Forecast

Recovery in global economy delayed

Finnish economy | 17 January 2020

Uncertainty in the global economy poses a substantial risk to the Finnish growth outlook. In 2019, growth in the main export markets has been slower than previously expected, and uncertainty factors may cause further slower-than-expected developments. If materialised, the risks would particularly affect the exports of a small open economy such as Finland. This alternative scenario analyses the transmission of a temporary dip in Finnish export demand to different segments of the economy. The alternative scenario has been prepared using the Bank of Finland's dynamic general equilibrium model Aino.



Scenario assumptions

The basis of the alternative scenario is as follows. The recovery in the global economy is delayed, and growth in Finnish export demand in 2020–2021 is accordingly one percentage point lower year-on-year compared with the baseline (Table 1). The baseline refers to the Bank of Finland's December 2019 forecast. Correspondingly, the rise in export prices of Finland's competitors will year-on-year remain half a percentage point below the baseline due to the weaker cyclical conditions. This corresponds with the average relation between the development of Finnish export demand and of the export prices of competitors during Finland's participation in the

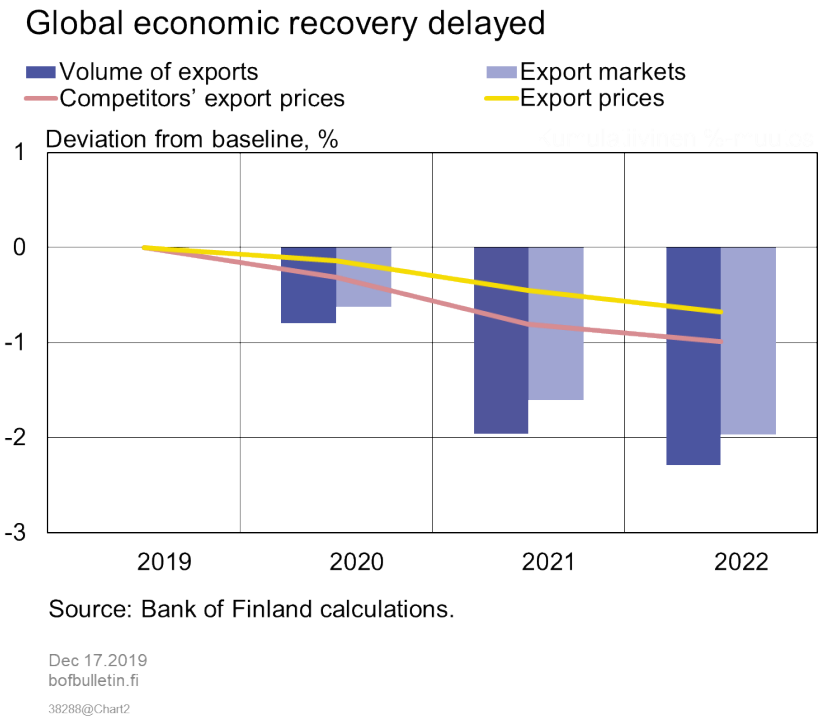
Monetary Union.

In the alternative scenario, wages remain at the baseline level for the next three years, i.e. they are not expected to react to the weakened foreign demand. This illustrates a situation where the collective labour market and wage agreements have already been settled based on the forecast economic developments, and wages are inflexible downwards. The role of wages is significant in the economy's adjustment to shocks, particularly when individual member states of a monetary union cannot adjust their economy via the exchange rate or nominal interest rates (Juvonen et al.: Do wages contribute to flexibility and competitiveness in a monetary union?).

Negative effects throughout

With export demand weaker than expected, export growth is also slower than the baseline. There is also a slowdown in the growth of imports, as Finnish export companies use a lot of intermediate goods in their manufacturing processes. However, import growth slows less than export growth, because a portion of imports are for household consumption. Furthermore, the rise in Finnish export prices slows less than the rise in competitors' export prices (Chart 1), partly because the increase in wage costs of Finnish companies does not slow correspondingly. Thus the competitiveness of Finnish products on international markets deteriorates and export growth slows more than import growth. Finnish export companies lose market share.

Chart 1.



The slowdown in export growth leads to oversupply in the domestic economy, followed by negative price pressures. The rise in import prices also slows. Thus the rise in consumer prices throughout the entire review period is subdued compared with the baseline.

Due to the deteriorated cyclical conditions, labour demand decreases and the employment rate stops rising. In this scenario, the price of labour does not contribute to an adjustment of the economy, as the rise in average earnings is assumed to follow the baseline in 2020–2022. In 2022, the employment rate starts rising, in contrast to the baseline, and the rate is 0.6 of a percentage point higher in 2022. The real average hourly earnings of those who have kept their jobs increases, as price rises are more subdued than before.

The effects of weakened export demand are also reflected in domestic demand, because export companies also use domestic production inputs. The growth of both private consumption and private investment slows in 2020–2022. Private consumption is determined particularly by households' purchasing power, which remains below the baseline due to the weakening trend of employment and slowdown of growth in aggregate wages. The general government deficit relative to GDP grows, because the rise in tax revenue slows and unemployment increases.

Overall, the decline in export demand slows foreign trade in particular, with the effects also being transmitted broadly through the entire economy. GDP growth slows by 0.2 of a percentage point annually, and in 2022 comes in 0.6 of a percentage point below baseline.

Table 1.

Alternative scenario: Global economic recovery delayed

		2019	2020	2021	2022	202 leve devi
Percentage change on previous year, unless otherwise indicated						
GDP	Baseline forecast	1.3	0.9	1.1	1.3	212
	Alternative scenario	1.3	0.8	0.8	1.2	211
	Deviation	0.0	−0.2	−0.3	−0.2	−0.6

Imports	Baseline forecast	0.7	1.3	1.8	2.5	92 9
	Alternative scenario	0.7	0.8	0.9	2.1	91 3
	Deviation	0.0	−0.5	−0.9	−0.4	−1.7
Exports	Baseline forecast	4.0	0.9	2.2	2.6	93 0
	Alternative scenario	4.0	0.1	1.0	2.3	90 9
	Deviation	0.0	−0.8	−1.2	−0.3	−2.3
Private consumption	Baseline forecast	0.7	1.3	1.2	1.2	114
	Alternative scenario	0.7	1.2	1.0	1.0	114
	Deviation	0.0	−0.1	−0.2	−0.2	−0.5
Private investments	Baseline forecast	1.1	−0.3	0.8	2.1	40 5
	Alternative scenario	1.1	−0.3	0.5	1.6	40 2
	Deviation	0.0	−0.1	−0.3	−0.5	−0.8
Harmonised index of consumer prices	Baseline forecast	1.2	1.2	1.4	1.6	108,
	Alternative scenario	1.2	1.0	1.0	1.3	107,
	Deviation	0.0	−0.2	−0.4	−0.3	−0.9
Export prices	Baseline forecast	0.0	0.1	1.4	1.9	110,

	Alternative scenario	0.0	−0.1	1.1	1.7	109,
	Deviation	0.0	−0.1	−0.3	−0.2	−0.7
Unemployment rate, %	Baseline forecast	6.7	6.7	6.6	6.4	6.4
	Alternative scenario	6.7	6.8	7.0	7.0	7.0
	Deviation	0.0	0.1	0.4	0.6	0.6
Employment rate, 15–64-year-olds, %	Baseline forecast	72.5	72.7	73.0	73.4	73.4
	Alternative scenario	72.5	72.5	72.4	72.5	72.5
	Deviation	0.0	−0.2	−0.5	−0.8	−0.8
Export markets	Baseline forecast	1.6	1.7	2.5	2.7	122.
	Alternative scenario	1.6	1.0	1.5	2.3	120.
	Deviation	0.0	−0.6	−1.0	−0.4	−2.0
Competitors' export prices	Baseline forecast	1.7	1.8	2.2	2.2	115.
	Alternative scenario	1.7	1.5	1.7	2.0	113.
	Deviation	0.0	−0.3	−0.5	−0.2	−1.0
Average hourly earnings	Baseline forecast	2.6	2.5	2.2	2.5	23.5
	Alternative scenario	2.6	2.5	2.2	2.5	23.5
	Deviation	0.0	0.0	0.0	0.0	0.0

Demand components in million euro at reference year 2010 prices. In the export market indicator and price indices 2
excl. the HICP, where 2015=100. Average hourly earnings in euro per hour worked.

Keywords

alternative scenario, export markets, exports, international economy, risks