



EUROJÄRJESTELMÄ  
EUROSYSTEMET

# **Bank of Finland Bulletin 4/2013**

## **Monetary policy and the global economy**

Governor  
Erkki Liikanen  
17 September 2013

# Monetary policy and the global economy

## ◆ *Articles and a BoF Online:*

- *Financial cycles, monetary policy and macroprudential policy in the euro area*
  - *Hanna Freystätter, Hanna Putkuri and Jukka Vauhkonen*
- *Liquidity regulation makes a comeback*
  - *Karlo Kauko*
- *Fiscal multipliers revised*
  - *Pasi Ikonen, Tuomas Saarenheimo and Matti Virén*
- *Foreign trade statistics based on value added challenge the traditional picture of international trade*
  - *Elisa Newby*
- *A perspective on the German ‘job miracle’: labour market outcomes and welfare after the labour market transformation*
  - *Michaela Schmöller*



## **Presentation themes**

- ◆ *Cyclical situation and global economic outlook*
- ◆ *ECB's forward guidance reinforces accommodative monetary policy*
- ◆ *Banking union is an important structural reform*

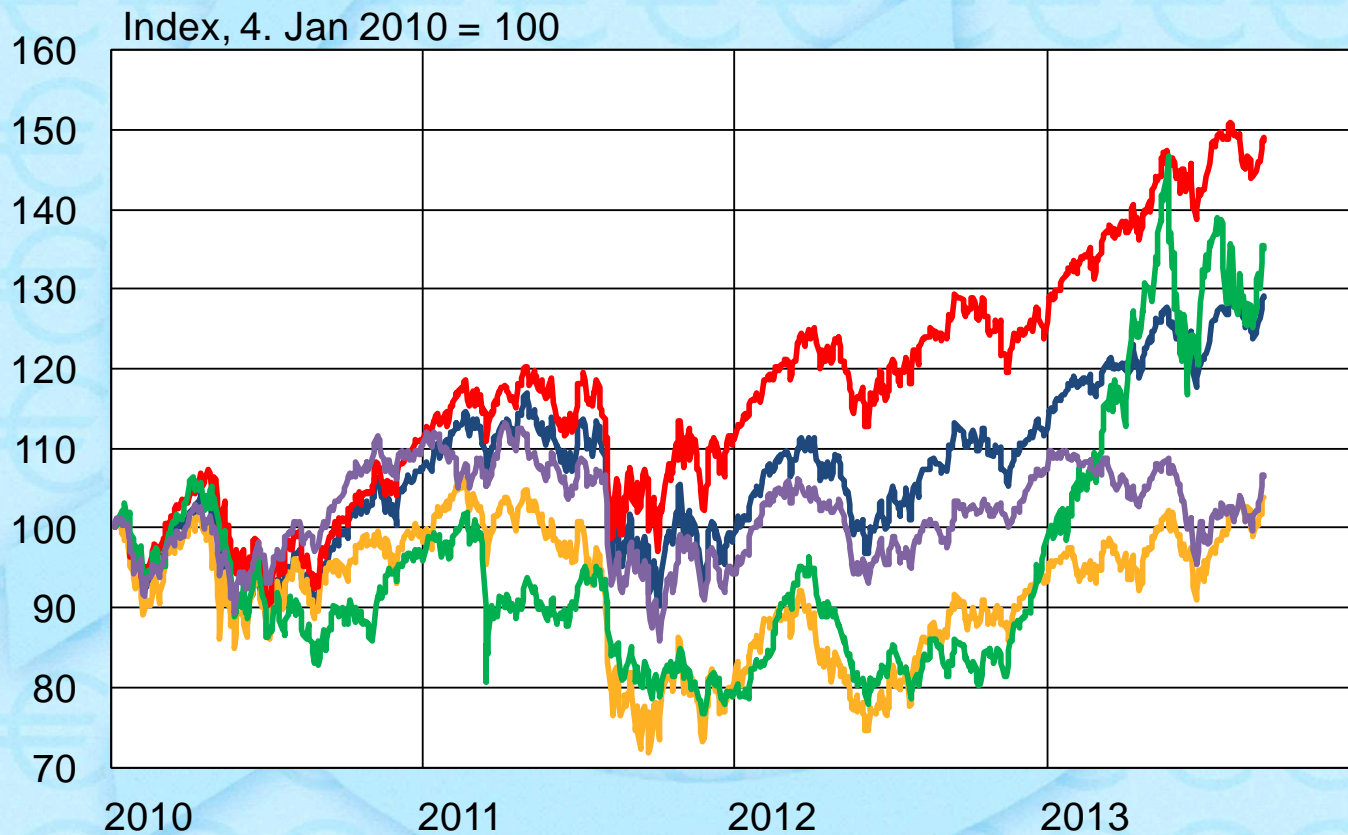


***The cyclical situation and the Bank of  
Finland's global economic forecast***



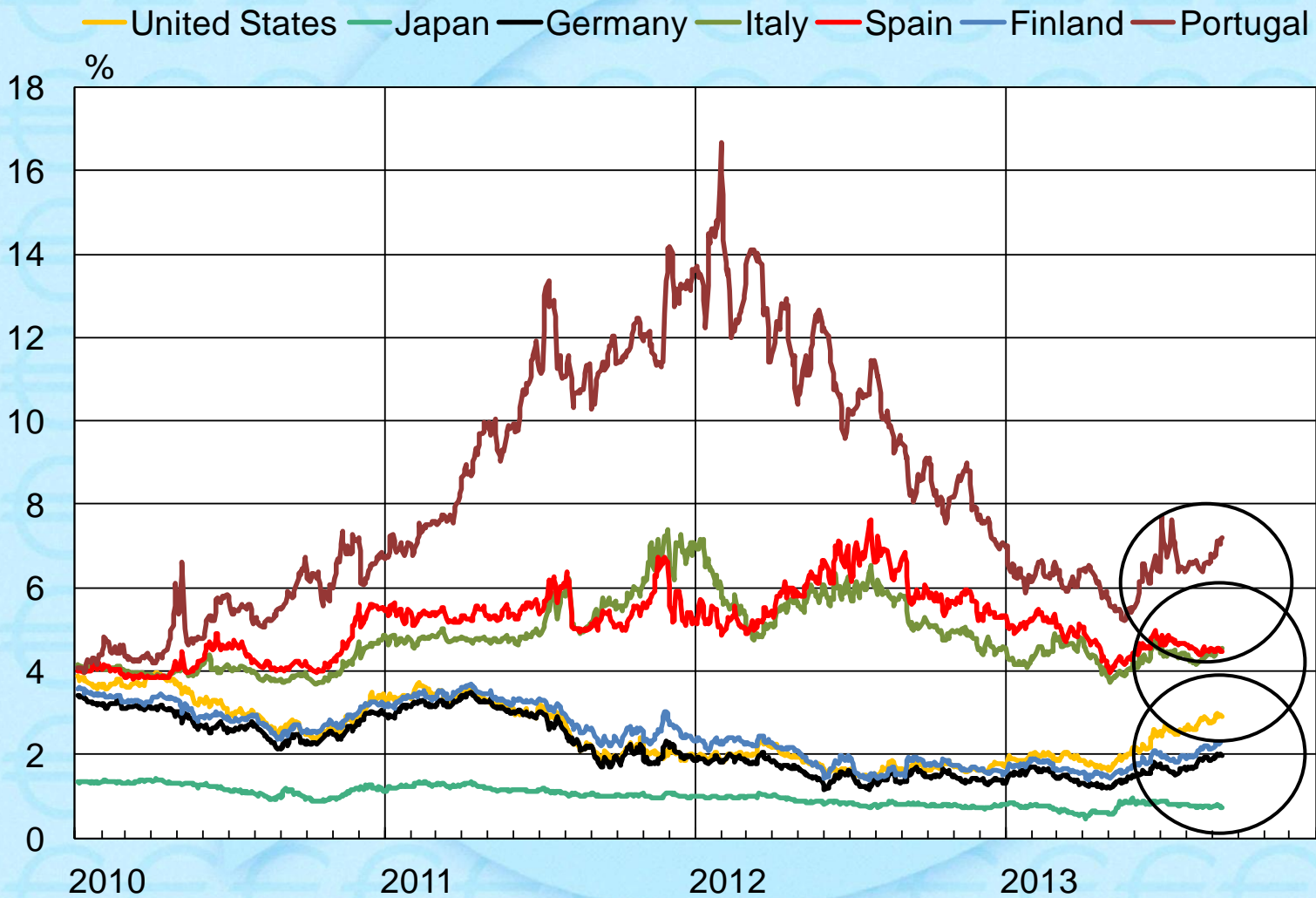
# Share prices reflect differences in growth outlooks

— Advanced economies — Euro Stoxx — United States — Japan — Emerging economies



Source: Bloomberg.

# Bond markets tell a similar story



Yields on 10-year government bonds.  
Source: Reuters.

# In China, data on real economy raises questions

Citigroup economic Surprise Indices: real economy

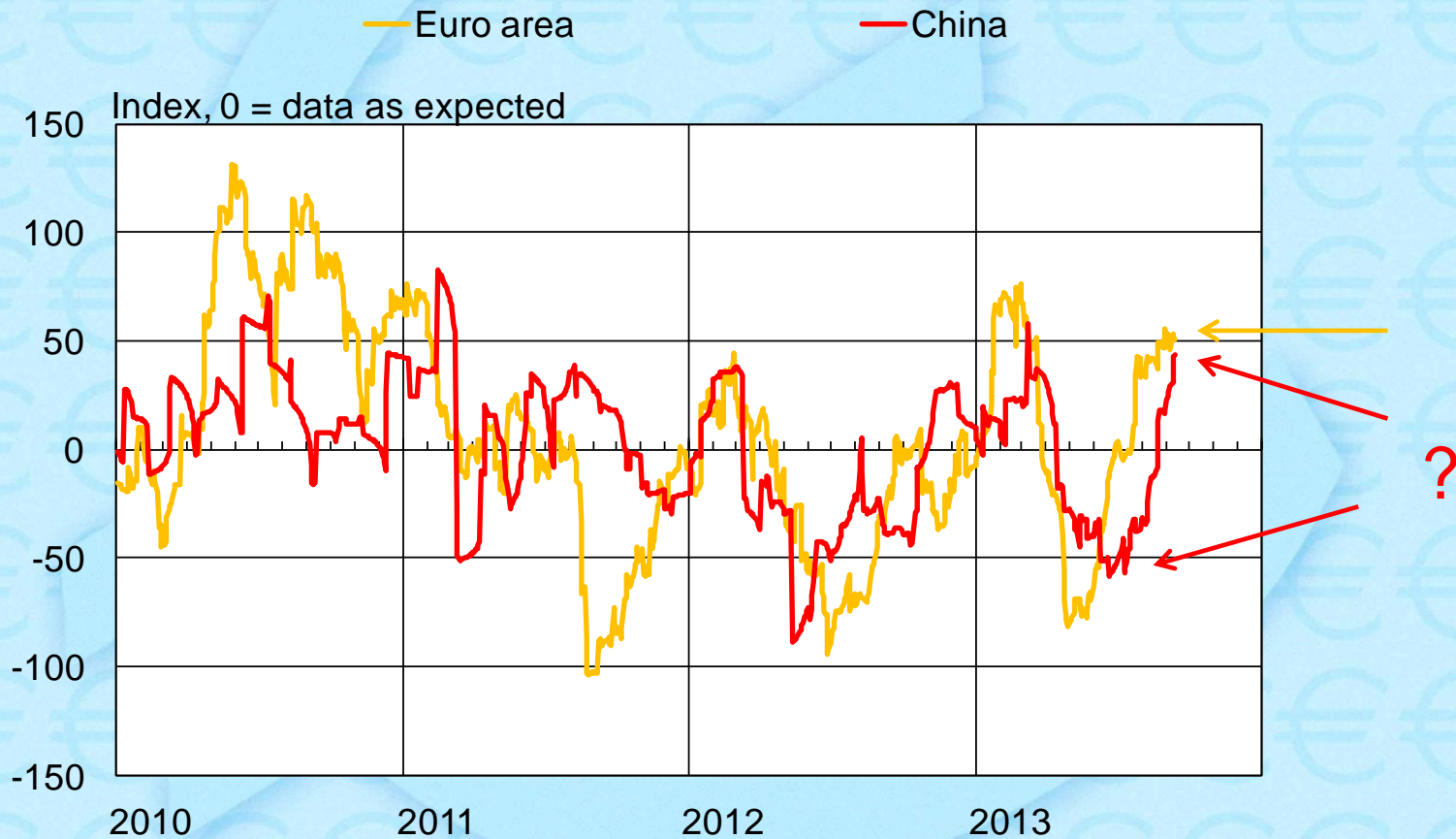


Source: Macrobond.



# In China, data on real economy raises questions, euro area data better than expected

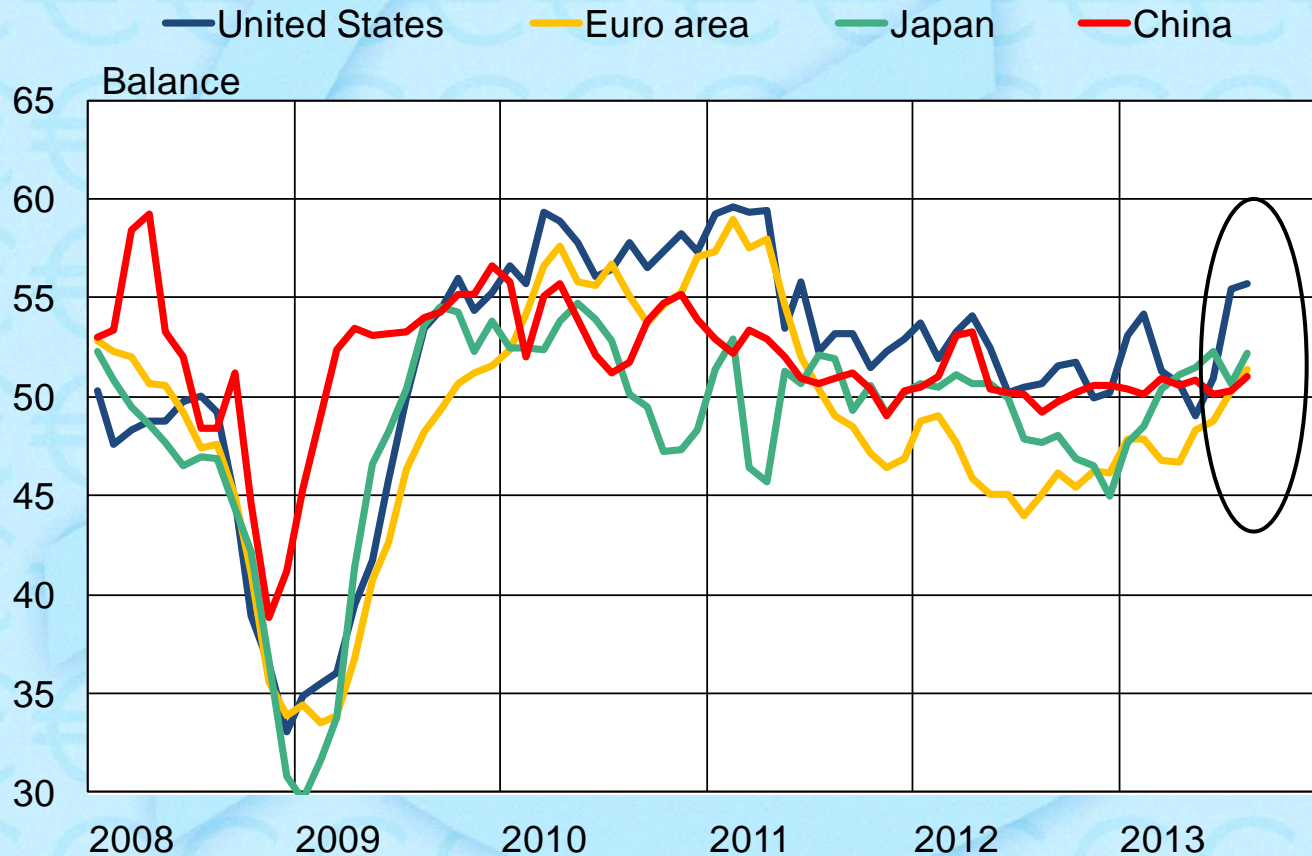
Citigroup economic Surprise Indices: real economy



Source: Macrobond.

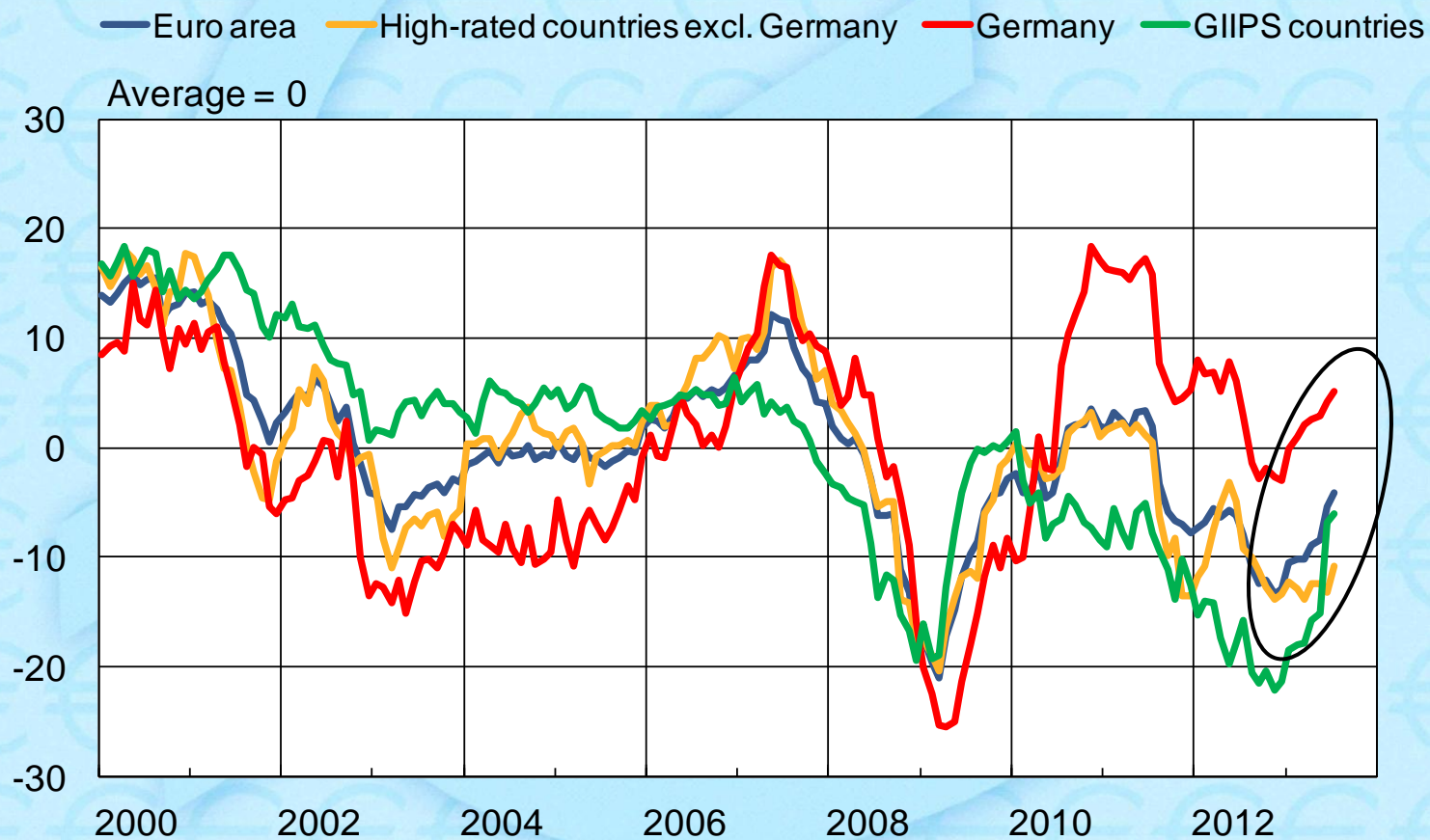


# Industrial confidence improved, especially in euro area and United States



Source: Bloomberg.

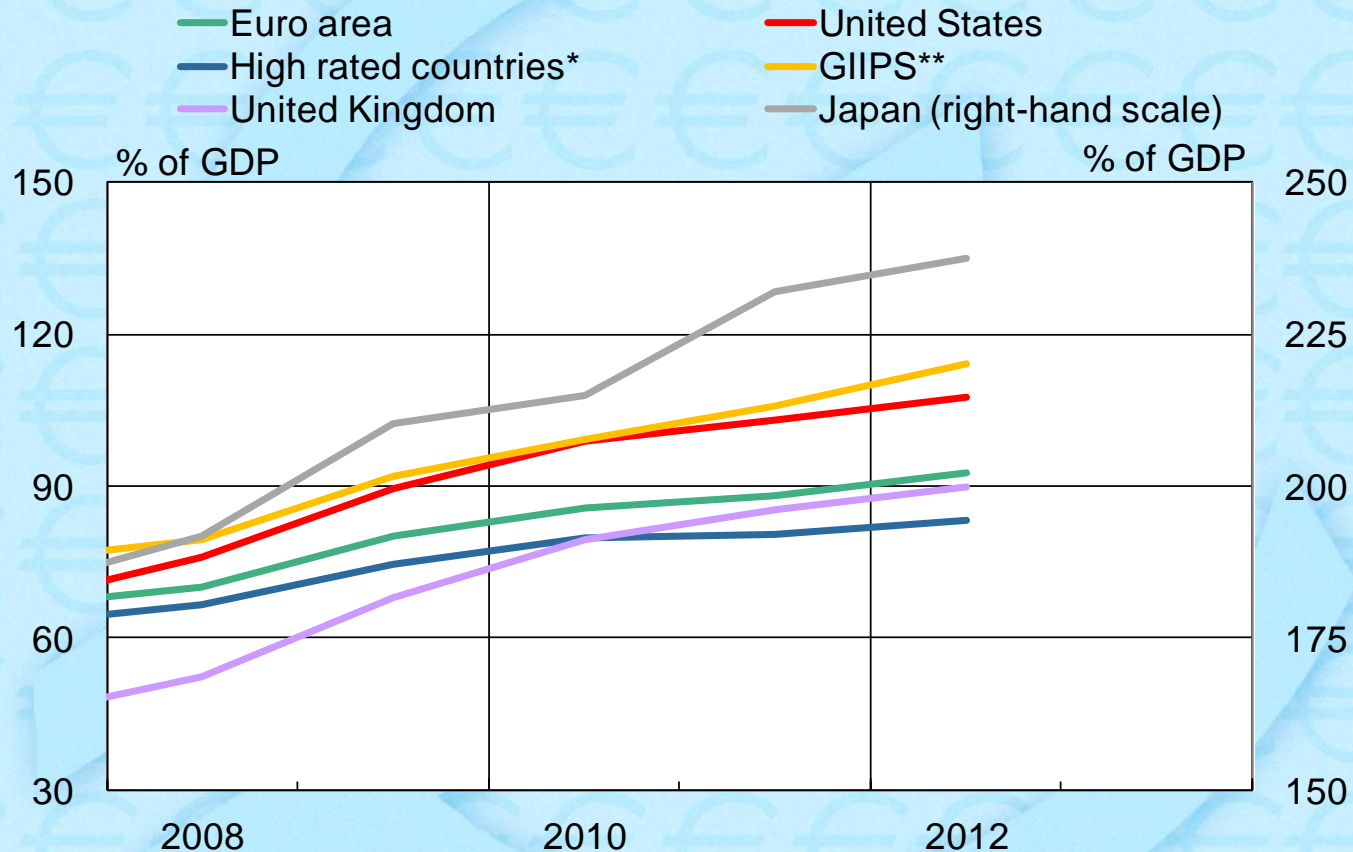
# Euro area consumer confidence improved, especially in Italy and Spain



Sources: European Commission and Bank of Finland.



# Public debt ratios still growing



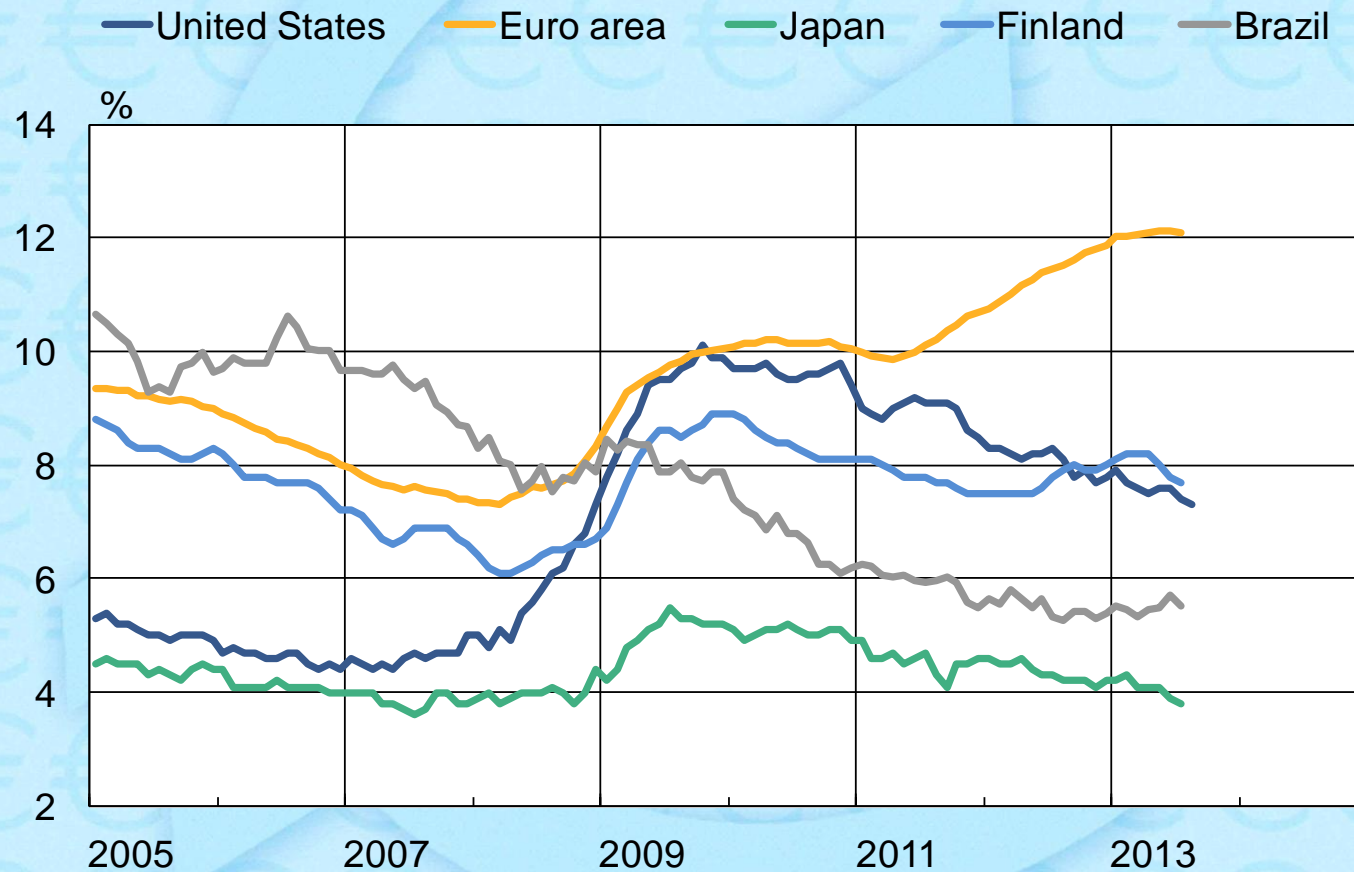
\* Germany, France, Netherlands, Belgium, Austria and Finland.

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

The figures for 2012 are based on European Commission spring 2013 forecasts.

Sources: European Commission, ECB and calculations by the Bank of Finland.

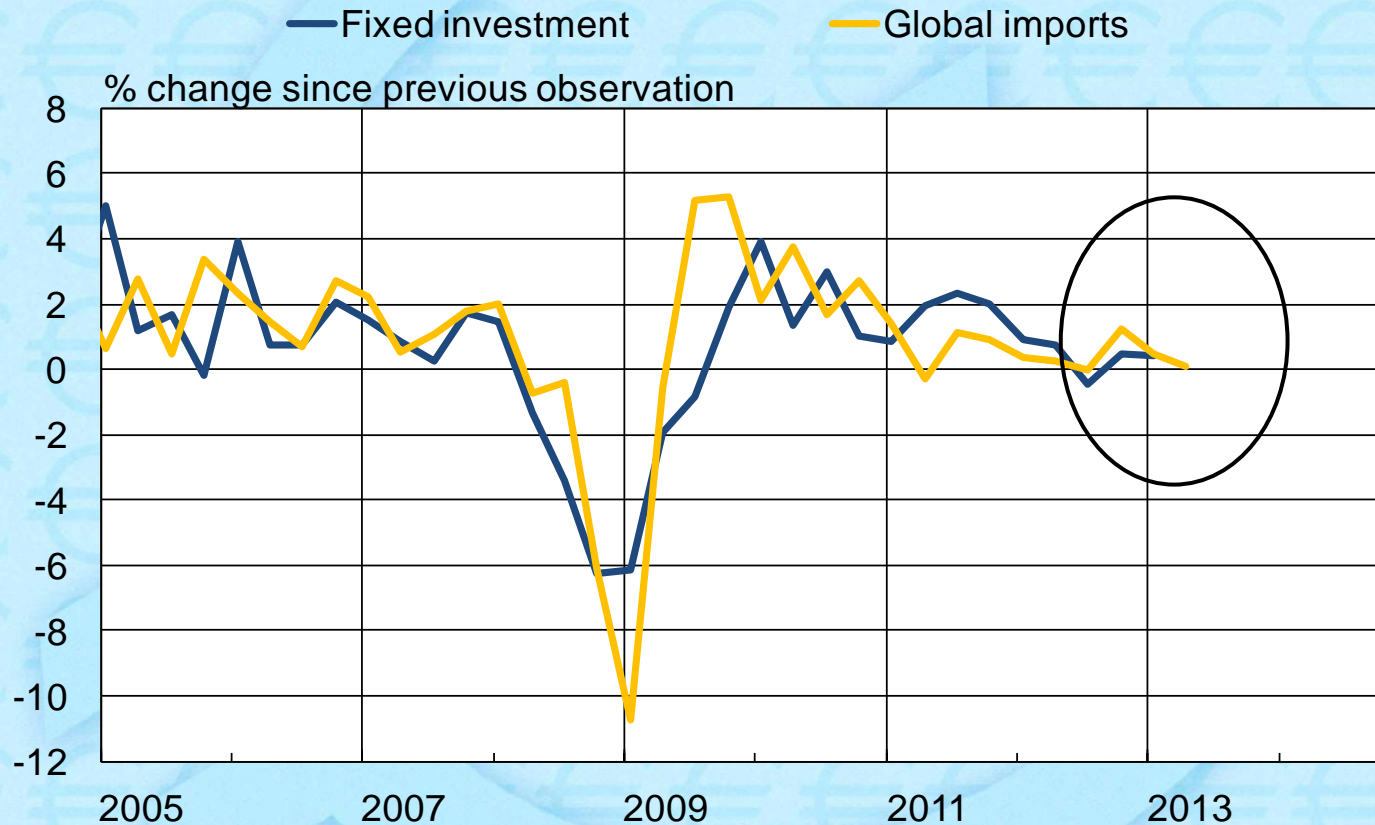
# Euro area unemployment still high



Brazilian figures have been seasonally adjusted at the Bank of Finland.  
Sources: Bloomberg, Eurostat and Statistics Finland.

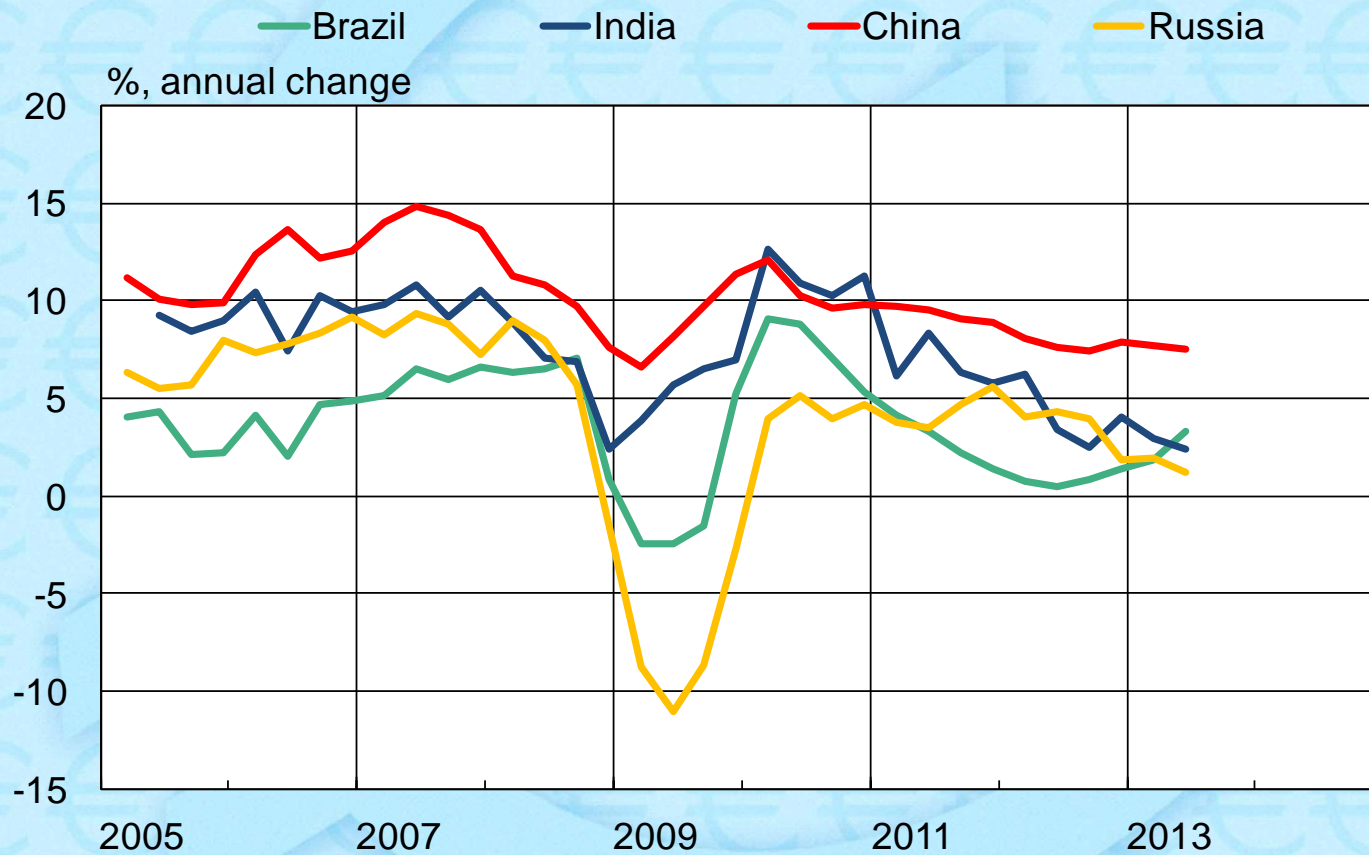


# Fixed investment and world trade have slowed almost in tandem



The concept of fixed investment is slightly different in different countries and includes data from the United States, Japan, Germany and United Kingdom. Sources: BEA, CPB, Macrobond and calculations by the Bank of Finland.

# Slower growth in emerging economies



Source: Macrobond.



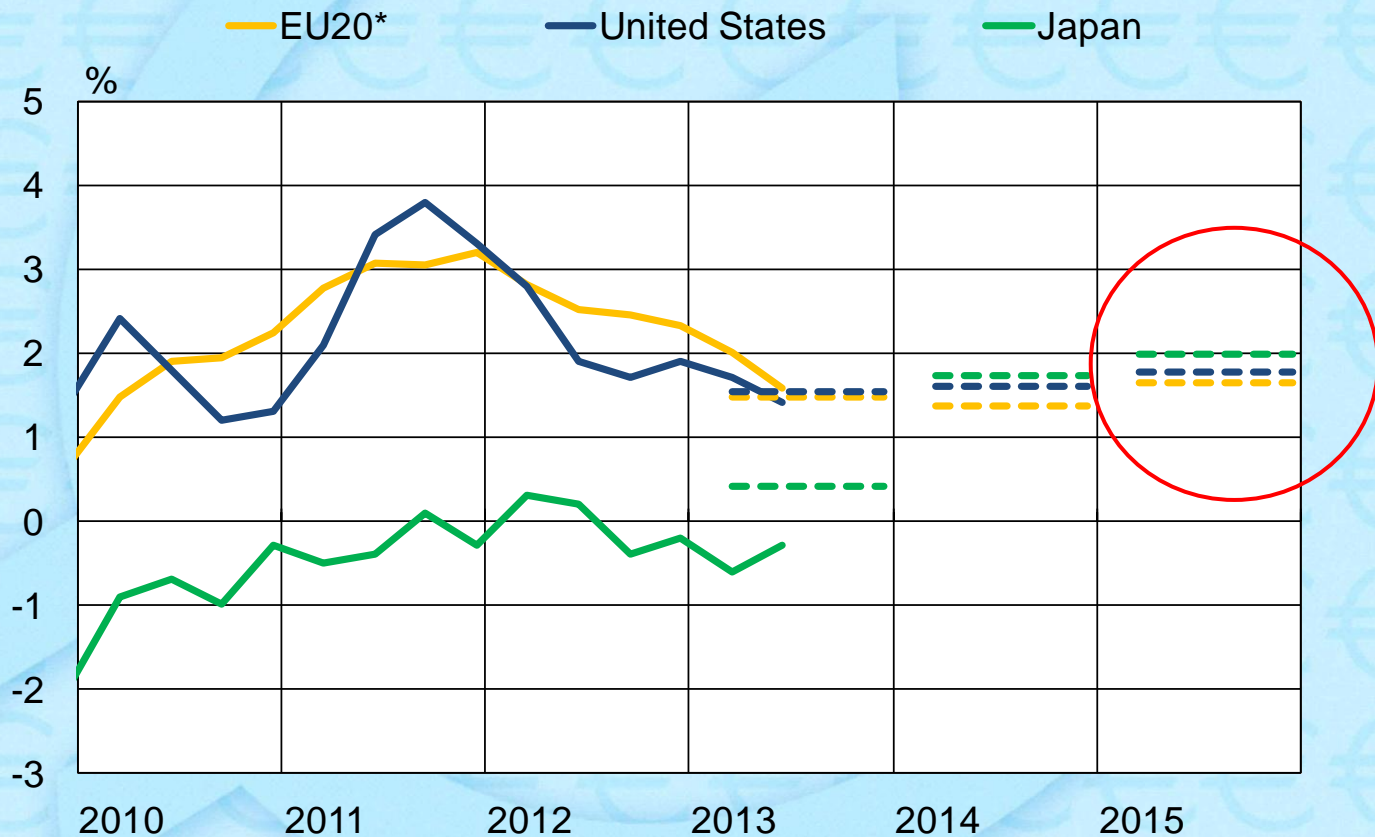
# Bank of Finland growth forecast: changes minor

<b>GDP</b>	<b>2012</b>	<b>2013f</b>	<b>2014f</b>	<b>2015f</b>
<b>United States</b>	<b>2.8</b>	<b>1.6</b>	<b>2.5</b>	<b>2.9</b>
		1.8	2.4	2.8
<b>EU20</b>	<b>-0.4</b>	<b>-0.1</b>	<b>1.2</b>	<b>1.6</b>
		-0.4	1.1	1.5
<b>Japan</b>	<b>2.0</b>	<b>1.6</b>	<b>1.5</b>	<b>1.2</b>
		1.1	1.7	1.0
<b>China</b>	<b>7.8</b>	<b>7.5</b>	<b>7.0</b>	<b>7.0</b>
		8.0	7.0	7.0
<b>Russia</b>	<b>3.4</b>	<b>1.8</b>	<b>3.3</b>	<b>3.2</b>
		3.4	3.4	3.0
<b>World</b>	<b>3.4</b>	<b>3.0</b>	<b>3.7</b>	<b>3.8</b>
		3.2	3.6	3.8
<b>World trade</b>	<b>3.0</b>	<b>2.6</b>	<b>5.1</b>	<b>5.9</b>
		4.0	5.7	6.3

% change on previous year. Previous forecast beneath current one.

EU20 = euro area, Sweden, Denmark and United Kingdom.

# Bank of Finland forecast: inflation still slow



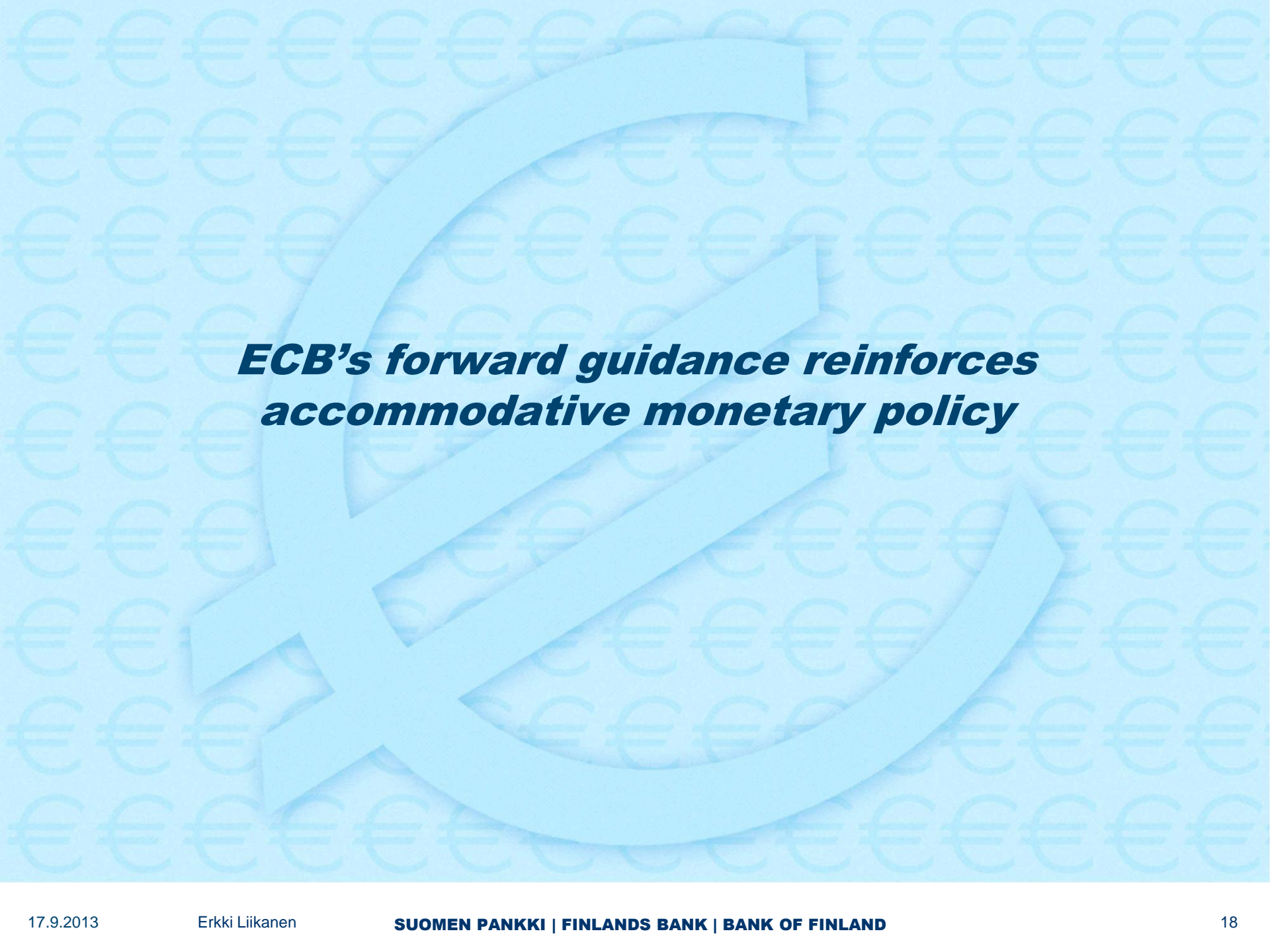
\* Euro area, United Kingdom, Sweden and Denmark.

Sources: National statistical authorities and calculations by the Bank of Finland.



## Forecast risks

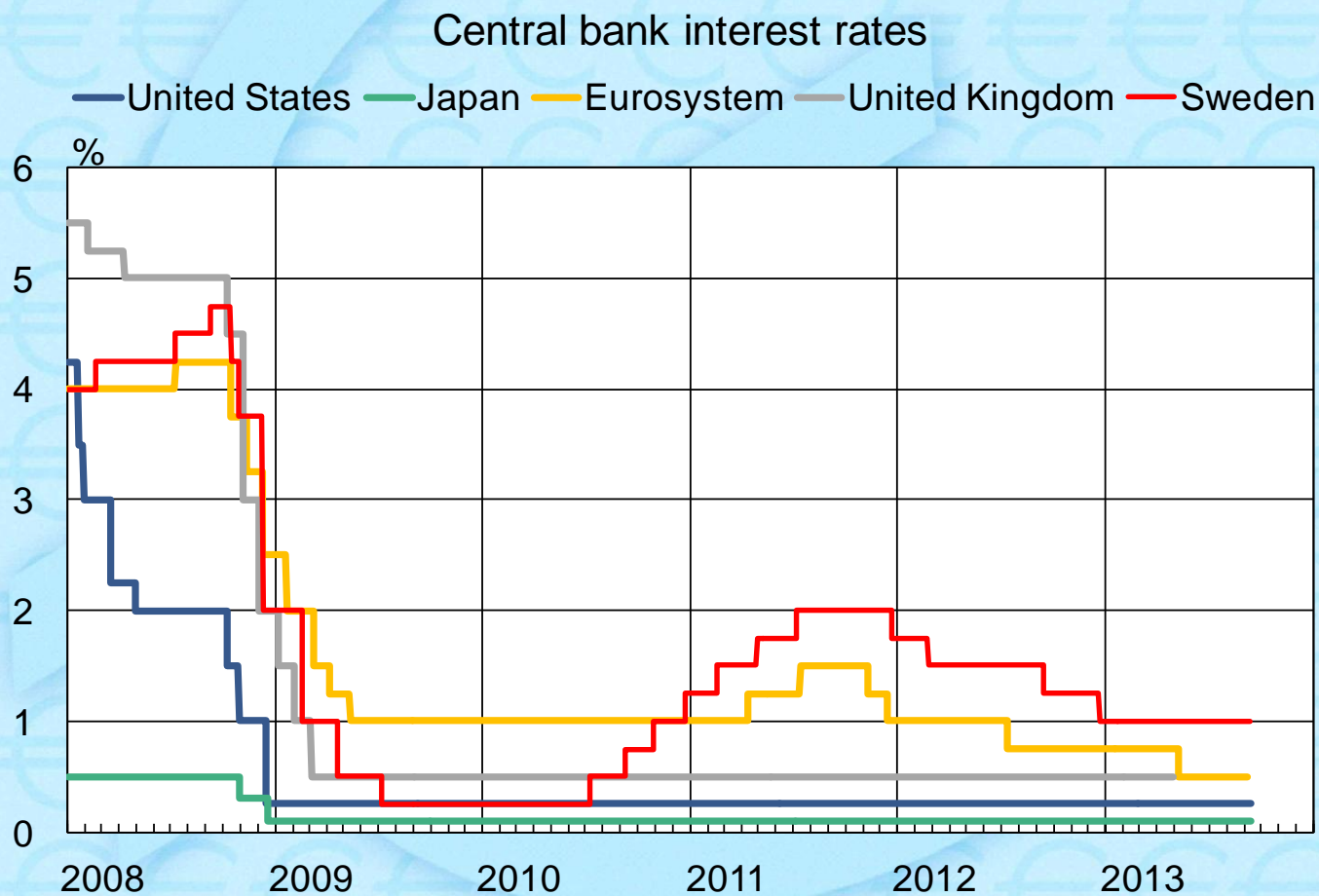
- ◆ ***Debt crisis flaring up again remains the greatest single risk, although now less likely***
  - *Market data improved across a broad range*
  - *Threat of renewed flare-up relates to implementation of programmes and their reforms; political risks hard to forecast*
- ◆ ***Otherwise there are both on upside and downside risks***
  - *US economy could perform better than forecast*
    - Strong undertone to both labour and housing markets
    - Communication of monetary policy particularly important in present forecast period
  - *Euro area growth could be slower than forecast*
    - Delays to structural reforms could lead to slow productivity development and slower-than-forecast growth



***ECB's forward guidance reinforces  
accommodative monetary policy***

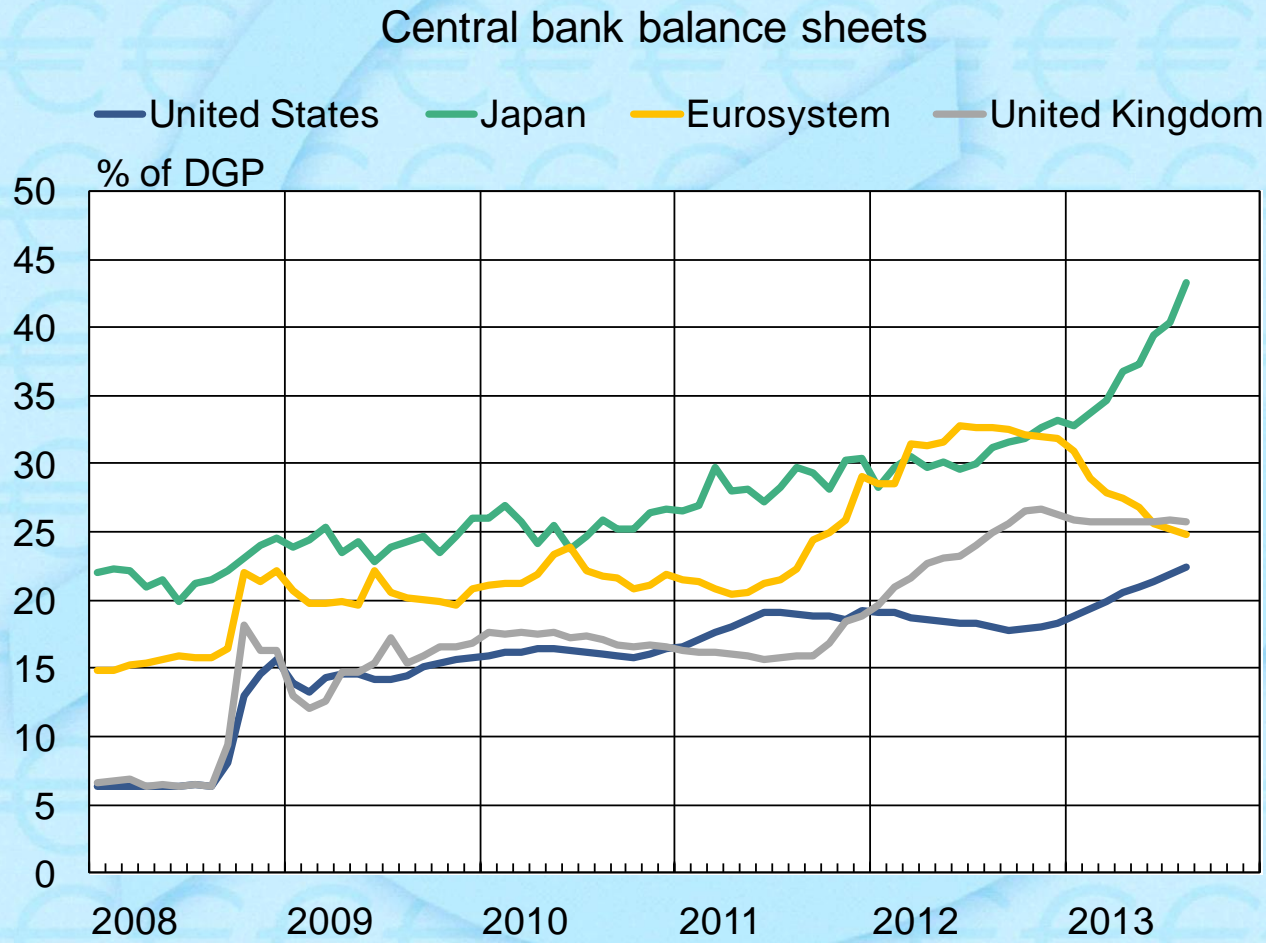


# Era of historically low interest rates continues for fifth consecutive year



Source: Bloomberg.

# Repayment of central bank credits has reduced Eurosystem balance sheet



Sources: National statistical authorities, Eurostat and Bloomberg.



# Monetary policy forward guidance

## ◆ **Fed (December 2012):**

- *The exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6.5%.*

## ◆ **ECB (July 2013):**

- *The Governing council expects the key ECB interest rates will remain at present or lower levels for an extended period of time.*

## ◆ **BoE (August 2013):**

- *The MPC intends not to raise the Bank Rate above its current level of 0.5% ..... at least until the headline measure of unemployment has fallen to a threshold of 7%.*

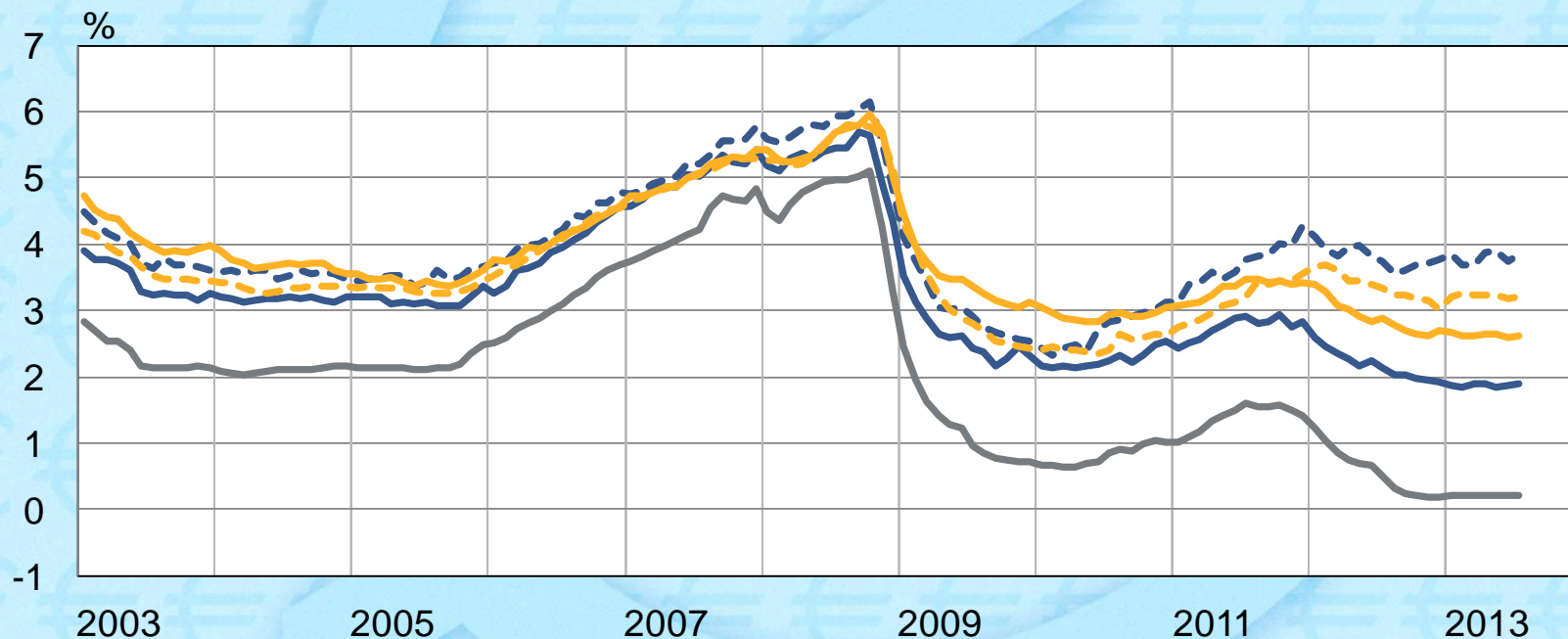
# Forward guidance by the ECB Governing Council

- ◆ ***The ECB's monetary policy stance will remain accommodative as long as is necessary***
  - *The Governing council expects the key ECB interest rates will remain at present or lower levels for an extended period of time.*
- ◆ ***Euro area price pressures are expected to remain moderate over the medium term***
  - *The short and medium-term inflation outlook remains moderate, with the real economy extensively weakened and the monetary economy subdued.*



# Sluggish transmission of accommodative monetary policy

- High-rated countries\*, bank loans
- - - GIIPS countries\*\*, bank loans
- High-rated countries\*, housing loans
- - - GIIPS countries\*\*, housing loans
- 3-month Euribor



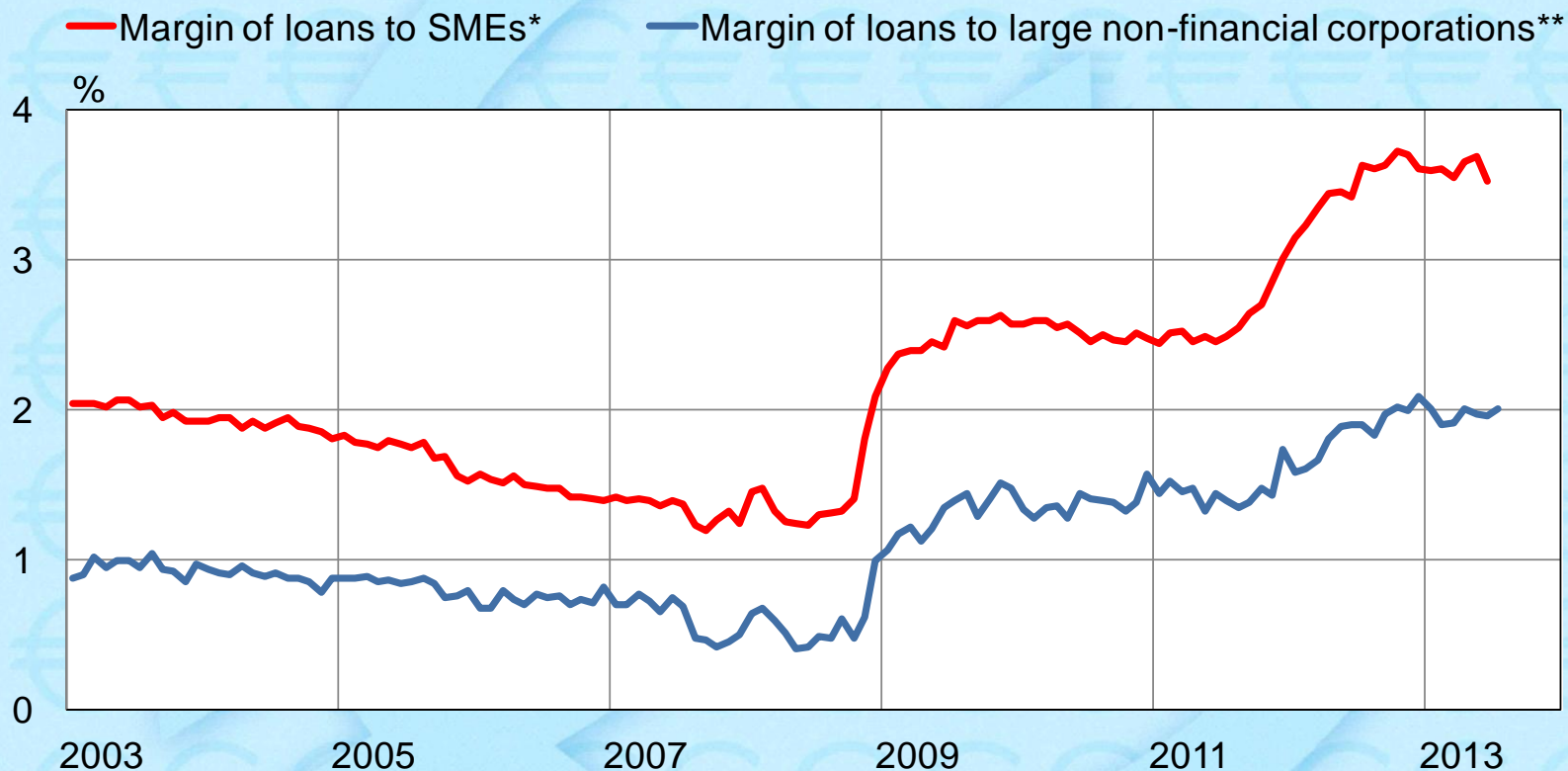
\* Germany, France, Netherlands, Belgium, Austria and Finland.

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

New corporate and housing loan agreements with original interest fixed for at most 1 year.

Sources: ECB and Bank of Finland calculations.

# Tight financial conditions for SMEs hampering the economy



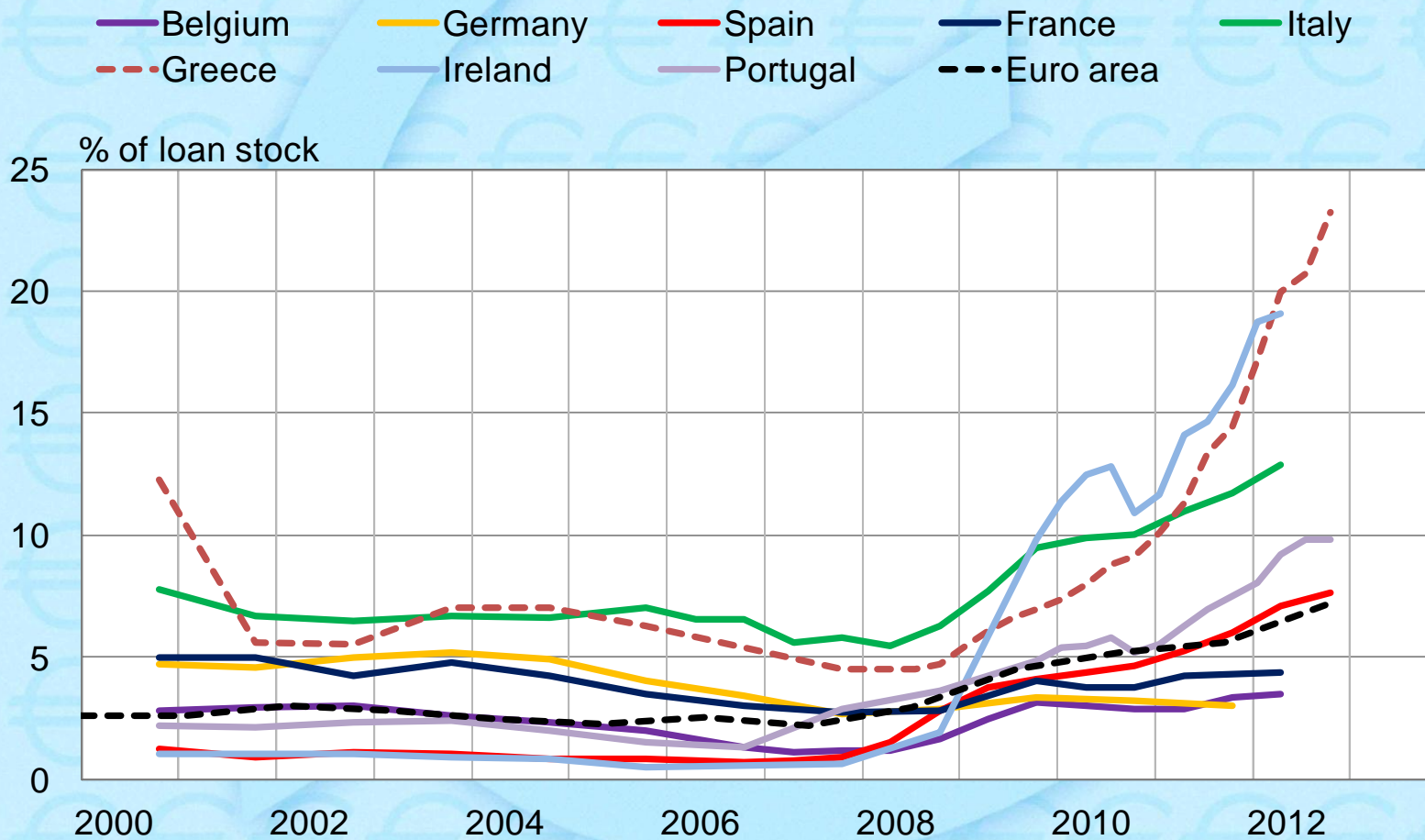
\* Average rates of new corporate loans for up to 1 million tied to at most 1 year's reference rates - 3-month Euribor.

\*\* Average rates of new corporate loans for over 1 million tied to at most 1 year's reference rates - 3-month Euribor.

Source: European Central Bank.



# Growth in loan defaults sustains uncertainty over the condition of banking balance sheets



Source: IMF.



***Banking union is an important structural reform***



# Banking supervision and resolution institutions must be reinforced

- ◆ A single monetary policy, integrated financial markets and national supervision and resolution create a fragile package (a 'financial trilemma').
- ◆ The mutual interdependence between a bank and its home state constitutes a 'fateful connection'.
- ◆ Banking supervision and resolution requires better institutions than currently available.

# What should banking union comprise?

## Banking supervision

- Effective,
- supranational and
- uniform supervision

## Resolution

- Harmonised tools
- Investor responsibility (bail-in)
- Sectoral responsibility (funds)
- No bank support

## Deposit guarantee

- Harmonisation
- Sectoral responsibility (funds)

## Bank support (bail-out)

- Expensive, politically charged
- case-by-case political discretion (ESM)



When this is implemented with care...

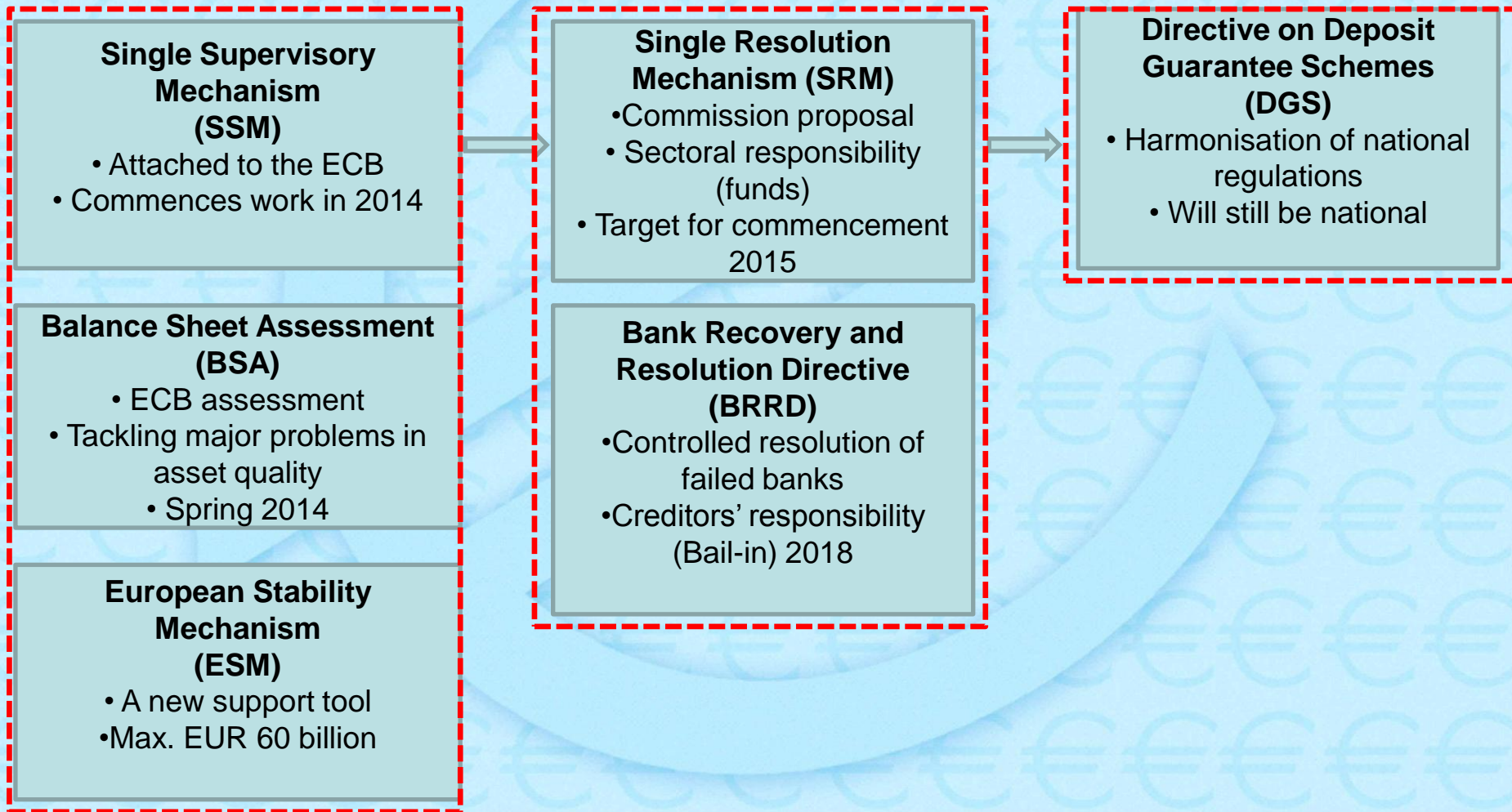


...the need for this is substantially reduced!



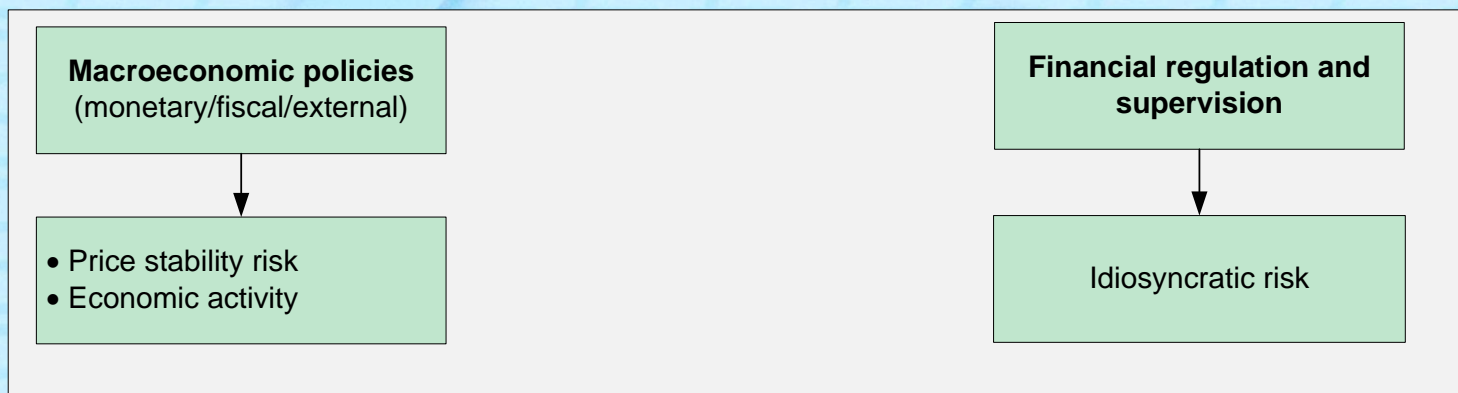
# What is already agreed?

## How is the construction of banking union progressing?

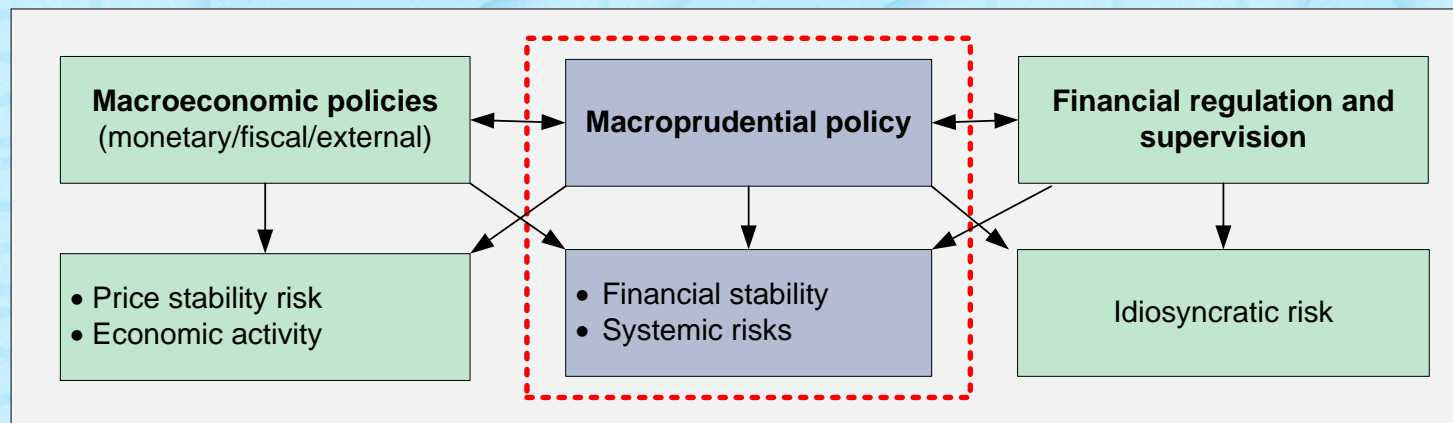


# Authorities should foster the stability of the entire financial system

## Pre-crisis



## ...and post-crisis



Source: IMF.





***In conclusion***

# Towards a more stable euro area

## Member States

- ◆ Better rules
  - Six-pack, two-pack, ...
  - Balance of the entire national economy is vital
- ◆ Market discipline
  - Countries are not identical
  - Risks reflected in price

## Financial system

- ◆ Better rules
  - Banking union
  - Integrated application and interpretation
- ◆ Market discipline
  - Banks are not identical
  - Risks reflected in price



# Summary

- ◆ **Cyclical situation and outlook for the global economy**
  - *Good news: forecasts have not had to adjusted downwards*
  - *Global economic outlook still subdued*
- ◆ **Monetary policy forward guidance**
  - *The ECB Governing Council expects key ECB interest rates will remain at present or lower levels for an extended period of time.*
  - *Assessment conditional on inflation outlook*
- ◆ **Banking union**
  - *An important structural reform*
  - *Strengthens confidence in the banks and their operational capacity*



***Thank you!***