

Governor Erkki Liikanen

Bank of Finland

Monetary policy and its transmission to the economy





1. Commitment to accommodative monetary policy benefits the economic outlook



Interest rate policy in 2014

- ***Central bank interest rates reduced to the zero lower bound***
 - *Interest rate on main refinancing operations 0.05% (September 2014)*
 - *Interest rate on the deposit facility -0.20% (September 2014)*

- ***The full allotment policy safeguarding banks' access to central bank refinancing will be continued at least until the end of 2016.***



The decisions to support provision of credit in 2014

- ***Banks have access to longer-term central bank refinancing (maturing in 2018) at a fixed rate of 0.05% for provision of credit to the real economy (excl. housing)***
- ***Third purchase programme for covered bonds issued by banks (CBPP3)***
 - *Since October 2014, purchases conducted to the value of EUR 85 billion*
- ***Asset-backed securities purchase programme (ABSPP)***
 - *Since November 2014, purchases conducted to the value of EUR 7 billion*



The decisions on large scale asset purchases and forward guidance in January 2015

■ ***Expanded asset purchase programme***

- Bonds issued by euro area governments, government agencies and European institutions as a new target for purchases
- Combined monthly asset purchases under the three programmes of EUR 60 billion from March 2015 until at least September 2016 (totalling EUR 1,140 billion)
 - *The Bank of Finland will primarily buy Finnish government bonds (itself carrying the credit risk involved) and bonds issued by European institutions (for which the credit risk will be shared amongst Eurosystem central banks).*

– ***Forward guidance***

- ***Purchases will be continued, if necessary, even after September 2016 until the Governing Council of the ECB considers the inflation rate has returned to levels consistent with the price stability objective.***



2. Large scale asset purchases stimulate both demand and inflation



Signalling and portfolio balance effects of a large scale asset purchase programme

- ***The signalling effect contributes to re-anchoring inflation expectations more in line with the medium-term objective.***
- ***The portfolio balance effect extends the effects across the whole financial system even though only a comparatively narrow range of high-quality securities is purchased.***
 - ***Investors are encouraged to shift holdings into other asset classes.***



ECB's accommodative monetary policy

- ***Lowers real interest rates and eases financing conditions in the economy***
 - *interest rates at the longer end decline, financing conditions for companies and households become easier, asset prices rise*
 - *higher inflation expectations mean lower real interest rates*

- ***Increases demand and boosts inflation***
 - *external value of the euro depreciates*
 - *consumption and the profitability of investments increase*
 - *corporate and household confidence improves*



Commitment to accommodative monetary policy stance has already raised inflation expectations



Source: Bloomberg.



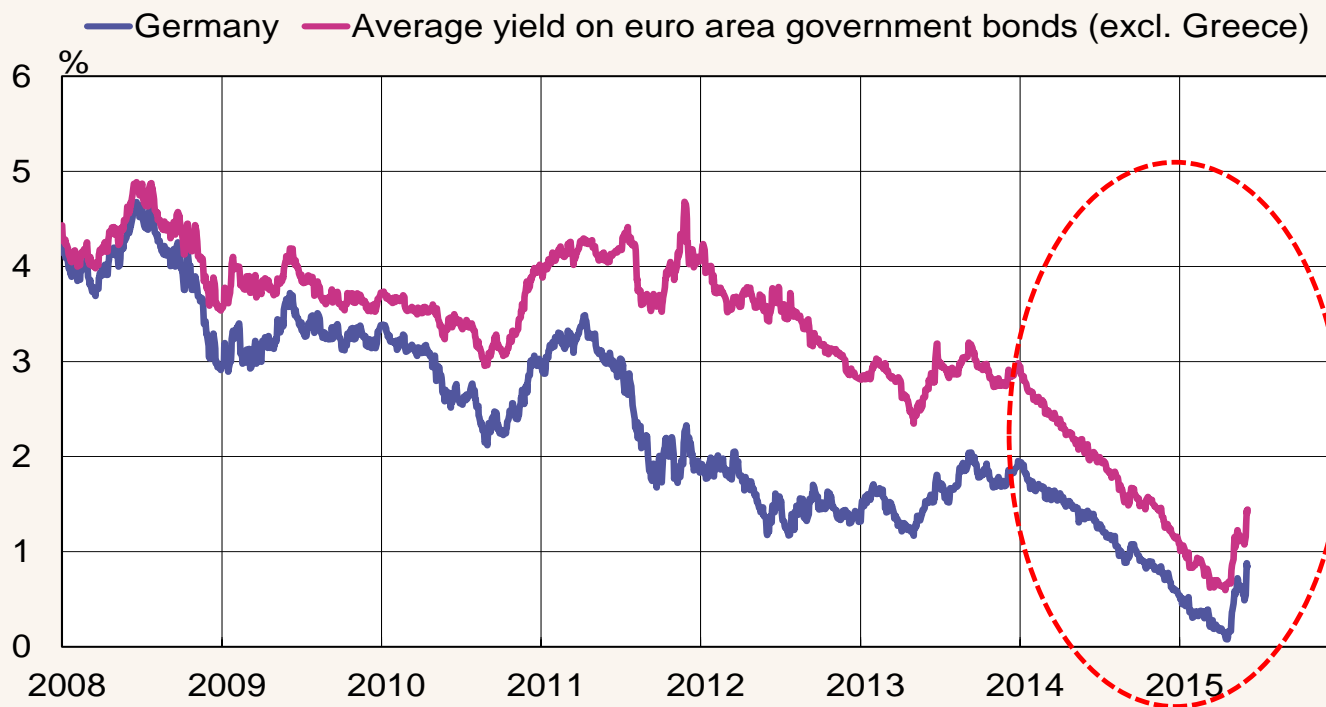
Divergence in monetary policy cycles reflected in the euro



Source: Macrobond.



Sharp fall in long-term bond yields over the past year, some reversal recently



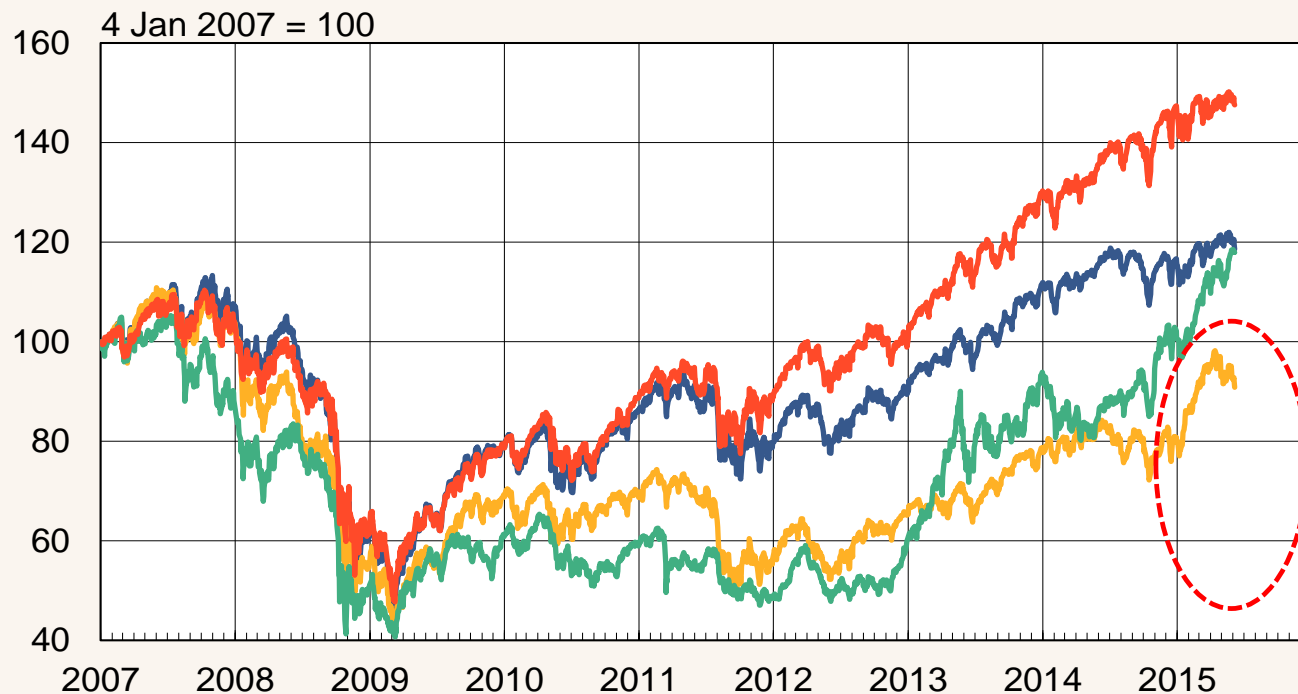
*Weighted average of euro area countries' 10-year government bonds (excl. Greece).
Sources: Bloomberg and calculations by the Bank of Finland.



Stock prices have increased

Share prices

- United States: Morgan Stanley (world, developed economies)
- Euro area: DJ EURO Stoxx (broad)
- Japan: Nikkei
- United States: S&P 500



Source: Bloomberg.

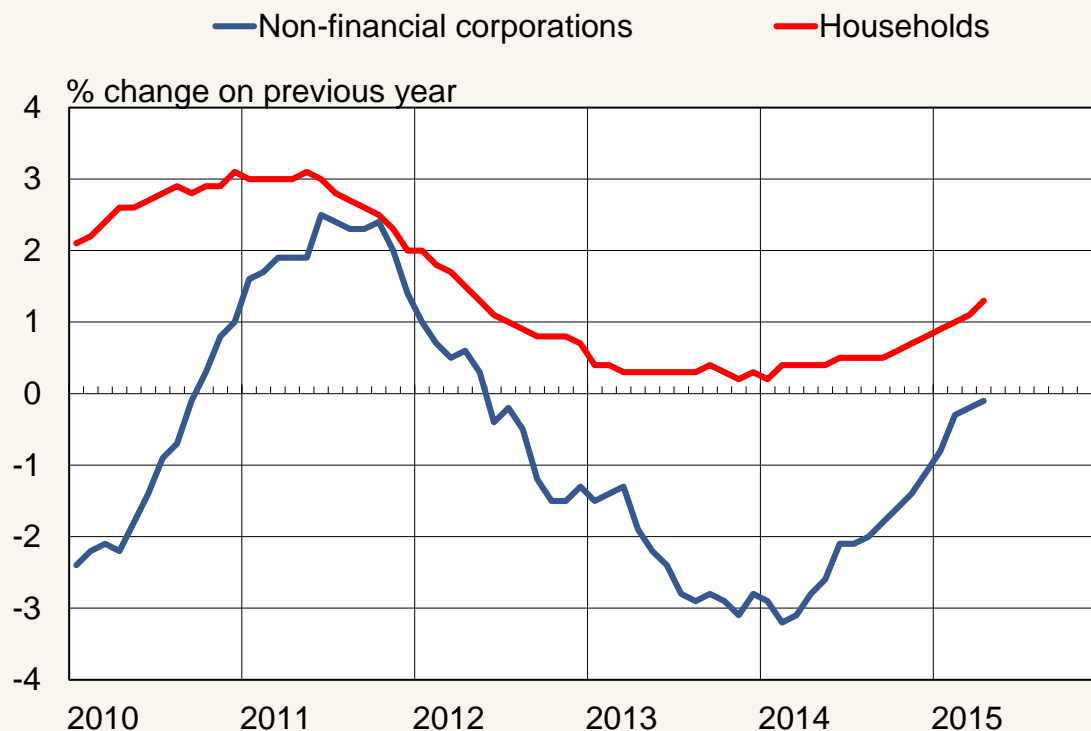


3. Monetary policy transmission to the real economy is improving



Monetary policy measures support bank lending

Pace of growth in euro area loan stock



Source: European Central Bank.
Adjusted for securitisation and balance sheet transfers.



Monetary policy transmission via bank lending is improving

Banks' funding costs

- Average interest on stock of deposits
- Average interest on new fixed-term deposits
- 3-month Euribor
- ESCB's minimum bid rate
- Average yield on covered bonds (EUR)
- Average yield on unsecured senior bonds (EUR)

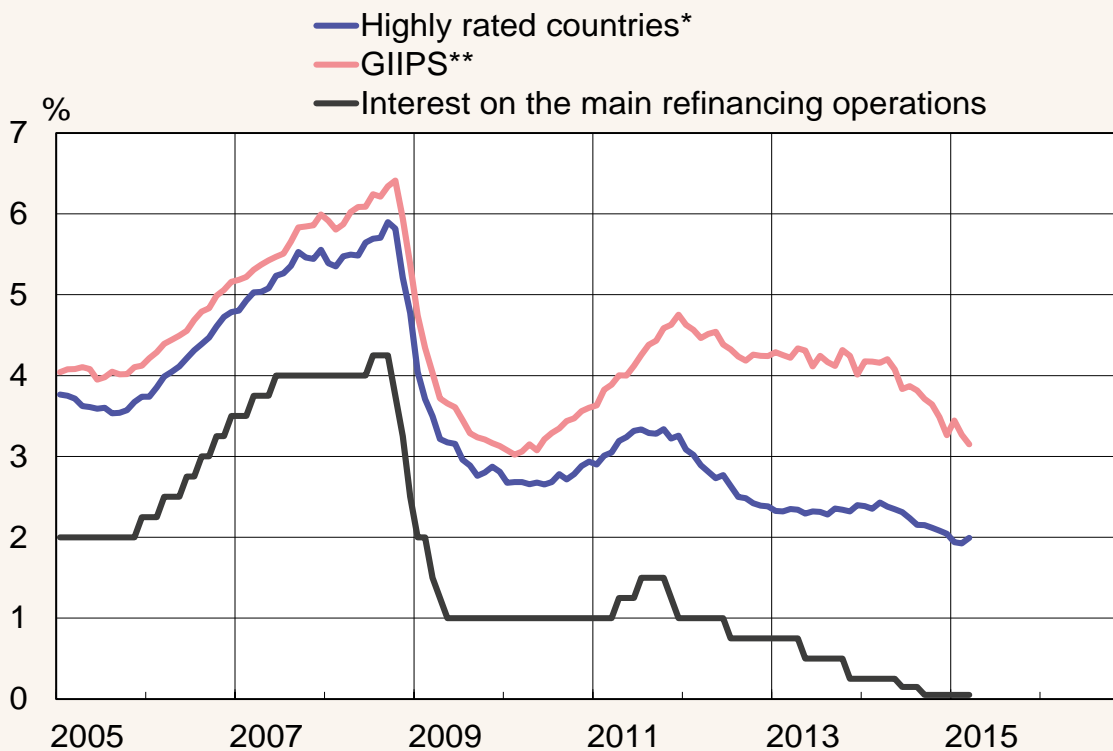


Sources: ECB and Barclays.



Monetary policy transmission to non-financial firms improved, but still uneven

New corporate loan agreements, average interest



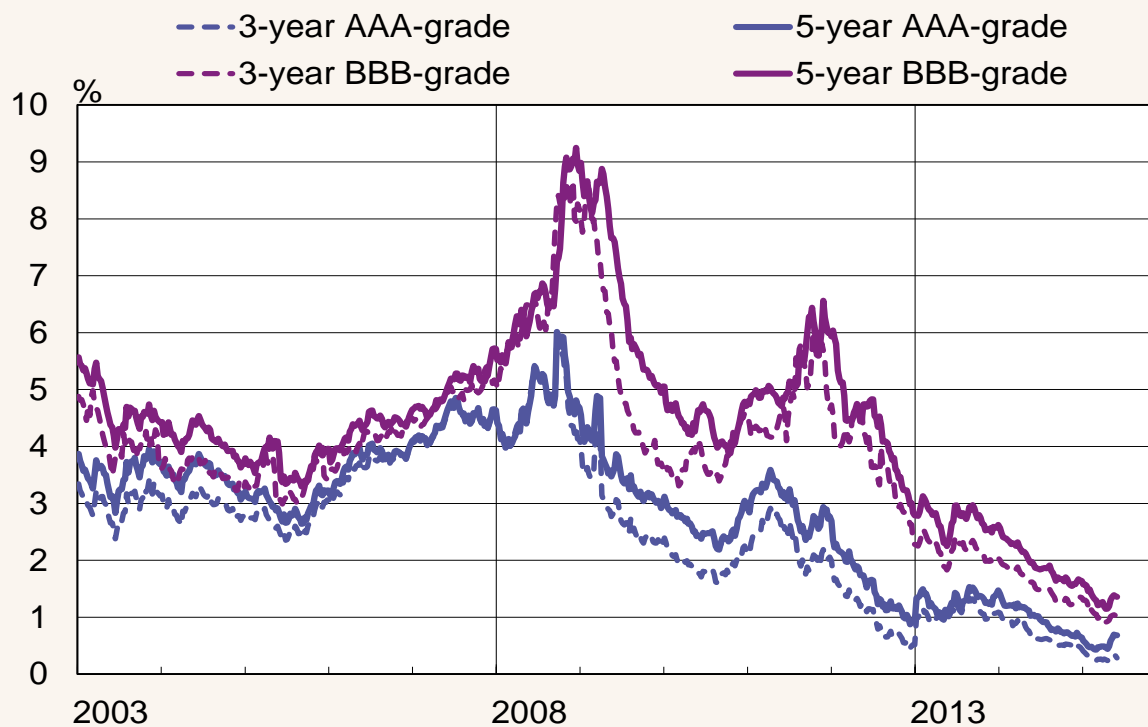
Source: European Central Bank.

* Germany, France, Netherlands, Belgium, Austria and Finland.

** Greece, Ireland, Italy, Portugal and Spain.



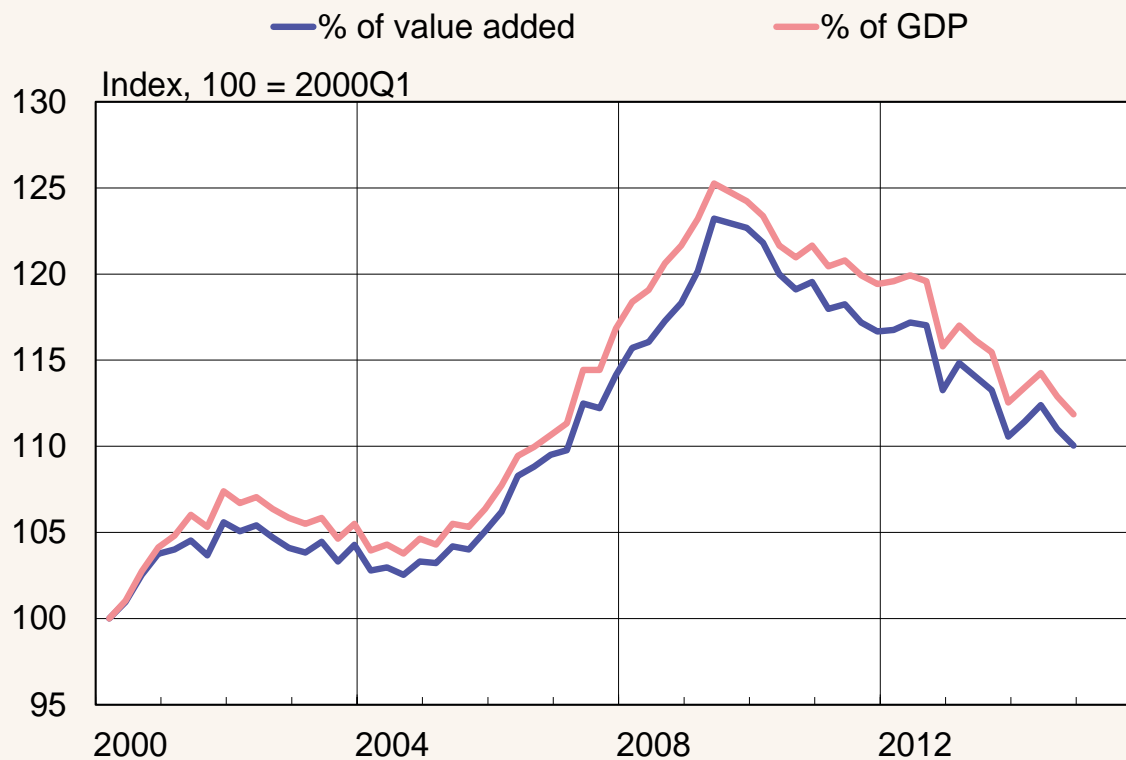
Corporate bond yields remain low, some reversal recently



Source: Macrobond.



Corporate sector debt ratios declining

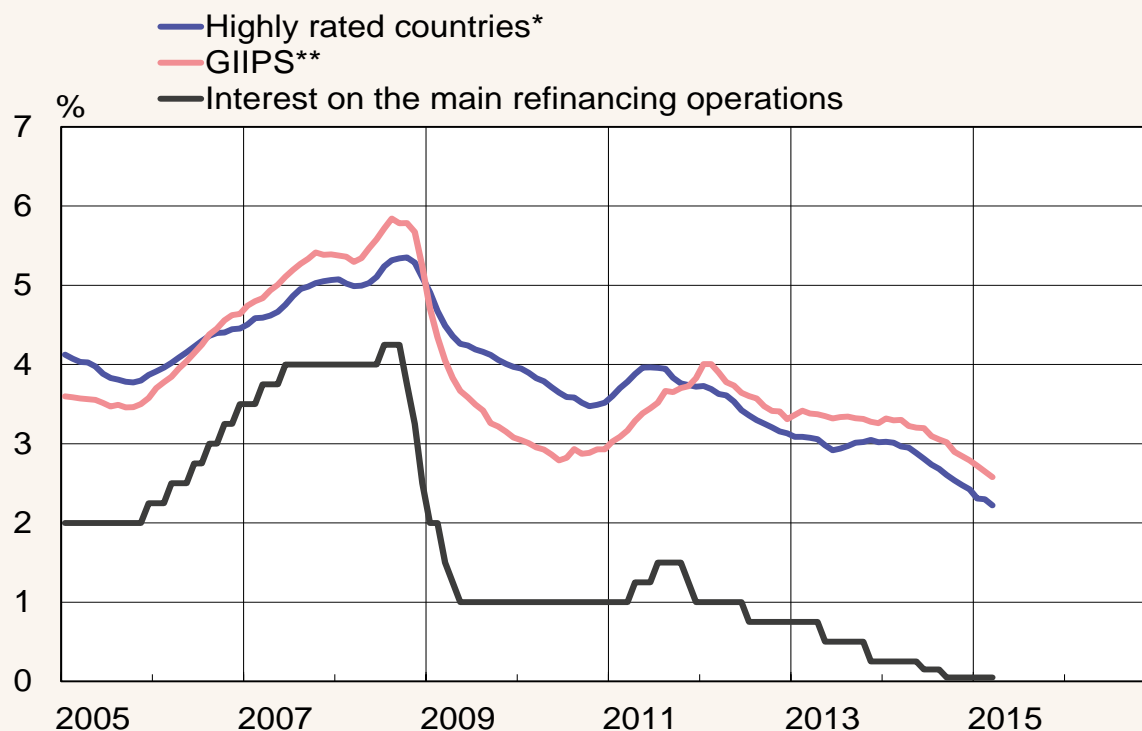


Sources: Bank of France and Bank of Finland calculations.



Average interest rates on new housing loans have declined

New mortgage loan agreements, average interest



Source: European Central Bank.

* Germany, France, Netherlands, Belgium, Austria and Finland.

** Greece, Ireland, Italy, Portugal, and Spain.



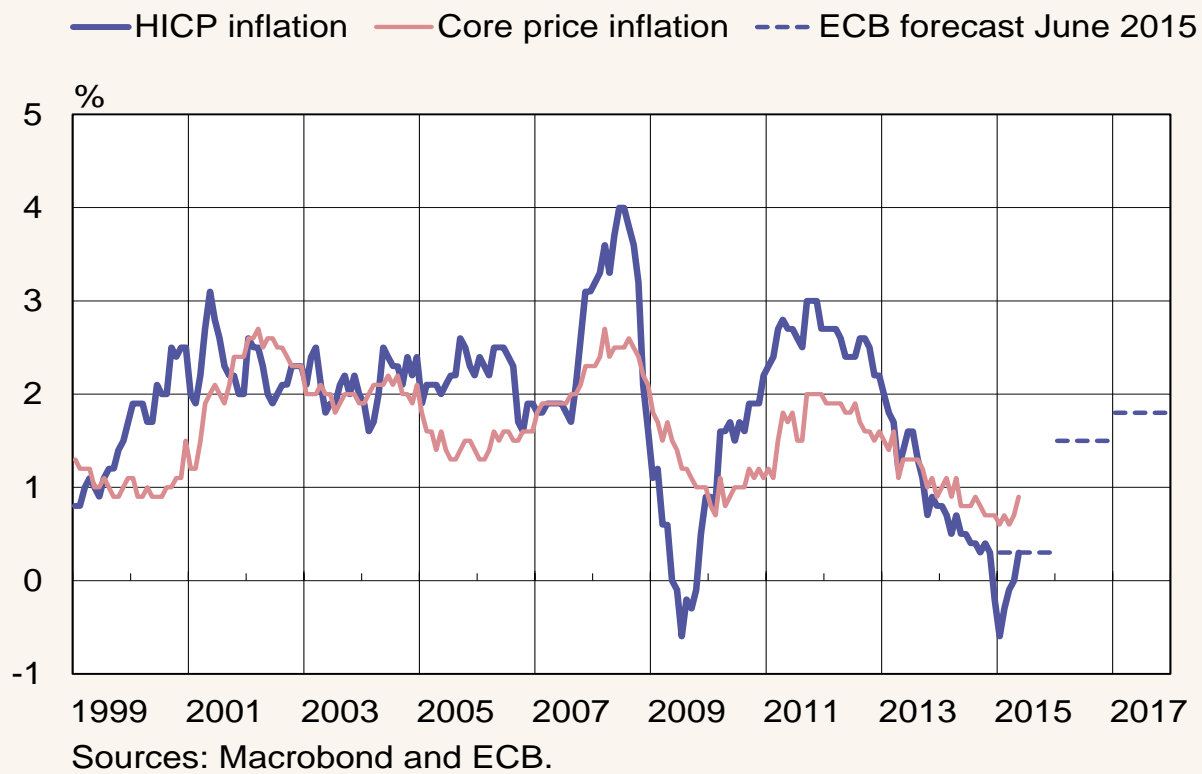
Eurosystem projections in June 2015

- ***GDP:***
 - 2015: 1.5%***
 - 2016: 1.9%***
 - 2017: 2.0%***

- ***Inflation:***
 - 2015: 0.3%***
 - 2016: 1.5%***
 - 2017: 1.8%***



Inflation outlook has improved



31546@chart4(2)



4. Financial stability and macroprudential policy

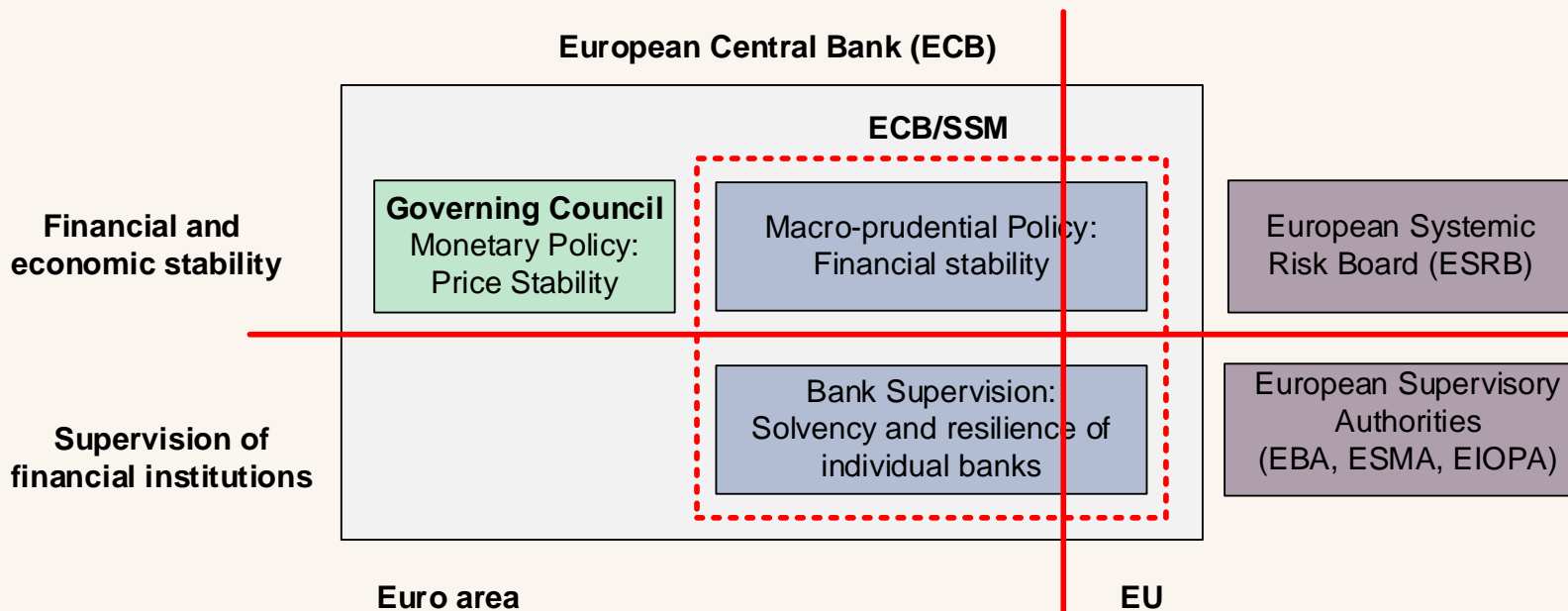


The mandate of the ECB

- **Maintaining price stability will remain the primary objective of the ECB.**
- **Without prejudice to price stability, the ECB will support the general economic policies in the EU, including balanced economic growth.**
- **Financial stability is key to realizing this mandate.**
- **The SSM regulation assigns macroprudential responsibilities to the ECB with power to apply tighter macroprudential requirements than the designated national macroprudential authorities.**



The ECB's role in the new supervisory architecture



Sources: Smets (2013) and Bank of Finland.



The ECB reinforces but cannot substitute national macroprudential policies

- ***National macroprudential authorities bear the main responsibility in detecting systemic risks and taking appropriate macroprudential action.***
- ***National macroprudential action should be timely, bold and intrusive.***
- ***The ECB can reduce the inaction bias inherent in national macroprudential policies.***



Macroprudential policy is important in a time of exceptionally accommodative monetary policy

- ***Negative side-effects of accommodative monetary policy cannot be entirely ruled out:***
 - ***a prolonged low level of interest rates and the additional relaxation brought by securities purchases could inflate the risks to financial stability;***
 - ***the euro area must maintain readiness to actively deploy macroprudential policy tools if required;***
 - ***Every Member State must have an effective macroprudential toolbox.***



5. Transparency improves the accountability and effectiveness of monetary policy



Transparency, accountability and efficiency: Accounts of the monetary policy meetings

- ***Transparency is an important tool for an independent central bank like the ECB***
 - The days of ‘never excuse, never explain’ and central banks acting as opaque and secretive institutions are over.
- ***Transparency facilitates accountability and efficiency***
 - The ECB is accountable to achieve its mandate, price stability.
 - Conveying the Governing Council’s ‘reaction function’ facilitates efficiency and makes it easier to attain monetary policy objectives.
- ***The accounts convey a balanced account of discussions in the Governing Council***
 - They provide a fair and balanced summary of the main arguments.
 - The language reflects collegiate, consensus-oriented mode of discussion and decision-making.



Thank you!