

Aktia's economic forecast 6/2022:

**The period of strong
growth is behind us**

Aktia

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Finland's economic growth will slow down to 1.6% this year. Our growth forecast for next year is 0.9%. As the coronavirus pandemic and its economic impact has been driven to the background, Russia's attack on Ukraine plunged the world economy into a new period of uncertainty. The coronavirus was a deep and short shock for the economy, whereas this new shock will be less deep but drawn out over a longer period of time. Russia is Finland's seventh largest export market, but the slowdown in the European and global economic growth poses a greater risk to Finland. The price increase in raw materials, especially in energy, puts an exceptionally heavy strain on the already high-inflation EU economies. In the midst of the new uncertainty, the recovery of consumption from the coronavirus pandemic and the depreciation of the euro will balance the otherwise negative economic environment.

Europe's growth outlook is the biggest challenge for exports

The Finnish export and industry survived the pandemic with little damage because we produce various kinds of investment and industrial commodities for the needs of foreign companies

The corona dip was so short that the production did not have much time to react. The current situation is different. We expect the economic uncertainty caused by the war to be clearly more drawn out, which weakens the willingness of foreign companies to invest and, consequently, weakens the export prospects of Finnish companies.

In 2021, 4.5% of Finland's exports went to Russia. As a result of sanctions and refusals to trade with Russia, Finland's exports to Russia will almost cease to exist within a relatively fast time frame. This has an immediate impact on the economy, particularly on companies engaged in trade with Russia. At the same time, uncertainty and high inflation are slowing

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down economic growth in the EU – and the EU is Finland's most important export region.

There is also a small gleam of hope on the horizon of Finland's exports. The depreciation of the euro will improve the competitiveness of Finnish export companies and soften the blow to their economies, but it will not solve all problems. The exports of services may benefit more than usual from the depreciation of the euro. Unlike exports of goods, services are not dependent on foreign raw materials. As the euro depreciates, the goods and raw materials purchased in dollars by Finnish companies will become more expensive and thus erode the export advantage created by the weak euro.

Imports fairly closely follow the general development of the economy. As far as imports are concerned, we see that the greatest risk is related to the availability of imported goods rather than the increase in import prices. The imports from Russia to Finland are higher than Finland's exports to Russia. Finland is less dependent on Russian gas than many other European countries. This will significantly reduce the effectiveness of Russia's energy weapon against Finland. The availability problems regarding industrial production commodities, such as wood and steel, and the rising import prices will also significantly increase consumer prices.

Services will stimulate the blurred outlook for private consumption

The strain on the growth of private consumption this year and next year is caused by more than one factor, but consumption also has one obvious stimulus.

The war beginning was strongly reflected in consumer confidence. This weakens the willingness of consumers to make larger purchases in particular, such as home improvements or furniture purchases. A high number of home improvements were made during the coronavirus pandemic, so expectations regarding large purchases were already pessimistic.

Another factor that weakens consumption is inflation. In April, consumer prices increased by 5.7% in Finland compared to one year before. Prices were increased as a consequence of the rising prices of various raw materials, such as oil and construction materials. Salaries are currently increasing at a slower rate than prices. This will lead to a weakening of consumer purchasing power, i.e. the ability to consume.



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The balancing of the uncertainty and the inflation risks comes from service consumption. The corona restrictions have been dismantled and consumers can finally eat out and use other services. The growth in service consumption will balance the otherwise weak outlook for consumption. However, it is important to remember that the coronavirus has not been defeated for good and that the recovery of the demand for services requires the pandemic to remain under control.

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Construction and productive investments as a challenge to investments

This year and the year before, Finland's investment growth has been supported by construction investments, which account for about 60% of all our investments.

The outlook for construction investments has clearly weakened. The year 2022 will be a very busy year in housing construction. However, the year 2023 will be clearly more difficult as the number of building permits granted has shifted to a clear decline, which will result in a clear reduction in construction investments. In addition, significant price increases in materials and supplies as well as availability problems will create additional challenges in construction.

When it comes to investments in production as well as in research and development, Finland is in significant need of new initiatives. These investments depend on our competitiveness, the demand in our export countries and Finland's attractiveness as an investment destination. There has been much debate recently about Finland's possible membership in NATO and the increasing country risk. A NATO membership would certainly reduce investors' concerns about the risks to Finland, but it will not significantly change the investment outlook. Through the membership, it can be ensured that we do not lose any investments, but there is no reason to expect significant "NATO growth" when it comes to investments.

Continued decline in the unemployment rate unlikely

The unemployment rate in Finland has declined steadily since the peak caused by the coronavirus.

In April 2022, the unemployment rate was 6.9%. Similarly, the employment rate has even increased to record figures. The current situation may not be quite as rosy. The hours worked do not yet exceed the level preceding the pandemic, even though the employment rate long ago exceeded the level of the corresponding period. This indicates that part time employment has become more common. The growth outlook has clearly weakened since the

war started, which will reverse the decline in the unemployment rate.

In the industrial sector, the risk of unemployment has increased. On the other hand, the number of people in employment in the service sector, especially in the hotel and restaurant sectors, has not fully recovered from the pandemic's lowest figures. The recovery of the service sectors will balance the negative labour market effects of the global economy.

Annual volume growth, %				Forecast		
	2019	2020	2021	2022	2023	2024
GDP	1,2	-2,3	3,5	1,6	0,9	1,3
Exports	6,7	-7,5	4,7	5,1	1,0	2,3
Imports	2,4	-6,6	5,3	5,4	1,4	1,8
Consumption	1,1	-2,7	3,2	2,4	1,5	1,1
<i>Private</i>	0,7	-4,1	3,1	2,6	1,5	1,1
<i>Public</i>	2,0	0,4	3,2	2,2	1,5	1,1
Investment	-1,5	-0,3	1,2	2,8	-0,3	1,2
<i>Buildings</i>	-1,5	0,0	1,6	3,0	-1,1	0,8
<i>Machinery and transport equipment</i>	-4,4	0,3	1,0	3,8	0,7	2,6
<i>Intellectual property</i>	2,1	-2,1	0,2	1,2	0,9	0,7
Key figures, %						
<i>Trade balance of GDP</i>	0,4	0,0	-0,2	-0,3	-0,5	-0,3
<i>Unemployment</i>	6,8	7,7	7,7	7,4	7,6	7,8
<i>Inflation</i>	1,0	0,3	2,2	5,1	1,9	0,9

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However, the service sectors affected by the pandemic will not be able to cover all future job losses – the weakening of the export and construction outlook will have a greater negative impact on the employment. The industrial sector employs more than 300,000 people in Finland, while construction employs more than 177,000. The hotel and restaurant sector, which is still under recovery, employs just over 90,000 people.

The growth outlook has clearly weakened since the war started, which will reverse the decline in the unemployment rate.

Consumer prices increase as a result of world market events

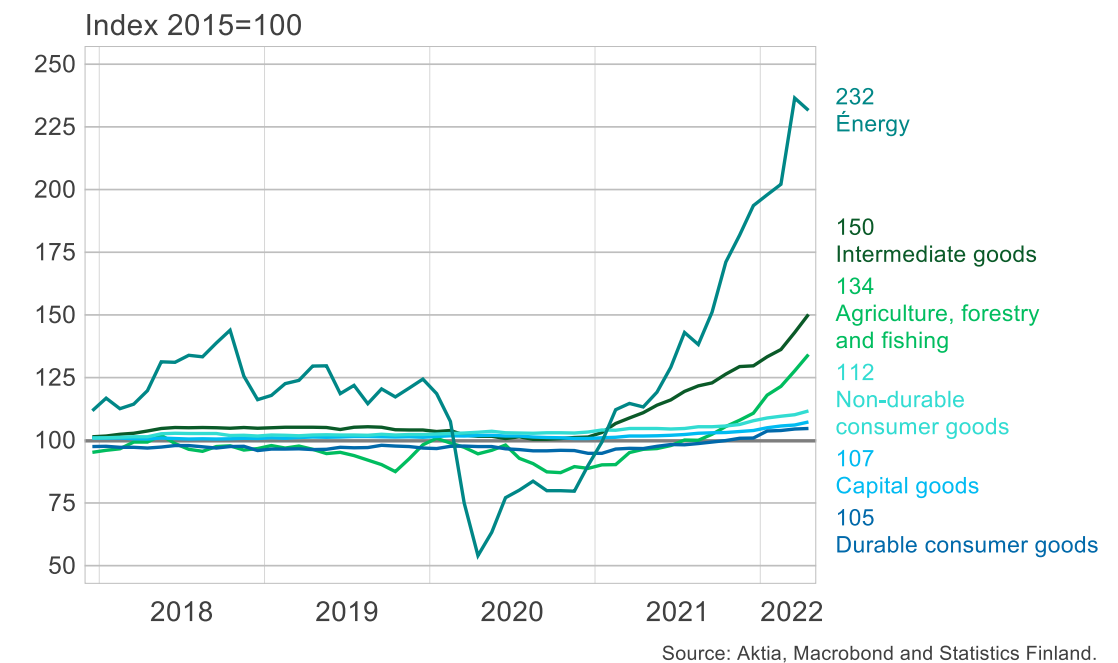
In Finland, the acceleration of inflation is mainly due to the rising prices of imported products and not due to the exceptionally high domestic demand, as in the United States.

In April, consumer prices increased by 5.7% compared to the situation a year before. We predict an increase in consumer prices, i.e. inflation, with consumer prices increasing by 5.1% in 2022 and decreasing to 1.9% in 2023. At that point, the strongest price increase in raw materials will be behind us, and the clear slowdown in the economic growth will weaken demand.

The coronavirus pandemic did not cause earnings in Finland to

go through the same strong growth as in, for instance, the United States, as we supported households in a more moderate way. We did not get any free money from the government in the form of support cheques. On the contrary – it was only this year that the combined salary of Finland's employees reached the development trend that preceded the pandemic. Similarly, the disposable income of Finns still decreased even last

Import price index in Finland



year. Therefore, Finnish consumers' ability to consume declined during the pandemic years. In other words, the increase in domestic demand is not the reason for the price increase

Finland is a small country. We have no option but to embrace the price development of the global market with open arms, and that is what the high inflation rates in Finland are all about. We produce about 0.2% of the global GDP.

Therefore, we cannot influence almost any global prices through national measures.

Higher prices, therefore, come to Finland as imported goods. Import price statistics show this development. Energy has become exceptionally expensive, as have many raw materials and production commodities, which affects, among other things, the prices in construction and renovation. Many consumer products from abroad have also become more expensive. A good example of this is coffee.



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Lasse Corin has functioned as Aktia's Chief Economist since spring 2020 and in this role, he monitors and analyses the development of macroeconomics and the investment market. Lasse Corin has an extensive experience of expert positions in the banking sector and his goal is to focus especially on domestic economy and to discuss how changes in the world economy affect Finland and Finnish households.

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