IN-DEPTH ANALYSIS

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Real challenges to the ECB

Supporting monetary policy scrutiny

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Real challenges to the ECB

Abstract

As it brings inflation down, the ECB faces lingering real-side disturbances inherited from the pandemic and the invasion of Ukraine. Its actions sometimes even deepen these disturbances. The paper argues that it simply cannot deal with them, and should not try to.

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LIST OF ABBREVIATIONS

APP	Asset purchase programme
ECB	European Central Bank
EU	European Union
GDP	Gross domestic product
HICP	Harmonised index of consumer prices
OMT	Outright monetary transactions
PEPP	Pandemic emergency purchase programme
TPI	Transmission protection instrumen

LIST OF FIGURES

EXECUTIVE SUMMARY

- **As the ECB battles inflation, it is confronted with headwinds from the real economy**. The classic trade-off between strong inflation and weak growth is made worse when inflation has a strong supply-side origin, because monetary policy acts on the demand side. In the case of the ECB, the challenge is even more difficult by heterogeneous situations across and within the member countries and as the transmission of its policies is undermined.

- **Fiscal policies enacted during the pandemic and extended in the wake of the Ukraine invasion do not help with the fight against inflation**. In many countries, the budget deficits remain large and are not expected to be significantly rolled back. They support growth just as the ECB needs to create enough slack to moderate price hikes. Their financing, which requires issuing more public debt instruments, complicates quantitative tightening, which implies unwinding of holdings by central banks of the same instruments.

- **Raising interest rates fragilise high public debts that keep growing**. This represents a threat to financial stability.

- **Interest rate on borrowings by households and firms are markedly different among euro area member countries**. This undermines the transmission of monetary policy and stands to lead to very different abilities to recover from the succession of shocks that occurred since 2020.

- **The labour markets are generally very tight**. This situation encourages nominal wage increases, which feeds the inflation spiral. As a result, the ECB must raise the interest rates further and longer, until the labour markets soften.

- **Yet, real wages have declined**. They have borne the lion's share of the transfers to producers of imported primary commodities (including oil and gas) whose prices have sharply increased. Even if these prices revert to their pre-pandemic levels and the transfers stop, domestic consumer prices are unlikely to decline. For real wages to recover, nominal wages will have to keep increasing, which will feed the inflation spiral.

- **Several distributional issues lie at the intersection between fiscal policies and the evolution of labour markets**. The shocks have had a differentiated impact on individual earnings and economic sectors. Governments have often stepped in to protect those worse hit, but these policies must be discontinued, just as the tight monetary policy stance may further skew income distribution.

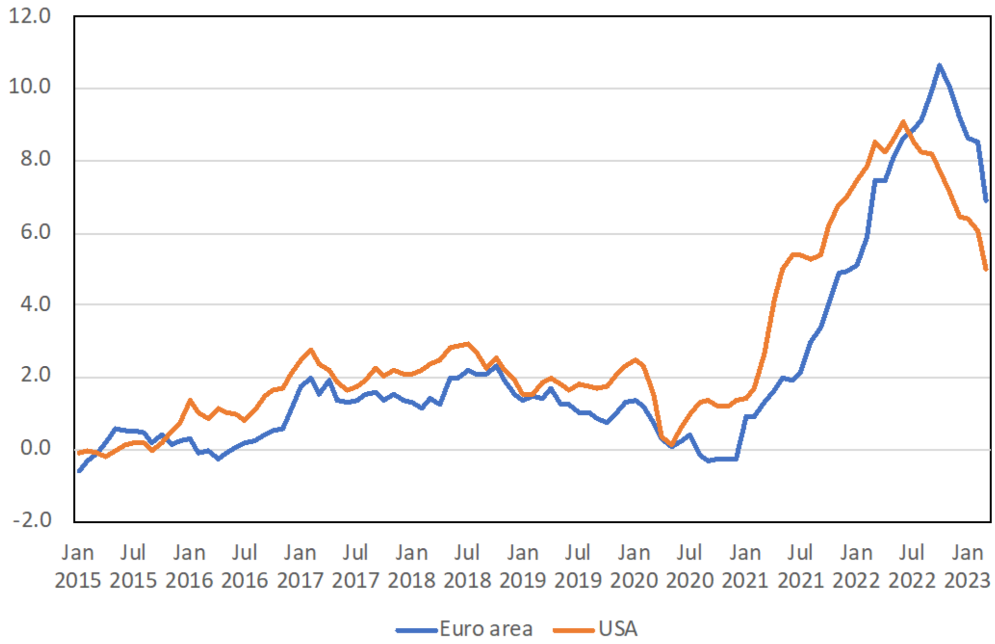
- **Inflation has differed among euro area member countries**. This means that some countries have lost price competitiveness against others. Since there are no exchange rates among euro area member countries, future inflation rates will have to undo what past inflation rates have done. The ECB is unable to do anything about this.

- **As it faces a more challenging situation than other central banks, the ECB should be spared unhelpful criticism**. It is not omnipotent and most of the real-side issues identified here belong to the domain of government responsibilities. Avoiding a recession is clearly desirable but this may be an unavoidable effect of the fight against inflation. The inflation surge is not entirely due to monetary policy. If governments do not wish to discontinue their exceptional support measures, the ECB should not be asked to help out. Nor should it be pressed to lower interest rates to support public and private investment.

1. INTRODUCTION

The inflation surge that started in 2021 is historically unique.[1] It has come after a long period when inflation has been too low despite unsuccessful efforts by many central banks to bring it up to their stated targets. As Figure 1 shows, it started during 2020, mid-year in the United States (USA) and at the end of the year in the euro area. It picked up speed in the aftermath of the lockdowns imposed during the COVID-19 pandemic, when many commodity prices began to rise due to disruptions in global supply chains. This is also the time when most governments, eager to soften the blow of the pandemic, extended historically large transfers to households and firms. Much of these transfers were maintained until the end of 2021 when it was perceived that the acute phase of the pandemic was ending thanks to vaccinations and immunity from exposure. Parts of these savings were pent during 2022, leading to rapid expansions that fed inflation. The invasion of Ukraine added more pressure, even though a frequent narrative wrongly asserts that this is what caused the inflation surge.

Figure 1: Consumer price inflation



Source: *International Financial Statistics*, IMF.

The inflation surge is thus driven by many different shocks that occurred in short succession. They combine demand and supply shocks, which originate from, and affect, both the monetary and real sides of the economy. Facing this unusual combination, most central banks dithered. It took time for them to recognise that the surge was not a short-lived temporary phenomenon. Like most public and private forecasters, they were blinded by their forecasting models, which had been developed and estimated in the "normal" period that preceded. Having lost some precious time, the central banks then swung into resolute action. Not only they had to shift to a contractionary policy stance, but they first had to reverse the highly stimulating stance that has prevailed over the previous decade.

They also had to counteract the expansionary fiscal policy stance maintained by many governments. In addition, stung by spectacular forecasting errors, they have abandoned their vaulted forward guidance and must now rely on observed data. Given that monetary policy deploys its effects with a long lag, from 12 to 18 months, they are likely to keep restraining growth and inflation for too long.

[1] Hall and Sargent (2022) draw a fascinating parallel with the two World Wars.

They fully accept this risk as they draw lessons from previous episodes during which premature policy relaxation led to a resumption of inflation, which imposed heavy costs (Schnabel, 2022).

The euro area is in a more difficult situation than the USA because it is a large net importer of oil and gas, which means that a significant part of incomes must be transferred to foreign oil producers, hurting growth. In contrast, as a net exporter of oil and gas, the USA benefits from these transfers. Dependence on Russia has greatly complicated the adjustment to sanctions imposed after the invasion of Ukraine. A further complicating factor is the need to deal with climate change.

It is not surprising, therefore, that criticism of central banks is mounting. The risks of a recession and of financial instability feed a view that monetary policy is excessively tight, especially as it disproportionately hurts the poorer households, which are less well equipped to face the situation. This is undoubtedly true. Yet, it does not mean that the criticism is warranted. The primary responsibility of central banks is to ensure price stability. In an era of high inflation, which disproportionately hurts the poorer households, central banks must adopt unpopular policies. This is precisely why central banks are independent. Hopefully, the criticism will not threaten that independence, which has proved crucial for a long while now.

The next section starts by reviewing two major real aspects of the current situation, the strong fiscal response of governments and the tight labour markets, which directly impinge on monetary policy. Section 3 brings into the picture two little-discussed aspects that are specific to the euro area: changes in member country price competitiveness and cross-country divergences in the cost of private borrowing, both of which affect the real side of the economy. These various developments greatlycomplicate the task of the European Central Bank (ECB) as it belatedly struggles to bring inflation to the 2% target. The concluding Section 4 reviews some of the most prominent criticisms addressed at the ECB and argues that they are unhelpful because monetary policy cannot deal with real-side disturbances.

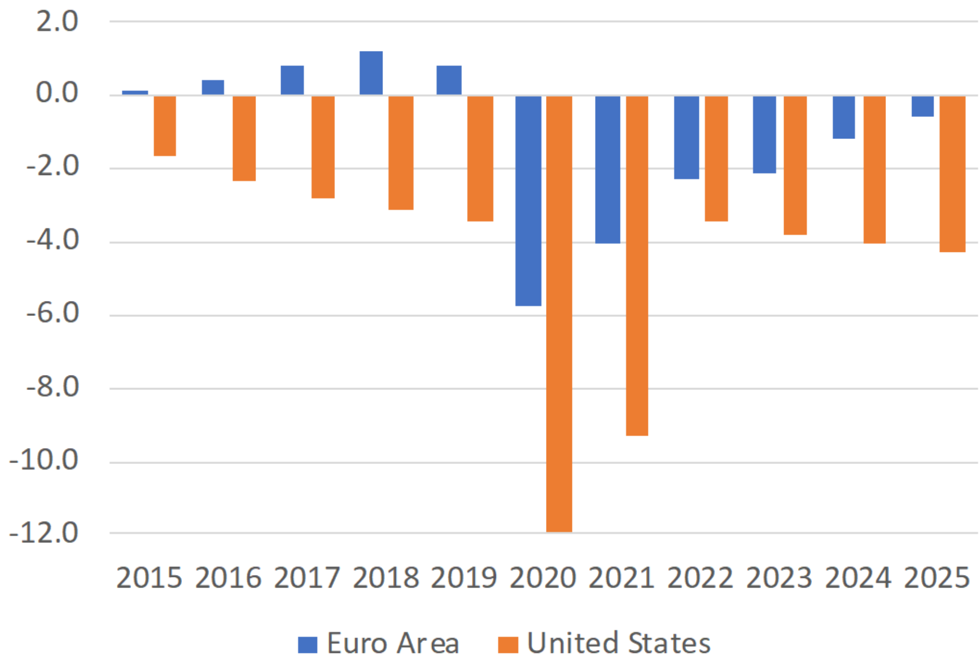
2. PUBLIC POLICIES

Much of the on-going discussion about inflation centres on supply-side factors such as commodity prices and supply chain disruptions. While these aspects are important, they are not the whole story. This section points two other important developments, fiscal policies and the situation in the labour markets.

2.1. Fiscal policies

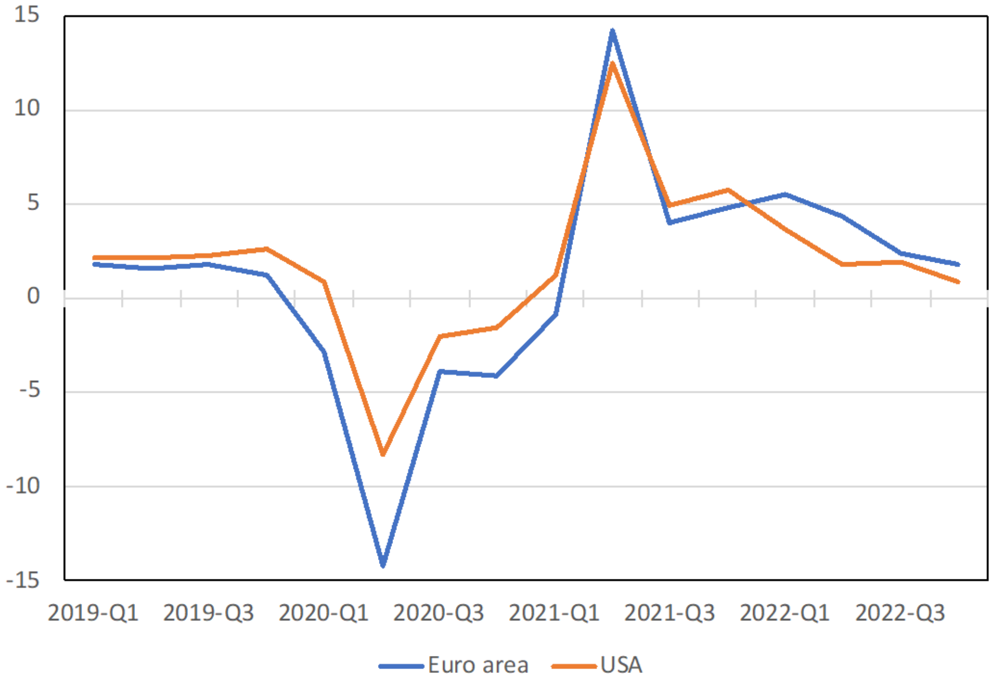
The shift to highly expansionary fiscal policies has been spectacular. Compared to 2019, in 2020 the primary budget deficits – deficits net of public debt service – as a ratio to gross domestic product (GDP) increased by 6.5 and 8.5 percentage points in the euro area and the USA, respectively, see Figure 2. The aim was to soften the blow of the social distancing measures taken to face the onslaught of the COVID-19 pandemic. Under the prevailing troubled conditions, the sharply rising deficits were not an immediate source of inflation, but they remained large in 2021 when growth bounced back, as shown in Figure 3. This is when inflation took off.

Figure 2: Primary budget deficits (% of GDP)



Source: *Fiscal Monitor*, IMF, 2023.

Figure 3: Real GDP growth rates (%)

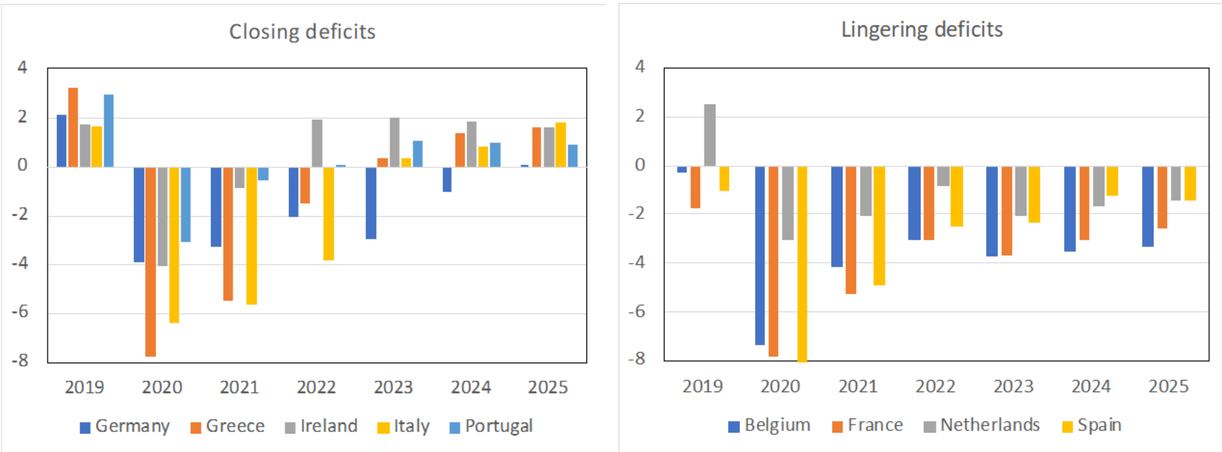


Source: *Economic Outlook, OECD*.

Clearly, large budget deficits alone do not explain the inflation surge. Figures 1 and 2 show that the US deficit was much larger than in the euro area and, yet, inflation has increased further (but later) in the euro area. Part of the explanation is that the energy and commodity price shocks have been larger in the euro area. Still, it is not possible to ignore the impact of the budget deficits, especially as they matter for the future.

Indeed, a big question is how and when these deficits will be closed. It has not helped the central banks that monetary and fiscal policies were set in opposite directions. In addition, because the combination of high and rising interest rates and of quantitative tightening (QT) is a making financial markets fragile, the large public debt increases of the recent past need to be reversed in due time, especially in countries where indebtedness was already high before the pandemic. Public debt risks will emerge as an important issue in the euro area, calling up memories of the debt crisis of the 2010s. Early indications are mixed, and disquieting. Figure 4 display the evolution of primary deficits, including forecasts by the International Monetary Fund (IMF) for 2023-2025. The left-hand side chart shows the case of countries where the deficits are rapidly closing down and are expected to turn into surpluses, while the right-hand chart identifies countries where the deficits are lingering. Interestingly, the “virtous” countries were already virtuous before the pandemic while, with one exception (the Netherlands), the “spendthrift” countries were already spendthrift in 2019 and they increased their deficits much more in 2020 and 2021.

Figure 4: Primary budget balances (% of GDP)



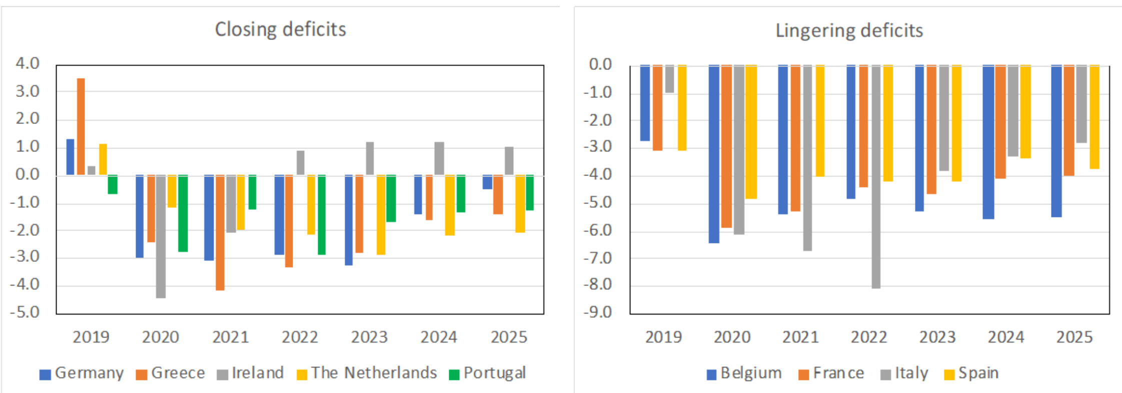
Source: *Fiscal Monitor*, IMF, 2023.

Figure 5 presents the cyclically adjusted primary balances of the same countries as those displayed in Figure 4. To recall, these deficits are a better measure of what governments choose since they take into account the automatic budgetary impact of business cycles. The comparison between these two figures leads to a number of observations:

- The large increases in actual deficits in 2020 are partly due to the recession.
- The improvements in 2021 and after are partly due to the return of growth.
- Except for Ireland, even the "virtuous" countries are not expected to bring their cyclically adjusted primary deficits – which ignore debt service – to balance by 2025.
- The cyclically adjusted primary deficits are not expected to be reduced in the spendthrift countries.
- Looking at the cyclically adjusted primary budgets, the Netherlands moves to the 'virtuous' category while Italy joins the spendthrift country group.

Overall, according to the IMF projections, only two euro area countries (Cyprus and Ireland) are expected to bring their 2025 cyclically adjusted primary balance back to the 2019 level.

Figure 5: Cyclically adjusted budget balances (% of GDP)



Source: *Fiscal Monitor*, IMF, 2023.

For 2023-25, these are forecasts, which may change. Taking them at face value, the implications for monetary policy are:

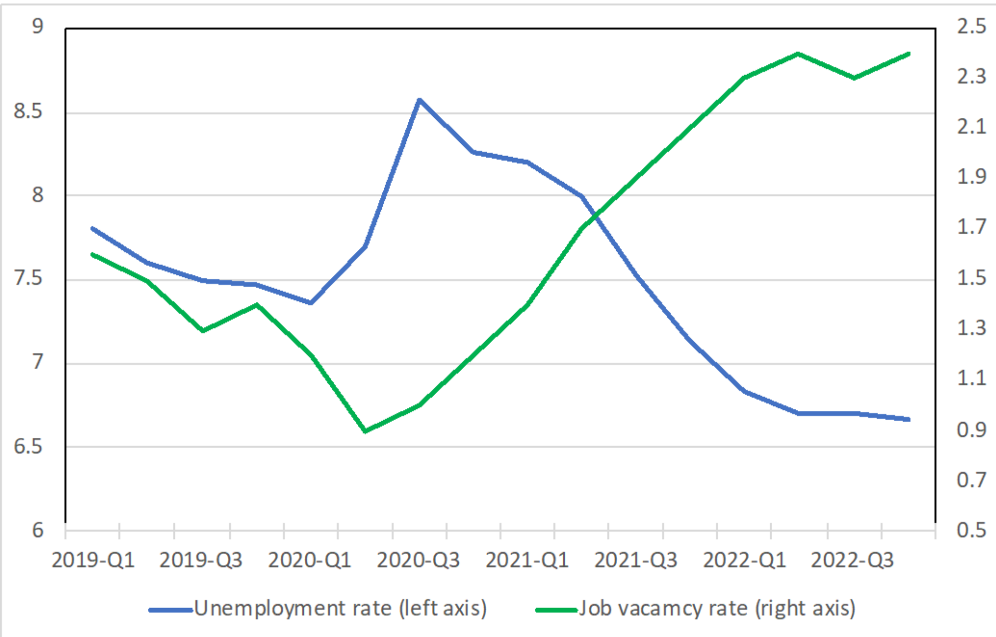
- Over 2022-23, fiscal policies are not helping the ECB in its effort at bringing inflation down to 2%, in effect they force the ECB to lift its interest rate higher and faster, with a negative impact on financial stability.
- The Eurosystem should also seek to normalise the sizes of central bank balance sheets. After many years of quantitative easing (QE), the Eurosystem holds about one third of euro area public debts. QT implies large run-offs or sales of these debts, which would be made easier if new borrowing to finance deficits were reduced. The forecasts envision no significant reduction of deficits from 2023 onwards.
- The inflation surge has mechanically reduced the ratio of public debts to GDP in 2022. If the ECB manages to cut inflation down, this side effect will disappear, which could raise pressure on the most indebted governments.

2.2. Labour markets

2.2.1. Labour market tightness

Euro area labour markets are historically tight. Figure 6 shows that the unemployment rate in the euro area briefly jumped when the first lockdown was imposed but then declined to a level unseen since the Great Recession of 2009. It also shows that the job vacancy rate recovered even faster after an early decline. The ratio of the unemployment rate to the job vacancy rate, a measure of labour market tightness, declined from 11.4 in 2015Q1 to 4.9 in 2019Q1 and to 2.8 in 2022Q4. Firms are looking to fill more jobs from a lower pool of unemployed workers. Numbers differ from country to country, but the situation is fairly general in the euro area. This tightness is not due to a reduction in labour force participation, which stands at a high level.

Figure 6: Unemployment and job vacancy rates in the euro area (%)



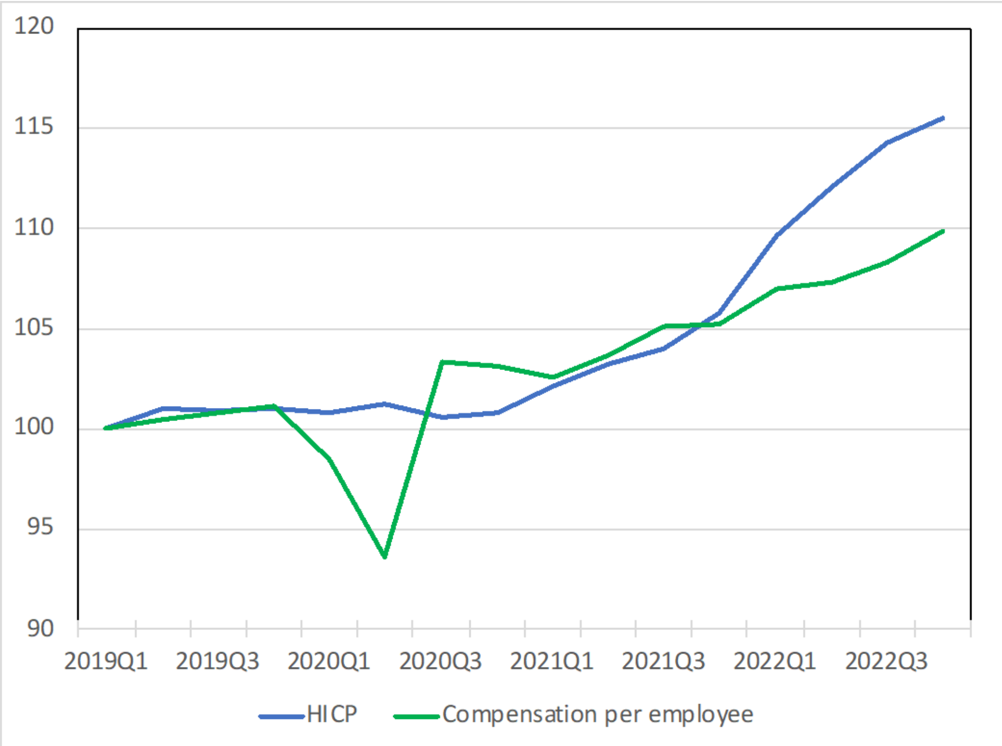
Sources: Unemployment rate: *Employment Outlook*, OECD; Job vacancy rate: Eurostat.

Notes: The unemployment rate measures the percentage of the number of unemployed people to the number of of working age (15-64). The job vacancy is the ratio of open positions to the number of total jobs.

Labour market tightness usually encourages wage increases. Over 2022, average labour costs indeed increased by 5.7% in the euro area, a figure not seen since the end of the inflation period of the 1980s.

However, over the same period, the harmonised index of consumer prices (HICP) rose by about 9%. Figure 7 depicts the evolutions of the price level (HICP) and of average compensation per employee since 2019. Compensations declined during the lockdown because many workers were put on leave or laid off, but these measures did not affect the "indispensable" workers who were mostly occupying low skill jobs. The average compensation caught up as the higher skilled workers returned to work. Then, over 2021 and 2022, wages did not keep up with inflation. Compared to early 2019, in late 2022 the loss amounted to 5.6%.[2] These contrasted evolutions are important for monetary policy.

Figure 7: Prices and wages in the euro area (index 100 = 2019Q1)



Source: ECB.

The early view that inflation would be temporary and therefore did not require a tightening of monetary policy was based on the assumption that, once the increases in primary commodity prices stabilise, consumer prices would stabilise as well. For this assumption to work, wage increases should be limited, so production costs would only grow because of higher costs in intermediate products. In contrast, the inflation spiral view holds that price increases lead to wage increases which lead to price increases and so on. It was often described as outdated. As it turned out, the inflation spiral view is not outdated. The ECB will not bring inflation down until wage increases moderate.

2.2.2. Absorbing the increases in imported commodity prices

The gap between labour compensation and the price level exhibited in Figure 7 means that the purchasing power of wages has declined on average by more than 5% since 2019. This is a frequent impact of quickly rising inflation as wage increases lag, due to infrequent wage negotiations. But there is more to it this time around. The increase in imported primary commodity prices means that, collectively, the euro area is transferring income to the producers. This income loss, estimated at some

[2] Over time, wages grow faster than prices. The difference captures on-going advances in labour productivity.

2% of GDP, must be shared somehow. The decline of the purchasing power of wages shows that the burden has been borne mostly by workers so far.

Will this loss be erased eventually? If primary commodity prices retreat to levels seen before the pandemic, the income transfers will stop. If consumer prices decline accordingly, the purchasing power of wages could be restored without wages increasing further. This is an unlikely scenario, though. A generalised price decline, that is deflation, is a rare event, and one that the ECB would not wish to see after having battling too low inflation over a decade. A more likely scenario is that wages increase faster than prices in the coming years, which would make it difficult to break the inflation spiral.

Thus, the future evolution of commodity prices presents the ECB with two difficult situations. If passed through to the consumer price index, a return to pre-2020 prices could lead the ECB to promptly reverse its policy stance to block any return to too low inflation. [3] If instead the prices of commodity prices remain at their current levels, the loss in the purchasing power of labour compensation stands to be reversed through a continuation of the inflation spiral, which would lead the ECB to maintain its policy stance.

2.2.3. Income distribution

A number of distributional issues lie at the intersection between fiscal policies and the evolution of labour markets. The shocks have had a differentiated impact on earnings and economic sectors. A detailed view is emerging with a rich web of effects that have changed over time. A brief summary is as follows:

- Through social distancing measures and self-restraint, the COVID-19 pandemic has led to a sharp contraction in the service sector, hitting recreation, travel, and hospitality. Other services, which can function through remote work have been spared, or even benefitted. Public transfers to households have led them to accumulate savings, some of it went into purchases of durable goods.
- During that period, government programmes also encouraged work at home and job retention. Those left out of these programmes were severely hit. The "essential" workers suffered from exposition to COVID-19, restrictions from public transportation and difficult working conditions but have also continued to earn wages. Middle-income workers, who could not work from home seem to have been hit more than lower-income "essential" workers and higher-income workers who worked from home and saved on transport costs. [4]
- When normality started to return, dissaving boosted the industrial sector but the recovery was weak or even inexistent in sectors affected by supply chain constraints (e.g., the car industry). Similarly, demand for services surged but supply was hampered by labour market tightness. The result has been an uneven recovery and a reallocation of workers across sectors.
- The increase in energy and food prices has taken a heavy toll on poorer people. Many governments have responded with various support measures.
- The interest rate increases have affected the housing market. Mortgages have become more expensive, especially where they are indexed to short-term interest rates. Financial market turmoil is leading to tightened access to bank lending, affecting both households, especially the less well-off, and firms that face difficulties to carry out productive investments.

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[3] It would also represent a setback for the fight against climate change, which has been boosted conveniently by the increase in energy prices.

[4] Gros (2023) argues that we know little about whether income inequalities have increased or decreased.

These real-side developments complicate monetary policy. Monetary policy is never neutral but, as it shifts back and forth from accommodating and restrictive stances, the burden ends up being shared over time across income groups. Coming on the steps of the COVID-19 and post-COVID-19 shocks and the Ukraine crisis, the tightening under way often hurts the same less-favoured groups and the firms that emerged fragilised from the pandemic. There is nothing that the ECB can do about the impact of its policy stance, short of prematurely giving up on its efforts to bring inflation down. Income distribution is an issue that belongs to governments. It is incumbent on them to decide how to deal with inequities. A natural response is to use fiscal policy, but any inflationary impact may force the ECB to push interest rates even higher. Re-distributing income from the better-offs and winners of the past shocks to those who are hurt and don't have resources to cope with the shock, while keeping a lid on the budget deficit, is possible. It calls for precisely targeted measures.

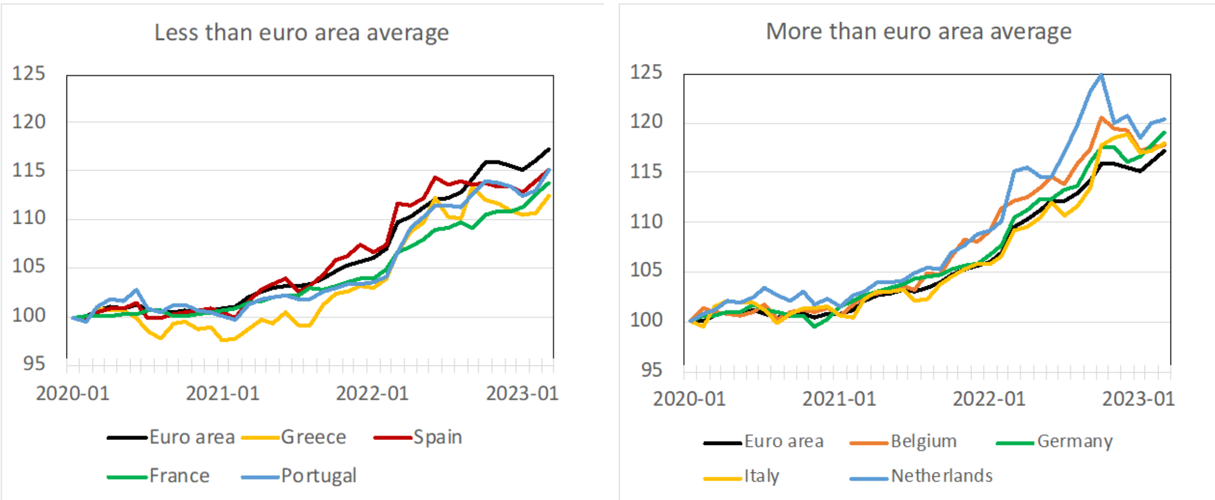
3. COMPETITIVENESS WITHIN THE EURO AREA

The heterogeneities presented in the previous section suggest that the effects from the shocks vary across the euro area member countries as well. The absence of exchange rates within the euro area, mean that differences affecting price competitiveness cannot be easily corrected. With risk premia also affected, differences in interest rates affecting public debts, as well as the costs of public and private investment, cannot be dealt with traditional monetary policy.

3.1. Price developments

Figure 8 depicts the evolution of the consumer price index in two groups of countries. The left-hand chart shows the cases of some countries where the price level rose less than the euro area average, while the right-hand chart shows the cases of some countries where the price level rose more than the euro area average. It seems that these differences are largely driven by policy measures. The countries with less inflation are those where governments subsidised firms to allow them to absorb the shocks without raising prices too quickly. In the countries that appear in the right-hand chart, the subsidies were smaller or much delayed as in Belgium and the Netherlands. These subsidies varies but they usually included direct transfers to firms and wage supports. The differences also reflect the extent of the shocks, for example the collapse of tourism in Greece or the dependence on oil and gas imports from Russia as in Germany and the Eastern countries.

Figure 8: Evolution of consumer prices (index: 100=January 2020)

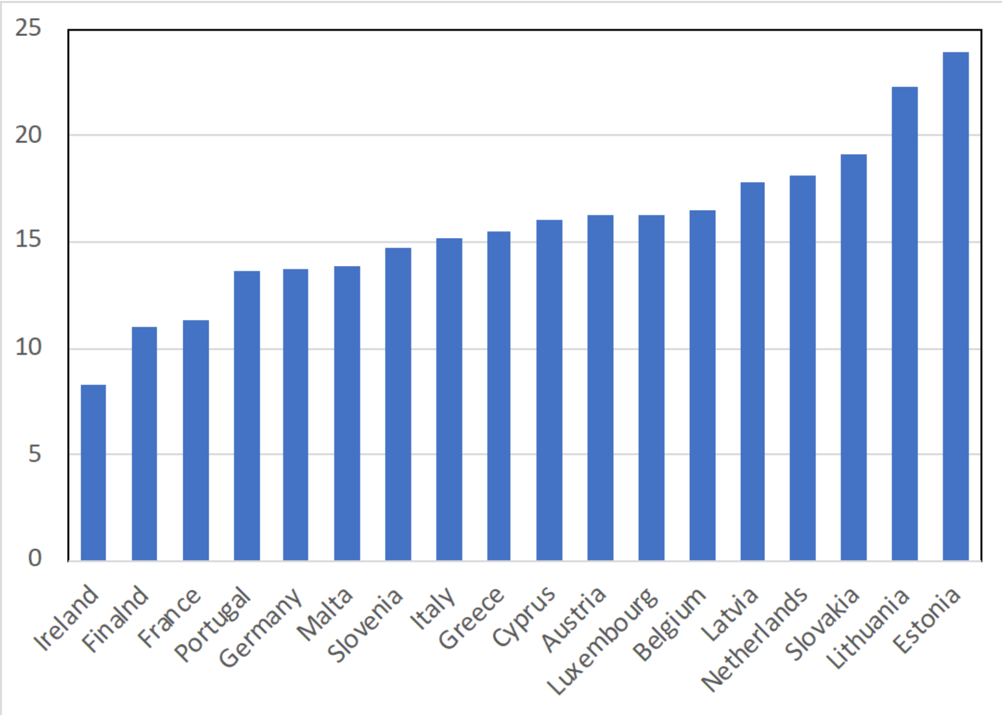


Source: Eurostat.

What matters here is that divergent price evolutions affect countries' competitiveness, a real side characteristic. Consumer prices may not a good description of price competitiveness as they include nontraded goods and services. A better measure is the price of industrial goods, which are generally either exported or imported, at any rate subject to foreign competition. The increases in the prices of industrial goods are reported in Figure 9. They are aligned with the evolution of consumer prices. The differences across countries are significant. For example, the index rose by 8.3% in Ireland and by 24.0% in Estonia.

An open question is whether and how these differences will be corrected in the future. It will depend on the causes that lie behind the differences. One cause is varied government support schemes – including energy subsidies. These schemes will have to disappear reasonably soon, both because they are costly and because they run against Single Market rules that have been temporarily lifted. Another cause is the dependence on Russian imports. This effect will also diminish as the most affected countries diversify their imports. The more challenging aspect is the flip side of dependence on Russia – including as a customer. Some countries had previously benefitted from a comparative advantage in terms of lower energy costs. As this advantage disappears, they will have to undergo an industrial restructuring, which is bound to be protracted. The common currency makes it impossible to absorb the blow with exchange rate adjustments. This is one aspect of the well-understood fact that the main costs of belonging to a monetary union is the occurrence of asymmetric supply shocks.

Figure 9: Increase in industrial goods prices (%, 2020:1 to 2022:3)



Source: Eurostat.

Note: The index excludes energy prices.

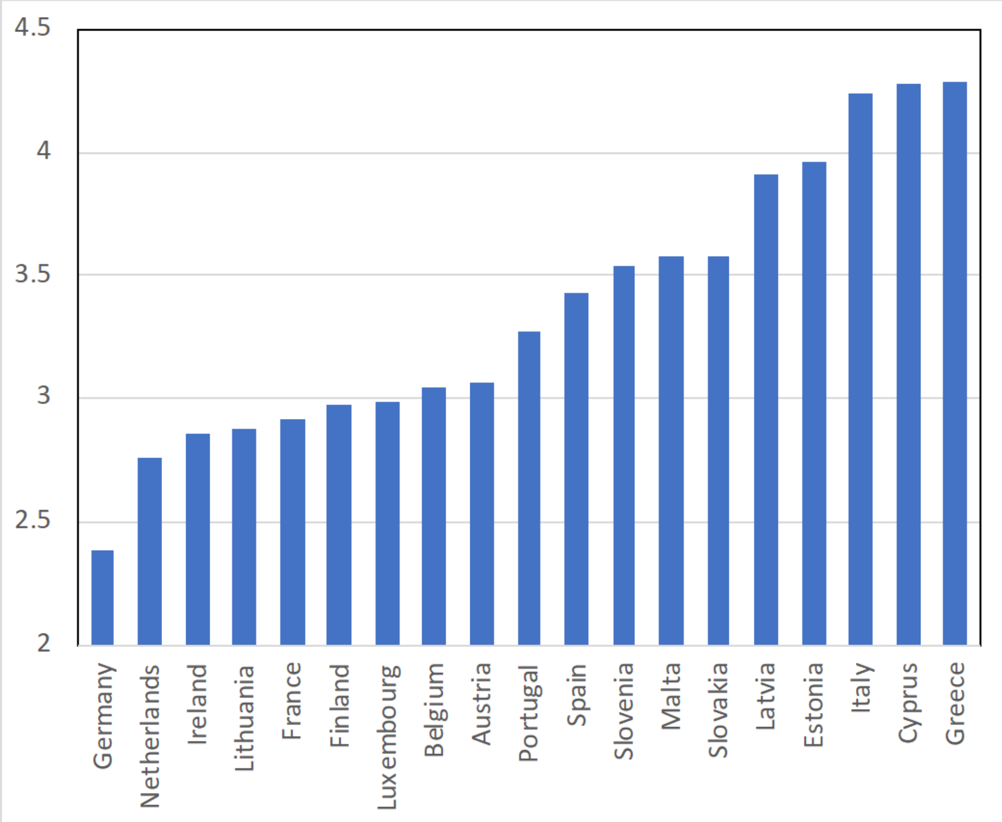
3.2. Interest rates

The recovery and the adjustment to climate change will require an increase in productive investments. Countries where borrowing costs are higher will face a competitive disadvantage. This will also affect the costs of servicing the public debt. As can be seen from Figure 10, long-term interest rates exhibit large differences across euro area member countries. These are nominal interest rates, while those that matter for investment are the real rates. Unfortunately, to compute real interest rates, we need corresponding measures of expected inflation and existing forecasts are not reliable at this juncture. [5]

In general, private borrowing rates are related to public borrowing rates. In turn, public borrowing costs are driven by the rates set by the central bank, and how they are expected to evolve over time, and by a risk premium that is related to the sustainability of the public debt. Since the euro area countries share the same central bank, differences in public borrowing rates reflect the risk premia. Private borrowing is customarily seen as less safe than public borrowing, which implies an additional risk premium.

[5] There is no discernible relationship between the nominal rates and current inflation.

Figure 10: Interest rates (10-year bonds, %) – March 2023



Source: ECB.

This is not the end of the story, though. The link between the interest rates displayed in Figure 10 and national public debts is very weak. In addition, in the euro area, it is not obvious that private borrowing riskiness should be tightly related to public debt in the home country. Within the EU, private borrowers can in principle borrow in any country and the Banking Union is meant to encourage cross-border borrowing and lending. However, the Banking Union is incomplete and factors such competition in the financial sector and the legal framework play an important role, as documented in Van Leuvensteijn et al. (2011).

More generally, like many economic variables, the current levels of interest rates in the euro area must be driven by many of the exceptional factors that make the current situation special. The message from Figure 10 is that the euro area countries face different challenges as they need to invest to deal with the real-side difficulties that have arisen since 2019. The euro area is not the level-playing field that the ECB needs to conduct its policy. The much-vaulted transmission of monetary policy is deeply perturbed and there is no obvious way to circumvent this challenge.

4. CONCLUSION: UNHELPFUL MYTHS

Fighting inflation is the bane of central banks as they must enact unpopular contractionary policies. This is made worse when inflation has a strong supply-side origin because monetary policy acts on the demand side and thus faces a difficult trade-off between strong inflation and weak growth. In the case of the ECB, the challenge is even more difficult as it faces heterogeneous situations across and within the member countries, and as the transmission of its policies is undermined. With the Outright Monetary Transactions (OMT), Pandemic Emergency Purchase Programme (PEPP) and the Transmission Protection Instrument (TPI), the ECB has already shown a willingness to depart from its traditional one-size-fits-all approach to respond to threats to national public debts. Dealing with divergent inflation rates, differences in interest rates and, more generally, asymmetric shocks that may linger, a priori seems impossible. It is also difficult to see how it can deal with the income distribution consequences of monetary policy, and therefore it should not try.

All this adds up to unusual challenges for the ECB as higher interest rates and QT are needed to bring inflation down to its target. At least, its task would be made easier if a number of myths are not taken seriously by the various actors shaping economic and financial conditions.

The myth of central bank omnipotence. Central banks have been successful at keeping inflation rates low, at trying to raise them when they were too low and at responding to bouts of financial instability, apparently with quasi-infinite resources. They have acquired the status of problem-solvers of first resort, but many of the current challenges lay outside their competence. This is the case of the various heterogeneities that have emerged across and within euro area member countries. The ECB has no instrument and no legal basis to deal with these heterogeneities.

The myth of avoiding a recession. There are numerous claims that monetary policy tightening should be moderated, possibly even stopped, to avoid an outright recession and to limit increases in unemployment. The only tool available to central banks when they need to bring inflation down is to create enough slack in the economy, including in the labour markets, to discourage prices and wages from spiralling up. Given the massive uncertainty that currently prevails, any hope of fine-tuning monetary policy to bring inflation down without entering into a recession is unrealistic. The ECB is clearly aware of the difficulty (Lane, 2023; Schnabel, 2023).

The myth that inflation is entirely due to monetary policy. Obviously, external price increases (food, energy, primary commodities) have played a role in the inflation surge. Unusually large fiscal expansions have also contributed. It remains true that, in the long run, it is monetary policy that will determine inflation, which is why the ECB is right to focus on this objective, but we are still in the process of digesting the shorter-run impact of exceptional shocks.

The myth of supporting fiscal policies. The emergency fiscal measures taken during the COVID-19 pandemic and following the invasion of Ukraine can be withdrawn. If, for some reason, governments decide that some measures cannot be discontinued, they now should finance them through reductions in spending or tax increases. Criticism that monetary policy should assist governments by lowering the interest rate runs counter to the objective of price stability, which is the key responsibility of central banks.

The myth of urgent need to invest. It is often claimed that now is the time to carry out public investment to deal with climate change and the scars left by the shocks. In the same vein, it is claimed that private investment is urgently needed to sustain and amplify the recovery. Implicitly, these claims imply that bringing inflation back to target can wait. These claims are based on two misleading premises. First, they ignore the fact that it is more costly to fight inflation it becomes entrenched, which occurs the longer it lasts. Second, investments take a long time to deploy their beneficial effects, but spending comes first and stands to undermine ECB's efforts.

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As it brings inflation down, the ECB faces lingering real-side disturbances inherited from the pandemic and the invasion of Ukraine. Its actions sometimes even deepen these disturbances. The paper argues that it simply cannot deal with them, and should not try to.

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