The right policy mix for stability, growth, and competitiveness

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SUOMEN PANKKI FINLANDS BANK

EUROJÄRJESTELMÄ
EUROSYSTEMET

Structure of the presentation

1. Recent ECB monetary policy decisions
2. Development of the Euro area economies
3. Further actions are needed

1. Recent ECB monetary policy decisions

ECB Governing Council decisions

- June-September 2014: series of targeted longer-term refinancing operations (TLTROs)
  - aimed at improving bank lending to non-financial private sector
- November-December 2014: intention to move ECB balance sheet towards the dimensions of early 2012
- January 2015: extended asset purchase programme
  - carried out until end-September 2016 and
  - in any case until the path of inflation is sustainably moving towards target

Key contents of January 2015 decisions:

- Extended asset purchase programme
  - Purchases to include bonds issued by euro area governments, agencies and European institutions
  - Continue to buy ABS and bank covered bonds
  - Combined monthly asset purchases to amount to €60 billion
  - Further details: see ECB press release
- Forward guidance
  - Key ECB interest rates kept unchanged
  - Asset purchases carried out until inflation path sustainably moving towards medium term inflation target (close, but below 2 %)
- Removing the 0,1 % margin from future TLTRO operations

Institutions to ensure financial system stability

- **European Stability Mechanism (ESM)** provides financial assistance to Euro Area member states threatened by financing difficulties
- **ESM instruments include**:
  - Lending
  - Primary and secondary market purchases
  - Precautionary financial assistance
  - Indirect recapitalisation of financial institutions
  - Direct recapitalisation → one of the building blocks of the **Banking Union,** operational as of 12/2014

Banking Union

Single Supervision Mechanism (SSM)

- **Main task**: check that banks comply with the EU banking rules
- As of 11/2014: ECB directly supervises the largest banks, national supervisors continue to monitor the rest

Single Resolution Mechanism (SRM)

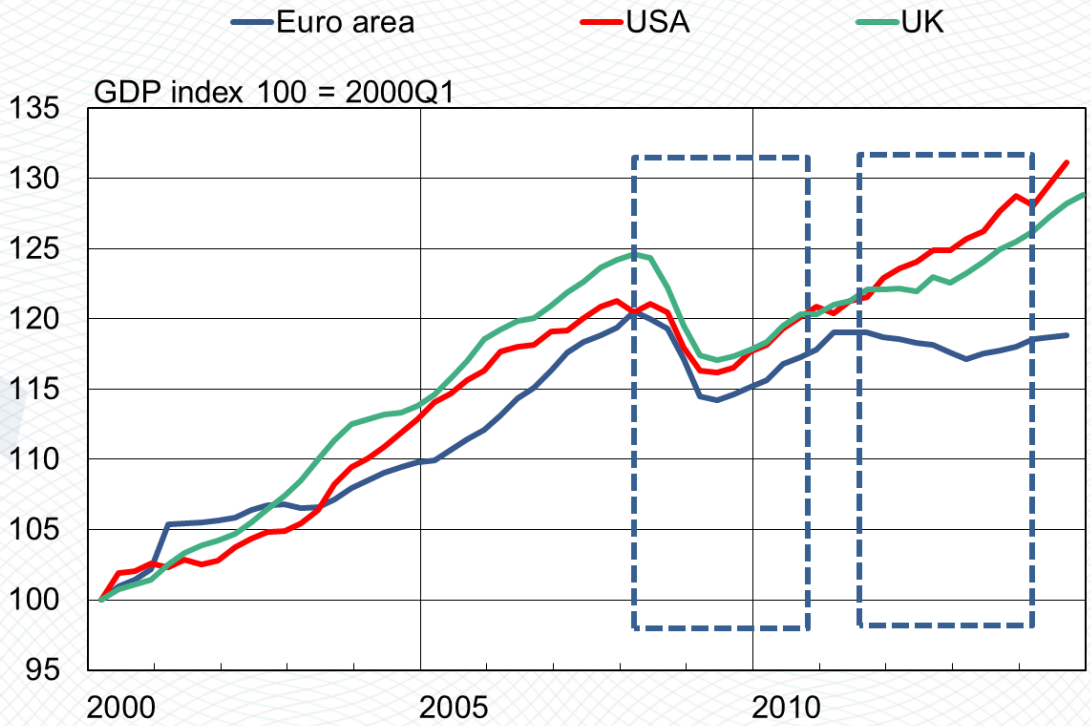
- **Main task**: if bank fails despite stronger supervision, SRM manages orderly resolution with minimal costs to tax payers and real economy
- **Single Resolution Board (SRB)** carries out resolutions of banks in trouble and is in charge of the **Single Resolution Fund (SRF)**, a pool of money financed by the banking sector
- As of 01/2015: SRB started developing resolution plans, will be fully operational with full set of resolution powers from 01/2016

Single Rulebook

- Foundation of the Banking Union
- Legislation all financial institutions in EU must comply with (about 8300 banks)
- E.g. capital requirements, depositor guarantee, bank recovery and resolution

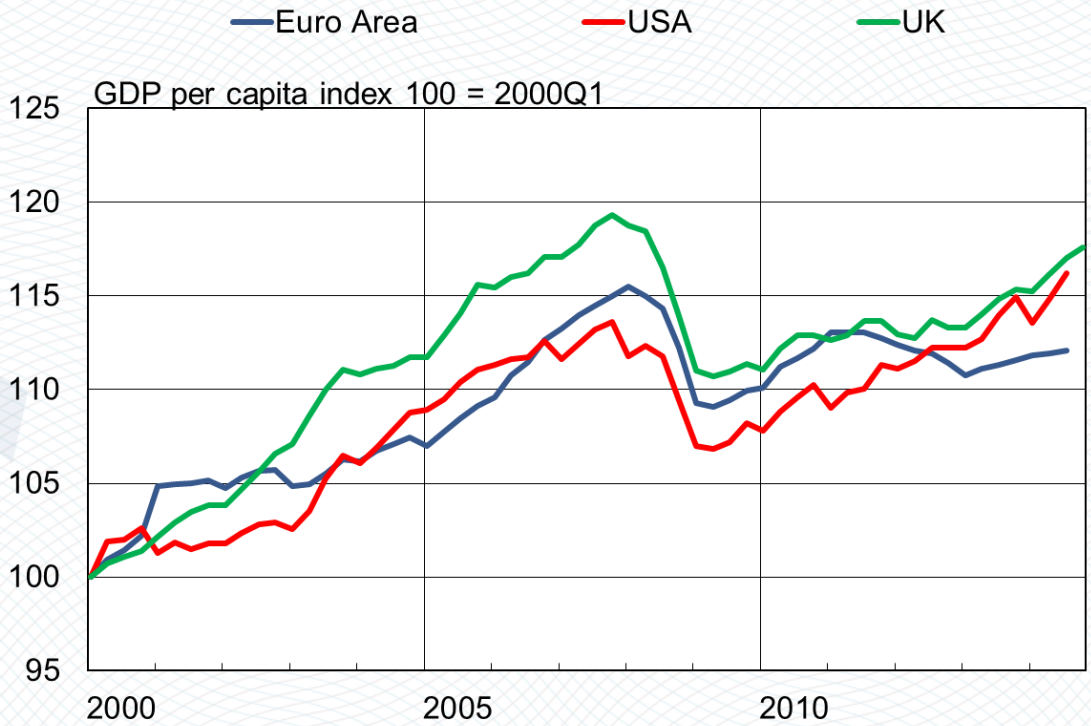
2. Development of the Euro Area economies

Euro area experiencing a double-dip recession: GDP developments



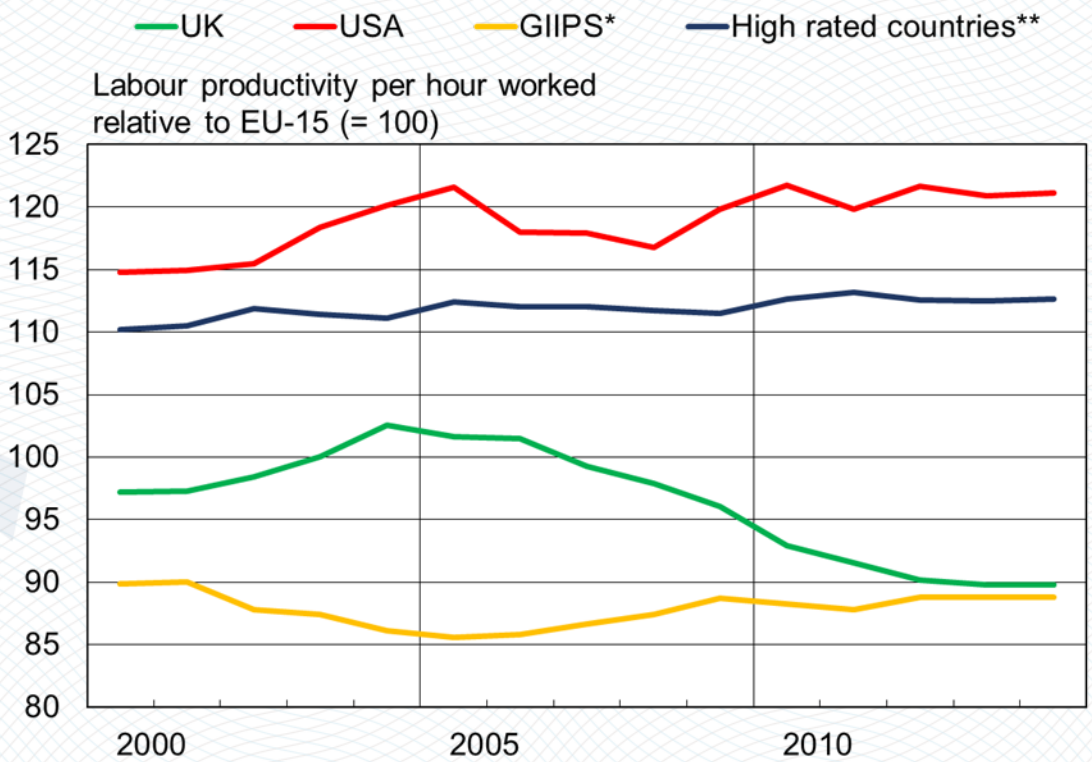
Source: Eurostat, Macrobond and Bank of Finland calculations.

Differences remain in per capita terms



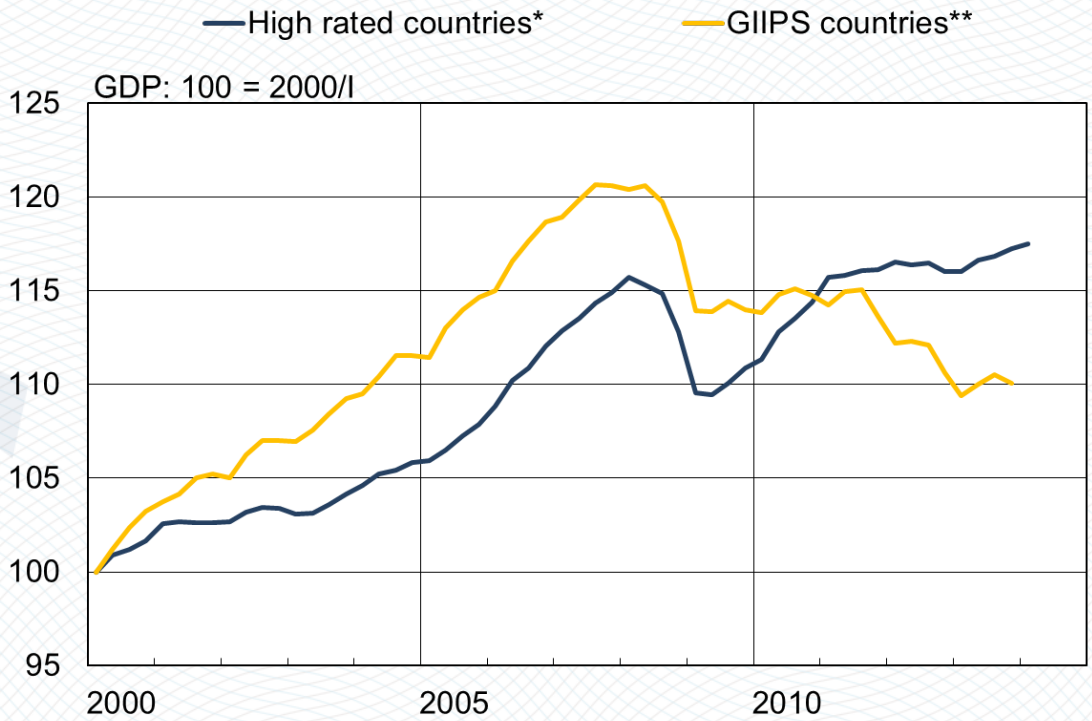
Source: Eurostat, Macrobond and Bank of Finland calculations.

Large differences in labour productivity



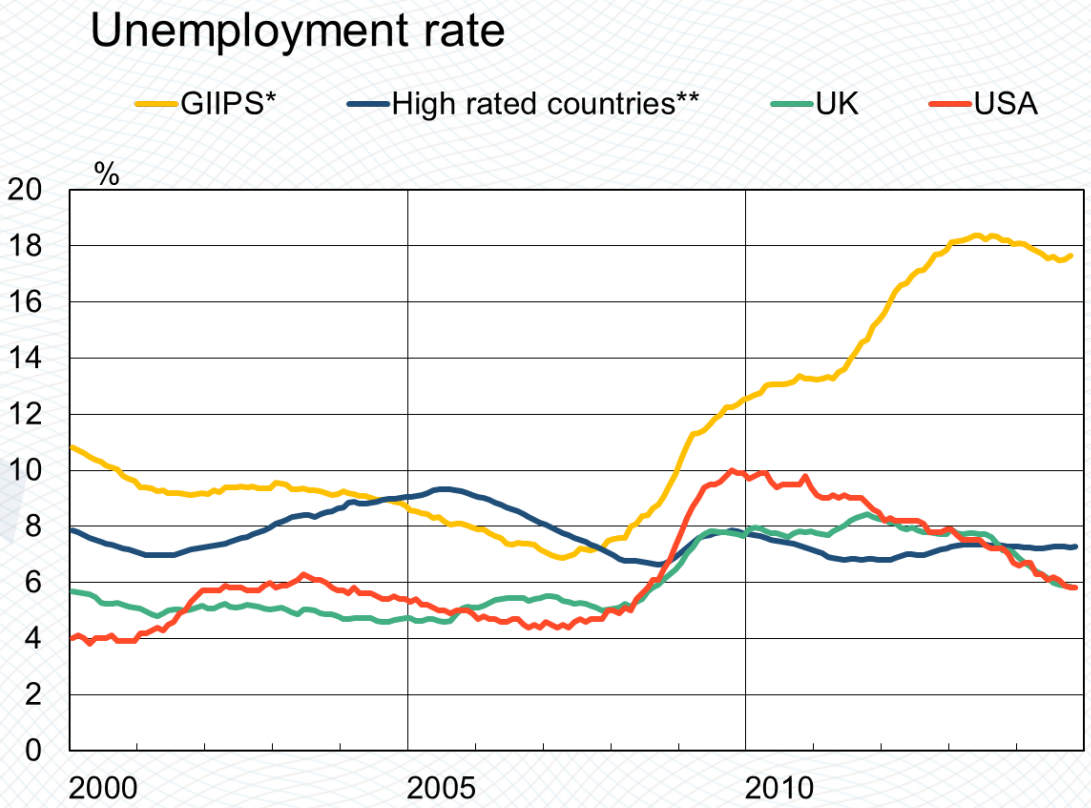
Source: European Commission and Bank of Finland calculations
* Germany, Finland, France, Netherlands, Belgium, Austria
** Greece, Ireland, Italy, Portugal, Spain
Gross domestic product at current market prices per hour worked, relative to EU-15

Paths also vary between Euro area countries



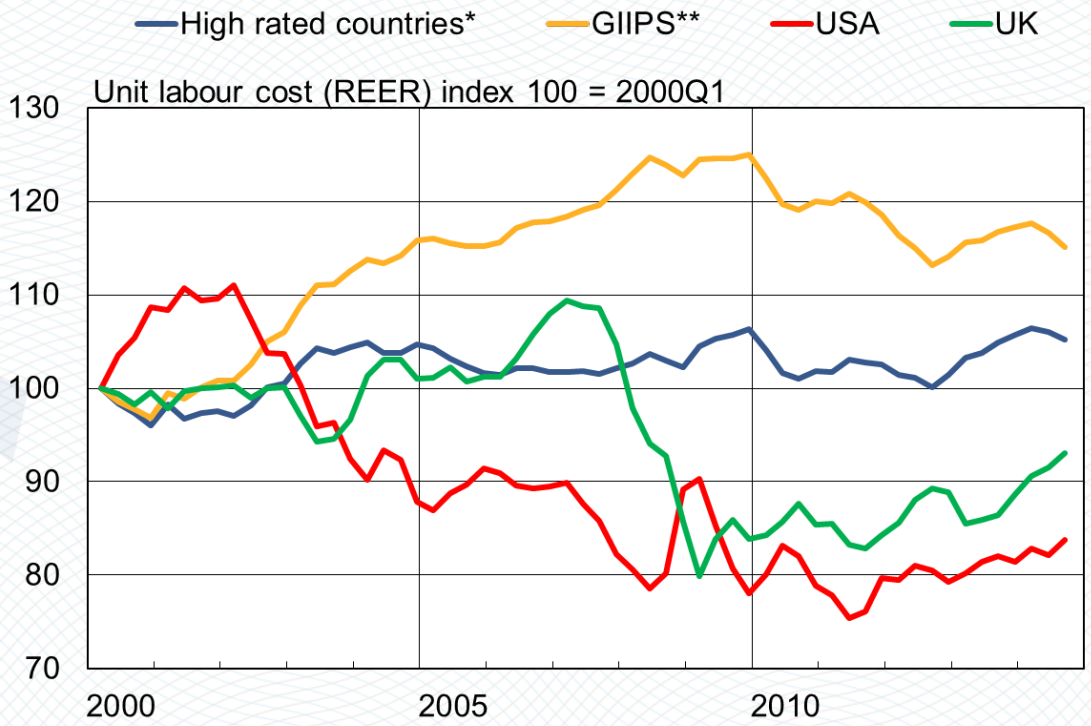
Source: Eurostat and Bank of Finland calculations.
* Germany, France, Netherlands, Belgium, Austria, Finland
** Greece, Italy, Ireland, Portugal, Spain

Unemployment rate is still very high in GIIPS countries



Source: ECB and Bank of Finland calculations.
* Greece, Ireland, Italy, Portugal, Spain
** Finland, Austria, Belgium, Germany, France, Luxembourg, Netherlands

Competitiveness: developments in unit labour costs



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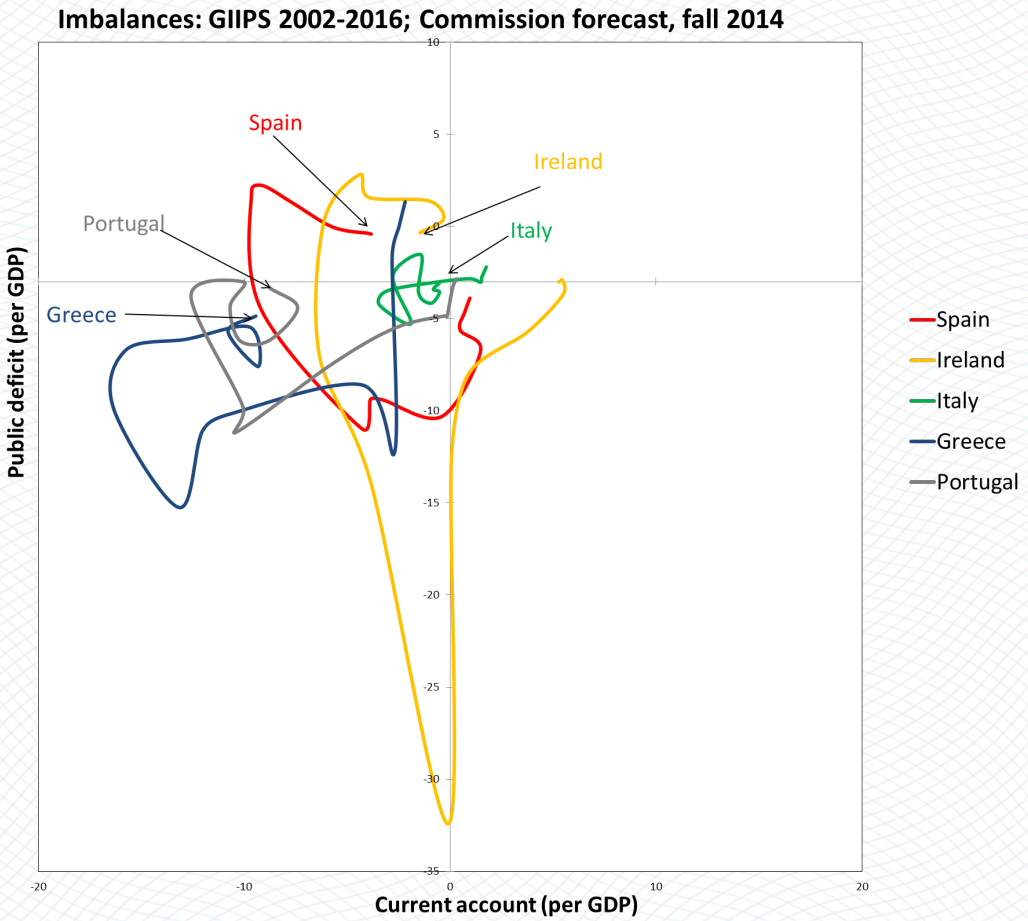
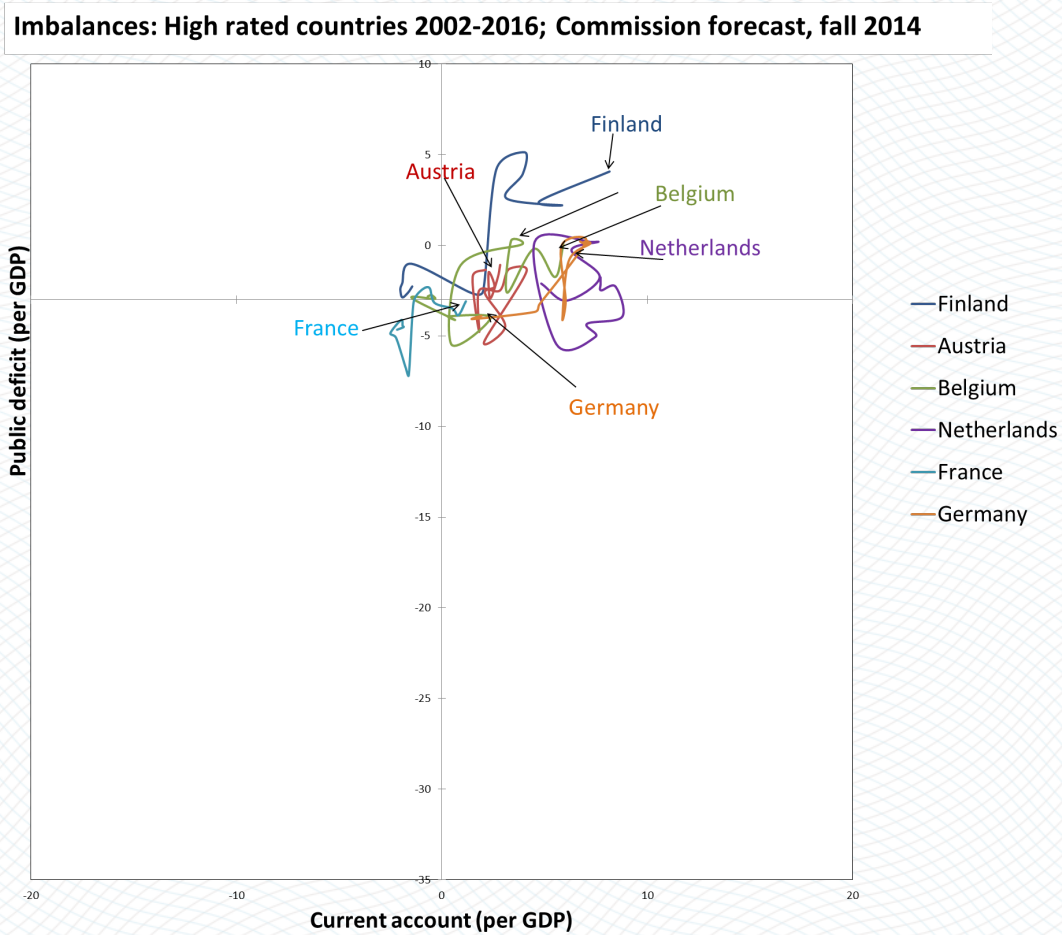
Imbalances in current accounts in GIIPs countries



Time starts running from the point marked by the arrow (year 2002)

Imbalances high rated Euro countries

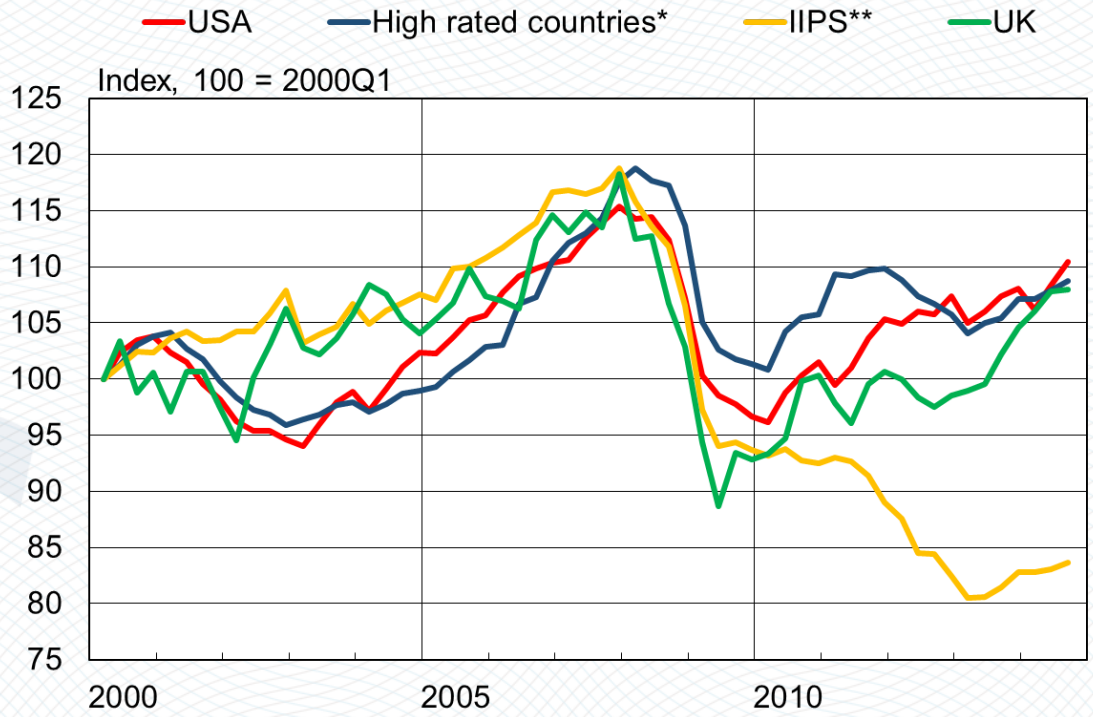


Time starts running from the point marked by the arrow (year 2002)

Outstanding imbalances remain a concern

- Imbalances in external accounts led to high levels of external liabilities in GIIPS countries.
- Reduction of external liability stocks weakens investment.
  - weighs negatively on growth prospects.
- Long lasting imbalances make Euro area more vulnerable to risks.

Investments (per capita) especially badly hit in Ireland, Italy, Portugal and Spain



Source: OECD, Macrobond and Bank of Finland calculations.
* Germany, France, Finland, Austria, Netherlands, Belgium
** Ireland, Italy, Portugal, Spain.
(Greece is omitted because of missing observations during crisis years)

Investment gaps have built up

- Before crisis, capital flows were often allocated inefficiently.
- During crisis, investments were affected by negative demand and financial shocks.
- Investment decisions were affected asymmetrically across sectors, countries and firms.
- Small firms' investment decisions sensitive to bank debt.

3. Further actions are needed

Comment: these are my personal views.

Monetary policy has done more than its share for economic recovery

- Monetary policy: main focus on price stability over the medium term but also contributed to support of economic activity.
- Banking Union and macroprudencial policies to enhance financial system stability.

- **Other policy areas must contribute decisively.**
  - Boosting investment leads to better job creation and higher productivity.
  - Many measures are for individual countries, some are at EU-level.

Fiscal policy to support growth

- More efficient and business-friendly taxation.
- Ensuring debt sustainability under the Stability and Growth Pact.
  - Anchor for confidence.
- Composition of fiscal policies should be more growth-friendly.
  - Focus more on productive spending.
- Predictable fiscal policy reduces uncertainty.

Increase economic cooperation inside and outside EU

- EU internal market development:
  - Facilitates further integration and improves competition.
    - Example: digital single market.

- Global markets more accessible:
  - Example: TTIP Free Trade Agreement between EU and USA.

Structural policies to support investment

- Product market reforms
  - reduce administrative costs, facilitate legal procedures for businesses, increase competition in non-tradables and tradables
- Labour market reforms
  - reduce skill mismatches by improving training and reduce disincentives to work
- Financial sector
  - improves access to finance

What has been lacking: implementation

- Crucial that structural reforms are implemented swiftly, credibly and effectively:
  - increases future sustainable growth in Euro Area,
  - raises expectations of higher incomes,
  - encourages firms to invest already today.

- More credible policy contributes to improved expectations and to raises chances for economic recovery.

Thank you!