

# Finland Business Forecast Report Q2 2014

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## Abstracts

### Core Views

Over the short term, we believe that Finland's fiscal situation remains one of the most robust in Europe, and do not expect it to suffer from a ratings downgrade in the near future, expecting it to remain one of just four remaining countries in the eurozone to be awarded AAA status from all three major ratings agencies.

However, over a longer time horizon, looming structural challenges pose a threat to public debt dynamics and may impede fiscal flexibility. Several key sectors, including forestry and papermaking, shipbuilding and telecommunications remain in terminal decline, while high labour costs are acting as a deterrent for investment and importers of Finnish goods, despite strong structural competitiveness. This has cast doubt over the government's ability to sustainably increase aggregate demand through fiscal stimulus.

### Major Forecast Changes

We have revised down our estimates for real GDP in 2013, and now expect a contraction of 0.8%, versus a previous forecast of 0.2%, followed by growth of 1.1% in 2014 and 1.6% in 2015.

### Key Risks To Outlook

A deeper than anticipated eurozone recession represents a severe downside risk to our export forecasts for Finland. While we are already pencilling in a significant slowdown, a eurozone real GDP contraction of 1% or greater could severely impinge upon Finland's highly integrated export market, weighing heavily on Finland's real GDP growth in 2013 and beyond as a consequence.

While not our core view, due to the strong historical legacy of consensus-based political decision making in Finland, we do not rule out the possibility that the rise of the populist euro-sceptic parties could lead to more difficult domestic policy formation.

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Despite solid key creditworthiness metrics, structural issues will prevent the Finnish government from adopting looser fiscal policy as the country enters its third technical recession. Nonetheless, we believe that despite poor demographics, Finnish policy flexibility should allow the country to avoid accumulating excessive public debt over the medium-term.

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### **CHAPTER 2: ECONOMIC OUTLOOK**

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Long-Term Growth Drivers Unclear

The outlook for Finnish economic activity has not improved substantially, and the economy is struggling to find growth drivers as austerity, high unemployment and a cooling housing market weigh on household consumption and investment. Key industries appear to be caught in terminal decline, reducing positive feed-through from improving eurozone demand.

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Passive monetary tightening and improved investor sentiment will compound policy inertia from the ECB has keep the euro strong heading into 2014. However, weak economic growth, high unemployment, euro strength, deflation risks, a potential LTRO-cliff and anaemic structural reform are becoming increasingly unpalatable for policymakers. As such, we expect substantial monetary intervention in 2014.

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ECB Cut: Pushing On A String

A cut in the ECB's refinancing rate will do little to ease monetary policy in the eurozone, given the fractured credit transmission channel and passive tightening resulting from banks repaying LTRO funds. While there are few easy options to ease policy in the near term, we warn that if the long running disinflationary trend evolves into full blown deflation, the ECB may have to look at more aggressive forms of policy stimulus.

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