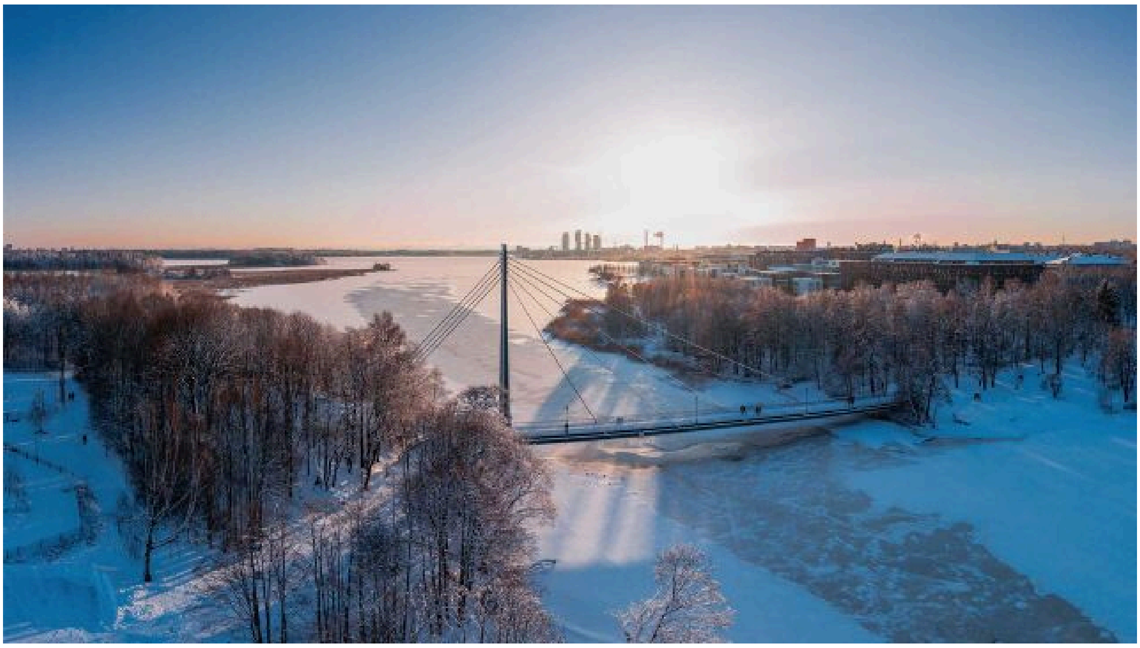
FORECAST

Finland's economy will pick up gradually

Finnish economy | 04.02.2025

Finland is making a slow recovery from recession. The economy will show a contraction of 0.5% for 2024. Uncertainty in the global economic outlook is dampening export growth. The improvement in private consumption is slow, because confidence in the economy is weak and unemployment still rising. On the other hand, a further reduction in interest rates is anticipated, which will support investment and consumption. Finland's economy is forecast to grow by 0.8% in 2025, and by 1.8% in 2026 and 1.3% in 2027. Inflation will stay below 2% in the immediate years ahead. The growth pick-up in the economy and the Government's substantial fiscal adjustment measures will strengthen Finland's public finances, though these will continue to be deeply in deficit.



Overview

Growth in the world economy has been fairly subdued in 2024, and growth in the euro area economy has been sluggish. In Finland's export markets, growth will recover gradually as international trade picks up in the immediate years ahead. However, rising geopolitical tensions threaten the outlook for the euro area economy and the world economy.

Financing conditions have become considerably less restrictive due to the reduction in interest rates. The financial markets expect the 3-month Euribor rate to fall further in 2025 and 2026. The easing of financing conditions will support the economic recovery both in Finland and the euro area.

Aggregate demand in the economy will be down by 0.5% in 2024. In 2025, the economy will grow by 0.8%, and in 2026 by a higher rate, 1.8%. In 2027, at the end of the forecast period, growth will soften to 1.3%, which is close to the long-term growth potential.

Despite stronger purchasing power, private consumption will be down in 2024 because of weak consumer confidence and an elevated threat of unemployment. Consumption will increase only a little in 2025, as the improvement in household purchasing power will be halted temporarily by a rise in unemployment, higher taxation and cuts to social benefits. Private consumption growth will pick up in 2026 and 2027. Purchasing power will start to rise again when cyclical conditions strengthen and employment and household income improve.

Investment has still been declining steeply in 2024. Investment confidence will gradually start to return as cyclical conditions improve, and the markets are anticipating a further reduction in interest rates. Private non-residential investment will slowly begin to grow in 2025, but in residential construction there will still be hardly any growth. Rising confidence and population growth will revive housing demand and residential construction in the latter half of the forecast period. The growth in non-residential investment will also gather pace.

Finland's exports for the full year 2024 will be fairly weak, although some signs of growth have been evident. Exports will pick up gradually from 2025 onwards as cyclical conditions improve in Finland's export markets. Monetary policy has already become less restrictive, and interest rates have fallen worldwide. This will increase economic activity and stimulate global demand for Finnish exports of investment goods. Subdued growth in the euro area economy will nevertheless moderate the growth in Finnish exports.

Inflation has fallen considerably in 2024. However, increases in taxation will raise consumer prices in 2025. In 2026–2027, the upturn in the economy will gather pace and household purchasing power will rise, which means a modest inflation rate will be sustained by domestic consumer demand. Inflation will nevertheless remain below 2% for the entire forecast period.

The persistence of weak cyclical conditions is weighing on the labour market. In the early part of the forecast period the economy will not yet boost the demand for labour by enough to lift the employment rate. Employment will improve when labour demand picks up during the upswing in 2026–2027. The unemployment rate will fall to 7.7%, which is close to the level of structural unemployment.

Finland's fiscal deficit for 2024 will rise to 4% of gross domestic product (GDP). The deficit will not fall below 3% until 2027. The fiscal balance will start to improve from 2025 as a result of rising GDP growth and the Government's fiscal adjustment measures. However, in parallel with this, the public finances will be under strain from the rising need for public services, the growth in interest expenditure and the increases in government spending on defence. The general government debt ratio will rise to 87% in 2027.

The risks surrounding the forecast are predominantly on the downside. The anticipated tightening of trade policy by the United States threatens to hamper the growth opportunities for Finnish exports. Uncertainty in the global economy is elevated by the geopolitical tensions in Ukraine and the Middle East. In Finland, fiscal policy tightening could, in the short term, weaken private consumption by more than has been forecast. It is also possible that the economy could grow more quickly than expected in the immediate years ahead. The pace of economic recovery at turning points in the business cycle has often proved to be faster than initially expected.

Table 1. Key forecast outcomes

Percentage change on the previous year	2023	2024[f]	2025[f]	2026[f]	2027[f]
GDP	-1.2	-0.5	0.8	1.8	1.3
Private consumption	0.3	-0.3	0.5	1.5	1.2
Public consumption	3.4	0.2	-0.4	0.3	-0.0
Fixed investment	-9.0	-7.5	3.4	6.1	3.3
Private fixed investment	-10.1	-10.6	0.9	6.7	4.6
Public fixed investment	-3.6	7.1	13.3	4.2	-1.3
Exports	0.2	-0.3	2.7	2.7	2.9
Imports	-6.6	-1.1	2.2	3.5	3.0
Effect of demand components on growth					
Domestic demand	-1.3	-1.8	0.9	2.2	1.4
Net exports	3.2	0.3	0.2	-0.3	-0.1
Changes in inventories and statistical	-3.1	1.0	-0.3	0.0	-0.0

[f] = forecast.

Sources: Statistics Finland and Bank of Finland.

Percentage change on the previous year	2023	2024f	2025f	2026f	2027f
error					
Savings rate, households, %	1.4	3.1	2.6	2.6	2.4
Current account, % of GDP	-0.4	0.5	0.1	-0.4	-0.5
	2023	2024f	2025f	2026f	2027f
Labour market					
Number of hours worked	0.2	-1.2	0.0	0.9	0.5
Employment rate (20–64-year-olds), %	77.9	76.7	76.3	76.5	76.6
Unemployment rate, %	7.2	8.3	8.7	8.2	7.7
Unit labour costs	5.3	-0.6	2.5	1.7	1.8
Labour compensation per employee	3.5	-0.1	3.5	2.7	2.5
Productivity	-1.7	0.5	1.0	1.0	0.7
GDP, price index	3.9	1.1	1.5	1.7	2.0
Private consumption, price index	4.6	1.0	1.9	1.6	1.8
Harmonised index of consumer prices	4.3	1.0	1.9	1.5	1.7
Excl. energy	5.0	2.0	2.5	1.6	1.7
Energy	-1.8	-7.9	-3.6	-0.1	1.0
General government, % of GDP					
General government balance	-3.0	-4.0	-3.7	-3.3	-2.9
General government gross debt (EDP)	77.1	81.7	84.6	85.9	87.3

f = forecast.

Sources: Statistics Finland and Bank of Finland.

Operating environment: assumptions and financing conditions

Global economic growth strengthened somewhat during the autumn. International trade is expected to pick up gradually in the immediate years ahead, and the demand for Finland's exports will grow. Inflation will remain modest in the main economic regions worldwide and financing conditions are expected to ease further, bolstering economic growth both in Finland and elsewhere. However, mounting uncertainty over future trade relations between the United States and China is threatening to weaken the outlook for world trade. The Bank of Finland forecast is based on data available on 26 November 2024.

World economy to grow sluggishly in the immediate years ahead

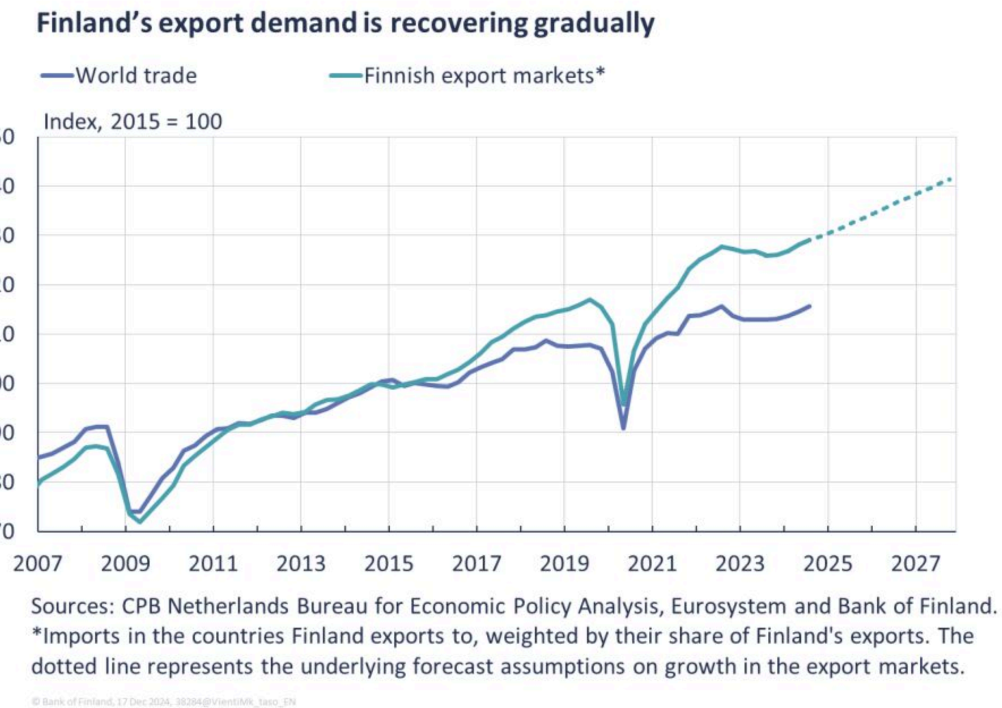
While the performance of the global economy was rather subdued in 2024, the growth in world trade strengthened slightly in the autumn (Chart 1). Growth in the international goods trade has been slow, reflecting the weak cyclical conditions in industrial production in the world's main economic regions. Growth across the global economy has been mixed, however. The US economy, in particular, has grown in 2024 and its labour market has remained strong, whereas the Chinese economy has suffered from subdued domestic demand and a continuation of serious problems in the real estate sector.

Following the period of high inflation in 2022–2023, the rise in consumer prices has clearly slowed in the advanced economies, boosting consumers' purchasing power. With inflation falling, monetary policy has been widely eased and interest rates have been reduced. The forecast is based on the assumption that global economic growth will pick up slightly in 2025, as cyclical conditions start to improve especially in the emerging economies. This will coincide with a gradual revival of world trade in response to a strengthening of international demand. Annual growth in the world economy will then stabilise at a rather modest pace of slightly over 3% (Table 2), as moderating growth in the United States and China will weigh on the performance of the global economy.

Cyclical conditions in the euro area have been subdued for a considerable time, and industrial production, in particular, has performed very weakly, above all in Germany. Euro area economic growth is expected to gradually gather strength in 2025–2026, in response to a rebound in private consumption and investment. Nevertheless, in the immediate years ahead, euro area GDP will only grow at a rate of just over 1% annually. Inflation will fall back to 2% by 2026 and will also remain modest thereafter, which will further boost economic growth.[1]

Growth in Finland's export markets will also gradually gather pace as global cyclical conditions improve (Table 2). The demand for Finnish export products will grow, especially from outside the euro area, although euro area demand for Finland's exports will be hampered by sluggish GDP growth and the persistent difficulties faced by the German economy, in particular. However, the still rising geopolitical tensions, the tightening of US trade policy and the concerns over a trade war between the US and China are threatening to slow the growth in world trade and in the demand for Finland’s exports (see Import tariffs and trade policy uncertainty will dampen economic growth).

Chart 1.



Trends in commodities prices have diverged in 2024. Oil prices have fallen since 2023 due to the muted demand for oil arising from the weak cyclical conditions worldwide and notably in China, and because of a marked increase in oil production by non-OPEC producer countries and the ample spare production capacity in the oil producing countries. The forecast assumes that the price of oil will decline in line with market expectations, reaching around USD 69 per barrel in 2027 (Table 2). However, the conflicts and tension in the Middle East are maintaining upward pressure on oil prices.

By contrast, the prices of other commodities have increased in 2024. They are expected to rise further in 2025 and to remain high in 2026–2027 (Table 2). Food commodities – notably coffee and soybeans – have risen in price during 2024 due to the periods of drought suffered by Brazil, one of the major coffee and soybean producing countries. Underlying the rise in metals prices is the downward turn in the global interest rate cycle, among other things.

Interest rates are expected to fall further

At its December meeting, the European Central Bank (ECB) decided to lower all three policy rates by 0.25 percentage points.[2] The ECB's principal policy rate – the deposit facility rate – was lowered to 3.00%, the interest rate on the main refinancing operations to 3.15% and the interest rate on the marginal lending facility to 3.40%. According to the ECB's Governing Council, the disinflation process in the euro area is well on track. Based on the Governing Council's assessment, most measures of underlying inflation suggest that inflation will settle sustainably around the 2% target in the medium term. The Governing Council will follow a meeting-by-meeting and data-dependent approach to determining the monetary policy stance. In particular, the interest rate decisions will be based on an assessment of the inflation outlook in the light of the incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission.

Financing conditions have been eased considerably in 2024. The 12-month Euribor has fallen well below 3% from its autumn 2023 peak of 4.2%. At the same time, the average interest rate on new housing and corporate loans has declined significantly (Chart 2). Financial markets expect the 3-month Euribor to fall further in 2025–2026, and to reach 2.2% in 2027 (Table 2). The easing of financing conditions will support the economic recovery both in Finland and the euro area.

According to the ECB's Bank Lending Survey, credit terms and loan margins for both household and corporate loans remained unchanged in Finland in the autumn and there were no significant changes in Finnish banks' credit standards. Banks did not anticipate any changes to their credit standards during the remainder of 2024, either. The Confederation of Finnish Industries' Business Tendency Survey indicates that difficulties in accessing finance had eased somewhat during the autumn compared to the beginning of the year. Financial difficulties were no longer increasing in the construction sector either during the autumn, although they are still a common problem in the sector.

Chart 2.

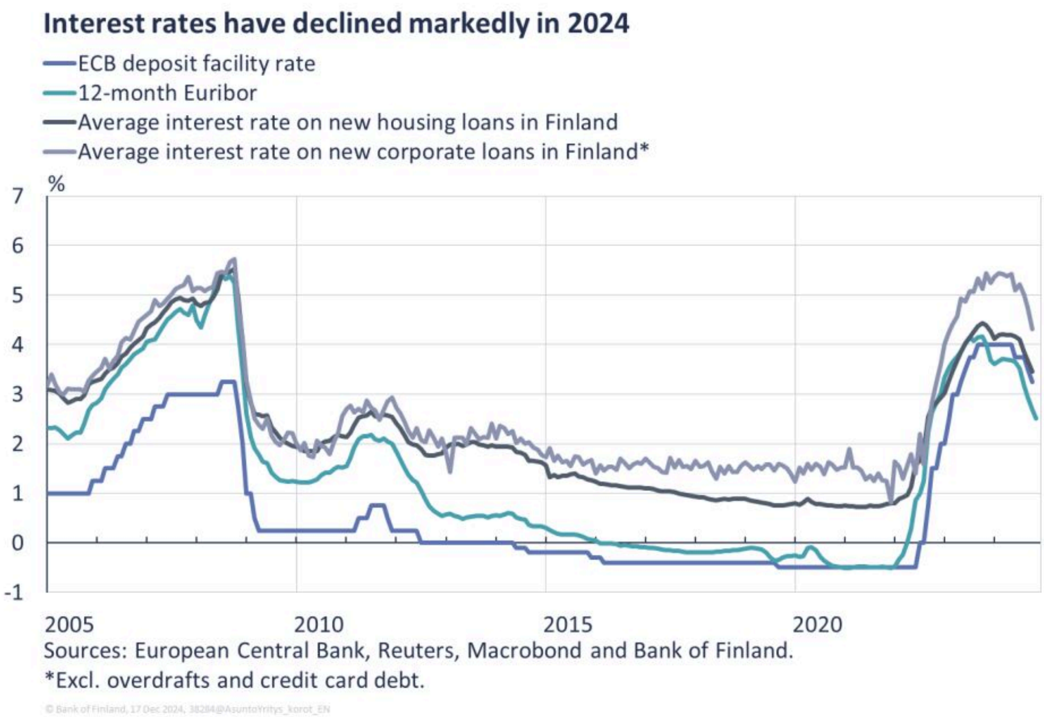


Table 2. Forecast assumptions

Volume change year on year, %	2023	2024[f]	2025[f]	2026[f]	2027[f]
Euro area GDP	0.5	0.7	1.1	1.4	1.3
World GDP (excl. euro area)	3.6	3.4	3.5	3.3	3.2
World trade (excl. euro area)*	0.9	4.0	3.6	3.3	3.2
	2023	2024[f]	2025[f]	2026[f]	2027[f]
Finland's export markets, % change**	-0.2	1.7	2.9	3.0	2.9

**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.*

****Technical assumption derived from market expectations.*

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

******Assuming no changes in the exchange rate.*

[f] = forecast.

Sources: European Central Bank and Bank of Finland.

Volume change year on year, %	2023	2024f	2025f	2026f	2027f
Oil price, USD/barrel***	83.7	81.8	71.8	70.1	69.2
Raw material prices (excl. energy), USD, % change	-12.5	8.9	5.8	-0.4	-1.7
Export prices of Finland's competitors, EUR, % change	-4.6	0.2	2.0	2.2	2.0
3-month Euribor, %***	3.4	3.6	2.1	2.0	2.2
Finland's nominal effective exchange rate****	101.5	102.8	102.5	102.5	102.5
USD value of one euro*****	1.08	1.08	1.06	1.06	1.06

**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.*

****Technical assumption derived from market expectations.*

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

******Assuming no changes in the exchange rate.*

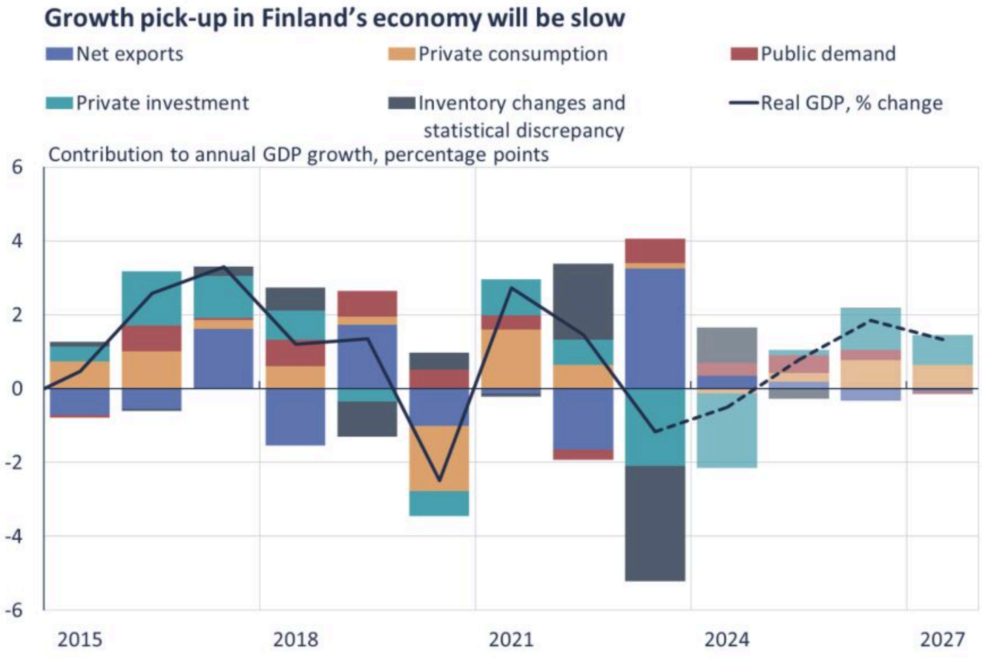
f = forecast.

Sources: European Central Bank and Bank of Finland.

Demand and the public finances

The Finnish economy will show a contraction for the full year 2024. Aggregate demand in the economy will slowly start to grow in 2025. Private consumption and investment will gradually start to recover as consumer and business confidence in the economy steadily improve and economic uncertainty dissipates, and at the same time the interest rate level is expected to decrease. The world economy will gradually pick up, strengthening Finland's export growth. The public finances will remain deeply in deficit, and the general government debt ratio will continue to grow, although substantial fiscal adjustment measures will gradually improve the general government budgetary position.

Chart 3.



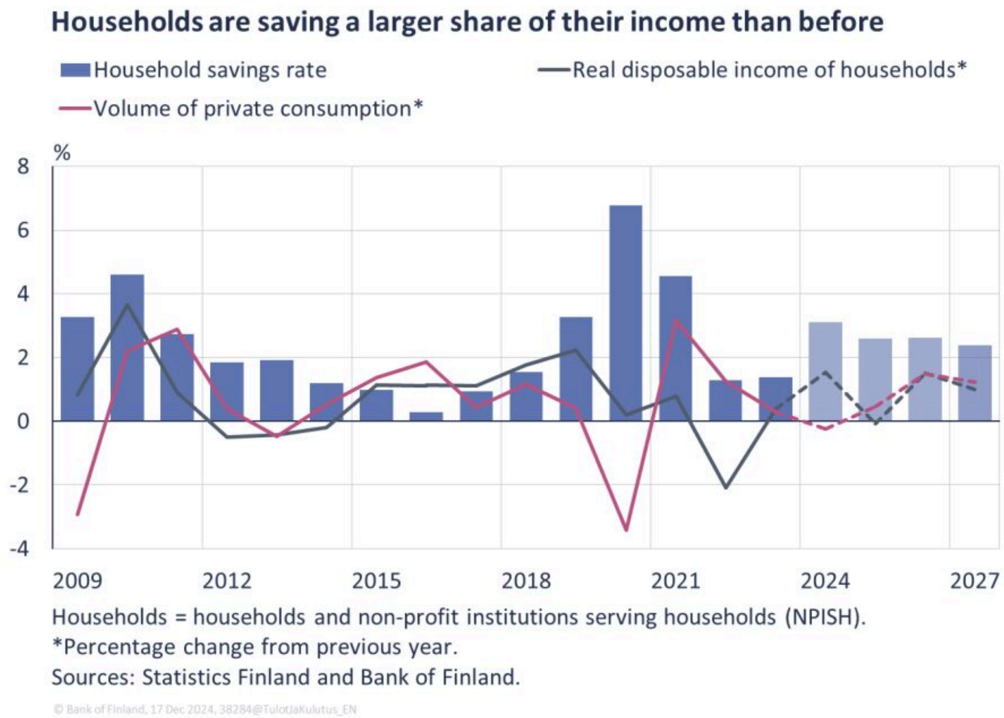
The contribution of each demand component to GDP growth is calculated on the basis of its volume growth and its value share in the previous year. The figures for 2024–2027 are forecasts.
Sources: Statistics Finland and Bank of Finland.

Private consumption will slowly grow

The real disposable income of households, i.e. their purchasing power, started to improve in 2023 when inflation slowed down substantially (Chart 4). According to the forecast, household purchasing power for the full year 2024 will show a further strengthening, as inflation is moderate and wages are rising in accordance with previously concluded collective bargaining agreements. Interest rates have declined significantly during the autumn, which is rapidly reducing the interest burden of indebted households. The large index-linked increases to pensions, social assistance and certain other social benefits at the beginning of 2024 have also strengthened purchasing power as a whole. However, purchasing power growth is not being supported by earned income growth in 2024, as the labour market has cooled significantly and unemployment has increased during the summer and autumn. Various social benefits have also been cut during 2024, eroding the incomes of many households.

Despite stronger purchasing power, private consumption will be down in 2024, because the appetite to consume is low and economic uncertainty remains substantial (Chart 4). Consumer confidence has been very weak for a long time, and there are no signs of an improvement in consumer sentiment for the time being. Many households are cautious, and in 2024 households are saving a larger share of their income compared with the previous year. This increase in savings is attributable to low inflation and declining interest payments.

Chart 4.



In 2025, private consumption will grow only a little, as the rise in purchasing power will temporarily cease (Chart 4). Inflation will rise slightly, because the standard VAT rate was raised in September 2024 and more tax increases will enter into force in early 2025. The weak labour market conditions will continue, and no decline will yet be seen in the unemployment rate. Furthermore, many social benefits will still be subject to cuts. Consumers' uncertainty about their own finances and the economy will stay high, reducing the appetite to consume. Consequently, the savings rate will remain relatively high. At the same time, however, the financial markets anticipate that interest rates will decline further during 2025. This will support the purchasing power and consumption prospects of indebted households, in particular.

Private consumption growth will accelerate in 2026 and 2027. Purchasing power will pick up further when cyclical conditions strengthen and employment and household income improve. Consumers' confidence in the economy will also recover gradually. Inflation will remain moderate over the coming years, allowing households to continue saving part of their income. The savings rate will stay above 2% for the entire forecast period.

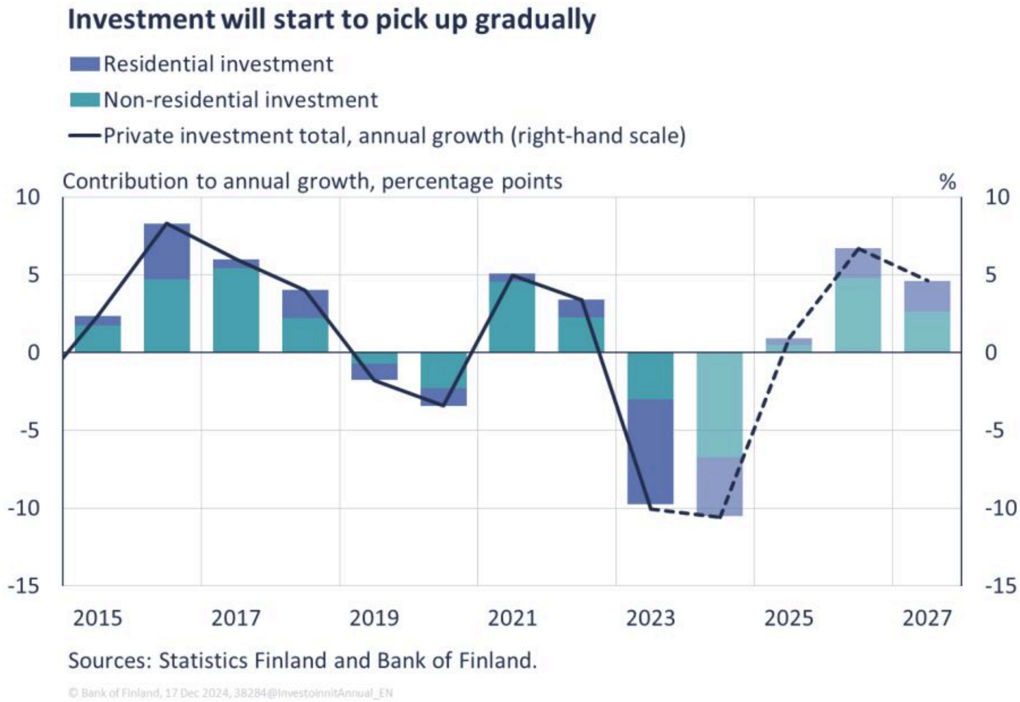
Investment confidence will gradually start to return

Private investment contracted substantially in 2023. Housing construction, in particular, has been in considerable difficulty, but non-residential investment has also declined significantly. According to the forecast, the weak conditions for private investment will not show any easing in 2024, but instead continue to deteriorate substantially from the previous year (Chart 5).

Housing construction is still falling sharply year on year in 2024. The numbers of residential building permit applications and housing starts have fallen by an exceptional amount, almost to the level of the 1990s recession. Since the number of unsold new dwellings remains high, hardly any new construction projects are being started. Consumers also remain cautious. Market-based construction has plummeted to exceptionally low levels, and in 2024 housing construction has consisted largely of publicly supported construction, including state-subsidised ARA housing production.

Non-residential investment is also down in 2024, because the weak demand outlook is making companies more reluctant to invest. Uncertainty has increased in the global economy during 2024, due to geopolitical tensions, conflicts and concerns regarding the policies of the next US administration, and this also reduces corporate investment at the annual level. Green energy investments, for example, have already experienced a setback as companies have cancelled or postponed projects.

Chart 5.



In 2025 private investment will slowly start to pick up (Chart 5). The downturn in housing construction will ease, but growth will start very slowly. Non-residential investment will start to grow gradually in 2025 when demand strengthens. A decrease in interest rates, which is expected by the financial markets, will help to trigger investment growth.

Growth in private investment will accelerate in 2026 and 2027, when both housing construction and non-residential investment will pick up. The financial markets expect interest rates to remain low in 2026 and 2027 as well. Consumer confidence will strengthen, which will gradually start a recovery in the demand for new housing. This will activate market-based housing construction, in particular. In contrast, state-subsidised housing construction is projected to decrease. The country's growth centres will increase in population, and the growing need for housing will boost housing construction in the latter part of the forecast period. However, the volume of housing construction in the immediate years ahead will remain far behind its earlier peaks.

The growth in non-residential investment will continue in 2026 and 2027 but will remain fairly subdued overall. Demand will grow in Finland's key export markets when cyclical conditions strengthen in the global economy. Export companies will then expand their production capacity. Domestic production will also gradually recover when the economic outlook improves and confidence in the economy increases. Nevertheless, the volume of non-residential investment will be significantly below its 2022 level.

Export growth under dark clouds

Export growth was very minor in 2023 (Chart 6). Goods exports increased but service exports declined substantially. The economy was weak in Europe, especially in Germany and Sweden, and also in Finland's other key export markets, and economic uncertainty was high.

Chart 6.

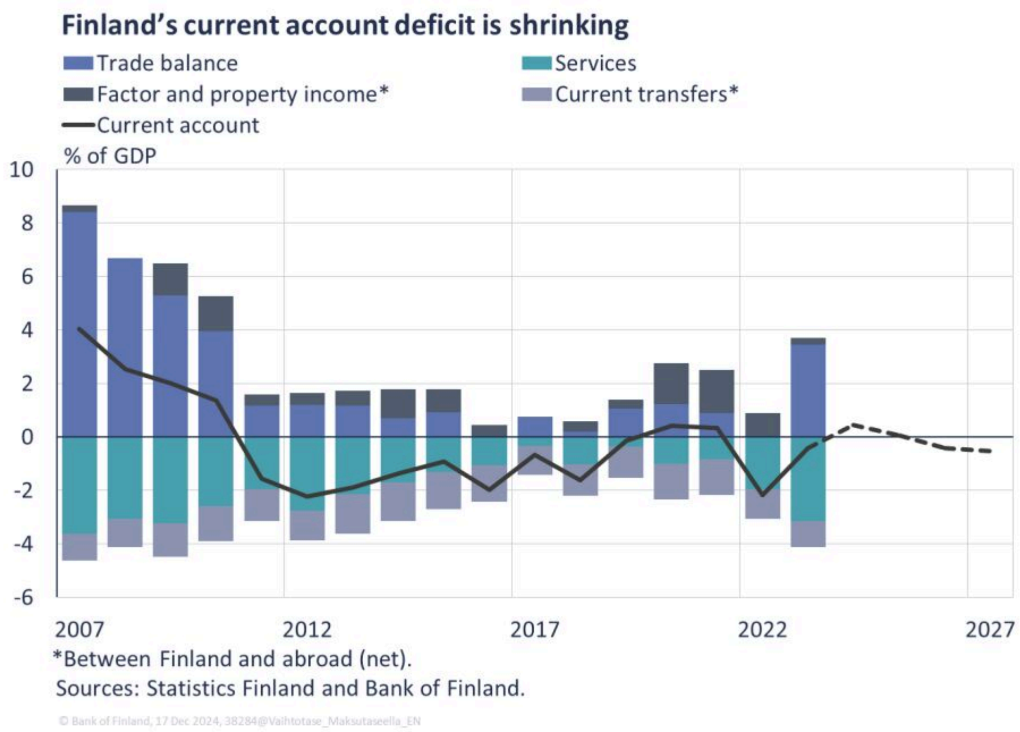
According to the forecast, Finland's export growth for the full year 2024 will continue to be quite low. Export market growth remains muted and corporate investment in Finland's key export markets is hindered by uncertainty over the outlook for the global economy. The annual growth in exports is also adversely affected by individual factors, such as the political strikes taken in Finland in the early part of 2024. However, there were already signs of growth in exports during the summer and autumn.

Exports will pick up in 2025 when growth in world trade gains some momentum (Chart 6). Monetary policy has already been eased and the interest rate level has declined globally, increasing economic activity and boosting corporate fixed investment around the world. Companies are increasing their production capacity and replacing capital stock.

Imports have grown more slowly than exports during the past two years, which has meant a rise in net exports. Imports will start to grow in 2025 and beyond, when domestic demand strengthens. This is in part because domestic production uses a lot of imported inputs. Defence-related procurement will also contribute to increased imports.

The trade balance strengthened substantially in 2023, reducing the current account deficit (Chart 7). According to the forecast, the trade balance for 2024 is still in surplus and the current account almost in balance. Towards the end of the forecast period, the current account will show a slight deficit again as imports grow in relation to exports. In 2027, the deficit will be around 0.5% of GDP.

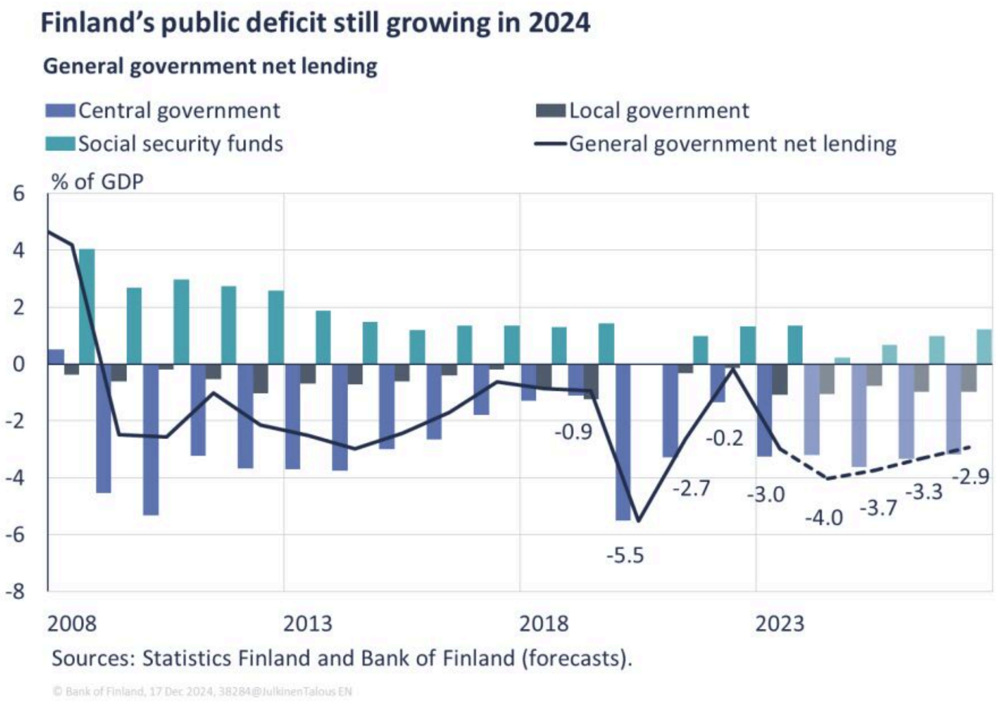
Chart 7.



Public finances will remain in deficit

According to the forecast, the general government deficit in 2024 will rise to 4% of GDP (Chart 8). After this, economic growth will pick up, inflation and rising costs will remain moderate, and government cost-saving measures will start to strengthen the public finances. The deficit will slowly start to contract, though it will not fall below the 3% reference value in the EU rules until 2027.

Chart 8.



Although tax revenue will grow more favourably in 2024 than in the previous year, reductions in social security contributions will make a dent in the public finances. The rise in interest rates has boosted public property income, but this growth will slow from 2024 onwards. Starting in 2025, the Government's tightening of indirect taxes – especially value added tax – will improve the general government budgetary position.

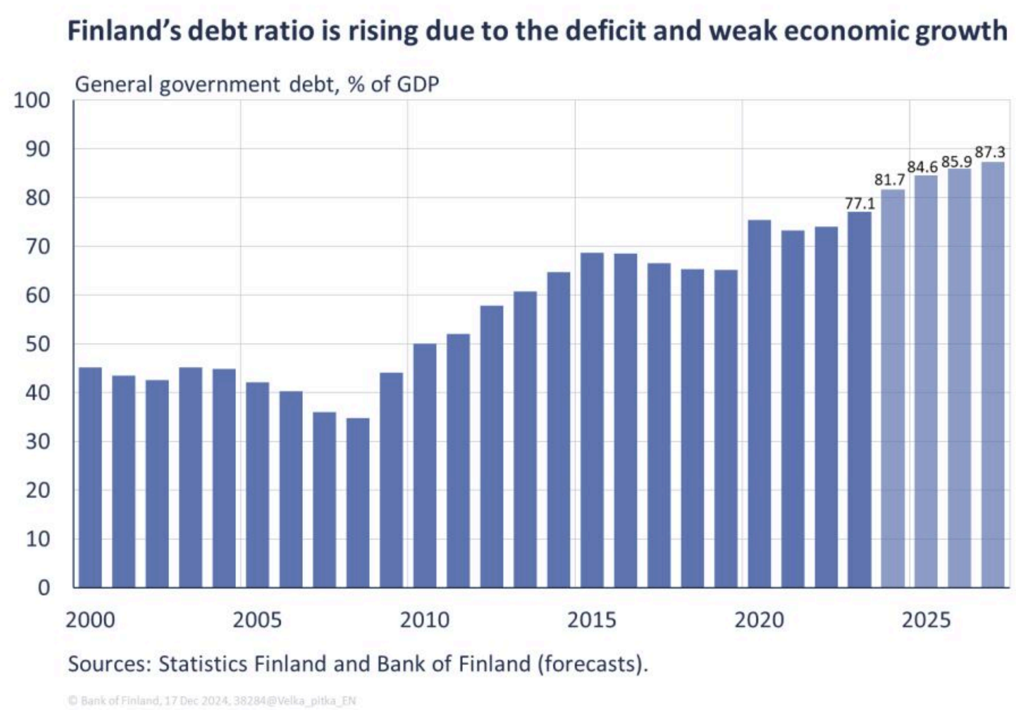
However, in 2024 public spending is still growing more quickly than revenues, but the general government deficit will later start to contract. The Government's fiscal adjustment and cost-saving measures will start to improve the balance of both central and local government finances, especially from 2025 onwards. At the same time, however, the public finances will be strained by large pay increases that were agreed earlier, and by the increased need for public services and the growth in interest expenditure. Moreover, the cost-saving measures will also be countered by increases in government spending on defence and R&D financing. The ex-post control of the funding for wellbeing services counties in 2025 will temporarily increase the central government deficit and correspondingly reduce the local government deficit.[3]

Index-linked increases will raise pension expenditure considerably in 2024. The growth in pension expenditure and reductions in social security contributions will substantially reduce the surplus of the social security funds in 2024. Because of the cuts to unemployment benefits, unemployment expenditure will not increase in 2024, despite the cooling labour market. The growth in social benefits paid will slow down from 2025, and the surplus of the social security funds will start to grow again.

Public investment will increase significantly in 2025 due to commencement of the deliveries of multirole combat aircraft and the replacement of equipment delivered to Ukraine. Moreover, the Finnish Border Guard will purchase new patrol vessels, and delivery of the Navy's Squadron 2020 vessels will entail additional investment at the end of the forecast period.

Finland's public debt amounted to 77% of GDP at the end of 2023, and in 2024 the debt ratio will approach 82% (Chart 9). This increase in the debt ratio is a result of the deep deficits of central and local government, but the rise in the debt ratio will be particularly steep in 2024–2025 due to the weak GDP trajectory. The debt ratio will reach 87% by the end of 2027.

Chart 9.



Supply and cyclical conditions

The Finnish economy is slowly recovering from recession. In 2025, the output gap will remain negative and resources will be underutilised. The unemployment rate is high and will continue to exceed the level of structural unemployment in 2025 and 2026. In 2026, economic growth will strengthen due to cyclical factors and the economy will grow at a rate above its growth potential, which will improve the employment situation. The stronger growth will not be sustained, as potential output growth is low and has possibly been weakened by the crises of recent years.

Labour market will recover after economy improves

The weak cyclical conditions have continued for some time and are weighing on the labour market. The employment rate has declined from the record highs of 2022 and unemployment has increased. Hours worked have decreased at a higher pace than the fall in the number of persons employed. This is partly due to an increase in temporary lay-offs, but there has also been a trend decrease in the number of hours worked per employee, and the amount of part-time work has increased in recent years.

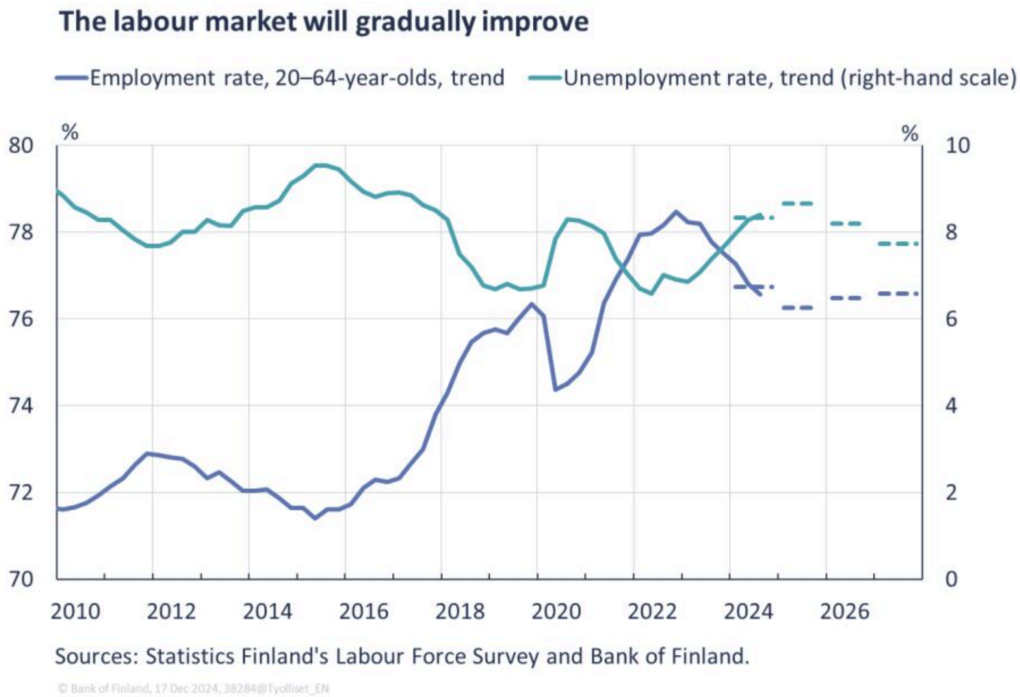
The weak cyclical conditions have decreased the demand for labour. This is reflected in the sharp decrease in vacancies. In addition, temporary lay-offs and redundancies have increased in 2024. The labour force participation rate has nevertheless remained high. Unemployment has risen, as there are an increasing number of people flowing into unemployment from among the employed and from outside the labour force, and also fewer unemployed people have been able to find work. The current unemployment rate is estimated to be above the level of structural unemployment.

In the early part of the forecast period the economy will not yet boost the demand for labour by enough to lift the employment rate and to decrease the number of unemployed persons. As a consequence, the labour market will deteriorate further in the early part of the forecast period. In 2025, the employment rate will decline slightly to 76.3% (Chart 10), and the unemployment rate will be 8.7%.

The demand for labour will increase as the cyclical conditions improve, and the employment rate will rise to 76.6% in 2027. The employment rate at the end of the forecast period will not see a return to its 2022 high of 78%, since employment at that time was boosted by good cyclical conditions. The public sector has seen strong employment growth in recent years. This is not expected to continue during the forecast period, thereby further dampening employment growth.

The unemployment rate will start to decline as cyclical conditions improve, and in 2026 it will be at 8.2%. In 2027, the unemployment rate will decrease further to 7.7%, reaching the level of structural unemployment.

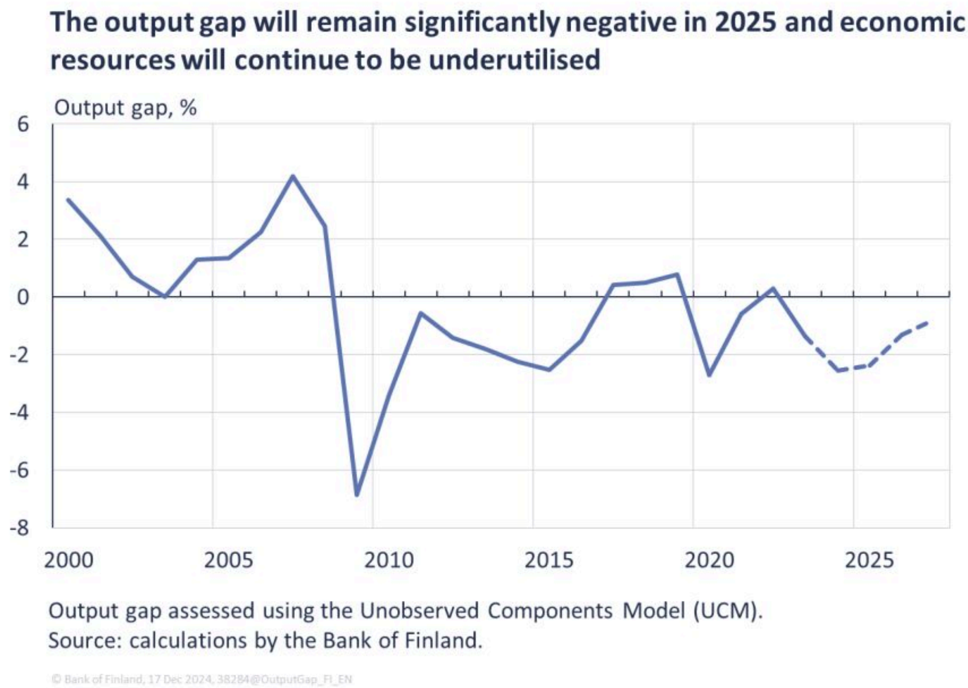
Chart 10.



Potential output will grow slowly

The Finnish economy is slowly recovering from recession. In 2025, the output gap will remain significantly negative and economic resources will continue to be underutilised.[4] In 2026, economic growth will strengthen cyclically and surpass the growth in potential output. Towards the end of 2027, the economy will be in a more balanced position, with the output gap close to neutral and economic growth near to its potential (Chart 11).

Chart 11.



The growth in Finland’s potential output in the years 2024–2027 will be low, rising at an average annual rate of less than 1% (Chart 12). The growth in all production factors (capital, labour input, total factor productivity) will be subdued.

Growth in investment and therefore also in the capital stock will be slow in the early part of the forecast period, which will curb growth in potential output. Economic uncertainty and the earlier increases in interest rates on corporate loans have made corporate fixed investments less appealing. The situation will improve a little towards the end of the forecast period with the reduction in interest rates expected by the markets and as economic uncertainty eases. However, the crises of recent years have weakened growth in total factor productivity due to the cessation of trade with Russia, the reorganisation of production chains and the use of more expensive inputs.[5] Further difficulties in international trade could exacerbate the economic situation. Weak productivity growth is also attributable to the fact that a majority of employment growth in recent years has not been in the private sector but in public services, where productivity growth is below average.

The growth in labour supply is faster than previously estimated. After a long decline, the number of working-age people has started to grow in 2023 and 2024 due to increased immigration.

According to Statistics Finland’s new population projection the working-age population will continue to grow in the future as a result of net immigration. This will support growth in potential output (Chart 12). However, the supply of labour will be weakened by employees working considerably fewer hours on average than before the COVID-19 crisis. Population ageing will also weaken the prospects for growth in the average number of hours worked if it increases the amount of part-time employment. In addition, the high structural unemployment rate will reduce the importance of labour as a source of potential output.[6]

Chart 12.

The chart presents estimates of the growth in potential output (produced using the Bank of Finland’s Unobserved Components Model) and the contributions of the different components. Source: calculations by the Bank of Finland.

Crises hamper estimation of potential output

The economy has been hit by various different crises in recent years. This has led to uncertainty about the growth potential of the economy. The growth potential could alter if there are permanent changes in, for example, globalisation, production methods, energy prices, household behaviour or immigration.[7] Climate change is also causing uncertainty over the long-term prospects for growth.[8]

Russia’s invasion of Ukraine and geopolitical tensions could weaken the growth potential of the economy in the long term if they reduce international trade permanently and lead to a less effective global division of labour. This would weaken productivity growth. Allocating resources to defence instead of productive activities could also impede productivity growth in the long term. By contrast, technological advances, such as the use of artificial intelligence, could boost productivity.

The future development of the capital stock will be affected by a number of factors, pulling in opposing directions. The reorganisation of production and the possibility of extensive investments in the green transition could strengthen the capital stock. On the other hand, investments may be cancelled or postponed due to geopolitical uncertainties and uncertainty over trade policy, which would weaken the growth of capital stock in the short term.[9]

Some of the capital stock could become obsolete if there are major disruptions in the availability of energy or if the price of energy was to rise to a permanently high level. Furthermore, the removal of polluting capital stock will reduce the stock overall and require new investment to replace it with less polluting stock.

There is much uncertainty about the growth in labour input concerning, for example, how immigration to Finland will take shape and how immigrants will be integrated into the labour market. The increase in working remotely since the crises of recent years could boost the labour supply if this greater flexibility means that more economically inactive people are attracted to the labour market than before. The increase in the supply of labour would then strengthen potential output.

Prices and costs

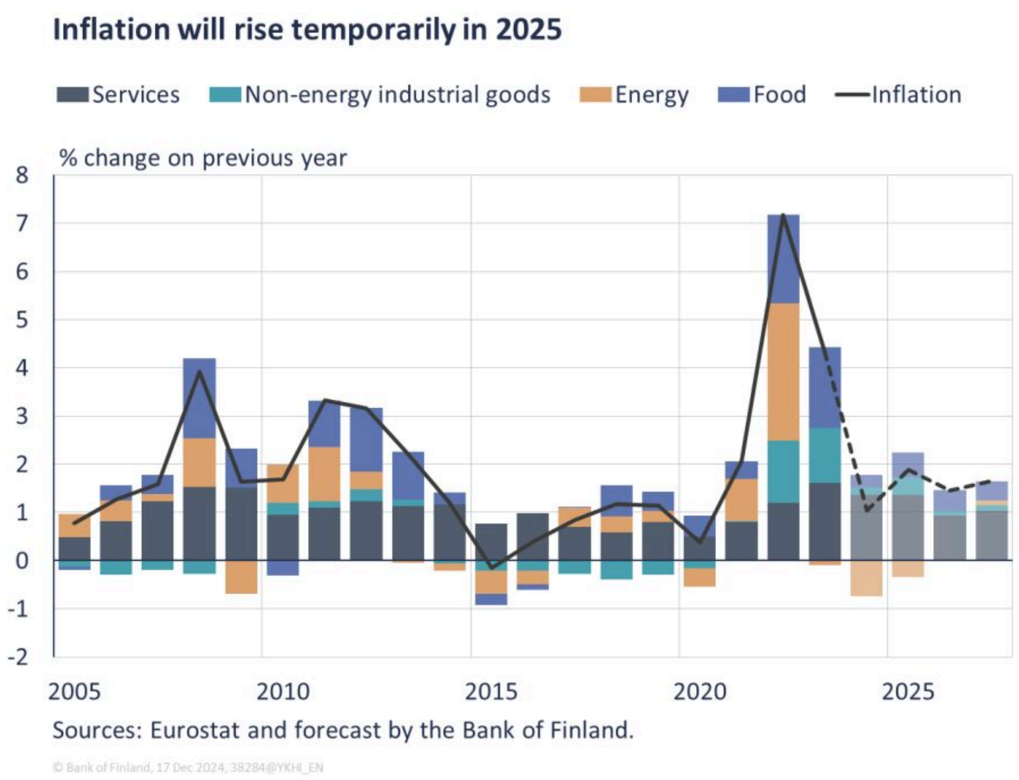
Inflation has declined considerably in 2024 from the levels seen in 2022–2023 during the period of high inflation. However, increases in value added tax and in other indirect taxes will push up consumer prices particularly in 2025. In 2026–2027, inflation will be sustained by a rise in household purchasing power and growth in consumer demand. Annual inflation will nevertheless remain below 2% for the entire forecast period. Nominal earnings will continue to increase in the immediate years ahead, and real earnings will also grow. The Finnish economy's cost competitiveness has improved in 2024 relative to the euro area, and it will remain virtually unchanged in 2025–2027.

Inflation will remain below 2% in the immediate years ahead

Inflation in Finland, as measured by the Harmonised Index of Consumer Prices (HICP), has risen slightly in recent months. The rise in consumer prices is attributable especially to the September 2024 increase in the standard rate of value added tax (VAT) to 25.5%. Moreover, the disinflationary impact of the earlier tightening of monetary policy has started to fade. Weak cyclical conditions, consumer caution and lower energy prices have nevertheless kept inflation at a moderate level. The inflation rate for the full year 2024 will be 1.0% (Chart 13).

Finland's economy will gradually start to recover, and inflation will rise to 1.9% in 2025. The inflationary impact of the tax and excise duty increases will be at its strongest in 2025, when the reduced rates of VAT will be raised and excise duties increased on tobacco products, soft drinks and spirits.[10] Core inflation, which excludes energy and food prices, will rise to 2.5%, and food prices (including alcohol and tobacco) will increase significantly. In contrast to the other components of HICP inflation, consumer prices for energy will continue to decline moderately.

Chart 13.



Inflation will fall to 1.5% in 2026, when the inflationary impact of the 2025 tax and duty increases fades. However, there will be an improvement in the economy and in household purchasing power, and so inflation will be sustained by domestic consumer demand. In 2027, inflation will increase slightly. The output gap will nevertheless still be negative, i.e. there will be economic slack, and the upward pressure on consumer prices will remain moderate. As a result, inflation will stay below 2%.

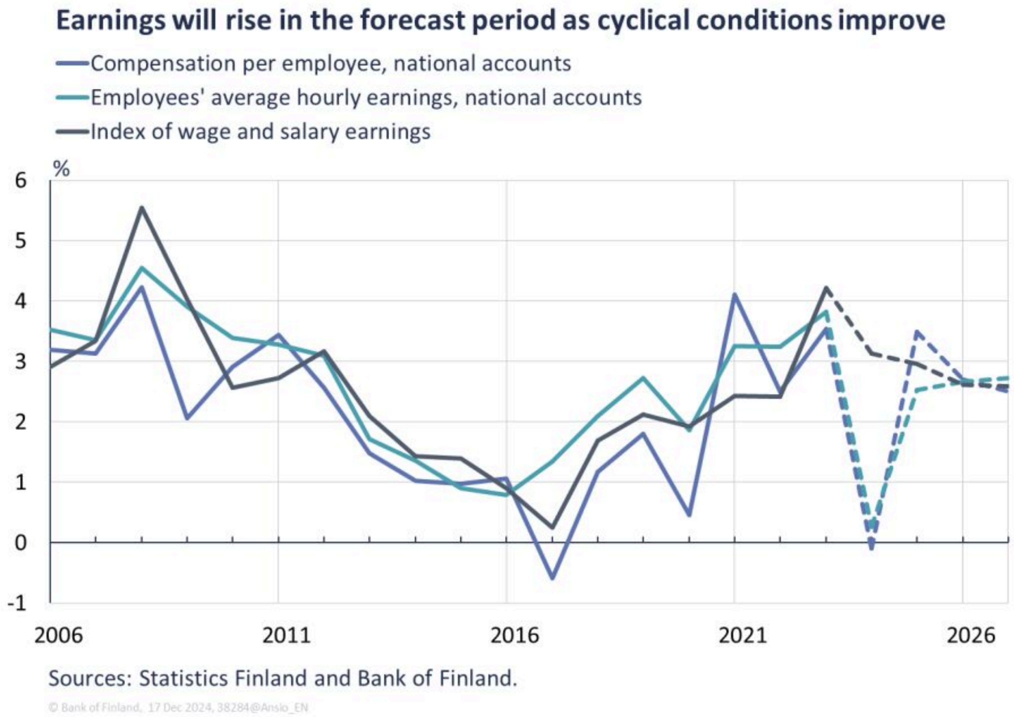
Interest rates on housing loans and consumer credit are expected to decline in line with market expectations, and this will, in the immediate years ahead, mechanically reduce inflation as measured by the national Consumer Price Index (CPI). CPI inflation in Finland will thus remain below 1% in 2025 and will rise only slightly in 2026.

Employees' real earnings will rise in the immediate years ahead

The round of negotiations for new collective agreements that started in autumn 2024 will largely determine growth in nominal earnings in 2025 and 2026. The Bank of Finland's earnings forecast incorporates the assumption that, based on long-term observation, real wages will increase at about the same rate as labour productivity. Based on this assumption, the growth in nominal earnings, as measured by the index of wage and salary earnings, is expected to be approximately 3% in 2025 and about 2.6% in 2026 and also in 2027 (Chart 14). With the annual inflation rate at the same time remaining significantly below 2% on average, employees' real earnings will exceed their 2021 level towards the end of the forecast period.

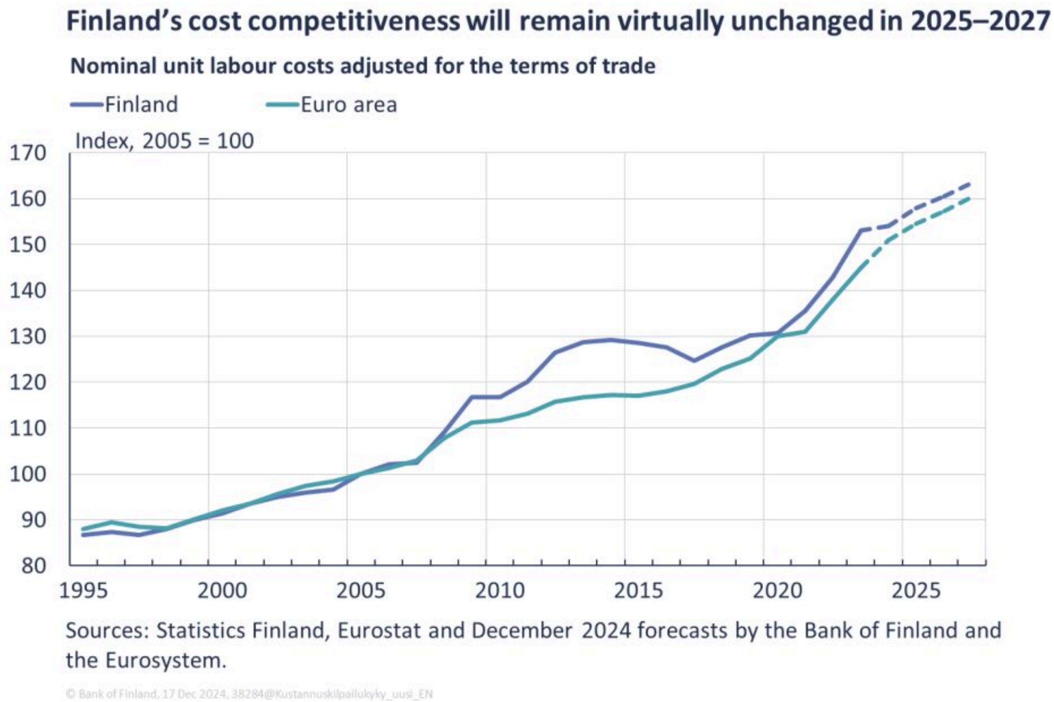
Growth in wages and salaries as given in the National Accounts has been low in 2024, due to the weak cyclical conditions. In addition, the reduction in unemployment insurance contributions paid by employers has slowed the growth in compensation per employee. As a result, 2024 will see only a weak rise in the earnings indicators that accord with the National Accounts. However, earnings growth will strengthen in the forecast period as cyclical conditions improve.

Chart 14.



Finland's cost competitiveness measured using relative unit labour costs adjusted for the terms of trade has improved in 2024 in comparison with the euro area average, due to the significant growth in labour costs in the euro area. According to the forecast, Finland's cost competitiveness will remain virtually unchanged in the period 2025–2027 (Chart 15). Labour cost growth and growth in labour productivity per person employed will be close to the euro area average.

Chart 15.



Risk assessment

The economic outlook for Finland in the immediate years ahead is surrounded by many uncertainties. In terms of economic growth, the risks to the forecast are predominantly on the downside, but the inflation risks to the forecast are better balanced.

The global trade environment is becoming less favourable for Finland's exports. The United States is threatening to impose new import tariffs, and these may also apply to imports from Europe. The tariffs, if implemented, would hamper Finnish exports both directly and by dampening growth in Finland's other export markets (see Import tariffs and trade policy uncertainty will dampen economic growth). High tariffs on US imports from China could prompt Chinese businesses to look for alternative markets in Europe, and this would tighten competition in Finland's main export market. Higher barriers to trade would also increase friction in international supply chains. A deterioration in economic relations between the United States and China could, at worst, escalate into a trade war.

Geopolitical tensions in Ukraine and the Middle East are also adding to volatility in the global economy. Russia's hybrid operations in Finland and the neighbouring areas are affecting households and businesses and adding to general uncertainty. An escalation of the Middle East situation could disrupt energy markets and companies' supply chains.

The construction sector's recovery will be on a shaky foundation. If household confidence remains weak, even a decline in interest rates will not necessarily be enough to revive housing demand. Without state-subsidised housing production, the recession in residential construction would have been even deeper. The volume of subsidised housing production is nevertheless being cut significantly, and this may impede the recovery in housing construction more strongly than anticipated. If the recession in construction drags on, more jobs could be lost in the sector than forecast. On the other hand, in the slightly longer term, a low level of housing production will increase the risk of excessive housing demand. In the immediate years ahead, housing demand will also be boosted by the stronger growth in immigration than was previously estimated.

The balance of the public finances has been improved in 2024 through expenditure cuts and tax increases, and fiscal adjustments will continue in 2025. The measures will reduce purchasing power and also weaken household confidence. The fiscal adjustments may even cause private consumption to contract more than expected.

Negotiations between the social partners in the labour market have become more strained during the autumn. Any demands for wage increases to compensate for the labour market reforms introduced by the Government will bring additional pressure to the autumn wage negotiations. If finding a solution in the negotiations is prolonged, this will increase the risk of extensive industrial action.

Geopolitical uncertainty and the increase in extreme weather events as a result of climate change are increasing the risk of global energy and food price spikes. If the risks materialise, they could also drive up inflation, in Finland too. Domestic inflation risks, on the other hand, are tilted to the downside. In terms of economic growth, the risks to the forecast are predominantly on the downside, and if demand is weaker than expected, this would also slow down inflation in Finland. On the other hand, wage pressures in the labour market elevate the risk of a pick-up in inflation in the short term.

It is also possible that the Finnish economy will grow more quickly than forecast in the immediate years ahead. The pace of economic recovery at turning points in the business cycle has often been faster than initially expected. Investment, in particular, could provide a positive surprise, for instance in energy production and energy-intensive industries.

Footnotes

1. More detailed information on the euro area forecast is available on the ECB website. ↑

2. More detailed information on the ECB’s monetary policy decisions is available on the ECB website. ↑
3. The funding for the wellbeing services counties will be adjusted in accordance with actual costs based on financial statements data, with a lag of two years. The finances of the wellbeing services counties were EUR 1.35 billion in deficit according to financial statement estimate data for 2023. On the basis of this deficit, and also the estimated increased need for public services and the index-linked increases, a permanent ex-post adjustment of approximately EUR 1.5 billion will be added in 2025 to the funding for the wellbeing services counties. From 2026, the amount of the ex-post adjustment will be either increased or decreased annually on the basis of actual costs. ↑
4. Potential output is the volume of GDP when all the inputs in the economy are in normal use. The output gap is the difference between the economy’s actual and potential GDP. When actual and potential GDP are at the same level and are growing at the same rate, the output gap will be zero and the economic cycle is said to be neutral. ↑
5. Higher and more volatile prices of energy may weaken potential output through various channels. See e.g. Deutsche Bundesbank (2022b) Impact of permanently higher energy costs on German potential output, Monthly Report, December 2022, p. 29, and the ECB’s projections (ECB Bulletin 5/2022, Box 4). ↑
6. In estimating the potential output in the forecast period, a technical assumption is made in which the participation rate is set at the average level of the previous business cycle. ↑
7. European Commission’s Spring 2023 Economic Forecast, special issues. ↑
8. See the ECB’s article on the impacts of climate change on potential output (How climate change affects potential output, ECB Economic Bulletin, Issue 6/2023). ↑
9. Greater uncertainty and the high cost of energy will dampen the investment appetite. ↑
10. An increase in the excise duty on soft drinks in 2025 is included in the central government budget proposal for 2025, and the Government will later issue a bill on this. ↑

Key words

consumption, economic forecast, forecast, GDP, households, inflation, interest rates