Forecast

Forecast assumptions: Political changes increase uncertainty surrounding global economic outlook

Finnish economy | 27 January 2017

The global economy is envisaged to grow at a pace of well over 3% in 2017–2019, i.e. slightly faster than in 2016. World trade growth will accelerate during the forecast period, but will remain slow relative to GDP, as in recent years. The markets' first impressions of the future stance of US economic policy have strengthened the dollar, reinforced inflation expectations and raised long-term interest rates especially in the United States, but also in Europe. Overall, estimates of forthcoming US economic policy are still on shaky ground. Brexit will cloud the growth outlook for the United Kingdom, in particular, but also for the rest of Europe. Euro area growth is expected to continue at a fairly brisk pace, driven by domestic demand. Chinese growth will remain strong, sustaining recovery in the global economy.



During the past half year, the uncertainty surrounding the outlook for the global economy has been increased by political events. It is hard to assess the economic impact of the outcome of the Brexit vote in the United Kingdom and the upcoming economic policy changes led by the new US president. Political uncertainty increased in the euro area when the Italian prime minister resigned at the beginning of December as a result of the negative outcome of a referendum on constitutional reform.

The markets' first impressions of the future stance of US economic policy, particularly the expected fiscal stimulus, have strengthened the dollar, reinforced inflation expectations and raised long-term interest rates especially in the United States, but also in Europe. On the other hand, potential revisions to US trade policy and the growth of protectionism may dampen economic prospects. Overall, estimates of forthcoming US economic policy are still on shaky ground.

In the ECB's projections, the euro area is expected to grow smoothly at a pace of approximately 1.6% in 2017–2019, driven by domestic demand. Growth will be supported by an accommodative monetary policy, and over the forecast horizon by a broadly neutral fiscal policy. Ongoing growth during the forecast period will contribute to improvements in the employment situation and fuel inflation, which will edge up to 1.7% at the end of the forecast horizon. Brexit will cloud the growth outlook for the United Kingdom, in particular, but also to some extent for the rest of Europe. UK growth is expected to slow markedly for the next couple of years, compared with 2016.

The emerging economies will continue to recover during the forecast period. However, following the US presidential election, the currencies of many emerging economies depreciated relative to the US dollar, which may add to concerns about an expanding debt burden in domestic currency of the emerging economies' non-financial corporations that have taken out US dollar loans. Chinese growth will slow slightly from about 6.5% in 2016 to 6%, amid the transition of the economy from one driven by investment to one driven by private consumption. The mild increase in the price of oil will bolster the gradual rebound of the Russian economy. Over the forecast horizon, the oil price is assumed to rise from about USD 43 per barrel in 2016 to USD 55 in 2019. The oil price will reach a level a little higher than envisaged by the Bank of Finland in our previous forecast for the Finnish economy.

The ECB projects global economic growth of well over 3% in 2017–2019, i.e. slightly faster than in 2016. World trade growth will accelerate to just under 4% in 2018–2019. Even so, it will remain slow relative to GDP growth, as seen in recent years. Growth in Finland's export markets will gradually gain momentum over the forecast horizon, from 1.8% in the current year to 3.7% in 2019.

According to market expectations, major central banks will keep their respective monetary

policies accommodative for a prolonged period, although interest rates in the United States are expected to rise moderately. The euro area price outlook remains subdued. In December, the European Central Bank decided to maintain the accommodative stance of monetary policy by extending the duration of the asset purchase programme from March until the end of December 2017. Asset purchases will be made at a monthly pace of EUR 80 billion until the end of March, after which they will continue at a monthly pace of EUR 60 billion.

The interest and exchange rate assumptions in the forecast have been derived from financial market prices and will remain almost unchanged over the forecast horizon. According to market expectations, the 3-month Euribor will remain exceptionally low, i.e. slightly negative almost throughout the forecast period. The yield on Finnish 10-year government bonds will also remain unusually low, rising only slowly to around 1% in 2018–2019. The exchange rate of the euro relative to the US dollar will be somewhat weaker than previously predicted. Finland's nominal competitiveness indicator, i.e. the trade-weighted exchange rate, will be stable throughout the forecast period, albeit a bit stronger than in 2016. This will be reflected in the elevation of export prices of countries to which Finland exports, as measured in euro terms, in such a way that export price increases will be muted in 2017, but will speed up to some 3% in 2018–2019.

Forecast assumptions

	2015	2016^{f}	2017^{f}	2018^{f}	2019^{f}
Finland's export markets[1], % change	0.1	1.8	2.8	3.6	3.7
Oil price, USD/barrel	52.4	43.1	49.3	52.6	54.6
Euro export prices of Finland's trading partners, % change	-0.3	3.9	-1.2	3	2.5
3-month Euribor, %	0	-0.3	-0.3	-0.2	0
Yield on Finnish 10-year government bonds, %	0.7	0.4	0.7	0.9	1.1
Finland's nominal competitiveness indicator[2]	97.8	99.1	100.5	100.5	100.5
US dollar value of one euro	1.11	1.11	1.09	1.09	1.09

[1] Growth in Finland's export markets equals growth in imports by countries to which Finland

Sources: Eurosystem and Bank of Finland.

Forecast assumptions
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.

Keywords

economic development, economic situation, Finland, forecast