Editorial

Editorial: Monetary policy exceptionally accommodative for a prolonged period

International economy, Monetary policy | 24 September 2015

A slower recovery in the euro area would present new challenges for monetary policy. The ECB Governing Council monitors all incoming information. The asset purchase programme provides sufficient flexibility in terms of adjusting the size and duration of the programme. The package of articles on monetary policy and the international economic forecast will be published in English on 2 October 2015.



The outlook for the global economy weakened during summer 2015. The sudden slowdown in economic growth in China was reflected in a considerable weakening of global stock markets and rising long-term interest rates. The situation in China is dichotomous. On one hand, lower imports are dampening world trade, while, on the other hand, the focus of domestic demand on consumption at the expense of investment would serve to rebalance the Chinese economy. The

global economy has also been affected by uncertainty about the timing of the US Federal Reserve's monetary policy tightening. Capital inflows shifting into capital outflows from emerging economies has impaired their prospects. In the euro area, growth has been held back by the weakness of the Greek economy.

Euro area monetary policy is exceptionally accommodative: policy rates are at the zero lower bound, forward guidance and asset purchases have together brought long-term interest rates down, credit operations have lowered the costs of bank funding and eased securities-based borrowing. Clear signs of an improvement in the situation are visible on the financial markets, for instance the private credit markets.

The fading outlook for the global economy and, as a partial consequence, the decline in the price of oil have led to downward revisions in growth and inflation forecasts. Owing to increased uncertainty, the risks to both growth and inflation are also on the downside. However, the September ECB staff projections expect euro area growth to increase to 1.8% in 2017.

Monetary policy is responsible for achieving the price stability objective. In January 2015, euro area HICP inflation was still -0.6% compared with a year earlier. Through its actions, the Eurosystem has succeeded in breaking the harmful deflationary spiral, and the most recent inflation outcome from August pointed to an increase of 0.1% in prices. Underlying inflation is advancing even faster, having recorded 0.9% in August. According to the September ECB staff projections, euro area inflation is expected to pick up so as to reach 1.7% on average in 2017.

Despite the expected acceleration in inflation, inflation expectations have again weakened slightly and the likelihood of deflation derived from market prices has increased. At the beginning of September, the Governing Council of the ECB judged it 'premature to conclude on whether these developments could have a lasting impact on the outlook for prices and on the achievement of a sustainable path of inflation towards our medium-term aim, or whether they should be considered to be mainly transitory.'

Given that overall euro area recovery has been slow, the resultant situation, if continuing, will pose new challenges to euro area monetary policy. The European Central Bank has access to monetary policy instruments for continuing the accommodative stance of monetary policy over a longer period of time than announced thus far and also stands ready to deploy additional measures, if necessary. For example, the expanded asset purchase programme provides sufficient flexibility in terms of adjusting the size, composition and duration of the programme.

The key role of inflation expectations in monetary policy underlines the importance of a firm policy commitment, particularly in a prolonged period of low interest rates. An increase in average inflation to a level below, but close to, 2% means having to accept that inflation will occasionally

exceed 2%.

Helsinki, 23 September 2015

Erkki Liikanen

Governor

Bank of Finland

Keywords

ECB, economic situation, EU, global economy, inflation, monetary policy