S&P Global
Ratings

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Finland

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This report does not constitute a rating action.

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Credit Highlights

Overview

Institutional and economic profile	Flexibility and performance profile
Although the war in Ukraine has tainted Finland's economic prospects, the impact so far has been less severe than initially expected.	Despite surging inflation, impacts from the Russia-Ukraine conflict on Finland's fiscal and external balances will likely remain modest over the medium term.
– We expect real GDP growth of 2% this year, given strong domestic demand in the first half of the year and less trade exposure to Russia, including previously high energy imports.	– We expect fiscal effects of the conflict will be manageable and public deficits will continue to narrow throughout the remainder of 2022.
– That said, the impact of higher inflation on consumption and lower economic activity in Finland's main trading partners will stunt the Finnish economic outlook over the next quarters, with about 0% real growth in 2023.	– The current account balance will deteriorate only modestly this year due to higher import prices and primary income outflows.
– We expect Finland's application for NATO membership will progress in the near term.	– Rising energy and food prices will push inflation past 7% this year, the highest level in three decades, but below the eurozone average.

So far, Finland has effectively managed the economic fallout of the Russia-Ukraine conflict. This resilience stems partly from a reduction in the previously significant direct trade exposure to Russia, mainly in the form of energy imports. We expect higher inflation will curb consumption and that the economic slowdown in main trading partners in the EU will drag on external demand over the coming months, slowing real GDP growth in 2023 to about 0%.

Importantly, Finland's economy will continue to diversify away from Russian energy imports. Effective efforts include import substitutions from other countries, the commission of a new nuclear power plant, the installation of a new liquified natural gas terminal (LNG), and additional investments into renewable energy production over the next years.

We project that fiscal and external balances will remain resilient in 2023. Fiscal deficits should narrow this year, as higher interest costs and targeted economic support measures appear to be counterbalanced by high nominal revenue growth. Furthermore, the current account will only deteriorate slightly this year to negative 2.7% of GDP, due to higher import prices and primary income outflows.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that Finland's economy will continue to absorb the negative economic, external, and fiscal effects of the Russia-Ukraine conflict without a permanent deterioration of the country's credit metrics. The outlook also reflects our expectation that there is limited impact from Finland's efforts to decouple the economy from Russian energy supplies.

Downside scenario

We could consider a negative rating action in the next two years if Finland's economy took a harder hit from the conflict in Ukraine, leading to a pronounced and protracted deterioration in the country's fiscal position.

Upside scenario

We could raise the long-term ratings should the economic fallout from the conflict prove to be contained and structural reform efforts strengthened economic growth prospects. Structurally stronger fiscal and external performance could also create ratings upside.

Rationale

Institutional and economic profile: Finland's efforts to reduce its trade expose to Russia will mitigate the conflict's long-term economic repercussions

Despite the conflict in Ukraine, domestic demand in Finland has strengthened more than initially expected, with real growth of about 2% this year. However, the outlook for Finland's economy over the next quarters remains blurred. We expect real disposable incomes will decline this year as high inflation, currently estimated at over 7% for 2022, will outpace average wage growth and mute consumption. We also expect markedly slower economic activity in Finland's main trading partners, such as Germany and Sweden, over the coming months will weigh on external demand. Importantly, Finland's labor market remains strong; employment stands well above pre-pandemic levels at close to 74% and unemployment is at a low 6.7%. Although Finland reports the highest direct trade exposure to Russia among Nordic countries, it has successfully and substantially decreased trade flows over the past few months. Exports to Russia have dropped to about2% of the total, compared with 5%-6% before the conflict. Similarly, imports from Russia are now close to 5% from an average 12%-13% during the years before the conflict.

Diversification away from Russian energy has been an important part of Finland's efforts to protect itself from the conflict's economic fallout. Before the conflict, Finland used to import about one-third of its energy consumption with the lion's share originating from Russia, including 15%-20% of the country's annual electricity consumption. Finland has remedied this much faster than expected, replacing all oil and gas imports from Russia with those from other countries. Additionally, it will rent a U.S. LNG terminal in the winter. The country has also slashed its electricity imports from Russia, swapping it with imports from other Nordic countries. The recent commissioning of a nuclear power plant has markedly reduced the necessity for electricity imports and further investments into renewable energy production will continue to support these efforts.

Although the conflict's effects will persist well into 2023, we expect Finland's economy should remain resilient in the medium term. We project economic growth will gradually approach 1.3%-1.5% from 2024. Nevertheless, the momentum will be challenged by structural constraints, including lackluster productivity growth amid a shrinking employment pool. Although employment levels have improved recently, we expect a slight deceleration as skills mismatches in the labor market become more evident and the labor market tightens. We expect unemployment to remain at 6.5%-7.0% despite high vacancies and government reforms to fill gaps by investing in infrastructure and research and development.

In our view, Finland's stable and mature institutional setup and consensus-oriented policy style are credit rating supportive. Also, we expect broad policy continuity after the general election in spring 2023. Following Russia's invasion of Ukraine, Finland--as well as Sweden--formally applied to enter NATO. Although accession had stalled earlier this year, we expect swifter progress over the next three to six months. Finland's application prompted a strong diplomatic response from Russia, but we don't expect this to increase tensions.

Flexibility and performance profile: A low net debt position, strong external balances, and access to deep capital markets, alongside other eurozone benefits, continue to support Finland's ability to absorb shocks

Despite the conflict's repercussions, Finland's general government finances will continue to strengthen this year, fueled by rapid tax revenue growth and unaffected by the relatively limited support measures amid elevated inflation. Concretely, the war's adverse effects on public finances include weaker real economic activity; increases in specific expenditures, such as refugee-related costs and defense spending; targeted anti-inflationary measures; and increasing interest costs in line with global trends. However, these are more than offset by the current boost to revenue from high nominal GDP growth rates, leading to a reduction of the headline general government deficit to about 1.5% of GDP this year, according to our estimates, from 2.6% in 2021. We project the fiscal deficit to remain at an average 2% between 2023 and 2025.

As a result, public debt, net of liquid government assets, will remain at a modest 35%-40% of GDP through to 2025. In assessing Finland's net general government debt, we deduct from gross debt the Finnish treasury's cash holdings and minority ownership of publicly listed companies through the state-owned asset manager Solidium as well as approximately 30% of GDP in liquid assets held by the public sector's earnings-related pension funds. In line with global trends, interest costs have risen, but debt-servicing costs still appear moderate and manageable. We expect interest expenses will remain below 2% of government revenues over the next four years.

Finland has sizable contingent liabilities--predominantly guarantees--of slightly below 25% of GDP. But we do not believe that these will weigh on public debt over the next few years. Most guarantees relate to Finnvera, the state's export credit agency. About 60% of those guarantees are linked to the Finnish cruise ship sector, which suffered pandemic fallout. We understand the situation for Finnish shipbuilding has improved, but observe that Finnvera has yet to reverse any of the loss provisions made in 2020. In 2022, Finnvera made additional loss provisions of €210 million on operations it had underwritten in Russia. Following these actions, Finnvera's total exposure in Russia currently stands at €536 million. The government has also supported its majority-owned airliner Finnair through the pandemic and extended €540 million in loan guarantees while providing aid via a hybrid bond of €350 million and a capital injection of €300 million.

Finland is experiencing its share of the global surge in inflation, with a recent spike to 8.4% in September--the highest in 30 years. We expect inflation will average more than 7% for 2022. As in other countries, food and energy prices are the primary drivers of price increases, rising by almost 12% and more than 30%, respectively, year on year. However, the share of these goods in Finland's consumer basket is relatively low, especially compared with those of lower-income peers. Moreover, prices for services have not increased materially from historical levels. These factors have kept Finland's inflation below the eurozone average and prompt us to anticipate a potential reduction in inflation to about 4% on average next year. However, we do not exclude the risk of a wage-inflation spiral, in part due to the very high levels of unionization in the country.

If higher wages were to drive up prices--which would likely parallel similar developments in other eurozone countries--the ECB might accelerate its monetary tightening. The ECB has raised its main policy rate by a cumulative 1.25% this year to 0.75%, and we expect further rate hikes over the coming months. In our view, Finland's eurozone membership reduces its monetary flexibility. However, similar to other eurozone members, the country has benefited from the euro membership including from access to deep capital markets and the ECB's asset-purchase programs in recent years, namely the public-sector purchase program and the pandemic emergency purchasing program.

Despite the previously significant direct trade exposure to Russia, we assume pressure on Finland's external balances will remain modest. We expect the current account will move into a deficit of about 2.7% of GDP this year, then narrow over the medium term. Although the current rise in energy prices represents a shock for the country's terms of trade, the overall shift seems more modest than in other countries and follows positive developments over the past two years. That the current account shifted into deficit recently also relates to significant dividend outflows through primary income balance following the discontinuation of the ECB's restrictions on dividend payouts for financial institutions.

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 from 250% previously. The financial sector's large cross-border exposure, including funding related to foreign-financed wholesale funding, is 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 over 200% of CARs on average in 2022-2025. Still, if we consider Finland's net international investment position, the country's external profile is much stronger, with external assets largely equal to external liabilities.

We expect the Finnish banking sector will remain profitable and hold robust capitalization through 2023. We do not believe it will represent a contingent liability for public finances. In general, the country's banking sector is large, concentrated, and characterized by intense competition and low lending margins. The high market share of cooperative and mutual banking groups with a focus on plain vanilla retail and corporate banking translates into stable profitability and very high capitalization for the overall banking sector. However, continuous mortgage loan growth amid low interest rates has led to higher private sector debt. Although the level of debt remains moderate in a peer comparison, the rising interest rates, alongside high inflation, will weaken households' disposable income and consumption, given more than 90% of mortgage loans are at variable rates. We expect households' sound financial buffers and a prevailing strong social safety net and heightening demand for interest rate hedges on mortgages will continue to underpin the private sector's solid repayment capacity. Furthermore, we do not expect the banking sector will depart from its moderately conservative underwriting standards.

Finland--Selected Indicators

	2016	2017	2018	2019	2020	2021	2022bc	2023bc	2024bc	2025bc
Economic indicators (%)										
Nominal GDP (bil. EUR)	217.5	226.3	233.5	239.9	238.0	251.4	272.0	282.9	293.6	303.5
Nominal GDP (bil. $)	240.8	255.7	275.7	268.5	271.9	297.3	284.6	282.3	314.8	335.5
GDP per capita (000s $)	43.9	46.5	50.0	48.7	49.2	53.7	51.4	50.9	56.6	60.3
Real GDP growth	2.8	3.2	1.1	1.2	(2.2)	3.0	2.0	0.0	1.3	1.3
Real GDP per capita growth	2.5	2.9	1.0	1.1	(2.3)	2.8	1.9	(0.2)	1.1	1.1
Real investment growth	9.0	4.8	3.6	(1.5)	(0.9)	1.5	3.5	(1.0)	2.0	2.0
Investment/GDP	23.3	24.0	25.3	24.1	24.5	24.4	24.9	24.3	24.4	24.5
Savings/GDP	21.3	23.2	23.4	23.8	25.2	25.0	22.2	23.1	23.7	23.9
Exports/GDP	34.8	37.6	38.5	39.9	35.9	39.4	42.4	43.7	44.2	44.7

Finland--Selected Indicators

Real exports growth	3.9	8.8	1.5	6.7	(6.8)	5.4	5.8	2.3	2.6	2.5
Unemployment rate	8.9	8.7	7.5	6.8	7.7	7.7	6.7	6.7	6.5	6.5
External indicators (%)										
Current account balance/GDP	(2.0)	(0.8)	(1.9)	(0.3)	0.7	0.6	(2.7)	(1.2)	(0.7)	(0.6)
Current account balance/CARs	(4.7)	(1.8)	(4.0)	(0.6)	1.6	1.3	(5.1)	(2.2)	(1.2)	(1.1)
CARs/GDP	42.9	45.4	46.6	49.4	44.7	49.1	52.7	54.5	54.0	54.1
Trade balance/GDP	0.0	0.7	0.1	1.0	1.3	1.1	0.2	0.6	0.8	0.9
Net FDI/GDP	(6.5)	1.3	(4.9)	3.2	(2.7)	1.5	0.5	1.3	1.0	1.0
Net portfolio equity inflow/GDP	1.8	(0.8)	1.5	(3.0)	(1.2)	(0.5)	(0.1)	(1.0)	(1.0)	(1.0)
Gross external financing needs/CARs plus usable reserves	393.4	339.4	288.9	349.6	362.2	348.0	342.5	338.3	322.6	315.2
Narrow net external debt/CARs	224.1	248.8	220.0	196.1	258.4	218.5	214.5	224.1	217.8	215.2
Narrow net external debt/CAPs	214.1	244.5	211.6	194.9	262.4	221.4	204.2	219.4	215.2	212.8
Net external liabilities/CARs	(10.7)	(1.7)	10.9	(18.0)	54.1	51.9	46.1	50.2	52.6	54.9
Net external liabilities/CAPs	(10.2)	(1.7)	10.5	(17.9)	55.0	52.6	43.8	49.1	52.0	54.3
Short-term external debt by remaining maturity/CARs	327.0	268.2	208.6	276.1	297.8	281.5	275.7	273.6	255.4	247.1
Usable reserves/CAPs (months)	1.1	1.1	1.0	0.9	1.2	1.1	1.3	1.3	1.3	1.2
Usable reserves (Mil. $)	10467.89	10,516.8	10,310.5	11,417.6	13,491.5	16,758.5	17,034.6	17,966.3	19,005.1	20,112.2
Fiscal indicators (general government %)										
Balance/GDP	(1.7)	(0.7)	(0.9)	(1.0)	(5.5)	(2.7)	(1.5)	(1.9)	(2.1)	(2.1)
Change in net debt/GDP	1.6	(1.6)	0.0	1.2	6.3	(2.3)	7.0	3.9	2.6	2.1
Primary balance/GDP	(0.6)	0.4	0.1	(0.1)	(4.8)	(2.2)	(0.9)	(1.0)	(1.2)	(1.1)
Revenue/GDP	54.0	53.0	52.5	52.4	51.6	52.8	52.0	52.0	52.0	52.0
Expenditures/GDP	55.7	53.6	53.4	53.3	57.2	55.5	53.5	53.9	54.1	54.1
Interest/revenues	2.0	1.9	1.8	1.7	1.4	1.0	1.2	1.7	1.8	1.9
Debt/GDP	66.4	64.3	63.2	63.3	73.2	70.9	70.5	72.4	73.5	74.5
Debt/revenues	123.1	121.4	120.3	120.8	141.7	134.3	135.6	139.2	141.4	143.2
Net debt/GDP	29.5	26.8	26.0	26.5	32.9	28.9	33.7	36.3	37.6	38.5
Liquid assets/GDP	36.9	37.6	37.2	36.8	40.2	42.0	36.8	36.1	36.0	36.0
Monetary indicators (%)										
CPI growth	0.4	0.8	1.2	1.1	0.4	2.1	7.1	4.3	2.0	1.8
GDP deflator growth	0.1	0.8	2.0	1.5	1.5	2.6	6.1	4.0	2.5	2.1
Exchange rate, year-end (EUR/$)	1.0	0.8	0.9	0.9	0.8	0.9	1.0	1.0	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	4.3	4.0	3.0	3.0
Banks' claims on resident non-gov't sector/GDP	94.9	93.7	95.0	96.7	101.5	100.1	96.5	96.5	95.8	95.4
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

Finland--Selected Indicators

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)	7.1	(5.0)	(3.6)	7.7	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 ECB 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: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Recession Risks Deepen, Oct. 12, 2022
- Sovereign Risk Indicators, Oct. 10, 2022; a free interactive version is available at http://www.spratings.com/sri
- Sovereign Ratings Score Snapshot, Oct. 7, 2022
- Sovereign Ratings History, Oct. 5, 2022
- Sovereign Ratings List, Oct. 5, 2022
- Europe Braces For A Bleak Winter: A Downside Scenario Assuming A Russian Gas Cutoff, Aug. 29, 2022
- Default, Transition, and Recovery: 2021 Annual Global Sovereign Default And Rating Transition Study, May 4, 2022

Ratings Detail (as of October 26, 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+
25-Sep-2015		AA+/Negative/A-1+
10-Oct-2014		AA+/Stable/A-1+
16-Sep-2016	*Local Currency*	AA+/Stable/A-1+

Ratings Detail (as of October 26, 2022)*

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.