



**BANKA  
SLOVENIJE**

EVROSISTEM

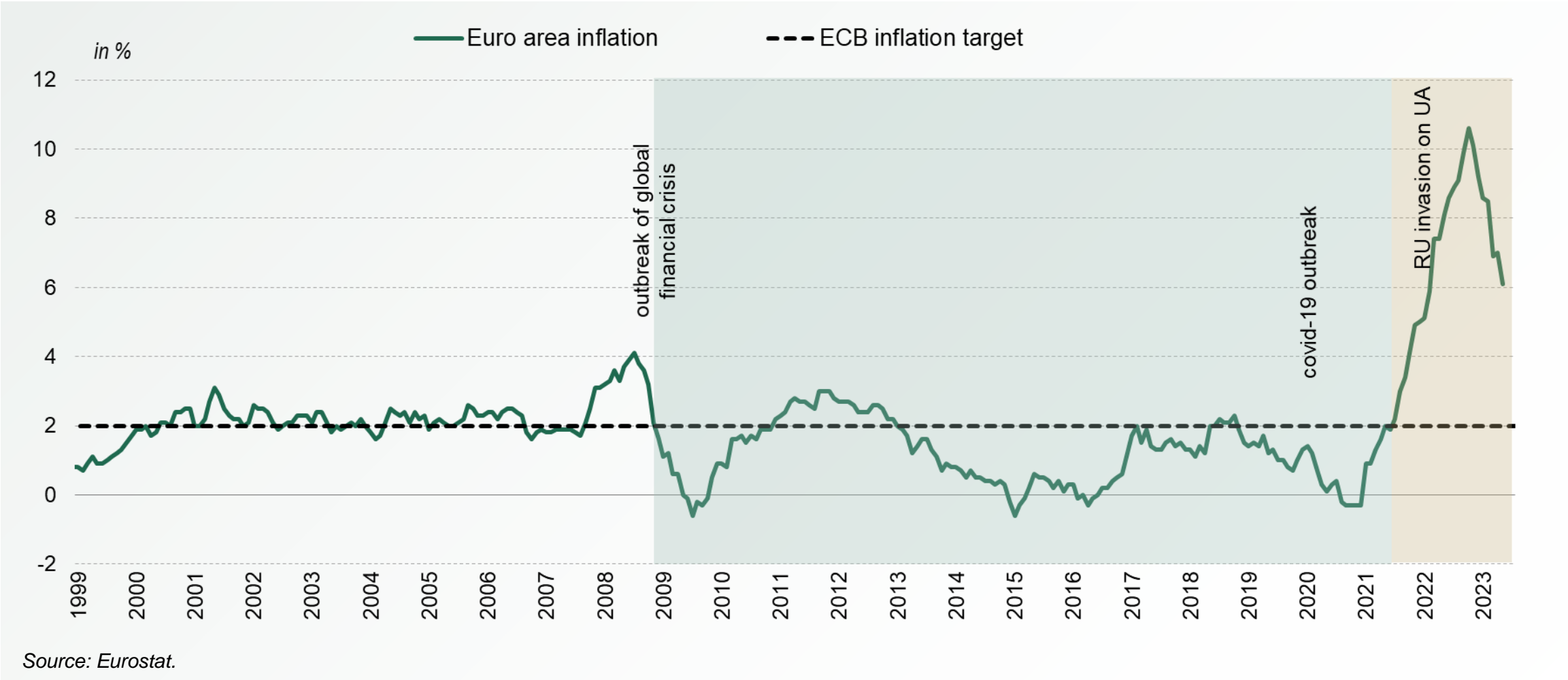
# Four last milestones in addressing high inflation

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Frankfurt

July 14, 2023

# Inflation developments in the past 25 years



# Unconventional monetary policy toolkit

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*July 2012 – July 2022*

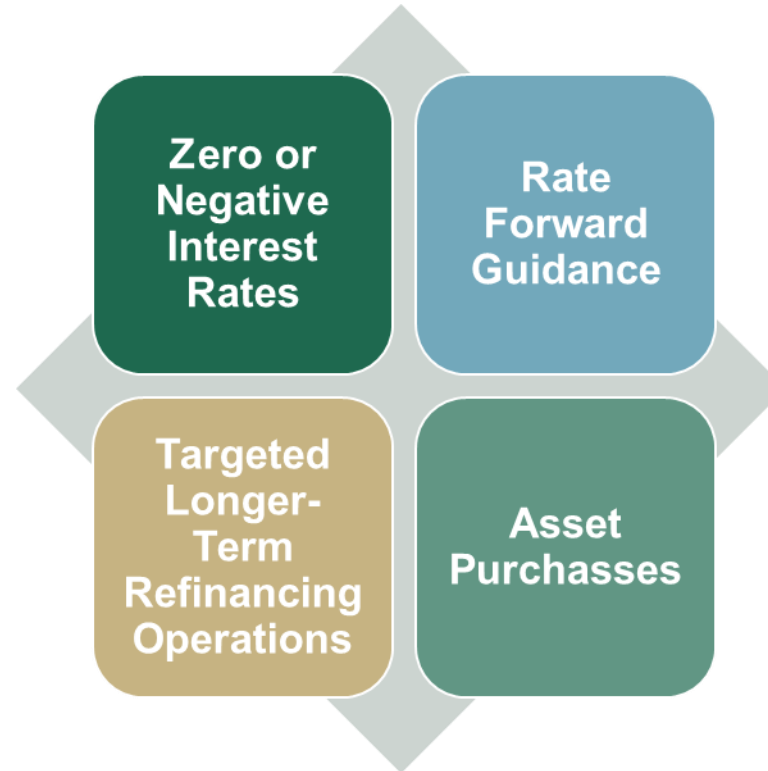
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Since June 2014 extension of the interest-rate space into the negative territory

*Sept. 2019 – Dec. 2021*

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TLTRO III: Lending money at very low interest rates to banks for longer periods of time to stimulate bank lending (eligibility for the "bonus rate" conditional on increased lending to the real economy)



*July 2013 – July 2022*

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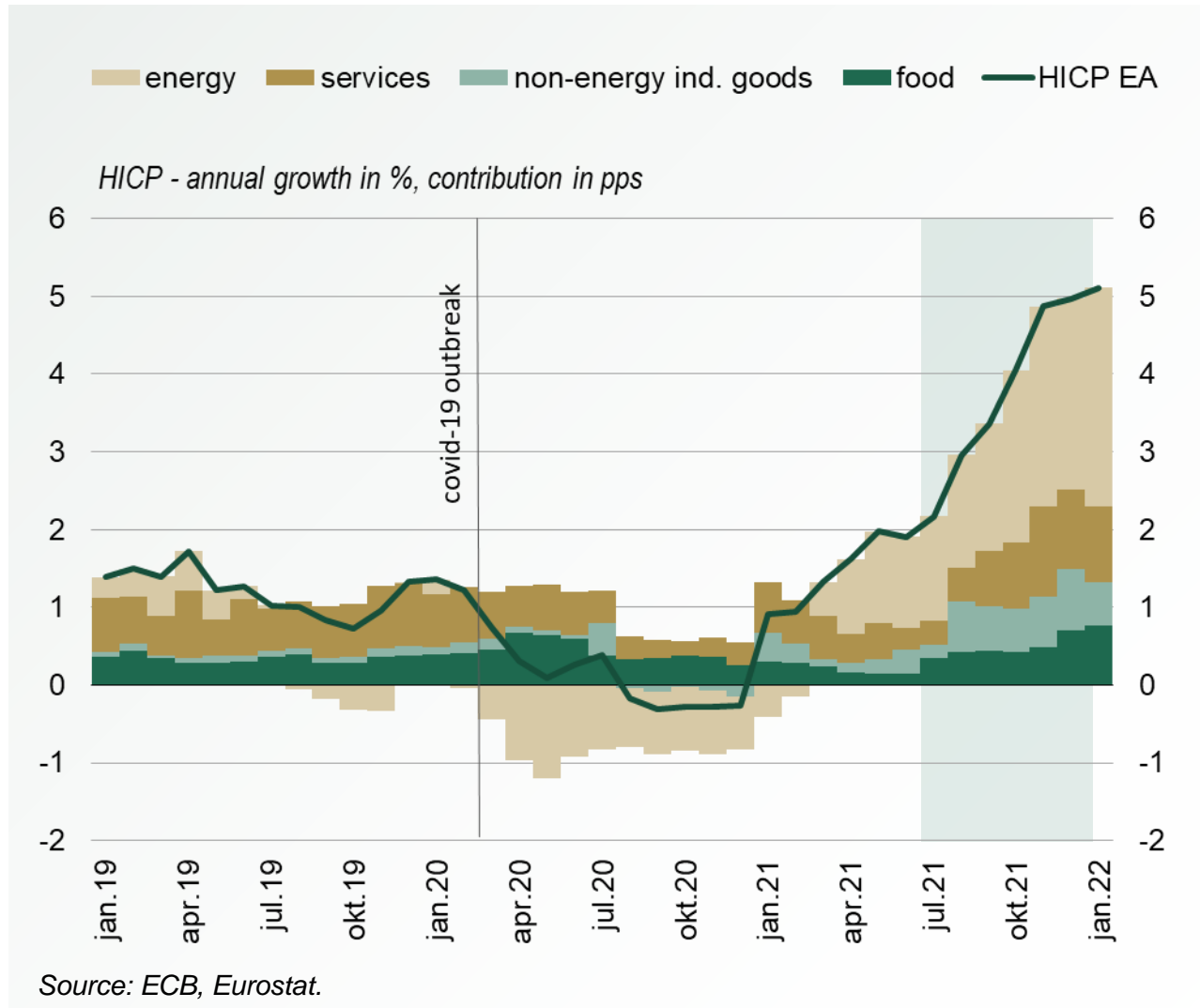
Signalling the future path of interest rates

*January 2015–July 2022*

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Net purchases of government bonds, corporate bonds, ABS and covered bonds (APP, PEPP)

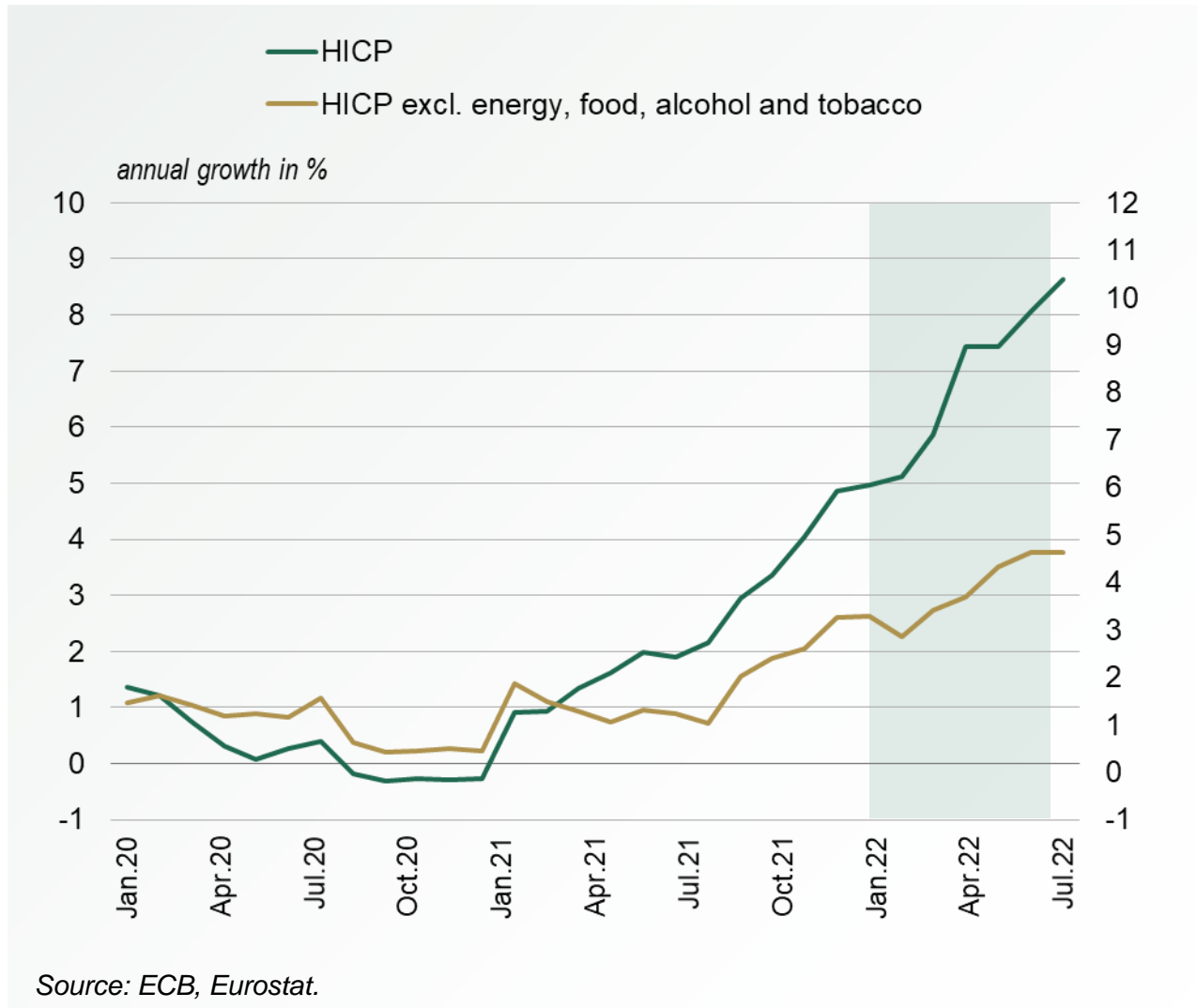
# Milestone 1: Looking through supply-driven price shocks (H2 2021)



## Main considerations

- recovery / surge in **energy prices** – a key driver of rising inflation
- **supply bottlenecks** to gradually ease with rebalancing of demand and supply
- **uncertainty** about the course of the pandemic
- benign medium-term inflation projections

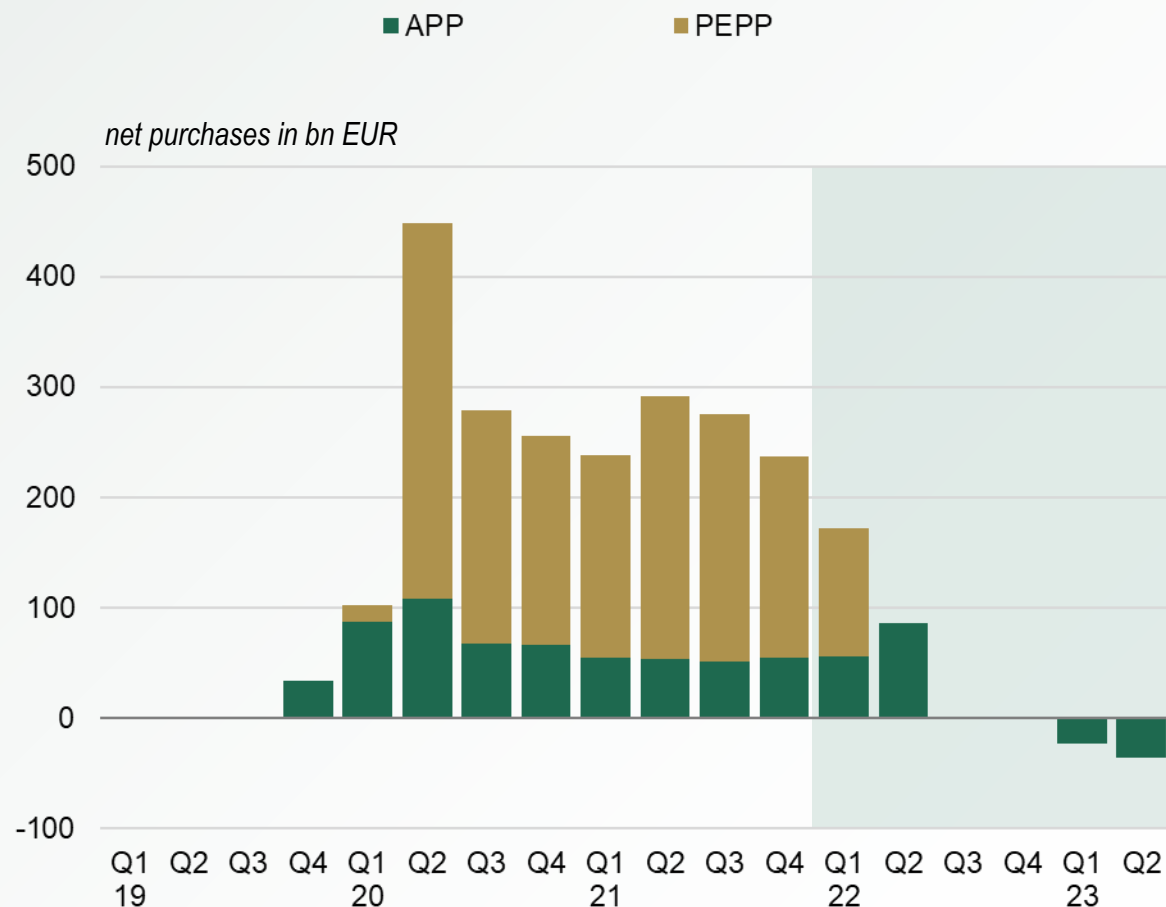
# Inflation increasing further in H1 2022



## Considerations:

- fast progress in economic recovery
- additional shock (RU aggression)
- realization of second-round effects of higher energy and other commodity prices

# Milestone 2: Gradual withdrawal of net asset purchases (H1 2022)



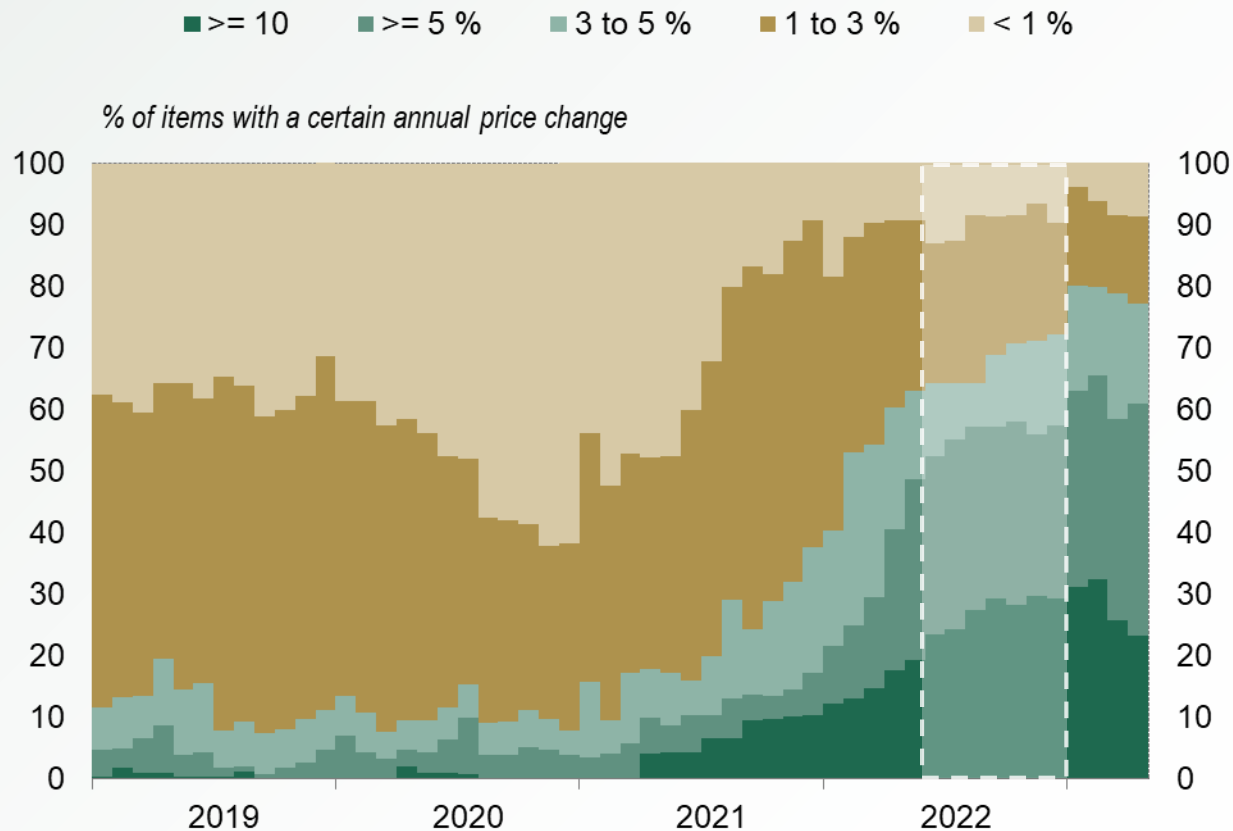
Source: Bloomberg data, series smoothed by Banka Slovenije.

- Step-by-step **reduction in net asset purchases** from Dec. 2021
- End of **PEPP** net purchases in March 2022
- End of **APP** net purchases as of 1 July 2022
- Only **partial APP reinvestment** from the beginning of March 2023
- **End of APP reinvestment** at the end of June 2023



# Acceleration and broadening of inflation in H2 2022

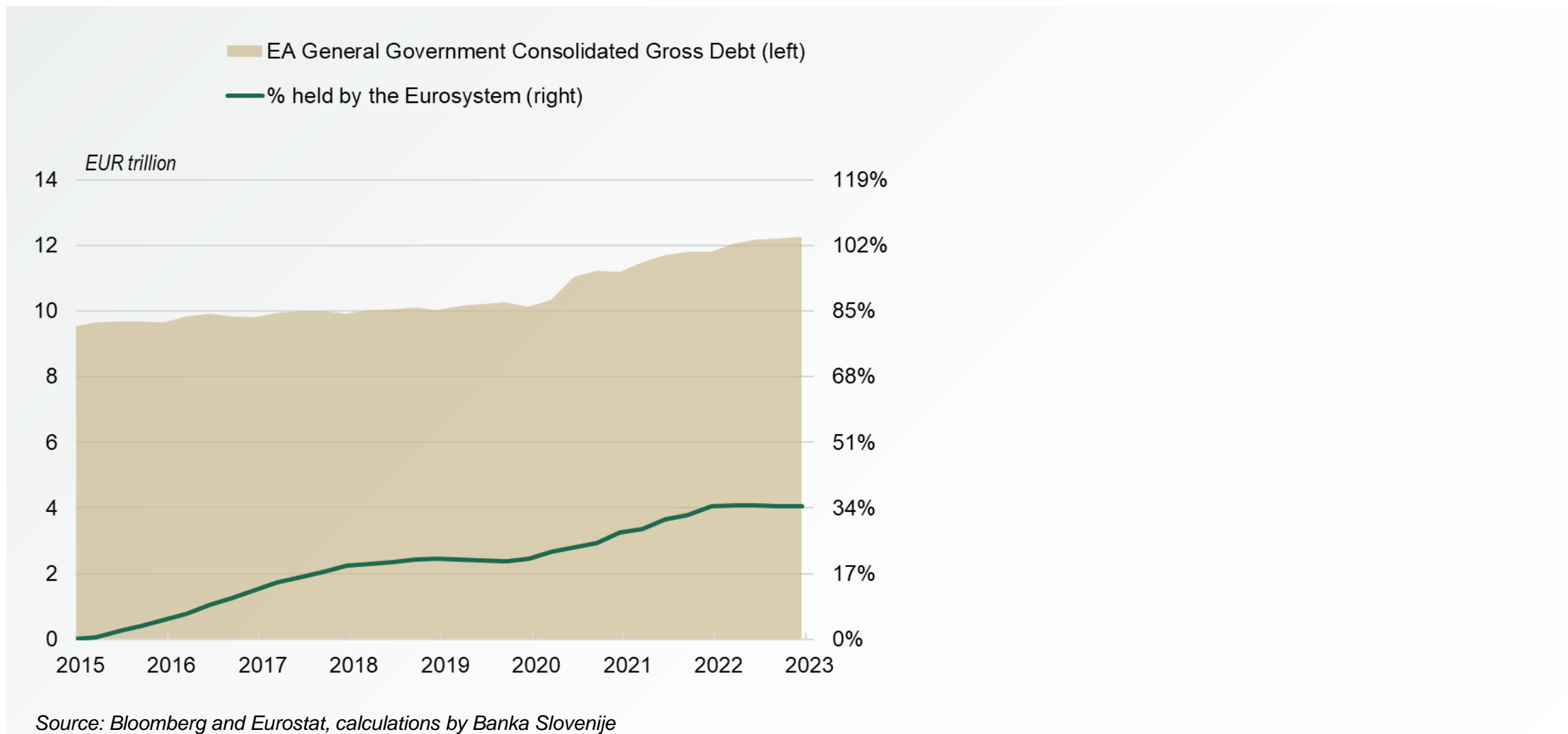
## Inflation distribution among HICP items, euro area



Source: Eurostat, Banka Slovenije calculations

- The share of items in the HICP basket with price increase by  $\geq 5\%$  annually
  - below 20% in Autumn 2021
  - around 50% in mid 2022
  - above 60% in early 2023

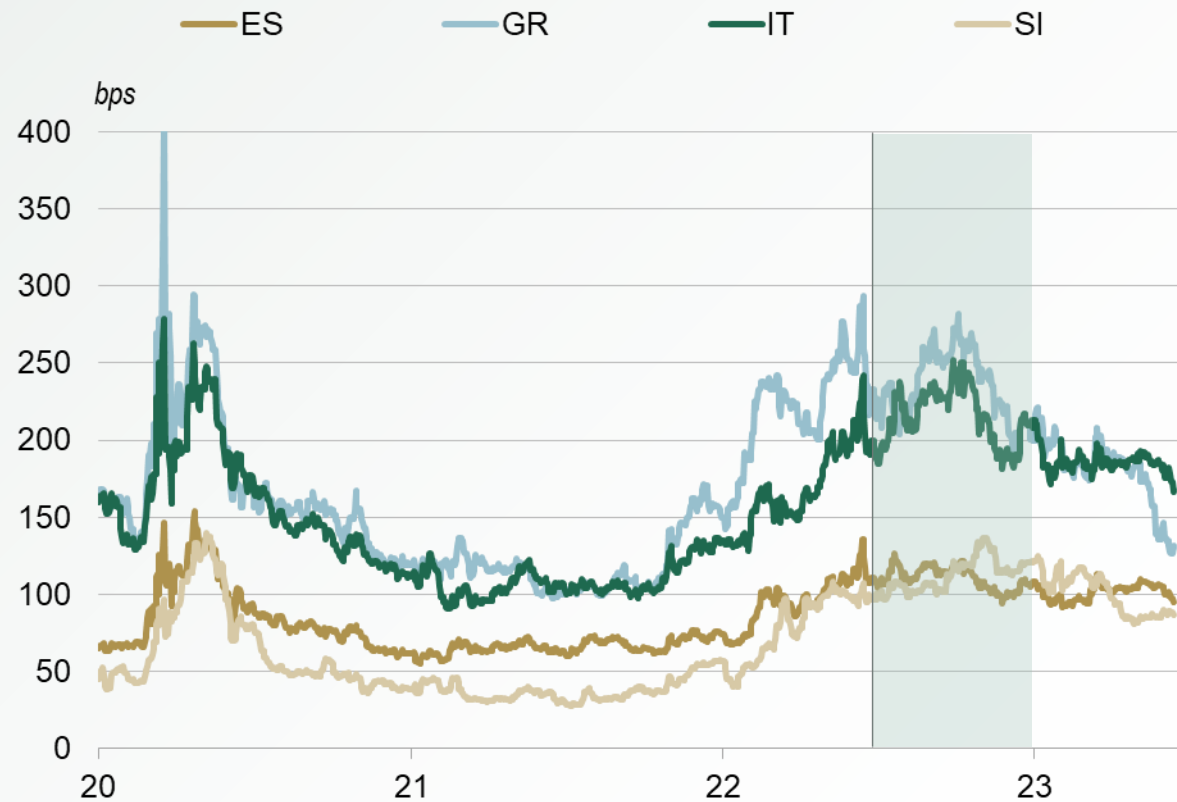
# Eurosystem's increased footprint in financial markets





# Milestone 3: Supporting the effective transmission of MP... (H2 2022)

10-year government bond yield spread against Germany



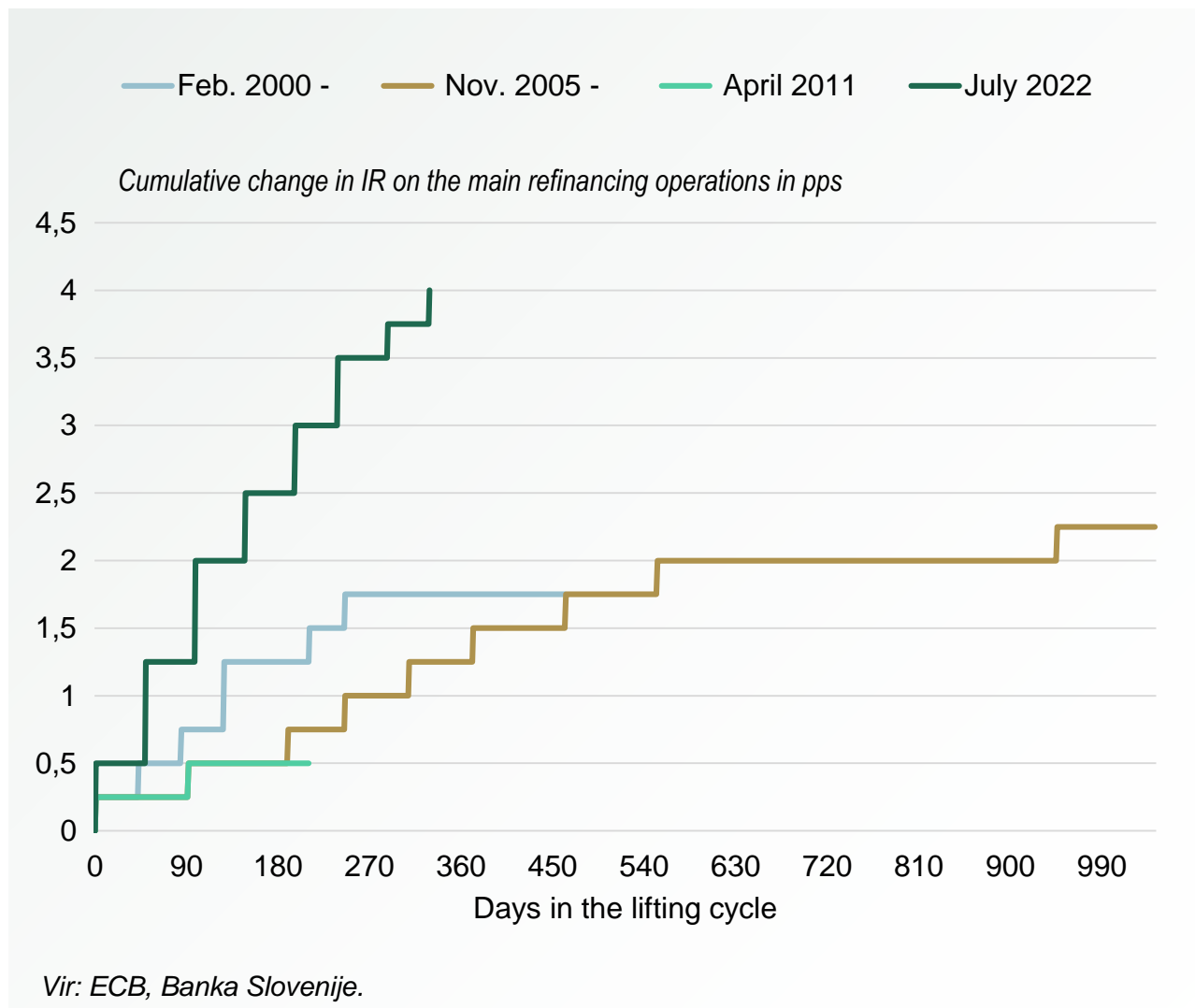
Vir: Bloomberg.

- July 2022: introduction of the **Transmission Protection Instrument (TPI)** to address unwarranted, disorderly market dynamics (market fragmentation).  
*Country eligibility criteria:* compliance with the EU fiscal framework.

Also available:

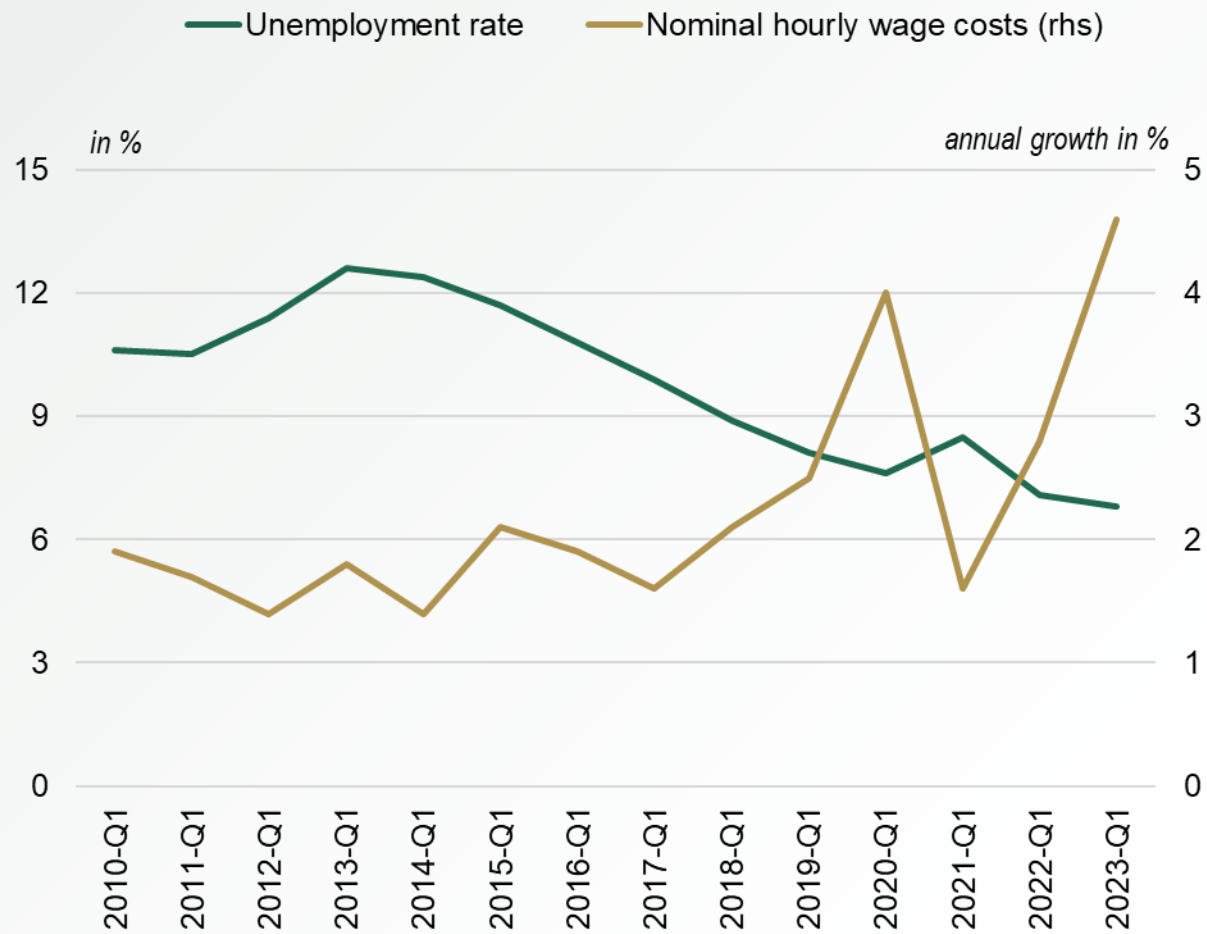
- **PEPP reinvestments** (until 2024)
- **Outright Monetary Transactions (OMT, 2012)**

# Milestone 3: ... and start of the rate hike cycle (H2 2022)



- July 2022: **by 50 bps** (1st increase since 2011, *exit from negative IR territory*).
- Sept. and Oct. 2022: **by 75 bps**
- Dec. 2022, Feb & March 2023: **by 50 bps**
- May & June 2023: **by 25 bps**

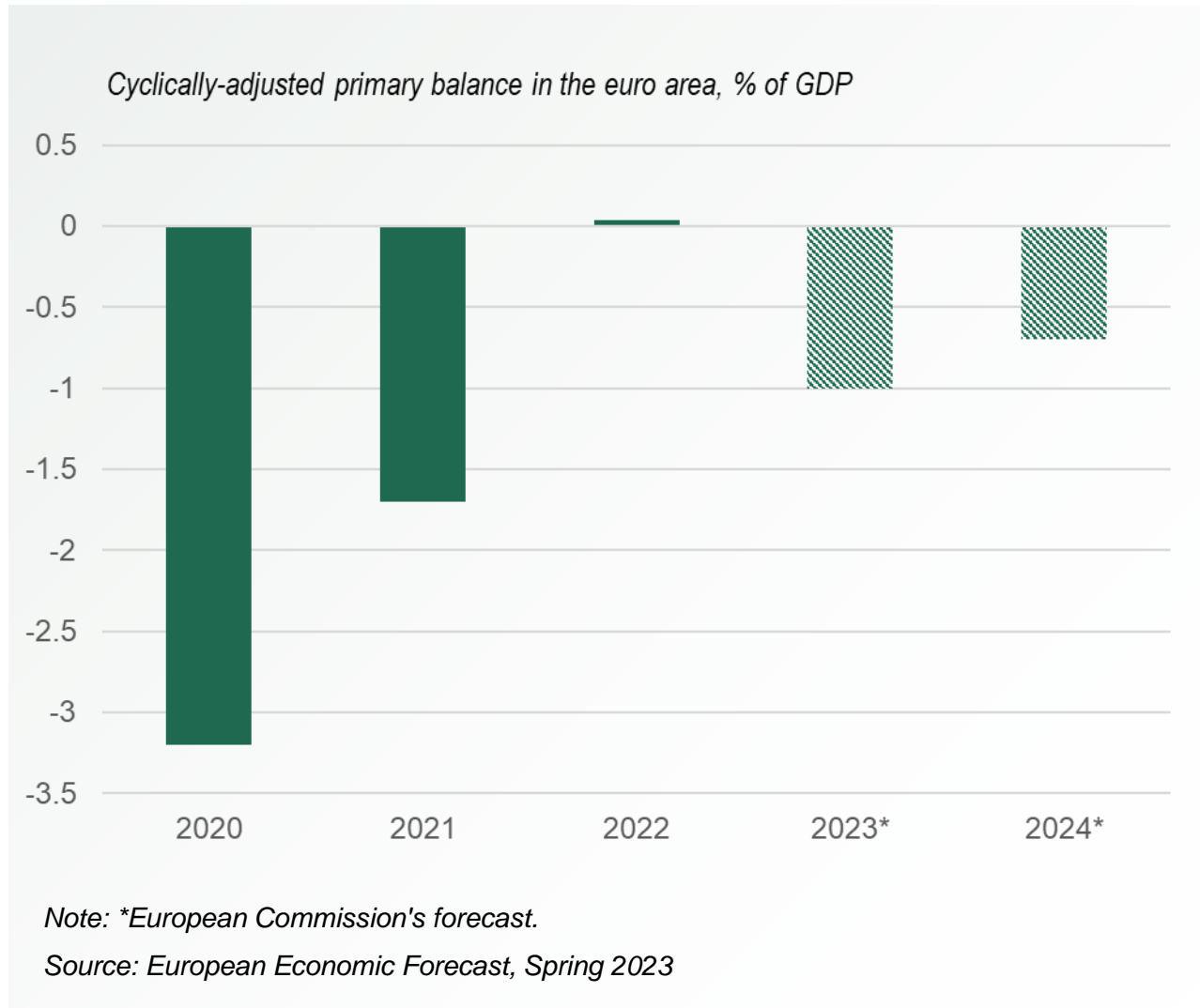
# Shift to domestic price pressures: labour market



Source: Eurostat.

- high degree of tightness
- increased wage pressures

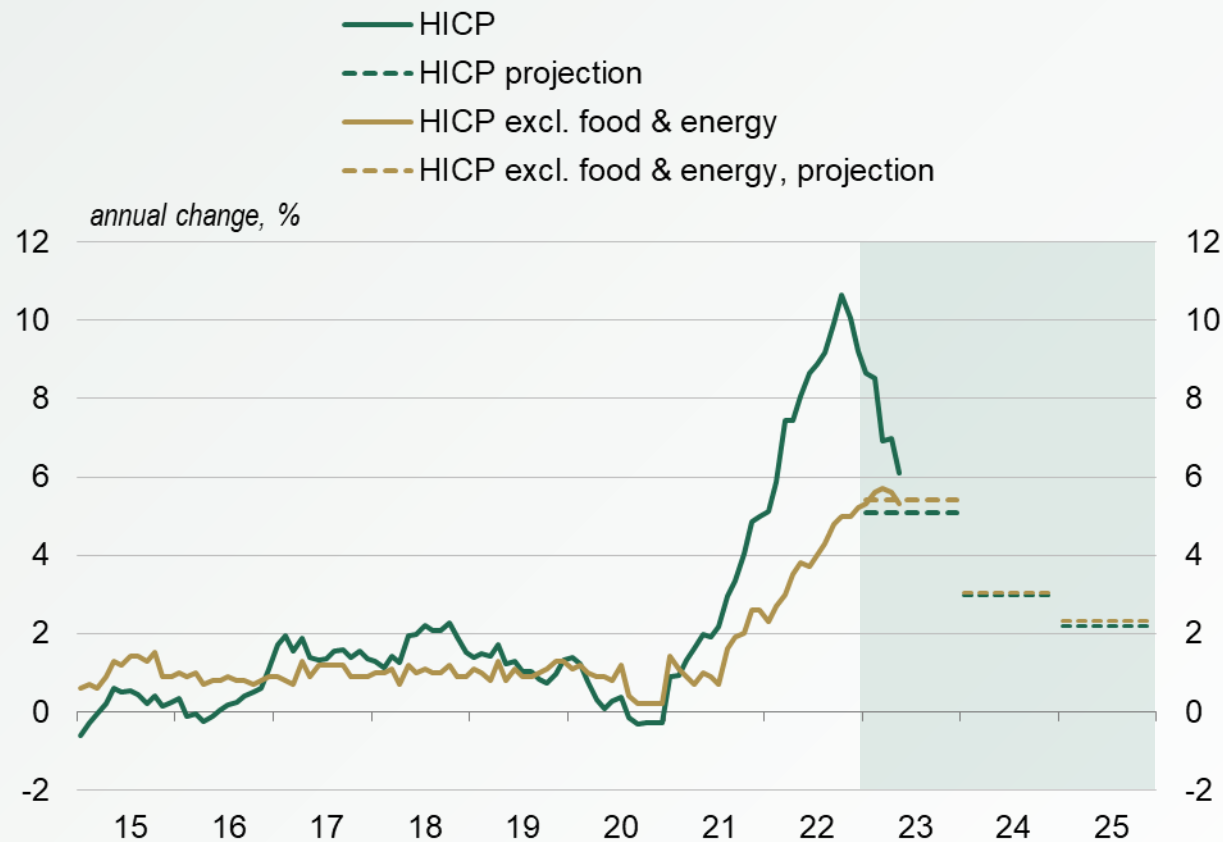
# Shift to domestic price pressures: fiscal policy



...missing the opportunity to help lowering inflation

# Core inflation remains elevated

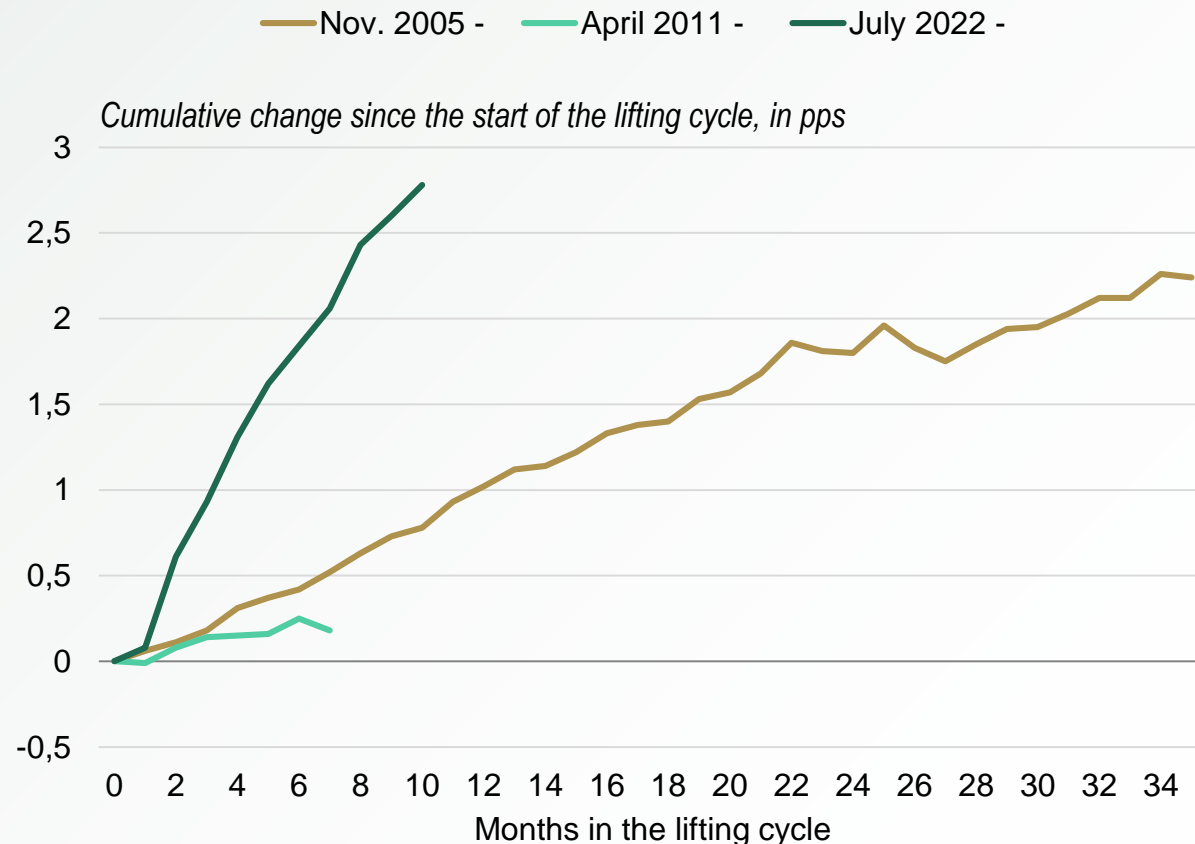
## ECB projections of headline and core inflation



Source: Eurostat and ECB projections (June 2023 BMPE).

# Milestone 4: Complemented policy reaction function (H1 2023)

## Average interest rate for new loans to corporations in the euro area

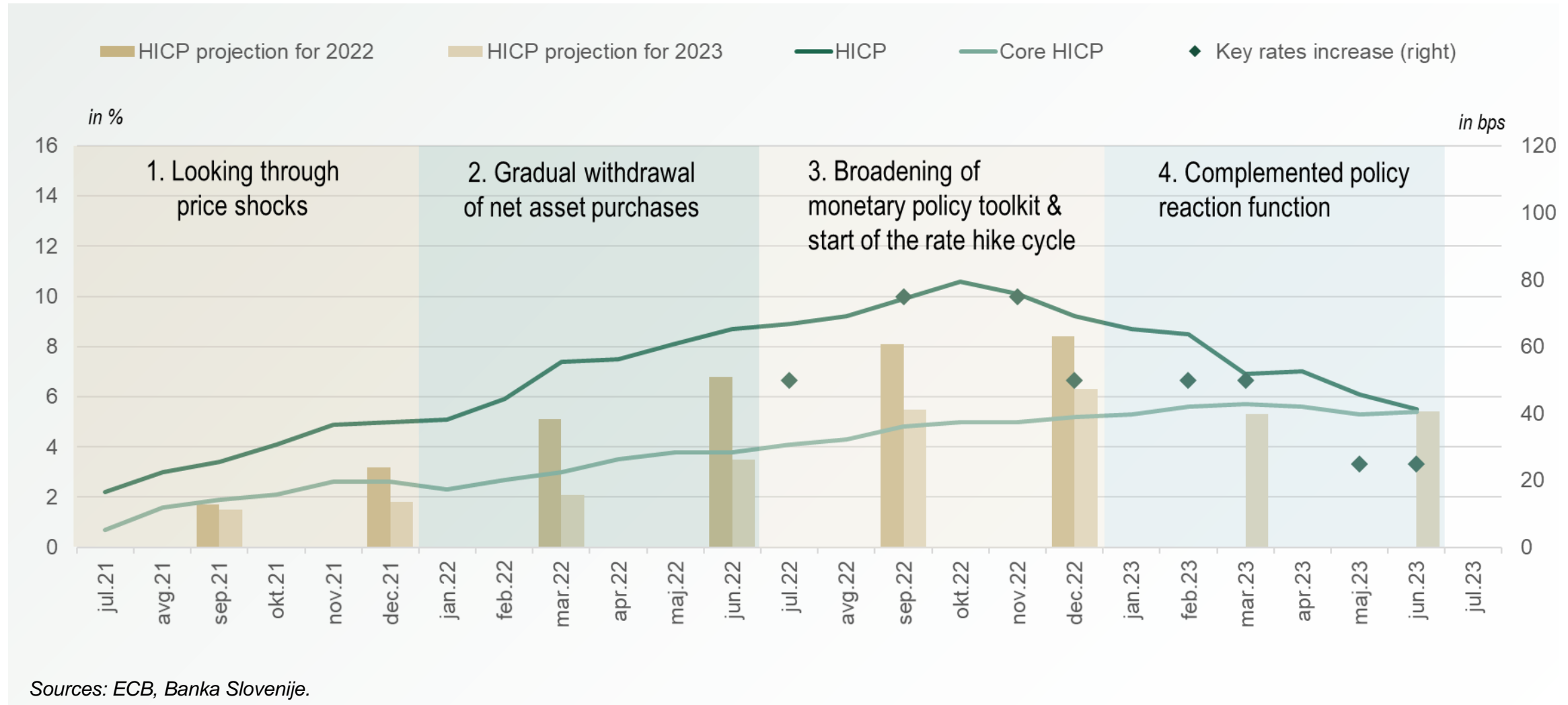


Source: ECB.

Adjusted reaction function taking stock of:

1. the implications of the incoming economic and financial data for the inflation outlook,
2. the dynamics of underlying inflation,
3. the strength of monetary policy transmission.

# Milestones in a nutshell





# Key monetary policy dilemma in H2 2023

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- **The profile of further policy rate increases**
  - increasing rates more gradually and then staying at the level reached for longer
  - raising interest rates more quickly and then lowering them earlier if necessary
- **Weighing up the pros and cons**
  - impact on economic activity and financial markets, incl. the transmission of MP measures
  - the cost of restarting the tightening cycle (inflation expectations and credibility of the ECB)

# Thank you for your attention

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