Eurozone

EY Eurozone Forecast

December 2014

Austria
Belgium
Cyprus
Estonia
Finland
France
Germany
Greece
Ireland
Italy
Latvia
Luxembourg
Malta
Netherlands
Portugal
Slovakia
Slovenia
Spain

EY
Building a better working world

Outlook for Finland

Road to recovery remains strewn with obstacles

Published in collaboration with

OXFORD ECONOMICS

Highlights

GDP growth

2014 −0.2%

GDP growth

2015 0.5%

- With the Finnish economy still struggling to escape recession, GDP in 2014 as a whole is likely to have contracted for the third consecutive year, by 0.2%. We also believe that recovery will be modest at best in the coming quarters, leading us to further downgrade our growth forecasts to just 0.5% in 2015 (from 1.5%) and 1.2% in 2016 (previously 1.7%), with only a modest acceleration to just over 2% in 2018.
- Consumer spending was initially a key driver of post-crisis growth, but is now being dampened by difficult labor market conditions and fiscal austerity measures. We expect consumer spending to fall 0.1% in 2015, before rising slowly to grow at 2% in 2018.
- Finland's export performance is also suffering from loss of competitiveness and the decline of its paper and pulp and electronics industries. These structural problems will only be resolved gradually, but the weakening of the euro should provide some boost to Finnish exporters. Export growth is expected to pick up from an estimated 0.4% in 2014 to 2.6% in 2015, with a further acceleration to over 3% a year in 2017–18.
- Risks to these forecasts remain on the downside, given the economy's substantial exposure to external trade and finance. In particular, Finland would be significantly affected by any escalation of tensions between the European Union (EU) and Russia, as Russia is one of its largest trading partners.
- Against this background, it was hardly surprising that Finland lost its AAA rating from Standard & Poor's. Finland needs to implement structural reforms to boost its growth performance, but progress in this area has been slow due to divisions within the parliament.
- We expect investment to start rising again in 2015, as the economy stabilizes and confidence is gradually restored. Finland still has a number of strengths, including its favorable business environment and highly skilled workforce, both of which provide a solid foundation for new businesses to lead this upturn and help to rebalance the economy toward new growth opportunities.

Unemployment

2014 8.6%

Consumer prices

2014 1.3%

Road to recovery remains strewn with obstacles

A long period of economic adjustment lies ahead

Economic activity in 2014 as a whole is expected to contract (by 0.2%) for the third consecutive year, and we believe that any recovery will be modest at best in the coming quarters. As a result, we have further downgraded our GDP growth forecasts to just 0.5% in 2015 (from 1.5% in our September report) and 1.2% in 2016 (from 1.7% previously).

Structural challenges will continue to restrain the pace of expansion for some time, as Finland struggles to regain cost competitiveness and compensate for the decline of its paper and pulp and electronics industries (the latter having contracted sharply from 6% of total value-added in 2007 to just 1% currently). We therefore expect only a modest acceleration in GDP growth in the next few years to 2.1% by 2018.

A weak labor market is dampening consumer sentiment …

Consumer spending was initially a key driver of growth in the post-crisis period, but more recently performance has been anemic due to difficult labor market conditions. The headline unemployment rate reached 8.9% of the workforce in October 2014 (on the EU harmonized measure). Moreover, the headline rate masks a worrying rise in the number of discouraged workers who are no longer actively seeking employment, which threatens to undermine the economy's underlying rate of sustainable growth.

Wage growth has also slowed sharply following the latest settlement between the social partners for more modest wage increases (although this also has positive implications in terms of the economy's competitiveness).

Consumer confidence has also deteriorated again in recent months according to the European Commission survey, with opinions on all four main topics of the survey (personal finances, Finland's economy, unemployment in general, and personal threat of unemployment) clearly more pessimistic than the long-run average. This broad-based gloom is likely to reflect both the weak economic backdrop as well as concerns about the ongoing tensions between Russia and the EU.

Table 1

Finland (annual percentage changes unless specified)

	2013	2014	2015	2016	2017	2018
GDP	-1.2	-0.2	0.5	1.2	1.8	2.1
Private consumption	-0.7	-0.4	-0.1	1.0	1.7	2.0
Fixed investment	-4.9	-3.1	1.3	2.0	2.3	2.3
Stockbuilding (% of GDP)	-0.1	0.6	0.6	0.4	0.4	0.4
Government consumption	1.5	-0.5	0.7	1.2	1.4	1.4
Exports of goods and services	-1.7	0.4	2.6	2.8	3.2	3.3
Imports of goods and services	-2.5	0.1	2.2	2.4	2.9	2.9
Consumer prices	2.2	1.3	1.4	1.6	1.6	1.8
Unemployment rate (level)	8.1	8.6	8.4	8.0	7.4	7.0
Current account balance (% of GDP)	-1.4	-2.1	-1.6	-0.4	-0.2	0.1
Government budget (% of GDP)	-2.4	-2.7	-2.3	-1.2	-0.6	-0.2
Government debt (% of GDP)	54.8	57.2	58.4	57.8	56.2	54.2
ECB main refinancing rate (%)	0.5	0.1	0.1	0.1	0.2	0.8
Euro effective exchange rate (1995 = 100)	120.8	123.4	119.2	117.2	116.6	116.2
Exchange rate (US$ per €)	1.33	1.33	1.24	1.21	1.20	1.19

Source: Oxford Economics.

Although it is likely that the unemployment rate is now close to its peak, the slow pace of the economic recovery means that labor market conditions will improve only gradually. Moreover, the planned fiscal consolidation efforts for 2015–18 include higher taxes and lower welfare benefits, which will put additional downward pressure on disposable incomes. As a result, we expect household consumption to fall 0.1% in 2015, with spending growth only rising slowly to 2% by 2018.

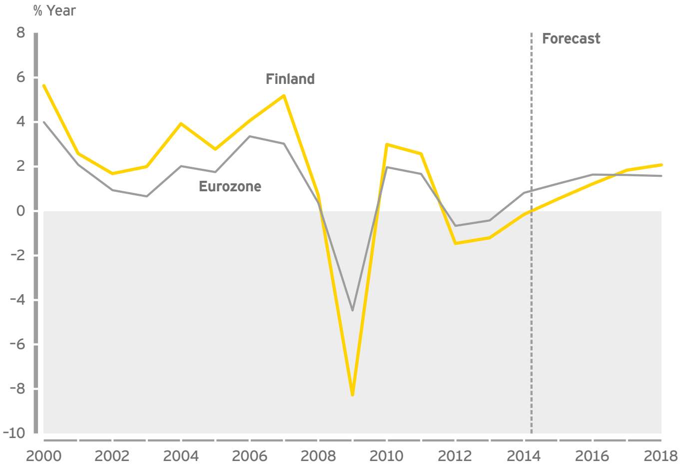
… and investment is constrained by ongoing slack in production

Corporate investment has also remained subdued in the light of the uncertain outlook for demand and capacity utilization levels that remain below long-run average rates. Business surveys support the view that it is lack of demand rather than credit constraints that are causing firms to shelve capital spending plans. Indeed, financing costs for Finnish corporations remain among the lowest in the Eurozone and credit is still easily accessible even for small and medium-sized enterprises. As such, it is unlikely that the European Central Bank's latest monetary policy measures will provide a significant boost to corporate investment in Finland, although there could be indirect benefits for the domestic economy if these policies manage to lift demand elsewhere in the Eurozone.

We expect investment to start to rise again in 2015, as the economy stabilizes and confidence is gradually restored. Finland still has a number of strengths, including its favorable business environment and highly skilled workforce, both of which provide a solid foundation for new businesses to lead this upturn and help to rebalance the economy toward new growth opportunities. Nevertheless, this rebalancing process is likely to be protracted without a more concerted push to implement structural reforms from policy-makers. We therefore expect investment growth to average 1.3% in 2015, with the annual rate accelerating gradually to 2.3% by 2017–18.

Figure 1

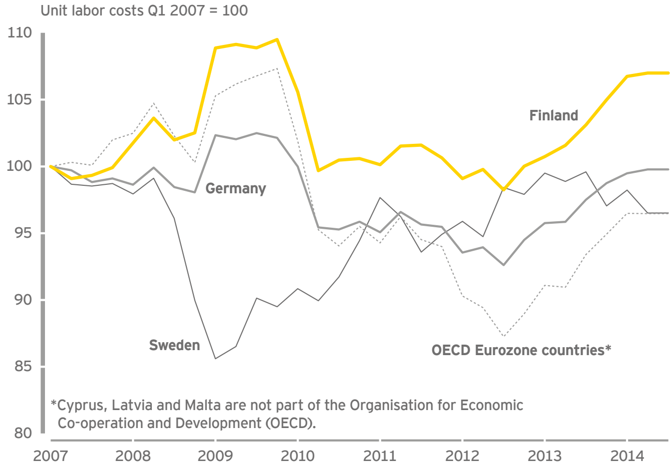
GDP growth



Source: Oxford Economics.

Figure 2

International competitiveness



Source: Oxford Economics; Haver Analytics.

Table 2

Forecast for Finland by sector (annual percentage changes in gross added value)

	2013	2014	2015	2016	2017	2018
GDP	-1.2	-0.2	0.5	1.2	1.8	2.1
Manufacturing	-3.1	-4.1	4.9	3.3	3.7	3.7
Agriculture	3.1	-4.5	-1.7	-1.1	-0.6	-0.2
Construction	-2.8	2.1	0.8	1.0	1.3	1.5
Utilities	0.6	-0.7	-1.2	0.2	1.1	1.5
Trade	-3.7	0.6	-0.8	0.8	1.6	1.9
Financial and business services	-0.5	0.0	-0.8	0.6	1.5	1.9
Communications	2.3	1.7	1.0	2.1	2.9	3.3
Non-market services	-0.3	1.2	0.4	1.0	1.3	1.4

Source: Oxford Economics.

Exports will be the main driver of recovery ...

With domestic demand likely to remain weak for some time, the export sector will be the main driver of economic recovery. Although exporters are currently suffering from the country's loss of competitiveness, the national agreement to limit wage increases over the next few years will help to reverse this deterioration, while the recent weakening of the euro should provide an additional boost to Finnish exporters. Export growth is therefore expected to pick up from an estimated 0.4% in 2014 to 2.6% in 2015, with a further acceleration to over 3% in 2017–18.

... but EU-Russia tensions represent an additional risk to the outlook

Risks to these forecasts remain skewed to the downside, given the economy's substantial exposure to developments in Russia. With almost 10% of Finnish exports destined for Russia in 2013, an escalation of tensions between the EU and Russia would have a significant direct impact on Finland's economy through trade, as well as indirect negative confidence effects. Simulations of the economic impact of an escalation in Russia-Ukraine tensions (including Russian sanctions through the disruption of energy supplies) suggest that Finnish GDP would contract by more than 2% in 2015 in such a scenario.

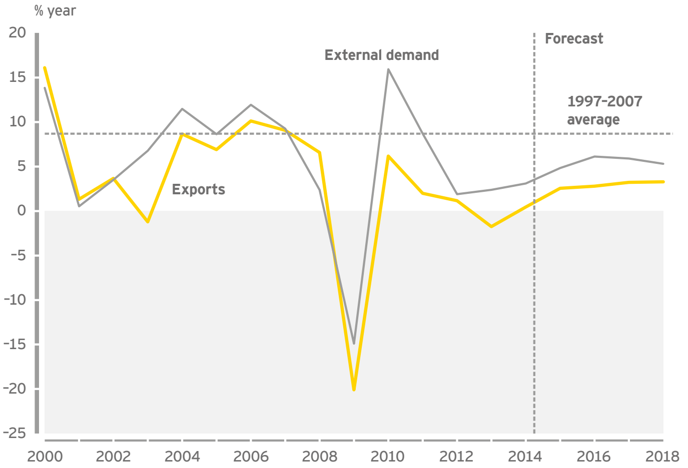
Loss of AAA rating should be a wake-up call

Against this background, it was not too surprising that Finland has lost its coveted AAA rating from Standard & Poor's, with the rating agency citing the risk of "protracted stagnation" in the economy. Finland desperately needs to implement structural reforms to boost growth potential, but progress in this area has been slow due to a weak parliamentary situation.

As the ruling coalition has only a one-seat majority, it is difficult for the Government to implement ambitious and politically contentious structural reform measures. Parliamentary elections will be held in April 2015, and the hope is that this will represent an opportunity to build a stronger political consensus on the need for progress in this area. Finland is well placed to reinvent itself as an economic powerhouse — it just requires a push in the right direction.

Figure 3

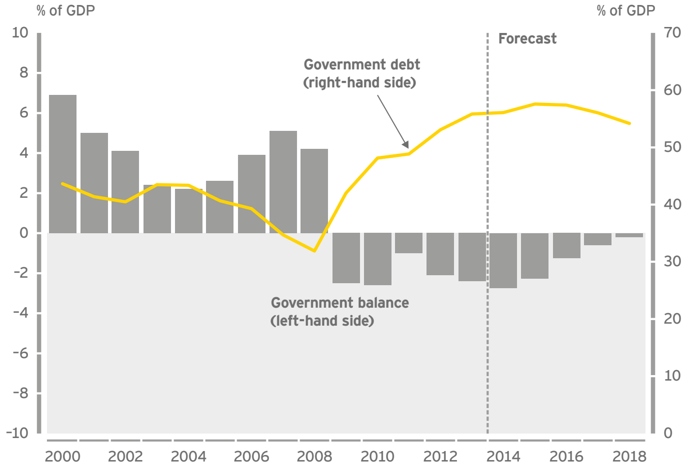
Exports and external demand



Source: Oxford Economics.

Figure 4

Government balance and debt

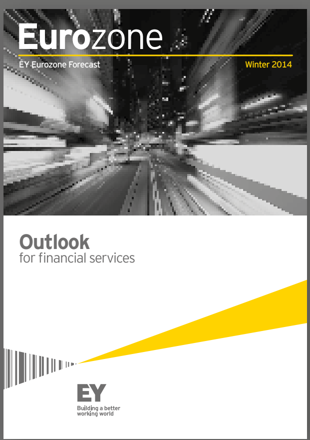


Source: Oxford Economics.

Macroeconomic data and analysis at your fingertips

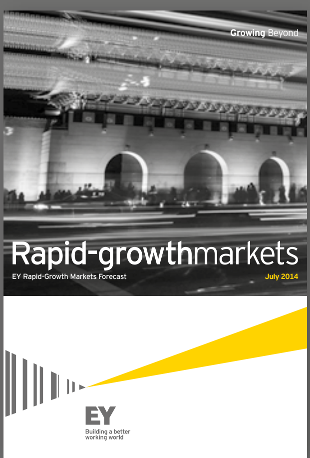
Learn more about the *EY Eurozone Forecast* at ey.com/eurozone:

- Download the latest *EY Eurozone Forecast* and individual forecasts for the 18 member states.
- Use our dynamic Eurochart to compare country data for the next five years.
- Use the trend analysis tool to compare forecasts for specific economic indicators across the 18 Eurozone nations.



EY Eurozone Forecast: outlook for financial services — Winter 2014

- The *EY Eurozone Forecast: outlook for financial services* explores the implications of the latest Eurozone economic forecasts for banks, asset managers and insurers.
- Our latest forecast sees improving GDP, growth in consumer spending and falling unemployment across the Eurozone.
- Learn more and download the report at ey.com/fseurozone.



EY Rapid-Growth Markets Forecast: July 2014

- *EY's Rapid-Growth Markets Forecast* provides analysis of 25 emerging economies.
- Our latest report explores the role of urbanization in the rapid-growth markets.
- Learn more and download the report at ey.com/rapidgrowth.

EY's attractiveness survey: Europe 2014

- *EY's attractiveness surveys* are annual reports that examine the attractiveness of selected nations and regions to foreign investors.
- *EY's attractiveness survey: Europe 2014* finds that Europe remains the world's top destination for foreign direct investment.
- Learn more and download the report at ey.com/attractiveness.

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EYG no. AU2798

EMEIA Marketing Agency
1001608

ED None

ey.com

About Oxford Economics
Oxford Economics was founded in 1981 to provide independent forecasting and analysis tailored to the needs of economists and planners in government and business. It is now one of the world's leading providers of economic analysis, advice and models, with over 700 clients including international organizations, government departments and central banks around the world, and a large number of multinational blue-chip companies across the whole industrial spectrum.

Oxford Economics commands a high degree of professional and technical expertise, both in its own staff of over 90 professional economists based in Oxford, London, Belfast, Paris, the UAE, Singapore, New York and Philadelphia, and through its close links with Oxford University and a range of partner institutions in Europe and the US. Oxford Economics' services include forecasting for 200 countries, 100 sectors, and 3,000 cities and sub-regions in Europe and Asia; economic impact assessments; policy analysis; and work on the economics of energy and sustainability.