19. FINLAND

After a strong fall in 2020, economic activity is expected to recover robustly on the back of domestic demand. Employment and wage growth are set to remain supportive of private consumption. The impact of the crisis on the deficit of public finances now looks likely to be smaller than previously forecast.

Smaller-than-expected contraction in 2020

Finland's GDP fell by 2.8% in 2020. As in other countries, the downturn was most pronounced in contact-intensive service sectors, with accommodation and food services being the most affected. While the economy took a heavy hit, the fall was smaller than initially expected. After a sharp decline in the second quarter of 2020, GDP growth turned positive in the second half of the year. Containment measures remained broadly lax thanks to the relatively contained situation of the pandemic in the country, which in turn helped the economy to recover. Private consumption suffered the most, followed by investment. Exports and imports fell equally, with exports partly aided by a delivery of one large cruise ship in December 2020. Government spending was a critical factor in cushioning the shock.

Domestic demand to drive robust growth ahead

GDP is forecast to grow by around 2¾% in both 2021 and 2022. The full effect of the long-awaited reopening of the services sector is expected to be delayed until the third quarter of 2021, which will in turn imply lower GDP growth in 2021 compared to the previous forecast and an increase in the carryover for 2022.

Domestic demand is expected to drive GDP growth over the forecast period. Private consumption is forecast to increase strongly, as consumer-facing activities open up and employment starts to recover. In addition, real disposable income growth, accumulated savings during the crisis and favourable financing conditions provide solid foundations for private consumption to flourish. Public consumption will remain strong in 2021 but its contribution to GDP is expected to turn negative in 2022 as the economic situation improves and the extra spending is rolled back. Investment, particularly in construction, already proved to be rather robust during the crisis and once business confidence in economic momentum is restored, investment is likely to gather pace. This will be aided by public investment plans which are expected to provide a temporary boost.

The expected pick-up in private consumption is likely to boost imports, but the impact on net exports is forecast to remain limited, as a parallel rise in external demand should boost exports.

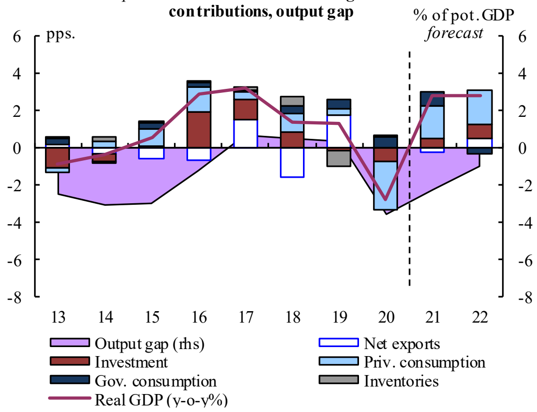
Labour market to recover gradually

Employment is expected to rise gradually by around 1% each year as the recovery gathers pace but employment growth is likely to remain more sluggish in sectors that were more affected by the crisis. Wages are expected to rise due to the wage bargaining agreements reached before the crisis hit.

Consumer price inflation remains muted

Owing to lower energy prices and in the absence of demand pressures, consumer prices increased only by 0.4% in 2020. In the short term, prices are expected to be temporarily boosted by rising energy prices, bringing the inflation rate above 1%. However, limited demand pressures are expected to keep inflation low over the forecast horizon.

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



Short-term outlook for public finances is better than expected

The general government deficit in 2020 is estimated at 5½% of GDP – significantly lower than the Commission's autumn forecast of 7½% of GDP - thanks to lower government expenditure and somewhat higher-than-expected revenues. The fiscal impact of temporary COVID-19-related measures accounted for about 3% of GDP.

In 2021, the general government deficit is forecast to narrow to 4½% of GDP, as the negative impact of the pandemic on public finances is expected to fade out. The economic recovery will increase government tax revenues while the termination of worker lay-offs will diminish the burden of social expenditure. On the other hand, fiscal measures related to the pandemic are forecast to amount to at least 1.5% of GDP. They include health-related expenditure on testing, vaccinations and research; continued support measures for businesses; temporary benefit schemes for the unemployed; as well as some investments, notably in the transport network and research & development.

In 2022, the expected normalisation of the health situation and the continued economic recovery should lead to a further improvement in public finances. The general government deficit is projected to decline close to 2% of GDP. Based on current information, the temporary measures related to the COVID-19 pandemic will have no significant impact on the deficit.

The forecast incorporates measures related to the implementation of the Recovery and Resilience Facility (RRF) in Finland. The planned RRF-financed expenditure is going to support the economic recovery in 2021 and 2022 with both capital investment and current spending on investment in human capital.

In 2020, the public debt ratio increased by 10 pps. to 69% of GDP, driven by a higher deficit and measures not recorded in the deficit, such as tax deferrals, loans and recapitalisations. In 2021, the debt ratio is projected to inch up to 71% of GDP, before decreasing again to 70% of GDP in 2022.

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	240.3	100.0	1.3	3.2	1.3	1.3	**-2.8**	**2.7**	**2.8**
Private Consumption	125.9	52.4	2.1	0.8	1.8	0.7	**-4.9**	**3.4**	**3.6**
Public Consumption	55.8	23.2	1.1	0.2	1.8	2.0	**2.3**	**3.2**	**-1.3**
Gross fixed capital formation	57.3	23.9	1.0	4.8	3.5	-0.9	**-3.1**	**2.1**	**3.4**
of which: equipment	12.1	5.0	1.6	9.4	-2.3	-4.0	**-9.1**	**3.4**	**6.5**
Exports (goods and services)	95.6	39.8	2.1	8.8	1.4	6.7	**-6.6**	**5.1**	**7.0**
Imports (goods and services)	95.2	39.6	3.2	4.3	5.6	2.2	**-6.6**	**5.9**	**5.8**
GNI (GDP deflator)	241.4	100.5	1.4	2.8	1.7	1.3	**-2.2**	**2.8**	**2.8**
Contribution to GDP growth: Domestic demand			1.5	1.5	2.2	0.6	**-2.8**	**3.0**	**2.3**
Inventories			0.0	0.1	0.5	-0.8	**0.1**	**0.0**	**0.0**
Net exports			-0.3	1.5	-1.6	1.7	**0.0**	**-0.3**	**0.4**
Employment			0.6	1.0	2.5	1.8	**-1.5**	**0.9**	**1.1**
Unemployment rate (a)			8.3	8.6	7.4	6.7	**7.8**	**7.6**	**7.2**
Compensation of employees / head			2.5	-1.1	1.3	1.3	**-0.1**	**2.1**	**2.0**
Unit labour costs whole economy			1.8	-3.2	2.5	1.8	**1.2**	**0.3**	**0.4**
Real unit labour cost			0.2	-3.9	0.5	0.3	**-0.4**	**-1.4**	**-1.3**
Saving rate of households (b)			7.9	6.9	7.3	8.7	**13.3**	**9.8**	**8.3**
GDP deflator			1.6	0.8	1.9	1.5	**1.7**	**1.7**	**1.7**
Harmonised index of consumer prices			1.7	0.8	1.2	1.1	**0.4**	**1.2**	**1.2**
Terms of trade goods			-0.5	-0.8	0.8	-0.9	**1.2**	**-0.1**	**0.2**
Trade balance (goods) (c)			5.3	0.7	0.1	1.0	**1.4**	**1.2**	**1.8**
Current-account balance (c)			2.2	-0.8	-1.8	-0.3	**0.3**	**0.0**	**0.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			2.3	-0.7	-1.8	-0.3	**0.4**	**0.1**	**0.6**
General government balance (c)			0.7	-0.7	-0.9	-0.9	**-5.4**	**-4.6**	**-2.1**
Cyclically-adjusted budget balance (d)			1.1	-1.0	-1.2	-1.1	**-3.4**	**-3.3**	**-1.5**
Structural budget balance (d)			-1.0	-1.0	-1.1	-1.2	**-3.4**	**-3.3**	**-1.5**
General government gross debt (c)			46.5	61.2	59.7	59.5	**69.2**	**71.0**	**70.1**

(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.