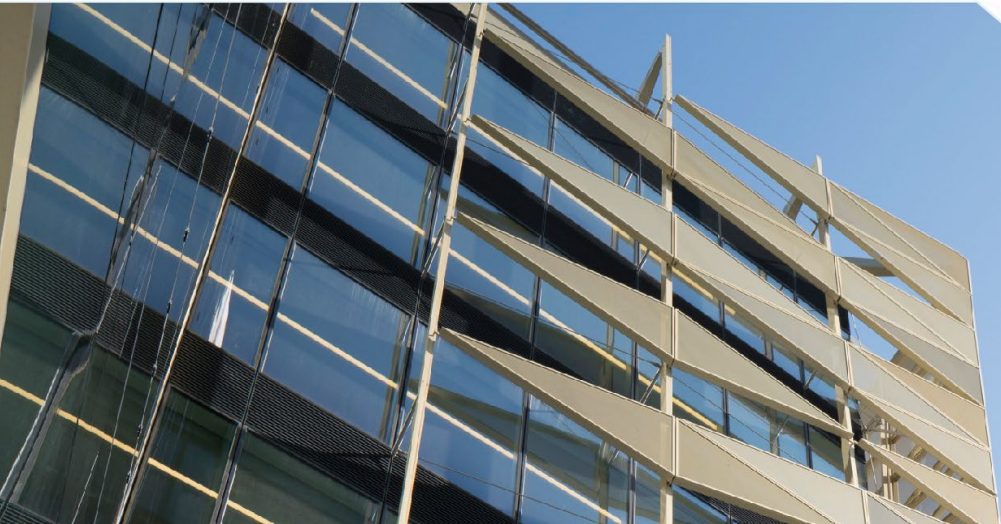




Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem



What inflation did next? The path to restoring price stability

Gillian Phelan, Central Bank of Ireland, 16 September 2022

Disclaimer: *These are my own views and not those of the Central Bank of Ireland or the European System of Central Banks*

Outline

1. The challenge: burden of higher costs
2. The cause: energy, pandemic, and war
3. Looking ahead: forecasts and risks
4. (Monetary) policy response



1. The challenge: burden of higher costs

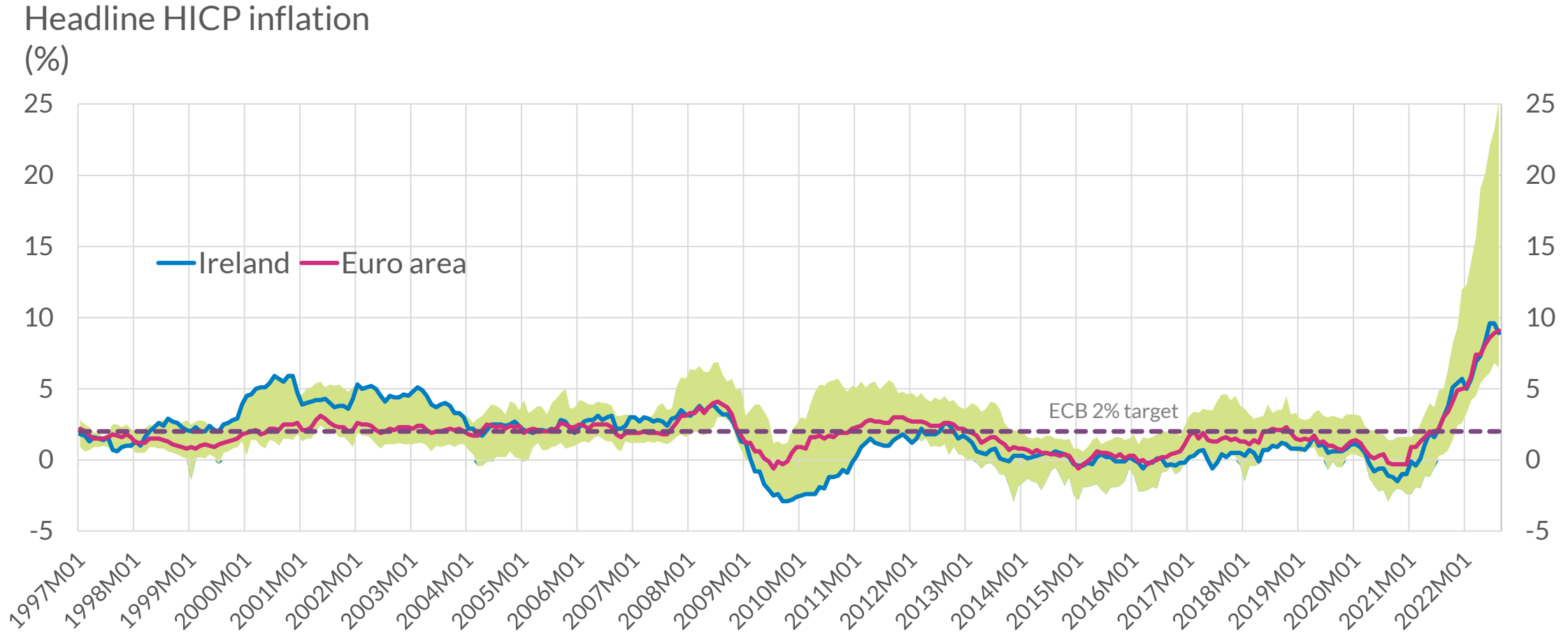
Falling purchasing power with differential effects threatening the economic outlook



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Inflation across the euro area has reached record highs...



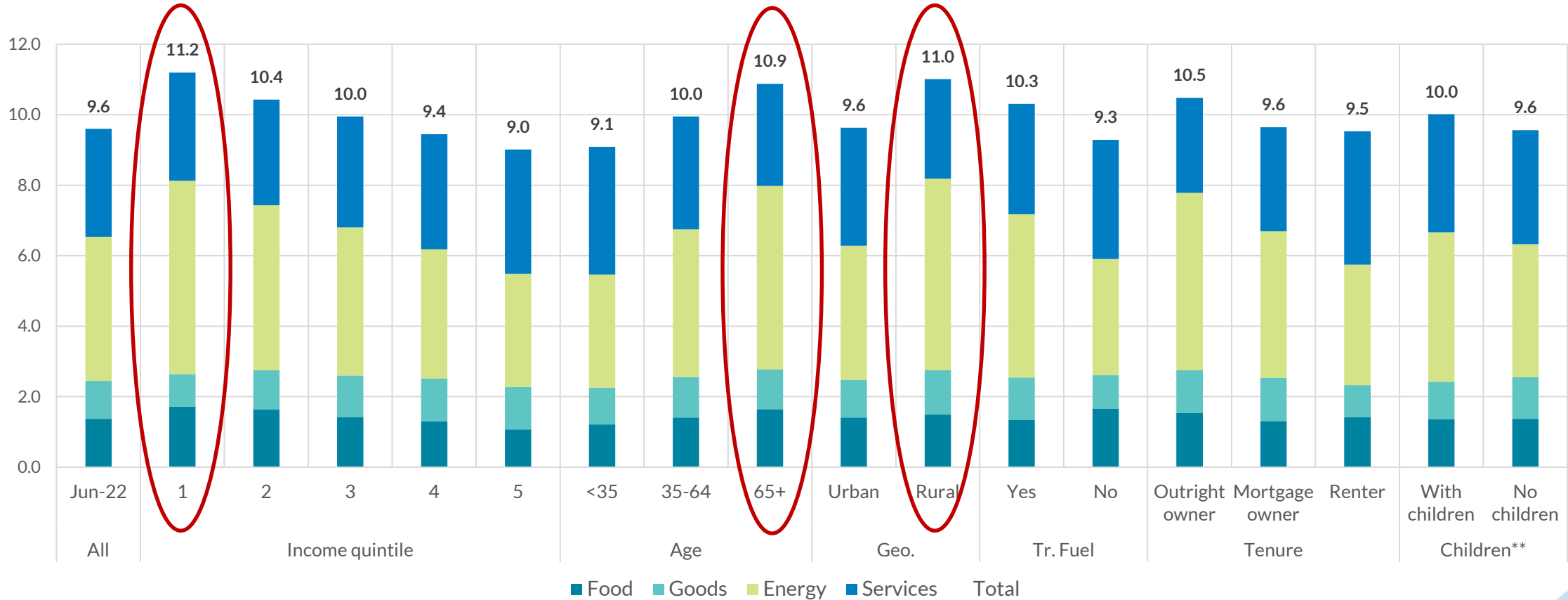
Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Source: Eurostat
Last data point August 2022

...with differential impacts across households

HICP expenditure weights for main sub-components, by income, in Ireland
June 2022 (%)



Source: Eurostat, Lydon, 2022 (updated)



Households face falling real incomes and confidence is suffering....

Consumer confidence, euro area

Diffusion index



Source: European Commission



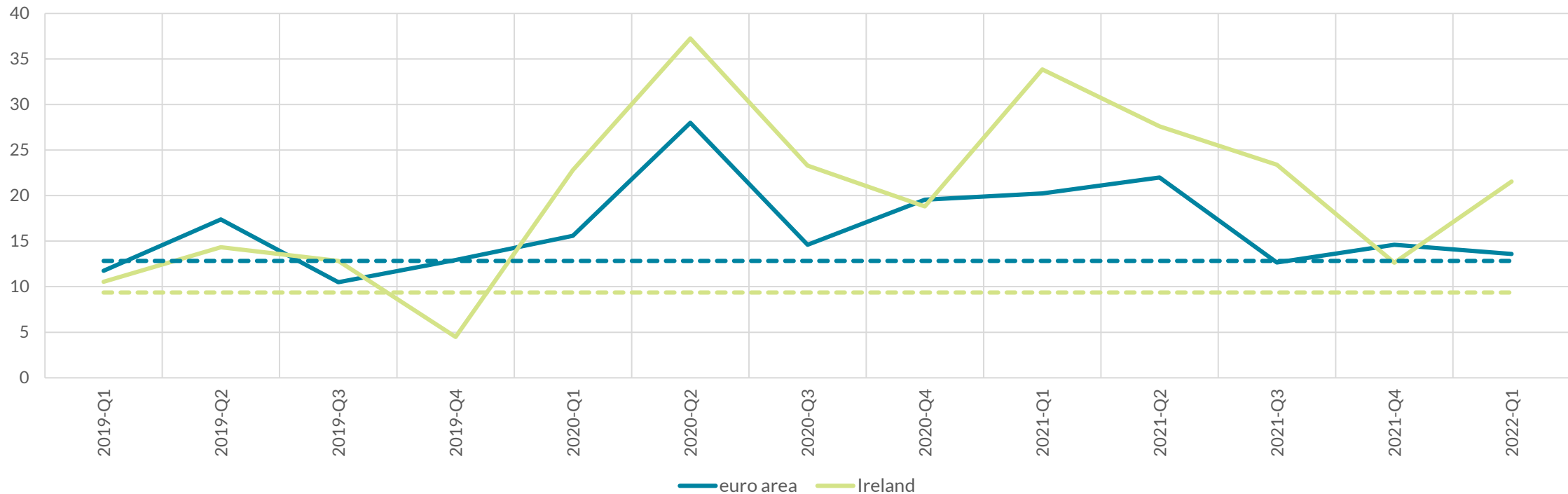
Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

...buffered by saving up to now

Household saving rate

% Disposable income



Source: Eurostat

Notes: dashed line represents long-term average (2000 Q1 - 2019 Q4)



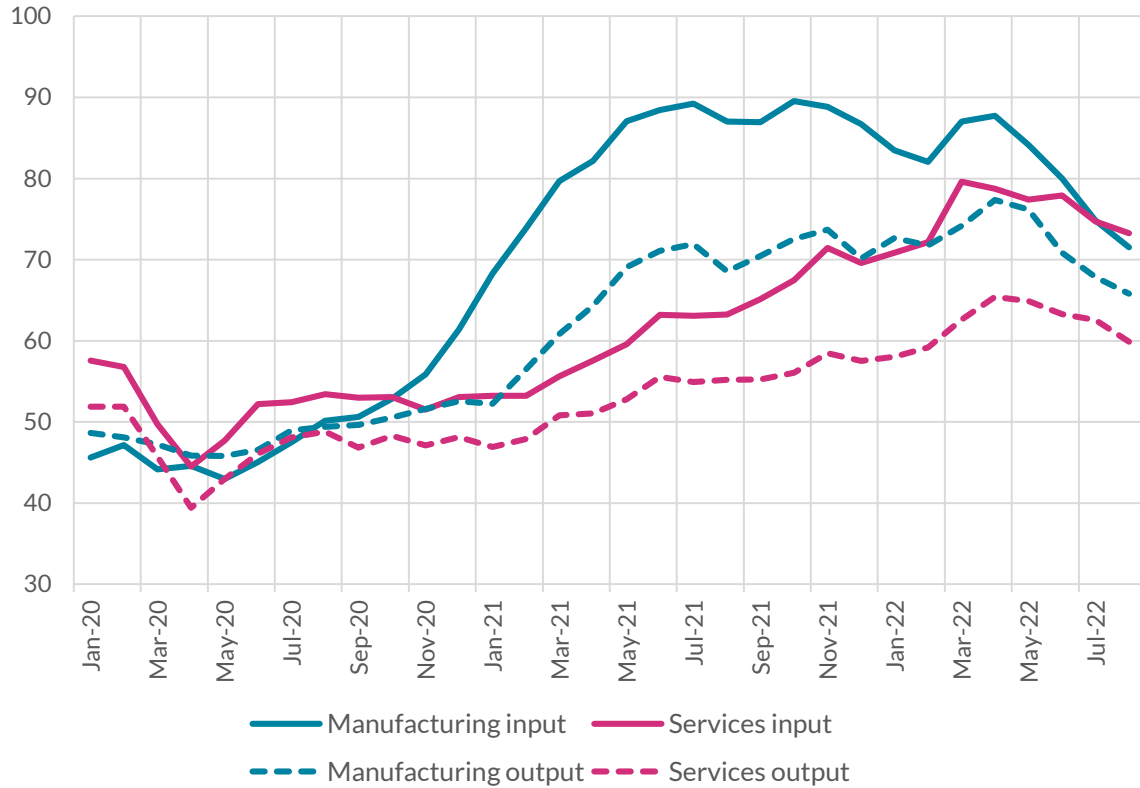
Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Firms face higher input costs, with falling economic expectations

PMI price indicators, Euro Area

Diffusion index



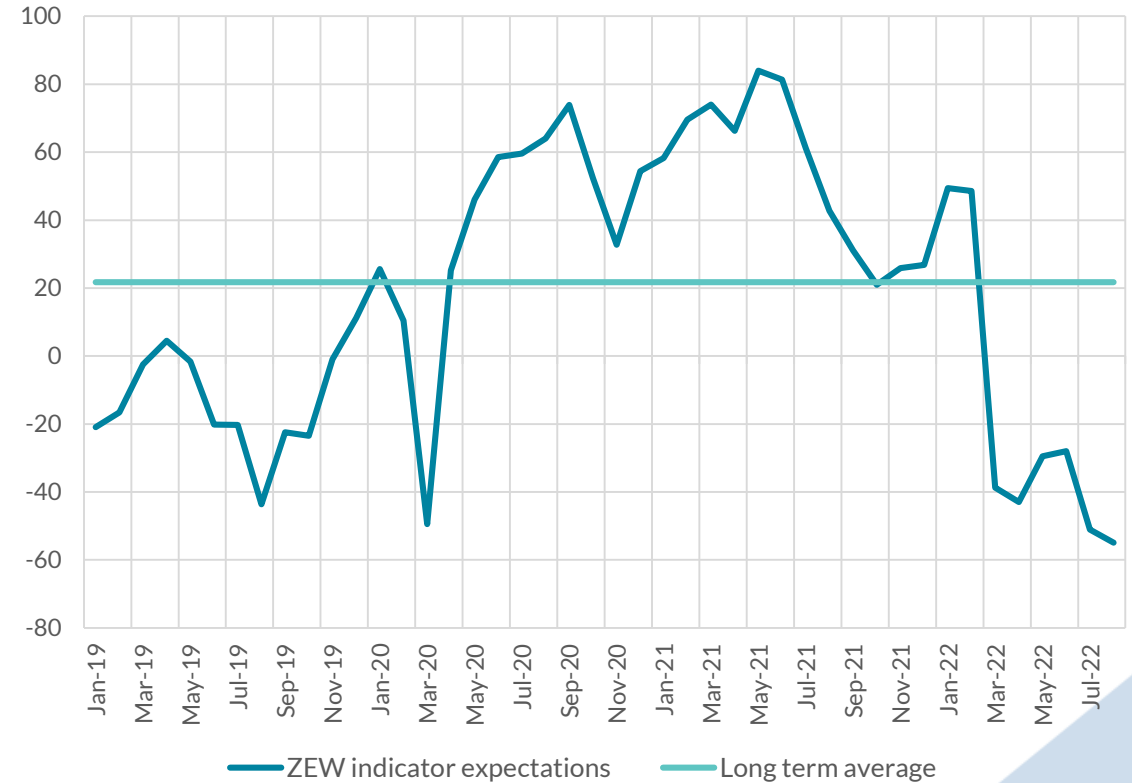
Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Source: S&P Global

ZEW Indicator economic expectations, Euro Area

Net percentage

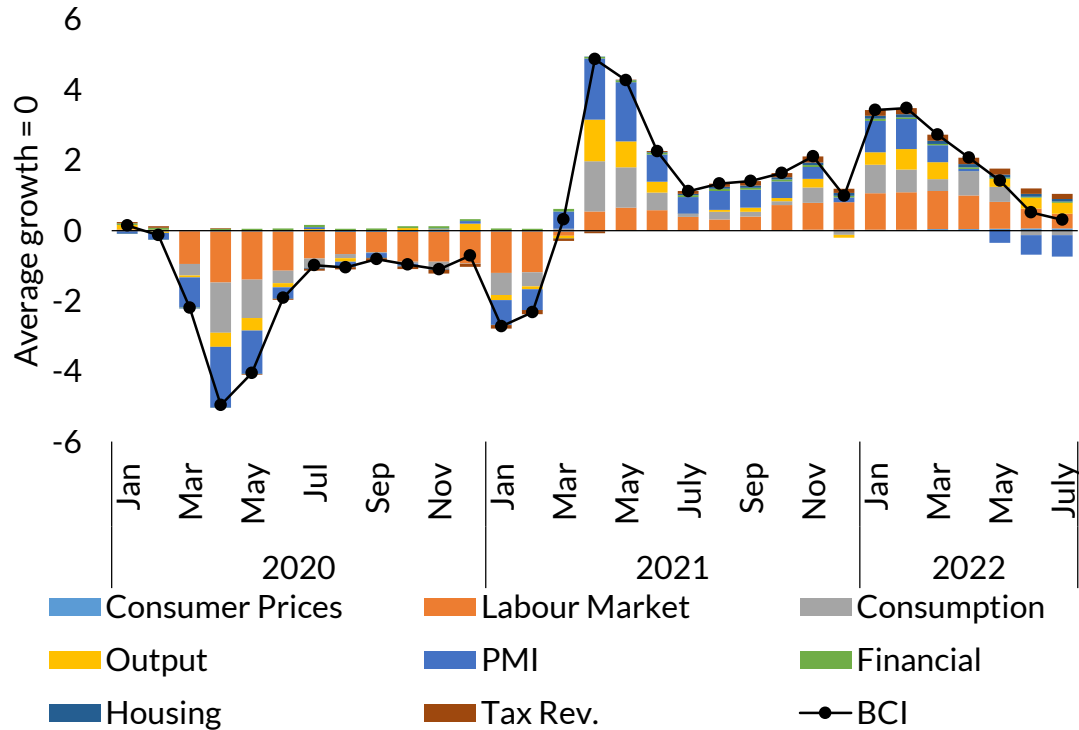


Source: ZEW

The outlook for growth has weakened, with downside risks

Business cycle indicator, Ireland

BCI Contributions Jan 2020 to July 2022

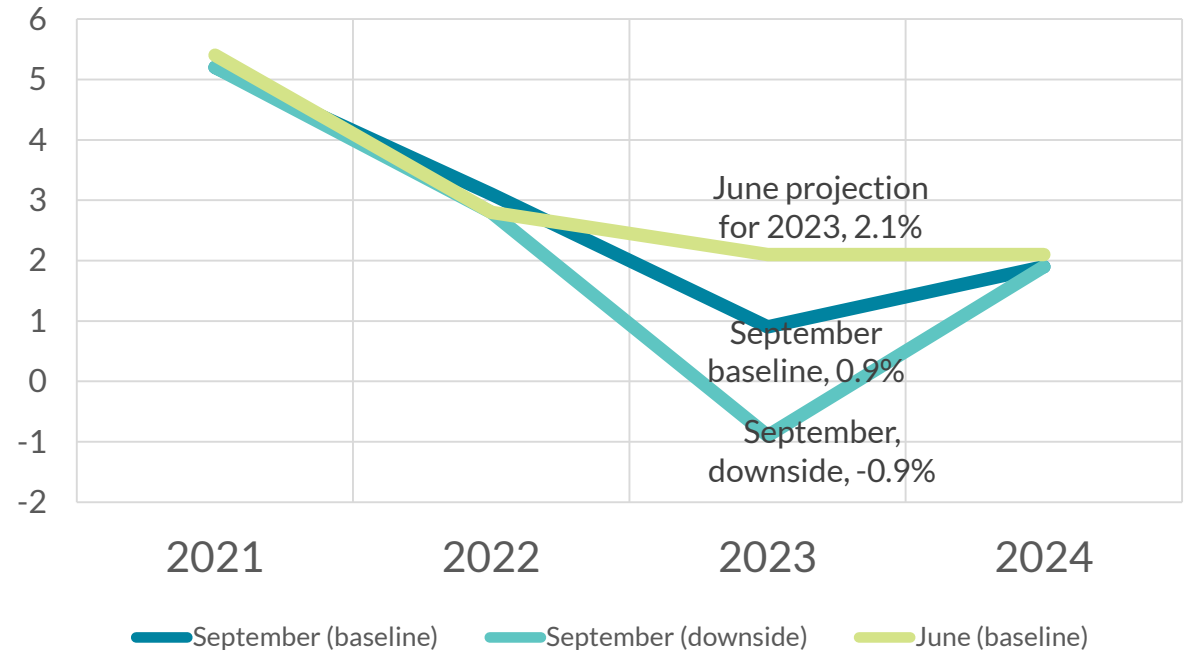


Source: CBI calculations. Updated: 22/08/2022

Note: preliminary July estimate is based on labour market data, consumer sentiment, and PMIs. Retail sales and industrial production is not yet available.

Real GDP growth projections, Euro Area

(per cent)



Source: ECB (September 2022)



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

2. The cause: energy, pandemic, war

Global shocks but reverberating domestically



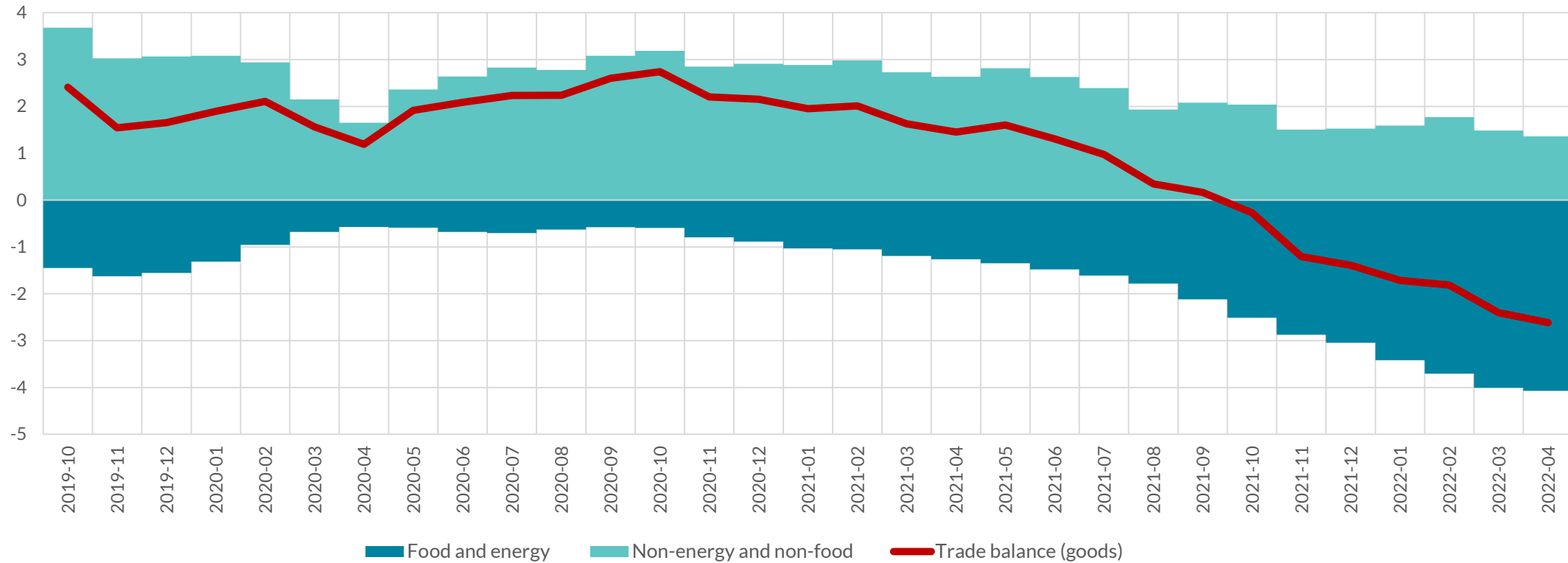
Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

A terms of trade shock with negative income effect for euro area.

Goods trade balance, Euro Area

% GDP



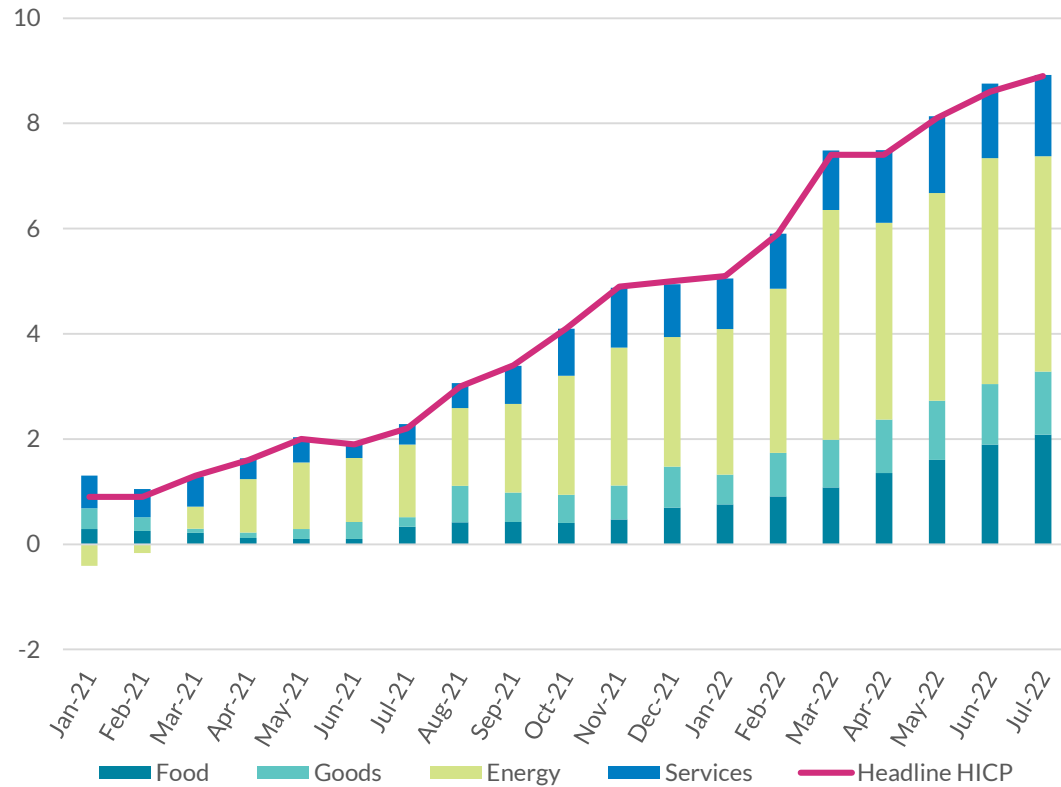
Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

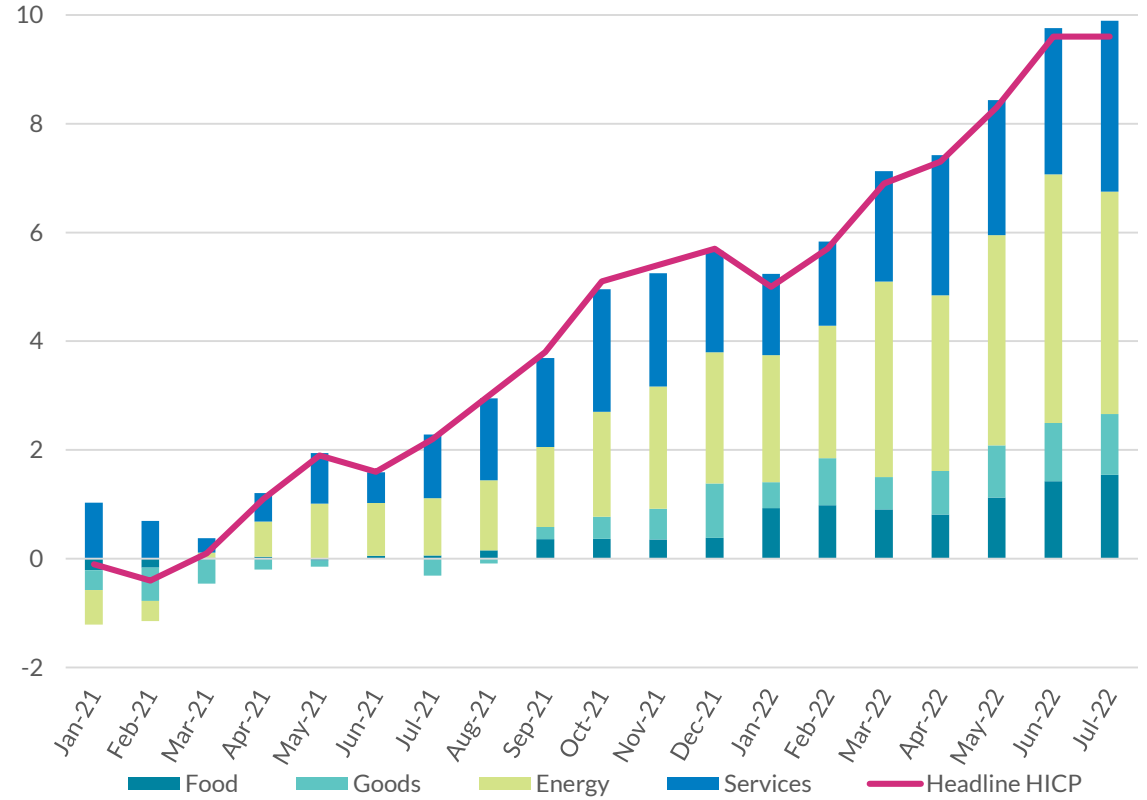
Source: Eurostat

Energy has been a key driver...

HICP inflation and component contributions, Euro Area
(annual % and p.p.)



HICP inflation and component contributions, Ireland
(annual % and p.p.)



The pandemic is having a persistent impact on supply chains...but some evidence pipeline price pressures easing

Global supply chain pressure index
(Index)



Source: New York FED
Last data point July 2022



War in Ukraine is adding a stagflationary shock

Effect of Russian gas shut off on GDP growth in 2022

Percentage points, square brackets reflect interval

ECB June BMPE (downside)	-1.80
ESM for euro area (rationing induced)	[-1.70, -1.1]
IMF for EU integrated scenario	-0.40
IMF for EU fragmented scenario	-1.80
Goldman Sachs euro area (total switch off)	-2.20
European Commission (no demand reduction + mild winter)	[-0.6, -1]
European Commission (demand reduction 15% + mild winter)	[-0.4, -0.6]



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Source: ESM, IMF, Goldman Sachs, ECB, European Commission.
Notes: All scenarios are relative to baseline.

3. Looking ahead: forecasts and risks

Elevated uncertainty remains but high inflation levels expected to gradually recede; price pressures are becoming more broad based and the risk of wage price spirals needs monitoring



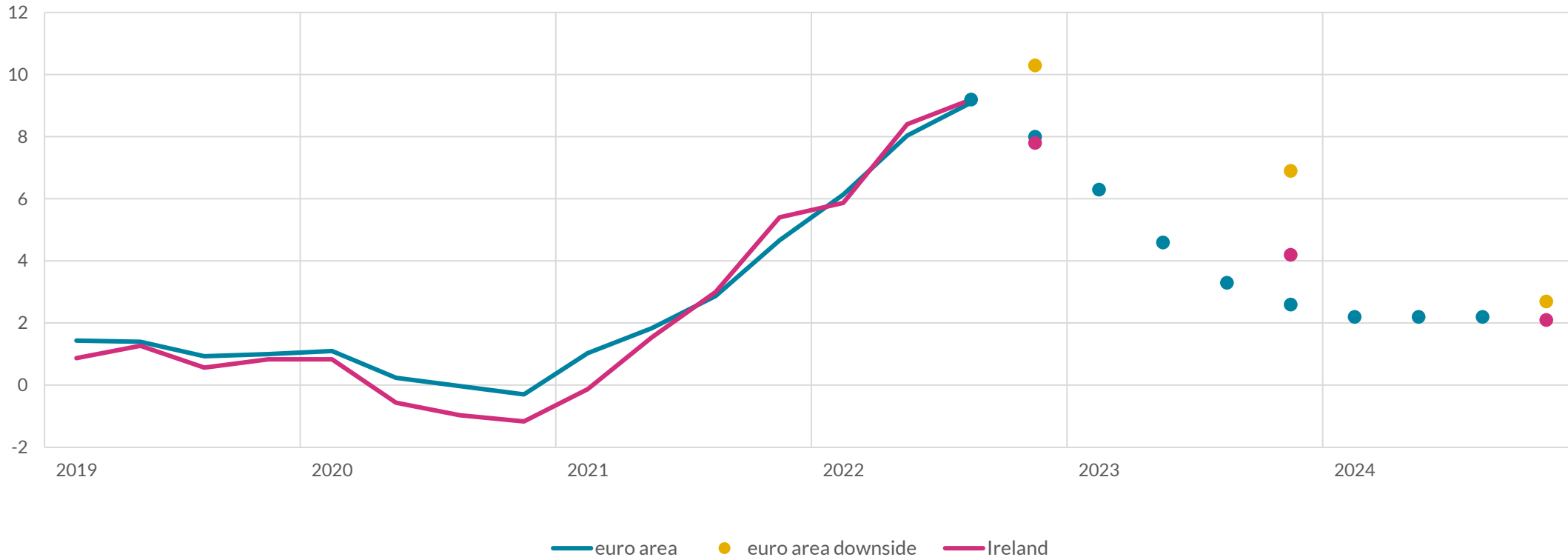
Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Forecasts show inflation is expected to recede...

Inflation and forecasts

% YoY



— euro area ● euro area downside — Ireland



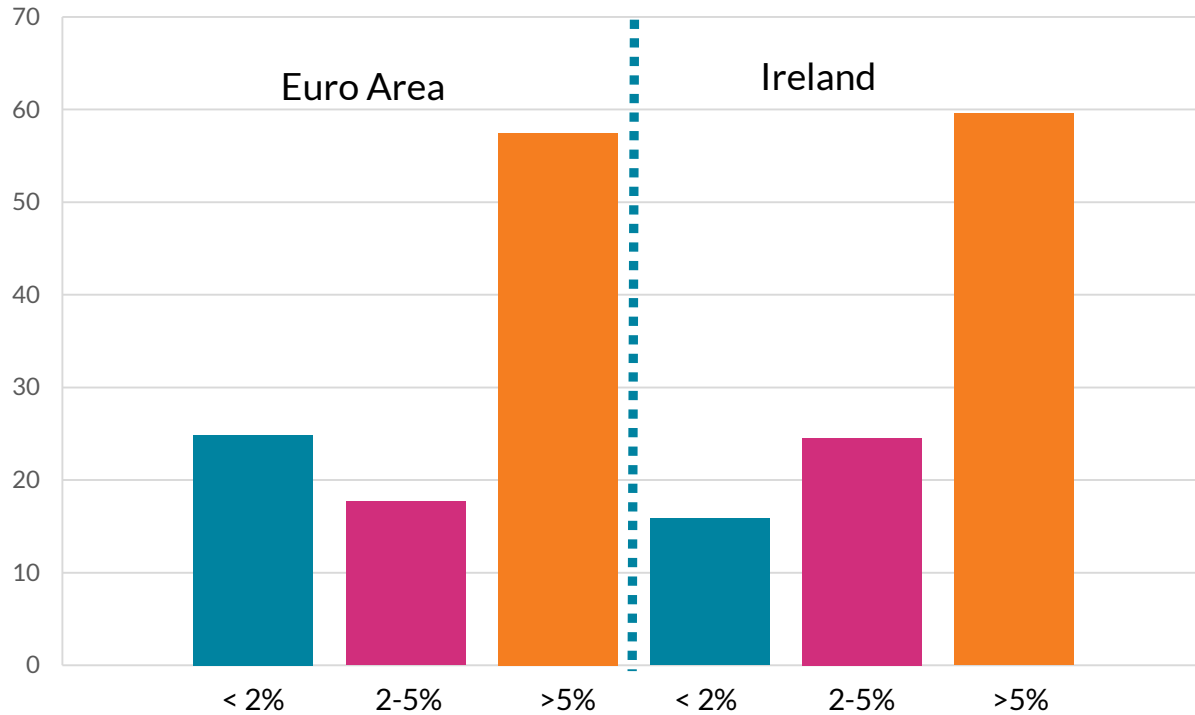
Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

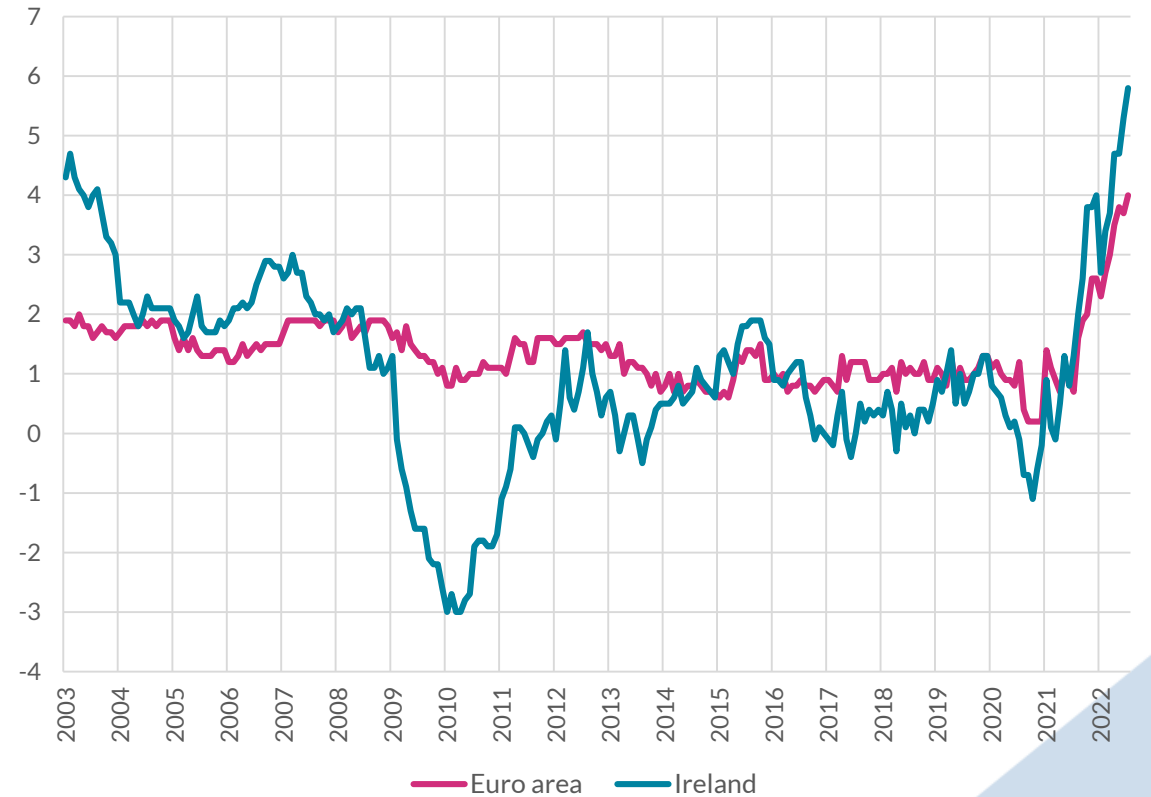
Source: ECB (September 2022),
CBI (July 2022)

...but price increases are broad based

Distribution of inflation rates
(%)



Underlying measures of inflation
(annual %)



Source: Eurostat
Latest data point: July 2022

Source: Eurostat, ECB
Last data point July 2022



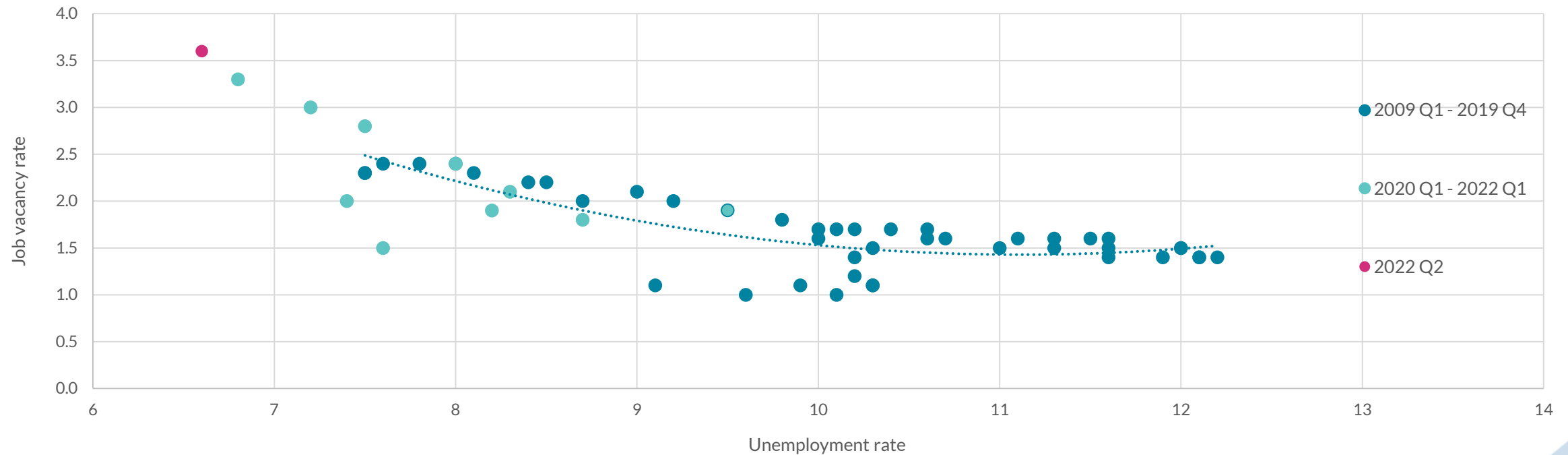
Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Labour markets continue to tighten, despite threat to growth...

Beveridge curve, Euro area

%



Banc Ceannais na hÉireann
Central Bank of Ireland

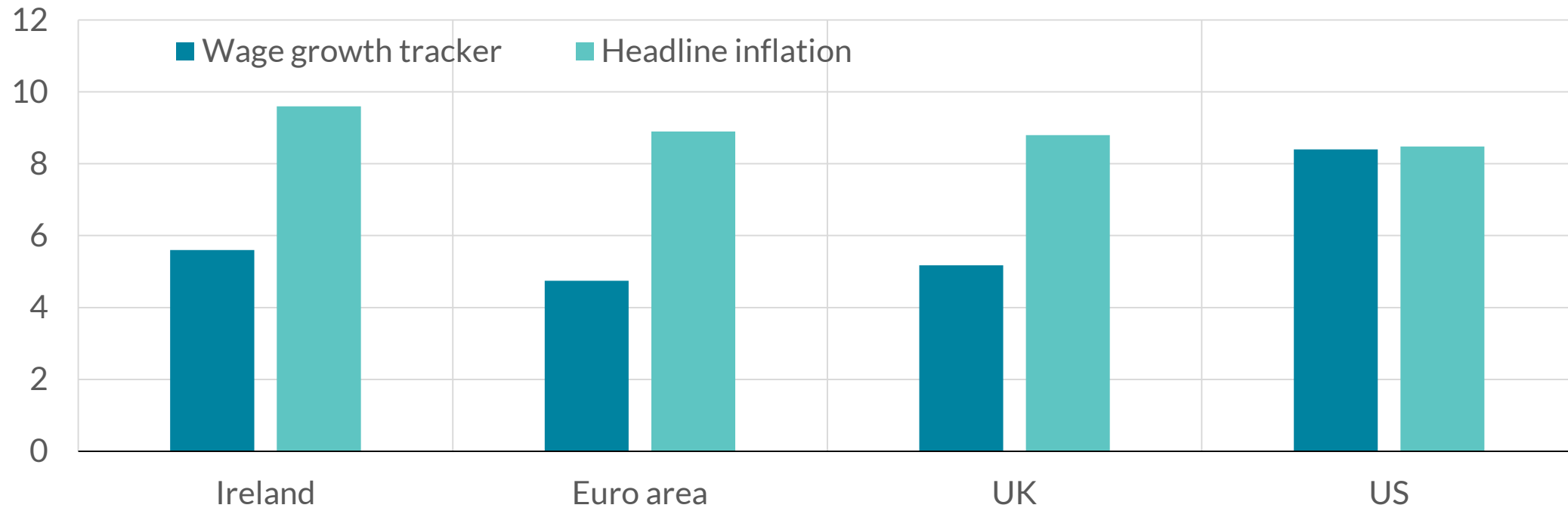
Eurosystem

Source: Eurostat

....but wages not keeping pace with inflation

Inflation and wage growth from job ads, July 2022

%YoY



Notes: The wage growth tracker for Ireland, the UK and Euro area is annual growth in average wages for jobs posted on *Indeed*. For the US, it is annual growth in wages for *job changers* from the Atlanta Fed Wage growth Tracker.



Central Bank of Ireland

Eurosystem

4. (Monetary) policy response

Challenging when risks to growth are to the downside and risks to inflation are to the upside



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Monetary policy normalisation is underway...

❑ Interest rates:

=> raised by 50bps in July and 75bps in September; bringing them out of negative territory to 0.75%

❑ Asset purchase programmes:

=> no further net purchases; path for QT not yet outlined

❑ Targeted lending operations (TLTRO's):

=> last maturity 2024

❑ Transmission protection instrument:

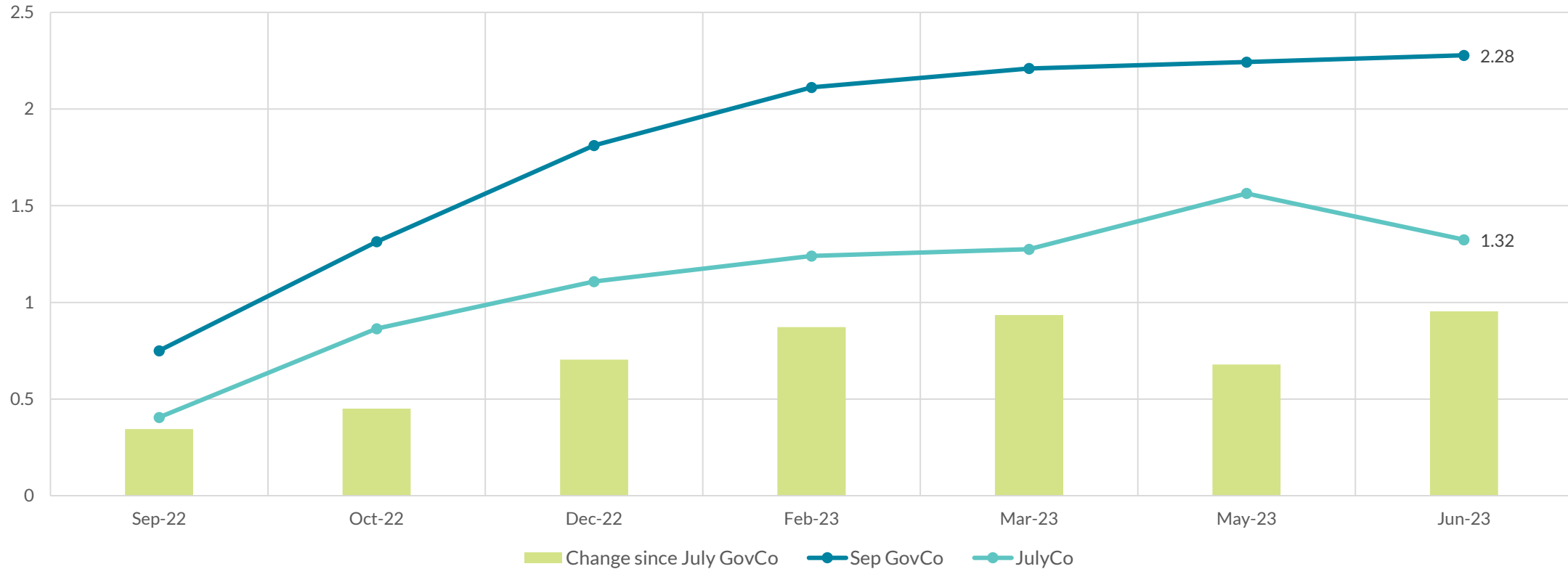
=> to guard against fragmentation



...with markets expecting further hikes in the coming months

Market implied path of rate rises

%



Source: Bloomberg, 9/9/22



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Where next? Outstanding questions for policy with implications for inflation...

- Globalisation: from efficiency to resilience?
- Climate change: the cost and pace of transitioning to net zero?
- War: how long will the fog of war remain?
- Analytical framework: what have we learned from the pandemic?
- Transmission of monetary policy: what is the elasticity of the macro environment to interest rates?
- How does fiscal policy and monetary policy interact in this environment?

