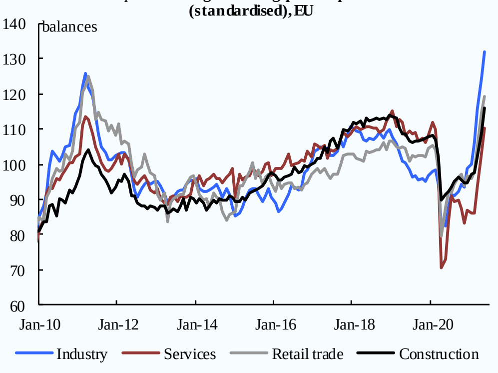
Box 1.1: Selling price expectations of business managers on the rise

Since the beginning of the year, rapidly rising consumer inflation and emerging bottlenecks at different stages of the production chain amid increasing commodity prices have raised the question whether price pressures may eventually feed more strongly into consumer prices. The analysis in this Box takes a close look at the results from the European Commission's monthly business surveys on managers' selling price expectations to provide additional information about potential price pressure going forward. ([1])

Graph 1: **Managers' selling-price expectations (standardised), EU**



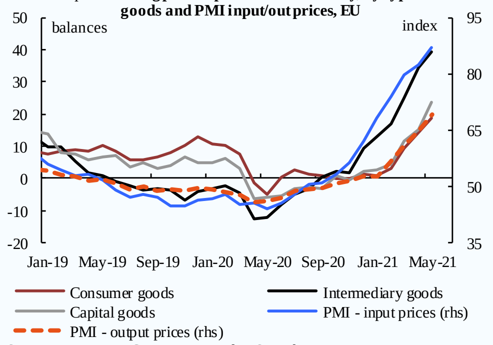
Managers' selling price expectations for the three months following the date of the survey have been on an upward trend across all surveyed sectors (see Graph 1). In industry, this trend was already visible in the final quarter of last year but steepened in the last three months until May, when selling-price expectations reached an all-time high. This increase suggests that the steep rise in industrial producer prices ([2]) visible since the beginning of the year will continue. Marked increases in selling price expectations were reported in all six largest EU Member States. Selling price expectations in construction and retail trade also rose markedly, largely driven by a strong increase in Germany, and are now well above their respective pre-crisis levels. In services, selling price expectations started to rise steeply in March, but have so far remained slightly below their pre-crisis level. The increase was broad-based across the six largest EU Member States.

The results from the Commission surveys are in line with IHS Markit's PMI results for EU output prices ([3]) for manufacturing and services, and euro-area input prices for construction. ([4]) Early survey data releases confirm that the increase in selling price expectations has continued in June. ([5])

A strong increase for industrial intermediate goods

Increases in selling price expectations in industry are broad-based across subsectors, but are particularly strong for intermediate goods, and especially in the manufacture of wood, paper, rubber and plastic products, and basic metals. ([6]) This is consistent with the reading of PMI's industrial input price indicator, and points to price pressures at the early stages of the production chain, potentially feeding into different sectors of activity, including construction (see Graph 2).

Graph 2: **Selling price expectations in industry, by type of goods and PMI input/output prices, EU**



Sources: European Commission and IHS Markit.

Managers' reported intention to charge higher prices may be related to cost factors (i.e. the recent

([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 last available data for PPI in manufacturing in the EU as measured by Eurostat points to a year-on-year growth rate of 4.6% in April 2021.

([3]) PMI questions inquire about current prices compared to the previous month.

([4]) For construction, the PMI price index is available only for input prices in the euro area.

([5]) According to the June Flash release, PMI input and output prices for the euro area increased further in manufacturing and services. Country-specific data from the Commission's business survey programme, released before the cut-off date of this forecast, also indicate further strong increases in selling price expectations in industry, retail trade, construction and, to a lesser extent, services.

([6]) Corresponding to the sectors 16, 17, 22 and 24 of the NACE Rev. 2 classification of activities.

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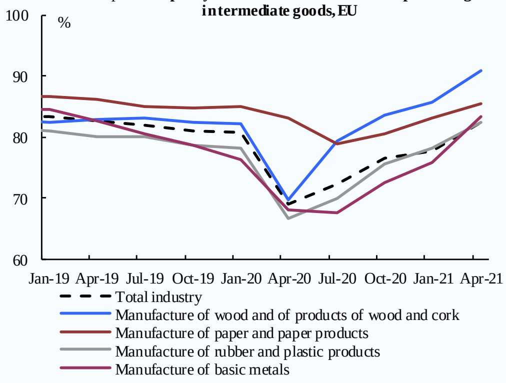
Box (continued)

surge in shipping costs and the increase in commodity prices – see Section 1.3), or the result of the observed bottlenecks in upstream segments of global supply chains (e.g. shortage of semiconductors and cars globally, construction materials in the US, electricity shortages in China) or still, more broadly, stronger demand. In the Commission's business surveys, managers increasingly point to the shortage of material/equipment as the main factor limiting production (see Graph 1.7 in Section 1.5). A number of other indications from the industry surveys are suggestive of price pressure due to high demand. In April, managers' production expectations reached an all-time high and reported capacity utilisation rates were back to pre-crisis levels, or even well above that level in sub-sectors such as the manufacture of basic metals, rubber and plastic products and, in particular, wood (Graph 3). Moreover, the percentage of managers assessing their current order books as more than sufficient (above normal) has been increasing even in subsectors that are currently reporting lower than pre-crisis capacity utilisation levels. This suggests that demand pressure will remain strong in the coming months. Finally, managers' assessment of their stock of finished products has reached an all-time low in May 2021, suggesting a role for both demand and supply factors in shaping price developments.

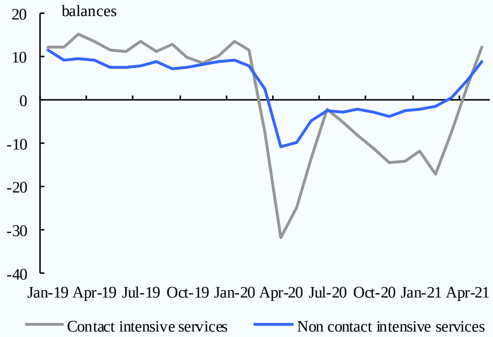
Graph 3: **Capacity utilisation in selected sectors producing intermediate goods, EU**



Developments in the services sector

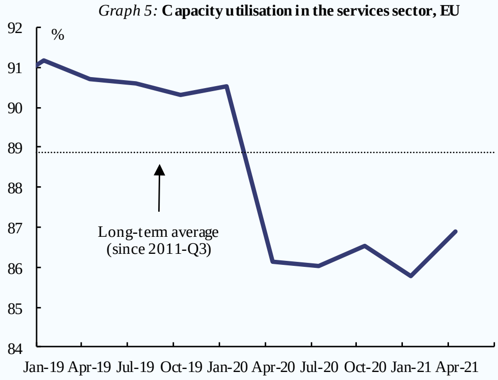
The striking increase in selling price expectations in services registered over the last three months was driven by contact-intensive services such as accommodation, restaurants, and travel-related services, which started re-opening recently (Graph 4). Managers in these particularly affected activities had revised their selling price expectations sharply downward in the two lockdown periods of spring 2020 and last autumn/winter. As the restrictions started being lifted, their selling price expectations have been on the rise, as had been the case in spring/summer 2020 after the first lockdown. Overall, they are now broadly at pre-crisis levels in both contact and non-contact intensive services activities.

Graph 4: **Selling-price expectations in the services sector, EU**



As regards factors limiting business activity, services managers do not currently signal shortage of space or equipment (see Graph 1.7 in Section 1.5). Despite the uptick in labour as a limiting factor in April, the percentage of managers reporting labour shortages is still well below the pre-crisis level. Similarly, while capacity utilisation (7) in the services sector started to recover at the beginning of the year, it is still well below both its pre-crisis level and long-term average (see Graph 5).

Graph 5: **Capacity utilisation in the services sector, EU**



(7) Capacity utilisation in the services sector is inquired by asking managers whether the volume of activity could be increased with present resources and, if so, by how much. The measure of capacity utilisation is then calculated as $CU = \frac{1}{1+percentage\ \ of\ increase}$

(Continued on the next page)

Box (continued)

However, demand expectations have been increasing since March, bringing the indicator above its pre-crisis level. Currently a clear majority of managers expect an increase in demand for the coming months, which could indicate further pressure on prices going forward.

Developments in the retail trade and construction sectors

Selling price expectations in construction and retail trade have significantly increased since April, driven by a surge in Germany. In construction, the increase appears to be a result of raw material shortages, especially in Germany. Unlike in other sectors, managers in the construction sector do not expect a large increase in demand and report past demand as still below its pre-crisis level.

By contrast, in retail trade, increasing selling price expectations appear to be mainly due to returning demand. As COVID-restrictions are being lifted, retailers assess their past business activity as back on track and expect further improvement in the coming months.

Overall, according to the Commission's business surveys, upside pressure on prices appears to be a response to shortage of material/equipment and broad demand pressures, as highlighted by increasing capacity utilisation and orders and low levels of stocks. However, in the services sector, survey results suggest that price pressure remained overall contained in May. Still, with demand returning forcefully to certain contact-intensive services after a protracted standstill, shortage of labour may temporarily push up prices in contact-intensive activities further.

1.6. THE OUTLOOK

1.6.1. Economic growth outlook

The European economy is expected to have moved onto its recovery path in the second quarter of this year at a stronger pace than projected in the Spring Forecast. Economic activity in the EU is forecast to grow by 1.3% in the second quarter, before accelerating to 2.7% in the third, on the back of continued easing of containment measures and strong resumption of social activities (see Box 1.2). The growth momentum is forecast to ease but to remain solid in the fourth quarter (1.2% q-o-q), also on the back of tailwinds from external demand. Compared to the spring projections, the stronger rebound that is now expected in the second quarter anticipates some of the bounce-back that was projected in the third.

Growth is expected to be led by a sustained rise in consumer spending, as a broad spectrum of spending opportunities become available again and household purchasing power is supported by resilient disposable incomes, and the large stock of savings accumulated during the lockdown periods. As uncertainty fades, employment is expected to move in tandem with economic activity, initially mainly through recovering average hours worked.

As idle capacity in manufacturing continues to shrink rapidly and profitability recovers amid reviving demand, investment is expected to continue performing strongly. While risk aversion and a weaker financial position of some firms may hold back its momentum, corporates are set to significantly benefit from an expected strong impulse provided by projects implemented in the context of the Recovery and Resilience Facility with increasing intensity over the forecast horizon.

As highlighted in Section 1.3, the ongoing upswing among the EU's major trading partners offers further traction to European export growth, particularly for goods. Production constraints in some sectors, however, are expected to hold back its momentum in the very short-run. Given remaining impediments to cross-border movement for tourists originating from outside the EU, exports of services are still projected to lag behind.

All in all, the EU and euro area economies are forecast to grow by 4.8% in 2021. The rebound benefits from the substantial carry-over effect from the previous year, the strong pick up in private consumption, as well as the impact of the Recovery and Resilience Facility from the second half of the year. In 2022, real GDP is projected to grow by 4.5% in both areas, again helped by a significant carry-over.