



Monetary and economic policy as the pandemic recedes

Bank of Finland Bulletin press conference

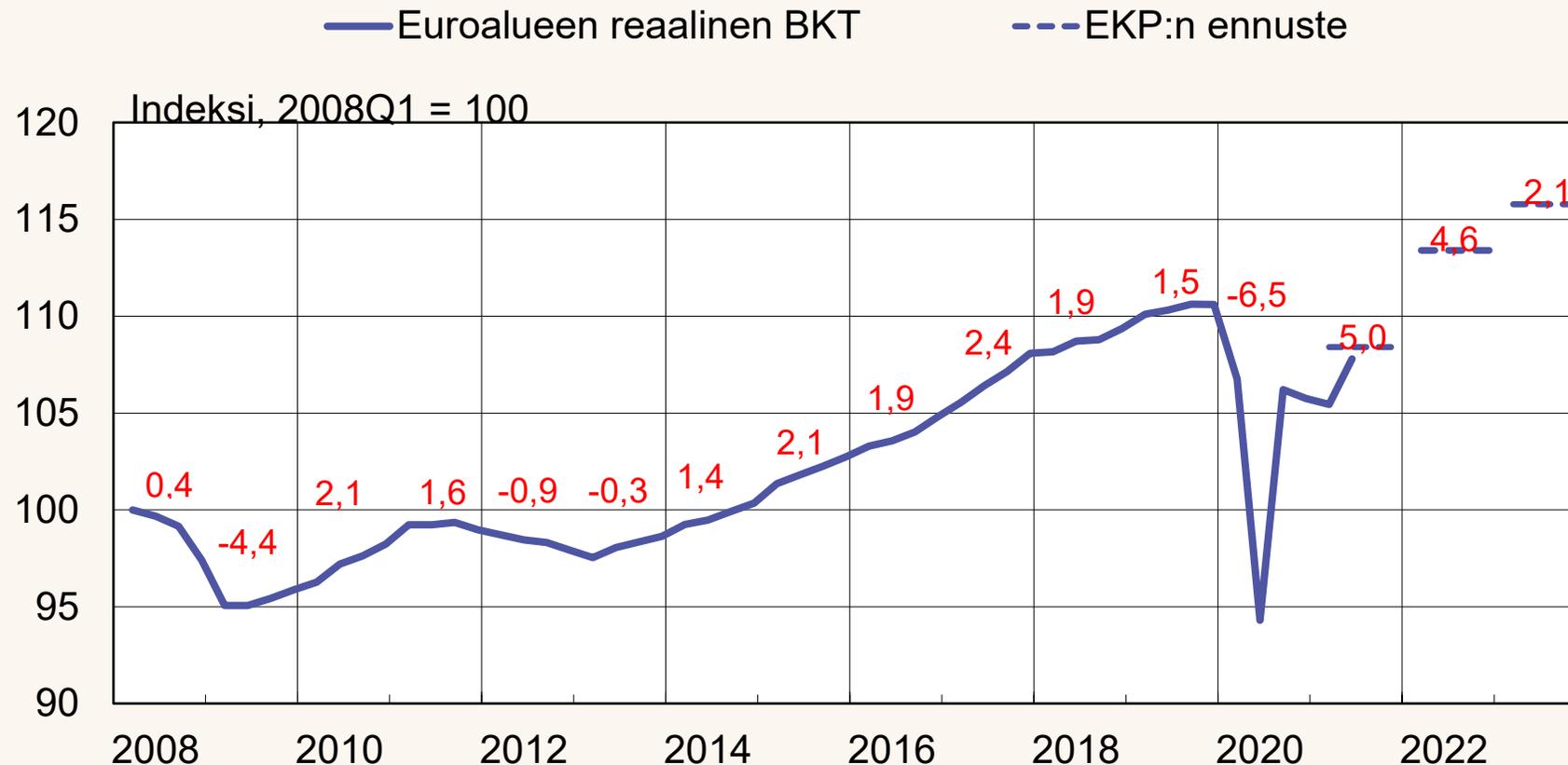
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Continued recovery in the world economy and European economies

- The world economy is recovering rapidly, but globally the percentage of those with full vaccination coverage is still only some 30%:
 - EU 60%
 - Finland 57%
 - Africa 3.4%
 - Source: Our World in Data
- The increase in COVID-19 cases in developed economies during the summer has impacted the pace of recovery, but has not halted it.
- Euro area growth is now robust, but we still need support from economic policy. The outlook is overshadowed by production bottlenecks, the possibility of new virus variants as well as low vaccination coverage in the developing world.
- These impacts are however not expected to be very large or long-term in the developed economies where vaccination coverage is high.

ECB forecast: Euro area economic growth brisk in 2021 and 2022



Euroalueen muuttuva kokoonpano. Käyrän yläpuolella olevat luvut ovat vuosikasvuja.

Lähteet: Eurostat ja EKP.

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ECB forecast: Euro area inflation lower than target in 2022 and 2023



* Tilastointimenetelmän muutos vääristää vuoden 2015 vuosi-inflaatiota.

Käyrän yläpuolella olevat luvut ovat vuosikasvuja.

Lähteet: Eurostat ja EKP.

Underlying inflation will pick up only slightly

Hintapaineet arvioidaan vähäisiksi



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Lähteet: Eurostat ja EKP.

The new monetary policy strategy helps to prevent lower-than-target inflation

- Achievement of the price stability objective would be facilitated if the recent spike in inflation would not turn out to be transitory overall, but as the economy recovers, inflation pressures would increase compared to pre-pandemic levels.
- This requires strong aggregate demand in the economy, supported by monetary policy.
- Prevention of lower-than-target inflation is supported by the ECB's new monetary policy strategy, which was adopted by the Governing Council in July.

The ECB's new monetary policy strategy

- The old inflation target of "below but close to 2%" was often interpreted as a ceiling, an upper limit.
 - This reduced the scope for appropriate economic stimulus particularly during periods of zero lower bound when more persistent stimulus measures are necessary.
- **The ECB's new target is symmetric 2% inflation over the medium term.**
- Negative and positive deviations from this target are considered as equally undesirable.
 - The new strategy allows transitory periods in which inflation is above the 2% target.
- The new target also improves the possibilities to pursue sustainable growth and full employment, without prejudice to the price stability objective.

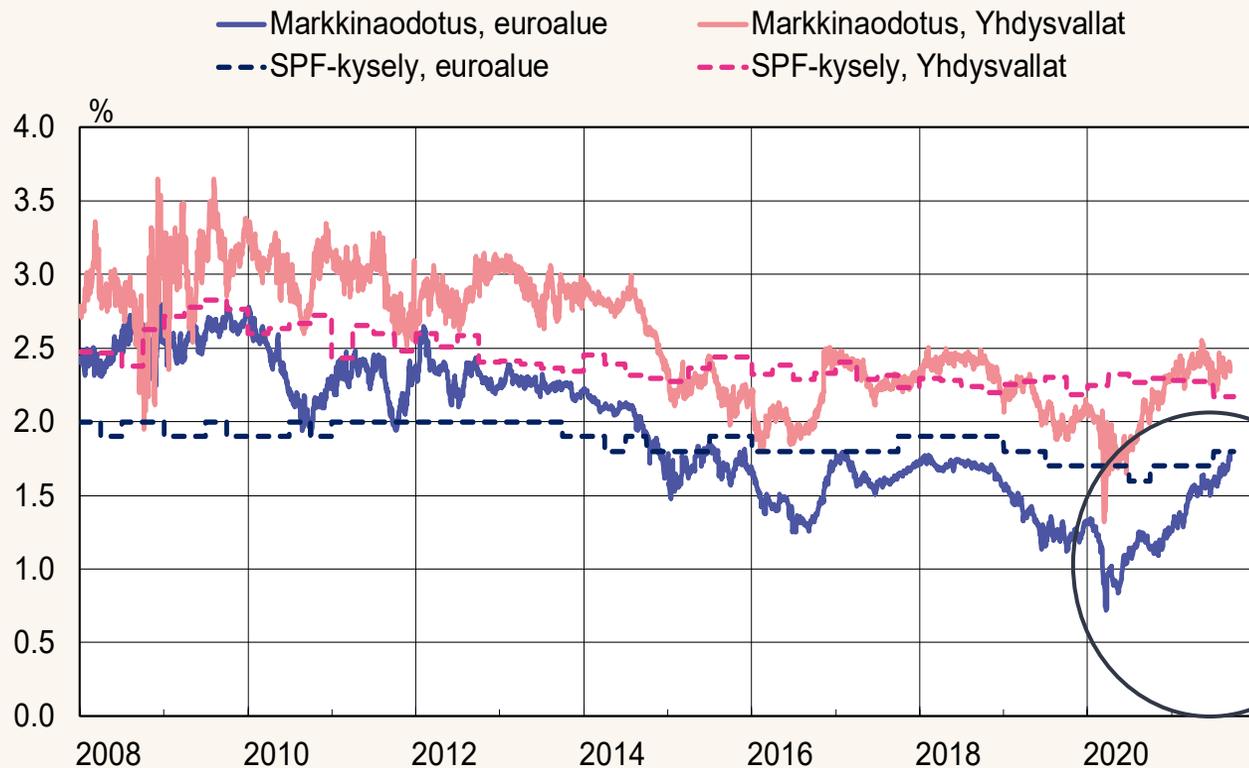


The ECB's monetary policy supports the euro area recovery and an adjustment of inflation to 2%

- The Governing Council expects the key ECB interest rates to remain at their present or lower levels until it sees inflation reaching 2% durably.
 - The new strategy allows transitory periods in which inflation is above the 2% target.
 - Asset purchases will be continued to ensure favourable financing conditions.
- The Governing Council in September: "favourable financing conditions can be maintained with a moderately lower pace of net asset purchases under the pandemic emergency purchase programme (PEPP) than in the previous two quarters."



Euro area long-term inflation expectations still below the ECB's inflation target



Markkinaodotukset johdettu 5 ja 10 vuoden inflaatiowapeista. SPF-kyselyt 5 vuoden päähän.
 Lähteet: Bloomberg, EKP, Fed of Philadelphia ja Macrobond.
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- Inflation expectations have however increased significantly since the worst phase of the COVID-19 crisis (EA 5/5 23.3.2020 0.7175)

- EA 5/5 13.9. 1.785

- EA 5/5 14.9. 1.741

- US 5/5 13.9. 2.379

- US 5/5 14.9. 2.342

Monetary and fiscal policy interaction more pronounced at times of zero lower bound – with total Keynesian economics in mind

- Close to the effective lower bound, the role of other economic policies than monetary policy becomes more important.
- Fiscal policy that operates with the principle of countercyclical economic policy can in deep recessions increase the effectiveness of monetary policy. A countercyclical fiscal policy during recessions requires that buffers are built up during upswings, to ensure fiscal sustainability.
- In such a situation, monetary and fiscal policy can complement each other and strengthen their effect mutually, and thus their combined stimulus effect on the economy.

Time, place and economic policy: there is a time to provide stimulus and accumulate debt, and a time to build up buffers

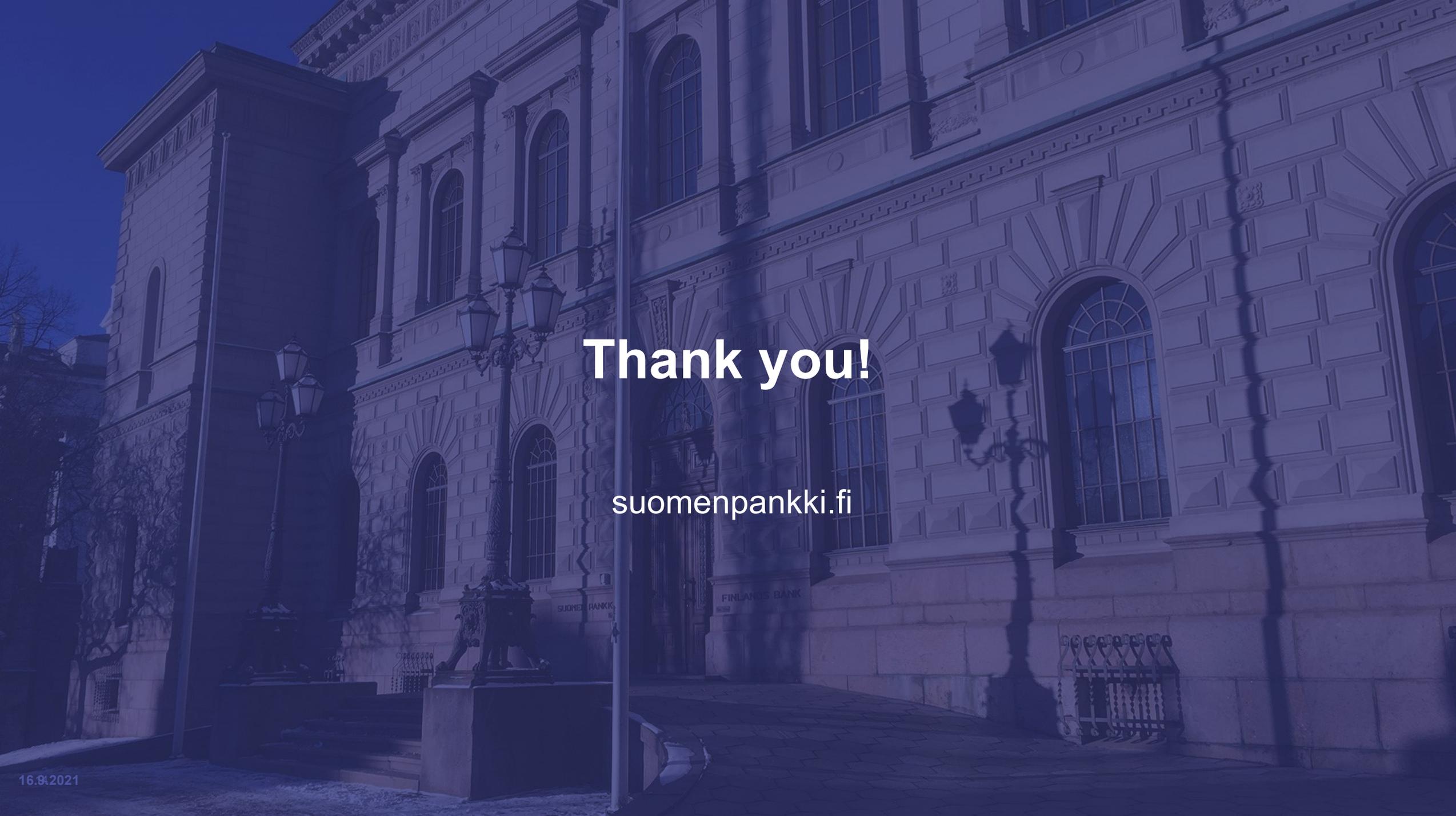
- Large public expenditure to mitigate the pandemic and its impacts has been justified. Growth in debt levels during the crisis has been inevitable.
- The repercussions of large deficits must however also be understood. Even though a rise in interest rates is not yet in sight, we will nevertheless have to face it one day. This should be considered in budgetary planning by all the euro area countries.

Rapid recovery in the Finnish economy – competitiveness of Finnish labour must be ensured

- Economic growth in 2021 will be higher than previously forecast, and subsequently there is a slowdown in sight.
- In wage setting, it is important to maintain export industry-driven coordination.
- Forecasts indicate a weakening of cost-competitiveness as the COVID crisis is left behind.

Summary

- The symmetric inflation target as defined in the new strategy means that accommodative monetary policy will be continued for a longer period of time.
- The paradigm has changed in the sense that the importance of the mutual effect of monetary and fiscal policy is recognised.
- Monetary and fiscal policy interaction has indeed been successful now.
- The paradigm has not changed in the sense that debt sustainability is still important in the medium term.
- The immediate years ahead are a window of opportunity for euro area countries to invest in the green and digital transition and for general economic reform – and this opportunity should not be missed.



Thank you!

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