



EUROJÄRJESTELMÄ
EUROSYSTEMET

Bank of Finland Bulletin 1/2012 Monetary Policy and the Global Economy

Governor
Erkki Liikanen

15 March 2012

Themes

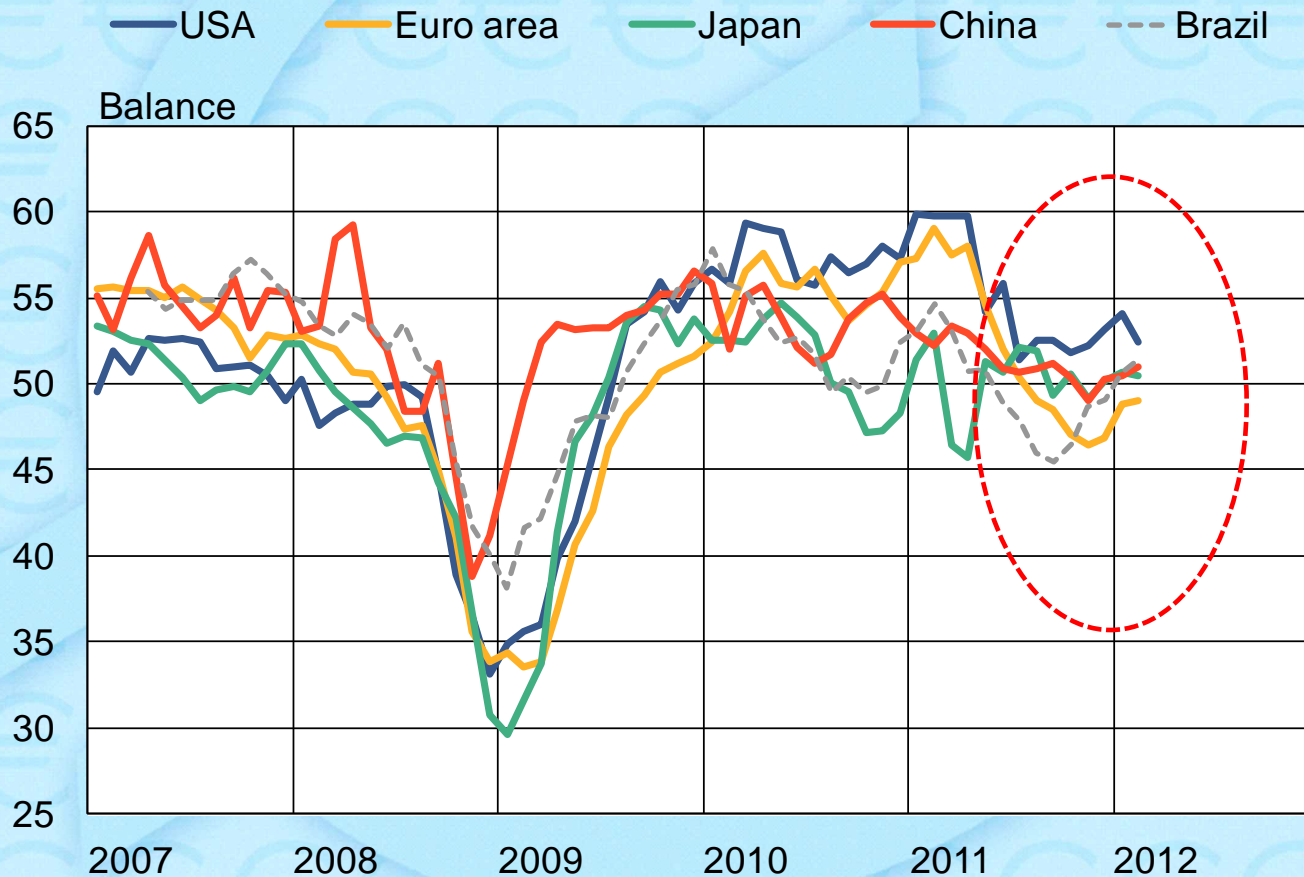
- ◆ ***The markets, a cyclical snapshot and the forecast***
 - ***Market developments and cyclical indicators***
 - ***Assumptions and the Bank of Finland forecast for the global economy***
 - ***Forecast risks***
- ◆ ***Major differences within the euro area***
 - ***Condition of public finances***
 - ***Youth unemployment***
- ◆ ***Recent monetary policy measures***
 - ***Global monetary policy stance***
 - ***Steps taken by the Eurosystem***



Market developments and cyclical indicators

Major changes in confidence

Purchase Managers' Indices: manufacturing

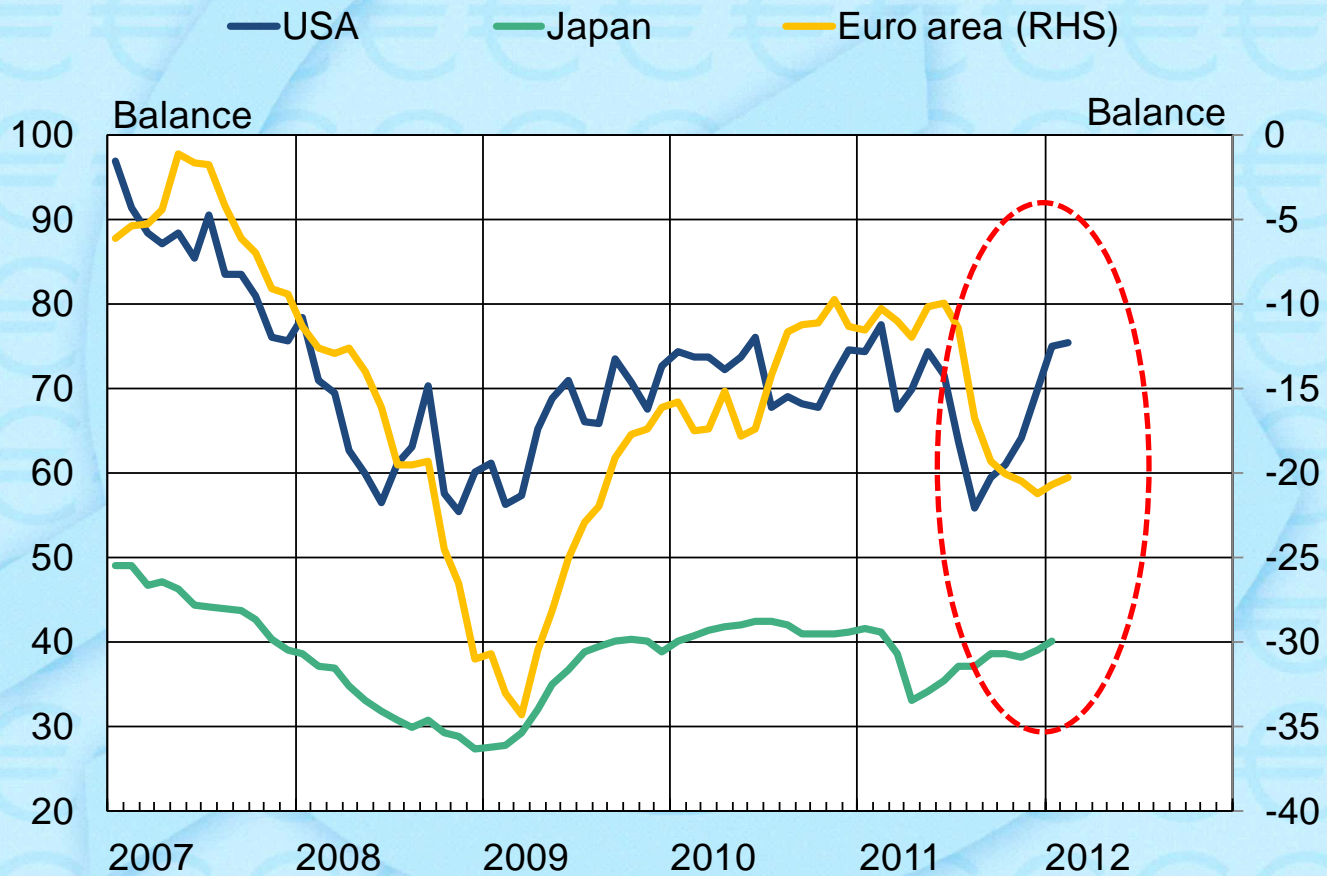


Source: Bloomberg.

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Major changes in confidence

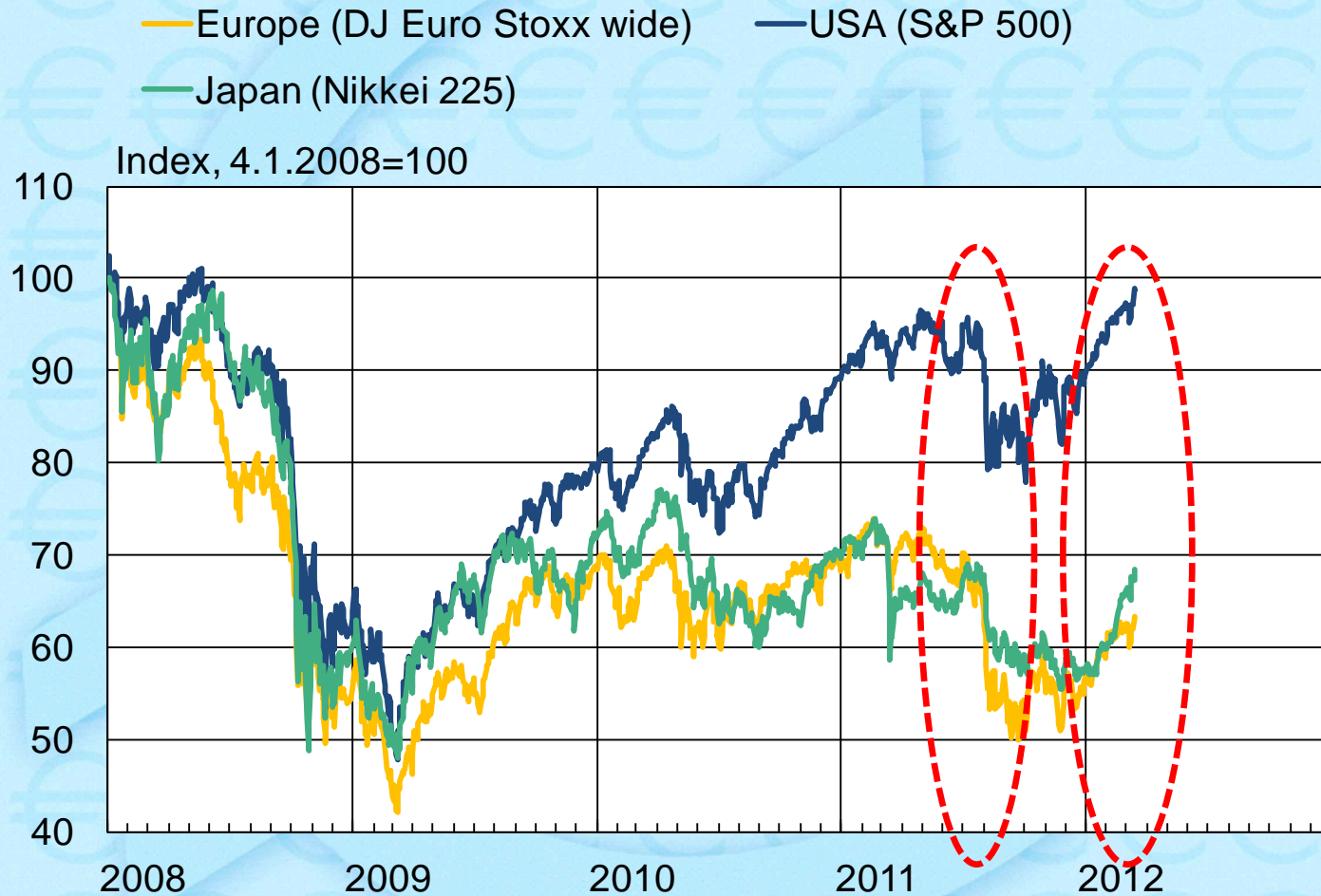
Consumer confidence indicator



Sources: European Commission and Bloomberg.

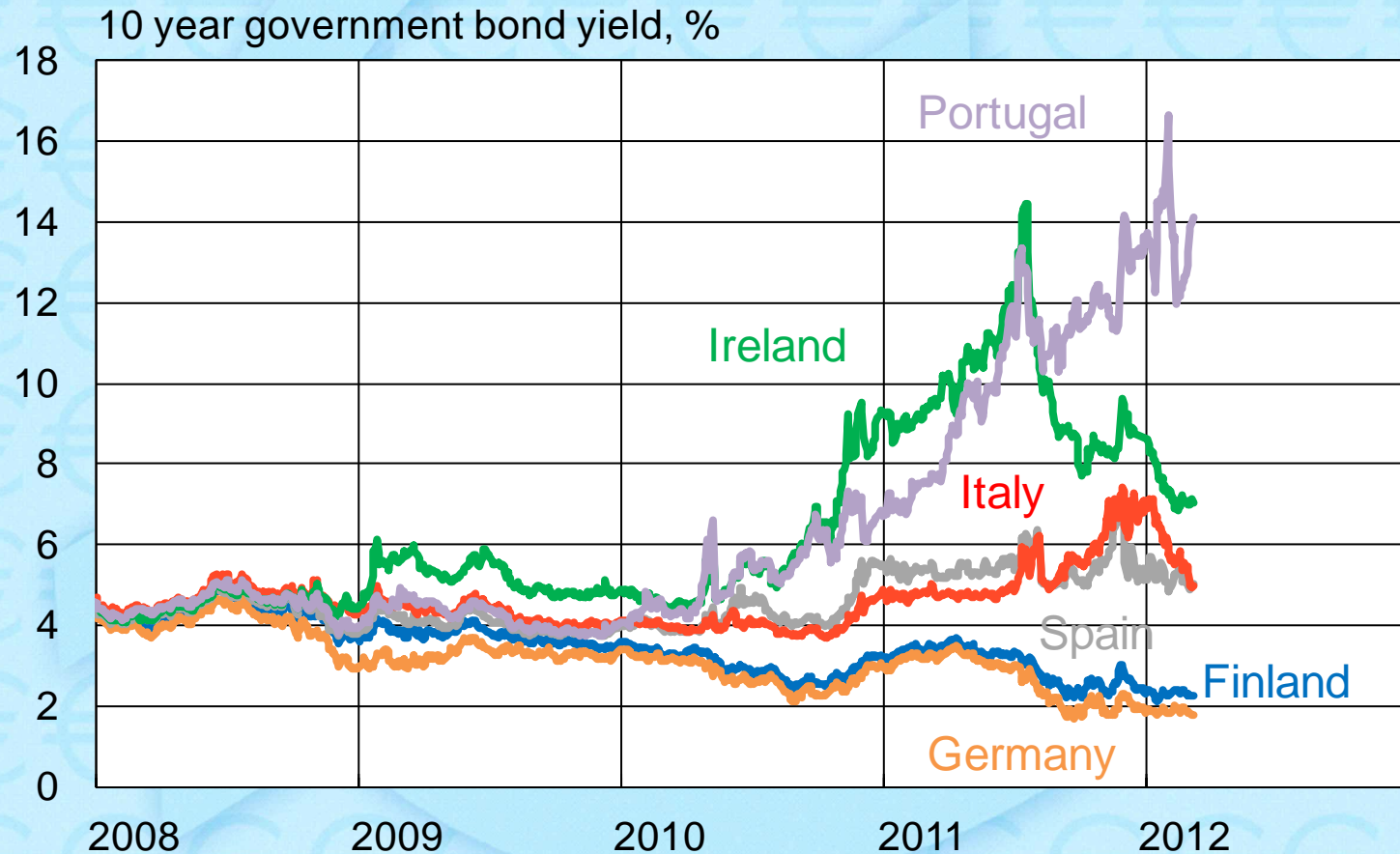
25200@Chart87 (enET)

This is also reflected on the stock markets



Source: Bloomberg.
19002@stocks_main2_en

Some improvement on the government bond markets



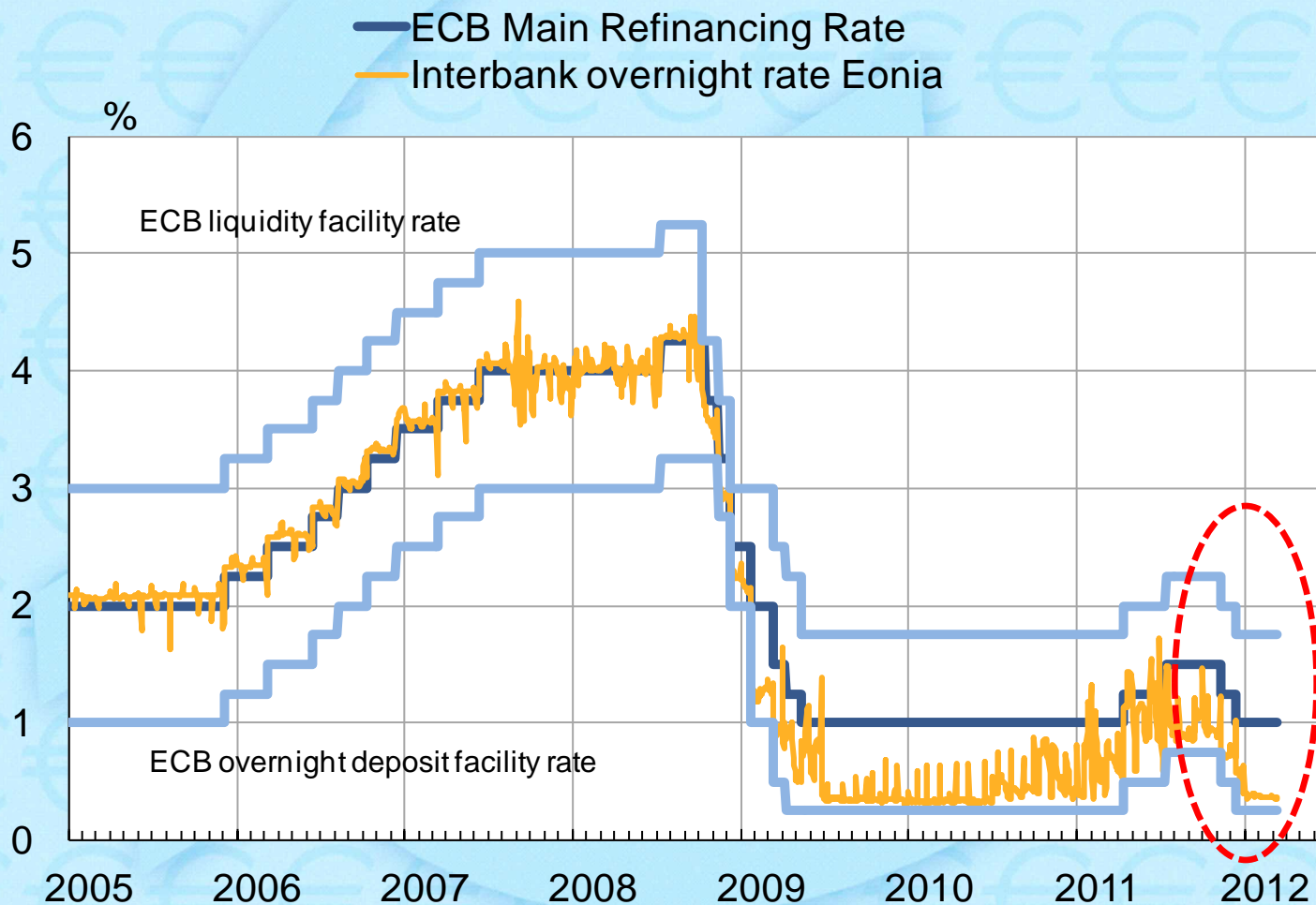
Source: Reuters.

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Stabilisation measures

- ◆ ***The monetary policy decisions of the ECB-council***
 - ***e.g. three year LTROs***
- ◆ ***The EU level decisions made in early December***
 - ***'Six-pack' entered into force on 13th December***
 - ***'Fiscal compact'***
- ◆ ***Decisions taken at national level***
 - ***The stabilisation programmes in Italy and Spain***
 - ***Agreement on the 2nd package of Greece***

Cut in policy rate and expansion in central bank credit have relaxed monetary conditions in the euro area

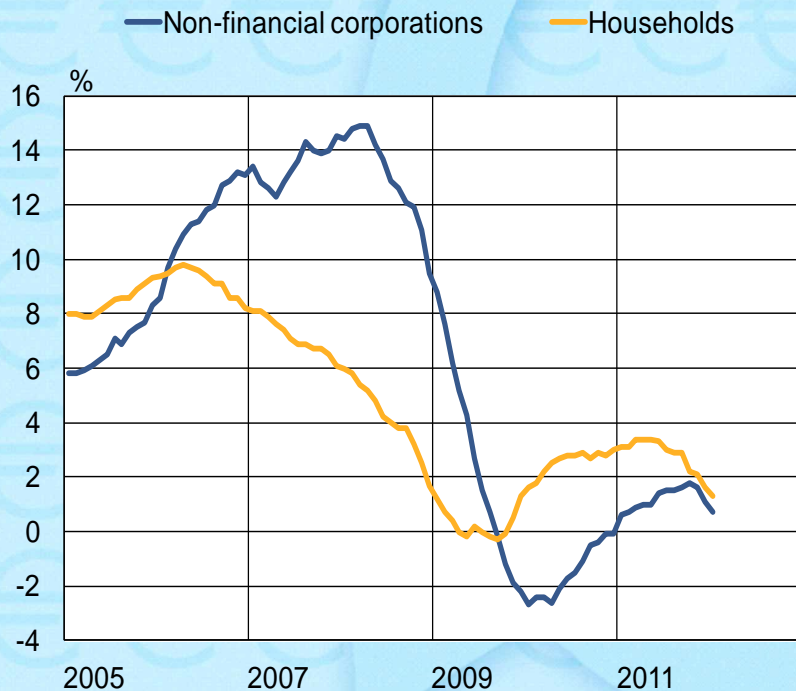


Sources: ECB and Reuters.

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Country specific differences in financial conditions are still large

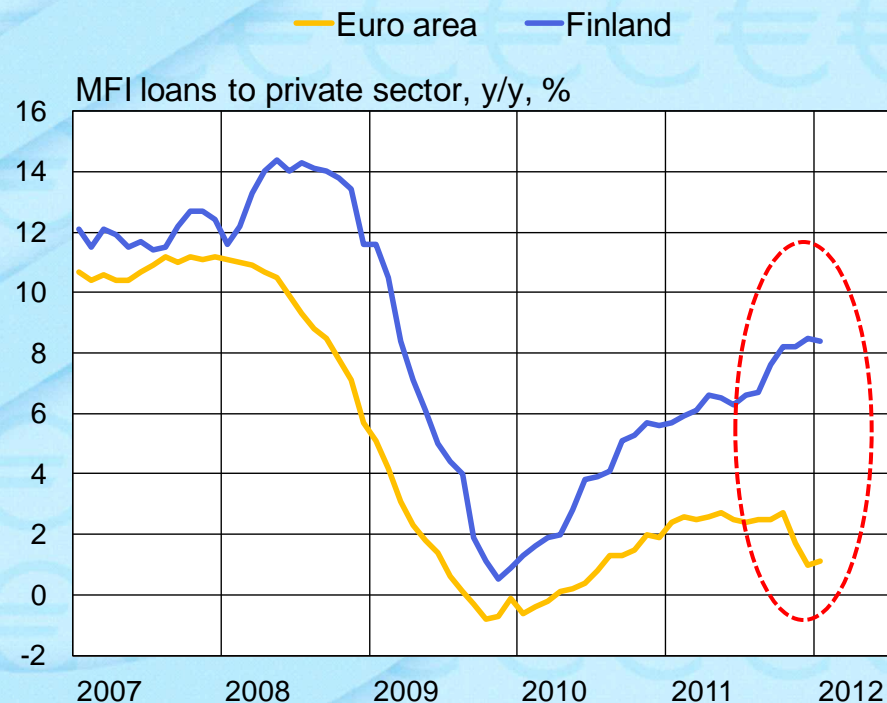
Euro area



Source: ECB.

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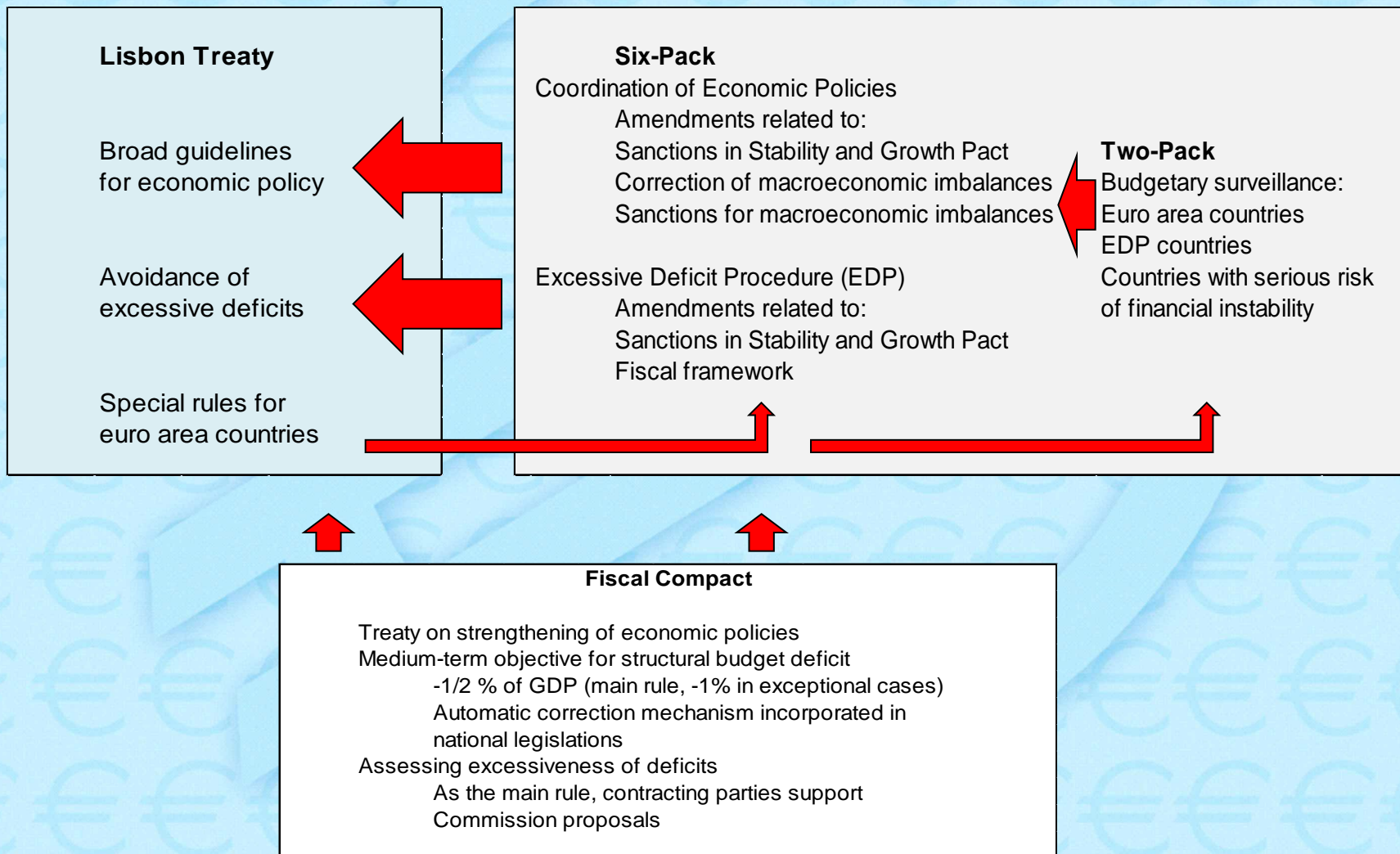
Finland



Sources: European Central Bank and Bank of Finland.

25827

European crisis management framework



The background of the slide features a repeating pattern of light blue Euro symbols (€). Overlaid on this pattern is a large, stylized, light blue graphic of the Bank of Finland logo, which consists of a circle with a diagonal slash through it.

Bank of Finland's global economy forecast

Assumptions for Bank of Finland's international forecast

- ◆ **Multidimensional uncertainty**
 - **Economic uncertainty,**
 - **Political uncertainty, ...**
- ◆ **Assumption: action is taken to calm down the crisis**
 - **Euro area countries adhere to their promised adjustment measures in respect of both 1) adjustment of debt levels and 2) strengthening the foundations of growth**
 - **Contributes to public confidence and lower interest rates**
- ◆ **Finding a new balance is a slow and gradual process**
 - **Restoring credibility and correcting high debt levels take time**

Bank of Finland's forecast outcomes

GDP	2010	2011f	2012f	2013f	2014f
United States	3,0	1,7 (1,5)	2,3 (1,9)	2,6 (2,6)	2,5
EU20	1,9	1,5 (1,6)	-0,2 (0,9)	1,0 (1,6)	1,6
Japan	4,5	-0,9 (-0,6)	1,4 (2,4)	1,5 (1,3)	1,7
China	10,4	9,2 (9)	8 (8)	8 (8)	7
Russia	4,3	4,3 (4,4)	3,7 (4,4)	3,7 (3,6)	3,4
World	5,3	3,8 (3,9)	3,2 (3,6)	3,9 (4,0)	3,9
World trade	13,7	6,0 (6,2)	3,5 (6,1)	5,8 (7,1)	6,3

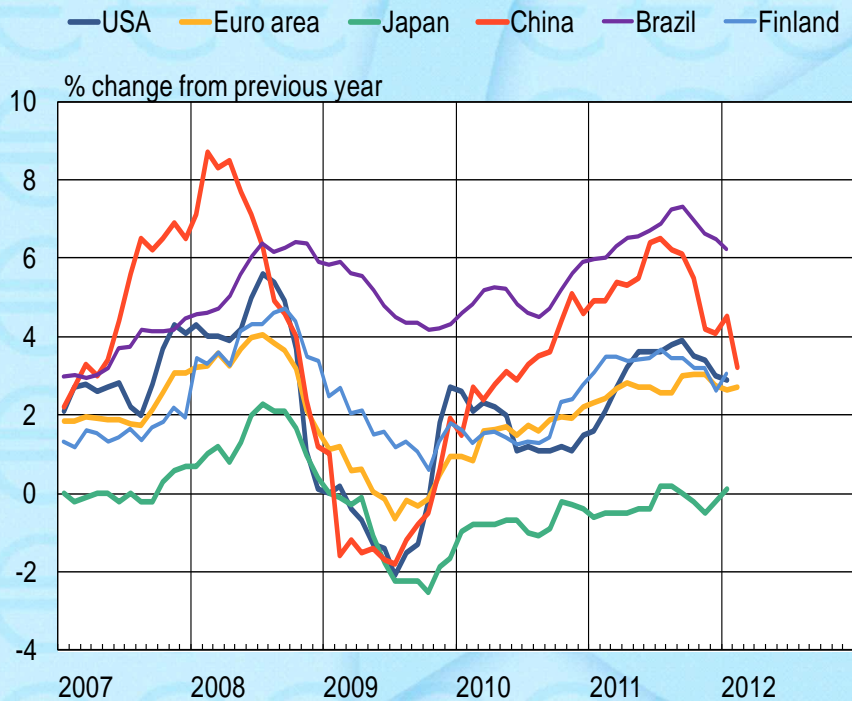
f = forecast

% change on the previous year (previous forecast in brackets).

Source: Bank of Finland.

Inflation slows during the current year

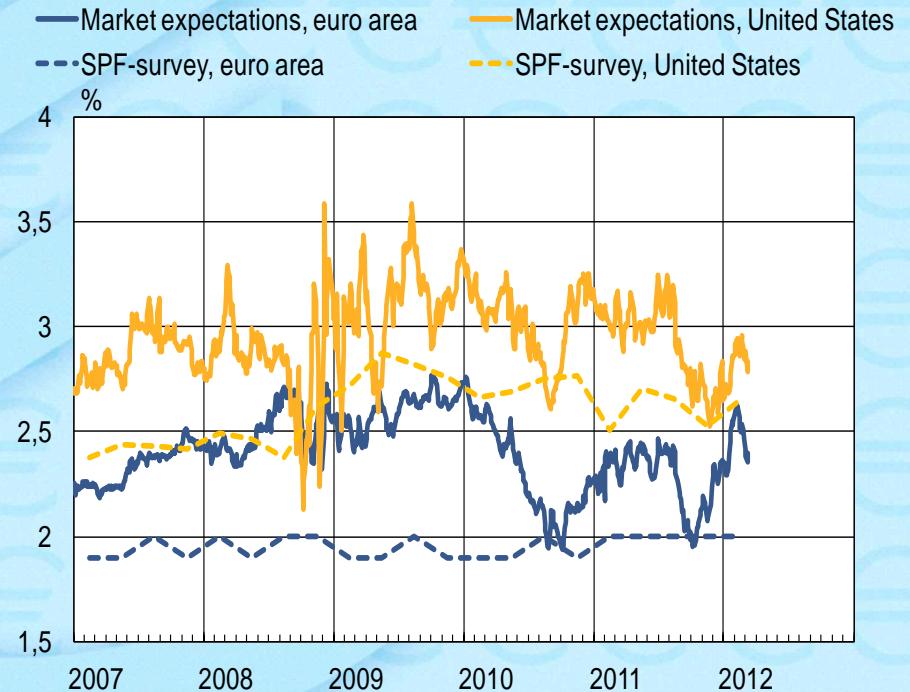
Inflation



Source: National statistical authorities.

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Inflation expectations

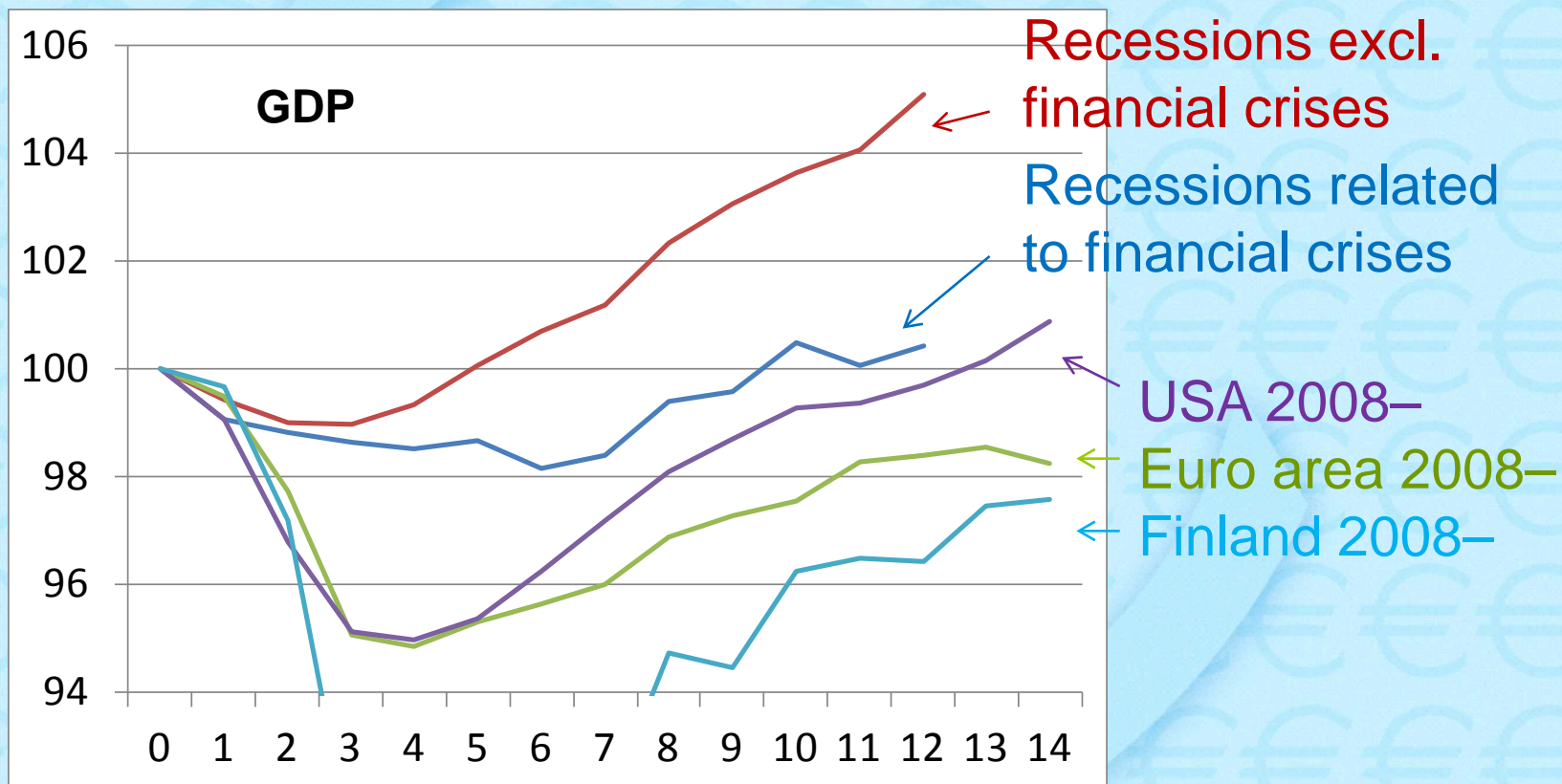


Inflation expectations based on 5-year inflation swaps. 3-day moving averages. SPF-survey 5 years ahead.

Sources: Bloomberg, ECB, Fed of Philadelphia and Bank of Finland calculations.

25456@ET 2012-1 (en)

Why is this crisis different: slow recovery from financial crises



Horizontal axis: time since peak in quarters.

Vertical axis: median of observations, index: peak = 100.

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Sources: IMF WEO April 2009, Eurostat, BEA, and Statistics Finland.

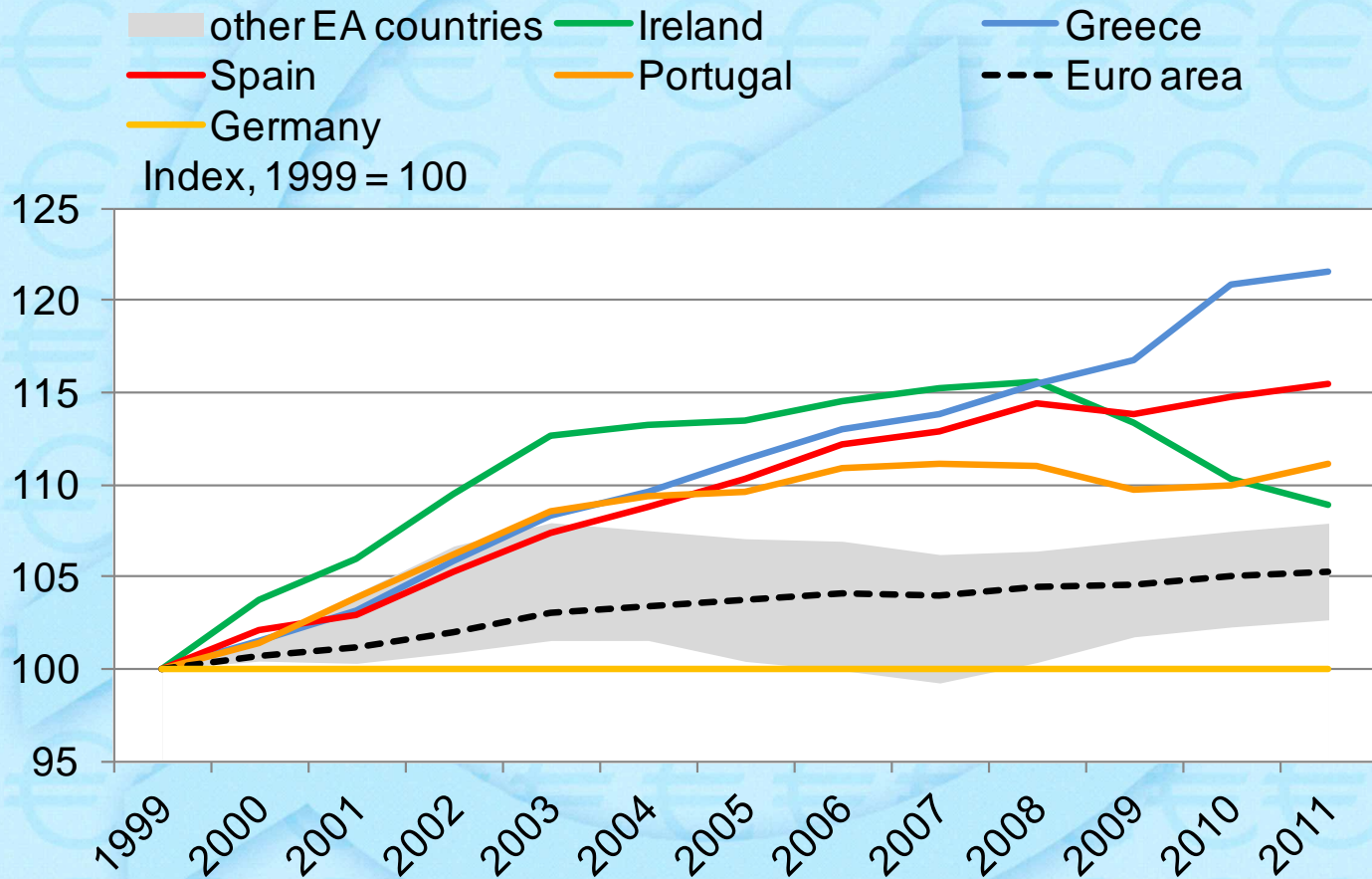
Risks to the forecast mainly on the downside

- ◆ Recovery from the debt crisis a slow and uneven process
 - A positive spiral may come to a halt abruptly and unexpectedly
 - Reasons: failure in carrying out adjustment programmes, market reactions to weaker-than-expected data releases, ...
- ◆ Euro area countries' ability to implement reforms of critical importance
 - How is crisis countries' external balance adjusted?
 - How does the adjustment affect the credibility of the euro area as a whole?
 - How far is it necessary to go to find the new balance?
- ◆ There are also positive risks
 - Recent developments in the United States



Major internal differences in the euro area

Faster inflation than elsewhere and the resultant low level of real interest rates led to over-indebtedness in GIPS countries



Source: Eurostat

25005

Developments in euro area countries' consumer prices vis-à-vis Germany, 1999-2011.

Fiscal policy faces important challenges

	Projected Deficit	Objectives of Stability and Convergence Programmes*		
	2011	2011	2012	2013
Euro area	-4,3	-4,3	-3,1	-2,1
Germany	-1,1	-2,5	-1,5	-1,0
France	-5,7	-5,7	-4,6	-3,0
Italy	-3,9	-3,9	-1,6	0,0
Spain	-8,5	-6,0	-4,4	-3,0
UK	..	-8,6	-7,8	-6,5
US	..	-9,5	-8,0	-6,4

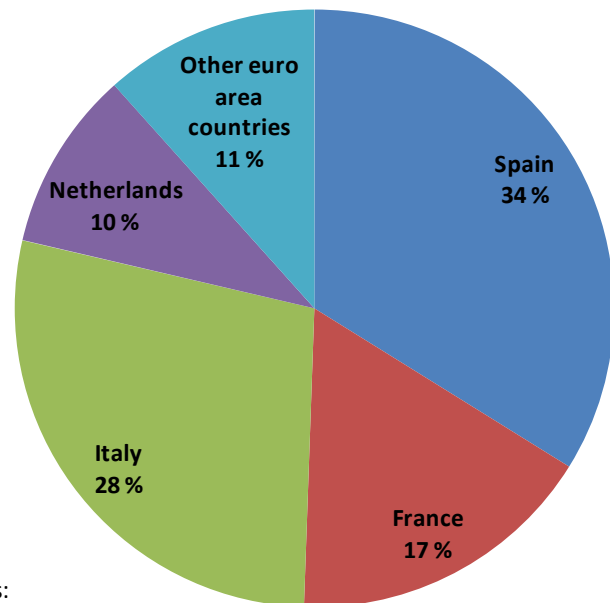
* UK and US figures are IMF projections for deficit.

Sources: IMF, European Commission and announcements by countries .

Italy, Spain and France implementing strongest adjustments

2012

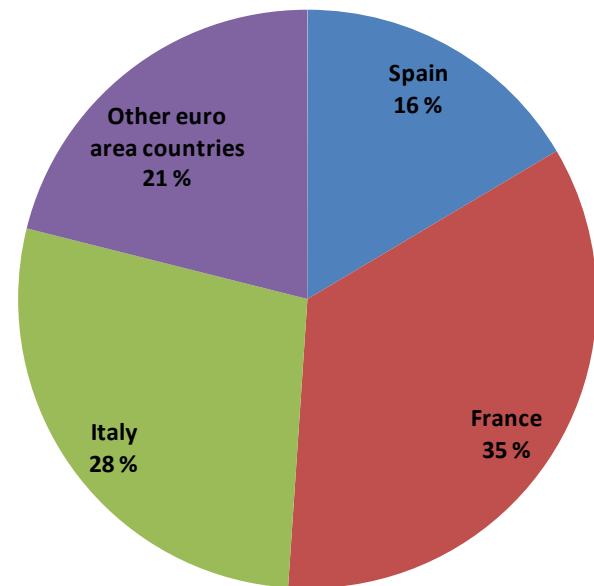
**Euro area Fiscal Consolidation -
Country Breakdown**



Sources:
IMF, European Commission, announcements by countries and Bank of Finland calculations.

2013

**Euro area Fiscal Consolidation -
Country Breakdown**

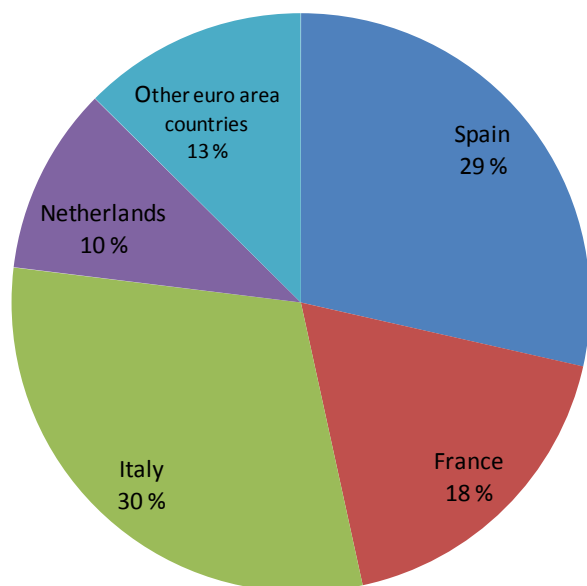


Sources:
IMF, European Commission, announcements by countries and Bank of Finland calculations.

Italy, Spain and France implementing strongest adjustments

2012

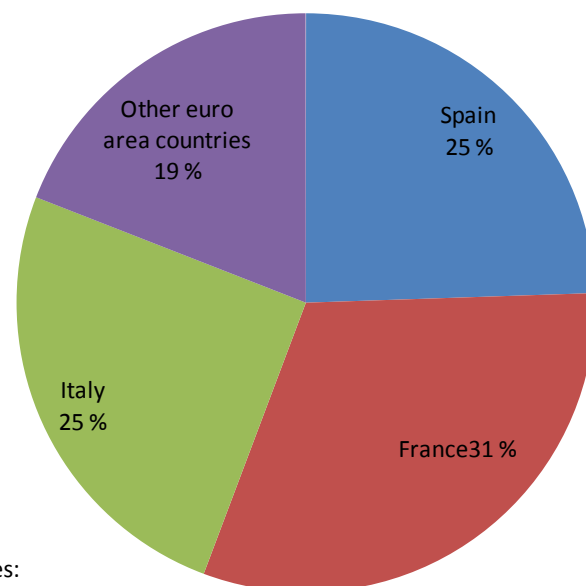
Euro area Fiscal Consolidation - Country Breakdown



Sources:
IMF, European Commission, announcements by countries and Bank of Finland calculations.

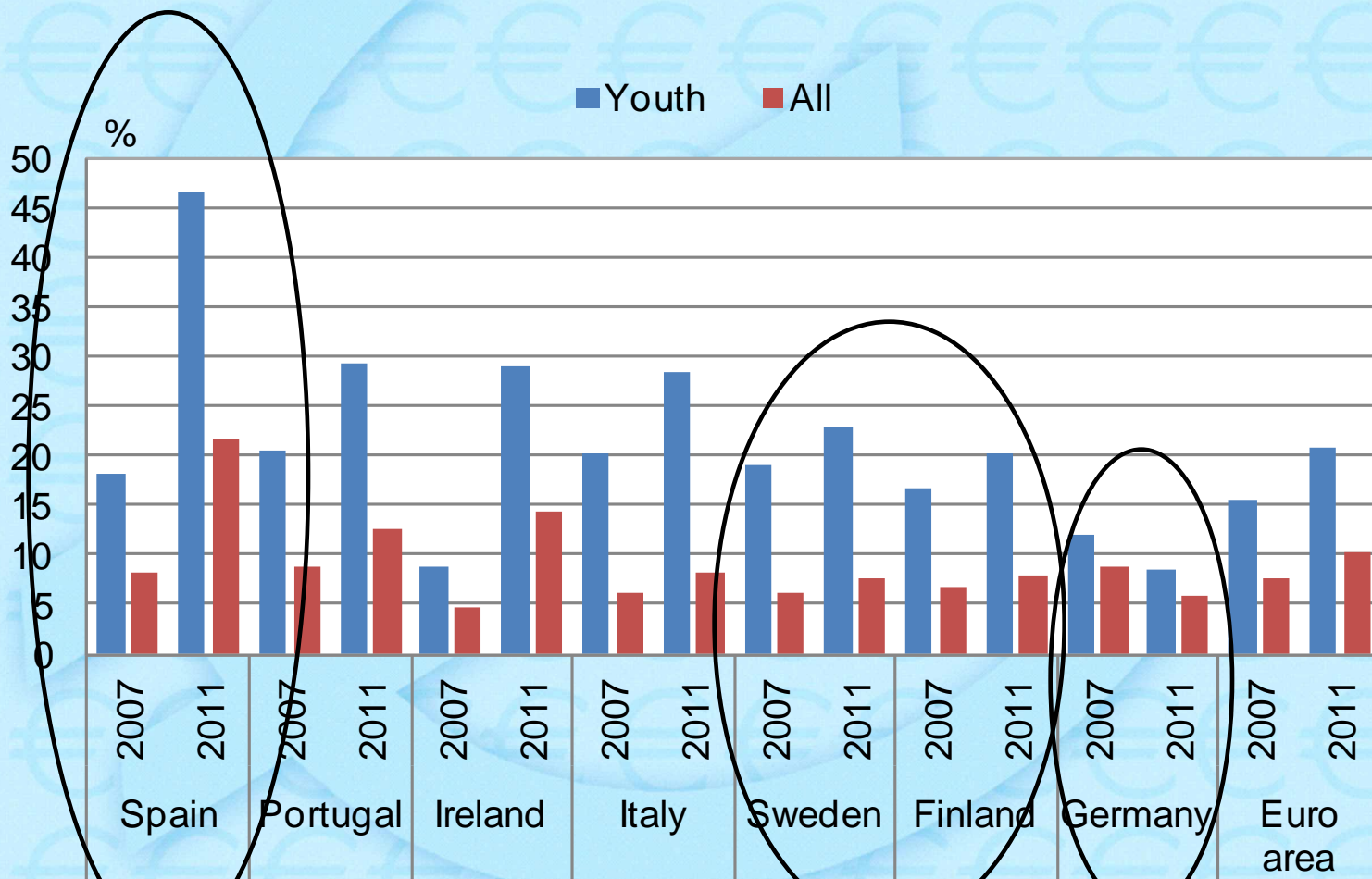
2013

Euro area Fiscal Consolidation - Country Breakdown



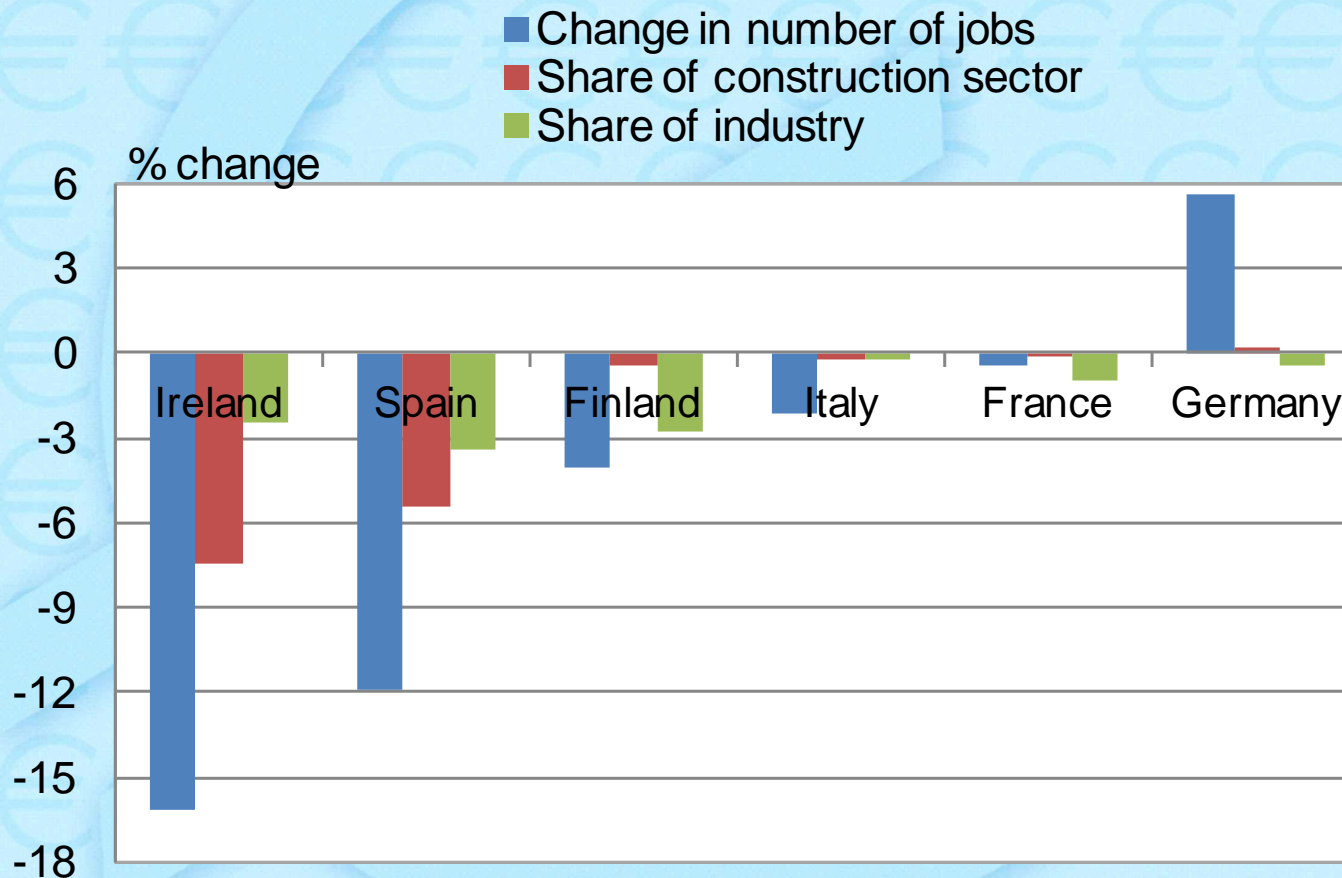
Sources:
IMF, European Commission, announcements by countries and Bank of Finland calculations.

Large differences in youth unemployment by country



Source: Eurostat.

Financial crisis affected different areas in different countries



Change calculated between post 2005 employment peak and employment situation in 2011/Q3.

Source: Eurostat

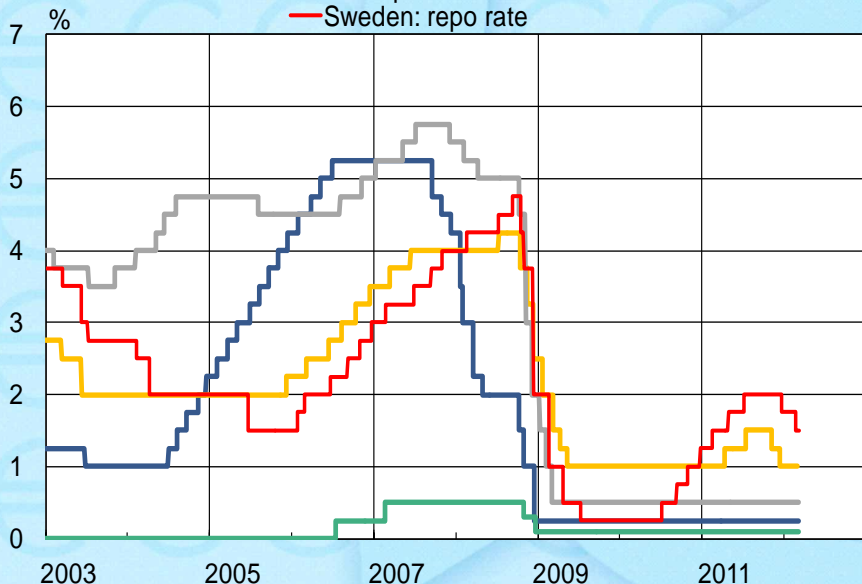


Recent monetary policy measures

Monetary policy globally accommodative

Central bank interest rates

- USA: fed funds target rate
- Japan: over night rate
- Euro system: main refinancing rate*
- UK: repo rate
- Sweden: repo rate

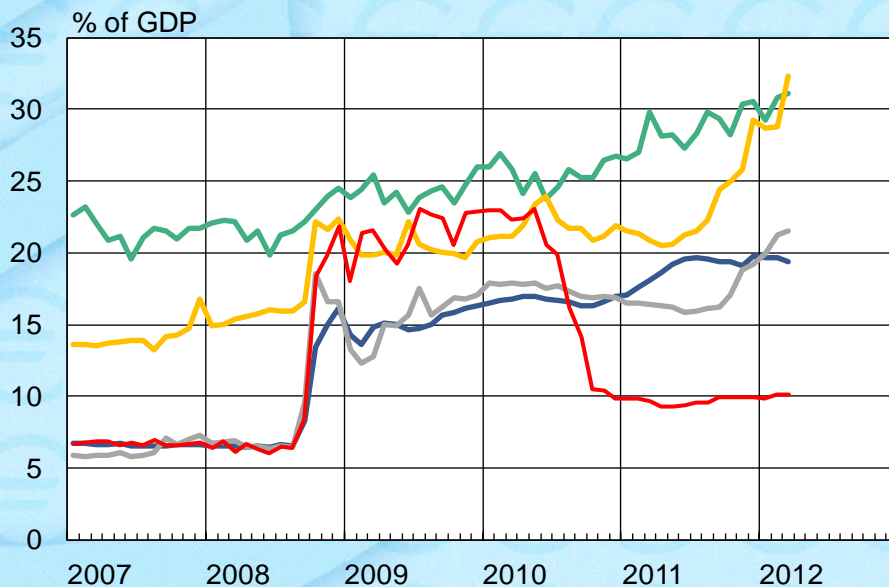


* To 15 Oct 2008, minimum bid rate
Source: Bloomberg.

25200@Keskuspankkikorkoja (er)

Central bank balance sheets

- FED
- BOJ
- ECB
- BOE
- Riksbank



Sources: National statistical authorities, Eurostat ja Bloomberg.

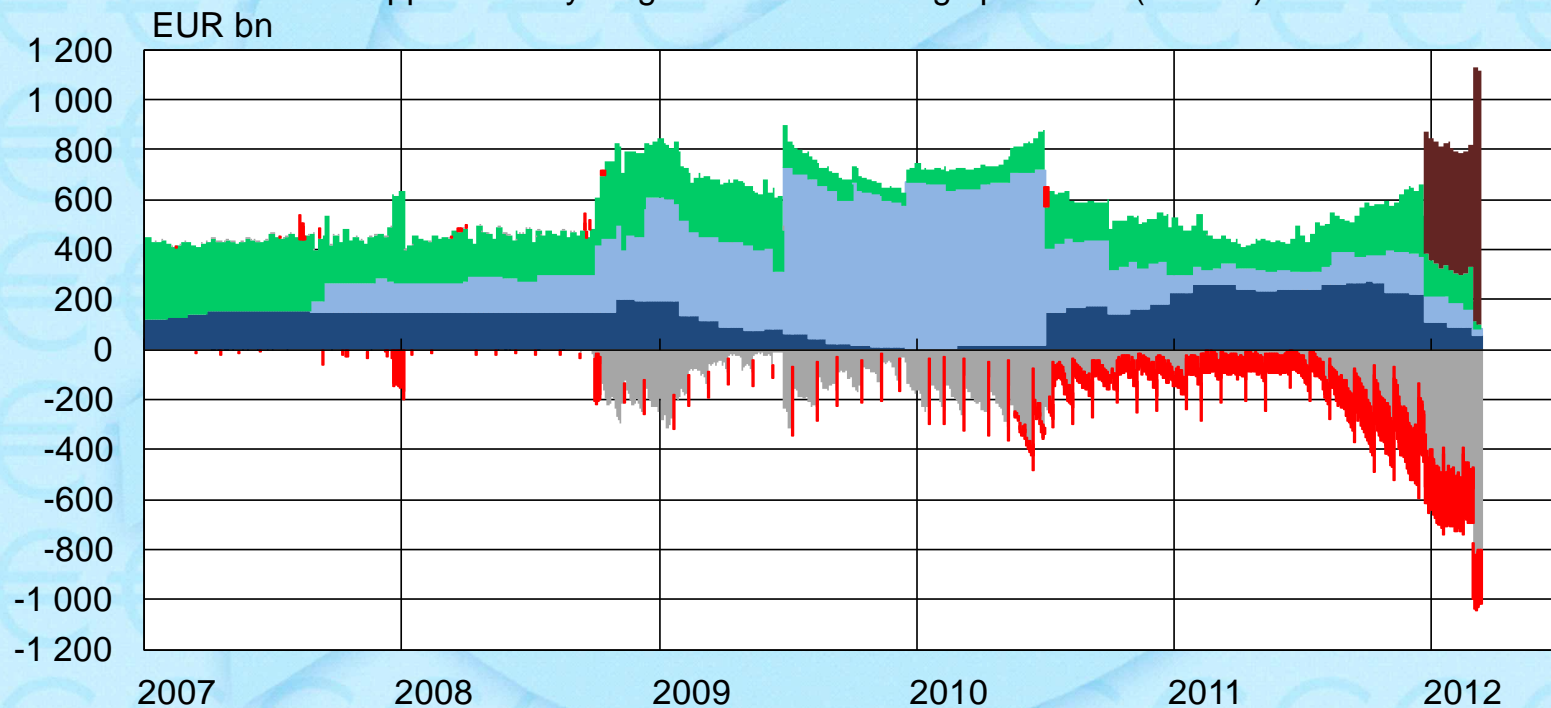
25200@KP_taseet (enET)

On Eurosystem monetary policy

- ◆ Standard monetary policy measures
 - Key interest rates reduced on two occasions to 1%.
- ◆ Non-standard monetary policy measures
 - Three-year longer-term refinancing operations in December and February
 - Expansion of eligible assets
 - Reduction of minimum reserve ratio 2% => 1%
- ◆ Preliminary estimates suggest that measures have been effective

Refinancing operations by maturity

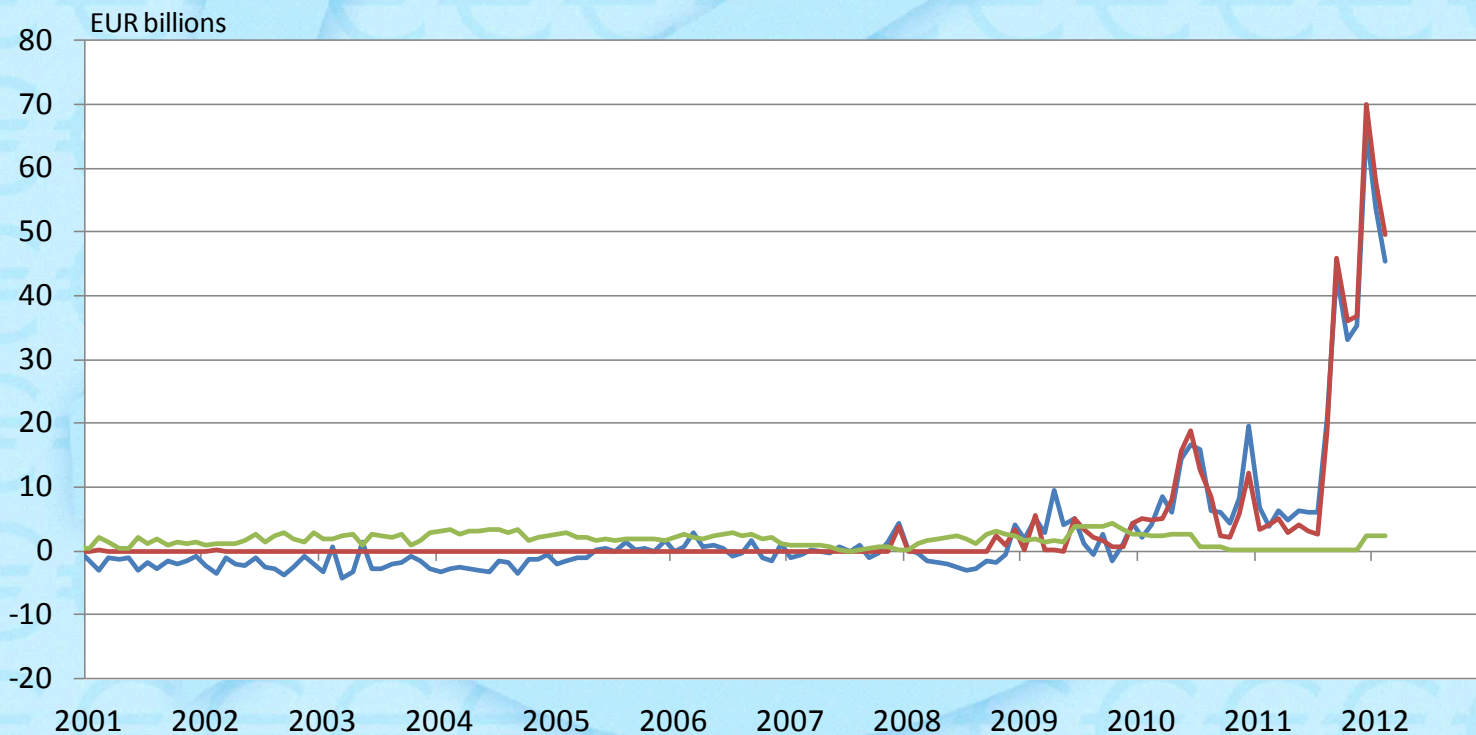
- Longer-term refinancing operations (3 mth)
- Supplementary longer-term refinancing operations (1-12 mth)
- Main refinancing operations (1 week)
- Net recourse to the standing facilities (overnight)
- Fine-tuning operations (1-7 days)
- Supplementary longer-term refinancing operations (36 mth)



Source: Bank of Finland.

Bank of Finland's claims relating to payment systems

- Bank of Finland claims related to Target and correspondent accounts (net)
- Use of deposit facility and fixed-term deposits of banks operating in Finland
- Lending to banks operating in Finland related to monetary policy operations



Source: Bank of Finland.

Operation has eased interbank market tensions

Banking risk indicators

— VSTOXX index (LHS) — iTraxx Europe Finance (RHS)

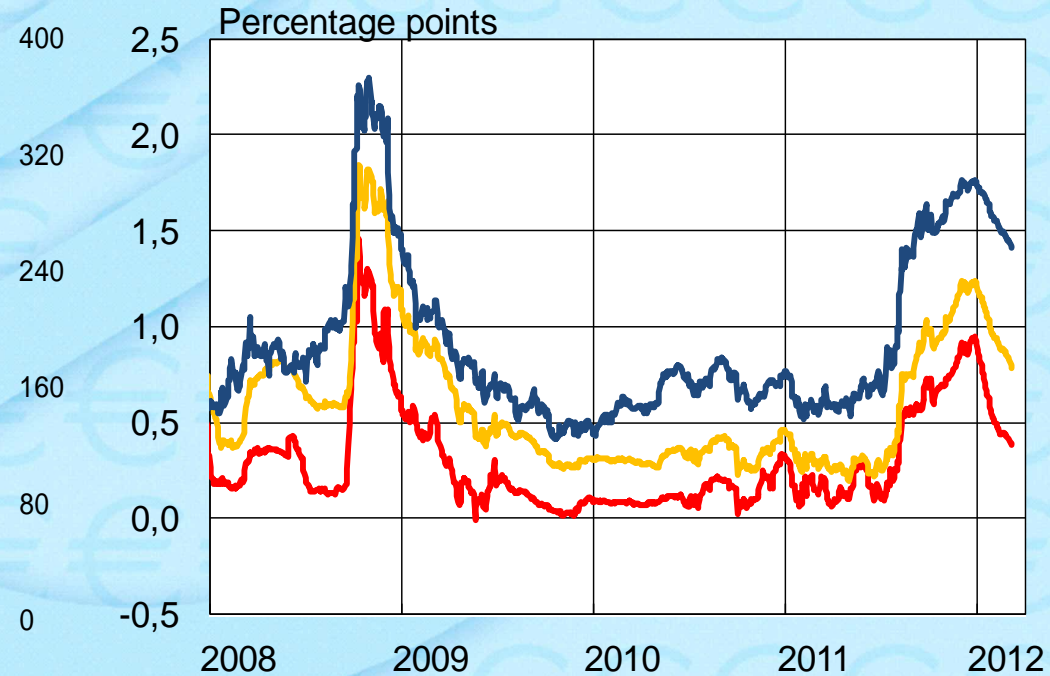


Source: Bloomberg.

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Money market indicators

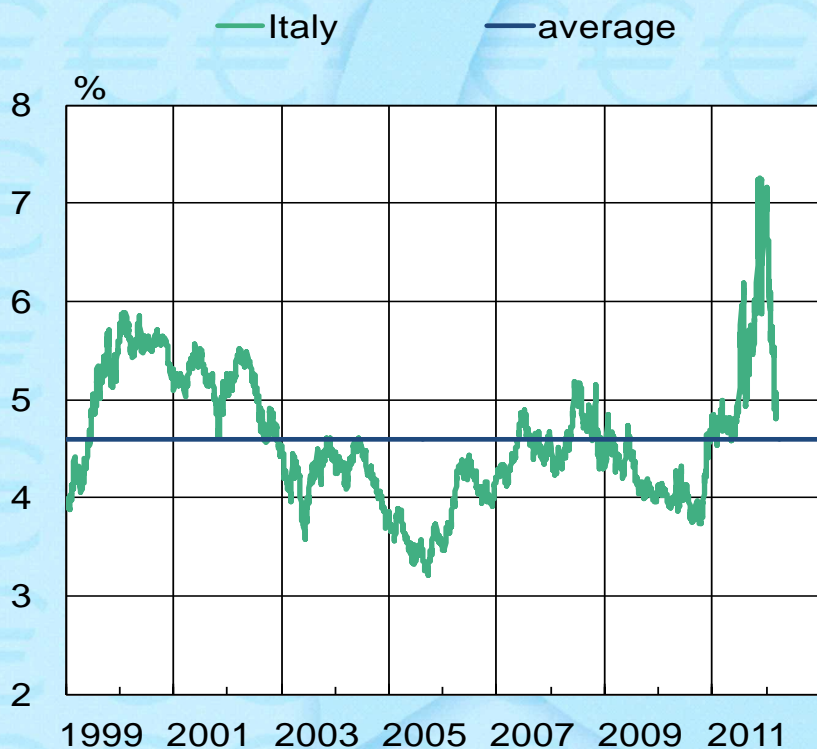
— 1 month — 3 month — 12 month



Source: Bloomberg.

Sovereign risk premia have also decreased

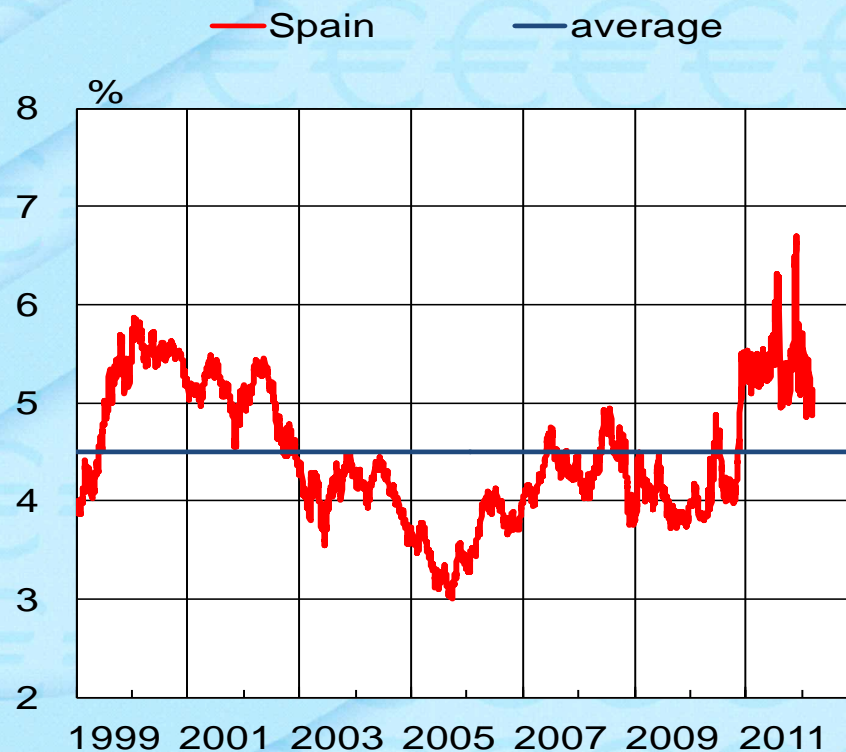
10-year Italian government bonds



Source: Bloomberg.

25200@Italia 10v (en)

10-year Spanish government bonds



Source: Bloomberg.

25200@Espanja 10v (en)

Conclusion

- ◆ **Central bank measures can calm the markets**
 - **Recent measures have ensured bank liquidity**
 - **Operating environment continues to be challenging**
- ◆ **Permanent resolution requires government action**
 - **Countries need to take advantage of the window for opportunities**
 - **Public finances need to be put back on a sustainable footing**
 - **Measures to strengthen growth potential are necessary**
- ◆ **Efficiency of crisis management is assessed ex post**
 - **Timely exit strategies important part of overall action**

Bank of Finland Bulletin 1/2012 contents

- ◆ ***Main article: Monetary policy and the global economy***
 - ***Cyclical situation and risks***
 - ***Monetary and fiscal policy***
 - ***Structural policy and macroeconomic imbalances***
- ◆ ***Additional articles:***
 - ***Monetary policy transmission and debt in the euro area***
 - ***Euro area economic policy coordination: what has been done, and why?***
 - ***Quantitative easing in monetary policy***