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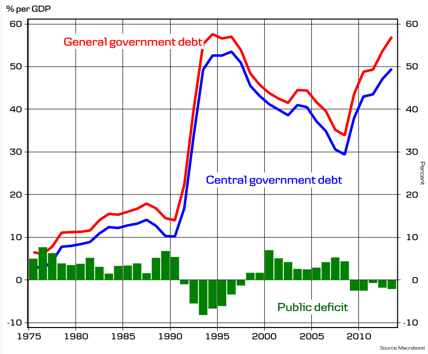
Research

Finnish economy: fiscal tightening hits growth in 2015

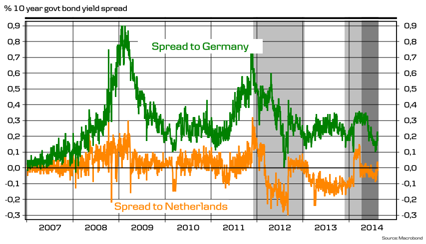
- The Finnish coalition government has convened four times for a budget debate during the parliamentary term and has cut budget expenditure four times. The latest cuts are the deepest and it looks as though nominal expenditure will fall two years in a row for the first time since the depression of the early 1990s.
- The government projects the budget deficit will be slightly less than EUR4bn in 2015. Thus, borrowing is declining. However, government debt relative to GDP is still rising faster than previously expected due to weak economic growth. We expect details of the budget to be announced on 28 August. We expect the measures to stabilise public debt to GDP slightly above 60%, if GDP grows modestly.
- The budget framework covers 2015-18, which extends beyond the next parliamentary elections. Therefore, the expenditure cuts are frontloaded. The government estimates total austerity will be EUR3.3bn or 1.6% of GDP in 2015.
- The coalition government currently includes five parties and 112 members in the 200-seat parliament. Its Prime Minister (Alexander Stubb) and Finance Minister (Antti Rinne) changed in June and we expect the government to focus on implementation of structural reforms. The next elections are due in April 2015 and the next big budget decisions are likely to be left for the next government.
- The Finnish economy operates below potential (the IMF estimates 3.0%, OECD 3.8% of potential GDP) and the economy would have benefited from stimuli since 2012, when Finland sank into a sticky recession. Additional debt would not have been too costly, because a comparably low level of government debt and excellent sovereign credit ratings have kept Finnish government bond yields close to German bunds.
- The need for fiscal austerity derives largely from two main sources: the fear of Finland losing its triple-AAA rating and the need to address the sustainability gap caused by ageing. As for ratings, there exists a real risk that Finland could lose the top rating but this would not necessarily raise funding costs much. It would also seem that rating agencies are more worried about the poor growth outlook than about debt levels. Determined implementation of much-debated structural reforms would abate the worries relating to temporary stimulus, because the reforms could boost the long-term growth potential. Higher growth would narrow the sustainability gap significantly.
- Fiscal stimulus always has several pitfalls: timing, selecting sensible targets and leakage to abroad in an open economy. However, Finland operates well below potential output and is full of opportunities for infrastructure building, for example.
- The economic outlook for Finland continues to be weak. Despite a slow recovery in the euro area, Finnish GDP is set to fall in 2014. Domestic demand remains depressed and exports to Russia are likely to be dented. The government could try to find a better balance between the long-run fiscal sustainability gap and short-term need to support domestic demand. The risk of a much higher unemployment should be addressed.

Debt ratio to reach 60%



Source: Macrobond Financial

Rating outlook and spread



Grey area 1 = S&P put Finland on negative outlook
Grey area 2 = S&P cut Dutch AAA to AA+
Grey area 3 = S&P put Finland on negative outlook
Source: Macrobond Financial

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