GDP growth in Germany, the United Kingdom and Japan, which are the main markets for the Finnish forest industry, has weakened considerably in 2008 compared with 2007. The Swedish and Canadian economies – both competitor countries for Finland’s forest industry – have also slowed down. Real GDP growth in the world economy weighted according to Finnish forest industry exports will be 2.6% for the full year 2008. Rising inflation, higher interest rates, curtailed demand in export markets and the uncertainties in the housing and financial markets have all served to slow GDP growth in the euro area to about 1.5% during 2008, and will slow growth in 2009 to even less than 0.5%. German GDP growth will be up by about 1.5% in 2008, but in 2009 the German economy could experience zero growth. Growth in the UK economy for 2008 will be about 1% and could even be negative in 2009.

GDP growth in the Russian and Chinese economies will slow a little on the 2007 figures, but will nevertheless remain high in both 2008 and 2009. Growth in the US economy has slowed in 2008 and may even come to a standstill in 2009. The greatest uncertainties surrounding forecasts for the world economy are an escalation of the financial crisis into a global credit crisis, a deepening of the downward slide in the euro area’s housing markets, and a sharp rise in raw material and energy prices.

Euro Area on the Brink of a Recession?

Euro area GDP growth in 2007 was moderate, despite the very modest private consumption growth as a result of various factors adding to uncertainty. Investment in the euro area in 2008 will nevertheless be up by a total of more than 6%, and export growth will reach 4.4%. Euro area GDP growth was 2.6% in 2007.

The effects of the housing and financial market crisis, which originated in the United States, a strong euro, rapidly rising raw material and energy prices and high interest rates, pushed the euro area onto a slower growth track in the first half of 2008. Although first-quarter GDP was up by 1.8% on the same quarter in 2007, the second-quarter figure showed a contraction of 0.8% on the first quarter (adjusted to annual rate). Indicators show that the financial crisis has caused a quick deterioration in business and household confidence regarding the future, and that this confidence is now at a very low level.

With accelerating inflation and the consequent reduction in households’ real purchasing power, and with the deteriorating employment situation and the crisis in the financial markets, consumers have become very cautious. The postponement of purchases and purchase decisions has meant a clear slowdown in the euro area’s private consumption growth in 2008. Although exports to Asia and Eastern Europe have continued at moderate levels in the first half of 2008 and the euro has weakened against the US dollar since summer 2008, export growth will slow down in the second half of the year as GDP growth and demand slow in the world economy. Export growth for the full year 2008 is expected to be approximately 4%.
High interest rates, rising costs, tighter credit terms and the weakening demand for products are also curbing investment growth. This is also being exacerbated by the slump in the housing market in Spain and Ireland, the sluggish growth in the French economy, and the continued poor housekeeping in the Italian economy. Nordea forecasts that euro area investment growth for 2008 as a whole will be in excess of 3%, and GDP growth 1.3%.

Although the euro is expected to continue to weaken slightly in 2009, and thus to aid the export industry, the concurrent slowdown in global demand will restrain the growth in euro area exports, keeping this to just short of 2%. Investment growth is being substantially curtailed by the high interest rates, fears of a steepening decline in housing markets and concern that the financial crisis will turn into a credit crisis for Europe. Private consumption in 2009 will not show any marked improvement on 2008, despite lower inflation. According to the International Monetary Fund (IMF), the Irish, Spanish and Italian economies could even go into recession in 2009, and the overall euro area GDP growth will be only 0.2% for the year.

Germany, constituting about one third of the entire euro area economy, is the single most important export market for the Finnish forest industry by value. The latest figures on the German economy – an indicator of what to expect elsewhere in the euro area in 2009 – are gloomy. Even though figures for the first half of 2008 show a further drop in unemployment, the IFO index of business confidence hit a 15-year low in August. Second-quarter German GDP growth also showed a contraction on the first-quarter figure. It is clear that uncertainty is limiting growth in private consumption, which constitutes around half of all GDP growth in developed economies. Germany’s GDP growth is expected to be up by about 1.5% in 2008, while in 2009 it is expected to be almost at a standstill.

The greatest forecasting uncertainties for the euro area are the state of the US economy, the continuation of uncertainties in the financial markets, a possible credit crisis, developments in the housing market and the inflation rate. The worst of the upward pressure on prices is over, however, because the slower GDP growth in the second half of 2008 will reduce the demand for oil products and raw materials. In 2009, the inflation rate is expected to settle at about 2%, which will allow the European Central Bank to continue to reduce its reference rate by 0.5–1 percentage points in order to revive the economy and the financial markets. Any interest rate reductions will also have an adverse effect on euro exchange rates. The US dollar’s average rate against the euro in 2009 is forecast to be below 1.40, compared with the average of 1.53 (based on monthly figures) for January–August 2008. With the world economy in a somewhat fragile state, even minor storm damage in oil production locations or regional conflicts or other uncertainties will be quickly felt in the world price of oil, in costs in general, in EUR/USD exchange rates, in inflation expectations and, through these, in monetary policy decisions. Even with calm gradually descending on the financial world following the autumn 2008 crisis, uncertainty will keep interest rate margins above their normal levels.

Slowdown Elsewhere in Europe Too

The Finnish forest industry’s second-most important trading partner in terms of export value is the United Kingdom, where GDP growth in 2007 amounted to 3.1%. The rise in world market prices of raw materials and oil has accelerated inflation in the UK to almost 4%. The growth in private consumption and investment in the UK is slowing down as a consequence of the reduction in real household wealth following the housing slump and due to the deteriorating employment situation. Together with the crisis on the financial markets and due to the weak demand on export markets, this will reduce the UK’s GDP growth for 2008 to about 1%, and the economic difficulties are set to continue in 2009. The growth in private consumption could almost come to a standstill and investment may even decline if the problems on the housing and financial markets become more acute. Exports will be up in 2009 by only less than 1% because of
the expected strengthening of the pound against the euro and the poor export demand. Although lower inflation will provide the opportunity for the Bank of England to introduce a further cut in its central rate, the effects of this would not extend into 2009. The IMF expects the UK’s GDP to shrink by 0.1% in 2009.

In contrast to Sweden’s 2007 GDP growth of 3%, it looks like the country will experience much lower GDP growth for 2008. Due to the slowdown on the export markets and the faint strengthening of the krona against the euro, the growth in exports will slow to 4.5% for 2008 and to 3.5% in 2009. Construction investment in 2008 will be up by only less than 1%, and in 2009 such investment is not expected to grow at all. With the inclusion of public investment projects, overall investment will be up by a total of over 4% in 2008, though this is likely to fall back to about 0.5% in 2009. Despite real growth in households’ purchasing power, the increase in uncertainty is also evident in private consumption, which will be up by just short of 2% in 2008, and by a little over 1% in 2009. Sweden’s GDP is expected to grow by almost 1.5% in both 2008 and 2009.

The period of sustained growth in the new EU member states has now come to an end as well. In Estonia, the slump in the housing market, the sluggish demand on export markets and the deterioration in price competitiveness internationally are all contributing to a reduction in GDP growth, by more than 1% in 2008 and by 0.5% in 2009. A similar fate threatens the Latvian economy. In Lithuania, however, GDP growth will be approximately 3.5% for 2008 as a whole, and about 1% in 2009 on account of the country’s successful fiscal policies and its exports of refined oil products. Elsewhere in Eastern Europe, GDP growth is showing a general slowdown, and economies are not expected to pick up until at least the latter half of 2009.

Russian Economy Almost Unchanged

The Russian economy has been growing at an annual rate of 7–8% in recent years. In 2007, Russia’s GDP growth reached 8.1%, and almost this level of growth is expected to continue in both 2008 and 2009. The country’s high growth has been based on exports of oil and energy products, and the rapid rise in world market prices of oil and raw materials that began in 2007 has further boosted Russia’s export earnings. Although most of these earnings have been directed to a special fund, some of them have also been channelled into consumption and investment.
Figures for the first half of 2008 indicate that Russian GDP growth has continued to be strong, although investment growth is showing a slight drop on the 2007 figure. Private consumption is expected to be up for the full year 2008 by more than 12%, and investment by 18%. The increase in public consumption is being held at only about 4% for economic policy reasons. Russia’s GDP growth for the full year 2008 is nevertheless expected to be approximately 7%.

Strong economic growth has brought with it high inflation, which has long been at almost double figures, and the country’s major population centres are already experiencing occasional labour shortages. Furthermore, Moscow is now said to be the world’s most expensive capital city. Russia’s inflation rate is forecast to rise to as much as 15% for the full year 2008, which will weaken household purchasing power and adversely affect consumption in 2009. The effects of the tighter monetary policy measures begun in spring 2008 will not be evident in the economy until 2009. Private consumption is nevertheless expected to be up in 2009 by a further total of about 10%, and investment by 16%. High inflation and the balance of payments’ current account surplus will also have an adverse impact on the country’s real price competitiveness in foreign trade. Despite the momentary weakening of the ruble as a result of the Georgian conflict, its value is expected to pick up during 2009. This, together with the drop in demand in the euro area and in other important export markets, will slow export growth in 2009 to slightly over 3%. Russia’s GDP growth in 2009 is forecast to be 5–6%.

US Economic Downturn Continues

GDP growth in the United States was 1.7% in 2007. Following the slump in the housing market, with housing construction down by almost 18% in 2007, growth has been maintained by the increase in private consumption and exports.

Figures for the first half of 2008 show that the US economy grew in the first quarter by an annual equivalent of 0.9%, and in the second quarter by 1.9%. The figures give to some extent too positive a view of the situation, because the growth is based largely on the tax relief introduced in advance of the presidential elections and on the growth in public consumption. The effects of these measures are now diminishing, and the situation for the second half of 2008 looks gloomy. Private consumption is being kept in check by higher inflation (over 5%), household indebtedness, declining house prices (and thus the drop in real household wealth), the deteriorating employment outlook, the chaos on the financial markets and the general increase in uncertainty. The growth in private consumption in 2008 as a whole is therefore expected to be no more than just under 1%. Housing construction in 2008 has slumped by almost 20% on the previous year’s figure, and corporate investment in machinery and equipment has also continued to decline. Supported by the weak dollar, exports have so far saved the US economy from recession. Nordea forecasts indicate that the 2008 growth in US exports will be almost 8%, and that the country’s GDP growth will slow to an overall 1.3%.

The economic downturn will continue in 2009. Housing construction is forecast to shrink further by almost 4%, and investment in machinery and equipment is also expected to decline on account of the poor outlook for business profitability. The growth in private consumption is likely to be positive, but by only a small margin. The only bright spot in the economy will be the export growth of nearly 5%, which is nevertheless lower than in 2008. Exports will be adversely affected by the slower demand growth in the world economy and the strengthening of the dollar. IMF forecasts give a figure of 0.1% for GDP growth in the United States in 2009.

The greatest forecasting uncertainties are again inflation and the problems on the financial markets, which, if they worsen, would lead to lower GDP growth than expected. Although inflation is expected to fall as a result of the decrease in oil and raw material prices, there is still some way to go to reach the target level of about 2% set by the US Federal Reserve. The central rate (currently 1.5%) is unlikely to be altered before the end of 2008. Any sudden increase in inflation
could even add pressure to raise interest rates, which would further stifle economic growth. The pace of the revival in private consumption and investment will also be slowed by any increase in general uncertainty due to the problems of the housing and financial markets, and by any credit crisis. In the worst case, a ‘credit crunch’ could even lead to a short-term recession in the economy. The ability of a new administration to respond through fiscal policy measures will also be a key factor in reviving public confidence and the economy in general.

Canada’s GDP growth in 2007 was 2.7%, though there was a clear reduction in growth in the second half of the year. GDP growth in the first quarter of 2008 showed a contraction of almost 1% on the first-quarter figure. Second-quarter growth was only 0.3%. Although private consumption is growing at an annual rate of almost 4%, the weak demand in the neighbouring US economy will mean a fall of over 4% in Canada’s export growth in 2008. With the decline in construction too, Canada’s GDP growth will be 0.8% in 2008, according to OECD estimates. In 2009, the Canadian dollar is forecast to remain unchanged against the euro but to weaken a little against the US dollar. This will help the export industry achieve a growth rate of more than 1%. With 3% growth in private consumption and a revival in investment, Canada’s 2009 GDP growth is expected to be 1.9%.

China Fares Well, Japan Does Not

China’s GDP growth has been running at an annual rate of over 10% for many years, and in 2007 it amounted to 11.9%. However, as a result of the deteriorating outlook on China’s export markets and the tighter monetary and fiscal policies pursued by the Chinese government, the country’s GDP growth – which has overheated in places – will slow a little both in 2008 and 2009. The price competitiveness of China’s exports is weakening as a result of the increase in inflation to 7% during 2008, and the strengthening of China’s currency. Exports are nevertheless forecast to be up by an annual total of 11%, and in 2009 by 12%. Investment will be up as well in 2008, by as much as 14%, though this is a somewhat misleading figure. The total includes, for instance, construction projects for the Olympic Games and reconstruction work following earthquake damage, which account for several percentage points of the overall growth in investment. Growth on China’s domestic market will continue to be strong though, with private consumption growth forecast to be 10–12% both in 2008 and 2009. China’s GDP growth is expected to be up in 2008 by 10%, and in 2009 by 9%.

Japan’s economy grew by 2.1% in 2007. Although its first-quarter GDP in 2008 was 3.2% up on the previous quarter, the second-quarter growth was already down by 2.4%. With private consumption and investment being in the doldrums in recent years, exports have been driving growth in the Japanese economy. Now, however, due to the weakness in demand on the export markets, Japan’s export growth will also slow in 2008, to a little over 6%, and in 2009 to 4%. With interest rates low, Japan has no room for manoeuvre in seeking to revive the economy through monetary policy measures. Furthermore, indebtedness prevents any attempt at revival through extensive fiscal policies. With different confidence indicators warning of bad times ahead for businesses in Japan, the willingness of businesses to invest is diminishing. Consumer confidence is also low due the weakening employment situation and rising inflation. Total investment is expected to be down in 2008 by 2%, and in 2009 by about 0.5%, and private consumption growth will be about 0.5% both in 2008 and 2009. Japan’s GDP growth for 2008 as a whole will be less than 1%, and in 2009 about 0.5%.

According to OECD figures, GDP growth in Egypt, Morocco, Algeria and Libya will average almost 6.5% in both 2008 and 2009. Investment growth in some of these markets could even exceed 10%.