PRESS RELEASE

APRIL 23, 2021

DBRS Morningstar Confirms Republic of Finland at AA (high), Stable Trend

SOVEREIGNS

DBRS Ratings GmbH (DBRS Morningstar) confirmed the Republic of Finland's Long-Term Foreign and Local Currency – Issuer Ratings at AA (high). At the same time, DBRS Morningstar confirmed the Republic of Finland's Short-Term Foreign and Local Currency – Issuer Ratings at R-1 (high). The trends on all ratings remain Stable.

KEY RATING CONSIDERATIONS

The Coronavirus Disease (COVID-19) weakened considerably Finland's economic and fiscal performance last year and remains an important source of risk. Nevertheless, the Finnish economy has been relatively more resilient than expected and also more so than most European economies. Provided that the pandemic shock is temporary, the long-lasting effects on the Finnish economy appear to be small thanks to the policy support, although the re-imposition of restrictions could delay the recovery in the short-term. DBRS Morningstar expects the fiscal deficit to narrow over time as the economy recovers and the temporary support is withdrawn. The public debt ratio is expected to continue to increase at a slower pace in coming years, but to remain manageable.

The Stable trend reflects DBRS Morningstar's view that pandemic-induced economic and public finance deterioration is offset by Finland's credit strengths underpinning its AA (high) ratings. These include the strong balance sheet of the public sector, which reinforces its ability to fund future liabilities, and the Finnish government's commitment to sound economic policies. Finland's wealthy economy, with significant human capital and high value-added sectors, also supports the ratings. On the other hand, an ageing population will constrain potential growth and burden public finances over the medium term. As an open and small economy, Finland remains exposed to external shocks. Furthermore, DBRS Morningstar notes that the high level of household debt, which could amplify economic downturns, remains a concern.

RATING DRIVERS

One or any combination of the following factors could trigger an upgrade: (1) progress in curbing healthcare and long-term care spending growth pressures, (2) improvement in Finland's medium-term economic performance, and (3) sustained improvement in fiscal performance and a reduction in the public debt ratio.

One or any combination of the following factors could trigger a downgrade: (1) long-lasting economic effects of the pandemic on potential economic growth, compounding the challenges from an ageing population, or (2) a deviation from prudent fiscal policies that prevents stabilisation of the public debt ratio in the longer term.

RATING RATIONALE

The Finnish Economy Stood Resilient Against COVID-19 But Ageing Issues Remain In The Background

The pandemic shock resulted in a 2.8% contraction in Finland's GDP in 2020, which was less severe than previously expected and when compared to most of its European peers. DBRS Morningstar considers some key factors could explain Finland's higher resiliency to the pandemic shock including a comparatively lower pandemic incidence and restrictions, a smaller reliance on the hospitality and retail trade sectors, its digitalization and telework capabilities, and a strong public sector position that underpinned its policy response (please see Nordic Economies: Not Immune but More Resilient to the Coronavirus Disease (COVID-19)). https://www.dbrsmorningstar.com/research/376638.

DBRS Morningstar considers that Finland's embedded automatic stabilisers and discretionary fiscal support to households and firms continues to soften the pandemic blow and reduces the risk of long-lasting effects on growth, provided that the health crisis does not become entrenched. In this regard, despite the increase in unemployment in Finland, the labour market has endured relatively well the effects of the pandemic thanks to the furlough scheme and it should recover more strongly once the economy reopens more fully. Assuming no additional setbacks, the drop in the pandemic caseload and one of the highest take-up rates of at least one vaccine dose in Europe (29.8% of the adult population as of April 18, 2021) could lead to relaxation of the measures in the summer.

The Ministry of Finance (MoF) in its latest projections in December 2020 forecasts GDP growth at 2.5% in 2021, 2.0% in 2022 and 1.4% in 2023, although with significant uncertainty associated to the evolution of the pandemic. Since then, the re-imposition of tougher restrictions in March to control the spread of the pandemic is expected to hold back the rebound in private consumption and the hospitality and entertainment sectors in the short-term. On the other hand, Finland's manufacturing sector has been resilient and could benefit over time from a pickup in investment in Europe. The deployment of the EU's Recovery and Resilience Facility funds, of which EUR 2.1 billon grants are estimated for Finland, and a brighter external backdrop could lead to a stronger recovery than previously expected in coming years.

Finland's high GDP per capita, at USD 48,984 in 2020, reflects its very skilled labour force, high value-added economy, and relatively strong R&D investment intensity. On the other hand, the number of the working age population (aged 15 to 64), which started dwindling already in 2010, is projected to shrink in coming decades. In light of the prospects of an ageing and shrinking working-age population, the main economic challenge over the medium to long term will remain fostering higher employment rates, capital formation, and productivity. In this sense, DBRS Morningstar considers policy measures that successfully lift potential growth and improve economic competitiveness key to improving credit metrics.

Strong Fiscal Track-Record But Pandemic And Age-Related Expenditures Weigh on Public Finances

DBRS Morningstar considers that Finland's track record and commitment to prudent fiscal policy, supported by a strong fiscal framework, are key credit strengths. Before the pandemic hit, Finland managed to lower the fiscal deficit from 3.0% of GDP in 2014 to 0.9% in 2018 by controlling expenditures and benefiting from job gains. The pandemic-induced recession, which triggered its strong automatic stabilisers, and the introduction of supplementary discretionary policies substantially widened Finland's fiscal deficit-to-GDP ratio from 1.0% in 2019 to a 5.4% in 2020, albeit less than anticipated. To cushion the impact from the shock of the pandemic, the government implemented targeted grants to support businesses, extended unemployment and social benefits, reduced private sector pension contributions, and enhanced the healthcare response. The impact of the COVID-19 measures on the fiscal deficit is estimated at 3.0% of GDP in 2020 and 1.4% of GDP in 2021. The government has authorised some below-the-line measures including guarantees, loans, and capital injections for over 5.0% of GDP, which have been tapped only partially thus far.

The MoF's latest projections foresee a gradual improvement in Finland's fiscal position as the economy recovers and the coronavirus-related measures are gradually phased out. The MoF projects the fiscal deficit to remain high at 5.2% of GDP in 2021 as the COVID-19 expenditure measures continue. The expiration of these measures should allow a substantial drop in the deficit ratio in 2022 to 3.3% of GDP, assuming a no-policy change scenario and a shrinking output gap. While DBRS Morningstar considers the effects of the pandemic on Finland's fiscal deficit will not be significant in the long-term, the deficit is not expected to return to its pre-coronavirus levels at least until 2025. The economic and labour market repercussions from the pandemic are expected to compound Finland's demographic driven spending pressures for a few more years. On the other hand, the better fiscal and economic outturns in 2020 coupled with a potentially stronger economic recovery than previously expected could accelerate the fiscal improvement.

The main challenge for the public accounts in the medium to long term is posed by the increasing fiscal pressures from an ageing and shrinking working-age population. In relation to this, the government submitted a series of bills last December outlining its plan to transfer the responsibility for organising health, social and emergency services from the municipalities to newly created 'wellbeing services counties' by the start of 2023. The reform could face further delays and the savings remain uncertain at the moment. The reform is expected to create transitional costs for several years and potentially generate savings around the turn of the decade and onwards, which will hinge on the potential economies of scale and the incentives for an efficient provision of these services.

Public Debt Deteriorates But Healthy Overall Public Sector Balance Sheet and Favourable Financing Costs and Debt Profile Mitigate Risks

Finland's strong public finances have provided sufficient room to cushion the COVID-19 shock. As a consequence, the public debt-to-GDP ratio considerably increased to 69.2% of GDP in 2020 from 59.3% of GDP in 2019, reversing the reduction that took place during 2016-2019. The MoF projects the debt ratio to continue to edge higher slowly towards 75.0% by 2025 due to sticky primary budgetary deficits only partially compensated by nominal GDP growth, assuming no-policy changes. The economic developments linked to the pandemic remain the key risk to this projection. Finland's high and rising stock of explicit guarantees—adding up to around 30% of GDP in 2019—or its implicit liabilities associated with a relatively large banking sector, pose additional risks to the public debt ratio. On the other hand, DBRS Morningstar considers there are also upside risks to the MoF's fiscal and economic paths that could result in a lower debt ratio for the forecasting horizon. In this vein, the IMF projects a less pronounced increase in the debt ratio to 71.2% by 2026.

Despite public higher debt levels, Finland's strong public balance sheet and good debt affordability reinforce the government's ability to fund its liabilities. The general government net financial assets ratio stood at 64.2% of GDP in 2020, although around two-thirds of the assets are ring-fenced for pension payment and not appropriable for budgetary purposes. Finland's central government debt has an average maturity of 7.3 years and minimal exchange rate risks after swaps. Debt interest rate expenditures are expected to remain below or equal to 1% of GDP in coming years.

Financial System is Sound and Risks to Financial Stability are Contained

The Finnish banking system remained strong despite the more challenging operating environment caused by the pandemic. According to European Banking Authority data, Finnish banks' CET 1 capital ratio at 18.1% and leverage ratio at 6.2% at end-2020 remain healthy and higher than the EU averages. Despite the pandemic-led substantial increase in loan loss provisions and lingering pressure from the ultra-low interest rate environment, Finnish banks' profitability levels were still positive and better than the EU average in 2020. The non-performing loans ratio remained very low at 1.52% at end-2020. The strong capital buffers should allow the Finnish banking system to absorb a potential deterioration in asset quality over time, especially for the most affected sectors when support is eventually withdrawn, and continue to provide credit to the economy under most scenarios. On the other hand, the Finnish banking system's relative size, concentration, interconnectedness, and reliance on wholesale funding are structural features that could amplify shocks to the economy, especially if combined with investor confidence deterioration.

DBRS Morningstar notes that the high level of household debt, at 136.9% of disposable income in 2020, is still below its Nordic peers, but remains a source of concern. According to the Bank of Finland, one-fifth of all borrowers have debts over three times their annual disposable income. On a positive note, Finland's fully amortising mortgages, stricter credit policies, and lower tax deductibility have helped to contain further build-ups of risks in recent years. DBRS Morningstar considers that the risks to financial stability remain contained. The banks remain highly exposed to the property market; however, there is no discernible evidence of residential or commercial property overvaluation.

Finland Has Recovered Cost-Competitiveness and Shows No Evidence of External Imbalances

Before the pandemic hit, Finland had largely restored cost-competitiveness thanks to the Competitiveness Pact and to wage moderation between 2016 and 2018. The current account recorded an average deficit of 1.4% of GDP during 2011-2019, following a period of ample surpluses during the 2000s before the structural changes brought by the demise of Nokia's handset business and the decline in global demand for paper. DBRS Morningstar see no sign of imbalances building up given that the current account deficit has remained small and stable over time. Finland's net international investment position stood at 1.0% of GDP at end-2020. While Finland's gross external debt-to-GDP ratio remains high at 222.9% of GDP, a sizable portion of these liabilities corresponds to long-term debt and intercompany lending, which tends to be more stable than other sources of financing.

In 2020, the current account posted a small surplus of 0.5% of GDP. The pandemic and travel restrictions have considerably reduced in 2020 the traditionally negative travel balance for Finland while the telecommunications, computer and information (ICT) services exports keep underpinning Finland's shrinking deficit in services trade. Finland's trade balance for goods remained slightly positive. Going forward, tourism related exports are expected to recovery only gradually, while Finland's ICT service exports and goods exports traditionally tilted to capital and intermediate goods could benefit from a strong recovery in its top export markets (northern Europe, the United States, and China) and a rebound in investment abroad.

Strong Institutional Framework and Policy Stability

Finland's political and institutional framework is among the strongest in the world, consistently being ranked among the top performers in the World Bank's governance indicators. Despite the political fragmentation, a tradition of coalition governments with strong majorities leads to stable and consensus-based policy making. Prime Minister Sanna Marin (Social Democratic Party) heads a five-party centre-left coalition government that holds a majority in parliament. In response to the deterioration generated by the coronavirus, the government outlined its objective to stabilise the government debt-to-GDP ratio by the end of the decade, with an emphasis on raising economic growth, employment, public administration efficiency, and reforming the healthcare and social services reform. The current government programme includes the objective of reaching carbon neutrality by 2035 and becoming carbon negative soon after.

ESG CONSIDERATIONS
A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at https://www.dbrsmorningstar.com/research/373262.

For more information on the Rating Committee decision, please see the Scorecard Indicators and Building Block Assessments. https://www.dbrsmorningstar.com/research/377286

EURO AREA RISK CATEGORY: LOW

Notes:
For more information regarding rating methodologies and Coronavirus Disease (COVID-19), please see the following DBRS Morningstar press release: https://www.dbrsmorningstar.com/research/357883

All figures are in euros (EUR) unless otherwise noted. Public finance statistics reported on a general government basis unless specified.

The principal methodology is the Global Methodology for Rating Sovereign Governments, https://www.dbrsmorningstar.com/research/364527/global-methodology-for-rating-sovereign-governments (July 27, 2020). Other applicable methodologies include the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings, https://www.dbrsmorningstar.com/research/373262/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings (February 3, 2021).

The sources of information used for this rating include Ministry of Finance (Winter 2020 Economic Survey, December 17, 2020; Budget review 2021, January 18, 2021), Central Government Debt Management Office, Statistics Finland (Tilastokeskus), Bank of Finland, European Commission (EC), European Banking Authority, Finnish Financial Supervisory Authority (FIN-FSA), European Centre for Disease Prevention and Control, The Social Progress Imperative (2020 Social Progress Index), European Central Bank, Statistical Office of the European Communities, Bank of International Settlements, Organisation for Economic Co-operation and Development, International Monetary Fund (IMF), World Bank, UNDP, Haver Analytics. DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

With respect to FCA and ESMA regulations in the United Kingdom and European Union, respectively, this is an unsolicited credit rating. This credit rating was not initiated at the request of the issuer.

With Rated Entity or Related Third Party Participation: YES
With Access to Internal Documents: NO
With Access to Management: NO

DBRS Morningstar does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

Generally, the conditions that lead to the assignment of a Negative or Positive trend are resolved within a 12-month period. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. DBRS Morningstar understands further information on DBRS Morningstar historical default rates may be published by the Financial Conduct Authority (FCA) on its webpage: https://www.fca.org.uk/firms/credit-rating-agencies.

The sensitivity analysis of the relevant key rating assumptions can be found at https://www.dbrsmorningstar.com/research/377282.

This rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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For more information on this credit or on this industry, visit www.dbrsmorningstar.com.

Ratings

Finland, Republic of

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
23-Apr-21	Long-Term Foreign Currency - Issuer Rating	Confirmed	AA (high)	Stb	EU U
23-Apr-21	Long-Term Local Currency - Issuer Rating	Confirmed	AA (high)	Stb	EU U
23-Apr-21	Short-Term Foreign Currency Debt - Issuer Rating	Confirmed	R-1 (high)	Stb	EU U
23-Apr-21	Short-Term Local Currency Debt - Issuer Rating	Confirmed	R-1 (high)	Stb	EU U

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