S&P Global
Ratings

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Full Analysis:

Finland

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This report does not constitute a rating action.

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Key Rating Factors

Institutional and economic profile

The economic rebound has firm traction, and we estimate Finnish economic output will exceed pre-pandemic levels already in 2021.

- We estimate that a broad-based economic recovery will push Finland's growth to 3.2% in 2021.
- The government's pandemic response measures have preserved productive capacity and shielded employment levels.
- Structural constraints continue to weigh on longer-term growth prospects.

Flexibility and performance profile

Finland's solid government balance sheet has allowed it to absorb the temporary, pandemic-induced fiscal slippage.

- We expect the government to gradually move forward with a fiscal consolidation agenda that stabilizes its net debt to GDP ratio around 30%.
- The large banking sector underpins high external financing requirements.
- We estimate that Finland's borrowing costs will remain at historical lows, thanks to low interest rates and European Central Bank (ECB) response measures.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that the deterioration of Finland's public finances will moderate through 2023 as COVID-19 fiscal stimulus measures are withdrawn, the economy rebounds, and the government embarks on a program of fiscal consolidation alongside the recovering economy.

Downside scenario

We could consider a negative rating action in the next two years if Finland's economic recovery is much weaker than expected, leading to a pronounced deterioration in the country's fiscal position.

Upside scenario

We could raise the long-term ratings if Finland's external performance structurally improves, combined with reform that significantly strengthens economic growth potential and secures stronger public finances.

Rationale

The Finnish economic rebound has found traction, and we expect output to surpass its pre-pandemic level before the year-end, because it has been growing at a 3% clip in 2021. The broad-based recovery is underpinned by returning demand as the economy has opened up with progressing vaccination schemes both at home and abroad, fueling Finland's manufacturing sector and its export order books and spurring business investments.

Although Finland's fiscal position has weakened, we consider the budgetary fallout as temporary and anticipate the government will embark on a gradual consolidation path in 2022 that stabilizes net general government debt of around 30% of GDP by 2023. We still consider this comparatively low, and it provides the country with some fiscal headroom.

We believe that the trajectory for Finland's economic growth and the sustainability of its public finances after 2023 will depend on the effectiveness of the government's measures to foster structural reforms that alleviate constraints from a shrinking employment pool and an aging population. Our base-case assumption implies the government will remain committed to incremental progress toward structural reform needs, especially in terms of the labor market.

Finland's high level of economic prosperity; its stable institutions; and the benefits of eurozone membership, including the high credibility of the ECB's monetary policy and access to deep capital markets, further support the ratings. In particular, Finland's debt-servicing costs stand at historical lows because government bond yields benefit from ECB purchasing programs.

Institutional and economic profile

We expect the Finnish economy to record a real growth rate of 3.2% in 2021 and return to pre-pandemic levels by the third quarter of 2021. In tandem with progressing vaccination schemes at home and abroad, economic activity has geared up with confidence indicators among businesses and households reaching high points over the summer. We expect that private consumption will increase meaningfully through 2021 and be a chief driver of the rebound. In our view, households have emerged from the pandemic financially unscathed, thanks to the comprehensive nature of income support systems and boosted by directed government-financed schemes, have sustained incomes, and kept unemployment in check. Moreover, a substantial overhang of household savings is set to vitalize private consumption when pandemic restrictions are fully lifted. Specifically, households recorded a savings rate at 5.7% of disposable incomes in 2020. This stands ready to be channeled into the economy, together with pre-pandemic accumulated savings of €9 billion.

We forecast these robust growth dynamics to extend into 2022 on the back of stronger exports, investments in machinery and construction, and dynamic private consumption. To date we have observed only minor interruption in Finnish industry from supply chain bottlenecks, such as the shortage of semiconductors over the first half of the year, and we do not expect such to emerge despite the high import content of Finnish exports. Our forecast remains sensitive, however, to the epidemiological situation with regard to possible emergence of unchecked virus variants that would require prolonged or extended containment measures.

For 2023-2024, we expect growth will recede to 1.4% because Finland's medium-term growth potential will be increasingly tested by structural constraints that include lackluster productivity growth amid a shrinking employment pool. Although we have observed a notable increase in employment over 2021 and forecast the employment level to approach 75% by year-end 2021, matching issues in the labor market are evident from a persisting 7% unemployment rate, despite high vacancy levels. We expect government reform activity will speed up to counter inefficiencies in the labor market. The government has ambitions to mitigate skills mismatches while initiating investments in infrastructure and research and development to counter these challenges and strengthen growth potential. We also foresee a substantial part of investment for the transition to green energy.

Finland’s reform momentum received a boost over the summer as the government navigated through parliament a longstanding major reform initiative in the social and health care sector--the SOTE reform. The SOTE reform is aimed to provide for a more efficient provision of health care services by transferring those services to counties, and to assist the sustainability of public finances, which, aside from the impact of COVID-19, are under structural pressure from an aging population. The reform will be implemented in stages with county elections due in 2022. The organization of services is planned to be fully transferred to counties on Jan. 1, 2023.

Flexibility and performance profile

We estimate that Finland's public deficit for 2021 will come in at 3.7% of GDP as fiscal support lingers to support the economic recovery. Our projection incorporates the direct fiscal measures and the operation of automatic stabilizers. As the pandemic gradually subsides, we anticipate the government will move its focus to fiscal consolidation. Even though we expect some additional expenditure will be required to implement the SOTE reform over 2022-2024, we estimate that government consolidation efforts will tighten the deficit toward 2% of GDP in 2023-2024, which will stabilize Finland's net general government debt at below 35% of GDP by 2024, which we consider a modest level in a global context.

On top of the direct fiscal measures, the central government guarantees authorizations worth about 4% of GDP as part of COVID-19 support packages to businesses. We understand the take-up under these arrangements has been limited, the exception being in aviation where airliner Finnair has received support from the government, which in its capacity as a 55% shareholder has extended €540 million in loan guarantees while administering support through a hybrid bond of €350 million and a capital injection of €300 million.

Finland's contingent liabilities, which are predominantly guarantees, are large at almost 30% of GDP. Of the guarantees, 60% relate to deliveries of Finnish cruise ships, a sector that has seen a postponement of orders in 2020. We do not see significant risks accumulating in the government's guaranteed exposures and consider fallout risks from nonfinancial guaranteed liabilities as modest.

We forecast Finland's net general government debt will GDP will reach 29% of GDP at year-end 2021 and stabilize below 35% in 2023. In calculating this metric, we deduct from gross debt not only the Finnish treasury's cash holdings, which increased to a substantial 3% of GDP at year-end 2020, and its minority ownership of publicly listed companies through the state-owned asset manager Solidium. But also, and more importantly, we deduct from gross debt approximately 30% of GDP in liquid assets held by the public sector's earnings-related pension funds. In addition, we factor in the benefits of the ECB's monetary policy, which we believe will keep the interest bill in check, allowing the Finnish government to weather the temporary shock without a lasting adverse impact on its credit metrics. While Finland's debt stock is rising, its debt-servicing cost stands at historical lows with government bonds enjoying negative yields through the 10-year maturity, which will contain the cost of its fiscal response to the pandemic.

We estimate Finland's current account reached a surplus of about 1% of GDP 2020 as dampened demand reduced imports, while exports benefitted from a late-year boost from the delivery of a cruise ship. In addition, the recurring deficit on the services balance reduced thanks to lower spending by Finns on overseas vacations, with the income balance similarly tightening because of lower income outflows from restrictions on banking sector dividends. We assess these factors as temporary or one-off and forecast Finland's current account to return to annual deficits through 2024 because increasing domestic consumption will generate imports and with income account outflows resuming on returning banking dividends.

Finland's external ratios continue to be dominated by financial institutions. Although the relocation of Nordea Bank to Finland in 2018 has affected the country's international investment position, with both assets and liabilities increasing significantly, these moved in tandem, leaving the net position largely unaffected. However, Nordea Bank's redomiciling has substantially increased the size of the banking sector to about 300% of Finland's GDP, compared with 250% previously. Although Nordea Bank is under the ECB's remit, its move to the Finnish market has prompted the Finnish Financial Supervisory Authority to upscale local supervision and regulatory activities to highlight the importance of continued close regional cooperation and preparedness for crises.

The financial sector's large cross-border exposures, including funding risk related to foreign-financed wholesale funding, are still the key risk. In particular, the economy's external short-term debt will remain well above 100% of current account receipts (CARs), and narrow net external debt will stay high at about 195% of CARs on average over 2021-2023. Still, if we consider Finland's net international investment position, the country's external profile looks much stronger, with external assets largely equal to external liabilities.

Housing market transactions have remained dynamic over the past year and Finnish house prices, in tandem with mortgage loan growth, have increased. We understand that the government is considering various means of containing overall household debt levels, among them a maximum home loan term and a debt-to-income limit, both endorsed by the central bank. Of note, although Finnish private sector credit has gradually increased on mortgage and consumer lending growth over the past decade, it remains moderate in a peer comparison, and households' wealth and a strong social safety net will support the private sector's repayment capacity. We expect Finnish banks' asset quality will weaken through 2021 as COVID-19 related policy measures gradually mature. However, we believe the banking sector's core profitability and superior capitalization will absorb this burden. We do not expect the banking sector will depart from its moderately conservative underwriting standards, given persistent low interest rates. For more information please see "Banking Industry Country Risk Assessment: Finland, " published Feb. 9, 2021 on RatingsDirect.

Republic of Finland--Selected Indicators

	2015	2016	2017	2018	2019	2020	2021bc	2022bc	2023bc	2024bc
Economic indicators (%)										
Nominal GDP (bil. EUR)	211.4	217.5	226.3	233.5	240.1	236.2	249.1	261.2	271.2	280.5
Nominal GDP (bil. $)	234.5	240.8	255.7	275.7	268.8	269.8	301.1	316.1	328.2	339.4
GDP per capita (000s $)	42.9	43.9	46.5	50.0	48.7	48.8	54.4	57.0	59.1	61.0
Real GDP growth	0.5	2.8	3.2	1.1	1.3	(2.9)	3.2	3.0	1.8	1.4
Real GDP per capita growth	0.2	2.5	2.9	1.0	1.3	(3.0)	3.0	2.8	1.6	1.2
Real investment growth	0.5	9.0	4.8	3.6	(1.6)	(0.7)	2.5	3.1	2.7	2.0
Investment/GDP	21.7	23.3	24.0	25.3	24.2	24.1	23.9	23.8	23.9	24.1
Savings/GDP	20.8	21.3	23.2	23.4	23.9	24.9	23.8	23.4	23.3	23.4
Exports/GDP	35.4	34.8	37.6	38.5	39.8	36.2	36.8	37.5	38.0	38.4
Real exports growth	0.4	3.9	8.8	1.5	6.8	(6.7)	5.0	5.0	3.5	2.5
Unemployment rate	9.4	8.8	8.6	7.4	6.7	7.8	7.7	7.0	6.7	6.5
External indicators (%)										
Current account balance/GDP	(0.9)	(2.0)	(0.8)	(1.9)	(0.3)	0.8	(0.1)	(0.4)	(0.6)	(0.6)
Current account balance/CARs	(2.2)	(4.7)	(1.8)	(4.0)	(0.6)	1.7	(0.2)	(0.9)	(1.3)	(1.4)
CARs/GDP	43.4	42.9	45.4	46.6	49.3	45.5	45.1	45.9	46.1	46.4
Trade balance/GDP	0.9	0.0	0.7	0.1	1.0	1.3	1.4	1.4	1.1	1.0
Net FDI/GDP	7.8	(6.5)	1.4	(4.9)	3.2	(1.5)	1.0	1.2	1.2	1.2
Net portfolio equity inflow/GDP	0.8	1.8	(0.8)	1.5	(3.0)	(1.2)	(1.0)	(1.0)	(1.0)	(1.0)
Gross external financing needs/CARs plus usable reserves	478.3	393.4	339.4	288.9	349.5	364.5	345.1	335.7	327.0	318.6
Narrow net external debt/CARs	210.6	224.1	248.8	220.0	205.4	224.3	207.8	194.5	185.3	177.3
Narrow net external debt/CAPs	206.2	214.1	244.5	211.6	204.1	228.1	207.4	192.9	182.9	175.0

Republic of Finland--Selected Indicators

Net external liabilities/CARs	(9.8)	(10.4)	(1.3)	14.1	(7.8)	(5.7)	(2.4)	(2.1)	(2.4)	(2.7)
Net external liabilities/CAPs	(9.6)	(9.9)	(1.2)	13.6	(7.7)	(5.8)	(2.4)	(2.0)	(2.4)	(2.7)
Short-term external debt by remaining maturity/CARs	426.3	327.0	268.2	208.6	276.1	300.1	279.2	262.9	250.8	240.2
Usable reserves/CAPs (months)	1.2	1.1	1.1	1.0	0.9	1.1	1.2	1.0	0.9	0.9
Usable reserves (Mil. $)	10,018.0	10,467.9	10,516.8	10,310.5	11,417.6	13,491.5	12,127.9	11,653.8	11,325.6	10,986.2
Fiscal indicators (general government %)										
Balance/GDP	(2.4)	(1.7)	(0.7)	(0.9)	(1.0)	(5.5)	(3.7)	(2.5)	(2.5)	(2.0)
Change in net debt/GDP	2.8	1.3	(1.8)	(0.3)	(1.1)	5.7	4.7	3.0	2.5	2.0
Primary balance/GDP	(1.3)	(0.6)	0.4	0.0	(0.1)	(4.8)	(3.3)	(2.0)	(1.8)	(1.2)
Revenue/GDP	54.1	54.0	53.0	52.6	52.3	51.5	52.0	53.0	53.0	53.0
Expenditures/GDP	56.5	55.7	53.6	53.4	53.2	57.0	55.7	55.5	55.5	55.0
Interest/revenues	2.1	2.0	1.9	1.7	1.6	1.3	0.9	1.0	1.3	1.6
Debt/GDP	62.0	61.5	59.5	58.1	57.9	67.9	71.2	70.9	70.8	70.5
Debt/revenues	114.6	114.1	112.2	110.5	110.7	131.9	136.9	133.8	133.6	132.9
Net debt/GDP	24.1	24.7	21.9	20.9	19.3	25.3	28.6	30.3	31.7	32.6
Liquid assets/GDP	37.9	36.9	37.6	37.2	38.6	42.7	42.6	40.6	39.1	37.8
Monetary indicators (%)										
CPI growth	(0.2)	0.4	0.8	1.2	1.1	0.4	1.9	1.5	1.7	1.7
GDP deflator growth	1.6	0.1	0.8	2.0	1.5	1.3	2.2	1.8	2.0	2.0
Exchange rate, year-end (EUR/$)	0.9	1.0	0.8	0.9	0.9	0.8	0.8	0.8	0.8	0.8
Banks' claims on resident non-gov't sector growth	0.9	1.3	2.8	4.6	4.5	4.3	4.0	4.5	4.5	4.5
Banks' claims on resident non-gov't sector/GDP	96.4	94.9	93.7	95.0	96.6	102.3	100.9	100.6	101.2	102.3
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(3.0)	(3.6)	(6.8)	6.3	(5.1)	(4.2)	N/A	N/A	N/A	N/A

Sources: Eurostat, Statistics Finland (Economic Indicators), Statistics Finland, Eurostat (External Indicators), Statistics Finland, the Bank of Finland (Fiscal Indicators), and the Bank of Finland, International Monetary Fund (Monetary Indicators).

Adjustments: Government debt adjusted by excluding guarantees on debt issued by EFSF.

Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A- Not applicable. EUR--euro. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	2	Generally strong track record of policies that deliver sustainable public finances and balanced economic growth. Unbiased enforcement of contracts and respect for rule of law with generally effective checks and balances between institutions. Finland is one of the most cohesive civil societies, as shown through high social inclusion, degree of social order, and capacity of political institutions to respond to societal priorities. However, coordination requirements at the level of the Economic and Monetary Union may hinder timely policy responsiveness.
Economic assessment	1	Based on GDP per capita (US$) and growth trends as per Selected Indicators in Table 1.
External assessment	4	Based on narrow net external debt/CARs as per Selected Indicators in Table 1.
		The sovereign has external short-term debt by remaining maturity that generally exceeds 100% of CARs, as per Selected Indicators in Table 1.
		The sovereign's net international investment position is more favorable than the narrow net external debt position by over 100% of CARs, as per Selected Indicators in Table 1.
Fiscal assessment: flexibility and performance	2	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1 excluding the exceptional deviation from the fiscal package of emergency measures.
		The sovereign has large liquid assets relative to GDP as per Selected Indicators in Table 1.
Fiscal assessment: debt burden	2	Based on net general government debt (% of GDP) and general government interest expenditure (% of general government revenue) as per Selected Indicators in Table 1.
		Nonresidents hold over 60% of government commercial debt.
Monetary assessment	2	Finland is a member of the Economic and Monetary Union. In the context of our monetary assessment, we consider the euro to be a reserve currency.
		The European Central Bank has an established track record in monetary authority independence with clear objectives and a wide array of policy instruments, including nonconventional tools. The consumer price index is low and in line with that of its trading partners.
Indicative rating	aa+	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	None
Sovereign credit rating		
Foreign currency	AA+	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt
Local currency	AA+	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Banking Industry Country Risk Assessment Update: August 2021, Aug. 24, 2021
- Sovereign Ratings List, Aug. 17, 2021
- Sovereign Ratings History, Aug. 17, 2021
- Sovereign Ratings Score Snapshot, Aug. 3, 2021
- Sovereign Risk Indicators, July 12, 2021; a free interactive version is available at http://www.spratings.com/sri
- European Economic Snapshots: The Economy Is Responding Quickly To The Grand Reopening, July 9, 2021
- The ECB's New Strategy Signals Smooth Tapering And Cautious Greening Ahead, July 9, 2021
- European Developed Sovereign Rating Trends Midyear 2021, June 29, 2021
- Economic Outlook Europe Q3 2021: The Grand Reopening, June 24, 2021
- Next Generation EU Will Shift European Growth Into A Higher Gear, April 27, 2021
- Default, Transition and Recovery: 2020 Annual Sovereign Default And Rating Transition Study, April 12, 2021
- Stress Scenario: The Sovereigns Most Vulnerable To A COVID-19-Related Slowdown In Tourism, March 17, 2020
- Sovereign Debt 2021: Global Borrowing Will Stay High To Spur Economic Recovery, March 1, 2021
- Sovereign Debt 2021: Developed EMEA's Commercial Borrowing Could Reach $1.4 Trillion, March 1, 2021