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The Eurosystem's accommodative monetary policy: effects and side effects

For me as a central banker, the balance of positive and negative aspects of the Eurosystem's current expansionary monetary policy stance is clearly tilted to the positive side. Of course, a long period of ultra-low interest rates bears risks. These risks are mainly associated with financial stability concerns, as low interest rates may induce households and businesses to invest in more risky assets. Moreover, cheap interest rates on loans may tempt economic agents to take up higher loans than they will be able to pay back once the interest rate level normalises again. Low interest rates are of course also challenging for banks and insurance companies, as their profitability might suffer. As monetary policy makers, we aim for macroeconomic stability and, consequently, we are concerned with these risks and monitor them closely.

The economic and financial crisis highlighted the importance of financial stability, which is a necessary precondition for macroeconomic stability. Consequently, policy makers around the globe concluded that we need more policy instruments to safeguard financial stability. Thanks to this learning process, we now have more such instruments at hand than before the crisis, for example micro- and macroprudential regulation. These new tools are designed to mitigate the risks mentioned above, and we are optimistic that they will help to deal with these risks.

Now let me turn to the positive effects of the Eurosystem's accommodative monetary policy, which – in my view – clearly prevail over possible risks. Unfortunately, it is difficult to argue with counterfactuals. However, the argument that the European economy would be in a much worse state without the Eurosystem's ultra-accommodative monetary policy stance is still valid.

The global economic and financial crisis made real euro area GDP contract by about 5% and drove unemployment up dramatically. It was of utmost importance to counteract these disruptive forces. The Eurosystem's monetary policy lowered interest rates to unprecedented levels, generously provided banks with central bank liquidity and targeted different financial market segments with asset purchase programmes in order to broadly reduce the interest rate level. Now, in 2017, ten years after the outbreak of the crisis, we observe that monetary policy measures have been working. Interest rates are very low, and financial frictions have been reduced.

Confidence has returned, GDP growth rebounded – bringing aggregate real euro area GDP back to its pre-crisis level in 2015 – and unemployment started to recede. In fact, euro area unemployment has been steadily declining. More than four million jobs have been created since 2013, when the unemployment situation was at its worst. And finally, HICP inflation has left the deflationary danger zone and has started to increase toward 2%. The quantitative impact of our policy measures is difficult to estimate. However, we are confident that their cumulative impact exceeds 1 pp for GDP growth and is around 1½ pp for HICP inflation over a three-year horizon.

Nevertheless, we must keep in mind that the longer low interest rates remain in place, the more pronounced the side effects will become. However, the Eurosystem's monetary policy stance has to stay accommodative until economic recovery in the euro area has gained sufficient momentum to bring inflation back into line with the Eurosystem's definition of price stability, namely an inflation rate of below, but close to, 2%. That this process has been taking longer than anticipated has to do with the severity of the crisis on the one hand and, on the other, with the time lag of the structural reforms necessary to make our economies more competitive and flexible.

The sooner these reforms are implemented, the stronger and more sustainable the recovery will be.

For the sake of future generations, we have to boost potential economic growth in the euro area. Unfortunately, this is nothing monetary policy can deliver. This requires policies that set the right incentives for investment. To push forward economic recovery and raise potential economic growth, structural reforms are indispensable. ●