EDITORIAL

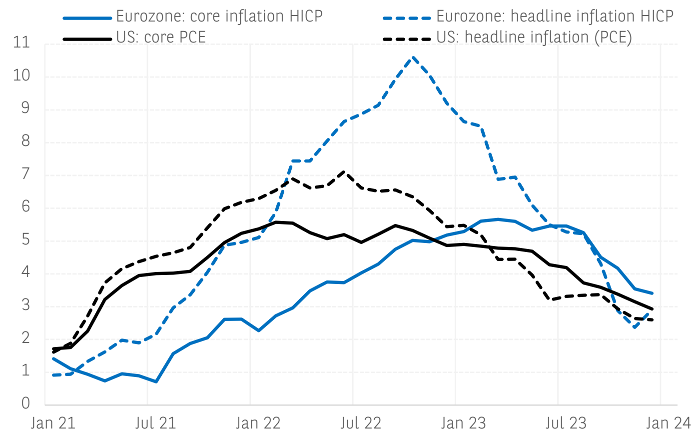
THE 'LAST MILE OF DISINFLATION', A NARRATIVE RUNNING ON ITS LAST LEGS

The narrative of the last mile of disinflation being the hardest, which in 2023 became popular in the world of central banking, reflects concern that after having dropped significantly, further declines in inflation would be more difficult.However, it seems that relevance of this narrative is increasingly being questioned. The account of the December 2023 meeting of the ECB governing council mentions that it has been debated. It seemed that the disinflation of 2023 had been faster than in previous episodes, raising doubts about the relevance of the narrative. A paper of the Federal Reserve Bank of Atlanta analyses this topic for the US. Based on recent research on the Phillips curve, it concludes that the 'last mile' is likely not significantly more arduous than the rest. Before the terminal rate was reached, referring to the 'last mile' was a form of implicit policy guidance: it might be necessary to have more elevated rates or to keep rates high for longer. At the current juncture, the policy debate is all about when to start cutting rates and the 'last mile' narrative is quickly losing its relevance

In 2023, the narrative of the last mile of disinflation being the hardest became popular amongst central bankers and their watchers[1]. It reflected concern that after having dropped significantly, further declines in inflation would be more difficult. When discussing this with a colleague who is also an experienced long-distance runner, he replied that the last mile was not the most arduous because getting close to the finish provides extra energy. Rather, the ten miles before the last one are the toughest. After all, the metaphor was perhaps not well chosen. Interestingly, it has also come under attack from economists and central bankers. The account of the December 2023 meeting of the ECB governing council mentions that members debated the notion of the 'last mile[2]'. It was noted that in terms of economic activity, the cost of the disinflation had been relatively mild and that a soft landing remained possible, whilst acknowledging that with services inflation still at 4%, the 'last mile' might be challenging. However, it was also argued that "*it was not clear why the nature of the disinflationary process would change as the target drew closer.*" Moreover, it seemed that the disinflation of 2023 had been faster than in previous episodes, raising doubts about the relevance of the 'last mile' narrative.

A recent paper of the Federal Reserve Bank of Atlanta analyses this topic for the US and concludes that the 'last mile' *"is likely not significantly more arduous than the rest[3]."* The author quotes recent research[4] showing that the Phillips curve is nonlinear with a steep, negative slope for relatively high inflation rates before coming rather flat when inflation falls below 2%. This would imply that inflation can move back to target without a large negative impact on the labour market and that the 'last mile' of disinflation before reaching the target is not more arduous[5]. Another potential argument in favour of the 'last mile' narrative would be elevated inflation expectations, through their impact on wage demands and price setting by companies. However, one-year-ahead inflation expectations of US companies[6] have declined from 3.8% in March 2022 to 2.4% in December 2023, so it seems unlikely that they would make the 'last mile' more difficult. The Federal Reserve paper also mentions sticky services prices as a potential reason for slow disinflation arguing that price stickiness does not mean that disinflation becomes more difficult, it simply takes more time and requires more patience from policymakers.

INFLATION IN THE US AND THE EUROZONE, Y/Y



SOURCE: REFINITIV, BNP PARIBAS

This interpretation is debatable: to the extent that services inflation persistence requires official rates to remain high for longer, the detrimental impact on activity, demand and the labour market could be significant. Unsurprisingly, these issues are also debated in the Eurozone. The ECB meeting account mentions that "*it was argued that the main condition that would make inflation more persistent in the proximity of the inflation target was if inflation expectations became unanchored, which ultimately depended on the credibility of monetary policy.*" Interestingly, safeguarding credibility was also used as an argument to stop referring to the 'last mile' because it *"might undermine confidence in the ECB's inflation target being achieved in a timely manner."* This brings us to the key question of why using the narrative. Before the terminal rate was reached, one can argue that it helped in giving guidance by insisting that the 'last mile' might require more elevated rates or keeping rates high for longer. At the current juncture, the policy debate is all about when to start cutting rates. In this debate, the 'last mile' narrative is quickly losing its relevance.

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1 *The last mile of disinflation*, BNP Paribas, Ecoweek, 13 November 2023.
2 Source: ECB, Account of the monetary policy meeting of the Governing Council of the European Central Bank held in Frankfurt am Main on Wednesday and Thursday, 13-14 December 2023, 18 January 2024.
3 David Rapach, *Is the last mile more arduous?,* Federal Reserve Bank of Atlanta's policy hub, no. 1–2024, January 2024.
4 Erin Crust, Kevin Lansing, and Nicolas Petrosky-Nadeau, *Reducing inflation along a nonlinear Phillips curve,* Federal Reserve Bank of San Francisco Economic Letter, 2023-17.
5 The conclusion would clearly be different if the kink in the estimated Phillips curve would occur when inflation is still well above 2% because this would require more rate hikes -with a detrimental impact on the economy and specifically the labour market- to bring inflation back to target.
6 The author refers to the results of the Federal Reserve Bank of Atlanta's business inflation expectations survey.