MINISTRY OF FINANCE

Economic Survey

Summer 2017

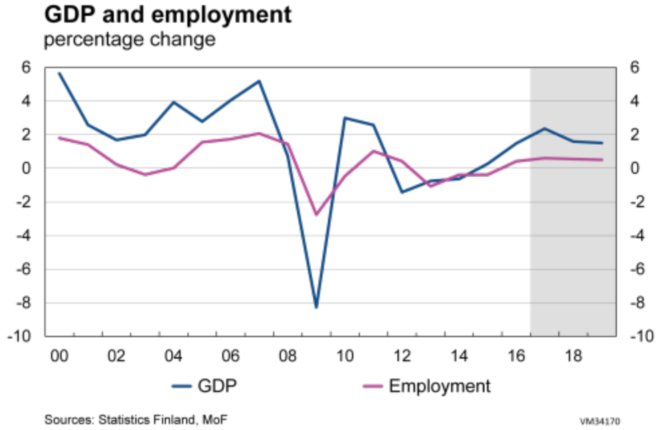
Ministry of Finance publications – 28c/2017

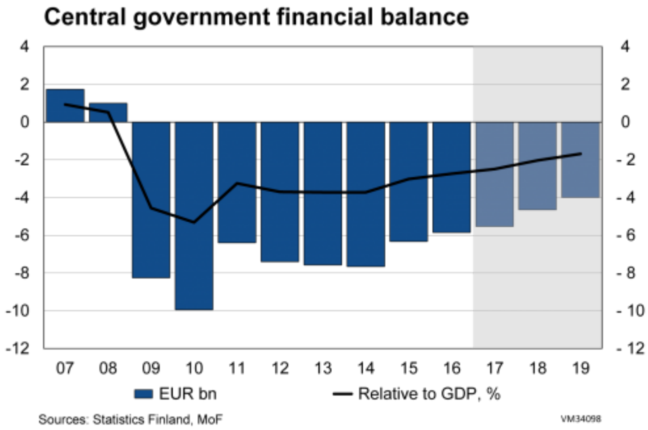
Economic Prospects

Contents

Summary

- Finnish GDP is forecast to grow by 2.4% in 2017, 1.6% in 2018 and 1.5% in 2019.
- The global economic outlook has improved, with global GDP adjusted for purchasing power growing by 3.4% in 2017, 3.6% in 2018 and 3.7% in 2019.
- Growth clearly exceeded forecasts in the first quarter of 2017.
- Economic growth is plainly accelerating and increasingly diversified.
- Higher employment rates are boosting growth in private consumption.
- Growth in private investment will fall over the next few years as the increase in construction investment gradually tails off.
- The emphasis in private investment will shift to investing in production.
- Export growth will gather pace over the forecast horizon due to improved economic prospects in export markets.
- A broad and rapid economic recovery brought an upswing in employment during the spring of 2017.
- Even though economic growth will strengthen general government finances over the next few years, the favourable cycle will not resolve its structural problems.





Key forecast figures

	2016 EUR bn	2014	2015	2016	2017**	2018**	2019**
		change in volume, %					
GDP at market prices	214	-0.6	0.3	1.5	2.4	1.6	1.5
Imports	78	-1.3	3.2	2.9	3.0	2.6	3.1
Total supply	**293**	**-0.6**	**0.8**	**1.9**	**2.5**	**1.9**	**2.0**
Exports	76	-2.7	0.8	1.5	4.7	3.7	3.9
Consumption	171	0.4	1.1	1.5	1.4	0.8	0.7
private	119	0.8	1.5	1.9	2.3	1.1	1.0
public	52	-0.5	0.1	0.5	-0.5	0.0	-0.1
Investment	45	-2.6	1.1	5.2	3.6	2.9	3.4
private	37	-3.4	2.6	6.1	4.2	3.0	4.1
public	8	0.9	-4.9	1.4	1.2	2.4	0.0
Total demand	**293**	**-0.8**	**1.2**	**1.9**	**2.7**	**2.0**	**2.1**
domestic demand	217	-0.1	1.4	2.0	2.0	1.5	1.5

Other key forecast figures

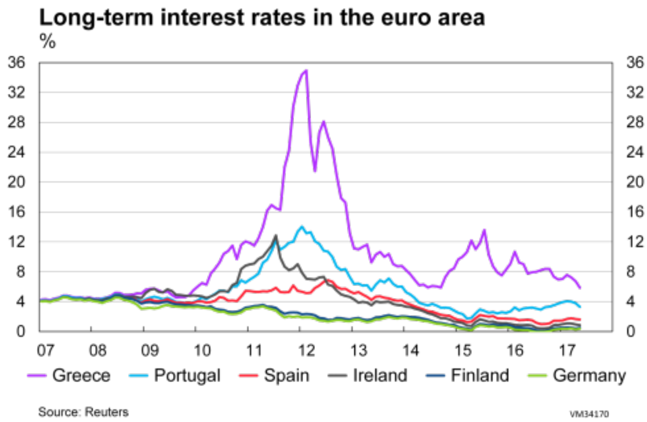
	2014	2015	2016	2017**	2018**	2019**
GDP. EUR bn	205	210	214	222	229	237
Services. change in volume. %	-0.4	0.9	0.9	2.0	1.5	1.3
Industry. change in volume. %	-0.2	-2.1	0.7	6.3	2.0	1.9
Labour productivity. change. %	0.1	0.4	0.2	1.4	1.2	1.1
Employed labour force. change. %	-0.4	-0.4	0.5	0.6	0.6	0.5
Employment rate. %	68.3	68.1	68.7	69.3	69.8	70.2
Unemployment rate. %	8.7	9.4	8.8	8.5	8.1	7.8
Consumer price index. change. %	1.0	-0.2	0.4	1.0	1.3	1.4
Index of wage and salary earnings. change. %	1.4	1.4	1.1	0.2	1.2	1.5
Current account. EUR bn	-2.6	-1.2	-2.3	-3.2	-2.4	-2.0
Current account. relative to GDP. %	-1.3	-0.6	-1.1	-1.4	-1.1	-0.8
Short-term interest rates (3-month Euribor). %	0.2	0.0	-0.3	-0.3	-0.2	0.0
Long-term interest rates (10-year govt. bonds). %	1.5	0.7	0.4	0.5	0.9	1.3
General government expenditure. relative to GDP. %	58.1	57.0	56.1	54.5	53.6	53.2
Tax ratio. relative to GDP. %	43.9	44.0	44.3	43.0	42.4	41.9
General government net lending. relative to GDP. %	-3.2	-2.7	-1.9	-1.8	-1.7	-1.4
Central government net lending. relative to GDP. %	-3.7	-3.0	-2.7	-2.5	-2.0	-1.7
General government gross debt. relative to GDP. %	60.2	63.7	63.5	63.8	63.8	63.6
Central government debt. relative to GDP. %	46.3	47.6	47.8	48.5	48.6	48.6

Introduction

A clear recovery has finally begun in the Finnish economy. GDP growth will also continue into the next few years, though at a slightly lower pace. The provisional quarterly accounts of Statistics Finland show that the Finnish economy grew by 1.2 per cent in the first quarter of 2017 compared to the previous quarter, which was clearly more rapid than expected.

The economy is forecast to grow by 2.4 per cent in 2017, with growth of 1.6 per cent expected in 2018 and 1.5 per cent in 2019. Economic growth is also diversifying as it accelerates. Economic activity no longer relies solely on domestic demand, as exports are also clearly growing. The restoration of healthy growth in industry is also driving a rapid improvement in productivity.

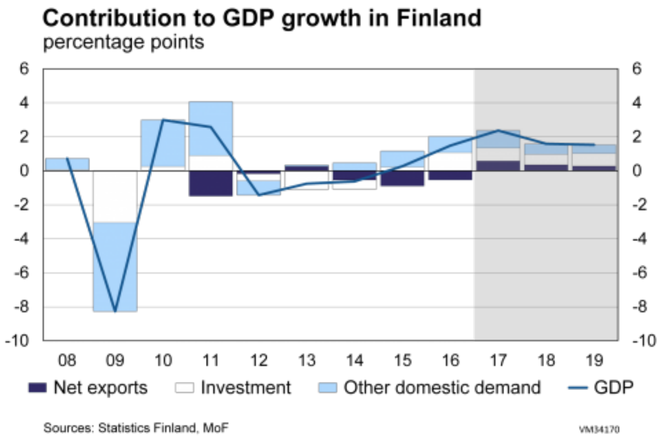
The global economic outlook is recovering. Global GDP adjusted for purchasing power will grow by about 3½ per cent in 2017, with even faster growth forecast for 2018 and 2019.



Some uncertainty remains concerning the sustainability of global prospects for economic growth. Growth of the US economy is continuing across a broad base, with high expectations of economic growth in households and businesses. Signs of accelerating growth in the euro area include a broadly-based increase in economic activity and quickening inflation. The slowdown in growth of overall output from China is expected to continue alongside rapid growth in India, with the Russian economy showing signs of recovery.

The underlying assumptions of the forecast are largely supportive of growth, as is the monetary policy of central banks. Expectations of inflation are normalising. Short-term interest rates will remain negative throughout the forecast period, and the ten-year interest rate will also remain exceptionally low. The EUR-USD exchange rate will continue to fall over the forecast period. A moderate increase in the price of oil combined with a rise in other commodity prices will stoke global inflation.

The rate of GDP growth in Finland will increase to 2.4 per cent in 2017. Growth in private consumption will be rapid in relation to the overall economic trend. An increased employment rate, real income growth in private households and higher consumer expectations will support growth in consumption. The emphasis in private investment is shifting from investment in housing and construction to investment in industrial and business machinery and equipment, and in research and development. The growth will also be more diversified, with growth in exports rising by nearly five per cent. The contribution of foreign trade on GDP growth will become positive in 2017.



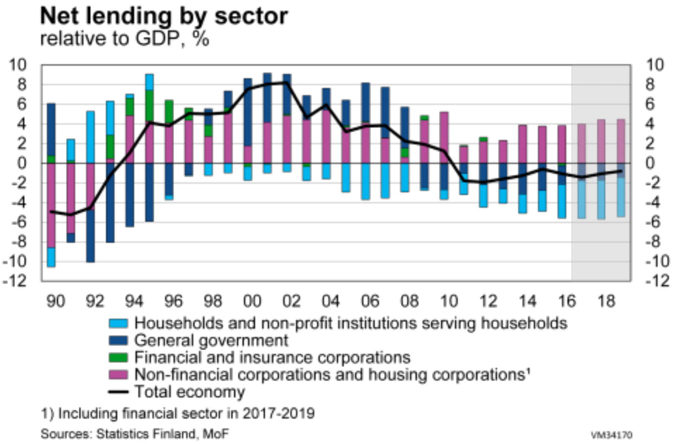
Growth in production will be weighted towards industry as exports recover, and growth in industrial output will also support a rapid improvement in the economy as a whole. The broad and rapid economic recovery brought an upswing in employment during the spring of 2017, and even though the fall in joblessness stalled at the start of the year, this accelerating economic growth will restore the downward path with an unemployment rate of 8.5 per cent forecast for 2017. Prices are forecast to rise by only one per cent in 2017, with an estimated increase of 0.2 per cent expected in the earnings level index.

GDP will grow by 1.6 per cent in 2018. The rate of growth in private consumption will fall in particular as real growth in household income slows. Growth in private investment will also decline as growth in construction investment levels off. Export growth will decline slightly in 2018 to align with growth in export demand. Employment will continue improving, but the official unemployment rate will fall slowly in 2018 as the rise in vacancies activates unregistered jobseekers. Earnings are expected to increase by 1.2 per cent in 2018. Although the rise in consumer prices will be more broadly based than this year, rising service prices will continue to exert the greatest impact on overall inflation.

The rate of GDP growth will remain at 1.5 per cent in 2019. The rate of growth in private consumption will continue to fall as real growth in disposable income slows. Growth in private investment is expected to accelerate again with a recovery of international economic development, and due to major investment projects planned for Finland. Exports will continue to lag behind the growth in export markets despite accelerating growth. The current account deficit will remain in deficit throughout the forecast period notwithstanding the upturn in the trade balance. The service account deficit will maintain a deficit in foreign trade. A gradually rising oil price and strengthening US dollar are expected to accelerate inflation over the forecast period, with a consumer price increase of 1.4 per cent forecast for 2019.

General government finances fell into severe deficit at the end of the last decade. Though economic growth has been sluggish in recent years, the deficit has nevertheless declined due to government consolidation measures. While the economic upturn will improve the fiscal position, the forecasted economic growth will not alone be enough to correct a structural imbalance in public finances. Central government and local government are in deficit, the earnings-related pensions sector and other social security funds are in surplus. The debt ratio will stay at a high level over the next few years.

The forecast technically consolidates the finances of the county government due to begin in 2019 into central government. This reform will impair central government finances, but slightly improve the local government balance.



The risks in global economic development tend towards weaker progress than forecast. Increasing protectionism may impede world trade more than expected. The projected progress may be exceeded if wage growth in Germany boosts demand and rising oil prices encourage Russian imports more than anticipated. A broad increase in commodity prices may also be an indicator of faster growth than forecast.

Finland's economic growth involves both upside and downside risks. If household consumer confidence remains high, then private consumption may increase more rapidly than forecast, which would boost economic growth. This would further increase the already high debt ratio of private households.

The negative risks involved in private consumption could, in turn, be realised if employment grows more slowly than forecast. The impact on consumption would be visible through both revenue generation and consumer expectations, which could make consumers more cautious and lead to rising savings.

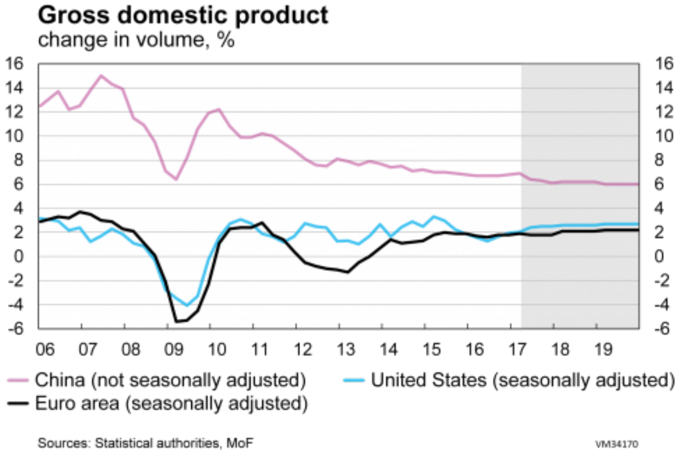
Global economy

Broader growth in the global economy

Global economic growth gathers pace despite uncertainty

Growth in the global economy is accelerating, but some uncertainty remains concerning the solidity of growth prospects. Growth is gaining momentum in the USA and the euro area, while Japan has also begun growing slowly. The outlook is more complex in emerging economies. The slowdown in growth of overall output from China is expected to continue alongside rapid growth in India. The Russian economy is showing signs of recovery. Global economic growth of around 3½ per cent at the end of the forecast period will still be maintained by emerging economies, even as exports also increase in developed economies.

Signs of accelerating growth in the euro area include a broadly-based increase in economic activity, falling unemployment and higher inflation. This growth is largely due to an increase in consumption and investment. The long-established monetary policy of low interest rates in the euro area has boosted growth and demand. The increasing inflation has largely consisted of rising energy prices, whereas the rate of core inflation has remained low.



Growth of the US economy is continuing across a broad base, with high expectations of economic growth in households and businesses. The economy is approaching full employment, and accelerating inflation has already led to a tightening of monetary policy. Positive growth prospects are nevertheless overshadowed by political uncertainty.

The long-sustained deflationary spiral in Japan now seems to be over, with consumer prices returning to a moderate upward track. The key to economic recovery is the growth-oriented policy of the central bank, with the weakening yen boosting the long-depressed export sector. Slower growth rates in China reflect both the waning of the construction boom and a rise in manufacturing costs in the coastal industrial cities. The economic transition away from export-driven growth and towards a model driven by domestic demand is also visible in growth prospects. A high level of debt nevertheless overshadows the economic outlook in China. Despite its recent banknote reform, the Indian economy is pulling strongly, with structural reforms progressing in taxation and other areas.

Global trade recovers from last year's downturn

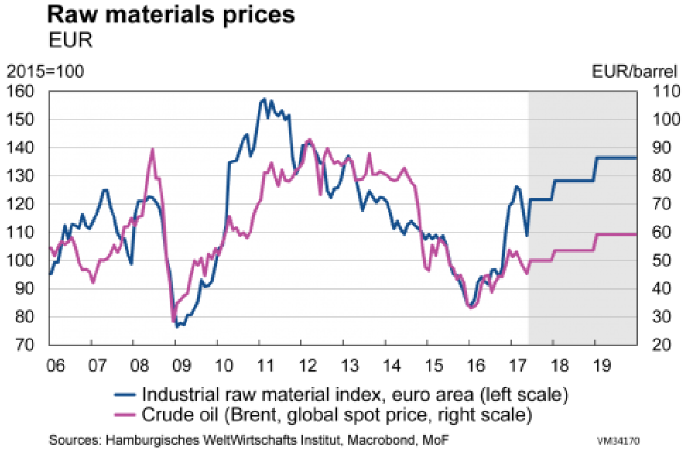
Despite the strong upturn in the final months, growth in world trade was the slow-est for several years in 2016. World trade will recover as demand strengthens in the USA, the euro area and emerging economies, but growth will not reach that of preceding the financial crisis. The contraction of Finland's market share of world trade has ended and a slight recovery has occurred.

Risks remain on the downside

Downside risks to the global economy are due to economic uncertainties, such as the growing threat of protectionism, the risks involved in China's indebtedness, and the ongoing structural reforms of the euro area countries. There are also considerable geopolitical risks that could affect the outlook for growth in the global economy.

Inflation moderately gathering pace

The rapid increase in crude oil prices seen towards the end of last year came to an end in early 2017, with the barrel price hovering at just over USD 50 in recent months. The reasons for this price stabilisation include high stocks of petroleum products and the improved viability of alternative oil drilling methods. In May of this year OPEC decided to continue limiting oil production until March of 2018. Crude oil prices are expected to rise moderately over the forecast period.



Though a slight fall in other industrial commodity prices began in early 2017, the upward trend is expected to return during the forecast period as global demand recovers.

Inflation accelerated in early 2017 due to the bottoming out effect of the low oil price in the previous year. A further increase is expected over the forecast period due to the economic recovery and positive employment trends.

A normalisation of interest rates has begun in the USA, and this trend is expected to continue over the forecast period, whereas euro area interest rates will increase slowly over the forecast period, remaining at a clearly lower level than preceded the euro area debt crisis.

Export growth track restored

Finland's export prospects have improved, with the latest statistics indicating a return to a growth track. The export growth in the quarterly accounts for 2016 has been revised upwards from less than one per cent to 1.5 per cent. Exports in the first quarter of 2017 were 8.8 per cent higher than a year earlier and 5 per cent higher than in the preceding quarter. The rapid first quarter growth was based on an increase in goods exports.

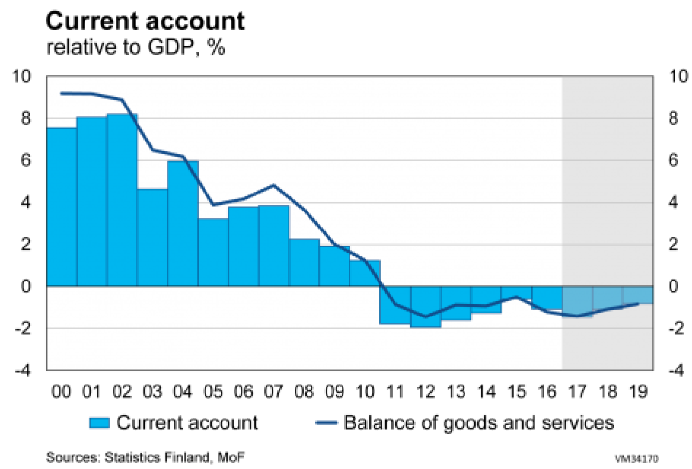
The economic outlook of Finland's trading partners and of world trade have improved this year. Growing demand in the export market and rapid growth at the start of the year will result in growth of as much as 4.7 per cent in 2017, momentarily exceeding the growth of the export market. The growth in exports will be maintained by the recovery in the export market coupled with favourable development in cost competitiveness. Exports will grow by 3.6 per cent in 2018, and growth will accelerate to 3.9 per cent in 2019. Finland's long-sustained loss of market share will end, with a slight upturn in market share predicted over the forecast period.

While the first quarter of 2017 saw a fall of one per cent in imports compared to the previous quarter, the year-on-year increase was 3.6 per cent. A more even distribution of imports in economic activities between the manufacturing and trade will keep the growth of imports at three per cent in 2018 and 2019. Growth in exports will exceed that of imports over the forecast period, resulting in a positive contribution of net exports to the GDP growth.

The increase in import prices that began in the latter half of 2016 continued steadily in the first quarter of 2017. Import prices will continue increasing at a more moderate pace in 2018 and 2019.

The current account deficit has increased since the improvement seen in 2016, with the 12-month rolling sum of current account balance standing at EUR -2.2 billion at the end of Q1/2017.

Despite strong export growth, the current account deficit will continue in 2017 due to the service balance deficit and more rapid growth in import than export prices. The current account deficit will decrease in 2018 and 2019 as the trade surplus increases, reaching a level of 0.8 per cent of GDP in 2019.



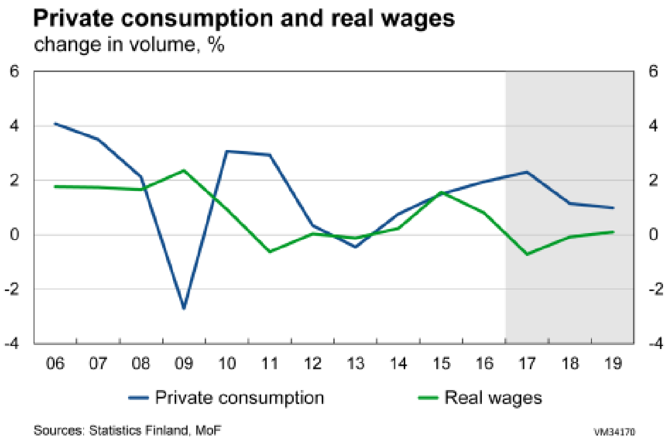
Supply and demand

Consumption growth gradually slowing

Consumer Survey findings suggest a recovery of overall confidence in personal finances and in Finland's economic performance. Consumption grew particularly rapidly in the first quarter of 2017. The quickening growth of consumption this year will mainly be due to growth in consumer durables and services. Service industry turnover indicators have broadly risen so far this year.

An increase of more than two per cent in real disposable income will boost the purchasing power of private households in 2017, as inflation will increase only minimally due to moderate growth in energy prices. Higher employment rates and a decline in unemployment are also boosting growth in private consumption. The Consumer Survey suggests that the perceived risk of unemployment has clearly fallen over the last year, and even though growth in private consumption will decline towards the end of the year, it will reach 2.3 per cent for the year as a whole.

Consumption will continue growing, but more slowly in 2018, supported by higher employment and growth in disposable household income. This growth will be checked by rising inflation and moderate agreed wage increases.



Growth in private consumption will continue slowing in 2019, while nevertheless staying above one per cent. Accelerating inflation will prevent any growth of employee purchasing power, notwithstanding the rise in employment.

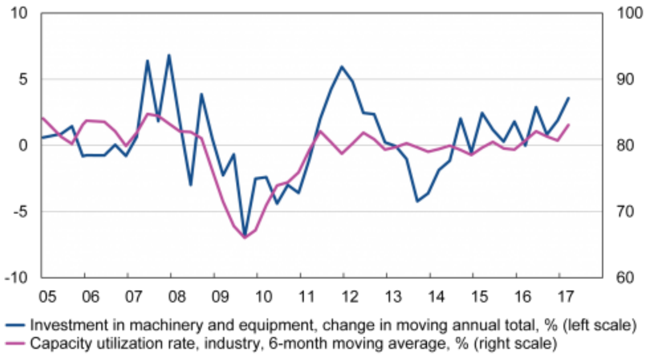
The private household savings rate has fallen almost continuously since 2010, and will reach a clearly negative level in 2017-2019 with some impact also visible on household indebtedness. Low interest rates and readily available loans have increased borrowing, and these factors may therefore combine with improved confidence levels in private households to accelerate the growth of indebtedness beyond the projected level. This would be visible both in the housing market and in private consumption.

Private investments

Emphasis shifting to investment in production

The virtuous cycle of investment is continuing, with very rapid growth of overall private investment in the first quarter. Investment increased particularly in machinery, equipment and transport vehicles due to an increase in industrial capacity utilisation and the need for industrial retooling. This means that the emphasis in private investment is shifting from investment in housing and construction to investment in industrial and business machinery and equipment, and in research and development.

Investment and capacity utilization rate



Source: Statistics Finland

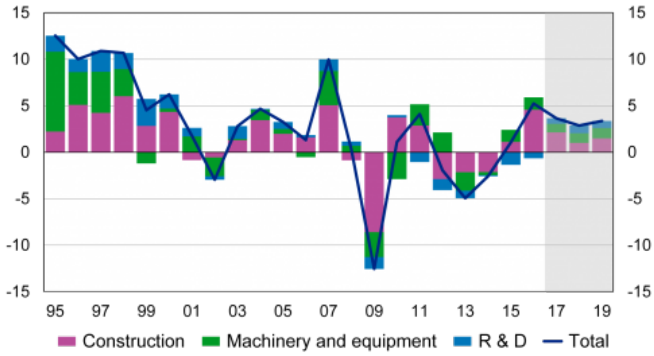
The growth in private investment clearly exceeded expectations in the first quarter of the year, and the investment forecast has been increased for the current year. Growth for the whole year is expected to be more moderate than the start of year, totalling just over four per cent. The number of new housing starts reached a record high in March, but is expected to decline towards the end of the year. This will retard the pace of investment particularly in 2018, as housing construction investments are the single largest investment subcategory.

The improved global economic outlook, good growth in Finnish exports and the recovery of the domestic market will increase demand for output in industrial and other sectors, leading to both construction investment and higher investment in machinery and equipment. The facilitation of retail zoning is also expected to increase investment towards the end of the forecast period. Private investment should increase by just over four per cent in 2019, with a boost predicted at this time due to projects planned in the forest industry.

In addition, the growth of R&D investment is particularly positive due to its potential for increasing productivity, and the six-year downturn in R&D investment seems likely to end this year, as the outlook for R&D investment in the influential technology industries is clearly positive.

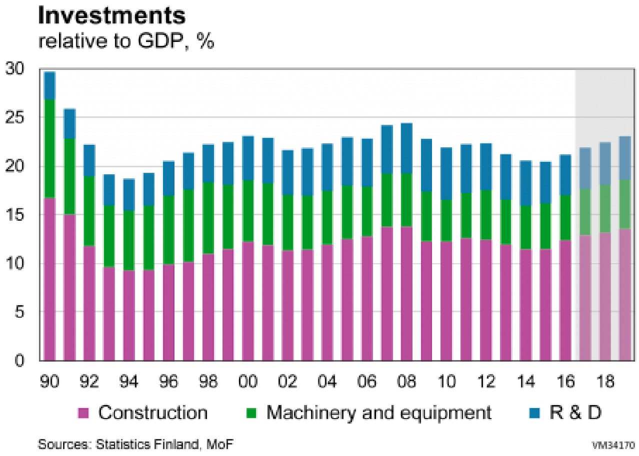
Investments

change in volume and growth impact, %



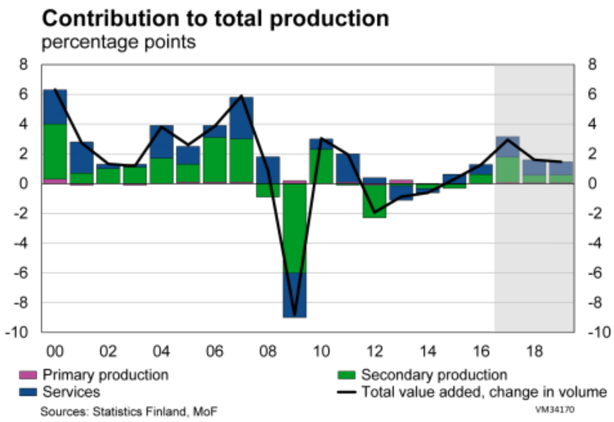
Sources: Statistics Finland, MoF

Negative real interest rates and good access to financing will boost investment throughout the forecast period. This is evident, for example, in the fact that private investment is growing more rapidly than GDP. Favourable investment performance will restore the ratio of private investment to GDP back to a level approaching the pre-financial crisis figure of about 19 per cent.



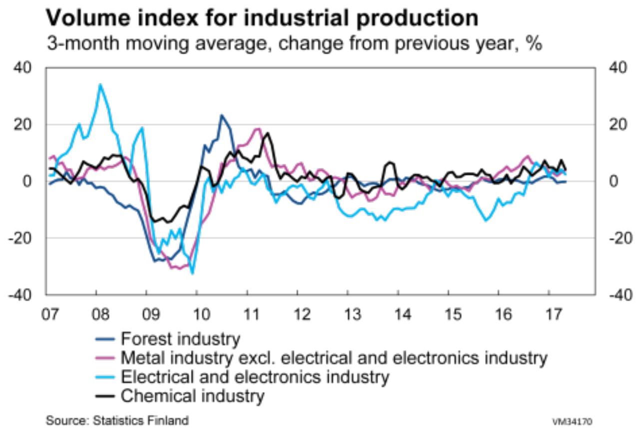
Output pushes towards broad growth

A clear recovery of output has finally begun in Finland. Value added in the entire economy grew by 1.3 per cent last year, with economic growth rising significantly at the start of the new year and growth in output reaching 4.6 per cent in the first quarter. The most positive aspect of the rapid growth was its breadth, with growth in all major sectors, including industry. Economic activity no longer relies solely on domestic output and demand, but foreign demand is also boosting the growth in output. The restoration of clear growth in industry is also driving a more rapid improvement in productivity across the entire economy.



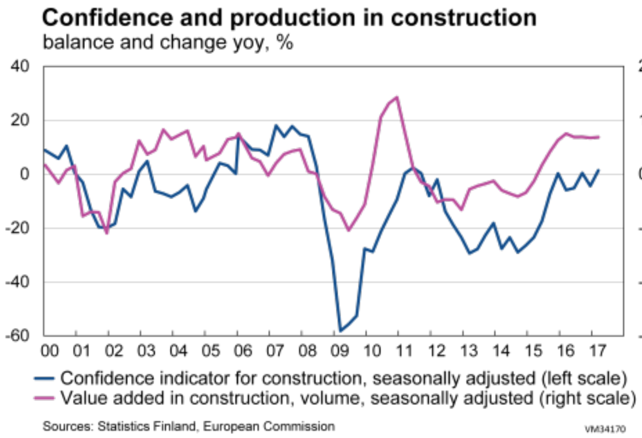
Forecasting indicators suggest that the growth in output seems to be limited to the start of the year. The outlook for the principal sectors has improved, even since the winter, with stronger global economic growth and demand for Finnish export products. The output and sales expectations of enterprises are favourable in industry, construction and the service sectors. Accomodative monetary policy stance and high capacity utilisation rates are boosting the growth of global investment, and thus also resuscitating Finnish export industries.

The current year looks set to be very strong compared to recent years from a cyclical perspective, but restructuring of demand, especially in the paper industry, is retarding growth of the sector despite the increase in export demand. Total value added will grow by almost three per cent this year, but this growth will level out at 1½ per cent in 2018 and 2019.



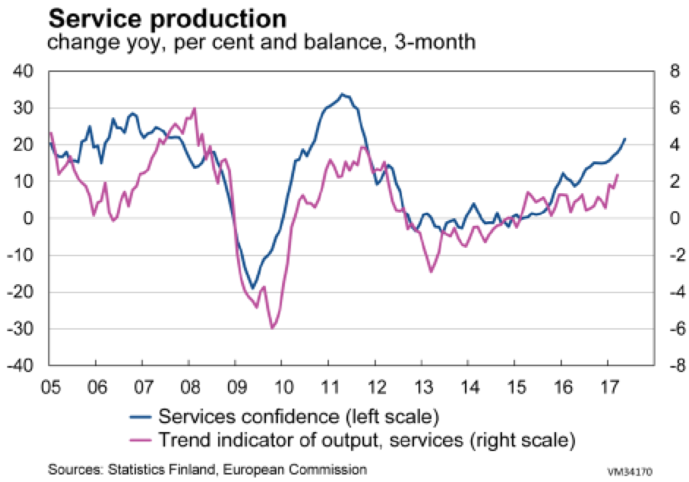
Output grew more rapidly in the first quarter of 2017 than in the previous year in all major sectors. After many years of recession, the most rapid growth was achieved in industrial output, with an increase of eight per cent in value added in the first quarter compared to the same period of the previous year. New orders led to particularly rapid growth in the metal industry, and export orders also increased output in the forest and chemical industries. The outlook is also rosier for the textile and food industries, meaning that growth will continue to be broadly based.

A recovery of export demand, improved cost competitiveness, increases in production capacity and the efforts of enterprises to make their products more competitive will boost industrial output in the coming years. Even though value added from industry will grow by more than six per cent due to the strong start to the year, growth will stabilise at about two per cent next year and in the following year.



Construction output was the engine of economic growth last year, with a further quickening of growth in the first quarter due to an eight per cent year-on-year increase in value added from construction. The growth rate will nevertheless fall over the year as a whole after passing the early year peak of new building construction starts – particularly in multi-storey residential buildings – and growth will stabilise in construction generally. Growth in output is constrained by a shortage of construction sites in the Helsinki Metropolitan Area and by the availability of skilled labour for work in specific enterprises.

Growth in business and office construction will nevertheless accelerate as building permits granted for have increased. Furthermore, renovation operations continue to support the overall growth in construction. At just under five per cent, growth in value added from construction this year will fall slightly short of last year's figure. Construction will grow by about 1½ per cent in 2018 and 2019 as new building construction work levels off.



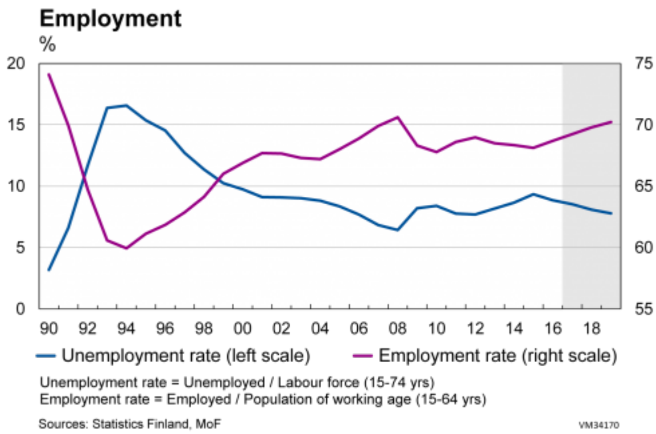
Growth in service sector output rose from just under one per cent last year to a level of just over three per cent at the start of this year. Business sales expectations continued to improve during the spring, with a clear increase forecast particularly in trading sales and in output from the transport and financial sectors. Continued rapid growth is also expected in other service sectors. Growth will be boosted both by the home market and by the rising demand of export enterprises for intermediate products. Consumer demand was also lively in the early part of the year. Service output will increase by two per cent this year, and by about 1½ per cent in 2018 and 2019 as demand from other business operations levels off and growth in demand for consumer services slows down.

Employment, prices and wages

Strengthening economic growth improves employment

A broad and rapid economic recovery brought an upswing in employment during the spring of 2017, with an increase of 0.6 per cent in the number of people in work in January-April compared to the previous year. Despite the increase in annual working time agreed in the Competitiveness Pact, the number of hours worked grew by only 0.5 per cent at the start of the year. Growth in job vacancies has slowed at the start of the year, but the number of vacancies has remained high. Broadly based economic growth will increase employment by 0.6 per cent year-on-year in 2017 pushing the employment rate to over 69 per cent.

The Labour Force Survey of Statistics Finland shows an unexpected slight increase in unemployment at the start of 2017, with a rise in the unemployment rate trend to 8.9 per cent in April. The Employment Service statistics of the Ministry of Economic Affairs and Employment nevertheless indicate that unemployment fell in all sectors and in all age and occupational groups at the start of the year. The slight rise in the unemployment rate would seem to be due to the activation of disguised unemployed, which is normal when the economic climate improves. Accelerating economic growth will restore the downward path of unemployment, with an unemployment rate of 8.5 per cent forecast for 2017.



Moderate sustained growth of GDP in 2018 and 2019 will further improve employment, while reducing joblessness. Employment is forecast to improve by 0.6 per cent in 2017 and 0.5 per cent in 2018, meaning that the employment rate will slightly exceed 70 per cent by 2019.

Activation of disguised unemployed will slow the fall in the official unemployment rate over the next few years, and the large pool of underemployed workers may similarly retard improvement in official employment figures if the demand for labour is partly absorbed by this section of the workforce without increasing the number of people in work. Unemployment will accordingly remain fairly high despite greater economic growth throughout the forecast period. The unemployment rate will fall to 8.1 per cent in 2018 and to 7.8 per cent in 2019.

Although the number of long-term unemployed is still very high, the trend is now clearly falling in all age groups. The number of long-term and structural unemployed can be expected to decline still further with stronger economic growth.

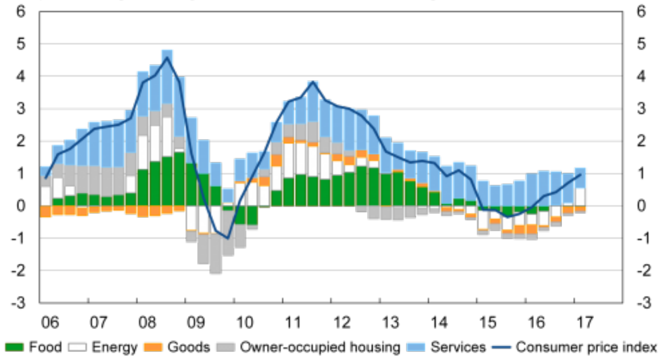
Various regional and occupational mismatching problems between jobseekers and vacancies continue to hamper the employment situation, but it appears that these problems are no longer increasing, with Employment Service statistics of the Ministry of Economic Affairs and Employment indicating a fall in unemployment in all geographical regions and vocational groups at the start of 2017. The large number of vacancies has thus begun to reduce unemployment, meaning that the problem of labour market mismatching has eased.

Consumer prices

The National Consumer Price Index increased by 1.0 per cent year-on-year in the first quarter of 2017 indicating renewed, though still slower than normal growth in consumer prices. Inflation was boosted at the start of the year by energy prices, which rose by 9.4 per cent in the first quarter year on year. A corresponding rise of 1.3 per cent occurred in service prices. On the other hand, the price of goods fell by 0.4 per cent and processed food prices were 0.2 per cent lower. The prices of unprocessed food remained almost unchanged year on year in the first quarter of 2017.

The inflation forecast for this year is 1.0 per cent, as measured by the national consumer price index. The rate of inflation depends especially on the price of crude oil, with a positive bottom effect affecting the index this year. This effect will nevertheless deteriorate towards the end of the year, as the world market price of crude oil is expected to rise only moderately. The impact of energy prices on inflation will still remain positive throughout the forecast period from 2017 to 2019.

Consumer price index
percentage change and contribution to change



Sources: Statistics Finland, MoF

Service prices are expected to increase by about 1.4 per cent this year, which is clearly slower than the rate of increase in 2016. This will depend on such factors as the wage freezes agreed for this year in the Competitiveness Pact, and on a lower rate of rent increases. Service inflation was boosted by increases in health care service charges last year that will not recur to the same extent this year.

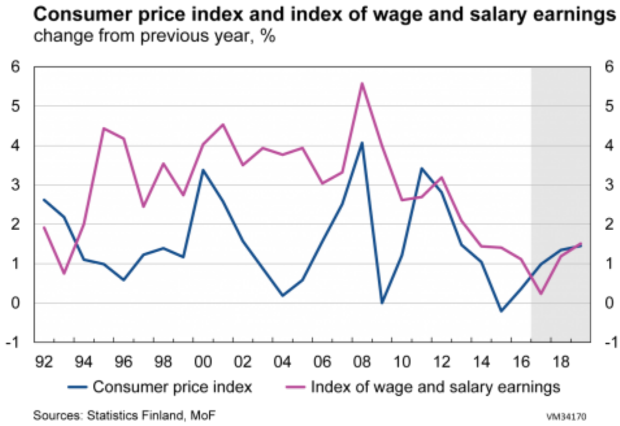
The price trend in foodstuffs will remain moderate this year owing to such factors as the abolition of sweets tax as of the start of the year. The prices of goods depend on import prices, which have begun to rise again in 2017 following a sustained period of decline. A slight upturn in product prices is accordingly expected towards the end of the year, but the annual average growth will still remain negative. The inflationary impact of tax increases in 2017 is estimated at 0.2 percentage points. This will be affected by increases in motor vehicle, fuel and tobacco taxes, but on the other hand the abolition of sweets tax and a reduction in car tax will tend to reduce inflation.

The rate of inflation as measured by the national consumer price index is expected to increase to 1.3 and 1.4 per cent in 2018 and 2019 as economic growth continues. Although the rise in consumer prices will be more broadly based this year, rising service prices will continue to exert the greatest impact on overall inflation. A moderately rising oil price, strengthening US dollar and low but increasing interest rates are expected to accelerate inflation over the forecast period.

At 1.8 per cent, euro area inflation in the first quarter of 2017 reached its highest level in four years, as measured by the Harmonized Index of Consumer Prices. The increased pace of inflation was due in particular to the rise in energy prices and its indirect effects. Price pressures in other respects have remained moderate and base inflation is still low, although euro area economic growth is gradually strengthening. Expert estimates at the European Central Bank suggest that euro area inflation will be 1.5 per cent this year. Growth will decline to 1.3 per cent in 2018, and rise again to 1.6 per cent in 2019. A corresponding forecast of inflation in Finland prepared by the Finnish Ministry of Finance using the Harmonized Index of Consumer Prices suggests rates of 1.1 per cent in 2017, 1.3 per cent in 2018, and 1.4 per cent in 2019.

A very moderate rise in earnings

Nominal earnings increased by 1.1 per cent in 2016, as measured by the index of wage and salary earnings. The increase in negotiated wages was 0.6 per cent, while other factors increased the index by 0.5 per cent.



The main factor determining the growth of earnings in 2017 will be the Competitiveness Pact negotiated by the social partners. There will be no increase in negotiated wages, and public sector holiday bonuses will be cut by 30 per cent. The estimated combined impact of these factors is an average fall of 0.3 per cent in negotiated wages. The forecast of growth in earnings assumes that factors other than contracted pay rates will increase earnings by 0.5 per cent, meaning that nominal earnings are expected to rise by 0.2 per cent in 2017.

The rise in earnings is forecast to remain moderate, with increases of 1.2 per cent in 2018 and 1.5 per cent in 2019. This is still lower than the average for the 2000s, and consistent with high employment.

Public finances

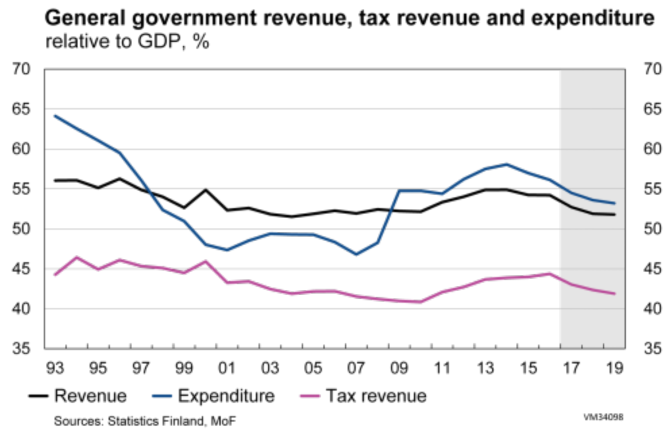
Economic growth to strengthen public finances in coming years

Finland's general government deficit has declined in recent years. Although the favourable economic cycle will increase general government revenues, the ageing population will inevitably increase public spending over the forecast period. General government finances will remain in deficit towards the end of the decade despite scheduled consolidation measures and a recovery of economic growth. The favourable economic cycle will not resolve the structural problems of public finances, and it will not be enough to ensure sustainable public finances in the long run. The public debt ratio will stay at a high level over the next few years.

The summer 2017 public finances forecast of the Finnish Ministry of Finance technically consolidates the county government that is due to begin in 2019 into the central government. This means that expenditures and revenues corresponding to the functions assigned to the purview of counties will be transferred from local government to the central government. Statistics Finland will decide on the sector classification of regional government units in national accounts at a later date. The reform will impair central government finances, but slightly improve local government balance. The impact assessment is based on a technical assumption regarding the structure and level of expenditure.

The data published by the Finnish State Treasury indicates that central government deficit remained at roughly the level of the previous year in January-April. The tax cuts associated with the Competitiveness Pact will reduce tax revenues, which are on the other hand increased by the stronger economic growth. The first supplementary budget for the current year adds EUR 300 million in budgeted expenditure. The net borrowing requirement for the budget economy this year is EUR 5.4 billion. Though improving over the forecast period, the central government balance will remain in deficit.

Government debt amounted to EUR 102 billion at the end of last year, and is set to reach approximately EUR 108 billion by the end of this year. The debt ratio will stay at a high level over the next few years. Interest payments on government debt remain moderate due to low interest rates. In addition to the debt, the government has guarantee liabilities that have already risen to EUR 46 billion.



The local government budgetary position will remain at approximately last year's level. Growth in the need for services resulting from the changing age structure of the population will increase local government health care and long term care expenditures until the reform of social services, health care and regional government takes effect. Consumption expenditure will nevertheless even show a slight fall over the current year due to planned government consolidation measures, and to the holiday bonus cut, reduction in employer social security contributions and longer of annual working hours agreed in the Competitiveness Pact. There is some uncertainty nevertheless attached to the savings arising from longer working hours, as this will require exploiting employee retirement and staff turnover when work is reorganised.

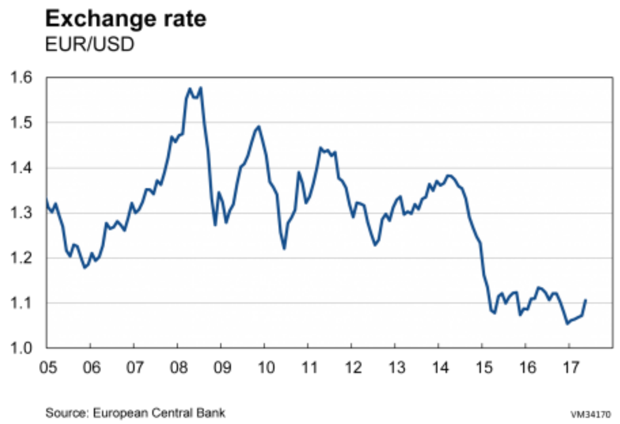
A moderate upturn in growth of local government consumption expenditure is expected next year. Consumption expenditure will be halved in 2019 when responsibility for financing social and health services and fire and rescue operations is assigned to county administration following the reform of social services, health care and regional government. The forecast for local government finances does not take into account local authorities' own additional adjustment measures for 2018–2019.

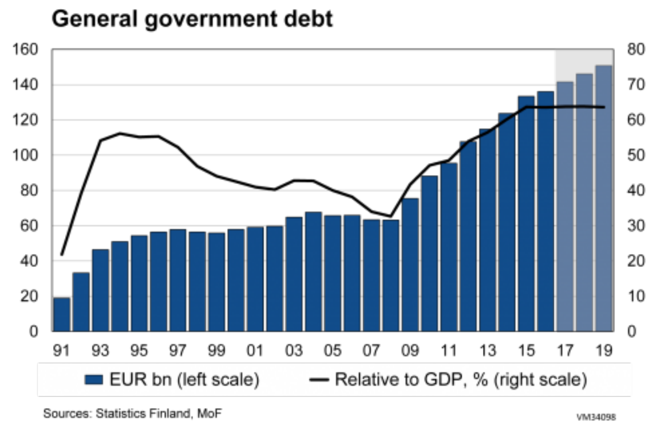
Local government revenues will grow modestly over the next couple of years. Government consolidation measures affecting local authorities will reduce statutory government transfers over the forecast period. The modest growth in tax revenues for the current year is explained by the holiday bonus cut agreed in the Competitiveness Pact and by the increase in employee social security contributions. Local government tax revenues will increase slightly in 2018, but fall to about half of the current level in 2019 when the reform of social services, health care and regional government takes effect.

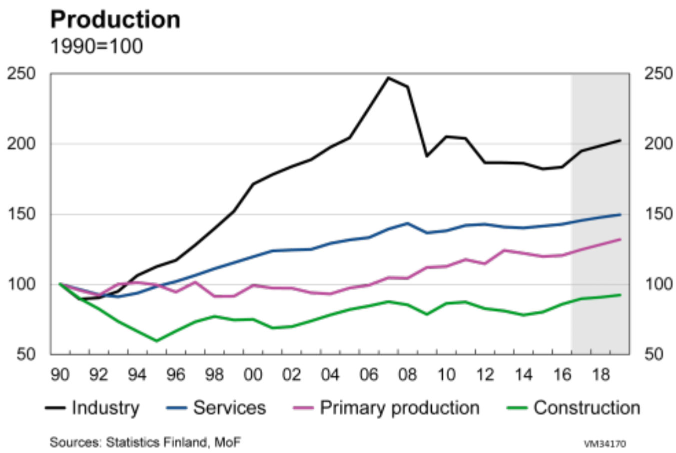
Gradual attrition of the surplus held by employment pension schemes will continue over the forecast period, with the surplus reaching a level of less than 0.5 per cent of GDP in 2019. Earnings-related pension expenditure will continue to increase rapidly as the number of pensioners increases and the average pension level rises. Moderate wage growth will retard the increase in insurance contributions. The revenue-building effect of the 0.4 percentage point increase in the private sector earnings-related pension contribution will be nullified due to declining public sector contributions as of the start of the year. The property income of employment pension institutions will show a moderate upturn over the forecast period while remaining low due to low interest rates.

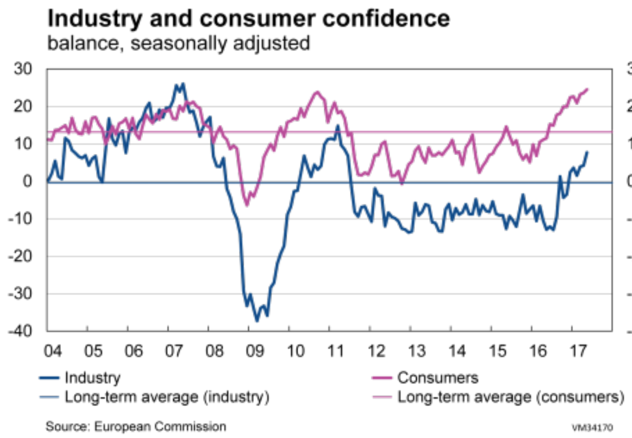
Other social security funds mainly comprise the Unemployment Insurance Fund and the Social Insurance Institution of Finland (Kela). Falling unemployment costs will moderately increase the slight surplus of this sector over the forecast period as government savings decisions curb growth in outlays by other social security funds. If unemployment falls as expected and the unemployment insurance contribution remains unchanged, then the Unemployment Insurance Fund will be able to pay off its debt and accumulate assets in its cyclical buffer fund to offset future unemployment spending.

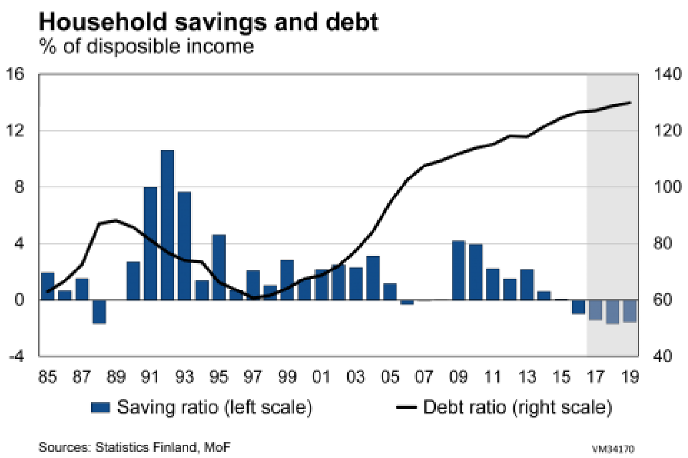
Additional graphs

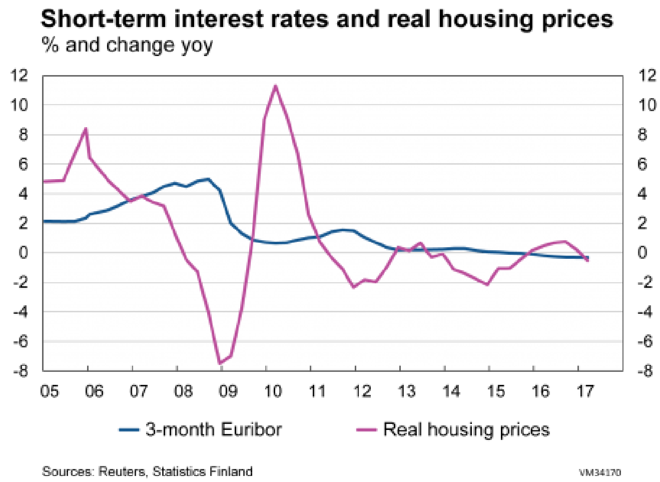












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