Monetary policy in the euro area - a brief assessment

Speaking points by Yves Mersch, Member of the Executive Board of the ECB, at the MNI Connect Roundtable, Singapore, 10 October 2018

- The euro area economy is currently experiencing a broad-based economic expansion. Although growth moderated somewhat in the first half of this year, following several strong quarters in 2017, we expect the expansion to continue at a pace slightly above potential in the period ahead. At the same time, risks relating to increased global protectionism and vulnerabilities in emerging markets warrant continued monitoring.
- Monetary policy measures introduced since 2014 have been pivotal to these developments. They have set-in-train a return of euro area inflation to a rate below, but close to, 2% over the medium term.
- Real GDP expanded by 0.4% quarter-on-quarter in the second quarter of 2018 – the 21st consecutive quarter of positive growth – with the level of real GDP 10% above the trough. While the external environment is less favourable, the underlying strength of the euro area economy is expected to persist on account of strong domestic demand dynamics.
- This ongoing expansion has led to strong employment gains. There are now 9.2 million more people employed in the euro area than at the low-point in mid-2013 and the unemployment rate is at its lowest level for almost a decade.
- The investment outlook also continues to strengthen and is supported by an ongoing need to modernise the capital stock after years of subdued investment, as well as by very favourable financing conditions, an improvement in profitability and solid demand.
- Since we announced our policy measures in June 2014, financial conditions have eased considerably. Lending rates for non-financial corporations and

households have dropped by around 130 basis points and 110 basis points, respectively.

- Rates on very small loans, which can be taken as a proxy for loans to small and medium-sized enterprises (SMEs) have declined by more than 210 basis points. Heterogeneity of lending rates across countries has also fallen sharply, which indicates that the pass-through of our monetary policy has become more even.
- At the same time, loans to euro area households and firms continue to remain favourable with annual growth of 3.1% and 4.2% in August 2018, respectively. This pick-up in credit growth has not led to a crowding out of other forms of external finance for euro area NFCs, with firms continuing to issue new equity.
- Overall, this narrative of a continued broad-based expansion is echoed in the latest September 2018 staff projections. Real GDP is projected to grow at an annual rate of 2.0% in 2018, 1.8% in 2019 and 1.7% in 2020.
- While risks to growth remain broadly balanced, those related to global factors, including the threat of increased protectionism, the finalisation of the Brexit negotiations and vulnerabilities in emerging markets are gaining prominence.
- Turning to inflation developments, euro area headline inflation reached 2.1% in September 2018, up from 2.0% in August 2018, which largely reflects higher energy costs. Based on the latest oil futures prices, headline inflation is expected to remain around the current level for the remainder of the year.
- According to the latest September 2018 staff projections, inflation is expected to rise to 1.7% in 2018, 2019, and 2020, which is unchanged since the June exercise. The stable path masks changes in inflation components, with the decline in the contribution of the energy component over the projection horizon expected to be offset by the gradual increase in underlying inflation.
- While measures of underlying inflation remain generally subdued, they are increasing from previous lows. As the labour market continues to tighten this should lead to higher nominal wage growth, which in turn should support underlying inflation.
- Overall, we remain confident that the underlying strength of the euro area economy will continue to support the gradual build-up of price pressures in order for inflation to return to levels below, but close to, 2%. Yet, much of the medium-term increase in inflation that we predict is based on the premise of quite some degree of monetary policy accommodation.
- Against this backdrop, this month we began reducing our monthly net asset purchases to €15 billion and we continue to anticipate that – subject to incoming data confirming the medium-term inflation outlook – net purchases will cease at the end of this year.

- That being said, in order to ensure that a sufficient degree of monetary accommodation continues to support the further build-up of headline inflation, the Governing Council decided to:
    - reconfirm its forward guidance on the likely path of our policy interest rates, whereby rates are expected to remain at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term;
    - restate the intention to continue to reinvest the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time after the end of our net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.
- Looking ahead, monetary policy will be firmly guided by the outlook for price stability and our stance will evolve in a data-dependent and time-consistent manner.