Euler Hermes Economic Research

Country Report

Finland

Time to reform

General Information

GDP	USD270.67bn (World ranking 41, World Bank 2014)
Population	5.46mn (World ranking 114, World Bank 2014)
Form of state	Parliamentary Republic
Head of government	Juha SIPILA
Next elections	April 2019, legislative

Strengths

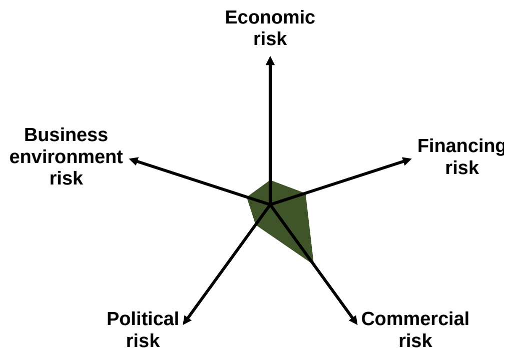
- Strong business environment
- High R&D spending
- Low fiscal deficit
- Contained public debt
- Improving competitiveness

Weaknesses

- Exposure to Russia still high
- Rapidly deteriorating current account balance
- High private debt, notably linked to the housing loans

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total, 2014)

Exports		Rank		Imports
Paper	16%	1	11%	Crude Oil
Refined Petroleum Products	10%	2	6%	Refined Petroleum Products
Iron Steel	7%	3	4%	Cars And Cycles
Electrical Equipment	4%	4	4%	Electrical Apparatus
Precision Instruments	4%	5	4%	Miscellaneous Hardware

By product (% of total, 2014)

Exports		Rank		Imports
Germany	12%	1	14%	Germany
Sweden	11%	2	14%	Russia
Russia	8%	3	13%	Sweden
United States	6%	4	6%	Netherlands
Netherlands	6%	5	6%	China

Source: Chelem

Economic Overview

An earlier-than-expected exit from recession

In 2015, Finland exited recession after three consecutive years of contraction, with GDP expanding by +0.7% (see Figure 1). This acceleration was mostly driven by private consumption which benefited from low consumer prices (in particular gasoline and food). In addition, given the high housing debt, the banks started to grant housing loan holders a year free of amortization, which released money for consumption. Unemployment, even if it still is at high levels (9.1% in Q1 2016), is on a decreasing trend. Going forward, this positive trend along with consumer prices remaining subdued (inflation at +0.3% on average in 2016) should contribute to consumer spending, set to grow by +1.5% in 2016. However, the ongoing fiscal consolidation measures will somewhat restrain households' spending.

Total investment, which contracted for four years in a row (-10% from the 2011 peak and -17% from the 2008 peak) is finally bottoming out (+1.6% in 2016). Construction confidence surveys, housing permits, and new starts reflect a positive assessment of the sector and of demand, notably in Greater Helsinki. This bodes well for future investment in construction, which should rise by +4.4% in 2016. Indeed, the low interest rates remain supportive for demand while big shares of housing loans are variable rate loans. However, investment in equipment is expected to pick-up only in 2017 (+2.7%) as the sector is restructuring given the overcapacity in investment goods and the low global demand.

Low nominal GDP growth remains a drag on firms' turnover while margins continue to erode

Three years of recession and loss of competitiveness, notably in the manufacturing sector, have been a drag on manufacturing firms' turnovers (see Figure 2). The economic recovery which started to materialize in the end of 2015 has however translated into a gradual improvement in turnovers, namely for key sectors such as Paper, which represent 13% of Finnish exports to the world, and is going through a period of restructuring, but also Wood and Textile. However, the recovery should remain subdued as nominal growth remains weak, at +1.4% in 2016. Investment in equipment will remain capped by the erosion in firms' margins (see Figure 3).

Reforms should boost competitiveness

The cost of an hour worked is higher than the EU average. In order to address this and to regain competitiveness abroad, the Finnish government has designed a reform package, recently approved by social partners and workers' unions, which will help reduce the cost of labor (target of -4% by 2019). The reforms include social payments transfer from employers to employees, lengthening working hours and cutting holidays bonuses, namely in the public sector.

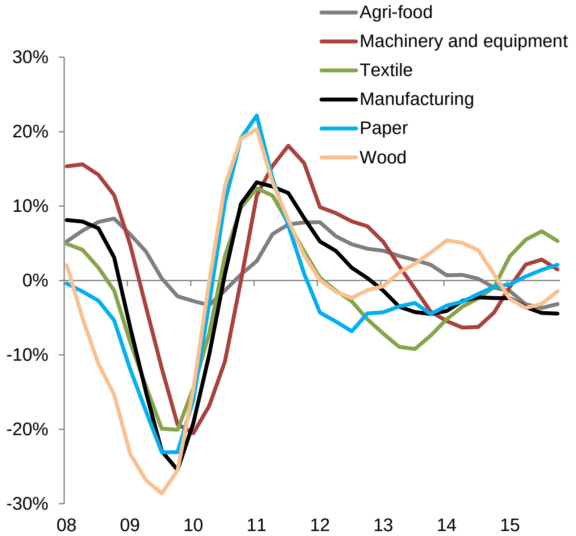
Figure 1 – Key economic forecasts

Finland		share	2014	2015	2016	2017
GDP		100%	-0.7	0.7	1.2	1.3
Consumer Spending		56%	0.6	1.4	1.5	1.6
Public Spending		24%	-0.3	-0.9	0.0	0.1
Investment		20%	-2.6	-1.1	1.6	2.3
Stocks	*	0%	0.0	-0.1	0.6	0.0
Exports		40%	-0.9	0.6	-1.1	1.9
Imports		40%	0.0	-0.4	0.4	2.0
Net exports	*	0%	-0.4	0.4	-0.6	-0.1
Current account	**		-2	0	-1	-1
Current account (% of GDP)			*-0.9*	*0.1*	*-0.6*	*-0.6*
Employment			-0.4	-0.4	0.4	0.4
Unemployment rate			8.7	9.4	9.1	9.0
Wages			1.4	1.3	1.1	1.1
Inflation			0.9	-0.3	0.3	0.9
General government balance (% of GDP)			*-3.2*	*-2.8*	*-2.6*	*-2.4*
Public debt (% of GDP)			*59*	*59*	*60*	*60*
Nominal GDP	**		205	208	211	214

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

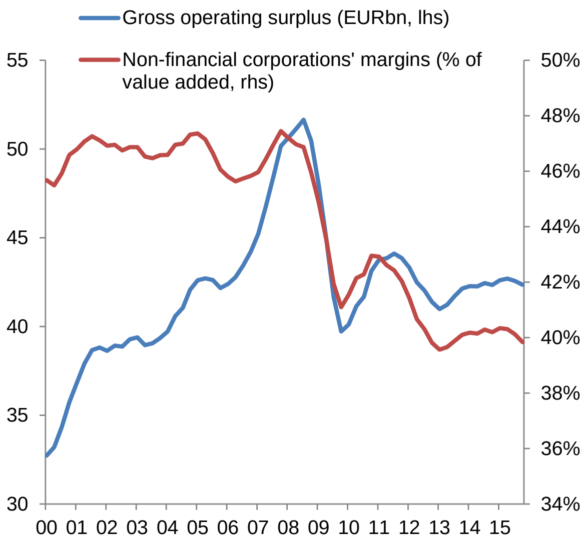
Sources: National sources, IHS, Euler Hermes

Figure 2 – Firms' turnover for a selection of sectors, 12M/12M change



Sources: IHS, Euler Hermes

Figure 3 – Firms' profitability indicators



Sources: Eurostat, Euler Hermes

The package will also improve the functioning of the Finnish labor market by making the job-matching process between employers and jobseekers more fluid.

Taking advantage from the German positive growth cycle

Among the eurozone countries, Finland is one of the rare countries not to have seen strong real export growth over the past years. Real exports remain 12% below the 2008 peak. The strong recovery that most of the eurozone countries have registered in 2015 on the back of the lower euro did not occur in Finland because of its exposure to Russia. However, Finland's exposure to the Russian market has gradually diminished since 2014, in favor of Germany which in 2015 represented 14% of total exports. Exposure to Sweden has been stable over the last ten years.

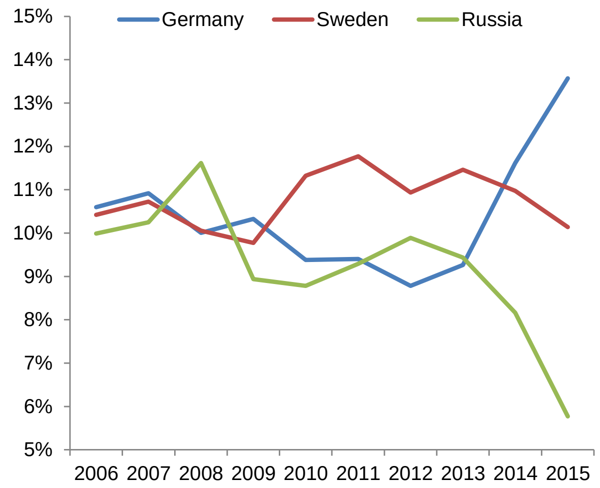
Being more connected to the German and Swedish markets than to Russia means less exposure to the latter while benefiting from good economic performances by the former. Germany is set to grow by +1.7% in 2016 and the manufacturing sector – in part exporting Finnish products – is in good shape. Sweden will grow by +3.4% in 2016 after +3.9% in 2015: the demand for Finnish goods will remain high.

Higher linkages with better performing markets along with regained price competitiveness should help firms export more, especially in 2017 as these reforms come into force.

Fiscal consolidation ongoing

As a means to reduce the public deficit which was widened by three years of recession, fiscal consolidation will be carried forward by the government of Sipila. This includes reduced public unemployment spending and a rise in the effective retirement age by 1.5 years by 2025. The General Government Fiscal Plan for 2017-2020 – which is Finland's EU Stability Program – sets out to diminish public spending by EUR4bn over the period. In total, Juha Sipila's government plans to adjust public finances by EUR10bn (5% of GDP) during the next four years.

Figure 4 – Evolution of export shares (goods) for Finland's Top 3 export markets



Sources: Chelem, Euler Hermes