CREDIT OPINION
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Update

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Government of Finland - Aa1 stable

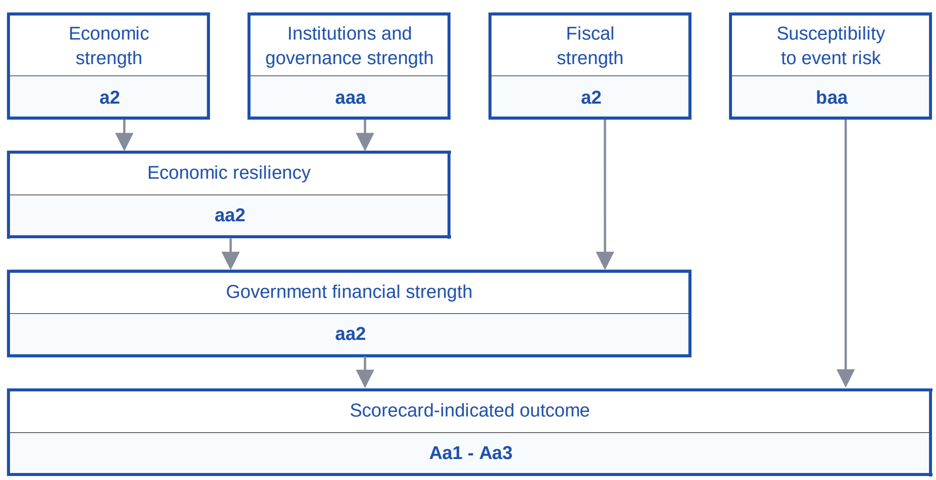
Update following rating affirmation, outlook maintained stable

Summary

Finland's credit profile is supported by the strength of the country's institutions and knowledge-based economy. These institutions, which are among the strongest in Moody's rated universe, have produced a strong track record of structural reforms, which is reflective of the country's very strong institutional and governance framework. These reforms continue under the current government, which is looking to further bolster the country's strong focus on innovation and address structural labour market challenges by boosting the labour force participation rate and attracting skilled migrants.

However, the public finances have come under considerable pressure since 2020 following the pandemic and Russia's invasion of Ukraine (Ca stable). Higher energy prices and borrowing costs drove the government to enact a series of measures to boost purchasing power, which contributed to an increase in debt burden and interest expenditure. However, we assess that the measures that the government is putting in place through two consolidation packages worth 3.8% of GDP between 2025 and 2028 will materially narrow the deficit and put the debt on a gradual downward trajectory from 2027 onwards.

Exhibit 1
Finland's credit profile is determined by four factors



Source: Moody's Ratings

Credit strengths

» Skilled labour force and strong institutional focus on innovation support knowledge-based economy

» Commitment of the authorities to structural reforms

» Stable, consensus-based political system and effective institutions

Credit challenges

» Elevated general government debt levels that are unlikely to decline within the next three years.

» Preservation of fiscal strength and fostering potential growth in light of demographic change

» Elevated exposure to geopolitical risk

Rating outlook

The stable outlook reflects balanced risks at the Aa1 level. Finland retains its significant competitiveness, and changes to migration patterns and government policy are meaningful steps to counteract labour supply issues.

The recent deterioration in the public finances is also being addressed, most notably by a large fiscal consolidation package announced in April 2024. Should further fiscal efforts be needed to put debt firmly on a downward path, Finland's strong institutional framework suggests that these will be forthcoming.

Factors that could lead to an upgrade

Finland's Aa1 rating could come under upward pressure if we were to see a sustained improvement in the debt trajectory earlier and faster than what we currently expect. This could be accompanied by favourable surprises to the impact of structural reforms—particularly related to labour force participation of older workers and migration of skilled workers. These reforms could result in an improvement in the country's medium- to long-term growth potential.

Factors that could lead to a downgrade

Downward pressure on the outlook, or ultimately the rating, could develop if the government did not deliver on its commitment to reverse the deterioration in fiscal metrics. More precisely, a failure to take additional measures if its medium-term fiscal strategy underperformed expectations would place downward pressure on Finland's credit profile. A material worsening of the medium-term growth outlook, combined with an unwillingness or inability to address the impact of lower growth on the public finances would be credit negative, too. Although it is not our baseline assumption, an escalation of Russia's war in Ukraine that directly involves NATO members would also exert downward rating pressure.

Key indicators

Exhibit 2

Finland	2019	2020	2021	2022	2023	2024F	2025F	2026F
Real GDP (% change)	1.3	-2.5	2.7	1.5	-1.2	-0.5	1.2	1.5
Inflation rate (% change average)[1]	1.1	0.2	3.2	8.8	1.3	1.1	1.8	2.0
Gen. gov. financial balance/GDP (%)	-0.9	-5.5	-2.7	-0.2	-3.0	-3.7	-3.0	-2.1
Gen. gov. primary balance/GDP (%)	-0.1	-4.9	-2.1	0.4	-1.8	-2.4	-1.5	-0.5
Gen. gov. debt/GDP (%)	65.3	75.4	73.2	74.0	77.1	82.4	85.3	86.2
Gen. gov. debt/revenues (%)	126.5	148.0	139.6	141.1	146.2	154.9	159.2	160.9
Gen. gov. interest payment/revenues (%)	1.6	1.3	1.0	1.1	2.2	2.5	2.8	2.9
Current Account Balance/GDP (%)	-0.1	0.4	0.3	-2.2	-0.4	-1.1	-1.1	-1.0

[1] Harmonized Index of Consumer Prices (HICP)Harmonized Index of Consumer Prices (HICP)Harmonized Index of Consumer Prices (HICP)Harmonized Index of Consumer Prices (HICP)

Source: Moody's Ratings

Detailed credit considerations

We assess Finland's **economic strength** as “a2”, above the initial score of “baa1”, reflecting the country's high wealth levels, a very well-educated labour force and strong institutional support for innovation, which create a solid foundation for a knowledge-based economy. Finland shows comparatively high spending on research and development (R&D) relative to the size of its economy, which explains its high scores in global competitiveness rankings.

Finland continues to be ranked among the top 10 countries globally for innovation performance in 2022 by the World Intellectual Property Organisation. The 2022 PISA scores, which focused on mathematical literacy, showed Finnish students performing above the OECD average, though their performance deteriorated relative to 2006 (the country's best-performing year).

Having said this, our assessment also takes into account long-standing productivity challenges, such as labour and skills shortages in the most productive sectors. Longer term, population ageing is a particular challenge, though recent changes in migration patterns are resulting in significant improvements to demographic trends. In October 2024, Statistics Finland published new population forecasts in which net immigration increased to 40,000 from the previous assumption of 15,000 made five years ago. Event if Statistics Finland's assumptions prove to be optimistic, independent forecasting body ETLA thinks that it is reasonable to assume that long-term net migration will be at least 60% higher than what was previously assumed.

Our assessment of Finland's **institutions and governance strength** is “aaa”. This is underpinned by the government’s high credibility, transparency and consensus on key macroeconomic policies. There is broad political consensus in favour of fiscal consolidation, though current plans anticipate that this will happen at a slow pace. Finland’s fiscal framework is tied to multi-annual expenditure ceilings with the Ministry of Finance setting annual limits on central government spending (real expenditure ceiling in absolute terms) for the remaining years of its term.

The assessment also reflects the professional and well-staffed public administration, including the Bank of Finland and Finnish Financial Supervisory Authority, which oversee financial stability and have implemented several rounds of macro-prudential measures to counter rising household debt. Furthermore, Finland scores strongly in global surveys assessing rule of law, voice and accountability, and the control of corruption.

We score Finland’s **fiscal strength** as “a2”, which is higher than the initial score of “baa1”. This adjustment reflects the temporary nature of the debt increase and the partially funded nature of its pension commitments, which reduces pension-related risks.

Public finances in Finland have come under considerable pressure since 2020 following the pandemic and Russia's invastion of Ukraine. Higher energy prices and borrowing costs drove the government to enact a series of measures to boost purchasing power, which ultimately contributed to an increase in the debt burden and interest expenditure.

We anticipate that Finland will start to run primary surpluses from 2027 onwards. In structural terms, the European Commission's estimate is that the primary balance will turn positive from 2025 onwards. However, material stock-flow adjustments, such as those associated with statutory earnings-related pension funds, government investments funded through the sale of central government assets and defence procurement, are a structural feature of Finland's debt dynamics and mean that debt reduction from 2028 onwards will be slow in the absence of even more consolidation measures.

Finland's overall score of “baa” for **susceptibility to event risk,** driven by political risk. Russia’s invasion of Ukraine marked a paradigm shift in the post-Cold War European security order. Finland’s geographical proximity to Russia is a clear source of vulnerability in the current context, though on balance we see its susceptibility to geopolitical risks as being similar to that of most NATO members; Finland joined NATO in 2023.

Finland is exposed to cyber risks, particularly from Russia, though these risks are largely mitigated by its modern and sophisticated technological infrastructure. To address these risks, the government has published a new Cyber Security Strategy, which extends until 2035; this addresses the requirements of the EU's Cyber Security Directive. The strategy will allocate resources to further modernise technological equipment across the government sector (particularly in the well-being service counties, where there are notable vulnerabilities).

Domestic political risk is low in spite of differing views on the economy, immigration, the EU, and climate policy within the government. The current coalition, which comprises four parties and is led by the National Coalition Party, remains committed to policy continuity, consensus-driven policy-making and fiscal consolidation. Resistance to higher levels of immigration could complicate efforts to increase productivity growth given the decline in the working-age population.

Our banking sector risk score of “a” reflects the large size of the banking system, mitigated by solid capital adequacy and stable profitability of the Finnish banks. Challenges could emerge due to a combination of declining household savings rates, a sharp rise in households' indebtedness, and increased lending to housing corporations. The relocation of Nordea Bank AB (Aa3 positive) headquarters to Helsinki in October 2018 led to a doubling in size of the domestic banking system.

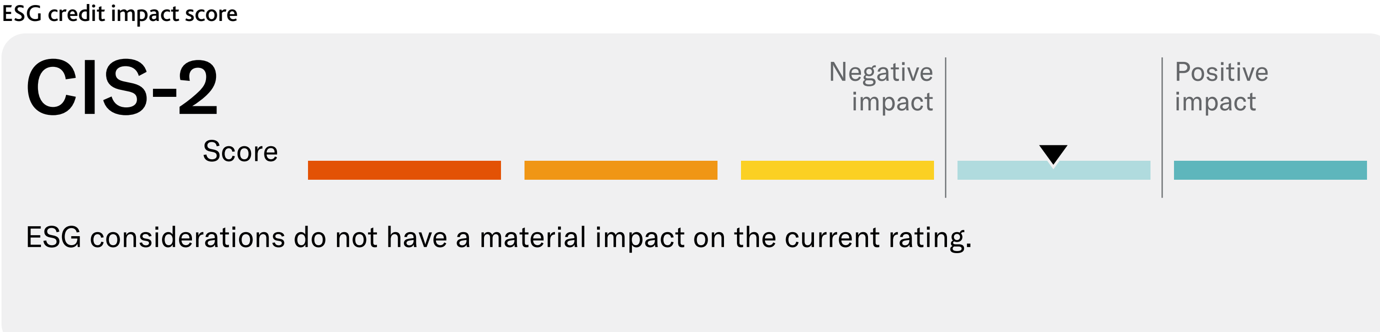
Our government liquidity risk score of “aaa” reflects the government's very strong access to domestic and external funding sources, as illustrated by its very low financing costs.

Our “aa” external vulnerability risk score reflects Finland's relatively stable current-account balance and net international investment position.

ESG considerations

Finland's ESG credit impact score is CIS-2

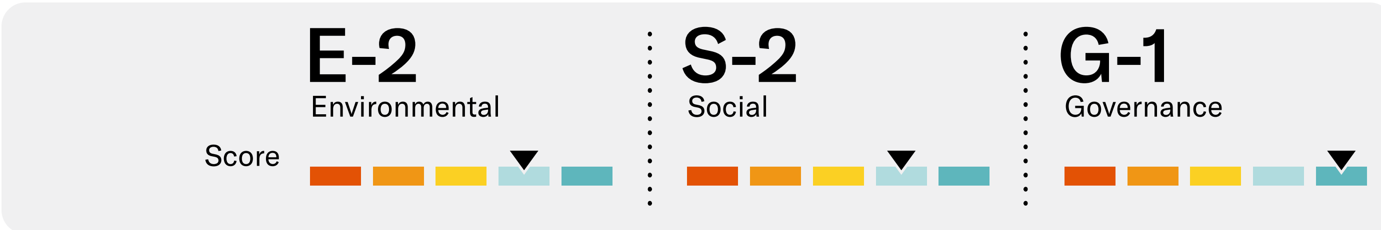
Exhibit 3
ESG credit impact score



Source: Moody's Ratings

Finland's ESG Credit Impact Score of **CIS-2** reflects low exposure to environmental and social risks, very strong governance and, as a result, overall strong capacity to respond to shocks.

Exhibit 4
ESG issuer profile scores



Source: Moody's Ratings

Environmental

Finland's exposure to environmental risks is **E-2**, which reflects its low risks across all categories, such as physical climate risks, carbon transition, water management, natural capital, and waste and pollution.

Social

Finland has very low or low exposure to most sources of social risks, which is reflected in its **S-2** issuer profile score. Finland has high-quality education, housing, healthcare and basic services categories that, in our view, support the credit profile. While other countries' education systems have become even more competitive, Finland's remains a particularly strong point. Like many advanced economies, Finland faces long-term economic and fiscal pressures from demographic change, marked by a shrinking working age population and a relatively high dependency ratio, though there are some signs the changes to migration and education policy could be changing these dynamics for the better.

Governance

Finland's institutions and governance is a noteworthy credit strength, which is reflected in the highest-possible G issuer profile score (**G-1**). This is underpinned by the government's high credibility, transparency and consensus on key fiscal policy goals and macroeconomic policies. It also reflects the professional and well-staffed public administration and Finland's very strong scores in global surveys assessing rule of law, voice and accountability, and the control of corruption. Coupled with comparatively strong government financial strength this supports a high degree of resilience.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our report on how the scores depict varied and largely credit-negative impact of ESG factors and our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology.

Recent developments

The government is taking decisive action to address the deterioration in fiscal metrics

We estimate Finland's budget deficit will widen from 3% in 2023 to around 3.7% in 2024. In 2024, increased spending on inflation-linked social benefits, a higher public sector wage bill and higher interest costs put upward pressures on expenditure. An additional series of one-off expenditure items contributed to higher expenditure in 2024 relative to the planned budget, namely related to aid to Ukraine, operating expenditure and cost of construction associated with the Border Force and the eastern border with Russia as well as compensation for producers for animals killed due to the bird flu.

In light of the fiscal challenges, the government has taken several steps to consolidate the public finances. So far, these include two consolidation packages that the European Commission estimates as having a total fiscal impact worth 3.8% of GDP.

The first consolidation package accounts for around 2/3 of the total consolidation effort and emphasised expenditure cuts that sought to incentivise work, raise the participation rate of older workers, and increase the efficiency of health care and social spending. The package also instituted tax cuts on labour, with an eye toward reducing the tax wedge.

The second consolidation package introduced in April 2024 further accelerates the pace of deficit reduction. This included a VAT tax hike from 24% to 25.5% which has been in effect since September 2024, as well as measures boosting operational savings in the central government, and health and social care spending cuts.

The 2025 budget outlines a series of consolidation measures which will partly mitigate the deterioration in fiscal metrics, although the full effect of these measures will take time to crystallise. As the April 2024 fiscal strategy comes into force, we expect a boost to revenues from the VAT rate increase. Further expenditure cuts and an upturn in economic growth will also cause a cyclical improvement in growth-sensitive tax receipts.

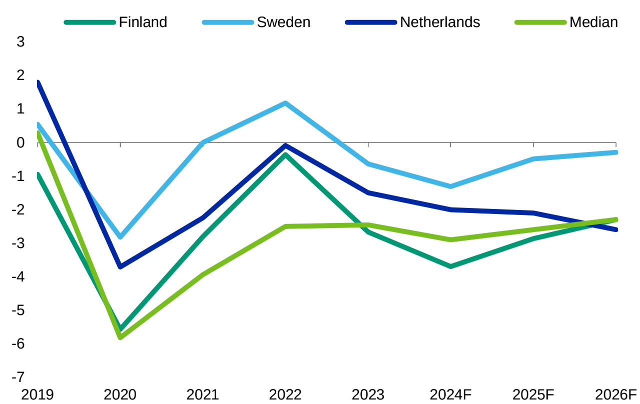
In its late November assessment, the European Commission found Finland's Medium-Term Plan 2025-2028 to be in compliance with its new fiscal rules, and announced that Finland will not enter into the Excessive Deficit Procedure (EDP). While net expenditure is projected to exceed the European Commission's reference trajectory, the government's plan meets all criteria set forth in the new fiscal rules. Differences in the projected net expenditure path of the European Commission and the Finnish government being driven by different macroeconomic assumptions the difference in net expenditure path is due to different macroeconomic assumptions which the Commission deemed to be reasonable. The Commission will assess in spring 2025 whether an EDP should be opened based on a breach of the general government deficit criterion.

Looking ahead, fiscal consolidation measures will not avert an increase in the debt burden, which we expect will peak in 2027. The increase in debt is driven partly by significant stock-flow adjustments, to statutory earnings-related pension funds (which are invariably in surplus but may not be used to service debt), defence procurement, social housing loans and government investments that are funded by the sale of government assets.

Exhibit 5

The deficit will widen in 2024...

Financial balance, % of GDP

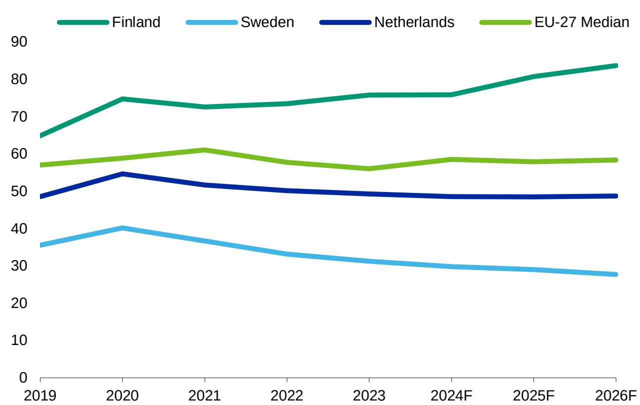


Sources: Eurostat and Moody's Ratings

Exhibit 6

... as the debt burden increases in the medium term

General government debt, % of GDP



Sources: Eurostat and Moody's Ratings

Finland will face modest rebound after two consecutive years of negative growth; government attempting to tackle structural growth challenges

The Finnish economy entered a recession in 2023, with real GDP contracting by 1.2%. The economy then suffered two successive quarterly contractions of 1.3% y/y and 1.4% y/y in the first and second quarters of 2024 respectively, before a modest rebound of 0.3% y/y in the third quarter of the year. The recession was mostly driven by a large drop in investment, with gross fixed capital formation contracting by over 5% y/y in every quarter since the first quarter of 2023; this is largely the result of a decline in residential construction. Private consumption growth remained subdued, with modest growth driven by government consumption as a result of cost-of-living support measures, which are expected to decrease in 2025, as well as a recent surge in net exports.

From a sectoral perspective, reduced investment hit the construction sector the most, with the sector facing large contractions of 13.7%, 11% and 5.4% in the first three quarters of 2024. As private consumption remained muted and investment contracted again, a surge in exports of goods and services drove the modest expansion in the third quarter of 2024. Services exports increased by 14% y/

y as of September 2024 as external demand strengthened, with a more modest pick-up in the exports of goods driven by the recovery from strikes earlier in the year further contributing to growth.

Inflationary pressures have mostly subsided and inflation is expected to remain close to target. A sharp decline in energy prices during 2023 drove the price level stabilisation, with the HICP standing at 1.5% in October 2024 and having remained below the 2% target throughout all of 2023. We expect inflation to reach 2.3% in end 2024, as the impact of the standard VAT hike from 24% to 25.5%, which took effect in September 2024, has not yet fully passed through to prices yet. Moreover, while unemployment is relatively high in Finland compared to peers, it has remained broadly stable despite the contraction, standing at 7.2% in 2023.

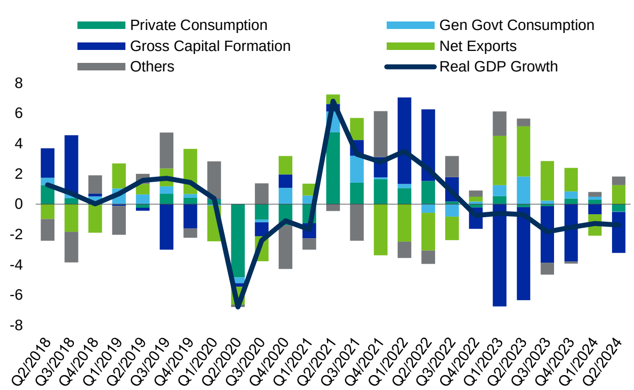
Looking ahead, we expect the Finnish economy to gradually recover. After a small contraction of 0.5% in 2024, we expect an expansion of 1.2% in 2025 and 1.5% in 2026. We also expect inflation to be broadly stable, avergaing 1.1% and 1.8% in 2024 and 2025 respectively. The unwinding of monetary policy and lower interest rate environment is expected to contribute to a relatively swift pick-up in the construction sector, which is currently still placing the main drag on growth. The monetary policy transmission mechanism is particularly quick in Finland due to an overwhelming majority of mortgages being on variable rate or fixed for very short periods. As such, we expect new mortgage lending to be a leading indicator of the upcoming recovery. As borrowing costs decrease, we also expect private consumption to recover.

The long-term growth prospects for Finland will also be boosted as the new government's reform agenda aims to tackle Finland's structural growth problems related to ageing, skills mismatches in the labour force and long-term unemployment. These include a planned social security reform, which aim to ease up the bureaucracy related to the benefits and merge the two non-earnings related unemployment benefits, thereby increasing the incentive to seek employment and reversing the increasing trend of long-term unemployment. In order to attract high-skilled workers, the government is also simplifying the process for foreign students to apply for Finnish universities. High-skilled migrants particularly from Asian countries, along with a recent large influx of Ukrainian migrants, have contributed towards population growth in Finland. Different forecasts of long-term population growth yield different estimates of potential growth, which we now forecast to average around 2% in the long-run.

Exhibit 7

Falling investment is the main drag on growth

Percentage contribution to growth

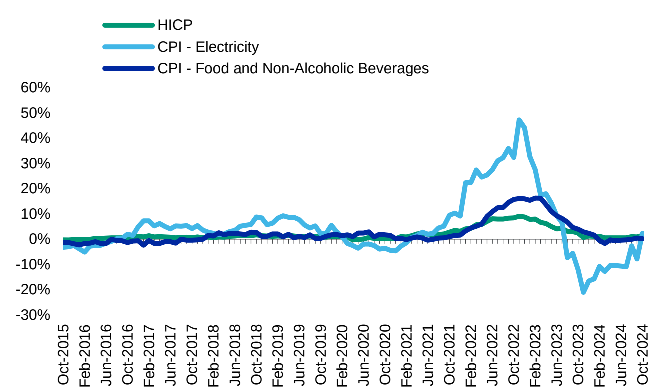


Sources: Eurostat and Moody's Ratings

Exhibit 8

Falling energy prices keep driving disinflation

Year-on-year, % change



Sources: Eurostat and Moody's Ratings

Geopolitical risks remain contained amid higher defence expenditure

Geopolitical risks associated with Russian interference have so far remained limited. This is partly due to Finland's modern digital infrastructure as well as the political landscape, which does not feature a popular pro-Russian political party, have contributed to minimise risks. The full closure of all air traffic and of the eastern border with Russia, along with increased investment in the control of the border, further reduce the risk of interference. The Finnish government also accuses Russia of encouraging an influx of asylum seekers in 2023 and 2024 in order to stoke domestic political tensions; this prompted a complete closure of the land border between the two countries. Nevertheless, the country has experienced a number of cyber attacks, possible damage to communications infrastructure (i.e. undersea cables), and the Balticconnector gas pipeline.

Despite this, Finland is increasing its defence expenditure, which has already for years been aligned with NATO targets. The government has recently purchased 64 F-35 fighter jets from the United States of America (US, Aaa stable) costing EUR 12.7 billion or 4.6% of GDP, which are expected to be delivered starting in 2025, and it will also purchase a Squadron 2020 combat vessel expected to be delivered by 2027-2029, costing EUR 1.45 billion (or 0.5% of GDP). The cost of the F-35s and Squadron 2020s are already incorporated into the debt burden, but will be recorded in the deficit statistics upon delivery. Total defence expenditure is expected to increase by just over EUR 1 billion (or 0.4% of GDP) in 2024 and by around EUR 2.3 billion in 2025 and 2026 (around 0.8% of forecasted GDP each year).

Moody's rating methodology and scorecard factors: Finland - Aa1 stable

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial Factor Score	Final Factor Score	Weights
Factor 1: Economic strength				baa1	a2	50%
Growth dynamics	Average real GDP growth (%)	2019-2028F	0.7	caa2		25%
	MAD Volatility in Real GDP Growth (%)	2014-2023	1.4	ba1		10%
Scale of the economy	Nominal GDP ($ billion)	2023	295.6	a2		30%
National income	GDP per capita (PPP, Intl$)	2023	63,558.7	aaa		35%
Adjustment to factor 1	*# notches*				2	max ±9
Factor 2: Institutions and governance strength				aaa	aaa	50%
Quality of institutions	Quality of legislative and executive institutions			aaa		20%
	Strength of civil society and the judiciary			aaa		20%
Policy effectiveness	Fiscal policy effectiveness			aaa		30%
	Monetary and macroeconomic policy effectiveness			aaa		30%
Specified adjustment	Government default history and track record of arrears				0	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				aa3	aa2	
Factor 3: Fiscal strength				baa1	a2	
Debt burden	General government debt/GDP (%)	2023	77.1	ba3		25%
	General government debt/revenue (%)	2023	146.2	a1		25%
Debt affordability	General government interest payments/revenue (%)	2023	2.2	aa1		25%
	General government interest payments/GDP (%)	2023	1.2	aa2		25%
Specified adjustments	*Total of specified adjustment (# notches)*			-2	-1	max ±6
	Debt Trend - Historical Change in Debt Burden	2015-2023	8.4	0	0	
	Debt Trend - Expected Change in Debt Burden	2023-2025F	8.2	-1	0	
	General Government Foreign Currency Debt/ GDP	2023	0.0	0	0	
	Other non-financial public sector debt/GDP	2023	24.5	-1	-1	
	Government Financial Assets including Sovereign Wealth Funds / GDP	2023	2.0	0	0	
Other adjustment to factor 3	*# notches*				1	max ±3
F1 x F2 x F3: Government financial strength				aa3	aa2	
Factor 4: Susceptibility to event risk				baa	baa	Min
Political risk				baa		
	Domestic political risk and geopolitical risk			baa		
Government liquidity risk				aaa	aaa	
	Ease of access to funding			aaa		
Specified adjustment	High refinancing risk				0	max -2
Banking sector risk				a	a	
	Risk of banking sector credit event (BSCE)	Latest available	a3	aaa-a3		
	Total domestic bank assets/GDP	2023	263.4	230-400		
Adjustment to F4 BSR	*# notches*				0	max ±2
External vulnerability risk				aa	aa	
	External vulnerability risk			aa		
Adjustment to F4 EVR	*# notches*				0	max ±2
Overall adjustment to F4	*# notches*				0	max -2
F1 x F2 x F3 x F4: Scorecard-indicated outcome				**Aa2 - A1**	**Aa1 - Aa3**	

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the scorecard-indicated outcome. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Footnotes: (1) Initial factor score: scorecard indicators combine with the automatic adjustments to produce an initial factor score for every rating factor, as detailed in Moody's Sovereign Ratings Methodology. **(2) Final factor score:** where additional analytical considerations exist, initial factor scores are augmented to produce a final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Ratings Methodology; details on country-specific considerations are provided in Moody's research. **(3) Scorecard-indicated outcome:** Factor 1: Economic Strength, and Factor 2: Institutions and Governance Strength, combine with equal weight into a construct we designate as Economic Resiliency (ER). An aggregation function then combines ER and Factor 3: Fiscal Strength, following a non-linear pattern where Fiscal Strength has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the government financial strength as given by combining the first three factors. **(4) There are 20 ranking categories for quantitative sub-factors:** aaa, aa1, aa2, aa3, a1, a2, a3, baa1, baa2, baa3, ba1, ba2, ba3, b1, b2, b3, caa1, caa2, caa3, ca and 8 ranking categories for qualitative sub-factors: aaa, aa, a, baa, ba, b, caa, ca **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

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