

RISK&OPPORTUNITIES

Société Générale Economic and Sector Studies

In France, inflation is still mainly imported, for the time being

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For the past year, the widespread rise in prices has fuelled the debate as to its origin: is it an imported phenomenon, resulting from the price shocks experienced by the global economy, or is it also driven by domestic factors, linked to the production process in France? We observe that imported inflation has accelerated sharply since 2019, which is significantly less the case for inflation on domestic production. The heterogeneity of the situations is however marked at the level of certain branches of activity, but the strong variations in the price of value-added observed seem to be mainly the result of external factors. Finally, domestic inflation is more moderate in France and in the so-called “peripheral” economies than elsewhere in the euro area, which reflects a favourable evolution of relative price dynamics for these economies.

Imports, the main driver of inflation

The generalised increase in the price of goods and services is mainly the result of the strong increase in the price of imports, less so of domestic production.

A GENERALISED RISE IN THE PRICE OF GOODS AND SERVICES

Inflation has been vigorous over the past year and is not limited to the prices of goods and services consumed by households (even though this inflation receives a significant amount of public attention). Indeed, the other components of demand (also called “uses” in national accounts), namely investment, government consumption and exports, have shown a marked increase in their prices since 2019.

The evolution of the ratio between values and volumes of each of these uses (also called the “deflator” and here “prices” for simplicity’s sake) shows that goods and services intended for export have become 19% more expensive since 2019; they have been driven by the sharp rise in the price of sea freight and agricultural prices. Similarly, the price of goods and services for investment has risen by 9%, driven mainly by the increase in the price of raw materials (e.g., building materials). Finally, the price of goods and services produced by public administrations has also increased, by 6% since 2019. The pandemic has reduced the volume of production of public non-tradable services (closure of some administrations, museums, etc.), but the

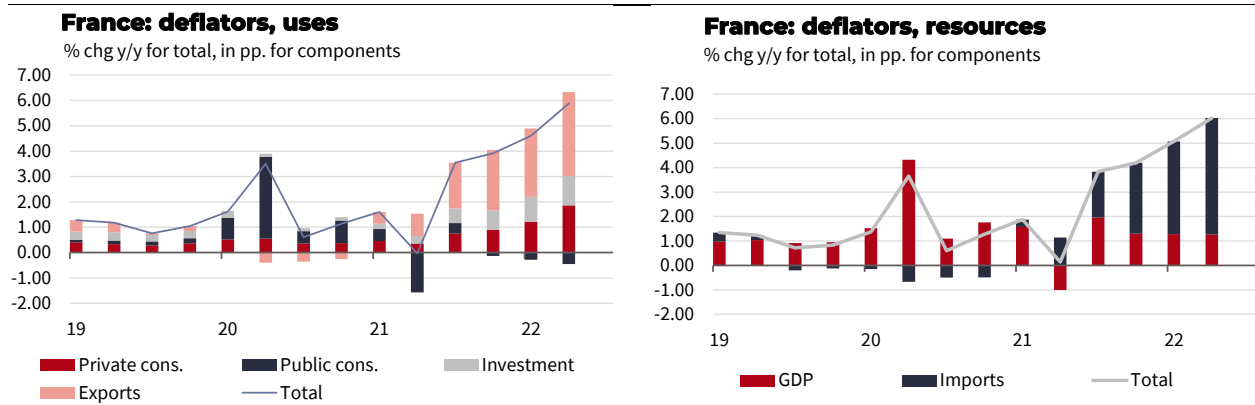
continuation of wage payments in these sectors, largely financed by taxes, has preserved production in value terms. Households and companies have therefore paid as much for fewer services, which is equivalent to a price increase.

In total, the deflators of the various uses have increased at a rate close to or even higher than that of household consumption, which has risen by 7% since 2019.

ALMOST 80% OF THE PRICE INCREASE IS DUE TO IMPORTS

On the supply side (also called “resources” in national accounts), price increases can come from either domestic production (the simplified measure of which is GDP) or non-resident production (imports) or a combination of both. Since 2019, it is the dynamics of import prices that explain most of the inflation experienced by the French economy: the import deflator has indeed increased by 24% over the period, while the GDP deflator has increased by 6%. Once these increases are adjusted for the weight of each resource in total supply, in 1H-22, 80% of the 5.8% increase in the total price of supply over one year is due to the price of imports and only 20% to the price of domestic production. In 2019, before the pandemic, these weights were reversed; the increase in the supply price was also much smaller (of the order of 1% over the year).

In 1H-22, 80% of inflation comes from imports, 20% from domestic production



Source: INSEE, SG Economic and Sector Studies

Interpretation: in 2Q-22, the resource deflator was 6% higher than its level in 2Q-21: GDP contributed 1.2 points and imports 4.8 points. On the use side, the 5.9% increase - by construction identical to that of resources (except for inventories which are not included here and explain the 1/10th difference) - is broken down into: 1.9 points in private consumption, -0.5 points in public consumption, 1.2 points in investment and 3.3 points in exports.

Moderate domestic inflation, with significant industry differences

Domestic inflation is more moderate, but there are heterogeneous situations at the level of certain branches of activity. The marked upward or downward variation in the price of value-added in these branches is mainly due to exogenous factors.

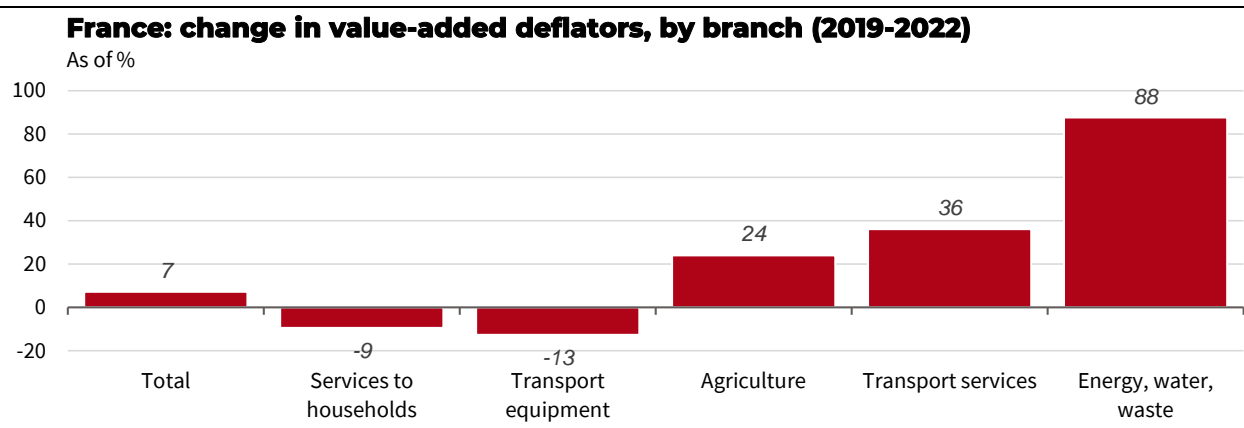
THE PRICE OF VALUE-ADDED UP SHARPLY IN ENERGY, TRANSPORT, AND AGRICULTURE...

Three branches have seen the price of their value-added increase since 2019 at rates much higher than that of the economy as a whole: energy, water, and waste (+88%); transport services (+36%); agriculture (+24%).

In these branches, the price increase is mostly explained by the global supply-demand imbalances caused by the pandemic in 2020-21, reinforced in some cases in 2022 by the repercussions of the war in Ukraine.

The energy, water, and waste industry has thus benefited from the general rise in energy prices (oil, gas, electricity) since 2021. Within the transport services branch, freight transport services were buoyed by the surge in the price of sea freight (the situation was less favourable for passenger transport services). Finally, in agriculture, prices were supported by the combination of a generally poor harvest in 2021 and a strong recovery in demand. This has become more pronounced in 2022 with concerns about the availability of Russian and Ukrainian production. Often, the low demand elasticity of the products of these branches and storage have reinforced the upward movements.

Five branches show a marked change in the price of their value-added since 2019



Source: INSEE, SG Economic and Sector Studies

... AND A SIGNIFICANT DECLINE IN TRANSPORT EQUIPMENT AND SERVICES TO HOUSEHOLDS

At the same time, the price of value-added has fallen quite sharply in two branches: transport equipment and services to households. In the former, prices have fallen by 13% since 2019. This decline hides a heterogeneous situation at the divisional level (motor vehicles, manufacture of ships and boats, railway rolling stock and aerospace construction). For example, while the available data suggest an increase in unit value-added in the automotive sector since 2019, the price of exports of aeronautical equipment fell over this period (before rising again recently) according to customs data, in line with the trend observed at the level of the sector.

In household services, prices fell by 9%. This decrease mainly reflects the decline in household demand for this easily compressible consumption as purchasing power deteriorates. More structurally, the demand for services related to household maintenance and those involving a high level of social interaction (housekeepers, childcare, etc.) has also fallen with the pandemic and the development of teleworking. Finally, the reduction in tax benefits for certain services has also played a role.

Whether up or down, these marked changes in the price of value-added are mainly the result of the exogenous shocks that the French economy has been experiencing for the past two years, in connection with the pandemic and more recently the outbreak of war in Ukraine. None of the sectors affected by a rise in the price of goods have seen a similar rise in unit labour costs.

Relative price developments favourable to the French and “peripheral” economies

Domestic inflation is more moderate in France than in the euro area, even if the latter conceals a great heterogeneity of national situations. In this respect, the recent evolution of relative prices is favourable to the competitiveness of the French and “peripheral” economies compared to the “core”.

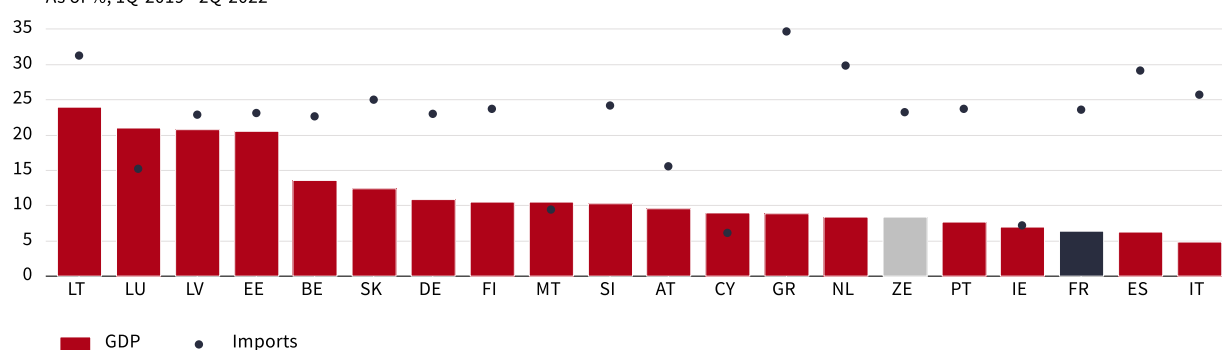
HETEROGENEOUS DOMESTIC INFLATION DYNAMICS IN THE EURO AREA

Since 2019, the French economy has shown more moderate domestic inflation than the average observed in the euro area: the GDP deflator has increased by 8.3% in the euro area since 2019, compared with 6.4% in France. Only Spain and Italy show a more moderate increase, of 5.6% and 4.8%. In Portugal and Ireland, the deflator increased by 6.6% and 7.0%, a pace close to that observed in France.

Domestic inflation is very heterogeneous in the euro area

Euro area: change in deflators, resources

As of %, 1Q-2019 - 2Q-2022



Source: Eurostat, SG Economic and Sector Studies

The average for the euro area hides again a very strong heterogeneity of situations. The rise in the GDP deflator is lower than or in line with the average for the monetary union in France, the Netherlands, and the so-called “peripheral” economies: Italy, Spain, Greece, Portugal, Ireland, and Cyprus. In contrast, most of the so-called “core” economies have seen their domestic output prices rise faster than the euro area average. Within this group, there is also heterogeneity: the increase in the deflator is close to or above 20% in the Baltic States, compared with around 10% in Germany.

RELATIVE PRICE DYNAMICS CURRENTLY FAVOURABLE TO FRANCE AND THE “PERIPHERAL” ECONOMIES

One of the main conclusions to be drawn from the recent evolution of deflators in the euro area is that the dynamics of relative prices have been more favourable to the competitiveness of the economies of the enlarged “periphery” than to those of the “core” since 2019. For example, the ratio of the price of domestic production in Italy to that in Germany has fallen by 5% in two and a half years. This is as much as over the past decade.

The reasons for this divergence in price dynamics remain to be investigated. A comparison of the evolution of GDP and import deflators over the period does not reveal any significant correlation. Italy thus shows one of the strongest increases in the price of imports and the most moderate increase in the price of GDP.

The transmission of imported inflation to domestic production is the result of complex interactions of several factors such as, among others, the degree of fiscal policy interventionism (major over the recent period and very different from one country to another), the dynamics of unit labour costs, the evolution of inflation expectations or the margin behaviour of companies. The evaluation of the respective importance of these factors will allow a better understanding of the recent dynamics of relative prices within the monetary union.

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