

Is 'Greedflation' real?

Prices remain stubbornly high in many economies, but are inflated profit margins to blame?

Prices have peaked in economies around the world thanks to high energy and raw material prices and rising labour costs.

Hit by a perfect storm of cost pressures, many businesses have been forced to share the pain with consumers in the form of higher prices.

But is that all they've been doing? There are increasing claims and interventions by governments suggesting that companies are using a high inflationary environment, fuelled by the Covid pandemic and war in Ukraine, to push profit margins higher.

In this article we look at the data to assess if 'greedflation' is real. Are businesses actually a cause of inflation, rather than victims of it?

Inflation is falling but remains high

Inflation has certainly been high, though it is now falling around the world. Eurozone inflation fell to 6.1% in May, a significant fall from a high of nearly 10% in 2022.

At the same time, the US inflation rate edged lower to 4.9% in April, the lowest level since April 2021.

But while inflation is falling, it remains well above target levels. Wages are also rising as consumers struggle to meet daily outgoings.

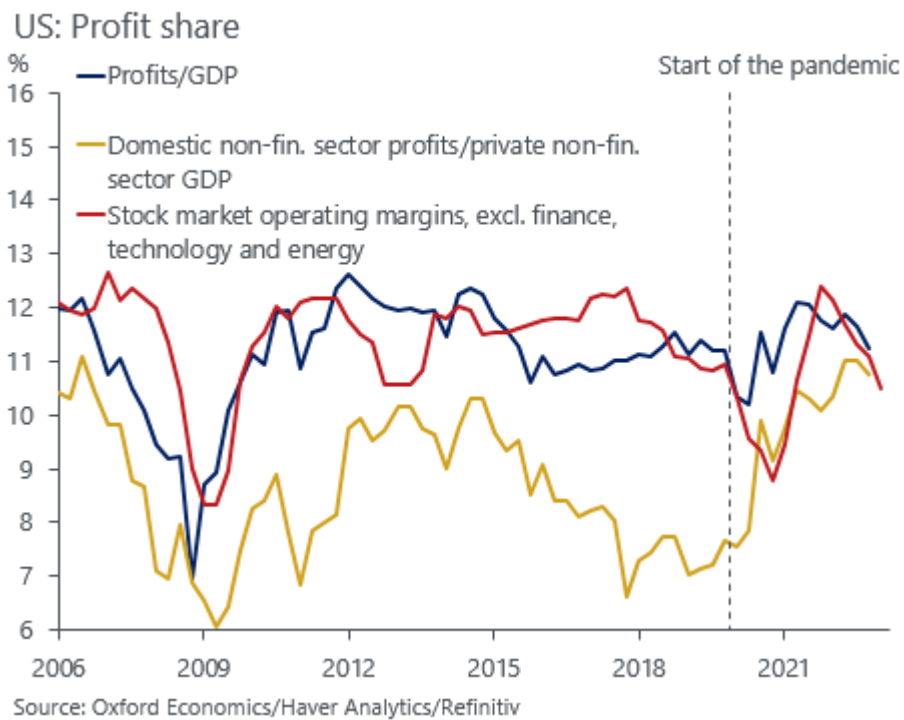
"In the short term we expect inflation to remain sticky," says Theo Smid, economist at Atradius. "It is likely to remain above the target of 2% in the next two to three years, but we do expect it to gradually move back towards the target."

What of the possibility of a wage-price spiral? "We do not expect a long-lasting, self-reinforcing wage-price spiral to emerge," says Theo. "It's more likely that nominal wages will rise in the coming period to compensate for the initial price shock, and that this effect will fade over time when inflation starts to fall again."

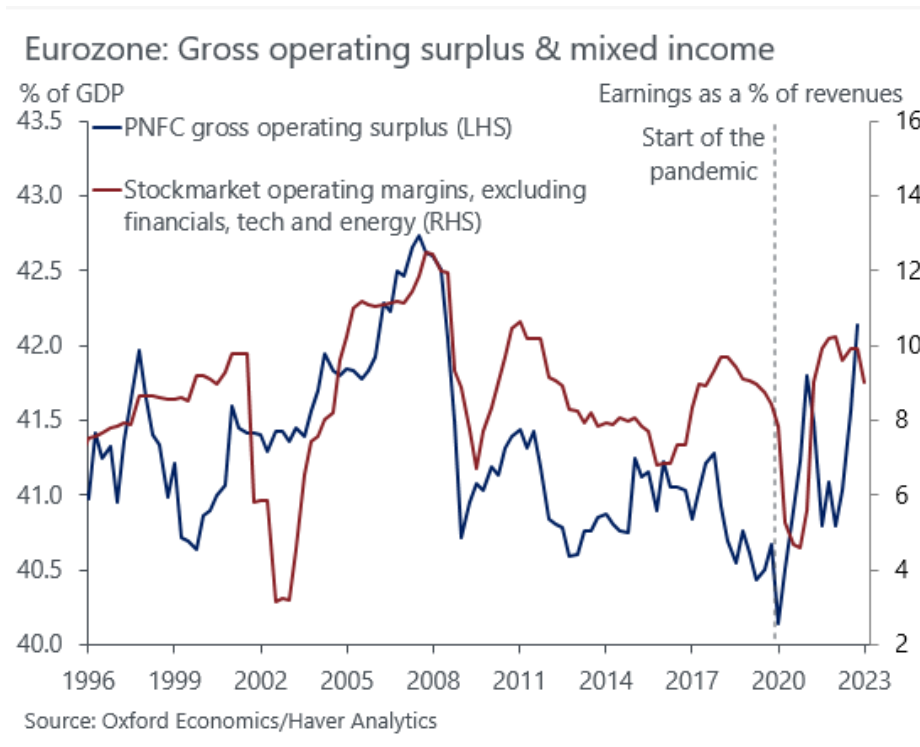
Are profit margins driving inflation?

Food and energy inflation, exacerbated by the war in Ukraine, has played a large part in keeping prices well above pre-pandemic levels. But are rising profit margins also to blame?

Certainly, profit margins have increased on average in both the US and the Eurozone since the pandemic. Many companies are making more money, despite high raw material, energy and labour costs.



But the data shows that profit margins, particularly in the US, are now on a downward trajectory.



That is not true everywhere. Recent figures from the UK suggest that, with the exception of oil and gas companies, most businesses had not seen high inflation translate into excessive profits.

Nevertheless, there is evidence that in some countries, and in some sectors, businesses have used the public's expectation of price rises to drive revenue.

"In the US and Eurozone there is evidence that companies used their increased market power, stemming from strong demand for services and goods and more acceptance of higher prices by customers, to increase their profit margins in the second half of 2022," says Theo.

But the wider effects are likely to be limited. "On balance we don't think that profits have been the main inflation driver in any of the advanced economies and that margin compression is likely to have already started," Theo adds.

Like inflation, profit margins are now on a downward curve, and any effects of greedflation will be temporary. As wages rise, companies are likely to absorb at least some of the extra cost themselves.

Are governments acting on greedflation?

Rising profit margins can be a challenge for economies, and a challenge for governments trying to manage them.

Social well-being (and government popularity) is undermined when basic life essentials - like food and energy - become less affordable for significant sections of the population.

In addition, when prices rise for necessities, discretionary spending falls. Leisure and entertainment sectors suffer. Major purchases are abandoned or delayed. That can impact economic growth.

Governments can act against this in a number of ways, including taxing profits and imposing tariffs. At the moment, most are content to issue warnings.

In France, for example, the government is urging supermarkets and suppliers to negotiate lower prices for consumers, and manufacturers to pass on reduced production costs. The government wants to see “concrete, tangible decreases” in prices and has indicated that it is prepared to consider sanctions against companies that “do not play the game.”

In Spain, the Ministry of Economic Affairs has threatened to publicly expose businesses that are profiteering from the cost of living crisis, by making profits data more available.

In the UK, the government is considering asking retailers to cap the price of basic items. But price controls are an extreme measure and are vehemently opposed by retail bodies.

What is the outlook for profit margins?

Governments will hope that, as profit margins in most economies begin to fall, punitive measures will not be necessary. Theo predicts a gradual return to some kind of economic normality.

“We believe the current situation is temporary and that signs of a rebalancing - where companies and consumers absorb their fair share of the pain of inflation - is already happening,” he says. “As supply chain disruptions ease, things should slowly start to return to normal.”

Geopolitical turbulence means that further price shocks cannot be entirely ruled out, and inflation may take longer than normal to return to target levels. But, while the evidence for greedflation is real, it is unlikely to be playing a significant role in keeping prices stubbornly high.