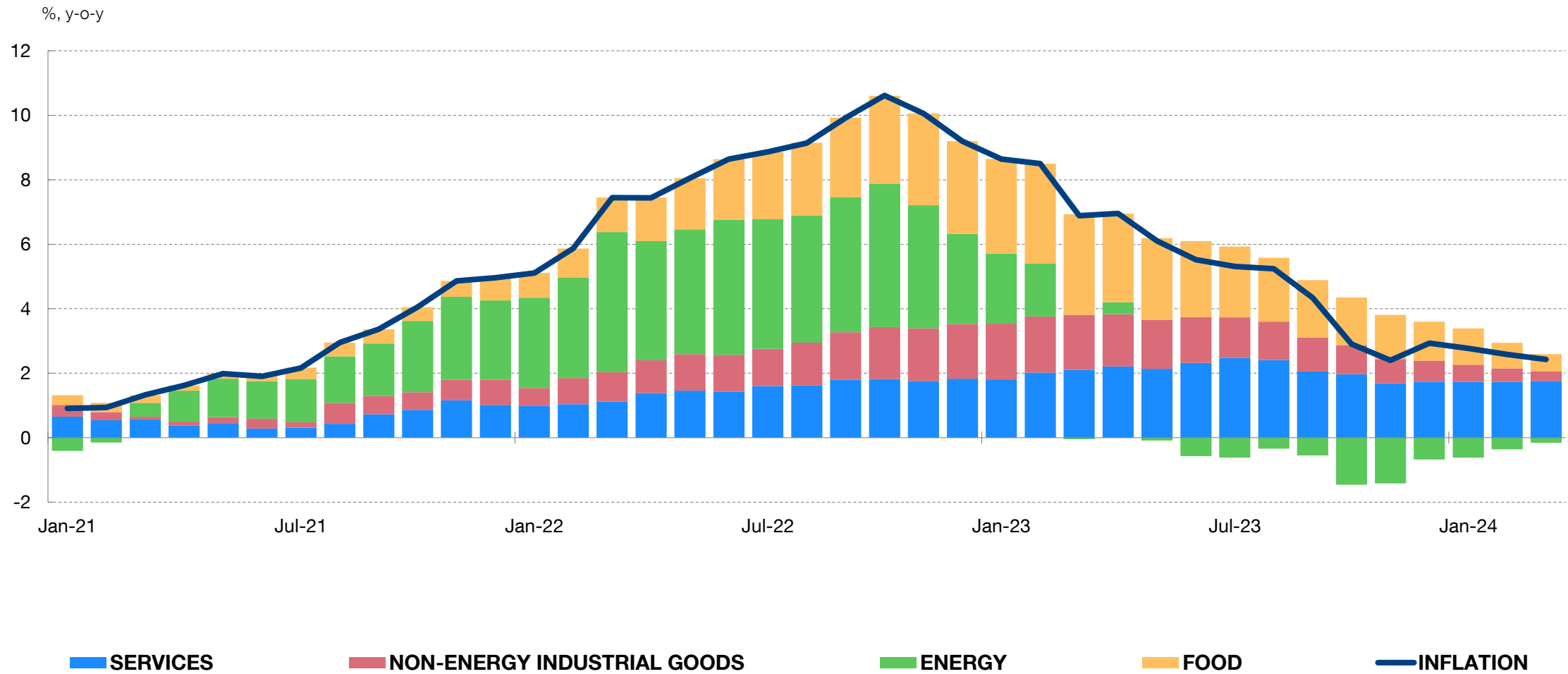# REFLECTIONS ON MONETARY POLICY ANALYSIS FROM THE LATEST INFLATIONARY-DISINFLATIONARY EPISODE

Pablo Hernández de Cos

Frankfurt

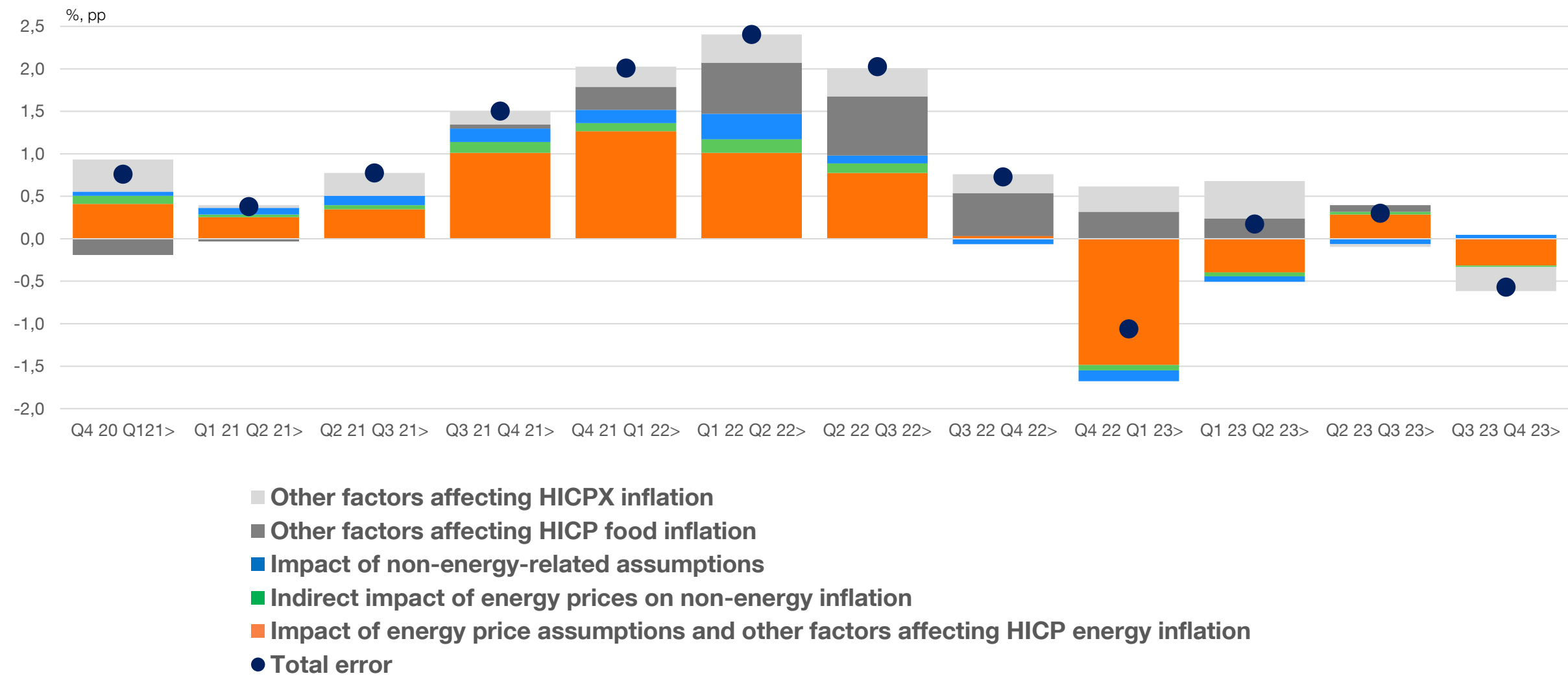27 January 2025

1. THE INFLATIONARY SHOCK WAS UNPRECEDENTED IN SCALE AND PERSISTENCE
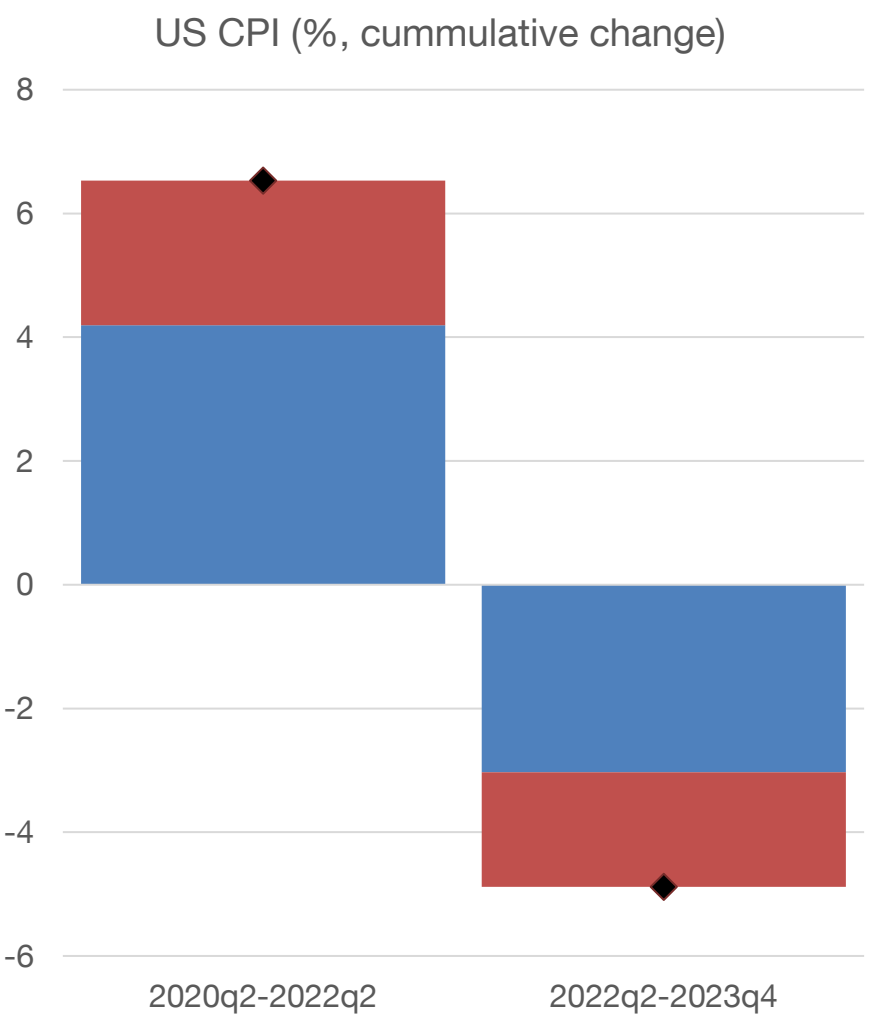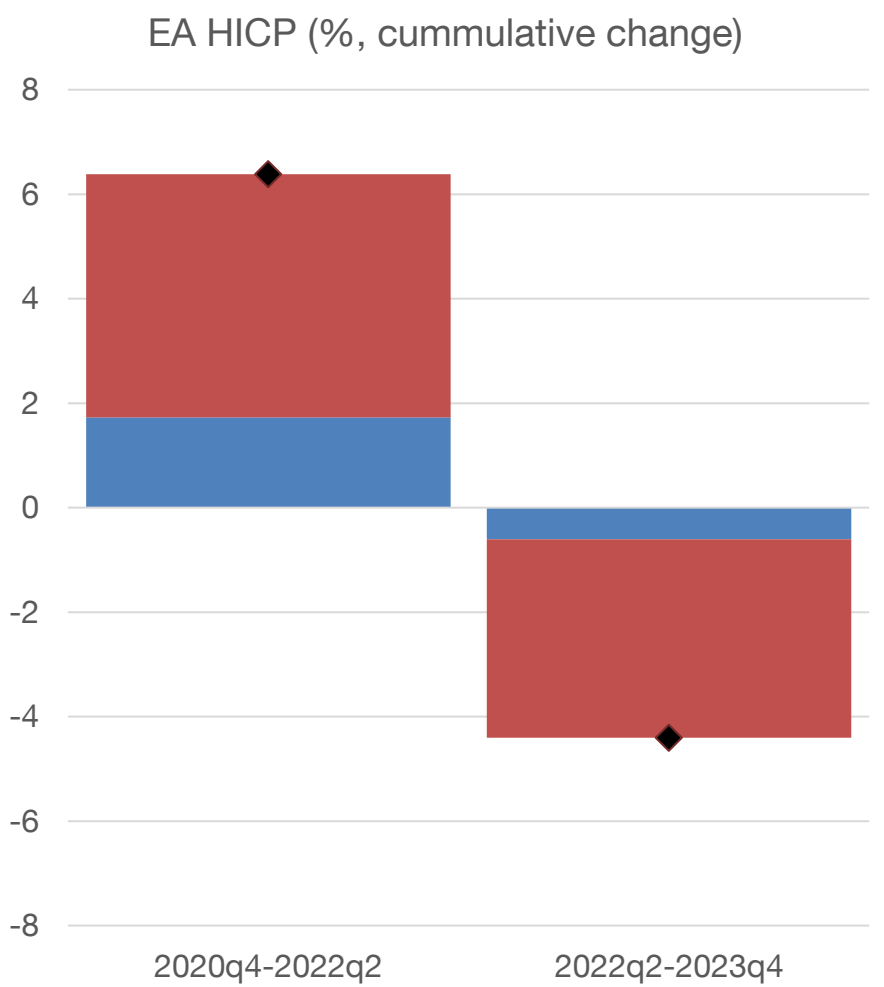
CONTRIBUTIONS TO HCPI INFLATION IN THE EURO (a)

%, y-o-y

Legend: SERVICES · NON-ENERGY INDUSTRIAL GOODS · ENERGY · FOOD · INFLATION

AND SURPRISED ALL FORECASTERS

**DECOMPOSITION OF ONE-QUARTER-AHEAD HICP INFLATION ERRORS IN
EUROSYSTEM/ECB STAFF PROJECTIONS (b)**

Legend:
- **Other factors affecting HICPX inflation**
- **Other factors affecting HICP food inflation**
- **Impact of non-energy-related assumptions**
- **Indirect impact of energy prices on non-energy inflation**
- **Impact of energy price assumptions and other factors affecting HICP energy inflation**
- **Total error**

PASSIVE VS ACTIVE MONETARY POLICY UNDER NEGATIVE SUPPLY SHOCKS

1. ANNUAL HICP INFLATION

%, yoy

ACTING — LOOKING THROUGH — — 2% Target

2. ANNUAL CORE INFLATION

%, yoy
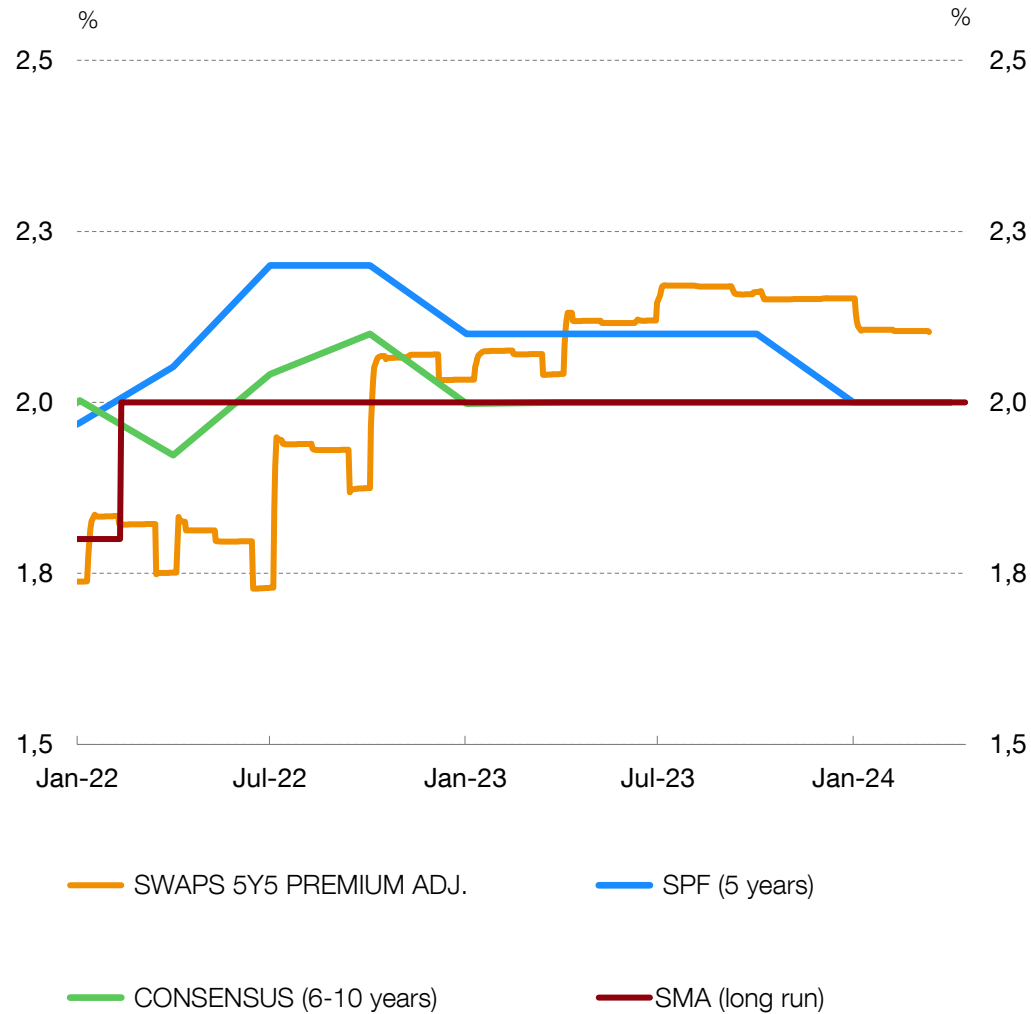

ACTING — LOOKING THROUGH — — 2% Target
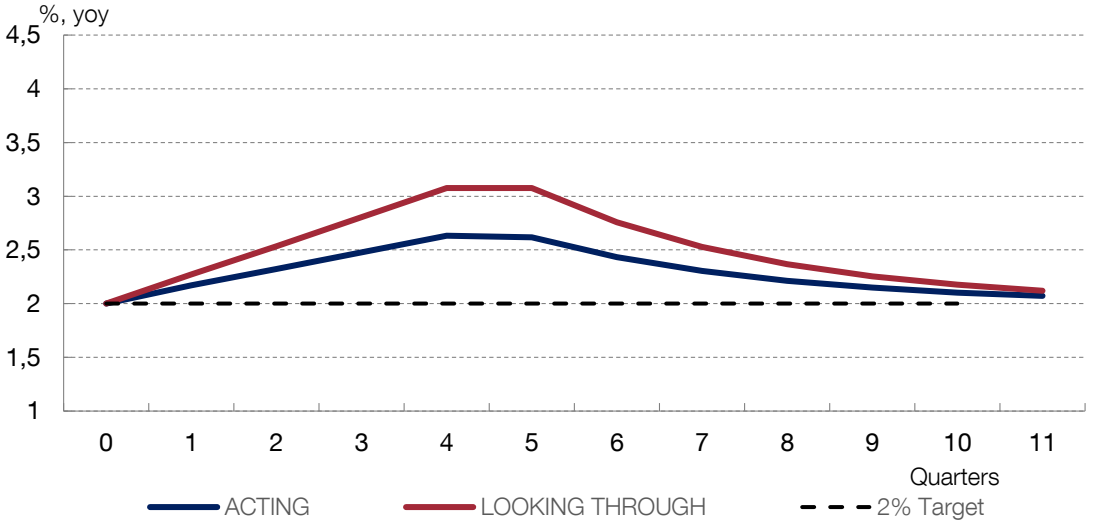
Notes: Energy price level increases 10% permanently. The "acting" scenario corresponds to monetary policy conducted through a standard Taylor rule. The "looking through" counterfactual scenario corresponds to monetary policy not reacting to inflation developments.

3. UNCERTAINTY HAS REMAINED ELEVATED

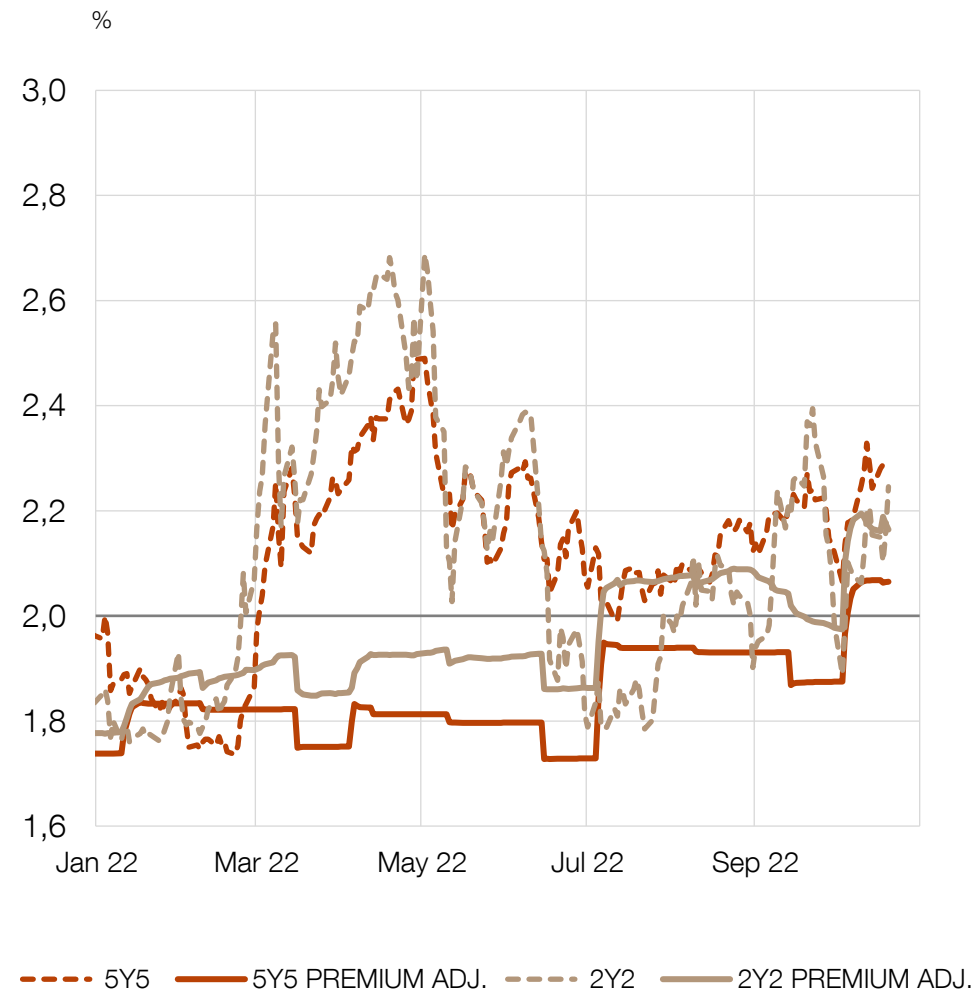Monthly Global Economic Policy Uncertainty Index
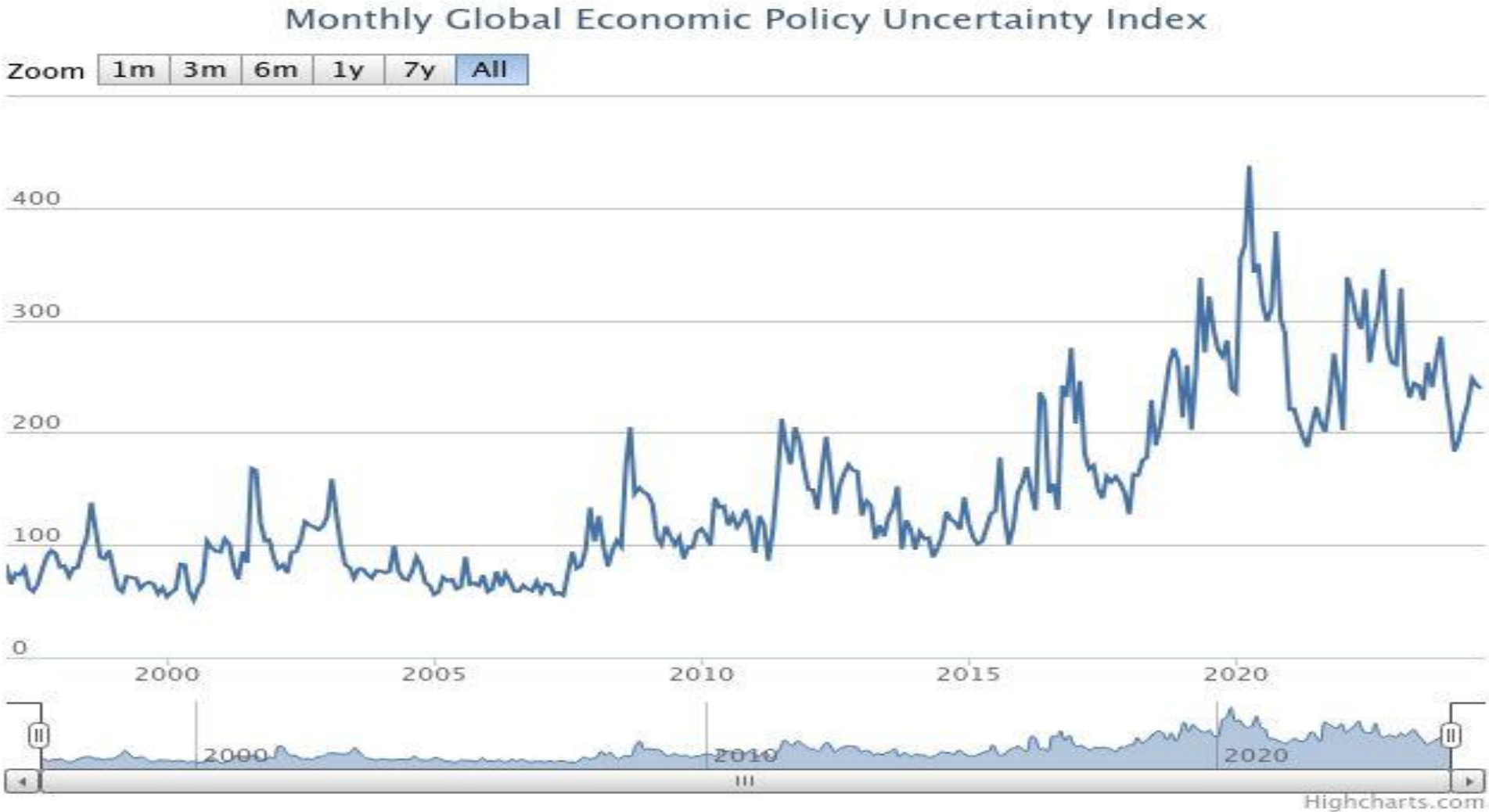
4. ANCHORING OF INFLATION EXPECTATIONS IS KEY

EURO AREA: LONG-TERM INFLATION EXPECTATIONS (a) BASED ON ANALYSTS AND MARKET SURVEYS

Legend:
- SWAPS 5Y5 PREMIUM ADJ.
- SPF (5 years)
- CONSENSUS (6-10 years)
- SMA (long run)

EURO AREA LONG-TERM INFLATION EXPECTATIONS

Legend:
- 5Y5
- 5Y5 PREMIUM ADJ.
- 2Y2
- 2Y2 PREMIUM ADJ.

5. MOST ESTIMATES OF THE NATURAL INTEREST RATE (R*) POINT TO AN INCREASE AFTER THE PANDEMIC, BUT ITS LEVEL REMAINS LOW

ESTIMATES OF THE EURO AREA REAL NATURAL RATE
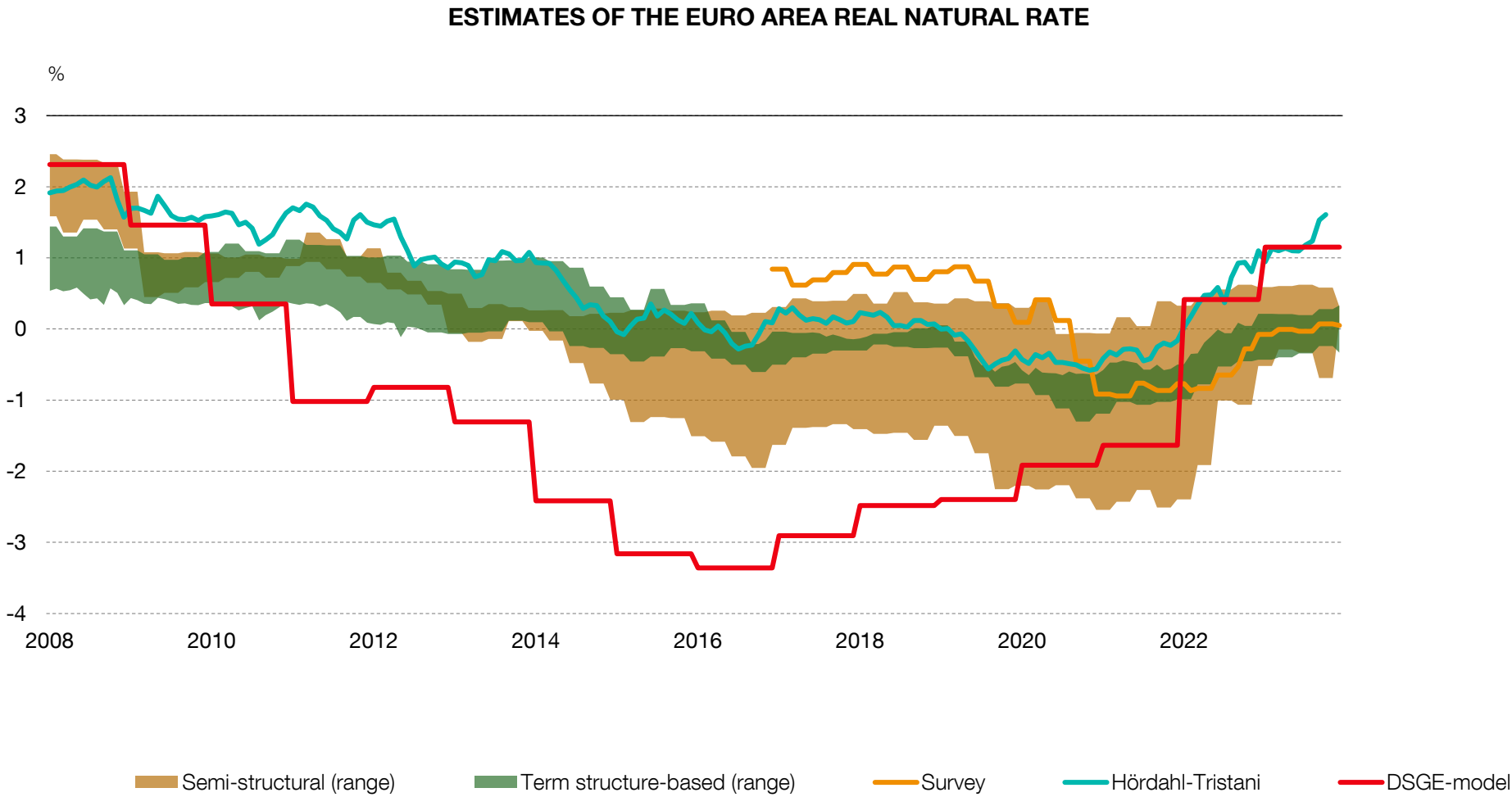
6. MONETARY POLICY TRANSMISSION TO CREDIT STANDARDS AND NET CREDIT FLOWS HAS BEEN STRONGER THAN IN OTHER TIGHTENING EPISODES

CHANGE IN EURO AREA BANK LENDING STANDARDS (a)

Legend:
- INTEREST RATE HIKING CYCLE 2005. 2005 Q3 - 2006 Q3
- GLOBAL FINANCIAL CRISIS. 2008 Q3 - 2010 Q1
- SOVEREIGN DEBT CRISIS. 2010 Q1 - 2012 Q2
- INTEREST RATE HIKING CYCLE. 2022 Q1 - 2023 Q4

LOAN PROJECTIONS (YoY). SPANISH NON-FINANCIAL FIRMS (b)

Legend:
- OBSERVED
- DEC-21
- MAR-22
- JUN-22
- SEP-22
- DEC-22
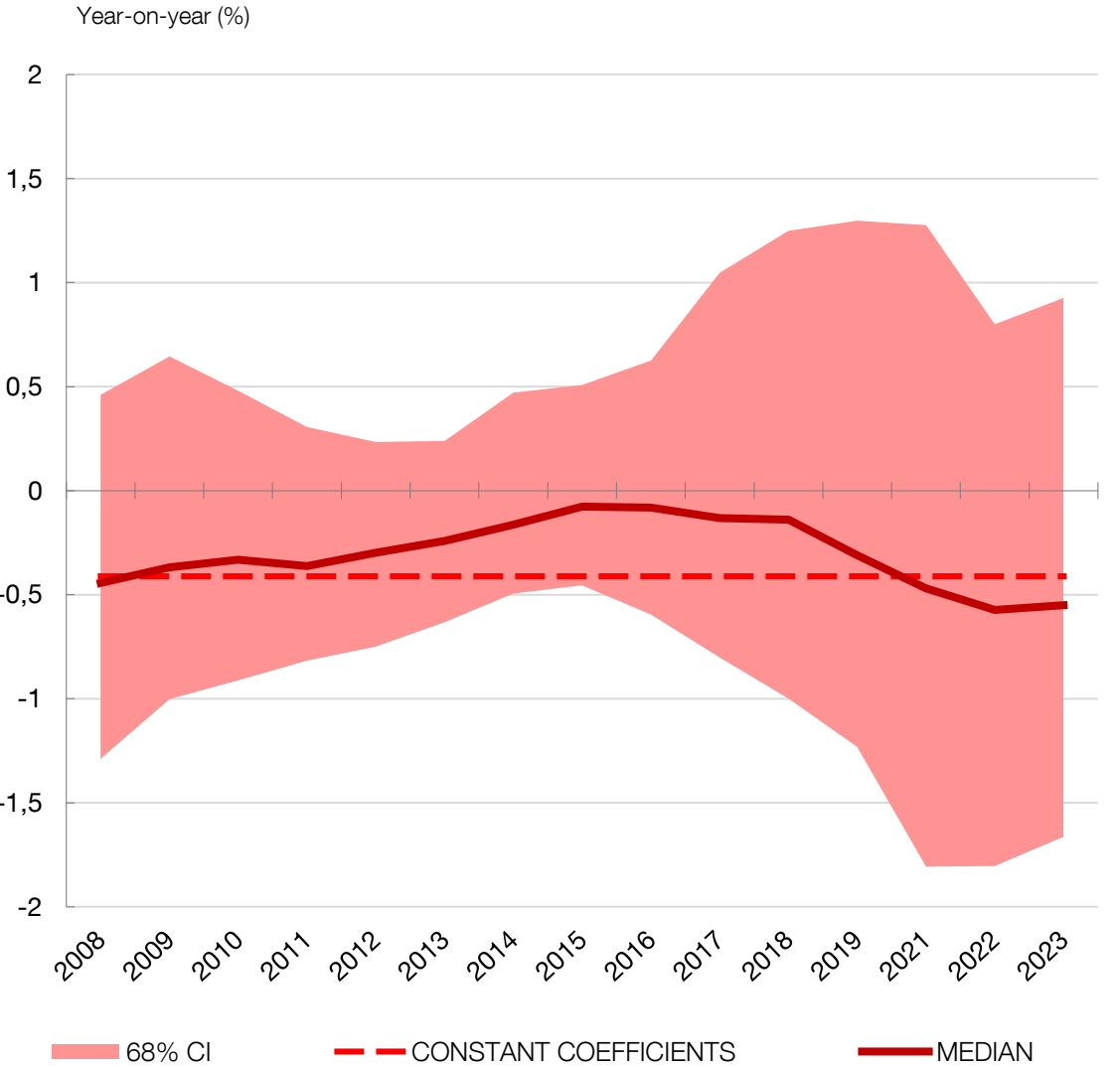- MAR-23
- JUN-23
- SEP-23
- DEC-23
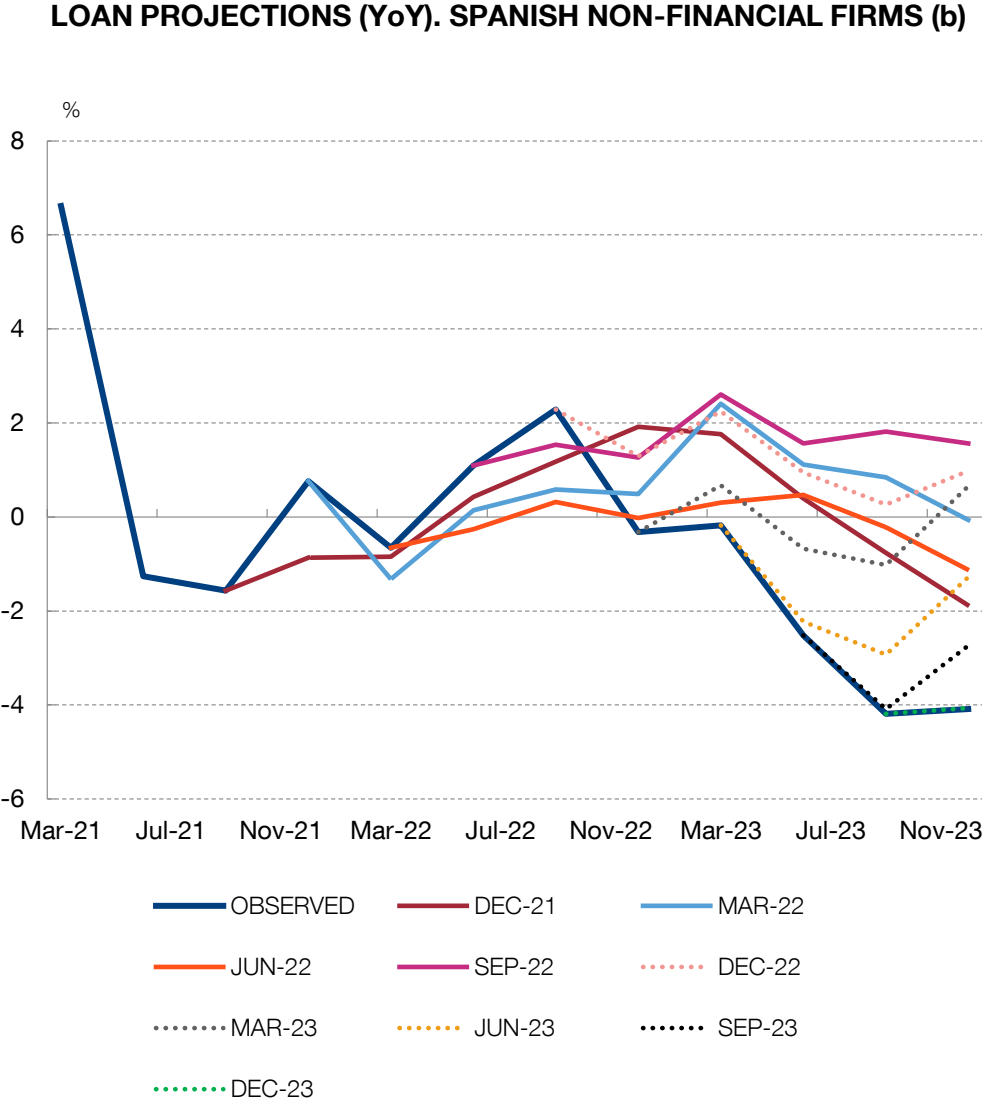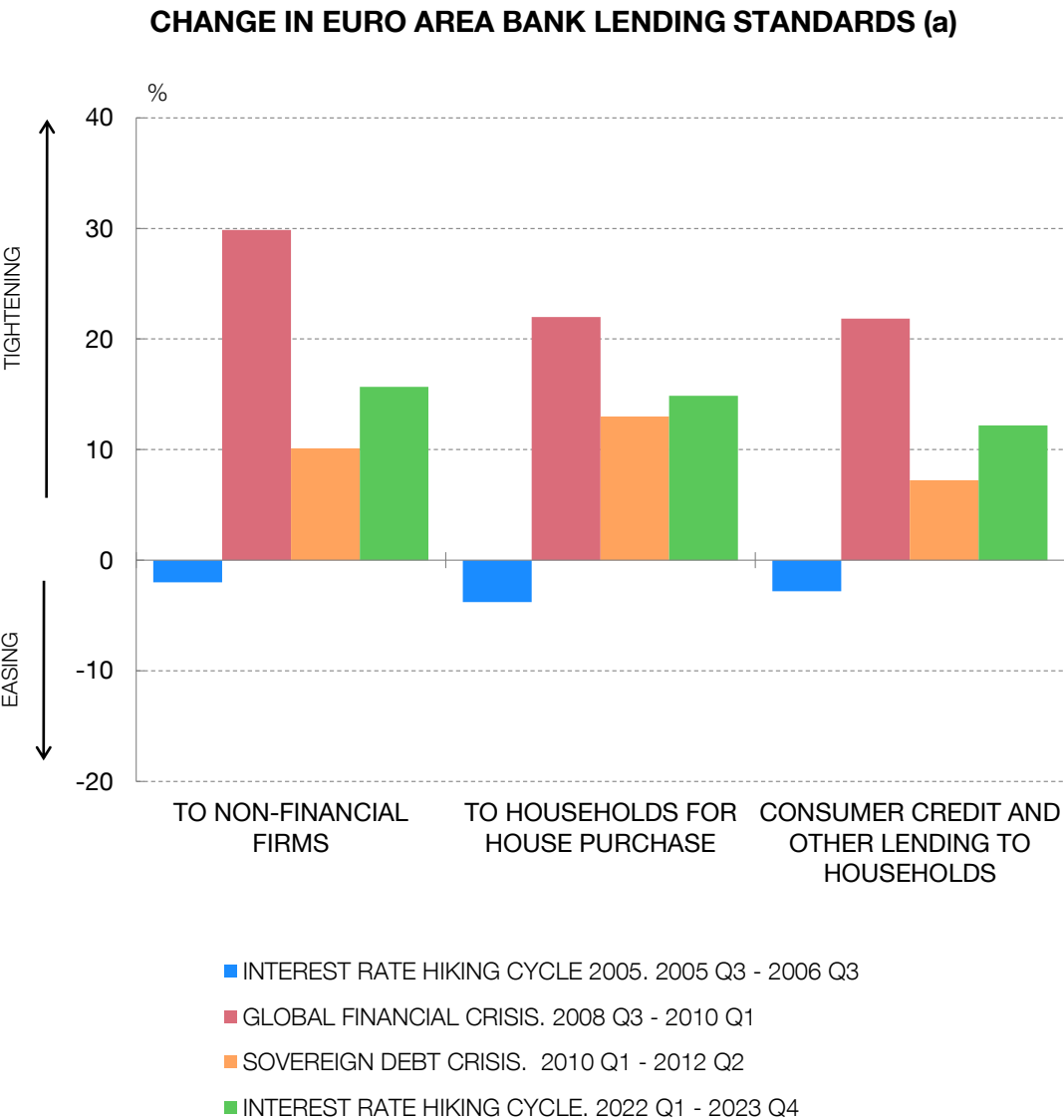
TIGTHER FINANCIAL CONDITIONS HAVE TRANSMITTED MORE FORCEFULLY TO ACTIVITY AND (ALTHOUGH NOT SIGNIFICANT TO) INFLATION THAN IN PREVIOUS CYCLES ON AVERAGE
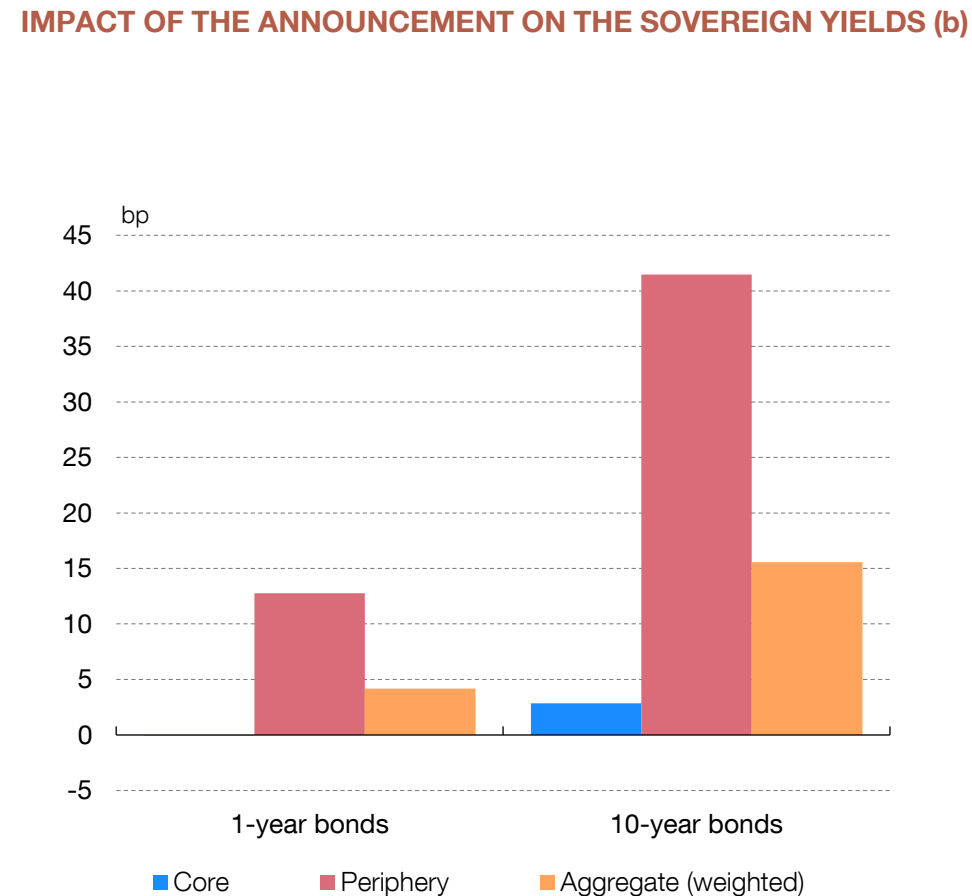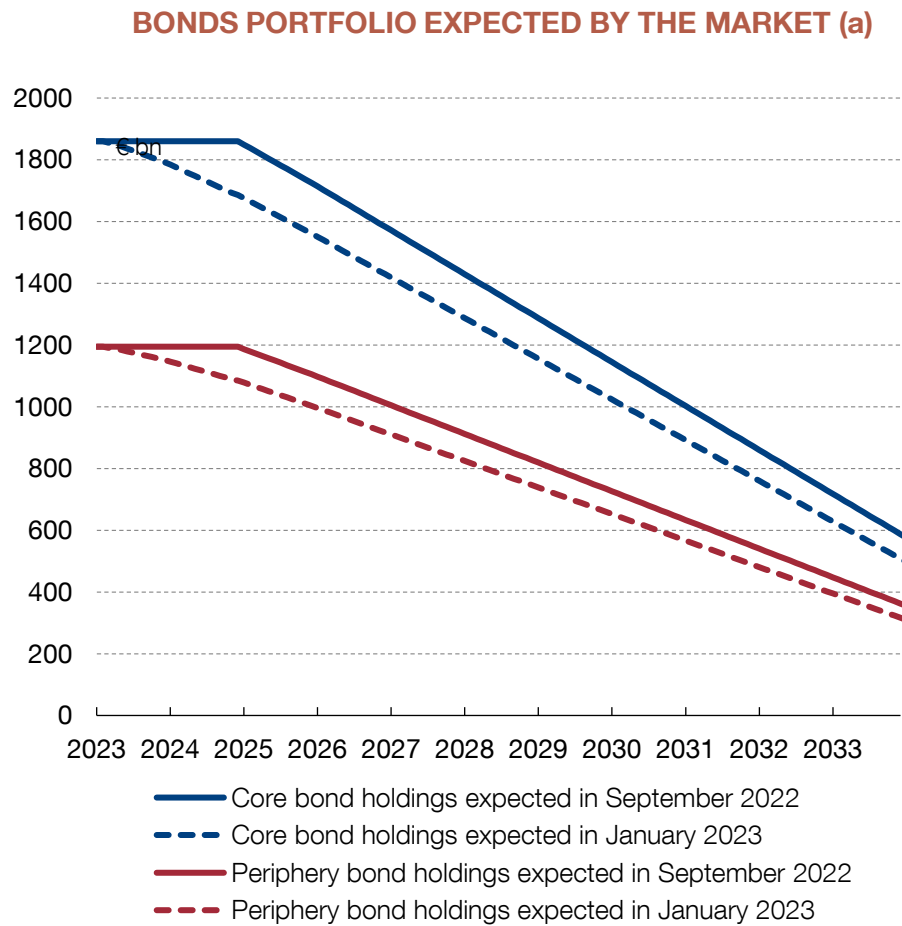
TIME-VARYING IMPACT OF A 100 BPS SHOCK ON GDP OVER THE <u>FIRST</u> YEAR
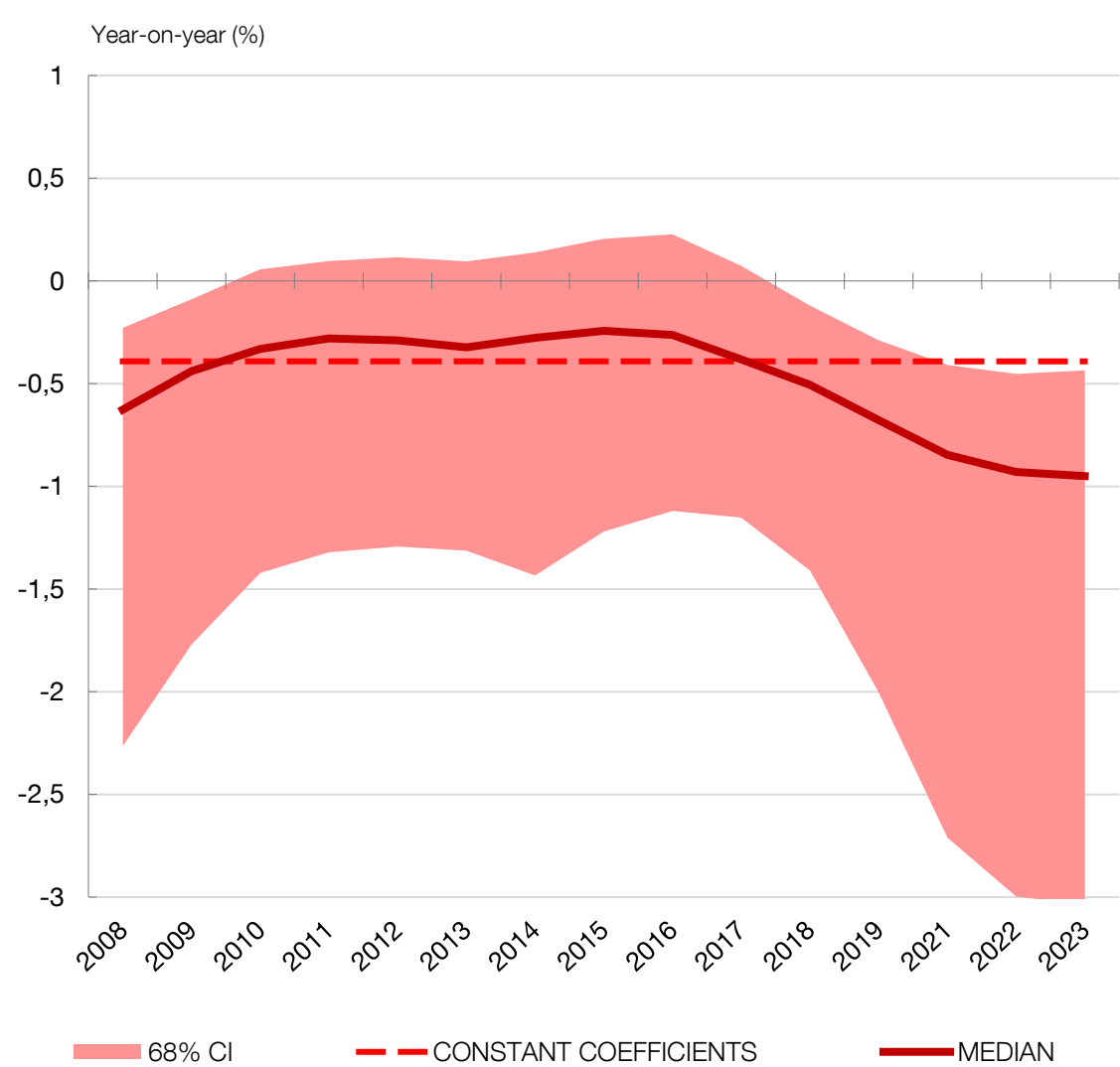
TIME-VARYING IMPACT OF A 100 BPS SHOCK ON HICP OVER THE <u>SECOND</u> YEAR

7. SIMULATING A SURPRISE REDUCTION IN THE EUROSYSTEM'S SOVEREIGN BOND PORTFOLIO

BONDS PORTFOLIO EXPECTED BY THE MARKET (a)

€bn

- Core bond holdings expected in September 2022
- Core bond holdings expected in January 2023
- Periphery bond holdings expected in September 2022
- Periphery bond holdings expected in January 2023

IMPACT OF THE ANNOUNCEMENT ON THE SOVEREIGN YIELDS (b)

bp

■ Core   ■ Periphery   ■ Aggregate (weighted)

Sources: European Central Bank, Bloomberg, Refinitiv Datastream and Banco de España.
Analysis based on J. Costain, G. Nuño, y C. Thomas (2022), "The term structure of interest rates in a heterogeneous monetary union", Working Paper No. 2223, Banco de España.
a. These portfolios refers to sovereign bonds held by Eurosystem central banks under the asset purchase programme (APP) and pandemic emergency purchase programme (PEPP). Expectations on the evolution of this portfolio are obtained from surveys conducted by Bloomberg associated with each monetary policy meeting of the ECB's Governing Council. 'Core' refers to holdings of Germany and France and 'Periphery' refers to holdings of Spain and Italy.
b. The chart shows the changes in euro area sovereign bond yields attributable to the portfolio reduction announcement from the ECB's monetary policy meeting in December 2022. 'Core' refers to the average between Germany and France, 'Periphery' to the average of Spain and Italy and 'Aggregate' to the average of the 4 countries; all averages are weighted by 2022 GDP.

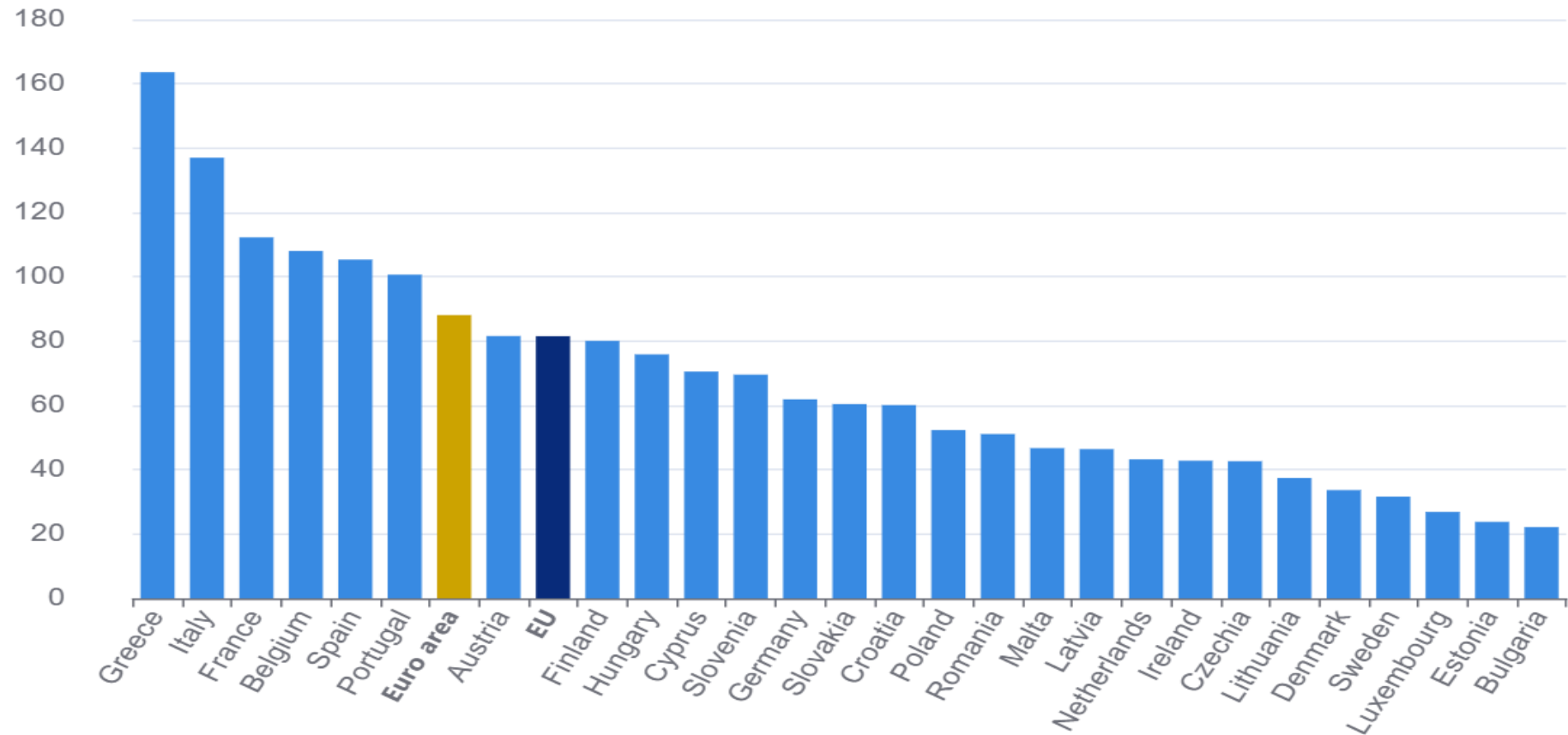# 8. MONETARY POLICY AND FINANCIAL STABILITY

10-year government bond yield spreads to Germany, in %
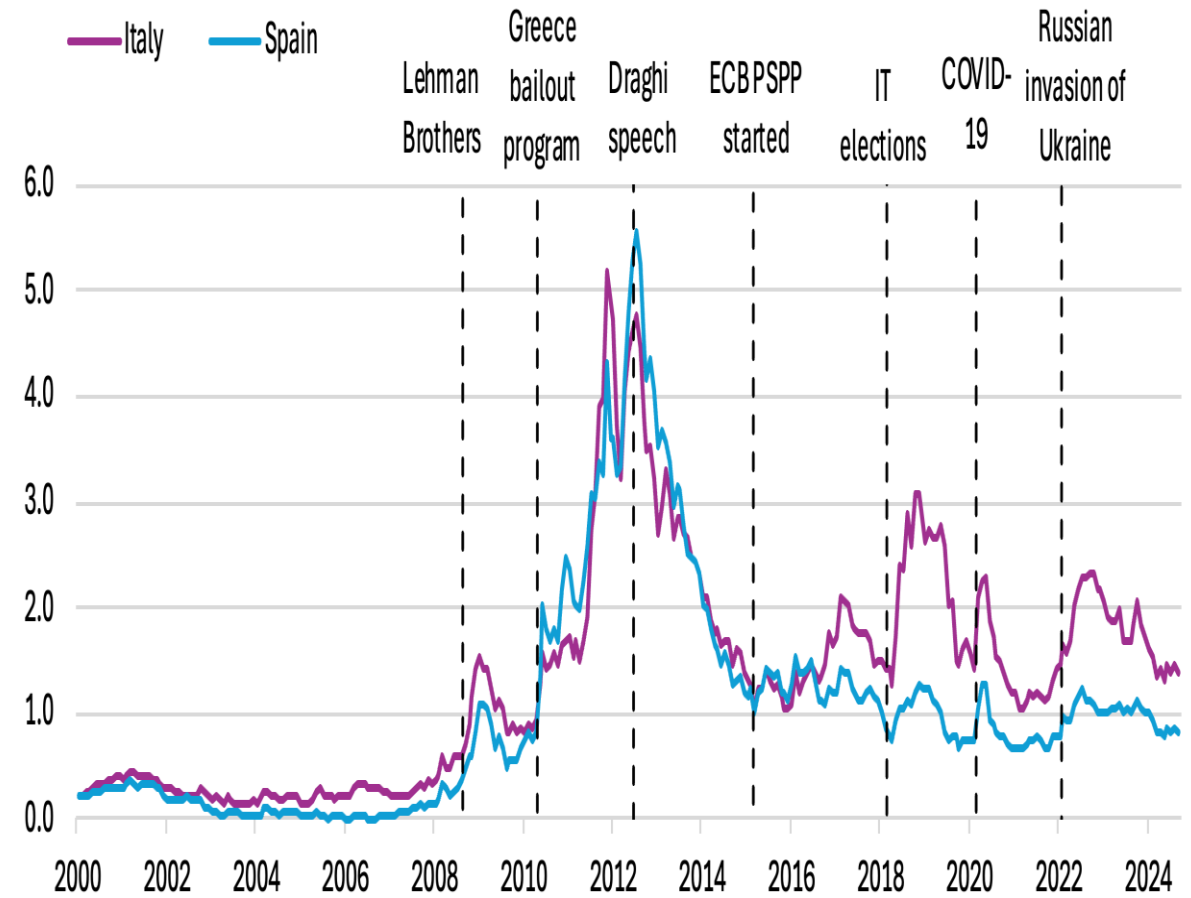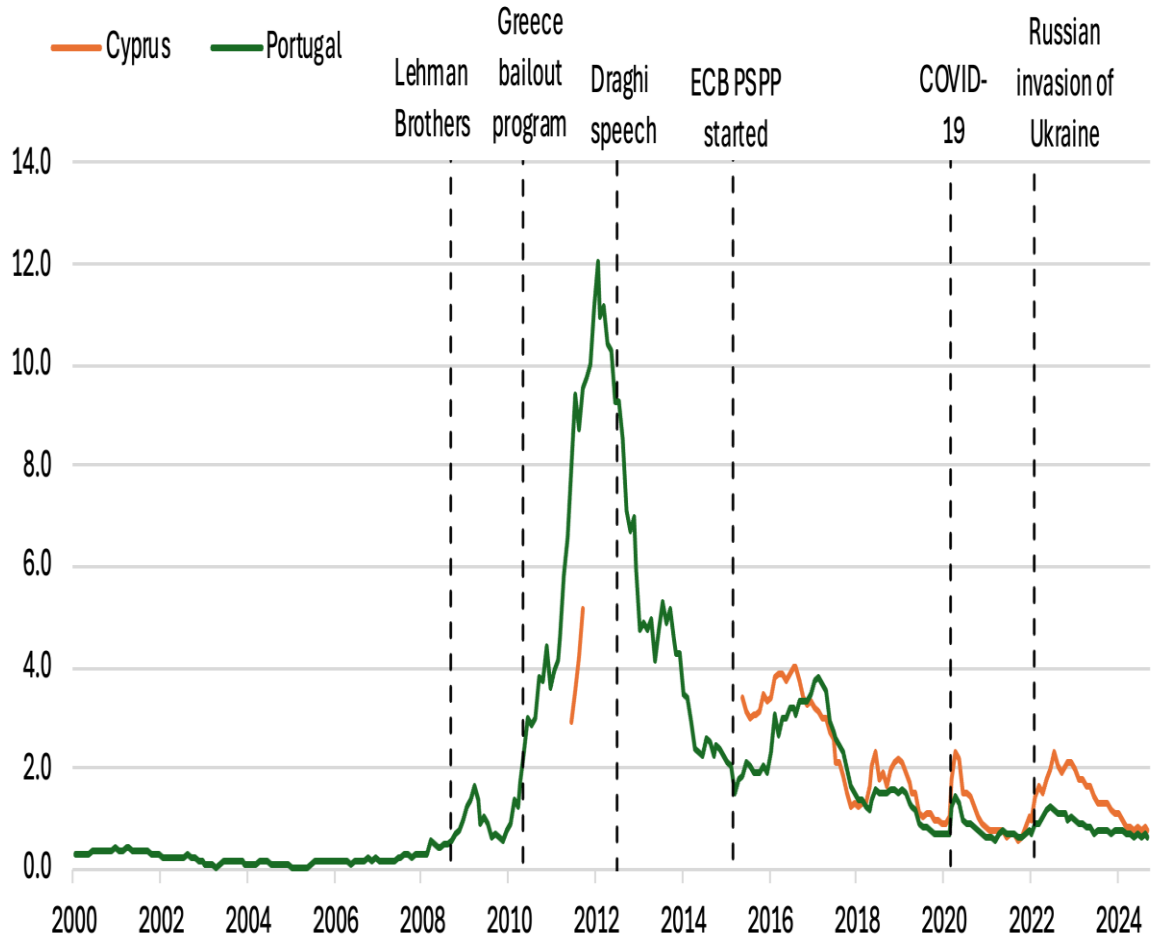
9. MONETARY AND FISCAL POLICY INTERACTIONS

General government gross debt to GDP ratio, 2024Q2

In percentage

10. MONETARY POLICY AND STRUCTURAL REFORMS

Projections for potential output growth and contributions of components

(average annual percentage growth over five-year periods)

- ● Potential GDP growth
- ■ Labour input: hours worked
- ■ Total factor productivity
- ■ Capital deepening (contribution to labour productivity)

Sources: 2024 Ageing Report and ECB staff calculations.
Notes: The data refer to average growth in the specified year and the following four years. Capital deepening refers to changes in the ratio of capital to labour. * For 2022, the data refer to average growth in the period 2022-24. ** For 2070, the data refer to annual growth in the year 2070.