1 World Economy

The recovery in the world economy that began during 2009 has started to slow since spring 2010 as stocks are replenished and government stimulus packages are gradually brought to an end. The rate of recovery nevertheless varies widely between different countries and regions. Real GDP growth in the world economy weighted according to the distribution of Finnish forest industry exports will be up by 2.6% for the full year 2010, and by 2.4% in 2011. 2010 GDP growth in the euro area, the most important market for the Finnish forest industry, will be almost 2%, driven by the German economy. Euro area GDP growth may slow in 2011, however. Growth in the United Kingdom economy will be in step with the euro area, while Sweden’s growth will exceed this despite the strengthening of the krona and rising interest rates.

In the United States, GDP growth will slow down towards the end of 2010. The full-year growth in the US economy is forecast to be 2.5%, and a little less in 2011. With the exception of Japan, Asia’s GDP growth will continue to be strong for both 2010 and 2011, fuelled by the almost 10% growth in China’s GDP. Japan’s growth will be held at around 2% as a result of the strengthening of the yen, the low level of domestic demand and the country’s structural problems.

Although the world economy is no longer at rock bottom, it has entered a period of slower growth, overshadowed by uncertainties over the future course of the US economy and the debt-ridden economies of the euro area. Exchange rates will be affected by the central banks’ interest rate rises, by market interventions and by expectations regarding these.

Value of Finnish Forest Industry Exports Fell by Almost a Quarter in 2009

The downturn in the world economy and the weakening of demand in key export markets led to a considerable drop in Finnish forest industry exports in 2009 compared with 2008. Exports of sawnwood fell by 13%, plywood by 38% and paper by 20%. By value, the Finnish forest industry’s exports shrank by almost a quarter. The value of sawnwood exports fell by 23%, plywood exports by 45% and pulp and paper industry exports by 21%.

Despite the contraction in export volumes the geographical distribution of exports remained almost unchanged. The most important export market was once again the European Union, and Germany in particular. The United Kingdom’s share of Finnish sawnwood exports exceeds that of Germany, however. Africa’s share of the exports of the entire Finnish forest industry in 2009 rose by one percentage point as a result of the good demand for sawnwood.

This chapter looks at the extent of economic growth in the Finnish forest industry’s main export markets. Along with regional and national GDP forecasts, assessments of investment and especially construction can be used in forecasting future export levels in the wood products industry. Based on projections of private consumption growth, forecasts can be made of, for example, the demand for packaging materials, paperboard and paper. The forest industry’s export competitiveness and production profitability are also affected by the state of the economy in the main competitor countries and by fluctuations in exchange rates.
Recovery Under Way in World Economy

In terms of GDP growth, 2009 was the world economy’s most dismal year for many decades. With the exception of China, there was a contraction in the economies of all the main regions in the world economy. In total, the world economy shrank by more than 1% in 2009. The year nevertheless also saw world trade begin to grow again, and in the first half of 2010 this growth continued at a faster rate than expected. Economic forecasts were thus revised upwards repeatedly after the spring and summer, for both 2010 and 2011.

However, trade and the economic recovery have for the most part been attributable to the replenishment of stocks and the substantial fiscal policy stimulus packages introduced by governments. As stocks become replenished and with the gradual completion of stimulus packages, GDP growth is widely forecast to slow down during the latter half of 2010 and the early months of 2011. After that, growth is expected to rely more on a recovery in private consumption and the consequent increase in demand. The International Monetary Fund forecasts that the world economy will grow by 4.8% in 2010 and by 4.2% in 2011. There will, however, be considerable differences by region and by country in the rate of recovery.

The principal risks surrounding the forecasts concern the uncertain development of the US economy and the possibility of a new bout of turbulence on the financial markets. If the United States were to be plunged into a double-dip recession, the impact would be quickly felt in other economies, too, through the effects of world trade.

The financial markets have calmed down since the spring, thanks to the huge support packages put together by EU member states and the IMF for countries in the grip of financial crises and because of the stress tests applied to banks. Nevertheless, any new debt crises would create confusion on the financial markets and reverse the euro area’s emerging growth, turning it into a new downturn.

Germany Slowly Driving Euro Area into Growth

The euro area’s GDP was down by more than 4% in 2009. Euro area exports in 2009 nevertheless began to rise again as world trade started to grow a little. The weakening of the euro in the early months of 2010 boosted export growth, which in turn boosted euro area GDP above the preceding quarterly figure. This growth strengthened in the second quarter of 2010.

The recovery of economies within the euro area has been two-track, however. Germany – a key export market for Finland – has again been driving the growth. The German economy is forecast to show 3% growth for the full year 2010, aided by exports in particular. Private consumption and the construction sector are also picking up in Germany. The French and Italian economies are showing signs of moderate growth as well. By contrast, those euro countries
experiencing a debt crisis will still have to wait for their economic recovery, and the Greek and Spanish economies are even expected to report further shrinkage in 2010. Although the indicators of consumer confidence in many of the euro countries are predicting an improvement in household confidence and there are some signs of an increase in private consumption, no significant growth is expected in consumption during the latter part of 2010. The low industrial capacity utilisation rate suggests that investment growth will remain low. Growth in the euro area economy for the full year 2010 is expected to be almost 2%.

In 2011, many euro countries will have to tighten their fiscal policy in order to keep government debt under control. This will be achieved by cutting public consumption, raising taxes or both. Since stocks will already have been replenished, economic growth will slow down at least in the first half of the year. This will also affect world trade, which is expected to grow more slowly than in 2010. By contrast, the improvement in consumer confidence, an increase in new jobs and a fall in unemployment indicate that there will be a slight recovery in private consumption. Moreover, industry’s greater confidence in the economy will lead to moderate growth in investment. Although the euro area’s GDP growth will remain uneven, the figure for 2011 will be a growth of 1.5%.

Slow Recovery in EU’s Non-Euro Countries Too

In common with the euro area, the United Kingdom’s economy is experiencing a slow recovery from the downturn. In 2009, the UK economy shrank by 4.9%, but the substantial weakening of the pound against the euro in 2008 has since served to boost export growth, and the slack monetary and fiscal policies have supported private and public consumption as well as investment. The UK’s GDP growth for 2010 is forecast to be approximately 1.5%. However, efforts are being made to cut the government’s rapid spiral of debt in 2011, which may lead to dramatically tighter fiscal policies. An increase in value added tax from the start of the year will weaken household purchasing power. In the first half of 2010, the pound strengthened against the euro and it is expected to strengthen a little further, which will slow the growth in exports. The UK economy will grow in 2011 by about 2%.

In 2009, the Swedish economy contracted by 5.2%. Sweden’s economy has nevertheless seen the quickest recovery in Europe. Its export-driven recovery was already under way in 2009 as world trade picked up and the cheap krona boosted export price competitiveness. Although the krona has strengthened during 2010 against other key currencies, the growth of orders in hand indicates that exports will continue to be strong in the latter part of the year, too. The rather low level of household indebtedness and the high balance figures for the confidence indicators suggest there will be growth in private consumption and investment. Housing construction has already begun to increase since the spring. Sweden’s GDP growth for 2010 is expected to exceed 4%. The central bank expects a continuation in 2011 of the interest rate rises begun in 2010, which will add momentum for a strengthening of the krona. Together with the dip in world trade, this will reduce export growth. The growth in the economy in 2011 will in fact be driven more by the domestic market. A drop in unemployment and a rise in real earnings will support private consumption growth and investment. The Swedish economy is forecast to grow by 2–3% in 2011.

The downturn in the world economy was especially tough for the Baltic countries, whose economies shrank by 14–18% in 2009. Spring 2010 marked a turning point, however, with a growth in exports from the Baltic countries as their most important export markets slowly recovered. The fastest recovery was seen in Estonia, which will join the euro area at the start of 2011. Estonia is already forecast to record a GDP growth of almost 2% for 2010, but growth across the Baltic countries as a whole is not expected until 2011, when private consumption and investment will also pick up a little, alongside exports. However, these countries’ major debt burdens will limit the scope for using fiscal policy for a quicker recovery. In 2011, the Baltic countries’ GDP growth is expected to be 3–5%.
Russia’s Exports Begin to Take off

In 2009, the Russian economy contracted by 7.9%. Even though part of the government’s stabilization fund built from export revenues has been discontinued and spending has been targeted at public consumption, these measures have not compensated for the deterioration in the rest of the economy. The demand recovery in the world economy in the first half of 2010 and the rise in the world market price of oil have nonetheless supported exports, and the balance of trade has moved substantially into surplus. By contrast, private consumption has remained cautious on account of the weak state of incomes and the rise in unemployment. Consumption and investment have also been restrained by the weak state of the domestic credit market. Foreign investment has been kept in check by the uncertainty of Russia’s business environment and legislation, and by the immense bureaucracy. Russia’s GDP for 2010 is set to be up by 5%.

With a gradual fall in the unemployment rate and an increase in consumer confidence in 2011, the focus of growth in Russia’s economy will switch increasingly to growth in private consumption and investment. Export price competitiveness will be adversely affected by the anticipated strengthening of the ruble, due largely to interest rates being higher than in the euro area. The strengthening of the currency will also diminish the benefit enjoyed from the rise in world market prices of oil and raw materials. Russia’s GDP is expected to grow in 2011 by almost 5%.

US Economy Full of Uncertainty

Although the United States economy started to grow as early as summer 2009, the full year’s GDP for 2009 shrank by 2.6%. Growth continued in the first quarter of 2010, at about 1% year on year. The main reasons for the flurry of growth were the replenishment of stocks that had become depleted during the downturn, and the administration’s substantial fiscal policy measures. As these measures tailed off, growth slowed during spring and summer 2010 to less than 0.5% in comparison with the start of the year. By contrast, the traditional engine of US economic growth – namely private consumption – is still sputtering. The rate of saving has been pushed to a record high as a result of the high level of unemployment, the still expectant mood on the housing market and the general economic uncertainty. While this is a healthy corrective movement for reducing the debt burden of households, it also restricts the growth in private consumption. With the exception of construction, investment has nevertheless been growing slightly during the first part of the year.

Growth forecasts for world economy (real GDP, annual percentage change).

<table>
<thead>
<tr>
<th>Area</th>
<th>Proportion of Finnish forest industry’s total export value 2009, %</th>
<th>Actual GDP growth % 2009</th>
<th>ETLA 2010</th>
<th>IMF 2010</th>
<th>ETLA 2011</th>
<th>IMF 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weighted by proportion of Finnish forest industry exports</td>
<td>100.0</td>
<td>– 3.4</td>
<td>2.6</td>
<td>2.7</td>
<td>2.4</td>
<td>2.5</td>
</tr>
<tr>
<td>EU-27</td>
<td>63.7</td>
<td>– 4.3</td>
<td>1.5</td>
<td>1.7</td>
<td>1.5</td>
<td>1.6</td>
</tr>
<tr>
<td>Euro countries</td>
<td>40.7</td>
<td>– 4.1</td>
<td>1.5</td>
<td>1.7</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Germany</td>
<td>18.7</td>
<td>– 4.8</td>
<td>3.0</td>
<td>3.3</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>11.4</td>
<td>– 4.9</td>
<td>1.5</td>
<td>1.7</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Sweden</td>
<td>3.9</td>
<td>– 5.2</td>
<td>4.0</td>
<td>4.4</td>
<td>2.5</td>
<td>2.6</td>
</tr>
<tr>
<td>Russia</td>
<td>5.3</td>
<td>– 7.9</td>
<td>5.0</td>
<td>4.0</td>
<td>4.5</td>
<td>4.3</td>
</tr>
<tr>
<td>United States</td>
<td>5.5</td>
<td>– 2.6</td>
<td>2.5</td>
<td>2.7</td>
<td>2.5</td>
<td>2.2</td>
</tr>
<tr>
<td>Asia</td>
<td>11.8</td>
<td>2.9</td>
<td>7.5</td>
<td>7.9</td>
<td>6.5</td>
<td>6.7</td>
</tr>
<tr>
<td>Japan</td>
<td>3.6</td>
<td>– 5.2</td>
<td>2.5</td>
<td>2.8</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>China</td>
<td>2.5</td>
<td>9.1</td>
<td>10.5</td>
<td>10.5</td>
<td>10.0</td>
<td>9.6</td>
</tr>
<tr>
<td>Other</td>
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The strengthening of the dollar has pushed the balance of trade into deficit. There remains a big question mark over the course of the US economy in the latter part of 2010. Consumer confidence continues to be weak, long-term unemployment is on the rise, and on the housing market there are even signs of a new downturn following the end of homebuyers’ tax credits in the spring. The substantial level of public debt restricts the scope for further stimulus packages. Although a new downturn is not regarded as probable, the risk is present nonetheless. The United States’ GDP for 2010 is forecast to be up by 2.5%.

GDP growth in 2011 will slow as private consumption remains lacklustre. There will again be very few new jobs, and unemployment will remain high. However, investment in machinery and equipment will increase somewhat on the 2010 figures, but growth in housing construction may only be modest. Export growth is also forecast to slow. The United States’ GDP in 2011 is forecast to grow by about 2%. The swift growth in the Canadian economy in the first half of 2010 is slowing towards the end of the year, in the wake of the US economy. Canada has nevertheless come through the downturn in the world economy with only fairly minor damage, and in 2011 at the latest it should be in a position to return to its pre-downturn growth track. Private consumption and housing construction have already picked up during 2010. However, exports are overshadowed by the weakening of demand in the United States and by the strengthening of the Canadian dollar against both the euro and the US dollar. Canada’s GDP growth for 2010 is expected to be more than 3%, and in 2011 it should exceed 2%.

Growth Continues in China; Slower Recovery in Japan

Among the principal regions of the world economy, China alone experienced no shrinkage during the global economic downturn. Although its growth rate did slow a little in 2009, it still posted GDP growth of 9.1%. Despite exports being hit by the drop in international demand, China managed to refocus its growth on the domestic market very quickly, using Keynesian monetary and fiscal stimulus policies. During 2010 the country’s monetary policies have correspondingly been tightened and public-sector stimulus measures reduced in order to control the overheating of investment. In the first half of 2010 the Chinese economy nevertheless still grew by 11%. Since the summer, exports have returned to their pre-recession level and the balance of trade surplus is at a record high. Private consumption is continuing its almost double-digit growth. China’s GDP growth for 2010 will be nearly 10%.

In 2011, the country’s GDP growth will remain at the earlier annual growth rate of almost 10%. Although export growth is expected to slow a little due to the weakening of demand on the world market, the domestic market will continue to grow as before. Under the protection of a strong balance of payments’ current account and using active economic policies China can respond quickly to a threat of overheating or a slowdown in growth.

By contrast, Japan’s economy is in danger of returning to a slow growth track. In 2009, the country’s economy shrank by 5.2%. With world trade picking up in 2009, Japan’s exports began to grow, principally to markets elsewhere in Asia. However, exports have been choked off by the weak demand in the United States, which has traditionally been Japan’s most important trading partner, and especially the considerable strengthening of the yen. Deflation, which has long troubled Japan’s domestic market, and the low confidence in the economy have prevented growth in private consumption and investment. Low interest rates and the high level of debt restrict any recovery based on monetary and fiscal policies. Japan’s growth forecasts were revised downwards a number of times during the first part of 2010, and the GDP growth for the full year is forecast to be about 2–3%. GDP growth for 2011 is expected to be less than this. Growth continues to be strong in Asia’s emerging economies.

Following a minor dip in 2009, the economies of North Africa and the Middle East, which are important markets for Finland’s sawnwood
exports, will post growth figures averaging 5% both in 2010 and 2011. Construction activity in North Africa in particular remains brisk.

Central Banks’ Interest Rate Policy Also Affects Exchange Rates

Interest rate increases by central banks also have a direct effect on exchange rates between currencies. A central bank that raises its interest rates first will have to accept that its currency will strengthen, which will be detrimental to the price competitiveness of exports. An awareness of this will control the urge to bring forward any increases in interest rates. If GDP growth in the United States were to continue in 2011 at a level below the European rate, this would add to the pressure for a renewed strengthening of the euro. This does of course presume that Europe has no new debt crises and that there is no turbulence on the financial markets. In Sweden, interest rate rises and expectations of further rises have already led to a strengthening of the krona.

Both the US Federal Reserve and the European Central Bank have kept their central rates at record low levels for a considerable time already. In Europe, market interest rates have in fact risen slightly since winter 2009/2010, but this has been due mainly to larger risk premiums demanded by the banks and a reduction in liquidity on the interbank market. In the United States, the Federal Reserve has increased market liquidity by purchasing government debt securities, which in practice means quantitative easing. High unemployment and continued low inflation mean that neither the Federal Reserve nor the ECB are expected to raise interest rates before the latter part of 2011. In the euro area there may nevertheless be pressure for an earlier interest rate rise in response to any unexpectedly rapid GDP growth in Germany and other major economies. Such an early interest rate rise may be considered even though it would also threaten the emerging recovery in weaker euro area economies.

The market operations of the central banks could also result in exchange rates moving in a completely opposite direction. During the downturn, both the ECB and the Federal Reserve engaged in expansive monetary policies by purchasing government debt securities and increasing market liquidity. If there is renewed turbulence on the financial markets in the euro area and the ECB has to keep market liquidity at a greater and less restrictive level than in the United States, this would have the effect of strengthening the dollar, via yield and interest rate expectations. The belief currently is that the euro is nevertheless more likely to strengthen a little against the dollar than to weaken against it in 2011.