

# The Change in Inflation Expectation During and Post the Pandemic in European Region

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**Abstract.** What people anticipate inflation to be in the future is known as inflation expectations. These future inflation expectations are significant because they have an impact on people's actions now, which in turn has an impact on inflation in the future. It is crucial to get the inflation expectation as close to the central bank's target as possible because doing so makes it easier for the bank to achieve its goal of inflation. This study tries to explore the inflation expectations in the European region and how they change during the pandemic and post-pandemic periods. The paper also offers a future prediction regarding the inflation expectation. In order to forecast the level of expected future inflation, the study conducts a comparative analysis including the GDP, unemployment rate, and consumer price index. In the end, it was discovered that future inflation expectations are typically less firmly anchored and higher than the central bank's target. The study's conclusion also suggests a possible way to make the expectation more certain.

**Keywords:** De-anchored inflation expectation, pandemic period, European region.

## 1. Introduction

When the first case was discovered in France in January 2020, the pandemic in Europe officially began. The virus began to spread throughout Europe from that point on. With the introduction of lockdown in European nations in March 2020, the pandemic has made the world less globalized. Considering how interdependent the world is today and how many major economic issues could arise without trade between countries, this is not beneficial for any of them. For instance, the lockdown was implemented in France on March 17, 2020, and as a result, France's GDP began to decline at that time [1]. Lockdown has also contributed to other potential economic issues like a rise in the unemployment rate and a widening of the wealth gap. The lockdown and pandemic affect not only France but also other European nations. Many European countries' GDPs started to fall in the first quarter of 2020 and kept falling through the third. Although Europe didn't fully recover from the pandemic by late 2020, there are some encouraging signs that the situation is improving. For instance, the GDP has been rising in the majority of European countries since 2020 quarter 4. This does not imply that the economy has been doing well lately, though. To control the virus, governments must impose strict rules, and many businesses have suffered as a result of these policies. Due to the lockdown, it has been particularly difficult for small and medium-sized businesses to sell their goods, which has resulted in bankruptcy. Many small businesses find it more difficult to operate during the pandemic because borrowing is more difficult. Some larger companies have also been experiencing liquidity issues due to a lack of cash. And the government of Europe should focus on achieving this goal. The government must provide more support and more funding to stimulate the economy [2]. Governments attempt to stimulate the economy by lowering interest rates in order to increase aggregate demand. Some governments have even begun to distribute money in order to encourage citizens to spend.

These policies did significantly contribute to the recovery of the economy, but they also brought inflation to the nations of Europe. It's not unusual because most nations today experience high inflation. But it appears to be worse for European nations. Many factors contribute to the inflation in Europe, but the excess demand following the pandemic phase is the main culprit. Following the removal of all restrictions, consumers began to spend more money. However, due to disruptions in the global supply chain, the supply could not keep up with this demand, and prices rose. An energy

crisis in the European region was also brought on by the conflict in Ukraine. The inflation rate in the UK recently hit a recent high of 8%. Because people can now buy fewer things than they could in the past, high inflation will lower people's living standards. This usually results in less consumption, which eventually will push a country into recession. And the way that people perceive the inflation trend in the future can actually alter it. People have the power to easily bring about their own self-fulfilling prophecies. As a result, if they expect high inflation, the inflation rate tends to rise in the future. This expectation is influenced by a variety of factors, including how people perceive the direction of the economy, any new information that comes in, the news, and the central bank's handling of crises. Therefore, it is imperative that the government and central bank act and ensure that this expectation is well controlled because a well-controlled expectation can both make the central bank's job easier and speed up the recovery of the economy from the pandemic.

## 2. Literature Review

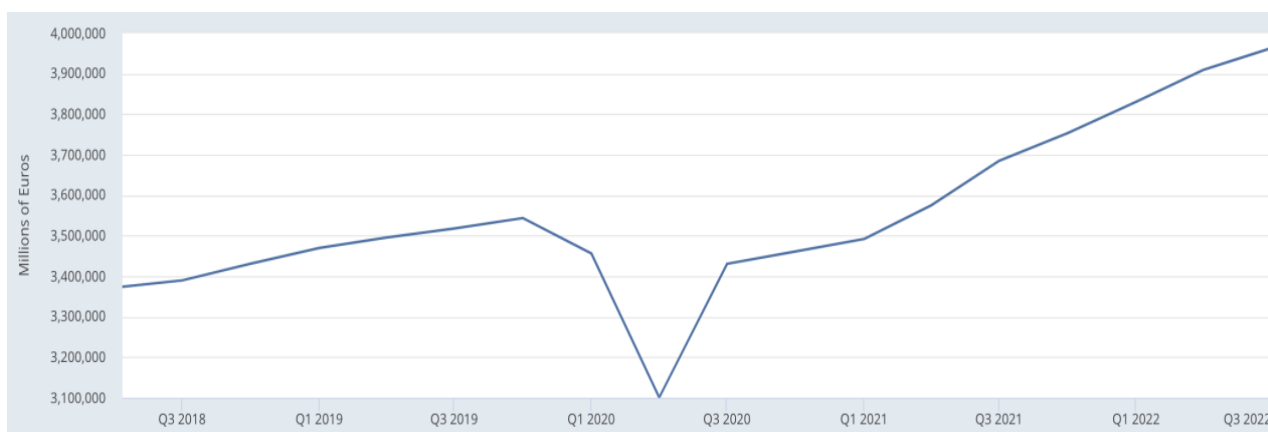
The post-pandemic phase has begun, and governments in the vast majority of the world's nations have been working arduously to lessen the harm the pandemic caused while also trying to aid the weak economy in recovering. However, there has always been a problem with inflation. COVID-19 has changed people's spending habits too quickly, making it more difficult for authorities to accurately predict future price levels using the consumer price index. To reduce future inflation estimation errors, the rebasing date should be moved up [3]. This means that when inflation starts to rise, the central bank may also underestimate the possible costs to society. As a result, the wrong action may be taken, which could make the inflation even worse. Galati et al. also found that the general public's expectations for inflation were outside the target range set by the central bank. Consumers' long-term inflation expectations for the euro area have consistently exceeded the ECB's inflation target throughout the pandemic. Future inflation may be more likely as a result of this. (Over the 2% inflation target set by the ECB). The evidence has demonstrated that during a pandemic, consumers' inflation expectations are de-anchored. This study also shows that people with higher levels of education or income tend to have longer-term inflation expectations. The government could set this as a goal and continue to work toward it as a way to help people have more firmly grounded expectations [4]. For an economy to be stable, inflation expectations must be firmly anchored. Since 2011, inflation expectations in the European region have been weakly anchored [5]. Similar thinking was found in Autrup and Grothe's research, which examined inflation both before and after the crisis but revealed that the Euro market tends to maintain its inflation expectation constant throughout the crisis [6]. Some researchers have found that long-term inflation expectations in the euro area are more firmly anchored than in the US by comparing data from various countries [7]. Lyziak and Paloviita pay close attention to European inflation expectations in particular. The findings show that changing short- and long-term inflation expectations depends on how central banks react to inflation, which is something that European governments and central banks are working very hard to achieve [8]. If the central bank reacts negatively to inflation, people may predict higher inflation rates in the future, which may cause them to become more pessimistic about the future. The government must therefore effectively respond to the inflationary pressure. The question of whether the current situation's high level of uncertainty will cause people's inflation expectations to once again spiral out of control and what steps the government can take to prevent this arises because a higher level of uncertainty will make the expectation less anchored [9].

However, there is a lack of research on inflation expectations in the context of the current pandemic. In order to estimate the inflation expectation in the post-pandemic period, this article will compare earlier research conducted by other researchers about changes in inflation expectations under other crises. It's important to understand how well expectations are currently anchored and what steps can be taken to make them more anchored because European countries are currently experiencing high inflation, an energy crisis, as well as other potential problems brought on by those two, such as the high unemployment rate.

### 3. Analytical Framework

#### 3.1. Economic Development in European Region

This paper examines how well inflation expectation in the European region varies after the pandemic phase. People's inflation expectations in the European region have become de-anchored since 2011 and haven't gone back to being anchored. This indicates that people's expectations of inflation are outside of what central banks can control and predict, making it challenging for them to do so. From the year 2021, the European region's inflation expectation during the pandemic is 2% higher than the central bank's inflation target, which may lead to higher inflation in the future. The Covid-19 pandemic struck the European region at the beginning of 2020. In comparison to other regions, the economic contraction in the European area in 2020 is among the largest in the world. The economic activity has decreased by 7% in this year, and the IMF anticipates a rebound to 4.7%. The lockdown has also been introduced in European countries, and as a result, many economic activities have been canceled or delayed, resulting in a decline in GDP in the European region. Figure 1 and Figure 2 show the GDP growth of European Union and United Kingdom, respectively.



**Figure 1.** Gross domestic product for European Union (27 countries from 2020)  
 Source: <https://fred.stlouisfed.org/series/CPMNAACSCAB1GQEU272020>



**Figure 2.** Gross domestic product for United Kingdom  
 Source: <https://fred.stlouisfed.org/series/UKNGDP>

#### 3.2. Relevant Inflation Expectation Factors in European Region

During this time, a lot of people are also losing their jobs, and the unemployment rate in the region of Europe has risen to a high of 8.92% (as shown in Figure 3). According to the IMF regional report 2020, the overall outlook for the European region's economy is still gloomy, and regional differences in recovery have persisted.



**Figure 3.** Unemployment rate: Aged 15-64: All Persons from the Euro Area

Source: <https://fred.stlouisfed.org/series/LRAC64TTEZQ156S>

As the situation in the European region is worse and is likely to enter a recession in the near future, this year's consumer inflation is likely to remain low or be in line with the central bank's target. The government will attempt to use stimulus policies to stimulate the economy in order to help it recover from the pandemic. For example, by reducing the interest rate, providing support to households and businesses, as well as to reduce the fearing from unemployment, missed education, low investment in the economy, etc., many people will believe the inflation rate tends to rise after the pandemic is over. But very few people anticipated that there would be a second COVID-19 infection in 2021, which makes it more difficult for many European nations to recover. However, as evidenced from the data, many nations are gradually recovering from the initial COVID-19 impact. The GDP in European Union and United Kingdom are increasing, and the unemployment rate in European region is decreasing.

The inflation rate will rise steadily between January 2021 and May 2021, reaching a normal level of about 2.5%. However, the inflation rate began to quickly increase between September 2021 and January 2022, reaching a level of about 5% that should be regarded as abnormal. The inflation rate began to increase as 2022 approached, peaking at 10% around September 2022. The government's stimulus program used to aid in the economy's recovery from the pandemic as well as the increase in demand across all regions, which is defined as "revenge spending," are to blame for the high inflation rate on a global scale. The price has also increased significantly as a result of the energy crisis and the shortage of many goods on the market. However, governments in European nations must choose between lowering the inflation rate and assisting households in navigating the energy crisis brought on by the Russo-Ukrainian conflict. The inflation expectation will depend on how the government respond to inflation and a higher level of uncertainty will make the expectation less anchored. If the government doesn't respond to the inflation well, people might feel pessimistic towards the future, as a result, the inflation expectation will be higher [10]. Since the government's policy has opposing goals, it has been abundantly clear that the current situation is bad. Many European governments have decided to concentrate on resolving the issue of the energy shortage first as it is thought to be a more serious issue. As a result, people will continue to feel pessimistic due to rising inflation, which will raise their expectations for the future. As a result, the inflation expectation in the European region tends to stay higher than the central bank's target and to be less anchored in the future. Nevertheless, as most inflation expectation is done by doing survey, the result might be inaccurate, therefore the conclusion is hard to be drawn.

#### 4. Conclusion

Considering the situation in the European Union over the last three years, Inflation expectations frequently remain unanchored. Due to the energy crisis, it is difficult to control inflation in the European region at the moment. However, because the inflation expectation is high and outside of

the central bank's target range, it will inevitably result in higher inflation in the future. The government can use forward guidance to help solve inflation and make it more anchored. "Forward guidance" in monetary policy refers to providing some specifics about potential policy settings. In recent years, the Bank of England, the ECB, the Federal Reserve, and the Bank of Canada have all used various kinds of forward guidance. When a central bank provides forward guidance, it means that it is outlining its intentions for future monetary policy based on how it currently perceives price stability. People are aware of what the central bank will do, and when an inflation shock occurs, they are confident that it can be resolved by the central bank, which prevents them from panicking and potentially de-anchoring expectations. Combining the current situation in Europe, this solution might be the best way to pacify people, as the government cannot increase the interest rate to reduce the consumption since there's the problem of a rising cost of living driven by increasing the price of energy.

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