

Pentti Hakkarainen: Economic outlook

Presentation by Mr Pentti Hakkarainen, Deputy Governor of the Bank of Finland, to the YIT group and division management boards, Lahti, 17 September 2015.

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The slides can be found at the Bank of Finland website [Slides](#)

1. Global economy

The world economy is growing, albeit a bit slower than it was expected a year ago. The economic outlook in the United States has remained encouraging and the Euro area prospects have clearly improved.

However last August was a bumpy month for financial markets. Stock markets around the world were infected by the Chinese stock market crash. The crash was preceded by the Shanghai composite index more than doubling in the course of little less than a year. The stock market bubble burst in two phases: in June and in August. First phase had little effect globally, but in August, the crash spread around the major stock exchanges causing turmoil. Since then, the situation has somewhat stabilized. Volatility has remained high, but around a new – and lower – level.

Also raw material prices have decreased, partly reflecting the impaired economic outlook in China. In oil markets, the supply side is also partly to be blamed for. Oil supply has remained solid despite the price collapse.

What did stock market volatility and falling raw material prices reflect? One answer is that these illustrated at least partially the uneven progress of the world economy. Especially the general assessments on Chinese growth prospects have been revised down. Situation in China has also increased downward risks for other emerging market economies.

Growth moderation in China is caused by the change in its economic structure. Currently the economy is undergoing a phase shift with the share of household consumption increasing. In 2012, the share of consumption to GDP was just 35 % which is low by all standards. For example in the United States, household consumption makes roughly 70 % of GDP. This shift will take time. Bank of Finland's forecast for Chinese GDP growth in 2016 is 6 %. And that is still a very good number.

2. Euro area

Euro area economy has been doing better for some time. Total production is increasing in the four biggest Euro area economies; Germany, France, Italy and Spain. In the first half of 2015, Euro area economy grew 0,5 % in the first quarter and 0,4 % in the second. Especially Spain has been growing rapidly after all the hard years it has lived through.

In Euro area, unemployment is slowly declining, although from high levels. Improved employment, lowered oil price and low interest rates have increased household real income and consumption. In the corporate sector, investments have been supported by accommodative monetary policy and improving financial conditions. Although investments have been very low for a long time, there is finally some positive signs available. Looking at the European Central Bank Staff projections from September, Euro area GDP growth rate is projected to pick up from 1,4 % in 2015 to 1,8 % in 2017. Inflation is projected to be 0,1 % in 2015, and gradually increase to 1,1 % in 2016 and to 1,7 % in 2017.

3. Russia

Russian economy has faced economic headwinds. The largest impact has come from the fall of the oil price that occurred since the middle of 2014. This illustrates the dependence of the economy on exports of oil, oil products as well as gas. A decreasing oil price easily puts the exchange rate on a downward slide. That has been the case also in Russia.

The fall of the oil price also has pushed down domestic demand in Russia this year. This has pressed the GDP to a level that in the second quarter was 4.6 % lower than one year earlier. There are signs that the slide may have stopped. However, for example the Bank of Russia in its latest forecast projects that this year the decline of the GDP will amount to 3.9–4.4, if the oil price stays at slightly below 50 dollars per barrel for the rest of the year.

Similar to the crisis of 2009, Russia's imports have fallen significantly this year, reacting strongly both to diminishing domestic demand and the weakening of the rouble. In terms of their value in euros, imports of goods and services into Russia fell by 20 % in the first half of this year from the first half of 2014. Expectations about the fall of the import volume for the entire year 2015 range between 20 and 30 %.

Regarding another burden, GDP growth in Russian slowed down already years earlier before oil price declined and sanctions due to geopolitical tensions. This slowdown reflected the economy's systemic shortfalls like low level of fixed investments. This is naturally the fundamental burden when thinking about the future, about Russia's growth perspectives in a longer term.

4. Finland

Finland is falling further behind euro area growth. According to the last Bank of Finland forecast from June 2015, Finland will not catch up with the pace of recovery in the other euro area countries.

Economic growth in Finland has been slow for a prolonged period, both historically and by international comparison. Finnish exports have suffered a considerable loss of market share since 2009, the most severe year of the recession.

Growth has been depressed by sectoral and structural problems. The forest industries and electrical engineering and electronics, in particular, have experienced serious difficulties. Also an ageing population and lackluster productivity development have weakened the growth potential. In addition, Finnish export growth remains subdued partially because of the weak performance of the Russian economy.

During the first half of the year the growth rate of the Finnish economy has been pulled to mildly positive territory mainly due to global economic developments. These include oil price developments and low interest rates and the Euro area recovery. However, there are headwinds to a more robust recovery. In addition to the structural factors mentioned above, factors such as weak competitiveness, labour market matching problems, and lacking implementation of planned structural reforms hamper growth in Finland.

The labour market situation has deteriorated rapidly during the past year. Unemployment is now higher than in the recession year 2009, the unemployment rate standing at 9.6 % in July. The employment rate is falling. The rise in unemployment has been widespread, affecting all age groups, although especially the rise in youth unemployment has accelerated during the first half of the year.

Over the past 5 years there has been a soft, if lengthy landing in the Finnish housing market, reflecting the protracted economic downturn. The housing loan cycle in Finland is now passing its second trough after the burst of the global financial crisis.

There can be a strong regional divergence in house prices and household indebtedness within countries, too. These regional differences are driven by both demand and supply-side

factors. Growth areas are typically characterised by increasing population, younger residents, a better employment situation and higher household income than the national average. This is also reflected in brisker housing markets and higher house prices in these areas.

For example, in Finland the market conditions in the metropolitan areas are diverging from the conditions prevailing in areas where the population is diminishing. The largest housing loans are concentrated in the biggest cities and growth centres. In these centres, house prices are also highest.

Ladies and gentlemen, let me now draw main conclusions:

- The US economy is growing and today we will hear from the Fed OMC-meeting how strong the growth is, and also we will hear whether monetary policy stance needs to be changed.
- Emerging market economies have had difficult times; e.g. Brazil and Russia have faced strong headwinds and China's growth is levelling off.
- Growth outlook for Europe has improved, unfortunately Finnish economy has not recovered accordingly and our economy requires tough medicine to cure its worsened and dire competitive position.