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MEDIA RELEASE

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GLOBAL GROWTH CONTINUES TO BE SLOW - FINLAND'S GDP WILL GROW BY 0.3 PER CENT IN 2013

- *The euro area recession has deepened, but the calming of the financial markets provides hope for the latter part of 2013*
- *Finland's GDP will grow by 0.3 per cent in 2013, while next year growth will accelerate to 1.8 per cent*
- *The volume of exports will expand in 2013 by half a per cent, while growth in 2014 is expected to be 3.5 per cent*
- *Private consumption will increase by only 0.3 per cent in 2013, but a modest improvement in purchasing power will boost the growth rate to 1.3 per cent in 2014*
- *Business investment will fall due to weak demand in 2013, but it will begin to increase in 2014 as demand picks up*
- *The unemployment rate will be 8.3 per cent in 2013 and 8.1 per cent in 2014*
- *Finland's consumer prices will rise 2.4 per cent in 2013 and by a couple of per cent in 2014; the increase in VAT rates will boost inflation this year, but raw material price pressures have eased*
- *The economic slowdown erodes the effect of fiscal belt-tightening; the government's goal of getting the debt-to-GDP ratio back on a declining path is in danger*

World GDP growth will remain at about last year's 3 per cent in 2013. Tightened fiscal policy due to market pressures and the crisis in the euro countries are dampening factors.

Growth is expected to pick up in mid-2013 if the confidence of the financial markets is sustained and the deficits of the crisis countries can be put on sustainable paths. Fiscal policy is still stringent in many countries, but the private sector could even afford to take on more debt.

The expansionary policies followed in the aftermath of the 2008-2007 financial crisis have most likely prevented the reoccurrence of a recession like that experienced in the 1930s. However, in many of the economies the leeway for stimulus measures has been used up almost completely in both fiscal and monetary policy.

In the United States and Germany aggregate output has already surpassed the level prevailing at the beginning of 2008. Throughout the rest of the euro area, including Finland that level has not yet been reached.

In the US, GDP is expected to grow by 1.7 per cent in 2013. The political infighting regarding the budget will curb growth. In Russia, GDP growth will subside to 3.5-4 per cent. Growth in China will accelerate slightly to around 8 per cent thanks to a lax fiscal policy and a pick-up in domestic demand. The weakness of western demand is slowing export growth.

To begin with, the euro area also staged a recovery. At the end of 2011, however, due to several member countries facing a deficit and debt crisis, the area was driven into recession.

In early 2012 an upturn was still expected to occur towards the end of last year. However, a new escalation of the euro crisis in the spring and summer led to a continuation and deepening of the recession. The euro zone crisis is also dampening economic growth in the rest of the world. A turnaround is expected no earlier than mid-2013. The total EU area's GDP will fall by a further 0.2 per cent in 2013.

There is still a high risk of substantially less favourable development in the world economy. At the moment, the most pressing risk relates to the EU countries' ability to stabilize the financing of the public sectors in problem countries. This affects the financial markets' faith in problem solving, as well as mutual trust between market players. In the United States, the main challenges are restoring the confidence of the private sector and political decision-making related to government debt. The worst case scenario for the western world is an escalation of the financial market unrest into the type of panic experienced in 2008. This kind of crisis would also hit Russia and Asian countries, including China. A risk of crude oil price increasing due to e.g. Iran's political situation still exists.

Eurozone upswing expected in second half of 2013

In 2012, the euro countries' GDP fell 0.5 per cent. The euro area has in practice been in a recession since the last quarter of 2011. The recession was at its deepest in the fourth quarter of 2012. The recession has been exacerbated by the tight fiscal policy aimed at curbing over-indebtedness.

The European Central Bank (ECB) last lowered its key interest rate by 0.75 per cent in July 2012. The central bank has also intermittently carried out so-called non-standard monetary policy measures, by which it has sought to promote the functioning of financial markets and to ensure sufficient liquidity. When the financial market unrest was at its peak in the summer and autumn of 2012, the ECB announced that it would buy an unlimited amount of crisis countries' short-term bonds in the secondary market, as long as the crisis countries sought European Stability Mechanism (ESM) financing. The mere announcement of this offer has reassured the market, because it means that the risk of disintegration of the euro is deemed to have been reduced significantly.

Crisis countries are now responsible themselves for taking action to consolidate their public finances and restore their competitiveness. Tight fiscal policy will dampen overall demand in the short term, but in the long term it is essential to restore the confidence of investors. A credible economic policy requires the parties belonging to these countries' governments commit themselves to fiscal stabilization.

There will be differences in growth between euro area countries also in 2013. Production in the crisis countries Greece and Portugal is still declining the most. Italian and Spanish production will also decrease significantly. In Germany, GDP will grow by half a per cent. In France, there will be zero growth.

Euro area GDP is expected to contract by 0.5 per cent in 2013. The decline will continue in the first half of the year, but production will begin to increase in the second half. In 2014, the euro area GDP growth will be one per cent and in 2015 more than one and a half a per cent.

Finland's volume of total output declined last year

According to Statistics Finland's preliminary figures, Finnish GDP decreased 0.2 per cent in 2012. In the fourth quarter production fell 0.5 per cent from the previous quarter and 1.5 per cent from the same quarter a year ago. The volume of exports decreased by one and a half per cent in 2012, in particular due to weak European demand and Nokia's production cutbacks. Private consumption increased by one and a half per cent. Purchasing power was cut by high inflation rates. Weakening consumer confidence due to the euro crisis has also hindered consumption. Investment fell due to weak demand by a scant 3 per cent. Machinery and equipment investment as well as residential investment declined significantly.

GDP will grow by 0.3 per cent in 2013 and 1.8 per cent in 2014

Last September's forecast of one per cent GDP growth for 2013 has been revised downwards to 0.3 per cent. The key reasons for the revision are the starting level at the end of last year being lower than expected and the weakening growth prospects in the euro area. Exports and private consumption will grow less than expected last fall. The long-awaited economic turnaround is finally expected to occur during the mid-year. In 2014 Finland's GDP will already grow nearly two per cent. This will require that the financial markets remain calm. Growth rate will accelerate to slightly less than three per cent in 2015. These growth rates cannot be considered to be good because of the low starting level. Employment and the fiscal deficit in particular will improve with a lag.

Euro crisis, Nokia and erosion of competitiveness still hamper exports

Last year the export of goods decreased by 1.2 per cent from the previous year. The export of telecommunications equipment and related services decreased because of Nokia's problems with products and structural changes. Exports of cyclic products, such as metal refining, also fell substantially. Chemical industry products and transport equipment exports were some of the few bright spots. Service exports fell by two per cent.

The euro zone recession will still be widely felt in Finnish exports during the first half of 2013. Total exports are expected to grow this year by only half a per cent. Exports of goods will increase 0.3 per cent and exports of services one per cent. Telecommunications equipment exports will decline sharply as a result of the closing of Nokia's Salo factory last autumn. The turnaround predicted for mid-2013 year will spawn a rise in exports.

In 2014, exports will grow 3.5 per cent. In 2015, growth will accelerate to about 4.5 per cent. The projected export growth will require an improvement in cost competitiveness, as well as significant investments in the development and marketing of new products. Finland's cost competitiveness has deteriorated due to costs rising swiftly and productivity growth declining.

Corporate investments decline further due to weak demand

According to Statistics Finland in December 2012, some 74.7 per cent of industrial capacity was in use. This was 3.1 percentage points lower than a year earlier. There is thus still a significant amount of idle capacity. Furthermore, since the outlook for both exports and private consumption is uncertain, companies are reluctant to carry out investments. Total investment is forecast to decline by two per cent in the current year. Next year it will grow 3.3 per cent. Machinery and equipment investment will decrease this year by 3 per cent. Next year, it will grow by 3 per cent, as the demand outlook begins to improve and there begins to be a shortage in capacity supply. Housing investment will decline a couple of per cent in 2013, but it will witness a 3.5 per cent upswing in 2014.

In 2015, overall investment growth will strengthen to 4.5 per cent as the economic situation improves. Companies need to increase production capacity. Residential construction will also continue to expand, as there continues to be a need for sufficient housing in major growth centres. Investment growth will accelerate further as the construction of new nuclear power plants begins.

Shrinking working age population curbs rise in unemployment rate

In 2012, the unemployment rate fell by 0.1 percentage points to 7.7 per cent. Thus, unemployment did not begin to increase in spite of the stagnation of aggregate output. A major reason for this is the fact that the working-age population has started to decline due to aging. The employment rate rose by 0.4 percentage points to 69 per cent. In 2013, the unemployment rate will rise to 8.3 per cent due to this year's weak economic growth and lagging effects carried over from last year. In 2014 the unemployment rate will decline to 8.1 per cent as production recovers slightly. In 2015, the unemployment rate is 7.8 per cent and the employment rate 69.9 per cent.

Slow growth of purchasing power curbs consumption

Private consumption is expected to grow only 0.3 per cent in 2013. Real earnings will increase slightly as a consequence of the framework agreement signed a couple of years ago and the slowdown in international inflation compared to last year. The increase in VAT rates by one percentage point at the beginning of 2013 will nevertheless cut purchasing power. Income taxation will also be tightened slightly since the tax scales were not adjusted at the beginning of the year for inflation and the rise in earnings. The number of employed persons will decrease compared to last year and labour input will decline. The household savings ratio will fall. In 2014, private consumption is expected to grow by 1.3 per cent. Labour input will rise slightly as the economy recovers. The forsaking of income tax scale adjustments will dampen the growth of the purchasing power also in 2014. Private consumption is estimated to grow by 2.2 per cent in 2015. Enhanced employment opportunities will have a positive impact on consumption.

VAT hike fuels inflation in 2013

In 2013, consumer prices are expected to rise by 2.4 per cent. The inflation forecast has been lowered from that made last autumn since international inflation has weakened. Average interest rates on loans are falling slightly in the wake of the ECB's lowering of its key interest rate last year. Margins on new loans, however, are on the rise. Inflation is being boosted by about 0.7 percentage points due to the hike in VAT rates carried out at the beginning of this year. The level of earnings will increase by just under 3 per cent in line with the collective wage settlement. In 2014, consumer prices are expected to rise by about 2 per cent. However, the prognosis is very uncertain, as there is currently no information on incomes policy agreements or possible taxation changes. Also the international inflation outlook may change significantly. In 2015, inflation is anticipated to fluctuate around the two per cent level.

Sluggish growth erodes impact of fiscal belt-tightening

The ratio of central and local government's net lending to GDP was 4.8 per cent in 2012, which was nearly one percentage point higher than in 2011. The central government's deficit as a percentage of GDP was 3.8 per cent while that of the municipalities was one per cent. The slowdown in economic growth offsets the impact of savings and tax increases. In 2013, the ratio of central and local government's deficit to GDP will decline only marginally to 4.7 per cent. The size of the employed labour force will be reduced. This will hamper the growth of income tax revenue. Owing to the government's programme and last spring's decision on spending limits as well as economic growth, the central government's net lending as a percentage of GDP will be reduced to 3.5 per cent in 2014 and further to 3 per cent in 2015. The general government's EMU deficit will be 1.3 per cent of GDP in 2015. The EMU debt-to-GDP ratio will continue to rise, reaching 59.3 per cent in 2015. In 2016, it will already exceed the 60 per cent ceiling.

The government's goal of getting the central government's debt-to-GDP ratio back on a declining path during its term in office will not be fulfilled without additional adjustments to expenditure and revenue. According to our forecast the debt-to-GDP ratio will still increase by almost one percentage point in 2015. The stabilization of the debt ratio at the previous year's levels would require additional belt-tightening measures equivalent to some 1.8 billion euros. Achieving the goal of a maximum deficit of 1 per cent of GDP is even more difficult because it would require about 4 billion euros in additional austerity measures during the government's term in office. The government is running out of time.

Further belt-tightening is not deemed prudent in the next few years in light of the weak financial position of the central government. Austerity measures equivalent to about one billion euros should be enough in this year's budget framework negotiations. The government could be more flexible than expected in light of the clearly weaker economic situation. Agreement should nevertheless be reached in the budget framework negotiations on actions to reduce the long-term sustainability gap stemming from the aging of the population.

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Finland’s balance of supply and demand

	Value	Volume change, %					
	Bill. EUR	Compared to previous year				Average	
	2012*	2012*	2013F	2014F	2015F	2008-12	2013-17F
GDP at market prices	194.5	-0.2	0.3	1.8	2.9	-0.6	2.0
Imports	78.4	-3.7	-0.5	2.7	3.6	-2.0	3.2
- Goods	56.6	-6.6	0.1	2.8	4.1	-2.5	3.6
- Services	21.8	4.6	-1.9	2.5	2.5	-0.5	2.2
Total supply	272.9	-1.2	0.0	2.1	3.1	-1.0	2.3
Exports	77.3	-1.4	0.5	3.5	4.4	-3.0	3.3
- Goods	56.8	-1.2	0.3	3.5	4.2	-3.3	3.1
- Services	20.4	-1.8	1.0	3.4	5.0	-2.0	3.9
Investments	37.8	-2.9	-2.4	3.4	4.6	-1.7	3.5
- Private	32.7	-3.4	-2.7	3.7	4.9	-1.9	3.8
- Public	5.0	0.5	0.0	1.0	2.5	0.0	1.6
Consumption	157.8	1.4	0.3	1.0	1.6	0.7	1.3
- Private	109.5	1.6	0.3	1.3	2.2	0.8	1.7
- Public	48.3	0.8	0.4	0.4	0.4	0.4	0.3
Changes in inventories[1)]	0.1	-1.1	0.0	-0.1	0.2	0.0	0.0
Total demand	272.9	-1.2	0.0	2.1	3.1	-1.0	2.3
Domestic demand	195.7	-1.2	-0.2	1.3	2.5	0.1	1.8
Public demand	53.3	0.8	0.3	0.5	0.6	0.4	0.5

1) Including statistical discrepancy.
Source: Statistics Finland.

Key forecasts

	2010	2011*	2012*	2013F	2014F	2015F
Consumer price index change, %	1.2	3.4	2.8	2.4	1.9	1.7
Wage level change, %	2.6	2.7	3.3	2.0	2.6	3.0
Unemployment rate, %	8.4	7.8	7.7	8.3	8.1	7.8
Current account surplus, % of GDP	1.6	-1.3	-1.6	-1.1	-0.3	0.2
Industrial output change, %	5.3	3.5	-2.1	-0.4	3.4	4.0
Euribor, 3-month, %	0.8	1.4	0.5	0.4	0.6	1.3
EU27 countries, GDP change, %	2.1	1.5	-0.3	-0.2	1.1	1.5
- EMU countries	2.0	1.4	-0.5	-0.5	1.0	1.7
EU27countries, change in CPI, %	2.1	3.1	2.6	1.9	1.8	2.1
- EMU countries[1)]	1.6	2.7	2.5	1.7	1.6	1.9
Finland’s EMU surplus, % of GDP	-2.5	-0.8	-1.9	-2.0	-2.0	-1.3
Finland’s EMU debt, % of GDP	48.6	49.0	53.0	56.0	58.1	59.3

1) Harmonised index.

Source: Statistics Finland.