

Seppo Honkapohja

Suomen Pankki

Euro area economic developments and monetary policy

June 11, 2017





Topics

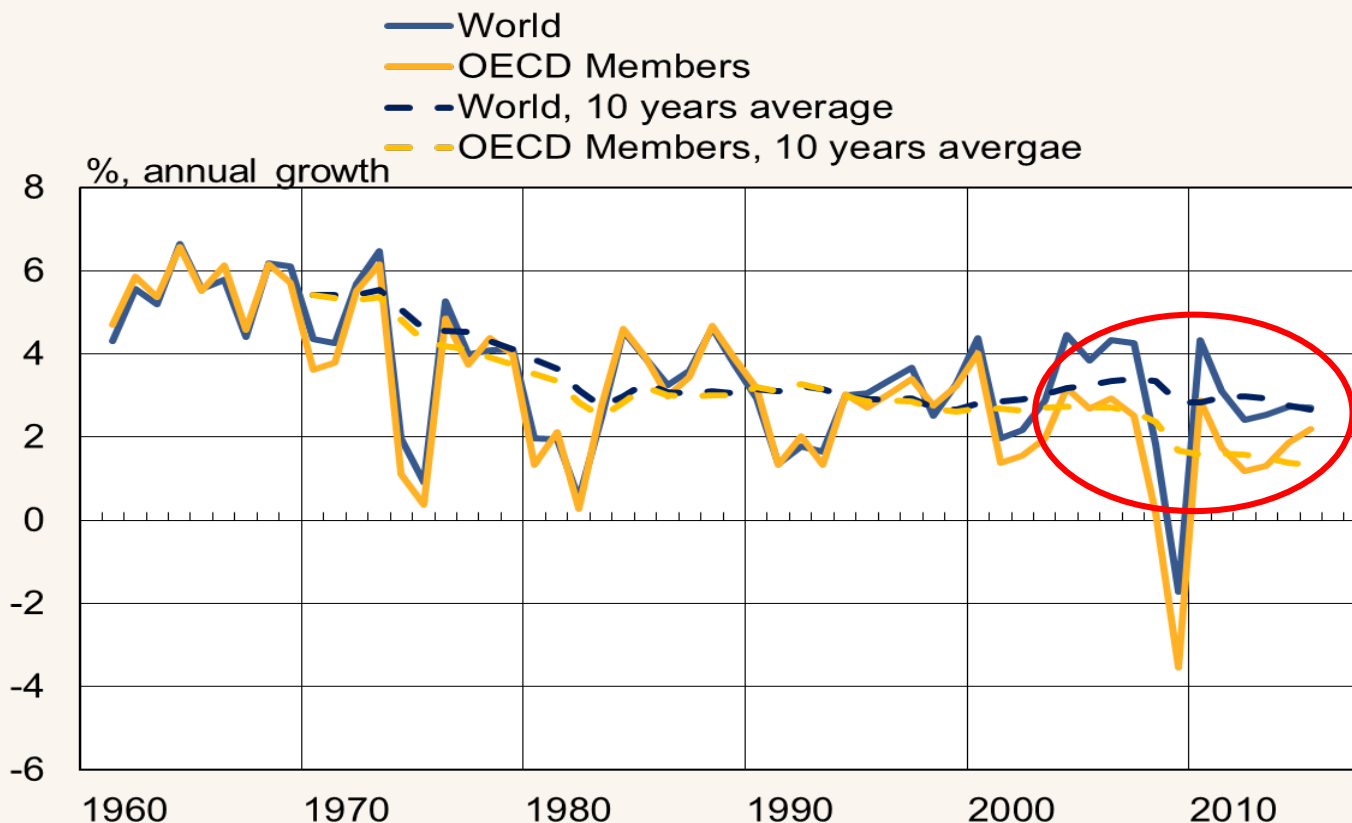
- ***Growth in advanced economies weaker than in earlier decades***
- ***Recent developments show gradual improvement in the euro area in the end of 2016 and early 2017***
- ***ECB's monetary policy highly accommodative***
- ***Challenges in the euro area***



Growth in advanced economies has been weaker than in earlier decades



Growth in the advanced economies weakened in last 10 years



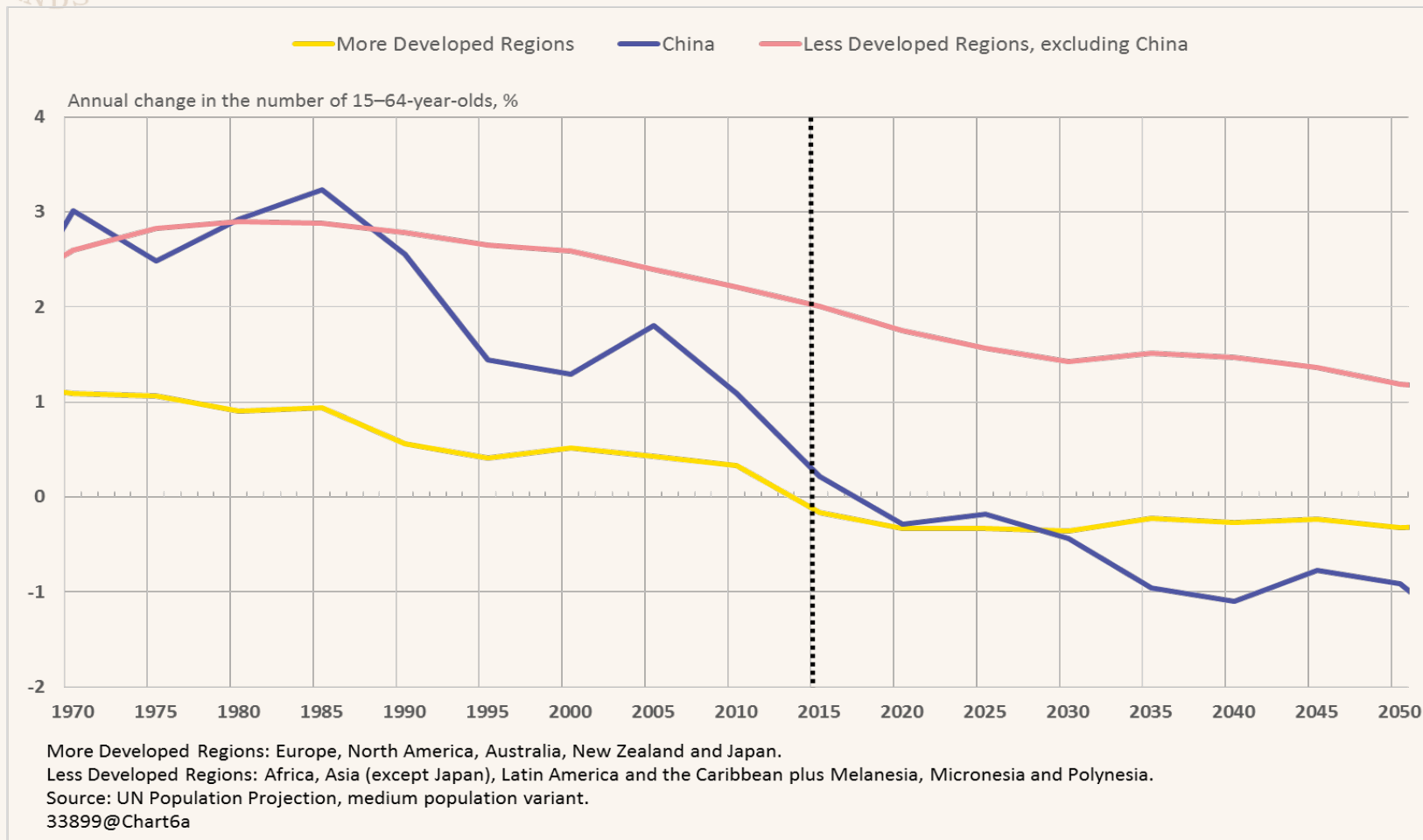
OECD Members: AU, AT, BE, CA, CL, CZ, DK, EE, FI, FR, DE, GR, HU, IS, IE, IL, IT, JP, KR, LV, LU, MX, NL, NZ, NO, PL, PT, SK, SI, ES, SE, CH, TR, GB, US

Sources: Macrobond, World Bank.

34020@Chart11

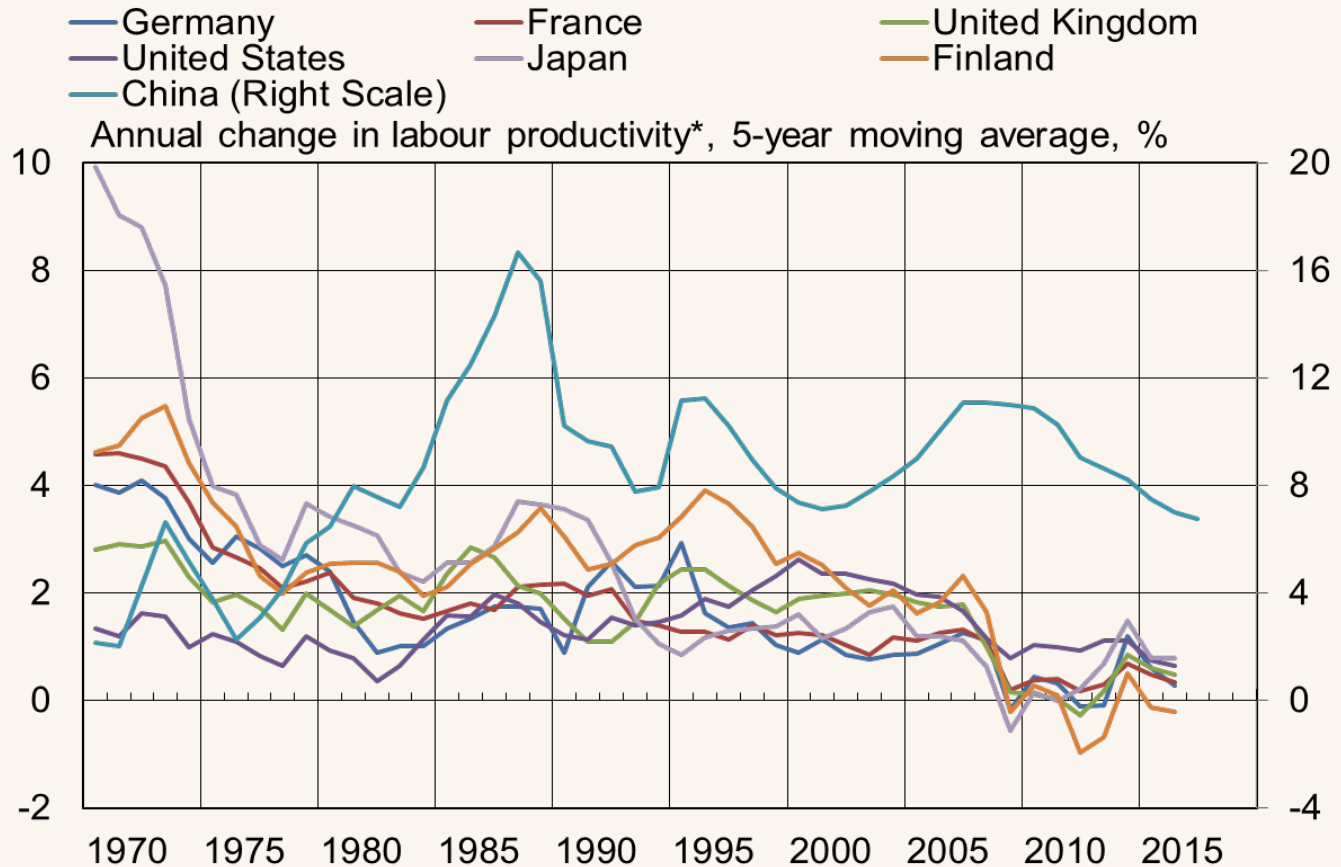


Working-age population has started to decline in advanced economies





Growth of labour productivity has slowed in advanced economies



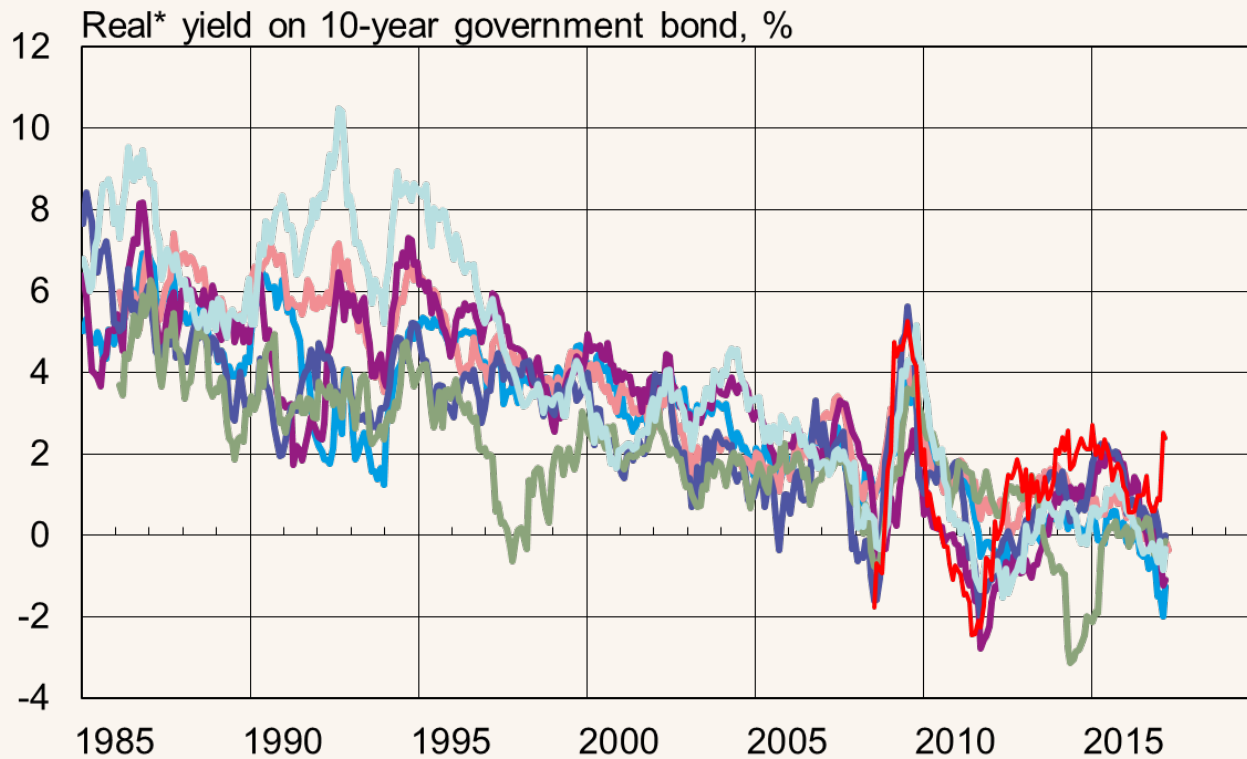
*) Output per person employed.
Source: Conference Board.

33899



Long-term real interest rates have declined globally

— Germany — France — United Kingdom — United States
— Japan — Finland — China



*) Difference between nominal interest rate and actual 12-month inflation rate.
Sources: Macrobond and OECD.

33899



Natural rate of interest has declined (*)

- ***Natural rate of interest = real interest rate at which aggregate production is at potential and price stability is achieved***
- ***Estimated natural rate of interest has declined in advanced economies, when potential growth has slowed***
- ***If monetary policy needs to be accommodative, real policy rate must be set below the natural rate***

(*) See Houston, Laubach & Williams, FRBSF WP. 2016-11, Lauri Vilmi, E&t 4/2016).

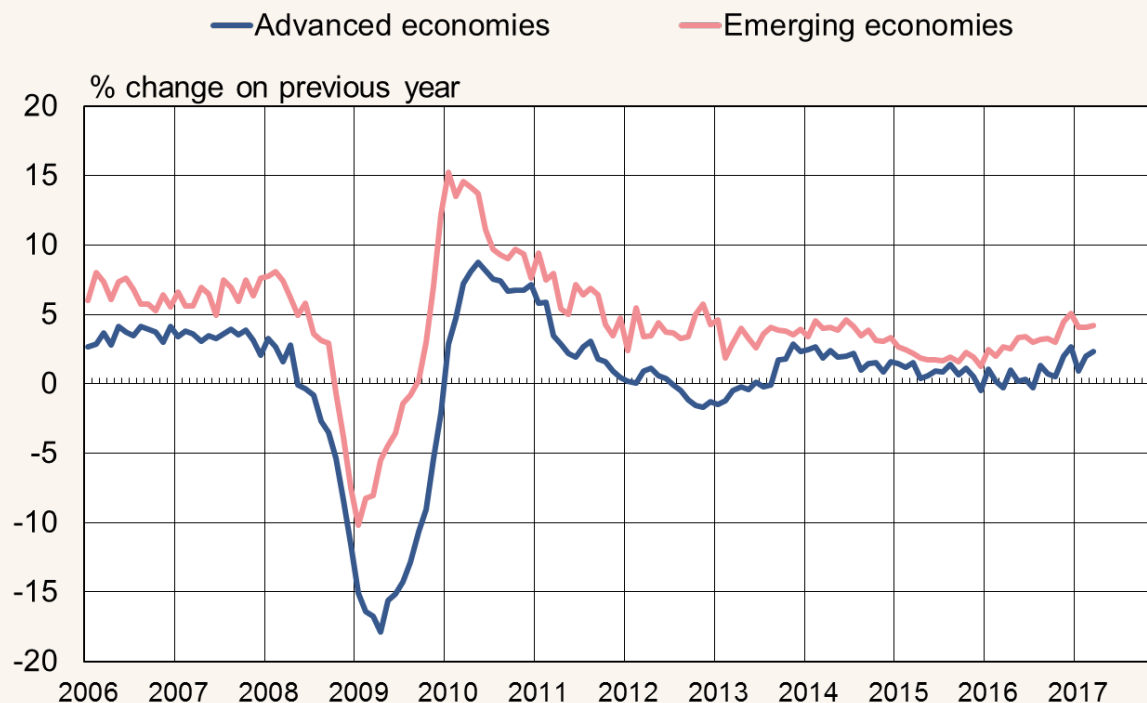


Recent developments in the euro area – growth becomes gradually broadly based in the end of 2016 and early 2017



Global economy recovering

Industrial output (excl. construction)



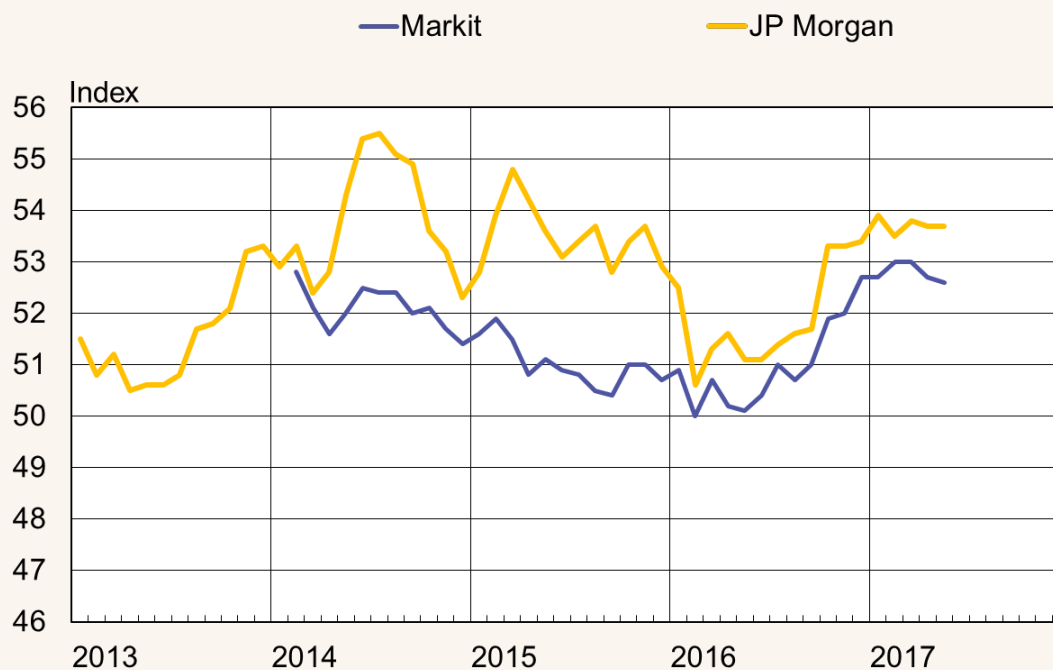
Sources: CPB and Macrobond.

32427@world_ip(en)



Also indicators point to economic expansion...

Global PMI - manufacturing



Sources: Markit, JP Morgan, OECD and Macrobond.

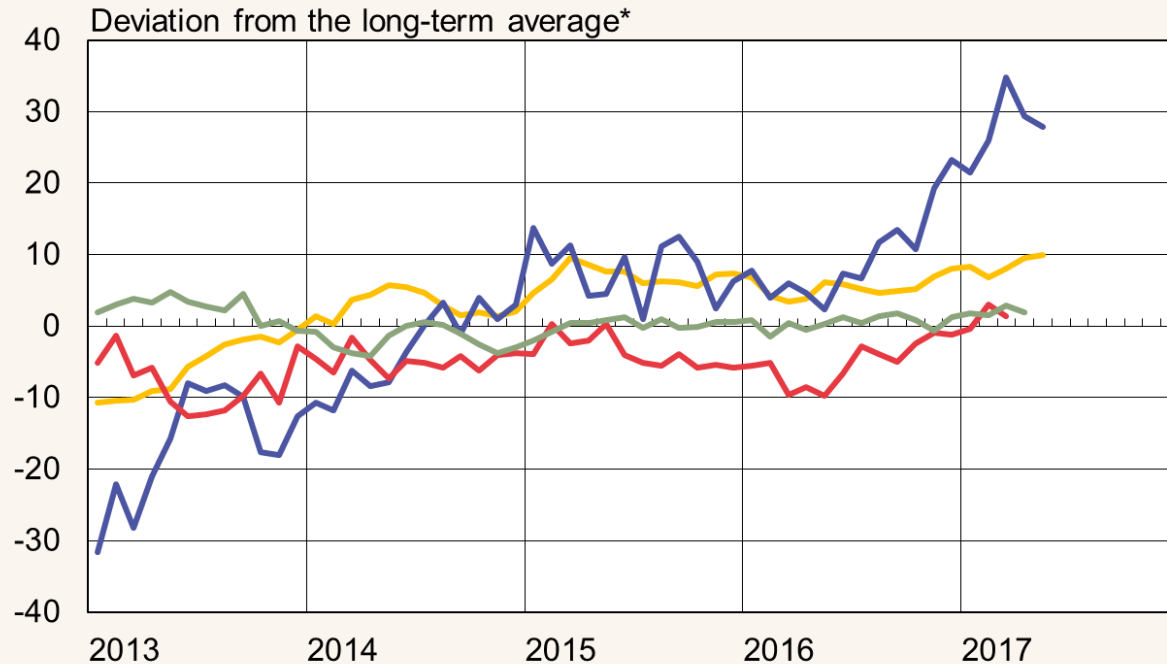
patu32427@worldPMI



... and consumer confidence globally above historical averages

Consumer Confidence

— Euro area — United States — China — Japan



Sources: National statistical authorities, European Commission and Macrobond.

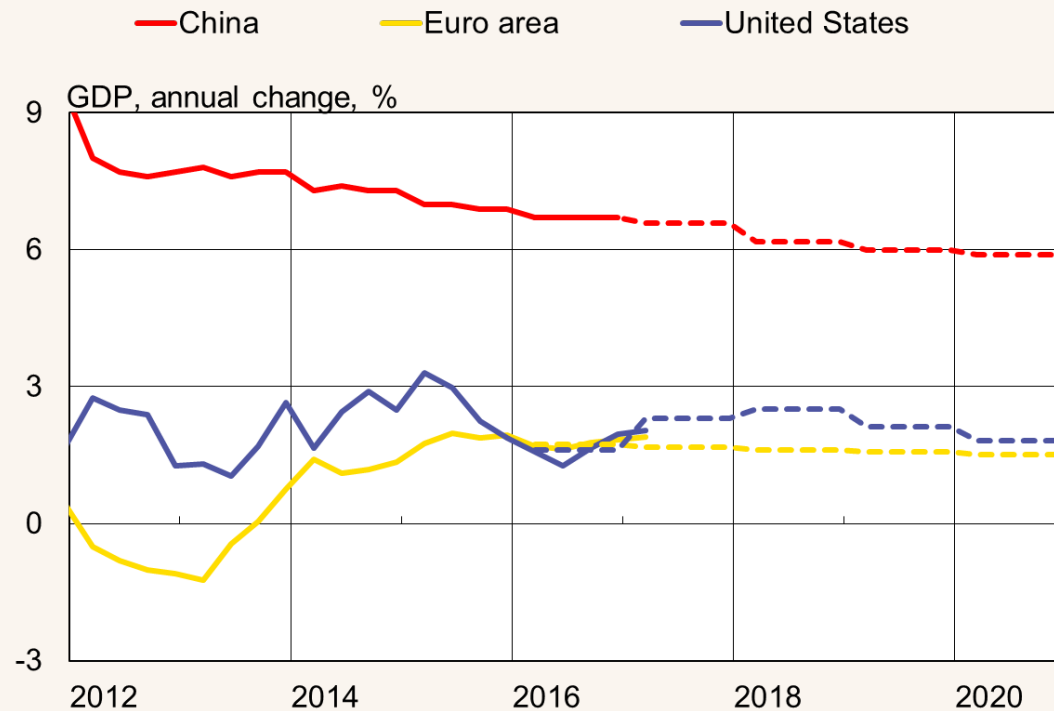
* years 1991-2015

patu32427@kluottamus



GDP growth relatively stable

GDP Forecasts



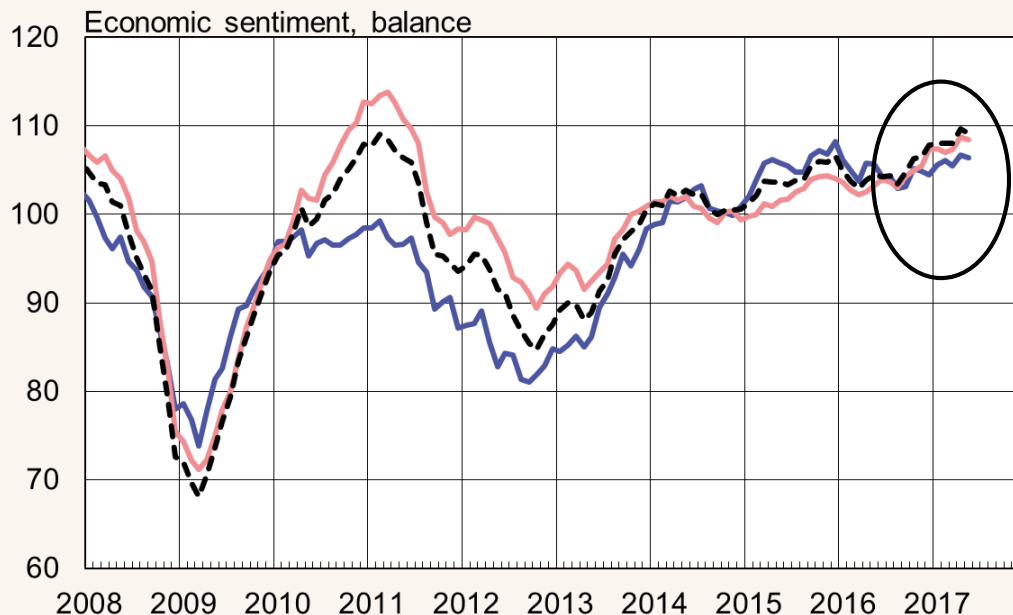
Sources: IMF and Macrobond.
Dashed lines: Latest IMF Forecast.

patu32427@BKT(IMF)



Economic sentiment has improved in euro area

— GIPS-countries* — Highly rated countries*
- - - Euro area — GIPS_painot



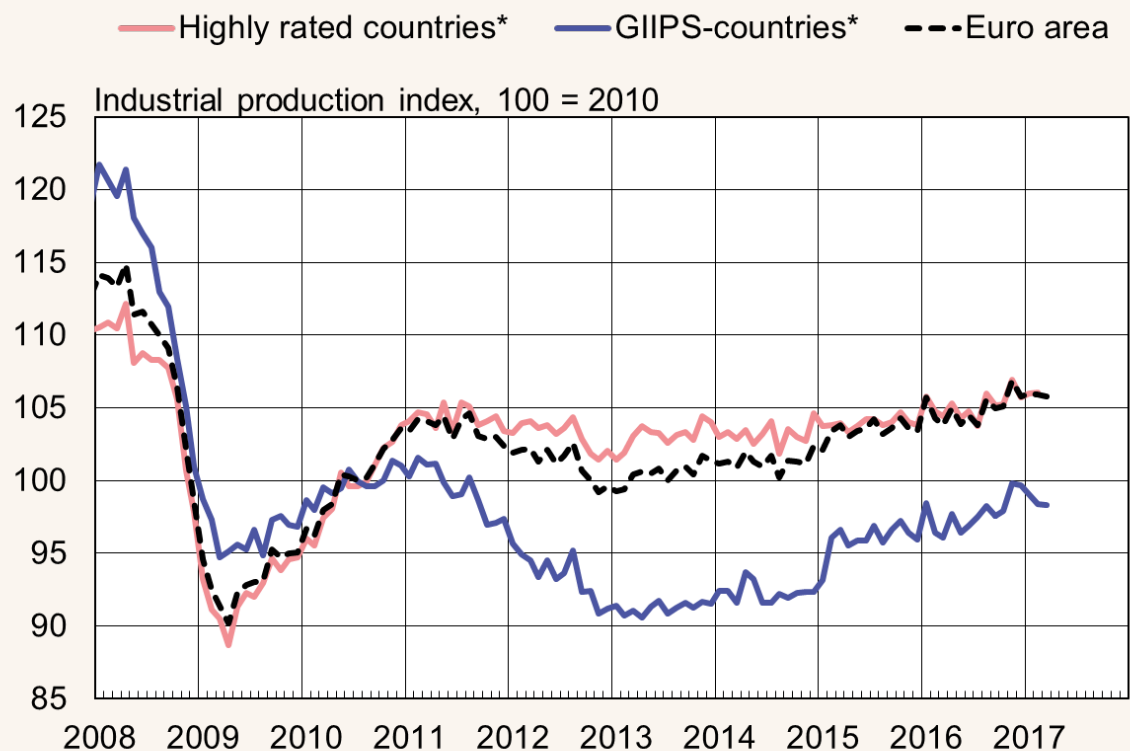
Sources: European Commission, Macrobond and Bank of Finland calculations.

*GIPS: Greece, Italy, Portugal, Spain. Highly rated: Germany, France, Netherlands, Belgium, Austria, Finland.

patu32425@luotGiips(EN)



.. and industrial production has developed positively

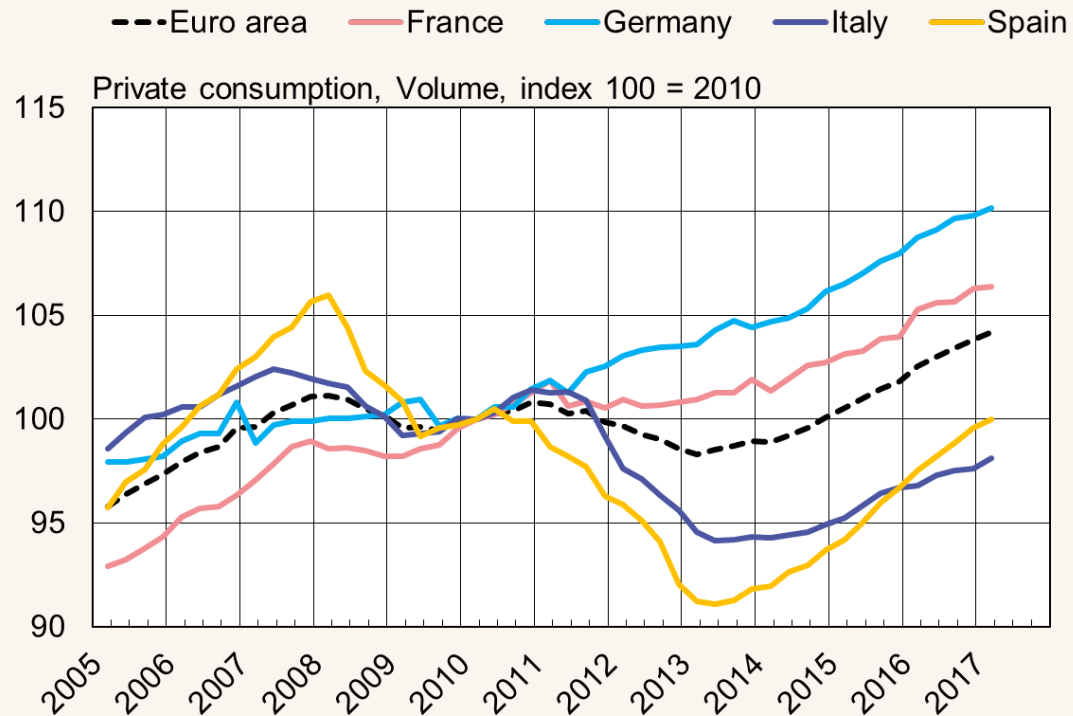


Sources: Eurostat, Macrobond and Bank of Finland calculations.

*GIIPS: Greece, Italy, Ireland, Portugal, Spain. Highly rated: Germany, France, Netherlands, Belgium, Austria, Finland.
patu32425@teollGiips(EN)



Private consumption has recovered well...

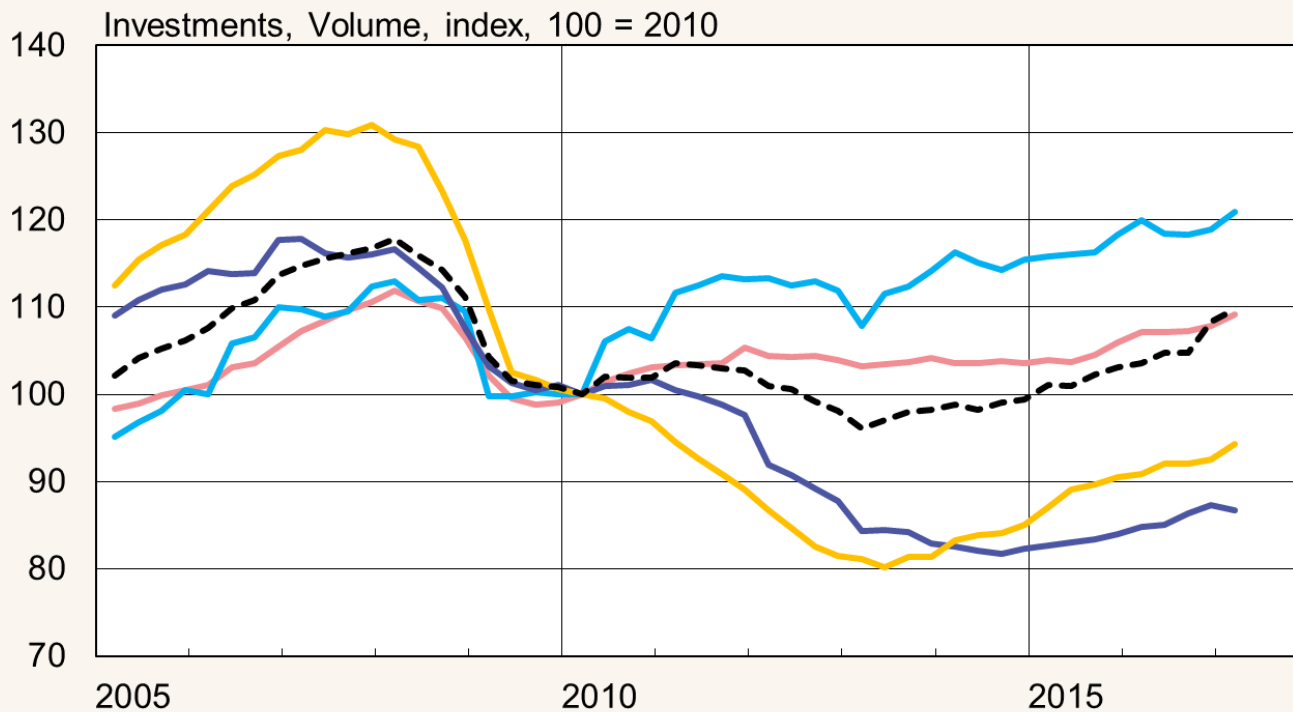


Sources: Eurostat and Macrobond.
patu32425@kulutuisot_EN



...whereas investments are stalling

— France — Germany — Italy — Spain - - - Euro area

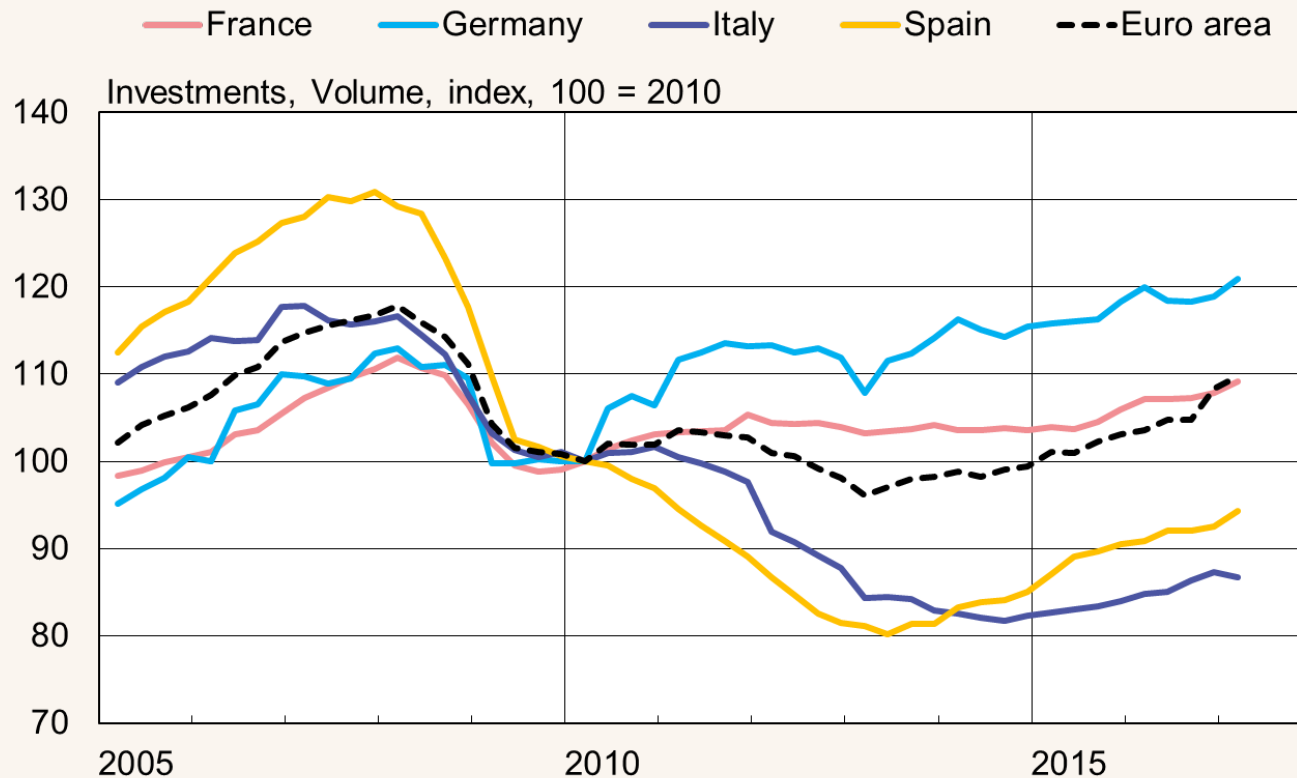


Sources: Eurostat and Macrobond.

32425@volinvest



Investment grows fairly slowly



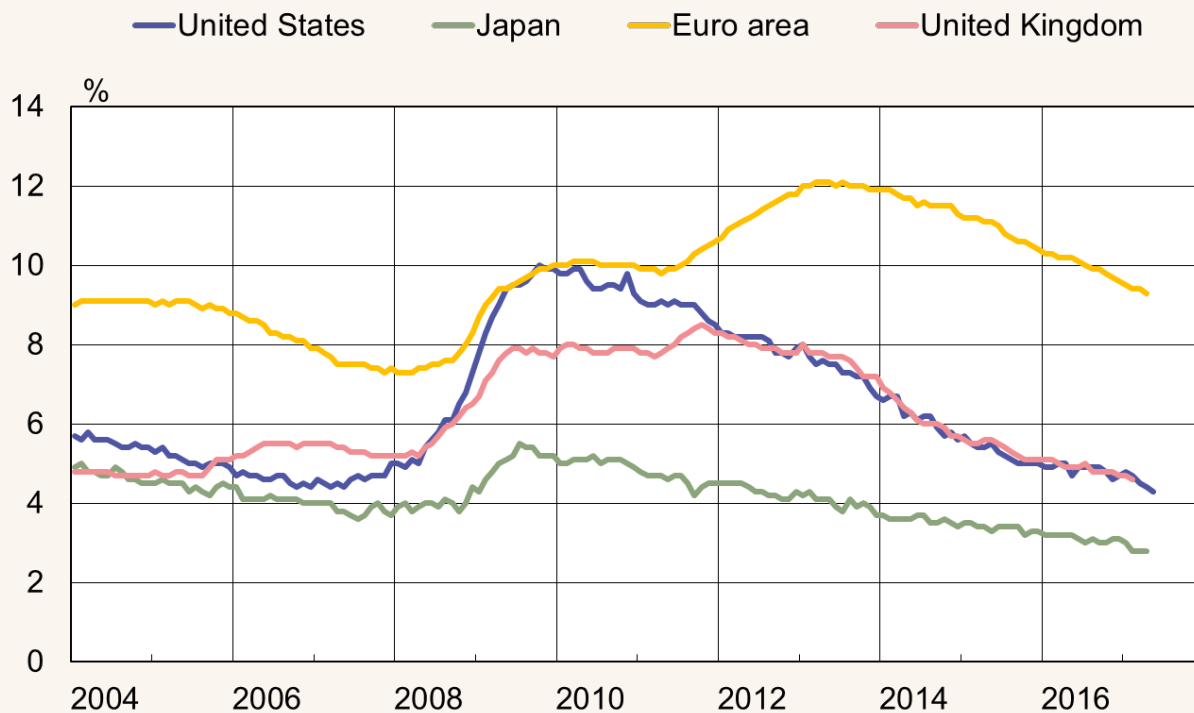
Sources: Eurostat and Macrobond.

32425@volinvest



Unemployment has declined

Unemployment rate

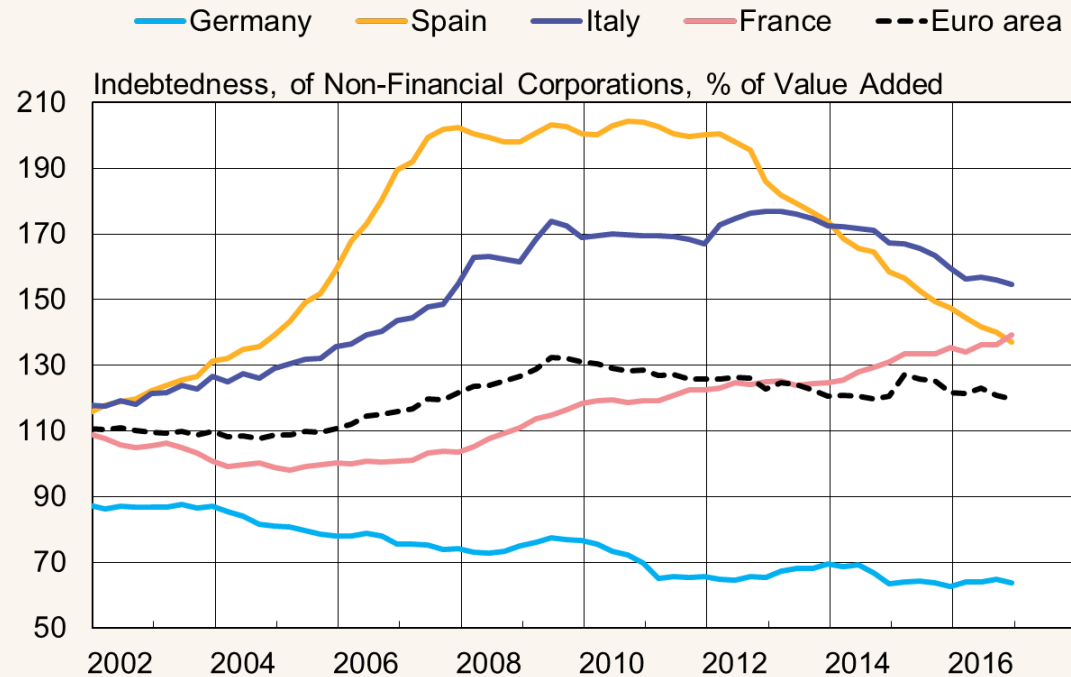


Source: National statistical authorities (Macrobond).

32427@työttömyys(en)



Corporate sector has consolidated their balance sheets particularly in crisis countries...



Sources: Bank of France and Macrobond.

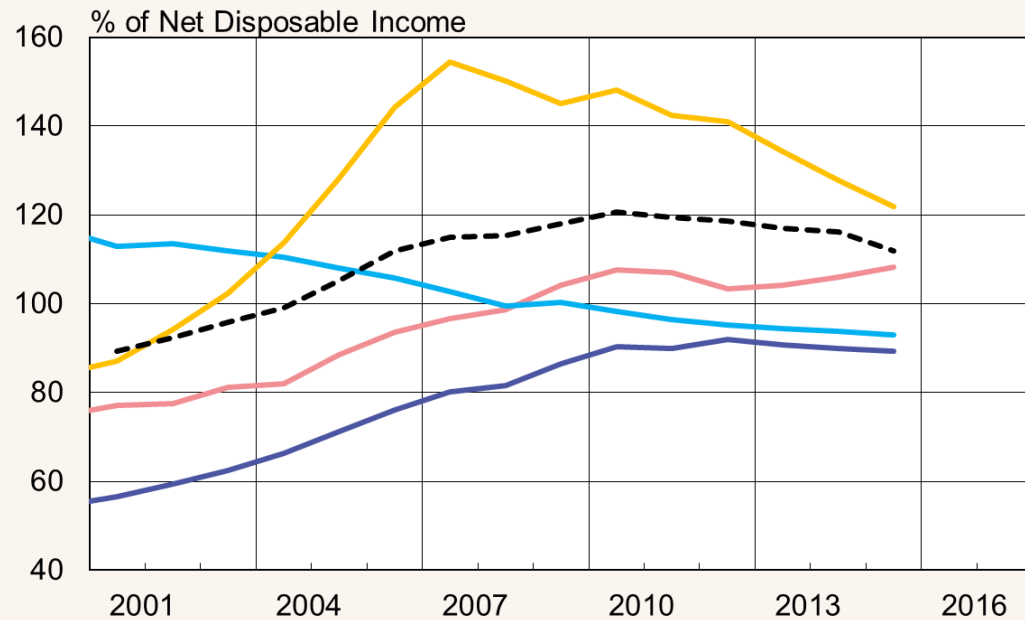
patu32423@yvelkaal



...and also household debt levels have declined

Household debt

— France — Germany — Italy — Spain - - - Euro area



Sources: OECD and Macrobond.

patu32423@hhdebt



ECB June 2017 Macroeconomic Projection

- **Euro area GDP Growth:**

2017: 1.9 %

2018: 1.8 %

2019: 1.7 %

- **Euro area inflation:**

2017: 1.5 %

2018: 1.3 %

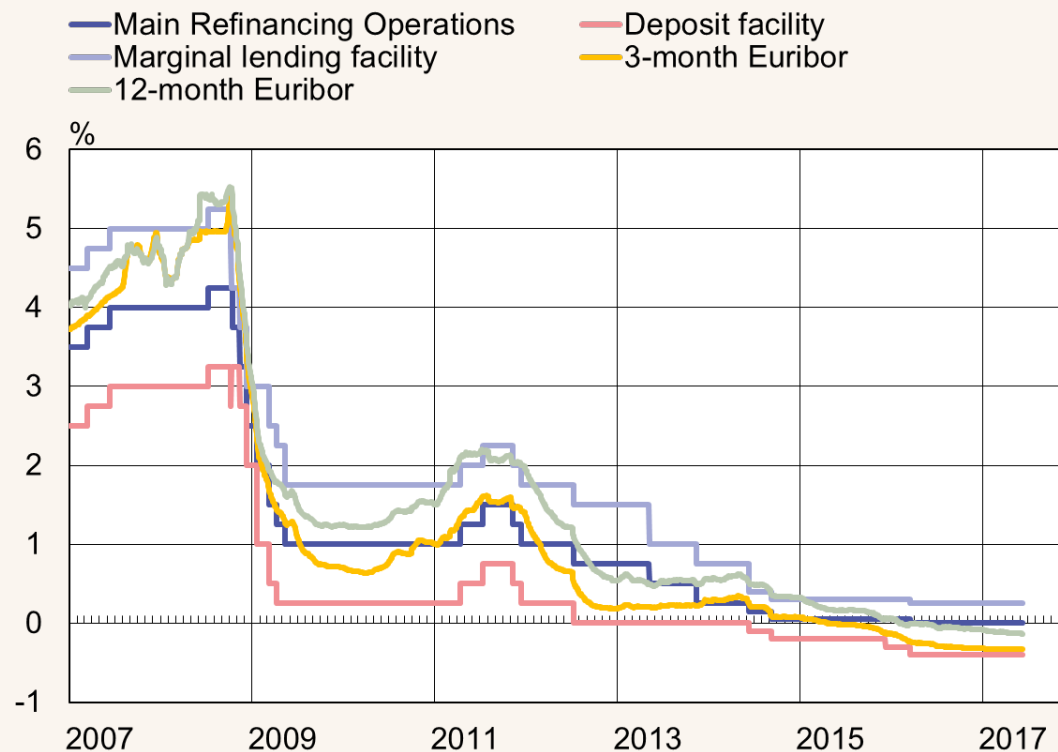
2019: 1.6 %



ECB's monetary policy highly accommodative



ECB's monetary policy rates are exceptionally low

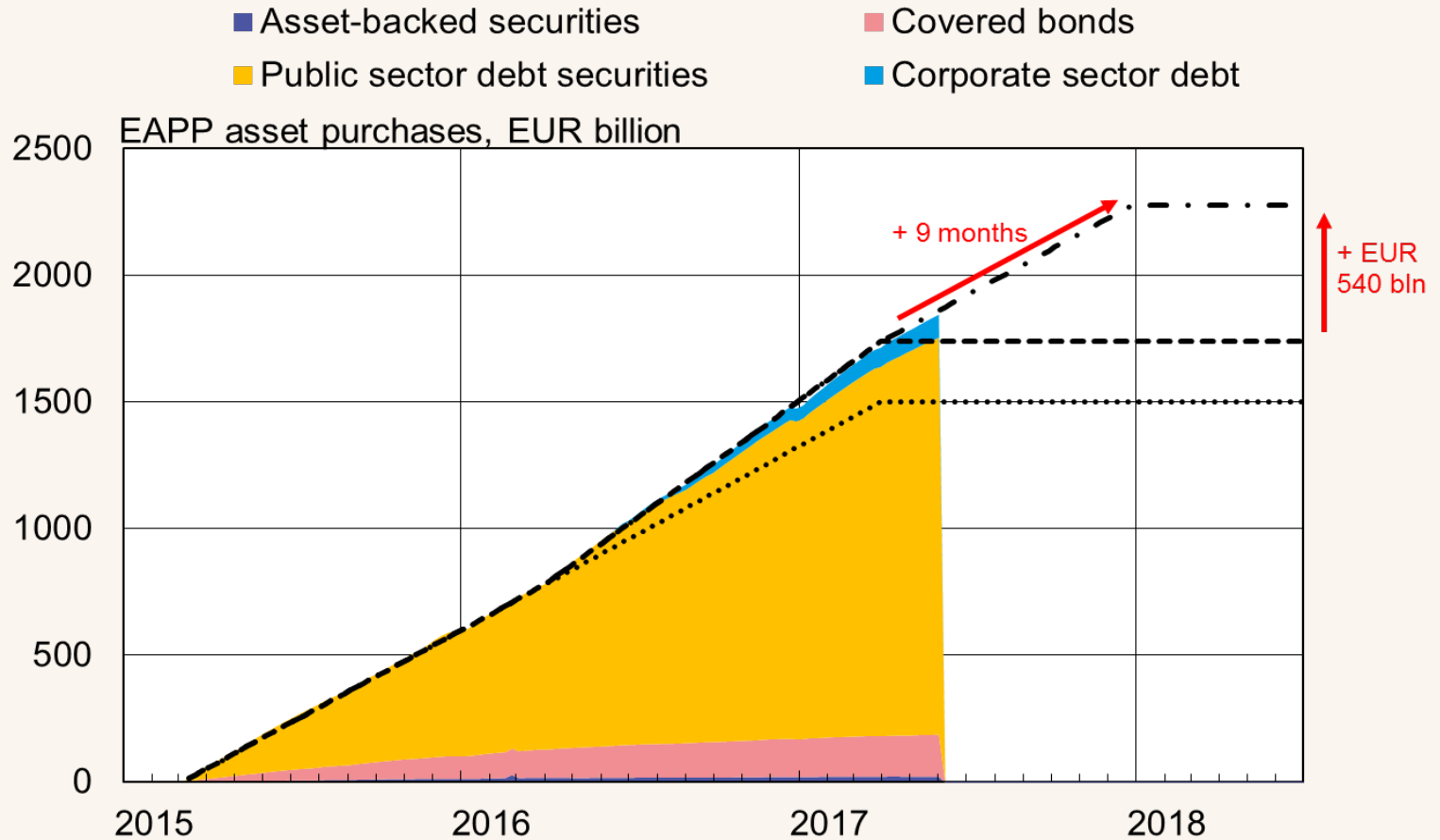


Sources: ECB and Macrobond.

[@ohjauskorot\(en\)](mailto:petu32422@ohjauskorot(en))



ECB's Asset Purchases to continue at least to the end of 2017.



Sources: ECB and Macrobond.

32422@EAPP (eng)

The dash-dotted line shows target path announced in December 2016, the dashed line shows target path announced in March 2016, and the dotted line shows the initial target path announced in December 2015.



Highly accommodative monetary policy transmits to loan rates

- Euro area, households
- Euro area, corporate sector
- Finland, households
- Finland, corporate sector



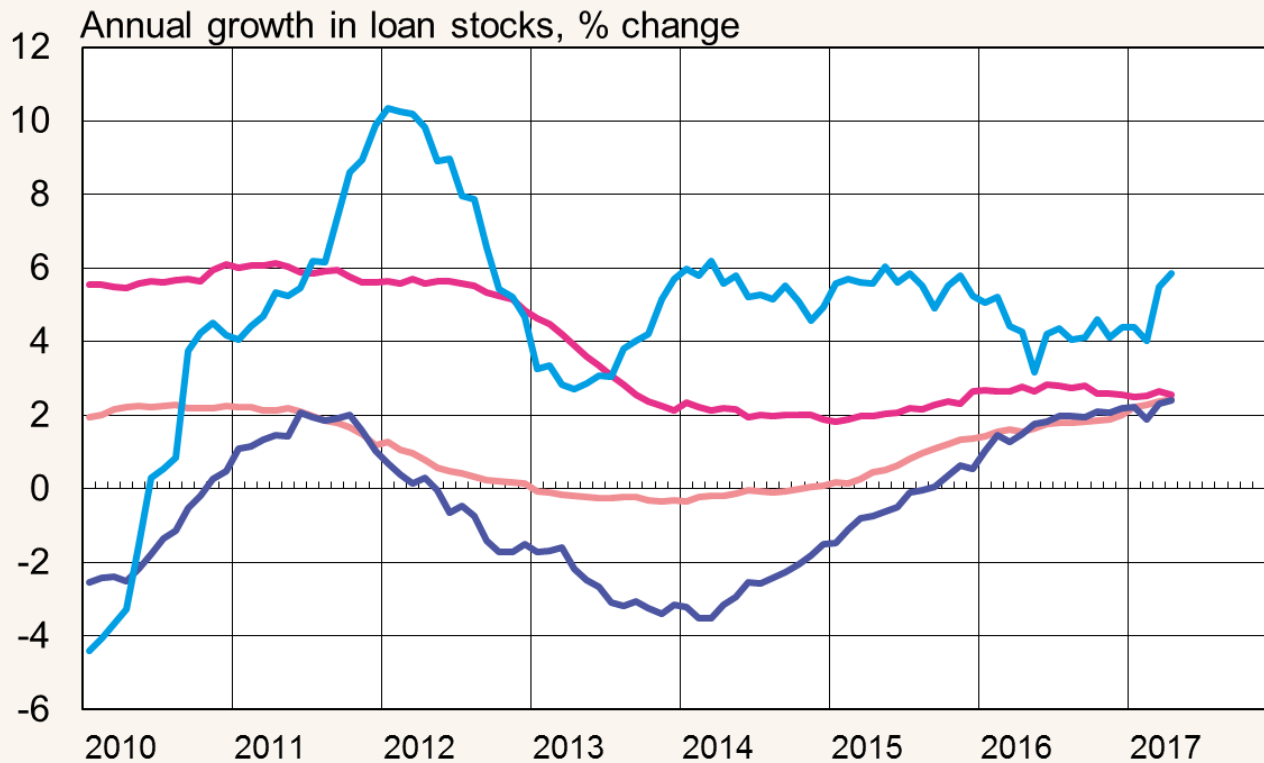
Sources: ECB and Macrobond.

32422@antolainakorot (sv)



.. and supports lending volumes

- Euro area, households
- Finland, households
- Euro area, corporate sector
- Finland, corporate sector



Loan stocks adjusted for balance sheet transfers and securitisation.

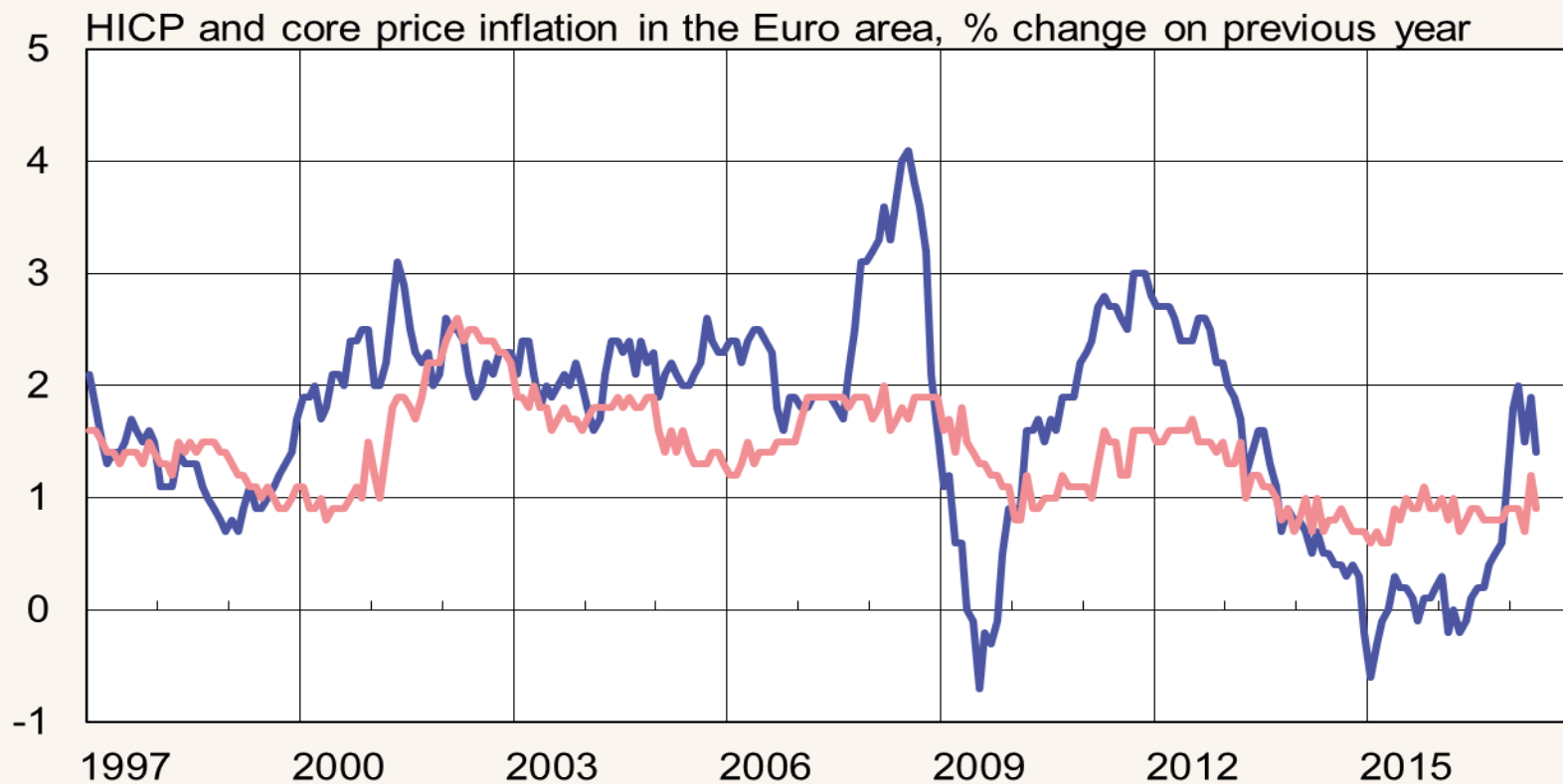
Sources: ECB and Macrobond.

32422@lainakannat (ENG)



Oil price impact fuels inflation – core inflation slower

— HICP inflation — Core price inflation*



* HICP excl. energy, food, alcohol and tobacco.

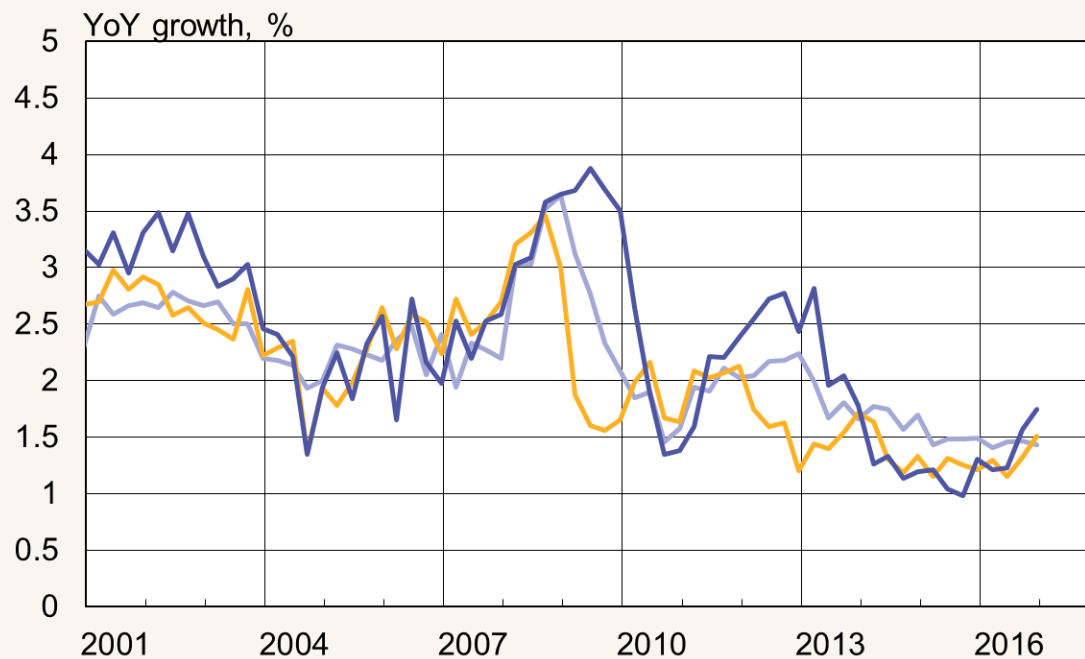
Sources: ECB and Macrobond.

patu32426@YKHI(ENG)



Wage growth in the euro area still modest

- Indicator of Negotiated Wage Rates, euro area
- Compensation per Employee, euro area
- Hourly Compensation, euro area



Sources: ECB and Macrobond.

patu32426@negowa



Four requirements of the price stability objective

"Price stability is defined as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below, but close to, 2%."

1. Price stability has been defined and is measured **over the medium term**.
2. The path of inflation needs to converge on the objective **in a durable way**; a mere passing increase in prices is not enough.
3. Inflation must be **self-sustained** and remain in line with the objective even after the current highly accommodative monetary policy stance comes to an end.
4. The objective has been defined for average **inflation in the euro area as a whole**; inflation in individual countries can diverge markedly from the average.



The Governing Council decided on 8 June 2017 to continue its highly accommodative monetary policy stance

1. APP purchases are intended to run until the end of 2017, or beyond, if necessary, until there is a sustained adjustment in the path of inflation consistent with the inflation aim.
2. Policy rates are expected to remain at their present levels for an extended period of time, and well past the horizon of our net asset purchases.



Inflation expectations in the euro area remain moderate

Euro area inflation expectations

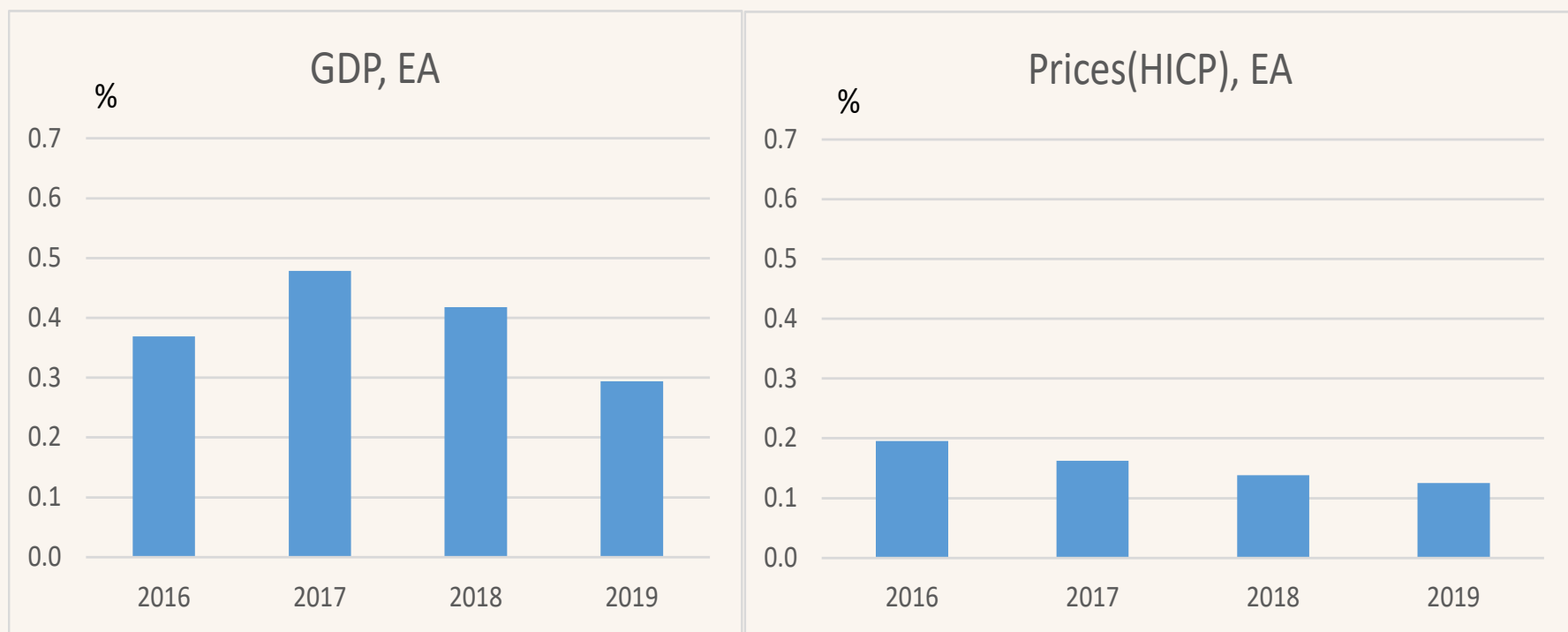


Sources: Bloomberg and ECB.

27227@ea_odotukset en



Effects of ECB December 2015 and March 2016 decisions in the eurozone



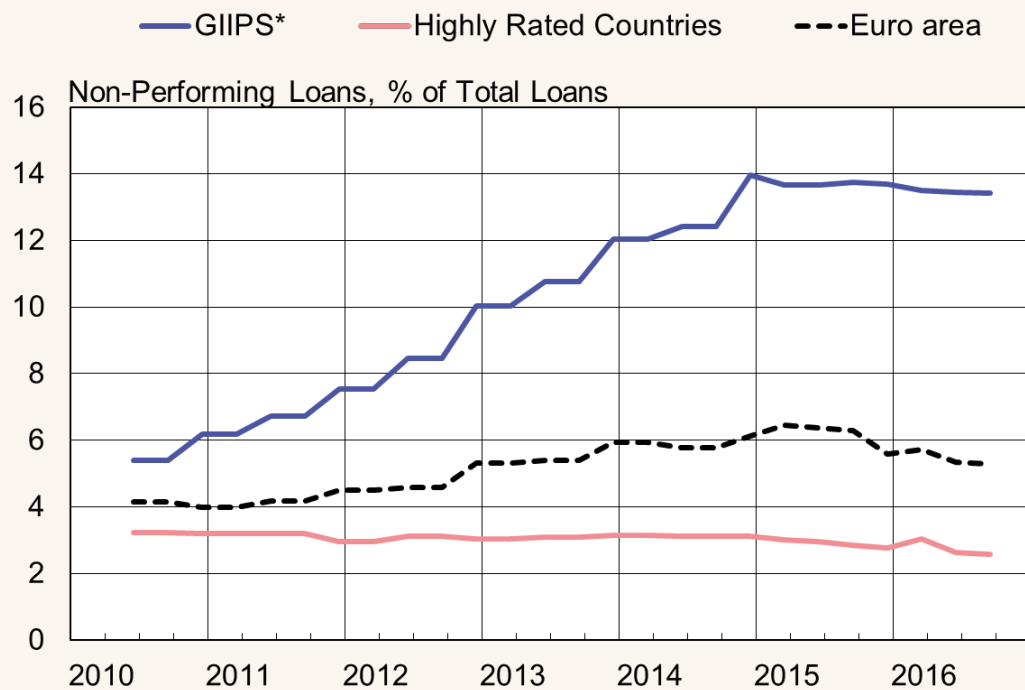
Source: Bank of Finland, www.eurojatalous.fi



Challenges in the euro area



In some Member States the share of NPLs still elevated



Sources: ECB and Macrobond.

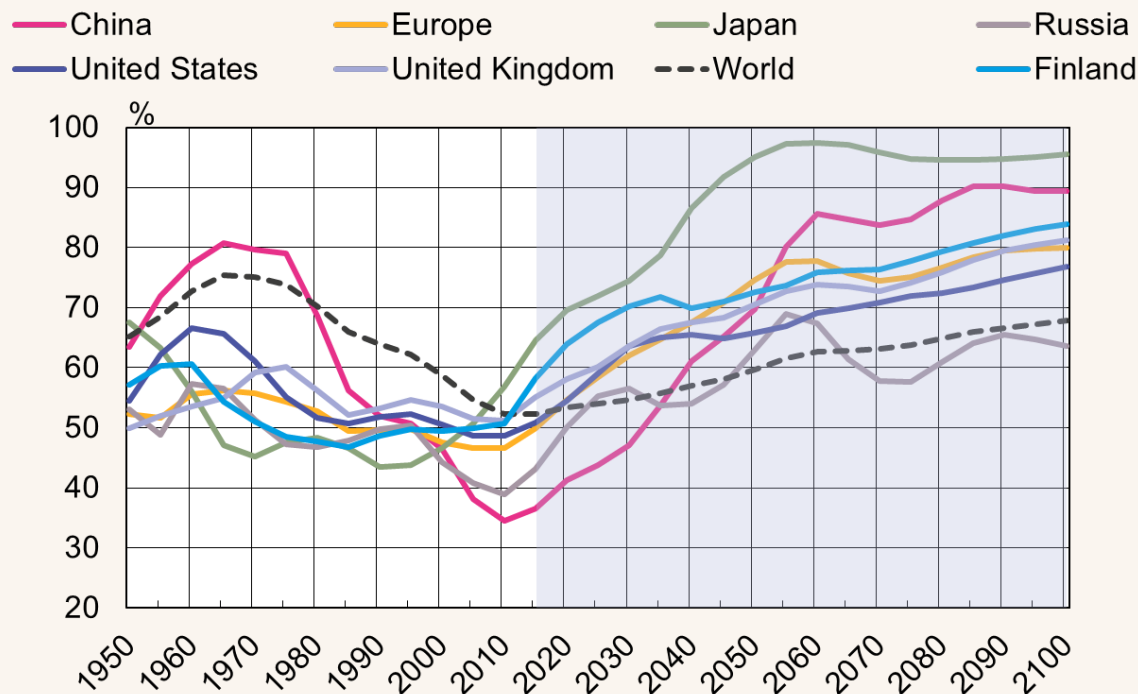
patu32423@NPL2Giips

* GIIPS (GR,IT,IR,PO,SP); Highly Rated (FI,BE,AT,FR,GE,NL)



Ageing population will restrain growth and increase strain on public expenditures

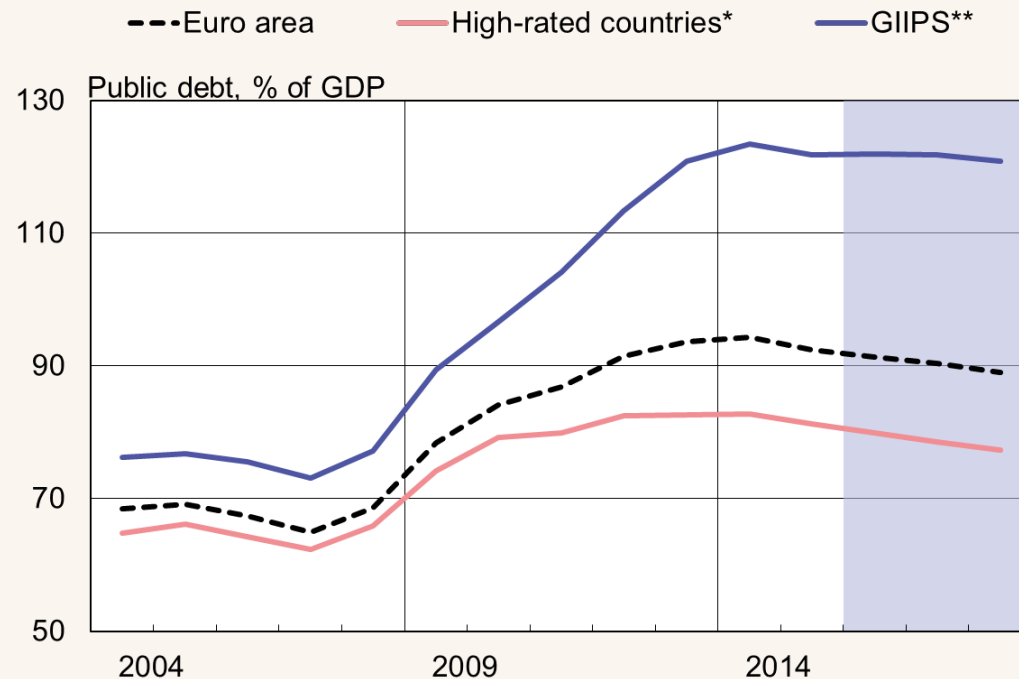
Total Dependency Ratio



Sources: UN Population Projection and Macrobond. patu32427@demografia
Ratio of Population Aged 0-14 & 65+ per 100 Population 15-64



... and public debt levels still elevated



* Austria, Belgium, Finland, France, Germany and the Netherlands. 32424@Julk. velka kolmijako(ENG)

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

The figures for 2015-2017 are based on the European Commission's forecast.

Sources: European Commission, Macrobond and Bank of Finland calculations.



Thank you!