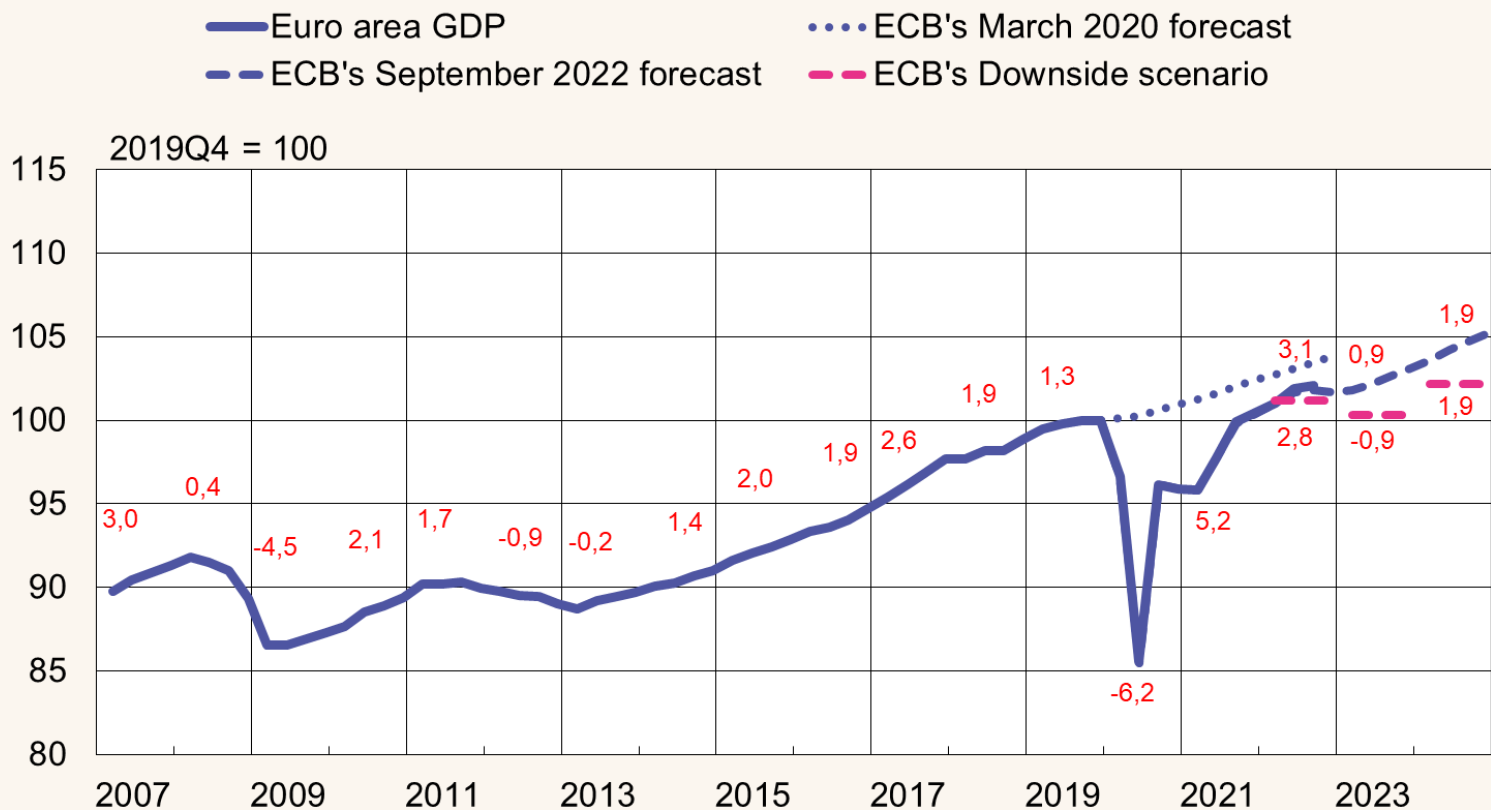




European economic policy in the times of crisis: Rules, discretion and coordination

EU Heads of Mission
28 November 2022

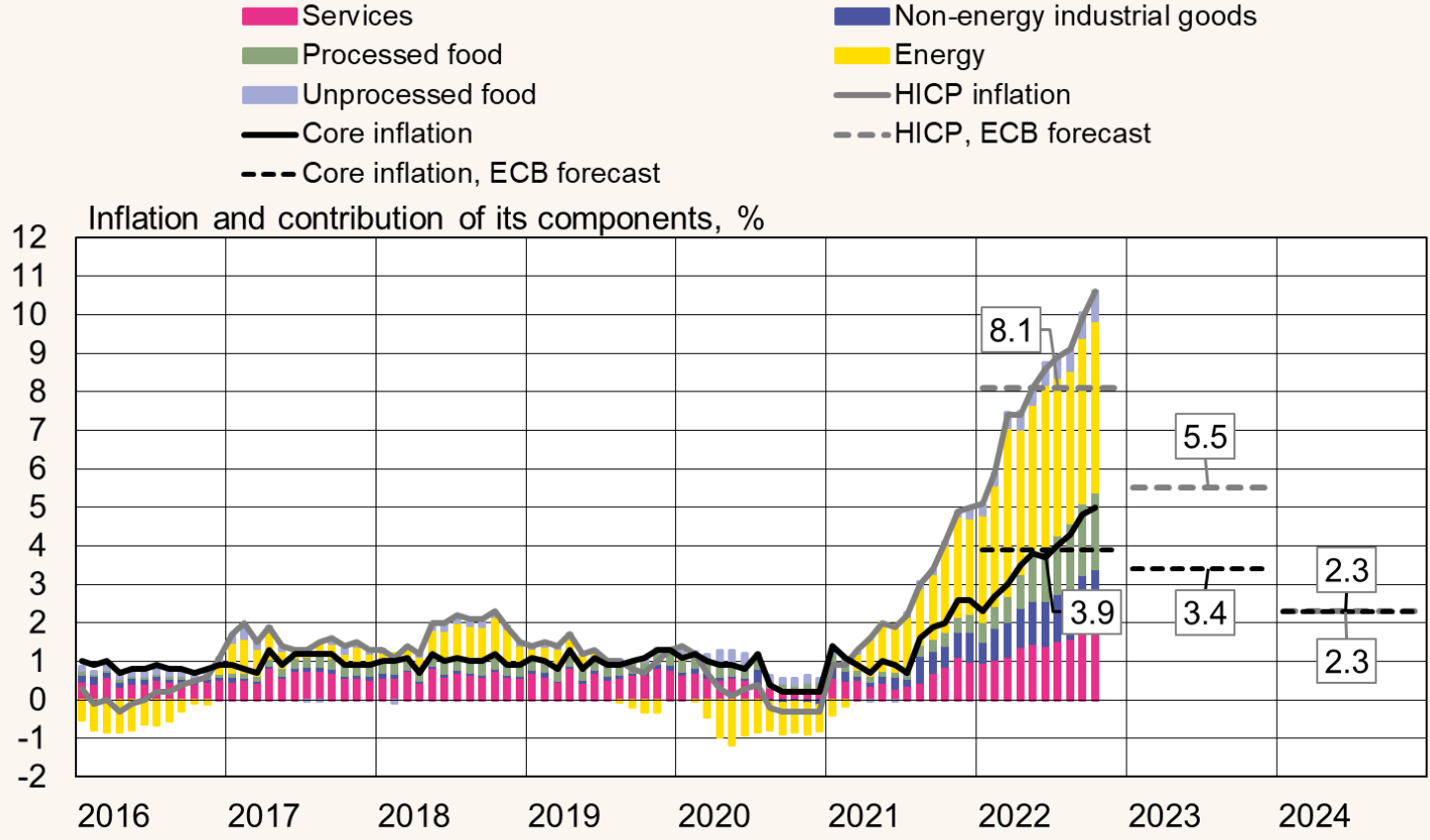
Probability of recession has grown in euro area



Figures next to the curve are annual growth rates, %
Sources: ECB calculations and Bank of Finland.

35781@MMS(2007-)_LV

Euro area inflation has risen further: 10.6% in October, with underlying inflation at 5.0%

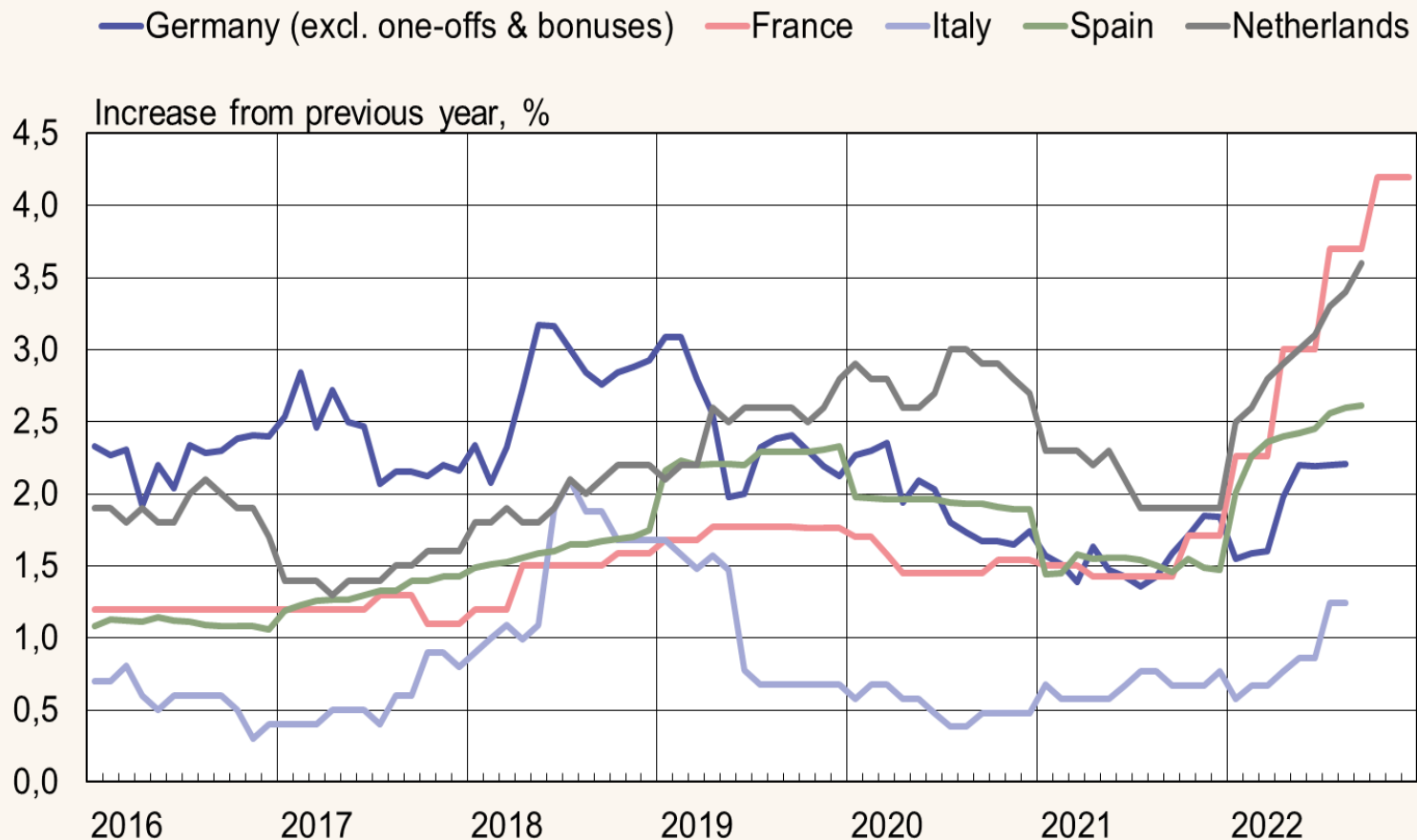


Sources: Eurostat and ECB.

32426@YKHlkontrib(2)en

Wage inflation has long been moderate, but has risen in 2022

Wage indicators



Sources: Bundesbank, INSEE, ISTAT, Spanish Ministry of Economy and Business, CBS.

32426@Negowage_kk(2) en

What is essential for price stability in the current situation?

- Monetary policy cannot really influence the energy prices directly. Monetary policy must nevertheless respond to the rise in the general level of prices (both goods and services).
- Tightening of monetary policy essentially reduces the risk of a detrimental wage-price spiral. Such a wage-price spiral would signal de-anchored inflation expectations.
- If expectations are no longer anchored, tighter monetary policy would be needed to achieve the inflation target, which would lead to drastically slower growth and higher unemployment.

Confidence in monetary policy retained – inflation expectations are still in the proximity of 2 percent



Sources: ECB and Bloomberg.
* Forward rates based on inflation swaps.

32426@odotusSPF_2_en

The ECB has raised key policy rates to stabilise inflation at 2% over the medium term

1. Key ECB interest rates have now been raised three times in July–October meetings: by 0.5 percentage points in July and by 0.75 percentage points both in September and October.
2. Inflation remains far too high and will stay above the target for an extended period. The Governing Council expects to raise key ECB interest rates further to ensure the return of inflation to the 2% medium-term target.
3. The future policy rate path will continue to be based on the evolving outlook for inflation and the economy, following a meeting-by-meeting approach.

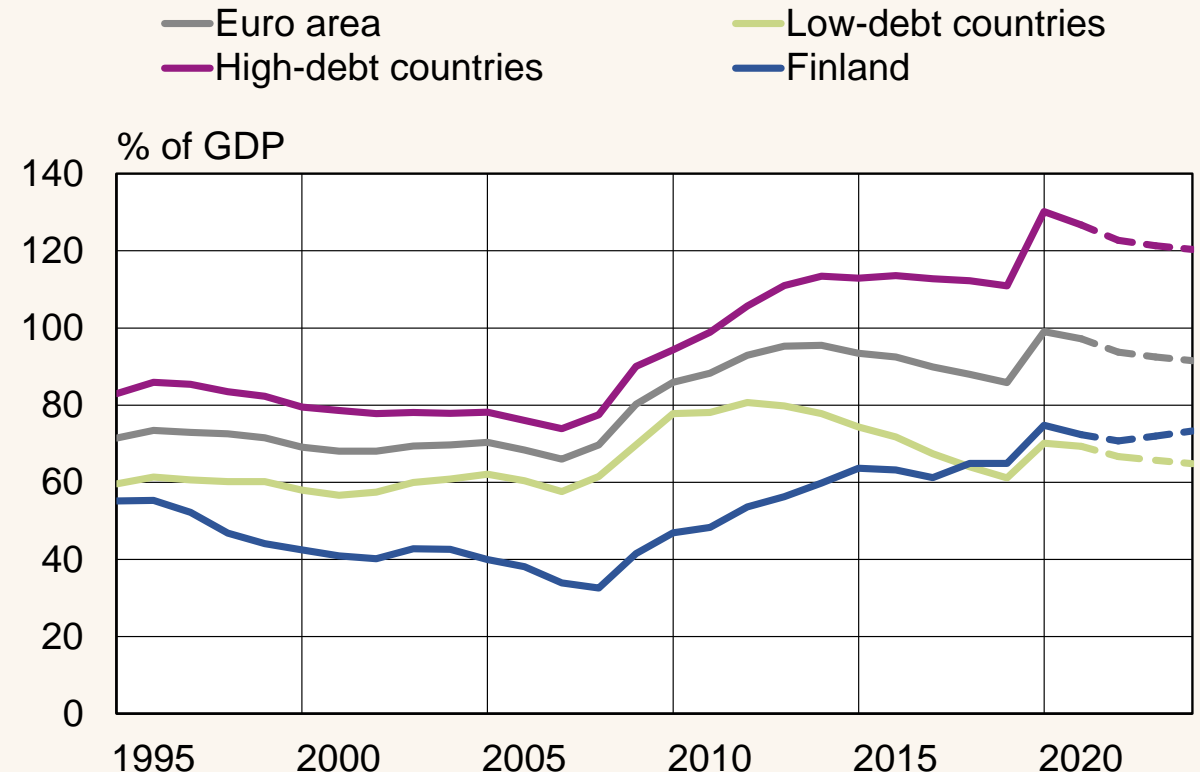
Green transition in the energy economy is now moving forward in another way than planned

- Energy prices already began to rise last year in the context of global economic recovery from the pandemic
- This winter characterised by major imbalance between demand and supply
 - Efforts should be made to get the most out of all demand flexibilities and energy saving opportunities
- Euro area is still by far too dependent on fossil energy imports – and regrettably the long-term direction of Europe’s energy policy is undecided, unresolved!

Successive crises have put pressure on fiscal sustainability in Europe

- Neutral fiscal policy stance would support containing inflationary pressure
- Compensatory measures for energy and cost-of-living crisis should be carefully targeted and temporary
- Fiscal sustainability best served with rules-based fiscal framework

Public debt ratio



Source: European Commission, Bank of Finland.

41258@Debt EA

New fiscal policy framework with rules and discretion: the Commission proposal, Nov 2022

National ownership embedded in EU framework

- Fiscal-structural plan with reference adjustment path for 4–7 years

Simplification and focus on fiscal risks

- Net expenditure growth path anchored on debt sustainability

Enforcement

- Deficit (3%) and debt based EDP
- Financial sanctions and macroeconomic conditionality

Principles for the reform of EU economic governance

- Enhances productivity- and growth-boosting structural reforms
- Supports investments, especially for the green transition in the energy economy
- Ensures a level playing field for all member states, large and small
- Promotes national ownership of both fiscal sustainability and growth-enhancing reforms

Conclusion

- Escalation of the energy crisis has increased the risk of a recession both in the entire euro area and also in Finland, and inflation has remained higher than forecast
- While the ability of monetary policy to influence energy prices is limited, measures are needed to respond to the surge in the general price level
- Fiscal policy must balance between short-term relief and long-term sustainability
- In the face of enormous challenges, strong unity, determination and the capacity for reform are now needed in Europe



Thank you!

bof.fi