BANK OF FINLAND BULLETIN

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FORECAST ASSUMPTIONS

Global economic growth will gain momentum in the forecast period

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Global economic growth will gain momentum in the forecast period. The sliding oil price will benefit oil-importing countries. In the euro area, the Extended Asset Purchase Programme (EAPP) has reduced funding costs, improved lending and strengthened the confidence of economic agents. The exchange rate developments to date support the growth and inflation outlooks of the euro area and Japan, while the recovery of the US economy is consistent with the strong US dollar. The Russian economy will contract over the next two years, following the collapse of the oil price. Economic growth in China will remain relatively robust.

Global economic growth is expected to pick up from 3.2% in 2015 to 3.8% in 2016 and 2017. The decline in the oil price experienced in the latter part of 2014 and early 2015 is broadly reflected in global economic conditions and the global outlook. The oil price decline mainly represented a positive supply shock, which, in the short term, will support growth in net oil-importing countries. However, the revenue outlook for oil-producing countries and energy sector companies has deteriorated, which has been reflected in higher interest rates on the financial markets and rising funding costs.

The Eurosystem's Extended Asset Purchase Programme (EAPP) has had numerous positive effects on the euro area. Short-term market rates and longer-term government bond yields have fallen markedly. The lowering of inflationary expectations has been reversed. Funding costs have decreased, and access to lending has improved. Furthermore, the money supply has grown and credit developments have strengthened. Confidence in the economy has improved, thus helping the effects of the Eurosystem's measures feed through to the real economy. Economic recovery is expected to gradually gather strength in the euro area and become more broadly based.

GDP growth in the euro area in the first quarter of 2015 was 0.4% on the previous quarter. The economy expanded in all major euro area countries. Growth was supported by, for instance, rising real income in response to the fall in the oil price, low interest rates and the depreciation of the euro. In the ECB's macroeconomic projections, euro area growth is expected to pick up to 1.5% in the current year, to 1.9% in 2016 and to 2.0% in 2017 (see Table 1).

Table 1.

Growth in GDP and world trade

% change on previous year

GDP	2014	2015[f]	2016[f]	2017[f]
United States	2.4	2.6	3.1	2.7
Euro area	0.9	1.5	1.9	2.0
Japan	–0.1	0.5	1.5	0.7
Non-Japan Asia	6.5	6.2	6.6	6.3
World	3.4	3.2	3.8	3.8
World trade	2.9	2.6	5.0	5.3
Finland's export markets[1]	2.6	1.8	4.4	5.1

[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.

f=forecast

Source: Eurosystem.

Of the advanced economies, the US economy has the strongest outlook, as the balance sheet adjustments undertaken in recent years have substantially reduced the degree of private sector debt. On the whole, the declining oil price has impacted positively on the US economy, despite the difficulties faced by the country's schist oil production. US economic growth will remain robust throughout the forecast period, driven by strong private consumption and investment. During the forecast period, the US economy will expand at an average rate of 2.8% per annum.

The near-term outlook for Japan is moderately positive. In China, economic growth is expected to climb to roughly 7% this year and to moderate to around 6.5% towards the end of the forecast period. The Russian economy is already in its third year of significant deceleration. Following the collapse of the oil price, the economy will contract by more than 4% this year. In response to the assumed slight rise in the oil price, the contraction in Russian GDP will level off.

World trade growth will remain much slower in 2015 than assumed in December 2014. Compared with developments in world trade, Finnish export markets have posted slower growth in recent years. This is explained by the weak economic outlook for regions pivotal to Finnish exports, such as Russia. Part of the sluggish growth in export markets is compensated for by the depreciation of the euro and the consequent improvement in the price-competitiveness of Finnish exports.

World market prices of commodities, and energy in particular, fell considerably in the latter part of 2014 and early 2015. (Table 2). The decline in the oil price mainly represented a positive supply shock. In the course of 2015, the prices of crude oil and other commodities will begin to edge up, but prices will remain well below those witnessed in recent years and assumed by the Bank of Finland in the previous forecast.

The forecast assumes interest and exchange rates will develop in line with financial market prices and will remain practically unchanged during the forecast period. According to market expectations, the 3-month Euribor will remain exceptionally low in 2017, at 0.2%. Analogously, the yield on Finnish 10-year government bonds will rise slowly, reaching 1.3% in the last quarter of 2017.[1]

Table 2.

Forecast assumptions

	2013	2014	2015f	2016f	2017f
Finland's export markets[1], % change	2.3	2.6	1.8	4.4	5.1
Oil price, USD/barrel	108.8	98.9	58.0	64.7	68.3
Euro export prices of Finland's trading partners, % change	–2.9	–0.1	6.2	2.8	2.5
3-month Euribor, %	0.2	0.2	0.0	0.0	0.2
Yield on Finnish 10-year government bonds, %	1.9	1.4	0.7	1.1	1.3
Finland's nominal competitiveness indicator[2]	101.6	102.4	98.1	97.8	97.8
US dollar value of one euro	1.33	1.33	1.09	1.8	1.08

[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.

1. The interest rate assumptions in the forecast are derived from market expectations current on 12 May 2015. The interest and exchange rate assumptions are purely technical and do not anticipate the monetary policy of the Governing Council of the European Central Bank or estimates of equilibrium exchange rates.

Tags

- economy
- economic situation
- forecast
- Finland