FORECAST ASSUMPTIONS

International economy and external assumptions

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The global economy is still growing strongly, but there are already small signs that the growth rate is levelling off. Growth is still sustained by the effects of the accommodative fiscal policy in the United States and brisk growth in emerging economies. The rising oil price has boosted the economies of oil-producing countries for almost a year. All the while, concerns over the rise of protectionism have increased uncertainty. The growth prospects for the euro area remain good, although the first quarter of 2018 turned out weaker than anticipated – probably due to temporary factors. It is possible that the euro area has reached the peak of the business cycle and growth rates will rise no further. Slower growth in the euro area in 2019 has long been included in the predictions of several major forecasters.

Euro area already reached peak of cycle

According to the ECB's June forecast, the global economy outside the euro area is expected to grow 4.0% in 2018 and slow to 3.9% in 2019, and even further, to 3.7% in 2020. Export demand in the euro area will continue to grow strongly in 2018, but this too will slow in the immediate years ahead. Growth in Finnish export markets will slow down slightly from 2017, but will still remain at 5.2% in 2018, while dropping to 4.3% in 2019 and further, to no more than 3.7% in 2020. The export prices of Finland's competitors will rise 0.3% in 2018, 2.5% in 2019 and around 2.2% in 2020.

Accommodative fiscal policy boosts economic growth in the USA

US GDP grew 2.3% in 2017, and the economy is expected to continue to grow very strongly in 2018 despite the fact that economic growth in the first quarter was slow even there. US growth is supported particularly by an accommodative fiscal policy, including tax cuts introduced under the taxation reform, and by increased public spending. Economic confidence remains strong in the United States. Consumer sentiment has continued to improve, supported in part by the unemployment rate falling below 4%.

Euro area growth flattening out

In 2017, euro area GDP grew by 2.5%, but growth will slow in 2018. The GDP growth rate in the first quarter was well below the ECB's March forecast. Key reasons are temporary factors, such as the harsh winter weather, a severe flu epidemic and the strong exchange rate of the euro against the US dollar. Economic growth in the euro area has relied mostly on domestic consumption. GDP growth fell behind the early year forecast especially in Germany, where industrial output and industrial confidence have evolved poorly in early 2018.

According to the ECB's June BMPE projections, GDP growth in the euro area will stall at 2.1% in 2018, which is three-tenths of a percentage point lower than the ECB assumed in the March forecast. The 2019 forecast has remained unchanged at 1.9%, and the 2020 forecast at 1.7%. Investment is growing strongly in 2018. Exports are also growing briskly, but, due to the rapid growth of imports, net export growth will be moderate in 2018 and turn negative in 2019. The current account surplus of the euro area is therefore expected to be much smaller relative to GDP than expected in the March forecast. Unemployment is still receding, but at a slightly slower pace than forecast in March. The inflation forecasts for both 2018 and 2019 have been revised up by three-tenths of a percentage point, to 1.7%. According to recent projections, unit labour costs will go up this year by almost half a percentage point faster than forecast in March. Growth is still supported by the accommodative monetary policy. The slowing of global economic activity and international trade will gradually begin to erode the euro area's growth prospects, too.

Chinese growth remains strong

The Chinese economy has continued its strong growth, showing only moderate signs of slowing down. China's prospects have, however, been overshadowed by the trade policy conflict with the United States. While it appears that not all protectionist threats will materialise, protectionism remains a downside risk to the economy. China is pursuing a more consumption-driven economic structure and the country's investment ratio has in fact been decreasing for several years. The Chinese financial markets are carrying a lot of risks, as growth is mainly based on debt accumulation by both companies and households. In Russia, output and investment have recovered slowly, but demand has recovered faster and exports have developed well.

Strong demand boosted prices of oil and other commodities

The growth of the global economy and, in particular, Chinese industrial output has raised metal prices. Low interest rates have also increased investors' interest in industrial raw materials. The growing prevalence of electric cars increases demand for the minerals used in their batteries.

The price of crude oil has multiplied since 2016. The increase has been driven particularly by high demand. Supply-related factors have also contributed to the increase, such as pacts to limit production made by OPEC and some other oil countries, the collapse of Venezuelan oil production due to the economic crisis and the United States' decision to reinstate Iranian sanctions. On the other hand, supply has been balanced by the highly increased shale oil production in the United States. Both the sector's productivity growth and rising oil prices have encouraged producers not only to re-open closed oil fields but also to develop new ones. However, capacity constraints currently hamper attempts to significantly increase shale oil production.

The barrel price of oil is predicted to settle at around USD 74.5 in 2018 and expected to come down to USD 73.5 in 2019, and to just under USD 68.7 in 2020. The price is expected to be almost 13 dollars higher in 2018, and around 14.5 dollars higher in 2019 than foreseen in the previous forecast.

Interest rates to rise slowly

The interest rate assumptions in the forecast are derived from financial market prices. Based on market expectations, the assumption for the 3 month Euribor rate in 2018 has remained unchanged at -0.3%, while the assumption for 2019 has been revised down slightly to -0.2%. In contrast, the assumption for 2020 has been revised up by one tenth of a percentage point, to 0.2%.

The assumption concerning yields on Finnish 10-year bonds has been revised up across the board. Yields are expected to gradually rise from 0.8% in 2018 to 1.2% in 2020.

The euro's value relative to the US dollar is assumed to slightly appreciate from 2017. In 2018, the value is assumed to be US 1.20, and over the following two years to be USD 1.18. Finland's trade-weighted exchange rate is assumed to increase (index value 108) from the previous forecast, when the index was at roughly 102.

Table.

Forecast assumptions

	2016	2017	2018f	2019f	2020f
Finland's export markets[1], % change	2.6	6.0	4.9	4.3	3.7
Oil price, USD/barrel	44.0	54.4	74.5	73.5	68.7
Export prices of Finland's competitors, euro, %	–4.6	3.0	0.3	2.5	2.2
3 month Euribor, %	–0.3	–0.3	–0.3	–0.2	0.2
Finnish 10-year government bonds, %	0.4	0.5	0.8	1.0	1.2
Finland's nominal competitiveness indicator[2]	104.3	104.6	108.0	108.0	108.0
US dollar value of one euro	1.11	1.13	1.20	1.18	1.18

[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: Statistics Finland and Bank of Finland.

Tags

economic development, Finland, forecast