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Economic Survey

Summer 2019

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Economic Prospects

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Economic Survey

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<p>Abstract</p> <p>Over the next few years, the Finnish economy will grow at a more moderate rate than in recent years. Slower growth in world trade will be reflected in Finnish export growth during the forecast period. Finland's general government budgetary position will strengthen next year but will gradually weaken after that. The general government debt to GDP ratio will also start increasing again in the early years of the 2020s.</p> <p>The summer 2019 macroeconomic forecast prepared by the Ministry of Finance does not include the economic policy measures for the period 2020-2023 outlined in the Government Programme of Prime Minister Rinne's Government.</p> <p>Finland's GDP is expected to grow by 1.6% in 2019. Even though the outlook for exports and the world economy is now more subdued, there will not be any substantial weakening in the outlook for Finland's export industries in the early part of the forecast period. The growth of private investments is expected to decelerate while public investments will continue to grow. The outlook for production investments is bright. Private consumption growth is supported by higher earnings and a higher employment rate. Household disposable income will continue to grow at a rapid rate.</p> <p>In 2020, GDP will grow by 1.2 %. A slowdown in economic growth and a rise in nominal wages will gradually weaken employment growth. Further decline in the working-age population will push the employment rate to 73.5% by 2021. However, economic growth alone will not push the employment rate to 75% without significant additional measures. In 2021, economic growth will slow down to 1.1%.</p> <p>As unemployment is falling and the mismatch between labour supply and demand is increasing, the rate of growth in earnings is expected to approach the annual rate of three per cent, the average for the past 19 years.</p>			
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Tiivistelmä	<p>Taluskasvu jää viime vuosia maltillisemmaksi tulevien vuosien aikana. Maailmankaupan hitaampi kasvu heijastuu Suomen viennin kasvuun ennustejakson lopulla. Julkisen talouden rahoitusasema vahvistuu ensi vuonna, mutta alkaa sen jälkeen vähitellen heikentyä. Myös julkinen velka suhteessa bruttokansantuotteeseen kääntyy 2020-luvun alkuvuosina uudelleen kasvuun.</p> <p>Valtiovarainministeriön kesän 2019 kokonaistaloudellinen ennuste ei sisällä pääministeri Rinteen hallituksen hallitusohjelmassa linjattuja talouspoliittisia toimenpiteitä vuosille 2020-2023.</p> <p>Vuonna 2019 Suomen BKT kasvaa 1,6 %. Vaikka näkymät vientimarkkinoilla ja maailmantaloudessa ovat heikentyneet, Suomen vientiteollisuuden näkymät eivät ennustejakson alkupuolella heikkene merkittävästi. Yksityisten investointien kasvun arvioidaan hidastuvan ja julkisten investointien kasvu jatkuu nopeana. Tuotannollisten investointien näkymät ovat valoisat. Kulutuksen kasvua tukee ansiotason nousu sekä työllisyyden koheneminen. Kotitalouksien käytettävissä olevien tulojen kasvu pysyy nopeana.</p> <p>Vuonna 2020 BKT: kasvaa 1,2 %. Taluskasvun hidastuminen ja nimellispalkkojen nousu alkavat asteittain heikentää työllisten määrän kasvua. Työllisyysaste nousee 73,5 prosenttiin vuoteen 2021 mennessä työikäisen väestön edelleen vähentyessä. Talouden kasvu ei kuitenkaan riitä nostamaan työllisyysastetta 75 prosenttiin ilman merkittäviä lisätoimia. BKT:n kasvu hidastuu 1,1 prosenttiin v. 2021.</p> <p>Työttömyysasteen laskiessa ja työvoimakapeikkojen lisääntyessä ansiotason nousun arvioidaan lähestyvän lähivuosina 2000-luvun keskimääräistä, noin kolmen prosentin vuosittaista kasvuvauhtia.</p>		
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Referat	<p>Under de kommande åren blir den ekonomiska tillväxten mer måttfull än de senaste åren. Världshandelns långsammare tillväxt avspeglas i exporttillväxten i Finland under prognosperioden. Saldot i de offentliga finanserna stärks nästa år, men börjar därefter gradvis försvagas. Även den offentliga skulden i förhållande till bruttonationalprodukten börjar öka på nytt under de första åren på 2020-talet.</p> <p>Finansministeriets övergripande ekonomiska prognos sommaren 2019 innehåller inte de finanspolitiska åtgärder för perioden 2020–2023 som fastställts i regeringsprogrammet av statsminister Rinnes regering.</p> <p>År 2019 förutspås Finlands BNP växa med 1,6 procent. Utsikterna för Finlands exportindustri försämras inte märkbart i början av prognosperioden, trots att utsikterna på exportmarknaderna och för den globala ekonomin har försämrats. Tillväxten av privata investeringarna förväntas börja avta och de offentliga investeringarna fortsätter att öka snabbt. Utsikterna för de produktionsmässiga investeringarna är ljusa. Den stigande inkomstnivån och förbättrande sysselsättningen understöder ökningen av privata konsumtionen. Hushållens disponibla inkomster fortsätter att öka snabbt.</p> <p>År 2020 växer BNP med 1,2 procent. Den avtagande ekonomiska tillväxten och ökningen av de nominella lönerna bidrar stegvis till att ökningen av antalet sysselsatta mattas av. Sysselsättningsgraden stiger till 73,5 procent före 2021 då befolkningen i arbetsför ålder minskar ytterligare. Den ekonomiska tillväxten räcker ändå inte till att höja sysselsättningsgraden till 75 procent utan omfattande åtgärder. År 2021 avtar den ekonomiska tillväxten till 1,1 procent.</p> <p>I och med att arbetslöshetsgraden sjunker och flaskhalsarna på arbetsmarknaden ökar uppskattas inkomstnivån under de närmaste åren stiga så att den närmar sig den genomsnittliga årliga tillväxttakten på cirka tre procent under 2000-talet.</p>		
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PREFACE

This Economic Survey offers projections of economic developments in 2019–2021. The forecast and trend projections in the survey are prepared independently by the Ministry of Finance Economics Department based on the Act on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and on multi-annual budgetary frameworks (869/2012).


The forecasts are based on national accounts data for 2019 published by Statistics Finland in May 2018 and on other public statistical sources available by 11 June 2019.

Helsinki June 2019


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The source for all data on materialised developments is Statistics Finland unless otherwise indicated.

SYMBOLS AND CONVENTIONS USED

-	nil
0	less than half the final digit shown
..	not available
.	not pertinent
**	forecast
CPB	CPB Netherlands Bureau for Economic Policy Analysis
HWI	Hamburgisches WeltWirtschafts Institut
IMF	International Monetary Fund
MoF	Ministry of Finance

Each of the figures presented in the tables has been rounded separately.

Contents

Preface	7
----------------------	---

Summary	11
----------------------	----

1 Economic outlook	22
---------------------------------	----

1.1 Global economy	22
--------------------------	----

1.2 Foreign trade.....	27
------------------------	----

1.2.1 Exports and imports.....	27
--------------------------------	----

1.2.2 Prices and current account	28
--	----

1.3 Domestic demand.....	30
--------------------------	----

1.3.1 Private consumption	30
---------------------------------	----

1.3.2 Public consumption.....	35
-------------------------------	----

1.3.3 Private investment.....	37
-------------------------------	----

1.3.4 Public investment	40
-------------------------------	----

1.4 Domestic production.....	40
------------------------------	----

1.4.1 Total output.....	40
-------------------------	----

1.4.2 Secondary production.....	43
---------------------------------	----

1.4.3 Services	47
----------------------	----

1.5 Labour force	48
------------------------	----

1.6 Incomes, costs and prices.....	54
------------------------------------	----

1.6.1 Wages and salaries	54
--------------------------------	----

1.6.2 Consumer prices	55
-----------------------------	----

2 Public finances	58
--------------------------------	----

2.1 General government finances.....	58
--------------------------------------	----

2.2 Central government.....	62
-----------------------------	----

2.3 Local government.....	65
---------------------------	----

2.4 Social security funds.....	69
--------------------------------	----

Boxes

Economic policy measures set out in the Government Programme.....	19
---	----

There will be further rises in household debt.....	33
--	----

The effects of an increase in the labour market matching efficiency.....	52
--	----

Summary

Economic outlook for 2019-2021

Over the next few years, the Finnish economy will grow at a more moderate rate than in recent years. Slower growth in world trade will be reflected in Finnish export growth during the forecast period. The outlook for Finland's key export markets has weakened even though from the next year onwards, export demand will again pick up.

In the medium term (2022-2023), due to structural factors affecting the economy, economic growth will slow down to under one per cent. A decrease in working-age population will be followed by a contraction in labour input. High structural unemployment is also limiting the growth of labour input.

Finland's general government budgetary position will strengthen next year but will gradually weaken after that. The general government debt to GDP ratio will also start increasing again in the early years of the 2020s.

The summer 2019 macroeconomic forecast prepared by the Ministry of Finance does not include the economic policy measures for the period 2020-2023 outlined in the Government Programme of Prime Minister Rinne's Government.

World trade growth slows down temporarily

World trade will grow at a considerably slower rate this year than in 2018. The slowdown is largely a result of the trade conflict between the United States and China but economic growth has continued, supported by domestic demand. World economic growth will slow down from 3.6% in 2018 to 3.3% this year.

There was a sharp slowdown in world trade growth during the last months of 2018 and the growth will decelerate to 2.5% this year. The better-than-expected growth figures for the first months of 2019 indicate that world trade is picking up again.

Economic growth in the United States was stronger than expected during the first quarter of this year, following weak performance during the last months of 2018. However, growth will slow down from last year because it is no longer supported by private consumption contribution in the same way as in 2018. Total output growth will slow down from last year's 2.9% to 2.3% in 2019 and to 2.1% in 2020.

Chinese economic indicators suggest that the slowdown will continue. Slowdown in retail trade, reflecting trends in private consumption, has continued for some time. Export outlook for the next few years is overshadowed by the continuing trade conflict with the United States. The Chinese government has introduced stimulating fiscal policy measures to boost economic growth. Growth will, however, remain slightly below six per cent during the forecast period.

The outlook for the euro area weakened during 2018. Many European economies posted better-than-expected growth figures for the first quarter of this year. Growth in major economies is supported by domestic demand as the outlook for exports remains modest. Growth in the euro area will slow down to 1.2% this year but will accelerate to slightly more than 1.5% in the next few years.

In the United States, the fact that consumer price inflation has remained under the target set by the central bank has fuelled expectations of lower key interest rates. Short-term market rates in the euro area are expected to remain at low levels as the expectations of higher key interest rates have not materialised. Interest rates on government loans in the euro area have remained low. The only exception is Italy where political tensions have caused the rates to rise.

Weaker outlook for foreign trade

Finland's GDP is expected to grow by 1.6% in 2019. The volume of exports will grow by 2.9%, mainly due to deliveries of ships. Growth in other industrial sectors will be modest. Exports of services will again grow at a slightly faster rate. The demand for Finnish exports will only grow by 1.8% in 2019, primarily due to a weaker outlook in Europe. Even though the outlook for exports and the world economy is now more

subdued, there will not be any substantial weakening in the outlook for Finland's export industries in the early part of the forecast period.

Housing investments will fall but the outlook for production investments is bright. Private investments are expected to go into decline during 2019, while public investments will continue to grow. Public investments are the main factor boosting non-residential building construction and civil engineering construction.

Growth in private consumption will remain steady in 2019 even though real household disposable income will increase by almost 3%. According to Statistics Finland, private consumption contracted during the first quarter. In 2019, private consumption will be boosted by higher earnings and a higher employment rate. Household disposable income will continue to grow at a rapid rate.

The number of employed people will increase by 1.1% in 2019, even though about half of this growth was already achieved during the last quarter of 2018. The employment rate for the whole of 2019 is expected to be at 72.6%.

However, there has not been any further fall in unemployment during the early months of 2019 and the seasonally adjusted unemployment rate has remained at 6.6% since January. Driven by growth in employment, unemployment will continue to fall in 2019. The projected unemployment rate for 2019 is 6.6%.

Agreement-based pay increases will be higher in 2019 and the wage drifts coming on top of them are expected to grow faster than in 2018. As a result, nominal earnings will rise by 2.7%. As the employment rate is rising, the total wage bill is expected to grow by 3.8% this year.

The projected inflation rate for 2019 is 1.2%. As a whole, inflationary pressures are higher than last year but the impact of tax increases will be lower this year than in 2018. As earnings are rising, prices of services are again expected to increase more rapidly than in 2018. However, as in 2018, prices of goods will have a negative impact on inflation and as a result, baseline inflation will remain moderate.

In 2020, economic growth will slow down to 1.2%. In line with export demand, exports will grow at a moderate rate. There will not be any increase in Finland's share of world exports. The rate of export growth will slow down towards the end of the forecast period and Finland's share of the world markets will shrink.

Finland's foreign trade surplus will reach almost EUR 1.5 billion towards the end of the forecast period but the service account deficit will persist, amounting to more than EUR 2.5 billion euros throughout the period. The current account will continue to show a deficit because there will not be any reduction in the deficit in factor incomes and current transfers. In addition to current transfers, the primary income account will also be slightly in the deficit in the forecast period.

The outlook for production investments is fairly bright even though they will grow only modestly this year. A large number of billion-class projects are planned in Finland. Private consumption will grow as the growth in earnings accelerates. Despite slower growth in the number of employed people, the total wage bill will grow at the same rate as this year.

A slowdown in economic growth and a rise in nominal wages will gradually weaken employment growth. A situation where unemployment is falling to the levels experienced during the cyclical peak before the financial crisis will tighten the labour market, which in turn will create more pressures for wage increases and give rise to labour bottlenecks in the Finnish economy.

In 2021, Finland's GDP will grow by 1.1%. Decrease in housing investments will slow down the overall growth in private investments. As a result, private investments will grow at an average rate of only 1.2%. Their GDP ratio will remain unchanged, at slightly more than 18%.

Private consumption growth will remain stable, despite a moderately faster inflation rate. Boosted by further increases in earnings, real income will continue grow at a rapid rate. As a whole, inflationary pressures are expected to grow only slowly in the later years of the forecast period. The rise in earnings is expected to gradually have a broader impact on prices and consumer demand will grow steadily.

Further decline in the working-age population will push the employment rate to 73.5% by 2021. However, economic growth alone will not push the employment rate to 75% unless the Government takes measures in addition to those that have already been introduced.

As unemployment is falling and the mismatch between labour supply and demand is increasing, the rate of growth in earnings is expected to approach the annual rate of three per cent, the average for the past 19 years.

Without new measures to boost employment, Finland’s public finances will gradually deteriorate

The steady growth of the Finnish economy for the past three years has improved the state of general government finances. Finland’s general government budgetary position will continue to strengthen next year but will gradually weaken after that. The general government debt to GDP ratio will also start increasing again. Finland’s general government finances are burdened by a rise in expenditure resulting from an ageing population.

Despite steady economic growth, central and local government expenditure exceeds the revenue. The combined central and local government deficit will reach EUR 4.9 billion by the year 2023. Only employment pension institutions will post a surplus towards the end of the Government term.

The summer 2019 macroeconomic forecast prepared by the Ministry of Finance does not include the economic policy measures for the period 2020-2023 outlined in the Government Programme of Prime Minister Rinne’s Government, which took office on 6 June 2019. The measures set out in the Government Programme will be considered in the forecasts as the decisions on them become more specific and their effects can be verified.

Table 1. Key forecast figures

	2018	2016	2017	2018	2019**	2020**	2021**
	EUR bn	change in volume, %					
GDP at market prices	234	2.8	2.7	2.4	1.6	1.2	1.1
Imports	92	5.4	3.8	3.8	1.9	2.6	1.9
Total supply	326	3.5	2.9	2.8	1.7	1.6	1.3
Exports	91	3.5	7.7	1.5	2.9	2.9	2.0
Consumption	178	2.1	0.7	1.4	1.3	1.3	1.2
private	125	2.2	1.2	1.4	1.5	1.6	1.7
public	53	1.8	-0.4	1.4	0.7	0.4	0.3
Investment	53	8.6	4.3	3.2	0.9	0.5	0.5
private	43	8.7	4.8	3.3	0.4	1.8	1.2
public	10	8.0	2.4	3.0	3.3	-5.3	-2.5
Total demand	323	3.3	3.3	2.0	1.6	1.5	1.2
domestic demand	233	3.3	1.8	2.2	1.1	0.9	0.9

Table 2. Other key forecast figures

	2016	2017	2018	2019**	2020**	2021**
GDP, EUR bn	216	224	234	242	250	258
Services, change in volume, %	1.9	1.7	1.8	1.4	1.3	1.2
Industry, change in volume, %	2.7	6.5	2.5	2.9	1.9	1.7
Labour productivity, change, %	2.1	1.9	-0.5	0.6	0.9	0.9
Employed labour force, change, %	0.4	1.1	2.6	1.1	0.5	0.3
Employment rate, %	68.7	69.6	71.7	72.6	73.2	73.5
Unemployment rate, %	8.8	8.6	7.4	6.6	6.3	6.2
Consumer price index, change, %	0.4	0.7	1.1	1.2	1.5	1.7
Index of wage and salary earnings, change, %	0.9	0.2	1.7	2.7	3.3	3.1
Current account, EUR bn	-1.6	-0.7	-4.4	-3.6	-3.6	-3.6
Current account, relative to GDP, %	-0.7	-0.3	-1.9	-1.5	-1.4	-1.4
Short-term interest rates (3-month Euribor), %	-0.3	-0.3	-0.3	-0.3	-0.2	0.1
Long-term interest rates (10-year govt. bonds), %	0.4	0.5	0.7	0.3	0.6	1.1
General government expenditure, relative to GDP, %	55.9	54.2	53.1	52.8	52.3	52.2
Tax ratio, relative to GDP, %	44.0	43.3	42.4	42.2	42.2	42.0
General government net lending, relative to GDP, %	-1.7	-0.8	-0.7	-0.6	-0.3	-0.4
Central government net lending, relative to GDP, %	-2.7	-1.8	-1.2	-0.7	-0.7	-0.7
General government gross debt, relative to GDP, %	63.0	61.3	58.9	58.3	57.8	58.1
Central government debt, relative to GDP, %	47.4	47.2	44.9	44.2	43.4	43.2

Under the Government Programme, balancing Finland's general government finances by the year 2023 in a situation where the world economy grows at a normal rate is one of the key targets for the current Government term. This objective can only be met if Finland achieves the employment rate target of 75% set by the Government.

Risks inherent in the economic growth

Intensification of the trade conflicts is the key downside risk in the economic outlook. The risk is heightened by the unpredictability of the US trade policy. A hard Brexit would weaken the outlook for Europe. If the risks inherent in the Italian economic policy are realised, the effects may be felt in the entire euro area. Heightening of geopolitical tensions would lead to higher crude oil prices.

Lowering of the trade tensions is probably the most important positive risk. Domestically the role of large projects as a risk factor for the investment forecast is highlighted in the long run. Without the decisions to launch major projects, investments would grow at a substantially slower rate and if most of the projects are initiated, the forecast would be too cautious.

Medium-term outlook

Finland's gross domestic product grew by more than two per cent in 2018. This year, growth is projected to slow down to around one and a half per cent. In 2020 and 2021, growth will continue at a moderate rate of just over one per cent. In the medium term, between 2022 and 2023, economic growth is expected to fall below one per cent.¹ In historical terms, the growth expected for the medium term is slow, which is a result of the structural factors affecting the economy.

The growth in labour input boosts potential output growth in the current and, to some extent, also in the next year. After this, there will be a gradual reduction in labour input because working-age population continues to fall. High structural unemployment is also a factor limiting the growth in labour input.

In historical terms, growth in total factor productivity has been modest in recent years and this trend will continue. The output of high-productivity sectors has declined and services have become more predominant in the overall structure of the economy. Total factor productivity growth trend is expected to be close to one per cent in the medium term, which can be compared with an average annual growth of more than two per cent in the early years of the 2000s. The predicted total factor productivity growth trend is nevertheless well above the average of the past ten years.

¹ The medium-term economic outlook can be estimated on the basis of the potential output, which is considered to define the growth potential for the economy. In its assessments of potential output, the Ministry of Finance uses the production function method jointly developed by the European Commission and EU Member States, in which potential output growth is divided into projections of potential labour input, capital and total factor productivity. Potential output and output gap are latent variables, the assessment of which involves uncertainties, especially during a strong economic cycle and under conditions of rapid changes in the production structure.

In addition to labour input and total factor productivity, the production conditions of the economy are also influenced by the capital stock. The low investment rate that continued for several years slowed down capital stock growth and thus weakened the growth potential of the economy. Investments have picked up and the rise in the rate of investment will also increase potential output by an annual rate of about half a per cent through capital stock growth.

The output gap is expected to be about half a per cent positive relative to potential output in 2019. Finland's gross domestic product will grow at a slightly slower rate than potential output in the period 2020-2021, when the positive output gap is expected to start closing. In the medium term, the positive output gap is expected to close as the period of high economic growth will gradually come to an end. However, it is extremely difficult to predict the start of the next economic downturn.

Table 3. Key forecast figures for the medium term

	2017	2018	2019**	2020**	2021**	2022**	2023**
GDP at market prices, change in volume, %	2.7	2.4	1.6	1.2	1.1	0.9	0.7
GDP, EUR bn	224	234	242	250	258	265	272
Consumer price index, change, %	0.7	1.1	1.2	1.5	1.7	1.8	1.8
Unemployment rate, %	8.6	7.4	6.6	6.3	6.2	6.3	6.5
Employment rate, %	69.6	71.7	72.6	73.2	73.5	73.5	73.3
General government net lending, relative to GDP, %	-0.8	-0.7	-0.6	-0.3	-0.4	-0.6	-0.7
Central government	-1.8	-1.2	-0.7	-0.7	-0.7	-0.7	-0.8
Local government	-0.2	-0.8	-1.0	-0.8	-0.9	-1.0	-1.0
Social security funds	1.2	1.3	1.1	1.3	1.2	1.1	1.1
Structural balance, relative to GDP, %	-0.5	-0.8	-1.0	-0.4	-0.5	-0.7	-0.7
General government gross debt, relative to GDP, %	61.3	58.9	58.3	57.8	58.1	58.6	59.4
Central government debt, relative to GDP, %	47.2	44.9	44.2	43.4	43.2	43.2	43.5
Output gap, % of potential output ¹	-0.5	0.3	0.4	0.2	0.2	0.2	0.0

¹ Estimated according the method developed jointly by the EU Commission and Member States

ECONOMIC POLICY MEASURES SET OUT IN THE GOVERNMENT PROGRAMME

The economic policy decisions of the Government Programme have not been included in the macroeconomic forecast

The Government of Prime Minister Rinne took office on 6 June 2019. The programme of the new Government was published on 3 June 2019. Under the Government Programme, the key targets for the government term are as follows: raising the employment rate to 75% by the end of 2023, balancing Finland's general government finances by the year 2023 in a situation where the world economy grows at a normal rate, and reducing inequality and income gaps. The aim is also to ensure that Finland can be put on a path towards achieving carbon neutrality by 2035.

The summer 2019 macroeconomic forecast prepared by the Ministry of Finance does not include the economic policy measures for the period 2020-2023 outlined in the Government Programme. The spending limits and the scale of the permanent changes in expenditure and taxation at 2023 level are described in the Government Programme. The scale of the one-off expenditures for the period 2020-2022 is also described in the document. The timing of the measures will, however, be specified at a future date. The economic policy measures set out in the Government Programme will be included in the macroeconomic forecasts of the Ministry of Finance as the decisions on them become more specific and their effects can be verified.

Calculation of the economic policy measures and objectives set out in the Government Programme

This box presents a calculation of how the economic policy measures and objectives contained in the Government Programme could impact Finland's general government finances if they are carried as set out in the document.

Economic policy measures and objectives set out in the Government Programme

Direct budgetary measures:

- Permanent spending increases totalling EUR 1.3 billion at 2023 levels.
- Spending limits will include a supplementary budget provision of EUR 0.1 billion and an unallocated reserve of EUR 0.1 billion at 2023 levels.
- A total of EUR 0.2 billion in expenditure will be reallocated.
- One-off expenditures totalling EUR 3.05 billion between 2020 and 2022. Most of these will be funded through property income.
- A tax package with a net impact of slightly more than EUR 0.7 billion on general government finances.

Objective requiring structural measures:

- Employment rate of 75%

As the measures set out in the Government Programme have not yet been fully specified, this calculation is based on the following assumptions:

- Half of the permanent spending increases, reallocation of expenditure and tax measures will be implemented in 2020, one quarter in 2021 and the rest in 2022.
- The one-off expenditures of about EUR 3 billion will be evenly allocated throughout the period 2020-2022.
- There will be a steady improvement in the employment rate between 2020 and 2023 so that at the end of the government term, the number of employed people will be 60,000 higher than under the baseline scenario.
- The general government expenditure arising from the measures raising the employment rate will be covered through expenditure reallocation or by including the expenditure in the permanent or one-off expenditure increases set out in the Government Programme.

Table. Economic growth required for the targeted employment rate and general government budgetary position

	2019	2020	2021	2022	2023
General government net lending. % of GDP					
baseline (Ministry of Finance. June 2019)	-0.6	-0.3	-0.4	-0.6	-0.7
baseline + direct budgetary measures	-0.6	-0.9	-1.0	-1.2	-1.0
baseline + direct budgetary measures + economic growth required for achieving the employment rate target	-0.6	-0.3	-0.1	-0.2	0.1
Employment rate. %	72.7	73.7	74.4	74.9	75.0
GDP. % change in volume	1.6	2.8	2.5	1.4	1.1
Inflation. %	1.2	1.5	1.9	1.9	1.9

Without measures raising the employment rate, general government finances would post a deficit of about one per cent relative to GDP in 2020-2023. The direct budgetary measures contained in the Government Programme will weaken general government budgetary position by about EUR 0.6 billion at 2023 level.

- The permanent spending increases, the supplementary budget provision and the unallocated reserve will increase general government expenditure by about EUR 1.5 billion compared to the spring forecast of the Ministry of Finance at 2023 level if the supplementary budget provision and the unallocated reserve are fully used.
- The tax package and the reallocation of expenditure will cover about EUR 0.9 billion of the impact of the permanent spending increases, the supplementary budget provision and the unallocated reserve.

- The Government is planning to fund most of the one-off expenditures of EUR 3.05 billion through property income. Income from the sales of property is not recorded as revenue in the national accounts. For this reason, the one-off expenditures will weaken general government budgetary position in the period 2020-2022. If the investments will end in 2022, they will have little impact on general government budgetary position in 2023.

The Government Programme target of balancing Finland's general government finances is based on raising the employment rate to 75% by the year 2023. The economic growth rate required for achieving this is analysed in the calculation. Sustainable economic growth requires a higher employment rate and higher labour productivity.

The employment rate target can only be achieved if major structural reforms boosting labour supply and demand are introduced. It requires that:

- Social partners agree on effective and adequate measures improving the match between labour supply and demand, structural unemployment is reduced and more individuals outside the labour force are activated to seek work.
- The Finnish economy and the demand for labour grow more rapidly than under the baseline scenario throughout the government term.
- Higher employment will only improve general government finances if the new jobs are created in the private sector.

The average annual GDP growth should be one percentage point faster than under the baseline scenario over the next four years so that the number of employed people would be 60,000 higher than forecast by the year 2023. Labour productivity should also grow faster than forecast.

Achieving faster economic growth would require more competition in the product market, deregulation and reforms creating more jobs. Measures boosting economic growth through job creation would also improve labour productivity. Such measures would also slow down GDP price rise. At the same time, higher indirect taxes will boost consumer price rises. The additional expenditure set out in the Government Programme will also boost demand for labour, mostly during the first years of the government term.

The employment rate target can be achieved in a variety of GDP growth scenarios. Measures substantially improving the supply of jobs might even lower labour productivity in the short term even though in the long term, they will boost economic growth and labour productivity.

1 Economic outlook

1.1 Global economy

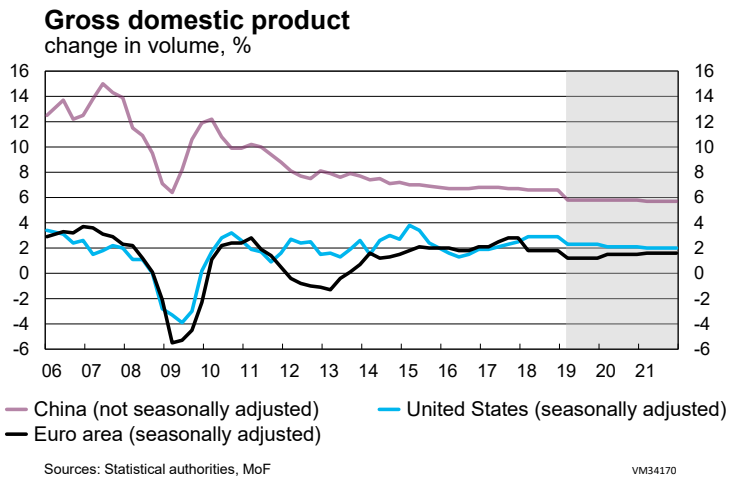
Uncertain outlook for the world economy

This year, world output will grow at a considerably slower rate than in 2018. This development is largely the result of the trade conflict between the United States and China, which is slowing down growth in world trade. In many key economies, growth is driven by domestic demand. World economic growth will slow down from 3.6% in 2018 to 3.3% this year. The better-than-expected figures for the first months of the year would indicate that a recovery is on the way but as a whole the outlook remains uncertain.

Economic growth in the United States was stronger than expected during the first quarter of this year, following a weak performance during the last months of 2018. However, growth will slow down from last year because of the waning contribution of private consumption. Consumer confidence remains strong but expectations about the future are weaker. The trade conflict with China is dampening expectations of new export orders. The fact that consumer price inflation has remained under the target set by the central bank has fuelled expectations of lower steering rates. Total output growth will slow down from last year's 2.9% to 2.3% in 2019 and to 2.1% in 2020.

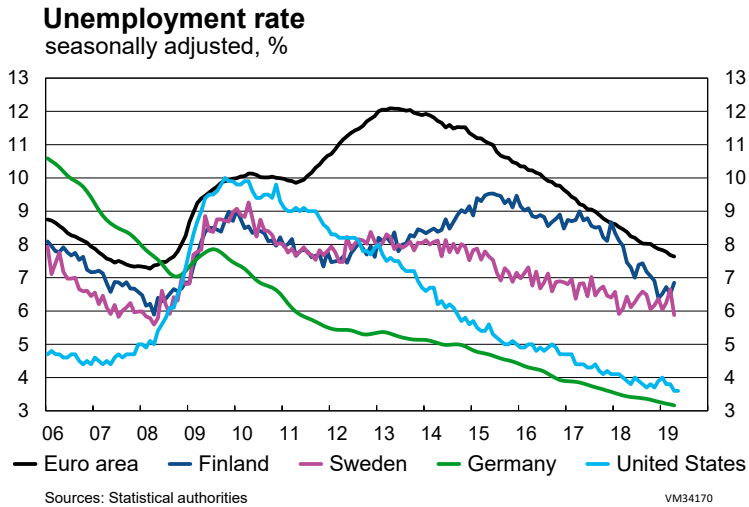
Chinese economic indicators suggest that the slowdown will continue. Slowdown in retail trade, reflecting trends in private consumption, has continued for some time. Export outlook for the next few years is overshadowed by the continuing trade conflict with the United States. The Chinese government has introduced stimulating fiscal policy measures to boost growth. Growth will, however, remain slightly below six per cent during the forecast period.

The outlook for the Japanese economy in the next few years is characterised by slow growth, which is largely due to structural factors. Inflation has not accelerated as expected, which means that the extremely light monetary policy supporting growth is expected to continue. Increase in the value-added tax in October this year is creating uncertainty. Growth will remain at slightly below one per cent in the next few years.



The outlook for the euro area weakened during 2018. There was a particularly steep fall in industrial confidence. However, many European economies posted better-than-expected growth figures during the first quarter of this year. Growth in major economies is supported by domestic demand as the outlook for exports remains modest. Growth in the euro area will slow down to 1.2% this year but will accelerate to slightly more than 1.5% in the next few years.

The uncertainty arising from Brexit is dampening growth prospects in the United Kingdom. Despite low unemployment, consumer confidence remains weak. The outlook for industry is difficult. Economic growth will remain sluggish in the coming years, at about one per cent.

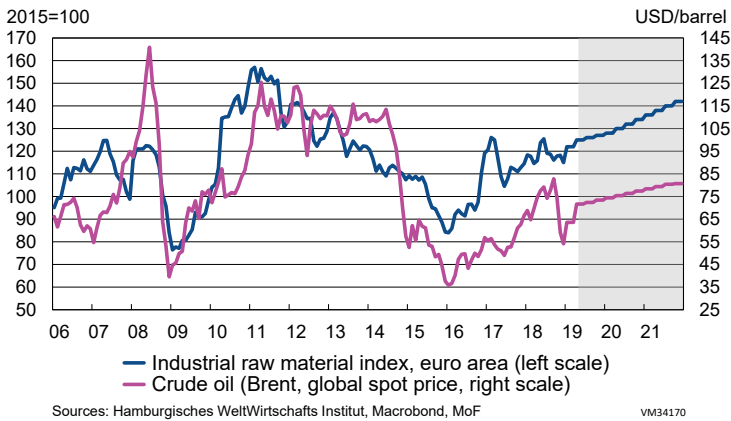


The Russian economy grew at a faster-than-expected rate in 2018. The growth potential of the economy remains modest, However, and economic outlook is hampered by sizeable structural problems, such as low capacity utilisation rate, low labour productivity and inadequacies in the business operating environment. Growth will slow down to slightly below 1.5% in the next few years.

Driven by domestic demand, the Indian economy will grow rapidly in the next few years. The positive outlook is enhanced by the structural reforms introduced over the past few years.

Crude oil prices have risen slightly from the low levels at the start of the year even though there has been a sharp fall recently. Oil prices are extremely sensitive to rapid changes. Gradual price increases can be expected in the next few years. Prices of other raw materials are expected to go up moderately in the forecast period.

Raw materials prices



Short-term market rates in the euro area are expected to remain at low levels as the expectations of higher steering rates have not materialised. Interest rates on government bonds in the euro area have remained low. The only exception is Italy where political tensions have caused the rates to rise.

World trade is overshadowed by tensions

The outlook for world trade is overshadowed by the trade conflict between the United States and China. There was a substantial slowdown in world trade growth at the end of 2018 and as a result, the growth contribution for this year will be negative. This year, world trade growth will slow down to 2.5% but a recovery is expected in the next few years.

World trade

change in volume, %



There are risks overshadowing the outlook for world economy

Spreading of trade conflicts is the key downside risk in the economic outlook. The risk is heightened by the unpredictability of the US trade policy. A hard Brexit would weaken the outlook for Europe. If the risks inherent in the Italian economic policy are realised, the effects may be felt in the entire euro area. Heightening of geopolitical tensions would lead to higher crude oil prices.

Easing of trade policy tensions is a potential positive risk.

Table 4. Gross domestic product

	2016	2017	2018	2019**	2020**	2021**
	change in volume, %					
World (PPP)	3.2	3.6	3.6	3.3	3.4	3.3
Euro area	1.8	2.4	1.8	1.2	1.5	1.6
EU	1.7	2.3	1.8	1.2	1.4	1.5
Germany	1.9	2.2	1.5	0.6	1.6	1.7
France	1.2	2.2	1.6	1.3	1.4	1.3
Sweden	1.3	2.1	2.4	1.4	1.8	1.8
United Kingdom	1.8	1.8	1.4	1.0	0.9	0.8
United States	1.6	2.4	2.9	2.3	2.1	2.0
Japan	1.0	1.9	0.8	0.9	0.8	0.7
China	6.7	6.8	6.6	5.8	5.8	5.7
India ¹	6.7	6.2	7.4	7.6	7.4	7.3
Russia	-0.2	1.6	2.3	1.4	1.3	1.2

¹ Fiscal year

Sources: Eurostat, statistical authorities, IMF, World Bank, MoF

Table 5. Background assumptions

	2016	2017	2018	2019**	2020**	2021**
World trade growth, %	1.5	5.1	3.7	2.5	3.3	3.2
USD/EUR	1.10	1.15	1.18	1.11	1.08	1.08
Industrial raw material price index, EA, € (2015=100)	96.5	114.5	118.5	124.9	131.0	139.0
Crude oil (Brent), \$/barrel	45.2	54.8	71.6	70.3	75.9	79.7
3-month Euribor, %	-0.3	-0.3	-0.3	-0.3	-0.2	0.1
Government bonds (10-year), %	0.4	0.5	0.7	0.3	0.6	1.1
Export market share (2010=100) ¹	90.0	94.0	92.0	92.0	92.0	91.0
Import prices, %	-2.2	3.8	3.6	2.4	2.4	1.8

¹ Ratio of export growth to world trade growth

Sources: Statistical authorities, CPB, HWWI, Reuters, MoF

1.2 Foreign trade

Slower growth in world trade will be reflected in Finnish export growth during the forecast period. Export demand will grow more slowly in 2019, which is primarily due to a more moderate economic growth in the euro area. The outlook for Finland's key export markets has weakened even though from the next year onwards, export demand will pick up again.

1.2.1 Exports and imports

The demand for Finnish exports will only grow by 1.8% in 2019, primarily due to a weaker outlook in Europe. In the first months of the year, there has been a decline in new orders in manufacturing in Germany and Sweden, Finland's biggest export markets. Europe accounts for a large proportion of Finland's exports, which means that the demand for Finnish exports will grow more slowly than world trade. Furthermore, world trade will only grow by 2.5% in 2019 because emerging economies are growing at a slower rate than expected.

Even though the outlook for export markets and the world economy is now more subdued, there will not be any substantial weakening in the outlook for Finland's export industries in the early part of the forecast period. However, exports will grow primarily as a result of ship deliveries in 2019. Growth in other industrial sectors will be modest. Exports of services will grow at a slightly faster rate. The volume of exports grew by 3.8% in the first quarter of 2019. Exports of both goods and services contributed to the growth even though service exports grew more rapidly. The volume of exports will grow by 2.9% in 2019.

World trade and the demand for Finnish exports are expected to pick up in 2020 and 2021. The demand for Finnish exports will grow by 2.7% in 2020 and by 2.6% in 2021. The brighter outlook for export demand is mainly due to a more rapid economic growth in Finland's most important export markets. In line with export demand, exports will, however, grow only moderately. There will not be any increase in Finland's share of world exports. The rate of export growth will slow down towards the end of the forecast period.

Functioning of the international trade system is one of the uncertainties affecting Finland's exports. The trade tensions between major economies may have an impact on world trade and, consequently, on Finland's exports. At the same time, increases in unit labour costs may have a negative impact on exports during the forecast period if costs in our competitors rise more slowly than in Finland.

The volume of imports fell by 1.9% in the first quarter of 2019. This was due to a decline in goods imports as imports of services increased substantially. During the early part of the forecast period, imports will be sustained by domestic consumer demand even though imports will grow at a substantially slower rate in 2019 than in the past few years. Imports will grow by 1.9% in 2019. Faster rise in investments in machinery and equipment at the end of the forecast period will also be reflected in imports and imports will pick up in 2020.

Table 6. Foreign trade

	2016	2017	2018	2019**	2020**	2021**
	change in volume, %					
Exports of goods and services	3.5	7.7	1.5	2.9	2.9	2.0
Imports of goods and services	5.4	3.8	3.8	1.9	2.6	1.9
	change in price, %					
Exports of goods and services	-1.9	3.3	3.8	1.9	2.1	1.8
Imports of goods and services	-2.2	3.8	3.6	2.4	2.4	1.8

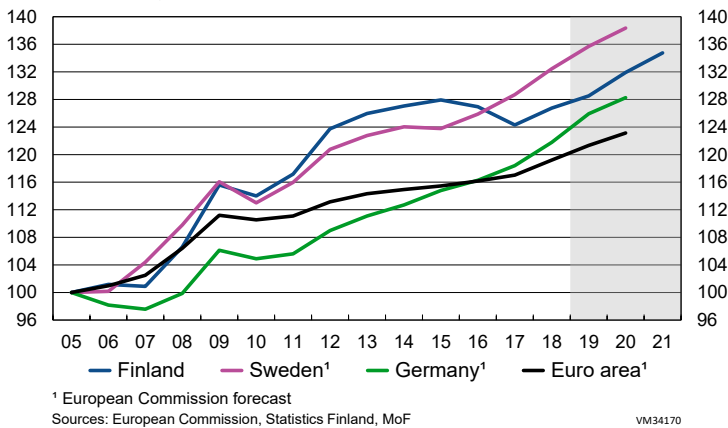
1.2.2 Prices and current account

Driven by raw material prices, import prices rose in the first quarter of 2019. Price rises in industrial raw materials and oil will lead to further increases in import prices during the forecast period. The rises in the prices of imported goods will peak in 2020 and the rate of growth will slow down in 2021.

Terms of trade weakened substantially during the first quarter of the year as prices of export goods rose only slightly. As a whole, export prices will rise at a moderate rate in the forecast period and more slowly than import prices. In 2020, export prices will rise more rapidly than in 2019, which is in line with increases in import prices. There will not be any significant weakening in the terms of trade towards the end of the forecast period.

The value of both exports and imports will increase in the forecast period, a result of higher volumes and higher prices. In 2019, the value of exports will grow faster than the value of imports, which will narrow the current account deficit. In 2020 and 2021, the value of exports and imports will grow at more or less the same rate. Finland’s foreign trade surplus will reach almost EUR 1.5 billion towards the end of the forecast period but the service account deficit will persist, amounting to more than EUR 2.5 billion euros throughout the period. The current account will continue to show a deficit because there will not be any reduction in the deficit of factor incomes and current transfers. Furthermore, in addition to current transfers, the primary income account will also be slightly in the deficit during the forecast period.

Unit labour costs
2005=100, nominal



Current account
relative to GDP, %

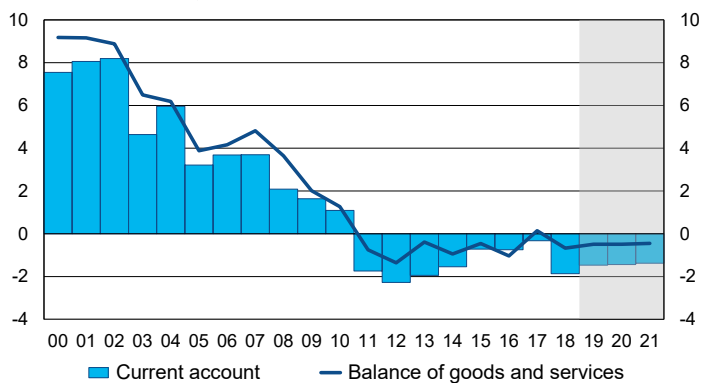


Table 7. Current account

	2016	2017	2018	2019**	2020**	2021**
	EUR bn					
Balance of goods and services	-2.2	0.3	-1.6	-1.2	-1.2	-1.2
Factor incomes and income transfers, net	0.6	-1.0	-2.8	-2.4	-2.4	-2.4
Current account	-1.6	-0.7	-4.4	-3.6	-3.6	-3.6
Current account, relative to GDP, %	-0.7	-0.3	-1.9	-1.5	-1.4	-1.4

1.3 Domestic demand

1.3.1 Private consumption

Households are saving more

Growth in private consumption will remain steady in 2019 even though real household disposable income will increase by almost 3%. According to Statistics Finland, private consumption contracted during the first quarter. The demand for durable goods in particular fell during the first months of the year as first registrations of cars decreased. There was also a year-on-year decline in the demand for services, compared to the first quarter of 2018. In fact, the household savings rate is now positive even though the rate is at historical lows.

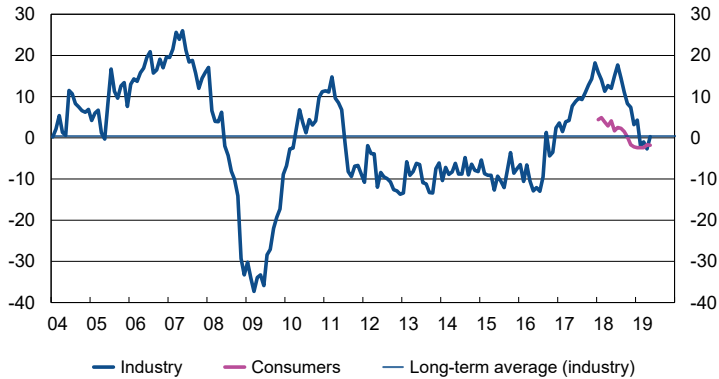
In 2019, private consumption will be boosted by higher earnings and a higher employment rate. The wage bill will increase by almost 4% and it will sustain a rapid growth in household disposable income.

Supported by disposable income, private consumption will grow in 2020. Growth in the wage bill will be sustained by a more rapid increase in earnings as the employment rate is no longer rising at the same rate as in 2019. The total wage bill will grow at the same rate as this year. Reinstatement of the public sector holiday bonuses in 2020 will temporarily accelerate the growth in earnings.

Earnings will continue to grow at a rapid rate in 2021. However, there will be a slight slowdown in wage bill growth as the employment rate is no longer growing as rapidly as in 2020. This will also slow down the growth in household disposable income. However, there will not be any slowdown in the growth of private consumption. Despite a slightly faster inflation rate, a rapid growth in real income

will continue. Private consumption will continue to grow slightly more slowly than income, which will boost household savings. Household savings rate relative to disposable income will gradually rise to about one per cent.

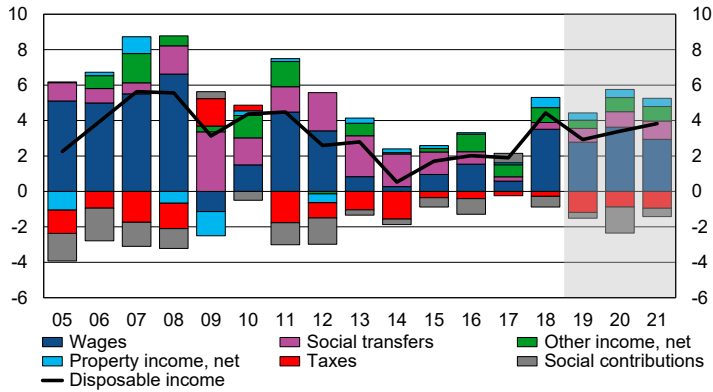
Industry and consumer confidence
balance, seasonally adjusted



Source: European Commission

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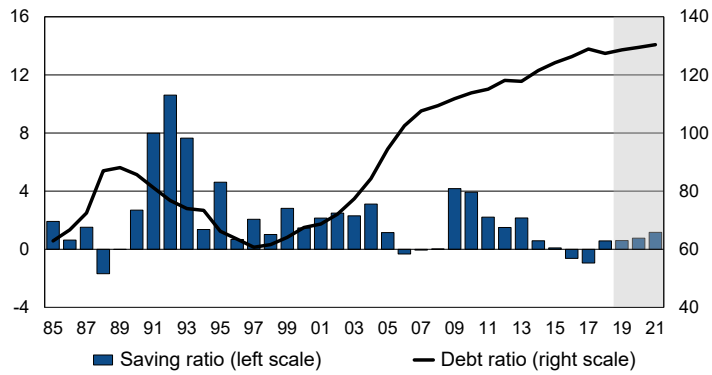
Households' disposable income
change and growth impact, %



Sources: Statistics Finland, MoF

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Household savings and debt % of disposable income



Sources: Statistics Finland, MoF

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THERE WILL BE FURTHER RISES IN HOUSEHOLD DEBT

The need to slow down increases in debt and ways to do this have been discussed in a number of forums. In recent years, growing household debt has been a source of concern in many quarters, for example, the European Systemic Risk Board and the IMF have highlighted the issue in their reports on Finland. The largest debts have been accumulated by a relatively small number of households, making them particularly vulnerable to negative developments in the economy or the housing market. Popularity of variable rate loans and the resulting sensitivity to interest rate risks among households has also caused concern. This spring, the Bank of Finland highlighted the worryingly high levels of household debt. In addition to housing loans, there has also been concern over consumer credit and a rapid increase in housing company loans.

Three out of five households in Finland have debts. About 18% of them have debts amounting to more than 300% of their total wealth. As recently as two decades ago, such households accounted for only two or three per cent of all households. If large debts are measured as debt to total wealth ratio and the lower limit for large debts is put at 75%, the percentage of large debts has remained more or less unchanged since the late 1990s. In 2016, one out of four households with debts had debts exceeding 75% of its total wealth. In this definition, an owner-occupied home was by far the most important asset item as it accounted for about one half of all total wealth.

Finns in the age groups 35-44 and 25-34 have the highest debts relative to income. In these groups, housing loans account for almost 80% of all household debts. Debts among those under the age of 24 have remained at 80% relative to disposable income. On average, only one out of three households has housing loans, while about 60% of all households have debts in general.

The debt to income ratio is highest among couples with children aged under seven. In these households, the average debt to income ratio exceeds 200%. This group has been the most indebted group in all wealth surveys and it has also been accumulating debts at a faster rate than any other group over the past 20 years. The housing loan to wealth ratio among couples with children aged under seven is above average but the changes over the past two decades have not been significant. In relative terms, the debt to wealth ratio among people under the age of 35 (single households or childless couples) has risen fastest over the past 20 years, while the change in the debt to income ratio has been closer to the average.

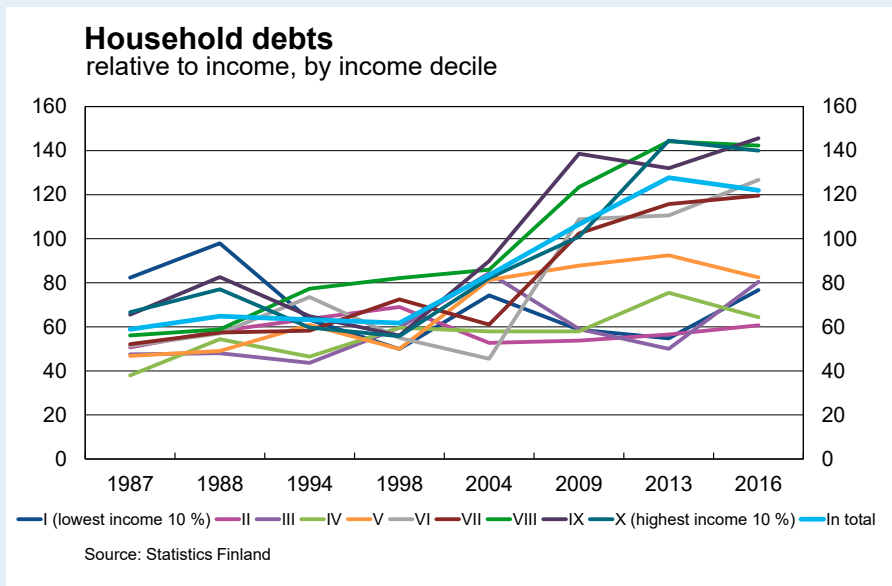
Indebtedness is particularly common among high-income households. About 60% of all households have debts but in the three highest income deciles, more than three quarters of all households have debts. In the two lowest income deciles, less than 10% of all households have debts. According to Statistics Finland, six per cent of all Finnish households were subject to credit restrictions in 2016. In most cases, the restrictions applied to single-parent households of whom 15% said that they had encountered

difficulties in obtaining credit. Debt ratios among high-income households are significantly above average but below the levels of families with children. Debt ratios among low-income households are substantially below average but they have increased considerably since the previous wealth survey.

The indebtedness of Finnish households has continued to increase after 2016. The household debt relative to annual gross income stood at 127.4% in 2018, which is above EU average, though well below the levels in other Nordic countries.

The debt to income ratio is highest in the Uusimaa region (excluding the Helsinki region) and lowest in Northern and Eastern Finland. However, there is more housing equity in Uusimaa than in Northern and Eastern Finland. The housing debt to housing equity ratio is substantially lower in Uusimaa and the Helsinki region than elsewhere in Finland even though the household-specific housing loan median is significantly higher in the Helsinki region and Uusimaa than elsewhere in Finland. Housing equity has not, however, risen at the same rate as housing debts. When measured with the consumer price index, real housing equity rose by only 3% between 1987 and 2016, while housing debts increased by 50%

Household debts relative to income, by income decile



1.3.2 Public consumption

The largest items in public consumption expenditure are personnel expenses, and goods and services purchased. Local government consumption accounts for approximately two thirds and central government for less than one third of public consumption, while consumption by social security funds makes up the remainder. Public consumption expenditure increased last year and the rise in local government consumption expenditure was particularly rapid. Growth has continued during the first quarter of 2019. The price of public consumption will be boosted this year by already agreed pay rises and the expiry of the holiday bonus cuts.

Public consumption expenditure will continue to grow in the next few years. The expenditure adjustment measures introduced by the Government of Juha Sipilä will no longer slow down the growth and the need for services will continue to increase as the population is ageing. Pressures to raise wages will become stronger as the unemployment rate is approaching the level of structural unemployment. The assumption is that this will accelerate the growth in earnings, which will also boost the price of consumption.

Table 8. Consumption

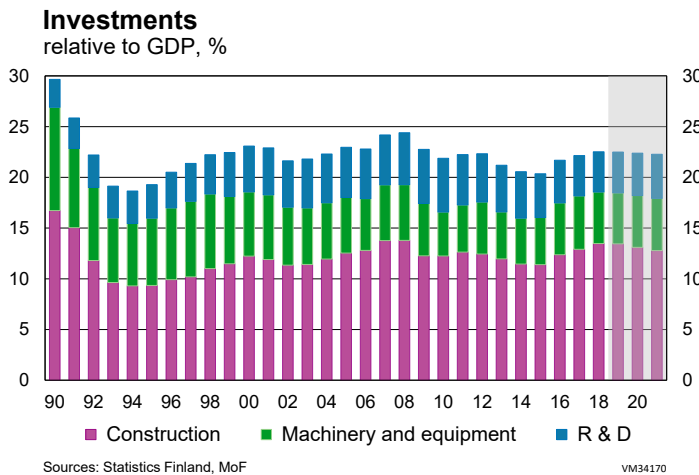
	2018	2016	2017	2018	2019**	2020**	2021**
	share, %	change in volume, %					
Private consumption	100.0	2.2	1.2	1.4	1.5	1.6	1.7
Households	95.4	2.2	1.2	1.7	1.5	1.7	1.7
Durables	8.0	5.8	3.5	4.6	1.0	2.1	1.6
Semi-durables	7.7	2.6	2.5	1.8	1.8	2.8	2.3
Non-durable goods	25.5	0.5	-0.5	0.3	0.5	1.5	1.1
Services	54.3	2.1	1.7	1.9	2.0	1.5	1.8
Consumption by non-profit institutions	4.4	2.8	0.6	-3.7	1.5	0.5	0.5
Public consumption	100.0	1.8	-0.4	1.4	0.7	0.4	0.3
Total		2.1	0.7	1.4	1.3	1.3	1.2
Individual consumption expenditure in general government		0.9	0.5	2.0	1.9	0.3	0.3
Total individual consumption expenditure		1.9	1.2	1.3	1.1	1.4	1.5
Households' disposable income		2.0	1.9	4.4	2.9	3.4	3.8
Private consumption deflator		0.4	0.6	1.3	1.4	1.5	1.7
Households' real disposable income		1.6	1.3	3.1	1.5	1.8	2.1
		%					
Consumption as proportion of GDP (at current prices)		78.9	77.3	76.2	75.8	75.9	76.0
Household savings ratio		-0.6	-0.9	0.6	0.6	0.8	1.2
Household debt ratio ¹		126.3	128.9	127.4	128.6	129.5	130.4

¹ Household debt at end-year in relation to disposable income.

1.3.3 Private investment

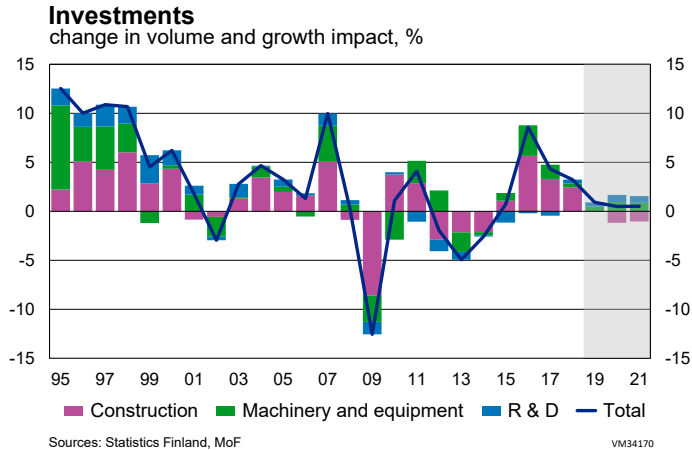
Decrease in housing investments - bright outlook for investments in productive capital

Private investments are now growing at a slower pace because they only increased by 0.5% during the first quarter of 2019. Private investments are expected to start declining during 2019 as the fall in the number of building permits will also mean fewer housing starts. A decrease in housing investments will slow down the overall growth in private investments during the forecast period and as a result, private investments will grow at an average rate of only 1.2%. Their GDP ratio will remain unchanged, at slightly more than 18%.



Housing construction has been at exceptionally high levels in the past two years, as housing starts have totalled about 45,000 each year. However, as expected, the number of new building permits have decreased by almost one third during the first months of 2019, compared with the same period last year.

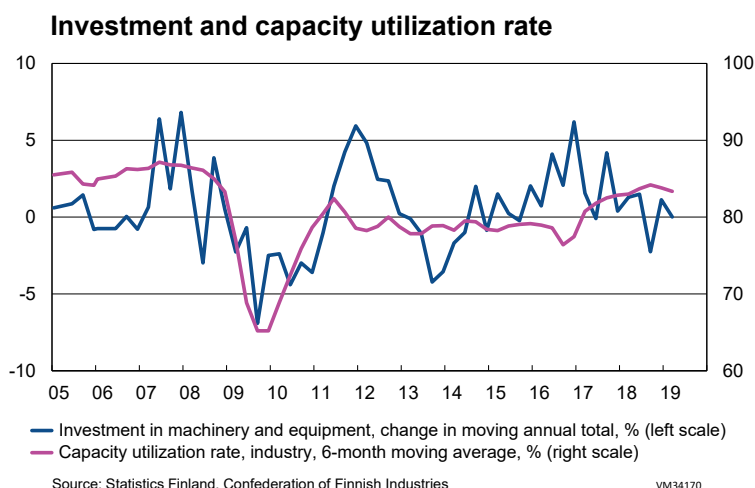
Nevertheless, the number of new housing starts increased year-on-year, which came as a slight surprise. The number of new housing starts is projected to decline to 38,000 this year and the downward trend is expected to continue in 2020 and 2021. Housing investments will nevertheless remain at fairly high level and no collapse is expected. Renovation construction investments are expected to grow steadily, at an annual rate of between one and two per cent, throughout the forecast period.



The outlook for production investments is fairly bright even though they will grow only modestly this year. A large number of billion-class projects are planned in Finland. This is an exceptional situation because never before have so many such projects been under way simultaneously. Especially in the forest industry, there are plans to construct several production facilities that are more environmentally friendly than the existing plants.

However, all these projects will be multi-stage processes (for example, they require a large number of different permits), which means that it is not yet known when they will actually be built. Changes in the economic situation may also have an impact on the decision to go ahead with the projects. These projects will give a boost to industrial construction and, at a later state, probably also to warehouse construction.

Likewise, a substantial increase in machinery and equipment investments is expected during the forecast period. The value of the projects in the forecast that are expected to be implemented has been raised from one billion euros to about EUR 1.5 billion. This is because decisions on some of the projects have already been made and especially as additional projects have been announced. The large projects with construction starts planned for the period 2019-2021 total about EUR 7 billion.



Public investments are the main factor boosting non-residential building construction and civil engineering construction. More building permits for hospitals and schools have been granted, which means that more starts in these building categories can be expected.

Further increases in research and development expenditure are expected this year, as indicated by the investment survey of the Confederation of Finnish Industries (EK) at the start of the year. Public investments in research and development are also on the increase.

Table 9. Fixed investment by type of capital asset

	2018	2016	2017	2018	2019**	2020**	2021**
	share, %	change in volume, %					
Buildings	50.3	10.1	6.6	4.9	-1.0	-1.6	-2.2
Residential buildings	30.3	10.7	6.5	5.4	-2.4	-4.5	-4.5
Non-residential buildings	20.0	9.4	6.8	4.3	1.2	2.6	1.0
Civil engineering construction	9.5	9.9	1.9	0.5	5.4	-3.8	0.2
Machinery and equipment	22.6	13.7	6.1	1.6	2.0	4.2	3.8
R&D-investments ¹	17.6	-0.9	-2.3	2.2	2.5	4.1	3.7
Total	100.0	8.6	4.3	3.2	0.9	0.5	0.5
Private	81.5	8.7	4.8	3.3	0.4	1.8	1.2
Public	18.5	8.0	2.4	3.0	3.3	-5.3	-2.5
		%					
Investment to GDP ratio (at current prices)							
Fixed investment		22.0	22.3	22.5	22.3	22.2	22.1
Private		17.8	18.2	18.3	18.1	18.2	18.3
Public		4.1	4.1	4.2	4.2	4.0	3.8

¹Includes cultivated assets and intellectual property products

1.3.4 Public investment

Public investments account for slightly less than 20% of all investments. Local government investments account for more than half of public investments, while central government investments account for the rest. The proportion of social security funds is very small. Almost 30% of the public investments are civil engineering investments, and other building investments account for a same proportion of the total. Research and development investments account for slightly more than 25% and machinery and equipment investments for slightly over 10 % of the total.

Public investments will grow rapidly this year because there will be more investments in the local government sector. The growth is due to such factors as hospital construction and infrastructure investments. Public investments will probably be cut next year as a result of tighter central government investment budgets and stay at this level in 2021. The additional public sector investments set out in the Government Programme of Prime Minister Rinne's Government are not included in the forecast.

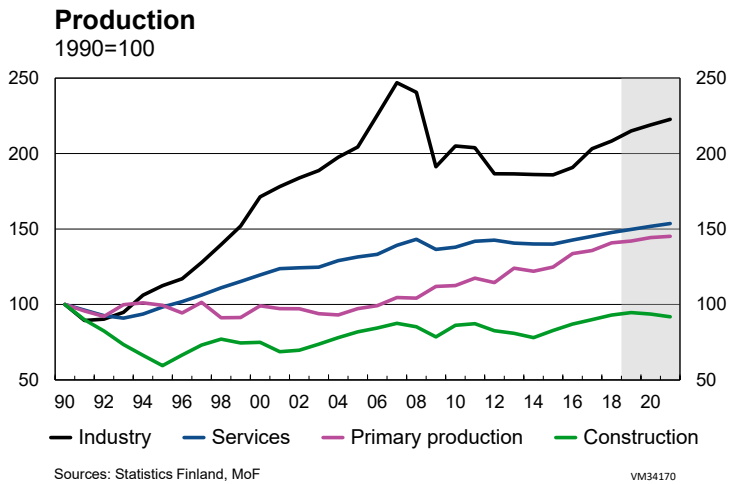
1.4 Domestic production

1.4.1 Total output

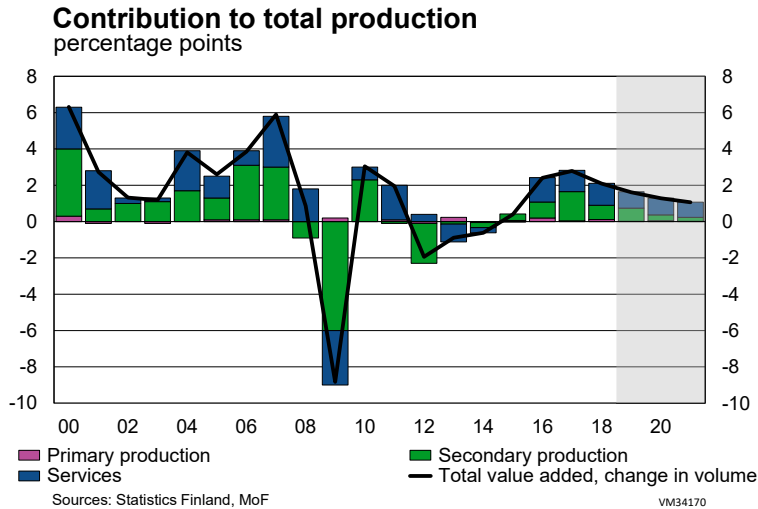
Economic growth will continue but at a slower rate

Economic growth slowed down during the first months of the year. Gross value added in the economy was 1.5% higher in January–March than a year earlier. The slowdown was equally distributed among all main sectors but the trend was strongest in primary production as the value added in agriculture contracted. However, the value added in secondary production and services increased year-on-year, which means that the Finnish economy is still growing on a fairly broad basis. The gross value added remains one per cent lower than before the financial crisis because Finland's industrial output is still at a substantially lower level. The chemical industry is the only sector where output is higher than before the financial crisis more than a decade ago.

Economic productivity is weak. Labour productivity per hours worked contracted by 0.5% last year and the trend has continued during the early months of 2019. This is because productivity in the service sector fell by nearly one per cent. Productivity in Finland only achieved the pre-financial crisis levels in 2018 though it is about ten per cent above the euro area average.

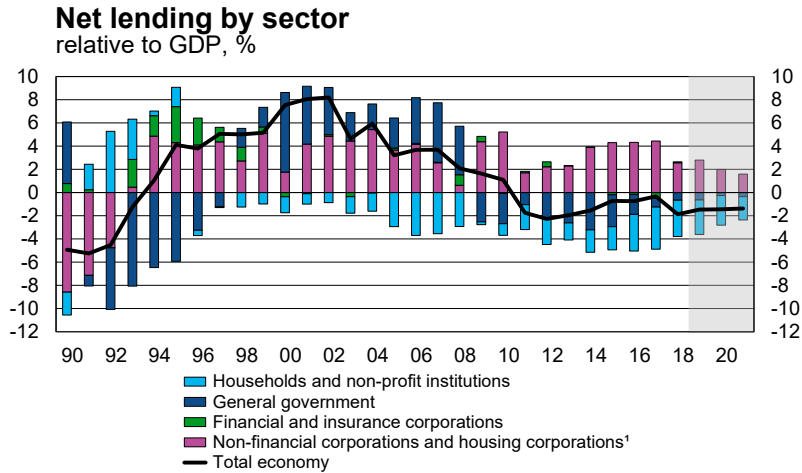


More signs of output growth have been received during the early months of 2019. These include the above-average order books in a number of industries, the expectations of continuing growth in the main sectors and a high level of construction activities in growth centres. At the same time, however, there are also more signs of limits to the growth because many sectors still suffer from a shortage of skilled labour and weak demand is more common in many private business sectors than at the end of 2018. In fact, more than half of all industrial, construction and service-sector companies are facing obstacles to growth.



Despite obstacles to growth, the Finnish economy will still grow on a broad basis this year. The growth is driven by an increase in orders demonstrating continuing international demand in manufacturing, progress made in numerous construction and renovation projects, and growth in service production. Although the period of fastest growth appears to be over, the business tendency surveys carried out by EK indicate that the positive trend will continue at least until late 2019. The forecast's background assumptions concerning continuing growth of world trade and global economy also support export-oriented industrial production and therefore, indirectly, business services. Growing imports of Finland's most important trading area, Europe, are good news for Finnish industries manufacturing investment and intermediate products. Due to broad-based growth and a positive growth base, gross value added for the economy will grow by slightly more than 1.5% this year. Growth rate will level off in 2020 and 2021, but total output will still increase by slightly more than one per cent in both years.

The forecast described above involves a large number of risks. There are numerous uncertainties that may slow down the growth by weakening international demand and, consequently, export-oriented industrial production. At the same time, however, capacity increases in industries and services arising from the realisation of investment plans may lead to faster than expected growth.



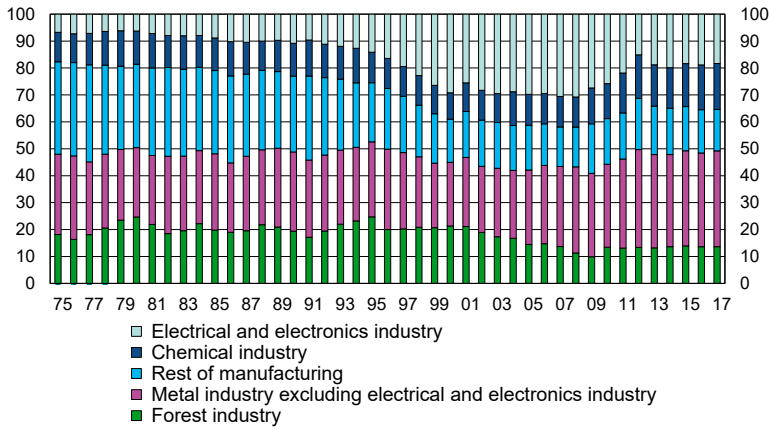
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1.4.2 Secondary production

Industrial output is slowing down

Finland's industrial output will no longer grow at the same rate as in 2018. In the early part of 2019, industrial output was one per cent higher than in the same period of 2018, which means that growth was considerably slower than last year. With the exception of the forest industry, output increased in all sectors. Growth in the output of electrical and electronics and chemical industries was the main factor contribution to the increase. The chemical industry boosted its turnover in Finland, while the electrical and electronics industry increased its exports sales. The volume of forest industry output declined as prices increased at a significantly faster rate than the value of production.

Manufacturing % of gross value added



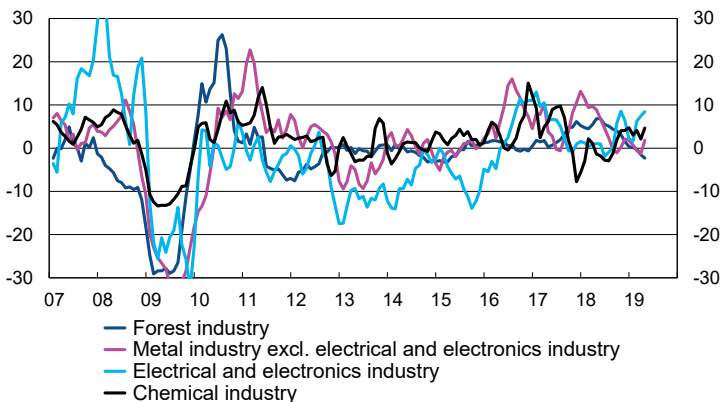
Source: Statistics Finland

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Raw materials and investment goods for exports account for most of Finland's industrial production and the demand for these items is sustained by an upswing in the global economy and trade and higher capacity utilisation. At the same time, however, the cost competitiveness of Finnish companies in terms of nominal unit labour costs no longer improved in 2018, compared to the rest of the euro area. In fact, the value of new industrial orders only grew by 2.1% in the early months of the year. Nevertheless, the order stock remains at average levels in many sectors. The highest number of orders has been won by the metal industry but increasing order books have also been reported by the chemical industry. Thus, the output expectations for the coming six months are still fairly positive.

Volume index for industrial production

3-month moving average, change yoy, %



Source: Statistics Finland

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According to business tendency surveys, companies in the forest, chemical, food, building product and metal industries still expect the growth to continue in the coming months. Textile and clothing and printing industries are the sectors with the weakest output expectations. In forest industry, the output is pushed up by increased demand for pulp, paperboard and sawn timber. Capacity increases in the sector will also boost growth in the forest industry. In particular, orders for transport equipment will uphold production in the metal industry for years to come. As a whole, industrial output will increase by almost three per cent this year, a result of positive growth prospects, the new orders received in the first months of the year and the growth already experienced.

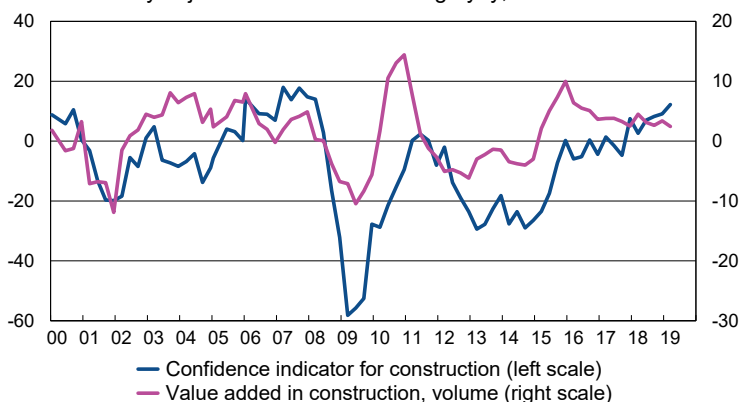
In the next few years, growth in export demand will be modest as world trade continues to grow and imports are expected to increase in 2020 and 2021, especially in the European market, which is important for Finnish companies. Increases in production capacity and measures taken by companies to improve the competitiveness of their products will provide Finnish industries with a stronger output basis in the years ahead. Finland's cost-competitiveness relative to the euro area may weaken next year. Industrial value added will grow by about two per cent next year but only by slightly more than 1.5% in 2021. Despite the growth, the volume of industrial output in 2021 will remain ten per cent lower than in the peak year of 2007.

The level of construction activity will fall from a high level

Construction continued to boost total output growth during the early part of the year. Value added continued to grow at a steady rate of more than 2.5%. There are numerous major construction projects in progress and during the past six months work has started on new sites. The diverse nature of the construction activity also helped to boost the growth. Migration is boosting the demand for housing in growth centres and companies have launched capacity expansion and replacement projects, which has been reflected in office, industrial and agricultural construction. However, levels of new construction are higher in growth centres than outside them, which means that growth is unevenly distributed across the regions. The need for renovation construction is high, particularly in residential and public buildings.

Confidence and production in construction

seasonally adjusted balance and change yoy, %



Sources: Statistics Finland, European Commission

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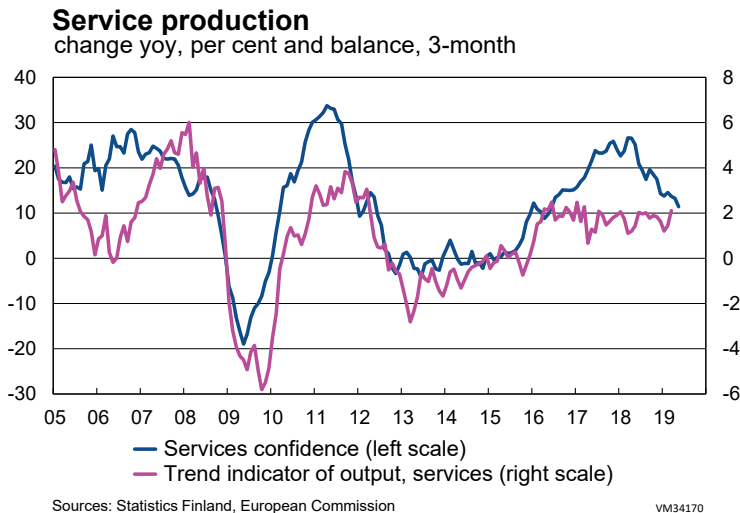
Output expectations in construction companies remain at a fairly high level because the order stock is higher than average. However, many large buildings will be completed this year and some of them are one-off projects, which means that there will not be similar new construction projects to replace them in the near future. The number of building permits has also declined for months, albeit from a high level, especially in housing construction and the construction of commercial and office buildings. The construction business is also the sector with the most serious shortage of skilled labour. Supported by building projects in progress, construction will increase by two per cent this year.

Construction will remain buoyant in growth centres in 2020 and 2021, but the number of new starts will no longer increase at the same rate as in the past few years, which means that construction will decline. Sharpest falls are expected in the construction of blocks of flats and commercial buildings as well as in the civil engineering sector. In 2020 and 2021, the focus will be on a small number of regional construction projects and renovation construction, which means that construction value added will decrease at an annual rate of about 1.5%. Despite the fall, the level will still be substantially higher than before the financial crisis and the volumes achieved in 2017.

1.4.3 Services

Services will support economic growth

Finland's service industries are undergoing a structural transformation. Usually, private services are the main factor boosting service production but over the past six months, the value added of public-sector services has grown at a substantially faster rate than private-sector services. The value added of the whole service sector increased by 1.5% in the first months of the year. Fastest growth was posted by business services and services in the information and communications industries. At the same time, however, the fall in the value added of the financial and insurance sectors accelerated, while retail sales and wholesaling also contracted.



The cyclical position of private services remains positive. Sales are on the increase and the growth is generally expected to continue for the rest of the year. In service sectors, weak demand and shortage of skilled personnel are slowing down growth and more than half all companies taking part in business tendency surveys have experienced obstacles to growth. The information and communication services as well as the real estate business are the sectors best-placed for growth. Sales in the retail and wholesale sector are also expected to grow. At the same time, the outlook for finance and insurance are weaker than in other sectors. The increase of value added in services this year will be 1.5% year-on-year.

In the future, services will be supported by the demand for end and intermediate products of industries and other service sectors, which means that services remain well-placed for growth. Consumer-driven services will benefit from increases in purchasing power. However, the fact that construction is expected to take a downward turn will reduce the need for services in the sector. In 2020 and in 2021, there will be a slight slowdown in service production growth and the average annual growth will be at slightly more than one per cent.

Table 10. Production by industry

	2018	2016	2017	2018	2019**	2020**	2021**
	share, % ¹	change in volume, %					
Industry	21.4	2.7	6.5	2.5	2.9	1.9	1.7
Construction	7.3	5.1	3.3	3.4	1.8	-1.1	-2.0
Agriculture and forestry	2.9	7.1	1.5	3.7	0.8	1.6	0.5
Industry and construction	28.7	3.2	5.7	2.7	2.6	1.1	0.7
Services	68.4	1.9	1.7	1.8	1.4	1.3	1.2
Total production at basic prices	100.0	2.4	2.8	2.1	1.6	1.3	1.1
GDP at market prices		2.8	2.7	2.4	1.6	1.2	1.1
Labour productivity in the whole economy		2.1	1.9	-0.5	0.6	0.9	0.9

1) Share of total value added at current prices.

1.5 Labour force

Achieving an employment rate of 75% will require additional measures

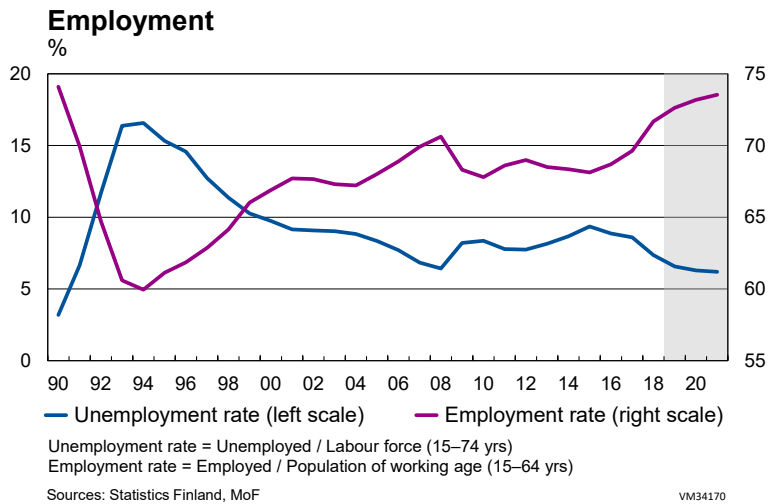
During 2018, employment grew more rapidly than what could be concluded on the basis of the level of economic activity. However, Finland's GDP and employment rate growth slowed down during the first quarter of 2019. In April, seasonally adjusted employment rate stood at 72.4%.

There has been a further increase in the demand for labour during the first months of the year. According to Statistics Finland, the number of job vacancies in the first quarter of 2019 was slightly higher than a year before. According to the confidence indicators of the European Commission, the employment expectations of Finnish companies remained at high level in April. However, when measured with the vacancy rate (the percentage of job vacancies of all jobs), Finland is only at average level among EU countries.

The number of employed people will increase by 1.1% in 2019, even though about half of this growth was achieved during the last quarter of 2018. The employment rate for the whole of 2019 is expected to be at 72.6%.

There was a rapid fall in unemployment¹ in all regions and in all age groups during 2018. However, there has not been any further fall in unemployment during the early months of 2019 and the seasonally adjusted unemployment rate has remained at 6.6% since January.

Driven by a growth in employment, unemployment will continue to fall in 2019, but at a slower pace compared to last year. The projected unemployment rate for 2019 is 6.6%.



1 The report 'The overall costs of unemployment for the national economy' was published in January in the publications series of the Government's analysis, assessment and research activities: <http://urn.fi/URN:ISBN:978-952-287-645-4>. At the level of the national economy, the overall costs of unemployment totalled EUR 10.8 billion in 2016. The report also examines the costs of the unemployment at individual level using the SISU microsimulation model and assesses the costs and benefits of the labour market policy measures.

A slowdown in economic growth and a rise in nominal wages will gradually weaken the growth in the demand for labour force in 2020 and 2021. A situation where unemployment is falling to the levels experienced during the cyclical peak before the financial crisis will tighten the labour market, which in turn will create more pressures for wage increases and give rise to labour bottlenecks in the Finnish economy.

Growth in the number of employed persons will slow down to 0.5% in 2020 and to 0.3% in 2021. Further decline in the working-age population will push the employment rate to 73.5% by 2021. However, the projected economic growth will not be enough to raise the employment rate to 75% unless the Government takes extensive measures in addition to those that have already been introduced.

As the employment rate is continuing to increase, there will be a further reduction in the number of unemployed in 2020. However, a faster rise in labour costs will mean that unemployment will not fall below six per cent in 2021.

There has been a further fall in the number of long-term unemployed and structurally unemployed in the early months of 2019, which has contributed to the decline in the unemployment rate. According to the employment service statistics of the Ministry of Economic Affairs and Employment, the number of structurally unemployed persons totalled 142,000 in April or 22,000 fewer than a year before. Despite a fall in long-term unemployment, the number of long-term unemployed in the age category 20-54 is still substantially higher than during the previous cyclical peak in 2008.

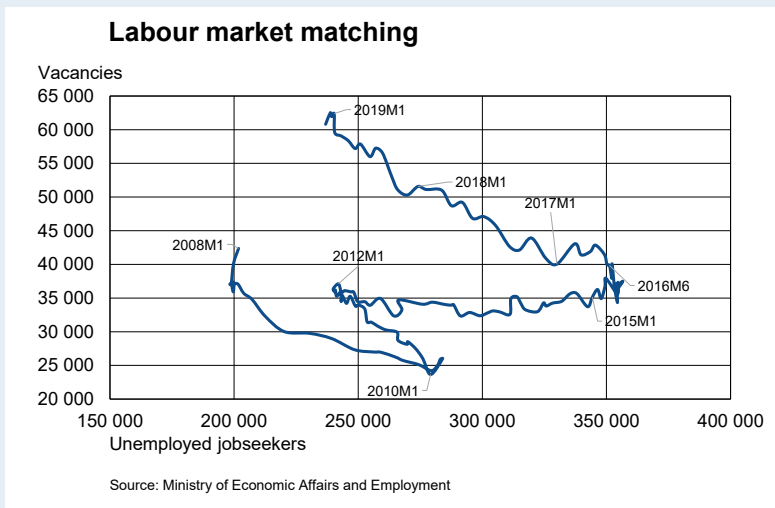
A tighter labour market has already led to labour bottlenecks in a number of professions. According to the business tendency survey published by EK and the employment outlook by occupation published by the Ministry of Economic Affairs and Employment, there is a shortage of construction and real estate service professionals and cleaners as well as ICT and healthcare and social welfare service experts. Raising the employment rate to 75% would require measures to eliminate the mismatch between labour supply and demand, such as additional training places for sectors suffering from labour shortages and more conversion training for the unemployed.

Table 11. Labour market

	2016	2017	2018	2019**	2020**	2021**
	annual average, 1,000 persons					
Population of working age (15–74 yrs)	4109	4114	4124	4130	4131	4123
change	7	5	10	6	1	-8
Population of working age (15–64 yrs)	3463	3451	3439	3431	3423	3416
change	-13	-12	-12	-8	-8	-7
Employed (15–74 yrs)	2447	2474	2539	2568	2581	2588
of which 15–64 yrs	2379	2403	2465	2492	2505	2512
Unemployed (15–74 yrs)	238	233	202	180	173	171
	%					
Employment rate (15–64 yrs)	68.7	69.6	71.7	72.6	73.2	73.5
Unemployment rate (15–74 yrs)	8.9	8.6	7.4	6.6	6.3	6.2
	1,000 persons per annum					
Immigration, net	16	17	16	15	15	15

THE EFFECTS OF AN INCREASE IN THE LABOUR MARKET MATCHING EFFICIENCY

The demand for labour has increased over the past few years. The number of job vacancies started to increase rapidly during 2016 and has almost doubled over a period of five years. At the same time, the number of unemployed jobseekers decreased, which has led to a labour market tightening (increase in the number of job vacancies in relation to unemployed jobseekers). Furthermore, a mismatch between labour supply and demand is making it more difficult to fill job vacancies in specific professions and regions. These phenomena can be studied using the Beveridge curve, which describes labour market matching. In the figure, mismatch between labour supply and demand is shown as a shift towards the upper left corner, which often occurs during a period of rapid economic growth. At the same time, however, the outward shift of the curve (which was typical of the period between 2012 and 2015) is an indication of a labour market mismatch.



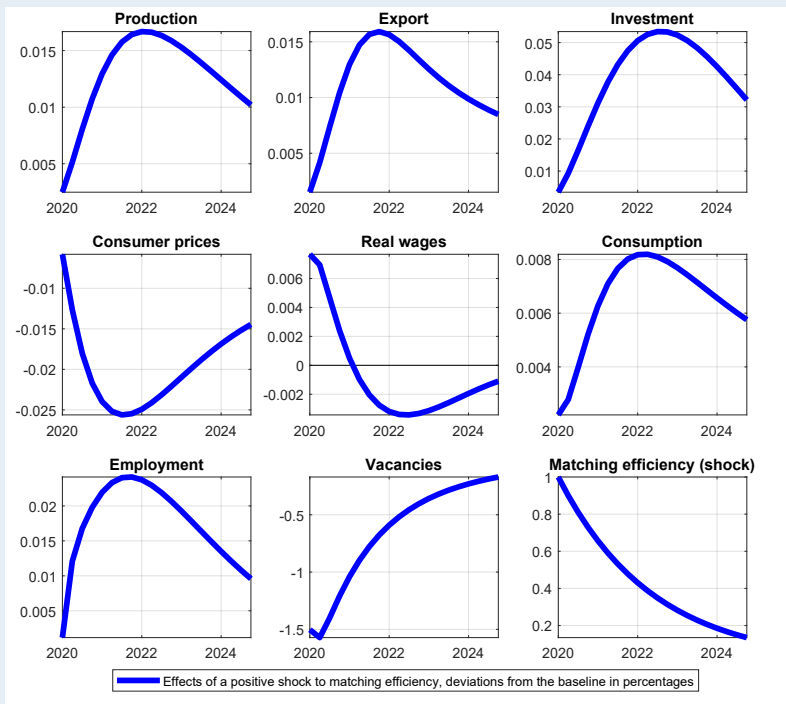
Labour market mismatch is characterised by a simultaneous shortage of labour and jobs. The mismatch arises when it is difficult to fill job vacancies with employees possessing the right training and skills or living in the right regions. At the same time, unemployment remains high because of changes in the industrial structure or incentive-related phenomena. Even though labour market matching problems have eased somewhat after 2016, ensuring better labour market matching remains a key issue in the efforts to boost employment.

The macroeconomic effects of an increase in the labour market matching efficiency can be examined using the macroeconomic model (KOOA) developed by the Ministry of Finance Economics Department. In the KOOA model, the matching efficiency in the labour market is defined as a ratio of new jobs to the equation of the unemployment

and job vacancies. As there are no accurate indicators for the matching efficiency, the focus is on the qualitative effects of an efficiency increase. The study analyses the impulse response functions to a shock that improves the matching efficiency in the Finnish labour market by one per cent in a quarter at the start of 2020. The results are reported as the percentage deviations from the baseline, such as the economic growth projection prepared by the Ministry of Finance Economics Department presented in this publication.

An increase in the labour market matching efficiency strengthens the economy as it leads to a more effective use of economic resources. The positive matching efficiency shock has a positive impact on employment because, despite the decrease in the number of unemployed and job vacancies, companies are able to fill a higher proportion of the job vacancies. Furthermore, more efficient matching in the labour market boosts output, exports and investment. Consumption will grow half as rapidly as output, partially because the real wage becomes negative as the shock weakens.

A positive shock to matching efficiency has a delayed effect on the economy. This result follows from a slow adaptation of wages and prices. More efficient labour market matching will ease pressures on wages and nominal wages will fall. However, initially, consumer prices will fall more rapidly than wages, which means that in the first year, real wages will rise and in the following years, real wages will fall more slowly than nominal wages. The shock has a limited effect on public-sector revenue but an increase in the matching efficiency will reduce public expenditure as unemployment falls.



1.6 Incomes, costs and prices

1.6.1 Wages and salaries

In 2018, nominal earnings rose by 1.7%, as measured by the index of wage and salary earnings. Boosted by employment growth, the total wage bill increased by 4.7% last year.

Negotiated pay increases will be higher in 2019 and the wage drifts coming on top of them are expected growth faster than in 2018. As a result, nominal earnings will rise by 2.7%. As the employment is still rising, the total wage bill is expected to grow by 3.8% this year.

With falling unemployment and tightening labour market, the rate of growth in earnings is expected to approach the annual rate of three per cent, the average for the past 19 years. Reinstatement of the holiday bonuses in the public sector will also temporarily boost earnings in 2020, and as a result, nominal earnings are expected to grow by 3.3% and the total wage bill by 3.8%. In 2021, nominal earnings are projected to grow by 3.1% and the total wage bill by 3.4%.

Table 12. Disposable income

	2018	2016	2017	2018	2019**	2020**	2021**
	share, %	change, %					
Compensation of employees	47.3	1.7	0.6	3.9	3.1	4.0	3.2
Wages and salaries	39.1	1.4	2.2	4.7	3.8	3.8	3.4
Employers' contributions to social security schemes	8.2	2.5	-5.9	1.4	-0.4	4.7	2.5
Property and entrepreneurial income, net	22.2	7.7	6.8	3.6	6.6	3.7	4.5
Taxes on production and imports minus subsidies	13.2	5.9	1.4	5.2	2.9	2.0	2.2
National income	100.0	3.8	2.4	4.1	4.0	3.6	3.4
Disposable income		3.7	2.7	3.6	3.8	3.3	3.2
Gross national income, EUR bn		219	224	233	242	249	257

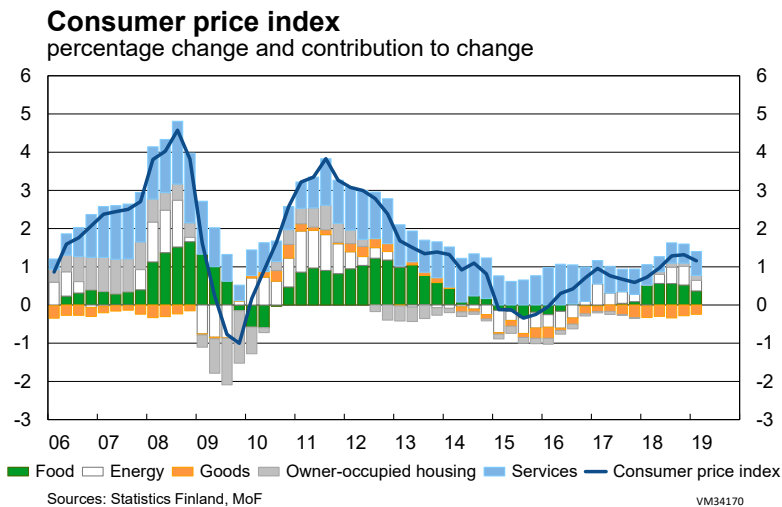
Table 13. Index of wage and salary earnings and labour costs per unit of output

	2016	2017	2018	2019**	2020**	2021**
	change, %					
Index of negotiated wage rates	0.6	-0.3	1.2	2.0	2.3	2.1
Wage drift, etc.	0.3	0.5	0.5	0.7	1.0	1.0
Index of wage and salary earnings	0.9	0.2	1.7	2.7	3.3	3.1
Real earnings ¹	0.5	-0.5	0.6	1.5	1.9	1.3
Average earnings ²	0.7	0.3	2.1	2.8	3.4	3.2
Labour costs per unit of output whole economy ³	-0.8	-2.1	2.0	1.4	2.6	2.2

- 1) The index of wage and salary earnings divided by the consumer price index.
- 2) Computed by dividing the national wage bill by the number of hours worked by wage and salary earners. The figures are affected by structural changes in the economy.
- 3) Compensation of employees divided by gross value added in volume at basic prices.

1.6.2 Consumer prices

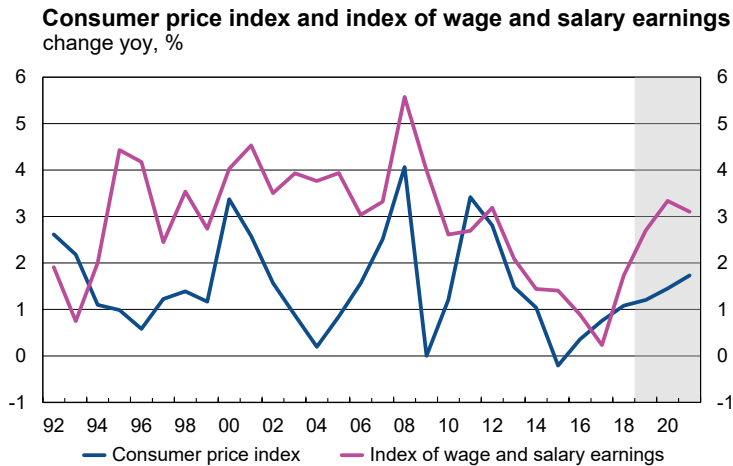
The consumer price index rose by 1.2% during the first quarter of 2019, whereas in 2018, inflation was 1.1%. Service prices, in particular, have risen faster during the first months of the year, compared to 2018. In the first quarter of 2019, they increased by 1.8% year-on-year, whereas in 2018, the average rise was 1.3%. At the same time, tax increases have had a lower impact on consumer prices than in 2018.



The projected inflation rate for 2019 is 1.2%. As a whole, inflationary pressures are higher than last year but the impact of tax increases will be lower this year than in 2018. As earnings are rising, prices of services are expected to again increase more rapidly than in 2018. However, as in 2018, prices in goods will have a negative impact on inflation, and as a result, baseline inflation will remain moderate. Boosted by tax increases, prices of food, alcohol and tobacco products are expected to rise during the year, though at a slower rate than in 2018. According to the forecast, the crude oil barrel prices in euros will, however, remain close to 2018 levels, while at the same time, energy prices will be boosted by increases in electricity prices.

As a whole, inflationary pressures are expected to grow only slowly in the later years of the forecast period. The rise in earnings is expected to gradually have a broader impact on prices and consumer demand will grow steadily. Euro area market rates are expected to start rising slowly during the forecast period, which will help to slow down inflationary pressures. The national consumer price index is expected to rise by 1.5% in 2020 and by 1.7% in 2021.

According to expert estimates published by the European Central Bank in March 2019, inflation in the euro area is expected to slow down to 1.2% in 2019 from 1.7% in 2018. This is mainly due to a substantial slowdown in the energy price inflation. After that, inflation is expected to accelerate to 1.5% in 2020 and to 1.6% in 2021. Domestic inflation is expected to remain at average euro area levels in the forecast period.



Sources: Statistics Finland, MoF

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Table 14. Price indices

	2016	2017	2018	2019**	2020**	2021**
	change, %					
Export prices ¹	-1.9	3.3	3.8	1.9	2.1	1.8
Import prices ¹	-2.2	3.8	3.6	2.4	2.4	1.8
Consumer price index	0.4	0.7	1.1	1.2	1.5	1.7
Harmonised index of consumer prices	0.4	0.8	1.2	1.3	1.5	1.7
Basic price index for domestic supply, including taxes	-1.2	4.9	4.7	2.0	2.4	2.3
Building cost index	0.5	0.3	2.2	1.8	2.3	2.4

¹ As calculated in the National Accounts

2 Public finances

2.1 General government finances

The positive economic cycle for the past three years has improved the general government finances. There was a further narrowing in the general government deficit last year. Despite steady economic growth, Finland's general government finances will remain in deficit throughout the forecast period. Economic growth is expected to slow down in the 2020s and the general government financial balance will start weakening again.

General government debt to GDP ratio has fallen below 60%. However, in euro terms, the debt will increase during the forecast period. Despite strong economic growth, general government debt ratio has declined only slowly. The ratio will start growing again at the start of the 2020s.

There are still severe structural problems in Finland's general government finances. The population is ageing, which will mean increasing pressures to pension, health care and long-term care expenditure. Age-related expenditure will increase general government expenditure by an average of some EUR 0.5 billion each year. The fiscal buffers accumulated for the next downturn will be slim, which is partly due to the higher expenditure arising from the ageing of the population.

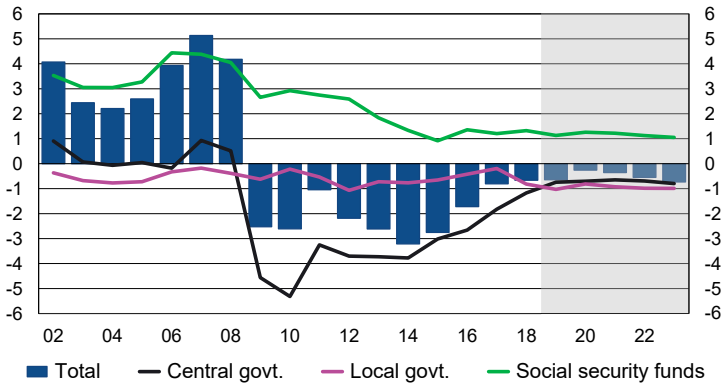
Last year, central government was the general government sector with the highest deficit. The deficit will still narrow this year as a result of economic growth and the adjustment measures introduced by the previous Government. After these adjustment measures have been implemented and economic growth slows down, central government deficit will no longer shrink.

Slow growth in tax revenue combined with higher consumption expenditure weakened the local government budgetary position last year. Local government expenditure will continue to grow at a rapid rate this year. An increasing need for services arising from an ageing population is burdening local government finances. The combined central and local government deficit will amount to EUR 3.8 billion at the start of the 2020s.

The employment pension institutions, which are part of the social security funds, have a substantial surplus. The surplus of these institutions will remain at about one per cent in the forecast period. Even though pension expenditure is rising rapidly, steady economic growth is generating more pension contribution payments, while higher interest rates are boosting property income. Other social security funds have a slight surplus. Unemployment expenditure is expected to fall further and the estimate is that the unemployment insurance contribution will be lowered in the forecast period. Lowering the contribution will reduce the surplus of the other social security funds close to balance.

There was a further decline in the expenditure rate (expenditure to GDP ratio) in 2018. The rate has fallen by five percentage points from its peak in 2014. The reduction has been due to measures slowing down expenditure growth and lower unemployment expenditure. The expenditure rate will remain around 52% over the next few years. The tax rate (taxes and tax-like payments relative to GDP) has decreased as a result of tax cuts and the Competitiveness Pact. The tax rate will remain more or less unchanged in the next few years.

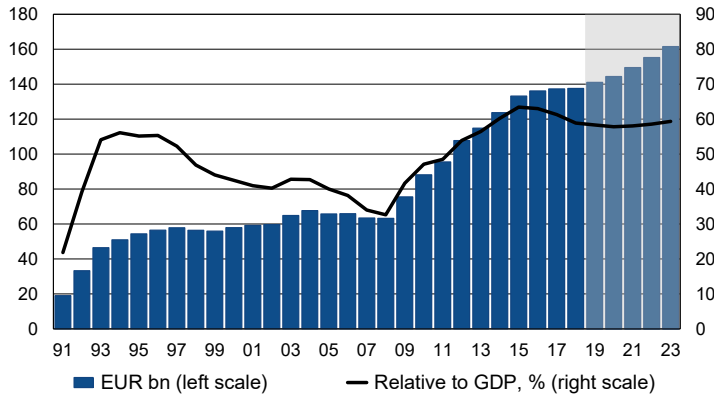
The financial balance of general government relative to GDP, %



Sources: Statistics Finland, MoF

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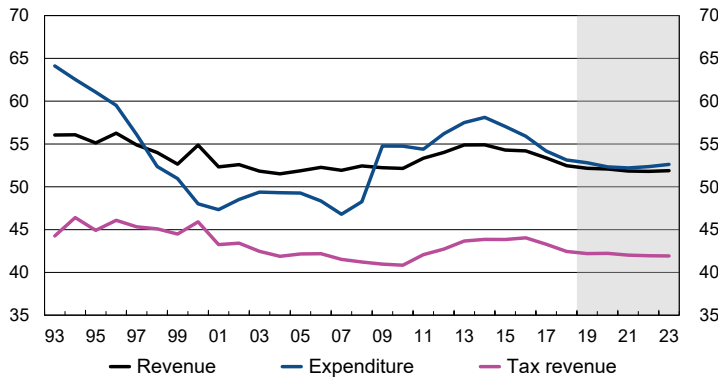
General government debt



Sources: Statistics Finland, MoF

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



Sources: Statistics Finland, MoF

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Table 15. General government finance¹⁾

	2016	2017	2018	2019**	2020**	2021**
	EUR billion					
Current taxes	35.6	37.2	37.4	39.4	40.5	42.0
Taxes on production and imports	31.1	31.5	33.1	33.5	34.1	34.7
Social security contributions	28.0	27.3	28.0	28.4	30.1	30.7
Taxes and contributions, total ²⁾	95.2	97.0	99.1	102.1	105.4	108.2
Other revenue ³⁾	22.5	23.5	24.1	24.8	25.3	26.1
of which interest receipts	1.9	1.8	1.9	1.7	1.9	2.0
Total revenue	117.1	119.5	122.6	126.1	130.0	133.5
Consumption expenditure	51.5	51.5	53.1	54.9	56.9	58.8
Subsidies	2.7	2.7	2.7	2.8	2.7	2.8
Social security benefits and allowances	42.2	42.6	43.1	44.0	45.0	46.3
Other current transfers	5.7	5.3	5.7	5.6	5.8	6.0
Subsidies and current transfers, total	50.6	50.6	51.5	52.3	53.5	55.1
Capital expenditure ⁴⁾	9.2	9.5	9.9	10.5	10.3	10.3
Other expenditure	9.5	9.7	9.6	9.9	10.0	10.3
of which interest expenses	2.3	2.2	2.0	2.0	2.0	2.0
Total expenditure	120.8	121.3	124.1	127.7	130.7	134.4
Net lending (+) / net borrowing (-)	-3.7	-1.8	-1.6	-1.6	-0.6	-0.9
Central government	-5.7	-4.1	-2.7	-1.8	-1.7	-1.7
Local government	-0.9	-0.4	-1.9	-2.5	-2.0	-2.4
Employment pension schemes	2.4	2.0	2.4	2.4	2.7	2.9
Other social security funds	0.5	0.7	0.7	0.4	0.5	0.3
Primary balance ⁵⁾	-3.3	-1.3	-1.4	-1.2	-0.5	-0.9

1) As calculated in the National Accounts

2) Incl. capital taxes

3) Incl. capital transfers and consumption of fixed capital

4) Gross fixed capital formation and capital transfers

5) Net lending before net interest expenses

Table 16. Main economic indicators in general government

	2016	2017	2018	2019**	2020**	2021**
	relative to GDP, %					
Taxes and social security contributions	44.0	43.3	42.4	42.2	42.2	42.0
General government expenditure ¹	55.9	54.2	53.1	52.8	52.3	52.2
Net lending	-1.7	-0.8	-0.7	-0.6	-0.3	-0.4
Central government	-2.7	-1.8	-1.2	-0.7	-0.7	-0.7
Local government	-0.4	-0.2	-0.8	-1.0	-0.8	-0.9
Employment pension institutions	1.1	0.9	1.0	1.0	1.1	1.1
Other social security funds	0.2	0.3	0.3	0.1	0.2	0.1
Primary balance ²	-1.5	-0.6	-0.6	-0.5	-0.2	-0.3
General government debt	63.0	61.3	58.9	58.3	57.8	58.1
Central government debt	47.4	47.2	44.9	44.2	43.4	43.2
General government employment, 1,000 person	614	619	619	619	616	615
Central government	131	131	131	131	129	128
Local government	472	476	476	476	475	475
Social security funds	11	11	11	11	11	11

1) EU-harmonized definition

2) Net lending before net interest expenses

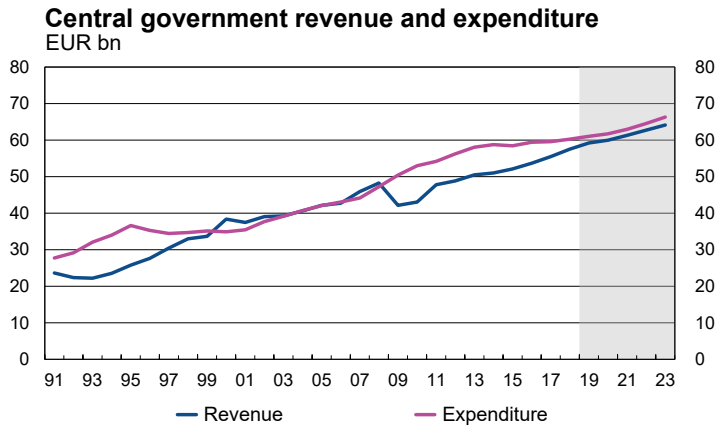
2.2 Central government

Central government deficit has narrowed over the past few years but the positive trend will be halted in the early years of the 2020s. Rapid increase in tax revenue (especially income tax and VAT revenue) is the main reason behind the improvements. At the same time, the adjustment measures introduced by the Government of Juha Sipilä have helped to slow down expenditure growth. The cuts in employer's contributions introduced as part of the Competitiveness Pact and the temporary cuts in holiday bonuses have also reduced the employee compensations paid by the state in recent years. Correspondingly, the elimination of the temporary cuts in holiday bonuses will increase employee compensations in 2019.

In 2020, central government deficit will remain at previous year's levels because a slowdown in economic growth will also mean less tax revenue. Furthermore, there will be more current transfers to local government as a result of such factors as the compensation for the cuts made in central government transfers. There has been a

substantial reduction in central government interest payments in recent years and it is estimated that they will decrease further in 2020 and 2021. Despite this positive trend, central government deficit will still be high at the end of the forecast period.

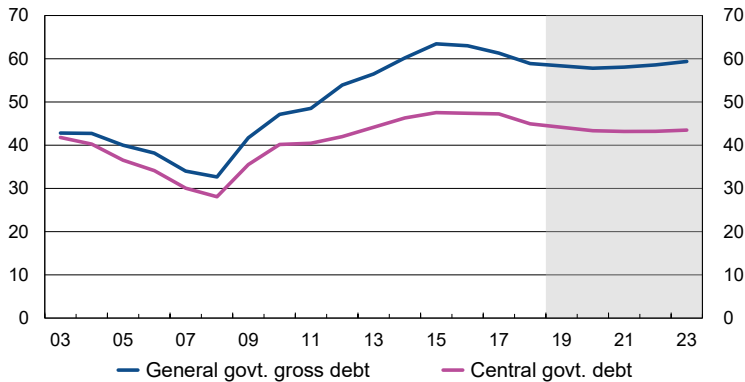
Central government debt decreased by EUR 0.8 billion last year, which was partially due to exceptional factors. Central government debt totalled EUR 105 billion at the end of 2018. However, on-budget entities will remain in the deficit in the coming years, which means that central government will accumulate additional debts during the forecast period. The debts will, however, grow at a substantially slower rate than at the start of the decade. Central government debt is expected to total about EUR 111 billion in 2021, which is about 43% of GDP. From 2021 onwards, central government debt will be increased by the appropriations budgeted for the fighter aircraft project of the Finnish Defence Forces.



Sources: Statistics Finland, MoF

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General government debt relative to GDP, %



Sources: Statistics Finland, MoF

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Table 17. Central government¹

	2016	2017	2018	2019**	2020**	2021**
	EUR billion					
Current taxes	13.7	14.4	14.9	15.8	16.1	16.7
Taxes on production and imports	31.1	31.5	33.1	33.5	34.1	34.7
Social security contributions	0.0	0.0	0.0	0.0	0.0	0.0
Taxes and social security contributions, total ²	45.3	46.9	48.7	50.0	50.9	52.2
Other revenue ³	8.7	8.8	9.0	9.0	8.9	8.9
of which interest receipts	0.3	0.3	0.2	0.2	0.2	0.2
Total revenue	54.0	55.7	57.7	59.1	59.8	61.1
Consumption expenditure	14.0	13.5	13.6	13.8	14.3	14.7
Subsidies and current transfers, total	38.8	39.5	40.2	40.3	41.0	41.9
to general government	27.1	28.1	28.4	28.4	28.9	29.5
Interest expenses	2.2	2.1	1.9	1.9	1.8	1.8
Capital expenditure ⁴	4.8	4.7	4.7	4.9	4.5	4.3
Total expenditure	59.7	59.7	60.4	60.9	61.5	62.8
Net lending (+) / net borrowing (-)	-5.7	-4.1	-2.7	-1.8	-1.7	-1.7
Primary balance ⁵	-3.8	-2.3	-1.0	-0.1	-0.2	-0.1

1) As calculated in the National Accounts

2) Incl. capital taxes

3) Incl. capital transfers (excl. capital taxes) and consumption of fixed capital

4) Gross fixed capital formation and capital transfers

5) Net lending before net interest expenses

2.3 Local government

With only a slight increase in revenue and a rapid increase in expenditure, there was a substantial weakening in the state of local government finances in 2018. It seems that the rapid increase in expenditure has continued in the first months of 2019. The local government deficit will continue to grow this year, compared to 2018. The expenditure will be boosted by growing need for healthcare and social welfare services as well as by local government pay rises and the expiry of the holiday bonus cut under the Competitiveness Pact. Most of the impacts of the reinstatement of the holiday bonus will already be felt in 2019. Investment expenditure will also continue to grow as substantial funds will be allocated to the construction and renovation of hospitals, schools, transport infrastructure and urban infrastructure.

Local government revenue will grow steadily in 2019 as a result of tax revenue but it will not be enough to cover the expenditure. Municipalities' tax revenue growth will be boosted by a growth in earned income and the one-off tax revenue increase resulting from the bringing forward of back tax payments. At the same time, there will be a reduction in government aid in 2019 due to such factors as the revision of the division of costs between central and local government. In accordance with the Government Programme of Juha Sipilä's Government, no index adjustment will be made to central government transfers to municipalities in 2019 either.

The local government finances projection for the years 2020 and 2021 is a pressure calculation, in which consideration is only given to already detailed measures impacting local government finances that are included in the spring 2019 General Government Fiscal Plan. The projection does not include municipalities' and joint municipal authorities' own measures for the years 2020 and 2021. They will only be included in the projection after the budgets have been finalised. Municipal tax rates have been kept at 2019 levels. The measures laid out in the Government Programme of Prime Minister Rinne's Government are not considered in the projection.

The growth pressures on local government consumption expenditure result from the ageing of the population, which will increase healthcare and nursing expenditure. At local government level, the pressures to increase spending are eased by a reduced need for educational services, a result of falling birth rates and

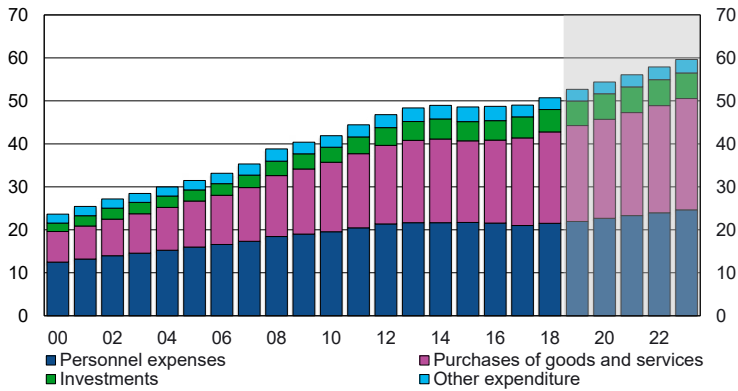
smaller age classes. However, it remains uncertain whether the savings potential generated by a reduced need for educational services can be fully realised. In municipalities with reduced service needs, the number of daycare centres, schools and early childhood education and teaching personnel should be rapidly adjusted in accordance with the shrinking number of children.

There will be a slight improvement in the local government budgetary position in 2020, compared to 2019, but it will remain substantially in the deficit. Central government transfers and grants in particular will increase substantially as municipalities will receive a compensation of about EUR 240 million for the holiday bonus cut laid out in the Competitiveness Pact so that the cut would not be taken into account twice in central government transfers to local government. Government transfers and grants will also be increased by the expiry of the temporary cuts introduced with the Competitiveness Pact, compensations for lost tax revenue paid to municipalities and index increases in central government transfers to local government. At the same time, local government expenditure is also expected to increase as the tight labour market is likely to boost earnings.

Local government will also post substantial deficit in 2021. Wage bill growth will ensure a steady increase in tax revenue. Central government transfers will also be boosted by compensations for lost tax revenue paid to municipalities and index increases. However, a relatively steady growth in revenue will not be enough to improve the state of local government finances as investments will remain at a high level and more healthcare and social welfare services are needed for an ageing population.

Local government debt to GDP ratio decreased in 2017 and remained at more or less unchanged in 2018. However, the debt ratio will rise this year and the rate of growth will be rapid throughout the forecast period, a result of local government deficits and a slowdown in economic growth.

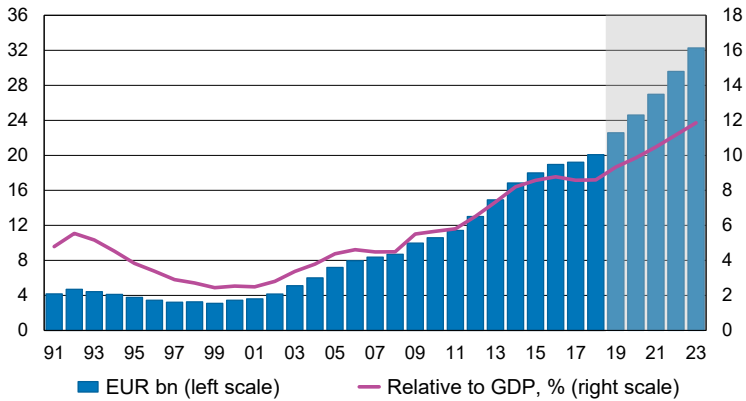
Local government expenditure EUR bn



Sources: Statistics Finland, MoF

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Local government debt



Sources: Statistics Finland, MoF

VM34098

Table 18. Local government¹

	2016	2017	2018	2019**	2020**	2021**
	EUR billion					
Taxes and social security contributions	22.0	22.8	22.5	23.6	24.4	25.3
of which municipal tax	18.7	19.1	18.8	19.8	20.5	21.3
corporate tax	1.5	1.9	1.9	2.0	2.0	2.1
real estate tax	1.7	1.8	1.8	1.9	1.9	1.9
Other revenue ²	18.9	18.8	19.3	19.5	20.8	21.2
of which interest receipts	0.3	0.3	0.3	0.3	0.3	0.3
transfers from central government	14.3	13.9	14.3	14.2	15.3	15.6
Total revenue	40.9	41.6	41.8	43.2	45.2	46.5
Consumption expenditure	34.0	34.4	35.8	37.2	38.6	40.1
of which compensation of employees	21.6	21.0	21.5	22.0	22.7	23.3
Income transfers	3.3	2.7	2.7	2.7	2.7	2.8
of which social security benefits and allowances	1.4	0.7	0.8	0.8	0.8	0.8
subsidies and other transfers	1.8	1.9	1.8	1.8	1.8	1.8
interest expenses	0.1	0.1	0.1	0.1	0.2	0.2
Capital expenditure ³	4.5	4.9	5.2	5.7	6.0	6.0
Total expenditure	41.8	42.0	43.7	45.6	47.3	48.9
Net lending (+) / net borrowing (-)	-0.9	-0.4	-1.9	-2.5	-2.0	-2.4
Primary balance ⁴	-1.0	-0.6	-2.1	-2.6	-2.1	-2.4

1) As calculated in National Accounts

2) Incl. capital transfers and consumption of fixed capital

3) Gross capital formation and capital transfers

4) Net lending before net interest expenses

2.4 Social security funds

Employment pension schemes were able to increase their surplus to 1.0% of GDP in 2018. However, there has been a substantial reduction in the surplus of the employment pension schemes over the past decade because in the first decade of the 2000s, the average surplus stood at more than three per cent. The surplus is expected to remain more or less at 2018 levels throughout the forecast period. Steady economic growth has helped to increase pension contribution revenue but it will not be enough to substantially improve the budgetary position of the employment pension schemes. A rapid rise in employment pension expenditure will continue as the number of pensioners is increasing and further rises in average pensions are expected. On other hand, property income of employment pension schemes will return to a moderate growth path in the forecast period. The assumption is that the private-sector pension contribution will remain at its current level (24.4%) throughout the forecast period.

The other social security funds are the Social Insurance Institution (Kela), which is mainly responsible for basic social security, and the Employment Fund and unemployment funds managing the earnings-related unemployment security schemes. The surplus of the other social security funds remained at 0.3% of GDP in 2018. A gradual reduction in the surplus of the other social security funds is expected in the forecast period. This is because against the background of a substantial surplus in the Employment Fund arising from the economic upturn, the unemployment insurance contribution was lowered by 0.8 percentage points at the start of 2019. Improvements in the employment situation will continue to reduce unemployment expenditure in the coming years and the rising wage bill will boost social security contribution income. In the situation presented by the forecast, the unemployment insurance contribution should, under the current legislation, be lowered still further and the reduction should be introduced by 2021. Thus, the assumption is that the unemployment insurance contribution would be cut by 0.4 percentage points from 2021.

Benefits, allowances and medical care reimbursements relative to GDP, %

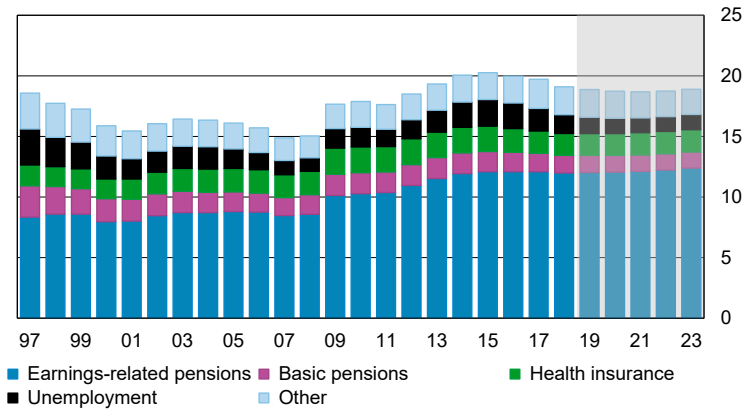


Table 19. Finances of social security funds¹

	2016	2017	2018	2019**	2020**	2021**
	EUR billion					
Investment income	3.5	3.7	4.2	4.4	4.7	5.1
Social security contributions	27.9	27.3	28.0	28.4	30.1	30.7
of which contributions paid by employers	18.8	17.6	17.8	17.7	18.6	19.1
contributions paid by insured	9.2	9.7	10.2	10.6	11.5	11.6
Transfer from general government	14.6	15.8	15.5	15.5	14.9	15.2
Other revenue	0.5	0.4	0.4	0.4	0.4	0.4
Total revenue	46.5	47.2	48.1	48.6	50.1	51.4
Consumption expenditure	3.6	3.6	3.7	3.9	4.0	4.0
Social security benefits and allowances	36.6	37.6	37.9	38.7	39.7	40.8
Other outlays	3.4	3.4	3.3	3.3	3.4	3.4
Total expenditure	43.6	44.5	45.0	45.9	47.0	48.2
Net lending (+) / net borrowing (-)	2.9	2.7	3.1	2.7	3.1	3.1
Earnings-related pension schemes	2.4	2.0	2.4	2.4	2.7	2.9
Other social security funds	0.5	0.7	0.7	0.4	0.5	0.3
Primary balance ²	1.6	1.5	1.7	1.5	1.8	1.7

1) As calculated in National Accounts

2) Net lending before net interest expenses



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