

RatingsDirect®

Summary:

Finland

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Summary:

Finland

Issuer Credit Rating

AA+/Stable/A-1+

Key Rating Factors

Institutional and economic profile	Flexibility and performance profile
<p>Finland's growth decelerates as external slowdown eats into business-cycle-dependent export basket</p> <ul style="list-style-type: none">• Economic growth slows down in 2019 as external demand softens and cyclical growth drivers lose speed.• Revival in structural reform momentum will be required to uphold improving employment levels and secure strengthened growth fundamentals.• Medium-term demographic challenges to long-term growth will require a policy response.	<p>Material external refinancing needs reflect Finland's large financial sector</p> <ul style="list-style-type: none">• We expect a mild fiscal expansion, as the new government plans to end a lengthy period of austerity.• The financial sector dominates the country's external position, and Nordea Bank's relocation to Finland has increased the economy's external assets and liabilities.• Current accounts will likely remain in deficit as domestic demand drives imports.

Outlook

The outlook is stable because we expect that continued economic growth, albeit slowing, will support the labor market and aid Finland's gradual fiscal consolidation. In addition, we maintain our expectation that Nordea Bank's re-location of its headquarters to Finland will not present supervision-related challenges or materially affect the country's current external position.

We could raise the long-term rating if the Finnish economy's external metrics improved, seen, for example, in strong and sustained current account surpluses that could result from strengthening market shares of Finnish exports together with improved income balances, or from a material reduction in short-dated external liability positions. Greater reform momentum to address challenges posed by a decreasing and aging workforce, resulting in longer-term sustainability of public finances, would be positive for the rating.

We could consider a negative rating action if structural reforms don't succeed, leading to weaker growth or a substantial deterioration in Finland's fiscal performance, in turn leading to sharply increasing debt.

Rationale

Our rating on Finland is supported by the sovereign's wealthy economy and its track record of stable, transparent, and effective governance and political institutions. The rating further reflects the government's low net debt and the benefits of eurozone membership, including high credibility of the European Central Bank's (ECB's) monetary policy and access to deep capital markets.

The rating remains constrained, however, by Finland's relatively large external debt, which stems from its extensive pan-Nordic financial system and the resulting significant external financing needs.

Institutional and economic profile: Growth outlook weakens as investments fade and structural challenges begin to weigh on long-term growth

Finland's growth outlook has weakened. After a cyclical peak in 2016-2017, economic growth slowed in 2018, when output expanded by 1.7%, a sizable slowdown from 3.0% in 2017. In the first half of 2019, most high-frequency indicators suggest that the economy's growth momentum has stalled on the back of slowing external demand, still muted private consumption, and contraction in fixed investment amid lower business confidence. We note that the trend of low investments in research and development continues, which impedes prospects for diversification of industry.

For 2020-2022, we expect the economy to grow in line with its potential growth rate at around 1.2%. As Finland's economic cycle shifts into a lower gear, we believe that economic growth will come less from investments and exports and rely more on domestic consumption, as the strengthening labor market should revive private consumption and become the key growth driver.

Following the general elections in April 2019, the left-wing Social Democratic Party (SDP) came out on top in a narrow victory with 17.7% of the vote. It is the first time in more than a century that no party has won more than 20% of the vote, which resulted in a highly fragmented parliament. The SDP now leads a five-party, center-left coalition, which has announced a government program focused on environmental policy initiatives, and has promised higher spending on public services than its predecessor.

We understand that a key underlying assumption to the incumbent government's policy agenda, budget spending structure, and associated financing hinges on an expected improvement in the employment rate reaching 75% over the legislative period. We consider this a meaningful increase from the current position at 72.5% and one which could prove challenging. In particular, we do not foresee that the government will benefit from the business cycle to achieve its employment goals, because cyclical components to economic growth have noticeably cooled. Employment data from July 2019 in fact suggest a stagnation of the improving trend in employment. As a consequence, we believe achieving the employment rate target will require some substantial structural reforms, on which there is limited visibility yet.

In this vein, confidence in Finland's overall reform ability took a hit in March 2019 when the parliament failed to pass legislation necessary to implement a longstanding major reform initiative in the social and health care sector, the "SOTE" reform. This prompted a government resignation, just five weeks before the April general elections. Even

though the content of the SOTE reform has been politically contested, we observe a strong political consensus about the need to push it forward to ensure the sustainability of public finances, as they are under pressure from an aging population. Therefore, we believe that the social and health care reform will stand as a top priority and return to the table of the government in these early days of its legislative term.

Stronger reform momentum will also be required to handle the structural challenges from an aging population and a declining employment pool. If not addressed, these will weigh on the economy's growth potential over the longer term.

Flexibility and performance profile: The large banking sector results in significant external debt positions with high financing requirements

The new coalition government intends to end a long period of austerity. After several years of budget cuts, the new government is planning to increase fiscal spending by about 1% of GDP over the coalition's four-year term, together with plans to initiate a €3 billion targeted one-off investment program. We expect the government will fund this mild fiscal expansion with a combination of tax increases, much of it environmental levies, and a possible sell-off of some €2 billion–€3 billion worth of state assets.

In spite of the mild fiscal expansion, we expect fiscal prudence to remain the norm with general government gross debt to GDP ratio trending down. According to our forecasts, Finland's gross general government debt now stands below 60% of GDP. In terms of holdings of government securities, over 70% of outstanding Finnish government debt continues to be held by nonresidents.

For net general government debt, we subtract from gross debt not only the Finnish Treasury's cash holdings and its minority ownership of publicly listed companies through the state-owned asset manager, Solidium, but also, and more importantly, we deduct approximately 30% of GDP in liquid assets held by the public sector's earnings-related pension funds. As a result, Finland's net general government debt ratio is among the lowest in the eurozone (for more details, see www.spratings.com/sri).

Finland's contingent liabilities (guarantees) amount to almost 25% of GDP, of which 60% are Finnvera export credit guarantees and which predominantly relate to deliveries of Finnish cruise ships. Currently, Finnish shipyards have a backlog of orders and the government has suggested meaningfully increasing the guarantee commitments awarded to Finnvera. In shipbuilding, there typically is a significant time lag between the contract being signed, ship delivery, and loan disbursement; hence the commitments are significantly higher than the guarantees extended. At year-end 2018, total Finnvera state guarantees amounted to almost €30 billion, with the total amount of drawn loans at €12 billion.

We expect the current account to remain in small deficits throughout the forecast period, as domestic consumption drives imports. Foreign direct investment inflows will likely remain highly volatile, owing to the impact of large acquisitions, such as foreign investors' past purchases of Finnish companies in the shipbuilding or technology sectors.

Finland's external ratios continue to be dominated by financial institutions. Although the relocation of Nordea Bank to Finland has affected Finland's international investment position, with both assets and liabilities increasing significantly, these moved largely in tandem, leaving the net position largely unaffected. However, Nordea Bank's move has substantially increased the size of the banking sector to about 375% of Finland's GDP, compared with 250% previously. This has prompted the Finnish Financial Supervisory Authority to upscale local supervision and regulatory

activities, while also highlighting the importance of continued close regional cooperation and preparedness for crises.

Large cross-border exposures of the financial sector, including liquidity risk related to foreign-financed wholesale funding, will be the key risk for external ratios. In particular, the economy's external short-term debt by remaining maturity, a reflection of the positions of its banking sector, will remain well above 100% of current account receipts (CARs) and narrow net external debt will stay around a high 175% of CARs on average over 2019-2022. That said, we note that Finland's external position, as indicated by the country's overall net external asset position, is much stronger than its narrow net external debt position.

Overall, Finland's banking system remains profitable and well capitalized. It is dominated by pan-Nordic banks and a domestic cooperative banking group (see "Banking Industry Country Risk Assessment: Finland," published Feb. 2, 2018, on RatingsDirect). In our view, the banking system poses only a limited contingent liability to the sovereign. Moreover, to address potential negative spillovers into Finland from other Nordic and Baltic financial systems, the so-called Nordic-Baltic Stability Group's (NBSG) remit was enhanced in January 2018. The NBSG comprises ministries, central banks, regulators, supervisors, and resolution authorities from the Nordic-Baltic region.

We forecast Finnish inflation will remain modest compared with that of most European peers. More generally, Finland benefits from the eurozone's deep and liquid debt markets, the credibility of the ECB's monetary policy, and the positive effects of the ECB's loose monetary settings on Finnish government bond yields. Still, membership in a monetary union reduces Finland's monetary flexibility, and we believe that monetary accommodation alone is unlikely to lead to sustained real economic growth.

Key Statistics

Table 1

Finland Selected Indicators										
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Economic indicators (%)										
Nominal GDP (bil. €)	203	205	210	216	224	232	238	245	253	261
Nominal GDP (bil. \$)	270	273	233	239	253	274	270	283	304	324
GDP per capita (000s \$)	49.8	50.1	42.6	43.6	46.0	49.7	48.9	51.1	54.9	58.4
Real GDP growth	(0.8)	(0.6)	0.5	2.8	3.0	1.7	1.3	1.2	1.1	1.3
Real GDP per capita growth	(1.2)	(1.1)	0.1	2.5	2.7	1.5	1.1	1.0	0.9	1.1
Real investment growth	(4.9)	(2.6)	0.7	8.6	5.2	3.1	1.5	1.5	1.7	1.7
Investment/GDP	21.4	20.9	20.9	22.1	22.8	24.0	23.8	23.6	23.5	23.5
Savings/GDP	19.5	19.4	20.2	21.4	22.1	22.4	22.5	22.8	22.7	23.0
Exports/GDP	38.8	37.2	36.4	35.9	38.5	39.2	39.5	39.9	40.2	40.6
Real exports growth	1.1	(2.7)	0.8	3.5	7.6	1.1	1.3	1.8	2.0	2.3
Unemployment rate	8.2	8.7	9.4	8.8	8.6	7.4	6.8	6.9	7.0	7.0
External indicators (%)										
Current account balance/GDP	(1.9)	(1.5)	(0.7)	(0.7)	(0.7)	(1.6)	(1.3)	(0.9)	(0.8)	(0.5)
Current account balance/CARs	(4.2)	(3.4)	(1.6)	(1.7)	(1.6)	(3.4)	(2.7)	(1.8)	(1.6)	(1.0)
CARs/GDP	46.4	45.7	44.3	44.7	46.2	46.8	48.0	48.4	48.6	48.8

Table 1

Finland Selected Indicators (cont.)										
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Trade balance/GDP	1.3	0.9	0.9	0.2	0.7	0.3	0.4	0.4	0.4	0.3
Net FDI/GDP	0.8	6.3	7.8	(5.7)	1.3	(3.6)	1.2	1.2	1.2	1.2
Net portfolio equity inflow/GDP	(2.1)	0.2	0.9	(3.6)	(1.4)	1.1	(1.0)	(1.0)	(1.0)	(1.0)
Gross external financing needs/CARs plus usable reserves	474.1	436.9	472.9	383.2	337.7	289.5	348.4	344.3	326.5	312.2
Narrow net external debt/CARs	207.2	197.4	211.8	212.5	244.2	199.7	196.6	186.2	174.6	164.0
Narrow net external debt/CAPs	198.8	191.0	208.4	209.0	240.4	193.1	191.4	182.9	171.9	162.3
Net external liabilities/CARs	(7.4)	6.8	(2.9)	(17.5)	(2.6)	1.8	4.5	3.9	5.1	5.8
Net external liabilities/CAPs	(7.1)	6.6	(2.9)	(17.2)	(2.5)	1.8	4.3	3.8	5.0	5.7
Short-term external debt by remaining maturity/CARs	411.8	372.9	420.1	317.4	266.4	209.8	273.4	269.1	248.9	233.2
Usable reserves/CAPs (months)	1.0	1.0	1.2	1.1	1.1	1.0	0.9	0.9	0.9	0.8
Usable reserves (mil. \$)	11,268	10,669	10,018	10,468	10,517	10,310	10,579	10,861	11,165	11,489
Fiscal indicators (general government; %)										
Balance/GDP	(2.6)	(3.2)	(2.8)	(1.7)	(0.8)	(0.8)	(0.8)	(1.0)	(0.5)	(0.4)
Change in net debt/GDP	2.4	2.0	2.3	1.3	(1.8)	(0.4)	0.8	1.0	0.5	0.4
Primary balance/GDP	(1.3)	(1.9)	(1.5)	(0.6)	0.2	0.1	0.1	0	0.6	0.8
Revenue/GDP	54.9	54.9	54.3	54.2	53.4	52.8	53.0	53.5	54.0	54.0
Expenditures/GDP	57.5	58.1	57.0	55.9	54.2	53.6	53.8	54.5	54.5	54.4
Interest/revenues	2.4	2.4	2.3	2.1	2.0	1.8	1.7	1.8	2.0	2.1
Debt/GDP	54.7	58.4	61.8	61.4	59.6	57.9	56.0	55.5	54.5	53.3
Debt/revenues	99.7	106.3	113.8	113.2	111.6	109.5	105.7	103.8	101.0	98.7
Net debt/GDP	20.0	21.8	23.6	24.3	21.6	20.4	20.7	21.1	21.0	20.7
Liquid assets/GDP	34.7	36.5	38.1	37.1	37.9	37.4	35.3	34.4	33.5	32.5
Monetary indicators (%)										
CPI growth	2.2	1.2	(0.2)	0.4	0.8	1.2	1.3	1.4	1.6	1.8
GDP deflator growth	2.6	1.7	1.7	0.1	0.6	2.0	1.4	1.7	1.9	2.0
Exchange rate, year-end (€/€)	0.73	0.82	0.92	0.95	0.83	0.87	0.88	0.85	0.82	0.80
Banks' claims on resident non-gov't sector growth	6.5	2.9	0.9	1.3	2.7	4.6	4.0	4.0	4.0	4.0
Banks' claims on resident non-gov't sector/GDP	96.5	98.3	97.0	95.5	94.7	95.6	96.8	97.8	98.7	99.4
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(3.9)	0.4	(3.1)	(2.4)	(7.4)	2.6	N/A	N/A	N/A	N/A

Sources: Eurostat, Statistics Finland (Economic Indicators), Statistics Finland, Eurostat (External Indicators), Statistics Finland, the Bank of Finland (Fiscal Indicators), and the Bank of Finland, International Monetary Fund (Monetary Indicators).

Table 1

Finland Selected Indicators (cont.)										
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Adjustments: Government debt adjusted by excluding guarantees on debt issued by EFSSF.										
Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. e--Estimate. f--Forecast. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.										

Ratings Score Snapshot

Table 2

Finland Ratings Score Snapshot		
Key rating factors	Score	Explanation
Institutional assessment	2	Generally strong track record of policies that deliver sustainable public finances and balanced economic growth. Unbiased enforcement of contracts and respect for rule of law with generally effective checks and balances between institutions. Finland depicts one of the most cohesive civil societies, as evidenced by high social inclusion, degree of social order, and capacity of political institutions to respond to societal priorities. However, coordination requirements at the level of the Economic and Monetary Union may hinder timely policy responsiveness.
Economic assessment	1	Based on GDP per capita (US\$) and growth trends as per Selected Indicators in Table 1.
External assessment	4	Based on narrow net external debt/CARs as per Selected Indicators in Table 1. The sovereign has external short-term debt by remaining maturity that generally exceeds 100% of CARs, as per Selected Indicators in Table 1. The Sovereign's net international investment position is more favorable than the narrow net external debt position by over 100% of CARs, as per Selected Indicators in Table 1.
Fiscal assessment: flexibility and performance	1	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1. The sovereign has large liquid assets/GDP as per Selected Indicators in Table 1.
Fiscal assessment: debt burden	1	Based on net general government debt (% of GDP) and general government interest expenditure (% of general government revenues) as per Selected Indicators in Table 1. Nonresidents hold over 60% of government commercial debt.
Monetary assessment	2	In the context of our monetary assessment, we consider the euro to be a reserve currency. The European Central Bank has an established track record in monetary authority independence with clear objectives and a wide array of policy instruments, including nonconventional tools. The CPI is low and in line with that of its trading partners. Finland is a member of the Economic and Monetary Union.
Indicative rating	aa+	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	None
Rating		
Foreign currency	AA+	
Notches of uplift	0	
Local currency	AA+	Default risks do not apply differently to foreign- and local-currency debt.

Table 2**Finland Ratings Score Snapshot (cont.)**

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings History, Sept. 4, 2019
- Sovereign Ratings List, Sept. 4, 2019
- European Developed Sovereign Rating Trends Midyear 2019, July 25, 2019
- Sovereign Risk Indicators, July 11, 2019. An interactive version is also available at <http://www.spratings.com/sri>
- Default, Transition, and Recovery: 2018 Annual Sovereign Default And Rating Transition Study, March 15, 2019
- Banking Industry Country Risk Assessment: Denmark, March 7, 2018
- Banking Industry Country Risk Assessment: Finland, Feb. 2, 2018

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