19. FINLAND

Outlook subdued as cycle matures

Economic growth, after solid 2019, is expected to moderate in 2020 as residential investment declines. Unemployment is set to fall gradually to its structural level while inflation is expected to remain low. The outlook for the general government balance has deteriorated substantially due to the decelerating economy and the government's expansionary fiscal plans.

Economic growth to ease

Finland's real GDP growth is expected to reach 1.4% this year, after having already decelerated in 2018. Amid weakening external demand and rising uncertainties, most high-frequency indicators point to a gradual slowdown in 2019 and 2020. Growth is expected to be broad-based this year, with positive and balanced contributions from all components. In 2020 and 2021, GDP growth is forecast to stay close to 1%, as the contribution from net exports turns negative.

Domestically driven growth in 2020 and 2021

Private consumption is expected to remain the main driver of growth, fuelled by the expected rise in wage income and modest increases in employment. Public consumption is set to contribute to growth more than in recent years, as the new government plans to increase spending.

Investment is expected to slow down in 2020, in particular its construction component. As indicated by the decline in the number of new housing permits requested and project starts, it is likely that residential construction growth will turn negative next year. This might be partially compensated by public infrastructure projects and investment in machinery and equipment but investment is likely to remain subdued overall.

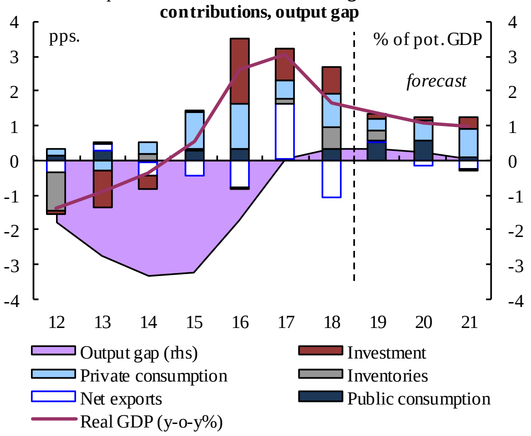
Exports are forecast to improve in line with the expected slow recovery in demand in Finland's main trading partners, but only gradually. Imports should follow a similar path but its growth rate is expected to outpace exports, leading to a slight deterioration in the trade balance.

Mild employment growth and low inflation

Wage increases are likely to outpace productivity growth as the unemployment rate nears its structural level. While the outlook for the labour market is still positive, further sizeable employment increases are unlikely. The expected rise in real income should boost household disposable income and help the household saving rate to recover.

Inflation remained low and below the euro area average in 2019. The pass-through from higher wages into services was smaller than in the past. This, coupled with expected low energy prices implies that the period of low inflation is likely to continue over the forecast horizon.

Graph II.19.1: **Finland - Real GDP growth and contributions, output gap**



Risks are tilted to the downside

Being a small open economy, Finland is vulnerable to disruptions in trade, which would further lower demand in Finland's main trading partners. Domestically, the slowdown in residential construction could turn out to be even stronger than anticipated.

Expansionary fiscal stance

The general government headline balance is forecast to deteriorate from -0.8 % of GDP in 2018 to -1.1% of GDP in 2019, revised down from -0.4% of GDP at the time of the spring forecast. While economic and employment developments should continue to support tax revenues and keep a lid on expenditures linked to social benefits, the outlook for government revenue has clearly deteriorated in line with the cyclical developments. Furthermore, higher-than-expected spending by local authorities in the first half of 2019 has further deteriorated the projected balance. Finally, recent statistical revisions have also resulted in a deterioration of the balance for 2018 by 0.1 percentage points.

The general government balance is forecast to further deteriorate to -1.4% of GDP in 2020 and – under a no-policy-change assumption – to -1.6% of GDP in 2021. In early October, the Rinne government adopted new medium-term fiscal plans underpinning the government's programme and the draft budget for 2020. Starting from 2020, the government plans to increase spending in several areas, including education, social security, health and long term care as well as its investment in infrastructure (in particular road and rail transport networks). These plans, if fully implemented, are projected to lead to a substantial increase in government expenditure that would only partially be funded by revenue increasing measures. Excise taxes on alcohol, tobacco and fuel will be raised as of 2020, but many other revenue-increasing measures that were announced will be specified and adopted only later during the government term. In addition, some revenue-increasing measures from the 2017 Competitiveness Pact are to kick in in 2020, but the impact of those is offset by new plans to cut income taxes paid by low and middle-income earners. Overall, the discretionary fiscal measures leave a substantial gap between expenditure and revenues, resulting in a growing deficit.

The structural budget balance is forecast to deteriorate from about -1% of GDP in 2018 to around -1½% in 2019. As the output gap will be gradually closing, the structural balance is projected to remain around the same level in 2020 and 2021.

The general government debt-to-GDP ratio is set to increase through 2021 but it will remain below the 60% benchmark ratio. From 2021, the debt will additionally increase due to the start of advance payments for delivery of new military equipment scheduled for mid-2020s. Population ageing is projected to put pressure on Finland's spending and weigh on debt sustainability in the long term.

Table II.19.1:

Main features of country forecast - FINLAND

	2018			Annual percentage change						
	bn EUR	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP		234.5	100.0	1.5	2.6	3.1	1.7	**1.4**	**1.1**	**1.0**
Private Consumption		123.7	52.8	2.0	2.4	1.0	1.8	**0.6**	**1.1**	**1.5**
Public Consumption		53.1	22.7	1.2	1.4	0.2	1.5	**2.4**	**2.5**	**0.4**
Gross fixed capital formation		55.5	23.7	0.9	8.9	4.0	3.3	**0.7**	**0.4**	**1.5**
of which: equipment		12.3	5.2	0.8	14.0	6.4	-1.1	**2.1**	**1.2**	**2.9**
Exports (goods and services)		90.4	38.6	2.8	3.7	8.8	2.2	**1.9**	**2.2**	**2.4**
Imports (goods and services)		92.1	39.3	3.7	5.8	4.1	5.0	**1.8**	**2.5**	**3.0**
GNI (GDP deflator)		235.2	100.3	1.6	2.2	2.5	2.0	**1.4**	**1.1**	**1.0**
Contribution to GDP growth:	Domestic demand			1.5	3.5	1.5	2.1	**1.0**	**1.2**	**1.2**
	Inventories			0.1	0.0	0.1	0.6	**0.3**	**0.0**	**0.0**
	Net exports			-0.1	-0.8	1.6	-1.0	**0.1**	**-0.1**	**-0.2**
Employment				0.7	0.5	1.0	2.6	**0.9**	**0.4**	**0.3**
Unemployment rate (a)				8.4	8.8	8.6	7.4	**6.7**	**6.5**	**6.4**
Compensation of employees / head				2.7	0.9	-1.1	0.7	**3.1**	**3.0**	**3.2**
Unit labour costs whole economy				1.9	-1.2	-3.0	1.7	**2.7**	**2.3**	**2.5**
Real unit labour cost				0.1	-1.4	-3.7	-0.4	**1.2**	**0.5**	**0.5**
Saving rate of households (b)				8.1	6.3	6.7	6.8	**8.7**	**9.0**	**9.6**
GDP deflator				1.7	0.2	0.7	2.1	**1.4**	**1.8**	**2.0**
Harmonised index of consumer prices				1.8	0.4	0.8	1.2	**1.2**	**1.4**	**1.5**
Terms of trade goods				-0.7	0.0	-0.9	0.5	**-0.7**	**-0.1**	**-0.2**
Trade balance (goods) (c)				6.1	0.0	0.7	0.3	**0.4**	**0.3**	**0.2**
Current-account balance (c)				2.8	-1.9	-0.8	-1.4	**-1.3**	**-1.5**	**-1.7**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				2.9	-1.9	-0.7	-1.3	**-1.2**	**-1.4**	**-1.6**
General government balance (c)				1.3	-1.7	-0.7	-0.8	**-1.1**	**-1.4**	**-1.6**
Cyclically-adjusted budget balance (d)				1.6	-0.7	-0.7	-1.0	**-1.3**	**-1.6**	**-1.6**
Structural budget balance (d)				-	-0.7	-0.7	-1.0	**-1.4**	**-1.6**	**-1.6**
General government gross debt (c)				45.2	62.6	60.9	59.0	**59.2**	**59.3**	**59.8**

(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.