

**EGOV**

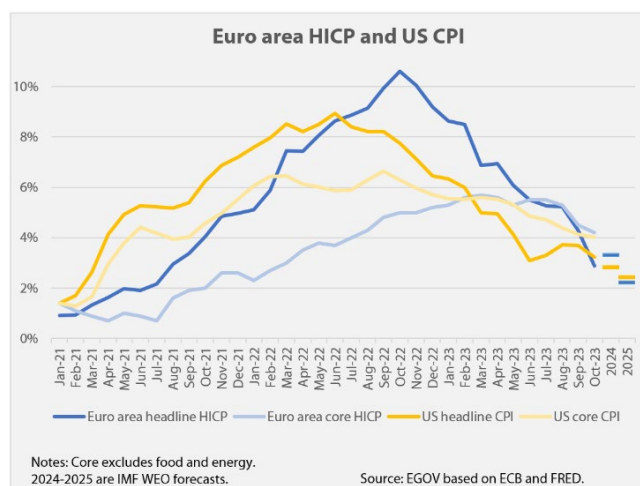
ECONOMIC GOVERNANCE AND EMU SCRUTINY UNIT



MONETARY POLICY

Comparative analysis of monetary policy and inflation dynamics in the euro area and the United States

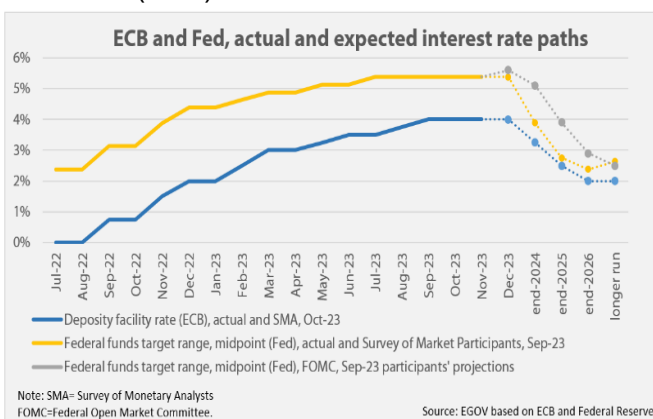
This overview was prepared ahead of the Monetary Dialogue between the Committee on Economic and Monetary Affairs (ECON) and the European Central Bank (ECB) President on Monday, 27 November.



The ECB increased key interest rates by 450 basis points (bps) since July 2022, and the Fed by 525 bps since March 2022. The ECB's deposit facility rate currently stands at 4% and the federal funds target rate is 5.25% to 5.50%. Market participants expect both the ECB and Fed to start cutting key interest rates in 2024, and to arrive to around 2% by the end of 2026.

Headline and core inflation rates in both the euro area and the US have been decreasing. In October, the headline euro area harmonised index of consumer prices (HICP) inflation rate was 2.9%, at the lowest level in 15 months. Core inflation (excl. food and energy) also slowed down, to 4.2%. In the US, the consumer price index (CPI) inflation rate for October was 3.2% and core CPI inflation was 4%.

Both central banks are not expected to reach their 2% inflation targets by 2025. The IMF forecasts average headline inflation at 3.3% (2024) and 2.2% (2025) in the euro area, and 2.8% (2024) and 2.4% (2025) in the US.



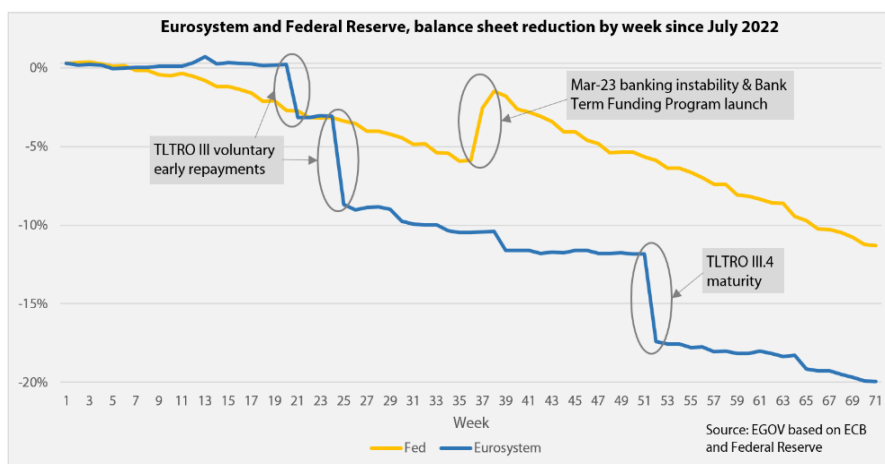
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The Eurosystem has reduced its balance sheet relatively more than the Fed in this tightening cycle. This is mainly due to reasons other than quantitative tightening: i) TLTRO III repayments reduced Eurosystem's balance sheet by EUR 1.85 trillion, ii) the launch of the Bank Term Funding Program by the Fed in March 2023 expanded its balance sheet by about USD 300 billion.



Overview of external expertise

[Luigi BONATTI, Andrea FRACASSO and Roberto TAMBORINI \(University of Trento\)](#) argue that the **two central banks' stances across the Atlantic share similarities but show also significant differences**. Similarities and differences are reflected also in inflation dynamics in the US and the euro area. Differences are mainly due to the mix of factors that originated the take-off of inflation, some structural features of the economies, the institutional contexts and associated fiscal stances.

[Karl WHELAN \(University College Dublin\)](#) finds that **the ECB and the Fed have taken similar approaches** to tightening monetary policy to tackle high inflation. However, relative to the US, **euro area inflation has been driven more by supply shocks and less by strong demand**. The euro area economy is also weakening while the US economy is still growing solidly. **Markets expect the Fed to ease more than the ECB in 2024 but falling inflation and a weak euro area economy may see the opposite occur.**

[Charles WYPLOSZ \(The Graduate Institute, Geneva\)](#) argues that **inflation has surged and then declined in broadly similar ways** in the euro area and the US, because it has been driven by the impact of the pandemic and its aftermath. Yet, **specific differences** reflect how monetary and fiscal policies responded as well as the impact of the Russian invasion of Ukraine. The central banks face **whole new challenges** as they prepare to **navigate the next phase now that inflation has rapidly declined**, but also further along.

[Manuela MOSCHELLA \(CASE and Scuola Normale Superiore\) and Davide ROMELLI \(Trinity College Dublin and CASE\)](#) compare the inflation dynamics and the monetary policy stance in the euro area and the US, while discussing the **challenges that the two monetary authorities confront**, also considering the **uncertainties brought about by the ongoing crisis in the Middle East**.

[Christophe BLOT and François GEEROLF](#) highlight **commonalities as well as differences** in recent inflation episodes, in terms of headline and core inflation, inflation differentials and causes, and monetary policy between the euro area and the US. They also propose **different scenarios for inflation and monetary policy**.

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