S&P Global Ratings

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Research Update:

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

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Overview

- Although Finland's economy started to recover in the second half of 2024, we project full-year real GDP will contract by 0.4% this year.
- The challenging economic outlook, higher interest costs, additional military expenditure, and social spending will push general government deficits to about 3.6% of GDP in 2024 from 2.9% of GDP in 2023.
- We expect the government's consolidation efforts will reduce deficits to about 2% of GDP by 2027, helping contain public debt, net of government assets, at 42% of GDP through 2027.
- We affirmed our 'AA+/A-1+' long- and short-term ratings on Finland and maintained a stable outlook.

Rating Action

On Oct. 25, 2024, 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 economic recovery will support the government's consolidation efforts, keeping net government debt moderate through to 2027.

Downside scenario

We could consider a negative rating action in the next two years if Finland's economic recovery is much weaker or delayed compared with our current expectations. Under this scenario, government's consolidation efforts would be more challenging, leading to a more protracted deterioration of the country's fiscal position.

Upside scenario

We could raise the long-term ratings if consolidation efforts strengthened Finland's fiscal performance and its external balance sheet improved significantly.

Rationale

Our sovereign ratings on Finland reflect the country's wealthy economy, stable and mature institutions, track record of fiscal prudence, moderate net government debt, and benefits of eurozone membership--including the high credibility of the European Central Bank's (ECB's) monetary policy and access to deep capital markets.

Finland's large net external debt, given the financial sector's large cross-border exposure, and the resulting significant external financing needs continue to constrain our ratings.

Institutional and economic profile: After a temporary recession, we project Finland's economy to expand by slightly more than 1% in the next few years

- We assume domestic demand will continue to recover in the second half of 2024 on rising wages, low inflation, and declining interest rates.
- We expect external demand will benefit from an expected recovery of Germany and Sweden, two of Finland's main trading partners.
- We project economic growth in Finland at 1.2% on average in 2025-2027, which, although moderate, is in line with growth rates for wealthy economies.

Finland's economic recession in the first half of 2024 was more protracted and deeper than we initially expected. We have therefore revised down our projections of real growth to 0.4% of GDP, marking a second consecutive year of output contraction. Still, the Finish economy has begun to recover, supported by domestic demand. Private consumption will benefit from several factors, such as inflation remaining low (currently 1% year on year); rising wage growth; declining interest rates; and an expected labor market recovery. Private-sector investment, specifically construction, will still take time to recover from high interest rates and a previous overhang of supply. At the same time, the rebound of external demand will critically depend on developments in Finland's main trading partners, namely Germany and Sweden, for which we project a recovery commencing in the second half of 2024.

We project Finland's real growth will gradually accelerate from 2025, as consumption and investment continue to strengthen. Nevertheless, momentum will be challenged by structural constraints, including lackluster productivity growth amid a shrinking employment pool. We expect skills mismatches in the labor market will persist and the labor market will tighten over the next few years. We therefore expect unemployment to remain higher than 7% despite reform efforts targeting the labor market, the government's substantial investment plans in infrastructure, as well as research and development relating to Finland's energy transition.

Positively, Finland's economy has decoupled from Russia, despite its previously high trade exposure and energy dependence. Remaining economic risks relating to the Russia-Ukraine conflict therefore remain low. Exports to Russia have dropped below 1% of Finland's total, compared with 5%-6% before the conflict. Similarly, imports from Russia are now less than 2% compared with an average of 12%-13% during the years before the conflict. These imports previously included about one-third of Finland's energy consumption before the conflict. All oil and gas imports from Russia have been substituted, and electricity imports from Russia (previously 15%-20% of annual consumption) have been replaced with imports from other Nordic countries and the commissioning of a nuclear power plant in 2022. Further investment in renewable energy production will continue to support these efforts.

In our view, Finland's stable and mature institutional setup and consensus-oriented policymaking are credit supportive. We expect broad policy continuity from the government over the next few months, with particular focus on ongoing consolidation efforts, given that all coalition parties concur on fiscal prudence. On April 4, 2023, Finland officially became a member of NATO, having applied for membership following Russia's invasion of Ukraine. Finland's membership prompted a strong diplomatic response from Russia, but we don't expect tensions to increase further.

Flexibility and performance profile: We expect the economic recovery and active consolidation measures will help reduce fiscal deficits over the next few years

- We expect a further widening of the general government deficit to 3.6% of GDP in 2024, followed by a period of robust fiscal consolidation with deficits reducing to 2.0% of GDP by 2027.
- Finland's current account deficit will remain close to balance through 2027, following the rebound in 2023.
- We expect inflation to remain at a low 1% on average in 2024, supported by lower energy prices and moderate core inflation.

Fiscal deficits will widen further in 2024 due to a combination of weak economic activity coinciding with rising spending pressures. Interest costs will likely increase threefold between 2021 and 2024, to about 1.5% of GDP; military spending and other security measures at the border could exceed 2.5% of GDP this year; and social and health expenditure is rising, including through wellbeing service counties at the subsovereign level.

To counter these expenditure pressures, the government has announced consolidation measures of €9 billion in total over several years, equivalent to about 3.3% of estimated GDP in 2024. Of these, €6 billion represent mainly budget expenditure cuts, as well as higher consumption taxes. A further €2 billion will come from economic reform mainly targeting the labor market, and €1 billion will be achieved through tighter health and social expenditure control at the county level. Most of the consolidation efforts will take effect in 2025, which, coupled with an improved economic outlook, will reduce deficits to 3.2% next year and to 2.0% by 2027. Given this fiscal path, Finland's government will avoid being subject to the European Commission's Excessive Deficit Procedure, even though deficits will exceed 3% of GDP next year as well, in our view.

Finland's projected fiscal trajectory implies that public debt, net of liquid government assets, will remain at a modest 51% of GDP on average through 2027. 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 23% of estimated 2024 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 appears moderate and manageable. We expect interest expense slightly higher than 3% of government revenue over the next four years.

Finland has sizable contingent liabilities--predominantly government guarantees--of about 23% of GDP. But we believe the likelihood of these being called is low and we do not expect they will weigh on public debt over our forecast horizon. Most guarantees relate to Finnvera, the state's export credit agency. Over 50% of these guarantees are linked to the Finnish cruise ship sector, which was previously affected by COVID-19 pandemic restrictions. We understand the situation for Finnish shipbuilding has improved and Finnvera has already reversed a significant share of the loss provisions applied in 2020. Similarly, Finnvera's total exposure in Russia has reduced by about 90% since February 2022 and currently stands at slightly over €90 million, down from about €1 billion at year-end 2021. The Finnish government has also supported its majority-owned airline 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.

Inflation in Finland--as measured by the harmonized index of consumer prices--has remained well below the eurozone average since mid-2021 and we expect it will average about 1% in 2024, despite a recent hike of the value-added tax rate and specific excises. Contributing to overall low inflation are decreasing energy prices, which had risen by 30% during 2022. At the same time, weak domestic demand and moderate wage growth have also kept core inflation below the eurozone average. Some of these effects will fade toward the end of 2024, but we believe inflation in Finland will remain below the ECB's target of slightly below 2% through 2027.

In our view, Finland's eurozone membership reduces its monetary flexibility. However, Finland also benefits from it, including from access to deep capital markets and the ECB's previous asset-purchase programs, namely the public-sector purchase program and the pandemic emergency purchasing program.

Finland's external deficit has continued to narrow in 2024, following an already substantial rebound in 2023, which occurred on the back of a reversal of the terms-of-trade shock from rising energy prices and a contraction in imports due to weak domestic demand. We expect Finland's current account will remain in a marginal deficit of 0.2%-0.3% of GDP over the next few years as trade and primary income flows continue to normalize.

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 about 210% of CARs on average in 2024-2027. Still, if we consider Finland's net international investment position, the country's external profile is much stronger, with external assets exceeding external liabilities by 25%-30% of CARs.

We expect the Finnish banking sector will remain resilient amid the ongoing house price correction and overall weak macroeconomic conditions. We therefore 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. Higher interest rates have been a boon for bank's earnings and retained earnings have further bolstered the system's already robust capitalization. In our view, the banking sector has sound buffers to absorb credit losses, even beyond our base case, given banks' strong operating profitability. Challenges arising from the recent recession and distress in certain sectors, especially real estate and construction translating into higher credit impairments, are unlikely to shake the banks' resilience.

Key Statistics

Table 1

Finland--Selected indicators

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Economic indicators (%)										
Nominal GDP (bil. LC)	232	239	236	249	266	273	277	285	293	301
Nominal GDP (bil. $)	274	267	270	294	280	296	303	326	341	353
GDP per capita (000s $)	49.7	48.4	48.9	53.2	50.5	53.1	54.4	58.4	61.1	63.0
Real GDP growth	1.2	1.3	(2.5)	2.7	1.5	(1.2)	(0.4)	1.4	1.3	1.2
Real GDP per capita growth	1.0	1.3	(2.6)	2.6	1.2	(1.4)	(0.5)	1.2	1.2	1.0
Real investment growth	4.4	(1.0)	(1.1)	1.7	2.6	(9.0)	(2.0)	3.0	2.0	1.8
Investment/GDP	25.7	24.5	25.1	24.8	27.2	22.2	21.8	22.0	22.0	22.1
Savings/GDP	24.1	24.4	25.5	25.1	25.0	21.8	21.5	21.7	21.7	22.0
Exports/GDP	39.1	40.6	36.2	39.9	46.1	42.8	41.2	41.2	41.0	40.9
Real exports growth	1.7	6.8	(8.5)	6.0	4.2	0.2	(1.4)	1.5	1.5	1.5
Unemployment rate	7.5	6.8	7.7	7.7	6.8	7.2	8.2	8.0	7.8	7.7
External indicators (%)										
Current account balance/GDP	(1.6)	(0.1)	0.4	0.3	(2.2)	(0.4)	(0.3)	(0.3)	(0.3)	(0.2)
Current account balance/CARs	(3.4)	(0.3)	0.9	0.7	(3.9)	(0.8)	(0.6)	(0.5)	(0.6)	(0.3)
CARs/GDP	47.4	50.6	45.2	50.0	56.3	54.3	50.7	50.1	49.7	49.5
Trade balance/GDP	0.2	1.0	1.2	0.9	(0.0)	3.5	3.3	3.3	3.3	3.3
Net FDI/GDP	(5.0)	3.6	(3.0)	1.1	(3.2)	0.4	0.5	0.3	0.3	0.2
Net portfolio equity inflow/GDP	1.5	(3.0)	(1.2)	(0.5)	(1.2)	(5.7)	(1.0)	(1.0)	(1.0)	(1.0)
Gross external financing needs/CARs plus usable reserves	281.8	339.2	368.6	344.1	293.2	319.4	327.0	313.5	310.9	308.1
Narrow net external debt/CARs	213.0	206.4	259.8	203.9	188.6	202.0	220.1	216.0	211.5	207.0
Narrow net external debt/CAPs	206.0	205.9	262.3	205.3	181.6	200.5	218.8	214.9	210.2	206.3
Net external liabilities/CARs	10.2	1.6	8.4	(4.4)	(11.4)	(34.6)	(30.5)	(24.9)	(24.7)	(26.8)
Net external liabilities/CAPs	9.8	1.6	8.5	(4.5)	(11.0)	(34.4)	(30.3)	(24.7)	(24.5)	(26.7)
Short-term external debt by remaining maturity/CARs	201.0	264.8	304.0	276.3	220.4	250.7	262.4	245.8	242.0	238.8
Usable reserves/CAPs (months)	0.9	0.9	1.1	1.1	1.2	1.2	1.3	1.2	1.2	1.2

Table 1

Finland--Selected indicators (cont.)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Usable reserves (mil. $)	10,308	11,424	13,488	16,750	16,067	16,939	17,089	17,339	17,589	17,839
Fiscal indicators (general government; %)										
Balance/GDP	(0.9)	(1.0)	(5.6)	(2.8)	(0.4)	(2.9)	(3.6)	(3.2)	(2.4)	(2.0)
Change in net debt/GDP	3.9	(1.2)	6.7	(0.2)	9.9	1.9	4.9	1.9	2.4	2.0
Primary balance/GDP	0.1	(0.1)	(4.9)	(2.3)	0.2	(1.7)	(2.1)	(1.5)	(0.7)	(0.2)
Revenue/GDP	52.9	52.7	52.0	53.4	53.4	53.8	52.0	52.7	52.9	53.1
Expenditures/GDP	53.7	53.6	57.6	56.2	53.7	56.7	55.7	55.9	55.3	55.1
Interest/revenues	1.8	1.6	1.4	1.0	1.1	2.2	3.0	3.2	3.2	3.3
Debt/GDP	63.6	63.6	73.7	71.7	72.5	75.7	79.2	80.3	81.4	82.1
Debt/revenues	120.3	120.7	141.7	134.2	136.0	140.7	152.1	152.2	153.8	154.6
Net debt/GDP	34.2	32.1	39.1	36.9	44.4	45.1	49.4	50.0	51.0	51.6
Liquid assets/GDP	29.4	31.5	34.6	34.7	28.1	30.6	29.7	30.2	30.4	30.5
Monetary indicators (%)										
CPI growth	1.2	1.1	0.4	2.1	7.2	4.3	1.0	1.7	1.6	1.6
GDP deflator growth	2.0	1.5	1.6	2.4	5.4	3.9	1.6	1.4	1.6	1.6
Exchange rate, year-end (LC/$)	0.87	0.89	0.81	0.88	0.94	0.90	0.89	0.87	0.85	0.86
Banks' claims on resident non-gov't sector growth	4.6	4.5	4.3	4.1	3.9	(0.4)	2.8	3.3	3.0	3.0
Banks' claims on resident non-gov't sector/GDP	95.7	97.2	102.3	101.2	98.2	95.3	96.7	97.2	97.2	97.4
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
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	7.0	(5.1)	(3.2)	8.8	3.2	2.8	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. 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.
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 of 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	
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

- Sovereign Ratings List, Oct. 9, 2024
- Sovereign Ratings History, Oct. 9, 2024
- Sovereign Ratings Score Snapshot, Oct. 8, 2024
- Sovereign Risk Indicators, Oct. 7, 2024. Interactive version available at http://www.spratings.com/sri
- Global Sovereign Rating Trends Midyear 2024: Outlook Balance Improves, July 25, 2024
- European Developed Markets Sovereign Rating Trends Midyear 2024: Lagging Regional Growth Could Weigh On Public Finances, July 25, 2024
- Sovereign Debt 2024: Developed European Governments To Borrow About $1.84 Trillion in 2024, Feb. 27, 2024
- Sovereign Debt 2024: Borrowing Will Hit New Post-Pandemic Highs, Feb. 27, 2024

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+