Finland: In the eye of the geopolitical storm

Despite all the geopolitical concerns Finland is facing, the economy is still performing quite well. Expect the cost of living problems to result in a contraction later in the year though

Finland's Prime Minister Sanna Marin

The war in Ukraine has marked a dramatic shift for Finland at the geopolitical level with the application for NATO membership as the most concrete result so far. The economy is still performing well, but the war in Ukraine and high inflation – not unrelated of course – have dented both business and consumer confidence significantly.

Trade disruptions are smaller than you'd expect

The energy impact on Finland is modest. Finland is not so reliant on Russia as a power source because it gets a large amount of its energy from renewables and nuclear sources. That leaves its dependence on natural gas quite limited – in fact it's only 6% of total energy in Finland, well below the 24% average for the eurozone. That 6% comes largely from Russia though, so the halting of the Russian gas supply in May does not come without consequence. While the Finnish gas supply has remained uninterrupted for the time being, prices have of course been increasing, adding to the purchasing power squeeze that the Finnish economy is experiencing.

In terms of total exports, the Finnish economy has also taken just a modest hit from sanctions on Russia. Yes, nominal exports have fallen to the lowest reading since the late 1990s – so volumes have dropped even more dramatically – but trade with Russia is not huge for Finland anyway. In recent years, exports to Russia made up about 5-6% of total exports, which has currently dropped to 2%. Total exports have continued to grow rapidly though and growth has actually accelerated since March. As total exports remain well above pre-pandemic levels, Finnish competitiveness is performing quite well for the moment and the hit from sanctions on Russia is therefore not visible in the aggregate data.

Sanctions have had a strong effect on exports to Russia

Source: Macrobond, ING Research

Slowdown in the making

Of course, the Finnish economy will not remain unscathed. Finnish central bank governor Olli Rehn recently said that the Eastern Finnish economy, which is directly connected to Russia by land border, is set to experience significant fallout from the conflict in Ukraine. Meanwhile, surging inflation is also impacting the Finnish consumer significantly. Consumer confidence has – in line with most of Europe – plunged to recessionary levels. Businesses are also becoming more pessimistic as both global and domestic demand are set to weaken over the second half of the year.

Still, the Finnish trend output indicator for April showed healthy economic growth at the start of the second quarter. Like the rest of Europe, it looks like the longer-lasting inflation impact on the economy will materialise later, making economic contraction in the second half of the year a strong possibility.

The Finnish economy in a nutshell

	2021	2022F	2023F	2024F
GDP (%)	3.5	2.2	0.3	1.2
Private consumption (%)	3.1	2.3	0.6	1.8
Investment (%)	1.2	1.1	0.7	2.2
Government consumption (%)	3.2	3.4	1	0.5
Net trade contribution (%)	-0.2	-0.4	-0.4	0
Headline CPI (%)	2.1	6.1	2.4	2

Source: ING Research

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