Monetary strategy in times of high inflation

A Trade Union perspective

EZA Brussels Conference 2023

Handelsblatt

Gewerkschaftsbund warnt EZB vor weiteren Zinserhöhungen

DÜSSELDORF (dpa-AFX) -Vor der Ratssitzung der Europäischen Zentralbank an diesem Donnerstag fordert der Deutsche Gewerkschaftsbund (DGB) die Notenbank zu einem Verzicht auf weitere Zinserhöhungen auf. "Wir

The European Central Bank today decided to increase its three key interest rates by 50 basis points.

Responding to the decision, ETUC General Secretary Esther Lynch said:

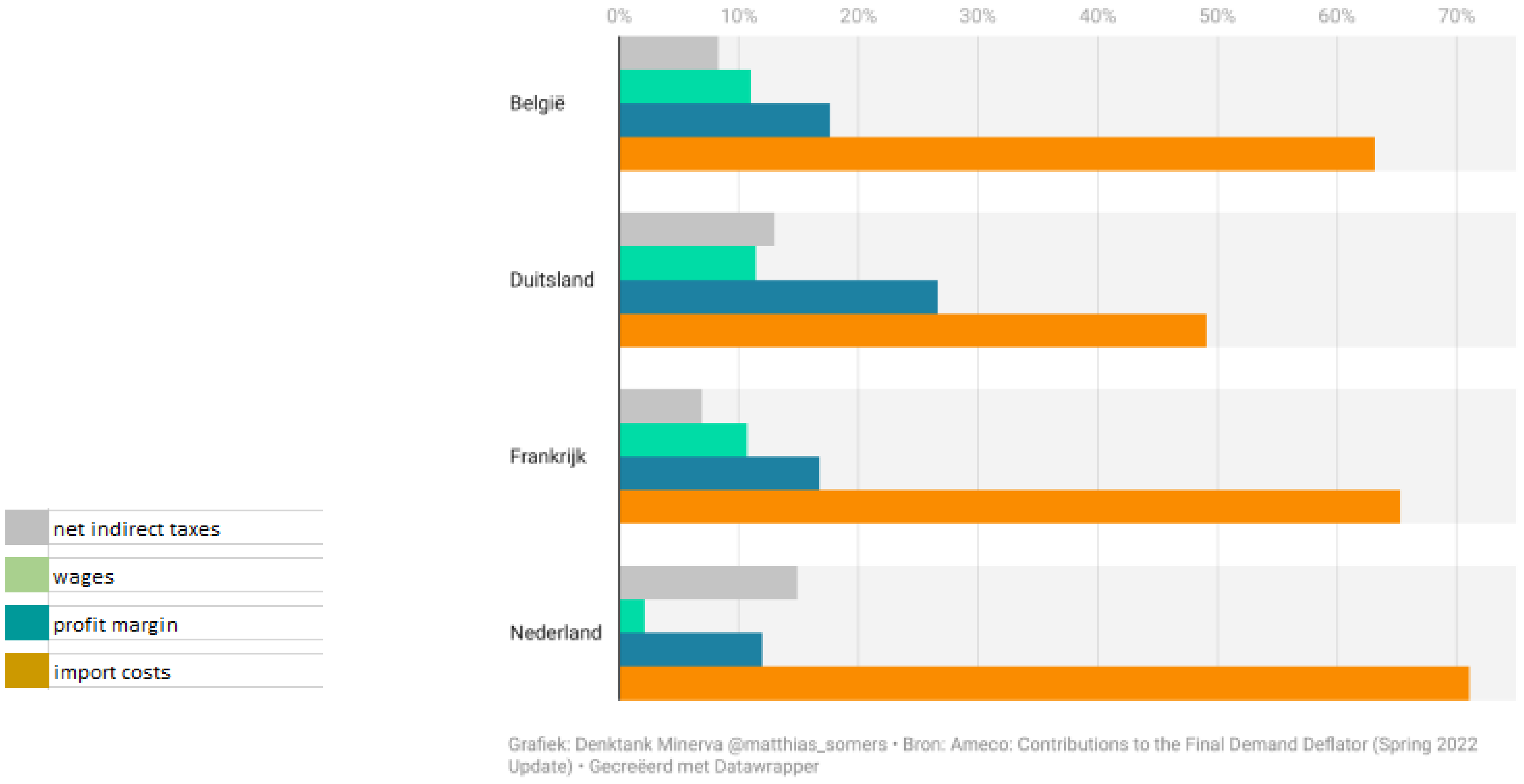
"Raising interest rates does nothing to deal with the supply-side causes of inflation which are destroying people's living standards and the cure is now starting to look more dangerous than the disease.

"Increased borrowing costs will also strangle investment at a time when it needs to increase if we're going to transition to a green economy or shield the most vulnerable households from the cost-of-living crisis.

"The ECB's own evidence says inflation has been driven by supply-chain bottlenecks and excess profits. It's time policymakers addressed the real cause of high inflation and stopped making working people pay for another crisis they didn't create."

The root causes of inflation

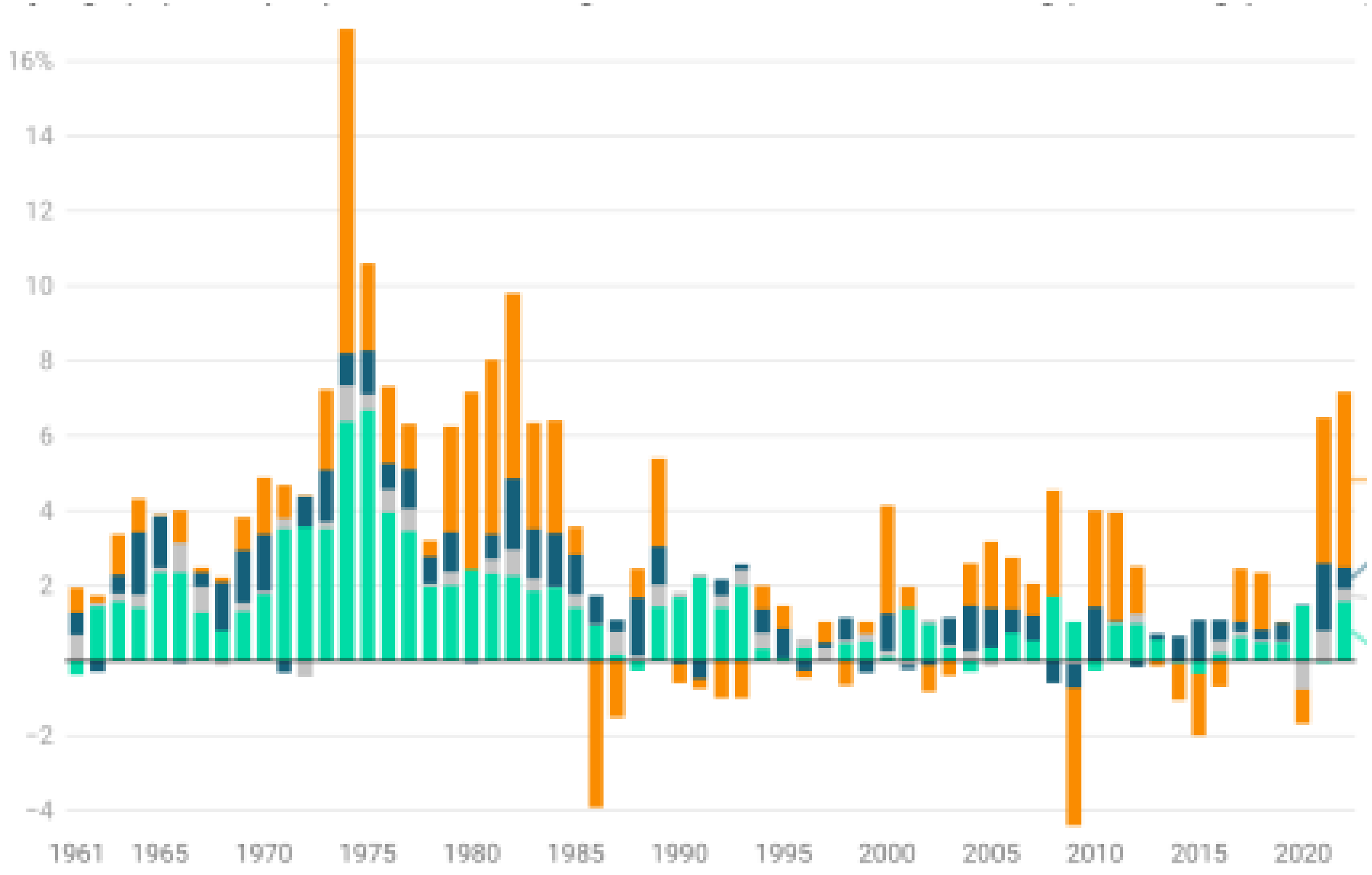
Determinants of the price level 2021-2022 : Belgium & neighbouring countries



The root causes of inflation

Composition of the deflator of the final demand

Contribution (in pct points) to the variation of the deflator of final demand (variation percentage of the price per unit)



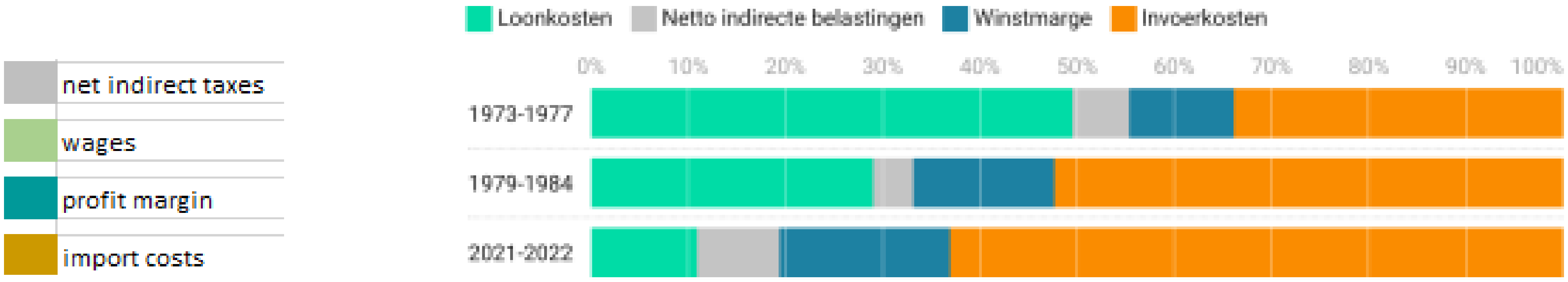
net indirect taxes per unit
unit labour cost
profit margin per unit
import costs per unit

The root causes of inflation

- Different situation in comparison to the oil shocks of the ’70-ies :

Determinants of the price level in times of crisis (Belgium)

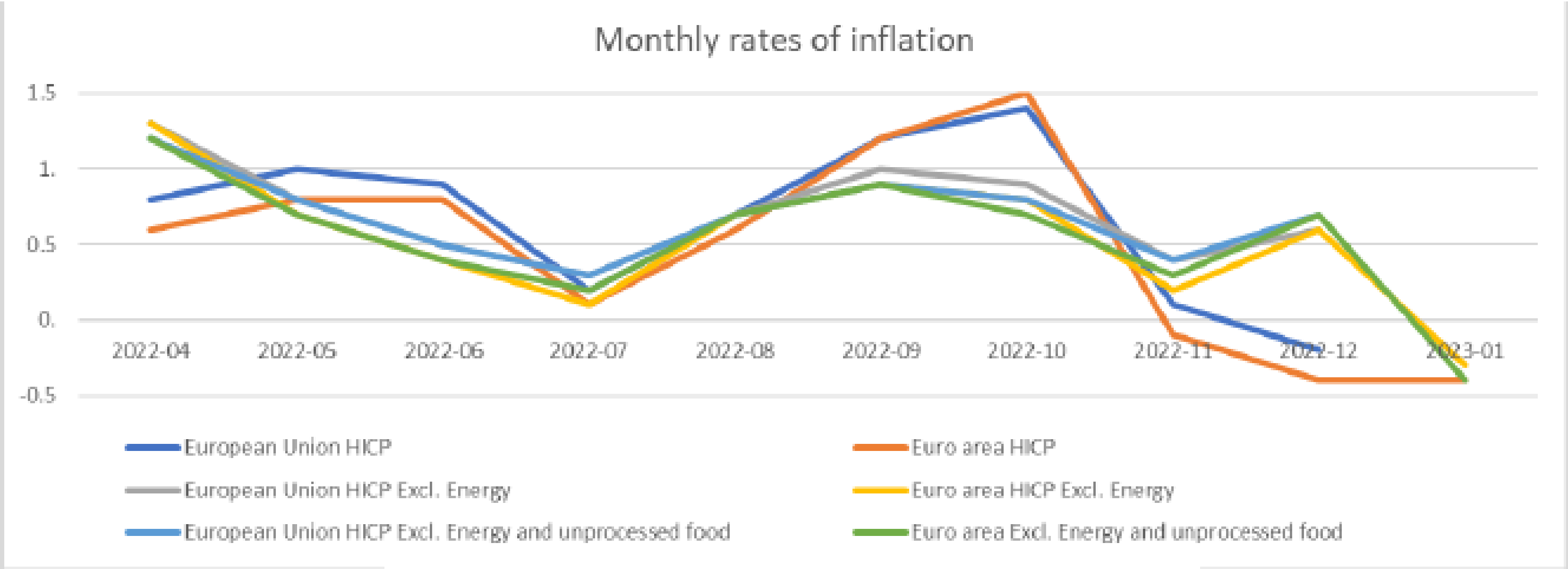
Part of various components in the deflator of final demand



First conclusions

- Energy costs are driving price hikes
- Actually, inflation is diminishing fastly as energy prices fall back
- Yet, core inflation is still on the rise
- Rise and fall of inflation was NOT caused by ECB monetary policy
- Inflation is harmful for workers in 2 senses :
  - Real wages degrade
  - Value of savings decreases
- But : the cure (higher interest rates) could be worse than the disease..

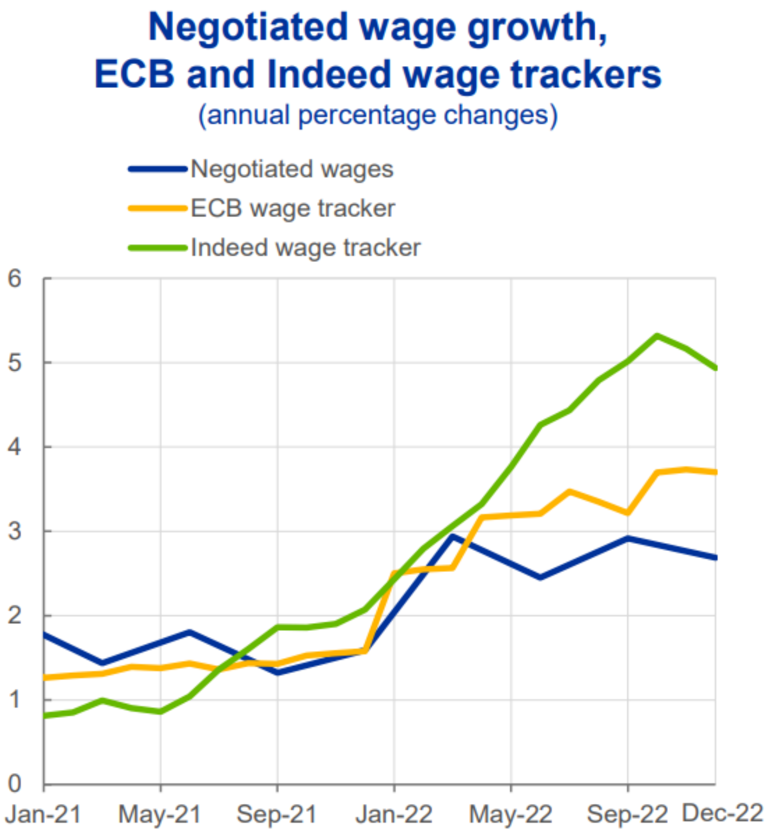
Inflation, additional figures

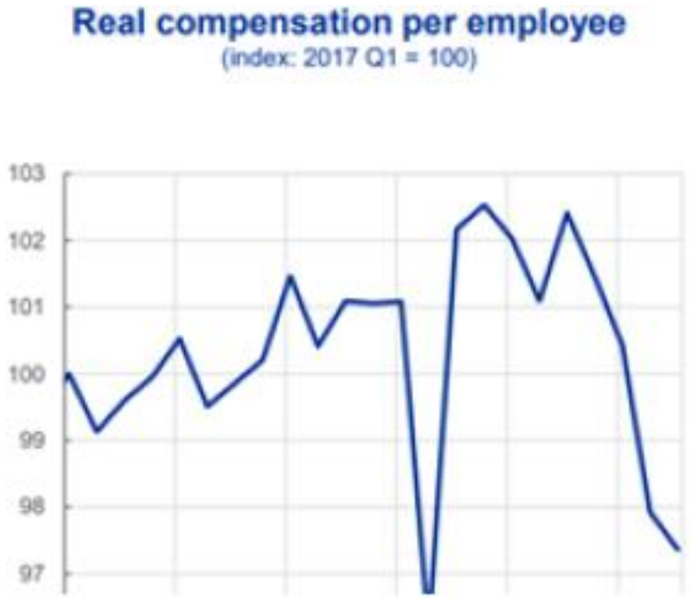


Euro area annual inflation and its components, %

	Weights (‰)	Annual rate							Monthly rate
	2023	Jan 22	Aug 22	Sep 22	Oct 22	Nov 22	Dec 22	Jan 23	Jan 23
All-items HICP	1000.0	5.1	9.1	9.9	10.6	10.1	9.2	**8.5e**	-0.4e
All-items excluding:									
> energy	897.0ep	2.5	5.8	6.4	6.9	7.0	7.2	**7.3e**	-0.3e
> energy, unprocessed food	852.0ep	2.4	5.5	6.0	6.4	6.6	6.9	**7.0e**	-0.4e
> energy, food, alcohol & tobacco	697.5ep	2.3	4.3	4.8	5.0	5.0	5.2	**5.2e**	-0.8e

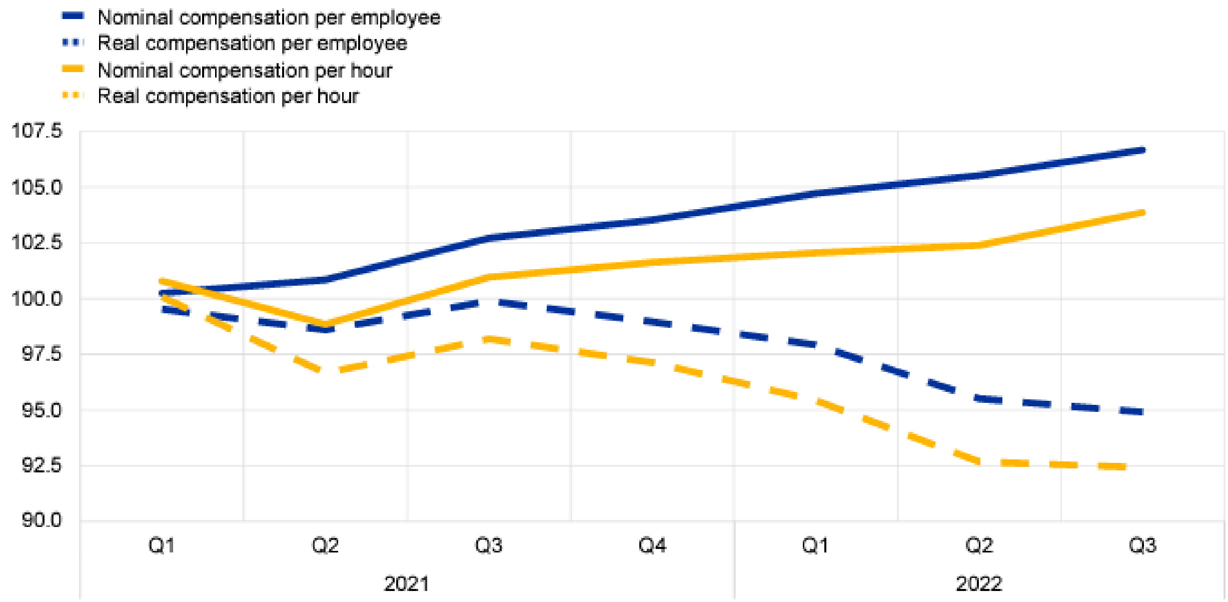
Inflation not caused by a wage spiral





Inflation – not a wage spiral

Nominal and real wage growth (consumer wages)
(index: Q4 2020 = 100)



Sources: Eurostat and ECB staff calculations.
Notes: Real compensation per employee and per hour are calculated using HICP (consumer wages).
The latest observations are for the third quarter of 2022.

→ Even in Belgium, where wages are automatically indexed, there's no wage spiral, as inflation is not higher than in neighbouring countries

→ Inflation in Belgium is even lower than in Germany or France, at the beginning of 2023

Some conclusions

→Today's inflation comes mostly :

- from **sectoral supply side disruptions**,
- largely the result of the **COVID-19 pandemic** and its consequent disturbances to supply chains;
- and disruptions to **energy** and food markets originating from **Russia's invasion** of Ukraine.
- In some sectors, these **effects** have been amplified as a result of the exercise of market power.
- But today's inflation, for the most part, is **not the result of significant excesses of aggregate demand** such as might have arisen from excessive US pandemic spending.

Some conclusions

→While we welcome the return of interest rates to more normal levels, which reduces a number of distortions associated with persistent, abnormally low interest rates :

- increasing interest rates too far and too quickly **risks a painful slowdown** to the economy :
  - Increased **unemployment** would hit hardest at marginalized groups
  - Could provoke **global debt crisis**, as capital flows back to advanced economies
- with **minimal benefits to inflation** short of a significant downturn.
- This would have **particular adverse distributional consequences**, especially for marginalized groups in the country.
- **2% target** is quite **arbitrary**
- Cost of getting there quickly may be very high (financial instability, ec. downturn)
- High i-rates **may make matters worse** : will discourage investment required for transition

Some conclusions

→There are **fiscal and other measures that can and should be taken** :

- to alleviate particular sectoral inflationary pressures,
- and that are likely to be more effective than broad-based interest rate increases.

→Recent data shows **significant moderation of inflationary pressures** :

- Bottlenecks are being resolved
- Disinflationary forces at play as sectoral prices normalize
- with nominal wage increases in particular being only a little over pre-pandemic levels
- This, together with other indicators such as **tempered inflationary expectations,** goes a long way in alleviating worries about an incipient wage-price spiral.