Finland: What can we learn from the new coalition?

Finland's new government reflects quite a few bigger European trends. It has an ambitious agenda that keeps the country ahead of the curve on green issues, but can this be done without increasing debt ratios?

The Finnish Prime Minister Antti Rinne

First of all, political fragmentation. The elections earlier this year resulted in a narrow victory for the Social Democrats (SDP) over the Finns Party. No party won more than 20% of the vote though, which has resulted in a government with no fewer than five parties participating. The Central Party - which led the previous government that fell in March - and the Swedish People Party represent the centre, and the Greens and the Left Alliance adding more left-wing flavours to the SDP led government. This results in doubts about how effective the new government can actually be, but there does not seem to be a lack of ambition at the start.

There are doubts about how effective the new government can be

Antti Rinne is the first Social Democrat to take the prime minister's office in 16 years and has vowed to end austerity policies that characterised the previous government. Indeed, the coalition agreement states there will be increases in government spending of 1.2 billion euros per year, which would mainly go to education, pensions and social services. There will also be one-off investments that amount to 3 billion euros – of which a large amount will go to rail infrastructure - over the four-year term of government.

This will be partly funded by increased taxes – fossil fuels are likely to bear a large burden - and there are plans for selling government assets. With growth around 2% per year, this should not cause debt to go up in the coming years as the government has mentioned. The question is whether this is realistic given global economic weakness and poor Finnish trend growth. It could well be that 2% growth is too much to ask, causing the government debt-to-GDP ratio to go up.

With the Greens in government, there is an important shift in focus for Finland. That focus on a return to economic competitiveness of the previous government has been replaced by a government targeting sustainability much more head on. The ambition is to become carbon neutral by 2035, which will require large investments in renewable energy, cutting back logging investments and will, in part, come from the higher fossil fuel taxes.

The ambition is to become carbon neutral by 2035

The success of this ambitious government agenda depends to a certain degree on the economy as it has made clear that the expansionary agenda will not cause debt levels to increase if the economy maintains a pace of around 2%. While GDP growth was indeed 2.3% in 2018, expectations of a weakening growth pace seem realistic. Finnish growth peaked at 2.8% in 2016 and uncertainty about the global economy is likely to cause GDP growth to fall further. Our estimates of growth of just over 1% would not be sufficient to bring down debt levels as government spending is set to increase.

Growth slowed to 0.2% QoQ in the first quarter, which came as a disappointment. Even though purchasing power has been improving on the back of a strengthening labour market, household consumption contracted in the first quarter. Net exports contributed positively to the modest growth pace, which was mainly due to contracting imports. That picture is set to change for the rest of the year though. The consumption outlook is at least decent and domestic demand will likely be the most important driver of growth this year as the external environment continues to provide a significant risk to the outlook.

This article is taken from the Eurozone Quarterly, which you can find here

Finnish economy in a nutshell (% YoY)

	2018	2019F	2020F	2021F
GDP (%)	2.3	1.2	1.1	1.3
Private consumption (%)	1.4	1.1	1.6	1.5
Investment (%)	3.2	2.9	2.4	1.0
Government consumption (%)	1.4	1.6	1.6	1.5
Net trade contribution (%)	-1.0	-0.3	-0.5	0.1
Headline CPI (%)	1.2	1.2	1.5	1.5

Source: Thomas Reuters, all forecasts ING estimates.

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