S&P Global
Ratings

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# Finland

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This report does not constitute a rating action.

## Credit Highlights

### Overview

| Institutional and economic profile | Flexibility and performance profile |
|---|---|
| Finnish economic output exceeded pre-pandemic levels in 2021. | Finland's solid government balance sheet has allowed it to absorb the temporary, pandemic-induced fiscal slippage. |
| --We expect the Finnish economy to expand by 2.8% in 2022. | --We expect the government to gradually proceed with a fiscal consolidation agenda that stabilizes its net debt to GDP ratio around 30% |
| --The government's pandemic response measures have preserved productive capacity and shielded employment levels. | --The large banking sector underpins high external financing requirements. |
| --Structural constraints continue to weigh on long-term growth prospects. | --We expect inflation to average 2.5% in 2022 up from 0,4% in 2020, due to supply chain disruptions, component shortages and high raw material prices. |

**We expect Finnish economic output to continue its broad-based rebound in 2022, expanding by 2.8% and supported by private consumption and net exports.** We believe second-round effects from Russia's military intervention in Ukraine could impair overall demand from Finnish trading partners, representing risks to our forecast.

**We view the notable widening of  Finland's budget deficit in 2020 as temporary.** The deficit narrowed sharply in 2021 and we believe the government has embarked on a gradual consolidation path and that net general government debt will stabilize around 30% of GDP by 2023. We still consider this a comparatively low debt burden, providing the country with some fiscal headroom.

**The trajectory for Finland's economic growth and the sustainability of its public finances 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.

# 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that the deterioration of Finland's public finances will moderate through 2023 as COVID-19 fiscal stimulus measures are withdrawn, the economy rebounds, and the government embarks on a program of fiscal consolidation alongside the recovering economy.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

**Institutional and economic profile: Solid near-term growth, long-term challenges**

We expect the economy to grow by 2.8% in real terms in 2022, followed by a slowdown towards Finland's potential growth rate of 1.5% in 2023-2025. We expect that private consumption will be the chief driver of Finnish economic activity in 2022. In our view, households have largely emerged from the pandemic financially unscathed, thanks to the comprehensive nature of income support systems and boosted by government-financed schemes, incomes have been sustained, and unemployment kept in check. On this note, a substantial overhang of household savings looks set to support private consumption in 2022 and beyond.

Finland's near-term growth dynamics appear solid as high vaccine rates are likely to allow authorities to lift its remaining restrictions in early March. As COVID-19's influence on economic activity wanes, geopolitical risks overtake the pandemic as the chief constraint to near-term economic expansion. We observe that about 5% of Finnish exports are to Russia, which is under comprehensive international sanctions in response to its military intervention in Ukraine. Although Finland's trade with Russia stands somewhat higher than the EU average, we believe the more pertinent transmission would be from second-round effects as the conflict risks dampening overall demand across the European continent.

For 2023-2025, we expect growth will gradually reduce toward Finland's potential growth rate of 1.5% as its medium-term growth potential will be increasingly tested by structural constraints. These include lackluster productivity growth amid a shrinking employment pool. We have observed a notable increase in employment over 2021, reaching 73.5% of the working age population in December. We forecast the employment level will inch upward but more slowly over 2022 as skills mismatches in the labor market become more evident, and the labor market tightens. We expect unemployment to remain around 7%, 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 investment 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. For this purpose, Finland has requested €2.1 billion (1% of GDP) in grants under the Recovery and Resilience Facility, whereby the majority will support the green transition and digital transformation projects.

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 at providing 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. County elections were held in January 2022 which established the political leadership of these administrative entities. The organization of services is planned to be fully transferred to counties on Jan. 1, 2023.

**Flexibility and performance profile: A low net debt position and benefits of eurozone membership, including access to deep capital markets, give flexibility to absorb shocks**

We estimate Finland's public deficit for 2022 at 2.3% of GDP, down from 2.8% on account of the phasing out of COVID-19-related support measures. Although we observe disagreement and growing tensions within the government coalition with regard to the stringency of budgetary expenditure ceilings, we anticipate it will increasingly shift its focus to fiscal consolidation over 2023-2024. We expect some additional expenditure to implement the SOTE reform over 2022-2024 and estimate that government consolidation efforts will tighten the deficit toward 2% of GDP in 2023-2024. This will position Finland's net general government debt at about 30% of GDP by 2024, which we consider a modest level in a global context.

In assessing Finland’s net general government debt, we deduct from gross debt not only the Finnish treasury's cash holdings, which stand at about 3% of GDP, 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 European Central Bank's monetary policy, which we believe will keep the interest bill in check. While Finland's debt stock is rising, its debt-servicing cost stands at historical lows, which will contain the cost of its fiscal response to the pandemic.

We expect Finnish inflation to average 2.5% through 2022, up from 0.4% in 2020 on account of supply chain disruptions, component shortages, and high raw material prices. The elevated prices pressures might give rise to stronger demand for wage increases as key wage negotiation rounds are conducted over 2022.

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 saw postponed orders in 2020 and including meaningful provisions for losses at Finnvera, the official Export Credit Agency of Finland. The government has supported its majority-owned (58%) airliner Finnair through the pandemic and has extended €540 million in loan guarantees while administering support through a hybrid bond of €350 million and a capital injection of €300 million.

We estimate Finland's current account reached a surplus of about 1% of GDP for the second consecutive year in 2021 as dampened demand reduced imports, while exports again benefited from a boost from the sale of a cruise ship. In addition, the recurring deficit on the services balance decreased, 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 the country's current account to return to annual deficits through 2024 because increasing domestic consumption, alongside public and private investment, will generate imports; and with income account outflows resuming on returning banking dividends.

Financial institutions continue to dominate Finland's external ratios. Nordea Bank's redomiciling to Helsinki in 2018 substantially increased the size of the banking sector to about 300% of the country's GDP, compared with 250% previously. The financial sector's large cross-border exposures, including funding related to foreign-financed wholesale funding, are still the key risk. In particular, the economy's external near-term debt will remain well above 100% of current account receipts (CARs), and narrow net external debt will stay high at about 180% of CARs on average over 2022-2024. 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.

The housing market has remained strong over the past year and Finnish house prices, in tandem with mortgage loan growth, have increased. While the government is exploring measures to contain overall household debt levels, it has stopped short of moving forward with a debt-to-income limit, a macroprudential tool endorsed by the Finnish FSA and the Band of Finland. 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.

## Finland--Selected Indicators

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022bc | 2023bc | 2024bc | 2025bc |
|---|---|---|---|---|---|---|---|---|---|---|
| Economic indicators (%) | | | | | | | | | | |

## Finland--Selected Indicators

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Nominal GDP (bil. EUR) | 217.5 | 226.3 | 233.5 | 239.9 | 236.0 | 249.7 | 261.3 | 271.8 | 281.4 | 291.4 |
| Nominal GDP (bil. $) | 240.8 | 255.7 | 275.7 | 268.5 | 269.6 | 295.3 | 301.1 | 316.6 | 331.0 | 342.6 |
| GDP per capita (000s $) | 43.9 | 46.5 | 50.0 | 48.7 | 48.8 | 53.4 | 54.3 | 57.0 | 59.5 | 61.5 |
| Real GDP growth | 2.8 | 3.2 | 1.1 | 1.2 | (2.8) | 3.5 | 2.8 | 2.0 | 1.5 | 1.5 |
| Real GDP per capita growth | 2.5 | 2.9 | 1.0 | 1.1 | (2.9) | 3.3 | 2.6 | 1.8 | 1.3 | 1.3 |
| Real investment growth | 9.0 | 4.8 | 3.6 | (1.5) | (0.8) | 3.3 | 3.0 | 2.6 | 2.0 | 2.0 |
| Investment/GDP | 23.3 | 24.0 | 25.3 | 24.1 | 24.0 | 24.0 | 24.0 | 24.0 | 24.1 | 24.2 |
| Savings/GDP | 21.3 | 23.2 | 23.4 | 23.8 | 24.9 | 25.0 | 23.3 | 23.3 | 23.5 | 23.3 |
| Exports/GDP | 34.8 | 37.6 | 38.5 | 39.9 | 36.2 | 36.7 | 37.4 | 37.9 | 38.3 | 38.7 |
| Real exports growth | 3.9 | 8.8 | 1.5 | 6.7 | (6.8) | 5.0 | 4.8 | 3.6 | 2.5 | 2.5 |
| Unemployment rate | 8.8 | 8.6 | 7.4 | 6.7 | 7.8 | 7.7 | 7.0 | 6.7 | 6.5 | 6.5 |
| **External indicators (%)** | | | | | | | | | | |
| Current account balance/GDP | (2.0) | (0.8) | (1.9) | (0.3) | 0.8 | 0.9 | (0.7) | (0.7) | (0.6) | (0.9) |
| Current account balance/CARs | (4.7) | (1.8) | (4.0) | (0.6) | 1.9 | 2.0 | (1.4) | (1.5) | (1.3) | (1.8) |
| CARs/GDP | 42.9 | 45.4 | 46.6 | 49.4 | 45.1 | 48.0 | 49.1 | 49.5 | 49.7 | 50.0 |
| Trade balance/GDP | 0.0 | 0.7 | 0.1 | 1.0 | 1.2 | 1.1 | 1.0 | 0.7 | 0.6 | 0.5 |
| Net FDI/GDP | (6.5) | 1.3 | (4.9) | 3.2 | (2.7) | 2.8 | 1.2 | 1.2 | 1.2 | 1.2 |
| Net portfolio equity inflow/GDP | 1.8 | (0.8) | 1.5 | (3.0) | (1.3) | (1.1) | (1.0) | (1.0) | (1.0) | (1.0) |
| Gross external financing needs/CARs plus usable reserves | 393.4 | 339.4 | 288.9 | 349.6 | 366.6 | 362.2 | 356.4 | 329.1 | 319.8 | 309.6 |
| Narrow net external debt/CARs | 224.1 | 248.8 | 220.0 | 205.4 | 254.9 | 209.4 | 202.8 | 191.0 | 177.1 | 170.3 |
| Narrow net external debt/CAPs | 214.1 | 244.5 | 211.6 | 204.1 | 259.8 | 213.6 | 200.0 | 188.2 | 174.9 | 167.4 |
| Net external liabilities/CARs | (10.4) | (1.3) | 14.1 | (7.8) | 10.5 | 4.5 | 5.6 | 5.1 | 0.5 | 0.7 |
| Net external liabilities/CAPs | (9.9) | (1.2) | 13.6 | (7.7) | 10.7 | 4.6 | 5.5 | 5.1 | 0.5 | 0.6 |
| Short-term external debt by remaining maturity/CARs | 327.0 | 268.2 | 208.6 | 276.1 | 302.9 | 298.7 | 295.5 | 260.4 | 248.2 | 234.8 |
| Usable reserves/CAPs (months) | 1.1 | 1.1 | 1.0 | 0.9 | 1.2 | 1.2 | 1.3 | 1.2 | 1.1 | 1.0 |
| Usable reserves (Mil. $) | 10,467.9 | 10,516.8 | 10,310.5 | 11,417.6 | 13,491.5 | 16,758.5 | 15,594.0 | 15,277.4 | 14,946.5 | 14,603.8 |
| **Fiscal indicators (general government %)** | | | | | | | | | | |
| Balance/GDP | (1.7) | (0.7) | (0.9) | (1.0) | (5.6) | (2.8) | (2.3) | (2.0) | (1.7) | (1.6) |
| Change in net debt/GDP | 1.3 | (1.8) | (0.3) | (1.0) | 5.6 | 2.8 | 3.3 | 2.5 | 1.7 | 1.6 |
| Primary balance/GDP | (0.6) | 0.4 | 0.0 | (0.1) | (4.9) | (2.3) | (1.8) | (1.3) | (0.9) | (0.8) |
| Revenue/GDP | 54.0 | 53.0 | 52.5 | 52.3 | 51.9 | 52.0 | 53.0 | 53.0 | 53.0 | 53.0 |
| Expenditures/GDP | 55.7 | 53.6 | 53.3 | 53.3 | 57.5 | 54.8 | 55.3 | 55.0 | 54.7 | 54.6 |
| Interest/revenues | 2.0 | 1.9 | 1.7 | 1.6 | 1.3 | 1.0 | 1.0 | 1.3 | 1.5 | 1.5 |
| Debt/GDP | 61.5 | 59.5 | 58.1 | 58.0 | 68.0 | 69.7 | 69.5 | 68.9 | 68.3 | 67.6 |
| Debt/revenues | 114.1 | 112.2 | 110.8 | 110.8 | 130.9 | 134.0 | 131.1 | 130.1 | 128.9 | 127.5 |
| Net debt/GDP | 24.7 | 21.9 | 20.9 | 19.3 | 25.2 | 26.7 | 28.8 | 30.2 | 30.8 | 31.4 |

## Finland--Selected Indicators

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Liquid assets/GDP | 36.9 | 37.6 | 37.2 | 38.7 | 42.7 | 43.0 | 40.7 | 38.8 | 37.5 | 36.2 |
| **Monetary indicators (%)** | | | | | | | | | | |
| CPI growth | 0.4 | 0.8 | 1.2 | 1.1 | 0.4 | 2.1 | 2.5 | 2.0 | 1.7 | 1.8 |
| GDP deflator growth | 0.1 | 0.8 | 2.0 | 1.5 | 1.2 | 2.2 | 1.8 | 2.0 | 2.0 | 2.0 |
| Exchange rate, year-end (EUR/$) | 1.0 | 0.8 | 0.9 | 0.9 | 0.8 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 |
| Banks' claims on resident non-gov't sector growth | 1.3 | 2.8 | 4.6 | 4.5 | 4.3 | 4.1 | 4.5 | 4.5 | 4.5 | 4.5 |
| Banks' claims on resident non-gov't sector/GDP | 94.9 | 93.7 | 95.0 | 96.7 | 102.4 | 100.8 | 100.7 | 101.1 | 102.0 | 103.0 |
| 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 | (3.7) | (6.8) | 7.2 | (4.8) | (5.0) | 2.1 | 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 |
| *Final rating* | | |
| Foreign currency | AA+ | |
| Notches of uplift | | 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

- General Criteria: Environmental Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

## Related Research

- Sovereign Ratings History, March 3, 2022
- Sovereign Ratings List, March 3, 2022
- Banking Industry Country Risk Assessment Update: February 2022, Feb. 25, 2022
- Sovereign Risk Indicators, Published Dec. 13, 2021, Dec. 13, 2021. An interactive version is also available at www.spratings.com/sri
- Banking Industry Country Risk Assessment: Austria, July 13, 2021
- Default, Transition, and Recovery: 2020 Annual Sovereign Default And Rating Transition Study, April 12, 2021

### Ratings Detail (as of March 07, 2022)*

| | | |
|---|---|---|
| **Finland** | | |
| Sovereign Credit Rating | | AA+/Stable/A-1+ |
| Transfer & Convertibility Assessment | | AAA |
| Senior Unsecured | | AA+ |
| Short-Term Debt | | A-1+ |
| **Sovereign Credit Ratings History** | | |
| 16-Sep-2016 | *Foreign Currency* | AA+/Stable/A-1+ |

## Ratings Detail (as of March 07, 2022)*

| | | |
|---|---|---|
| 25-Sep-2015 | | AA+/Negative/A-1+ |
| 10-Oct-2014 | | AA+/Stable/A-1+ |
| 16-Sep-2016 | *Local Currency* | AA+/Stable/A-1+ |
| 25-Sep-2015 | | AA+/Negative/A-1+ |
| 10-Oct-2014 | | AA+/Stable/A-1+ |

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.