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Reasserting growth after the crisis

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**Views expressed do not necessarily reflect those of the Bank  
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# I. Introduction

- ◆ Two aspects in the movement from crisis to growth
  - Recession has created large output gaps in most countries.
    - This gap needs to be closed.
  - The growth processes must be restarted.
    - Growth of potential output has slowed.
- ◆ Lessons from earlier financial crises
  - Crisis in Nordic countries in 1990s
    - Finland, Norway and Sweden
- ◆ Prospects and challenges for CEEI countries



## II. The 1990's Nordic crises

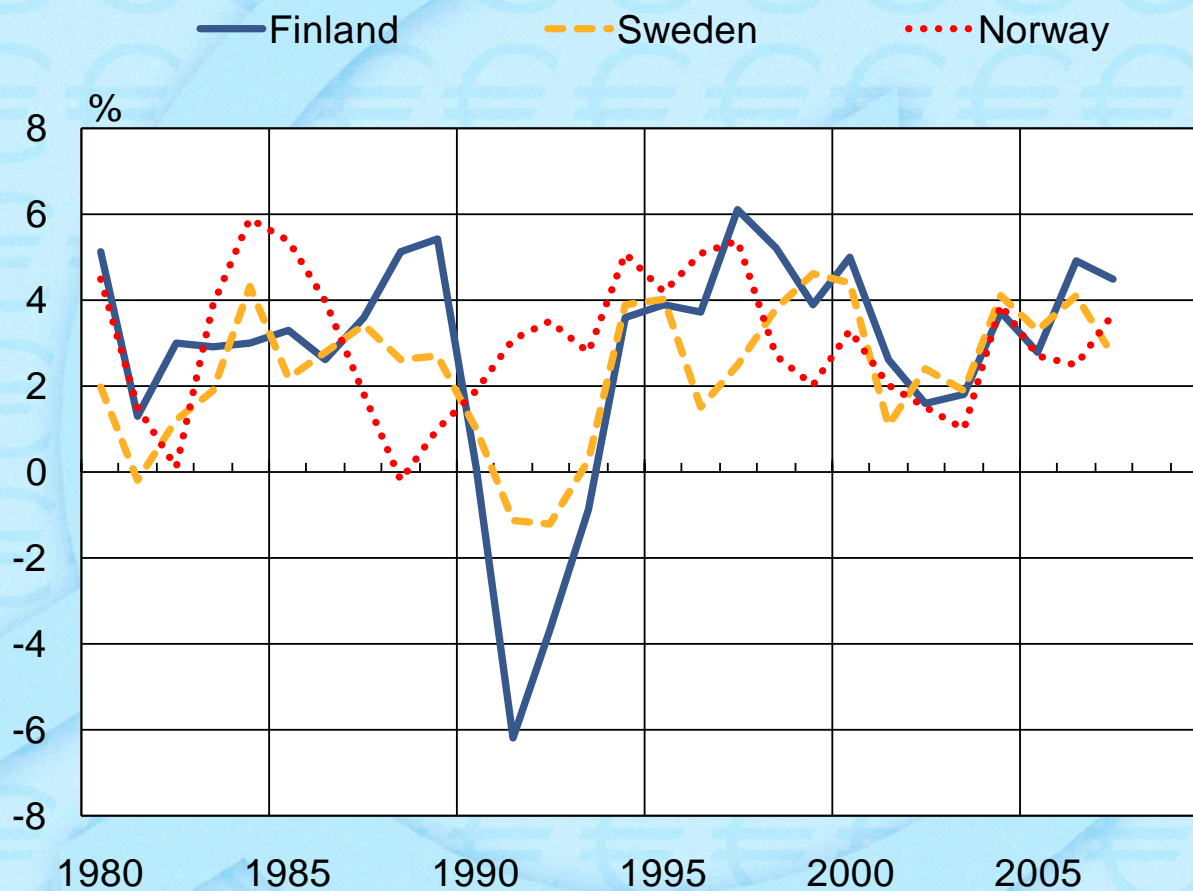
### ◆ Background:

- financial liberalization created a boom and overheating
- large increases in asset prices
- current account problems

### ◆ Classic crises

- Combined banking and currency crisis
- recession/depression
  - Significant period of negative growth (except in Norway)
- big increase in unemployment
- public debt shot up, but was gradually controlled

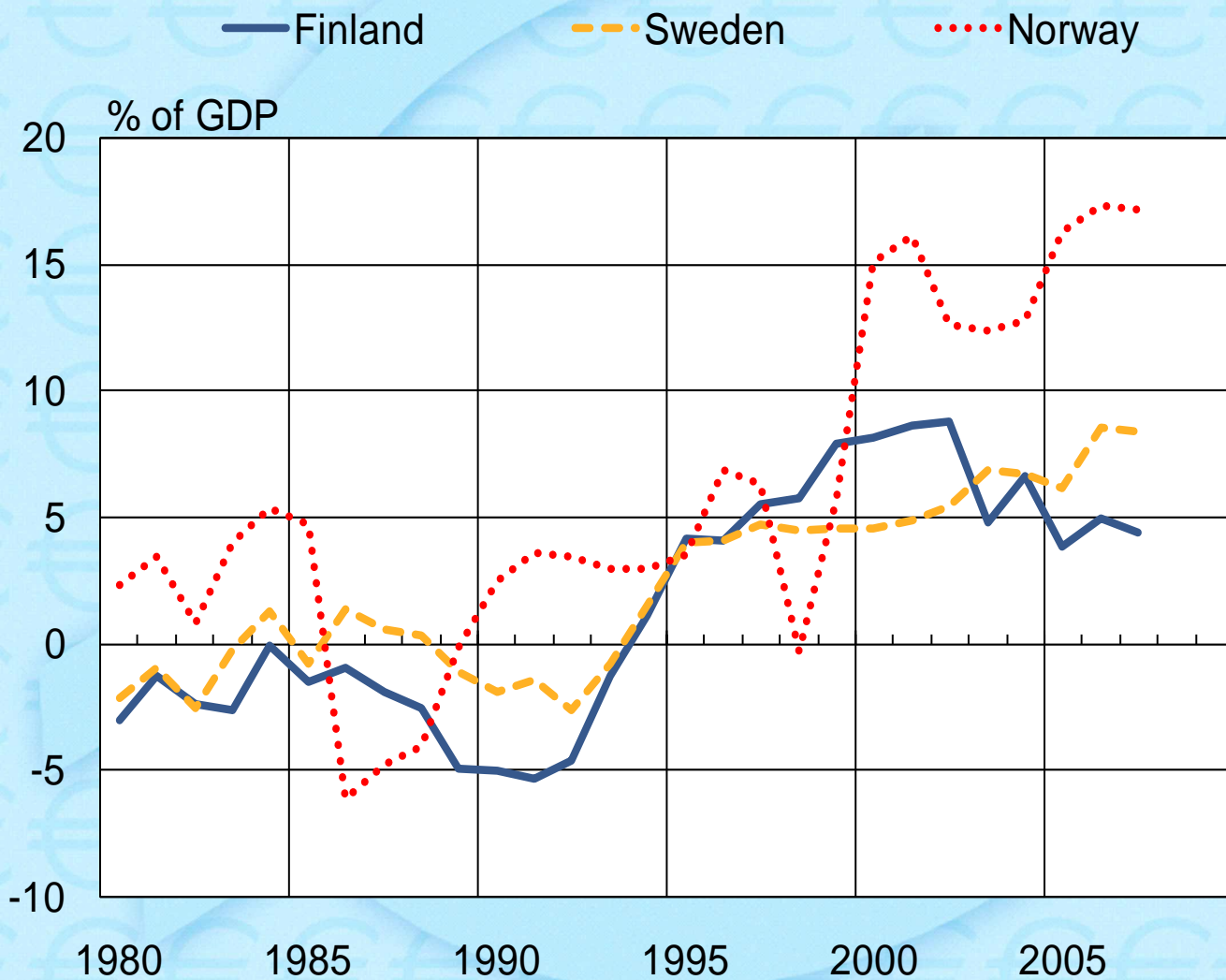
# Figure 1. Real GDP growth



Sources: Eurostat and IMF.

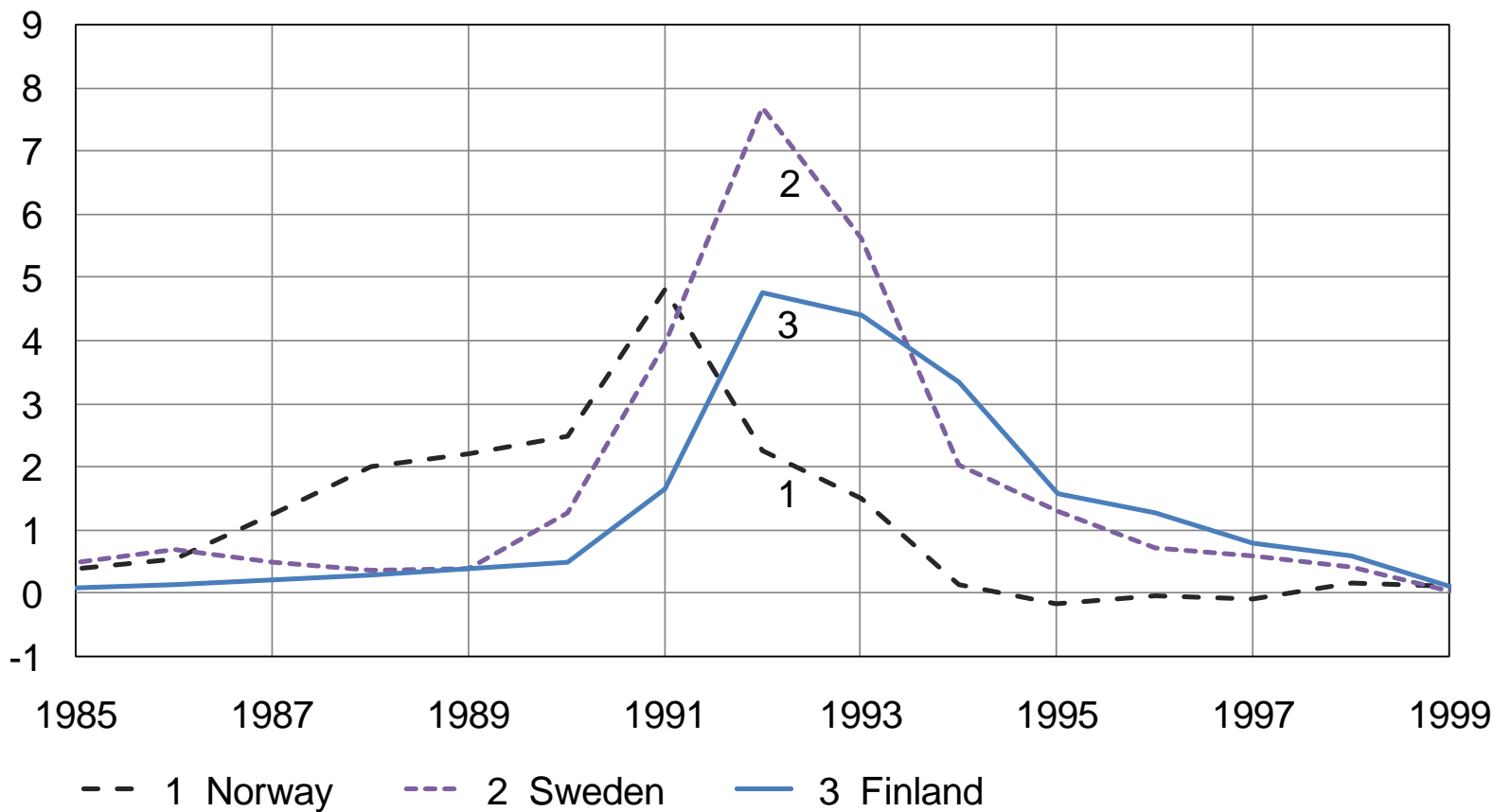


# Figure 2. Current account



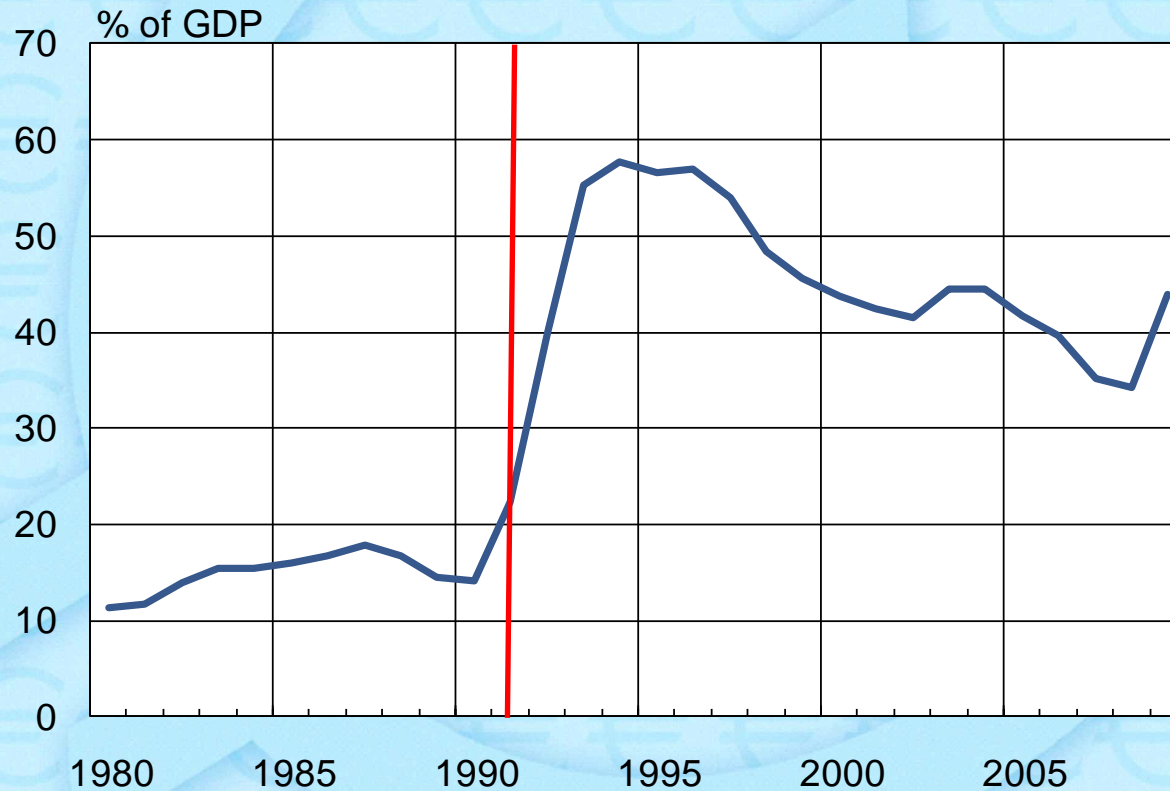
Source: European Commission.

## Loan losses/lending in the Nordic countries' banking sector 1985-1999, %



Source: Central banks.

# General government gross debt of Finland 1980–2009



Source: Statistics Finland.

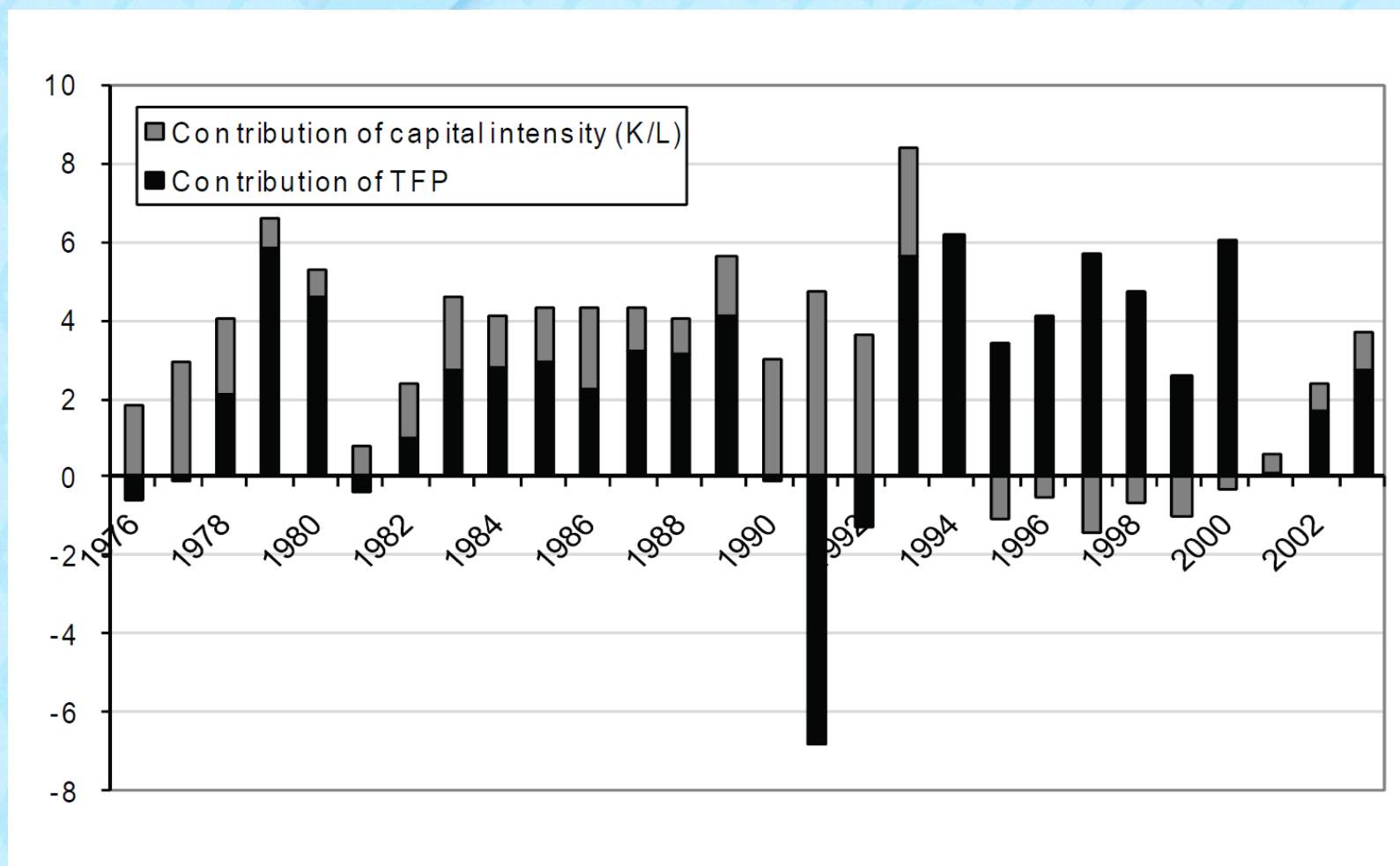


### III. Why did Finland and Sweden recover so well?

- ◆ Closing the output gap
  - correcting the competitiveness problem
    - Nordic countries floated their currencies
  - re-establishing credibility of monetary policy
    - Inflation targeting (Finland later joined the euro area)
  - clear fiscal strategy
    - Gradual consolidation after initial deficits
- ◆ Reattaining rapid growth
  - Focus on labor productivity growth
    - Capital intensity and TFP
  - Roles of human capital and R&D
  - ICT revolution as an example of successful structural change



# Reattaining growth I: TFP more important over time (labor productivity in Finland)

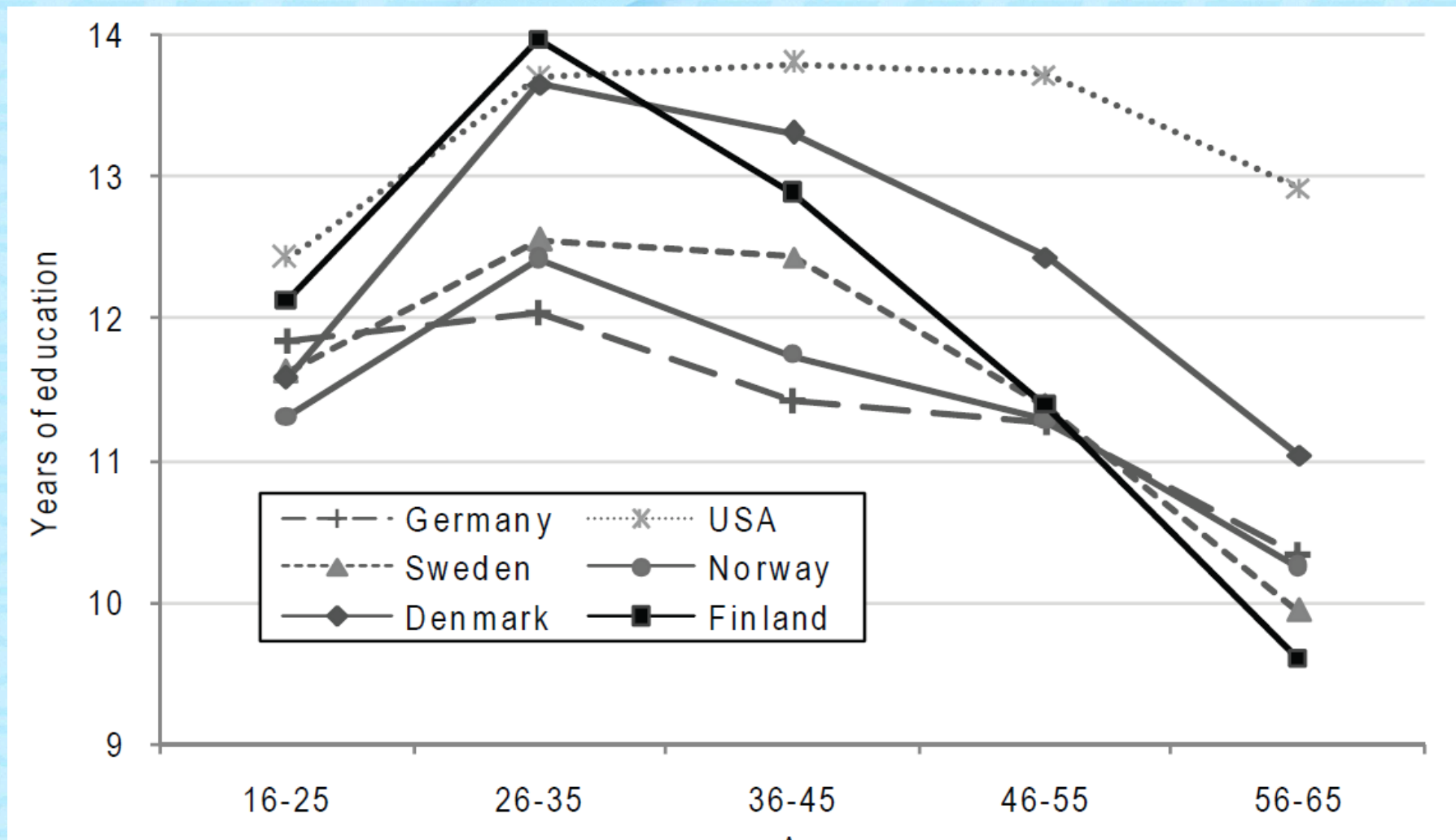


## Reattaining growth II: education, R&D and ICT

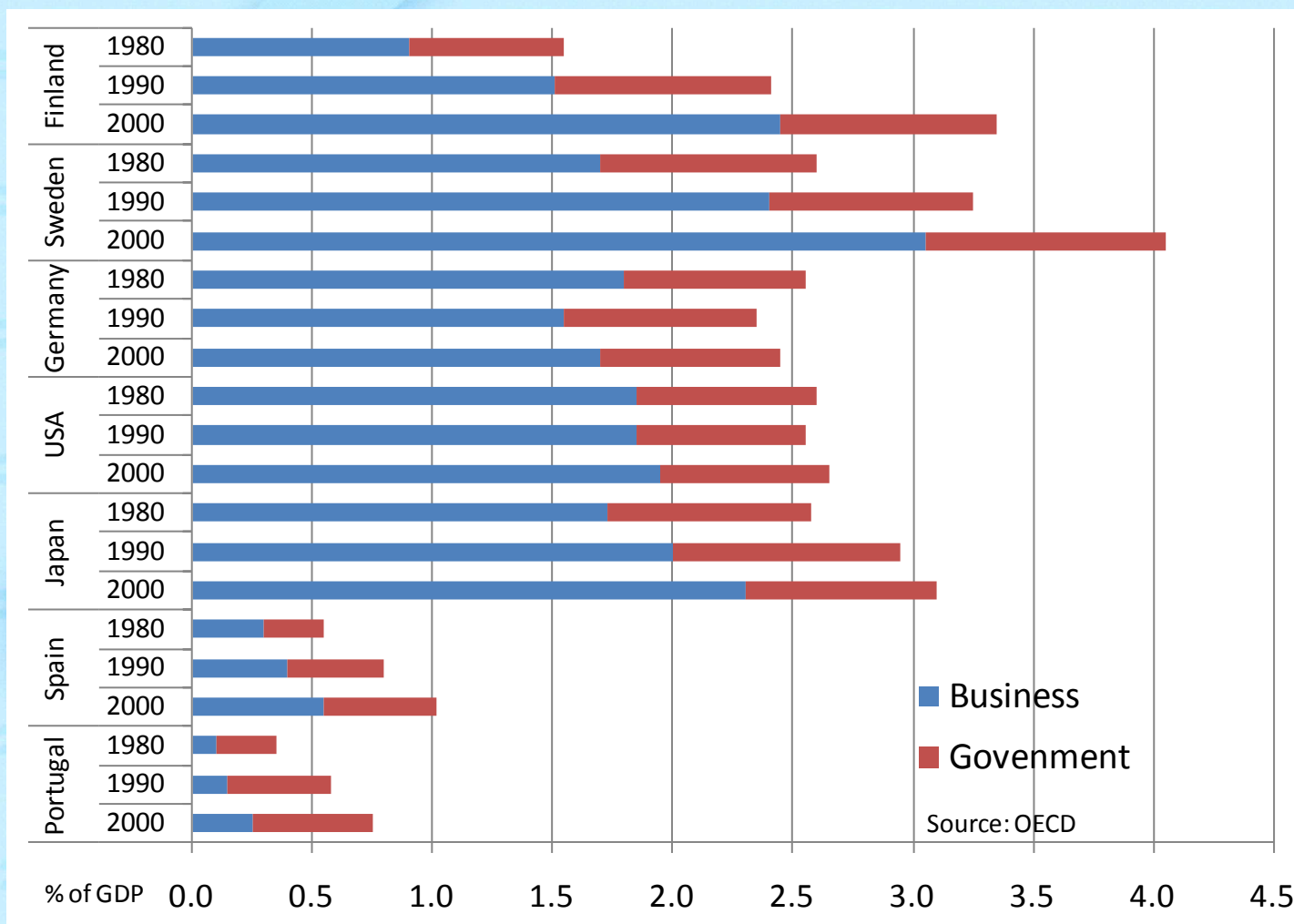
- ◆ Nordics had scope to improve quality of labor as older age cohorts were significantly less educated.
  - Sweden is an exception here.
- ◆ Nordics had high rates of R&D and significantly increased these rates after the crisis.
  - Norway is an exception here.
- ◆ Role of ICT was and is hugely important in Finland and also Sweden.
  - Growth accounting with ICT capital



# Education by age group



# R&D spending in international comparison

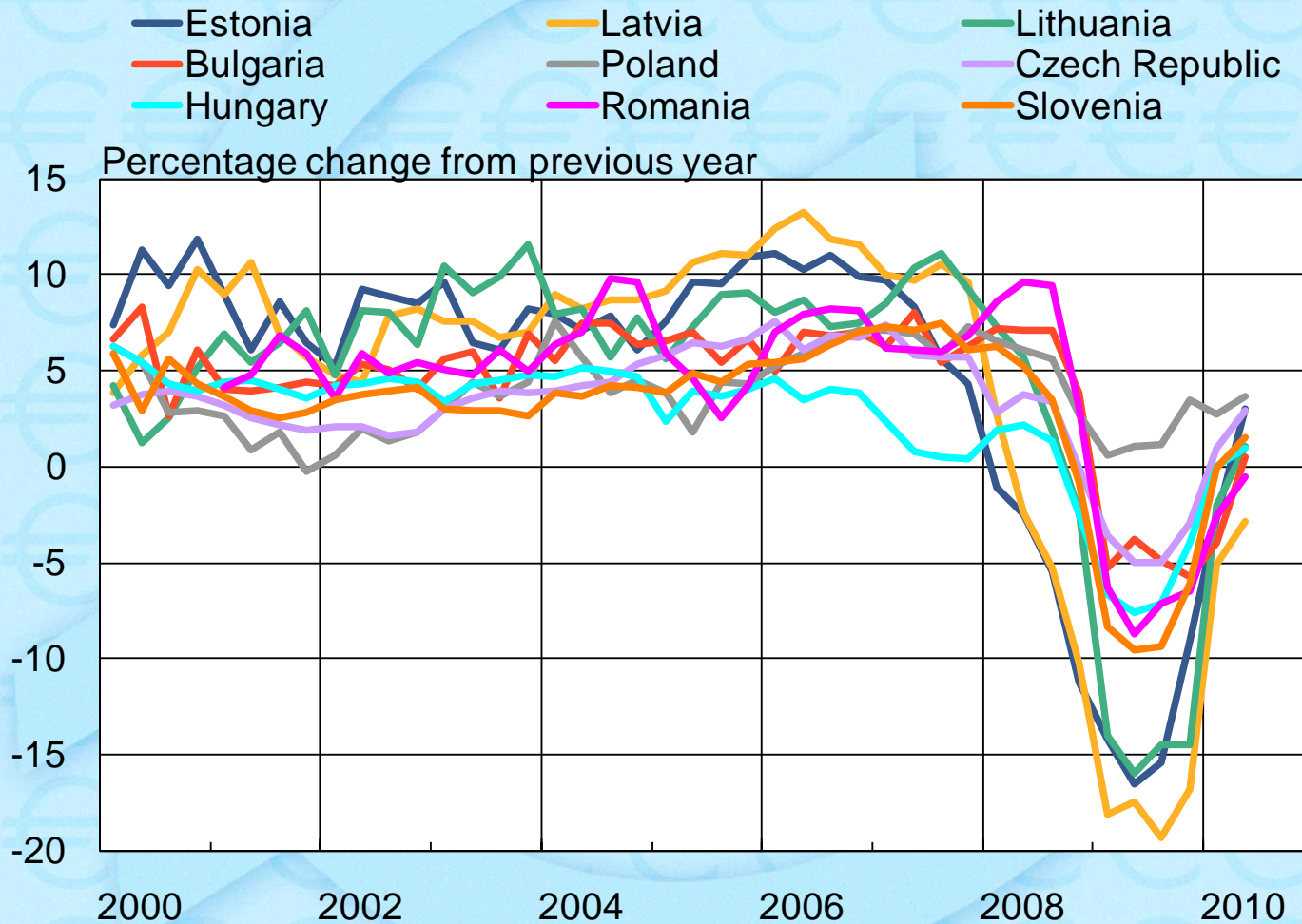




# Growth accounting for selected countries

	GDP growth	Contributions to GDP growth by			
		ICT capital growth	Non-ICT capital growth	Labour growth	TFP growth
<b>FINLAND</b>					
1995-2000	4.9	0.7	0.1	1.0	3.0
2000-2004	2.3	0.6	0.3	-0.3	1.7
<b>SWEDEN</b>					
1995-2000	3.5	0.8	0.4	0.7	1.7
2000-2004	2.1	0.4	0.2	-0.4	1.9
<b>THE US</b>					
1995-2000	4.2	0.9	0.6	1.3	1.5
2000-2004	2.4	0.6	0.4	-0.3	1.7

## IV. Restarting growth in CESEE countries: recession was deep but short-lived



Source: Eurostat.

21292@Chart50(en)



# Economic environment

- ◆ Future domestic environment challenging:
  - Risk perceptions remain high, finance is more difficult.
  - Deleveraging and higher saving in household sector.
  - Fiscal positions worsened, consolidation process will take a long time.
- ◆ Future international environment:
  - Trend growth will be slower in Western Europe and globally.
  - Reforms of financial architecture may improve CESEE financial systems.
  - Current tensions in the international financial system. For CESEE economies:
    - Flexible exchange rate vs. Euro membership objectives

## Restart I: closing the output gap

- ◆ Modest recovery in capital imports is likely
  - Higher domestic saving helps in narrowing S-I gaps
- ◆ Domestic finance of investment more important
- ◆ Challenges in the public sector
  - Focus on high-quality of public spending in view of fiscal sustainability concerns
  - Political stability and credibility are crucial for success
- ◆ Tackle unemployment to avoid decline in labor skills

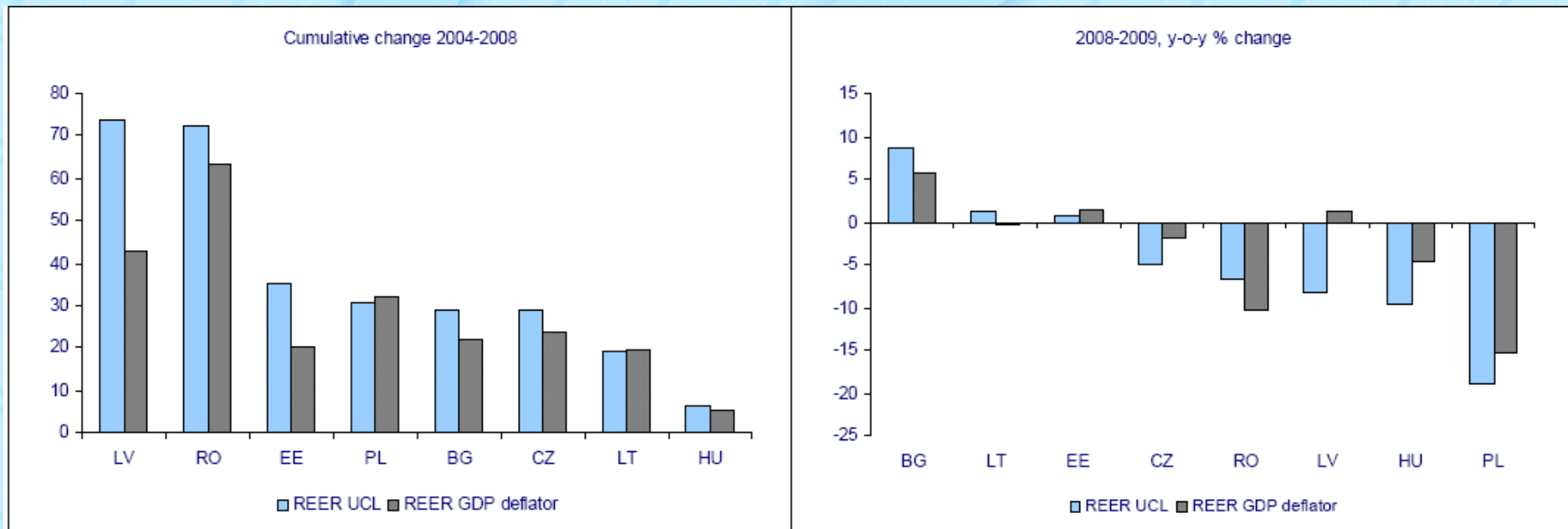


## Restart II: growth in potential output

- ◆ Relatively high human capital is a strength.
- ◆ EU membership continues to be central.
  - Some CESEE countries have weak tradable sectors.
- ◆ Maintaining competitiveness is key to success
  - cost control
  - productivity growth
- ◆ Continuing processes of structural change is vital
  - Crises provide good timing for reform
  - Recessions are conducive to innovation
  - Important to find new comparative advantages



# Competitiveness in CEE countries – Cumulative % 2004-2008 and % change 2008-2009



Source: Ameco



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Thank you