

Eurozone Inflation Forecast to Stay Higher for Longer as Gas Prices Surge

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Many economists predict that consumer prices will exceed 10% this year, and that recession will hit the bloc in 2023

Eurozone inflation will hit a double-digit rate in the autumn and remain higher for longer as a result of the surge in gas prices, economists have warned.

The higher inflation expectations are adding pressure on the European Central Bank to consider a bigger rise in interest rates despite many economists forecasting an increasingly deeper recession as soaring energy prices hit business and consumer activity.

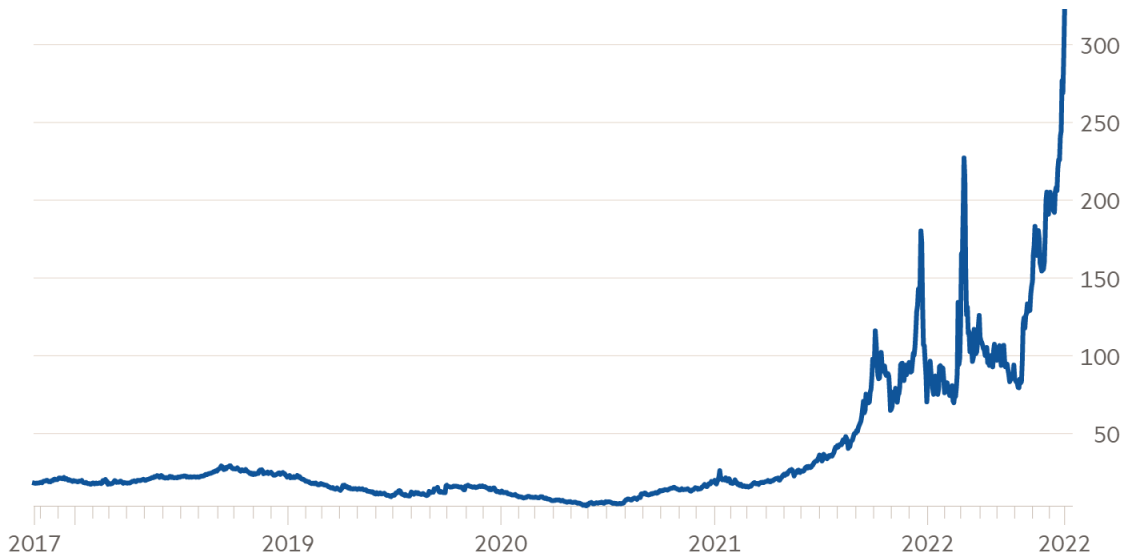
ECB policymakers warned at last weekend's gathering of central bankers at Jackson Hole, Wyoming, that greater sacrifices in terms of lost growth and jobs will be needed to bring inflation back under control.

The European gas price last week hit a record of €343 per megawatt hour, more than double the figure at the end of July and seven times the price in the same period last year. Reduced flows of Russian gas have increased fears of shortages, with the EU preparing emergency measures to curb soaring prices.

Many economists, who have also revised up their inflation forecast for next year, now predict that the annual change in consumer prices will accelerate from July's record level of 8.9 per cent to above 10 per cent in October. They expect August's inflation figure, to be released on Wednesday, to reach 9 per cent.

European gas futures have surged

NYMEX Dutch TTF natural gas front-month price (€ per megawatt hour)



Source: Refinitiv
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“The surge in gas prices deals a new severe blow to the European economies,” said Holger Schmieding, chief economist at financial company Berenberg. “Higher prices for consumers and higher costs for companies will deepen the recession and worsen the inflation outlook.”

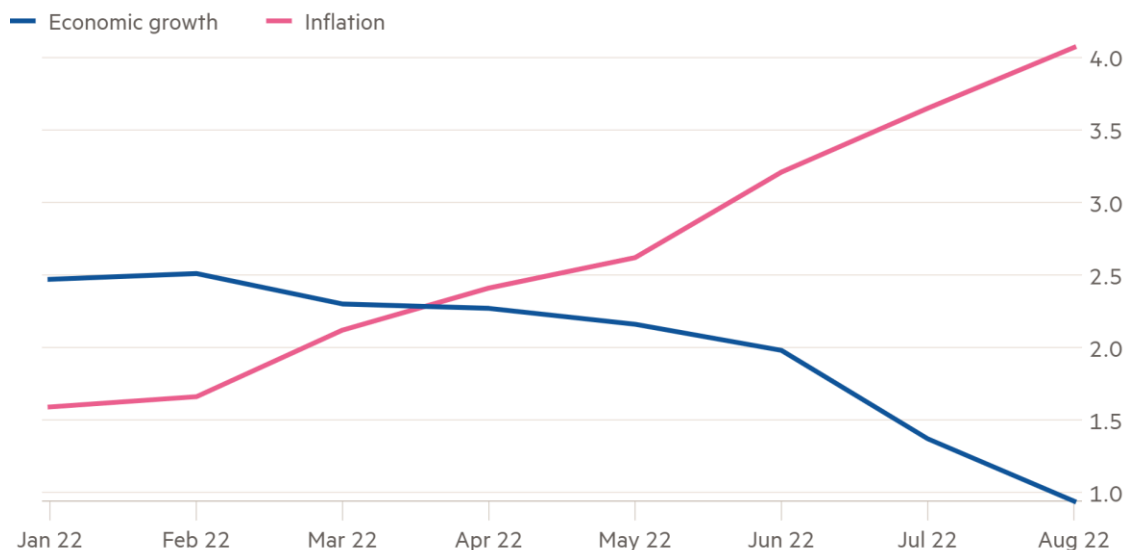
Economists surveyed by Consensus Economics this month revised up their eurozone inflation forecasts for 2023 to an average of more than 4 per cent, double the ECB’s 2 per cent target and nearly a percentage point higher than the average forecast in June. That month the ECB predicted that inflation would fall to 3.5 per cent next year; it will update its forecast at the next meeting on September 8.

The economists’ consensus forecast for eurozone gross domestic product in 2023 has become increasingly gloomy, with growth expectations halved from June to less than 1 per cent.

Many are more pessimistic. Schmieding revised down Berenberg’s forecast for 2023 eurozone GDP to a 1.5 per cent contraction, while raising inflation expectations for that period to 6.1 per cent, from 5 per cent.

Economists are revising up their 2023 inflation forecast while the economic outlook becomes gloomier

Inflation and GDP growth forecasts for 2023, by date of forecast



Source: Consensus Economics

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“A full pass-through” of wholesale gas prices of about €200 per MWh would add 7 to 8 percentage points to German inflation, Schmieding said. But the additional pressure would be diluted by long-term gas contracts, delays in higher prices passing through the production process, businesses absorbing some of the costs and government mitigation measures, he added.

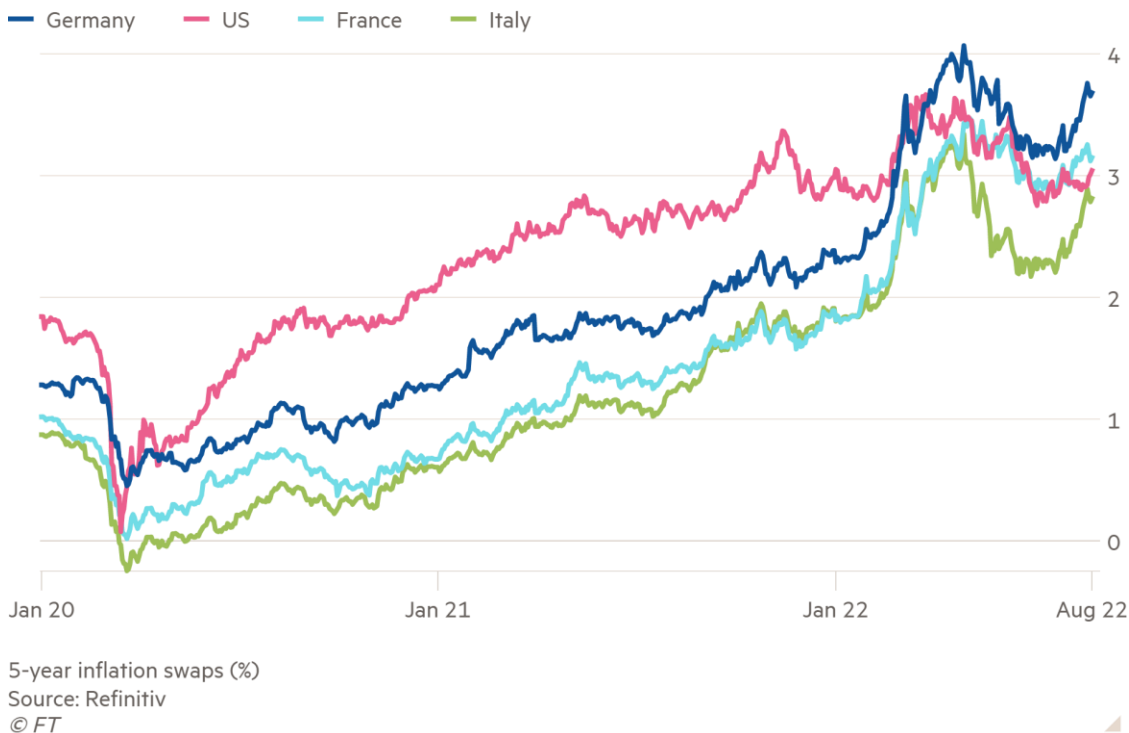
After countries were boosted by a resurgence in tourism this summer, the eurozone’s GDP “will likely contract significantly until spring 2023 as private consumption, business investment and exports fall”, Schmieding said.

The impact of surging gas prices on eurozone growth could be long-lasting, warned Andrew Kenningham, chief Europe economist at Capital Economics.

“The eurozone is less likely to regain its pre-pandemic trend growth rate because there will be some permanent loss of competitiveness which will lead to some loss of activity, especially in sectors such as metals and chemicals,” he said.

The five-year inflation swaps rate, a market indication of where inflation will be in five years’ time, has been rising in the eurozone in the past few weeks.

Market expectations of average inflation over the next five years have risen



Giada Giani, economist at Citi, expects eurozone inflation to peak at 10.3 per cent in the autumn with higher energy costs and the euro's fall to below parity with the dollar contributing to higher consumer prices.

She noted that “more importantly, the whole inflation trajectory for 2023 has shifted higher”, with Citi's 2023 average now at 6.2 per cent, up from 4.8 per cent in July with higher prices for items such as food and energy-intensive services embedded into the new projections.

While the largest upward revisions in inflation were forecast for Germany, the Netherlands and Spain, many economists noted that the policy response will be vital to managing energy price growth.

Germany, for example, is planning an extra gas levy from October, although the impact on households will be partly offset by a cut in VAT on gas sales. But several other temporary measures by governments to cushion the blow of high prices, such as Germany's €9 monthly train ticket that expires on September 1, are due to end soon, which could push inflation even higher.

Additional reporting by Martin Arnold in Frankfurt

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