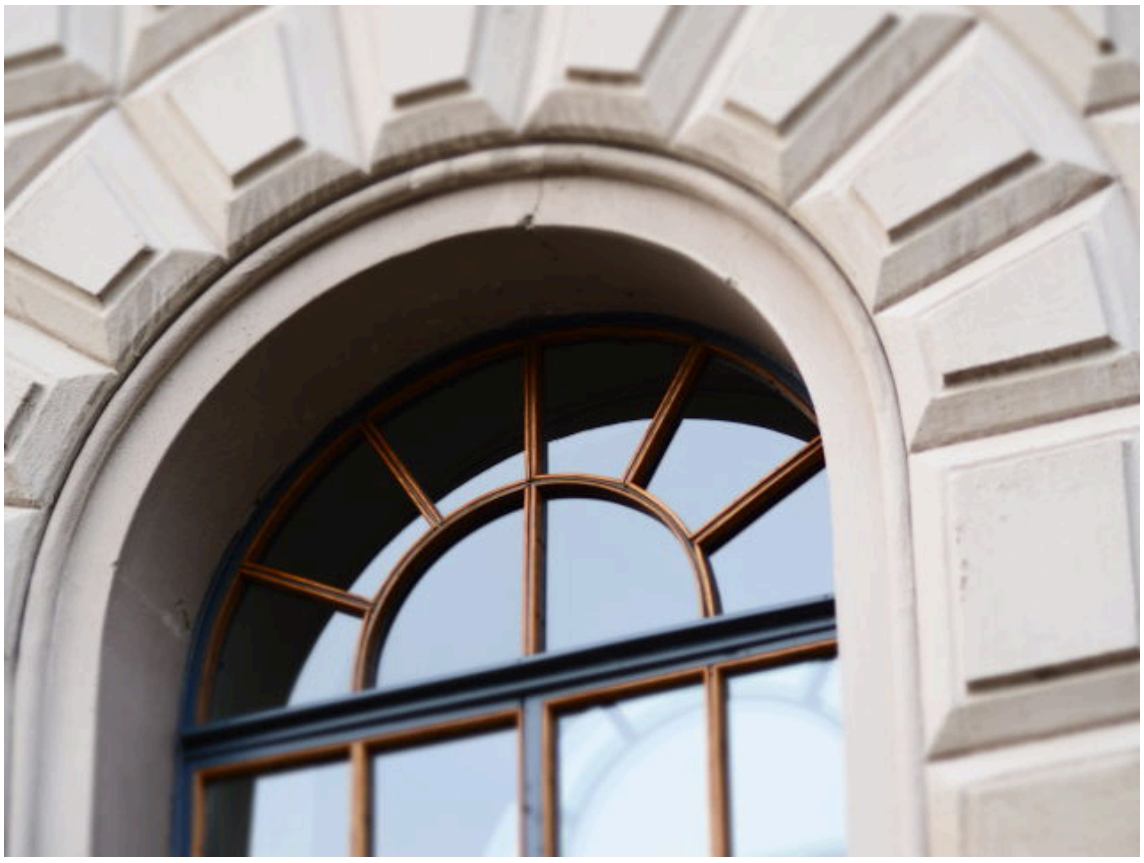
Editorial

Editorial: Monetary policy will continue to support price stability and growth

Finnish economy, Monetary policy | 20 December 2016

Of the various factors of uncertainty surrounding the international economic outlook at the present time, a substantial proportion relates to policy choices. Much expectation focuses on US economic policy in the immediate years ahead, but so far no details are known. Meanwhile, the United Kingdom's new arrangements in respect of its international economic relations remain undecided, while the UK Government's detailed objectives are not entirely clear. Politically motivated uncertainties regarding the economic outlook are also to be found elsewhere in Europe and beyond.



In many countries, the supporters of free trade and other international cooperation have been forced onto the back foot. Voices have been heard demanding national isolation. At the same time there is a great need for international cooperation and joint decision-making if we are to manage the current problems with climate change, the refugee situation and the economy.

Behind the political uncertainties could in part lie the deteriorating financial position of many households in the advanced economies. The sluggishness of the economy in recent years, unemployment and growing financial inequality have led to a sense of betrayal and a lack of opportunities. In such a situation positive attitudes towards, for example, international cooperation could suffer.

In Finland, too, many households are facing tougher times financially. Income differences between households in Finland grew around the turn of the millennium and the years immediately preceding it. Since 2008 unemployment has increased, with a decline in the number of jobs, particularly in industry. Long-term unemployment is more common than before.

Factors underlying the structural changes experienced in the advanced economies in recent decades include technological change and globalisation. These have generated a great deal of economic well-being, and viewed globally income differences have narrowed, as the emerging economies have gained ground on wealthier countries. At the same time, there is a greater need to manage the economic impacts of these trends within the advanced economies.

There is nothing to be gained from attempting to turn back the clock with regard to technological development and globalisation. When the economic environment undergoes rapid change, policy choices should be devoted to supporting the successful adaptation of economies to the new circumstances. At the same time it is important to care for those whose position has been weakened. There is an important role here for social protection and the labour market institutions. The education system has a key role to play in combating inequality, particularly over the longer term. Vital to cushioning the problems relating to unstable economic developments are successful fiscal and monetary policies.

Despite the various factors of uncertainty, economic growth has continued in the advanced economies in 2016, if at a moderate rate. Inflation in these economies has continued to be sluggish. In the euro area, growth has continued to be broadly based and firming, but inflationary pressures are subdued.

The ECB Governing Council decided at its meeting of 8 December 2016 to keep its policy rates unchanged and continue the expanded asset purchase programme (EAPP) until the end of 2017, and beyond if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. These measures have been calibrated to preserve the very substantial degree of monetary accommodation necessary to secure a sustained convergence of inflation rates towards levels below, but close to, 2% over the medium term.

The monetary policy pursued by the European Central Bank has also supported growth in Finland. Growth in the euro area economy boosts Finnish companies' opportunities to increase exports to

other euro area countries. The euro area's share of Finnish exports has in fact been growing over the past few years. Moreover, the monetary policy measures have affected financing costs in Finland, and interest rates on, for example, household and corporate loans are low. In this way, monetary policy has bolstered consumption and investment in Finland.

The Finnish economy has begun to recover after a prolonged period of weakness. GDP returned to gentle growth in 2015, and growth has continued through 2016. So far, growth has been largely dependent on household consumption and housing investment. Looking to the immediate years ahead, economic developments in Finland are forecast to gradually balance out. Exports will recover gradually as growth continues in the export markets and the cost-competitiveness of Finland's exports improves.

The position of Finland's public finances has remained difficult, partly due to the large numbers of unemployed. According to the Bank of Finland forecast, even GDP growth will not bring about a rapid shrinkage in the general government deficit in the immediate years ahead, and there will still be a need for measures to strengthen the public finances.

Such measures are also necessary in view of the longer-term outlook. The long-term sustainability of Finland's public finances has not been secured, which threatens a difficult future for the current generation of young people, who will have to bear not only the costs of caring for the older generation, but also the costs stemming from the now rapidly growing public debt.

Key factors in improving the foundations of economic growth are the operating environment for companies and the constant renewal of Finland's business community. The importance of young companies in advancing the economy is in some ways different to that of established companies. In the former, labour productivity growth is often more rapid than in older companies. On the other hand, the most important source of productivity growth across the economy as a whole is the gradual renewal of established firms, as the largest companies are predominantly old.

Young companies are important to employment development. A large proportion of jobs are created in a very small group of rapidly growing, often young companies. In recent years, the renewal of the stock of businesses in Finland has slowed and less new companies are emerging than in the past. The proportion of young companies is smaller in Finland than in many other countries.

It is hard for government to identify in advance those companies that will grow rapidly, and rapid growth that has already occurred cannot necessarily be used to anticipate the continuation of a similar trend in the future. The role of economic policy is to create equal opportunities for different sorts of companies and a positive environment for the birth of new enterprises and the growth of all sorts of companies.

When the economy develops the capacity to renew itself in such a way that productivity improves and employment opportunities are generated, the growth outlook will improve. At the same time the risk of increasing marginalisation and lack of opportunities will be reduced.

Helsinki, 12 December 2016

Erkki Liikanen
Governor of the Bank of Finland

Keywords

indebtedness, inequality, monetary policy, price stability, productivity