19. FINLAND

Strong government support measures and an effective containment response softened the impact of the COVID-19 pandemic on the economy, which at mid-2020 stood among the lowest in the EU. Still, the economy took a heavy hit and the recovery is expected to be only gradual, recovering its 2019 output level only by the end of 2022. The public debt ratio is set to increase by 10% of GDP due to the impact of the crisis and the policy measures taken to address it.

The economy is gradually recovering

By mid-2020, Finland had managed to contain the spread of the virus despite having milder restrictions than most other EU countries. Consequently, the economic hit was relatively mild, with GDP falling by 1.4 % and 4.4 % quarter-on-quarter in the first two quarters of the year, respectively. The main hit came from the decrease in private consumption, as consumer spending was constrained by a number of measures and consumers increased their precautionary savings. The milder GDP fall is explained by a larger decrease in imports than in exports and only a minor decrease in investment and public spending. High frequency indicators available so far in the second half of the year show a rebound, though the most recent data seem to suggest this may be coming to a halt.

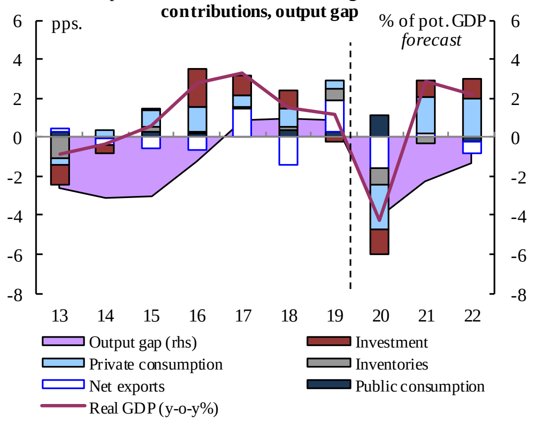
GDP in 2020 is expected to contract by 4¼ %. All demand components, except government consumption, are expected to fall in 2020. Private consumption is recovering in the third quarter but is still constrained by lower employment and confidence effects. Investment in machinery and equipment is expected to drop as companies remain uncertain about the duration and severity of the pandemic, as well as the stringency of any future measures that the government may take. However, investment in construction should show greater resilience given a step-up in public investment. Net exports are likely to be negative at year-end as imports have been outpacing exports in recent months.

Next year, as consumers and businesses adapt to the new COVID-19 environment, GDP is forecast to grow by 3%. Private consumption is forecast to rise, as consumers increase discretionary spending and employment recovers. Once uncertainty fades, investment is also likely to grow. Exports are forecast to recover partially, in line with external demand. The strong role of government spending is likely to diminish next year as the economic outlook improves. In 2022, GDP growth is forecast to slow down to 2¼% as the economy converges towards its potential, recovering to the pre-crisis levels by the end of the year.

Slowly growing employment and low inflation

Unemployment rose sharply in the first half of the year, with monthly layoffs peaking in April when 160 000 people lost their jobs. By now, many of the furloughed workers have returned to work but the unemployment rate is still set to rise, as some business will be unable to hoard labour for an extended period of lower demand. Once a gradual recovery takes hold in 2021, unemployment should start to fall. Wages are expected to rise due to the wage bargaining agreements reached before the crisis hit. The current period of very low inflation is forecast to continue, rising only slightly over the forecast horizon. Energy prices are expected to remain stable, making the services prices the only sizeable contributor.

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



This forecast scenario is subject to predominantly downside risks related to the pandemic. A more prolonged crisis could heavily affect export industries, including shipbuilding. At the same time, Finland's resilience, as shown in the first wave of the pandemic, and its fiscal space, could be the factors that help boost the economy faster once restrictions are eased.

Public finances in support of the economy

The economic slump due to the pandemic caused a fall in government revenues and a rise in government expenditure. Together with the cost of COVID-19-related measures, the crisis is set to push the general government balance to a deficit of 7½% of GDP in 2020.

The fiscal cost of measures included in the six supplementary budgets adopted this year up to mid-October amounts to about 2.6% of GDP. The measures include costs related to health care and public safety, but are mainly aimed at supporting the economy and society. Subsidies for companies include grants and compensations for losses incurred during the forced closure of business as well as targeted measures for the self-employed, restaurants, farmers etc. Employers benefit from a temporary lowering of pension contributions. Extensions to unemployment benefit schemes facilitate short-term layoffs of employees while other measures aim to help families and support children and young people. The government has also launched investments in transport, research and education. In addition, various non-budgetary measures have been taken to support liquidity in the economy, including public guarantees for loans, worth about 21% of GDP.

In 2021, government revenues are expected to undershoot their pre-crisis forecasts. Some unused budgetary allocations related to the pandemic have been transferred to following years while current costs, such as testing programmes, will also continue. Furthermore, the government assumes some losses from the loan guarantees it has extended. The general government deficit forecast for 2021 is 4¾ % of GDP. In 2022, the expected normalisation of the public health situation and economic growth should lead to an improvement in public finances, but the general government deficit is projected to remain above the Treaty threshold of 3% of GDP, assuming no policy change. The forecast does not include measures related to the implementation of the Recovery and Resilience Facility in Finland as they were not ready by the cut-off date.

The public debt ratio is set to increase by around 10 pps. in 2020, driven by the general government balance and by measures not recorded in the deficit, such as tax deferrals, loans and recapitalisations. By 2022, the debt ratio is projected to increase further to 72½% of GDP.

Table II.19.1:

Main features of country forecast - FINLAND

		2019		Annual percentage change						
	bn EUR	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP		240.6	100.0	1.3	3.3	1.5	1.1	**-4.3**	**2.9**	**2.2**
Private Consumption		126.0	52.4	2.1	1.0	1.8	0.8	**-4.4**	**3.5**	**3.9**
Public Consumption		55.3	23.0	1.2	0.1	1.6	1.1	**4.8**	**0.1**	**-0.9**
Gross fixed capital formation		57.5	23.9	1.0	4.8	3.9	-1.0	**-5.1**	**3.7**	**4.0**
of which: equipment		12.4	5.2	1.6	7.5	-0.8	-1.8	**-14.7**	**11.1**	**5.5**
Exports (goods and services)		96.7	40.2	2.1	8.6	1.7	7.7	**-12.4**	**5.6**	**3.9**
Imports (goods and services)		95.9	39.9	3.2	4.2	5.4	3.3	**-8.5**	**4.9**	**5.5**
GNI (GDP deflator)		241.7	100.5	1.4	2.9	1.8	1.3	**-4.2**	**2.9**	**2.2**
Contribution to GDP growth:	Domestic demand			1.5	1.7	2.2	0.5	**-2.4**	**2.7**	**2.8**
	Inventories			0.0	0.1	0.5	-0.9	**-0.3**	**0.0**	**0.0**
	Net exports			-0.3	1.5	-1.4	1.7	**-1.6**	**0.2**	**-0.6**
Employment				0.6	1.0	2.5	1.7	**-2.5**	**0.9**	**1.1**
Unemployment rate (a)				8.3	8.6	7.4	6.7	**7.9**	**7.7**	**7.4**
Compensation of employees / head				2.5	-1.1	1.3	1.4	**2.1**	**1.0**	**0.8**
Unit labour costs whole economy				1.8	-3.2	2.3	1.9	**3.9**	**-0.9**	**-0.2**
Real unit labour cost				0.2	-3.8	0.4	0.1	**2.4**	**-2.6**	**-1.9**
Saving rate of households (b)				7.9	6.9	7.3	8.6	**16.6**	**13.3**	**10.6**
GDP deflator				1.6	0.6	1.9	1.8	**1.5**	**1.7**	**1.7**
Harmonised index of consumer prices				1.7	0.8	1.2	1.1	**0.4**	**1.1**	**1.4**
Terms of trade goods				-0.5	-0.7	0.8	-0.9	**0.9**	**0.3**	**0.3**
Trade balance (goods) (c)				5.3	0.7	0.1	0.9	**0.1**	**0.5**	**0.7**
Current-account balance (c)				2.2	-0.8	-1.7	-0.2	**-1.5**	**-1.2**	**-1.7**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				2.3	-0.7	-1.7	-0.1	**-1.4**	**-1.1**	**-1.6**
General government balance (c)				0.7	-0.7	-0.9	-1.0	**-7.6**	**-4.8**	**-3.4**
Cyclically-adjusted budget balance (d)				1.1	-1.1	-1.5	-1.6	**-5.3**	**-3.5**	**-2.7**
Structural budget balance (d)				-	-1.1	-1.4	-1.7	**-5.3**	**-3.5**	**-2.7**
General government gross debt (c)				46.5	61.3	59.6	59.3	**69.8**	**71.8**	**72.5**

(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.