Euler Hermes Economic Research

Country Report

Finland

Poor economic prospects

General Information

GDP	USD250.024bn (World ranking 41, World Bank 2012)
Population	5.41 million (World ranking 113, World Bank 2012)
Form of state	Republic
Head of government	Alexander Stubb (National Coalition Party, KoK)
Next elections	April 2015, legislative

Strengths

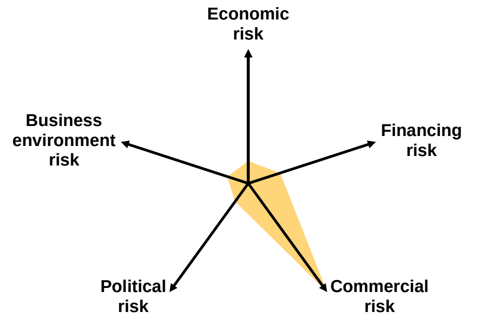
- Strong business environment
- High R&D spending
- Low fiscal deficit
- Contained public debt

Weaknesses

- Dwindling competitiveness
- Loss of export market share
- Rapidly deteriorating current account balance
- High private debt
- Trade sector highly dependent on Russia

Country Rating

AA2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Sweden	11%	1	17%	Russia
Russia	10%	2	13%	Germany
Germany	9%	3	12%	Sweden
United States	6%	4	7%	China
Netherlands	6%	5	5%	Netherlands

By product (% of total)

Exports		Rank		Imports
Paper	15%	1	12%	Crude Oil
Refined Petroleum Products	11%	2	5%	Refined Petroleum Products
Iron Steel	7%	3	4%	Electrical Apparatus
Electrical Equipment	4%	4	3%	Miscellaneous Hardware
Construction Equipment	4%	5	3%	Cars And Cycles

Source: Chelem (2012)

2014 marks the third consecutive year of recession

Finland's economy proved highly sensitive to the collapse in the global demand during the 2008-09 crisis. GDP was down 8.3% in 2009, the sharpest decline within the eurozone. Thereafter, the rebound was quite rapid, with the economy expanding by 3.7% in 2010 and 2.9% in 2011. Since 2012 the economy has been visibly hurt by the contagion effects from the eurozone crisis with GDP contracting by -1.5% in 2012 and by -1.2% in 2013. The start of 2014 has been far from bright as GDP fell by -0.3% q/q in Q1 and increased only slightly in Q2 (+0.2% q/q). Exports remain more than 14% below their 2008 peak and investment is down 19% since Q1 2008. GDP growth is expected to remain negative in 2014 (-0.5%) and to increase only very slightly in 2015 (+0.3%) driven by private consumption and investment.

Finland is the most exposed Western European country to Russia

Finland exports USD7.2bn to Russia (i.e. almost 10% of its total exports worldwide), with over 60% concentrated in the metal sector (USD3.1bn) and chemicals (USD1.7bn). In terms of energy, Finland imports 100% of gas consumption and 90% of its oil consumption from Russia, both equal to 3% of GDP in energy imports, with the concern finding alternative sources.

The depreciating RUB (EH expects a 15% fall against a USD+EUR basket in full year 2014) and slowing domestic demand will translate into lower exports to Russia. Finland could lose as much -0.6pp of GDP growth per year if exports to Russia decline by -20% (see Chart 1). The ban on agri-food imports from the EU accounts for EUR5bn and 90% of it is concentrated in 10 EU countries: Lithuania, Poland, Germany, Netherlands, Denmark, Spain, Belgium, Finland, France and Italy. However, the negative impact is material only for 3 of them: Lithuania (EUR920mn), Finland (EUR270mn) and Poland (EUR840mn) for which the ban represents 20%, 8% and 5%, respectively, of their worldwide agri-food exports.

First current account deficit in two decades in 2011

On the back of the worsening trade balance in recent years, the current account balance registered a deficit in 2011 (-1.8% of GDP), for the first time in two decades that has since worsened (-2.2% of GDP in 2013, see Chart 2). One of the explanations for this deterioration is the loss of competitiveness over the past few years, as wage increases have outpaced productivity improvements following a collective agreement reached just before the crisis started. Indeed, since 2010 nominal unit labour costs have increased by +7%, a rapid increase compared to the eurozone average (+2%), while labour productivity remained painfully weak (below 1%).

As a consequence, Finnish industry's global market share has decelerated since 2003 with more severe drops since 2008. The recent framework agreement for 2011-13 caps total annual wage increases at slightly above 2%, with specific settlements to be agreed in the industry sector.

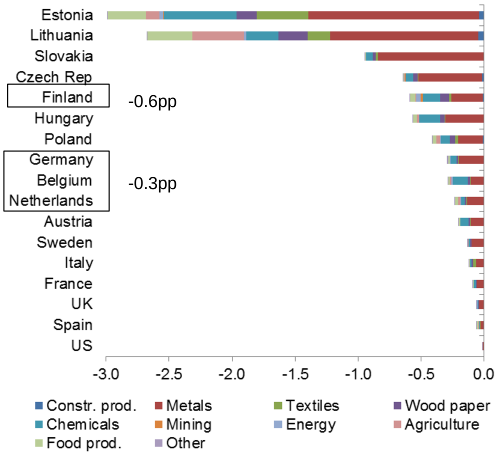
Table 1: Key economic forecasts

Finland		share	2012	2013	2014	2015
GDP		100%	-1.5	-1.2	-0.5	0.3
Consumer Spending		54%	0.1	-0.7	-0.3	0.3
Public Spending		24%	0.7	1.5	-0.6	0.4
Investment		22%	-2.5	-4.9	-3.0	1.7
Stocks	*	0%	-1.1	-0.4	0.7	0.3
Exports		39%	1.2	-1.7	-0.3	0.2
Imports		40%	1.3	-2.5	0.3	1.7
Net exports	*	0%	0.0	0.3	-0.2	-0.6
Current account	**		-4	-3	-3	-4
Current account (% of GDP)			*-1.9*	*-1.4*	*-1.7*	*-2.0*
Employment			0.4	-1.1	-0.3	0.6
Unemployment rate			7.7	8.2	8.5	8.4
Wages			3.2	2.1	1.5	2.3
Inflation			2.7	1.5	0.8	1.2
General government balance	**		-4	-5	-5	-5
General government balance (% of GDP)			*-2.2*	*-2.5*	*-2.5*	*-2.3*
Public debt (% of GDP)			*54*	*57*	*59*	*60*
Nominal GDP	**		199	201	203	206

Change over the period, unless otherwise indicated:
*contribution to GDP growth
**EUR bn

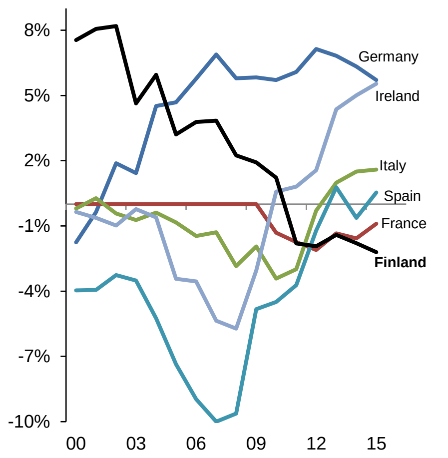
Sources: National sources, IHS, Euler Hermes

Chart 1: Annual impact of a -20% decline in exports to Russia *(pps annual impact in the baseline scenario)*



Sources: Chelem, IHS, Euler Hermes

Chart 2: Current account balance, % of GDP



Sources: National sources, IHS, Euler Hermes

The share of manufacturing in GDP has steadily decreased over the past few years, mainly due to the reduction in electronics production (e.g. mobile technology, i.e. Nokia) and the outsourcing of the manufacturing sites to other countries in the world. This loss has been only partly compensated by the increase in services, meaning that unemployment has increased by 2 percentage points since 2008.

Private sector deleveraging far from over

Household debt in Finland has almost doubled over the last decade and now stands at 62% of disposable income. On the corporate side, the debt of non-financial corporations is also high (i.e. 113% of GDP, see Chart 3). This brings total private debt in Finland to 175% of GDP, well above the 160% threshold set by the European Commission as part of a new exercise to detect and correct risky macroeconomic imbalances.

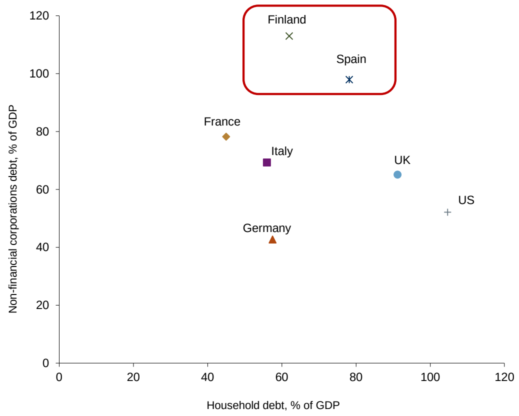
Business insolvencies still on the rise

After the fourth consecutive year of increase in 2013 (+6.5% with 3,700 cases), insolvencies reached a new high in Q1 2014 (~3,800) – see Chart 4. The trend remains on the upside (despite a small fall in H1, -4% y/y) and it is not expected to reverse before 2015 (+5% in 2014 and +1% in 2015). Firms continue to suffer from deteriorating profitability (margins down 8 percentage points since 2007 compared to 3pp for France for example) whereas operating profits lost more than 20% over the same period. Assuming that international and domestic business activity increases due the cut in the corporate tax rate in March 2014 by -4.5pp to 20%, the lowest rate in the eurozone after Ireland (12.5%) and before the UK (21%), we expect fiscal pressure to lessen going forward.

Healthy public finances

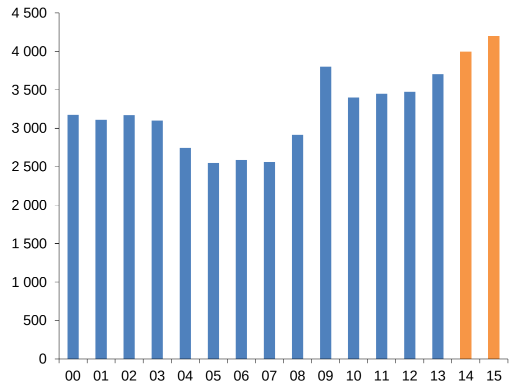
The fiscal deficit stood at -2.5% of GDP in 2013 and it is expected to remain stable in 2014 and to decrease to -2.3% of GDP in 2015. Bond interest rates remain at very low levels, comparable to Germany (see Chart 5) and interest expenditure is also well contained (2.6% of government revenues vs 10% for Italy for example). Further fiscal consolidation measures are scheduled for 2015 (EUR3.3bn). Public debt reached 57% of GDP in 2013 and it is expected to remain manageable in the coming years (at 60% of GDP in 2015).

Chart 3: Private sector debt, % of GDP



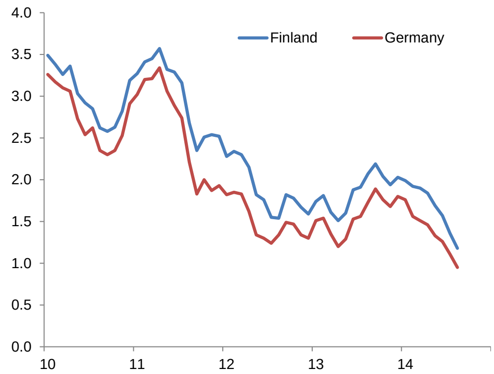
Sources: ECB, Bank of France, National sources, Euler Hermes

Chart 4: Business insolvencies



Sources: National sources, Euler Hermes

Chart 5: 10-year bond interest rates, %



Sources: IHS, Euler Hermes

Last review: 2014-09-18
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