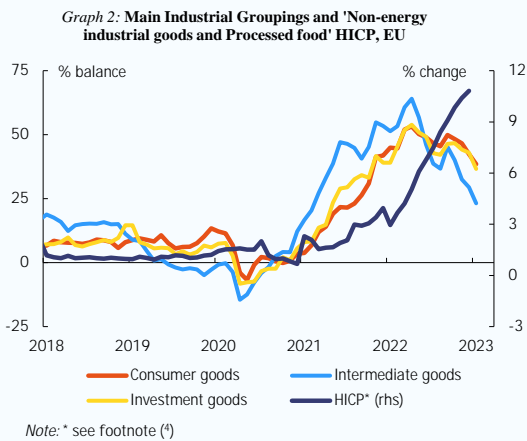
Graph 1 provides an overview of developments in selling price expectations in industry, services, and retail trade over the past five years. Expectations in the construction sector are not shown, as the output of building activities mainly relates to investment goods, with no direct correspondence to any core inflation item. Selling price expectations in industry and retail trade peaked in April 2022 and, while remaining at a high level, have since been declining. In the services sector, selling price expectations also peaked in April 2022 but have since remained broadly stable. On balance, expectations remain well above average in all three sectors – meaning that an unusually high share of managers keep reporting their intention to charge higher prices for their output in the near future.⁽³⁾ Overall, this suggests that core inflation could be about to peak, but is set to remain very high, with continued pressures especially on services.



Not all goods and services produced by the surveyed firms are destined to final consumption items. The remainder of this analysis therefore focuses on product groupings and sub-sectors that are geared towards consumers, and tries to map the relationship between their firms’ pricing intentions with the corresponding HICP sub-components up until December 2022, the latest month for which detailed inflation data are available.

Disaggregated sectoral developments

Within industry, the available breakdown of activities by Main Industrial Groupings (MIG) allows to single out consumer goods. Graph 2 shows that the observed dynamics of selling price expectations for the manufacturing sector as a whole are broad-based across the three Groupings. They all peaked in April 2022 and moved down thereafter. However, the magnitude of the swings differs somewhat, with intermediate goods (such



(1) The question on selling price expectations asked in all business sectors (i.e. industry, services, retail trade and construction) reads "How do you expect your selling prices to change over the next 3 months? They will increase, remain unchanged or decrease".
 (2) The only exceptions are sector 19 'Manufacture of coke and refined petroleum products', which in any case is not included in any of the three Main Industrial Groupings (MIGs) analysed in this Box and sector 47.3 'Retail sale of automotive fuel', which is included in the retail trade sector.
 (3) Percentage balances are the difference between positive and negative answer options, expressed as a percentage of total answers.

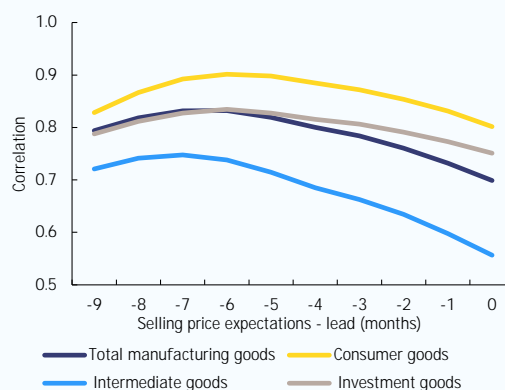
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Box (continued)

as chemicals, basic metals, and electrical equipment, affected by supply side bottlenecks) displaying the steepest increase in 2021 and the fastest decline after reaching the peak. **Manufacturers'** pricing intentions for consumer goods, typically comprising the HICP components of non-energy industrial goods and processed foods, appear to lead relatively well developments in inflation for these components.⁽⁴⁾ **Managers'** selling price expectations for these goods thus appear to provide reliable forward indications for core HICP developments in the coming months.

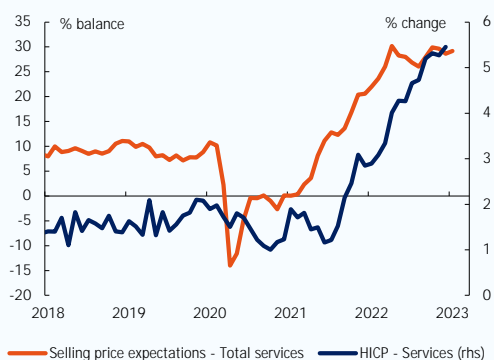
The above intuition is supported by the simple correlation analysis shown in Graph 3. The correlation between selling price expectations in the manufacture of consumer goods and HICP inflation for the aggregate of 'non-energy industrial goods and processed food' is relatively high (0.72 over the period January 2001 - December 2022), peaking at a lag of six months. This suggests that inflation for the core goods of the consumption basket, which was still increasing in December 2022, should start to moderate in the second half of this year.

Graph 3: Selling price expectations versus 'non-energy industrial goods and processed food' HICP inflation



For the service sector, which comprises services for both consumers and corporations, survey data does not offer a breakdown by sub-sector or type of activity that can be directly mapped to selected core inflation components. Graph 4 shows that selling price expectations for services as a whole nevertheless co-move quite well with service inflation⁽⁵⁾. Correlation is lower than for industrial consumer goods but still high, with BCS selling price expectations leading by some months (correlation is highest, at almost 0.7, when selling price expectations are five months ahead). Stabilisation of BCS selling price expectations after the peak suggests that services inflation, while not increasing further, is not set to abate soon either. This could be related to **managers'** expectations of higher wages, given the greater role played by labour costs in this labour-intensive sector.

Graph 4: Selling price expectations and HICP in services, EU



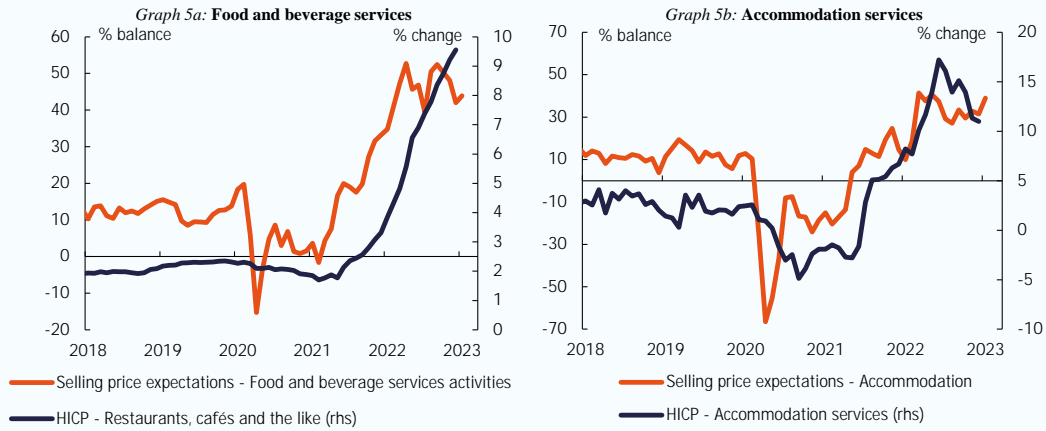
This general picture is the result of different dynamics within the sector. Focusing on specific services activities, clearly geared towards final consumers, the picture is mixed. In food services (like restaurants, cafés), for instance, selling price expectations have remained broadly stable since April 2022, while HICP inflation for the corresponding activities has continued to increase until December (see Graph 5a). This suggests that HICP inflation in this sub-sector may stabilise in the coming months. At the same time, inflation for accommodation services has moderated visibly since July 2022, whereas selling price expectations have remained broadly stable since September 2022, with an uptick in January (see Graph 5b). This suggests that the decline in inflation in these services may come to an end and remain stable or even revert in the coming months.⁽⁶⁾

⁽⁴⁾ 'Non-energy industrial goods and Processed food' HICP is calculated as the weighted average of the two aggregates 'Non-energy industrial goods' and 'Processed food including alcohol and tobacco' as published by Eurostat
⁽⁵⁾ HICP for services is defined as the year-on-year percentage change in the EU HICP special aggregate 'Services (overall index excluding goods)' as published by Eurostat.
⁽⁶⁾ The correlation between selling price expectations in food and beverage service activities and the corresponding HICP series is highest (0.9) when BCS data are six months ahead. In accommodation, correlation with its corresponding HICP series is highest (0.7) when BCS data are three months ahead.

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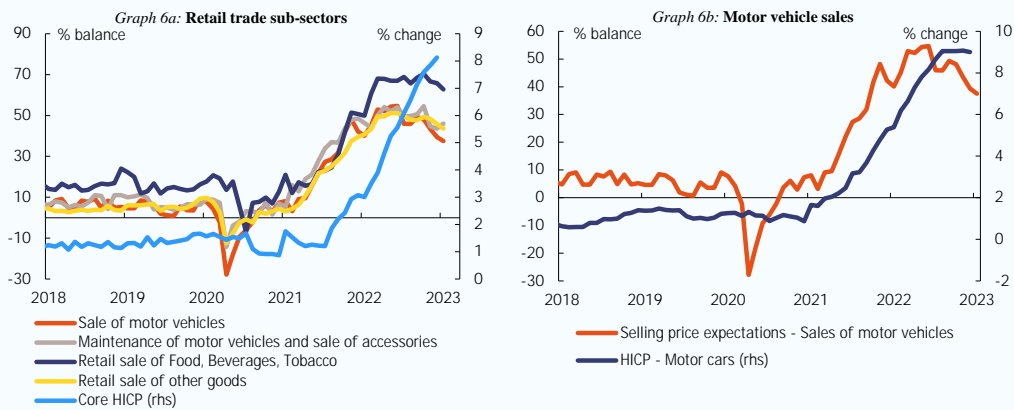
Box (continued)

Selling price expectations and HICP for selected services, EU



Finally, Graph 6a shows that BCS selling price expectations are declining across all the retail trade sub-sectors, largely anticipating HICP core inflation dynamics (for all sub-components excluding retail of fuel). ⁽¹⁾ Zooming into specific sub-sectors (see Graph 6b), the HICP for motor vehicles has remained stable since August, while managers' selling price expectations have been decreasing since July 2022, signalling abating inflationary pressures in the coming months.

Selling price expectations and HICP for selected retail trades, EU



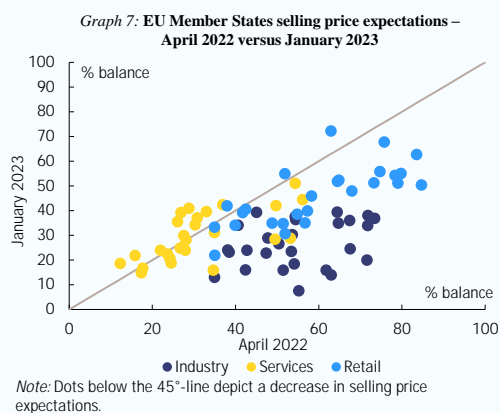
⁽¹⁾ The correlation between retail sub-sectors and core inflation is around 0.8 and highest when BCS data are six months ahead. For motor vehicle sales, correlation with its corresponding HICP is highest when BCS data are two months ahead.

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Box (continued)

Developments across EU Member States

The decrease in selling price expectations since April 2022 is widespread across countries (Graph 7). In industry and retail trade, all countries (except for AT, NL and FR in retail trade) have recorded a decrease in selling price expectations. By contrast, in services, stability of selling price expectations on aggregate in the EU masks some heterogeneity across countries. Expectations have decreased markedly in five Member States (i.e. CZ, EE, IE, HU and PL), have kept increasing in nine, notably in NL, BE and CY, and remained broadly stable elsewhere.



Overall, survey results show an easing in selling price expectations in the sectors producing goods and offering services destined to consumers. This suggests that, in the coming months, pressure on consumer prices should ease also for the corresponding core items of the consumption basket. However, inflation moderation may not materialise soon in the service sector, as selling price expectations, after having peaked, have remained broadly stable.