Rabobank

Country report **FINLAND**

Summary

The Finnish economy recovered strongly from the deep 2009 recession. Due to headwinds in the external environment, the growth outlook for 2012 and 2013 is weak. That said, the position of Finland remains robust due to a financially very healthy government, a competitive business sector and a stable banking system.

Things to watch:

- Recovery of the open economy is highly affected by the European debt crisis
- The current debate on the pension reform, which is needed due to rapid aging.
- Success of the ICT sector - especially Nokia – in regaining its leading status.

Author: **Michiel Verduijn**
International Macro Economic Research
Economic Research Department
Rabobank Nederland

Contact details: P.O.Box 17100, 3500 HG Utrecht, The Netherlands
+31-(0)30-21-30522
M.P.Verduijn@rn.rabobank.nl

Finland

National facts	
Type of government	Republic
Capital	Helsinki
Surface area (thousand sq km)	338
Population (millions)	5.3
Main languages	Finnish (91.2%)
	Swedish (5.5%)
Main religions	Lutheran (82.5%)
Head of State (president)	Sauli Väinämö Niinistö
Head of Government (prime-minister)	Jyrki Katainen
Monetary unit	EUR

Economy		2011
Economic size	*bn USD*	*% world total*
Nominal GDP	266	0.39
Nominal GDP at PPP	206	0.26
Export value of goods and services	106	0.49
IMF quotum (in mln SDR)	1264	0.58
Economic structure	*2011*	*5-year av.*
Real GDP growth	2.9	1.1
Agriculture (% of GDP)	3	3
Industry (% of GDP)	28	31
Services (% of GDP)	69	66
Standards of living	*USD*	*% world av.*
Nominal GDP per head	49601	460
Nominal GDP per head at PPP	38341	311
Real GDP per head	39217	483

Social and governance indicators	rank / total
Human Development Index (rank)	22 / 187
Ease of Doing Business Index (rank)	11 / 183
Index of Economic Freedom (rank)	17 / 179
Corruption Perceptions Index (rank)	2 / 183
Press Freedom Index (rank)	1 / 178
Gini index (income distribution)	26.9
Population below $1.25 per day (PPP)	n.a.

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
Germany	11	Russia	18
Sweden	10	Germany	15
Russia	8	Sweden	15
US	7	Netherlands	8

Main export products (%)	
Machinery and transport equipment	32
Chemicals and related products, n.e.s.	8
Mineral fuels, lubricants, and related materials	8
Raw materials	7
Main import products (%)	
Machinery and transport equipment	31
Mineral fuels, lubricants, and related materials	19
Chemicals and related products, n.e.s.	11
Food, drinks and tobacco	9
Openness of the economy	
Export value of G&S (% of GDP)	40
Import value of G&S (% of GDP)	40
Inward FDI (% of GDP)	2.7

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Full report:

The export-dependent Finnish economy was hit extremely hard by the global recession and activity fell by 8.4% y-o-y in 2009. Whilst the current level of GDP is already 2.5% above its pre-crisis level, the level of exports is still more than 20% smaller than mid 2008. The plummeting of exports does not only reflect the large dependency on growth of world trade, but also the poor performance of the manufacturing part of the Finnish ICT sector (and especially Nokia) which represented 6% of total value added in the economy in 2007 and only 3% in 2011. The economic recovery was mainly driven by consumer expenditure as households benefited from generous pay raises, many of them achieved by bargaining in previous years. The unemployment rate decreased from a peak of 8.7% end 2009 to 7.4 in February 2012.

The recovery came to a sudden halt end 2011 as the European debt crisis affected confidence levels of both Finland and its main export partners. Although Finnish sentiment indicators improved again since the start of the year, we believe domestic demand will grow at a much weaker pace in 2012 than in previous years. Consumer confidence is still considerably below its long term average, while muted nominal wage growth in the coming years will weigh on real disposable income. However, we believe there are upside risks to the EIU forecast (a GDP contraction of -0.1% in 2012), especially if world trade is able to gather some steam during the year. The Finnish Finance minister recently increased his GDP growth projection from 0.4% to 0.8% in 2012.

Due to the active role of the government during the deep recession, the budget balance deteriorated from a surplus of 5.3%-GDP in 2007 to a deficit of 2.5%-GDP in both 2009 and 2010. This looks worrying, but it should be noted that the government of Finland is financially one of the healthiest in Europe. Since the Nordic banking crisis (early 1990's), public finances have improved substantially with budget surpluses in almost every single year since then. Besides that, the level of gross public debt is substantially smaller than the public assets, predominantly social security funds, which results in net public assets of 65%-GDP in 2010.

The new six-party coalition (elections were held in June 2011) is determined to stick to Finland's prudent fiscal policy. The coalition recently reached agreement on a 2013-2016 budgetary framework which consists of modest budget cuts (€ 2.7 billion, 1.5%-BBP). Although the austerity measures are not strong enough to return to a budget surplus in the next couple of years, we believe the government should not aim for a surplus in the short term given the weak economic momentum and ample fiscal space. The focus of the government should be on the long term fiscal challenges, of which the rapid aging of the population is the most important. Although the expected rise of the old-age dependency rate until 2050 is only moderate from an OECD perspective, the increase until 2035 is relatively fast. With the current low effective retirement age (61.8 years for men, 61.4 for women in 2009) and only average labor participation rate (75.4% in 2010) a pension reform is inevitable to enhance potential economic growth and reduce the future pressure on public finances. The coalition intends to reform the pension system in the short term, but at this stage it is unclear whether the necessary agreement will be reached. Since the start of the debt crisis, Finnish government bonds have reaped the benefits of safe have flows with yields comparable to Dutch government bonds.

In contrast to the healthy public finances, the private sector of Finland has a relatively large net debt position (-59%-GDP in 2010). It should be noted that this net debt position has been brought down gradually since the Nordic banking crisis, helped by positive private sector contributions to the current account in almost every single year. Both the public and – in almost every year - the private sector contributed positively to these surpluses. However, since the crisis the surplus waned due to the large drop in exports and in the coming years the current account is expected to be around balance. Despite high wage growth in the decade before the crisis, unit labor costs developed positively amid high productivity growth in the booming ICT sector. In 2007, Nokia represented 3.2% of total added value of the economy (and 31% of total R&D), in 2009 Nokia's added value was only 1.5%. Although future developments in the ICT sector are difficult to predict, it is reasonable to expect that a further decline of the sector will have adverse effects on Finnish employment and productivity growth. In any case, a policy focus on competitiveness remains sensible to protect the high ranking (4^{th}) in the Global Competitiveness Index 2011-2012. In this light, the agreement between employers and labor unions to let nominal wages rise only modestly until 2013 is encouraging.

The Finnish banking sector is relatively well capitalized and has little exposures to high-risk countries. Although also Finnish banks will not be immune to increased stress in the European banking sector, we believe there is no reason for particular concern.

Finland

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)	5.3	0.3	-8.4	3.7	2.9	-0.1	1.1
Consumer prices (average % change pa)	1.6	3.9	1.6	1.7	3.3	3.0	2.5
Current account balance (% of GDP)	4.3	2.5	1.9	1.5	-0.7	-1.0	-0.5
Economic growth							
GDP (% real change pa)	5.3	0.3	-8.4	3.7	2.9	-0.1	1.1
Gross fixed investment (% real change pa)	10.7	-0.6	-13.3	2.6	4.6	1.0	2.0
Private consumption (real % change pa)	3.5	1.9	-2.7	3.0	3.3	1.1	1.2
Government consumption (% real change pa)	1.1	1.9	1.1	0.2	0.8	0.2	0.4
Exports of G&S (% real change pa)	8.2	5.8	-21.5	7.8	-0.8	-1.3	3.1
Imports of G&S (% real change pa)	7.0	7.5	-16.4	7.7	0.1	-0.2	2.9
Economic policy							
Budget balance (% of GDP)	5.3	4.3	-2.5	-2.5	-0.5	-1.2	-0.9
Public debt (% of GDP)	35	34	44	48	49	49	50
Money market interest rate (%)	4.0	3.8	0.7	0.5	0.8	1.0	1.2
M2 growth (% change pa)	14	12	1	7	6	6	4
Consumer prices (average % change pa)	1.6	3.9	1.6	1.7	3.3	3.0	2.5
Exchange rate LCU to USD (average)	3.7	3.7	3.7	3.7	3.7	n.a.	n.a.
Recorded unemployment (%)	6.9	6.4	8.2	8.4	7.8	7.6	8.0
Balance of payments (mln USD)							
Current account balance	10650	6883	4560	3496	-1900	-2700	-1400
Trade balance	12518	9985	4226	3394	-1600	-5500	-4700
Export value of goods	90112	96899	62841	69628	78800	74200	77500
Import value of goods	77594	86914	58615	66234	80400	79640	82230
Services balance	640	1025	600	299	1300	2400	2200
Income balance	-642	-1837	2113	2522	1500	2800	3500
Transfer balance	-1935	-2372	-2353	-2201	-2300	-2400	-2400
Net direct investment flows	5462	-10728	-4488	-3575	-1727	-3890	-3630
External position (mln USD)							
International investment position	-73882	-25136	-2360	22003	n.a.	n.a.	n.a.
Total assets	559361	564475	649263	731962	n.a.	n.a.	n.a.
Total liabilities	633243	589611	651623	709959	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	5.1	3.7	1.8	1.4	-0.6	-2.1	-1.8
Current account balance (% of GDP)	4.3	2.5	1.9	1.5	-0.7	-1.0	-0.5
Inward FDI (% of GDP)	5.2	-0.8	0.2	3.0	2.7	2.7	3.1
International investment position (% of GDP)	-30.0	-9.2	-1.0	9.2	n.a.	n.a.	n.a.

Source: EIU