The 2020-2022 Inflation Surge Across Europe: A Phillips-Curve-Based Dissection

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ABSTRACT: In 2021-22, inflation in Europe soared to multidecade highs, consistently exceeding policymakers' forecasts and surprising with its wide cross-country dispersion. This paper analyzes the key drivers of the inflation surge in Europe and its variation across countries. The analysis highlights significant differences in Phillips curve parameters across Europe’s economies. Inflation is more sensitive to domestic slack and external price pressures in emerging European economies compared to their advanced counterparts, which contributed to a greater passthrough of global commodity price shocks into domestic prices, and, consequently, to larger increases in inflation rates. Across Europe, inflation also appears to have become increasingly backward looking and more sensitive to commodity price shocks since the onset of the COVID-19 pandemic. This finding helps explain why conventional (Phillips curve) inflation models consistently underpredicted the 2021-2022 inflation surge, although it remains too early to conclude there has been a structural break in the inflation process.


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