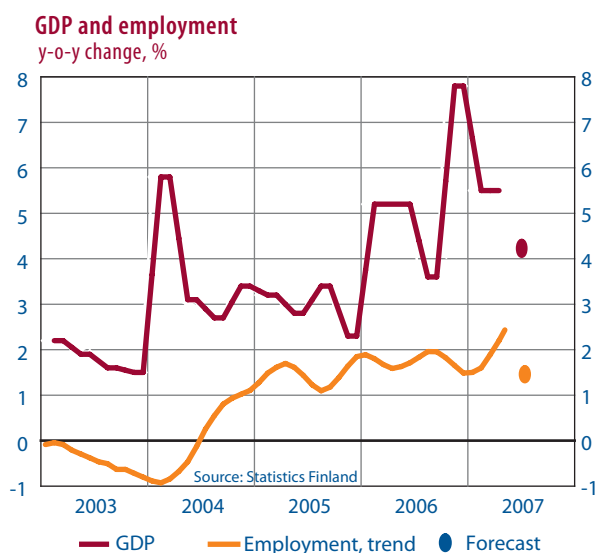


# Economic Bulletin

20.6.2007/2



The upward cycle continues to be stronger and is lasting longer than was anticipated earlier. Employment figures are also improving fast. At the same time, cost and price pressures are growing. The collective agreements concluded indicate a significant acceleration in the rate of pay rises and there is a risk that the price competitiveness of industry will begin to weaken towards the end of the cyclical peak. The central task of economic policy is now to safeguard economic stability.



Brisk growth continued in **world economy** in the first quarter in spite of a slowdown in the United States growth rate. After the beginning of the year, the price of oil has once more taken a turn upward and the increasing demand is likely to raise the average price level for the entire year a few dollars above that of the first half of the year. The prices of other production supplies also continue to go up. World trade increased by 8 per cent in the past year and nearly equal growth is expected for 2007. Employment figures are on the way up, which maintains the upward trend in demand. Production growth will probably remain close to 5 per cent for the fourth year running. The fear of accelerating price increases will probably keep central banks on their toes. The levelling off of differences in the growth in demand will alleviate the risks relating to imbalance in world economy. Expectations predict good growth rates for the following year, too.

In **the United States**, problems on the housing market and the narrowing down of household consumption potential have slowed down growth. At the beginning of the year production was growing as little as 0.6 per cent on the previous quarter. This has also reinforced signs of a more balanced trend in the economy. The deficit in central government finances has been reduced as a consequence of good revenue trends and the current account deficit is beginning to diminish in relation to the GDP. The status on the housing market continues to be problematic, but generally speaking the growth in production is expected to improve during the latter half of the year. The annual growth rate is predicted to be around 2 per cent. Growth may accelerate slightly the following year.



The situation in **the euro area** improved distinctly in the past year. The good trend continued in the first quarter of the current year and production increased more than 3 per cent on the previous year's figure. Domestic demand has speeded up the economy and investments especially are looking up. Better employment figures have also encouraged households to increase consumption. The unemployment rate had fallen to 7.1 per cent by April. Inflationary pressures have been kept well in check so far, but the rising price of oil causes increasing pressure. Pay pressures have also increased somewhat. The central bank has raised its reference rate to 4 per cent and interest rates are expected to keep rising. The good cyclical trend will improve central government finances. Production growth will this year be only slightly below the 2.7 per cent of the past year, and it is possible to achieve nearly the same rate next year, too.

The **Nordic economies** achieved nearly record growth figures last year, 4.5 per cent, driven by investment, private consumption and, in the case of Finland and Sweden, net exports. GDP rose 5.5 percent in Finland and 4.5 per cent in Sweden and Continental Norway, but the roughly 3 per cent growth rate of Denmark and Iceland was also high in relation to their low unemployment figures. This year economic growth will start slowing down in the Nordic countries but will still remain above that of the euro countries. Employment improved in the Nordic countries at a particularly brisk rate last year, by a few per cent, and the unemployment rate fell by one percentage point. This trend will continue in the current year, and labour markets will be tight in all Nordic countries. At the same time, price and cost pressures are increasing.

**In Finland, the growth in total output** has continued since the upturn at the beginning of 2006 at the brisk rate of 5 per cent in the early part of this year. The exceptional extent and force of the growth have led to a self-feeding cycle the like of which has been seen only a couple of times during the past 35 years. The upswing is indeed going to have an above-average duration, and the growth in the GDP will exceed 4 per cent this year, i.e. be a good one percentage point above the forecast made in March.

The assessment of the cyclical picture has been made particularly difficult by the vast differences between the industrial output volume index and the value added increase in quarterly accounting. In the January-March period, production according to the volume index fell 1 per cent on the previous year, while the increase according to the quarterly accounts was 7.7 per cent. The differences between these statistical figures and the significant change in the past year's GDP growth profile explain part of the need for adjustment in the GDP forecast. Some of the adjustment required is based on the unexpected strength of the cycle, even globally, and on the strong demand by households in particular. The nearly 5.5. increase in the GDP in this year's first quarter was based on domestic demand, for reductions in the exports of services left the entire export growth poor. Exports of goods have remained strong, however.

The cyclical prospects for companies have remained excellent and there has been a generous inflow of export orders. Companies' order books are exceptionally thick throughout, and both companies and households have strong confidence in the future extending to the following year. The demand for metal engineering products is particularly strong. It remains to be seen how long the upward cycle will continue.

Growth in **foreign trade** slowed down on the previous year as expected. In the first quarter, goods imports increased by 3.3. per cent and overall imports by 3.2 per cent. Goods exports increased 5.4 per cent but overall exports only 2.5 per cent, since exports of services fell by one tenth. The calculation of export and import of services is made more difficult by the slow information flow from companies; this may still cause significant changes in advance information: the rate of export growth will exceed that of imports during the year. The value of foreign trade will increase as a result of price hikes that have continued at a faster rate than expected as the strong demand for metal and timber will raise the price levels in exports and imports alike. The **current account** surplus will remain large, over EUR 10 billion. Thanks to Finland's good export success during the spring, the surplus exceeded that of last year, and the favourable trend would seem to continue. Next year the growth in foreign trade will slow down compared with 2007 but will still be export-intensive.

In addition to the export market, the **domestic market** is doing extremely well. The cyclical situation in industry and order stocks are exceptionally strong. Construction continues at the upper limits of capacity. Sales in the trade sector have increased along a large front at record rate, and the upward cycle in the service industries that is continuing for the fourth consecutive year now is not showing signs of slowing down. The upward cycle is reflected in the fact that the principal hindrance for sales growth in the service industries is now lack of skilled labour.

**Domestic trade** continues to show strong growth. Specifically the growth in the volume of retailing has accelerated further, and in the early part of the year, the confidence of entrepreneurs in this sector reached a record high for the decade. During the first three months of the year, trade production increased more than 7 per cent on the previous year. Demand continued to be strong and net sales to grow in the other service industries, too. The employment trend in the service industries has been favourable, but as a result of the continuation of the strong demand, sales growth is restricted by lack of skilled labour in every fifth service company, and the rise in the producer prices in the service sectors has accelerated from 1.5 to over 3 per cent.

The good **employment trend** continued in the first half of this year, particularly in private-sector services and the construction industry. In the January-May period employment rates grew faster than anticipated, 2 per cent on the previous year. It is estimated that in 2007 there will be an average of 40,000 more jobs than in 2006, which means that the employment rate will rise to 69.7 per cent. The supply of labour will also continue to increase, largely because of labour coming from outside the labour force and because employees will postpone their retirement. The unemployment rate will fall below 7 per cent this year.

There were close on 69,000 vacancies in the first quarter of the year, nearly 6,000 more than in the previous year. More than one third of the vacancies were, however, difficult to fill, and problems in the availability of labour have become worse, restricting production growth and increasing cost pressures.

The **productivity of labour** improved at an exceptional rate last year. The trend has continued to be good at the beginning of the year but will slow down as the upward cycle matures. Unit labour costs will not rise this year either, as a result of the moderate pay trend. The situation will change, however, as there will be new pay rises and the rise in productivity will slow down, and in 2008 labour costs will already be rising faster than production.

The **earnings level index** is expected to rise in 2007 by an average of 3 per cent, the same as last year. If the labour market solution achieved in the chemical industry reflects the general trend to be expected in the level of pay rises and the timing of such rises, the rate of increases in the level of earnings will reach 4.5 per cent by the end of the current year and will slow down slightly during 2008. The timing of the rises will, however, cause the level of earnings in 2008 to exceed this year's figure by an average of five per cent.

As a result of rises in the world market prices of crude oil and housing costs, for instance, **inflation** has been faster than was previously estimated in the past few months. The consumer price index is indeed expected to rise by 2.5 per cent in 2007. In 2008 the rate of increase in consumer prices is expected to remain unchanged.

This year's real disposable income of **households** will increase only slightly faster than last year. As far as wage-earners are concerned, the increase in purchasing power will be based on the improving employment situation and on lighter income taxation by government. In spite of rising interest rates, indebtedness has continued to increase rapidly in the early part of the year, and lending by banks to households has continued to increase at a rate of some 13 per cent. Private consumption will increase in the current year by 3.5 per cent, driven by goods acquisitions. If the income agreements already signed represent the general trend in increases to be agreed on, purchasing power will increase faster next year. Consumption will, however, be increasing faster than income, which means that the savings level will go down. Indebtedness will continue but will slow down.

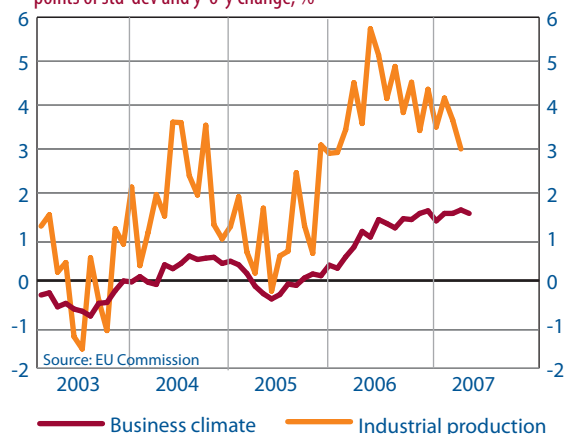
**Investment** increased 5.1 per cent last year. This year investment increased at the same rate; lively housing construction has continued for five consecutive years now and will gradually level off with the rising interest rates, although there are still office and commercial premises and infrastructure projects under construction. Increases in industrial investments will be caused by the need to renew and increase capacity, although a significant part of the sector's investments will continue to go abroad.

The financing position of **general government** will strengthen this year and be more than 4 per cent of GDP. The acceleration in economic growth will be reflected in central government tax revenues. The strong growth in capital income will also improve the financing position of general government. General government revenues will grow by some 5.5 per cent this year, while the growth in expenses will be 4.5 per cent. The expenses of general government will go down by one percentage point in 2007, to 47.5 per cent of GDP. Correspondingly, the proportion accounted for by taxes and social security contributions will go down by half a percentage point, to 42.7 per cent. The central government financing surplus will rise to just under 1.5 per cent of total output. The local government financing position will improve as tax revenues and central government transfers continue to rise rapidly. The social security fund surplus will remain at three per cent of total output thanks to the funding of employment pensions.

## International economy

In May, the **confidence** of companies in the euro area remained high in spite of a slight downward trend, and output expectations are good. In March there was an increase of 8 per cent in new orders received, compared with the previous year. Thus the strong growth in industry would seem to continue, in spite of a slowdown in April.

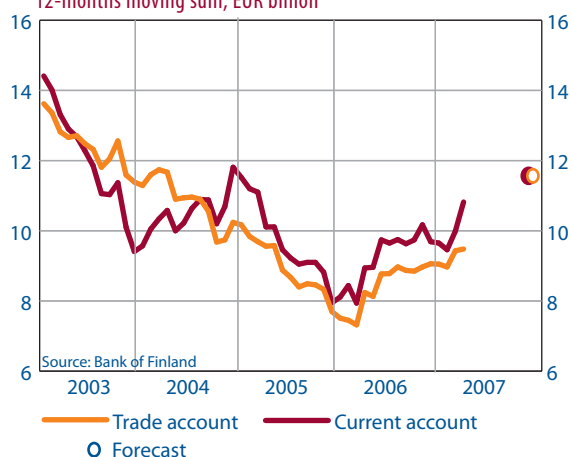
**Euro area business climate and industrial output,**  
points of std-dev and y-o-y change, %



## Economic development in Finland

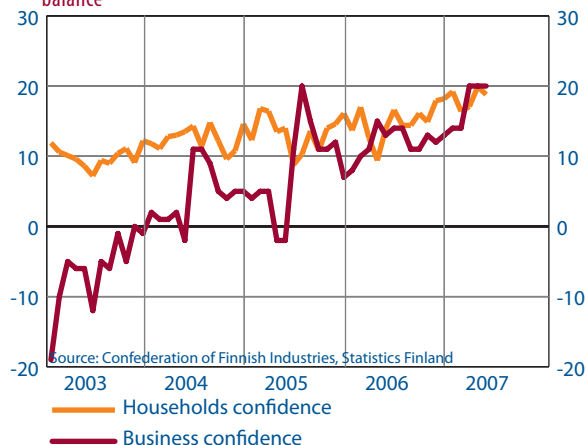
The annual surplus for the **trade account** was EUR 9.5 billion in April. The current account surplus exceeded it by over a billion euros, totalling EUR 10.8 billion. Both rose significantly on the previous year, and the surpluses for the entire year will exceed expectations. The vessel deliveries that took place in April made the April exports reach their all-time record monthly figure.

**External balance**  
12-months moving sum, EUR billion



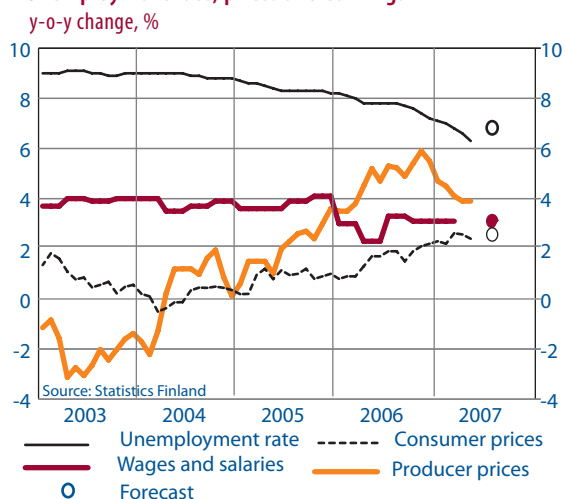
**Cyclical expectations** have continued to strengthen. The confidence of industry in the future remained strong in May and was significantly better than average. Favourable expectations were based on increases in the capacity utilization rate and order stocks. Confidence in construction revived and reached record level after the slight dip in April. Prospects looked up in the service industries, too. In May the consumers' confidence remained distinctly above average and confidence in the development of Finnish economy and the preconditions for saving were reinforced. Plans to purchase durables, however, fell below the long-term average.

**Industrial and households confidence**  
balance



The annual increase in the **consumer price index** was 2.4 per cent in May. The increase in industrial producer prices has slowed down but still exceeds distinctly the rise in consumer prices. The earnings level of wage-earners rose by 3.1 per cent in the first quarter of the year. The unemployment rate fell to 6.3 per cent in May.

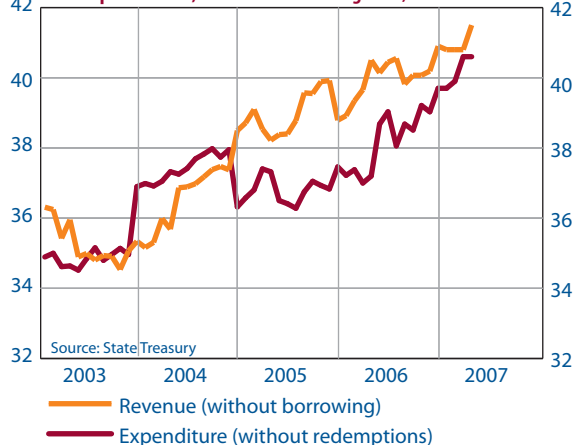
### Unemployment rate, prices and earnings



**On-budget** tax revenues increased in January-May by 5 per cent in comparison with the same period in the previous year. Added value tax revenues increased only 1 per cent, as the increase is reduced by the VAT refunds paid by the government. Total central government revenues increased 7.5 per cent, particularly as a result of increases in dividend income.

### Central government budgetary revenue

and expenditure, 12-months moving sum, Eur billion

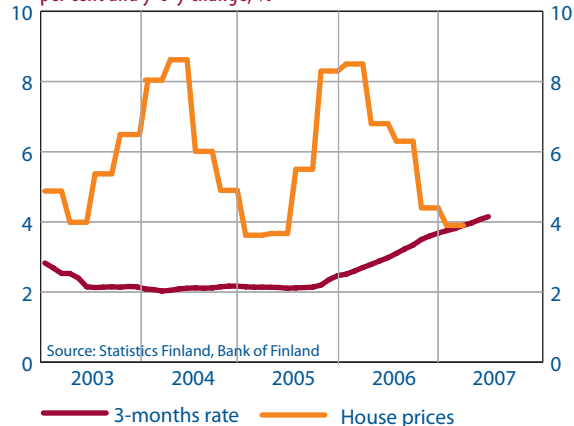


Expenditure decreased 1 per cent in January-May, largely as a result of timing of the payments of central government transfers to local government. Expenditure excluding the central government transfers increased by 2.5 per cent. The statement on the Budget outturn showed a surplus of EUR 3 billion for on-budget entities in January-May.

Short **rates** are rising, but also long rates have been going up recently. The average interest rate for new housing loans is as high as 4.6 per cent now. The housing loan growth rate has been stable at some 14 per cent.

### Short interest rates and real housing prices

per cent and y-o-y change, %

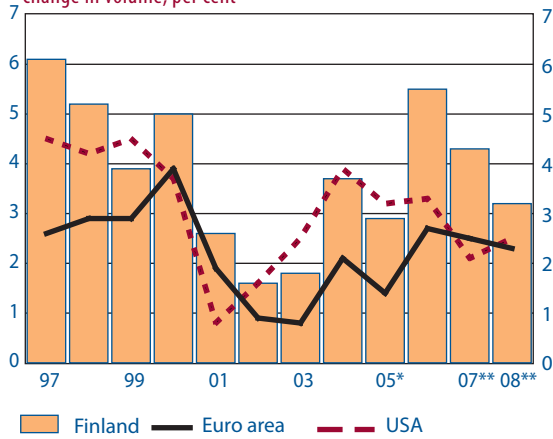


The price rises on the housing market have continued, but have levelled off somewhat. In the first quarter of the year, the prices of old apartments rose by 1.7 per cent on the previous quarter in the Helsinki Metropolitan Area and 1.3 per cent elsewhere in Finland. The increase in the Helsinki Metropolitan Area was still close on 8 per cent on the previous year.

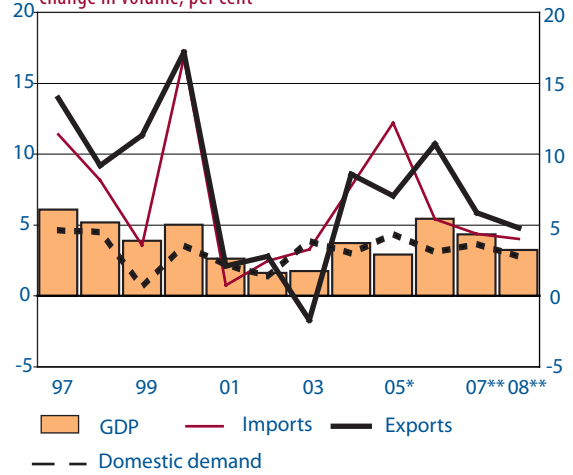
For further information, please contact:  
 Mr. Hannu Jokinen, Head of Forecasting Unit, tel +358-9-160 34879  
 Mr. Harri Kähkönen, Financial Counsellor, tel. +358-9-160 33194

<http://www.vm.fi/english>

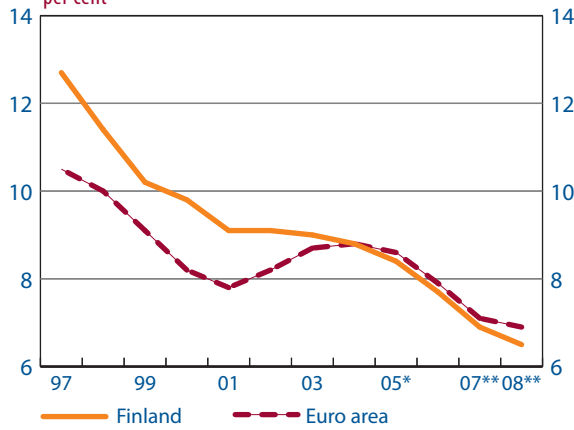
**GDP**  
change in volume, per cent



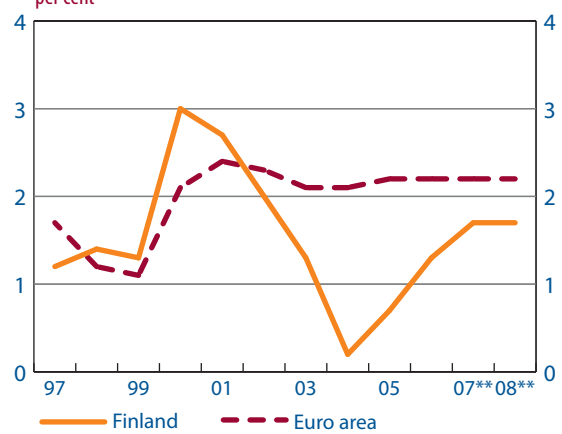
**Supply and demand**  
change in volume, per cent



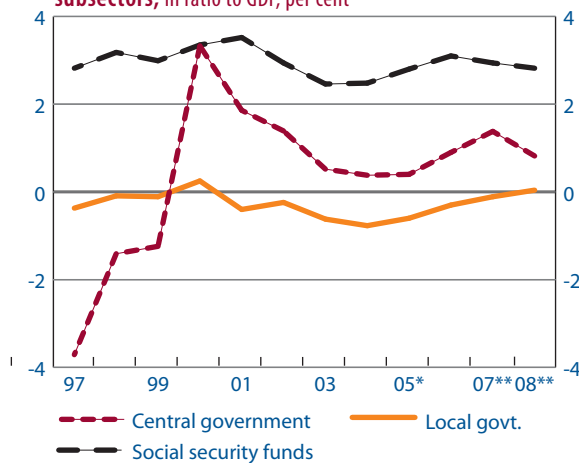
**Unemployment rate**  
per cent



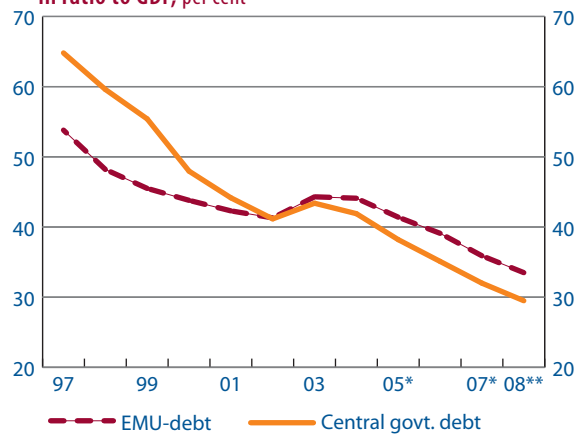
**Harmonised index of consumer prices**  
per cent



**The financial balance of general government**  
subsectors, in ratio to GDP, per cent



**General and central government debt**  
in ratio to GDP, per cent



## KEY FORECAST FIGURES

	2006*	2004	2005*	2006*	2007**	2008**
	EUR bn		change in volume, %			
GDP at market prices	168	3.7	2.9	5.5	4.3	3.2
Imports	64	7.8	12.2	5.4	4.4	4.0
Total supply	232	4.7	5.2	5.5	4.4	3.5
Exports	75	8.6	7.1	10.7	5.9	4.8
Consumption	121	2.6	3.2	2.3	2.9	2.8
private	85	3.0	3.8	3.0	3.6	3.3
public	36	1.8	1.7	0.9	1.2	1.7
Investment	32	3.6	3.7	5.1	5.0	3.0
private	28	3.6	6.4	5.6	4.9	2.6
public	4	3.7	-10.7	1.8	5.7	5.2
Total demand	232	4.7	5.2	5.5	4.4	3.5
domestic demand	157	3.0	4.3	3.1	3.6	2.8

	2004	2005*	2006*	2007**	2008**
Services, change in volume, %	3.3	2.4	3.6	3.0	2.6
Industry, change in volume, %	4.9	3.9	10.8	6.9	5.3
Labour productivity, change, %	3.0	1.8	3.8	3.1	3.0
Employment rate, %	67.2	68.0	68.9	69.7	69.9
Unemployment rate, %	8.8	8.4	7.7	6.9	6.5
Consumer price index, change, %	0.2	0.9	1.6	2.4	2.4
Index of wage and salary earnings, change, %	3.8	3.9	3.0	3.0	5.0
Current account, EUR bn	11.7	7.7	9.9	11.6	12.0
Current account, % of GDP	7.7	4.9	5.9	6.5	6.3
Short-term interest rates (3-month Euribor), %	2.1	2.2	3.1	4.2	4.6
Long-term interest rates (10-year Govt. bonds), %	4.1	3.4	3.8	4.5	4.7
General government expenditure, % of GDP	50.2	50.5	48.6	47.5	47.3
Tax ratio, % of GDP	43.4	43.9	43.3	42.7	42.5
General government net lending, % of GDP	2.1	2.5	3.8	4.2	3.7
Central government net lending, % of GDP	0.4	0.4	0.9	1.4	0.8
General government gross debt (EMU), % of GDP	44.1	41.4	39.1	35.9	33.5
Central government debt, % of GDP	41.9	38.2	35.1	32.0	29.5

### Sources:

Statistics Finland, Bank of Finland, OECD, EU

Forecast: Ministry of Finance, Economics Department