S&P Global Ratings

RatingsDirect®

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
S&P Global Ratings expects Finland's economy will stagnate in 2023.	The impact from the Russia-Ukraine conflict on Finland's fiscal and external balances will remain manageable.
– We project a moderate recovery in second-half 2023 will outweigh the current slump in domestic and external demand, resulting in real growth of 0% for the year.	– In our base-case scenario, we expect general government deficits will remain narrow, at about 2% of GDP.
– Domestic demand feels the pressure of inflation on consumption and higher interest weigh on investment activity, and the challenging economic outlook in Finland's main trading partners is also stunting external demand.	– The current account deficit will narrow this year after a sharp deficit in 2022 as the trade balance improves and primary income outflows normalize.
– We expect the Finnish economy to be resilient and expand by an average of 1.3% per year from 2024-2026, mostly curbed by structural constraints.	– Moderating energy prices and a slowdown in economic activity will push down headline inflation (measured by the Harmonized Index of Consumer Prices [HICP]) to below 5% this year.

So far, Finland has effectively managed the economic fallout of the Russia-Ukraine conflict, despite a previously high direct trade exposure to Russia. The country redirected a significant share of its exports away from Russia to other destinations. At the same time, energy imports from Russia decreased sharply and we expect Finland will further decrease required energy imports as domestic electricity production continues to increase, mostly due to rising nuclear and renewable energy production.

We expect broad policy broad policy continuity after the parliamentary elections this April. Post-election government formation might prove complex and lengthy due to differences on policy issues among election winners. Still, given Finland's mature institutions, we expect a reasonable degree of policy continuity. In particular, we expect continued prudent fiscal policies and project narrow fiscal balances. Higher interest costs and economic support measures will increase spending, but revenue benefits from high nominal growth, keeping deficits at about 2% of GDP over our forecast horizon. Accordingly, government debt, net of liquid government assets, will remain slightly above 30% of GDP.

Finland's external deficits will decrease. The current account deficit widened significantly in 2022, to almost 4% of GDP, on higher energy imports and primary income outflows. We expect it will narrow to below 2% this year as these effects partially reverse.

Outlook

The stable outlook reflects S&P Global Ratings' expectation that, despite this year's stagnation, Finland's economy will 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 of contained risks from Finland's ongoing efforts to decouple from Russia's energy supplies.

Downside scenario

We could consider a negative rating action in the next two years if Finland's economic outlook significantly deteriorates, 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 continue 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: We expect a moderate recovery in the second half of this year, which will counterbalance the current mild recession

We expect Finland's economy will stagnate in 2023 as the economy continues to adjust to higher inflation and interest rates. Consumption dynamics will be muted this year as real disposable incomes decline while inflation outpaces wage growth. The economic outlook in Finland's main trading partners, such as Germany and Sweden, will also remain challenging over the coming months, which will weigh on external demand. Although Finland's labor market has remained strong so far, we expect a slight softening in 2023 with unemployment increasing slightly to 7%. Importantly, the country has substantially decreased trade flows with Russia over the past year, after reporting the highest direct trade exposure among Nordic countries. Exports to Russia have dropped to about 2% of Finland's total, compared with 5%-6% before the conflict. Similarly, imports from Russia are now less than 3% 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 war's economic fallout. Before the conflict, the country imported about one-third of its energy consumption, with the lion's share originating from Russia, including 15%-20% of annual electricity consumption. Finland has remedied this much faster than expected, replacing all oil and gas imports from Russia. It also has rented a U.S. liquefied natural gas terminal that acts an alternate source of energy. 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 in general and further investment in renewable energy production will continue to support these efforts.

Despite these near-term challenges, we expect Finland's economy will remain resilient. 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 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-supportive. We expect broad policy continuity following the parliamentary elections in April this year. The elections resulted in the opposition National Coalition Party emerging as a winner. We expect government formation might take a few months given the sticking points between coalition members. Still, ahead of the elections, the majority of parties campaign on promises on fiscal prudence. On April 4, 2023, Finland officially became a member of NATO, to which it applied for membership following Russia's invasion of Ukraine. The country’s ultimate accession prompted a strong diplomatic response from Russia, but we don't expect this to increase tensions.

Flexibility and performance profile: Low government net debt, limited external risks, and eurozone membership continue to support Finland's ability to absorb shocks

Weaker economic activity, expenditure pressures, including from defense and targeted anti-inflationary measures, and increasing interest costs will widen the fiscal deficit in 2023. Despite the conflict's repercussions, Finland's general government finances strengthened in 2022, fueled by rapid tax revenue growth resulting from high nominal GDP, rising employment, and relatively limited support measures amid elevated inflation. However, we expect the previously strong revenue growth will taper and higher expenditure will increase deficits to close to 2% of GDP in 2023 and 2024 from 1% in 2022.

Nevertheless, public debt, net of liquid government assets, will remain at a modest 36% of GDP on average through 2026. 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 33% of GDP in liquid assets held by the public sector's earnings-related pension funds. In line with global trends, financing costs have risen, but given the long-dated maturity of government debt, the overall interest bill still appears moderate and manageable. We expect interest expense will remain below 5% of government revenue over the next four years.

Finland has sizable contingent liabilities--predominantly guarantees--of about 25% of GDP. But we do not believe these will weigh on public debt in our forecast horizon. Most guarantees relate to Finnvera, the state's export credit agency. Over 50% of those guarantees are linked to the Finnish cruise ship sector, which previously suffered pandemic fallout. We understand the situation for Finnish shipbuilding has improved and Finnvera has reversed a significant share of the loss provisions in 2020. In 2022, Finnvera made additional loss provisions of €210 million on operations it had underwritten in Russia. Currently, Finnvera's total exposure in Russia stands at €422 million. The government has also supported its majority-owned airliner Finnair through the pandemic and extended €540 million in loan guarantees while providing a hybrid bond of €350 million and capital injection of €300 million.

As in other countries, inflation--as measured by HICP--has increased sharply in Finland over the past year, averaging 7.2% in 2022. Food and energy prices were the primary drivers of price increases, rising by almost 11% and more than 30%, respectively. However, the relatively low share of these goods in Finland's consumer basket as well as only moderate services price increases have kept the country’s inflation below the eurozone average. Although headline inflation has fallen from its peak levels in November 2022 and stood at 6.8% in March 2023, it has become more broad-based, also on the back of a robust labor market. Despite relatively moderate wage increases so far, we still cannot fully preclude the risk of a wage-inflation spiral, in part due to the very high levels of unionization in the country. In our base-case scenario, we expect headline inflation will average about 5% for 2023 and move into the European Central Bank's (ECB’s) target range of slightly below 2% by 2025.

However, if higher wages were to drive up prices--which would likely parallel developments in other eurozone countries--the ECB might accelerate its monetary tightening. It has raised its main policy rate by a cumulative 3.5% since last year to 3.0%, 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 deficit will ease to 1.6% of GDP in 2023 and narrow further in the next couple of years. The rise in energy prices presented a shock for the country's terms of trade in 2022. Coupled with rising primary income outflows on higher dividend payouts--following the discontinuation of the ECB's restrictions on dividend payouts for financial institutions--this increased the current account deficit to 3.9% of GDP. We expect the terms-of-trade shock to slightly reverse and primary income outflows to normalize this year, which will help narrow the current account to about 1.8% of GDP this year with a declining trend.

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 2023-2026. 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 during the low interest rate period has led to higher private sector debt. Even if debt remains moderate in a peer comparison, the rising interest rates, alongside high inflation, will continue to weaken households' disposable income, given that more than 90% of mortgage loans are variable-rate (although this is partially mitigated by the high share of annuity loans). 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

	2017	2018	2019	2020	2021	2022	2023bc	2024bc	2025bc	2026bc
Economic indicators (%)										
Nominal GDP (bil. EUR)	226.3	233.5	239.9	238.0	250.6	266.7	282.7	291.8	301.2	310.1
Nominal GDP (bil. $)	255.7	275.7	268.5	271.9	296.4	280.8	303.3	328.1	350.9	362.7
GDP per capita (000s $)	46.5	50.0	48.7	49.2	53.6	50.6	54.6	59.1	63.1	65.1
Real GDP growth	3.2	1.1	1.2	(2.4)	3.1	2.1	0.0	1.1	1.4	1.3
Real GDP per capita growth	2.9	1.0	1.1	(2.5)	2.9	1.8	(0.2)	1.1	1.3	1.2
Real investment growth	4.8	3.6	(1.5)	(1.0)	0.9	5.0	0.0	1.0	1.5	1.8
Investment/GDP	24.0	25.3	24.1	24.5	24.1	26.6	26.8	26.4	26.2	26.2
Savings/GDP	23.2	23.4	23.8	25.1	24.6	22.7	25.0	24.8	25.0	25.0
Exports/GDP	37.6	38.5	39.9	35.8	39.6	44.9	42.5	42.2	42.8	43.2
Real exports growth	8.8	1.5	6.7	(7.8)	6.0	1.7	1.9	2.8	2.3	2.3
Unemployment rate	8.7	7.5	6.8	7.7	7.7	6.8	7.0	6.8	6.6	6.5
External indicators (%)										

Finland--Selected Indicators

Current account balance/GDP	(0.8)	(1.9)	(0.3)	0.6	0.5	(3.9)	(1.8)	(1.5)	(1.2)	(1.2)
Current account balance/CARs	(1.8)	(4.0)	(0.6)	1.3	1.0	(7.2)	(3.5)	(3.1)	(2.5)	(2.3)
CARs/GDP	45.4	46.6	49.4	44.6	49.3	53.9	51.7	50.2	50.3	50.7
Trade balance/GDP	0.7	0.1	1.0	1.2	0.9	(0.5)	(0.1)	0.2	0.5	0.5
Net FDI/GDP	1.3	(4.9)	3.2	(2.7)	1.5	(2.1)	1.5	1.0	0.8	0.8
Net portfolio equity inflow/GDP	(0.8)	1.5	(3.0)	(1.2)	(0.5)	(3.0)	(1.0)	(1.0)	(1.0)	(1.0)
Gross external financing needs/CARs plus usable reserves	339.4	288.9	349.6	363.2	348.3	329.1	332.7	328.5	319.7	317.1
Narrow net external debt/CARs	248.8	220.0	196.1	259.2	193.9	207.6	215.8	217.4	213.9	216.1
Narrow net external debt/CAPs	244.5	211.6	194.9	262.4	195.8	193.7	208.6	210.9	208.7	211.3
Net external liabilities/CARs	(1.7)	10.9	(18.0)	54.3	(4.0)	24.3	11.0	6.1	8.4	10.5
Net external liabilities/CAPs	(1.7)	10.5	(17.9)	55.0	(4.0)	22.7	10.7	5.9	8.2	10.3
Short-term external debt by remaining maturity/CARs	268.2	208.6	276.1	298.7	281.5	258.3	263.3	258.3	248.0	245.0
Usable reserves/CAPs (months)	1.1	1.0	0.9	1.2	1.1	1.2	1.2	1.2	1.1	1.1
Usable reserves (Mil. $)	10,516.8	10,310.5	11,417.6	13,491.5	16,758.5	16,054.8	16,500.0	17,000.0	17,500.0	18,000.0
Fiscal indicators (general government %)										
Balance/GDP	(0.7)	(0.9)	(1.0)	(5.6)	(2.8)	(1.0)	(1.8)	(1.7)	(1.8)	(1.8)
Change in net debt/GDP	(2.0)	3.0	(2.1)	6.2	(2.6)	8.1	2.3	2.9	2.1	2.1
Primary balance/GDP	0.4	0.1	(0.1)	(4.9)	(2.3)	(0.3)	(1.0)	(0.9)	(0.9)	(0.9)
Revenue/GDP	53.0	52.5	52.4	51.6	53.1	53.0	52.0	52.0	52.0	52.0
Expenditures/GDP	53.6	53.4	53.3	57.2	55.9	54.0	53.8	53.7	53.8	53.8
Interest/revenues	1.9	1.8	1.7	1.4	1.0	1.2	1.4	1.5	1.6	1.7
Debt/GDP	64.3	63.2	63.3	73.1	71.1	71.6	71.0	73.1	74.4	75.8
Debt/revenues	121.4	120.3	120.7	141.7	134.0	135.2	136.5	140.7	143.0	145.7
Net debt/GDP	25.4	27.6	24.8	31.2	27.1	33.6	33.9	35.8	36.7	37.7
Liquid assets/GDP	38.9	35.5	38.4	42.0	44.1	38.1	37.1	37.4	37.7	38.1
Monetary indicators (%)										
CPI growth	0.8	1.2	1.1	0.4	2.1	7.2	4.5	2.3	1.8	1.6
GDP deflator growth	0.8	2.0	1.5	1.6	2.2	4.3	6.0	2.1	1.8	1.6
Exchange rate, year-end (EUR/$)	0.8	0.9	0.9	0.8	0.9	0.9	0.9	0.9	0.9	0.9
Banks' claims on resident non-gov't sector growth	2.8	4.6	4.5	4.3	4.1	3.9	4.0	3.0	3.0	3.0
Banks' claims on resident non-gov't sector/GDP	93.7	95.0	96.7	101.5	100.4	98.0	96.2	96.0	95.8	95.8
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	(6.9)	7.0	(5.1)	(3.9)	7.5	(0.0)	N/A	N/A	N/A	N/A

Finland--Selected Indicators

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 the 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 ($) 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.
		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

- Sovereign Ratings History, April 11, 2023
- Sovereign Ratings List, April 11, 2023
- Sovereign Risk Indicators, April 10, 2023. An interactive version is also available at www.spratings.com/sri
- Sovereign Ratings Score Snapshot, April 6, 2023
- Economic Outlook Eurozone Q2 2023: Rate Rises Weigh On Return To Growth, March 27, 2023
- Sovereign Debt 2023: Borrowing Will Stay Elevated Despite Rising Cost Of Debt, March 9, 2023
- Sovereign Debt 2023: Developed Europe Government Borrowing Estimated At $1.7 Trillion, March 9, 2023
- Default, Transition, and Recovery: 2021 Annual Global Sovereign Default And Rating Transition Study, May 4, 2022
- Global Aging 2023: The Clock Ticks, Jan. 18, 2023

Ratings Detail (as of April 27, 2023)*

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+
25-Sep-2015		AA+/Negative/A-1+
10-Oct-2014		AA+/Stable/A-1+

Ratings Detail (as of April 27, 2023)*

*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.