Analysis

Rise in services prices has made Finland an expensive country

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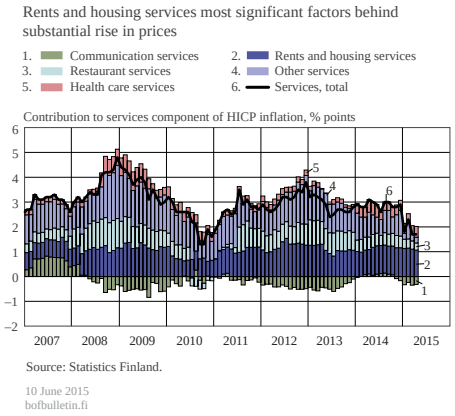
Consumer prices have risen in Finland at a higher pace than in the euro area. This has eroded Finnish consumers' purchasing power and weakened the competitiveness of the economy. Of household expenditure, approximately 40% is services-related, and Finnish services prices, in particular, have risen at a relatively rapid pace. Since the financial crisis, domestic services prices have risen by over 10% compared with the euro area average. Finnish services price inflation has been the highest in the euro area.



Finland is the most expensive country in the euro area, and Finnish inflation has in recent years been among the highest in the euro area. For Finnish consumers, the elevated prices mean that, despite relatively high income, purchasing power remains weak. From the perspective of businesses, high prices erode Finland’s attractiveness for investment and weaken the cost-competitiveness of exports.

Services constitute the largest expenditure item for consumers, and the rapid pace of increase in services prices has been the most significant factor behind the high level of Finnish inflation. In 2008–2014, services prices rose in Finland on average 3.0% per annum, compared with an average of 1.7% in the euro area (Chart 1). As a result of the prolonged rapid pace of increase in services prices, the difference between Finnish and euro area prices has grown by more than 10 percentage points.

Chart 1.

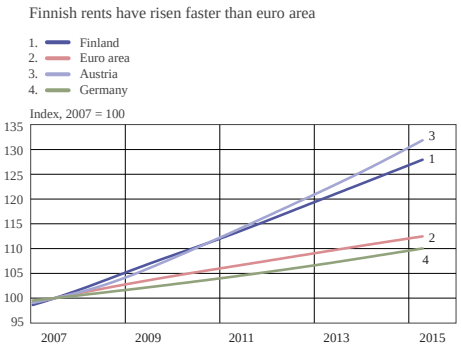


The rapid pace of services inflation has been sustained particularly by the rise in rents and the prices of housing services (Chart 2). The prices charged by restaurants, cafes and refectories and the prices of medical services have also risen at an elevated rate. In recent years, only the prices of mobile telephone services and Internet subscriptions have declined.

Chart 2.

In the years since the financial crisis, rents have risen in Finland an average 3.3% per annum, compared with only 1.5% in the euro area (Chart 3). Since 2008, rents in Finland have risen by 27%. Compared with the euro area, rents have risen by 15% cumulatively. Correspondingly, housing prices are in Finland higher than at the start of the financial crisis, whereas in the other euro area countries average prices have declined slightly.

Chart 3.



The trend in rents has been computed based on the harmonised index of consumer prices; HP-filtered.
Source: European Central Bank.

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At the beginning of 2015, services inflation slowed slightly. The slowdown has been broadly based and has been witnessed in several commodity groups. In early 2015, inflation slowed in e.g. day care charges and old-age home charges, and also in restaurant and recreational services. An actual decline in prices on the annual level has been witnessed only in mobile telephone services and Internet subscriptions.

In recent years, services inflation has been fairly high relative to the weakness of the economy. The rapid pace of rise in wages and weak productivity developments since the financial crisis have been reflected in higher consumer prices. The low level of competition on the retail market and tight regulation have contributed to keeping prices high.

In rents, upward pressure is due to the low volume of housing construction in growth centres, and housing-related subsidies. The high level of rents may contribute to weakening geographical mobility, in particular for low-paid workers, and thus aggravate the mismatch of labour supply and demand. At the same time, the costs of owner-occupied housing have declined as a result of the low level of interest rates, which has decreased the attractiveness of renting.

The broad-based slowdown in services inflation witnessed in Finland in early 2015 indicates that the developments may be due to macroeconomic factors. This may be an indicator of a longer-term turn in prices. Even though the turnaround is not yet reflected in the rents for residential accommodation, based on the recent fall in house prices, the upward pressure on rents will also decrease in the future. Developments in housing rents also depend largely on the housing policies to be pursued by the new government.

Slower consumer price inflation will boost consumers' purchasing power and alleviate the downward impact on aggregate demand caused by moderate wage developments.

Of the euro area economies, Austria, in particular, is in a very similar situation to Finland. Since the financial crisis, services inflation in Austria has been relatively rapid, and, for example, the pace of increase in rents has even exceeded that witnessed in Finland. Austria's rapid inflation, too, is due to the rapid pace of increase in rents. Like Finland, Austria is suffering from weak growth and has lagged behind developments in its neighbour, Germany.

Keywords

consumer prices, inflation, rents, services