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Decomposition of inflation in the Eurozone and the Netherlands

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AIECE Autumn Meeting, Nov 2023

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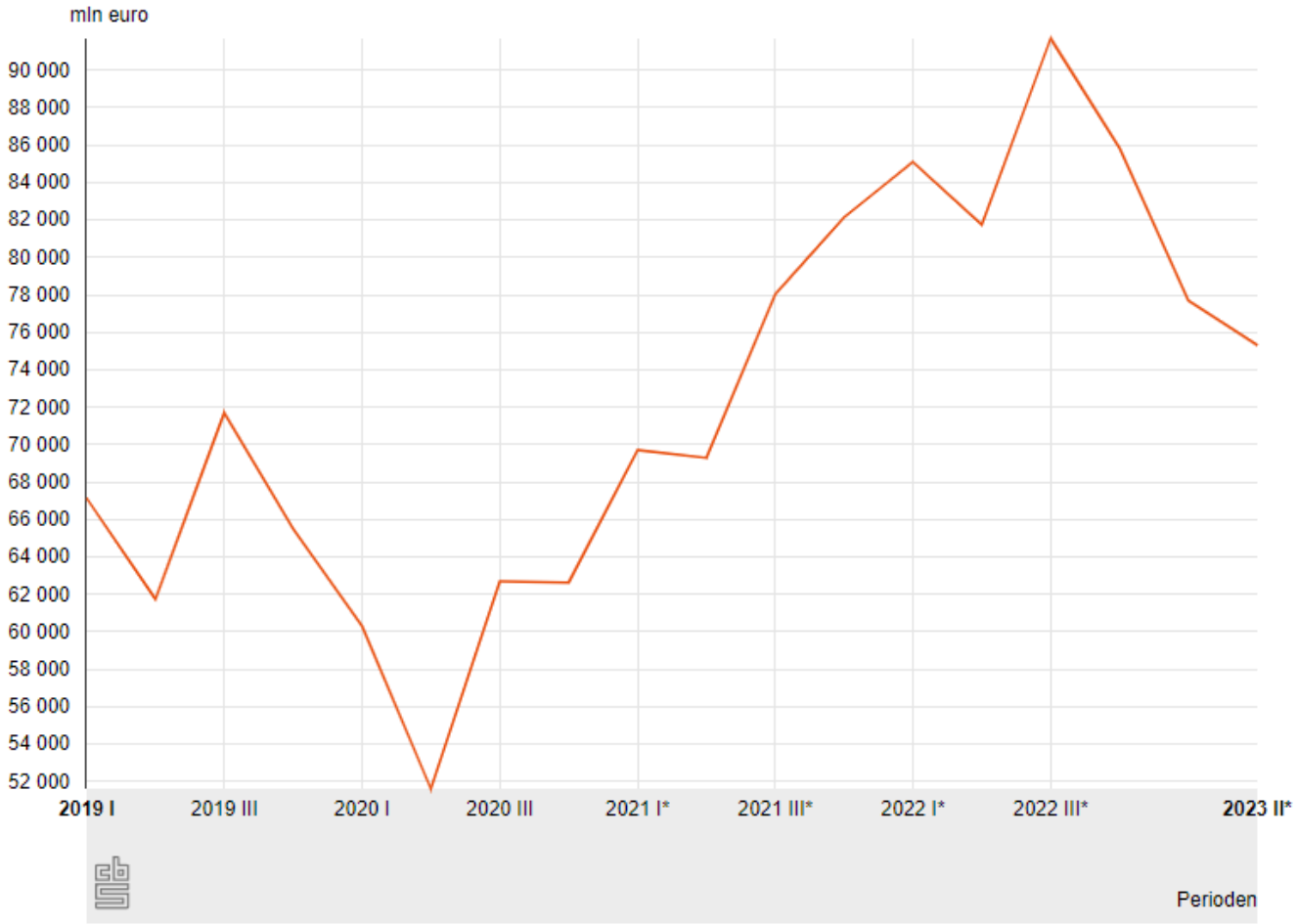
Relevance

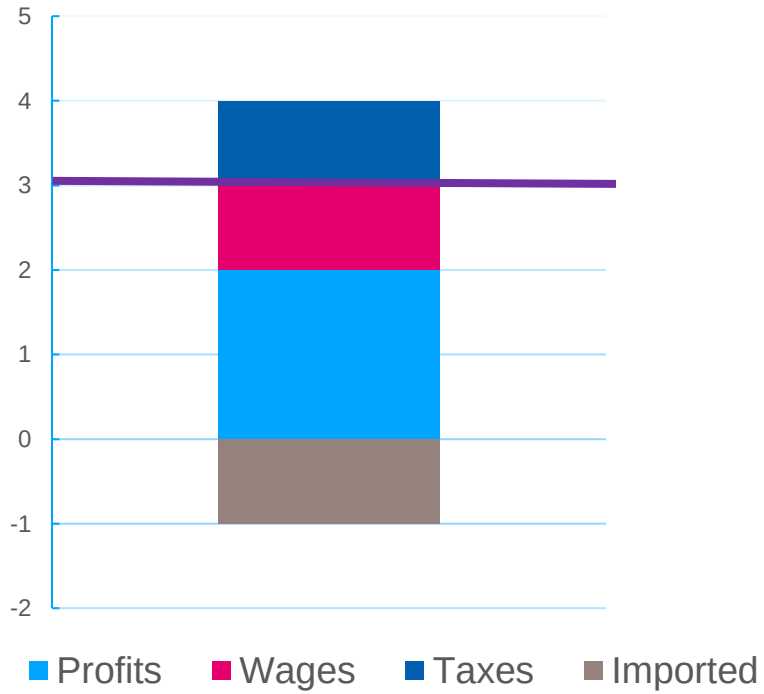
- Sharp increase in energy prices, followed by record profits
- Discussions on greedflation
- Research questions
  - What do we learn from a decomposition of inflation in the Eurzone and the Netherlands?
  - Particularly: what is the contribution of imported inflation versus profits?

CBS: profits of non-financial corporations, pre-tax



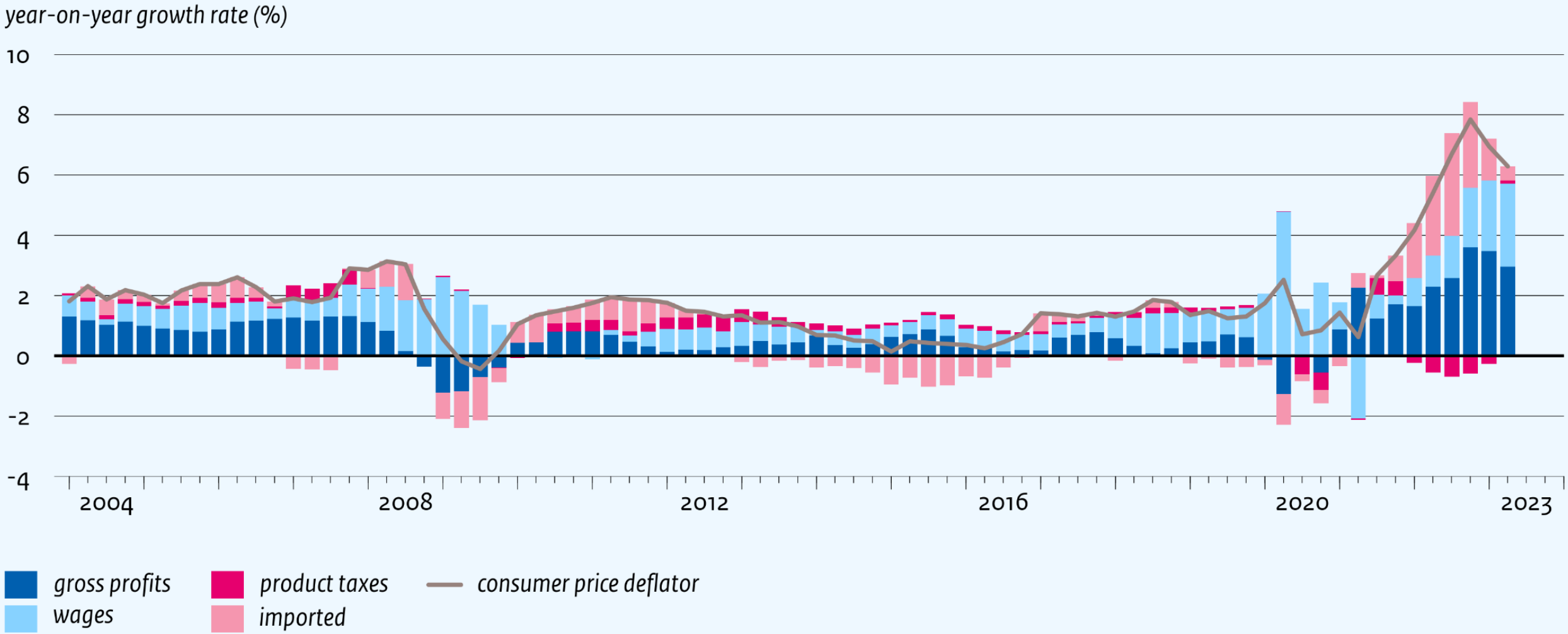
Two types of static decomposition, but why?

- GDP deflator does not offer insights into imported inflation. It only contains export prices.
- For the consumer price deflator, this is exactly the other way around.

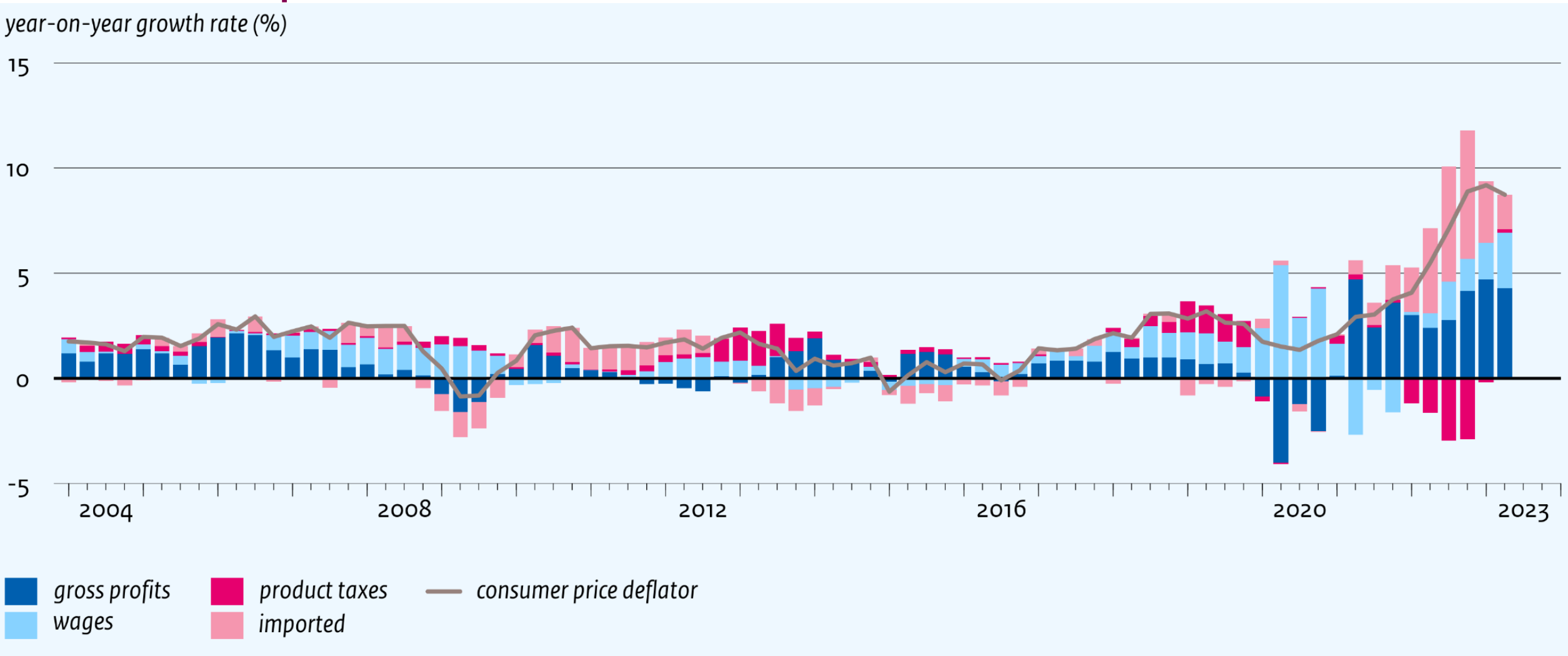


- For static/mechanical decompositions: components are not to be confused with causes of inflation. A dynamic approach can be more useful for that purpose.

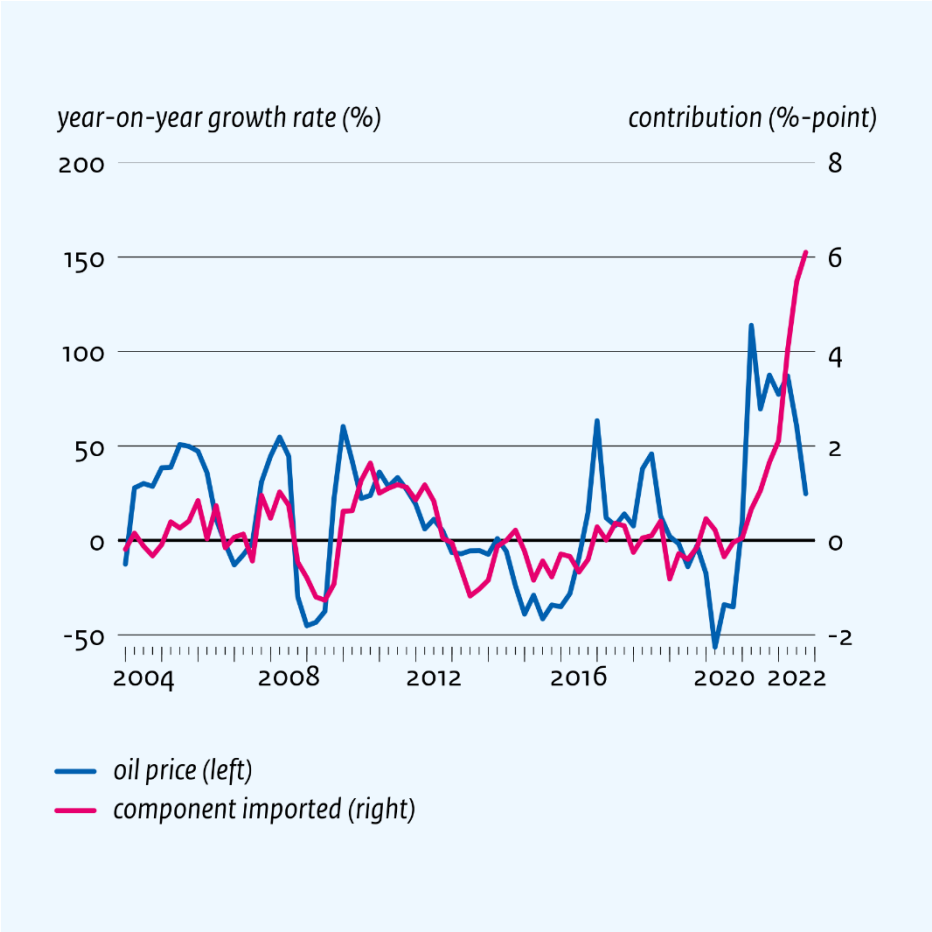
Decomposition: Eurozone

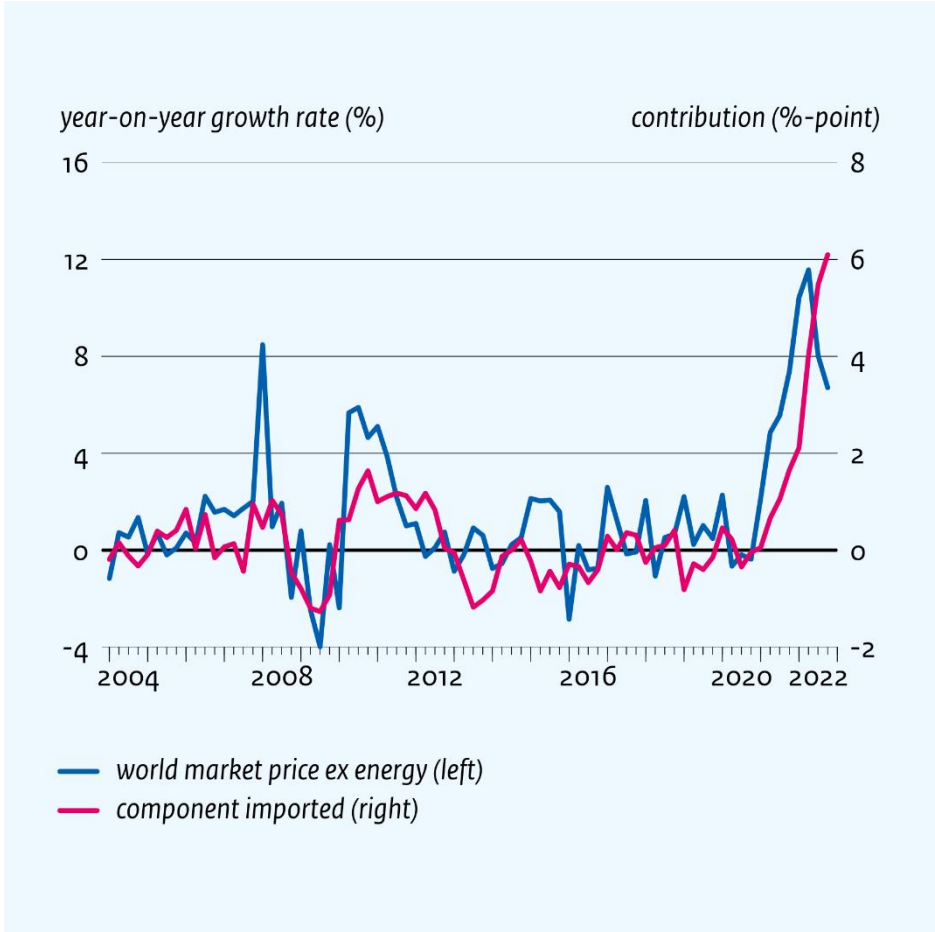


Decomposition: The Netherlands



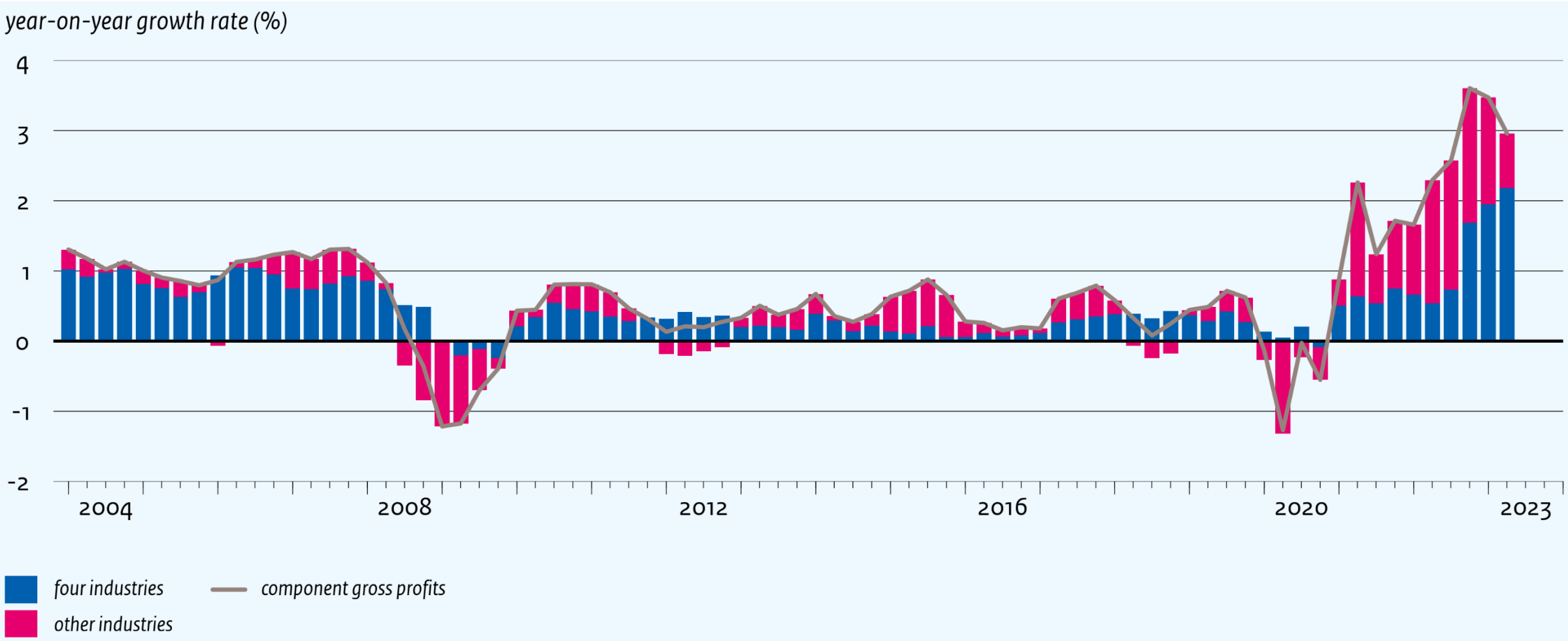
NL Contribution of imports?





EA Industry contributions: Profits

4 (energy, finance, real estate, gov) and other



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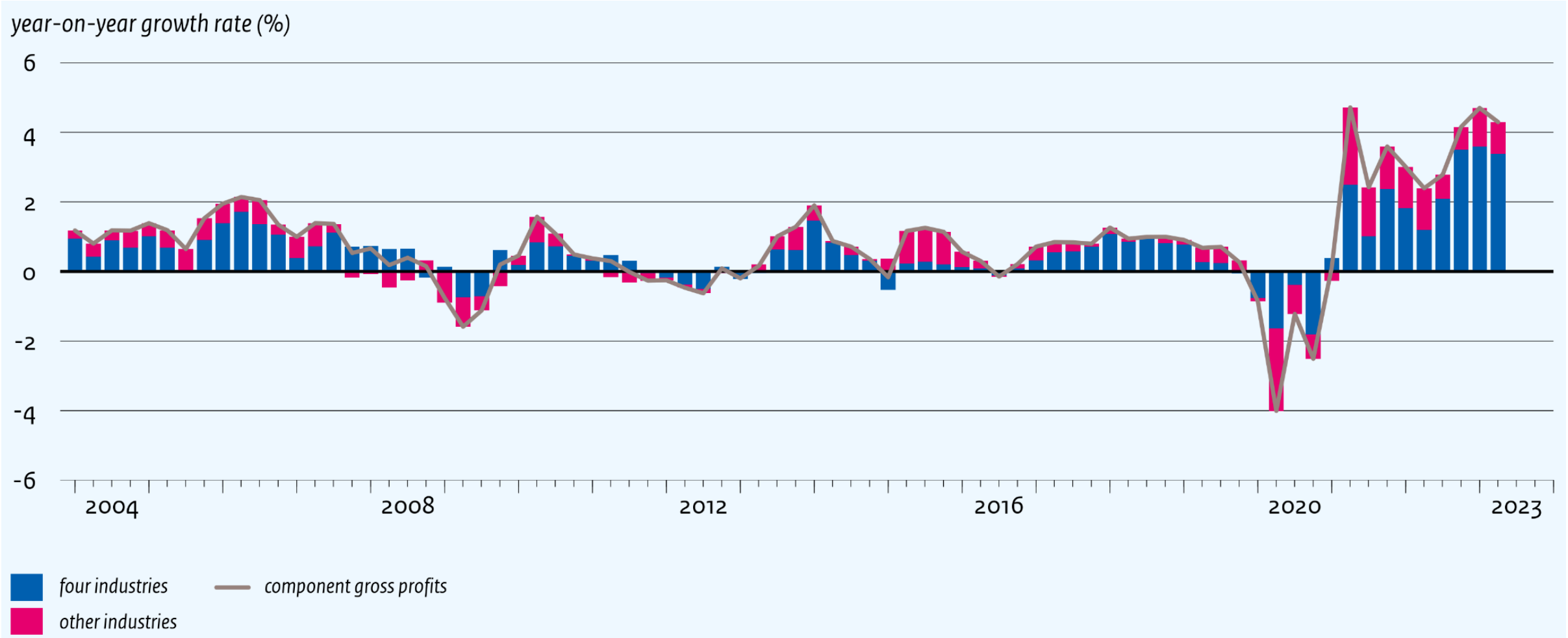
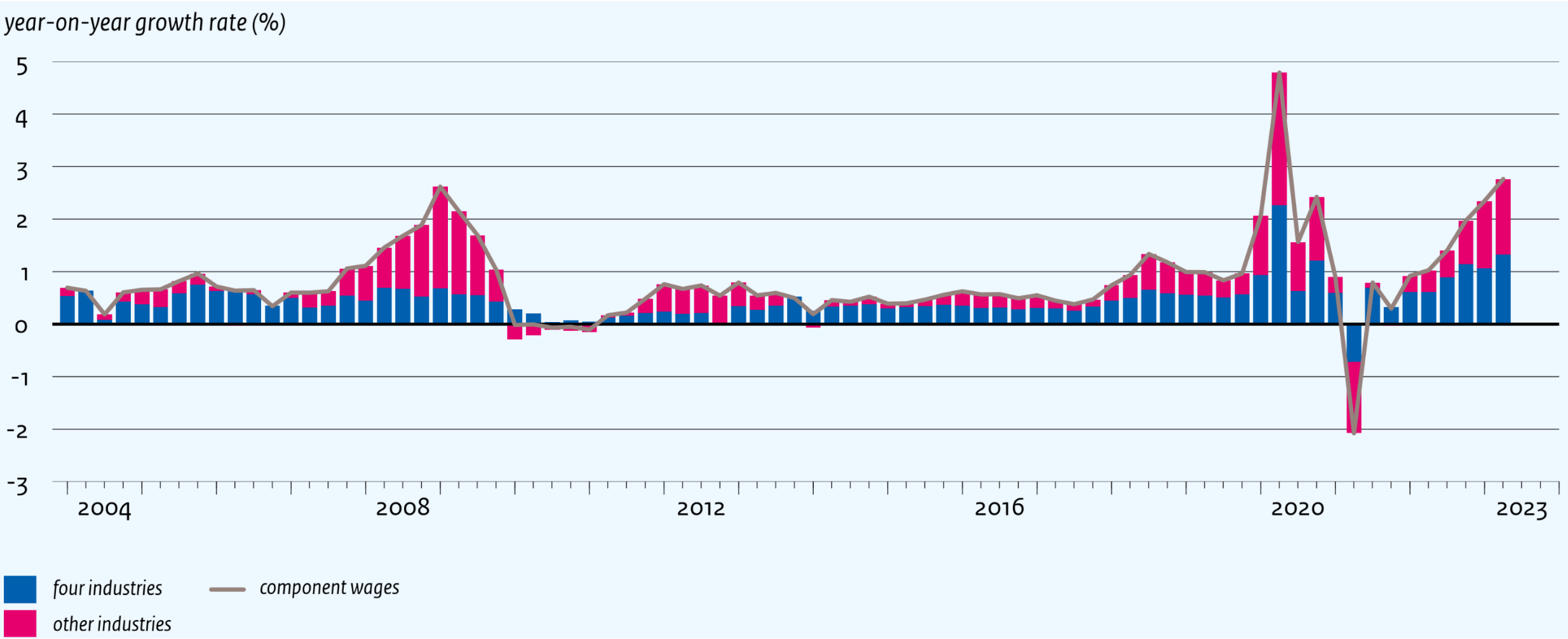


EA Industry contributions: Wages

4 (energy, finance, real estate, gov) and other



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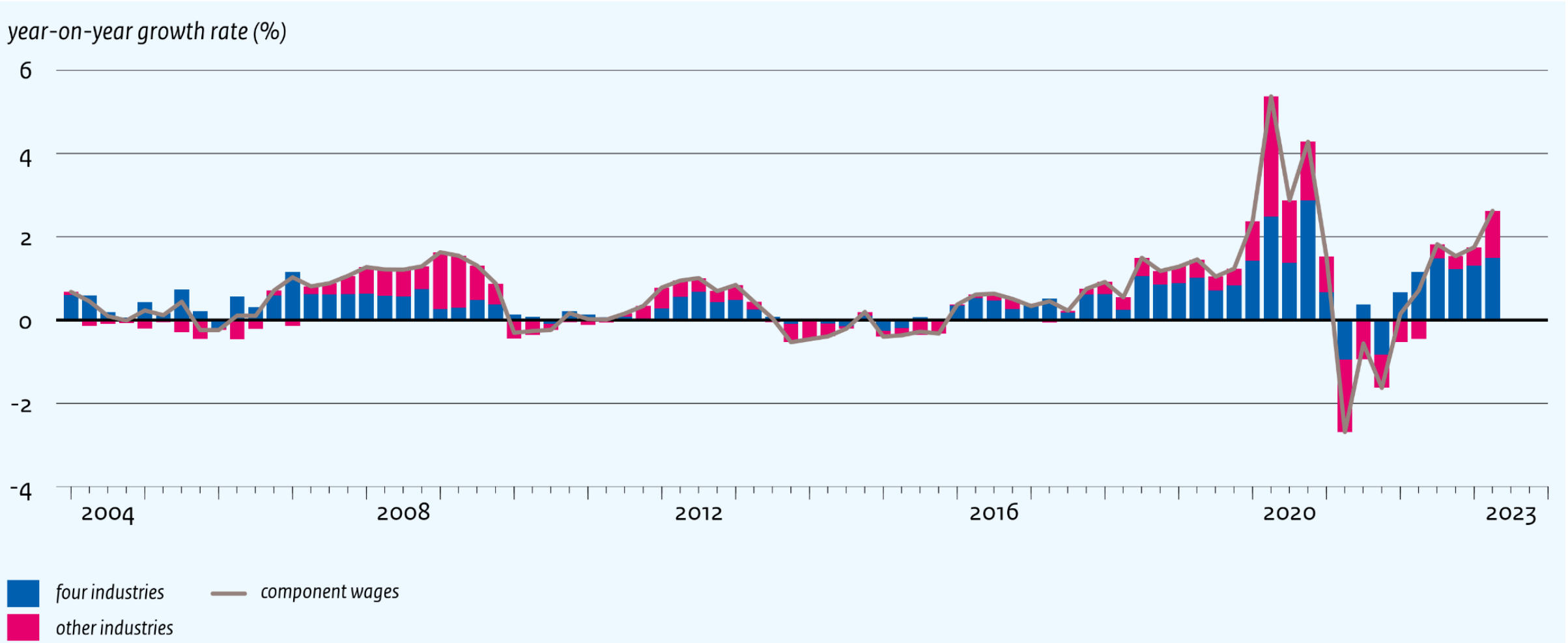
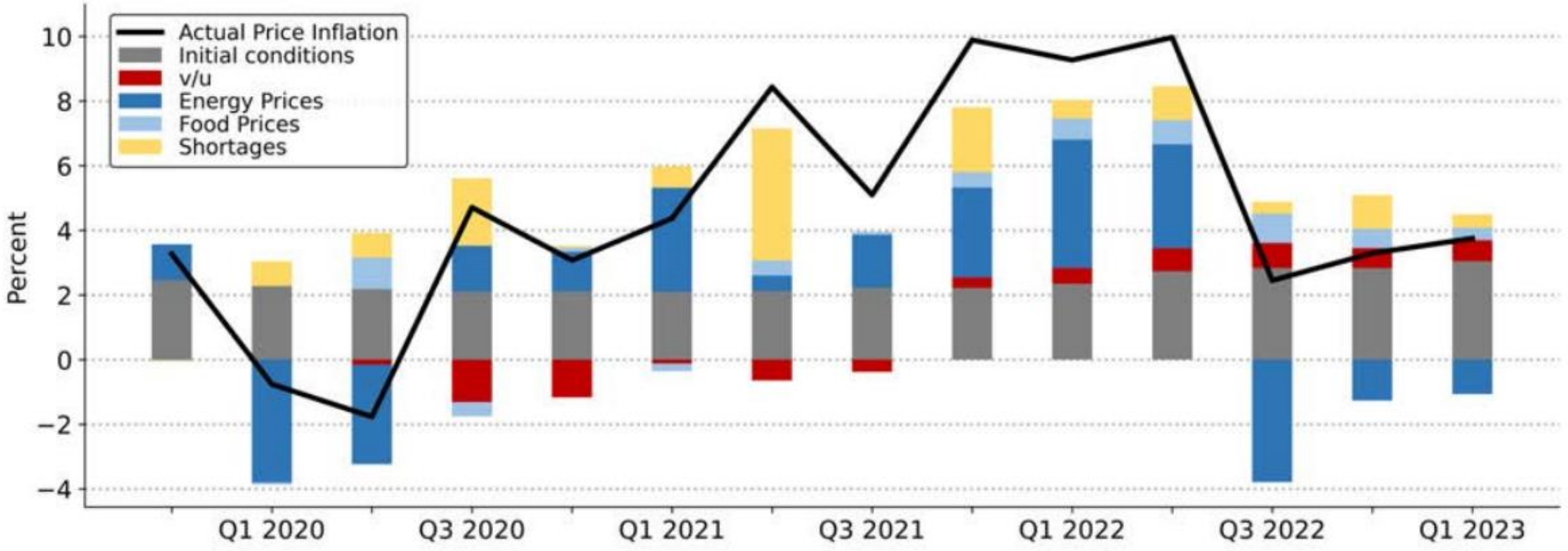


Dynamic approach: Blanchard and Bernanke (2023)

- Blanchard & Bernanke (2023) estimate a structural model for the US:
  - 4 endogenous: price inflation, wage growth, short- and long-term inflation expectations
  - 4 exogenous: labor market tightness (v/u), relative energy and food prices, shortages of goods
  - 4 quarter lags
  - Choice of variables and lags in each equation is motivated by a small, analytical model
- Dynamic simulations to calculate sources of inflation after 2020

B&B: sources of inflation in the US

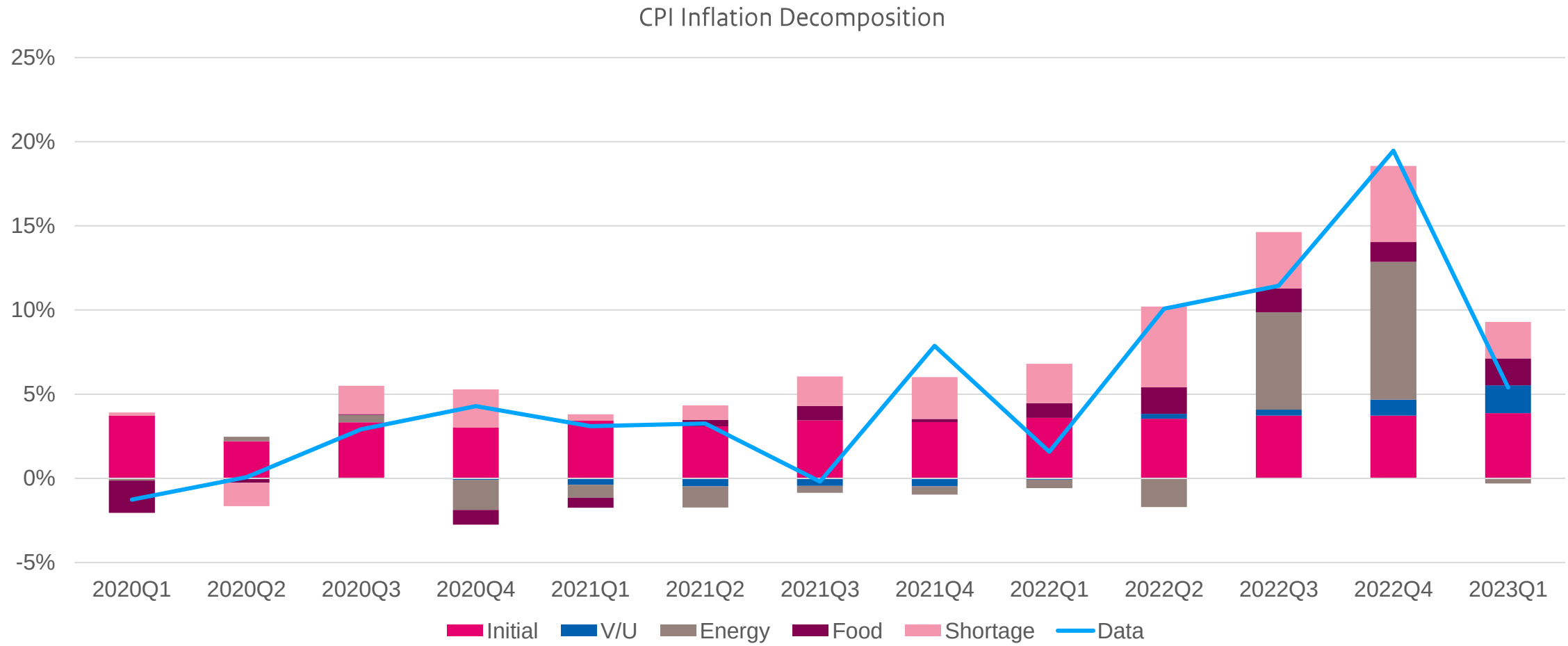


Inflation in 2021 started with shortages, followed by high energy prices and labor market tightness

Why the B&B model might be less suited for NL?

1. The model is estimated for a large monetary union, whilst NL is a small open economy within a monetary union.
2. Labor markets and the determination of wage costs differ between the US and NL. This may require a different specification of the wage equation.
3. Model is focused on labor market tightness, energy- and food prices, and shortages. Yet it does not include the role of profits.

First estimation for NL



Inflation in 2021 started with shortages, also in 2022 (chips). 2022: energy followed by wages and drop in energy in 2023.

Main conclusions

- Long-term: variation in decomposition
- 2022: imported inflation and profits per unit
- 2023H1: sharp drop imported inflation, wages increase and profits per unit.
- Profits mainly from four industries (energy, finance, real estate and government).
- The components cannot be considered as causation effects.
  - From the dynamic approach: shortages (since 2020), energy prices (since 2022) and labor market tightness (since 2022Q4) with a fall in energy component.

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