Analysis

Current account will remain in deficit

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The current account has fluctuated sharply in recent years, first because of the COVID-19 pandemic and then because of Russia's war in Ukraine. Fluctuations in energy prices affect the balance of trade, and the current account deficit has indeed narrowed rapidly this year in the wake of a strengthening trade balance. Finland's current account moved into deficit territory already in the early 2010s, when electrical engineering and electronics exports declined, weakening the balance of trade. A more careful examination of the service account and balance of trade shows that the current account is also likely to remain negative over the longer term despite the recent strengthening of the balance of trade.

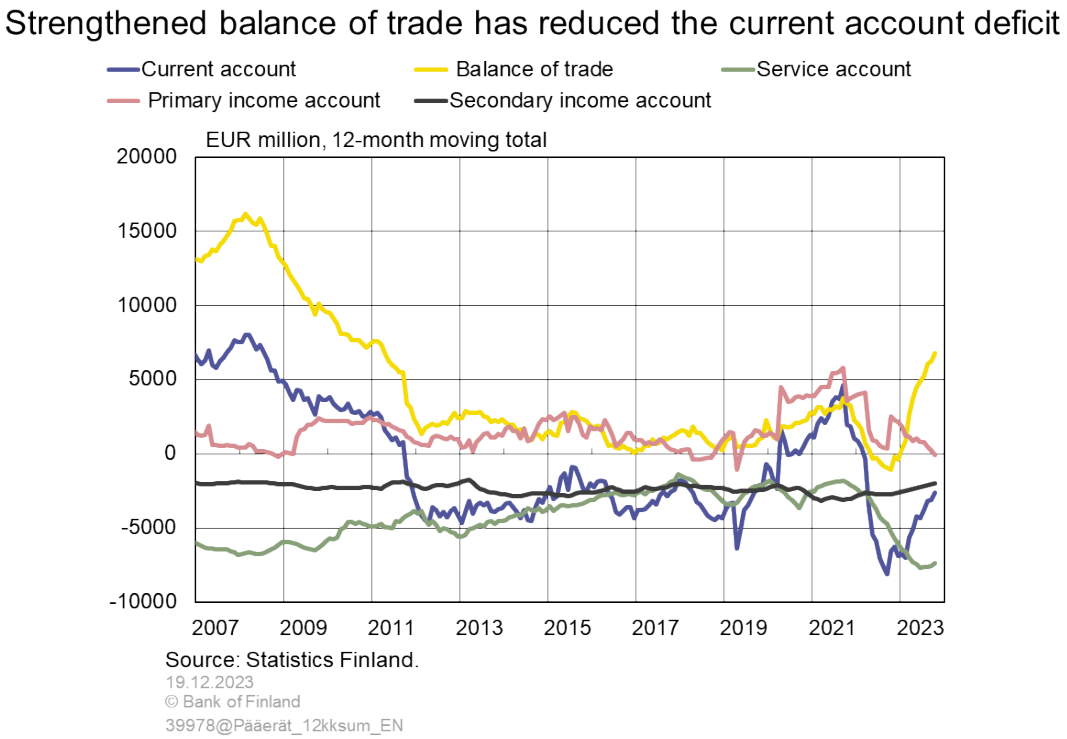


Strong fluctuations in current account in recent years

During the pandemic, Finland's current account moved into surplus in 2020 after a long period of deficit (Chart 1). The current account describes the balance in cross-border transactions, such as overseas trade in goods and services. At the beginning of the pandemic, of the factors making up the current account, particularly the surplus on the primary income account, which includes compensation of employees and investment income, increased substantially,[1] but the balance of trade also strengthened as goods exports grew more quickly than imports. The initial phases of the pandemic did not finally have a significant impact on the service account because the narrowing of the travel account deficit caused by the pandemic was compensated by an increase in the transport deficit.

However, the pandemic was soon followed by another shock – Russia's invasion of Ukraine and the energy crisis that came to a head as a result. The current account quickly reverted to deficit fuelled by several sub-categories: the service account deficit grew rapidly in 2022 when, for example, the flow of Russian tourists to Finland stopped. The balance of trade fell into deficit because of the increase in energy prices, among other things, and the exceptional factors boosting the primary income account were no longer in effect. On the other hand, the exceptionally wide current account deficit narrowed in 2023, as the trade surplus strengthened rapidly to its highest level in over a decade due to poorly performing imports. However, imports are likely to become gradually more closely aligned with exports.

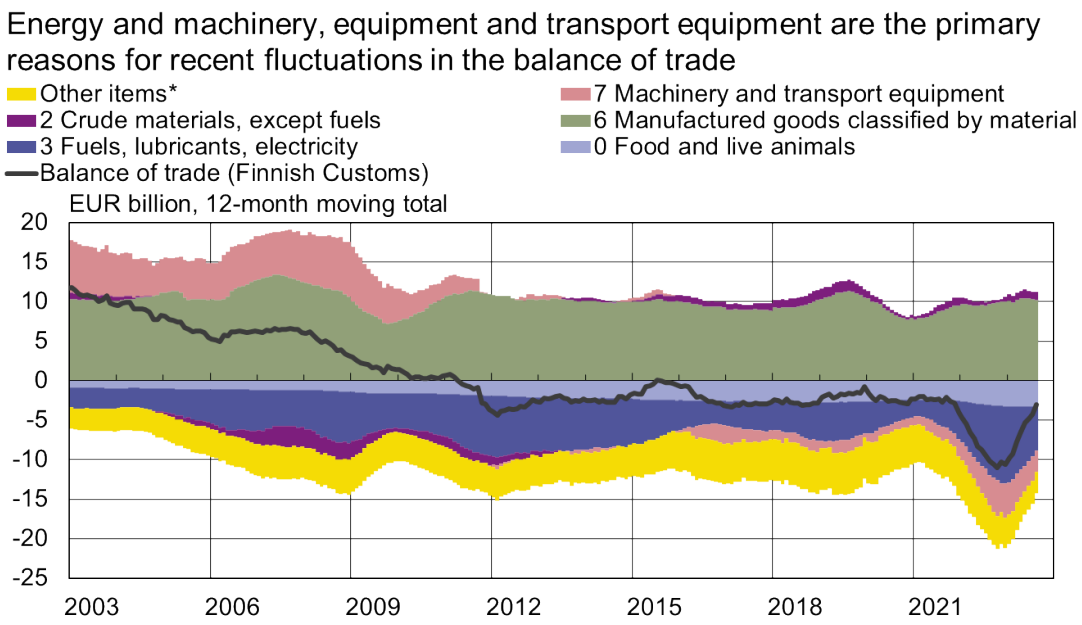
Chart 1.



Balance of trade swayed by energy prices

Both imports and exports of goods have performed poorly during the past year. Imports of energy and intermediate goods, in particular, have declined this year. The rapidly growing trade surplus is in fact a consequence of imports weakening more quickly than exports (Charts 3 and 4). In terms of categories of goods,[2] the sharp fluctuations in the balance of trade in recent years have been caused particularly by trade in energy but also by trade in machinery, equipment and transport equipment (Chart 2).

Chart 2.



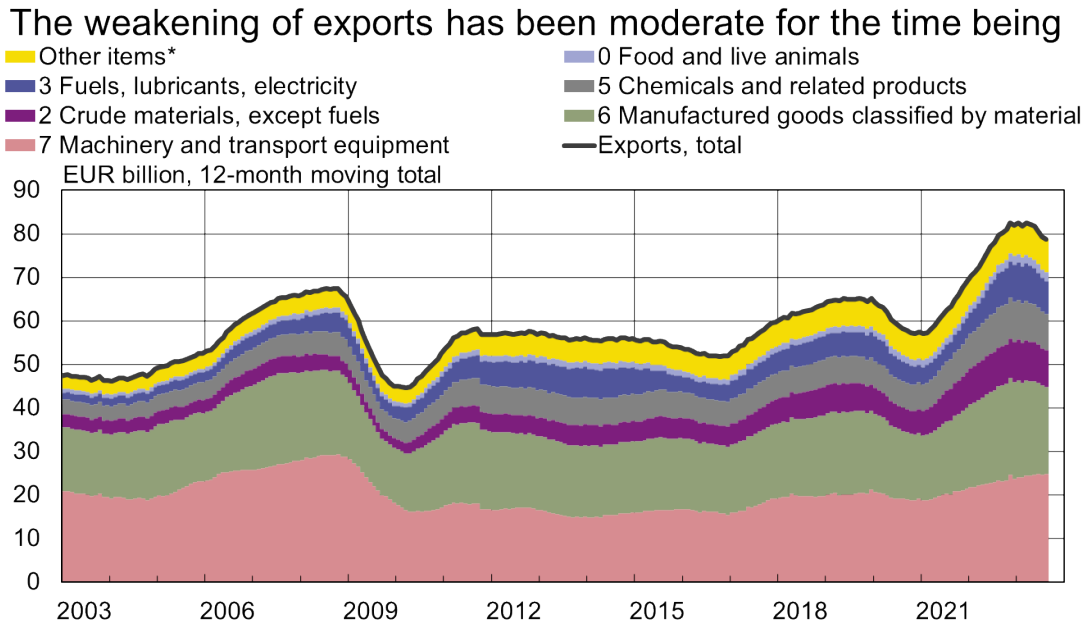
Source: Finnish Customs. * Includes the SITC categories 1 (Beverages and tobacco), 4 (Animal and vegetable oils and fats), 5 (Chemicals and related products), 8 (Miscellaneous manufactured articles) and 9 (Other goods).

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Chart 3.



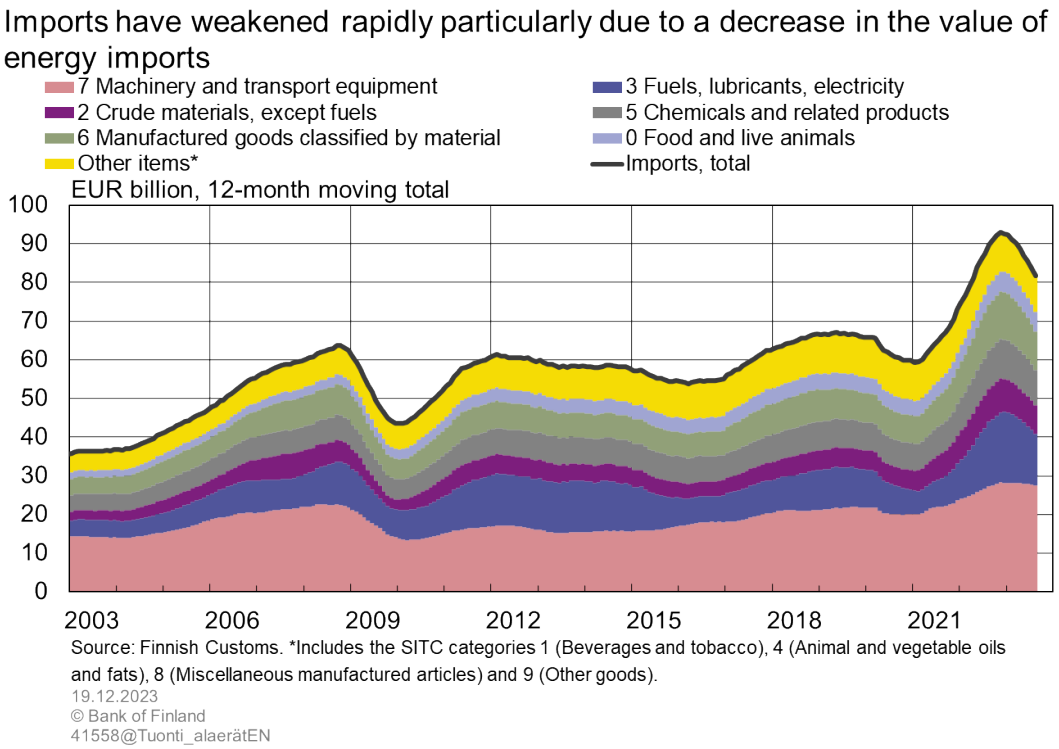
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Chart 4.



Trade in machinery, equipment and transport equipment fluctuates strongly from month to month, with exports being swayed by cruise ship deliveries, for example, and imports being affected by deliveries of components related to wind and nuclear power. As a whole, the machinery, equipment and transport equipment account has shown a deficit in recent years. One of the most significant structural changes in Finland's foreign trade in the 2000s, indeed, has been the weak performance of machinery, equipment and transport equipment exports, which has flipped the balance of the industry from a substantial surplus to a deficit. This is due to a rapid decline in exports of the electrical engineering and electronics industry, which includes mobile phones. However, in recent years exports of machinery, equipment and transport equipment have remained on a slight upward trend despite the weak performance of exports and the economy as a whole.

Finland's balance of trade is in surplus for intermediate goods. These include paper and paperboard, iron and steel and metals ('manufactured goods classified chiefly by material'). In addition to intermediate goods, the only component for which Finland's balance of trade shows a surplus is raw materials. Exports of raw materials have grown more quickly than imports, and trade in raw materials has been showing a surplus for nearly a decade.

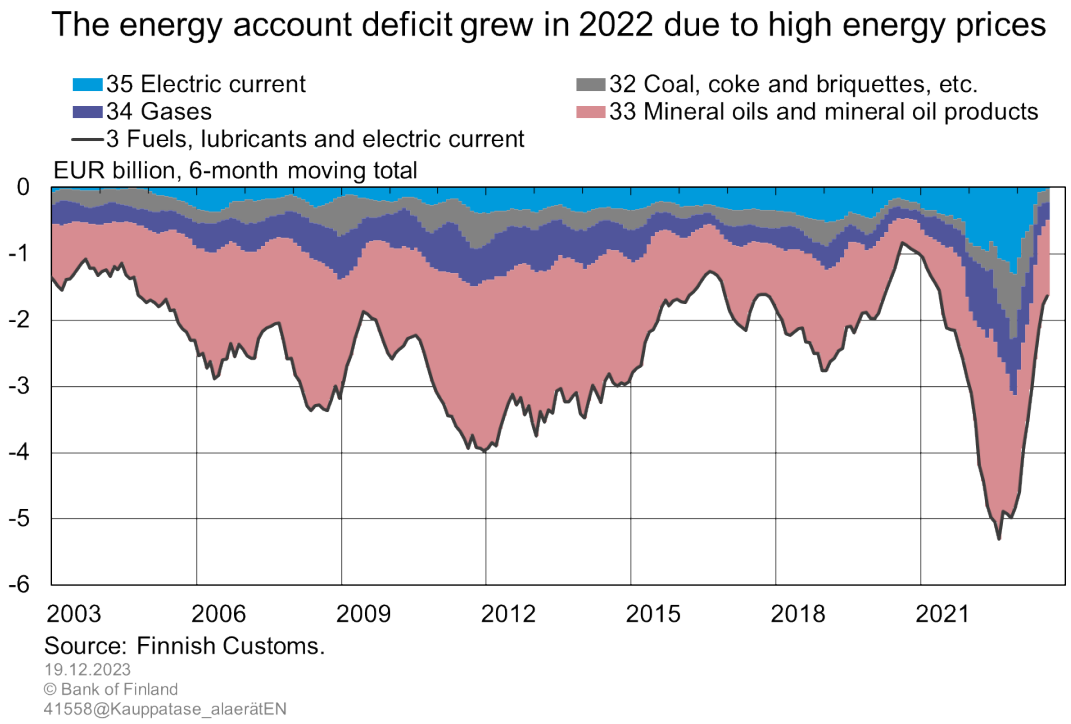
The energy account is in a structural deficit in Finland, i.e. more energy is imported than exported in euro terms. The volume of imported energy is also greater than the volume of exported energy,

but the difference has been shrinking already for several years. Energy exports have focused on petroleum products, while energy imports are more diversified.

Over the past year, energy imports have decreased more quickly than energy exports. The value of energy trade reflects fluctuations in energy prices. In 2022 world market prices of oil and many import prices rose because of Russia's invasion of Ukraine. That is why all the deficits of the energy components in Finland's current account grew, but the largest component, i.e. petroleum and petroleum products, had the greatest impact (Chart 5). Correspondingly, in 2023 the deficit has shrunk substantially in all the components, with energy prices having declined.

The value of energy trade is also influenced by exchange rate developments. The weakening of the euro in relation to the US dollar is contributing to deepening the deficit in the energy account because, particularly in trade of petroleum products, the dollar is commonly used as the trading and invoicing currency.

Chart 5.



When looking at trading volumes in petroleum and petroleum products, we can see that imports of Russian crude oil have been replaced by Norwegian crude oil, for example. As a whole, the volume of crude oil imports has declined and appears to have remained below the pre-pandemic level, but since the price of oil is higher than before, the value of crude oil imports has still increased. At the same time, exports of petroleum products have also decreased. The green transition could reduce

demand for crude oil and petroleum products to some extent also in the future as, for example, heating methods evolve and the vehicle fleet is renewed. Nevertheless, the petroleum and petroleum products account is also likely to remain in deficit in the future.

The chronic deficit in overseas trade in electricity has practically vanished as a result of the commissioning of the Olkiluoto 3 nuclear power plant and the increase in wind power capacity (Chart 5). The volume of electricity imports is currently historically low, and has declined steeply over the past year, whereas the volume of electricity exports has remained steady. The elimination of the trade deficit in electricity shrinks the deficit in energy trade but does not change the overall picture of a structural deficit in the entire energy account.

The most important destination countries for goods trade are changing

According to the balance of payments, the most important destination countries for Finland's goods exports are currently Sweden (around 12% of exports), the United States and the Netherlands, which surpassed Germany at the beginning of 2022 (Chart 7).[3] However, the top countries from which Finland imports are Germany (around 14% of imports), Sweden and China, although the importance of the United States has increased in recent years (Chart 8). Among the top trading partners, Finland's goods trade is in a substantial surplus with the United States and the Netherlands (Chart 6).

Chart 6.

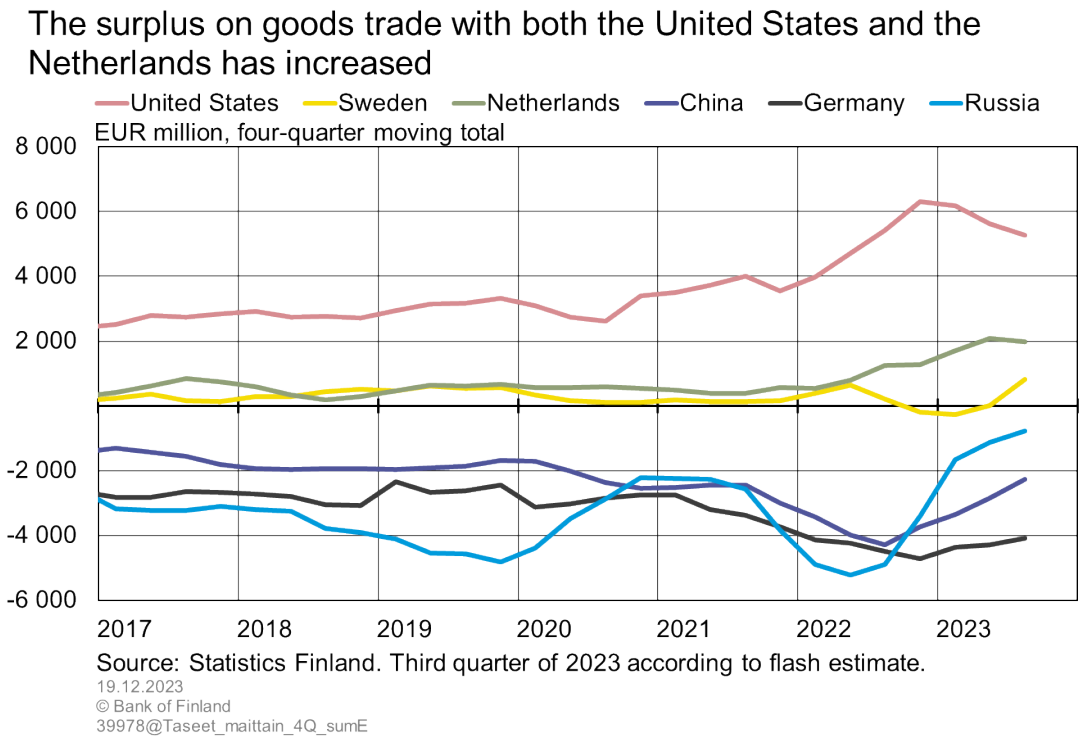


Chart 7.

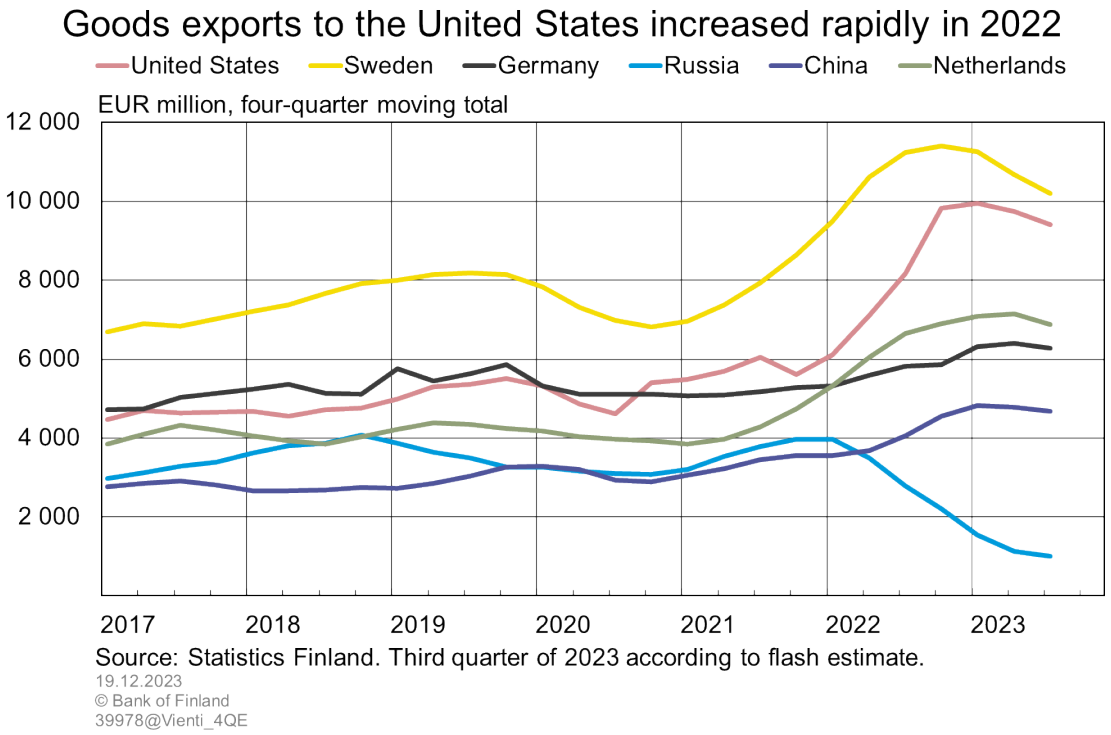
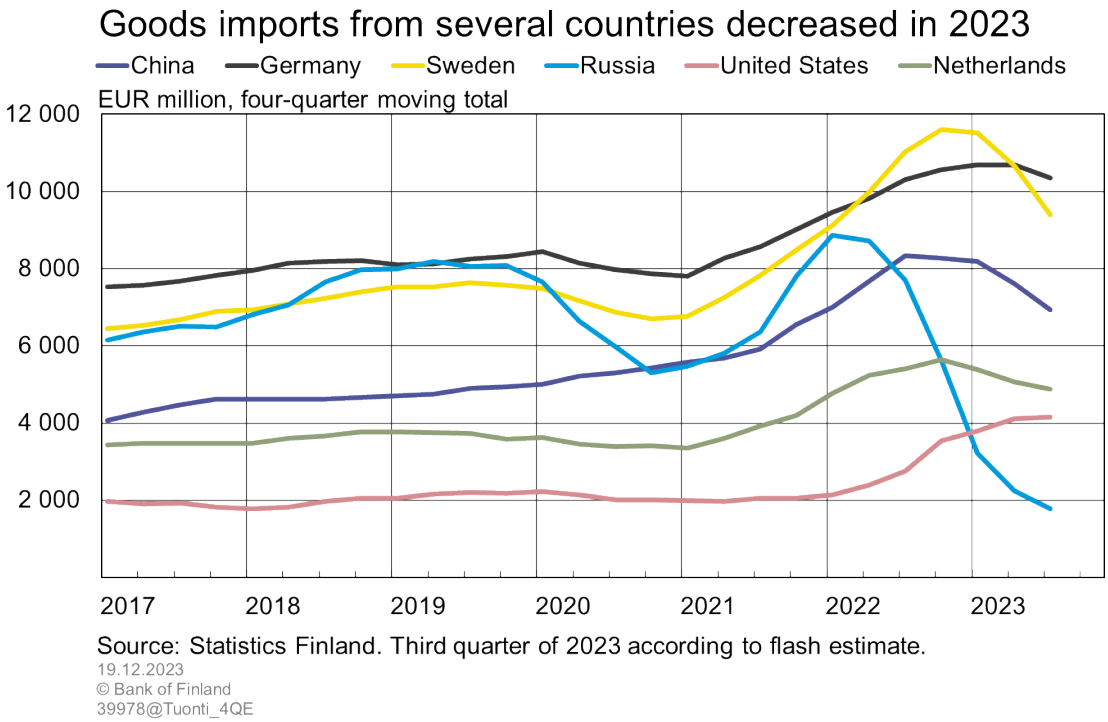


Chart 8.



Exports to the United States have grown rapidly, and not only on the back of large cruise ship deliveries. Goods trade with the United States is in a substantial surplus, although exports have declined over the last few quarters. Trade with Sweden has been swayed by energy for the past year, but in the longer term, the balance of trade with Sweden has been fairly neutral. Exports to the Netherlands have been growing since 2021. The development has been influenced particularly by growth in exports of iron and steel, metals, petroleum products and machinery and equipment.[4]

Trade with Russia has decreased to a historically low level, but since both imports and exports have diminished significantly, the balance is close to zero. Due to energy trade, imports from Russia have traditionally been more abundant than exports. Currently the oil-based energy trade has shifted to Norway, for example, or has been partially replaced by national electricity production. The trade deficit in relation to Norway has indeed grown substantially due to energy imports.

Deep deficit in the service account will not be corrected quickly

The deficit in the service account has grown substantially since 2022, as service imports have grown substantially more strongly than service exports (Charts 10 and 11). There are several

reasons for the weak development of services: the growing travel account deficit, the decrease in the telecommunications, computer and information services trade, and the growing deficit in other business-related services, such as consulting and R&D services (Chart 9). According to preliminary data for the third quarter of 2023, the deficit in the service account decreased but remained higher than before Russia's war in Ukraine. Although service exports have also grown in Finland in recent years, growth has been slower than in the rest of the EU.[5] Service imports and exports account for around 30% of overall imports and exports.

Chart 9.

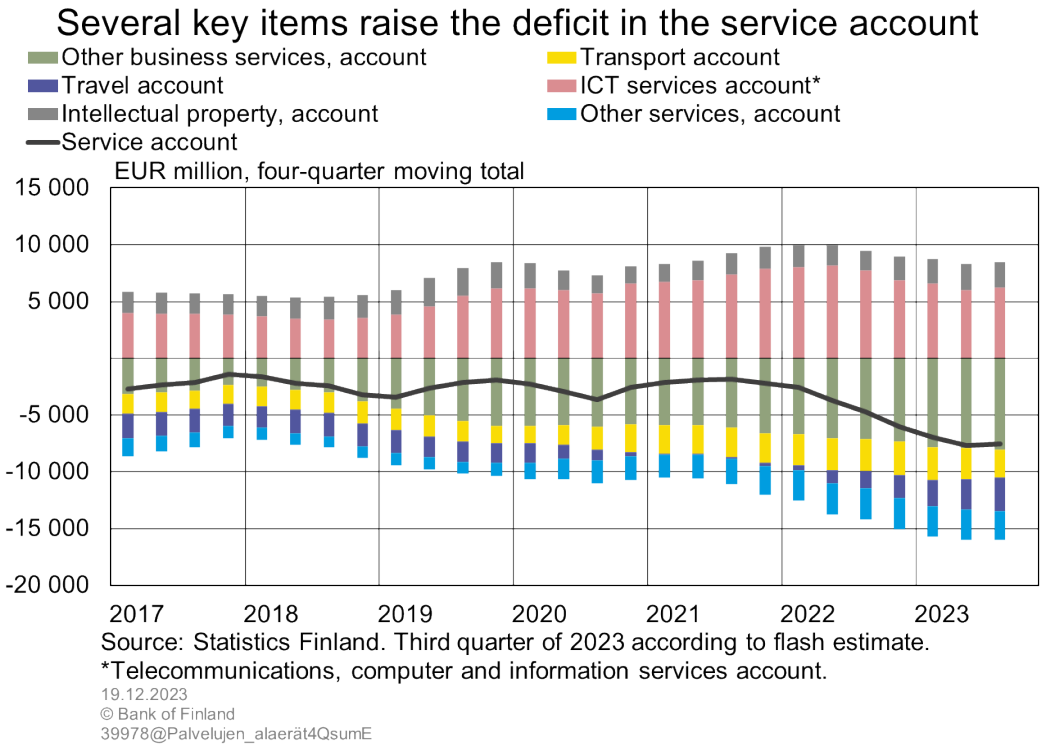


Chart 10.

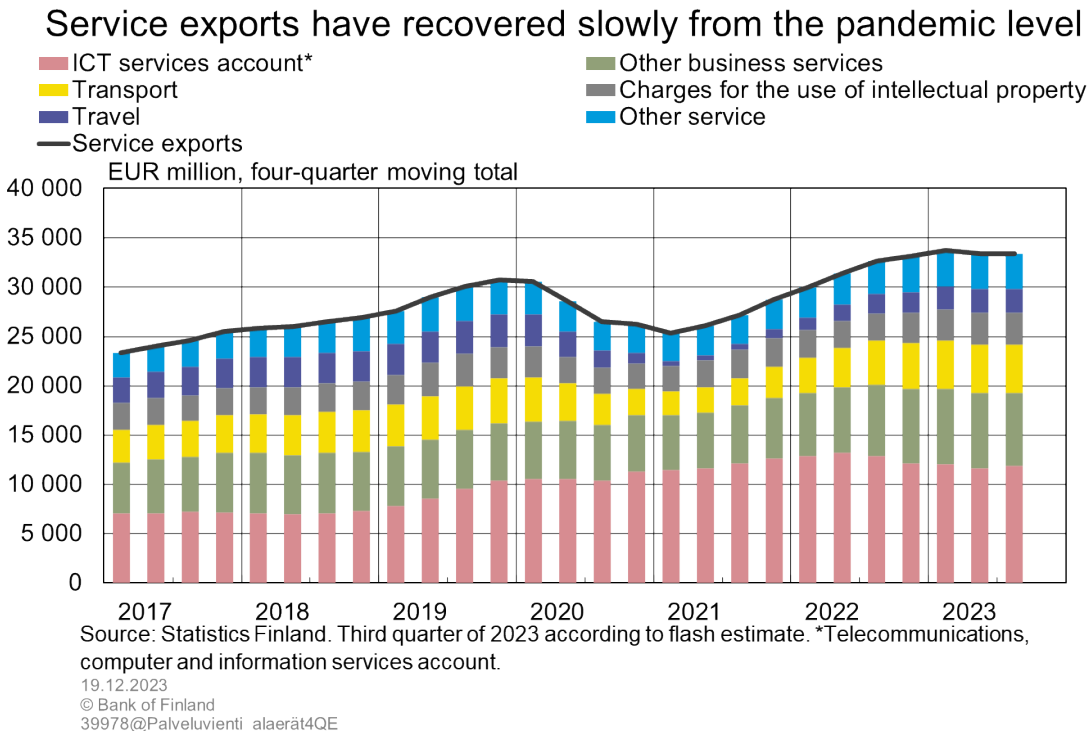
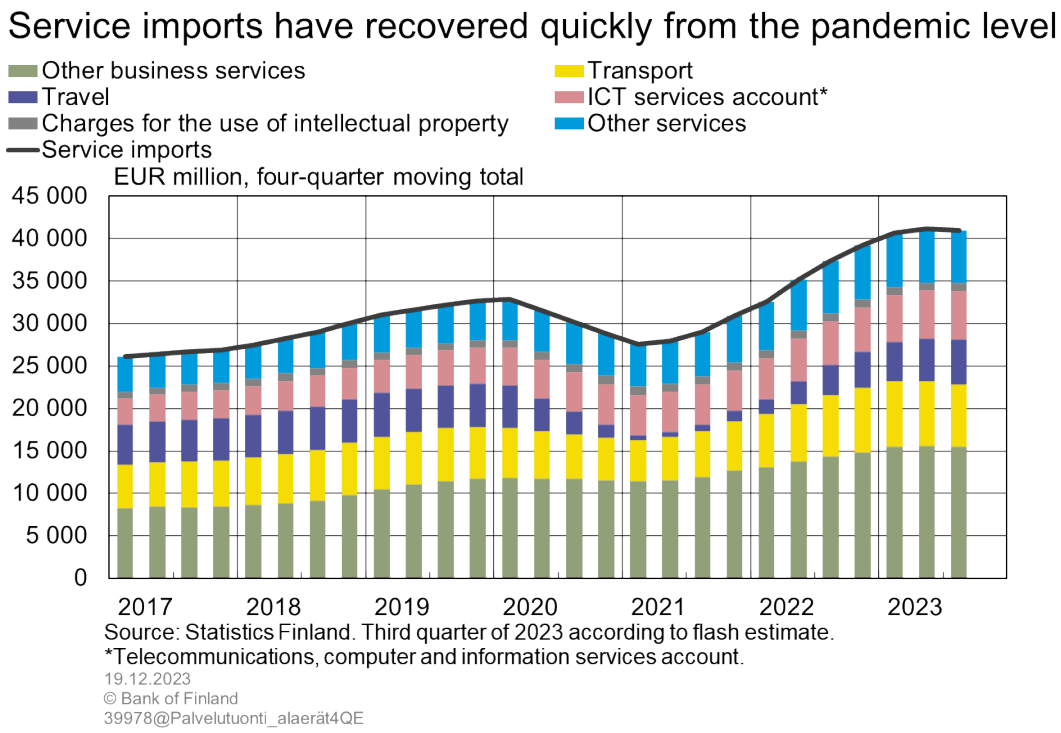


Chart 11.



The reason for the growth in the deficit in the travel account is travel imports returning to pre-

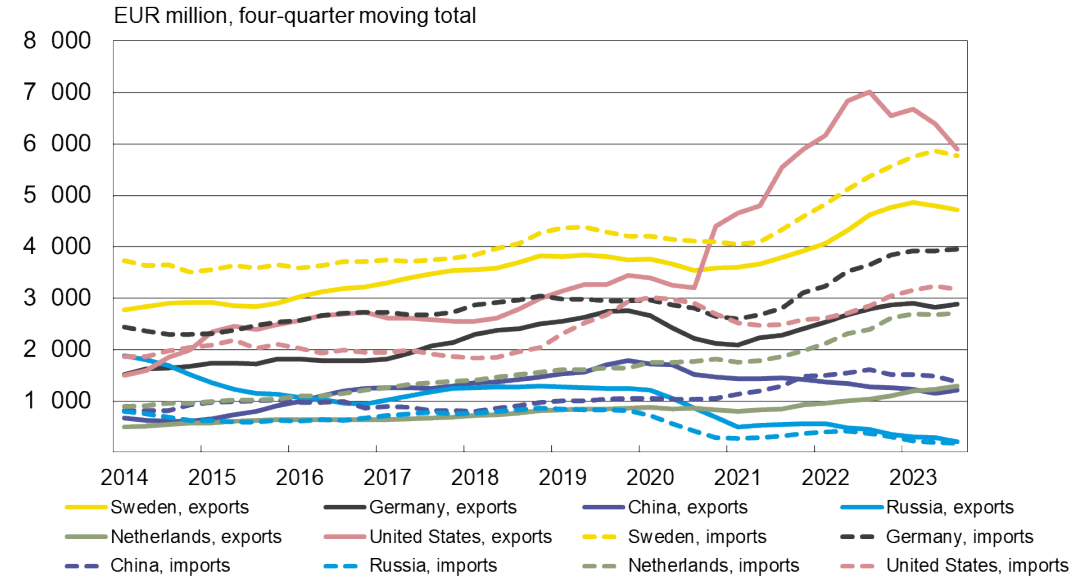
pandemic levels as Finns have eagerly travelled abroad following the easing of COVID-19 restrictions. Travel seems to have returned back to normal both within and outside the euro area. The recovery of travel exports has been much slower, and exports are still not on par with pre-pandemic levels. Travel volumes to Finland have been very low from non-EU countries, which is likely due to the low number of Russian and Chinese tourists, for example.

Exports of telecommunications, computer and information services grew strongly until mid-2022, after which export performance has been weak. This led to a narrowing of the surplus in telecommunications, computer and information services. Exports of telecommunications, computer and information services are directed particularly outside the euro area and the EU, for example in the United States, while imports of these services originate mainly from EU countries. On the other hand, the growth in the deficit in other business-related services is driven by faster growth in imports than exports.

Finland's most important market for exported services is Europe (around 60%), but in terms of individual countries, the most important destination country is currently the United States (around 20% of total exports) (Chart 12). Service exports to the United States have indeed been growing very quickly in recent years. The second most important destination country is Sweden, followed by Germany. As much as nearly 80% of imported services originate from Europe. The top three import markets, however, are the same as the key export markets: Sweden (approx. 15%), Germany and the United States. Among the key trading partners, service trade is in surplus only with the United States.

Chart 12.

Service exports to the United States have grown sharply in recent years



Source: Statistics Finland. Third quarter of 2023 according to flash estimate.
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Current account deficit may persist

The balance of trade will continue to be shaken by fluctuations in energy prices in the future. Although the improvement of energy self-sufficiency through increased domestic electricity production is strengthening the balance of trade, this will not be sufficient to shift the energy account into a surplus and therefore will not have a substantial impact on the current account as a whole. The procurement of defence materiel will cause imports to grow in the future when, for example, fighter jets are imported into Finland as of 2025. This will cause the trade surplus to narrow. Thus, there is no reason to expect that the trade surplus would grow substantially from the current level or remain higher than what was seen in the 2010s unless new, internationally competitive production that is saleable abroad is created in Finland. Since exports usually require significant imported inputs, the growth in goods exports requires growth in imports. This is another reason why balancing of the current account would be supported particularly by the strengthening of high-value-added export industries in Finland. As we saw earlier, however, Finland is a net exporter solely in the production of low-value-added intermediate products and raw materials.

The trade in telecommunications, computer and information services and U.S. demand for services have played a key role in strengthening the service account in recent years. There may still be lots

of potential for exports of these services to both the United States and Europe. A rapid correction is not expected in the deficit in services related to travel, as the deepening of the travel account deficit could at least to some extent be long-term, due to the geopolitical situation. Nevertheless, the deficit in travel services is unlikely to grow substantially in the coming years, as the pre-pandemic volume of travel from Finland abroad has already been reached.

The secondary income account deficit has been steady, and is not expected to change substantially. The primary income account surplus is also unlikely to grow, in any case, from the current level considering historic long-term performance. Therefore, the current account can be expected to remain in a structural deficit in the coming years.

Notes

1. For a more detailed discussion of the development of the primary income account during the pandemic see the Bank of Finland Bulletin article (in Finnish) by Annika Lindblad, Taina Sinivuori and Jarkko Kivistö. ↑
2. As there is no breakdown based on categories of goods in the balance of payments, we are using data provided by Finnish Customs. The foreign trade statistics of the balance of payments and Finnish Customs are dissimilar due to factoryless production, the CIF-FOB conversion and other differences. The disparity between the statistics has increased somewhat in recent years mainly due to growth in the surplus in factoryless production. However, the development of the balance of trade has followed a similar trend in both statistics. ↑
3. Foreign trading partner countries can also be studied using data provided by Finnish Customs, in which case the top source and destination countries for imports and exports may differ from those presented here. ↑
4. In the balance of payments, the destination country is the most recent known destination of an exported product. ↑
5. See Ali-Yrkkö, Jyrki and Kuosmanen, Natalia (30 November 2023) To What Extent Does Finland Engage in International Trade of Services?(In Finnish) Research Institute of the Finnish Economy (ETLA) Report No 142. https://pub.etla.fi/ETLA-Raportit-Reports-142.pdf. ↑

Keywords

balance of services, balance of trade, current account, foreign trade