

SUOMEN PANKKI
EUROJÄRJESTELMÄ



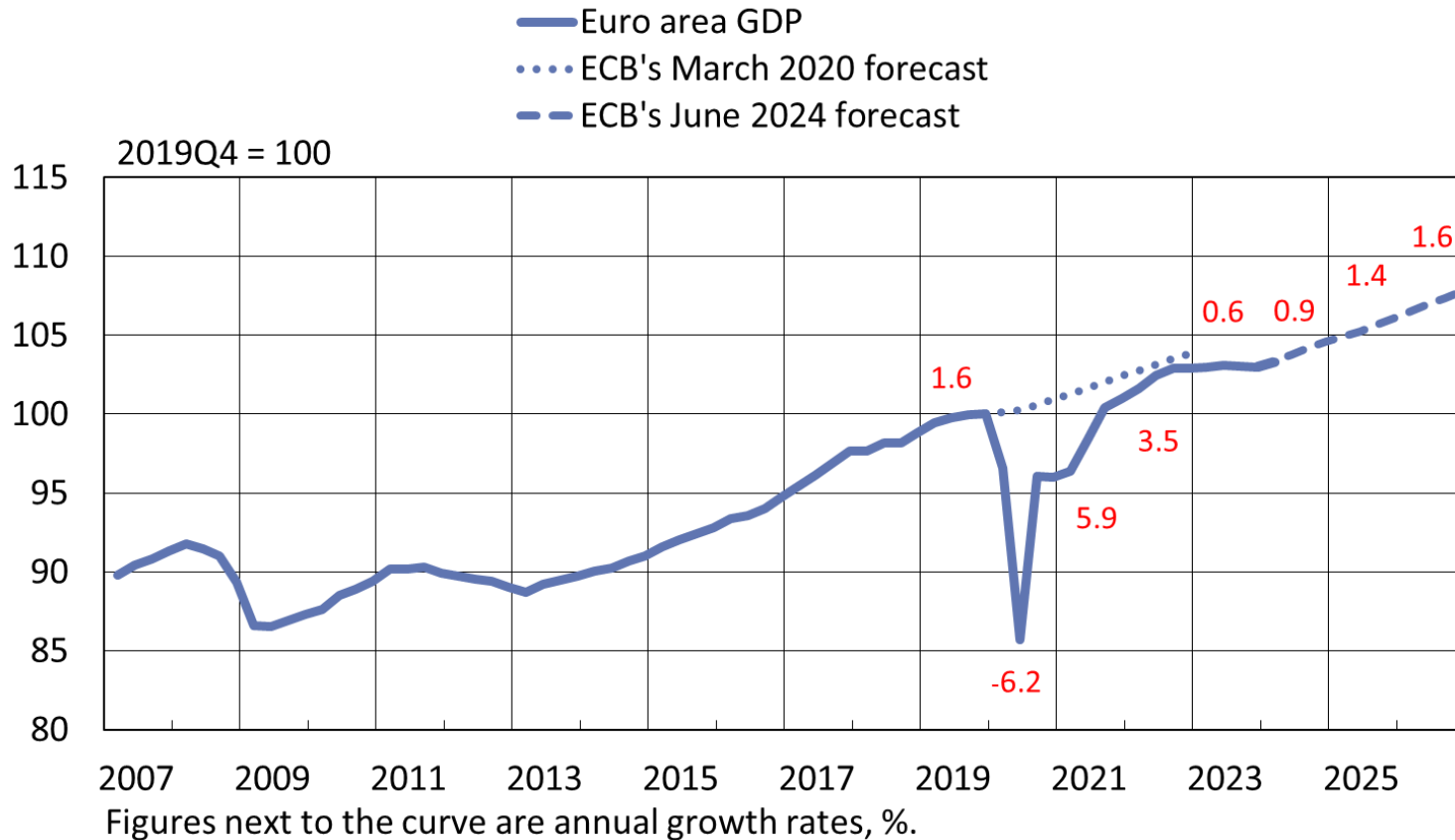
FINLANDS BANK
EUROSYSTEMET

The European and Finnish Economies: Pursuing Growth in the Shadow of Geopolitical Challenges

EACCNY & Consulate General of Finland
New York, 19 August 2024

Governor Olli Rehn
Bank of Finland

Euro area GDP growth is projected to gradually pick up

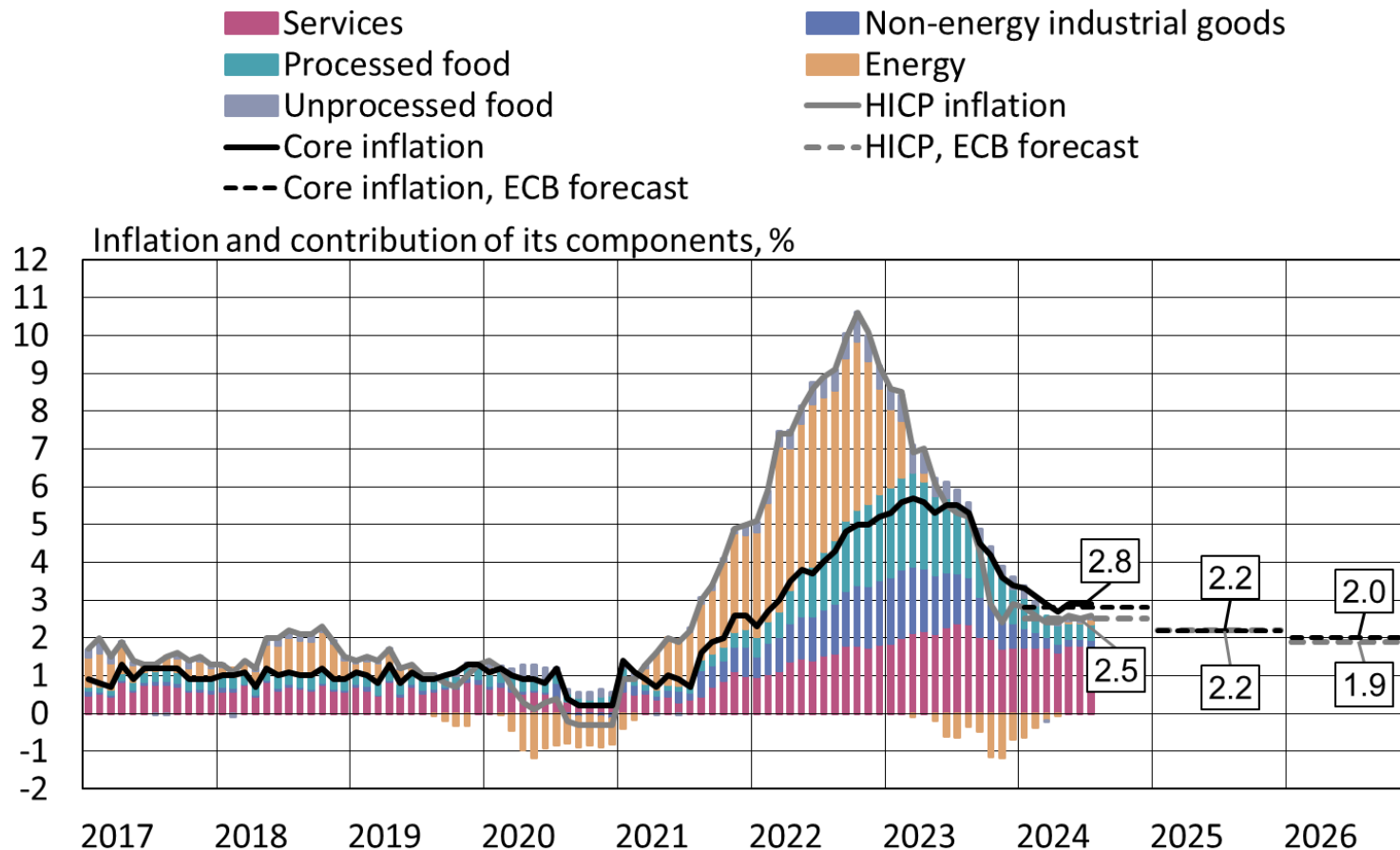


Sources: Eurostat and ECB.

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- In the ECB's June forecast, growth is accelerating to 1.4% in 2025 and to 1.6% in 2026.
- The rise in household real incomes is supporting private consumption.
- Demand for euro area exports is also projected to strengthen going forward.

Euro area inflation has been slowing – but still a bumpy road ahead for stabilising inflation at the 2% target



Sources: Eurostat and ECB.

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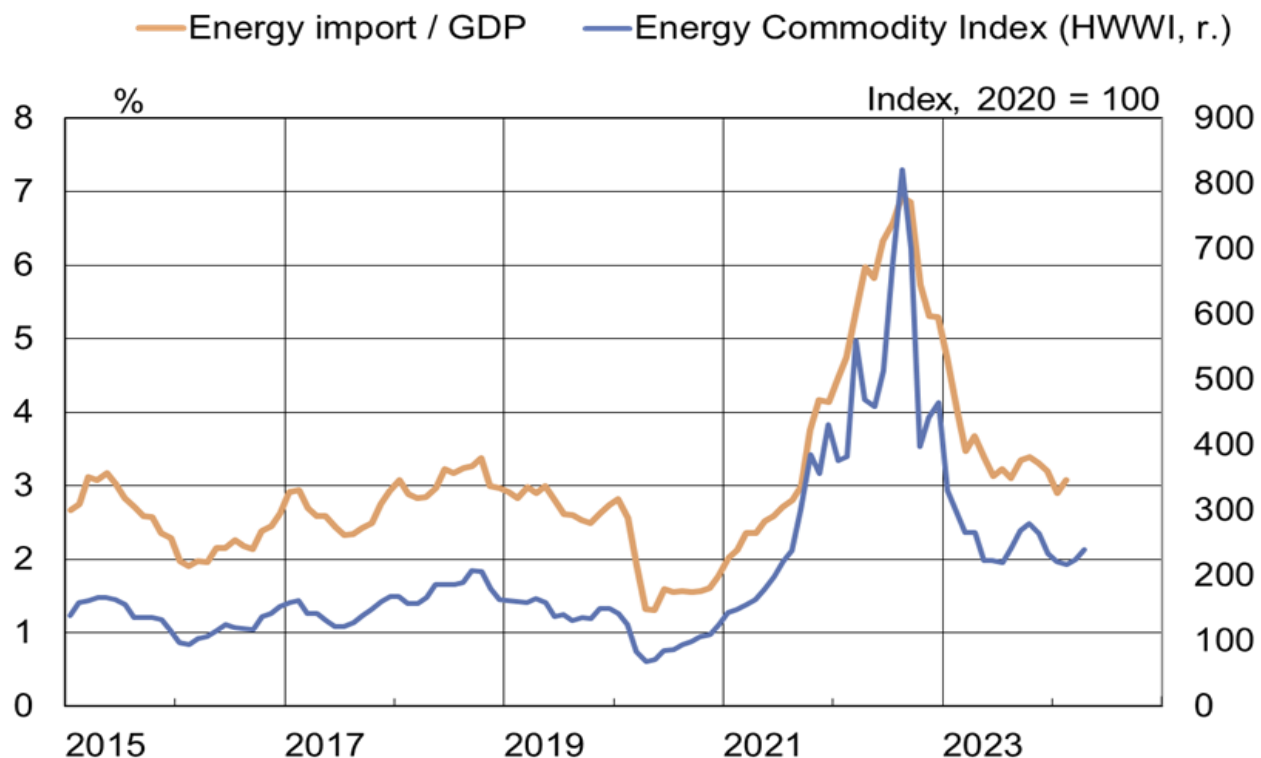
Monetary policy tightening has anchored euro area inflation expectations at around 2%



* Market expectations derived from inflation swaps. SPF = ECB survey of professional forecasters.
Sources: ECB, Bloomberg and calculations by the Bank of Finland. 32426@odotusSPF(en)

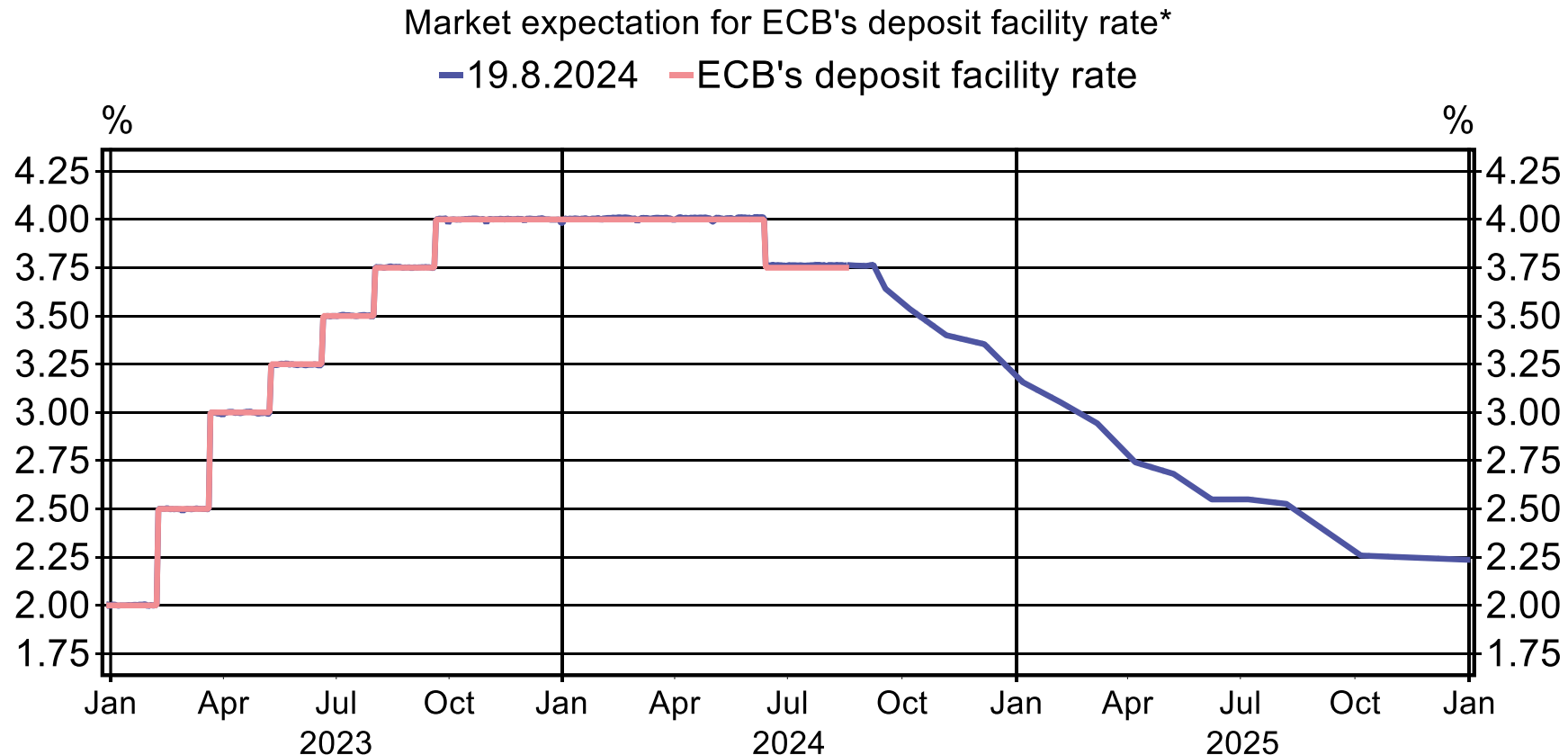
- Euro area medium-term inflation expectations are firmly anchored close to the ECB's 2% target.
- Consistent tightening of monetary policy in 2022-23 was critical to anchor inflation expectations.

Rapid rise of the energy imports bill and its subsequent stabilisation: energy imports as proportion of GDP in the euro area, 2015-2023



Source: Eurostat, ECB, Hamburg Institute of International Economics (HWWI) and Macrobond.
34020@energiatuonti_EA

Market expectations on the ECB policy rate going forward



Source: ECB, Bloomberg.

*Bank of Finland's calculations based on €STR OIS rates and an assumption of constant 10 bps spread between ECB's deposit rate and €STR.

Reflections on the ECB's next strategy review in 2025

- No need to change the symmetric inflation target of 2% over the medium term
- BUT need a better understanding of the inflation dynamics of recent years and of the secular trends affecting monetary policy going forward, for instance:
 1. Geopolitics and fragmentation: increasing supply shocks & inflation volatility? Analyse both **supply** and **demand** shocks
 2. Contradictory tendencies in the long-term real natural rate of interest
 3. Labour markets in transition: rise in the employment rate and immigration; a secular decline in labour productivity growth

What have we learnt about euro area productivity growth?

Secular decline in labour productivity growth

- Secular decline driven by declining contribution of TFP growth and weak capital deepening
- Climate policies with a negative TFP impact over the short to medium term
- Recent shocks (COVID, energy, bottlenecks) with negative TFP impact

Why is growth in total factor productivity declining? Lack of innovation and diffusion of new technologies

- Decline in innovative edge of manufacturing frontier firms; and manufacturing is a fundamental driver of aggregate productivity growth in the EU
- Increase in gap with the US in AI-related innovation
- Slow diffusion of new technologies to laggards
- Positive impact of digital tools only in few top firms

Some positive news over the medium term

- New wave of innovation in green technologies with possible positive impacts over the long term
- Faster diffusion of genAI than previous digital technologies
- Some of the required complementary investments and skills foreseen under NextGenEU

What is needed?

- Speedy implementation of Recovery and Resilience Plans
- Leverage of EU competitive advantages – green technologies; educated workforce
- Complete single market: we need scale!
- Facilitate access to finance, also for small firms (CMU)
- Support laggards to capitalise on existing new digital and green technologies

Source: Adapted from ECB

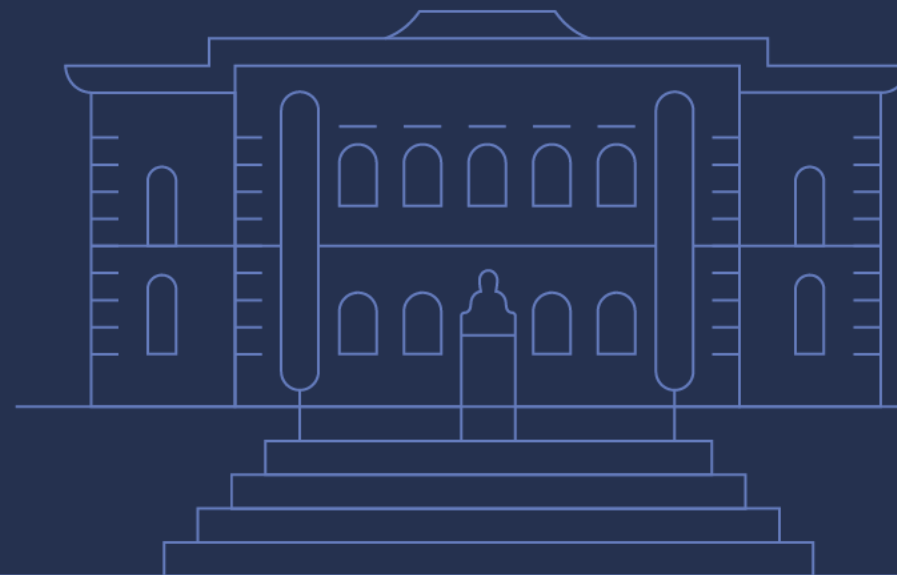
Conclusions

- Many crucial issues for Europe are at stake now – and they also matter to the United States, our closest partner and ally:
 1. European and Western unity is essential in the face of Russia's threat – support for Ukraine must be unwavering. We need to work on several fronts for international security and the NATO's capacities and cohesion.
 2. Reinforcing Europe's productivity growth and industrial competitiveness is of paramount importance. The EU and its member states must focus on improving the business environment, enhancing the diffusion of new technologies, and investing in cutting-edge research and innovation.
 3. Maintaining price and financial stability is the central banks' principal contribution for sustainable productivity growth and high employment.



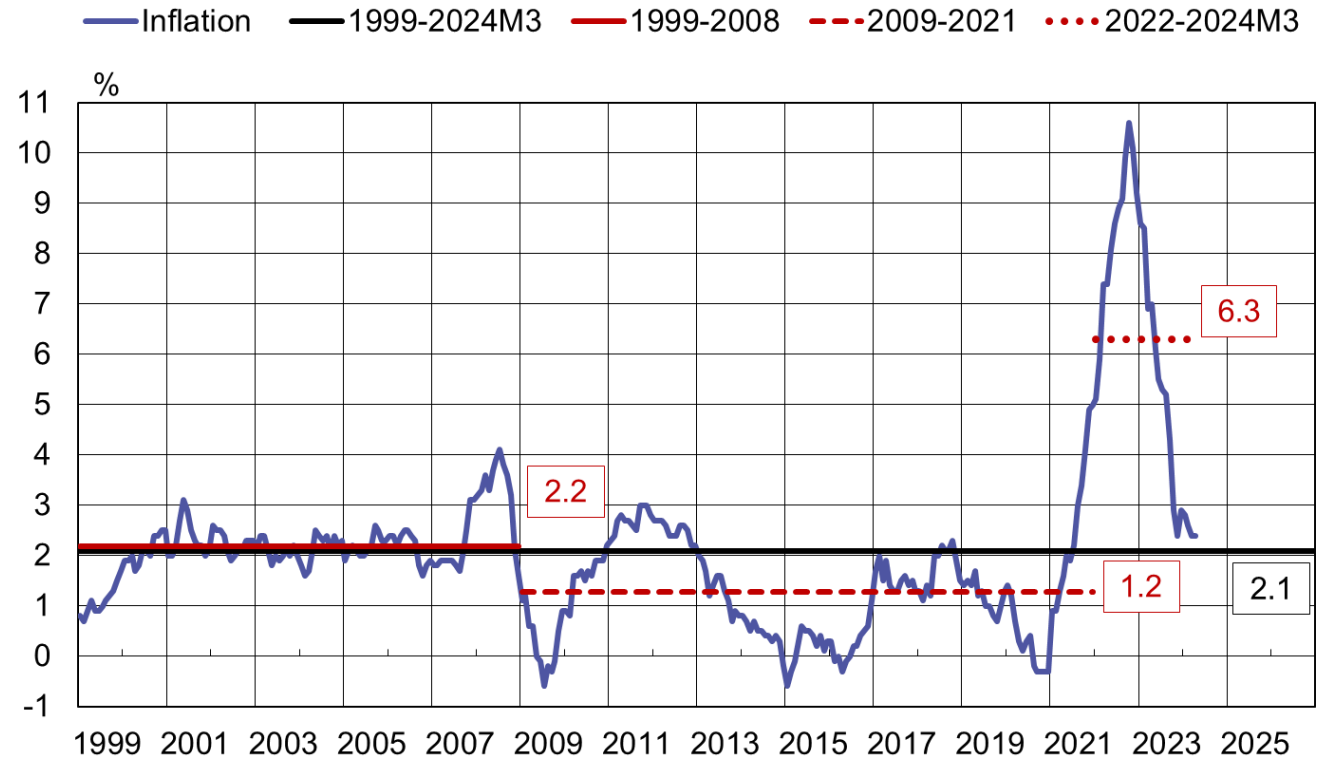
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Securing stability,
based on research.



Thank you!

Three periods of inflation in the euro area, 1999-2024

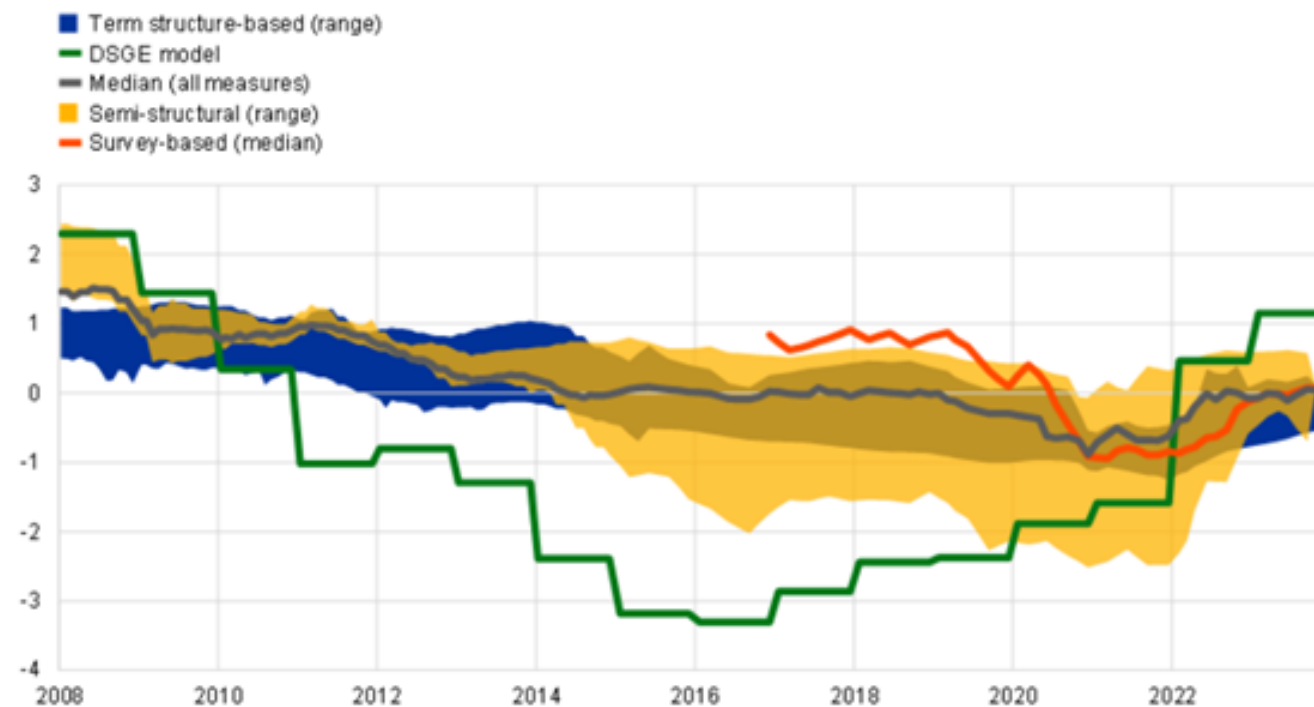


Source: Eurostat.
32426@HICP+averages

The natural interest rate is a necessary analytical framework but not a concrete policy-making tool

Real natural rates of interest in the euro area

(percentages per annum)



Sources: Eurosystem estimates, ECB calculations, Federal Reserve Bank of New York and Consensus Economics.

See ECB Bulletin 1/2024