Blog

Rates intact for now – monetary policy still supports disinflation

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Recent data on the state of the euro area economy are downbeat. The economic development of the euro area rests increasingly on services. ECB council decided to keep key interest rates unchanged.

Political uncertainty overshadows sentiment in the European economy. The twists and turns of French politics and the dramatic events in the US presidential campaigns and their ramifications increase uncertainty about the economic development of the euro area.

These matters were topical when we held a meeting of the Governing Council of the European Central Bank in Frankfurt this week. They underline the importance of the euro as an anchor of stability. We did not change policy rates this time. The most closely followed deposit rate thus remains at 3.75%, the level to which we lowered it in June.

Industrial gloom continues

Recent data on the state of the euro area economy are downbeat. The economic development of the euro area rests increasingly on services.

The situation of industry, on the other hand, is gloomy, and there is no sign of a pick-up. How permanent is this situation? The weakness of industrial production continues, even though the original contributing factors, including the rise in energy costs, seem to have largely disappeared. The euro area's energy bill (energy imports as a share of GDP) has fallen back from over 6% to around 3%, which is close to the long-term average.

If euro area industry and investments do not recover soon and growth remains dependent on

services, then the projected pick-up in productivity growth may also be at risk. We must also take into account the possibility that the slowdown in industrial production is not as temporary and cyclical in nature as has been assumed. A war is being fought on European soil and our competitive position in an international economy beset by technology and trade wars is in many ways very difficult.

Inflation is slowing towards the target

The big picture remains that inflation is slowing down to the ECB's 2% target in the medium term. This view is reinforced by the fact that inflation expectations are firmly anchored close to the target.

On the other hand, there is uncertainty surrounding the slowdown in inflation in the coming months, particularly due to persistent services inflation and underlying rapid wage development. The risks of higher-than-forecast inflation have therefore not disappeared.

In our decisions, we aim for an effective balance. In the ECB Council, we will ensure that inflation returns to its target of 2% in the medium term, and we will adjust the monetary policy stance accordingly. By not keeping interest rates at a restrictive level for too long, we will avoid unnecessary harm to economic growth.

Uncertainty delays interest rate cuts

In our decision-making, we assess three factors in particular: the inflation outlook, the dynamics of underlying inflation net of energy and food prices, and the strength of monetary policy transmission.

Uncertainty about the development of inflation as well as risks related to geopolitics and the rise of protectionism favour the approach where decision-making rests on up-to-date, diverse data. We use a broad range of statistics, analyses and forecasts to support our decision-making, rather than looking at individual datapoints. We are not pre-committed to a specific interest rate path.

My own summer has not been spent simply waiting for data to confirm a slowdown in inflation. I have spent the summer not only in the Frankfurt meeting rooms, but also on the sauna benches – and occasionally focused on the television screen. And I admit playing on the green grass myself, including in the veterans' Finnish Championship tournament – great fun.

The European Football Championships were decided in Germany last Sunday. The tournament was won by the *La Roja* of Spain, whose technical skill and active team play combined with a relaxed and joyful approach to the game carried them through to the trophy.

However, a seemingly relaxed and effortless passing game conceals a lot of exercise and background work, close analysis along the way and, if necessary, changes to playing style when the situation calls for it. This could also serve as a model in the economic sphere, enabling us to score goals and see solutions in the European economy.

Keywords

ECB, inflation, monetary policy, steering rate