



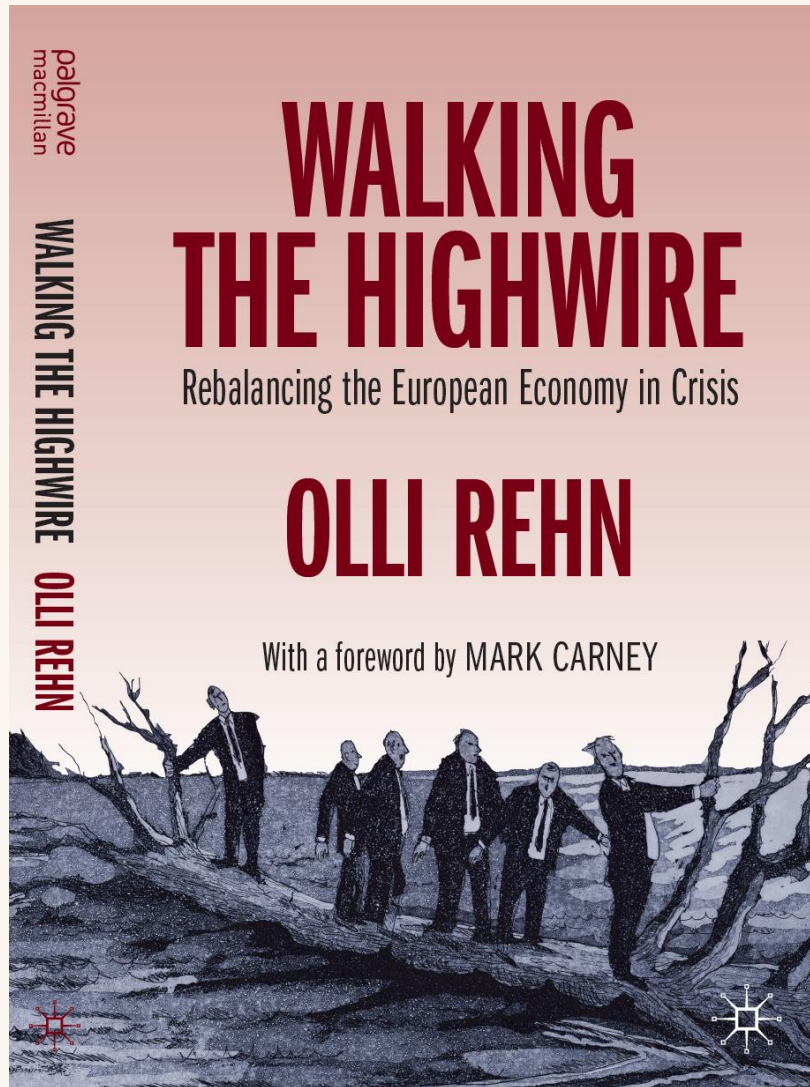
Managing Crisis in the Eurozone: What the past tells us about the present?

LSE PowerBreakfast, 25 March 2020

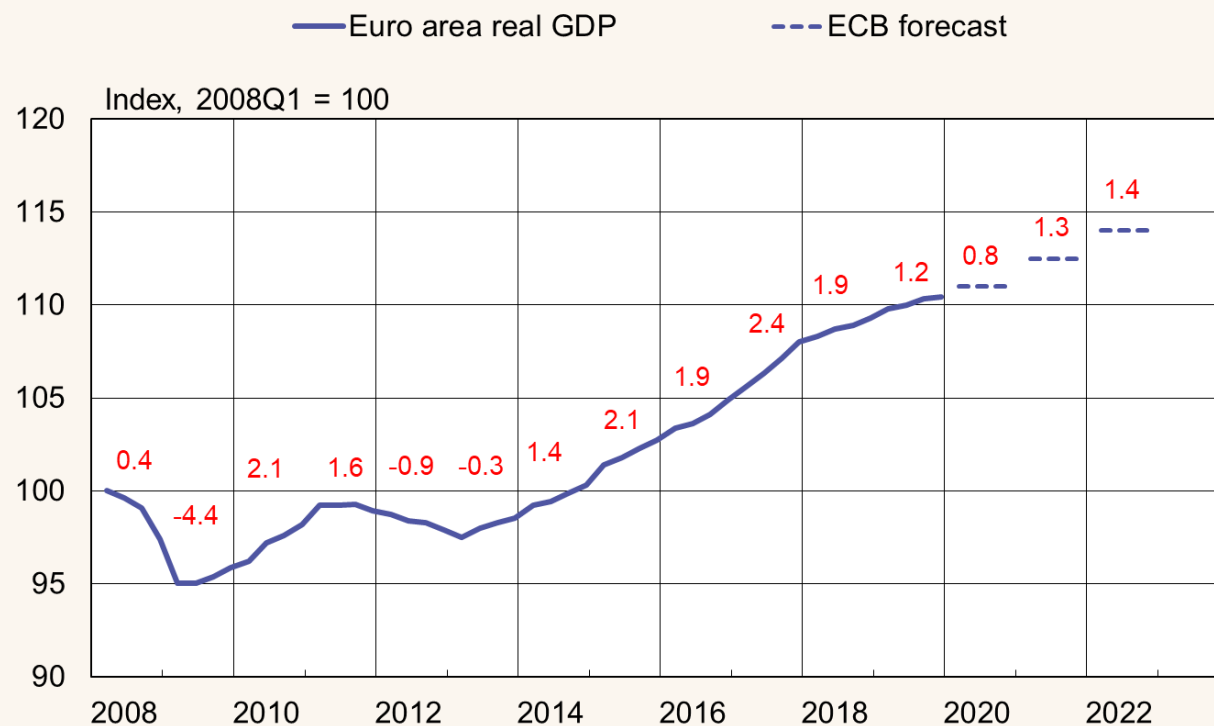
Olli Rehn, Governor
Bank of Finland

View from the office: a peripheral Finn at forced telework





Euro area real GDP, 2008-2022



Euro area, changing composition. Figures next to the line are annual growth rates.

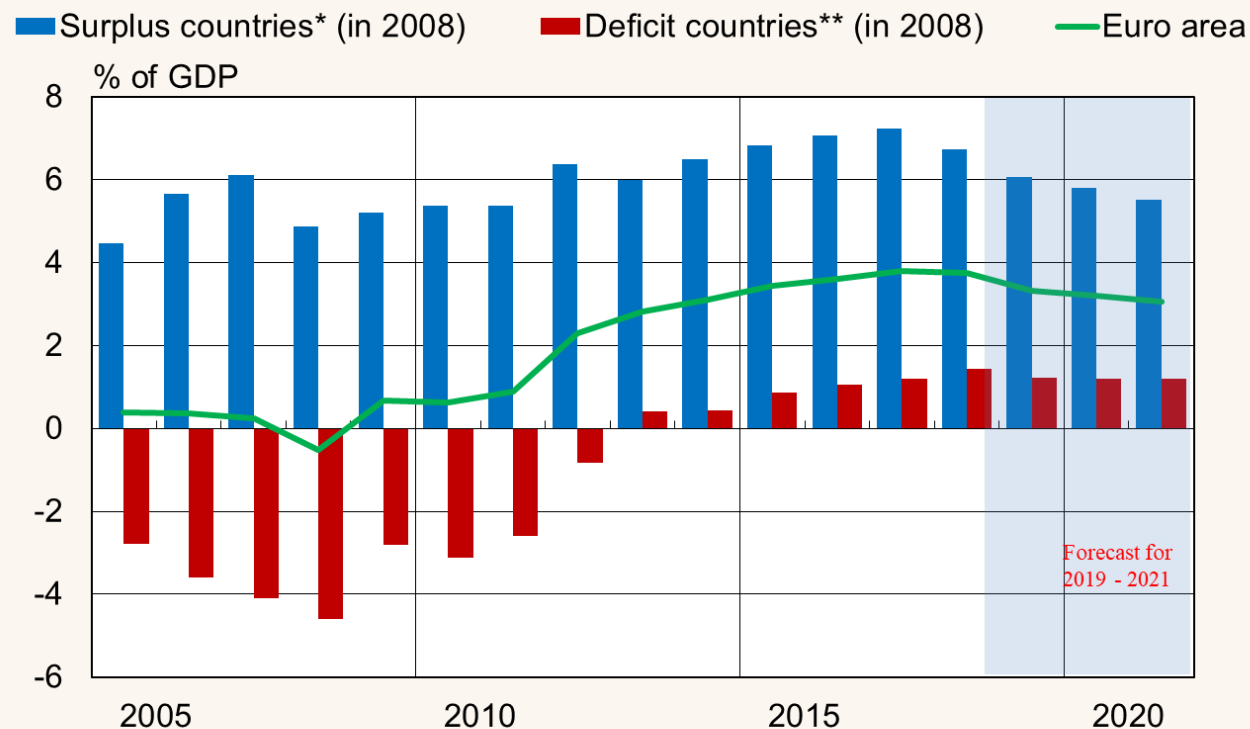
Forecast does not include the impacts of COVID-19 pandemic that will be substantial

Sources: Eurostat and ECB.

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Rebalancing of the Eurozone economy, 2007-21

Balance of current transactions with the rest of the world



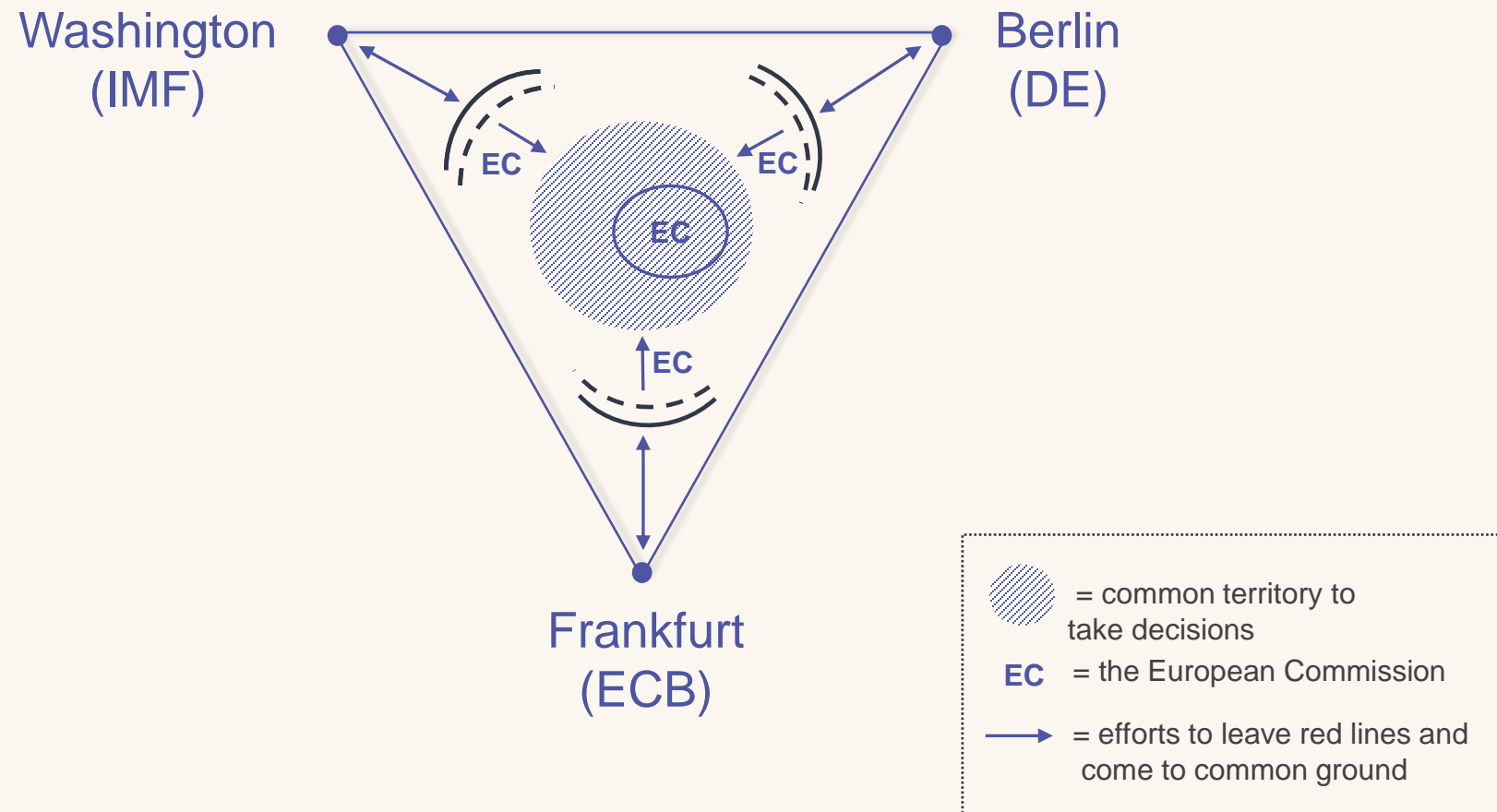
* Surplus countries: AT, BE, DE, FI, NL

** Deficit countries: FR, IT, ES, PT, IE, GR

Sources: European Commission, Macrobond.

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The “Impossible Triangle” of the Eurozone



Lessons learned from the euro crisis

1. A systemic crisis calls for a systemic solution. In 2010-12: the Comprehensive Crisis Response. The ECB: "from BuBa to Fed".
2. Financial stability was badly neglected at Maastricht:
 - Need a "big bazooka" to tame financial turbulence. ECB + ESM.
 - Banking union is key break the bank-sovereign nexus.
3. We need a better policy mix between monetary and fiscal policy – both in normal times and especially in crisis times.
4. While better economic policy coordination is a worthwhile goal, EA member states should still stay responsible for their economies and keep them in good shape. Resilience, flexibility, productivity.



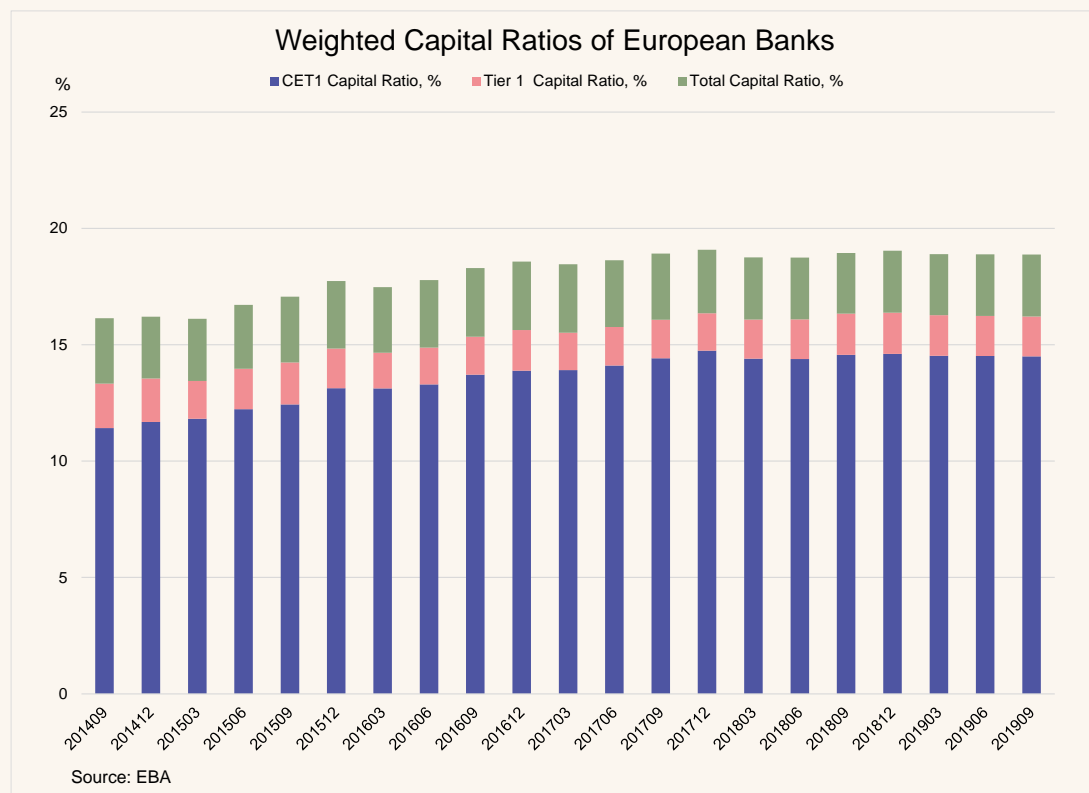
The coronavirus pandemic, economic consequences and policy responses

Olli Rehn, Governor
Bank of Finland

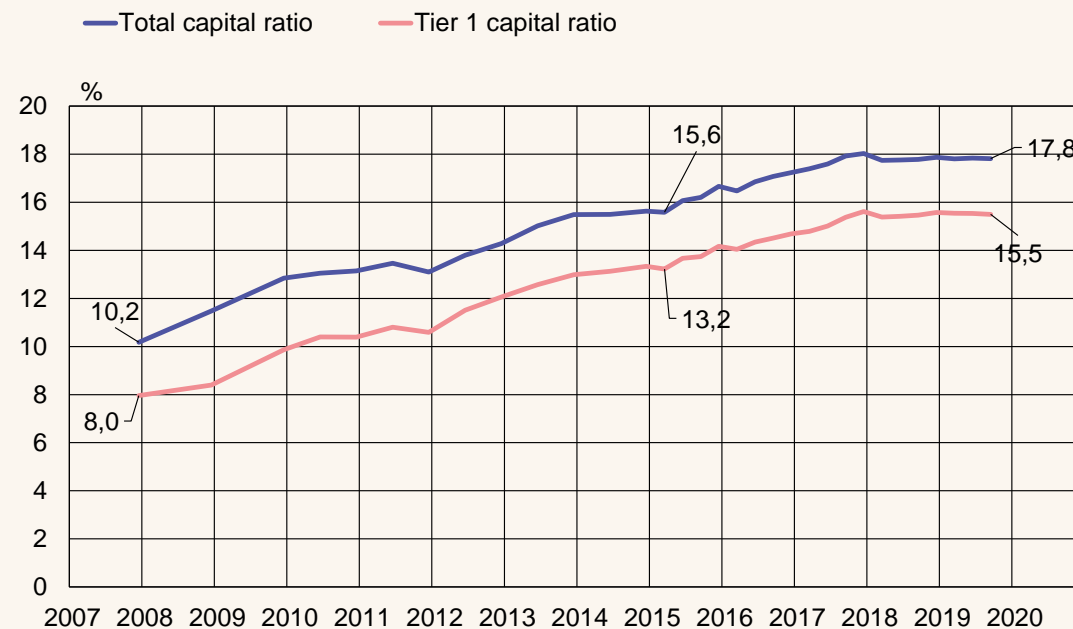
Comparison of the two crises, at this stage

- The corona crisis is NOT caused by large macro imbalances
- Banks in the euro area are better capitalized
- Reaction to the crisis has been quicker now
 - ECB is employing its big bazooka
 - Germany is launching a large-scale fiscal stimulus
- But the effect of the corona pandemic is wider in scope – a direct hit to the real economy and to the society at large
 - Seemed like a supply shock, but is as well a massive demand shock
 - In last weeks, has been a severe financial shock
- Bottom line: uncertainty dominates until the people can see and trust that the pandemic is brought under control?

Reinforcement of capital buffers – now and then



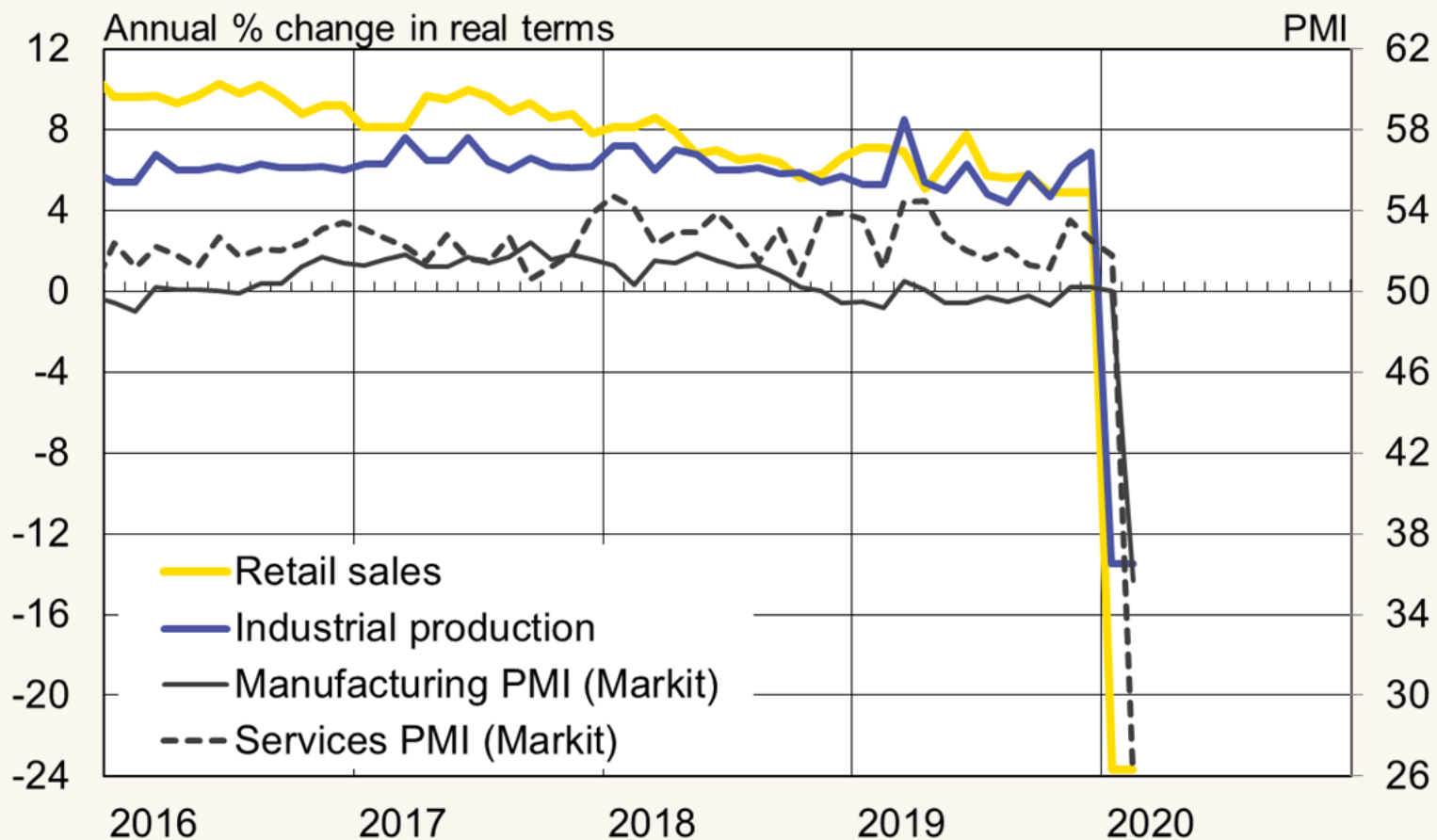
Total capital ratio and Tier 1 capital ratio of euro area banks



Source: ECB.

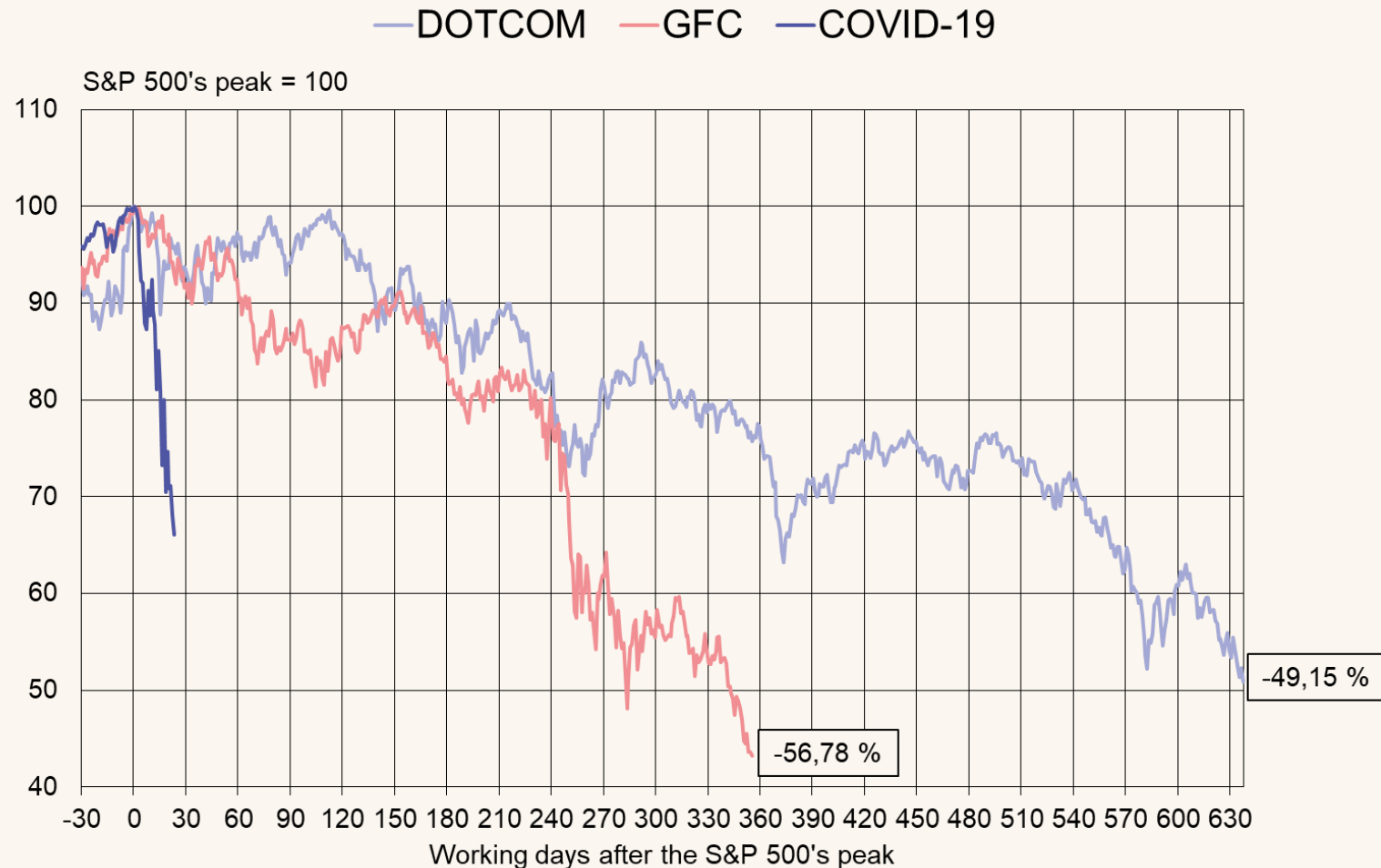
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A very sudden shock: e.g. the Chinese economy contracted sharply in January and February



Sources: Macrobond and CEIC.

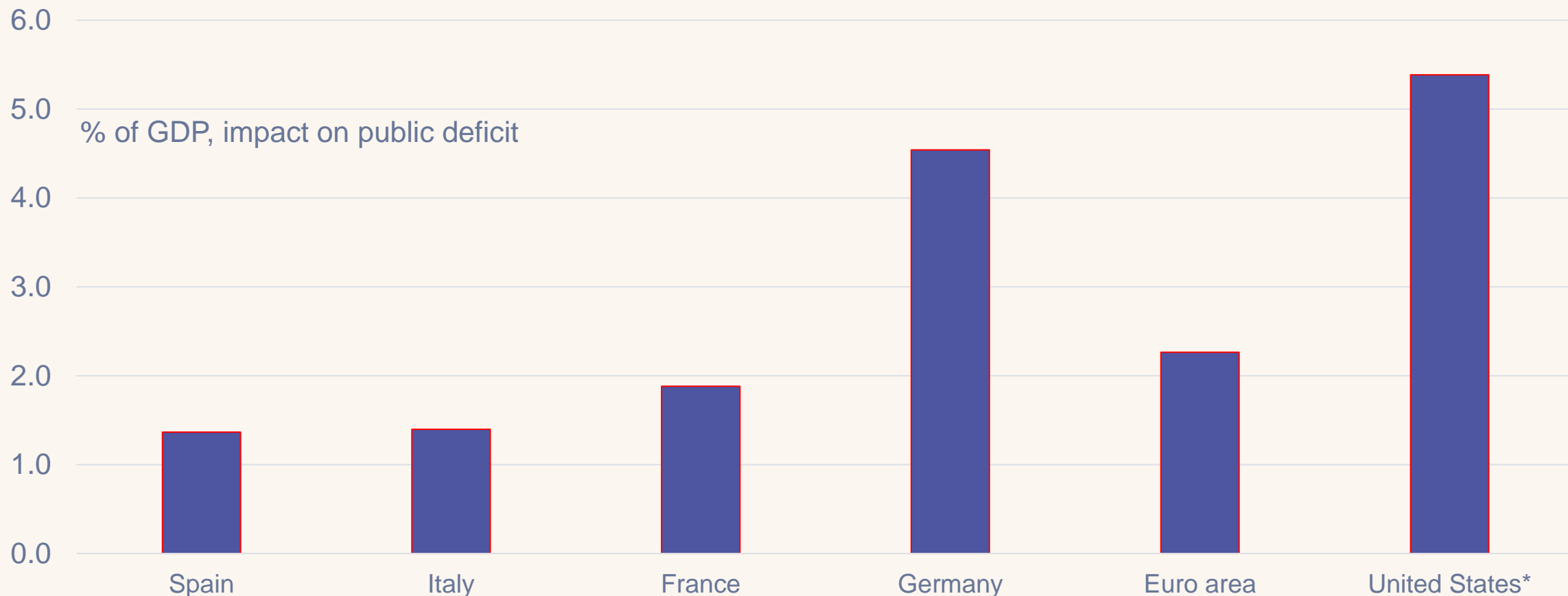
Stock markets down with a steep and sudden fall – different from the dotcom and financial crisis



The ECB's monetary policy decisions 18 March 2020

- Launch of a new asset purchase programme, the Pandemic Emergency Purchase Programme (PEPP)
 - Flexible purchases of securities totalling EUR 750 billion, conducted until the end of 2020
 - Includes all the asset categories eligible under the existing asset purchase programme (APP)
 - The ECB is fully prepared to increase the size of the programme and adjust its composition
 - Securities issued by the Greek government also eligible for purchase
- Expansion of the range of eligible assets under the corporate sector purchase programme (CSPP)
- Easing of collateral standards in refinancing operations
- The Governing Council will do everything necessary within its mandate to support all euro area citizens through this extremely challenging time.

Germany's planned supplementary budget (EUR 156 billion) will have a significant impact on the fiscal stance in the euro area

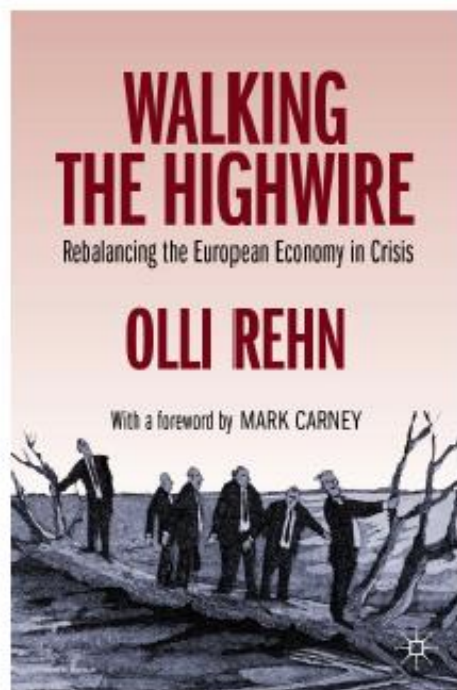


*US is approximated based on the 1 trillion dollar fiscal package on which details have not yet been decided.

Concluding remarks: Health first – but damage to the economy must be mitigated, whatever it takes

- Protecting public health must take precedence during a pandemic.
- But contingency measures to contain the virus have brought the global economy to an abrupt halt. Public authorities, including the central banks, will inevitably have to play a key role in mitigating the economic damage.
- Immediate challenge: secure the financing of businesses, esp. SMEs, and liquidity in the financial system. Next act: soften the blow to employees, save jobs and protect domestic demand. E.g. the Nordic way.
- Thus fiscal policy will inevitably have to play a stronger role from now on. Better in a coordinated way in Europe.
- Comprehensive recovery of economic output and confidence will only begin once people trust that the pandemic is under control.

Thank you!
- And the floor is yours!



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O. Rehn

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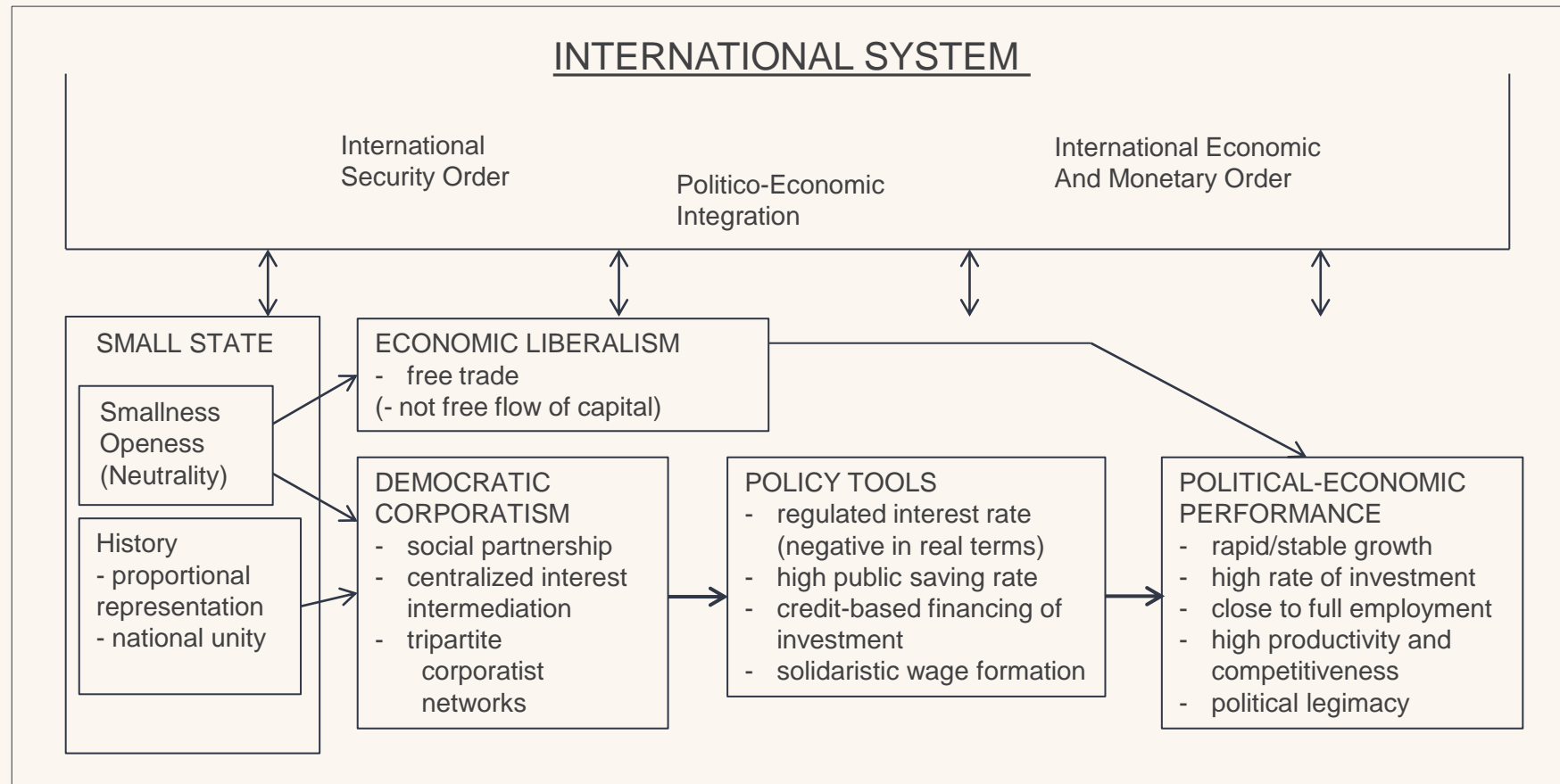
ECB monetary policy measures on 12 March will support lending conditions for households and firms

- 1) Additional longer-term refinancing operations (LTROs)
 - Immediate liquidity support to the euro area financial system
- 2) Targeted longer-term refinancing operations, series III (TLTRO III)
 - Considerably more favourable terms for all outstanding operations from June 2020 to June 2021
 - Ensures smooth bank lending to households and small and medium-sized enterprises
- 3) Net asset purchases (APP)
 - Additional net asset purchases of EUR 120 billion until the end of the year, to ensure a strong contribution from the private sector purchase programmes
 - Secures readiness to prevent market disruptions under all asset purchase programmes
 - Supports the availability of market-based funding for businesses

Fiscal policy measures – euro area

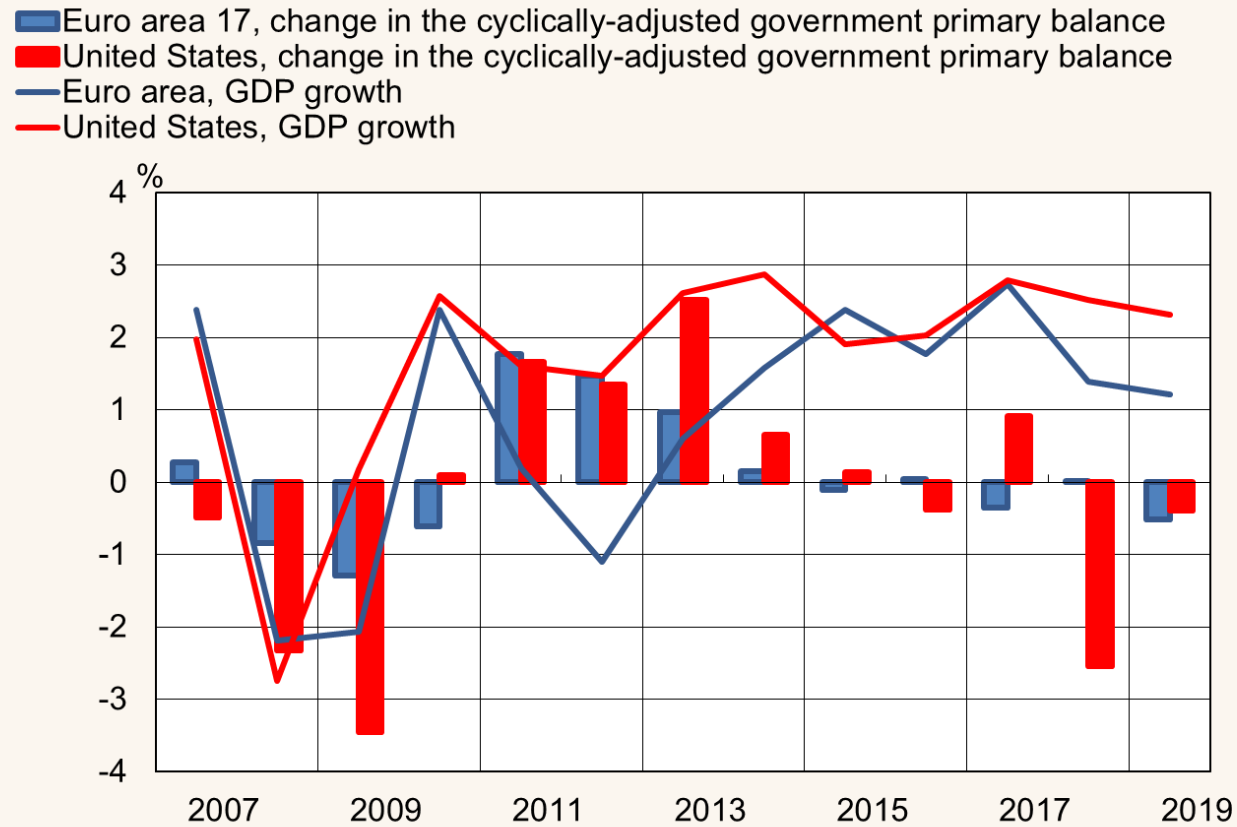
- National level
 - Announced increase in public spending so far about 1% of GDP
 - Germany planning a stimulus package of EUR 156 billion (4.5% of GDP)
 - Automatic stabilisers allowed to operate
 - Liquidity support for SMEs, about 10% of GDP
 - Support for workers with income losses
- European level
 - Coronavirus Response Investment Initiative (CRII) EUR 37 billion (0.3% of GDP, redirected from structural funds)
 - EUR 8–20 billion working capital lending to SMEs (0.06–0.16% of GDP)
 - Additional investment of EUR 20 billion into small firms by EIB (0.16% of GDP)
- Stability and Growth Pact
 - The coronavirus pandemic qualifies as an unusual event outside the control of governments, meaning the related temporary and targeted measures are not regarded as detrimental
 - On 20 March, the European Commission proposed the activation of the general escape clause, which permits deviation from the MTO adjustment path in case of a severe economic downturn

"Small States in World Markets" vs. the transformation of the world economy in the 80s/90s



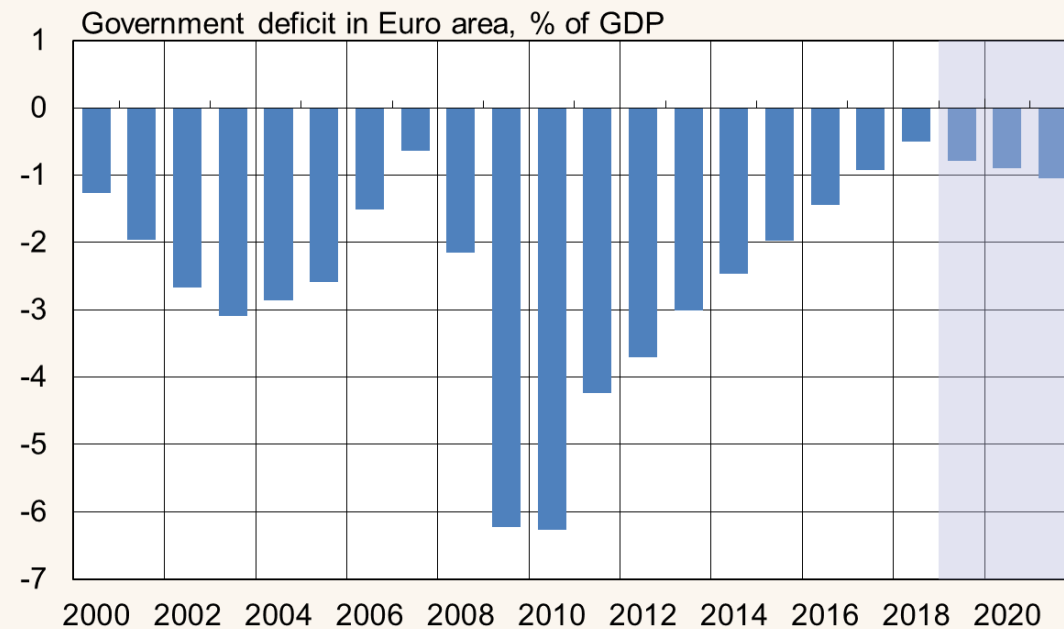
The Neocorporatist Model: National Industrial Strategy and Policy-making Structure of a Small European State.
Adapted from Hicks 1988: 134; Katzenstein 1985; Väyrynen 1988, 1989; Kosonen 1987: 140-145.

Growth and fiscal policy in the US and Eurozone (2008-2019)



Source: IMF, OECD and Macrobond.

Government deficit in Euro area 2000-2018*

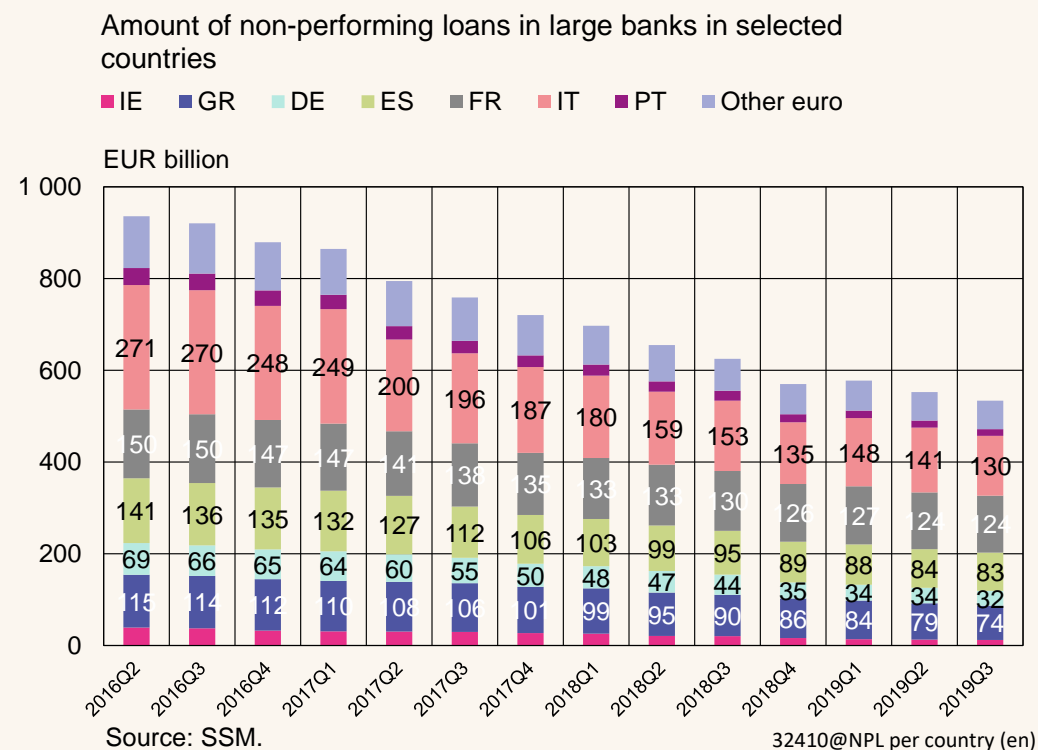


*Shaded area indicates forecasts.

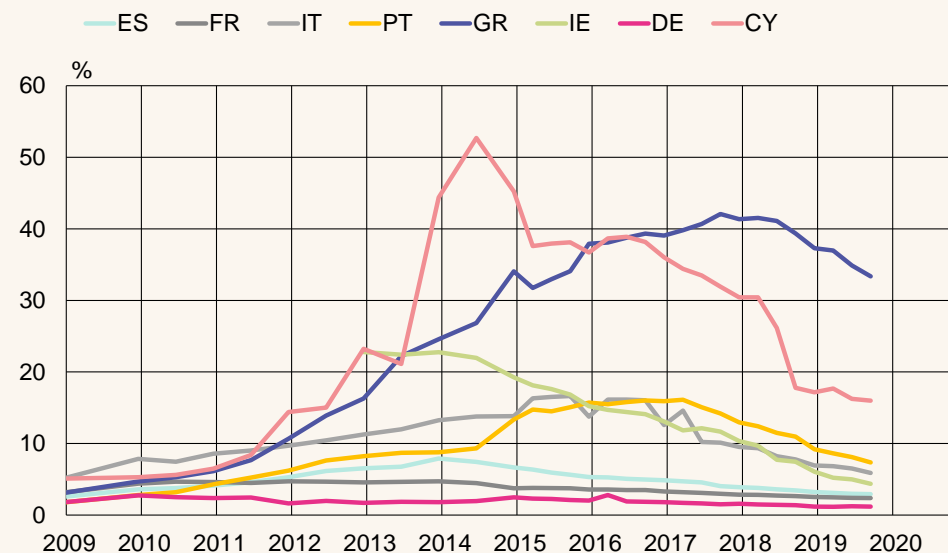
Source: European Commission.

32424@Julk.vaje(EA)

Development of NPLs in selected euro area countries



Gross non-performing exposures (NPE), % total bank exposures



Lähde: Euroopan keskuspankki.

32410@NPEselected

ECB Banking Supervision measures in response to the corona virus

- The ECB announced on 12 March measures that provide its directly supervised entities flexibility in the fulfilment of certain additional capital and liquidity requirements, incl. fulfilment of the Pillar 2 additional capital requirement.
 - Applies also to Finnish banks directly supervised by the ECB
- In Finland, the Board of the Financial Supervisory Authority (FIN-FSA) decided on 17 March to decrease the capital requirements that are subject to national decision-making by one percentage point, applicable to all banks.

The Bank of Finland's new measures to alleviate the impacts of the corona virus pandemic: purchases of commercial paper

- The purpose is to increase the supply of funding to businesses and preserve jobs as part of national and euro area crisis measures.
- The Bank of Finland launched on 17 March purchases of commercial paper. The size of the programme is initially EUR 500 million.
- The Bank of Finland Board decided on 18 March to increase the size of the programme to EUR 1,000 million, i.e. EUR 1 billion.
- The purchases will also indirectly ease the funding conditions for small companies, as banks can free up credit lines for other customers.