EUROPEAN CENTRAL BANK

EUROSYSTEM

**ECB-PUBLIC**

*COURTESY TRANSLATION*

Christine LAGARDE
President

Ms Manon Aubry
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 5 May 2023

L/CL/23/104

**Re: Your letter (QZ-010)**

Honourable Member of the European Parliament, dear Ms Aubry,

Thank you for your letter, which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs (ECON), accompanied by a cover letter dated 28 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 cost shocks have been passed through to selling prices, as firms had an incentive to protect, and in some sectors even to increase, their profit margins. On aggregate, the unusually strong pass-through may reflect growing supply-demand imbalances in the post-COVID high-inflation environment characterised by global supply scarcities, rebounding demand after the pandemic and high energy costs. At the same time, higher consumer prices have provided workers with an incentive to increase their wage claims to recoup real wage losses. Both effects are pushing up euro area inflation – a fact that has been clearly reflected in recent ECB publications.[1] The ECB closely monitors developments in underlying inflationary pressures stemming from both wage and profit developments. As I explained in my hearing before the ECON Committee on 20 March, the recent cost and price shocks should be absorbed in a way that ensures they do not lead to an upward spiral of price and wage adjustments,

[1] See for example section 3 on "Prices and costs" in Economic Bulletin Issue 2, 2023, ECB, available at: https://www.ecb.europa.eu/pub/economic-bulletin/html/eb202302.en.html#toc11.

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endangering price stability.[2] However, the details of burden-sharing between wages and profits are the responsibility of the social partners.

As regards monetary policy implications, inflation is projected to remain too high for too long. The ECB is determined to ensure the timely return of inflation to our 2% medium-term target. Higher policy rates increase the cost of borrowing for firms and households, which reduces the amount that people and businesses spend and invest. The resulting dampening in demand puts downward pressure on inflation and ensures that inflation expectations remain anchored at our target. This is how our monetary policy is transmitted to the economy and inflation, irrespective of the source of inflation pressures. Looking ahead, profit margins are expected to weaken over the medium term owing to the monetary policy-induced easing of demand pressures, some catch-up in real wages and further improvements in supply constraints. Finally, to the extent that profits arise due to insufficient competition in certain sectors, the competent competition authorities should take action to enforce prohibitions on the abuse of dominant positions and ensure the removal of undue entry barriers.

Yours sincerely,

[signed]

Christine Lagarde

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2 See transcript of the ECB President's ECON Committee hearing, 20 March 2023, available at: https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230320~8cfe38e846.en.html.

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