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The European Economy and Monetary Policy In and Out of the Crisis





Contents

- ECB and Eurosystem: composition, goal and a structural challenge
- Current Economic situation in Euro area
- Global trading system under stress

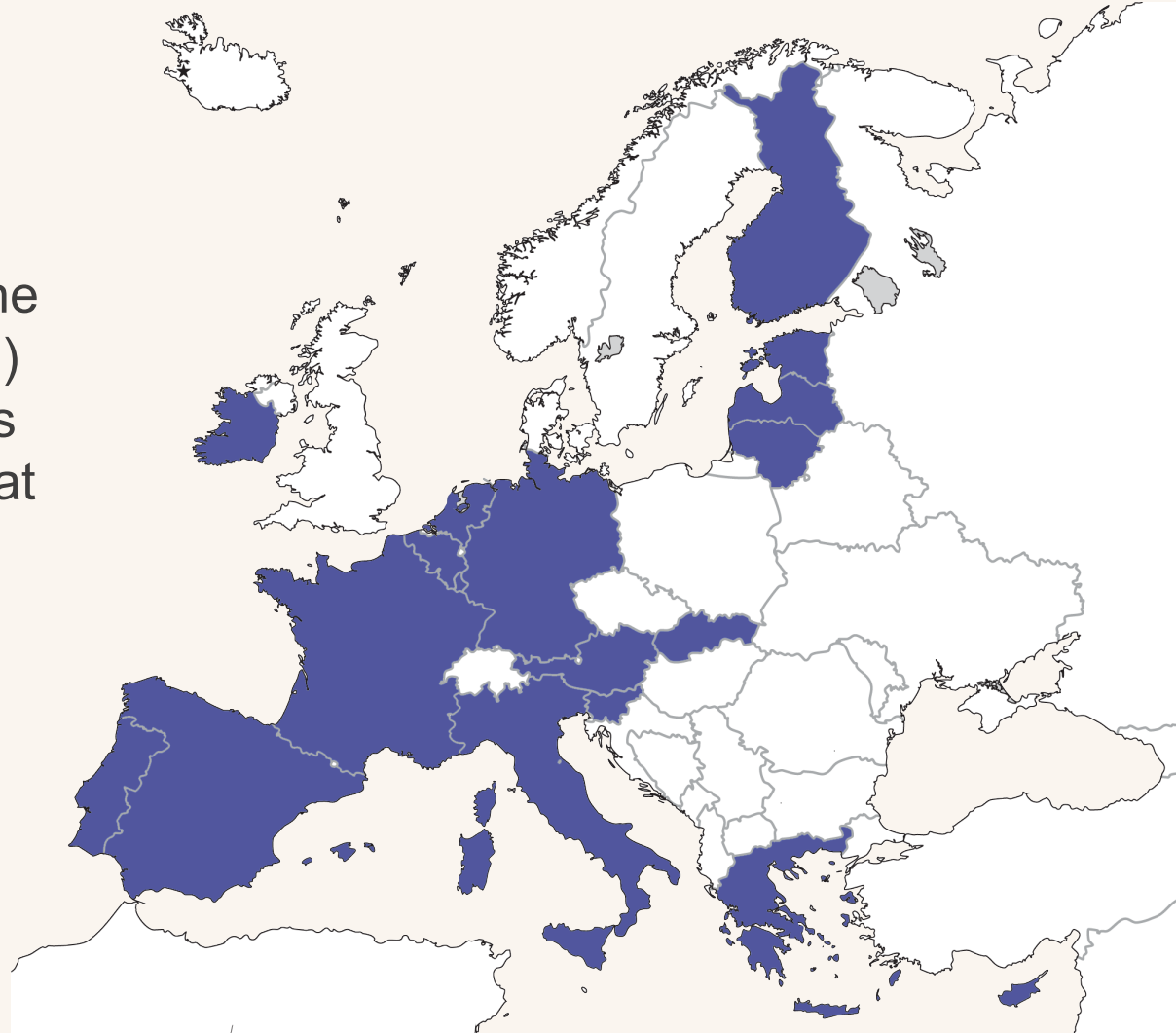


ECB, euro area and the Eurosystem



The Eurosystem and the euro area

The Eurosystem comprises the European Central Bank (ECB) and the national central banks (NCBs) of the 19 countries that have adopted the euro.



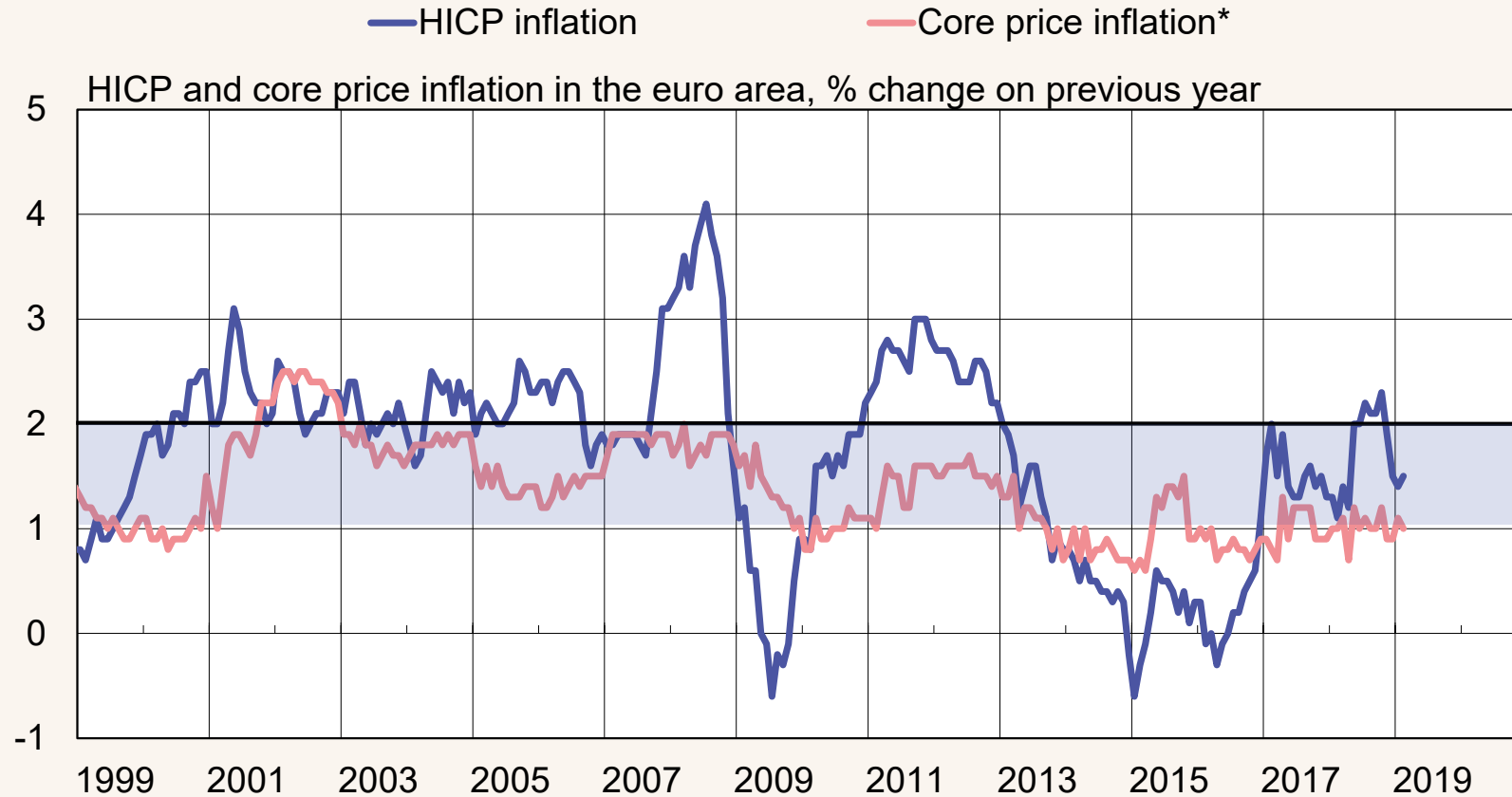


ECB's monetary policy objective

- Price stability is the primary objective of monetary policy.
 - The aim is to maintain annual euro area inflation rates below, but close to, 2% over the medium term.
- General economic policies in the European Union (EU) are supported.
 - Balanced and sustainable growth and employment are fostered **without prejudice to the objective of price stability.**



Our Track record: Harmonised Consumer Price Index



NB: Annual inflation rate of 2015 is distorted due to the change in methodology.

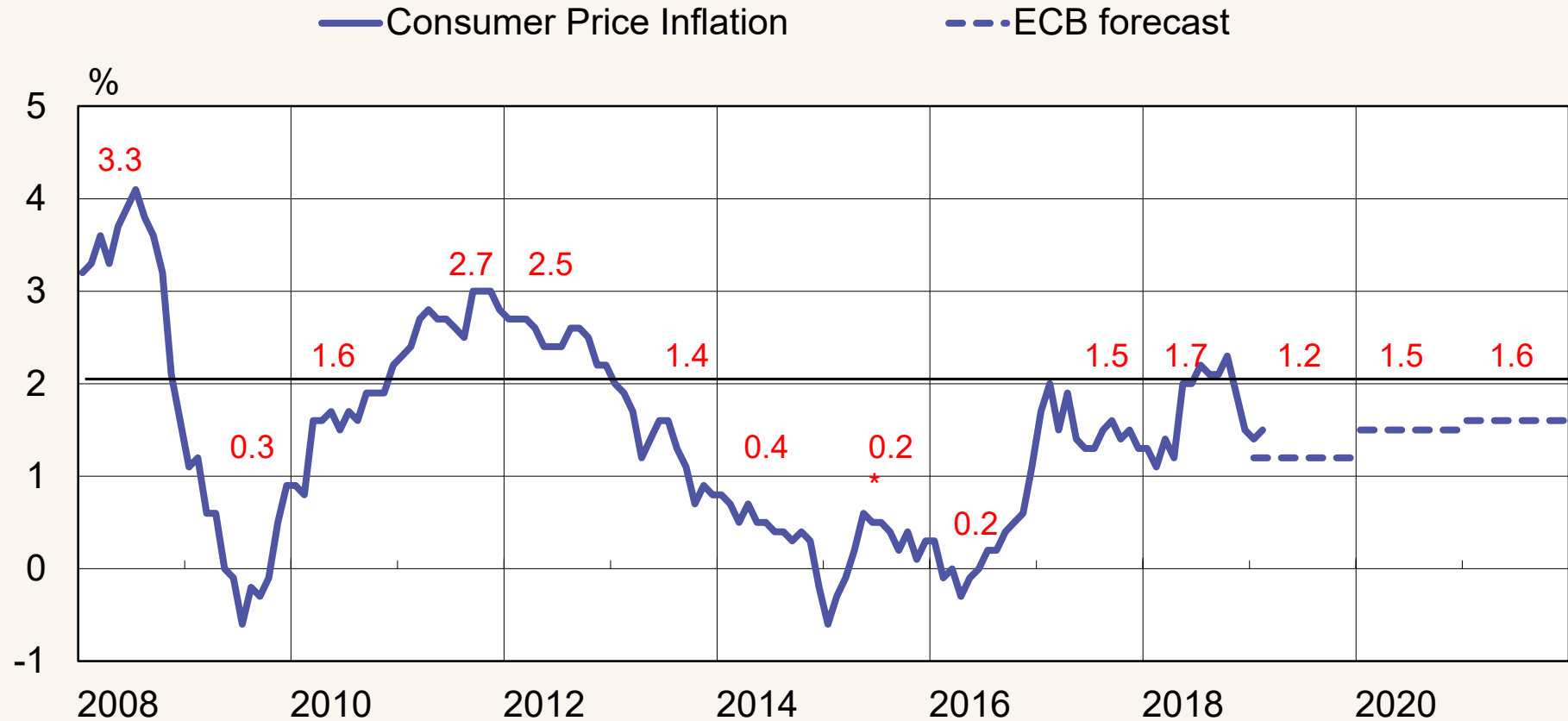
* HICP excl. energy, food, alcohol and tobacco.

Source: Eurostat.

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Current HICP on low side, but continues on a sustainable path towards the target



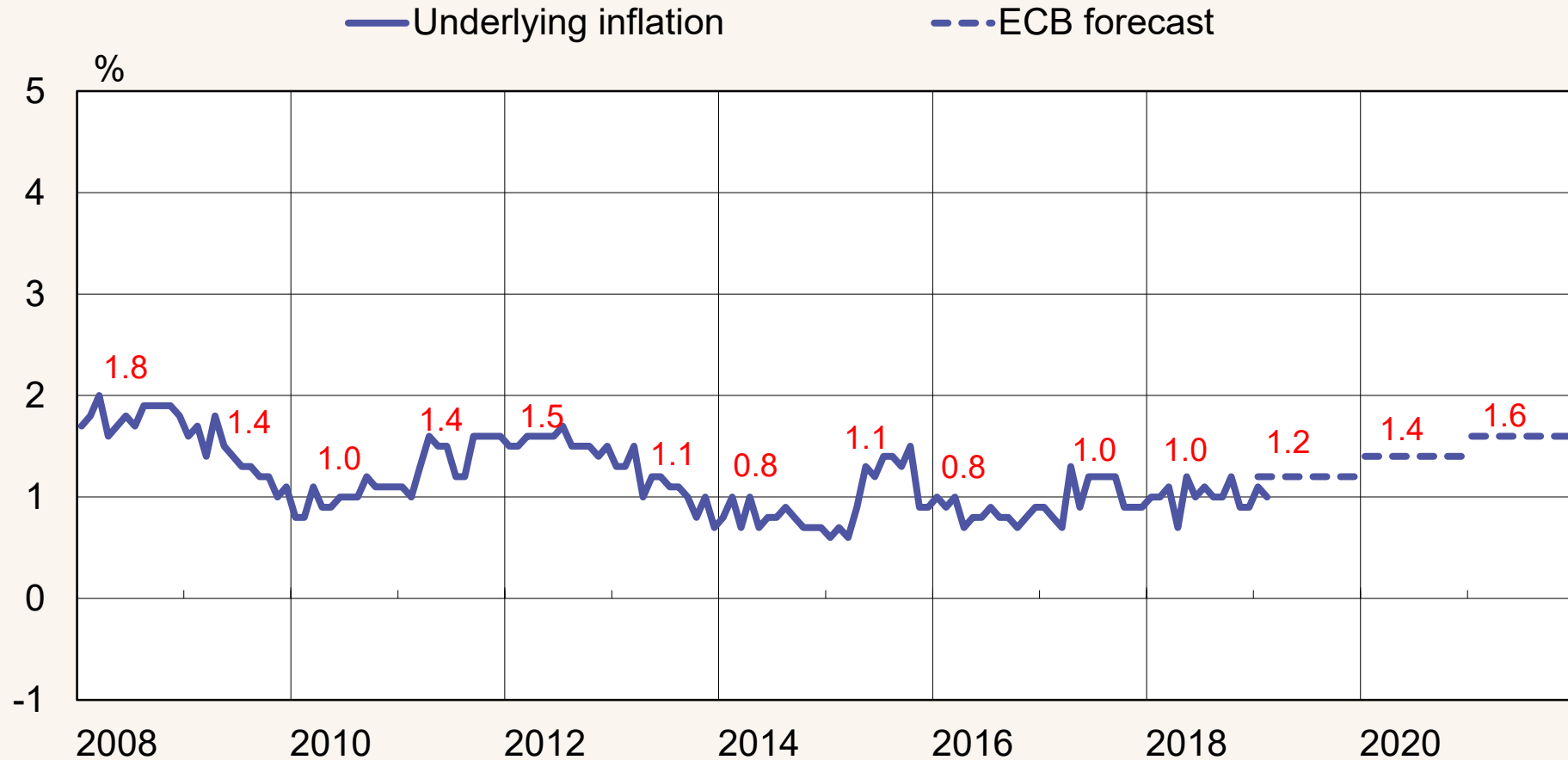
*Annual inflation rate of 2015 is distorted due to the change in methodology.

Figures above curve are annual growth rates.

Sources: Eurostat and ECB. 35781@Chart4(en)



Yet, underlying inflation has been extremely stable for quite some time...



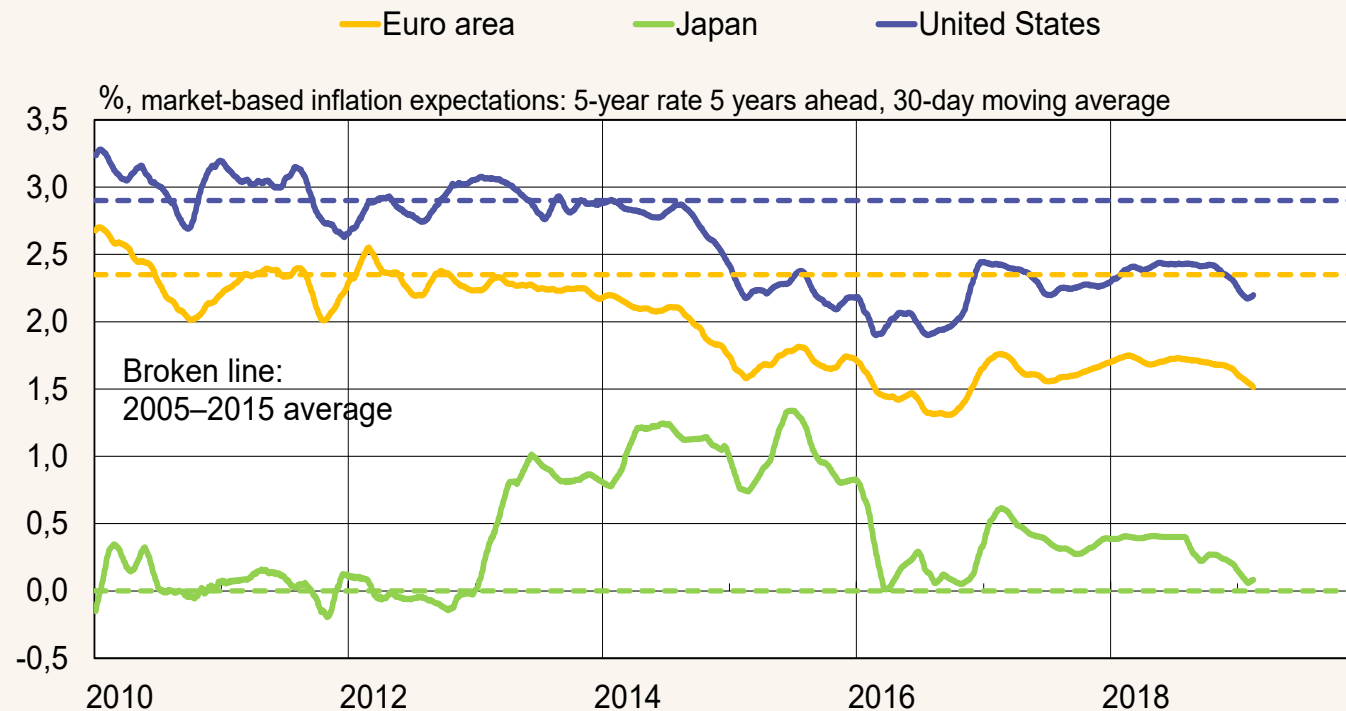
Figures above curve are annual growth rates.

Sources: Eurostat and ECB. 35781@Chart5(en)



...which has resulted in lower market expectations also for longer term

Inflation expectations have declined in recent years



Sources: Bloomberg and Bank of Finland.

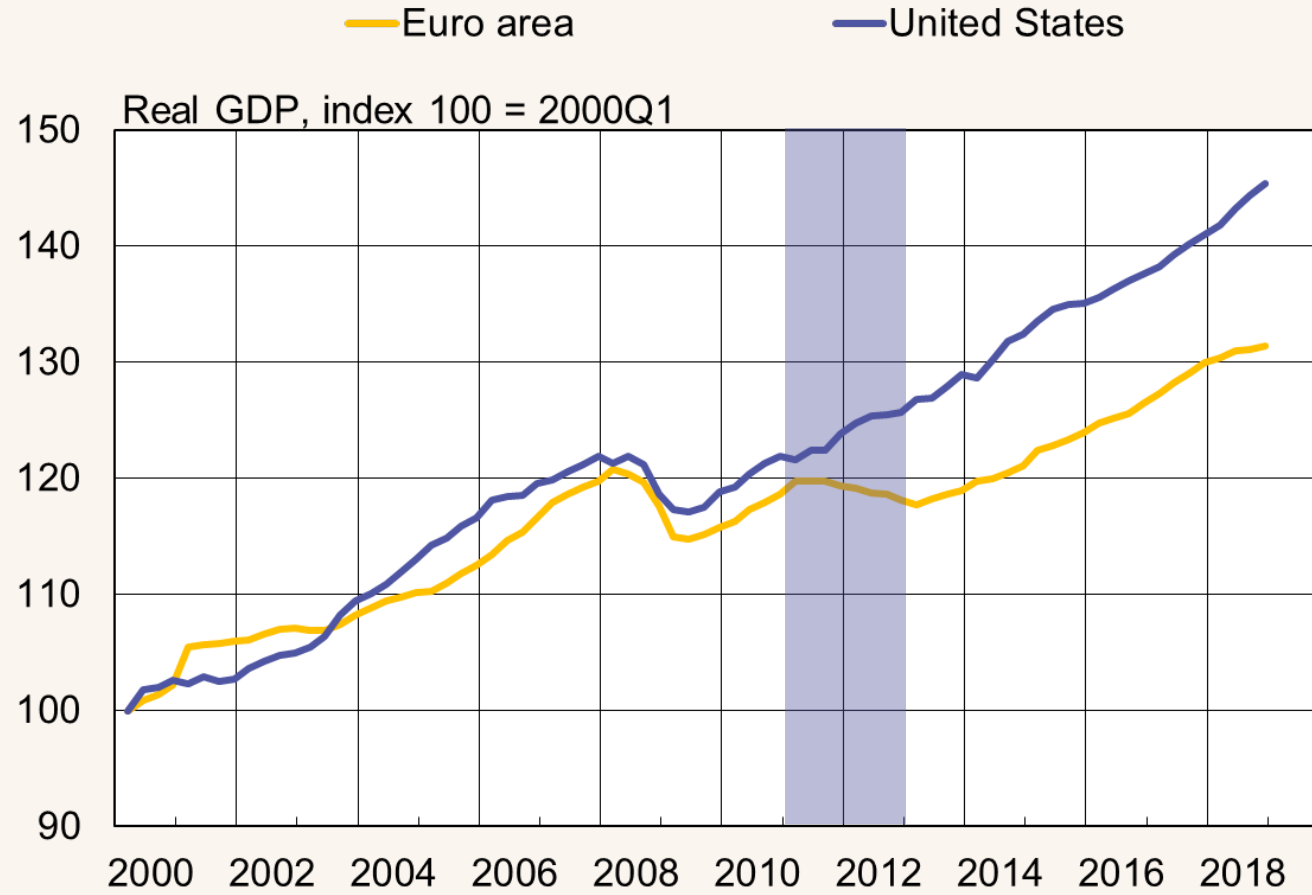
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Why are we so keen on getting inflation to 2%: The issue from monetary policy makers perspective



Euro area and US GDP since 2000

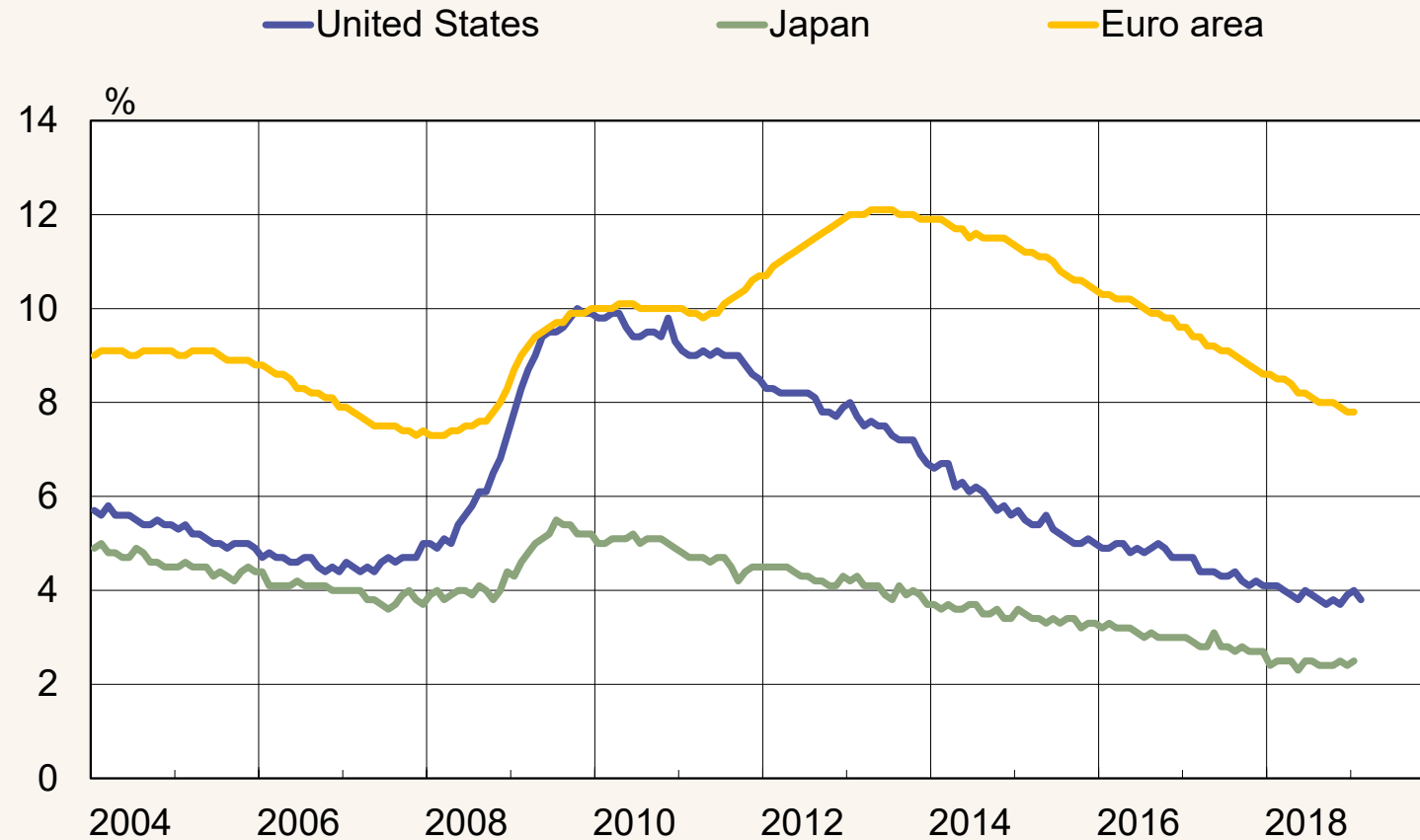


Source: BEA, Eurostat, Macrobond.

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Unemployment rates close to the pre-crisis levels

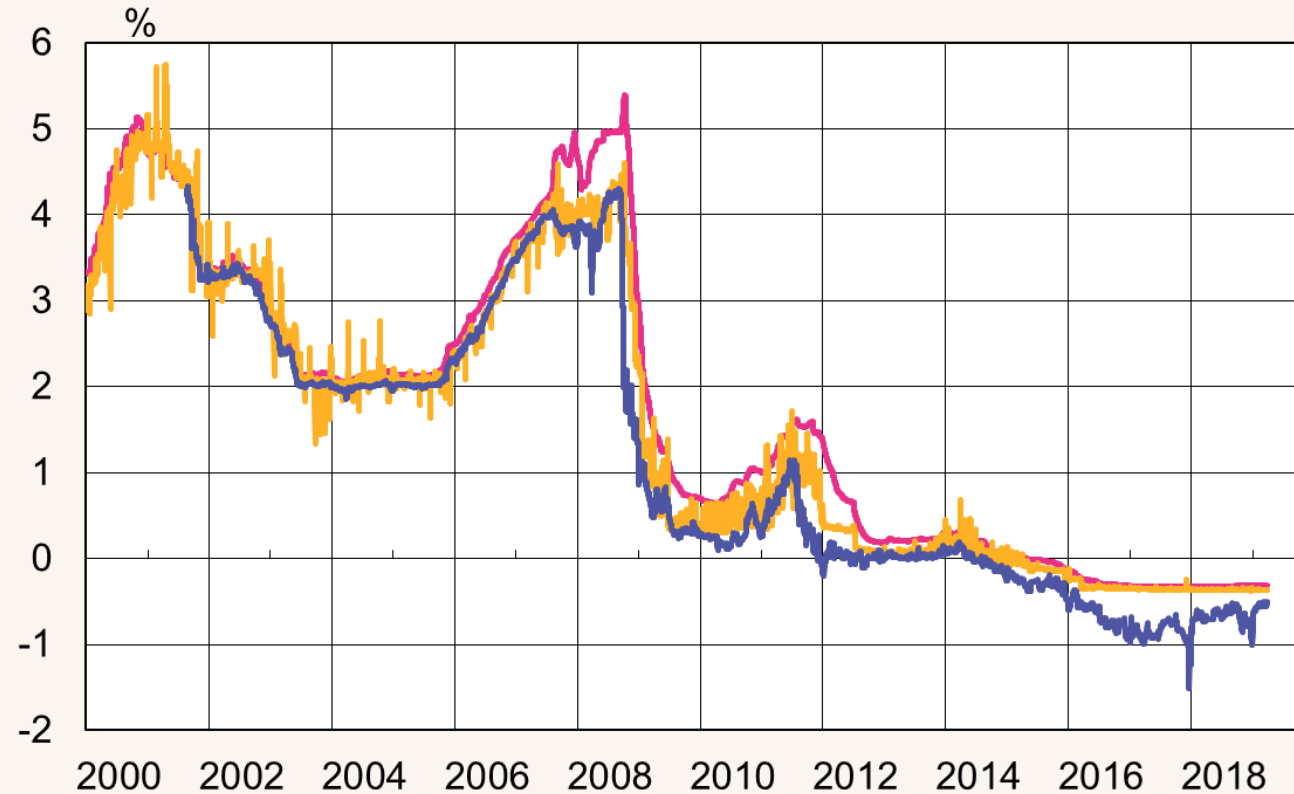


Source: National statistical authorities (Macrobond).



Very accommodative monetary policy stance: short term rates in the euro area

- EURIBOR 3m
- EONIA O/N
- Germany, government bond yield, 3m

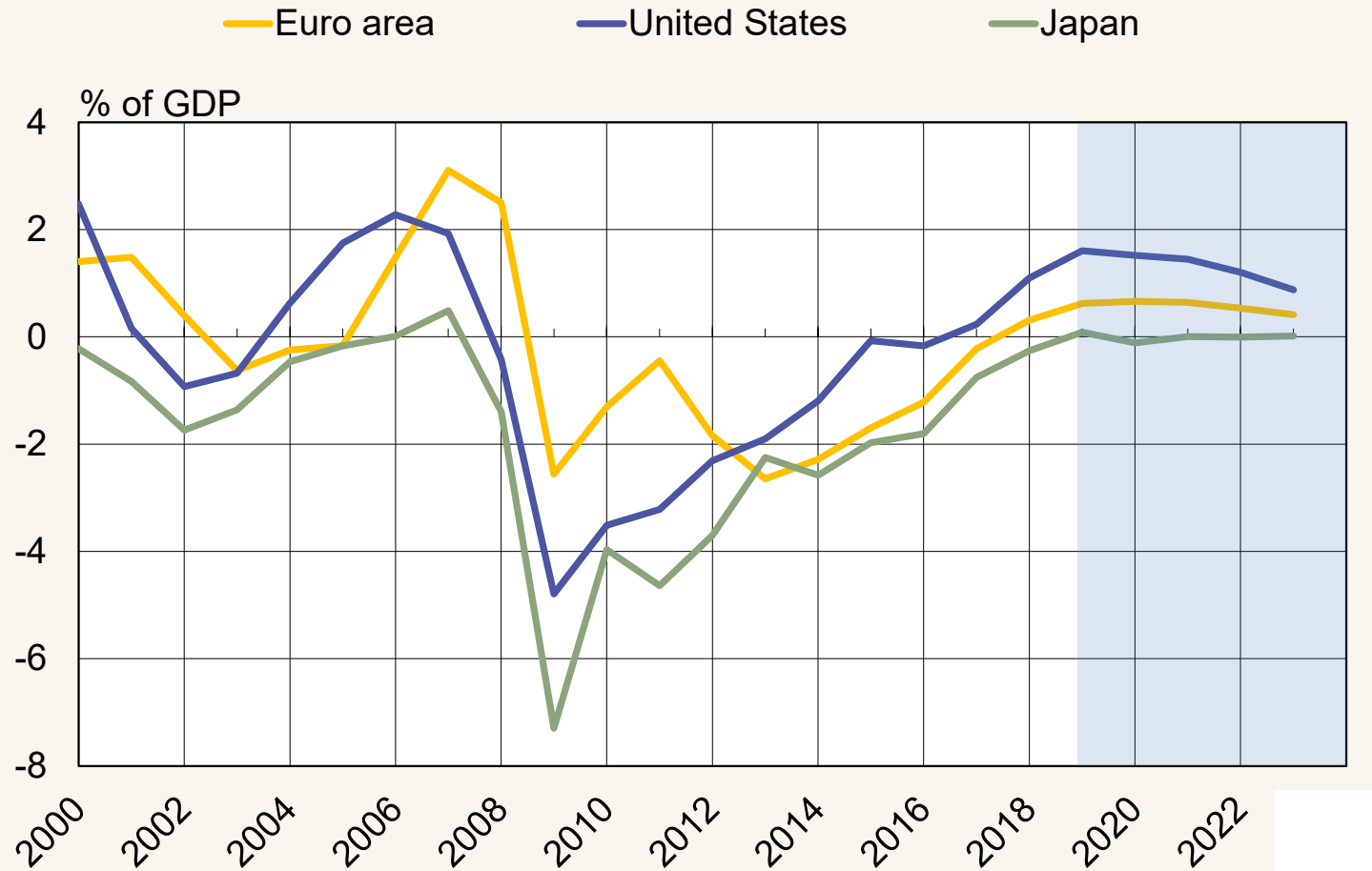


Source: ECB, Macrobond.

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Estimated Output Gaps (IMF)

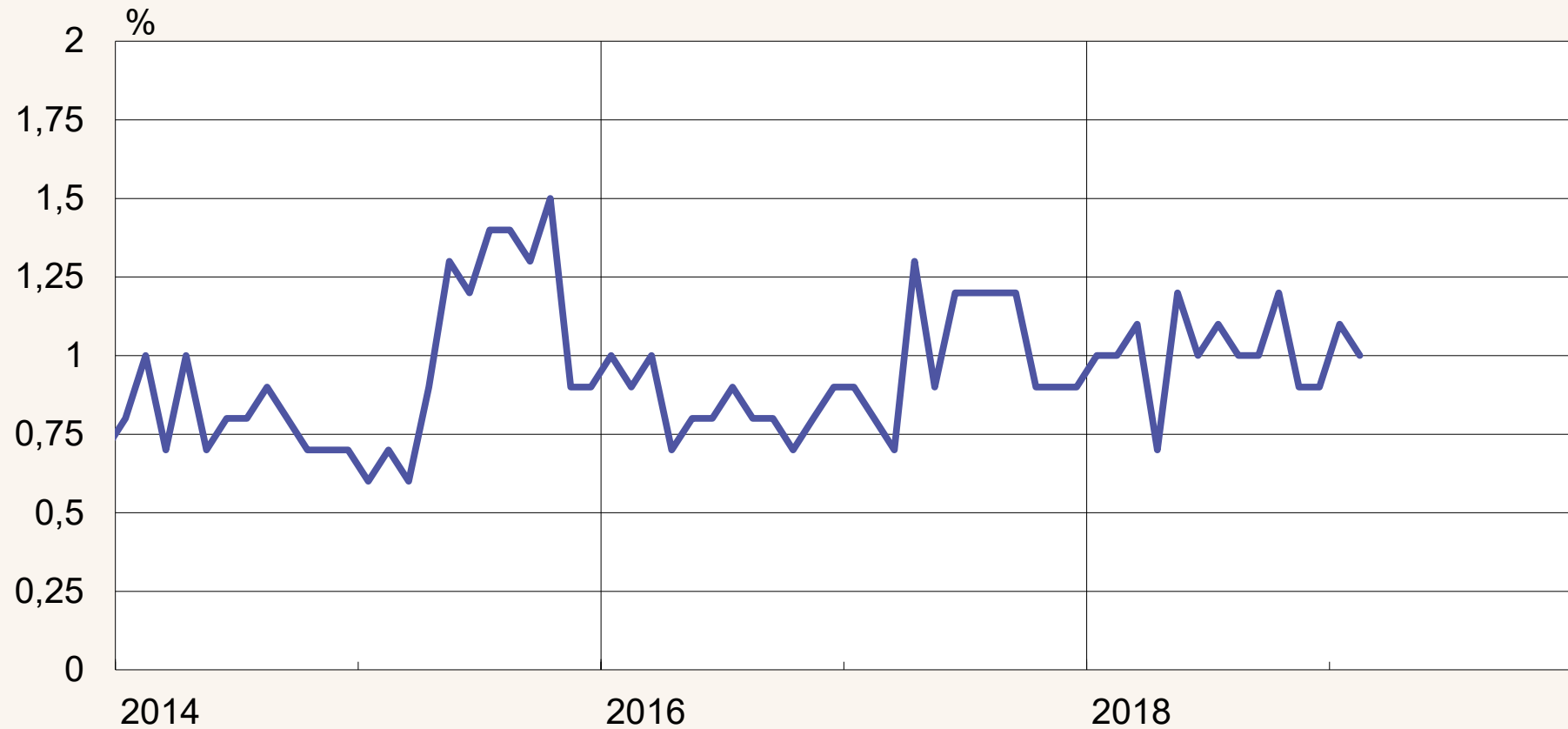


Source: IMF.

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...and still underlying inflation continues at around 1%



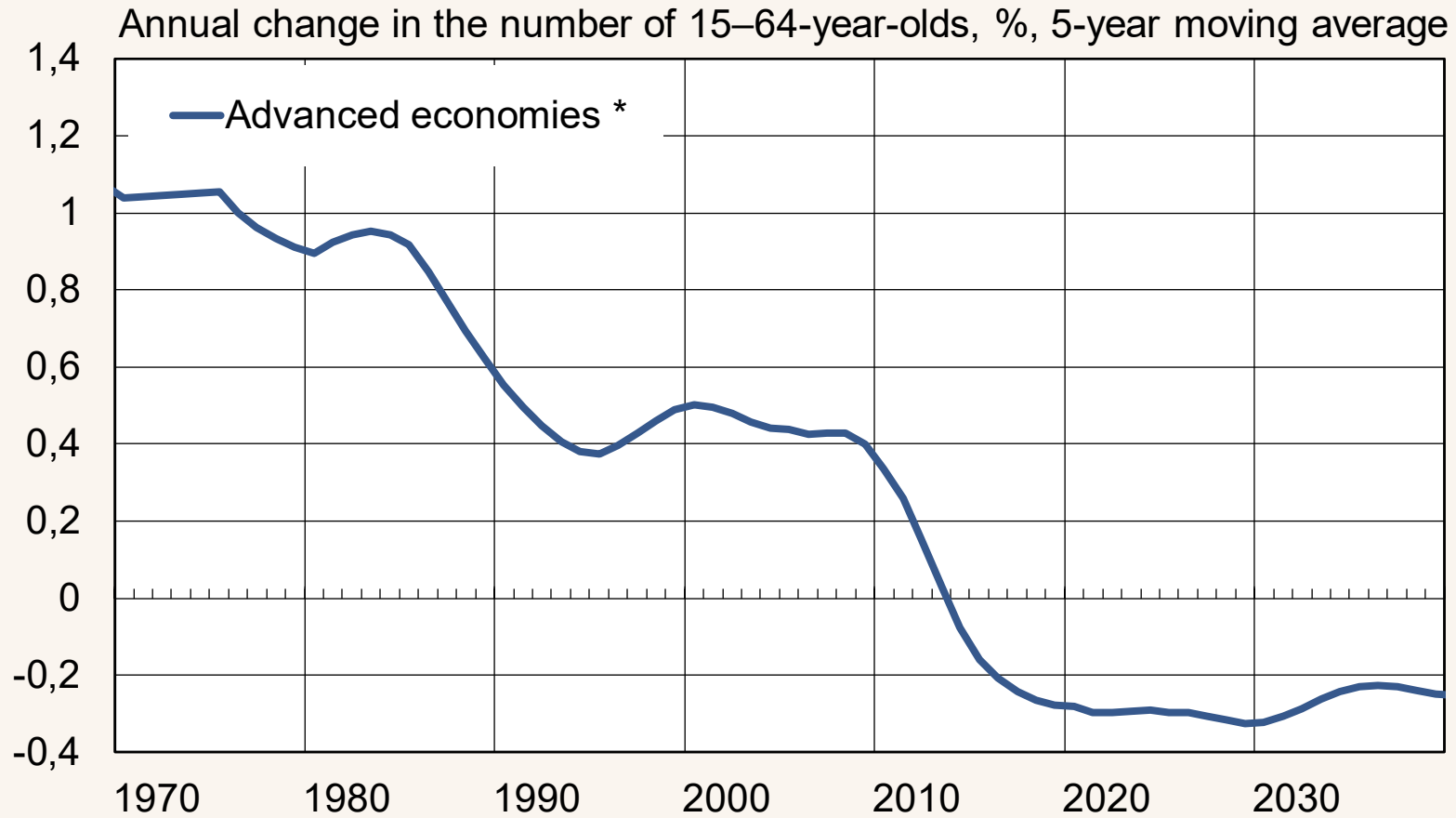
Sources: Eurostat and ECB.



On Some Structural Issues



1) Working age population declining in many industrialized countries



* Europe, North America, Australia, New Zealand and Japan.

Source: UN.

37019@pop3



2) Also labour productivity has been declining



* Output per hour worked.

Average of: US, UK, Japan, Germany, France, Finland.

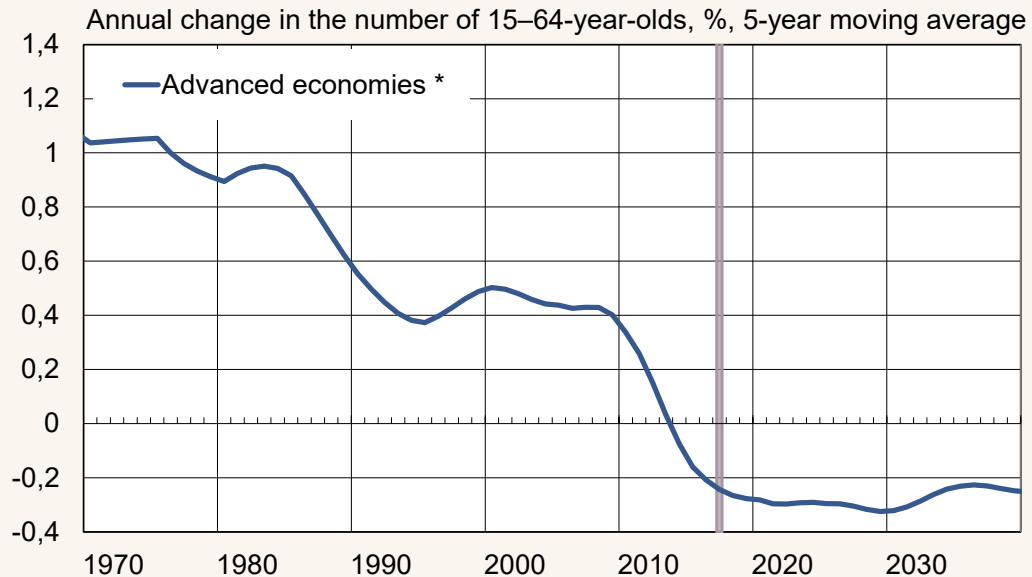
Source: Conference Board.

37019@pop4



1) + 2) = potential growth slower than it used to be

1



* Europe, North America, Australia, New Zealand and Japan.
Source: UN.

37019@pop3

2

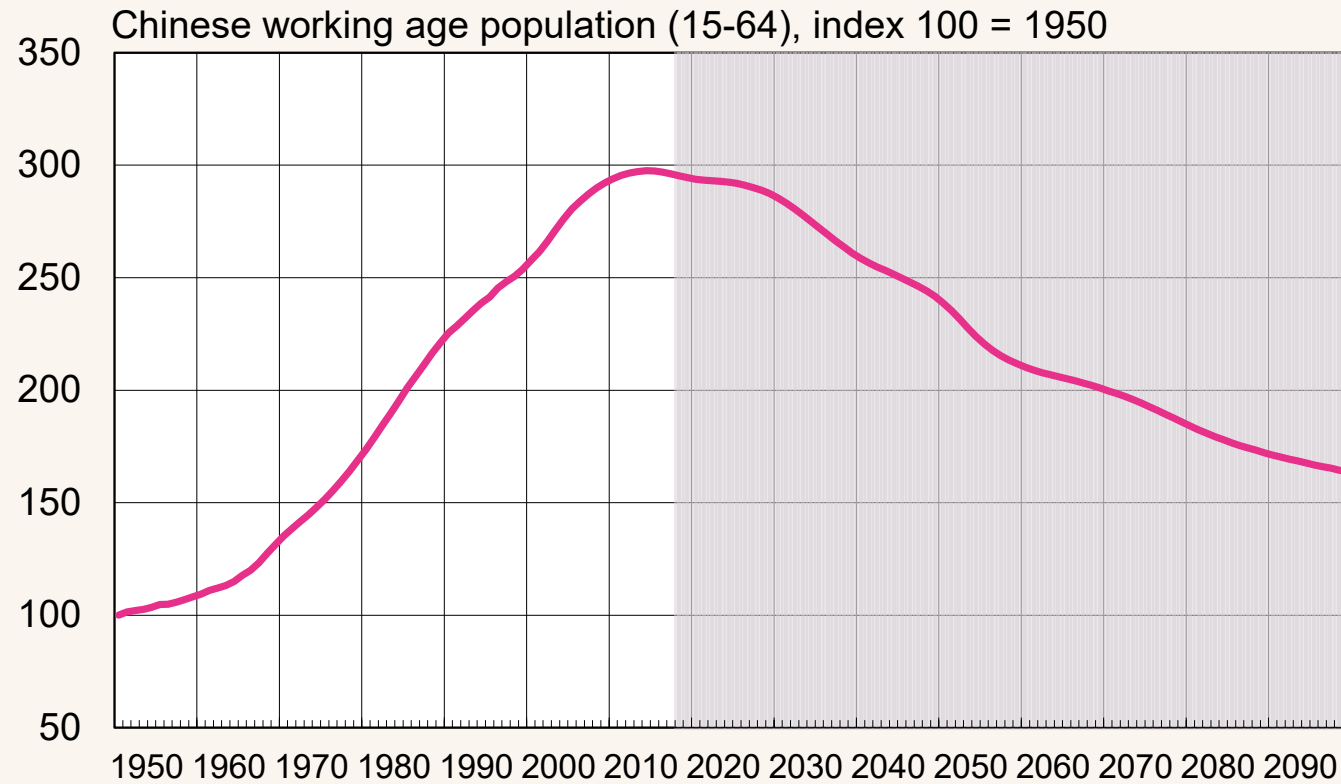


* Output per hour worked.
Average of: US, UK, Japan, Germany, France, Finland.
Source: Conference Board.

37019@pop4



Savings are still likely to grow globally: Growth rate of Chinese working age population



Source: UN.

37019@pop5



Lower potential output growth together with high saving rates have resulted in a secular decline in the real interest rates



* Nominal bond yield minus realized annual inflation rate.

Average of: US, UK, Japan, Germany, France, Finland.

Source: OECD, Macrobond.

37019@pop6



Furthermore, as price stability has been guiding monetary policy since the 1990s, nominal rates have declined even more rapidly



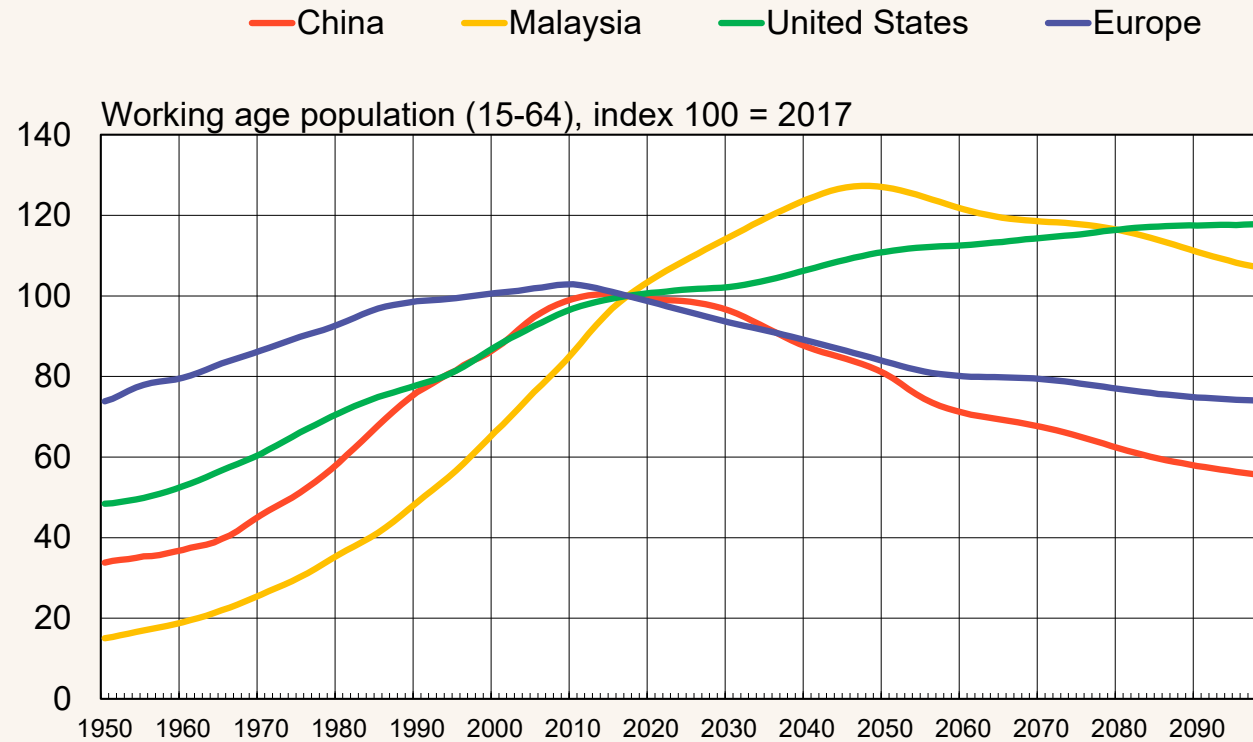


Based on the secular trends, ...

- *the natural rate of interest, i.e. the real rate that stabilizes economic growth and inflation is much lower than it used to be.*
- *nominal interest rates will be closer to zero than previously expected.*
- *non-standard monetary policy measures are like to be more standard in the future.*



A note of caution



Source: UN population projection.

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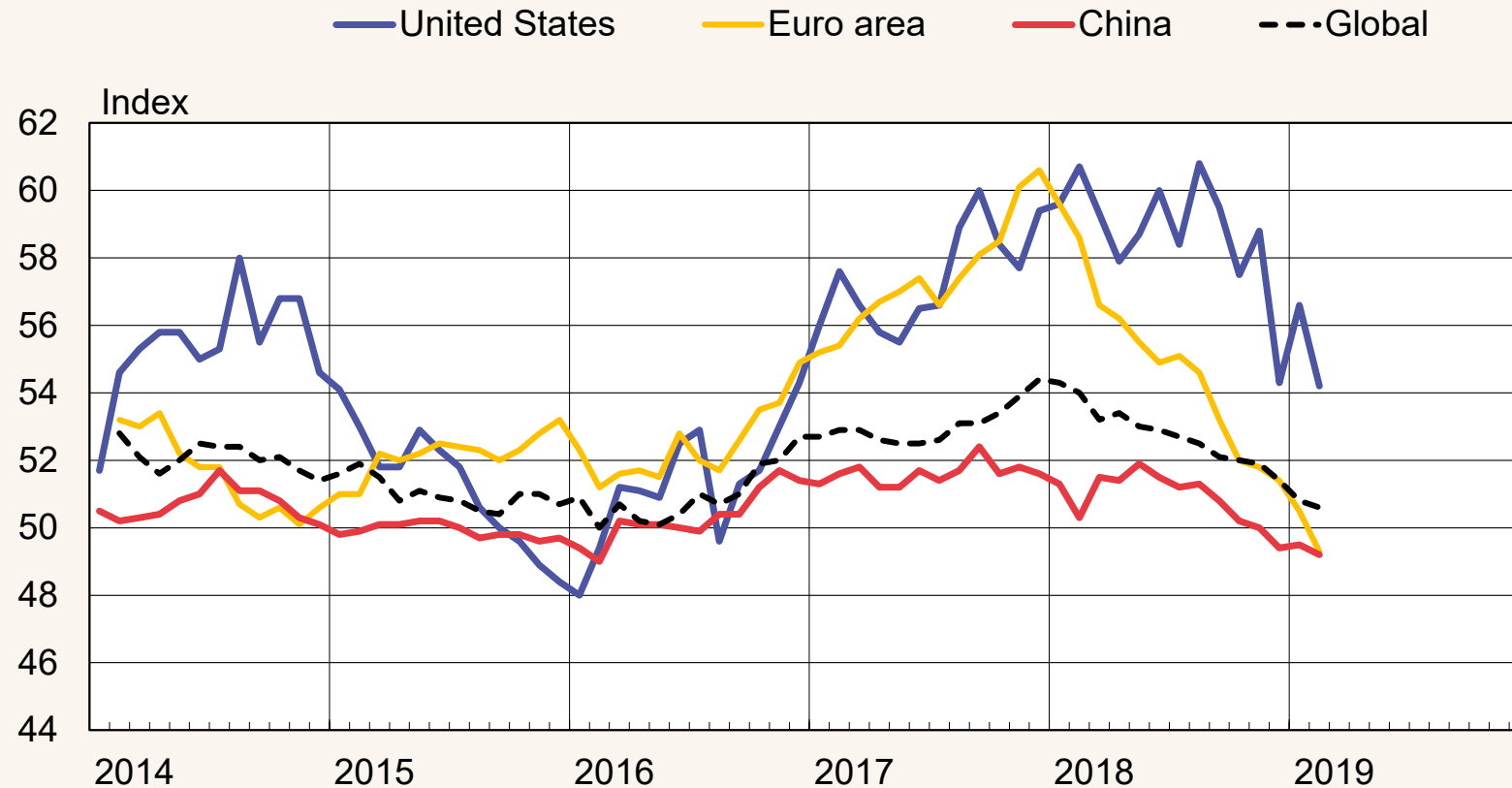


On the Current Economic Situation



Headwinds in the global economy...

Purchasing Managers' Index (manufacturing)



PMI Manufacturing.

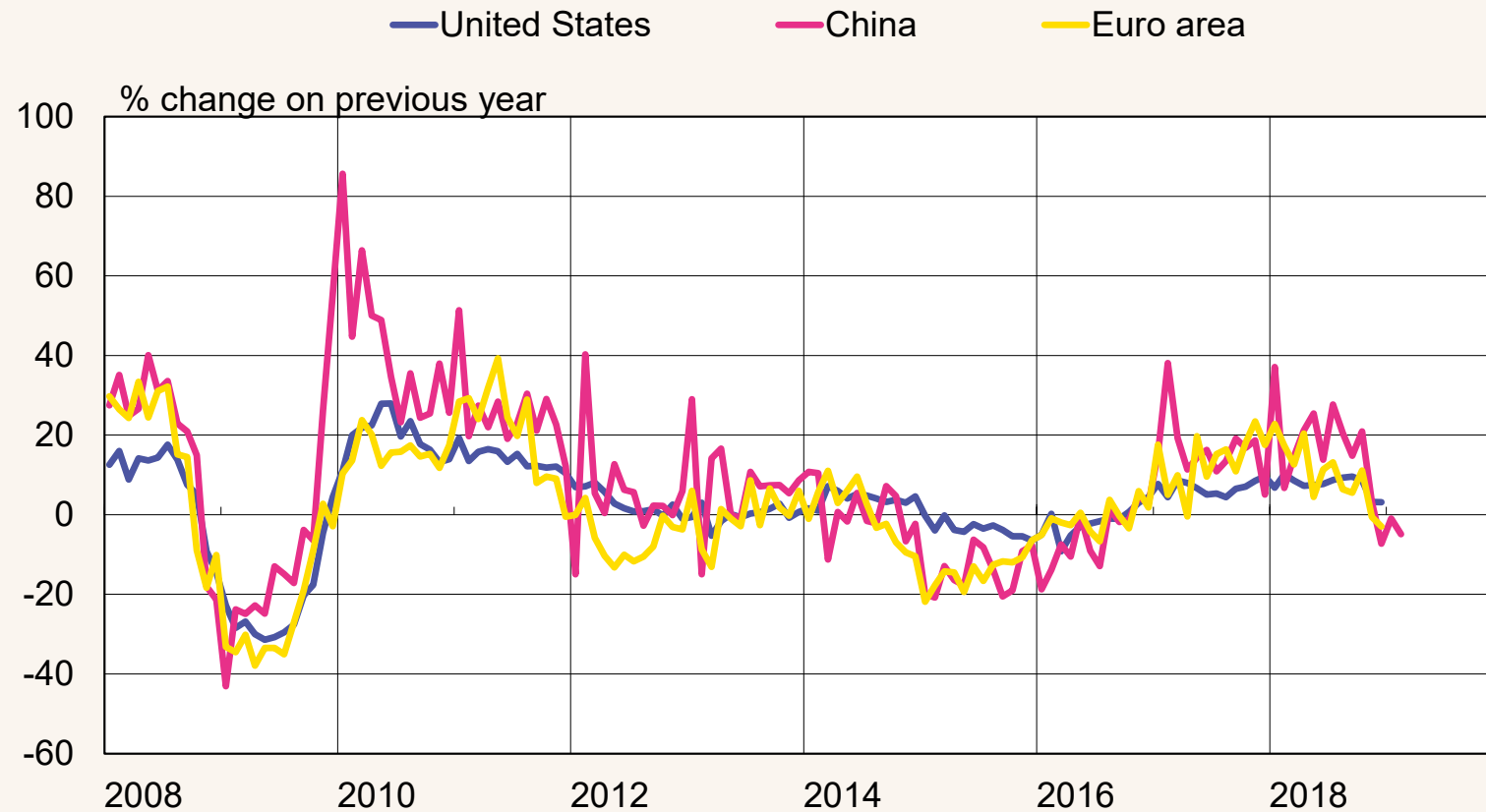
Sources: ISM and Markit.

Suomen Pankki – Finlands Bank – Bank of Finland



... are reflected in the global trade

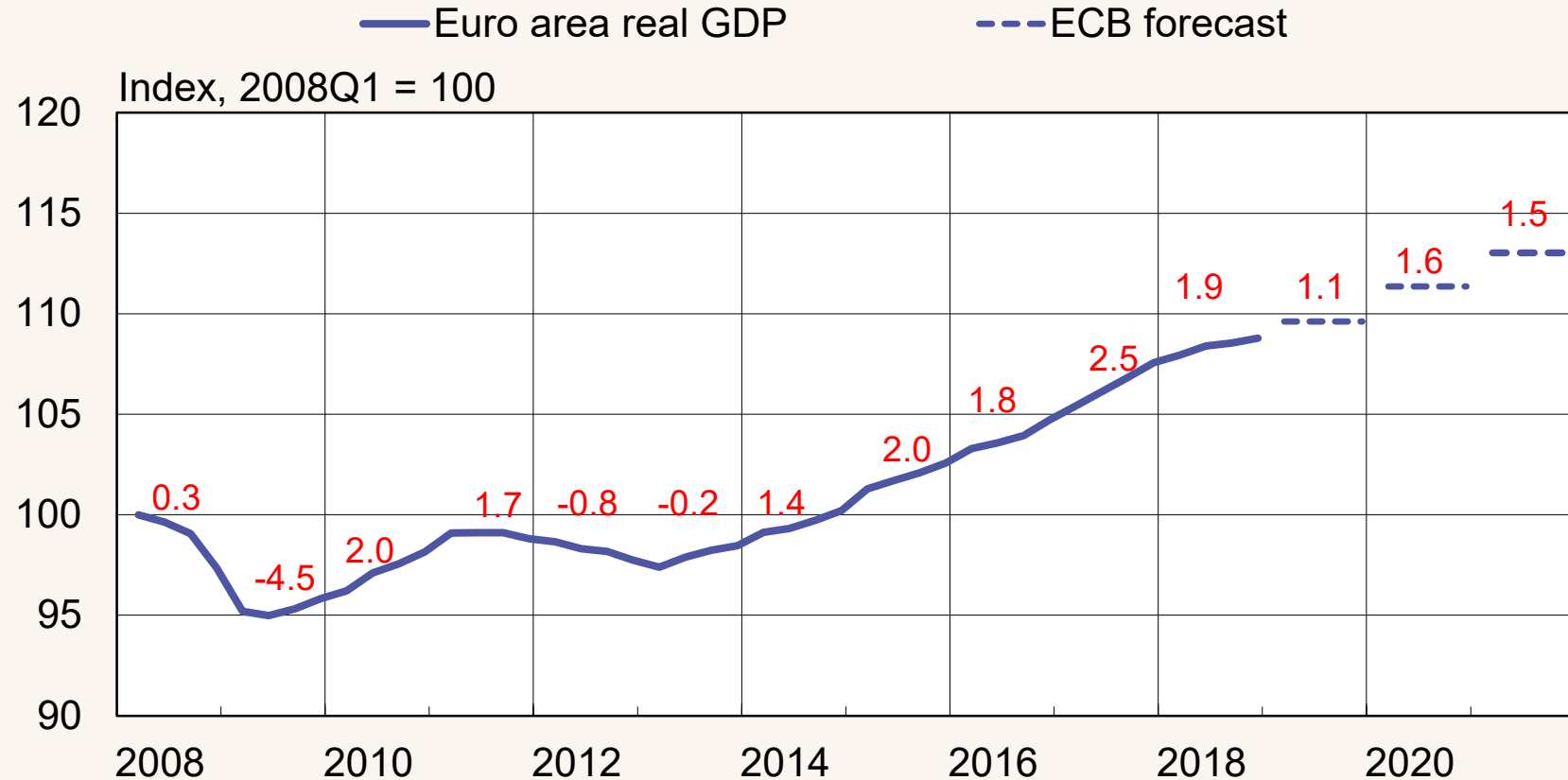
Imports in USD



Sources: National statistical authorities and Eurostat.



The euro area has been growing since 2013: lately growth has slowed down, but it's expected to accelerate again later this year



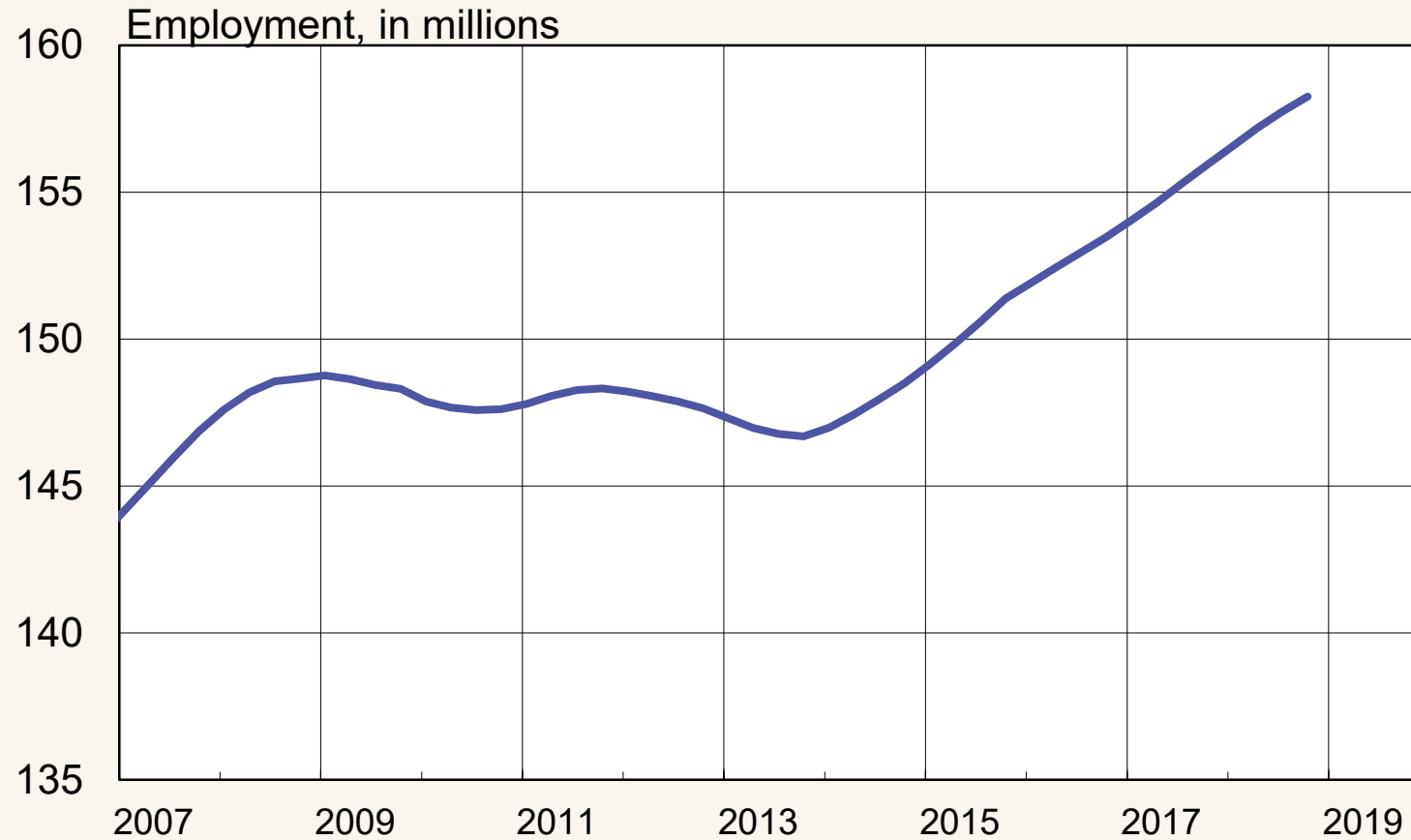
Figures next to the line are annual growth rates.

Sources: Eurostat and ECB.

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Euro area employment



Source: Eurostat, Macrobond.

37019@empl



Monetary Policy has helped to support Lending and Growth

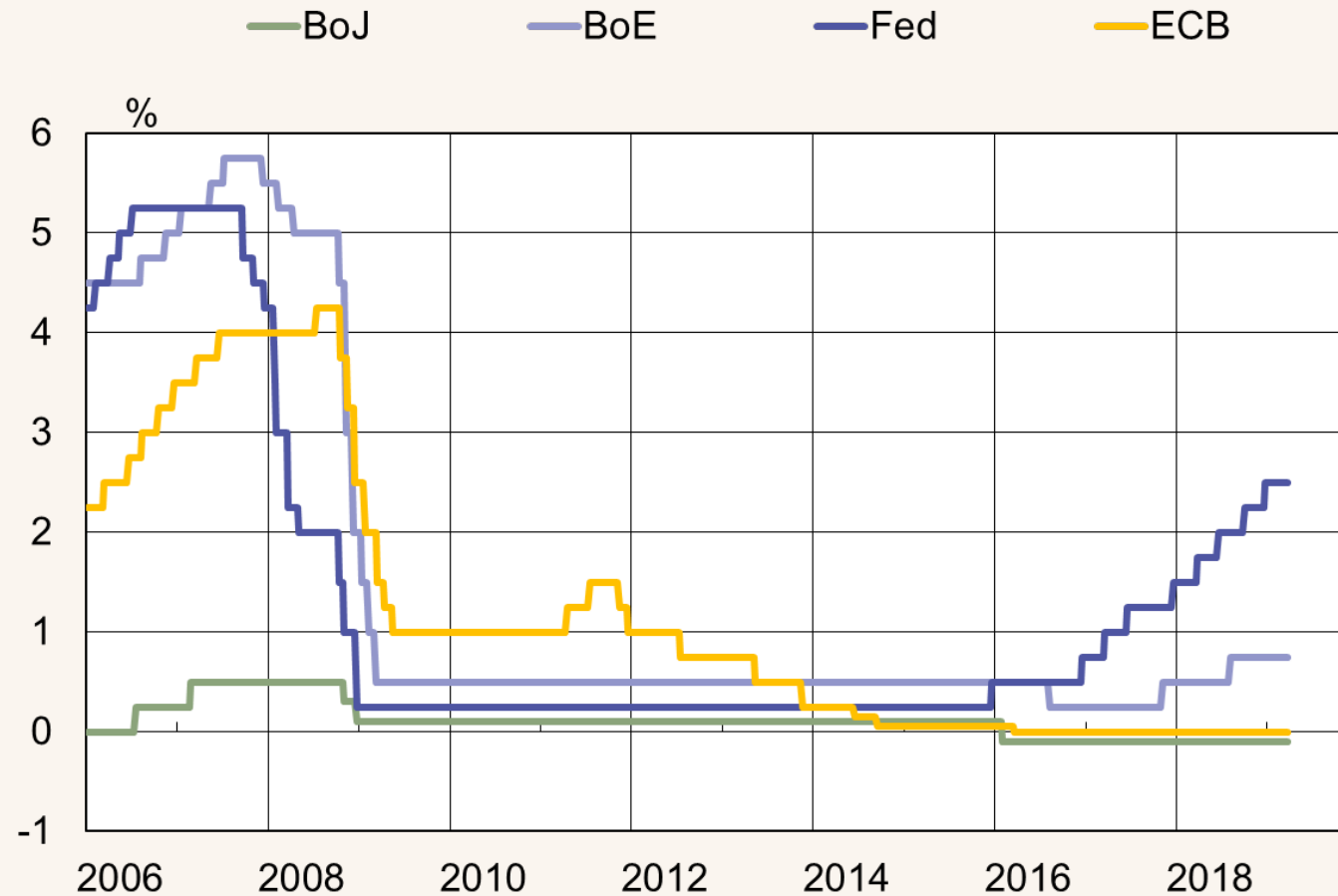


ECB monetary policy stance

- Key policy rates: lending rate 0.0%, deposit rate -0.4%
 - Rates are expected to be kept at current levels at least until the end of this year
- Net asset purchases discontinued at the end of 2018, but reinvestments will continue well past the first rate hike
- Quarterly Targeted Longer Term Lending Operations (TLTRO III) will restart in September and will be conducted until March 2021



Some international policy rates

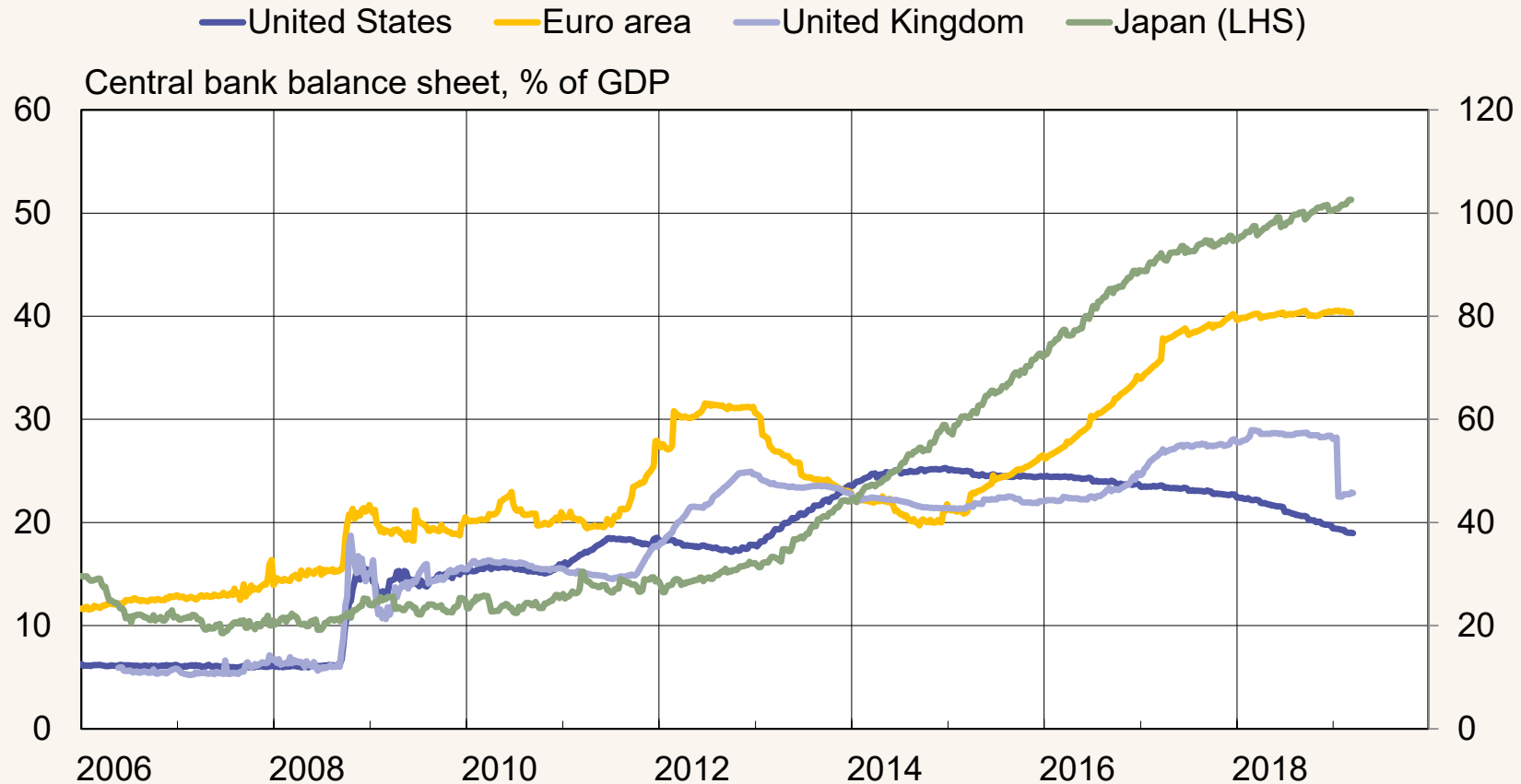


Source: Macrobond.

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Central bank balance sheets



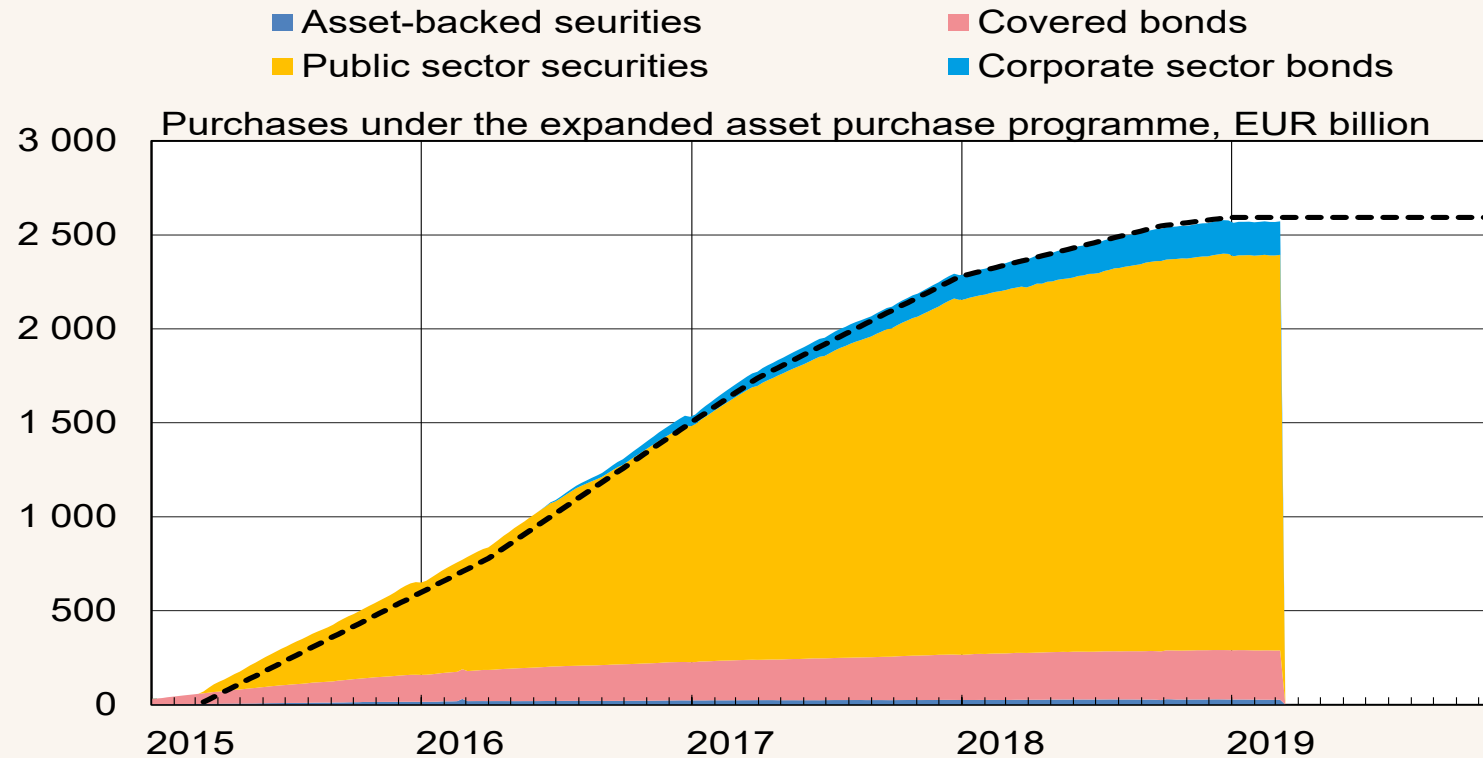
Drop in BoE balance sheet is due to amounts outstanding of central bank sterling loan to asset purchase facility.

Source: Macrobond.

37019@balance_GDP



Asset purchase programme – Eurosystem purchasing new securities with principal payments from maturing securities



Dashed line refers to the target level announced in June 2018.

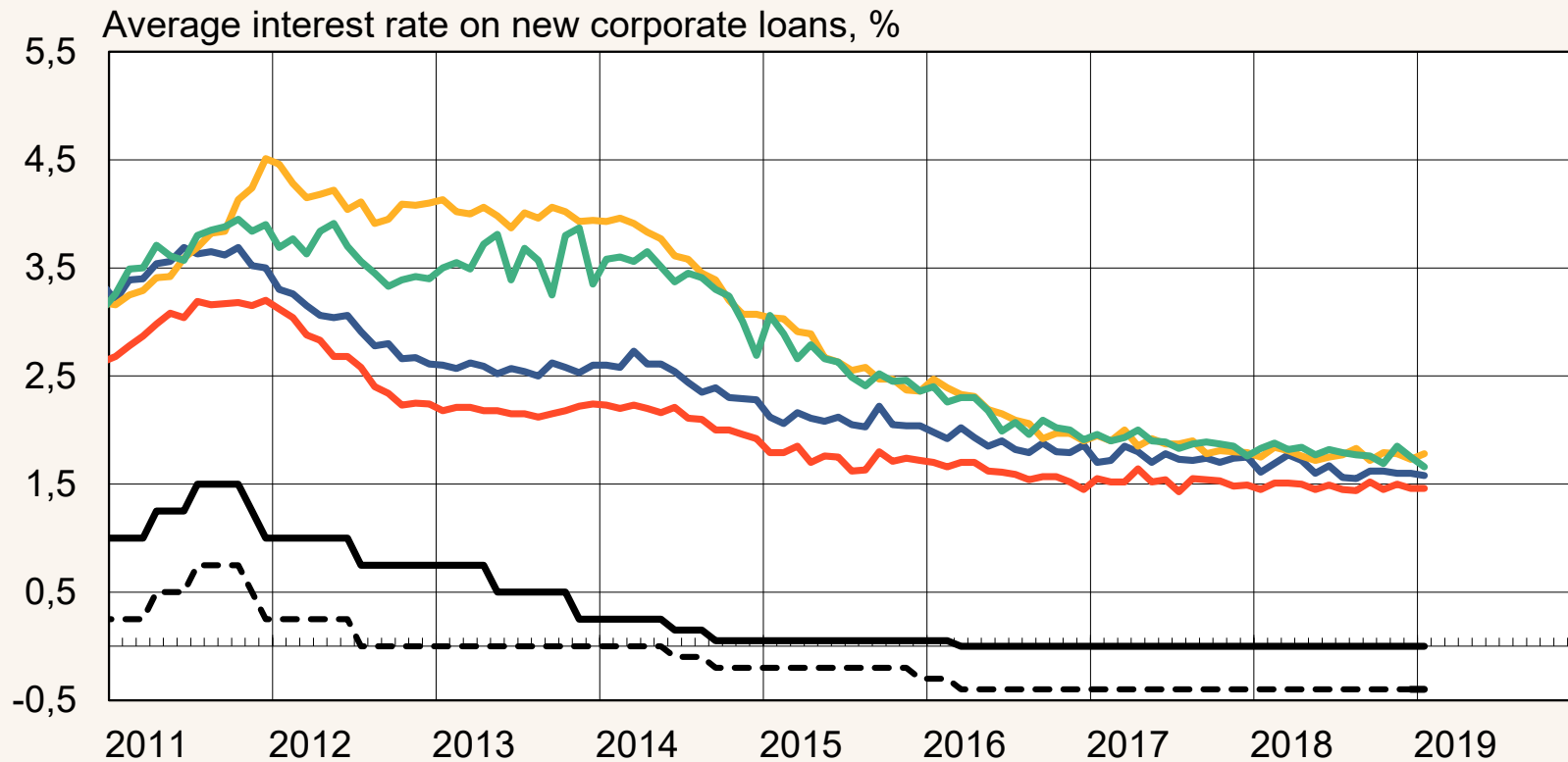
Source: ECB.

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Bank lending rates in some euro area countries

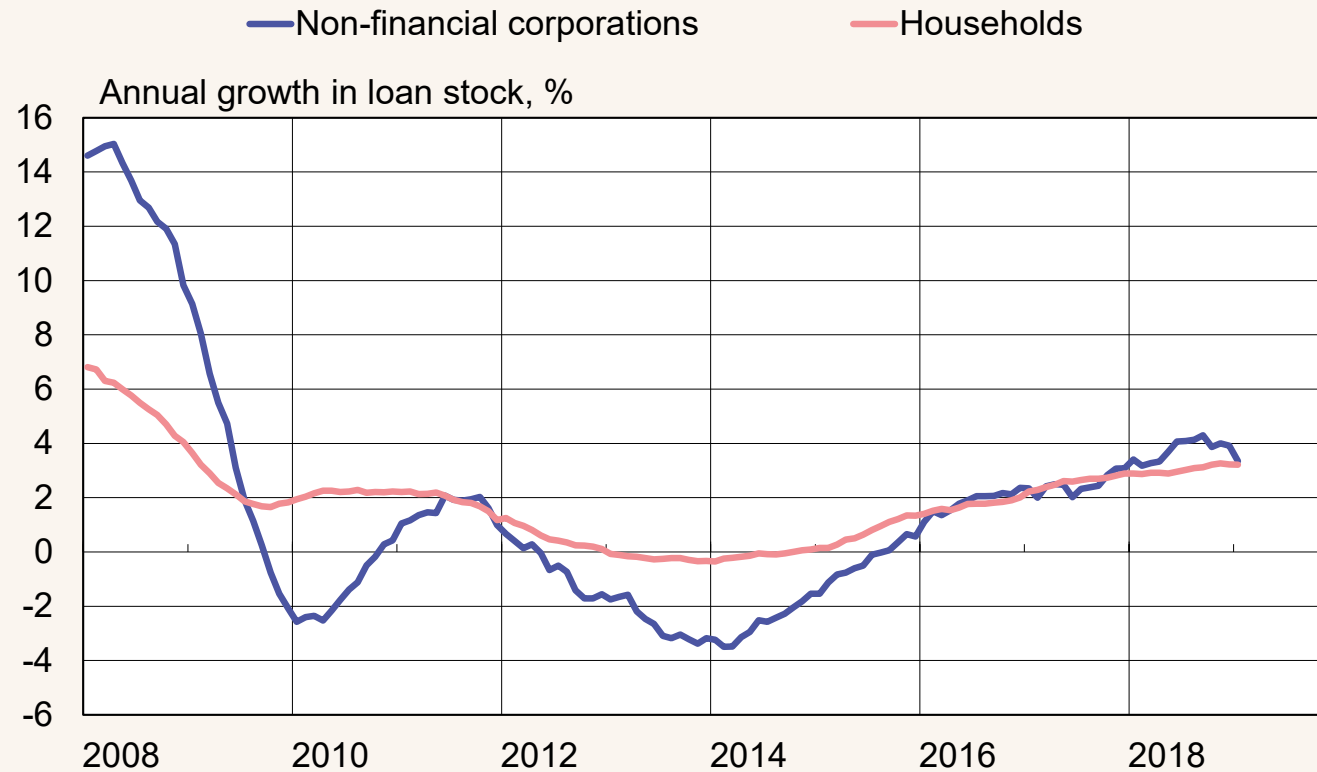
- Germany
- Italy
- Spain
- France
- ECB MRO interest rate
- ECB deposit rate



Sources: ECB.



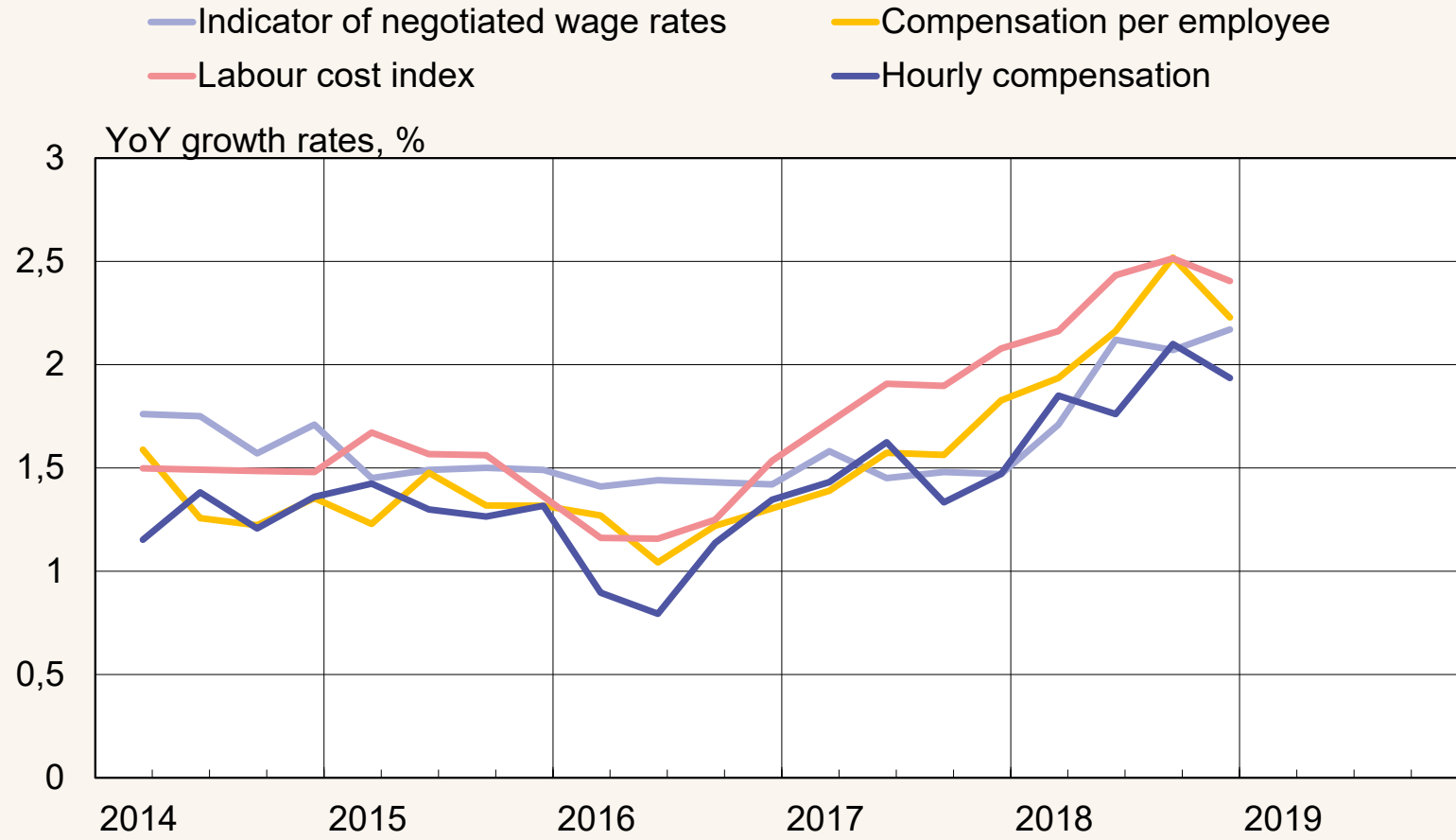
Growth of the loan stocks



Sources: ECB and Macrobond.
Adjusted for loan sales securitisation.
32423@lainakannat.en



Increase in wage inflation has not yet led to faster underlying inflation



Source: ECB.

32426@negowa

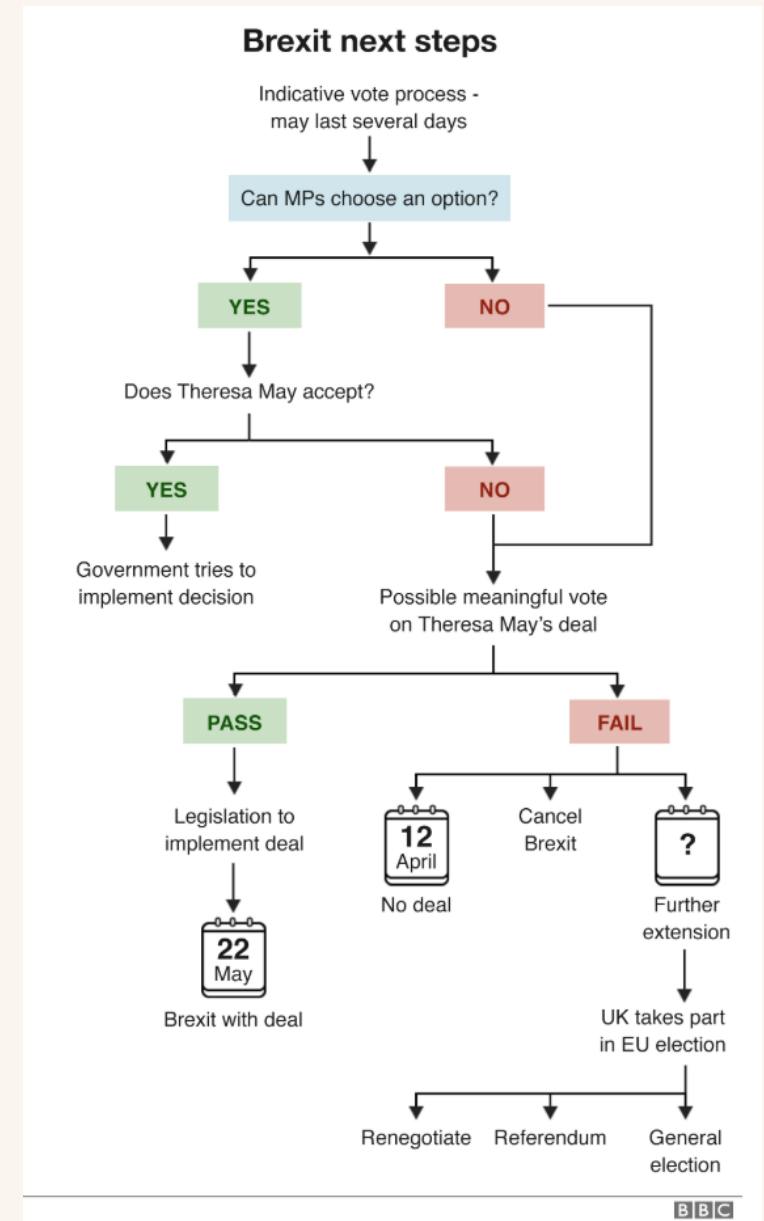


Global Trading System Under Stress



On Brexit?

- Brexit date postponed to 12 April 2019 (was initially 29 March)
- If British parliament passes Theresa May's Brexit deal, Brexit is delayed until 22 May
- In practice, all options are still possible: Brexit with a deal, Brexit with no deal, Brexit cancellation, further extension, new referendum, new general election..
- Prolonged uncertainty affects domestic demand, euro area exports to UK have decreased throughout 2018





Integration and disintegration of global trading system

- Further integration:
 - EU-Japan Free Trade Agreement into force in February 2019
 - Re-negotiated NAFTA, now United States-Mexico-Canada (USMCA) in the pipeline (hopefully)
- Disintegration:
 - US tariffs on Chinese goods, Chinese counter-tariffs, and threat of further tariffs – first round in July 2018, second in August 2018...
 - US tariffs on steel and aluminium imports (on “national security grounds” 25% tariff on steel and 10% tariff on aluminium; counter-tariffs e.g. from China and the EU)
 - Threat of US tariffs on e.g. EU auto imports



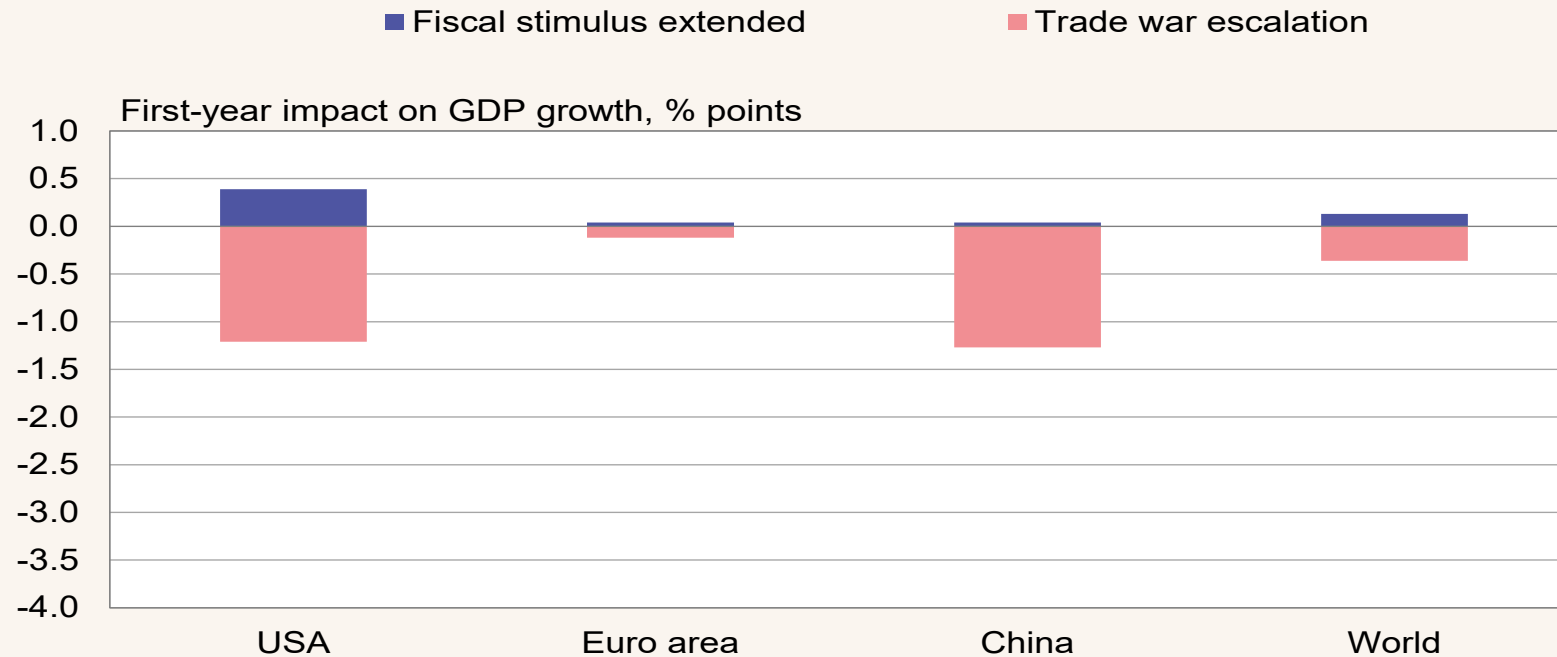
Global impact of the escalation of US fiscal and trade policy: Alternative calculations from Bank of Finland

■ Scenarios

1. United States extends its fiscal stimulus measures
2. United States imposes further tariffs
3. Financial conditions tighten in emerging economies
4. Financial shock expands to global scale



United States extends its fiscal stimulus measures (scenario 1) and imposes further tariffs (scenario 2)

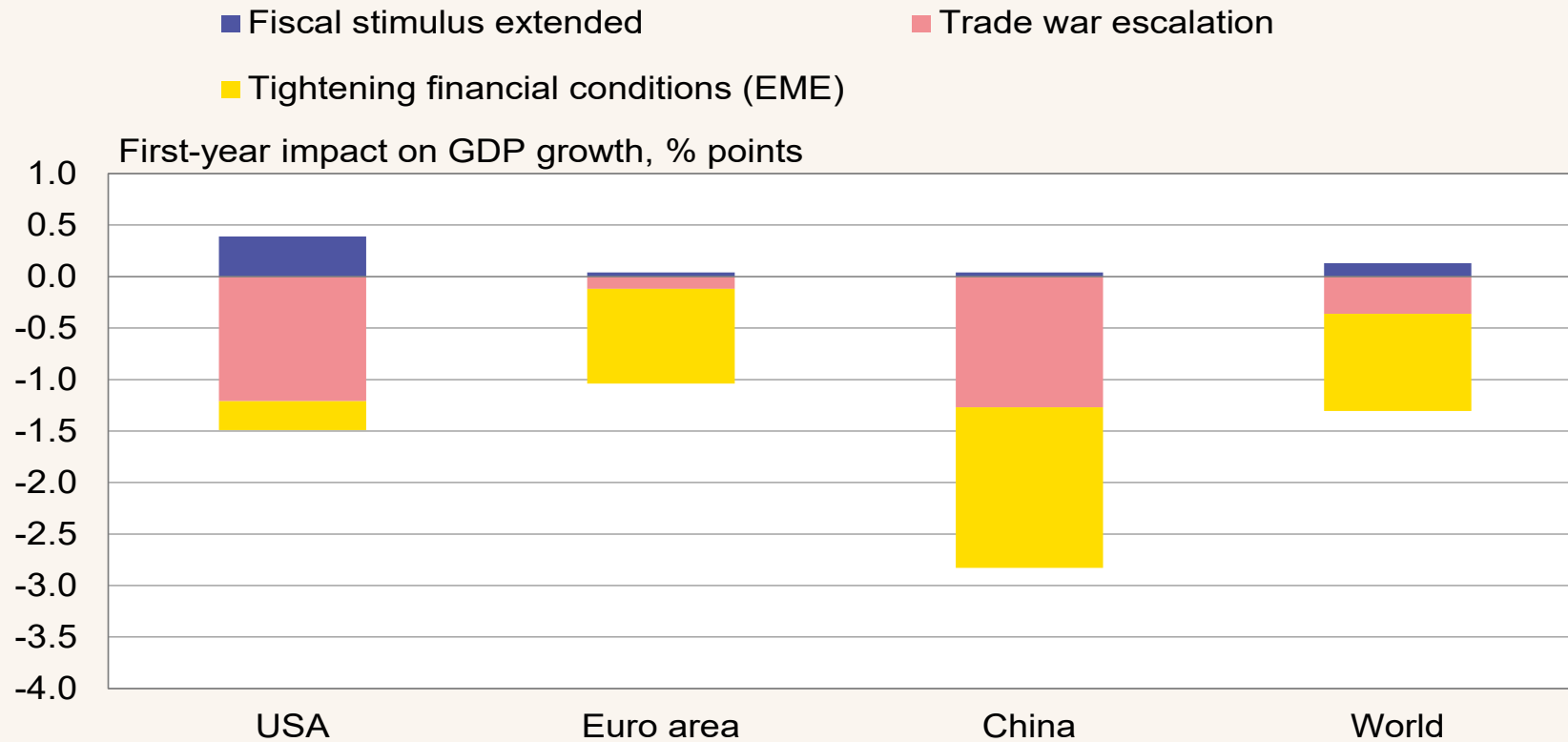


Source: Bank of Finland calculations.

eurojatalous.fi / bofbulletin.fi
15.3.2019



Financial conditions tighten in emerging economies (scenario 3)



Source: Bank of Finland calculations.

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15.3.2019



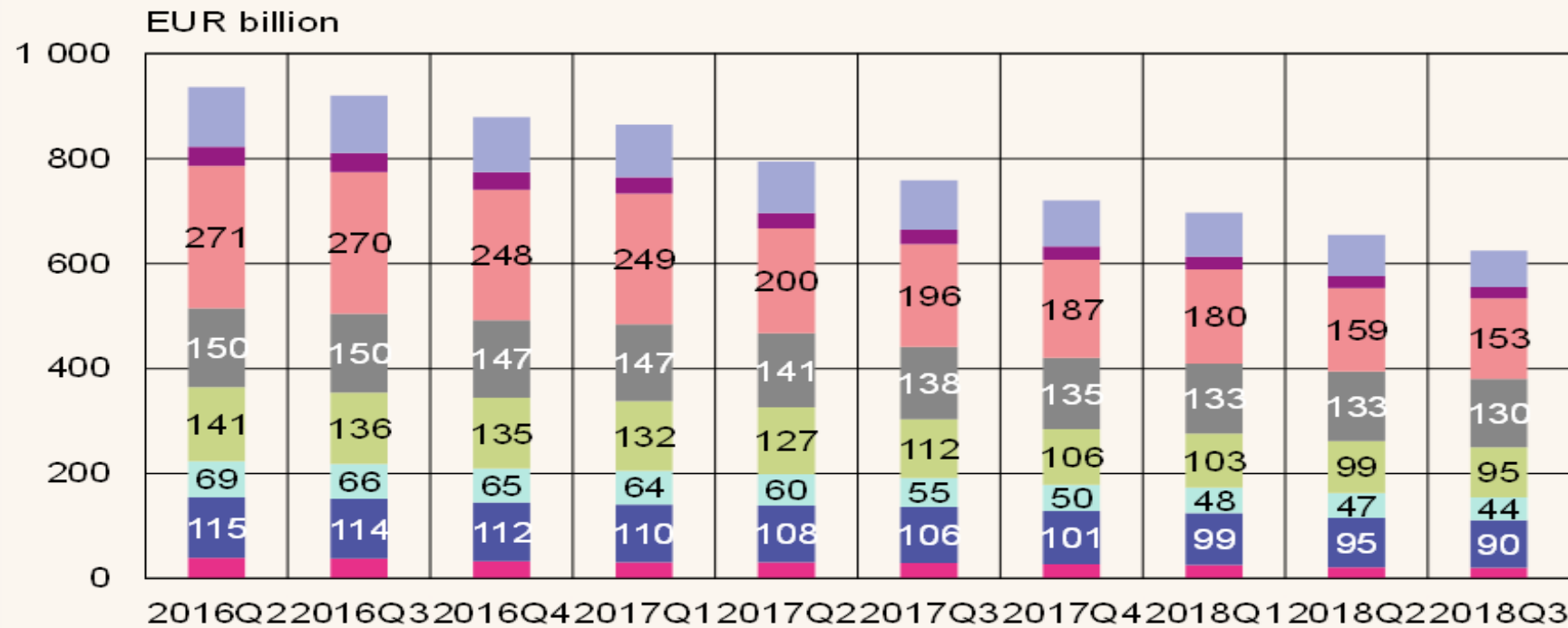
Thank you!



Banking sector recovering all over Europe, albeit challenges remain

Amount of non-performing loans in large banks in selected countries

■ IE ■ GR ■ DE ■ ES ■ FR ■ IT ■ PT ■ Other euro



Source: SSM.

32410@NPL per country (en)