The Euro Area Great Inflation and the ECB Response

Guido Ascari

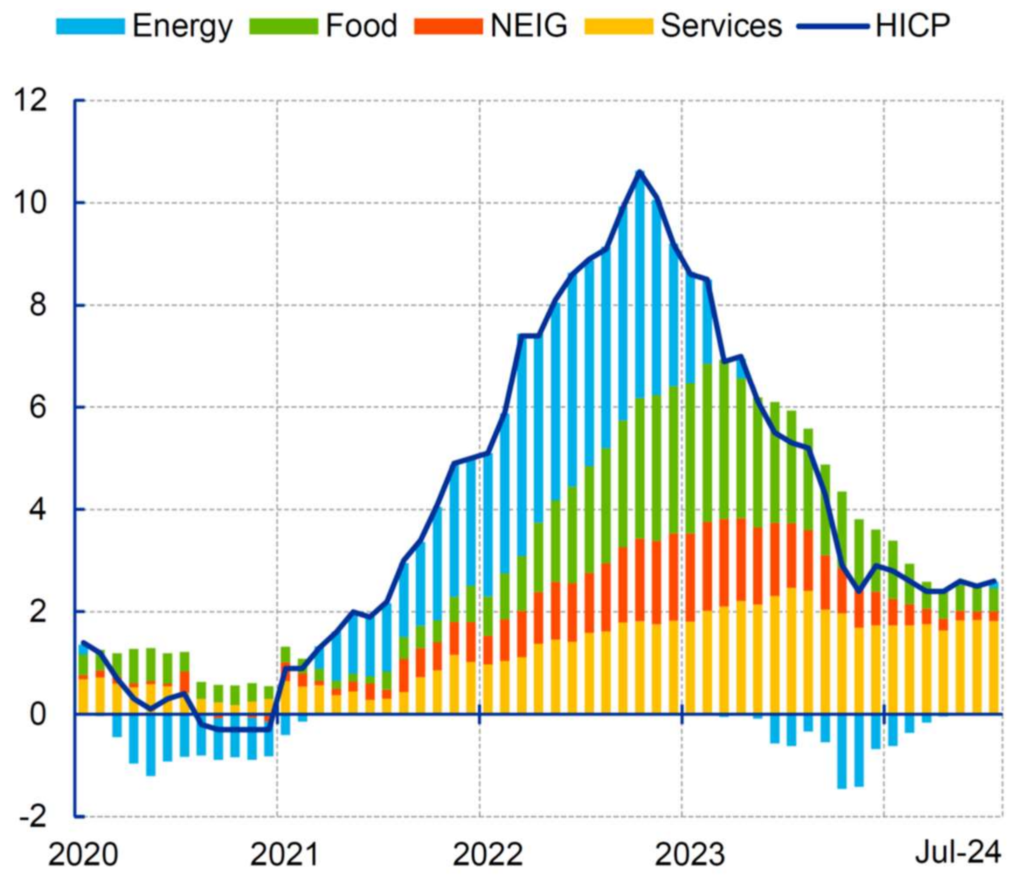
Plan

- **DNB Analysis**
- *The monetary policy response to high inflation, by* Paolo Bonomolo, Minke van der Heijden, Marco Hoeberichts, Jip Italianer, Inge Klaver and Sebastian Rast, August 2024

The views expressed are those of the authors, and do not necessarily reflect the official views of DNB.

HICP inflation

(annual percentage changes and percentage point contributions)



Sources: Eurostat and ECB calculations.
Latest observation: July 2024.

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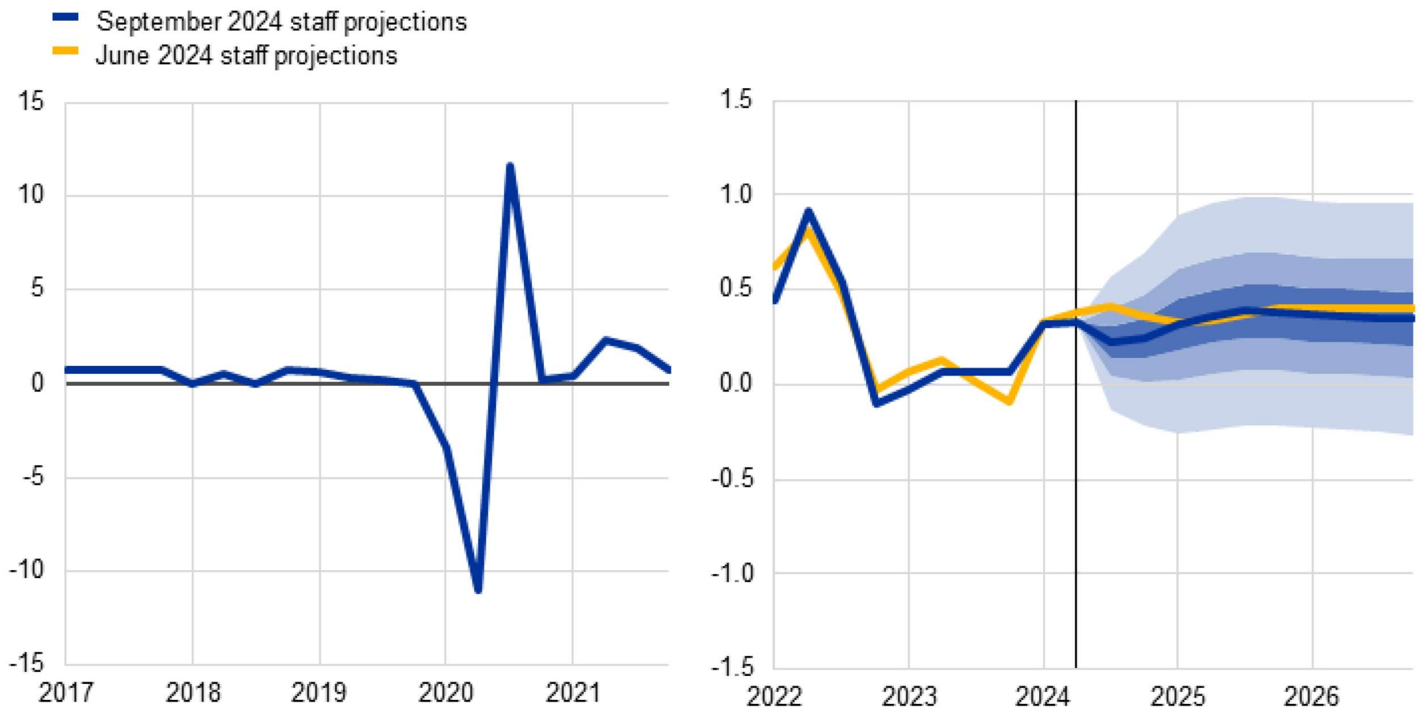
Chart 1

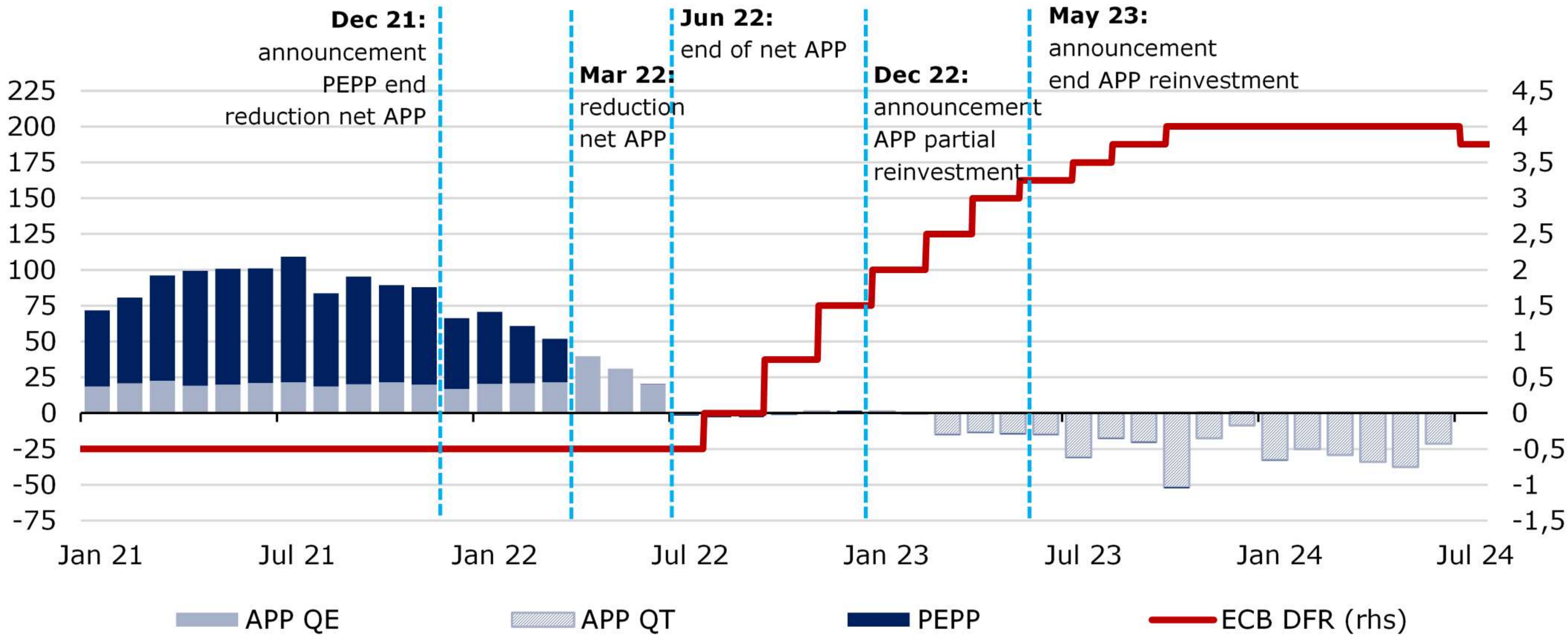
Euro area real GDP growth

(quarter-on-quarter percentage changes, seasonally and working day-adjusted quarterly data)



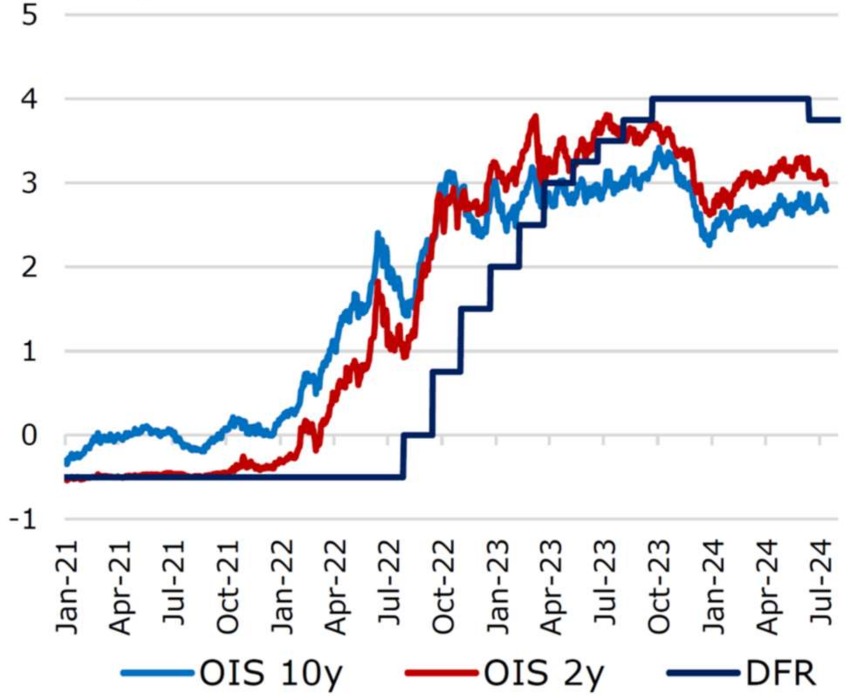
Notes: Historical data may differ from the latest Eurostat publications. The vertical line indicates the start of the current projection horizon. The ranges shown around the central projections provide a measure of the degree of uncertainty and are symmetric by construction. The ranges are based on past projection errors, after adjustment for outliers. The bands, from darkest to lightest, depict the 30%, 60% and 90% probabilities that the outcome of real GDP growth will fall within the respective intervals. For more information, see the box entitled "Illustrating the uncertainty surrounding the projections" in the March 2023 ECB staff macroeconomic projections for the euro area.

The response of monetary policy: the hiking cycle


Dec 21:
announcement
PEPP end
reduction net APP
Mar 22:
reduction
net APP
Jun 22:
end of net APP
Dec 22:
announcement
APP partial
reinvestment
May 23:
announcement
end APP reinvestment
225
200
175
150
125
100
75
50
25
0
-25
-50
-75
4,5
4
3,5
3
2,5
2
1,5
1
0,5
0
-0,5
-1
-1,5
Jan 21
Jul 21
Jan 22
Jul 22
Jan 23
Jul 23
Jan 24
Jul 24
APP QE
APP QT
PEPP
ECB DFR (rhs)

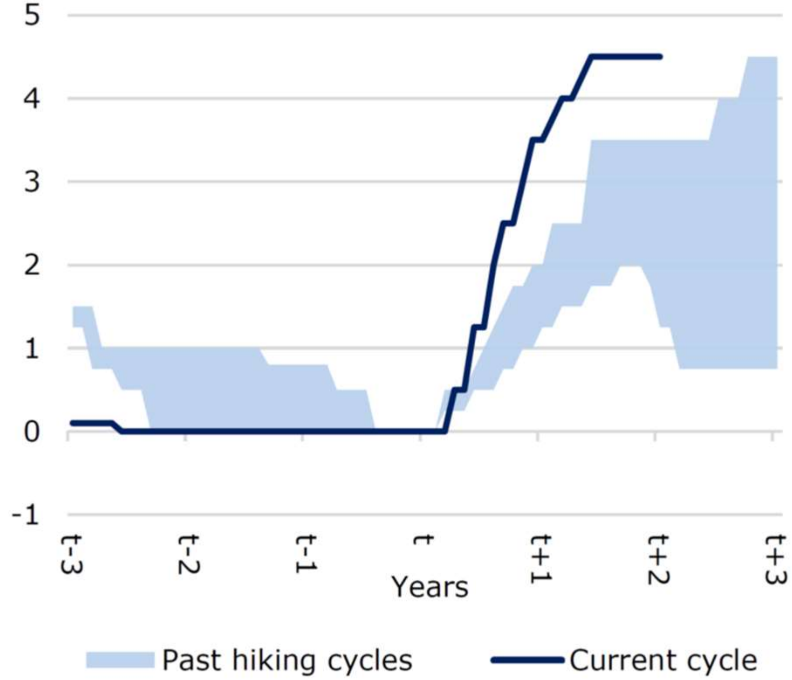
5. Risk-free rates

Percentages



6. Policy rate cycle comparison

Cumulative changes in percentage points

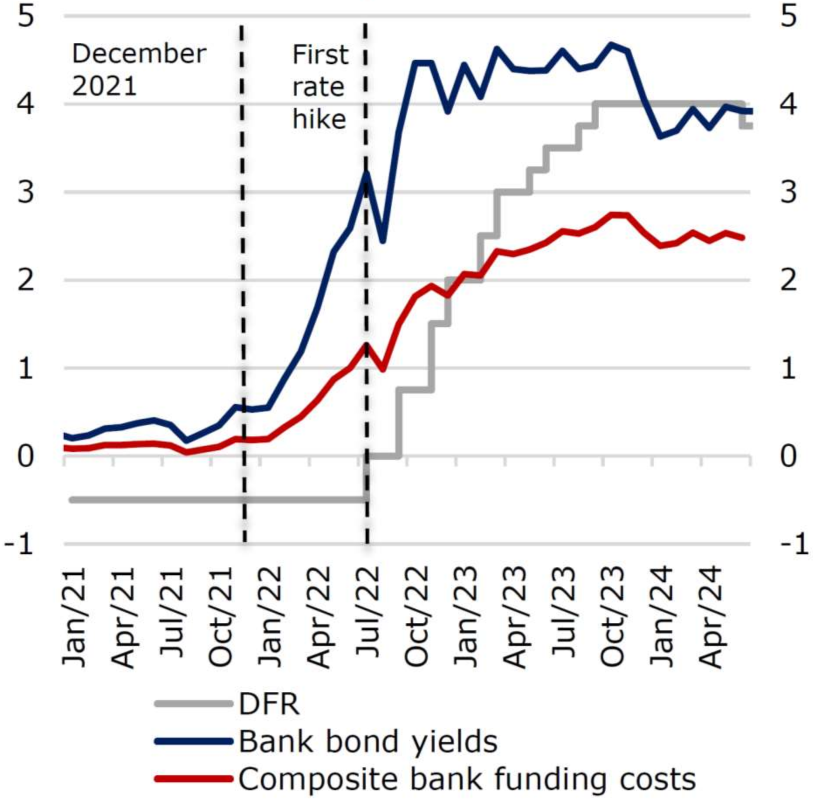


Source: LSEG, ECB

Transmission to broader financial conditions

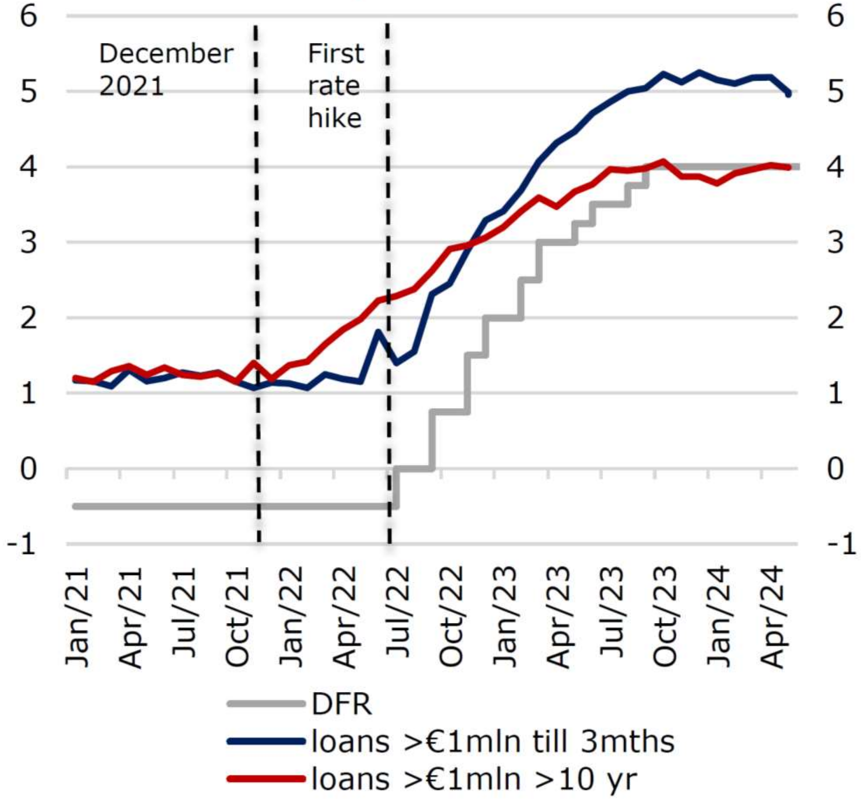
7. Bank funding costs

Percentages, monthly



8. Average cost of borrowing NFCs

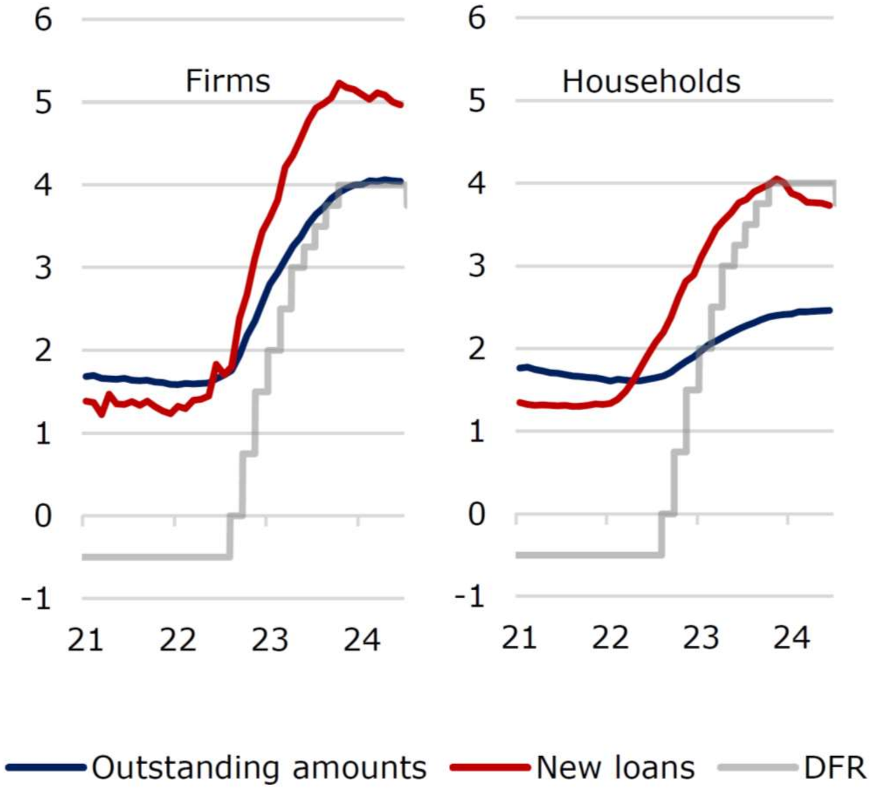
Percentages, monthly



Source: MFI-mir data, new business

9. Interest rate on bank loans to NFCs and households

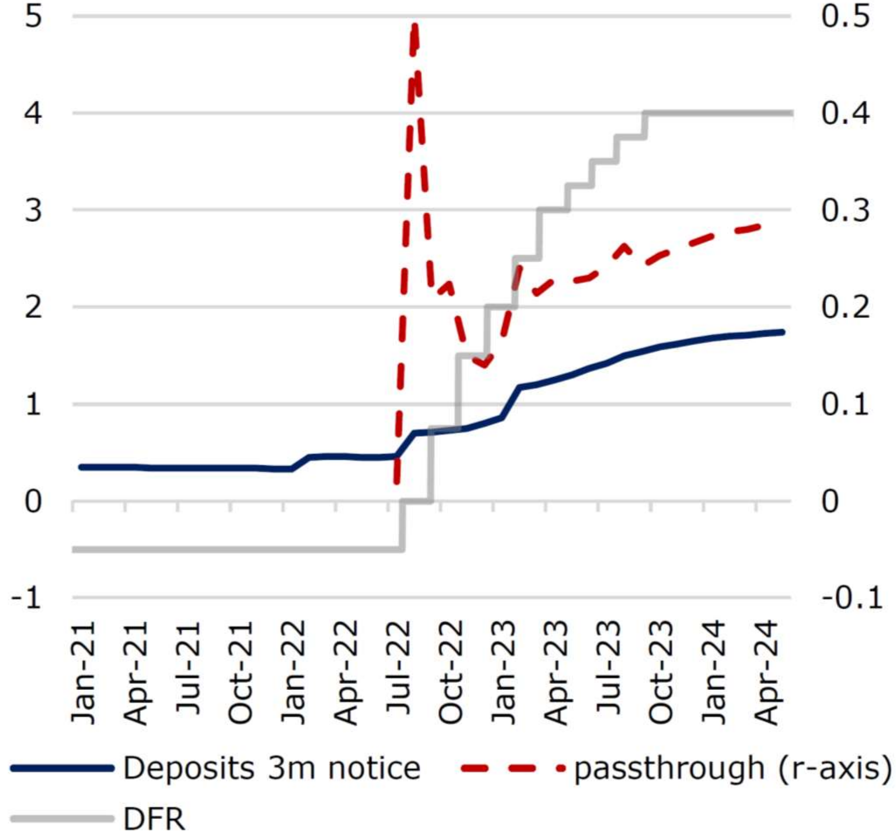
Percentage



Source: MIR data

10. Transmission to savings rates

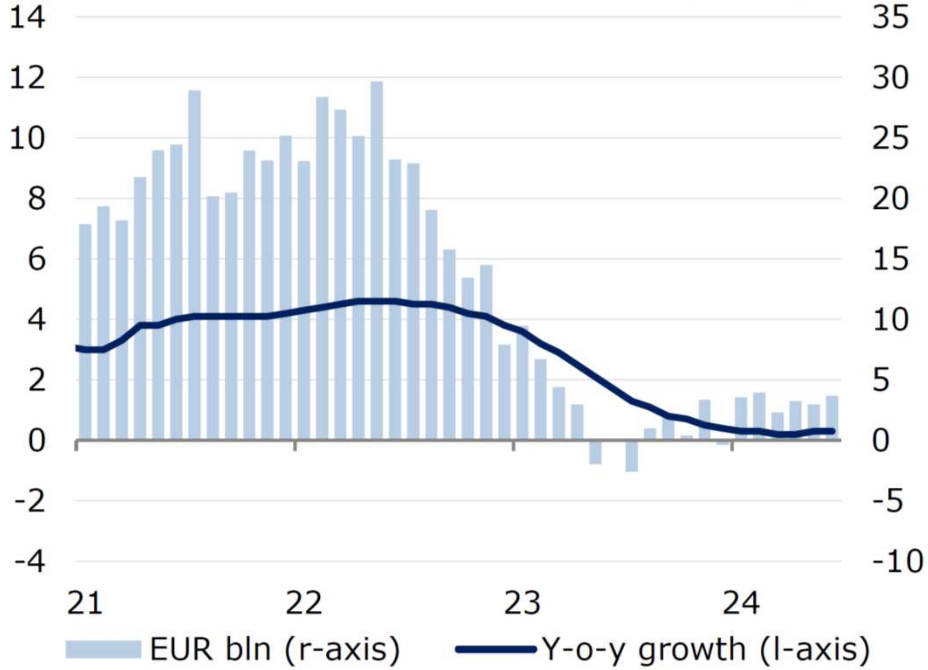
Percentage



Transmission to the real economy

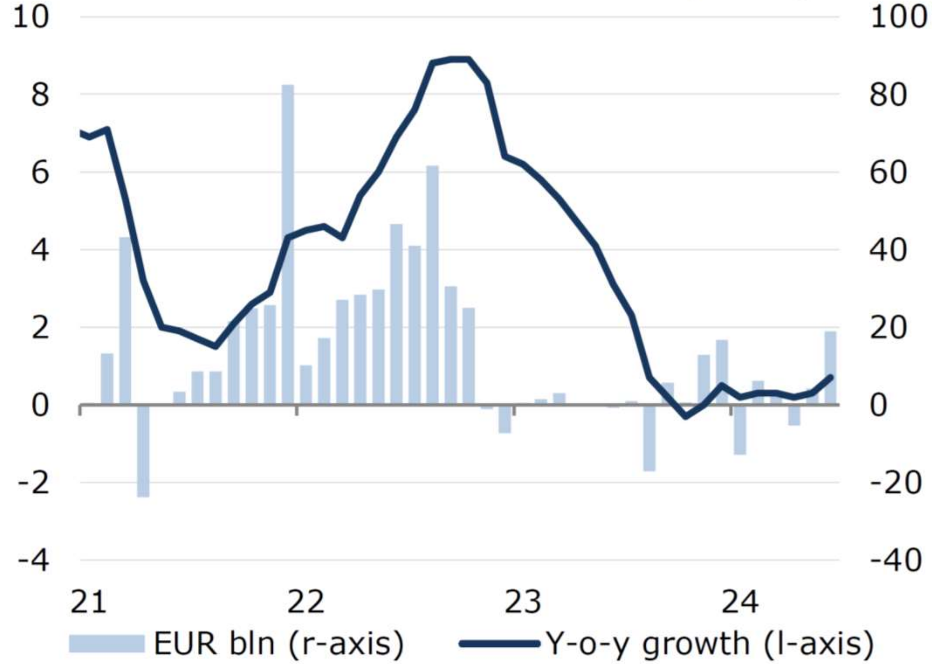
11. Credit to households

Corrected for securitisations and cash pooling



12. Credit to firms

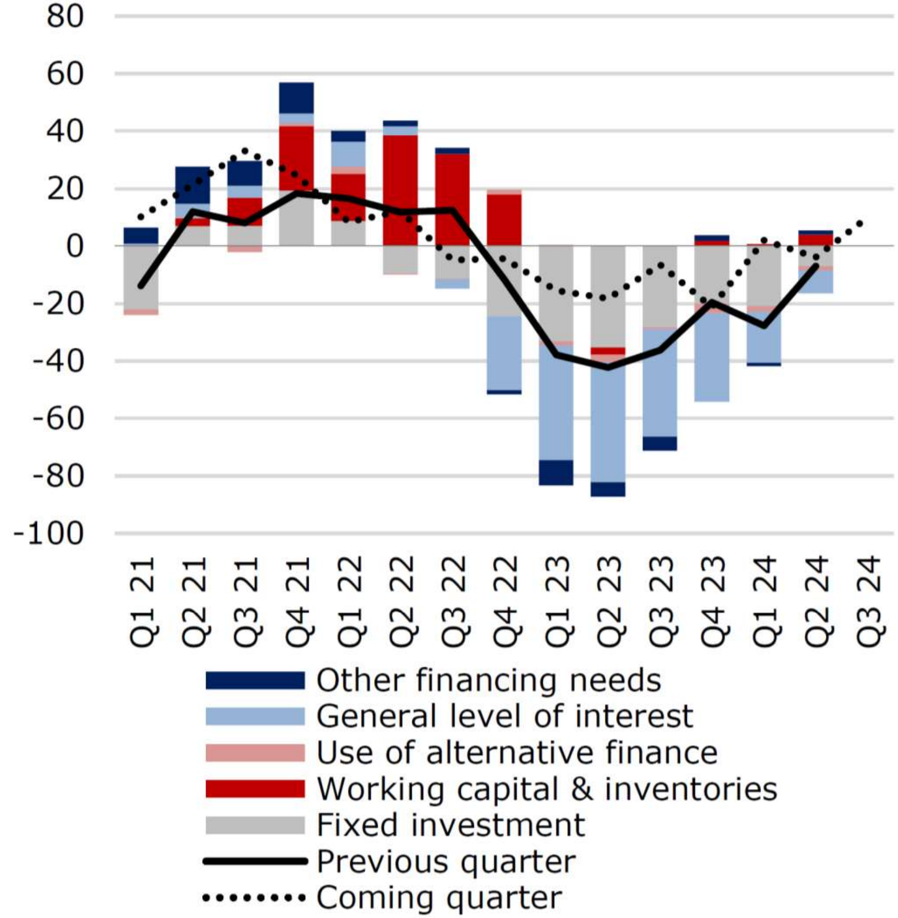
Corrected for securitisations and cash pooling



Source: ECB

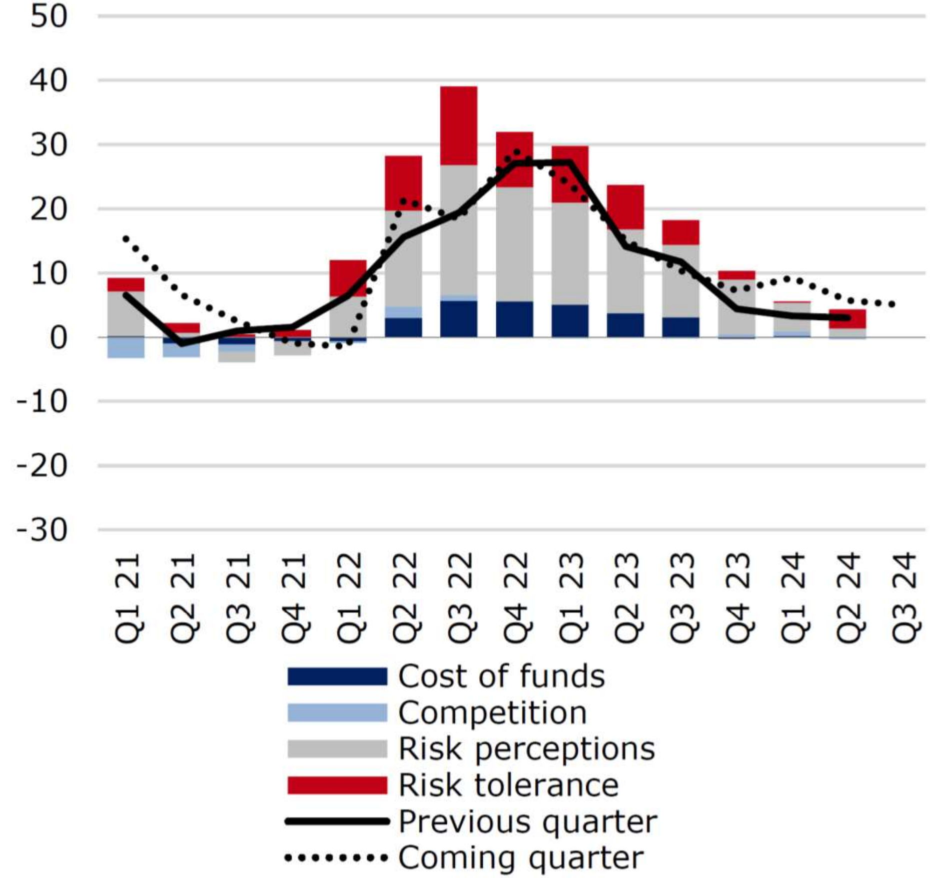
13. Credit demand (firms)

Net percentage of banks reporting an increase in demand



14. Credit standards (loans to firms)

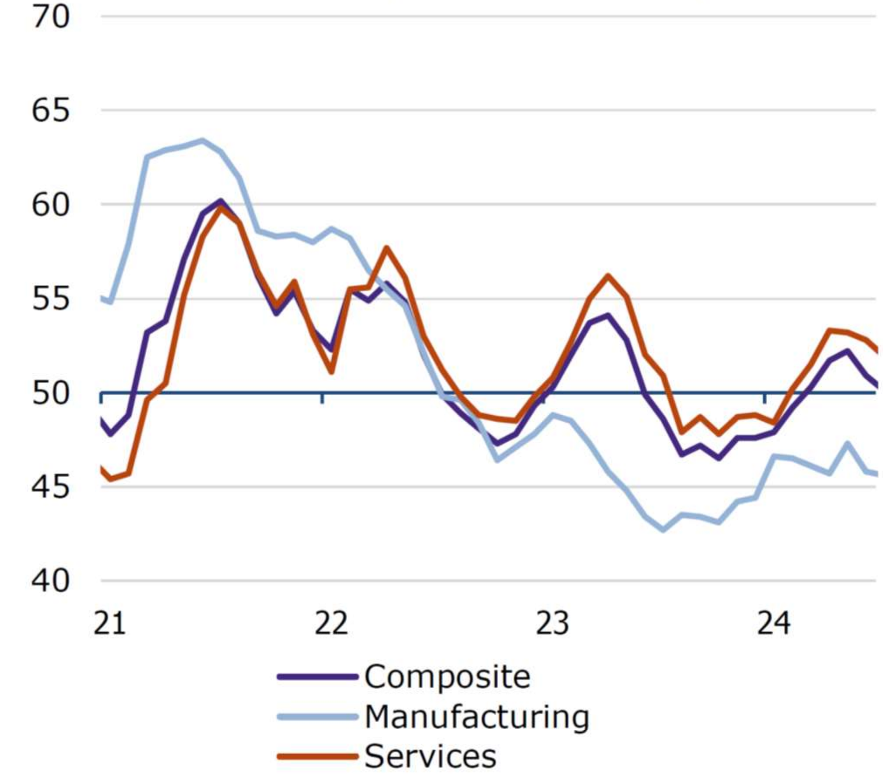
Net percentage of banks reporting a tightening of standards



Source: ECB, Bank Lending Survey

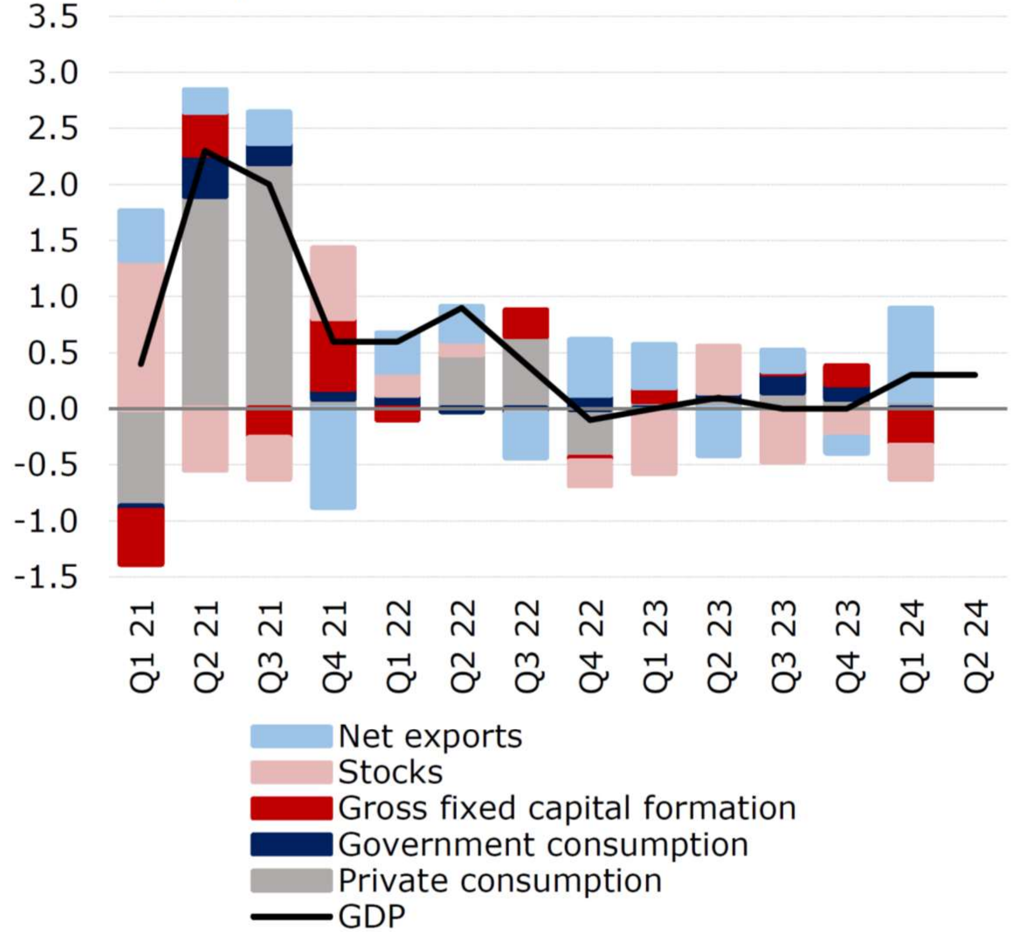
15. Purchasing managers index

Euro area, monthly, balance = 50 points



16. Decline in GDP growth

Percent q-o-q and contributions

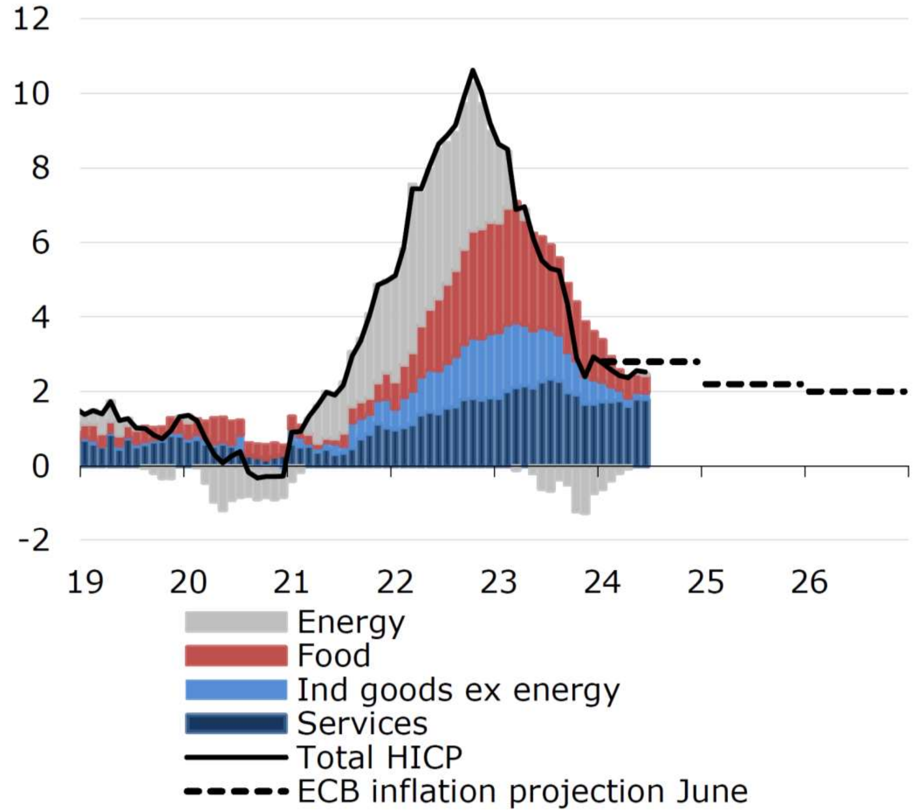


Source: S&P Global (PMI), Eurostat (GDP growth

Transmission to inflation

17. Composition of HICP-inflation

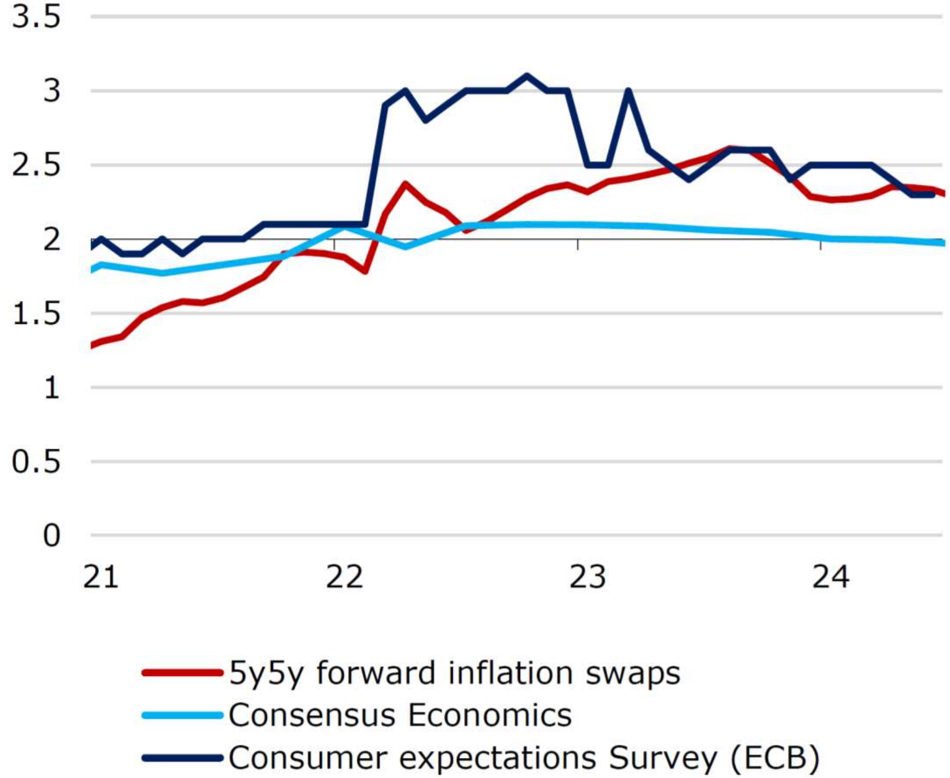
Percent and contributions



Source: Eurostat; ECB, Consensus Economics, Reuters.

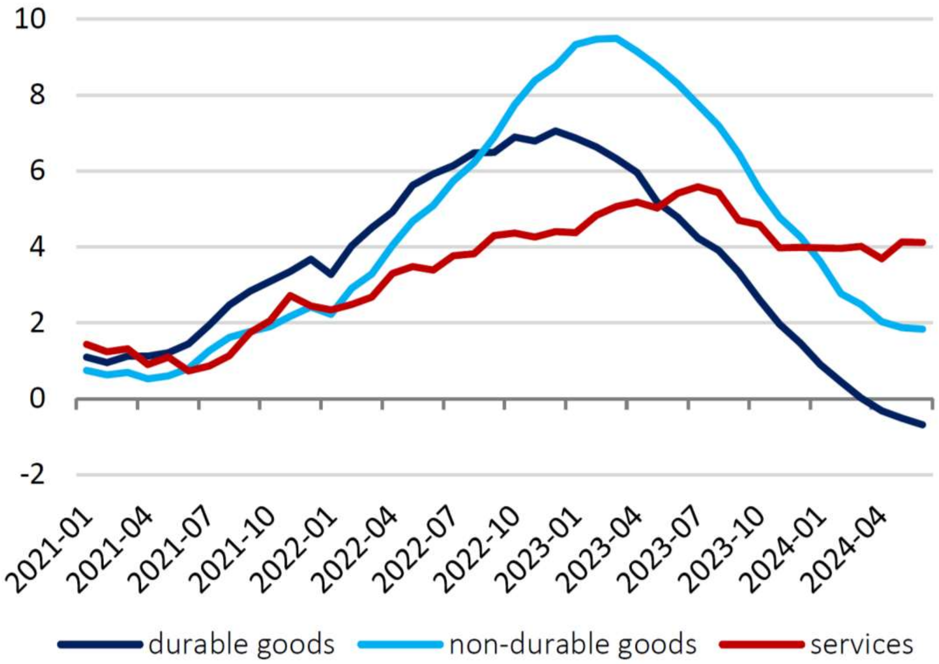
18. Long-term inflation expectations

Percent



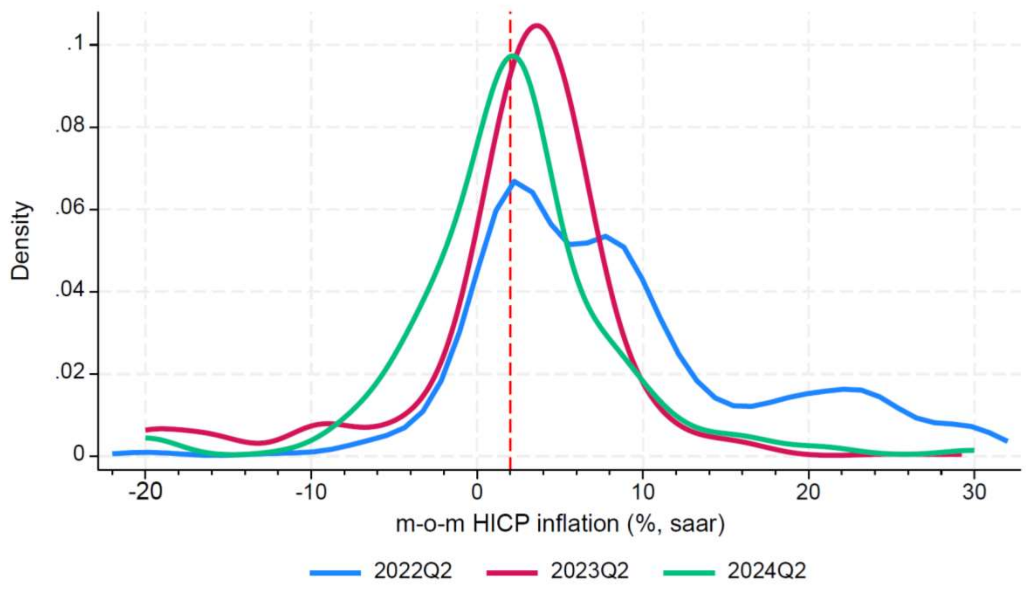
19. Sectoral inflation dynamics

Percent



Source: Eurostat, DNB calculations.

20. Distribution of price changes



What’s next?

	2023	2024	2025	2026
Real GDP	0,5	0,8	1,3	1,5
HICP	5,4	2,5	2,2	1,9
Core HICP	4,9	2,9	2,3	2,0

Table

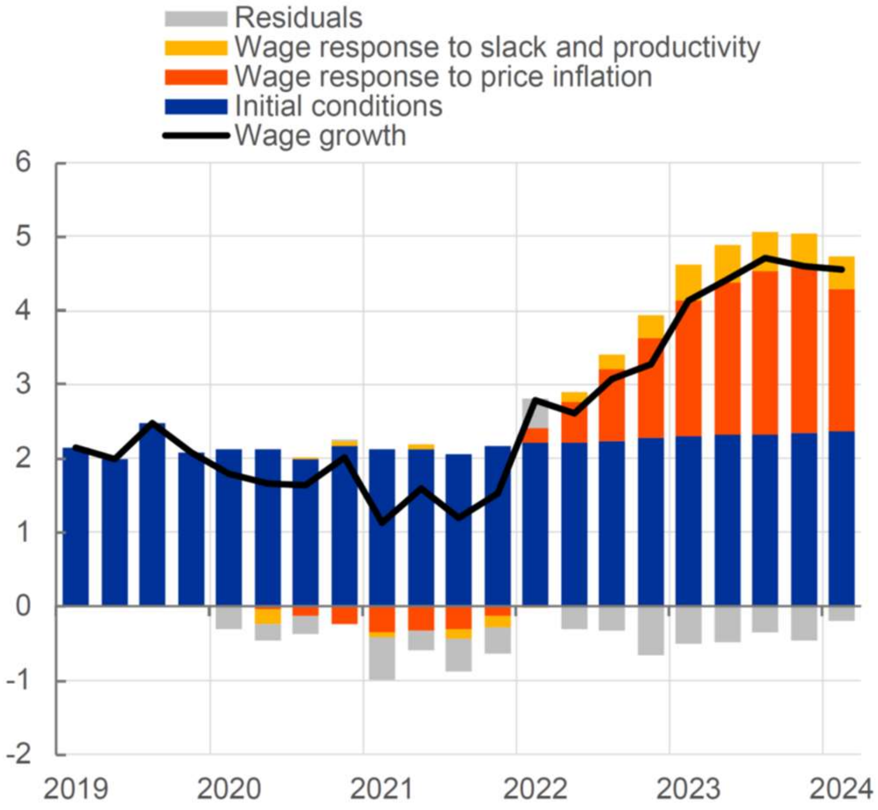
Comparison of recent forecasts for euro area real GDP growth and HICP inflation

(annual percentage changes)

	Date of release	GDP growth			HICP inflation			HICP inflation excl. energy and food		
		2024	2025	2026	2024	2025	2026	2024	2025	2026
ECB staff projections	September 2024	0.8	1.3	1.5	2.5	2.2	1.9	2.9	2.3	2.0
Consensus Economics	August 2024	0.8	1.3	1.4	2.4	2.0	1.9	2.8	2.2	-
Survey of Professional Forecasters	July 2024	0.7	1.3	1.4	2.4	2.0	1.9	2.7	2.2	2.0
International Monetary Fund	July 2024	0.9	1.5	-	2.4	2.1	-	-	-	-
European Commission	May 2024	0.8	1.4	-	2.5	2.1	-	2.7	2.1	-
OECD	May 2024	0.7	1.5	-	2.3	2.2	-	2.6	2.1	-

Model-based decomposition of negotiated wage growth

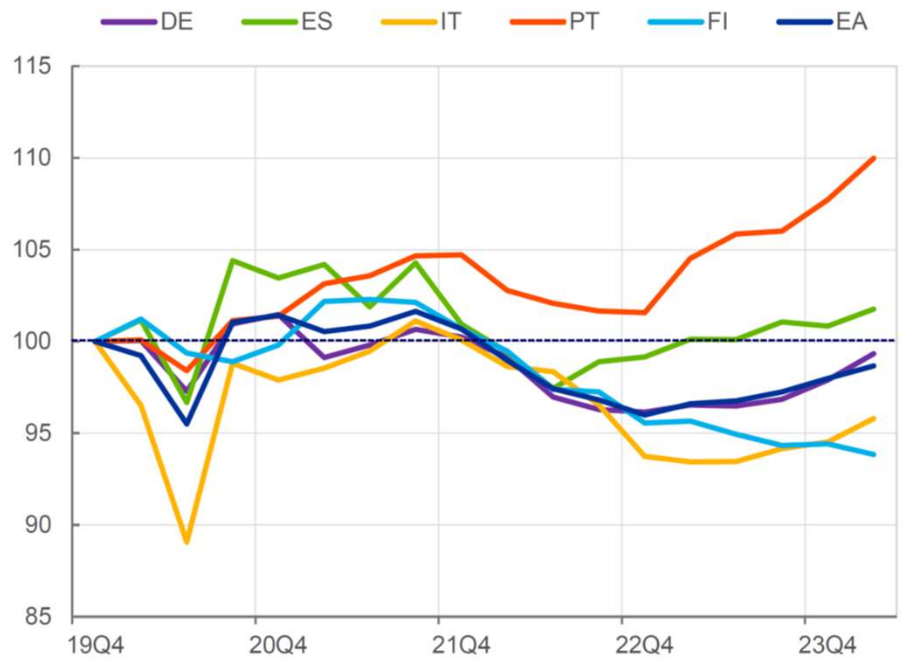
(year-on-year growth rate, percentage point contributions)



Source: ECB calculation is based on Arce, O., Ciccarelli, M., Kornprobst, A. and Montes-Galdon, C. (2024), "What caused the euro area post-pandemic inflation?", Occasional Paper Series, No 343, ECB.
Latest observation: 2024 Q1.

Real compensation per employee

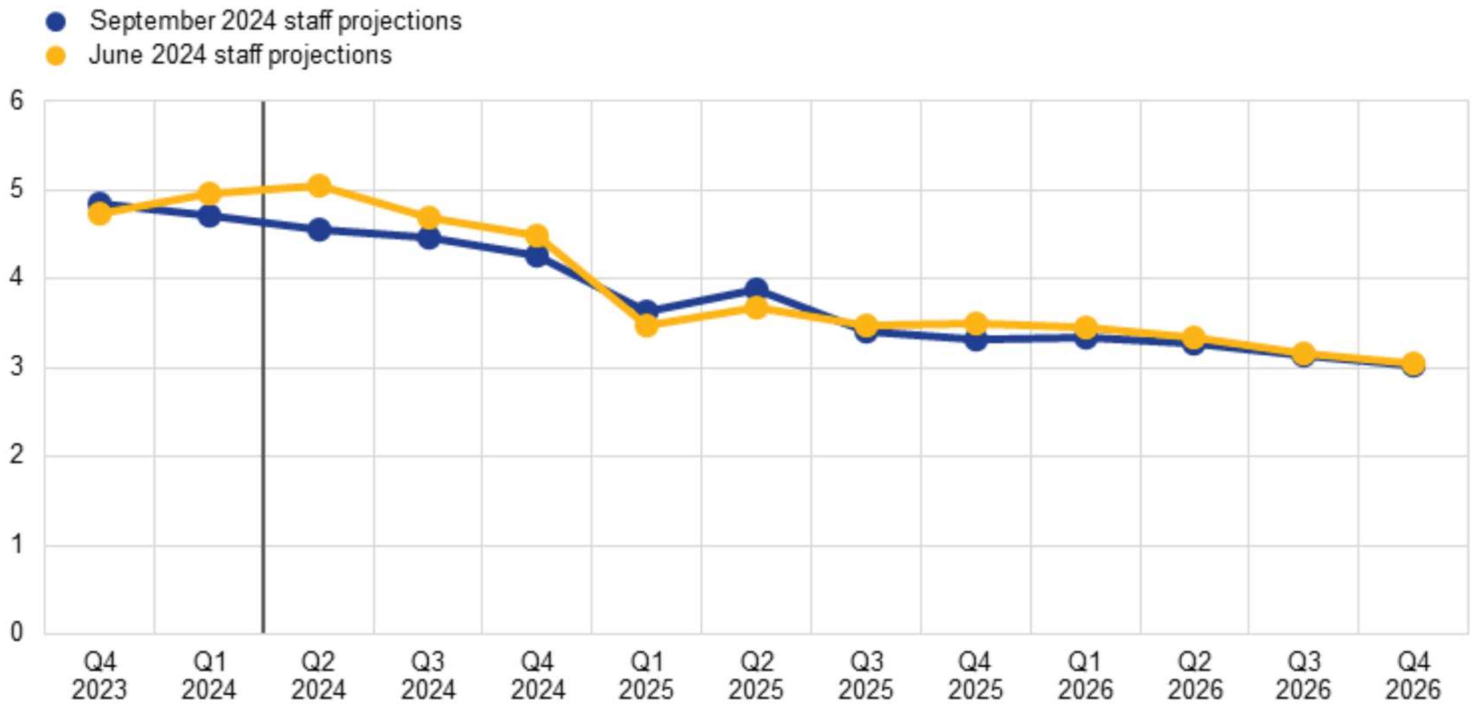
(indices: 2019 Q4 = 100)



Sources: ECB, BIS and ECB staff calculations.
Notes: Compensation per employee is deflated by national CPI for Germany (DE), Spain (ES), Italy (IT), Portugal (PT) and Finland (FI). The euro area (EA) is deflated by HICP.
Last observations: 2024 Q1.

Chart 11
Compensation per employee

(annual percentage changes)



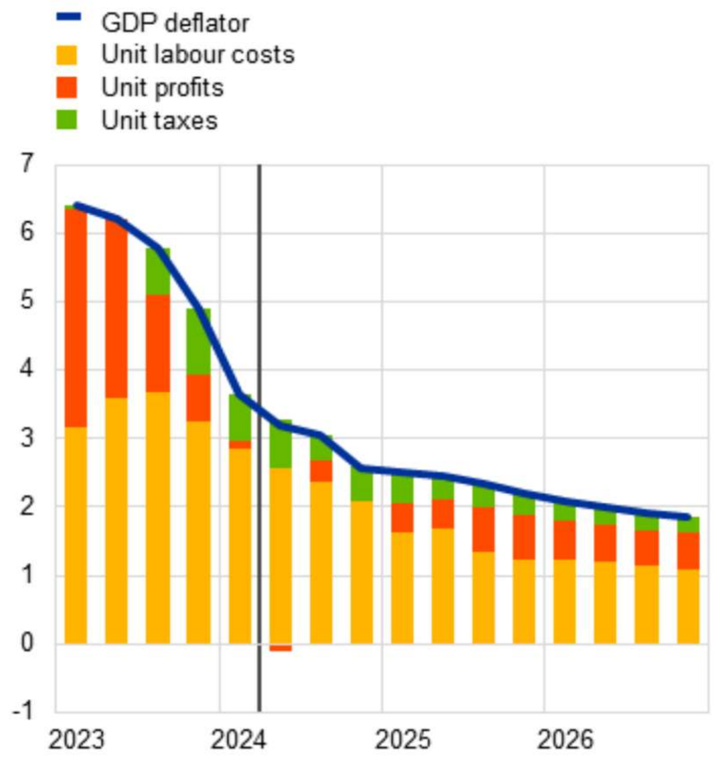
Notes: The vertical line indicates the start of the current projection horizon. Historical data may differ from the latest Eurostat publications (see footnote 9).

Chart 12

Domestic price pressures

a) GDP deflator and its components

(annual percentage changes, percentage point contributions)



Grazie per l’attenzione