Monetary policy tightening to bring inflation down to target – Managing energy crisis takes key role

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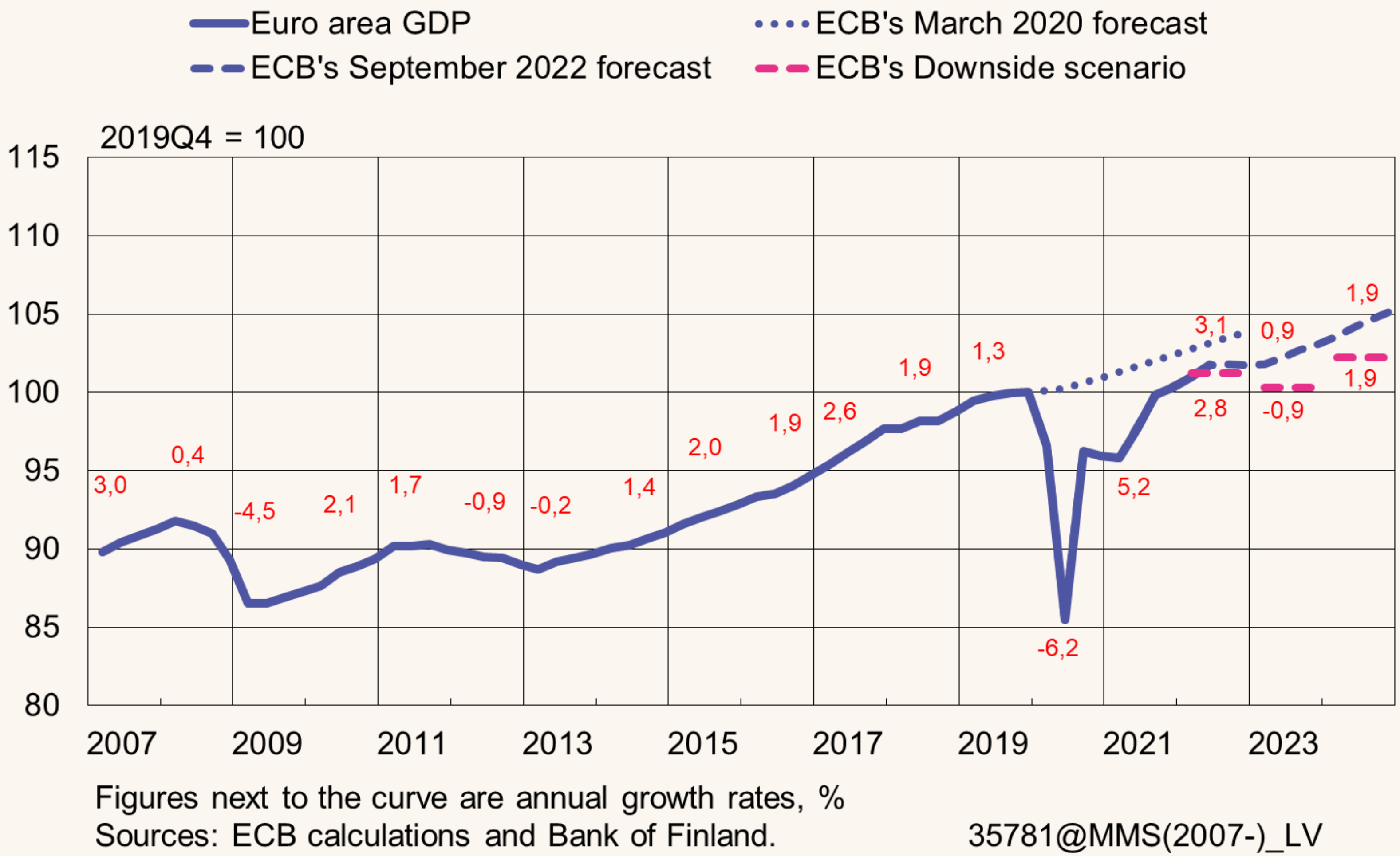
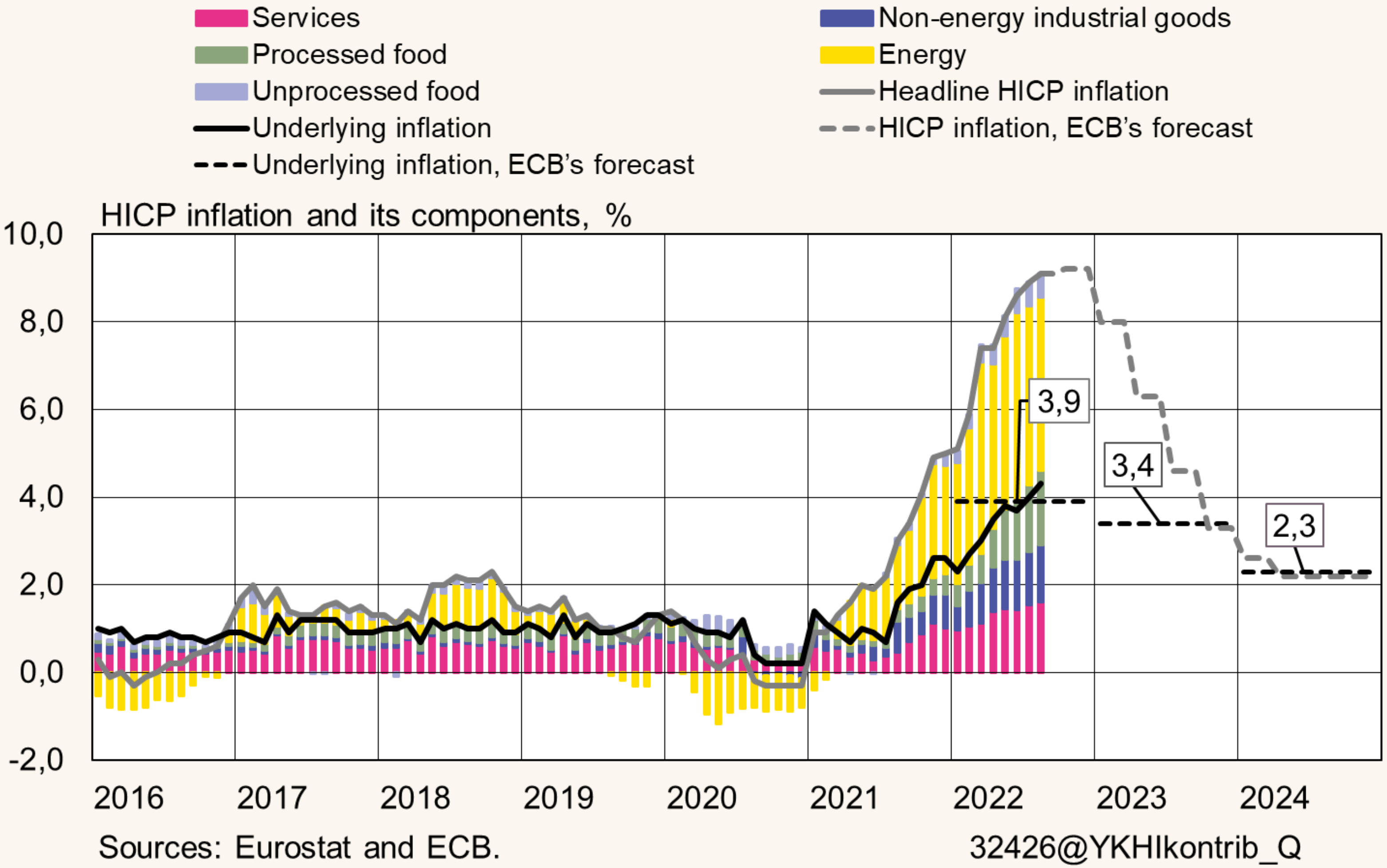
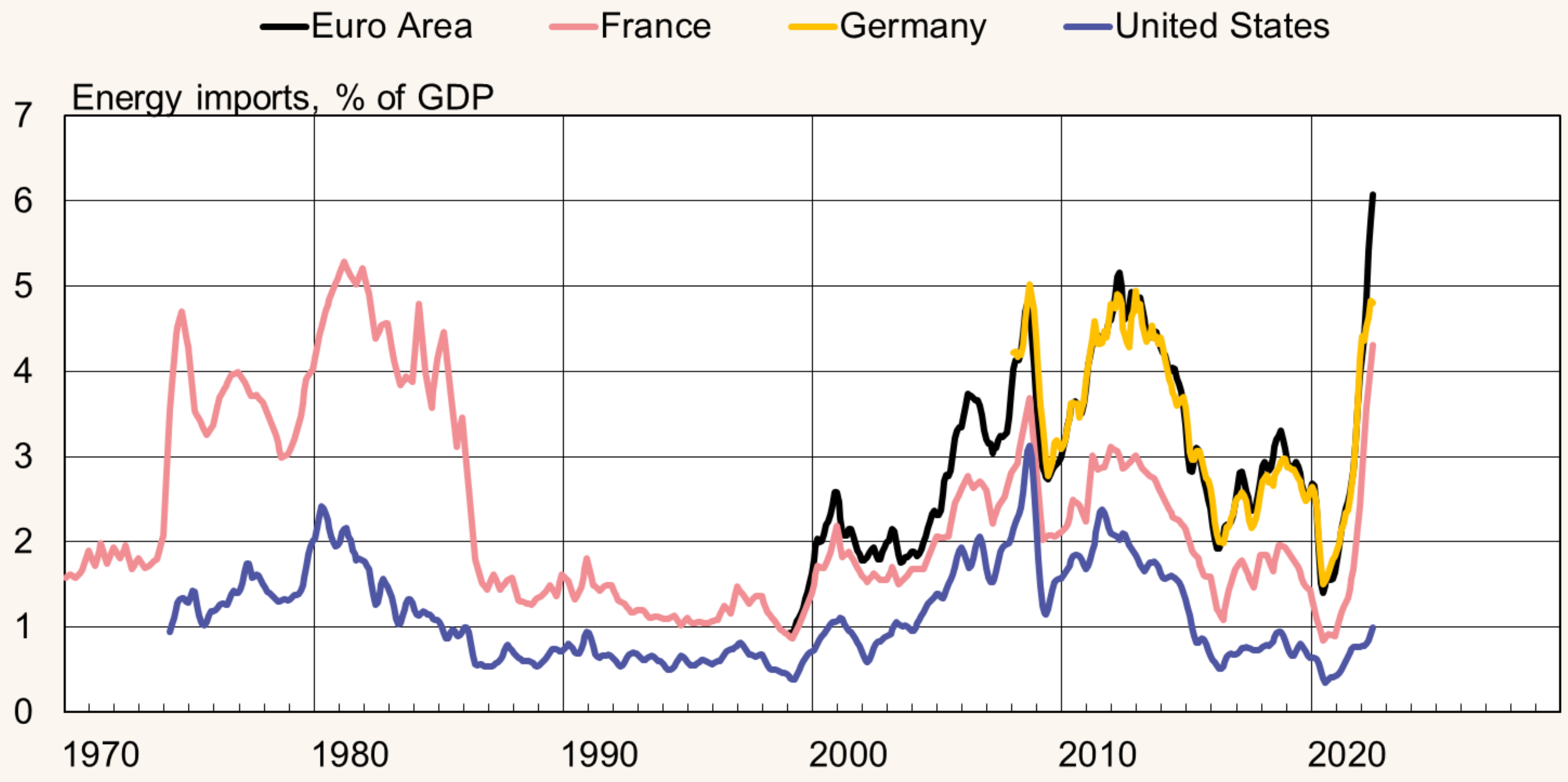
More risks in the path of growth – energy crisis may push euro area economy into recession



Inflation is now exceptionally high – energy price rises account for half the inflation rate



Euro area too dependent on fossil energy imports



Sources: Energy Information Administration (EIA), U.S. Bureau of Economic Analysis (BEA), French National Institute of Statistics & Economic Studies (INSEE), German Federal Statistical Office (Statistisches Bundesamt), European Central Bank (ECB) and Eurostat.
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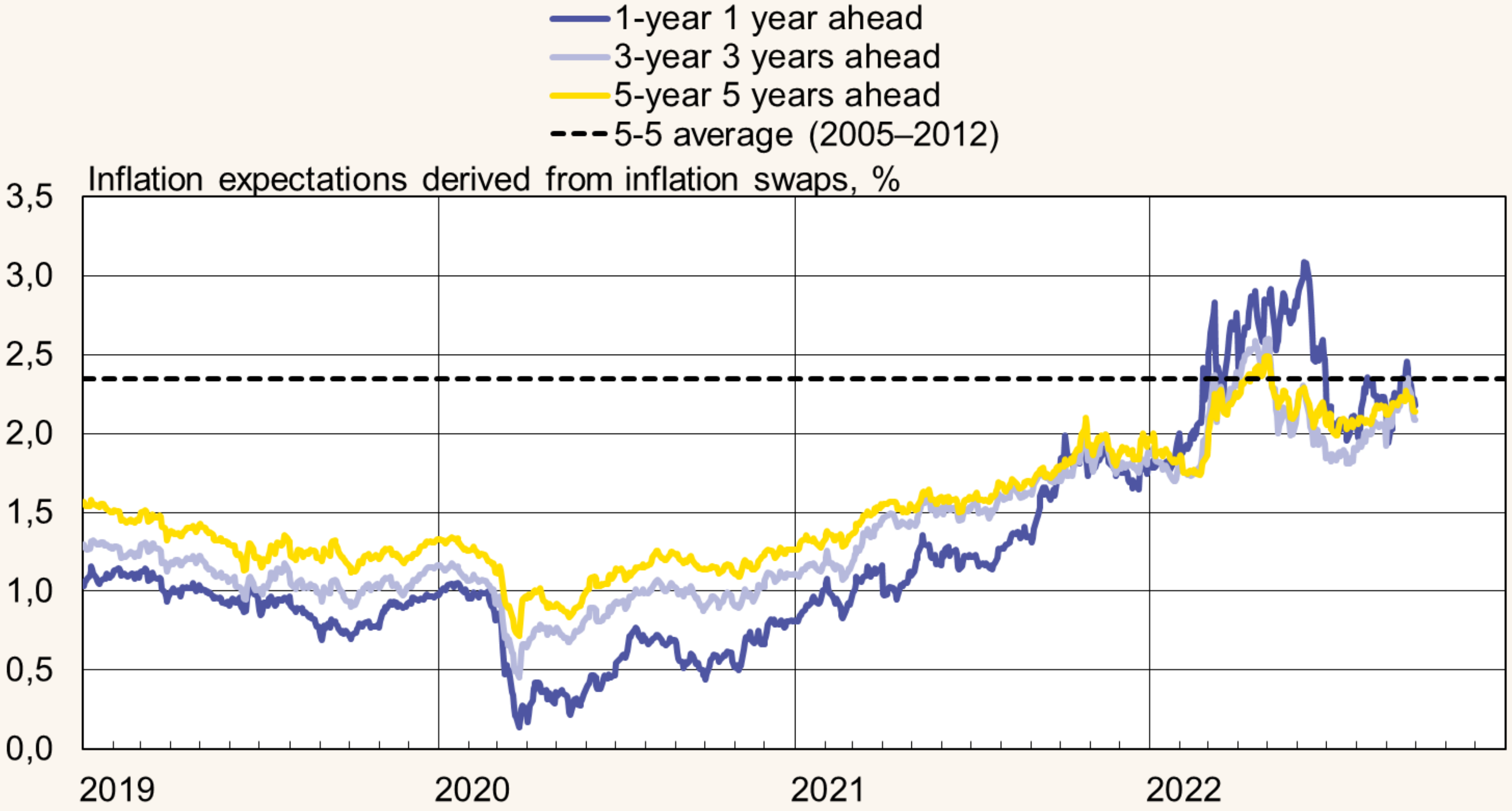
Rising inflation can be driven by various factors

- What factors can cause inflation?
  - Excess demand
  - Cost pressures
  - Overly expansionary economic policy
- The role of the various factors differs between countries and economic areas – in Europe, energy is the main driver; in the United States, expansionary fiscal policy plays a larger role
- Rising inflation also brings fluctuations in inflation rates and increases forecast errors

Inflation expectations play a key role and may change over time

Short-term inflation expectations in particular have increased



Market-based inflation expectations in the euro area.
Sources: Bloomberg and calculations by the Bank of Finland. 32426@odotus1-5+5ka

Rate of growth in negotiated wages in the euro area has remained fairly moderate

Interest rates will be raised to stabilise inflation at 2% over the medium term

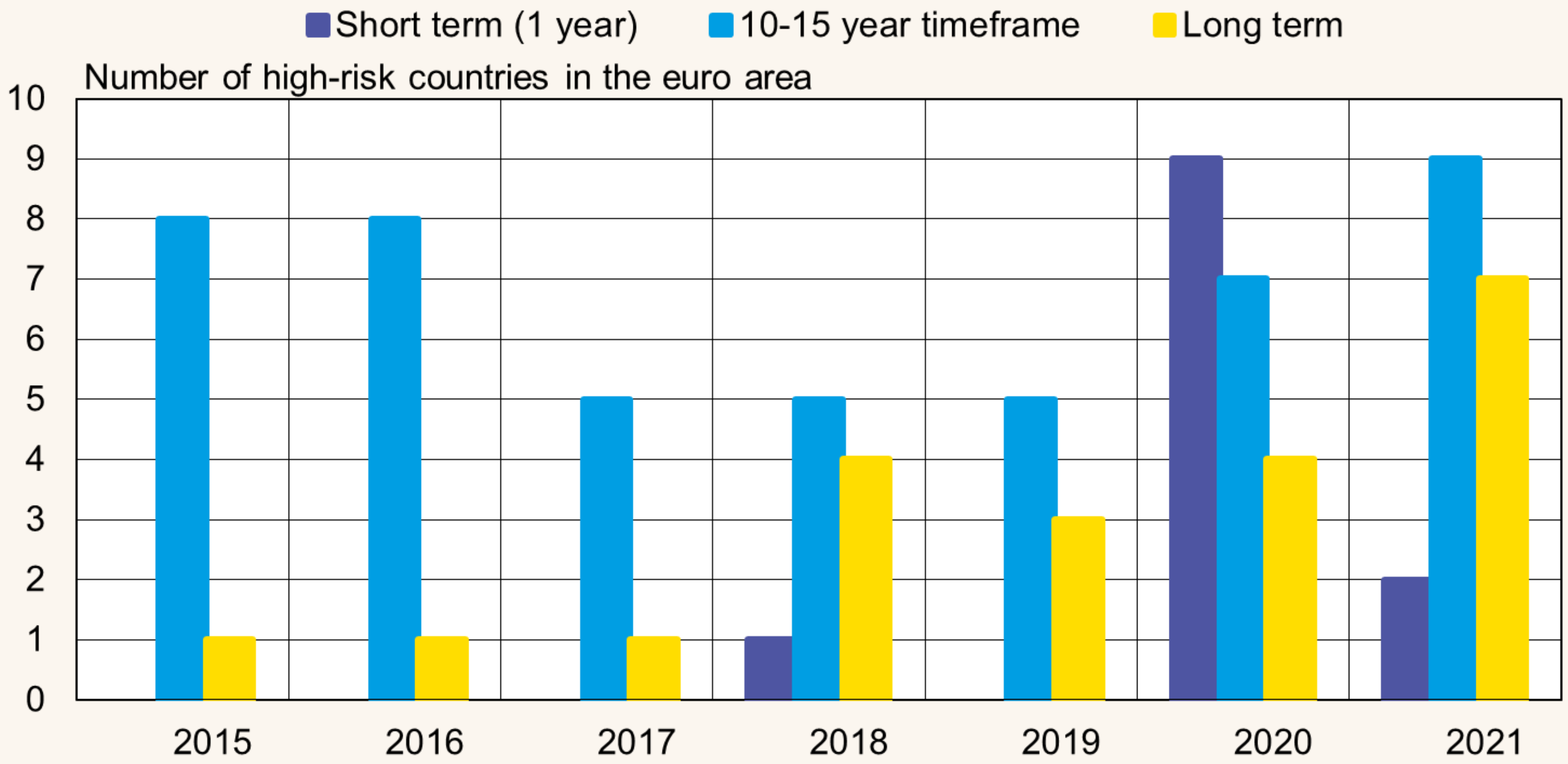
1. Net purchases in the ECB's purchase programmes ended on 1 July 2022.

2. Key ECB interest rates were raised by 0.50 percentage points in July and by 0.75 percentage points in September.

3. Inflation is still too high and is expected to remain above target for an extended period. Further policy rate increases are therefore likely.

4. The pace of policy rate increases will depend on the evolving economic situation and on information about how inflation is proceeding. Policy rate decisions will be taken meeting by meeting on the basis of incoming data.

Fiscal sustainability risks had already increased significantly before the energy crisis



Cyprus included only from 2016 onwards, and Greece from 2021.
Sources: European Commission and calculations by the Bank of Finland.
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Summary

- Gas supplies have clearly been weaponised by Russia in an energy war, so the European Union must bring order to its ranks once again and resolve this energy crisis. This is crucial also in terms of inflation.
- Wage inflation in the euro area has so far been relatively moderate and there are currently no clear signs of a wage-price spiral.
- The impacts of the energy crisis on economic growth are still to come.
- In fiscal policy, the focus should now be on fiscal balance and debt sustainability, and not on an indiscriminate increase in expenditure.
- The task of monetary policy is to ensure that inflation expectations remain anchored and that euro area inflation is brought down to the 2% target over the medium term.

Thank you!

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