2017-06-16

PRESS RELEASE

Low inflation in the euro area: causes and consequences
(Article for the June 2017 Economic Review)

Euro area inflation remained unexpectedly weak between 2012 and 2016. This was surprising as the region's ongoing economic recovery was expected to stimulate inflation. Persistently low inflation begs a great many questions: What are the underlying factors? Are the economic models used to predict inflation fit for purpose? Do falling inflation expectations point to a real "de-anchoring" from the inflation target? How can monetary policy combat weak inflation and its related risks? Should monetary policy be supported by other policy domains?

The Eurosystem has introduced a whole range of unconventional measures, including an asset purchase programme, with the aim of getting inflation back to its target of below, but close to 2%. To gain a full and comprehensive understanding of the complex issues underlying low inflation, it also set up the Low Inflation Task Force (LIFT) with a brief to investigate the above questions. The article discusses its main findings (see Ciccarelli and Osbat, 2017), which in short suggest that:

1) Inflation in the euro area has been held back chiefly by cyclical forces. More specifically, domestic shocks caused inflation to fall in the 2012-14 period, following which foreign shocks gained importance, e.g. the prolonged decline in oil prices.

2) Traditional models – and more specifically the Phillips curve, which captures the relationship between domestic economic activity and inflation – continue to be relevant for understanding and predicting inflation dynamics.

3) There was a real threat of inflation expectations becoming de-anchored, and the asset purchase programme proved justified. De-anchoring may result from declining confidence in both the effectiveness of monetary policy and the inflation target.

4) The asset purchase programme has proved successful as it has supported inflation, fostering its return to target in good time, and it has also contributed to re-anchoring inflation expectations.

5) Monetary policy can benefit from positive interactions with measures in other policy domains – e.g. structural reforms and budgetary policies – and particularly so in an environment where policy rates are close to their lower bound.

Communication
National Bank of Belgium Ltd.
boulevard de Berlaimont 14
1000 Brussels
phone + 32 2 221 46 28
www.nbb.be
Company's number:
0203.201.340 – RLP Brussels