

Erkki Liikanen

Bank of Finland

ECB's monetary policy

The condition of the banks and key unresolved issues in the global economy





Monetary policy was eased on 10 March 2016 with the adoption of a comprehensive monetary policy package.



Objectives of the March monetary policy decisions:

- *To further ease financing conditions in euro area countries*
- *To foster increased lending*

BACKGROUND:

- *Weakened outlook for global economy*
- *Tightening of financing conditions in early year*
- *Subdued inflation outlook*

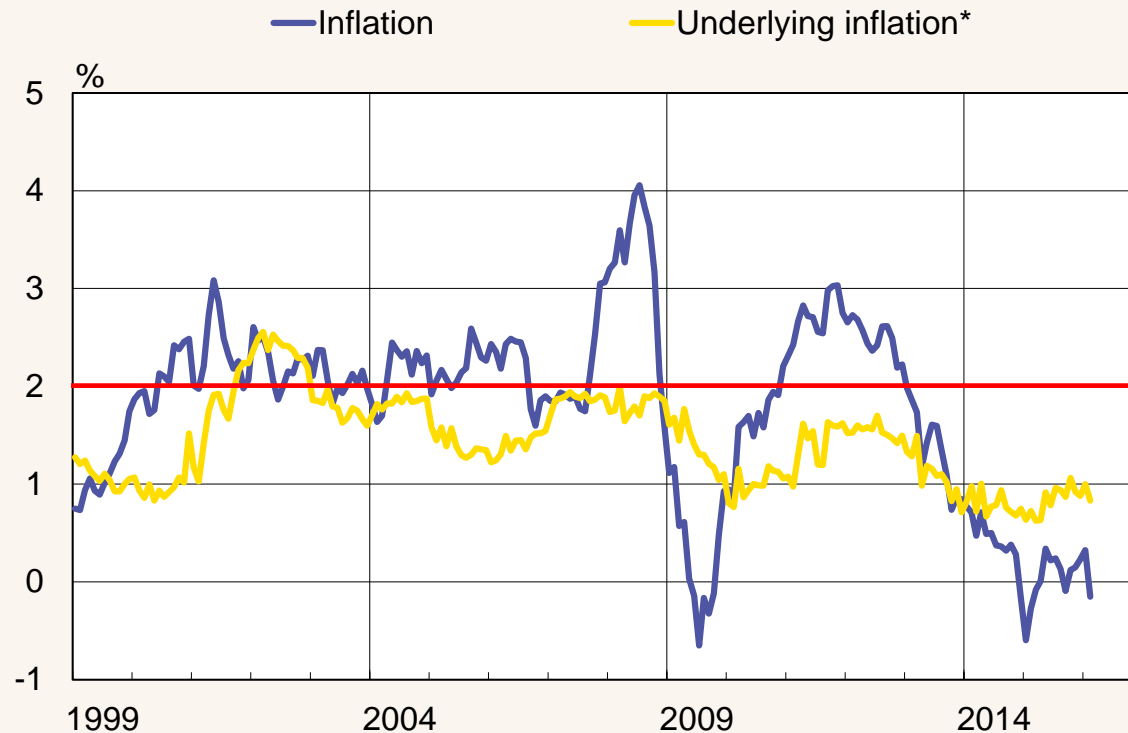


Inflation outlook weakened and expectations subdued



Still weak consumer price inflation

Euro area consumer price inflation (HICP)

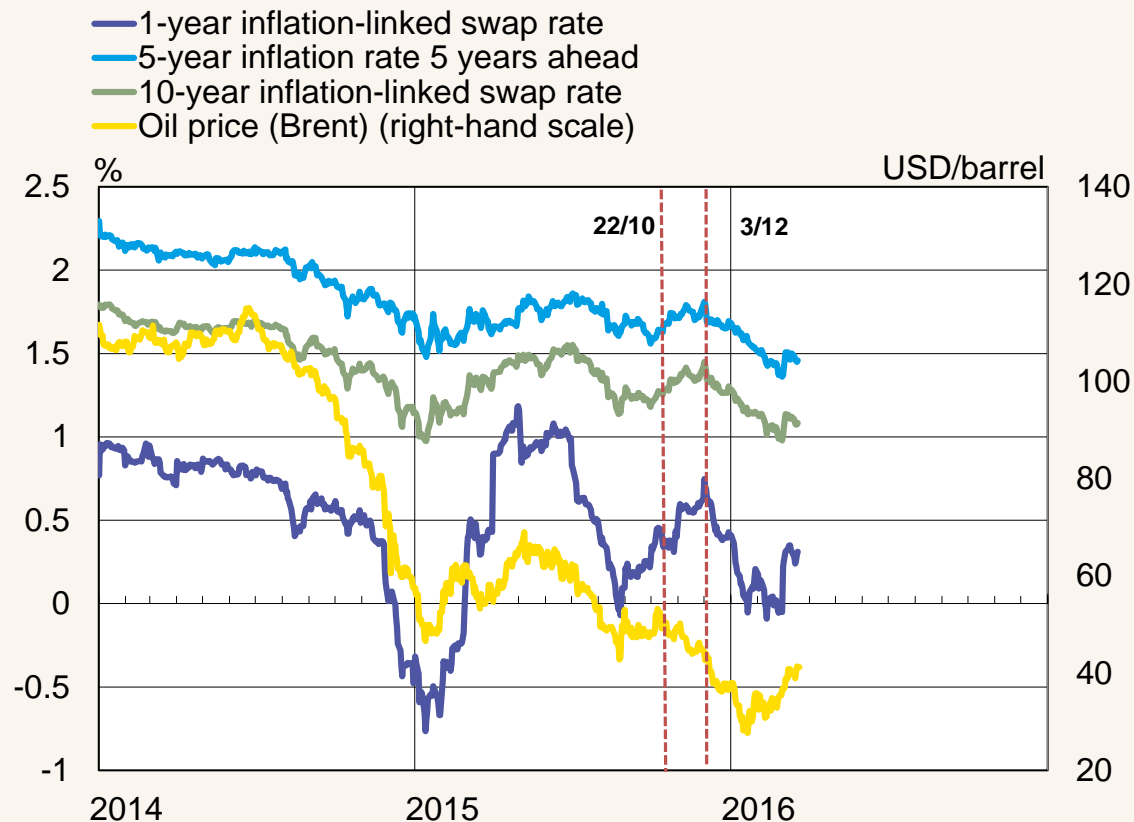


* Underlying inflation = inflation excluding energy, food, alcohol and tobacco.

Sources: ECB and Bank of Finland.



Oil price strongly depressing short-term inflation expectations

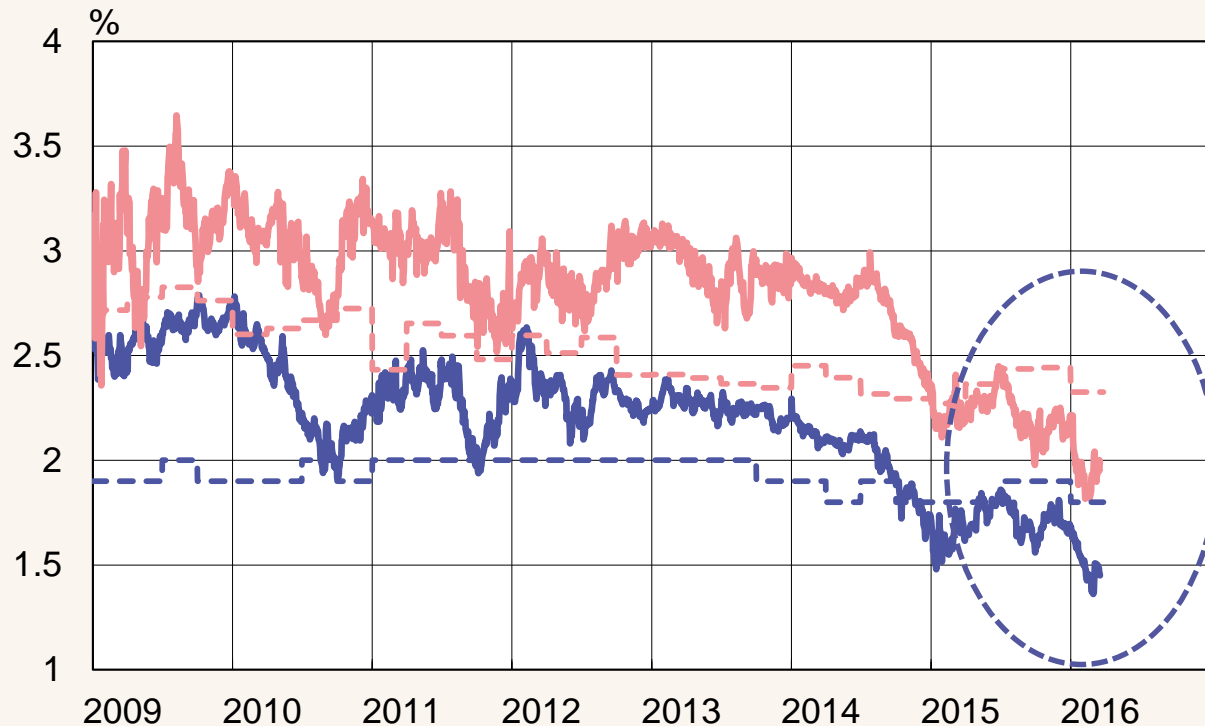


Sources: Bloomberg, Macrobond and calculations by the Bank of Finland.



Long-term inflation expectations have weakened again in euro area and USA

— Market expectations, euro area — Market expectations, USA
- - - SPF survey, euro area - - - SPF survey, USA



Sources: Bloomberg, ECB, Fed of Philadelphia and Marcobond.
Market expectations are based on 5-year and 10-year inflation-linked swap rates. The SPF survey horizon extends five years ahead.



What monetary policy decisions were taken on 10 March?



Governing Council decisions in March 2016

- ***Monetary policy rates were lowered***
 - Key interest rate (MRO) to **0.0%** (change -5 bp)
 - Deposit facility rate to **-0.40%** (-10 bp)
- ***Monthly purchase volumes in the extended asset purchase programme (EAPP) were expanded (by €20 bn) to €80 bn as of 1 April 2016***
 - Investment-grade bonds issued by non-banking-sector corporations were included on list of assets eligible for purchase
- ***A second series of targeted longer-term refinancing operations (TLTRO 2) will be launched in June 2016.***
 - These will enhance the transmission of monetary policy measures to the economy by encouraging banks to increase lending to the real economy.
 - Each operation will have a 4-year maturity, and the interest rate can be as low as the rate on the deposit facility.



Forward guidance on monetary policy

- ***Purchases are intended to run until at least the end of March 2017, or beyond, if necessary, until inflation is on a sustained path towards a level below, but close to, 2%.***
- ***In view of the current outlook for price stability, the Governing Council expects the key ECB interest rates to remain at present or lower levels for an extended period of time, and well beyond the horizon of the asset purchases.***

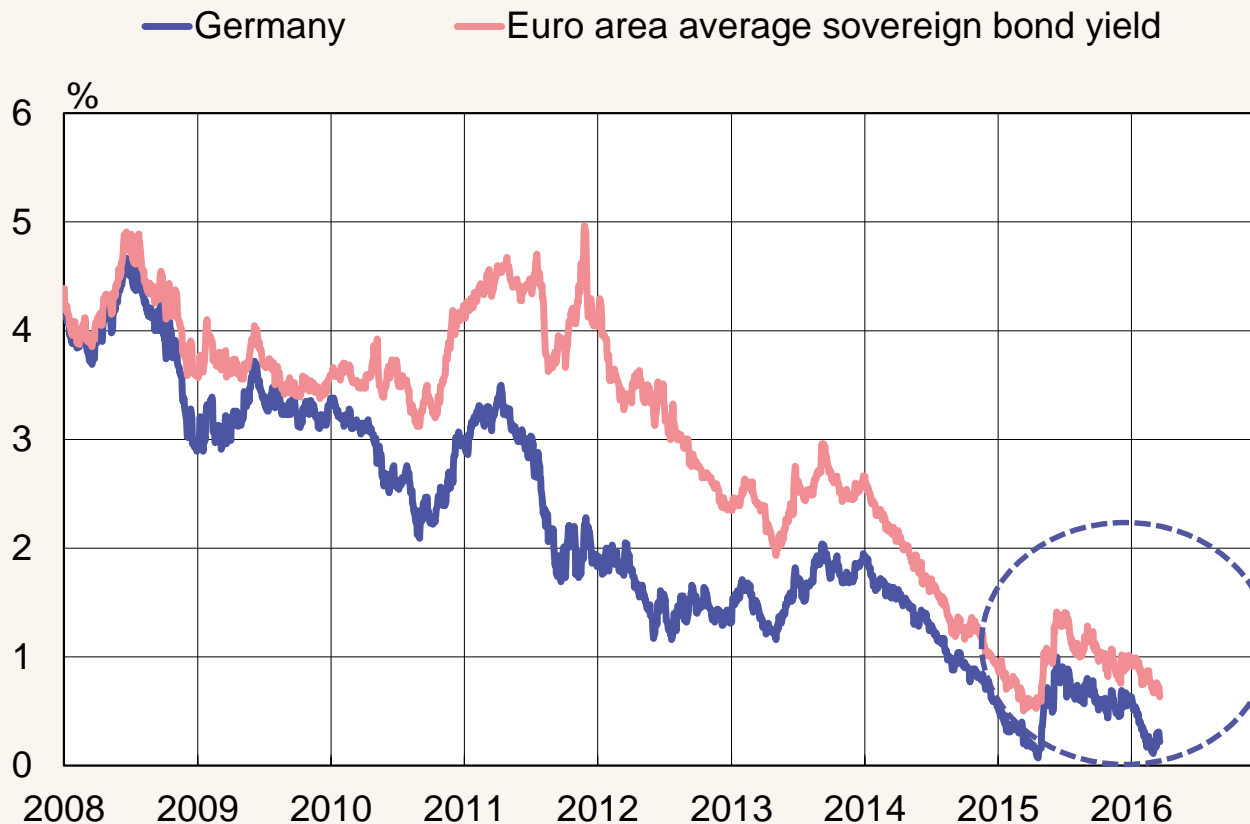


Transmission of monetary policy:

The historically accommodative stance of monetary policy supports economic recovery and price stability through several transmission channels.



Euro area sovereign bond yields at low levels

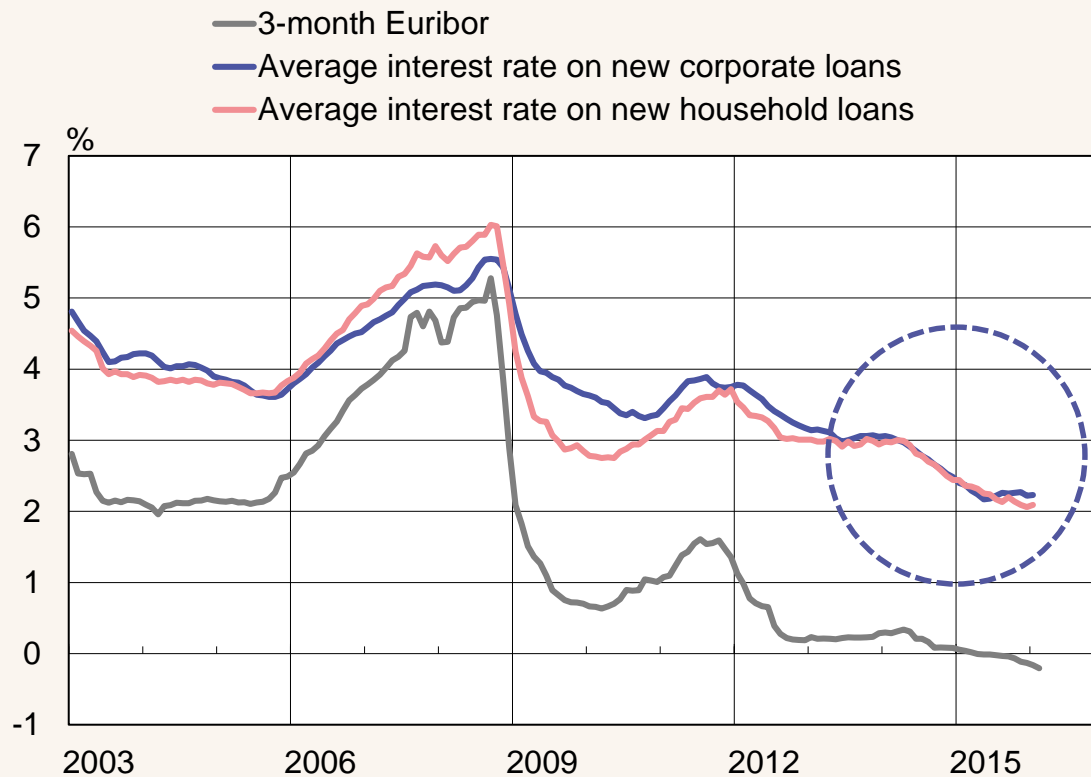


10-year sovereign bond yield.

Source: Macrobond.



Bank lending rates on household and corporate loans have decreased

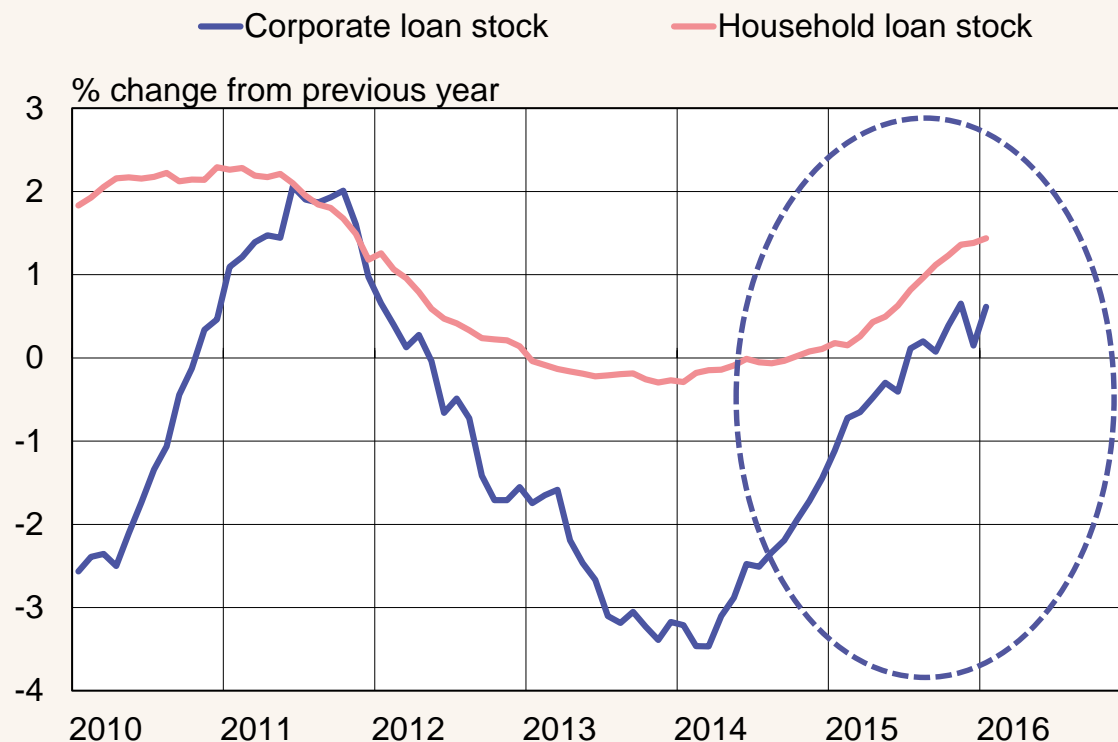


Sources: ECB and Macrobond.



Growth in bank loans has accelerated

Annual growth in loan stocks



Loan stocks adjusted for balance sheet transfers and securitisation.
Sources: ECB and Macrobond.

Erkki Liikanen
Bank of Finland

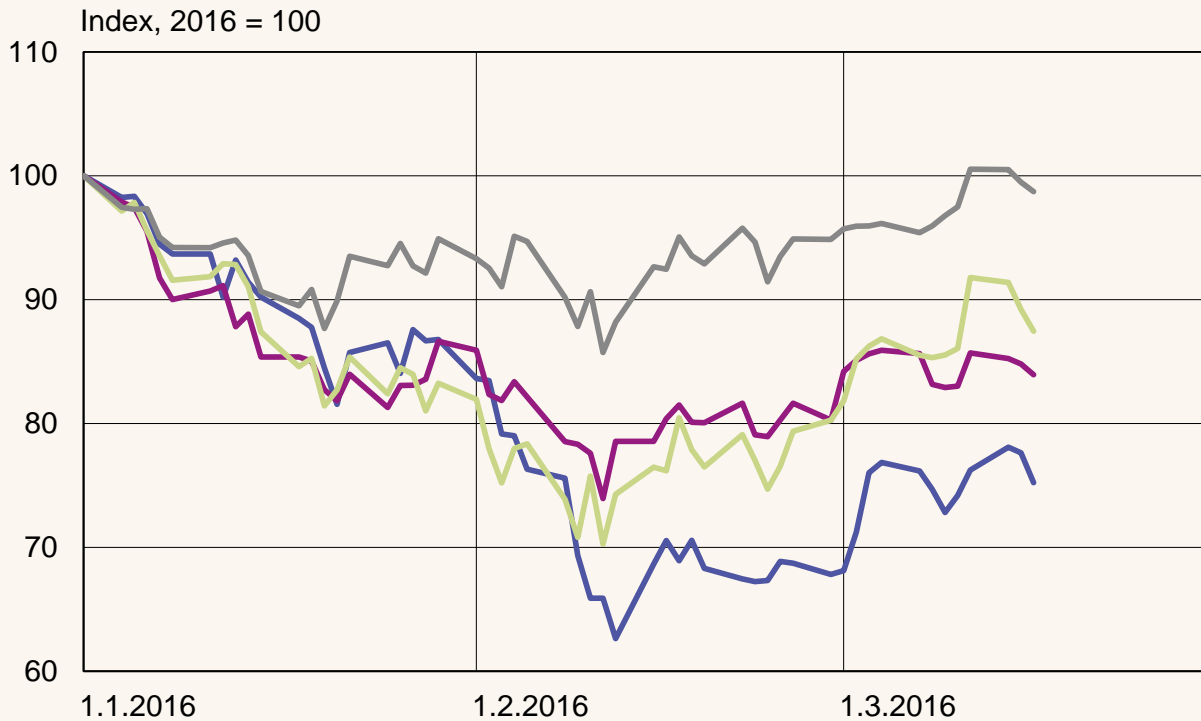
Condition of the banks





Evolution of large banks' share prices at the beginning of the year

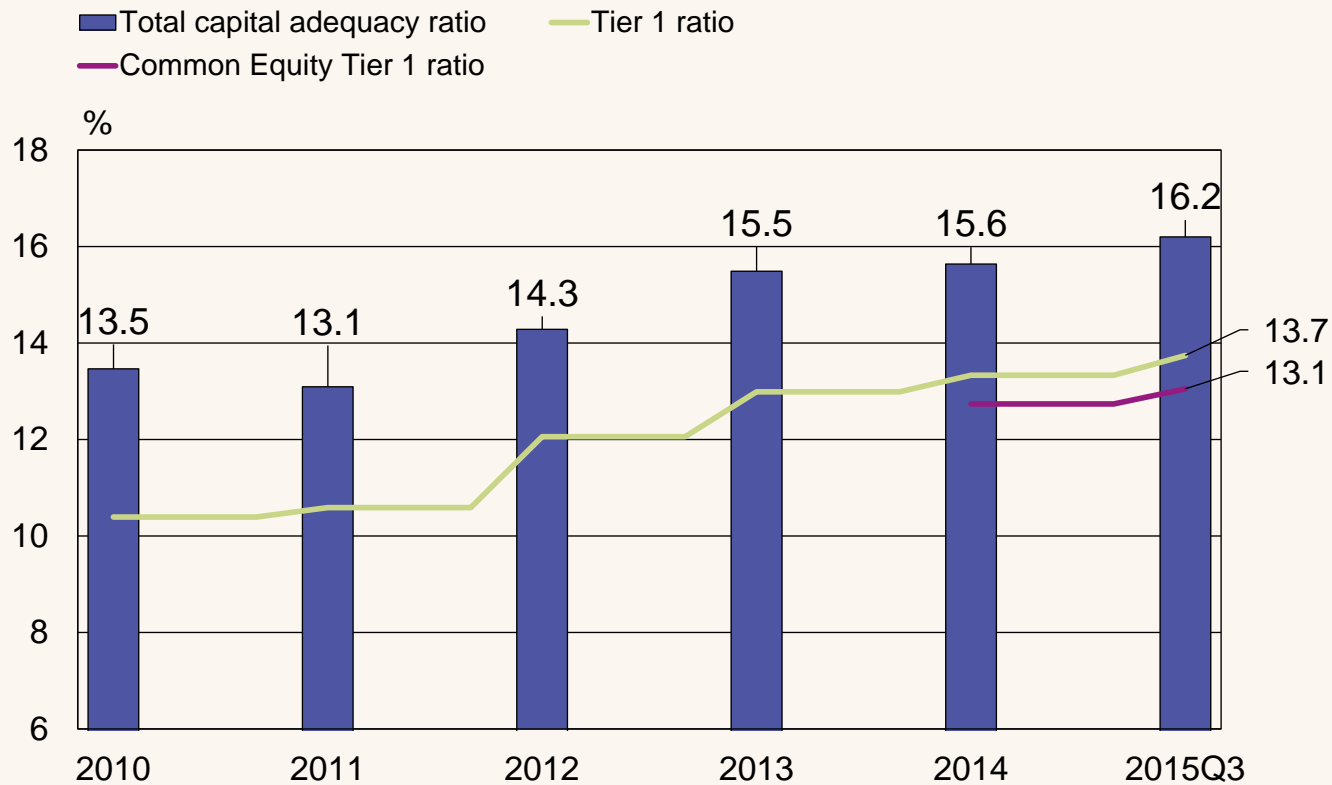
— Japan — United States — Europe — Nordic countries



Source: Bloomberg.



Euro area banks increased their capital



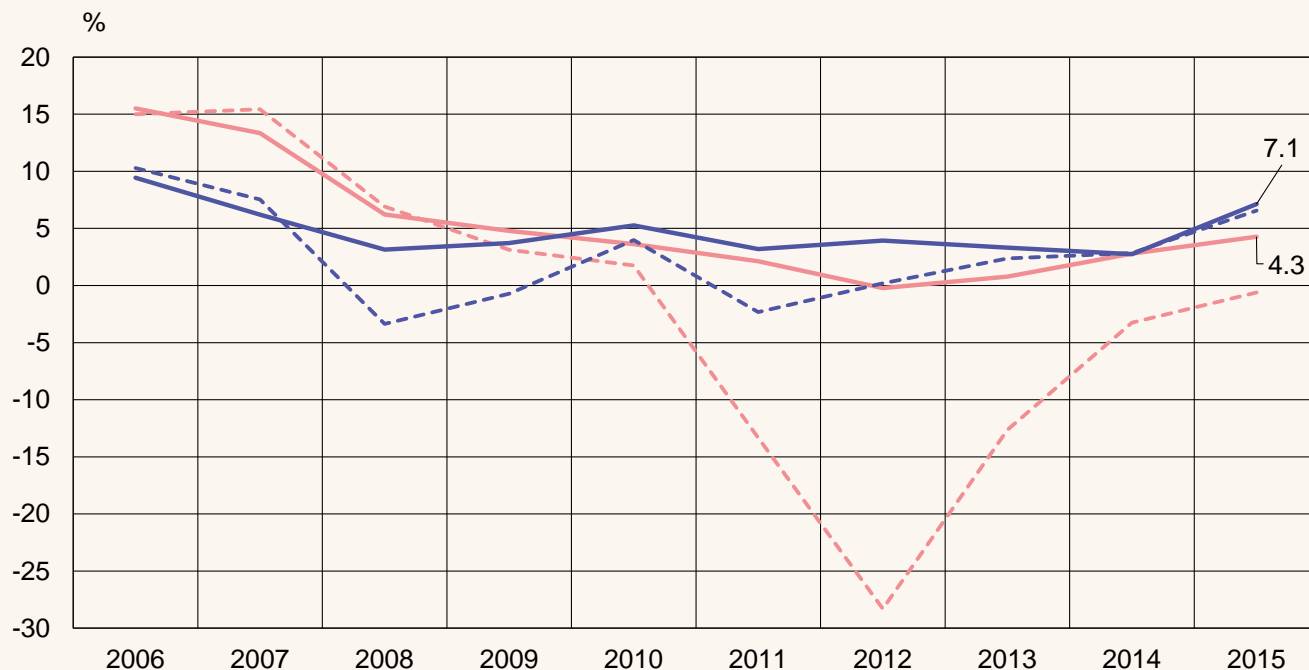
Source: European Central Bank.



Banks' financial results improved since the crisis

(Return on equity, ROE)

- Non-core countries, median *
- - - Non-core countries, unweighted average *
- Core-countries, median**
- - - Core-countries, unweighted average **



*Non-core countries = CY, ES, GR, IE, IT and SI.

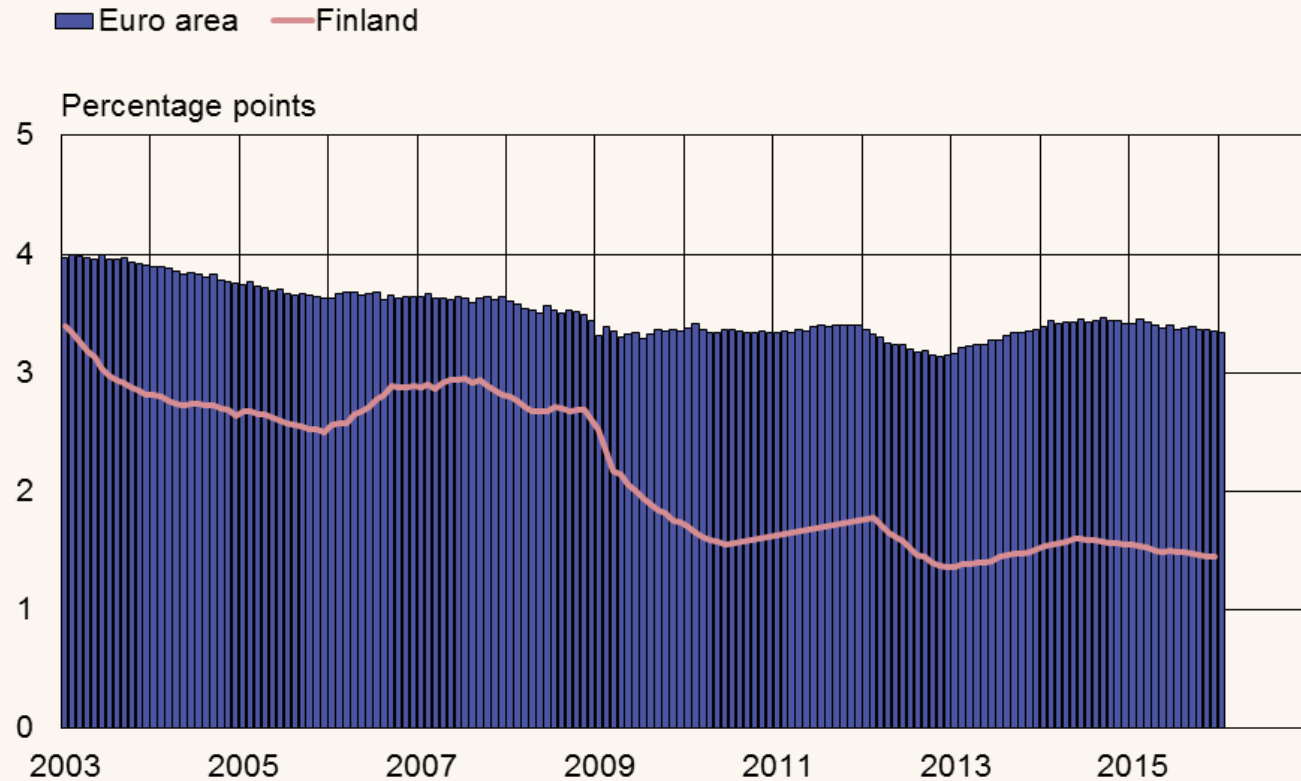
**Core-countries = AT, BE, DE, FI, FR and NL.

*** 2015 covers all banks that have reported year-end financial statement by 16 March 2016

Source: Sni.



The differential between bank lending and deposit rates has decreased



Source: European Central Bank.



Non-performing loans weigh on banks

- *The problem of non-performing loans particularly affects mid-sized banks in countries hit by the crisis.*
- *The amount of non-performing loans has decreased in some countries, but progress is uneven and takes time.*
- *A swift reduction in non-performing loans is essential for banks' ability to grant new loans.*



Tax-payers' or creditors' responsibility?

- ***The crisis resolution framework that entered into force at the beginning of the year emphasises creditor involvement in situations where a bank runs into trouble.***
- ***Functions critical to society can be preserved and problems dealt with in an orderly manner.***
- ***The transition to the new resolution framework will not be easy, but it is important to complete it.***

Erkki Liikanen
Bank of Finland

Structural change in China's economy



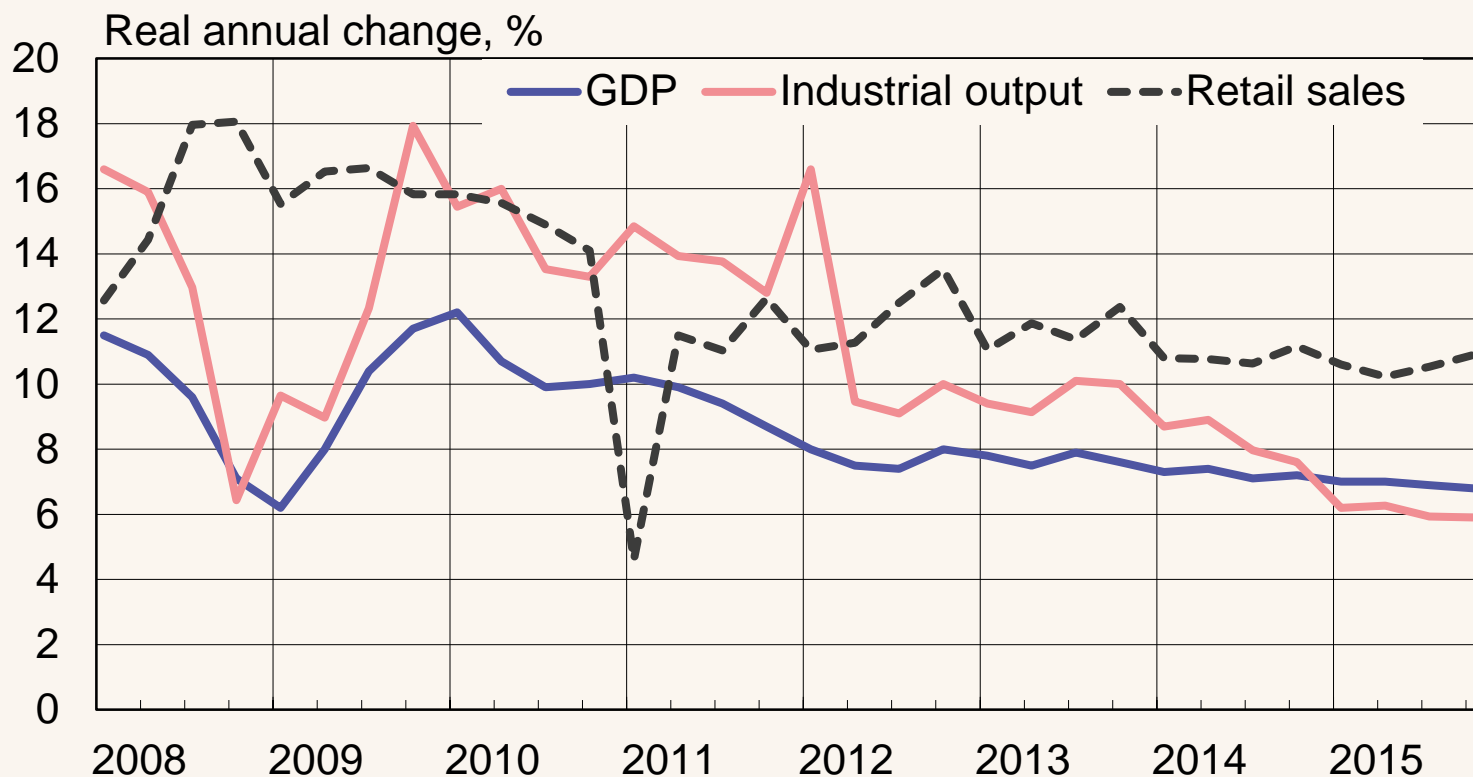


Will China's economic growth slow down?

- *Growth has been slowing and the transition towards a different growth model been ongoing for years already.*
- *Policy has facilitated this change in China's growth model in a number of ways, including easing of the monetary policy stance.*
- *Capital movements have also been liberalized, including direct foreign investment by Chinese investors.*



Growth slowdown and transition towards a different growth model have been ongoing for several years already



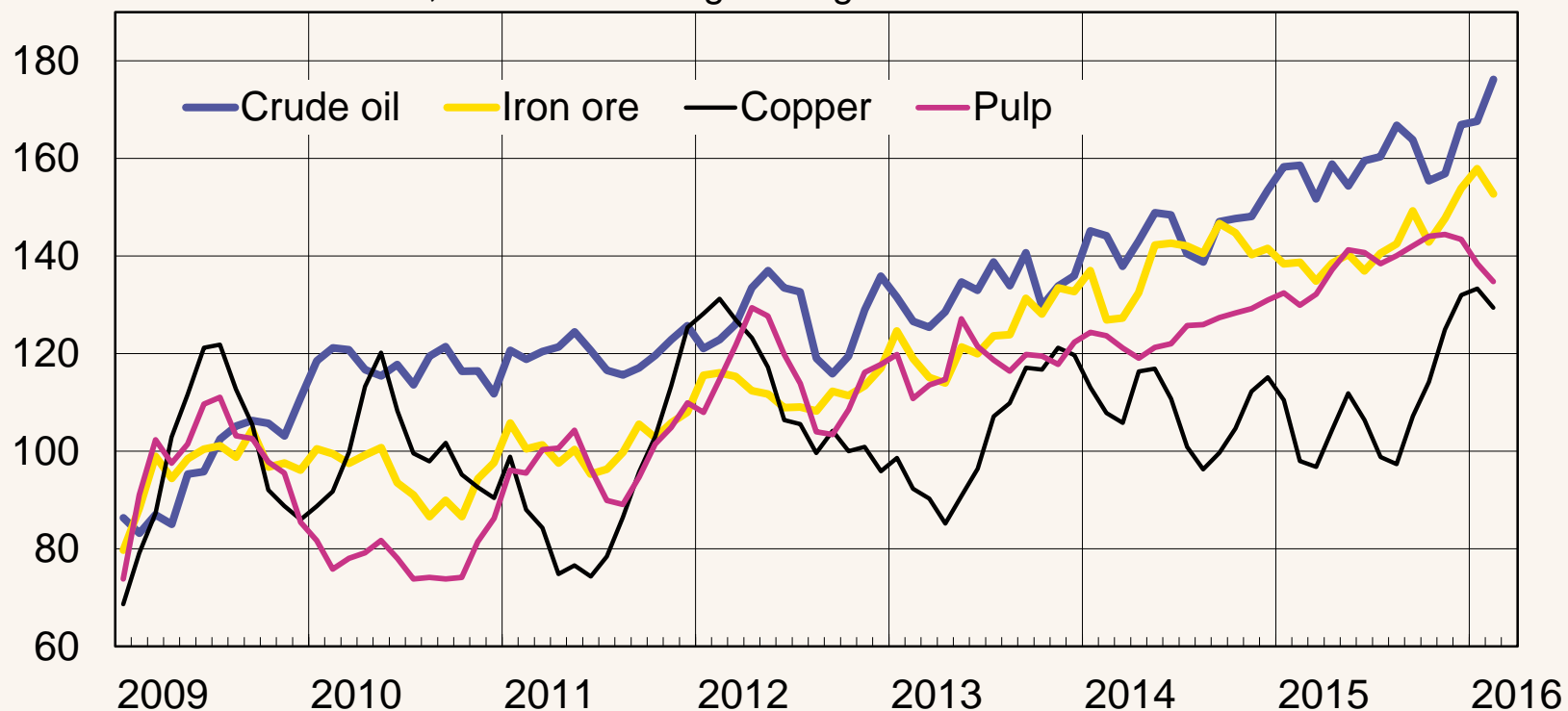
Source: Macrobond.



Volume of China's commodities imports not decreased much

China's commodities import volume

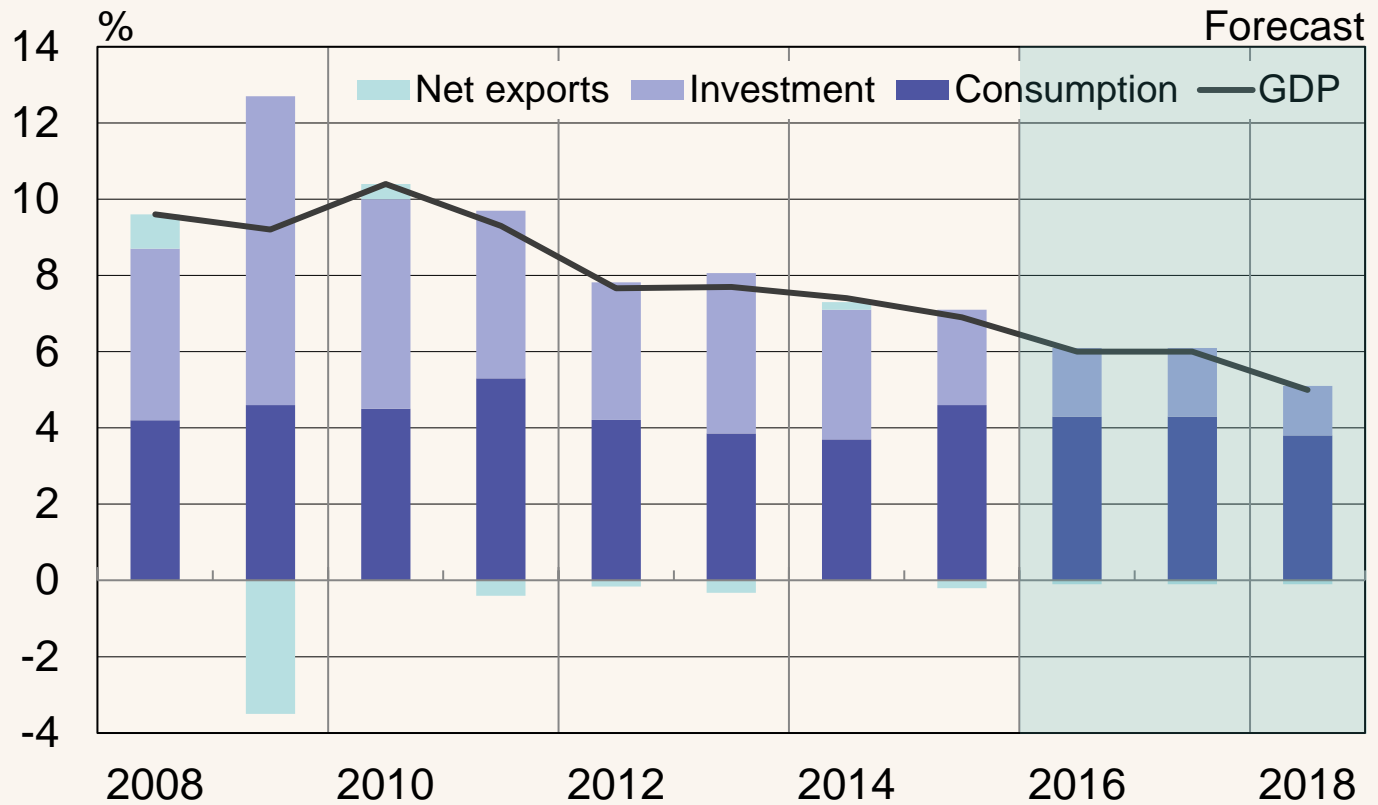
Index 2009 = 100, 3-month moving average



Source: Macrobond.



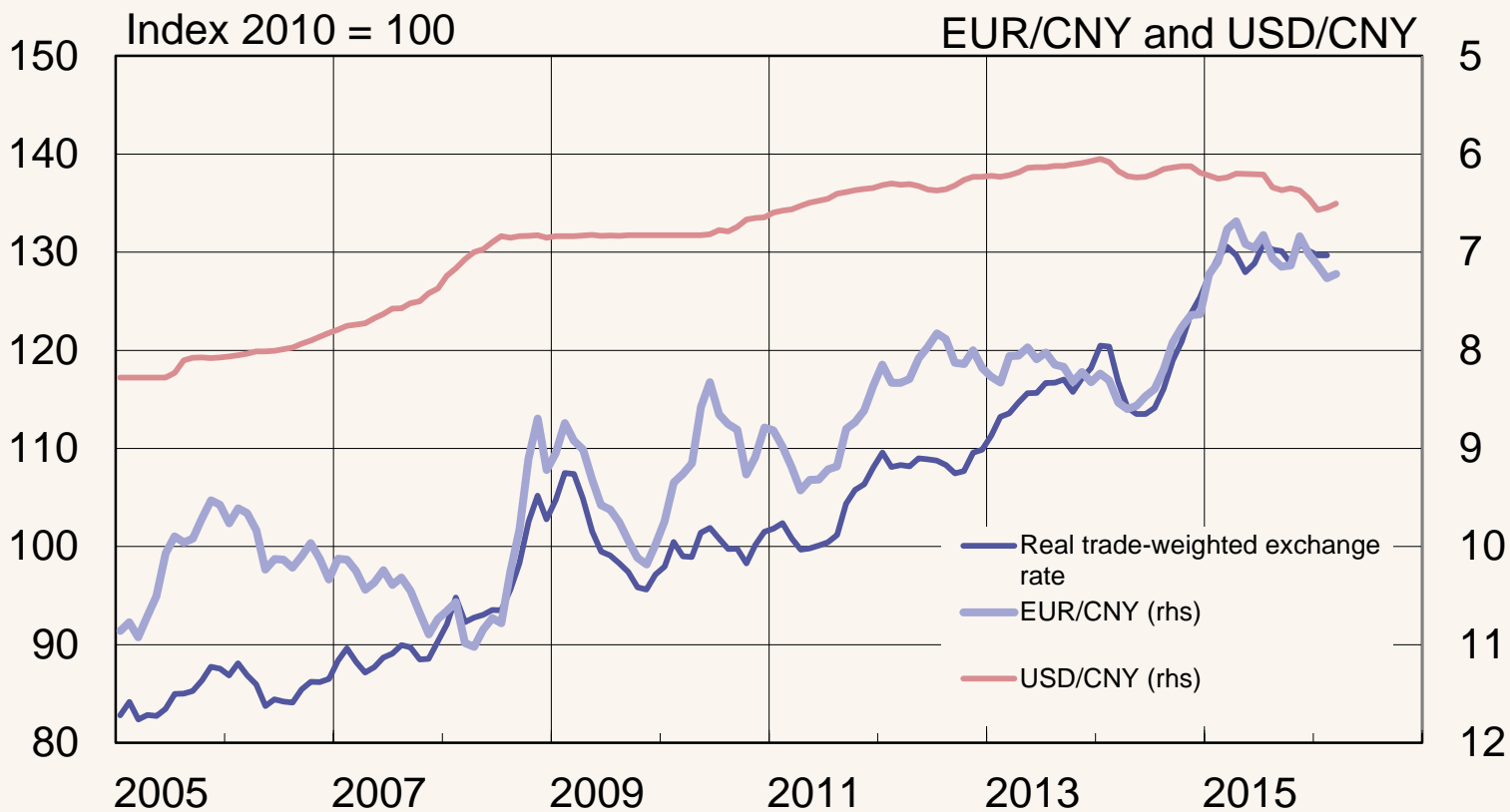
Bank of Finland's economists' forecast on China



Sources: NBSC and BOFIT



China's exchange rate appreciated significantly over past decade



Sources: BIS, Bloomberg.

Erkki Liikanen
Bank of Finland

Climate change and the financial sector





Paris climate agreement is crucial

“This is a historic moment, not just for us and our world today, but for our children, our grandchildren and future generations. The Paris Agreement is a turning point in the world’s fight against unmanaged climate change...”

Nicholas Stern’s comments on the Paris climate agreement (press release dated 12 December 2015).



What are the financial implications of climate change?

- ***Climate change is a global problem with significant costs***
 - Climate policy implies sharing costs temporally and geographically
- ***It affects economic growth, inflation and financial stability and adds to uncertainty***
 - Implications for growth and financial stability are assessed to be mainly negative, also over the short term
- ***Analysing the implications for financial stability is crucial.***



How does climate change affect financial stability?

- **The increasing frequency and amplitude of extreme weather events leads to an increase in financial losses**
 - The value of banks' investment portfolios and debtors' debt servicing ability decrease; insurance companies reimburse damages covered by insurance policies.
- **Restrictions of emissions create uncertainty regarding the business continuity of companies generating significant emissions in their business**
 - The risk concerns a significant share of globally traded securities, and banks have been lending to these companies.



Why is determination and rapid progress important in climate policy?

- ***Climate change is taking place now and cannot be stopped immediately***
 - Decisions taken and investments made will have an impact for decades ahead.
 - Emissions remain in the atmosphere for decades.
- ***Determined and consistent climate policy will minimise adverse effects – also for financial stability.***
- ***It is better to take the right decisions now than to wait.***
 - Principle of prudence
 - No unnecessary limits to alternatives
 - Precarious to trust on salvation by innovation

Erkki Liikanen

Bank of Finland

Bank of Finland financial statements and result



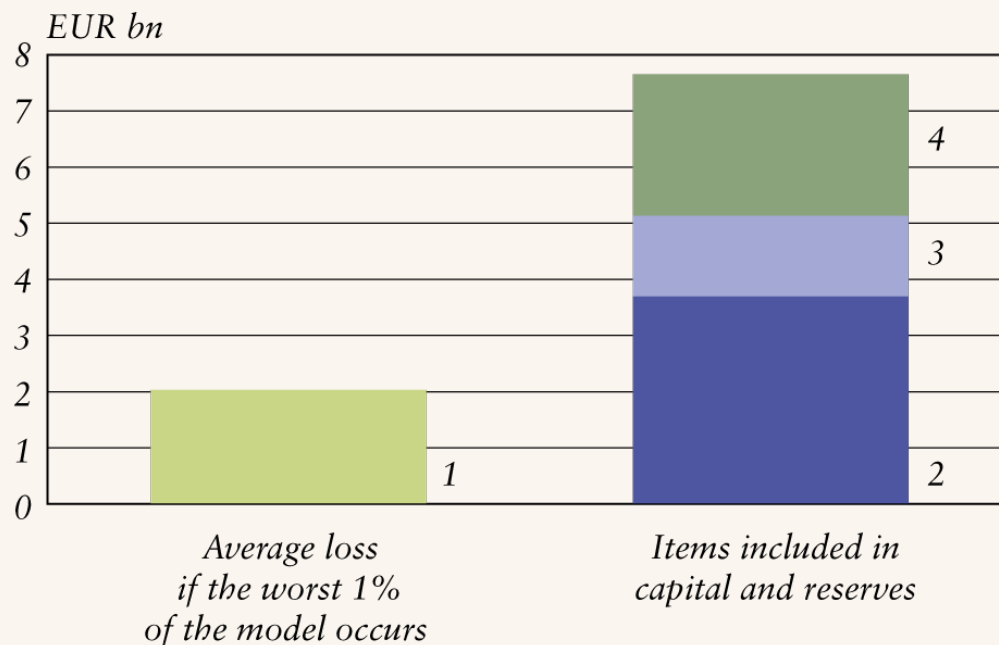


Central bank result discloses prevailing monetary policy

- ***The central bank's primary task is to take measures to ensure price stability in the euro area. The profit of the central bank is generated as a result of these operations.***
- ***The Bank of Finland operates efficiently and aims to ensure distribution of profit to the State.***
- ***The Bank of Finland's income consists of interest income on banknotes and monetary policy items as well as investment income on foreign reserves and other financial assets of the Bank.***
- ***The accommodative monetary policy shows in the Bank's balance sheet and profit and loss account. Interest income has decreased due to the low interest rates.***



Total risks (excl. gold) in relation to balance sheet risk buffers 31 Dec 2015

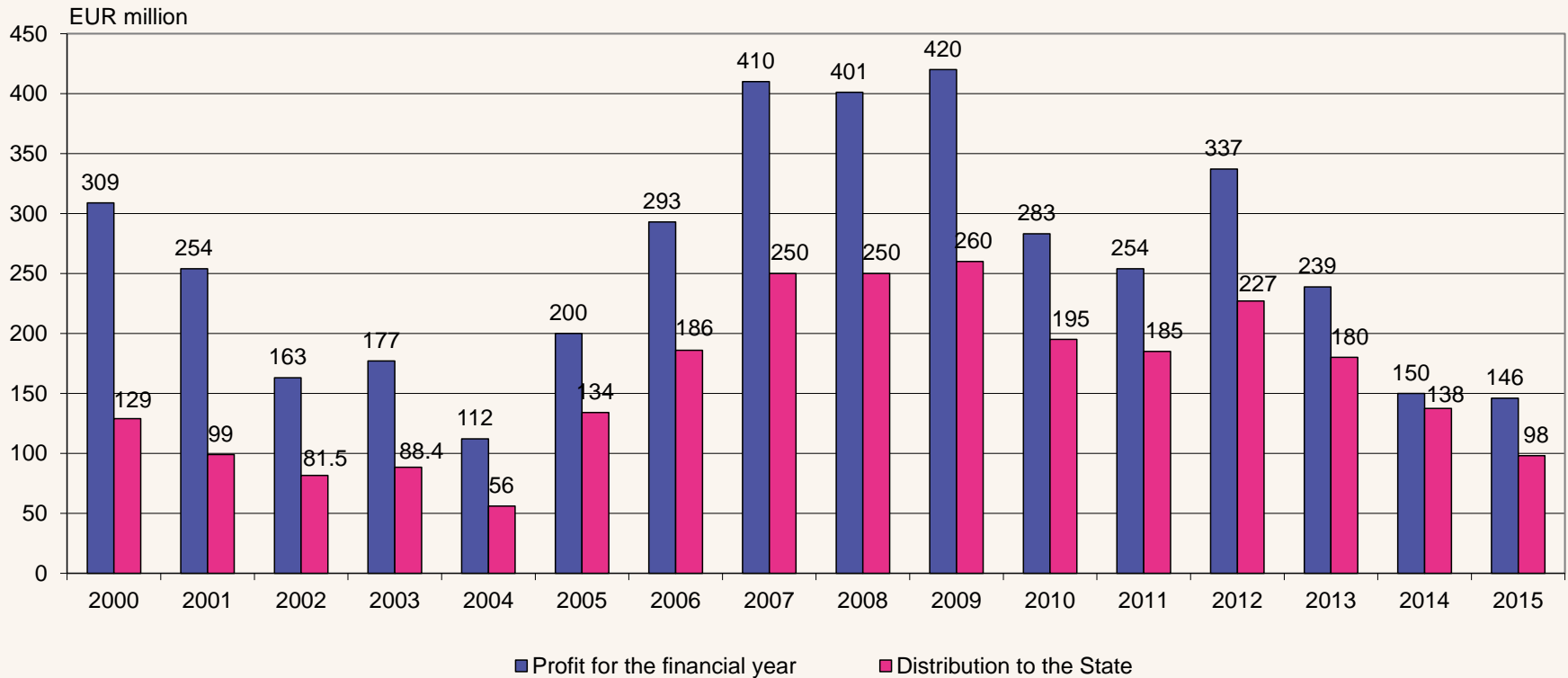


1. ■ Market and credit risk
2. ■ Disposable provisions
3. ■ Disposable revaluation accounts
4. ■ Capital and reserves, excl provisions and revaluation accounts

Source: Bank of Finland.



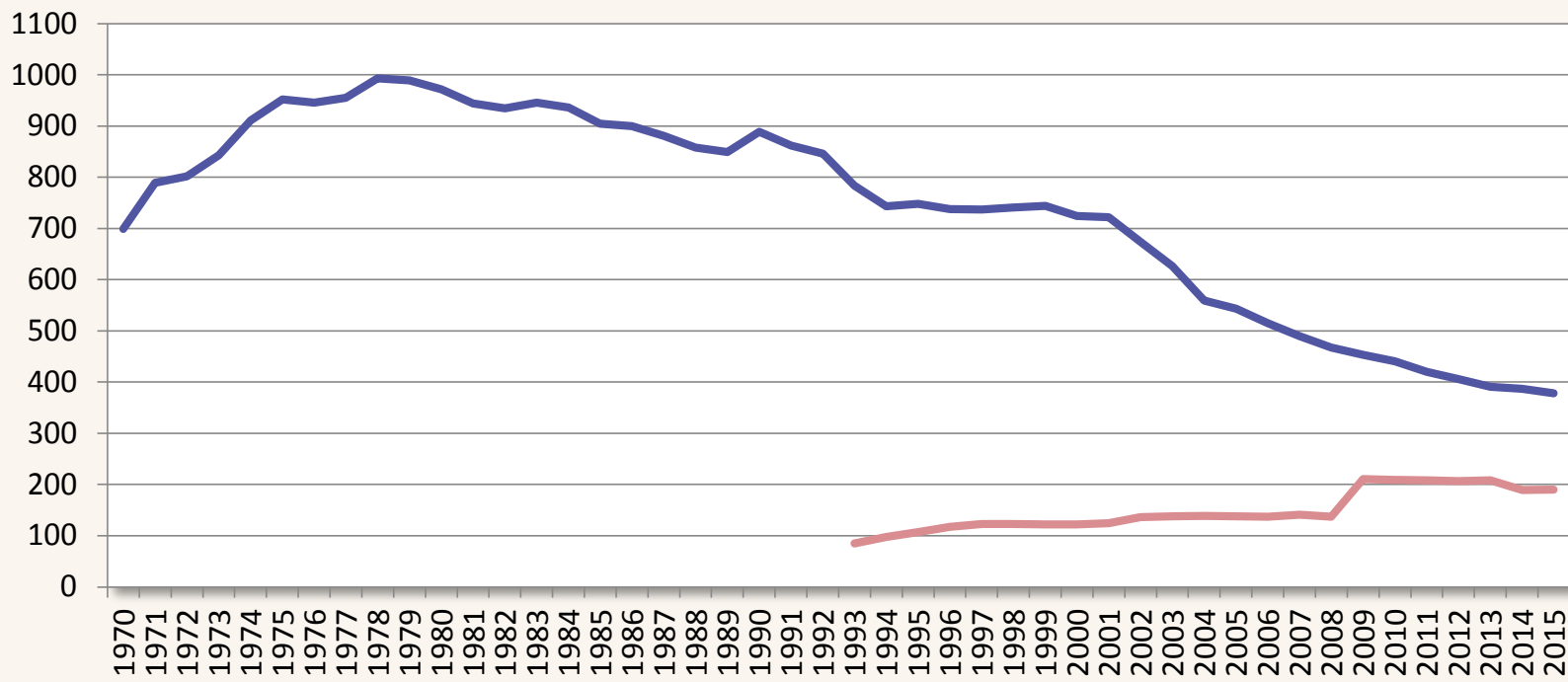
Bank of Finland profit and distribution of profit to the State 2000–2015





Changes in headcount, 1970-2015

— Bank of Finland — Financial Supervisory Authority





Thank you!