

Peter Praet: The euro area economic outlook and monetary policy

Intervention by Mr Peter Praet, Member of the Executive Board of the European Central Bank, at a panel discussion at the G-20 conference "The G20 Agenda under the German Presidency", organised by the Institute of International Finance, Frankfurt am Main, 15 March 2017.

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The euro area recovery has been firming and broadening across sectors. GDP has posted 15 consecutive quarters of positive growth. The unemployment rate has reached its lowest level since 2009. The February composite output PMI stands at its maximum since April 2011. And consumer confidence, despite a slight decline in February, has so far remained undeterred by the elevated political uncertainty. Overall, these indicators suggest that the cyclical recovery may be gaining momentum.

The ECB's monetary policy has been a key contributor to this positive track record. It has ensured supportive financial conditions and facilitated their pass-through to the borrowing costs of firms and households. As a consequence, euro area bank lending rates hover around their historical lows and have converged across countries. The resultant monetary stimulus has been indispensable to shield the recovery from an unsupportive global environment and strong deleveraging pressures in the private and public sectors.

Supported by monetary policy, the recovery is likely to continue and we have more confidence in the outlook. The latest ECB staff projections foresee a continued stable economic expansion over the next three years, with annual growth rates ranging between 1.6% and 1.8%. Moreover, the downside risks around the growth outlook have become less pronounced, albeit remaining tilted to the downside. Accordingly, we are no longer concerned about deflation risks.

At the same time, the recovery has yet to translate into a durable and self-sustained pick-up in inflation. The recent sharp uptick in headline inflation was mainly due to energy and food price inflation. Our staff projections foresee that these price pressures will cause a hump on the inflation path that was projected in December, with the medium-term outlook for headline inflation largely unaltered. Underlying inflation pressures continue to remain subdued as unutilised resources still weigh on wage and price formation. Inflation rates excluding energy and unprocessed food, for instance, have remained below 1% for almost a year. Importantly, inflation dynamics continue to be conditional on a very substantial degree of monetary accommodation.

Looking through recent volatility, the inflation outlook does not at this stage warrant a reassessment of the current monetary policy stance. As in the past, the ECB's monetary policy will be forward-looking and geared towards a medium-term horizon. It will not respond to short run fluctuations. Sustained adjustment in the path of inflation to levels below, but close to 2% over the medium term still requires very favourable financing conditions, which remain predicated on a very accommodative monetary policy stance. We still need to build sufficient confidence that inflation will indeed converge to this aim over a medium-term horizon and will remain there even in less supportive monetary policy conditions.

Monetary policy can support the absorption of economic slack, but it cannot strengthen potential growth. The current track record of the euro area economy is encouraging when judged against the subpar performance in the post-crisis years. But it is insufficient when judged against the long-term challenges the euro area is facing due to the debt loads inherited from the crisis and the implicit liabilities created by its ageing societies. So while short-term risks to the economy have somewhat abated in recent times, growth-enhancing structural policies remain warranted to tackle persisting longer-term vulnerabilities.