I World Economy

The short-term outlook on the Finnish forest industry’s exports markets is overshadowed by uncertainty and a new setback for growth in the world economy. GDP growth in the world economy weighted according to the distribution of Finnish forest industry exports will slow to just over 2% for the full year 2011, but will pick up to about 2.5% in 2012. Euro area GDP growth for 2011 will be about 1.5%, and in 2012 about 1%. If the debt crisis turns into a wider financial crisis, this will bring the prospect of a new recession in Europe. GDP growth in the German and Swedish economies is forecast to be above the average for the euro countries, but will be sluggish in the second half of 2011 and in 2012. Growth in the United Kingdom economy for the full year 2011 will be only about 1%, though slightly higher growth is forecast for 2012.

In the United States, the economy’s post-recession recovery was short-lived, as GDP growth came almost to a standstill in summer 2011, with the housing market remaining subdued, private consumption weak and public debt growing despite cutbacks. Growth is expected to remain low well into 2012. GDP growth in the US is forecast to be approximately 1.5% for 2011, while forecasts for 2012 vary in the range 1.6–2.5%. As a result of the debt problems and poor short-term growth prospects in the euro area and the United States, it is the emerging economies and especially China that are becoming the driving force behind the world economy. China’s GDP growth will slow only a little in 2011 and the coming years. Japan’s economy is picking up in the second half of 2011, but this will not be sufficient to compensate for the effects of the earthquake in the early part of the year and the slowdown in world trade. The Japanese economy is expected to contract by about 0.5% for the full year 2011. Its GDP in 2012 is forecast to grow by 2–3%.

Export Value of Forest Industry Products Up 23% in 2010

The total value of Finnish forest industry product exports in 2010 was EUR 10.7 billion. This was 23% up on the recession year of 2009. The growth was attributable to improved demand in the main export regions and the slow post-recession recovery in world trade. The value was boosted not only by export volumes but also by the higher unit values of sawnwood exports and exports of pulp and paper industry products. About four fifths of export income came from pulp and paper industry products, and one fifth from products of the wood products industry. The value of sawnwood exports rose in 2010 by 32%, plywood exports by 21% and pulp and paper industry exports by 23%.

The distribution of exports by region has remained almost unchanged in recent years. The most important market for Finnish forest industry products is still the euro area, and especially Germany, which in 2010 accounted for almost one fifth of the total value of Finnish forest industry exports. Key export destinations for sawnwood also include the Netherlands, the United Kingdom, France, Japan and countries in North Africa and the Middle East. Russia has become an important trading partner for paper products. It is also significant that, in terms of export value, exports to China have already grown to almost the size of those to Japan.
Growing Uncertainty in World Economy

Following the economic recession of 2008–2009, the world economy grew by 4.4% in 2010. This was due to increased demand and a strengthening in world trade, and because of the replenishment of stocks that had been depleted during the recession. Fiscal policy stimulus packages in various countries also played a role. The distribution of growth across the world’s regions was nevertheless uneven. The euro area economies recovered slowly, posting fairly low growth figures, whereas GDP growth in Asia remained quite high. Within the euro area too, the pattern of growth was extremely uneven.

In spring 2011, however, the world economic outlook deteriorated rapidly. The unrest in North Africa and the Middle East, which had already begun at the start of the year, fuelled uncertainty over oil prices in particular. In March, the powerful earthquake and ensuing destruction in Japan added to uncertainty about whether the recovery in the world economy would continue. In Europe, the debt crisis became critical again in the spring when market doubts emerged about the ability of Italy and Spain to cope with their debts. Political debate in Europe focused on a second bailout package for Greece and the associated loan guarantees, and by the end of September there was still no solution of any substance to the debt crisis. As the autumn progressed it became increasingly evident that Greece could face debt restructuring, which could quickly precipitate a financial crisis affecting the entire euro area. Figures for the first half of the year also indicated that the post-recession recovery in the US economy was slower than anticipated. The financial markets were plunged into further disarray in July with the announcement of a downgraded credit rating for the US and the heated public debate over raising the US debt ceiling. As a consequence of all these uncertainties, share prices have fallen substantially around the world, weakening consumer and business confidence over what the future may hold.

Nordea forecasts that world GDP growth will be 3.2% for the full year 2011 and 3.3% in 2012. Growth forecasts have nevertheless been widely revised downwards since the summer, and a number of barometers and indicators are already signalling a new recession. If, for instance, Greece has to restructure its debts, any subsequent chaos on the financial markets would rapidly affect the real economy, and the 2011 growth forecasts would have to be further reduced a little. The adverse effect of any crisis and recession on 2012 GDP growth would be considerably greater. The effects of this would quickly be evident in the Finnish forest industry via sluggish demand and exports, and the forecasts presented in this Economic Outlook report would have to be revised downwards.

Euro Area Heading for New Recession?

Euro area GDP growth was 1.7% in 2010. The emergence from the recession and the subsequent GDP growth were attributable almost exclusively to export growth, which was in double digits. By contrast, there was only minor growth in the other key components of GDP, namely private and public consumption and investment. The distribution of economic growth in the euro area nevertheless showed a marked division between countries in the north – especially Germany, which was driving the growth – and the south, where there were barely any signs of growth, and with the Greek economy even shrinking further.

Euro area GDP growth in the first quarter of 2011 was still fairly strong, but then dried up almost completely in the second quarter. The rapid deterioration in the world economy slowed exports to destinations outside the euro area.
area. Private consumption is being curtailed by uncertainty over the future, and this is visible in the lower consumer confidence indicators across Europe. The level of precautionary saving is rising, due to fears of higher unemployment and a tightening of fiscal policy. Investment is being held back not only by uncertainty, but also the fear of a serious financial crisis and the tougher credit terms and standstill in industrial production growth. The steep drop in share prices that began at the end of the summer and the September Purchasing Managers Index for euro area industries, which signifies the production trend, both indicate that production has already contracted.

Within the euro area, the health of national economies is to a large extent determined by the state of the German economy. Although German exports were up in the summer in comparison with a year earlier, they were nevertheless down significantly on the figures for previous months. Furthermore, Germany’s quarter-on-quarter GDP growth had already slowed to almost zero in the second quarter. A similar trend was also evident in the other growth economies of the euro area. In Greece and Portugal, GDP fell throughout the first half of 2011.

The lower growth figures have also brought lower inflation as the level of economic activity declines. With growth slowing and inflationary pressures easing, the European Central Bank (ECB) is expected either to keep its central rate unchanged in the second half of 2011 or to reduce it. Although a weakening euro will actually help exports outside the euro area in the latter part of the year, GDP growth will at the same time slow considerably as a result of stricter fiscal policy and growing economic and political uncertainty over the management of the debt crisis. It is nevertheless perfectly possible that the euro area will enter a new recession during the second half of 2011. With the early part of the year having been reasonably good, the euro area’s GDP growth for the full year 2011 is expected to be 1.5%.

The situation in 2012 is very difficult to forecast, however, as there are a great many uncertainties in the euro area. Even if the debt restructuring threatening Greece were to materialise in the latter part of 2011 or early in 2012, the financial crisis would not necessarily spread to, for instance, Portugal, Spain, Italy or Ireland. The slower growth in the second half of 2011 will nevertheless continue well into the first half of 2012. The factors contributing to a slow recovery in 2012 will include an increase in production to replace depleted stocks, continuing low interest rates and inflation, and an anticipated weakening of the euro – especially if the ECB cuts its central rate. On the other hand, factors limiting any recovery in growth include continued uncertainty, higher unemployment, which will slow private consumption growth in particular, and stricter fiscal policy as governments seek to keep their budget spending under control. The pattern of GDP growth within the euro area will remain uneven. In 2012 the euro area economy as a whole is forecast to grow by about 1%, provided that the debt crisis does not turn into a major financial crisis.

Rest of Europe in Line with Euro Area

Among the European countries outside the euro area, the performance of the economies of greatest importance for Finnish forest industry exports and the economies of competitor countries has been broadly similar to the euro area economy. However, any financial crisis that may shake the euro area will not directly affect these countries to the same extent. The impact would nevertheless be seen indirectly via a contraction in euro area demand and thus a reduction in exports to the euro area. Movements in exchange rates will also affect the profitability of exports.

The United Kingdom’s economy grew by 1.6% in 2010. The early part of 2011 saw a continuation of modest growth. Although the weak pound was still helping export growth in the first half of the year, the contraction in overall private consumption will reduce the UK’s GDP growth for the full year 2011 to about 1%. Consumption is being curtailed by the continuing high level of unemployment and by the decline in real incomes and purchasing power as a result of rising inflation and tougher fiscal policies. The programme of cuts in public finances will also continue in 2012. Even if monetary policy was to be kept fairly light and no increases made in
interest rates, private consumption and investment would still be low in 2012. Driven by exports, the UK’s GDP is forecast to grow by approximately 1.5% in 2012.

Growth forecasts for the Swedish economy were still being revised upwards in the early part of 2011, especially due to the brisk growth in investment and the buoyant level of exports, and for a moment it even seemed that the exceptional 5.8% GDP growth of 2010 would be exceeded. But then export growth slowed rapidly during the spring and summer as demand slowed in the world economy, and now the growth forecasts are being revised downwards due to the weakening outlook in the second half of 2011. A drop in the industrial and consumer confidence indicators suggests that a deterioration in the market is anticipated. Sweden’s central bank has gradually tightened its monetary policy and raised interest rates in order to control overheating in investment, and particularly the housing market, and thus to keep inflation in check. However, at the same time the higher interest rates, combined with having GDP growth above the world average, have strengthened the krona exchange rate. With Sweden’s GDP growth remaining above that of the euro area, the krona will continue to be strong in 2012, even if interest rates are lowered during the year. However, the Swedish economy is also affected considerably by the state of the euro area economy, and so the spread of any financial crisis in Europe will quickly produce a gloomier outlook for Sweden. GDP growth in Sweden for the full year 2011 is nevertheless forecast to be about 4%, but the figure for 2012 is not likely to be higher than about 2%.

The Baltic countries have adopted differing policy strategies for restructuring their economies, and this can clearly be seen in the extent to which they have been able to recover from the economic recession. Estonia pursued internal devaluation, reducing both costs and earnings domestically, and this has improved the price competitiveness of the country’s exports, boosting them by almost a quarter on the previous year’s figure and producing 6–7% GDP growth for 2011. Although price competitiveness has brought with it a rapid rise in unemployment, there has also been substantial growth in private consumption and investment. It is also noteworthy that Estonia’s state budget is almost in balance, and its public debt as a proportion of GDP is very small, allowing room for manoeuvre in fiscal policy in the future. Exports have also increased in Lithuania and Latvia, but the rigidity of their economies has slowed recovery, particularly on the domestic market, and GDP growth has been significantly lower than in Estonia. Lower export growth in 2012 will slow GDP growth in all the Baltic countries to about 3–4%.

Growth to Continue in Russia

Russia’s economy grew by 4% in 2010. The demand recovery in the world economy and a rise
in world market prices of oil brought in export earnings for Russia, which helped support growth on the domestic market. However, consumption and investment goods are mostly imported items, which is evident as a year-on-year growth in imports of almost 25%. As a result of the inefficiencies in Russia’s domestic production and the economy’s considerable reliance on oil revenues, developments in the world economy are quickly reflected in the Russian economy.

Private consumption continued to grow in Russia in the early part of 2011. This was supported by developments in the banking sector, easier borrowing, an increase in employment, and the trend in real earnings. The growth in domestic industrial production is also an indication that investment will be up for the full year 2011 and in 2012. The Russian Central Bank raised interest rates in the first half of 2011 in order to combat high inflation. This has also meant a strengthening of the ruble. In 2012 the Russian Central Bank will continue to seek a balance between inflation and the strengthening ruble. Russia’s GDP growth for the full year 2011 is expected to be 4–5%. If the world market price of oil remains at the present level, oil revenues and the growth in private consumption and investment will ensure that GDP growth in 2012 is close to the 2011 level.

Growth in US Economy Curtailed by Various Problems

For a while it seemed as if the US economy was slowly emerging from the 2008–2009 recession and that the 3% GDP growth of 2010 would continue. However, data for spring and summer 2011 revealed that private consumption growth had come to a standstill and that export growth, assisted by the weak dollar, was not high enough to lift the economy up by itself. Two factors in particular have been acting as a brake on private consumption growth: the high level of household indebtedness and the continuing difficulties on the housing market. Residential property assets are typically the biggest single asset against which US households have been able to borrow money. However, the housing market continues to be weak, with prices standing still, and construction starts for housing and office construction are not growing. The fall in share prices has also eaten into the value of assets. Stubbornly high unemployment and rising inflation and fuel prices in the first half of 2011 affected the mood of consumers and chipped away at purchasing power. Although it is generally anticipated that the United States will continue the temporary tax relief that is due to expire at the end of 2011 and extend the length of the unemployment security period, fiscal policy measures will not provide the huge stimulus needed for economic recovery. Moreover, the spending cuts due in the next few years to control public debt may slow the level of growth. The main emphasis in achieving a recovery in the economy will instead be on monetary policy. The US central bank, the Federal Reserve, has announced that it is freezing interest rates at a low level until the middle of 2013. In the short term, growth in US exports will be hampered by a strengthening of the dollar against the euro, as the ECB is expected to reduce its central rate, narrowing the interest rate differential with the United States. GDP growth in the US for the full year 2011 is forecast to be about 1.5%. The economy is expected to recover a little in the second half of 2012 as inflation weakens and overall demand picks up. The forecasting institutions’ estimates of growth in 2012 vary in the range 1.6–2.5%.

Canada’s economy grew by 3.2% in 2010. After a reasonably good start to the year, the country’s export growth was hit by the weakening demand in the US and the strong Canadian dollar in relation to the US dollar. The household saving rate on the domestic market has risen, and the growth rate in private consumption will be about 2% for the full year 2011 and in 2012. The growth in investment in machinery and equipment for the full year 2011 will be in double digits, although the corresponding figure for 2012 will be more subdued. The emergence of growth in the real economy is not expected until the second half of 2012, when demand in the United States picks up. GDP growth in the Canadian economy will reach an estimated 2.4% for 2011 and will be a little below this in 2012. The Bank of Canada is likely to keep its central rate unchanged or to lower it slightly to support growth in the economy. This will keep the Canadian dollar strong in 2012, too.
Asia Has the Only Bright Spots in the World Economy

With growth slackening in the economies of the euro area and the United States, China has risen to become the driving force in the world economy. China’s GDP growth in 2010 was no less than 10.3%. In autumn 2010, rapid output growth and accelerated inflation led to a tightening of monetary policy, which was evident as a minor dip in output at the start of 2011. In spite of this, the Chinese economy was growing at a rate of almost 10% in the first half of 2011. However, growth in the second six months is expected to slow down as demand slackens abroad, affecting exports. This view is given further credence by the drop in the Purchasing Managers Index and the summer data that shows slower growth in industrial output. On the domestic market, both industrial investment and construction investment are nevertheless still growing at a double-digit rate. To avoid overheating and inflation, China has gradually let its currency strengthen rather than tighten its monetary policy. The yuan is expected to strengthen further in the future, in particular against the US dollar. Despite the substantial growth in exchange reserves and its foreign trade surplus, China’s public sector deficit has grown. Although the ownership structure of the credit institutions and banks means that all public debt is inside the country, the amount of debt and its growth may, at some time in the future, affect the country’s economy, its GDP growth and the economic policy it pursues.

The focus of China’s economic policy has been on strengthening domestic demand and especially consumption. Fiscal policy measures have in fact led to the launching of major house-building and infrastructure projects. Growth in private consumption is, however, left to households. A major share of household income is nevertheless still put into savings and making contingencies for meeting healthcare and education and training costs. The weakening demand in the world economy is having only a slight impact on China, and the country’s economy is expected to post GDP growth of 9.5% for 2011. The figure for 2012 will be only a little below this.

Although Japan’s economy grew by 4.2% in 2010, export growth slowed considerably in the second half of the year. In March 2011 Japan experienced a massive earthquake and its aftereffects, which, according to various estimates, caused destruction equivalent to several percentage points of the country’s GDP. The launch of efforts to repair the destruction was slower than anticipated, as Japan experienced problems in assembling the financial resources for reconstruction. The already sizeable debt burden of Japan’s public finances has prevented additional debt from being taken, and fiscal policy is expected to be tightened in the coming years in order to finance reconstruction and repayment of debts, which are in fact mostly from domestic investors. This, together with the deflation troubling the economy, is also having a direct impact in restricting private consumption growth. Export growth in the second half of 2011 is also limited by the strength of the yen and the weakening US demand. Only the demand from China, which has become Japan’s most important trading partner, has kept export growth positive in 2011. Despite a minor recovery in the second half of 2011, the Japanese economy is expected to contract by about 0.5% for the full year 2011. In 2012, the prospects for export growth will be improved by the predicted strengthening of the Chinese yuan and the demand recovery in the world economy in the second six months. Added to this will be progress with reconstruction work and a slight rise in private consumption, resulting in growth of 2–3% in Japan’s economy in 2012.

In North Africa and the Middle East, which are both key regions for Finnish sawnwood exports, GDP growth for 2011 will be down significantly on the previous year’s level. Repair of the infrastructure that suffered in the wake of the spring and summer unrest is expected to start during the latter part of 2011. With a recovery in world trade and demand in 2012, the economies in North Africa and the Middle East will also pick up. The growth percentages will vary greatly from one country to the next, however, and outbreaks of further unrest are possible.