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EDITORIAL

Commitment to accommodative monetary policy benefits economic outlook

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Euro area inflation, core inflation and both short and long-term inflation expectations declined strongly during the second half of 2014. As a result of the prolonged period of exceptionally weak price developments, the ECB's price stability objective began to lose its role as a solid anchor to price formation in the euro area.

In January, the Governing Council of the ECB decided that, as of March, the Eurosystem would purchase on the secondary market a significant amount of euro-denominated public sector securities. In the latter half of 2014, the Governing Council had already begun purchases of private sector asset-backed securities and covered bonds. Securities purchases will total EUR 60 billion per month. As to the duration of the purchases, the Governing Council has stated that *'they are intended to be carried out until end-September 2016 and will in any case be conducted until we see a sustained adjustment in the path of inflation which is consistent with our aim of achieving inflation rates below, but close to, 2% over the medium term.'*

The aim of these accommodative monetary policy measures is to maintain price stability over the medium term. Relaxation of the monetary policy stance will also contribute to supporting economic developments more generally. Determined implementation of all the ECB's measures will help restore inflation sustainably to slightly under 2%.

Commitment to an accommodative monetary policy stance is all the more important, the lower interest rates are and the further inflation expectations are below the price stability objective, as the monetary policy channel is key to raising inflation expectations and boosting confidence amongst economic agents. The Eurosystem's expanded securities purchase programme is a clear indication of the Governing Council's determination to bring price developments back into line with the price stability objective.

The monetary policy decisions taken have already had a significant positive impact. The short market rates and longer reference rates based on government bonds have declined noticeably in the euro area. The downward trend in inflation expectations has come to a halt, and expectations have begun to climb. Funding costs have fallen and access to credit has improved. Moreover, both monetary growth and lending growth have become stronger. Confidence in the economy has improved, which will speed up the impact of measures on the real economy.

Indeed, the economic recovery is expected to gradually strengthen and become more extensive. Euro area exports should also grow as a consequence of the depreciation in the euro's effective exchange rate as price competitiveness improves and the global economy recovers. In February, the annual rate of HICP inflation in the euro area was -0.3%. This is against the background of the steep fall in the price of oil. Inflation is forecast to gradually pick up, as the boost to aggregate demand from the recent monetary policy measures, euro depreciation and assumptions over a slight rise in the price of oil in the immediate years ahead all support inflation.

Although the accommodative monetary policy stance is justified in order to ensure price stability, negative side-effects cannot be entirely ruled out. Prolonged low monetary policy interest rates and the additional impact from the securities purchases could in some euro area countries or some sectors increase the risks to financial stability. Indeed, the euro area must stand ready to actively apply macroprudential policy tools should this prove necessary. This means that all euro area countries need to have effective macroprudential tools at their disposal.

If we are to derive all the benefits of the monetary policy measures, we will need determined action in other areas of policy, too. Euro area recovery will require structural reforms and balance sheet adjustments in a number of sectors.

Fiscal policy measures to stimulate demand are not necessarily possible or warranted if the government budget has been in deficit for a prolonged period, tax rates are high and the long-term growth outlook is weak. The need for structural reforms to boost potential output growth is particularly strong in those countries with limited scope to increase public demand or where the working-age population is no longer growing. At the same time, full and consistent adherence to the Stability and Growth Pact will sustain the credibility of the general government steering framework.

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Tags

- monetary policy
- inflation
- euro area