***Danuta Hübner***

***Member of the Economic and Monetary Affairs Committee, European Parliament***

***"Inflation expectations: A balancing act amid uncertain times"***

**Participation in livestream panel hosted by German Economic Institute (IW) and the Association of German Banks (BdB) on "Rising inflation – is it here to stay?"**

*24th January 2022, European Parliament, Brussels, Belgium*

Even though this inflation was expected, it has brought a lot of uncertainty.

Actually, every economic theory predicted the inflation to come back. Still once it started moving on it was indeed impressive to see how fast the inflation level went up. It is legitimate to continue asking whether the current wave of inflation will be a short-term phenomenon or will rather morph into a persistent one.

Generally, those who insist it is temporary, base it on an assumption that factors behind the current inflation will soon fade away. I feel tempted to say that we should be very cautious in our judgements because we are still in a territory we do not understand profoundly. Will price pressures recede, what targeted policies are needed to achieve it, what role will time lags play and how successful will monetary policy be. Here diverging views do not come as surprise.

The good news is that compared to 1970s, there is a consensus that these are the central banks who have the duty and the power to keep price growth in check. There seems clearly to be less political will to introduce price controls in some sensitive sectors. In main jurisdictions, the central banks have made it clear that they will not act until there is evidence of excessive inflation. That might reset inflation expectations to higher level. That might mean that favouring some inflation is seen as less damaging than protracted periods of low inflation. One could say that this

implies sort of redefining inflation. In any case, timing of central banks actions is an issue in itself.

My second point is about factors behind inflation. It is a fact that we face multiple severe inflationary pressures for the first time in decades, with some global inflation component. The list of contributing factors is long, from the output gap closing rather quickly, high public deficits due to unprecedented public funds injected into economies, speed of recovery with removal of lockdowns leading to skyrocketing spending, tight energy markets vulnerable to shocks and disruptions, locked global supply chains, power based international trade undermining competition, risk that even if gas availability improves, their price level would rather stay.

I would like to add to these widely recognized list two specific concerns.

The first is that potential withdrawal of public support measures and the ECB stimulus might open rather soon the question whether it will be feasible to raise interest rates without undermining the recovery.

The second worry is about the role wages can play in 2022. There is a lot of uncertainty regarding the labour market, initially ignored in analytical reflection on cost inflation. The challenge is that once wage inflation spiral starts working it is rather too late to stop it. That was the experience of the 70s. Most likely major adjustment in negotiated wages will take place this year with upward wage pressure growing, differentiated across jurisdictions. It seems, that wage - price loop cannot be excluded. The challenge here is to what extent enterprises facing cost increases will be able to absorb higher wages in their margins rather than raising prices.

Productivity growth will play an important role, and it is reasonable to expect it. My understanding is that some spikes in prices have very clear drivers behind them. It is true that they are very small compared to the size of injected liquidity. It may however recede. Then again, their future evolution cannot be taken for granted. We can assume that some factors can generate strong inflationary pressures in mid-term (shortages, wages). There is uncertainty here.

Few words about the world economy's shortage problem. We could see over the last two years that scarcity has been an impediment to global growth. Supply side has been struggling to keep up with demand. Global supply chains require capital investment to expand capacity. This takes time.

Time lags in policymaking will play a role.

Economic nationalism plays a role.

Power based trade plays a role.

Financial markets seem to assuming transitory nature of inflation.

The banking sector, with an unprecedented liquidity operates in an environment of muted risk. Andrea Enria says there is evidence of mispricing the risk. Low interest environment prompts search for yield, leading to some sort of relaxation in terms of risk taking. That implies that if inflation outlook grows, there will be a repricing of risk.

To conclude, let me say that I do not see out of control inflation on the horizon.

However, we have to understand better the importance of investment boosting to reduce the risk of shortages, to cope with higher costs, to avoid failure on fundamental long-term policies related to climate change and to boost competitiveness of our economy in an evolving situation in the labour market. So political and policy environment in which the central bank will deliver on keeping inflation under control matters strongly. The old well-known line "whatever it takes" will apply, though for different purpose.

The inflation will have to be kept under control without harming the recovery, based on navigating smartly between asset purchase and interest rate policies.