

Demand-driven inflation

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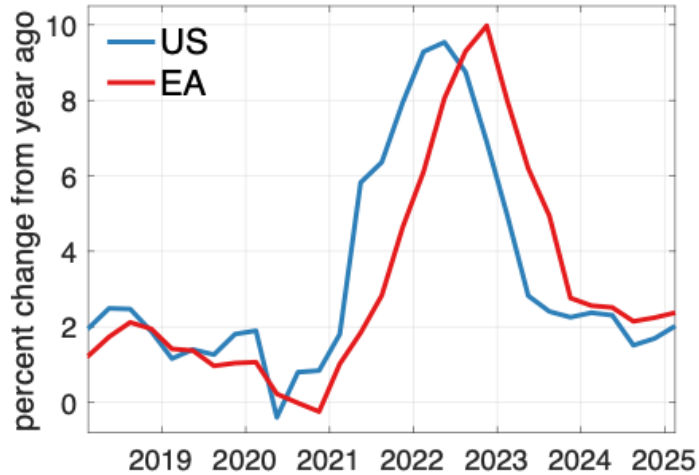
The recent inflation surge was predominantly driven by **unexpectedly strong demand forces**

Evidence

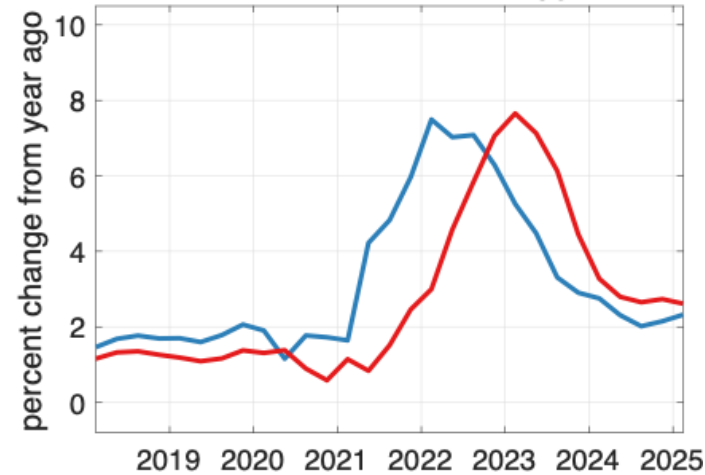
- Structural VAR(s)
- Economic intuition
- Survey data on real-time forecast errors
- DSGE model

Post-covid inflation in the US and the EA

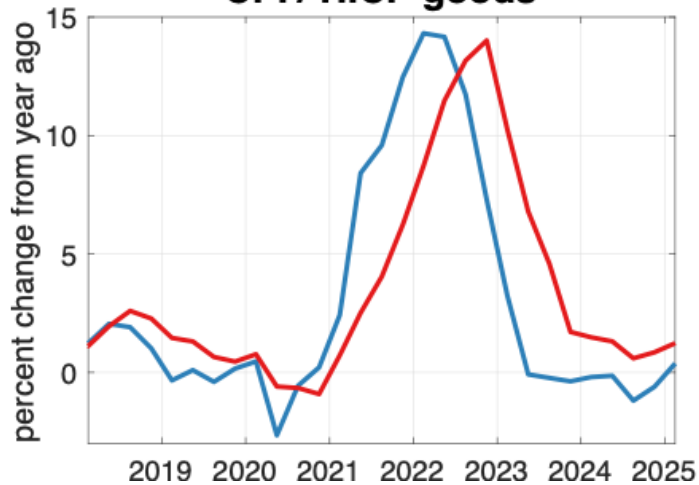
CPI / HICP



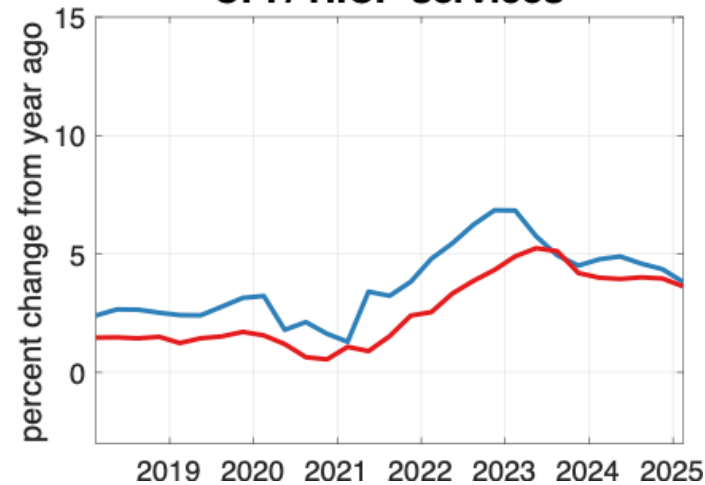
CPI / HICP ex energy



CPI / HICP goods



CPI / HICP services



**nearly identical inflation
in the US and the EA**

The drivers of post-pandemic inflation: Demand or Supply?

■ Structural VAR

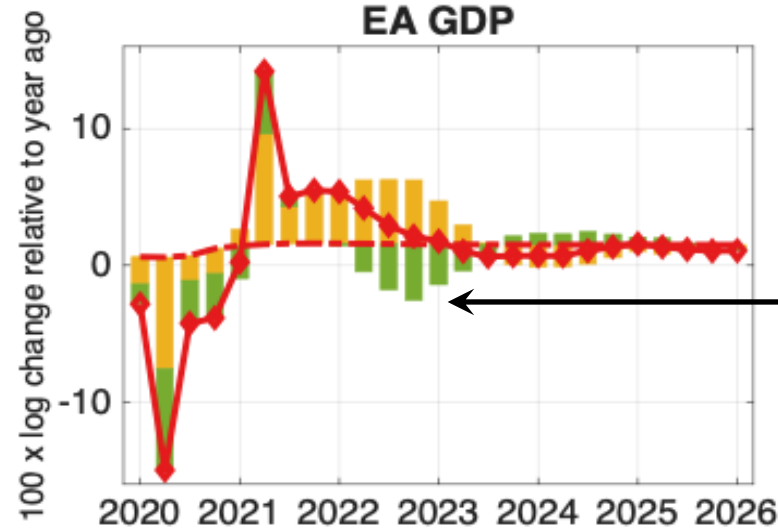
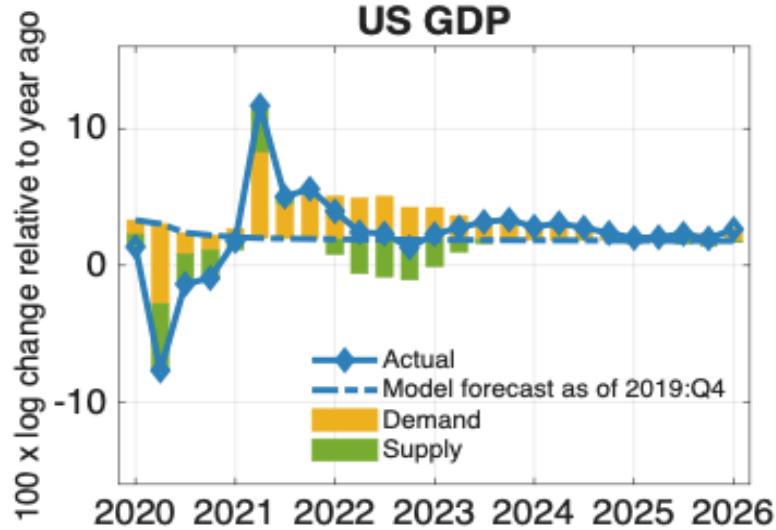
- 2 variables: **real GDP** and **CPI/HICP**
- quarterly data, 4 lags

■ Identify 2 shocks

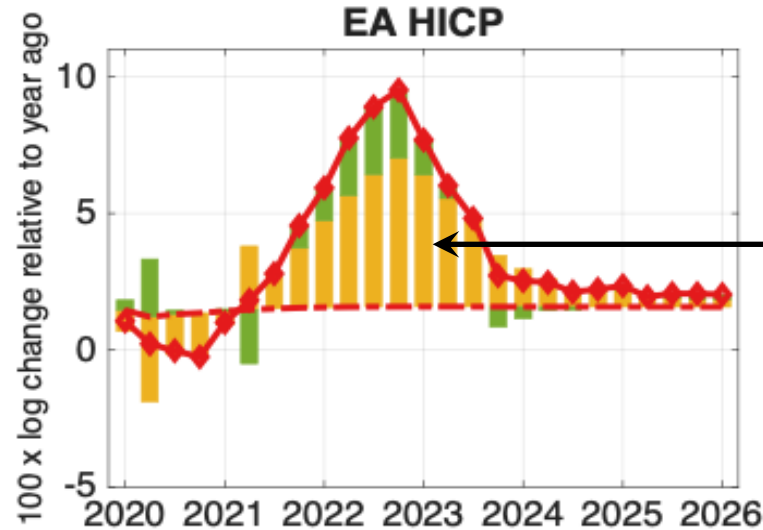
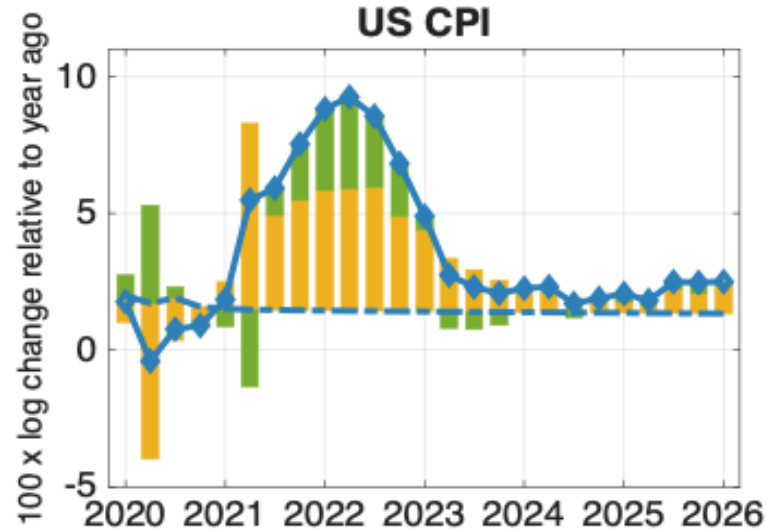
- demand disturbances $\Rightarrow Y \uparrow$ and $P \uparrow$
- supply disturbances $\Rightarrow Y \uparrow$ and $P \downarrow$

➡ **Decomposition of post-2020 dynamics**

The drivers of post-pandemic inflation: Demand or Supply?

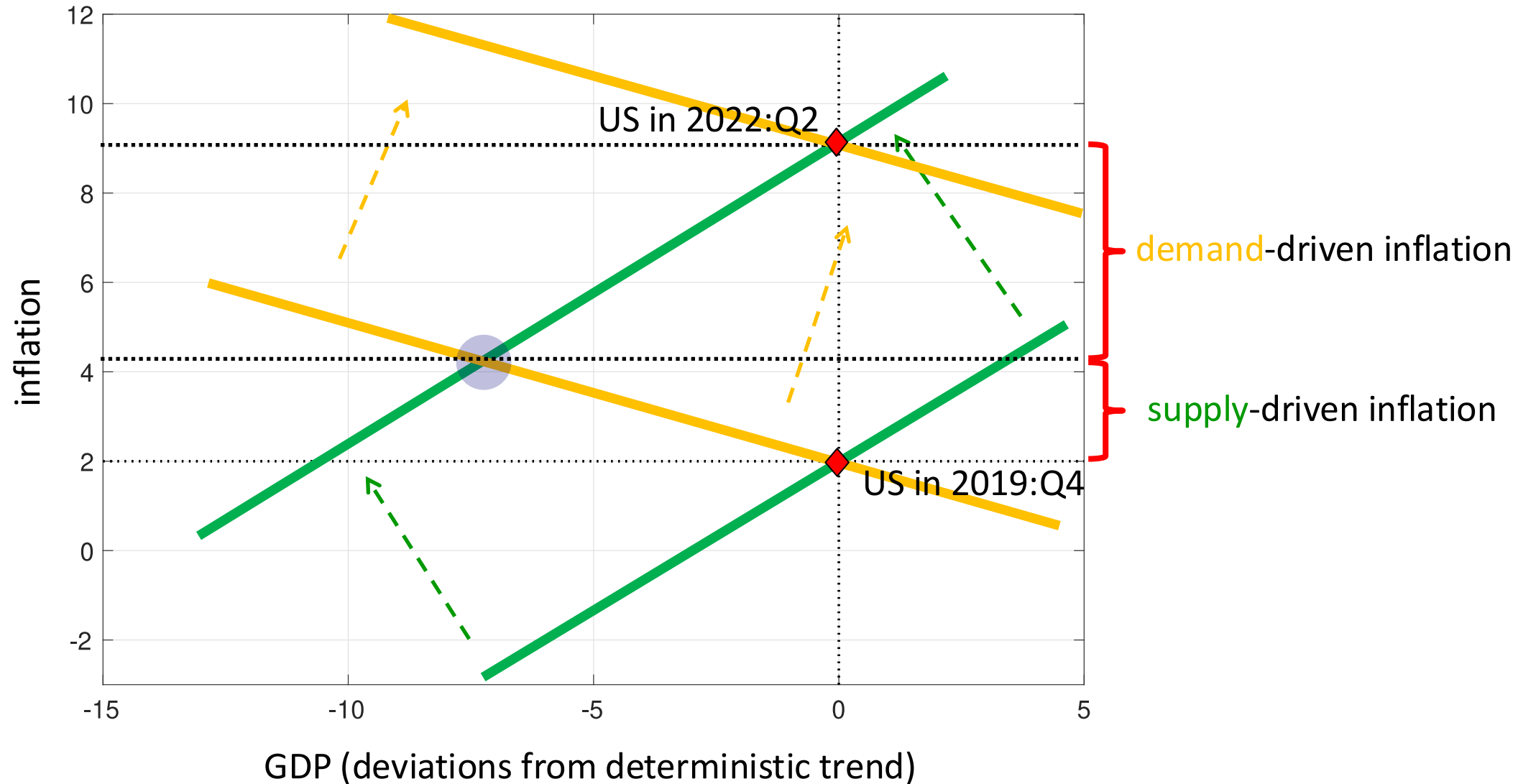


Adverse **supply** conditions have constrained economic activity



Inflation largely driven by **demand** factors

The drivers of post-pandemic inflation with a relatively flat AD curve



The recent inflation surge was predominantly driven by unexpectedly strong demand forces

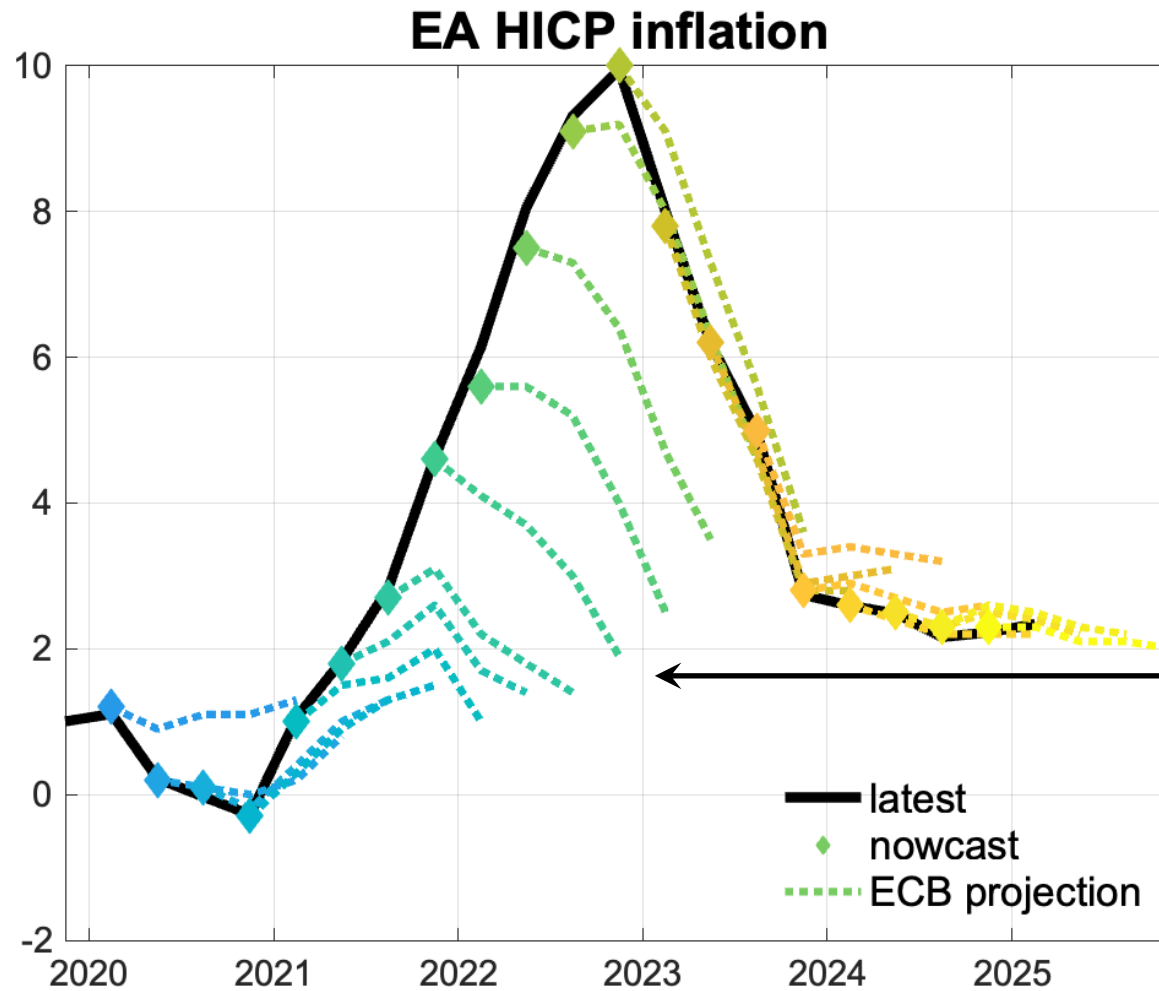
Evidence

- Structural VAR(s)
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A “sniff test” of the demand-driven interpretation

- Compute inflation and GDP forecast errors of the ECB staff and the US SPF
 - Examine whether they were positively or negatively correlated in 2021–22
- ➡ **A simple (less model dependent) test of whether inflation was primarily demand driven**

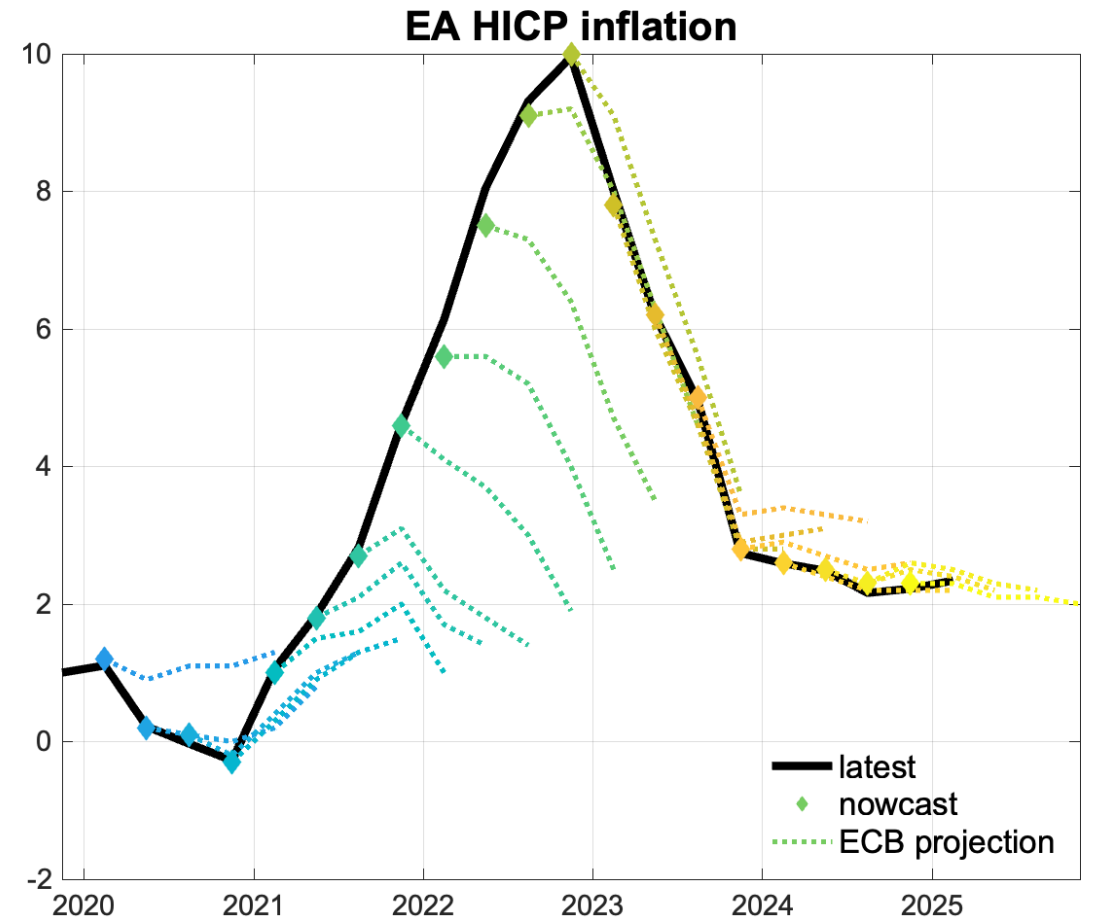
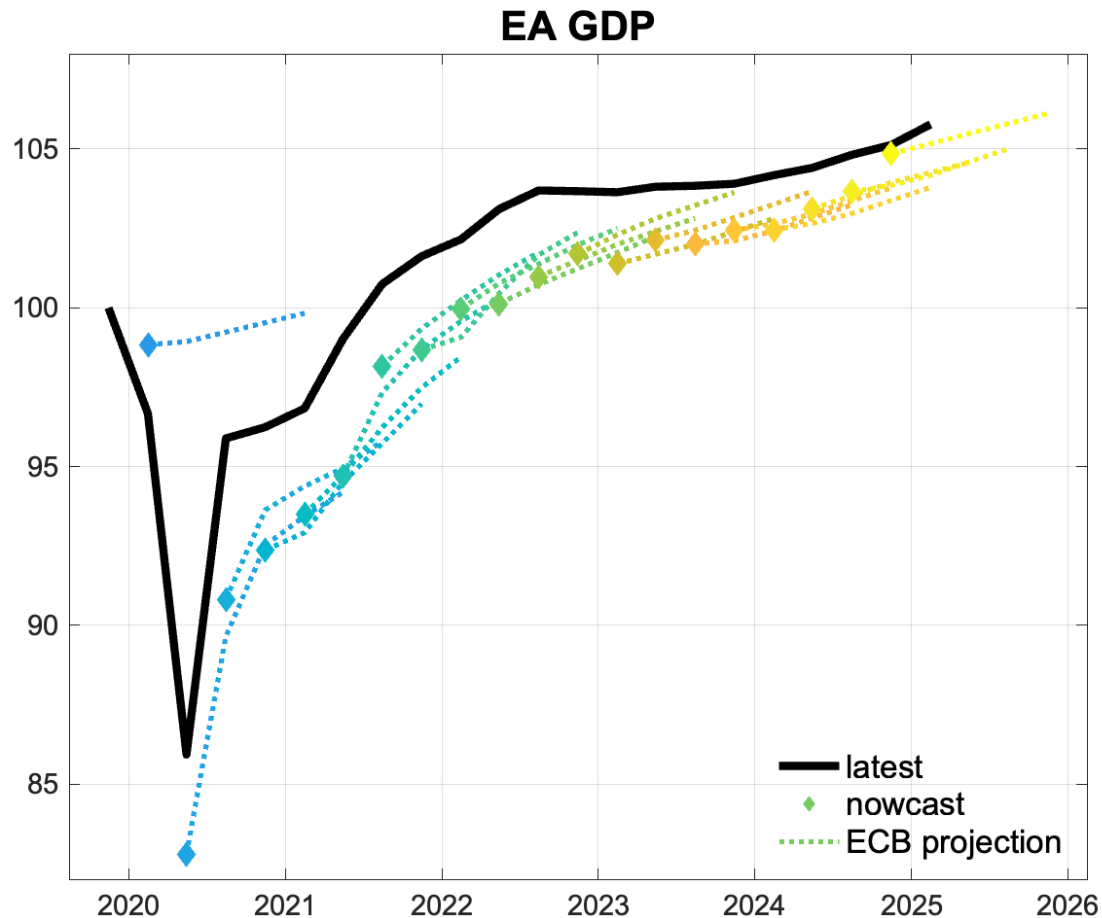
The sniff test: The forecast errors of the ECB



The ECB underpredicted inflation

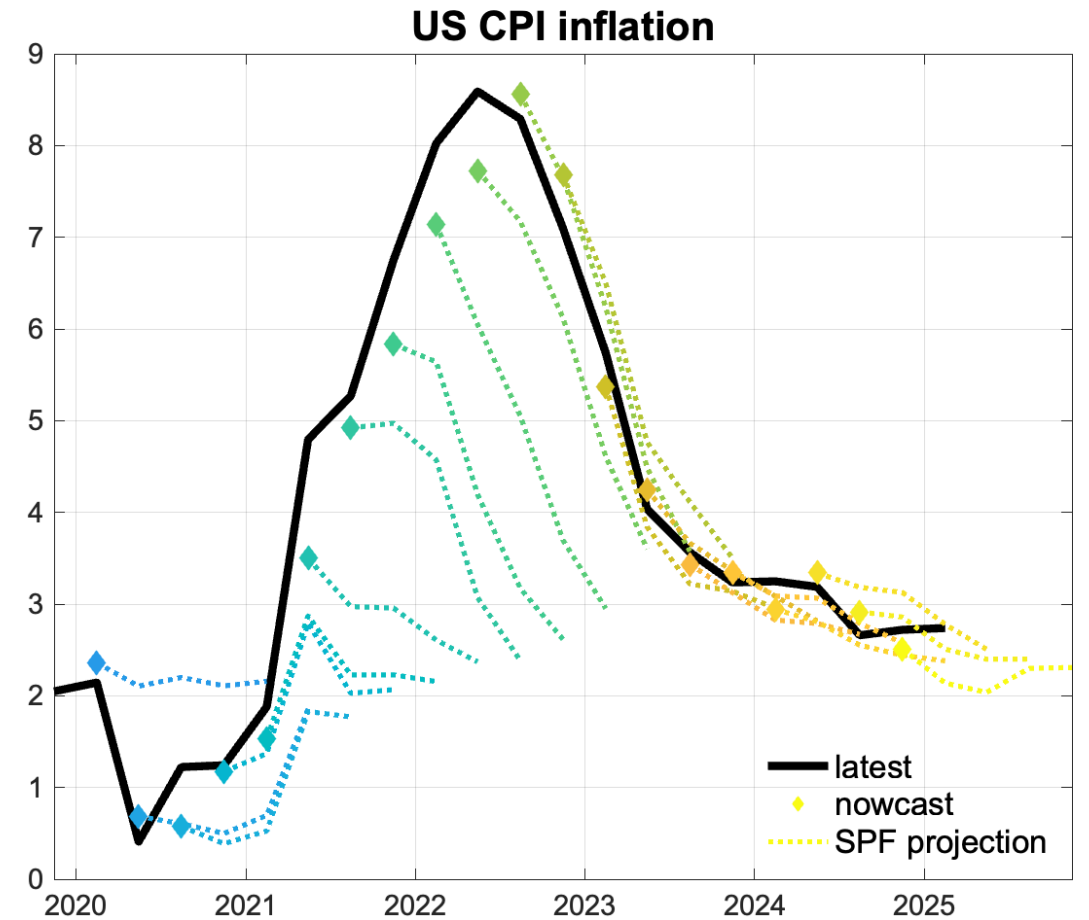
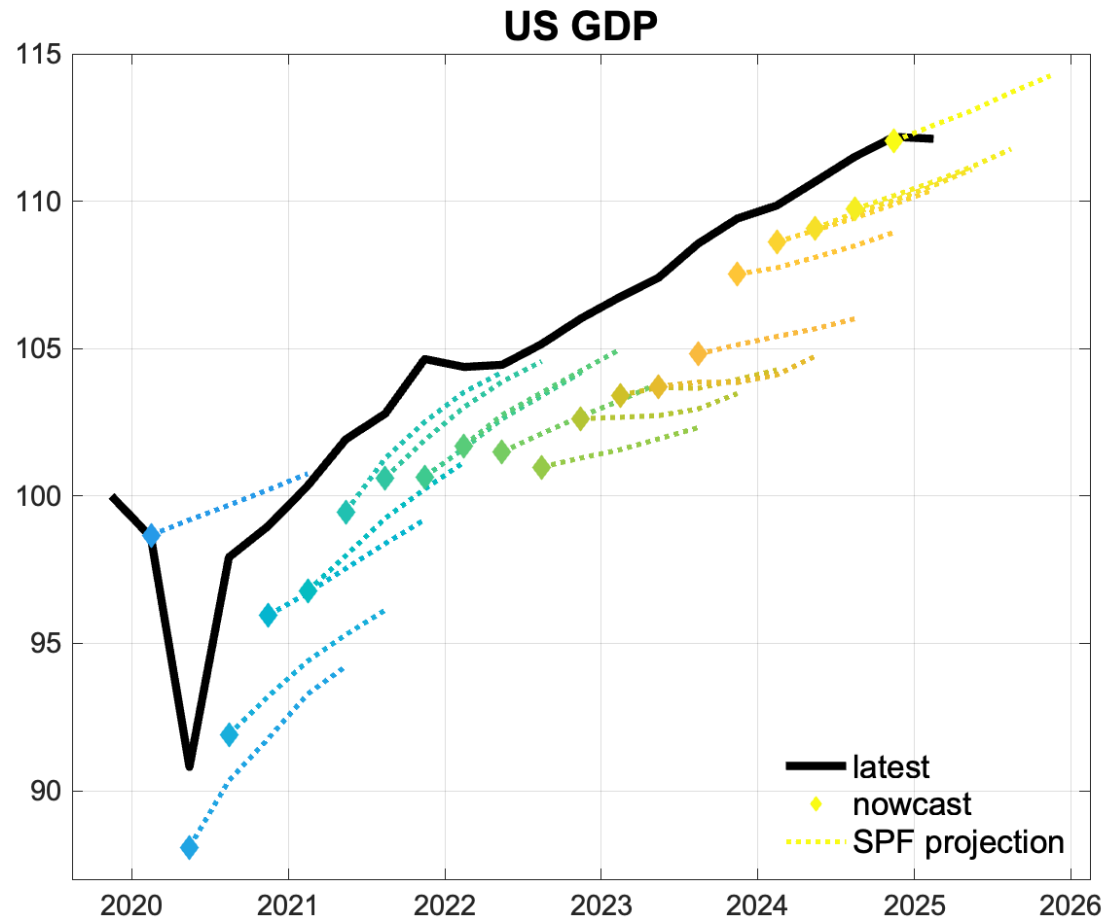
➤ Unsurprising, almost everyone did

The sniff test: The forecast errors of the ECB



The ECB has underpredicted **both** EA inflation **and** GDP in 2021-22

The sniff test: The forecast errors of the SPF



The SPF has underpredicted **both** US inflation **and** GDP in 2021-22

A “sniff test” of the demand-driven interpretation

- Compute inflation and GDP forecast errors of the ECB staff and the US SPF
 - Examine whether they were positively or negatively correlated in 2021–22
-
- ➡ **Pattern of FE consistent with the view that inflation was primarily demand driven**
 - ➡ **Real-time data might have masked some of these demand pressures, providing excessive support to the supply-side narrative of inflation**

The recent inflation surge was predominantly driven by **unexpectedly strong demand forces**

Evidence

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