Yves Mersch: Monetary policy in the euro area - solid expansion with timid price pressure

Contribution by Mr Yves Mersch, Member of the Executive Board of the European Central Bank, to the EUROFI magazine, submitted on 21 March 2018 and published on 26 April 2018.

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The euro area economy currently is solidly expanding and the upswing is broad-based. Recent data indicate that in the near term the economy is likely to expand even faster than had been expected. The monetary policy measures introduced since 2014 have effectively supported growth and employment, with real GDP growth expected to remain consistently above potential growth in the coming years.

In spite of the favourable growth dynamics, underlying inflation continues to be subdued. While our policy measures have been successful in preventing the disinflation of 2014 from spiralling into deflation and are contributing to an improved inflation outlook, an ample degree of monetary accommodation remains necessary to secure a return of inflation rates towards levels that are below, but close to, 2% over the medium term.

Looking ahead, the evolution of monetary policy will be firmly guided by the outlook for price stability. In this regard, the transition towards policy normalisation will begin once the Governing Council assesses that there has been a sustained adjustment in the path of inflation. Such a judgement will be based on three criteria for inflation: convergence, confidence and resilience. Convergence implies that headline inflation will need to be on track to reach levels below, but close to, 2% within a medium-term horizon. The Governing Council will also need to have confidence that the upward adjustment in inflation has a high enough probability of materialising and that it can do so on a sustainable basis. Thirdly, resilience, it will need to be ensured that the sustained adjustment in the path of inflation will be maintained even without additional net asset purchases.

In fact, confidence has recently risen and convergence is being confirmed – partly because the temporary decline in the inflation rate has been weaker than our internal calculations had predicted when we had reduced the purchasing program from EUR 60 billion to EUR 30 billion. More resilience will follow eventually. Still, patience and persistence with respect to our monetary policy is required. The former is necessary as it takes time for price pressures to build-up and the latter reflects the fact that the pick-up in inflation still needs to be supported by the prevailing monetary policy stance.

Once the Governing Council judges that progress towards meeting the three criteria is sufficiently advanced, our net asset purchases will be brought to an end. This is in line with our guidance on the expanded asset purchase programme (APP). Thereafter, the monetary support necessary for inflation to converge to our aim of below, but close to, 2% will be provided by reinvestments continuing for an extended period of time and policy rates remaining at their present levels well past the end of our net asset purchases. Policy decisions will continue to be firmly guided by the outlook for price stability for the euro area as a whole and not for any individual country.

The ECB remains committed to its price stability mandate, but other actors need to do their part to boost the resilience of the euro area and individual economies. Governments should take advantage of the increasingly solid and broad-based recovery to rebuild their fiscal buffers in line with the Stability and Growth Pact (SGP). At the same time measures to increase euro area economies' productivity should be forcefully pursued. And finally, the completion of the banking and financial unions would be a substantial step towards strengthening the euro area's capacity to withstand any future shocks.