

Gediminas Šimkus: Descending from the inflation peak - lessons and insights

Welcome address by Mr Gediminas Šimkus, Chairman of the Board of the Bank of Lithuania, at the Economics Conference "Descending from the Inflation Peak: Lessons and Insights", Vilnius, 3 October 2023.

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Dear Guests, Distinguished speakers, Ladies and gentlemen, Dear all,

It is my great pleasure to welcome you to the 7th annual Economics Conference, organised by the Bank of Lithuania. This year's topic is on descending from the inflation peak and the lessons so far.

In the words of John F. Kennedy, change is the law of life. And that is true speaking of economic life over the last year. Most importantly, inflation was forced to change its direction and is on the way down.

The specifics of the current inflation, monetary policy stance and how we proceed from here will be addressed by our keynote speaker, Doctor Philip Lane. I am sure that for a large audience of distinguished policymakers, academics, and people having a general interest in economics, Philip needs no introduction. He is ECB's Chief Economist and a member of the Executive Board. Dear Philip, thanks for being with us.

Ladies and gentlemen,

Inflation demon has many heads and we need to chop-off all. In Lithuania and the euro area more generally, this particular episode was sparked by a number of unprecedented supply-side shocks hitting the economy in quick succession. A once-in-a-lifetime global pandemic, supply-chain bottlenecks, the return of the full-scale war to the European continent, energy crises were severe disruptions. Also highlighting the importance of the supply-side shocks to the economy. Prompt response of fiscal and monetary policies was effective. It prevented the economies from a prolonged period of suppressed activity and financial stresses after pandemic shock.

Inflation, in quite literate terms, was an unexpected price to pay. A year ago, it peaked well into the double digits in Lithuania. The good news – it's on the declining path since and approached 4 percent based on September's flash estimate. The reasons for such a trend are twofold.

First, abating supply-side pressures as pandemic-related bottlenecks eased and energy prices declined. For Lithuania, the latter is of particular importance. Energy was not only directly accountable for one-third of the average annual inflation last year, but it also contributed to price increases through indirect channels.

Second, the ECB's monetary policy response. ECB's Governing Council has hiked policy rate 10 times or – overall – by 450 basis points since last July to ensure that inflation returns to target in a timely manner. The policy also ensures that longer-term

inflation expectations remain anchored.

Distinguished guests,

Despite recent positive news on the inflation front, celebrating victory would be way too early. Yes, the latest Bank of Lithuania economic projections see average annual inflation falling below 3 percent in 2024. But that is mostly because of the base effects. Core inflation is still projected to remain higher despite the fall in headline numbers. And sizable uncertainty regarding future inflation path in Lithuania remains. The macroeconomic environment is far from stable as Russian aggression continues on European soil. In short, inflation on the way down still faces important lines of resistance and the celebration can only be warranted when those lines are breached.

Now let me return to John F. Kennedy and the second part of his statement. Which tells us that those who look only to the past or present are certain to miss the future. And the future of our monetary policy, to my mind, calls for consistency and strategic patience. Over the past year, we have covered a lot of ground. However, keeping rates for as long as necessary in the territory that is sufficiently restrictive is needed for the inflation to convincingly get back to target. And follow data dependency and meeting-by-meeting approaches as we have been successfully doing so far.

Dear all,

I think I cautioned you enough. And after doing so let me again bring you more positive news. These are the welcome remarks after all. Despite the prolonged monetary tightening episode and the steep rise in borrowing costs, financial stability risks are contained in Lithuania and the growth of credit is moderate. The strength of the financial sector is not accidental. It represents a decade-long hard work done by the Bank of Lithuania, implementing and fine-tuning macroprudential policy measures. Of course, as mentioned inflation shock is not yet over, and the geopolitical environment is anything but stable. However, the financial sector has solid capital and liquidity shields.

To conclude. Over the medium-to-long run, central banks determine the rate of price changes in an economy. However, as I mentioned, the inflation demon has many faces. This is because, over the short term, it is affected by energy and other supply-side shocks, wage setting and bargaining, changes in patterns of international trade, etc. Thus, I am very glad that this wide range of perspectives will be covered in our conference.

Finally, my colleagues and I intend this conference to serve you as a forum to exchange thoughts and ideas.

With that, I wish you active participation and fruitful discussions.

Thank you.