Constantinos Herodotou: Introduction - 13th Limassol Economic Forum

Introduction of Mr Constantinos Herodotou, Governor of the Central Bank of Cyprus, at the 13th Limassol Economic Forum, Limassol, 21 October 2022.

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I would like to start with thanking Yiannis and Mario for accepting my invitation to participate in this panel discussion with me. – Mario, Obrigado por aceitar o meu convite.

It is a pleasure to discuss the inflation challenges during these difficult times of high inflation and elevated economic uncertainty with my Governing Council colleagues and friends Mario and Yiannis.

The war in Ukraine has disrupted the return to normality that we expected after the end of the pandemic lockdown periods. Central Banks around the world are facing the challenge to put under control excessive and persistent inflationary dynamics.

So it is informative to look at the main components of these inflation dynamics, in other words which items drive inflation up the most.

The war exacerbated massively cost push inflation, primarily through the energy price shock. In measuring energy inflation we include among others the prices of fuel, gas as well as electricity prices. This inflationary dynamic continues to persist with energy price pressures, in the most recent measure last month, being extraordinarily high at 40.7% compared to 38.6% in August. The second major contributor to inflation is food prices which grew by 11.8% in September compared with 10.6% in August. This is attributed to higher input costs related to the energy price increases, disruptions to trade in food commodities and adverse weather conditions.

Inflation in services is also increasing but here it is interesting to point out that whereas supply side factors were the main driver of services inflation until the end of 2021, demand factors have been making an increasing contribution to services inflation throughout 2022, and ended up surpassing supply driven factors in the third quarter. A similar increasing contribution of demand drivers versus supply drivers is observed in Non-Energy Industrial Goods inflation in 2022.

So, Headline HICP inflation is projected to rise further from the already very high levels, averaging to 8.1% in 2022, then decreasing to 5.5% next year and to 2.3% in 2024. But these are annual averages of inflation. This is also important because in order to reach the 5.5% average inflation next year, since inflation starts in the coming year at a high level, it means that inflation is expected to be at 3.3% in the fourth quarter of 2023, assuming, of course, there are no new external shocks.

The aim of monetary policy, through higher interest rates, is to support disinflationary pressures through downward pressure on demand. So Monetary Policy has a "more" difficult job than when dealing only with "typical" demand driven inflation.

Given the above considerations and the current highly uncertain environment, the inherent flexibility of the meeting by meeting approach we decided at the Governing Council is well suited to calibrating monetary policy, in line with the incoming data and the evolving outlook.

Thank you.