



BANCA D'ITALIA  
EUROSISTEMA

# “There has been an awakening”: inflation, disinflation and ECB’s monetary policy

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### Quali lezioni dopo un biennio di politica monetaria antinflazionistica?

Fondazione Cesifin

Firenze, 19 April 2024

# Outline

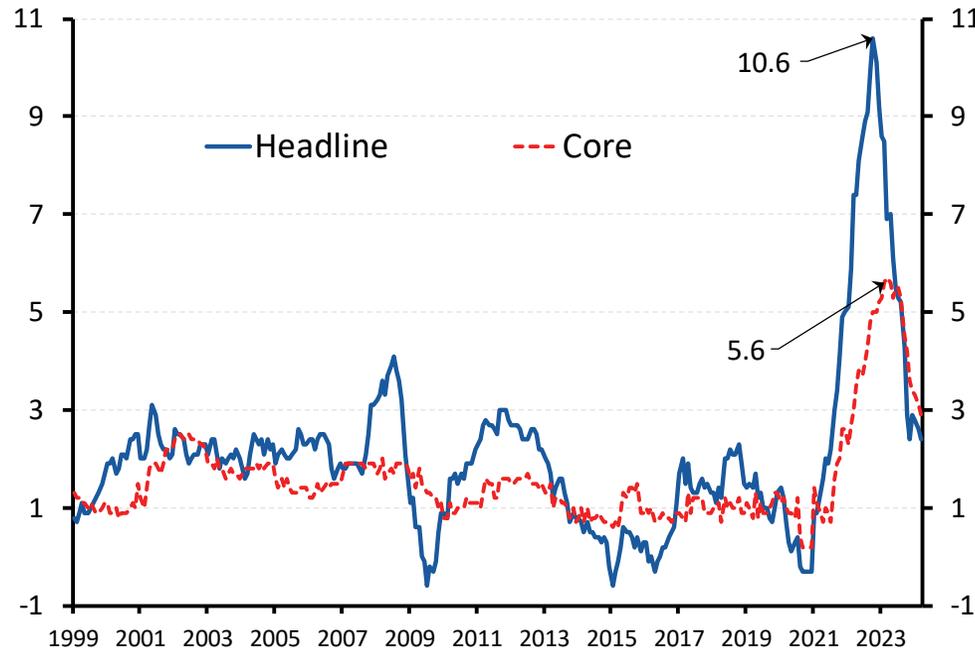
- 1. The 2021-22 inflation**
- 2. The 2023 disinflation**
- 3. Lessons for the ECB's monetary policy**

I would like to thank for their comments and suggestions Ivano Galli, Roberta Zizza, Giuseppe Ferrero, Margherita Bottero, Marco Bernardini, Martina Cecioni, Antonio Maria Conti, Francesco Corsello, Alessandro Notarpietro, Alessandro Secchi, Fabio Buseti, Fabrizio Venditti and Riccardo Poli.

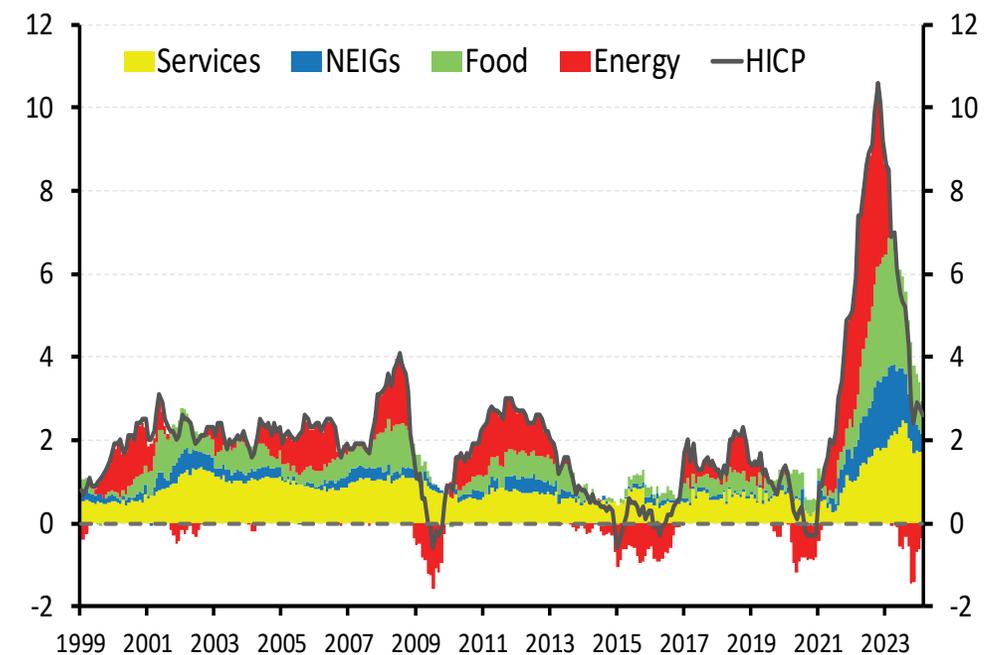
# The 2021-22 inflation

# Euro-area headline inflation reached double-digit figures...

Headline and core inflation  
(per cent)



Headline inflation: by component  
(per cent and percentage points)



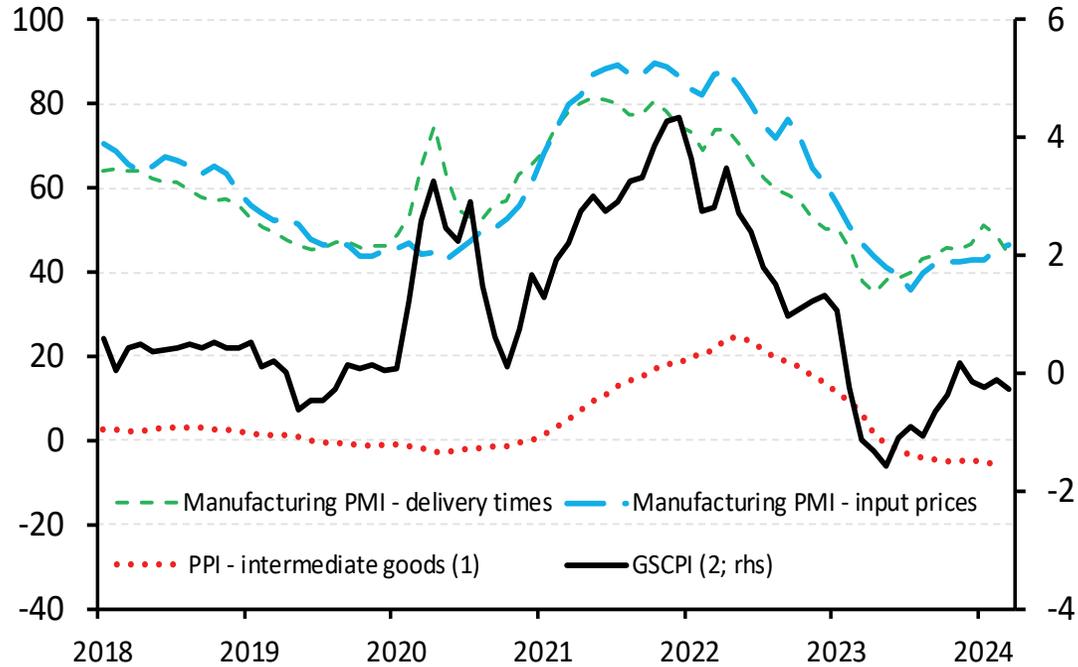
Source: Eurostat. Note: latest observation March 2024.

- Inflation increased markedly in 2021 and 2022, reaching a historical record in October 2022
- Core inflation reached unprecedented levels in spring 2023
- All main categories contributed to raising inflation; supply shocks played largest role (Neri et al., 2023)

# ... driven by reopenings, supply bottlenecks and energy prices

## Indicators of supply bottlenecks and producer prices

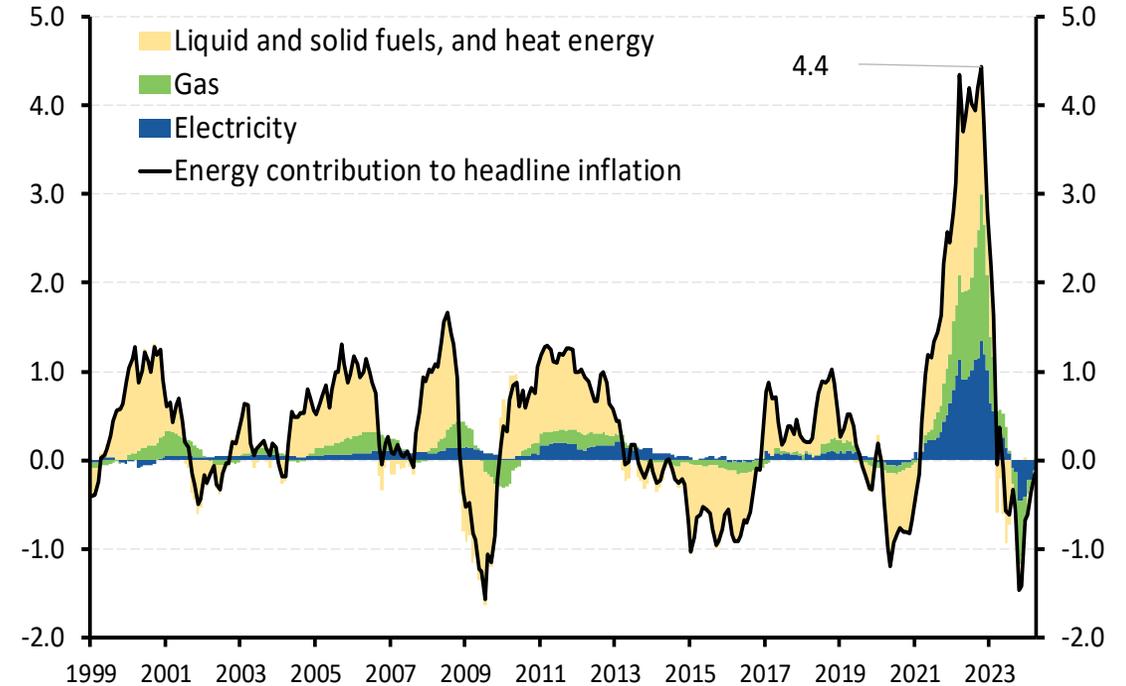
(percentage points)



Source: Eurostat, Federal Reserve Bank of New York and S&P Global. Note: (1) Annual percentage changes. (2) Standard deviations from the index's historical average. Latest observation March 2024 for all but PPI – intermediate goods (February 2024).

## Energy contribution to headline inflation

(percentage points)



Source: Eurostat. Note: latest observation March 2024.

- Post-pandemic reopenings and global supply bottlenecks led to a strong increase in services and goods inflation in advanced economies
- Strong global demand for energy commodities and Russia's invasion of Ukraine led to an unprecedented increase in cost of energy (gas, electricity and fuels) in euro area

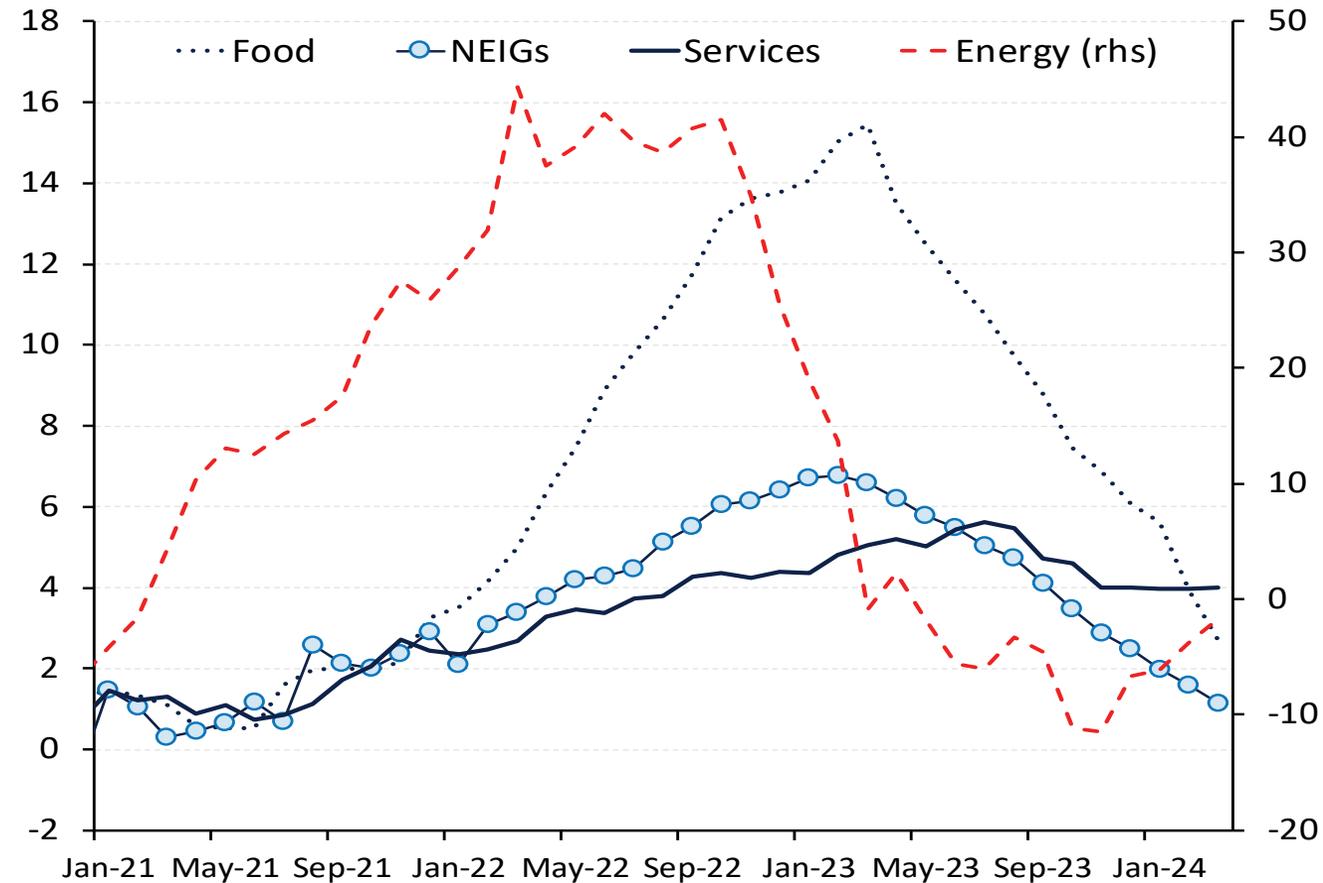
# The 2023 disinflation

# A heterogeneous disinflation

- Energy disinflation started in late 2022, as gas and oil prices fell from summer peaks
- Food and NEIGS inflation peaked in spring 2023 as commodity prices decelerated and supply restrictions eased
- Services inflation peaked later, its fall stalled in November 2023
- Rapid inflation and disinflation consistent with high frequency of price adjustments (*“Large shocks travel fast”*; Cavallo, Lippi and Miyahara, 2023)

HICP inflation: main categories

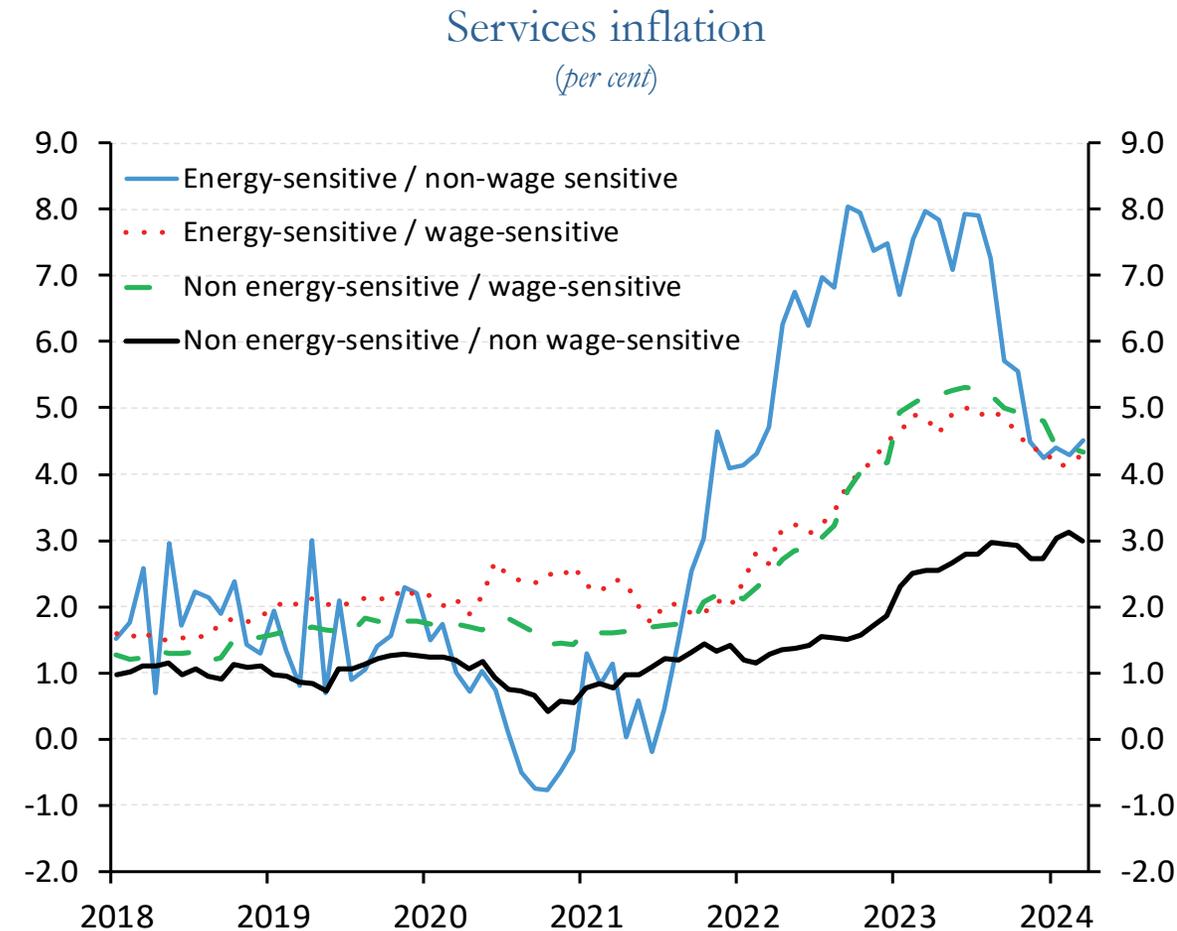
(per cent)



Source: Eurostat. Note: latest observation: March 2024.

# Services inflation: the last hurdle

- In recent months, disinflation in euro area has been held back by services inflation
- Narrative on stickiness of services has recently focused on contribution of wage-sensitive sectors
- However, services inflation remains high due to acceleration of prices of items neither wage- nor energy-sensitive
- Prices of these items are non-cyclical, staggered and backward-looking (“late-comers”)
- They are partly administered (e.g. postal, hospital and education services), reset infrequently (e.g. insurance and financial services), and often adjusted for past inflation (e.g. rents)



Source: Eurostat. Note: latest observation March 2024.

# Lessons for the ECB's monetary policy

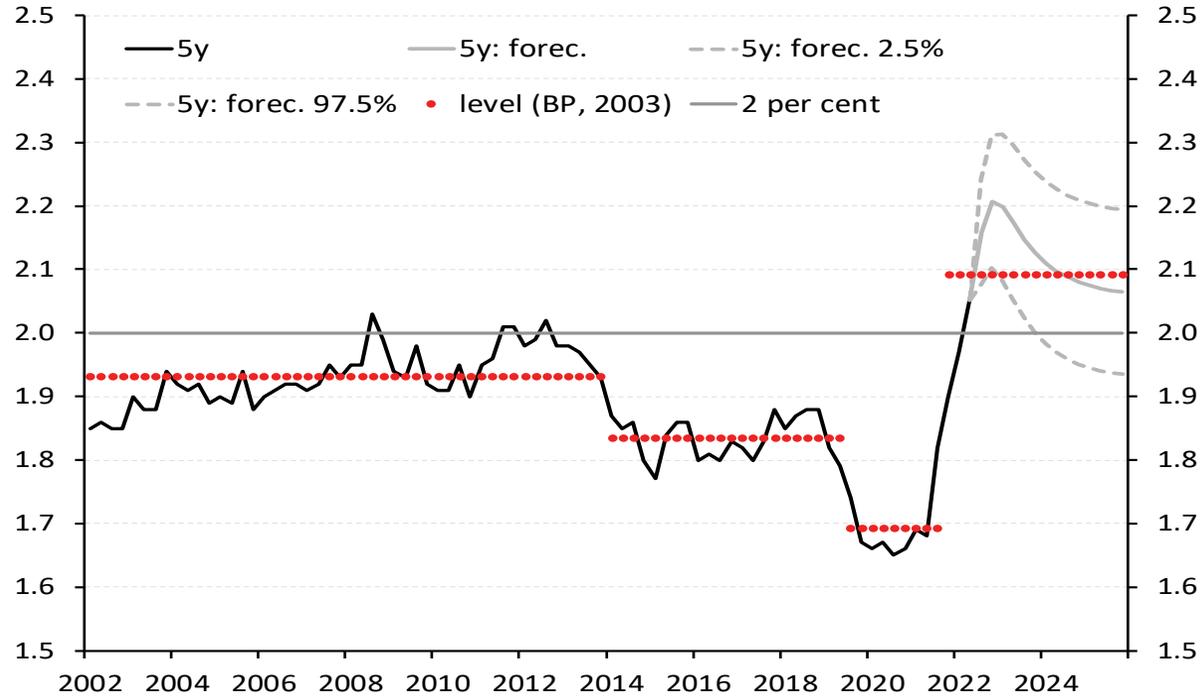
# ECB faced an extremely complex environment

- ECB has faced an extremely complex environment in last couple of years (Panetta, 2023a)
- Unprecedented sequence of shocks made it difficult to disentangle supply and demand shocks in real time and assess their role in raising inflation
- Exceptional circumstances called for an exceptional response
- Was response of ECB's monetary policy:
  - necessary?
  - timely?
  - adequate?
- Was a data-dependent and meeting-by-meeting approach useful?



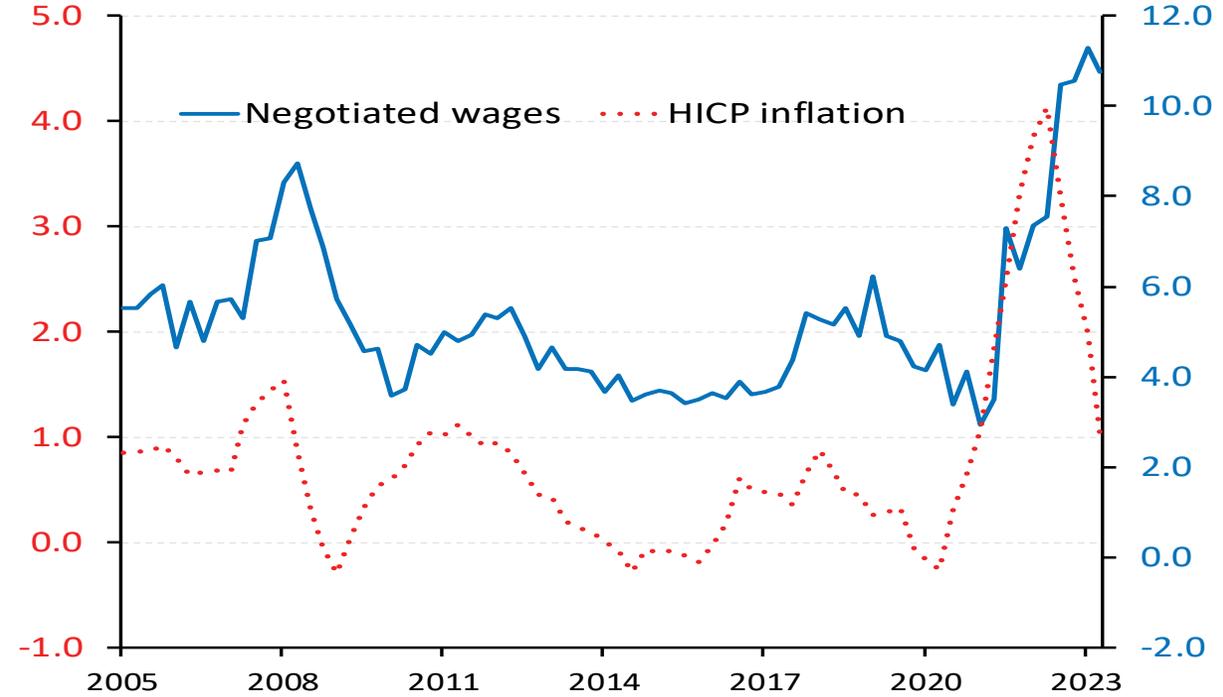
# Was ECB's response necessary?

## Risk of de-anchoring (per cent)



Source: Neri (2024). Latest observation: April 2022 Survey of Professional Forecasters.

## Negotiated wages and inflation (per cent)



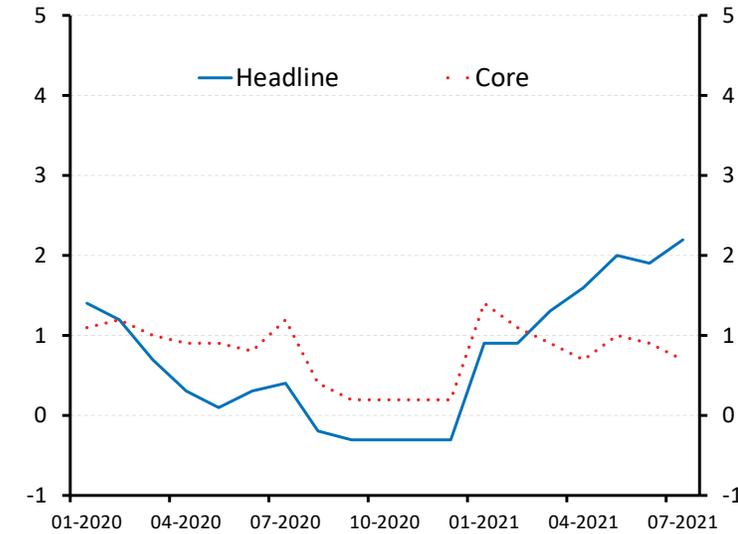
Source: ECB and Eurostat. Note: latest observation 2023:Q4.

- Was ECB's response necessary?
- Surge in inflation could risk an upward de-anchoring of long-term inflation expectations and fueling a wage-price spiral, even if supply shocks were dominant drivers of inflation

# Was ECB's response timely?

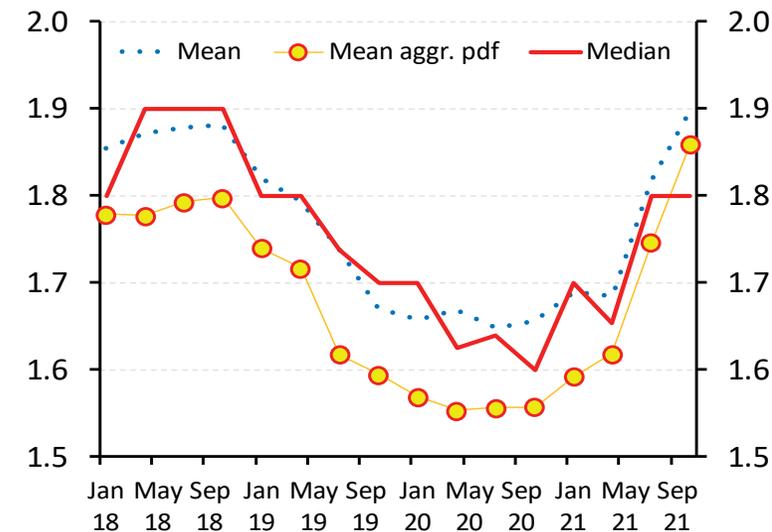
- ECB began normalization in December 2021
- **Was ECB's response timely?**
- Progress in recovery and expected convergence of inflation to new 2% symmetric target allowed ECB to reduce net asset purchases
- After Strategy Review, headline inflation was converging to 2%, core was still below 1 (Visco, 2023)
- Special October 2021 ECB SPF: 2% symmetric inflation target as key element of review
- Sharp increase in gas prices in Autumn 2021 was perceived as temporary
- Counterfactual simulations show limited gains from earlier tightening

Headline and core inflation  
(per cent)



Source: Eurostat.

Long-term inflation expectations  
(per cent)

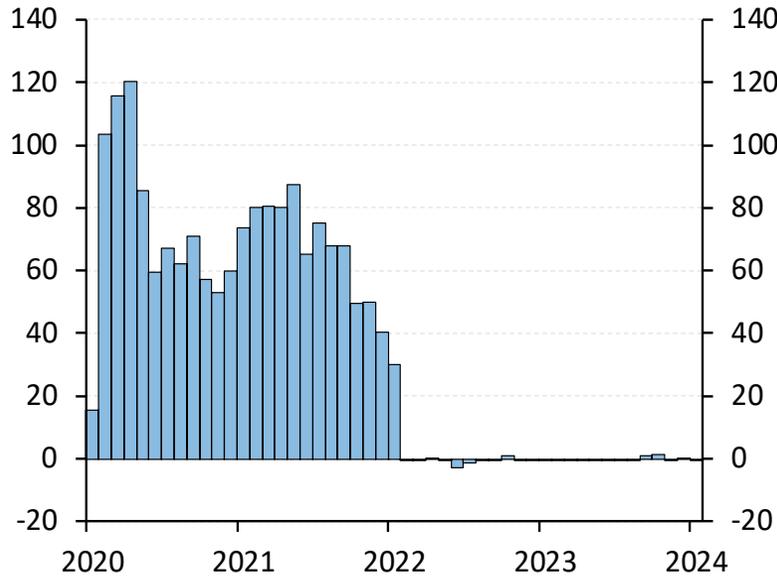


Source: ECB SPF.

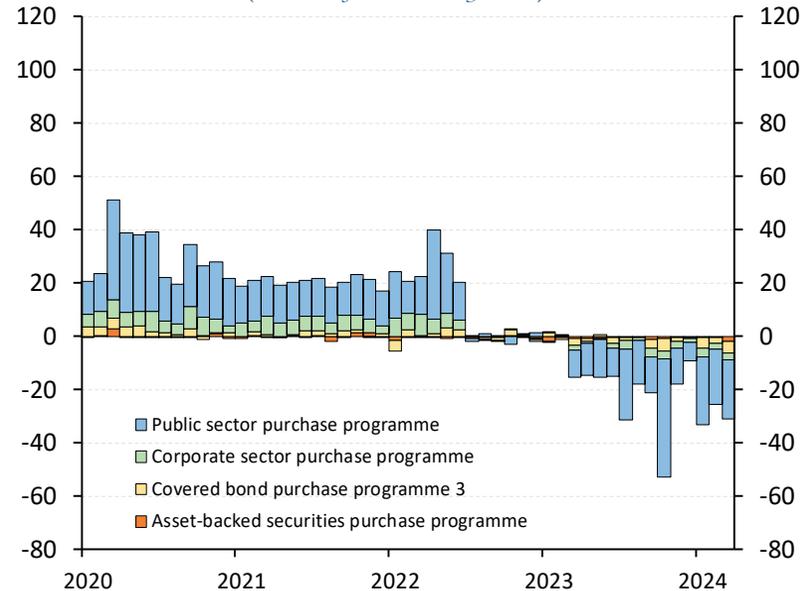
# Was ECB's response adequate?

- In late 2021, rate on deposit facility was in negative territory (-0.5%; MRO at 0) and Eurosystem was purchasing private and public assets (PEPP and APP)
- **Was ECB's response adequate?**
- ECB rapidly reduced net asset purchases and raised key rates rapidly and by an unprecedented amount
- Markets anticipated beginning of tightening cycle already in 2021

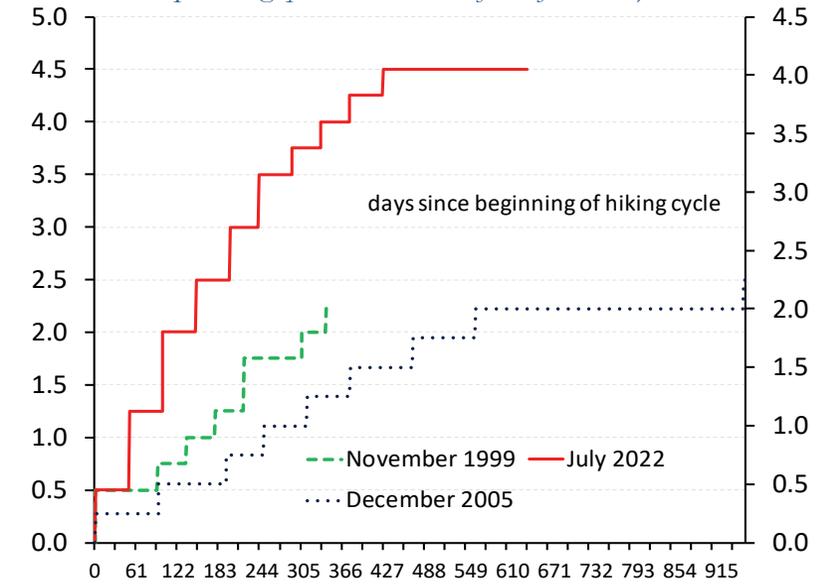
Net asset purchases: PEPP  
(billions €; monthly data)



Net asset purchases: APP  
(billions of €; monthly data)



Cumulative change of ECB's MRO rate  
(percentage point;  $t = 1$  time of the first hike)



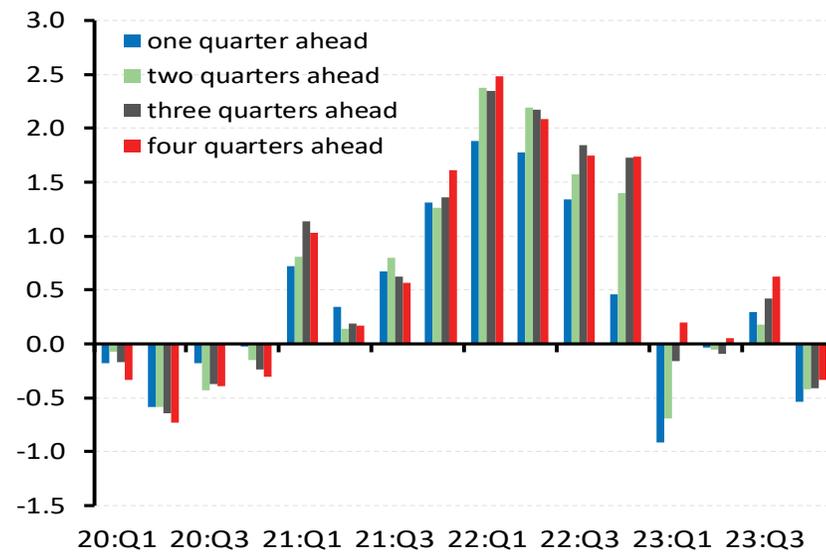
Source: ECB. Note: latest observation March 2024.

Source: ECB. Note: latest observation 17 April March 2024.

# Was a data-dependent and meeting-by-meeting approach useful?

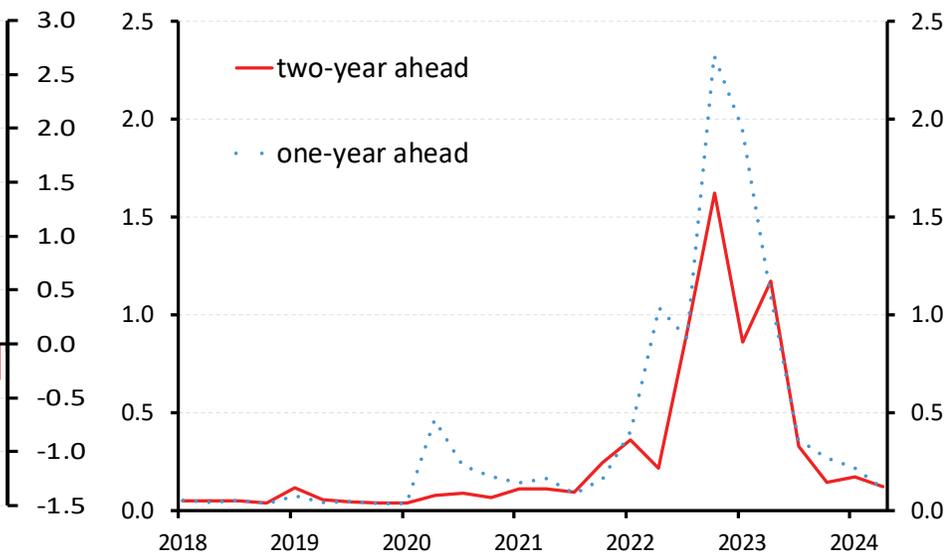
- Forecasting inflation has become challenging since outbreak of Covid-19. However, large and persistent errors in forecasting inflation were not due to failure of models
- *“In view of the uncertainty [...], it is no longer appropriate for monetary policy to give detailed forward guidance. Given the complexity [...] we are facing, being able to respond to the incoming data is a major advantage.”* Lagarde, 4/11/2022
- **Was a data-dependent and meeting-by-meeting approach useful?**
- More focus on incoming data allowed ECB to flexibly adjust the policy stance
- **Is it still useful?**  
Confidence in projections has increased and outlook is less uncertain

ECB/Eurosystem inflation projection errors  
(percentage points)



Source: ECB MPE and Eurosystem BMPE.

Disagreement among SPF participants  
(percentage points)



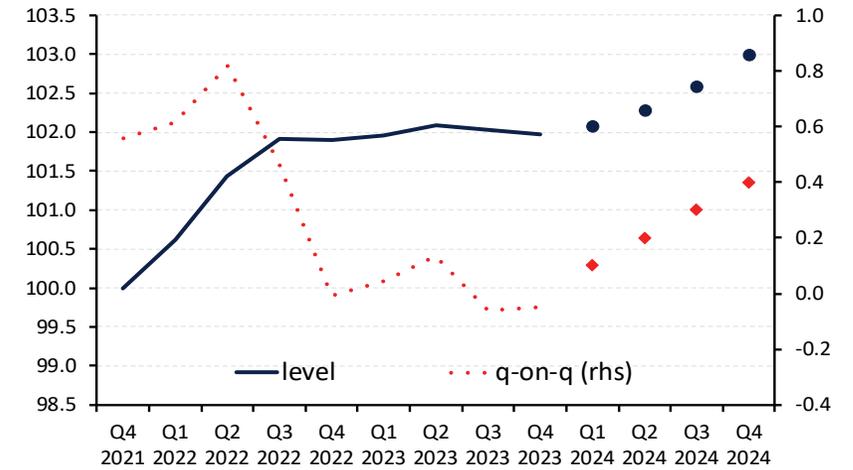
Source: ECB Survey of Professional Forecasters.

Note: April 2024 Survey of Professional Forecasters. Standard deviation of aggregate probability distribution.

# Looking forward: mind downside risks

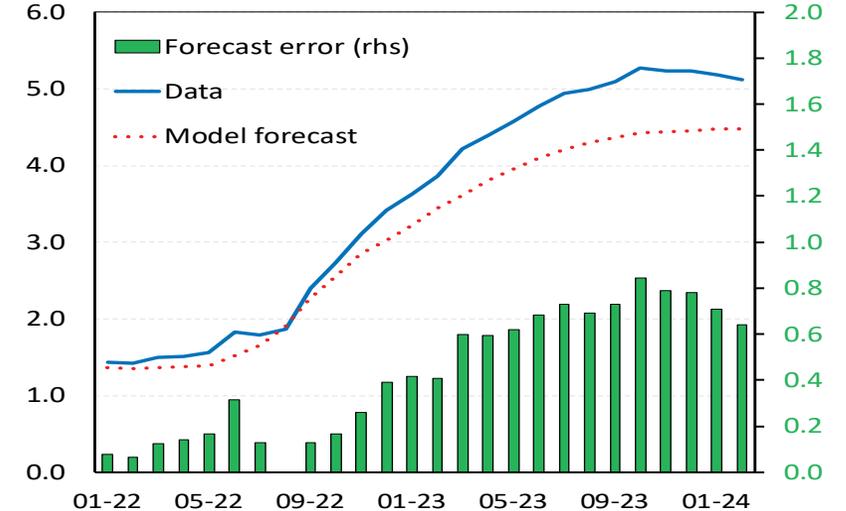
- Economic activity in euro area has been stagnating since 2022:Q4 (six consecutive quarters)
- Projected path for growth in 2024 is subject to downside risks, risks to inflation are balanced
- Tightening of financing conditions is stronger than in past; impact on economic activity is larger
- Tight monetary policy stance will continue weighing on demand and inflation throughout 2024 due to transmission lags (Panetta, 2024)
- With inflation projected to reach target in mid-2025, time has come to reduce downward pressure on aggregate demand and minimize unnecessary costs (Panetta, 2023b)

Euro-area real GDP  
(per cent; index: 2021:Q1 = 100)



Source: Eurostat and ECB  
March 2024 MPE.

Lending rates: euro-area firms  
(per cent)



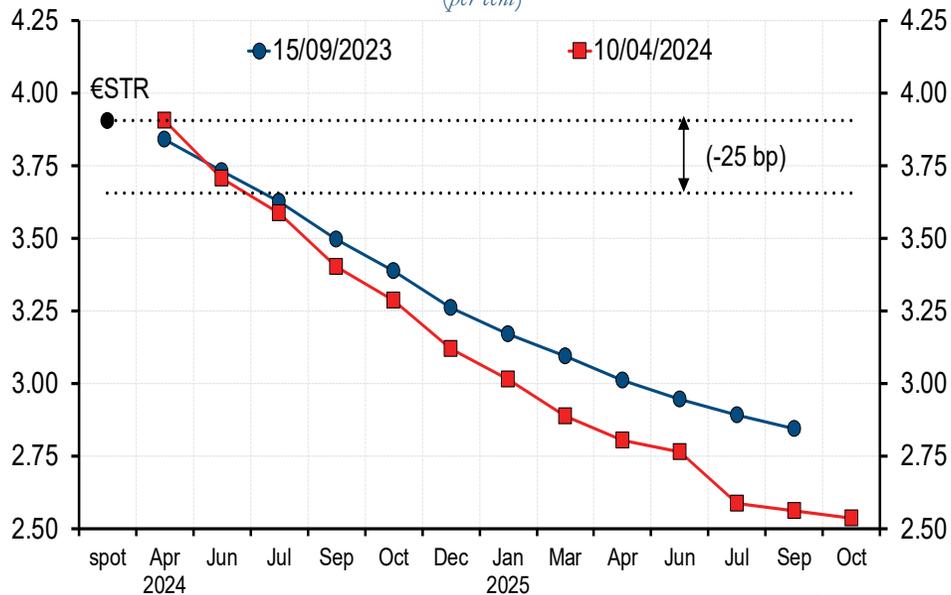
Source: Bottero and Conti (2023).

# Monetary policy stance is expected to remain restrictive

- Rate on deposit facility is expected to remain above long-run “equilibrium” level throughout 2024 and until end-2025
- Analysts expect 3 rate cuts this year, starting next June; markets are pricing a similar path

€STR forward curve

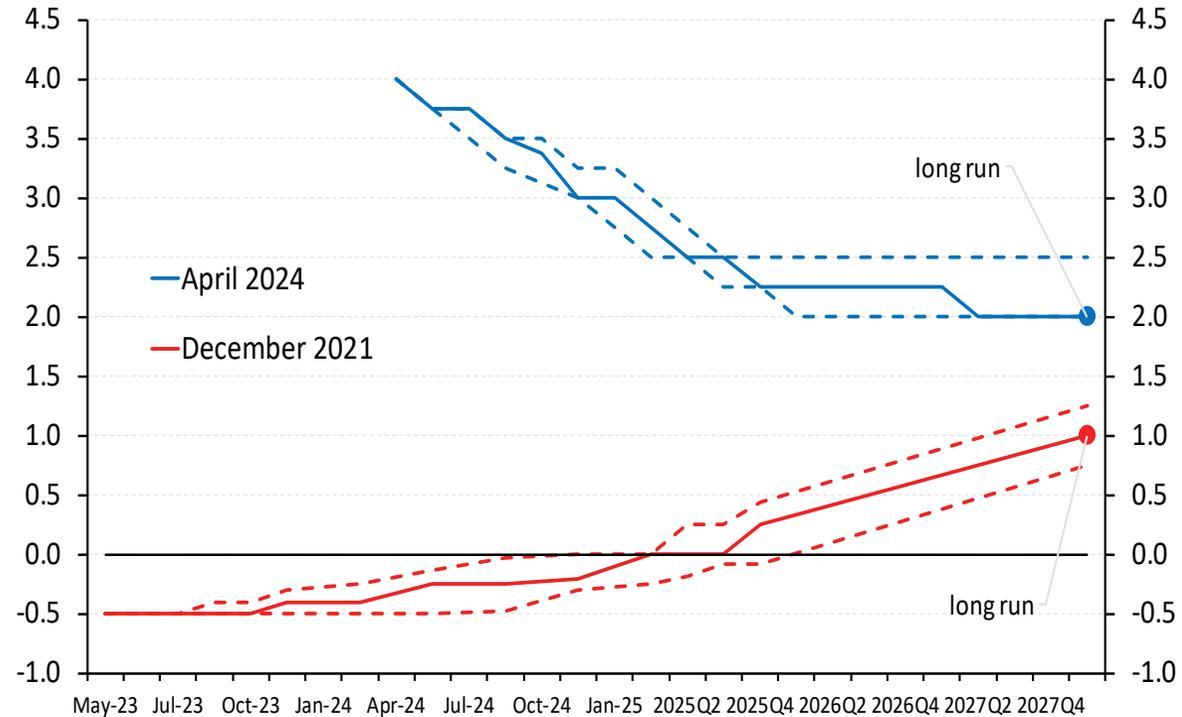
(per cent)



Source: Refinitiv and Bloomberg.

Expected rate on deposit facility

(per cent)



Source: ECB Survey of Monetary Analysts. Latest observation: April 2024.

# Key lessons for ECB'S monetary policy

- In summer of 2021, euro-area inflation woke up for first time in many years
- Facing a sequence of exceptional supply shocks, **monetary policy must stand ready to act timely and forcefully** to prevent a de-anchoring of inflation expectations and materialization of second-round effects
- Once monetary policy stance is sufficiently restrictive and confidence on inflation convergence to its target strengthens, **monetary policy should aim at minimizing its impact on economic activity**
- 2022-23 tightening cycle is different from past episodes: Eurosystem's balance sheet is shrinking

*Thank you for your attention!*

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