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## Finland

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# Finland

## Key Rating Factors

Sovereign Credit Rating

AA+/Stable/A-1+

Institutional and economic profile	Flexibility and performance profile
<p>The recently appointed government is faced with the need to vitalize reform momentum to address structural constraints to faster growth</p> <ul style="list-style-type: none"><li>• Private consumption and expansionary fiscal policy will drive growth in 2020 amid external headwinds.</li><li>• The social and health care sector faces increasing cost pressures as decade-long reform efforts continue to underwhelm.</li><li>• A revival of structural reform momentum will be required to uphold improving employment levels, boost productivity, and ensure fiscal sustainability.</li></ul>	<p>The financial sector dominates the country's external position</p> <ul style="list-style-type: none"><li>• The government is ending austerity in attempts to ignite the lackluster economy.</li><li>• Net government debt remains low despite stagnating consolidation efforts.</li><li>• The current account will likely remain in deficit as domestic demand drives imports.</li></ul>

## Outlook

The stable outlook reflects our expectation that Finland will maintain solid public finances, despite lower economic growth and mild fiscal loosening over the coming two years. In addition, we maintain our expectation that relocation of financial institutions to Finland will not present supervision-related challenges or materially affect the country's current external position.

### Upside scenario

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 or a reduction in the financial sector's short-term financing requirements. Greater reform momentum to address the challenges posed by a decreasing and aging workforce, resulting in longer term sustainability of public finances, would similarly be positive for the rating.

### Downside scenario

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

The ratings on Finland are supported by the sovereign's wealthy economy and its track record of stable and transparent governance and political institutions. In our base-case scenario, we expect the economy to navigate external headwinds as a mild fiscal expansion and solid household purchasing power support growth through 2023. 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.

### **Institutional and economic profile: Structural reforms become increasingly pressing as the economy begins to face constraints from a declining employment pool and skills mismatches**

We expect the Finnish economy to grow in line with its potential growth rate at about 1.2% in 2020-2023. As the economic cycle shifts into a lower gear, we believe that growth will rely more on domestic demand as the business-cycle-dependent Finnish export basket faces external headwinds. Even though household consumption ran at a subdued clip through 2019, where household hesitance manifested itself through an uptick in the savings ratio, we believe the still solid labor market, improving employment, a pickup in wages, and low interest rates will support private consumption to step into the shoes of the key growth driver over 2020-2021. We believe that the recent proposed fiscal stimulus will also provide a useful near-term support to growth.

At the same time, Finland's growth outlook could face further challenges, stemming predominantly from external factors such as the fragile eurozone economy, which could add further clouds to Finland's export horizon. In addition, the risks of heightened global trade protectionism, as well as coronavirus-related economic repercussions, could start disrupting global value chains. This could ultimately weigh on Finland's open, export-driven economy. Domestically, the expected slowdown in residential construction, after three years of significant growth impetus, could be deeper than anticipated.

The current round of wage negotiation has commenced with the social partner of the exports industry agreeing on a 3.3% growth pickup over the next two years. We expect the most contentious wage bargaining round to pertain to the public sector, which largely considers it had borne the brunt of the previous efforts concluded in the "competitiveness pact" and now expects a rebound in compensation. The wage negotiations for the public sector are expected to close in third-quarter 2020. The "competitiveness pact" agreed between employers and unions in 2016 helped to curb wage growth and brought Finnish unit labor costs closer to those of European peers.

Former prime minister Antti Rinne, who led his Social Democratic Party to victory in the closely contested March 2019 election was forced to step down in December 2019, just six months into his term, amid the government's poor handling of labor disruptions that cost him the support of coalition partner the Centre Party. The five-party ruling coalition, now led by Prime Minister Sanna Marin has maintained the government's program commitments to spending more on education, employment, infrastructure, and climate policies as it intends to end a long period of austerity.

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. As a consequence, we believe achieving the employment rate target will require some substantial structural reforms, on which there is currently limited visibility.

Finland's unemployment rate seems to be stuck at 6.7%, despite still substantial vacancies and a large pool of unemployed, signaling acute skills mismatches. This suggests that reforms to boost employment and upgrade the workforce's skill sets are becoming increasingly pressing.

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. Despite the reform delays, we observe a strong political consensus about the need to push the SOTE reform forward to ensure the sustainability of public finances, as they are under pressure from an aging population. We also believe swift progress on the SOTE reform could benefit the local government sector, which has found itself in dire expenditure straits recently. Therefore, we believe that the social and health care reform will remain on top of the policy agenda for the government in 2020.

### **Flexibility and performance profile: The large banking sector underpins high external financing requirements**

After several years of budget cuts, the new government is set to increase permanent general government expenditure by about 0.5% of GDP over the coalition's four-year term, and plans to initiate a €3 billion targeted one-off temporary spending program. We expect the government will fund this mild fiscal expansion with a combination of tax increases, much of them environmental levies, and a possible sell-off of some €2 billion-€3 billion of state assets.

We believe that the government's fiscal plan would delay a previously planned consolidation. Given the slowing economy, meeting the government objective to see the budget in balance by 2023, after a temporary relaxation, will likely be challenging. We hence forecast moderate fiscal deficits through 2023.

That said, we consider Finland to hold fiscal space to absorb this mild fiscal easing. Even though we see rising budgetary pressures in the local government sector, gross general government debt should stay at around a moderate 55% of GDP through our forecast horizon to year-end 2023.

Our preferred debt metric--net general government debt--stands substantially lower than gross debt: We forecast it will average 22% of GDP in the next few years, suggesting that Finland's public finances will remain a rating strength. When estimating this ratio 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.

Finland's contingent liabilities (guarantees) amount to almost 25% of GDP, of which 60% are Finnvera export credit guarantees which predominantly relate to deliveries of Finnish cruise ships. Currently, Finnish shipyards have a backlog of orders and the government has suggested significantly 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.

Finland's current account position strengthened in 2019 on the back of one-off cruise ship delivery, which boosted exports in December 2019. While it swung the current account to almost a balance, the transaction had no impact on GDP accounting as it was offset by negative inventory investments. We expect the current account to remain in small deficits 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 in tandem, leaving the net position largely unaffected. However, Nordea Bank's move has substantially increased the size of the banking sector to about 335% of Finland's GDP, compared with 250% previously. Although Nordea is under the ECB's remit, the redomicile of the major Nordic bank 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. 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.

Large cross-border exposures of the financial sector, including liquidity risk related to foreign-financed wholesale funding, continue to present the key risk going forward. 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 high at around 175% of CARs on average over 2020-2023. That said, we note that Finland's external balance sheet, as indicated by the country's net international investment position, remains significantly stronger, with external assets largely equal to external liabilities.

Overall, Finland's banking system remains profitable and well capitalized. It is dominated by pan-Nordic banks and domestic cooperative banking group (see "Banking Industry Country Risk Assessment: Finland," published Oct. 9, 2019, on RatingsDirect). In our view, the banking system poses only a limited contingent liability to the sovereign.

Household debt has been increasing of late, especially from housing company loans and consumer lending. While Finnish household debt remains below that in other Nordic countries, it is now surpassing the eurozone average in disposable income terms. In order to curb household debt growth, the authorities are taking steps to address these developments and the results of a government-appointed working group has proposed the introduction of a debt-to-income (DTI) limit at 4.5x annual gross income, including housing company loans, 25-year maximum maturity and limitations to housing company loans in new housing construction. The parliamentary discussions on these proposals are set to begin in 2020.

We forecast Finnish inflation will remain modest, in line with most eurozone 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**

<b>Finland Selected Indicators</b>										
<b>(Mil. €)</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>
<b>Economic indicators (%)</b>										
Nominal GDP (bil. LC)	207	211	218	226	234	241	248	256	264	273
Nominal GDP (bil. \$)	275	235	241	255	277	270	277	293	313	323
GDP per capita (000s \$)	50.4	42.9	43.9	46.4	50.2	48.9	50.2	52.9	56.4	58.2
Real GDP growth	(0.4)	0.5	2.7	3.1	1.7	1.0	1.0	1.0	1.3	1.3
Real GDP per capita growth	(0.8)	0.2	2.4	2.8	1.6	0.9	0.8	0.8	1.1	1.1
Real investment growth	(1.8)	0.5	8.8	4.0	3.2	(1.1)	1.2	1.5	1.6	1.6
Investment/GDP	22.1	21.7	23.3	23.8	25.2	24.3	23.9	24.0	24.1	24.2
Savings/GDP	20.8	20.8	21.3	23.1	23.9	24.2	23.6	23.6	23.7	23.9
Exports/GDP	36.5	35.4	34.8	37.7	38.6	39.9	40.2	40.5	40.7	41.0
Real exports growth	(2.0)	0.4	3.7	8.8	2.2	7.1	1.2	1.4	1.6	2.0
Unemployment rate	8.7	9.4	8.8	8.6	7.4	6.7	6.6	6.7	6.7	6.7
<b>External indicators (%)</b>										
Current account balance/GDP	(1.3)	(0.9)	(2.0)	(0.8)	(1.4)	(0.1)	(0.3)	(0.4)	(0.4)	(0.4)
Current account balance/CARs	(2.9)	(2.2)	(4.7)	(1.7)	(2.9)	(0.2)	(0.6)	(0.9)	(0.8)	(0.8)
CARs/GDP	45.5	43.4	42.8	45.7	46.6	47.8	48.2	48.5	48.3	48.6
Trade balance/GDP	0.7	0.9	0.0	0.7	0.3	1.1	0.7	0.4	0.3	0.2
Net FDI/GDP	6.1	7.8	(6.3)	1.4	(4.9)	0.8	1.2	1.2	1.2	1.2
Net portfolio equity inflow/GDP	0.0	0.8	1.8	(0.7)	1.3	(2.9)	(1.0)	(1.0)	(1.0)	(1.0)
Gross external financing needs/CARs plus usable reserves	436.7	478.3	393.5	338.0	286.9	355.0	346.2	331.6	319.1	312.2
Narrow net external debt/CARs	197.1	210.6	223.6	246.9	218.3	193.5	185.2	175.7	166.0	160.7
Narrow net external debt/CAPs	191.5	206.2	213.5	242.9	212.1	193.1	184.0	174.1	164.6	159.4
Net external liabilities/CARs	6.8	(9.8)	(10.4)	0.6	13.3	3.5	1.8	2.5	3.1	3.7
Net external liabilities/CAPs	6.6	(9.6)	(9.9)	0.5	12.9	3.5	1.8	2.5	3.1	3.7
Short-term external debt by remaining maturity/CARs	373.1	426.3	327.0	266.7	207.4	283.2	273.3	255.7	240.1	231.1
Usable reserves/CAPs (months)	1.1	1.2	1.1	1.1	1.0	1.0	1.0	0.9	0.8	0.7
Usable reserves (mil. \$)	10,669	10,018	10,468	10,517	10,310	10,722	10,666	10,374	9,904	9,581
<b>Fiscal indicators (general government; %)</b>										
Balance/GDP	(3.0)	(2.4)	(1.7)	(0.7)	(0.8)	(1)	(1.3)	(1.3)	(1.0)	(1.0)
Change in net debt/GDP	2.0	2.3	1.3	(1.8)	(0.3)	1.0	1.3	1.3	1.0	1.0

Table 1

Finland Selected Indicators (cont.)										
(Mil. €)	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Primary balance/GDP	(1.8)	(1.3)	(0.7)	0.3	0.1	(0.1)	(0.3)	(0.3)	0.0	0.1
Revenue/GDP	54.3	54.1	53.9	53.0	52.3	53.0	53.5	54.0	54.0	54.0
Expenditures/GDP	57.3	56.5	55.6	53.7	53.1	54.0	54.8	55.3	55.0	55.0
Interest/revenues	2.3	2.1	2.0	1.9	1.7	1.7	1.8	1.8	1.9	2.0
Debt/GDP	58.0	61.4	61.0	59.1	57.4	56.6	56.4	56.1	55.4	54.7
Debt/revenues	106.9	113.5	113.2	111.5	109.9	106.8	105.3	103.9	102.6	101.4
Net debt/GDP	21.7	23.5	24.2	21.5	20.4	20.8	21.5	22.2	22.5	22.7
Liquid assets/GDP	36.3	37.8	36.8	37.6	37.0	35.8	34.8	33.9	32.9	32.0
Monetary indicators (%)										
CPI growth	1.2	(0.2)	0.4	0.8	1.2	1.1	1.4	1.5	1.6	1.8
GDP deflator growth	1.6	1.6	0.2	0.7	2.0	1.8	2.0	2.0	2.0	2.0
Exchange rate, year-end (LC/\$)	0.82	0.92	0.95	0.83	0.87	0.89	0.89	0.86	0.83	0.83
Banks' claims on resident non-gov't sector growth	2.9	0.9	1.3	2.7	4.6	4.5	4.5	4.5	4.5	4.5
Banks' claims on resident non-gov't sector/GDP	97.6	96.4	94.9	93.9	94.7	96.2	97.6	99.0	100.1	101.3
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	0.3	(4.2)	(4.0)	(7.6)	2.8	(2.8)	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).

Adjustments: Government debt adjusted by excluding guarantees on debt issued by EFSF.

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. LC--Local currency.

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 is 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.

Table 2

Finland Ratings Score Snapshot (cont.)		
Key rating factors	Score	Explanation
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 relative to 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
Foreign currency	AA+	
Notches of uplift	0	Default risks do not apply differently to foreign-and local-currency debt.
Local currency	AA+	

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. CAR--Current account receipts. CPI--Consumer price index.

## 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

- Banking Industry Country Risk Assessment Update: February 2020, Feb. 21, 2020
- Sovereign Ratings History, Feb. 10, 2020
- Sovereign Ratings List, Feb. 10, 2020



- Sovereign Ratings Score Snapshot, Feb. 4, 2020
- Sovereign Risk Indicators, Dec. 12, 2019. An interactive version is also available at <http://www.spratings.com/sri>
- Banking Industry Country Risk Assessment: Finland, Oct. 19, 2019
- Global Sovereign Rating Trends: Midyear 2019, July 25, 2019
- European Developed Sovereign Rating Trends Midyear 2019, July 25, 2019
- Default, Transition, and Recovery: 2018 Annual Sovereign Default And Rating Transition Study, March 15, 2019

### Ratings Detail (As Of March 6, 2020)\*

#### Finland

Sovereign Credit Rating	AA+/Stable/A-1+
Transfer & Convertibility Assessment	AAA
Senior Unsecured	AA+
Short-Term Debt	A-1+

#### Sovereign Credit Ratings History

16-Sep-2016	<i>Foreign Currency</i>	AA+/Stable/A-1+
25-Sep-2015		AA+/Negative/A-1+
10-Oct-2014		AA+/Stable/A-1+
16-Sep-2016	<i>Local Currency</i>	AA+/Stable/A-1+
25-Sep-2015		AA+/Negative/A-1+
10-Oct-2014		AA+/Stable/A-1+

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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