Forecast

From significant recession towards growth

Finnish economy | 04 April 2024

The Finnish economy is still in recession. Gross domestic product (GDP) has declined almost continuously since mid-2022. Growth in Finland's export markets is slow, and higher prices and interest rates are weighing on private consumption and investment. Residential construction is particularly weak. Employment has remained robust in relation to the economic conditions, and inflation has also slowed substantially. The recession has reached its lowest point, and a gradual recovery is expected to begin towards the end of 2024.



The Bank of Finland's interim forecast[1] is based on data available on 14 March 2024, and on assumptions updated on 12 February 2024 regarding changes in Finland's external operating environment and key financial market variables in the immediate years ahead.[2]

Forecast in brief

The Finnish economy has not yet recovered from its recession. Exports, consumption and private investment are performing weakly, and only public final consumption expenditure has increased. According to this March 2024 interim forecast made by the Bank of Finland, GDP will contract by 0.5% this year, which is slightly more than forecast in December 2023. However, the economy will

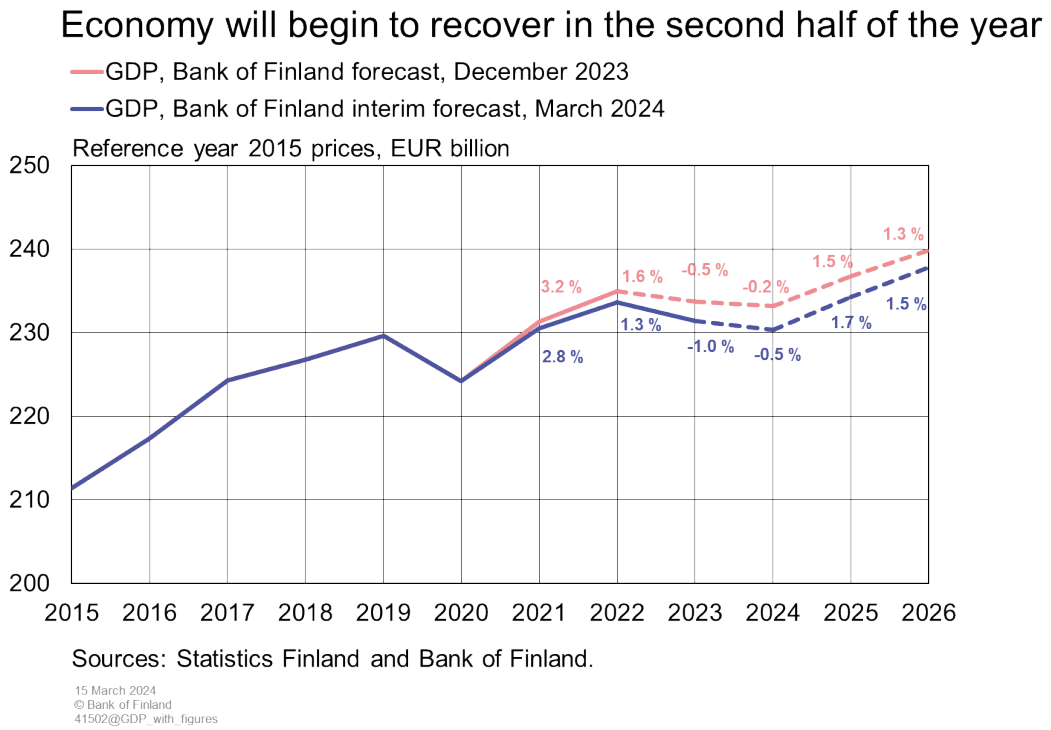
gradually start to recover from the recession, and in 2025 GDP will grow by 1.7%, and by slightly less in 2026.

Despite the recession, the employment situation has remained fairly good, measured in terms of the number of people employed. However, the employment rate for the 20 to 64 age group will decrease by 0.7 percentage points to 77.2% this year. In 2025, the employment rate will start to rise as economic conditions start to improve. The employment rate in the years of the forecast will nevertheless not rise above its 2023 level.

Growth in the purchasing power of Finnish households has been supported by the rapid rise in nominal wages and current transfers, and by the decline in inflation. Inflation is expected to fall to less than 1% in 2024, which will further strengthen purchasing power. The slowing of inflation is attributable to lower energy prices, in particular. The consumer prices of services continue to rise, however.

The risks surrounding the forecast are on the downside. Geopolitical risks have not eased during the winter. Should these risks materialise, they could disrupt the global economy and financial markets and will in any case increase the uncertainty surrounding the forecast. In the euro area, there is a risk of persistent above-target inflation, which would delay the turnaround in interest rates. In Finland, the outlook for the construction industry is subject to especially great uncertainty. If the recession in residential construction does not begin to ease, the employment situation in the industry could become much worse than anticipated. The manufacturing sector as a whole is facing difficulties as well. The outlook for the economy in the coming months is also overshadowed by the possibility of further extensive industrial action.

Chart 1.



1. INTERIM FORECAST SUMMARY

	2023	2024[f]	2025[f]	2026[f]
Annual GDP growth (%)				
Interim forecast, March 2024	-1.0	-0.5	1.7	1.5
Forecast, December 2023	-0.5	-0.2	1.5	1.3
Employment rate, 20–64-year-olds (%)				
Interim forecast, March 2024	77.9	77.2	77.5	77.9
Forecast, December 2023	78.0	77.2	77.4	77.7
Unemployment rate, 15-74-year-olds (%)				
Interim forecast, March 2024	7.2	7.8	7.4	7.2
Forecast, December 2023	7.2	7.8	7.5	7.3

[f] *= forecast.*

Sources: Bank of Finland and Statistics Finland.

	2023	2024[f]	2025[f]	2026[f]
Inflation (%)				
Interim forecast, March 2024	4.3	0.9	1.4	1.7
Forecast, December 2023	4.4	1.0	1.4	1.7

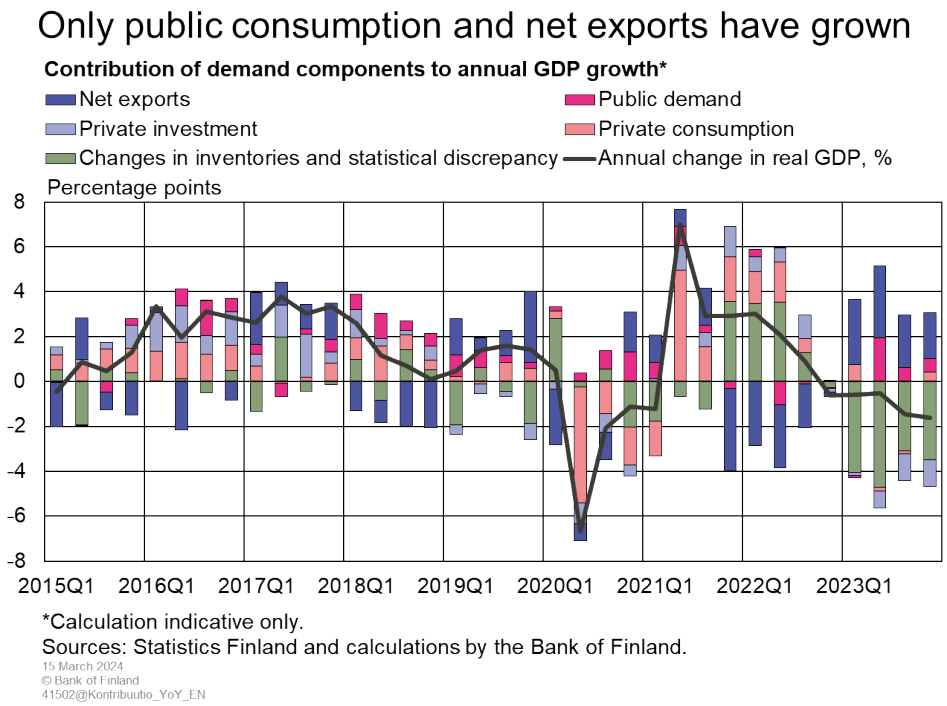
[f] *= forecast.*

Sources: Bank of Finland and Statistics Finland.

Finnish economy still in recession

The Finnish economy is still in recession. During the last two quarters of 2023, the quarter-on-quarter change in Finland's GDP was negative, and for the whole of 2023 there was a year-on-year contraction of around 1%. Statistics Finland has also adjusted the growth figures for 2021 and 2022 downwards (Chart 1). The weakness in the economy has been widespread (Chart 2). Private investment and exports decreased, and private consumption was flat. Higher public consumption served to underpin the level of growth in the economy. Growth was also supported by net exports, although the growth in net exports was a consequence of imports contracting more than exports.

Chart 2.



Although companies' business outlook expectations have picked up slightly in relation to the autumn, the current state of the economy is still seen as being weak. Instead of a shortage of skilled staff, companies' growth is now restricted by insufficient demand. Industrial production declined in most industries in 2023, and especially in the electronic and electrical industry and the forest industry. Growth in manufacturing order books was also weak in the latter half of 2023, which will be reflected in manufacturing output for a long time to come.

Growth is not being bolstered by Finland's export markets either. Although growth in the global economy is already fairly brisk, world trade is flat. Nearly three quarters of Finland's exports are destined for European countries, where economic growth is forecast to remain subdued. Service exports performed even less well than goods exports, and declined significantly in 2023.

The economic outlook is even weaker in residential construction than in manufacturing. Demand for housing is still suffering from the rapid rise in interest rates, and the prices of new dwellings have not shown much flexibility. Selling the backlog of already completed new residences also takes time. The volume of building permits and building starts declined steeply in 2023, but there are already signs that the situation is stabilising slightly. Sales of existing dwellings remain subdued as well, and the real prices of these have already declined by around one fifth during the 2020s. A slight improvement is expected in the housing market during the latter part of the year if interest rates start to decrease in line with market forecasts and households' confidence in the

future starts to improve gradually.

Non-residential investment has remained low in recent months. Companies' willingness to invest is being hindered not only by the muted growth outlook for the Finnish economy but also by higher financing costs and a deterioration in corporate profitability. Growth in corporate profits, measured in terms of the operating surplus given in the National Accounts, was only around half of the growth in earnings in 2023. The decrease in profitability is also reflected in the increased number of bankruptcies. While the largest number of bankruptcies have been in the construction industry, bankruptcies have also become much more common in the retail and wholesale trade and in the restaurant sector.

Although in the service sector the recession has not been as obvious as in manufacturing, turnover volume in services has still been in decline during the autumn and winter. Turnover volume in the retail and wholesale trade has been falling since the end of 2021. The service industries' business outlook expectations have picked up since the autumn, despite the difficulties that occurred during the autumn months.

Consumers' assessments regarding the current state of their own finances and the Finnish economy (i.e. consumer confidence measures) have remained pessimistic. The weak position of households has been evident in private consumption, which barely grew at all last year.

However, the worst of the situation for households may soon be over. Real earnings of households turned to significant growth already in 2023, due to larger than usual wage increases, a strong rise in index-linked benefits and lower inflation. Despite the recession, the employment situation has also remained fairly good.

The impacts of recent developments in the economy on the short-term economic outlook for Finland have been systematically assessed using the Bank of Finland's short-term forecasting, or nowcasting, models (Table 2).

2. NOWCASTING MODEL RESULTS

GDP, quarterly growth	2023Q3	2023Q4	2024Q1	2024Q2
BVAR	-1.0 %	-0.6 %	0.0 %	0.2 %
Factor model	-0.5 %	0.5 %	-0.3 %	-0.2 %

Nowcasting models updated 11 March 2024.

**Updated after release of National Accounts 29 February 2024.*

Sources: Statistics Finland and calculations by Bank of Finland.

GDP, quarterly growth	2023Q3	2023Q4	2024Q1	2024Q2
Bridge model	-0.2 %	0.0 %	0.2 %	
Model average	-0.6 %	-0.4 %	0.0 %	0.0 %
Actual growth	-1.1 %*	-0.7 %*		

Nowcasting models updated 11 March 2024.

**Updated after release of National Accounts 29 February 2024.*

Sources: Statistics Finland and calculations by Bank of Finland.

Based on the latest economic data, which is slightly more optimistic than before, the nowcasting models indicate that the lowest point of the recession has been reached. According to the average value calculated from the forecasts, GDP will remain unchanged in the first quarter of 2024.

Adjustments make operating environment assumptions more favourable overall

The interim forecast's revised assumptions regarding growth in Finland's export markets are slightly weaker than before. The euro area, in particular, is expected to grow more slowly than assumed in the December forecast (Table 3). The price competitiveness of Finnish exports is assumed in total to decrease marginally.

While the price of crude oil remained nearly unchanged in early 2024, electricity has been less expensive than expected. Assumptions on future energy and raw material price developments are based on market expectations, which anticipate a decrease in the prices of oil and electricity in the forecast years.

The financial markets' expectations of a decrease in interest rates were brought forward a little during the winter in comparison with the assumptions made in the previous forecast. Both the 3-month Euribor rate and long-term interest rates are still expected to start declining during 2024. Lower interest rates will provide slightly more support for Finland's economic growth during the forecast years than was estimated in December.

3. FORECAST ASSUMPTIONS

Volume percentage change on previous year	2023	2024[f]	2025[f]	2026[f]
Euro area GDP	0.5	0.6	1.5	1.6
World GDP (excl. euro area)	3.5	3.4	3.2	3.2
World trade (excl. euro area)*	1.2	2.8	3.1	3.2
	2023	2024[f]	2025[f]	2026[f]
Finland's export markets**, % change	-0.1	1.6	3.0	3.1
Oil price, USD/barrel***	83.7	79.7	74.9	72.2
Export prices of Finland's competitors, EUR, % change	-4.5	1.1	2.6	2.4
3-month Euribor, %***	3.4	3.4	2.4	2.4
Finland's nominal effective exchange rate****	110.3	110.9	110.9	110.9
USD value of one euro*****	1.08	1.08	1.08	1.08

**Calculated as a 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.

On the basis of updates to recorded GDP growth figures and to nowcasting models and external assumptions, the Bank of Finland's assessment of economic growth for 2024 has been adjusted slightly downwards. For the full year 2024, GDP is forecast to contract by 0.5%, which is slightly more than in the December 2023 forecast. On the other hand, the economy's recovery from recession will be faster than was forecast in December. In 2025, GDP will grow by as much as 1.7%, and by slightly less in 2026 (the corresponding figures in December were 1.5% and 1.3%).

Inflation will slow further

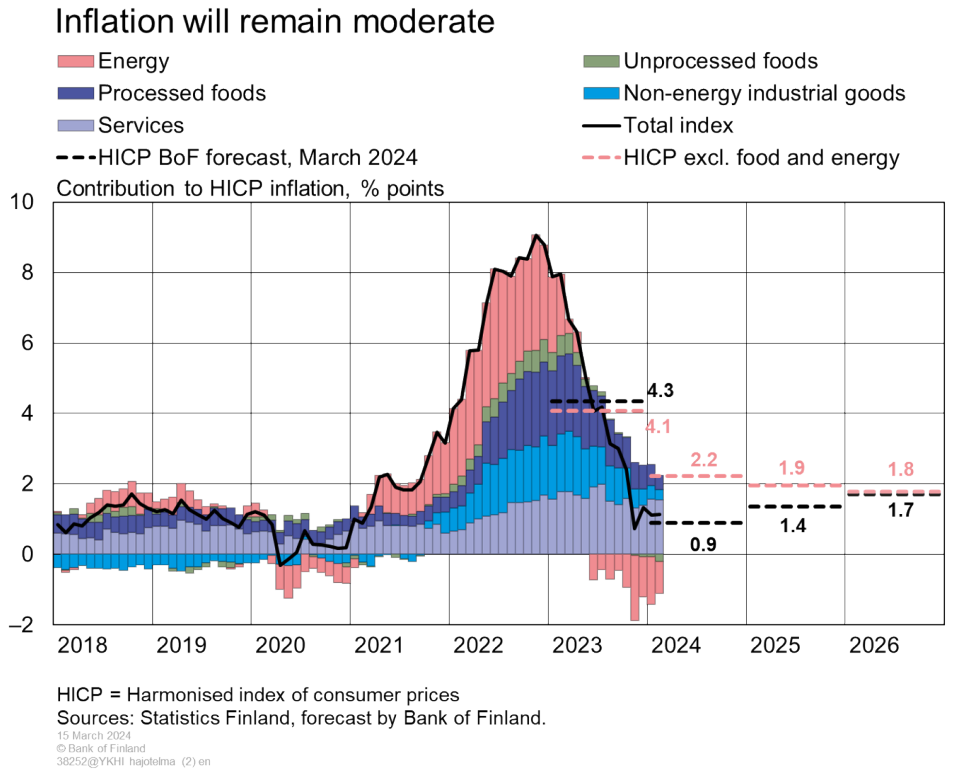
Consumer price inflation has continued to slow. In February, the Harmonised Index of Consumer

Prices (HICP) grew by just 1.1% year-on-year (Chart 3). Inflation has slowed especially as a result of lower energy prices, which have then been transferred to consumer prices. If energy and food prices are removed, the underlying level of inflation is higher than this. The rise in prices of services, in particular, is continuing, due to wage growth, among other things. Rents have also been increasing at a higher rate. Nevertheless, underlying inflation has slowed to around 2%.

Inflation is forecast to slow further in 2024, to an average of 0.9%. In 2025, inflation will rise slightly amid growing demand, but will remain at around 1.5% in 2025 and 2026, as measured by the HICP index.

Measured using the national Consumer Price Index (CPI), inflation will still be above the HICP inflation rate in 2024 because the CPI includes interest on housing loans and consumer credit. However, next year, CPI inflation will be significantly lower than HICP inflation.

Chart 3.



Employment has remained robust relative to the circumstances

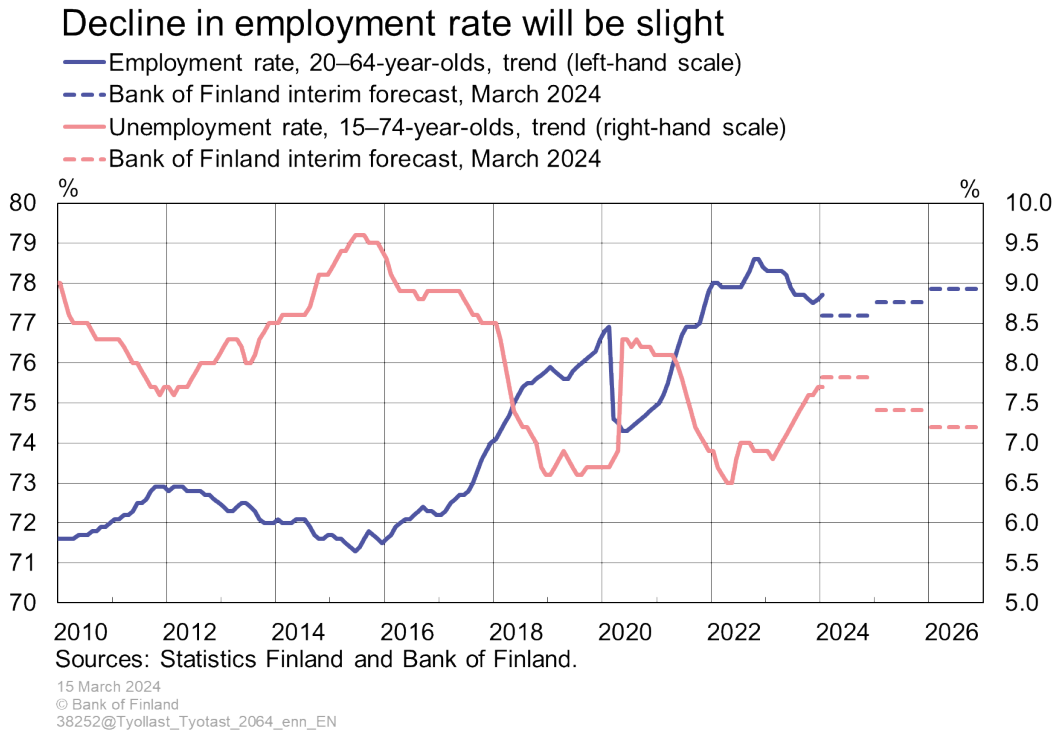
The employment rate has remained quite good in relation to the economic conditions. In January, the number of employed persons aged 20 to 64 was roughly at the same level as a year earlier, and

the trend employment rate was 77.7%. In recent months, the employment rate has decreased in most private sector industries. However, in social services and health care, the number of people employed has continued to grow.

The unemployment rate has risen by nearly 1.5 percentage points from its lows in spring 2022, and, especially towards the end of 2023, companies increasingly resorted to temporary layoffs. The increase in the number of layoffs is not seen directly as corresponding changes in the employment and unemployment figures provided by Statistics Finland, but is reflected in the average number of working hours of those in employment. Working hours have decreased at a significantly higher rate than the number of people employed. Especially in the construction sector, layoffs could turn into redundancies if the industry does not begin to pick up soon from its present slump.

The continued strong level of immigration has helped to increase the size of the working-age population. At the same time, growth in the potential labour force has been slowed by a decline in the labour force participation rate (persons aged 15 to 74). Furthermore, the number of job vacancies has been in steep decline in recent months. However, companies' employment expectations have already taken a tentative turn for the better. The employment rate is expected to decrease by a further few tenths of a percentage point in 2024. In 2025, the employment rate will improve slightly with the recovering economy.

Chart 4.



Is today in any case better than tomorrow?

The risks to the forecast are predominantly on the downside. Geopolitical uncertainty remains elevated, slowing the growth of the global economy and world trade. Inflationary pressures in the euro area may turn out to be more stubborn than anticipated, due to the persistence of wage inflation and logistics bottlenecks, for example. This could mean that interest rates will not be lowered until a later date than previously anticipated. This would directly slow economic recovery and would hinder recovery in Finland's euro area export markets.

The biggest risks in Finland concern the housing market. If the demand for housing does not start to pick up in the coming months, the recession in residential construction will deepen, which will inevitably be reflected in the industry's employment rate. One substantial risk in the labour market is the continuation of industrial action which, in the worst case, could lead to substantial production losses.

Without the growth in public consumption, the economy would have contracted last year by even more than it did. However, the Government is currently planning new fiscal adjustments to public expenditure and taxes. The final scope and structure of these measures and their impact on demand and short-term economic growth is still highly uncertain.

Notes

1. The Bank of Finland publishes interim forecasts for the Finnish economy twice a year, in March and September. These are technical updates of the forecast, in which the outlook for GDP, employment and inflation is updated. The interim forecast does not necessarily reflect the views of the Eurosystem. The Bank's more extensive forecasts for the Finnish economy are published in June and December each year. ↑
2. The forecast's underlying assumptions about changes in Finland's external environment and financial market variables are based on the assumptions made in the European Central Bank's March 2024 forecast. ↑

Keywords

employment, forecast, GDP, inflation