ELINKEINOELÄMÄN TUTKIMUSLAITOS
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MEDIA RELEASE

Economic Forecast 2015/2:

FINLAND'S GDP WILL INCREASE A BIT THIS YEAR – NEXT YEAR GROWTH IS EXPECTED TO ACCELERATE SLIGHTLY

- *Finland's GDP will increase by 0.2 per cent in 2015, after which growth will accelerate to 1 per cent in 2016 and to 1.3 per cent in 2017*
- *Export- and investment-led growth requires the continuation of wage moderation and an improvement in competitiveness and recovery of export markets in the expected manner*
- *The euro area continues its cautious recovery; the US economy is still growing rapidly while China's growth is slowing down*
- *The volume of Finnish exports will decrease by one per cent in 2015 while in 2016 growth is expected to be approximately 2.5 per cent*
- *Private consumption is increasing by only 0.7 per cent in 2015 and by 0.4 per cent in 2016 due to the modest growth of purchasing power*
- *Investment will still decline by a couple of per cent in 2015 due to weak demand, but it will start to expand by almost 3 per cent growth in 2016 in the wake of the recovery of demand*
- *The unemployment rate will rise to 9.6 per cent in 2015, dropping to only 9.5 per cent in 2016*
- *Finland's consumer prices will fall 0.1 per cent this year owing to the decrease in oil prices while next year the inflation rate will rebound to 0.7 per cent*
- *The public sector's fiscal consolidation will be slow despite austerity measures*

FALL IN FINLAND'S GDP HAS COME TO A HALT

According to the most recent National Accounts figures, Finland's GDP contracted by 0.4 per cent in 2014. In the first quarter of 2015, GDP remained at the same level as in the fourth quarter of last year and grew in the second quarter by 0.2 per cent compared to the first quarter. In the first half of this year GDP remained at approximately last year's level on a year-on-year basis. Exports were growing on a quarter-on-quarter basis. Year-on-year growth figures were hit negatively by the decline in the value of Russian exports by one third. A maintenance shutdown at Neste's oil refinery also contributed to the fall in exports. Exports of services were growing. Private consumption increased slightly. Consumption was boosted by low inflation and offers by banks allowing borrowers to postpone principal repayments temporarily on their housing loans. The rise in unemployment and rather weak consumer confidence had the opposite effect. Investment continued to decline. Machinery and equipment investment nevertheless grew in the first quarter compared with the previous quarter. Consumer prices fell slightly.

GDP GROWTH SLIGHTLY POSITIVE IN 2015, 1% GROWTH FORECAST FOR 2016

GDP is estimated to grow by 0.2 per cent in 2015. In March we forecast 0.5 per cent growth. The revision is due to the somewhat weaker than expected development of exports and investment. In the second half of this year exports are expected to gain a slight boost from the euro area's recovery and the normalization of oil refining output. The deteriorating employment situation will dampen the growth of private consumption towards the end of the year. In 2016, GDP will grow by one per cent. These forecasts have been revised downwards due to the austerity measures to be taken by the government. The forecast is close to the alternative scenario we presented this spring. The economic upturn will be driven by exports and investment. Private consumption growth will be moderate owing to the modest rise in real income and high unemployment. Our GDP growth forecast for 2017 is 1.3 per cent. The growth is still fuelled by exports and investment. This requires the continuation of wage moderation and an improvement in competitiveness and recovery of export markets in the expected manner.

CHINA DAMPENS WORLD ECONOMY GROWTH

Last year GDP grew in the United States by 2.4 per cent, in the EU countries by 1.2 per cent and in the total OECD area by 1.6 per cent. In the United States, Germany and Sweden, among others, GDP has already surpassed the level prevailing at the beginning of 2008. This level has yet to be achieved in the euro area on average and in Finland.

GDP growth of the European OECD countries measured on a quarter-on-quarter basis has picked up slightly since the second half of 2014. In the fourth quarter of 2014 it was 0.5 per cent and in the first quarter of this year 0.6 per cent. Aggregate figures confirm Germany's strong recovery, but growth strengthened slightly also in other EU countries. The United States has continued to grow strongly. In China, on the other hand, the growth of industrial production in particular has slowed down.

GDP is expected to grow in the United States by 2.6 per cent in 2015 and 2.7 per cent in 2016. The forecast has been revised downwards slightly from that of last spring. Growth is fuelled by domestic demand, which has nevertheless been somewhat more sluggish than expected. The GDP of the total EU area will rise by 1.6 per cent this year and 1.8 per cent in 2016. The sharp fall in the price of oil is providing a boost to energy-intensive economies importing oil. In Russia, GDP will shrink by 4 per cent in 2015 and another couple of per cent in 2016. Domestic demand will contract considerably more sharply than GDP. The weakness of growth stems from low energy prices, sanctions imposed because of the crisis in Ukraine and the slow pace of economic reforms. China's GDP will increase by 6-7 per cent in the next few years, which is clearly less than previously. The growth of production will be dampened by the uncertainty prevailing in financial markets, the desire to curb the strong growth in debt and the economy’s large overcapacity left over from previous stimulus programmes.

In 2015, total world GDP growth will slow down slightly from last year's 3.4 per cent to 3.2 per cent. In 2016, growth will accelerate to 3.6 per cent. The United States will be the locomotive of global economic growth in both years. Europe will get a boost from the strengthening of the German demand recovery. The growth of the so-called emerging economies will be dampened by the slowdown in China's growth and the weakening of foreign capital inflows due to the anticipated tightening of monetary policy in the United States.

World economic growth is expected to continue strengthening if confidence in the financial markets is maintained and the crisis countries' deficits can be steered back onto a sustainable path. Fiscal policy is still tight in many countries.

The risk of substantially less favourable development is still high. Recently, concerns have been raised by the slowdown in Chinese growth and risks related to its financial markets, even though China is carrying out a massive stimulus to combat these problems. The debt levels of many euro area countries are high, which may spur crises. In the United States sustaining private sector confidence will be of key importance. The up-coming presidential election may give rise to economic policy tensions.

Eastern Ukraine is becoming a so-called frozen conflict. Sanctions cannot be rescinded in the near future and the crisis will have an impact on economic relations between Russia and Western countries for several years. An even gloomier alternative is possible: the worst case scenario would be the outbreak of military conflict in which Russia and the Western powers openly participate. Given its close economic relations, Finland is particularly vulnerable to Russia's development and sanctions on assorted economic activities.

RECOVERY HAS CONTINUED IN EURO AREA

In 2014, GDP in the euro area grew by 0.9 per cent from that of the previous year. GDP growth was almost stagnant in the second quarter of 2014 compared to the previous quarter. This was due to the weak economic situation in the largest countries of the region, i.e. Germany, France and Italy. In the second half of the year, GDP growth picked up again in the euro area. In the first half of this year growth has been 0.4 to 0.5 per cent on a quarter-on-quarter basis. The recovery is just getting started and its continuation depends crucially on developments in business and household confidence. The sharp fall in the price of oil is bolstering the growth of energy importing euro economies.

The weakened exchange rate of the euro will strengthen their exports.

The European Central Bank lowered its refinancing rate on 4 September 2014 to 0.05 per cent. The banks' overnight deposit rate had already previously been lowered to a -0.2 per cent. In addition to interest rate policy, the central bank has when necessary resorted to the so-called non-standard monetary policy measures via which it has sought to promote the functioning of financial markets and to ensure sufficient liquidity. In January 2015 the ECB announced that in March it will begin to buy government bonds on the secondary market. The magnitude of the bond purchases was set at EUR 60 billion a month, and they will continue at least until September 2016. They may be continued even after that until the rate of inflation has permanently risen toward the central bank's target of a little less than 2 per cent.

The most concrete impact of the ECB's easy monetary policy is that interest rates will remain low and the euro exchange rate will be weaker than it otherwise would be. Low interest rates and abundant liquidity will boost stock prices. In some countries, it may cause a rise in housing prices. There is a risk that asset bubbles could emerge in a few years.

The acute financial crisis in Greece has at this time been brought under control. Its impact on the rest of the euro area remained modest because crisis management mechanisms have been implemented in the area, and the private sector of other countries no longer has large amounts of receivables from the Greek government. However, the situation is not completely over as the early parliamentary elections held in Greece in September 2015 create their own concerns about the implementation of the terms of the agreed financial package. The high level of public debt constitutes a risk in euro countries larger than Greece, especially Italy. The new crisis management mechanisms might be insufficient if large countries encountered financial problems in the euro area.

The euro economies are experiencing divergent growth trends also in 2015. In Italy GDP will expand by half a per cent. In France, the Netherlands and Belgium, the growth is over one per cent. In Germany, GDP will rise a couple of per cent, and in Spain by 3 per cent. The fastest GDP growth, 3.5 per cent, is forecast for Ireland, which has staged a rapid recovery from its crisis. The current account deficits will continue to decline and the rise in the public debt will slow down, though not very quickly. High levels of public debt make the economies of many European countries vulnerable.

The euro area's GDP is projected to grow by 1.5 per cent in 2015. Growth will accelerate to1.8 per cent in 2016 and further to 1.9 per cent in 2017.

OIL PRICE FALL BOOSTING FINLAND'S WESTERN EXPORTS, EXPORTS TO RUSSIA FALLING

The volume of goods exports decreased in the first half of 2015 by almost one per cent compared to the same period last year. Exports of services were growing. The volume of total exports was of the same magnitude as that achieved in the first half of last year. In 2015, the volume of goods exports will decrease by 1.5 per cent. Exports of services will grow by half a per cent. Total exports will decline by one per cent. Food industry exports are being reduced by difficulties in exports to Russia and import restrictions. Chemical industry exports are lower than normal due to a prolonged oil refinery maintenance shutdown. Exports of motor vehicles are experiencing a clear rise. Also, exports of machinery and equipment are expected to recover towards the end of the year as investment demand picks up. Exports to Russia will fall in value terms by 25-30 per cent. Western export growth is expected to be driven by lower oil prices and the weakening of the euro. In 2016, the volume of total exports is projected to grow by 2.7 per cent. The growth rate will be boosted by the current low level of chemical industry exports used as the basis for comparison. Exports to Western countries will be fuelled by market growth. Exports to Russia will decrease further, but significantly less than in 2015. In 2017 the volume of exports will increase by 3 per cent.

CORPORATE INVESTMENT REBOUNDING TOWARDS END OF YEAR FROM LOW LEVEL

Investments fell in the first half of the year to about 3 per cent a year ago compared to the same period a year ago. Private investment contracted by 2.5 per cent while public investment fell by 6 per cent. Residential construction fell by about 4 per cent. According to Statistics Finland 80.4 per cent of industrial production capacity was in use in June 2015. The figure was 0.3 percentage points higher than a year earlier.

Companies have curbed their investments as the outlook for both exports and private consumption has been uncertain. The investment survey of the Confederation of Finnish Industries indicates that companies' desire to invest is on the rise. Investment is nevertheless forecast to decline this year a couple of per cent. Next year, it will grow by almost 3 per cent. Machinery and equipment investment will decrease slightly this year. Next year it will increase by about 3 per cent as capacity is beginning to be in short supply. Housing investment will decline in 2015 by a couple of per cent, but it will expand by 1.5 per cent in 2016.

In 2017 total investment will increase by 3 per cent. Companies need more production capacity and production investments will grow by 4 per cent. Residential construction will continue to grow moderately. The demand for housing will remain high in major growth centres, but growth will be dampened by weak household purchasing power and high unemployment.

UNEMPLOYMENT RATE WILL RISE MORE THAN PREVIOUSLY EXPECTED

The rise in unemployment was for many years relatively moderate compared to the sharp fall in GDP. This stems from the fact that the decline in production took place to a considerable extent in high-productivity export sectors and because the size of the working-age population decreased due to aging. Recently, however, domestic demand has weakened because among other things, the wholesale and retail trade has reduced its workforce. The supply of labour has also been increased substantially by persons outside the workforce entering the labour market. These factors have increased the unemployment rate this year. In 2015, the unemployment rate will rise one percentage point from last year's 9.6 per cent due to weak economic growth and the lagging effects coming from last year. In 2016, the unemployment rate will fall only slightly to 9.5 per cent. In 2017, the unemployment rate will still be 9.5 per cent and the employment rate will be 68.6 per cent.

SLOW GROWTH OF PURCHASING POWER WILL DAMPEN CONSUMPTION

The change in private consumption was on average around zero in 2012-2014. This year, low inflation will boost real wages, but on the other hand the weakening of employment will have a negative impact on purchasing power. Private consumption is projected to increase by 0.7 per cent. In 2016, private consumption will grow by 0.4 per cent, i.e. about the same as household real disposable income. Also in 2017, private consumption will grow by 0.4 per cent. Household real purchasing power will grow by only 0.1 per cent as real income falls and the employment situation improves only slightly. The public sector’s austerity measures, moderate wage settlements, weak employment trends and the slight acceleration of inflation will dampen the growth of private consumption in the coming years.

DAMPENING EFFECT OF FALLING OIL PRICES WILL FADE

In the first half of 2015, consumer prices fell slightly from the previous year. Inflation for 2015 as a whole is forecast to be -0.1 per cent. International inflation has been weakened by the steep fall in oil prices. Nominal wages and salaries will rise in 2015 by about one per cent. In 2016, consumer prices are expected to rise by 0.7 per cent. Inflation will be fuelled by the expected moderate rise in oil prices and the strengthening of global economic growth, which will boost international inflation. In 2017 consumer prices are forecast to rise by 1.4 per cent. Interest rates are anticipated to be on the increase already by then, which will contribute to higher inflation.

GOVERNMENT AGREES ON FURTHER AUSTERITY MEASURES AND STRUCTURAL REFORMS

In 2014, the total public sector deficit was 3.3 per cent relative to GDP, which was higher than generally anticipated and exceeded the 3 per cent EMU limit. The central government’s deficit was 4.0 per cent of GDP while the municipalities’ deficit was 0.7 per cent. The so-called structural deficit of the public sector was estimated by the Commission to be 1.6 per cent relative to GDP. The EMU norm is a maximum of 0.5 per cent, but it has its own flexible mechanisms. The general government gross debt stood at 59.3 per cent of GDP.

In 2015, the public sector deficit will fall to 3.0 per cent of GDP and in 2016 it will decrease further to 2.5 per cent owing to the government’s austerity measures. The debt will rise this year to 62 per cent and next year to just over 64 per cent. Based on ETLA's forecast, the public sector’s structural deficit calculated according to the EU Commission's methodology is projected to be 1.2 per cent of GDP in 2015 and 1.1 per cent in 2016. We expect the declining trend to meet the demands of the Stability and Growth Pact.

The gross public debt already will already exceed the 60 per cent ceiling this year, but the EMU criteria takes into account the aid given to euro area crisis countries, estimated by the Commission to be 2.9 per cent of GDP in 2015. In addition, the economic situation is taken into account. Finland will thus not be subject to EU sanctions on the basis of the debt criterion in the next few years.

Our forecast for the total public sector deficit, in spite of the new austerity measures, is still 1.6 per cent in 2019. The general government's gross debt to GDP ratio will by then have risen to 68 per cent. When Finland's economic situation improves over time and cyclical adjustment is removed, Finland will at that level be in clear violation of the debt criterion. The critical question is in which direction is the debt expected to develop after that.

To comply with the Stability and Growth Pact and to avoid uncontrollable growth of the debt, Finland has to adjust public finances in the next legislative term. According to the government's programme, the agreed adjustments "strengthen public finances by EUR 4 billion on the level of the year 2019." The debt level of the public debt according to the EMU criteria will not be achieved until the parliament's next term starting in the year 2019 at best. This will require the adjustments to expenditure and revenues as well as the implementation of structural reforms and the strengthening of qualitative and cost competitiveness.

For additional information:

Research Director Markku Kotilainen,
tel. +358 9 609 90206 or +358 50 351 1192,
markku.kotilainen@etla.fi

Balance of Resources

	Value	Change in volume, %					
	€ Billion	Y/Y				Average	
	2014*[2)]	2014*	2015[F]	2016[F]	2017[F]	10 - 14	15 – 19[F]
GDP	186,3	-0,4	0,2	1,0	1,3	0,5	1,0
Import	75,5	0,0	-1,6	2,5	1,9	2,8	1,8
- goods	53,5	1,4	-2,1	3,6	2,3	3,6	2,1
- services	22,0	-3,3	-0,5	0,0	0,8	1,2	1,2
Total supply	261,8	-0,3	-0,3	1,5	1,5	1,1	1,3
Export	75,0	-0,7	-1,0	2,7	2,9	1,9	2,5
- goods	55,5	1,6	-1,6	3,6	3,4	3,0	2,8
- services	19,5	-6,8	0,5	0,3	1,3	-0,8	1,6
Investment	38,2	-3,3	-1,8	2,8	3,1	-1,2	2,0
- private	30,5	-3,9	-1,3	2,9	3,2	-1,7	2,1
- public	7,6	-0,9	-3,7	2,4	2,6	1,3	1,2
Consumption	148,2	0,3	0,5	0,2	0,2	0,9	0,3
- private	103,0	0,5	0,7	0,4	0,4	1,3	0,5
- public	45,2	-0,2	0,0	-0,2	-0,1	0,2	-0,1
Changes in inventories[1)]	1,3	0,5	-0,5	0,2	0,1	0,0	0,0
Total demand	262,7	-0,2	-0,6	1,5	1,5	1,3	1,2
Domestic demand	187,7	0,0	-0,5	0,9	0,9	1,0	0,6
Public demand	52,8	-0,3	-0,5	0,2	0,3	0,3	0,1

[1)] Contribution to GDP growth, percentage points, incl. statistical error

[2)] In 2010 prices

Sources: Statistics Finland, ETLA

Key forecasts

	2012	2013*	2014*	2015[E]	2016[E]	2017[E]
Consumer price index change, %	2,8	1,5	1,0	-0,1	0,7	1,4
Wage level change, %	3,2	2,1	1,7	1,1	1,1	1,2
Unemployment rate, %	7,7	8,2	8,7	9,6	9,5	9,4
Current account surplus, % of GDP	-1,9	-1,8	-2,2	-1,0	-0,5	0,1
Industrial output change, %	-2,8	-3,3	-1,2	-1,4	1,5	1,9
Finland’s EMU surplus, % of GDP	-2,1	-2,5	-3,3	-3,0	-2,6	-2,3
Finland’s EMU debt, % of GDP	52,9	55,6	59,3	62,1	64,4	66,0
Euribor 3-month, %	0,56	0,22	0,21	-0,01	0,0	0,4
EU27 countries, change in GDP, %	-0,5	0,2	1,4	1,6	1,8	1,9
EMU countries	-0,8	-0,3	0,9	1,5	1,8	1,9
EU27countries, change in CPI, %	2,6	1,5	0,6	0,2	1,3	1,8
EMU countries[1)]	2,5	1,3	0,4	0,2	1,3	1,7

[1)] Harmonised index

Source: Statistics Finland, ETLA