Tightening labor markets, inflation and growth sustainability

RBI Panel

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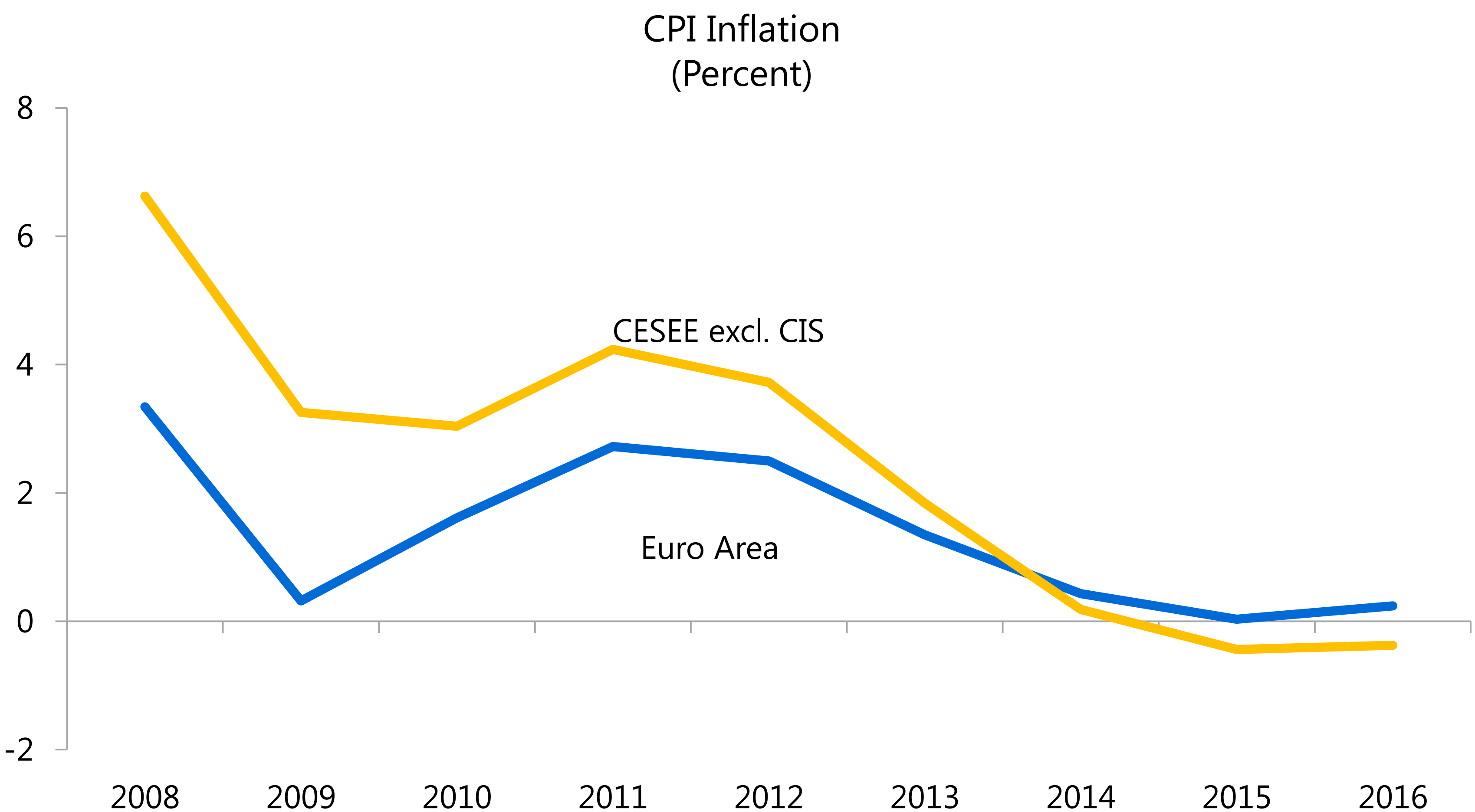
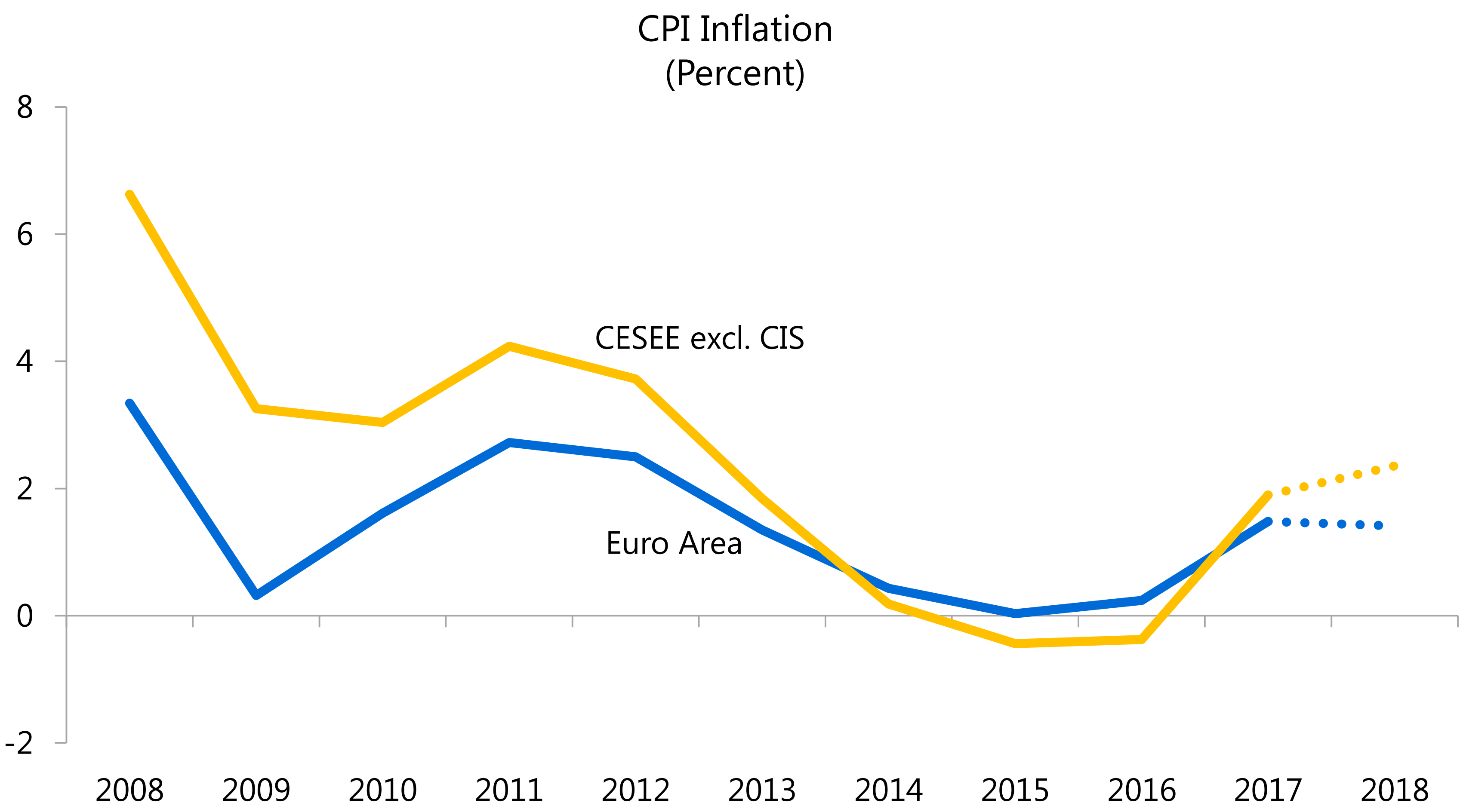
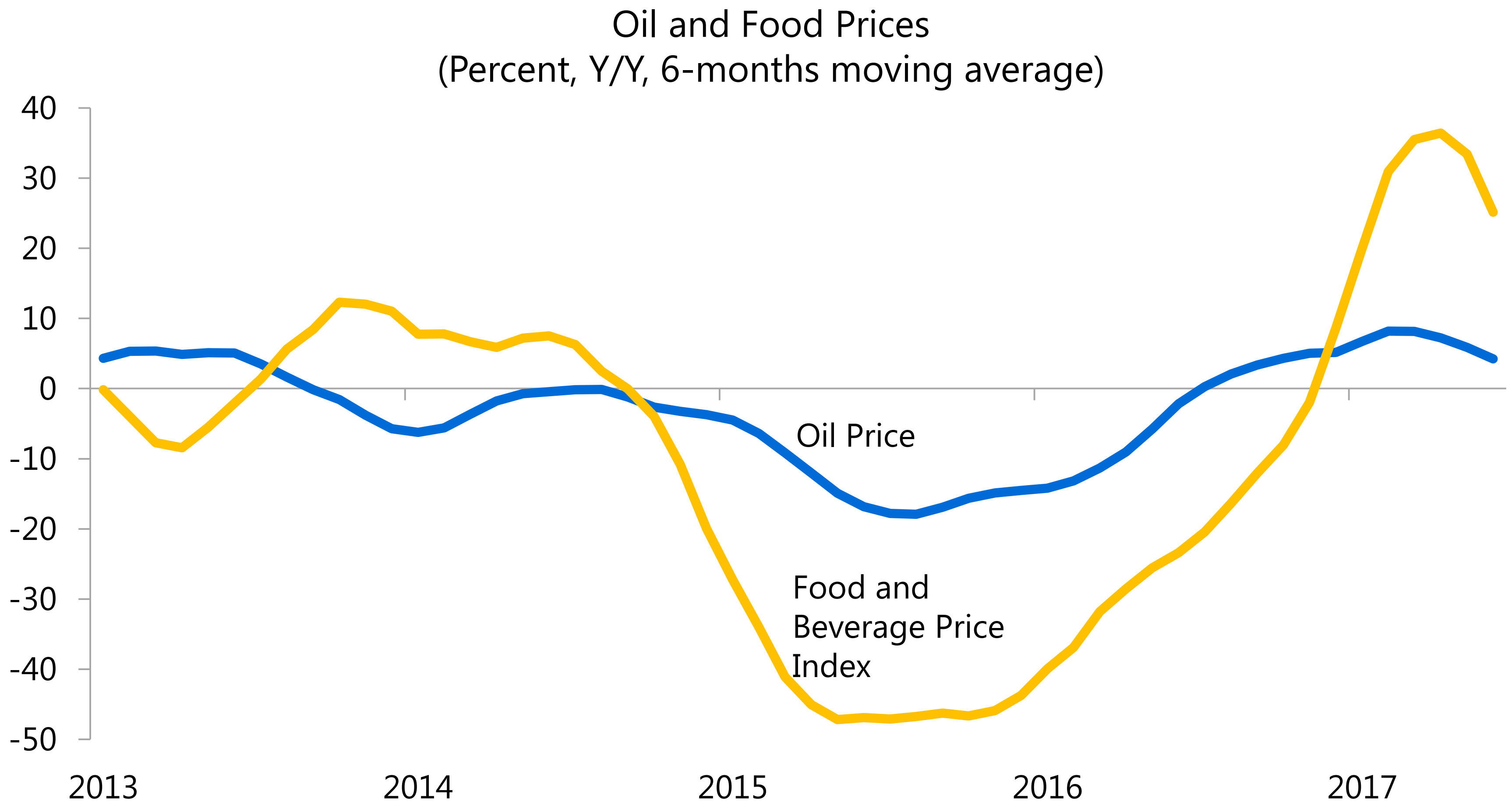
In 2014-16, inflation was very low in –even lower than Western Europe



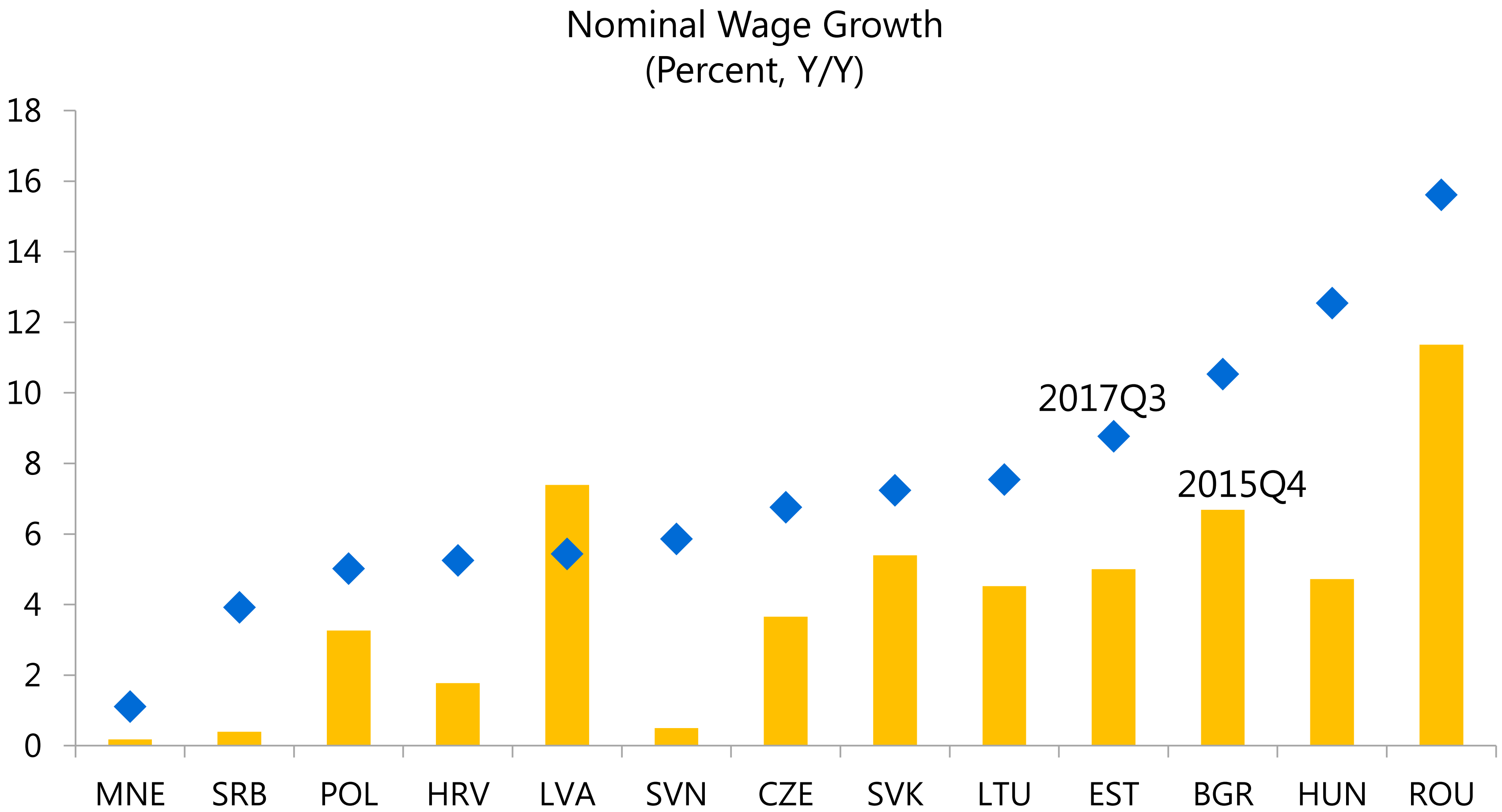
In 2017 inflation picked up



Energy and food prices played key role in resurgence of inflation

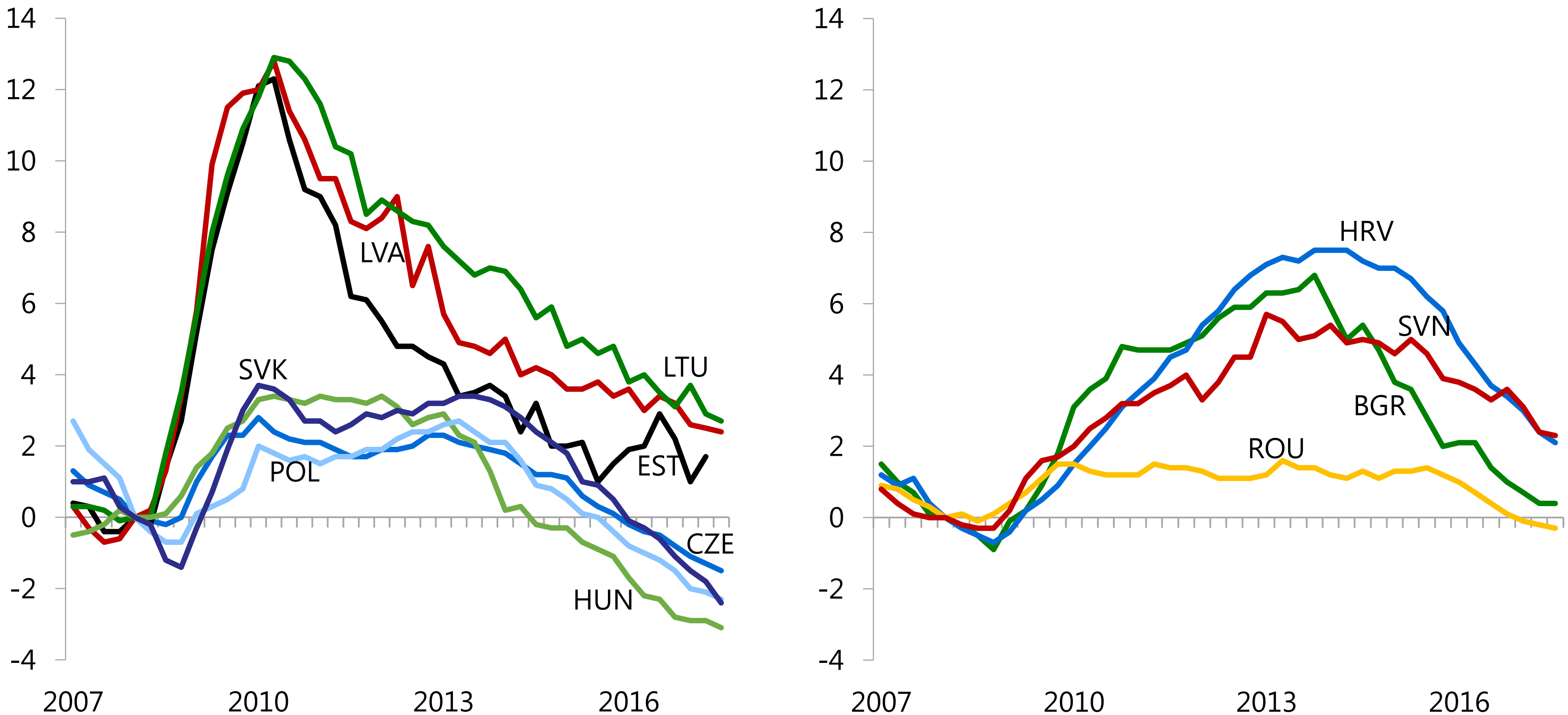


However, wage growth has also notably accelerated over the past two years…



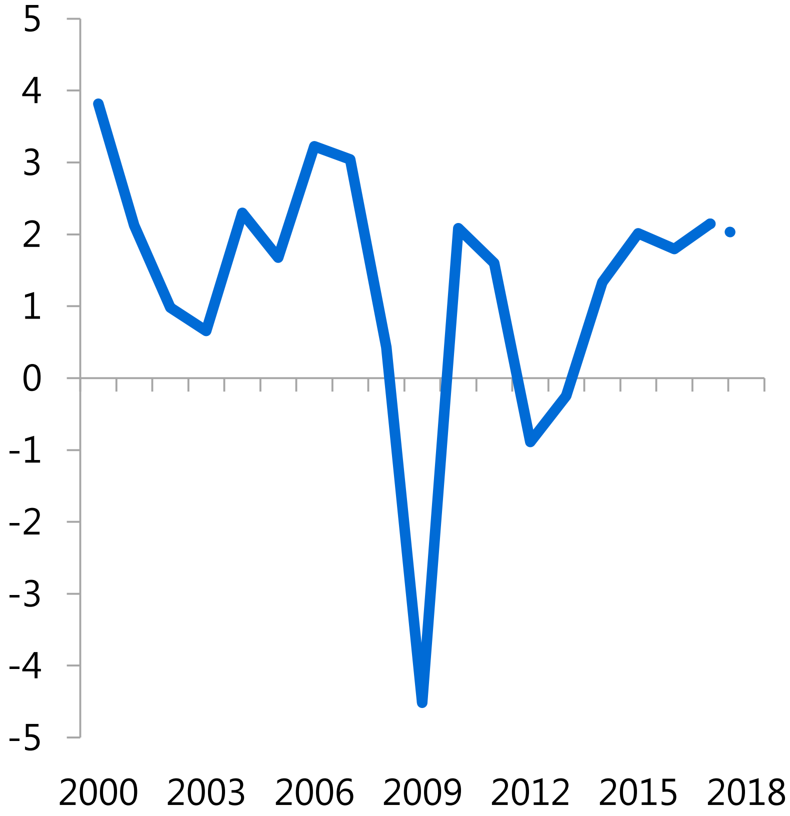
…as labor markets are getting tight

Cumulative Changes in Unemployment Rate
(2008Q1=0, seasonally adjusted)

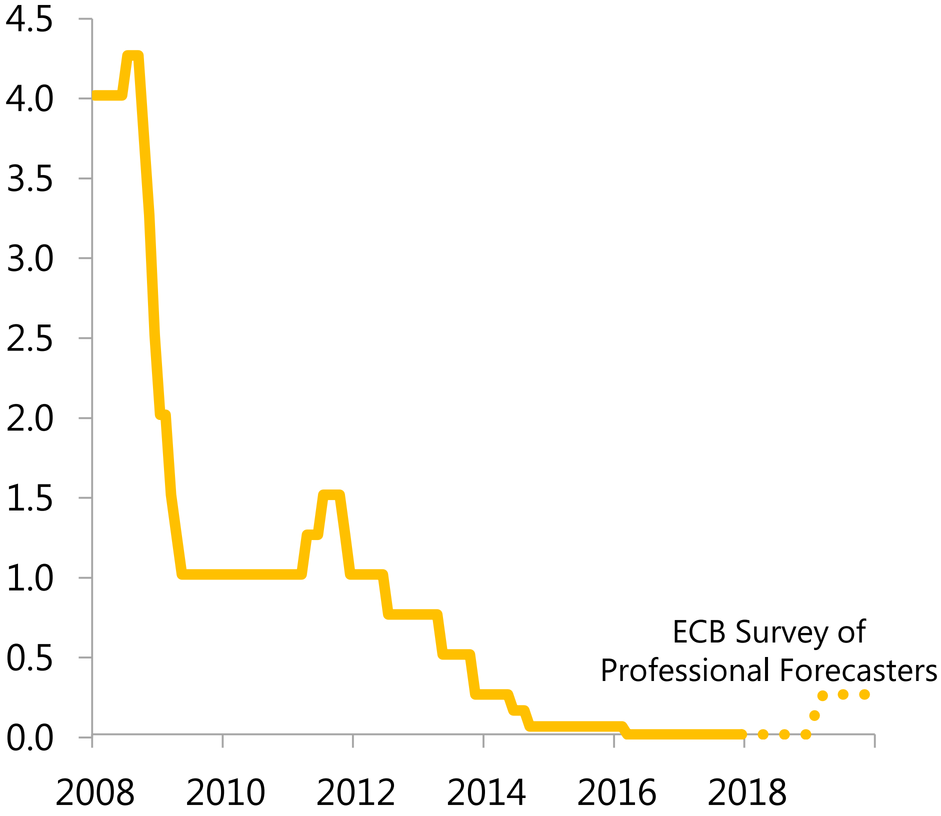


Outlook for Western Europe is for continued recovery and low interest rates

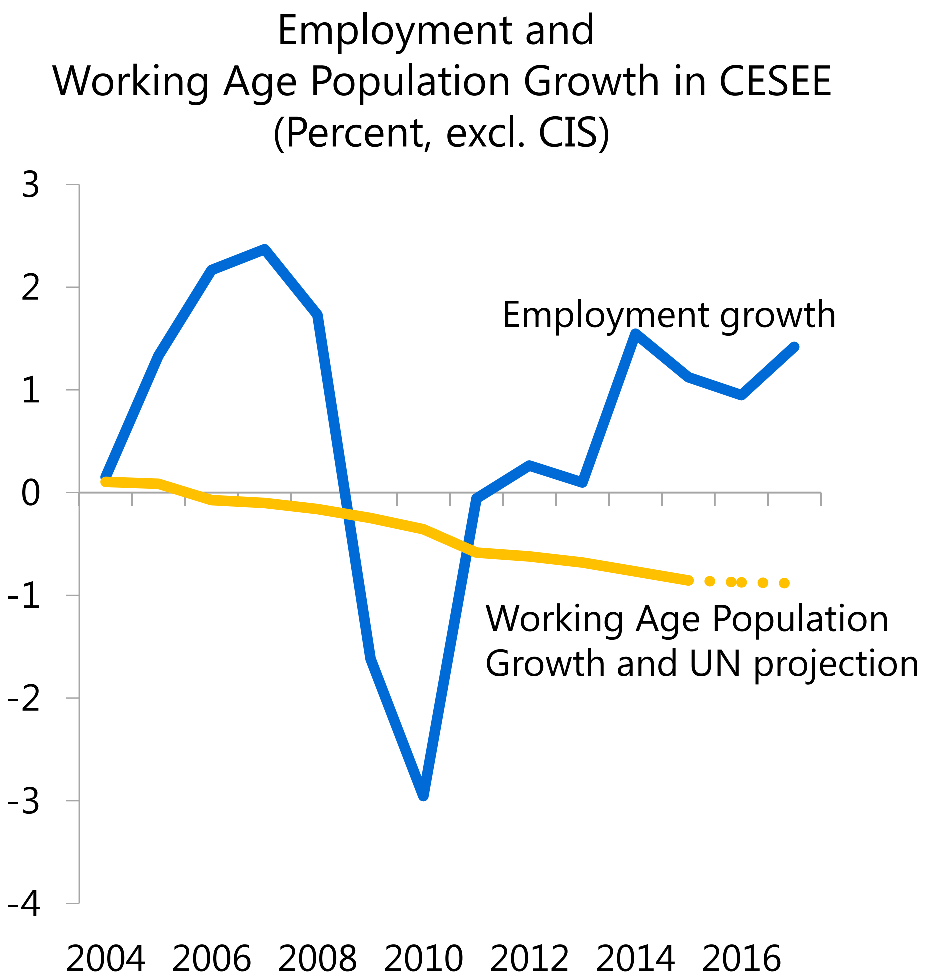
Real GDP Growth in Euro Area
(Percent)



Euro Area Policy Rate and Its' Forecast
(Percent)



Rapid growth in CESEE likely to continue.
Will rapid growth run into labor-market bottlenecks?



- Labor productivity growth around 2 percent
- Working age population falling by 1 percent
- Growth faster than 1 percent only possible if unemployment rate drops or labor force participation rate increases

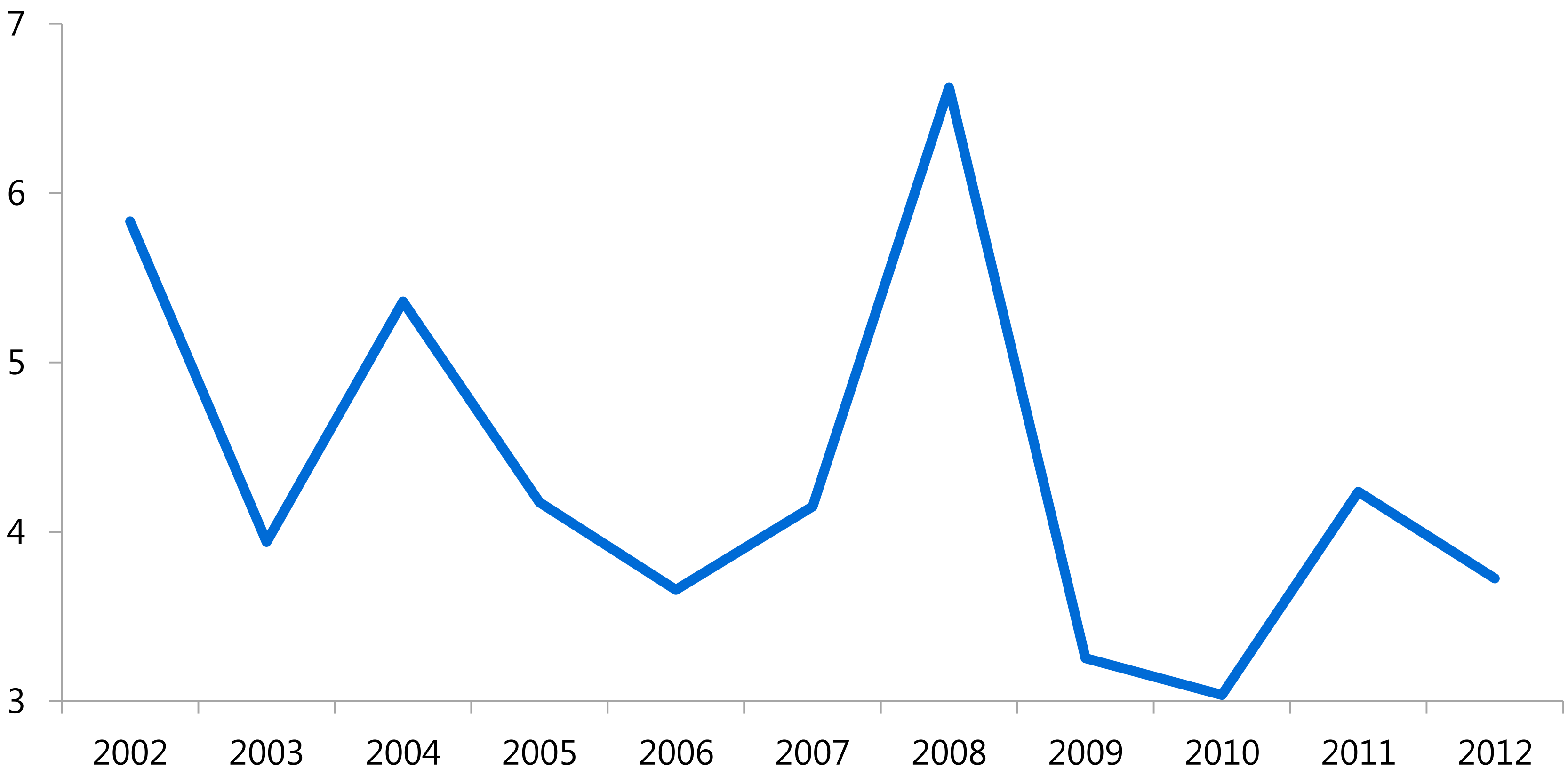
While labor markets are getting tight, it does not mean we will see surge in inflation in near-term

- Much of inflation in CESEE depends on
  - Food and energy prices
  - Imported inflation

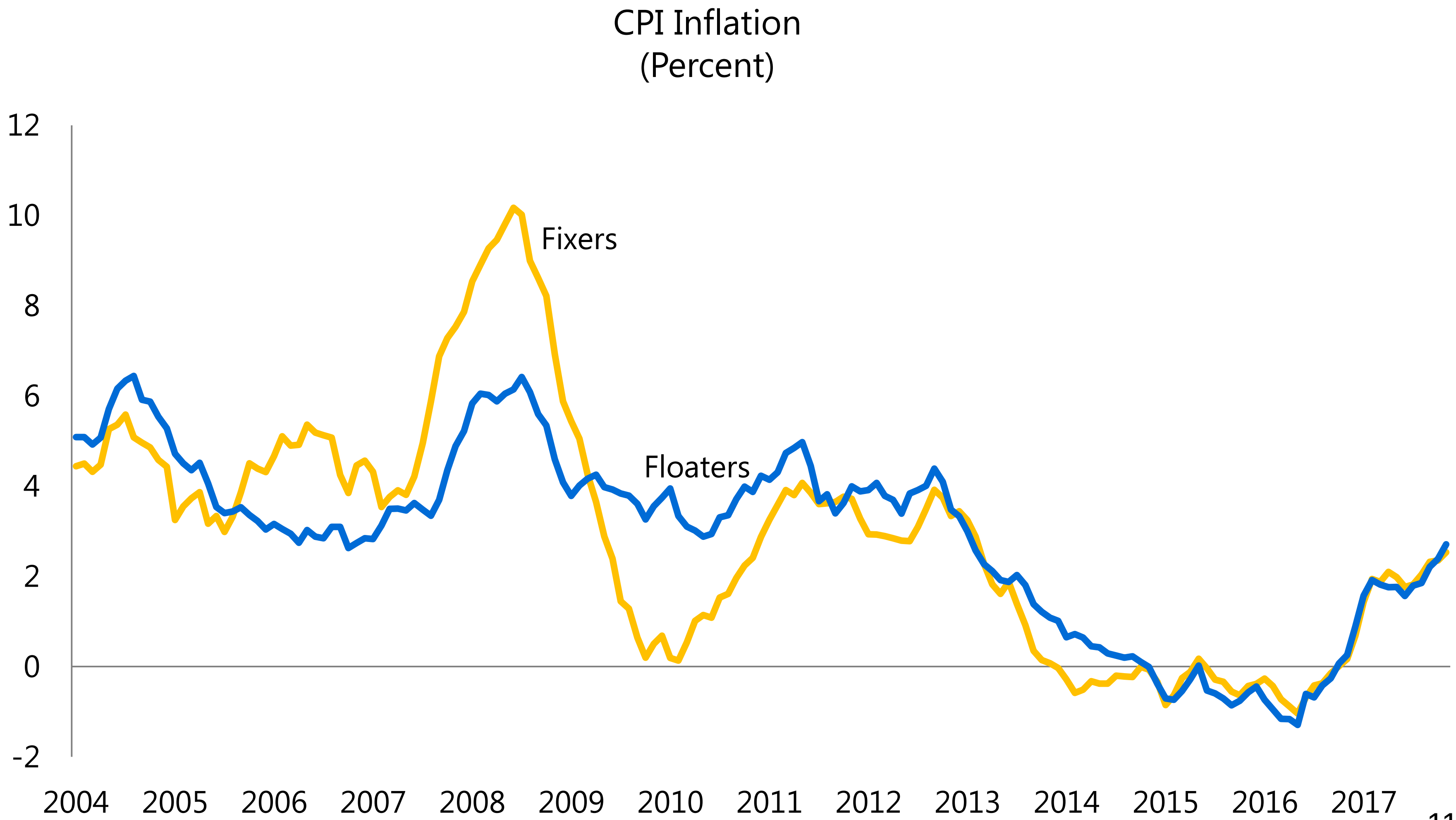
- Exchange rate appreciation in some countries may keep inflation low

Pre-crisis, inflation really picked up only in 2007-08, when oil shock added to tight labor markets

CPI Inflation in CESEE
(Percent, excl. CIS)

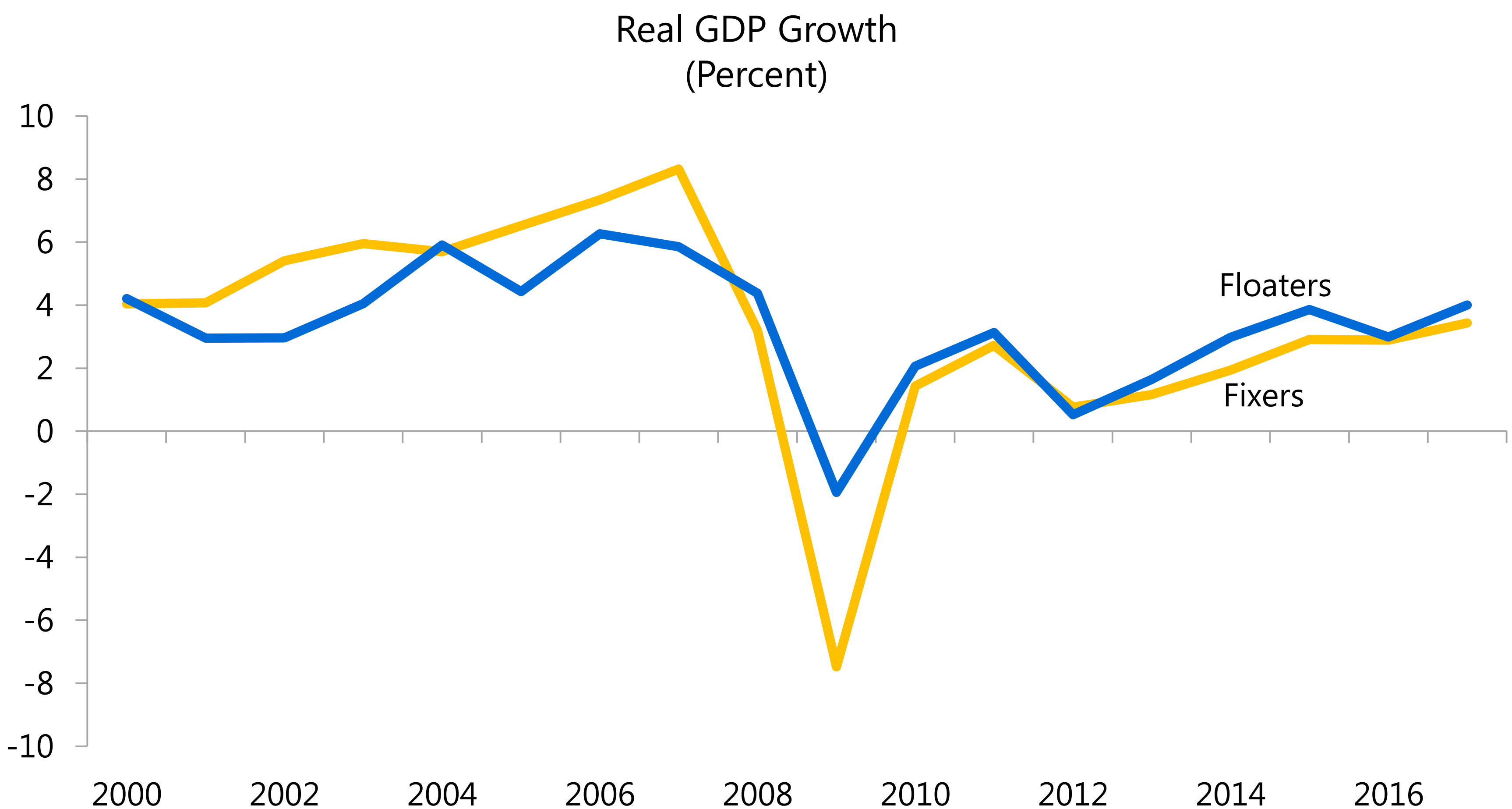


Countries with floating exchange rates may find it easier to keep inflation low



Note: Fixers include BGR, EST, HRV, LVA, LTU, SVN and SVK. Floaters include CZE, HUN, POL and ROU.

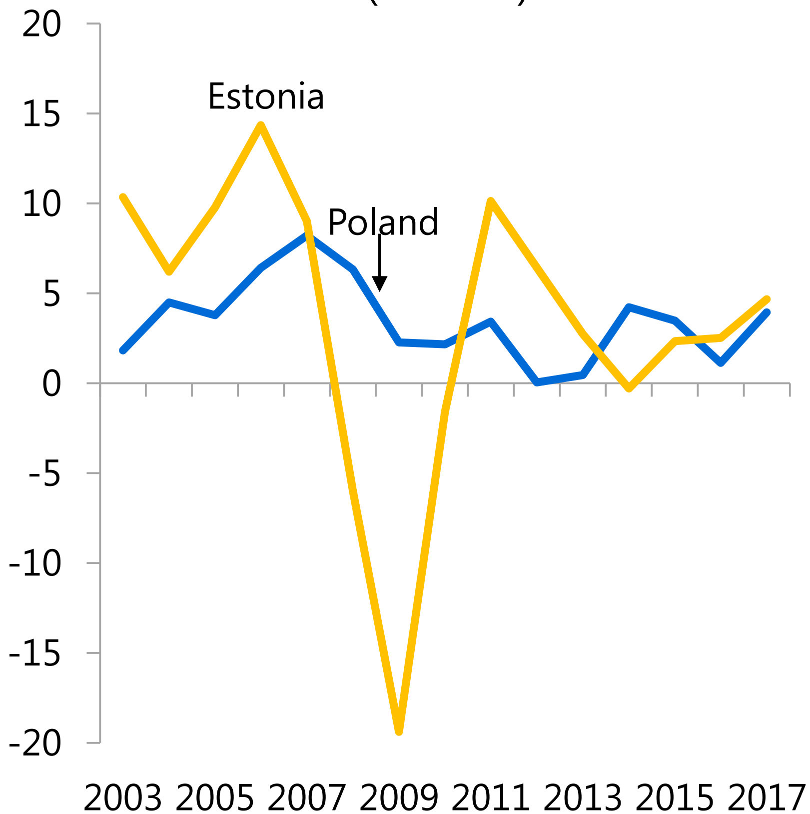
Pre-crisis, floaters where currencies appreciated faced less of a boom-bust



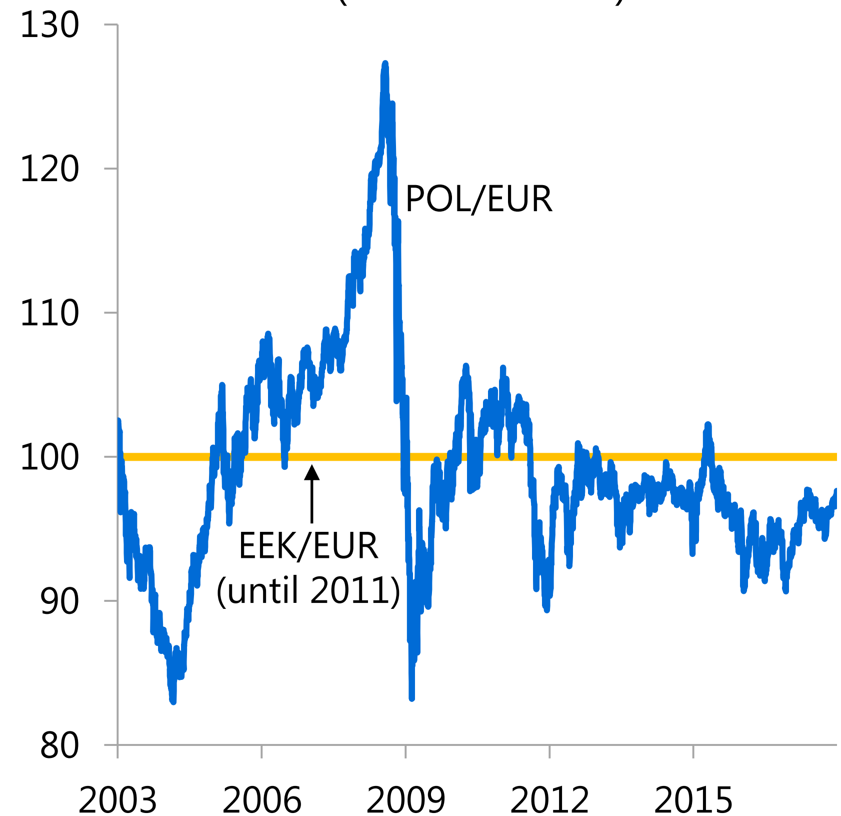
Note: Fixers include BIH, BGR, EST, HRV, LVA, LTU, SVN and SVK. Floaters include ALB, CZE, HUN, POL, ROU and SRB.

Appreciating exchange rates keep real interest rates higher and mitigate domestic boom-bust

Real Domestic Demand Growth
(Percent)



PLN/EUR and EEK/EUR
(Jan-2003=100)



Conclusions

- In the recent years, we had rapid decline in unemployment rates
- This cannot continue. Labor markets will eventually overheat
- To ensure continued growth, productivity will need to improve

Hence: Supply side policies are more important

Thank you