19. FINLAND

Thanks to a strong GDP rebound in the second quarter of this year and a relatively mild economic contraction last year, economic activity has already reached the pre-crisis level in mid-2021. Economic growth is expected to continue over the forecast horizon, driven by private consumption and investment, favourably impacting the labour market. Public finances are also improving on the back of the ongoing recovery.

Recovery already in 2021

Finland's economy grew strongly (2.2% quarter-on-quarter) in the second quarter of 2021, after a weak first quarter. All demand components contributed to the result, with private consumption clearly leading the pack. This is expected to continue, albeit at a slower pace, with GDP surpassing its 2019-level by the third quarter of this year. Early high-frequency indicators point to improved consumer and business outlook for the second half of the year. The vaccination rate is relatively high, providing another reassurance for economic activity. Following a contraction of 2.9% in 2020, annual GDP is forecast to grow by 3.4% in 2021. While the economy has recovered overall, the worst-hit sectors still need time to recover fully, relying heavily on further normalisation in the external environment.

Domestic demand to drive solid growth ahead

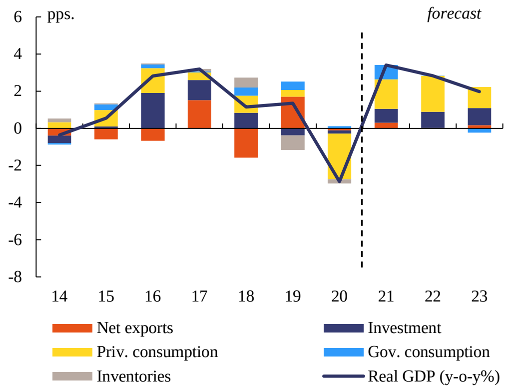
GDP is forecast to grow by 2.8% in 2022 when the growth momentum is expected to take full effect, with a normalisation of the services sector. In 2023 the economic cycle is projected to normalise towards the long-term potential GDP growth rate (1.2 - 1.4%), with an estimated 2.0% growth.

Domestic demand is set to drive GDP growth in the medium term. Private consumption is forecast to dominate, as consumers readjust their consumption patterns and employment and wages grow. In addition, the accumulated savings during the crisis and favourable financing conditions should further support private consumption. On the other hand, public consumption, while strong during the peak of the crisis and also in 2021, is expected to stabilise and to subsequently gradually decline, as the need for the extra spending dissipates and economy grows.

Investment growth is forecast to gather pace on the back of strengthening business confidence, rekindled interest in the residential property, low interest rates and buoyant demand. This is set to be further strengthened by public investment plans, which will be partly financed by the Recovery and Resilience Facility (RRF), especially in the area of the green transition. Exports are forecast to grow in line with the global recovery, maintaining Finland's export market share.

The risks to the outlook are balanced. On the downside, apart from lingering pandemic risks, possible supply bottlenecks and a possible strong acceleration in prices could hamper private consumption and hence growth prospects. On the upside, growth could be even stronger if consumers markedly decrease their accumulated savings.

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



Rising employment and the return of inflation

Employment is expected to continue growing towards pre-pandemic levels, with crisis-hit sectors expected to catch up substantially during 2022. Wages are expected to rise moderately in 2022 and 2023.

Consumer prices are rising strongly in 2021 primarily because of a strong upswing in energy prices. This factor is expected to fade away in 2022, but the recovery in the services' sector, general demand pressures and tightening labour market are set to keep inflation over the forecast horizon higher than in recent years.

The deficit gradually returns to the pre-crisis trend

In 2021, the general government deficit is forecast to narrow to 3¾% of GDP on the back of the strong economic rebound and the reduction of COVID-19 support measures. The strong recovery of output, employment and domestic demand is expected to boost tax and social contribution revenues, while fewer lay-offs will ease the burden of social expenditure. Fiscal measures related to the pandemic are projected to amount to 1¾% of GDP, consisting mainly of temporary health-related expenditure and support measures for companies.

In 2022, economic growth, recovery on the labour market and the planned termination of the pandemic-related measures are expected to lead to a further improvement in public finances. The general government deficit is projected to decline to close to 2½% of GDP. This trend is forecast to continue also in 2023. The planned withdrawal of temporary fiscal measures stemming from the government's original programme adopted in 2019 it set to help improve the balance in 2023 by about ½% of GDP. In 2023, the General Government deficit is forecast to shrink to 1% of GDP, close to the pre-pandemic level. The RRF-financed expenditure is projected to support the economic growth in 2022 and 2023 with capital investments and spending on human capital.

The public debt ratio, which increased some 10 pps. during the pandemic, is expected to stabilise. It is forecast to reach 71% of GDP in 2021 and remain at this level through 2023.

Table II.19.1:

Main features of country forecast - FINLAND

	2020			Annual percentage change						
	bn EUR	Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP		236.2	100.0	1.3	1.1	1.3	-2.9	**3.4**	**2.8**	**2.0**
Private Consumption		120.7	51.1	1.9	1.7	0.7	-4.7	**3.1**	**3.8**	**2.2**
Public Consumption		57.7	24.4	1.0	2.0	2.0	0.5	**3.2**	**0.0**	**-1.0**
Gross fixed capital formation		57.1	24.2	1.2	3.6	-1.6	-0.7	**3.1**	**3.6**	**3.8**
of which: equipment		12.0	5.1	1.8	-1.7	-4.9	-0.6	**9.2**	**7.0**	**8.5**
Exports (goods and services)		85.5	36.2	2.5	1.5	6.8	-6.8	**8.1**	**6.6**	**4.7**
Imports (goods and services)		84.7	35.8	3.4	5.7	2.3	-6.5	**7.3**	**6.6**	**4.4**
GNI (GDP deflator)		240.2	101.7	1.3	1.5	1.4	-1.7	**3.5**	**2.9**	**2.1**
Contribution to GDP growth:	Domestic demand			1.5	2.2	0.4	-2.5	**3.1**	**2.8**	**1.8**
	Inventories			0.1	0.5	-0.8	-0.2	**0.0**	**0.0**	**0.0**
	Net exports			-0.2	-1.6	1.7	-0.1	**0.3**	**0.0**	**0.2**
Employment				0.6	2.5	1.8	-2.1	**2.0**	**1.5**	**0.7**
Unemployment rate (a)				8.3	7.4	6.7	7.8	**7.7**	**6.9**	**6.5**
Compensation of employees / head				2.2	1.3	1.3	0.8	**1.9**	**2.6**	**2.8**
Unit labour costs whole economy				1.4	2.6	1.7	1.6	**0.5**	**1.2**	**1.5**
Real unit labour cost				0.0	0.6	0.2	0.3	**-1.4**	**-0.8**	**-0.8**
Saving rate of households (b)				7.8	7.2	8.7	12.8	**9.7**	**7.9**	**7.0**
GDP deflator				1.5	2.0	1.5	1.3	**1.9**	**2.0**	**2.3**
Harmonised index of consumer prices				1.6	1.2	1.1	0.4	**1.8**	**1.9**	**1.9**
Terms of trade goods				-0.7	0.8	-0.9	1.4	**-0.2**	**-0.1**	**0.1**
Trade balance (goods) (c)				4.6	0.1	1.0	1.2	**1.8**	**2.0**	**2.2**
Current-account balance (c)				1.6	-1.8	-0.3	0.8	**1.2**	**1.2**	**1.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				1.7	-1.8	-0.2	0.9	**1.3**	**1.3**	**1.6**
General government balance (c)				0.4	-0.9	-0.9	-5.5	**-3.8**	**-2.4**	**-1.1**
Cyclically-adjusted budget balance (d)				0.8	-1.1	-1.1	-3.3	**-2.8**	**-2.0**	**-1.1**
Structural budget balance (d)				-1.0	-1.0	-1.2	-3.3	**-2.8**	**-2.0**	**-1.1**
General government gross debt (c)				47.8	59.8	59.5	69.5	**71.2**	**71.2**	**71.0**

(a) Eurostat definition. (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.