



# Navigating the disinflation journey: Key risks on a turbulent path

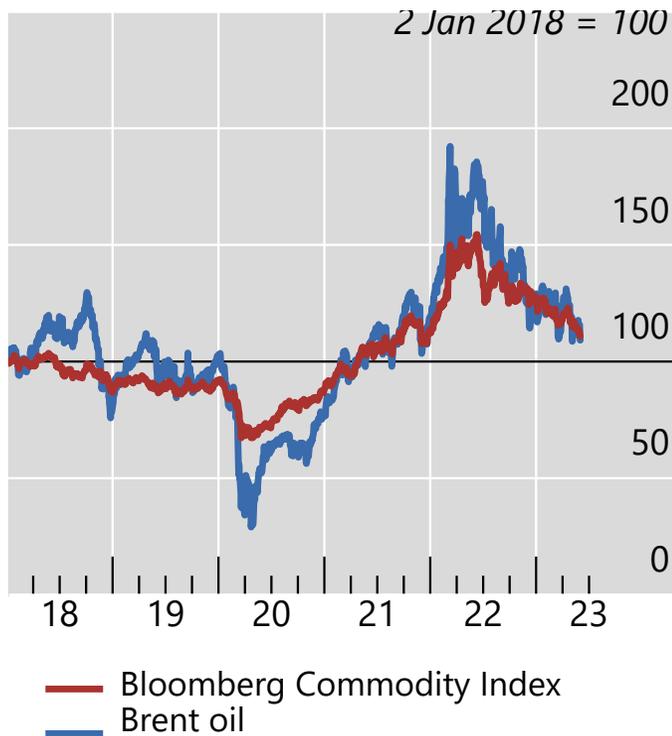
Deniz Igan

June 23, 2023

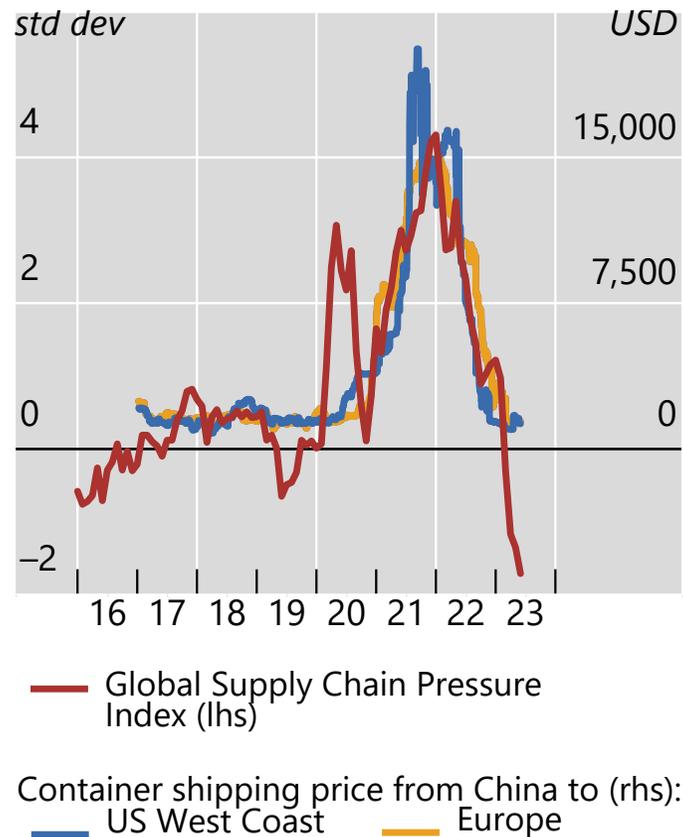
The views expressed are those of the presenter and do not necessarily represent those of the BIS.

# Factors that triggered the initial inflation surge weaken

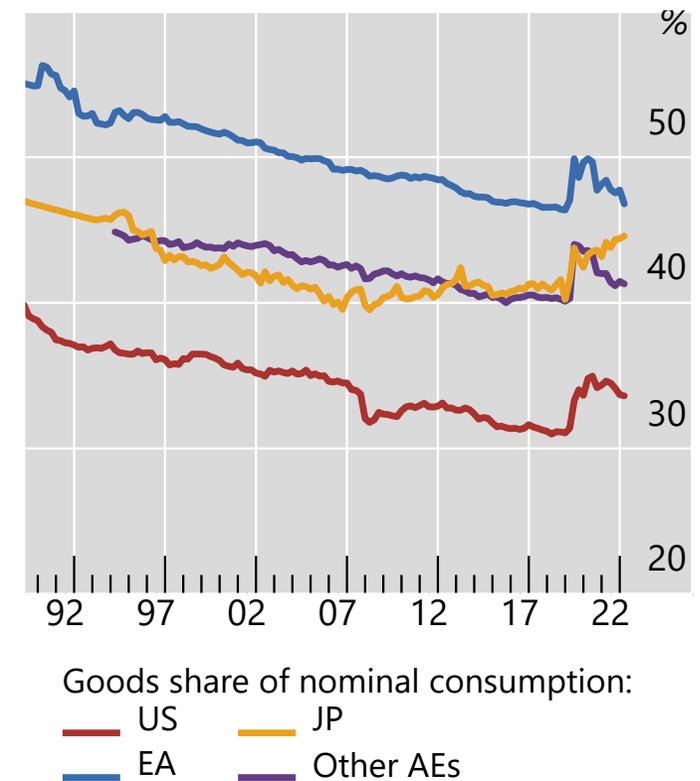
Commodity prices retreat...



...supply chain disruptions ease...



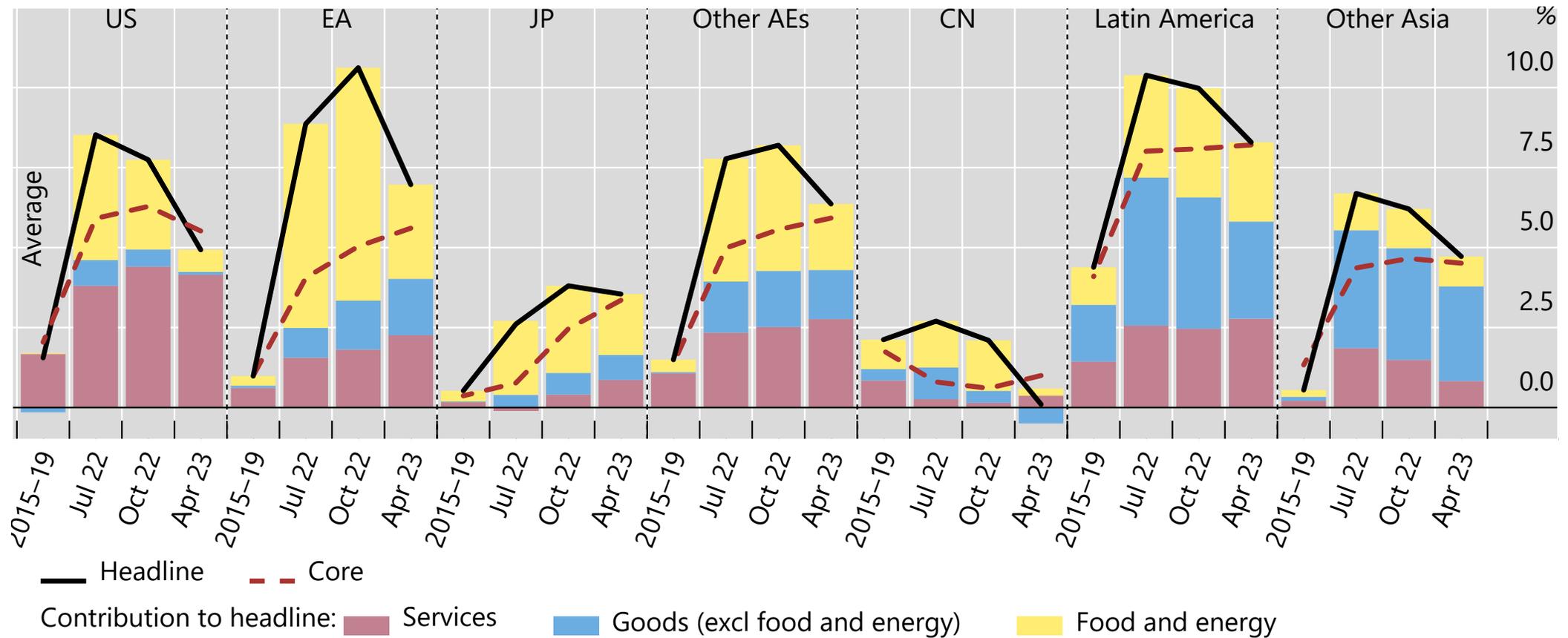
...spending rotation starts to revert



Source: BIS Annual Economic Report, 2023

# Headline inflation abates while core inflation proves sticky

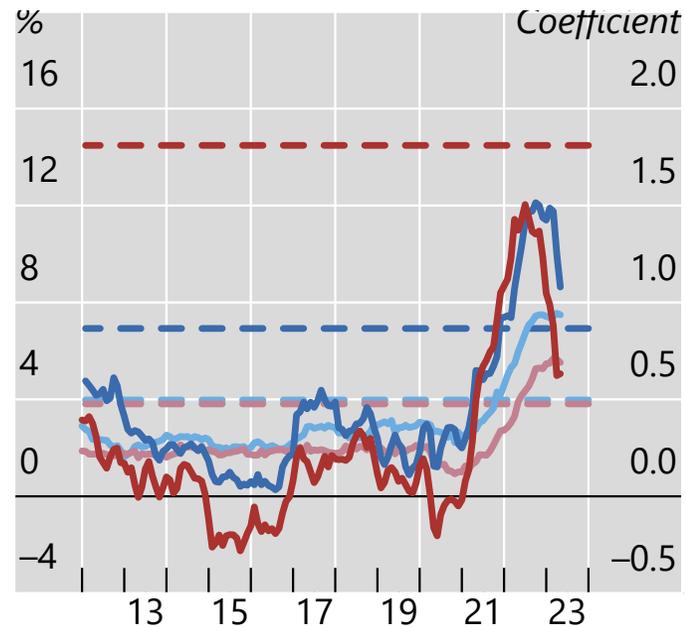
Contribution to year-on-year inflation



Source: BIS Annual Economic Report, 2023

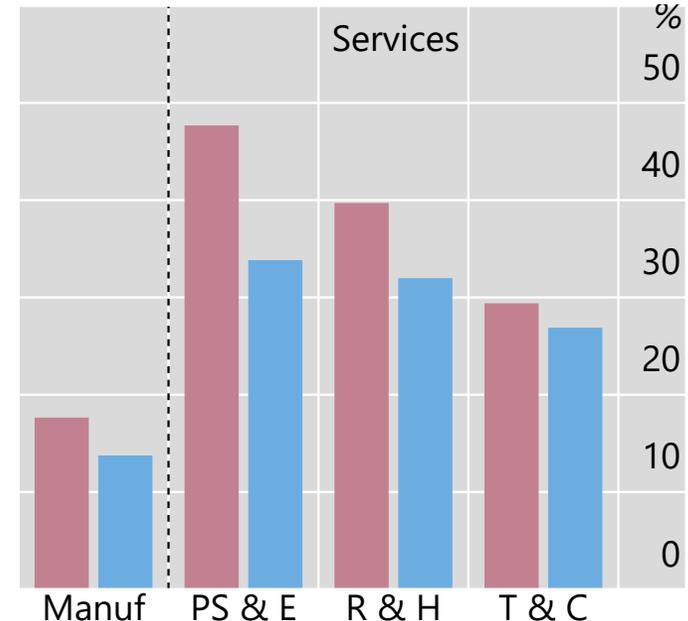
# Larger contribution from services may imply more persistent inflation

Services prices continue to rise at an increasing pace



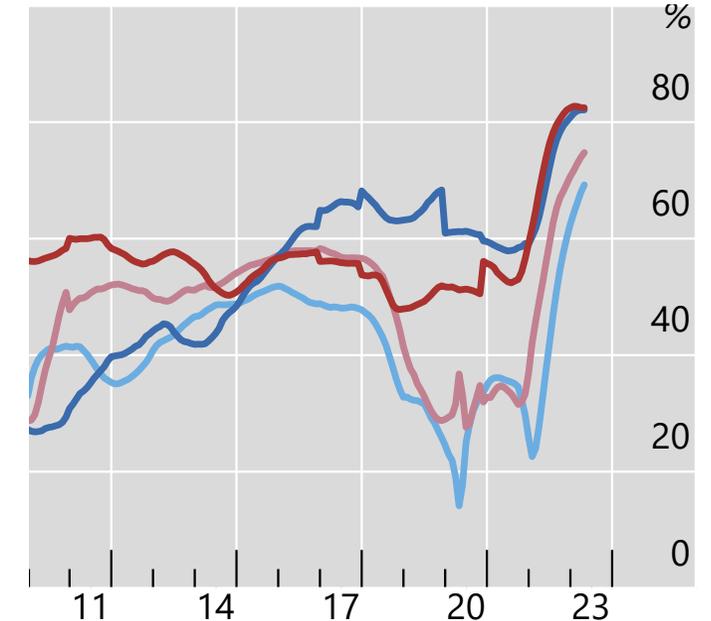
	Goods:		Services:
Price, yoy change (lhs):	<span style="color: red;">—</span> AEs	<span style="color: blue;">—</span> EMEs	<span style="color: red;">—</span> AEs
	<span style="color: red;">—</span> EMEs	<span style="color: blue;">—</span> AEs	<span style="color: blue;">—</span> EMEs
Coefficient of variation (rhs):	<span style="color: red;">- -</span> AEs	<span style="color: blue;">- -</span> EMEs	<span style="color: red;">- -</span> AEs
	<span style="color: red;">- -</span> EMEs	<span style="color: blue;">- -</span> AEs	<span style="color: blue;">- -</span> EMEs

Share of labour costs is higher in services



■ AEs ■ EMEs

Common global factor explains less of changes in services prices

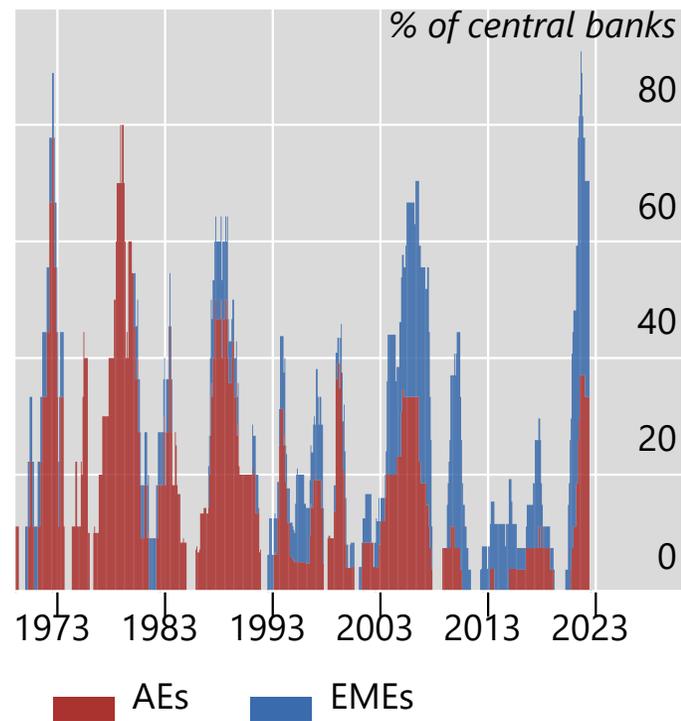


Goods:		Services:
<span style="color: red;">—</span> AEs	<span style="color: blue;">—</span> EMEs	<span style="color: red;">—</span> AEs
<span style="color: red;">—</span> EMEs	<span style="color: blue;">—</span> AEs	<span style="color: blue;">—</span> EMEs

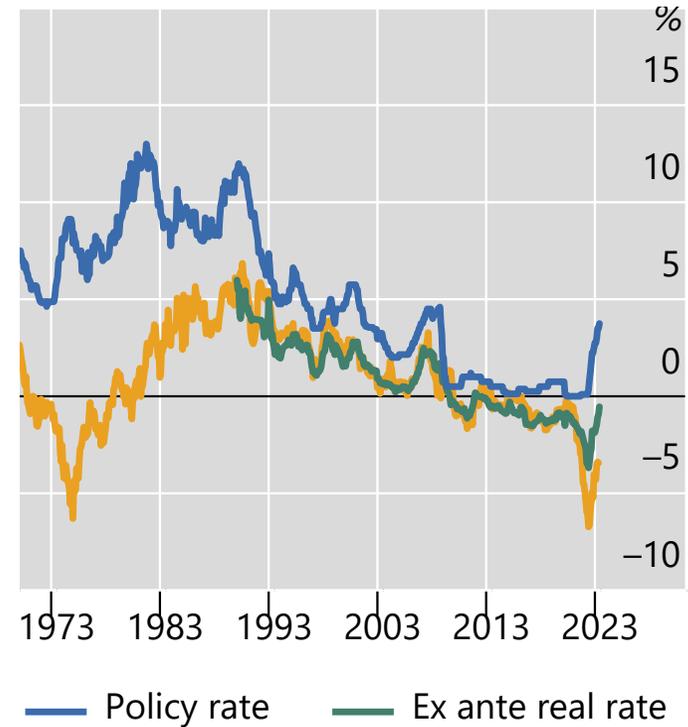
Source: BIS Annual Economic Report, 2023

## Synchronised monetary tightening lifts rates from historic lows

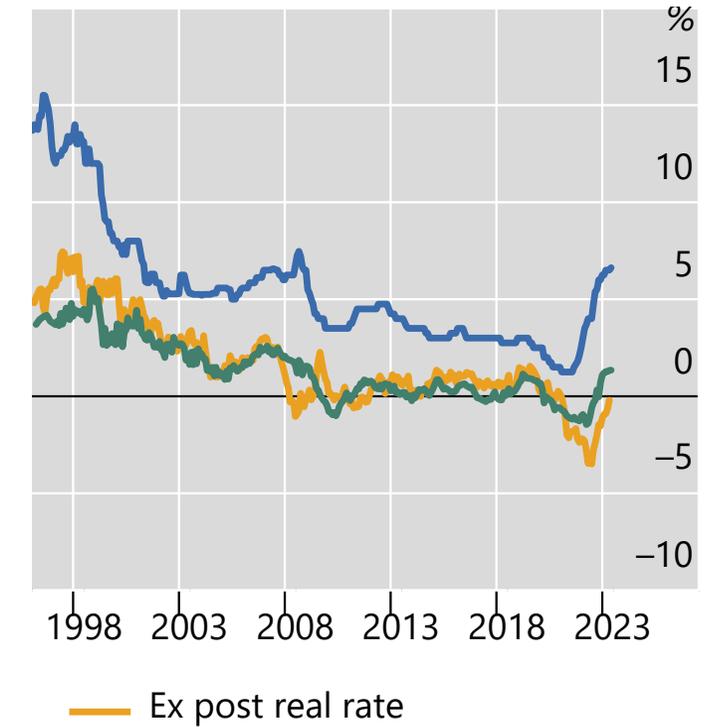
### Monetary tightening episodes



### Policy rates in AEs



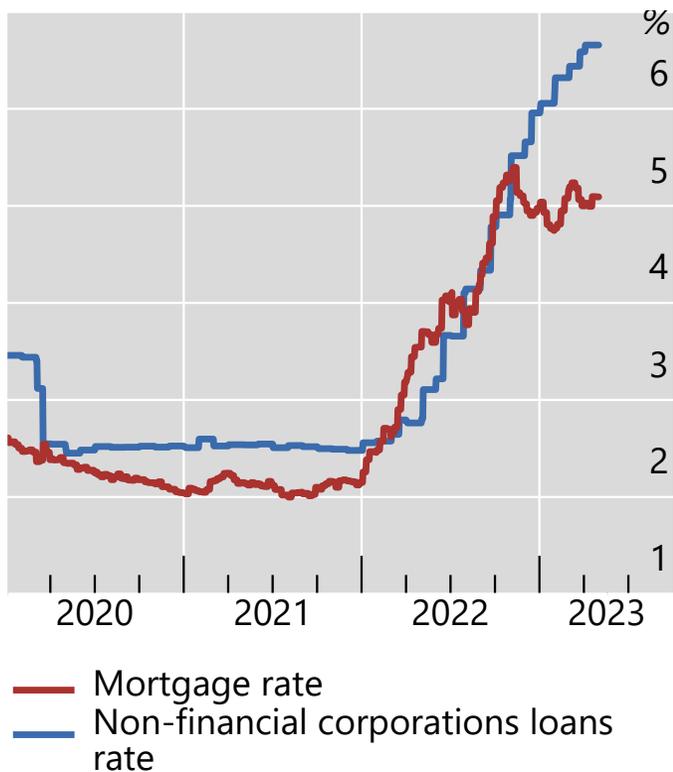
### Policy rates in EMEs



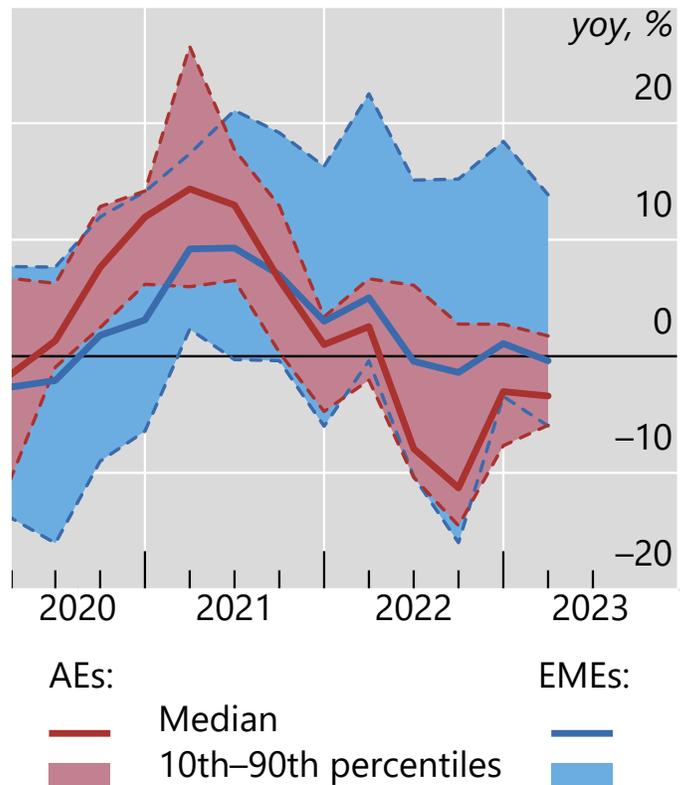
Source: *BIS Annual Economic Report, 2023*

# Monetary tightening raises borrowing costs and slows demand

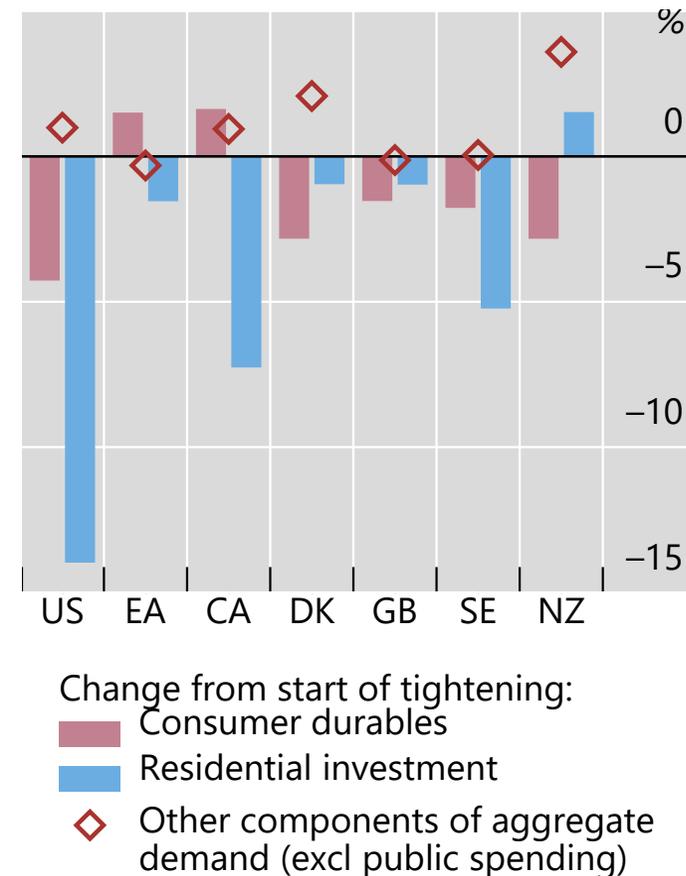
New mortgage and lending rates in major AEs rise...



...and bank credit growth drops...



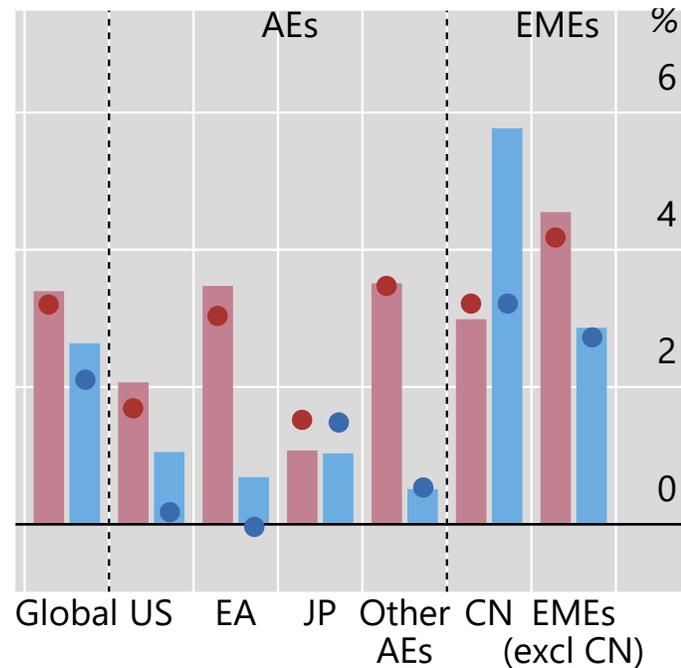
...while durables and residential investment growth slows down



Source: BIS Annual Economic Report, 2023

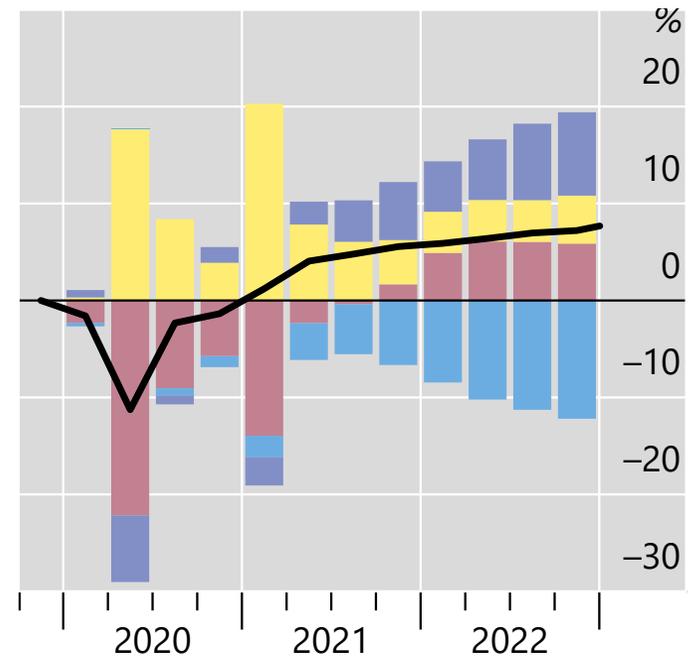
# Activity holds up better than expected, in part thanks to transfers and savings

Evolution of output forecasts



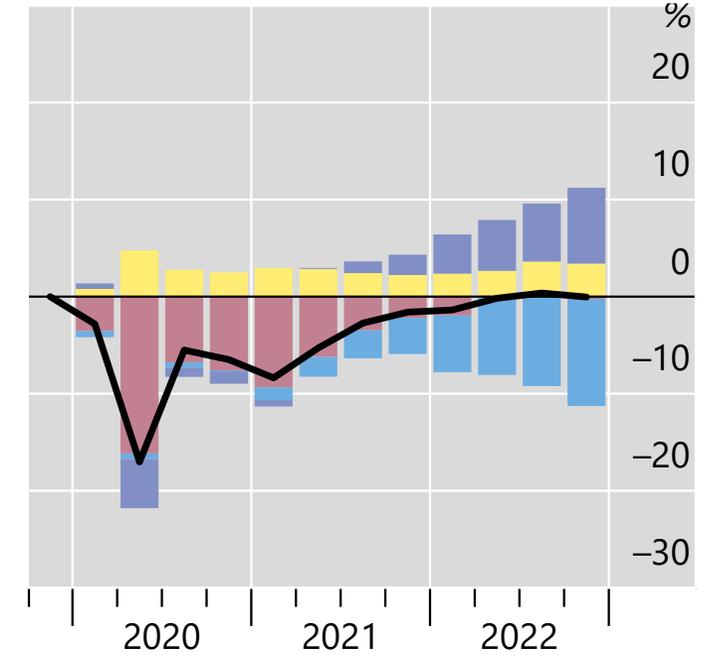
2022: Realised/latest forecast (red bar), October 2022 forecast (red dot)  
 2023: Realised/latest forecast (blue bar), October 2022 forecast (blue dot)

Real consumption growth drivers in the United States



Savings rate change (red bar), Consumption deflator (blue bar), Transfers (yellow bar)

Real consumption growth drivers in other AEs

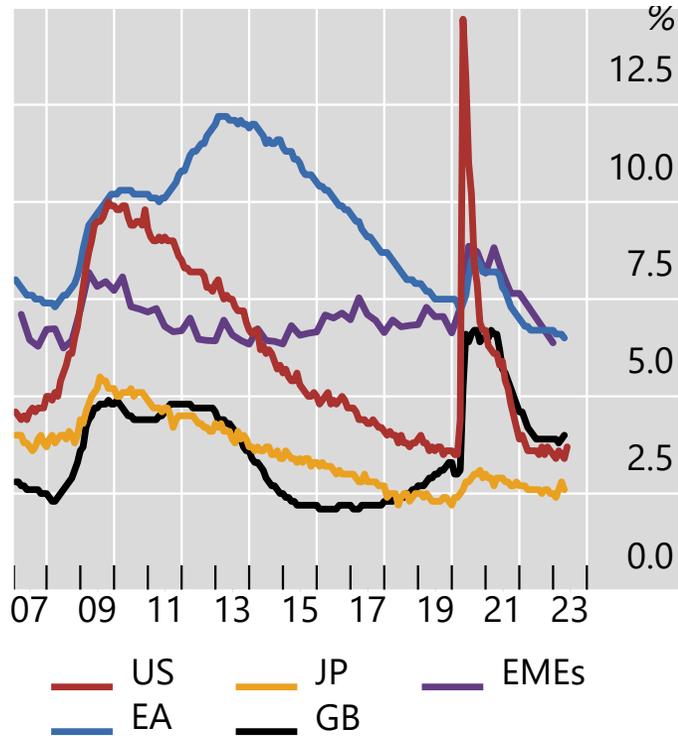


Net income (blue bar), Real consumption (black line)

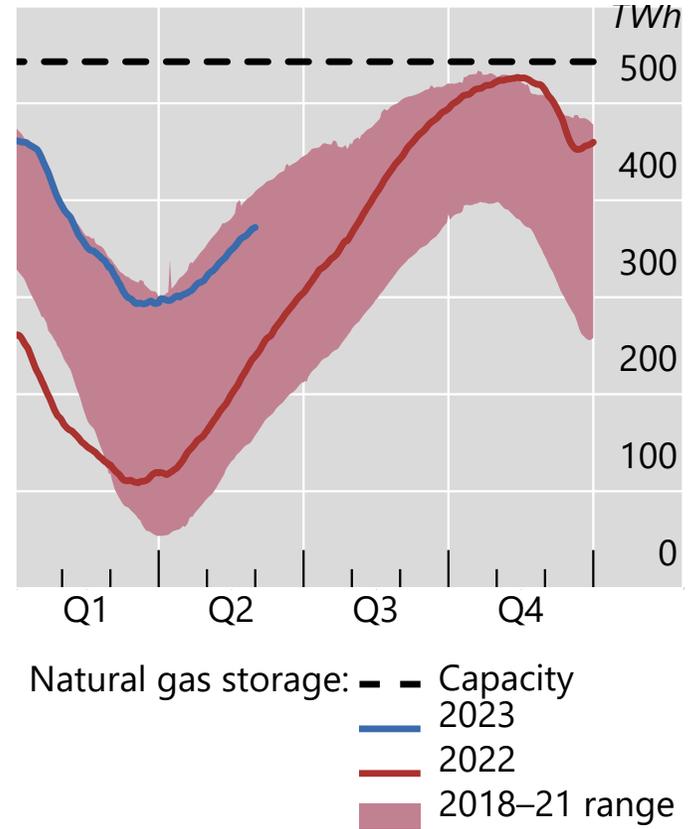
Source: BIS Annual Economic Report, 2023

# Strength in activity owes in part to strong labour markets and positive surprises

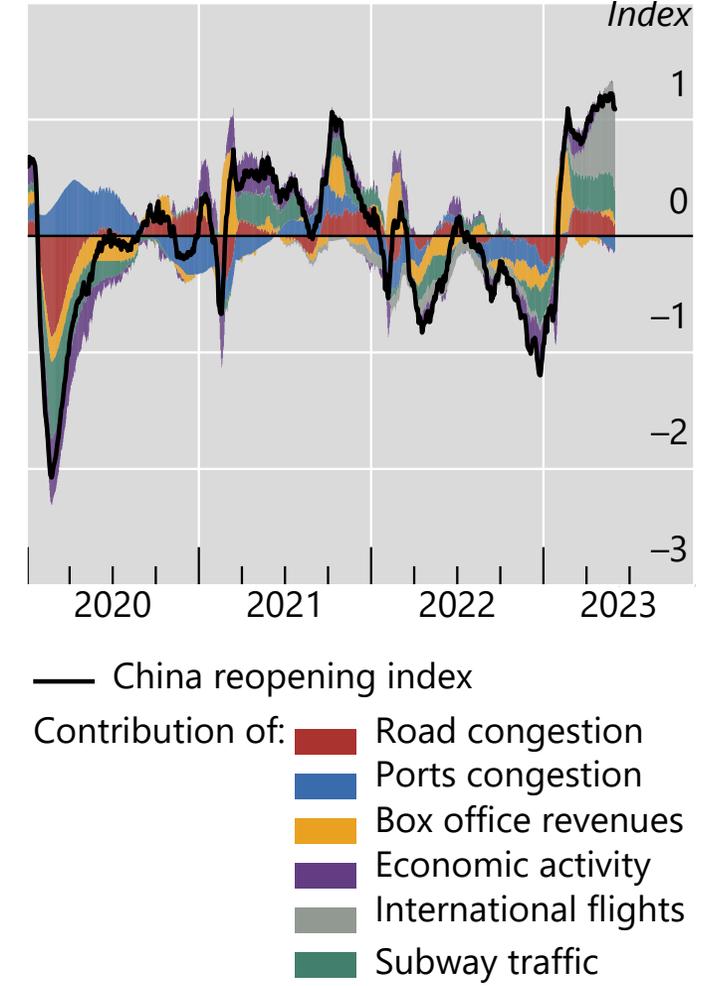
Unemployment rates are at historical lows



Natural gas storage levels in Europe build up rapidly



China reopens earlier and more vigorously than expected

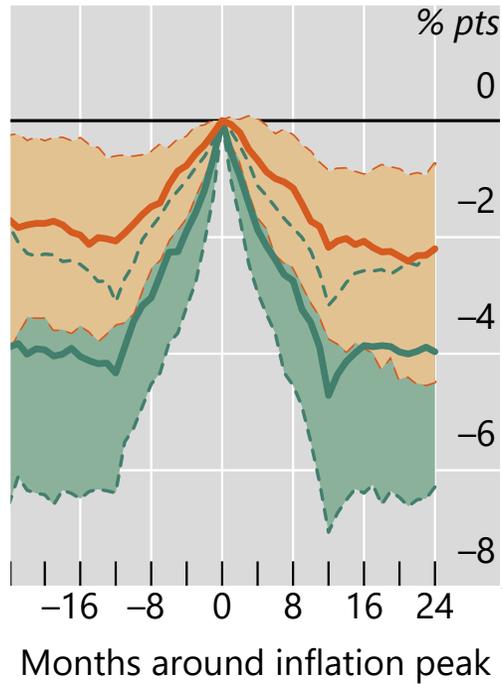


Source: BIS Annual Economic Report, 2023

Key risk I:  
Persistent inflation

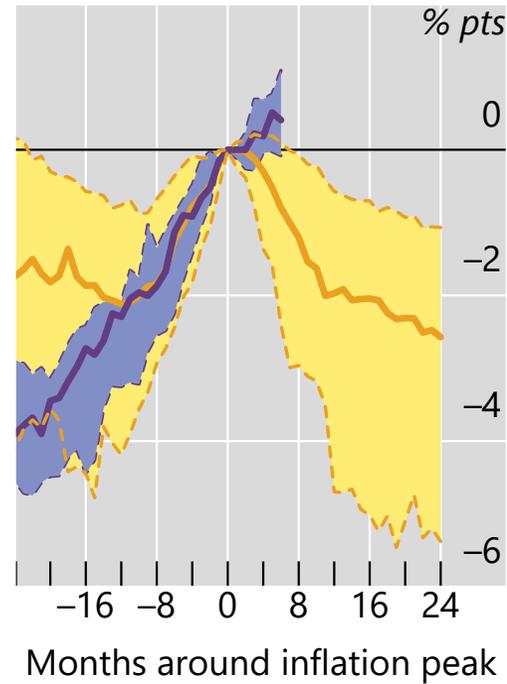
# Disinflation takes time

Past disinflation episodes



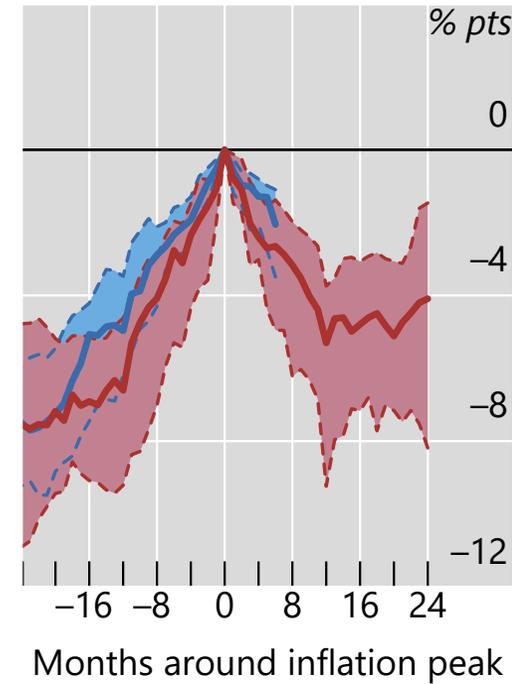
Core: Median (orange line), Interquartile range (orange shaded area)  
 Headline: Median (green line), Interquartile range (green shaded area)

Services price growth



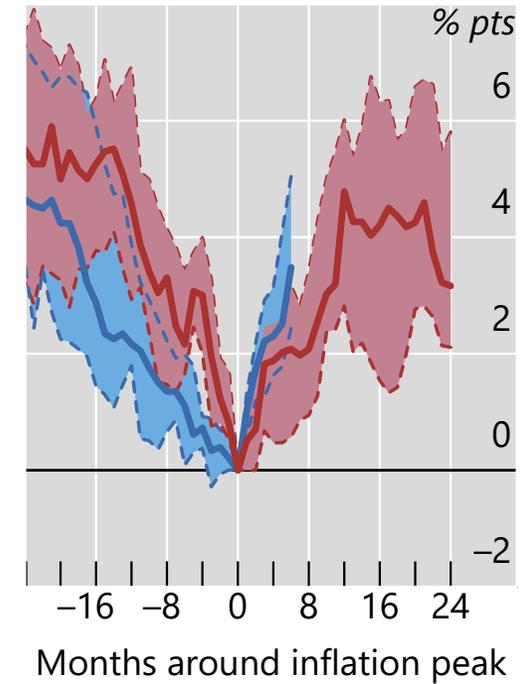
Historical: Median (yellow line), Interquartile range (yellow shaded area)  
 2022-23: Median (purple line), Interquartile range (purple shaded area)

Headline inflation: 1970s vs now



1970: Median (red line), Interquartile range (red shaded area)  
 2022-23: Median (blue line), Interquartile range (blue shaded area)

Real interest rate: 1970s vs now

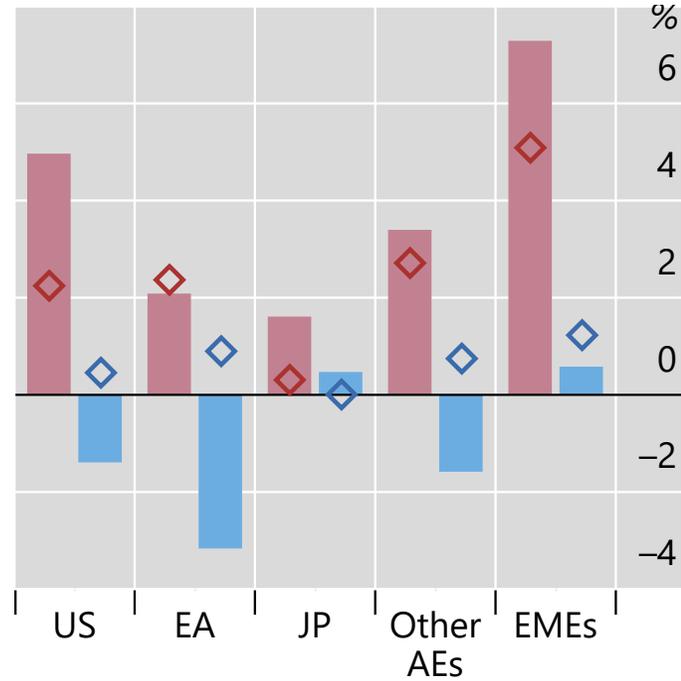


2022-23: Median (blue line), Interquartile range (blue shaded area)

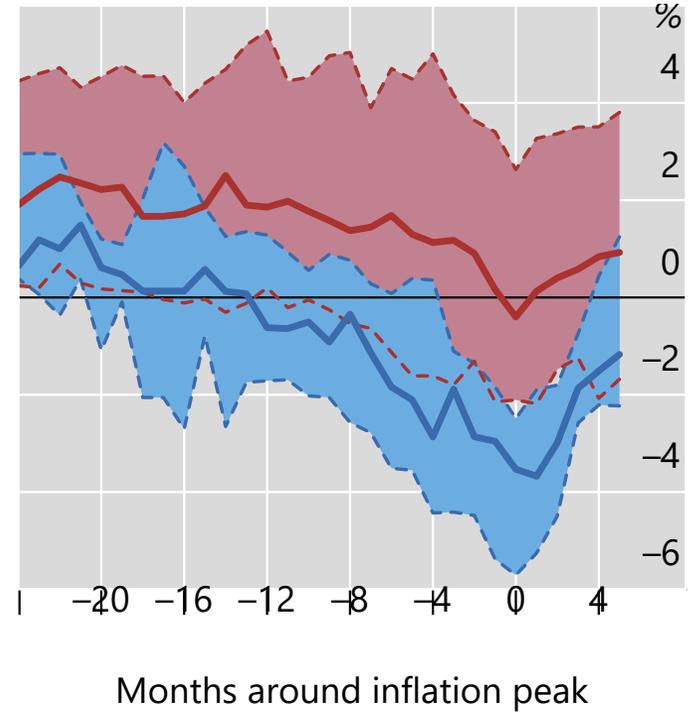
Source: BIS Annual Economic Report, 2023

# Wage- and price-setting could easily change, with implications for inflation

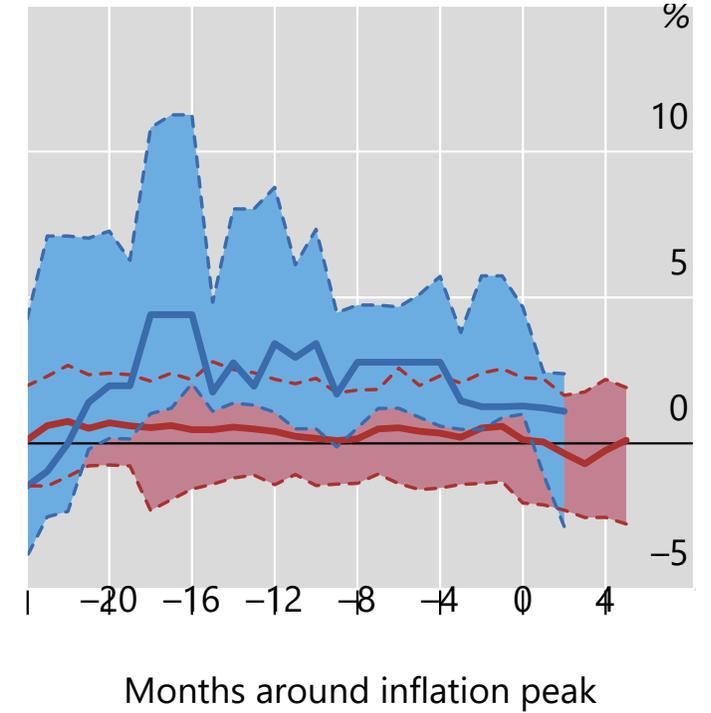
Purchasing power of households has been eroded



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 █ Real:  
◇ 2008-19 ◇

Historical:  
— Median  
█ Interquartile range

2022-23:  
—  
█

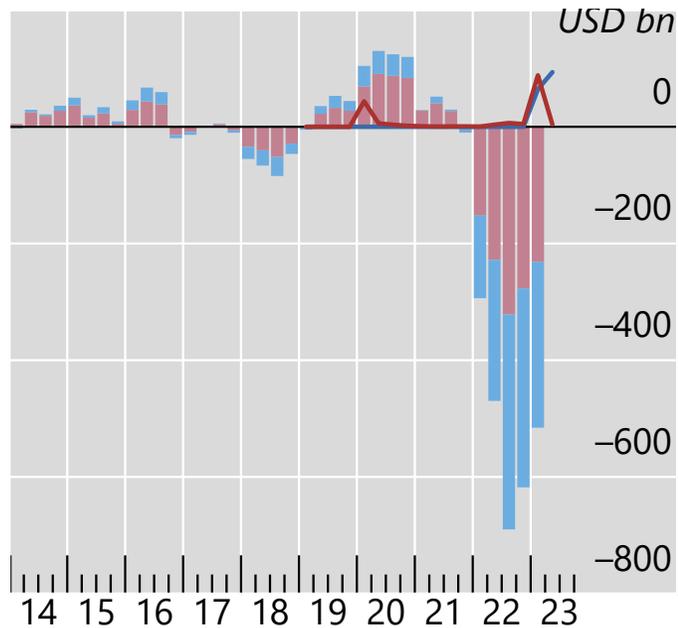
Source: BIS Annual Economic Report, 2023

Key risk II:  
Financial instability



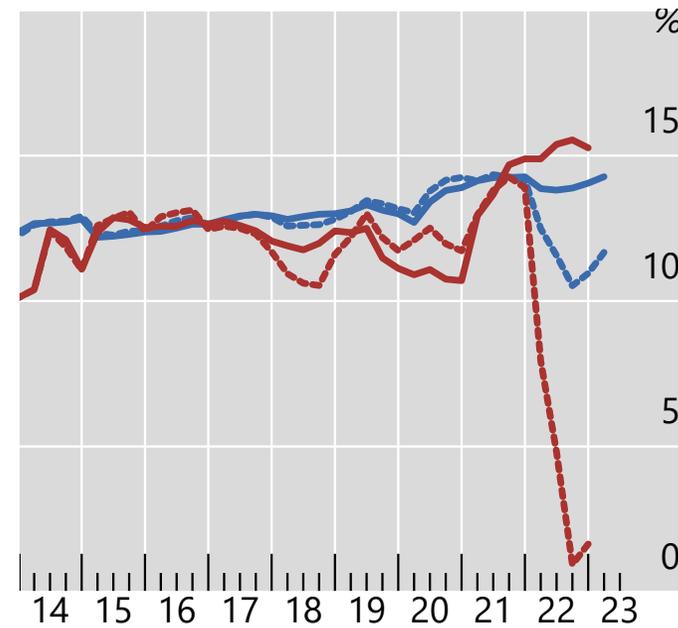
# Rising interest rates test bank resilience

Losses on debt securities accumulate, authorities intervene



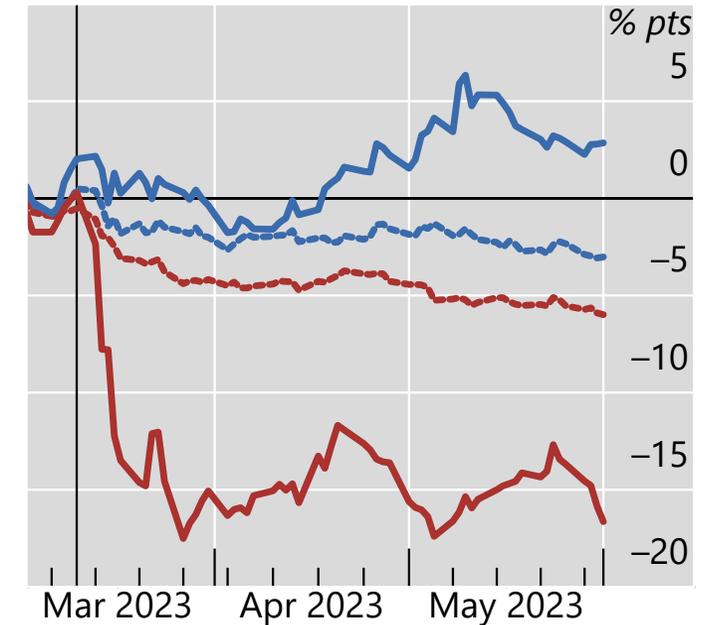
- AFS
- HTM
- Bank Term Funding Program
- Loans to domestic banks through the discount window

Recognition of unrealised losses would weigh on capital ratios



- CET1 capital ratio:
- SVB
- Other banks
- Adjusted for unrealised losses:
- - - -
- - - -

Equity investors differentiate across banks



- AE banks:
- Low PBR
- - - - High PBR
- EME banks:
- 
- - - -

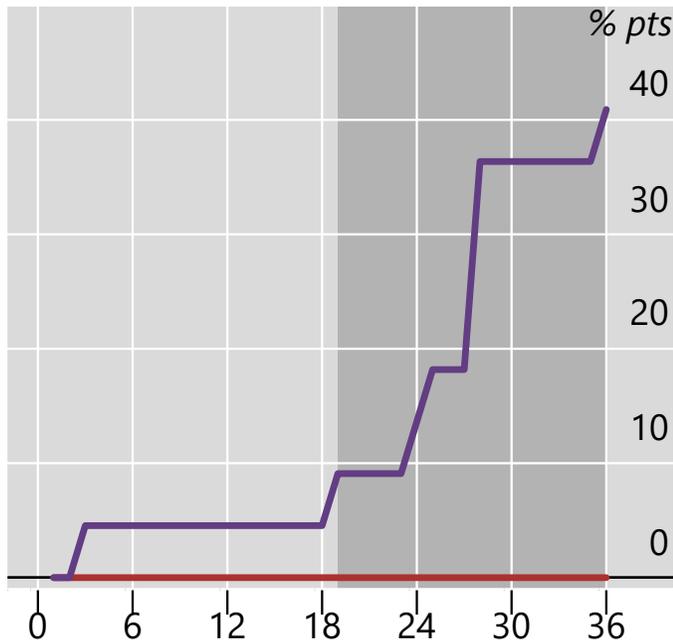
Source: BIS Annual Economic Report, 2023

# Boxes are ticked for financial stress during monetary tightening

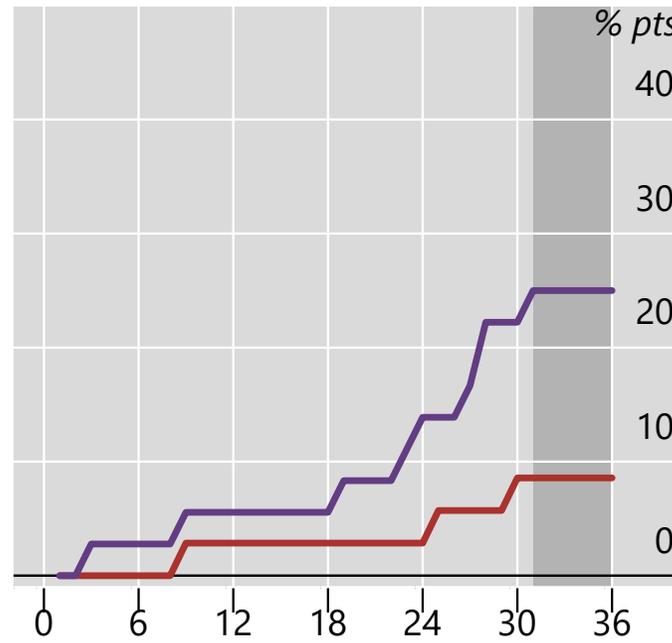
Stress more likely when private credit-to-GDP is high...

when the surge in inflation is strong...

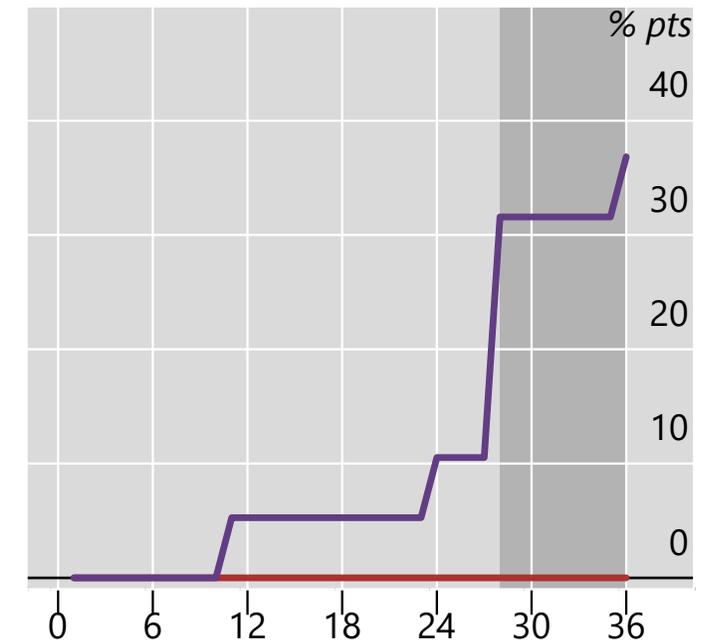
...when house prices grow rapidly



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



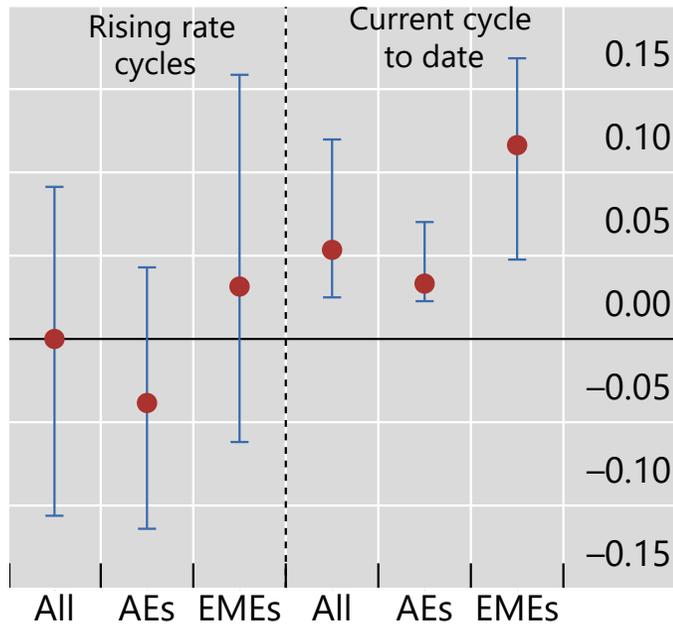
— First quartile    — Fourth quartile



Source: BIS Annual Economic Report, 2023

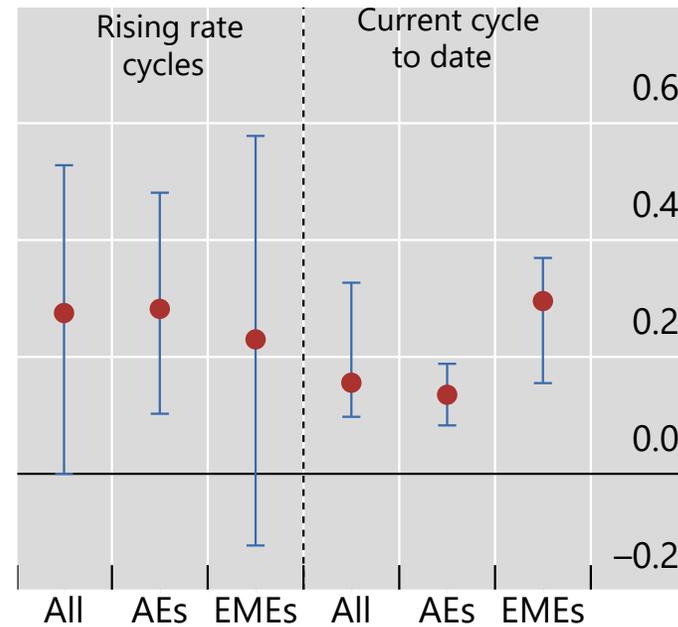
# Sensitivity of bank interest margins to increase in policy rates looks different

NIMs have risen with policy rates in this cycle



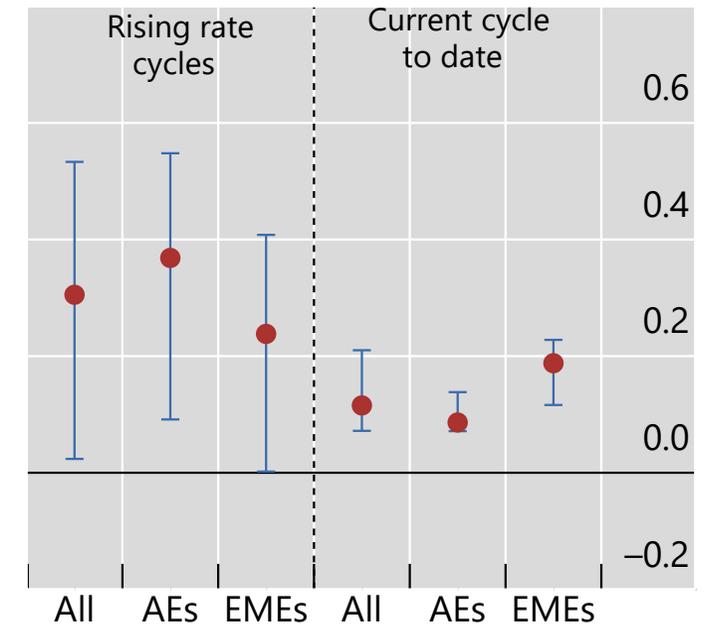
Cumulative change relative to change in policy rates over rising rate cycles:

Rise in asset yields to date suggests scope for further rise in AEs



● Median — Interquartile range

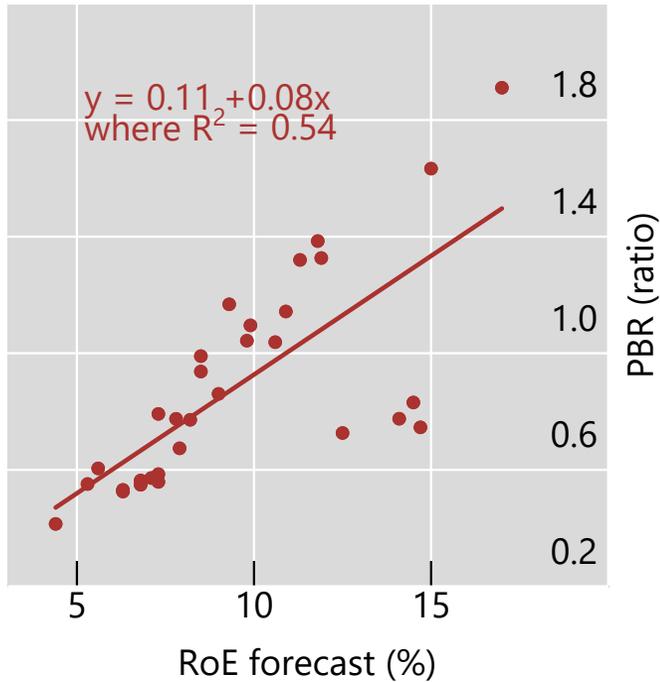
Debt funding costs lag adjustment to higher interest rate environment



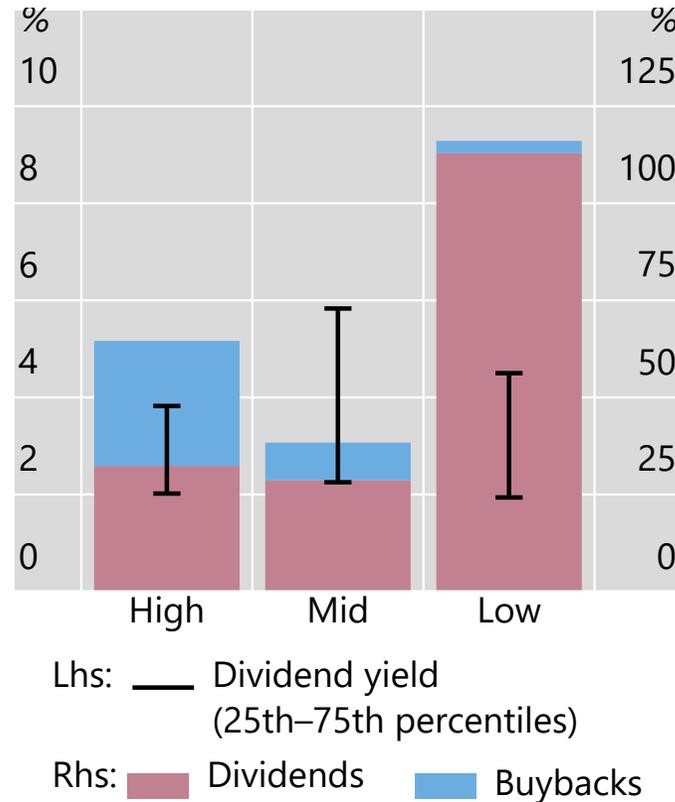
Source: BIS Annual Economic Report, 2023

# Low-valuation banks: balancing market demands amid low profitability

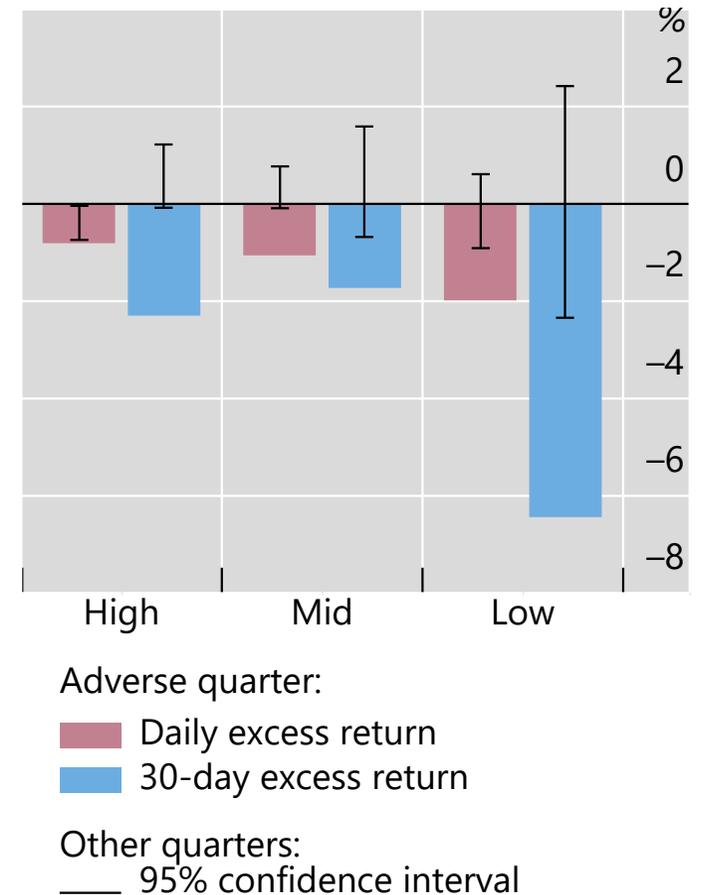
Tight link: RoE forecasts and PBR



Low-valuation banks pay out a higher share of their income



Low-valuation banks' stocks suffer more after large RoE declines



Source: BIS Annual Economic Report, 2023



## Thanks go to the team:

Pongpitch Amatyakul, Miguel Ampudia, Alessandro Barbera, John Caparusso, Gabriele Freo, Emanuel Kohlscheen, Nicolas Lemercier, Cristina Leonte, Ulf Lewrick, Marco Lombardi, Nikola Tarashev, Karamfil Todorov

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