Profits are driving inflation. When will politicians an...

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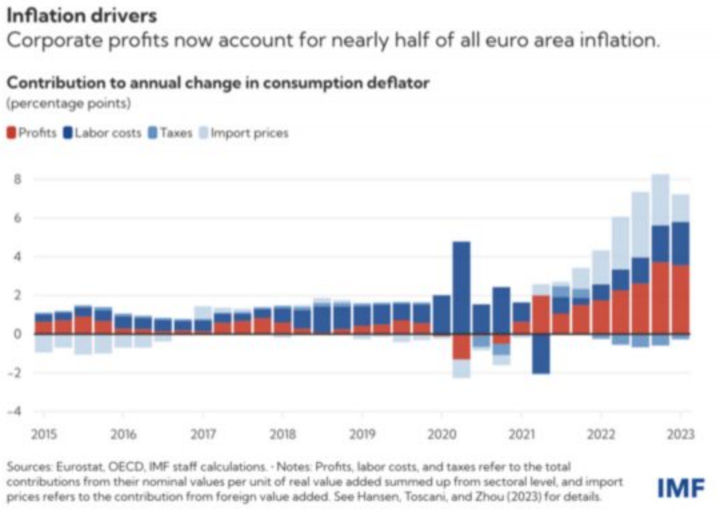
As the IMF has just reported:

Rising corporate profits account for almost half the increase in Europe’s inflation over the past two years as companies increased prices by more than spiking costs of imported energy. Now that workers are pushing for pay rises to recoup lost purchasing power, companies may have to accept a smaller profit share if inflation is to remain on track to reach the European Central Bank’s 2-percent target in 2025, as projected in our most recent World Economic Outlook.

I stress, this is the euro area. It does not change my suggestion on the role of interest rates, which are a peculiarly UK phenomenon. But this chart is still telling:



Wages have driven only a small part of inflation in Europe. I also suspect that is true here too.

I also note that the IMF say:

Europe’s businesses have so far been shielded more than workers from the adverse cost shock. Profits (adjusted for inflation) were about 1 percent above their pre-pandemic level in the first quarter of this year. Meanwhile, compensation of *employees (also adjusted) was about 2 percent below trend.*

This does not necessarily mean profits have risen, but there has been a major shift in the distribution of rewards.

As they also note:

Assuming that nominal wages rise at a pace of around 4.5 percent over the next two years (slightly below the growth rate seen in the first quarter of 2023) and labor productivity stays broadly flat in the next couple of years, businesses' profit share would have to fall back to pre-pandemic levels for inflation to reach the ECB's target by mid-2025. Our calculations assume that commodity prices continue to decline, as projected in April's World Economic Outlook.

Should wages increase more significantly—by, say, the 5.5 percent rate needed to guide real wages back to their pre-pandemic level by end-2024—the profit share would have to drop to the lowest level since the mid-1990s (barring any unexpected increase in productivity) for inflation to return to target.

In other words, the correct call for those now wanting to maintain purchasing power in the economy whilst controlling inflation (which together are a totally reasonable goal) is for profits to be sacrificed now to restore appropriate wage rates.

Very oddly we are hearing nothing like that from the Bank of England, politicians or supposed economists in the UK. You would think they all agree wage-earners should suffer instead. But at least their agenda is becoming increasingly clear.