FORECAST ASSUMPTIONS

The global outlook has weakened slightly

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Overall, the outlook for the global economy has weakened slightly during the last six months. The difficulties of the emerging economies are dampening global prospects at the same time as growth in the advanced economies has even exceeded the estimated growth rate for potential output. During the forecast period (2016–2018), moderate growth in the advanced economies will continue. World trade will grow slowly, at the same pace as global GDP.

Concerns about the Chinese economy will continue to affect the global outlook. Although growth in China has slowed as expected, structural changes in the economy and high debt levels resulting from expansionary policies following the financial crisis have added to the uncertainty. The Russian and Brazilian economies slipped into deep recession in 2015. Of the BRICS countries, which were the growth miracles at the beginning of the new millennium, only the outlook for the Indian economy has not been downgraded from earlier forecasts.

In the major economic areas, growth in the developed countries has been driven by the domestic markets. While consumption and services developed favourably, industrial production and investment were lacklustre. Against a backdrop of subdued industrial production, world trade growth has remained exceptionally sluggish.

Inflation has been stagnant in all major economic areas. World market prices of commodities, and energy in particular, fell considerably in summer and early autumn

2015 and again in the first quarter of 2016. Oil price volatility has masked the persistent sluggishness of core inflation, excluding energy and fresh food prices, particularly in the euro area.

Euro area monetary policy is very accommodative: policy rates are at their lower bound, a combination of forward guidance and asset purchases has brought long-term interest rates down, credit operations have lowered the costs of bank funding and eased securities-based borrowing. Clear signs of an improvement in the situation have been visible in the financial markets, including the private credit markets.

Moderate growth in euro area GDP will continue, mainly due to private consumption. A pick-up in consumption will be maintained by the ongoing exceptionally low level of interest rates, the improved employment situation, and growth of real incomes, underpinned by slow inflation. Even so, investment growth will still be slow against its historical trend. The export outlook is clouded by deteriorating growth prospects for the emerging economies and world trade. The very accommodative stance of monetary policy will, however, bolster growth. Fiscal policies will also be mildly accommodative. In the ECB's projections, euro area growth is expected to accelerate to 1.6% in the current year and to 1.7% in 2017 and 2018.

Of the advanced economies, the US economy has the strongest outlook, as the balance sheet adjustments undertaken in recent years have substantially reduced private sector debt. On balance, the declining oil price will have a positive impact on the US economy, despite the country's shale oil production sliding into trouble. US economic growth will remain robust throughout the forecast period, driven by strong private consumption and investment. The ECB's projections foresee average growth of well over 2% in the US economy in 2016–2018.

The near-term growth outlook for Japan is moderately positive. In China, economic growth is still expected to climb to 6.4% in 2016 and to ease to around 6.0% towards the end of the forecast period. Economic growth in Russia has already been slowing significantly for three years. Following the collapse of the oil price, the Russian economy will still contract by 1.4% in the current year. On the back of the assumed mild upturn in the price of oil, the Russian GDP contraction should bottom out towards the end of the forecast period.

Growth of world trade in 2016 and 2017 will be significantly slower than assumed in December 2015. The ECB's projections foresee growth of approximately 3% in 2016–2018. The easing of trade performance reflects a variety of more permanent structural factors.[1] The most important permanent structural factor in the forecast period is the shift in China's growth model from exports to domestic demand, meaning that the country's propensity to import will decline. As a consequence, among other things, growth of world trade in the forecast period will converge towards global GDP growth. Finland's export markets will grow at roughly the same pace as world trade in 2016–2018.

In the course of 2016, prices of crude oil and other commodities will begin to edge up

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1. Bank of Finland Bulletin 1/2016: Why has world trade slowed?

slowly, but the forecast assumptions are for price levels to remain well below those that we have been accustomed to in recent years and assumed by the Bank of Finland in its previous forecast.

The interest and exchange rate assumptions in the forecast have been derived from financial market prices, and they will remain almost unchanged throughout the forecast period. According to market expectations, the 3-month Euribor will remain exceptionally low, i.e. at –0.3% in 2018. The yield on Finnish 10-year government bonds will also remain unusually low, rising very slowly to stand at 0.9%, on average, in 2018.[2]

Table.

Forecast assumptions

	2014	2015	2016f	2017f	2018f
Finland's export markets[1], % change	2.7	0.1	2.3	3.6	4.1
Oil price, USD/barrel	98.9	52.4	42.5	48.0	50.3
Euro export prices of Finland's trading partners, % change	–0.3	3.9	–1.2	3.0	2.5
3-month Euribor, %	0.2	0.0	–0.3	–0.3	–0.3
Yield on Finnish 10-year government bonds, %	1.4	0.7	0.5	0.6	0.9
Finland's nominal competitiveness indicator[2]	102.2	97.8	98.4	98.5	98.5
US dollar value of one euro	1.33	1.11	1.13	1.14	1.14

[1] Growth in Finland's export markets equals growth in imports by countries to which Finland exports, on average, weighted by their respective shares of Finnish exports.

[2] Narrow plus euro area, 1999Q1 = 100

f = forecast

Sources: Eurosystem and Bank of Finland.

Tags

forecast, Finland, economic development, economic situation

2. The interest rate assumptions in the forecast are derived from market expectations current on 18 May 2016. The interest and exchange rate assumptions are purely technical and do not anticipate the monetary policy decisions of the Governing Council of the European Central Bank or estimates of equilibrium exchange rates.