



# To the point!

Cross-Asset- and Strategy-Research

## Prevent a price-profit-wage spiral of inflation

Firms and workers both have to make compromises

The driver of the recent surge in inflation in the euro area, but also elsewhere, was a meteoric rise in energy prices. And not just since the brutal invasion of Ukraine. Prices for gas and electricity had already risen significantly in 2021. Energy prices have now been falling from their peaks last summer. In March, energy prices even contributed negatively to euro area yearly inflation.

So why is inflation still so high? This can be explained simply: In the wake of rising energy prices, the prices of other goods and services also increased, and not only because everything we consume has an inherent energy component. Food example: Fertilizer, tractor fuel, processing, cooling, and transportation all use energy. Food is currently the main driver of inflation.

### The first leg of inflation: Price-profit spiral

But that is only half the truth. Companies, as well as retailers, have taken advantage of inflation to dig deeper into their customers' pockets. After all, when everything around is getting more expensive, it becomes increasingly difficult for consumers to judge which price increases are disproportionate. Many companies have therefore raised [prices above what would have been necessary to pass on their own rising costs](#). As broken supply chains reduced competition between suppliers in the past year (some simply couldn't deliver!), pricing power increased.

This explains why, for example, DAX companies as a whole increased sales and profits last year despite the war and inflation.

### The second shoe is yet to drop: Price-wage spiral

"Wait a minute, that's totally unfair!" you may be saying here. Sure, it is, because the price-profit nexus is one-sidedly at the



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Many companies have hiked their mark-ups

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expense of consumers and workers. That's why, completely predictably, wage demands are now increasing. This is intended to offset the loss of real incomes. The unions' wage ambitions are just as understandable from the employees' perspective as were the companies' exploitation of their pricing power.

### All have to lose a little

The partial logics of corporations and unions add up to an inflationary spiral. Let's remember: Inflation was fed by higher energy prices. However, Europe imports more than half of its energy, Germany even around [70%](#). This means that we have lost prosperity. Part of our wealth is now in Qatar, Norway, Abu Dhabi and wherever else we import energy from.

If we have become somewhat poorer as a society as a whole, then it is a logical impossibility that companies and employees will both be able to put themselves back in the same position of prosperity they had been in before energy inflation. After all, the cake to distribute has become smaller.

An "eye for an eye" approach, where neither party is willing to accept some loss of prosperity is not only inconsistent with the new reality, it also leads inevitably to unremitting inflationary pressures. The ECB would then be forced to tighten interest rates even more and longer to combat the price-driving distributional struggle. The economy would suffer, and ultimately everyone would lose. Therefore, please apply moderation! Not only the unions, but also the companies.

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Now workers demand that their loss of income is offset

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Energy inflation has left us poorer. This loss of prosperity needs to be distributed fairly

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