EDITORIAL

# Monetary policy remains accommodative, net asset purchases about to end

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Monetary policy has remained decidedly accommodative in the euro area, all throughout the different phases of the global financial crisis, sovereign debt crisis and the once-looming threat of deflation. To begin with, key interest rates were lowered rapidly. Secondly, the Outright Monetary Transactions (OMT) scheme was implemented to spare the monetary union the risk of break-up, which proved to be highly effective in raising confidence despite the total absence of asset purchases. Thirdly, the public sector purchase programme (PSPP) was initiated.

Monetary policy has played an important role in supporting economic growth. Without it, the output potential of many euro area countries would have deteriorated considerably more than actually occurred during the crises. The chosen policy path has also given rise to economic conditions which are conducive to structural reforms. Yet monetary policy is in itself powerless to implement reforms in labour markets, taxation or competitiveness; the responsibility and jurisdiction for these lie with other authorities.

Together, subdued inflation expectations and weakness in wage growth and price formation maintained a cycle where a sustained fall in the prices of goods and services, i.e. deflation, seemed possible. The asset purchase programme, which began in March 2015, has proved to be an indispensable tool for achieving the price stability objective in the euro area. Its effects have gained further strength from the low interest rate environment and the policy of forward guidance. The effects of monetary policy can also be felt throughout the entire yield curve, where market rates have lowered across the entire maturity range, spanning from the deposit facility to over 10-year rates.

At its monetary policy meeting on 14 June, the Governing Council of the ECB undertook a careful review of the progress towards a sustained adjustment in the path of inflation consistent with its policy objective. The price stability objective is defined as maintaining inflation rates below, but close to, 2% over the medium term. The Governing Council anticipates that, after September 2018, subject to forthcoming data confirming the Governing Council's medium-term inflation outlook, the monthly pace of the net asset purchases will be reduced to EUR 15 billion until the end of December 2018 and that net purchases will then end.

The Governing Council noted that an ample degree of monetary accommodation will still remain, as the Council intends to maintain its policy of reinvesting the principal payments from maturing securities purchased under the APP for an extended period of time after the conclusion of net asset purchases. Furthermore, the Governing Council expects the key ECB interest rates to remain at their present levels at least through the summer of 2019 and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with the current expectations of a sustained adjustment path.

Finland's economic recovery began in the course of 2015, after a period of weak developments lasting several years. Growth has become more broadly based over the past two years, as exports and private investment have increased. Consequently, the economy's recovery now rests on a more solid foundation.

Finland's public finances have gathered strength. The general government deficit has shrunk and the ratio of public debt to GDP has begun to contract. This has been due to both general government consolidation measures and the increasingly robust economic conditions.

However, determined efforts are still required to address the challenges to fiscal sustainability in the long term; public sector revenues are expected to fall short of expenditures in the forthcoming decades, assuming no new decisions on measures that would bolster the public finances.

For one, the effects of population ageing have already led to a decline in the number of working-age persons but a rise in pension expenditures. Beginning from early next decade, population ageing is also expected to raise public healthcare costs and demand for care services, as they will be increasingly needed by Finland's Baby Boomers.

Servicing public debt would be less problematic if the economy's long-term outlook mirrored that of past decades. Yet, according to the Bank of Finland's latest long-term projections, economic growth will remain slower in Finland than it was before the global financial crisis.

Fiscal policy is estimated to have eased this year, and it will remain largely neutral in 2019, barring significant policy decisions. In an environment where economic conditions have significantly improved but where the long-term sustainability of public finances remains ambiguous, it would appear prudent to strengthen the general government balance at a pace faster than forecast.

The current balance and future outlook of general government finances, structural reforms that might strengthen them, and domestic cost developments are all issues that are directly related to the Bank of Finland’s mission. Hence, the Bank has commented on these topics on a consistent basis. The Bank has additionally conducted analyses on issues related to its objectives but which may also involve value considerations. These include inclusive economic growth, social security, housing policy and the impact of regulations restricting competition.

All such statements and analyses are grounded in research data, international experience and the Bank of Finland's own independent analysis, wherein the economic forecast plays an important role. By virtue of research data, we can strive to create a balanced view on the nature and effects of different kinds of policy decisions. In the future, economic research can be expected to lend strength to and illuminate our national debate on economic policy even further as the new Helsinki Graduate School of Economics is launched. Nevertheless, many of the issues that central banks seek to address are not restricted to the domain of economics; solving them will require research contributions, expertise and collaboration across a variety of disciplines.

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## Tags

economic development, Finnish economy, public finances, public debt, economic situation, monetary policy