

Presidency Issues Note for Ministers' Working Lunch: ADDRESSING RISING COSTS FOR HOUSEHOLDS AND BUSINESSES – NATIONAL EXPERIENCES AND CONSIDERATIONS

Introduction

Although the EU economy entered 2023 on a healthier than expected footing, inflation remains elevated and there is still high uncertainty regarding its persistence. To counter high inflation, central banks have raised policy rates at a historically rapid pace. The strain inflation has put on vulnerable households and businesses has led to significant challenges for national policymaking as governments have sought to provide financial aid without contributing to inflationary pressures. In addressing these challenges and partly conflicting policy goals, discussions both in the Eurogroup and the Ecofin over the last year have proven valuable to share experiences and lessons learned between Member States. As the economic conditions and challenges develop, a continuous dialogue between Member States is warranted in order to ensure effective and well targeted policy responses.

Inflation development in the European Union in the past two years

Inflation in the EU started to increase considerably from the second half of 2021 and reached its peak in October 2022. While all Member States have experienced high inflation during 2022, the magnitude of the price changes varied significantly. Higher input prices, such as high energy costs, coupled with supply chain disruptions and a strong domestic demand in the wake of the end of the COVID-19 pandemic led to a rapid rise in the prices of goods and services during 2022. The price of food and non-alcoholic beverages has increased by almost 12 percent in 2022 (as measured by HICP), which is several times higher than the average annual price increase of 2.3 percent between 2001 and 2021. Energy prices have however decreased since November 2022, and this has brought lower overall HICP-inflation in the EU the past few months. Nevertheless, core inflation, which has been more persistent than anticipated, has not yet come down.

Challenges stemming from the current inflationary situation

The rapid increase in inflation has affected the EU economy in several ways. In the short run, already vulnerable households now find it more difficult to afford their basic cost of living and many businesses have experienced difficulties carrying out their core operations. If high inflation were to become entrenched, there is a risk for long-term negative effects.

The effects on households and businesses are felt both through higher energy and food prices and higher interest rates. For vulnerable households with the smallest margins, this creates a particularly difficult situation. The urgent, short-term challenge is to protect this group through targeted fiscal measures whilst simultaneously not putting upward pressure on inflation. If not properly calibrated, there is a risk that measures intended to be a relief to vulnerable groups and sectors may distort price signals and delay necessary structural adjustment. Moreover, a lack of targeting brings substantial deadweight losses and overall fiscal costs, possibly even complicating the funding of future-oriented expenditure.

Apart from budgetary support to households and businesses, there are other important policy options. Rapid and potentially unwarranted price rises make taking action against market distortions and inefficient competition a priority. A high energy intensity in the economy amplifies inflation, strengthening the case to improve energy-efficiency. Wage negotiators face a difficult trade-off, when having to respond to demands for alleviating the fall in real wages while trying to avoid contributing to a wage-price spiral.

In addressing these challenges, it is important to build on our shared experiences. Many measures have been introduced in the Member States over the past year. It is valuable to discuss what the outcome of these has been as well as what considerations should be taken into account in designing effective and targeted measures suited for the economic reality we face.

Questions for discussion:

- How do you view the balance between supporting households and businesses and the risk of putting upward pressure on inflation, as well as the risk of disrupting market mechanisms?
- What measures beyond budgetary support to households and businesses can be taken to tackle the challenges posed by high inflation? Do you have national experiences and examples to share?
- How can public understanding of the fiscal trade-offs best be ensured?

