ELINKEINOELÄMÄN TUTKIMUSLAITOS
THE RESEARCH INSTITUTE OF THE FINNISH ECONOMY

Not to be published before 26.9.2012 10 AM

MEDIA RELEASE

SUHDANNE 2012/2:

GLOBAL ECONOMIC RECOVERY DELAYED - FINLAND'S GDP GROWTH REMAINS AT 0.5 PER CENT IN 2012

- *The euro crisis escalated again in the summer and the global economic recovery has been delayed; an upswing is not expected until mid-2013 at the earliest*
- *Finland's GDP will grow 0.5 per cent in 2012; next year growth will remain at 1 per cent due to weak exports and consumption*
- *Finland's consumer prices will rise by 2.9 per cent in both 2012 and in 2013; the VAT hike and rise in food prices will spur inflation next year*
- *Private consumption will increase by 1.1 per cent in 2012, but in 2013 the modest improvement in purchasing power will cause growth to drop to 0.6 per cent*
- *Business investment will decline due to weak demand both in 2012 and 2013*
- *The unemployment rate will be 7.7 per cent in 2012 and 8.0 per cent in 2013*
- *The economic slowdown will erode the effect of fiscal belt-tightening; the government's goal of bringing about a decline in the debt / GDP ratio is in danger*

The growth of the world economy will slow down, as the euro area recession curbs economic activity also in the rest of the world. Early in the year, an upswing was still expected for the end of the year, but the new escalation of the euro crisis in the spring and summer has triggered a new decline in leading indicators. An upswing is expected no earlier than mid-2013.

The entire EU area’s GDP will contract by 0.3 per cent this year. U.S. gross domestic product is expected to increase by about 2 per cent in 2012. Russia’s GDP growth rate will fall to 3.5-4 per cent. China is still expanding by some 7.5 to 8 per cent. Weakening western world demand and domestic inflationary pressures are retarding growth there, too.

In 2012 the entire world's GDP growth will slow from last year's 3.5 per cent to 2.8 per cent. Tightened fiscal policy due to market pressures and the crisis in the euro countries are dampening factors. Growth may accelerate in mid-2013 if the crisis countries' deficits can be steered toward sustainable paths and market confidence can be restored. Fiscal policy is still stringent in many countries, but the private sector could even afford to increase its borrowing.

There is still a high risk of substantially less favourable development in the world economy. At the moment the most critical risk is related to the EU countries' ability to stabilize the financing of the public sector of the problem countries. In the United States, the main challenges are restoring the confidence of the private sector and political decision-making during the presidential election.

The worst case scenario for the western world is still the financial market turbulence escalating into a panic like the one experienced in 2008. This kind of crisis would also affect Russia and Asian countries, including China. Recently, a possible increase in the price of crude oil from the present level has become a new risk due to e.g. Iran's political situation.

EUROZONE CRISIS ESCALATED AGAIN IN THE SUMMER

In practice, the euro area has been in recession since the end of last year. In 2011 the real GDP of euro countries grew by 1.5 per cent. However, in the fourth quarter it decreased from the previous quarter. In the first quarter of 2012 GDP was at the level of the previous quarter but fell again in the second.

The actions of the European Central Bank late last year and early this year, as well as restructuring of Greek public debt in connection with the aid package negotiated in February contributed to calming the financial markets and boosted confidence.

Turbulence increased again in the spring and summer, however, as the crisis spread to the government bond markets of Italy and Spain. At the same time euro area business and consumer confidence plummeted. The economic turnaround expected for the latter half of this year will be clearly delayed into next year.

Crisis countries must now perform all actions necessary to consolidate their public finances and restore competitiveness. Tight fiscal policy weakens overall demand in the short term, but in the long term it is crucial in restoring the confidence of investors. The European Central Bank and the European Financial Stability Facility (EFSF) as well as the permanent European Stability Mechanism (ESM) beginning to operate next year can act as some sort of bridge financiers to restore confidence. In September the ECB agreed to buy the crisis countries’ short bonds from the secondary market on the condition that they apply for long-term financing from the afore-mentioned mechanisms. This has increased market confidence in the normalization of the interest rates of problem countries, which is a necessary, though not sufficient, condition for them to achieve renewed growth. The ECB may also further lower its repo rate from the current 0.75 per cent to 0.5 per cent.

There are significant differences in growth between euro area countries in 2012. The output of crisis countries Greece and Portugal will decline the most. Italian, Spanish and Dutch output will also decrease significantly. In Germany, GDP will grow by half a per cent, and in France growth is close to zero. Exports in these countries will also be affected as demand in the crisis countries falls.

Real GDP in the euro area is expected to contract by 0.6 per cent in 2012. Output will start to expand again towards the middle of next year. In 2013 euro area GDP growth will be half a per cent, and in 2014 about one and a half per cent.

GDP GROWING BY HALF A PER CENT IN 2012 AND ONE PER CENT IN 2013

According to Statistics Finland's revised preliminary data, Finnish GDP grew by 2.7 per cent in 2011. In last year's first quarter output increased slightly less than 5 per cent, but the rate of growth slowed down after this. In the first quarter of the current year, real GDP rose by 2.2 per cent on a year-on-year basis and 0.9 per cent over the previous quarter. During the second quarter, real GDP contracted by 1.1 per cent from the previous quarter. Weak export development has slowed growth from the second quarter of last year onwards. Private consumption still continued to grow rapidly during the first quarter of this year, but in the second quarter growth began to decelerate.

The 0.9 per cent GDP growth projected for 2012 in March has been revised to 0.5 per cent. The development of exports and private consumption will be worse than expected before. The global economic upswing expected for the second half of this year is being postponed by almost a year. In 2013 Finland's GDP growth will remain at one per cent due to the simultaneous weakness of both exports and consumption. Again, this requires that the acute phase of the euro crisis is resolved in the coming months. Growth will become more rapid at 2.2 per cent as exports pick up in 2014.

EURO CRISIS, NOKIA AND EROSION OF COMPETITIVENESS STILL CURBING EXPORTS

Exports of goods decreased during the first half of this year by 0.7 per cent compared to last year. The significantly steeper decline of service exports led to a reduction in total exports by a couple of per cent. The exports of communication equipment and related services decreased due to Nokia's product problems and structural changes. Exports also fell significantly in cyclical products such as paper. Petroleum products, motor vehicles and food exports were among the few highlights of exports.

The euro zone recession is reflected clearly in Finnish exports in 2012 and still in the first half of 2013. Export as a whole is expected to decline by 1.1 per cent in the current year. Exports of goods will fall by one per cent and services by one and a half. Communication equipment exports will decline sharply towards the end of this year as Nokia's Salo factory closes. The turnaround predicted to take place towards the middle of next year will spawn growth in exports. In 2013, exports will grow 2.7 per cent. In 2014, growth will accelerate to about 4 per cent. Finland's cost competitiveness has deteriorated due to rapidly rising costs and weakened productivity growth. The projected export growth requires an improvement in cost competitiveness as well as significant investments in the development and marketing of new products.

BUSINESS INVESTMENT FALLING DUE TO WEAK DEMAND

According to Statistics Finland 74.5 per cent of industrial capacity was in use in July 2012.Thus, there is still a significant amount of idle capacity. Moreover, since the outlook for both exports and private consumption are uncertain, businesses are curbing investment. Investments as a whole are forecast to decline by 1.5 per cent this year and 1.3 per cent next year. Machinery and equipment investment will decrease by 5 per cent this year and 2.5 per cent next year. Housing investment will fall by about one and a half per cent in both 2012 and 2013.

In 2014 overall investments will start to grow at a rate of 4 per cent as export demand picks up. Companies will begin to add more production capacity. Housing construction will also recover. Housing demand remains high in growth centres. Investment will be boosted from 2014 onwards by the start of construction of two new nuclear power plants.

SHRINKING WORKING AGE POPULATION DAMPENS RISE IN UNEMPLOYMENT RATE

In 2011 the unemployment rate fell nearly half a percentage point to 7.8 per cent. The decrease was driven by moderate real GDP growth. The size of the working-age population has started to decline due to aging. The unemployment rate will not, therefore, start to rise in 2012, despite the clear slowdown in GDP growth, but rather it will even decline to 7.7 per cent. In 2013 it will rise to 8.0 per cent. In 2014 the unemployment rate will dip back to 7.7 per cent as output recovers. The supply of labour will remain roughly unchanged due to the increase in the labour force participation rate. The employment rate will rise from last year's 69.8 per cent to 71 per cent by 2014.

SLOW GROWTH OF PURCHASING POWER CURBING CONSUMPTION

Private consumption is expected to increase by 1.1 per cent in 2012. Real wages will rise slightly as a consequence of inflation slowing from last year and the comprehensive wage settlement made last year. The number of the employed persons will increase slightly from last year. The household savings rate is still falling. In 2013 private consumption is expected to grow by only 0.6 per cent, which is attributable largely to the savings rate turning negative. The number of employed persons will decrease slightly due to weak economic development. Increasing the VAT by one percentage point from the beginning of 2013 onwards as well as rising food prices will cut purchasing power. Leaving income tax rates unadjusted for inflation and the rise in earnings also has the same effect. It will furthermore curb the growth of private consumption in 2014, when growth in consumption is also slowed down by households trying to restore their savings rate to normal levels. The rate of growth is thus estimated at 1.3 per cent.

VAT HIKE SPURRING INFLATION IN 2013

In 2012, consumer prices are expected to rise by 2.9 per cent. The weakening of the euro will in part spur inflation. Inflation will be fuelled by excise taxes being raised in the beginning of this year by slightly over half a percentage point. On the other hand slight decline of interest rates on loans due to the already realized lowering of interest rates of the ECB will restrain the rise on consumer prices a little. The level of earnings will increase by about 3 per cent both this year and next year due to the contract wage increases agreed last year. In 2013 consumer prices will also rise by 2.9 per cent. The one percentage point increase of the VAT going into effect in the beginning of next year will increase consumer prices by about 0.7 percentage points. Due to this year's poor harvests food prices will also contribute to inflation. In 2014, the inflation rate is expected to be at about two per cent, although very reliable forecasts cannot be made due to numerous elements of uncertainty.

SLOWDOWN IN GROWTH ERODES IMPACT OF FISCAL BELT-TIGHTENING

The central and local government's ratio of net lending to GDP declined in 2011 by almost two percentage points to -3.7 per cent. This year the reduction will come to a halt due to the slowdown in aggregate growth. The number of employed persons will increase only slightly. This will hamper the growth of income tax revenue. Next the central and local government's joint deficit is 3.4 per cent of GDP. The debt of the central government will rise by 5 billion euros while that of the local government will increase by 1.5 billion euros. Due to the government's programme and decisions made in the long-term budget framework last spring as well as economic growth, the central and local government's net lending will shrink to -3.0 per cent of overall output in 2014 and further to -2.6 per cent in 2015. The so-called EMU debt ratio to GDP will continue to grow, reaching 53.7 per cent in 2015.

The goal of bring about a decline in the debt-to-GDP ratio included in the government's programme during its term in office can only be achieved if the burden for adjustment is shifted significantly to the municipalities. Central and local government's joint debt per GDP is still climbing. It seems the deficit target of no more than 1 per cent will not be achieved. Due to the poor economic situation further tightening is not even appropriate in the coming years.

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Finland’s balance of supply and demand

	Value	Volume change, %					
	Bill. EUR	Compared to previous year				Average	
	2011*	2011*	2012F	2013F	2014F	2007-11	2012-16F
GDP at market prices	189.2	2.7	0.5	1.0	2.2	-0.5	1.7
Imports	78.3	5.7	-1.3	1.3	3.4	0.1	2.6
- Goods	57.9	6.9	-1.8	1.3	3.8	-0.7	2.9
- Services	20.5	0.3	0.1	1.3	2.5	2.2	2.0
Total supply	267.6	3.6	0.0	1.1	2.6	-0.3	2.0
Exports	77.1	2.6	-1.1	2.7	4.1	-1.7	3.1
- Goods	56.6	1.9	-0.9	2.2	4.0	-2.9	2.9
- Services	20.5	2.3	-1.6	4.2	4.5	2.4	3.6
Investments	37.1	6.8	-1.5	-1.3	4.1	-1.3	2.2
- Private	32.4	7.7	-2.0	-1.6	4.3	-1.4	2.1
- Public	4.6	0.6	2.0	1.0	3.0	-0.2	2.7
Consumption	151.0	1.9	0.9	0.6	1.1	0.8	1.1
- Private	105.0	2.5	1.1	0.6	1.3	0.9	1.4
- Public	46.0	0.4	0.5	0.5	0.7	0.6	0.6
Changes in inventories[1)]	2.4	0.8	0.1	0.0	0.0	0.0	0.0
Total demand	267.6	3.6	0.0	1.1	2.6	-0.3	2.0
Domestic demand	190.5	4.1	0.5	0.3	1.7	0.4	1.4
Public demand	50.6	0.4	0.6	0.6	0.9	0.5	0.9

1) Including statistical discrepancy.

Source: Statistics Finland.

Key forecasts

	2009	2010*	2011*	2012F	2013F	2014F
Consumer price index change, %	0.0	1.2	3.4	2.9	2.9	1.8
Wage level change, %	4.0	2.6	2.7	3.3	2.9	2.8
Unemployment rate, %	8.2	8.4	7.8	7.7	8.0	7.7
Current account surplus, % of GDP	2.0	1.6	-1.2	-1.2	-0.4	0.1
Industrial output change, %	-18.3	5.3	3.5	-1.4	0.4	3.7
Euribor, 3-month, %	1.2	0.8	1.4	0.5	0.6	1.2
EU27 countries, GDP change, %	-4.4	2.1	1.5	-0.3	0.6	1.5
- EMU countries	-4.4	2.0	1.4	-0.6	0.5	1.5
EU27countries, change in CPI, %	1.0	2.1	3.1	2.4	2.0	2.0
- EMU countries[1)]	0.3	1.6	2.7	2.1	1.8	2.0
Finland’s EMU surplus, % of GDP	-2.5	-2.6	-0.6	-0.9	-0.6	-0.2
Finland’s EMU debt, % of GDP	43.5	48.6	49.1	51.2	52.8	53.7

1) Harmonised index.

Source: Statistics Finland.