

Economic Survey

Winter 2016

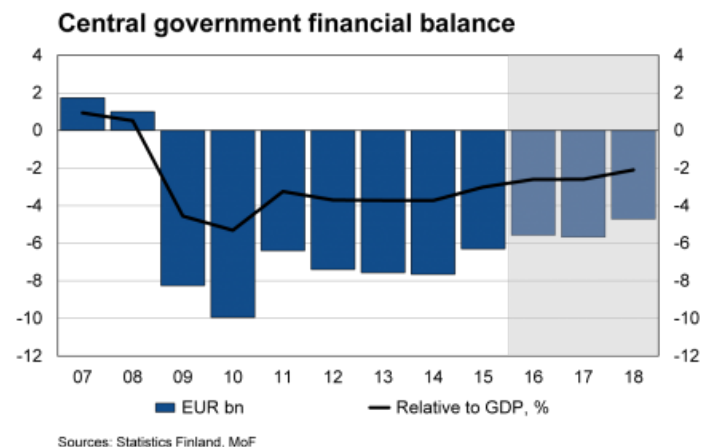


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Economic Survey

- Finnish GDP is predicted to grow by 1.6% in 2016, 0.9% in 2017 and 1.0% in 2018.
- The global economic outlook has become more subdued. World purchasing power adjusted GDP will grow by 3.1% in 2016, 3.4% in 2017 and 3.9% in 2018.
- In Finland first part of 2016 saw faster than predicted GDP growth. In the third quarter GDP was up 1.6% from Q3 last year.
- Growth in 2016 has been driven by domestic demand, particularly the growth of private consumption. Construction investment has also increased rapidly.
- The labour market situation has improved during 2016 and the trend of the unemployment rate has dropped back to 8.6%.
- In 2017 private consumption growth is set to slow in response to accelerating inflation and the consequent slow-down of real income growth. Short-term wage bill growth will be muted because of the Competitiveness Pact agreement.
- Private investment growth will slow temporarily in 2017 with the turnaround in the growth of construction investment.
- In 2017 the volume of public consumption will fall by 0.5%. Public consumption expenditure will decrease as a result of adjustment measures adopted in the Government Programme.
- Export growth will accelerate in 2017 and 2018. This growth will be driven by transport equipment deliveries already scheduled.
- Changes to social security contributions and tax cuts under the Competitiveness Pact will entail a short-term deterioration of public finances.
- Central government and local government are firmly in deficit, the earnings-related pensions sector is in surplus and other social security funds marginally in deficit. General government debt to GDP will continue to grow in the immediate future.
- The Competitiveness Pact agreement provides a platform for taking advantage of emerging export opportunities and strengthens confidence in domestic economic policy. However, it will take some time for the benefits of the Competitiveness Pact to filter down into real economic development.



Key forecast figures

	2015	2013	2014	2015	2016**	2017**	2018**
	EUR bn	change in volume, %					
GDP at market prices	209	-0.8	-0.7	0.2	1.6	0.9	1.0
Imports	78	0.5	-0.2	1.9	1.6	2.4	3.4
Total supply	287	-0.4	-0.6	0.7	1.6	1.3	1.6
Exports	77	1.1	-1.7	-0.2	1.0	2.4	3.2
Consumption	167	0.0	0.3	1.1	1.4	0.5	0.4
private	116	-0.5	0.6	1.5	1.9	0.9	0.6
public	51	1.1	-0.5	0.4	0.2	-0.5	0.0
Investment	43	-4.9	-2.5	0.7	4.1	2.7	3.2
private	35	-6.6	-3.4	2.2	3.5	3.2	4.2
public	8	2.6	0.9	-5.1	6.6	0.8	-1.1
Total demand	288	-0.4	-0.6	1.0	1.7	1.4	1.7
domestic demand	211	-1.1	-0.2	1.4	1.9	1.0	1.1

Other key forecast figures

	2013	2014	2015	2016**	2017**	2018**
GDP, EUR bn	203	205	209	214	219	224
Services, change in volume, %	-1.4	-0.5	0.8	0.6	0.5	0.9
Industry, change in volume, %	0.0	-0.5	-2.5	2.1	2.2	2.9
Labour productivity, change, %	0.5	-0.1	0.2	-0.3	-0.5	1.0
Employed labour force, change, %	-1.0	-0.4	-0.4	0.5	0.4	0.5
Employment rate, %	68.5	68.3	68.1	68.7	69.1	69.5
Unemployment rate, %	8.2	8.7	9.4	8.9	8.5	8.1
Consumer price index, change, %	1.5	1.0	-0.2	0.3	1.3	1.3
Index of wage and salary earnings, change, %	2.1	1.4	1.3	1.2	0.8	1.2
Current account, EUR bn	-3.3	-2.3	-0.9	-0.5	-0.7	-1.0
Current account, relative to GDP, %	-1.6	-1.1	-0.4	-0.2	-0.3	-0.4
Short-term interest rates (3-month Euribor), %	0.2	0.2	0.0	-0.3	-0.3	-0.2
Long-term interest rates (10-year govt. bonds), %	1.9	1.3	0.7	0.4	0.5	0.9
General government expenditure, relative to GDP, %	57.5	58.1	57.7	57.2	56.3	55.6
Tax ratio, relative to GDP, %	43.7	43.9	44.1	44.4	43.2	42.8
General government net lending, relative to GDP, %	-2.6	-3.2	-2.8	-2.2	-2.5	-2.0
Central government net lending, relative to GDP, %	-3.7	-3.7	-3.0	-2.6	-2.6	-2.1
General government gross debt, relative to GDP, %	56.5	60.2	63.6	63.7	65.3	66.1
Central government debt, relative to GDP, %	44.1	46.3	47.7	47.7	49.2	50.2

Introduction

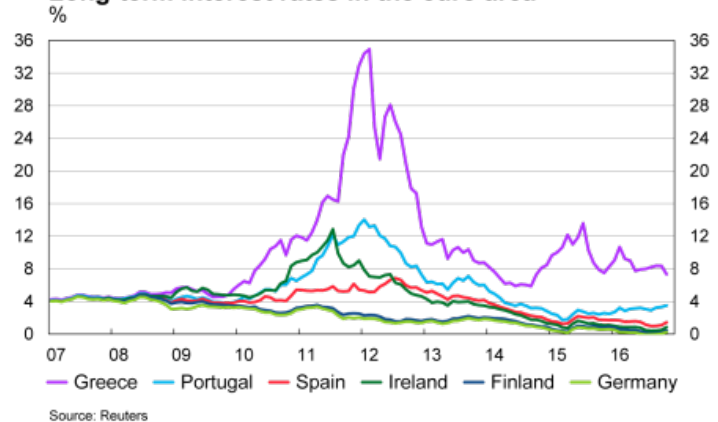
In contrast to the four previous years, gross value added in the national economy increased significantly in the first three quarters of 2016, showing growth of 1.2% from the year before. Output growth has been broad-based, but clearly driven by domestic demand. The export sector has continued to struggle.

Preliminary national accounts data from Statistics Finland show that the economy posted quarter-on-quarter growth of 0.4% in Q3. Economic growth in the first part of the year has also exceeded preliminary estimates. Despite the slight rebound, the Finnish economy will continue to make only slow progress over the next couple of years. Growth prospects are subdued, and there is no significant improvement in sight for public finances.

Finland's GDP growth forecast for 2016 is 1.6%. The projected growth rate for 2017 is 0.9% and for 2018 an estimated 1.0%. Public consumption will contract in 2017 when the adjustment measures adopted in the Government Programme and Competitiveness Pact lower operational costs of the central and local government.

The global economic outlook has become more subdued. World purchasing power adjusted GDP will grow by no more than some 3% in 2016 and accelerate only slightly in 2017 and 2018. Growth is at its slowest rate since the financial crisis and below the long-term average. Many emerging economies have seen a clear slowdown in the pace of growth, and the rebound in industrial countries remains modest because of sluggish investment, slow wage development and the consequent weakness of consumer demand.

Long-term interest rates in the euro area



Sluggish demand is reflected in slow world trade growth and lower-than-targeted inflation in most major economies. Private investment is widely below the long-term trend in industrial countries, indicating that businesses expect demand growth to remain subdued. Weak demand has also contributed to depress export prices. In many industrial countries unemployment is falling only slowly.

The US economy is continuing to rebound, but slowly. However it is possible that this growth is increasingly oriented to US domestic markets. Finland's major trade partners have posted stronger growth than emerging economies, but even they have seen slowing rates of growth.

The assumptions behind the current forecast are largely supportive of growth. The monetary policy pursued by central banks is growth-supportive. The European Central Bank has further expanded its exceptional monetary policy operations, and ECB reference rates will remain at historically low levels. Short-term interest rates will remain negative throughout the forecast horizon, and the ten-year interest rate will also remain exceptionally low.

It is projected that the euro to dollar exchange rate will continue to fall over the outlook period. The slide in oil prices came to a halt as oil producers reached agreement on production restrictions. The forecast incorporates a moderate increase in oil prices. Rising oil and other raw material prices will accelerate global inflation.

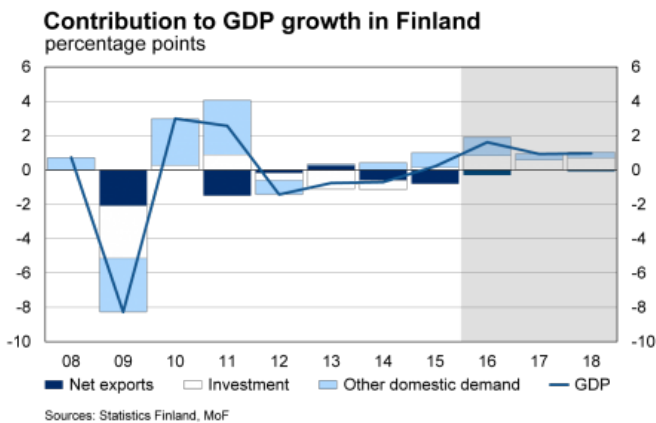
Finnish GDP growth in 2016 will come in at around 1.6%. Private consumption growth is robust for the current economic situation. Consumption growth is supported by rising household real disposable income, improving consumer expectations as well as the falling savings rate. Private investment and construction investment in particular will increase in 2016. Export growth will reach no more than around 1%, which is still slower than global trade growth. Rebounding investment and consumption will drive imports to stronger growth than exports, and therefore foreign trade as a whole will have a negative impact on GDP.

on the other hand, is still not increasing. It is predicted that prices will increase by no more than 0.3% in 2016. The index of wage and salary earnings is expected to rise by 1.2%.

GDP growth in 2017 is forecast at 0.9%. Private consumption growth in particular will slow because of accelerating inflation and the slowdown of household real income. Short-term wage bill growth will be muted because of the Competitiveness Pact agreement. This applies above all to the public sector, where a temporary reduction in holiday bonuses coupled with a lengthening of working hours and lowered employers' social security contributions will reduce the amount of employee compensations paid out by the public sector. The Competitiveness Pact will reduce the volume of public consumption by 0.5% and therefore contribute to slow the rate of GDP growth.

Private investment growth will slow mainly in response to the turnaround in construction investment. In 2017 export growth will accelerate to 2.4% as the main locus of growth shifts from emerging economies to Europe, the United States and other key export markets for Finland. During the outlook period export will be driven by transport equipment deliveries already scheduled. Employment will continue to improve, but the unemployment rate will fall slowly in 2017 as the growing number of job vacancies will activate the disguised unemployed to search for work. Earnings growth will slow to 0.8% in 2017. Changes in indirect taxation in 2017 will accelerate inflation by an estimated 0.2–0.3 percentage points, and consumer price inflation will pick up to 1.3%.

Projected GDP growth for 2018 is just 1.0%. The focus of demand will shift from the domestic markets increasingly to exports. Private consumption growth will be subdued.

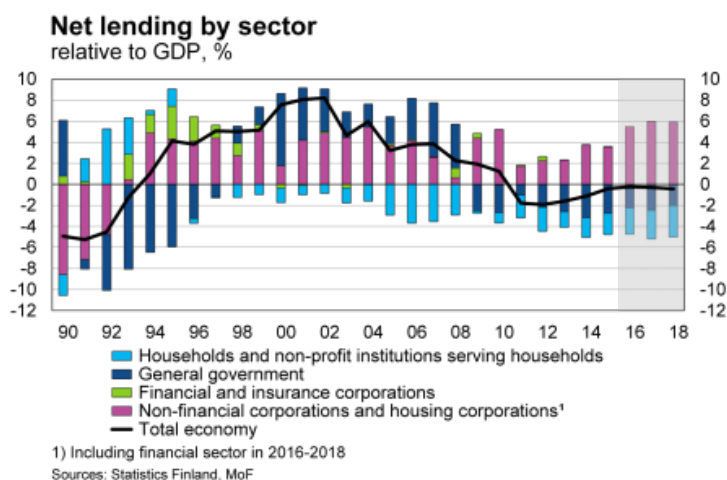


Industrial output growth is broad-based, with only primary production declining. Growth is particularly brisk in the construction sector. The labour market situation has improved in the first part of the year. The trend of the unemployment rate has dropped back to 8.6%, and employment is increasing especially in construction. Labour productivity,

There will be hardly any improvement in household purchasing power as inflation is expected to remain unchanged from the year before and the earned income tax rate will increase. It is expected that private investment growth will start to pick up again on the back of a strengthening global economy and the planned start-up of major domestic investment projects. Exports growth will accelerate yet still remain slower than growth in Finnish export markets. The current account will remain in deficit throughout the outlook horizon. The deficit in the service account balance will keep the foreign trade balance in deficit. Gradually rising oil prices and the strengthening US dollar are expected to accelerate inflation. In 2018 the change in consumer prices is expected to come in at 1.3%.

General government finances slid into a substantial deficit towards the end of the previous decade, and the imbalance between revenue and expenditure has been sizeable ever since. General economic weakness, industrial restructuring and protracted structural unemployment have reduced tax revenue and increased spending on benefits. At the same time, population ageing has brought a rapid increase in pension expenditure.

The projected rate of economic growth will not alone be enough to correct the imbalance in public finances. Changes to social security contributions and tax cuts under the Competitiveness Pact will entail a short-term deterioration of public finances. Furthermore, age-related expenditure will continue to rise rapidly, hampering efforts to restore balance in public finances. Central government and local government are firmly in deficit, the earnings-related pensions sector is in surplus and other social security funds marginally in deficit. General government debt to GDP will continue to grow in the immediate future.



The risks to global economic development are weighted to the downside. Increasing protectionism may have the effect of slowing world trade more than predicted. As the former favourable conditions have now dried up, economies in the euro area may struggle even more than anticipated to recover. The ability of the euro area to resist negative shocks will remain weak. The uncertainties associated with the Brexit process may have greater negative repercussions than anticipated not only in the UK itself, but globally.

Better than forecast developments are possible if rising wages in Germany boost demand and if rising oil prices generate a stronger than predicted increase in Russian imports. The broad-based rise in raw material prices may be another indication that growth will pick up more rapidly than predicted.

There are both upside and downside risks to the forecast for private consumption. Private consumption may develop more favourably than forecast if household debt continues to grow in the same way as in recent years. In Finland the ratio of household debt to disposable income is slightly higher than in the EU on average. The persistently low interest rates coupled with the postponement of loan repayments may well leave households with

a false impression of the risks involved in an increasing debt burden. Low interest rates and ready access to loans, coupled with improved household sentiment, may therefore increase household indebtedness more than expected. This would be reflected not only in private consumption, but also in the housing market. Increasing household and housing corporation indebtedness also carry a risk for slower investment growth.

The downside risks associated with private consumption may materialise if employment trends are weaker than expected. The ef-

fects on consumption would be reflected both through income formation and consumer expectations, which might add to consumer caution and lead to a higher savings rate.

There is also an upside risk in exports. The Competitiveness Pact provides a platform for taking advantage of emerging export opportunities and strengthens confidence in domestic economic policy. However, it will take some time for the benefits of the Competitiveness Pact to filter down into real economic development.

Global economy

Global recovery remains sluggish

World purchasing power adjusted GDP growth will reach no more than some 3% in 2016 and accelerate only slightly in 2017 and 2018. This growth is at its slowest rate since the financial crisis and below the long-term average. Many emerging economies have seen a clear slowdown in growth, and the rebound in industrial countries remains modest because of sluggish investment, slow wage development and the consequent weakness of consumer demand.

Weak demand is reflected in slow world trade growth and in lower-than-targeted inflation in most major economies. Private investment is widely below the long-term trend in industrial countries, indicating that businesses expect demand growth to remain subdued. Sluggish demand has also contributed to depress export prices. In many industrial countries unemployment is falling only slowly.

Productivity growth has been slow for a long time now. However OECD data indicate that productivity is increasing at the same rate as before in the most efficient companies, but slowed significantly in others.

In the United States, broad-based but relatively slow recovery is continuing. Growth is supported by stronger household balance sheets, favourable labour market trends and a lighter fiscal policy. Both nominal and real wages are continuing to rise quite robustly. Consumer confidence is at a high level, but expectations have declined somewhat. Investment is set to grow at a moderate rate. The easing of fiscal policy will also contribute

to revive demand. Because unemployment is low and production is running close to capacity in many branches, inflation is accelerating and the dollar is strengthening.

The euro area has remained on a slow growth track, partly as a result of reduced import prices. However, these tailwinds are now beginning to dissipate. The supply of credit and overall financing conditions have improved, and both fiscal policy and monetary policy are expansionary. These factors are contributing to drive private consumer demand, and investment is also slowly rebounding. The strengthening of the dollar is improving euro area demand to some extent. On the other hand, the strengthening of the current account suggests that imbalance and weak demand will continue in the euro area.

The outlook of the UK economy is overshadowed by the uncertainty caused by the country's pending departure from the EU, which means that companies are postponing their investments and households are reducing their consumption. UK growth will slow in 2017–2018. Long-term growth, too, will be slower than predicted earlier, which will further reduce investment. The UK's pending exit from the EU is also causing uncertainty in the euro area, which may have slight adverse effects on investment and growth. In Spain, Ireland and elsewhere, earlier structural reforms have contributed to a return to relatively brisk growth. Euro area growth is still hampered by a slowly falling unemployment rate. In Sweden, growth is slowing slightly, but both growth and employment nonetheless remain strong.

The Russian economy remains dependent on oil and gas exports. The country has failed to transform itself or to use the revenue generated from raw materials to diversify its production structure and to generate increased value added. Its growth potential is effectively hampered by unmade investments and obsolete economic structures, such as public interference in private sector investment and production decisions, and continued ownership uncertainty. Growth in Russia will remain extremely slow even after the current recession.

In China, growth in industry, construction and foreign trade has already slowed significantly, and these trends are set to continue. The Chinese economy is now in transition from an export and investment driven model to one led by domestic consumption and services. Historically, corresponding changes have resulted in a marked slowdown of growth. If the country is successful in its policy, the slowdown will be well controlled. On the other hand, China continues to adhere to old structures, which will slow the process of restructuring.

sluggish investment in industrial countries. World imports growth will remain modest, especially in emerging economies.

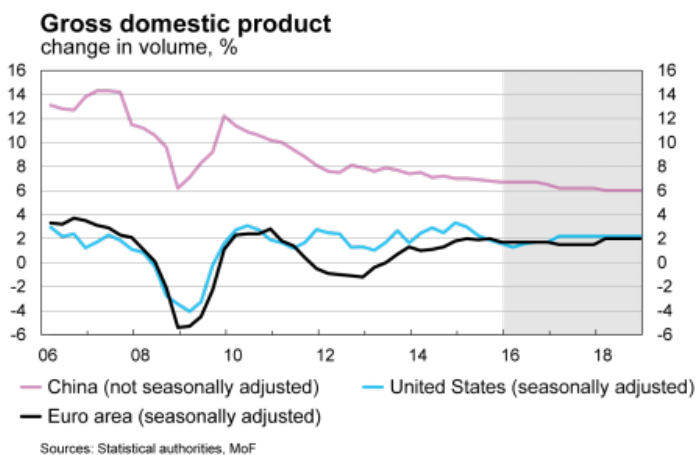
In the 1990s and early 2000s the growth rate for goods trade was more than twice as high as industrial output growth, but at the moment trade is actually growing more slowly than production. Earlier, such slow rates of trade growth have only been seen under conditions of recession. Industrial countries' import elasticity to GDP dipped even before the financial crisis, but has since partly recovered. In emerging economies, by contrast, it seems that there has been a permanent decline in import intensity, which means that trade growth continues to remain modest.

Finland's market share in world trade has continued to shrink, but this trend has now slowed. Global trade will not provide a strong demand impetus for Finnish exports.

Dispersed inflation outlook

The slide in crude oil prices has ended and prices have slowly moved up, partly as a result of the agreement reached by OPEC and Russia as well as some other countries to restrict production. The extremely high level of oil product stockpiles coupled with the rapid introduction of unconventional oil sources especially in the United States effectively limit a sharp upturn in prices, at least any longer-term price hikes. Other industrial raw material prices have also been picking up, and the slide in producer prices due to excess capacity in China has come to a halt. Together, these factors are driving global inflation.

In the United States, inflation expectations have been rising, and inflation is set to accelerate. In the euro area, inflation expectations are still well below the targeted level,

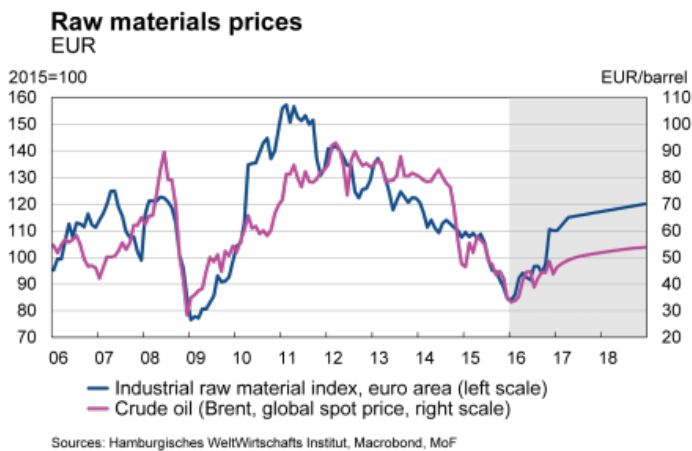


World trade growth extremely modest

Slow world trade growth reflects the slowdown of Chinese manufacturing growth and

and inflation targets will not be met during the forecast horizon even under an unconventional monetary policy regime.

may expose the economy to a sharper than anticipated slowdown. At the same time, indebtedness has continued to grow rapidly in the private sector, and the risk of problems in the financing sector has continued to escalate.



In the euro area, too, the risks remain skewed to the downside. As the former favourable conditions have now dried up, economies may struggle even more than anticipated to recover. The ability of the euro area to resist negative shocks will remain weak. The uncertainties associated with the Brexit process may have greater negative repercussions than anticipated not only in the UK itself, but globally.

Interest rates still low

The economic situation in Russia remains tight, and adjustment to the period of slow growth that lies ahead may cause political and economic uncertainties.

Interest rates have remained low due to the scarcity of investment and search for safe investments, which has resulted in reduced risk premiums on long-term interest rates. In the United States, interest rates have begun slowly to move back to normal, but they will remain relatively low throughout the outlook horizon. In the euro area in particular, interest rates will long be at a clearly lower level than was seen during the pre-crisis period.

Extremely low interest rates in industrial countries and a stronger search-for-yield mentality have steered investment flows into the housing and stock market, which may have led to overvaluations. In Sweden, for instance, housing prices have risen very sharply. The winding down of unconventional monetary policy, the edging up of interest rates and the strengthening of the US dollar may cause strong reactions in the financial market. Many emerging economies in particular may see more strong movements of capital.

Risks remain to the downside

Better than forecast developments are possible if rising wages in Germany boost demand and if rising oil prices generate a stronger than predicted increase in Russian imports. The broad-based rise in raw material prices may be another indication that growth will pick up more rapidly than predicted.

Increasing protectionism may have the effect of slowing world trade to a greater extent than predicted in the baseline scenario.

It is unclear how successful China will be in reforming its economic model without this leading to a significant slowdown in growth. Furthermore, its adherence to old structures

Supply and demand

Exports to turn to moderate growth

It is projected that Finnish exports will turn to moderate growth on the back of strengthening export demand. Nevertheless Finnish exports will be slower than world trade growth over the outlook horizon.

According to the latest national accounts figures, Q3 exports were down 3.4% from the previous quarter. This is explained by a ship-building order that was entered for Q2. Nevertheless exports were up 1.4% from the year before. The export growth forecast for 2016 is 1.0%.

In 2017 exports are predicted to increase by 2.4% and in 2018 by 3.4%. This growth will be driven by rising export demand and transport equipment deliveries scheduled for the forecast horizon. Finnish exports will nonetheless record slower growth than our export markets. Economic growth in Finland's major export markets will remain moderate.

Imports fell by 3.4% in Q3 from the previous three-month period. It is predicted that imports will increase by 1.6% in 2016. The growth of imports will accelerate in 2017 and 2018 on the back of growing exports and investments.

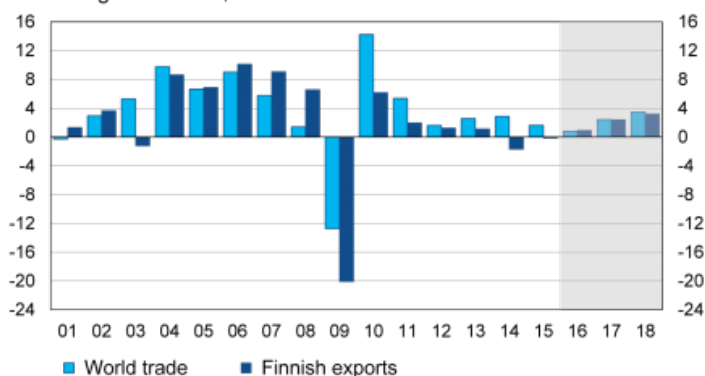
Current account to slip into deficit

Import prices will still fall in 2016, but start rising in 2017 with increasing oil prices and the weakening of the exchange rate. Net exports will have a slightly negative effect throughout the outlook horizon.

The 12-month sum of the current account at the end of Q3 2016 showed a deficit of 1.1% of GDP. The current account has again dipped into negative territory as the goods trade surplus has decreased.

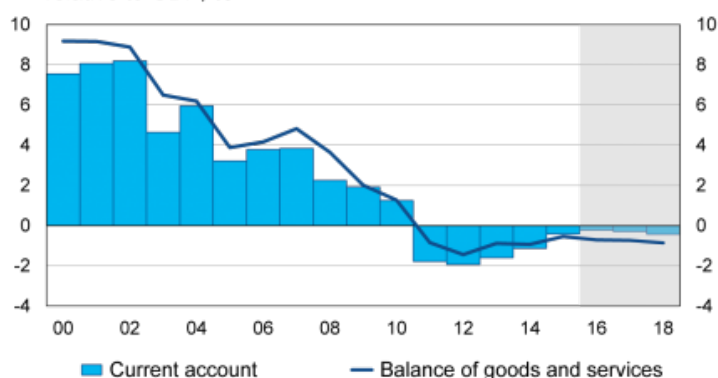
The current account will remain in deficit over the outlook horizon as the service account balance keeps the foreign trade balance in deficit. Primary income together with the secondary income account will also remain in slight deficit. In 2018 the current account to GDP ratio will be -0.4%.

World trade
change in volume, %



Sources: CPB Netherlands Bureau for Economic Policy Analysis, Statistics Finland, MoF

Current account
relative to GDP, %



Sources: Statistics Finland, MoF

Consumption growth slowing

The latest Consumer Surveys indicate that public confidence in both personal finances and in the outlook of the economy in general has improved clearly during 2016. In particular, consumers feel that this is a better-than-average time to make purchases of durables. Indeed, private consumption growth has been fastest precisely for durables. In 2017, durables consumption is expected to increase by almost 7%, primarily on the back of growing car sales.

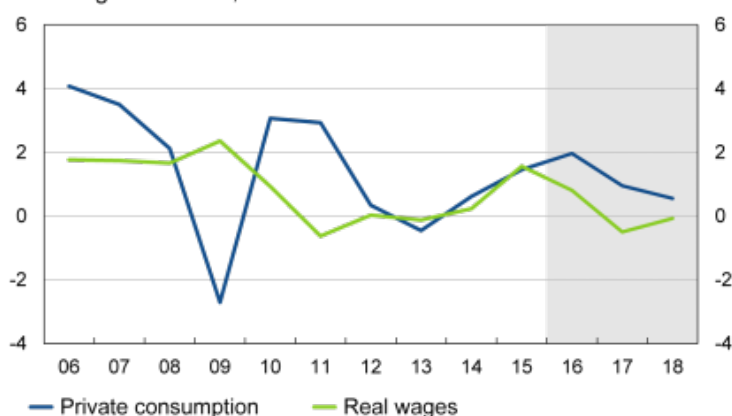
In 2016 household purchasing power will be bolstered by an increase of over 1.5% in household real disposable income. This is largely attributable to low oil prices and the consequent slower-than-usual inflation, which will come in at just 0.3% in 2016. Private consumption growth is also supported by improving employment and falling unemployment. Consumer Survey data indicate that the perceived risk of unemployment has been significantly reduced during the current year. Although private consumption growth will slow towards the end of the current year, it will still reach 1.9% in 2016.

In 2017 private consumption growth will slow to 0.9%. One contributing factor is the slowdown of household real income. The growth of disposable household income will be slowed by accelerating inflation, cuts to social transfers and moderate wage increases. Wage bill growth will slow despite improving employment, and the positive effects of tax reductions on purchasing power will remain moderate.

Private consumption growth will remain subdued in 2018 and reach just 0.6%. Despite accelerating employment growth, household purchasing power will hardly improve at all because of rising inflation and higher tax rates on earned income.

The household savings rate has fallen almost without interruption since 2010, and in 2016–2018 it will be slightly negative. The fall in the savings rate reflects in part the growth of household indebtedness. Low interest rates and ready access to loans have increased borrowing. The persistently low interest rates coupled with the postponement of loan repayments may well leave households with a false impression of the risks involved in an increasing debt burden. Low interest rates and ready access to loans, together with strong household sentiment, may therefore increase household indebtedness more than expected. This would be reflected not only in the housing market, but also in private consumption.

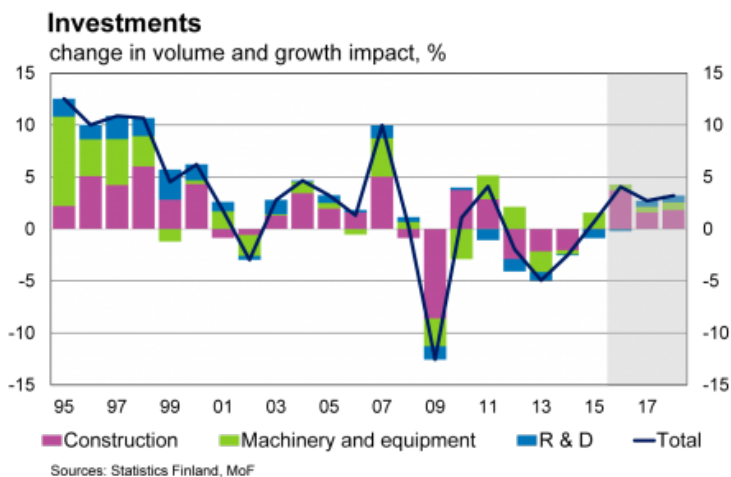
Private consumption and real wages
change in volume, %



Sources: Statistics Finland, MoF

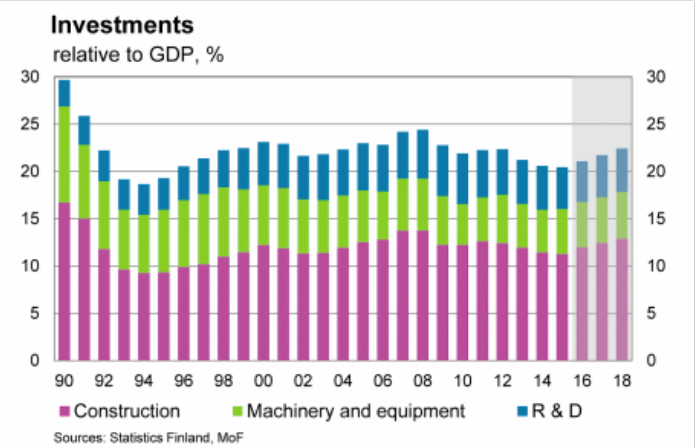
Private investment showing good growth

As expected, private investment has shown good growth: the figure for January–September was up 2.8% from last year. The strong growth of private investment is explained by the strong cyclical position in construction and by the new bioproduct mill in nekoski, where most of the machinery installation work will be completed in 2016. Furthermore, new registrations of transport equipment are also at a much higher level than last year. Civil engineering investment has continued to post strong growth at around 4% during the first three quarters of 2016. R&D investment is the only category that remains on a slight downward trajectory.



A turnaround is expected in construction investment, however, as the number of planning permissions granted is sharply falling. In 2017, therefore, private investment growth will slow to some extent. The completion of an exceptionally large manufacturing investment will also be reflected in figures for investment in machinery and equipment. In 2015 and 2016 real estate investors channelled substantial investment into rental

housing based on high return expectations, but next year's investment demand in this category is somewhat uncertain as there will be a substantial increase in the number of new housing completions in 2017.



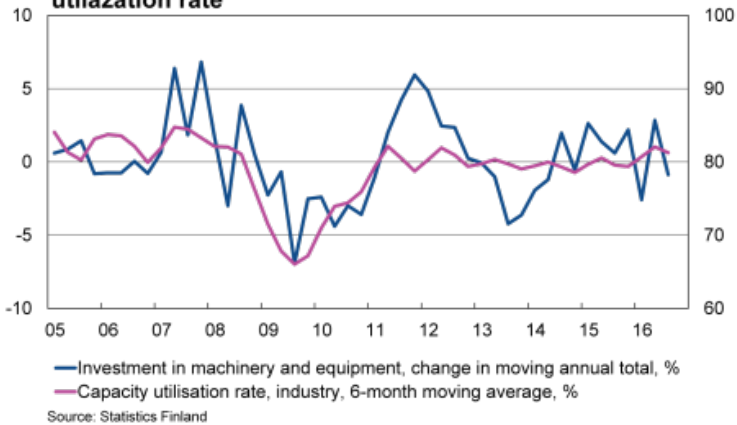
Commercial building investment is not expected to post significant growth in 2017. Construction of public service premises, by contrast, has shown strong growth, with investment in both hospital and school buildings on a clearly rising trajectory. Renovation activities slowed in 2016 as some master builders moved over to the new housing production sector. In 2017 and 2018 it is projected that renovation will show moderate growth of around 2% a year. The repair debt programme adopted by the Government will contribute to keep civil engineering investment on a growth track.

It is forecast that R&D investment will stop falling in 2016 and return to growth in 2017. R&D investment will pick up especially in the electrical and electronics industry and in the ICT sector, both of which are expected to rebound to a growth track in 2017. Public sector R&D expenditure will decrease to some extent throughout the forecast period.

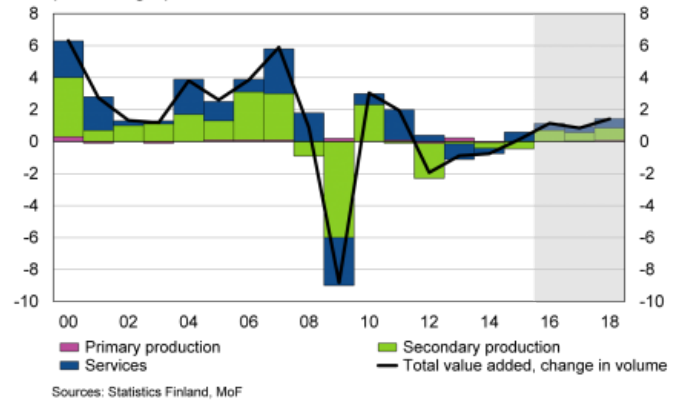
It is expected that with the rebound of the global economy and the planned start-up of major domestic investment projects, private

investment will return to accelerating growth in 2018. The main risks to the investment outlook are weaker-than-expected exports, increasing household and housing corporation indebtedness and uncertainties in global economic development.

Investment in machinery and equipment and capacity utilization rate



Contribution to total production

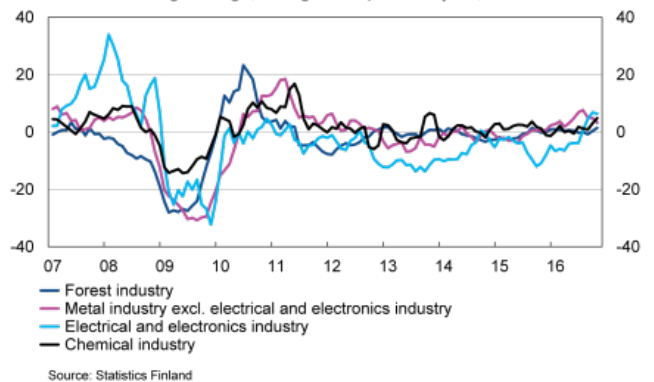


The output growth rate recorded early in the year is at its highest level since 2011. However, growth will be slowing around the turn of the year because industry order books are continuing to decline and growth in construction is set to slow with the falling number of planning permissions. Accelerating world trade growth and increasing demand for investment goods will sustain total output growth at a level of around 1% in 2017 and drive value added growth to almost 1.5% the following year. Restructuring especially in the electronics industry and in part in the forest industry will have the effect of slowing value added growth, despite the strengthening of export demand.

Strong output growth to slow temporarily

In contrast to the four previous years, gross value added in the national economy has increased significantly from the year before at 1.2%. This growth has been broad-based, as primary production was the only main sector of the economy that did not post growth in January–September. Growth was fastest in business services, the forest and chemical industry and in construction. Output levels were lower than the year before in public services, ICT services, the electrical and electronics industry as well as in agriculture. It is particularly noteworthy that after five years, industry was finally out of recession early in the year, with value added figures up a couple of per cent from the year before.

Volume index for industrial production



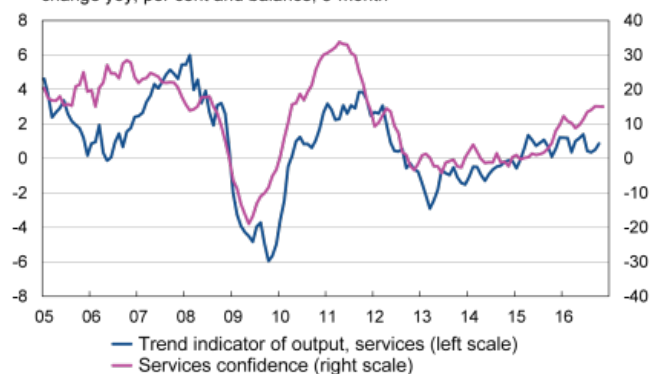
It seems that the strong growth recorded in industry early in the year will not continue into the new year because the value of new orders is still falling and business tendency

surveys indicate that industrial companies expect to see muted production growth in the next few months ahead. The number of companies expecting continued growth is highest in the construction materials industry, the chemical industry and the paper industry. The technology and printing industry, on the other hand, are expecting a downturn. Rebounding export demand, improving cost competitiveness, lower stockpile levels and the weakening external value of the euro will boost industry output in the years ahead. In 2016 industry value added will increase by around 2%. As a result of the weakness around the turn of the year, industry output will rise by no more than 2% in 2017, but in 2018 output growth will accelerate to around 3%.

of the sector in the first part of the year, value added in construction will increase by around 4.5% this year. In 2017 growth will slow to around 1.5%, but pick up to over 2% the following year as new construction projects get underway. Renovation activities will support the growth of value added in construction throughout the outlook horizon.

Service production

change yoy, per cent and balance, 3-month

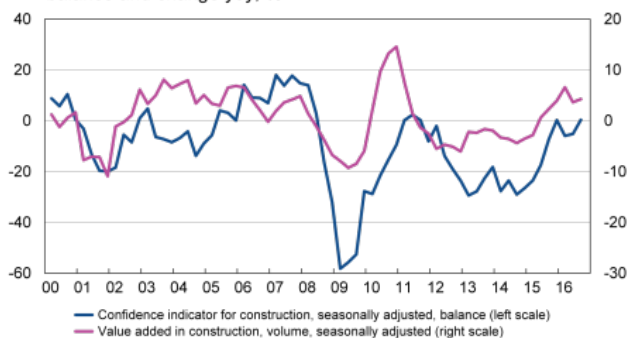


Sources: Statistics Finland, European Commission

In 2015 service production increased value added in the economy, while industrial production declined. In 2016 these roles have been somewhat reversed, and in the early part of the year service production growth was just half the rate of growth in industry, i.e. less than one per cent. According to business tendency surveys service companies expect to see moderate cyclical improvement over the next few months as well as slight growth in sales: less than one-sixth of them anticipate an increase in production in the months ahead. The number of companies expecting to see growth is highest in the ICT and the hotels and restaurants sector. Companies in the trade and transport sectors, by contrast, are primarily expecting a downturn. In 2016 and 2017 service production will increase by no more than half a per cent. In 2017 there will be only very limited growth in consumer services. In 2018 production will increase by around one per cent on the back of rebounding business.

Confidence and production in construction

balance and change yoy, %



Sources: Statistics Finland, European Commission

Construction output growth has been strong for a whole year now, primarily on the back of booming new building construction. In January–September construction value added was almost 5% higher than one year ago. However, this growth is set to slow as the number of planning permissions granted declined in many building categories by a total of 30% in Q3 from one year ago. Furthermore, this growth is regionally imbalanced: there are some regions where there is a shortage of end product demand, and others where there is lack of skilled labour and other production factors. Given the strong performance

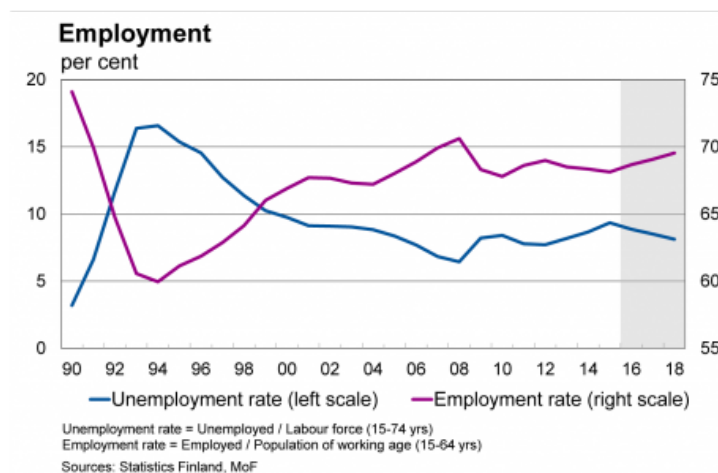
Employment, prices and wages

Unemployment rate falling, disguised unemployment rising

The employment situation has improved during the current year as the economy has returned to growth. The rebound in economic activity especially in construction is reflected in the increasing number of job vacancies and number of hours worked. Increasing demand for labour will turn employment to growth of 0.5% this year.

Unemployment growth has turned around and the number of people out of work has begun to fall in 2016, according to both Statistics Finland's sample-based Labour Force Survey and employment service statistics compiled by the Ministry of Employment and the Economy. In October the trend of the unemployment rate was 8.6%. The projected unemployment rate for the whole year is 8.9%.

At the same time, though, disguised employment has increased, and therefore the current official unemployment rate probably presents the current situation in too positive a light. The 'disguised unemployed' are persons outside the labour force who would be willing and available for work but who have not searched for work in the past four weeks. Other reasons for disguised unemployment other than the discontinued search for work are studying, child care or health reasons.



Moderate GDP growth in 2017 and 2018 will be strong enough to keep employment on an upward trend and at the same time to slowly reduce the number of unemployed persons. In the absence of more robust economic growth, however, unemployment will remain high throughout the outlook period. Employment is predicted to improve by 0.4% in 2017 and by 0.5% in 2018. The employment rate will edge up to 69.5% in 2018.

It is forecast that unemployment will fall slowly in 2017 as some of the disguised unemployed will probably return to actively searching for work with the increasing number of job vacancies. The unemployment rate will edge back to 8.5% in 2017 and further to 8.1% in 2018.

Despite the improved employment outlook, broad unemployment or the total number of unemployed job seekers and those under activation programmes has not dropped from its current high level of around 450,000. In 2016 the number of people under activation programmes has increased by the same amount as the number of unemployed persons has decreased. Long-term and structural unemployment numbers have also increased during

the current year, although in recent months the rate of this increase has slowed. In this light it is not expected that there will be any immediate decrease in unemployment-related costs.

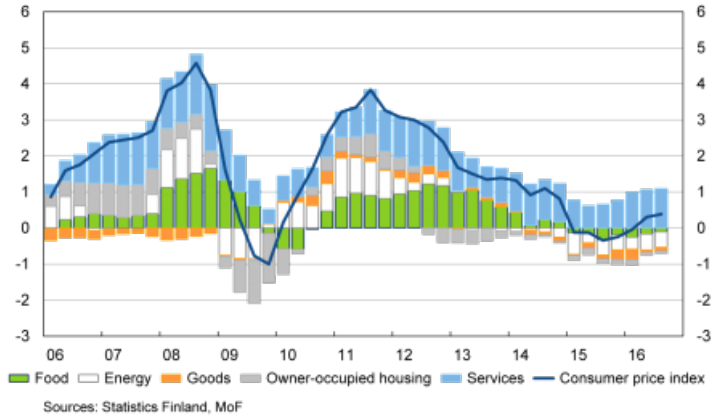
Regional and occupational mismatch problems between unemployed job seekers and job vacancies continue to hamper any improvement in the employment situation. The number of job vacancies has increased by more than 40,000 in 2016, bringing the total to the same level as during the cyclical peak in 2007. In contrast to what might be expected, however, this clear increase in labour demand has not reduced the broad unemployment rate.

Consumer prices

The national consumer price index increased by 0.4% in the third quarter of 2016 as compared with the corresponding period last year. In other words, consumer prices have continued to rise slowly, but the negative price trends early in the year have turned positive. Inflation was mainly driven by higher service prices, which in Q3 increased by 2.4% from the year before. Energy prices were down 4.9% and goods prices 0.6%. Food prices, on the other hand, were more or less unchanged from the corresponding period last year.

The inflation forecast for the current year is 0.3% as measured by the national consumer price index. Inflation will be driven above all by the price of crude oil, which has risen from its rock bottom level in early 2016. In the last quarter of 2016 it is expected that the price of oil will begin to push up consumer inflation. Energy prices will continue to have an upward effect on inflation through to the end of the outlook horizon.

Consumer price index
percentage change and contribution to change



It is anticipated that service prices will rise by around 2.4% this year, faster than the year before. Increases to social and health care client fees are one contributing factor. Food prices have developed moderately as a result of competition in the daily consumer goods sector. Goods prices have also been affected by weak demand and import prices, which will start rising in 2017 after a long period of decline. It is estimated that tax hikes will push up inflation by 0.6–0.7 percentage points in 2016.

Inflationary pressures will remain lower than usual over the next years of the forecast horizon as there are idle resources in the economy and the output gap is still negative. It is expected that the national consumer price index will increase by 1.3% in both 2017 and 2018. Gradually rising oil prices and the strengthening US dollar are expected to accelerate inflation. Changes in indirect taxes in 2017 will drive inflation by an estimated 0.2–0.3 percentage points. Increases to the annual vehicle tax, fuel oil tax and tobacco tax will add to inflationary pressure, but on the other hand the removal of the sweet tax and the reduction of the motor car tax will have the opposite effect. The forecast is also impacted by assumptions of moderate wage increase and low but gradually rising interest rates.

In the third quarter of 2016 the euro area inflation rate in terms of the harmonised consumer price index came in at 0.3%, and the same slow trend is expected to continue for the remainder of the year. The latest ECB forecast is that euro area inflation will be 0.2% in 2016, 1.2% in 2017 and 1.4% in 2018. The comparative MoF growth forecasts for Finland based on the harmonised consumer price index are 0.4% in 2016, 1.3% in 2017 and 1.3% in 2018.

Earnings rising very moderately

Nominal earnings, as measured by the index of wage and salary earnings, increased by 1.3% in 2015. Contractual wages increased by 0.6% and other factors pushed up the index of wage and salary earnings by 0.7%.

In 2016 earnings will develop in line with the framework agreement negotiated by the social partners in June 2015. The Pact for Employment and Growth will push up the standard wage rate by an average of 0.6%. The forecast for the development of earned income is based on the assumption that the contribution of factors other than contractual wage increases will drive up earnings by 0.6% a year. Therefore it is predicted that nominal earnings will rise by 1.2% in 2016.

It is predicted that earnings growth will continue to slow, with the growth forecast for 2017 at 0.8% and for 2018 at 1.2%. This is considerably below the average of the 2000s, and well in line with the sluggish economy and slow employment trends.

Consumer price index and index of wage and salary earnings
change from previous year, %



Sources: Statistics Finland, MoF

Public finances

General government debt still growing

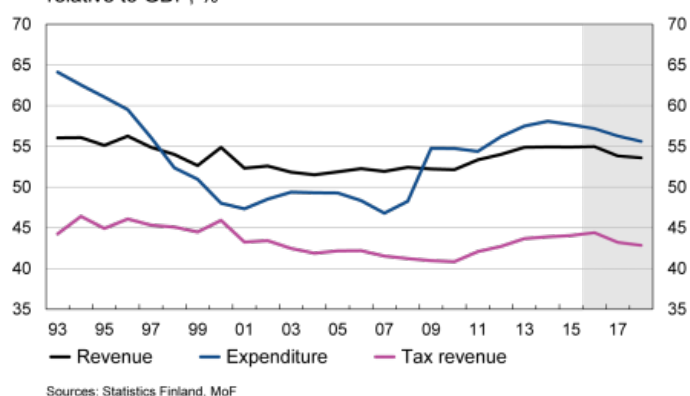
Finnish general government finances have long been in deficit and therefore the general government debt burden has grown rapidly. Sluggish economic growth is not generating enough tax revenue to finance public expenditure, which is furthermore increasing with population ageing. The fiscal adjustment efforts of successive governments have nonetheless managed to curb the growth of the deficit.

The immediate economic outlook remains subdued and the projected rate of economic growth will not be enough to correct the imbalance in public finances. The Competitiveness Pact agreement reached by the labour market organisations and the associated tax cuts introduced by the Government will entail a short-term deterioration of public finances. Central government and local government are firmly in deficit, the earnings-related pensions sector is in surplus and other social security funds marginally in deficit. General government debt to GDP will continue to grow in the immediate future.

Central government revenue will increase in 2016 with the rebounding economy and the deficit will shrink. On the other hand, the Government's key projects and immigration-related costs will drive up expenditure. The 2017 budget still shows a deficit position. Reduced social security contributions and cuts to holiday bonuses as set out under the Competitiveness Pact will reduce labour costs. Furthermore, longer working hours will reduce central government spending on em-

ployee compensations. On the other hand, tax cuts will have the effect of reducing central government tax revenue. In addition, central government expenditure will increase as a result of central government transfers to cover Kela sickness insurance expenditure and to offset losses in local government tax revenue.

General government revenue, tax revenue and expenditure relative to GDP, %



The financial position of local government will remain more or less unchanged in the years ahead. Adjustment efforts and moderate cost developments mean that overall local government expenditure will increase only marginally in 2016. Consumption expenditure will fall in 2017 with the introduction of holiday bonus cuts, reductions to employers' social security contributions and longer annual working hours as set out under the Competitiveness Pact. In order to take advantage of the cost savings made possible by longer annual working hours, municipalities and joint municipal authorities will need to take active decisions to that effect. On the other hand, the savings in personnel costs associated with the Competitiveness Pact agreement and Government measures to strengthen local government finances may

replace local authorities' own fiscal adjustment efforts in the years ahead.

In recent years the main focus of municipalities' and joint municipal authorities' fiscal adjustment efforts has been on curbing expenditure growth. In 2016 municipal tax rates were moderately increased. In 2017 only 47 municipalities will increase and as many as 14 municipalities will lower their tax rates. The average municipal tax rate will rise by just 0.05 percentage points to 19.91%.

The surplus of earnings-related pension institutions will continue gradually to deteriorate over the outlook period, and come in at just over half a per cent of GDP in 2018. The increasing number of pensioners and the higher average level of pensions will continue to drive up pension expenditure. Continued slow wage bill growth will act to slow the growth of revenue from insurance contributions. The revenue-increasing effect of the 0.4 percentage point hike in private sector earnings-related pension contributions in 2017 will be cancelled out by the reduction of

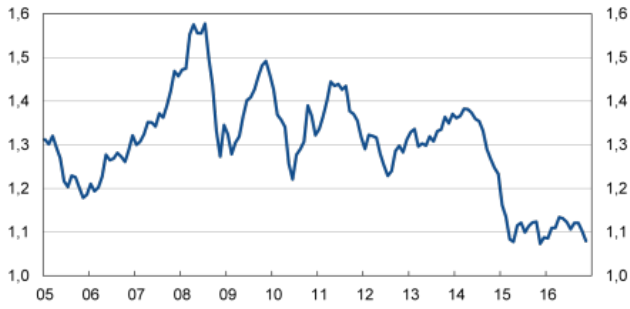
public sector contributions. In addition, authorised pension providers' property income will remain subdued because of low interest rates.

The deficit of other social security funds (the Unemployment Insurance Fund and the Social Insurance Institution Kela) will shrink in 2016 because the unemployment insurance contribution was increased by one percentage point from the beginning of the year. Furthermore, the growth of earnings-related unemployment insurance expenditure will come to a halt and the growth of basic unemployment security expenditure will slow. In 2017 unemployment expenditure will begin slowly to fall. The savings decisions taken by the Government will curb the growth of other social security funds' expenditure during the outlook period. The reduction to the employer's sickness insurance contribution as agreed under the Competitiveness Pact will not increase the deficit of other social security funds as the shortfall in Kela's revenue will be compensated with additional funding from central government.

ADDITIONAL GRAPHS

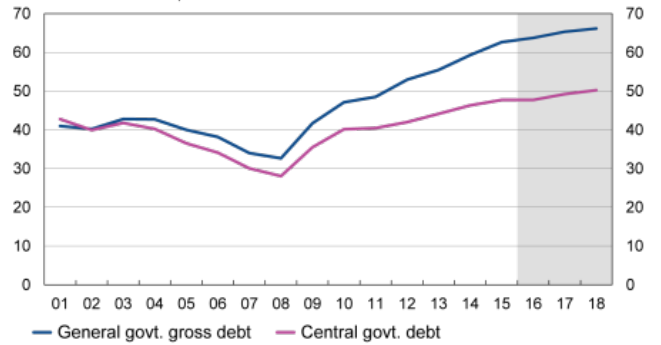


Exchange rate
EUR/USD



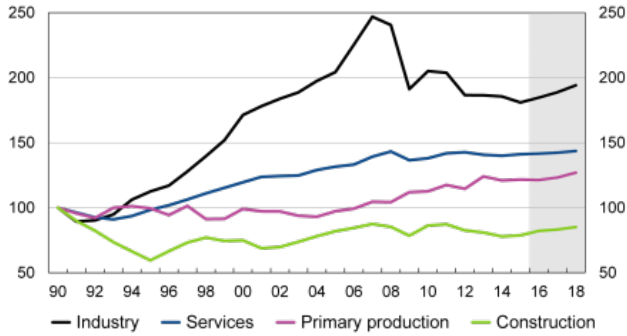
Source: European Central Bank

General government gross debt and central government debt relative to GDP, %



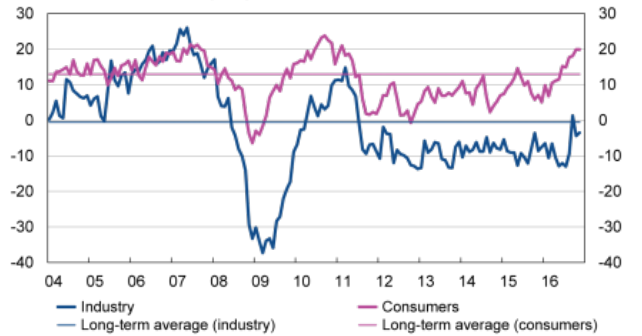
Sources: Statistics Finland, MoF

Production
1990=100



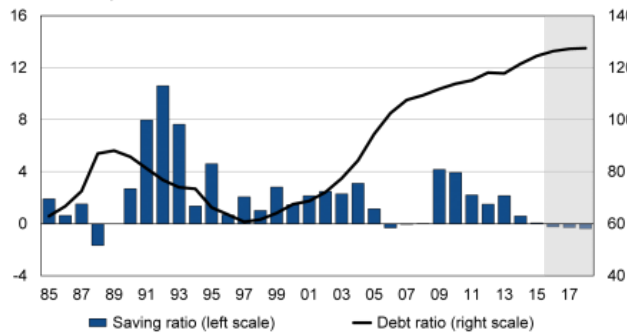
Sources: Statistics Finland, MoF

Industry and consumer confidence
balance, seasonally adjusted



Source: European Commission

Household savings and debt
% of disposable income



Sources: Statistics Finland, MoF

Short-term interest rates and real housing prices
% and change yoy



Sources: Reuters, Statistics Finland

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Economic Survey, Winter 2016

Ministry of Finance publications – 42c/2016
ISSN 1797-9714 (zine)
ISBN 978-952-251-817-0 (zine)