

Inflation: should bygones be bygones?



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In December 2024 the European Commission published its standard Eurobarometer for autumn 2024, with field work conducted during October of that year

There are several interesting findings that emerge from such survey. For example, support for the euro has reached a new peak of 81% in October, while support by Maltese citizens increased to 84%.

However, what was most interesting in the latest Eurobarometer survey was that inflation continues to be the biggest concern for Euro Area (EA) citizens, including those of Malta.

In the latest survey, one third of EA citizens placed rising prices at the top of their concerns, while for Malta it was higher at 43%. Although when compared to the Spring 2024 Eurobarometer, the latest survey results show that concerns regarding inflation have receded, both in the EA and Malta, from 38% and 58% respectively, nevertheless it is clear that rising prices remain the major worry for citizens. This is also likely to be a major underlying source of the political shifts that have been observed in recent times, both in Europe and beyond.

The key question is: are such

% Change in HICP & Components Index between January 2020 and October 2024	% Change in Price Level	
	Euro Area	Malta
Food (including alcohol & tobacco)	28.6	28.2
Processed Food	30.6	31.7
Unprocessed Food	28.1	36.1
Energy	34.9	-3.5
Overall index excluding energy, food, alcohol & tobacco	17.1	23.2
Non-Energy Industrial Goods	16.3	16.4
Services	17.4	27.3
Restaurants & Hotels	26.4	44.1
Catering Services	23.1	24.6
Accommodation Services	40.6	63.0
Overall HICP	21.7	22.5
Overall HICP (excluding Accommodation Services)*	20.7	18.1
% Increase in Compensation per Employee (2019-2024)**	18.6	17.9

* own calculation based on Eurostat data

** based on data up to first half of 2024

Source: Eurostat

concerns misplaced given that inflation for quite some time has been on a clear downward trajectory? After all, inflation had peaked two years ago in October 2022 at 10.6% in the EA and at 7.4% in Malta, falling steadily thereafter to 2% in the EA and 2.4% in Malta by October 2024, with both standing at around their average inflation rate for the 25-year period since the inception of the euro in 1999!

The table shows that the overall price level between January 2020 (the last month before the outbreak of Covid) and October 2024 had increased by 21.7% in the EA and by 22.5% in Malta. More

significantly, those items which are purchased frequently by citizens and account for a sizeable share in the consumption basket of low-income households, namely food and energy (electricity and fuels) increased by almost 30% and 35% respectively in the EA, with Malta recording a similar rise in food prices, though in the case of energy the price level did not increase as prices were frozen by Government policy.

As the table shows, both the EA and Malta experienced a rise in food prices and energy (EA only) that by far outpaced the rise in compensation per

employee, which represents the main source of income for working households.

On the other hand, the price level of non-energy industrial goods increased at a slightly lower rate than the increase in compensation per employee, both in the EA and Malta. This was also the case for services in the EA. By contrast, in Malta, the price level for services increased by 27.3%, outstripping by a wide margin the increase in compensation per employee.

However, this component was mostly influenced by Accommodation Services, where the price level increased by 63% in Malta compared to 40.6% in the EA. This largely reflects consumption by tourists using accommodation facilities (hotels). Indeed, given the larger share of tourism activity in Malta relative to the EA, this component has a weight of 7.3% in the overall HICP for Malta, while that for the EA is only around a third at 2.4%. Such increase in the price level could be interpreted as a favourable terms of trade

shock for Malta given that during this period the number of tourists also increased to record levels. Additionally, excluding this component from the HICP, which is mostly consumed by tourists, the price level in Malta for domestic households would have increased by less than the EA, and the gap from the increase in compensation per employee narrows to just 0.2ppts.

The lessons to be drawn from the data shown in the table and the results of the Eurobarometer survey are that it seems that the price level matters more for citizens, and this is more likely to influence consumer confidence. This is because the price level does not only impact the purchasing power of their income, but it also affects that of their past savings and may therefore choose to increase their savings rate to rebuild the purchasing power of their financial wealth, especially after periods of high inflation.

If households care more about the price level, then this also raises the question whether monetary policy should similarly have the price level as its strategic objective. In the EA and other advanced economies, the goal of monetary policy is an inflation target, usually of around 2%. Such monetary policy strategy implies that if inflation was well above the target in the past, going forward the central bank would still aim to achieve its targeted inflation rate.

However, this could mean that the current price level is higher than the one had the central bank achieved its targets in the past. This is because the philosophy underpinning inflation targeting regimes is to let bygones be bygones and hopes rest on periods of inflation above target being compensated for by periods of inflation below target. By contrast, a monetary policy strategy based on price level targeting accounts for past performance in its actions to achieve its future price level goal. Given that the price level seems to matter more for citizens, is it perhaps time to debate again whether not to let bygones be bygones?

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