



EUROJÄRJESTELMÄ
EUROSYSTEMET

Small economies and financial crisis

Horwath Nordic

30.1.2009

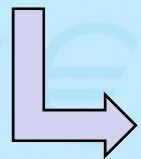
Pentti Hakkarainen

Deputy Governor

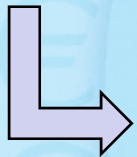
Bank of Finland

A chronology of the global financial crisis

Money and financial market crisis



Changes in the financial systems and structures



Weakening of growth prospects



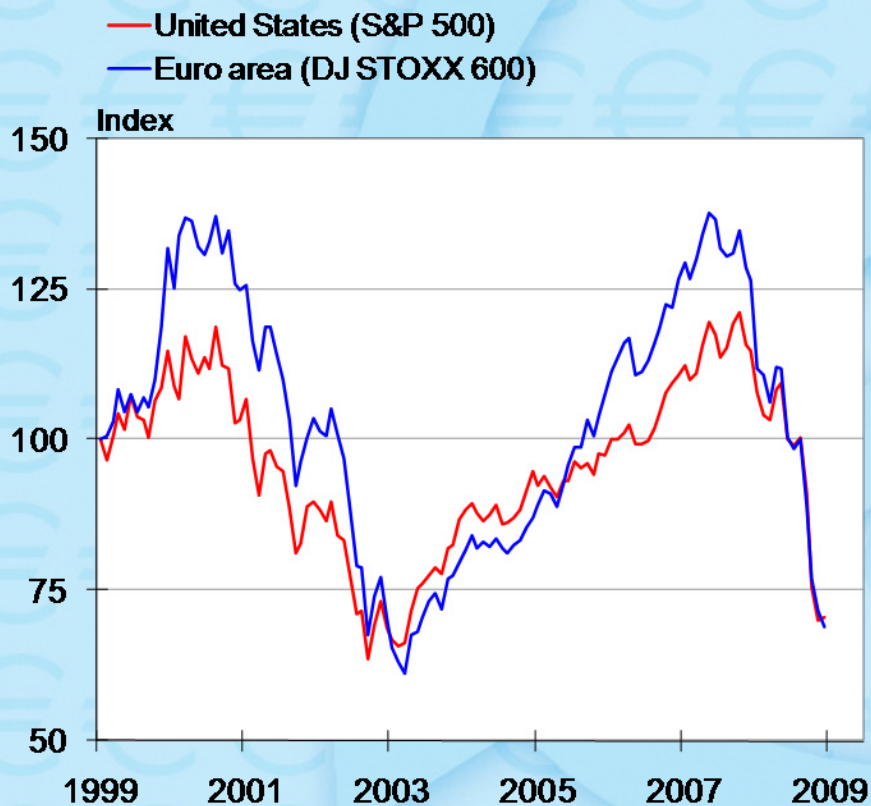
Deterioration of public-sector finances



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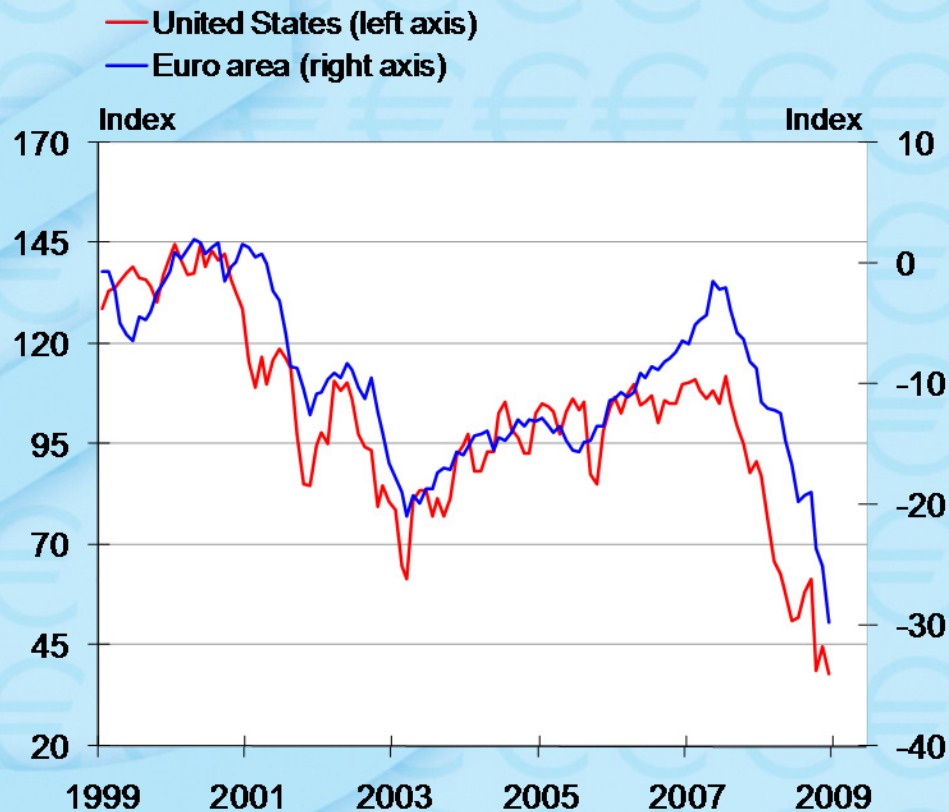
Financial markets and economies are interconnected globally

Stock indices



Source: Bloomberg.

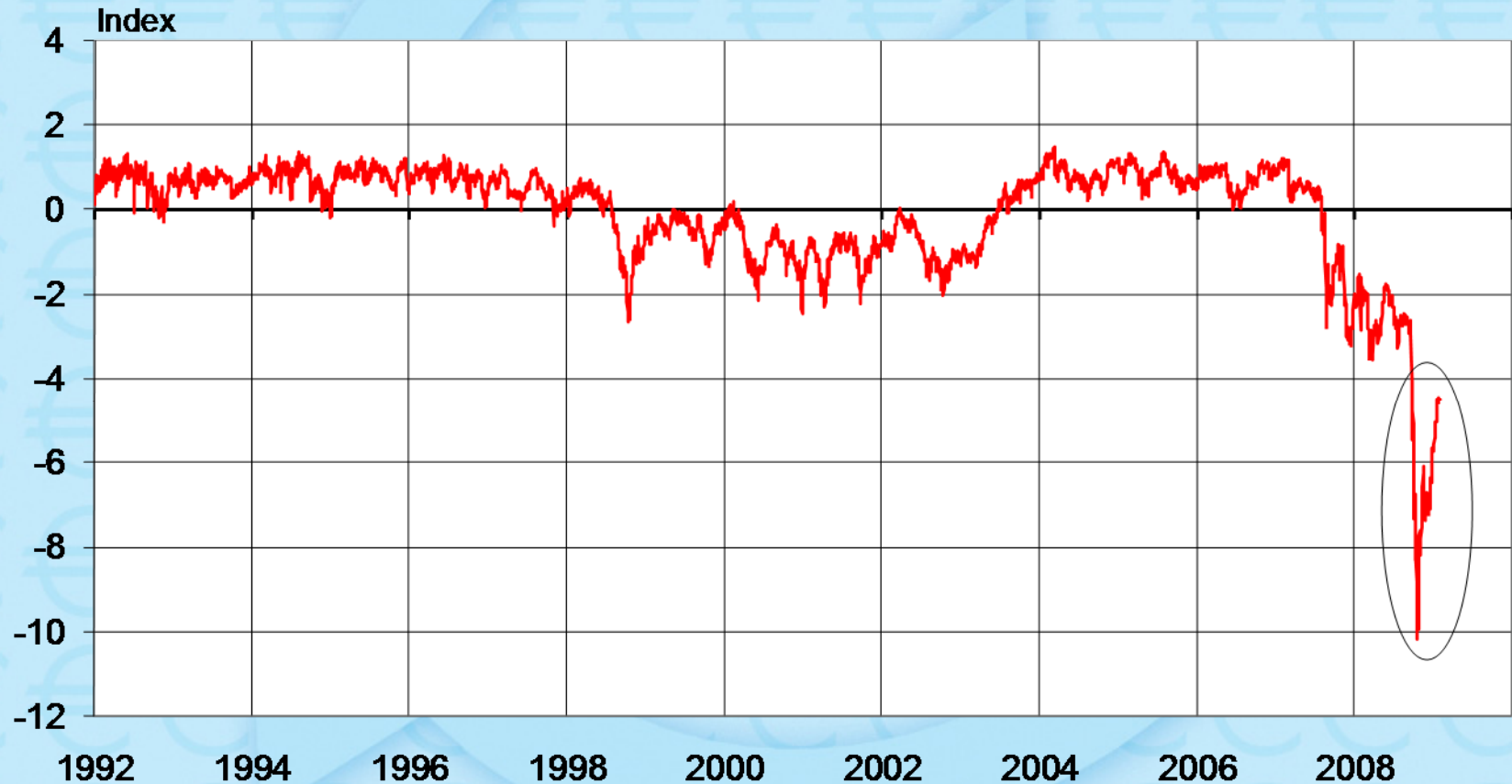
Consumer confidence



Source: Bloomberg.

Financial market conditions in the U.S. as compared with the average conditions during 1992-2009

— Overall index on the conditions in the money, fixed income and stock markets



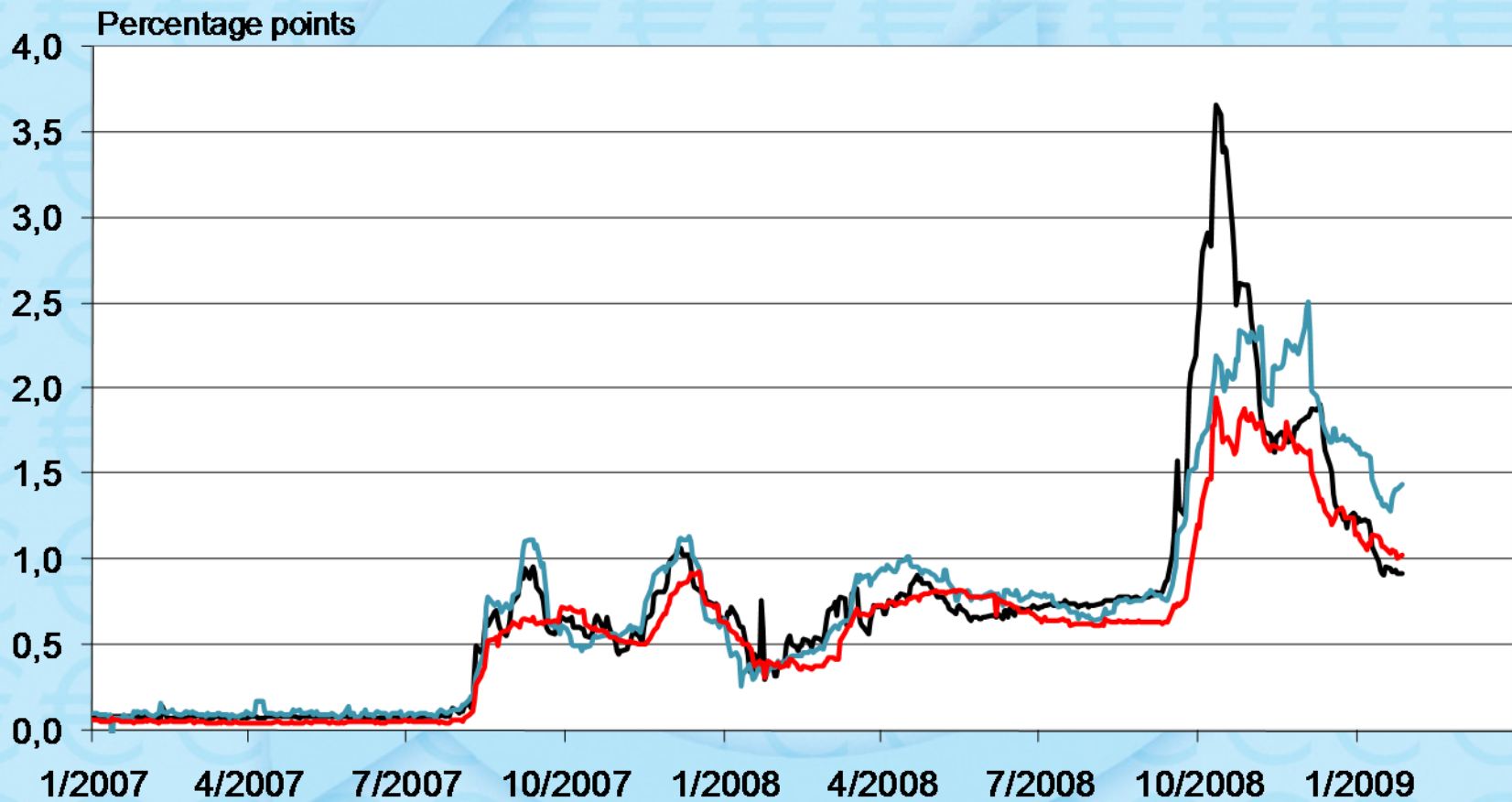
Source: Bloomberg.

* Index shows how many standard deviations the current market conditions differ from the 1992-2009 average.

PTMO/MP

Risk premia in the interbank markets in three months maturity

— United States — United Kingdom — Euro area

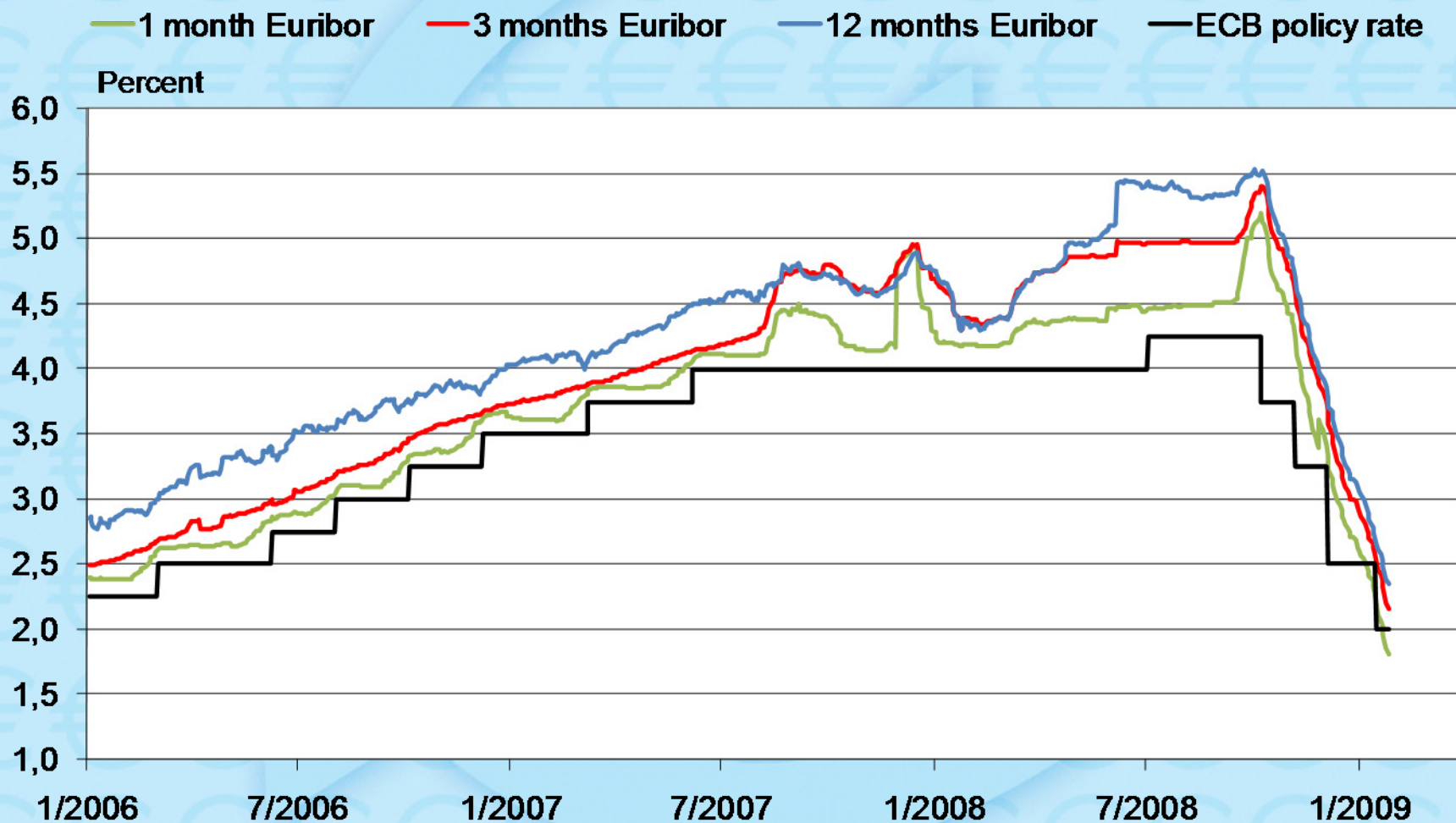


Source: Bloomberg.

* Differences between Libor/Euribor and OIS rates

PTMO/MP

Money market rates in the euro area

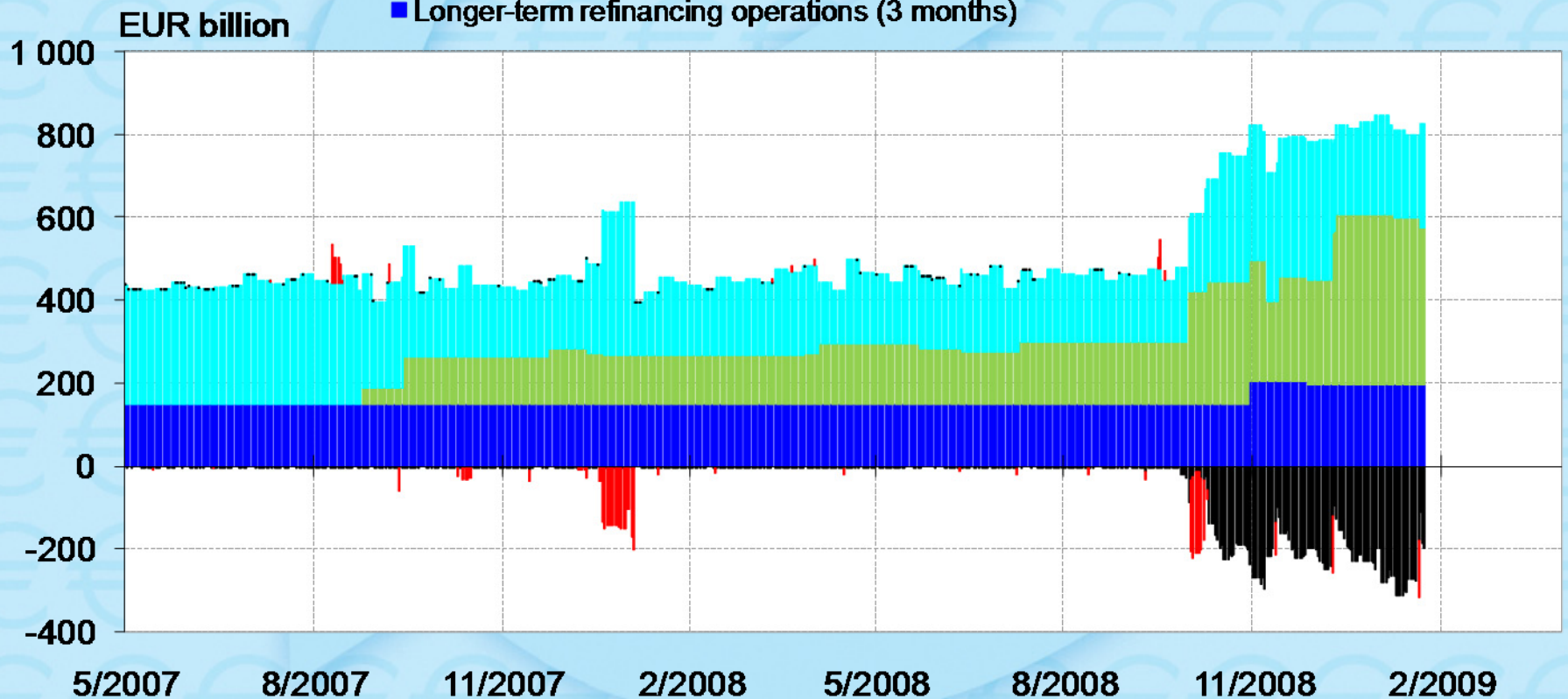


Source: European Banking Federation, European Central Bank.

PTMO/MP

Eurosystem's open market operations

- Fine-tuning operations (1-5 days)
- Net recourse to the standing facilities (1 day)
- Main refinancing operations (1 week)
- Supplementary longer-term refinancing operations (1-6 months)
- Longer-term refinancing operations (3 months)



Source: Bank of Finland.

PTMO/MP

Bank credit risk premia in the credit derivative markets (CDS)

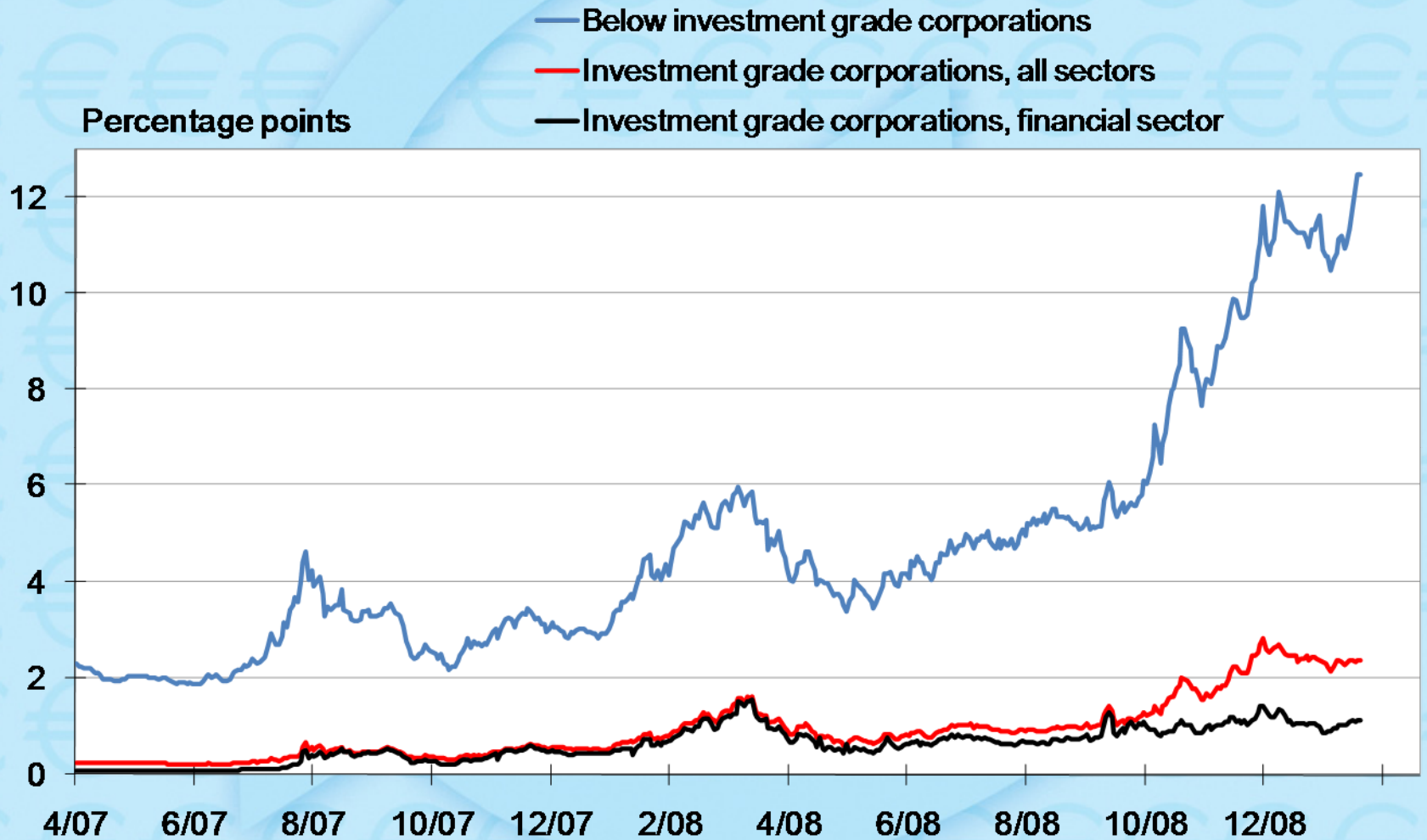
— UBS — ABN Amro — Barclays
— Deutsche Bank — Banco Santander — Societe Generale



Source: Bloomberg.

PTMO/MP

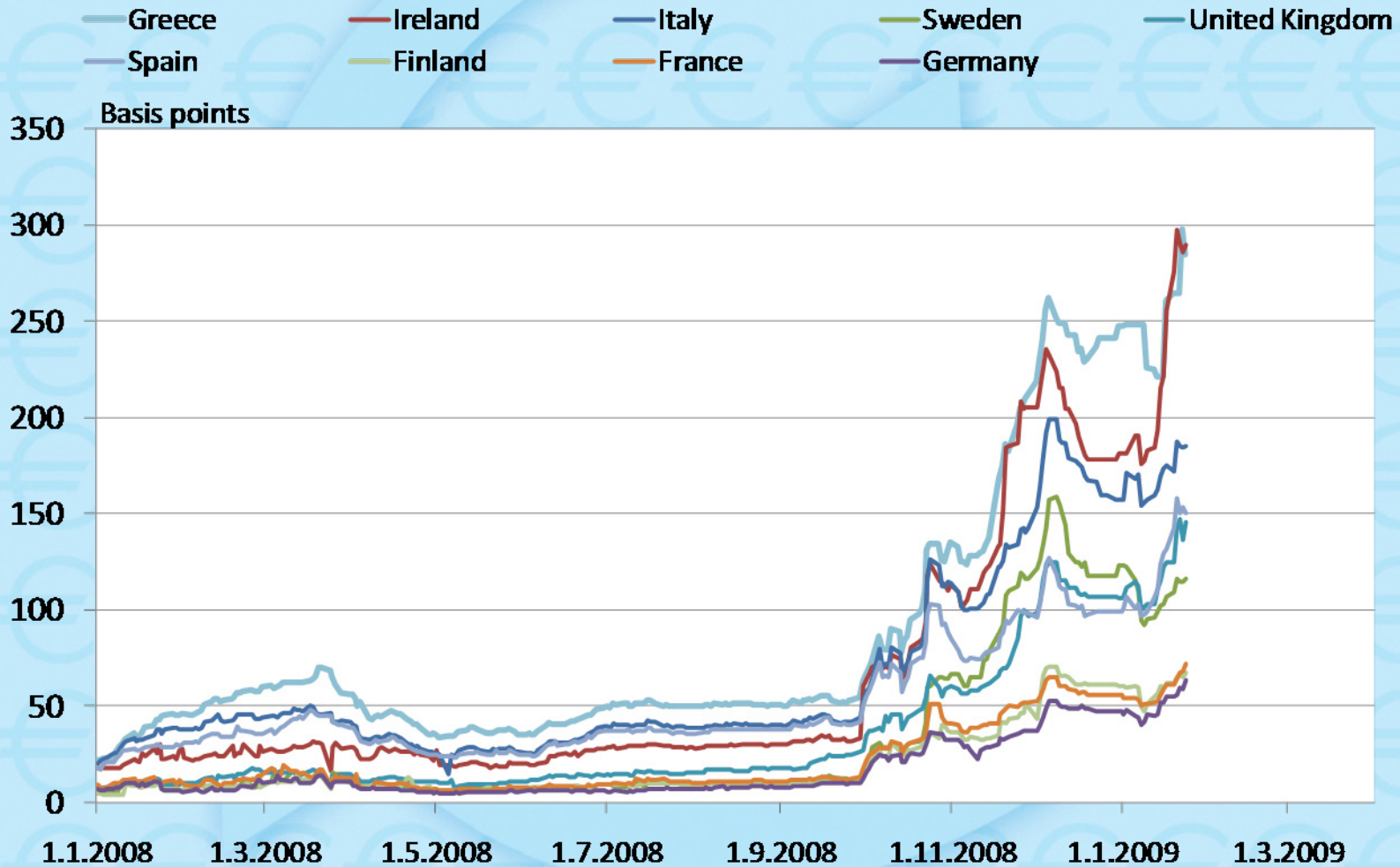
Corporate credit risk premia in the credit derivative markets (CDS)



Source: Bloomberg.

PTMO/MP

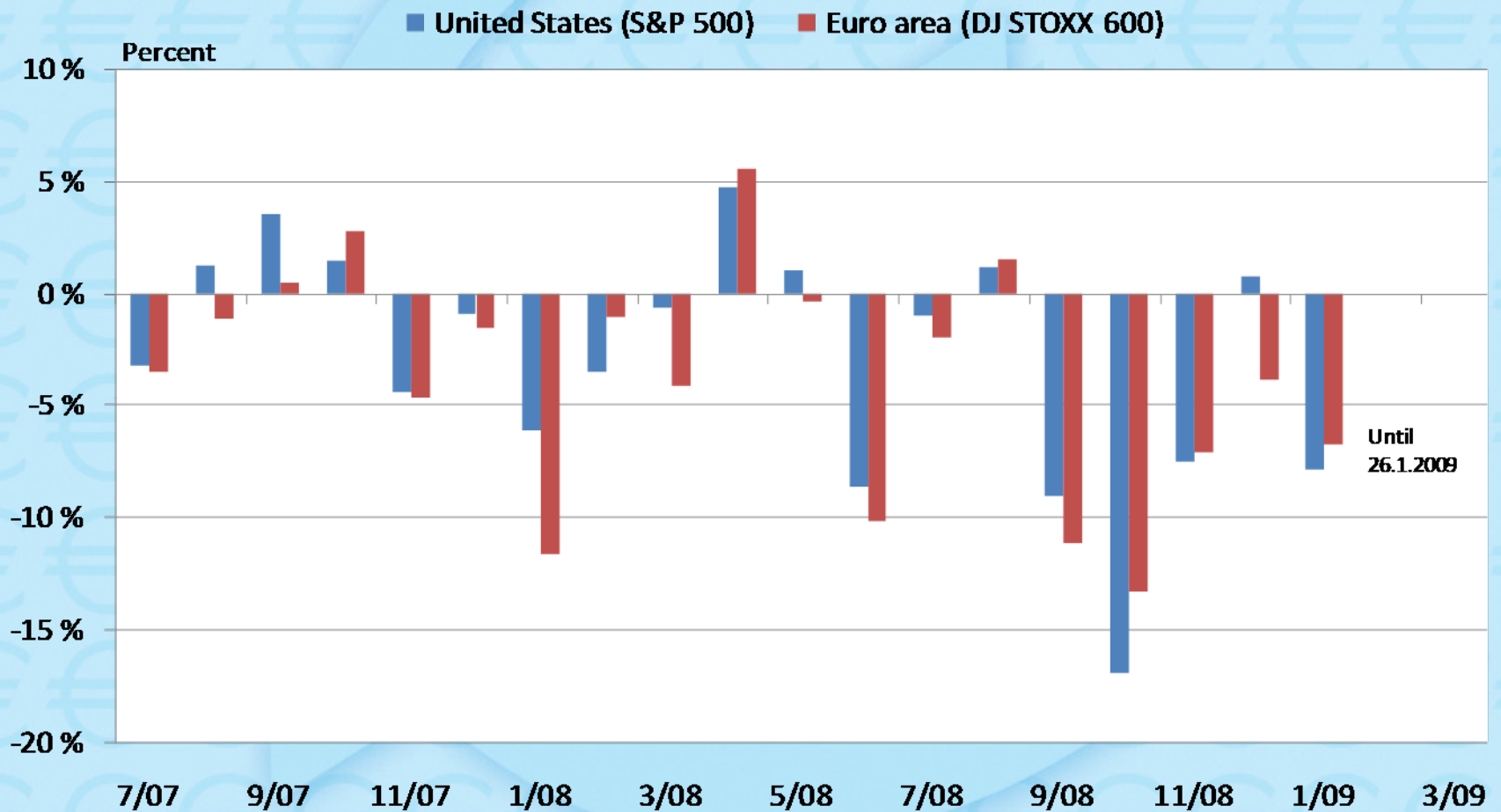
Sovereign credit risk premia in the credit derivative markets (CDS)



Source: Bloomberg.

PTMO/JH

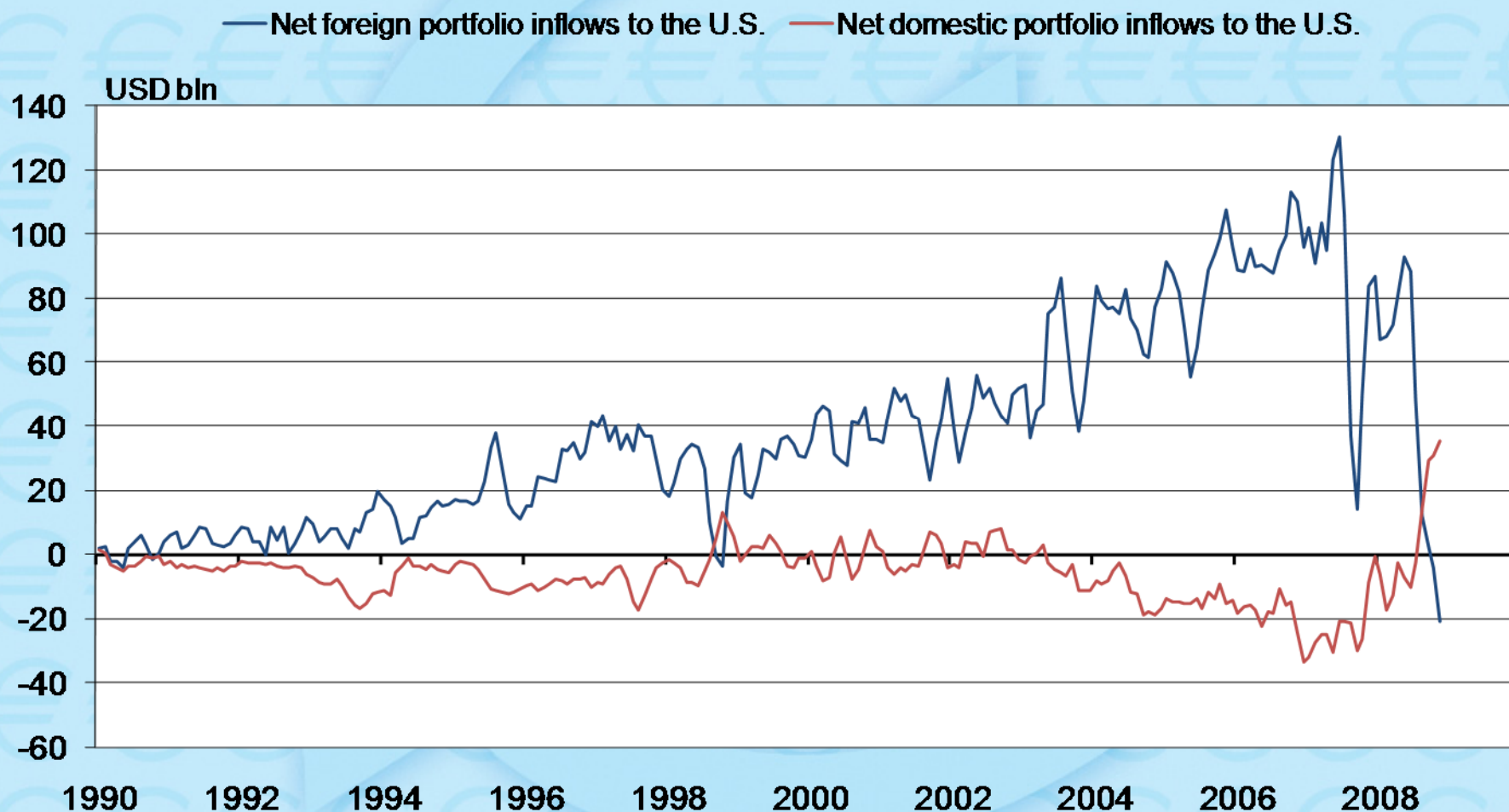
Monthly returns of stock indices in the United States and the Euro area



Source: Bloomberg.

PTMO/MP

International capital flows in the United States

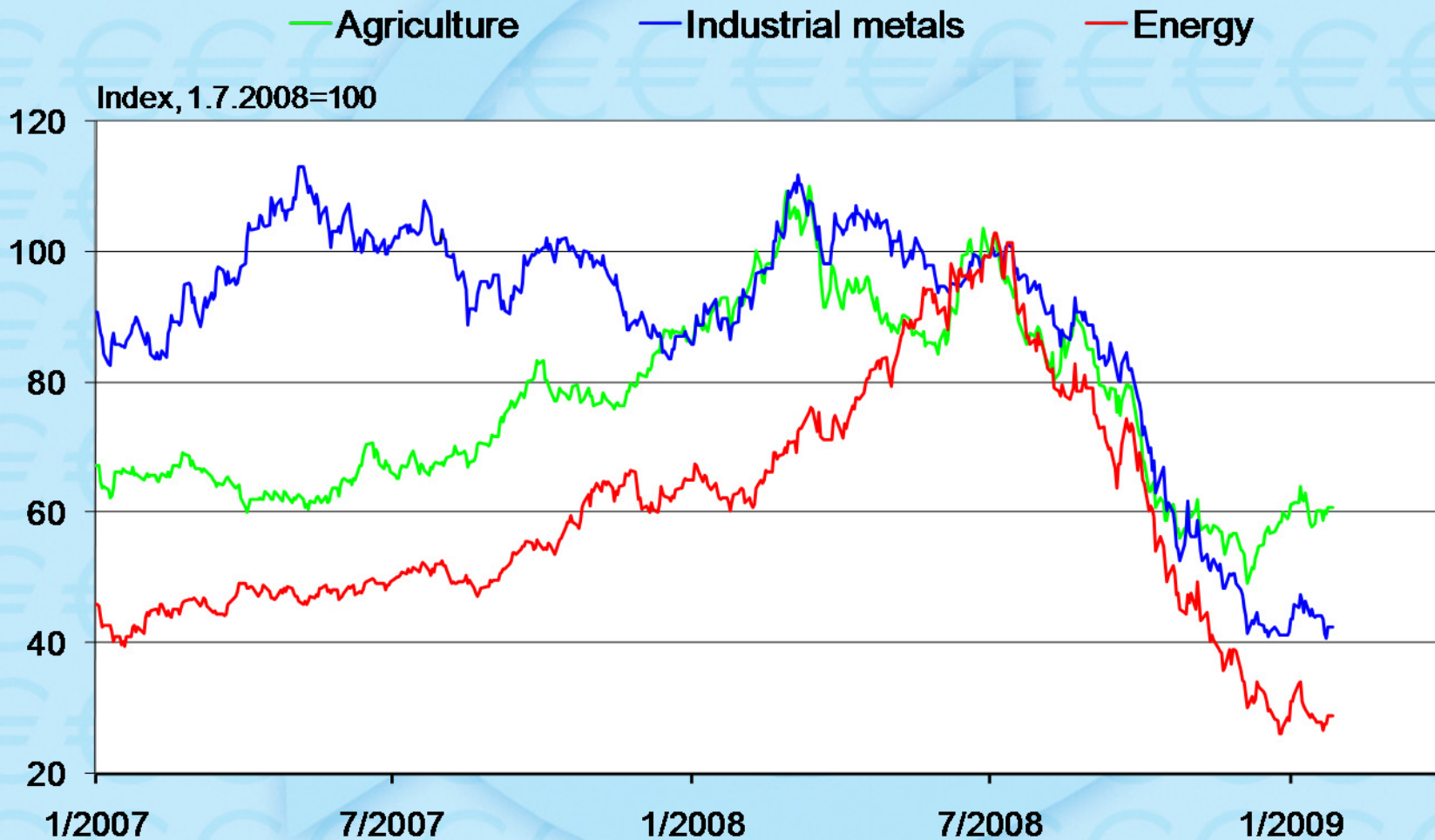


Source: US Treasury.

* Three months moving averages

PTMO/MP

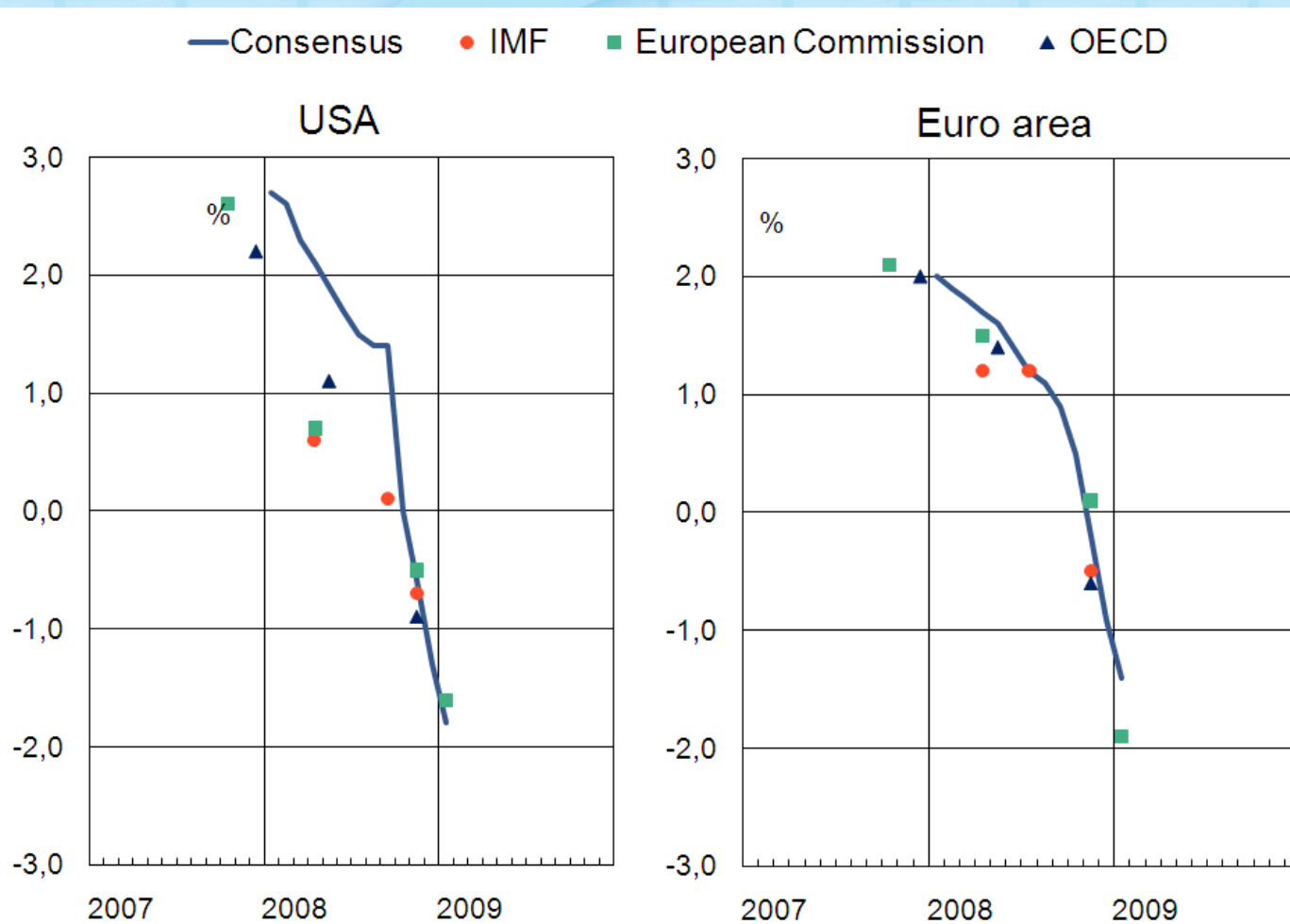
Commodity price indices



Source: Bloomberg, S&P.

PTMO/MP

GDP growth forecasts for 2009



Sources: Consensus Economics, IMF, OECD, European

Economic outlook deteriorating rapidly

	Bank of Finland December 2008		European Commission January 19, 2009	
	2009	2010	2009	2010
Forecast for Finland				
GDP	-0.5	0.7	-1.2	1.2
Consumption	0.7	1.9	0.5	1.8
Investment	-6.4	-1.1	-3.8	0.3
Exports	-3.3	1.0	-4.0	1.1
Imports	-2.1	2.6	-1.7	1.4
Unemployment	7.2	7.7	7.8	7.0
Public deficit	2.0	0.7	2.0	0.5
<i>Memorandum items</i>				
World imports	3.1	5.7	negative	..
US GDP	-0.9	0.7	-1.6	1.7
Euro area GDP	-0.5	1.0	-1.9	0.4
Euro area deficit	-4.0	-4.4

Public finances in Finland

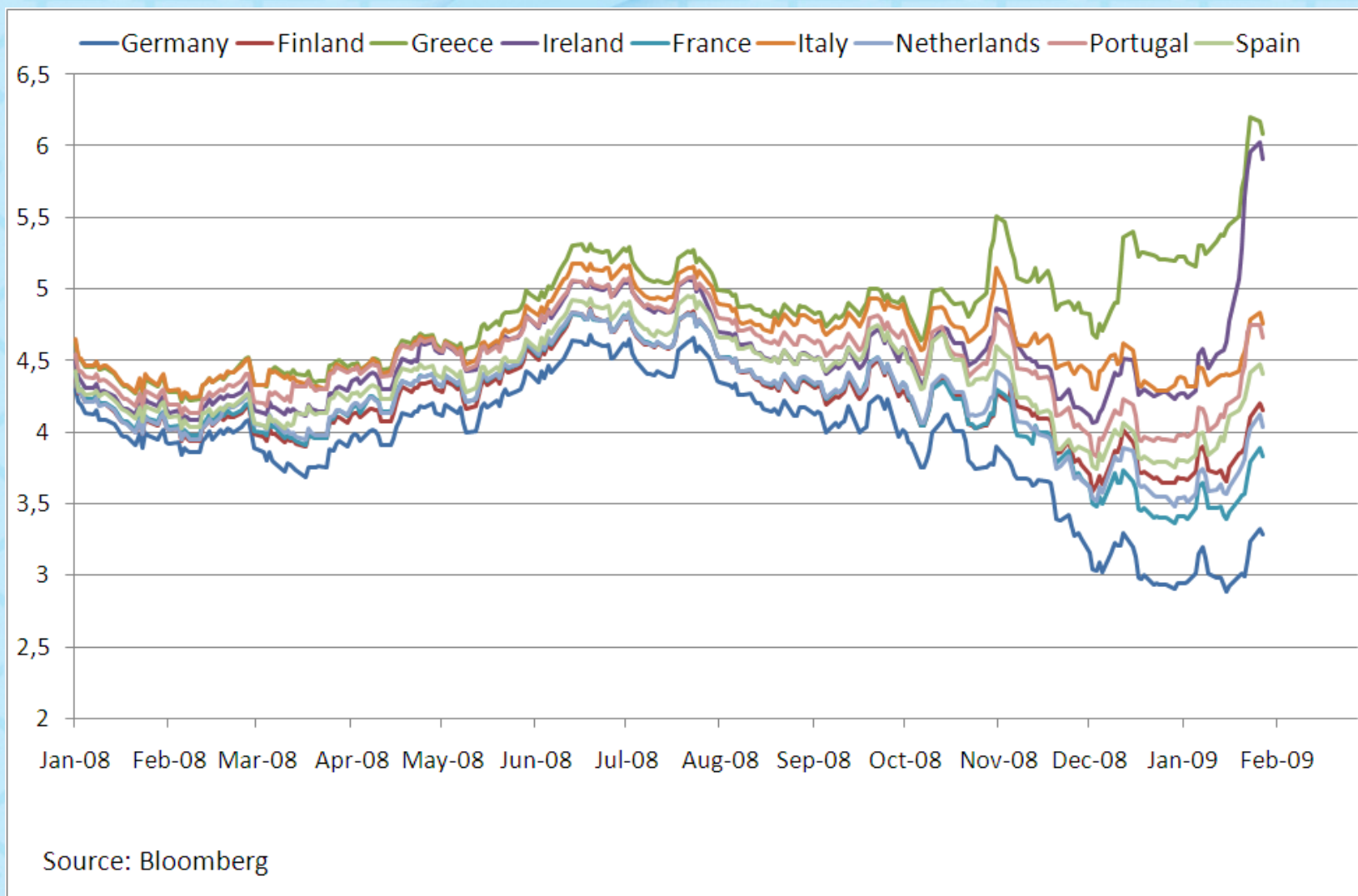
- ◆ History of fiscal prudence.
 - Gross public debt low, around 30% of GDP.
 - Public and semi-public financial assets 60-70% of GDP.
- ◆ Solid reputation invaluable in a crisis
 - ... particularly for a small and peripheral country.
- ◆ High credibility.
 - Credit derivatives price the likelihood of Finnish default the 2nd lowest in the EU (after Germany).
- ◆ Downside: small issuer, low liquidity
 - Relatively high liquidity premium.
- ◆ Overall cost of public debt among the lowest in the EU.

General government balance in some EU countries (Commission forecasts)

% of GDP	2007	2008f	2009f	2010f
Spain	2,2	-3,4	-6,2	-5,7
Ireland	0,2	-6,3	-11,0	-13,0
Italy	-1,6	-2,8	-3,8	-3,7
Greece	-3,5	-3,4	-3,7	-4,2
France	-2,7	-3,2	-5,4	-5,0
Germany	-0,2	-0,1	-2,9	-4,2
Finland	5,3	4,5	2,0	0,5

Lähde: European Commission, Interim Forecast, January 2009.
f = forecast

10-year Euro government bond yields



Finland and the financial crisis

– risks and challenges

- ◆ Finnish economy strongly dependent on world trade.
 - A highly open economy, Finland was a prime beneficiary of globalisation. Now vulnerable to breakdown of global trade and a potential increase in protectionism.
 - High share of capital goods – exposure to investment-led recession.
- ◆ No exchange rate policy – vulnerable to competitors' exchange rate depreciation.
 - Sweden, Russia.
- ◆ Increase in risk aversion and flight to quality puts peripheral countries at a disadvantage.
 - Small country pays a higher liquidity premium.
- ◆ Structure of the banking sector complicates support measures.
 - Foreign ownership, cooperative structure.

Finland and the financial crisis - strengths

- ◆ Global currency
 - Shields from volatility and speculative pressures.
 - Monetary policy anchors inflation expectations.
- ◆ Strong balance sheets
 - Banking sector well capitalised and with negligible exposure to toxic assets.
 - Corporate sector balance sheets generally strong.
 - Robust public finances provide room for fiscal stimulus.
- ◆ Balanced economic starting point.
 - Strong current account.
 - No significant property bubble or construction sector overheating.



Thank you!