DISCUSSION OF “THE DRIVERS OF POST-PANDEMIC INFLATION”

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The drivers of post-pandemic inflation

- U.S. and EA faced similar inflation dynamics since the pandemic
- EA recovery relatively more sluggish
- Empirical estimates point to:
  - Demand shocks as the main drivers of inflation
  - Supply disruptions behind EA slower recovery
  - ECB’s accommodation significantly contributing to EA recovery
Demand-driven inflation

Figure 5
Historical decomposition of GDP and inflation dynamics

Sources: Data from Eurostat, the European Central Bank, the Bureau of Labor Statistics, and the Bureau of Economic Analysis; accessed via Haver Analytics; computations by authors.

Panel (a) illustrates that demand factors have boosted economic activity since 2021, while supply shocks have been a substantive drag on output. When it comes to US inflation, more than half of its rise and fall can be attributed to demand disturbances, as shown in panel (b). The figure paints a similar picture for the EA, with the difference that supply factors exert a larger negative contribution to the EA GDP. On the contrary, demand shocks play an even more dominant role for inflation in the EA relative to the US.

In simpler terms, at the onset of the pandemic, both economies were severely impacted by significant negative supply and demand shocks, which drastically reduced economic activity. As conditions started to improve, aggregate demand rebounded faster than predicted, and aggregate supply slower than expected. But our results suggest that the former has contributed more to the surge in inflation. This finding might seem surprising and deserves further discussion, given the popular narrative that negative supply forces have plagued the EA economy and are largely responsible for the rise of inflation. We will explain the intuition of our result about the major role of demand factors for EA inflation in the next section. For now, we stress that this is a robust finding. It holds in many alternative specifications of the model with (i) other measures of real activity and prices (appendix B); (ii) the addition of energy prices (section 5 and appendix C); (iii) the addition of monetary variables (section 6 and appendix D); (iv) the explicit distinction between the price and consumption of goods and services (appendix B).
A flat aggregate demand – limited inflationary effects of supply shocks
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U.S. and EA: similar roles for demand shocks but very different drivers

Others: very different demand drivers but similar inflation patterns
Evidence pointing to cross-country shock transmission
U.S. and EA: different policy implications from monetary shocks

Figure 8
Historical decomposition of GDP, inflation and the 1-year interest rate rate dynamics

The big elephant in the (ECB Governing Council) room
The EA economy has been subject to large unfavourable supply shocks since 2020, but these shocks alone cannot explain the behaviour of inflation. Instead, according to our results, post-covid inflation has been fuelled by surprisingly strong demand forces—a combination of uncommonly expansionary fiscal policies, unexpectedly strong pent-up demand following the pandemic restrains, and unusually loose monetary policies. For example, according to Andersson et al. (2021), the total fiscal response to the pandemic amounted to approximately 10 percent of GDP in the US and 7 percent in the EA (see also Lenza, 2023).

While the dominant source of inflationary pressures emerges clearly from our empirical evidence, assessing whether the ECB has handled these pressures (a) US GDP (b) EA GDP (c) US CPI (d) EA HICP (e) US interest rate (f) EA interest rate

Actual Model forecast as of 2019:Q4
Monetary Non-monetary demand Supply
To conclude

- Great and careful paper
- Important lessons from the pandemic and implications for policy
- Results pointing to non-trivial transmission of shocks across economies
- Many interesting questions for future research