

## Finland’s economic recovery exceeded expectations – but some cracks are observable in the global economic outlook

The Finnish economy recovered faster than expected in 2021. Consumer confidence is at a very high level, and companies have also become more optimistic about the future. Employment figures have also climbed above expectations, but labour shortage is becoming a persistent problem. We raised our forecast on this year’s GDP growth to 3.2%.

**MUNIFIN**  
**ECONOMIC FORECAST FOR FINLAND, SEPTEMBER 2021**  
Change, %

		2020	2021f	2022f	2023f
<b>Supply</b>	GDP	-2.9	↑ 3.2	→ 3.0	→ 1.8
	Import	-6.4	↓ 1.5	→ 5.0	→ 2.5
<b>Demand</b>	Private consumption	-4.7	↑ 3.2	↓ 3.4	→ 1.8
	Public consumption	0.5	↑ 2.7	↓ 0.0	→ 0.5
	Investments	-0.7	↑ 2.2	↑ 4.0	→ 2.0
	Export	-6.7	↓ 2.0	→ 5.5	→ 3.0
<b>Other forecasts*</b>	Unemployment rate (ages 15–74)	7.8	↑ 7.8	→ 7.1	→ 6.6
	Consumer price inflation	0.3	↑ 2.1	→ 1.9	→ 1.8

Arrows: forecast    ↑ raised    ↓ lowered    → unchanged

\* Forecasted annual average. Sources: Statistics Finland, MuniFin

## Growth driven by domestic demand

In the first quarter of 2021, Finnish GDP grew only modestly, but after the COVID-19 shutdown in March ended, domestic demand began to recover at a rapid pace. Finland's GDP bounced back to pre-pandemic levels sooner than expected in the second quarter, with private consumption growing by nearly 2% and investments by approximately 1.3% in the April-June period. Investments in machinery and equipment have been growing for the past year, signalling a rapid recovery of investment courage. Construction seems to be recovering significantly faster than predicted as well.

However, a worrying downtrend of investments in intangible assets continues. A significant upturn in research and product development needs to happen to strengthen Finnish know-how and long-term economic growth potential.

## Boost in exports is expected

The growth of Finnish exports has not been quite as strong as anticipated. The effect of net exports on GDP growth was negative during the first half of 2021. Exports of services turned upwards, but exports of goods have remained in the negative. Some of this development can be attributed to normal quarterly fluctuation, as the ship exports in late 2020 caused a positive spike in goods export statistics, which have since levelled out. Looking at a longer timescale, total exports already experienced a positive turn last autumn. Since then, Finnish industries have gained high amounts of new orders, giving confidence in future operations. Net exports are expected to have a positive effect on GDP during the second half of 2021.

**"We raised our forecast on this year's GDP growth to 3.2%."**

As economic growth has exceeded expectations, we have raised our forecast of this year's GDP growth to 3.2%. Growth will become more moderate in the future, but we predict this year's GDP growth will carry over and stay at around 3.0% in 2022. In 2023 it will slow down to 1.8%.

## Slightly weakened global economic forecasts

Finland's economy is currently growing across the board with most indicators being positive. Globally things are looking somewhat less stable: forecasts for the global economy estimate that peak growth may already have passed. A drop in long-term interest rates from highs seen in the spring adds to this impression. This does not necessarily imply a dramatic change in global economic outlook, however. Recovery from the pandemic has happened in a more front-loaded manner than initially expected, and on the other hand, supply side bottlenecks in global value chains may have been underestimated. The swift recovery of consumption has strained global supply chains, and many sectors of the industry are suffering from a shortage of components. Some goods are also moving slowly due to a lack of available shipping containers.

Outlook of the COVID-19 pandemic has also changed yet again during the past few months. Achieving herd immunity through vaccination has become more difficult due to new, more infectious variants, but the vaccines have proved effective against severe forms of the disease, which makes the situation in the Western world easier. Large-scale restriction measures are therefore no longer needed for the time being. However, the situation is still risky in emerging economies where vaccination programmes are proceeding slowly.

**"A particularly unexpected phenomenon has been the substantial increase in available workforce."**

## Employment figures recovered rapidly, boosted by part-time jobs

Perhaps the biggest surprise in Finland has been the fast recovery of employment. The trend of the employment rate has already reached the pre-pandemic top level of 72.7%. Growth in employment figures can mostly be explained by part-time jobs, because working hours still amount for less than before the pandemic. In other words, work is now divided among more people. On a positive note, as working hours are growing more slowly than production output, this could be interpreted as a sign of improved efficiency.

Employment growth has been proportionally fastest in the age group 65 and above. Some of this growth is due to increased demand in healthcare, which has been filled by retired healthcare professionals returning to work. Age groups 55–64 and 25–34 have also recovered in terms of employment, while the group aged 45–54 remains considerably below the pre-pandemic level.

A particularly unexpected phenomenon has been the substantial increase in available workforce, as a large number of people who were previously outside of any working prospects have become active in the labour market again. The total available workforce is currently tens of thousands larger than before the pandemic.

Due to the increased number of people participating in the labour market, unemployment has not decreased in sync with the rising number of employed people. The average unemployment rate in 2021 therefore remains at 7.8%, which is slightly higher than our earlier predictions. We still expect unemployment to drop to 7.1% in 2022 and to 6.6% in 2023 in line with our previous forecast.

## Labour shortage becoming a persistent problem – also in municipalities

As a flipside of rapid economic recovery, significant bottlenecks have developed in the labour market. A record number of jobs are now open, and the resulting acute labour shortage is restricting production growth in many sectors. A skills gap also exists: jobs lost during the pandemic are being replaced with new, but slightly different ones with different skill requirements. The situation calls for more education and more foreign workers, but both take a lot of time.

The sectors that took the heaviest hits from the pandemic – for example, the tourism, restaurant and event industries – are also suffering from labour shortage because their employees moved on to different sectors. The healthcare sector also lost employees to other sectors because of the extremely stressful nature of healthcare work during the pandemic.

**“Labour shortage is as much of a problem for the public sector as it is for the private sector.”**

Labour shortage is as much a problem for the public sector as it is for the private sector. Municipalities and joint municipal authorities have in fact experienced a relatively even faster growth in demand for labour than the private sector. In the municipal sector, the need for new workers is most dire in municipal healthcare and education.

### Regional differences in economic outlook

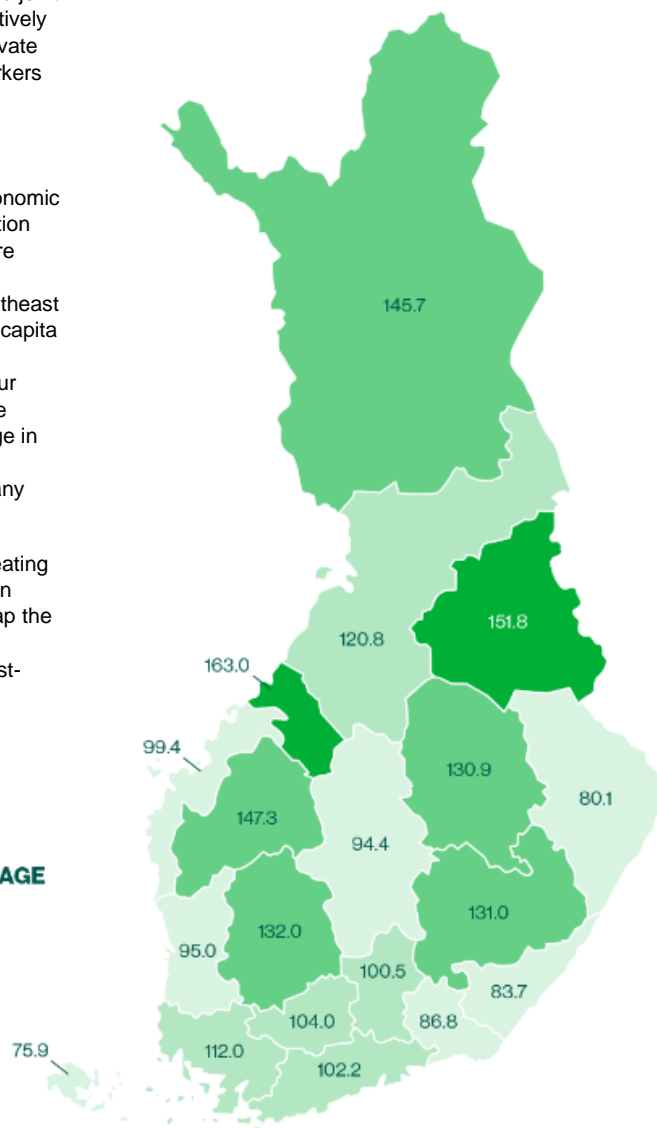
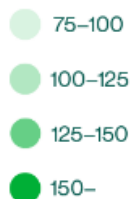
In the private sector, labour shortage is a sign of economic recovery as companies aim to increase their production capacity in response to revitalised demand. There are noticeable regional differences in the need for new workers. Employment has improved overall, but Southeast Finland and North Karelia have fewer open jobs per capita than the Finnish average, while South and Central Ostrobothnia, Kainuu and Lapland have more. Labour shortage is evident especially in Ostrobothnia, where unemployment is substantially lower than the average in Finland. Kainuu and Lapland are suffering from a particularly difficult employment mismatch where many jobs are available, but unemployment remains high.

The COVID-19 crisis transforms the economy by creating new business and new kinds of jobs. Regions with an educated and economically active population will reap the most benefits from the economic upswing. This also means that regional differences may grow as the post-pandemic recovery continues.

**“Regional differences may grow as the post-pandemic recovery continues.”**

Northern Finland differs from the rest of the country in that the crisis of the tourism industry will likely continue longer than in the other sectors. GDP per capita has grown most in Lapland since the turn of the century, but this trend may change if the corporate infrastructure of the tourism industry is permanently damaged and the available workforce migrates away.

### OPEN JOBS PER 10,000 RESIDENTS, 12-MONTH MOVING AVERAGE



source: Ministry of Economic Affairs and Employment of Finland

## No signs of permanently accelerating inflation in Europe yet, but risks are growing

As supply and demand have recovered at different speeds in 2021, inflation has begun to accelerate noticeably. The rise in consumer prices was at its fastest in the spring. In the USA, monthly inflation rate has remained high also after the spring, and permanent acceleration in inflation is a genuine macroeconomic risk. In Europe, inflation is much less severe, and for the time being the situation is more about reduced risks of deflation than persistent inflation.

Whether inflation remains a temporary spike or a more persistent phenomenon is still completely uncertain. A lot can be determined by how long the supply chain bottlenecks create cost pressures, whether wage inflation starts to accelerate, and how price expectations will change. Inflation expectations are largely about mass psychology, which is difficult to forecast.

## Long-term economic outlook positive despite some bottlenecks

Bottlenecks that slow down economic recovery create short-term risks, but experiences gained from the pandemic also create potential for better economic development. The pandemic forced many companies into time-outs but also gave them a moment to refine their business ideas and processes. The use of digital tools has taken a big leap forward, and investments to green technology are making progress. There are clear signs of increasing productivity.

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Public investment projects, supported by the EU recovery fund, aim to set European GDP development into a higher but also more ecologically sustainable track.

## Optimism in municipal finances, but preparing for the health and social services reform is a massive undertaking

The improving economy has a positive effect on municipal finances as well. Employment and total payroll have grown faster than expected, resulting in more tax income. However, favourable economic conditions alone will not solve the structural challenges that municipalities struggle with. The transforming age structure and dwindling working population continue to threaten the economic sustainability of many municipalities.

Implementing the health and social services reform is a burdensome exercise for municipalities. Moreover, the municipality-specific impact assessments are only preliminary and can change in the future, creating much uncertainty. Part of the uncertainty is related to the practical transfer of functions: ambiguities may remain, for example, in the division of responsibilities between the new wellbeing services counties and municipalities. Services that remain with municipalities after the reform may have to undergo reforms in terms of their functions and human resources.

The final transferred net costs are still uncertain for municipalities. The predictions of tax income transferred to the region are also still imprecise. If the predictions in net costs and tax income err to opposite directions, even small variations can significantly affect where in the reform's allowed range of fiscal impact (EUR ±60 per resident) a municipality ultimately lands. While this uncertainty is still ongoing, municipalities are expected to determine their post-reform level of taxation for the year 2023 this autumn. This is a difficult task due to the fiscal uncertainties around the reform.

MuniFin's Economic Forecast is written by Chief Economist, Doctor of Social Sciences **Timo Vesala**. His economic commentary is available in MuniFin's economic forecasts and market reviews.