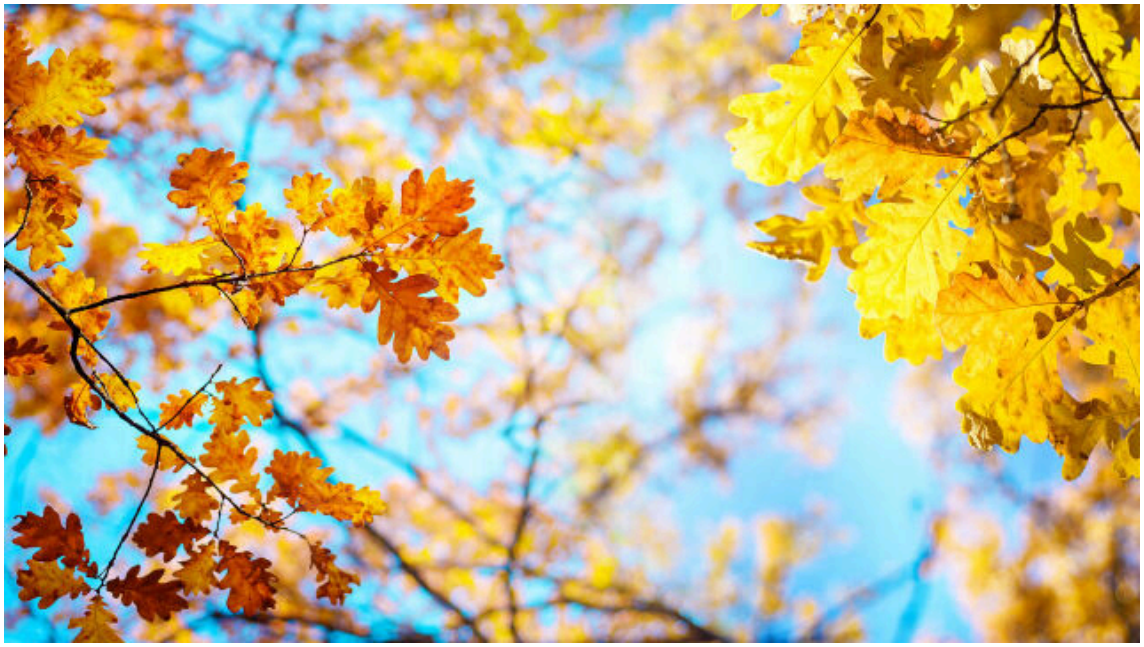
Forecast

Economy recovering apace

Finnish economy | 30 September 2021

The Finnish economy strengthened faster than expected in the course of spring and summer 2021. For the year as a whole, the interim forecast of September 2021 projects stronger economic growth than the June forecast. The major uncertainties surrounding the forecast in the immediate years ahead relate to the progress of the pandemic both in Finland and globally. While robust economic growth will continue in 2022, the rate of growth is expected to taper off towards the end of the forecast horizon in 2023 and resume its long-term growth path.



The Bank of Finland's interim forecast [1] is based on data available on 8 September 2021 and assumptions updated on 16 August 2021 concerning developments in Finland's external environment and key financial market variables for the immediate years ahead.

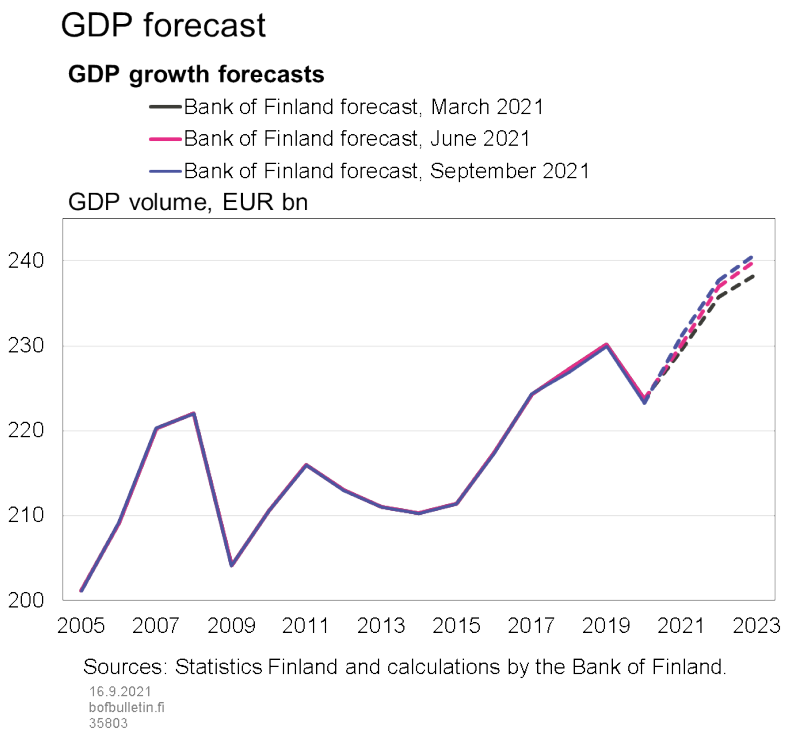
Economic growth gathered momentum in the early part of the year

The growth outlook for the Finnish economy is brighter than foreseen in the forecast last June. In

spring 2021, economic growth was much stronger than expected, and both business and household confidence has improved in step with the progress of vaccinations and lifting of restrictions. GDP growth is projected at 3.5% in 2021 and 2.8% in 2022 (Chart 1). Driven by robust economic growth, employment also increased faster than expected during the summer. In the wake of strong economic growth, consumer price inflation has accelerated, reflecting a rise in energy prices, in particular.

The major downside risks to economic growth are still related to the COVID-19 pandemic. With the increasing prevalence of the Delta variant, infection numbers turned up again in the summer, and the development of the pandemic will still be accompanied by risks for a lengthy period. As well as the domestic pandemic situation, uncertainty is sustained by the global development of the pandemic, notably in developing countries, where the roll-out of vaccines is slow.

Chart 1.



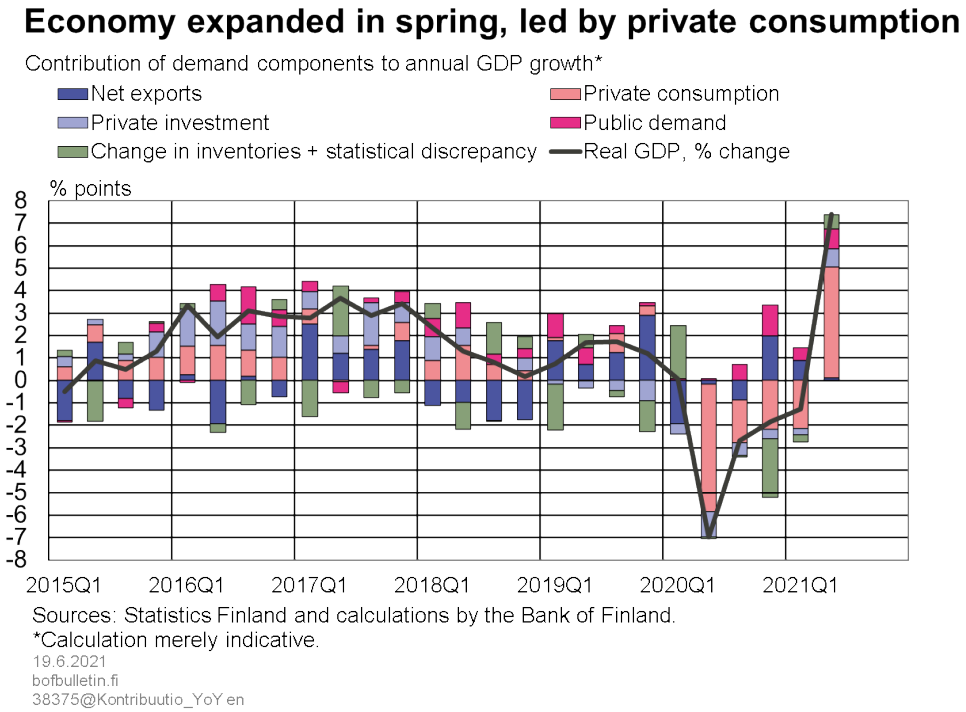
The economy has grown strongly in the early part of 2021. GDP growth was especially robust in the second quarter of the year, rising 2.1% quarter-on-quarter and 7.4% year-on-year (Chart 2). In fact, GDP has already bounced back to its pre-pandemic level.

Economic growth has rebounded, led by private consumption, as restrictions have been lifted and consumer uncertainty has receded. Similarly, retail trade has continued its robust expansion, and demand for services has picked up. That said, in some hardest-hit services, such as events and

traffic, recovery remains in its infancy. Private investment has been boosted notably by the pick-up in residential construction early in 2021. There were already more new residential construction sites in the second quarter of 2021 than ever in recorded statistical history (1995-).

The positive momentum of the global economy is expected to be reflected in Finnish exports with a minor time lag. While industrial output and orders posted brisk growth in the early part of the year in all Finland's key export industries, export growth nevertheless remained weak. Underlying the weakness of export growth in early 2021 are, partly, supply constraints, such as the delivery problems faced by some export companies.

Chart 2.



A breakdown by industry shows that economic recovery has been fairly broad-based. Output growth has picked up in both manufacturing and construction, and in the services hardest hit by the COVID-19 pandemic. In fact, the turnover in services already climbed in the summer close to the pre-pandemic level. Yet there are still major differences between individual service industries, and the turnover in travel and leisure services still lags far behind pre-crisis levels.

Turnover in retail trade has also continued to increase. Of consumer durables, cars especially have been selling well. However, having shown an upward trend throughout the beginning of the year, first time registrations dropped in July. Rather than a faltering of demand, the dip in first time registrations is likely to reflect delivery constraints due to the shortage of components faced by

the automotive industry.

Pick-up in economic growth will be temporary

On the back of stronger-than-expected growth in the early part of the year, and an improvement in the external environment, the growth forecast for 2021 has been revised upwards. Hence, GDP growth for 2021 is projected at 3.5%, up from 2.9% in June (Table 1).

Private consumption will continue to expand in 2022. Growth will also be supported by residential construction and investments in machinery and equipment, and export growth will rebound, too. The forecast for GDP growth in 2022 is 2.8%. The spike in economic growth following recovery from COVID-19 will, however, remain transitory and the economy is expected to resume its long-term growth path already in 2023, when the rate of GDP growth will slow to 1.3%. The ageing of the population and weak productivity growth will act as constraints on Finland's growth potential even after the COVID-19 crisis has passed.

The employment situation has improved markedly on the back of the robust economic growth. According to the forecast, the average employment rate for 2021 will be 72.0%, which is higher than projected in the June forecast. Strong employment growth will continue in 2022, when the employment rate will climb further, to 72.7%. There is still room for the number of employed to grow as the pandemic recedes, especially in services. Although the rate of economic growth will moderate towards the end of the forecast horizon, the employment rate will continue to rise, reaching 73.2% in 2023.

The revival in economic growth has also powered an increase in consumer price inflation. The rate of inflation as measured by the Harmonised Index of Consumer Prices (HICP) is projected to rise to 1.9% in 2021, from 0.4% in 2020. Half of the inflation already recorded in 2021 reflects a rise in energy prices that is already levelling off. Given that inflation expectations have remained moderate, the rate of inflation is anticipated to slow to 1.5% in 2022 and rise back slightly towards the end of the forecast horizon, to stand at 1.6% in 2023.

Interim forecast summary

		2019	2020	2021f	20
GDP, annual growth (%)	Interim forecast, September 2021	1,3	-2,9	3,5	2

Sources: Statistics Finland and Bank of Finland.

Interim forecast summary					
	Forecast, June 2021	1,3	-2,8	2,9	3
Employment rate (%)	Interim forecast, September 2021	71,7	70,7	72,0	7
	Forecast, June 2021	71,7	70,7	71,4	7
Inflation (%)	Interim forecast, September 2021	1,1	0,4	1,9	1
	Forecast, June 2021	1,1	0,4	1,7	1

Sources: Statistics Finland and Bank of Finland.

Pandemic still causing uncertainty in the economic outlook

Following the emergence of the Delta variant as the dominant form of the SARS-COV-2 virus, infection figures turned up again in late summer. So far, the fourth wave of the pandemic has not been as forceful as the waves experienced last winter, with especially the number of severe cases of infection being reasonable in relation to the capacity of health care services.

The containment of the pandemic is still surrounded by risks that may jeopardise economic growth both in Finland and globally. In developing countries, the roll-out of vaccinations has been slow, which heightens the risk of the emergence of new, even more dangerous virus mutations. Hence, we cannot declare victory over the COVID-19 pandemic until it has been defeated globally.

The acceleration of global economic growth is reflected in raw material prices

The revised June forecasts partly reflect changes in Finland's external operating environment.

The global economy has recovered rapidly from the COVID crisis in early 2021, and the euro area economy is also growing rapidly. Consequently, growth in Finland's export markets is projected to exceed 9% in 2021 (Table 2). However, the recovery from the COVID crisis is still ongoing, as China is so far the only large economy to rebound to pre-crisis GDP levels. The fastest rate of growth in the global economy and world trade has also levelled off during the late summer months. Confidence indicators suggest that global economic growth will continue, although the increase in uncertainty is reflected in the most recent indicators.

In addition to the pandemic, global economic growth is limited by supply side factors such as component shortages and increased transport costs. Both production bottlenecks and rapid growth in the global economy have led to a rapid rise in raw material and energy prices in early 2021.

The change in the growth outlook for the global economy compared with the summer has been taken into account in the outlook's external assumptions, which have been somewhat revised since the June forecast. Overall, with the new assumptions, Finland's economic outlook has become slightly more favourable.

In 2021–2023, growth in Finland's export markets will exceed the predictions put forward just a while ago in the June forecast. At the same time, however, output growth will be hampered by the faster-than-expected price surge for both crude oil and other industrial raw materials, especially in 2021. In 2022, the price of crude oil is expected to turn down and other raw material prices to stabilise.

In the latest forecast, export prices in competitor countries are expected to grow at a faster rate than forecast in June. The exchange rate has also weakened slightly since the June forecast. Financial conditions will remain accommodative over the forecast horizon.

Forecast assumptions	2019	2020	2021f	2022f	20
Volume change year-on-year, %					
Euro area GDP	1,5	-6,5	5,0	4,6	2
Global GDP, (excl. euro area)	2,9	-2,3	6,3	4,5	3
World trade* (excl. euro area)	-0,1	-8,4	11,9	5,3	4
Finland's export markets, % change**	1,8	-8,5	9,3	6,0	3
Oil price, USD/barrel	64,0	42,3	67,8	67,3	6
Export prices of Finland's competitors, euro, % change	1,6	-3,9	5,8	1,9	0

**Calculated as the weighted average of imports.*
***The growth in Finland's export markets is the import growth in the countries Finland exports to, weighted by their average share Finland's exports.*
****Broad nominal effective exchange rate, 2015 = 100. The index rises as the exchange rate appreciates.*
Sources: Eurosystem and Bank of Finland.

Forecast assumptions	2019	2020	2021f	2022f	20
3 month Euribor, %	-0,4	-0,4	-0,5	-0,5	-
Finland's nominal effective exchange rate***	106,0	108,7	109,6	109,3	10
USD value of one euro	1,12	1,14	1,19	1,18	1

**Calculated as the weighted average of imports.*
***The growth in Finland's export markets is the import growth in the countries Finland exports to, weighted by their average share Finland's exports.*
****Broad nominal effective exchange rate, 2015 = 100. The index rises as the exchange rate appreciates.*
Sources: Eurosystem and Bank of Finland.

Short-term models anticipate continued strong growth towards the end of the year

The GDP forecasts for the third and fourth quarters of 2021 have been produced by using the Bank of Finland's nowcasting short-term forecast models, which are based on monthly statistics (Table 3). However, the limited amount of statistical data increases the uncertainty related to the forecast for the last quarter of the year.

GDP	2021Q1	2021Q2	2021Q3	2021Q4
Quarterly GDP growth				
BVAR	1,4 %	1,6 %	1,0 %	1,1 %
Factor model	0,4 %	1,2 %	1,4 %	1,2 %
Bridge model	0,5 %	1,1 %	1,0 %	
Financial market model	0,7 %	0,7 %	0,8 %	0,5 %
Actual growth	0,1 %*	2,1 %*		

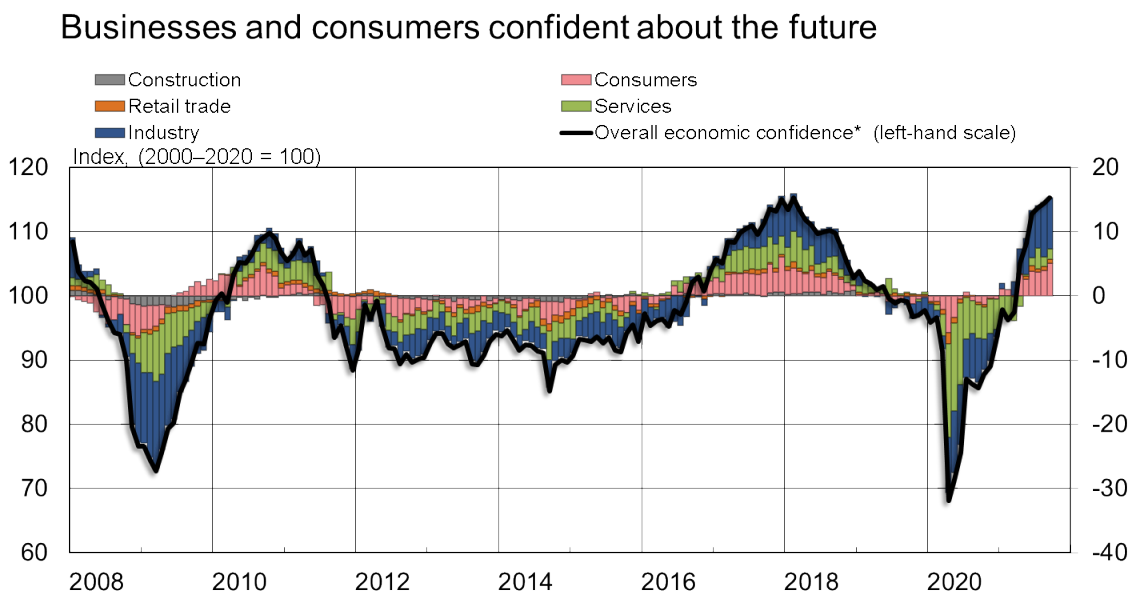
**) Quarterly national accounts, latest release 31 August 2021.*
Sources: Statistics Finland, calculations by Bank of Finland. The models were updated on 3 September 2021.

The short-term models anticipate that economic growth will continue at a rapid rate over the

remainder of 2021. The forecasts reflect, in particular, the strong growth in the export markets. Business and consumer confidence indicators have also shown positive improvement over the summer.

Business confidence continued to improve in August. In August, the score of the business confidence indicator was notably above its long-term average. Both industrial output and new orders grew strongly in early 2021. However, industrial output growth is currently limited by component shortages and rising material prices.

Chart 3.



Construction is underpinned by the rapid recovery in residential construction. In the second quarter of 2021, more new residential construction projects were started than ever before in the history of new-build construction statistics. Based on the number of new building permits, the upswing in residential construction will continue, as new building permits increased by 12.6% from the previous year.

Confidence in the service sector decreased slightly in August, but still remains above its long-term average. The flattening of confidence in the sector in the late summer months is explained by the resurge of infections in the summer, which meant that restrictions on restaurant opening hours and gatherings, for example, had to be tightened again.

The consumer confidence indicator climbed to new records. In August, consumers' confidence in

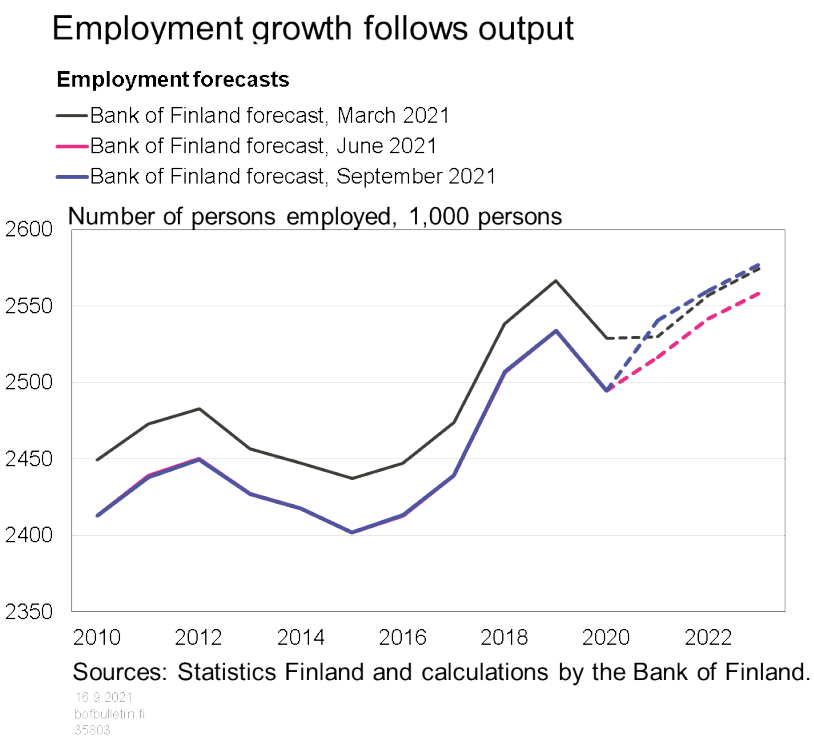
their own economy at present was the most positive in the entire measuring history from 1995 to 2021, and consumers' expectations concerning the development of their own economy over the next year was very optimistic. In addition to the recovery of confidence, private consumption is supported by a strong increase in household purchasing power, which is explained, in particular, by the improvement in employment. In the second quarter, wages and salaries received by households increased by more than 8% from the previous year.

Rapid strides in employment, but unemployment limping behind

The brisk growth in the economy is evident in the sharp rise in the number of people employed. In May–July 2021, there was an average of about 100,000 more people in work than a year earlier, and the average employment rate for 2021 is projected to be 72.0%, which is higher than forecast in June.

The rapid improvement in employment over the summer was attributable especially to the recovery in many parts of the service sector. Normal seasonal variation may also be another contributory factor. Among different age groups, the number of people in employment has climbed the fastest in the under-35 group, for which the employment rate typically rises temporarily in the summer due to seasonal employment.

Chart 4.



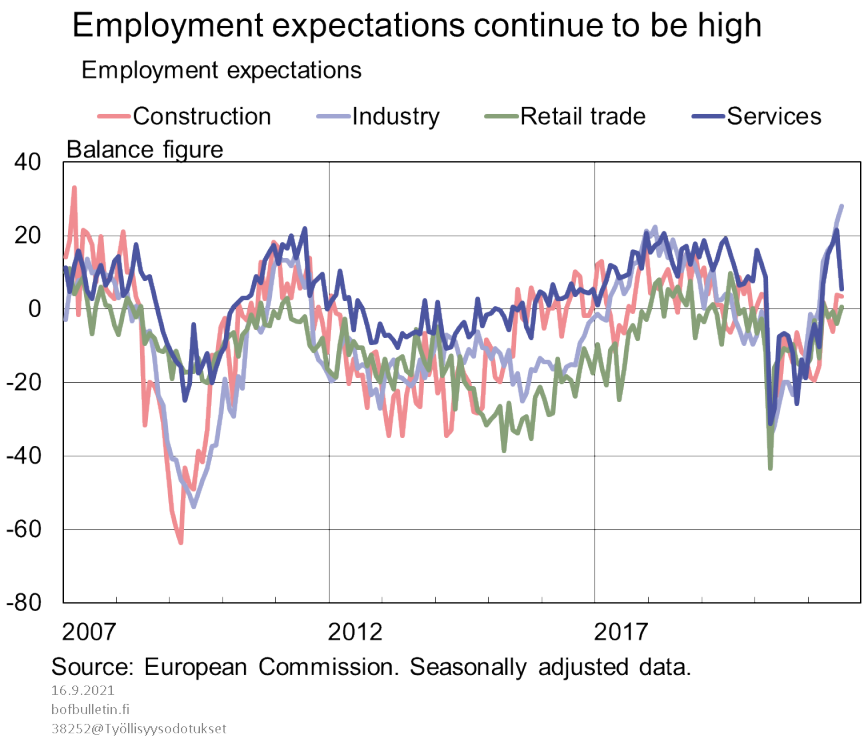
With the robust growth in the economy, employment will continue to rise in 2022, reaching a rate of 72.7%. Businesses' employment expectations are still good, and the number of vacancies is already greater than the pre-pandemic level. In contrast to other sectors, however, employment expectations in the service sector fell slightly in July. This dip can be explained by the fresh rise in COVID-19 infections and the tightening of restrictions, and by the difficulties experienced by businesses in finding people with the right skills. In 2023, the employment rate is projected to be 73.2%.

Bringing down unemployment has proved to be tougher than expected: the fall in the unemployment rate has been quite slow in relation to the strong rise in employment. Figures from the labour force survey indicate that the number of unemployed people in July 2021 was only marginally lower than a year earlier. Long-term unemployment has actually risen during the COVID-19 crisis. Moreover, the newly employed appear to have come not from among the unemployed but most often from outside the workforce, for example students engaging in summer jobs. Seasonal variation in the labour market can also explain why unemployment has been slow to fall.[2] During the forecast period, unemployment is expected to gradually decline more steeply as the effects of temporary factors in the labour market recede.

The exit of working-age people from the labour market accelerated during the early stage of the pandemic, but more and more are returning to the jobs market as the number of vacancies

increases. The demand for labour has grown quickly in some sectors, notably health and social services and accommodation and food services, creating difficulties in filling vacancies. In fact, there appear to be mismatch problems on the labour market, which may slow the rise in employment.

Chart 5.



Inflation driven up by higher energy prices

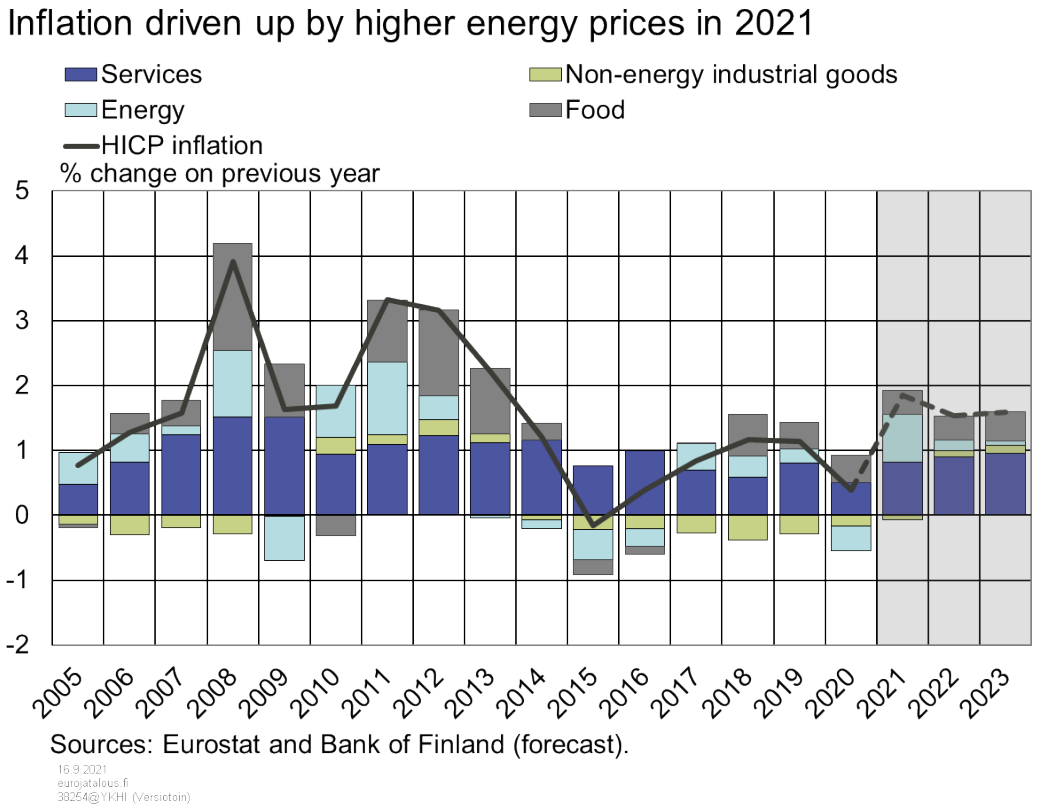
The rise in consumer prices gained further impetus from the quickening pace of GDP growth in the first half of the year. Measured by the harmonised index of consumer prices, inflation for 2021 as a whole will rise to 1.9% (Chart 6). The rise in the rate of inflation this year is partially attributable to a restoration from the exceptionally low rate of 0.4% in 2020. Instead of a broadly based rise in prices, the higher inflation rate has been caused more by a rise in the prices of individual groups of items, principally energy. Higher priced energy explains around half of this year's inflation. A significant element in the higher energy prices is liquid fuels, the rising price of which is due to the increase in crude oil prices in the early part of 2021.

The prices of industrial raw materials rose in the first half of 2021, and this was due also to disruptions in industrial supply chains and elevated transportation costs. Among consumer goods, the prices of used cars in particular rose during the spring and summer.

Prices of services surged at a rate of almost 2% in the first half of the year, but among the subcategories of this group there is considerable variation in the price trend. The rise in rents has slowed to less than 1%, but the prices of certain travel services, for example, began to increase clearly again during the summer.

The growth in the economy will continue to be strong and will ensure a rise in consumer prices again in 2022. The rate of inflation will nevertheless slow to 1.5%, as the rise in energy prices flattens out. In raw materials other than oil, the rise in prices has already levelled off during the summer. In parallel with the declining effect of energy prices on inflation, there will be a steepening rise in underlying inflation, covering goods and services. In 2023, consumer prices are projected to rise by 1.6%.

Chart 6.



Notes

1. The Bank of Finland publishes an interim forecast for the Finnish economy twice a year. These forecasts are published in the spring and autumn and provide a revised outlook for economic growth, employment and inflation developments in Finland. The Bank's more detailed forecasts for the Finnish economy are published in June and December. ↑
2. For instance students returning temporarily to the labour market are recorded as being ↑

unemployed during the period in which they are looking for but have not yet found work.↑

Keywords

COVID-19 crisis, employment, Finnish economy, forecast, gross domestic product, inflation