Forecast

# Sticky recovery in Finland's economy

Finnish economy | 08 October 2024

Finland's economy is making a sluggish recovery from recession. According to the Bank of Finland's September 2024 interim forecast, Finland's gross domestic product (GDP) for the full year 2024 will again show a contraction. The economy will recover slowly, and in 2025 GDP will grow by 1.1%. In 2026, growth will pick up to 1.8%. Inflation of just over 1% is forecast for 2024, from which it will rise nearer to 2% in the immediate years ahead. The labour market has suffered from the weak economy, but in 2025 the unemployment rate will start to decline. The risks surrounding the forecast are, in the short term, predominantly on the downside.



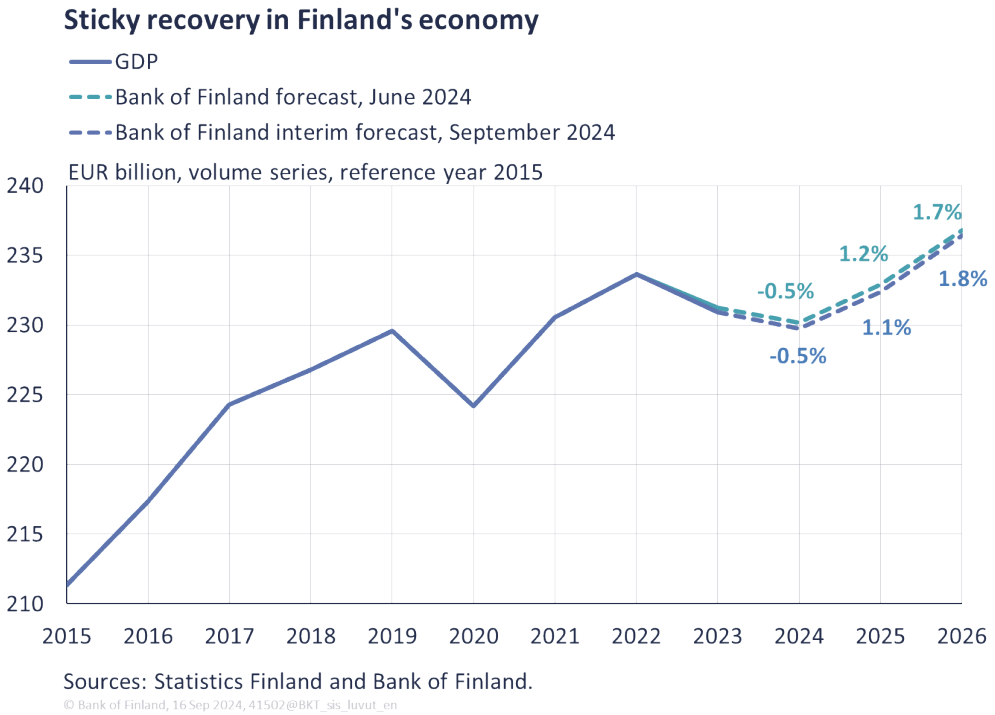
The Bank of Finland's interim forecast[1] is based on data available on 11 September 2024, and on assumptions updated on 19 August 2024 regarding changes in Finland's external operating environment and key financial market variables in the immediate years ahead.[2]

## Forecast in brief

In the first half of this year, growth in the Finnish economy was subdued. Private consumption and

private investment have been weak, and the fragile economic growth has relied on exports and public demand. According to the Bank of Finland's September 2024 interim forecast, Finland's GDP will contract by 0.5% this year (Chart 1 and Table 1). However, the economy will gradually pick up, and in 2025 GDP will grow by 1.1%. In 2026, growth will rise to 1.8%. The Bank of Finland's June forecast estimated that GDP would contract by 0.5% for the full year 2024. This forecast for the current year has therefore remained unchanged since June. The short-term forecasting, or nowcasting, models used by the Bank of Finland indicate that GDP performance will be subdued for the remainder of the year.

Chart 1.




The outlook for the economy is nevertheless improving, and the level of economic uncertainty is slowly dissipating. At the same time the financial markets are expecting interest rates to fall gradually. Improving employment and rising earnings will strengthen purchasing power next year. The preconditions for purchasing power recovery will also be supported by a moderate inflation rate. The growth in Finland's export markets will also become more robust. The recovery of the Finnish economy and the rise in GDP growth in the immediate years ahead will be underpinned by these factors.

There has been a broad-based drop in inflation (Chart 3).[3] The Bank of Finland's inflation forecast for 2024 is 1.1% (Table 1). Due to international raw material prices and exchange rate effects, the inflation forecast has been adjusted slightly downwards from the June forecast. The inflation rate

will rise in 2025 to 1.8% and then fall back to 1.6% in 2026.

The impact of the weak economy is also felt in the labour market. The unemployment rate has risen, and there has been a drop in the employment figures. The unemployment rate will rise to 8.3% for 2024 as a whole (Table 1 and Chart 4). The number of unemployed people is projected to fall slightly in 2025 as the economy recovers, and the unemployment rate will start to decline.

There are risks surrounding the forecast, and growth for the latter part of the year remains uncertain. Although there are already early signs of a turn for the better in manufacturing and exports, it is not certain that this will continue. Exports will largely depend on how Finland's export markets develop in the final part of 2024 and in early 2025. Geopolitical risks are still present, including fragmentation into competing blocs in the global economy, the reshaping of value chains, and armed conflicts. Domestically, it is uncertain how long consumers will continue to be cautious, and at what point the construction sector will eventually start to recover. However, positive surprises are also possible. The economic recovery could be faster than forecast if business and household confidence improves, which would increase private consumption and housing investment.

## Table 1. INTERIM FORECAST SUMMARY

| | 2023 | 2024[f] | 2025[f] | 2026[f] |
|---|---|---|---|---|
| Annual GDP growth (%) | | | | |
| Interim forecast, September 2024 | -1.2 | -0.5 | 1.1 | 1.8 |
| Forecast, June 2023 | -1.0 | -0.5 | 1.2 | 1.7 |
| Unemployment rate (%) | | | | |
| Interim forecast, September 2024 | 7.2 | 8.3 | 8.1 | 7.8 |
| Forecast, June 2023 | 7.2 | 8.1 | 7.8 | 7.6 |
| Inflation* (%) | | | | |
| Interim forecast, September 2024 | 4.3 | 1.1 | 1.8 | 1.6 |

*[f] = forecast.*

** Harmonised Index of Consumer Prices (HICP).*

*** Harmonised Index of Consumer Prices (HICP) excl. food and energy.*

*Sources: Bank of Finland and Statistics Finland.*

| | 2023 | 2024[f] | 2025[f] | 2026[f] |
|---|---|---|---|---|
| Forecast, June 2023 | 4.3 | 1.2 | 2.0 | 1.6 |
| Core inflation** (%) | | | | |
| Interim forecast, September 2024 | 4.1 | 2.2 | 2.4 | 1.7 |
| Forecast, June 2023 | 4.1 | 2.2 | 2.5 | 1.6 |

*[f] = forecast.*

** Harmonised Index of Consumer Prices (HICP).*

*** Harmonised Index of Consumer Prices (HICP) excl. food and energy.*

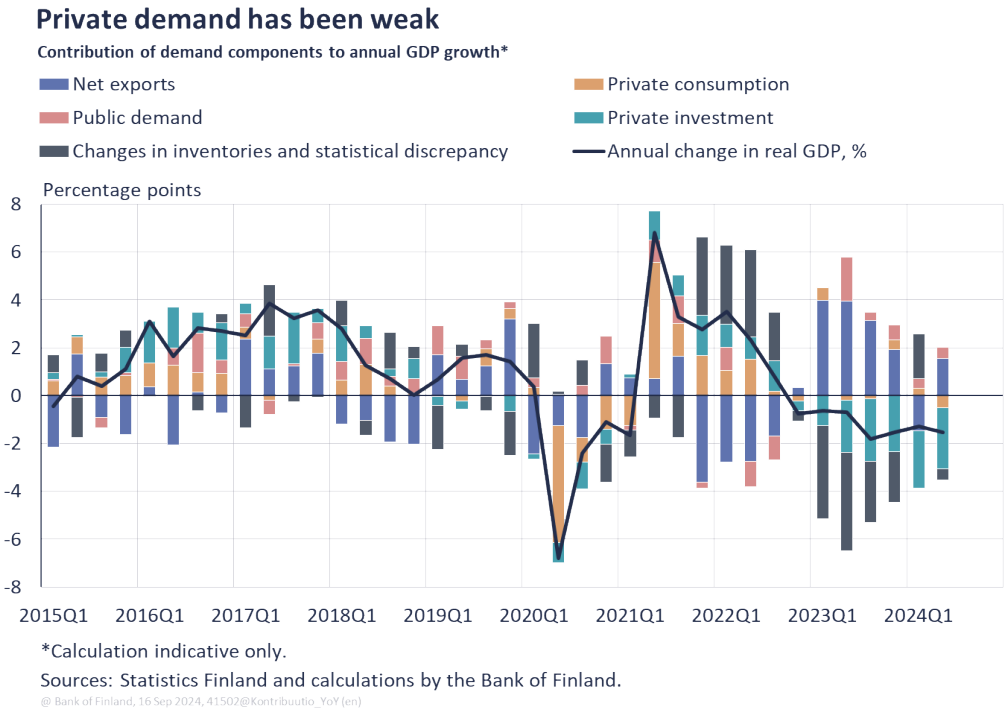
*Sources: Bank of Finland and Statistics Finland.*

## Subdued growth in first half of 2024

Growth in the Finnish economy was subdued in the first half of 2024. In both the first and second quarter of the year, GDP growth on the previous quarter was 0.3%.[4] The composition of the growth appears somewhat discouraging in terms of domestic demand, as both private consumption and private investment have been weak. The fragile growth has relied on exports, changes in inventories and public demand.

Although exports declined in the first quarter of 2024, they recovered markedly in the second quarter. The first quarter's weak performance is accounted for by the disruption caused by strikes. The strong growth of goods exports in the second quarter was due to specific factors such as the rebound after the strikes and a cruise ship delivery to Germany in June. The impact of positive net exports (exports minus imports) on GDP growth was clearly favourable in the second quarter (Chart 2). Overall, there are early signs of an improvement in manufacturing and exports: industrial orders have picked up slightly, and confidence in the future, as measured by business surveys, has also risen. Service exports also grew throughout the first half of the year.

Chart 2.




Private consumption was muted in the first half of the year. Consumer confidence is also still low. Although consumers' assessment of their own finances has shown a slight improvement, consumption intentions remain modest, and people are concerned about the threat of unemployment. Household real earnings growth has been lower than expected. Subdued consumption is also reflected in the lacklustre turnover growth in the retail and wholesale trade, and the low confidence of companies operating in the sector. In the services sector, by contrast, confidence improved slightly during the summer but remains clearly lower than usual.

Private investment declined, especially investment in residential construction, which has been falling since 2022. Confidence among construction companies in July–August 2024 improved on the second quarter, but there are still no signs of a clear turnaround for the better. The number of building permits issued continued to decline. Public investment, however, which has not been hit as hard as private investment, is on the rise. Public final consumption expenditure grew steadily in the first half of 2024, but the cost-saving measures of wellbeing services counties and central government will hinder their growth in the future.

The impacts of recent developments in the economy on the short-term economic outlook for Finland have been systematically assessed using the Bank of Finland's short-term forecasting, or nowcasting, models (Table 2). The models forecast, in rough terms, zero growth for the remainder of the year.[5]

The economy will grow in 2025, as the economic outlook is improving and the level of economic uncertainty is slowly dissipating. At the same time the financial markets are expecting interest rates to fall gradually. Improving employment, earnings growth and a moderate inflation rate will support the preconditions for a recovery in private consumption. The growth in Finland's export markets will also become more robust. These factors will also bring a rebound in investment from its low level. GDP growth will then gather pace as the upswing progresses towards the end of the forecast period.

## Table 2. NOWCASTING MODEL RESULTS

| GDP, quarterly growth | 2024Q1 | 2024Q2 | 2024Q3 | 2024Q4 |
|---|---|---|---|---|
| BVAR model | 0.0% | -0.8% | 0.0% | 0% |
| Factor model | -0.5% | -0.3% | -0.2% | -0.2% |
| Bridge model | 0.2% | 0.0% | 0.2% | |
| Model average | -0.1% | -0.3% | 0.0% | -0.1% |
| Actual growth | 0.3%* | 0.3%* | | |

*Nowcasting models updated 10 September 2024.*

** Updated after release of National Accounts 30 August 2024.*

*Sources: Statistics Finland and calculations by the Bank of Finland.*

## External assumptions underlying the interim forecast

Compared with the June 2024 forecast, the external environment assumptions underlying the interim forecast have changed, becoming in part more favourable and in part less favourable for the Finnish economy (Table 3). However, the overall impact of the changes in relation to the June forecast is very small. In the ECB's September projections, GDP growth in the euro area is expected to be 0.8% in 2024 and to reach 1.5% by 2026. Compared with the June forecast, the GDP growth outlook has been adjusted slightly downwards for each year of the forecast horizon. Finland's export markets are expected to grow especially in 2025 and 2026. Finland's trade-weighted exchange rate has strengthened slightly.[6]

The financial markets expect interest rates to fall during the forecast period. Lower interest rates

would further support Finland's economic growth. Assumptions regarding future energy and raw material prices are also based on market expectations. The price of crude oil is expected to fall and the world market prices of other raw materials to rise only moderately.

## Table 3. FORECAST ASSUMPTIONS

| Volume percentage change on previous year | 2023 | 2024[f] | 2025[f] | 2026[f] |
|---|---|---|---|---|
| Euro area GDP | 0.5 | 0.8 | 1.3 | 1.5 |
| World GDP (excl. euro area) | 3.5 | 3.4 | 3.4 | 3.3 |
| World trade (excl. euro area)[1] | 1.0 | 3.1 | 3.4 | 3.3 |
| | 2023 | 2024[f] | 2025[f] | 2026[f] |
| Finland's export markets[2], % change | -0.1 | 1.2 | 3.1 | 3.2 |
| Oil price, USD/barrel[3] | 83.7 | 83.2 | 76.1 | 73.2 |
| Raw material prices (excl. energy), USD, % change[4] | -12.5 | 7.3 | 1.3 | 2.5 |
| Export prices of Finland's competitors, EUR, % change | -4.7 | 0.3 | 1.8 | 2.2 |
| 3-month Euribor, %[3] | 3.4 | 3.6 | 2.5 | 2.2 |
| Finland's nominal effective exchange rate[5] | 110.3 | 111.8 | 112.3 | 112.3 |
| USD value of one euro[6] | 1.08 | 1.09 | 1.10 | 1.10 |

[1] *Calculated as a weighted average of imports.*

[2] *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.*

[3] *Technical assumption derived from market expectations.*

[4] *Technical assumption derived from market expectations. In the longer term, raw material prices are assumed in part to follow movements in global economic activity.*

[5] *Broad nominal effective exchange rate, 2015 = 100. The index rises as the exchange rate appreciates.*

[6] *Assuming no changes in the exchange rate.*

[f] *= forecast.*

*Sources: European Central Bank and Bank of Finland.*

## Upward pressures on prices are moderate

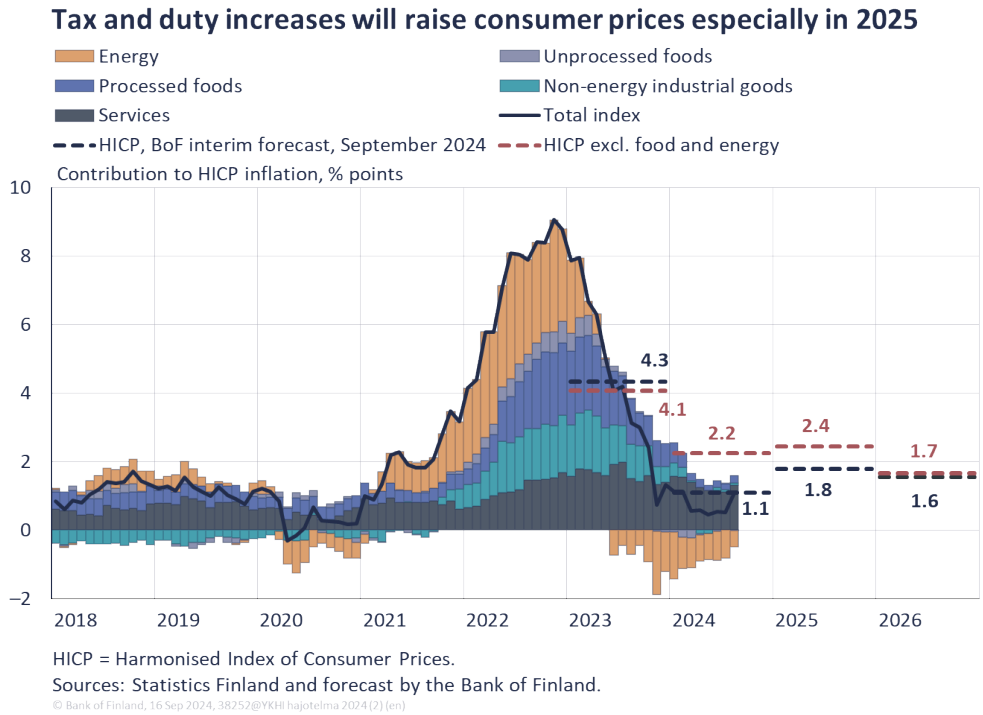
Consumer price pressures are currently moderate due to the weak economy and the disinflationary effects of monetary policy. Inflation has indeed fallen substantially during 2024. In August 2024, inflation was at 1.1%, measured using the Harmonised Index of Consumer Prices (Chart 3). Finland's inflation rate was just 0.5% in July, but a key factor behind the low inflation figures is a technical adjustment to the electricity price index made by Statistics Finland in August 2023.[7]

Core inflation, which excludes energy and food prices, was 2.0% in August 2024. Headline inflation is currently notably lower than this, because energy prices are declining and food prices have stopped rising.

If the September increase in the general VAT rate is transferred in full to consumer prices, this will raise the annual inflation rate by around 0.7 percentage points. However, the impact is expected to be slightly less than this. This VAT-related increase is also a non-recurring change that does not indicate growth in inflationary pressures.

Price pressures will nevertheless start to rise gradually as the economy recovers. In addition, the increases planned for 2025 on, for example, the lower VAT rates and the excise duties on tobacco products and soft drinks will push up annual consumer price inflation in 2025. In 2026, inflation will fall again slightly to 1.6%. Although the inflationary impact of the tax and duty increases will diminish, inflation will nevertheless be sustained by the economic upswing and earnings growth.

Chart 3.



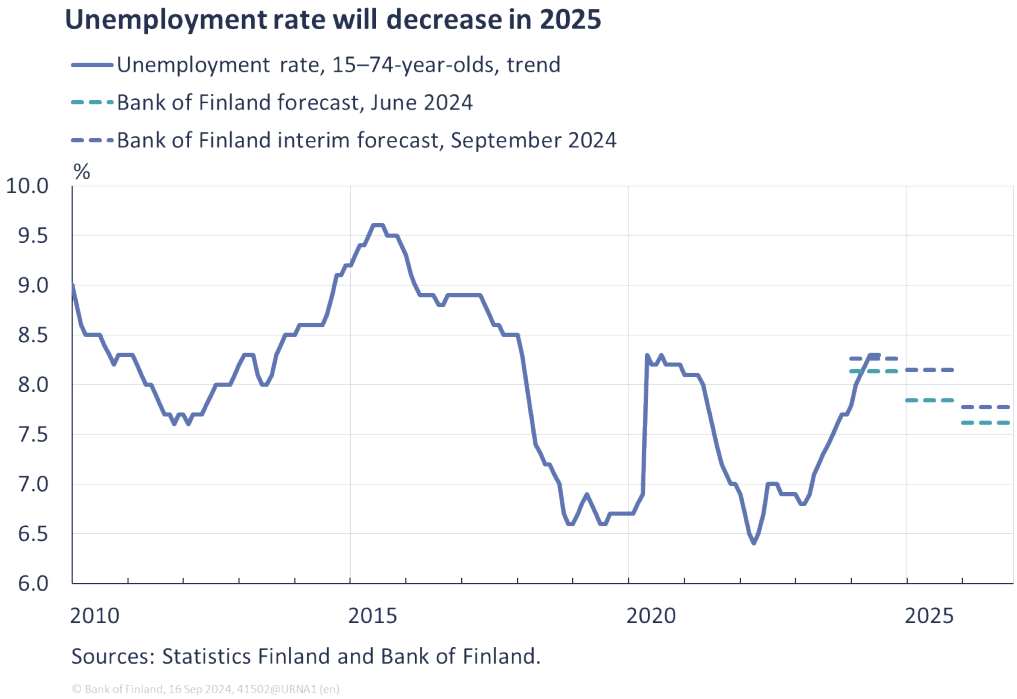

HICP = Harmonised Index of Consumer Prices.
Sources: Statistics Finland and forecast by the Bank of Finland.
© Bank of Finland, 16 Sep 2024, 38252@YKHI hajotelma 2024 (2) (en)

## Labour market has weakened with the economy

The persistently weak cyclical conditions are reflected in the labour market as a rise in the unemployment rate and fall in the employment rate. However, there were signs in the summer that the labour market is stabilising. Although the number of unemployed people continued to rise in July, the decline in the employment figures seems to be slowing. In July 2024, the unemployment rate was 8.3%, and the employment rate of the working-age population (aged 20 to 64) was 76.8%.[8]

According to National Accounts data, the number of employed people and total hours worked in the private sector declined in the second quarter of 2024, while in the public sector these increased. Long-term unemployment has been on the increase since spring 2023, and this gathered pace in summer 2024. The possibilities for employment growth in the near term are hampered by a decline in the number of job vacancies and companies' low employment expectations. The unemployment rate for 2024 will rise to 8.3%. As cyclical conditions improve, the unemployment rate will start to fall, and will decrease to 7.8% in 2026 (Chart 4).

Chart 4.




## Both downside and upside risks

In the short term, the risks surrounding the interim forecast are tilting to the downside, but towards the end of the forecast period there are also positive growth risks.

Regarding Finland's export growth, a lot will depend on the performance of the euro area and Finland's other export markets. Geopolitical tensions, such as the conflicts in Ukraine and the Middle East, and problems in the economic relations between the United States and China, create significant risks for global stability and international trade. The recent volatility in the raw material and capital markets has also increased uncertainty in the global economy, as these markets have been sensitive to negative news. If they were to materialise, these risks would have an impact on inflation as well as growth.

In Finland, the situation of mortgage-borrowing households and of companies will be influenced by future interest rate movements. In addition, the fiscal adjustment measures could weaken domestic demand more than anticipated. It is also possible that more jobs could be lost in the construction industry if the weak situation continues. There are also employment risks in other industries, and temporary layoffs could turn into permanent redundancies if domestic demand does not pick up.

Positive surprises are also possible. The pace of economic recovery at turning points in the business cycle has often turned out to be faster than initially expected. This could happen if consumer confidence recovers more quickly than expected and households consequently spend more. A faster than expected rebound in construction could also further boost growth in the economy from the current low levels. The implementation of planned investment projects for the green transition in Finland could, furthermore, lead to faster investment growth than was forecast.

## Notes

1. The Bank of Finland publishes interim forecasts for the Finnish economy twice a year, in March and September. These are technical updates of the forecast, in which the outlook for GDP, unemployment and inflation is updated. The interim forecast does not necessarily reflect the views of the Eurosystem. The Bank's more extensive forecasts for the Finnish economy are published in June and December each year. ↑
2. The forecast's underlying assumptions about changes in Finland's external environment and financial market variables are based on the assumptions of the European Central Bank's (ECB) September 2024 projections. ↑
3. In this report, inflation refers to consumer price inflation as measured by the Harmonised Index of Consumer Prices (HICP), and core inflation refers to inflation excluding energy and food prices. ↑
4. The growth figures of the quarterly National Accounts data presented in this report describe seasonally adjusted and working day adjusted changes in volume on the previous quarter, unless otherwise separately indicated. The information is provided by Statistics Finland. The quarterly statistics presented are susceptible to data revisions due to revisions of source data for the quarterly National Accounts and the balancing to the annual National Accounts, as well as the uncertainty brought by the seasonal adjustment models used. ↑
5. The data used for forecasting the last quarter of 2024 is currently rather limited, and so the assessment is especially susceptible to changes. ↑
6. Measured as the broad nominal effective exchange rate. ↑
7. This adjustment has lowered inflation by 0.7 percentage points on average during the past 12 months. This means that actual inflation has been higher than indicated by the official figures. However, the adjustment will no longer affect the annual change in consumer prices from August onwards. Therefore, the higher inflation in August is not due to new price pressures but factors related to the calculation. ↑
8. In this report, the employment and unemployment rate are expressed as trend figures. ↑

## Keywords

employment, Finnish economy, forecast, GDP, inflation