Forecast

Clouds over the global economy

Finnish economy | 06 July 2018

Finland is a small open economy, and uncertainties in the global economy are also strongly reflected in Finland. The calculations presented here illustrate uncertainties relating to export and GDP forecasts by means of fan charts that demonstrate the uncertainties associated with the external environment. The fan charts incorporate both uncertainties in forecasting external factors and a view of asymmetric risk factors.



Concerns about a rise in protectionism increase the uncertainties for the Finnish economy that stem from the global economy. The political events in Italy also create uncertainty about economic growth in the euro area. The United States and China have imposed import tariffs on a number of products, and there is a risk that such measures restricting international trade may spread further. In addition, the United Kingdom's exit from the EU may also have negative effects on cross-border trade.

An extensive use of restrictions on international trade – i.e. tariffs – and technical barriers to trade would substantially weaken economic growth and global trade. Technical barriers to trade refer to a wide and varying range of regulations and standards related to goods and services and various procedures to assess whether products conform with, for example, certification or licence requirements. Protectionism raises import and export prices and has a negative effect on export market growth and thereby also on economic growth. A small, export-driven country such as Finland is highly dependent on as free cross-border mobility of goods and services as possible.

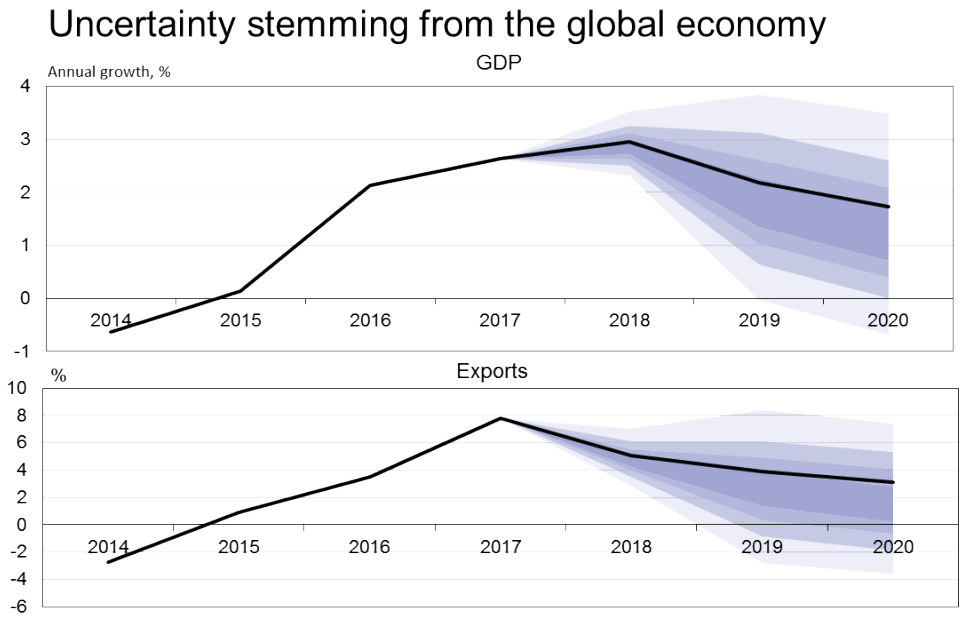
The calculations in this article constitute a sensitivity analysis, where Finnish GDP and export growth are subject to alternative assumptions concerning the export markets, exchange rates and international prices. The covariation of these variables of the global economy has been modelled based on historical data. The model can then be used to create a large variety of alternative forecast paths for the global economy. The forecast paths incorporate a view of the balance of risks surrounding the global economy, produced by constructing asymmetric distributions. The asymmetry of the distributions has been generated by assuming more positive or negative shocks to the baseline scenario.

Export market growth varies around the baseline scenario in a range between -3% and +8% over the forecast period 2018–2020 (Chart 1). The asymmetry of the distribution reflects the view that downward risks to export market developments are slightly higher than upward risks. Export market price developments, in turn, display a spread of 0% to +5%. Price developments are somewhat less asymmetric than export demand developments. For instance, protectionist measures would have direct price-increasing effects due to tariffs, for example. On the other hand, a more moderate global trade growth would have price-decreasing effects via weaker demand.

The alternative paths for the variables of the global economy can be entered into the Aino model to produce a variety of alternative forecasts for Finnish GDP and export growth. Export growth varies around the baseline scenario in a range from about -3% to +8% over the forecast period 2018–2020 (Chart 2). The alternative forecast paths for exports are tilted towards negative outcomes, reflecting the risks to export market developments. GDP growth varies in a range from -1% to +4% in the forecast period. As in the case of exports, the distribution of alternative paths for GDP growth is skewed downwards.

The calculation shows that, for economic growth to come to a complete standstill, export markets would need to contract for several years. However, the probability for this, and therefore also for a halt in economic growth during the forecast period, is very small.

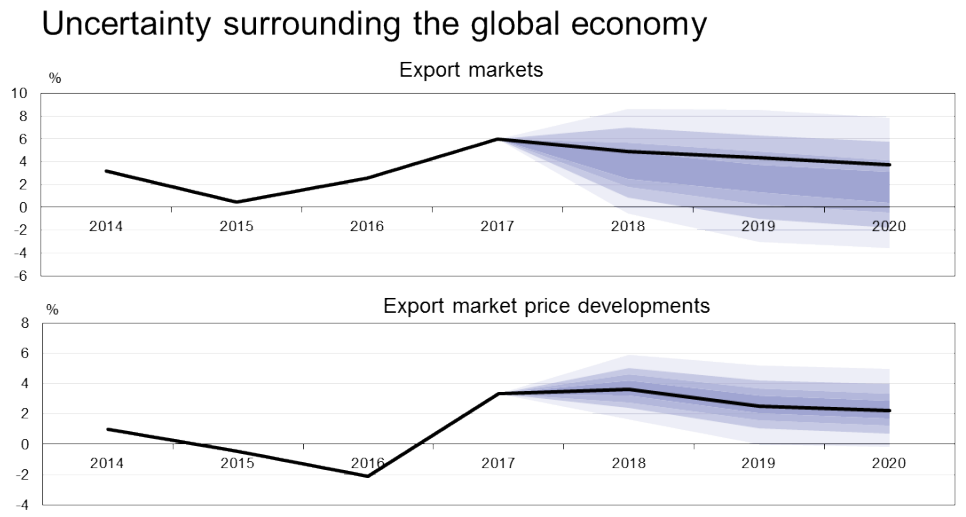
Chart 1.



Sources: European Central Bank, Statistics Finland and calculations by the Bank of Finland. The different shades of colours represent 90%, 70%, 50% and 30% probability intervals.

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Chart 2.



Sources: European Central Bank and calculations by the Bank of Finland. The different shades of colours represent 90%, 70%, 50% and 30% probability intervals.

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Keywords

economic growth, export markets, exports, fan chart, gross domestic product