



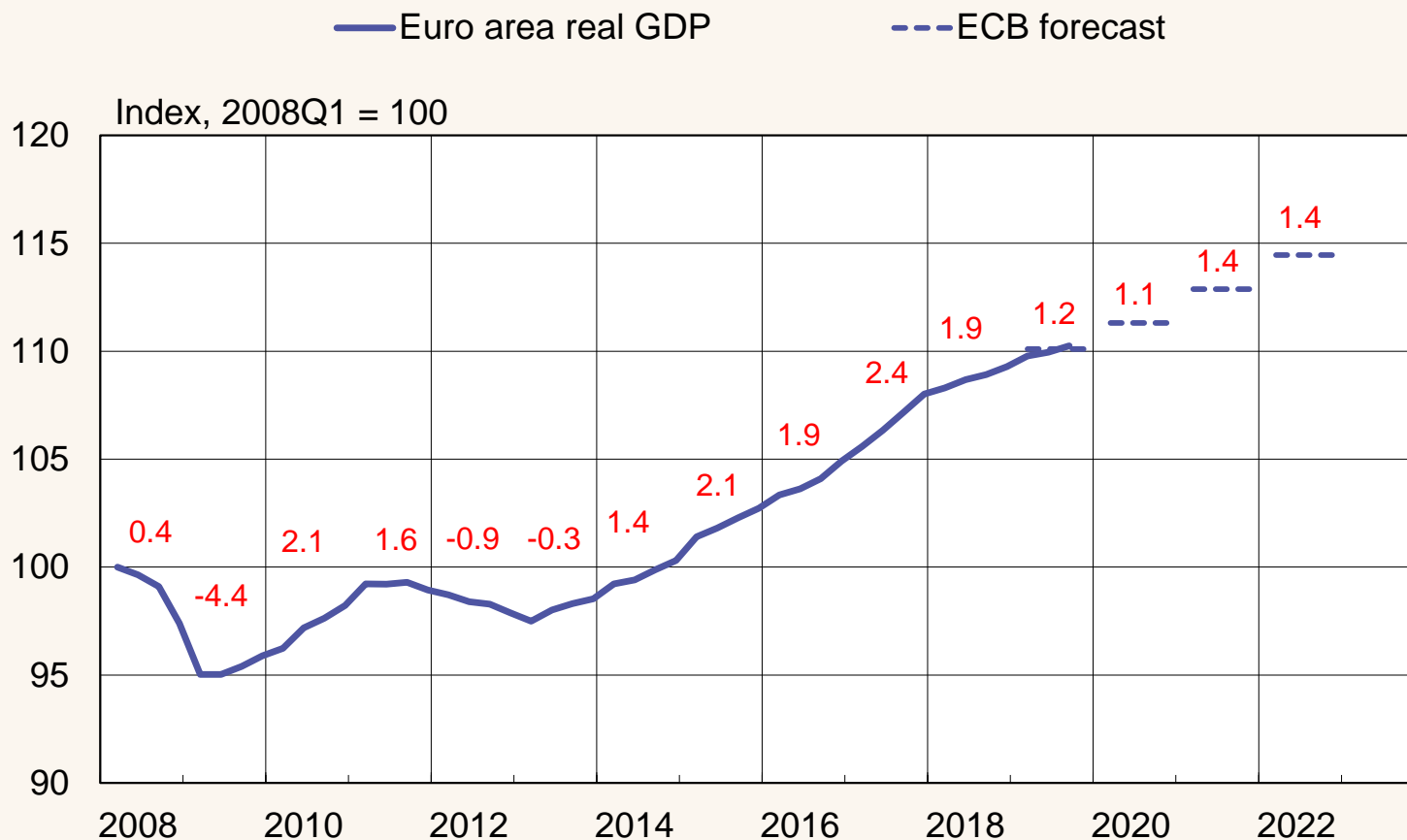
Transformation of central banking and monetary policy in Europe

Current Trends on European Politics

University of Helsinki

30 January 2020

Economic activity in the euro area 2008-2022



Euro area, changing composition. Figures next to the line are annual growth rates.
Sources: Eurostat and ECB.

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Outline of today's talk

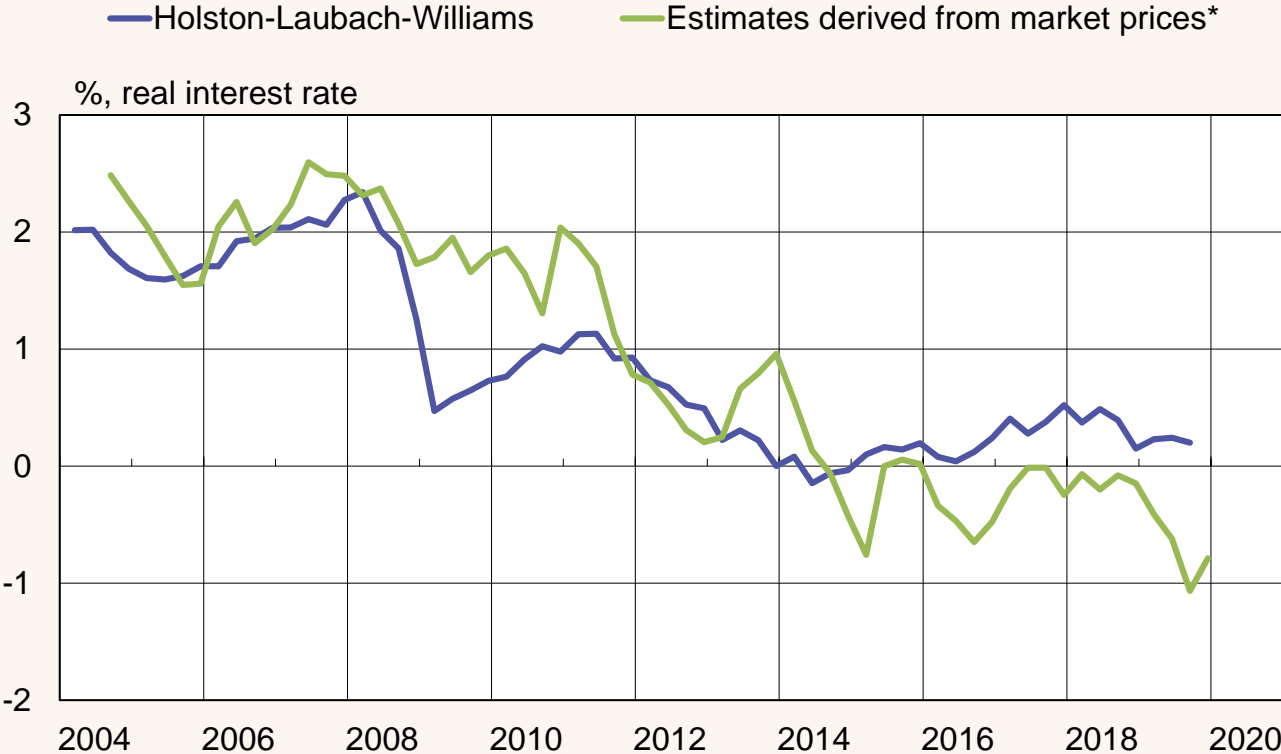
1. The ECB's transformation
2. The importance of financial stability
3. Contemporary challenges of monetary policy
4. The strategy review of ECB monetary policy

A common-sense definition of price stability

- *“Price stability is the state in which expected changes in the general price level do not effectively alter business or household decisions.”*
 - Alan Greenspan: FOMC meeting 2–3 July 1996
- *“A workable definition of reasonable ‘price stability’ would seem to me a situation in which expectations of generally rising (or falling) prices over a considerable period are not a pervasive influence on economic and financial behavior.”*
 - Paul Volcker, 28 Dec 1983

Estimates of the natural rate of interest

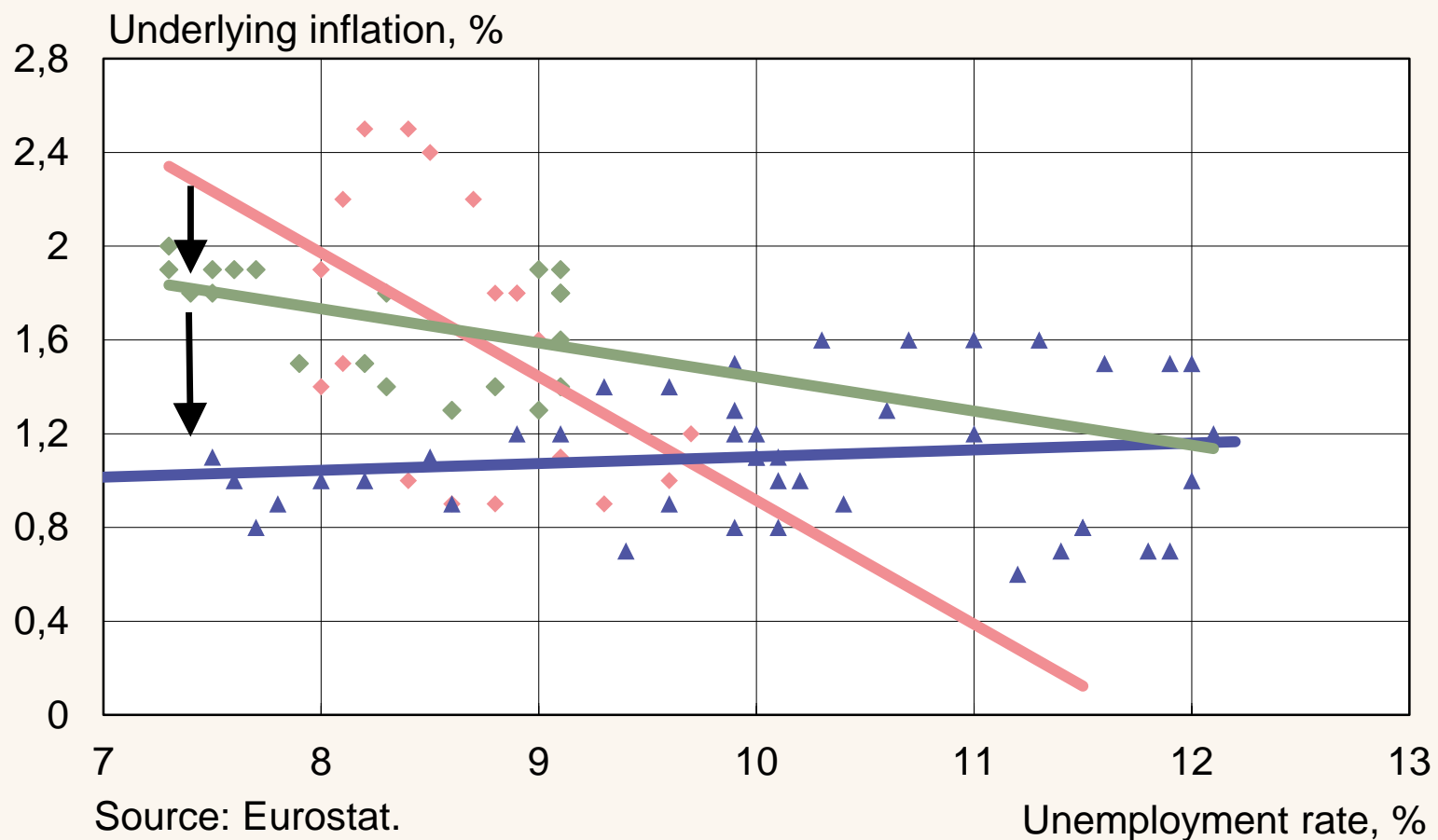
Estimates of the natural rate of interest in the euro area



*5-year rate 5 years ahead, difference between interest rate swap and inflation swap.
Sources: Macrobond, Bloomberg and calculations by the Bank of Finland. 32429@NIR

The Phillips curve in the euro area, 1999-2019

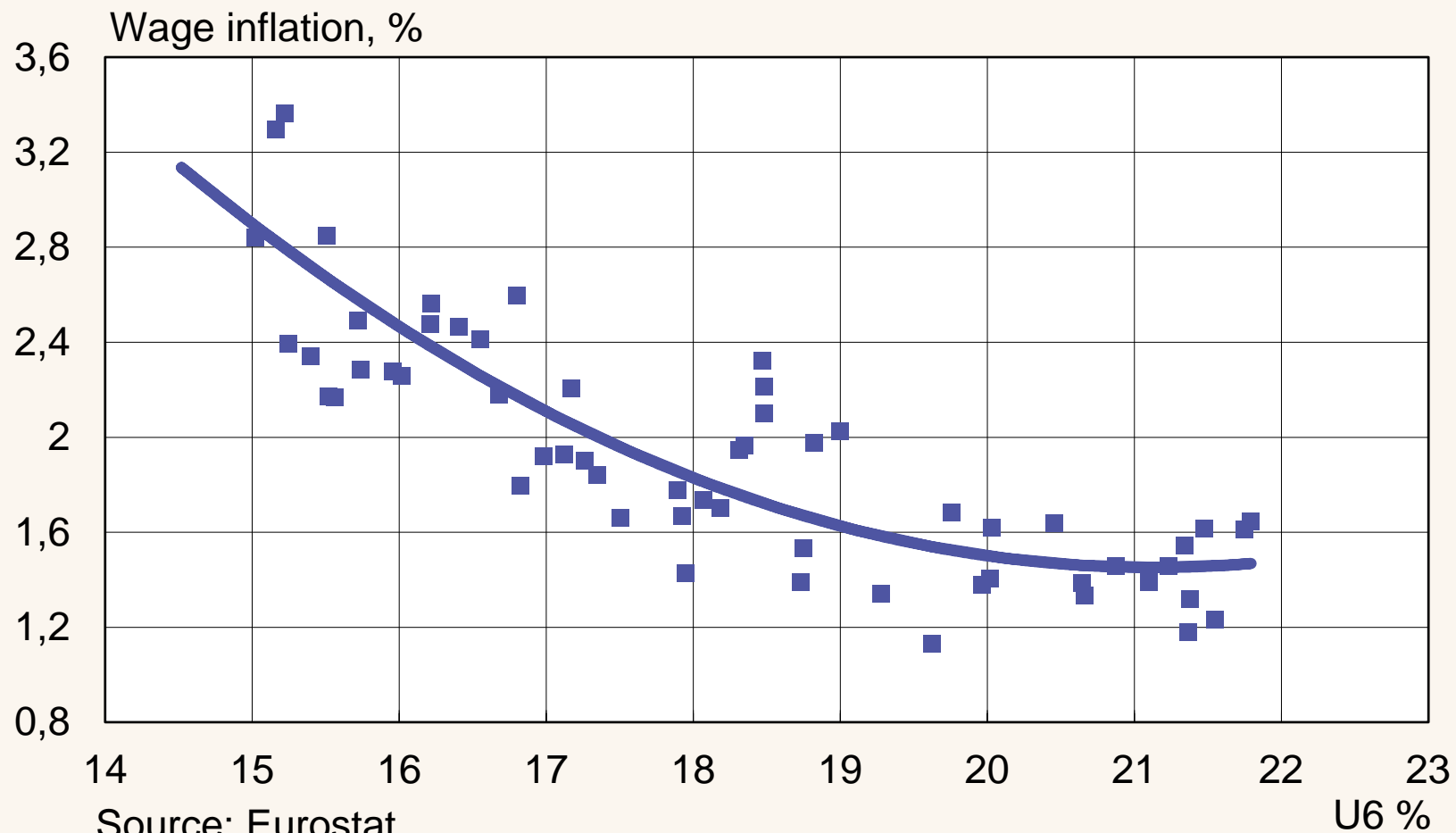
1999 - 2003, 2004 - 2008 and 2009 - 2019



Source: Eurostat.

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The non-linear Phillips curve in the euro area, 2005-19



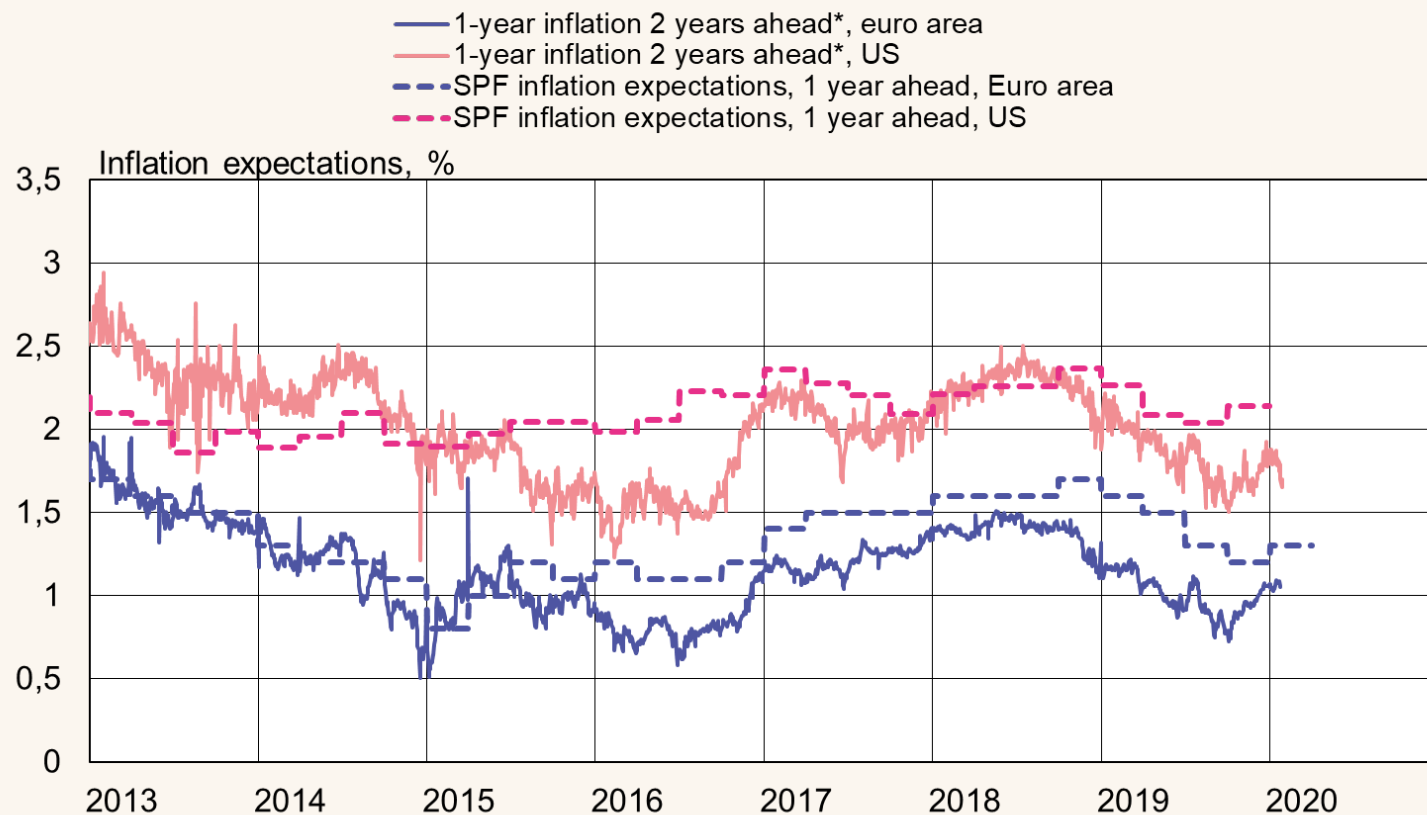
Source: Eurostat.

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Economists on the Phillips curve – six quotes from five economists, the ECB Forum on Central Banking, Sintra 2018

- *“The Phillips curve is alive and well, but needs to be found.”*
Lucrezia Reichlin, Professor, London Business School
- *“Who killed the Phillips curve?”*
James Bullard, President, Federal Reserve Bank of St. Louis
- *“The flattening of the Phillips curve is really there.”*
James H. Stock, Professor, Harvard University
- *“The Phillips curve is alive, but not kicking very much.”*
Charles Wyplosz, Professor, Graduate Institute Geneva
- *“Are we sure the slope of the Phillips curve will stay stable over the coming years?”*
Mario Draghi, President, European Central Bank
- *“Unexplained residuals in the standard wage Phillips curve model are gradually reducing.”*
Mario Draghi

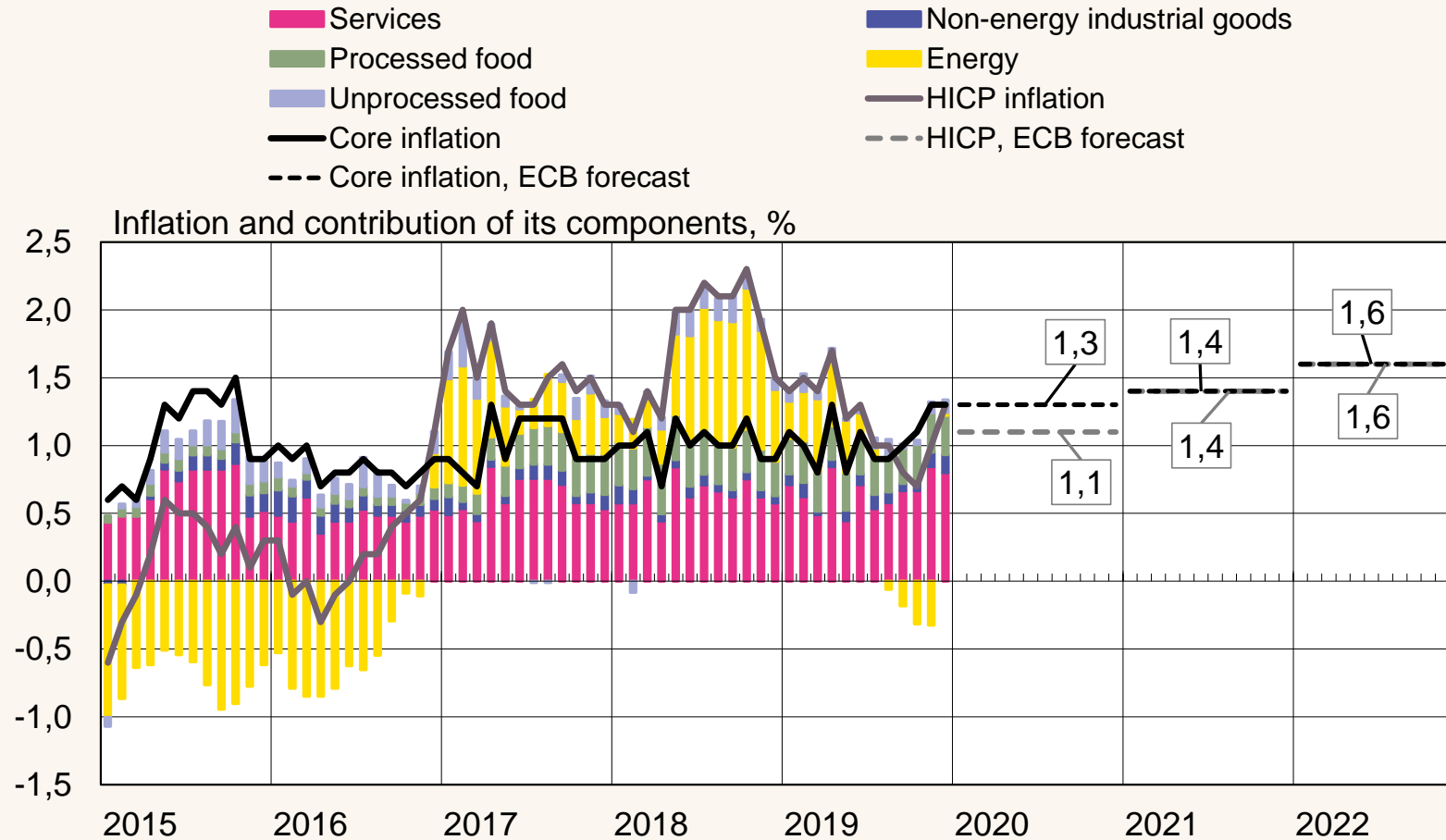
Subdued inflation expectations in the euro area



* Market expectations derived from inflation swaps. SPF = ECB survey of professional forecasters.

Sources: ECB, Bloomberg and calculations by the Bank of Finland. 32426@odotusSPF

Inflation clearly below the ECB's target



NB: Annual inflation rate of 2015 is distorted due to the change in methodology.

Sources: Eurostat and ECB.

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ECB's strategy review in 2020

1. Primary topics include:

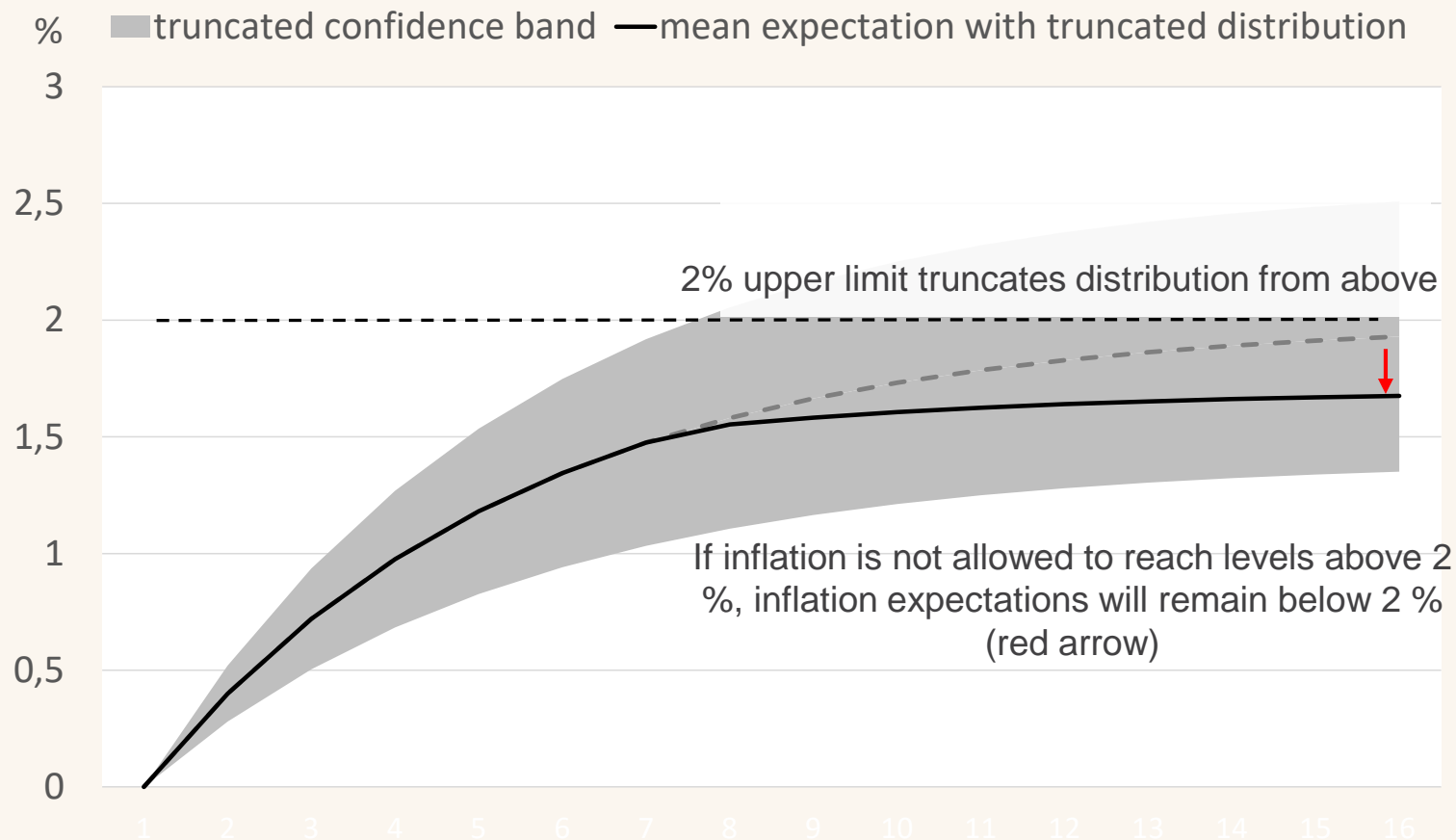
- Analysis of structural changes in the operational environment
- Definition of price stability; the inflation aim
- Instruments of monetary policy – impact and side-effects
- Communication practices

2. Other considerations, such as

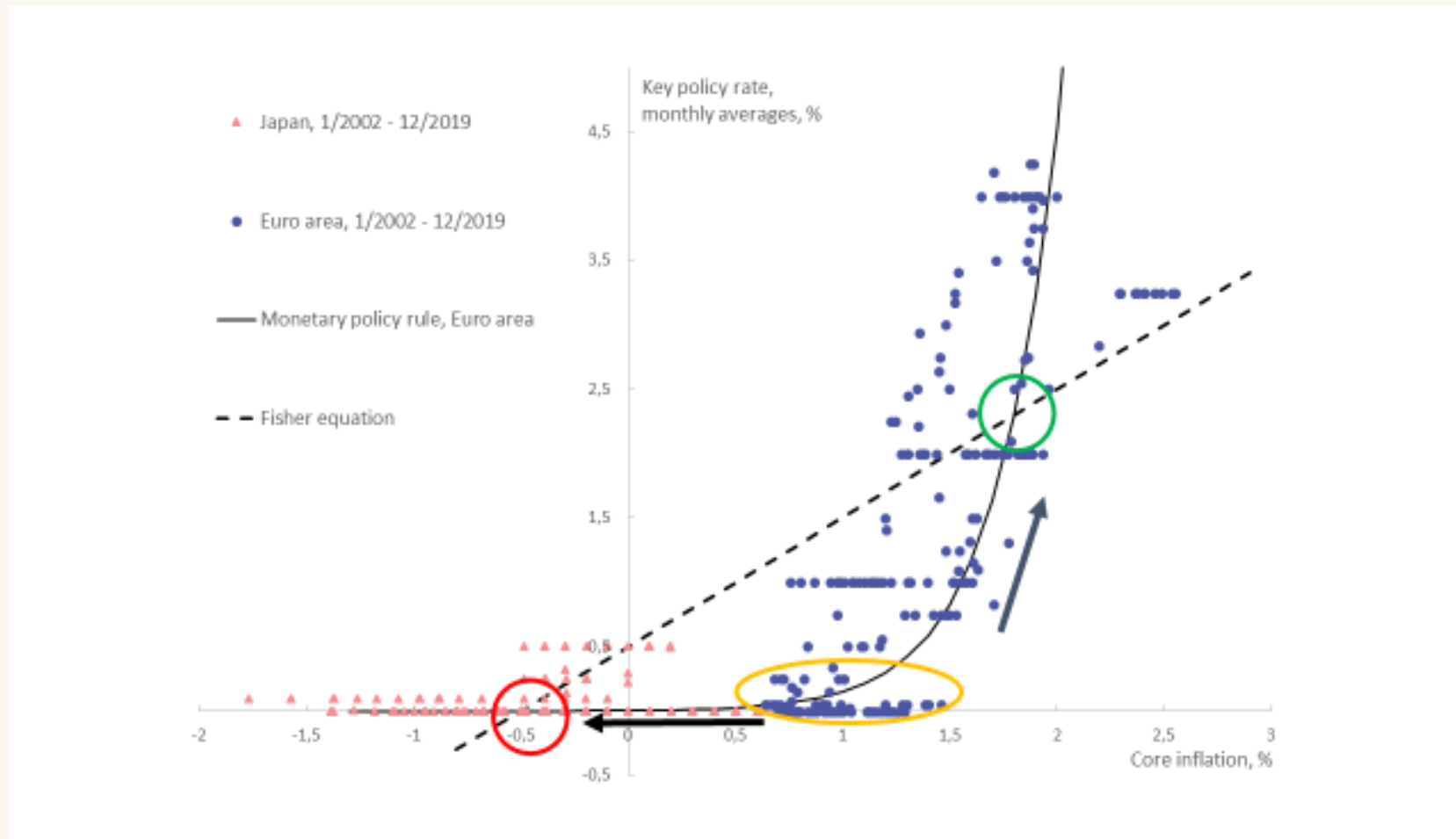
- Employment
- Financial stability
- Climate change

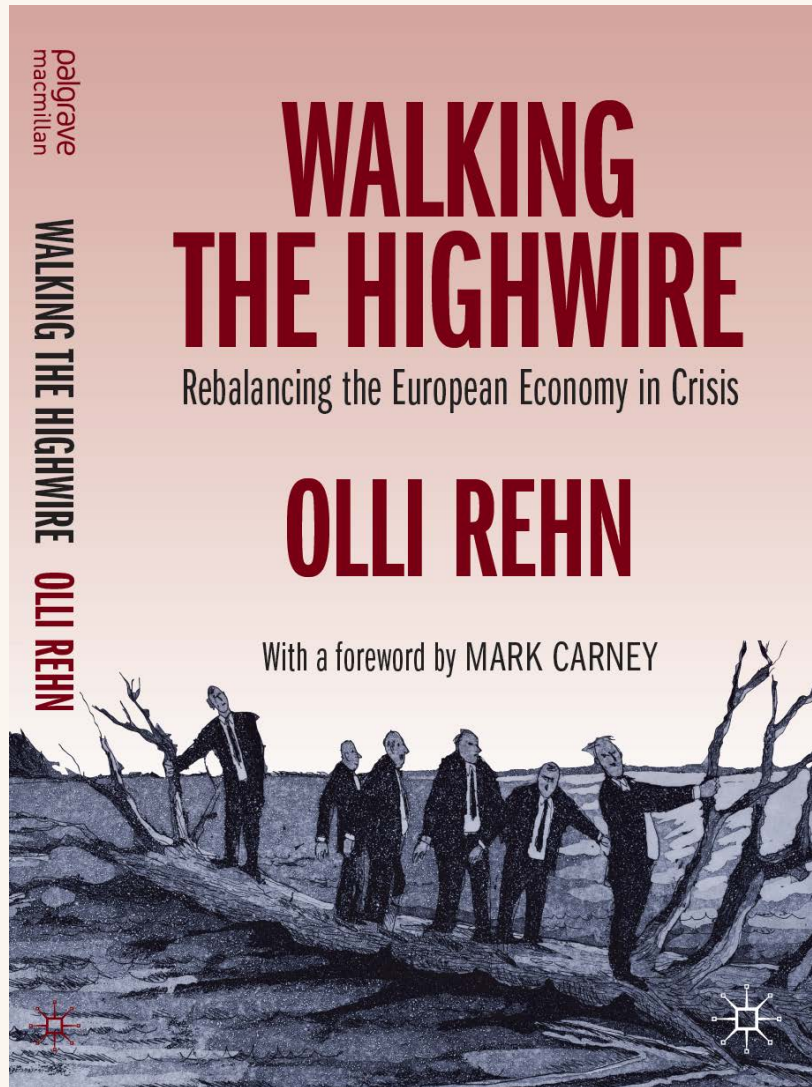
**engaging with all
stakeholders**

A de facto ceiling of 2 % for inflation dampens inflation expectations and lowers average inflation in the long-term



Japanification: **Good** or **bad** equilibrium for the euro area





Central banking and learning from economic history

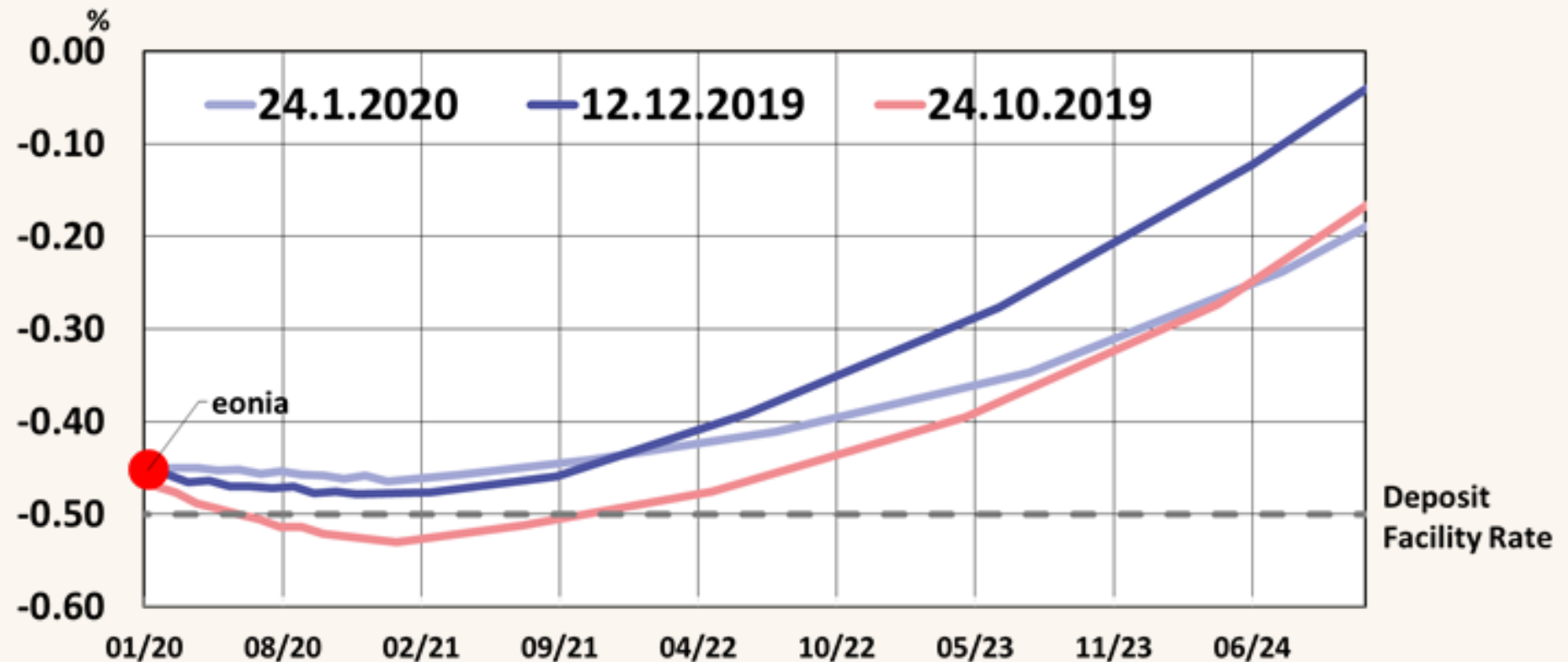
- *“I believe I have learned equally much from studying central bank history than from central bank theory. Thus, I urge all those of you who are contemplating a career as a central banker to read history books.”*
Stanley Fischer
- *with the help of economic history students and policymakers are able to “recognise that major discontinuities in economic performance and economic policy regimes have occurred many times in the past, and may therefore occur again in the future”*
Kevin O’Rourke



Thank you!

suomenpankki.fi

Market's expectations for the ECB policy rate



Forward rates based on euro area OIS-rates.
Source: Bloomberg