

MONETARY POLICY AND ITS PERSPECTIVES IN ADVANCED ECONOMIES

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XVIII REUNIÓN DE RESPONSABLES DE POLÍTICA MONETARIA

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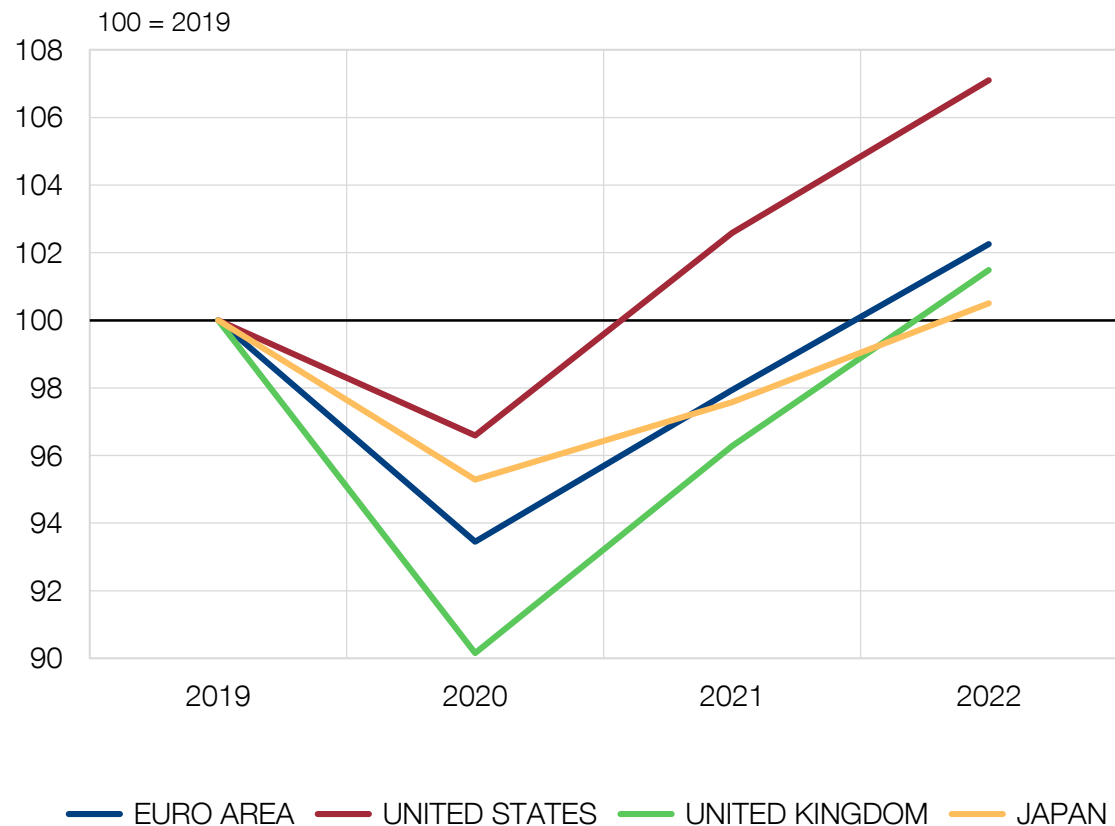
SUMMARY

- 1. Uneven global recovery with a sharp (temporary) rise in inflation**
2. ECB strategy review and monetary policy perspectives
3. US FED new strategy and monetary policy perspectives
4. Monetary policy prospects in other advanced economies

LARGE HETEROGENEITY IN THE RECOVERY ACROSS ADVANCED ECONOMIES

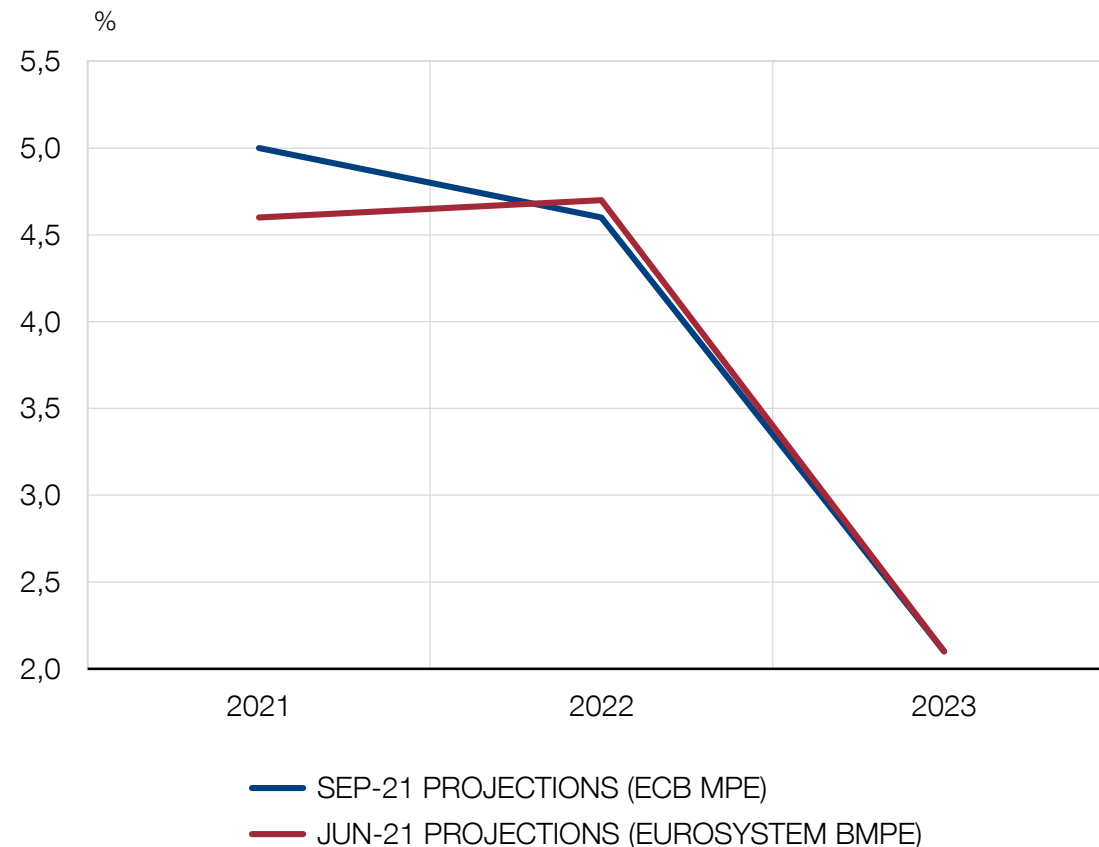
- The US reached 2019 GDP level this year; the euro area, the UK and Japan expected to do so in 2022
- The recovery in the euro area has been more intense and faster than anticipated in June

REAL GDP IN ADVANCED ECONOMIES
Consensus forecast. August



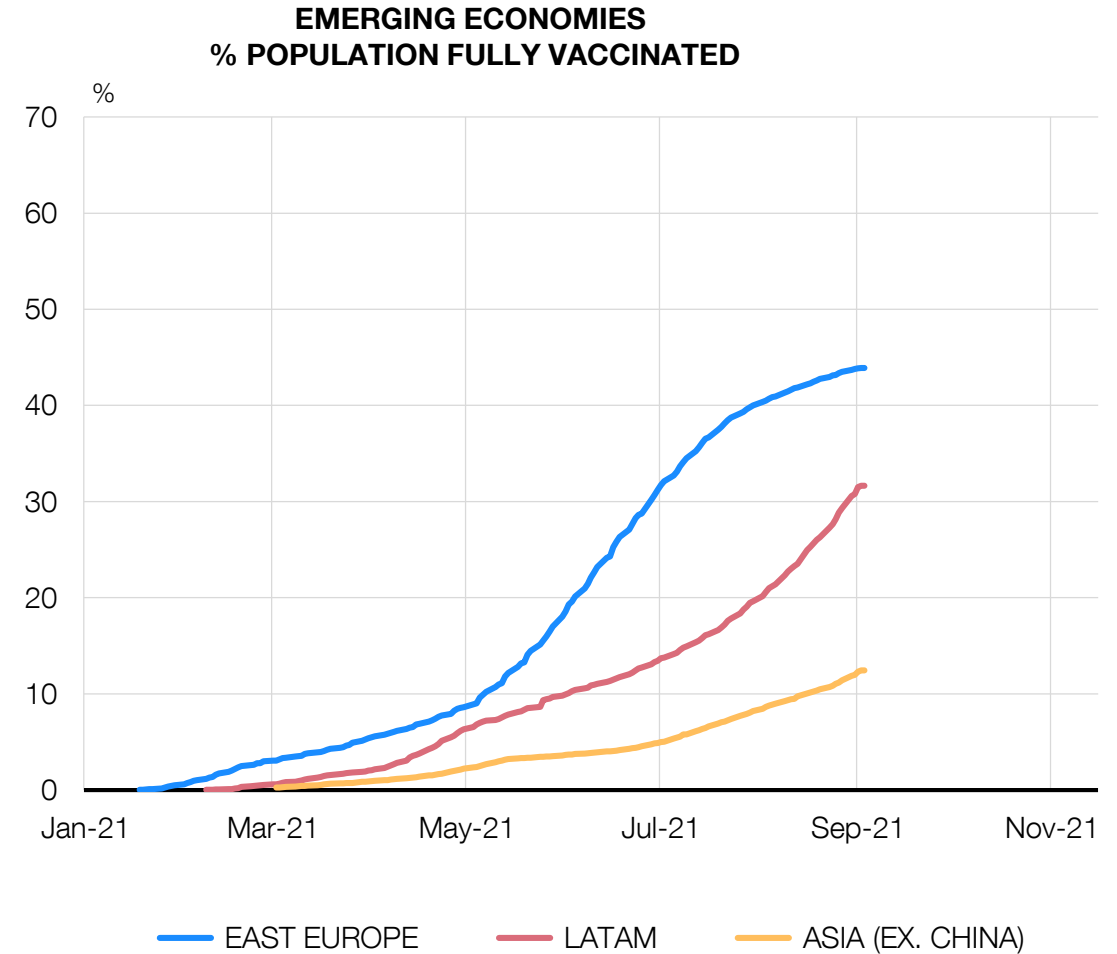
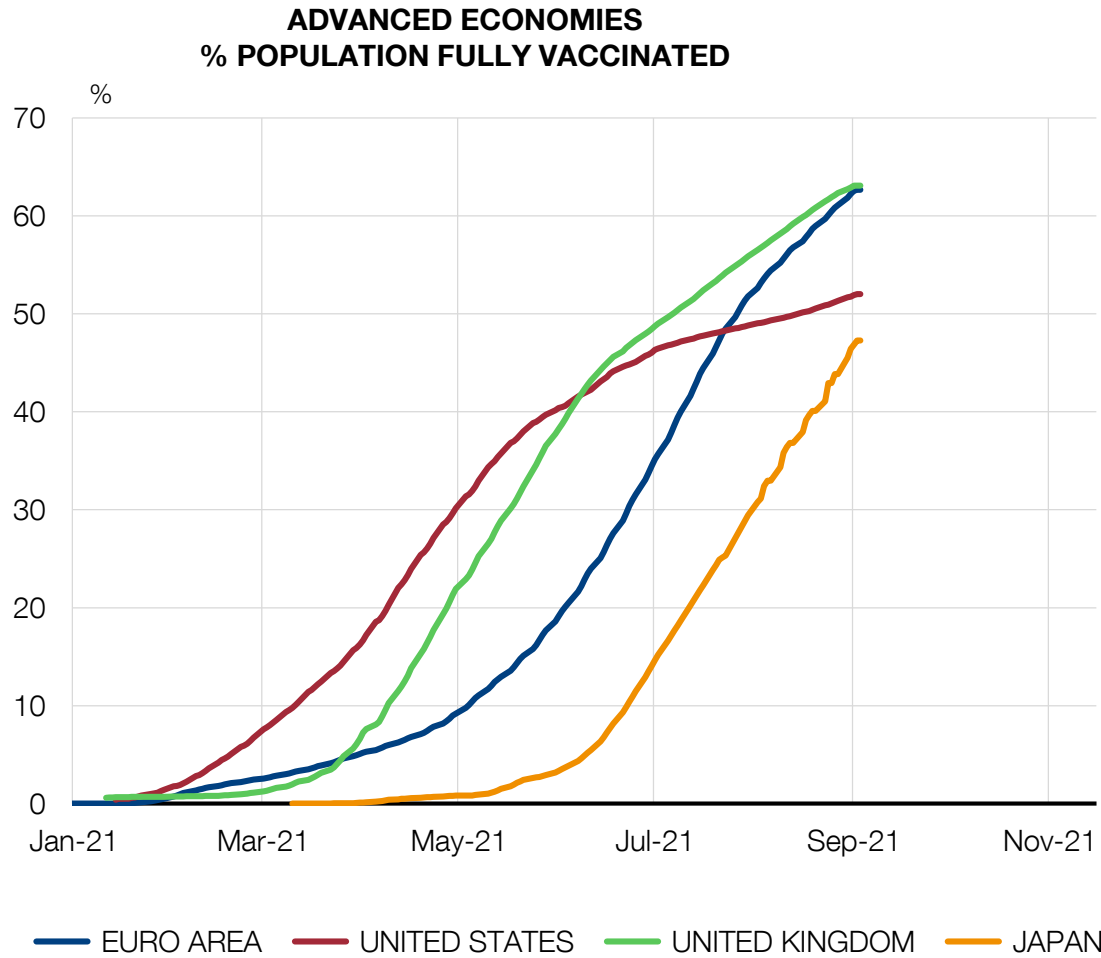
Sources: Eurostat, ECB, Refinitiv Datastream, Consensus

EURO AREA GDP GROWTH PROJECTIONS



VACCINATION AND THE ECONOMIC RE-OPENING, AMID MASSIVE GLOBAL POLICY SUPPORT, ARE PUSHING DEMAND UP IN ADVANCED ECONOMIES

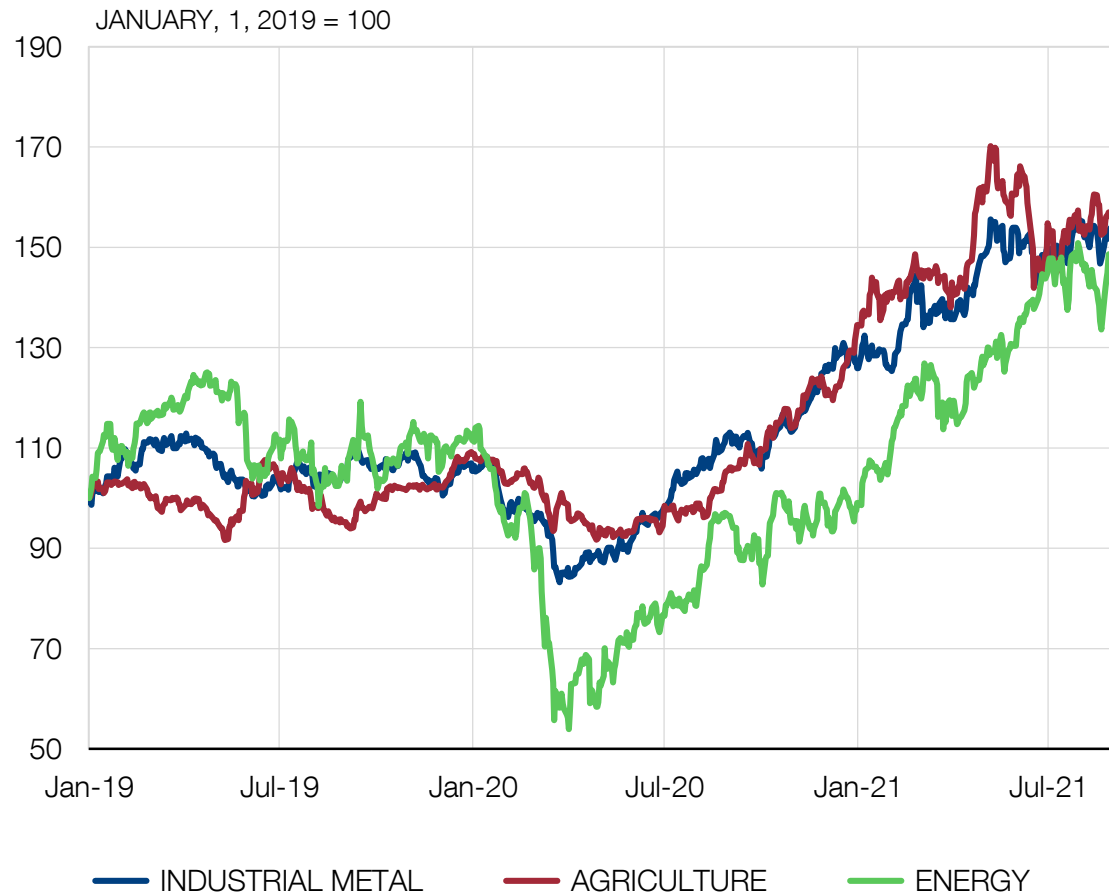
- Risks persist in emerging countries due to pandemic incidence



Sources: Our World in Data

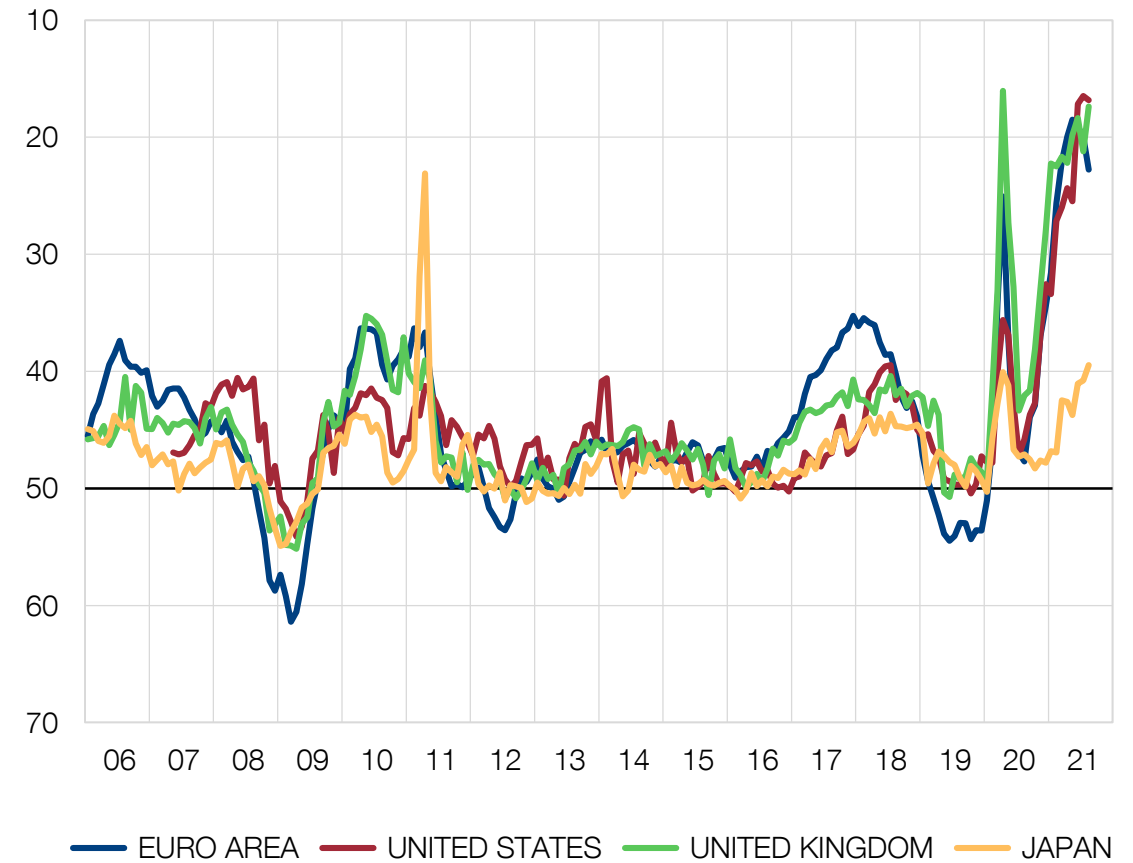
SHARP RISE IN COMMODITY PRICES AND THE EMERGENCE OF PRODUCTION BOTTLENECKS IN ADVANCED ECONOMIES

PRICES OF RAW MATERIALS



PMI SUPPLIERS' DELIVERY TIME INDEX

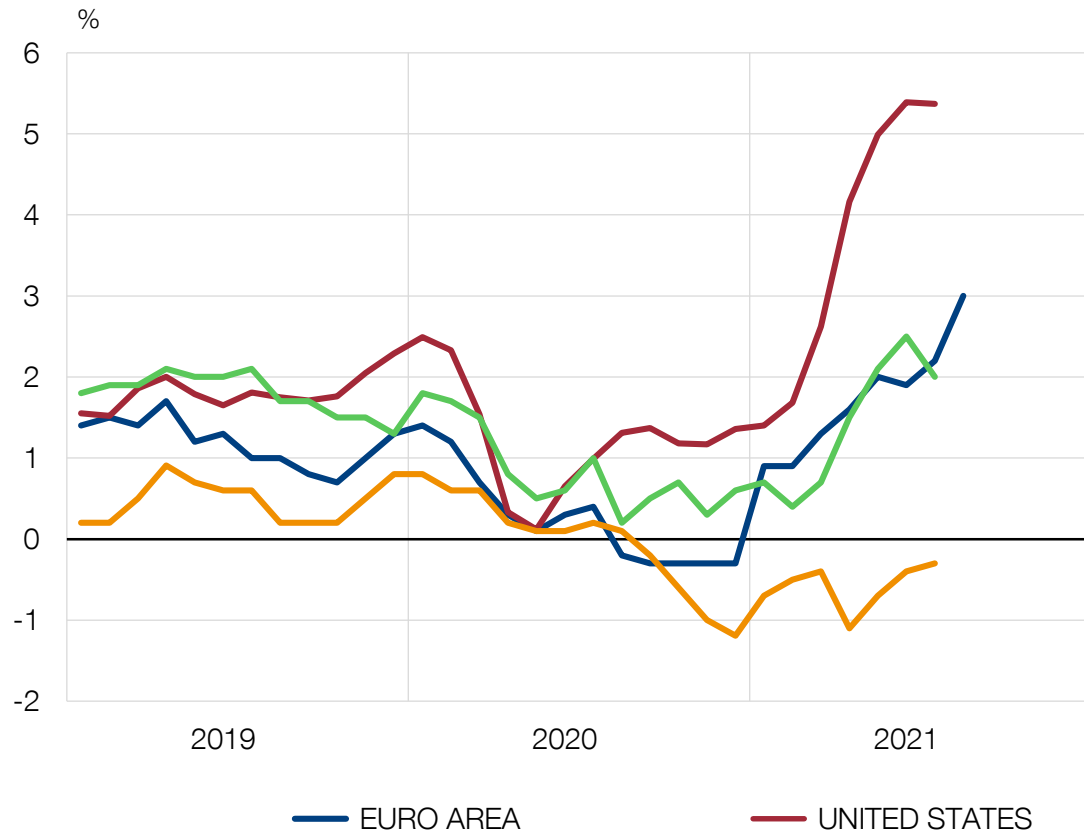
Inverted scale



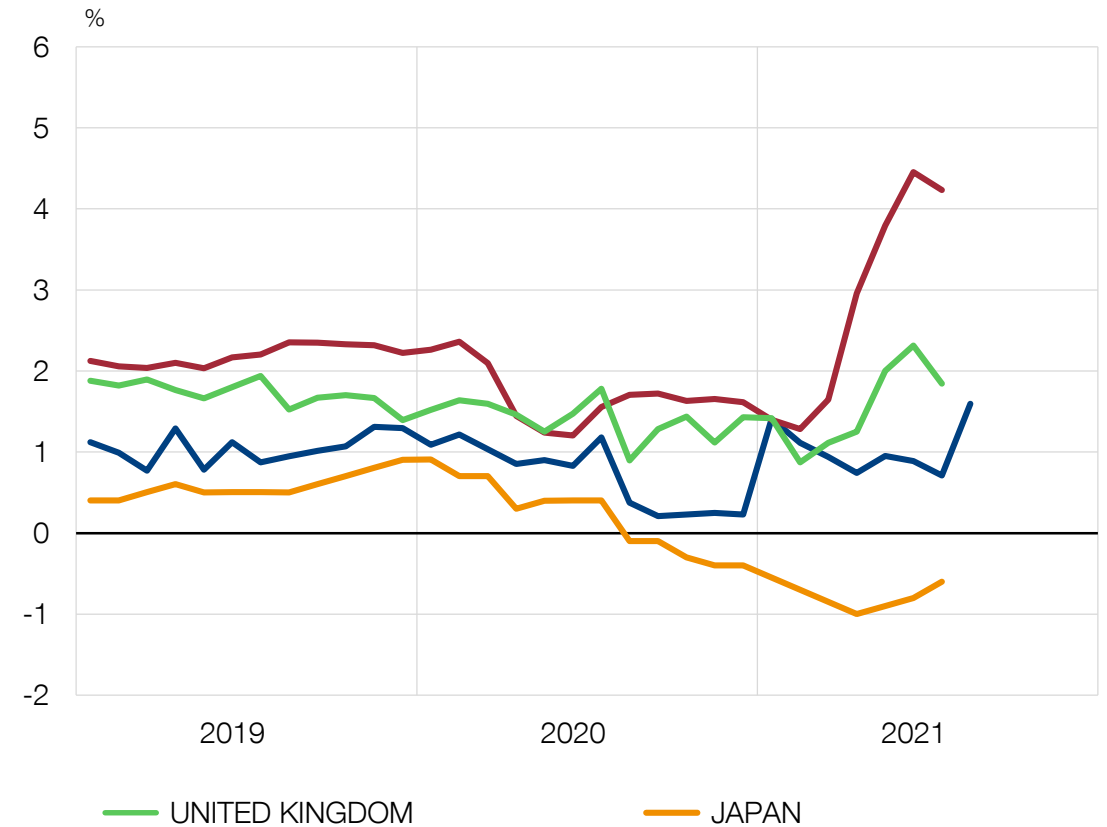
Sources: Refinitiv and Markit

INFLATION RATES HAVE INCREASED SHARPLY, ESPECIALLY IN THE US, MAINLY AS A RESULT OF TEMPORARY FACTORS

HEADLINE CPI INFLATION



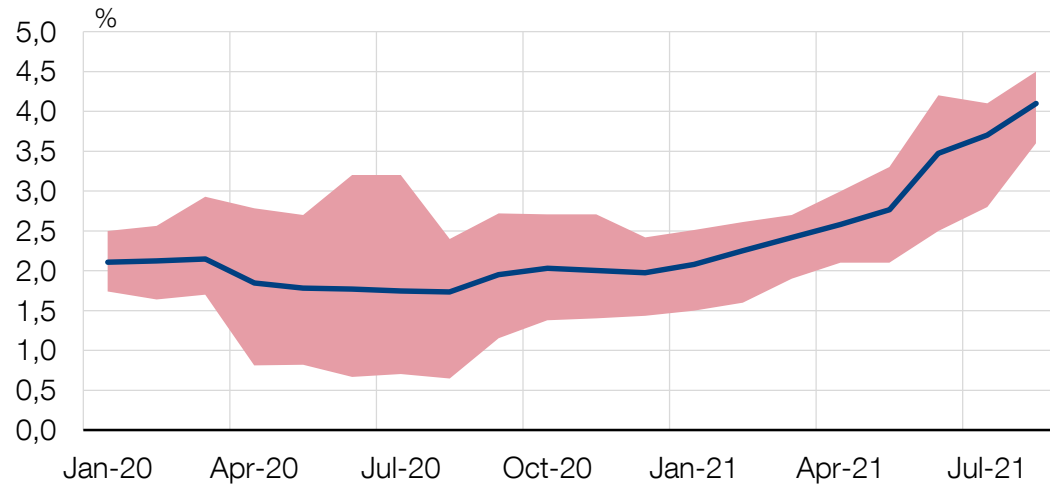
CORE CPI INFLATION EXCLUDING ENERGY AND FOOD



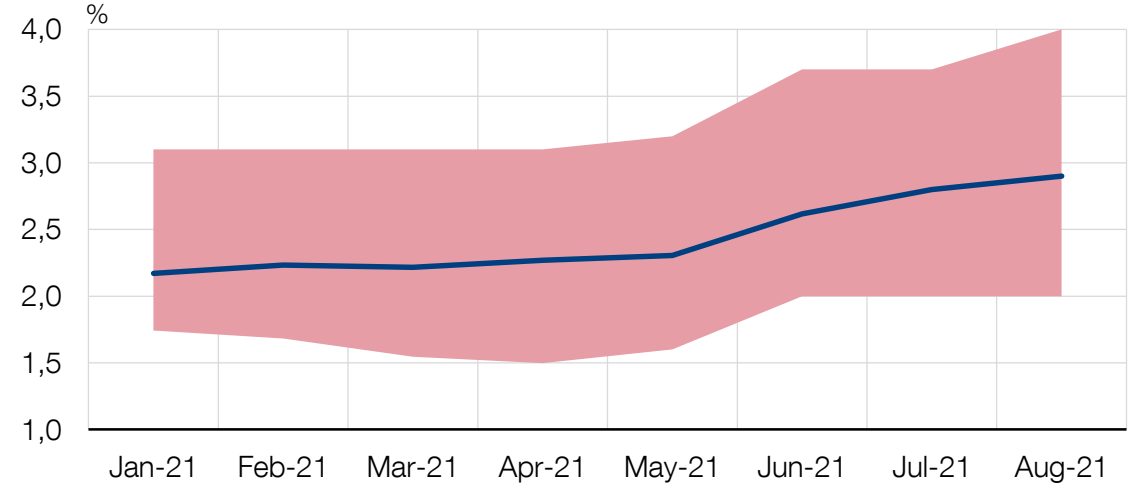
Source: Refinitiv

INFLATION PROJECTIONS HAVE INCREASED SHARPLY FOR 2021, BUT REMAIN SOMEWHAT MORE STABLE FOR 2022

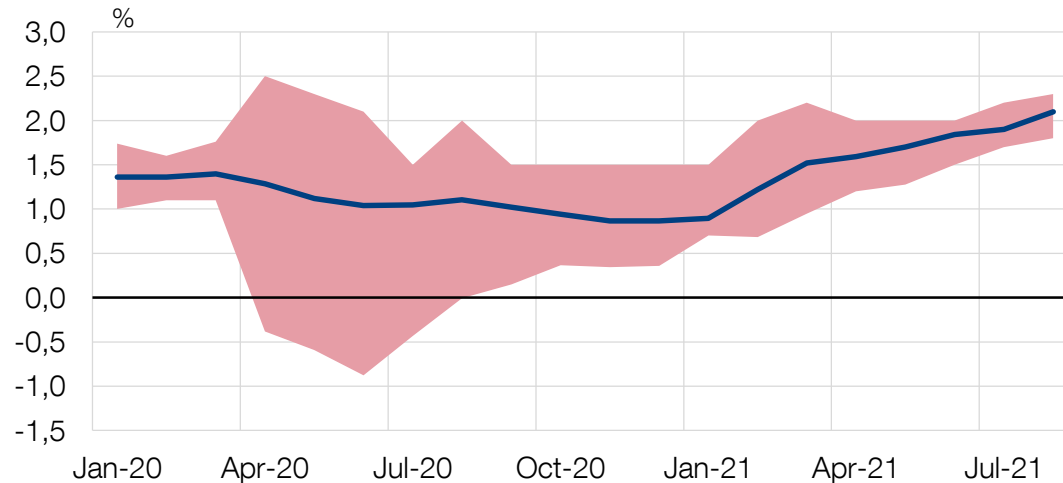
UNITED STATES: INFLATION FORECAST 2021



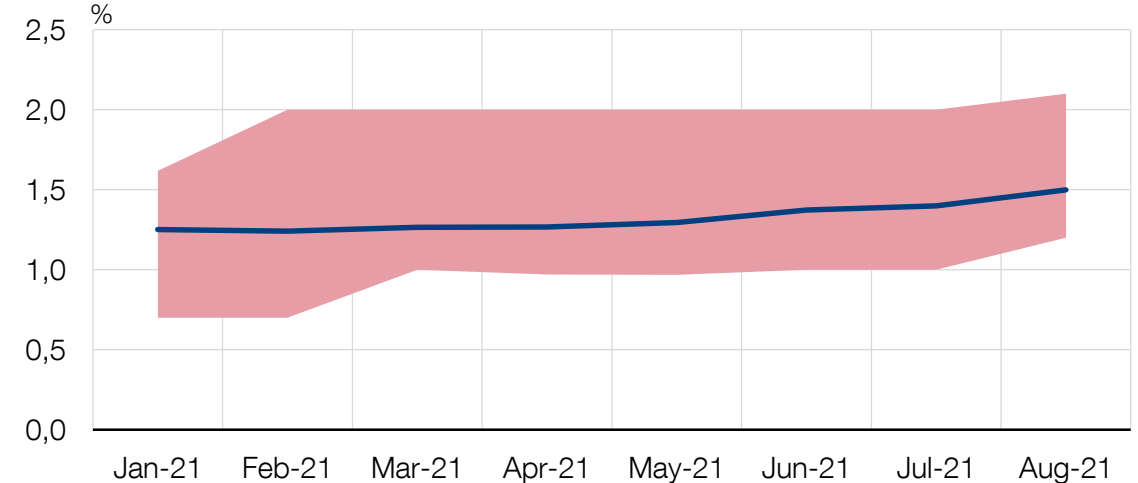
UNITED STATES: INFLATION FORECAST 2022



EURO AREA: INFLATION FORECAST 2021



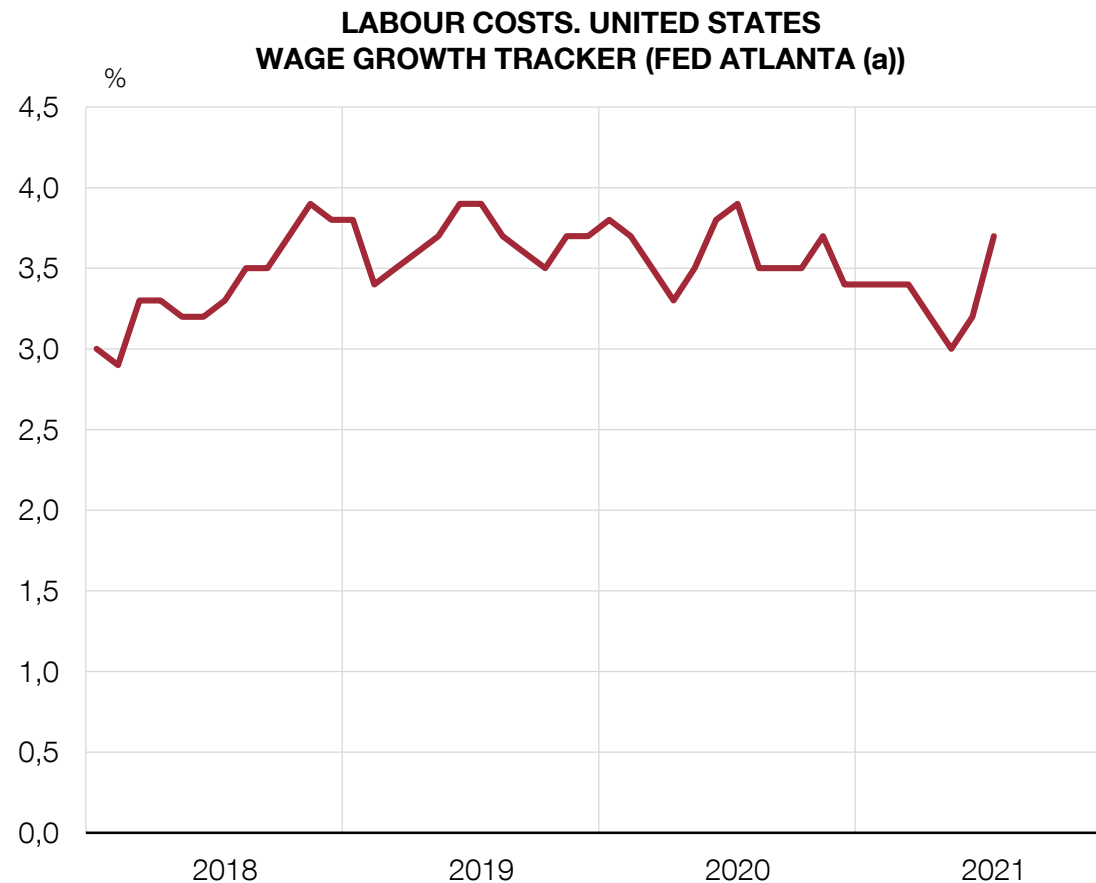
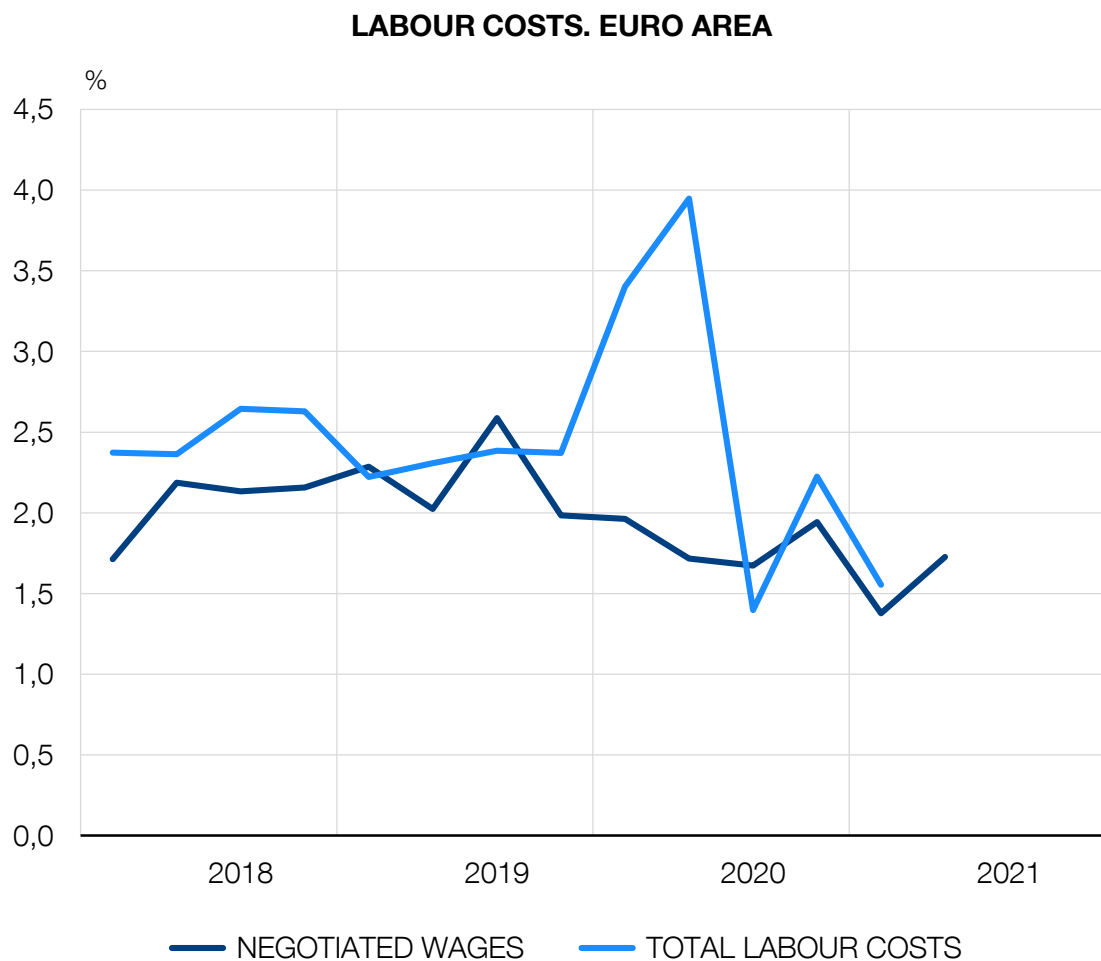
EURO AREA: INFLATION FORECAST 2022



Source: Consensus Forecast

WAGES DO NOT, SO FAR, INCORPORATE SIGNIFICANT SECOND-ROUND EFFECTS

- **Although, second round effects could be more likely than in the past amid the supply side bottlenecks and high private savings (pent-up demand)**



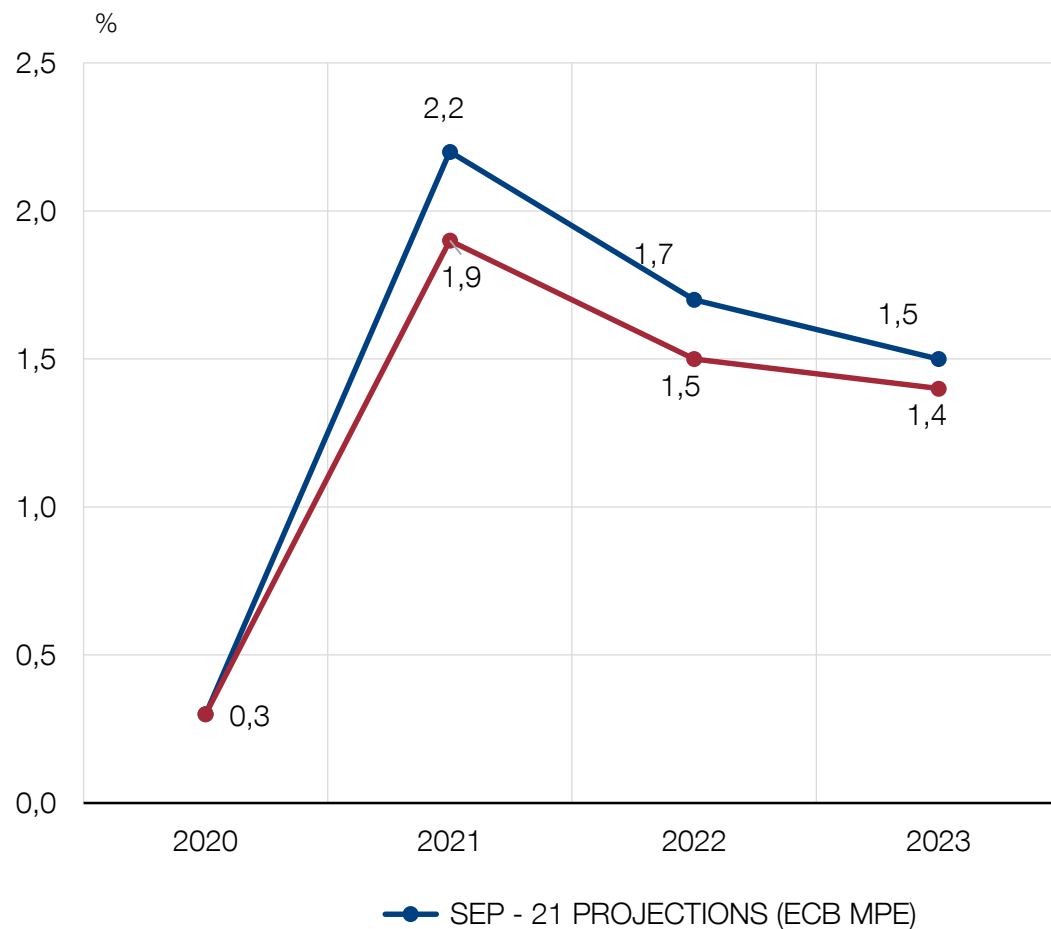
(a) Median percentage change in hourly wages of individuals, from micro data

Sources: Eurostat and Fed Atlanta

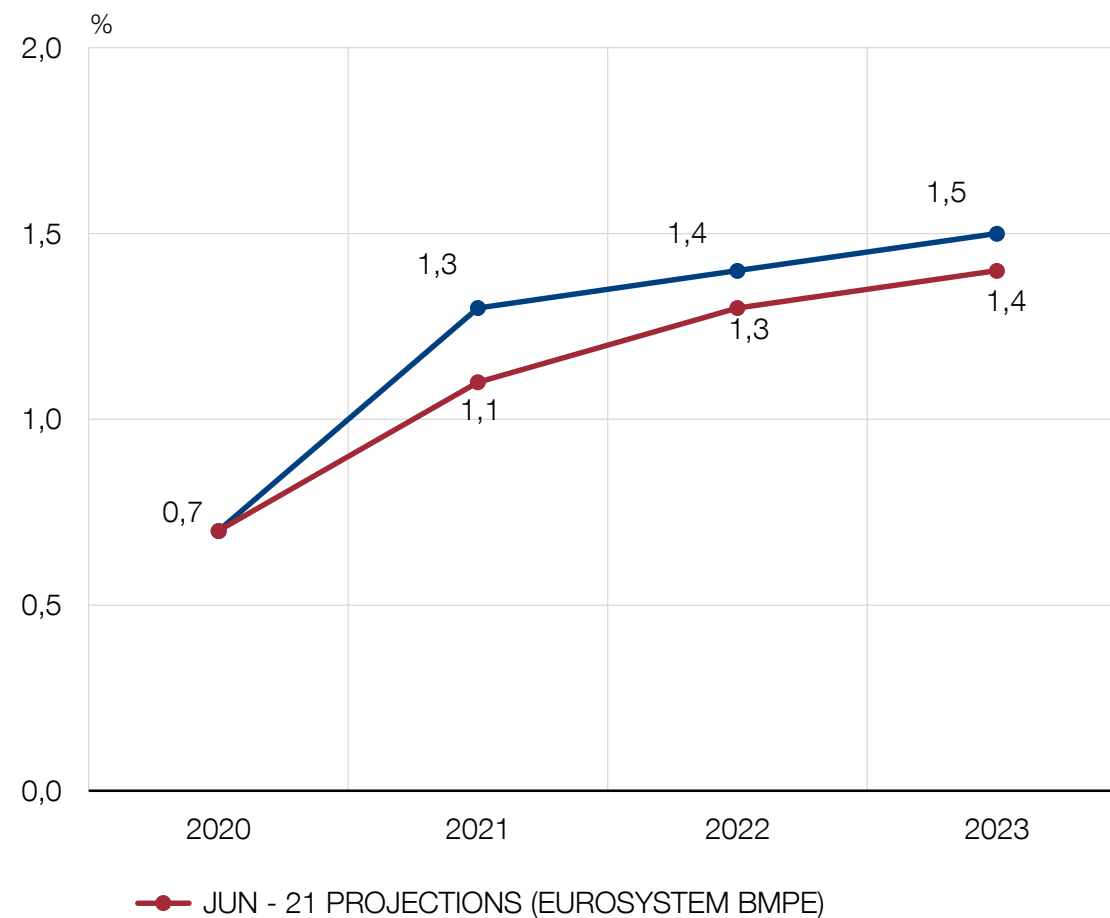
THE LAST ECB PROJECTION EXERCISE REVISES INFLATION UPWARDS

EURO AREA INFLATION PROJECTIONS

INFLATION RATE (HICP)



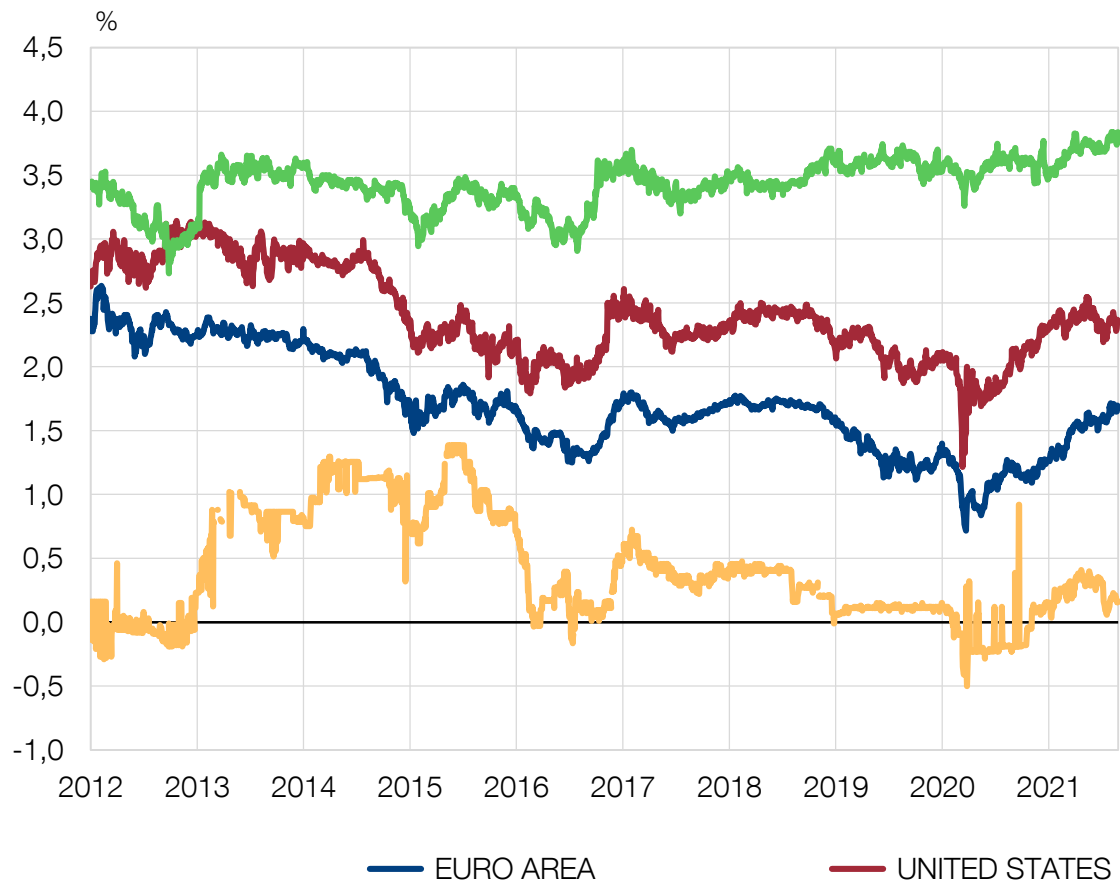
HICP EXCLUDING ENERGY AND FOOD



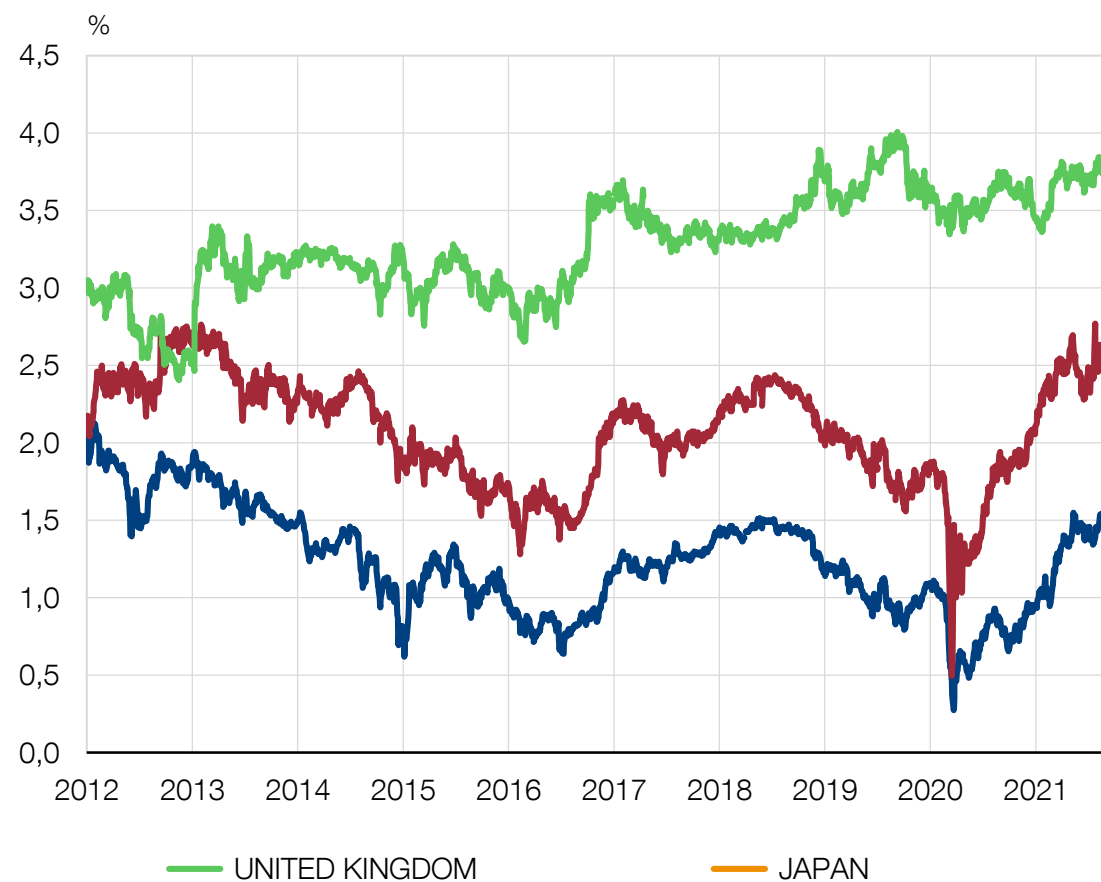
Source: ECB

MEDIUM TERM INFLATION EXPECTATIONS HAVE ALSO INCREASED, BUT STILL REMAIN RELATIVELY WELL ANCHORED

BREAKEVEN 5Y-5Y



BREAKEVEN 2Y-2Y



Sources: Bloomberg, Barclays. Last observation, August

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NEW INFLATION TARGET

- **2 %** inflation target over the **medium term**.
- The commitment to this inflation target is **symmetric**: negative and positive deviations of inflation from the target are equally undesirable.

ADDRESSING THE LOWER BOUND

- When the economy is close to the lower bound, this requires especially **forceful or persistent monetary policy measures** to avoid negative deviations from the inflation target becoming entrenched.
- This may also imply a **transitory period** in which inflation is moderately **above target** (*overshooting*)

MONETARY POLICY INSTRUMENTS

- Forward guidance, asset purchases and longer-term refinancing operations remain as an integral part of the **ECB's toolkit**.

THE ECB'S NEW MONETARY POLICY STRATEGY INCLUDES OTHER ELEMENTS, INCLUDING AN AMBITIOUS CLIMATE-RELATED PLAN

INFLATION MEASUREMENT

- The **Harmonised Index of Consumer Prices (HICP)** remains as the appropriate price measure for assessing the achievement of the price stability objective.
- Recognition that including the **costs related to owner-occupied housing** in the HICP would better represent the inflation rate that is relevant for households, and commitment to take into account inflation measures that include initial estimates of such cost.

AMBITIOUS CLIMATE-RELATED ACTION PLAN

- Incorporation of **climate factors in the monetary policy assessments.**
- Changes in the **monetary policy implementation framework** related to:
 - Disclosure requirements for private sector assets.
 - Risk assessment.
 - Corporate sector asset purchases (incorporating climate change criteria).
 - Collateral framework (including climate change risks).

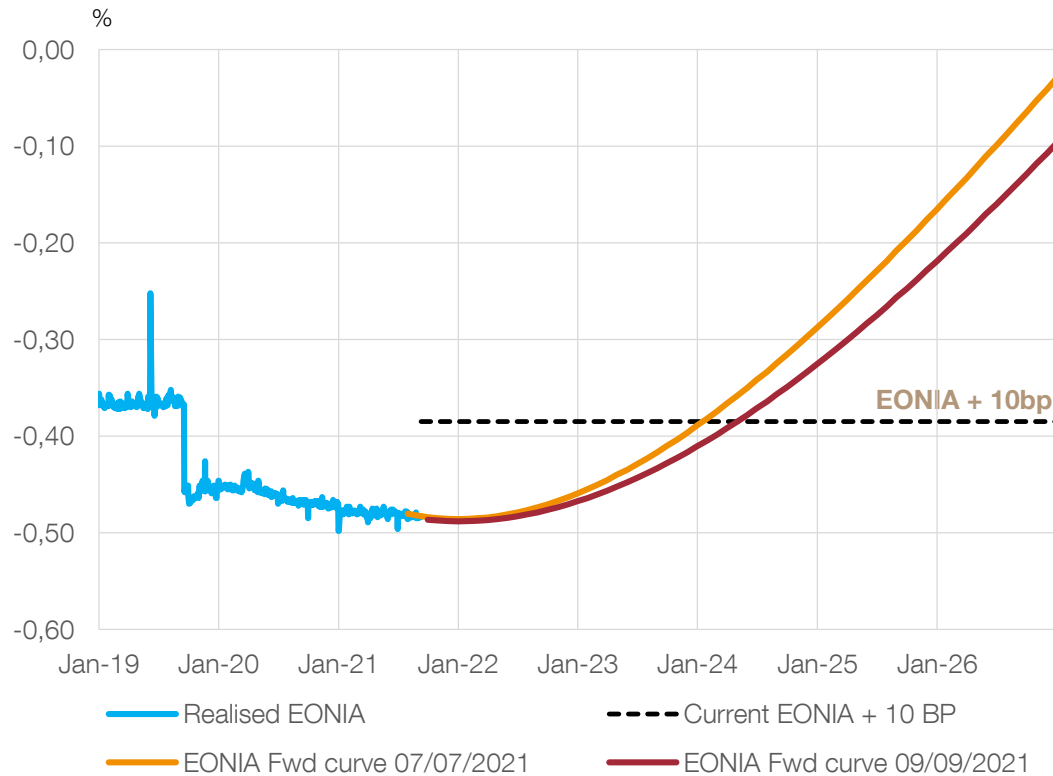
PERIODICAL ASSESSMENTS

- **Periodical assessment of the appropriateness of the strategy.**
- Next assessment expected in 2025.

SINCE THE STRATEGY REVIEW ANNOUNCEMENT, THE TIMING OF RATE INCREASES HAS BEEN POSTPONED AND THE FUTURE INFLATION PATH HAS MOVED UP

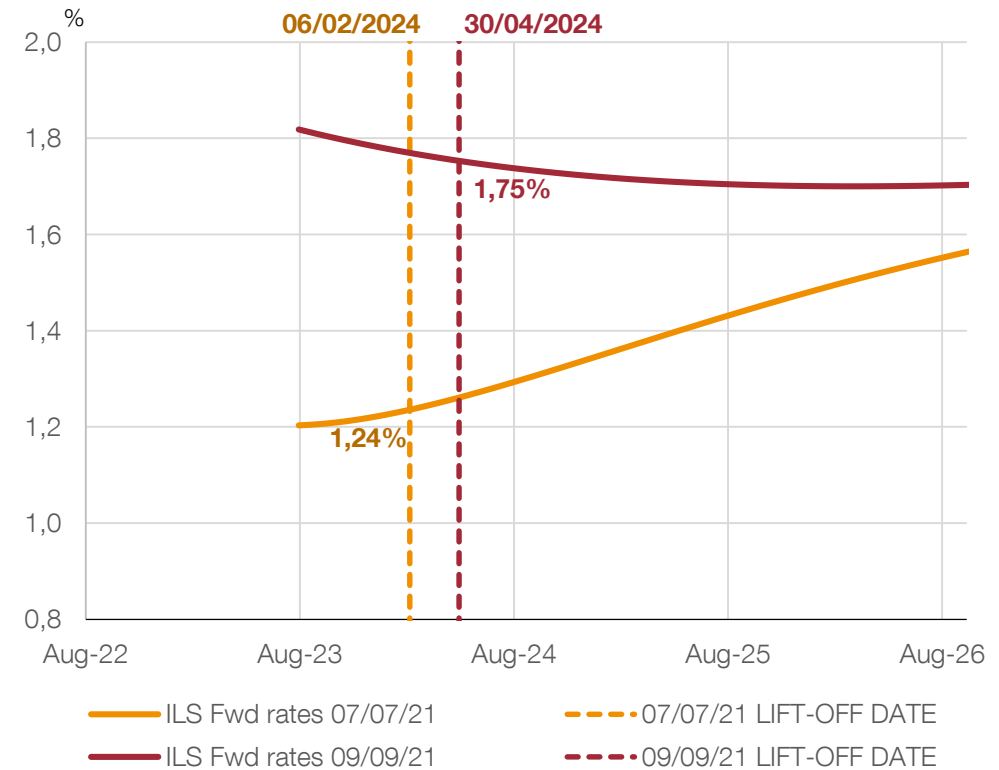
- **ECB monetary policy is likely to remain very accommodative for some time**

EONIA FORWARD CURVE



Source: Refinitiv Datastream and own calculations

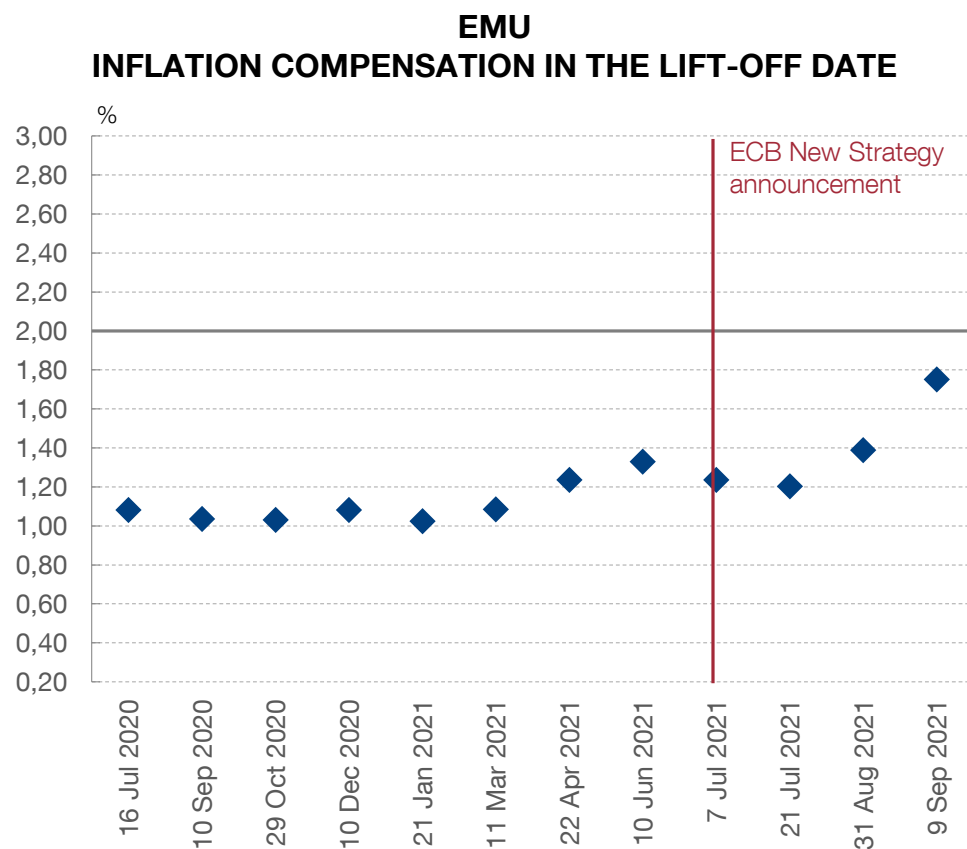
PROJECTED INFLATION AND MARKET IMPLIED LIFT-OFF DATE



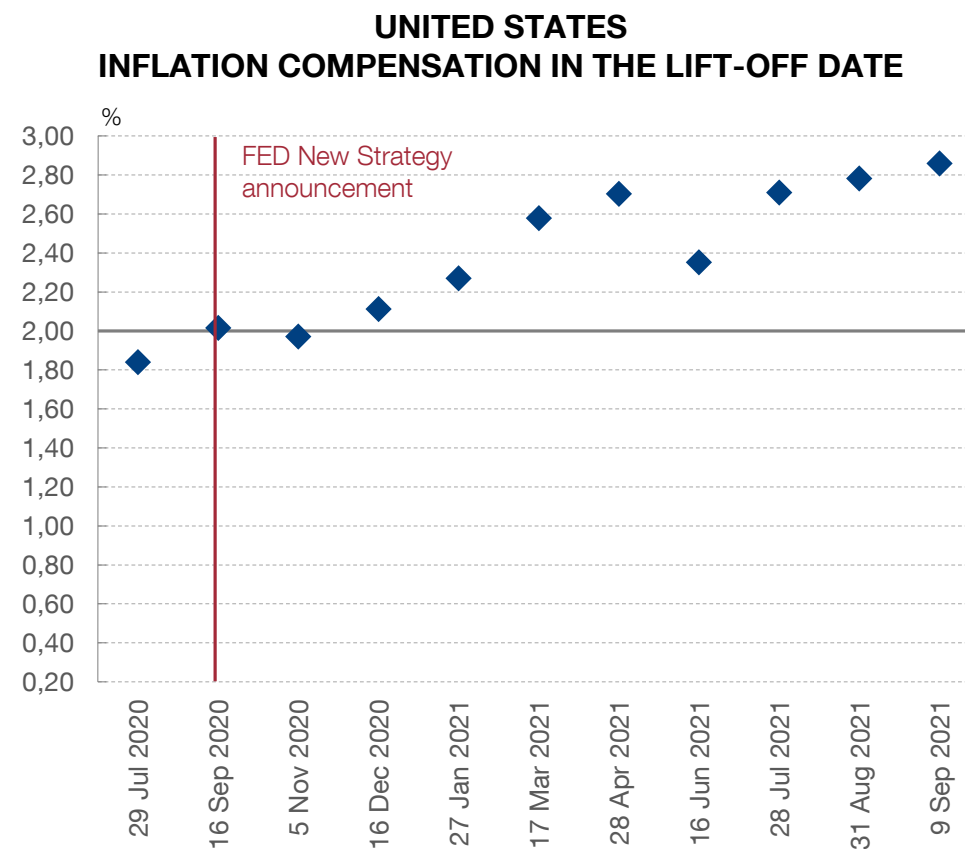
Source: Refinitiv Datastream and own calculations

EURO AREA: INFLATION AT THE EXPECTED TIME OF LIFT-OFF HAS INCREASED AND NOW STANDS CLOSE TO 1,8 %

- In the US, inflation compensation at the expected lift-off date stands well above 2%



Source: Refinitiv Datastream and own calculations

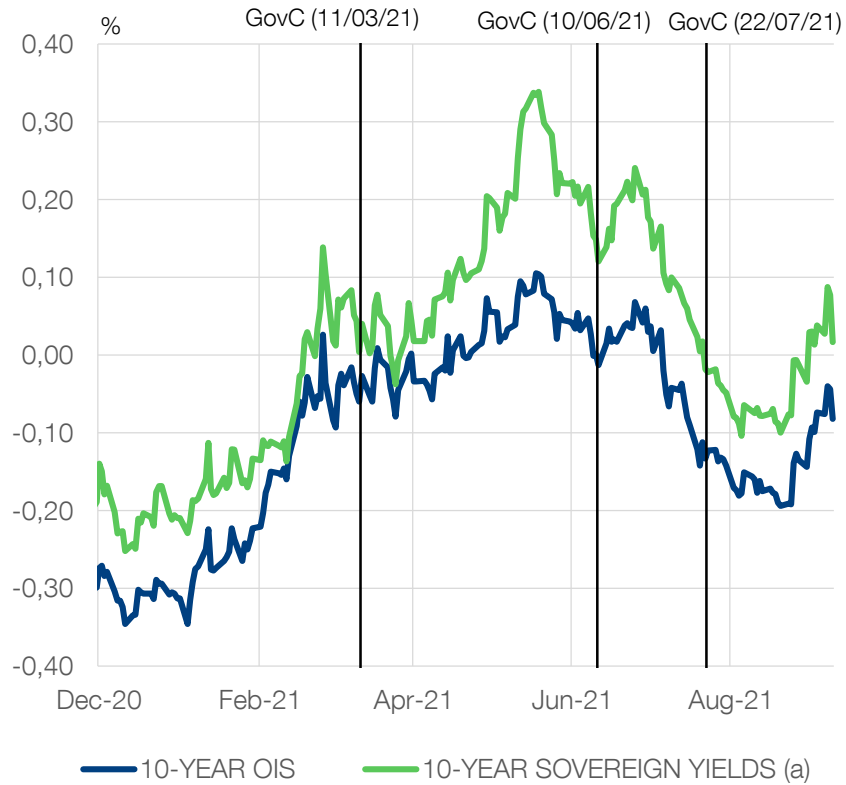


Source: Refinitiv Datastream and own calculations

SINCE DECEMBER 2020 PEPP PURCHASES ARE CONDUCTED FLEXIBLY WITH THE OBJECTIVE OF MAINTAINING FAVOURABLE FINANCING CONDITIONS

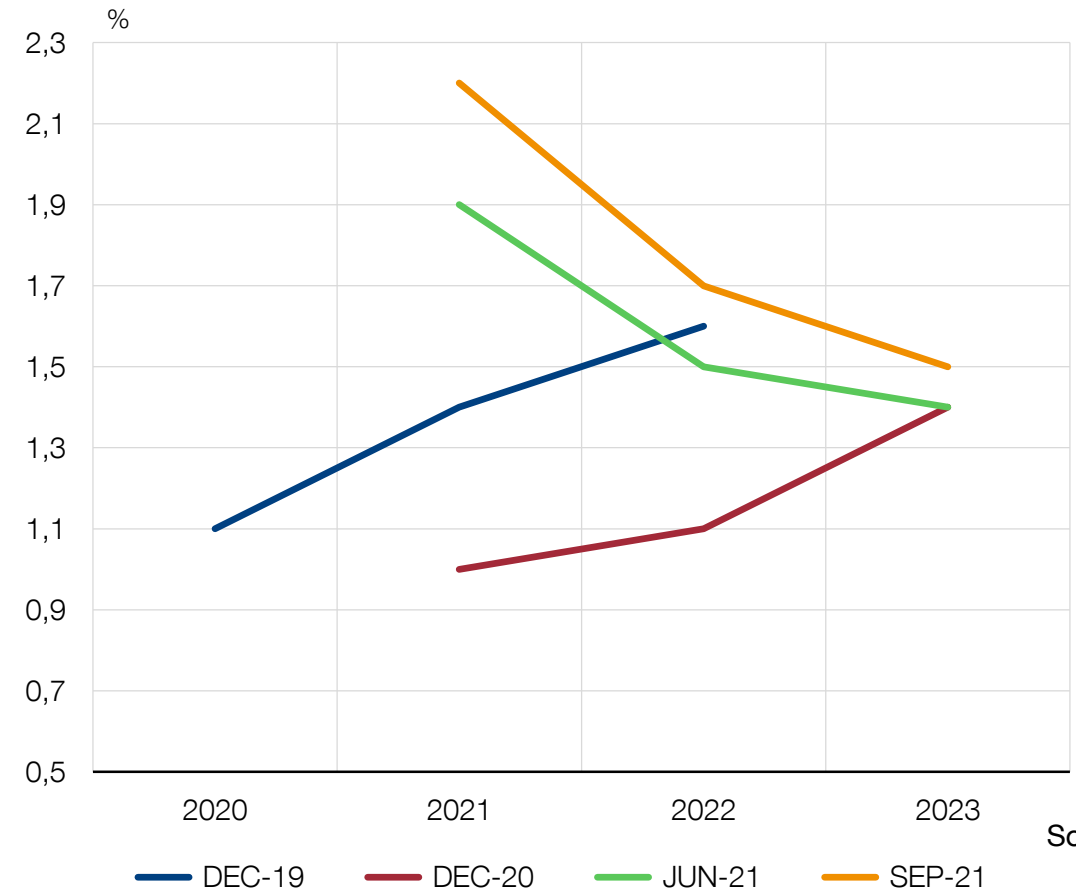
- In September, in view of easing of financing conditions (FC) since June and slight improvement in inflation outlook, the ECB has decided to moderately lower the pace of PEPP purchases
- However, recent reversal in FC is a powerful reminder that they remain volatile and highly dependent on policy support

10-YEAR OIS AND SOVEREIGN YIELDS. EMU



Source: Refinitiv Datastream and ECB. Latest observation: 09/09/2021
 (a) GDP-weighted 10y sovereign yield of Big-4 (Germany, France, Italy, Spain).

ECB/EUROSISTEM PROJECTIONS OF EURO AREA INFLATION



Source: ECB.

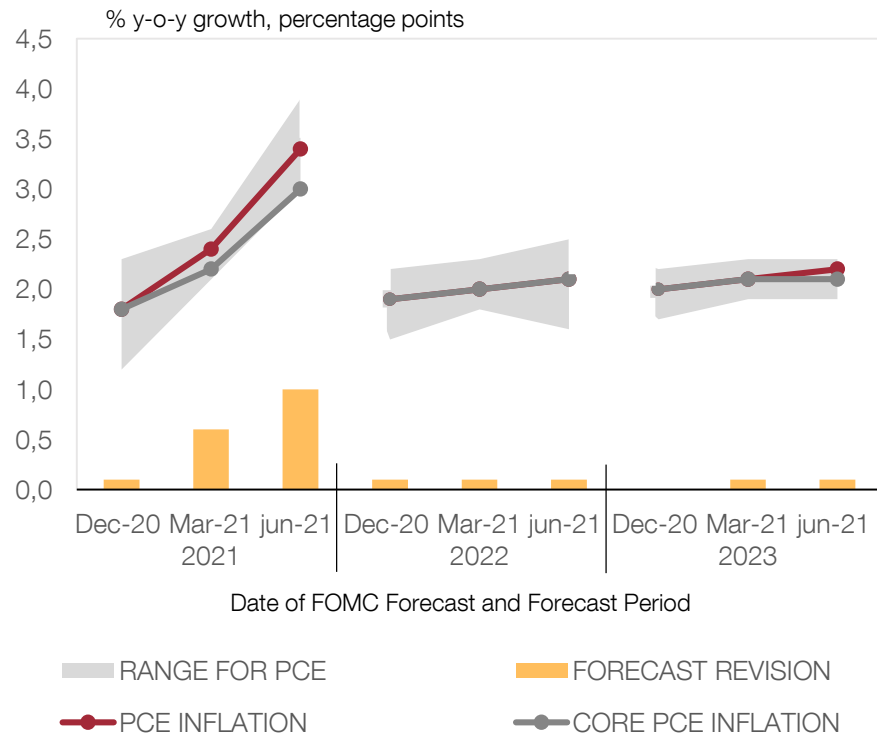
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THE FED CONSIDERS THE SPIKE IN INFLATION AS TRANSITORY AND STILL SEES A LARGE GAP TO FILL IN THE EMPLOYMENT OBJECTIVE...

- Fed argues the inflation rise is transitory and concentrates on labor market shortfalls

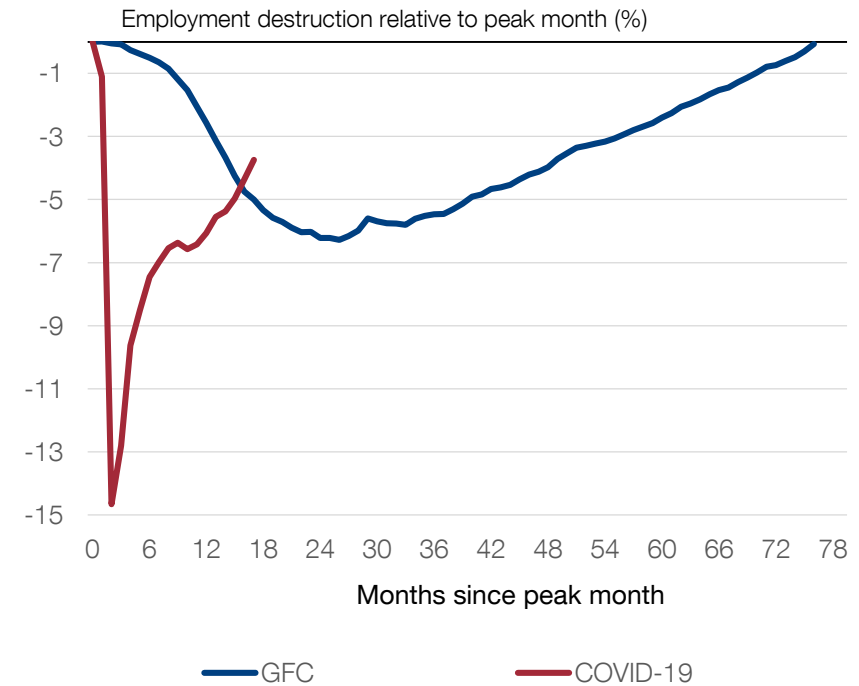
FOMC INFLATION PROJECTION (MEDIAN, RANGE AND FORECAST REVISIONS)



Source: Federal Reserve.

Notes: Range for PCE refers to the forecast range of FOMC members for PCE inflation

EMPLOYMENT DESTRUCTION COVID-19 COMPARED TO GFC

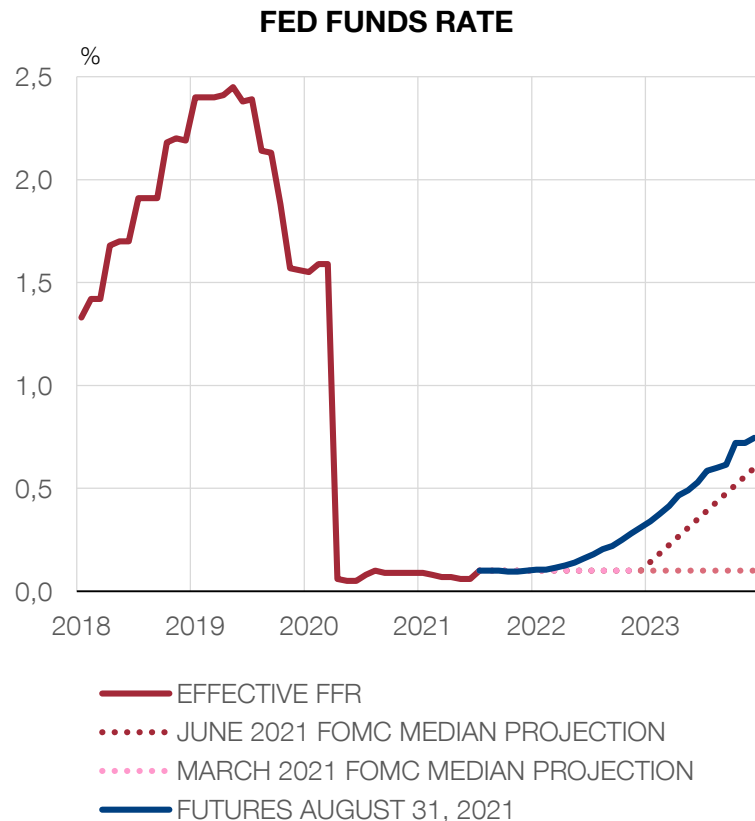


Source: BLS.

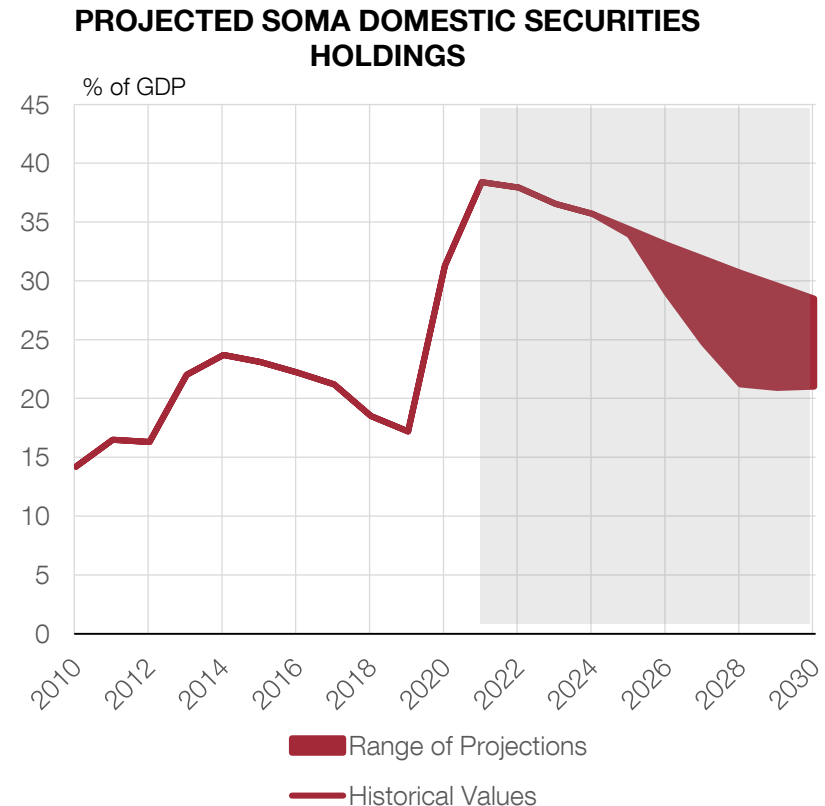
Notes: Peak month for Global Financial Crisis (GFC) and Covid-19, respectively, December 2007 and February 2020.

... SO IT WILL BE PATIENT WITH THE NORMALIZATION OF POLICY RATES ALTHOUGH IT IS PLANNING TO START THE TAPERING OF ASSET PURCHASES AT THE END OF THIS YEAR

- **Powell's Jackson Hole speech: The Federal Reserve will still be patient with the normalization of policy rates, while it is considering to start tapering asset purchases at the end of this year.**



Source: Federal Reserve, Refinitiv Datastream



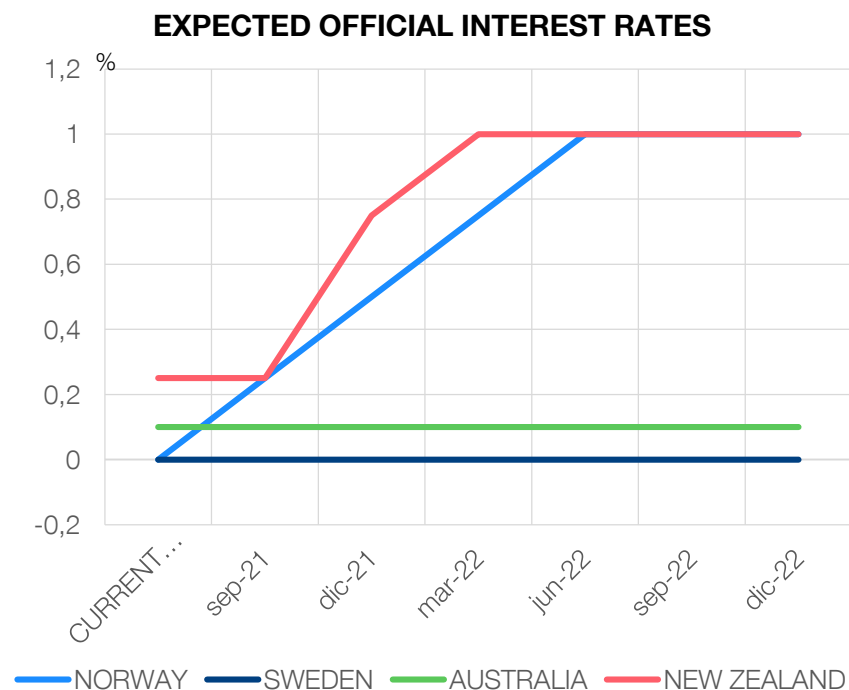
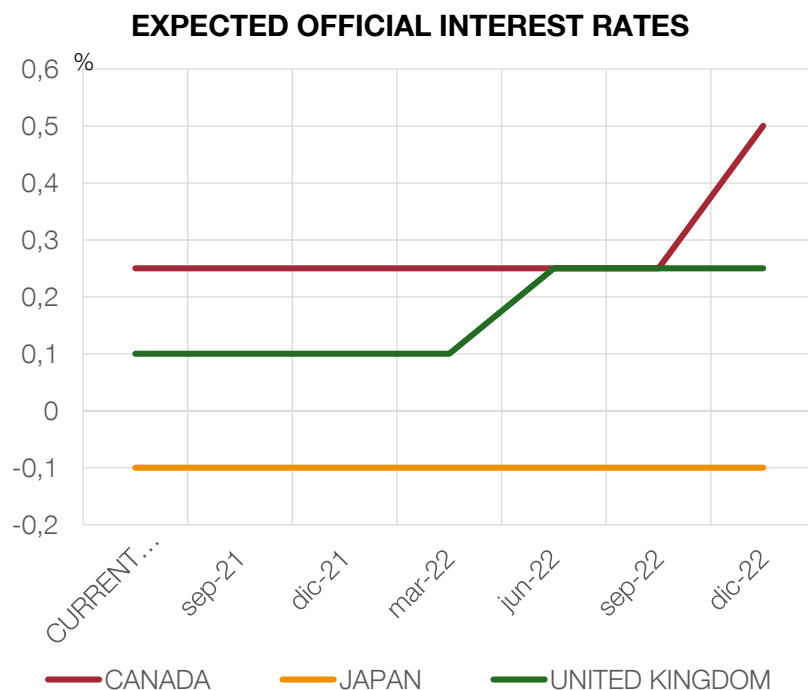
Source: FRB New York.

Notes: Figures are as of year-end. Figures for 2010-1H 2021 represent historical data; figures for 2H 2021-2030 are shaded and represent projections. The range after 2025 reflects outcomes for the portfolio between full reinvestment and full run-off. Projections for 2H 2021 – 2023 based on the Survey of Primary Dealers conducted by the New York Fed in July 2021. Assumptions for SOMA purchases, interest rates, length of the reinvestment phase, and the growth of key liabilities for 2024-30 are based on the Survey of Primary Dealers and the Survey of Market Participants conducted by the New York Fed in March 2021. Projected figures are rounded.

SUMMARY

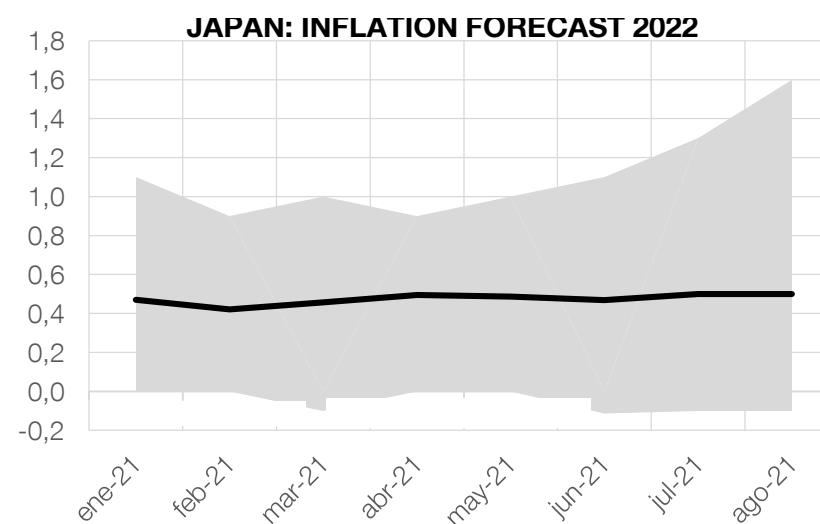
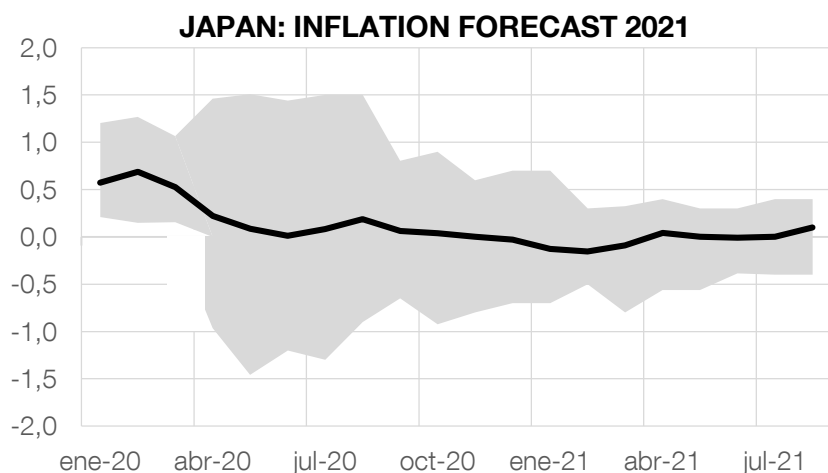
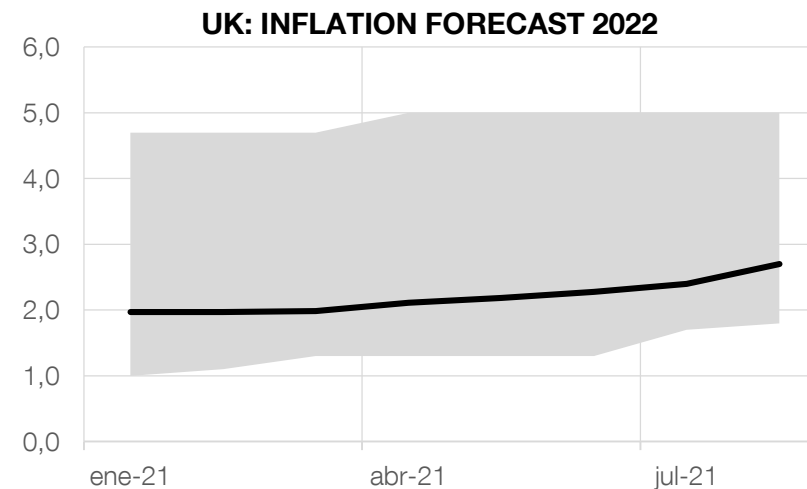
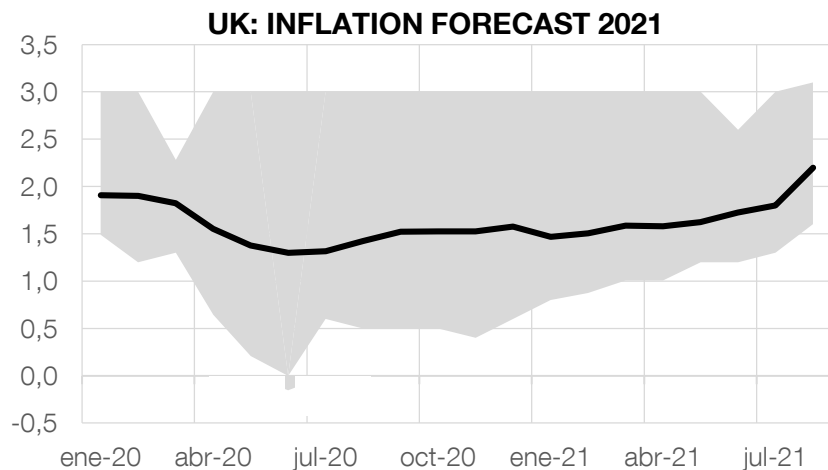
1. Uneven global recovery with a sharp (temporary) rise in inflation
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- **Some central banks are in the process of normalization of monetary policy. Norway projects a rate rise this month (Sept. '21). New Zealand postponed last month lift-off because of the new wave; Canada in end of 2022; in 2024 Australia and Sweden (Riksbank set to complete asset purchases this year)**
- **Bank of England: expected rate rise in 2022, and to cease reinvestments of maturing assets when Bank Rate has risen to 0.5%**
- **Bank of Japan still fighting with very low inflation will keep short- and long-term interest rates at their present or lower levels for the foreseeable future**



Source: JP Morgan as of August 27.

Inflation forecasts for the UK in 2021 and in 2022 have increased slightly in the last months. However, inflation forecast for Japan have barely moved since the beginning of the year

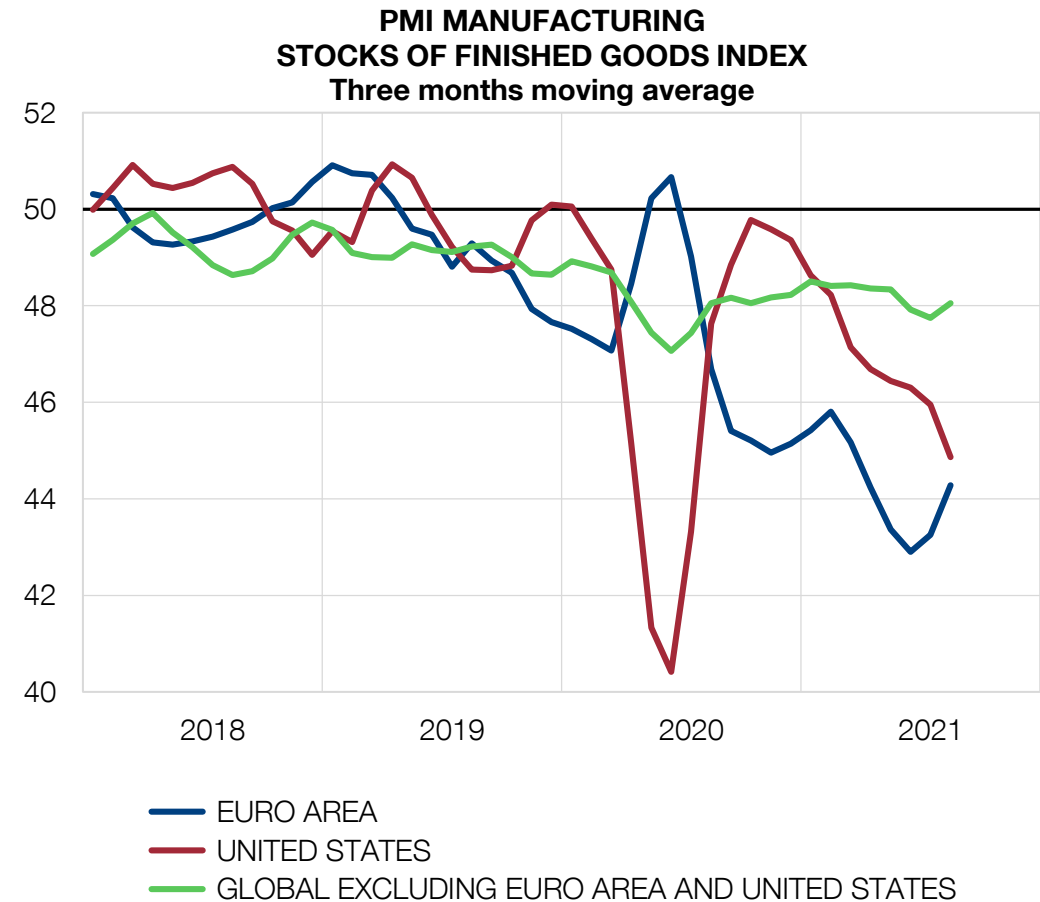
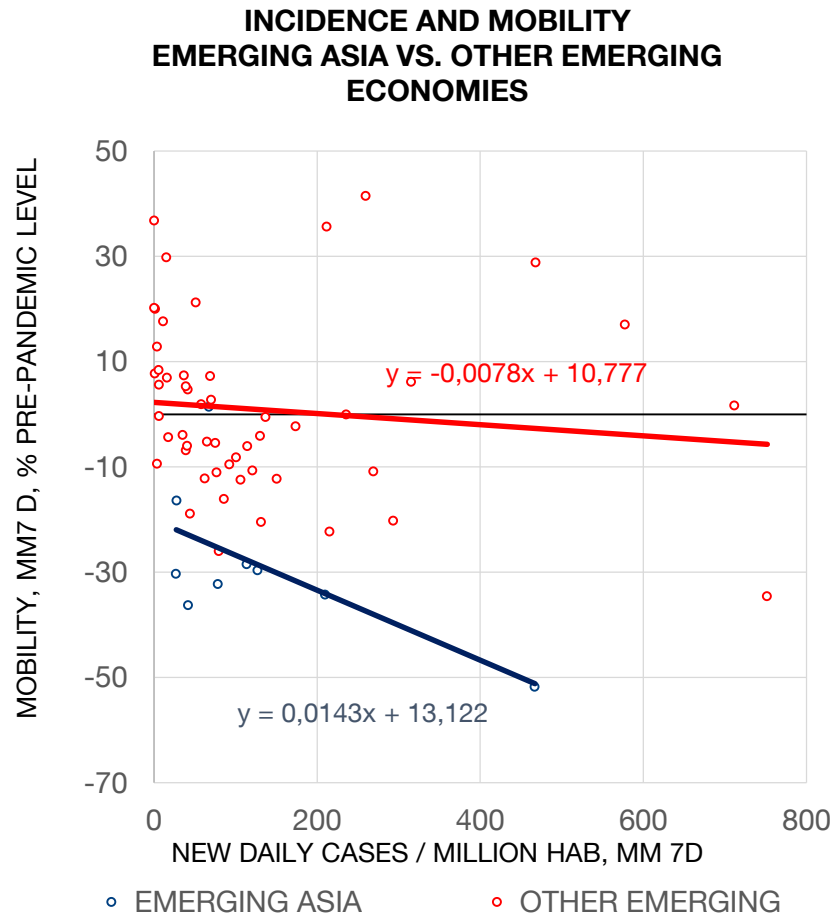


Source: Consensus Forecast

- **A central scenario of temporary inflation spikes, with some differences across AEs..... :**
 - **US:**
 - Pre-crisis period: normalization of monetary policy, with inflation outlook in line with objective
 - Near/medium term: Fast recovery and rising inflation; Fed narrative: inflation rise is transitory, focus on labor market weaknesses
 - Yet conditions could be conducive to a relatively early normalization of monetary policy
 - **Euro area:**
 - Pre-crisis: long period of subdued inflation, persistently low inflation expectations
 - Near term/medium: Deeper impact of crisis, more gradual recovery, relatively muted inflation expectations
- **...but risks of alternative scenarios should not be overlooked:**
 - Stronger and/or more persistent bottlenecks and second-round effects...
 - ...potentially leading to tighter policies in AEs and EMEs against a context of high private and public debt

RISKS TO GLOBAL ECONOMY PERSIST DUE TO THE PANDEMIC AND ITS IMPACT ON GLOBAL VALUE CHAINS

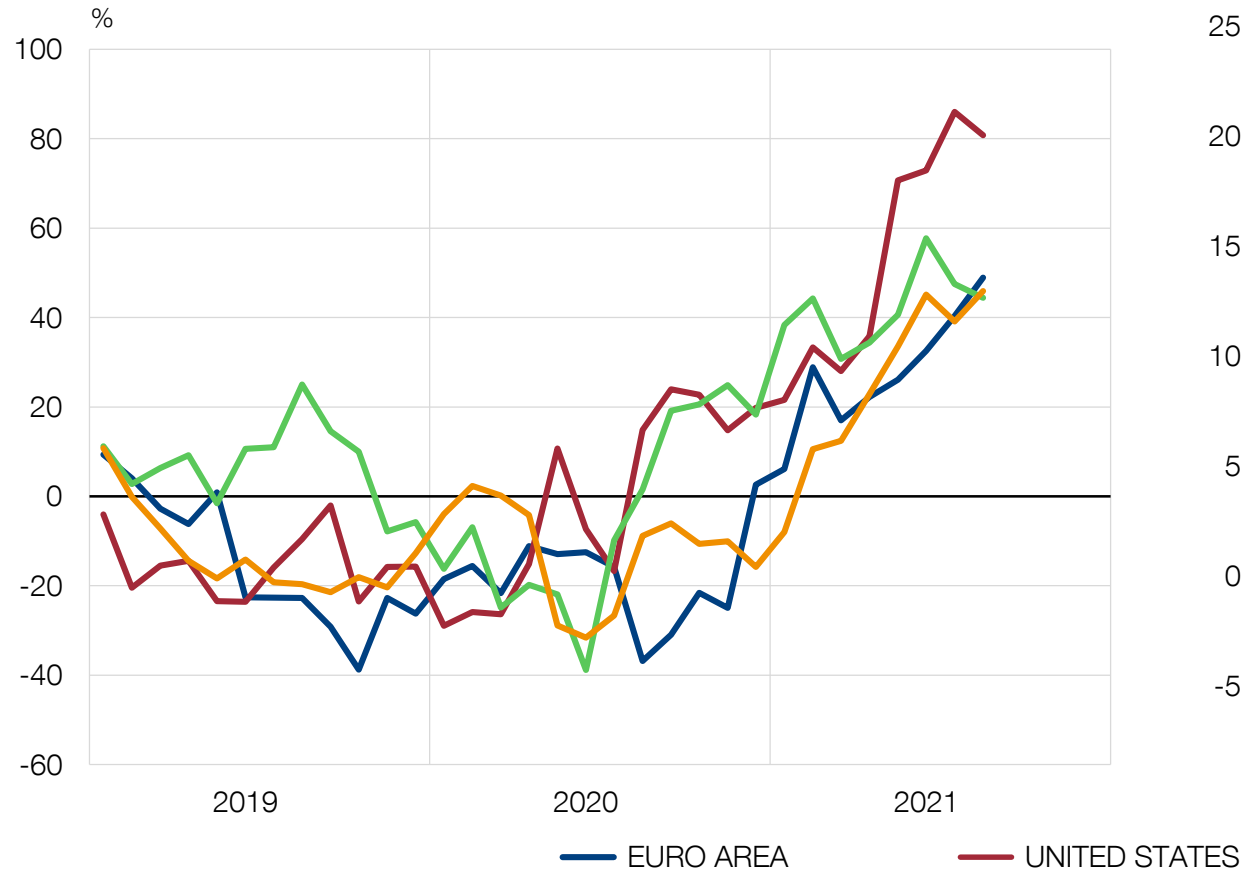
- **Pandemic risks especially affect emerging Asia, where mobility is severely restricted in response to new outbreaks due to low vaccination rates. This dynamic could exacerbate bottlenecks in global supply chains, given Asia's central role.**



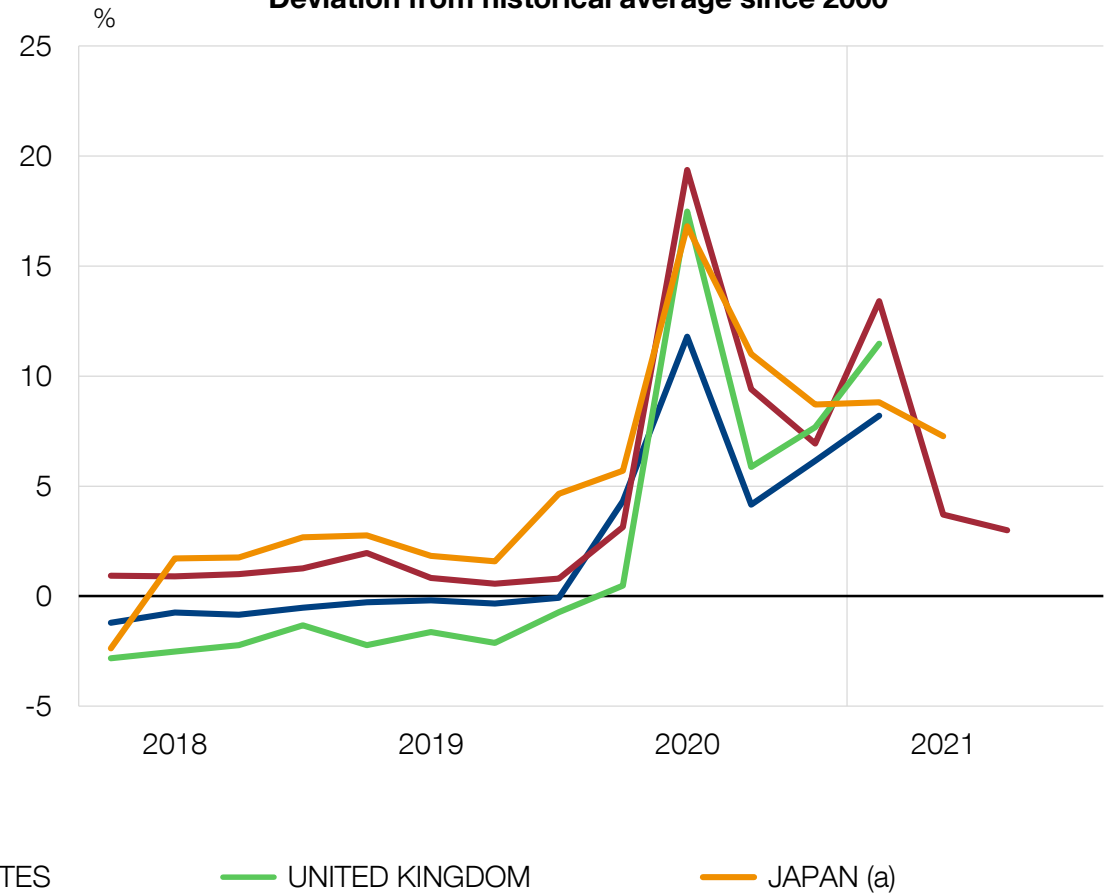
SECOND ROUND EFFECTS FROM INFLATION SURPRISES COULD BE MORE LIKELY THAN IN THE PAST AMID THE SUPPLY SIDE BOTTLENECKS AND HIGH PRIVATE SAVINGS (PENT-UP DEMAND)

- The materialization of these risks could lead to an early tightening of monetary policy in the US, which could have negative effects on the rest of the advanced economies and, especially, on emerging markets.

CITIGROUP INFLATION SURPRISE INDEX



HOUSEHOLD SAVING RATES
Deviation from historical average since 2000



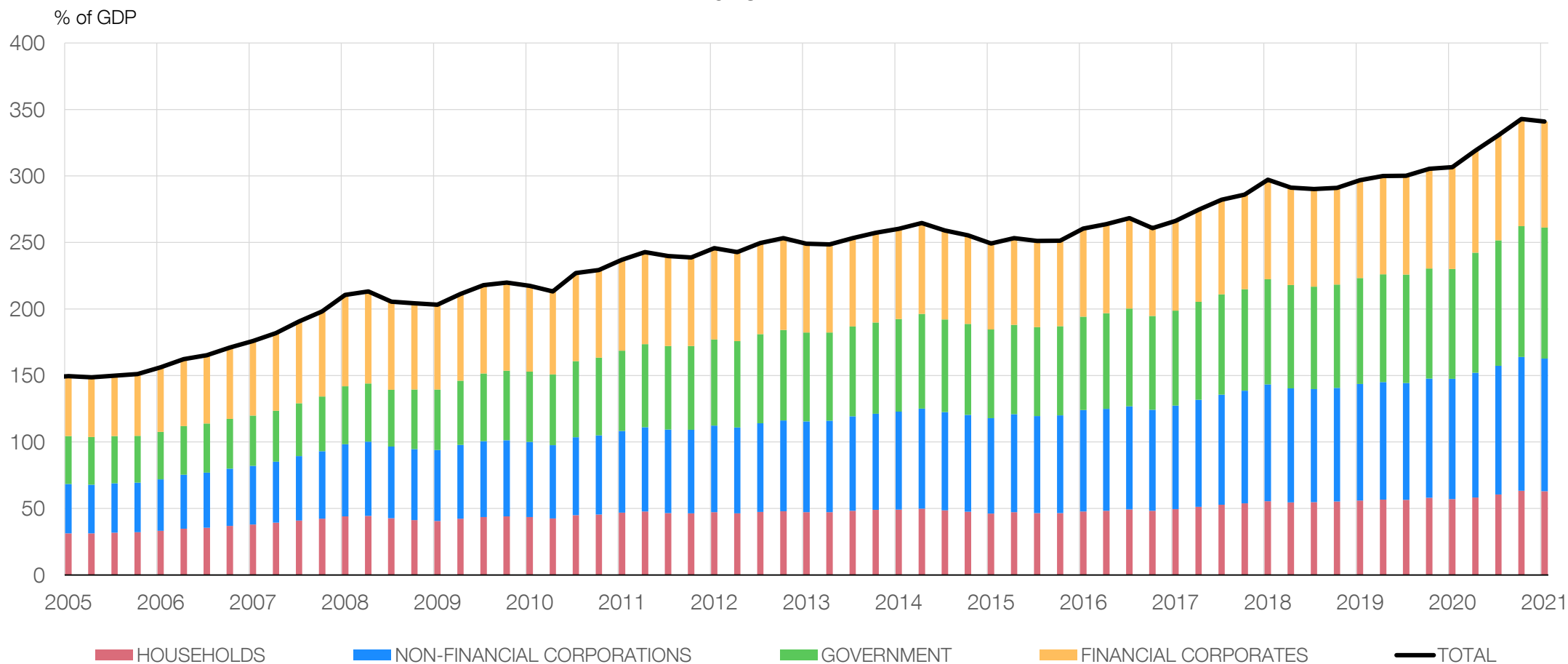
(a) Net saving rate for Japan.

Sources: Eurostat, Bureau, OECD and ONS.

ONE OF THE MAIN CONSEQUENCES OF THE PANDEMIC IS THE SURGE IN GLOBAL DEBT

- **Global debt has increased around 34 percentage points since the outbreak, especially in the Government and Non-Financial Corporations sectors.**

GLOBAL DEBT

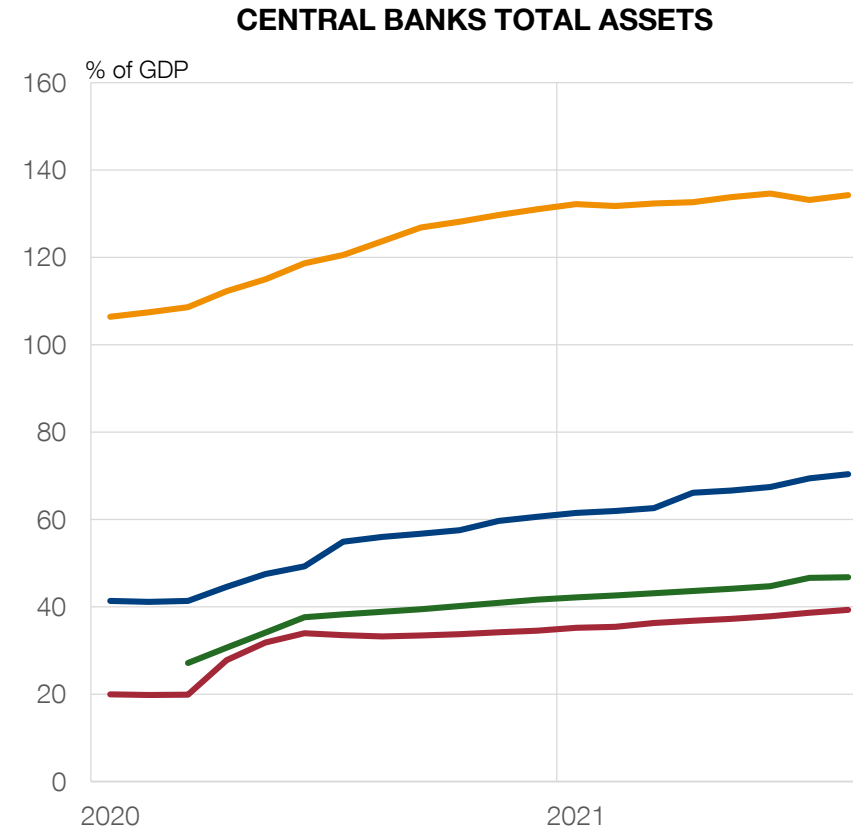
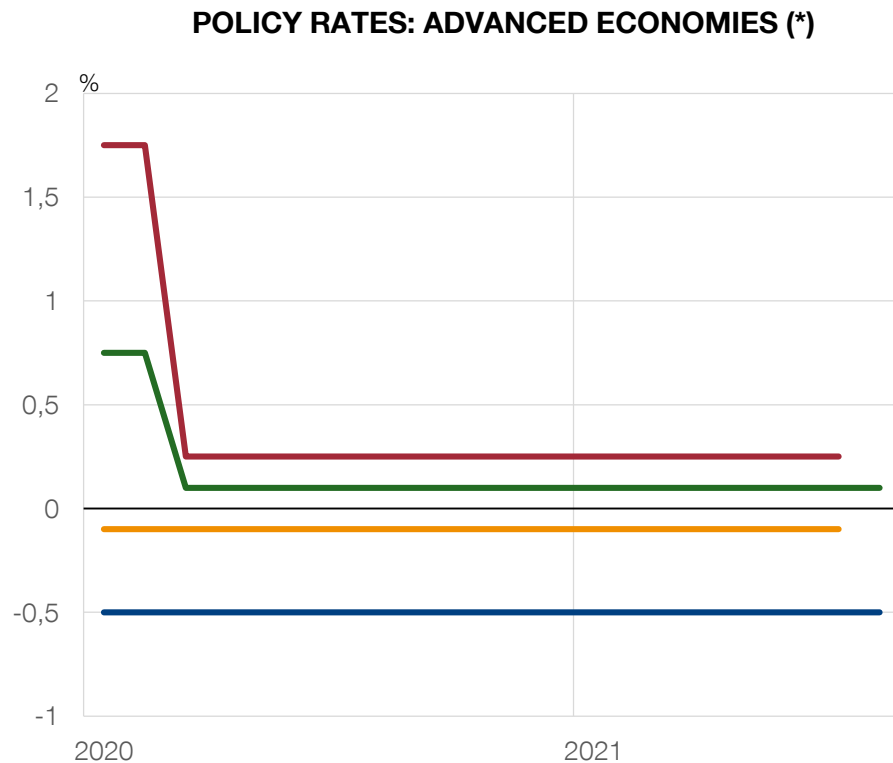


Source: Institute of International Finance Global Debt Monitor May-21.

THANK YOU FOR YOUR ATTENTION

ADVANCED ECONOMIES RESPONSE OF MONETARY POLICIES TO THE PANDEMIC

- The monetary policy response to the pandemic during 2020 was widespread across geographies and with very diverse measures, including policy rate cuts, asset purchases...

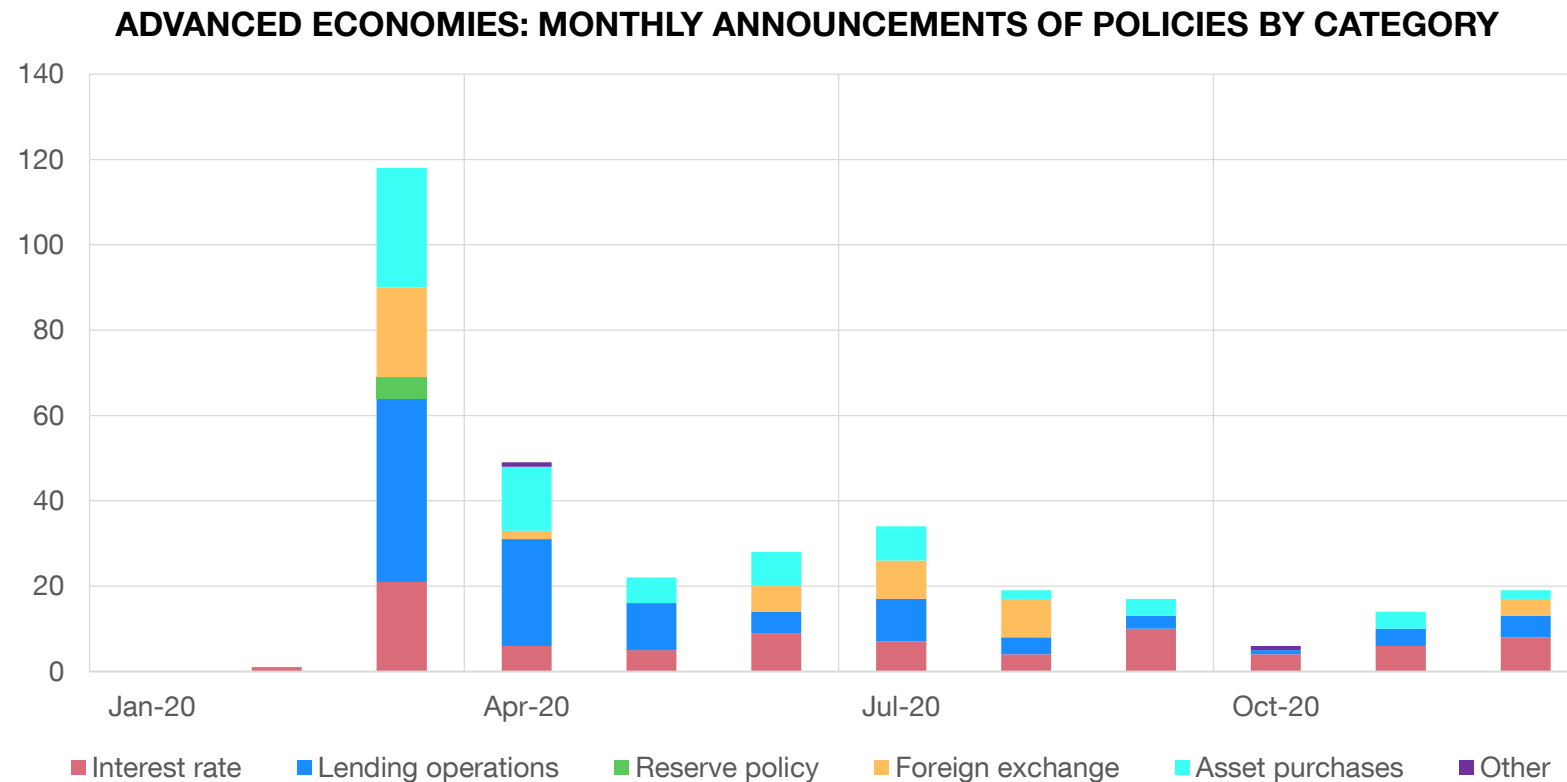


— UNITED STATES — EMU (*) — UNITED KINGDOM — JAPAN

(*) For EMU, Deposit facility rate.

Source: Refinitiv and IMF (2021) "Asset Purchases And Direct Financing: Some Guiding Principles For EMDEs During Covid-19 And Beyond". Data until August 2020..

- ...and other unconventional monetary and financial measures



Sources: BIS WP #934