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Finnish economy growing fast, but pace will slow in near future

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The economy is continuing to recover from the steep downturn caused by the COVID-19 pandemic. The recovery is, however, being slowed by a worsening of the virus situation, shortfalls in raw materials and electronics components, and an increase in the general level of prices measured by the inflation rate. Economic growth will continue to be bolstered particularly by household spending on goods and services and investment by businesses. Once we have recovered from the recession, the pace of growth will slow, as the long-term outlook for the Finnish economy is overshadowed by the ageing population and the slow pace of labour productivity growth.



The global economy has continued its recovery from the recession caused by the COVID-19 pandemic. The virus situation has, however, deteriorated again during the autumn, maintaining uncertainty and inducing businesses and households to be cautious. The economic recovery has been slowed by supply-side problems, i.e. difficulties in the production of raw materials and electronics components and in the transport and logistics sector. We should not expect a quick solution to these problems.

Despite the worsening of the virus situation and the supply-side problems, the global economy is expected to continue to grow, which will also sustain demand for the goods and services provided by Finnish exporters. Finland's exports will be bolstered particularly by economic growth in the euro area and increasing investment globally. Finland's goods exports have rebounded rapidly and are now as high as before the pandemic.

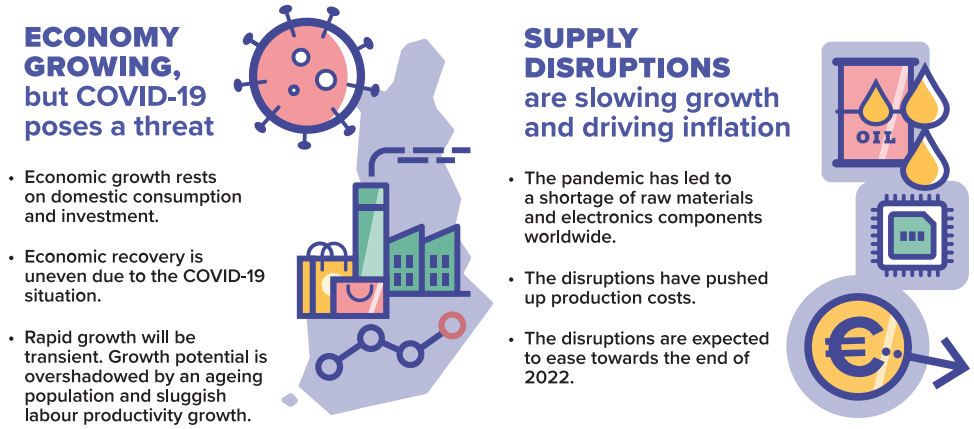
Finland's economic growth will be supported particularly by household consumption and corporate investment. Although the virus situation has once again deteriorated, households continue to have confidence in the outlook for their own finances. Household incomes have grown, as employment has improved and wages are rising. In such circumstances, household consumption will also rise. Rising prices for goods and services will, however, erode some of the growth in purchasing power.

The biggest contributing factor in the rising inflation rate is the increase in fuel and electricity prices. As a result of transportation difficulties and component shortages, industrial goods, such as electronics, have also become more expensive. The prices of many services have also risen as the pandemic has eased and demand for these services has grown.

Although household consumption continues to grow, this growth is not spread evenly across the different service sectors. Particularly in the fields of culture, leisure activities and tourism, demand is still lower than normal. Demand will fluctuate according to how the pandemic develops. During the pandemic, households have saved a larger proportion of their income than previously, as both the opportunities and the desire to consume have been less than normal. Saving is, however, expected to fall back to a normal level as the pandemic recedes.

Economic growth will also be bolstered by investment, particularly in 2022. Housing construction will continue to be brisk, especially in the Helsinki region and in the other larger urban areas. In addition to housing construction, investments in machinery, equipment and product development will also grow markedly in the next few years. Particularly in manufacturing, many companies' profitability and future prospects have remained good despite the pandemic, and they are keen to renew or expand their production capacity. Corporate investment is helped by the current availability of bank loans and the low level of interest rates

Chart 1.



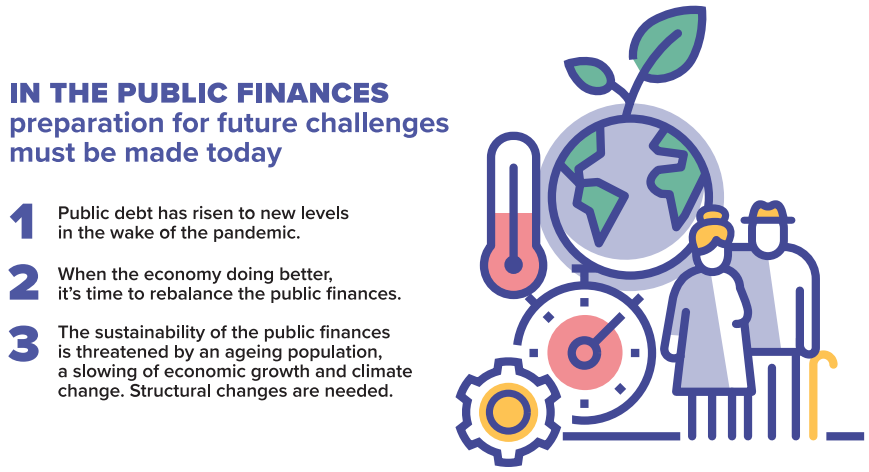
Source: Bank of Finland

The rapid growth in employment will slow as the quickest phase of economic growth is left behind. Employment growth is also being inhibited by a shortage of suitable labour, which makes it harder to fill vacant jobs. The recent rise in employment could, moreover, appear better than it actually is, as a larger proportion than normal of the new jobs have been part-time or fixed-term.

The general government deficit, or the negative imbalance between government revenues and expenditure, has grown during the pandemic. The economic recovery will help reduce the deficit, as tax revenues will grow and the pandemic-related growth in expenditure will slow. Even so, the deficit will not be completely wiped out during the forecast period of 2021–2024.

When expenditure exceeds revenue in central government finances, the government borrows. In the years 2021–2024, the debt will also be swelled by the procurement of defence equipment, such as new fighter aircraft. By the end of the forecast period, in 2024, public debt relative to GDP will be almost 68%. This is a much higher figure than the debt ratio prior to the COVID-19 crisis.

Chart 2.



Source: Bank of Finland

Growth in the economy will be influenced by many unforeseeable factors and could therefore differ, even considerably, from the forecast. Particularly in the immediate years ahead, growth could be weaker than forecast. The largest risks in the short term relate to a further deterioration in the pandemic. There could be significant new virus variants in the future, too, before the pandemic is brought under control worldwide. In addition to the pandemic, economic uncertainty is also increased by supply-side disruptions that could prove to be more persistent than expected and have a considerable impact on the economy.

On the other hand, the economy could actually perform better than expected. As the caution due to the pandemic eases its grip, households could begin to spend the savings they have accrued during the pandemic to purchase goods and services. Thus, household consumption could grow faster and for longer than forecast.

Investment could also surprise in a positive sense. The forecast foresees a slowing in the pace of investment growth in 2024. This is due primarily to structural problems in the Finnish economy, such as an ageing population and weak labour productivity growth. It is, however, normal for investment activity to fluctuate strongly, which makes the volume of investment hard to predict. Hence, the rapid growth in investment could actually continue longer than expected.

Keywords

COVID-19, COVID-19 crisis, Finland, forecast, households, investment, supply, supply disruption