

ECB's new challenges

Presentation July 19th 2022

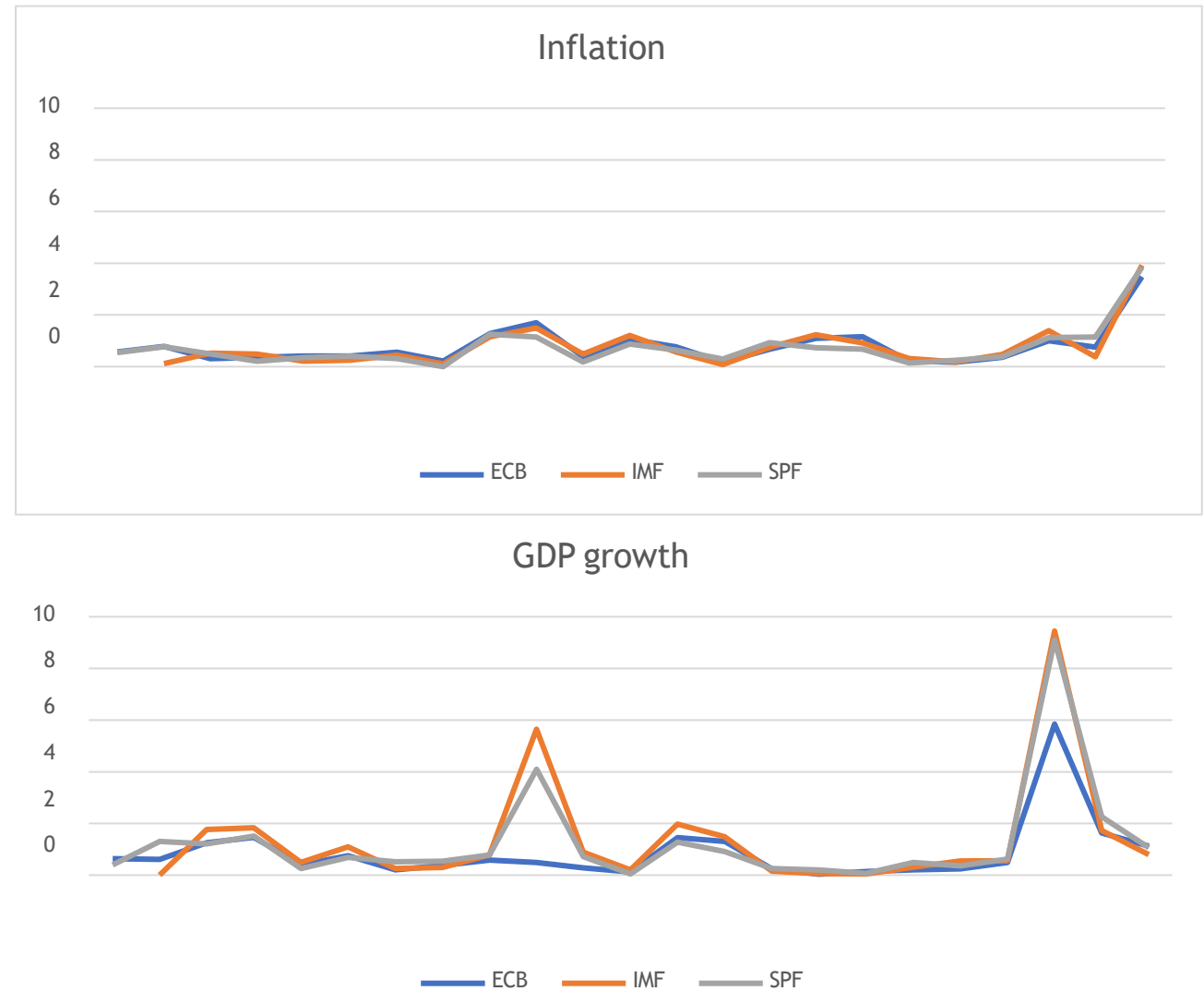
Francesco Papadia

My plan

- I. Unprecedented macroeconomic uncertainty
- II. Faulty inflation control
- III. Prospects of monetary tightening
- IV. Risk of problems in the periphery of the €-area

I. Unprecedented macroeconomic uncertainty

Figure 1: Changes in the ECB, IMF and SPF forecasts averaged over the different time horizons (percentage points difference) ³



Source: Grzegorzyc and Papadia, Measuring macroeconomic uncertainty during the euro's lifetime. Bruegel Working paper, June 2022

Figure 2: Inflation and ECB inflationary projections.
2002-2022.

II. Faulty
inflation control
-1

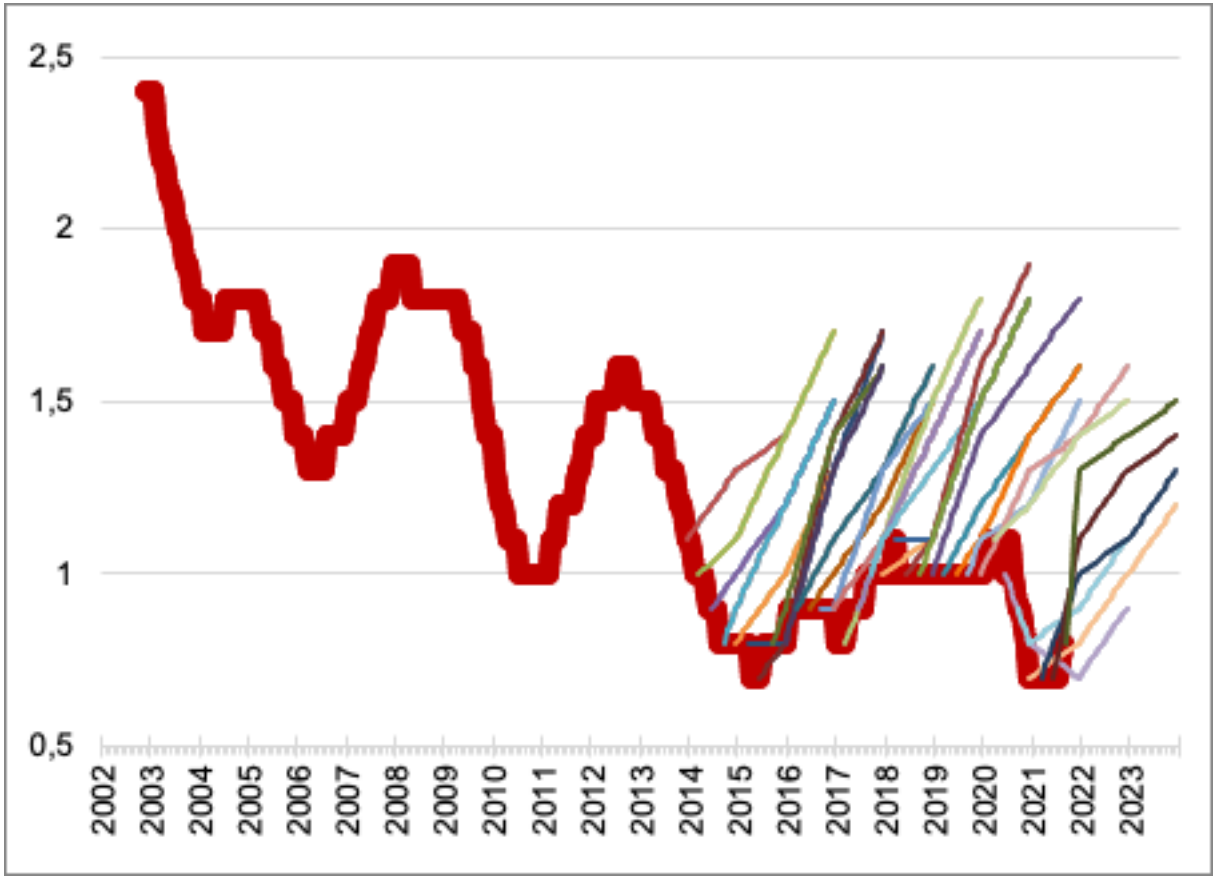


Figure 3: Consumer price level, 2% trend increase of the price level. 1999-2022

II. Faulty
inflation control
- 2

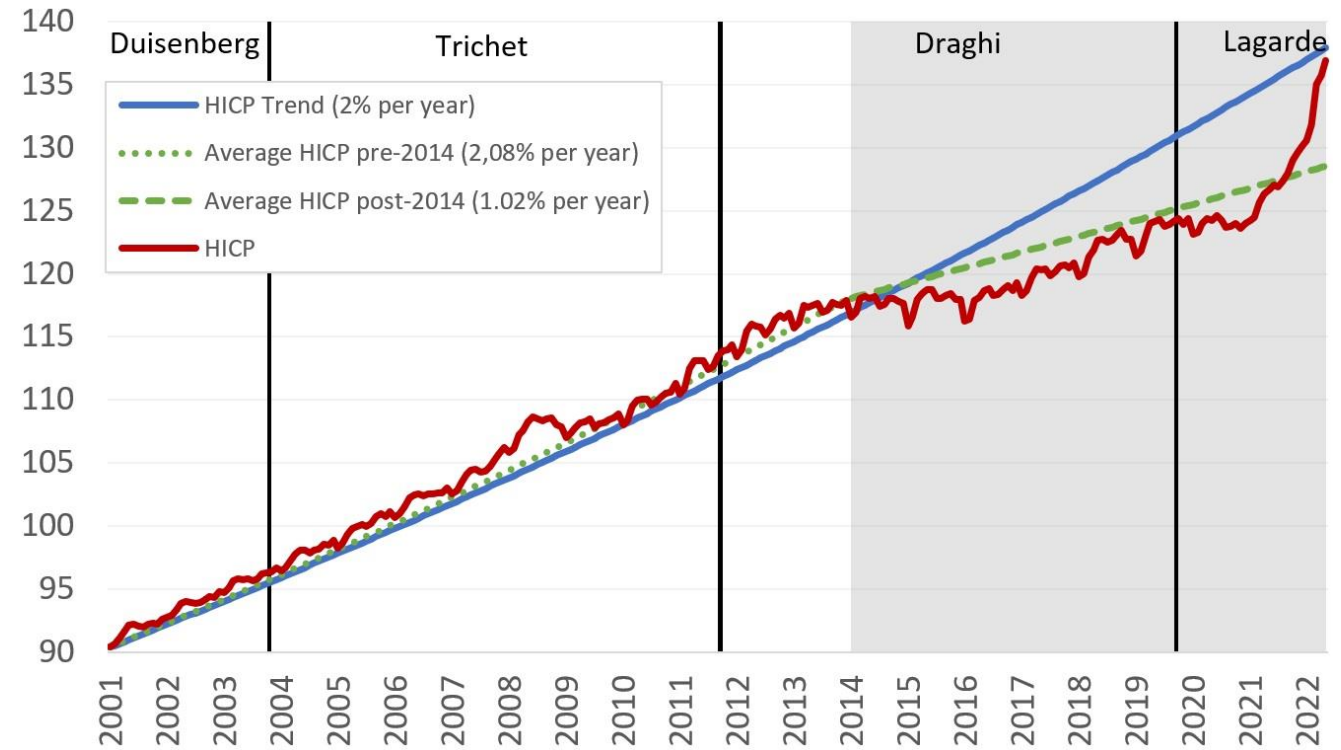
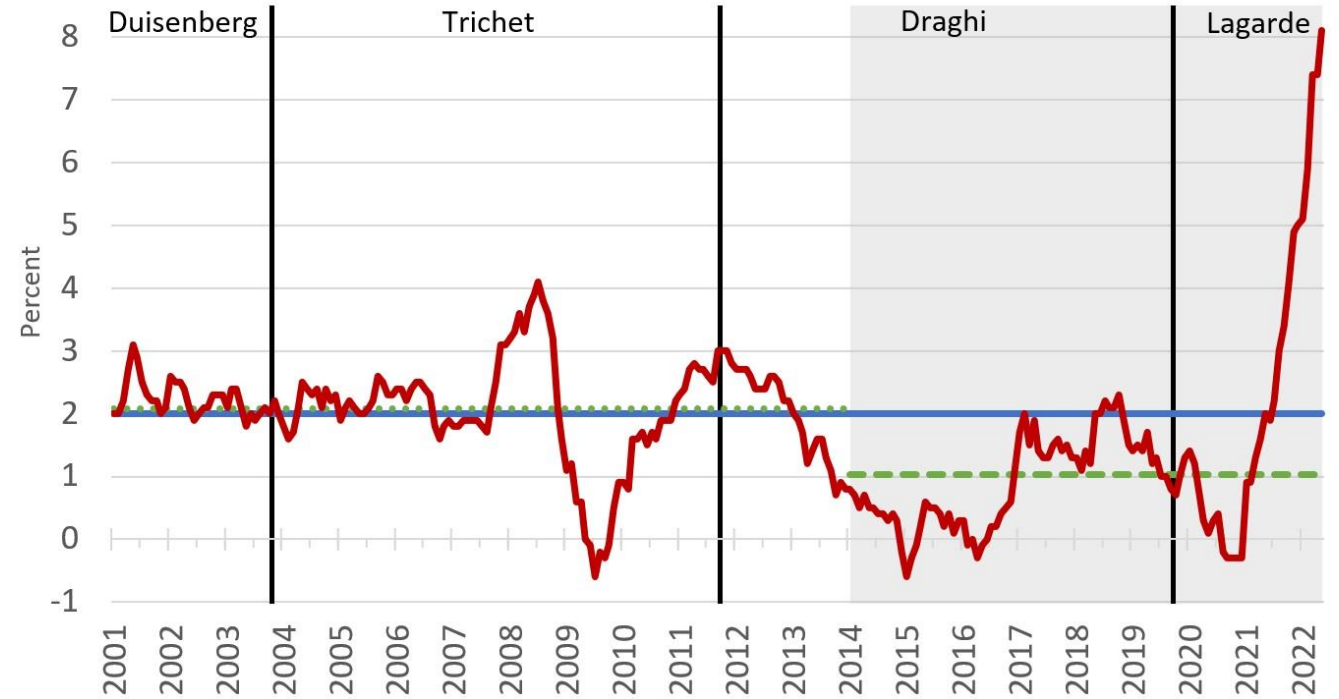


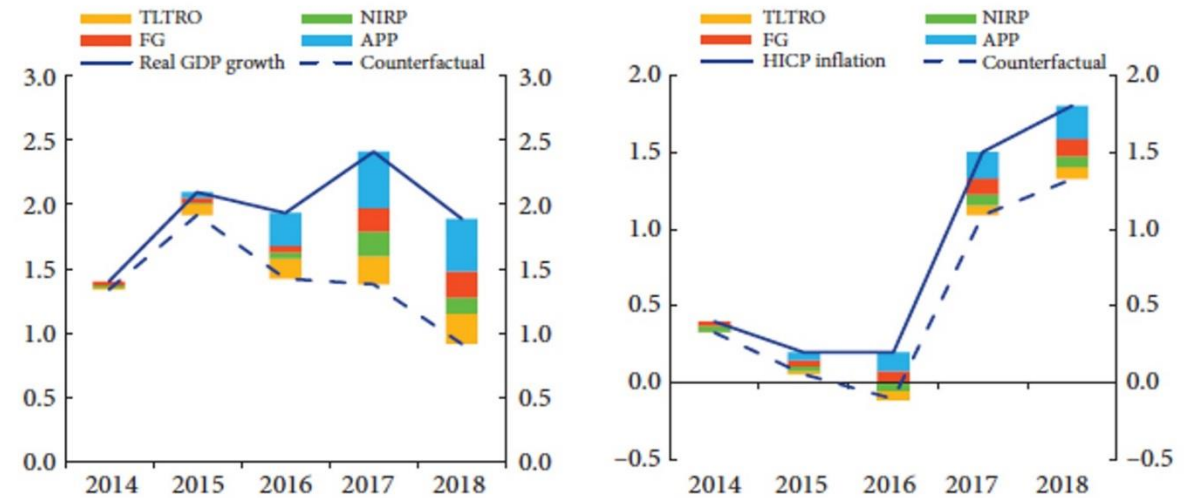
Figure 4: Rate of consumer inflation during the tenure of the first four ECB Presidents

II. Faulty
inflation control
- 3



Faulty inflation control - 4.
Dispiriting bang for the buck

Figure 5: Cumulated effect of unconventional monetary policy. (2014-2018)



Real GDP growth (average annual % change)

HICP inflation (average annual % change)

Actual real GDP growth and HICP inflation, and counterfactual paths in absence of ECB's non-standard measures

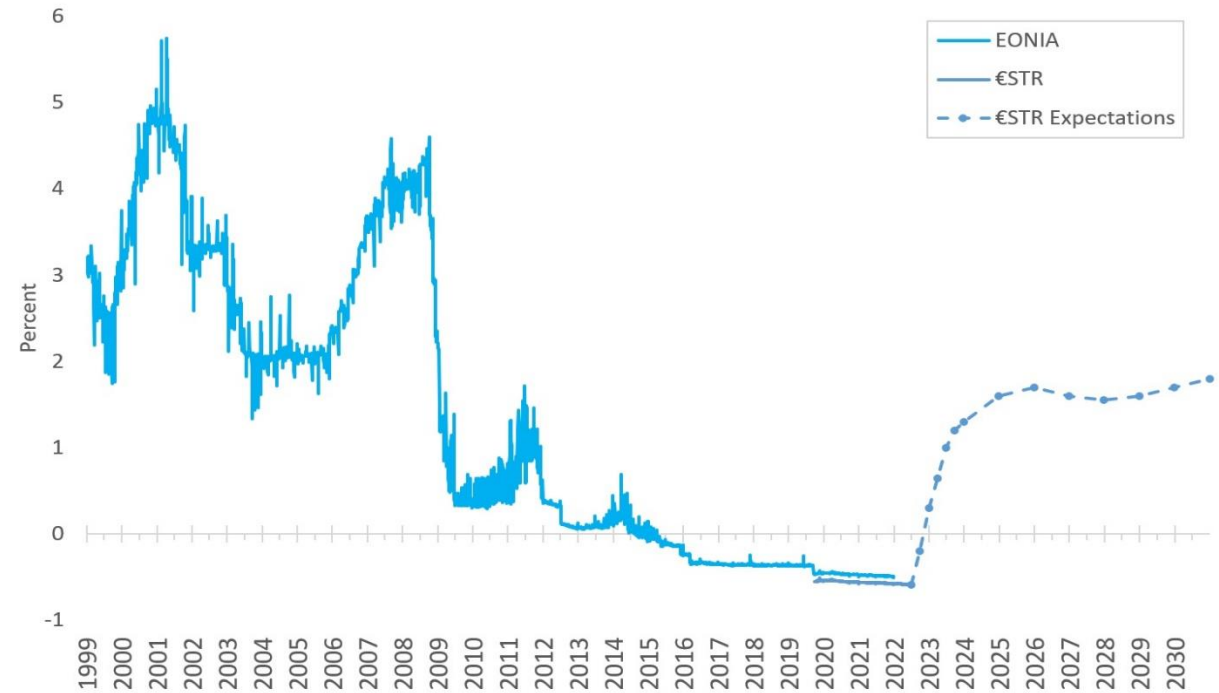
Table 1: Medium term scenarios, growth and inflation for the euro area

	Growth		Inflation	
	2021	2022	2021	2022
	December	April	December	April
IMF	2022: 4.2%	2022: 2.8%	2022: 2.5%	2022: 5.8%
	2023: 2.0%	2023: 2.4%	2023: 2.2%	2023: 2.9%
		2024: 2.1%		2024: 2.0%
ECB	December	June	December	June
	2022: 4.6%	2022: 2.8%	2022: 1.7%	2022: 6.8%
	2023: 2.1%	2023: 2.1%	2023: 1.5%	2023: 3.5%
		2024: 2.1%	2024: 2.1%	
OECD	December	April	December	April
			HICP	HICP
	2022: 4.3%	2022: 2.6%	2022: 2.7%	2022: 7.0%
	2023: 1.6%		2023: 4.5%	
	2023: 2.1%	2024: 1.5%	Core inflation	Core inflation
			2022: 1.5%	2022: 3.8%
				2023: 2.4%
Goldman Sachs	December	April	December	April
	2022: 4.4%	2022: 2.5%	2022: 2.0%	2022: 6.8%
	2023: 2.4%	2023: 2.0%	2023: 1.3%	2023: 2.5%
	2024: 1.6%	2024: 1.6%	2024: 1.4%	2024: 2.2%
CITI	December	April	December	April
	2022: 3.9%	2022: 2.3%	2022: 2.0%	2022: 7.1%
	2023: 2.4%	2023: 1.8%	2023: 1.3%	2023: 3.4%
		2024: 1.4%	2024: 2.4%	
			2025: 2.1%	

Really return to normal?

III. Prospects of monetary tightening - 1

Figure 6: Overnight interest rate in the €-area



III. Prospects of monetary tightening - 2

Table 2. Possible sequence of ECB rate increases

Date	bp increase
July 2022	25
September 2022	50
October 2022	25
December 2022	25
2023	50
2024	25

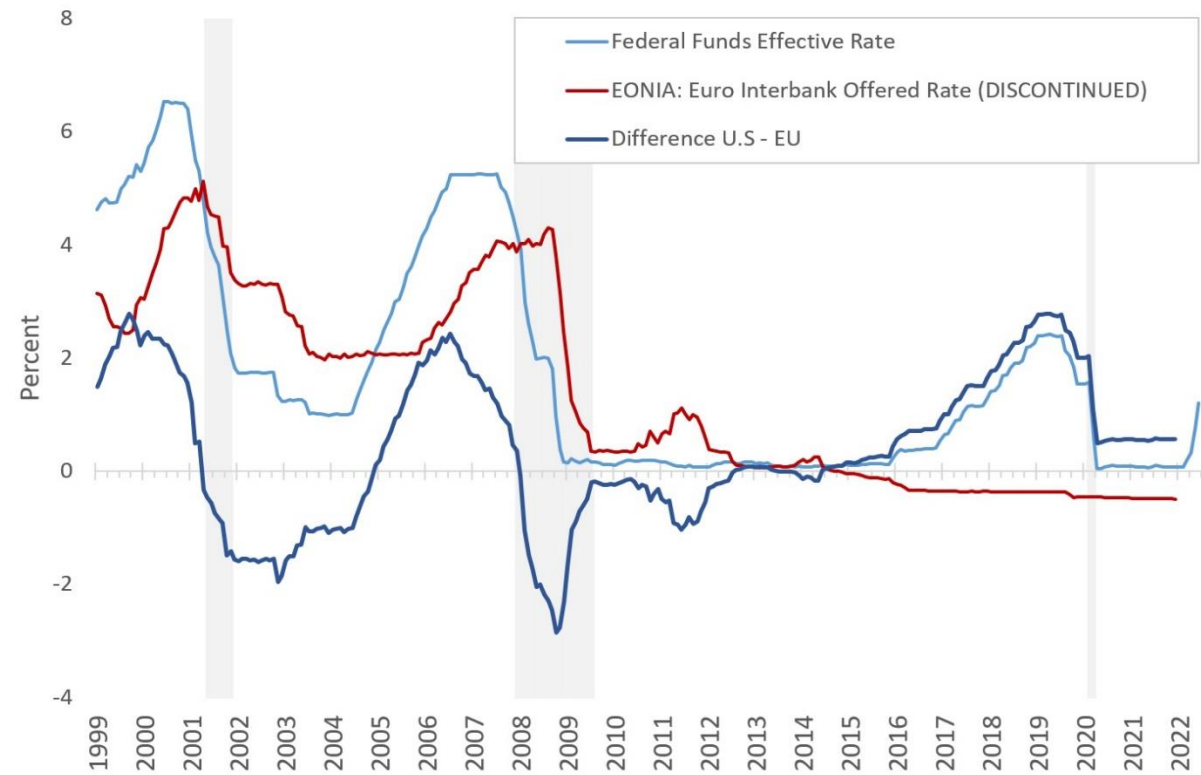
Table 3. Expected interest rates in the FED dot plot

Date	EFFR level
End 2022	3.4
End 2023	3.7
End 2024	3.4
Longer term	2.5

III. Prospects of monetary tightening - 3

III. Prospects of monetary tightening - 4

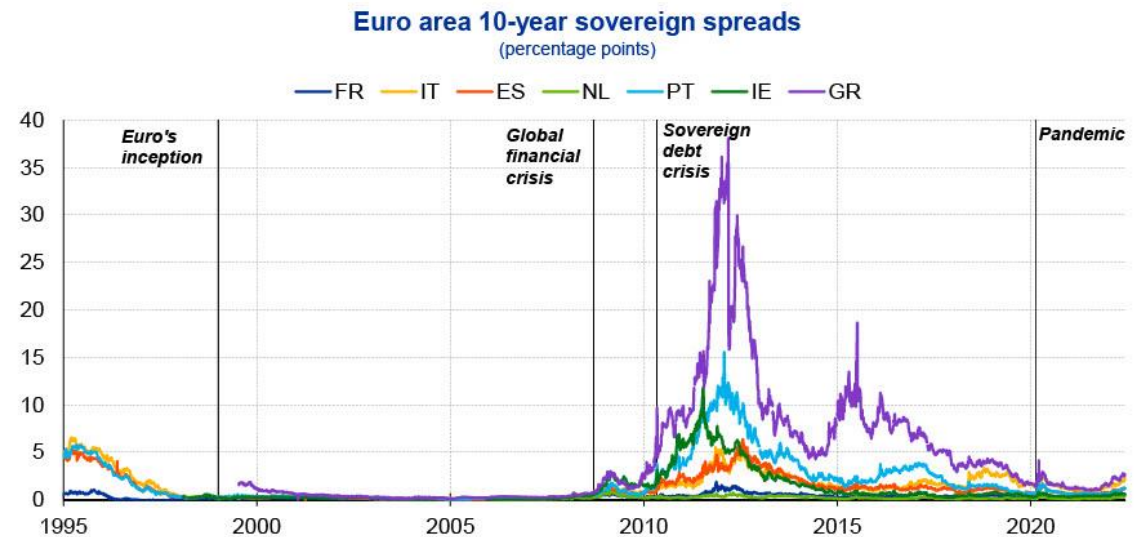
Figure 7: Overnight interest rates in the US and the €-area.



IV. Risk of problems in the periphery of the €-area - 1

Figure 8: 10-year sovereign spread.

Turbulent history of bond market fragmentation in the euro area

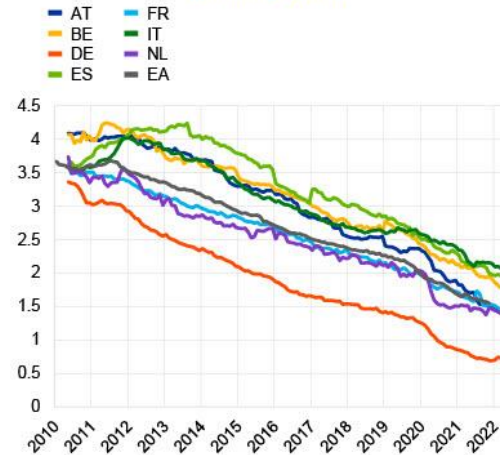


Source: Schnabel, *United in Diversity – Challenges for monetary policy in a currency union*. June 14th 2022. Haver. Notes: 10-years sovereign bond yields over 10-years German Bund. The vertical lines mark the beginning of each phase. Latest observation: 10 6 2022

Figure 9: Borrowing costs and maturities of selected government bonds.

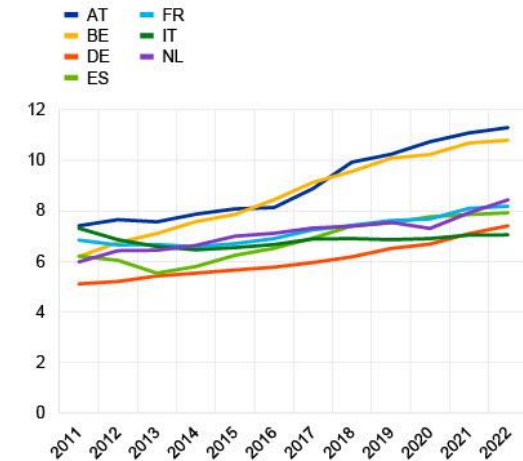
Borrowing costs for euro area sovereigns declined, while maturities increased

Average nominal sovereign yields on total government debt securities (percentage points)



Source: ECB and ECB calculations.
Note: Last observation: April 2022

Residual maturities (years)



Source: ECB and ECB calculations.
Notes: All original maturities. Annual averages per year, for 2022 average over the period January – April.

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IV. Risk of problems in the periphery of the €-area - 2

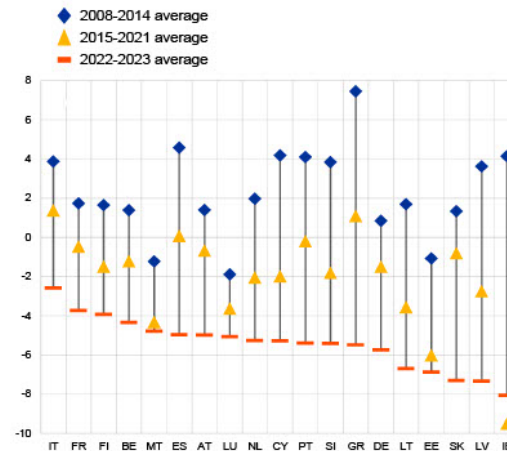
Source: Schnabel, *United in Diversity – Challenges for monetary policy in a currency union*. June 14th 2022.

IV. Risk of problems in the periphery of the €-area - 3

Figure 10: Interest rate growth differential and debt/GDP ratio.

Given favourable interest rate-growth differentials, public debt ratios likely to decline

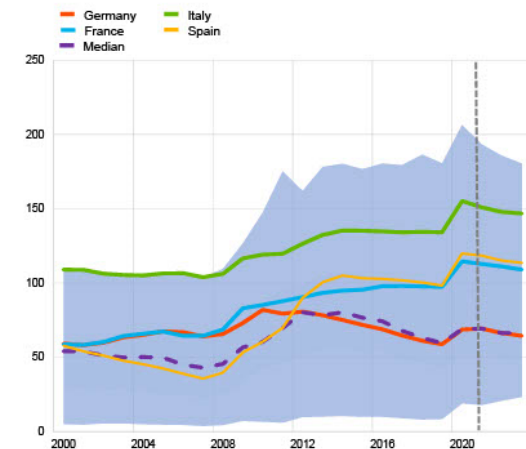
Interest rate-growth differential
(percentage points, average over period)



Sources: European Commission, ECB calculations.

Notes: The interest rate-growth differential is calculated using the implicit interest rate on government debt and the growth rate of nominal GDP. The implicit interest rate in year t is interest payments by the government in year t divided by government gross debt in $t-1$. Countries are sorted according to the 2022-2023 average interest rate-growth differential. Figures for 2022 and 2023 refer to the European Commission 2022 Spring forecast.

Government debt in selected countries
(percent of GDP)



Sources: European Commission

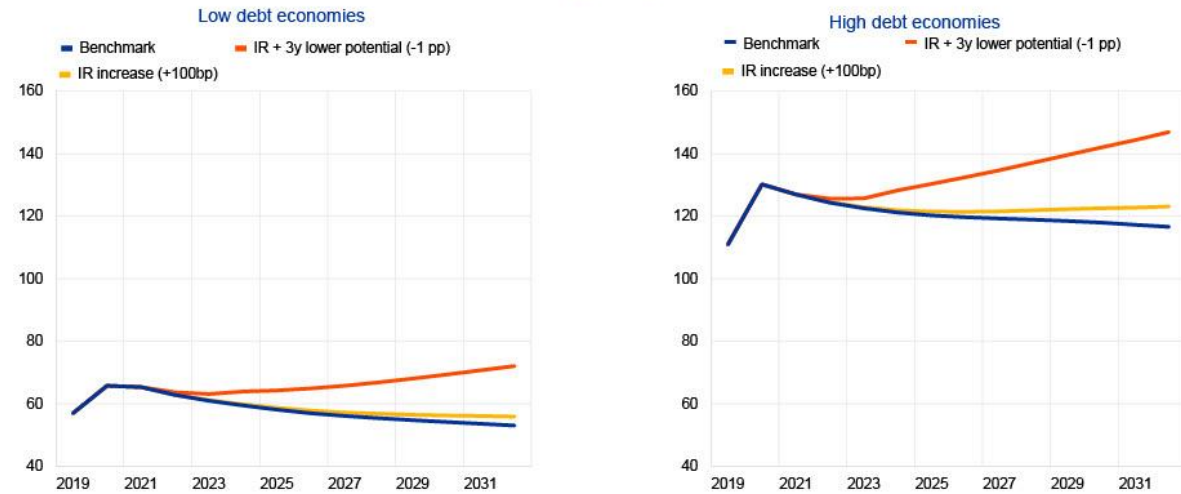
Note: The range shows the min and the max of all euro area countries. Figures for 2022 and 2023 refer to the European Commission 2022 Spring forecast. Latest observation: 2023

Source: Schnabel, *United in Diversity – Challenges for monetary policy in a currency union*. June 14th 2022.

Figure 11: Impact of growth and interest rate changes on gross financing needs.

Potential growth matters more for sovereign finances than interest rates

Impact of an interest rate and GDP shock on sovereign gross financing needs (percent)



Sources: European Commission, ECB calculations.

Notes: High debt economies are countries with a debt-to-GDP ratio exceeding 90% in 2019; Interest rate shock assumes permanently higher interest rates by 1pp across countries and maturities; Potential growth shock assumes potential growth lower by 1 percentage point for 3 years, implying permanently lower potential output levels.

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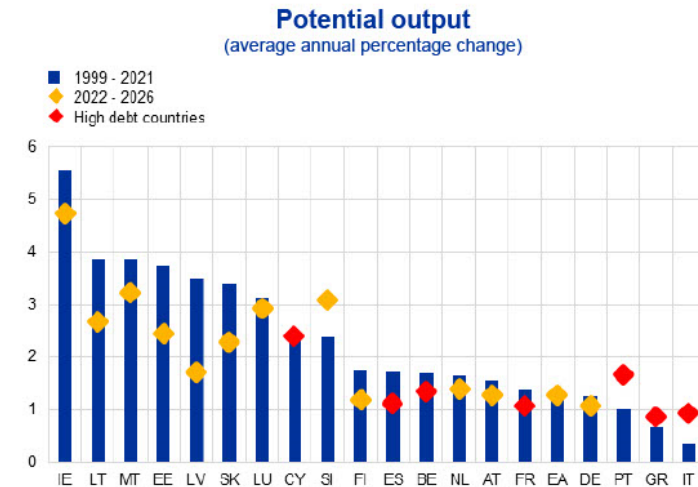
Source: Schnabel, *United in Diversity – Challenges for monetary policy in a currency union*. June 14th 2022.

IV. Risk of problems in the periphery of the €-area - 4

IV. Risk of problems in the periphery of the €-area - 5

Figure 12: Potential growth

Potential growth outlook above historical average for some high-debt countries

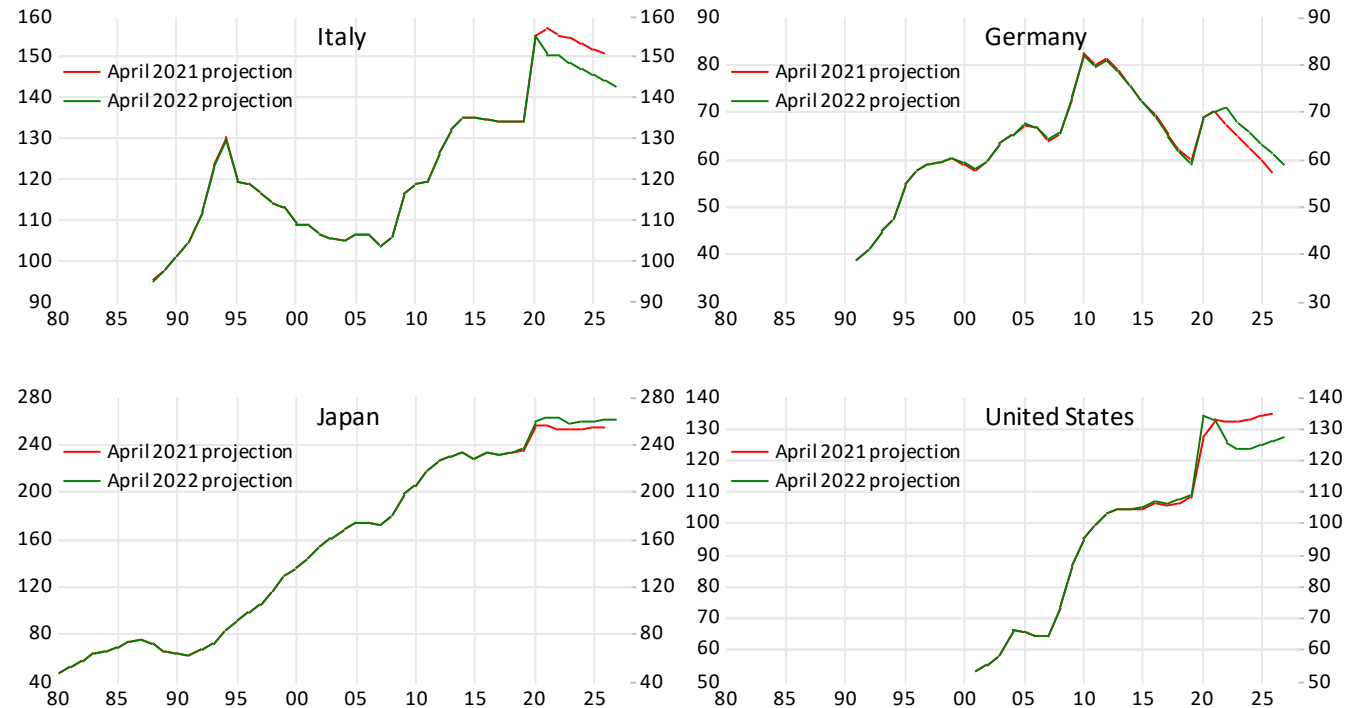


Source: European Commission, EPC Working Group on Output Gaps
Note: The definition of high debt countries is debt to GDP ratio of over 90% of GDP in 2019.

Source: Schnabel, *United in Diversity – Challenges for monetary policy in a currency union*. June 14th 2022.

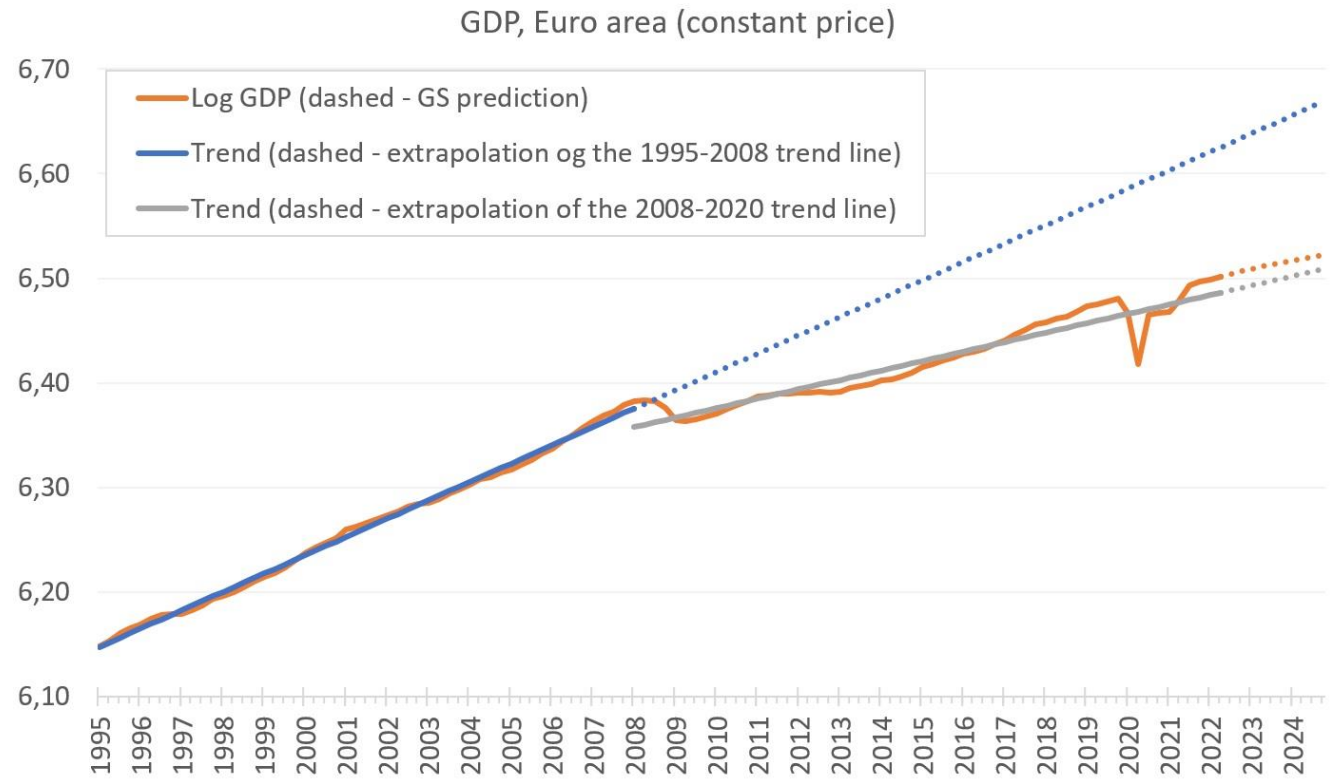
IV. Risk of problems in the periphery of the €-area - 6

Figure 13: Gross public debt to GDP ratio, comparing the April 2022 and April 2021 IMF World Economic Outlook projections (% of GDP)

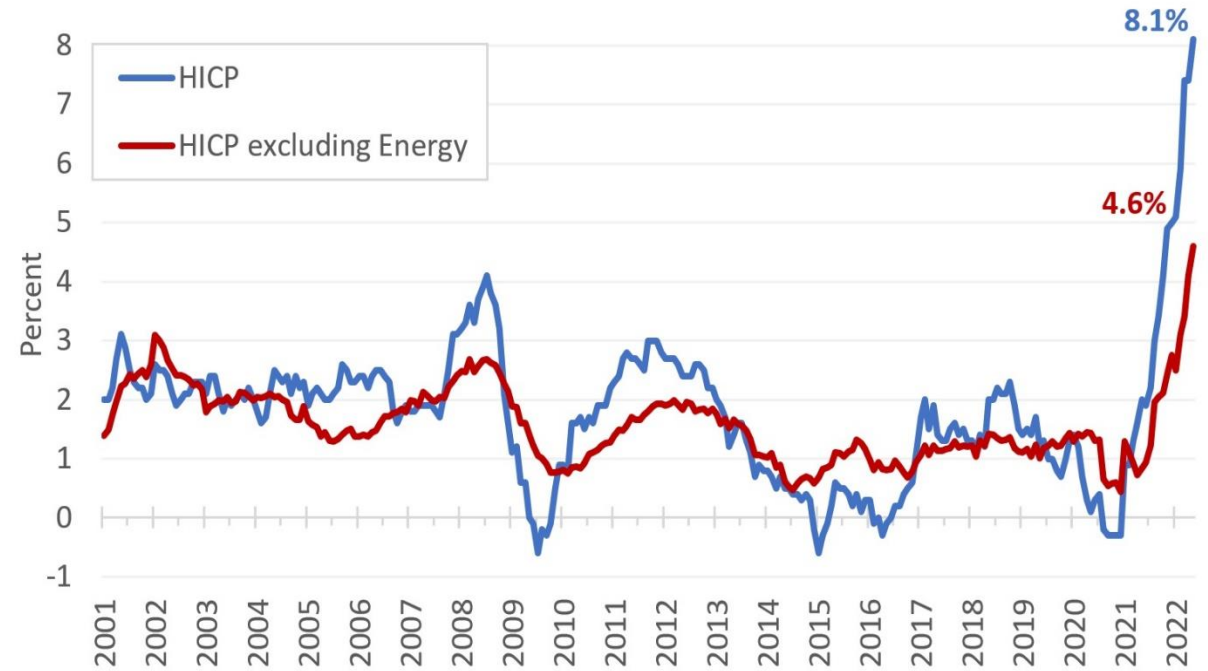


Source: Zsolt Darvas, *The implications for public debt of high inflation and monetary tightening* | Bruegel post.

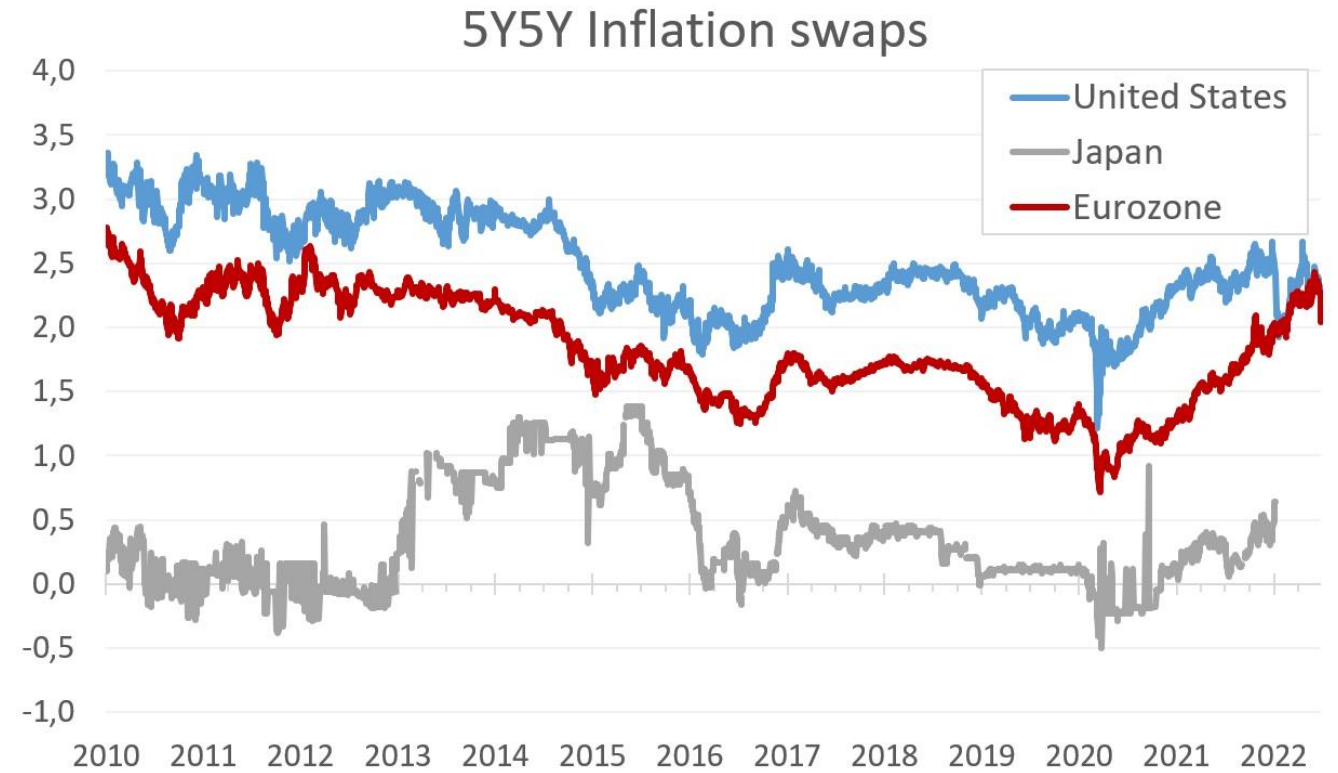
Additional figures -1



Additional figures - 2

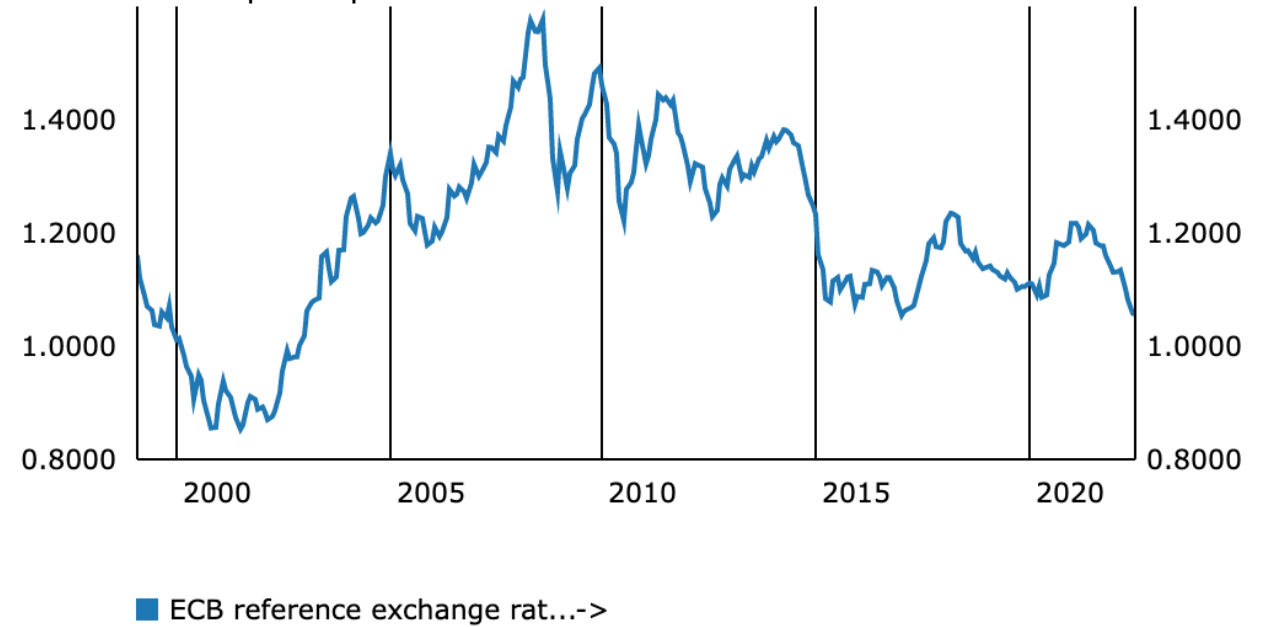


Additional
figures - 3



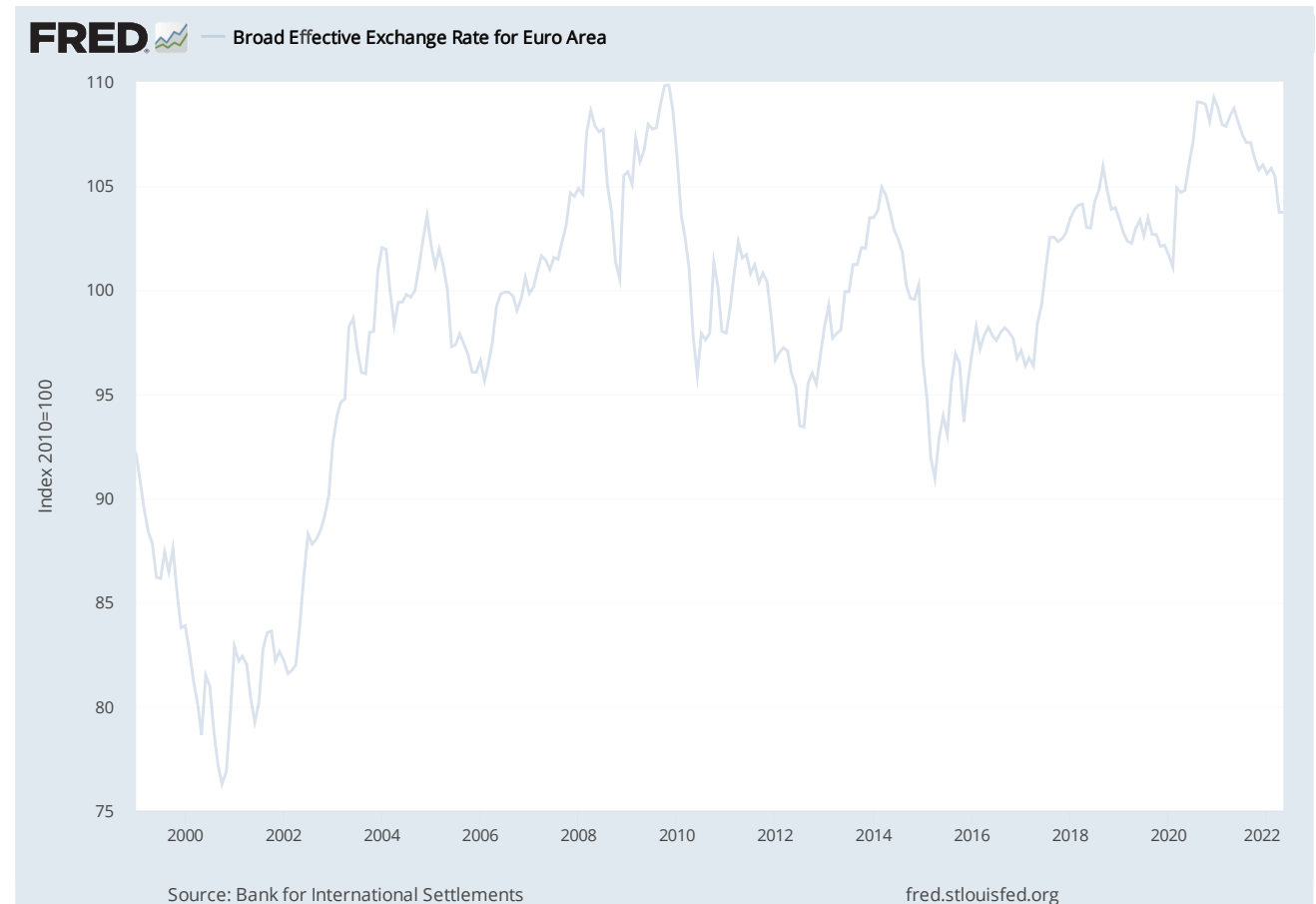
Additional figures - 4

\$/€ exchange rate



Broad effective exchange rate of the euro

Additional
figures - 5



Broad dollar effective exchange rate

Additional
figures - 6

