FORECAST ASSUMPTIONS

Accelerating global growth raises price of oil

11 Jan 2018 – Forecast – Finnish economy

The global economy is still enjoying strong and broadly based growth. A growth spurt was seen in world trade in 2017, reflecting in part an upward correction from a lacklustre previous year. Consequently, the growth in world trade has accelerated past that of global GDP for the first time in several years. Many economies continue to support growth through accommodative financing conditions and stimulus measures. In the advanced economies, a return to conventional monetary policy has been delayed by persistently low inflation, although this does now appear to be accelerating somewhat.

The global economy's growth outlook has remained good and the outlook for the immediate years ahead has also brightened. The growth in world trade has been exceptionally strong during the past year, but part of this is a correction from a sluggish year in 2016. Growth in global trade lagged behind that of global GDP for several years. This ratio seems to have been reversed during the past year, but this does not in itself guarantee a sustained trend.

Import growth in Finland's export markets is expected to increase by almost 6% in 2017 and by at least 4% in 2018. In addition, the export prices of Finland’s competitors are set to increase, although at a considerably lower rate than previously forecast. This year their export prices will increase by 3.6%, but this rate is expected to fall to under 0.5% next year before levelling out to slightly over 2% annually.

US growth outperforms expectations

The pace of economic growth in the United States surpassed forecasts set for this year. In 2017 Q3, annual growth accelerated to 3.3%, despite the hurricanes that hit the country in late summer, and is expected to remain strong in the immediate years ahead.

Private consumption has proved to have been a key source of growth. Consumer confidence is significantly above the long-term average, while industrial confidence is also strong, reaching its highest level for seven years. Industrial production has also picked up after a couple of weak years, with production increasing 1.7% in January–October compared with a year earlier.

Meanwhile, US unemployment has fallen to close to 4%, yet wage growth remains relatively modest. This is thought to reflect both underemployment, i.e. unused capacity in the labour force, as well as lethargic productivity growth.

US inflation has accelerated since 2016 and has trended around 2% in recent months, largely owing to the increasing price of oil. However, the personal consumption expenditure (PCE) measure, which the Federal Reserve uses as its primary measure of inflation, only suggests an inflation rate of approximately 1.5%. Nevertheless, inflation expectations are well above those of the euro area, and markets expect the Fed to introduce further rate hikes to continue.

Strong recovery in euro area

Economic recovery in the euro area has proved to be strong this year and has exceeded expectations. Tailwinds in global trade have driven demand for euro area exports, although this has also coincided with increased demand for imports. As such, euro area economic growth is being driven by domestic demand, covering both consumption and investment, rather than net exports.

Meanwhile, industrial confidence has strengthened on the back of increased demand for exports. The annual growth rate of industrial output has accelerated to almost 4% over the summer and autumn and is thus faster than in the United States.

World trade driven by Chinese demand

The growth of world trade heavily relies on the development of the Chinese economy. Although the pace of China's economic growth is still expected to slow, this year saw growth that not only beat forecasts but also improved upon the previous year.

Moreover, consumer confidence has risen above the long-term average. Retail trade has slowed down from previous years but remains strong.

China's investment ratio has continued its almost decade-long downward trend. The underlying problem behind the current economic growth is that it is largely debt-driven and is thus feared to pose a risk to the stability of the country's financial markets.

Brighter outlook for emerging economies

Compared with the previous forecast, the growth outlook appears brighter for many emerging economies. The rise in the price of oil has played a particularly important role in supporting the Russian economy, where private consumption turned toward accelerating growth in the early months of 2017. In addition, Brazil, whose economy has suffered considerable setbacks, has re-established a positive growth trend.

The assumption concerning the price of oil has been revised substantially upwards relative to the previous forecast. The difference is only a few dollars a barrel in 2017, but is forecast to reach approximately ten dollars a barrel in 2018, when the oil price is expected to surpass 60 dollars. Following this upswing, the price will fall slightly. The main rationale behind the revised estimate is the increase in demand driven by accelerating growth in the global economy.

Interest rates will rise slowly

The interest rate assumptions in the forecast are derived from financial market prices. Both short and long-term rates are expected to slowly increase.

Based on market expectations, the assumption for the 3-month Euribor in 2017 has remained unchanged at -0.3%, and the estimate for 2018 has been revised down to the same level. In 2019, it is assumed to have risen to -0.1%, and by 2020, to a positive value of 0.1%.

The assumption concerning yields on Finnish 10-year bonds has been revised downward somewhat. Yields are expected to gradually rise from 0.5% in 2017 to 1.1% in 2020.

The euro's value relative to the dollar is assumed to slightly appreciate in 2017 and 2018, but to thereafter remain steady until the end of the forecast period. Finland's trade-weighted exchange rate will somewhat increase in 2017 and 2018 and will remain relatively unchanged throughout 2019 and 2020.

Table.

Forecast assumptions

	2016	2017f	2018f	2019f	2020f
Finland's export markets[1], % change	2.4	5.9	4.3	3.9	3.6
Oil price, USD/barrel	44.0	54.3	61.6	58.9	57.3
Export prices of Finland's competitors, euro, % change	–4.5	3.6	0.4	2.2	2.2
3-month Euribor, %	–0.3	–0.3	–0.3	–0.1	0.1
Yield on Finnish 10-year government bonds, %	0.4	0.5	0.7	0.9	1.1
Finland's' trade-weighted exchange rate[2]	101.6	104.3	104.6	106.8	106.8
US dollar value of one euro	1.11	1.13	1.17	1.17	1.17

[1] The growth in Finland's export markets is the import growth in the countries Finland exports to weighted by their average share of Finland's exports.

[2] Broad nominal effective exchange rate.

Sources: Eurosystem and Bank of Finland.

Tags

economic development, forecast, economic situation, Finland