OESTERREICHISCHE NATIONALBANK
EUROSYSTEM

Challenges and outlook for the Eurosystem's monetary policy

Keynote at the 6th SUERF ChiefEconForum

Prof. Robert Holzmann
Governor, Oesterreichische Nationalbank

Vienna, 6 December 2022

www.oenb.at

Outline

I. Inflation developments in the euro area

II. The monetary policy response in the euro area

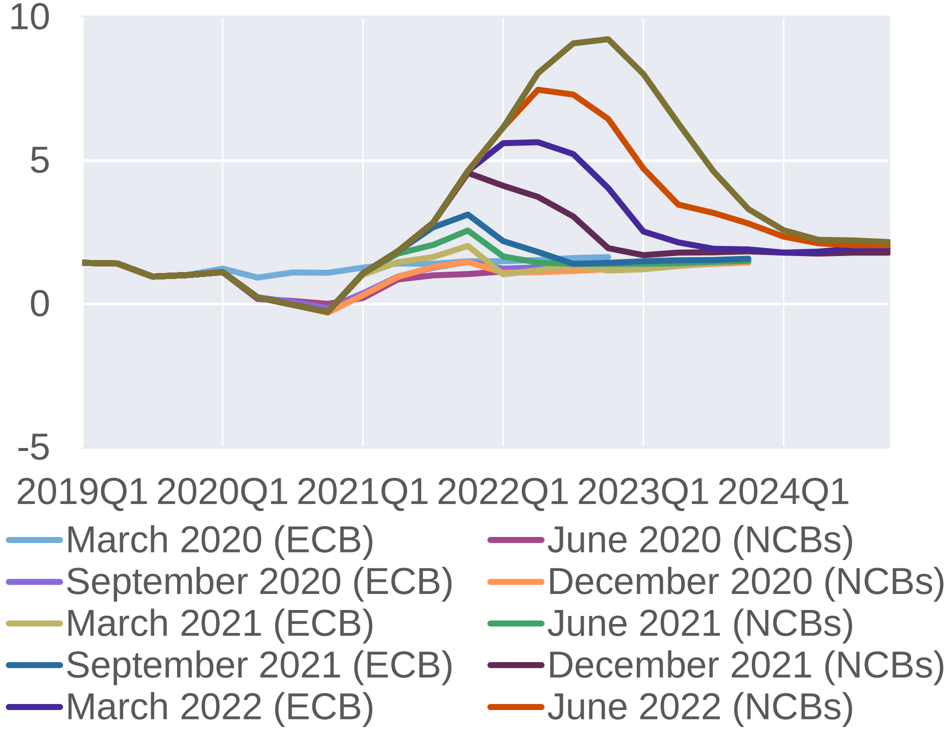
III. Themes and challenges going forward

I. Inflation developments in the euro area

Euro area inflation projections were continuously revised upward

HICP-inflation-forecast vintages

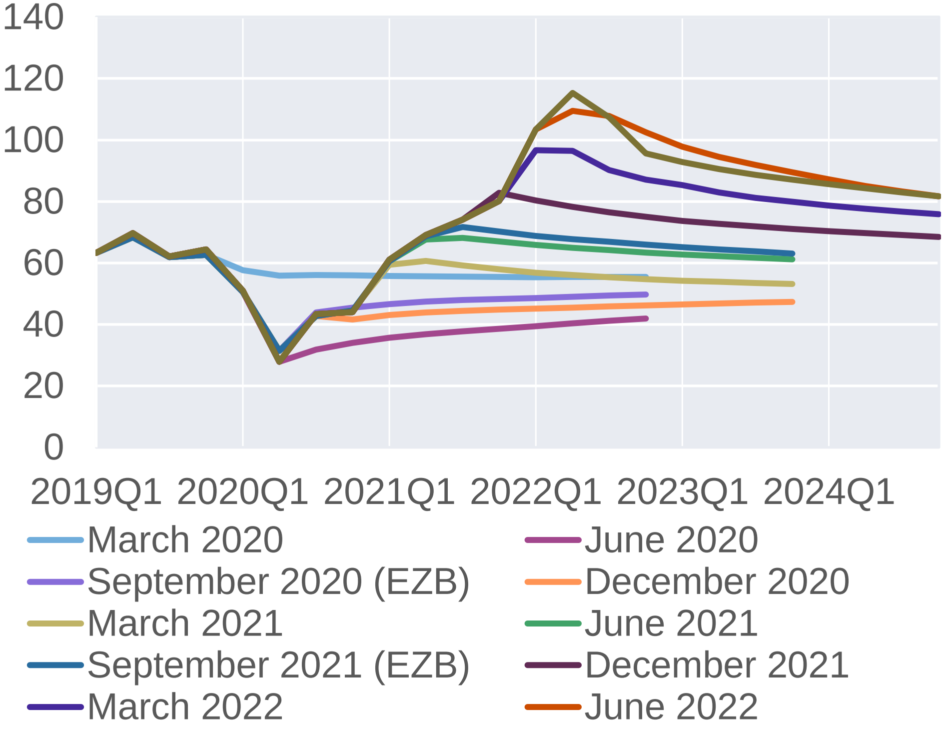
Change to previous year in %



Source: Eurosystem, ECB.

Oil-price assumptions since 2019

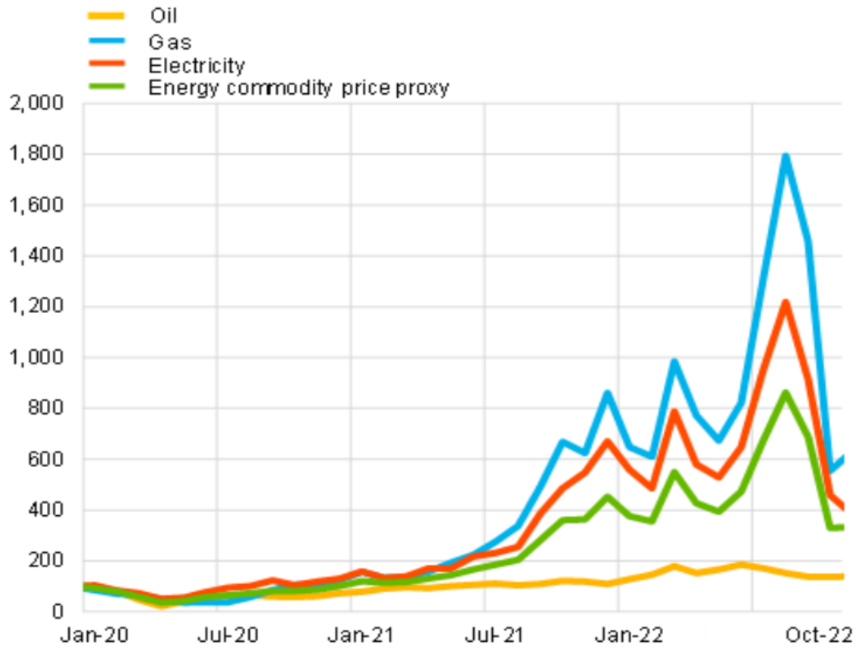
USD per barrel Brent



Source: Eurosystem, ECB.

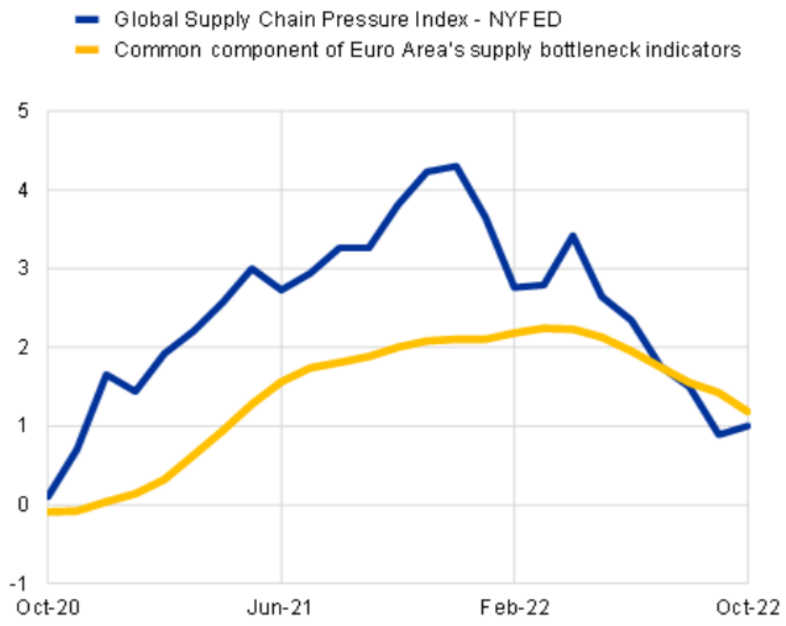
Upward revisions due to volatile (and disregarded far away) energy and commodity prices events as well as pass-through from pipeline pressures

Developments in energy commodity prices



Sources: ECB.

Supply bottlenecks indicator

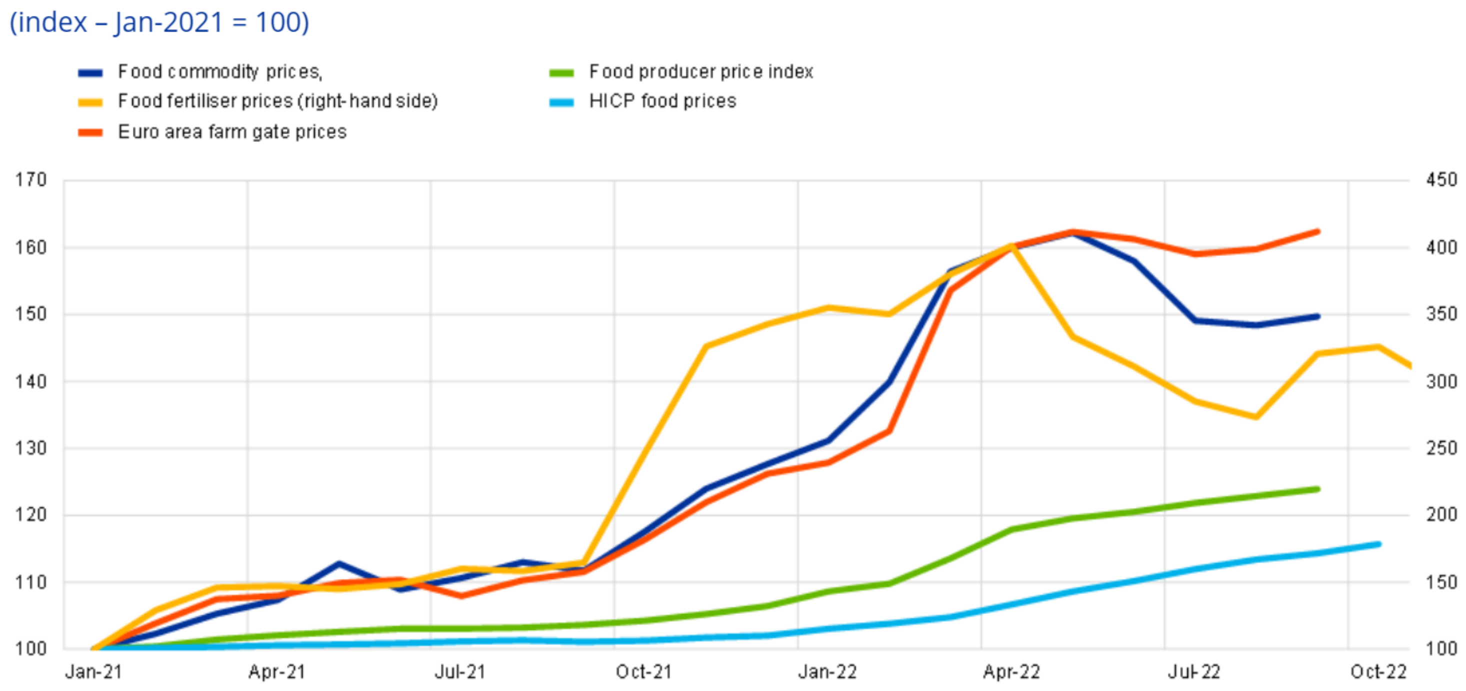


Sources: Federal Reserve Bank of New York (NYFED), ECB.

- **Revisions of oil, gas and energy price assumptions** explain **more than 2/3 of the forecast error** for the euro area (Q1:2021 to Q1:2022)
- Persistent **upward pressure** from **supply bottlenecks** and **pipeline pressures** (Taiwan and China) but slowly **subsiding**

Surges in food commodity prices and food fertiliser prices continue to pass-through to consumer prices

Prices of food and food commodities



Sources: ECB.

- Pipeline pressures from **euro area farm gate prices** and **food producer price index remain** high
- Forecast error also affected by changing **pace** and **extent of pass-through from** (energy and non-energy) **producer prices to consumer prices**
- **Is enhanced pass through speed symmetric?**

HICP inflation is expected to slowly subside given declining energy commodity prices and weakening outlook for economic growth

Projections for real GDP growth and HICP inflation

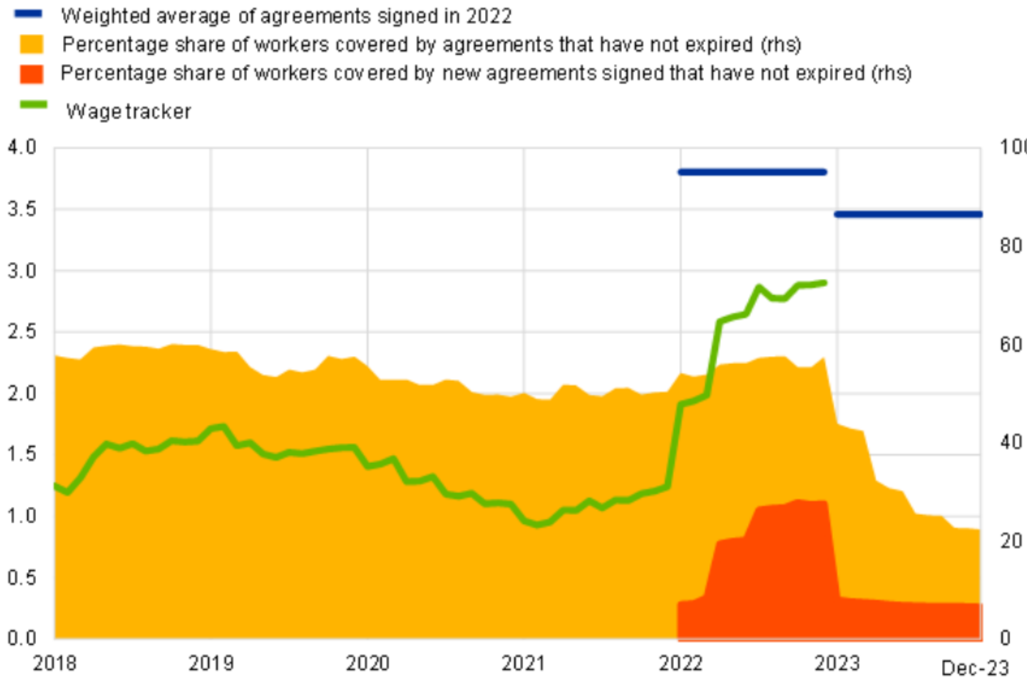
	ECB/MPE			OECD			IMF		European Commission		
	September 2022			November 2022			October 2022		November 2022		
	2022	2023	2024	2022	2023	2024	2022	2023	2022	2023	2024
	Veränderung zum Vorjahr in %										
Real GDP	3,1	0,9	1,9	3,3	0,5	1,4	3,1	0,5	3,2	0,3	1,5
HICP	8,1	5,5	2,3	8,3	6,8	3,4	8,3	5,7	8,5	6,1	2,6
HICP excluding food & energy[1]	3,9	3,4	2,3	3,9	4,7	3,1	×	×	4,8	5,0	2,9

Source: ECB, OECD, IMF, EC Ameco.

[1] OECD: HICP excluding food, energy, alcohol and tobacco. - European Commission: HICP excluding food and unprocessed food.

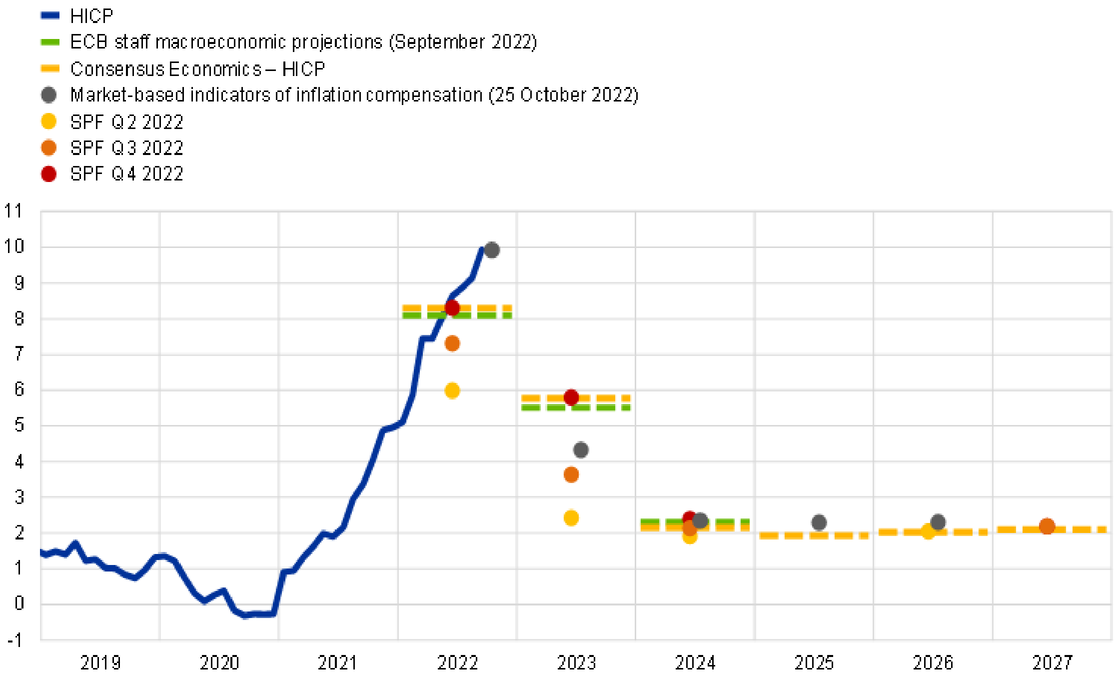
Inflation projection highly uncertain with risks tilted to the upside

Experimental forward-looking tracker of negotiated wage growth in the euro area



Sources: ECB.

Survey-based indicator of inflation expectations and market-based indicators of inflation compensation

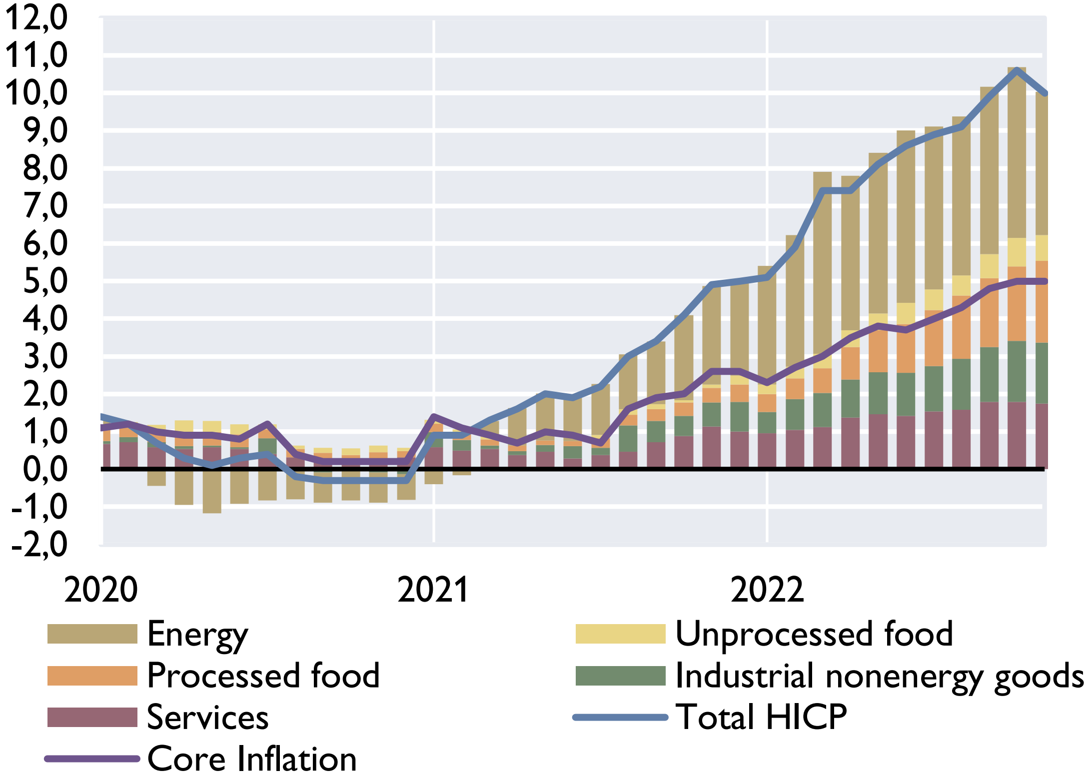


Sources: ECB.

Surge in core inflation driven by supply- and demand-side factors

Euro area: HICP inflation rate and its components

annual percentage change in % and contributions in percentage points



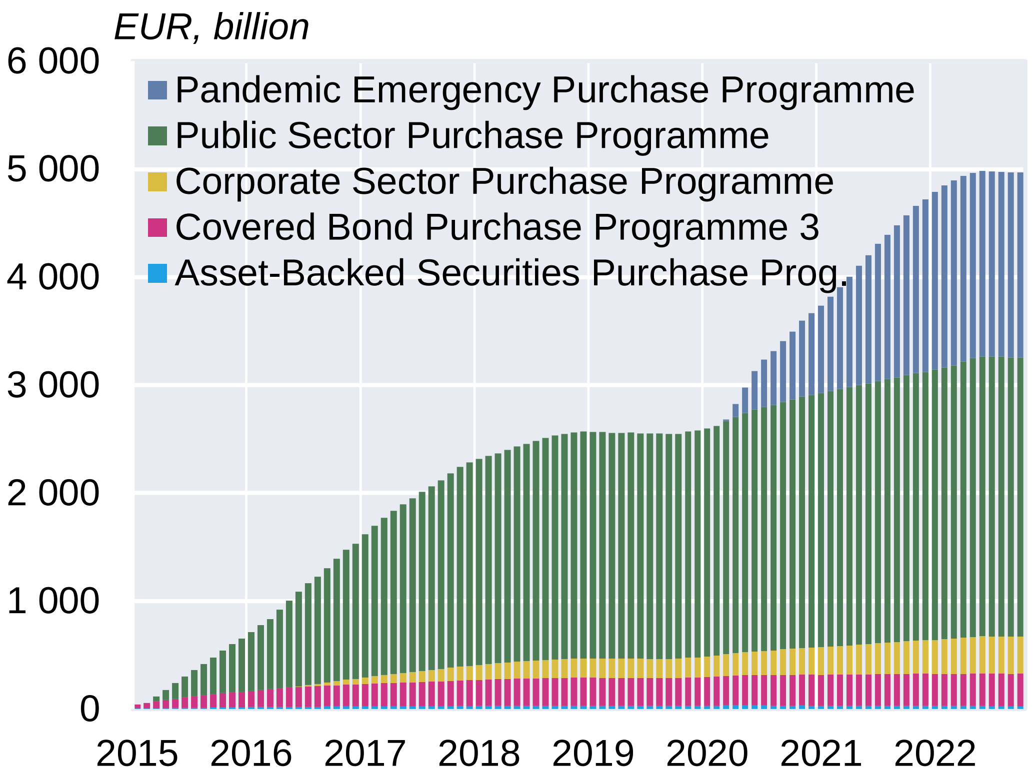
Source: Eurostat. Last observation: November 2022

- **Core inflation** (HICP inflation excl. food and energy) since Q4/2021 above 2% (5.0% in November 2022)
- **Non-energy industrial goods inflation** affected by **pass-through of high commodity prices** and **energy transition**
- **Services inflation** driven by **upward effects on prices** from **reopening**
- Other **measures of underlying inflation** have increased to a **range of 4-8.5%** in Oct. 2022
- Currently high readings for underlying inflation are **not matched by similarly high end-of-horizon inflation projections**

II. The monetary policy response in the euro area

The Eurosystem reacted to surging inflation by accelerating normalization with first ceasing net asset purchases …

Monetary policy purchase programmes

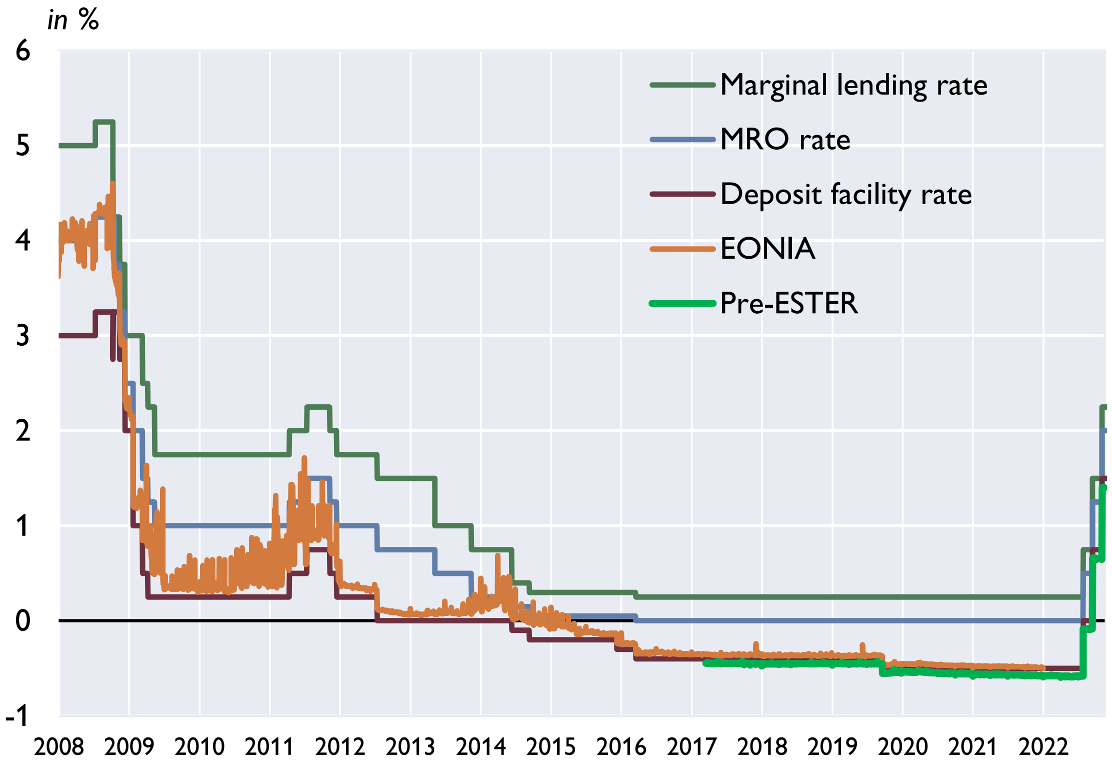


Source: ECB.

- In **Q4/2021** the **ECB Governing Council** started to **lower** the **pace** of **net asset purchases under PEPP**
- **PEPP net asset purchases ended** in **March 2022**
- **APP net asset purchases ended** in **June 2022**
- **End** of **purchases** was **pre-condition** of then valid forward guidance of June 2021 for interest rate rise
- The **principal payments** from **maturing PEPP-securities** will be **reinvested until at least the end of 2024**
- **Maturing assets** from **APP** are **reinvested** for as long as **necessary**

… increasing policy interest rates …

ECB key interest rates and money market rates



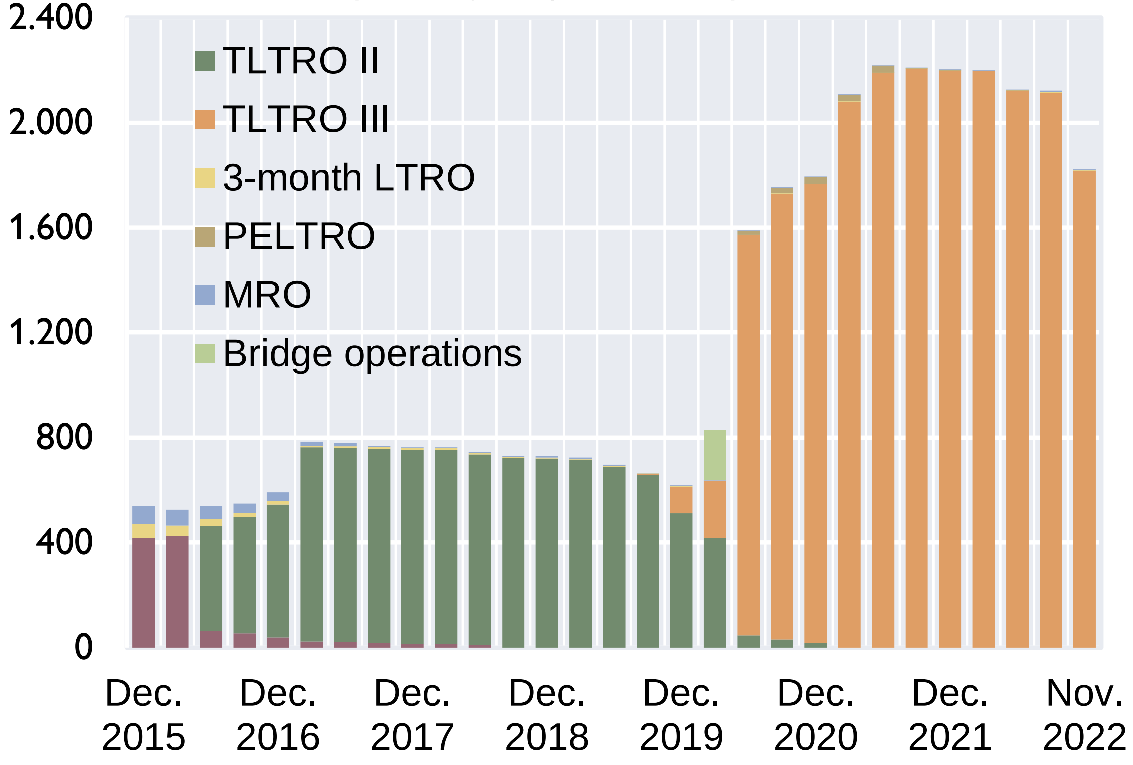
Source: ECB, Macrobond.

- The **three key policy interest rates** were **raised** in **three steps** (on 27 July, 14 September and 2 November 2022) by a total of **200 basis points**
- These decisions drove the **policy rate** from its highly accommodative stance **towards** a **neutral level**
- The Governing Council expects to **raise interest rates further**, to ensure the **timely return** of **inflation** to its **2% target**
- It will, however, base future policy rate decisions on the **evolving outlook** for **inflation** and the **economy**, following a **meeting-by-meeting approach**

... and changing conditions for Targeted-Longer Term Refinancing Operations III

Eurosystem's refinancing operations

EUR billion (lending at quarter end)

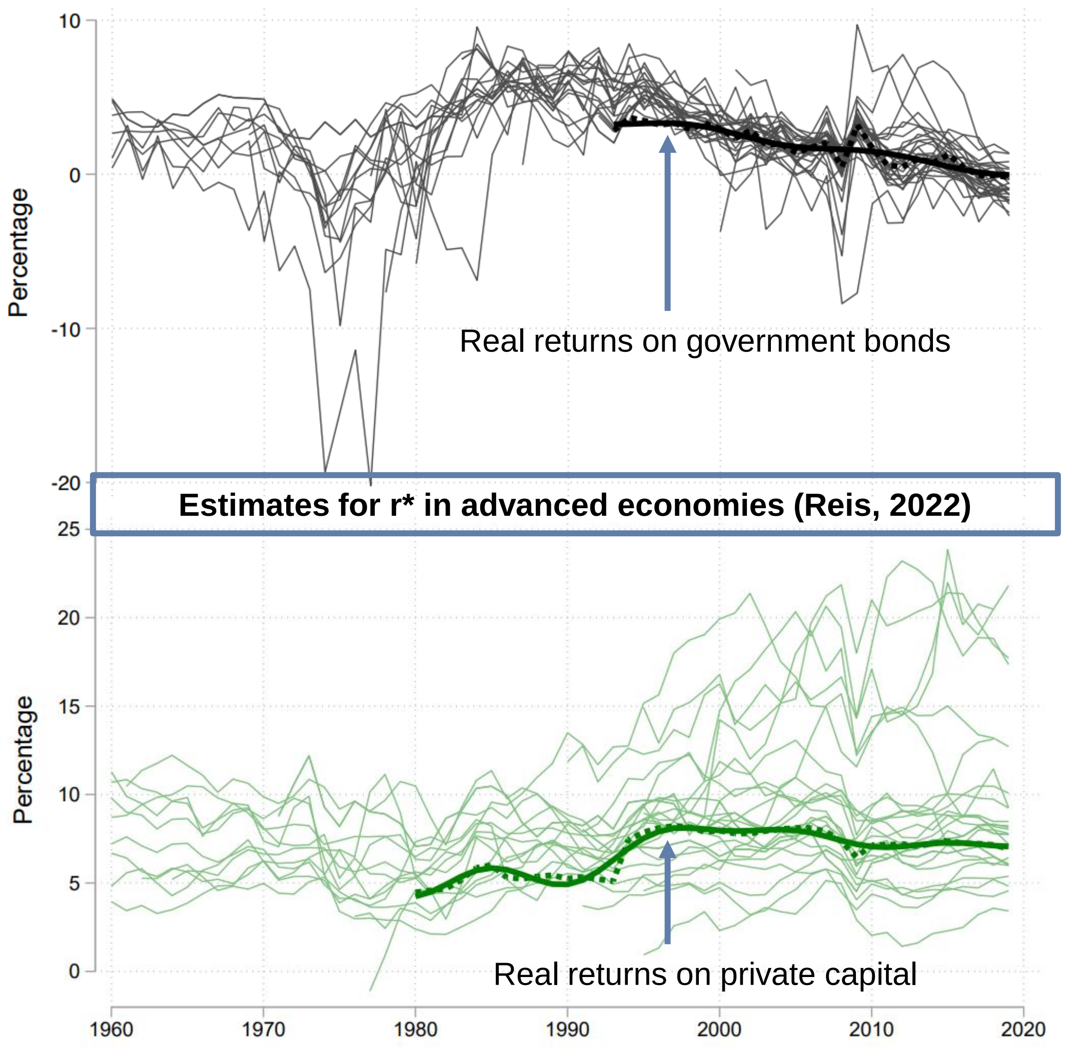


Source: ECB.

- **TLTROs III**: central bank loans with 3 year maturity
- ECB Governing Council decided to **adjust** the **interest rates** applicable to TLTRO III
- This **recalibration** …
  - tightens refinancing conditions for banks → supports monetary policy normalization
  - removes deterrents to the early voluntary repayments → reduces central bank's balance sheet size
  - releases collateral that is mobilized with the Eurosystem → alleviates collateral scarcity
- On the first additional repayment opportunity (on 23 November 2022) banks repaid 296 billion EUR (see graph)

III. Themes and challenges going forward

Looking ahead (I): r* and key ECB policy rates



Old and new questions on the usefulness of standard r* concept as guidepost for monetary policy

- Large divergence of r* estimates within and across countries
- Recent estimates for r* have been revised upwards
- New concepts for relevant real neutral rates (e.g. chart on the left by Reis, 2022)

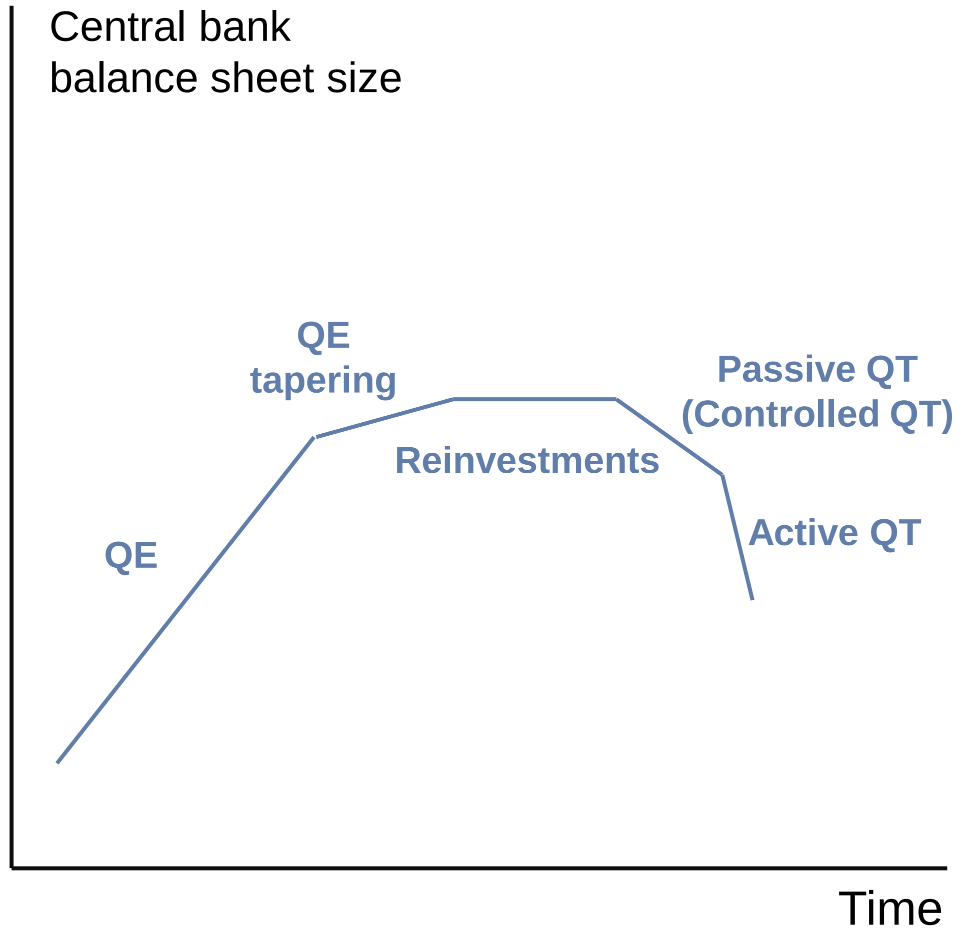
Appropriate level of policy rates going forward

- Main goal: achieve price stability while minimizing costs of disinflation
- Avoid over-tightening (too much front-loading) vs. loss of credibility (too cautious steps)
- High inflation outlook requires forceful action

Discussion about potential terminal rate too early

- Uncertainty about future inflation outlook

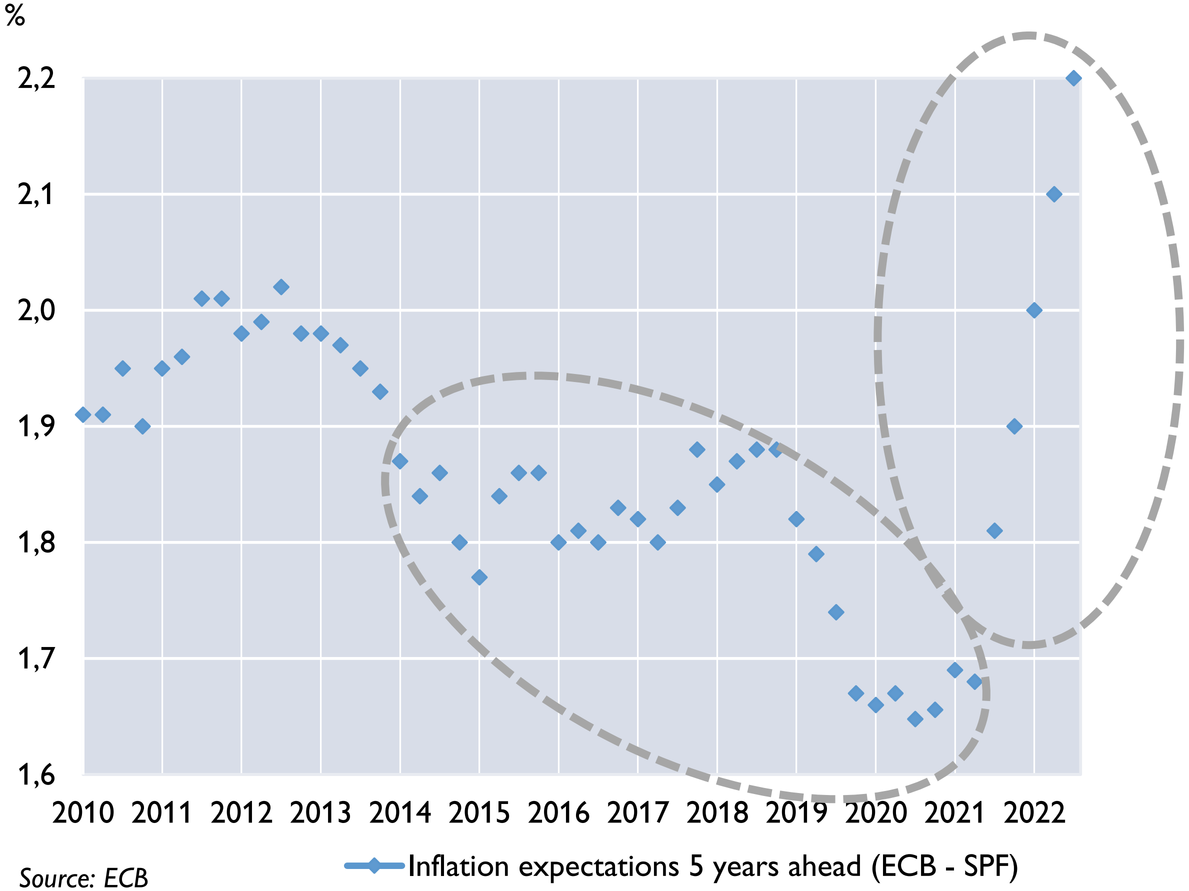
Looking ahead (II): quantitative tightening (QT)



- **Possible motivations for QT:**
  - Additional tightening scope and yield curve control
  - Lower public footprint/asset price distortions
  - Further alleviation of collateral scarcity
- **QT as a multidimensional process:**
  - Types: elapsing, smoothing, selling, …
  - Fine-tuning: timing, speed, terminal scope, …
- **Automatic run-off** due to end of TLTROs unlikely to be enough
- Proper **communication** and **macro-financial assessment** is paramount for financial stability (e.g. experience of Federal Reserve vs. Bank of England)
- Heterogeneity in EA requires **particular caution**

Current challenges (I): monetary policy credibility in the euro area

Survey-based inflation expectations for the euro area



Source: ECB

Survey of Professional Forecasters (SPF)

- Part of most "sophisticated", forward-looking agents
- Known for sticking closely to target

Key insight:

Extent of anchoring appears to have decreased markedly even among SPF participants.

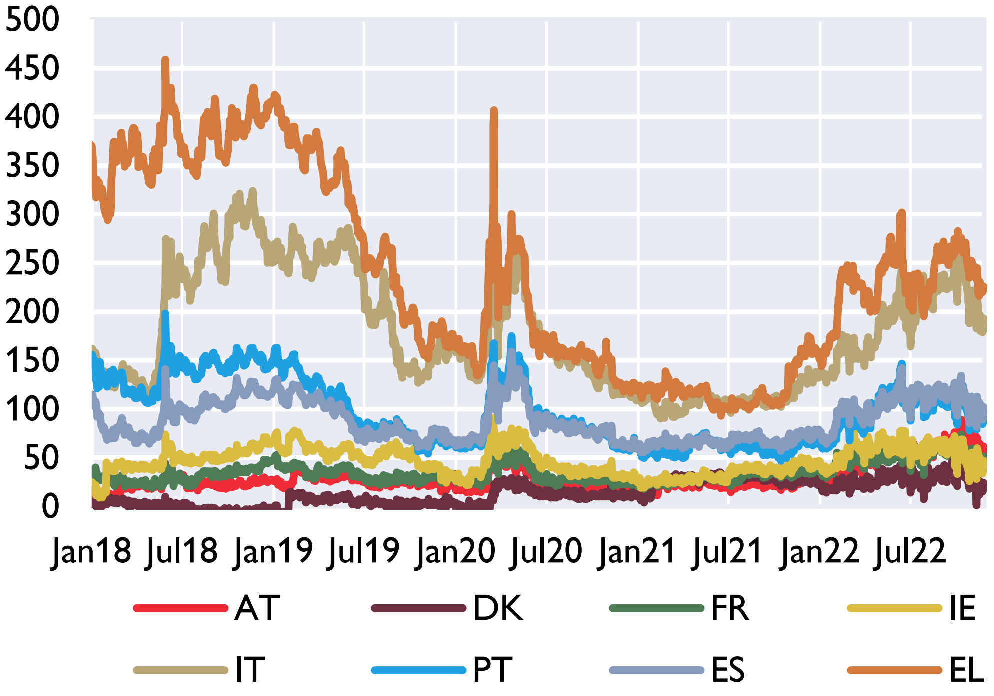
Two special episodes:

1. Aftermath of sovereign debt crisis
2. Recent episode since mid-2021

Current challenges (II): sovereign spreads in the euro area

10-year benchmark bond spreads for selected countries

in basispoints, rel to DE *last obs. Nov, 25*



Source: Macrobond.

- **Increased volatility** of **sovereign yields** with **increasing spreads** since the start of the war against Ukraine
- However, **no signs** of **decoupling** from **macroeconomic fundamentals**
  - → fragmentation risks remain low
  - → approval by Governing Council of Transmission Protection Instrument (TPI) had positive effects
- Recent dynamics point towards **decreasing yields and spreads** → increasing demand for safe-haven assets due to global economic outlook
- Euro area **yield curve shows inversion tendency**

Concluding Remarks

- **Our primary target: inflation of 2% over the medium term**
  - HICP inflation expected to subside, but risks remain tilted to the upside amid high uncertainty
  - Unprecedented shocks, faster/stronger transmission to prices, and so far higher persistence
  - Demand and supply side effects are conjectured to continue to matter
- **Eurosystem’s monetary policy strategy**
  - Given inflation outlook monetary policy may have to become restrictive (above r*)
  - Forceful and determined monetary policy needed to fulfil mandate and safeguard credibility
  - Need to keep inflation expectations anchored and avoid second-round effects
- **Eurosystem’s reaction function going forward**
  - Policy-rate path will be based on the evolving inflation outlook (meeting-by-meeting approach)
  - Due to high uncertainty too early to discuss terminal rate, but risks being higher than neutral
  - Tightening will also require cautious and gradual balance sheet normalization

Danke für Ihre Aufmerksamkeit

Thank you for your attention

www.oenb.at

oenb.info@oenb.at

@nationalbank_oesterreich

@nationalbankoesterreich

Oesterreichische Nationalbank

@oenb

OeNB