Forecast

# Interim forecast: Energy crisis will shrivel growth in Finnish economy

Finnish economy | 21 September 2022

The economy in Finland is weakening after a strong start to the year. The energy crisis and rising inflation have increased the risk of a recession, and the economy is expected to contract slightly in 2023. The faltering economy is signalling an end to the favourable employment trend. Inflation will remain high for the time being. The upward pressures on consumer prices will not subside until next year.



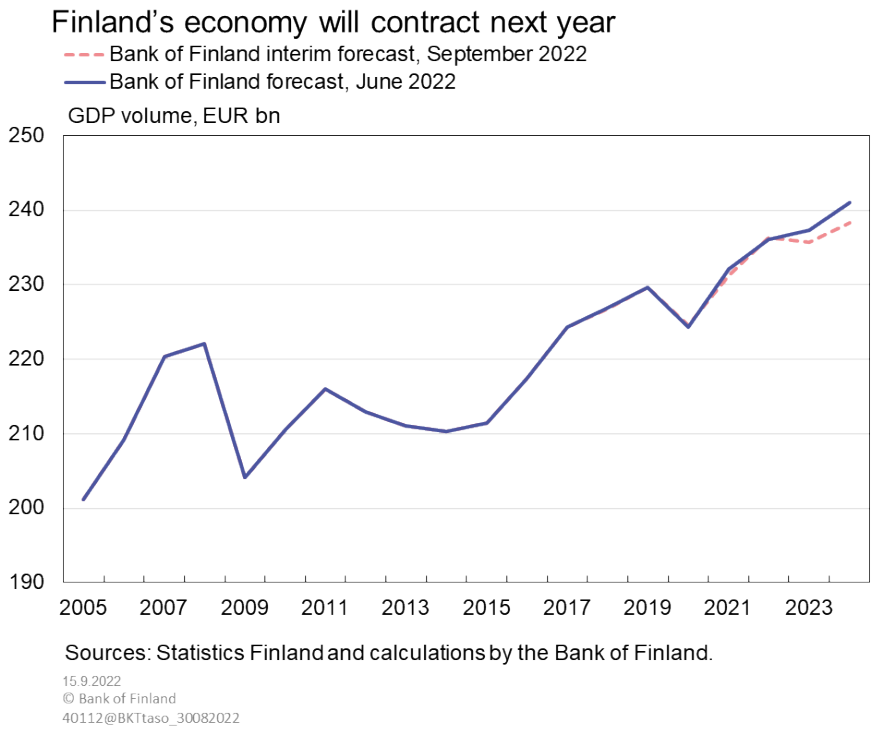
The Bank of Finland's interim forecast[1] is based on data available on 7 September 2022 and assumptions updated on 22 August 2022 concerning Finland's external environment and key financial market variables for the immediate years ahead.

## Energy crisis will stifle growth towards year end

The outlook for the Finnish economy deteriorated during the summer. Although the robust start to the year provides a good foundation for growth in 2022, the energy crisis triggered by Russia's invasion of Ukraine will stifle growth towards the end of the year. Exceptionally high inflation is diminishing households' purchasing power and consumer confidence has sunk to a very low ebb,

curbing private consumption. The Finnish economy is forecast to grow by 2.2% in 2022 and to contract by 0.3% in 2023 (Chart 1, Table 1). Growth will return to just over 1% in 2024, close to the economy's estimated long-term potential growth rate.

Chart 1.




Slower growth in the economy and diminished employment expectations are signalling an end to the favourable employment trend. This will be reflected as a decline in the employment rate in 2023 (Table 1).

The upward pressures on consumer prices will not subside until next year, when the rise in energy prices will slow. Inflation in Finland will rise to 7% in 2022 and will still be more than 4% in 2023. However, there is substantial uncertainty surrounding the inflation forecast due to the energy crisis.

Interim forecast summary

| | | 2020 | 2021 | 2022$^{f}$ | 2023$^{f}$ | 2024$^{f}$ |
|---|---|---|---|---|---|---|
| GDP, annual growth (%) | Interim forecast, September 2022 | -2.2 | 3.0 | 2.2 | -0.3 | 1.1 |

*Sources: Statistics Finland and Bank of Finland.*

| Interim forecast summary | | | | | | |
|---|---|---|---|---|---|---|
| | Forecast, June 2022 | -2.3 | 3.5 | 1.7 | 0.5 | 1.5 |
| Employment rate (%) | Interim forecast, September 2022 | 70.7 | 72.2 | 73.6 | 73.4 | 73.8 |
| | Forecast, June 2022 | 70.7 | 72.2 | 73.7 | 73.8 | 74.3 |
| Inflation (%)* | Interim forecast, September 2022 | 0.4 | 2.1 | 7.0 | 4.3 | 1.8 |
| | Forecast, June 2022 | 0.4 | 2.1 | 5.6 | 2.4 | 1.8 |
| *Harmonised index of consumer prices (HICP).<br>f=forecast. | | | | | | |

*Sources: Statistics Finland and Bank of Finland.*

The biggest risks associated with the forecast concern the path taken by the energy crisis in Europe. A prolonged high inflation rate would weaken households' purchasing power more than predicted. The inflation forecast is based on market expectations for energy prices in August. However, market expectations may change abruptly when circumstances and the outlook change. Energy prices may therefore rise higher or sink lower than the assumptions made, and so there is substantial uncertainty in the inflation forecast. Other downside risks relate to a slowdown in global economic growth as a consequence of, for example, the pandemic, a rapid tightening of monetary policy or a worsening of supply chain bottlenecks. On the other hand, the situation may turn out better than forecast if supply chain problems dissipate more quickly than estimated, private consumption manages to support growth beyond current expectations, and investments relating to the green transition are implemented more quickly than anticipated.

## Growth got off to a strong start in early 2022

Growth in Finland's economy was strong in the second quarter of 2022: 0.9% quarter-on-quarter and 3.0% year-on-year. In addition to this, growth for the first quarter was adjusted upwards from previous estimates. This means that Finland's GDP growth for the first six months of 2022 was robust overall. Growth relied particularly on the demand for services.

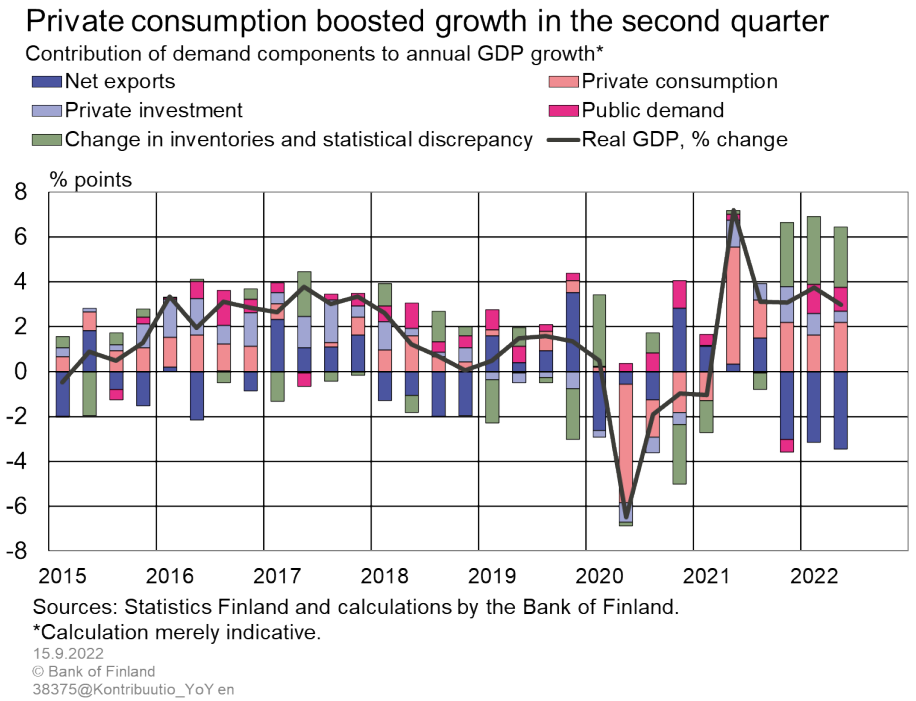
The second-quarter growth was driven by a marked increase in private consumption (Chart 2). Among the subcomponents of private consumption, year-on-year growth was particularly strong in service consumption, especially in accommodation and food service activities, which experienced a brisk second quarter. By contrast, the consumption of durable consumer goods

decreased significantly. The consumption of non-durable goods by volume was also down from one year ago, which is in line with the weak trend in the retail trade. It thus appears that the change in attitudes towards the pandemic and the release of pent-up demand for services contributed to a strong growth in consumption during spring and early summer.

Net exports also had a clear adverse impact on growth in the second quarter, when imports grew at a higher rate than exports. The deficit in foreign trade in services grew in the second quarter, particularly as travel abroad increased substantially relative to foreign tourism in Finland. Trade in goods also showed a deficit in the first half of 2022. The value of imports exceeded that of exports in the case of, for example, fuels and energy, and machinery and transport equipment.

Investments continued to grow in the second quarter, though they fell short of expectations. A directional shift is already on the horizon, however, particularly in residential construction. Public expenditure also grew clearly in the first part of 2022.

Chart 2.




## Rising energy prices are eroding growth and pushing up inflation

The updated forecast partly reflects the changes in Finland's external environment. The growth prospects for the global and euro area economies have weakened further (Table 2). Euro area GDP

growth is expected to slow to 0.9% in 2023 as a result of the energy crisis, and the projections are subject to downside risks.[2] Euro area growth around the turn of the year will also be adversely affected by the surge in inflation and by heightened uncertainty and weaker confidence. This will impede the growth in demand in Finland's export markets.

Higher energy prices will curb growth and drive up inflation in the immediate years ahead. High energy prices are now increasingly feeding through to the prices of food, consumer goods and services, and this has become visible in the euro area's underlying inflation, which has already risen above 4%. According to the market assumptions underlying the projection, the rise in interest rates will be stronger than previously expected but will stabilise at close to 2% (Table 2). The upward trend in interest rates will reduce the growth in private investment and consumption. The rise in global prices and the depreciation of the euro are putting a strain on business profitability and are contributing to inflation. Crude oil prices are projected to decline slightly but to remain at a relatively high level in the years to come.

| Forecast assumptions | | | | | |
|---|---|---|---|---|---|
| | **2020** | **2021** | **2022$^{f}$** | **2023$^{f}$** | **2024$^{f}$** |
| Volume percentage change on the previous year | | | | | |
| Euro area GDP | -6.2 | 5.2 | 3.1 | 0.9 | 1.9 |
| World GDP (excl. euro area) | -2.3 | 6.4 | 2.9 | 3.0 | 3.4 |
| World trade (excl. euro area)* | -8.0 | 12.5 | 4.6 | 2.7 | 3.4 |
| | | | | | |
| | **2020** | **2021** | **2022$^{f}$** | **2023$^{f}$** | **2024$^{f}$** |
| Finland's export markets**, % change | -8.3 | 10.4 | 2.9 | 1.6 | 3.3 |
| Oil price, US dollar/barrel | 41.5 | 71.1 | 105.4 | 89.8 | 83.6 |
| Export prices of Finland's competitors, euro, % change | -3.8 | 10.0 | 19.9 | 4.3 | 1.4 |
| 3 month Euribor, % | -0.4 | -0.5 | 0.2 | 2.0 | 2.1 |
| Finland's nominal effective exchange rate*** | 108.6 | 109.4 | 106.1 | 104.5 | 104.5 |

*Sources: Eurosystem and Bank of Finland.*

| Forecast assumptions | | | | | |
|---|---|---|---|---|---|
| US dollar value of one euro | 1.14 | 1.18 | 1.05 | 1.01 | 1.01 |
| *Calculated as the weighted average of imports. | | | | | |
| **The growth in Finland's export markets is the import growth in the countries Finland exports to, weighted by their average share of Finland's exports. | | | | | |
| ***Broad nominal effective exchange rate, 2015 = 100. The index rises as the exchange rate appreciates.<br>f=forecast. | | | | | |

*Sources: Eurosystem and Bank of Finland.*

## Nowcasting models are predicting a recession

The Bank of Finland uses several nowcasting models that condense mainly monthly economic indicator data into GDP forecasts for the current quarter and the following quarter (Table 3). At present, the models are predicting that the economy will shrink in the second half of 2022. For the last quarter of the year, the uncertainty surrounding the forecast is exacerbated by the lack of currently available statistics.

| Nowcasting model results | | |
|---|---|---|
| GDP<br>Quarterly growth | **2022Q1** | **2022Q2** |
| BVAR | 0.2% | 0.1% |
| Factor model | 0.7% | 0.5% |
| Bridge model | 0.5% | 0.1% |
| Financial market model | 0.5% | 0.6% |
| Model average | 0.5% | 0.3% |
| Actual growth | 0.5%* | 0.9%* |
| *) Quarterly national accounts, latest release 31 August 2022. | | |

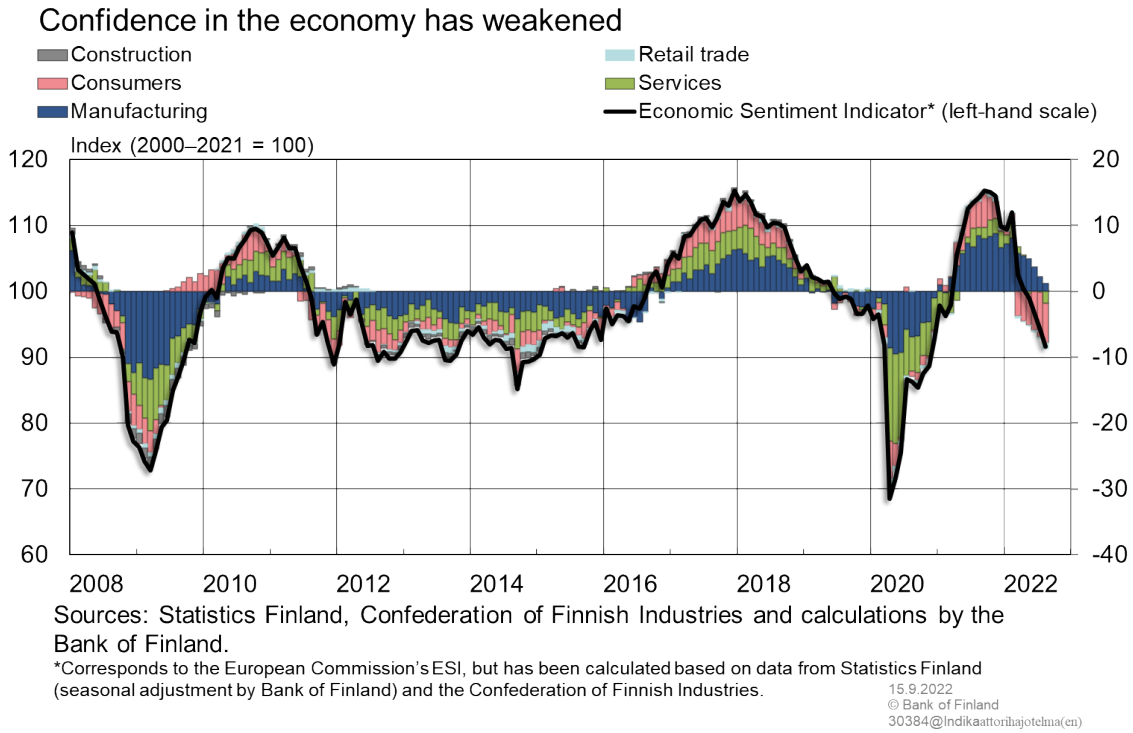
*Source: Statistics Finland, calculations by Bank of Finland.*

The latest economic statistics are signalling an increased risk of a recession. Confidence in the economy has this year sunk below its long-term average, albeit remaining above the lowest levels witnessed during the pandemic (Chart 3). Consumer confidence, in particular, is at a historically low level, which is likely to be a reflection of diminished household purchasing power. The decline in consumer confidence indicates that private consumption will decrease towards the end of the year.[3]

Business confidence and particularly the business outlook have also weakened.[4] The construction confidence indicator is at a low level, which is reinforcing the picture of an adverse change in residential construction, in particular. Retail trade confidence has fallen significantly due to decreasing sales and pessimistic views concerning future sales figures. Confidence figures for manufacturing and services have weakened but are still above the trough witnessed during the COVID-19 crisis. According to the Business Confidence Survey, order books in manufacturing have weakened slightly, but production is expected to remain on an upward trend in the coming months. Industrial production and new orders have thus far remained at a good level, despite the slight decline in both figures in July. In the service sector, the business outlook has deteriorated, despite the still positive views concerning expected sales in the coming months.

According to the Business Tendency Survey[5] published in July, the role of insufficient demand as a factor hampering growth has increased from previous quarters, which is also signalling a turn in the business cycle. The shortage of capacity and raw materials has also eased slightly, as global production and supply chain problems are gradually dissipating. The shortage of skilled labour is still the main factor holding back growth in the business sector, although in manufacturing this too has already eased slightly.

Chart 3.

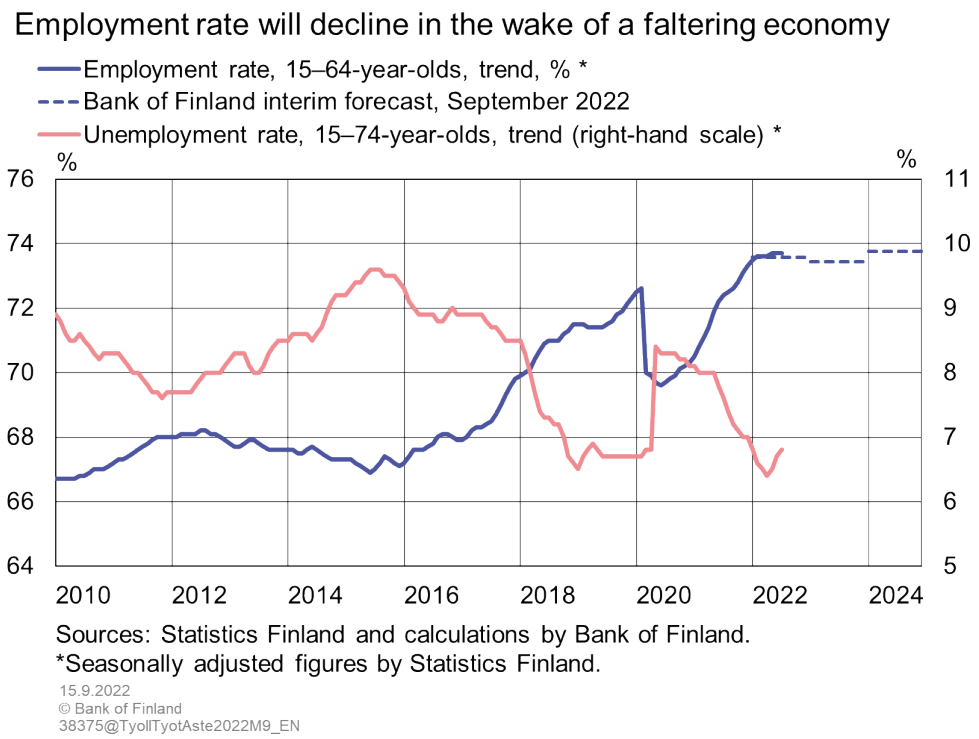



## Labour market tailwind will subside

The labour market has recovered well from the COVID-19 pandemic, and this has helped support consumer spending. However, the improvement in the employment rate has stalled in recent months and the unemployment rate has increased slightly (Chart 4). Long-term unemployment is still above pre-pandemic levels. Employment expectations too, have deteriorated in all the main sectors.

The labour market is still tight, despite the slight decrease in the number of job vacancies relative to unemployed jobseekers in recent months. The number of vacancies has no longer been increasing in the past few months. The employment trend in response to a faltering economy may be dampened somewhat as a result of the troubles experienced by businesses in obtaining skilled labour, as they may look to hold on to staff despite the difficulties in the economy. Overall, the employment rate will decline slightly in 2023 (Table 1).

Chart 4.

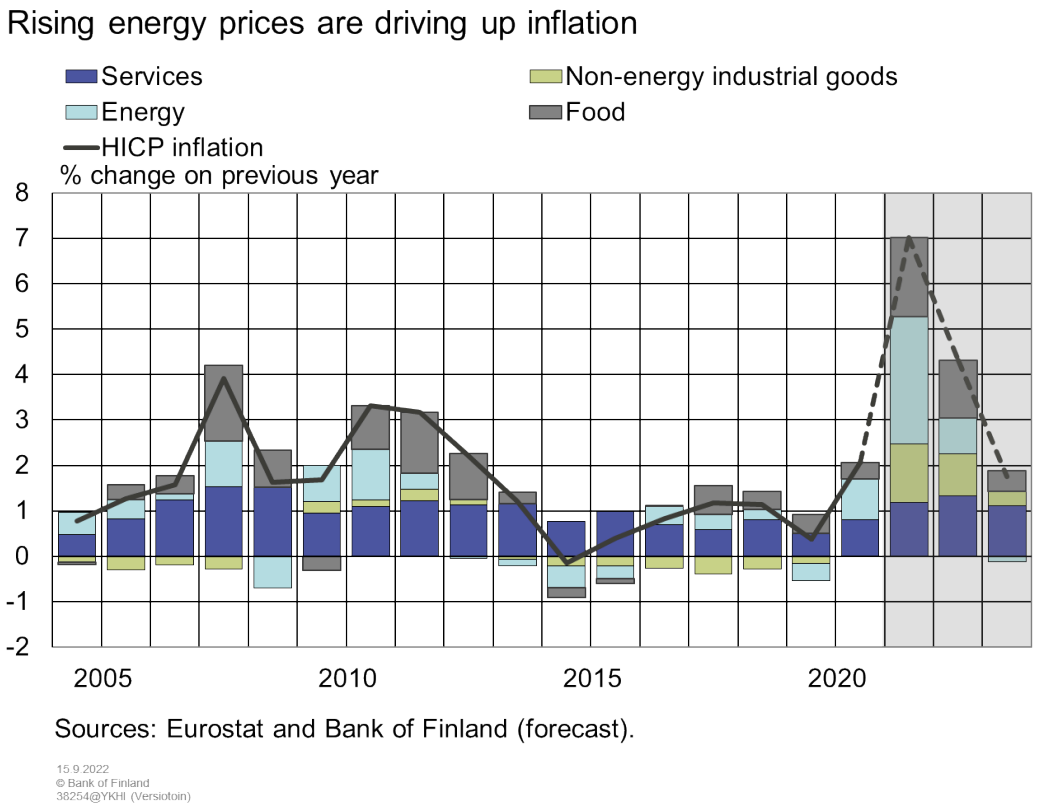



## Inflation will remain high for the time being

Consumer price inflation has risen sharply in 2022, fuelled in particular by the rise in energy prices (Chart 5). Inflation is projected to rise further towards the end of the year, reflecting the rise in electricity and food prices, in particular. The higher energy prices are gradually feeding through to other consumer prices, and therefore inflation in services is also expected to pick up in the next couple of quarters. The upward trend in the prices of industrial goods will abate in 2023, following the gradual easing of global supply chain bottlenecks and the weakening of aggregate demand.

The direct upward impact of energy prices on inflation is expected to decrease in 2023. The upward trend in consumer prices will moderate gradually by 2024, as underlying inflation also starts to slow more notably. Inflation in Finland is forecast to rise to 7% in 2022, and will still be more than 4% in 2023 (Table 1). In 2024, inflation will slow further, to just below 2%. Uncertainty surrounding the inflation forecasts is substantial as a result of Europe's energy crisis.

Chart 5.




## Notes

1. The Bank of Finland publishes an interim forecast for the Finnish economy twice a year. These technical forecast updates published in March and September provide a revised outlook for economic growth, employment and inflation in Finland. The interim forecast does not necessarily reflect the views of the Eurosystem. The Bank's more detailed forecasts for the Finnish economy are published in June and December. ↑
2. The latest euro area forecast and risk scenario are available on the ECB website. ↑
3. The link between consumer confidence and private consumption and GDP growth is examined in more detail here. ↑
4. EK Business Confidence Survey. ↑
5. EK Business Tendency Survey. ↑

## Keywords

economic outlook, energy price, Finnish economy, forecast, inflation, recession