Inflation, higher-for-longer rates, and macro-financial stability

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Disclaimer: the views expressed here are those of the presenter and not necessarily reflect those of the BIS.
A quick look back
Inflation makes a comeback in 2021 as supply and demand clash

Supply chain disruptions erupt...

...spending rotates from services to goods...

...commodity prices rise from lockdown lows

Source: BIS Annual Economic Report, 2023
A second blow from the war in 2022

Commodity prices hit record-highs...

...supply chain disruptions linger...

...spending rotation proves persistent

Source: BIS Annual Economic Report, 2023
Headline inflation abates while core inflation proves sticky

Contribution to year-on-year inflation

Source: BIS Annual Economic Report, 2023
More expansive policy mix has contributed to inflation surge

Fiscal policy

\[ y = 3.68 + 0.105x \]
where \( R^2 = 0.122 \)

Monetary policy

\[ y = 3.4 - 0.62x \]
where \( R^2 = 0.31 \)

Source: BIS Annual Economic Report, 2023
A look ahead
Directionally the same, notable differences in terms of distance to target

Inflation

Sources: Datastream; Macrobond; national data; BIS.
Factors that triggered the initial inflation surge weaken

Commodity prices retreat (yet recent tick is concerning)...

...supply chain disruptions ease...

...spending rotation starts to revert

Source: BIS Annual Economic Report, 2023
Disinflation takes time

Past disinflation episodes

Services price growth

Headline inflation: 1970s vs now

Real interest rate: 1970s vs now

Source: BIS Annual Economic Report, 2023
Larger contribution from services may imply more persistent inflation

Services prices continue to rise at an increasing pace

Share of labour costs is higher in services

Common global factor explains less of changes in services prices

Source: BIS Annual Economic Report, 2022

Price, yoy change (lhs):
- Goods: AEs
- Services: EMEs

Coefficient of variation (rhs):
- Goods: AEs
- Services: EMEs

Source: BIS Annual Economic Report, 2023
Wage- and price-setting could easily change, with implications for inflation

Purchasing power of households has been eroded

Real wages have fallen behind more than they did in the past

Firm profits have grown at a solid pace

Annual wage growth:
Nominal:
- 2020–22
- 2008–19

Real:

Historical:
- Median
- Interquartile range

2022–23:

Source: BIS Annual Economic Report, 2023
Boxes are ticked for financial stress during monetary tightening

Stress more likely when private credit-to-GDP is high...

when the surge in inflation is strong...

...when house prices grow rapidly

In the month of the first hike, the variable in the panel heading is in:

- First quartile
- Fourth quartile

Source: BIS Annual Economic Report, 2023
The long shadow of low-for-long: duration mismatches and exposure to outflows

US banks reach for long-duration assets

Projected decline in bank equity due to upward shift in yield curve

Funding shifts to short-term deposits during the low-for-long

Remaining maturity or next repricing:
- Median: More than 15 years
- Median: Five–15 years

Interquartile range:

Source: BIS Annual Economic Report, 2023
Rising interest rates test bank resilience

Losses on debt securities accumulate, authorities intervene

Recognition of unrealised losses would weigh on capital ratios

Equity investors differentiate across banks

Source: BIS Annual Economic Report, 2023
Corrections in real estate markets pose downside risks, including via NBFIs

Commercial and residential property prices

Source: BIS Annual Economic Report, 2023
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Read the full report at bis.org