19. FINLAND

Economic activity in Finland is being severely affected as a result of the COVID-19 pandemic and the measures taken to contain it. Still, thanks to unprecedented fiscal support, the economy is expected to rebound in line with the gradual lifting of containment measures, although it is not expected to re-attain its 2019 level over the forecast horizon. Public finances will be impacted by the measures taken to counteract the crisis, with both the general government deficit and debt growing significantly in 2020.

Economic growth to plunge

The economy ended last year on a weak footing. GDP growth unexpectedly decreased in the fourth quarter of 2019, bringing the annual GDP growth rate down to 1.0%, after 1.6% in 2018. Growth in 2019 was strongly driven by exports and private consumption, while investment spending contracted.

As a consequence of measures taken to contain the COVID-19 pandemic, GDP is forecast to contract sharply by about 6¼% in 2020, before rebounding 3¾% in 2021. As the main outbreak started later in Finland, the main blow is set for the second quarter of this year, followed by a rebound in the third quarter once the bulk of the containment measures are lifted.

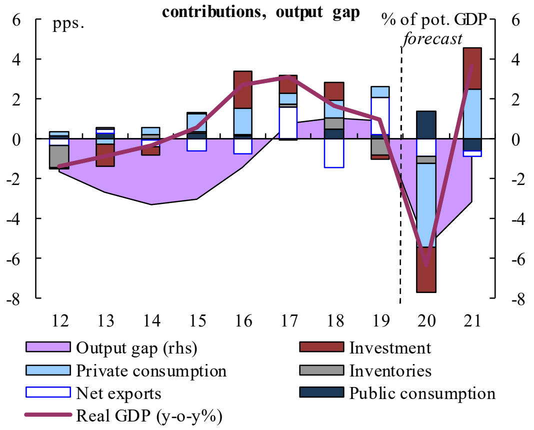
All demand components, except government consumption, are expected to fall in 2020. High uncertainties and rising unemployment is set to weigh on private consumption. Even households whose purchasing power is unaffected by the crisis are expected to increase precautionary savings, delaying discretionary spending. This effect is expected to slowly fade with the end of the outbreak, and private consumption should recover progressively in 2021. A strong, temporary increase in government spending and exceptional liquidity measures should soften the direct impact of the crisis during the most critical period.

Investment spending is set to fall sharply in 2020 due to uncertainties causing weak demand in both the housing market and the business sector. Public investment is expected to provide some stimulus over the crisis period, while a recovery in private investment is likely to take hold only in 2021, as surviving businesses get a clearer view of the demand outlook. Faltering external demand is initially set to bring exports down much more than imports. Exports are forecast to improve in line with the expected recovery in Finland's main trading partners, but only gradually. Consequently, net exports' contribution to GDP is forecast to turn negative. Falling productivity is likely to hit Finland's cost competitiveness.

Grim employment outlook and low inflation

The labour market, already stagnant prior to the crisis, is set to be strongly affected. Because of falling output, unemployment is set to rise markedly in mid-2020. As activity resumes, unemployment should start to fall, but remain at a higher level in 2021 than in 2019. Wages are expected to rise due to the wage bargaining agreements reached before the crisis hit, while unit labour costs are projected to rise even faster due to labour hoarding. Headline inflation is forecast to be even lower than in 2019, followed by a minor rise in 2021. The decrease in consumer demand and sharp declines in energy and commodity prices are set to outweigh the expected rise in food prices.

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



This forecast scenario is subject to downside risks mostly relating to the length and severity of the pandemic-induced domestic and foreign demand shock. A more prolonged crisis in some leisure-related activities, such as the cruise ship industry, could cause a sizeable additional shock. At the same time, Finland's main trading partners might enter recovery period more quickly than expected.

Commensurate fiscal response

Actions taken to contain the spread of the virus are set to take a heavy toll on public finances. This additional burden weighs on the 2020 budget that frontloaded expenditure related to implementation of the 2019-2023 government programme.

The fiscal cost of the pandemic relief measures adopted by mid-April 2020 amounts to about 1.7% of GDP. Most of them consist of subsidies for the most affected sectors of the economy, helping SMEs and the self-employed get through the lockdown period. The government also decided on the temporary lowering of pension contributions for private employers. The measures cover also the direct costs of dealing with the epidemic such as spending on healthcare and medical supplies, public order and border protection. The indirect impact of the crisis reflects the functioning of automatic stabilisers and stems from lower government revenues due to the economic recession and higher expenditure on social security. The overall impact of the crisis is currently projected to deteriorate the general government balance to -7½% of GDP in 2020.

Although a robust economic recovery is expected in 2021, government revenues are expected to remain below their pre-crisis forecasts, based on a no-policy-change assumption. The bulk of expenditure related to the pandemic has been temporary in nature and is expected to be fully cancelled by the end of 2020, but some business support programmes are set to continue in the following years. Furthermore, the government is expected to incur some losses from the loans and investments it has guaranteed. Consequently, the general government balance projected for 2021 is -3½% of GDP.

The public debt-to-GDP ratio is expected to jump by around 10 pps. in 2020. This is the result of the high deficit of the general government as well as some measures not recorded in the deficit, such as tax deferrals and investments in private companies. In 2021, the debt ratio is projected to marginally further deteriorate.

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		233.6	100.0	1.5	2.7	3.1	1.6	**1.0**	**-6.3**	**3.7**
Private Consumption		123.7	53.0	2.0	2.4	1.0	1.7	**1.0**	**-7.9**	**4.9**
Public Consumption		53.4	22.9	1.2	0.7	-0.2	2.1	**0.9**	**6.0**	**-2.4**
Gross fixed capital formation		55.8	23.9	0.9	8.8	4.0	3.7	**-0.8**	**-9.8**	**9.1**
of which: equipment		12.4	5.3	0.8	13.4	6.4	-0.3	**0.2**	**-17.4**	**15.3**
Exports (goods and services)		90.2	38.6	2.8	3.7	8.8	1.7	**7.2**	**-10.7**	**7.3**
Imports (goods and services)		92.5	39.6	3.7	5.8	4.1	5.5	**2.2**	**-8.6**	**8.1**
GNI (GDP deflator)		234.4	100.4	1.6	2.2	2.6	2.0	**0.4**	**-6.4**	**3.7**
Contribution to GDP growth:	Domestic demand			1.5	3.3	1.4	2.3	**0.5**	**-5.1**	**4.0**
	Inventories			0.1	0.1	0.1	0.5	**-0.8**	**-0.4**	**0.0**
	Net exports			-0.1	-0.8	1.6	-1.4	**1.9**	**-0.9**	**-0.3**
Employment				0.7	0.5	1.0	2.5	**1.0**	**-2.5**	**1.1**
Unemployment rate (a)				8.4	8.8	8.6	7.4	**6.7**	**8.3**	**7.7**
Compensation of employees / head				2.7	0.9	-1.1	1.3	**1.6**	**2.1**	**2.8**
Unit labour costs whole economy				1.9	-1.3	-3.1	2.2	**1.6**	**6.3**	**0.2**
Real unit labour cost				0.2	-1.5	-3.7	0.4	**-0.2**	**4.5**	**-1.6**
Saving rate of households (b)				8.1	6.3	6.7	7.3	**8.1**	**18.3**	**14.2**
GDP deflator				1.7	0.2	0.7	1.8	**1.8**	**1.8**	**1.8**
Harmonised index of consumer prices				1.8	0.4	0.8	1.2	**1.1**	**0.5**	**1.4**
Terms of trade goods				-0.7	0.0	-0.9	0.9	**-0.9**	**1.4**	**0.3**
Trade balance (goods) (c)				6.1	0.0	0.7	0.1	**1.1**	**0.4**	**0.4**
Current-account balance (c)				2.8	-1.9	-0.8	-1.6	**-0.8**	**-1.3**	**-1.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				2.9	-1.9	-0.7	-1.6	**-0.7**	**-1.2**	**-1.4**
General government balance (c)				1.3	-1.7	-0.7	-0.9	**-1.1**	**-7.4**	**-3.4**
Cyclically-adjusted budget balance (d)				1.3	-0.9	-1.1	-1.5	**-1.6**	**-4.2**	**-1.6**
Structural budget balance (d)				-	-0.9	-1.1	-1.4	**-1.7**	**-4.2**	**-1.6**
General government gross debt (c)				45.2	63.2	61.3	59.6	**59.4**	**69.4**	**69.6**

(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.