


"Perspectives on Inflation and Real Rates"

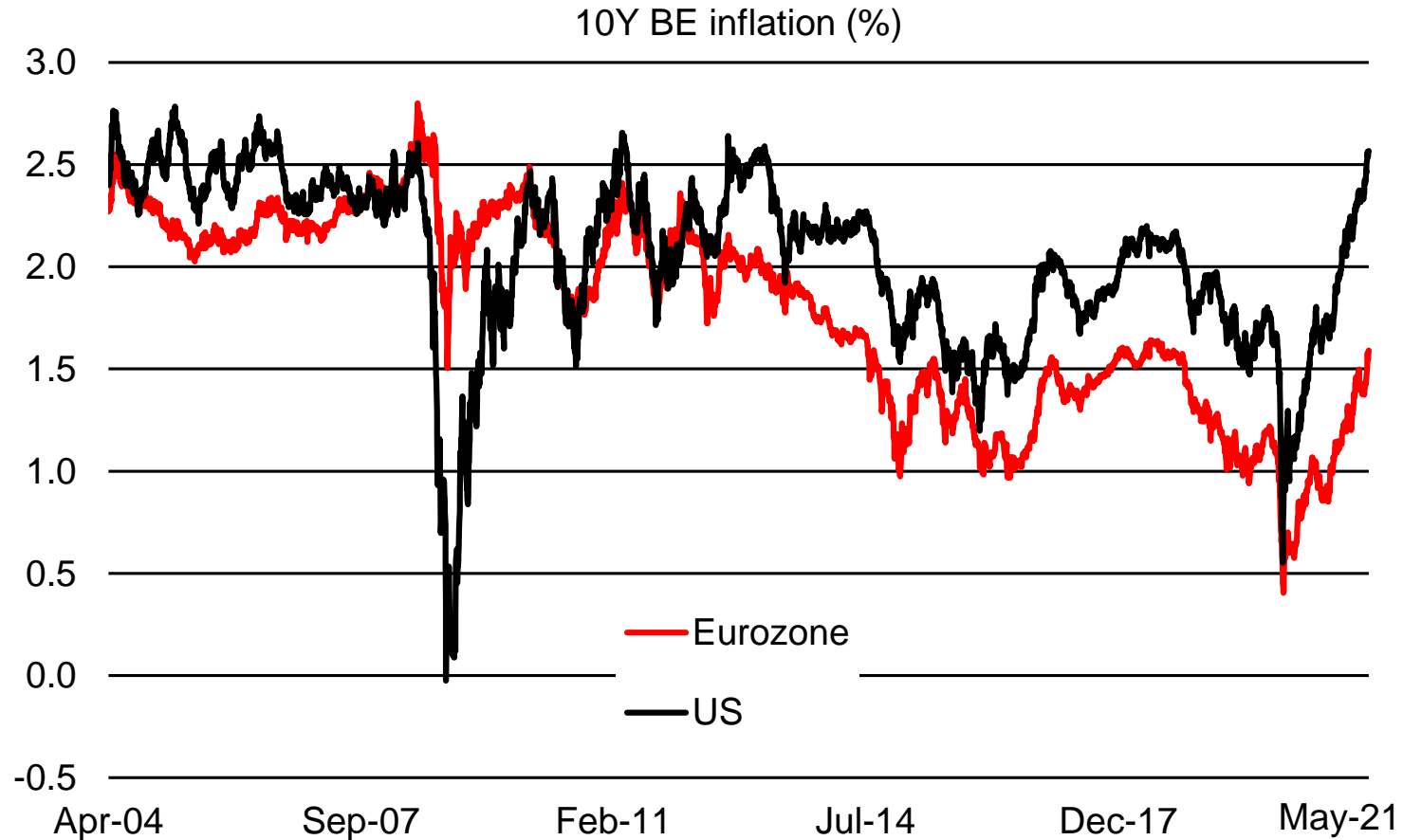
Market view

Marco Valli, Head of Macro Research, Chief European Economist (UniCredit Bank, Milan)

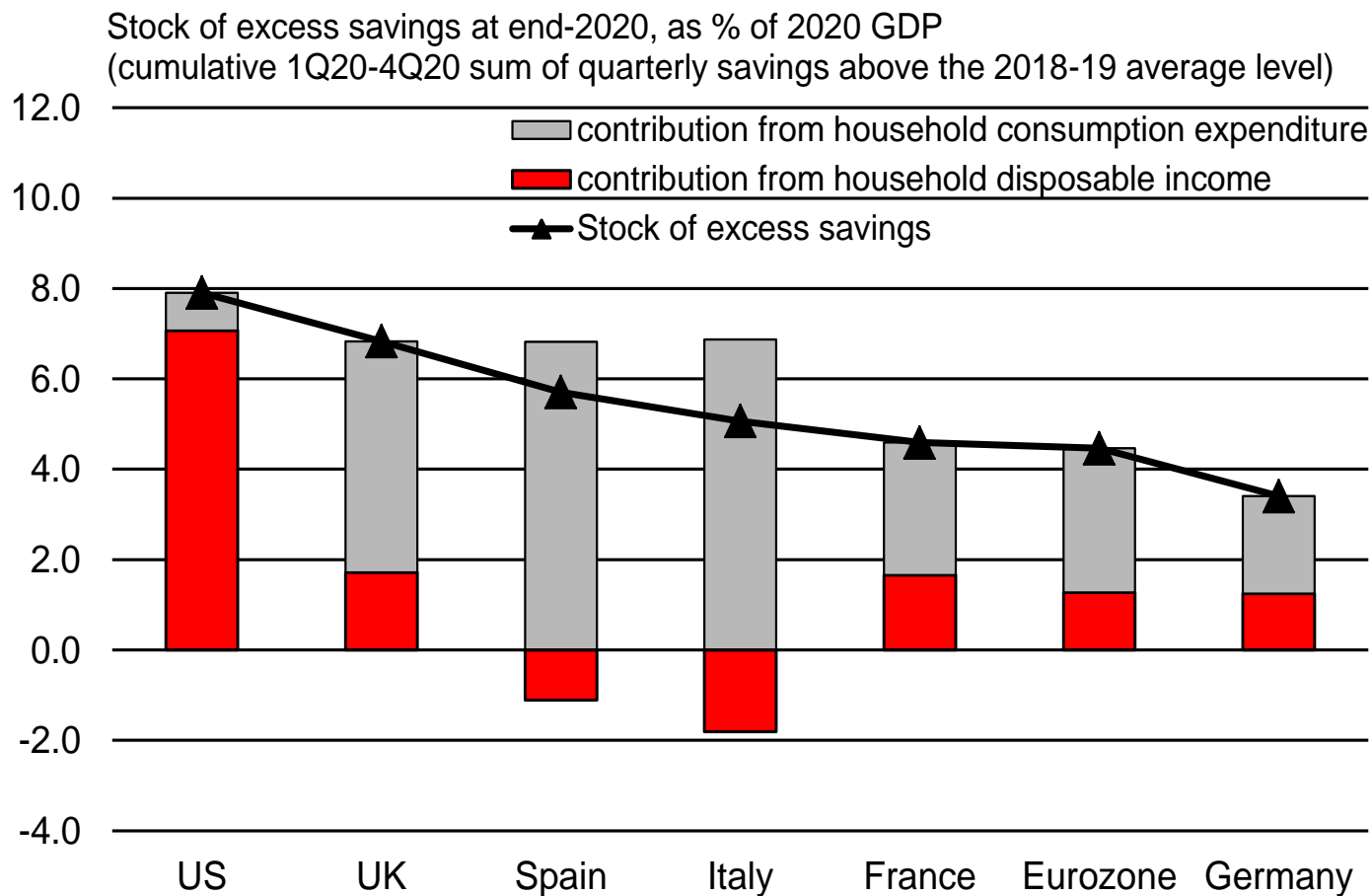
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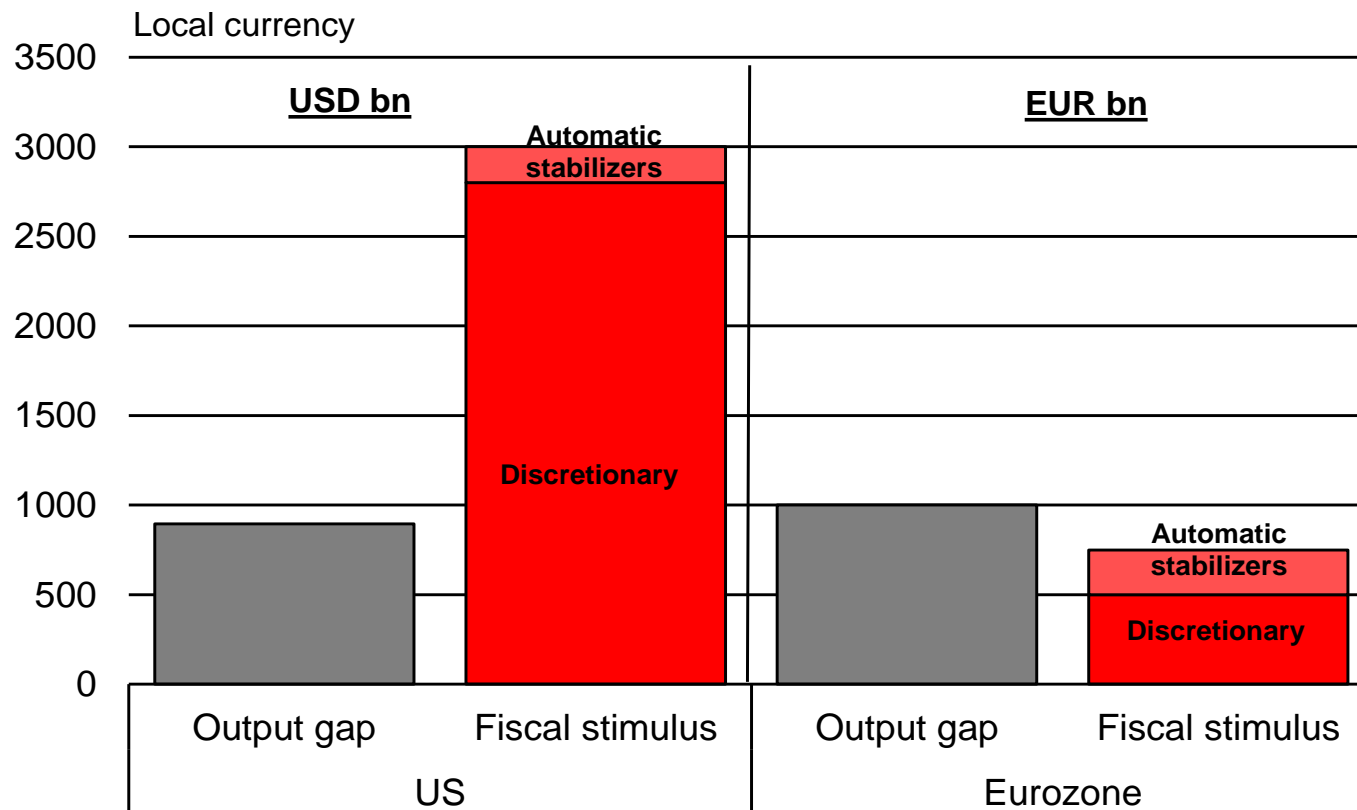
Strong increase in breakeven inflation, with US leading the way. Four factors have played a role



#1: Savings have surged, how much will be spent as economies reopen?



#2: Fiscal boost – massive in the US, unimpressive in the eurozone

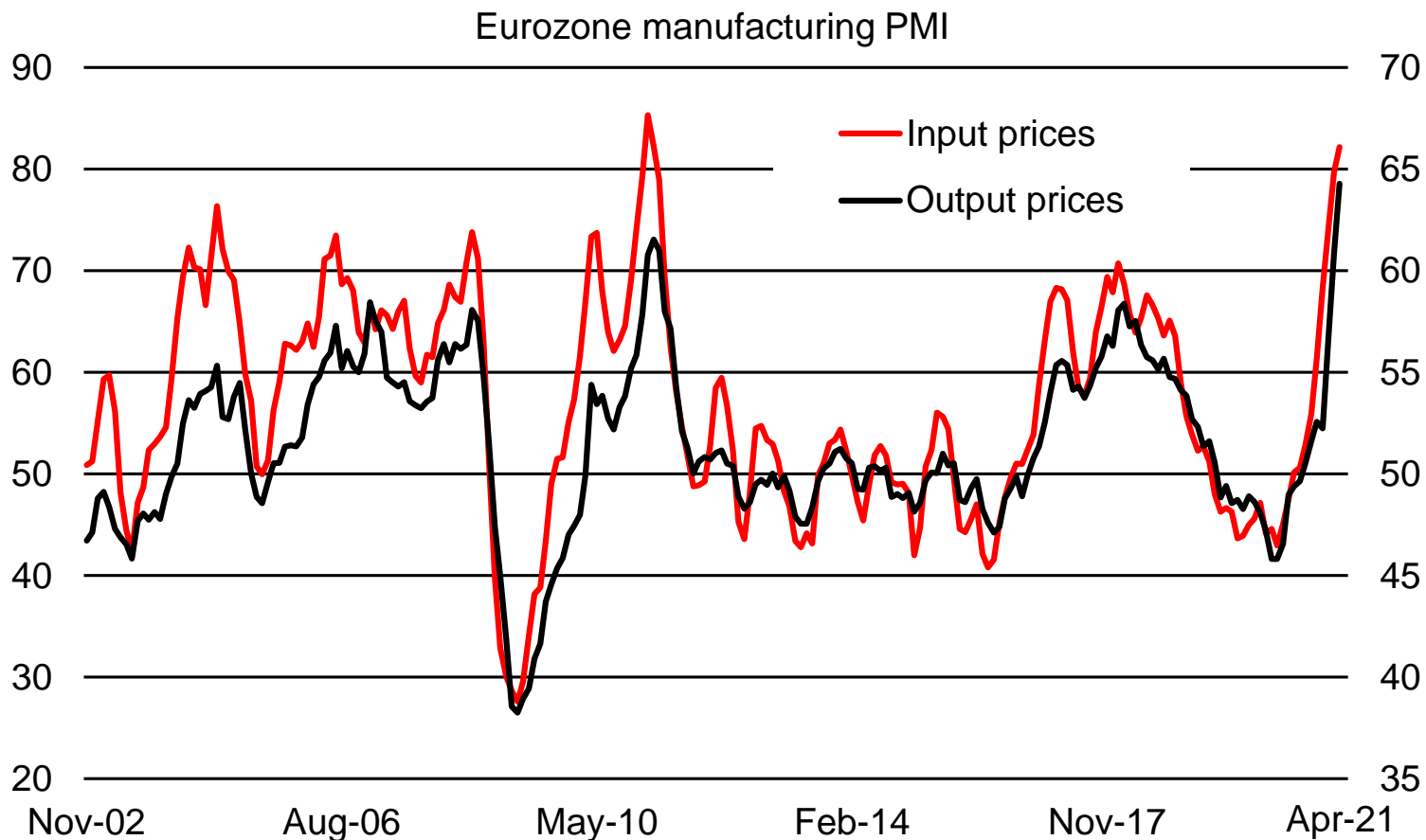


“Output gap” is made up of two components. The first component reflects the damage caused by the pandemic and is computed as the percentage gap between the level of real GDP in 4Q20 and its pre-crisis trend. The second component catches the pre-crisis output gap, which we estimate to have been (negative) 2-2.5% for the eurozone, and zero for the US. Percentages are then translated into current units of local currencies taking nominal 2020 GDP as reference.

“Discretionary” fiscal stimulus in the US includes the USD 900bn plus the USD 1.9tn packages, while longer-term spending plans are not included. In the euro area, it includes measures financed through both national and EU money.

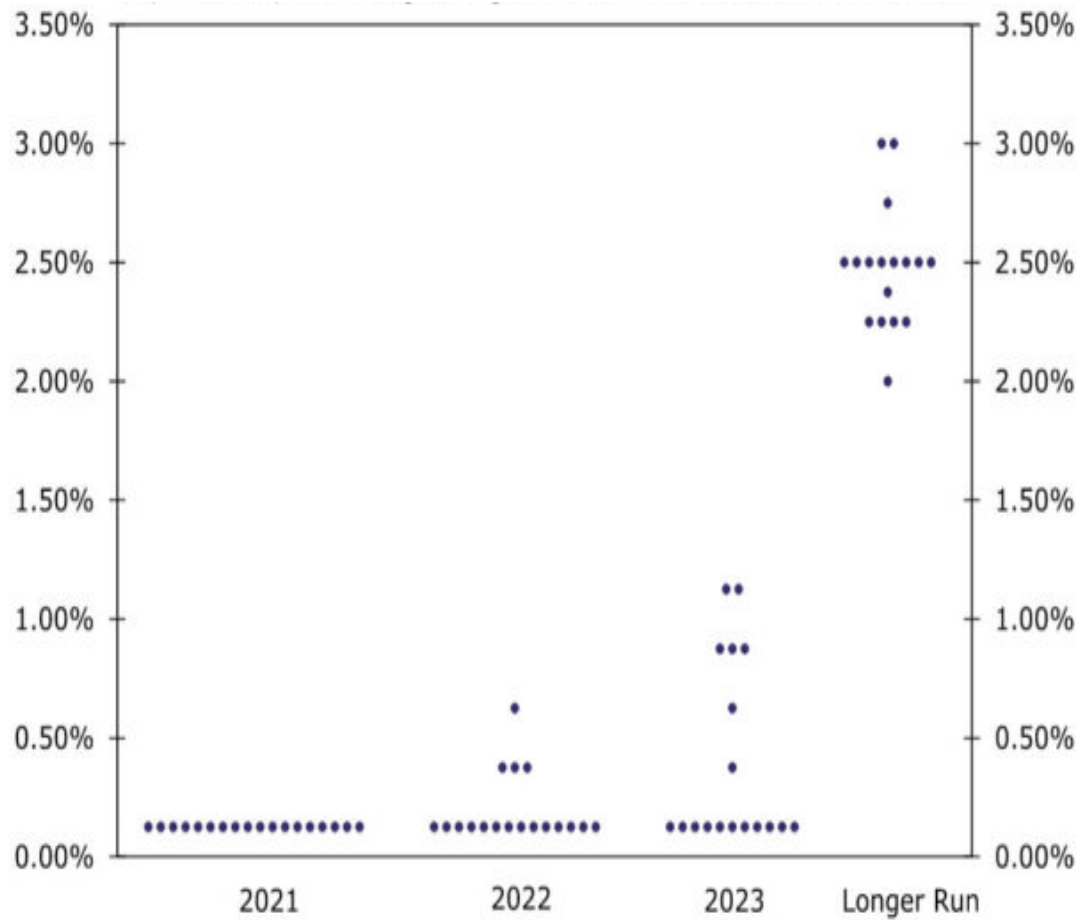


#3: Supply-chain woes and soaring commodity prices raise manufacturing pipeline price pressure

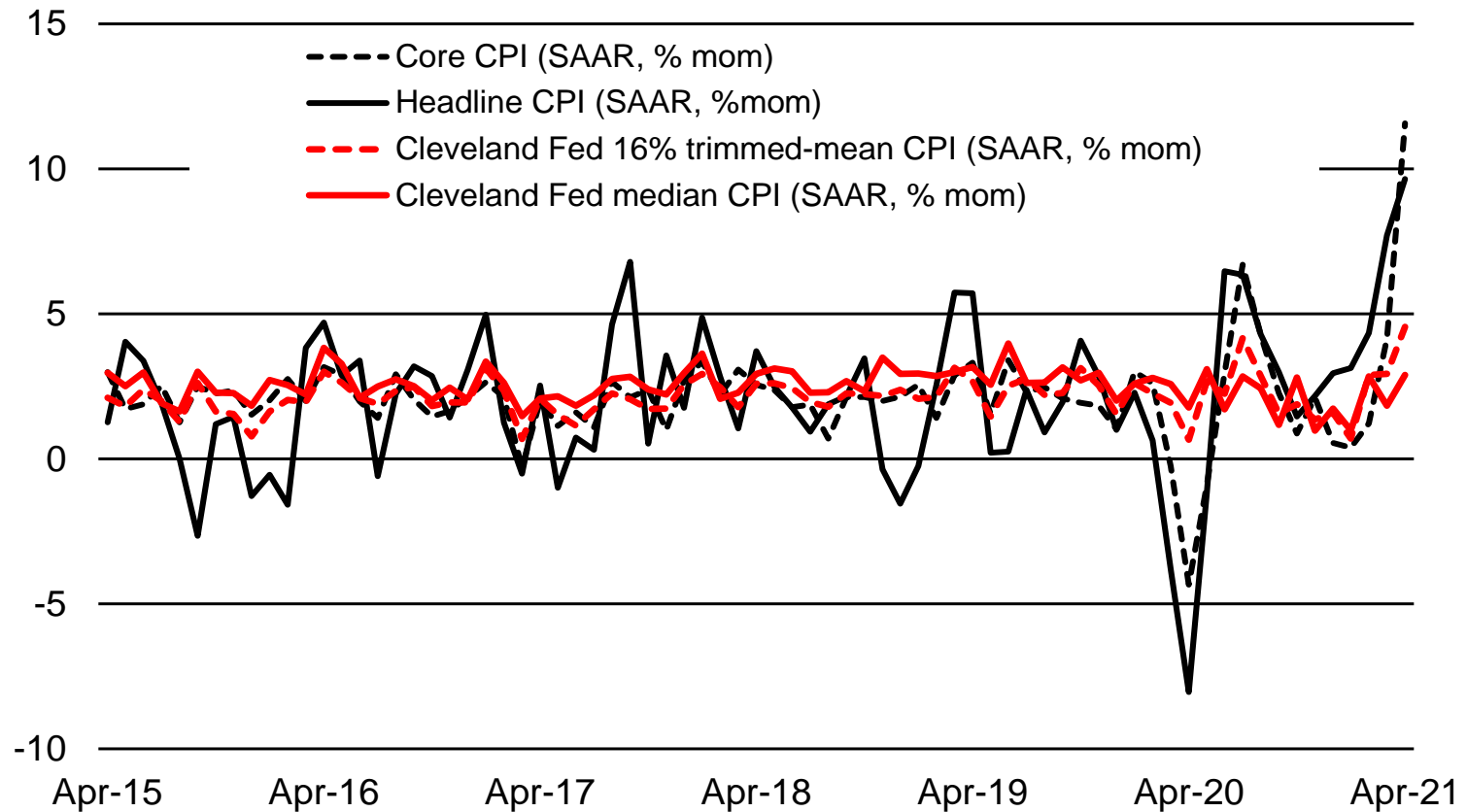


#4: Uncertainty about the Fed's reaction function

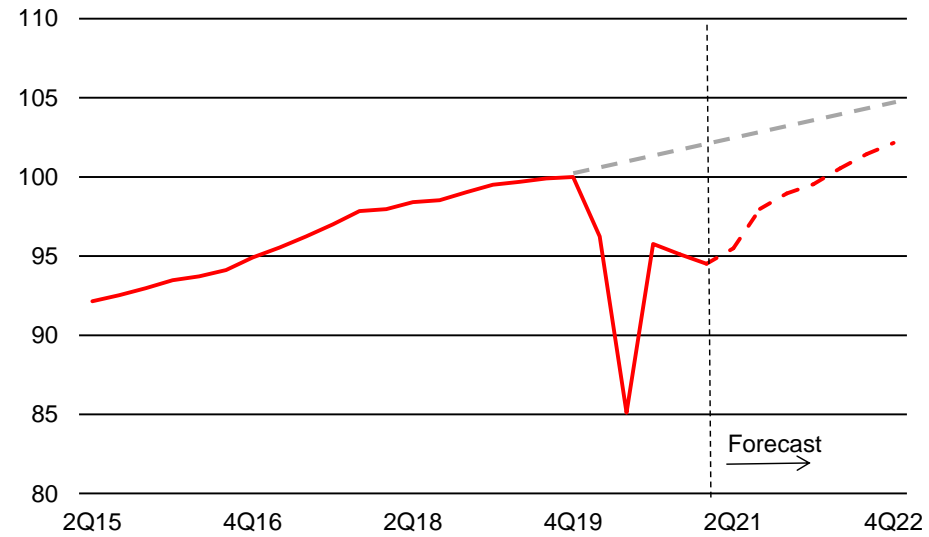
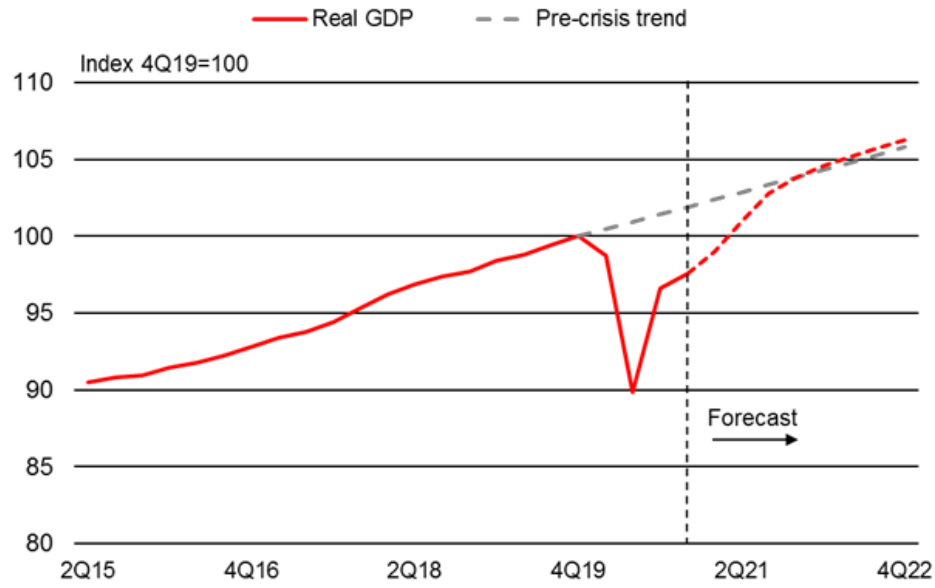
FOMC dot plot, March 2021
(mid-point of target range for the federal funds rate at year-end)



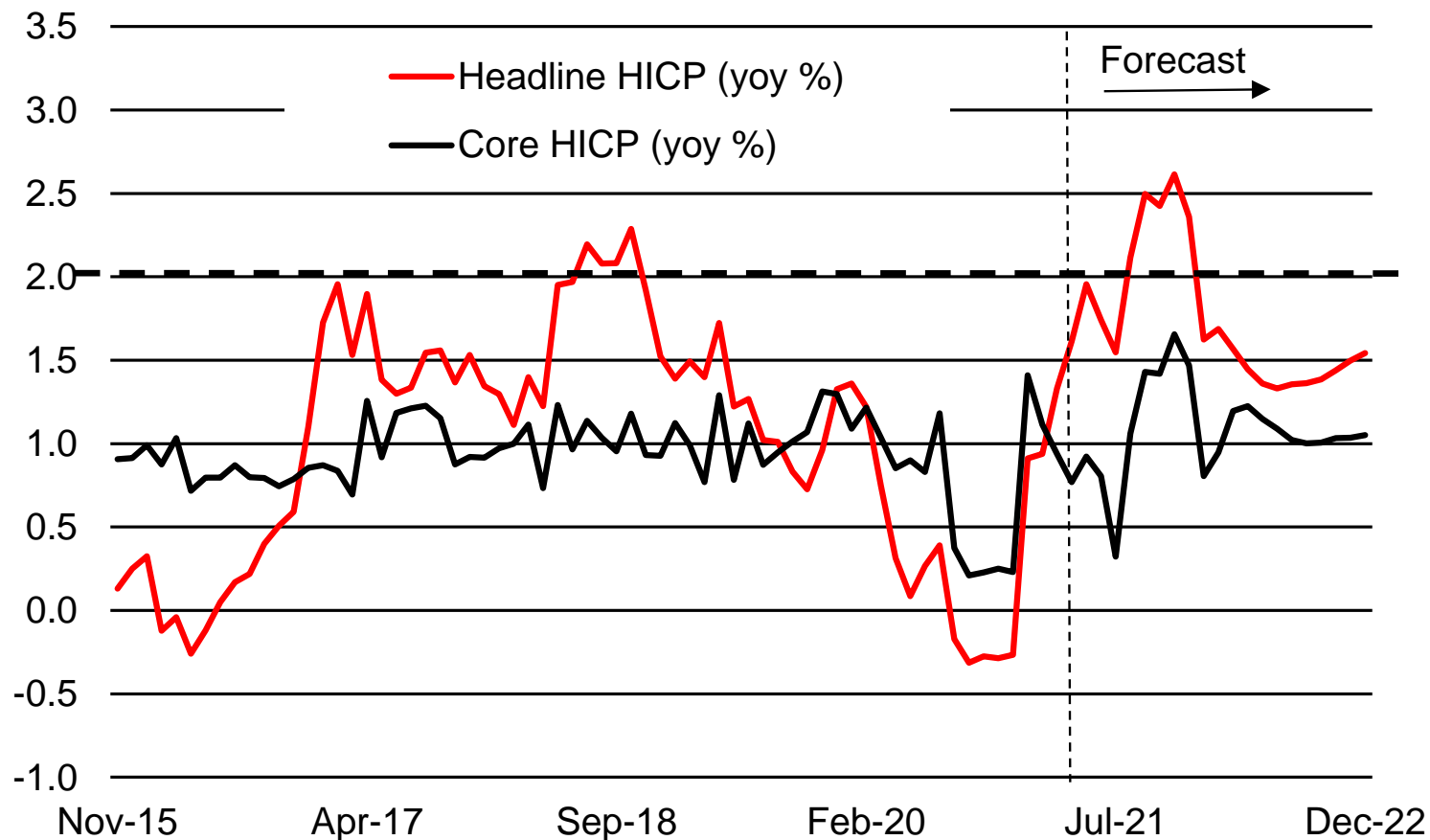
US April inflation jump: separating noise from signal



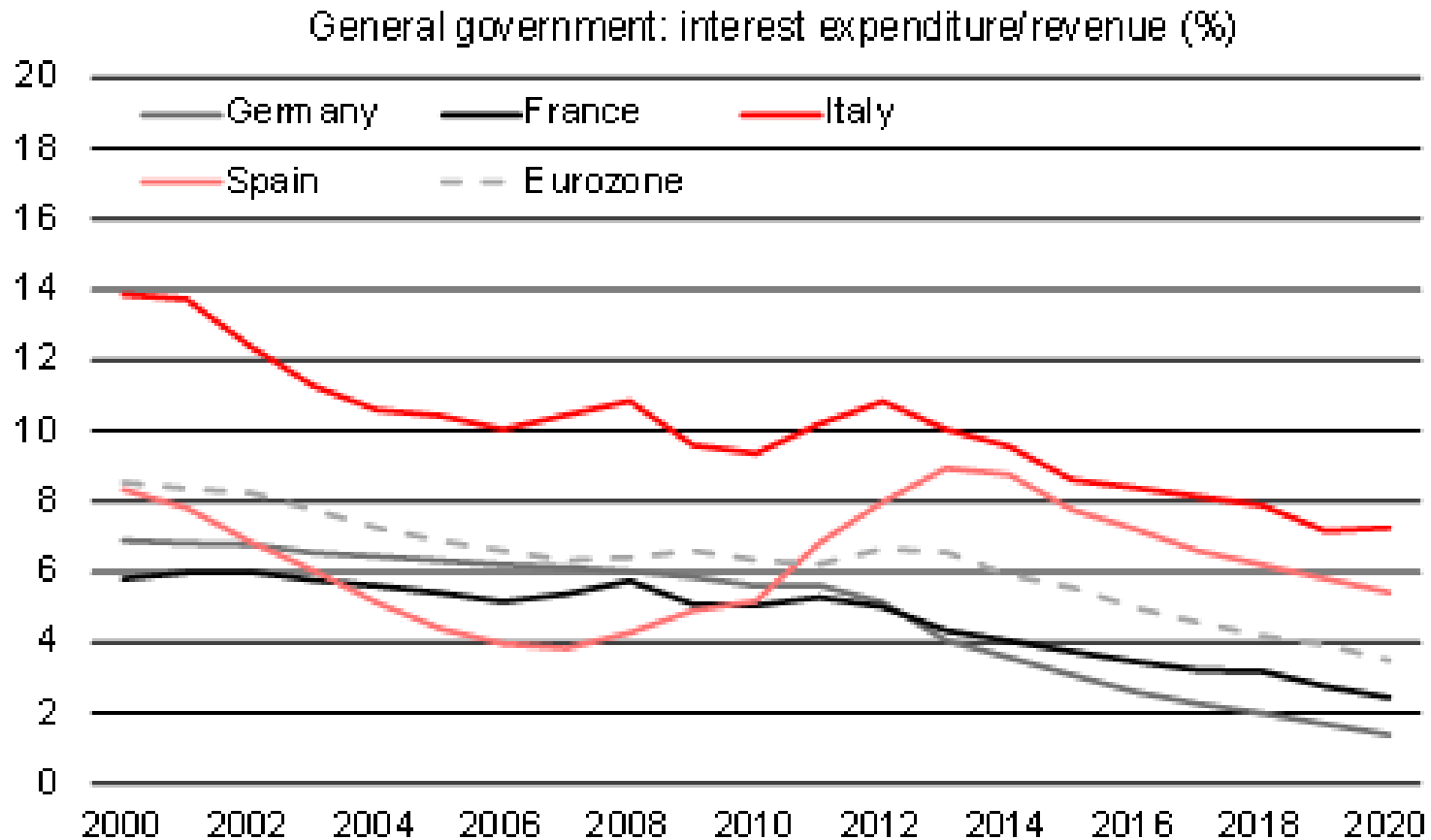
Spare capacity as key fundamental driver of inflation



Eurozone inflation on the rise, but medium-term outlook remains weak



Debt sustainability – focus on refinancing risk



Who holds public debt?

- **The central bank – interest payments are returned to the treasury as central bank profits**
This debt will stay on the central bank's balance sheet until the economy and inflation have recovered
- **Domestic private creditors – interest payments are channeled into the domestic economy**
Limited impact on growth via redistribution from the overall taxation of the economy to the creditors
- **Foreign creditors – interest payments flow abroad**
Drag on the domestic economy as taxation is collected domestically and transferred to creditors abroad



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