ONE OF THE MOST RESILIENT ECONOMIES IN EUROPE

Finland's economy was showing signs of weakness even before the Covid-19 pandemic started – indeed, GDP contracted a bit in the fourth quarter of 2019. In spite of that, the economy has been one of the most resilient in Europe. That is notably because the pandemic has been relatively contained, allowing the authorities to impose softer restriction measures. Another reason is the substantial support provided by the government.

So far, Finland's economy has been one of the least affected in Europe by the economic crisis triggered by the Covid-19 pandemic. In the second quarter, GDP contracted by « only » 4.5%. In addition, the recession in Finland will probably remain milder than in most other European countries.

First, Finland has been relatively spared from the pandemic itself. The mortality rate of Covid-19 in Finland is, at about 50 deaths per million population, among the lowest in Europe. Combined with the strong healthcare system, this has allowed the government to impose softer restriction measures than most other European countries – with the notable exception of Sweden – according to the Oxford Covid-19 Government Response Tracker[1].

What's more, the Finnish government has provided substantial support to the economy, including measures such as direct funding for firms, the extension of unemployment security, the extension of social benefits, and the temporary lowering of private-sector pension contributions. The Ministry of Finance estimates that these will be equivalent to about 2.5% of 2019 GDP. The government has also pledged loan guarantees worth more than EUR 10 bn (4.2% of 2019 GDP), capitalisations, and the easing of payment terms for taxes due this year. Existing automatic stabilisers should also provide strong support to households and businesses by limiting income losses. In total, the IMF estimates that, combined with these stabilisers, the government package of fiscal, liquidity and regulatory measures will, if fully utilised, represent a boost of nearly 30% of GDP.

When it comes to monetary policy, the European Central Bank has substantially eased its stance, notably by massively increasing its asset purchases as well as expanding and lowering the cost of its longer-term refinancing operations for credit institutions.

RISKS ARE TILTED TO THE DOWNSIDE

While Finland's economy seems well positioned to weather the crisis, it presents some weaknesses that could delay, or indeed derail, any recovery.

First, the country is highly reliant on intermediate goods, which makes it vulnerable to supply-chain disruptions. That could be a big drag on the economy if global trade failed to recover rapidly. In any case, the structural slowdown in trade that started with the global financial crisis is unlikely to end soon, and could thus become a slow-burning issue for this small and open economy.

What's more, Finnish public finances will come out of the crisis substantially weaker. The Ministry of Finance forecasts that the government deficit will exceed 8% this year, pushing the debt-to-GDP ratio up by nearly 12 percentage points to more than 70%. And it expects the ratio to keep rising after that. Admittedly, Finland can count on a still limited public debt burden, particularly compared to Southern European countries.

GROWTH AND INFLATION (%)

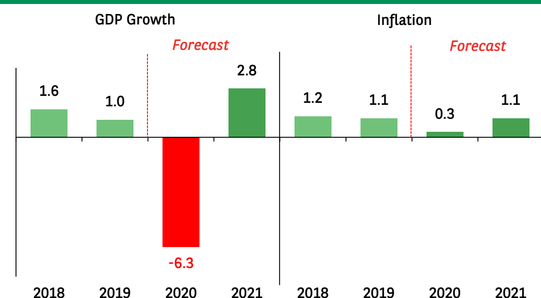

CHART 1 SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

However, weaker public finances could be an issue in the long term given the challenge that will arise from demographics. In 2014, the government enacted reforms raising the retirement age to 65 and linking it to life expectancy from 2027. Nevertheless, that might not be enough to balance the government's books, given the rapidly ageing population. The old-age dependency ratio –the ratio between the number of people aged 65 or over and the working age population– is, at 36.0% in 2020, already among the highest in Europe. According to Eurostat data, the ratio will rise to nearly 50% by 2050 and to more than 60% by 2100[2].

Another area of mild concern is the household sector, where both debt-to-GDP and debt-to income ratios have increased over the past decades – even though the ratios are still much lower than the equivalent ones for Sweden and Denmark for instance.

That being said, debt sustainability risks are likely to remain limited in both cases as long as interest rates remain low.

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1 https://www.bsg.ox.ac.uk/research/research-projects/coronavirus-government-response-tracker
2 https://ec.europa.eu/eurostat/web/products-datasets/-/tps00200