Monetary policy, inflation and the eurozone economy

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Outline of presentation

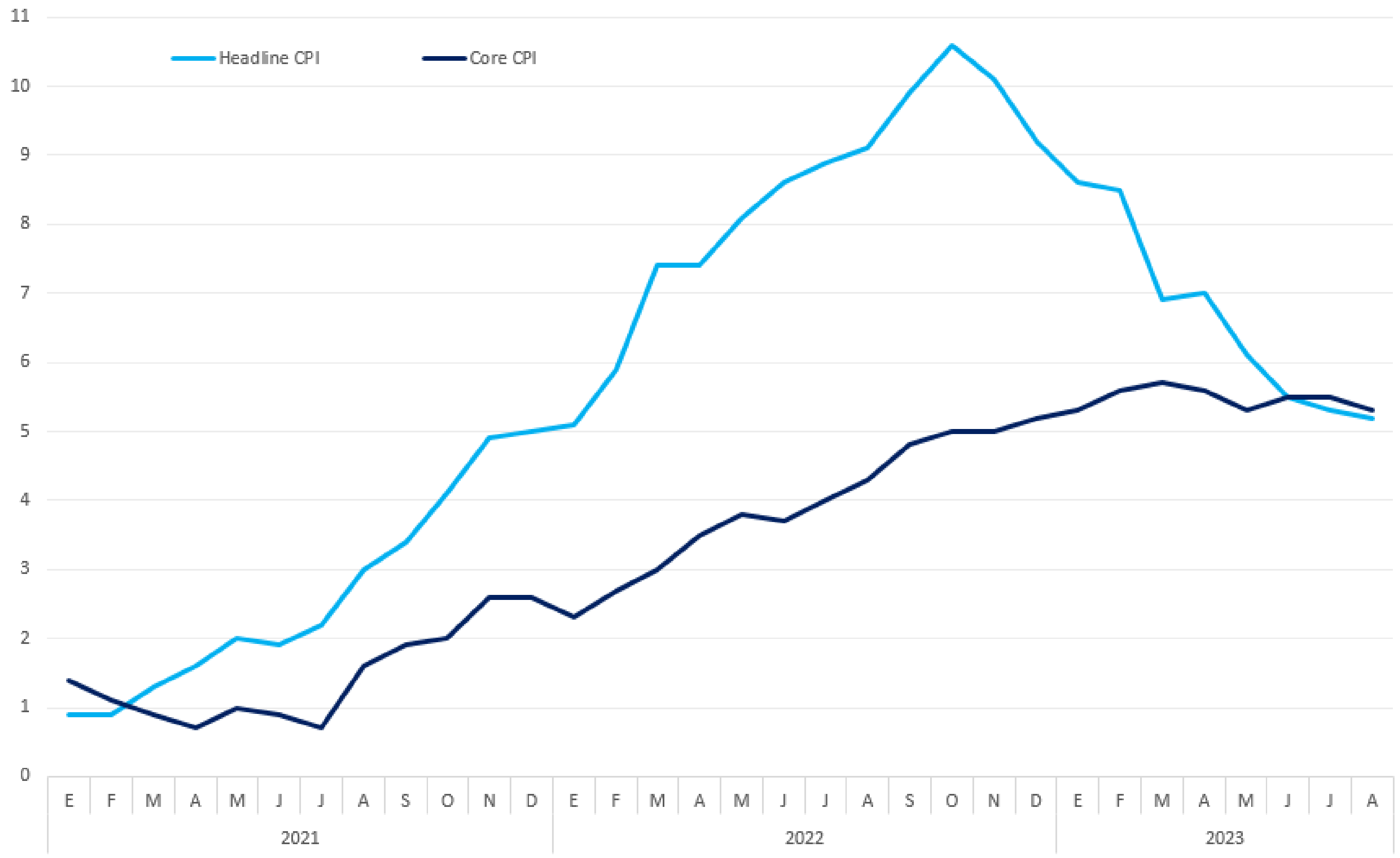
1. The inflationary process: a look at recent consumer-price trends and wage-profit dynamics

2. The eurozone economy and the monetary cycle

3. Risks

4. Concluding remarks

1.Inflation:
Tighter monetary policy has been accompanied by lower headline inflation and a stabilization in core inflation at above target levels…



Source: Eurostat.

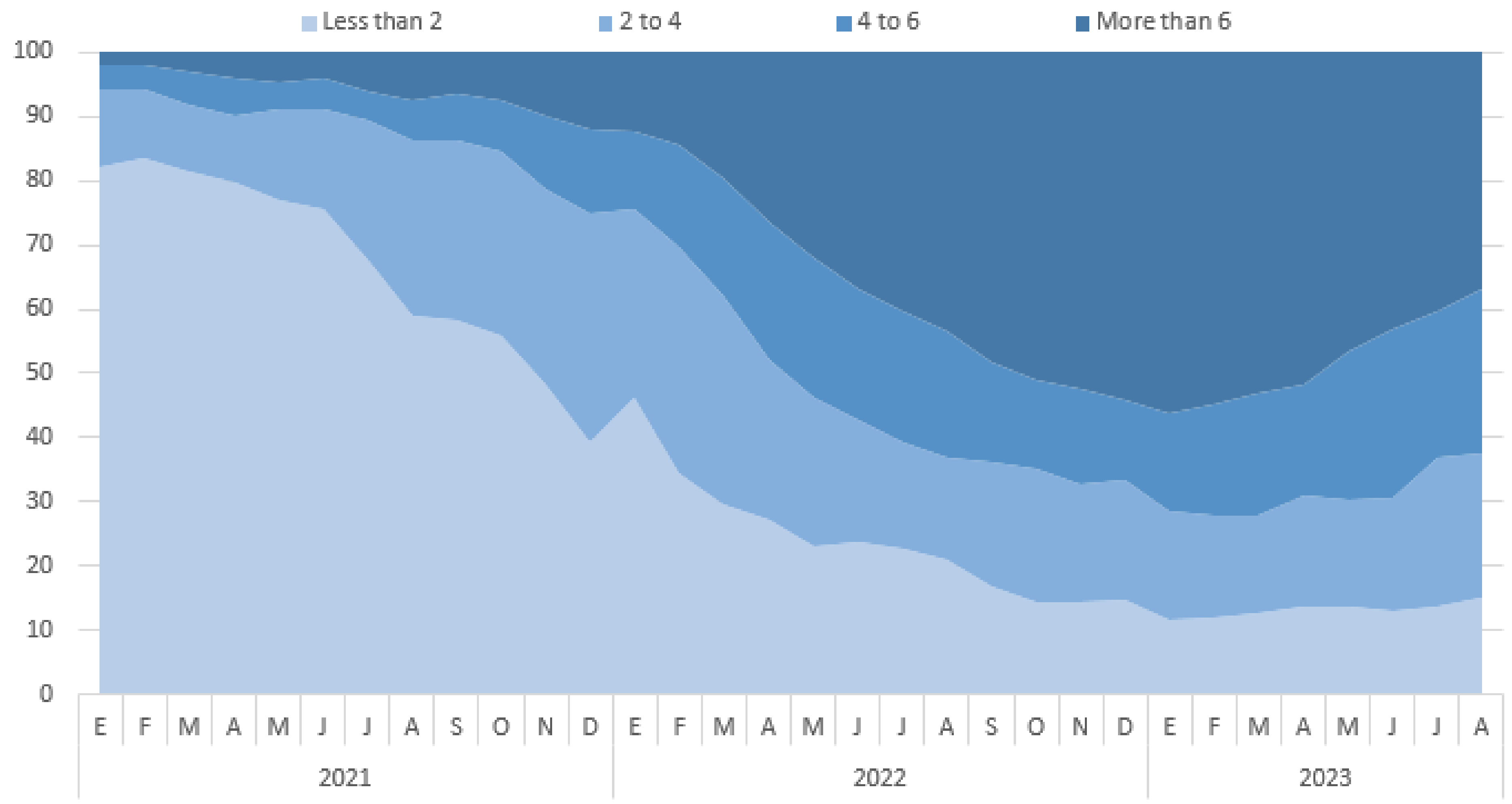
… but the underlying dynamics are for a further moderation

CPI dynamics, average monthly rates of change

	2021 H1	2021 H2	2022 H1	2022 H2	2023 T1	2023 T2	2023 july-aug
Headline CPI	0,4	0,4	1,0	0,5	-0,2	0,3	0,2
Energy	**1,7**	**2,2**	**3,9**	0,2	-0,9	-1,2	**1,6**
Food	0,3	0,2	**1,2**	**1**	**1,5**	0,3	0,1
Core	0,2	0,2	**0,4**	**0,4**	**0,4**	**0,5**	0,1

Source: Funcas calculations based on Eurostat.

The number of consumption items with inflation over 6% is falling, and conversely for items with inflation of less than 4%



Source: Funcas calculations based on Eurostat.

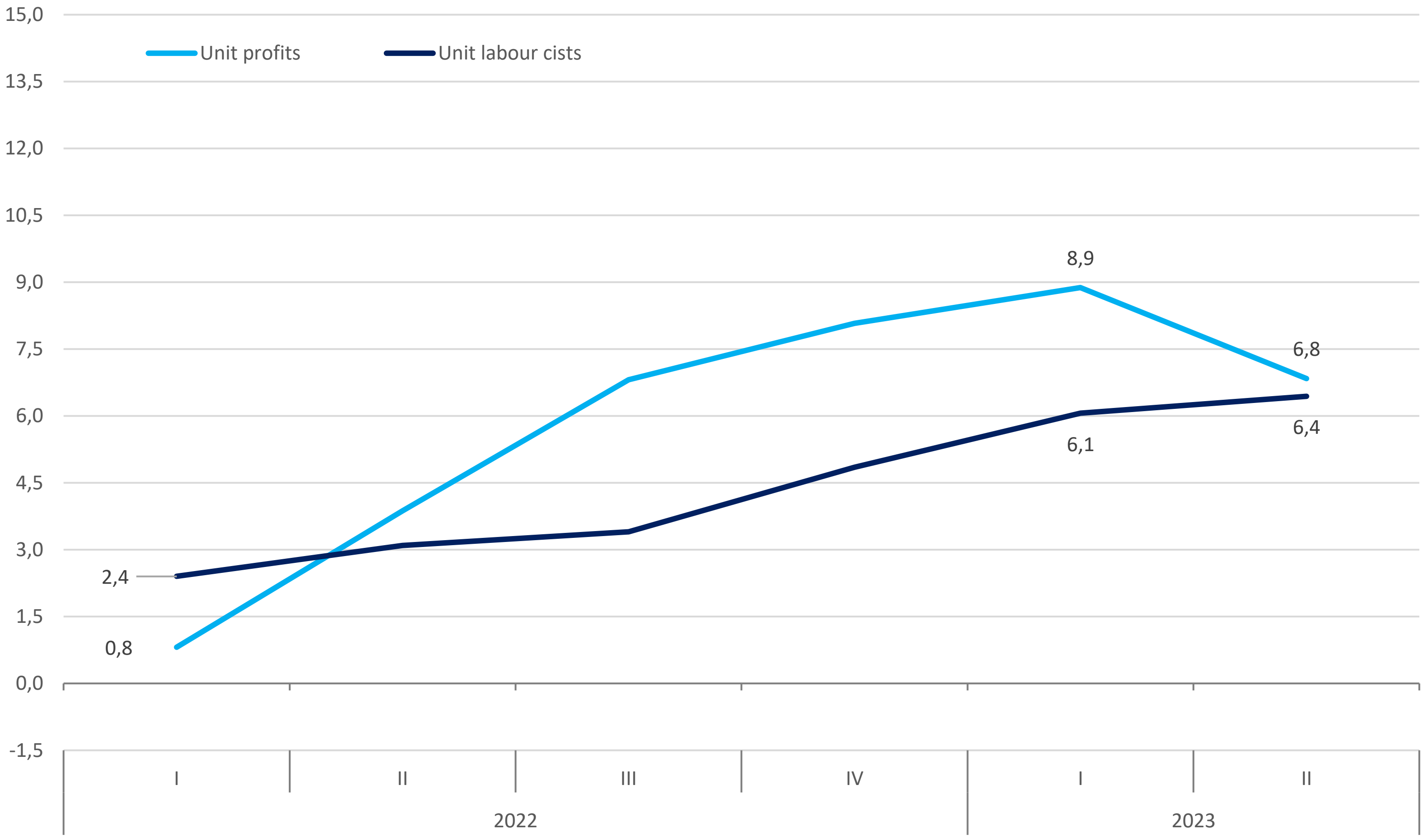
Core inflation tends to moderate in all countries (with only one exception)

	Mar-May	Jun-Aug
Euro area	0,8	0,2
Belgium	0,4	0,5
Germany	0,6	0,5
Estonia	0,7	0,5
Ireland	0,8	0,5
Greece	1,5	-0,3
Spain	0,9	0,1
France	0,6	0,4
Croatia	1,2	1,1
Italy	1,3	-0,6
Cyprus	1,1	0,8

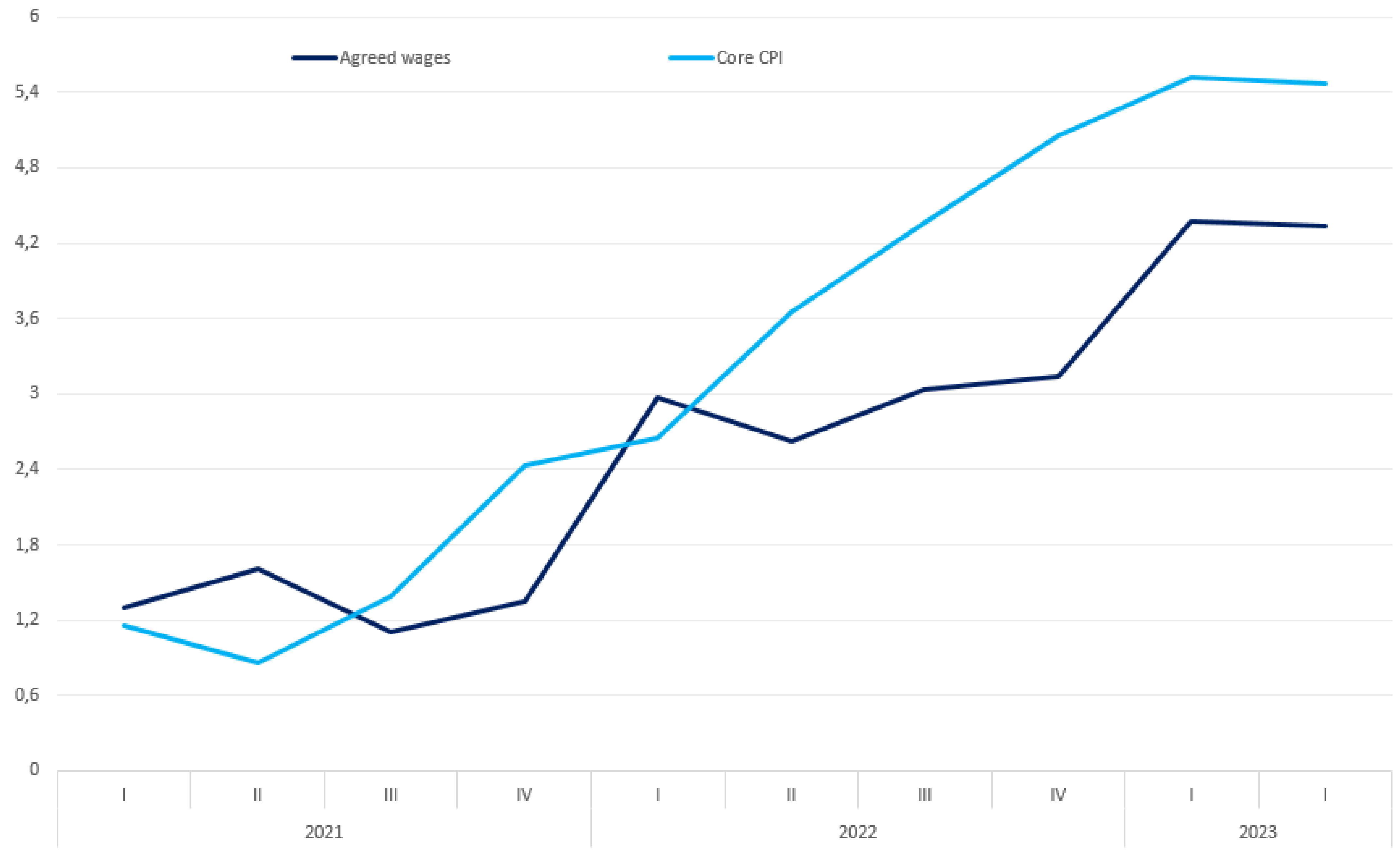
	Mar-May	Jun-Aug
Euro area	0,8	0,2
Latvia	1,4	-0,1
Lithuania	1,1	0,2
Luxembourg	0,6	0,3
Malta	2,6	0,9
Netherlands	1,0	0,2
Austria	0,7	0,0
Portugal	1,8	0,0
Slovenia	1,1	0,1
Slovakia	0,6	0,1
Finland	0,6	-0,1

Source: Eurostat.

From the cost point of view, inflation was mainly driven by profits, but the trend has started to reverse



Collective agreements are for higher wage increases in 2023, but mainly in the form of partial recuperation clauses and with a certain moderation

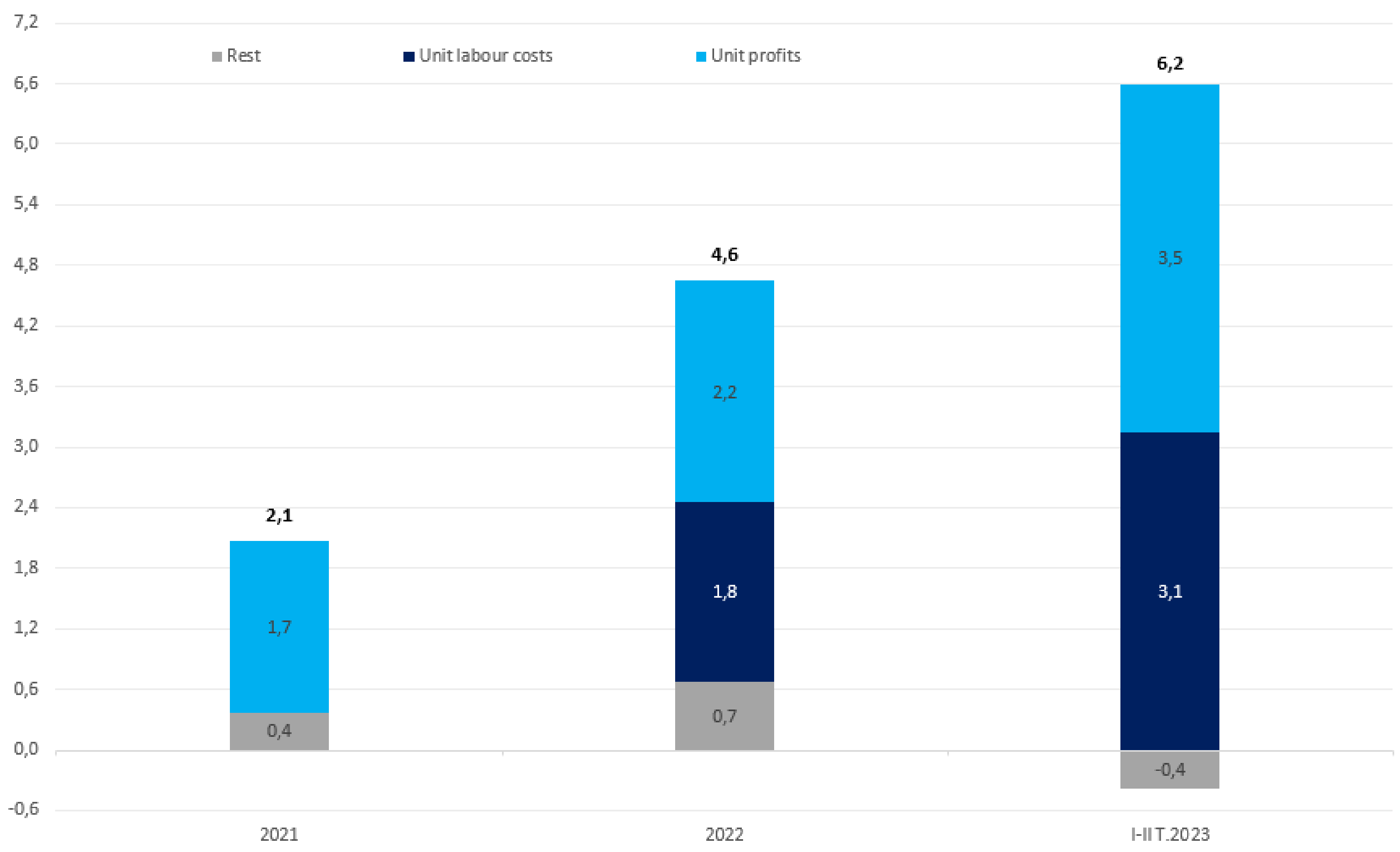


Source: ECB and Eurostat.

Profits have reached pre-pandemic levels as a percent of GDP, so they might be compressed as demand slows

Source: Eurostat.

Decomposition of growth of GDP deflator



Source: Funcas calculations based on Eurostat.

2. The economy: the eurozone is slowing markedly

	2022-Q1	2022-Q2	2022-Q3	2022-Q4	2023-Q1	2023-Q2
Gross domestic product at market prices	5,4	4,2	2,3	1,7	1,1	0,5
Final consumption expenditure of general government	3,1	1,3	0,4	0,6	-0,4	0,1
Household and NPISH final consumption expenditure	8,1	5,7	2,3	1,3	1,4	0,2
Gross fixed capital formation	3,6	2,6	4,6	0,9	1,9	1,3
Exports of goods and services	8,9	8,1	7,6	4,2	2,6	0,2
Imports of goods and services	10,1	9,1	10,4	3,1	1,7	-0,2

Source: Eurostat.

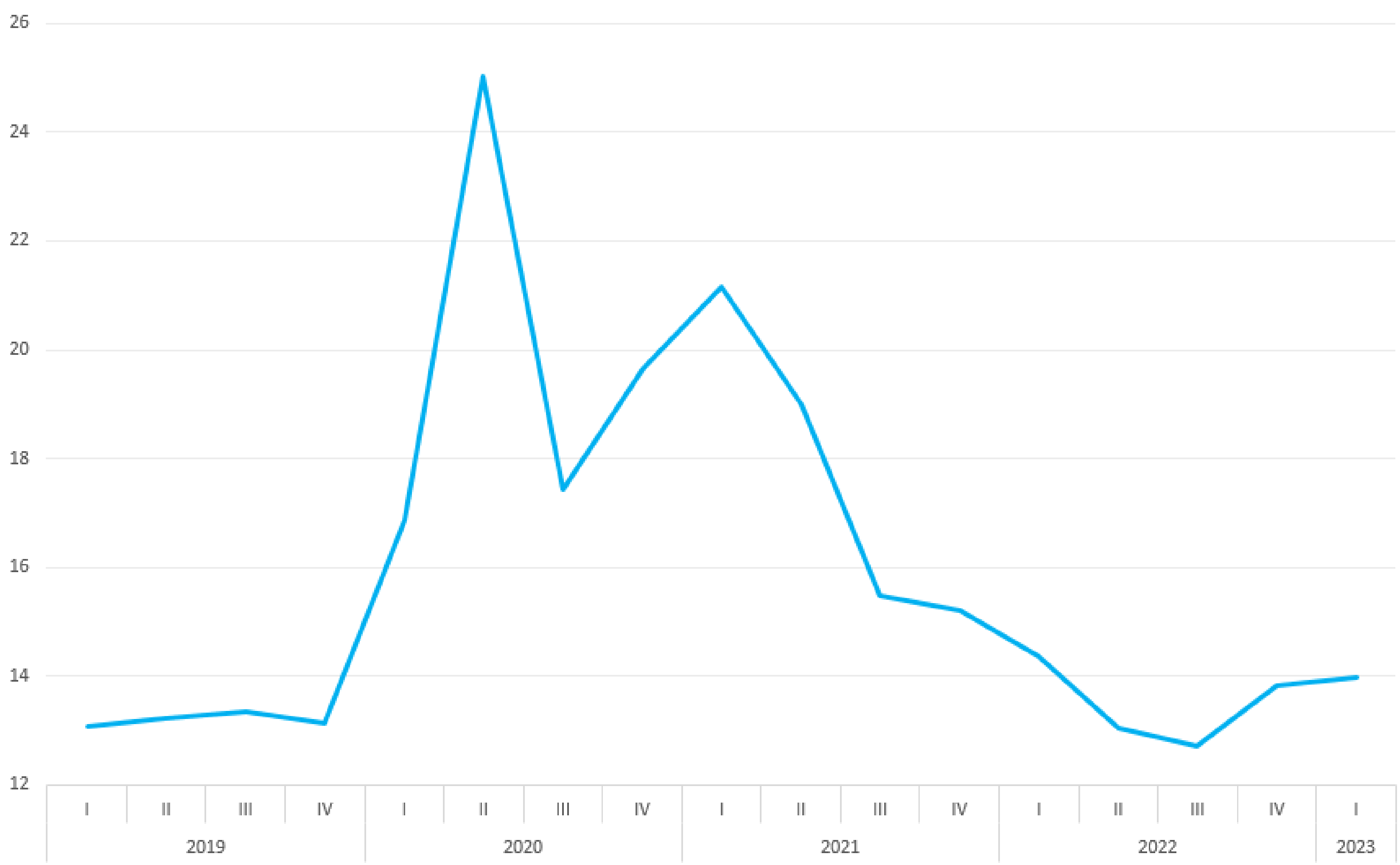
The main driver of te slowdown is domestic demand –striking difference in comparison with he US, where demand seems more resilient

	2021	2022	2023*
Eurozone			
GDP	5,6	3,4	0,4
Domestic Demand	4,3	3,6	-0,4
Net Exports	1,3	-0,2	0,8
United States			
GDP	5,9	2,1	2,1
Domestic Demand	7,2	2,5	1,7
Net Exports	-1,3	-0,4	0,4

**first half, at annual rates*

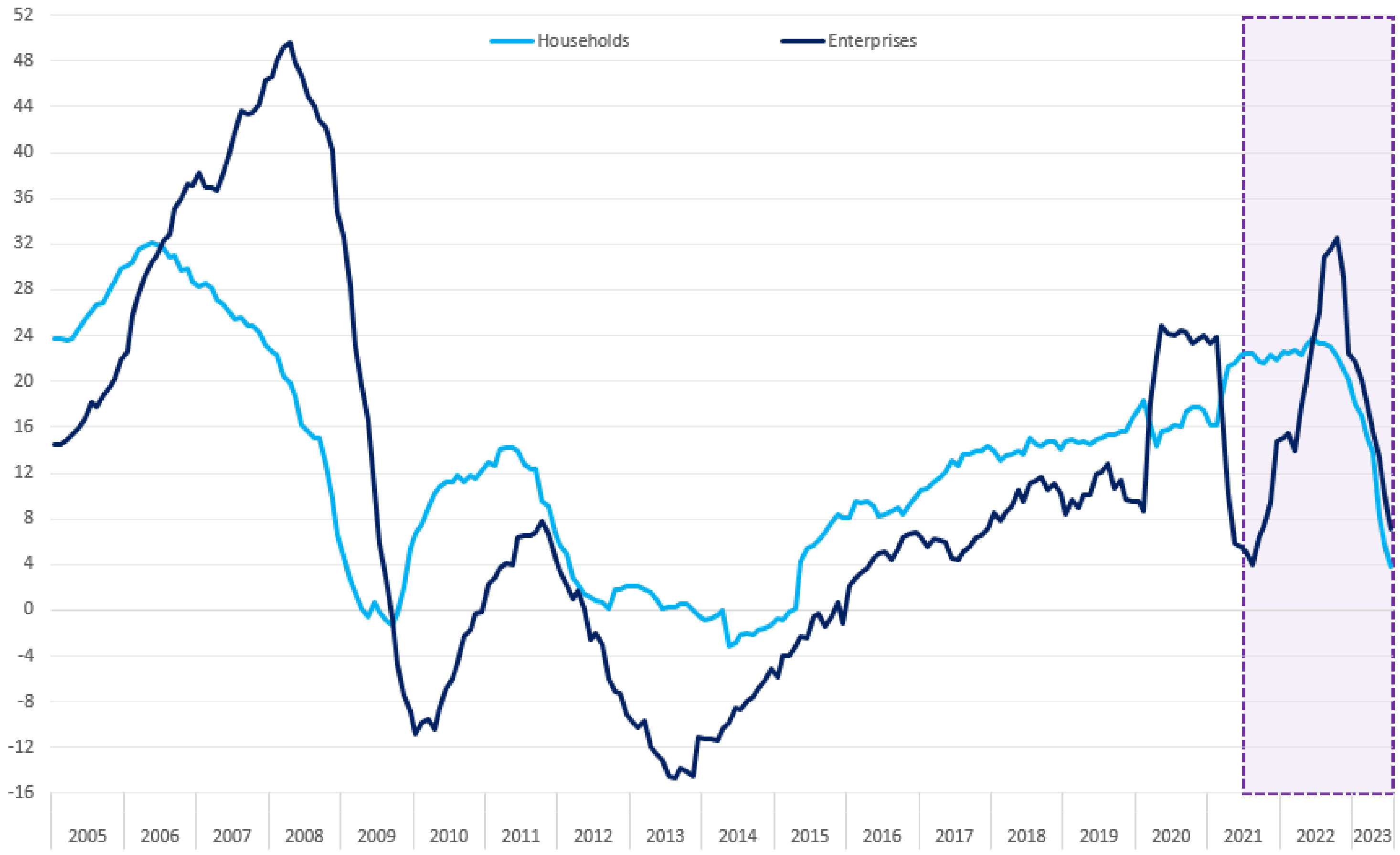
Households have depleted excess savings accumulated during the pandemic

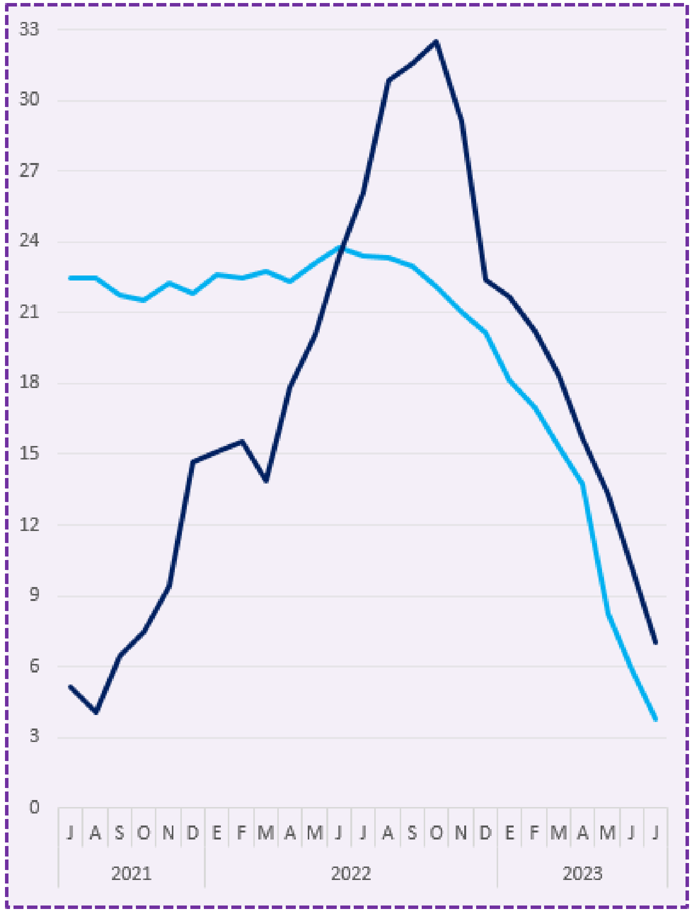
Eurozone household saving rate as percent of disposable income



Source: Eurostat.

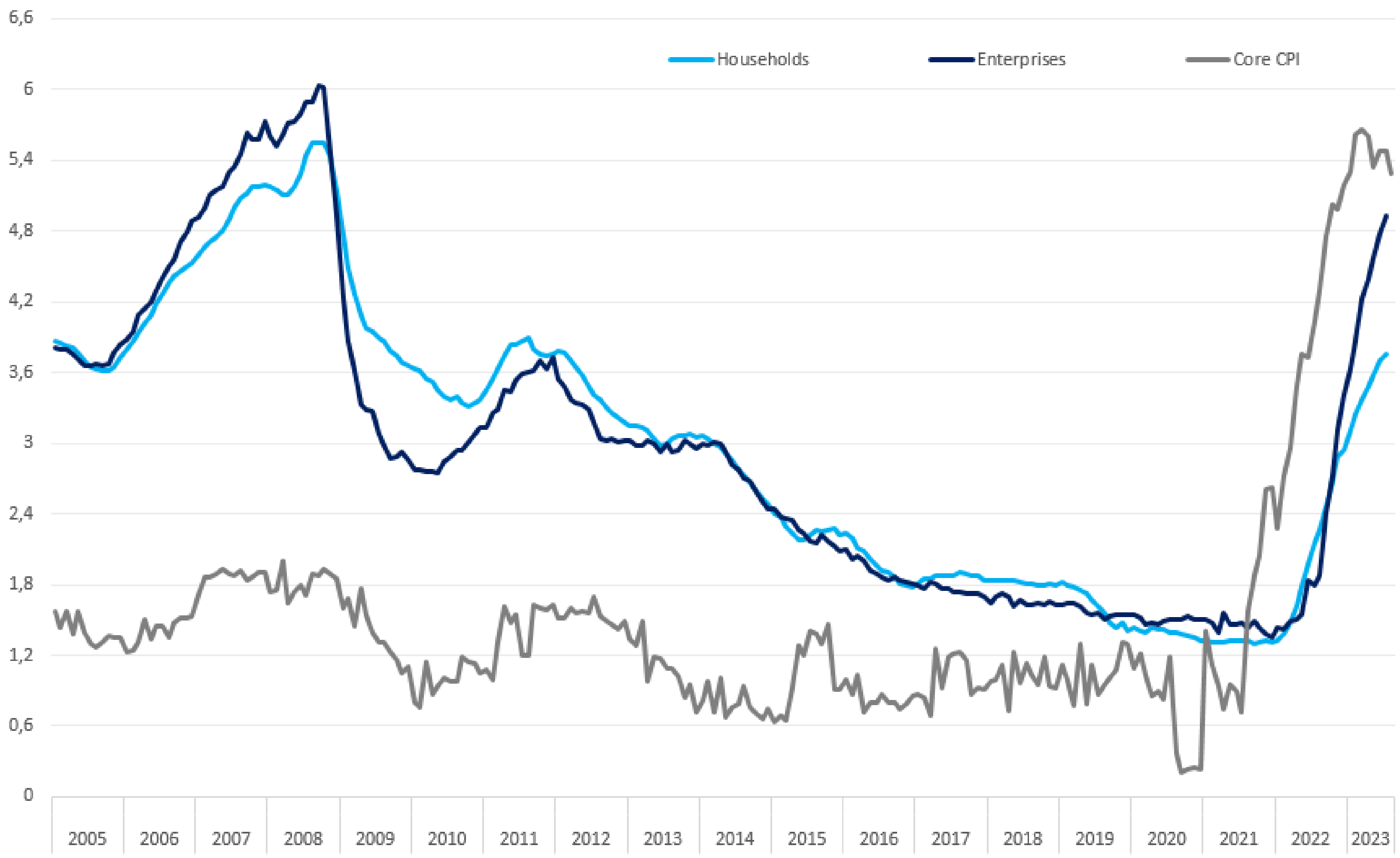
The volumen of new bank loans is contracting





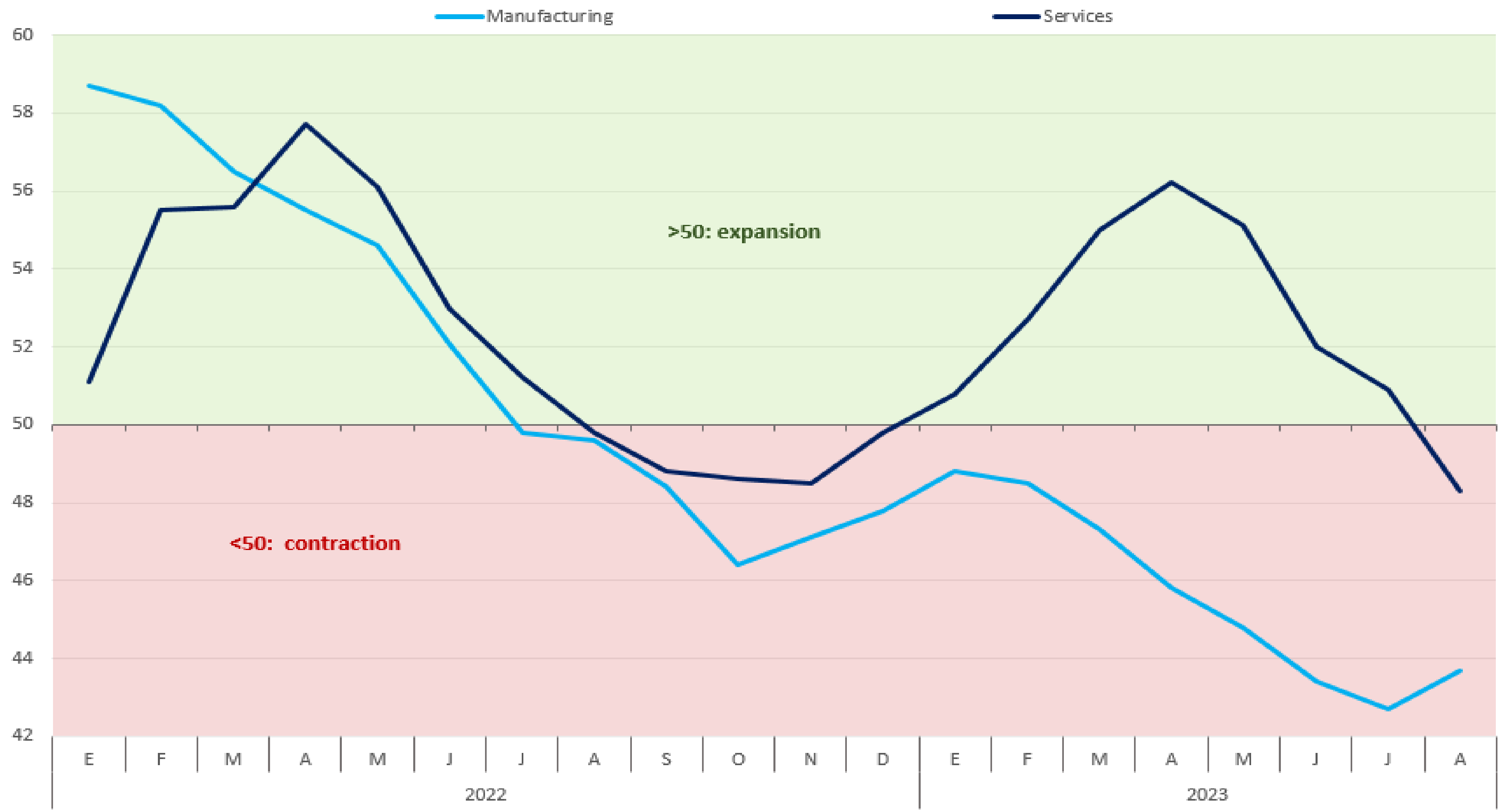
Source: ECB

Borrowing costs have risen significantly for households and, especially, enterprises



Source: ECB

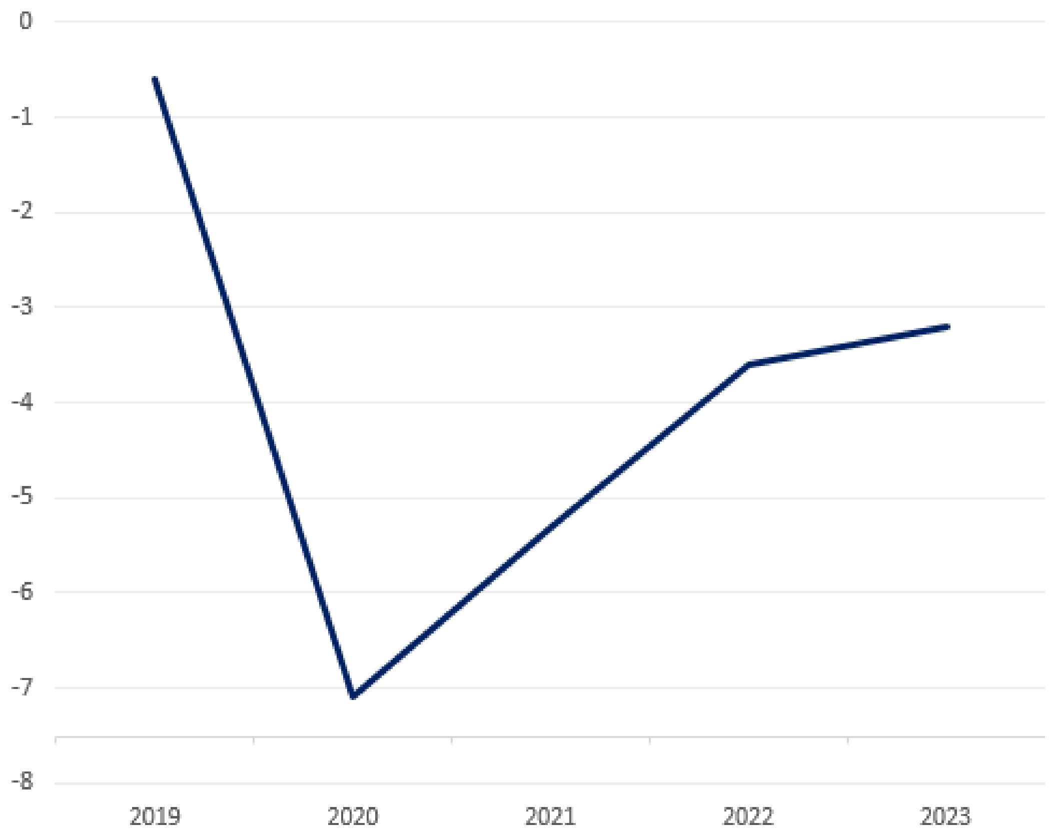
PMIs is contractionary territory in both manufacturing and, recently, services



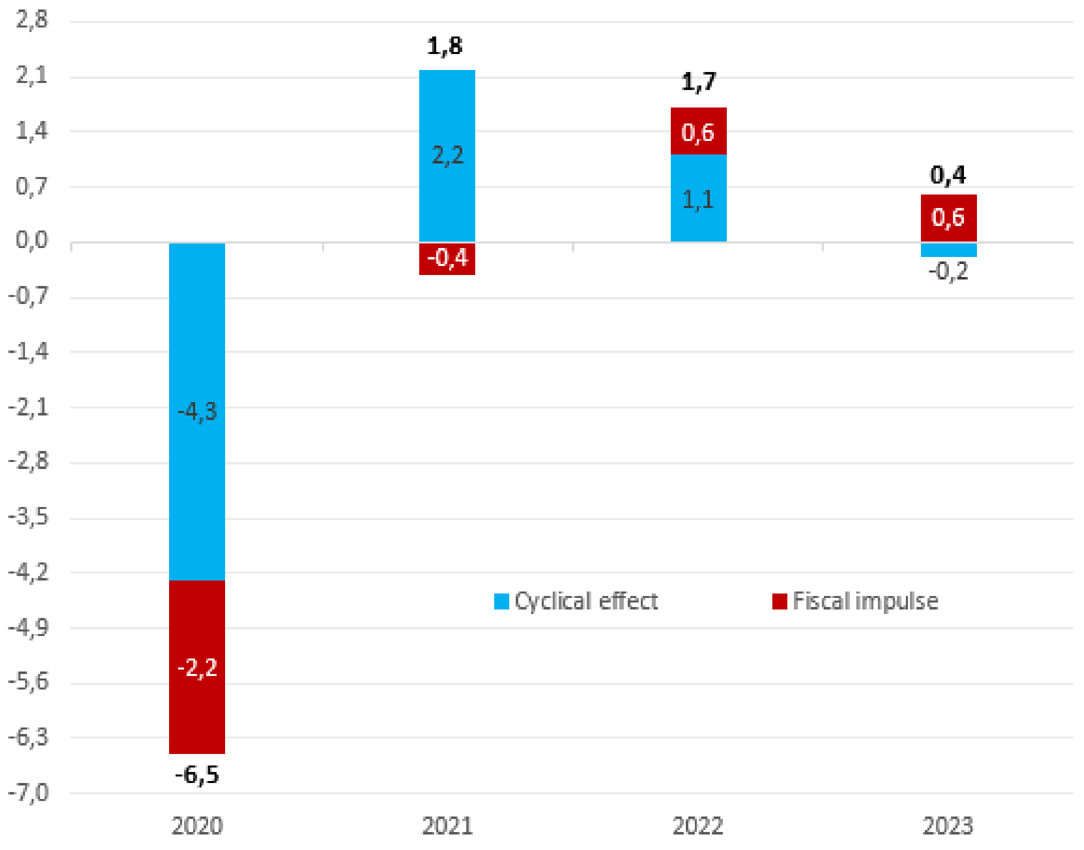
Source: Markit.

Fiscal policy is getting less accomodating

Eurozone fiscal déficit as % of GDP

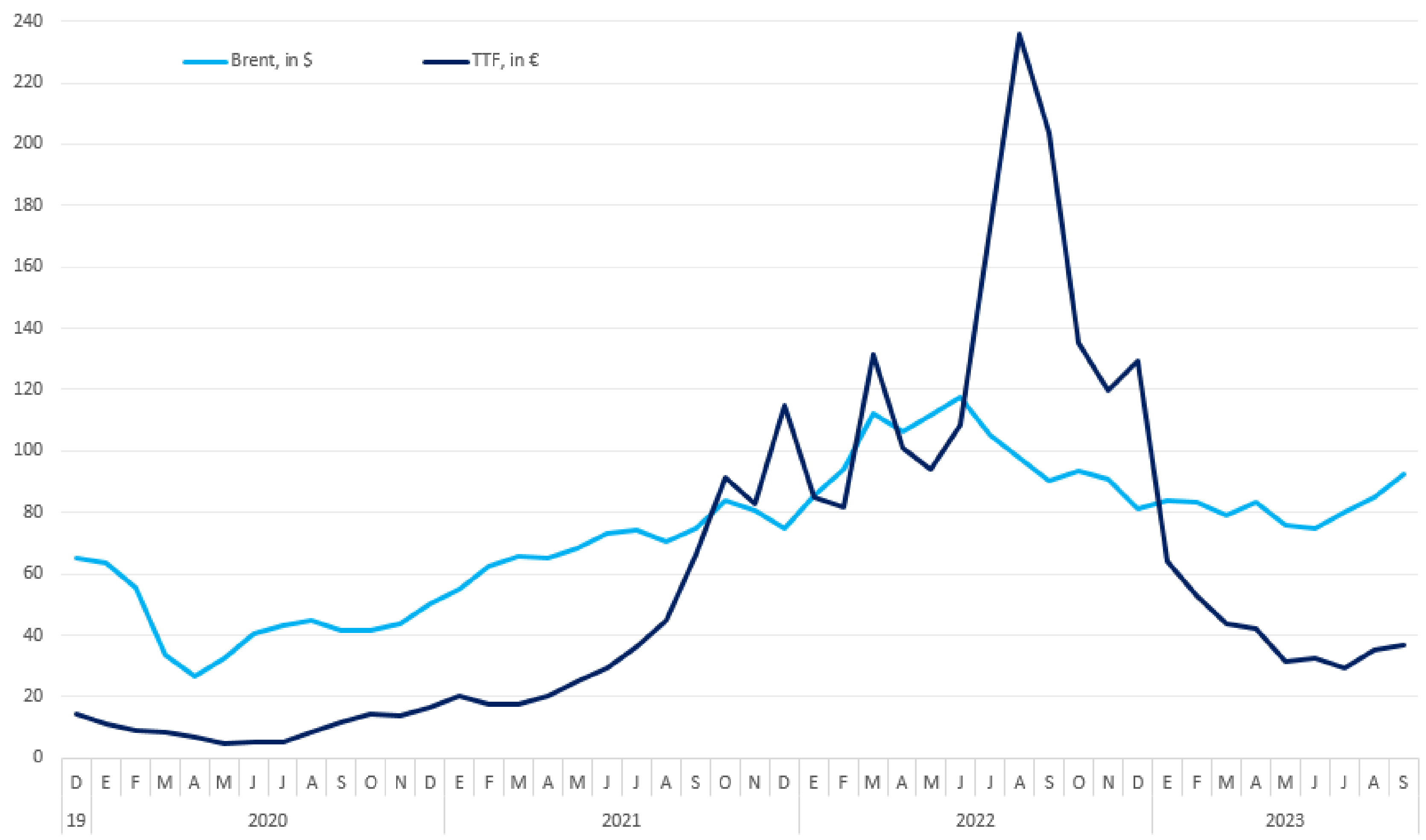


Components of the change in the fiscal déficit as % of GDP

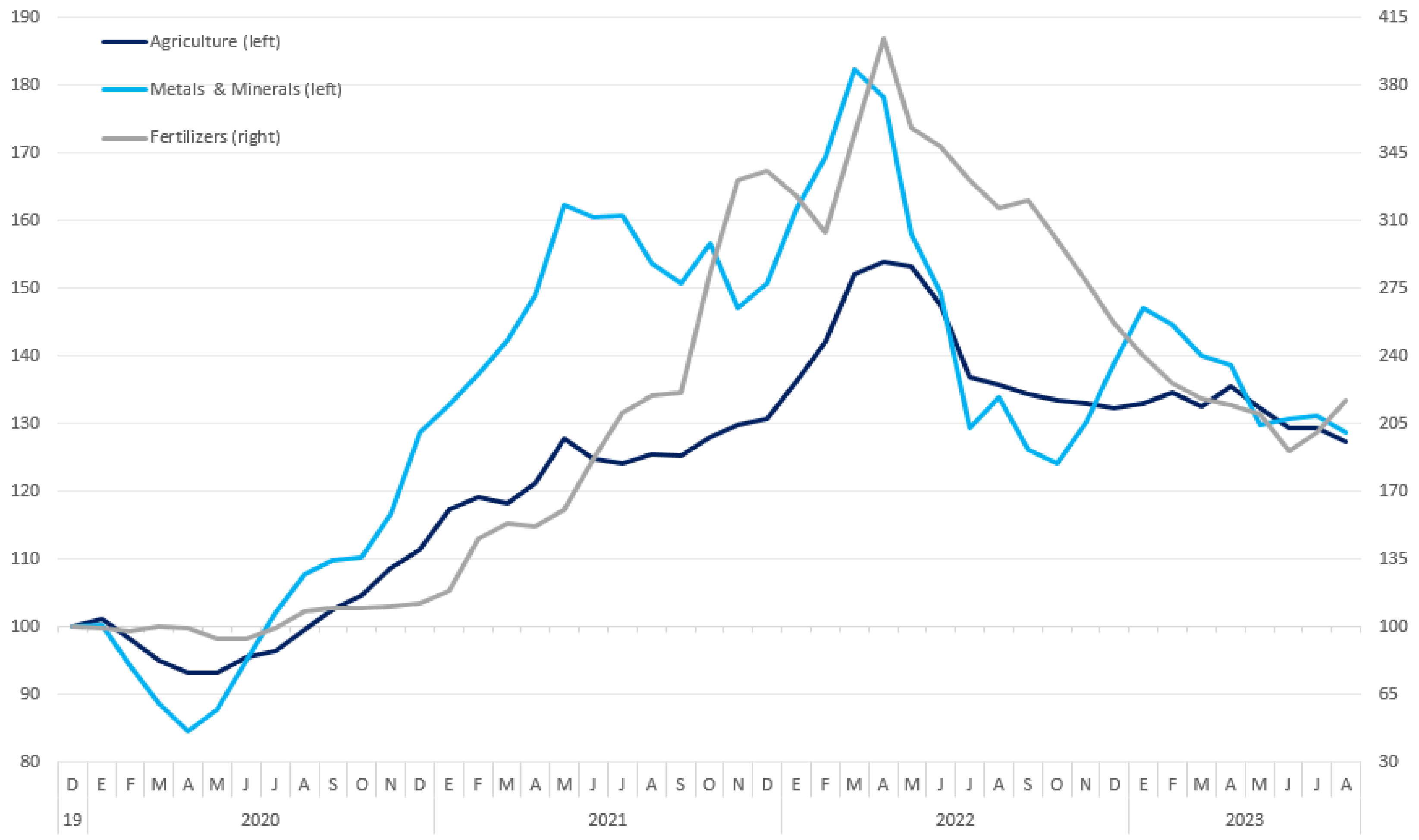


Source: Eurostat and Funcas based on European Commission projections for 2023.

3. Risks: oil prices are up, however so far the increase is less than in 2022…



… and is not accompanied by other commodity price shocks



4. Concluding remarks: significant risks of further monetary tightening

Trends do not make a case for higher rates

- Reversal of exogenous shocks still filtering into prices
- Slower economy putting downward pressure
- Higher oil prices are a risk, but limited compared with last year shock: smaller size of the spike, not accompanied by other exogenous price shocks, and profits may partly absorb it this time
- Wages could be a risk but labour markets will probably get less tight

Higher rates run risk of recession, possibly also exposing financial vulnerabilities… and may weaken the euro

This is suggestive of the need for a pause

Thank you for your attention!

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