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Bank of Finland

## Finland lags euro area in economic growth – what needs to be done?

Euro & talous 3/2015





# Accommodative monetary policy boosts the outlook for the euro area economy



## Factors underlying the improved outlook for the euro area

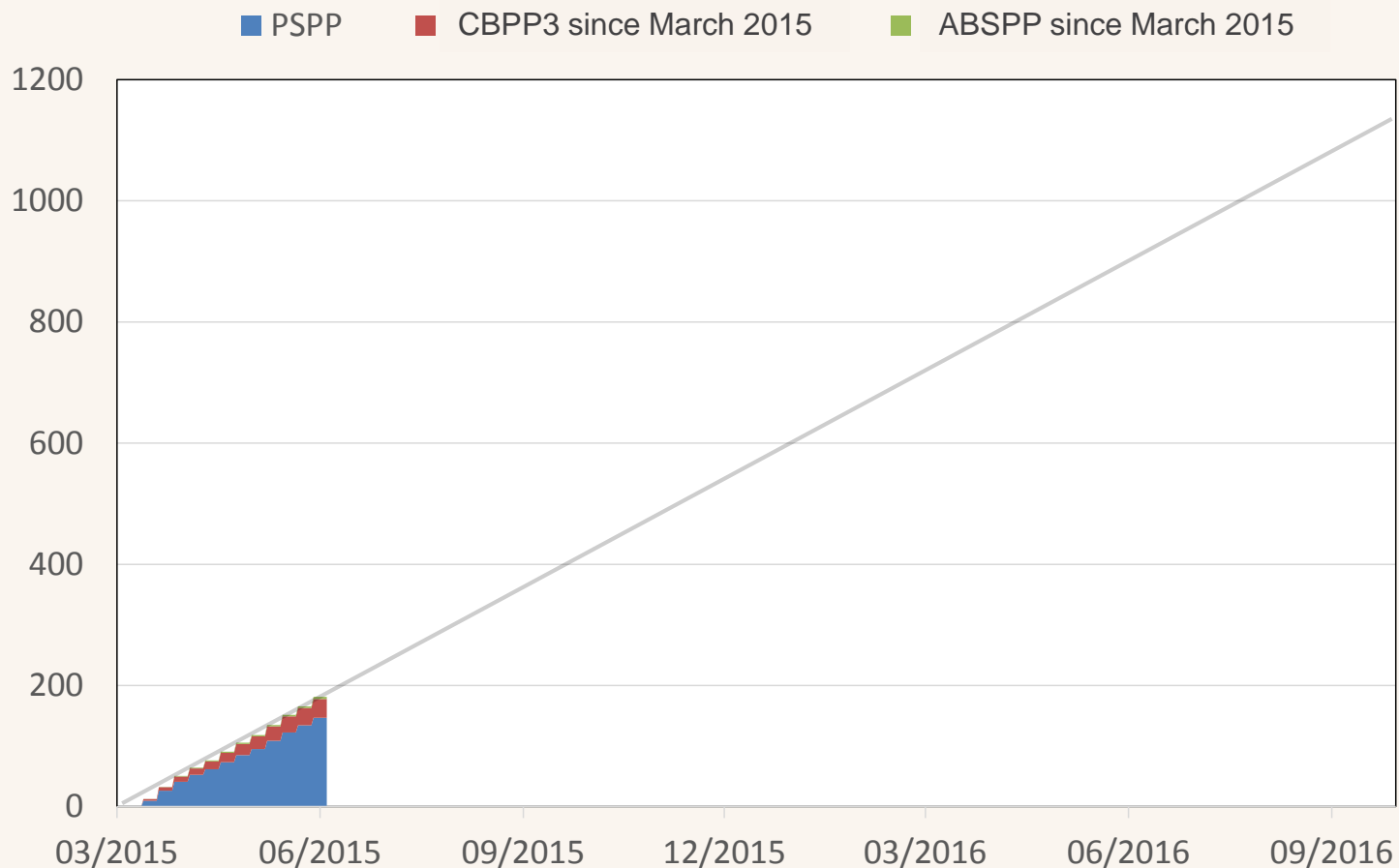
- *Relaxed monetary policy reduces funding costs and improves access to finance*
- *Euro depreciation*
- *Decline in oil prices in the latter part of 2014*

*In addition:*

- *Progress in fiscal consolidation*
- *Structural reforms moving ahead*
- *Stronger banking sector*
- *Lower private sector debt levels*

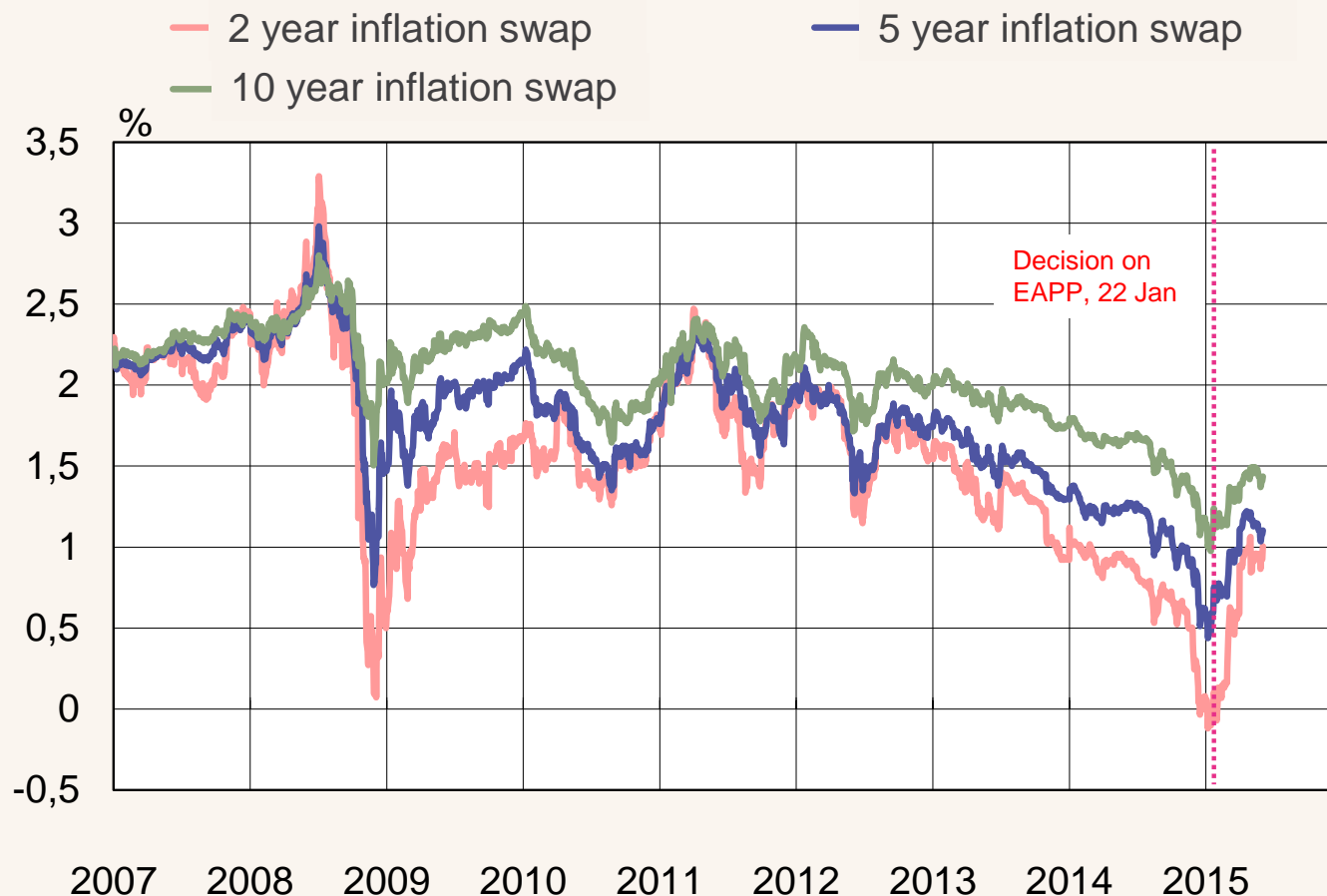


## Purchases under the Eurosystem's expanded asset purchase programme, EUR billion





# Recovery in market inflation expectations

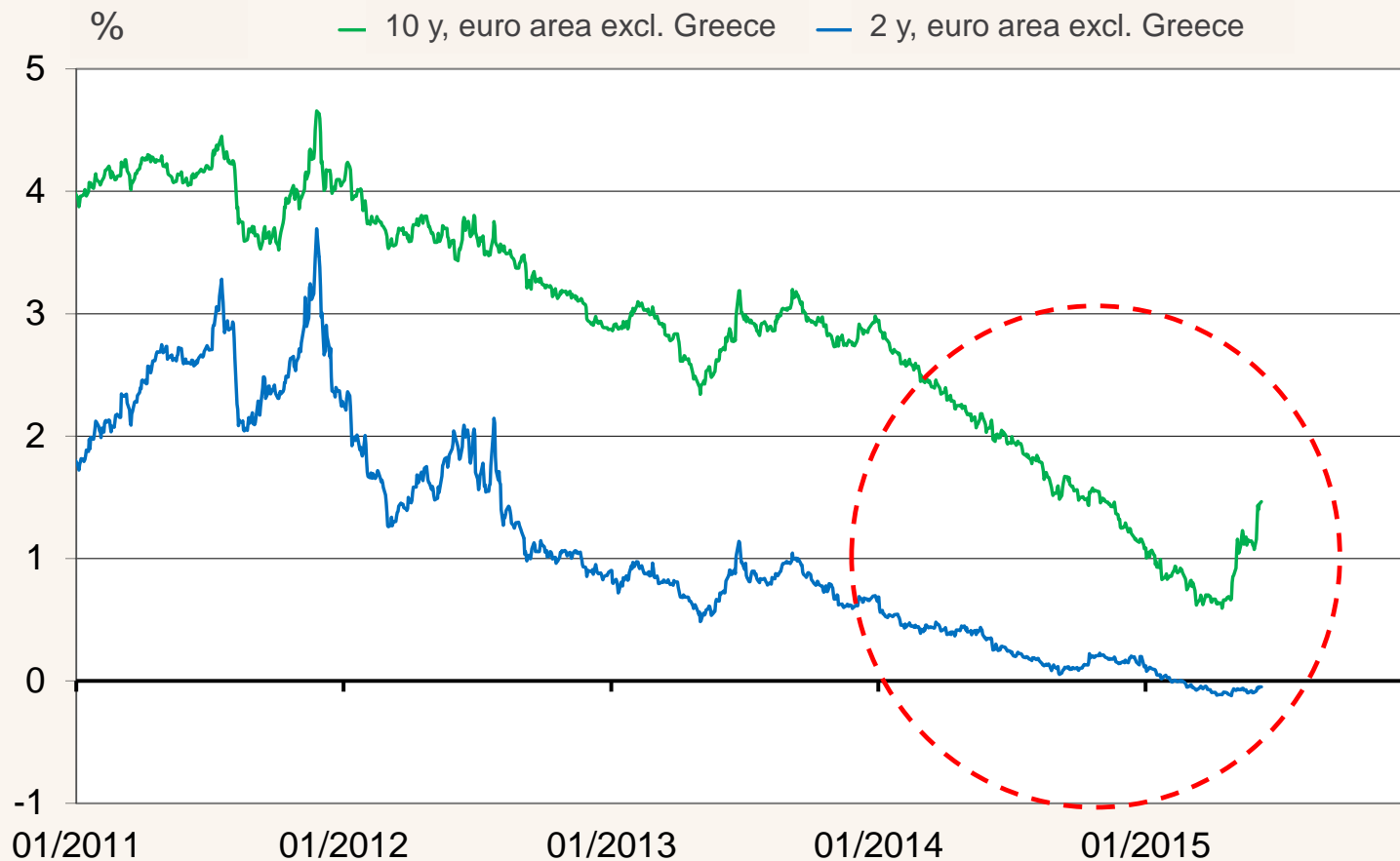


Source: Bloomberg

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## Government bond yields declined substantially; some reversal in long maturities in May



Source: Bloomberg



# Expanded asset purchase programme will also impact Finland

Elisa Newby and Seppo Orjasniemi: *Finland benefits from the Eurosystem's securities purchases*. Bank of Finland Bulletin 3/2015.

- ***Largest direct effects due to the decline in market interest rates and euro depreciation***
  - *83% of corporate loans and 94% household loans in Finland linked to Euribor rates*
  
- ***Model calculation: short-term contribution to GDP growth +0.3%***
  - *In addition, indirect effects from growth in Finnish exports to the euro area*
  
- ***Effects taken into account in the forecast***

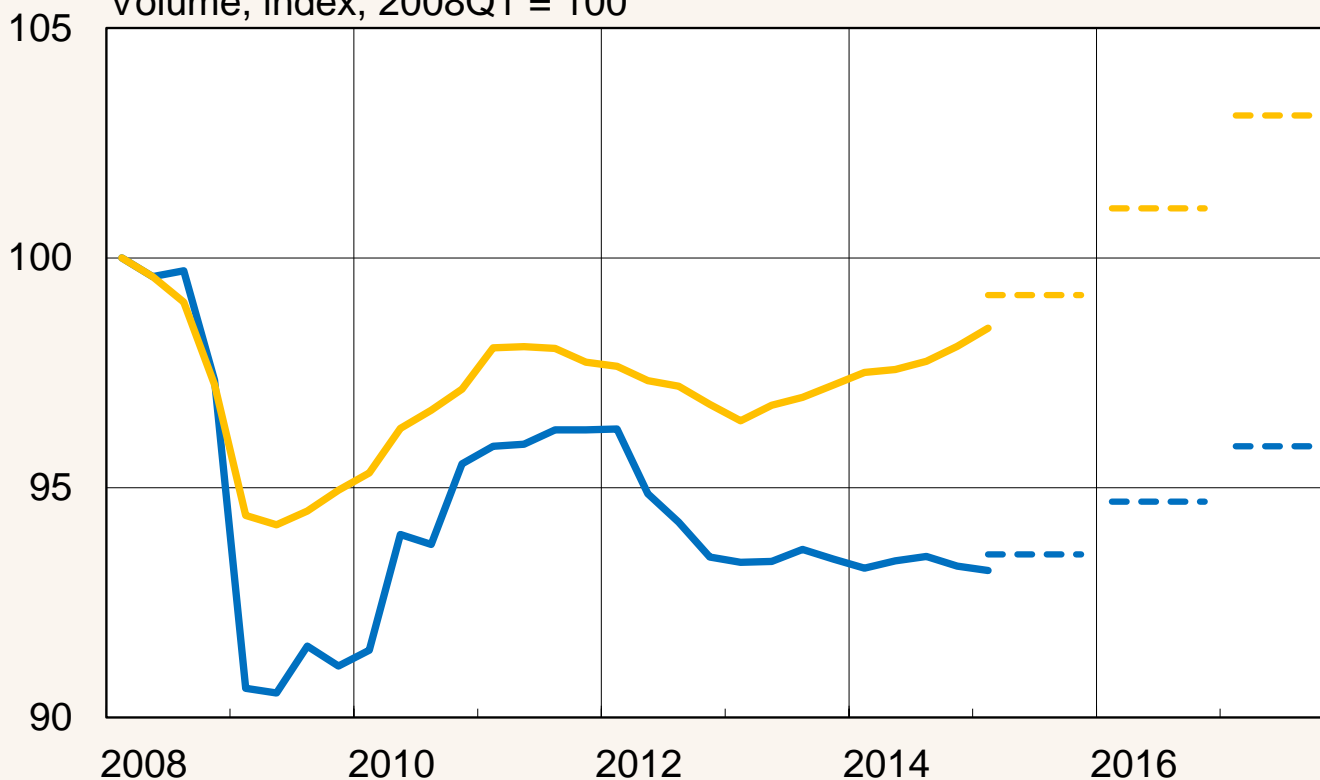


# Forecasts: growth still below euro area average

## GDP

— Finland — Euro area

Volume, index, 2008Q1 = 100



Forecasts: Bank of Finland (Finland) and ECB (euro area).  
Sources: Eurostat, Bank of Finland, and ECB.

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# When does the Bank of Finland take a stand on domestic economic policy?



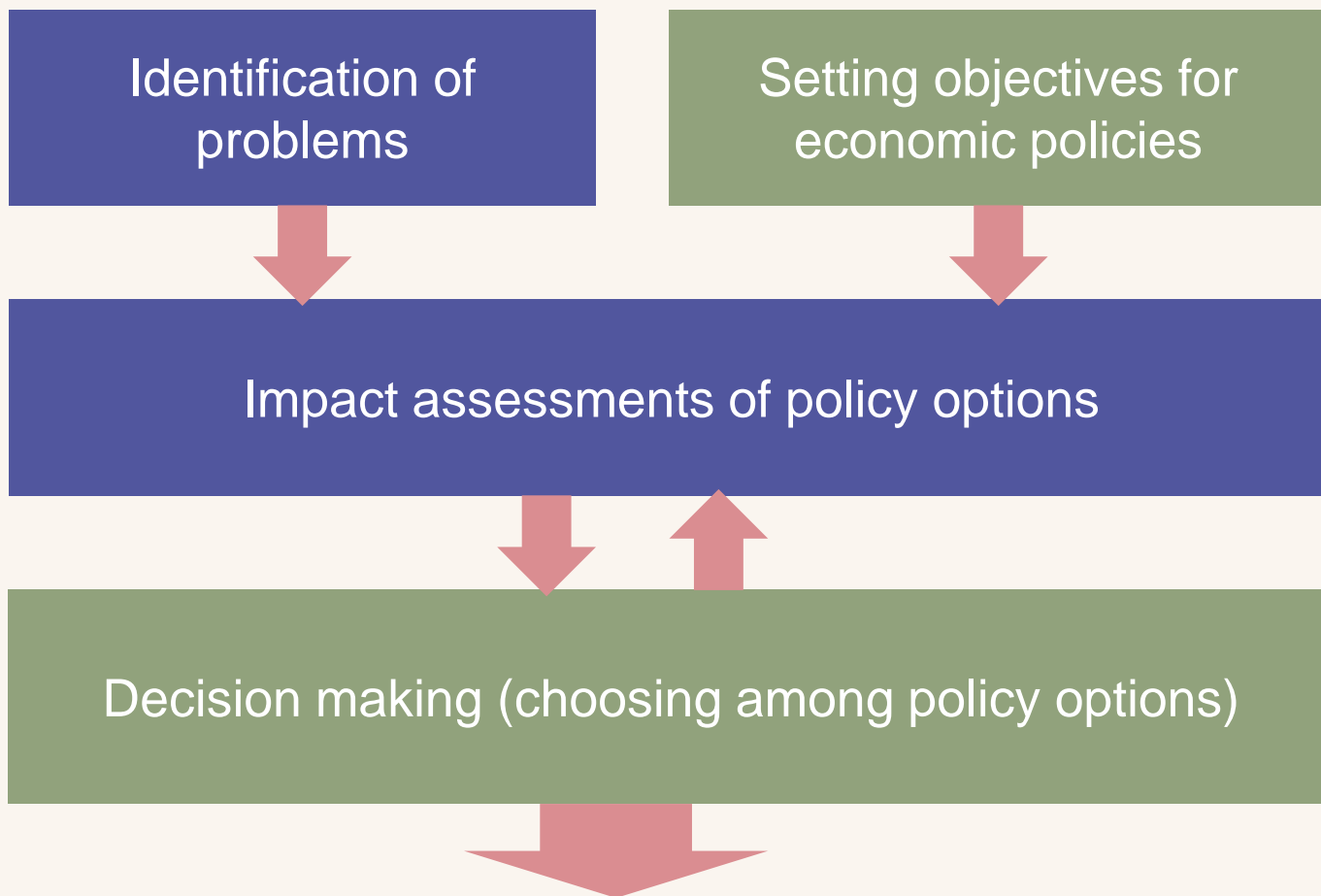
# Starting point: Objectives set for the Bank of Finland

- ***Status of the Bank of Finland:***
  - *Operational independence; objectives set democratically*
  
- ***Objectives of Eurosystem and Bank of Finland:***
  - *Primary objective: price stability*
  - *Other objectives include balanced economic growth*
  
- ***Necessary conditions for achieving price stability:***
  - *Sustainability of public finances*
  - *Balance in domestic cost developments*
  
- ***It is the responsibility of the Bank of Finland to support domestic economic policies according to its status***



# When does the Bank of Finland take a stand?

Stages with emphasis on  
expertise





## How does the Bank of Finland take a stand?

- ***Bank of Finland assesses scale of threats to economic stability, such as:***
  - *Need for fiscal consolidation and structural reforms*
  - *The level of cost competitiveness*
- ***Bank of Finland assesses impact of measures***
- ***Often not justified to recommend individual fiscal or structural policy measures***
  - *Value judgements belong to Parliament and Government*
- ***Statements and comments are based on research, international experience and other published analyses***



## Some characteristics of recent developments

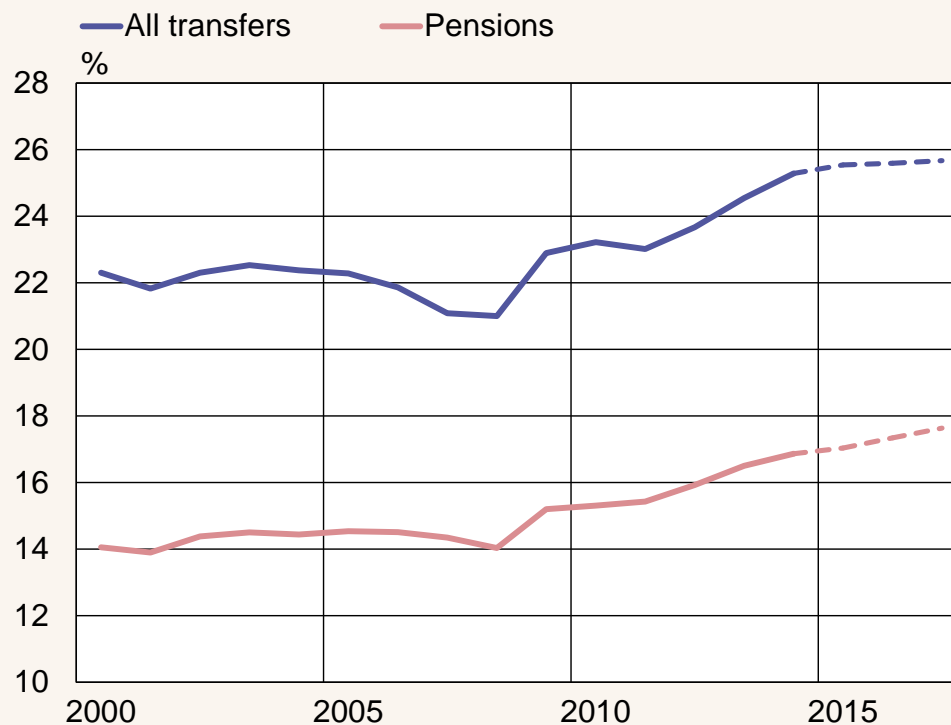
- Economic contraction has hurt especially those who have lost their jobs
- Prices and rents have risen



# Current transfers an increasingly significant source of household income

Helvi Kinnunen and Petri Mäki-Fränti: *Private consumption increasingly dependent on income transfers*. Bank of Finland Bulletin 3/2015.

## Share of transfers in total income



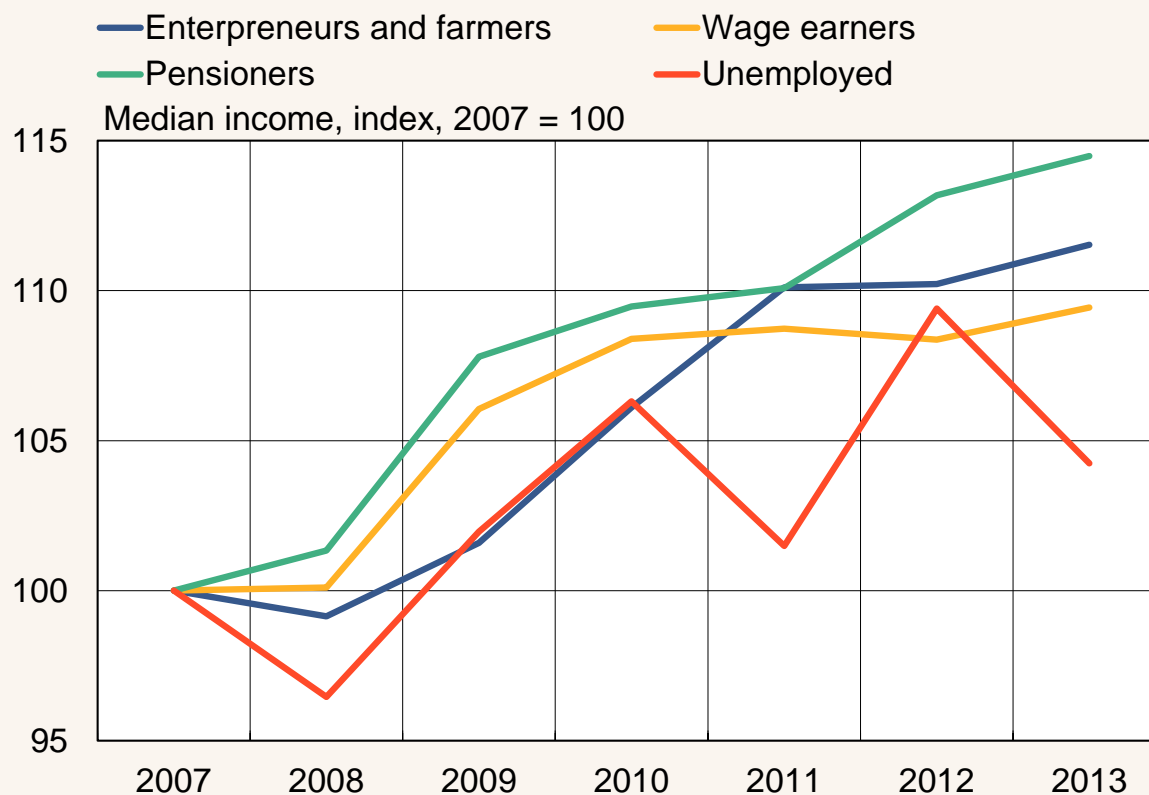
Sources: Statistics Finland and Bank of Finland.

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## Economic contraction has constrained income growth most for wage and salary earners and the unemployed

Helvi Kinnunen and Petri Mäki-Fränti: *Private consumption increasingly dependent on income transfers.* Bank of Finland Bulletin 3/2015.

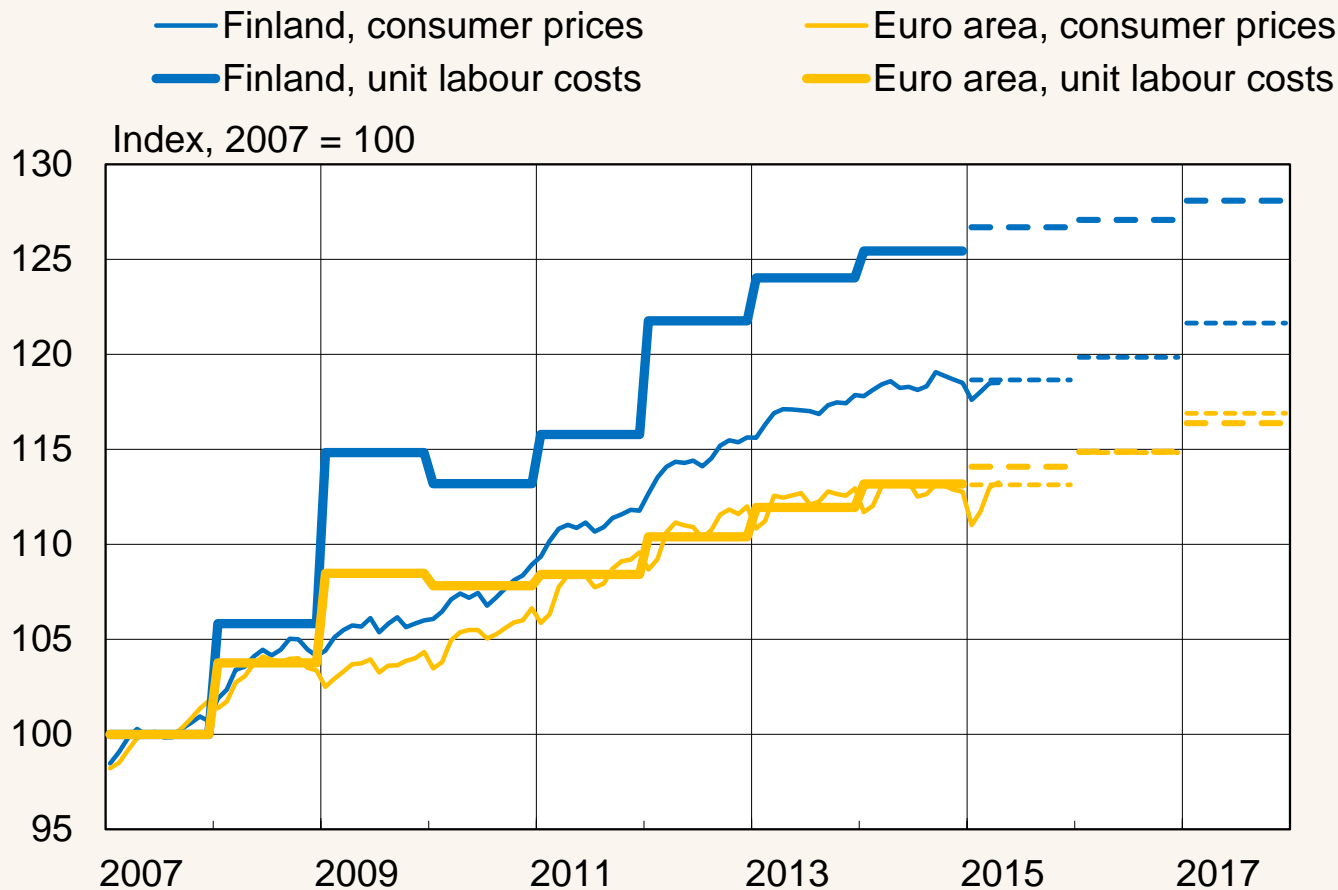


Sources: Statistics Finland and Bank of Finland.

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## Finnish prices and costs have risen faster than the euro area average



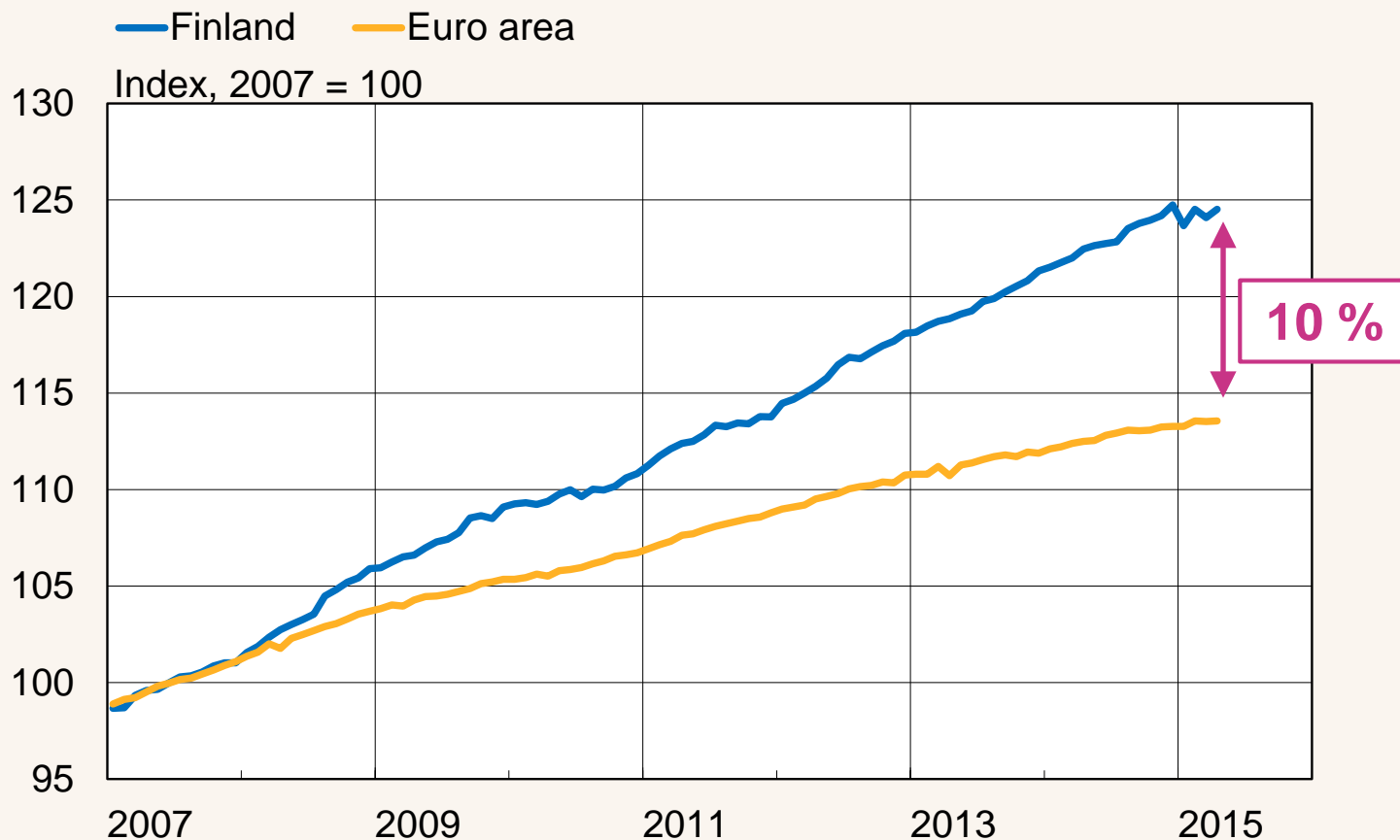
Forecasts: Bank of Finland (Finland) and ECB (euro area).

Sources: Eurostat, European Commission, ECB, and Bank of Finland. 27383





## Services inflation higher than in the euro area

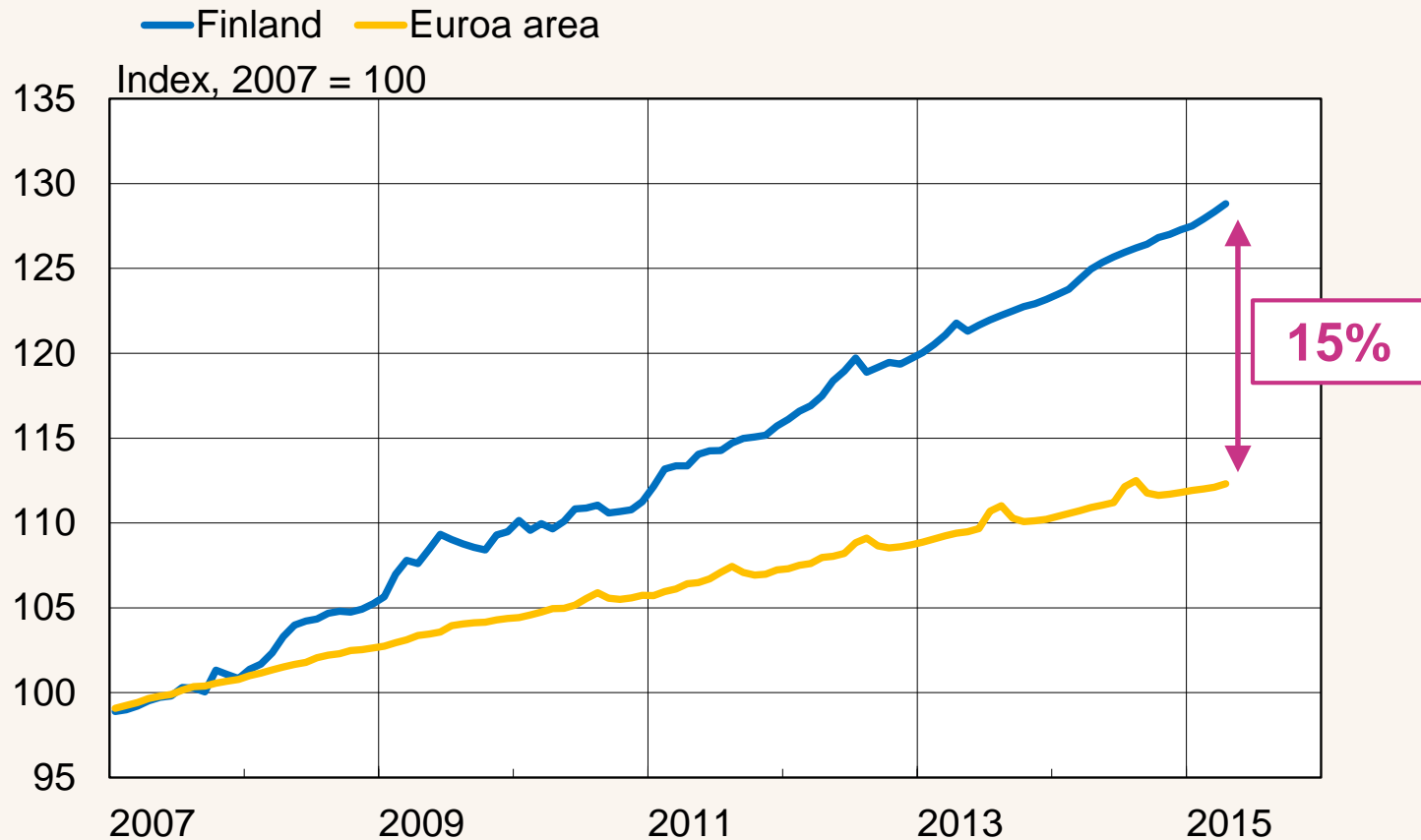


Seasonally adjusted Harmonised index of consumer prices: Services.  
Source: European Central Bank.

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## Higher rents reflected in service prices



Harmonised index of consumer prices: Rents.  
Source: European Central Bank.

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## How to overcome the difficulties

- Shift growth in public debt to a downward trajectory
- Structural reforms
- Restoration of cost competitiveness



## Size of the Government's consolidation plan justified

- ***Problems in the economy and public finances largely long-term and structural***
- ***Most of the impact of the necessary structural reform measures to be felt only after several years, and the size of impact is yet uncertain***
  - ***It is therefore necessary to continue the fiscal consolidation***
- ***The size of the consolidation plan of the new Government Programme is justified***
- ***Consolidation measures that would turn down the growth in the debt ratio in the next few years would not ensure long-term sustainability***



## Objectives of structural reforms must be set high and the related decisions must be implemented

- *The objectives of the spring 2014 Structural Policy Programme were well-founded, but implementation failed*
- *Important policy objectives and statements in the new Government Programme*
- *Significant decisions and swift implementation are needed now*



# Cost competitiveness: Need wage restraint and other measures

- ***Need to improve cost competitiveness by 10% or more***
- ***Moderate pay settlements alone improve cost competitiveness very slowly***
  - *Wages are expected to rise at a slow pace also in several other countries*
  - *Therefore, other measures in addition to wage moderation are needed*
- ***Finnish price and cost level must adapt relative to the euro area average***
  - *Cost competitiveness within the monetary union a prerequisite for success*
  - *Avoiding deflation is an ECB monetary policy issue for the whole monetary union*



## Summary

- *The problems are grave, and a strong recovery is not imminent*
- *The gravity of the problems is widely understood*
- *Now, need to aim high and act resolutely*



**Thank you!**