

The Competiveness Pact to benefit companies

General Information



| | |
|---------------------------|---|
| GDP | USD270.67bn (World ranking 41, World Bank 2014) |
| Population | 5.46mn (World ranking 114, World Bank 2014) |
| Form of state | Parliamentary Republic |
| Head of government | Juha SIPILA |
| Next elections | April 2019, legislative |



Strengths

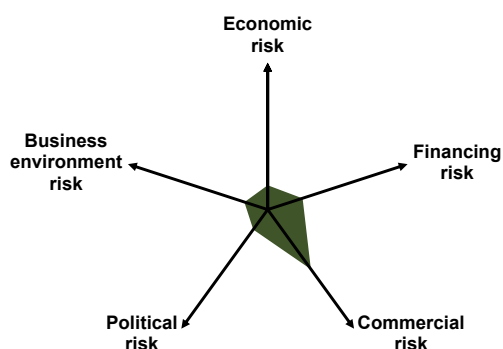
- Strong business environment
- High R&D spending
- Low fiscal deficit
- Contained public debt

Weaknesses

- High private debt, notably linked to the housing loans
- Rapidly deteriorating current account balance
- Weak competitiveness indicators despite recent reforms
- Falling long-term per capita income growth

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total, 2015)

| Exports | Rank | Imports |
|-------------------------------|-------|----------------------------|
| Paper | 17% 1 | Crude Oil |
| Refined Petroleum Products | 6% 2 | Cars And Cycles |
| Iron Steel | 6% 3 | Refined Petroleum Products |
| Non-Edible Agricultural Prod. | 4% 4 | Electrical Apparatus |
| Precision Instruments | 4% 5 | Pharmaceuticals |

By product (% of total, 2015)

| Exports | Rank | Imports |
|---------------|-------|-------------|
| Germany | 14% 1 | Germany |
| Sweden | 10% 2 | Sweden |
| United States | 7% 3 | Russia |
| Netherlands | 6% 4 | China |
| Russia | 6% 5 | Netherlands |

Source: Chelem



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Economic Overview

Moderate growth ahead on the back of reforms

GDP growth increased by +1.6% in 2016, an acceleration from +0.3% in 2015, and the highest pace of expansion in five years. Domestic demand was a driver while net exports subtracted -0.5pp from GDP growth due to poor export performance (+0.7% in volume).

Worldwide price pressures have triggered a fall in total nominal exports of goods and services to -EUR1.3bn. Private consumption growth ticked up +2% from +1.5% in 2015 due to low inflation (+0.4%), positive real wages growth, saving rate downward adjustment (-1pp since the end of 2015 to 5.8% of gross disposable income), and a lower unemployment rate (to 8.8% in 2016).

Fixed investment returned to positive territory (+1.6%) after three consecutive years of falls. Capacity utilization rates reached 81% in 2016, the highest level since 2010, but still below the long-term average.

The Construction sector registered strong growth in 2016 with investment up by +8.2%, the highest rate in a decade. Confidence in the sector reached its highest level since 2011 while permits expanded for the first time since the same year (+3% YTD in Q3 2016). Activity has picked up in both residential and non-residential sectors. Yet there is still room for improvement as nominal construction investment remains -6% below the 2008 high.

In 2017, we expect GDP growth to moderate to +1.2%. Export performance should benefit from the ongoing reforms and a lower euro (1.07 against the USD). Euler Hermes projects +3.1% growth in export volume, with gains equivalent to EUR4.6bn.

Better outlook for turnover growth and firms' profitability

Nominal GDP growth reached 2.4% in 2016 after 1.9% in 2015. Although still moderate this is the highest level since 2012. The end of deflationary pressures and inflation's return to positive territory in September 2016 should translate into firms' turnovers in 2017.

To address the high labor costs, compared to other European countries, the Finnish government has implemented a reform package.

The "Competitiveness Pact" sets a -4% decline in labor costs by 2019 as a target. It aims achieving that by increasing effective working time by 3 days or 24 hours per year, and by shifting part of the unemployment and social security costs from to employees.

The package will also improve the functioning of the labor market by streamlining job-matching. Unemployment benefits have been reduced to 400 days and should progressively boost labor supply. The Government aims to create 110K new jobs throughout its term in office and raise the employment rate to 72 % from 68.5% (compared to 76% in Sweden and 75% in Denmark).

Figure 1 – Key economic forecasts

| Finland | | share | 2015 | 2016 | 2017 | 2018 |
|--|--------------|-------|------|------|------|------|
| GDP | | 100% | 0.3 | 1.6 | 1.2 | 1.4 |
| Consumer Spending | | 56% | 1.5 | 2.0 | 1.7 | 2.0 |
| Public Spending | | 24% | 0.1 | 0.0 | -0.4 | 0.2 |
| Investment | | 21% | 1.1 | 5.2 | 4.4 | 1.7 |
| | Construction | 12% | 2.0 | 8.2 | 4.2 | 2.0 |
| | Equipment | 9% | -0.1 | 1.6 | 4.7 | 1.4 |
| Stocks | * | 0% | -0.3 | -0.1 | 0.0 | 0.2 |
| Exports | | 40% | 2.0 | 0.7 | 3.1 | 2.1 |
| Imports | | 41% | 3.1 | 2.0 | 4.3 | 2.7 |
| Net exports | * | -1% | -0.5 | -0.5 | -0.6 | -0.3 |
| Current account | ** | | -1 | -2 | -2 | -2 |
| Current account (% of GDP) | | | -0.4 | -0.8 | -0.7 | -1.0 |
| Employment | | | -0.4 | 0.5 | 0.5 | 0.6 |
| Unemployment rate | | | 9.4 | 8.8 | 8.6 | 8.4 |
| Wages | | | 1.4 | 1.2 | 1.0 | 0.8 |
| Inflation | | | -0.2 | 0.4 | 1.3 | 1.5 |
| General government balance (% of GDP) | | | -2.7 | -2.3 | -2.2 | -2.0 |
| Public debt (% of GDP) | | | 64 | 64 | 63 | 61 |
| Nominal GDP | ** | | 209 | 214 | 219 | 223 |

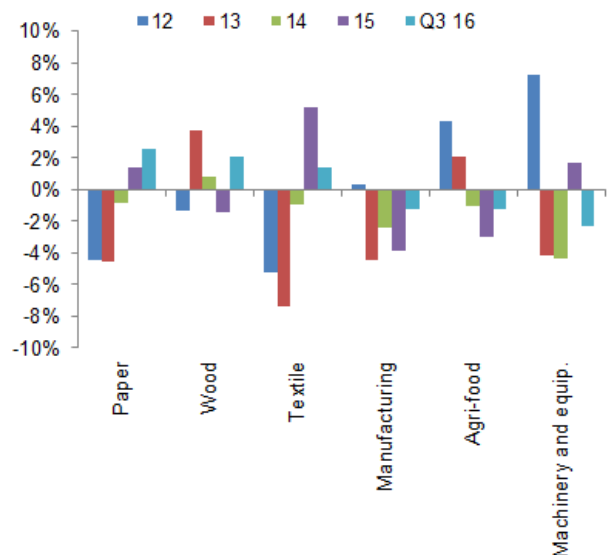
Change over the period, unless otherwise indicated:

* contribution to GDP growth

** EUR bn

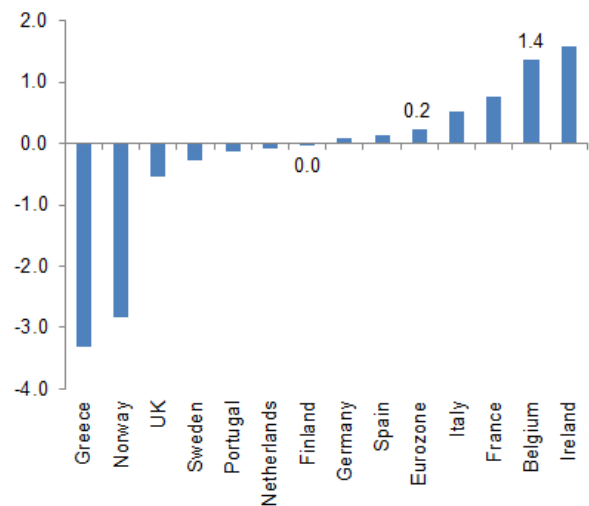
Sources: National sources, IHS, Euler Hermes

Figure 2 – Firms' turnover for a selection of sectors, 12M/12M change



Sources: IHS, Euler Hermes

Figure 3 – Change in firms' margins in 2016, pp of value added



Sources: Eurostat, Euler Hermes

In addition, the wage-setting system is also reformed from a highly-centralized wage bargaining process to a more flexible system in which salary negotiations will be hashed out at the firm level. This should improve productivity in the long-run and allow Finland to catch up with Sweden and Germany by 2018 and 2020 respectively.

However, despite reforms, the fall in oil prices, and low financing costs, firms' margins lagged behind other European countries. Finnish companies' margins remained stable in 2016 while their Belgian peers clocked an increase of +1.4pp for example (see Figure 3).

As the reforms should start to kick-in with falling labor costs in 2017, (stabilization is expected the year after), we expect margins to improve in 2017. Nevertheless, this could be limited by the rise in commodity prices and the lower euro which may trigger an increase in input prices.

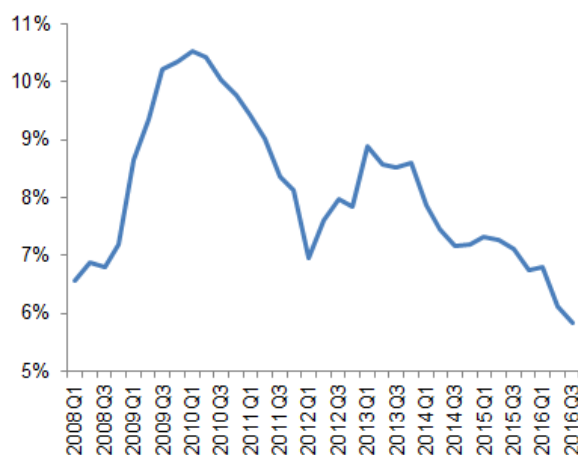
The business environment is already favorable in Finland. The country ranks high on indicators such as ease of doing business, corruption, rule of law, and regulatory quality. The working force is high-skilled.

Further improvements target SMEs and the removal of barriers to entrepreneurship through opening up the market to competition (e.g. liberalization of shopping hours) and cutting red tape. Several taxation measures targeting the smallest companies are also on the table.

Business insolvencies remain 11% above pre-crisis level

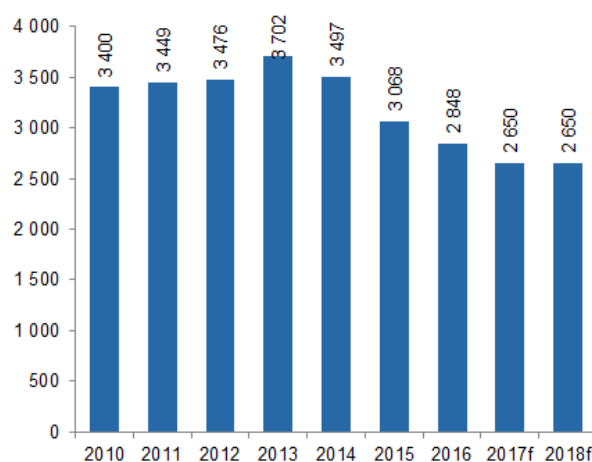
Business insolvencies fell by -7% in 2016 and are expected to continue moderating in 2017 (-7% to 2650 cases) before stabilizing in 2018.

Figure 4 – Household saving rate, % of gross disposable income



Sources: Eurostat, Euler Hermes

Figure 5 – Business insolvencies, number of cases



Sources: National sources, Euler Hermes

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