

Erkki Liikanen
Suomen Pankki

The euro area economy, ECB monetary policy and its transmission in the euro area and Finland

Euro & talous, 9 June 2016





**Euro area economic growth is broadly based,
but inflation still slow.**

**Monetary policy will ensure a sustained
adjustment in the path of inflation consistent
with the inflation target.**



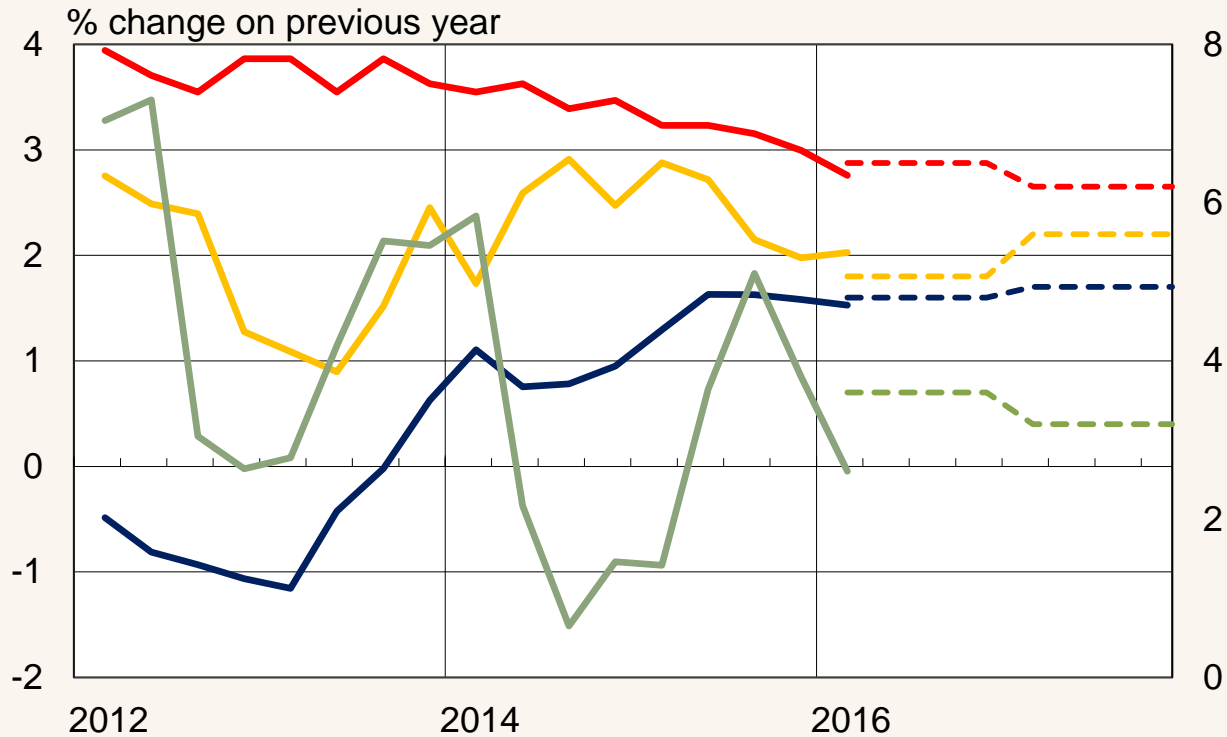
Outlook for the euro area economy



Euro area growth broadly based

Real GDP

— Euro area — United States — Japan — China, (right-hand scale)



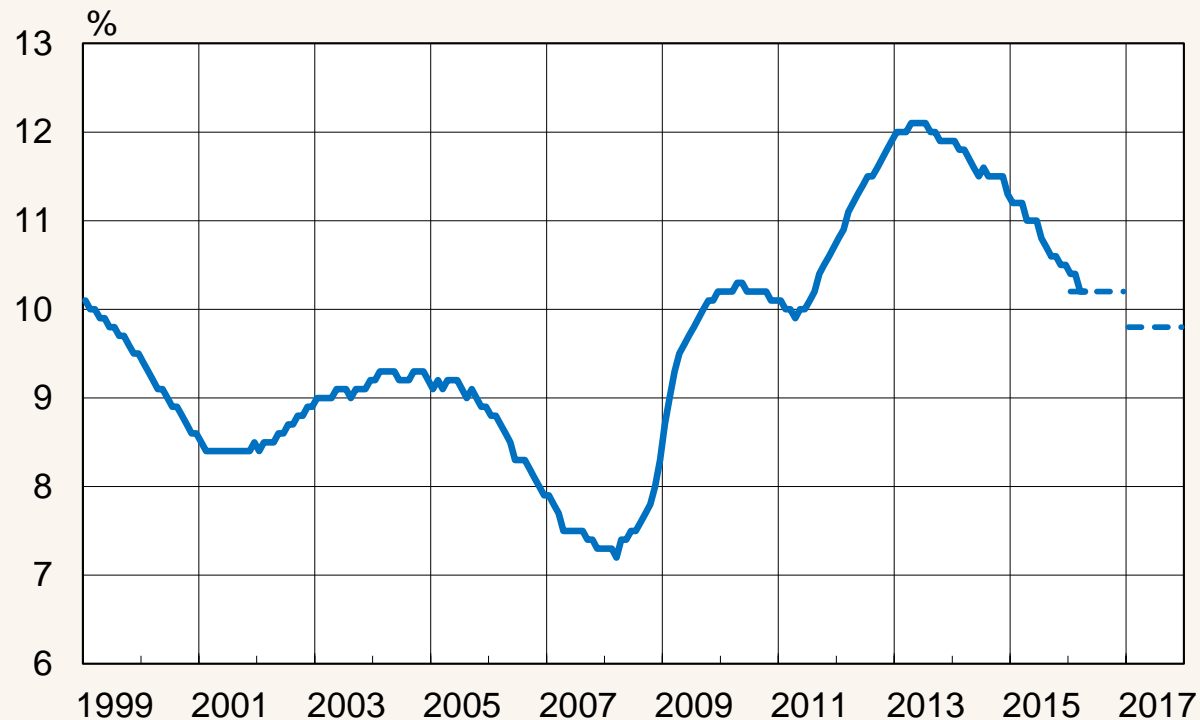
Sources: Eurostat and OECD.

Dash line: OECD June 2016 forecast.



Euro area unemployment rate recedes from high-water mark

Euro area unemployment rate



Forecasts: OECD, June 2016.

Sources: Eurostat and OECD.



Outlook for the euro area

Eurosystem staff macroeconomic projections, June 2016

(change on the March 2016 projections)

- **GDP**

2016: 1.6% (+0.2)

2017: 1.7% (0.0)

2018: 1.7% (-0.1)

- **Inflation**

2016: 0.2% (+0.1)

2017: 1.3% (0.0)

2018: 1.6% (0.0)



ECB monetary policy



Monetary policy objective is symmetric – but there is asymmetry in the tools

- ***When the price stability objective is pursued symmetrically,***
 - ***Inflation expectations are anchored in line with the objective, which is important for achievement of the objective***
 - ***Particularly important under current conditions***
- ***There is asymmetry in the tools that can be used to achieve the objective***
 - ***No upper bound on interest rates***
 - ***When inflation is too slow, non-standard measures are required***



ECB's monetary policy measures:

- ***Monetary policy rates are low***
- ***Expanded asset purchase programme***
 - *Was launched in March 2015.*
 - *Purchases under the corporate sector purchase programme began yesterday, on 8 June; Bank of Finland is one of the central banks that implement the programme*
- ***Targeted longer-term refinancing operations***
 - *The first operation under the second series starts on 22 June.*



Forward guidance on monetary policy

- *The key ECB interest rates are expected to remain at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases.*
- *The asset purchases will run until the end of March 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim.*

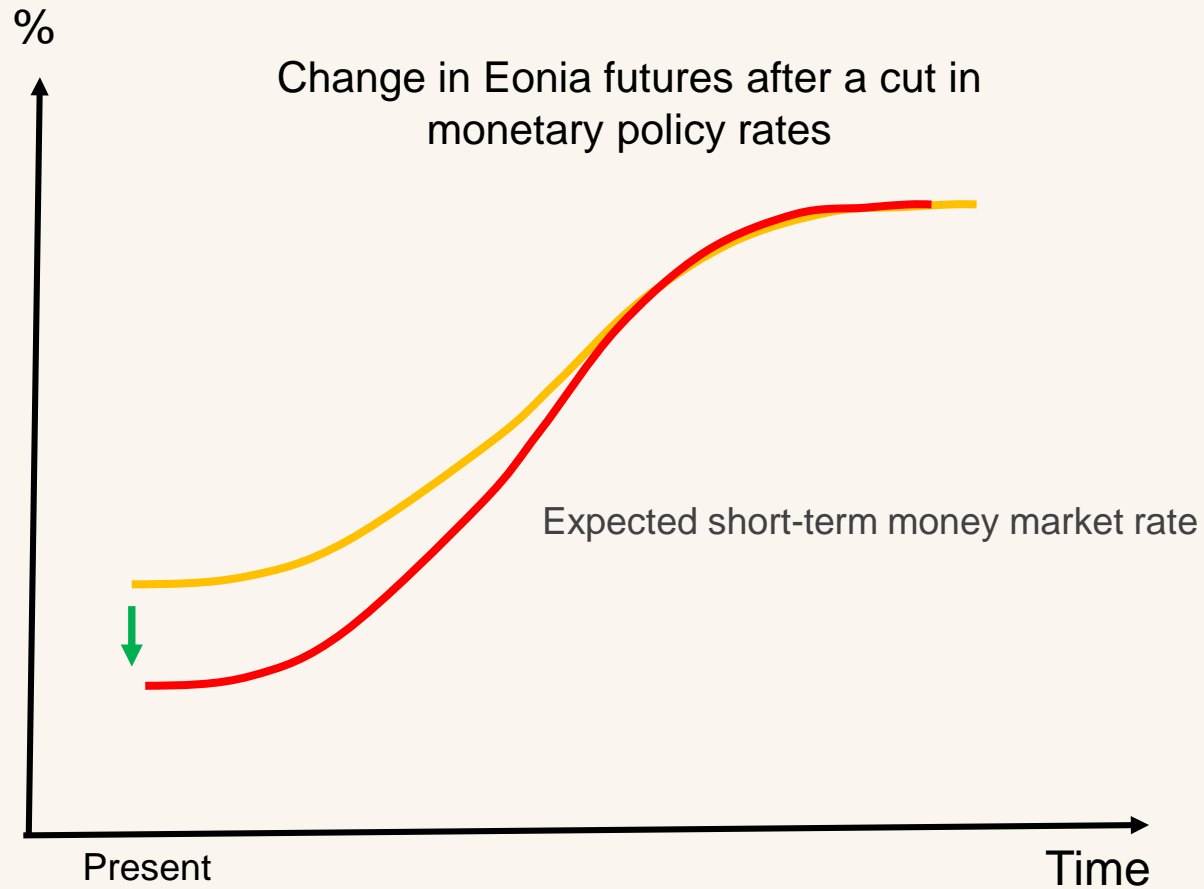


ECB Governing Council, 2 June 2016

- *In the current context, it is crucial to ensure that the very low inflation environment does not become entrenched in second-round effects on wage and price setting.*
- *The Governing Council will closely monitor the evolution of the outlook for price stability and, if warranted to achieve its objective, will act by using all the instruments available within its mandate.*

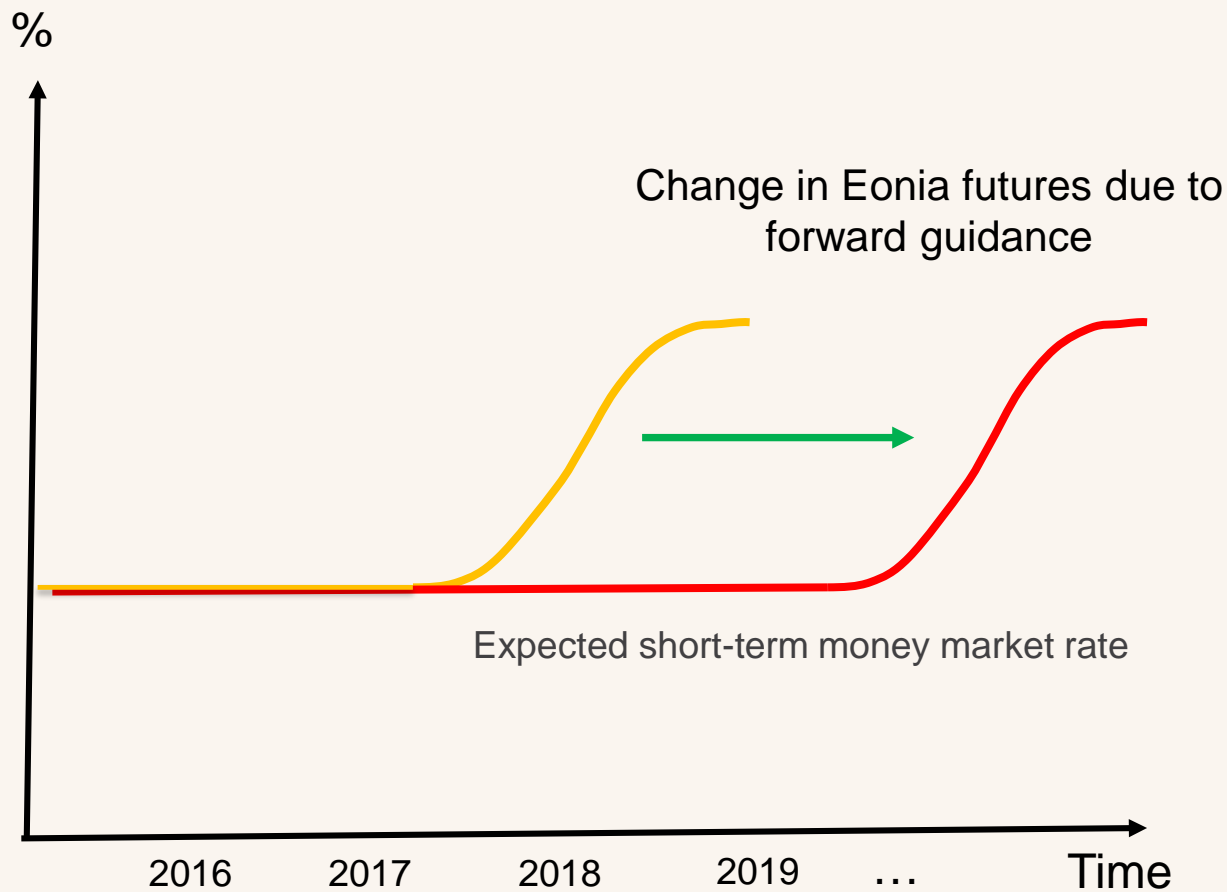


A cut in monetary policy rates lowers short-term money market rates ...



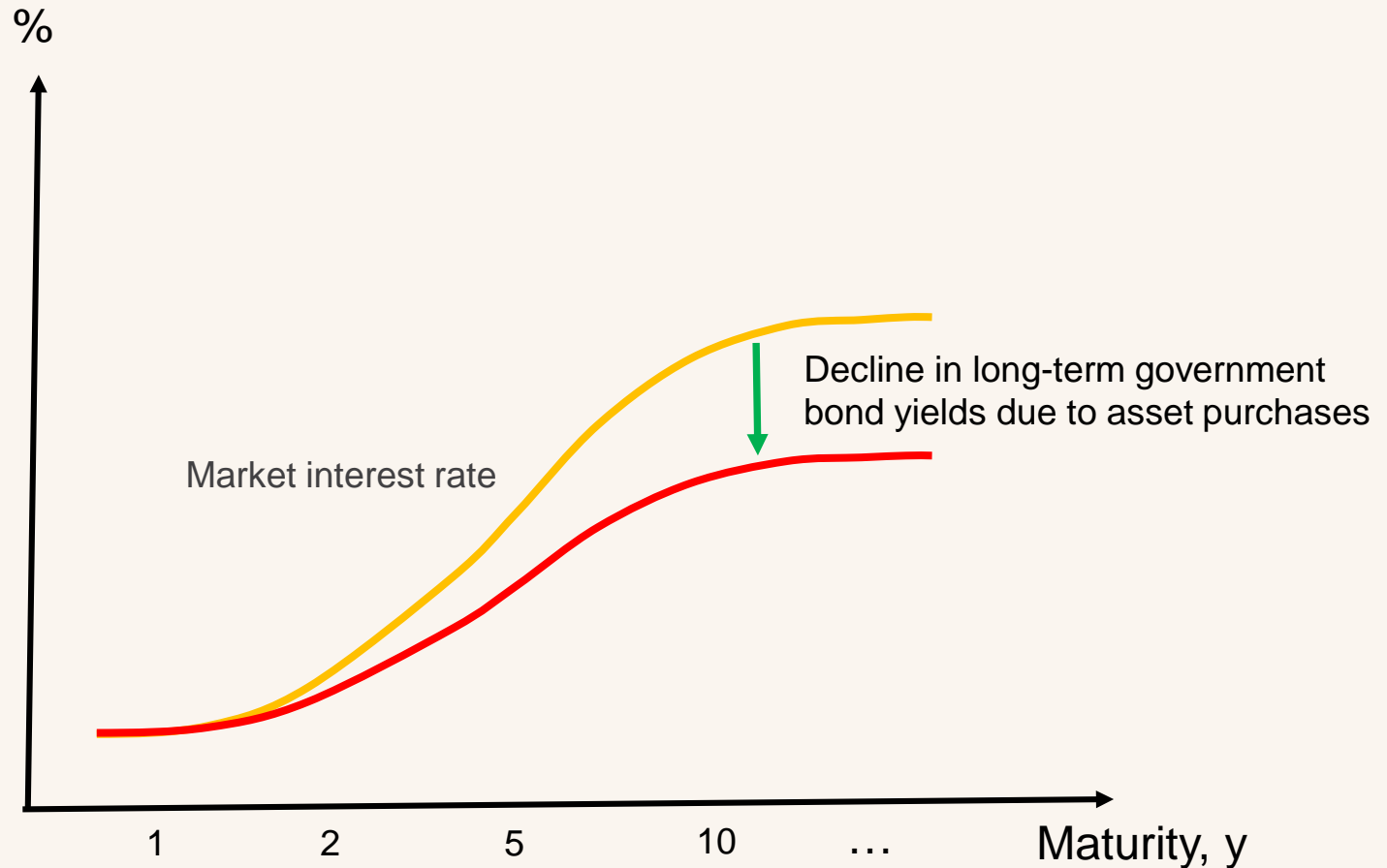


... forward guidance postpones the expected tightening of monetary policy ...





... and asset purchases can be used to depress long-term interest rates



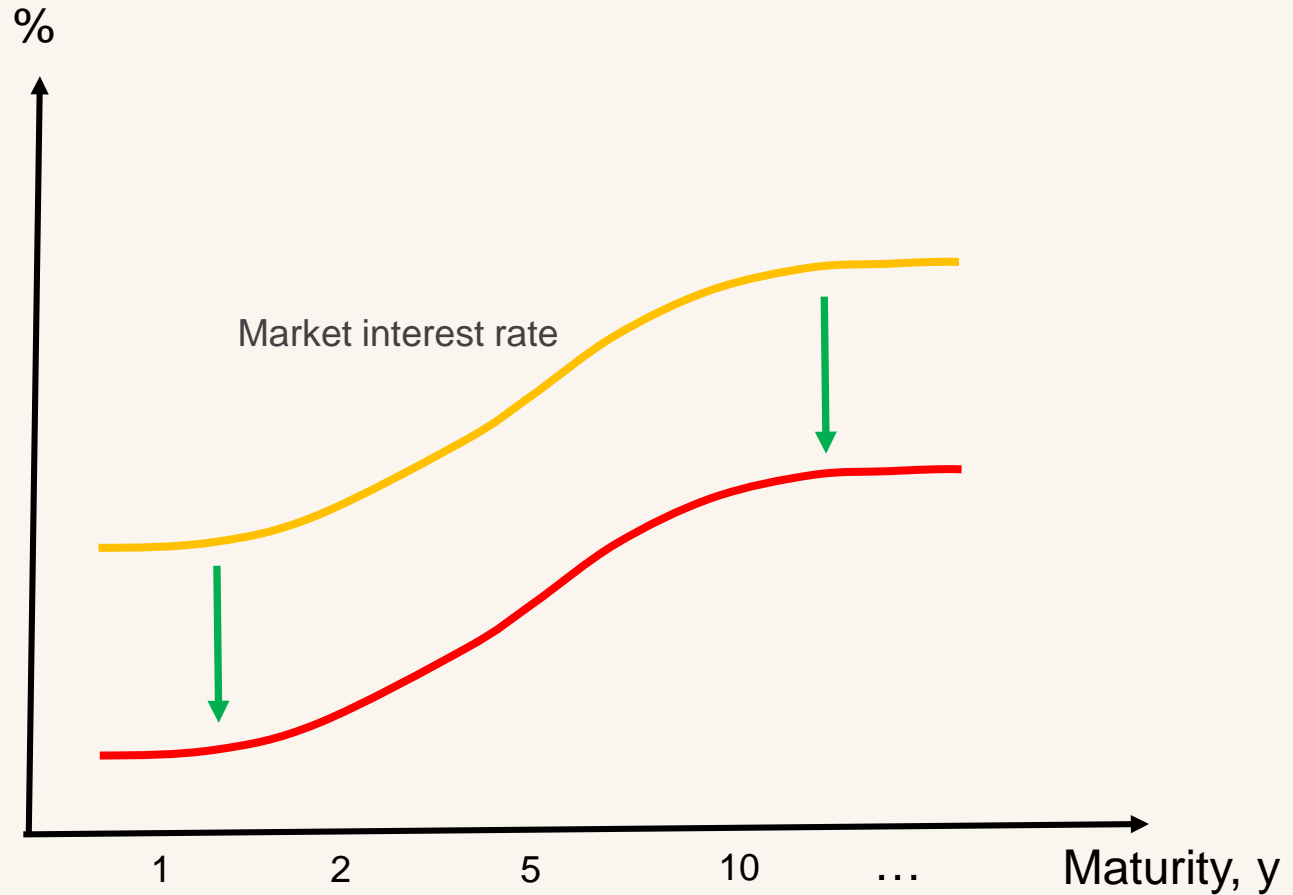


Combined effect of negative interest rates, purchase programmes and forward guidance

- ***A negative interest rate lowers short-term market rates and, together with purchase programmes and forward guidance, also long-term rates.***
- ***This supports consumption and investment, benefiting the economy as a whole and over time also savers, as the economy recovers and creates an environment in which the interest rate level can begin to rise.***



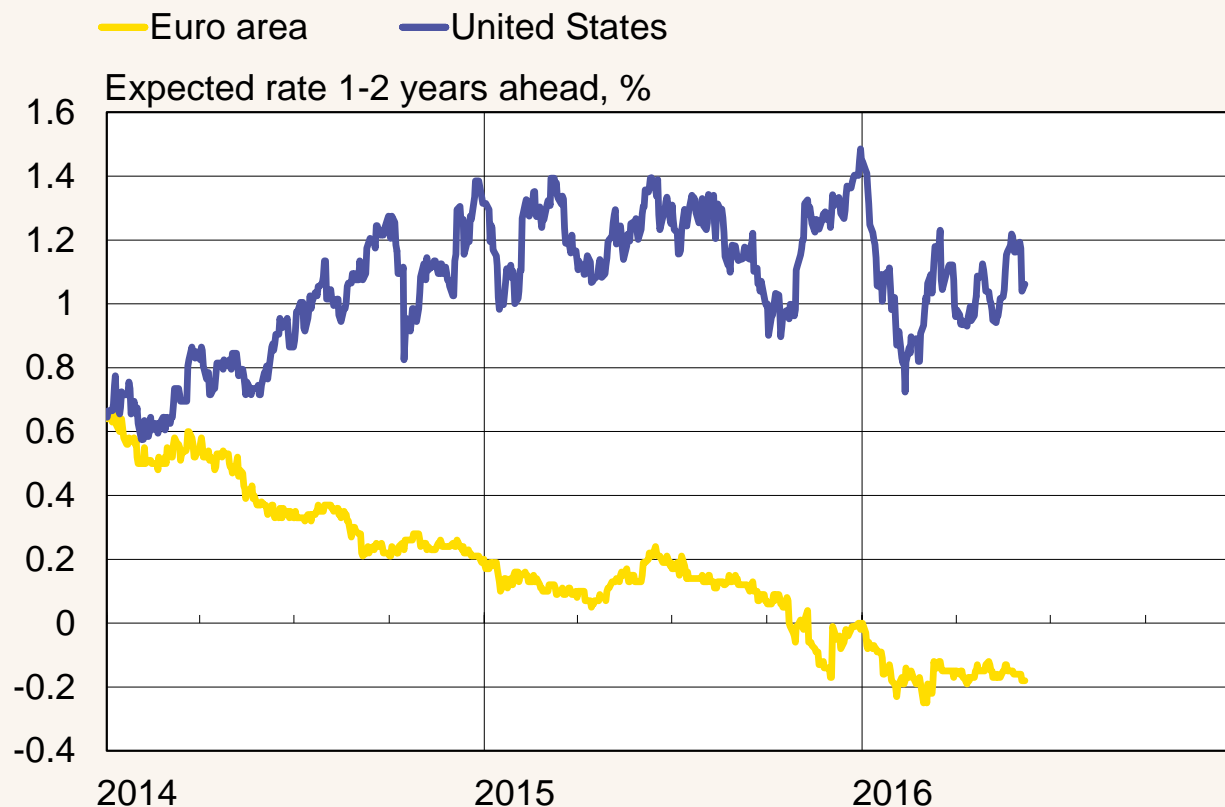
Combined effect: a decline in the entire yield curve





Euro area interest rate expectations lower due to negative interest rates and forward guidance

Expected interbank overnight rate



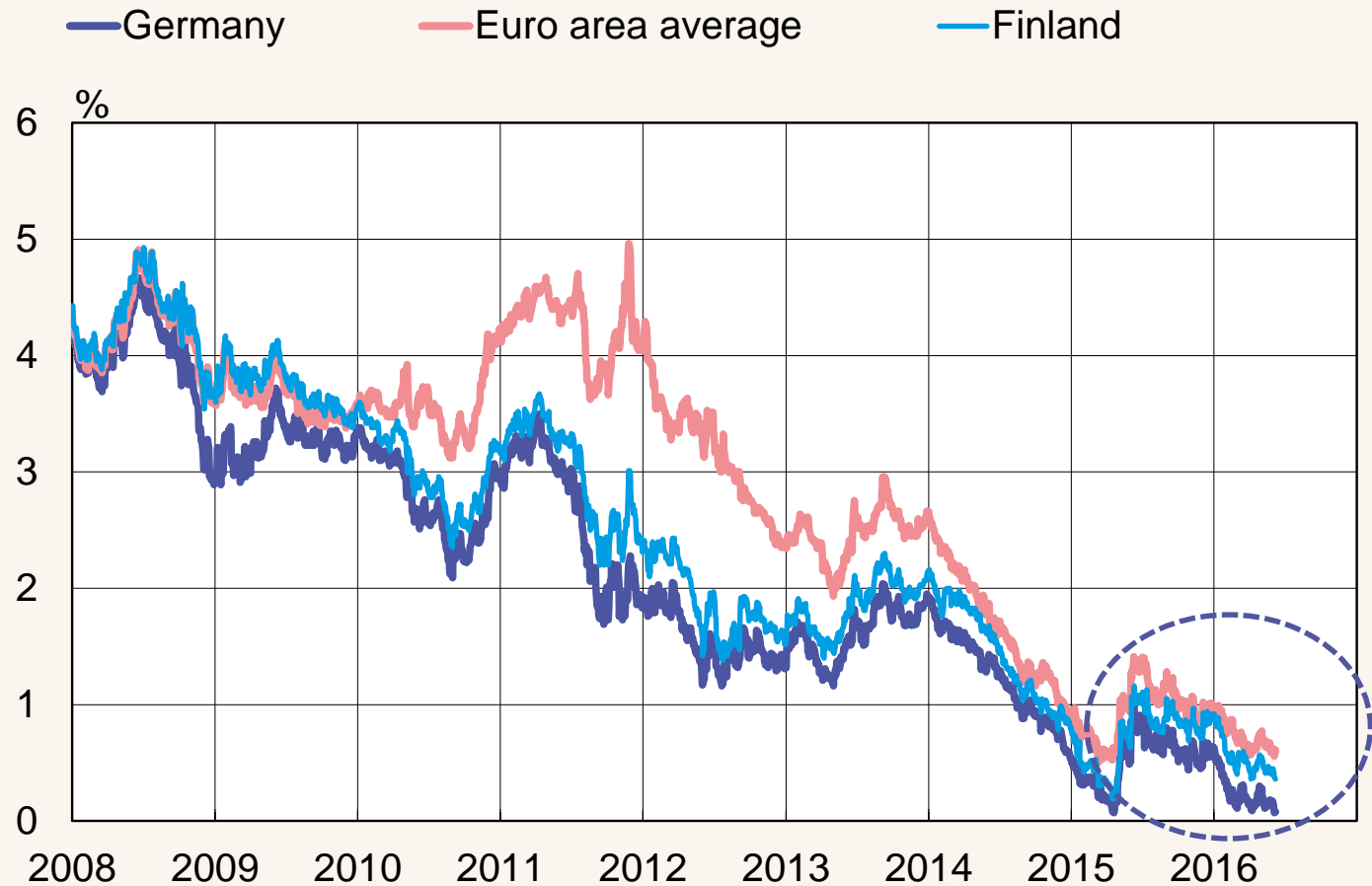
Calculated based on 1-year and 2-year interest rate swaps.
Source: Macrobond.



How is monetary policy transmitted to the euro area and Finnish economies?



Euro area long sovereign bond yields at low levels



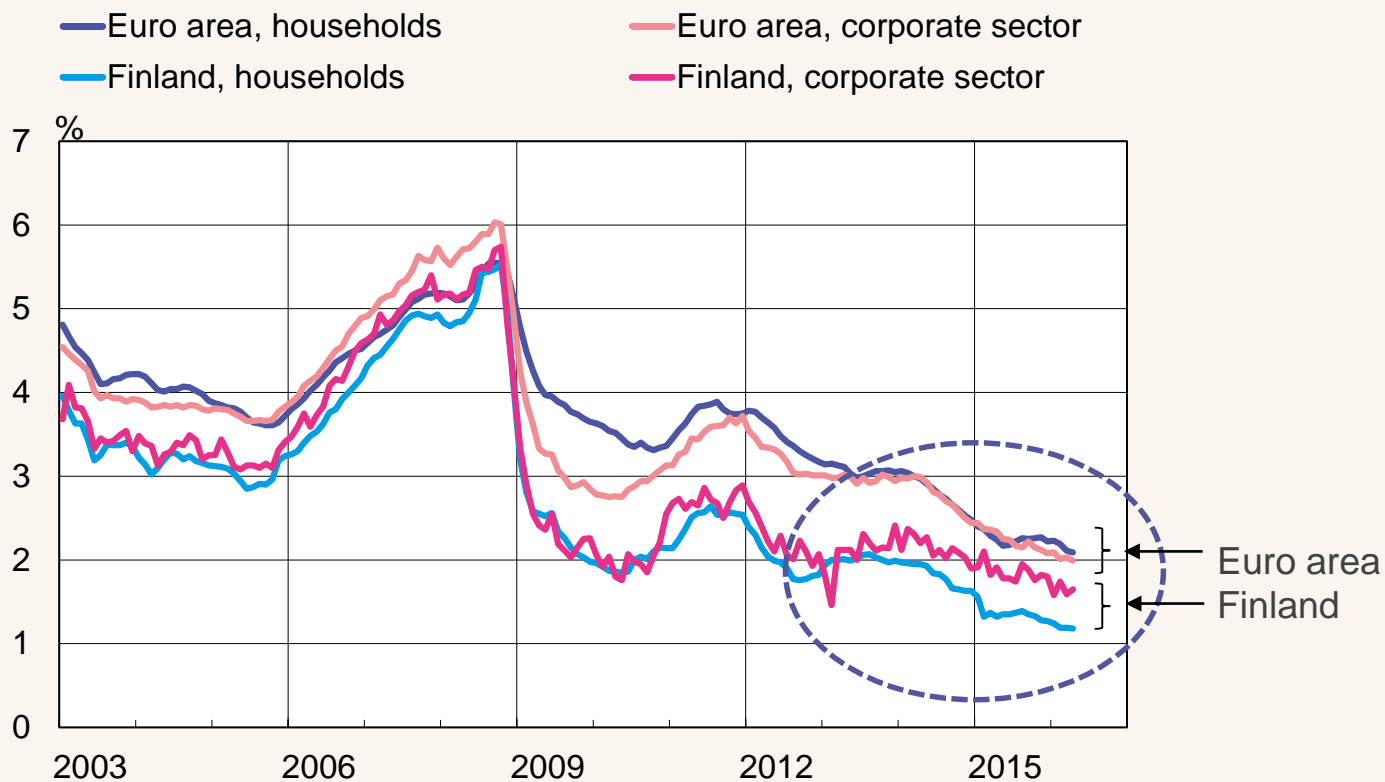
10-year sovereign bond yield.

Source: Macrobond.



Bank lending rates on household and corporate loans down

Average interest rate on new loans

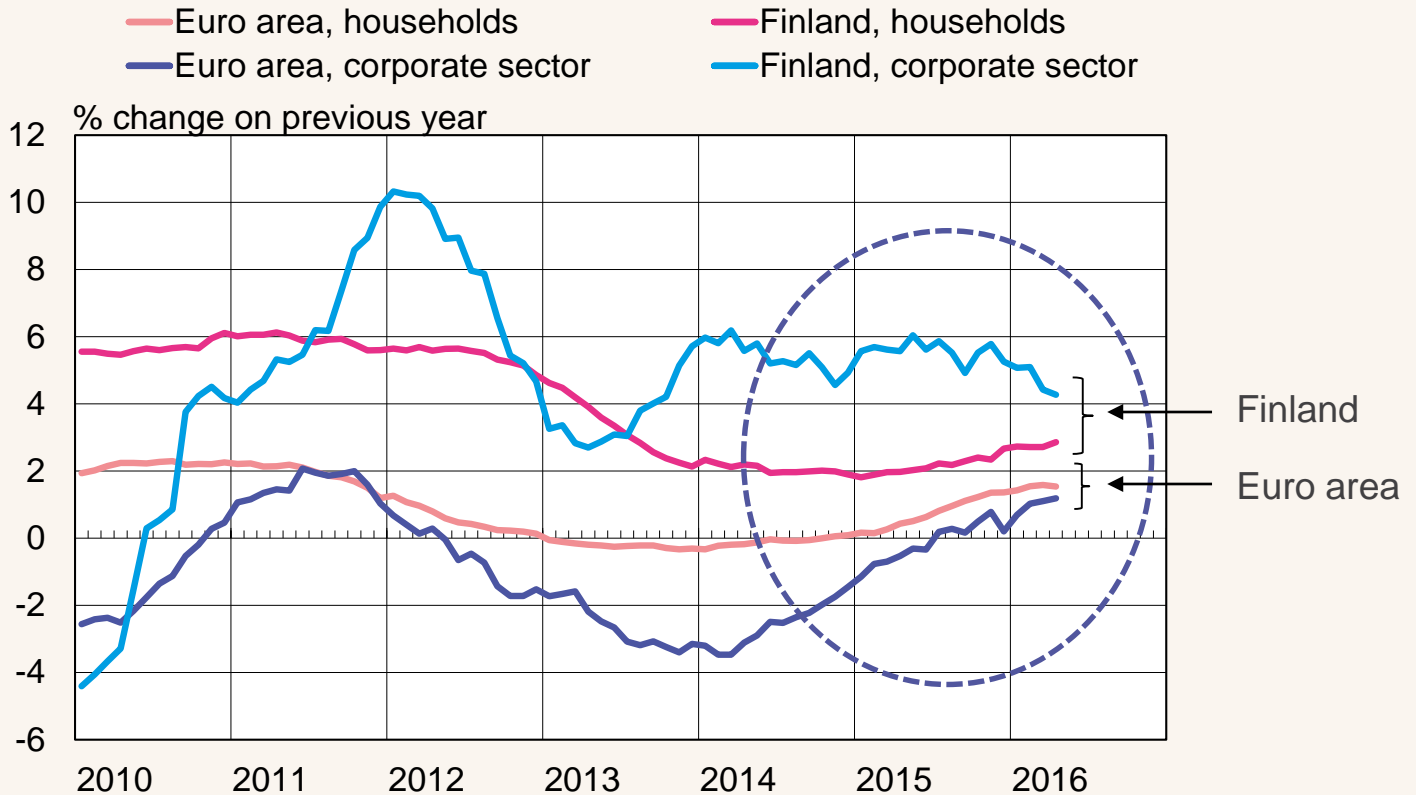


Sources: ECB and Macrobond.



Higher volumes of bank loans

Annual growth in loan stocks



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



Increase in Finnish exports to euro area

Change in the value of Finnish goods exports in 2014 and 2015, total, %	
Euro area*	+10
Germany	+38
Sweden	-15
Russia	-41
United States	+6
United Kingdom	-5

Share in the value of goods exports, %	2005	2015
Euro area*	34	37
Germany	11	14
Sweden	11	10
Russia	11	6
United States	6	7
United Kingdom	7	5

*) The current 19 euro area countries.
Source: Finnish Customs.



Domestic demand growing

Change in volume, %

	2015	2016, forecast
Private consumption	1.4	1.6
Private investment	-1.0	4.7
Exports	0.6	0.7

Sources: Statistics Finland and Bank of Finland.

- *Putting growth on a sustainable footing requires continued structural reforms and restoration of cost competitiveness, in which the competitiveness pact, if concluded, is an important step.*



Is economic growth generally slowing in the long term?



In Finland, risk of an extended period of subdued economic growth

- ***Productivity growth in Finland has been weak***
 - *Partly due to contraction of output in certain high-productivity sectors with no expectations for a rapid recovery*
- ***Outlook also dampened by demographic developments***
- ***A threat to the funding base of the welfare state***



Productivity growth is slow in developed economies

Annual change in labour productivity*, %

	1999– 2006	2007– 2013	2013	2014	2015	Forecast 2016
United States	2.4	1.1	0.3	0.5	0.3	-0.2
Japan	1.8	1.0	1.4	-0.4	0.1	0.4
Euro area	1.5	0.6	1.0	0.3	0.5	0.3

*) Real GDP per hours worked.
Source: Conference Board.

- ***Will productivity growth remain subdued?***





Now is the right time for measures to improve growth prospects

- Structural reforms
- Restoration of cost-competitiveness

Favourable financing
conditions support
investment

Conditions for economic growth



Article, Helvi Kinnunen and Sami Oinonen: Comparison of developments in Finland and Japan (in Finnish)

- *In both the countries, population ageing, public debt increasing and growth prospects weak*
- *In 15 years, population structure in Finland will correspond to present-day Japan*
- *Risk of over-indebtedness is lower in Finland than Japan, as immigration supports population growth*
- *Keeping the build-up of public debt in check requires sufficient economic growth in both countries*
- *Lessons from Japan: economic stimulus has limited effect if structures of economy not reformed*

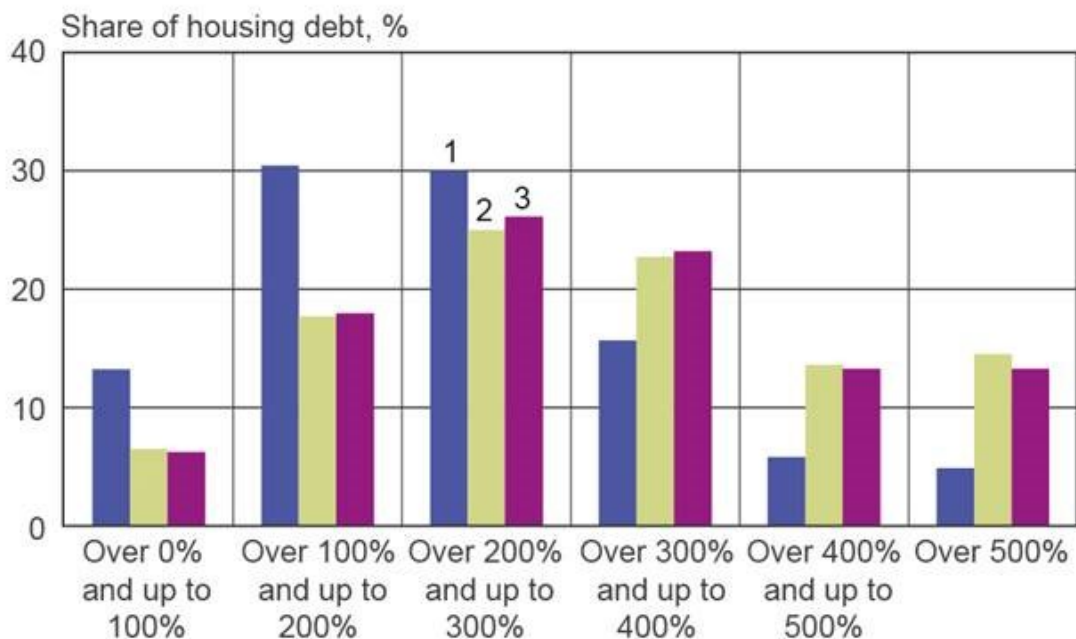


Household indebtedness

Weak growth outlook means household debt accumulation gives cause for concern

Significant share of housing debt borne by heavily indebted households

1. ■ Year 2002 2. ■ Year 2010 3. ■ Year 2014



In horizontal axis household debt ratio (total debt, % of disposable monetary income).

Sources: Statistics Finland and calculations by the Bank of Finland.



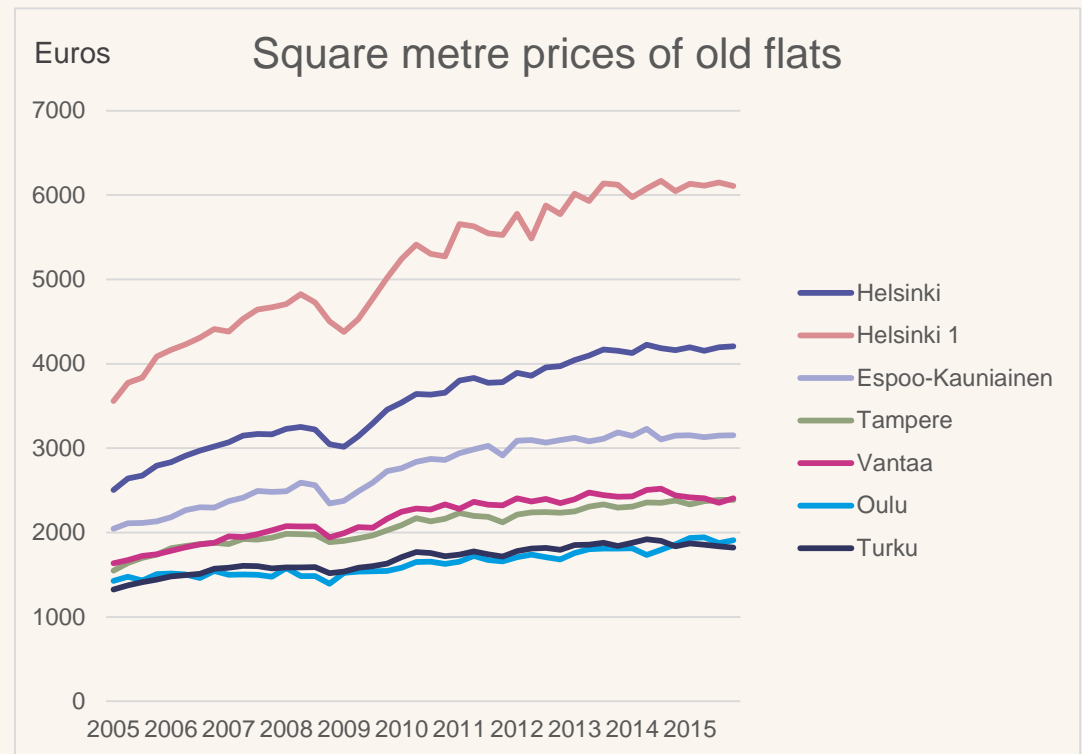
In the management of debt-related risks, a key role is played by macroprudential policy

- *Finland has introduced macroprudential tools gradually and decisions have been taken since 2015.*
- *Policy action requires time to have an impact: tools for reacting to growth in risks must be in place in advance, otherwise it is too late to react.*
- *Many countries have a more diverse macroprudential toolkit than Finland.*
- *Use of macroprudential tools is decided quarterly by the Board of the Financial Supervisory Authority*



Article, Essi Eerola: House prices in Helsinki have diverged from developments in rest of Finland (in Finnish)

- ***May be due to the increased attractiveness of the metropolitan area.***
- ***Lower interest rates on housing loans may also explain the growth in demand.***
- ***Prices have risen in areas where supply has not grown correspondingly.***





Constraints on housing production intensify price volatility and debt-related risks

Household income developments, interest rates
⇒ Fluctuations in housing demand

Housing production
does not react

Housing production
reacts

Strong volatility in
prices

Stable price
developments

- ***Volatility in house prices increases risks related to debt accumulation.***



Other articles (in Finnish)

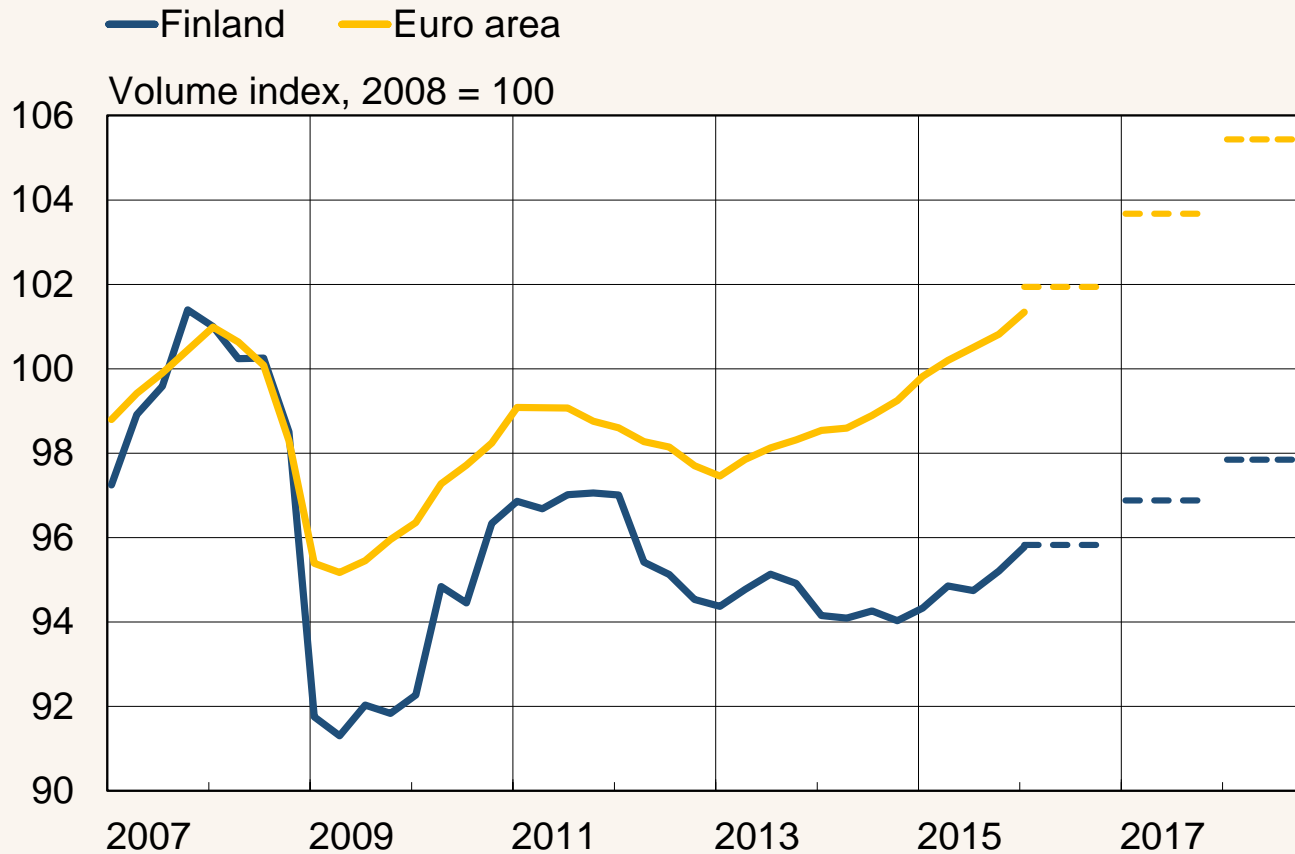
- ***Meri Obstbaum: Demographic changes reflected on the labour market***
- ***Juuso Vanhala, Matti Virén and Satu Nurmi (Statistics Finland): Job creation in firms – does Finland lack gazelles?***
- ***Petri Mäki-Fränti: Education and age ease uncertainties over income development***
- ***Juha Itkonen: How do we know where the economy is today?***



Final remarks:



How strong are the foundations for economic growth in Finland?



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

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Thank you!