



EUROJÄRJESTELMÄ
EUROSYSTEMET

Economic outlook for 2014–2016

Governor Erkki Liikanen

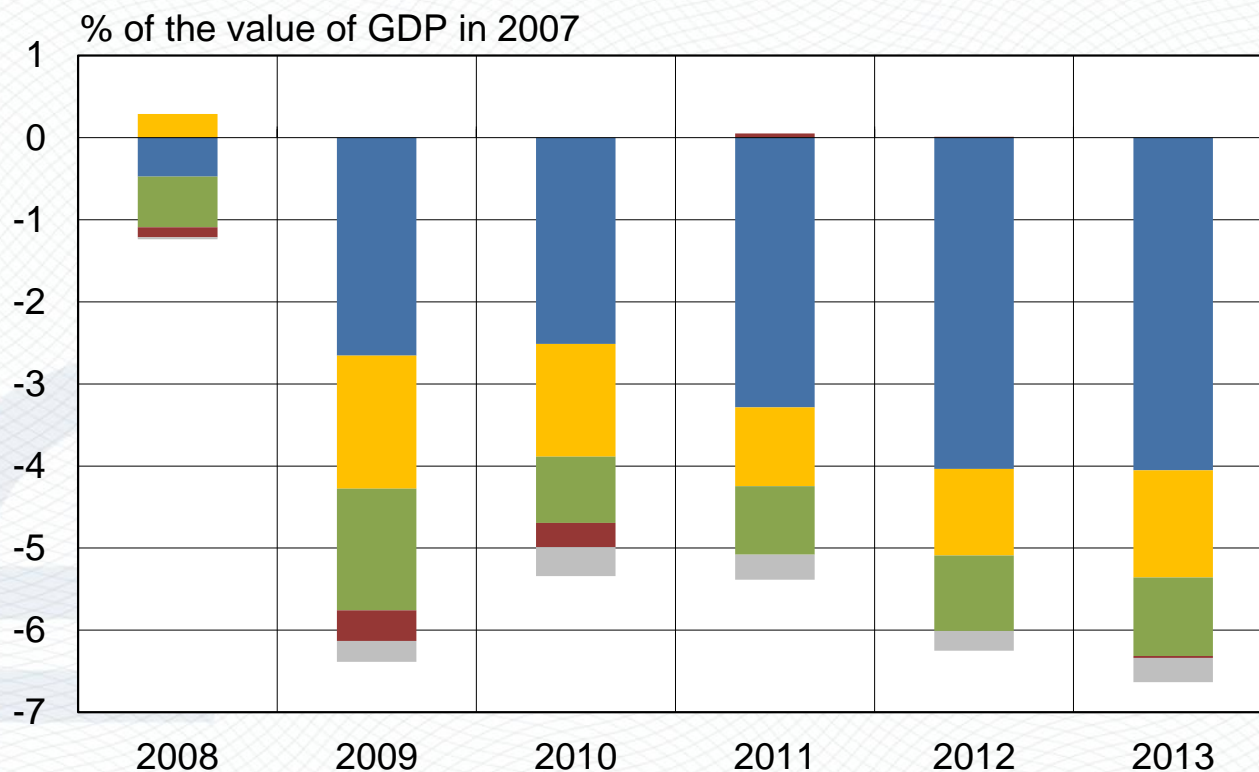
10 June 2014

Bank of Finland 11 June 2013:

‘The Finnish economy has faced structural change and a cyclical recession at the same time’

Change in value added since 2007

- Electrical engineering and electronics
- Other metal industry
- Forest industries
- Chemicals industry
- Other manufacturing

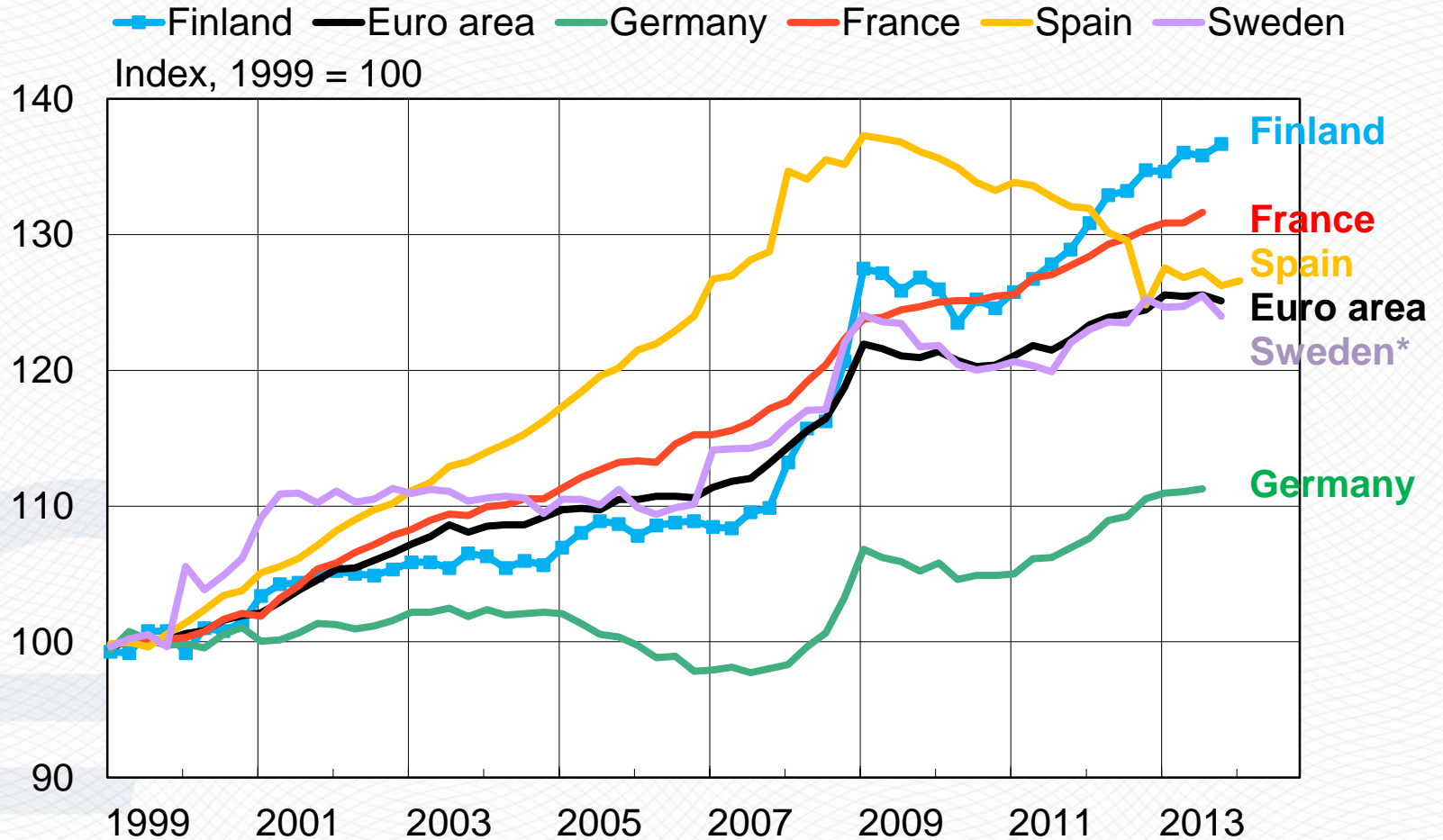


*Direct impact on GDP of decreased output by electrical engineering and electronics industry: -4%
BKT:hen -4 %*



Source: Statistics Finland.

Prolonged decline in cost-competitiveness

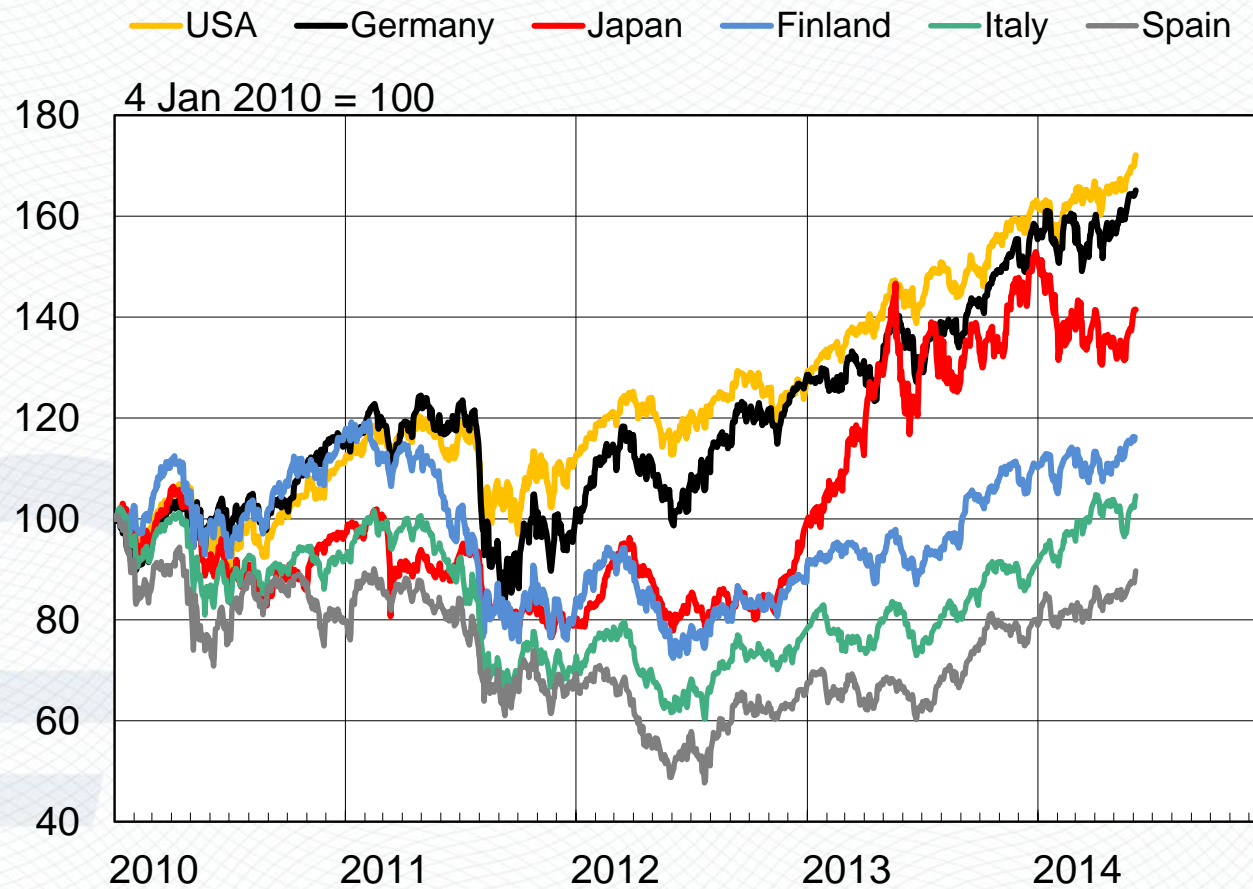


* SEK-denominated. Sources: Eurostat and OECD.

Developments in the international economy

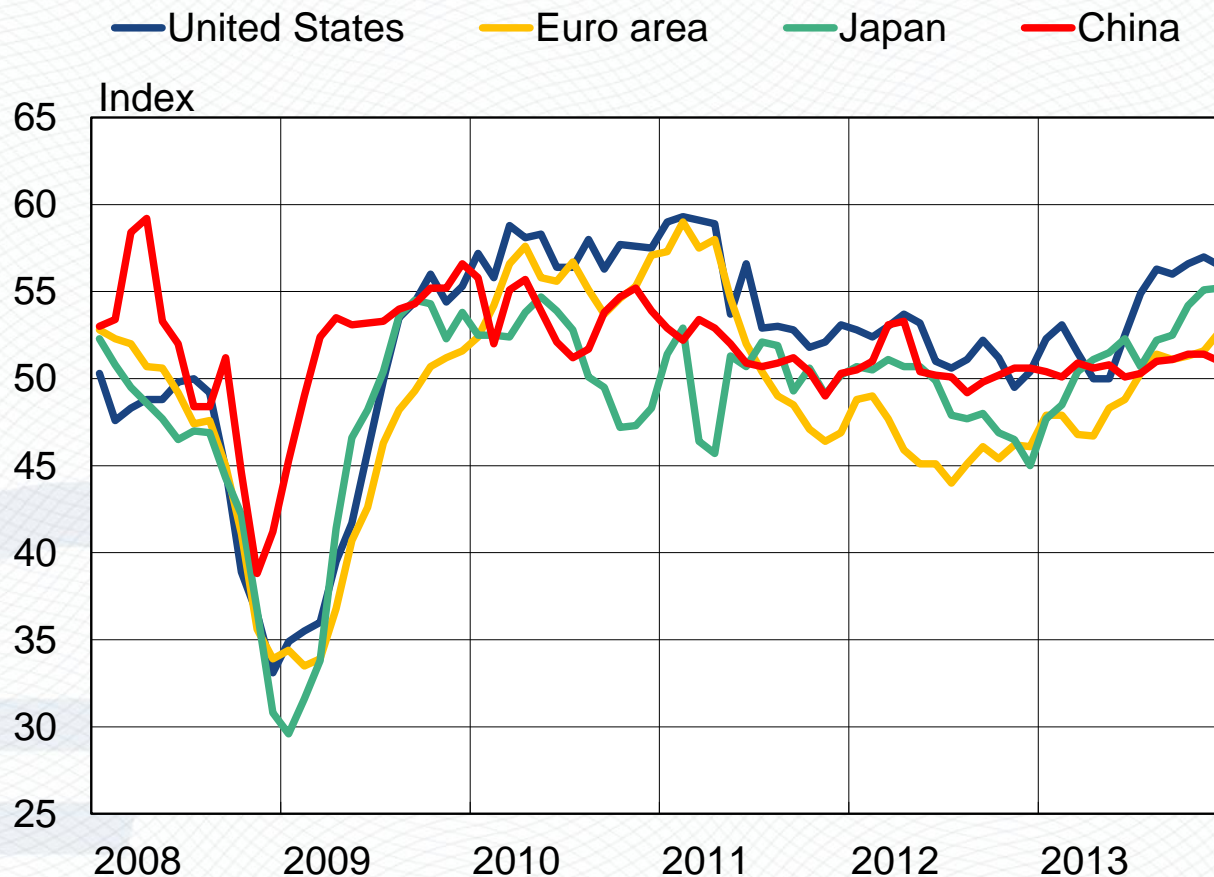


Bull market flattens out



Source: Bloomberg.

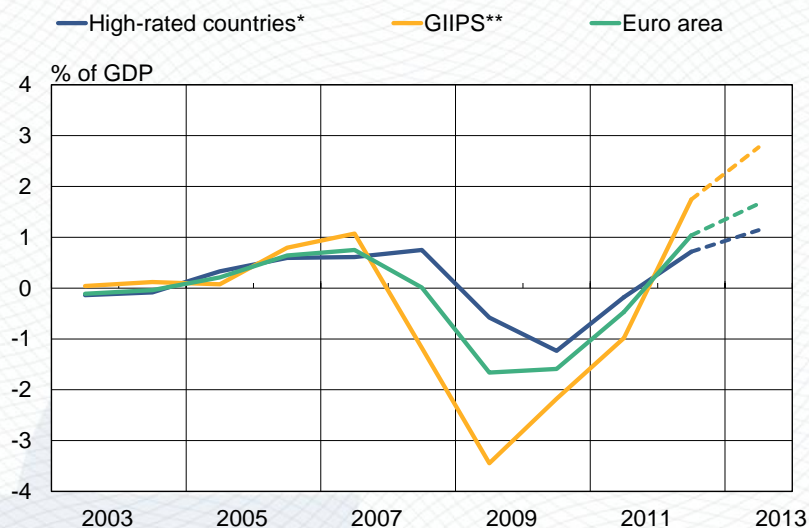
Purchasing managers' indices anticipate recovery in euro area and United States



Source: Bloomberg.

Progress in bringing balance to economies of crisis countries

General government structural primary balance



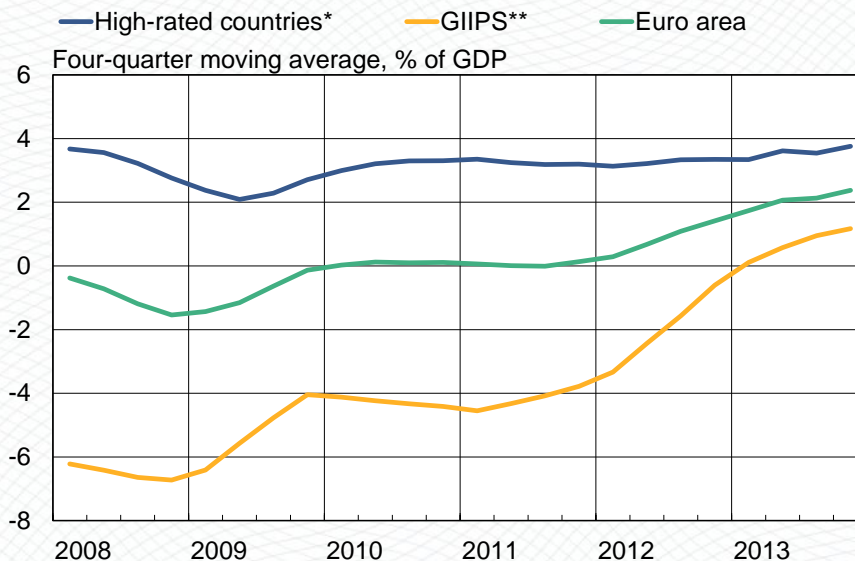
* Germany, France, Netherlands, Belgium, Austria and Finland.

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

The figures for 2013 are based on the Commission's 2014 spring forecast.

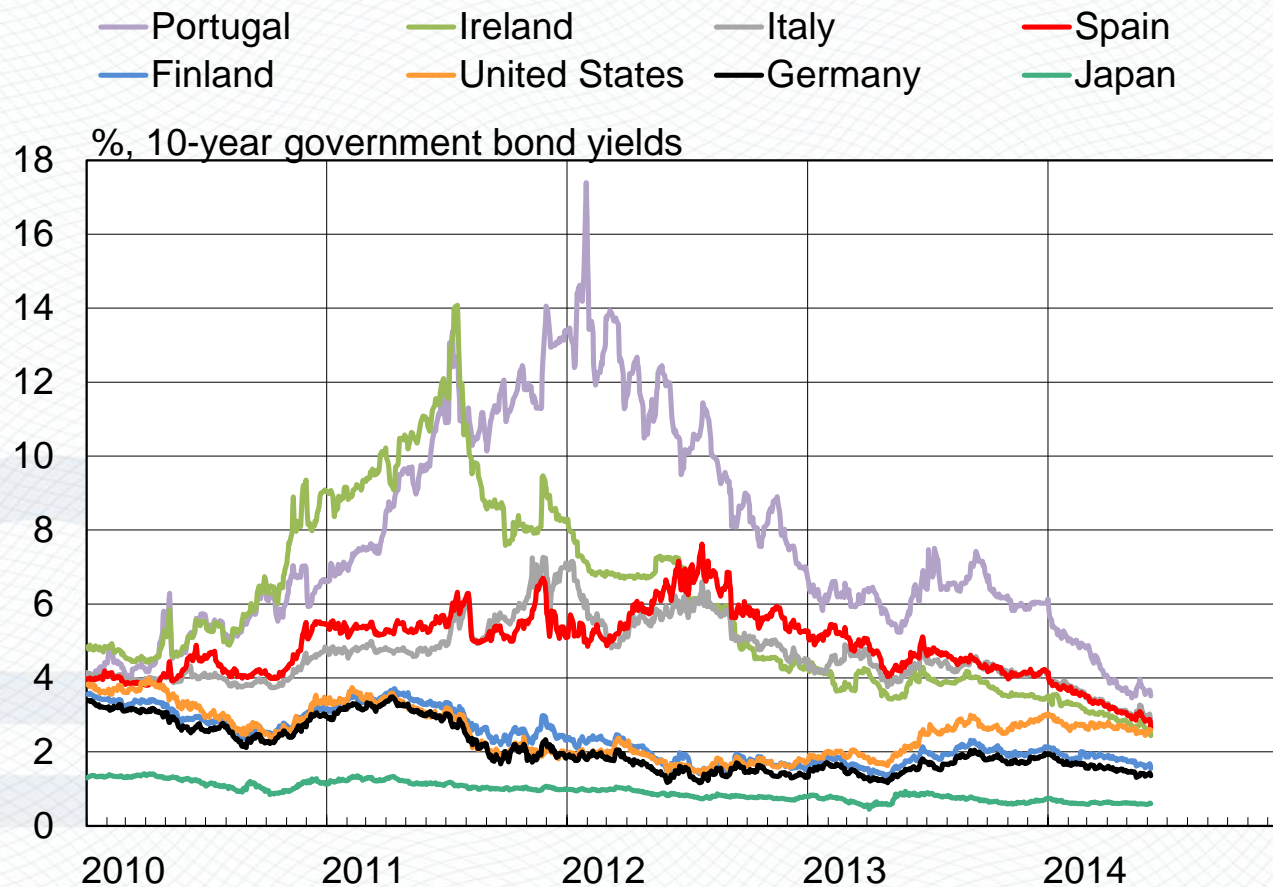
Sources: European Commission, ECB and calculations by the Bank of Finland.

Current account



Sources: ECB, Eurostat, national central banks/statistical authorities and Bank of Finland calculations.

Government bond yield differentials continue to narrow



Source: Bloomberg.
Bond maturities approx 10 years.

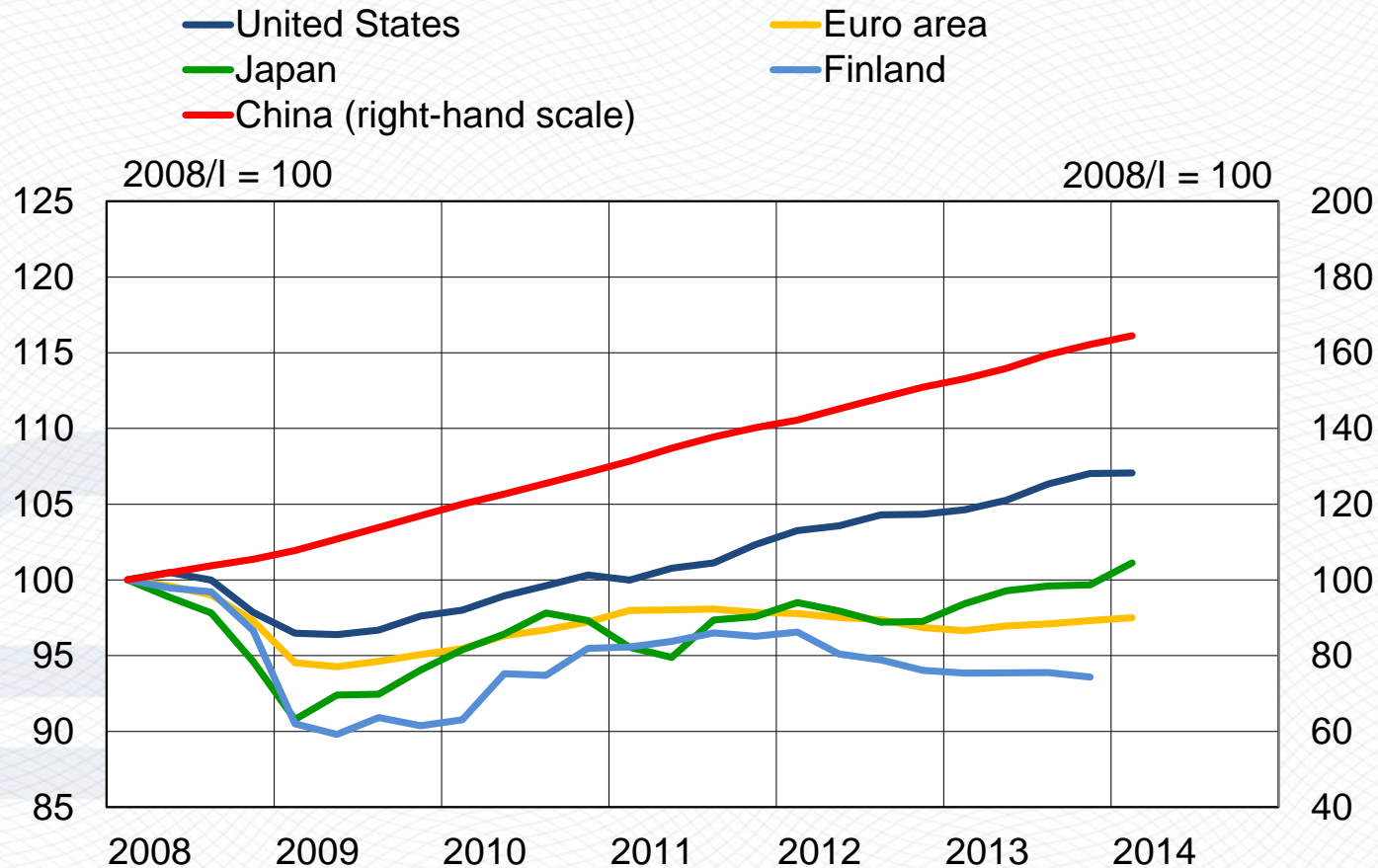
Russian growth outlook and share prices weakened



Source: BOFIT.

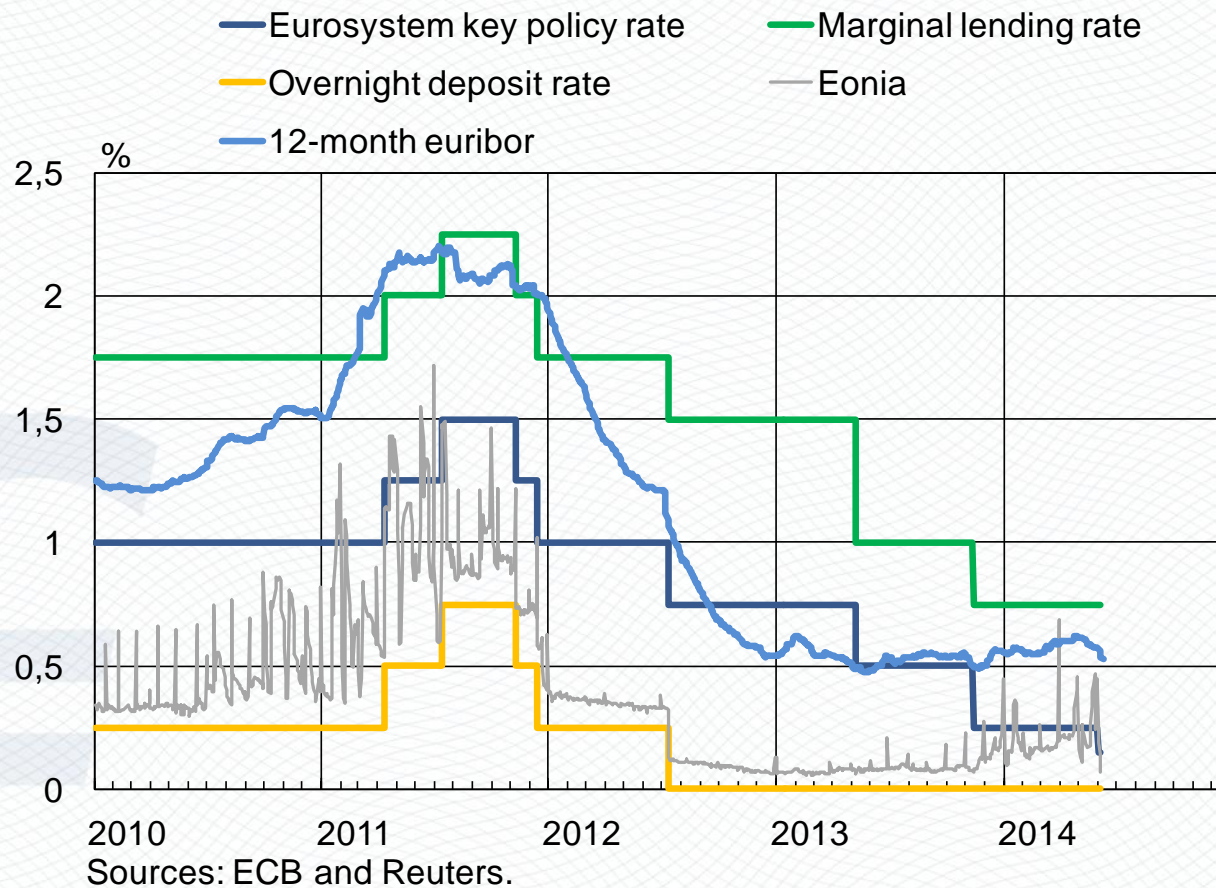
Global economy grows – Finland lags behind

GDP



Sources: National statistical authorities and Eurostat.

Policy interest rates historically low

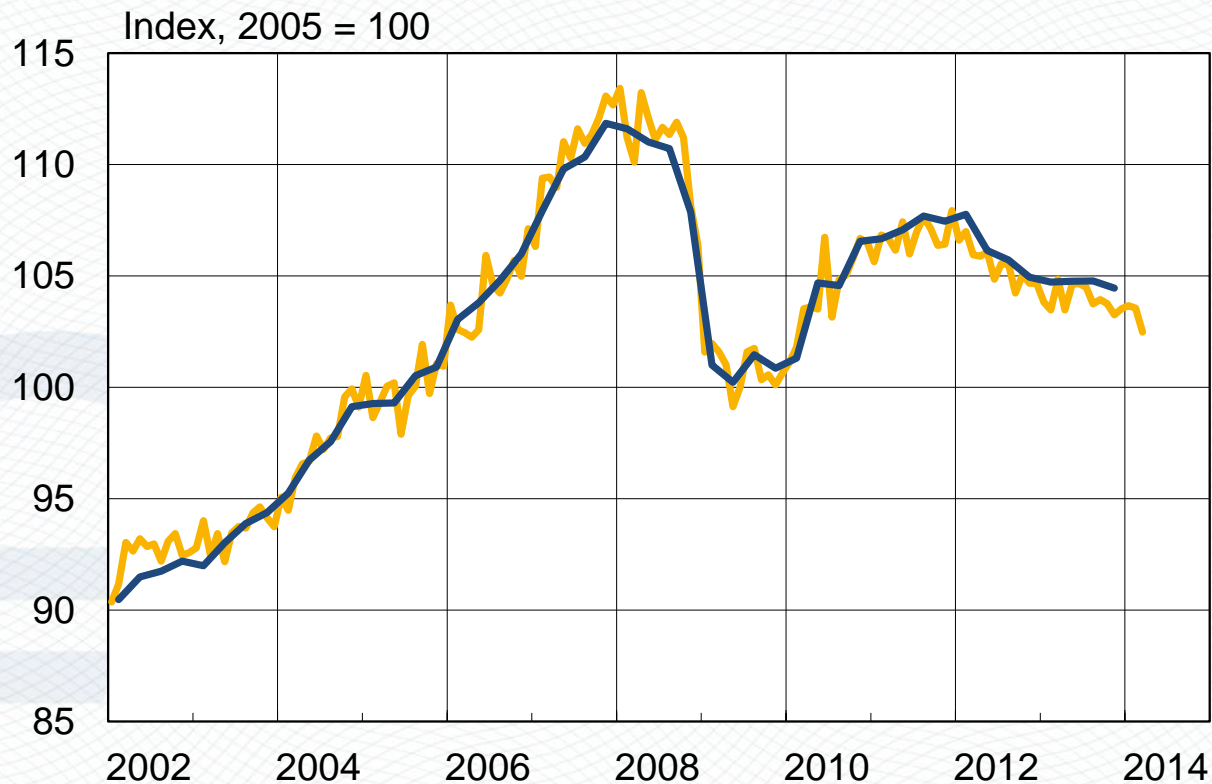


Finland's business cycle conditions remain weak



GDP continues to contract

— Trend Indicator of Output — GDP at market prices

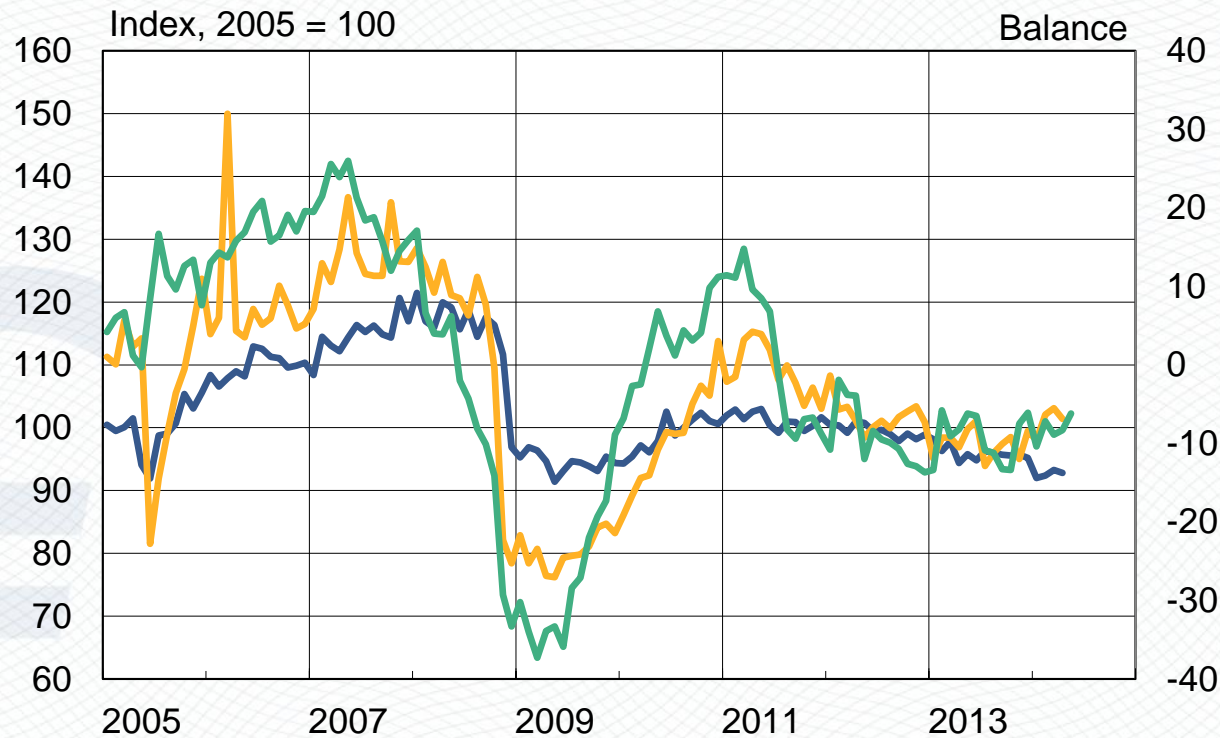


Seasonally adjusted figures.
Source: Statistics Finland.

First signs of recovery in industrial sector

Industrial output, new orders and industrial confidence indicator

- Volume index of industrial output (left-hand scale)
- New orders in manufacturing (left-hand scale)
- Industrial confidence indicator (right-hand scale)

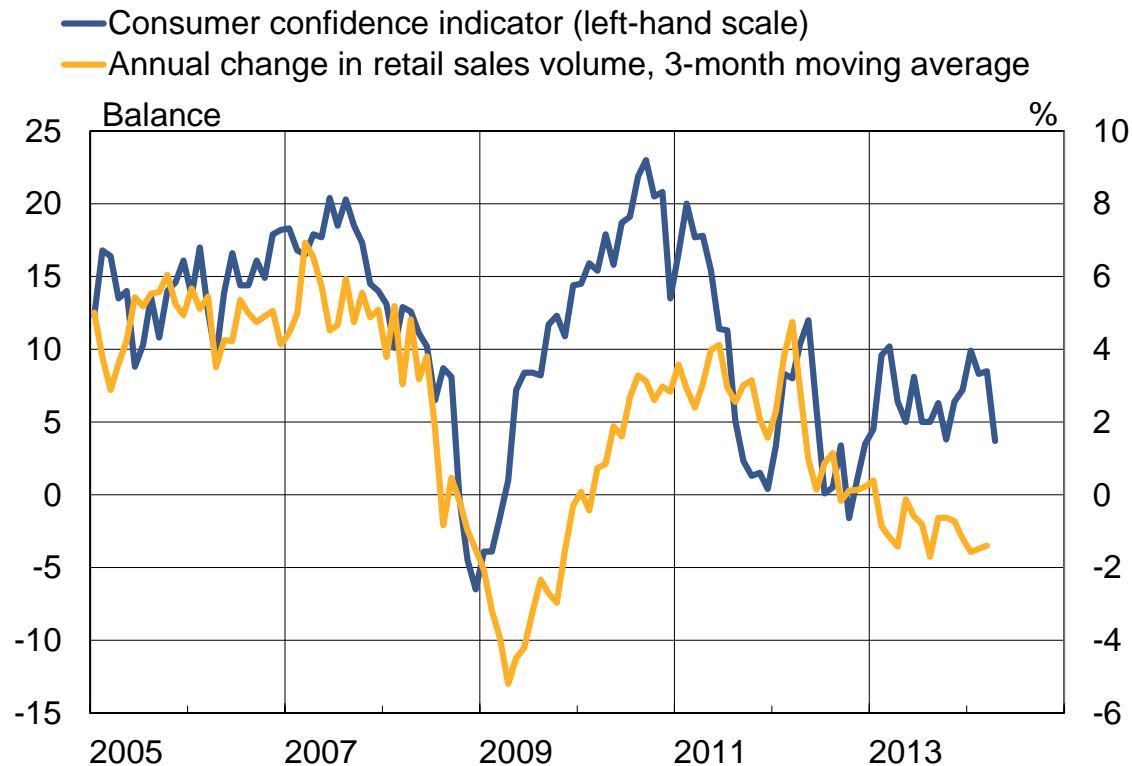


Seasonally adjusted figures.

Source: Statistics Finland and European Commission.

Domestic market cooling down: consumers still cautious

Consumer confidence indicator and retail sales volume



Source: Statistics Finland.

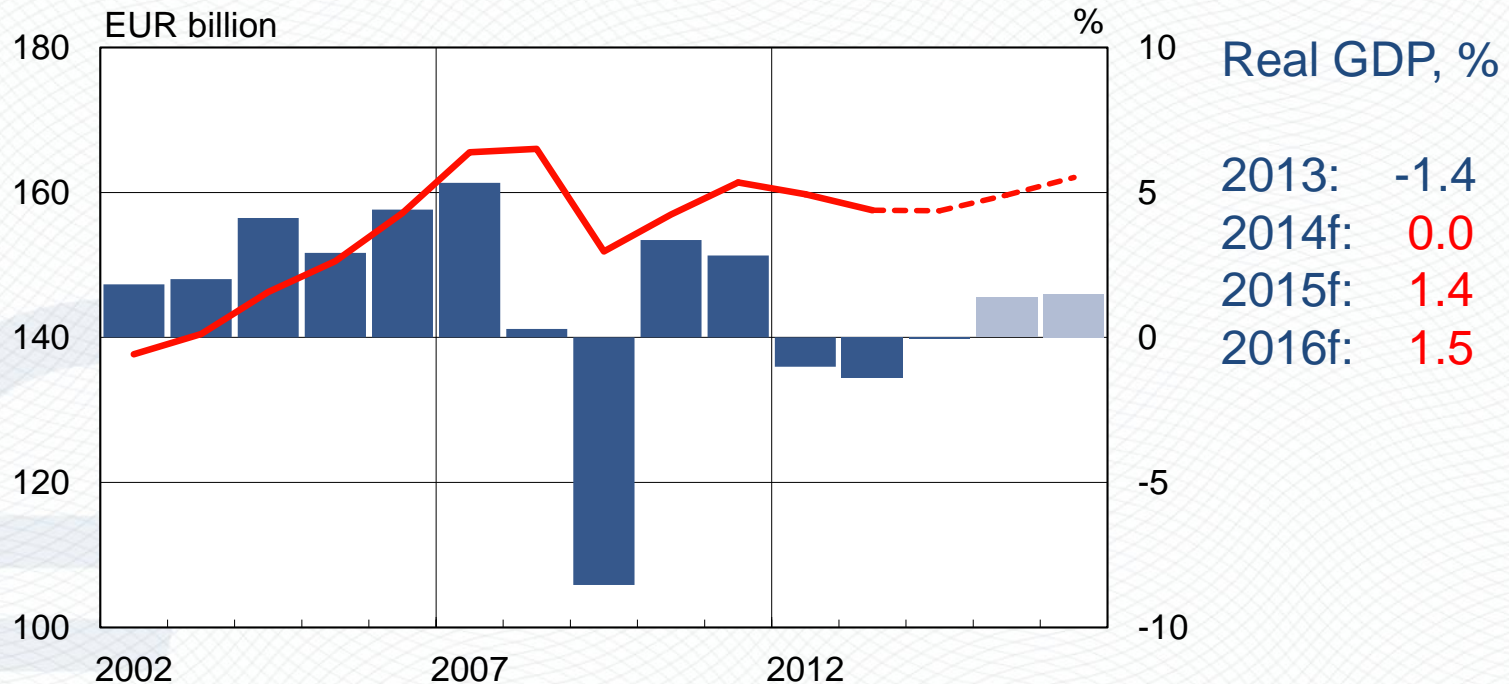
ECONOMIC GROWTH BEGINS, BUT REMAINS SLOW



Economy takes turn for the better, but growth remains slow

Real GDP

- % change on previous year (right-hand scale)
- At reference year (2000) prices (left-hand scale)



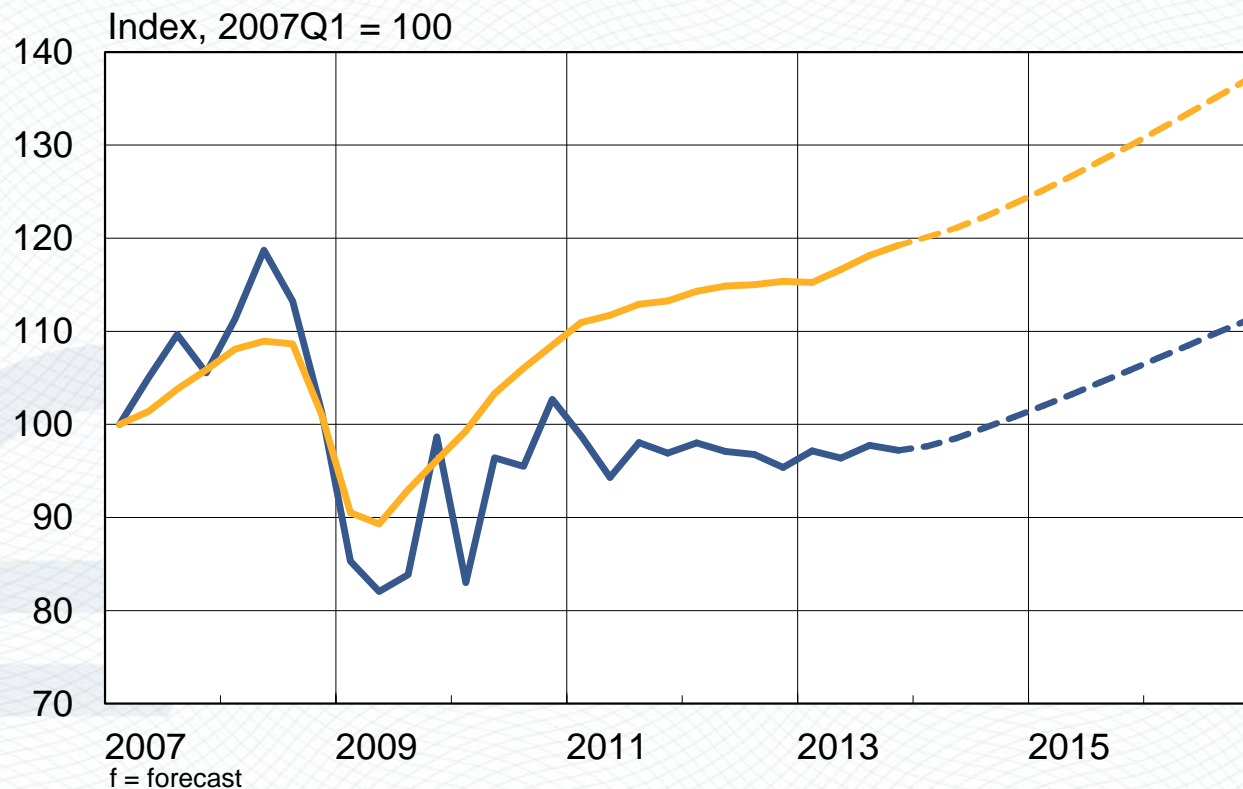
f = forecast

Sources: Statistics Finland and Bank of Finland.

Export markets pick up

Finnish exports and export markets

— Exports of goods and services — Finland's export markets



Exports, %

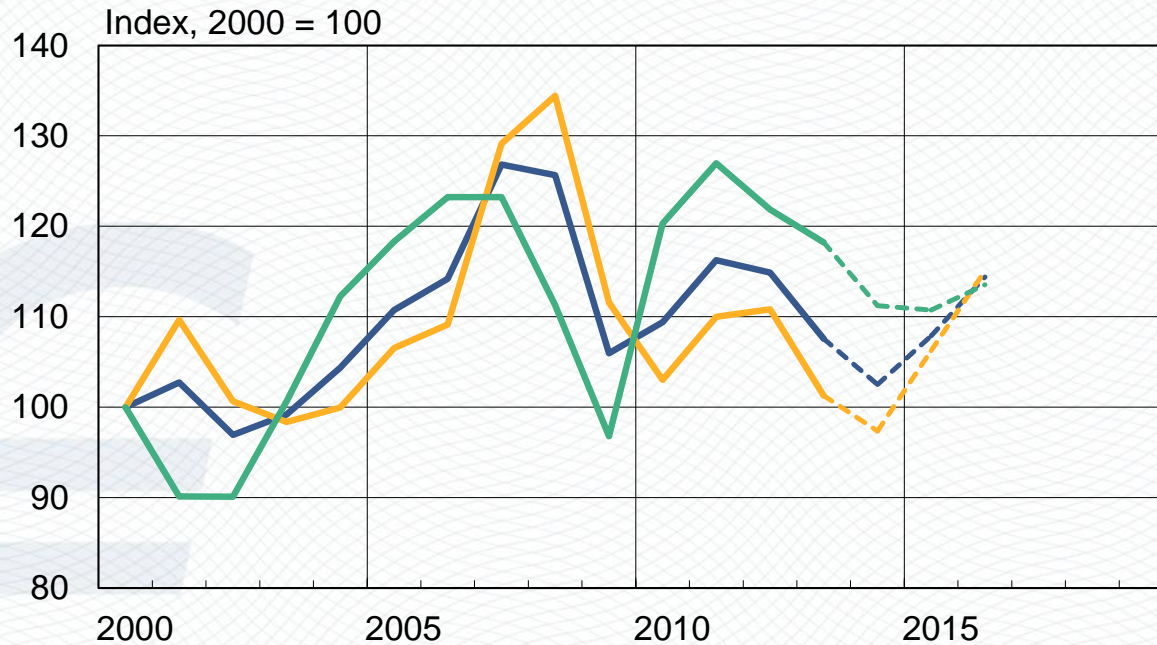
2013: 0.3
2014f: 2.1
2015f: 4.8
2016f: 5.0

Sources: Statistics Finland, Eurosystem and Bank of Finland.

Fixed investment takes off – housing investment sluggish

Real investment

- Private investment
- Private investment excl. housing
- Housing



f = forecast

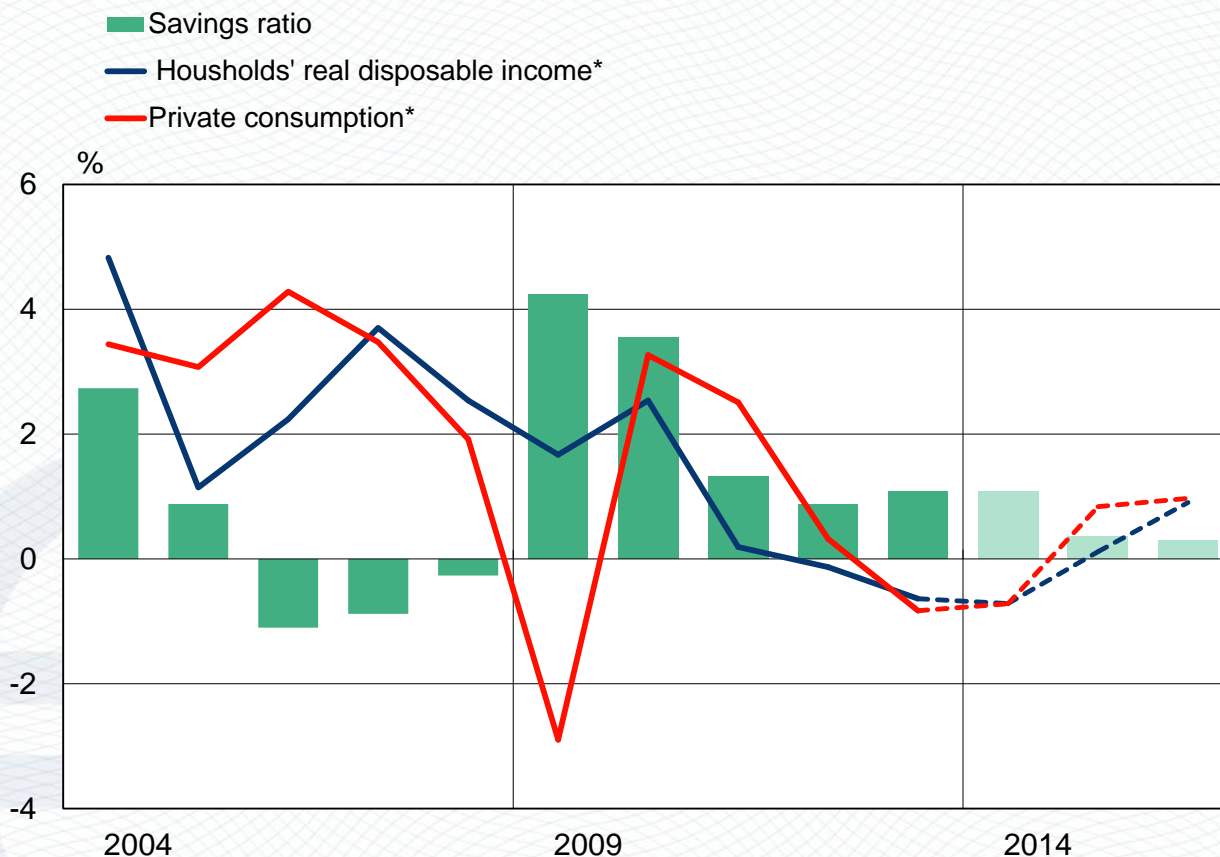
Sources: Statistics Finland and Bank of Finland.

Private investment, %

2013: -6.4
 2014f: -4.7
 2015f: 5.2
 2016f: 6.0

Household purchasing power grows slowly: consumption lacklustre

Household's disposable income, consumption and savings



Private consumption, %

2013: - 0.8
 2014f: - 0.7
 2015f: 0.8
 2016f: 1.0

f = forecast

Households = households and non-profit institutions serving households

* % change from previous year

Sources: Statistics Finland and Bank of Finland.

Inflation lower

Consumer prices

- Harmonised index of consumer prices, Finland
- Harmonised index of consumer prices, euro area

% change on previous year



Harmonised index of consumer prices, %

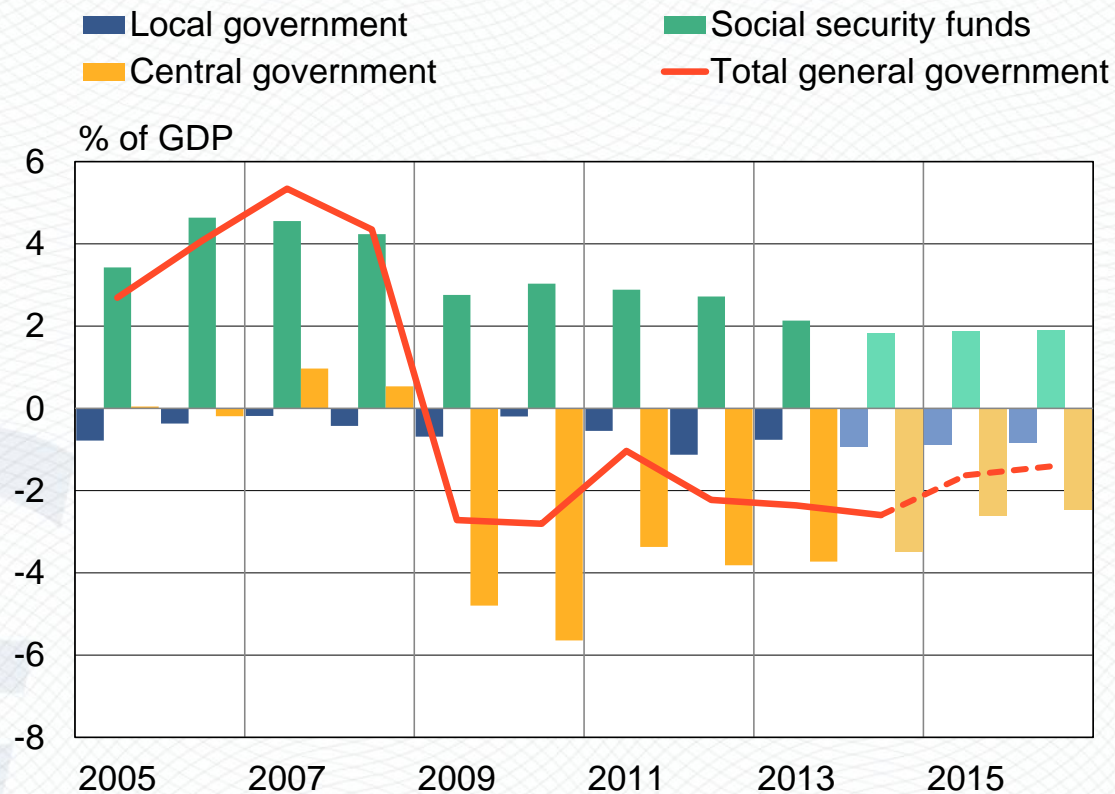
2013:	2.2
2014f:	1.2
2015f:	1.3
2016f:	1.5

f = forecast

Sources: Statistics Finland, Eurostat, ECB and Bank of Finland.

Public finances consolidate slowly

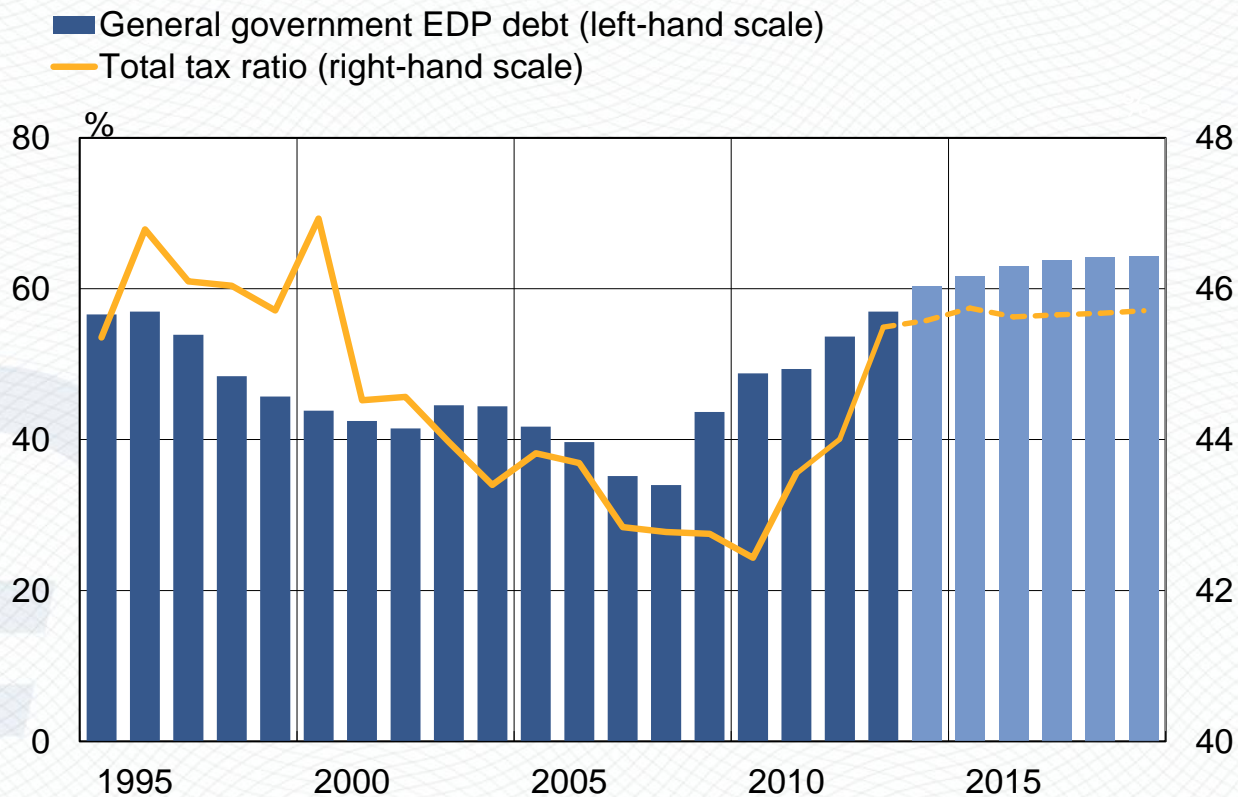
General government net lending



Sources: Statistics Finland and Bank of Finland.

Public debt and total tax ratio remain high

Public debt and total tax ratio,% of GDP



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

Forecast summary

– Supply and demand –

% change of previous year				
	2013	2014f	2015f	2016f
Gross domestic product	-1,4	0,0	1,4	1,5
December forecast	-1,0	0,6	1,7	
Private consumption	-0,8	-0,7	0,8	1,0
Private fixed investment	-6,4	-4,7	5,2	6,0
Imports	-1,8	1,0	4,1	5,0
Exports	0,3	2,1	4,8	5,0
Unit labour costs	2,2	0,4	0,4	1,0
Harmonised index of consumer prices	2,2	1,2	1,3	1,5
Unemployment rate, %				
	8,2	8,6	8,3	7,8
Current account balance, % of GDP				
	-1,1	-0,6	-0,2	-0,3

f = forecast

Sources: Statistics Finland and Bank of Finland.

Downside risks to growth

International risks

- Ukraine crisis and developments in Russian economy generate uncertainty
- Euro area structural reforms still unfinished and financial system still vulnerable
- Instability in China's financial sector

Domestic risks

- Growth recovery could dry up if export markets do not pull hard enough and competitiveness problems continue.
- Market confidence in Finland could be endangered if economic policy grip is insufficiently firm (alternative scenario).



ON THE POLICY DECISIONS

Restoration of competitiveness necessary for export and employment

- *Unit labour costs must rise more slowly than in trading partners for several years ahead*
- *Fostering arrangements at company level*
 - *Employees may secure their jobs and employers the profitability of their output when conditions get tougher*
- *Removal of obstacles to competition; supply of housing in growth centres*

Structural reforms needed to address economic problems

- ***Ambitious implementation of government structural policy programme***
- ***Pension reform key***
 - ***In the absence of a reform, there will be high upward pressure on the tax rate, while pension contributions are higher than before***
- ***Accumulation of general government debt must be stopped***
 - ***Increases the risks and does not solve the structural problems***

Challenging decisions taken, implementation lies ahead

- *Given the restrained economic situation, capacity to take corrective action is key.*
- *Confidence in economic policy is slowly built and quickly lost.*
- *Decisions on, on one hand, structural reforms and, on the other hand, on general government consolidation measures have been vitally important.*
- *If uncertainty were to arise regarding implementation of the decisions taken, the rebuilding of confidence could in the future require much more extensive measures than those currently posed.*



ALTERNATIVE SCENARIO

Financial conditions may tighten again

- Slow economic growth, in combination with little room for manoeuvre in the public sector, heighten the risk that market confidence in Finland's solvency will shake.
- Costs of financing general government debt may grow and overall financial conditions may tighten.
- Banks' access to funding will become more expensive, the supply of credit decline and the interest rate premium grow. The increase in uncertainty may also cause a fall in share and housing prices
- This alternative calculation aims to illustrate the macroeconomic effects of the scenario.

Model

- The alternative scenario is based on a model that illustrates the combined effect of the macro economy and financial factors
- In the calculation, demand and supply shocks, as well as shocks originating in financial markets, such as credit supply and asset price shocks, will be isolated from each other to be able to assess their impact on GDP growth and other model variables.
- The model is discussed in greater detail in one of the feature articles of the Bulletin.

Tighter financial conditions would depress GDP growth significantly

Vaihtoehtoislaskelma: luotontarjonnan vähentyminen

	2014	2015	2016
BKT**	-0.2	-0.8	-0.8
Inflaatio**	0.1	-0.1	-0.4
Uudet lainat**	-4.2	-5.0	-2.8
Asuntojen hinnat**	-1.0	-3.6	-3.5
Osakkeiden hinnat**	-2.9	-11.0	-10.8
Korkomarginaali*	0.1	0.2	0.2

** Muutos suhteessa ennusteen perusuran mukaiseen kasvuun, prosenttiyksikköä

* Muutos korkomarginaalissa, prosenttiyksikköä



Thank You!