S&P Global
Ratings

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Research Update:

Finland 'AA+/A-1+' Ratings Affirmed; Outlook Stable

October 27, 2023

Overview

- We expect economic activity in Finland in 2023 to be broadly flat. Real GDP growth will pick up and average 1.4% through 2026, as domestic demand recovers.
- The government's fiscal consolidation efforts will curb deficits to about 1.8% of GDP on average between 2024-2026.
- The Russia-Ukraine conflict's impact on Finland's economy, public finances, and external balances will remain manageable, supported by successful energy diversification away from Russia.
- We affirmed our 'AA+/A-1+' long- and short-term ratings on Finland. The outlook is stable.

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Rating Action

On Oct. 27, 2023, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term foreign and local currency sovereign credit ratings on Finland. The outlook is stable. We also affirmed our 'AA+' long-term foreign and local currency issue ratings on Finnvera PLC's senior unsecured euro medium-term note program, which the government of Finland guarantees.

Outlook

The stable outlook reflects our expectation that Finland's economy will recover after 2023's downturn, thanks to real wage growth, higher consumption, and stronger external demand from Finland's main trading partners.

Downside scenario

We could consider a negative rating action in the next two years if Finland's economic outlook significantly deteriorates compared with our current expectations, leading to a pronounced and protracted deterioration in the country's fiscal position.

Upside scenario

We could raise the long-term ratings if structural reform efforts strengthen Finland's fiscal performance and significantly improve its external balance sheet.

Rationale

Finland's economy will not grow in 2023, because inflation and high interest rates weigh on domestic demand, while external demand from Finland's most important trading partners, Germany and Sweden, has been particularly weak. That said, we expect a moderate recovery from 2024 with real growth averaging 1.4% between 2024-2026 as the impact of these effects wanes. Finland effectively decoupled its energy imports from Russia in 2022, supported by rising domestic electricity supply from nuclear and renewable energy production.

We expect the new coalition government to implement its fiscal consolidation plan, mostly by restricting expenditure growth. We expect this will help contain general government deficits at 1.8% of GDP on average over the next three years and keep government debt, net of liquid government assets, relatively stable near 36% of GDP on average through 2026. At the same time, Finland's external deficits will average about 1% of GDP over the same period, much reduced from 2022 because of lower energy import prices and primary income outflows.

The country's wealthy economy, its stable and mature institutions, and the benefits of eurozone membership--including the high credibility of the European Central Bank's (ECB's) monetary policy and access to deep capital markets--further support the ratings.

Institutional and economic profile: We expect moderate GDP growth over the medium term following 2023's downturn

- Still-relatively-high inflation and higher interest rates have weakened consumption and investment, while the tough economic outlook for Finland's main trading partners is stunting external demand.
- Between 2024-2026, we expect growth will average 1.4%, as inflation slows and domestic and external demand adjust to the tighter monetary conditions, but structural constraints curb further growth potential.
- Finland's new right-of-center government will focus on fiscal consolidation and pursue pro-growth structural reforms aimed at the labor market.

We expect Finland's real economy will not expand in 2023. Consumption dynamics will remain muted as real disposable incomes have declined. Despite a resilient labor market, real wages declined in the first nine months of the year. High interest rates and price increases for materials weigh on investment activity. This is particularly visible in the construction sector, which has contracted by more than 7% in the first half of the year. The economic outlook of some of Finland's main trading partners, such as Germany and Sweden, will remain challenging over the coming months, which will weigh on external demand. Sweden and Germany represent the only two European developed economies for which we forecast economic contractions in 2023. However, the decline in Finnish imports has been more pronounced than that in exports, thus contributing to an improvement in net exports.

Apart from weaker domestic demand, the improvement in net exports stems from Finland diversifying its imports away from Russia and partly replacing them with domestic production. Russia now represents about 1% of total goods imports, compared with over 11% in 2021. Previously, these included substantial energy imports, including 15%-20% of Finland's annual electricity consumption. Over the course of 2022, Finland replaced all oil and gas imports sourced from Russia. Finland's energy diversification efforts have been supported by the recent commissioning of a nuclear power plant, investment in renewable energy production, and the renting of a U.S. liquefied natural gas terminal that provides an alternate source of energy. Finland generates 40% of its energy needs from renewables and another 30% from nuclear energy and aims to reach net zero emissions by 2035.

Several factors that currently drag on growth should start to moderate from 2024, which is why we expect real growth to pick up to 1.3% next year and see similar growth rates in 2025-2026. Inflation will continue to slow and remain below the eurozone average, while the strong labor market will sustain higher wage growth, ultimately boosting disposable income and consumption. Similarly, we expect construction activity and business investment will pick up after 2023's slump, and further investments in green energy to provide an additional backstop to overall investment activity. Nevertheless, structural constraints, including lackluster productivity growth amid a shrinking employment pool, will curb growth momentum. 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% over the next few years despite 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. The new right-of-center government, which was formed at the end of June 2023, comprises four different parties with partially diverging political views. Nevertheless, we expect it to focus on implementing fiscal consolidation measures, tilted toward expenditure control. Also, the coalition agreement outlines structural reforms aiming at boosting economic growth through labor market reforms, addressing the aging population, and increasing competitiveness and productivity. On April 4, 2023, Finland officially became a member of NATO, to which it applied for membership following Russia's invasion of Ukraine. Russia was opposed to Finland's accession, but we do not expect this to have any specific economic implications for Finland.

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

- The current fiscal consolidation efforts will likely decrease general government deficits to about 1.8% of GDP on average over the next three years.
- The current account deficit will narrow this year after widening in 2022 as the trade balance improves and primary income outflows normalize.
- Lower energy prices and a slowdown in economic activity will push down headline inflation to slightly above 4% on average this year.

Weaker economic activity, expenditure pressures--including from defense and targeted anti-inflationary measures--and increasing interest costs will widen the fiscal deficit in 2023. From 2024, despite the expected recovery in economic growth, lower surpluses of some social security funds (partially because of legislative requirements) will weigh on general government balances. The government is actively trying to counterbalance these developments through active consolidation measures and thereby improve the overall fiscal stance over the coming years.

The government's consolidation plans include expenditure reductions of €4 billion over the medium term and the mobilization of €2 billion in additional revenue through structural economic reforms. We expect that, in addition to further fiscal measures, these reforms will help put general government deficits on a downward trajectory after 2024, averaging at about 1.8% of GDP over the next three years. Further consolidation measures may be required to achieve the government's 1% of GDP deficit target by 2027.

Despite the tighter fiscal stance, the government continues to pursue a sizable investment program of €4 billion over 2024-2027, aimed at green investments, funded by asset sales.

In line with this fiscal trajectory, we expect public debt, net of liquid government assets, will average 36% of GDP 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 pension funds. In line with global trends, financing costs have risen, but given the long-dated maturity of government debt, the overall interest bill remains moderate. We expect government interest expense will average 2.5% 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. Half of those guarantees are linked to the Finnish cruise ship sector, which experienced financial difficulties during the pandemic. We understand the situation for Finnish shipbuilding has improved and Finnvera has reversed a significant share of the loss provisions it assigned in 2020. Finnvera's remaining exposure in Russia stands at €121 million. The government supported its majority-owned airliner Finnair through the pandemic and extended €540 million in loan guarantees while providing a hybrid bond of €400 million and a capital injection of €300 million at the time.

As in other countries, inflation increased sharply in Finland in 2022, but we expect it will slow to 4.2% on average in 2023. This is below our expectations for the eurozone average of 5.6% in 2023, because of declining energy prices (following an increase of 30% in 2022), stagnating food prices, and moderate wage growth, which has limited growth of services' prices. We expect inflation will remain below the eurozone average, despite our expectations for moderate wage increases in 2024, partly because of the country's very high levels of unionization. Over the longer term, we expect headline inflation will roughly remain in line with the ECB's target range of slightly below 2% by 2025.

The ECB has raised its main policy rate by a cumulative 4.5% since 2022, and the rate on the main refinancing operations currently stands at 4.5%. In our view, Finland's eurozone membership reduces its monetary flexibility. However, like other eurozone members, Finland has benefited from its 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.

Last year's terms-of-trade shock, stemming from rising energy prices, as well as rising primary income outflows following discontinuation of the ECB's restrictions on dividend payouts for financial institutions, widened the current account deficit to 2.5% of GDP in 2022. We expect it to narrow to about 0.8% of GDP in 2023, with a modestly declining trend thereafter, as energy prices reverse and primary income outflows normalize.

Financial institutions continue to dominate Finland's external ratios. Nordea Bank's redomiciliation to Helsinki in 2018 substantially increased the size of the banking sector to about 350% 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 180% 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 and beyond. 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. Private sector debt remains moderate in a peer comparison, although high interest rates and 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.

Key Statistics

Table 1

Finland--Selected Indicators

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Economic indicators (%)										
Nominal GDP (bil. LC)	226	233	240	238	251	269	282	289	299	308
Nominal GDP (bil. $)	256	276	269	272	297	283	307	321	346	363
GDP per capita (000s $)	46.5	50.0	48.7	49.2	53.6	51.0	55.2	57.8	62.1	65.1
Real GDP growth	3.2	1.1	1.2	(2.4)	3.2	1.6	0.0	1.3	1.5	1.3
Real GDP per capita growth	2.9	1.0	1.1	(2.5)	3.0	1.3	(0.1)	1.3	1.3	1.2
Real investment growth	4.8	3.6	(1.5)	(1.0)	1.0	3.2	(2.5)	2.0	3.3	2.0
Investment/GDP	24.0	25.3	24.1	24.5	24.3	26.9	25.1	25.4	25.7	25.7
Savings/GDP	23.2	23.4	23.8	25.1	24.7	24.3	24.3	24.7	25.1	25.2
Exports/GDP	37.5	38.5	39.9	35.8	39.4	45.3	42.0	42.1	42.4	42.8
Real exports growth	8.8	1.5	6.7	(7.8)	5.8	3.7	(0.8)	2.5	2.0	2.0
Unemployment rate	8.7	7.5	6.8	7.7	7.7	6.8	7.0	6.8	6.6	6.5
External indicators (%)										
Current account balance/GDP	(0.8)	(1.8)	(0.3)	0.5	0.4	(2.5)	(0.8)	(0.7)	(0.6)	(0.6)
Current account balance/CARs	(1.8)	(4.0)	(0.6)	1.2	0.8	(4.6)	(1.5)	(1.4)	(1.2)	(1.1)
CARs/GDP	45.4	46.6	49.4	44.5	49.2	55.0	50.9	51.0	50.7	50.9

Table 1

Finland--Selected Indicators (cont.)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Trade balance/GDP	0.7	0.1	1.0	1.2	0.9	(0.1)	0.8	0.9	0.8	0.8
Net FDI/GDP	1.3	(4.9)	3.2	(2.7)	1.4	(2.6)	1.5	1.0	0.8	0.8
Net portfolio equity inflow/GDP	(0.8)	1.5	(3.0)	(1.2)	(0.5)	(1.1)	(1.0)	(1.0)	(1.0)	(1.0)
Gross external financing needs/CARs plus usable reserves	339.4	289.0	350.8	373.4	348.1	292.6	326.4	307.3	300.7	297.1
Narrow net external debt/CARs	248.8	223.1	206.7	257.9	196.3	192.7	191.1	186.7	178.3	173.0
Narrow net external debt/CAPs	244.5	214.6	205.4	261.0	197.9	184.3	188.3	184.1	176.2	171.1
Net external liabilities/CARs	(1.6)	13.3	(16.2)	1.3	(10.2)	(5.8)	2.1	3.2	3.6	4.0
Net external liabilities/CAPs	(1.6)	12.8	(16.1)	1.3	(10.2)	(5.6)	2.0	3.1	3.6	4.0
Short-term external debt by remaining maturity/CARs	268.2	208.7	277.5	309.8	281.2	219.5	258.5	236.8	228.6	224.1
Usable reserves/CAPs (months)	1.1	0.9	0.9	1.1	1.1	1.2	1.2	1.2	1.2	1.1
Usable reserves (mil. $)	10,517	10,310	11,418	13,491	16,758	16,055	16,500	17,000	17,500	18,000
Fiscal indicators (general government; %)										
Balance/GDP	(0.7)	(0.9)	(0.9)	(5.6)	(3.0)	(0.8)	(1.7)	(2.2)	(1.8)	(1.4)
Change in net debt/GDP	(2.0)	3.0	(2.1)	6.1	(2.6)	8.5	1.7	2.2	1.8	1.4
Primary balance/GDP	0.3	0.1	(0.1)	(4.9)	(2.5)	(0.3)	(0.6)	(0.8)	(0.4)	(0.0)
Revenue/GDP	53.0	52.5	52.4	51.6	52.7	52.5	52.5	52.5	52.5	52.5
Expenditures/GDP	53.6	53.4	53.3	57.2	55.7	53.4	54.2	54.7	54.3	53.9
Interest/revenues	1.9	1.8	1.6	1.4	1.0	1.0	2.0	2.6	2.7	2.7
Debt/GDP	64.3	63.2	63.3	73.1	71.0	71.5	71.0	72.7	73.7	74.5
Debt/revenues	121.4	120.3	120.7	141.7	134.7	136.1	135.2	138.5	140.3	141.9
Net debt/GDP	25.4	27.6	24.8	31.2	27.0	33.7	33.9	35.2	35.8	36.2
Liquid assets/GDP	38.9	35.5	38.4	42.0	44.0	37.8	37.1	37.6	37.8	38.2
Monetary indicators (%)										
CPI growth	0.8	1.2	1.1	0.4	2.1	7.2	4.2	1.2	1.6	1.6
GDP deflator growth	0.8	2.0	1.5	1.6	2.2	5.4	4.8	1.5	1.8	1.6
Exchange rate, year-end (LC/$)	0.83	0.87	0.89	0.81	0.88	0.94	0.91	0.89	0.86	0.85
Banks' claims on resident non-gov't sector growth	2.7	4.6	4.5	4.3	4.1	3.9	0.0	2.8	3.3	3.0

Table 1

Finland--Selected Indicators (cont.)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Banks' claims on resident non-gov't sector/GDP	93.7	95.0	96.7	101.5	100.3	97.3	92.9	92.9	92.8	92.9
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	(6.8)	7.0	(5.1)	(3.3)	6.8	3.3	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, IMF (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. LC--Local currency. 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

Table 2

Finland--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	1	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.

Table 2

Finland--Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
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	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.
		Finland is a member of the Economic and Monetary Union.
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	0	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

- Global Sovereign Rating Trends: Third-Quarter 2023, Oct. 16, 2023
- Sovereign Ratings List, Oct. 13, 2023

- Sovereign Ratings History, Oct. 13, 2023
- Sovereign Risk Indicators, Oct. 9, 2023. Interactive version available at http://www.spratings.com/sri
- Sovereign Ratings Score Snapshot, Oct. 9, 2023
- 2022 Annual Global Sovereign Default And Rating Transition Study, April 28, 2023
- Sovereign Debt 2023: Developed Europe Government Borrowing Estimated At $1.7 Trillion, March 9, 2023
- Global Aging 2023: The Clock Ticks, Jan. 18, 2023
- Banking Industry Country Risk Assessment: Finland, June 1, 2022

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed	
Finland	
Sovereign Credit Rating	AA+/Stable/A-1+
Transfer & Convertibility Assessment	AAA
Senior Unsecured	AA+
Short-Term Debt	A-1+
Finnvera PLC	
Senior Unsecured*	AA+
*Guaranteed by Finland.	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of