Euro area outlook and monetary policy

AIECE Spring Meeting 2024

Cologne, 16 May 2024
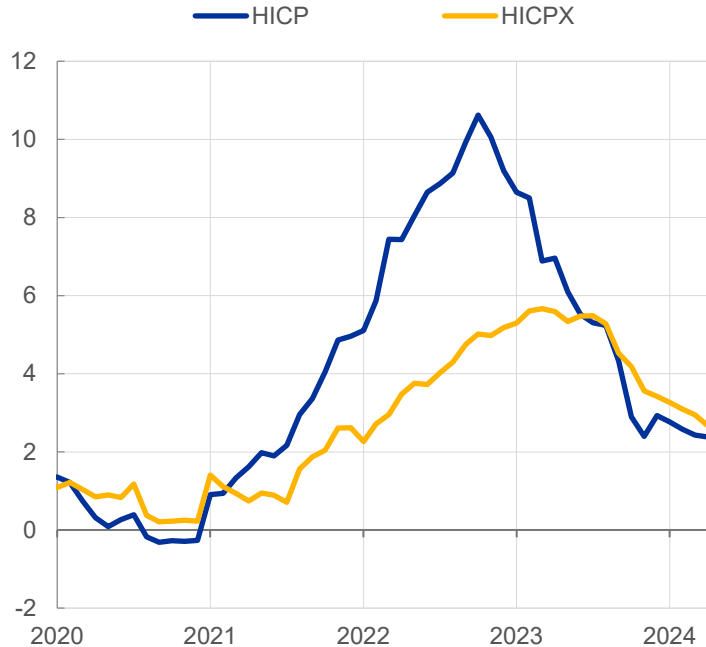
Fédéric Holm-Hadulla, Monetary Policy Strategy

The views expressed here are those of the speaker and do not necessarily reflect the views of the ECB

Ongoing handover from non-core to core and from goods to services inflation
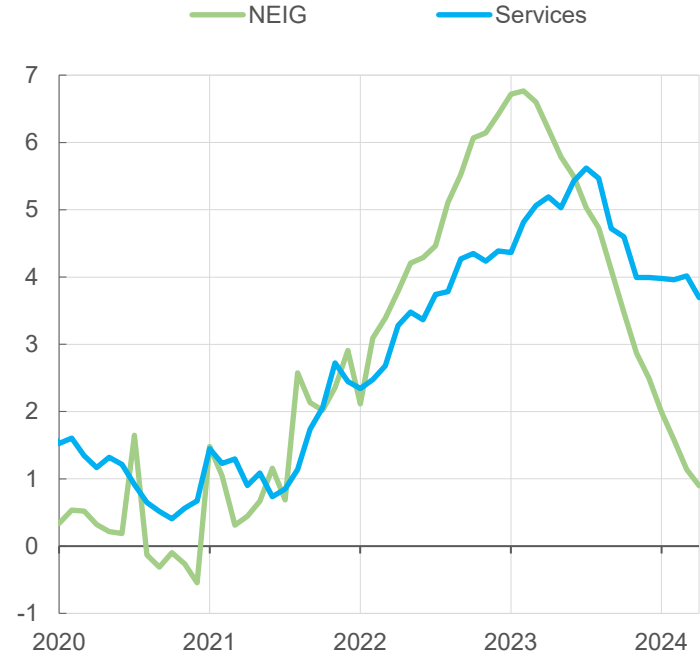
Headline and core inflation
(annual percentage changes)

Legend: HICP, HICPX

Source: Eurostat.
Latest observation: April 2024 (flash).

NEIG and Services inflation
(annual percentage changes)
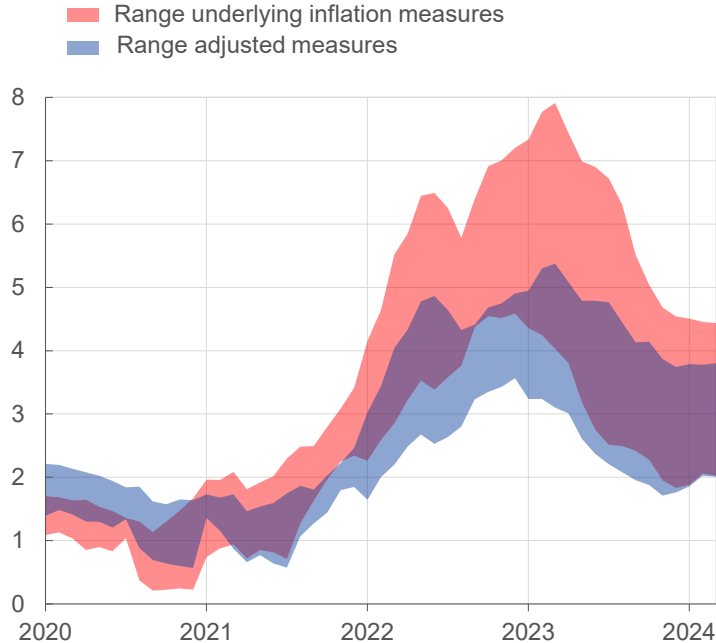
Legend: NEIG, Services

Source: Eurostat.
Latest observation: April 2024 (flash).

Disinflation driven by reversal of supply constraints and tight monetary policy

Indicators of underlying inflation
(annual percentage changes)

Range underlying inflation measures
Range adjusted measures

Notes: Range of underlying inflation measures include: HICP ex. energy, HICP ex. unprocessed food and energy, HICP ex. energy and food (HICPX), HICP ex. energy, food, travel-related items and clothing (HICPXX), PCCI, PCCI ex. energy, Supercore, and Domestic Inflation. The 'adjusted' measures abstract from energy and supply-bottleneck shocks using a large SVAR (see Bańbura, Bobeica and Martínez Hernández, (2023), "What drives core inflation? The role of supply shocks", ECB Working Paper, 2875), subtracted mechanically from each measure.
Latest observation: March 2024.

Impact of monetary policy tightening on HICP inflation
(year-on-year percentage points)

BASE   BASE - reactive
NAWM II   NAWM - adaptive
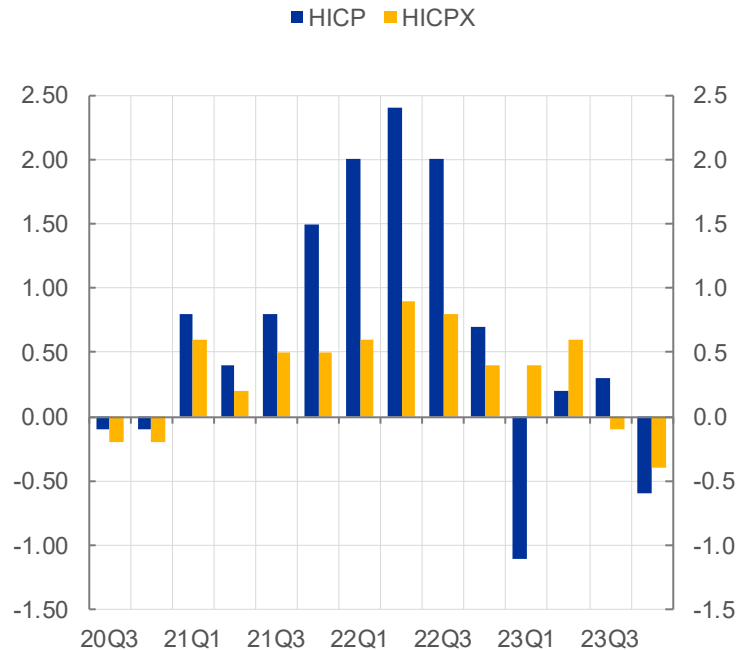MMR   MMR - unanticipated
Mean
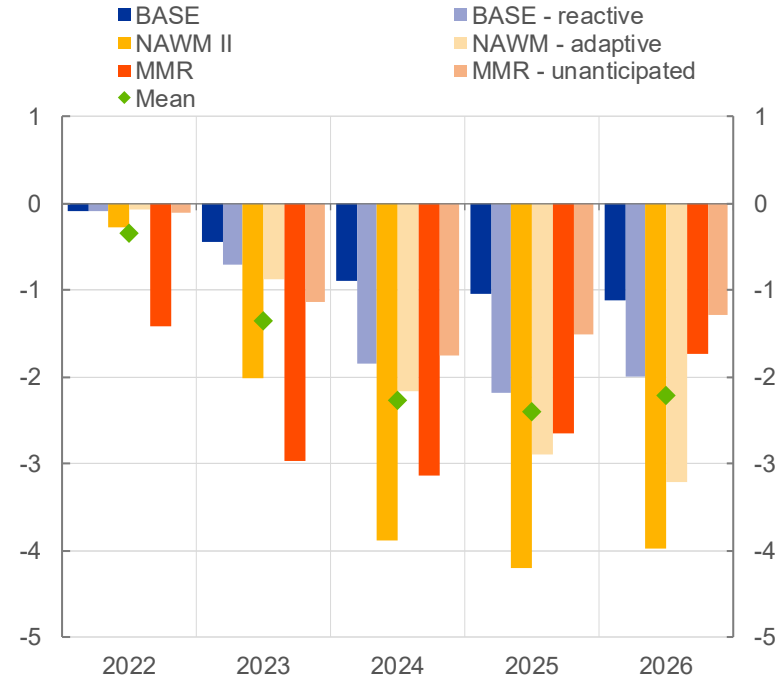
Source: ECB calculations based on the New Area-Wide Model (Coenen, Karadi, Schmidt, Warne, 2019), the MMR model (Mazelis, Motto, Ristiniemi, 2023), and the BASE model (Angelini, Bokan, Christoffel, Ciccarelli, Zimic, 2019). Notes: This chart reports the results of a simulation involving changes to short-term rate expectations between December 2021 and February 2024, and changes to expectations regarding the ECB's balance sheet between October 2021 and February 2024. "Mean" denotes the average across the six model variants. Latest observation: 09 Feb 2024 for the underlying short-rate expectations from MP-date ESTR forward contracts. January 2024 SMA expectations for the balance sheet.

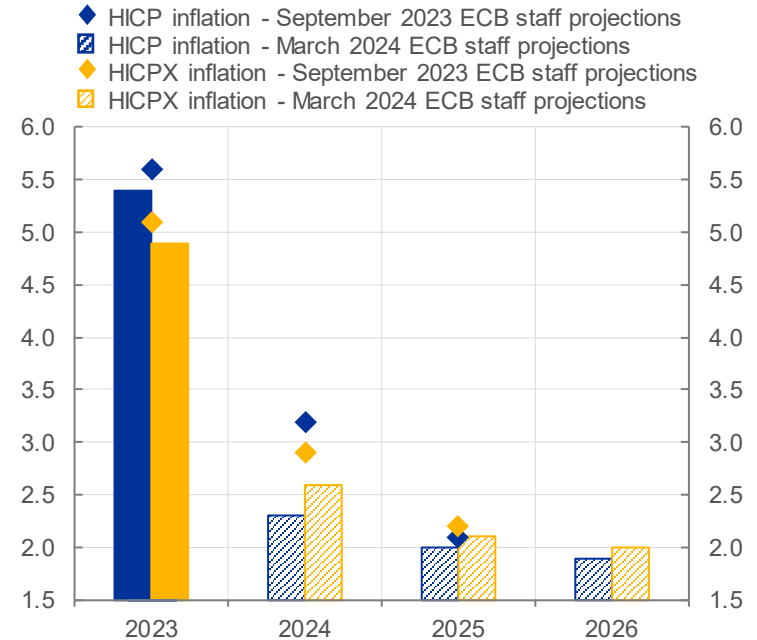# Projections again becoming a more reliable guidepost for inflation outlook

One-quarter ahead projections errors of headline and core inflation
(year-on-year percentage points)

■ HICP ■ HICPX

Source: ECB calculations
Notes: The projections errors show the difference between realised and projected values from the (B)MPE one quarter ago of headline HICP and HICP excluding energy and food (HICPX).
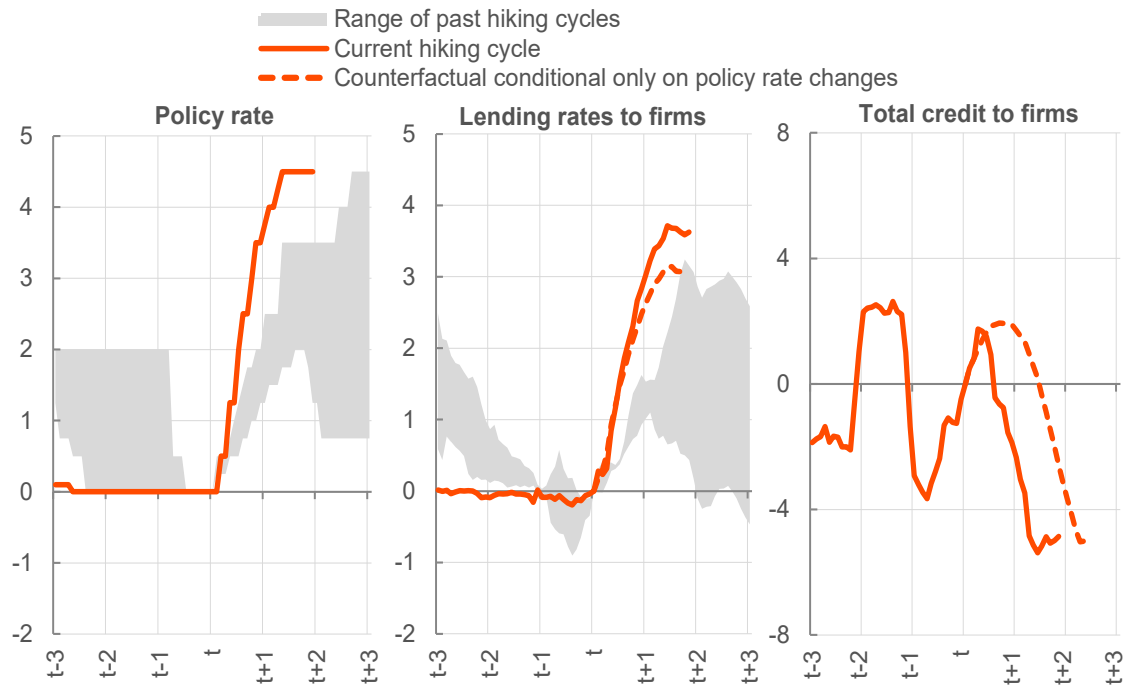Latest observation: Q4 2023.

Projections of headline and core inflation
(annual percentage changes)

◆ HICP inflation - September 2023 ECB staff projections
▨ HICP inflation - March 2024 ECB staff projections
◆ HICPX inflation - September 2023 ECB staff projections
▨ HICPX inflation - March 2024 ECB staff projections

Source: ECB.
Notes: the full bars for 2023 represent realised annual average headline and core inflation.

Strong transmission of policy rate hikes to broader financing conditions

Monetary policy transmission across hiking cycles
(x-axis: years; y-axis: cumulative changes in p.p. for rates, credit growth in deviation from the start of the cycle (t) in p.p. for total credit to firms)

Legend:
- Range of past hiking cycles
- Current hiking cycle
- Counterfactual conditional only on policy rate changes

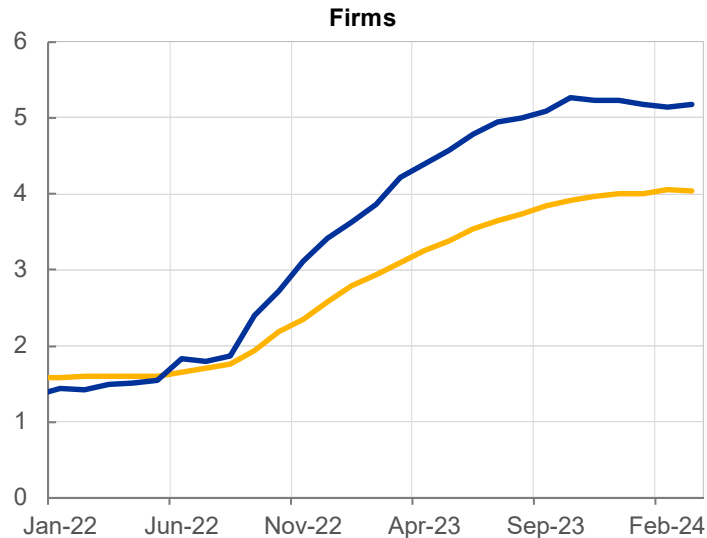Charts: Policy rate | Lending rates to firms | Total credit to firms

Sources: ECB (BSI, CSEC, MIR) and ECB calculations. Notes: The ECB relevant policy rate is the Lombard rate up to December 1998, the MRO up to May 2014 and the DFR thereafter. Total credit are loans and debt securities. MFI loans are adjusted for sales and securitisation and cash pooling. Starting months correspond to the month immediately preceding the first hike or explicit announcement of the hike of the cycle. Hiking cycles considered those starting in: June 1988, October 1999, November 2005 and May 2022. The dotted lines shows counterfactuals for lending rates and lending volumes, taking December 2021 as the last observation and projecting volumes conditional on the path of monetary policy rates. The exercise for lending rates is based pass-through equations. The one for lending volumes is based on the BVAR model in Altavilla, Giannone, and Lenza (2016). Latest observation: March 2024.

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… and a good chunk of inframarginal tightening still in the pipeline

Lending rates for new and outstanding amounts of loans to firms
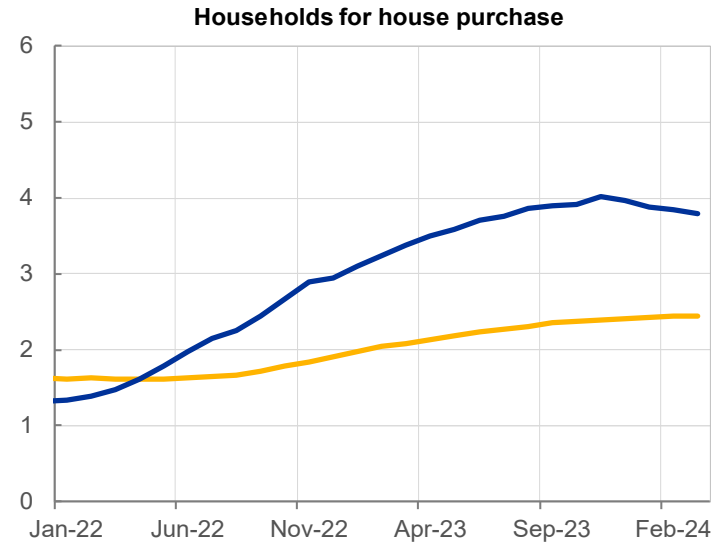### (percentages per annum)

— Interest rates on outstanding amounts
— Interest rates on new business volumes

Firms

Source: ECB (MIR).
Notes: Interest rates on new business for firms refer to the indicator for the total cost of borrowing, which is calculated by aggregating short-term and long-term rates on new business using a 24-month moving average of new business volumes.
Latest observation: March 2024.

Lending rates for new and outstanding amounts of mortgages
(percentages per annum)

— Interest rates on outstanding amounts
— Interest rates on new business volumes

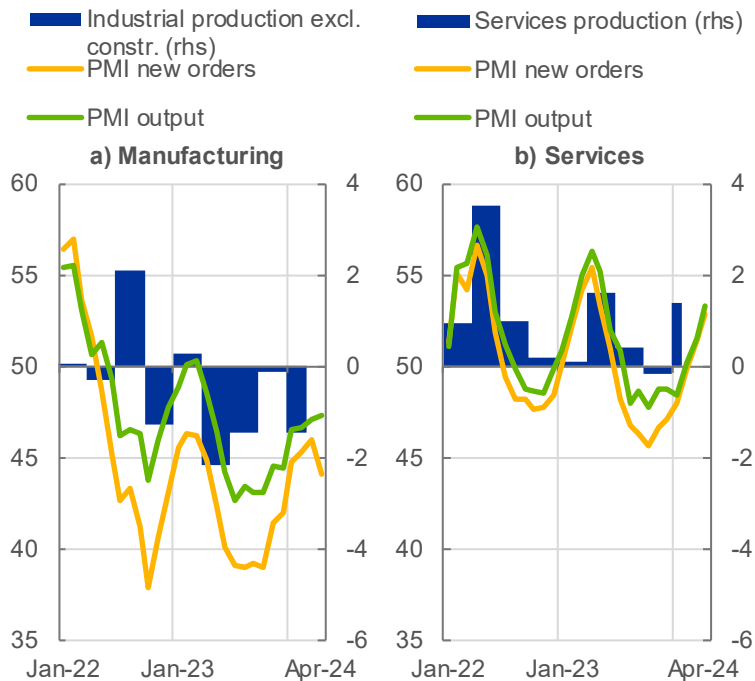**Households for house purchase**

Source: ECB (MIR).
Notes: Interest rates on new business for households for house purchase refer to the indicator for the total cost of borrowing, which is calculated by aggregating short-term and long-term rates on new business using a 24-month moving average of new business volumes.
Latest observation: March 2024.

Continued disconnect across manufacturing & services, policy weighing on both

Monthly indicators
(lhs: diffusion indices; rhs: q-o-q percentage changes)

Legend:
- Industrial production excl. constr. (rhs)
- PMI new orders
- PMI output
- Services production (rhs)
- PMI new orders
- PMI output

a) Manufacturing

b) Services

Sources: S&P Global, Eurostat and ECB staff calculations.
Latest observations: April 2024 for PMI indicators, February 2024 for industrial production, January 2024 for services production.

Monetary policy transmission and its interaction with service intensity
(percentages)

Legend:
- 1999 market services share
- 2022 market services share
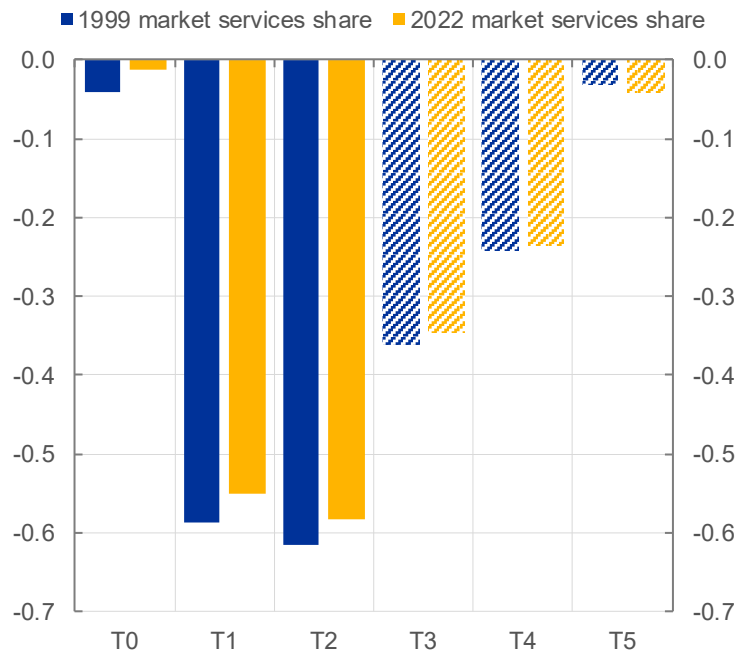
Sources: F. Holm-Hadulla and S. Hauptmeier (2023) "Industry structure and the real effects of monetary policy", Economic Bulletin, Issue 7/2023.
Notes: The chart shows the impact of a 25 basis point policy rate hike over a period of five years (T0 to T5), conditional on the services shares prevailing in 2022 and 2022 respectively. This corresponds to the sum of the slope coefficient of the monetary policy rate and the coefficient of an interaction term between the monetary policy rate and the services share. Solid bars indicate that the effects are significant to at least 10% level.

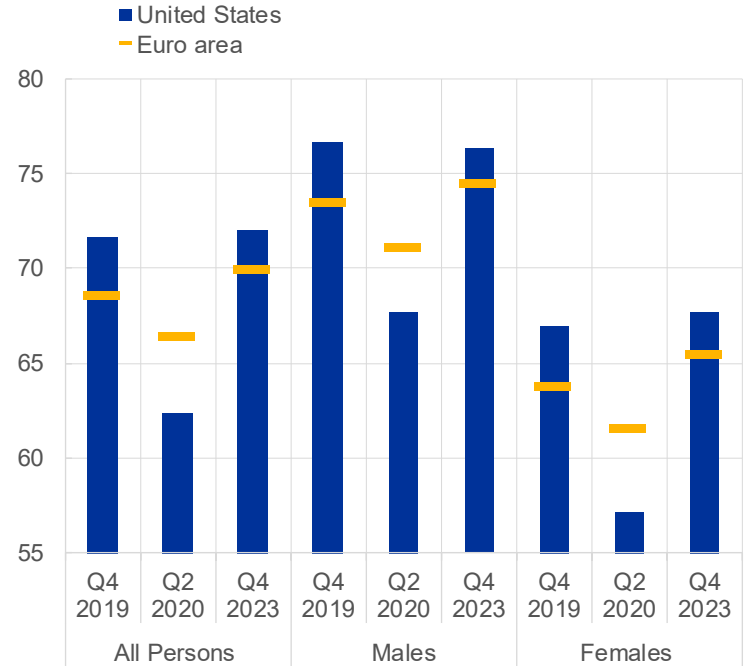# Cyclical labour market response blurred by major structural shifts

Employment, total hours and average hours worked in time series
(index, 2019Q4 = 100)
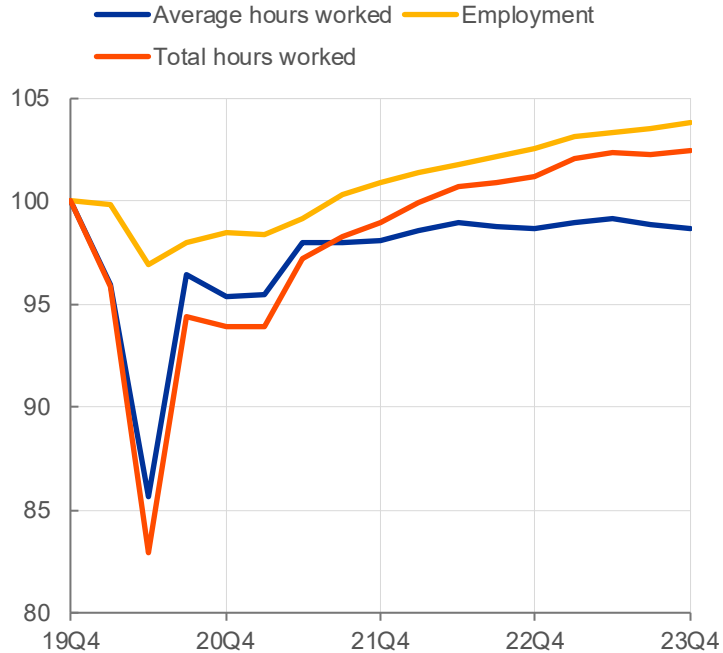
Sources: Eurostat and ECB calculations.
Latest observation: 2023 Q4.

Employment rates
(percentages of working age population)

Sources: OECD, Eurostat and BLS.
Note: The latest observations for the Euro area are for the third quarter of 2023.
Latest observation: 2023 Q4.