Briefing
17 November 2022

Cost of living – key messages on inflation and taxation

Key messages

Rising inflation is impacting consumer purchasing power amidst a global economic downturn and the prospect of recession in Europe. Key factors underlying current record inflation include increased costs of energy and commodities, supply chain disruptions and labour market shortages, factors all exacerbated by the impact of the Russian invasion of Ukraine.

Consumers are changing their shopping habits as the cost-of-living crisis and skyrocketing energy and petrol bills reduce their purchasing power.

Retailers and wholesalers are facing demands by their suppliers for significant price increases, often beyond the rise in suppliers' input costs. Our sector has been seeking to limit these increases, including by absorbing some extra costs, to ensure competitive prices for consumers. However, low retailer margins and declining sales mean that the scope for doing so is limited. The sector is facing a massive challenge as the cost of energy needed to maintain cooling, heating, ventilation and refrigeration in their premises goes up. The current crisis comes while business recovers from COVID-19 and seeks investments to meet the twin green and digital transition.

To face the current situation we ask European and national authorities to:

- **Mitigate inflationary pressures through fiscal measures and state aid support** so that the sector can minimise the impact on consumers.
- **Preserve a strong competitive single market** as key to Europe's recovery and the best guarantee for food security and consumer welfare in the form of affordable prices for consumers, choice and innovation. These elements should remain central to the current competition review process and priorities in enforcement.
- **Reconsider unnecessary trade defence measures** raising EU prices for products where there is insufficient supply from the EU, and challenge trade measures incompatible with WTO rules leading to artificially high prices for some commodities and inputs to EU industry. Diversification in sourcing (including for raw materials) can prevent disruptions and preserve food security.
- **Refrain from interfering in the process of setting prices of foods** beyond the existing CAP mechanisms; limiting retail price competition risks further strengthening the margins of already very profitable large manufacturers[1] at the expense of consumers, and with no benefit to farmers.
- **Take action against market fragmentation by large brands** (territorial supply constraints or 'TSCs') costing consumers at least € 14 billion a year[2] and **unfair industry practices** like unjustified price increases and delivery stops, which lead to higher prices and less choice for consumers.
- **Avoid new or delay planned burdensome fiscal or regulatory initiatives** which increase administrative costs for the retail and wholesale sector.
- **Avoid regulatory initiatives which weaken competition or exploit consumers**, for instance those allowing unjustified selective distribution systems or unfair price discrimination.
- **National governments should not impose any additional taxes.** Retailer and wholesaler margins are shrinking, and high turnover does not mean high profits.

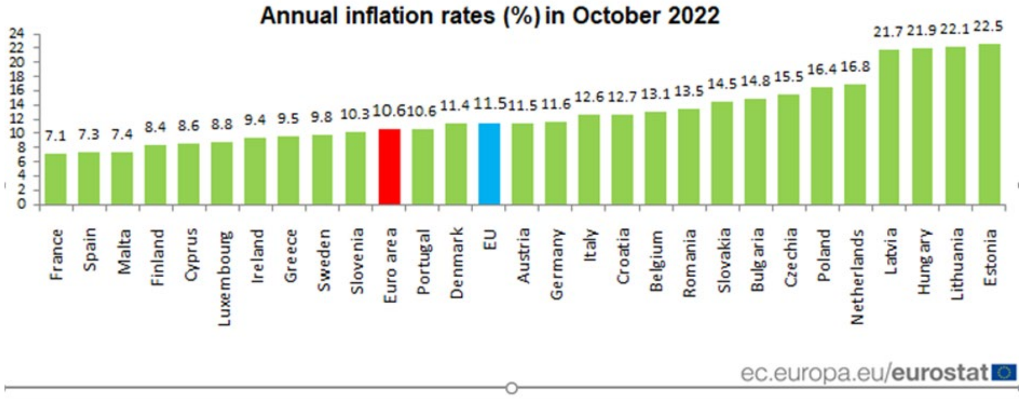
[1] Between 2016 and 2020 alone, the TOP 50 brand manufacturers were able to further increase their average profit margin from 16.4% to 18.7%: https://www.occstrategy.com/media/2725/occ-fmcg-global-50-2020_ready-for-the-storm_online.pdf
[2] European Commission *Study on territorial supply constraints in the EU retail sector: Final report* (2020), page 87.

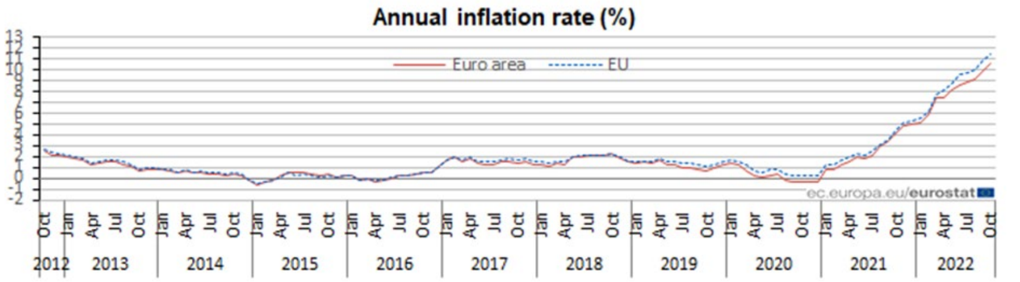
Background

The current economic context

1. Inflation in Europe is at its highest ever since the creation of the euro[3]. Euro area annual inflation was at 10.6% in October 2022, up from 9.9% in September 2022; in December 2020, the rate was 0.2%.

2. Key factors fuelling inflation include energy costs[4], costs of raw materials, followed by prices of services and industrial goods: in October 2022, the largest contribution to annual euro area inflation rate was from energy.[5]





3. The OECD's latest Economic Outlook projects global growth to decelerate sharply to around 3% this year and 2.2% in 2023.[6] Central banks across the globe increased interest rates.[7] Rising inflation and commodity prices, labour shortages and disruptions in global supply chains are adversely impacting supply chains in Europe for both food and non-food products:

4. The economic outlook worsened following the Russian invasion of Ukraine in February 2022. In relation to energy, the latest figures for gas futures for the winter 2022/2023 averaged 234.50 €/MWh.

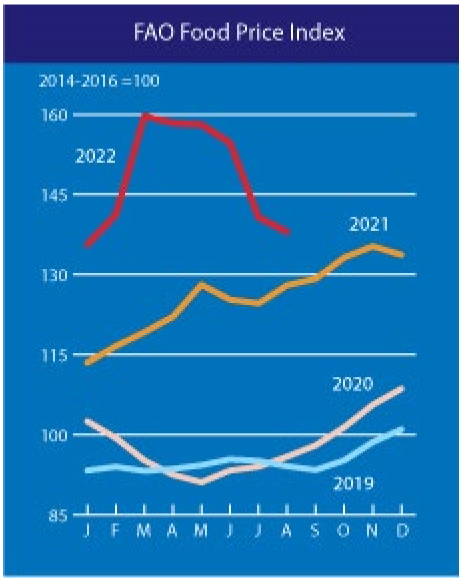
5. The EU is also experiencing gas supply cuts from Russia, with almost half of Member States already affected by reduced deliveries. The EU continues to take action to reduce dependency from Russian gas and reduce use by 15% before spring 2023.[8]

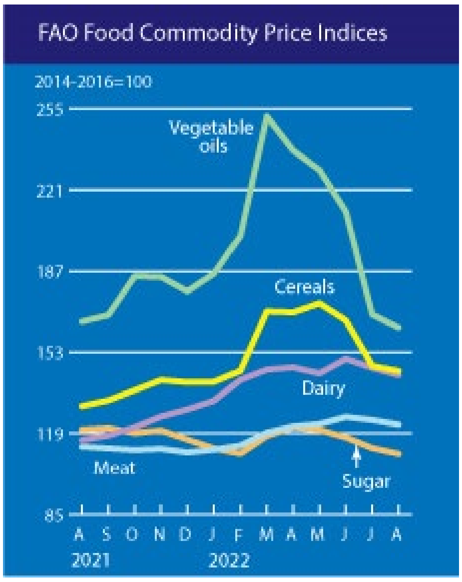
[3] Eurostat data, available here: b6953137-786e-ed9c-5ee2-6812c0f8f07f (europa.eu).
[4] When presenting a package of measures to face high energy price increases in October 2021, the European Commission indicated that wholesale electricity prices had increased by 200% on a yearly basis: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021DC0660&from=EN.
[5] https://ec.europa.eu/eurostat/documents/2995521/15265521/2-17112022-AP-EN.pdf/b6953137-786e-ed9c-5ee2-6812c0f8f07f?t=1668599256161.
[6] https://www.oecd.org/economic-outlook/september-2022/.
[7] https://www.mckinsey.com/featured-insights/inflation/how-inflation-is-flipping-the-economic-script.
[8] See the RePowerEU plan: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2022%3A230%3AFIN&qid=1653033742483 and the Save Gas for a Safe Winter proposal: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_4608.

6. The Russian invasion of Ukraine unleashed massive challenges in the food supply chain beyond spiralling energy costs: increasing prices for key inputs (animal feed, fertilisers) and scarcity of certain commodities (e.g. vegetable oils) needed to maintain a fully functioning supply chain. The knock-on effect of the rising costs is leading to decisions to cut production of fertilisers, which shall drive price increases further. The droughts experienced in the summer of 2022 across Europe may lead to further shortages.

7. The consequences of Russia's actions in Ukraine are compounded by the continued aftereffects of the COVID-19 pandemic, such as continued high prices for international freight and shortages of shipping as well as bottlenecks due to strict local lockdowns in China.

8. Price increases in agricultural commodities are particularly high: the FAO Food Price Index averaged 138.0 points in August 2022, down 2.7 points from July, but remaining 7.9% above its value in August 2021.[9]





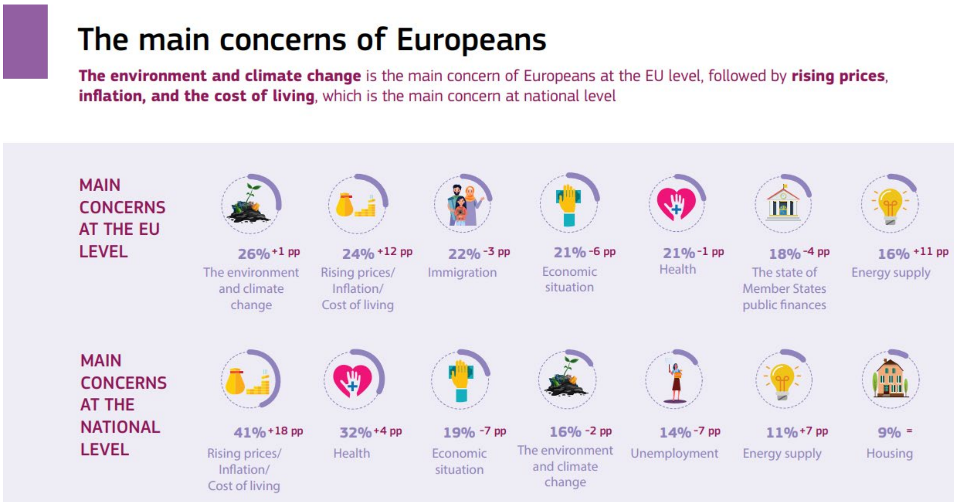
Source: FAO

The impact on retailers and wholesalers

9. Retailers and wholesalers are uniquely vulnerable to downturns in demand and are negatively affected by the significant slowdown in the growth of household purchasing power expected for 2023.[10]

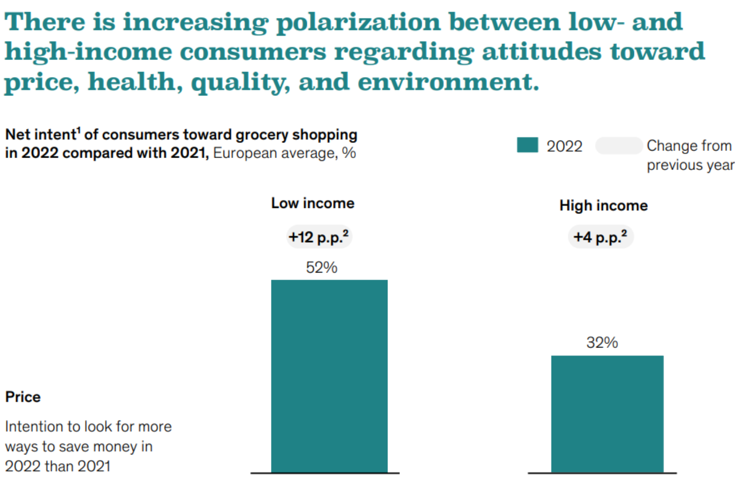
10. Retailers are observing a shift in consumer behaviour due to the loss of purchasing power by consumers facing a major cost-of-living crisis linked to skyrocketing energy bills and the impact of inflation on their wages:
    - High inflation is felt hardest by the 96.5 million Europeans living at risk of poverty or social exclusion,[11] since its impact is greater on cheaper and private label products.[12]
    - 41% of respondents to a recent Eurobarometer survey mentioned prices, inflation and cost of living as one of the most important issues facing their country, before health (32%) and the economic situation (19%).[13]

[9] https://www.fao.org/worldfoodsituation/foodpricesindex/en/.
[10] See for instance https://publications.banque-france.fr/en/macroeconomic-projections-june-2022; the Bank of France projects purchasing power per capita to fall by an average of 1.0% in 2022.
[11] Living conditions in Europe - poverty and social exclusion - Statistics Explained (europa.eu).
[12] For instance, in France consumer food prices increased by 7,97% in August 2022 compared to the same month in 2021, but the increase was of 13,05% for the premier prix (IRI Liquid Data August 2022).
[13] https://europa.eu/eurobarometer/surveys/detail/2553.



Source: EuroBarometer

- Retail sales have been declining in the first half of 2022. In France, FMCG sales decreased by 2,6% in the first 8 months of 2022.[14] In Italy, FMCG sales decreased in volume (-3%) in the first half of 2022 when compared to the same period in 2022, although they increased in value (+3,1%) due to higher prices.[15] In Germany, food and non-food retail sales decreased by 0,4% in April 2022 when compared to 2021.[16]
- More consumers are looking for ways to save money when shopping (+9% if compared to 2021, an increase of 12% for low-income consumers).[17] Consumers have turned to supermarkets[18] and discounters[19] and are switching from brands to the retailers' private labels.[20]
- Consumers are reducing purchases of fresh meat, fish and fruit and vegetables to buy more pasta, rice and canned products.[21]



Source: McKinsey/EuroCommerce

[14] IRI (August 2022).
[15] ISTAT (June 2022).
[16] Statistiches Bundesamt (April 2022).
[17] McKinsey/EuroCommerce
[18] Italian statistics institute ISTAT found an increase in value of sales of 4,6% value in Italian supermarkets and hypermarkets and a decrease of 0,9% for sales value in smaller stores. +
[19] +19% German consumers were considering shopping at a discounter in April 2022 (McKinsey & Company Europe Consumer Pulse Survey, 4/12–4/18/2022, n = 5,075 (France, Germany, Italy, Spain, UK), sampled to match European general population 18+ years.). discounters' turnover increased by 15% in June 2022 compared to 2021 (Nielsen June 2022).
[20] +4% of consumers want buy private label products instead of branded goods (McKinsey/EuroCommerce 2022).
[21] In France, sales of fresh (unpacked) products decreased by 2,8% during the first eight months of 2022 compared to 2021 (-2,6% for fruit and vegetables, -4% for meat, -13,6% for fish) (IRI August 2022). In Italy, sales of fresh seafood were down 18% compared to 2021, while sales of pasta, rice and meat were up respectively 20%, 17% and 20%.

11. As a result, the sector is suffering from a triple burden: fewer consumers willing to pay, rising costs and skyrocketing energy bills, all at the same time.
12. Due to the exploding energy costs, retailers are increasingly in a situation that potentially threatens their existence. For instance, based on current prices on the energy markets, an average retailer in Germany will have to pay around 300% for electricity and 700% for gas more in 2023 compared to 2021. The massive and largely incalculable business cost increases combined with consumers' reticence to spend will lead to a considerable number of retailers making losses next year if there is no noticeable relief.
13. As we head towards the winter, no consumer should have to make a choice between eating and heating. Retailers and wholesalers have been seeking to limit cost increases to ensure competitive prices for consumers:
    - Distributors play an important role as the key consumer-facing part of the supply chain and ensuring that consumers have a wide choice of quality products at affordable prices. Strong retail competition means that retailers have no choice but to absorb part of the price increases at least in the short term, but this is unsustainable in the long run due to its impact on their already limited margins (1-3% in the food retail sector).
    - Retailers across Europe are launching initiatives to support consumer purchasing power, for instance by offering promotions on essential private label products or 'freezing' the price of certain products for a period of time.[22]
    - Larger suppliers in the consumer goods industry of 'must-have' products are increasingly using their powerful market position to demand price rises well above the rising cost of their inputs. When retailers do not accept such unjustified price increases, global brand manufacturers at times stop delivery of goods. Retailers are increasingly exposed to these unfair industry practices (UIPs) such as unjustified price increases, delivery stops and TSCs. The balance of power in the supply chain for multinational branded products makes such unjustified and inflationary price demands and other UIPs difficult for (national) retailers and wholesalers to resist. Due to their private label business, retailers and wholesalers know that many of these demands are not based on increased costs: instead, the reference to general inflation is used as an excuse to further improve the already high profit margins of manufacturers[23] - in the interests of the shareholders of such multinationals and to the detriment of retailers and consumers. As an examples, sales by food manufacturers in Germany increased by 18.3% in June compared to the same month in 2022 [24] while, German retailers have seen the largest drop in sales since 1994,[25] and around one third of them expect not to be profitable in 2023.

[22] See for instance: https://www.carrefour.com/en/actuality/carrefour-bloque-les-prix-de-100-produits, https://press.delhaize.be/delhaize-lance-ses-ptits-lions-pour-supporter-le-pouvoir-dachat-avec-des-baisses-de-prix-sur-la-marque-propre.

[23] Large brands such as Pepsi, Henkel, Unilever, Nestlé and Coca-Cola were reporting margins of respectively 15,9%, 17%, 16,9 and 31%for the first half of 2022; also see: https://on.ft.com/3RZI5K9.

[24] See https://www.bve-online.de/presse/pressemitteilungen/pm-050922-bve-konjunkturreport-september.

[25] See https://www.destatis.de/DE/Presse/Pressemitteilungen/2022/08/PD22_323_45212.html.

Our key asks

14. Retailers and wholesalers are confronted with additional pressure on prices, linked to rapidly rising energy prices, increased regulatory pressure, market fragmentation and other UIPs from global manufacturers:

    - Retailers and wholesalers are facing expensive energy bills as significant users of energy for their cooling, heating, ventilation and refrigeration systems, all of which run 24 hours a day, 7 days a week. The sector largely fulfils the criteria of 3% of production value for being recognised as high energy consuming sector, as set down in EU legislation. Retail and wholesale should **receive state aid support from the EU and member states** under the Temporary Framework.

    - Retail and wholesale should **be treated as a priority sector** in any power reduction measures in order to be able to guarantee essential services to consumers and avoid the waste or decay of products temporarily defrosted or uncooled during power cuts and ensure only safe food reaches consumers.

    - Our ecosystem relies on a properly functioning single market to provide our customers with high quality products at a competitive price and preserve food security in the EU. It should be a priority for EU action to **roll back a rising trend of new national barriers** (such as export restrictions imposed by some member states in the aftermath of the Russian invasion of Ukraine). We also ask that the Commission **address market fragmentation imposed by global brand manufacturers** – through territorial supply restraints costing Europe's consumers more than €14 billion a year[26] while they face the highest inflation in decades. The internal market must be fully realised to the benefit of consumers.

    - **Refrain from imposing price caps and other price control mechanisms for food products**. Interference in competitive markets must be avoided. A number of member states have or are considering measures on food prices such as capping margins or consumer prices for certain food products. These measures can have **unintended consequences**, such as: a) whether they result in price increases for other goods, b) create availability issues or c) render a business unviable, thus leading to job losses, d) give rise to cross-border impact on neighbouring countries' economy and public discourse. The Portuguese Competition Authority recently warned of price control mechanisms as they may lead to collusion, damage smaller companies and cause supply chains disruptions and shortages.[27]

    - **National governments should not impose any additional taxes.** While inflation is visible in stores and there may be a perception that higher retail prices entail higher profits, data shows that is not the case. The sector's margins have decreased since the start of the inflationary crisis as retail and wholesale face the triple squeeze of higher prices by manufacturers, skyrocketing energy bills and reduced consumer purchasing power.

    - **Temporarily avoid additional** burdens on companies in the current crisis situation, e.g. through a moratorium on legislative proposals and other initiatives that negatively affect retailers and other market players. The economy needs to get back on track – otherwise, the crisis will be even more severe and lasting.

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[26] European Commission *Study on territorial supply constraints in the EU retail sector: Final report* (2020).
[27] See here.