



EUROJÄRJESTELMÄ
EUROSYSTEMET

Economic outlook for 2012–2014

Euro & talous (Bank of Finland Bulletin) 5/2012

Governor
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Signals from international economy point in two directions

Financial market situation improved since the summer...

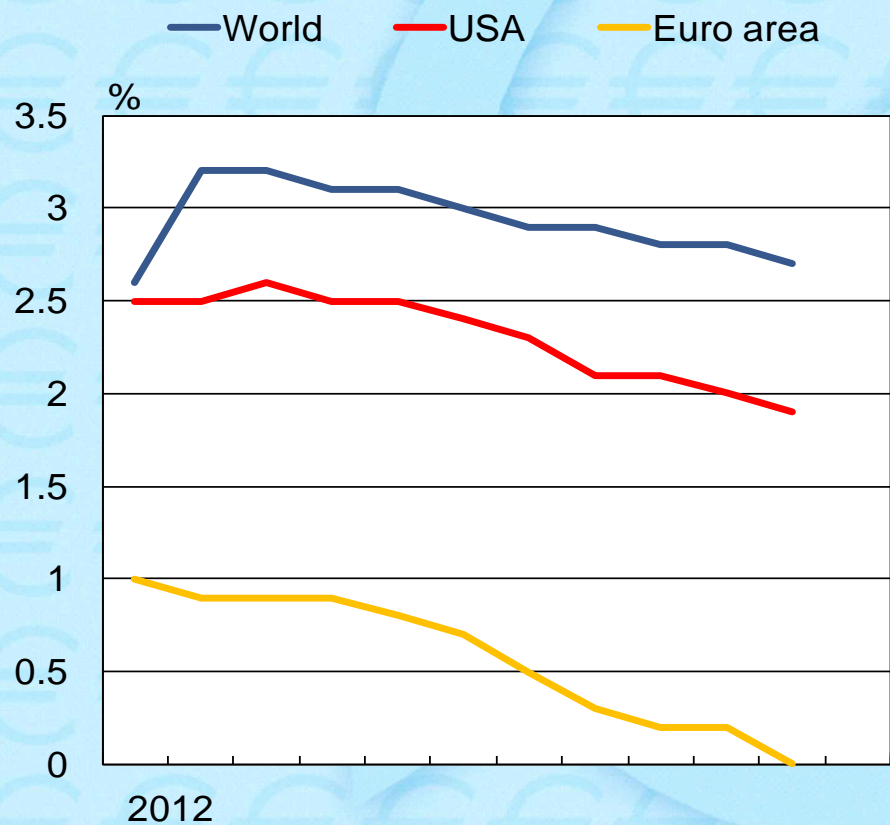
Stock prices



Source: Bloomberg.

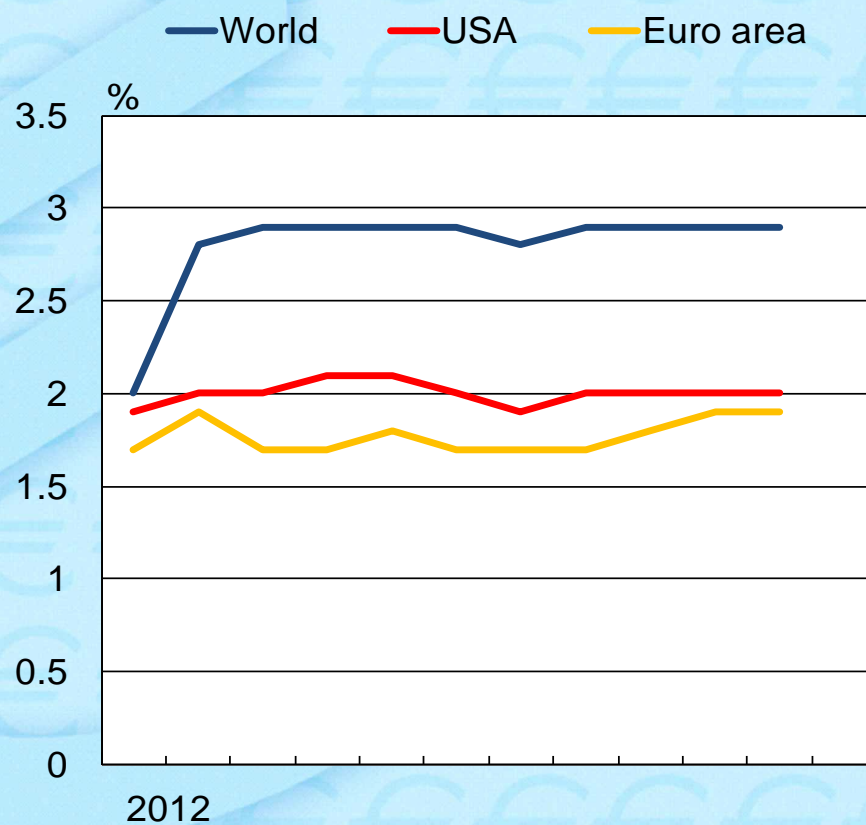
...but growth forecasts revised downwards during the course of the year

GDP forecasts for 2013



Source: Consensus Economics.

Inflation forecasts for 2013



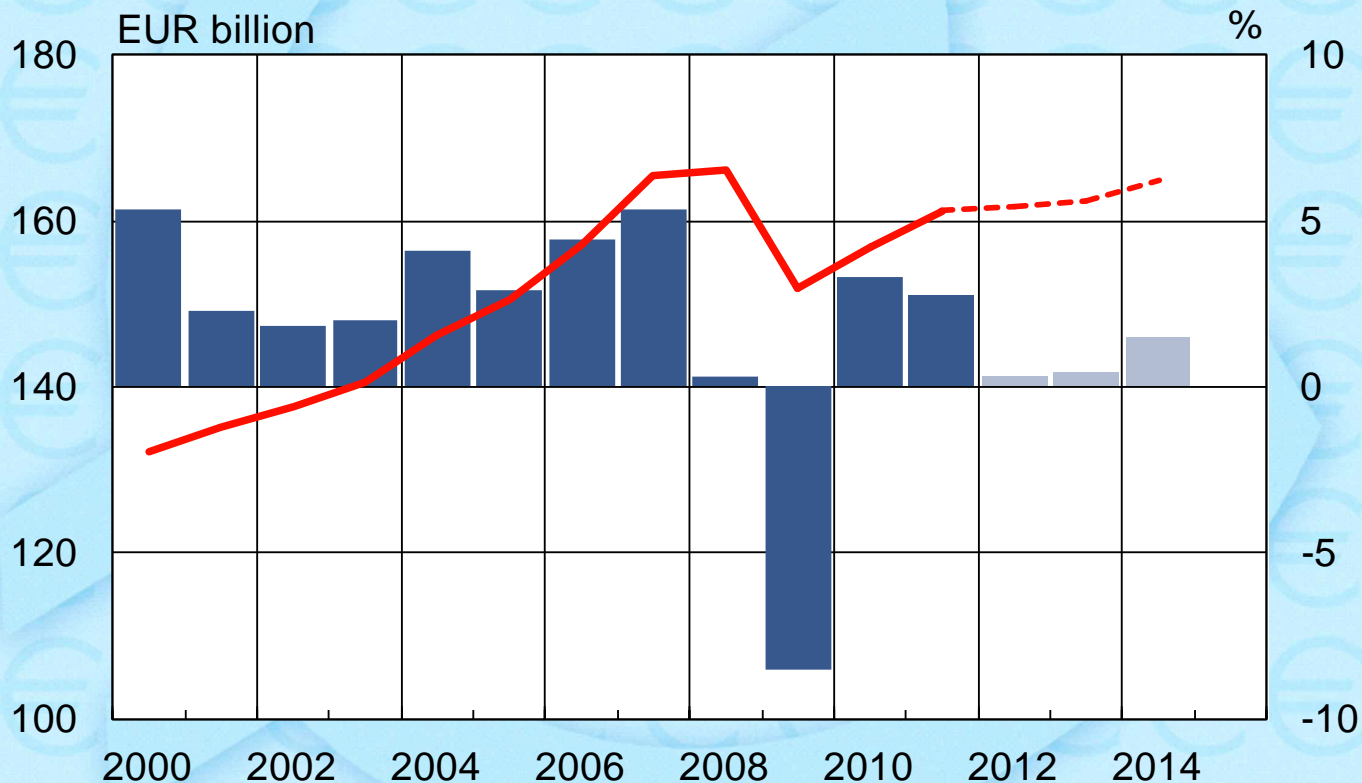
Source: Consensus Economics.



Growth outlook for Finland also weakened

Finland's economic growth very weak

- GDP: % change on previous year (right-hand scale)
- GDP at reference year (2000) prices (left-hand scale)



Sources: Statistics Finland and Bank of Finland.

Supply and demand

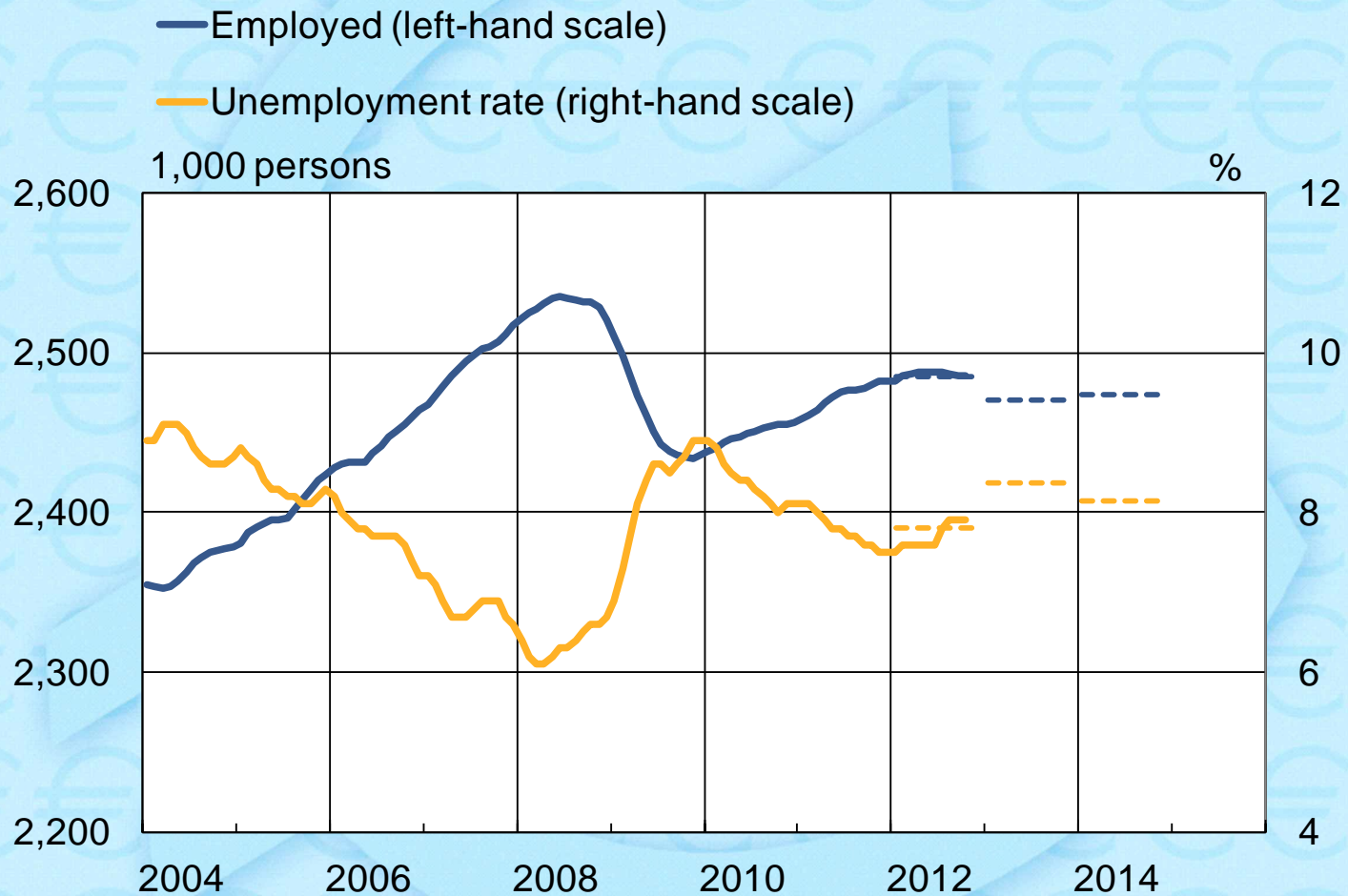
	2011*	2010	2011	2012e	2013e	2014e
	EUR billion	Volume, % change on previous year				
GDP	189,4	3,3	2,7	0,3	0,4	1,5
June forecast			2,9	1,5	1,2	1,6
Change			-0,2	-1,2	-0,8	-0,1
Imports	78,3	6,9	5,7	-1,2	1,0	4,2
Exports	77,1	7,5	2,6	-1,9	1,3	4,3
Private consumption	105,2	3,3	2,5	0,7	-0,1	1,2
Public consumption	46,0	-0,3	0,4	-0,3	1,0	0,6
Private investment	32,4	3,5	7,7	-0,9	0,4	3,5
Public investment	4,6	-7,7	0,6	0,4	0,5	1,3

* At current prices, EUR billion.



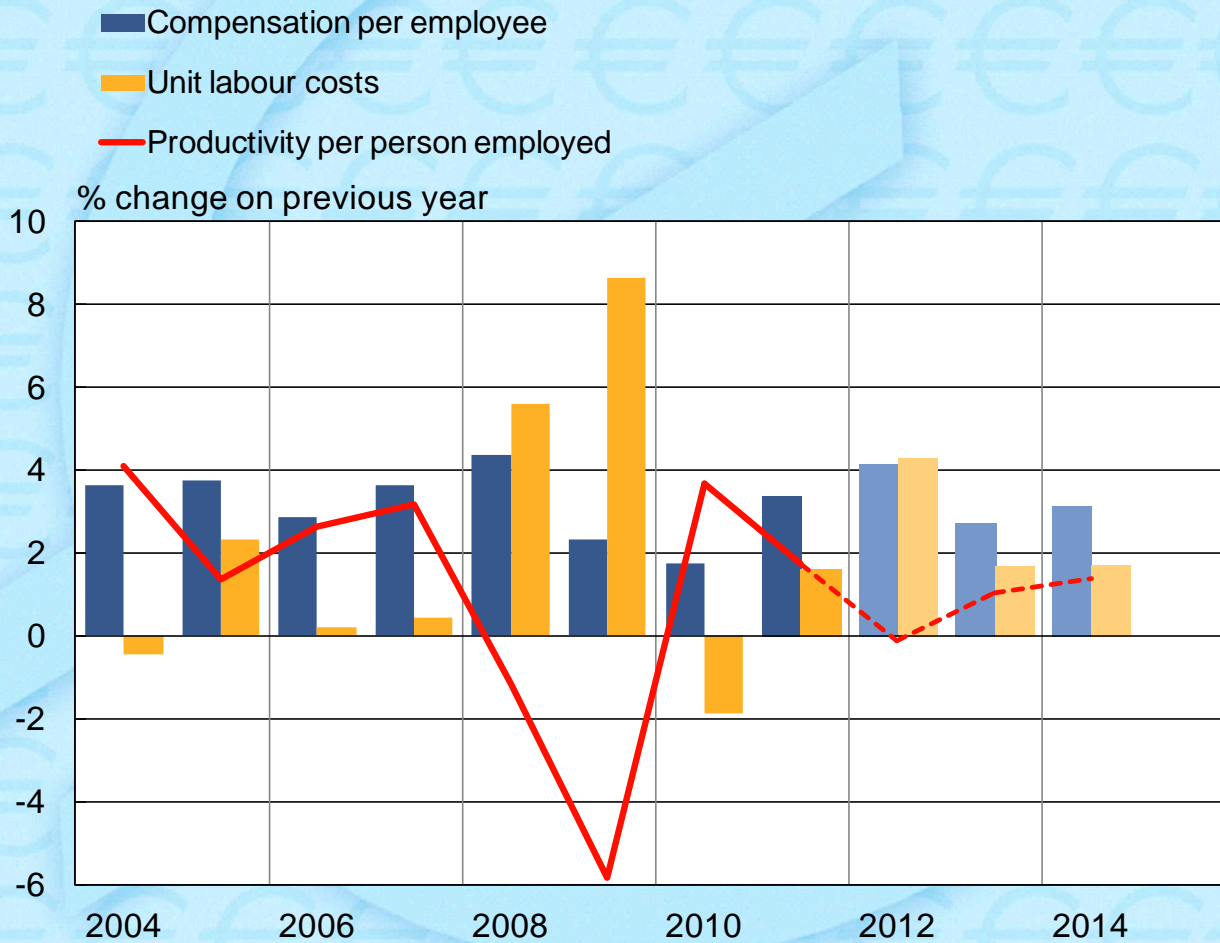
Labour markets deteriorating

Slow growth will push up unemployment



Sources: Statistics Finland and Bank of Finland.

Labour costs have risen

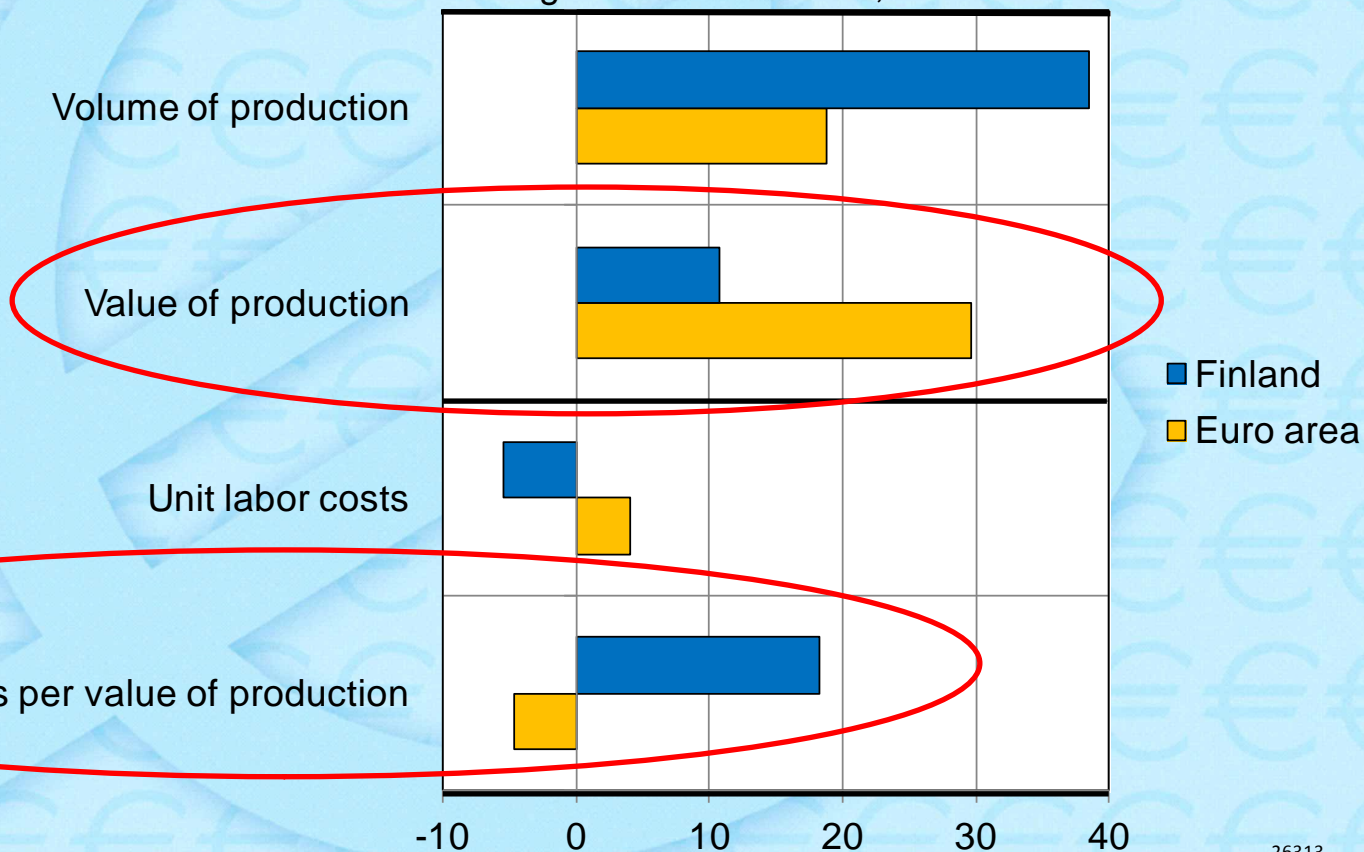


Sources: Statistics Finland and Bank of Finland.

Competitiveness weaker than manufacturing unit labour costs suggest

Manufacturing

Change 1999Q1-2012Q2, %



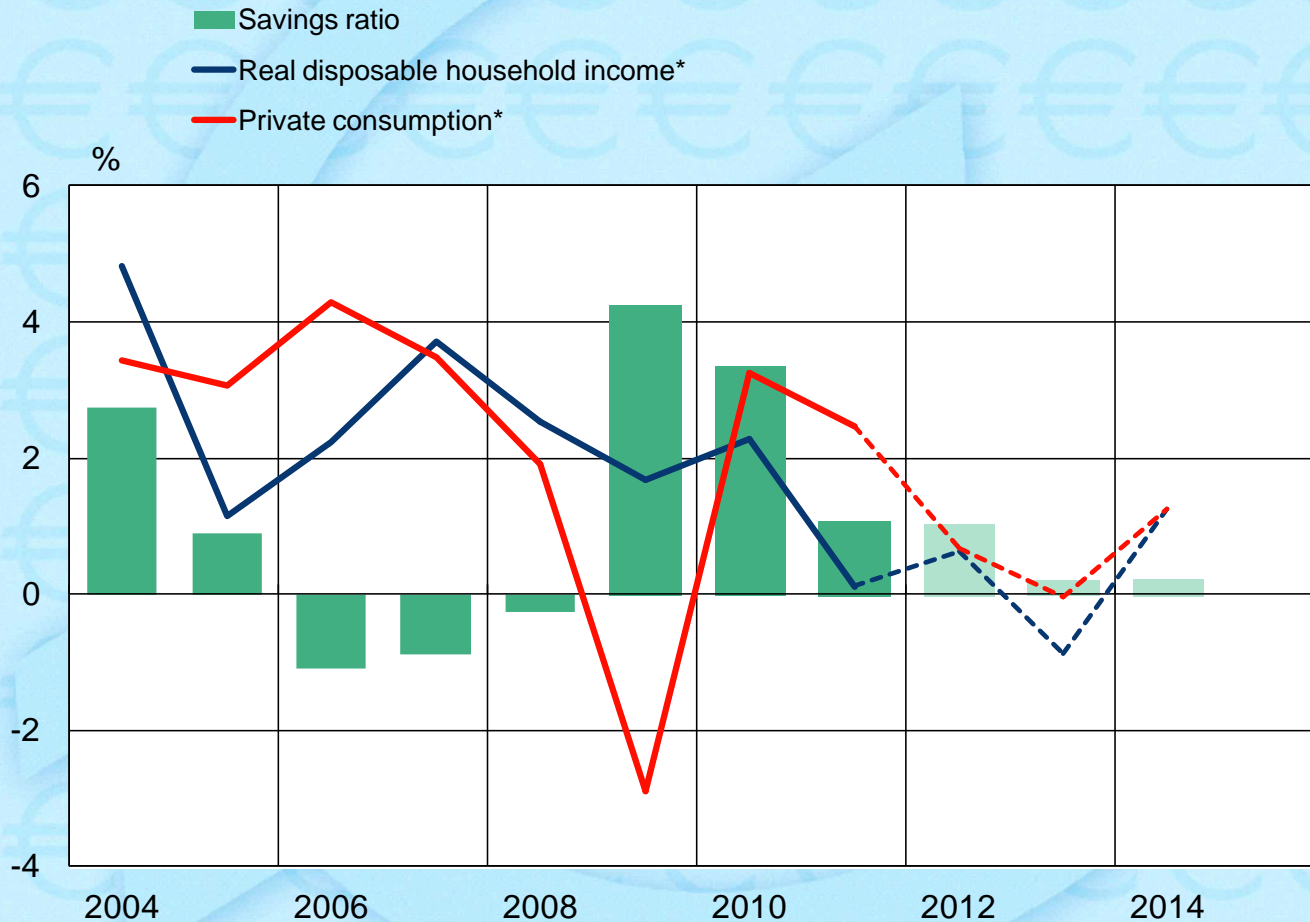
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Source: Eurostat. Production is gross value added.



Domestic demand fading, export outlook weak

Household consumption fading



Households = households and non-profit institutions serving households

* % change on previous year

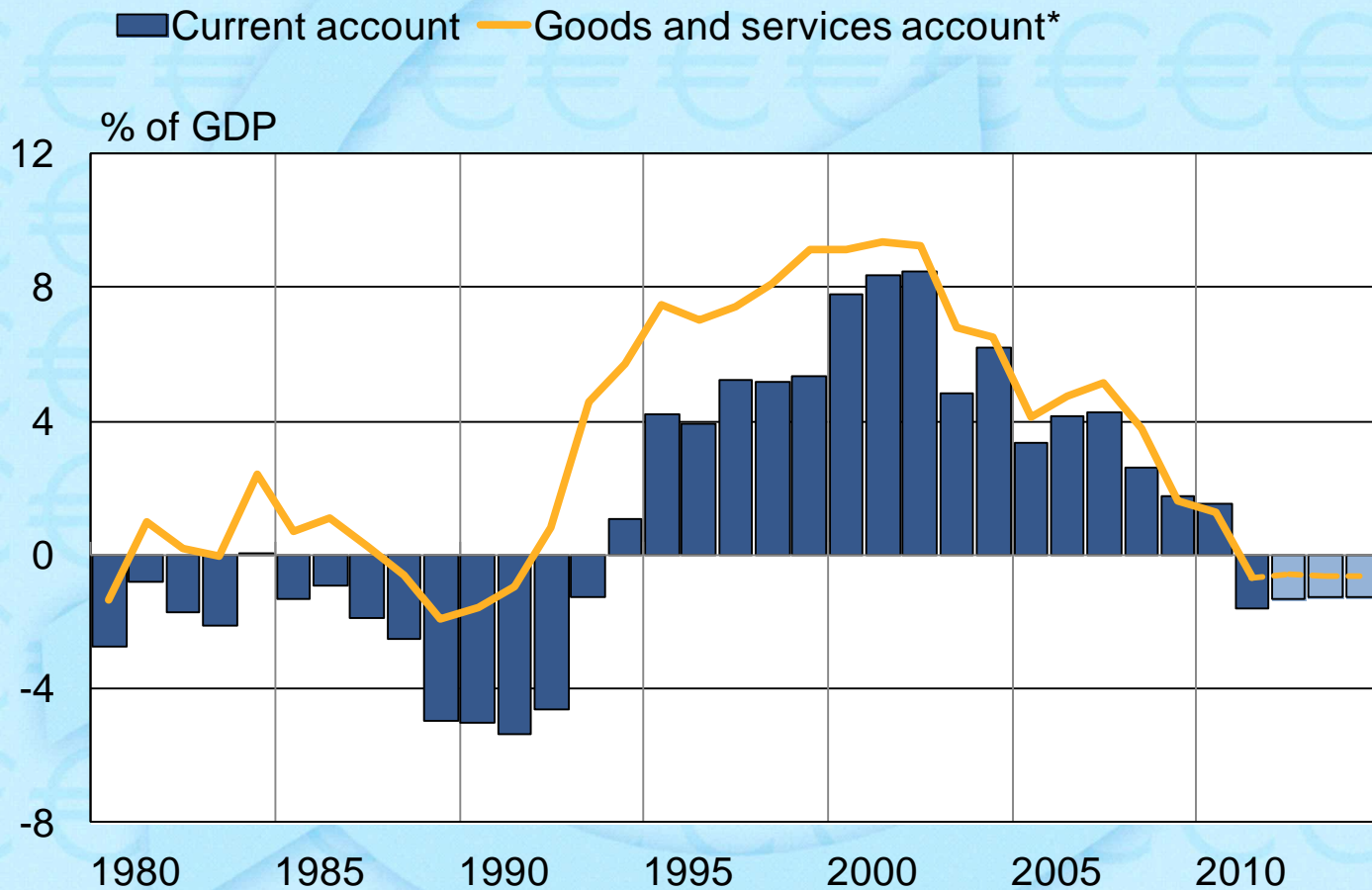
Sources: Statistics Finland and Bank of Finland.

Export growth weak



Sources: Statistics Finland, Eurosystem and Bank of Finland.

Current account remains in deficit



* National Accounts

Sources: Statistics Finland and Bank of Finland.

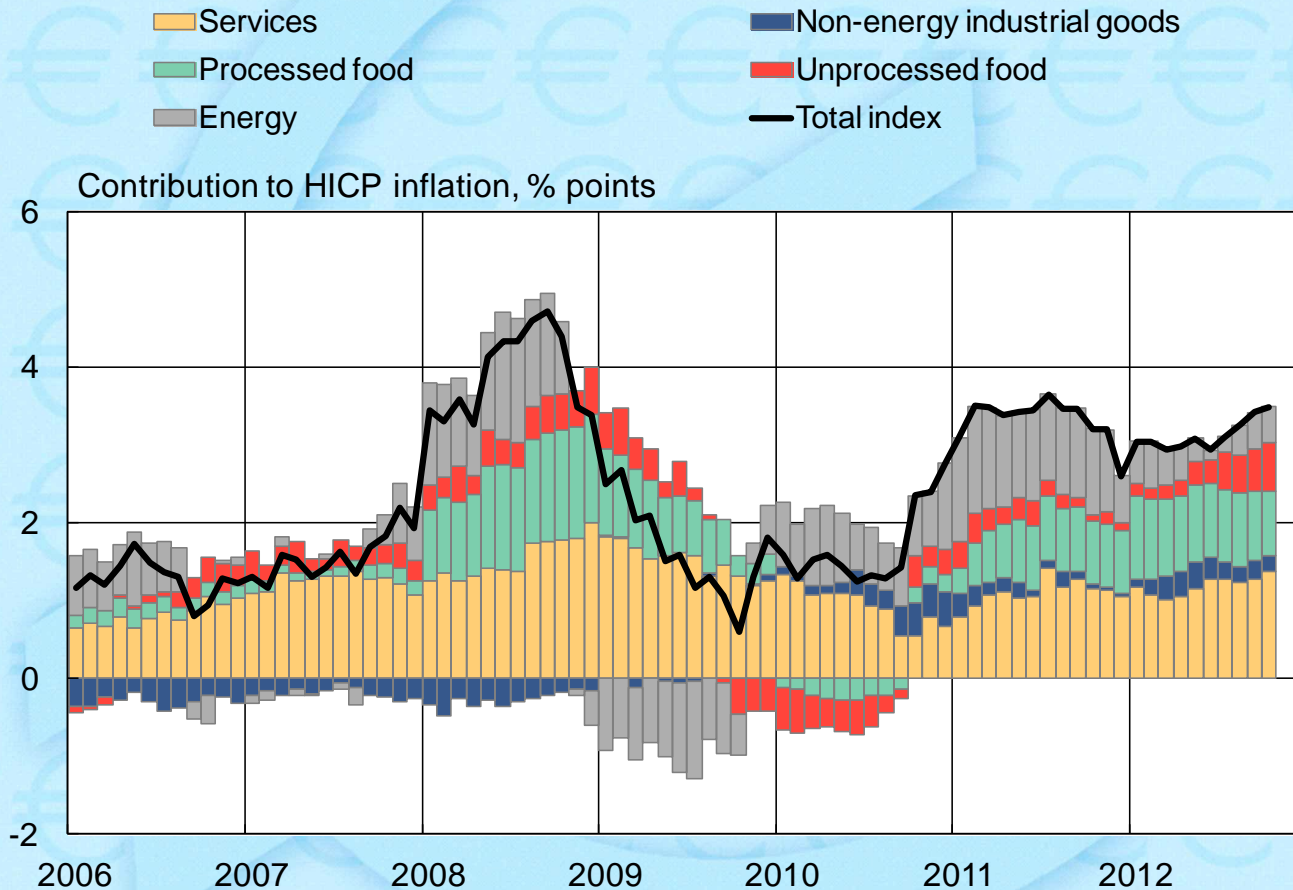
Situation of the open sector must be taken into account in pay agreements

- ◆ ***Exports developed weakly, outlook still weak.***
- ◆ ***Background:***
 - ***Sluggish international growth***
 - ***Special problems of electronics and paper industries***
 - ***Growth in labour costs***
- ◆ ***Export success, open sector employment and the foreign trade balance all require that the competitiveness of the open sector is strengthened.***



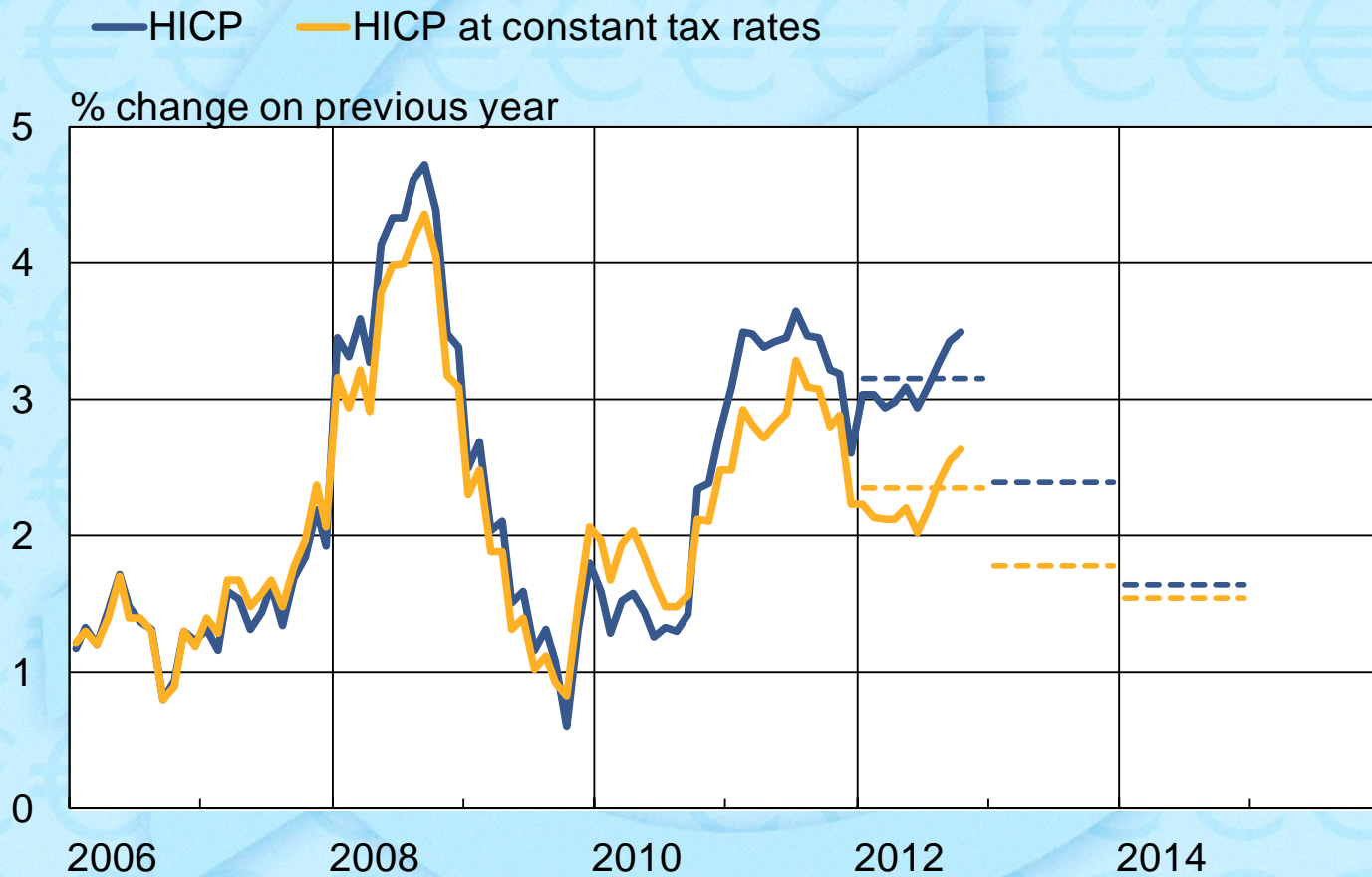
Inflation will gradually slow

Food and service prices risen rapidly



HICP = Harmonised index of consumer prices
Source: Statistics Finland.

Inflation will slow despite increases in indirect taxation

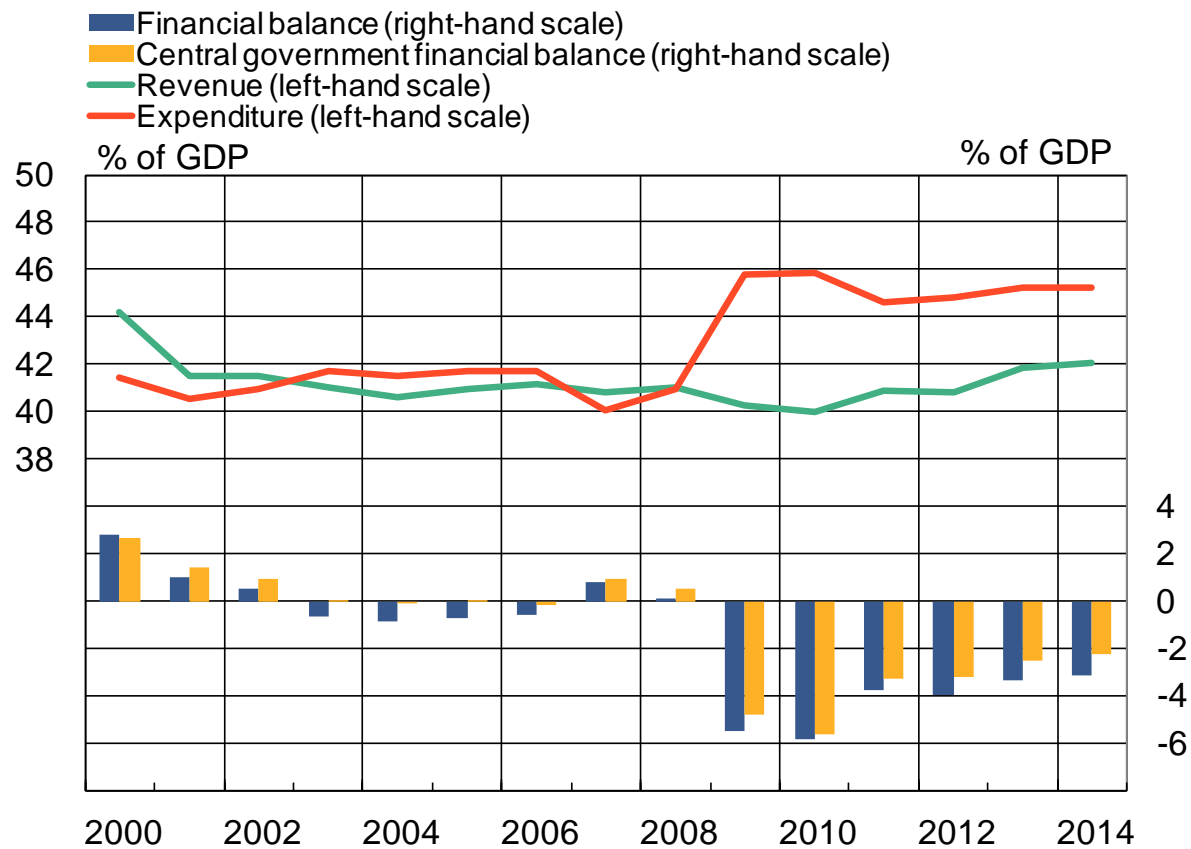


HICP = Harmonised index of consumer prices
Sources: Statistics Finland and Bank of Finland.



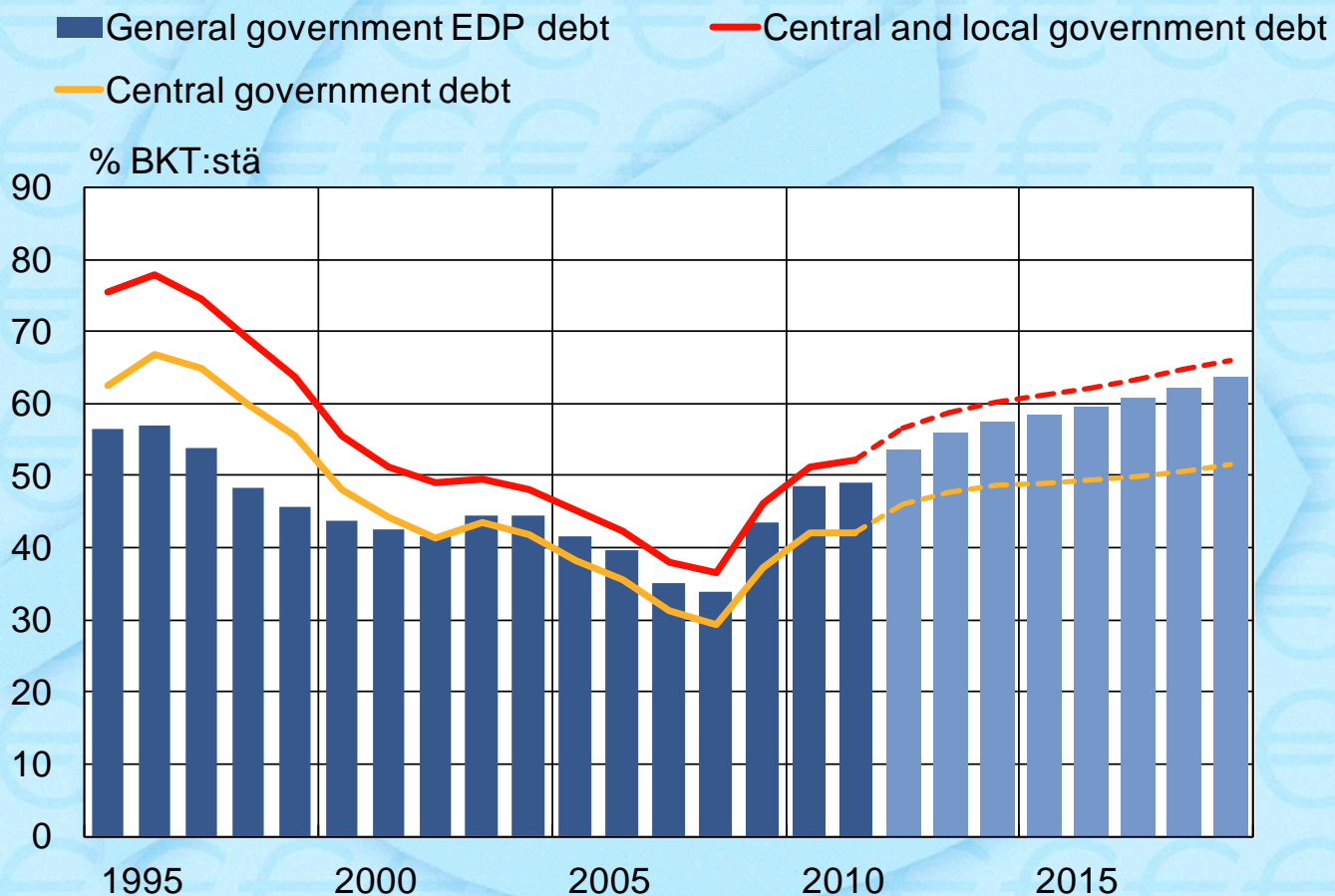
It is vital to strengthen the public finances

Central and local government deficit to contract slightly



Sources: Statistics Finland and Bank of Finland.

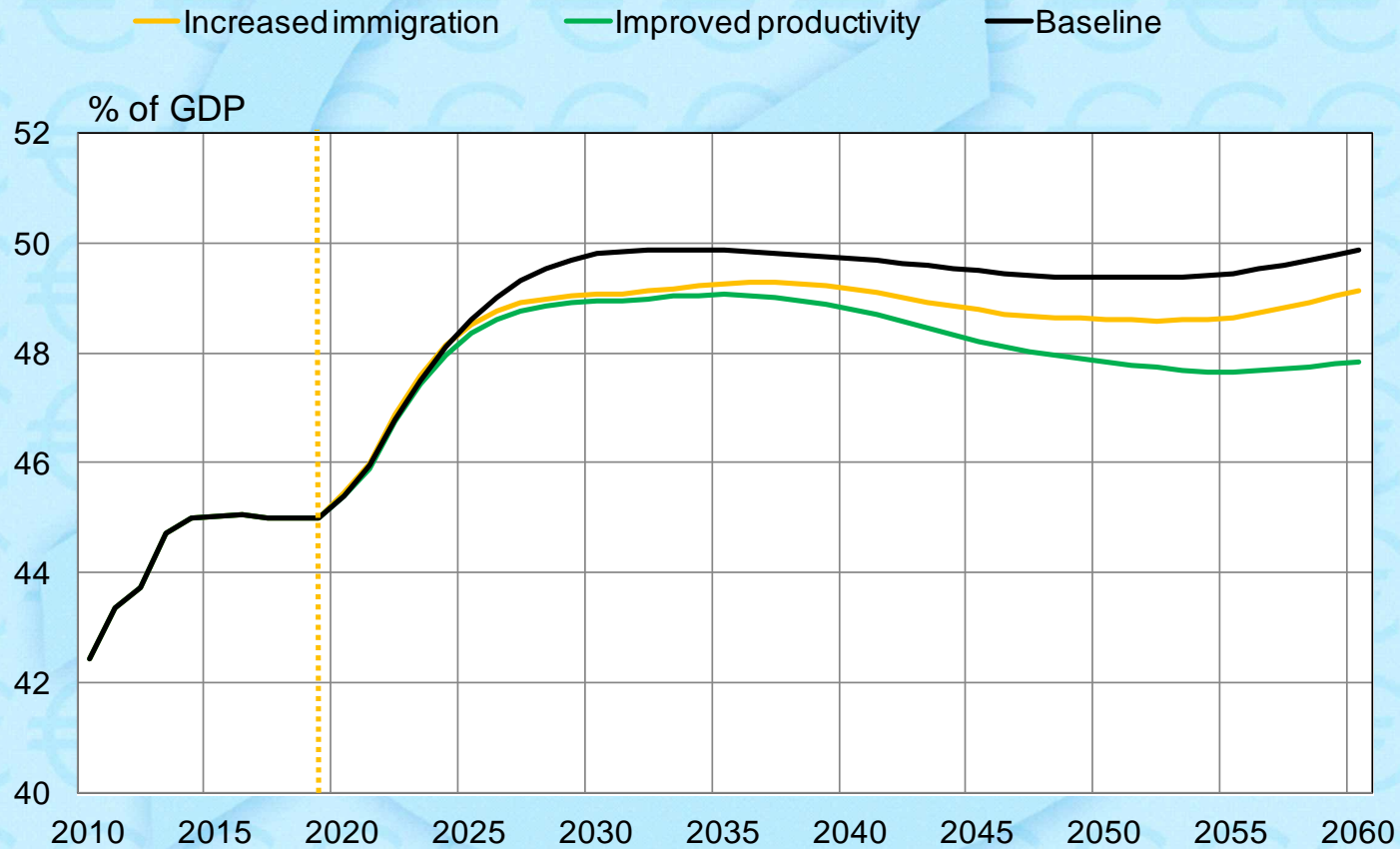
Trend in the public debt ratio will not turn downwards without additional measures



Sources: Statistics Finland, State Treasury and Bank of Finland.

Sustainability problem is substantial

Need for public finance adjustment measured in terms of total tax rate



Sources: Statistics Finland and Bank of Finland.

Need for public finance adjustment is substantial

- ◆ ***The decisions of spring 2012 were important, but economic developments are proving weaker than then expected.***
- ◆ ***The government's objective of turning the trend in the central government debt ratio downwards will not be achieved without additional measures.***
- ◆ ***More substantial measures are required to achieve a sufficient level of surplus in the general government balance.***
- ◆ ***A decade-long adjustment programme is required.***
 - ***The key in policy choices is the impact on growth.***
 - ***In central government, the expenditure ceiling should be gradually lowered to better match the funding base.***

Sustainable public finances cannot be achieved without structural measures

- ◆ ***With early fiscal policy measures, the sudden and hasty policy action at the beginning of the next decade can be avoided.***
- ◆ ***But sustainability cannot be secured without an increase in labour supply.***
- ◆ ***Labour input needs to be increased in all phases of working life. This would even out the costs between the different age groups.***
 - ***Earlier entry to working life***
 - ***Raising the effective retirement age***
 - ***Labour supply incentives***
- ◆ ***In local government, it is vital to improve productivity.***



Financial stability

International operating environment remains challenging, financial markets show early signs of stabilisation

- ◆ ***Despite the improvement in the sentiment of the financial markets, the European economy remains vulnerable.***
- ◆ ***Weak developments in the real economy would expose the European banking sector to a decline in asset prices and increase credit risks.***
- ***Rapid implementation of decisions and measures that promote financial stability is important.***

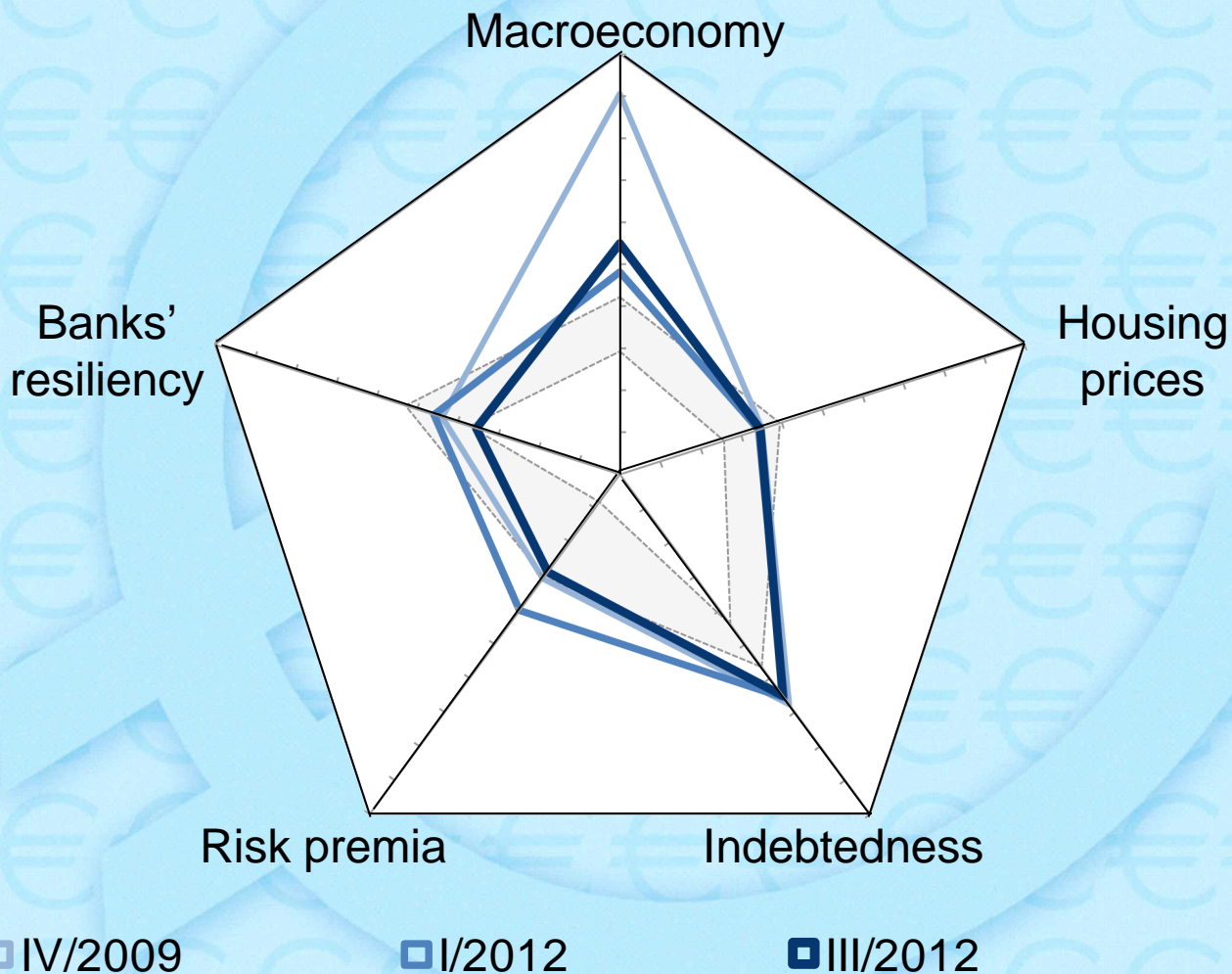
Banking union to be implemented

- ◆ ***Banking union would stabilise the financial markets and reduce the probability of banking crises.***
 - ***First the Single Supervisory Mechanism.***
 - ***In addition, a common crisis resolution system is essential.***
- ◆ ***The aim is to reduce the costs to governments and tax payers and make creditors bear more responsibility.***
 - ***A centralised system for crisis resolution will facilitate the controlled closure of even large banks without government support.***
 - ***Creditors' responsibility can be realised without banks being forced into bankruptcy.***

Confidence in European banks should be enhanced by improving transparency

- ◆ ***It is difficult for markets to get an overall picture of***
 - ***asset encumbrance***
 - ***forbearance***
- ◆ ***There are doubts about the comparability of the methods used in capital adequacy calculation.***
 - ***Risk weightings in loans differ considerably, depending on the method of capital adequacy calculation. Use of smaller risk weightings than competitors may distort competition.***

Finnish financial system stable - challenges relate to indebtedness, the weak outlook for the real economy and low interest rates



Sources: NASDAQ OMX Helsinki, banks, Statistics Finland and Bank of Finland.

Growing level of household indebtedness contains risks

- ◆ ***Growing indebtedness increases households' vulnerability in weak economic environment.***
- ◆ ***Household indebtedness should be reined in as follows:***
 - ***Households should be prepared against a possible rise in interest rates.***
 - ***Banks should comply with the Financial Supervisory Authority's recommendations on assessing the debt-servicing capacity of housing loan applicants and maximum loan-to-value ratios (LTVs).***
 - ***The authorities should be provided with adequate macroprudential tools.***

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Feature articles:

- ◆ ***Rahoitusjärjestelmän vakaus (Financial stability in Finland)***
- ◆ ***Suomen julkisen talouden kestävyystarkasteluja (Fiscal sustainability projections for Finland)***
Helvi Kinnunen, Petri Mäki-Fränti and Hannu Viertola
- ◆ ***Suomen kilpailukyky ja sen mittaaminen (Finland's competitiveness and its measurement)***
Lauri Kajanoja

Summary

- ◆ ***The need for adjustment in the public finances is already substantial in the present decade.***
- ◆ ***Long-term sustainability of public finances cannot be achieved without structural measures.***
- ◆ ***Pay settlements must take account of competitiveness in the open sector.***



Thank you!