Growth in the world economy is slowing as the euro area enters a downturn in the second half of 2012. Weighted according to the distribution of Finnish forest industry exports, world GDP growth will slow to about 1% for the full year 2012, and will be 1.5% in 2013. Due to the weakened economic outlook and the protracted sovereign debt crisis, the euro area economy will show a contraction of about 0.5% for 2012. In 2013, led by Germany the euro area economy is forecast to grow by the same proportion, 0.5%. GDP growth in the United Kingdom will largely follow the euro area trend. In Sweden, GDP growth will show a decline, moving to a growth track of just below 2% for both 2012 and 2013.

In the United States, the worst is over in the housing market and, supported by private consumption and investment, the economy will show growth of about 2% for 2012 as a whole and in 2013. GDP growth in 2013 will nevertheless be overshadowed by the conclusion of the fiscal policy stimulus measures at the end of 2012. If no new fiscal policy solutions are formulated, there is a risk that the US economy will again enter a downturn. In Russia, the high world market price of oil will ensure that growth remains at the rate of recent years. In China, GDP growth has fallen as a result of the faltering demand on export markets, but economic policy measures are sustaining growth at an annual rate of approximately 8%. The economies of Japan, the Middle East and North Africa – key export countries for Finnish sawnwood – are continuing to grow. The level of growth in the world economy is at risk because of the considerable uncertainty, particularly over the handling of the euro crisis.

In the first six months of 2011 the world economy and international trade were still continuing their slow recovery from the recession caused by the financial crisis. Despite growth of 3.3% in the world economy in 2011, the pace was already tailing off in the second half-year. There were a number of reasons for this. There was still no solution to the sovereign debt and banking crisis prevailing in the euro area, in spite of repeated efforts to resolve the crisis. The situation has in fact worsened into a political dilemma, with different countries seeking to further their own national interests. China chose to consciously tighten both its fiscal and monetary policies in 2011 in order to dampen the overheating of its economy and inflationary pressures. In Japan, the reconstruction following the devastating earthquake began more slowly than expected. The economic stimulus packages that had been introduced in different parts of the world drew to a close, while the ability to put together new packages was hampered by the substantial deficit problems in many countries. In the United States, growth did in fact continue in 2011, though at a slower pace than expected, but this alone was insufficient to ensure stable growth in the world economy.

The impact of 2011 on world GDP growth in 2012 has been far reaching. China’s response to the growth slowdown has been to further ease monetary and fiscal policies in the first half of the year, but the effects on its economy will not be evident until at least the closing months of 2012. Although growth in the US economy has continued at a slow rate, the potent use of fiscal policies has been limited by the proximity
of November’s presidential and congressional elections. The continued growth of the country’s public sector deficit is a threat that could affect the future course of the US economy. In the euro area, the crisis spread to Italy and Spain in spring 2012, despite various attempts to resolve it. The outcome of Greece’s parliamentary and re-run elections and its commitment to the deficit-reduction programme fuelled uncertainty in the spring and early summer. The latest indicators point to a euro area downturn in the second half of 2012, which, via weak demand, will also affect the world economy. World GDP growth for 2012 is forecast to slow to just below 3%.

The September 2012 announcements by both the European Central Bank (ECB) and the US Federal Reserve concerning substantial secondary market operations and securities purchase programmes will, when they take effect, briefly support GDP growth and boost market liquidity in the respective countries. The European Stability Mechanism (ESM), to be introduced in mid-2013, will also provide better support for the crisis countries than was the case with the temporary European Financial Stability Facility (EFSF). The actual structural problems behind the deficits will not, however, be eliminated by these actions and organisations, and the scope for manoeuvre in fiscal policy will remain small in the euro area.

In Asia and especially China, the easing of economic policies is expected to support a recovery in GDP growth in 2013. In the United States, the rise in consumer demand and investment and the gradual easing of the housing market problems are expected to keep the economy on a slow growth track. Although there are positive signs of an improvement in the economy, the economic outlook for 2013 will be overshadowed by the elevated level of uncertainty. The situation is particularly sensitive in the euro area, and political failure to resolve the problems could exacerbate the uncertainty and affect private consumer behaviour and investments. Uncertainty is also being generated by the conflict between Israel and Iran, which could affect world market prices of crude oil. Forecasting the 2013 price trend for other raw materials too is difficult. The forecast of GDP growth in the world economy in 2013 is about 3%.

**Euro Area Deeply Submerged, Brighter Prospects Keenly Awaited**

Since autumn 2008, developments in Europe’s economy have been dominated by a lurch from one crisis to another. The slump in the housing market in the United States, Ireland and Spain and the doubts over Greece’s ability to cope with its substantial debts led to a banking crisis that is tormenting the whole of Europe, and the increase in uncertainty raised interest rates on the interbank market. The interest rates on long-term loans in a number of countries also began to rise as the markets started to doubt whether countries would be able to cope with their major deficit...
burdens. Although the fiscal policy stimulus packages sought to guarantee continued growth in Europe, their impact has been only temporary. The scope for manoeuvre in fiscal policy has now been exhausted and countries have been focusing mainly on preventing deficits from growing. Tax increases and public spending cuts have even begun to have an adverse effect on GDP growth. Uncertainty in Europe has been heightened by the political arm-wrestling and the difficulty agreeing solutions to resolve the problems. The market operations of the ECB have also had only a fleeting impact in calming the markets. Euro area GDP growth, mainly led by Germany, was 1.4% in 2011.

The economic downslide in the euro area that began in the latter part of 2011 continued in the first half of 2012. Although the economy had shrunk in the previous quarter, this contraction was halted in the first three months of 2012, but the second quarter of the year again saw a shrinkage, by 0.2%. The latest statistics and indicators suggest that the contraction in the euro area economy continued in July and August, which would signify a recession. There are a number of reasons underlying the faltering economy. Although the euro’s weakening in the spring and summer supported exports to destinations outside the euro area, the growth slowdown in international trade and the decrease in internal demand within the emerging economies and the euro area have curtailed growth in exports and international trade. This has been particularly evident in Germany’s exports. Even though the German economy – the most important in the euro area – stayed on a growth track throughout the early months of 2012, this growth was nevertheless below the forecast level. What is more, the shrinkage of the Spanish and Italian economies, which began in 2011, continued during the first half of 2012. Due to their size, both of these economies, along with France and Germany, have a considerable effect on the trend in the entire euro area.

Uncertainty in the euro area economies increased during the spring and summer, due to the worsening problems of the Spanish and Italian economies, the turmoil associated with the Greek elections, and the failed attempts to resolve the deficit problems. Combined with increasing unemployment, this has had the effect of shrinking private consumption. In addition, investment has been adversely affected by the uncertainty over the future, a contraction in industrial output, underutilised capacity and weak demand. The indicators of industrial and consumer confidence have also fallen during the summer and early autumn, indicating that the euro area’s GDP growth in the second half-year will remain weak. This is also foreseeable on the basis of industry’s low level of orders in hand. The euro area economy is forecast to contract by about 0.5% for the full year 2012.

To ease conditions in the economy the ECB introduced a major financing package directed at banks at the end of 2011, which calmed the financial markets during the winter and early spring. Financial markets were further reassured by the July cut in the central rate and the September announcement of a conditional purchase of crisis country bonds on the secondary market. Although these measures are not sufficient in themselves to stabilise economic growth as structural reforms are also needed within the crisis countries, for the euro area they are nevertheless a step towards restoring confidence and will have an impact on growth in 2013. The ECB is in fact assuming the role of leading economic policy coordinator in Europe, and a further cut in the central rate is possible if the economy requires this. The introduction of the European Stability Mechanism (ESM) in mid-2013 will provide improved opportunities for supporting the course of the crisis countries’ economies than the existing European Financial Stability Facility (EFSF).

Slower GDP growth in the euro area than elsewhere in the world is further weakening the euro, though this is improving price competitiveness and exports to destinations outside the euro area. Exchange rates are, however, affected by decisions made outside the euro area and by the economic circumstances in such countries. The outlook for private consumption in 2013 has two key aspects. Although lower inflation will support consumption through greater real purchasing power, the deteriorating employment trend will limit the growth in consumption. If there is no major change in the general level of confidence, it is entirely possible that private
consumption will decline further in 2013. Investment, on the other hand, is expected to grow a little. The pattern of GDP growth within the euro area will nevertheless remain uneven. The economies of the Southern European crisis countries are forecast to shrink further, but growth in the core countries led by Germany will result in euro area GDP growth of about 0.5% in 2013.

Rest of Europe Marches to Euro Area Beat

In those countries of Europe which are outside the euro area, the economic indicators have been broadly following the euro area trends. As the euro area is the main market for most of these countries, the weak demand is affecting export growth and profitability, which are also affected by changes in exchange rates.

The United Kingdom’s economy grew by 0.7% in 2011. In the first half of 2012, however, the UK economy was experiencing a downturn. Despite the weakness of the pound sterling there was no surge in UK exports, because euro area demand was slackening. Higher unemployment, uncertainty and an increase in the rate of saving have conspired to keep private consumption at the 2011 level. Investment will be up only slightly for 2012 as a whole. Together with the continued programme of cuts in public finances, this could even mean that the UK will report a shrinkage in its economy for the full year 2012. The situation in 2013 is expected to improve slightly, provided that exports to the euro area begin to pick up again. Aided by the stimulus impact of monetary policies, a modest recovery in private consumption and investment should help the UK economy to achieve GDP growth of 1% in 2013.

Sweden’s economy has coped better with the effects of the euro crisis than the rest of Europe. Although the country’s GDP growth was 3.9% in 2011, the growth rate was already slowing in the latter half of the year. In the first six months of 2012, the economy nevertheless showed signs of picking up again, with a moderate growth in exports and especially an increase in domestic consumption. However, with demand weak and the Swedish krona strong, exports have again tailed off since the spring and private consumption growth has slowed. In manufacturing, the increase in unutilised capacity has diminished the desire to invest. The September decision to reduce interest rates by Sweden’s central bank, the Riksbank, was aimed at reinvigorating the declining GDP growth. It was probably also an attempt to weaken the external value of the krona and improve export potential. Sweden has been regarded as a safe haven for investments during the economic crisis, and this has gradually led to a strengthening of the krona.
exchange rate along with a GDP growth that has outperformed the rest of the world. The cut in interest rates makes the Swedish krona a less attractive investment and weakens its position. Sweden’s GDP growth for the full year 2012 is forecast to be about 1–1.5%. Exports in 2013 are forecast to rise again on account of improved demand on the world market and especially in the euro area. Growth in domestic consumption will be supported by an increase in real purchasing power and by the reasonably stable financial situation among households. Investments generally respond to demand growth after a time lag, and so investment will still have only a minor impact in 2013. The Swedish krona is expected to weaken a little from its current level, but will nevertheless remain strong against the euro. The Swedish economy is forecast to grow by almost 2% in 2013.

In the Baltic countries the dynamic growth of 2011 is continuing at a slower pace. The Estonian economy has been boosted by excellent growth in exports, though this has slowed significantly in 2012 due to the lack of demand. The situation in Estonia has been aided by previous years’ improvements in internal price competitiveness and the fact that GDP growth and demand on the country’s main export markets, Germany and the Nordic countries, have so far remained moderately good. In Latvia and Lithuania too, export growth is significantly slower than in 2011. The Baltic countries are in fact undergoing a structural change typical of emerging economies, where growth in domestic demand and investment constitute an increasingly important share of the overall growth in the economy. GDP growth in Estonia and Lithuania for the full year 2012 is forecast to be 2–3%, and in Latvia a little above this. Domestic demand factors in 2013 will remain strong, and supported by export growth the Baltic countries’ economies will grow by 2.5–4%.

**Russia’s Growth Maintained by Oil Revenues and Consumption**

The lack of diversity in Russia’s exports, being based on energy products, has frequently been considered a restraining factor on the development of the country’s other areas of industrial production. However, in the prevailing global debt crisis, this has been to Russia’s advantage. While the world market demand for capital goods and consumer goods has been weak, the demand for energy and for oil products has remained fairly stable despite the economic downturn. This has maintained growth in export revenues, which has enabled considerable growth in private consumption and investment. Private consumption is nevertheless largely linked to imported foreign goods, and Russia’s accession to the World Trade Organisation (WTO) at the end of the summer and the consequent lowering of customs duties is likely to increase its imports of consumer goods. The down side of the rapidly growing economy is a rise in consumer prices. The Russian Central Bank has reacted to this by tightening its monetary policies through raising central rates in September. Further interest rate rises are possible, which would add to the prospect of a further strengthening of the ruble. Although efforts have so far focused on maintaining the ruble’s external exchange rate within a certain fluctuation interval, Russia intends to gradually shift to a free-floating ruble within a few years. This will give more room for manoeuvre in deploying effective monetary policies without having to use other measures to neutralise the effects on the ruble’s external value. Russia’s GDP growth for 2012 is forecast to be at almost the 4.3% rate seen in 2011.

In 2013, the robust employment situation and rise in real earnings will keep private consumption growth at about the 2012 level. Growth will also continue in the total amount of investment. Although Russia is acknowledged to have an unattractive investment climate and has had difficulty attracting foreign investments, its WTO membership is likely to mean an increase in the number of foreign companies establishing in Russia in the coming years. This will naturally also depend on Russia’s willingness to see this happen and the speed with which it removes trade barriers. With the slow recovery in the world economy, Russia’s exports are forecast to grow in 2013, and its GDP is set to be up by 3.5–5%.
US Recovery Under Way, but Problems Still Abound

Growth in the United States economy in 2012 is expected to be slightly higher than the 1.9% growth recorded in 2011. Although growth slowed a little in the early months of 2012, figures released for the summer indicate that growth is again picking up slightly. The underlying reason for the continuing modest level of growth is the improved economic situation of households and the recovery in investment. Even though households are still repaying debts, their debt burden is not as serious as it was a few years ago. The recovery in consumption is also attributable to the improved state of the housing market. House prices have no longer been falling, selling times have shortened a little and there is distinct growth in residential construction. The modest rise in share prices has also improved the value of households’ assets. The level of general confidence has been improving due to the slowly rising employment figures and low inflation, which has not chipped away at purchasing power. The September decision of the Federal Reserve to continue with its relaxed monetary policies has improved market liquidity and the ability to plan ahead. The decision has also weakened the US dollar, which will support export growth and limit imports especially from China. Public consumption will be down on the 2011 figures, however. The growth in the United States’ economy for the full year 2012 is forecast to be slightly above 2%.

The economic outlook for the US in 2013 is overshadowed by the substantial public sector deficit, the growth in this deficit, and uncertainty over the continuation of the stimulus-oriented fiscal policies. At the end of 2012 a number of previously agreed fiscal policy stimulus packages will come to an end, the combined growth impact of which is estimated to have been as high as about four percentage points on the nation’s GDP. No new fiscal policy decisions are likely to be made before the November 2012 presidential and congressional elections, which means there will be little time for formulating new federal tax and spending packages. If these cannot be put together, there is a risk that the US economy may slide back into recession. It is nevertheless generally believed that after a period of political wrangling, agreements will be reached and fiscal policy will continue in the form of stimulus measures. It will, however, be essential to make some expenditure cuts in the budget in order to curb growth in the public sector deficit. Based on these assumptions the modest growth in private consumption and investment will continue, keeping the US economy on a 2% growth track in 2013.

Canada’s economy grew by 2.4% in 2011. Figures for the first half of 2012 show that growth has continued but has also slowed a little. Export growth eased up during the summer but is forecast to improve again in the second half of the year, supported by the steady demand growth in the US and by the weakening of the Canadian dollar. Falling inflation and rising employment are supporting the growth in private consumption. Residential construction will be up for the full year 2012, but in 2013 it is expected to decline slightly. Other investment will be up in both 2012 and 2013. The Canadian dollar has weakened slightly against the euro in 2012, but in 2013 it is forecast to remain at the same level. Growth in the Canadian economy is expected to be 2% for the full year 2012 and in 2013.

Growth Slowing in Asia

China is the one of the few countries in the world in which deficit problems have not yet prevented the active use of Keynesian economic policies. The 9.2% GDP growth of 2011 was following by accelerating inflation and the threat of overheating in the economy. China reacted to these by tightening both its monetary and fiscal policies in 2011. In the first half of 2012 these measures, in combination with the slower export growth, resulted in slower GDP growth. In order to support stable growth, China again slackened its economic policies in stages during the spring and summer by cutting interest rates and increasing infrastructure projects. Due to the weakening demand on world markets, China’s GDP growth cannot continue to rely only on exports but must also look to the domestic
market. However, shifting the focus of growth to private consumption is not easy without substantial structural reforms, such as the creation of a social safety net. Currently, a major share of household income is set aside as savings to guard against an uncertain future. To support its export growth, China let the yuan weaken against the dollar in the early part of the year, but because of the monetary policy decisions in the US and due to China outperforming the GDP growth of the rest of the world, the yuan is nonetheless expected to strengthen again in the second half of 2012. GDP growth in the Chinese economy will be about 8% for the full year 2012. In 2013, China’s economy is estimated to grow by about 8–8.5% due to the slight improvement in world market demand and the effects of economic policy decisions taken.

Japan’s GDP growth in 2011 was dominated by the March earthquake and its destructive aftermath. The reconstruction under way in the second half of the year was not, however, able to make up for the contraction in total output in the first half-year and the poor export performance that continued throughout the year. The country’s economy shrank by 0.8% in 2011. In the first half of 2012, there were two growth drivers in place: the reconstruction work and the level of private consumption, which was boosted through fiscal policies. Exports also grew, despite the strength of the yen. In the wake of the downward slide in the world economy, Japan’s GDP growth is nevertheless forecast to slow down in the second half of 2012.

The Japanese economy has long been troubled by deflation, and this does nothing to encourage consumption. With the aim of boosting consumption growth, Japan’s central bank has set a 1% inflation target, which, if successful, will encourage growth in private consumption. The September decision by the central bank to slacken monetary policies supports this target and also serves to weaken the strong yen. The improved level of world market demand expected in 2013 is forecast to increase Japan’s export volumes. The rate of investment is likely to slow in 2013, however. On account of the good growth in the first half of the year, Japan’s GDP growth for the full year 2012 is expected to be 2.5%. Growth in 2013 will be slower, at just below 2%.

In North Africa and the Middle East, which are both key export markets for Finnish sawnwood, the economic recovery has continued, following the unrest of 2011. The growth in the economies of the region for the full year 2012 will generally be in the range 2–4%. In 2013 the growth in these national economies is expected to continue at a slightly higher rate. The region is nevertheless politically in a very volatile state, and further unrest is possible.