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MEDIA RELEASE

Economic Forecast 2016/1:

GDP WILL GROW BY ALMOST ONE PER CENT THIS YEAR– IN 2017 AND 2018 THE GROWTH WILL GAIN MOMENTUM

- *Although general economic uncertainty has increased, the baseline scenario for the international economy is guardedly positive: economic growth in the euro area and the US will continue at last year's pace, China's growth will slow down in a controlled manner.*
- *Finland's GDP will grow by 0.9 per cent in 2016; growth will accelerate to 1.2 per cent in 2017 and to 1.4 per cent in 2018.*
- *In the forecast we have assumed that Finland will carry out the so-called social contract negotiated at the end of February 2016 and that the government will consequently lower income taxes by 500 million euros in both 2018 and 2019.*
- *The volume of exports will grow by one per cent in 2016; growth in the year 2017 is expected to be slightly over 3 per cent as the improvement in competitiveness resulting from the social contract will boost exports.*
- *Private consumption will increase by 0.6 per cent in 2016 due to the modest rise in purchasing power; in 2017 private consumption will not grow appreciably owing to the rise in non-wage labour costs and cuts in holiday pay; in 2018 growth will be only half of one per cent*
- *Investment growth will pick up from a low level to almost 4 per cent between 2016 and 2017; in subsequent years the growth will slow down slightly.*
- *Employment will improve slowly, the social contract will not start to have an impact until near the end of the parliamentary term; the unemployment rate will remain high, being 9.4 per cent in 2016, after which it will decline by only 0.1 percentage points per year.*
- *Finland's consumer prices will rise by only 0.3 per cent this year because of the continued decline in oil prices, next year inflation will rise to 1.1 per cent.*
- *Fiscal consolidation will be slow despite adjustment measures*

INCREASED UNCERTAINTY DAMPENING GLOBAL ECONOMIC GROWTH

According to preliminary figures, GDP grew last year by 2.4 per cent in the US, 1.8 per cent in the EU countries, by 6.9 per cent in China and 3.0 per cent in world as a whole. In the United States, Germany and Sweden, GDP has already clearly surpassed the level prevailing in 2008, and it has been reached in the total euro area. In Finland, however, GDP was still 5.5 per cent lower last year than it was in 2008.

The GDP growth of the EU countries calculated on a quarter-on-quarter basis slowed slightly in the second half of 2015. In the last quarter of 2015, the growth rate was 0.3 per cent. The overall figures were weakened by the slowdown in German and Italian growth. In the UK the growth rate remained at 0.4-0.5 per cent throughout the year. Growth in the United States fluctuated over the year due, among other things, to weather conditions. In China the rate of increase in industrial production has subsided and the focal point of growth in demand is shifting toward domestic services. At the same time, the rate of GDP growth is slowing down.

GDP is expected to grow in the United States by 2-2.5 per cent in 2016-2018. Forecasts have been revised downwards slightly from those of last autumn. The growth is driven by domestic demand, which has nevertheless been somewhat more sluggish than expected. The GDP of the total EU area will rise by 1.9 per cent this year and by 1.7 per cent in 2017. The continuation of the decline in oil prices will provide a boost to the energy-intensive and oil-importing economies. In Russia, GDP will contract by a few per cent in 2016. Domestic demand is decreasing considerably more sharply than GDP. The weakness of growth stems from low energy prices, economic sanctions imposed because of the crisis in Ukraine and the slow pace of economic reforms. In 2017 the Russian economy will achieve growth of one per cent in the wake of the rise in oil prices. China's GDP will increase by 6.4 per cent this year, which is clearly much lower than previously. Economic growth will be dampened by the uncertainty prevailing in the financial markets, attempts to curb the sharp rise in indebtedness, the large amount of excess capacity born in the aftermath of the previous economic stimulus and the shift in demand from the export industry to services. In 2017 growth will slow down to 6 per cent.

In 2016, the total world's GDP growth will remain around last year's 3 per cent. In 2017 growth will pick up slightly. The growth of the so-called emerging economies will be dampened by the slowdown in Chinese growth and the weakening of foreign capital inflows as a consequence of the anticipated tightening of monetary policy in the United States.

The risk of substantially less favourable development is still high. Recently, special concerns have been raised by the slowdown in Chinese growth and risks related to its financial markets even if China is striving to combat these problems with a massive stimulus. The debt levels of several euro area countries are high, which may trigger a new crisis. The United States is of pivotal importance for sustaining the confidence of the private sector. The approaching presidential election may spur economic policy tensions.

Eastern Ukraine has turned into a so-called frozen conflict. Sanctions will not be lifted any time soon and the crisis will hinder economic relations between Russia and the West for several years. Uncertainty is also exacerbated by the war in Syria and its neighbouring regions. At worst, there is the threat of a military conflict in which Russia and the Western powers openly participate. Finland is particularly vulnerable to the development of the Russian economy and the sanctions on various economic activities because of the close economic relations of the two countries,. The postponement of investment activities by EU countries would also curb the growth of Finnish exports.

EURO AREA'S RECOVERY HAS BOGGED DOWN

In 2015, the GDP of the euro area grew by 1.5 per cent. This was a clear improvement over the previous year, as in 2014 growth was only 0.9 per cent. However, in comparison to GDP in the previous quarter, growth slowed during the second half of last year, reflecting the weakening of global demand and uncertainty related to this. This trend was reflected in all major countries of the region, i.e. in Germany, France and Italy. The purchasing manager indexes indicate continuing sluggish growth this year in January and February. The continuation of the recovery is crucially dependent on the development of business and household confidence. The sharp reduction in the price of oil is bolstering the growth of energy importing euro economies. The weaker euro exchange rate will in turn strengthen their exports.

Due to poor economic developments, the European Central Bank lowered its key interest rate on March 10, 2016 from 0.05 per cent to 0.00 per cent. It lowered banks' overnight deposit rate from the previous -0.3 per cent to -0.4 per cent. In addition to its interest rate policy, the central bank is carrying out so-called non-standard monetary policy measures, through which it aims to boost overall demand and raise inflation closer to its target. In addition to the above-mentioned interest rate decisions, the ECB announced that it will raise the scale of secondary market securities purchases from 60 billion to 80 billion euros per month. Purchases will continue at least until March 2017, according to the decision announced in December 2015. They will be continued even afterwards until inflation is elevated permanently towards the slightly less than 2 per cent inflation target of the ECB. In addition, the ECB announced the launch of four new targeted long-term refinancing operations (TLTRO II), each of which has a maturity of four years.

The direct effect of the ECB’s loose 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 put upward pressure on share prices. However, a distinct downward correction took place in share prices towards the end of 2015 and early 2016. In some countries, the loose monetary policy could initiate an unhealthy rise in housing prices.

The acute financial crisis in Greece has been brought under control for the time being. Its impact on the rest of the euro area has remained minimal, because crisis management mechanisms in the region have been strengthened, and the private sectors of other countries no longer have an a lot of receivables assets from the Greek government. The situation is not completely over, however, because continuous commitment to the implementation of the austerity programme is required of the Greek political leadership. The Greek economic situation is also undermined by the considerable inflow of refugees through Greece to other EU countries. Another risk for the stability of the financial markets of the euro area stems from the high level of public debt in euro countries larger than Greece, especially Italy. If large countries were to encounter financial difficulties, even the new crisis management mechanisms of the euro area might not be sufficient.

There are also differences in growth rates between euro economies in 2016. In Ireland, GDP growth will be 4 per cent and 3 per cent in Spain. In Germany and France, growth will be 1.5 per cent while it will be about 1 per cent in Italy. Greece is lagging behind as overall output is not forecast to grow at all. Finnish growth will be the second weakest. The current account deficits are continuing to shrink and the rise in the public debt will slow down, though not very fast. High public debt makes the economy of many EU countries vulnerable.

Euro area GDP is forecast to grow by 1.6 per cent in 2016 and in 2017. Growth will accelerate to 1.7 per cent in 2018.

FINLAND’S GDP HAS STARTED TO GROW SLIGHTLY

Finland's GDP grew according to preliminary national accounts data by 0.4 per cent in 2015. The growth took place mostly in the beginning of the year. The entire volume of exports was roughly at last year's level. Exports were negatively affected by the value of Russian exports declining by one third from the previous year. Also, an oil refinery maintenance shutdown affected exports negatively. Service exports, however, were clearly on the rise. Private consumption increased by over one per cent. Consumption was bolstered by low inflation, grace periods for housing loan agreed with the banks and the car scrapping premium. The rise in the unemployment rate and the rather weak consumer confidence had an opposite effect. Investment continued to decline. Consumer prices fell slightly.

GDP GROWING 0.9 PER CENT IN 2016 AND 1.2 PER CENT IN 2017

GDP is expected to rise by 0.9 per cent in 2016. In September 2015 we forecast an increase of 1 per cent. The small correction downward is due to weaker export growth than previously expected. This is due to weakening world trade and the resulting deterioration of investment activities in EU countries since the end of last year. Domestic investment, however, is increasing clearly more than previously expected, albeit from a low level of comparison. In the second half of the year exports are expected to pick up slightly in the wake of recovering euro area investments. Weak employment prospects and moderate wage settlements will dampen the rise of private consumption. In 2017, GDP growth will accelerate slightly to 1.2 per cent, boosted by exports. Exports are strengthened by the pick-up of investment in EU countries and a gradual improvement in competitiveness in line with the so-called social contract. Private consumption will not grow at all. Real earnings will fall slightly, employment trends are weak and the social contract will increase employees' non-wage labour costs. The 2018 GDP growth is forecast to be 1.4 per cent. The growth is still driven by exports and investment. This requires the continuation of wage moderation and an improvement in competitiveness as well as a recovery in export markets. Private consumption will increase slightly if income taxation is eased as presumed.

SLUGGISH INVESTMENT OF EU COUNTRIES CURBS EXPORT GROWTH

The volume of total exports increased by 0.4 per cent in 2015. Exports of goods decreased by 1.4 per cent and exports of services increased by 5 per cent. In 2016, the volume of exports will grow by almost one per cent. Exports of goods will grow about half a per cent and exports of services by just under two per cent. Paper industry exports will stay at the previous year’s level. Exports of wood industry will increase slightly. In the chemical industry, exports will increase significantly as oil refinery operations return to normal levels after last year's maintenance shutdown. Exports of machinery and equipment are also expected to recover slightly towards the end of the year as investment demand strengthens. Exports of motor vehicles will be reduced temporarily due to changes in the brand of cars assembled. Exports to Russia will continue to decrease in value by a few per cent. Western export growth is expected to strengthen as a consequence of lower oil prices and the weakening of the euro. In 2017 the volume of total exports is projected to increase by over 3 per cent. The growth percentage is increased by notable ship and motor vehicle deliveries. Exports to western countries will strengthen as their investment activity becomes stronger. Exports to Russia will already achieve a small increase if oil prices strengthen as expected. In 2018, the volume of exports will increase by three per cent.

CORPORATE INVESTMENT AND CONSTRUCTION STARTING TO GROW FROM LOW LEVELS

Investments decreased last year by 1.1 per cent from the previous year. Private investment contracted by 1.4 per cent. Public investment remained at approximately the previous year's level. Residential construction fell by 2.4 per cent. According to Statistics Finland in December 2015, 77.8 per cent of industrial production capacity was utilized. The figure was 0.9 percentage points higher than a year earlier.

Businesses have curbed their investments because the outlook for both exports and private consumption has been uncertain. However, the investment survey of the Confederation of Finnish Industries (EK) suggests that businesses' willingness to invest is now on the rise. If the social contract is implemented as anticipated, investment activity in the export sectors can be expected to increase. Investment is expected to grow both this year and next year by nearly 4 per cent. Machinery and equipment investment will increase by more than 5 per cent this year. Next year it will increase by 4 per cent. Investment in residential housing will stage an upturn, increasing by around 2.5 per cent this year. In 2017 the growth will be of the same magnitude.

In 2018, total investment will increase by 2.5 per cent. Companies need to increase their production capacity. Residential construction growth will continue at a moderate rate of two per cent. The need for housing will remain high in growth centres, but the modest increase in the purchasing power of households and the still high level of unemployment will curb its growth.

UNEMPLOYMENT RATE FALLING SLOWLY, SOCIAL CONTRACT WILL BOOST EMPLOYMENT TOWARD END OF GOVERNMENT'S TERM

The rise in unemployment was relatively moderate for many years compared to the sharp fall of GDP. This was because a significant portion of the decline in output took place in export sectors with high productivity, and the amount of the working-age population decreased due to aging. Recently, however, domestic demand has weakened, so for example the wholesale and retail trade has reduced its workforce. The supply of labour has also increased substantially as those outside the labour force have entered the labour market. These factors have resulted in an increase in the unemployment rate in recent years. In 2016, the unemployment rate will be 9.4 per cent, the same as last year. After this, the unemployment rate will fall only 0.1 percentage points per year. In 2018, the unemployment rate will still be 9.2 per cent and the employment rate will be 69.8 per cent. The social contract will promote employment and reduce unemployment gradually in the following years. Asylum-seekers gradually entering the labour force will raise the unemployment rate by a few tenths of a percentage point. In 2020 the employment rate is estimated to be 71 per cent and the unemployment rate will be 8.9 per cent.

SLOW GROWTH OF PURCHASING POWER DAMPENS CONSUMPTION

The change in private consumption averaged around zero in 2012-2014. In 2015, low inflation and increased popularity of temporary grace periods for housing loans increased households' real disposable income available for consumption. Private consumption grew by 1.3 per cent. In the coming years the public sector's adjustment measures, moderate wage settlements, weak employment trends and somewhat accelerating inflation will curb the growth of private consumption. In 2016, private consumption is projected to increase by 0.7 per cent. Inflation will climb, the level of earnings will rise modestly and employment will improve only slightly. In 2017, private consumption will not grow at all. Real disposable household income will be reduced due to zero increases in contract wages, the acceleration of inflation, and hikes in employees' non-wage labour costs in conjunction with the social agreement. In 2018, private consumption will grow by 0.5 per cent. The expected 500 million euro income tax relief will boost consumption. However, increases in the non-wage labour expenses paid by employees and rising inflation will have a negative impact on households' real purchasing power.

DISINFLATIONARY IMPACT OF FALL IN OIL PRICES FADING

In 2015, consumer prices fell by 0.2 per cent from the previous year. International inflation weakened due to the sharp fall in oil prices and the level of earnings rose moderately. In 2016, consumer prices are expected to rise by 0.3 per cent. Inflation will be accelerated by an assumed moderate increase in oil prices during the year. In 2017 consumer prices are forecast to rise by 1.1 per cent with a continued rise in oil prices. In 2018, consumer prices will increase by 1.7 per cent. At this point interest rate levels are already estimated to be on the rise, which will contribute to higher inflation.

AUSTERITY MEASURES AND STRUCTURAL REFORMS WILL BALANCE PUBLIC SECTOR SLOWLY

In 2014, the general government deficit was 3.2 per cent of GDP, thus exceeding the 3 per cent EMU limit. The central government's deficit was 3.7 per cent while that of the local government was 0.8 per cent of GDP. The figures for the year 2015 have not yet been released when this was written. According to our own estimates the EMU deficit was 3.1 per cent of GDP. We estimate that the so-called structural deficit of the public sector was 1.6 per cent relative to GDP. Its EMU norm is a maximum of 0.5 per cent, but it has its own flexible mechanisms. The general government's gross debt is estimated to have been 62.6 per cent of GDP.

The public sector deficit will be reduced to 2.7 per cent of GDP in 2016 and to 2.6 per cent in 2017 owing to austerity measures decided by the government. The acceleration of economic growth will spur a decrease in the deficit. The fall will be dampened by the expenditures related to asylum seekers. In 2018 the decline will be curbed by the presumed cuts in income taxation. The debt will rise to 64 per cent of GDP this year and to almost 65 per cent next year. Based on ETLA's forecast and applying the EU Commission's methodology, we project the public sector's structural deficit to be 1.5 per cent of GDP in 2016, 1.6 per cent in 2017 and 1.8 per cent in 2018. We estimate that Finland will meet the deficit requirements of the Stability and Growth Pact in 2016 if the costs of asylum seekers of about 0.2- 0.3 per cent of GDP are taken into account. The rise in the structural deficit projected for the years 2017 and 2018, on the other hand, is not easily justified.

The government's gross debt already exceeded the 60 per cent limit last year, but the EMU criteria is adjusted for the support given to the euro area crisis countries, estimated by the Commission to be 2.9 per cent of GDP in 2015. In addition to the adjustments to the criteria due to the economic situation, the impact of asylum seekers on public finances is also taken into account. Finland is thus unlikely to be subject to the EU sanctions on the basis of the debt criterion in the next few years.

Our forecast for the general government's deficit is still 1.9 per cent in 2020 in spite of new austerity measures. The general government's gross debt-to-GDP ratio will have increased to 68 per cent by then. The debt is not growing at exactly the same pace as central and local government deficits, because we expect the public sector's pension insurance companies to buy government bonds at approximately the same pace as previously. Privatization will also slow down the growth of debt. When Finland's economic situation improves over time and the cyclical adjustment is removed, Finland may exceed the debt criterion - possibly also the structural deficit criterion. The ratio of debt to GDP will start to stabilize, however, and it may start to decline after 2020 if economic growth continues to be favourable.

To comply with the Stability and Growth Pact and avoid uncontrolled growth of its debt, Finland will have to follow strict public expenditure controls in the next Parliamentary term as well. According to the government's programme "through austerity measures, public finances will be strengthened by EUR 4 billion at the 2019 level." In addition to the spending and revenue adjustments, there is a need to carry out structural reforms as well as strengthen qualitative and cost competitiveness.

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Balance of resources

	Value	Change in volume, %					
	€ Billion	Y/Y				Average	
	2015*[2)]	2015*	2016F	2017F	2018F	11 - 15	16 – 20F
GDP	187,2	0,4	0,9	1,2	1,4	0,0	1,4
Import	74,9	-1,2	1,8	2,1	2,3	1,4	2,5
- goods	53,1	-1,4	2,4	2,6	2,1	1,5	2,7
- services	21,8	-0,9	0,0	1,0	2,8	1,0	1,9
Total supply	262,1	0,0	1,2	1,5	1,7	0,4	1,7
Export	75,2	0,4	0,8	3,4	3,2	0,8	3,2
- goods	54,8	-1,4	0,4	3,8	3,0	1,2	3,2
- services	20,4	5,3	1,8	2,2	3,7	-0,5	3,0
Investment	38,3	-1,1	3,7	3,7	2,5	-1,3	3,1
- private	30,6	-1,4	3,8	4,0	2,6	-2,2	3,4
- public	7,7	0,2	3,7	2,6	2,1	2,3	1,9
Consumption	149,4	0,8	0,5	0,1	0,4	0,7	0,5
- private	104,3	1,3	0,7	0,1	0,5	0,9	0,7
- public	45,1	-0,3	0,1	0,2	0,1	0,2	0,1
Changes in inventories[1)]	-0,7	-1,0	0,2	-0,1	0,2	0,0	0,0
Total demand	262,1	-0,3	1,2	1,5	1,7	0,4	1,7
Domestic demand	186,9	-0,6	1,3	0,7	1,0	0,2	1,1
Public demand	52,8	-0,2	0,7	0,6	0,4	0,5	0,4

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

[2)] In 2010 prices

Source: Statistics Finland, ETLA

Key forecasts

	2013	2014*	2015*	2016F	2017F	2018F
Consumer price index change, %	1,5	1,0	-0,2	0,3	1,1	1,7
Wage level change, %	2,1	1,4	1,2	1,1	0,7	1,3
Unemployment rate, %	8,2	8,6	9,4	9,4	9,3	9,2
Current account surplus, % of GDP	-1,9	-1,2	0,1	0,3	0,6	1,1
Industrial output change, %	-3,2	-1,3	-1,0	1,4	2,4	2,7
Finland's EMU surplus, % of GDP	-2,6	-3,2	-3,1	-2,7	-2,6	-2,4
Finland's EMU debt, % of GDP	55,4	59,3	62,6	63,9	65,9	67,1
Euribor 3-month, %	0,2	0,2	0,0	-0,2	0,0	0,5
EU27 countries, change in GDP, %	0,2	1,4	1,9	1,8	1,9	2,0
EMU countries	-0,3	0,9	1,6	1,6	1,6	1,7
EU27countries, change in CPI, %	1,6	0,4	0,0	0,2	1,5	1,8
EMU countries[1)]	1,4	0,4	0,0	0,2	1,4	1,8

[1)] Harmonised index

Source: Statistics Finland, ETLA