

Euro – How Big a Difference: Finland and Sweden in Search of Macro Stability *

Euroframe

Warsaw 24 May 2013

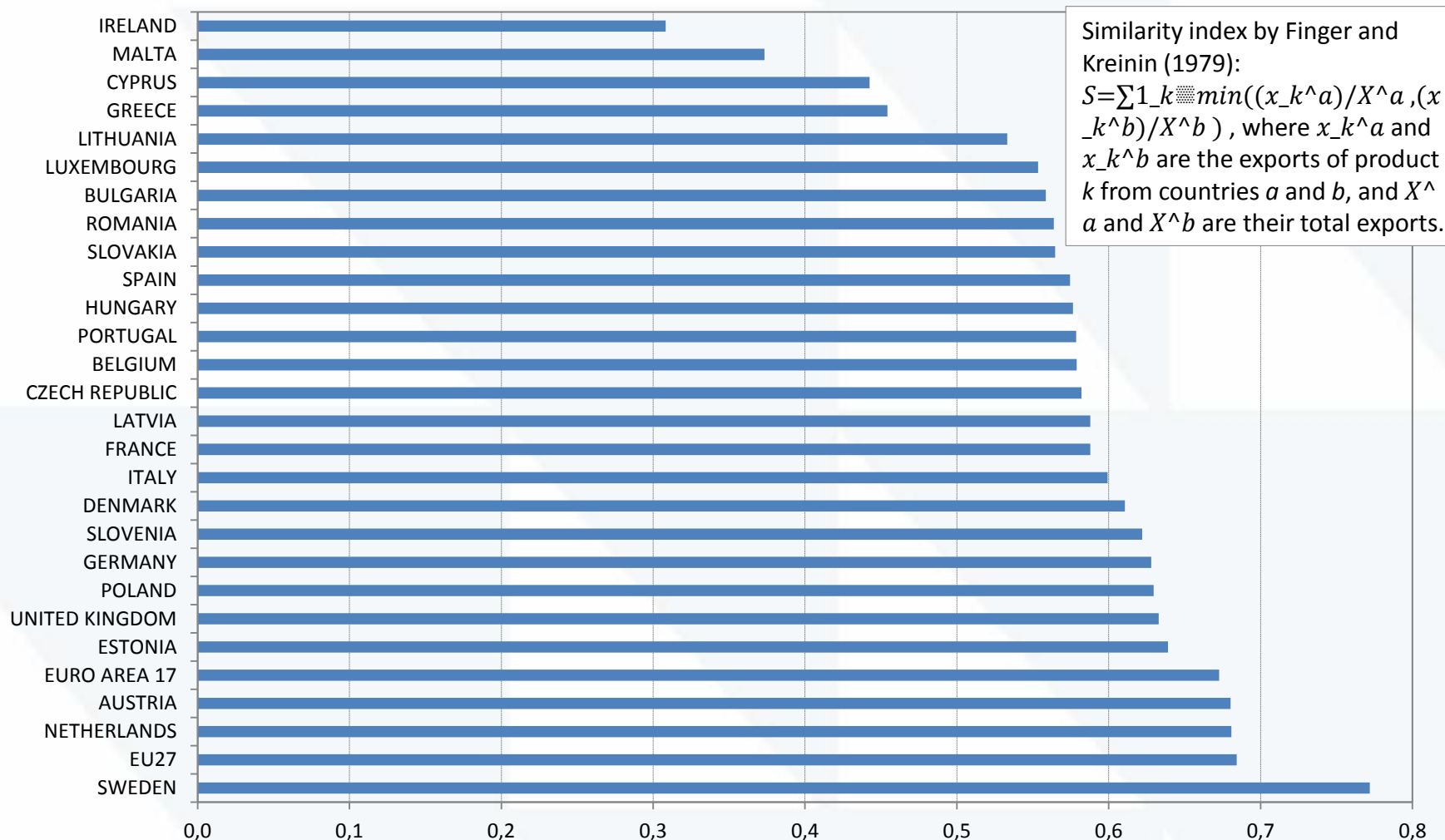
Vesa Vihriälä

* Based on ETLA Report 7/2013 by Paavo Suni and Vesa Vihriälä

Background

- ❑ The euro crisis => new interest in the pros and cons of the of membership in the EMU
- ❑ Different choices of Finland and Sweden an interesting test case
 - Economies and societies structurally rather similar
 - Many parallels also in macroeconomic history
- ❑ The EMU decisions only partially on economic grounds
 - Sweden: perception of inadequate flexibility for the EMU
 - Finland: primarily a political choice

Similarity of Finland's export structure (HS2) vis-à-vis other EU countries' export structures in 2012

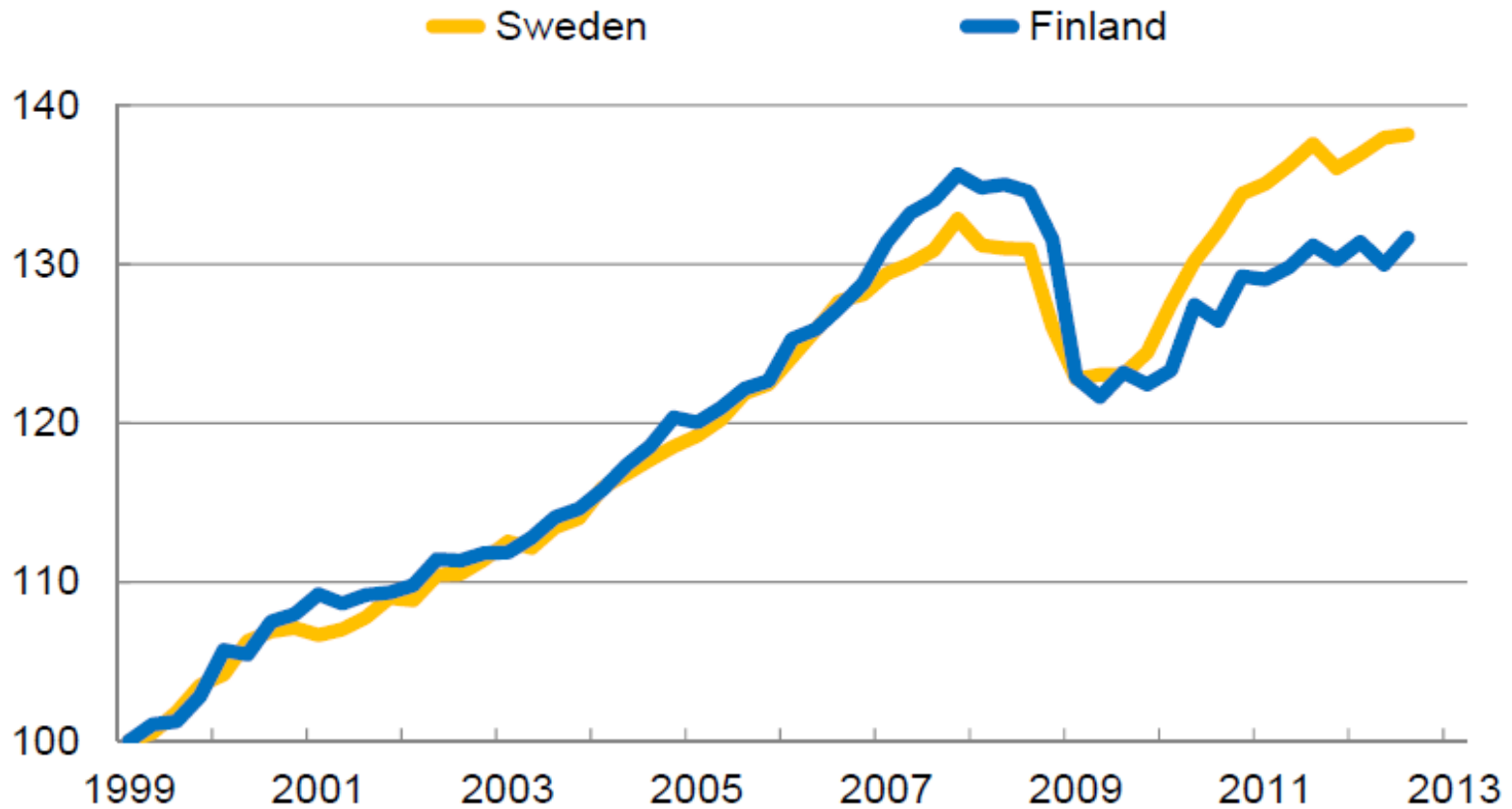


Macro performance in the EMU period

- GDP
 - until 2007 almost identical
 - Finland faster in 2007 and 2008 due to global boom favouring Finnish exports
 - Crisis hit harder and recovery slower in Finland
- Employment:
 - a parallel evolution throughout the EMU period
- Inflation:
 - marginally faster and more variable in Finland
- Effective exchange rate
 - on average stronger relative to 1999 in Finland
 - an important swing in Sweden during the crisis

GDP in Finland and Sweden

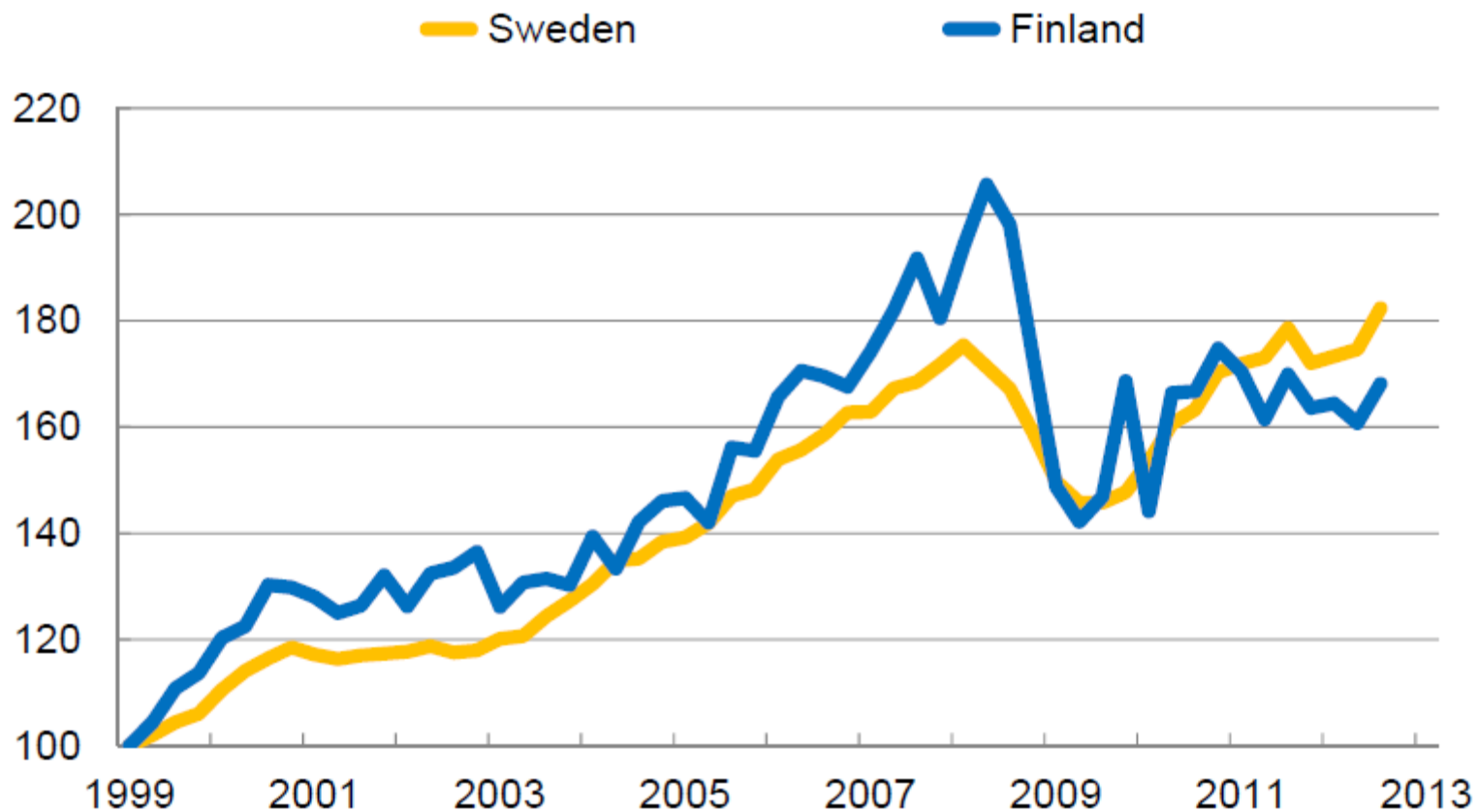
Quarterly data, index 1999/1 = 100



Sources: NiGEM, ETLA.

Exports of goods and services in Finland and Sweden

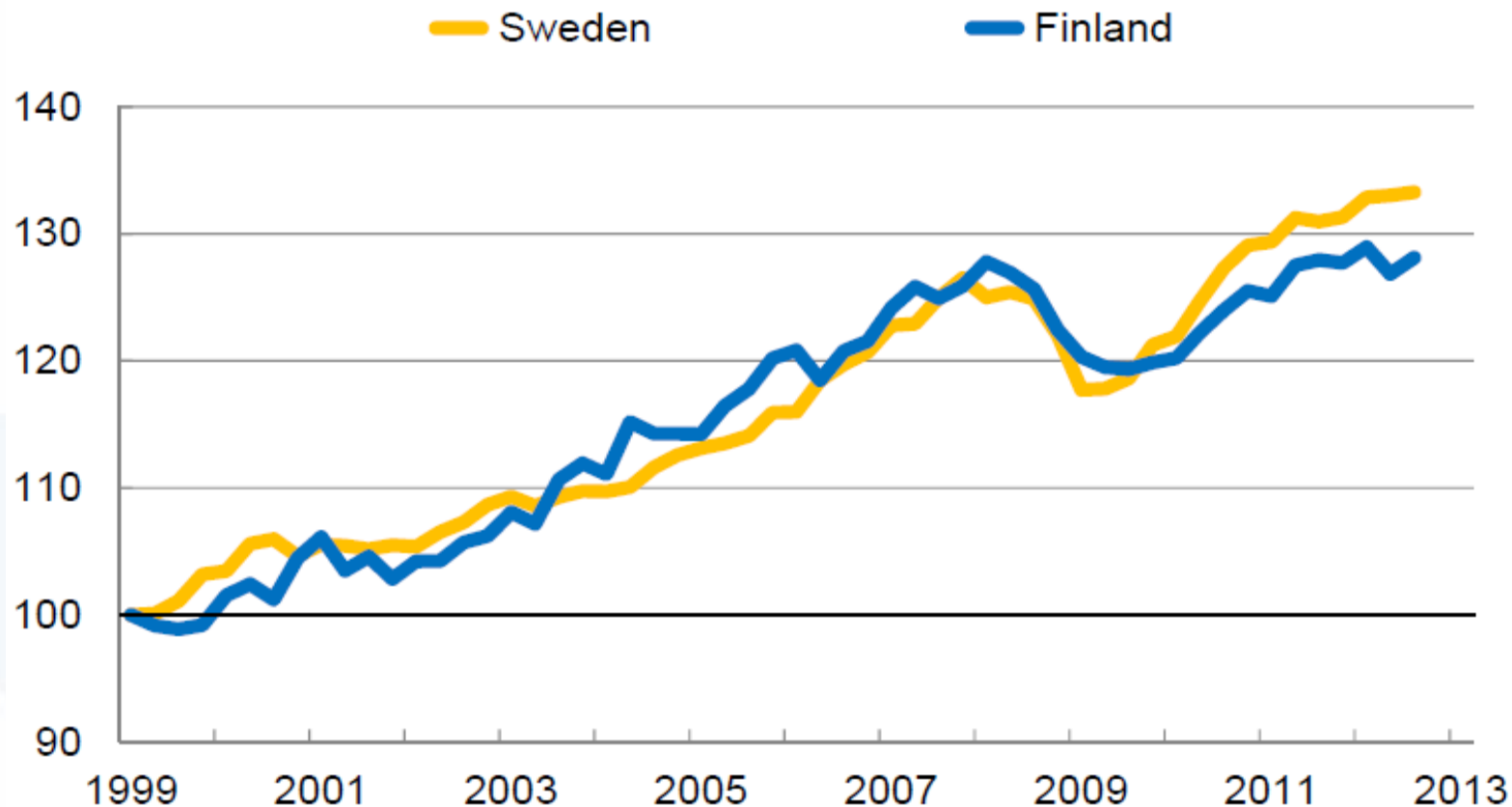
Quarterly data, index 1999/1 = 100



Sources: NiGEM, ETLA.

Total domestic demand in Finland and Sweden

Quarterly data, index 1999/1 = 100

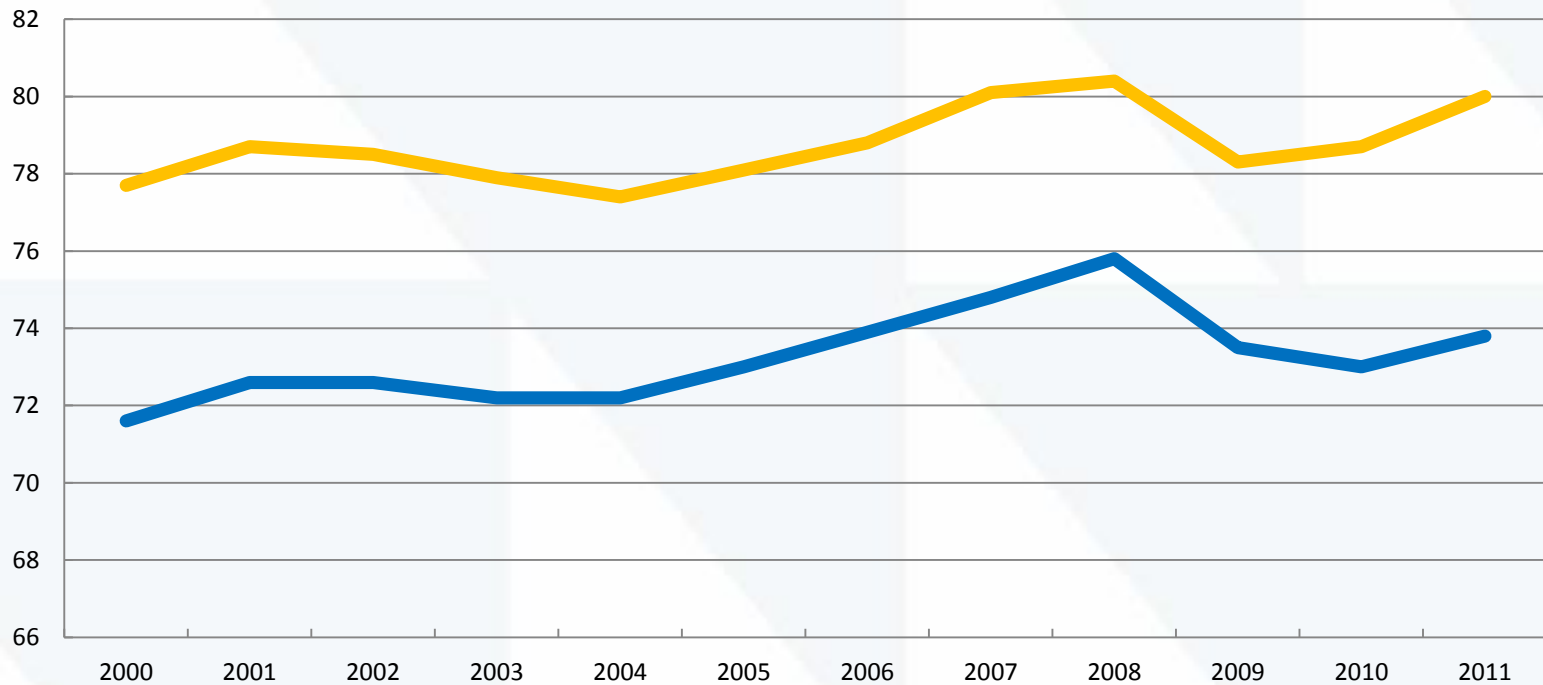


Sources: NiGEM, ETLA.

Employment rate

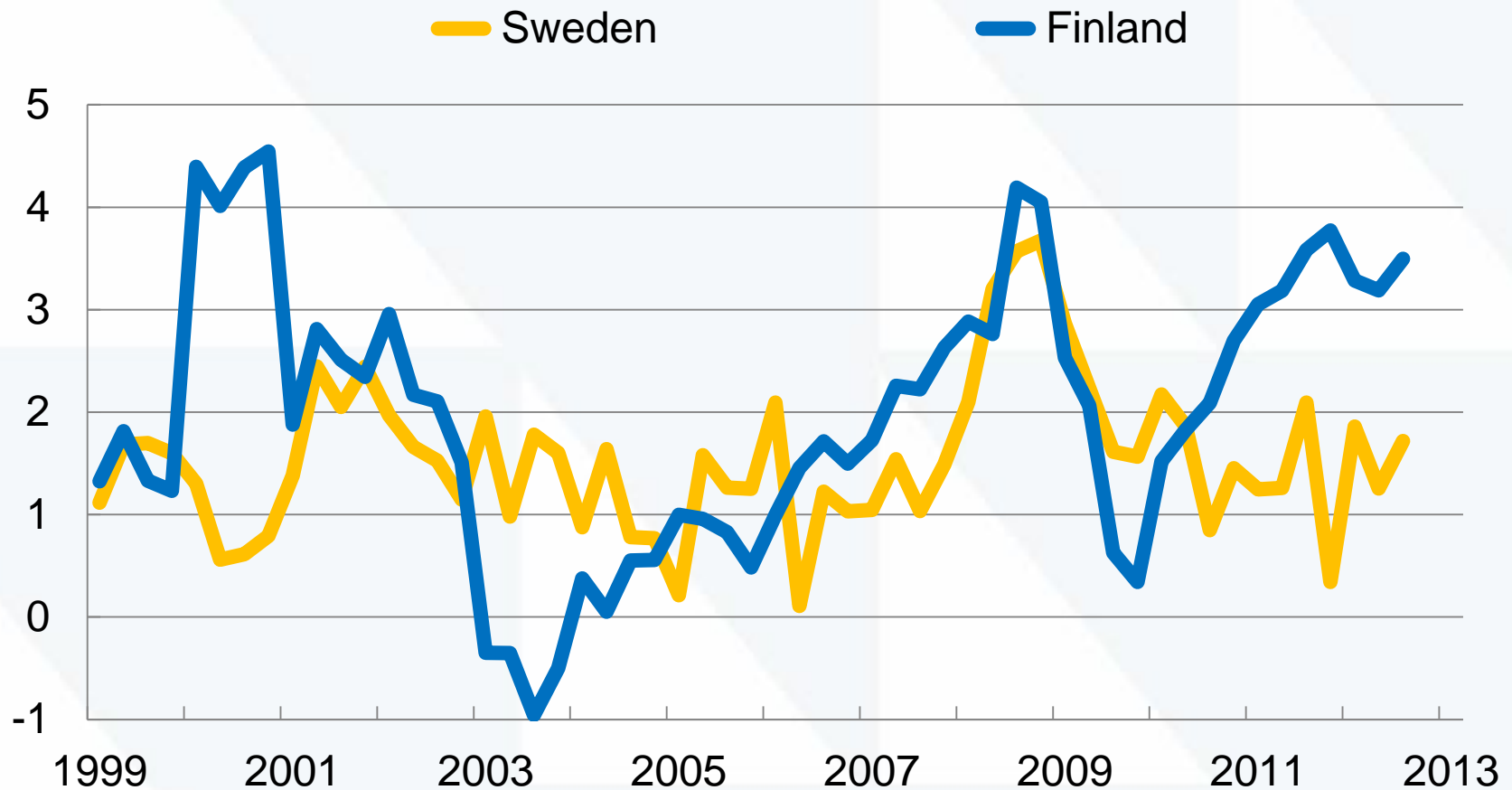
Employed per cent of population of 20-64 years of age

Finland Sweden



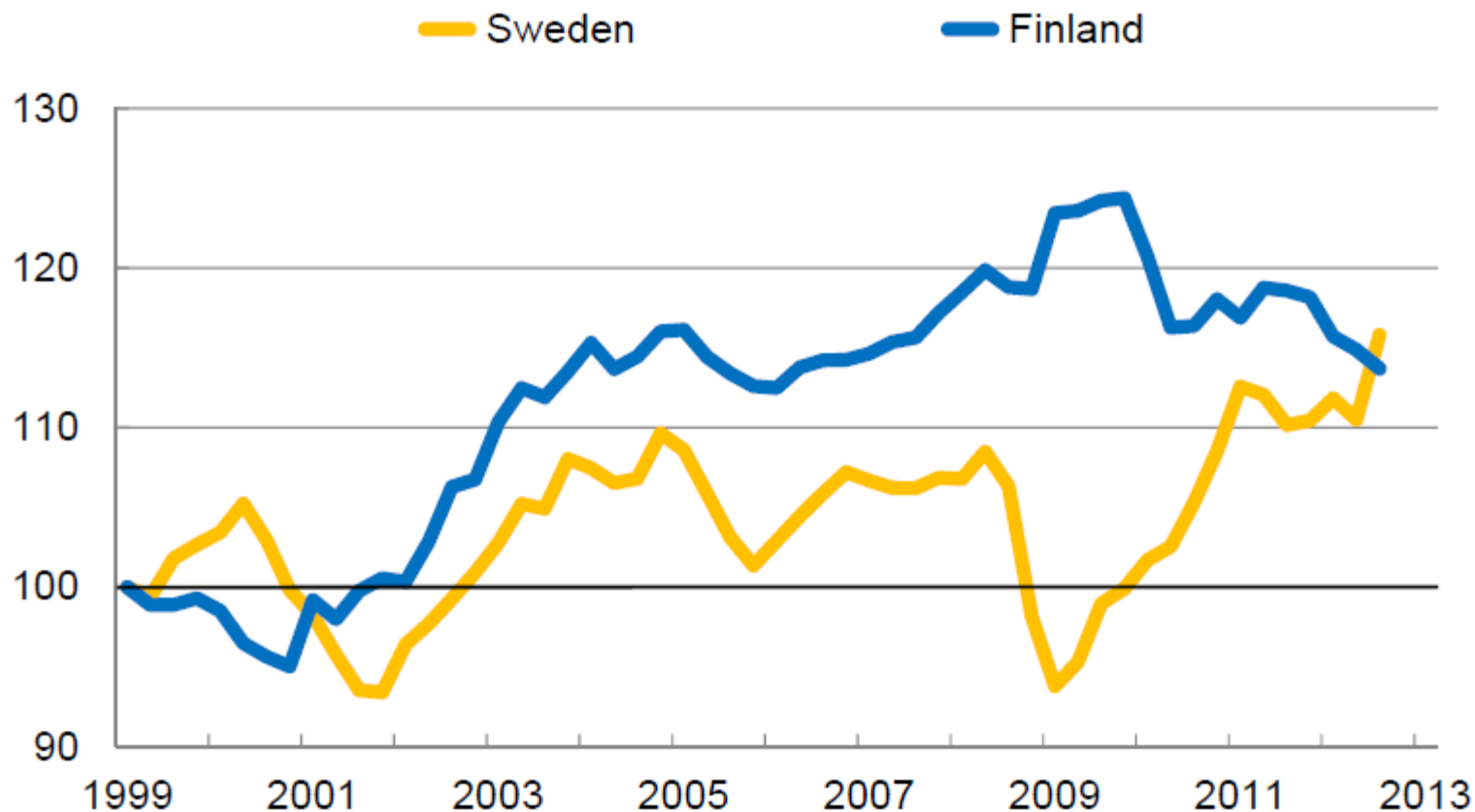
Source: EU Commission

Inflation: annual CPI change, %



Effective exchange rate in Finland and Sweden

Quarterly data, index 1999/1 = 100*



* Currency strengthens, when index numbers rise.
Sources: NiGEM, ETLA.

Price and exchange rate stability before and after the start of EMU

		1985/1-1998/4		1999/1-2012/4	
		Sweden	Finland	Sweden	Finland
Inflation (National concept)	Mean	4.3	3.2	1.5	1.8
	Stdev	3.2	2.1	1.2	1.3
Private consumption deflator Change in per cent)	Mean	4.9	3.4	1.5	2.0
	Stdev	3.3	2.0	0.7	1.3
Effective exchange rate, level	Stdev	6.6	6.3	4.3	4.8

A counterfactual simulation for Sweden in "EMU"

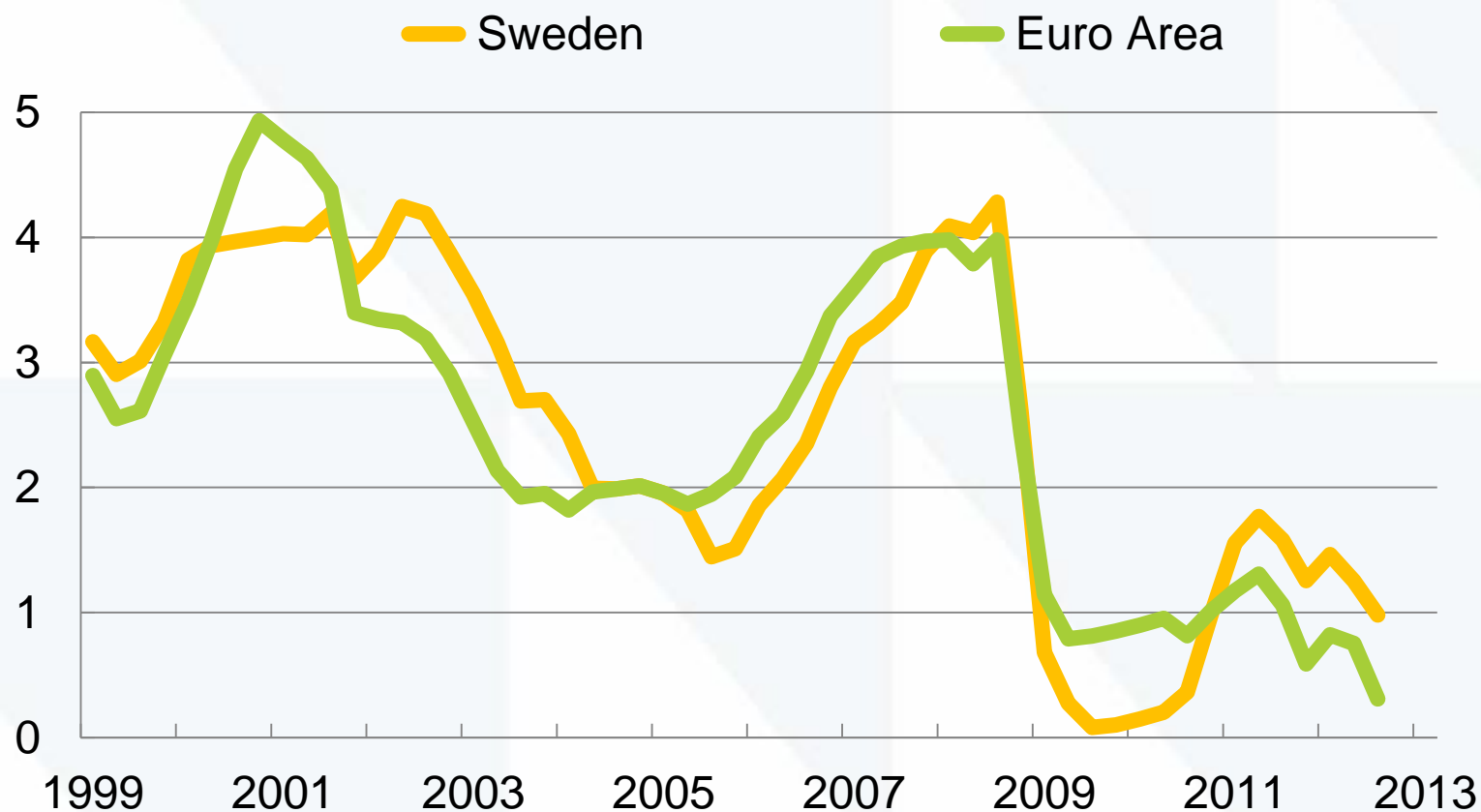
□ NiGEM

- A New Keynesian estimated structural model
- Demand determines production in the short term
- Backward or forward looking expectations

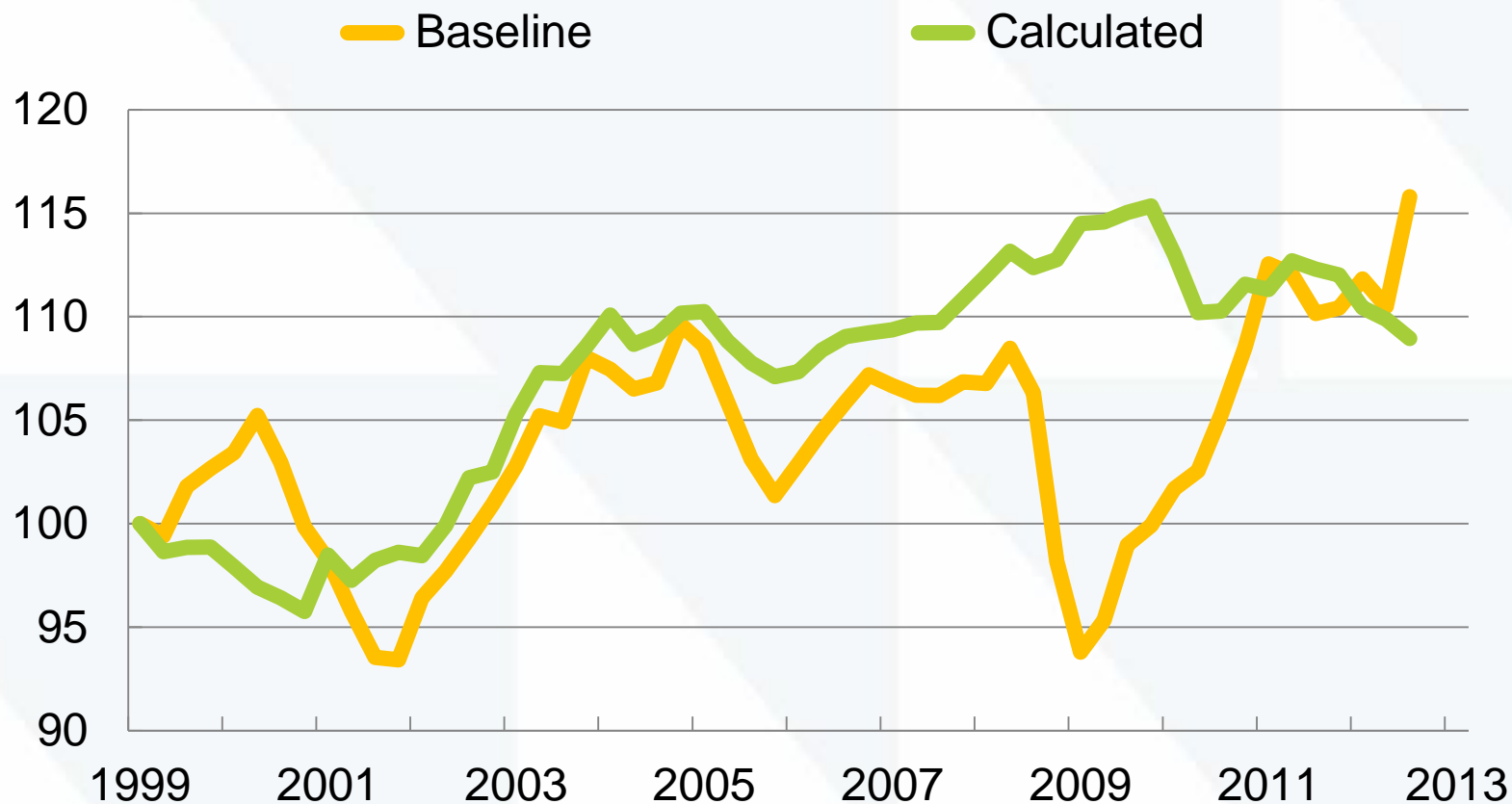
□ The counterfactual

- Imposing the EA monetary policy on Sweden as of 1/1999.
 - EA steering rates and short-term interest rates.
 - Fixing the SEK in euros, about 9.5 kroner per euro.

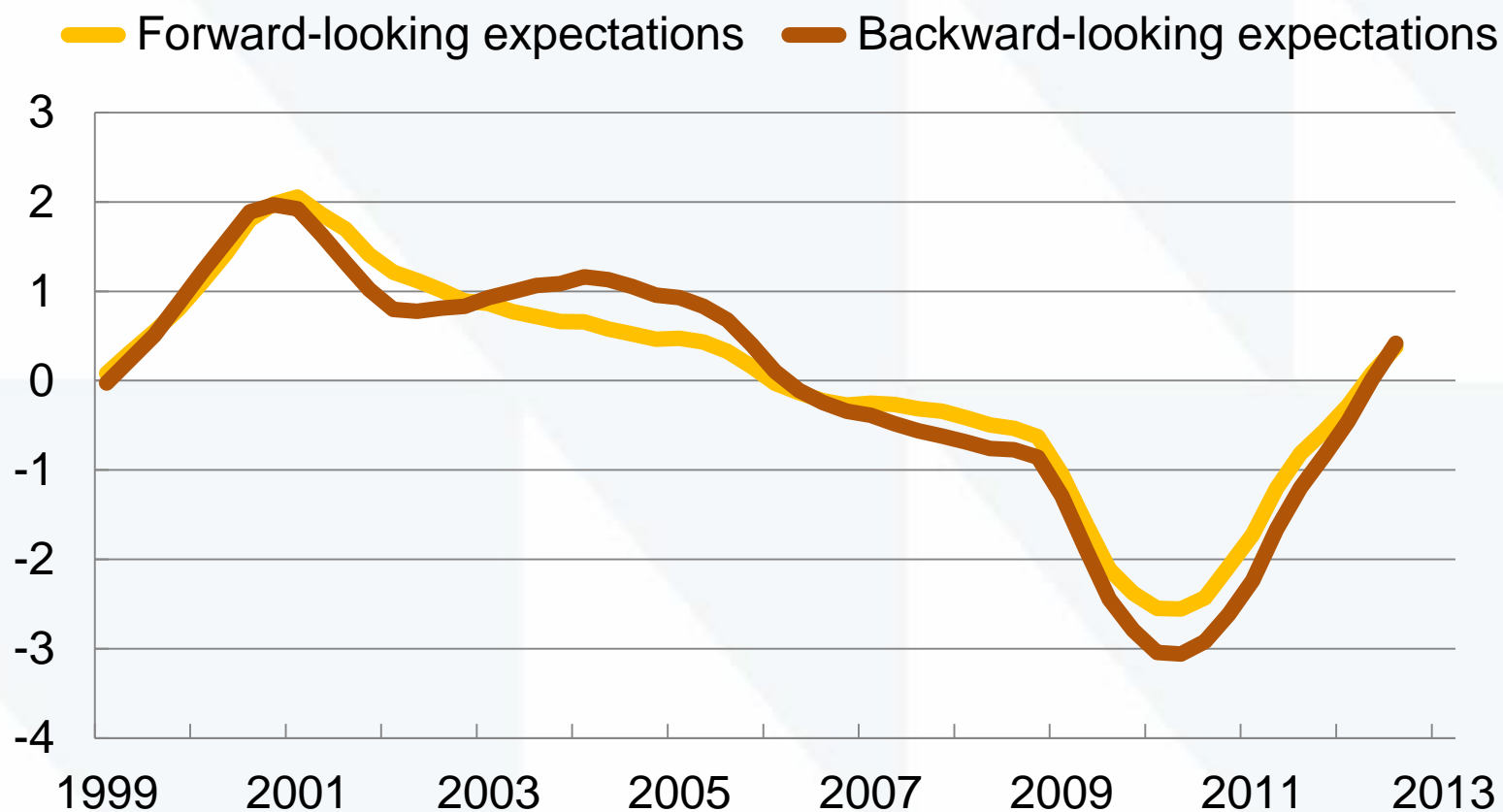
Three-month interest rates in the Euro Area and in Sweden, %



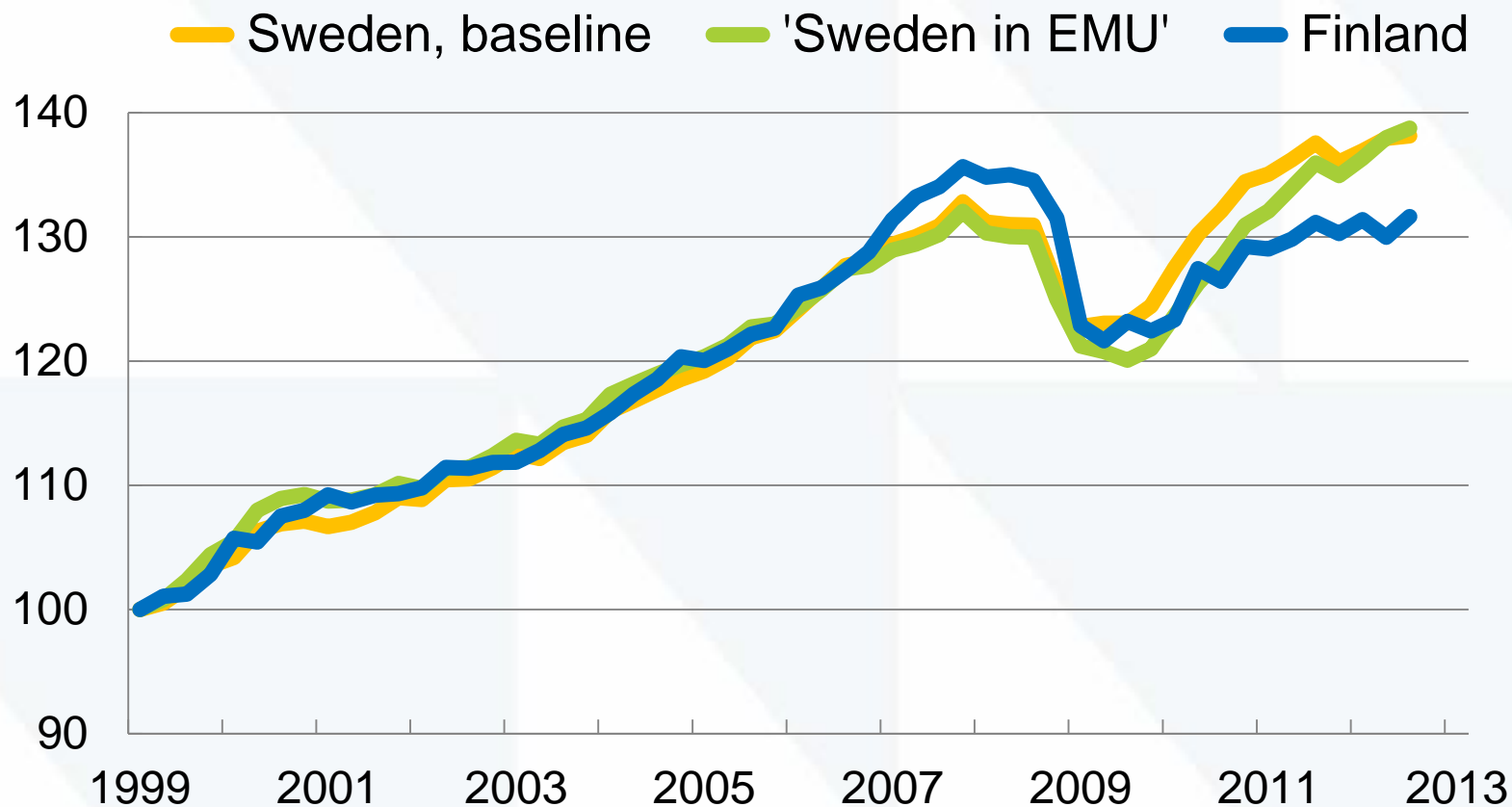
Calculated and baseline effective exchange rate in Sweden, 1999/1 = 100*



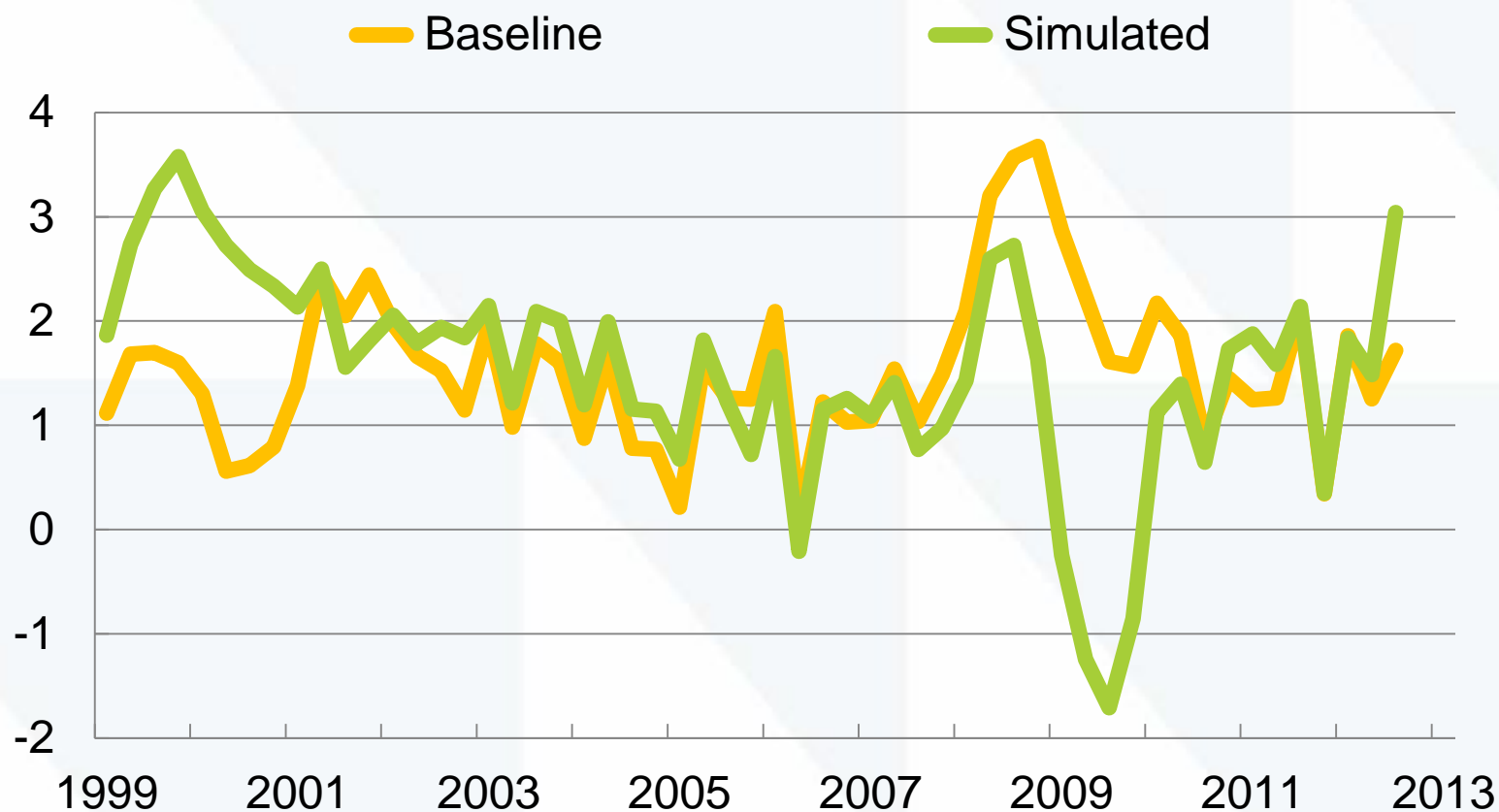
Deviation of the simulated GDP from the baseline in Sweden, %



Simulated and baseline GDP for Sweden and baseline GDP for Finland, 1999/1 = 100



Simulated and baseline inflation rate* in Sweden, %



* Private consumption deflator.

Conclusions

- ❑ An independent monetary regime softened the impact of the 2008/2009 shock on Sweden and made the recovery faster
- ❑ But no long-lasting impact on the GDP level
- ❑ The positive effects of largely due to stabilising exchange rate reactions, which may not obtain in all shock situations
- ❑ The relative discrepancy in the GDP level between Sweden and Finland in 2012 cannot anymore be explained by the different monetary regimes

- ❑ Monetary regimes matter, but the different choices of Sweden and Finland have not been very important for the relative performance of the two economies