



# Monetary Policy at a Crossroads

CEF 2022 Policy Panel by the Federal Reserve Bank of Dallas

The Southern Methodist University, Dallas

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Governor Olli Rehn  
Bank of Finland

# Eurozone economy was recovering well, but the war in Ukraine is eroding growth

Euro area GDP forecasts during the Covid-19 pandemic

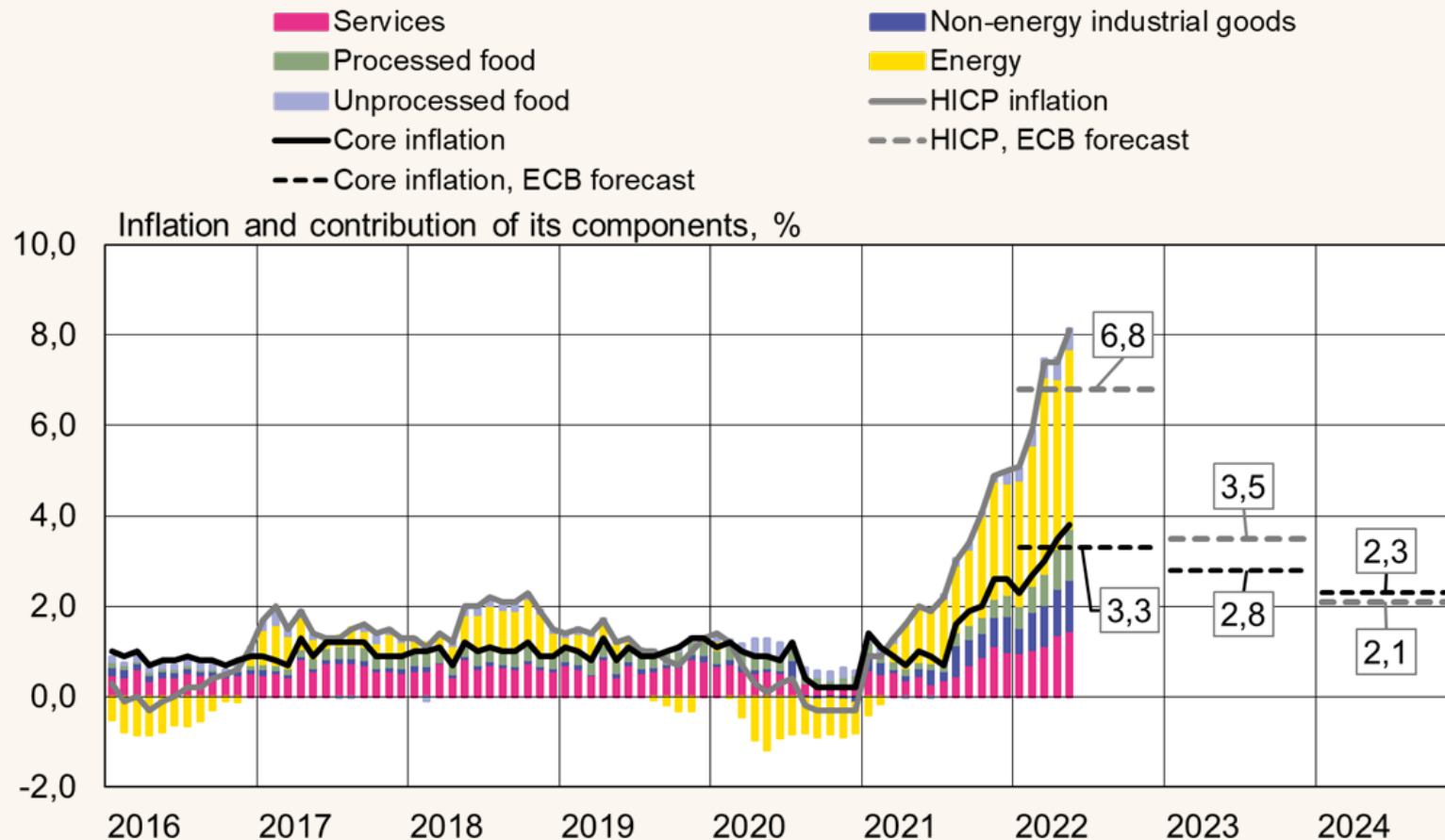


Source: ECB staff calculations and Bank of Finland.  
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# Inflation dynamics in the eurozone: a driver and an anchor

- Driver: rapid energy inflation
- Anchor: moderate wage inflation – until recently
- Monetary policy not very effective in containing energy prices
- Inflation expectations and the psychology of inflation
  - Will the anchor hold going forward?

# Inflation on the rise in the eurozone – energy inflation explains half of the total



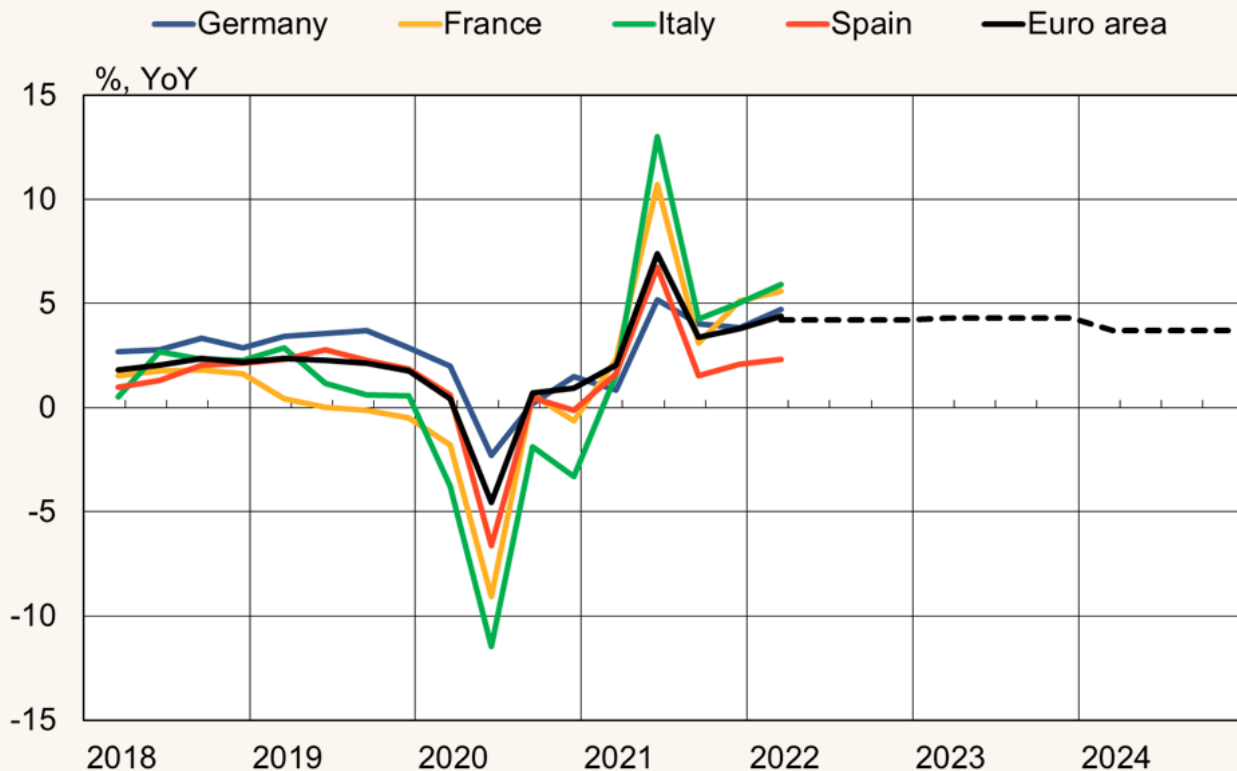
NB: Annual inflation rate of 2015 is distorted due to the change in methodology.

Sources: Eurostat and ECB.

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# Wage inflation has been moderate – until recently

Compensation per employee



Dashed line: ECB's latest projection.  
Source: ECB.

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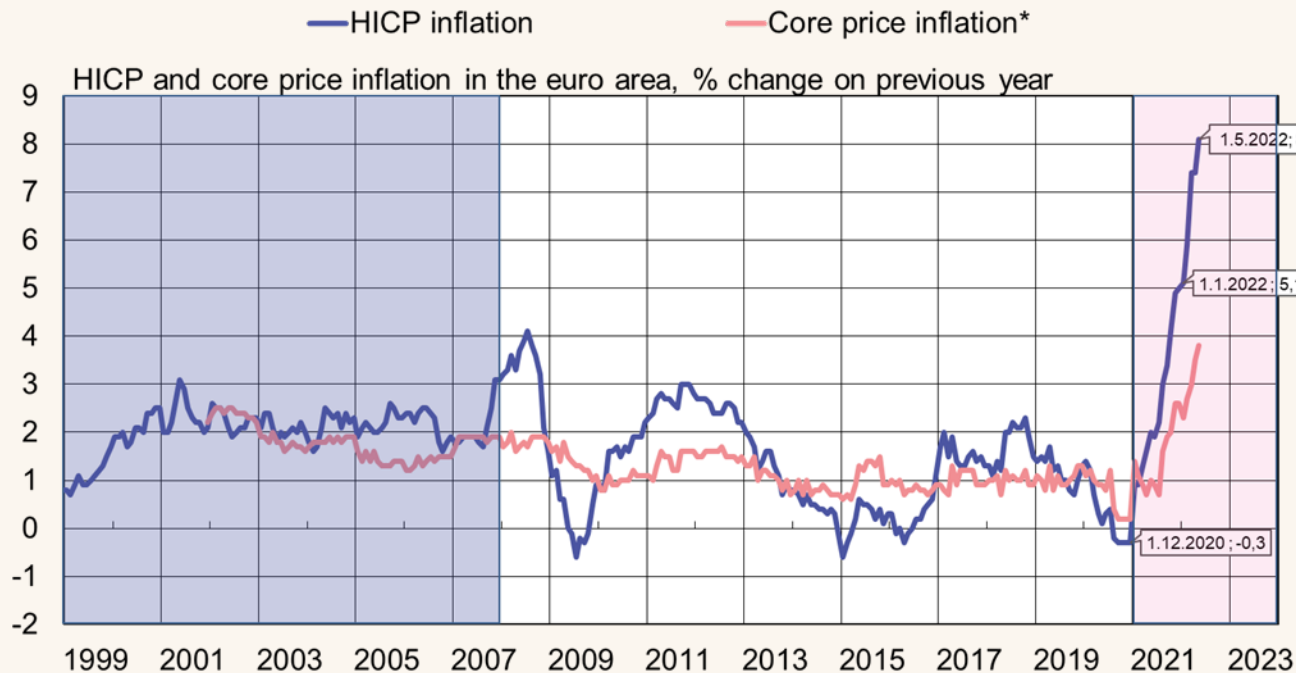
- Energy inflation and supply chain bottlenecks alone will not lead to a long-lasting (“permanent-ish”) rise in inflation...
- ... unless they cause significant, sustained second-round effects and a wage-price spiral
- In contrast to the US, wage inflation has been moderate in the euro area – at least until recently

# ECB's current monetary policy strategy: a symmetric 2% inflation target

- Previous inflation target of “below but close to 2%” was often interpreted as an upper limit.
- **ECB's current target is symmetric 2% inflation over the medium term.**
- Negative and positive deviations from this target are considered equally undesirable.
- Strategy allows transitory periods in which inflation is above the 2% target.
- Strategy also improves possibilities to pursue sustainable growth and full employment without prejudice to price stability objective.



# Dramatic shift in operational environment – inflation surge



NB: Annual inflation rate of 2015 is distorted due to the change in methodology.

\* HICP excl. energy, food, alcohol and tobacco.

Source: Eurostat.

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- 1999-2007: inflation stable but slightly above target
- 2008-2020: inflation volatile but low
- 2021- : rapidly rising inflation
- Russia's invasion of Ukraine on Feb 24 further accelerated inflation
- Energy price shock exceptionally large

# Monetary policy at a crossroads

- Sharp acceleration of inflation vs. deceleration of growth
- Need to curb inflation expectations to avoid wage-price spiral
- Gradual normalization of ECB monetary policy will be continued as announced on June 9<sup>th</sup>
- New strategy served us well under the changed circumstances
- The ECB Governing Council is ready to use all its instruments to stabilize inflation at its 2% target over the medium term



A blue-tinted photograph of the Finnish Bank building. The building is a grand, classical-style structure with multiple stories, arched windows, and ornate architectural details. In the foreground, there are several ornate street lamps and a lion sculpture. The text 'Thank you!' is overlaid in white in the center of the image.

Thank you!

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