SUOMEN PANKKI EUROJÄRJESTELMÄ FINLANDS BANK EUROSYSTEMET

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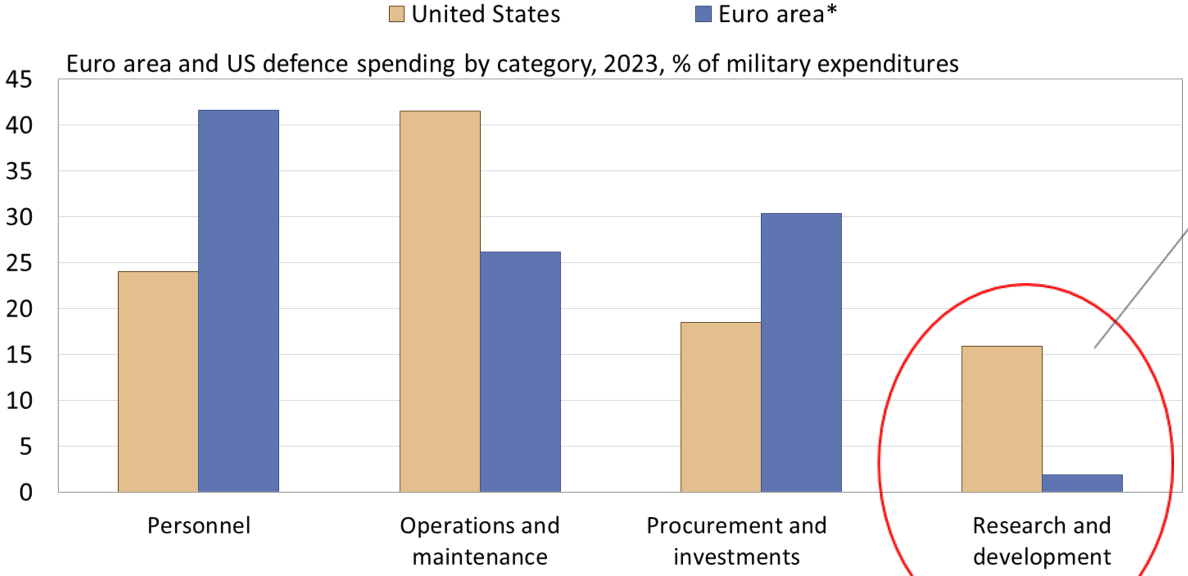
Will higher defence spending boost euro area growth? Allocation of the spending will be key

Defence spending composition in euro area differs from that in United States



* Germany, France, Italy and the Netherlands.
Source: UN Military Expenditures Database (UNMilEx). Data for the United States are based on a simplified reporting form and are therefore not fully comparable.
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- Personnel costs and expenditure on operations and maintenance account for 70% of defence spending.
- Share of R&D is less than 5% in the euro area, approximately 15% in the United States.
  - Statistics not entirely comparable, but share of R&D is in any case higher in the US.
- A higher share of R&D in defence spending could increase productivity and innovation.
- Some improvement in Europe: share of R&D in defence spending has risen slightly in recent years.
- An increase in the domestic content of procurements would also amplify growth impacts.

J. Nelimarkka, L. Vilmi, M. Lehmus

Main messages from the article ‘Will higher defence spending boost euro area growth?’

- **The fiscal multiplier for defence spending is likely to be less than one.**
- **Without compensatory measures, increases in defence spending will raise public debt in relation to GDP.**
- **The biggest positive effects observed are from exceptionally large investments in the United States in wartime situations.**
  - Can the same be repeated in Europe without wartime conditions?
  - Would require defence spending to be used in a way that supports private innovation (previously not so).
- **The materialisation of growth effects would require:**
  - Long-term and sufficiently large R&D investment
  - Dynamic private sector, large internal markets and efficient innovation ecosystems
  - EU-level coordination and joint procurement.

Feature article 2: Variable rate corporate loans strengthen transmission of monetary policy

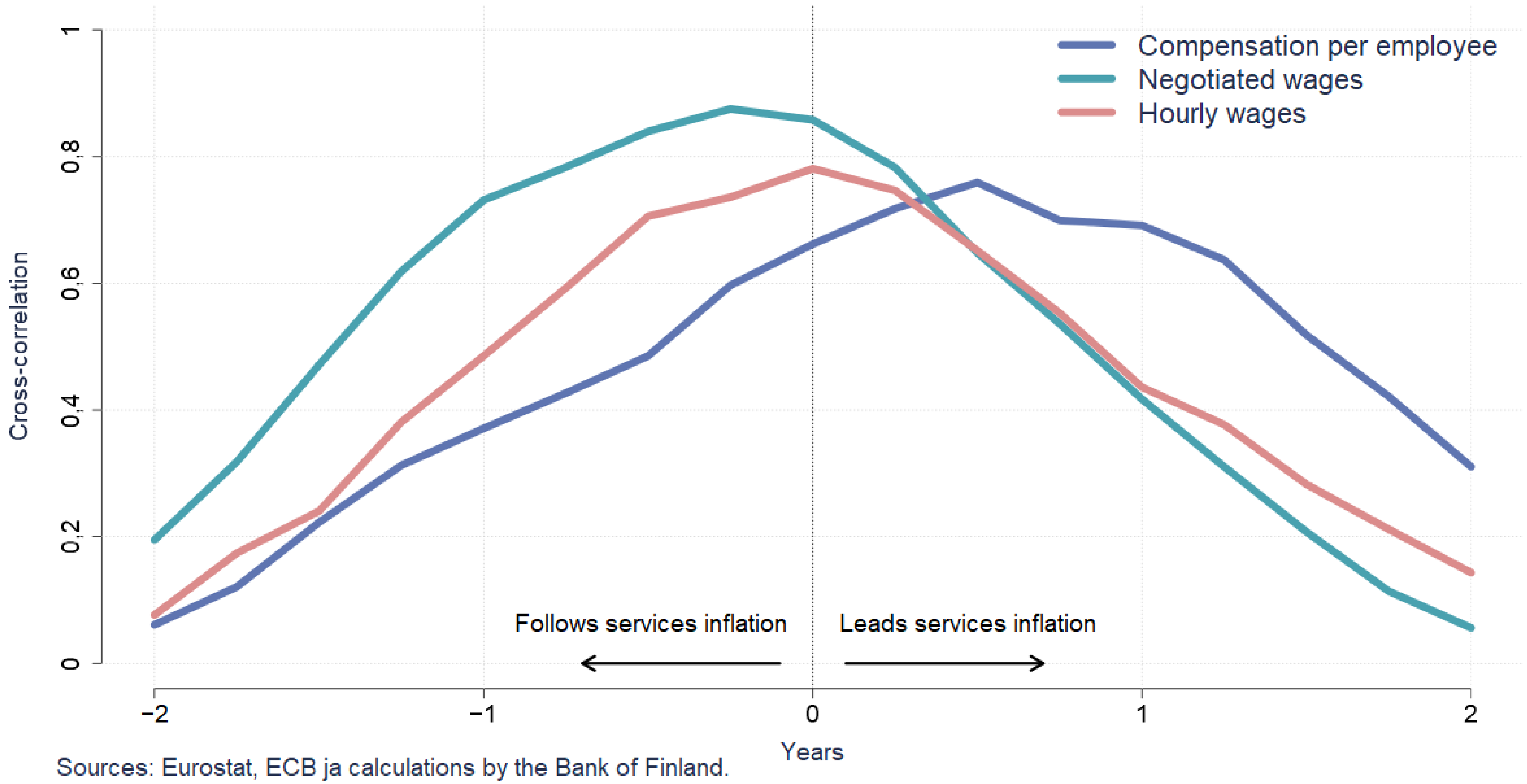
- Popularises the recent Bank of Finland Research Discussion Paper 'Heterogeneous responses to monetary policy: the role of floating rate loans' (Kerola, Laine and Paavola, 2025).
- Builds on the theoretical – and in this case empirically investigated – finding that the interest rate channel is more pronounced for companies with financial constraints.

J. Anttonen, S. Oinonen

Feature article 3: Wage indicators under review: What can they tell about services inflation in the euro area?

- Wage pressures in the euro area are monitored using several different indicators, which each have strengths and weaknesses.
- The ECB's primary wage indicator, which is also forecast in the quarterly macroeconomic projections, is the **compensation per employee** indicator derived from the National Accounts.
- One of the key alternative indicators is the **ECB indicator of negotiated wages**.
- Wage pressures affect the euro area's headline inflation mainly through services inflation.
- **ECB wage tracker**: the first properly forward-looking wage indicator for the euro area (another forward-looking indicator, though less so, is Indeed).

Main message of the feature article: compensation per employee is a fairly good predictor of services inflation



Sources: Eurostat, ECB ja calculations by the Bank of Finland.

- Negotiated wages correlate strongly with *current* services inflation, but compensation of employees predicts *future* services inflation better.
- **Another important message regarding the inflation target:** in addition to compensation per employee, the ECB wage tracker also suggests that euro area services inflation is slowing down after long remaining elevated.

Thank you!

P.S. See also the Monetary Policy Review to be published in Finnish on the Bank of Finland’s website eurojataous.fi on 17 September

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