EUROPEAN CENTRAL BANK

EUROSYSTEM

What is keeping inflation high?

Civil Society
Seminar Series

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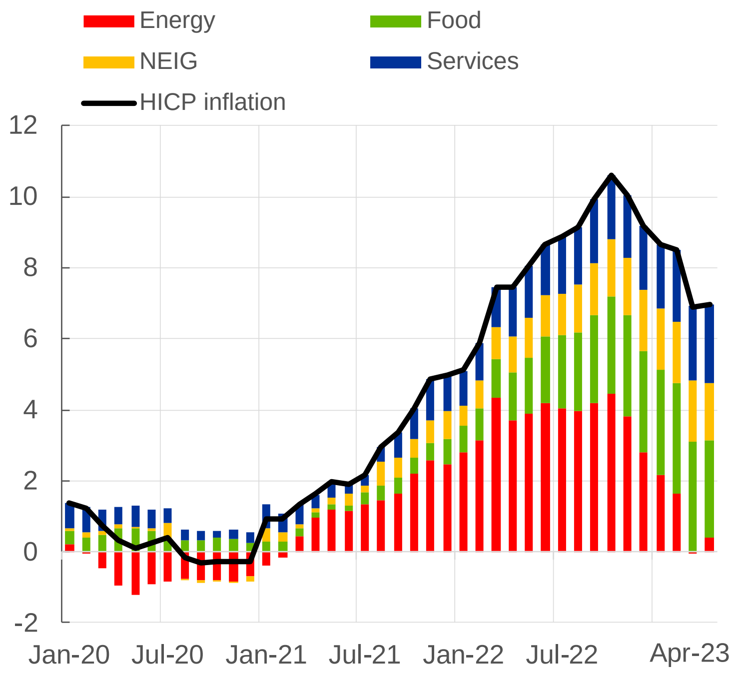
Origins of high inflation

- **Series of exceptional shocks** drove prices up
- **Adverse global supply shocks** from pandemic lockdowns and the Russia's war on Ukraine caused global supply chain disruptions and energy production cuts
- Reopening of the economy led to a rapid release of pent-up **demand**
- **Scale and size of shocks** led to faster and stronger pass-through into prices
- While headline inflation is falling, it remains too high and **underlying price pressures are still strong**

Headline inflation and main components
(annual percentage change and percentage point contributions)



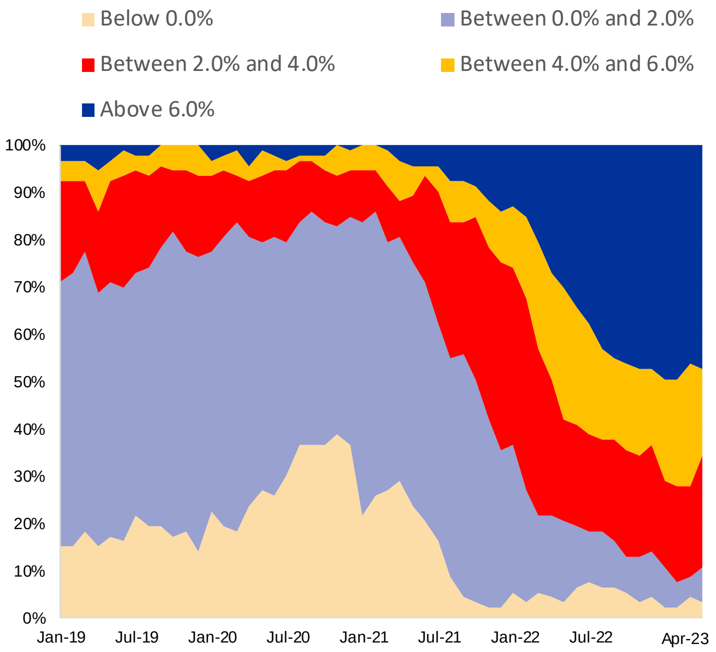
Sources: Eurostat and ECB calculations.
The latest observations are for April 2023.

Underlying inflation and persistence

- Demand in some sectors has been strong, supported by accumulated **savings**, also fuelling sustained high prices

- High costs and prices have **spread generally**

Share of items within inflation brackets
(percentages)



Sources: Eurostat and ECB calculations.
Note: Based on COICOP classification and includes 93 items. Represented is the unweighted share of items.
The latest observations are for April 2023 .

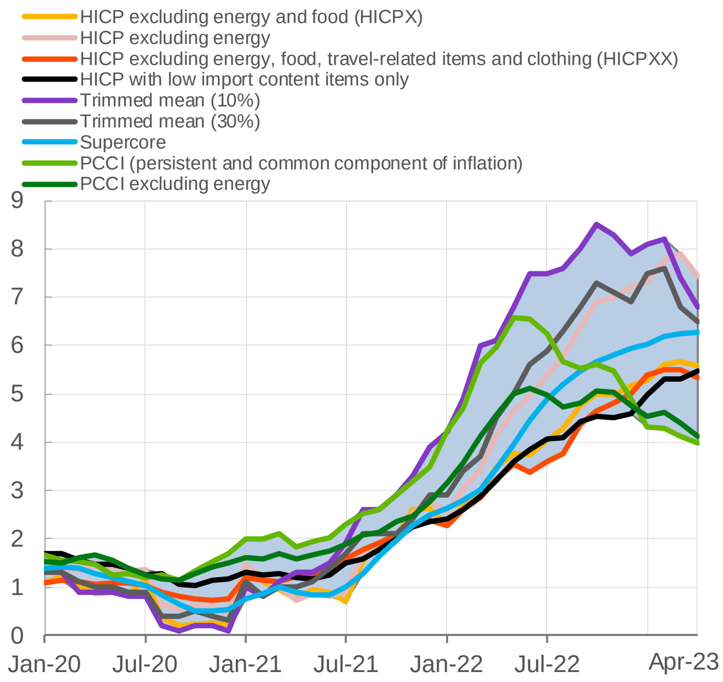
Underlying inflation and persistence

- Demand in some sectors has been strong, supported by accumulated **savings**, also fuelling sustained high prices

- High costs and prices have **spread generally**

- Measures of **underlying inflation**, which capture the more durable part of inflation, are still high

Indicators of underlying inflation
(annual percentage changes)



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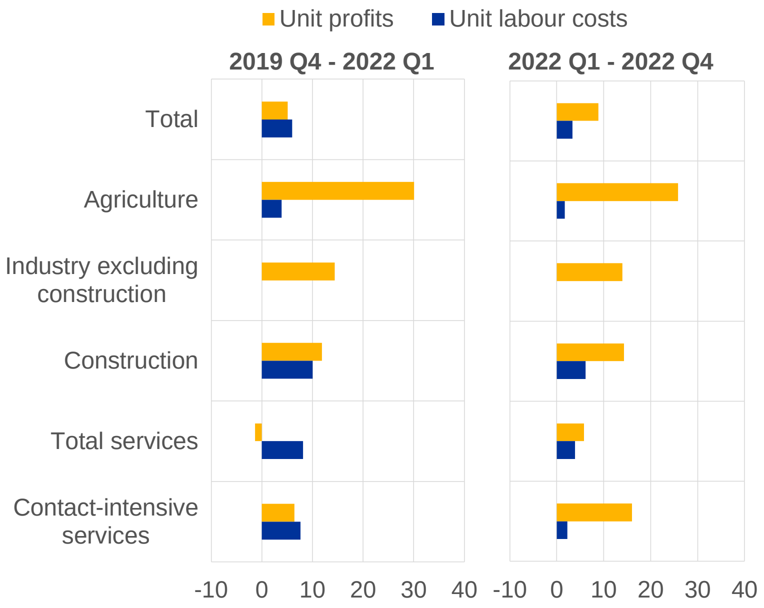
- **Unit profits** have contributed decisively to the increase in inflation in the last quarters

Sectoral unit profit developments

(percentage changes over the indicated period)



Sources: Eurostat, and ECB staff calculations.
Note: Unit profits correspond to gross operating surplus over real value added.
Contact-intensive services include trade, transport, accommodation and food and arts, entertainment, recreation and other services.
The latest observations are for Q4 2022.

Underlying inflation and persistence

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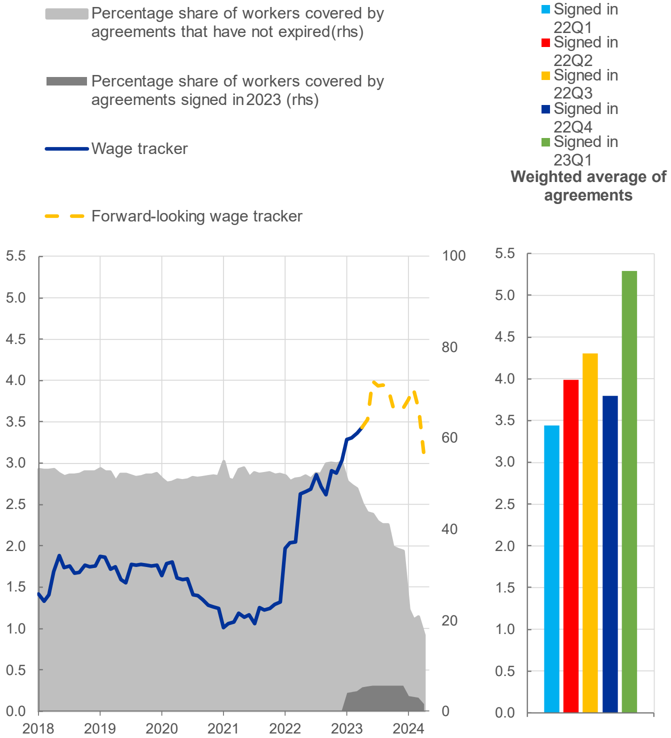
- High costs and prices have **spread generally**
- Measures of **underlying inflation**, which capture the more durable part of inflation, are still high
- **Unit profits** have contributed decisively to the increase in inflation in the last quarters
- In parallel, labour market remains strong and **wage growth** is increasing

Forward-looking wage trackers

(annual percentage changes and percentages)



Sources: Calculations based on micro data on wage agreements provided by Deutsche Bundesbank, Banco de España, the Dutch employers' association (AWVN), Oesterreichische Nationalbank, Bank of Greece, Banca d'Italia and Banque de France. Data for France are based on an updated version of Gautier, E. (2022): Negotiated wage rises for 2022: the results so far.

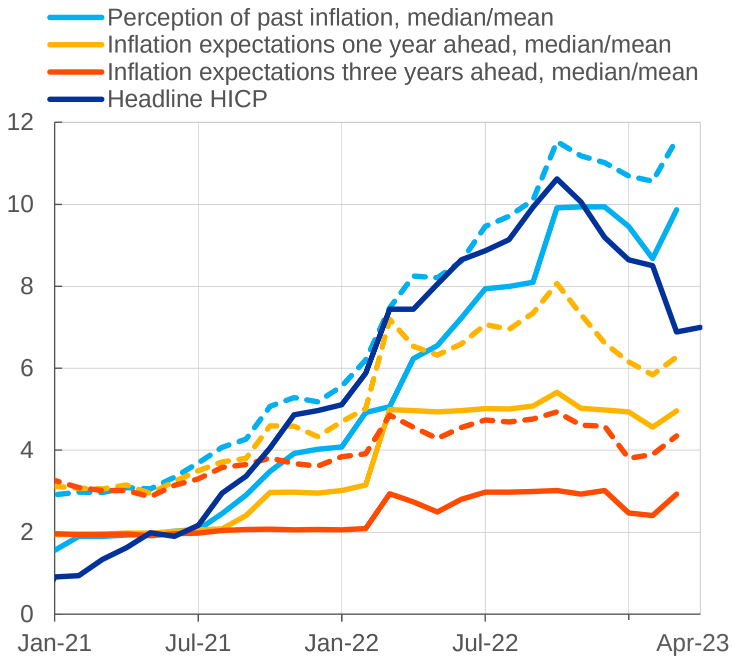
Note: Euro area aggregate based on ES, IT, GR, AT, DE, NL, FR as at May 2023.

The outlook for inflation

- **Inflation is expected to decrease** over the medium term

- Inflation has passed its peak, but it is descending from very high levels and is **expected to remain above our target for some time**

Consumers' inflation perceptions and expectations and HICP inflation
(annual percentage changes)



Source: Eurostat and Consumer expectation survey.
Note: Solid/dashed lines represent the median/mean.
The latest observations are for April 2023 for HICP and March 2023 for CES.

The outlook for inflation

- **Inflation is expected to decrease** over the medium term

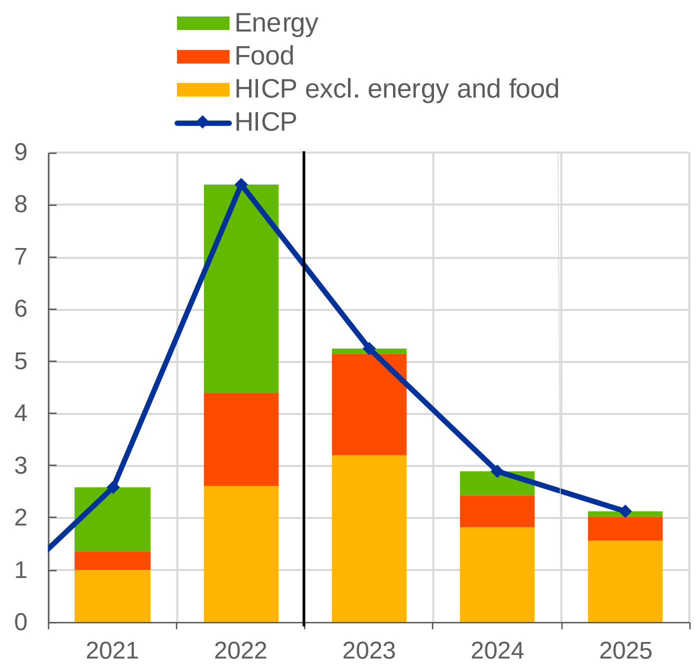
- Inflation has passed its peak, but it is descending from very high levels and is **expected to remain above our target for some time**

- Lower inflation this year is largely explained by falling energy prices, but food inflation will remain high for some time

- Latest ECB staff forecasts see headline inflation returning to 2.1% in 2025

Inflation developments and projections

(annual percentage change and percentage point contributions)



Source: March 2023 ECB Staff Macroeconomic Projection Exercise.

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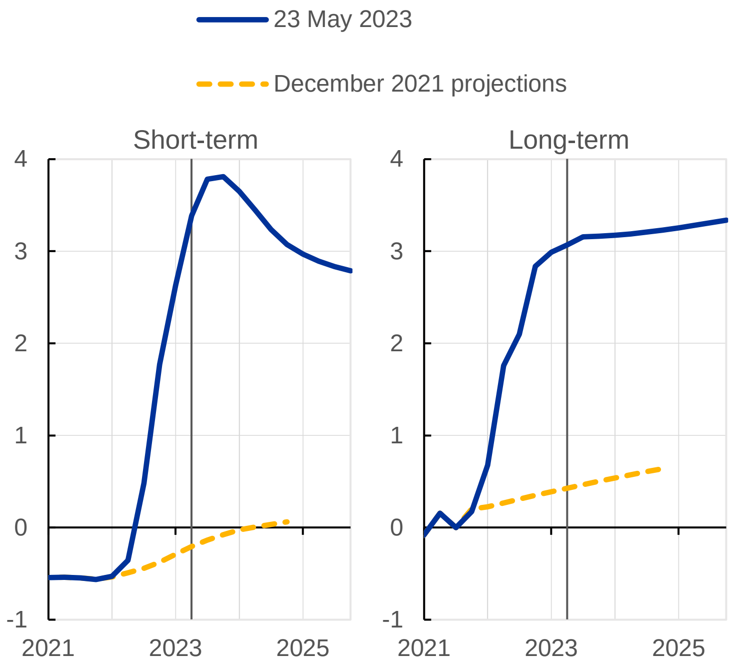
The ECB reaction

- In December 2021, the **ECB began adjusting its monetary policy**

- **Policy interest rates have increased significantly** to bring inflation back under control

Short- and long-term interest rates
(percentages per annum)

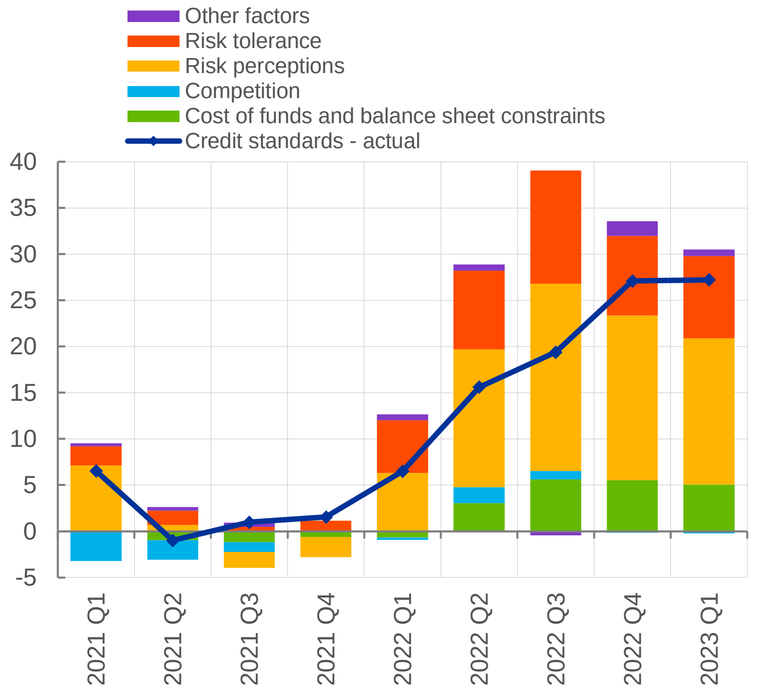


Source: ECB and Eurosystem staff projections – technical assumptions of respective projection rounds. Notes: The assumptions for short-term interest rates are based on market expectations of the three-month EURIBOR, as implied in futures rates. The long-term interest rates for the euro area are based on the weighted average of countries' ten-year government bond yields, weighted by annual GDP figures.

The ECB reaction

- In December 2021, the **ECB began adjusting its monetary policy**
- **Policy interest rates have increased significantly** to bring inflation back under control
- **Changes in our policy are transmitting through to financing conditions** for firms and households
- **Higher interest rates discourage spending and consumption** and will bring prices down
- The **full impact of policy rate changes on inflation will take time** to materialise

Changes in credit standards for loans to firms
(net percentages of banks reporting a tightening or an increase)



Source: ECB (BLS).
Notes: Net percentages refer to the difference between the percentages of banks reporting a tightening (an increase) and the percentages of banks reporting an easing (a decrease). "Other factors" refer to further factors which were mentioned by banks as having contributed to changes in credit standards. Latest observations: Q1 2023 (April 2023 BLS).

Summary

- The euro area economy was hit by an **unprecedented series of shocks** that drove prices and costs up

- **Scale and size of shocks** led to higher cost and price pressures spreading more generally throughout the economy

- This has resulted in **higher underlying inflation growth**

- **Unit profits and wages are also increasing** in response to the shocks

- **Inflation is expected to decrease** over the medium term

- **The ECB is responding and is committed** to bring inflation back to our target of 2% in the medium term