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After the crisis: how to optimise fiscal and monetary policy amid slow inflation and low interest rates?

University of Helsinki, Faculty of Social Sciences,
opening lecture of the academic year

3 September 2019



On the causes of and solutions to the euro area debt crisis

- Root causes: macroeconomic imbalances in the first decade of the 2000s
- Financial crisis: intellectual neglect by the economics profession
- Limited fiscal room for manoeuvre in Member States
- “Financial accelerator” important, but in reverse gear in 2008–2013
 - “financial accelerator” by Ben Bernanke
- ECB monetary policy gained more importance, especially from 2012 onwards

Fiscal policy and thinking outside the box

- “Modern monetary theory”
 - Not a consistent, empirically tested economic theory
- The ‘Blanchard debate’ on debt-based financing of fiscal deficits in the low interest rate environment
- Fiscal policy has gained in importance amid persistently low interest rates – no silver bullet, no magical money tree
- Fiscal-monetary policy mix supports growth, employment
- T. Padoa-Schioppa: “Independence should not mean institutional loneliness.”



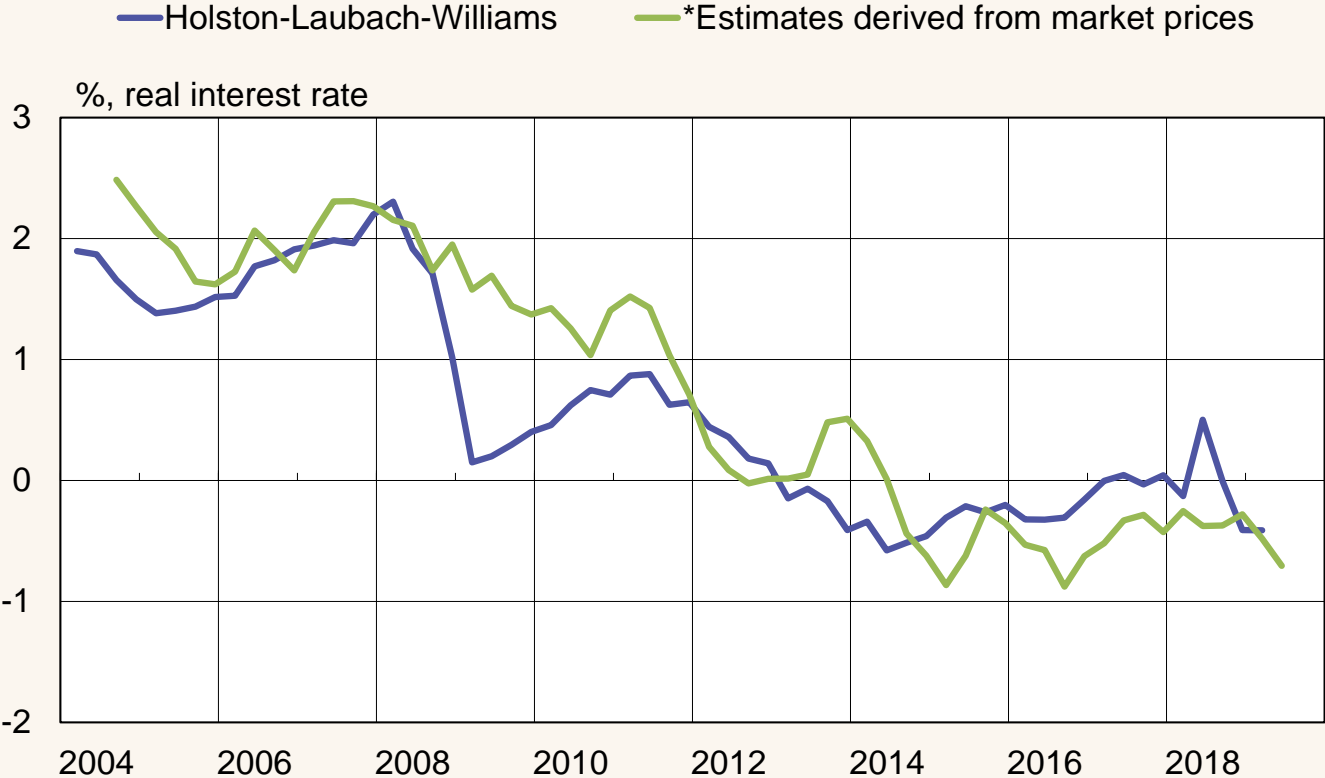
Walking the Highwire – Rebalancing the European Economy in Crisis

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Olli Rehn, 9 August 2019

Estimates of natural rate of interest have declined

Estimates of the natural rate of interest in the euro area

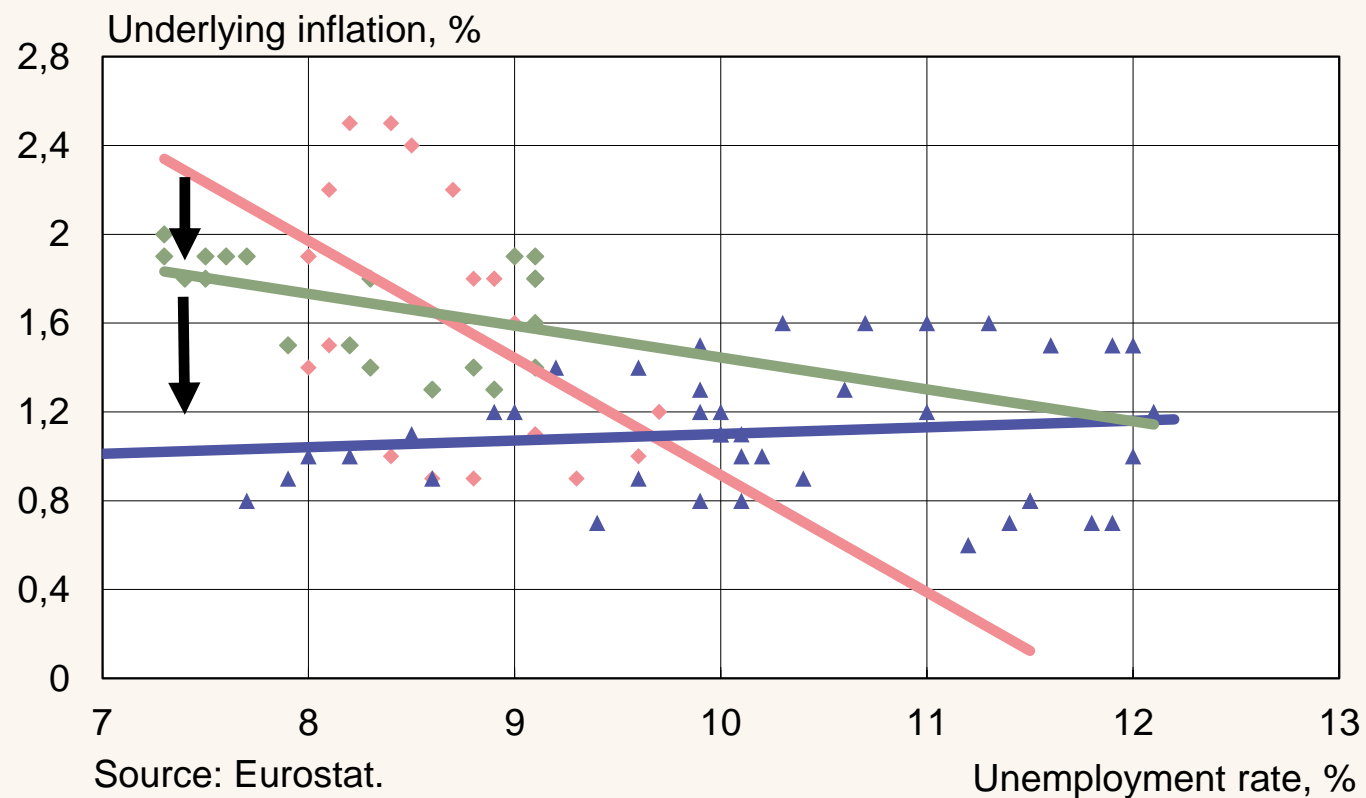


*5-year rate 5 years ahead, difference between interest rate swap and inflation swap.
Sources: Macrobond, Bloomberg and calculations by the Bank of Finland. 32429@NIR
4.10.2018 eurojatalous.fi

The Phillips curve is not stable – it has flattened

The Phillips curve in the euro area

1999 - 2003, 2004 - 2008 and 2009 - 2018



Source: Eurostat.
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Renewed decrease in inflation expectations derived from market prices



Market expectations derived from inflation swaps. SPF = ECB survey of professional forecasters.
Sources: ECB, Bloomberg and calculations by the Bank of Finland.

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Research and expertise

- To succeed in its mission, the central bank must understand the prevailing economic conditions and the implications of its actions.
- Research and expertise play an important role.
- Besides economics, history is a teacher.

Thank you!