Inflation outlook for the United States and the Euro area

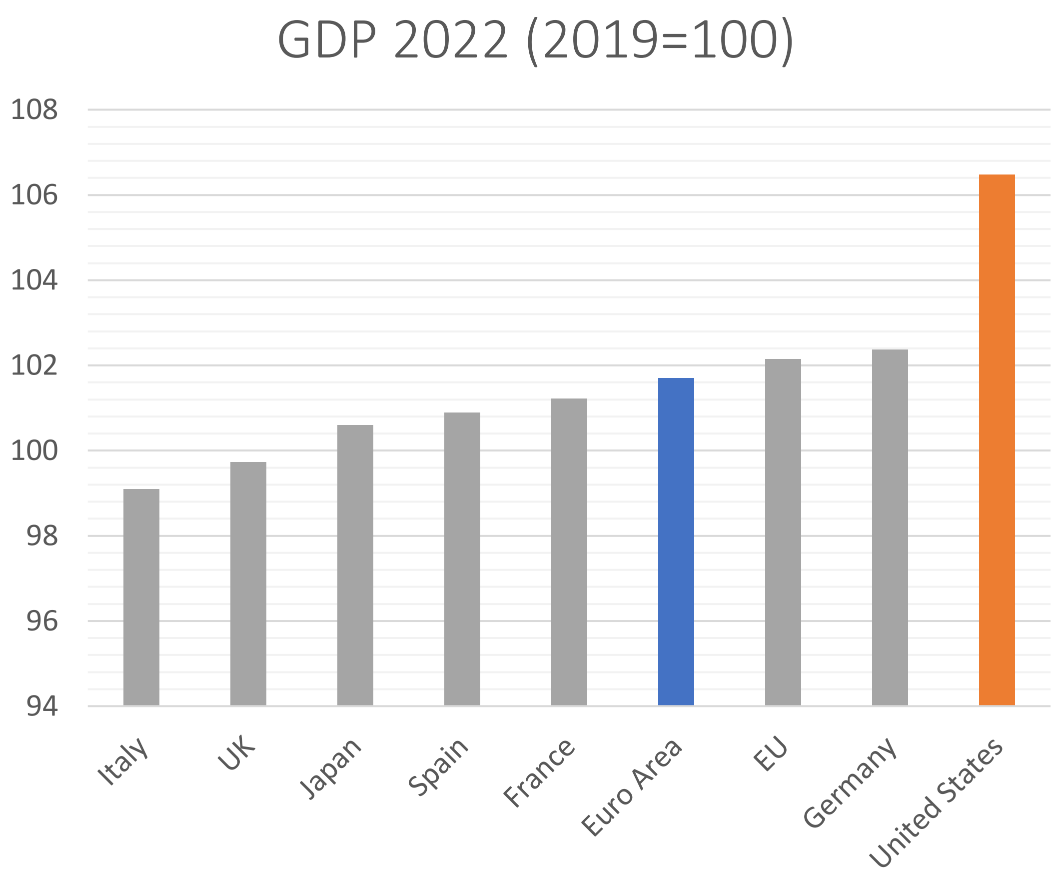
Presentation for the 27th Finanzmarkt Roundtable on 17 May 2021

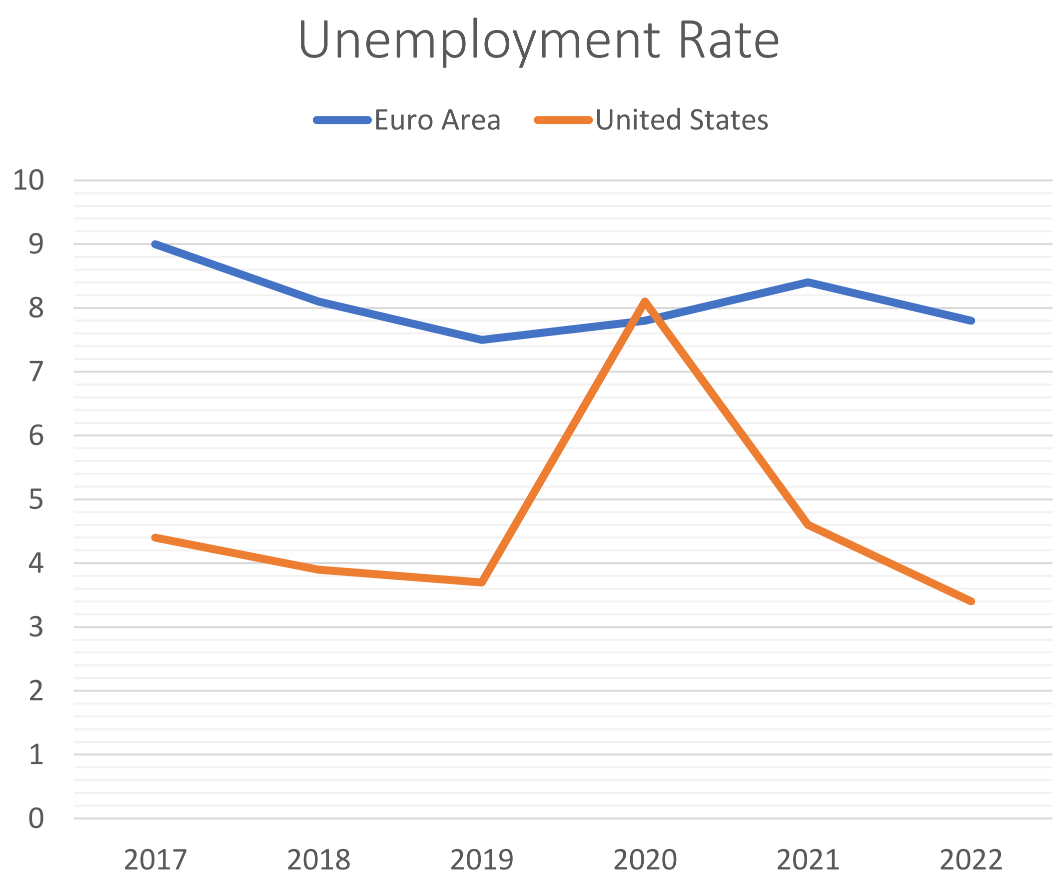
Organized by DekaBank, Institut der deutschen Wirtschaft and Börsen-Zeitung

Professor Dr. Peter Bofinger
Universität Würzburg

Inflation outlook for the United States and the Euro area differs

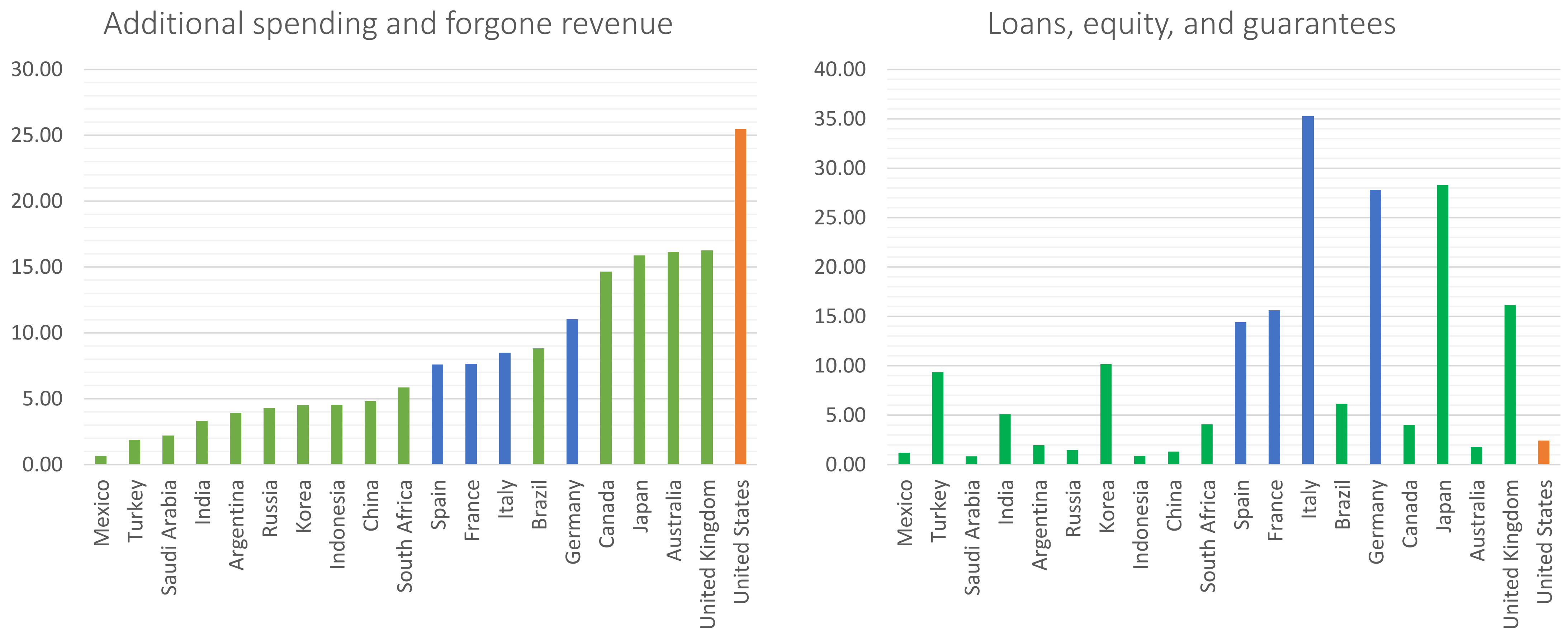
An uneven recovery





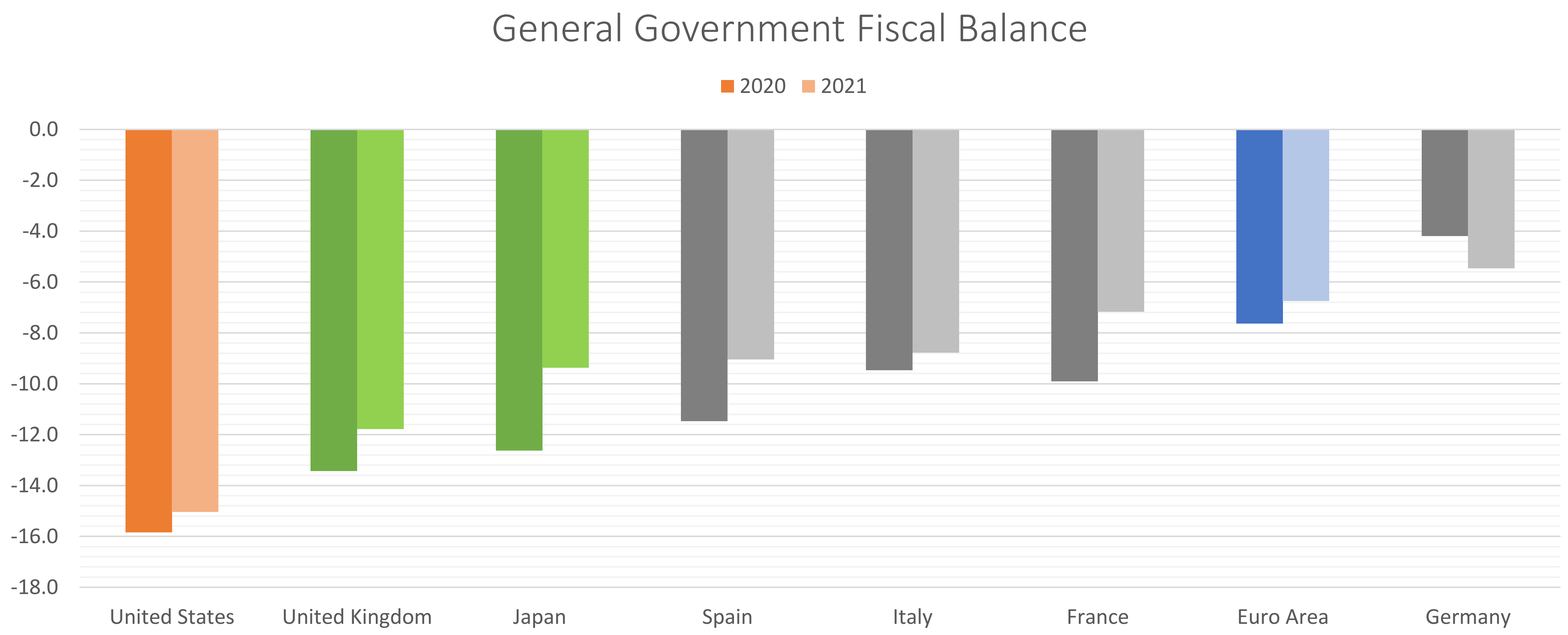
Source: European Commission, European Economic Forecast – Spring 2021

Government Fiscal Support In Response to COVID-19, 2020-21(Percent of 2020 GDP)



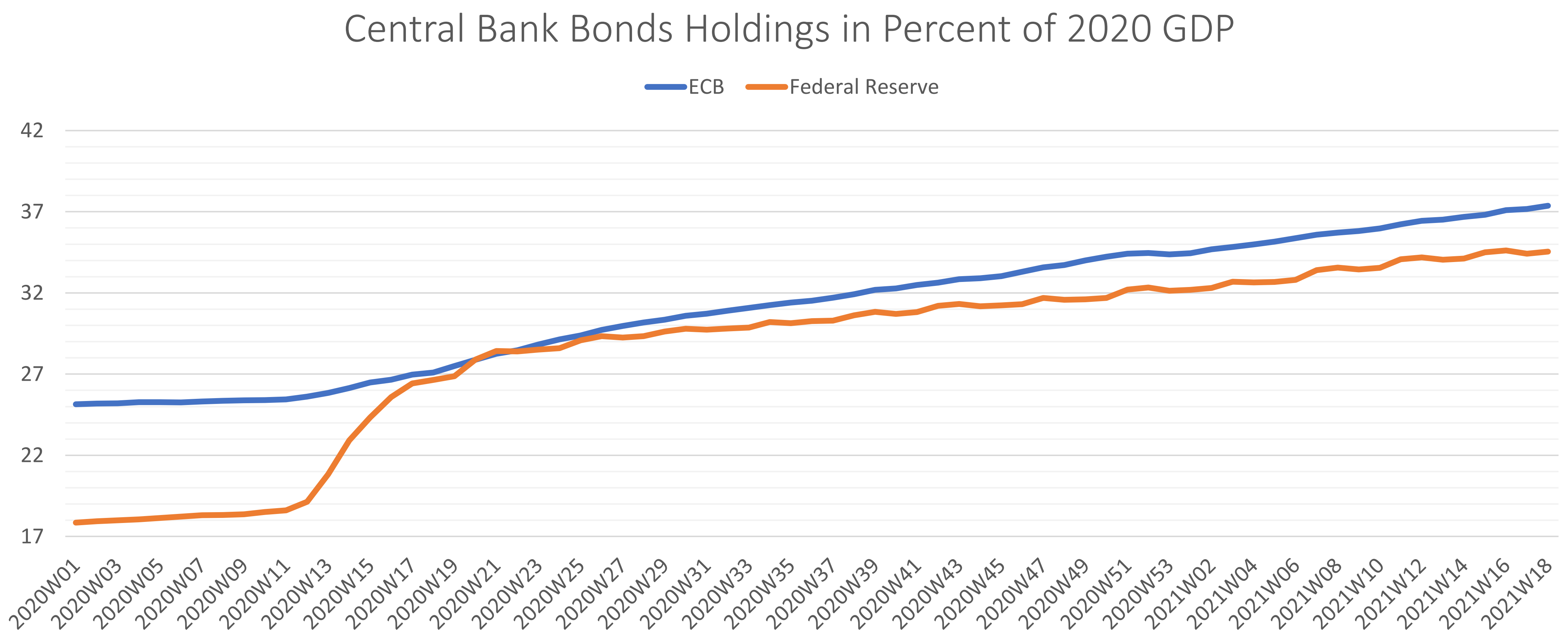
Source: IMF Fiscal Monitor, April 2021

General Government Fiscal Balance (Percent of GDP)



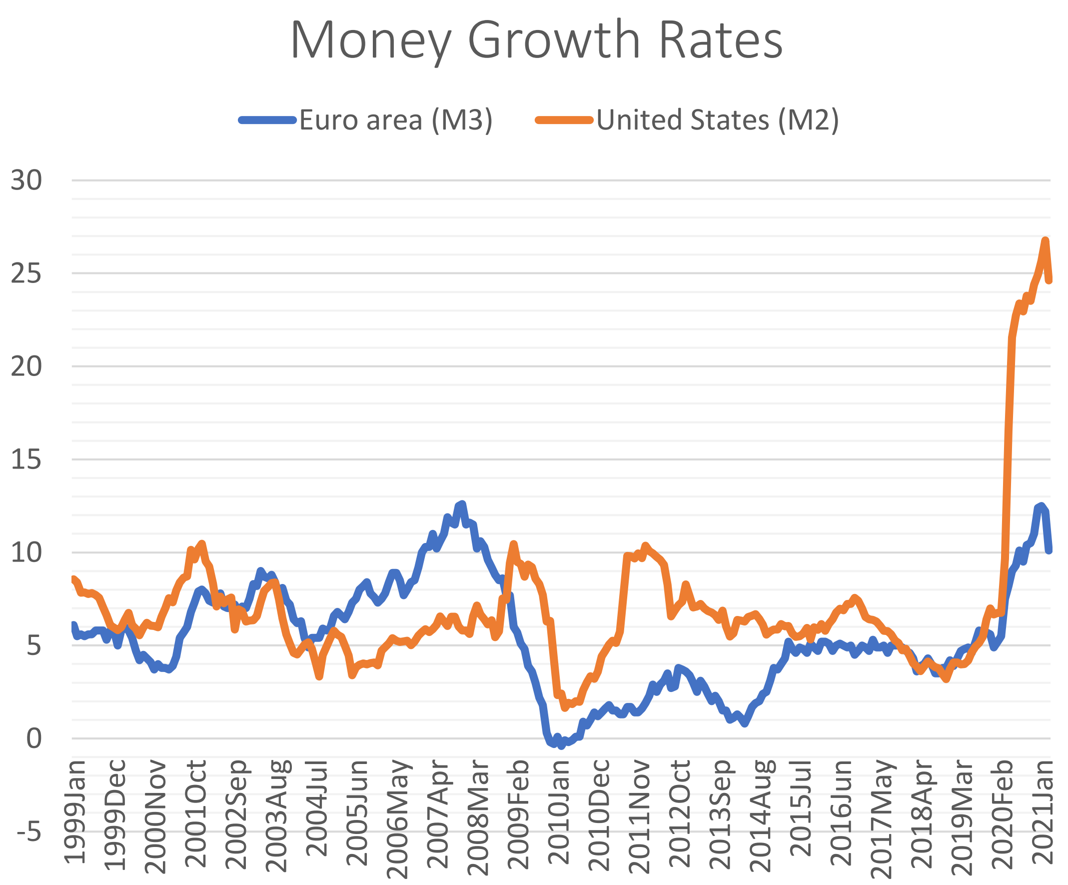
Source: IMF Fiscal Monitor, April 2021

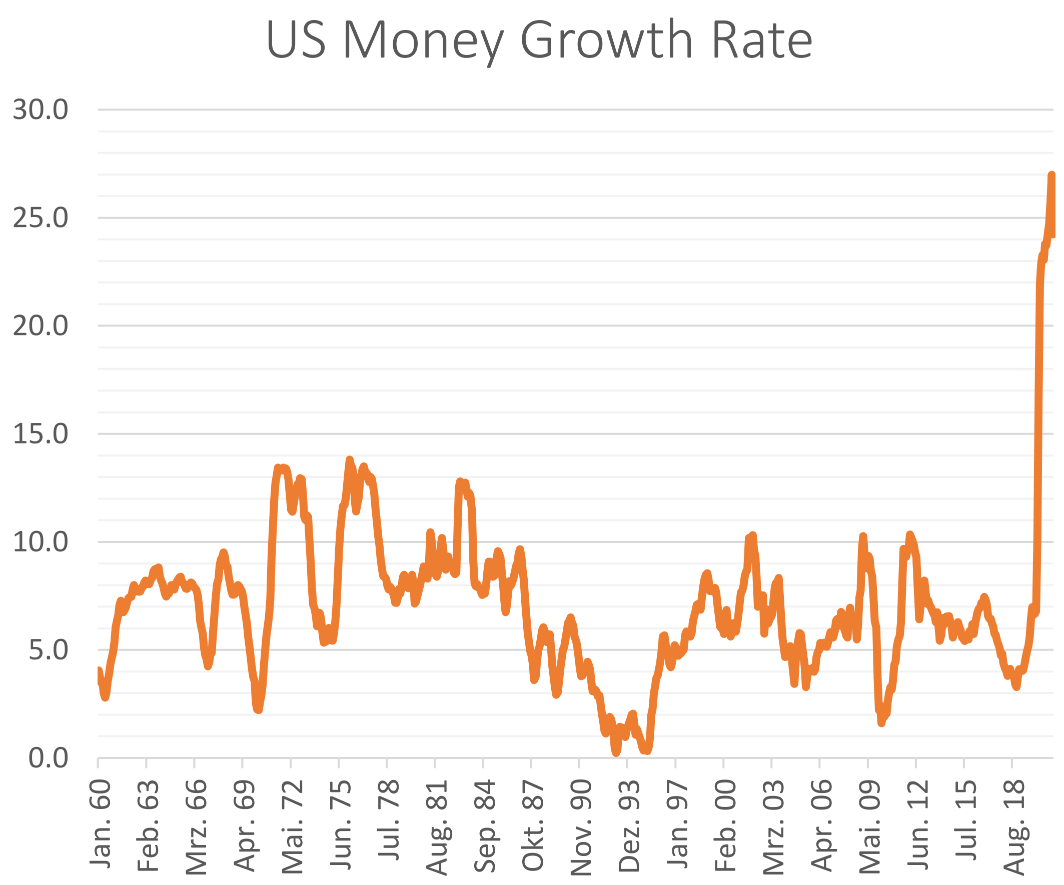
Increase in Bond Holdings since January 2020 (relative to GDP): FED + 16.7 %p, ECB + 12.2 %p



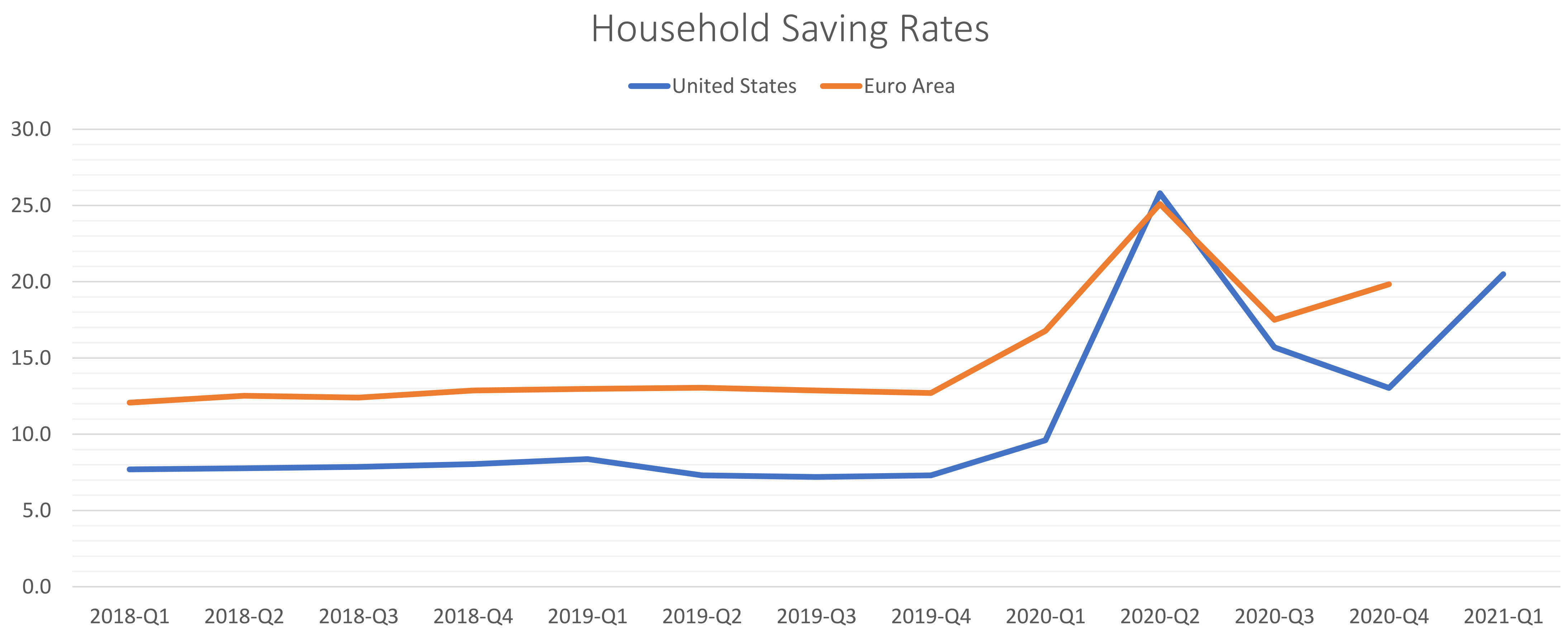
Source: ECB Statistical Data Warehouse and Fred (Federal Reserve Bank St. Louis)

Growth rates of the money stock differ
Increase in US is unprecented



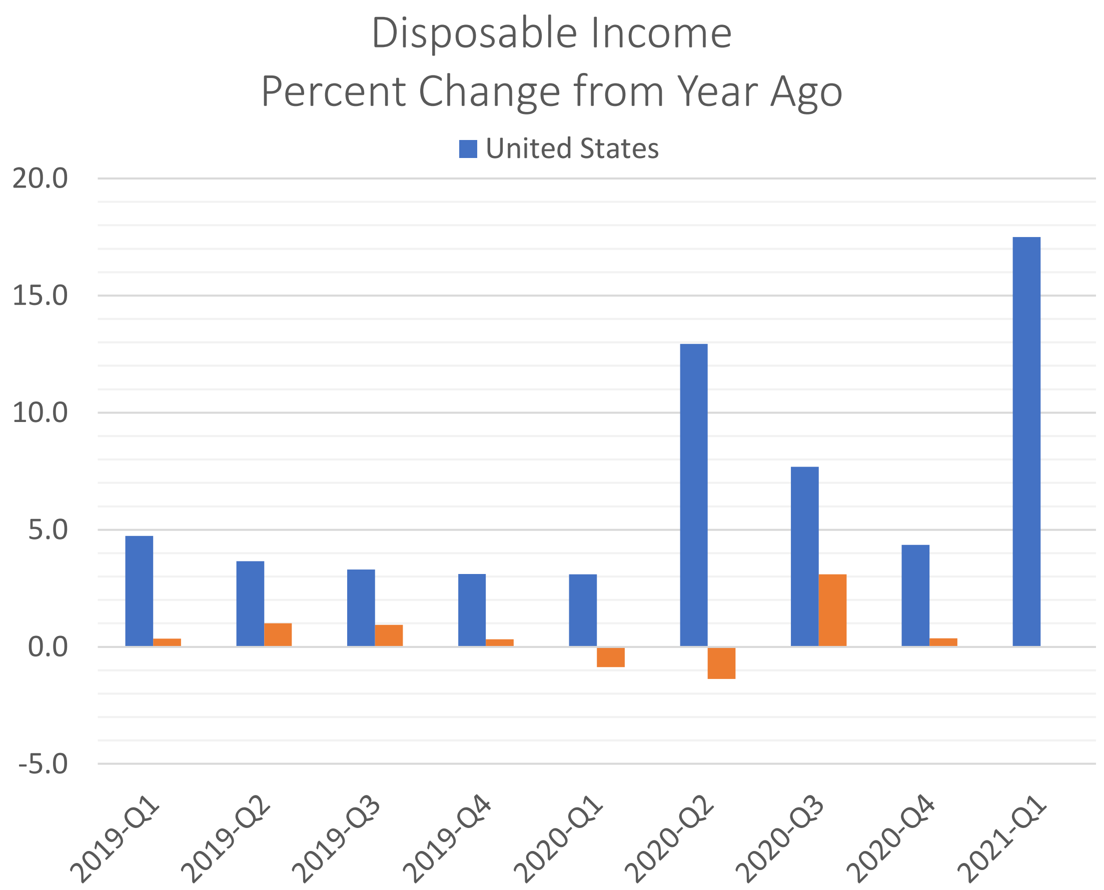


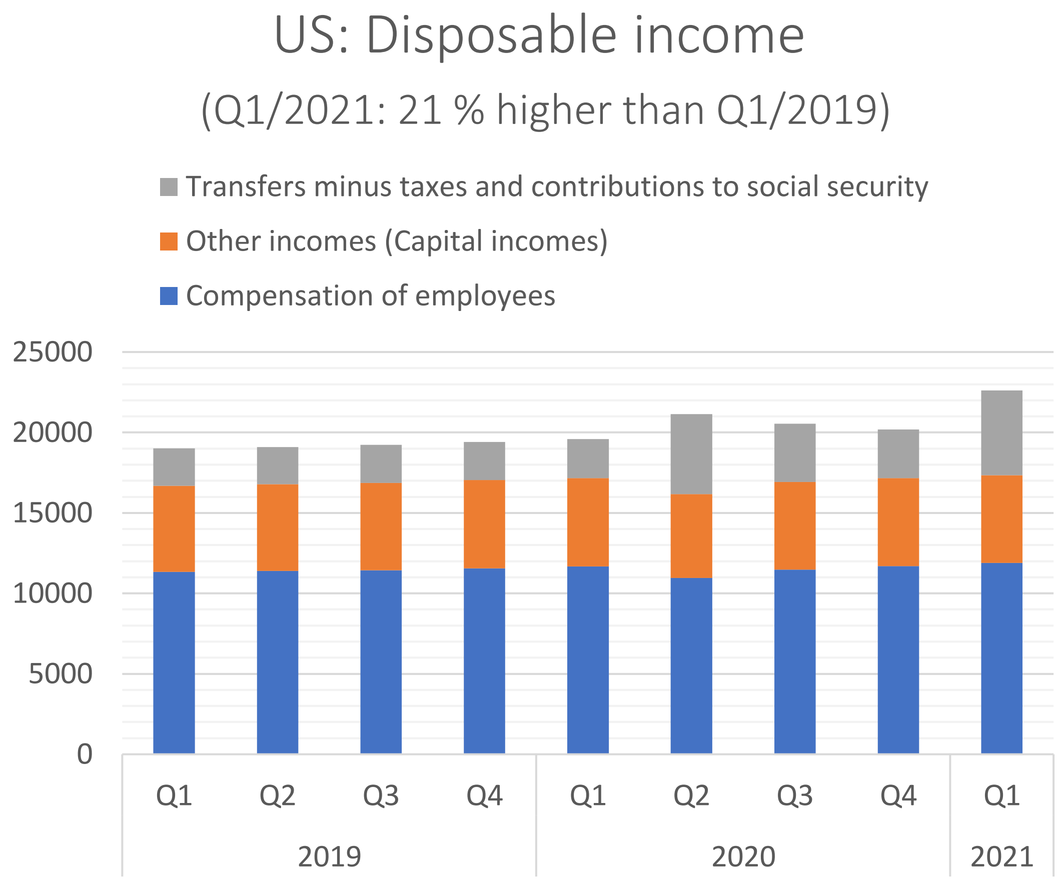
Increase in money stocks reflects very high saving rates



Source: Eurostat and Fred (Federal Reserve Bank St. Louis)

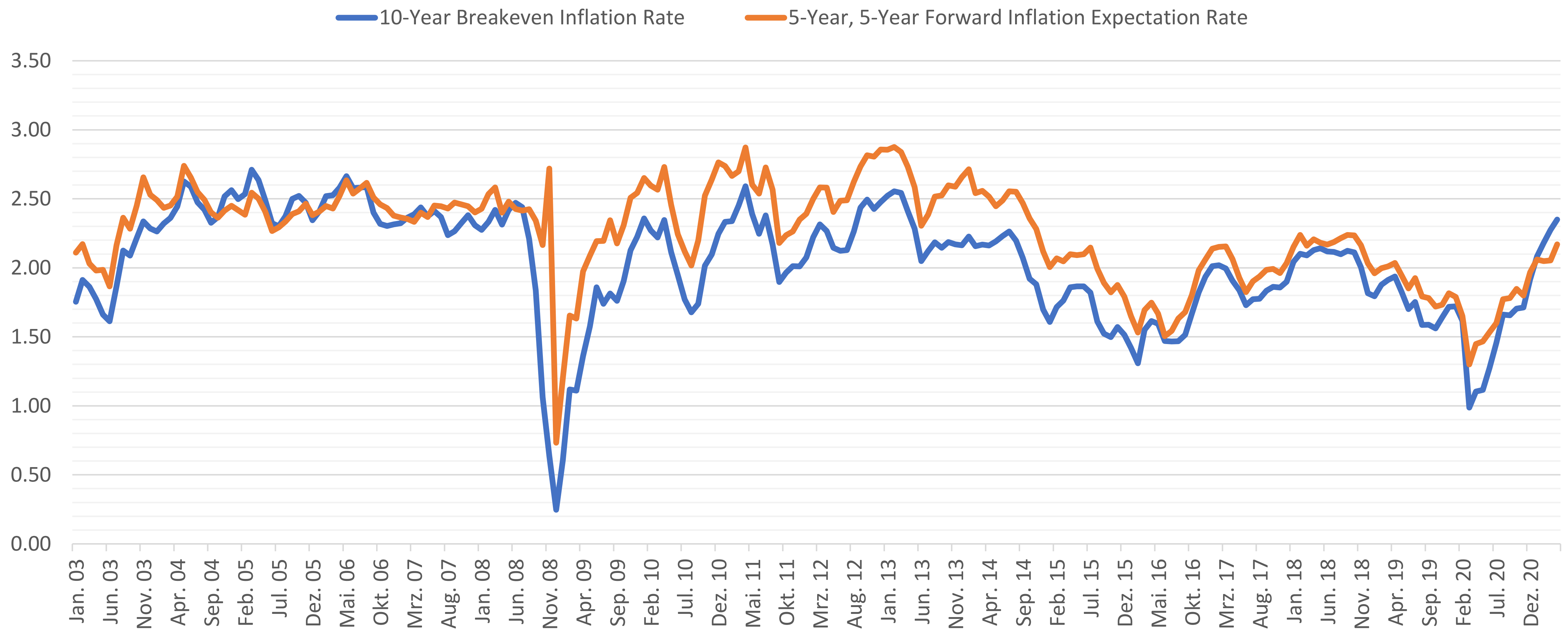
Very high transfers lift household incomes in the US





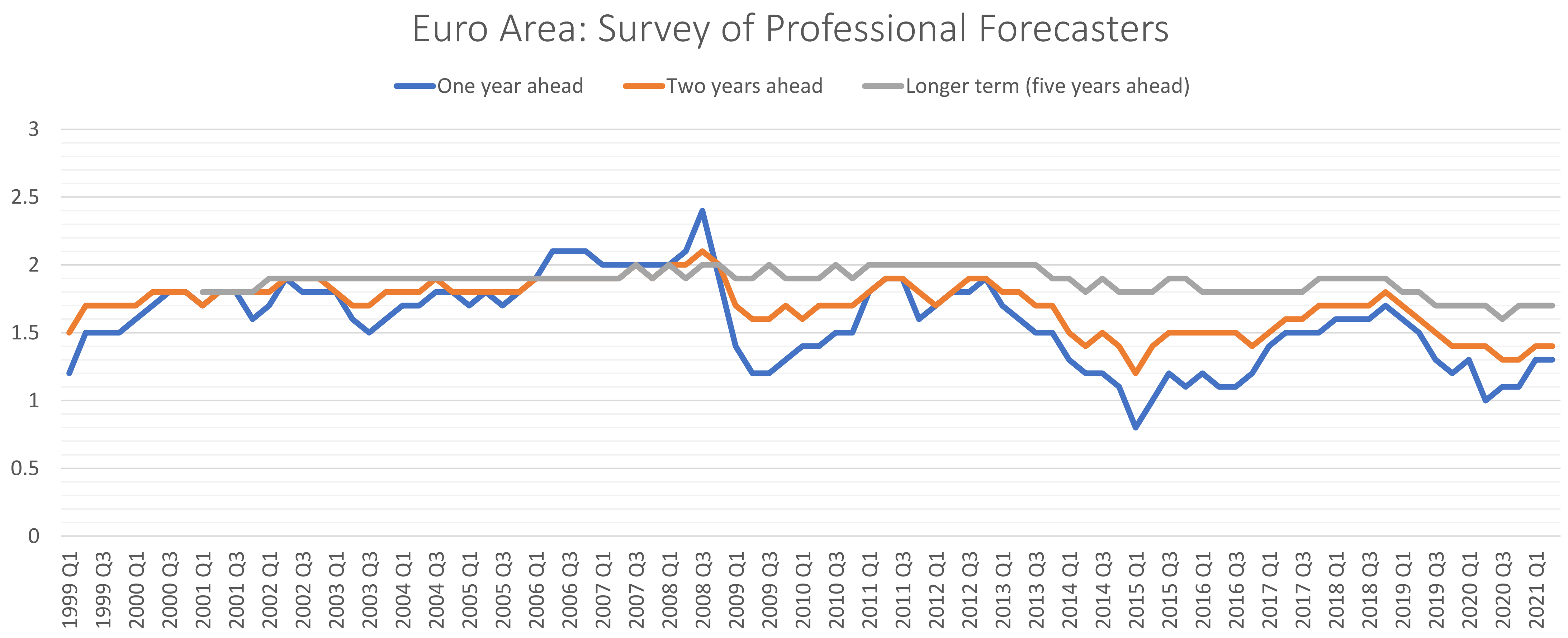
Source: Destatis and Bureau of Economic Analysis

US Inflation: Financial Market expectations still moderate



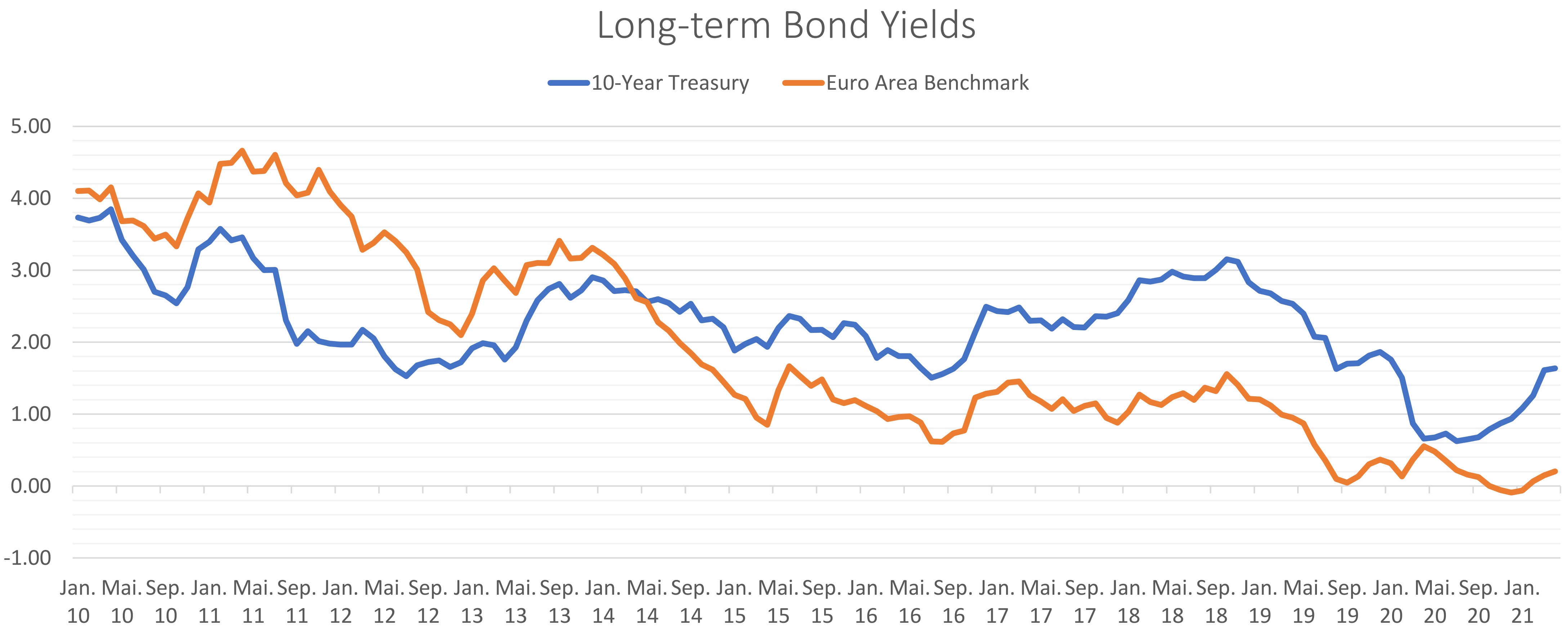
Source: Fred (Federal Reserve Bank St. Louis)

Euro area inflation: Forecasters see no inflation in the medium term



Source: ECB

How will the Federal Reserve react?

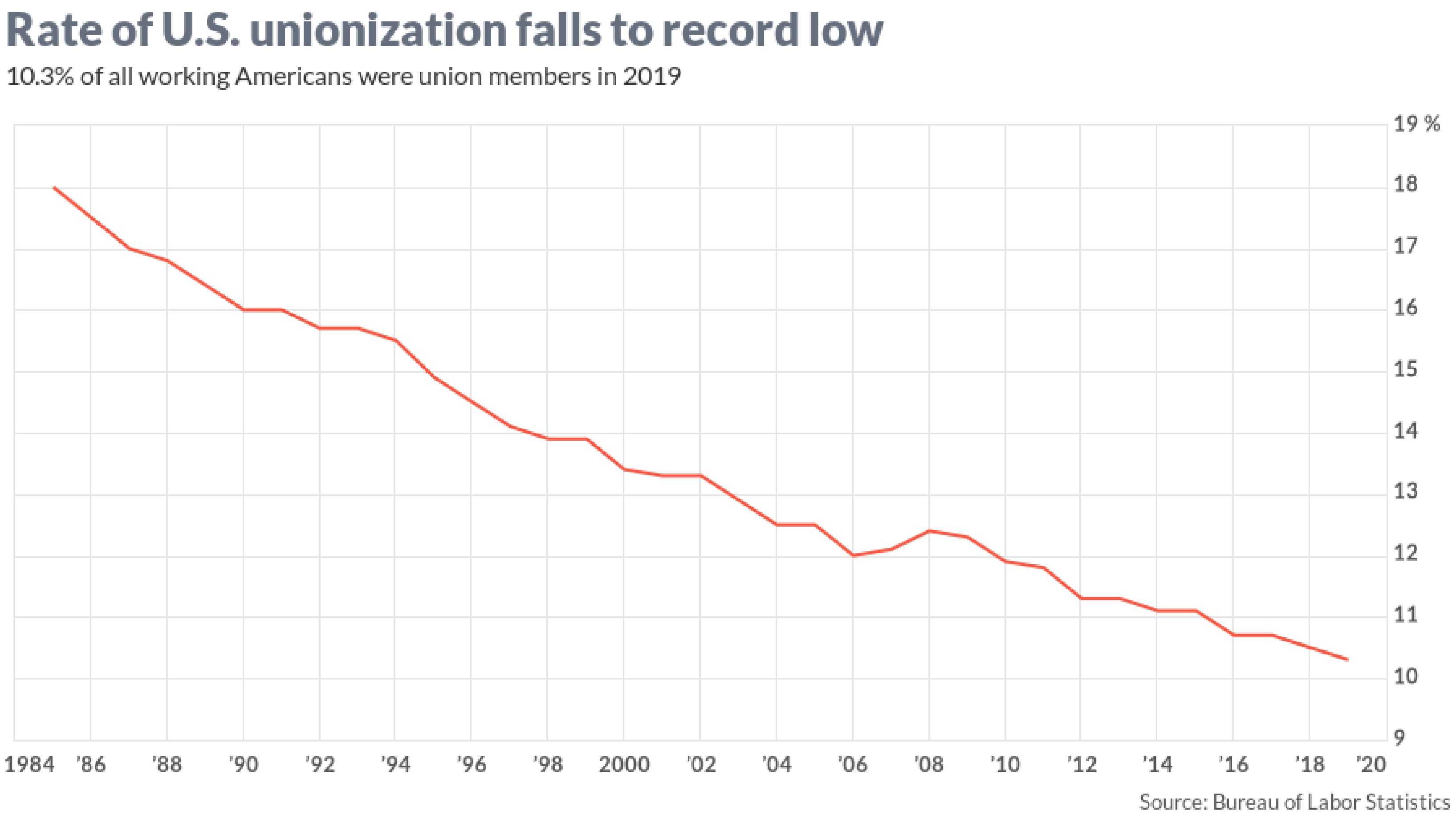


Fed strategy open for a temporary overshooting

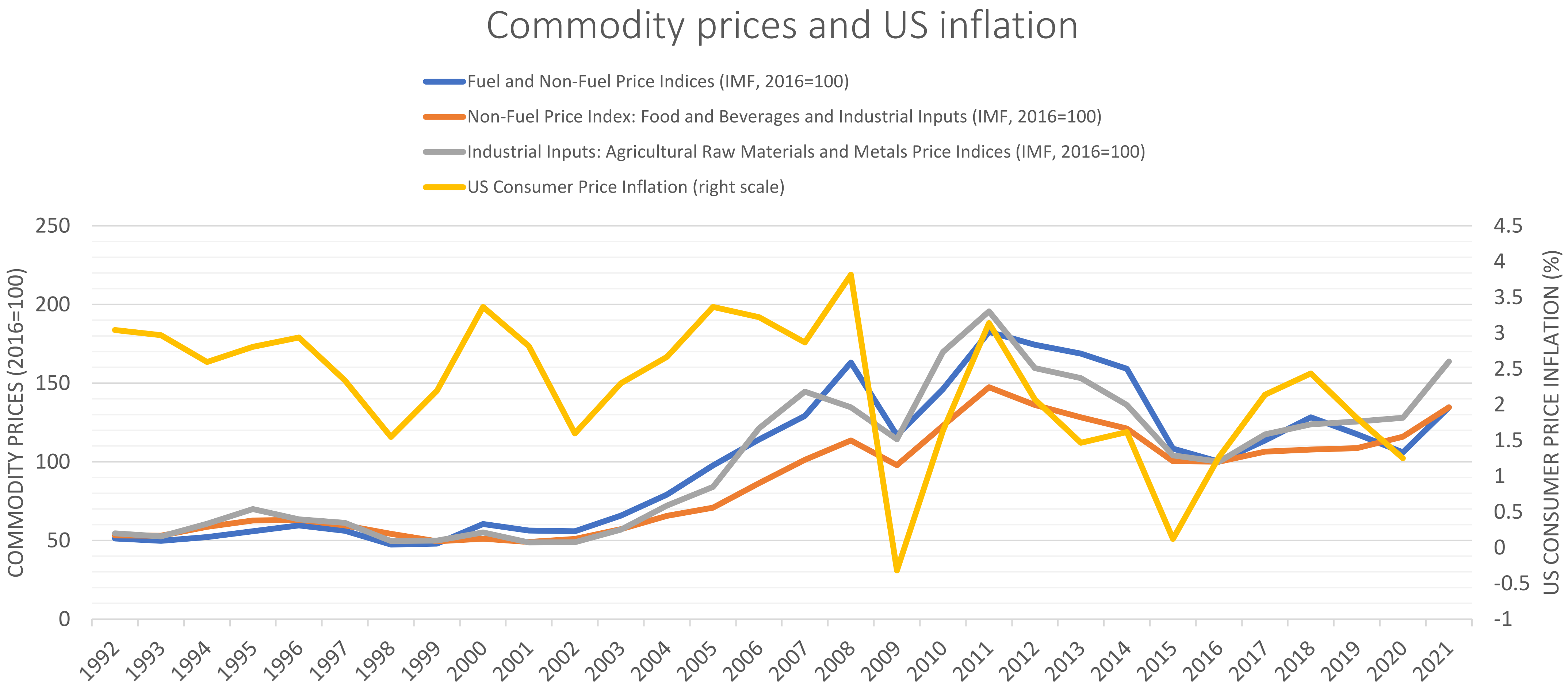
Fed Chairman Powell on 27 August 2020:

- “To prevent this outcome and the adverse dynamics that could ensue, our new statement indicates that we will seek to achieve inflation that averages 2 percent over time. Therefore, following periods when inflation has been running below 2 percent, appropriate **monetary policy will likely aim to achieve inflation moderately above 2 percent for some time**.
- In seeking to achieve inflation that averages 2 percent over time, we are not tying ourselves to a particular mathematical formula that defines the average. Thus, our approach could be viewed as a **flexible form of average inflation targeting**.”

Will a temporary US demand shock lead to second round effects?

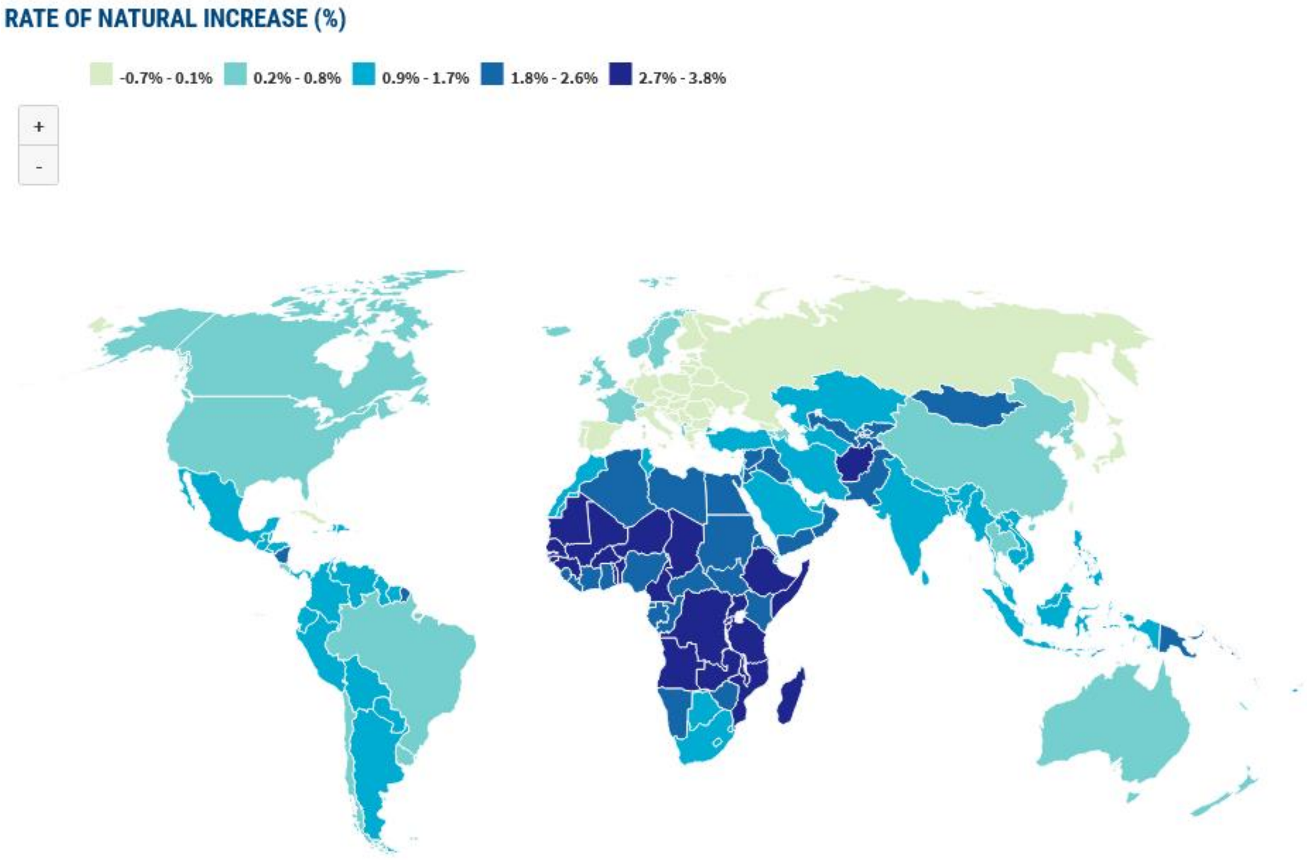


Secular drivers of inflation: Oil and commodity prices

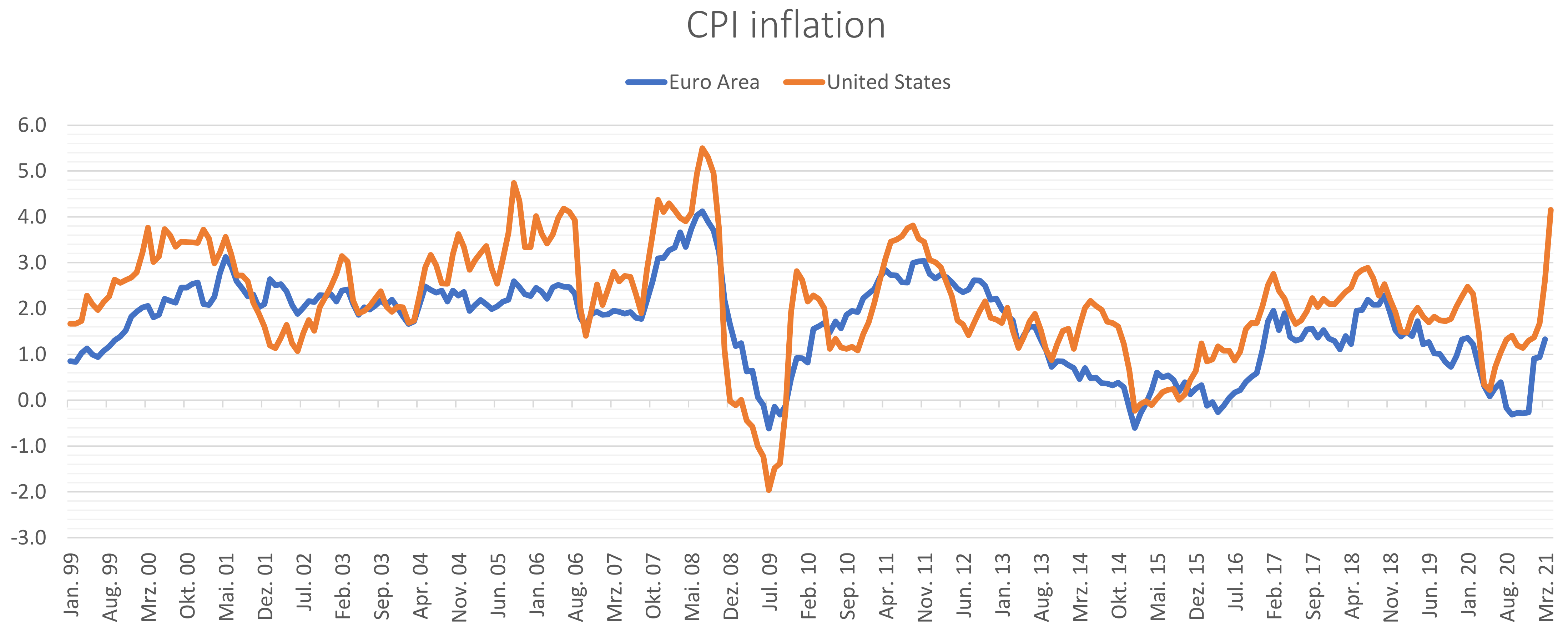


Secular drivers of inflation: Demografics

Annual populatoin growth until 2050



US inflation does not necessarily mean Euro area inflation



Summary

- United States are confronted with a significant positive demand shock that can lead to higher inflation.
- It is unlikely that it would lead to inflation processes as in 1970s/1980s
  - The Fed would not tolerate inflation rates above 4 percent for a prolonged period of time
  - Labor unions are weak
  - Oil prices will decline
- Compared with the US, the situation in the euro area looks unproblematic