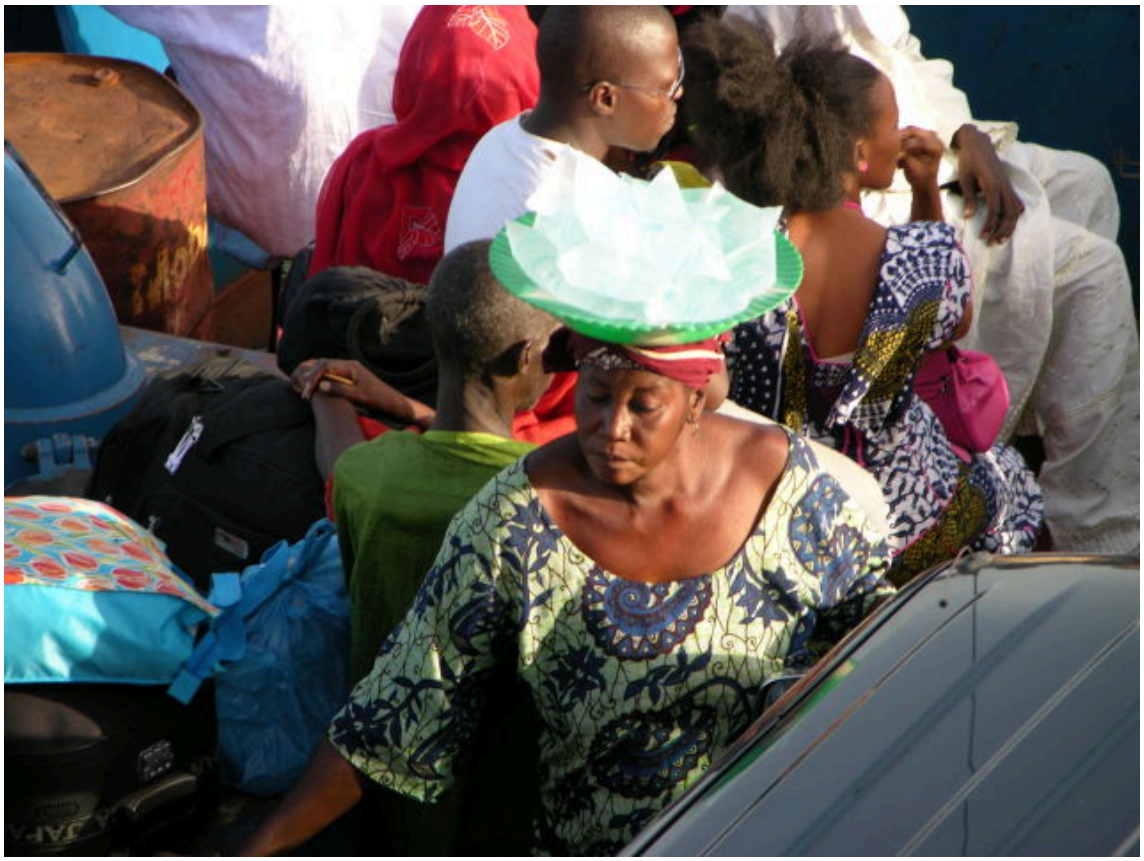
Forecast

# Uncertainty in global economy has increased

International economy | 02 October 2015

Uncertainty about the condition of the global economy increased in August–September. Concerns relate particularly to China, whose decelerating growth has unnerved the markets. In the Bank of Finland forecast, global growth will be 3.0%, 3.2% and 3.5% in 2015, 2016 and 2017, respectively. In addition to developments in China, the fact that world trade growth is past its peak weakens the outlook for the global economy compared with earlier predictions. There are downside risks to the forecast for the global economy.



## World trade to grow more slowly than previously forecast

Global growth in the first half of 2015 remained slightly lower than previously anticipated. Growth slowed particularly in the emerging economies, but the United States also witnessed a

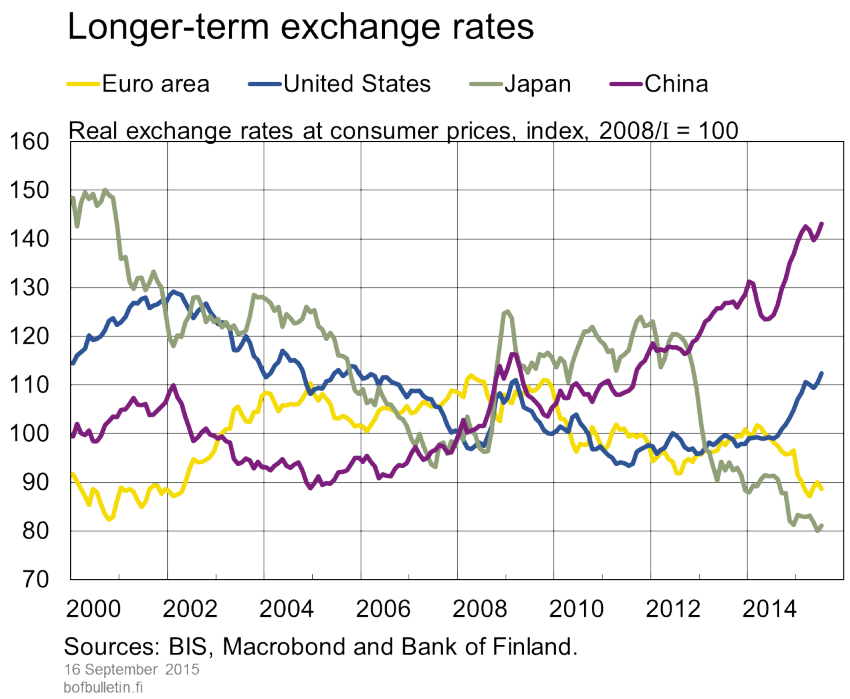
bumpy first half. The volume of world trade declined in the early part of the year, which is very exceptional. This volume reduction was due, mainly, to a contraction in Asian imports.

The Bank of Finland predicts higher growth in the global economy and trade during the course of 2015–2017. However, growth will lag behind earlier projections, with a weaker growth outlook for international trade, in particular. The modest trade performance impairs the export prospects for the advanced economies (incl. the euro area).

Near-term cyclical developments will be affected by four key factors: falling oil and other commodity prices, accommodative monetary conditions, exchange rate changes and the winding down of debt.

The oil price slide is due to an oversupply of crude oil: output has not responded to the lower oil price. But reductions in oil and particularly other commodity prices also reflect more subdued growth in their demand. In China, oil demand is held in check by changes in the structure of growth: the significance of commodity-intensive investments for growth is decreasing, while the role of private consumption is increasing. The low level of oil and commodity prices supports growth in the advanced economies but erodes the outlook for commodity-producing emerging economies.

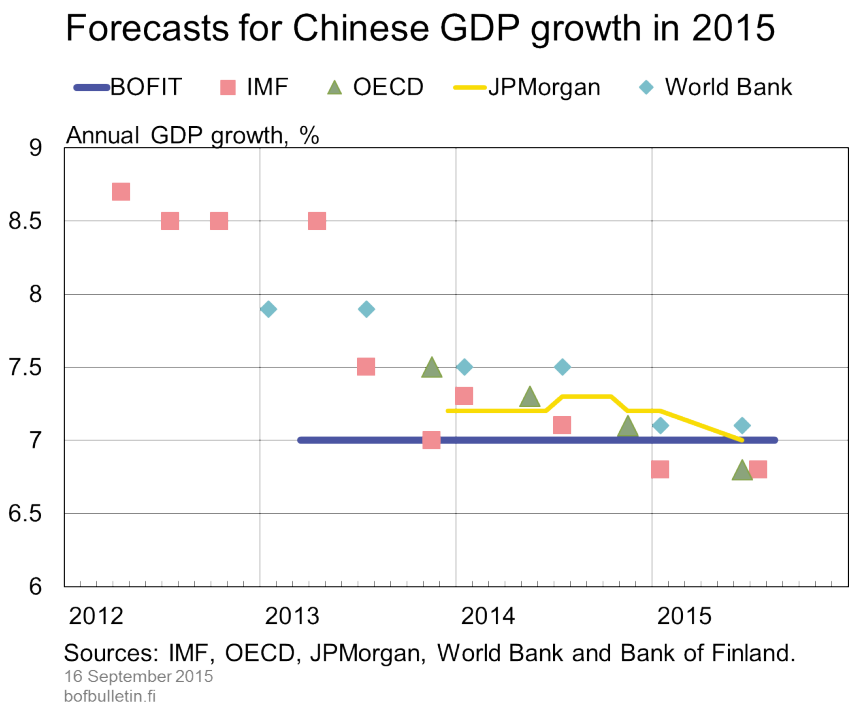
Chart 1.




The markets expect the US Federal Reserve to raise its policy rate later in the year. However, the

changes will be moderate and, overall, monetary conditions will still remain accommodative for a prolonged period. This will boost global growth and inflation throughout the Bank of Finland's forecast horizon. Viewed over the longer term, exchange rate movements have mirrored changes in countries' relative growth and inflation outlooks. The devaluation of the Chinese renminbi in early August 2015 has, in fact, been moderate relative to the renminbi being at end-July about 14% stronger than a year earlier.

Chart 2.

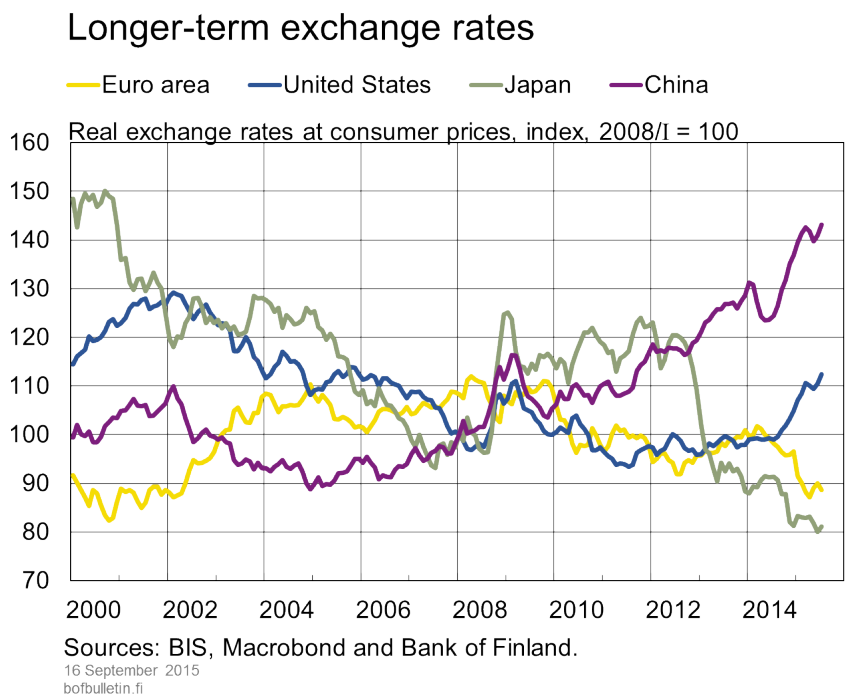



Private sector deleveraging (which previously put an overall drag on growth, particularly in the advanced economies), fiscal tightening and weak labour market developments are gradually easing. On the other hand, in many emerging economies, weak commodity price performance, the appreciation of the US dollar and the acceleration of capital outflows have sapped growth and growth prospects. Moreover, in some advanced economies debt levels have assumed considerable proportions.

On the whole, weaker growth prospects for the advanced economies and the fact that world trade growth has passed its peak have changed the outlook for the global economy in the Bank of Finland forecast. It is as yet difficult to assess the overall impact of such changes on the prospects for the advanced economies. The uncertainty is illustrated by market reactions in August–September to the situation in China. To what extent do they reflect local stock price corrections and to what extent changed estimates of the outlook for the global economy as a

whole? The growth forecast is subject to downside risks.

Chart 3.




## Growth to remain at 3%

In the Bank of Finland forecast,[1] global growth will pick up gradually from about 3% in 2015 to 3½% in 2017. World GDP growth in the forecast period will remain slightly lower than earlier projected, due, among other factors, to the more muted growth outlook for net exporters of oil, Latin America and other emerging economies. In contrast, the forecast for the EU22 remains broadly unchanged. The pace of world trade growth in 2015 will be around 3%. Even if trade growth were to accelerate, it would lag clearly behind the levels foreseen in the previous Bank of Finland forecast.

Table 1.

| **GDP and world trade** |
| --- |
| % change on previous year (previous forecast) |

*Source: Bank of Finland.*

| GDP and world trade | | | | |
|---|---|---|---|---|
| **GDP** | **2014** | **2015f** | **2016f** | **2017f** |
| United States | 2.4 | 2.6 | 3.0 | 2.8 |
| | *(2.4)* | *(3.1)* | *(3.0)* | *(2.8)* |
| EU22 | 1.3 | 1.7 | 1.8 | 1.9 |
| | *(1.2)* | *(1.6)* | *(1.9)* | *(1.8)* |
| Japan | −0.1 | 0.6 | 1.1 | 1.0 |
| | *(−0.1)* | *(0.6)* | *(1.4)* | *(1.0)* |
| China | 7.4 | 7 | 6 | 6 |
| | *(7.4)* | *(7)* | *(6)* | *(6)* |
| Russia | 0.6 | −4 | −2 | 1 |
| | *(0.6)* | *(−4.4)* | *(−1.8)* | *(0.5)* |
| **World** | **3.1** | **3.0** | **3.2** | **3.5** |
| | *(3.1)* | *(3.3)* | *(3.5)* | *(3.7)* |
| **World trade** | 3.4 | 1.8 | 3.7 | 4.5 |
| | *(3.5)* | *(4.2)* | *(5.0)* | *(5.4)* |
| f = forecast. | | | | |
| EU22 = euro area, Sweden, Denmark and United Kingdom. | | | | |

*Source: Bank of Finland.*

## In the euro area, growth is based on domestic demand

The low level of oil and other commodity prices, active and exceptionally accommodative monetary policy and the depreciation of the euro's external value in the past twelve months will underpin the euro area's cyclical outlook in the forecast period. The growth prospects for euro area export markets are, however, weaker than previously anticipated. The private sector's debt-servicing burden (which has long been a barrier to growth in euro area domestic demand), fiscal tightening and weak labour market developments are slowly easing. Euro area growth in the

forecast period will largely depend on domestic demand. Inflation will pick up from around zero to close to the ECB's price stability objective during the course of 2017.

The growth prospects for euro area export markets are slightly weaker than previously thought. On balance, the contribution of net exports to euro area growth will remain very limited during the forecast period.

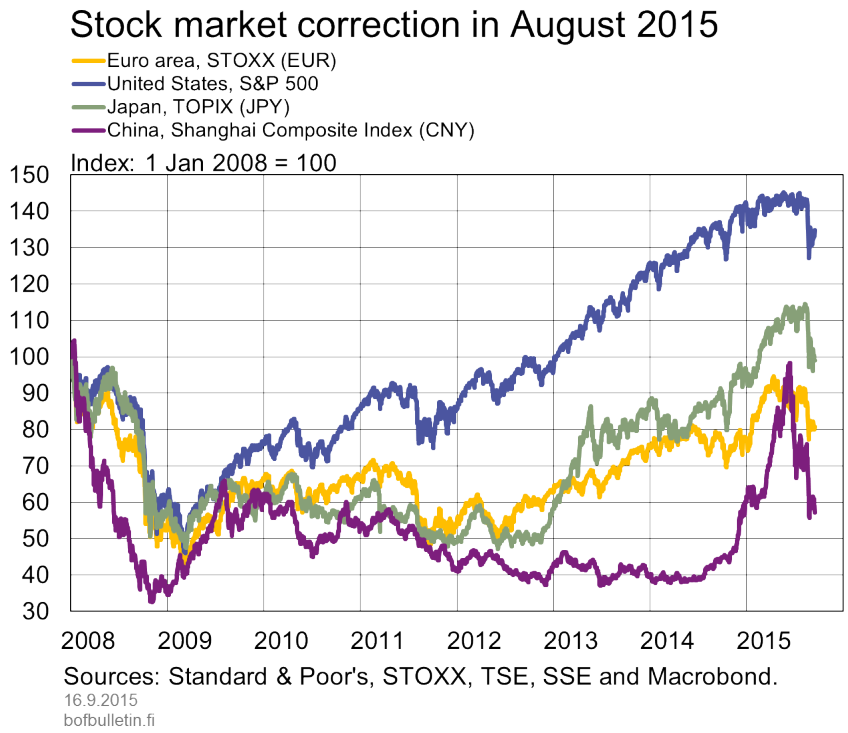
The aggregate demand component that contributed most to euro area GDP growth in 2014 was private consumption. Its value has risen steadily since the beginning of 2014, driven by real income growth amid an improved employment situation and falling energy product prices. Private consumption is expected to continue to recover as the employment outlook improves and the exceptionally low interest rate environment continues. With interest expenditures remaining moderate, repayments of loan principal will gather momentum and households will thus stand a good chance of improving their financial risk resilience.

The value of private fixed investment has grown in the euro area since the beginning of 2014, and the impact on growth in 2014 was mildly positive. Investment recovery has been held back by weak profitability, an abundance of free production capacity and, on occasion, lending bottlenecks. These factors will play a minor role going forward. Moreover, at the level of the euro area as a whole, an easing of debt-servicing pressures in the corporate sector will bolster investment growth. Partial relief will be provided by the European Fund for Strategic Investments (EFSI), scheduled to launch full-scale operations in mid-September with the aim of channelling a total of more than EUR 300 billion to non-financial corporations for the mobilisation of productive investments and the creation of jobs.

## Market disruptions shaking China

Indicators for China over the summer corroborate a picture of slowing growth. GDP growth in January–June was 7%, and data for July–August point to growth continuing broadly as earlier in the year, especially if the ongoing stimulus measures give traction for the rest of the year. China's reforms have also progressed roughly as expected, which is important for both the emergence of new drivers of growth and the solution of existing problems. The Bank of Finland still sees growth reaching nearly 7% this year and slowing to around 6% in 2016–2017. Consumer price increases in China have already been moderate for several years, and the Bank of Finland forecast estimates no material change in the situation in 2016–2017.

Chart 4.




Although market disruptions constitute a natural component of China's development phase, there is no reason to downplay the presence of problems and risks. The mere lack of statistics, the opacity of the system and big differences across the country's regions result in nobody having an accurate picture of the real economic situation in China. Worthy of note is that debt levels in the country are on the increase, meaning that this already key economic policy problem is worsening and risks in this respect are growing. For the situation in China, see the article 'Lower growth an inevitable feature of Chinese progress'.

## Steady growth in the United States

The US economy continues to rest on solid ground, as private consumption, which accounts for a large share of the country's GDP, is growing at a pace of around 3%. The economy has recovered well from the problems early in the year but, owing to the weak first quarter, forecasts for 2015 have been subject to slight downward revisions. Growth over the next couple of years is envisaged to accelerate to approximately 3%.

Stable employment growth and stronger household balance sheets have bolstered consumption. Likewise, the low price of oil has supported purchasing power. Consequently, consumer confidence is high. The unemployment rate has edged down to just over 5%. However, the employment rate is still low, despite cautious signs of improvement.

US exports have been hampered by the strong dollar and declining Chinese growth, and export growth is thus projected to remain sluggish in 2015. The significance of exports for the country's economy is, however, fairly limited. The US oil industry has been affected by the low price of oil. Even so, US investment is predicted to grow at a reasonable pace of around 5% in the forecast period.

The Bank of Finland foresees annual US inflation (consumer price inflation) remaining close to zero in 2015 but increasing thereafter so as to exceed 2% in 2017. This higher inflation can be mainly attributed to oil price changes dropping out of the calculation of the annual inflation rate and the tightening of the labour market, with consequent wage increases.

## Japanese inflation still slow

Japan continues to face difficulties in returning to growth. The near-term outlook is, nevertheless, cautiously optimistic. The low price of oil and subdued inflation will raise consumers' real incomes, thereby increasing private consumption. In addition, the government is seeking to boost the investment appetite of non-financial corporations by reducing the corporate tax rate.

Japan's prospects are overshadowed by the slowing of the Chinese economy. This impairs Japan's export outlook, despite competitive advantages brought about by the yen's weakness and increasing US import demand. Net exports will gain strength in the immediate future as the gradual restarting of nuclear reactors reduces the need for imported energy. The Bank of Finland forecasts approximately 1% growth in Japanese GDP in 2016–2017.

Japanese inflation plunged back close to zero as the impact of the consumption tax hike in April 2014 dropped out of annual price changes. Inflation has been further depressed by the falling price of oil, but underlying inflation is also slow. However, the labour market is tight and there are upward pressures on wages. The Bank of Finland forecast for Japan's inflation rate in 2015–2016 is around 1%. The consumption tax hike will cause inflation to rise to around 2% in 2017.

Japan's biggest medium-term problem is weakening potential output due to population ageing (See the article 'Structural reforms to provide boost during lean years in the global economy'), which poses challenges for efforts to wind down the considerable levels of debt and for rebalancing the economy.

## Russian economy to recover only gradually

The Russian economic outlook for the current year and the immediate years ahead remains unchanged. The economy is weighed down particularly by the low price of oil. According to the

Bank of Finland forecast, Russian GDP will contract by around 4% in 2015. In 2016–2017, the assumed fall in the price of oil will subdue domestic demand in Russia by slightly more than previously foreseen. Government expenditure is predicted to continue showing a slight contraction in real terms. A modest further reduction in investment is also expected, as the recession has freed up capacity. The Bank of Finland foresees a decline of around 2% in Russian GDP in 2016. There may also be some further decline in imports. The low level of imports will also be sustained, in part, by the likelihood of continuing external trade sanctions and Russian counter-sanctions.

The impact of the oil price collapse will fade in 2017, and growth in consumption, investment, exports, GDP and imports will rebound gradually. Slowing inflation will underpin consumption. Even so, economic growth will remain very modest, as the paucity of investment and the protracted structural problems in the Russian economy have weakened the economy's trend growth, bringing it down close to 1% in annual terms.

## Notes

1. Forecast assumptions about commodity prices, interest rates and exchange rates are based on market expectations current on 16 September 2015. Fiscal policy assumptions are based on structural reform estimates by national and international institutions, EU fiscal policy rules and forecast cyclical developments. The forecast also assumes that the situation in Greece will be resolved without aggravating the crisis. ↑

## Keywords

forecast, global economy, gross domestic product, inflation