Forecast

Interim forecast: Growth will strengthen as the pandemic recedes

Finnish economy | 30 March 2021

The recovery of the Finnish economy from the COVID-19 crisis has been boosted by stronger-than-expected developments in the second half of 2020. Economic growth in 2021 is expected to be higher than projected in the December 2020 forecast, despite the worsening of the pandemic in the early months of the year. The forecast is based on the assumption that as vaccination coverage increases, society can be opened, and economic growth will gather pace. The economy will continue to recover in 2022, but in 2023 growth will slow to a rate enabled by the structures of the economy.



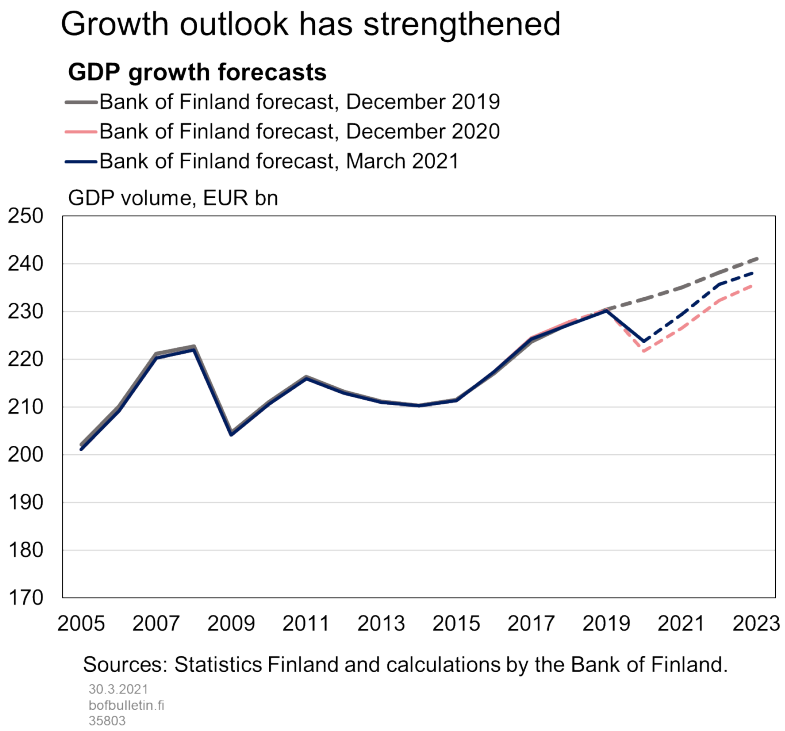
The Bank of Finland's interim forecast[1] is based on data available on 15 March 2021 and assumptions updated on 16 February 2021 concerning developments in Finland's external environment and key financial market variables for the immediate years ahead.

Positive economic sentiment defies pandemic

The outlook for economic growth in Finland has strengthened slightly compared with the Bank of Finland's December 2020 forecast (Chart 1). Actual developments in 2020 were more positive

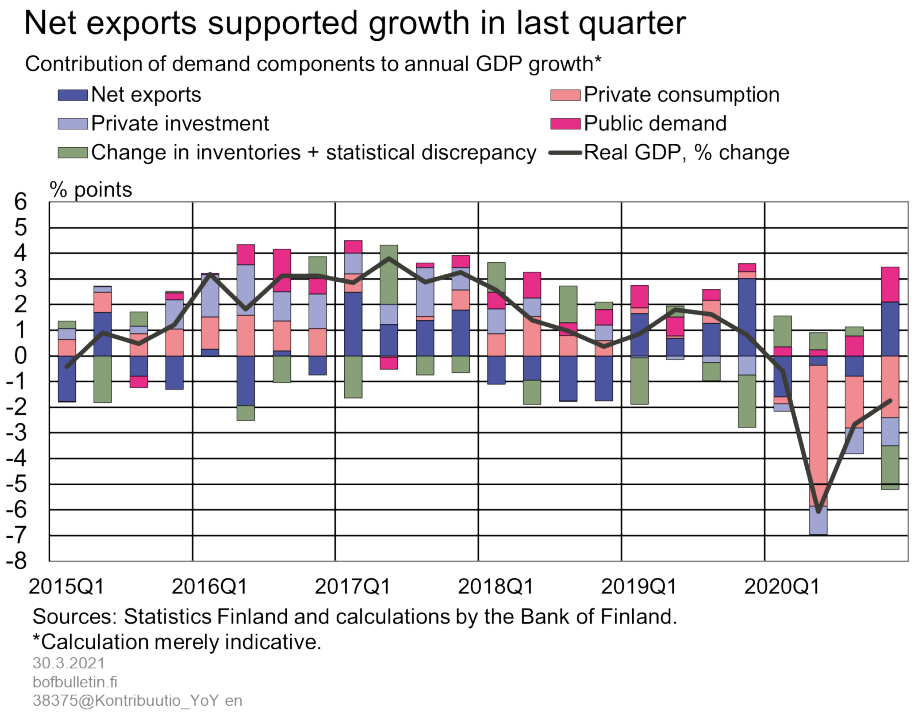
than expected and the confidence of economic agents continues to strengthen in response to the start of vaccination. The number of COVID-19 cases has, however, increased again in the first months of 2021 and containment measures have been tightened, which will slow economic recovery in the first half of the year. Economic growth will, however, pick up towards the end of the year, and in 2022 growth will continue at a brisk pace. In 2023, growth will slow significantly, close to the medium-term growth rate.

Chart 1.



According to preliminary data from Statistics Finland, GDP contracted in 2020 less than assumed in the Bank of Finland's December forecast, i.e. by 2.8%. In the third quarter of 2020, the economy grew at a stronger-than-expected pace, and in the fourth quarter, growth was further driven by net exports (Chart 2). Exports were supported by a large ship delivery in December. Growth in private consumption was strong in the third quarter of 2020, but started to contract again towards the end of the year. Growth in retail trade was relatively robust, whereas demand for other services (particularly accommodation and food service activities as well as transportation services) decreased strongly during the year, and the pre-Christmas season did not provide any relief. In manufacturing, order books improved and output expectations strengthened, despite the differences in the impact of the crisis on the various manufacturing industries. The volume of construction shrank in 2020, but residential construction showed some signs of a turnaround at the end of the year.

Chart 2.



Stronger-than-expected developments in the second half of 2020 and improvements in export markets will boost economic growth in 2021 (Table 1). GDP growth will be 2.6%, supported by the strengthening of private consumption towards the end of the year. In 2022, GDP growth will continue to gather pace and reach 2.7%, reflecting a gradual pick-up in investment. In 2023, economic growth will slow to close to 1% and approach the level of potential output in the economy.

Interim forecast summary

		2019	2020	2021f	2022f	2023f
GDP, annual growth (%)	Interim forecast, March 2021	1.3	-2.8	2.6	2.7	1.2
	Forecast, December 2020	1.1	-3.8	2.2	2.5	1.5
Employment rate (%)	Interim forecast, March 2021	72.6	71.6	71.9	72.8	73.2
	Forecast, December 2020	72.6	71.6	71.8	72.7	73.2
Inflation (%)	Interim forecast, March 2021	1.1	0.4	1.3	1.3	1.4
	Forecast, December 2020	1.1	0.4	0.9	1.2	1.5

Sources: Statistics Finland and Bank of Finland.

The December baseline forecast assumed that the containment measures remain in place in the first half of 2021 until sufficient vaccination coverage is reached. However, the number of COVID-19 cases in Finland started to grow rapidly in the second half of January. On 1 March 2021, the Government, in cooperation with the President of the Republic, declared a state of emergency in Finland. On 8 March 2021, the Government adopted a decision to temporarily close restaurants and other food and beverage service businesses to customers in areas where the pandemic is in acceleration or community transmission phase. Based on current information, the lockdown will last three weeks. The worsening of the pandemic and tighter restrictions will slow growth in the first quarter of 2021. New practices suited to the exceptional conditions have, however, already been introduced and the impacts on growth will be smaller than before. At the same time, the increase in vaccination coverage will raise economic confidence and activity. If the COVID-19 situation continues to deteriorate and tighter containment measures are introduced, economic developments may be weaker than expected. In addition, in the sectors that have been affected by the lockdown measures, the buffers are now weaker than a year ago and similar alleviations are not available for lay-off and bankruptcy proceedings.

The global pandemic already showed signs of easing in the first weeks of 2021, despite the setbacks in some regions. The gradual lifting of containment measures, albeit more slowly than previously expected, as well as the progress in vaccinations and the strong economic policy support have increased expectations, and as a result, the growth projections for Finland's export markets have been revised upwards. Growth in Finnish exports will, however, be slower than growth in the export markets, due to the more subdued recovery in global investment. Domestic private investment will recover slowly as new investment decisions continue to be constrained by uncertainty. Private consumption will be the engine for growth in 2021. The worsening of the pandemic will constrain possibilities for spending in the first half of the year, but as vaccination coverage increases, growth in private consumption will pick up. Growth in consumption will remain strong in 2022.

The employment rate decreased by just under one percentage point, to 71.6% in 2020, but will return to pre-pandemic levels in 2022. During the COVID-19 crisis, jobs have been lost particularly in services. Although the crisis has weakened employment in services, the effects may only be temporary as the demand for services returns. Much of the employment growth in recent years has taken place in services. Towards the end of the forecast period, improvements in employment will be impeded by slow economic growth and a further contraction in the working-age population.

Consumer price inflation slowed in 2020, due to the steep decline in energy prices, particularly the price of crude oil. Inflation as measured by the harmonised index of consumer prices (HICP inflation) will pick up, to 1.3% in 2021, reflecting higher energy prices and other temporary factors. In 2022–2023, inflation will be sustained by a rise in services prices.

Economic growth in the immediate years ahead will rely strongly on private consumption. The income of households who have avoided unemployment will grow steadily and consumer confidence will strengthen as the pandemic recedes. This year will reveal the extent of damage that the crisis will leave on affected sectors. After the crisis, the economy will resume slower growth, hampered by the decline in working-age population and slow productivity growth. Finland is facing the same structural challenges it has been wrestling with since the financial crisis. The recovery to pre-crisis GDP growth after the financial crisis took almost 10 years, which left the economy with a regrettably short period of growth before the onset of the current crisis. Public finances, likewise, had a weak starting point going into the COVID-19 crisis, with a structural deficit in general government finances and a relatively high debt ratio. In the years ahead, population ageing will increase the pressure for growth in public expenditure and slowing economic growth will complicate the balancing of the public finances.

Outlook for global economy strengthened

Global economic growth is projected to be stronger in 2021 than previously estimated, with GDP increasing by 6.5%.[2] In the early weeks of 2021, the pandemic showed signs of receding, but the latest data indicate a new increase in infections. The gradual unwinding of the stringent containment measures, albeit more slowly than previously anticipated, combined with growing vaccination numbers have improved the expectations of economic agents. Strong support from monetary and fiscal policy has also sparked optimism. The economic outlook in the euro area has improved as well, and both industrial output and production expectations have strengthened. Exports grew notably in the second half of 2020. In services, on the other hand, growth remains weak.

Finland's export markets will grow slightly faster than previously anticipated in 2021 and 2022. Crude oil and raw material price assumptions have been adjusted upwards in the light of recent price developments. Crude oil prices increased sharply in the second half of 2020, and, according to market expectations, oil prices will vary between USD 50 and USD 60 per barrel in 2021–2023.

Forecast assumptions

Volume percentage change on the previous year	2019	2020	2021f	2022f	2023f
Euro area GDP	1.3	-6.9	4.0	4.1	2.1
World GDP, (excl. euro area)	2.9	-2.4	6.5	3.9	3.7
World trade (excl. euro area)*	-0.4	-9.1	9.0	4.1	3.4
Finland's export markets**, % change	1.5	-9.7	7.3	5.4	3.4
Oil price, US dollar/barrel	64.0	42.3	59.3	55.7	53.7
Export prices of Finland's competitors, euro, % change	1.8	-4.3	1.7	1.5	1.3
3 month Euribor, %	-0.4	-0.4	-0.5	-0.5	-0.4
Finland's nominal effective exchange rate***	106.0	108.7	109.8	109.8	109.8
US dollar value of one euro	1.12	1.14	1.21	1.21	1.21

*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 of 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 growth

The current economic outlook is assessed by using forecasts produced by nowcasting models for predicting growth in the quarters immediately ahead. Based on the short-term forecast models updated by the Bank of Finland on 9 March 2021, economic growth will continue to accelerate in the first quarter of 2021 (Table 3). However, the short-term models are based solely on published monthly statistics, which do not necessarily reflect the deterioration in the pandemic in early 2021.

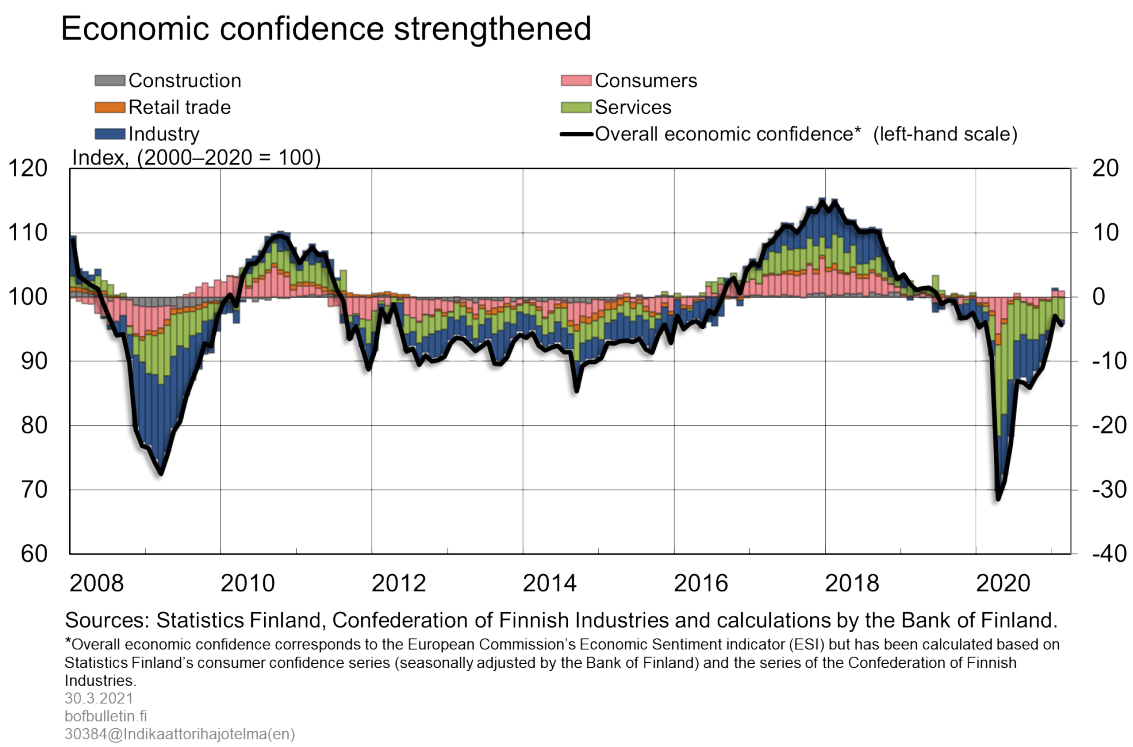
Pandemic poses challenges for short-term models				
Quarterly GDP growth	**2020Q2**	**2020Q3**	**2020Q4**	**2021Q1**

BVAR	-6.2 %	1.9 %	0.6 %	1.0 %
Factor model	-1.9 %	0.8 %	0.1 %	0.6 %
Bridge model	-1.2 %	0.9 %	0.3 %	0.4 %
Financial market model	-0.4 %	0.4 %	0.4 %	0.8 %
Outturn	-4.7 %	3.3 %	0.4 %	
Source: Bank of Finland.				

Changes in the situation surrounding the pandemic are first reflected in the forecasts produced by short-term models through economic confidence indicators. These represent the expectations of economic agents. In February, confidence in the economy took a turn for the worse after several months of strengthening, likely reflecting the worsening pandemic (Chart 3). However, consumer confidence has been strong in early 2021, even if the optimism focuses especially on the outlook for the future.

Industrial production expectations improved at the turn of the year, and order books are recovering. On the other hand, the number of new orders have varied from one industrial sector to another, as has output: growth has been recorded for the chemical industry and the electrical engineering and electronics industries, while output volumes are well below the pre-crisis level in the other metal industries and the forest industry. In January, goods exports were over 10% lower than a year earlier. Nevertheless, the trend in exports has been upward for six months, even though the level of exports is still lower than prior to the crisis.

Chart 3.



Services sector confidence remains low even though the most pessimistic phase is already behind us. Since March 2020, services sector (excl. trade) turnover has been weaker than a year earlier. Although the percentage drop in turnover eased to single-digit figures in the autumn, the change compared with a year earlier was again more negative in December. The crisis has particularly affected accommodation and food service activities as well as transport services. Demand problems in these sectors are also negatively reflected in the export of services. In the trade sector, the crisis has depressed wholesale trade in particular. Retail trade, in turn, grew in 2020, even though the end of the year was weak. Car sales have also rebounded to pre-crisis figures.

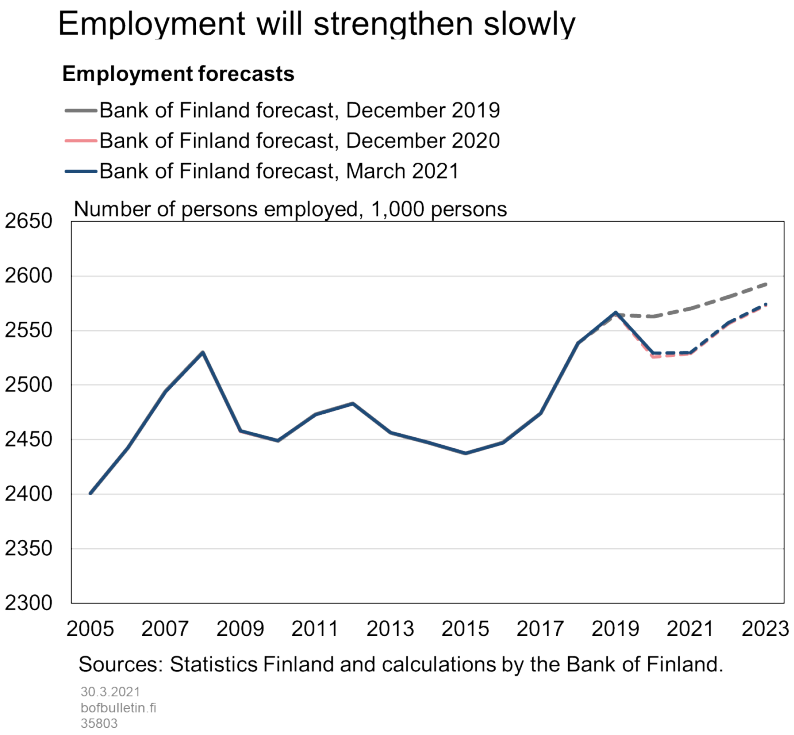
Employment will strengthen slowly

The COVID-19 pandemic broke the growth trend witnessed in employment up to 2019, and in 2020 the employment rate fell by 1 percentage point, to 71.6%. In April 2020, the number of persons employed contracted sharply. After the summer, when the pandemic situation was calmer, employment rebounded close to the level of a year earlier, but at the turn of the year the number of persons employed shrunk again. Broken down by age group, the employment rate in 2020 declined most among young people aged 15–24. The pandemic-induced containment measures were felt most acutely in accommodation and food service activities, where employment fell in 2020 by 19,000 persons on average.

During 2020, the number of persons unemployed increased on average by 29,000, and the average number of persons on furlough was 49,000. The number of persons furloughed rose again at the turn of the year, totalling over 57,000 in January 2021. Long-term unemployment also grew during the year, and in January the number of persons unemployed for over one year was 30,000 higher than a year earlier.

The recovery of employment towards the pre-crisis level will be slow (Chart 4). The employment rate will rise gradually, returning to close to 73% at the end of 2022. However, the number of persons employed will likely reach the pre-crisis level only in 2023. The difference in these two employment measures is due to the continuing decline in the working-age population in the coming years.

Chart 4.

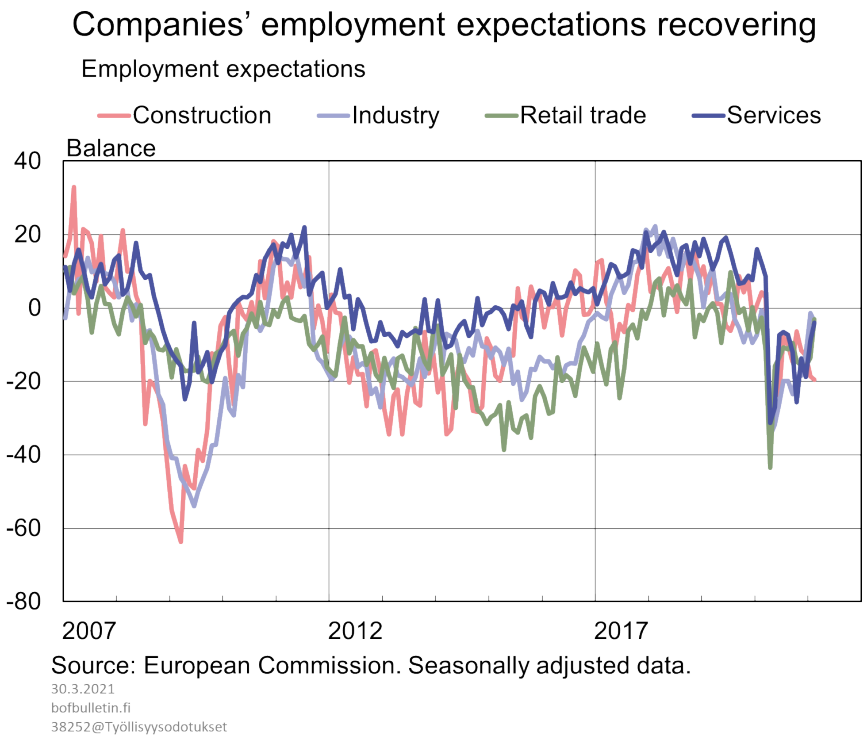


The number of persons employed will resume growth once vaccinations progress in the spring and summer and containment measures can be eased again. The worsening of the pandemic would delay this development and, should the buffers of companies in the sectors most affected by the crisis no longer be sufficient, a significant increase in bankruptcies could further weaken the employment situation.

Companies' employment expectations have improved slightly since the turn of the year, not only in retail trade and industrial sectors, but also in services (Chart 5). Although the expectations are still

weak, their evolution nevertheless points to more positive employment developments, as there are also prospects of the pandemic receding.

Chart 5.



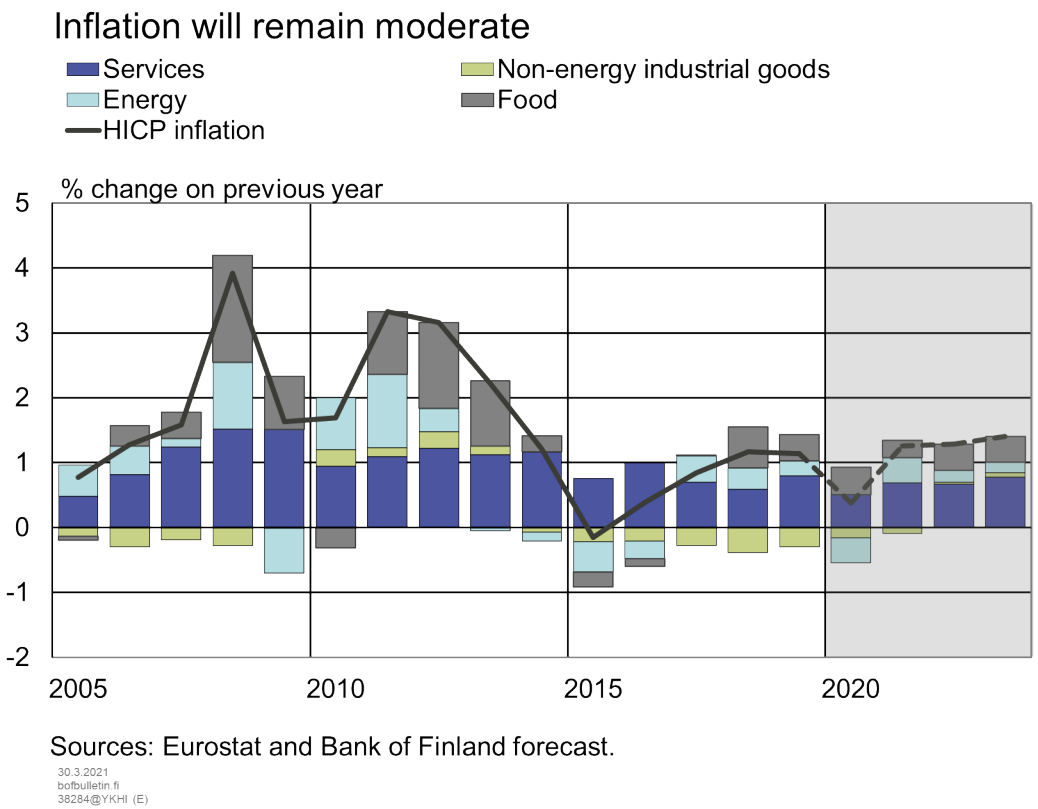
Consumer price inflation will remain moderate

Consumer price inflation as measured by the harmonised index of consumer prices (HICP) was muted in 2020, at only 0.4%. This was particularly due to the fall in energy prices during the year. Services prices also rose more slowly, as the pandemic and the related containment measures were notably reflected in consumption of services. However, services price inflation as a whole picked up in the last months of 2020 and the trend has continued in early 2021.

Inflation will increase to 1.3% in 2021, as the rise in crude oil prices will pass on to consumer prices of liquid fuels (Chart 6). Inflation will also be affected by other temporary factors, such as changes in the weightings of the consumer price index components in line with changes in the structure of consumption. In addition, tax increases on alcohol, tobacco and transport fuels will boost inflation by 0.4 of a percentage point in the early part of the year.

Inflation is expected to increase only marginally after 2021. In 2023, inflation will not exceed 1.4% on account of slower growth in total demand.

Chart 6.



Notes

1. The Bank of Finland publishes an interim forecast for the Finnish economy twice a year. These technical forecast updates published in March and September provide a revised outlook for economic growth, employment and inflation developments in Finland. The outcome of the interim forecast does not necessarily reflect the views of the Eurosystem. The Bank's more detailed forecasts for the Finnish economy are published in June and December. ↑
2. See Eurosystem staff projections for the euro area, March 2021. ↑

Keywords

COVID-19, COVID-19 crisis, economic forecast, Finnish economy, forecast, GDP