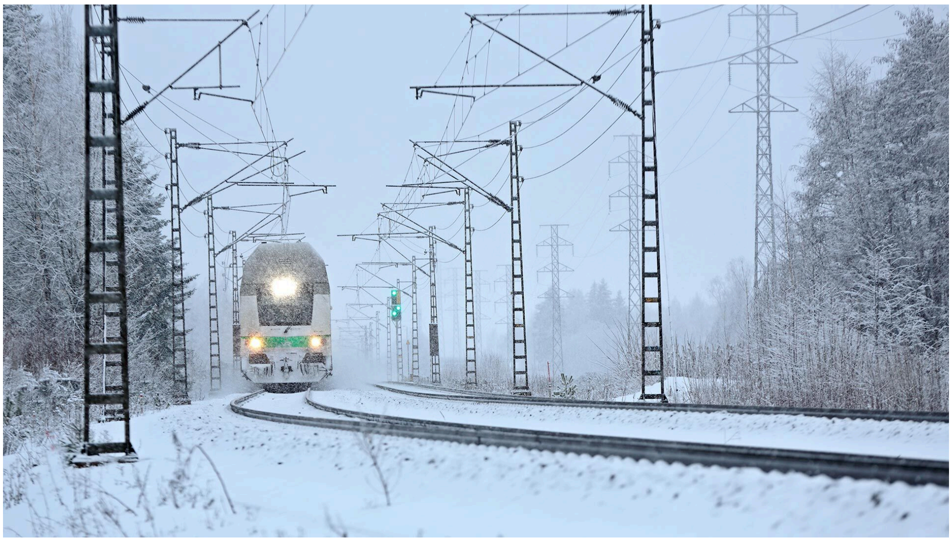
SIMPLY SHORT

Finnish economy set to slide briefly into recession

16 Dec 2022 – Simply Short – Finnish economy

Rising electricity and fuel prices have accelerated the increase in other prices. The resulting high level of inflation is weakening consumers' purchasing power and general confidence in the economy. The energy crisis will push the Finnish economy into a mild recession in 2023, but this will be short-lived. Energy prices will gradually fall, and in 2024 the economy will return to growth. In the country's public finances, spending will continue to exceed revenues.

Growth will stall temporarily due to Ukraine war and energy crisis Households will be under pressure as inflation broadens out
Public finances will remain in deficit

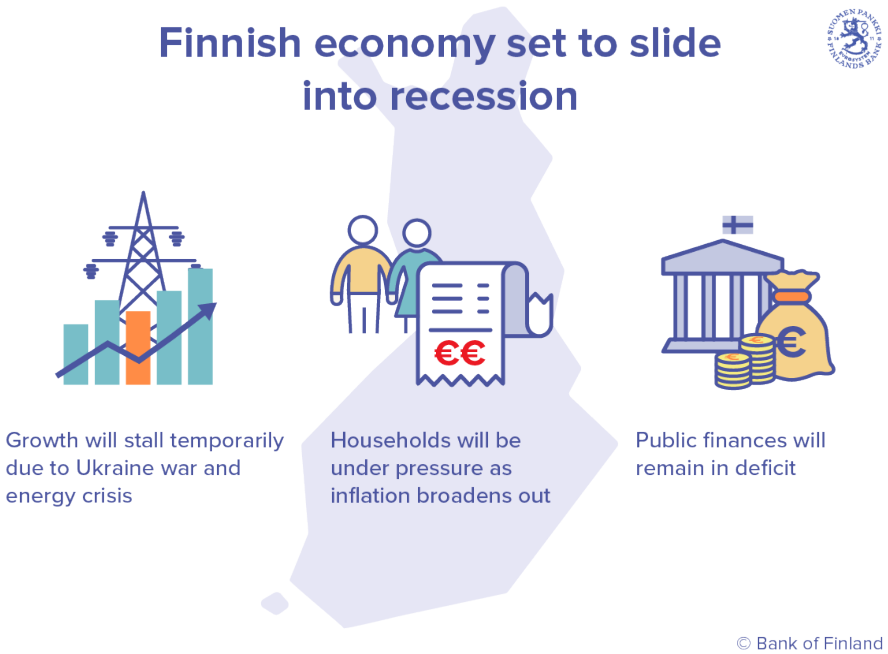


Economic growth picked up globally in the early part of 2022, when COVID-19 restrictions were removed and the pandemic began to fade from the spotlight. Finland's economy, too, grew briskly throughout the first half of the year. Growth then stalled again due to Russia's invasion of Ukraine. Consumers and businesses are now behaving cautiously.

The war in Ukraine has led to reduced availability of energy, and this has driven up electricity and fuel prices considerably. Businesses have responded to rising costs by raising their own prices, but consumers' incomes have not kept pace with this. The purchasing power of their incomes has weakened, despite income growth in a still favourable employment situation. A lot of new staff have been hired in the service sectors in particular. Businesses in many industries are experiencing a shortage of skilled staff, and many employers are therefore particularly keen to retain employees.

In the Bank of Finland forecast, the output of the Finnish economy in 2023 will fall below the figure for 2022, and the general rise in prices, or inflation, will remain high. Employment will no longer be growing, and consumption of goods and services in the economy will be held back by inflation. The elevated cost of living will be felt most by households that have few savings to rely on. Businesses will be cautious in their investment decisions due to the substantial uncertainty about the economic outlook. House building will also see a decline in the immediate years ahead.

Chart 1.



The forecast indicates that the recession will, however, be milder than during the pandemic in 2020, when Finland's economy came to a sudden standstill. The rise in energy prices will be halted in 2023 as energy imports from Russia are replaced with energy from other sources. Raw material and component shortages will subside further, and disruptions in the international transport of goods will continue to ease. In 2024, the Finnish economy will return to growth.

The European Central Bank has raised interest rates during the autumn. Interest on loan repayments is therefore taking a larger slice of family income for those households with outstanding loans. Higher interest rates will nevertheless help in tackling inflation, and in 2024–2025 inflation is expected to have been brought down to around 2%. This will be accompanied by an increase in consumers’ purchasing power and a decrease in economic uncertainty, giving a boost to consumption and economic recovery.

Central and local government expenditure will exceed revenues in all years of the forecast, and this deficit in the public finances will be met by borrowing. Over the next few years there will be additional central government expenditure arising from the need to strengthen the country’s security of supply and national security, and the Defence Forces’ purchase of new fighter aircraft. Population ageing will mean that health and social services expenditure will continue to rise for many years to come.

The pandemic and the war in Ukraine have demonstrated that the emergence of a crisis brings additional government expenditure needs. There has to be room for manoeuvre in the economy to allow for such contingencies. But this will not be possible unless public spending is brought into line with revenues in normal times. Central and local government revenue and expenditure must once again be extensively reviewed.