

The drivers of post-pandemic inflation

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Four questions and their answers

① Similar inflation in the US and the EA?

- Yes, nearly identical

② What caused it?

- Unexpectedly strong demand

③ What if the ECB had kept inflation closer to 2 percent?

- Substantial output loss

④ What should we expect going forward in the EA?

- Smooth path back to inflation target
- No loss of credibility

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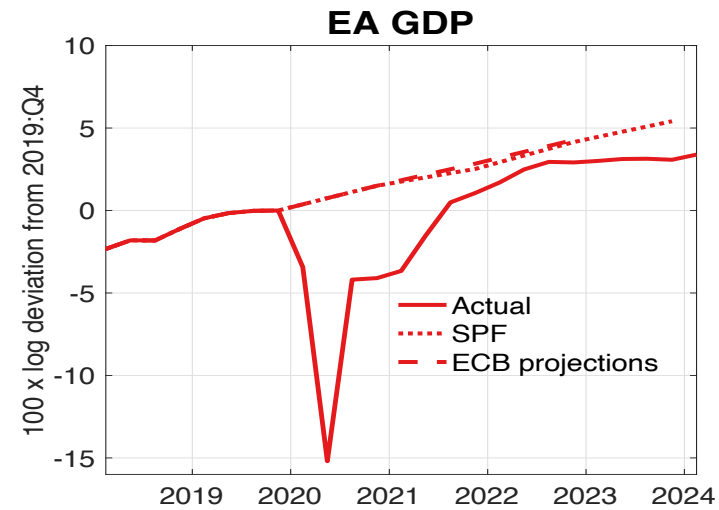
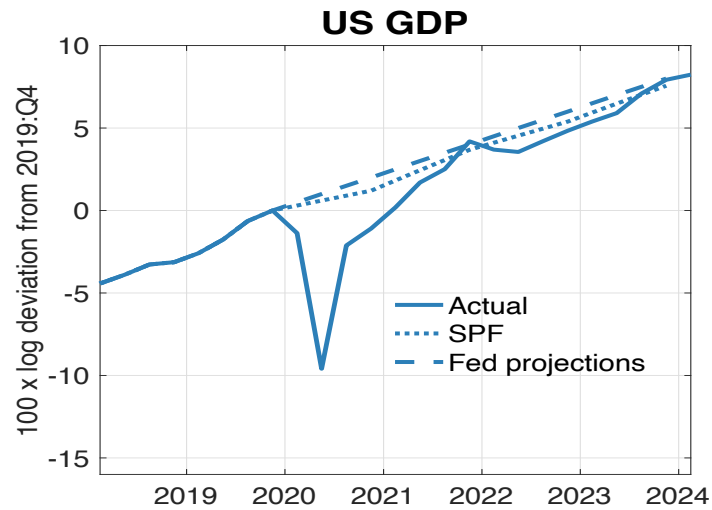
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US vs EA since 2020: Stylized facts

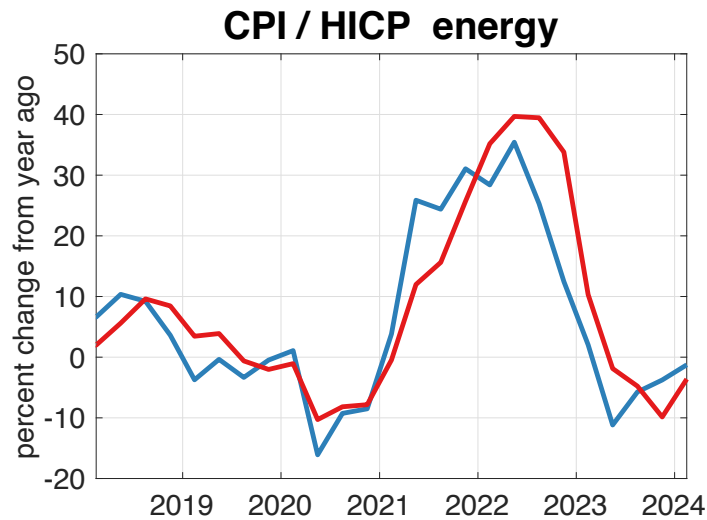
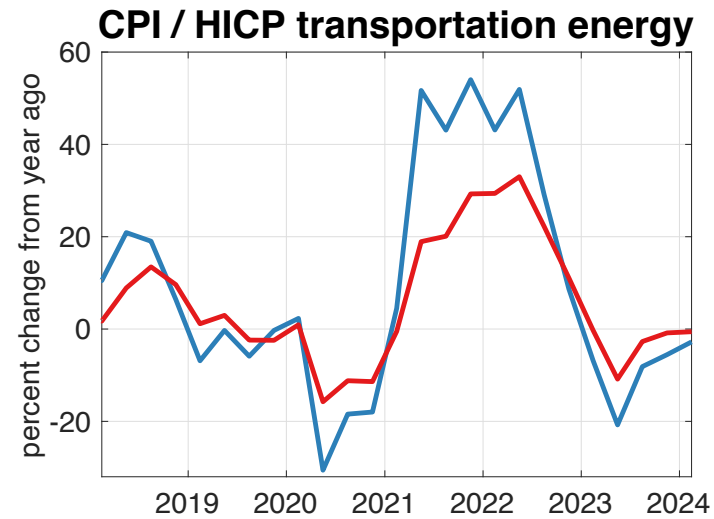
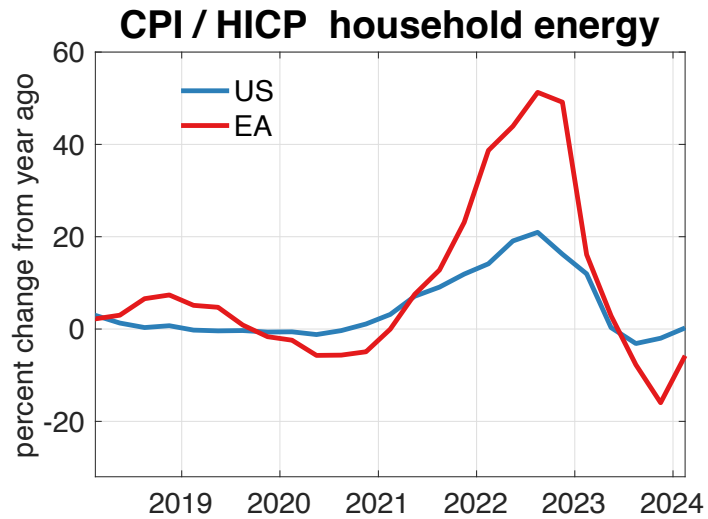


Real activity



Worse recession and
slower recovery in the EA

US vs EA since 2020: Stylized facts



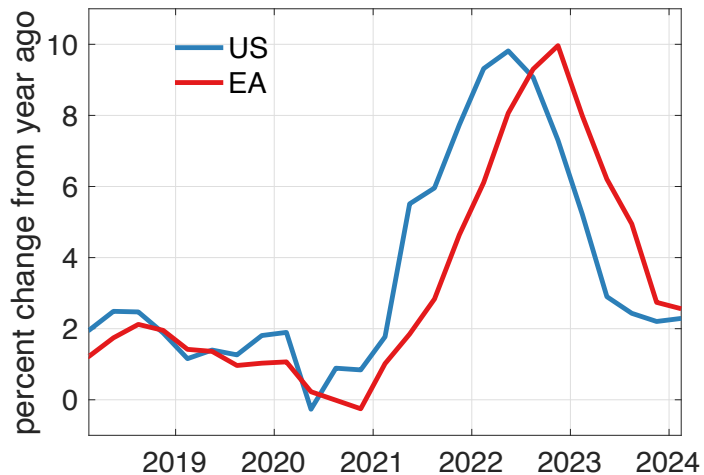
Energy prices



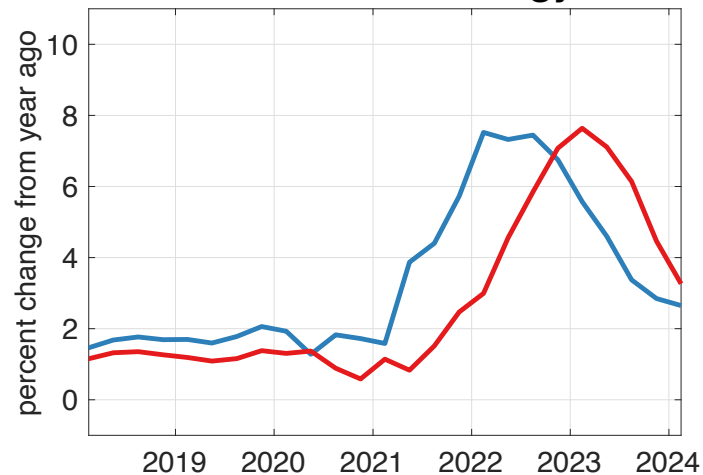
Broadly similar in the US and EA

US vs EA since 2020: Stylized facts

CPI / HICP



CPI / HICP ex energy

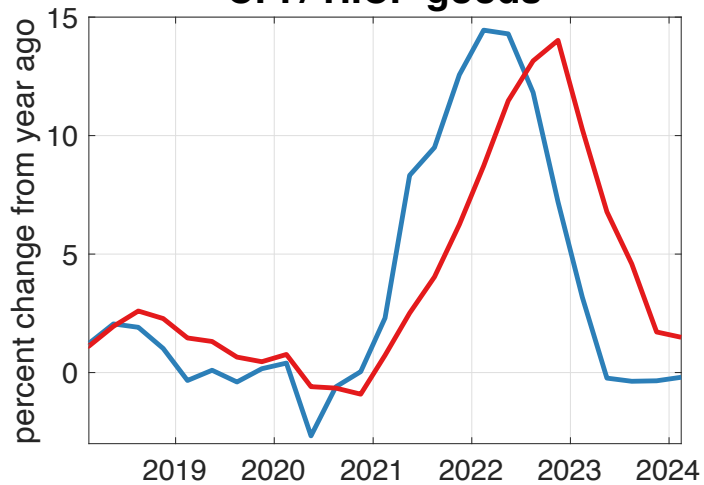


Inflation

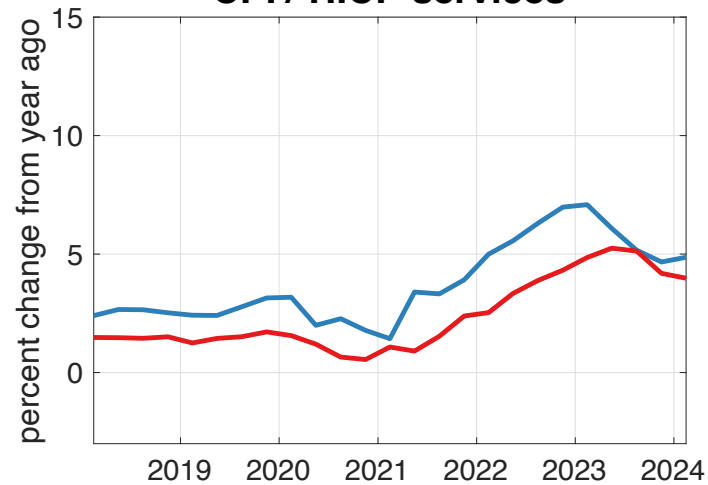


Nearly identical in the US and EA

CPI / HICP goods



CPI / HICP services



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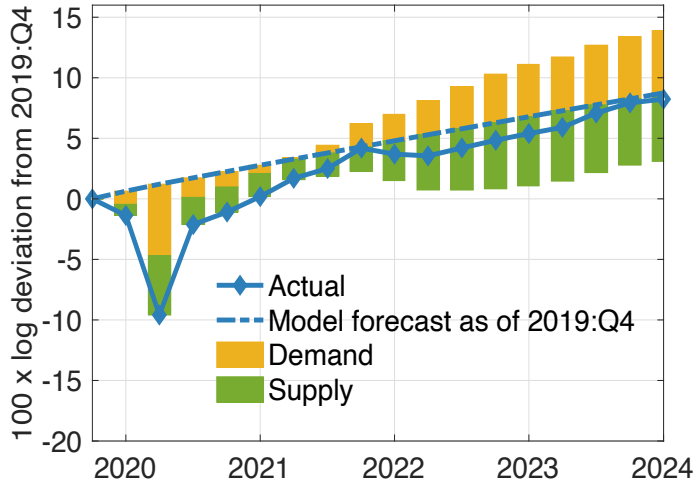
- Substantial output loss

④ **What should we expect going forward in the EA?**

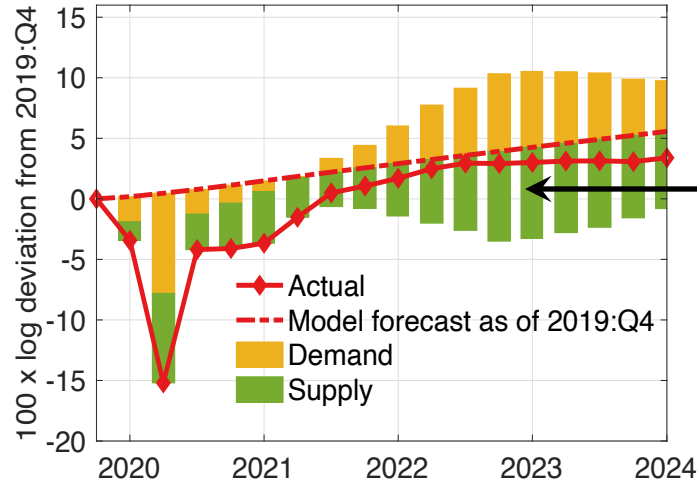
- Smooth path back to inflation target
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The drivers of post-pandemic inflation: Demand or Supply?

US GDP

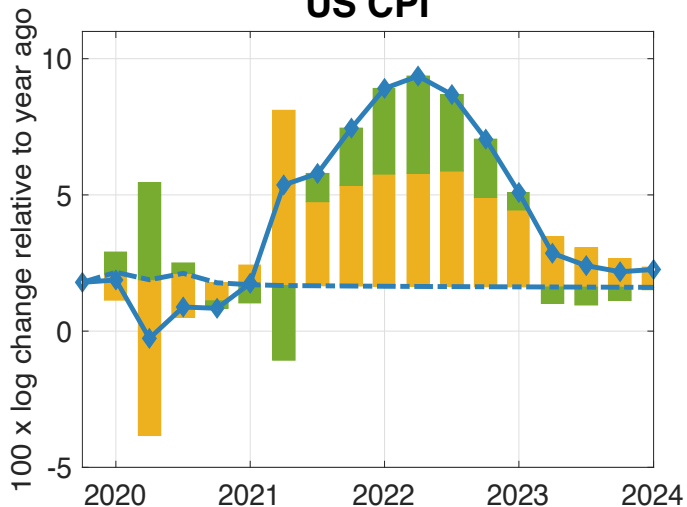


EA GDP

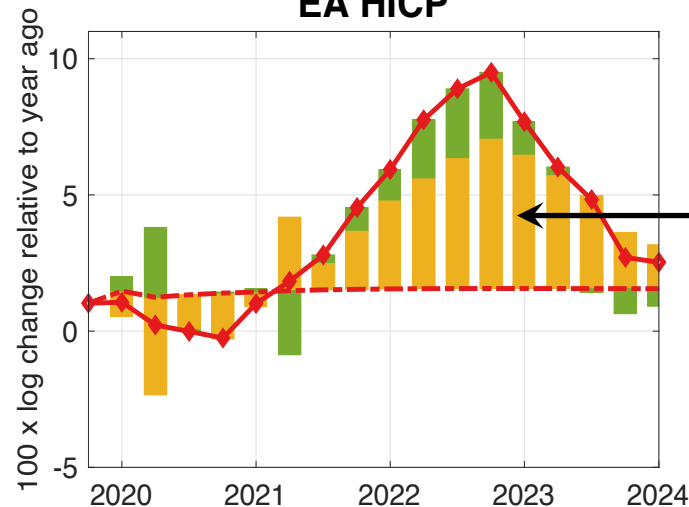


Adverse **supply** conditions have constrained economic activity

US CPI

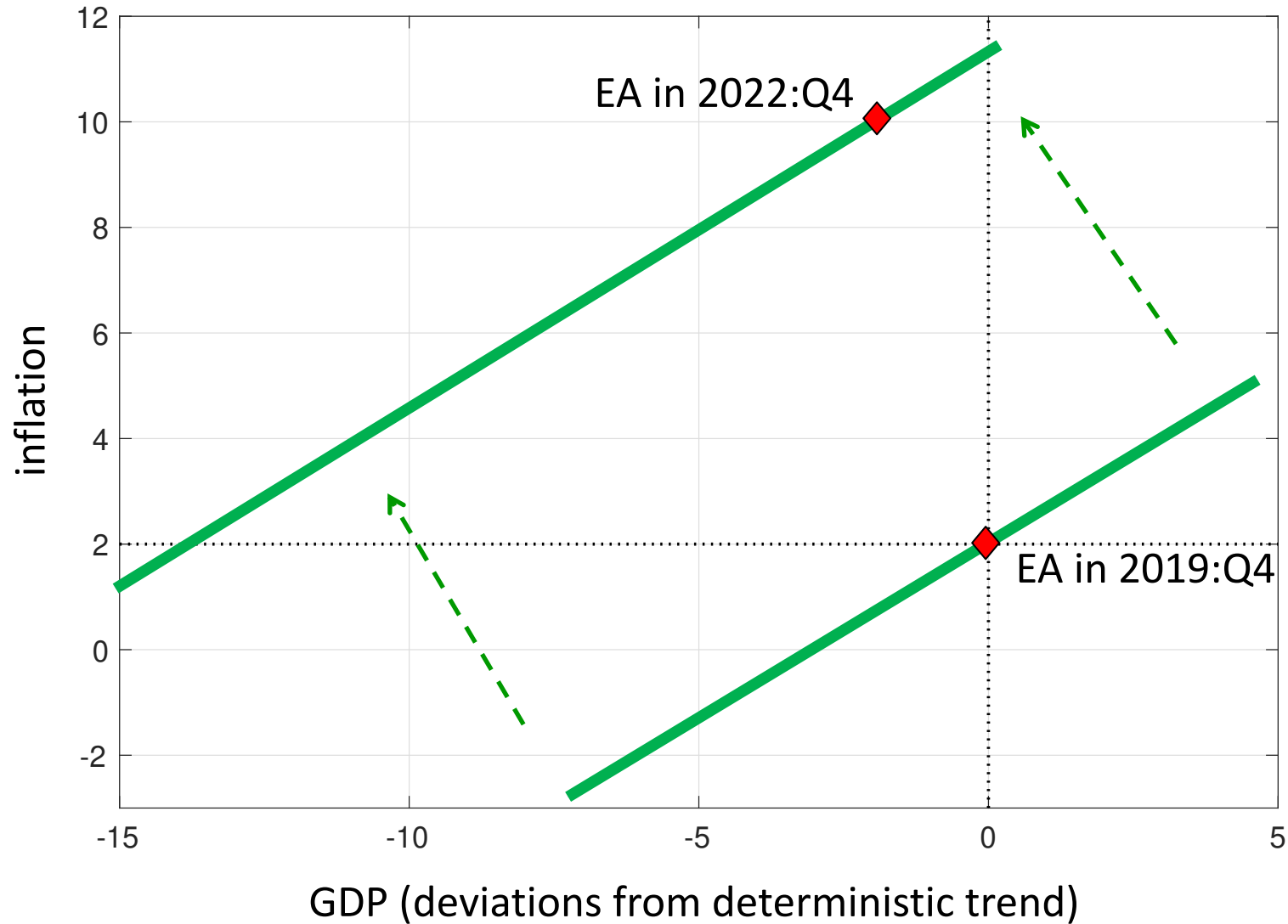


EA HICP

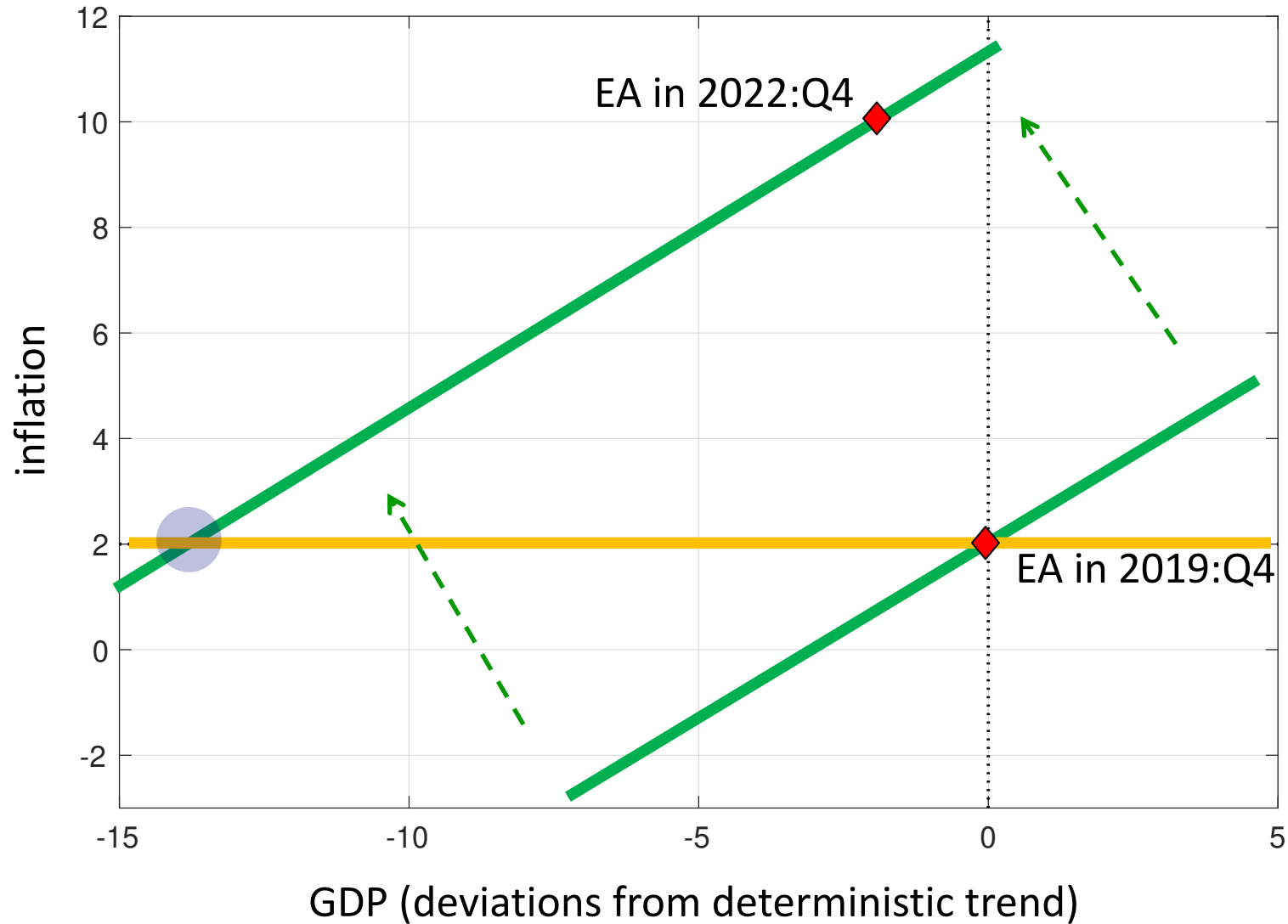


Inflation largely driven by **demand** factors

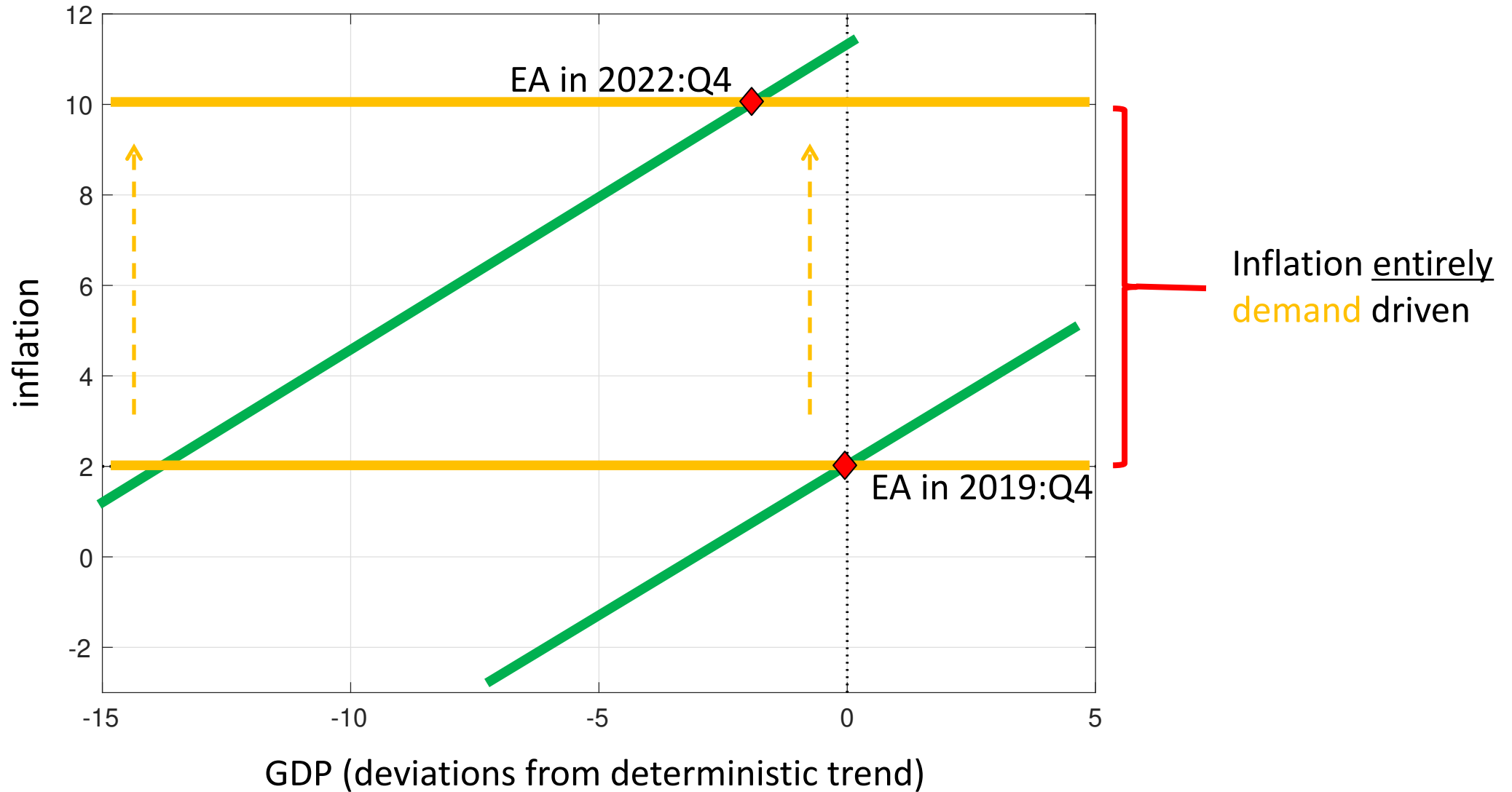
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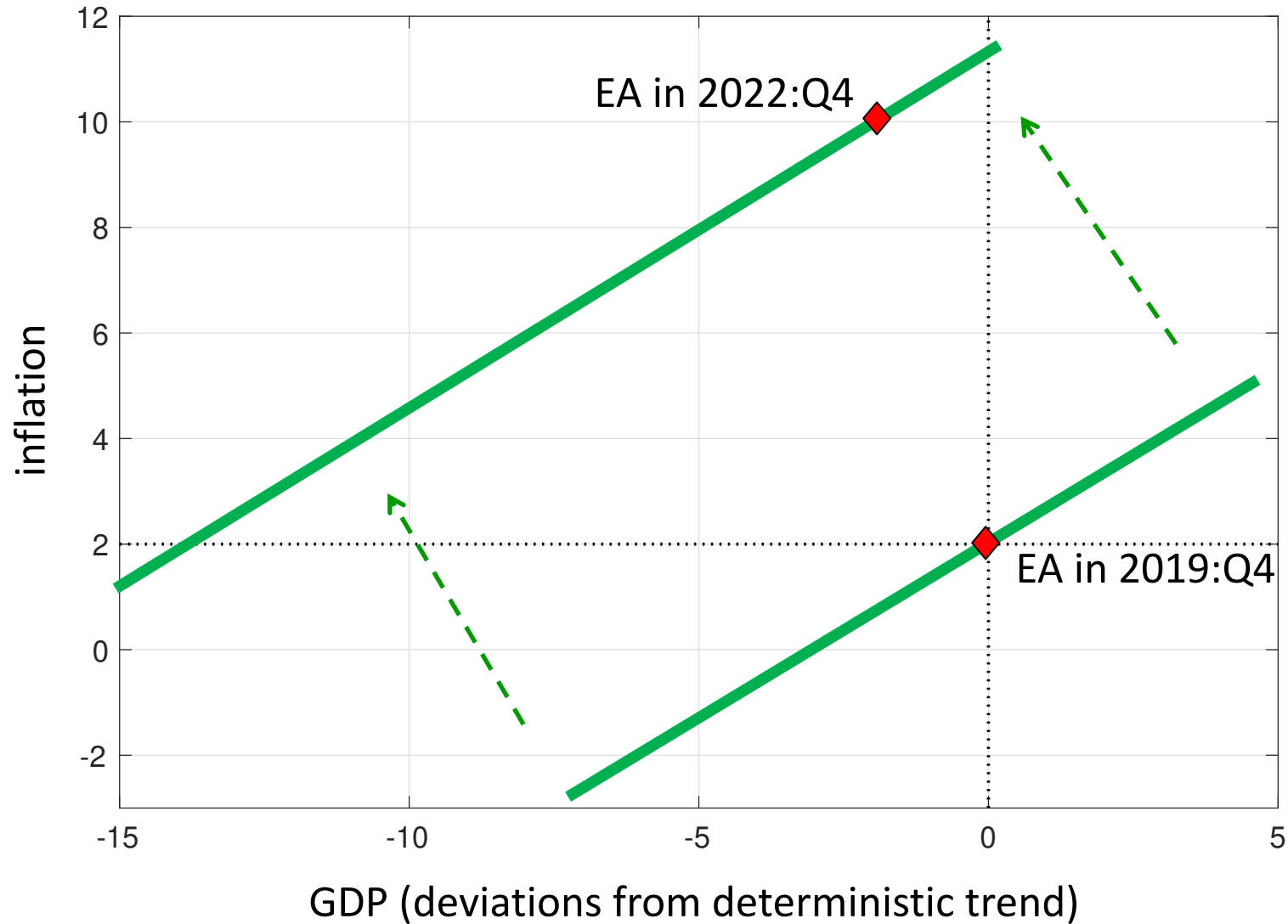
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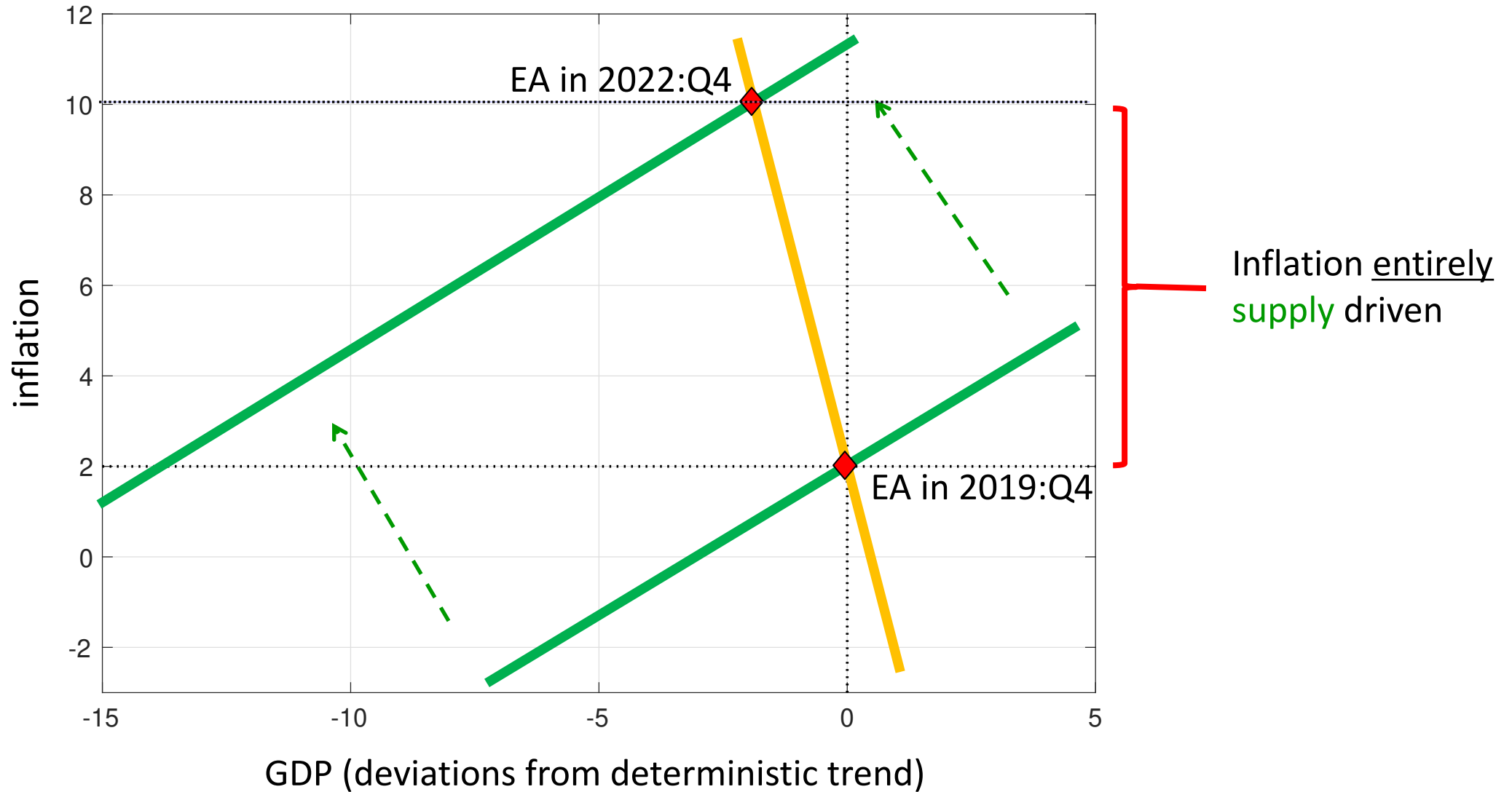
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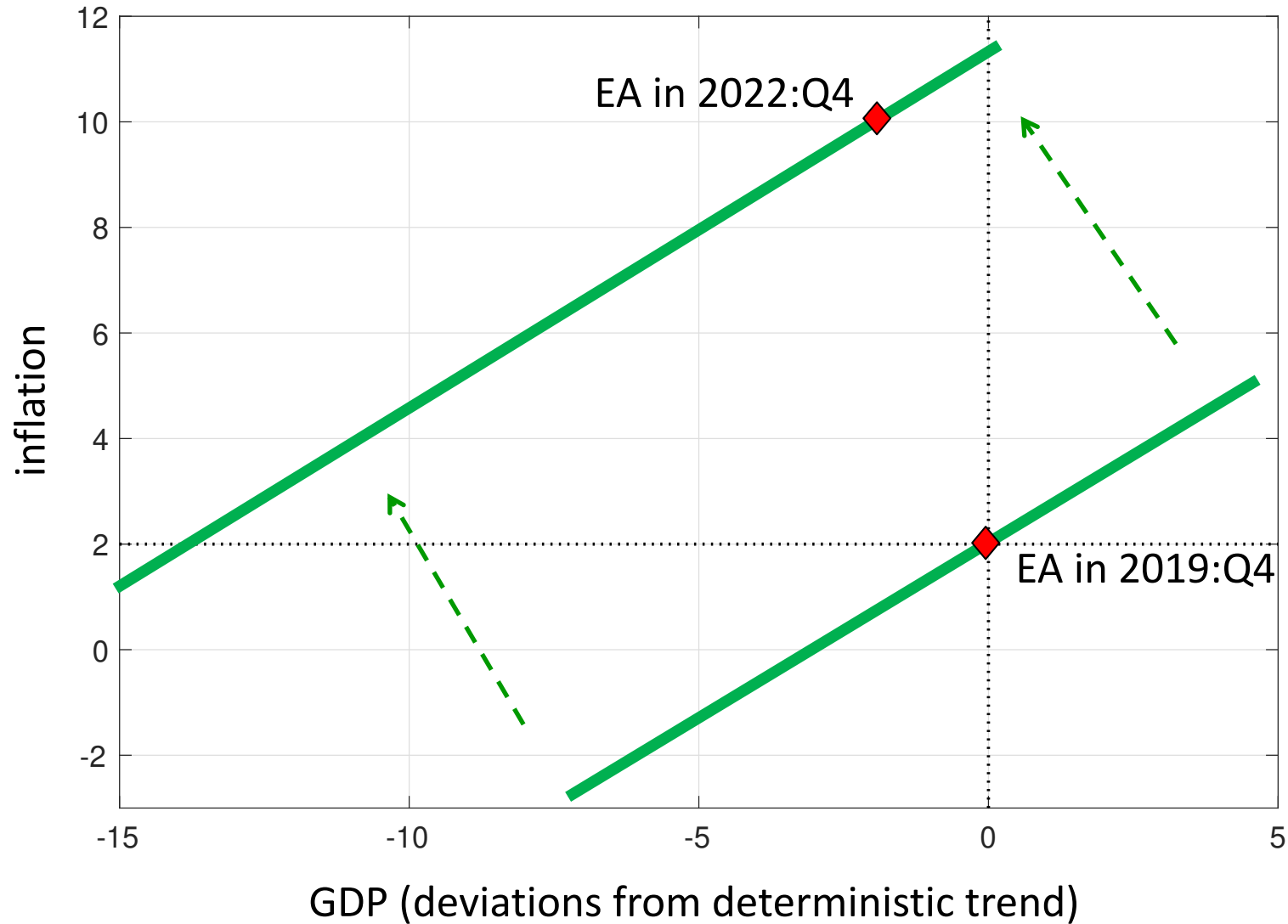
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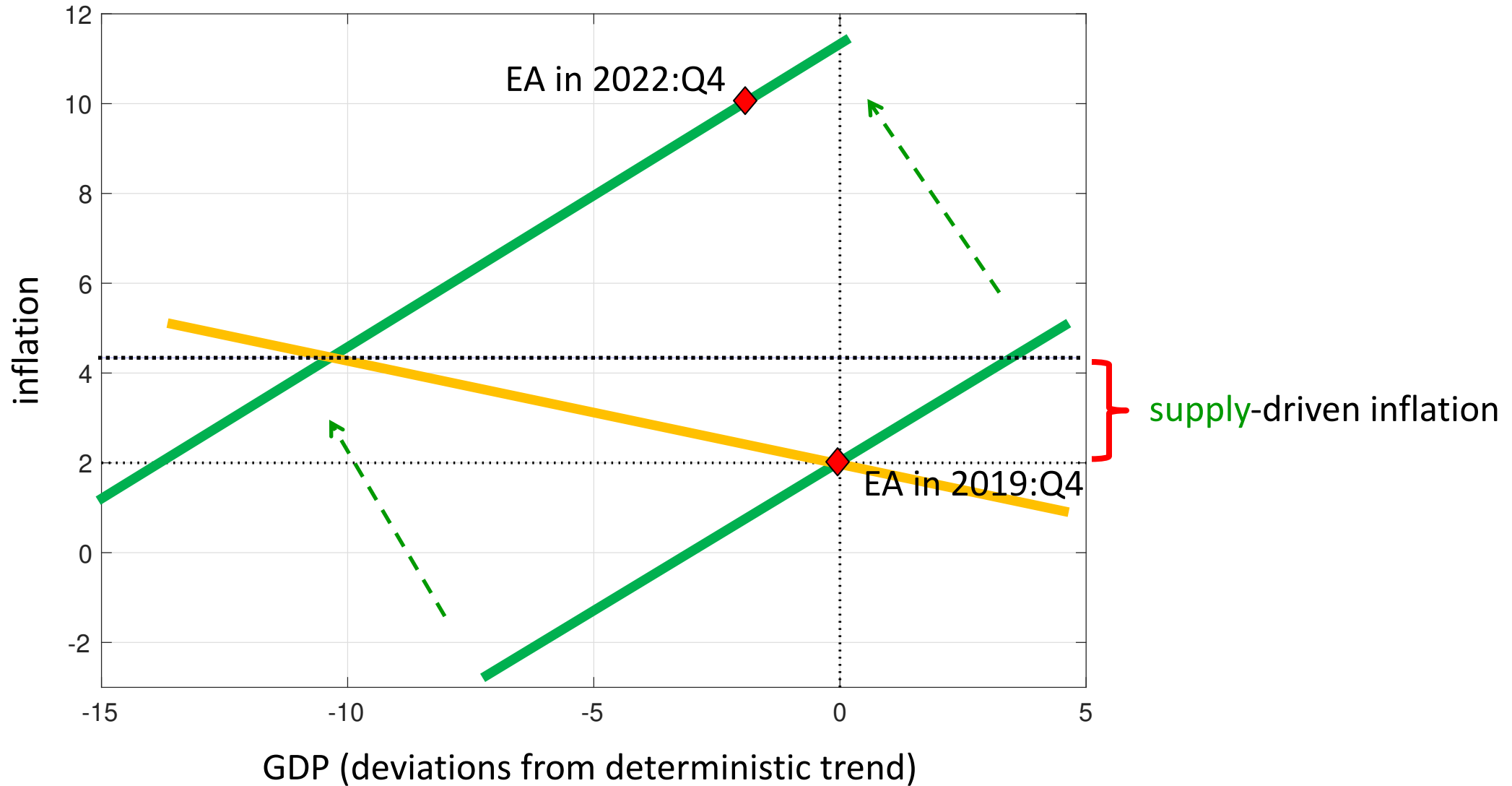
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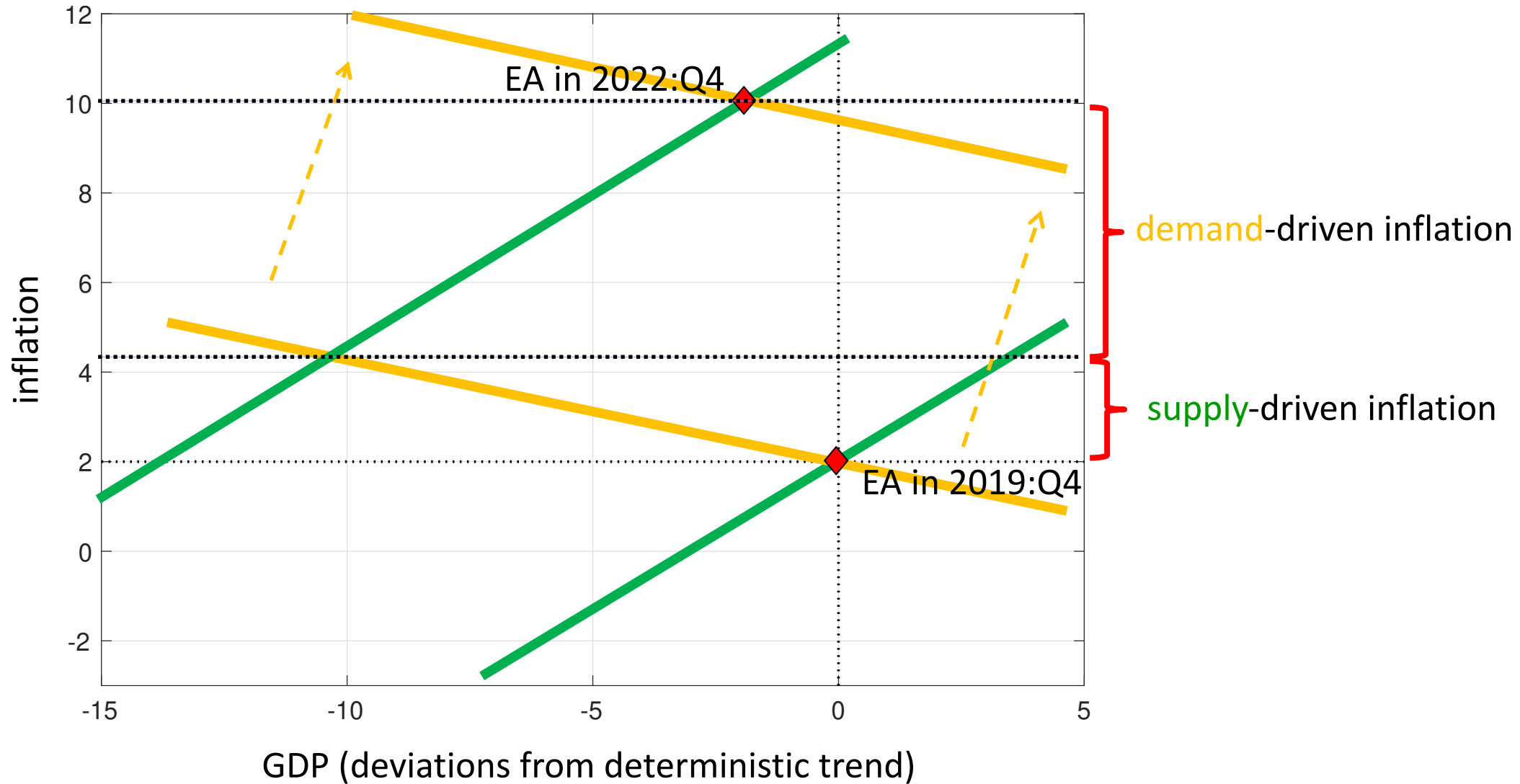
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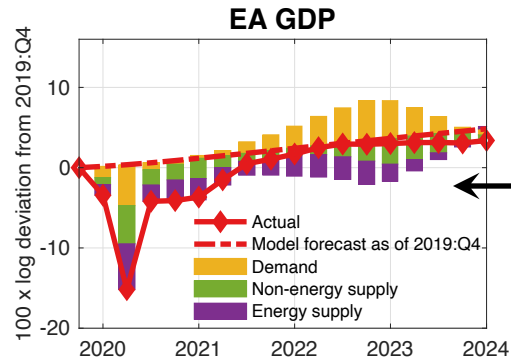
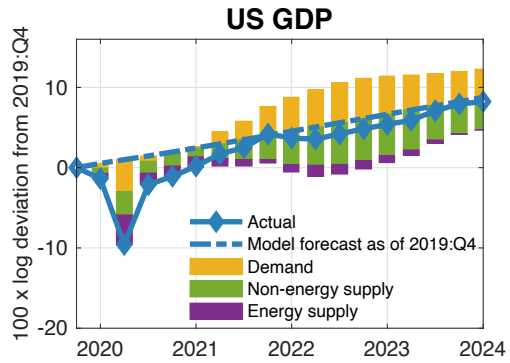
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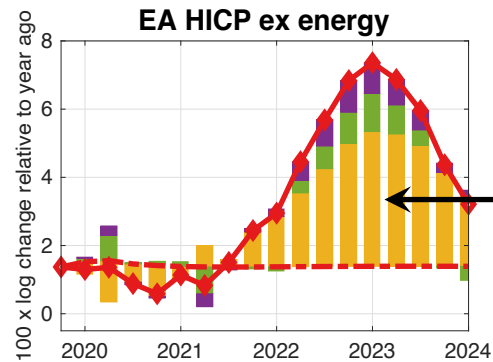
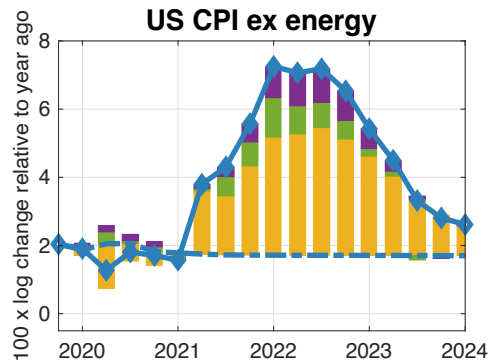
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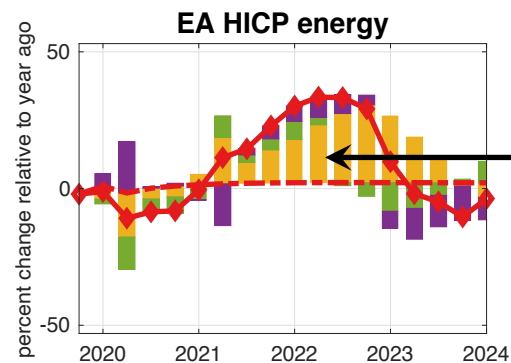
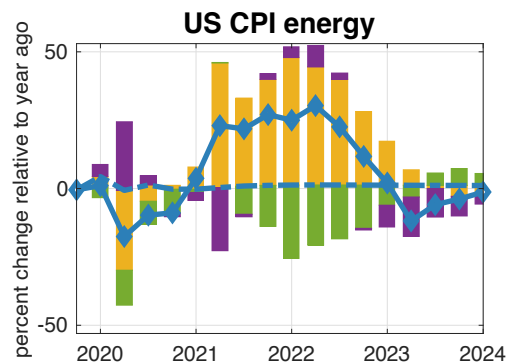
A model with energy prices and energy-supply shocks



Adverse **energy-supply** shocks have constrained economic activity



Inflation largely driven by **demand** factors



Energy inflation largely driven by **demand** factors

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Model with interest rates to study 3 counterfactual scenarios:

1. Tighten earlier

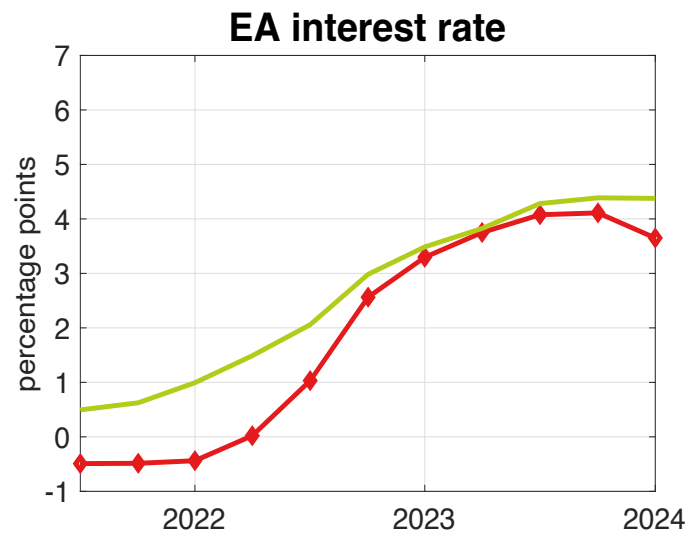
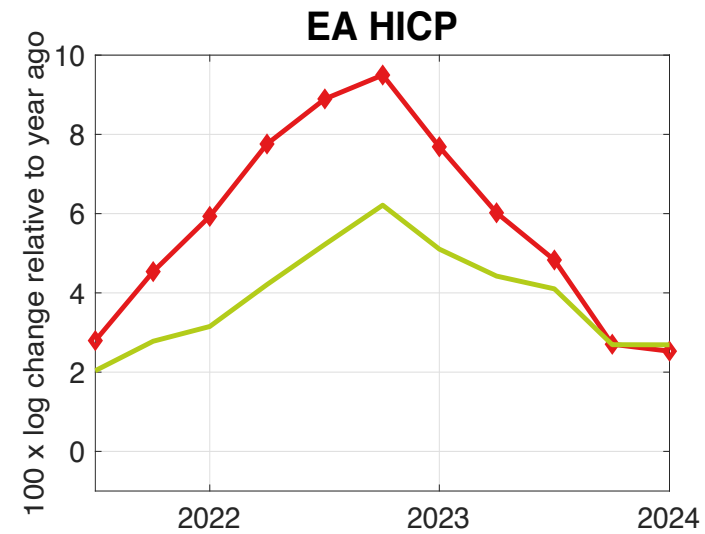
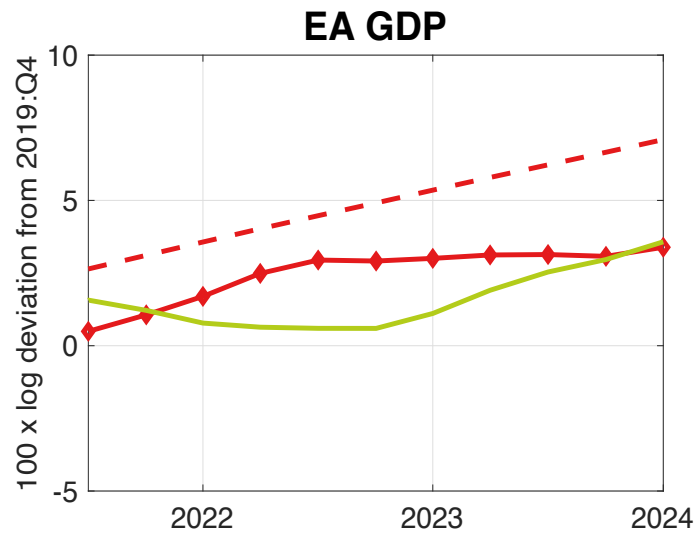
2. Lean against demand

- neutralize all the effects of demand shocks on inflation

3. Strict inflation targeting

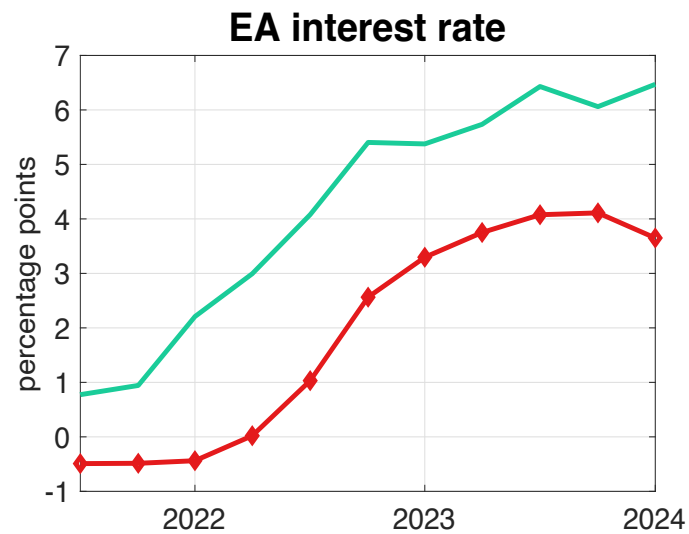
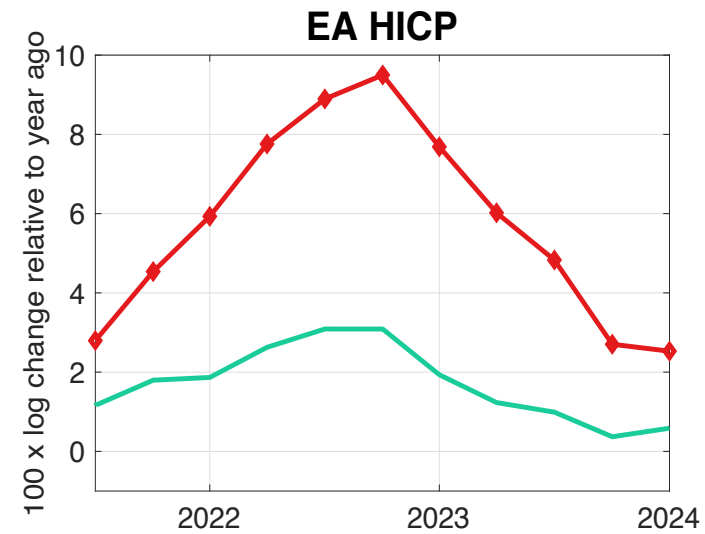
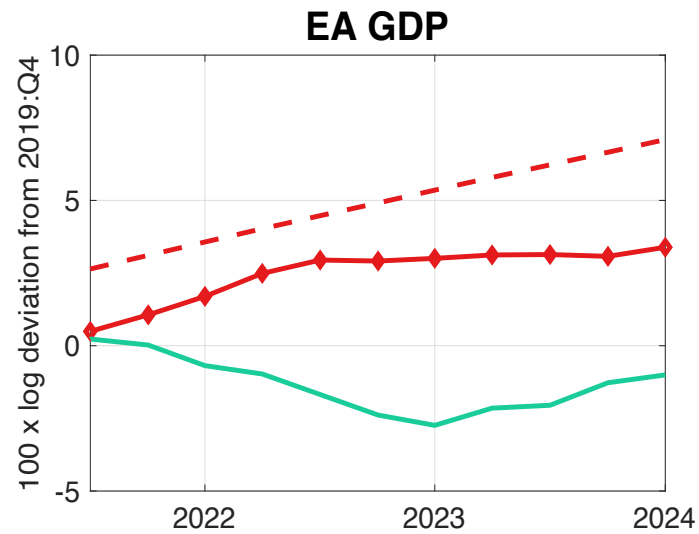
- neutralize the effects of all shocks on inflation, to keep it near 2 percent

Counterfactual ECB policies: Tighten earlier



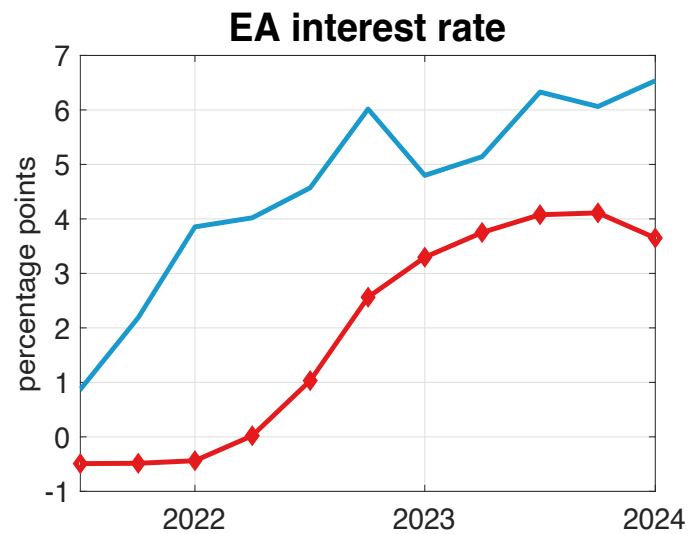
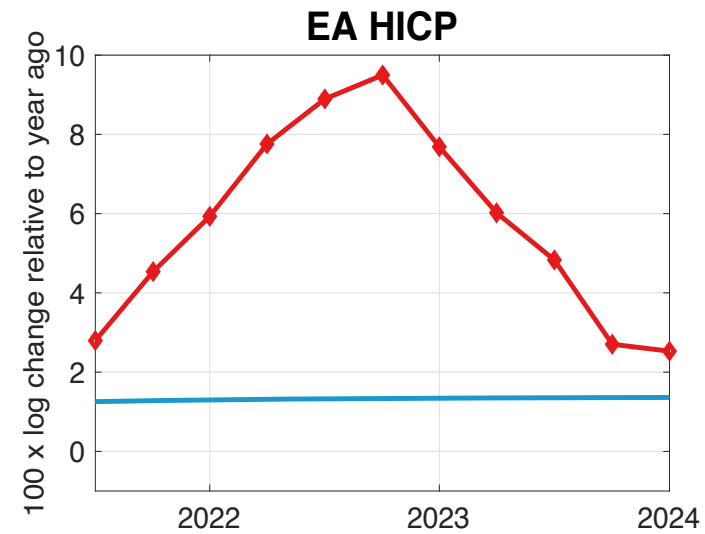
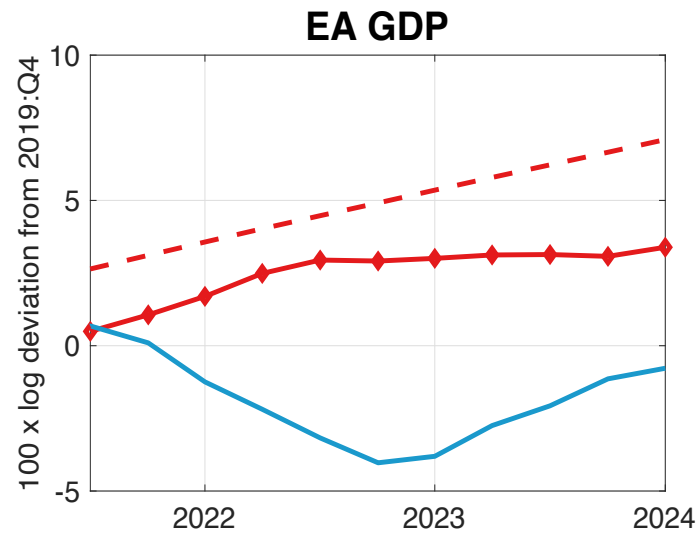
- ◆ Actual
- Pre-pandemic policy
- - Model forecast as of 2019:Q4

Counterfactual ECB policies: **Lean against demand**



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- Lean-against-demand policy
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Counterfactual ECB policies: **Strict inflation targeting**



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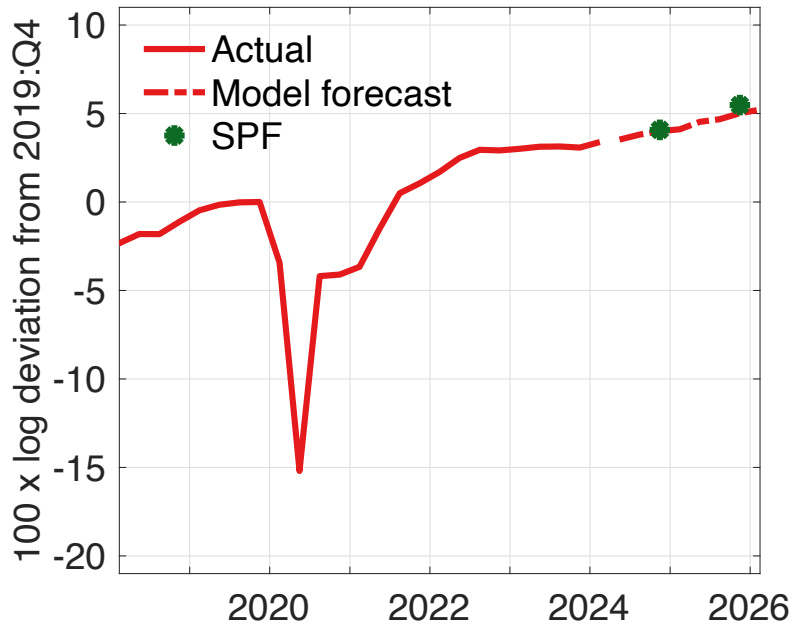
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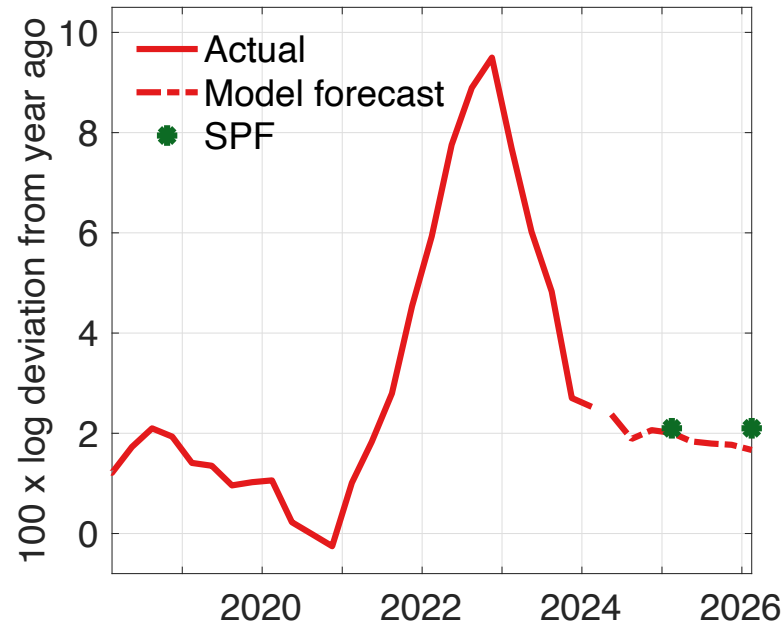
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The road ahead: Model and SPF projections

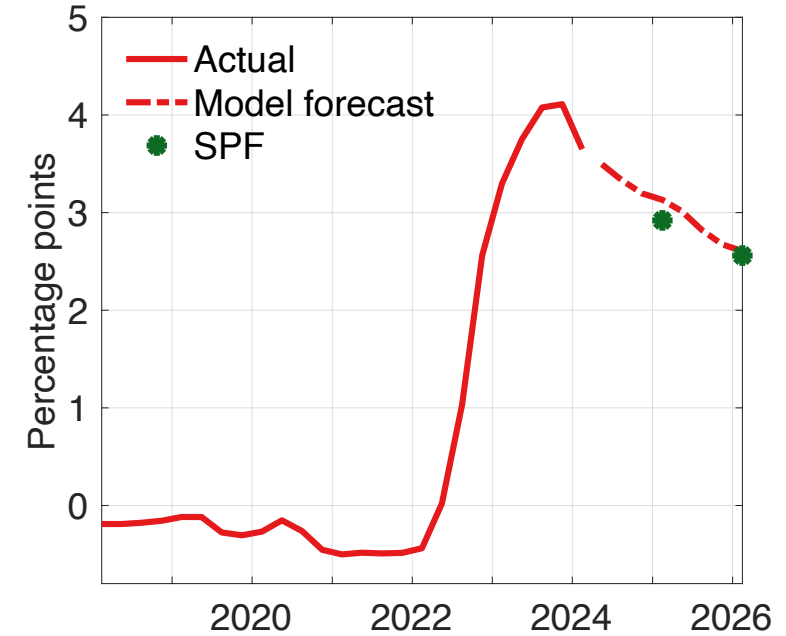
EA GDP



EA HICP



EA interest rate



- Model predicts smooth path back to inflation target and moderate growth
 - Gradual interest rate decline
- **SPF projections similar to model projections**, including interest rates
 - The public believes that monetary policy has already returned to its pre-covid standards

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