

# **MONETARY POLICY: FROM THE PANDEMIC CRISIS TO NEW CHALLENGES**

## **THE ECB AND ITS WATCHERS XXII**

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Panel debate  
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# The Phillips curve framework

$$\pi = \pi^e + \beta(y - y^*) + \varepsilon$$

**Inflation = Expected Inflation + Activity “gap” + Cost-push shock**

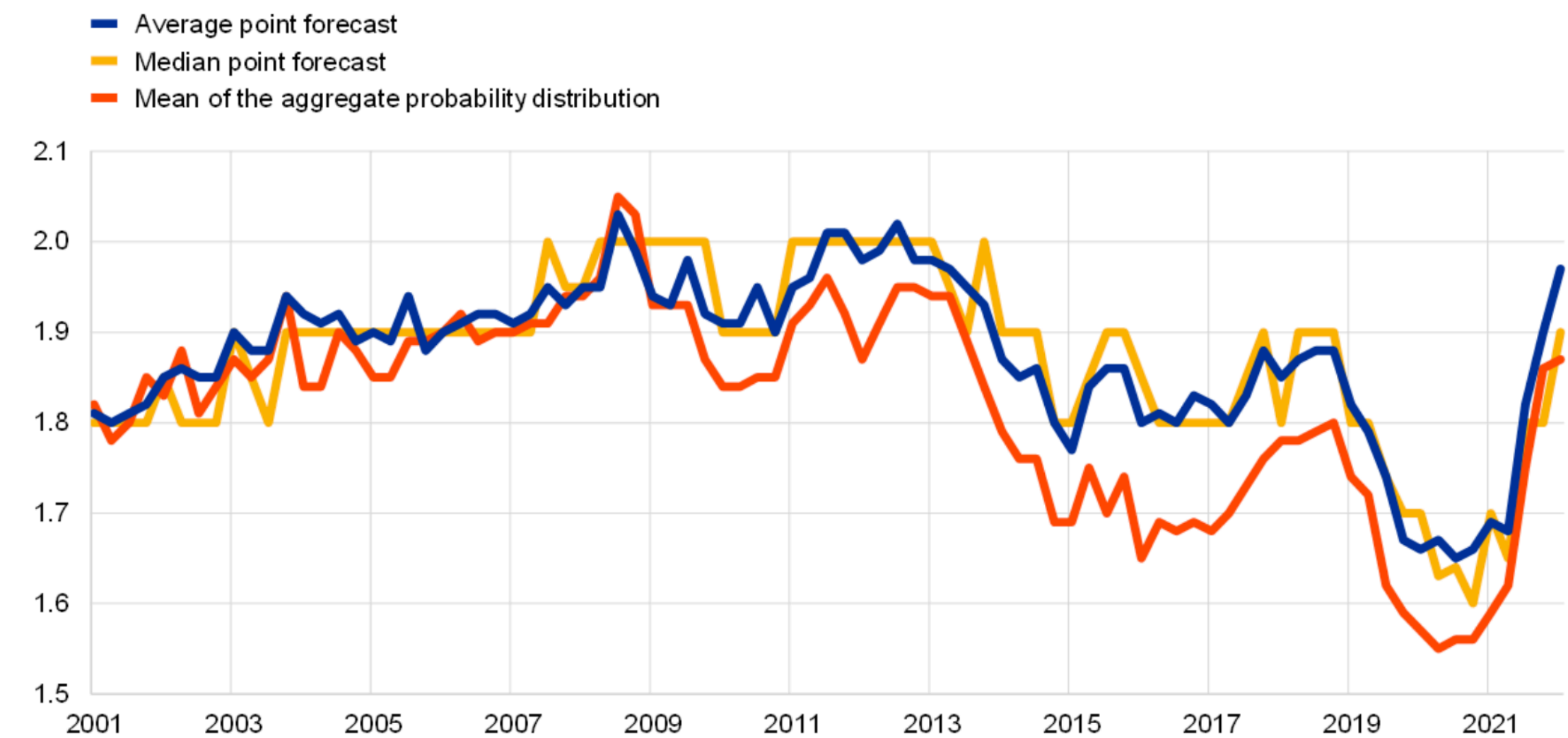
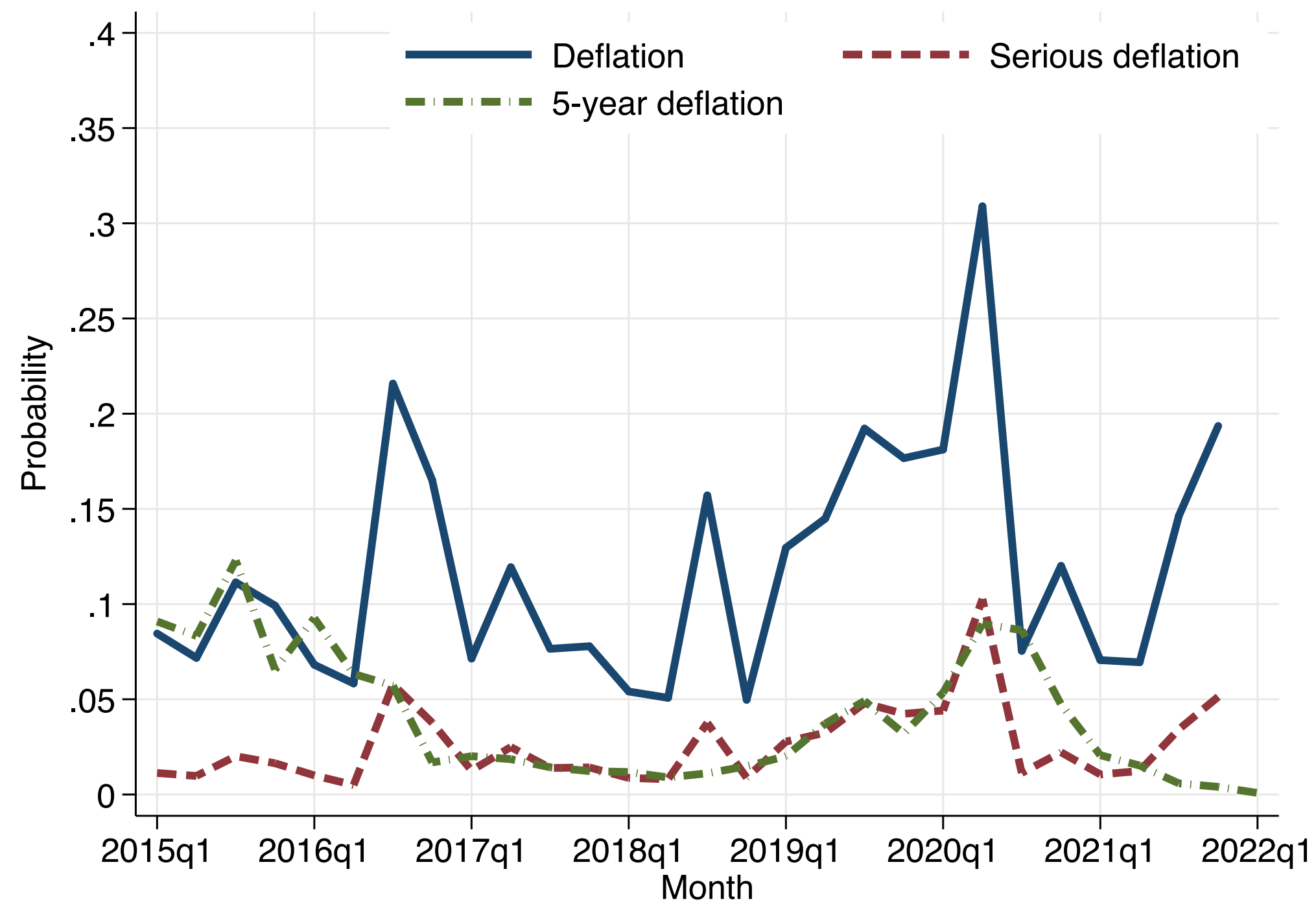
- By itself, an organizing framework, not a model (just part of one)
  - Measurement
  - Separate terms
  - Causality
- Horizon: in long-run, only expected term survives
- Focus on tail risks: deflation and high inflation

# Challenge 9-12 months ago

$$\pi = \pi^e + \beta(y - y^*) + \varepsilon$$

Longer-term inflation expectations

(annual percentage changes)



Re-anchor inflation expectations to be on average 2%: loose policy

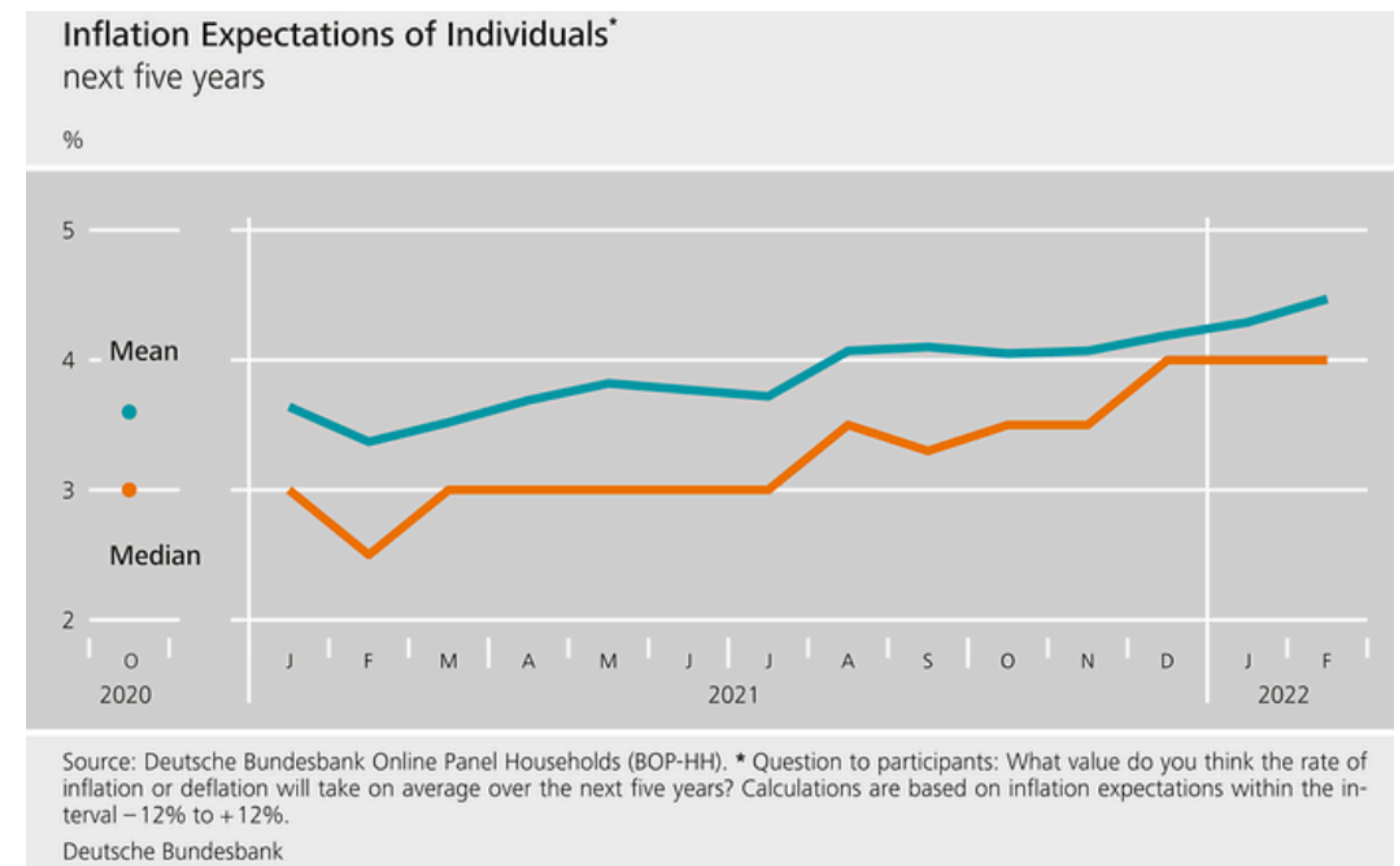
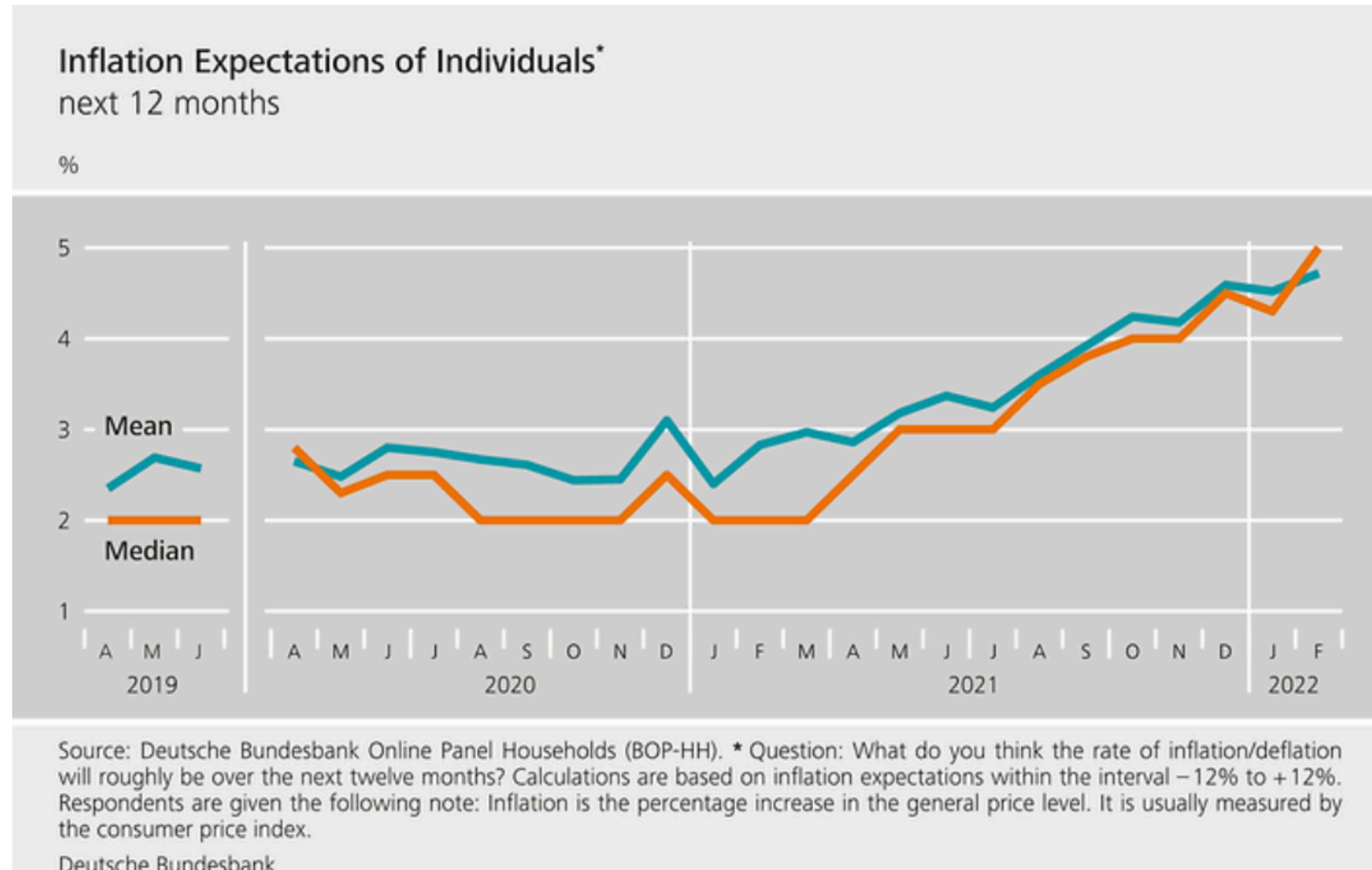
Practice: consider base effects, some catch up

Theory:  $r^*$ , liquidity traps.

History: Japan 2001

# Challenge 3-6 months ago

$$\pi = \pi^e + \beta(y - y^*) + \varepsilon$$



Bottlenecks interpreted as shocks

Emphasis: filter out relative prices, but they are temporary. **Loose**

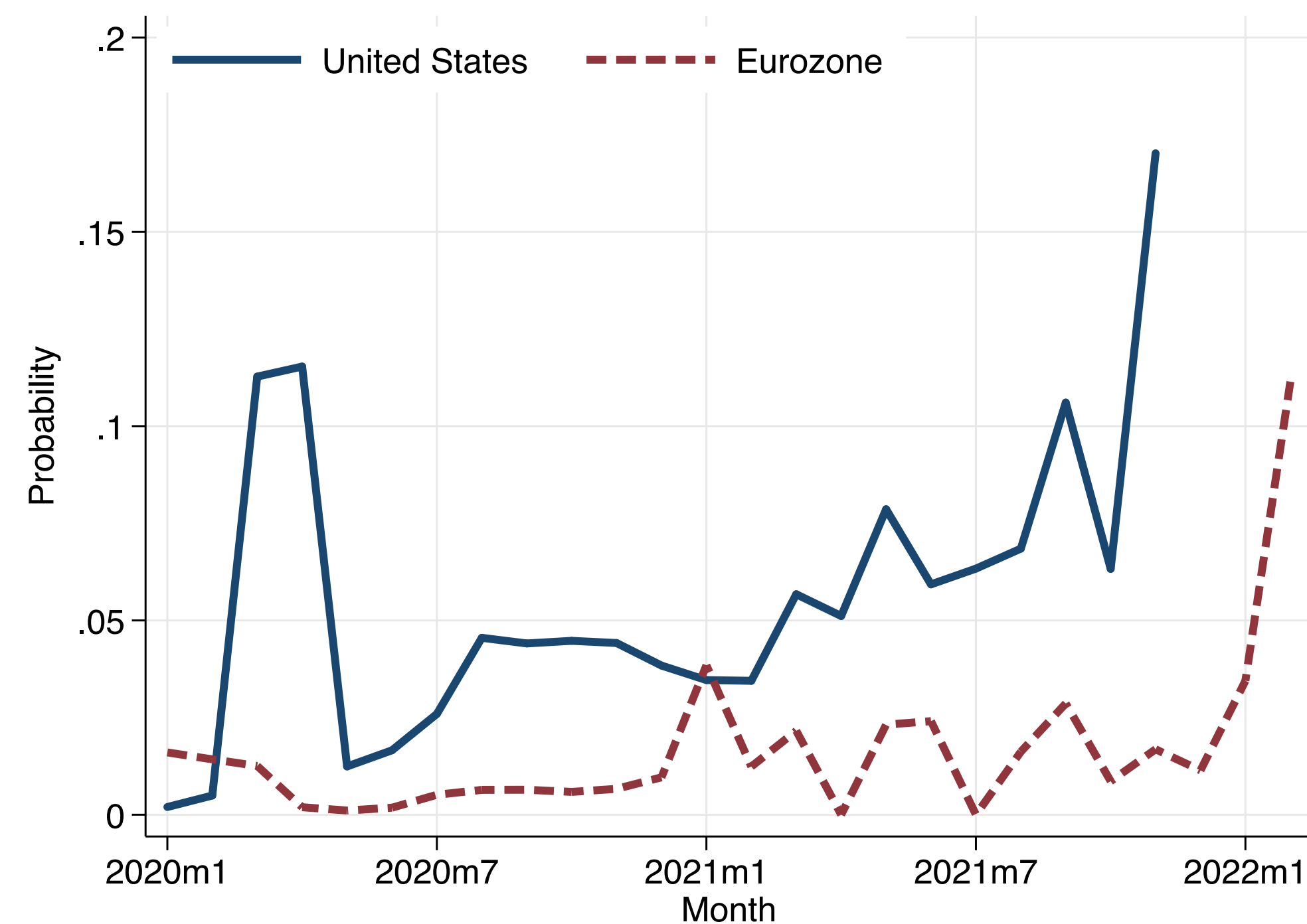
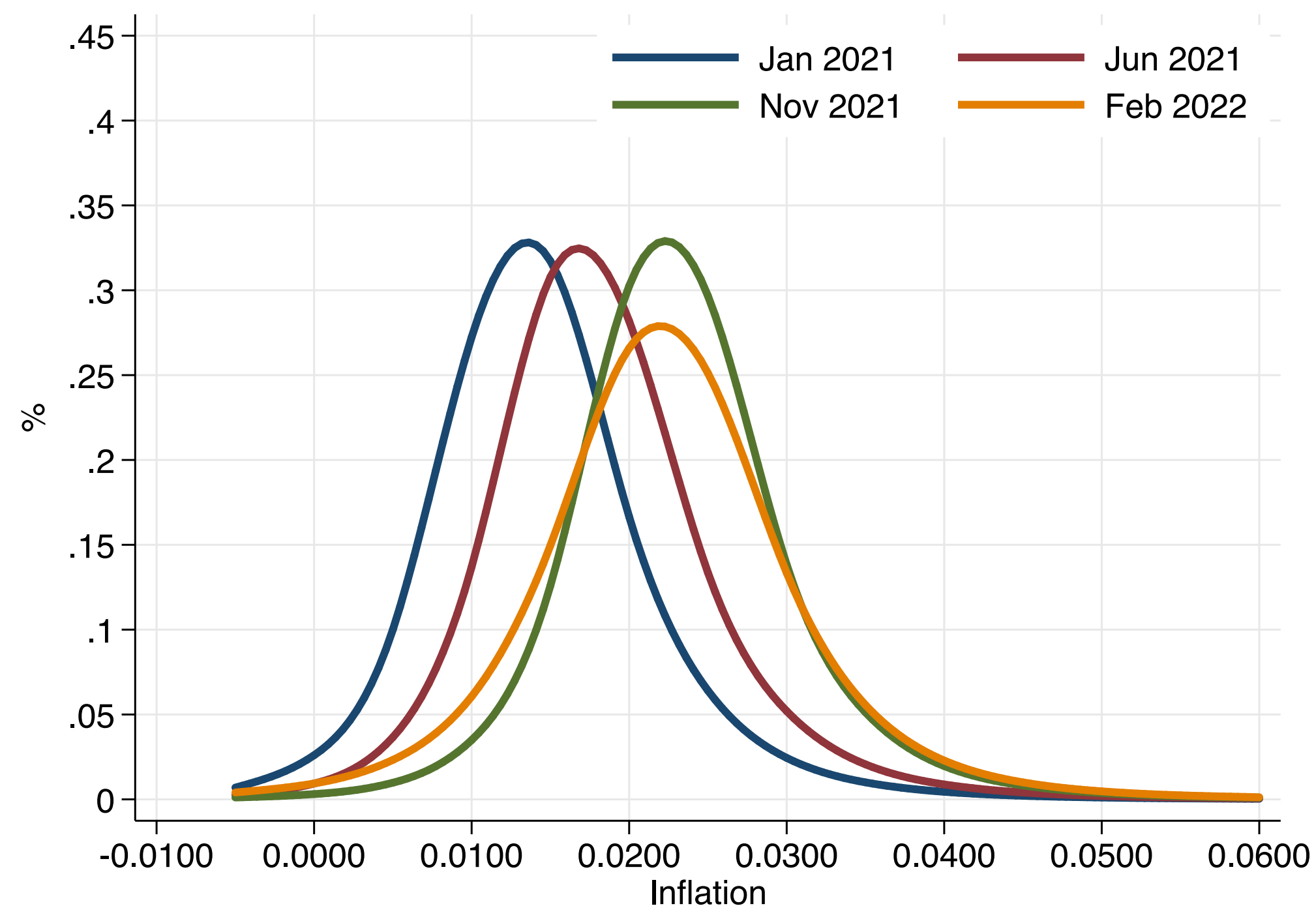
But: people form expectations on prices, rise in mean and fall in skew. **Gradual**

But: if shocks to production potential, keep inflation on target. **Tighten**



# Challenge today

$$\pi = \pi^e + \beta(y - y^*) + \varepsilon$$



Large, maybe persistent, energy shock

Focus on core, don't make the classic oil  $\Rightarrow$  tighten  $\Rightarrow$  recession. Gradual

Trade off higher inflation for smaller recession only goes so far. Tighten

Expectations unanchoring, inattention and hockey sticks. Hard tighten