I World Economy

Although the 2007 figure for GDP growth in the world economy will be below the previous year’s level, it will still be above the average of recent years. Weighted according to the distribution of Finnish forest industry exports, real GDP growth in the world economy in 2007 will be 3.6%, and in 2008, 3.4%. However, GDP growth in the euro area will be down to 2.7% in 2007, and to 2.4% in 2008. Export competitiveness will be hindered by the strong euro and rising costs, and so the euro area’s GDP growth will rely not on exports but on a revival in private consumer demand and on investment. With a growth track slightly above the euro area average, the German economy will continue to be the driving force within the euro area economy. GDP growth in the UK economy is also above the average for the euro area, though only marginally, while Sweden’s GDP growth in both 2007 and 2008 will be almost one full percentage point above the euro area average.

GDP growth in Asia and Russia continues to be strong in 2007 and will again be high in 2008. In Japan, an important market for Finnish sawnwood exports, the economy remains on a growth track of about 2%. By contrast, GDP growth in the United States is expected to be down in 2007, to below 2%, but to pick up to approximately 2.5% in 2008. Along with the interest-rate policy adopted by the European Central Bank in the coming months, the other principal uncertainty in these forecasts is the possible spread of the fiscal crisis that started in the US housing market to affect the rest of the economy and other countries around the world.

Finnish Forest Industry’s Main Markets and Competitors are Well Established

Despite the increased exports of Finnish forest industry products to markets outside Europe since 2000, the EU is still the industry’s main market. The most important individual trading partners are Germany and, outside the euro area, the United Kingdom. These two markets account for almost one third of the forest industry’s export income. The euro area accounts for over 40% of the value of the Finnish forest industry’s exports, and consequently a considerable share of the industry’s export income is in euros. Exchange rate fluctuations against the main trading currencies affect the income obtained from exports outside the euro area. Dollar-based exports account for an estimated 15–20% of the total. In sawmilling, the most important markets outside Europe are Asia and Africa, which together take about a quarter of the total delivery volume. In the pulp and paper industry, the US and Asia together account for almost 20% of deliveries.

Russia is becoming an increasingly important market for Finnish forest industry exports. With Sweden and Canada, it is also one of Finland’s strongest competitors on the sawnwood export market. Sweden is also a competitor in the market for pulp and paper industry products. More details on the main export markets and principal competitor countries for Finland’s forest industry products are given below. The other key information dealt with in this chapter as background to the more detailed economic forecasts for the Finnish forest sector
presented later on consists of the economic forecasts made by the world’s leading economies (and the factors affecting these forecasts).

**Euro Area GDP Growth Slowing Down**

Euro area GDP growth reached a peak in 2006, at 2.9%. Major contributory factors were the more than 8% growth in exports and an investment growth in excess of 5%. A revival in the growth of private consumption to a level of almost 2% as a result of the reduction in unemployment and the increase in households’ purchasing power was also a factor after years of slow growth. The promising signs seen in private investment and in construction in 2006 continued in the first part of 2007, despite the slowdown in housing construction due to higher interest rates. Euro area price competitiveness has been impaired by the strong euro, but demand from Asia and from elsewhere in Europe has ensured that exports continue to drive GDP growth. Consumer and business confidence in the economy has also remained strong. Despite a slight dip in July, the indicators of consumer and business confidence continue to be close to their highest levels since 2000.

The remainder of 2007 is expected to be favourable for the euro area economy in general, and company order books have remained high. However, some industrial sectors in the euro area are already experiencing capacity shortages, which will curtail output growth to a small extent. The euro exchange rate against the dollar is forecast to remain in the range 1.35–1.40. Together with production bottlenecks and slower demand on export markets, this will slow down export growth to an annual figure of about 7% for 2007. Investment activity in the euro area will also continue to be brisk. Despite slower growth in housing construction, the moderately good financial position of businesses will mean growth in other areas of construction as well as an increase in investment in machinery and equipment, contributing to the almost 5% growth in total investment in 2007. With a gradual recovery also continuing in the euro area’s internal consumer demand, GDP growth in the euro area in 2007 is expected to be 2.7%.

Euro area GDP growth in 2008 is forecast to slow down to just under 2.5%. Rising production costs and the strong euro will weaken price competitiveness outside the euro area. Together with a high capacity utilisation rate, this will slow export growth to about 6%. Although private consumer demand is forecast to remain high, it will be insufficient to compensate for the slower growth in exports and investment. The slowdown in investment will be attributable to the rise in costs and especially to high interest rates.

Despite the favourable picture for the euro area as a whole, GDP growth in the area will take on broadly two different forms. Germany – the most important export market for Finland’s forest industry – constitutes one third of the entire euro area economy, and in 2006 it grew by 2.9%. Figures show that Germany’s growth in the first part of 2007 continued at a higher level than the rest of the euro area. Exports and investment, in particular, have risen considerably, whereas private consumption is only beginning to pick up, following the VAT increase at the turn of the year. The country’s growth has been fuelled by an increase in productivity and the success of structural reforms to the economy. Germany’s GDP growth for 2007 is forecast to be 2.8%, and in 2008 about 2.5%. By contrast, growth has been sluggish in the French and Italian economies on account of the rigidities present and weak competitiveness. GDP growth in the French economy is forecast to be about 2%, and in the Italian economy just under 2%, both in 2007 and 2008.

The biggest threat concerning the GDP growth forecast is the possible effect on the euro area of the crisis that has begun in the US housing market, and the interest rate policy to be followed by the European Central Bank in order to prevent such a crisis spreading. As a result of growth in the economy and the improved employment situation, inflation is climbing above the ECB target (2%), fuelled by the ECB’s action in August to boost the amount of money in circulation in order to calm the financial markets and increase liquidity. An increase in the
central rate before the end of 2007 would dampen investment and reduce inflationary pressure. At the same time, however, it could act as a psychological signal for a contraction in consumer demand and in consumer confidence in the economy. Moreover, if interest rates were to rise or even remain unchanged, in conjunction with a September decision by the US Federal Reserve to reduce the federal fund rate, there would be further pressure to strengthen the euro, which would weaken the euro area’s export price competitiveness.

GDP Growth Slowing but Still Strong Elsewhere in Europe

The United Kingdom’s 2006 GDP growth of 2.8% has continued into 2007, with the forecast for the full year being 2.9%. This is due especially to an investment growth of more than 6% and the orientation of exports towards the euro area. The raising of interest rates by the Bank of England in early 2007 will slow investment growth in 2008 to 3%, however, and will encourage households to save. Private consumption will also be affected by the slacker housing market. Monetary policies may be loosened, though, as inflationary pressure decreases, which would weaken the pound somewhat against the euro, increasing export price competitiveness. The UK’s GDP growth in 2008 is forecast to drop to 2.4%.

Among the EU countries outside the euro area, Sweden’s economy grew by 4.2% in 2006. This was attributable above all to the more than 8% growth in exports and the increase of more than 14% in industrial investment. Sweden’s 2007 GDP growth is forecast to slow to 3.6% as a consequence of the weakening demand on export markets. The growth in the country’s private consumption will be almost 3% in 2007, due to a drop in unemployment and higher incomes, and is forecast to rise to almost 4% in 2008. The anticipated series of interest rate rises will dampen investment growth, but total investment will nevertheless be up by more than 5% in 2008. The Swedish krona is forecast to strengthen only a little against the euro, and so, with inflation remain-
ing moderate, Sweden’s export price competitiveness will continue to be good. Sweden’s GDP growth will be about 3.5% in 2008.

In the European Union’s new member states, rapid GDP growth is continuing in 2007, albeit below the level seen in 2006. The forecast growth for 2008 is slightly below the 2007 figure. According to the International Monetary Fund, GDP growth in 2007 will be 6.1%, and in 2008, 5.2%. There are, however, still considerable differences between the forecasts for each of these member states, with a figure as high as around 10% for Latvia and Lithuania, as against, for example, Hungary’s 2%. With the exception of Hungary, the GDP growth in the new member states has been driven by high export growth (more than 10%) and strong domestic consumer demand. Investment growth is also continuing at a high level. As a consequence of GDP growth, inflation has generally been rising, however, which is weakening export price competitiveness. A labour shortage in some sectors will also limit the growth in industrial production. The emerging economies of Eastern Europe are sensitive to changes occurring in the euro area, and so a possible setback in euro GDP growth beyond that anticipated would be quickly felt among the EU’s new member states.

**Russian Economy Still Going Strong**

In 2006, Russia’s GDP growth was 6.7%. The impressive economic statistics and high growth have continued for many years and are based on exports of energy products and especially the high world market price of crude oil. 2007 looks like being Russia’s strongest growth year since 2000. The investment boom that began in 2006 is continuing to be strong in 2007, supported by the rise in foreign direct investment to record levels early in the year. The oil sector has long been trying to attract investment, as its growth has slowed to 2–3%, mainly due to bottlenecks in production capacity. The country’s evolving capital market has also supported investment by increasing private sector lending. Investment is forecast to be up by as much as 20% in 2007. As households become better off, private consumer demand is also continuing to grow at a fast pace and is forecast to be up by 12% in 2007 and 10% in 2008. There continues, however, to be a lack of diversity in the structure of Russia’s exports, being based principally on the energy sector. Export growth is forecast to fall to about 4.5% in 2007 from the previous year’s 7% because energy and gas production cannot be increased any further, and because rising prices and a strengthening ruble are weakening the country’s real price competitiveness. Russia’s GDP growth is forecast to be 7% for 2007 as a whole.

Forecasts for 2008 suggest that the figures will be almost a repeat of 2007. Investment will once again be up by 20% and will be targeted not only at the energy sector but also at other sectors. In addition to the growth in private consumer demand, there will also be an increase in the use of state budget funds for public consumption and construction of infrastructure. Exports will be affected by the same problems as in previous years, and the growth in exports will be down to some 4%. Russia’s GDP growth in 2008 is forecast to be approximately 6%.

**Clear Slowdown in US GDP Growth**

In 2006, GDP growth in the United States was 2.9%. This was mainly due to a growth in exports of over 8%, assisted by the weak dollar, and a growth of more than 3% in private consumption. Private investment was up by 2.4%, but this was largely businesses investing in buildings and in machinery and equipment. By contrast, housing construction was down by almost 5%. Figures for the first half of 2007 show that the rate of saving by households has risen, and that private consumption (which accounts for over 70% of nominal GDP) is slowing down. The slowdown in consumption growth is due, above all, to uncertainty concerning the development of the housing market and property values. The latter constitute the greatest single asset for the majority of US households and are often used as security for loans as well as determining the scope for consumption.
spending. With uncertainty shifting in August from the housing market to the finance market, consumer confidence in the economy has further declined and the level of savings has increased. The latest figures indicating an increase in unemployment have also added to the uncertainty.

Despite the slowdown in consumer demand and the drop in house prices, the US economy is not expected to plunge into recession. Its GDP growth for 2007 is forecast to drop to just below 2%. Even though housing construction will show a contraction of almost 15% in 2007 in comparison with the 2006 figure, other construction investment will be up by around 10%. The slowing pace of consumer price rises and the weak dollar will together boost the profitability of the export industry, and exports are forecast to be up by 6.5% in 2007. This will partially compensate for the slower growth in consumption.

In 2008, growth in private consumption will be down to a level of 2% as a consequence of rising unemployment and a fall in the real purchasing power of households. Housing construction is forecast to be down by almost 13% on the 2007 figure. To revive the economy, the Federal Reserve cut its federal fund rate in September 2007 by half of one percentage point. Interest rate cuts are still possible in the remaining part of the year and in 2008, and this would revive corporate investment in machinery and equipment. In all, private investment is forecast to be up by just over 1% in 2008. With a lower rise in inflation again expected and with the dollar remaining weak, US exports are forecast to grow by over 7%. US GDP growth in 2008 is forecast to be 2.5%.

The state of the Canadian economy is strongly interconnected with that of the US economy. In 2006, Canada’s GDP growth was 2.8%, and the forecast for 2007 is a slower 2.5%. The reason for the anticipated slowdown is a reduction in consumer demand and investment and a fall in export growth, especially to the US, due to a strengthening of the Canadian dollar. Although the Canadian dollar is forecast to strengthen against the US dollar by about 5% in 2008, the increase in GDP growth forecast for the United States is expected to boost Canada’s exports by almost 3%. Public consumption and investment will also be up in 2008. Canada’s GDP growth for 2008 is forecast to be 2.6%.

Asia’s Growth Will Accelerate in 2008

China’s annual GDP growth has been about 10% in recent years and is forecast to be at approximately this level again in 2007 and 2008. Driving this growth is an annual increase of almost 20% in investment and exports. China’s export growth is attributable to its excellent price competitiveness, which is derived from the country’s low costs and successful exchange rate policy, as well as the strong demand in its main export markets, the United States and Japan. Although efforts have been made to stop the economy from overheating by tightening monetary policies, the effect on investment has been relatively small. The growth in private consumption in 2007 will rise to about 9% as a consequence of increasing wealth and low unemployment. Despite the very high growth figures, China’s economy has so far remained in good health structurally. Labour mobility and availability have been high, preventing the emergence of production bottlenecks, but higher earnings and rising inflation will weaken export competitiveness slightly in 2008.

Japan’s economy remains on a steady growth track, with GDP growth forecast to be 2.4% in 2007 and 2.2% in 2008. The revival in private consumption and the growing level of exports in 2007 will compensate for the shrinking investment in housing construction and the lower level of public sector investment. Private consumption is being fuelled by rising employment and higher pay. The drop in exports to the United States has been successfully countered by increasing exports to China and other Asian countries.