Can Finland make its way out of recession for the remainder of 2023?

Finland was in a technical recession in the second half of 2022 but recovered some of its losses at the start of 2023. We don't expect a double dip as our base case, but a vibrant bounce-back seems unrealistic given weak global demand, high inflation and elevated rates are weighing on the recovery

Finland has experienced a modest recovery in 2023 so far, following a technical recession in the second half of last year

The Finnish economy was among the first in the eurozone to enter into a technical recession last year. Quarterly declines of -0.2% and -0.5% in GDP in the third and fourth quarters of 2022, respectively, were not negligible and relatively broad-based as consumption, investment and net exports all contributed to the declines. The purchasing power squeeze, weakening global demand, a higher reliance on Russia, and higher interest rates were important drivers of last year's weakness.

So far, 2023 has been a year of modest recovery. GDP grew by 0.4% in the first quarter, which means that recovery is underway. Statistics Finland provides a trend indicator of output, which showed a sharp uptick in activity in April, indicating that the recovery was still ongoing at the start of the second quarter. Still, the pace of growth is set to lose steam due to factors like weakening global demand, fading post-pandemic spending on services, and higher interest rates, which leads us to believe that annual growth of just 0.1% is a realistic outcome for the year. So we do not expect a strong recovery from here on, but an economy that will struggle to gain momentum as headwinds mount in the second half of the year.

Upsides to the outlook should come from fading inflation and regained purchasing power. The historically strong labour market participation has boosted incomes, which will now also be supported by faster-rising wages. That should dampen the negative effects of inflation. With inflation trending down, real wage growth provides an upside to personal consumption over the second half of the year. The question is how the current spell of economic weakness is affecting the labour market. We don't expect a large uptick in unemployment given current labour shortages, but rising unemployment and easing labour market tightness could dampen the real wage recovery.

The weaker cyclical conditions put government budgets and debt ratios under pressure. The budget deficit is weakened, among other factors, by increased defence spending and higher debt service charges on the back of more elevated interest rates for the coming years. This means that the debt-to-GDP ratio is unlikely to make progress towards the 60% target. In fact, expectations are that it will trend up from the current level of 73%.

Finland in a nutshell

	2022	2023F	2024F	2025F
GDP (%)	2.1	0.1	0.7	1.1
Private consumption (%)	2	0	0.7	0.9
Investment (%)	5	-3.5	1.3	3.4
Government consumption (%)	2.9	1.6	0.2	0.2
Net trade contribution (%)	-0.2	0.2	0.2	0.2
Headline CPI (%)	7.2	4.7	2.1	2.2

Source: ING Research

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