



EUROJÄRJESTELMÄ
EUROSISTEMET

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Monetary policy and the global economy

Governor

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Themes

- ◆ ***Transmission of monetary policy in the euro area***
 - ECB Governing Council decided on new measures last week
 - Market responses to the decisions
 - Transmission of monetary policy and condition of the real economy
- ◆ ***Bank of Finland forecast for the global economy***
 - Second half of 2012 muted
 - Global economic growth will remain slow in 2012–2013
 - Risks to the forecast primarily on the downside



*Transmission of monetary policy
in the euro area:
Decisions of the ECB Governing Council*

Decisions of the ECB Governing Council on 6 September

- ◆ ***Governing Council decides to keep key interest rates unchanged***
 - Interest rate on main refinancing operations 0.75%, standing facilities corridor 0%–1.50%
 - Policy rates are in line with price stability
- ◆ ***Decision on a new programme: Outright Monetary Transactions (OMTs)***
 - An appropriate monetary policy transmission and the singleness of the monetary policy
 - Conditionality: EFSF/ESM programme
 - After this, the Governing Council's decision in full discretion
 - Target: purchases of programme countries' short-term government bonds (≤ 3 years)

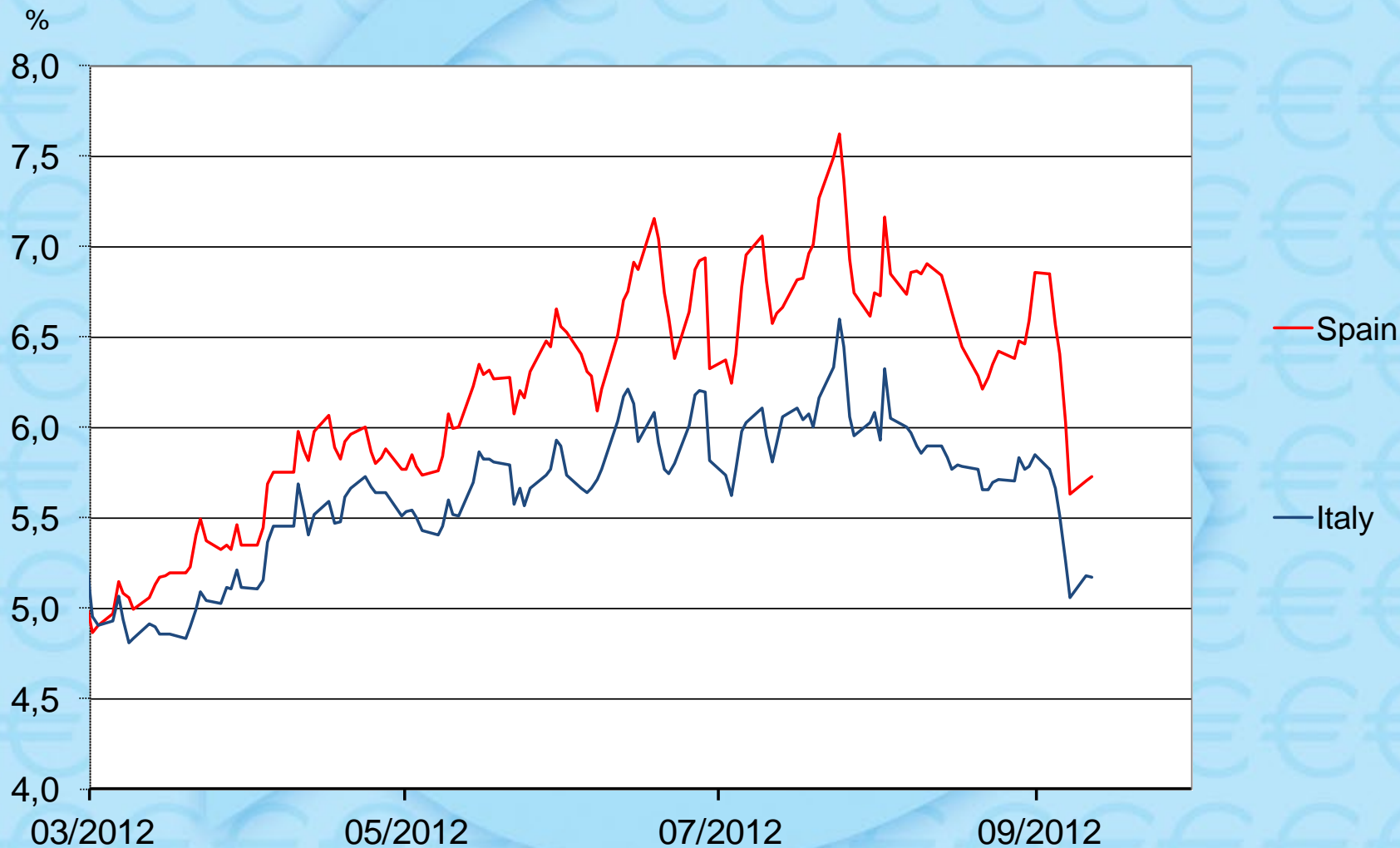
What do the decisions mean?

- ◆ ***The programme is European in nature***
 - Not for some countries against others
 - Applicable to all euro area countries, if necessary
 - The programme is in line with the ECB's price stability mandate
- ◆ ***Purchases concentrate on short-term instruments***
 - Particularly government bonds, maturity 1–3 years
 - Close to traditional monetary policy
 - Short maturities also ease risk management



*Transmission of monetary policy
in the euro area:
Market responses to the decisions*

Yields on Spanish and Italian 10 year government bonds



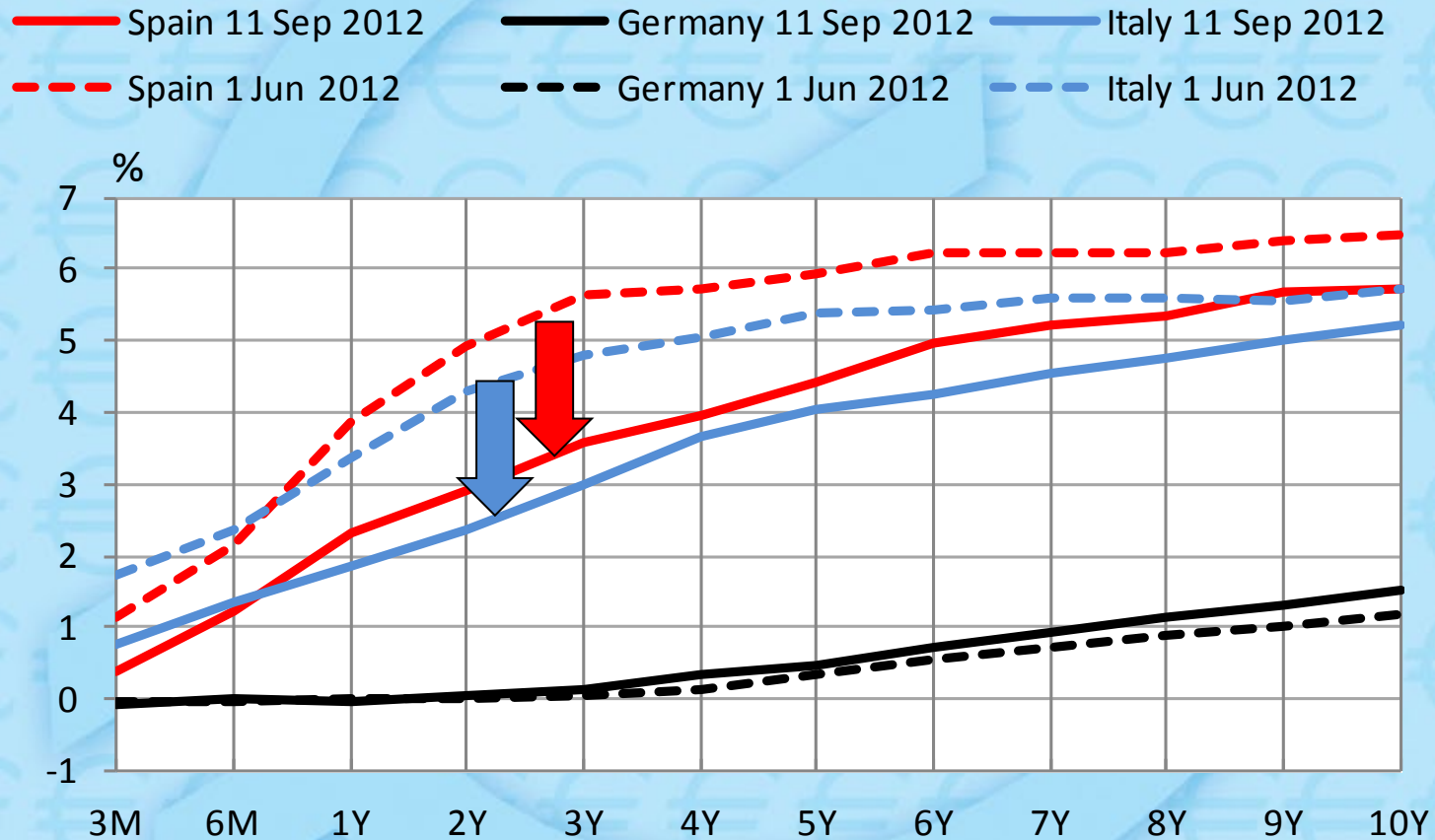
source: Bloomberg.

Spread between highest rated 10-year government bonds and Germany



Source: Bloomberg

Spanish and Italian yield curves



Source: Bloomberg

Stock markets



Source: Bloomberg.

26339@Pörssi-indikaattoreita (en)

Sovereign and banks' credit risk go hand in hand

Spain

— 5y sovereign CDS
— av. 5y CDS of some largest banks

%-points



Italy

— 5y sovereign CDS
— av. 5y CDS of some largest banks

%-points



Source: Bloomberg and Bank of Finland calculations



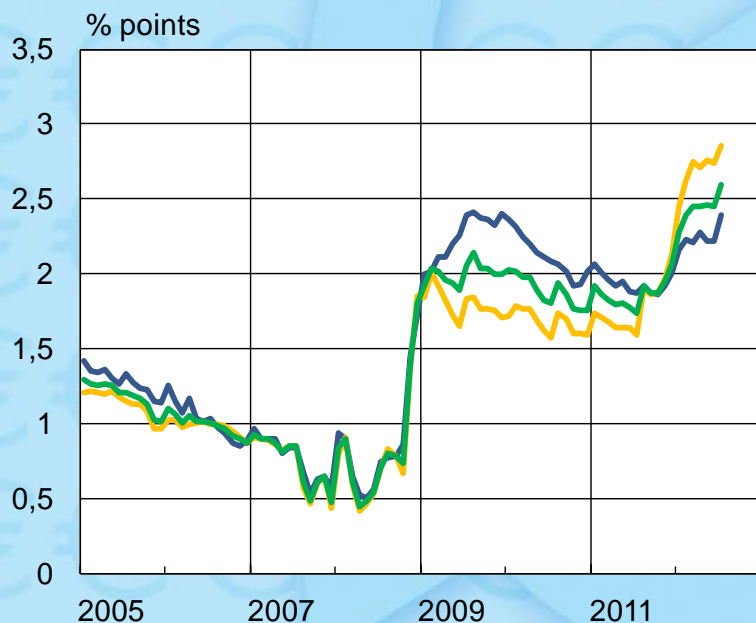
*Monetary policy transmission in the euro area:
Financial intermediation and the real economy*

Interest rate differentials transmitted to the credit market

Housing loans

Difference between new housing loans*** and 3-month Euribor

— High-rated countries* — GIIPS** — Euro area

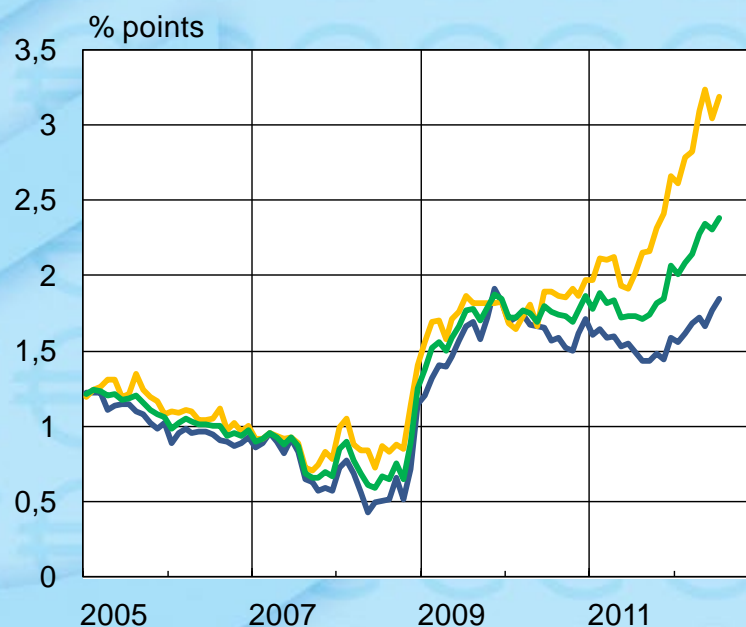


* Germany, France, the Netherlands, Belgium, Austria and Finland.
 ** Spain, Italy, Greece, Portugal ja Ireland.
 *** Variable interest housing loans linked to reference rates with a rate fixation period of at most 1 year.
 Sources: ECB and Bank of Finland calculations.

Corporate loans

Difference between new corporate loans and 3-month Euribor

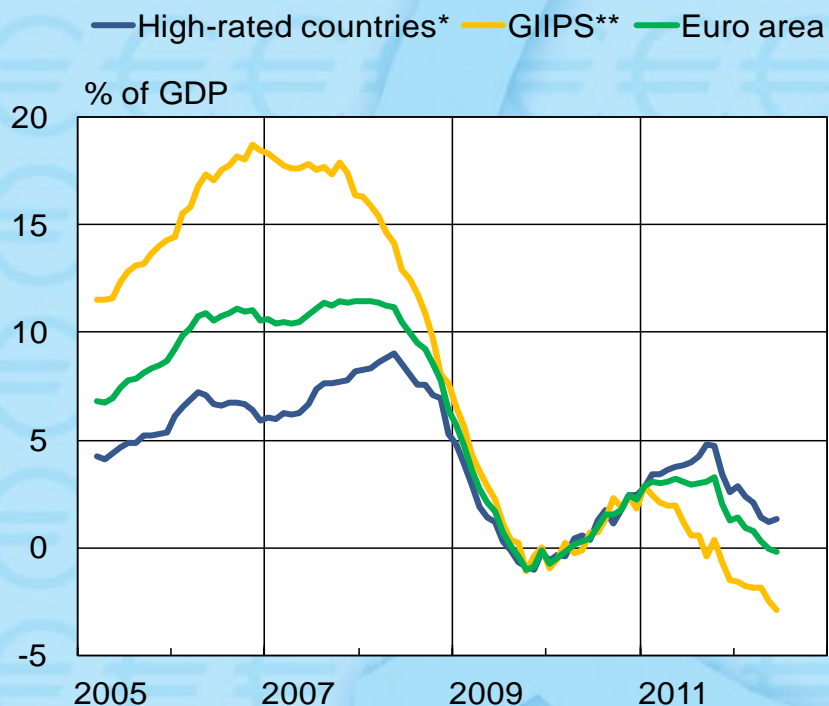
— High-rated countries* — GIIPS** — Euro area



* Germany, France, the Netherlands, Belgium, Austria and Finland.
 ** Spain, Italy, Greece, Portugal ja Ireland.
 Sources: ECB and Bank of Finland calculations.

Shrinking deposit and lending stocks in GIIPS countries

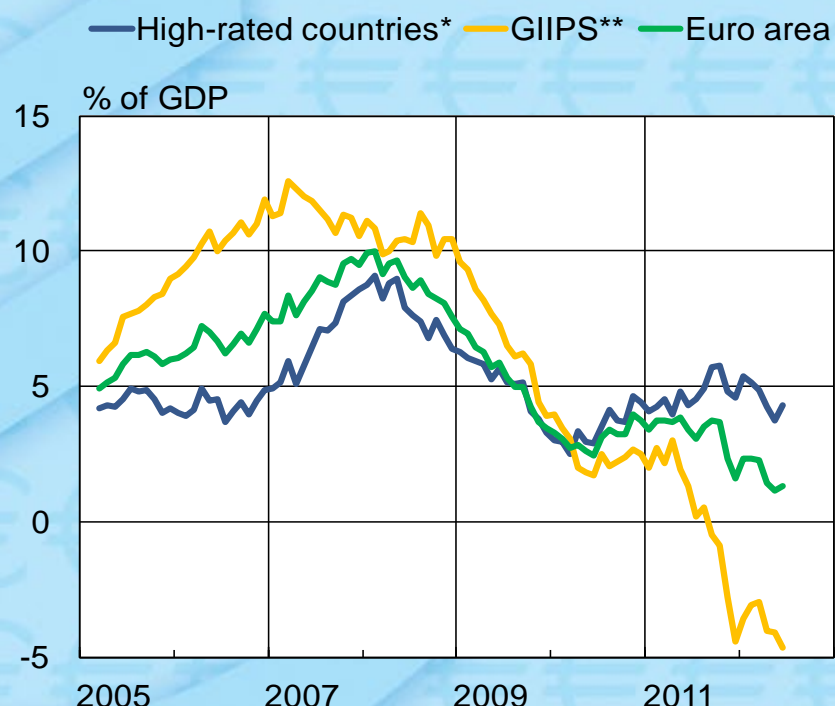
Loans to non-MFIs



* Germany, France, the Netherlands, Belgium, Austria and Finland.
** Spain, Italy, Greece, Portugal ja Ireland.

Sources: ECB and Bank of Finland calculations.

Deposits by non-MFIs



* Germany, France, the Netherlands, Belgium, Austria and Finland.
** Spain, Italy, Greece, Portugal ja Ireland.

Sources: ECB and Bank of Finland calculations.

Progress of euro area adjustment: Competitiveness and indebtedness

Unit labour costs

Wages/hour Productivity/hour Unit labour costs

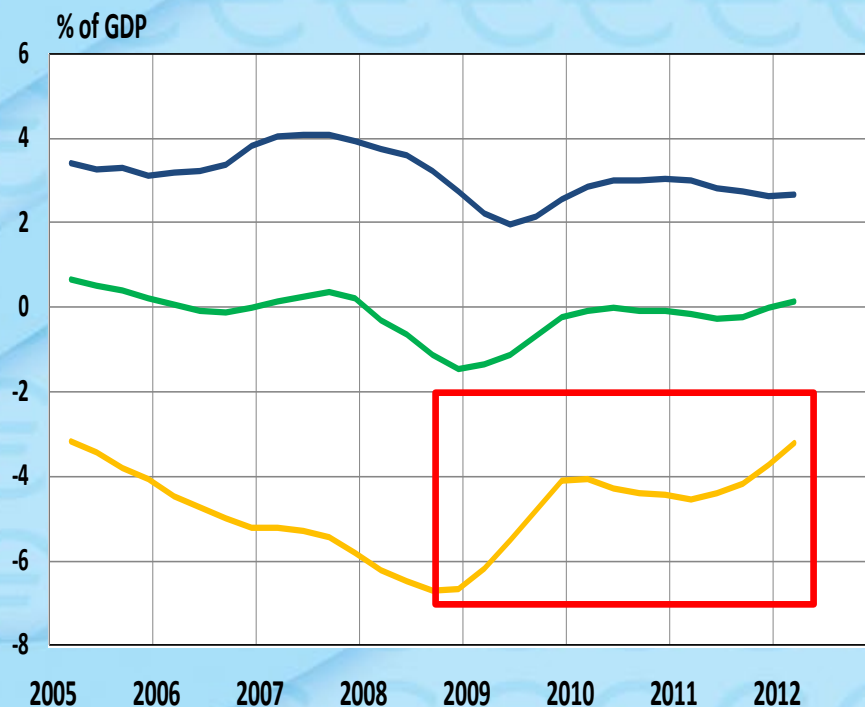
% change 2009 Q1 - 2012 Q1



Source: Eurostat.

Current account

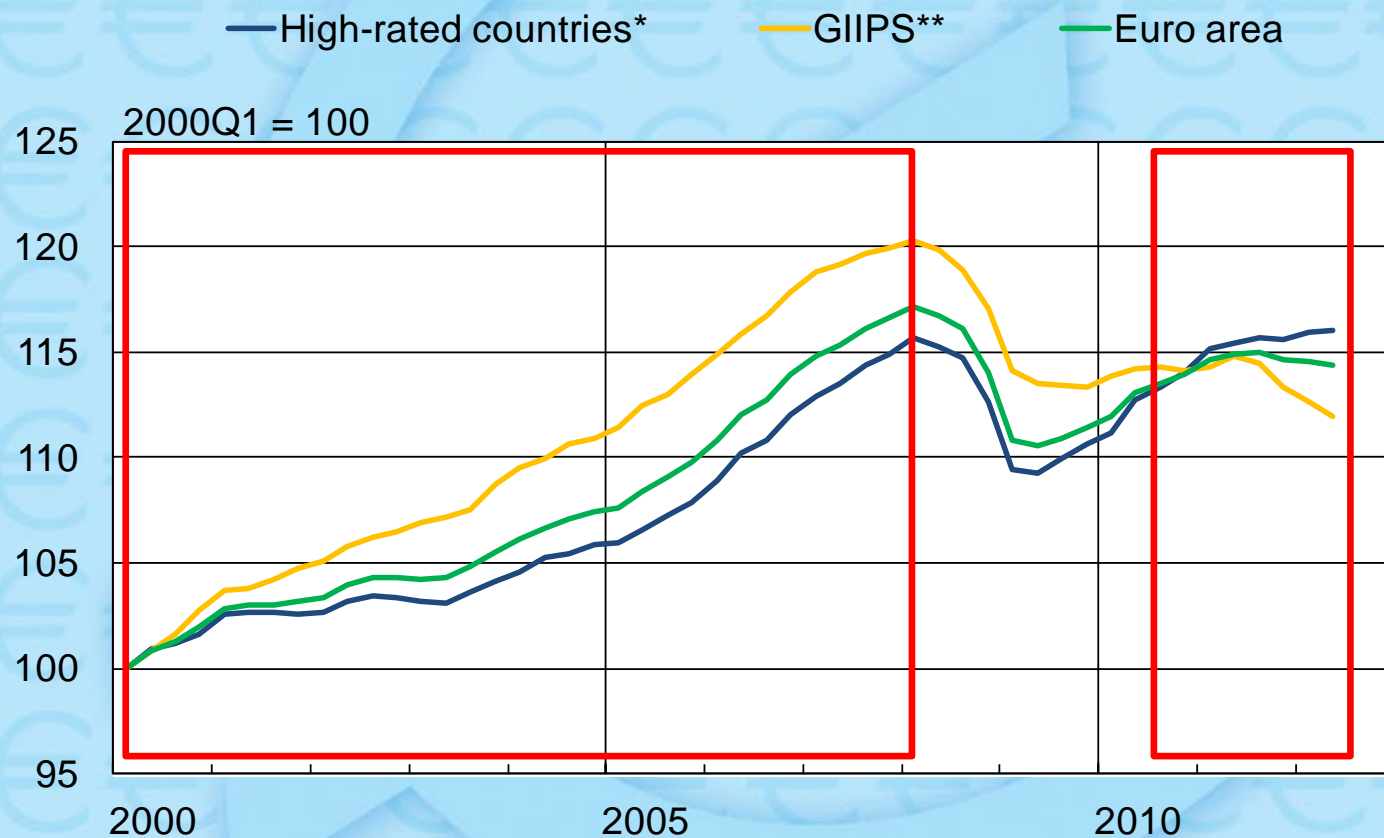
High-rated countries* GIIPS* Euro area



Sources: ECB, Eurostat and Macrobond.

* Sum of countries' current accounts.

Major differences remain, turnaround still far away GDP



*Germany, France, the Netherlands, Belgium, Austria and Finland.

** Greece (11-12 estimate), Ireland, Italy, Portugal and Spain.

Sources: Eurostat and Bank of Finland calculation.

What has improved since the spring?
Clear division of crisis management duties

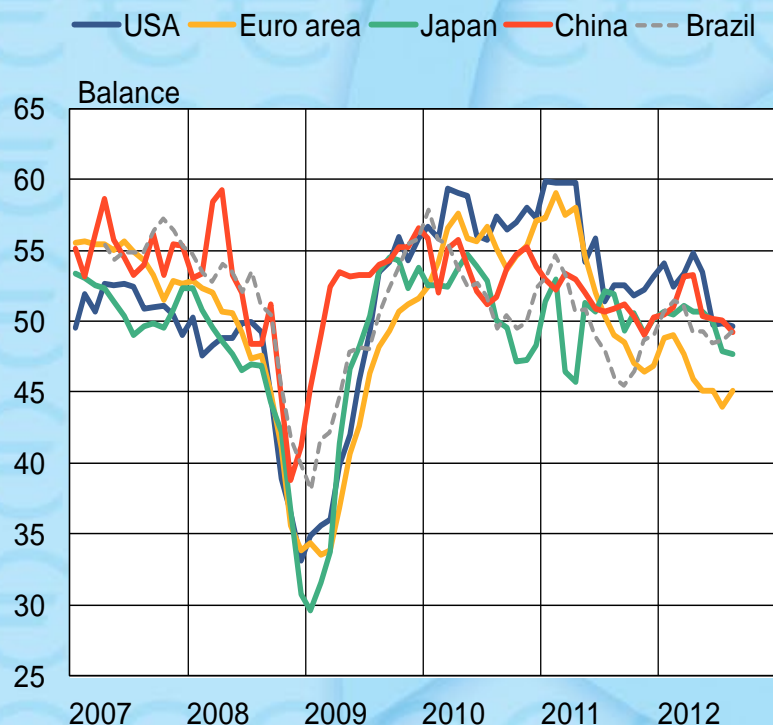
- ◆ ***Crisis countries' own measures***
 - Correction of structural distortions in the economy
- ◆ ***EU/IMF measures***
 - Programmes, conditionality, safeguarding of bridge financing
- ◆ ***ECB measures***
 - Safeguarding the operation of markets
 - Decisions of 6 September 2012
- ◆ ***All three measures and clear division of duties essential***



Forecast for the global economy

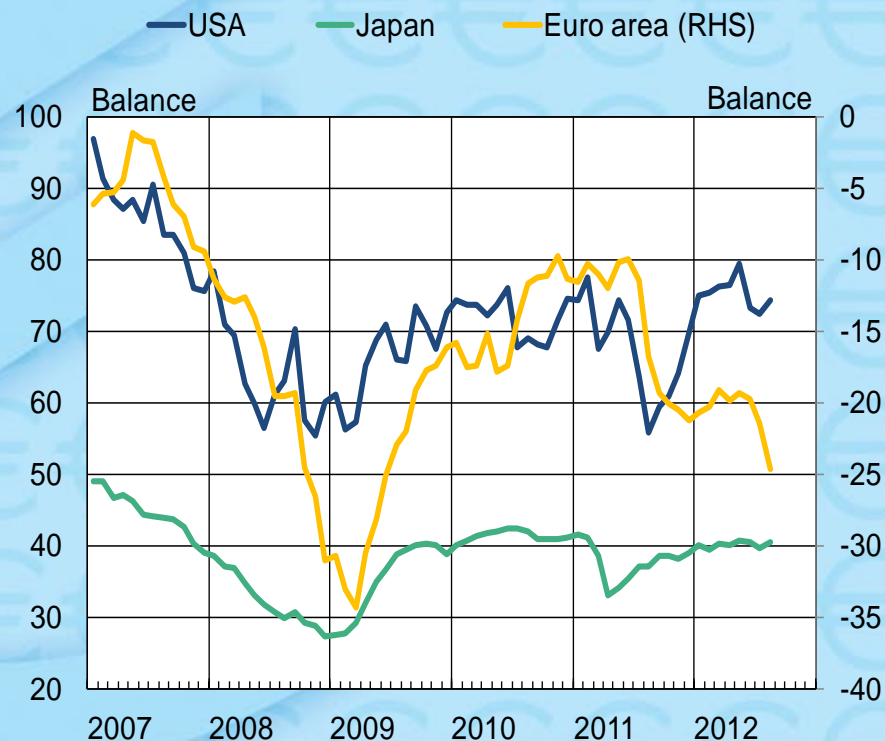
Industrial and consumer confidence at low levels

Purchase managers' indices



Source: Bloomberg.
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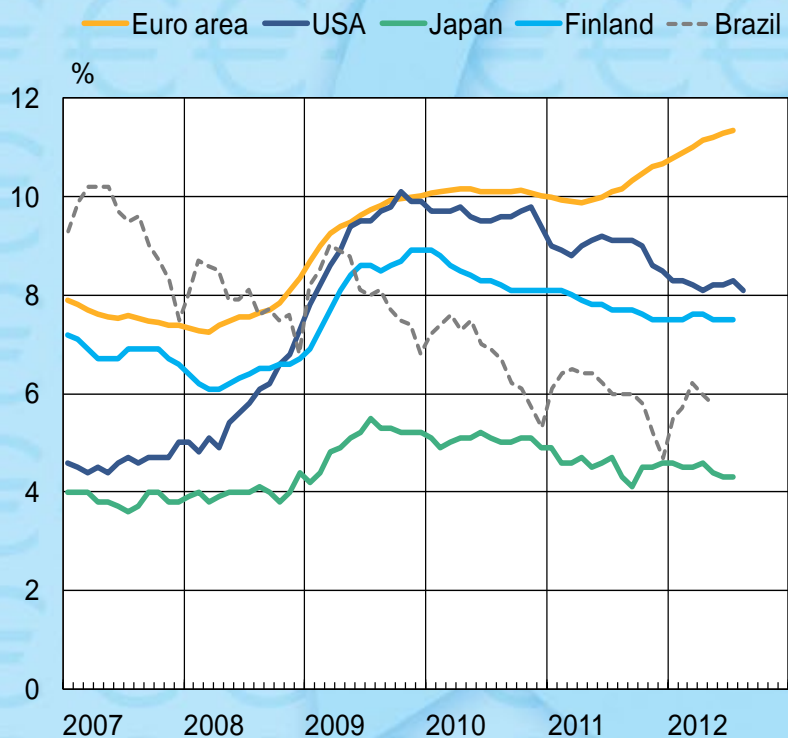
Consumer confidence



Sources: European Commission and Bloomberg.
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Unemployment on the increase, especially in euro area

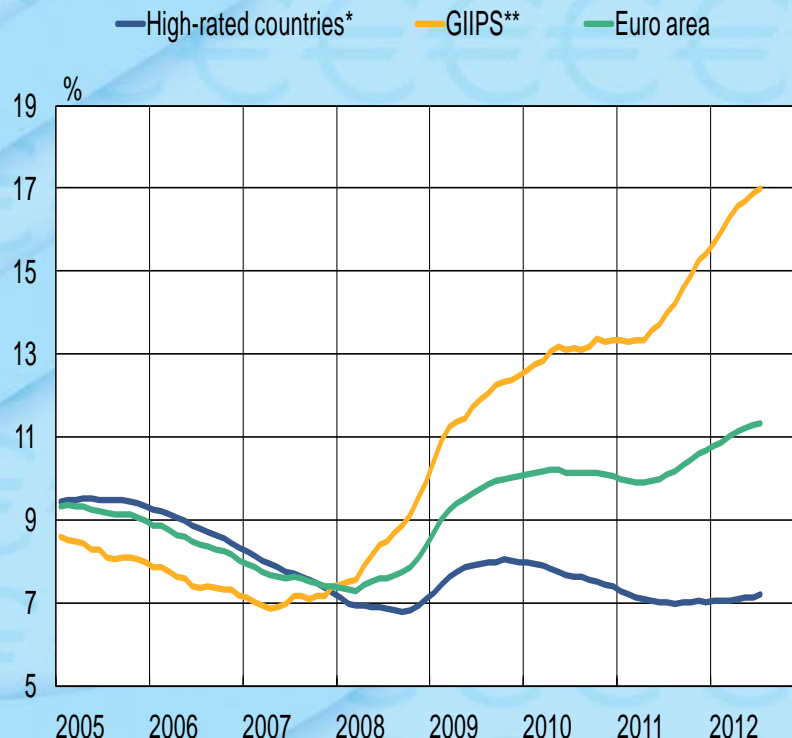
Main economic regions



Sources: BLS, Eurostat, Bloomberg and Statistics Finland.

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Euro area, specified



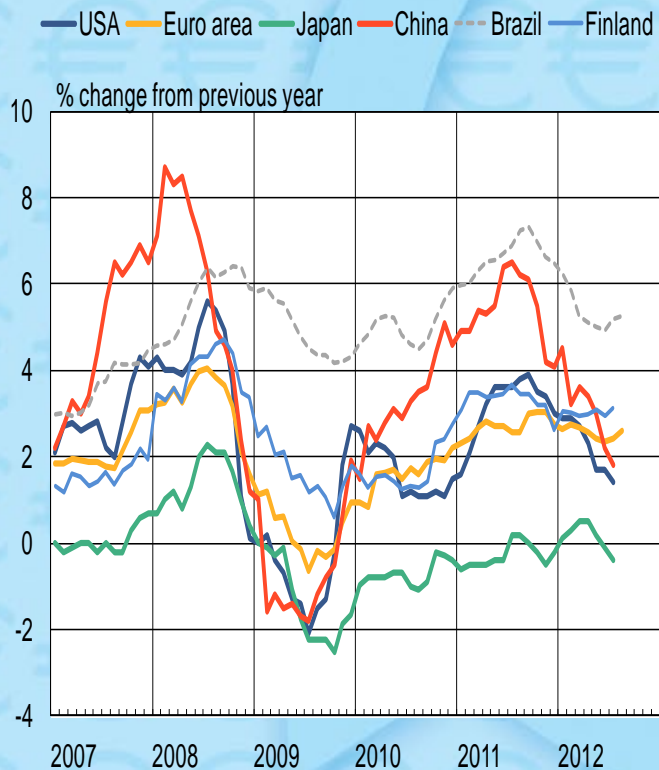
* Germany, France, the Netherlands, Belgium, Austria and Finland.

** Spain, Italy, Greece, Portugal and Ireland.

Sources: ECB and Bank of Finland calculations.

Inflation and commodity prices

Consumer price inflation



Source: National statistical authorities.

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Commodity prices



Sources: Bloomberg and HWWI.

Bank of Finland forecast assumptions

- ◆ ***Financial crisis can be brought under control with adequate policy measures***
 - At national level: fiscal consolidation and structural measures
 - At EU level: EFSF/ESM (programmes) and bank packages
 - Eurosystem measures conditional on implementing the above
 - ◆ ***Austerity measures weaken growth over the short term***
 - Increasing confidence will lower the general level of interest rates
 - Slow adjustment of debt and competitiveness in crisis countries
 - Growth outside crisis countries will pick up more quickly
- ⇒ *Uncertainty is set to prevail for a long time***

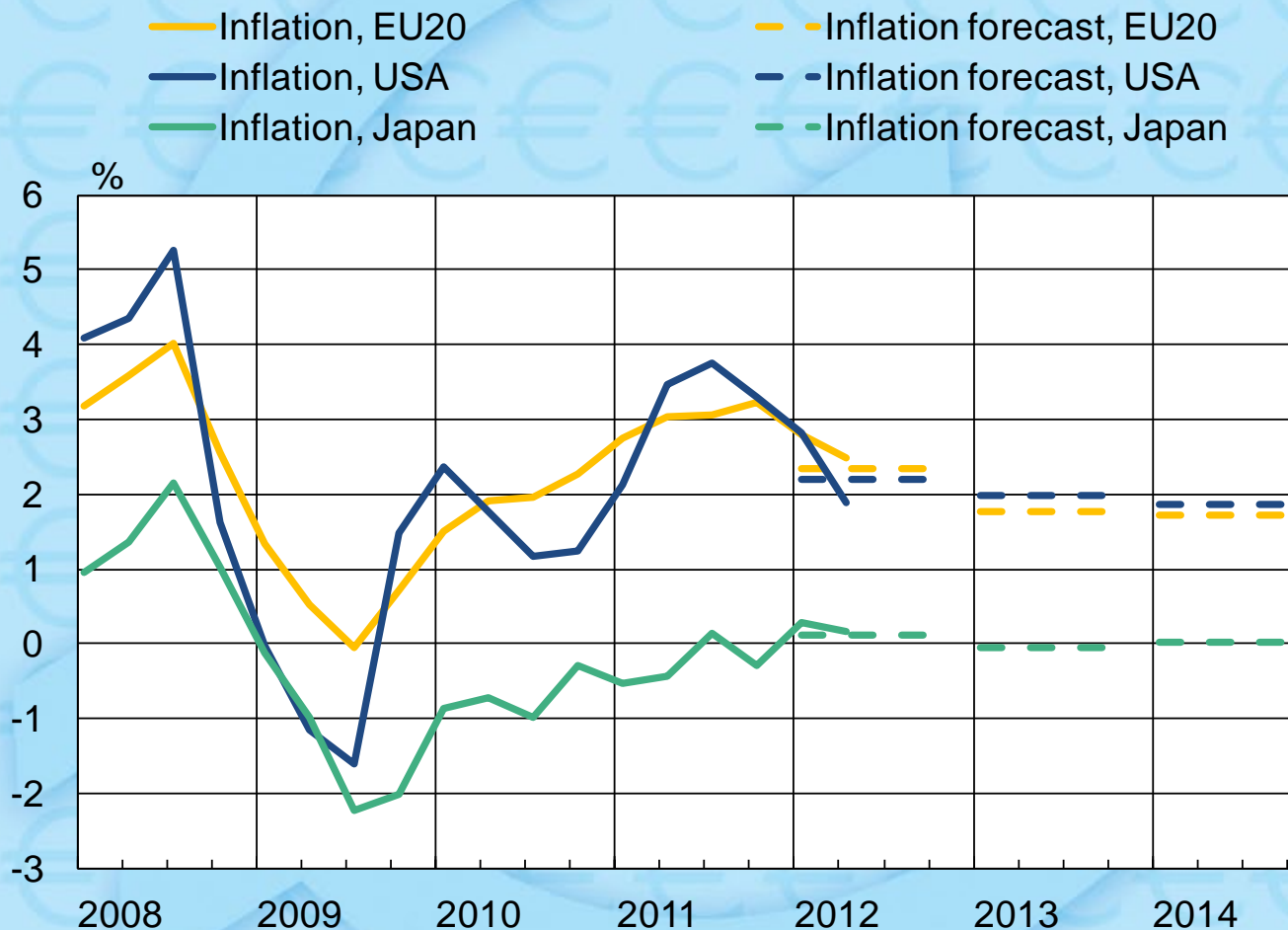
Main outcomes of the Bank of Finland forecast: GDP and world trade

% change on previous year (previous forecast in brackets)

GDP	2011	2012f	2013f	2014f
United States	1.8	2.2 (2.3)	2.2 (2.6)	2.6 (2.5)
EU20	1.4	-0.4 (-0.2)	0.4 (1.0)	1.4 (1.6)
Japan	-0.7	2.5 (1.4)	0.6 (1.5)	1.1 (1.7)
Non-Japan Asia	7.7	6.3 (6.6)	6.6 (7.2)	6.3 (6.8)
World	3.9	3.2 (3.2)	3.5 (3.9)	3.7 (3.9)
World trade	6.2	3.1 (3.5)	4.8 (5.8)	6.0 (6.3)

EU20 = Euro area, Sweden, Denmark and United Kingdom

Main outcomes of the Bank of Finland forecast: inflation



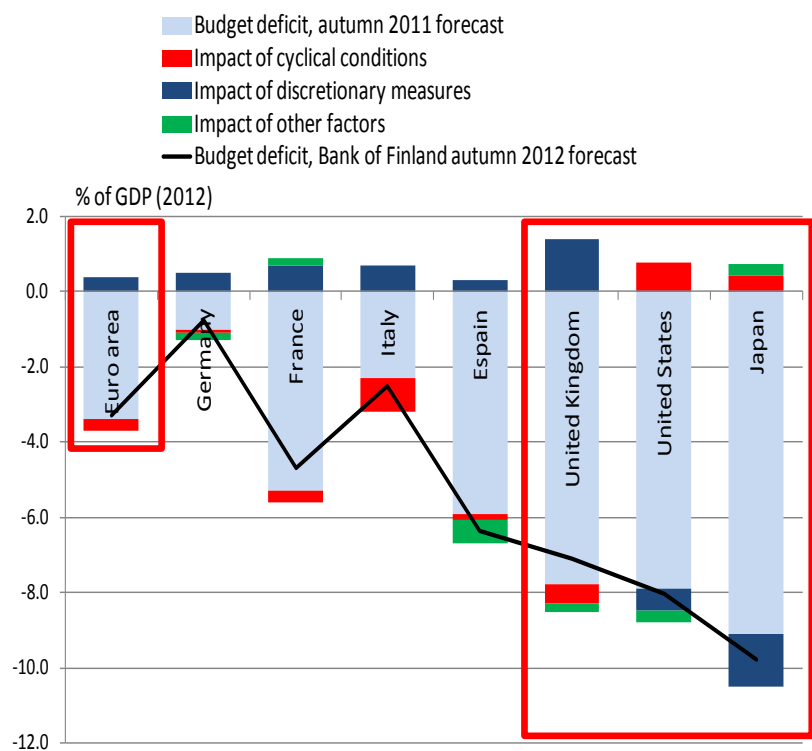
Sources: National statistical authorities and Bank of Finland calculations.

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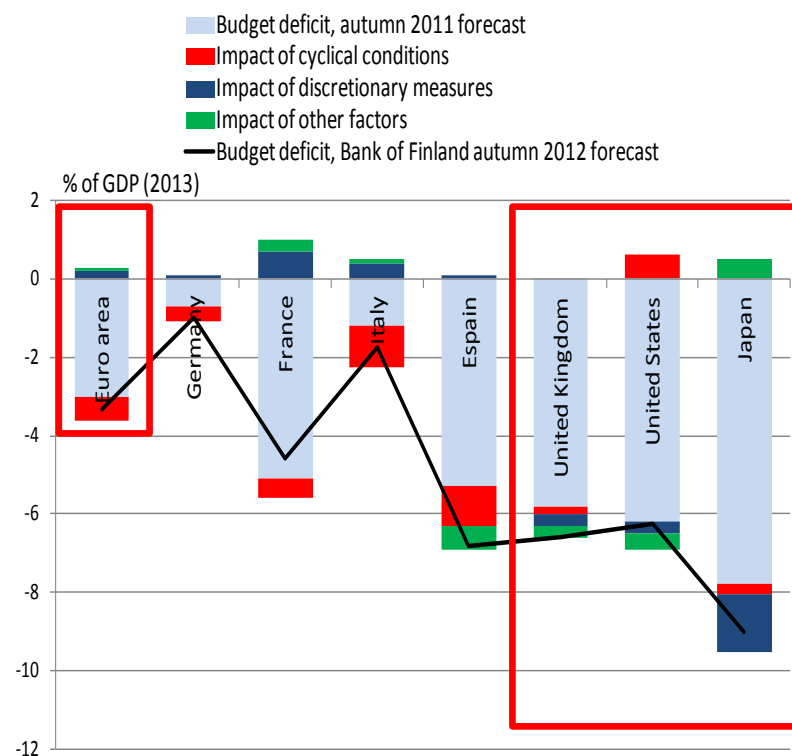
General government deficits cannot be corrected without further measures

2012

2013



Sources: European Commission projections and calculations by Bank of Finland.



Sources: European Commission projections and calculations by Bank of Finland.

Risks mainly on the downside

◆ **Main downside risks relate to the euro area situation**

- Measures turn out to be inadequate (data, decisions, implementation)
- Growth expectations critical for credible debt sustainability
- Failure in breaking the vicious circle

◆ **Fiscal risks also significant in the United States**

- Positive forecast assumption: no shock adjustment from the beginning of 2013
- In the absence of agreement on adjustment, fiscal policy would be tightened abruptly
- A halt in US economic growth would have wide spillover effects

There are also upside risks

◆ ***Confidence may improve faster than assumed***

- A clear division of crisis management duties to solve the debt problem
- Credibility would be restored more quickly than in the baseline
- Interest rates would decline more rapidly
- Adjustment measures easier to carry out in a more favourable growth environment

◆ ***Positive signs in the US economy***

- The worst phase of private-sector adjustment could be over
- Abundant pent-up demand in the housing market
- Rising asset prices could trigger a virtuous circle