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MEDIA RELEASE

Economic Forecast 2013/2:

THE EURO AREA RECESSION APPEARS TO BE OVER – FINLAND'S GDP WILL GROW BY 1.6 PER CENT IN 2014

- *The euro area recession appears to be over, but growth will remain slow*
- *Upturn began also in Finland in second quarter, but GDP for the year as a whole remains lower than in 2012*
- *Finland's GDP will fall 0.4 per cent in 2013 but grow by 1.6 per cent next year*
- *The volume of exports will still decline in 2013 by nearly one per cent; it is expected to grow by 3.5 per cent in 2014*
- *Private consumption will decline by 0.4 per cent in 2013 due to the rise in the savings ratio; in 2014 consumption expenditure will grow at almost the same rate as the increase of real purchasing power*
- *Business investment will decrease due to weak demand in 2013, but it will experience a modest increase in 2014 as demand picks up*
- *The unemployment rate will remain high at 8.2 per cent in 2013 and 2014; in 2015 it will fall to 7.9 per cent*
- *Finland's consumer prices will rise 1.7 per cent this year and next; the hike in VAT is spurring inflation this year, but the fall in interest rates is reducing the pressure on prices*
- *The public debt-to-GDP ratio is forecast to exceed 60 per cent in 2015*

The weak period of growth that has prevailed since the 2008 financial crisis is finally beginning to show signs of abating. The total OECD area's GDP growth accelerated in the first quarter to 0.3 per cent and to 0.5 per cent in the second quarter from a zero per cent growth during last year's last quarter. The corresponding figures in the United States were 0.3 and 0.4 per cent, respectively.

Economic development in EU countries has also experienced an upswing. The turning point occurred in the second quarter, with real GDP growth in the second quarter being 0.3 per cent. The recession in the EU began in the last quarter of 2011, reflecting in particular the slump in the euro area. Signs of growth in the EU are still fragile and a new escalation of the euro area's problems cannot be ruled out.

For instance in the United States, Germany and Sweden, GDP has already surpassed the level prevailing in early 2008. In the euro area and Finland, this level is yet to be achieved.

GDP is expected to increase in the US by 1.7 per cent in 2013. Growth is dampened by the decision to significantly reduce the federal debt by 2021, which means that fiscal policy is being tightened significantly already this year. GDP in the EU as a whole will still decline 0.5 per cent this year. In Russia, GDP growth will subside to a couple of per cent. In China, growth will remain at about 7.5 per cent. Both weak Western demand and attempts to mitigate the sharp increase in debt will slow the growth of production.

In 2013 the world's total GDP growth will slow down slightly from last year's figure of about 3 per cent. Factors hindering growth include fiscal policy, which has been tightened due to market pressures, and the euro area crisis.

The recovery is expected to continue if the financial market's confidence remains steadfast and the deficits of the crisis countries can be steered to a sustainable path. Fiscal policy is still stringent in many countries.

The world economy is still at a high risk of substantially less favourable development. At present, the most acute risk is still associated with the EU 's ability to stabilize the finances of public sectors in crisis countries. It affects the financial markets' belief in problem solving and mutual trust between market participants. In the US the biggest challenges are restoring confidence in the private sector and political decision-making relating to government debt. The worst case scenario for the Western world is the turbulence in the financial market turning into a panic as experienced in 2008. Such a crisis would also strain Russia and Asian countries, including China. The risk of crude oil prices rising especially due to the political situation in the Middle East still exists.

EUROZONE UPTURN ALREADY STARTED?

The prolonged recession in the euro area began in the fourth quarter of 2011. The recession was exacerbated by tight fiscal policy caused by over-indebtedness. GDP still continued to contract by 0.3 per cent in the first quarter of this year. During the second quarter, GDP grew from the previous quarter by 0.3 per cent, according to preliminary data. Growth is just beginning, and its continuation depends on the development of business and household confidence.

The European Central Bank (ECB) last lowered its key interest rate in May 2013 by 0.5 per cent. In addition to its interest rate policy, when necessary the ECB has conducted so-called extraordinary monetary policy measures to promote the functioning of financial markets and to ensure sufficient liquidity. When the financial market turbulence was at its peak during the summer and fall of 2012, the ECB announced the purchase of an unlimited amount of short-term debt of crisis countries in the secondary market, under the condition that these countries will apply for financing from the European Stability Mechanism (ESM). The mere statement has calmed the markets, because it is seen that the risk of the disintegration of the euro has been reduced significantly.

There are also differences in growth between euro area countries in 2013. Output is still declining most in the crisis countries, Greece and Portugal. Also Italian and Spanish production will decrease considerably. In Germany, GDP will grow by half a per cent. French production will decline somewhat.

The euro area's GDP is expected to contract by 0.6 per cent in 2013. Production began to increase in the second quarter and growth is expected to continue in the second half of the year. In 2014, the euro area's GDP will grow by one per cent and in 2015 more than one and a half per cent.

UPTURN BEGAN ALSO IN FINLAND IN SECOND QUARTER

Finland's GDP fell continuously from the second quarter of 2012 to the first quarter of 2013. According to the preliminary data of Statistics Finland, the turning point came in the second quarter of this year, when GDP grew by 0.2 per cent compared to the first quarter. The decline in the volume of exports has come to a halt, but on a seasonally adjusted basis it is still at the level as that prevailing in the first quarter of 2006. Private consumption, which curbed the fall of production during the recession, fell in both the first and second quarters of 2013 by 0.3 per cent from the previous quarter. Purchasing power was eroded by the one percentage point hike in VAT in the beginning of this year. Weakening consumer confidence also dampened consumption. The decline in investment came to a halt in the second quarter due among other things to the completion of a large ship investment. At the same time inventory investment declined sharply. Residential construction was still on the rise early in the year.

GDP FALLING 0.4 PER CENT IN 2013 AND GROWING 1.6 PER CENT IN 2014

The 0.3 per cent GDP growth forecast last March has been revised downwards to a decrease of 0.4 per cent. The main reasons for this are the recovery of international demand being slower than anticipated and weak consumer confidence. The weakness of exports and consumption, in turn, is reflected in investment, which is forecast to decline by more than estimated earlier. GDP is expected to continue expanding in the rest of the year, but due to the low starting level at the beginning of the year, positive figures will not yet be reached. In 2014, however, Finland's GDP will already increase by 1.6 per cent. This will require that the euro area continues to recover and that Finland maintains its export market shares. Growth will accelerate to 2.7 per cent in 2015. New nuclear power plant investments will begin to boost growth at this point. The improvement of employment and the general government deficit will lag behind.

EXPORTS WILL RECOVER GRADUALLY

Exports of goods increased slightly in the beginning of the year compared to the end of last year. In turn, exports of services fell. Compared to early last year, however, exports of goods decreased sharply due among other things to the shutdown of Nokia's Salo factory operations. Paperboard and pulp exports were on the rise early in the year, fuelled by the recovery in demand and increased production capacity. Petroleum products, chemicals, lumber as well as metal products were other bright spots of exports.

The eurozone recession is still widely visible in much of Finnish exports in 2013. The growth of consumer goods exports will accelerate relatively quickly as the export market recovers. The upturn in Finland's key capital goods exports, on the other hand, will occur with a lag. It will take time to receive new orders and start their production. Total exports are expected to decline this year by almost one per cent. Exports of goods will fall by almost two per cent from last year's level. Communication equipment exports will fall sharply due to Nokia's Salo factory being shut down last autumn. Service exports are estimated to grow by a couple of per cent as business service exports are beginning to recover.

In 2014 exports will grow 3.5 per cent. In 2015 growth will accelerate to about 4.5 per cent. Finland's competitiveness has deteriorated due to rising costs and declining productivity growth. The settlement reached in September 2013 on a moderate two-year wage agreement will gradually improve competitiveness, but it will take time before we see its impact on exports. The projected development of exports requires significant investments in new product development and marketing in the future, in order to fill the gap left by e.g. the contraction of the electronics industry. The continuation of wage moderation after 2015 would also support growth.

PRIVATE INVESTMENT STILL FALLING DUE TO WEAK DEMAND

According to Statistics Finland 75.8 per cent of industrial capacity was in use in July 2013. This was 1.6 percentage points higher than a year earlier. There is still a lot of idle capacity, but the trend is improving. Since the outlook for both exports and private consumption is still uncertain, companies will postpone their investments for a while. Total investment is forecast to decline by 4.3 per cent this year. Next year it will grow 0.7 per cent. Machinery and equipment investment will fall this year by 8 per cent and a further 5 per cent next year. Housing investment will decline in 2013 by one per cent, but it will rebound in 2014, increasing by two per cent.

In 2015 the total investment growth will pick up to 5 per cent as the economic situation improves. Companies need to increase production capacity and production investment will grow by 8 per cent. Also, residential construction will continue to grow as the demand for housing remains high in major growth centres. Investment will be boosted by the start of construction of new nuclear power plants.

FALL IN WORKING AGE POPULATION CURBING RISE IN UNEMPLOYMENT RATE

Despite the fall in output and modest employment growth, the unemployment rate fell by 0.1 percentage point to 7.7 per cent last year. One of the main reasons for this is that the size of the working-age population has started to decrease due to aging. The employment rate increased 0.4 percentage points to 69 per cent. In 2013, the employment rate will fall slightly and the unemployment rate will climb to 8.2 per cent due to the weak economic growth this year and lagging effects from last year. The rise in the unemployment rate is being dampened by the fact that part of the population has ceased active job search and is thus classified as being outside the labour force. In 2014, the unemployment rate will remain at 8.2 per cent. In 2015, the unemployment rate will be 7.9 per cent with the employment rate being slightly under 70 per cent.

SLUGGISH PURCHASING POWER GROWTH AND WEAK CONFIDENCE DAMPENING CONSUMPTION

Private consumption is projected to decrease by 0.4 per cent in 2013. The main reason for the decline is weak consumer confidence. The amount of new consumer loans has declined in the beginning of this year and the savings rate is on the rise. The number of employed persons will fall from last year, and labour input will shrink. Real earnings will rise by almost one per cent as a consequence of the 2011 comprehensive wage settlement and the slowdown in international inflation. The increase in VAT by one percentage point in the beginning of 2013 will nevertheless decrease purchasing power. The income tax burden is also increasing slightly since at the beginning of the year no adjustments were made in income tax rates for inflation or the rise in earnings.

Private consumption is expected to grow in 2014 by 1.2 per cent. Real earnings will fall, but labour input will rise slightly in the wake of the recovery in the economy. Pension income will grow because of the increase in the number of retired persons and adjustments of pensions for inflation. Real disposable household income will rise by about one per cent. Household confidence is expected to improve owing to the recovery in economic growth and improvement in employment. In 2015 private consumption is expected to grow by 1.9 per cent. The rise in employment will have a positive impact on employees' possibilities to consume, even if real wages are reduced by moderate wage hikes. The purchasing power of retired persons will increase more than that of employed persons owing to the inflation adjustment of pensions in 2015. Households' real purchasing power will rise by over one per cent. The improvement in consumer confidence is expected to continue.

VAT HIKE BOOSTING INFLATION IN 2013

Consumer prices are expected to rise by 1.7 per cent in 2013. The inflation forecast has been reduced from that made last spring because interest rates have continued to fall and the rate of international inflation has declined. Inflation is being boosted by about 0.7 percentage points by the hike in VAT implemented at the beginning of the year. Wage and salaries will increase this year by 2.4 per cent in accordance with the comprehensive wage settlement. The EU-harmonized inflation rate, where interest on housing loans is not included, will climb by approximately 2.5 per cent. Consumer prices are expected to rise by 1.7 per cent in 2014. The rate of inflation for 2015 is estimated at one and a half per cent.

SLOWDOWN IN GROWTH WILL ERODE IMPACT OF FISCAL BELT TIGHTENING

The central and local government's financial deficit increased one percentage point to 4.9 per cent of GDP in 2012. The central government deficit was 3.8 per cent of GDP. Slower economic growth eliminated the impact of spending cuts and tax increases. In 2013, the central and local government's deficit will decline slightly to 4.7 per cent as a percentage of GDP. As a consequence of tax increases, spending cuts and the upturn in economic growth, the central government's deficit-to-GDP ratio will decrease to 3.4 per cent in 2014 and to 3 per cent in 2015. The general government's EMU deficit will be 0.9 per cent of GDP in 2015. The ratio of the general government's EMU debt to GDP will continue to climb, exceeding the 60 per cent ceiling stipulated in the Stability and Growth Pact in 2015.

The government's goal of bring about a decline in the central government debt-to-GDP ratio during its term in office will not be fulfilled under the current growth projections without further adjustments to expenditure and revenue. We forecast that the debt-to-GDP ratio will rise by a further half a percentage point in 2015. The stabilization of the debt ratio on the previous year's level would require austerity measures of about one billion euros. Achieving the goal of a maximum one per cent deficit-to-GDP ratio is even more difficult because it would require additional austerity measures worth about 4 billion euros during the government's term in office. The government will run out of time.

In August 2013 the government presented its structural policy programme, which aims to reduce the long-term sustainability gap caused by the aging of the population. The programme will not have much time to affect the public sector's fiscal balance during the forecast period. If the programme can be implemented in a credible way, it will reduce the pressure for further austerity measures in the short term. The rise in the EMU debt above 60 per cent of GDP will nevertheless constrain the manoeuvring room in economic policy. For this reason, measures to shore up the general government's financial position will still be necessary in the medium term.

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Balance of resources

	Value	Change in volume, %					
	€ Mrd.	Y/Y				Average	
	2012*	2012*	2013F	2014F	2015F	08 - 12	13 – 17F
GDP	192,5	-0,8	-0,4	1,6	2,7	-0,7	1,7
Import	79,6	-1,2	-4,7	3,5	3,7	-0,1	2,3
- goods	56,9	-4,6	-4,4	3,5	4,2	-1,4	2,8
- services	22,8	8,6	-5,5	3,4	2,5	4,0	1,2
Total supply	272,2	-0,9	-1,7	2,1	3,0	-0,5	1,9
Export	78,0	-0,4	-0,8	3,5	4,5	-1,7	3,2
- goods	57,1	-0,5	-1,8	4,4	4,3	-2,8	3,0
- services	20,9	-0,1	2,1	1,0	5,0	2,4	3,8
Investment	37,7	-1,1	-4,3	0,7	5,0	-1,7	2,1
- private	32,7	-1,3	-4,7	0,9	5,4	-2,0	2,2
- public	5,0	0,9	-1,0	-0,5	2,6	0,4	1,2
Consumption	156,9	0,3	0,1	0,9	1,4	0,9	1,1
- private	108,5	0,2	-0,4	1,2	1,9	1,0	1,3
- public	48,3	0,6	1,4	0,4	0,4	0,7	0,6
Changes in inventories	0,3	-0,9	-0,9	0,4	0,1	0,0	0,0
Total demand	272,2	-1,0	-1,6	2,1	3,0	-0,5	1,9
Domestic demand	194,9	-1,3	-2,1	1,4	2,3	0,1	1,2
Public demand	53,3	0,6	1,1	0,3	0,6	0,7	0,7

Key forecasts

	2010	2011*	2012*	2013F	2014F	2015F
Consumer price index change, %	1,2	3,4	2,8	1,7	1,7	1,6
Wage level change, %	2,6	2,7	3,3	2,4	1,3	1,0
Unemployment rate, %	8,4	7,8	7,7	8,2	8,2	7,9
Current account surplus, % of GDP	1,7	-1,5	-1,9	-0,8	-0,1	0,6
Industrial output change, %	5,6	3,6	-2,4	-2,4	3,1	4,2
Euribor, 3-month, %	0,8	1,4	0,6	0,3	0,5	0,8
EU27 countries, GDP change, %	2,0	1,7	-0,4	-0,2	1,1	1,5
EMU countries	2,0	1,5	-0,6	-0,5	0,9	1,7
EU27countries, change in CPI, %	2,1	3,1	2,7	1,7	1,7	1,9
EMU countries[1)]	1,6	2,7	2,5	1,5	1,5	1,7
Finland's EMU surplus, % of GDP	-2,5	-0,8	-1,9	-2,1	-1,7	-0,9
Finland's EMU debt, % of GDP	48,6	49,0	53,0	57,4	59,0	60,2

[1)] Harmonised index

Source: Statistics Finland