Finland: Eurozone headwinds hit harder in Finland

Finland likely ended 2023 in recession and only a modest recovery is expected for 2024. Some of the bigger headwinds for eurozone markets hit harder in Finland

Finland's Prime Minister Petteri Orpo, right, weathering another storm with his Swedish counterpart

The third quarter was a tough reality check for the Finnish economy. It had slowly started economic recovery after a recession in the second half of 2022, but the third quarter of last year poured cold water on recovery hopes. A decline of 0.9% Quarter-on-Quarter brought Finnish economic activity back to the lowest level since Autumn 2021. This makes Finland one of the worst-performing countries in the eurozone in recent years.

Larger concerns than elsewhere for Finland

Worries experienced elsewhere in the eurozone appear to be larger in Finland for the moment. Like other markets, Finland faces headwinds from exports, but being a relatively open economy with its largest trade partners being Germany and Sweden, those concerns are somewhat bigger than average. Besides that, Finnish competitiveness is suffering partly because of losing cheap Russian inputs.

Higher interest rates are dampening economic activity

Another big driver of economic weakness in the eurozone comes from higher interest rates, dampening investment and general economic activity. In Finland, the economy responds rather directly to higher rates as mortgages are more variable than in most European markets. Prices for one-family houses have corrected by more than 12%, and the number of transactions has almost halved from its 2021 peak. In recent months, as longer-term rates have fallen somewhat, there have been tentative signs of recovery in the Finnish housing market, but it's safe to say the impact of the housing market on the economy has been largely negative this year.

Just modest upsides for 2024

For the coming year, the residual impact of higher rates on investment will continue to be felt. The construction market has already been hurt significantly by higher costs and lower house prices, adding to concerns about longer-term investment weakness in the sector. Elsewhere, investment is set to be impacted by weak global demand and higher rates, which will likely drag well into the year. Then again, given Finland’s higher sensitivity to rates, it could also benefit earlier from some relief once the ECB starts cutting and longer-term lower rates come in.

So, we only expect some recovery towards the end of this year. With inflation having come down more quickly than average in the eurozone, it does look like purchasing power can be restored in 2024, making a modest consumption-led recovery a realistic prospect. Lower ECB rates could be helpful there as well. But with just 0.4% GDP growth expected, there is no real revival of the Finnish economy in the making either.

Are more budget efforts going to be on the table in 2024?

The weak economic environment is not helpful to Finland's fiscal position either. A budget deficit of around 3% is a realistic expectation for the coming years, and debt levels are on the rise and could come close to 80% in 2025, according to the European Commission. The Finnish government has announced plans to gradually bring back the deficit to -1% of GDP in 2027, but with economic headwinds mounting, it could be difficult to achieve these targets. The question is whether those concerns will cause the Finnish government to make more budget-cutting efforts in 2024 or whether worries about short-term growth will prevail.

The Finish economy in a nutshe

	2022	2023F	2024F	2025F
GDP (%)	1.6	-0.4	0.4	1.2
Private consumption (%)	1.7	-0.6	0.4	0.9
Investment (%)	3.2	-4.9	1.2	3.4
Government consumption (%)	0.8	3.2	0.2	0.2
Net trade contribution (%)	-1.9	1.8	0	0.2
Headline CPI (%)	7.2	4.4	2	1.7

Macrobond, all forecasts ING estimates

Author

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

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