Editorial

Editorial: Monetary policy supporting sustainable economic recovery and a brighter outlook for inflation

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Growth in the euro area economy is expected to be brisk this year and in 2022 as economies are opened up, strong support is provided by economic policies and the global economy recovers. The rebound from an exceptionally severe and sudden crisis has been quick. The COVID-19 pandemic is not over yet though, and the spread of the Delta variant appears to have dampened the upward economic trend over the summer. But in developed economies with a high vaccination coverage the impact is not expected to be prolonged or of great significance.



Inflation slowed during the early phase of the COVID-19 crisis. In the current year, however, it has been rising. This has broadly been the case across the world's developed economies and especially in the United States. Inflation has risen in the euro area, too, reaching 3% in August. Factors contributing to the rise in inflation are the low price level of a year ago, which is the reference point for the comparison, and the increase in prices of raw materials, as well as various pandemic-related production bottlenecks. These are expected to be largely temporary factors.

Attaining the objective of price stability would be easier if the rising rate of inflation seen recently

were not to prove temporary overall, but instead if, as the economy picks up, there were to be an increase in inflationary pressures in comparison with the pre-pandemic period. This would require a robust level of aggregate demand in the economy, underpinned by monetary policy.

To help combat inflation levels that are too low the European Central Bank has a new monetary policy strategy, which we approved in the ECB's Governing Council in July. The most significant change in the monetary policy strategy is the newly defined inflation target together with how it is to be applied in decision-making.

Under the new strategy, price stability can best be maintained by aiming for a symmetric 2% inflation target over the medium term. Inflation may also be moderately above the target for a transitory period. The new strategy supports the aim that inflation will not return to the excessively low level at which it had long remained. The symmetric inflation target defined for the medium term will also better allow decision-making to emphasise sustainable growth and full employment, though without compromising price stability.

Based on this new strategy the monetary policy stance continues to be strongly accommodative. This has, additionally, now allowed both fiscal and monetary policy to provide a stimulus to recovery in all countries of the euro area, at a time when their economies are still feeling the weight of the COVID-19 crisis. From the very start of the crisis, considerable amounts of public funding have been used in the euro area not only for healthcare but also for supporting those households and businesses which have found themselves in difficulty. Measures taken have also supported the economy in general.

The growth in public spending to tackle the pandemic and its effects has been justified. But the consequences of major deficits should also be understood. General government debt in the euro countries has increased, and this represents a risk for the sustainable development of the economy. Even though a rise in interest rates is not yet in sight, we will nevertheless have to face it one day. This should be considered in budgetary planning by all the euro area countries.

Good use should be made of the space opened up by a strongly accommodative monetary policy and positive cyclical conditions to engage in reforms that encourage profitable activity and employment in businesses. This applies to the entire euro area, including Finland. When the economy is growing and the labour market performing well, even reforms which are difficult but unavoidable become less painful.

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Keywords

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