

## 26. FINLAND

### Moderate growth continues

The Finnish economy is expected to grow steadily over the forecast horizon at an annual rate similar to the one achieved in 2016. Private consumption and investment are expected to remain the main growth drivers and exports are expected to pick up due to the strengthening of global demand and improved competitiveness. The public deficit decreased in 2016 and the increase in the debt-to-GDP ratio came to a halt. In 2017, the deficit is projected to temporarily worsen slightly before improving again in 2018. The debt ratio is projected to increase in 2017 and 2018.

#### Economic recovery firms up

Real GDP growth accelerated to 1.4% in 2016, after just 0.3% in 2015, driven mainly by private consumption and construction investment. Construction investment benefitted from the rapid increase in the demand for new housing (9.1%) and increased non-residential construction (7.3%). Private consumption grew faster than real disposable income on the back of high consumer confidence and a substantial decline in the household saving rate. Net exports weighed more heavily on growth in 2016, as modest export growth was more than offset by the rise in imports, the latter being fuelled by consumption and investment.

The economy is expected to continue to grow at a similar pace in 2017 and 2018, by 1.3% and 1.7% respectively. Growth in private consumption is forecast to moderate temporarily in 2017, due to a wage freeze and slow employment growth, before increasing in 2018. However, the household saving rate is expected to stay on a historically low level. After an exceptional rate of 5.2% growth in 2016, investment is forecast to continue growing by around 3% in both 2017 and 2018, supported by a favourable interest rate environment and above-average manufacturing confidence.

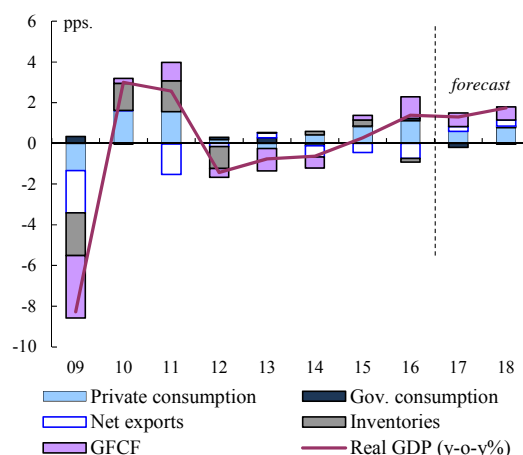
Exports are expected to pick up gradually as foreign demand increases and competitiveness improves following the implementation of the Competitiveness Pact. Despite this acceleration in exports, a loss in Finland's market shares is expected, as global demand is forecast to grow faster. Import growth is expected to slow down in 2017 as consumption eases but should pick up again in 2018. As a consequence, Finland's current account balance is forecast to remain broadly unchanged as the surplus in goods is offset by the deficit in services.

#### Inflation and employment are rising slowly

Despite some wage pressures following the wage freeze in 2017, wage growth in 2018 is expected to remain below productivity growth, thereby improving cost competitiveness. As a result of this, inflation is forecast to remain low over the forecast horizon. An expected modest rise in energy prices and subdued wage growth is expected to keep inflation in the 1.0-1.5% range.

In the labour market, employment growth is set to continue, supported by rising investment and growth in exports. The unemployment rate is forecast to decrease to 8.2% in 2018.

Graph II.26.1: Finland - Real GDP growth and contributions



#### Risks to the outlook are balanced

Risks to the forecast are broadly balanced. On the upside, investment may surprise positively and exporters are well positioned to benefit from any faster-than-expected recovery of the Russian economy. On the downside, overall uncertainty related to the external environment and the outcome of the upcoming sectorial wage negotiations could weigh on the growth of exports. These risks to the macroeconomic outlook would also have repercussions on public finances.

### After a positive surprise, the debt ratio continues to grow in 2017

Finland's general government finances improved more strongly than projected in 2016. The debt-to-GDP ratio declined slightly, mainly due to the use of cash buffers by the state treasury. The general government balance turned out somewhat less negative than expected at -1.9% of GDP. The improved economic situation, higher contributions to unemployment insurance and lower government wage costs were behind the smaller deficit.

In 2017, the deficit is projected to increase to 2.2% of GDP. This is driven by cuts in personal income tax and in employers' health insurance contributions, which put the growth of revenues on hold for a year. The revenue loss caused by these measures (0.6% of GDP) outweighs the impact of the expenditure cuts (about 0.5% of GDP) which

were decided in the government's fiscal plan and within the Competitiveness Pact. In 2018, accelerating economic growth is projected to increase revenues and to curb expenditure growth. Also the consolidation measures of the government's fiscal plan are expected to help bring the deficit down to 1.8% of GDP. The gross government debt-to-GDP ratio is projected to increase to 65.5% in 2017 and to continue to rise just above 66% of GDP in 2018. At the moment, risks to the fiscal outlook are considered broadly balanced.

In 2017 and 2018, GDP growth in Finland is expected to be above its estimated potential growth rate, which implies a narrowing negative output gap. Given the expected swings in the headline balance, the structural balance is projected to worsen by about ½ pps. of GDP in 2017, and remain broadly flat thereafter.

Table II.26.1:

#### Main features of country forecast - FINLAND

	2015			Annual percentage change						
	bn EUR	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP	209.5	100.0		2.5	-0.8	-0.6	0.3	1.4	1.3	1.7
Private Consumption	115.8	55.3		2.7	-0.5	0.8	1.5	2.0	1.1	1.4
Public Consumption	51.1	24.4		1.5	1.1	-0.5	0.1	0.5	-0.8	0.3
Gross fixed capital formation	42.9	20.5		2.6	-4.9	-2.6	1.1	5.2	3.1	2.9
of which: equipment	9.9	4.7		2.1	-8.7	-1.6	5.8	5.7	2.6	3.2
Exports (goods and services)	77.2	36.8		5.0	1.1	-2.7	2.0	0.5	2.3	3.3
Imports (goods and services)	77.8	37.1		5.3	0.5	-1.3	3.1	2.5	1.6	2.4
GNI (GDP deflator)	211.3	100.8		2.7	-0.9	-0.1	0.2	1.6	1.2	1.7
Contribution to GDP growth:										
		Domestic demand		2.2	-1.1	-0.3	1.1	2.3	1.1	1.5
		Inventories		0.1	0.0	0.2	0.3	-0.2	0.0	0.0
		Net exports		0.3	0.3	-0.5	-0.4	-0.7	0.2	0.3
Employment				1.2	-0.7	-0.5	-0.3	0.6	0.5	0.7
Unemployment rate (a)				8.9	8.2	8.7	9.4	8.8	8.6	8.2
Compensation of employees / head				3.1	1.3	1.0	1.6	1.0	-0.8	1.5
Unit labour costs whole economy				1.9	1.4	1.1	1.0	0.2	-1.5	0.5
Real unit labour cost				0.1	-1.1	-0.6	-0.7	-0.6	-2.0	-0.8
Saving rate of households (b)				8.7	8.6	7.2	6.7	5.5	5.5	5.6
GDP deflator				1.8	2.6	1.7	1.7	0.8	0.5	1.2
Harmonised index of consumer prices				1.9	2.2	1.2	-0.2	0.4	1.0	1.2
Terms of trade goods				-1.4	0.8	1.7	4.1	-0.5	-2.2	0.1
Trade balance (goods) (c)				5.5	0.1	0.7	1.1	0.3	-0.1	0.2
Current-account balance (c)				4.1	-1.9	-1.3	-0.7	-1.3	-1.8	-1.6
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				4.1	-1.8	-1.2	-0.7	-1.3	-1.7	-1.6
General government balance (c)				1.9	-2.6	-3.2	-2.7	-1.9	-2.2	-1.8
Cyclically-adjusted budget balance (d)				1.7	-1.3	-1.5	-1.2	-0.9	-1.3	-1.5
Structural budget balance (d)				-	-1.2	-1.6	-1.1	-0.9	-1.3	-1.4
General government gross debt (c)				43.0	56.5	60.2	63.7	63.6	65.5	66.2

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.

Note: Contributions to GDP growth may not add up due to statistical discrepancies.