

SUOMEN PANKKI
EUROJÄRJESTELMÄ



FINLANDS BANK
EUROSYSTEMET

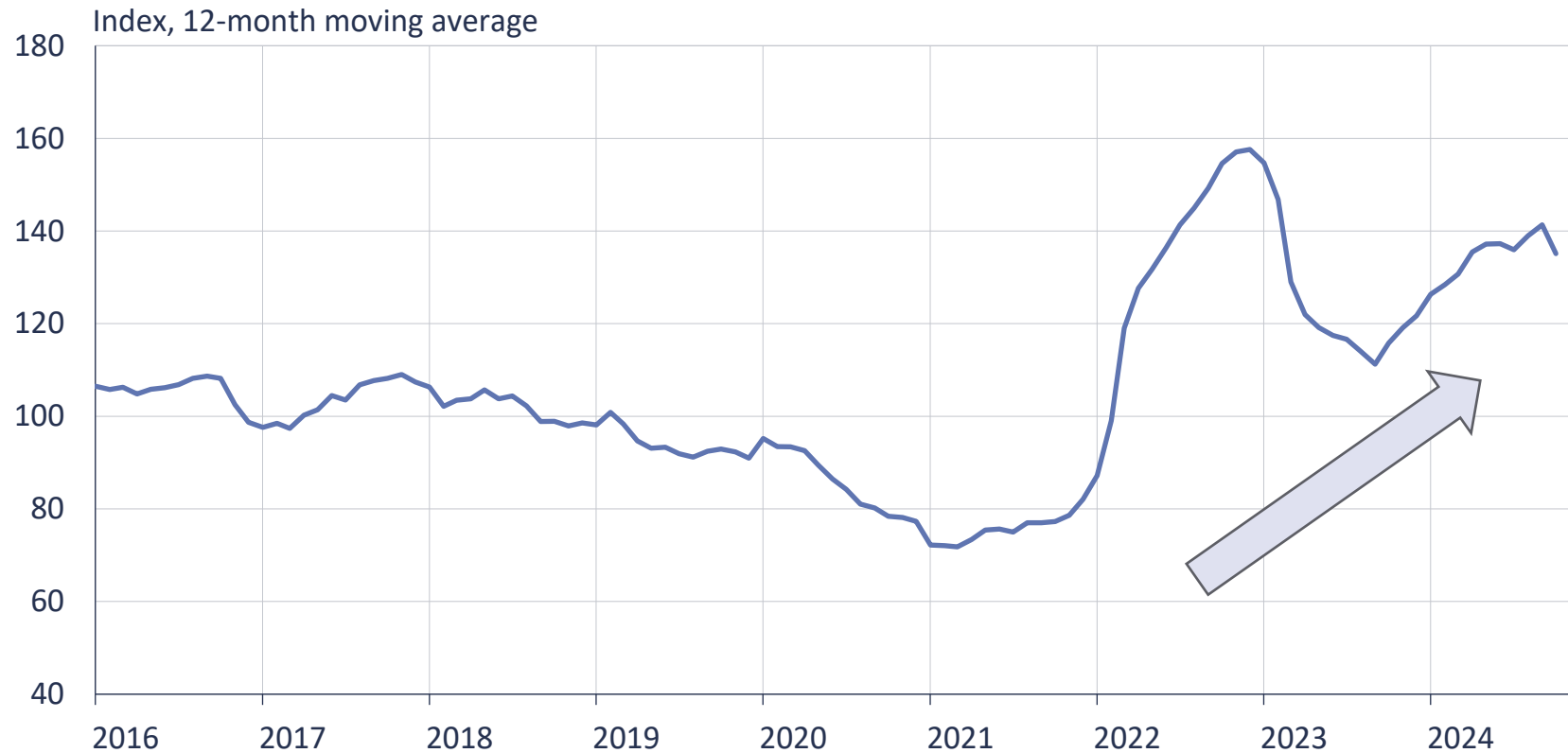
The European Economy under pressure: How is geopolitics impacting trade, finance, and competitiveness?

Meeting with EU Heads of Mission in Finland
2 December 2024

Governor Olli Rehn
Bank of Finland

Global geopolitical tensions remain elevated

Geopolitical Risk Index



Sources: BOFIT and Economic Policy Uncertainty, www.policyuncertainty.com.

Geopolitics overshadowing economic developments

Europe

- **Russia's war in Ukraine**
- Inflation stabilising to the 2% target
- Productivity and industrial competitiveness?

Global troubles

- **Middle East conflict and its escalation**
- Era of trade and tech conflicts
- The BRICS' challenge to liberal global order
- Climate goals slipping: on track to +2.5-3.0°C?

United States

- Policies of the incoming Trump administration: trade, fiscal, immigration?
- Will support for Ukraine hold?
- Strategic competition with China: trade, tech, Taiwan?



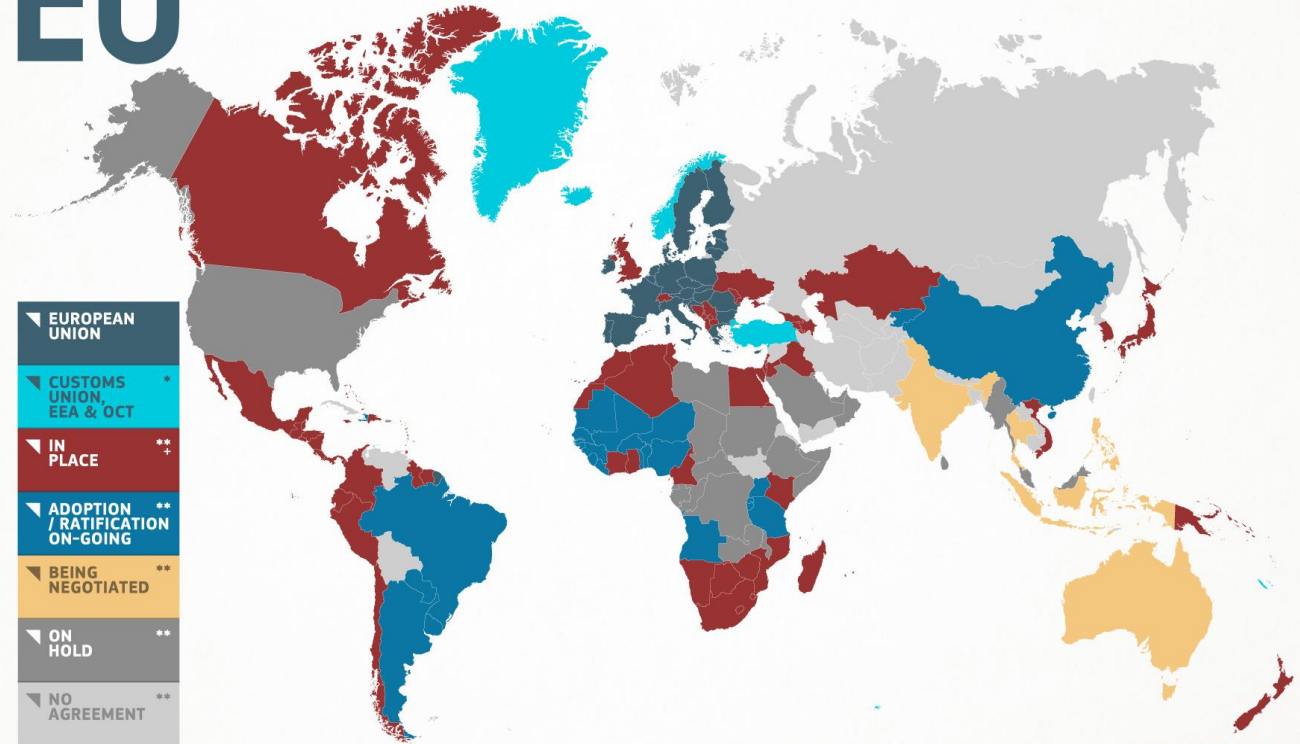
Asia

- China's economic woes
- India now world's most populous and fastest growing G20 country
- Asia's century under way – will it happen or collapse conflict in the South China Sea?

EU free trade agreements in 2024: status report

EU trade agreements 2024

Updated 24/07/2024

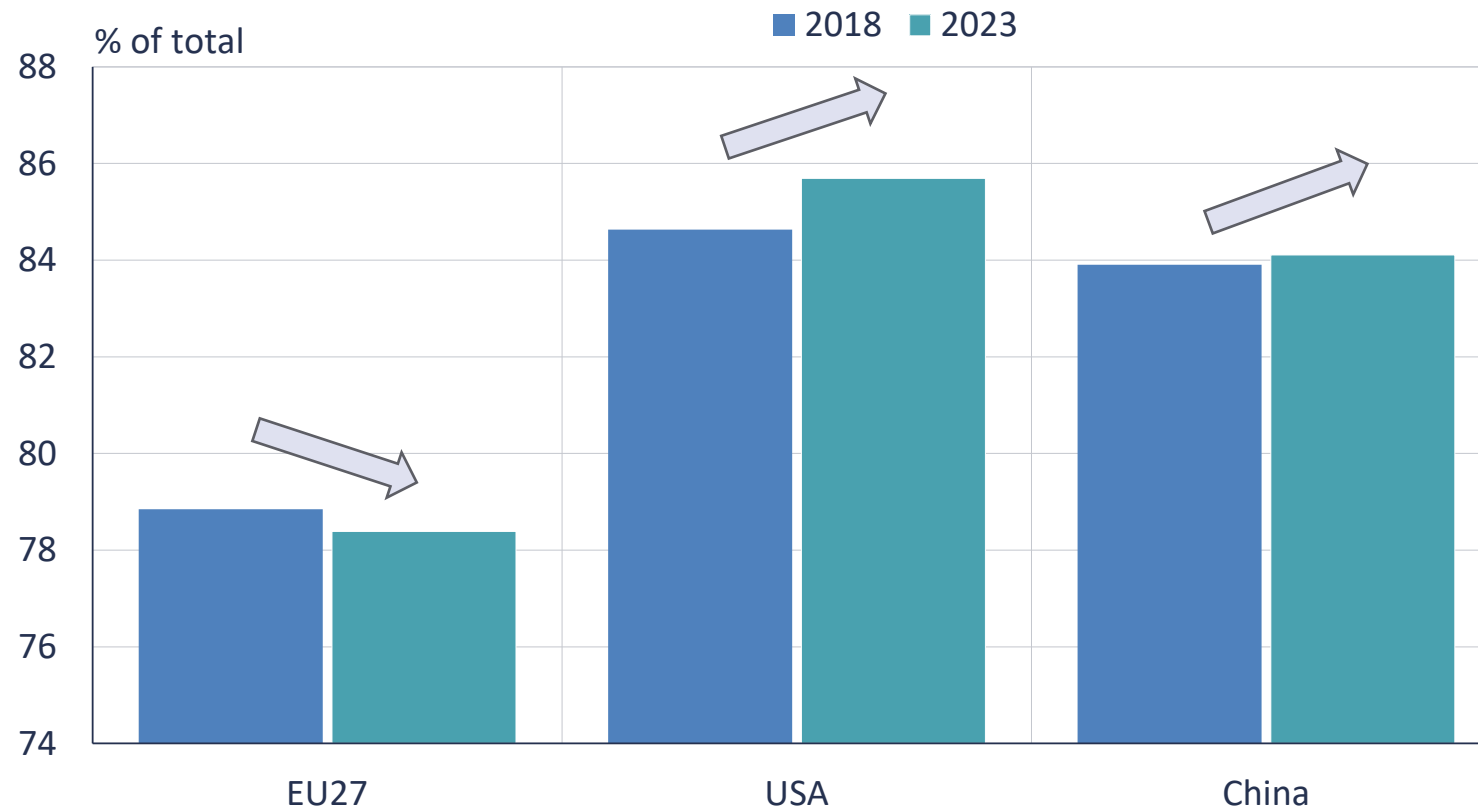


* European Economic Area (EEA) / Overseas Countries and Territories (OCT).
** Free Trade Agreement (FTA), Deep and Comprehensive Free Trade Agreement (DCFTA), Investment Agreement, Enhanced Partnership and Cooperation Agreement (EPCA), Partnership and Co-operation Agreement with preferential element (PCA).
+ The updated agreements with Tunisia, and Eastern and Southern Africa are currently being updated; the updated agreement with Chile is under ratification. The DCFTA with Georgia does not apply in South Ossetia and Abkhazia.



Domestic value added has decreased in the EU

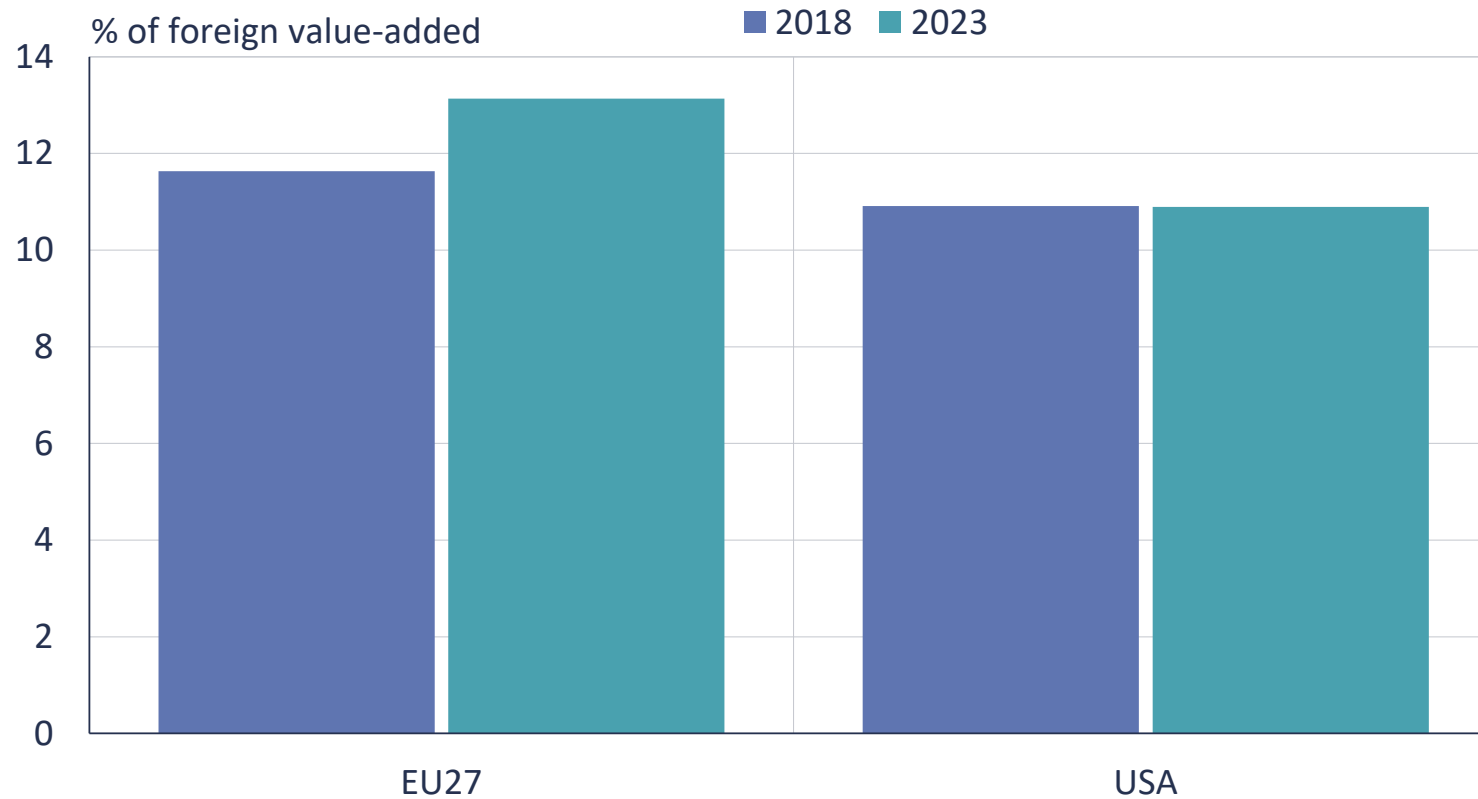
Domestic value-added in manufacturing in 2018 and 2023



Sources: BOFIT based on ADB data.

Chinese value added has increased in the EU and remains unchanged in the US

Chinese value-added in the EU and US manufacturing



Sources: BOFIT based on ADB data.

Monetary policy has been rather effective in reducing inflation

- Interest rate hikes in 2022-23 succeeded in keeping inflation expectations anchored at the 2% target level.
- The ECB Governing Council has lowered its policy rate three times: in June, September, and October 2024. The deposit rate now stands at 3.25%.
- The ECB Governing Council ensures through its decisions that inflation stabilizes at its symmetric 2% medium-term target in a timely manner.
- Next rate-setting monetary policy meeting of the ECB Governing Council will take place on 10-11 December.
- Inflation has stabilized close to the target level. At the same time, a recession has been avoided, and employment has continued to grow.

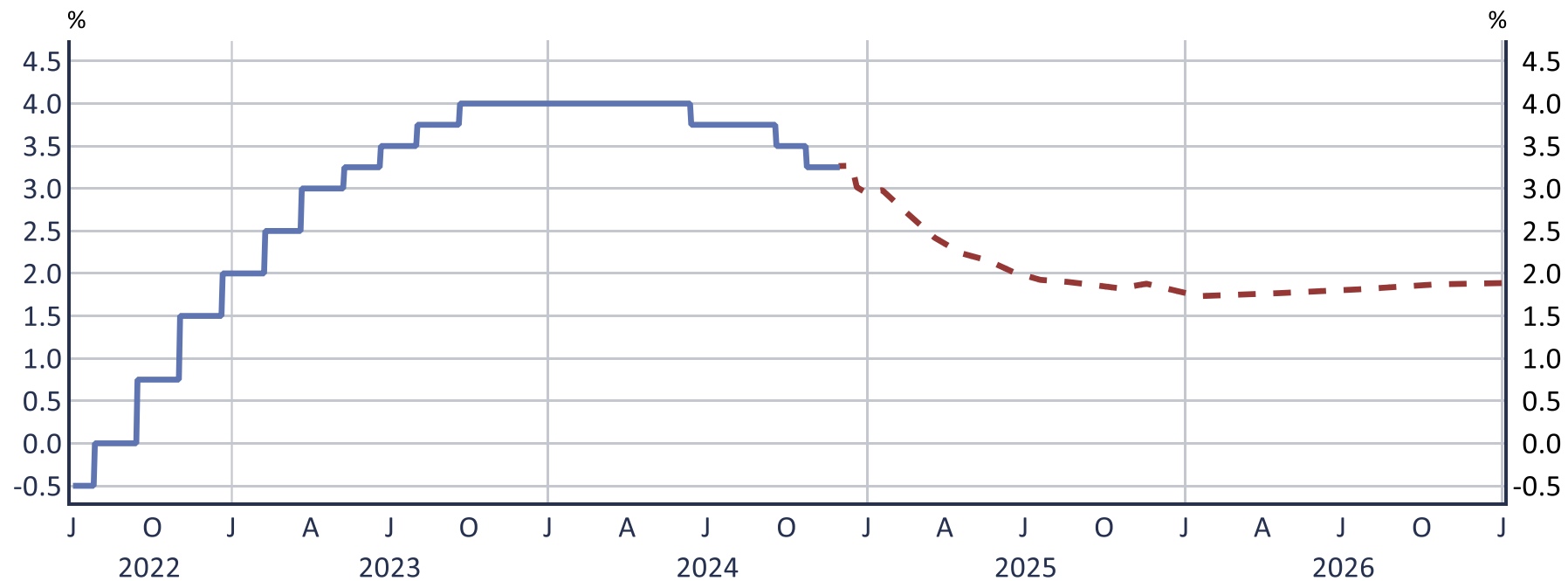
Reflections on the ECB's strategy review in 2025

- **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^***

Market forces expect the ECB to continue rate cuts

Market expectations for ECB's deposit facility rate

— ECB's deposit facility rate — Market expectations 29 November 2024*



Source: 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.

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Europe must find ways to increase productivity

- Europe's populations are ageing, green investments require funding, public debts and deficits are large and defence spending has to be raised.
- This calls for a strong and unified response from the EU → Draghi's report.
 1. Bridging the innovation gap with the United States by reforming the innovation process across its entire lifecycle and improving the level of education in Europe.
 2. Combining Europe's ambitious climate goals with industrial competitiveness.
 3. Enhancing security and reducing critical dependencies.
- The report is a necessary wakeup call and a brutally honest diagnosis of the causes of Europe's lacklustre growth and weak competitiveness.
- Monetary policy can best support sustainable growth and the investments needed to boost productivity by safeguarding price stability.

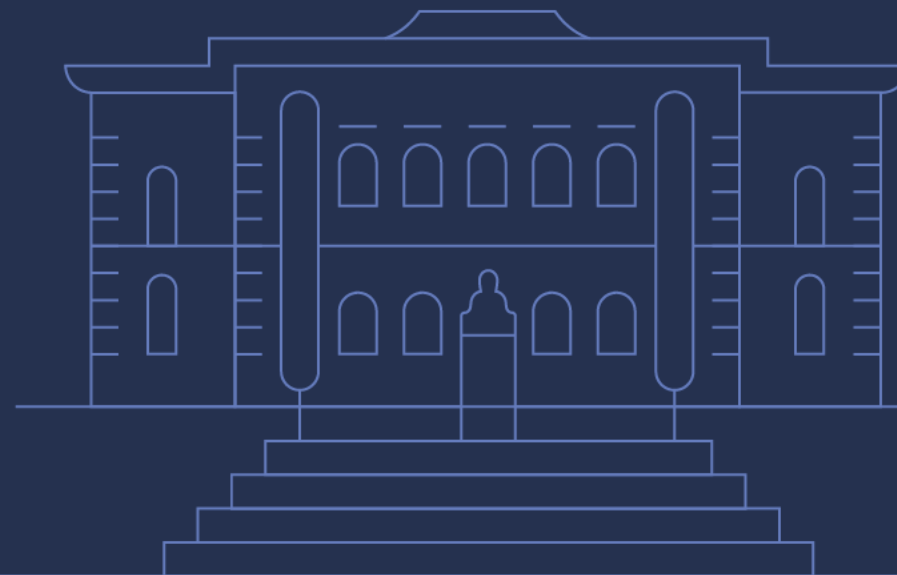
Summing up

- Geopolitical tensions contribute to significant uncertainty and volatility.
- A new trade war should be avoided, especially among allies. If a trade war were to start, Europe must not be unprepared for it.
- 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 sustainable growth.



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Securing stability –
in science we trust.



Thank you!