



EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-PUBLIC

Christine LAGARDE

President

Ms Henrike Hahn

Mr Ernest Urtasun

Mr Rasmus Andresen

Members of the European Parliament

European Parliament

60, rue Wiertz

B-1047 Brussels

Frankfurt am Main, 18 April 2023

L/CL/23/96

Re: Your letter (QZ-007)

Honourable Members of the European Parliament, dear Ms Hahn, Mr Urtasun and Mr Andresen,

Thank you for your letter, which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 17 March 2023.

The coronavirus (COVID-19) pandemic and Russia's war in Ukraine triggered strong imbalances between demand and supply, and massive cost increases especially for energy. These shocks pushed up prices to unprecedented levels. As I explained during my recent hearing before the Committee on Economic and Monetary Affairs, this price shock should be absorbed in a way that ensures it does not lead to upward spiralling of price and wage adjustments that would endanger price stability.¹ However, the details of burden-sharing between wages and profits are the responsibility of the social partners.

The European Central Bank (ECB) regularly analyses price developments based on a wide range of indicators and this analysis focuses to the same extent on wage and profit developments. At present, the analysis of wage and profit developments is of special importance, particularly for the assessment of underlying inflationary pressures. On the contribution of profits to inflation, our analysis indicates that higher profit margins have played a significant part in the increase in domestic cost pressures in the euro area. Many firms in sectors

¹ See *Speech by Christine Lagarde, President of the ECB, at the Hearing of the Committee on Economic and Monetary Affairs of the European Parliament*, Brussels, 20 March 2023, available at: <https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230320~8cfe38e846.en.html>.

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faced with constrained supply and resurgent demand have been able to increase their profit margins. In the fourth quarter of 2022, unit profits contributed slightly more than half to domestic price pressures, as measured by the annual growth rate of the gross domestic product deflator, while unit labour costs contributed slightly less than half.² Increases in unit profits were particularly strong in the energy, agriculture, construction, manufacturing, and trade and transportation services sectors.

Overall, our analysis suggests that, on aggregate, firms have not absorbed input price pressures through lower margins – a pattern that had been observed in the past – but have instead passed them through to their selling prices. The unusually strong pass-through may reflect reduced pressures from competition in a high-inflation environment characterised by global supply scarcities and rebounding demand after the pandemic. In such an environment, maintaining or expanding profit margins can come without loss of market share.

On data availability and future information gathering activities, the ECB regularly communicates about the underpinnings of its analysis of profit developments and publishes updated assessments, for example in the ECB's Economic Bulletin.³ For our macroeconomic analysis, we rely to a large extent on the data available in national and sectoral accounts. To complement this analysis, we consult additional sources to the extent possible. For instance, we look at more granular micro data⁴, such as firm-level balance sheet data, with results aggregated to the industry level, for which aggregate producer price inflation series are publicly available. We also consider indicators such as survey data on input and selling prices. In summary, as part of our regular assessment of the economic developments in the euro area, we allocate considerable resources to understanding profit developments, and we will continue to do so.

Finally, regarding your question on the dissemination of this information, I wish to highlight that the information from national and sectoral accounts is publicly available. The ECB regularly publishes and comments on the developments of gross operating surplus⁵, which is a profit measure available in the national accounts, in the

² The GDP deflator measures the “price” of total value added per unit of output; it can be decomposed into unit labour costs, gross operating surplus (or profit) per unit of output and net indirect taxes per unit of output. See also Arce, O., Hahn, E. and Koester, G., “How tit-for-tat inflation can make everyone poorer”, *The ECB Blog*, ECB, Frankfurt, 30 March 2023, available at: <https://www.ecb.europa.eu/press/blog/date/2023/html/ecb.blog.230330~00e522ecb5.en.html>.

³ See, for example: “Profit developments in the euro area”, *Monthly Bulletin*, ECB, Frankfurt, August 2008, available at: <https://www.ecb.europa.eu/pub/pdf/mobu/mb200808en.pdf>; “The role of profits in shaping domestic price pressures in the euro area”, *Monthly Bulletin*, ECB, Frankfurt, March 2013, available at: <https://www.ecb.europa.eu/pub/pdf/mobu/mb201303en.pdf>; “How do profits shape domestic price pressures in the euro area?”, *Economic Bulletin*, Issue 6, ECB, Frankfurt, 2019, available at: <https://www.ecb.europa.eu/pub/economic-bulletin/html/eb201906.en.html#DofBox6>; “The role of profit margins in the adjustment to the COVID-19 shock”, *Economic Bulletin*, Issue 2, ECB, Frankfurt, 2021, available at: <https://www.ecb.europa.eu/pub/economic-bulletin/html/eb202102.en.html#toc14>. Additionally, see my reply to your letter (QZ-022), available at: https://www.ecb.europa.eu/pub/pdf/other/ecb.mepletter220916_andresen_urtasun~bc3e7ce2f4.en.pdf?9c4db7a8c5f304b767bee3ab98118a47. See also Arce, O., et al., op. cit.

⁴ See, for example, Kouvaras, O., Osbat, C., Reinelt, T. and Vansteenkiste, I., “Markups and inflation cyclicality in the euro area”, *Working Paper Series*, ECB, Frankfurt, November 2021, available at: <https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2617~e9fc6596e1.en.pdf>.

⁵ Gross operating surplus is the surplus (or deficit) of production activities and represents the remuneration of the production factor capital.

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statistical release on households and non-financial corporations in the euro area⁶. Analyses that rely on firm-level data are based on proprietary data that the ECB must buy from external providers, subject to standard commercial license constraints on dissemination. These data are only available with long delays, usually on an annual basis, and they can only be used to study specific structural issues in depth. These data cannot be used for assessing recent developments.

Yours sincerely,

[signed]

Christine Lagarde

⁶ See, for example, *Households and non-financial corporations in the euro area: fourth quarter of 2022*, ECB, 5 April 2023, available at: https://www.ecb.europa.eu/press/pr/stats/ffi/html/ecb.eaefd_early2022q4~f1878fa0b5.en.html. The quarterly data on gross operating surplus are compiled by the European statistical system and published by Eurostat and the ECB.

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