

SUOMEN PANKKI
EUROJÄRJESTELMÄ



FINLANDS BANK
EUROSYSTEMET

Europe in Search of Growth and Productivity in the Shadow of Geopolitics

Peterson Institute for International Economics
Washington D.C, 22 October 2024

SUOMEN PANKKI

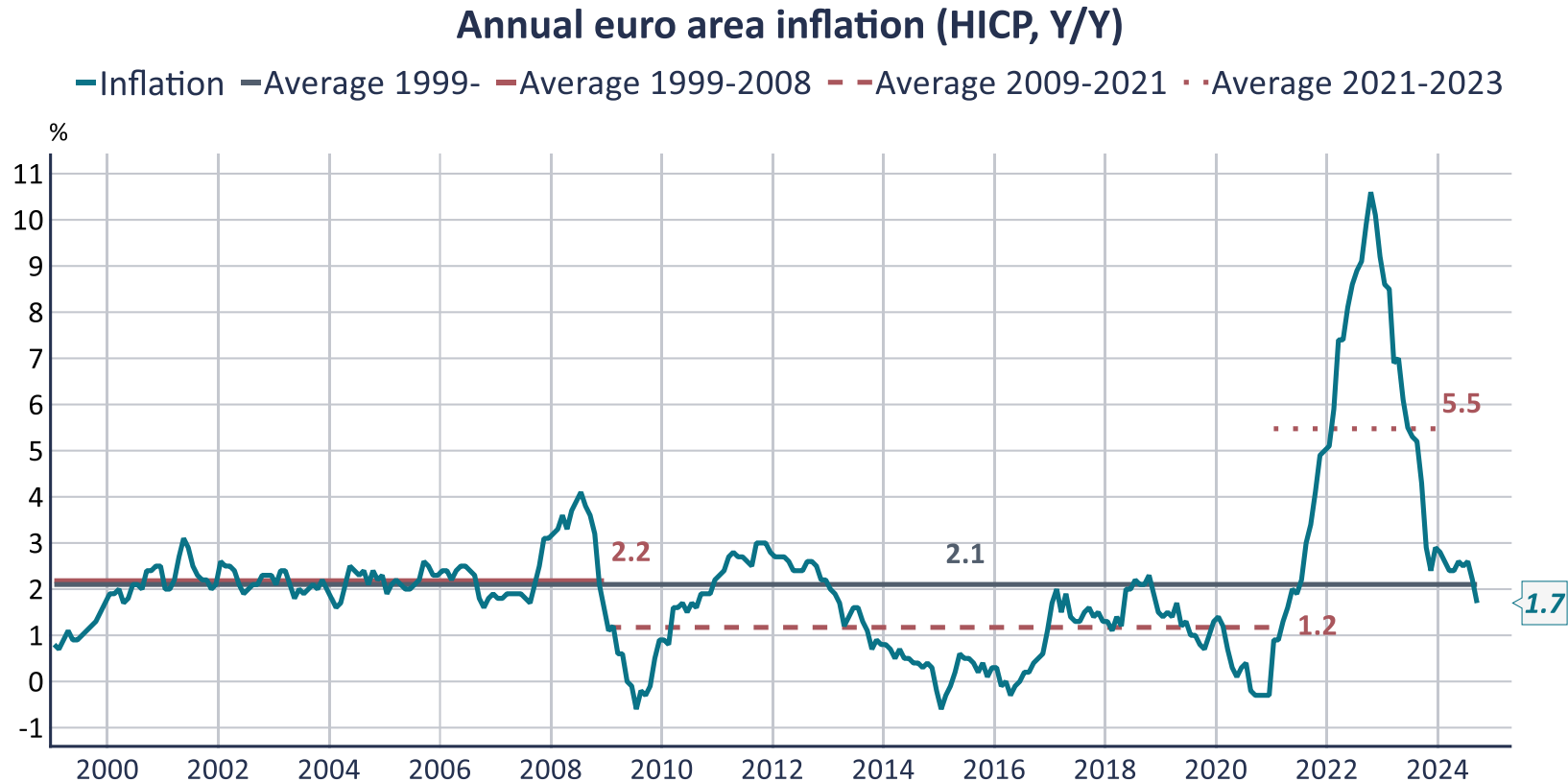
Governor Olli Rehn
Bank of Finland

ANDS BANK

Roadmap of today's talk

- 1. The ECB's monetary policy:** overview and our experience with the current monetary policy strategy
- 2. The rise in geopolitical tensions:** impact on the ECB's ongoing monetary policy strategy review
- 3. Europe's weak productivity growth:** implications for monetary policy and potential solutions

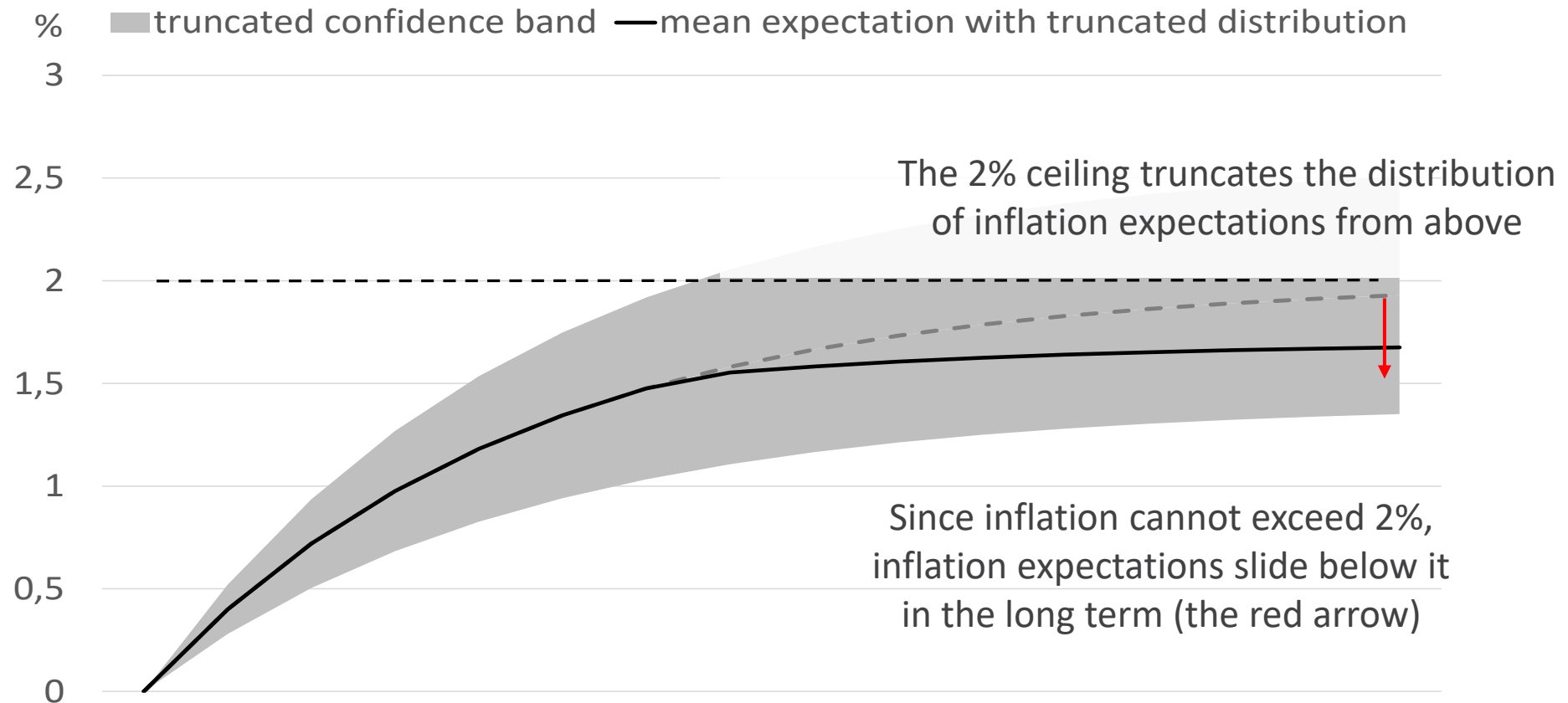
Three periods of euro area inflation, 1999-2024



Source: Eurostat. Last observation: 9.2024

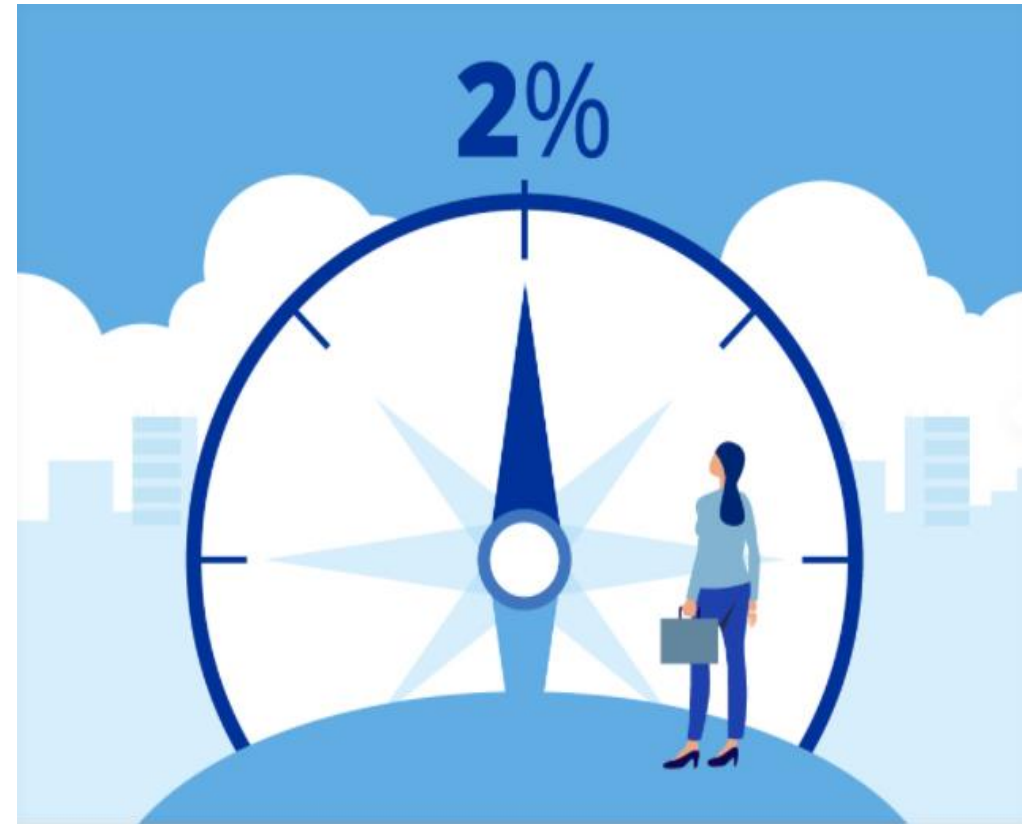
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The perceived de facto ceiling under the old target pushed inflation expectations clearly below 2%

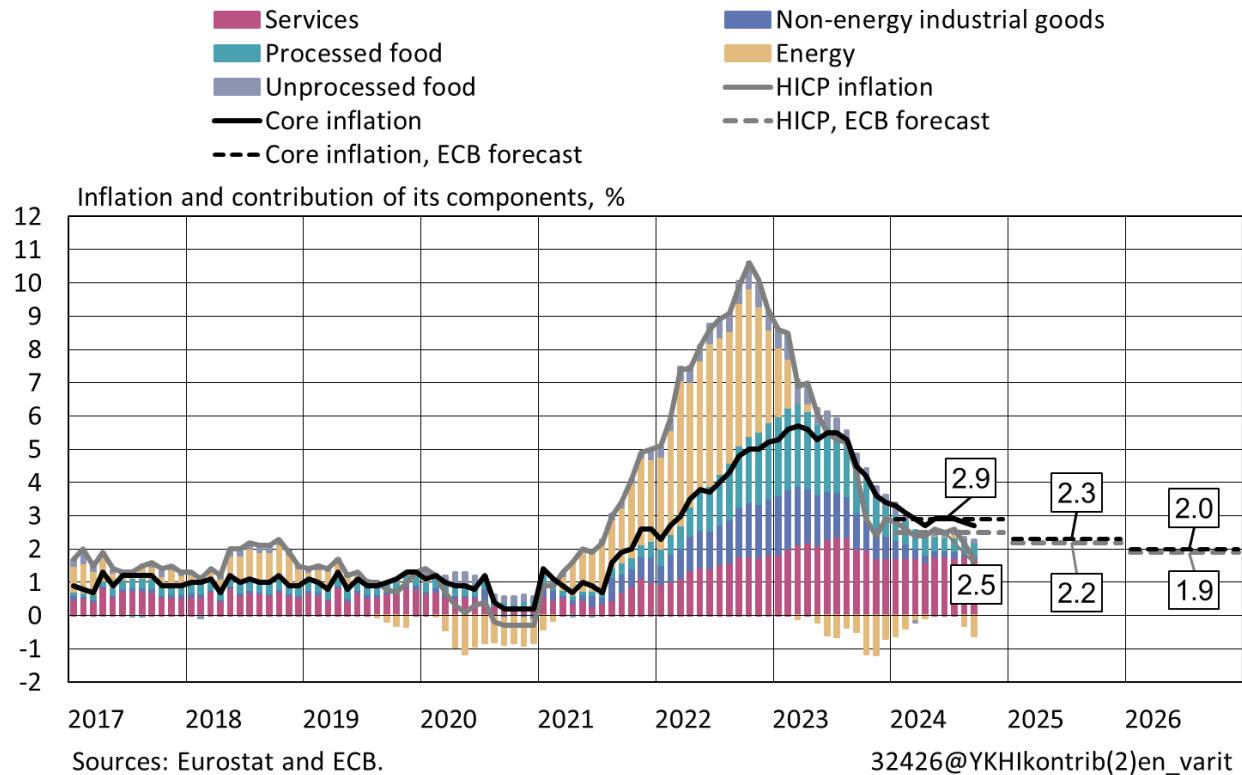


The ECB's current monetary policy strategy: a symmetric 2% inflation target over the medium term

- Previous inflation target of “below but close to 2%” was often interpreted as an upper limit.
- **The ECB's current target is symmetric 2% inflation over the medium term.**
- Negative and positive deviations from this target are considered equally undesirable.
- Strategy allows transitory periods in which inflation is above the 2% target.
- Strategy also improves possibilities to pursue sustainable growth and full employment without prejudice to price stability objective.



Inflation is stabilizing to our symmetric 2% target – which has served us well

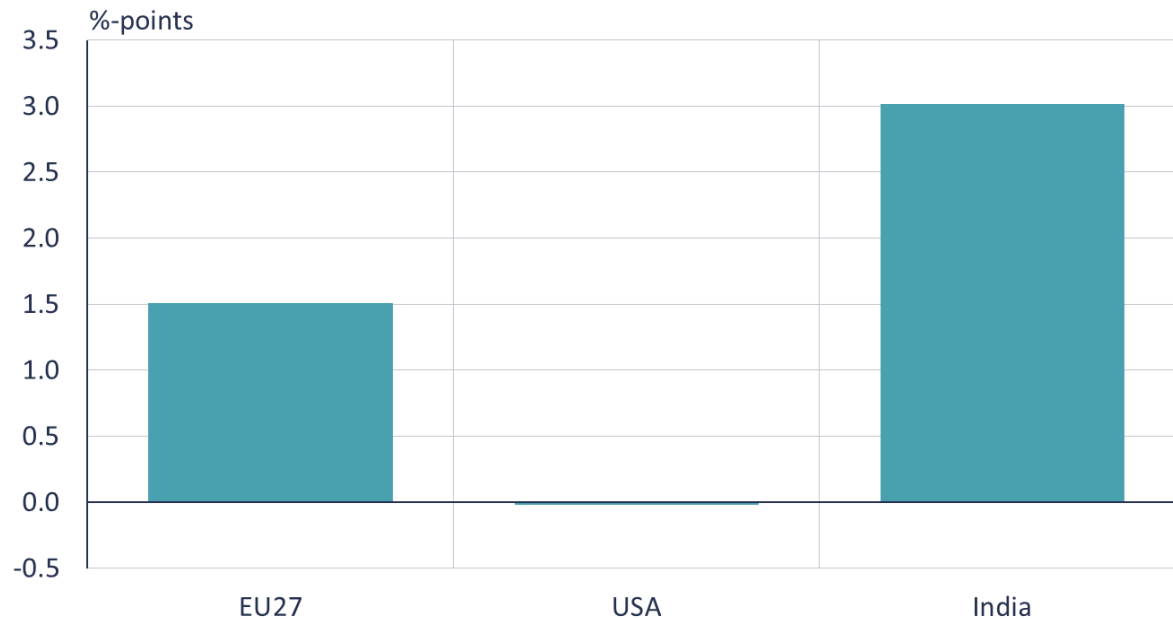


Reflections on the ECB's next strategy review in 2025

- 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. Labour markets in transformation: rise in the employment rate and immigration; a secular decline in labour productivity growth
 3. Contradictory tendencies in the long-term real natural rate of interest r^*

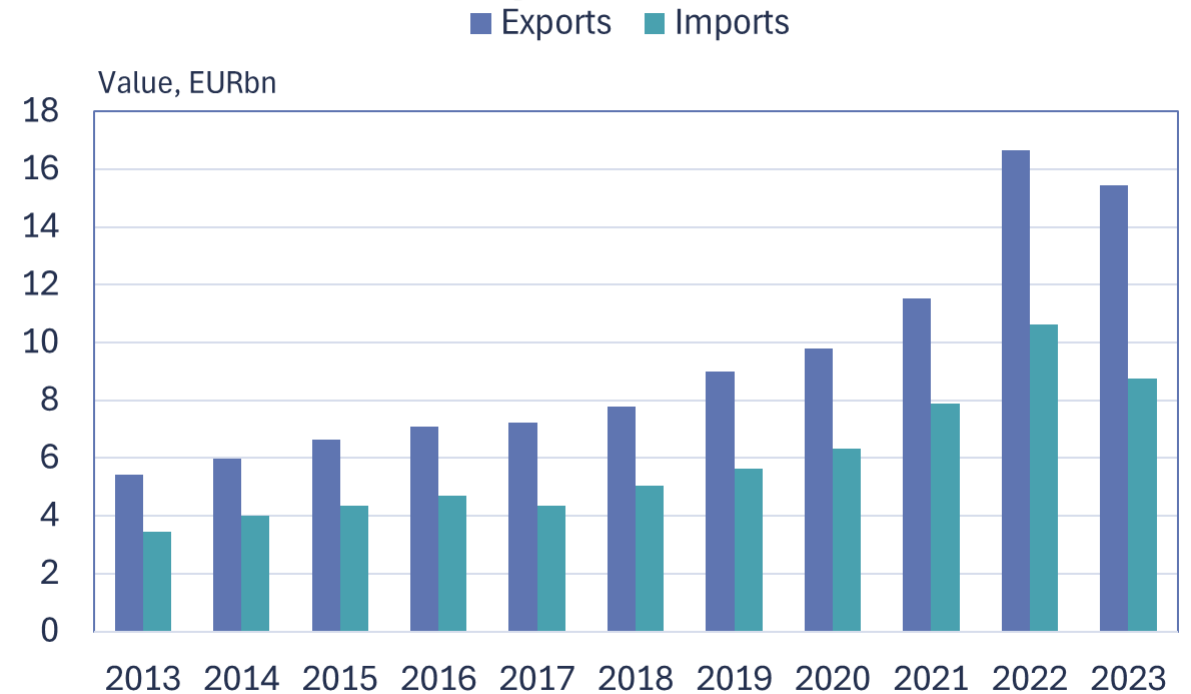
Geopolitics is shaping the operating environment of monetary policy – along with other secular trends

Change in the share of Chinese value-added in manufacturing output between 2018 and 2023



Source: BOFIT based on ADB data.

Finnish foreign trade with the USA

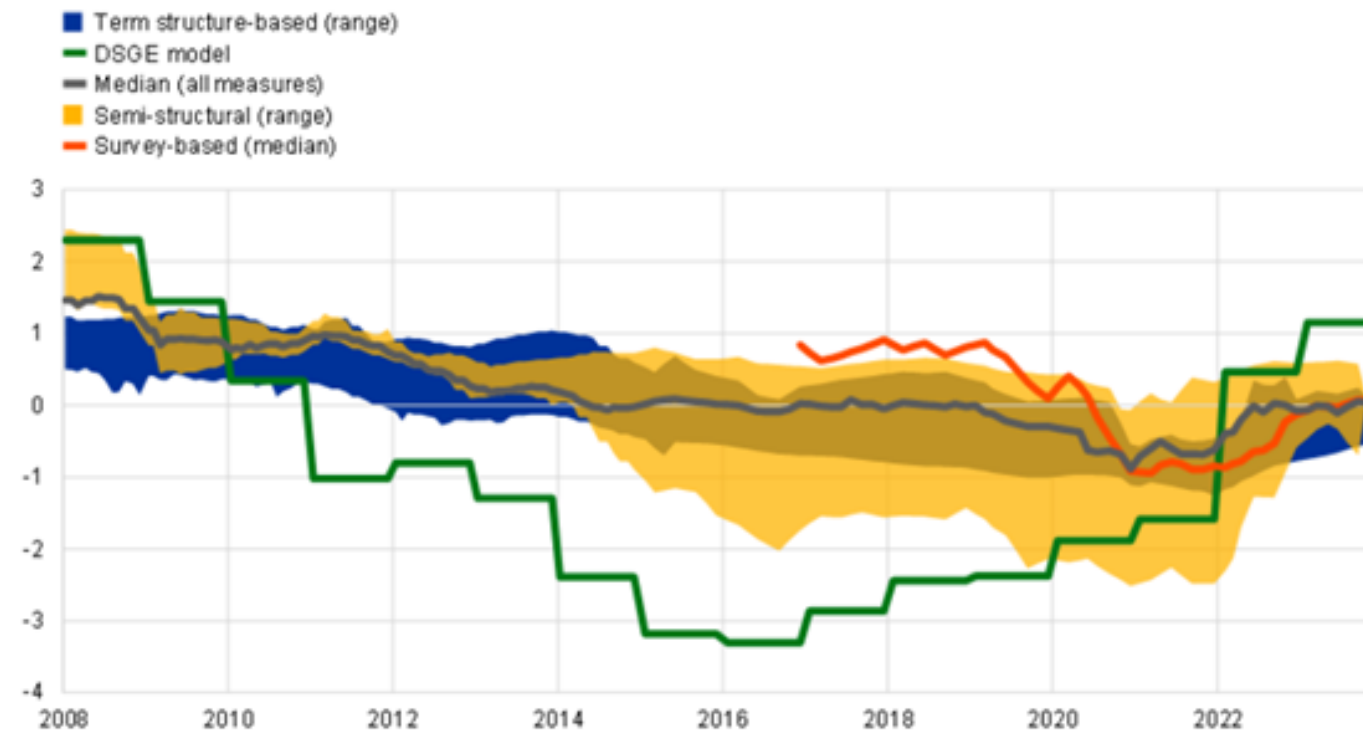


Source: Statistics Finland.

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

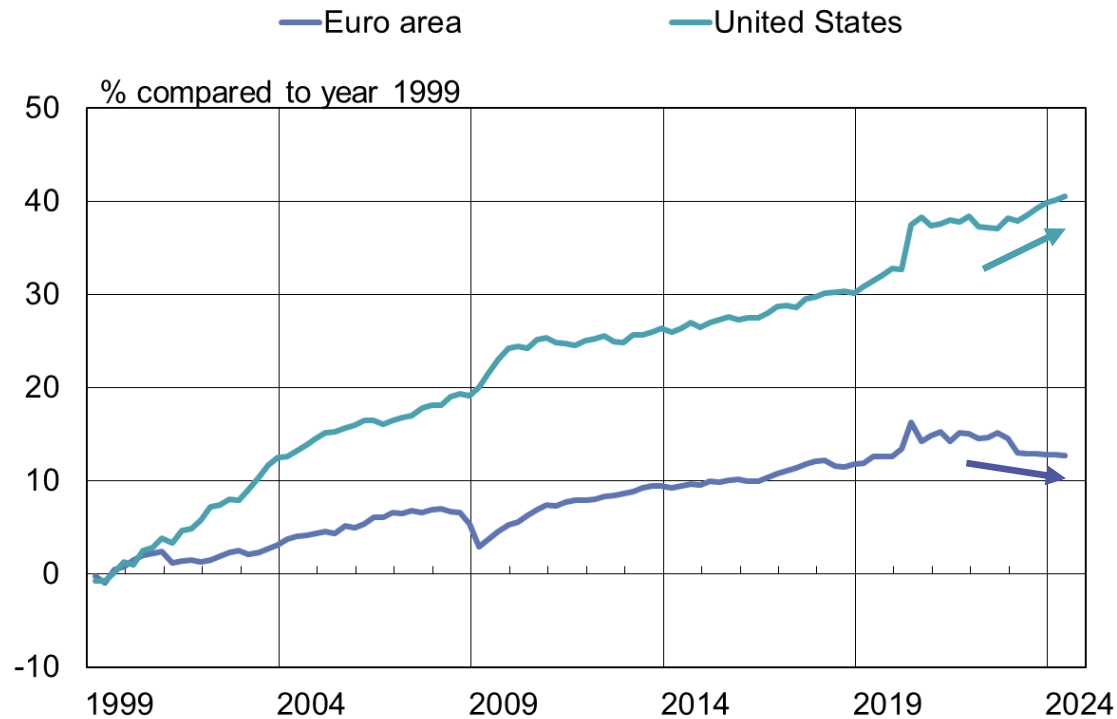
(percentages per annum)



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

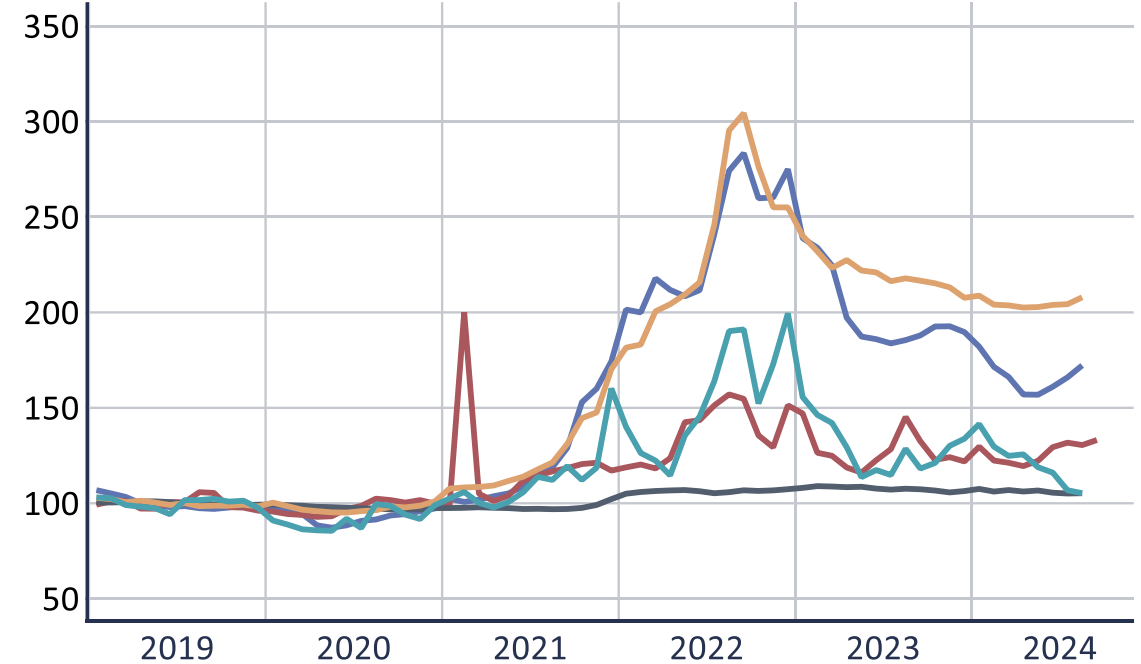
Productivity growth is Europe's Achilles' heel – we need decisive actions

Labour productivity (per hours worked)



Sources: BLS, BEA, Eurostat and BoF calculations.
 *Log-percentage change 32429@TuottQ_EA-USA_log_en

—Euro area —United States —China —Germany —Finland
 Producer prices for energy; index, 2019 = 100



Sources: Eurostat, BLS, China NBS. Last observation: EA 8.2024, USA 9.2024, CN 8.2024, DE 8.2024, FI 8.2024.

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18.10.2024 Energy PPIs by country

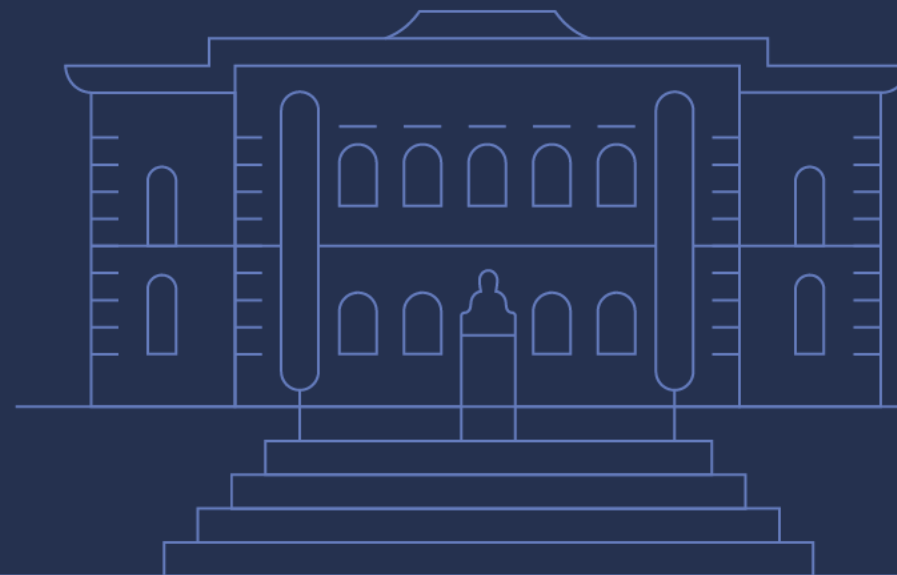
Conclusions

- Euro area seems to be heading for a soft landing – but amid structural growth concerns.
- Geopolitical changes and other secular trends challenge the long-term growth potential of Europe and shape the context of monetary policy.
- Strengthening European productivity growth and industrial competitiveness is key – determined national action and EU-wide cooperation is needed for success.
- Maintaining price and financial stability creates a sound environment for productivity-enhancing investments and long-term economic growth.



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Securing stability –
in science we trust.



Thank you!