MINISTRY OF FINANCE

Economic Survey

Spring 2015

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Economic Prospects

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Abstract

The Finnish economy is facing severe difficulties. The current downturn has persisted for a long time, and there are no signs of a quick or significant turnaround. The picture of the global economy has recently been mixed. In the Russian economy, growth prospects have long been bleak. On the other hand, the economies of many of Finland's major trading partners have developed favourably. Moderate economic growth has also got under way in the euro area, although there are marked country differences.

Finland's GDP growth forecast for 2015 is 0.5%. Exports are projected to increase by 1.5%, while imports growth will reach just 1% because of sluggish domestic demand. Private consumption will rise by 0.5% this year. Private investment will fall by 1%, which is mainly attributable to weak investment in building construction. The unemployment rate will edge up to 8.8% this year. The number of employed persons will rise somewhat, but that is explained in significant part by the increased availability of work for older age groups. Inflation will come in at just 0.3%, in large part in response to the effect of tax hikes.

In 2016, GDP growth will pick up to 1.4%. Growth will become more broadly-based as all demand items will have a positive impact on economic growth. Exports will be up by 3% from the year before, but rebounding domestic demand will drive imports to almost the same rate. Private investment will accelerate to 4.5%, and private consumption is expected to increase by 0.8%. The projected unemployment rate for 2016 is 8.6%. Inflation will pick up modestly, but the annual rate of increase in prices will still remain well below 2%.

The projected GDP growth rate for 2017 is 1.5%. Growth will be driven by domestic demand, with net exports having only very limited effect. Over the outlook period the Finnish economy will grow slightly faster than potential output, and therefore the negative output gap will shrink.

As far as the international economy is concerned, the risks to the forecast remain skewed to the downside. Domestically, the risks still come from the development of the real economy. An improvement in public finances is only possible under conditions of favourable real economic development. The projected economic scenario will not alone be enough to significantly improve the health of public finances in Finland.

In 2014 the general government deficit exceeded the 3% threshold of the EU Stability and Growth Pact, and the deficit will remain over 3% in 2015 as well. The 60% debt-to-GDP limit will also be breached. The deep deficit is due first and foremost to the long-standing downturn. Economic growth will remain subdued over the next few years, and it will not alone be enough to correct the imbalance in public finances. The general government fiscal position is furthermore weighed down by expenditure resulting from population ageing. However, the deficit will shrink with rebounding economic growth.

Preface

The Spring 2015 Economic Survey is prepared for background material for the Government's spending limits decision. The Survey offers projections of Finland's economic outlook for 2015–2017. In addition to short-term prospects, the Economic Survey includes medium-term projections extending to 2019.

According to the law the forecast and trend projections in this Survey have been prepared independently by the Ministry of Finance Economics Department.

The forecasts are based on provisional national accounts data for 2014 published by Statistics Finland in March 2015 and on other public statistical sources available on 26 March 2015. Both the short-term and medium-term projections take account of the decisions taken by the Government in its spending limits discussions on 24 March 2015.

Helsinki April 2015

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The source for all data on materialised developments is Statistics Finland unless otherwise indicated.

SYMBOLS AND CONVENTIONS USED

-	nil
0	less than half the final digit shown
..	not available
.	not pertinent
*	provisional
**	forecast
CPB	CPB Netherlands Bureau for Economic Policy Analysis
HWWI	Hamburgisches WeltWirtschafts Institut
IMF	International Monetary Fund
MoF	Ministry of Finance

Each of the figures presented in the tables has been rounded separately.

Contens

Boxes:

Summary

Economic outlook 2015-2017

The Finnish economy is facing severe difficulties. The current downturn has persisted for a long time, and there are no signs of an imminent or significant turnaround. Exports growth has long been slower than world trade growth, and therefore there has been a steady loss of market shares. It is expected that these trends will continue throughout the outlook period.

Preliminary figures from Statistics Finland show that GDP fell by 0.1% in 2014. Statistics Finland also revised downwards its seasonally adjusted figures for Q2 and Q3 2014. In the last quarter of 2014, GDP declined by 0.2% quarter-on-quarter. It is noteworthy that seasonally adjusted figures may be revised in forthcoming statistical publications and therefore the picture of the economy may still change somewhat.

The picture of the global economy has recently been mixed. In the Russian economy, growth prospects have long been bleak, and the downturn of the economy has been exacerbated by the Ukraine crisis. The Russian economy will contract over the next couple of years, which will also have a negative impact on Finnish exports. On the other hand, the economies of many of Finland's major trading partners have developed favourably. Especially in the United States and the UK growth is broadly-based, and both their economies are expected to remain strong throughout the outlook period. Moderate economic growth has got under way in the euro area, although there are marked country differences. Growth in Germany, a major export market for Finland, is expected to remain at around 1.5%. Sweden will continue to post faster economic growth than the euro area, and the Chinese economy will reach growth of around 7% over the next few years.

The forecast's background assumptions are supportive of growth. Overall ECB's monetary policy will provide a solid foundation for economic activity over the next couple of years. Short-term interest rates will remain extremely low, and the three-month Euribor interest rate in 2017 is expected to average 0.2%. The ten-year interest rate will remain at record-low level, and is predicted to average 0.9% in the last year of the forecast horizon. The euro to dollar exchange rate is anticipated to drop further, coming close to parity by year-end 2017. The weakening of the euro will bolster the price competitiveness of exports in markets where payments are settled in dollars. Lower energy prices, and oil prices in particular, are particularly good news for the growth prospects of energy-intensive economies such as Finland. Although it is projected that the price of oil will start rising moderately, it will nonetheless remain significantly lower than in recent years. The forecast assumes

a slow rise in earnings levels. In 2015, the index of wage and salary earnings is expected to rise by 1.2%, with the wage drift accounting for 0.6%. Over the next two years earnings are expected to rise by no more than around 1.5% per annum.

Finland's GDP growth forecast for 2015 is 0.5%. Poor performance in the last quarter of 2014 significantly reduced the carry-over effect into the current year. The forecast therefore predicts a very moderate cyclical improvement in 2015. Exports of goods and services will increase by 1.5%, while imports growth will reach just 1% because of sluggish domestic demand. Net exports will therefore have a significant growth-boosting effect. Private consumption will rise by 0.5% this year. Consumption growth will be curbed by consumer uncertainty, the weak development of real purchasing power, and the situation in the labour market. On the other hand, interest rates are extremely low and reduced energy prices are bolstering household consumption opportunities. Private investment will fall by 1%, mainly because of weak investment in building construction. Investment in machinery and equipment and R&D investment, on the other hand, are slightly picking up. Infrastructure investment will drive public investment to growth of 2.3%. It is forecast that the slide in industrial production will turn to marginal growth of 0.3%. Likewise, the volume of service production is expected to increase. The labour market situation will remain challenging. The unemployment rate will edge up to 8.8% this year. The number of employed persons will rise somewhat, but that is mostly explained by the increased availability of work for older age groups. The development of labour productivity will remain subdued. Inflation will come in at just 0.3%, and much of that increase will be in response to the effect of tax hikes.

In 2016, GDP growth will pick up to 1.4%. Growth will become broadly-based as all demand items in the balance of resources and expenditure will have a positive impact on economic growth. Net exports will become a less and domestic demand a more important driver of economic growth. Exports will be up by 3% from the year before, but rebounding domestic demand will drive imports to almost the same rate of growth. Exports growth will continue to remain slower than world trade growth. Overall, it is thought that private investment will develop positively, and investment in building construction will also be up. However, more will be spent on replacing capacity than on increasing capacity, and therefore growth will be limited. Private consumption is expected to increase by 0.8%, and household indebtedness will not increase significantly. On the supply side, industrial production will increase by around 2%. The Finnish service sector is heavily dependent on industry, and rebounding industry growth will see service output growth rise to 1.5%. In the labour market, the number of employed persons will start to edge up with the slight improvement in the cyclical situation. The projected unemployment rate for 2016 is 8.6%, and the share of the long-term unemployed will remain high. Inflation will pick up slightly, but still remain well below 2%.

The projected 2017 GDP growth rate is 1.5%. Growth will be driven by domestic demand, with net exports having only very limited effect. The forecast is that cumulative growth in 2015–2017 will reach no more than 3.4%, and GDP will remain 3% lower than at the previous cyclical peak in late 2007. Over the outlook period the Finnish economy will grow slightly faster than potential output, and therefore the negative output gap will shrink.

Public finances have remained in deficit because of the persistent cyclical weakness, although adjustment measures have helped to curb the growth of the deficit. Economic growth will remain subdued over the next few years, and it will not alone be enough to correct the imbalance in public finances. The general government fiscal position is furthermore weighed down by expenditure resulting from population ageing. Central government finances are deep in deficit, although the deficit will slowly decrease. Likewise, it is anticipated that local government will remain in deficit over the years ahead. Social security funds will continue to show a surplus, but that surplus is shrinking. Preliminary figures for 2014 indicate that Finland was in breach of the 3% deficit limit spelled out in the EU Stability and Growth Pact, and it will remain above that threshold in 2015 as well. Finland will probably also breach 60% debt to GDP limit this year.

As far as the international economy is concerned, the risks to the forecast remain skewed to the downside. Even though it is expected that economic activity in the euro area will pick up and growth prospects are strong for both the UK and the United States, the international economy is still vulnerable to negative shocks. In China, indebtedness and the value of homes, shares and other assets have increased rapidly. Under conditions of economic slowdown, these trends may well cause disruptions in the market. Generally speaking the outlook for the global economy and especially for world trade is subdued. Russia's economic performance over the next few years will be weak.

The situation in the financial markets has clearly eased, and the situation in the banking sector has recently improved as well. On the other hand, in an environment of a growth-supportive light monetary policy, low interest rates in industrial countries and an increased willingness to take risks have steered investment flows into the housing and stock market, which may have led to overvaluation. The end of unconventional monetary policy, an incipient rise in interest rates and the strengthening of the US dollar may cause strong reactions in the financial market.

The domestic risks still come from the development of the real economy. At the moment, it seems that in the short term economic growth in Finland will be slower than in many competitor countries. An improvement in public finances is only possible under conditions of favourable real economic development. The projected economic scenario will not alone be enough to significantly improve the health of public finances in Finland. In order to maintain a credible economic policy, there is an urgent need now for structural reforms that will make it possible to increase the output potential of the open sector. The most crucial factors with respect to the cost competitiveness of the open sector are the prices of production inputs and ease of access to those inputs. For these reasons alone, key reform priorities should include enhancing the incentive effects of the tax system and improving the efficiency of the labour market. Factors impacting the cost structure have crucial significance in the international competition for market shares. In the absence of restructuring, population ageing coupled with the mismatch problems in the labour market will become a real obstacle to growth. A predictable economic policy and a determined strategy that directly addresses the challenges facing public finances will help to create a sense of faith in the future at times of economic turmoil.

Table 1. Key forecast figures

	2014* EUR bn	2012	2013*	2014*	2015**	2016**	2017**
		change in volume, %					
GDP at market prices	204	-1.4	-1.3	-0.1	0.5	1.4	1.5
Imports	77	1.6	-1.6	-1.4	1.0	2.8	3.4
Total supply	281	-0.6	-1.4	-0.5	0.7	1.8	2.0
Exports	76	1.2	-0.7	-0.4	1.5	3.0	3.5
Consumption	164	0.4	-0.2	-0.1	0.4	0.7	0.8
private	113	0.3	-0.6	-0.2	0.5	0.8	1.0
public	51	0.5	0.6	0.2	0.2	0.5	0.4
Investment	41	-2.2	-5.3	-5.1	-0.4	3.7	4.1
private	32	-3.2	-7.3	-6.5	-1.0	4.5	5.0
public	8	2.6	4.0	0.6	2.3	1.1	0.4
Total demand	281	-0.6	-1.1	-0.7	0.5	1.8	2.0
domestic demand	205	-1.2	-1.3	-0.8	0.1	1.3	1.5
		2012	2013*	2014*	2015**	2016**	2017**
Services, change in volume, %		0.6	-1.6	0.7	0.9	1.5	1.7
Industry, change in volume, %		-8.5	-1.5	-1.3	0.3	2.0	2.6
Labour productivity, change, %		-2.1	0.4	0.2	0.3	1.2	1.5
Employed labour force, change, %		0.4	-1.1	-0.4	0.3	0.3	0.4
Employment rate, %		69.0	68.5	68.3	68.8	69.1	69.6
Unemployment rate, %		7.7	8.2	8.7	8.8	8.6	8.3
Consumer price index, change, %		2.8	1.5	1.0	0.3	1.4	1.7
Index of wage and salary earnings, change, %		3.2	2.1	1.4	1.2	1.3	1.5
Current account, EUR bn		-3.9	-2.9	-2.4	-1.3	-1.0	-0.8
Current account, % of GDP		-1.9	-1.4	-1.2	-0.6	-0.5	-0.4
Short-term interest rates (3-month Euribor), %		0.6	0.2	0.2	0.1	0.1	0.2
Long-term interest rates (10-year govt. bonds), %		1.9	1.9	1.4	0.6	0.7	0.9
General government expenditure, % of GDP		56.1	57.8	58.6	59.1	58.7	58.3
Tax ratio, % of GDP		42.7	43.9	44.2	44.4	44.3	44.0
General government net lending, % of GDP		-2.1	-2.5	-3.2	-3.4	-3.2	-3.1
Central government net lending, % of GDP		-3.6	-3.7	-3.7	-3.2	-3.1	-2.8
General government gross debt, % of GDP		52.9	55.8	59.3	62.5	64.4	66.0
Central government debt, % of GDP		42.0	44.4	46.6	48.7	50.2	51.6

Calculations of the effects of the weakening exchange rate using the Economics Department's macroeconomic model

The Kooma model developed at the MoF Economics Department has been used to study the macroeconomic effects of a temporary depreciation of the exchange rate. The analysis covers the period from 2015 to 2019. The results are reported in relation to a steady state path, such as the Ministry of Finance's outlook forecast as set out in its Economic Survey.

The euro to dollar exchange rate is down by some 20% from its 2008 highs, but the effects of this on exports have remained moderate because of other disturbancies. Furthermore, Finland's export-weighted exchange rate index has not fallen at the same rate as the euro dollar exchange rate. The impacts of exchange rate changes also depend on the currency in which businesses quote their prices. Measured in these terms, Finland conducts almost all of its trade in euros and US dollars. For this reason changes in the export-weighted exchange rate index may also underestimate the effects of the current euro dollar exchange rate to exports growth.

An overvalued euro vis-à-vis the US dollar, for instance, has been quoted as one reason for Finland's disappointing export record since 2010, even though the euro had by that time dropped by more than 10% against the dollar. This thinking is based on traditional devaluation policy that was often applied in Finland in 1950–1980. The benefits from devaluation were in part based on regulation in both the money and the labour market.

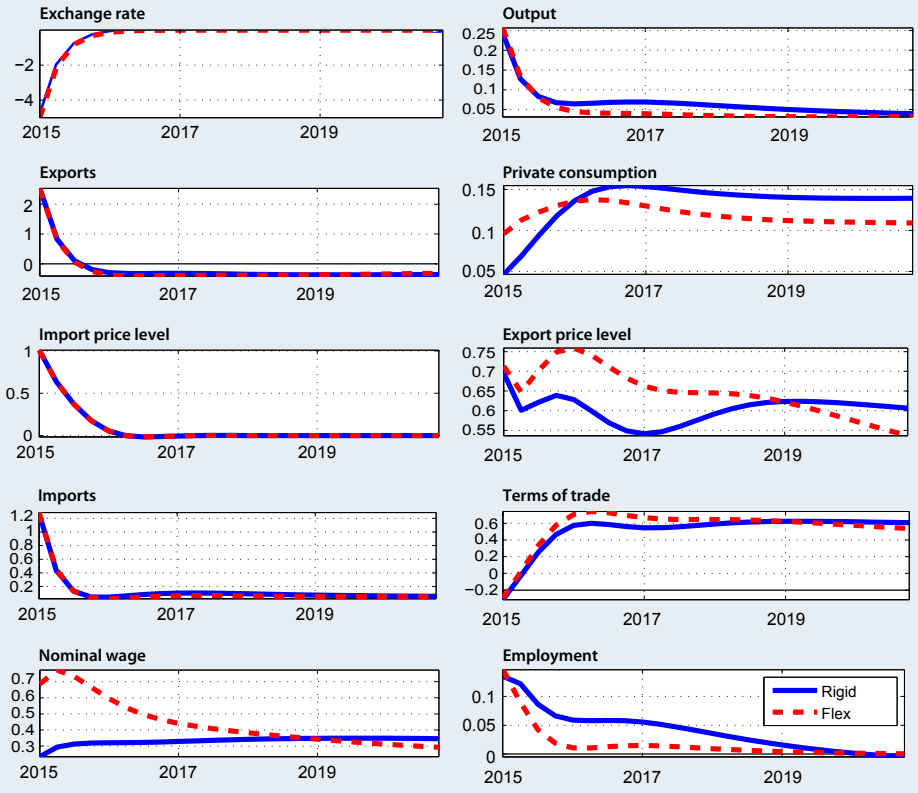
The calculation assumes a 5% fall in the exchange rate. The exchange rate change is modelled to fade within a very short period of time to describe the volatility associated with exchange rates. The exchange rate has returned to its steady state path after four quarters. According to the model, the effects of the exchange rate change spread through the economy very quickly. Import prices react rapidly to exchange rate changes. In the model, import is intermediate goods production. Companies engaging in imports are divided between those setting their prices in the local currency and those setting their prices in the producer's currency (euro). The impact of the exchange rate change is highest in the second quarter for companies using the local currency. In order to calculate these companies' import prices in the producer currency, they have to be multiplied by the exchange rate. The impact of the exchange rate change on import prices is therefore immediate.

The structure of an export company is similar to that of an import company. The euro-denominated prices of an export company that sets its prices in the local currency will rise immediately and those of a company using the producer currency more slowly in response to changes in marginal costs. A change in the exchange rate filters through into export prices more slowly than into import prices, and therefore the terms of trade deteriorate in the short term. The volume of exports rises very rapidly and even immediately after prices are converted into domestic prices using the exchange rate that has changed considerably.

Import prices feed through to the prices of end products via the manufacture of end products. A 5% change in the exchange rate pushes up import prices by 1% and export prices by 0.7%. It is therefore cheaper for the producer of the end product to use domestic inputs than more expensive foreign inputs, which has the effect of increasing domestic production. The weakening of the exchange rate increases Finnish GDP by some 0.25% in the short term. However, rising domestic prices through the wage and demand mechanisms eat into the effect of the weakening exchange rate and the terms of trade start improving as export prices remain longer at a higher level than import prices. At the same time, the improvement of exports remains a temporary phenomenon and exports drop below their steady state path.

As the weakening of the exchange rate drives up the prices of imported products, and increased demand drives up the prices of domestic products, wages also have a tendency to rise. The calculation examines different effects with different wage rigidities. The calculation assumes that either 20% (rigid) of wages can be renegotiated in each quarter, or up to 50% (flexible) can be renegotiated. The elasticity of the wage reaction has hardly any immediate effect on the weakening of the exchange rate on import prices, exports or production. As a result of more flexible wage formation, wages rise more sharply in response to the weakening of the exchange rate than in an environment of rigid wages. The size of the wage reaction has an impact on price rises and therefore on export competitiveness. Although private consumption develops more strongly as a result of flexible wage formation, employment remains lower as a result of higher wage increases. Production, too, falls more rapidly as rising wages reducues the effect of the falling exchange rate. In the current environment where wage formation is less regulated than before the 1980s, the benefits from changes in the external value of the currency are lesser than in a situation where wage rises are more limited.

Exchange rate shock with different wage rigidities



Medium-term outlook

Finnish GDP contracted in 2014 for the third consecutive year. At the same time, industry and the economy as a whole have been undergoing restructuring, which has also affected the longer term growth prospects of the economy. It is expected that the economy will turn to slight growth in 2015 and then slowly pick up momentum. However it is thought that growth will remain historically slow even in the medium term.

The medium-term outlook can be examined via potential output, which is thought to determine the economy's medium-term growth prospects. In its assessments of potential output the MoF Economics Department uses the production function method as developed jointly by the EU Commission and Member States, in which potential output growth is divided between projections of potential labour input, capital and total factor productivity. Potential output is an unobservable variable and its assessment, especially during a strong economic cycle and under conditions of rapid changes in the production structure, is challenging.

The shrinking of the working age population will reduce the labour input over the next few years, but labour participation rates are expected to increase somewhat, especially in older age groups. Another factor determining labour input growth is the structural unemployment rate: this is the level of unemployment below which upward pressures begin to emerge on wages and salaries. In practice this means that unemployment is above its structural level when real unit labour costs are falling, i.e. when wages are rising more slowly than productivity and inflation taken together. Using the EU harmonized method, it has been estimated that Finland's structural unemployment level is around 7.4%. The medium-term forecast is that unemployment will begin to approximate this level as the output gap closes. The trend of average hours worked will remain stable over the next few years. The contribution of labour input to potential output growth will average zero in the medium term.

Increasing total factor productivity growth has been a major source of economic growth for the past few decades. In recent years, however, total factor productivity has increased only modestly. This slowdown has been attributed to both cyclical and structural factors. Output has dropped significantly in high-productivity branches, and at the same time the economy as a whole has become more service-oriented. The total factor productivity trend can be extracted from observed productivity based on the capacity utilisation rate and other cyclical indicators. In recent years total factor productivity trend growth has been around zero, and it is expected that in the medium term the growth rate will remain much slower than in the early 2000s.

Potential output is also affected by the existing capital stock. Several years of low investment have acted to slow capital stock growth and therefore undermined the economy's future growth potential. Overall it is projected that the economy's growth potential will rise to just 0.8% cent by 2019. The difference between total actual output and potential output, i.e. the output gap is negative when actual output is lower than potential output. This means there is idle capacity in the economy and output can grow more rapidly than potential output without creating price pressures. In 2015 the output gap is estimated to stand at 2.8% of potential output. In 2015–2019 it is predicted that the economy will grow at an

average annual rate of 1.2%. According to the EU's common production function method, Finland's potential output growth is slower, on average 0.5% per year. When GDP growth exceeds its potential, the output gap contracts, and it is expected that the output gap will close in 2019. When the output gap closes, unemployment will approach its structural level, the labour participation rate will be at its trend level and total factor productivity growth will be equivalent to trend growth once all idle production capacity has been put to use.

Finnish public finances have been deep in deficit since 2009. Although economic growth is rebounding and the output gap is contracting, this growth will not be enough to heal the country's public finances and to halt the growth of public debt. Furthermore, population ageing has begun to weigh down on public finances, and general government revenue is no longer enough to sustain all the structures and functions of the public sector that were created on the foundations of stronger economic growth.

The slowdown of potential growth is having an adverse effect on the structural financial position of general government as economic growth and therefore tax revenue growth are expected to remain subdued in the years ahead. Despite the adjustment efforts that have been made, public finances are in structural deficit. The public debt to GDP ratio will exceed the 60% threshold in 2015, and will continue to rise in the medium term.

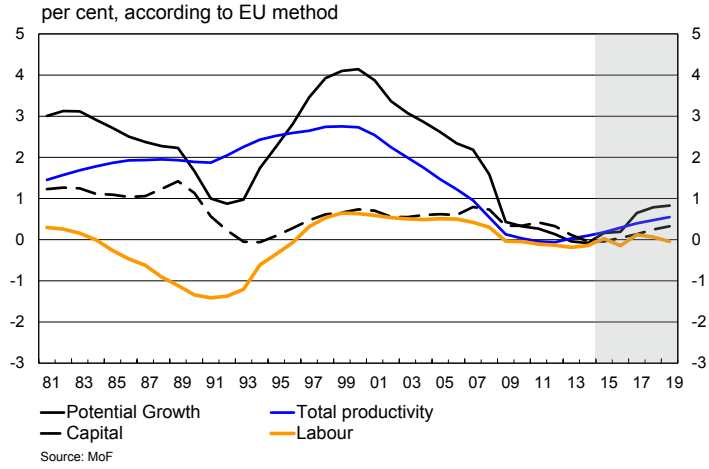
Table 2. Key forecast figures for the medium term

	2013*	2014*	2015**	2016**	2017**	2018**	2019**
GDP at market prices, change in volume, %	-1.3	-0.1	0.5	1.4	1.5	1.3	1.2
Consumer price index, change, %	1.5	1.0	0.3	1.4	1.7	1.8	1.8
Unemployment, %	8,2	8,7	8,8	8,6	8,3	7,9	7,6
Employment rate, %	68,5	68,3	68,8	69,1	69,6	70,0	70,3
General government net lending, % of GDP	-2.5	-3.2	-3.4	-3.2	-3.1	-2.7	-2.5
Central government	-3.7	-3.7	-3.2	-3.1	-2.8	-2.6	-2.3
Local government	-0.7	-0.9	-1.0	-0.9	-0.9	-0.9	-0.9
Social security funds	1.9	1.4	0.8	0.8	0.6	0.7	0.7
Structural balance. % of GDP	-0.8	-1.4	-1.8	-2.3	-2.6	-2.6	-2.5
General government gross debt, % of GDP	55.8	59.3	62.5	64.4	66.0	67.0	67.8
Central government debt, % of GDP	44.4	46.6	48.7	50.2	51.6	52.5	53.1
Output gap, % of potential output [1)]	-3.1	-3.1	-2.8	-1.6	-0.8	-0.3	0.0

[1)] Estimated according the method developed jointly by the EU Commission and Member States.

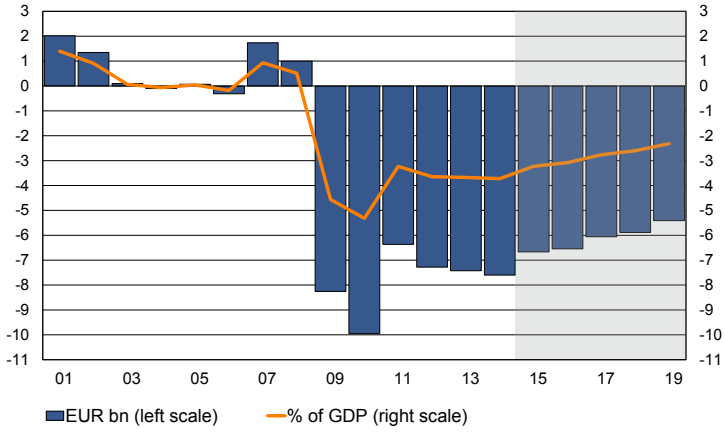
Contributions to Potential Growth

per cent, according to EU method



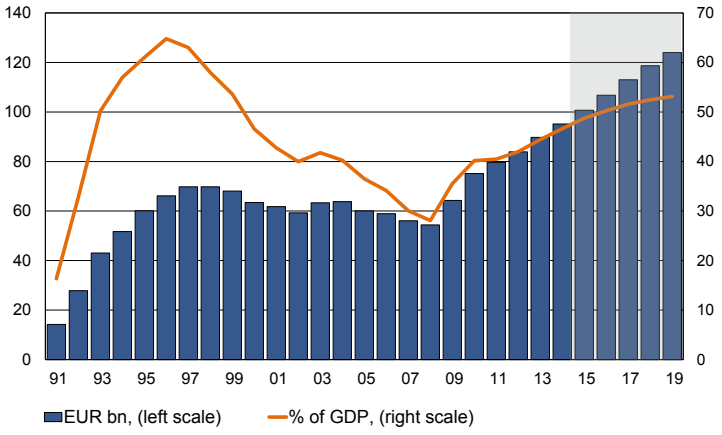
Source: MoF

Central government financial balance



Sources: Statistics Finland, MoF

Central government debt



Sources: State Treasury, MoF

Fiscal policy

Finnish public finances have been deep in deficit since 2009, and there is no significant turnaround in sight. In 2014 the general government deficit exceeded the 3% of GDP threshold. The 60% public debt to GDP limit will be breached in 2015. There is a real threat of a significant deviation from the medium-term objective set for Finland's structural budgetary position.

Public expenditure is financed from taxes and fees collected on the value added of the economy and from other revenue. In the long term general government revenue may only increase at the same rate as value added of the economy. The growth of value added and revenue thus sets a ceiling for expenditure growth.

Economic growth comes from the growth of labour, capital and productivity. Population ageing has started to reduce the number of people of working age. Even if labour participation rates in older age groups started to rise and if immigrants of working age were to arrive in the numbers predicted, the economy will not benefit from any growth impetus through increasing labour input at least in the foreseeable future. In recent years total factor productivity has shown only modest growth, and it is expected that in the medium term the growth rate will remain much slower than in the early 2000s or towards the end of the previous century. Furthermore, several years of low investment have slowed capital stock growth and undermined the economy's growth potential. The Ministry of Finance estimates that the economy's growth potential will rise to just under one per cent by 2019, and settle around 1.5% in the long term.

At the same time, age-related public expenditure is rising sharply as a result of population ageing. This will continue for the next two decades. Rapid expenditure growth is undermining the financial position of general government and causing great pressure for the local government sector in particular to increase its borrowing.

On this basis there is a huge sustainability gap in public finances: even under conditions of normal economic and employment trends the level of general government revenue is not enough to cover current public expenditure requirements – either in the short-term or long-term future. This means that the imbalance between revenue and expenditure is structural. Foreseeable economic growth and the return of output to its potential level are not alone enough to bridge the sustainability gap in public finances. If the structural imbalance between revenue and expenditure is not corrected, the ratio of general government debt to GDP threatens to spiral out of control in the decades ahead.

In fiscal and other economic policy it is imperative to try and strike a balance in order to carry domestic demand through the recession, to halt the growth of public debt in the medium term, to improve the conditions for economic growth and to ensure the sustainability of public finances in the long term.

Recent forecasts and preliminary statistics for 2014 show that Finnish general government finances are in a worse state than previously recognized. The next government's fiscal and economic policy must first and foremost be geared towards achieving sustainability in general government finances. The new government will be deciding on its first general government fiscal plan in autumn 2015. In that plan, the government must set out its objectives

for central and local government finances and for overall general government finances and so put public finances on a sustainable path. Furthermore, the government must specify the measures with which it proposes to achieve these objectives, including the overall scale of the measures and their timing.

Efforts to improve sustainability should include both immediate measures designed to increase central government and local government revenue and measures geared to reducing expenditure, as well as measures aimed at curbing longer-term expenditure pressures and at bolstering growth opportunities. These measures should be focused on the institutional framework of economic activity and the incentives created by this framework. They should be geared to the more efficient use of existing resources in the economy, including public finances, and create the conditions for more rapid growth in the long term. The scale of corrective measures required depends on their timing: the sooner they are put in place, the less dramatic the adjustment measures required.

It is imperative that steps are taken to slow the rise of social and health care costs. The reform of the social and health care service structure must be carried through in a manner that delivers the benefits expected from a reduction in the functions and duties of local government authorities as well as the targets of productivity growth set for the service system. Steps to bolster competitiveness and to create improved framework conditions for business and more effective labour markets are crucial to maximising the efficiency use of existing resources within the economy and to fostering competition in goods markets. It is particularly important to increase the labour participation rate and accelerate productivity growth in the economy as a whole, but especially in public service provision. At the same time, immediate measures designed to increase central and local government revenue and to reduce expenditure should contribute to the restructuring of the economy.

Immediate adjustment measures and structural reforms will help to instil confidence in Finland's ability to do everything necessary and in all conditions to manage its public finances and to meet its obligations. This confidence will provide the room to manoeuvre that is needed to put in place the long-term measures that will secure the sustainability of public finances.

It is imperative that action is taken immediately to prevent the threat of a vicious circle of escalating debt. The fruits of restructuring will only begin to emerge in the long term, however. In the medium term, the growth of debt can be slowed through the frontloaded reduction of central government deficits. The more credible the steps taken to strengthen the framework conditions for economic activity, the lesser the need for immediate adjustment that will hamper short-term economic growth. However, the fruits of structural measures cannot be harvested until there is reliable evidence of such fruits actually being reaped.

1 Economic outlook

1.1 Global economy – cross currents in Finland's economic environment

Falling oil prices created a significant demand surge in oil-importing countries in the latter half of 2014. In the euro area, the value of oil products net imports in 2015 will be more than one percentage point of GDP lower than in 2013, releasing this sum for other consumption or investment purposes. On the other hand, growth prospects remain overshadowed by geopolitical tensions in Russia, the Middle East and elsewhere. Confidence has not, however, deteriorated to the same extent as in some earlier political and currency crises. Global economic growth is mainly being driven by the United States and the UK. The rebound in these countries is supported by improved private sector balance sheets, continued slack monetary policy and a lighter fiscal policy. In many developing economies, by contrast, growth over the forecast horizon will be significantly slower than usual.

Russia cannot avoid recession either this year or next. Lower oil prices than in the past few years and increased uncertainty have combined to reduce Russia's export revenue, weaken the rouble, accelerate inflation and drive up interest rates. Investment and imports are set to fall dramatically. Russia is going to have to resort to its reserve funds to cover budget expenditure and to support the country's banks and possibly some of its major companies. For some time now, conditions for growth in Russia have been held back by the country's failing institutions, inflexible economic system and the absence of sufficient investment. The economy's underlying lack of competitiveness was previously masked by rising oil prices. Furthermore, the crisis has caused the Russian economy and politics to turn in on themselves even more than before, which is further hampering the country's prospects in the years ahead.

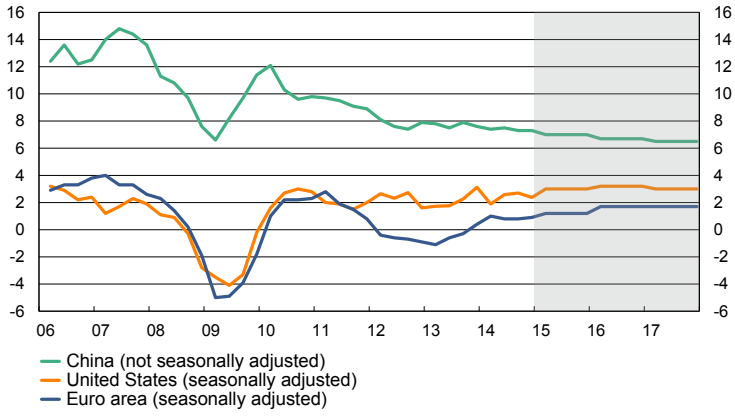
In the United States, recovery is continuing at a moderate rate and employment is improving strongly. Although interest rates will rise in the latter half of 2015, they will remain at a low enough level to sustain demand and keep consumers' debt servicing costs in check. The gap between euro area and US interest rates will deepen further. On the other hand, high rates of long-term unemployment and the lower labour participation rate will restrict growth throughout the forecast period.

In Europe, the most promising economy at the moment is the UK, which has returned to robust growth despite substantial public sector austerity. The fragility of growth in the euro area stems from the lingering effects of the debt crisis, even though the weakening

euro is improving external demand. In several member states growth is hampered by poor competitiveness, which is limiting supply opportunities. In the euro area private investment has continued to fall. Investment is held back by persistent high uncertainty and high levels of debt coupled with continued efforts to adjust balance sheets. In crisis-hit countries, investment is furthermore hampered by the high costs and limited availability of financing. Consumption growth is effectively prevented by persistently high unemployment. High levels of public debt will for some time limit the options available to governments when responding to possible future shocks.

In China, economic activity is dampened by weaker demand from industrial countries and many developing economies, which cannot be fully offset by demand from the domestic market, and by sharply rising costs. Nonetheless growth will remain at around 7% throughout the outlook period, provided that the country is successful in its economic policy.

Gross domestic product
change in volume, %

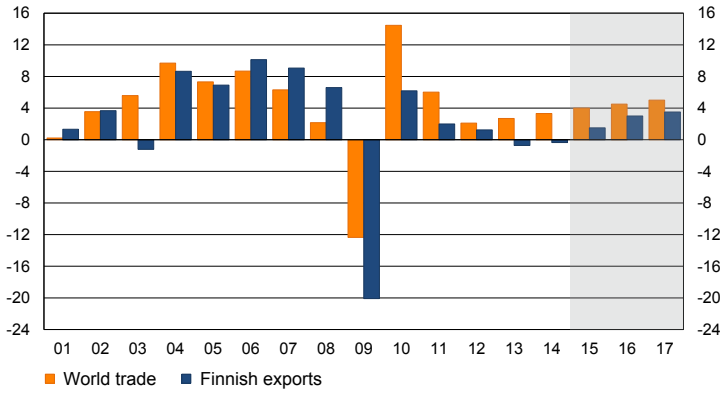


Sources: Statistical authorities, MoF

1.1.1 World trade to remain sluggish

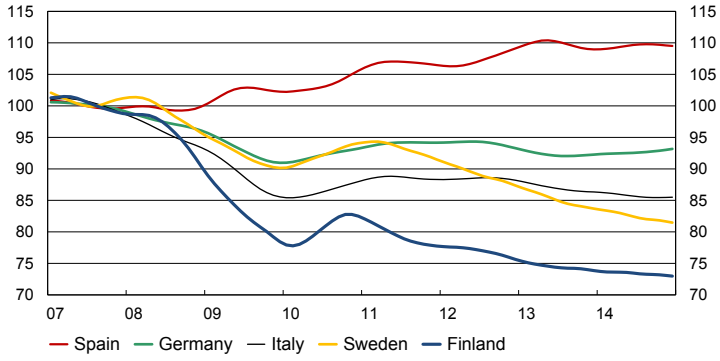
At the height of globalisation in the 1990s and 2000s, imports by industrial countries typically grew at around twice the rate of output growth. This rule of thumb no longer applies in the wake of the financial crisis. In recent years world trade has grown at more or less the same rate as output, partly because of weak investment demand. Trade growth will only slowly gather momentum towards the end of the outlook period as investment demand rebounds. However, the recovery of the global economy will no longer generate in Finland the same kind of demand surge that it used to, especially as we have lost substantial market shares in world trade.

World trade
change in volume, %



Sources: CPB Netherlands Bureau for Economic Policy Analysis, Statistics Finland, MoF

Market share in goods exports[1)]
2007=100, trend (HP)



1) Ratio of goods exports growth to world trade growth

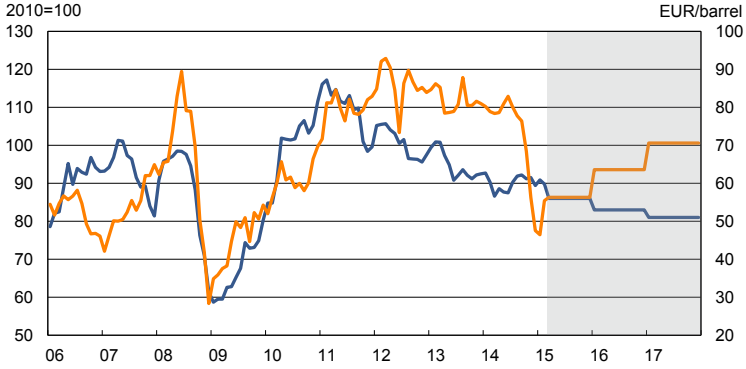
Sources: Macrobond, MoF

1.1.2 Inflation pressures moderate

Crude oil prices fell sharply in the latter half of 2014, above all in response to the deteriorating outlook in developing economies. It is expected that prices will rebound only very moderately over the outlook period (see the separate box on the oil market). Prices for industrial raw materials will fall during the outlook period, given the slowdown of demand from developing economies and high levels of supply.

Import and producer prices are set to fall in several industrial countries. Inflation expectations are extremely low, allowing central banks in industrial countries to persist with an unusual monetary policy stance. Crisis countries in the euro area are struggling to avoid deflation. However, the deflationary risk is reduced by the weakening of the euro, and there is no real threat of a deflationary cycle in sight.

Raw materials prices
EUR



Sources: Hamburgisches WeltWirtschafts Institut, Macrobond, MoF

In crisis countries interest rates on bank loans are still significantly higher than in the countries with the best credit ratings, which is deterring both consumption and investment. In the United States interest rates will be moving back to normal over the outlook period, but in the euro area interest rates will rise only very slowly.

1.1.3 Risks are stabilising

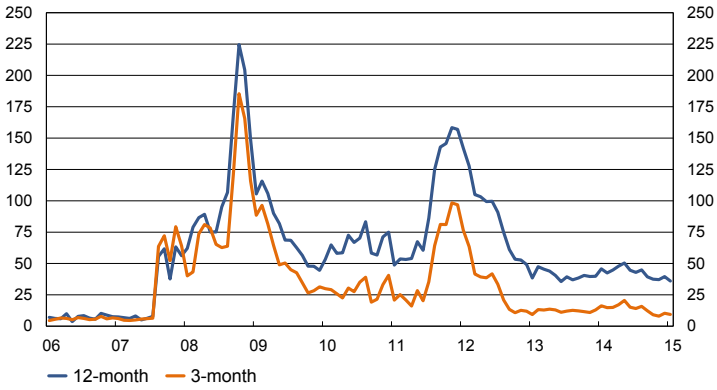
In the euro area, risks are still predominantly on the downside as households may have even greater difficulty than predicted recovering from the debt and financial crisis. Sluggish private sector demand for credit may reduce consumption or investment, and the risks may even cause the crisis to flare up again. It is also unclear how committed indebted member states are to adjusting their public sector balance sheets.

Russia's economic situation is dire. If the crisis in Ukraine persists, that would add to the climate of uncertainty and possibly increase the outflow of capital from Russia, reducing investment, further weakening the rouble and deepening the recession in Russia. The current geopolitical risks may adversely affect confidence and slow growth in the EU.

Low interest rates in industrial countries and an increased willingness to take risks have steered investment flows into the housing and stock market, for example, which may have led to overvaluation. The end of unconventional monetary policy over the outlook period, an incipient rise in interest rates and the strengthening of the US dollar may cause strong reactions in the financial market. In China, indebtedness as well as the values of homes, shares and other assets have increased rapidly. Under conditions of economic slowdown these trends may cause disruptions in the market.

Banking system risks

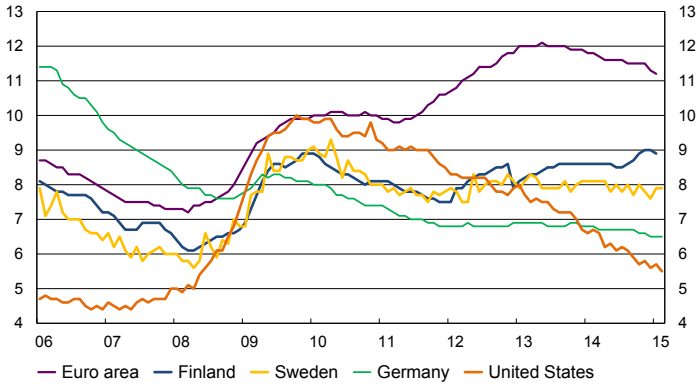
difference between secured Euribor and unsecured Eonia interest rate swap yield, basis points



Source: Macrobond

Unemployment rate

seasonally adjusted, %



Sources: Macrobond, statistical authorities

Table 3. Gross domestic product

	2012	2013	2014	2015**	2016**	2017**
	change in volume, %					
World (PPP)	3.2	3.2	3.2	3.5	3.8	4.0
Euro area	-0.5	-0.5	1.0	1.2	1.7	1.7
EU	-0.5	0.0	1.3	1.6	2.0	2.0
Germany	0.4	0.1	1.6	1.5	1.5	1.5
France	0.3	0.3	0.4	0.7	1.2	1.7
Sweden	1.3	1.6	2.0	2.2	2.7	2.5
United Kingdom	0.7	1.7	2.6	2.7	2.7	2.5
United States	2.1	2.2	2.4	3.0	3.2	3.0
Japan	1.7	1.6	0.0	1.0	1.5	1.0
China	7.8	7.7	7.4	7.0	6.7	6.5
Russia	3.4	1.3	0.0	-5.0	-2.0	0.0

Sources: Eurostat, statistical authorities, IMF, MoF

Table 4. Background assumptions

	2012	2013*	2014*	2015**	2016**	2017**
World trade growth, %	2.1	2.7	3.3	4.0	4.5	5.0
EUR/USD	1.29	1.33	1.33	1.12	1.07	1.02
Industrial raw material price index, EA, € (2010=100)	100.7	94.8	90.0	87	83	81
Crude oil (Brent), €/barrel	87.1	82.0	74.5	56	64	71
3-month Euribor, %	0.6	0.2	0.2	0.1	0.1	0.2
Government bonds (10-year), %	1.9	1.9	1.4	0.6	0.7	0.9
Export market share (2000=100) [1)]	82	79	76	74	73	72
Import prices, %	2.1	-1.3	-1.8	-1.2	1.1	1.3

[1)] Ratio of export growth to world trade growth.

Sources: Statistical authorities, CPB, HWWI, Reuters, MoF

The oil market

This box discusses the reasons behind the recent fluctuations in oil prices, possible future trends in oil prices and the macroeconomic effects of a drop in oil prices in the light of econometric results as well as market events and developments.

From early 2011 through to summer 2014, oil barrel prices hovered around 110 US dollars. Then, prices plummeted to lows of less than 50 dollars a barrel. Figure 1 shows the price of Brent crude from Jan 2007 to Feb 20015 as well as future price trajectories derived from realized futures prices for some specific dates. It seems that the barrel price has now settled at around 60 US dollars, and most forecasts predict that oil prices will rise only slowly. There have been periods in the past when oil prices have risen or fallen sharply (Figure 2). In 1985–1986, for instance, crude oil prices fell dramatically as non-OPEC supply increased sharply and OPEC decided no longer to try to regulate prices. In some respects the current oil market is similar to the situation in 1985–1986.

Figure 1. Brent Spot and Futures Prices, USD

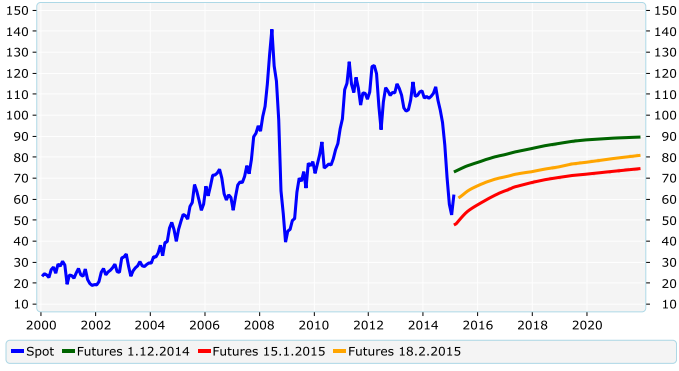
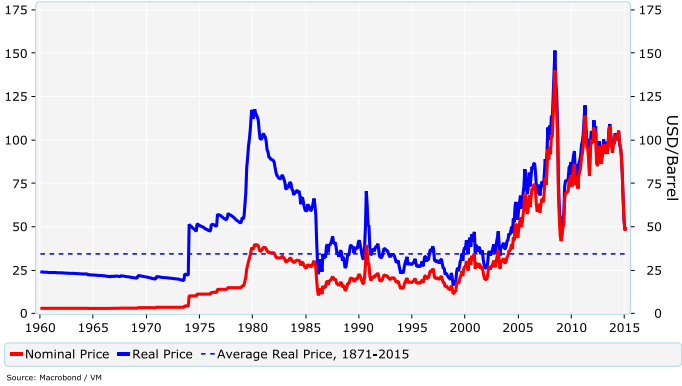


Figure 2. Nominal and Real Price of Crude Oil (USA 2014 CPI)



Demand, supply and speculation

What, then, lies behind the rapid and sharp fall in prices? Kilian (2009) pioneered a line of research inquiry to examine oil prices from the vantage point of supply and demand shocks by using structural vector autoregression models (SVAR). The key conclusion from these studies was that changes in the supply of oil have only limited impact on oil prices when compared with the impacts of changes in global activity and demand. The role of demand has been increasingly pronounced since the late 1990s.

In the past decade the market for derivatives tied to raw materials prices has expanded and prompted debate about tendencies of market securitization and the impact of financial markets on physical markets. A third potential source of shocks to prices comes from speculation in the financial market, for instance the anticipation of future price changes. Oil can be stockpiled even after it has been pumped from the ground. Kilian and Murphy (2013) and Kilian and Lee (2013) examined the role of speculative demand by taking account of the effect of changes in oil stockpiles. The idea is that expected price changes are reflected in changes in stockpile demand. They arrived at the same key conclusion as the examination above: changes in supply and speculation have only limited effect on oil prices.

Speculation can in principle be divided into two categories, viz. news-induced trading and destabilizing noise trading. Beidas-Strom and Pescatori (2014) elaborated the SVAR approach and discovered that the models mentioned above fail to make this distinction between two types of speculation and accordingly between their market effects. News-induced speculation does not add to volatility or market disruptions. On the contrary, as it makes sense for a speculator to sell oil under conditions of overpricing and to stockpile under conditions of underpricing, speculation has the effect of attenuating price changes. In this analysis news-induced speculation can to some extent be separated from destabilizing noise trading. Speculation may contribute more than changes in supply, but less than changes in demand to explaining short-term changes in oil prices.

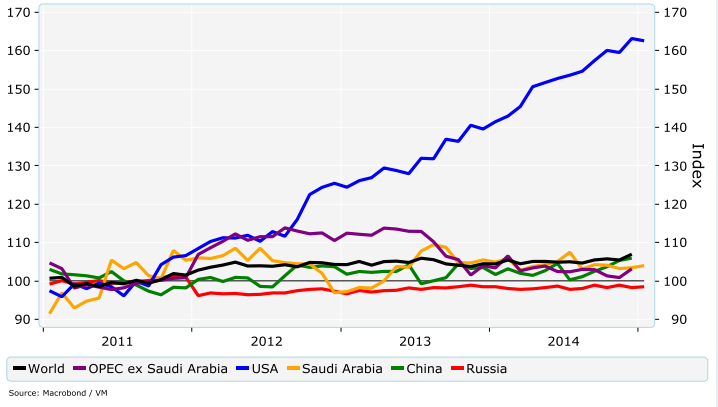
Another way to take into account the impact of possible shocks from the financial market on the oil market is to look at the expectations of the term structure of futures prices. In principle, it should be possible to derive a solid forecast from futures prices for future spot price trends inasmuch as they include the future expectations of all market players, provided that the differences in risk premiums are properly understood. Unfortunately, risk premiums change over time, which complicates the use of futures for forecasting purposes.

Hamilton and Wu (2012) and Baumeister and Kilian (2014) have worked to develop an analysis for the oil and the oil futures market that is based on factor models for interest rate term structures, and that also explains changes in risk premiums. Risk premium modelling produces market expectations calculated from futures, with the effect of changes in risk premiums eliminated from those expectations. The price expectations derived from this kind of model may differ significantly from price trajectories deduced directly from futures. For instance, in 2003–2008 spot prices increased sharply, but futures did not. This was due in part to the fact that futures risk premiums increased at the same time, which served to keep visible futures prices low.

The recent changes in oil prices can also be assessed against events in the marketplace (e.g. Baumeister and Kilian 2015; Badel and McGillicuddy 2015). At its June 2014 meeting OPEC came to the conclusion that demand for oil around the world will not develop as strongly as previously forecast. On the other hand, risks in the Middle East (e.g. ISIS, Libya, Syria) were elevated and the Ukraine crisis was coming to a head, and OPEC assumed that the risks of disturbances in supply would keep oil prices high. However, with barrel prices at over 100 dollars, US producers in particular were tempted to seek out unconventional oil sources, and production in the United States continued to grow briskly at around 15% (over one million barrels a day per annum). The geopolitical risks did not materialise either, and the global supply of oil remained

stable in 2014 (Figure 3). Slowing demand and continued abundant supply put downward pressure on prices. Saudi Arabia has often responded to price pressures by adjusting its production, but in summer 2014 it decided otherwise. The price of oil turned into a rapid fall.

Figure 3. Crude OIl Production, 2011=100



Analysts at the MoF Economics Department have developed a simple regression model in which changes in oil prices are explained by changes in a number of global demand activity but not oil production indicators (dry bulk goods freight and raw materials prices other than energy, world industrial output and trade, OECD cyclical indicator, US Purchasing Managers Index, interest rate yield curve, and trade-weighted exchange rate; see Figure 4). The demand model predicts around 25% of the drop in prices from June 2014 to February 2015. According to the model the difference between the 50% fall in true market prices and the decline forecast by the demand model would mainly be attributable to supply-based shock. As the global supply of crude oil was highly stable throughout 2014, possibly the greatest supply shock was that Saudi Arabia decided not to adjust its output in response to price pressures, in contrast to market expectations (Figure 3).

Figure 4. Brent Price, Y/Y

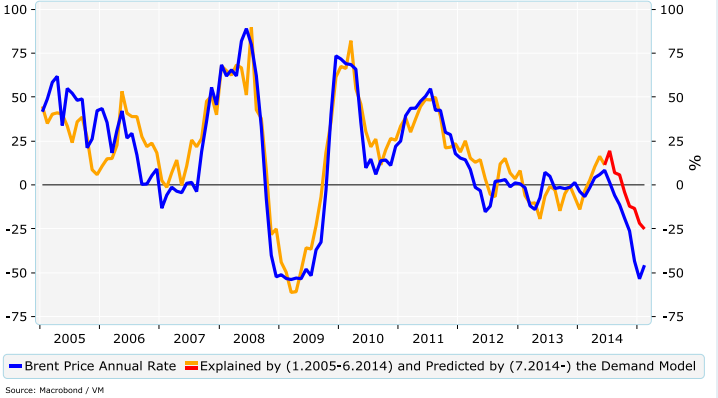
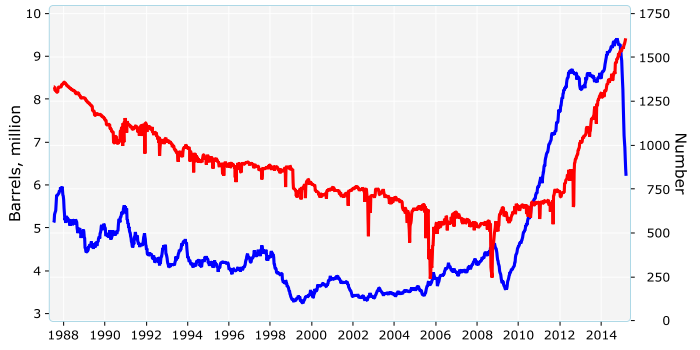


Figure 5. Oil Production, Barrels/Day (LHS), and Rig Count (RHS)



Economic effects

Changes in the price of oil are directly reflected in oil producers' revenue. For instance, part of US, Canadian and offshore oil drilling operations are profitable in the long term only when prices are high. In many places short-term marginal production costs are well below 50 dollars a barrel, so even at today's prices most of the current production will remain in the market. Although the United States has closed down some of its least profitable oil drilling rigs in response to falling prices, US oil production has continued to increase (Figure 5). The increased reliance on unconventional oil sources has apparently contributed to a more flexible oil supply as marginal and price sensitive production is now based on a larger number of smaller drilling sites that can be more flexibly opened and closed down than traditional large-scale sites.

Changing oil prices also have a direct impact on the costs of oil-consuming industries and the transport sector, as well as on household expenditure. Energy is a component in all goods and services, and therefore changes in energy prices are indirectly reflected in all costs, prices and markets. The value of net oil imports to Finland in 2015, for instance, will fall by more than EUR 2 billion compared with 2014. This will have income and substitution effects in both households and businesses. These reactions may in turn generate other indirect effects.

The third channel of influence comes through increasing risks, as all impacts of price changes are uncertain and hard to understand in advance. Part of this increased uncertainty stems from unpredictable policy reactions. Monetary, fiscal and structural policies may all react to oil prices. For instance, central banks may decide to ease their monetary policy in an environment of lower oil prices, especially if the core inflation rate that does not include oil or inflation expectations fall together with the price of oil. These kinds of policy reactions can create demand impulses in the economy.

Finally, at a global level the price of oil impacts the flow of revenue from oil-consuming countries to oil-producing countries. The savings rate is often higher in the latter than the former group, and historically they have had an influence on the global capital market. The relative diversion of real income from producer to consumer countries may therefore increase global consumption propensity and drive up demand, and accordingly tighten the capital market. This effect, however, is uncertain, and may be liable to change depending on the financial and budget restrictions faced by different countries. At a global level the prices of many raw materials, products and services also vary with the price of oil, which may bring further knock-on effects.

Assessing macroeconomic effects

Oil price shocks thus have an impact on economic activity via several different channels. There is an extensive body of literature on the macroeconomic effects of oil prices. For example, Anzuini et al. (2014) have estimated the precautionary demand for oil in spot and futures markets, concluding that the recessions in the United States in the 1990s and early 2000s were due in part to preparing for shocks in the oil market, but the great recession of 2008 was not.

Jimenez-Rodriguez and Sanchez (2005) estimate that a 10% movement in the price of oil causes a 0.3–0.6% change in economic activity in the United States and a 0.1–0.3% change in the euro area. The figures suggested by Cashin et al. (2014) and Peersman and van Robays (2012) are very similar. The magnitude of these estimates depends among other things on the oil intensity of the country concerned, the data available as well as on the methods used.

Based on these estimates, the 50% fall in oil prices that has now taken place should generate a demand surge of 0.5–1.5% in the euro area. This is hard to believe. At the very least the higher end of the estimate seems overly optimistic.

The impacts of oil price changes depend, firstly, on whether the shock is coming from the supply or demand side (Cashin et al. 2014; Hamilton, 2005; Kilian 2008, 2009, 2014; Melolinna, 2012; Peersman and van Robays 2012). A supply shock has an independent effect on the economy, while a demand shock is the result of changes in general economic activity. Indeed, it seems that supply shocks have a greater effect on global activity and on changes on the revenue flows between oil-producing and oil-consuming countries. Demand shocks have a weaker or statistically insignificant effect on activity.

Rapaport (2013) makes a distinction between shocks that are specific to the oil market – such as geopolitics in the Middle East – and economy-wide shocks, and uses a dynamic stochastic general equilibrium model to explore the effects of different types of shocks. The price increase (decrease) resulting from an oil market shock decreases (increases) economic activity and stock yields, whereas the effects of a price change due to an economy-wide shock are diametrically opposed.

Secondly, it has been argued in the literature that the effects of shocks are asymmetric, that price hikes have a greater impact than price drops (e.g. Hamilton 2003; Jimenez-Rodrıguez and Sanchez 2005; Kilian 2014; Feldkircher and Korhonen 2014). For instance, the sharp fall in oil prices in 1986 did not prompt a significant increase in economic activity in the United States. This might have been due to the costs incurred from the reallocation of inputs, increased insecurity, or monetary policy reactions. Central banks may react more strongly to threats of rising inflation than to a slowdown of inflation. Thirdly, the oil intensity of industrial countries has fallen over time. As a result the impacts of oil price changes in the economy are less pronounced than before, and analyses based on older data predict exaggerated effects (Blanchard and Riggi, 2013; Melolinna 2012). The price of oil also has a major impact on inflation. Changes in inflation and oil prices closely correlate with each other, even though the effects vary from country to country and over time. Rapid increases in the price of oil have led to episodes of high inflation (de Gregorio et al. 2007). Over time, inflation has also reacted less strongly to oil prices (de Gregorio et al. 2007; Hooker 2002; Jacquinot et al. 2009). What is clear, however, is that lowered oil prices will have the effect of lowering inflation. As energy is included as an input in all goods and services, falling oil prices also reduce pressure on prices indirectly. It is less clear to what extent the effects extend to underlying inflation or longer term inflation expectations.

Summary

At least half of the fall in the price of oil has been the result of a demand shock, above all slower than anticipated economic activity in developing economies. The supply shock consists in large part of OPEC's and above all Saudi Arabia's unexpected market behaviour. In addition, unconventional oil production has continued to rise sharply. These producers have stronger incentives to adjust their output according to changing market prices than companies operating major oil fields, whereby the price elasticity of supply is slightly greater than before. A more flexible supply reduces the price reaction. For net importers of oil, the explanation that the low price of oil is due to a demand shock is less good news today than a supply shock.

Oil will remain cheaper than it has been in recent years as the growth of demand from developing economies will be more moderate than previously anticipated and as OPEC, given its reduced market share, will no longer support oil prices by adjusting its supply, at least to the extent that it used to. Cheaper oil will boost EU and US recovery and at the same time contribute to keeping inflation in check. However there is no reason to expect any dramatic effects. Finland may in fact be more profoundly affected by Russia's negative growth cycle, which is being exacerbated by the oil market.

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1.2 Foreign trade

Exports to grow despite weaker outlook

According to Statistics Finland's national accounts figures in March 2015, exports fell by 0.4% in 2014. In 2014 the value of exports was on average 7% lower than at year-end 2010, at the height of recovery from the financial crisis. The decline in exports is the result of a combination of factors, most importantly industrial restructuring and reduced cost competitiveness. Customs statistics for 2014 show that the strongest growth was recorded for exports of transport equipment, although this consisted in large part of one-off deliveries. Electronics exports, on the other hand, have returned to growth after falling for several years.

Exports are projected to return to moderate growth. This will be on the back of rebounding economic growth in Finland's most important export markets and the gradual acceleration of global trade after a few quieter years. Euro area economic growth in 2015 will be faster than last year. In the short term, the weakening of the euro against the US dollar will improve export opportunities from Finland (see box). Although the weaker euro will bolster Finnish exports, the exchange rate also has indirect effects, for instance by increasing export demand in the euro area. However, the euro has not weakened against the US dollar enough to fully offset the exchange rate changes in our other trading partners' currencies. Lower oil prices have nonetheless created a demand surge and will help to drive Finnish exports. The problems in the Russian economy will in turn hamper Finnish export growth.

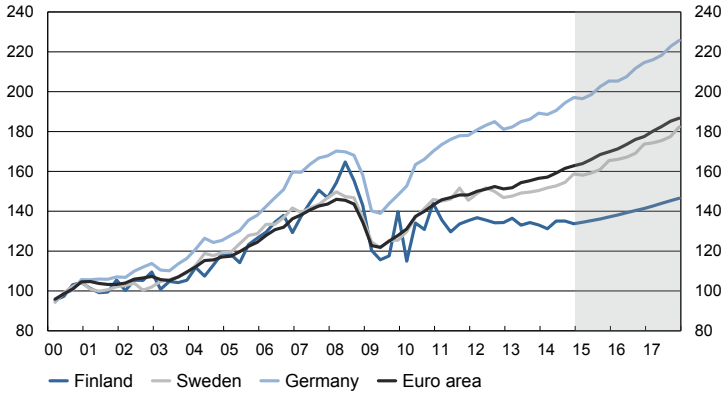
In 2016 exports growth will reach 3% and in 2017 pick up further to 3.5% on the back of increasing global trade. As developing economies remain on a faster growth track than their European rivals, Finland will continue to see its export market shares decline. Trade will increasingly be concentrated in the markets of developing economies, making it harder for Finnish companies to hold on to their market shares.

According to the March national accounts, the volume of imports fell by 1.4% in 2014. Customs figures show that the value of raw materials imports was up, but falling energy commodity prices in particular drove down the value of commodity imports. Imports will return to growth as both exports and domestic demand continue to pick up, albeit slowly. The return of investment and consumption to a growth path will accelerate imports growth in 2016 and 2017. As a consequence the positive contribution of net imports to GDP growth will decrease over the outlook period.

Table 5. Foreign trade

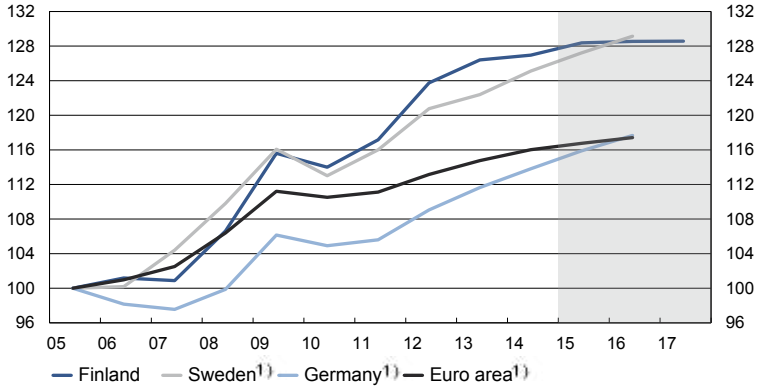
	2012	2013*	2014*	2015**	2016**	2017**
	change in volume, %					
Exports of goods and services	1.2	-0.7	-0.4	1.5	3.0	3.5
Imports of goods and services	1.6	-1.6	-1.4	1.0	2.8	3.4
	change in price, %					
Exports of goods and services	1.1	-0.8	-1.7	-0.3	1.2	1.4
Imports of goods and services	2.1	-1.3	-1.8	-1.2	1.1	1.3

Exports of goods and services
volume 2000=100, seasonally adjusted



Sources: Eurostat, MoF

Unit labour costs
2005=100, nominal



1) European Commission forecast

Sources: European Commission, Statistics Finland, MoF

Current account moving towards balance

In 2014 the current account deficit was down to EUR 2.3 billion, or 1.2% of GDP. Indeed, the deficit shrank considerably towards the end of the year. Over the outlook period the trade and current account deficits will decrease by some EUR 1.5 billion as a result of weak imports. Nonetheless in 2017 the current account deficit will still stand at EUR 0.8 billion, or around 0.4% of GDP.

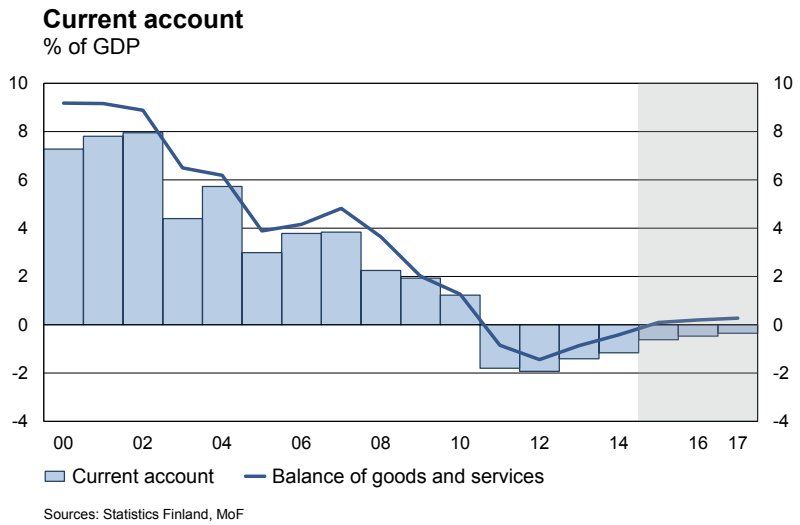
The sharp deterioration of the current account position is due to structural problems, including the reduced level of electronics production in Finland. However, the factors behind the narrowing of the deficit during the outlook period are cyclical by nature, as the pick-up

Table 6. Current account

	2012	2013*	2014*	2015**	2016**	2017**
	EUR bn					
Balance of goods and services	-2.9	-1.7	-0.8	0.2	0.4	0.6
Factor incomes and income transfers, net	-1.0	-1.1	-1.5	-1.5	-1.4	-1.4
Current account	-3.9	-2.9	-2.4	-1.3	-1.0	-0.8
Current account, % of GDP	-1.9	-1.4	-1.2	-0.6	-0.5	-0.4

of external demand and exports will see the current account move back towards balance. The rebound in investment will increase the output potential and allow the share of exports in GDP to return close to the level seen before the financial crisis.

The terms of trade improved clearly for the first time in almost 10 years, mainly in response to the sharp decline in oil prices in 2014. Export and import prices have fallen quickly and will continue to fall in 2015. In 2016 and 2017, it is predicted that foreign trade prices will begin to edge up. However import prices will rise only slowly as sluggish world trade growth means that the development of export prices from rival countries will remain moderate and as oil prices will only increase slightly over the outlook period. The weaker exchange rate will initially be reflected in higher import prices and, with some delay, in export prices. The terms of trade will improve somewhat during the outlook period. Export and import prices will follow similar trends as exports have become more diversified and export prices more closely follow competitors' prices.



Sources: Statistics Finland, MoF

1.3 Domestic demand

1.3.1 Private consumption

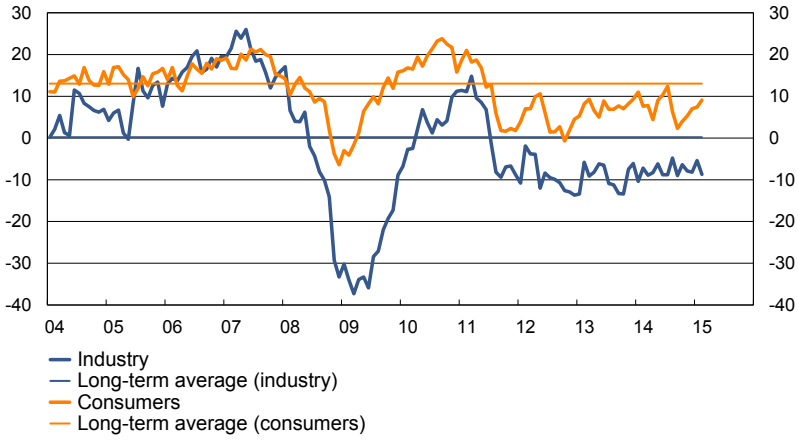
Private consumption growth to remain muted

The reduced level of real disposable income has adversely impacted on household consumption opportunities for the past three years. Weak real income growth is in part explained by the reduced number of employed persons and increased indirect taxes. In 2014 the volume of private consumption continued to fall by 0.3%. Private consumption growth will begin to pick up during the outlook period, but nonetheless remain relatively muted.

Uncertainty about the economic outlook and increasing unemployment have combined to keep consumer confidence below the long-term average. However expectations have shown some signs of improving. Confidence in both personal finances and the outlook of the economy in general has continued to strengthen over the past four months. In 2014 private consumption growth was fastest in the category of durables. In recent months respondents to the Consumer Survey have been increasingly positive in their assessments of the suitability of the current moment for durables acquisitions. This will continue to support demand for consumer durables during the current year, and it is anticipated that durables consumption will continue to grow much more rapidly than other consumption.

Confidence in the retail sector declined towards the end of last year. In December 2014 retail sector expectations were at record low levels. Last year the volume of retail sales declined by just over one per cent, i.e. more than private consumption. The value of retail sales as a proportion of total consumption is around one-third. Digitalisation and other developments are continuing to transform the retail sector. These developments have also brought increasing foreign competition, which may in part explain the poor performance in traditional retail. In January the volume of retail trade fell by 1.3% from the year before.

Industry and consumer confidence
balance, seasonally adjusted



Source: European Commission

New car registrations in January–February were also down from the year before. Car sales are sluggish because consumers remain unclear about what to expect concerning the structure of car taxation and the proposed car scrapping bonus scheme. However, recovering consumer confidence and strengthening purchasing power give grounds to expect that annual figures both for the retail branch and private consumption as a whole will be stronger than might be assumed based solely on data for the early part of the year.

Purchasing power and private consumption bolstered by moderate price developments

In 2015 the single most significant factor contributing to household real income growth is the exceptionally moderate trend of consumer prices, which is largely attributable to falling world market oil prices. Prices of private consumption will rise by just 0.3% this year, a record low rate. Oil prices are expected to start rising, although they will not rebound to the same level seen a few years ago. Next year the price of private consumption is set to accelerate, but will still remain slower than average.

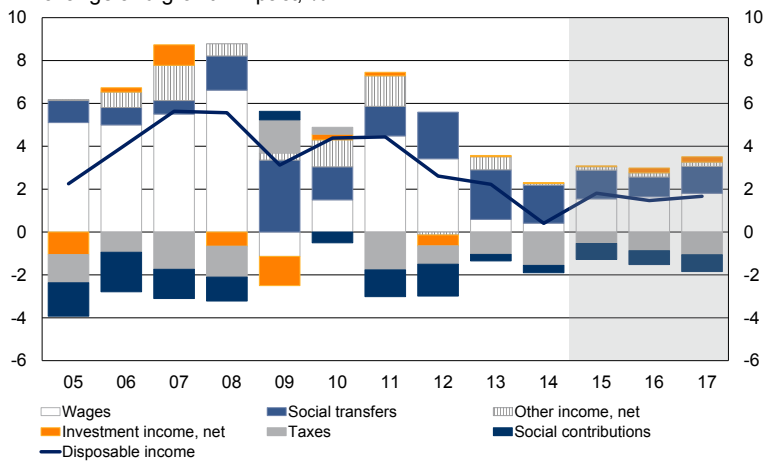
Employee compensations account for the bulk of household disposable income. Moderate wage settlements are crucial in order to strengthen national competitiveness and to ensure favourable employment trends in the next few years ahead. Wage and salary growth will pick up towards the end of the outlook period, but still remain more moderate than usual. It is projected that the number of employed persons will increase slightly in 2015, which will be reflected not only in the employee compensations received by households, but also in strengthening consumer expectations in response to the lower perceived risk of unemployment.

It is anticipated that interests rates will remain exceptionally low throughout the outlook period. Rebounding economic growth coupled with moderate labour cost trends will strengthen the financial position of the private business sector, which in turn will be reflected in household property income. Social income transfers will continue to rise with higher inflation towards the end of the outlook period and with the increasing number of pension recipients. Despite the improving cyclical situation, real disposable household income will increase only little in 2016–2017.

The number of people in the age bracket 15–64 has continued to fall since 2011. The increasing number of pensioners in the wake of demographic change together with the tendency of households to smooth their lifetime consumption are contributing to reduce the economy-wide savings rate. Short-term changes in the savings rate, however, are more dependent on trends in consumer confidence than on the pressures resulting from changes in the population age structure. The concrete effects of improving consumer confidence will only begin to show up towards the end of the outlook period in a declining savings rate. Private consumption volume growth will pick up towards the end of the forecast period, edging up to 1% in 2017.

Household indebtedness has continued to increase in recent years, despite a slowdown in the growth of the household loan stock. At the end of 2014 housing loans accounted for three-quarters of the total stock of household loans. The property market slowdown and the moderate decline in property prices have been reflected in the number of new housing

Households´ disposable income
change and growth impact, %

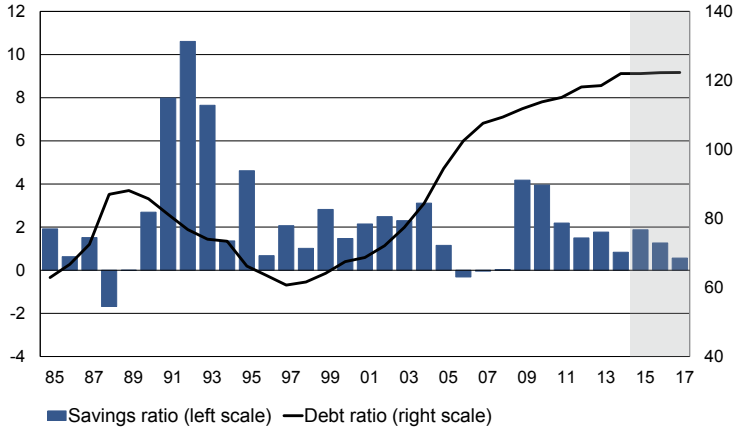


Sources: Statistics Finland, MoF

loans taken out. In 2014, demand for new housing loans fell by 1%. During 2015 the loan repayment holidays that banks are now pushing to consumers will contribute to maintain indebtedness, but at the same time also support private consumption growth. Household indebtedness will stop rising during the outlook period. The indebtedness of Finnish households is around the international average, and therefore as it stands does not constitute a serious problem for the balanced development of the economy.

In the short term the most significant risk to private consumption growth comes from the development of employment. If the employment situation does not improve, then favourable consumer expectations and purchasing intentions will not translate into consumption demand.

Household savings and debt
% of disposible income



Sources: Statistics Finland, MoF

1.3.2 Public consumption

Public consumption consists of central government, local government and social security funds consumption expenditure and amounts to some EUR 50 billion, or one-quarter of GDP. The biggest public consumption items are wages, employers' social security contributions and intermediate consumption, i.e. the value of goods and services used as inputs. Local government accounts for two-thirds of public consumption, central government for just over one-quarter, and social security funds for the remainder.

Preliminary figures for public consumption in 2014 show an increase of just 0.2%, clearly less than the long-term average. Over the next few years ahead the volume growth of public consumption will be based exclusively on increasing demand for basic municipal services.

Staff numbers in central government are turning down, and therefore the volume of central government consumption is declining. Just over one-quarter of people working in central government are employed in extra-budgetary units such as universities, the Finnish Broadcasting Company YLE and VTT Technical Research Centre of Finland. Wage and salary growth is also very moderate, and therefore the value of consumption will increase only marginally. It is projected that intermediate consumption will rise at an annual rate of around 1½%.

Local governments will continue their efforts to curb the growth of consumption expenditure in 2015 through increased efficiencies. It is estimated that adjustment measures will reduce the number of employees in the local government sector by close to 1,000 persons. Most of these staff reductions will be absorbed through layoffs and natural attrition. Moderate cost trends are also helping to keep in check the value of consumption in the local government sector. However, increasing service needs as a result of population ageing will continue to drive local government consumption over the next few years. The 2016–2019 forecast for the local government sector is based on scenario projections that only take account of measures already agreed upon. It does not consider the adjustment measures scheduled for implementation by local governments after 2015.

Expenditure by social security funds consists mainly of wages and social benefits in kind paid out by the Social Insurance Institution Kela (reimbursements for medicines and travel and rehabilitation allowances). In 2015, the growth of expenditure on social benefits in kind will slow as a result of savings decisions taken by the Government.

Table 7. Consumption

	2014 share, %	2012	2013	2014	2015**	2016**	2017**
		Change in volume,%					
Private consumption	100.0	0.3	-0.6	-0.2	0.5	0.8	1.0
Households	95.2	0.4	-0.6	-0.1	0.5	0.8	1.0
Durables	8.1	-0.5	0.1	2.4	2.8	1.6	2.0
Semi-durables	8.0	1.0	-0.2	-2.6	-0.6	1.0	0.8
Non-durable goods	27.6	-0.3	-0.7	-1.0	-0.1	0.1	0.1
Services	51.4	0.9	-1.1	-0.2	0.4	1.0	1.3
Consumption by non-profit institutions	4.8	-0.4	-0.9	-1.8	0.5	1.0	1.0
Public consumption	100.0	0.5	0.6	0.2	0.2	0.5	0.4
Central government	26.9	-0.3	3.6	-0.6	-0.5	-0.7	-0.6
Local government	66.0	0.9	-0.5	0.4	0.4	0.9	0.9
Social security funds	7.1	0.1	-0.1	1.2	0.9	1.2	-0.3
TOTAL		**0.4**	**-0.2**	**-0.1**	**0.4**	**0.7**	**0.8**
Individual consumption expenditure in general government		0.6	-0.4	0.4	0.6	1.0	0.8
Total individual consumption expenditure		0.3	-0.6	0.0	0.5	0.8	0.9
Households´ disposable income		2.6	2.2	0.4	1.8	1.5	1.7
Private consumption deflator		2.8	2.5	1.5	0.3	1.3	1.4
Households´ real disposable income		-0.2	-0.3	-1.1	1.5	0.2	0.3
		%					
Consumption as proportion of GDP (at current prices)		79.0	79.9	80.2	80.1	79.5	78.9
Household savings ratio		1.5	1.8	0.8	1.9	1.3	0.6
Household debt ratio [1)]		118.1	118.5	122.0	122.0	122.3	122.3

[1)] Household debt at end-year in relation to disposable income.

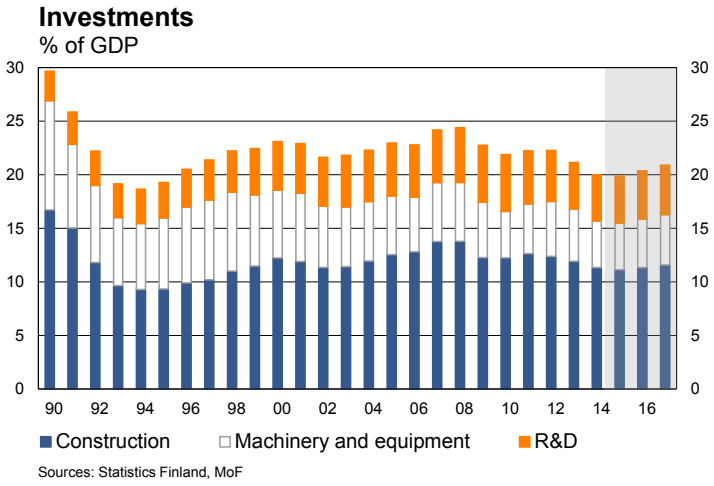
1.3.3 Private investment

Bridging the investment gap

Investment in the national economy will turn to growth in 2015, but the quarterly growth rate will not yet be enough to lift the annual investment figure into positive territory. It is anticipated that private investment will decline by around 1% this year. The investment forecast has been slightly revised downwards since December because national accounts figures indicate that last year's investment was somewhat lower than forecast and since the performance of the economy as a whole has fallen short of earlier predictions. The investment recession has been so deep that investment will not recover to its previous levels even by the end of the outlook period, even though it is projected that by then, private investment will pick up to annual growth of 4–5%.

The ratios of total and private investment to GDP will continue to fall this year and then turn to slow growth from 2016. Despite the strong annual growth projection, the private investment to GDP ratio will still be a couple of percentage points lower than the 10-year average at the end of the outlook period, i.e. 16.7%.

The forecast for investment in building construction is subject to more uncertainty than usual as statistics were temporarily discontinued in January and the latest reliable data available are from August 2014.



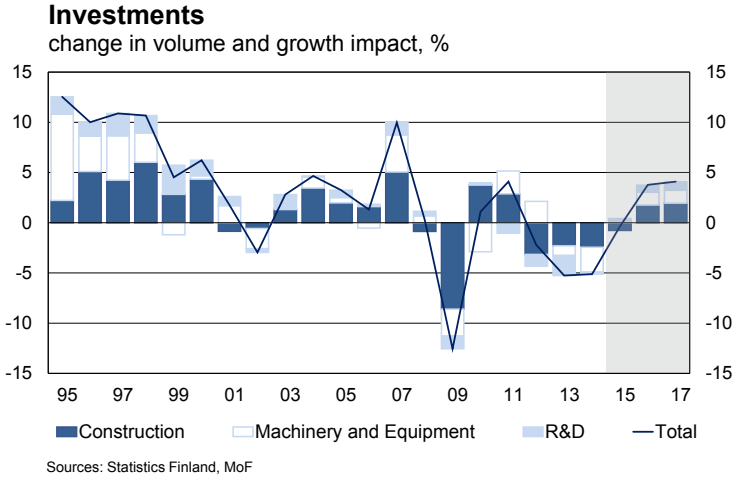
Sources: Statistics Finland, MoF

New residential construction sluggish, renovation increasing

The number of new housing starts in 2015 is estimated at 25,500, slightly higher than the figure last year. Nonetheless the volume of new residential construction is set to fall as projects completing the most expensive final stages exit the index and new projects at earlier, cheaper stages enter the index. This year's increase in new housing starts will be mainly attributable to the construction of state-subsidized housing units. The good news as far as new housing construction is concerned is that the number of unsold housing units is estimated to have fallen somewhat from the early part of the year.

In 2016 and 2017 residential construction will gather pace, but there is no major cyclical shift in sight. In the metropolitan Helsinki area major multi-storey development projects for ex. Kalasatama and Pasila are scheduled to continue through to the last years of the outlook period, but outside the metropolitan area a wait-and-see climate still persists. On the positive side, demand for investment property is acting to counterbalance the fall in consumer demand for owner-occupied housing. In growth centres, funds and foundations have a major role in purchasing new multi-storey developments.

Housing renovation activity is continuing to boom. However the number of new renovation projects under planning and starting up will continue to fall with the drying up of stimulus funding for renovation. When both renovations commissioned or undertaken by housing corporations and residents themselves are included, the single biggest category is represented by multi-storey renovations. The main areas of renovation are water and sewerage pipes as well as external surfaces and structures. It is predicted that residential renovation investment will increase by around 4.5% in 2015 and by around 3% in 2016–2017. Renovations undertaken by housing corporations also mean that their loans have increased. Loans to housing corporations accounted for one-third of the total corporate loan stock, and in 2014 they increased at around 12%.



Sources: Statistics Finland, MoF

Investment in commercial facilities not to rebound until 2016

The volume of other building construction is also expected to decline during the current year. Because of statistical problems, however, it is assumed that the true cubic volume figure for new building starts is probably slightly higher than the figure indicated by the statistics.

The figures for investment in commercial facilities reflect the impact of individual, very large-scale projects, including shopping centres in Tampere and Jyväskylä, one exceptionally large retail storage facility, the construction of the Western Metro Extension and Ring Rail Line station buildings and the business and office facilities built in connection with the stations, as well as the health care buildings in Kuopio, Espoo, Helsinki and Tampere.

The number of planning permissions granted for commercial and business construction has shown healthy growth, and even the number of commercial construction starts has increased despite the weakness of the economy. The trade sector, however, is facing a challenging situation and new projects are approached with caution. The construction of transport buildings is increasing the volume of investment, and the construction of office facilities is clearly gathering pace – although office construction has started from the lowest base level in the 2000s. In early 2015 the office vacancy rate in the metropolitan Helsinki area has been around 12.5%, but the number of property transactions has increased and in 2014 clearly exceeded the figures reached in the previous three years.

Investment in industrial construction is at a low level. One major factor is the relatively low rate of capacity utilisation in industry, which inevitably translates into modest investment needs. On the other hand the construction of power plants using renewable energy sources (e.g. wind turbines) and recycled waste is on the up. Investment in warehouse construction is strong, driven above all by a few megaprojects. In 2014 the construction of public service premises declined appreciably.

Renovation of other than residential buildings is also on the increase: the projected growth rate for the next few years is around 1–2%. Weakening employment is undermining both the demand for commercial premises and renovation activities in commercial premises. Savings measures in both the private and public sectors are likewise having a negative effect on the renovation of commercial facilities.

Civil engineering investment picking up

Civil engineering investment is projected to increase moderately throughout the outlook period. In 2015 investment growth will be bolstered by public infrastructure investment. Several infrastructure projects have received additional funding and been brought forward. Projects are starting up in the energy supply network, the water supply network, the rail network, the metro and at airports, for instance. In addition more than 10 relatively small road projects designed to support business and industry will be starting up in 2015. Another positive development is that lower oil prices will significantly reduce civil engineering costs.

On the other hand, civil engineering is adversely affected by the general economic recession, difficulties in exports and the situation in Russia. Furthermore, transport network maintenance funding is set to decline. These negative factors are also reflected in contractors' low bidding prices.

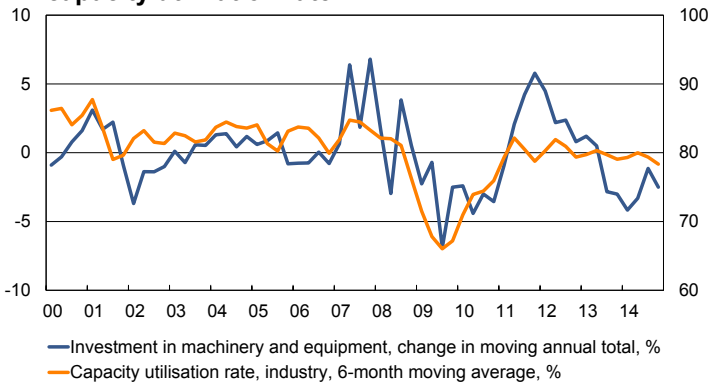
Investment in machinery, equipment and transport equipment cautiously edging up

The weakness of the economy is also reflected in investment in machinery, equipment and transport equipment. National accounts figures indicate a 10% decline for 2014, a sharper fall that in any other investment item. This came as quite a surprise as new registrations of transport equipment developed quite favourably last year. It is possible that figures for this investment item will be revised upwards in connection with the publication of the next annual accounts. This investment item is projected to show moderate growth in 2015. This is also borne out by the results of the latest investment surveys. In November, respondents to the Confederation of Finnish Industries EK investment survey still predicted that industry investment would increase by 6% in 2015, but according to the most recent surveys by Aalto University and the OP Financial Group as well as the SME barometer survey, there is still some wait before investment rebounds. However the SME sector, which accounts for around one half of all investment, took a more positive view on investment starts.

The EK survey found that by industry, companies in the food industry, the chemical industry and the engineering and metal products industry had active investment plans. Furthermore, the focus of investment is shifting towards capacity-enhancing investments.

In 2016–2017, it is predicted that investment in equipment will increase at a healthy pace of around 6%.

Investment in machinery and equipment and capacity utilization rate



Source: Statistics Finland

R&D and software investment to gradually edge up

R&D investment as well as software investment have declined for four years in a row, but this year it is expected that the growth of public investment will turn this trend around. In 2016–2017, investment in intellectual capital will increase at around 3%, and it is anticipated that growth will become more broadly-based across different industries.

Detailed figures on R&D investment are available about one year after the point of observations. The latest data on R&D personnel are for 2013, when they numbered around 80,000. However, it is thought that this figure will have fallen to some extent last year. Financial investment into product development has decreased most particularly in the electronics industry. On the other hand, R&D expenditure increased in the computer, software, consultancy and R&D branches.

Table 8. Fixed investment by type of capital asset

	2014 share, %	2012	2013	2014	2015**	2016**	2017**
		Change in volume,%					
Buildings	46.8	-5.6	-5.1	-5.1	-1.8	3.7	4.0
Residential buildings	28.8	-3.5	-2.7	-5.5	-0.3	3.6	3.7
Non-residential buildings	18.0	-8.6	-8.7	-4.3	-4.3	3.8	4.5
Civil engineering construction	9.8	-5.4	0.9	-0.7	1.0	0.7	1.0
Machinery and equipment	21.8	10.2	-4.1	-10.7	0.9	5.8	5.8
R&D-investments*	21.6	-5.3	-9.4	-1.0	1.0	3.2	3.8
Total	100.0	**-2.2**	**-5.3**	**-5.1**	**-0.4**	**3.7**	**4.1**
Private	79.2	-3.2	-7.3	-6.5	-1.0	4.5	5.0
Public	20.8	2.6	4.0	0.6	2.3	1.1	0.4
		%					
Investment to GDP ratio (at current prices)							
Fixed investment		22.3	21.1	20.0	19.9	20.4	20.9
Private		18.3	17.0	15.8	15.6	16.1	16.7
Public		4.0	4.2	4.2	4.3	4.3	4.2

* Includes cultivated assets and intellectual property products

1.3.4 Public investment

Preliminary data indicate that public investment increased slightly in 2014, even though investment by authorised pension providers showed a negative value due to sales of immovable property. It is projected that public investment will increase slightly over the years ahead on the back of transport infrastructure investment and major local government projects.

R&D investment accounts for almost one-half of total central government investment. R&D appropriations this year will rise to around EUR 50 million, and it is not expected that they will decrease in the years ahead either. Transport infrastructure projects account for over one-third of all central government investment. In line with the spring technical spending limits, it is anticipated that transport infrastructure investment will start rising from next year. Senate Properties are planning to sell off some of its properties this year, which will reduce central government investment.

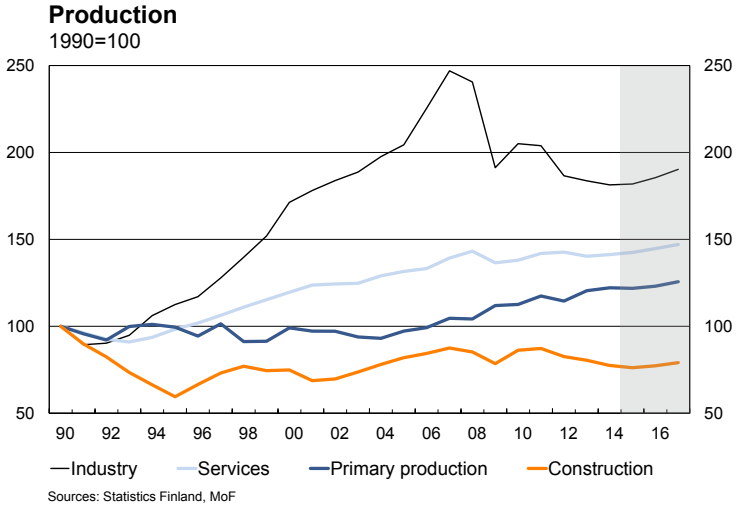
Local government investment will remain high over the medium term. This is due to major projects in growth centres, so-called repair debt, as well as major hospital investments. Almost half of total investment in the local government sector consists of building construction and less than one-third of infrastructure investment. However over the next few years the rising debt burden and the commitment to curb the growth of that burden will gradually begin to affect local government investment.

1.4 Domestic production

1.4.1 Total output

Slow return to growth

Late in 2014, economic growth grounded to a halt again. Gross value added for the economy in 2014 was unchanged from the year before. Midway through 2014, the economy grew marginally, but in the last quarter it contracted again as output declined in all main sectors of the economy. Value added in secondary production decreased for the fourth year in succession, but service output turned to growth and primary production also increased. Value added in industry fell by 1.3% as production in the forest and metal industries declined from the previous year. Output in the chemical industry, by contrast, was up from the year before. Value added in building construction declined for the third year running, falling by 3.6%. Service production increased by 0.7%, especially in information and communication, financial and insurance activities, and real estate activities. On the other hand, output declined in wholesale and retail trade, logistics and public services. Services continue to account for a growing share of national value added - the figure now stands at over 71% - at the same time as the share of secondary production has dropped to just over one-quarter. Total value added is still 8½% lower than before the financial crisis at the end of 2007.

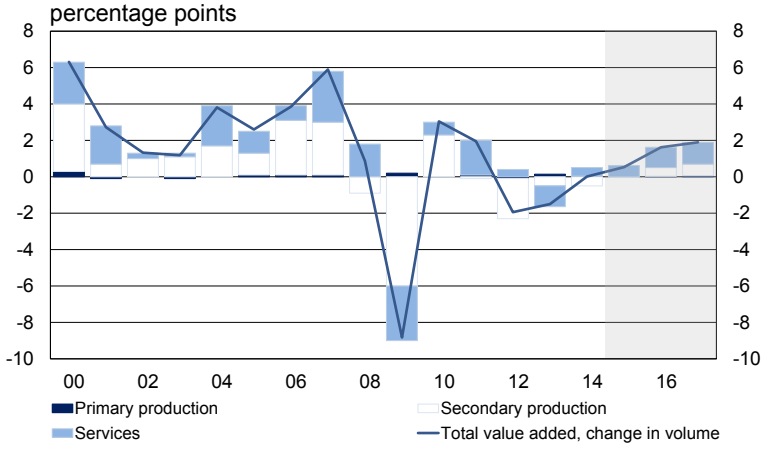


In 2014 the economy's resources remained largely underutilised. In manufacturing, the capacity utilisation rate fell by less than half a percentage point to just over 79%. Unemployment was up 6% and the unemployment rate climbed to 8.7%. It is thought that unemployment is largely structural and that there are significant mismatch problems. Furthermore, investment in production-related fixed assets has been falling for three years. The number of hours worked in the national economy fell by 0.2%, and therefore labour productivity improved only marginally, i.e. by 0.2%. Labour productivity has been poor since the financial crisis, continuing to remain 3½% lower than before the crisis. Part of the reason for this lies in industry restructuring as the contribution of high-productivity sectors to total output has declined.

It is expected that the economy will slowly return to growth during the current year as total demand gradually picks up. This year national value added growth is predicted to come in at around ½%. In 2016 growth will accelerate to 1½% and in 2017 to around 2%. The outlook in Europe, Finland's principal export market, is brighter than in the past few years, which will boost Finnish companies' export prospects. It is expected that growth in developing markets will remain clearly stronger than in the main market areas - with the exception of Russia, a major market for Finland. Overall, businesses have an abundance of idle capacity that allows them to respond quickly to changes in demand. It will take some time to counter the years of decline in cost competitiveness, but the moderate wage increases are a step in the right direction. Furthermore, the weakening of the euro will bolster cost competitiveness in markets where payments are settled in US dollars. Falling energy and raw materials prices will also ease the situation of companies that use these inputs in their production. In recent years output volumes in Finland have been significantly affected not only by industrial restructuring, but also by sluggish total demand, and for the time being at least there is no immediate or significant relief in sight.

Contribution to total production

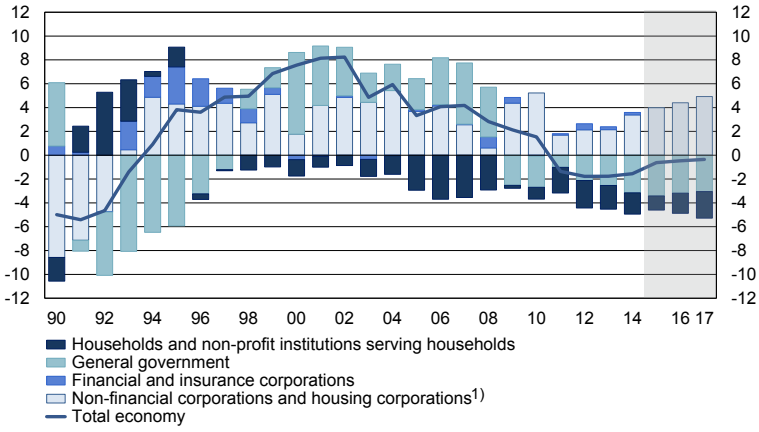
percentage points



Sources: Statistics Finland, MoF

Net lending by sector

% of GDP



1) Including financial sector in 2015-2017

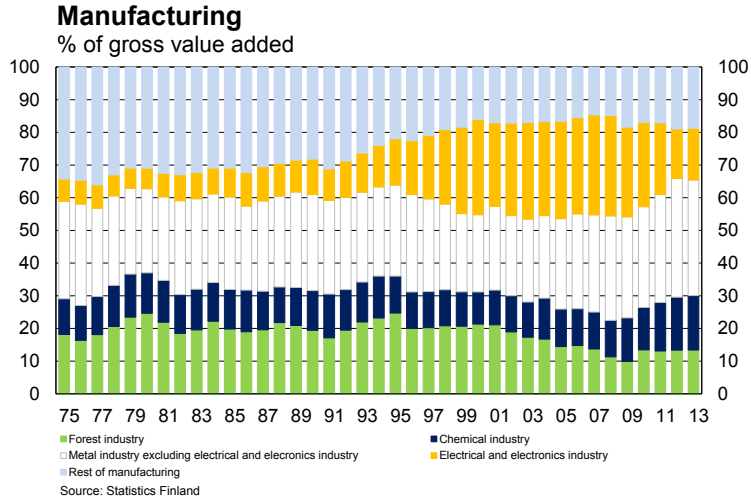
Sources: Statistics Finland, MoF

Finland is a small and open economy that is exposed to economic cycles and trends via its foreign trade. As before, it is expected that industrial output will recover with the rebound of export demand, as most of the country's industrial production is exported. The majority of services produced are used by the business sector, and therefore improving business output quickly improves the situation in services branches. Furthermore, digitalisation is increasing demand for ICT services. Household purchasing power will show only moderate improvement over the outlook period, and therefore private consumption demand will not significantly increase service production either this year or next. Based on the number of planning permissions granted the volume of new building construction will remain quite low in 2015, but pick up from next year with the revival of other economic activity. Building renovation activity, by contrast, will continue to increase throughout the outlook period.

1.4.2 Secondary production

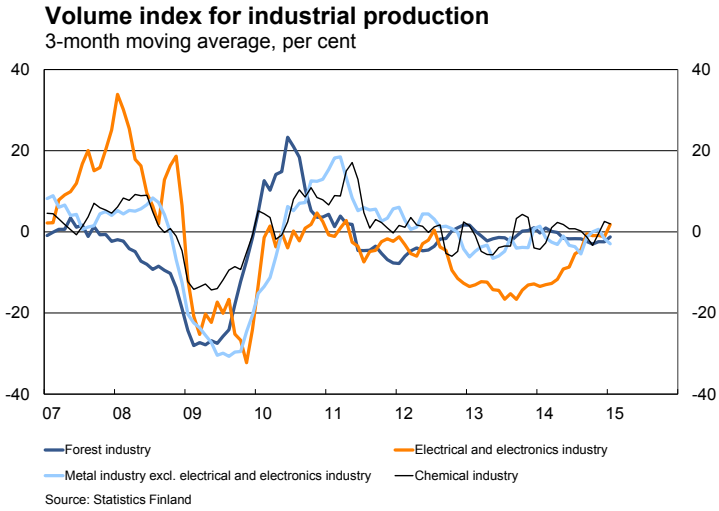
Industrial production needs more orders

The downturn in industrial production hardly slowed at all last year. Industry value added fell by 1.3% in 2014, almost as much as the year before. The decline in production was broadly based as the only branch recording an increase in production was the chemical industry, which was up 3.9%. Forest industry production fell by 0.6%: even though pulp and cardboard production both were up, demand for paper is trending to fall worldwide. Metal industry production declined by 0.7%, as most of the new orders received in the autumn were one-offs, though on the other hand they were enough to increase metal industry order books. The electrical and electronics industry slipped into deep recession again. Potential export demand for Finnish production has increased since 2013, and therefore it seems that Finland's share of world industrial value added continued to decline last year.



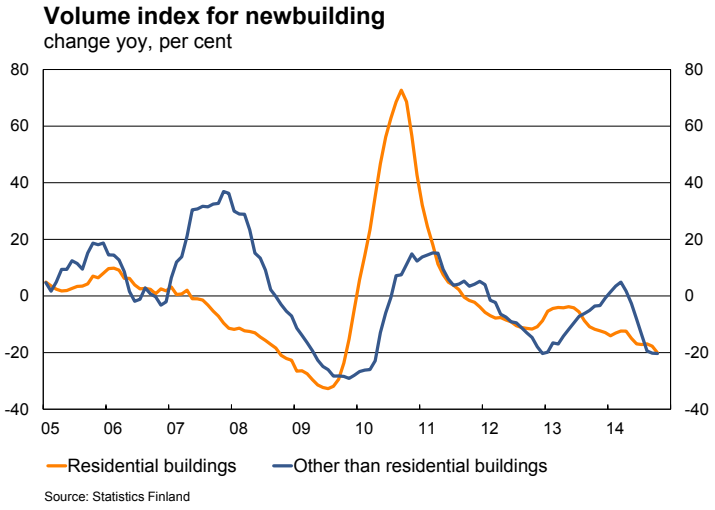
The outlook for industrial production improved early in the year. Business tendency surveys show that the cyclical outlook in industry no longer deteriorated in the first months of the year. In fact, output expectations improved somewhat. Almost half of the companies responding to the Confederation of Finnish Industries survey were still constrained by inadequate demand, but that proportion has no longer significantly increased during the course of the year. Order books are continuing to shrink, so the turnaround looks set to remain muted and businesses are continuing to adjust their finished products inventories according to the lowered level of demand. Competition has eased somewhat, at least in the domestic and non-EU market. In the EU internal market, by contrast, competition has become tougher. Rebounding export demand will see industrial production return to growth this year. The outlook for growth is strongest in the forest and technology industries, which have the largest number of companies expecting to post growth. The chemical industry, which in 2014 was on a growth path, is being held back by falling order books over the short term.

The food industry, for its part, desperately needs new markets to offset the losses in Russia. Total industry output is projected to increase only marginally this year at ½%, but in 2016 and 2017 growth will become more broadly based and accelerate to over 2%. However the growth rate is expected to remain far more moderate than in the years preceding the financial crisis, and in 2017 output will still be more than 20% lower than the pre-crisis figures.



New housing construction declining

The situation in the construction sector remains difficult and divided. It is estimated that the volume of new construction continued to fall last year, whereas renovation activities increased. However statistics are not yet available for year-end 2014 due to an overhaul of the statistical system, and therefore the exact situation remains unclear. However, value added in the construction sector declined for third year in succession, by 3.6% last year. The figure is more than 13% lower now than it was before the financial crisis.

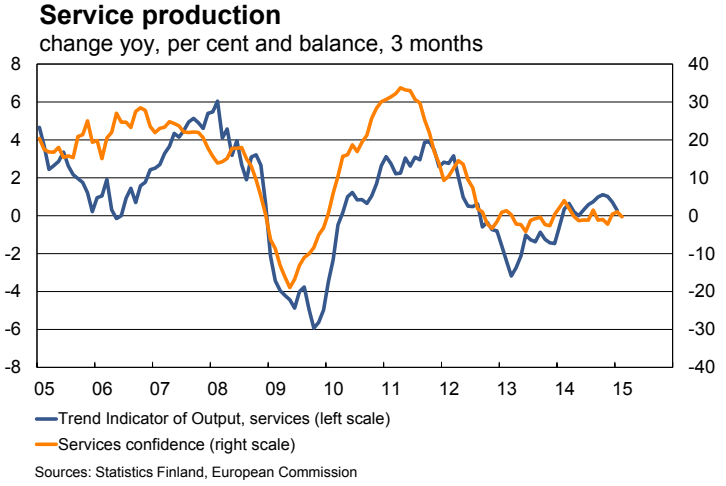


In the early part of the year the outlook no longer deteriorated in new building construction, either. Nonetheless inadequate demand has become an increasingly pervasive obstacle to growth, and in general almost three in four construction companies identify such obstacles. Furthermore, the recovery of residential building construction is hampered by the higher than average number of unsold dwelling units. Indeed there is no quick turnaround in sight for the construction sector, but new building construction will continue to fall in 2015. It is thought that renovation will continue to increase, and therefore value added in the construction sector as a whole will decline by 1½% this year, less than in 2014. Increasing activity in the rest of the economy will push new building construction onto a growth path in 2016 and 2017. The volume of construction output in 2017 will be some 8% lower than the peak figures of 2007.

1.4.3 Services

Services continue to drive economic growth

In 2014 economic growth was maintained by primary production and by private service branches. Value added in services increased by 0.7%. Growth was strongest in financial and insurance activities as well as in information and communication services at around 9%. Real estate activities also posted growth at over 1½ %. Value added in trade and transport, by contrast, fell for the second year running, and value added in public service provision continued to decline. Service production in 2014 accounted for 71.2% of the national value added. This share has increased by 7½ percentage points in the past 10 years.



The outlook in service industries has improved, but sales expectations are continuing to fall as inadequate demand remains an obstacle to growth for increasing numbers of service companies. On average the availability of skilled staff has improved somewhat, but business profitability is continuing to fall.

The majority of services produced go to the business sector, and therefore improving business output also translates into improved output in services branches. In addition, digitalisation is set to increase demand for information services in the long term. According to the expectations of businesses themselves, growth prospects are strongest in information and communications as well as in financial services. These branches have a much larger number of companies that expect to see an increase in sales than other service branches. On the other hand, the lack of skilled labour in real estate and cleaning services is a more common obstacle to sales growth than inadequate demand. Furthermore, growth prospects in retail trade are depressed by the sluggish development of purchasing power. Business services will see accelerating growth as demand picks up with rebounding economic activity, but in 2015, as a result on declining secondary production, service production as a whole will post growth of no more than around 1%. In 2016 and 2017 service production growth will exceed 1½%, the average growth rate in the 2000s. Unlike other main sectors of the economy, service production will exceed the pre-crisis level in 2017.

Table 9. Production by industry

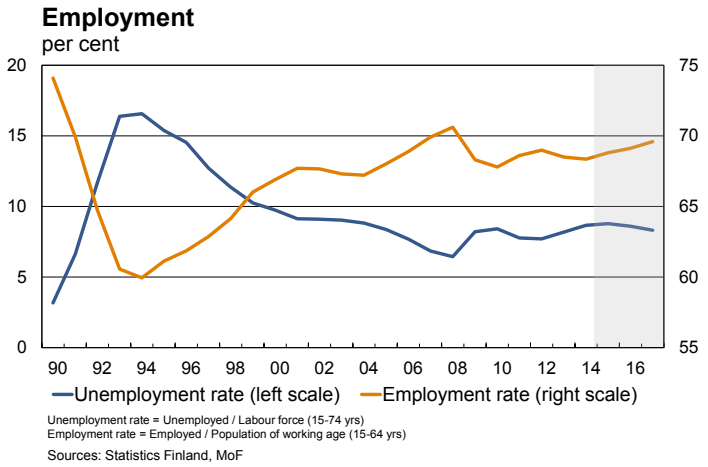
	2014* share, %[1)]	2012	2013*	2014*	2015**	2016**	2017**	Average 2014/ 2004
		change in volume, %						
Industry	19.8	-8.5	-1.5	-1.3	0.3	2.0	2.6	-0.9
Manufacturing	16.2	-11.5	-1.5	-0.8	0.5	2.2	2.9	-1.2
Construction	6.2	-5.3	-2.6	-3.6	-1.6	1.5	2.3	-0.1
Agriculture and forestry	2.8	-2.5	5.2	1.4	-0.2	1.0	2.1	2.8
Industry and construction	26.0	-7.8	-1.8	-1.9	-0.1	1.9	2.5	-0.7
Services	71.2	0.6	-1.6	0.7	0.9	1.5	1.7	0.9
Total production at basic prices	100.0	-1.9	-1.5	0.0	0.5	1.6	1.9	0.5
GDP at market prices		-1.4	-1.3	-0.1	0.5	1.4	1.5	0.6
Labour productivity in the whole economy		-2.1	0.4	0.2	0.3	1.2	1.5	0.4

[1)] Share of total value added at current prices.

1.5 Labour force

Unemployment rate to remain high in 2015

Employment trends were poor in the last two quarters of 2014. The number of unemployed persons in particular increased more than expected. Unemployment increased in the latter half of 2014 according to both the Labour Force Survey (Statistics Finland) and employment service statistics (Ministry of Employment and the Economy). It is expected that unemployment will remain high in 2015. The number of unemployed persons may still rise, but it is predicted that it will begin slowly to come down in the latter half of the year. The projected unemployment rate for 2015 is 8.8%. The number of employed persons, on the other hand, stopped falling in the last quarter of 2014, even though the annual number of employed persons continued to decline. In January 2015 the number of employed persons was 0.6% higher than at the same time one year earlier. However this increase was primarily attributable to improved employment in the age group over 65. In 2015 it is forecast that the number of employed persons will be 0.3% higher than in 2014.



Persistent cyclical weakness has led to increasing unemployment. Furthermore the ongoing international crises have shown no signs of abating, which has also had an adverse effect on the employment situation in Finland. On the other hand the weakening of the external value of the euro and falling oil prices have had the opposite effect. Nonetheless employment will continue to show only moderate improvement. In 2016 it is forecast that the number of employed persons will be 0.3% higher than this year. The unemployment rate is projected to edge down to 8.6% in 2016.

Cyclical weakness or structural problems?

Apart from the cyclical weakness, another obstacle to an improvement in the employment situation is presented by regional and occupational mismatch problems between unemployed job seekers and job vacancies. In the past ten years alone, the number of employed persons in industry has fallen by more than 80,000. This has adversely affected the employment situation most particularly in regions where industry has been a major employer. At the same time employment in service sectors has been edging slightly upwards. The unemployment rate among the higher educated has usually been much lower than in the population with a lower level of education. Recently, however, unemployment has also increased in higher educated groups.

Regional differences in unemployment have hardly increased at all despite the sharp rise in unemployment. This is mainly explained by the fact that in high unemployment regions jobless rates have fallen from the peak figures recorded in the early 2000s. At the same time, unemployment has recently been increasing in many low unemployment regions. In Uusimaa, for instance, unemployment has increased faster than average. A distinctive trend here has been the growth of unemployment among young people and those with a higher education. Even so the unemployment rate in Uusimaa is still well below the national average.

Opinions differ on the relative contributions of structural and cyclical factors to the recent upward trend in unemployment. Some commentators believe that the Finnish economy's difficulties in recent years stem largely from structural problems and that there is no reason to expect that they will disappear of their own accord. In other words, a pick-up in the international economy would not do away with the problems of the economy or unemployment in Finland. According to a report by the Economic Policy Council, the growth of unemployment has been largely cyclical in nature. However it seems reasonable to suggest that both cyclical factors and structural problems have contributed to the increase in unemployment (see also the box below on structural and long-term unemployment).

Table 10. Labour market

	2012	2013	2014	2015**	2016**	2017**
	annual average, 1,000 persons					
Population of working age (15-74 yrs)	4 075	4 087	4 096	4 109	4 108	4 123
change	16	12	9	14	-1	15
Population of working age (15-64 yrs)	3 524	3 508	3 491	3 478	3 468	3 456
change	-15	-16	-17	-13	-10	-12
Employed (15-74 yrs)	2 483	2 457	2 447	2 454	2 461	2 472
of which 15-64 yrs	2 431	2 403	2 386	2 393	2 397	2 405
Unemployed (15-74 yrs)	207	219	232	236	232	225
	%					
Employment rate (15-64 yrs)	69.0	68.5	68.3	68.8	69.1	69.6
Unemployment rate (15-74 yrs)	7.7	8.2	8.7	8.8	8.6	8.3
	1,000 persons per annum					
Immigration, net	17.4	18.0	18.6	17.4	17.4	17.3

Unemployment spells are lasting longer

The duration of unemployment spells increased in 2014. In January 2015, employment service statistics compiled by the Ministry of Employment and the Economy put the number of long-term unemployed people who had been out of work for more than 12 months at 102,000, up from 86,000 in January 2014. Even in favourable cyclical conditions it is harder for the long-term unemployed to find work in the open labour market than it is for those who have been unemployed for shorter periods. Furthermore, prolonged unemployment can lead to marginalisation from the labour market. It is paramount, therefore, that steps are taken to intervene in unemployment spells at as early a stage as possible and to increase incentives for unemployed people to actively search for work. The longer the duration of unemployment spells, the greater the significance of an active labour market policy. However, the termination of an unemployment spell by labour policy measures cannot, in itself, be considered a successful intervention if upon completion of these measures the individual returns to unemployment or recurring periods of labour policy measures.

The number of unemployed young people aged 15–24 increased and the duration of unemployment spells increased during 2014. However by European comparison the employment situation among young people is not yet particularly difficult. Under the youth guarantee scheme an active option is offered to all young people under 25 and all newly graduated youths under 30 within three months of the onset of unemployment. This option should preferably be employment in the open labour market or enrolment in the education system. Young people are more mobile than other groups in the labour force, both occupationally and geographically. Young people are keener than other age groups to start training and to move for job opportunities. The proportion of young people not in employment, education or training (the NEET rate) in Finland is lower than the EU average. Nevertheless it is important that special attention is given to young people's employment situation as research has shown that experiences of unemployment in the early stages of employment will have adverse effects at later career stages.

Population of working age decreasing

The number of people of working age (15–64 years) began to fall in 2010, and it is projected that this trend will continue for the next 10 years. Figures for both the employment rate and labour participation rate convey the worrying message that employment has in recent years fallen most particularly among people in their prime working age, i.e. 25–54. In the oldest age groups both these rates have risen, which is good news because in the future these age groups will account for a growing proportion of the labour force. Efforts to raise the employment rate among people in their prime working age should concentrate on preventing retirement on disability pension and enhancing well-being in the workplace. In the case of the youngest age groups it might also be useful to explore ways of shortening study times.

Changes to register practices

It is noteworthy, however, that part of the recent increase in the number of unemployed job seekers and the longer duration of unemployment spells may be explained by various

changes to register practices. For instance, before February 2014 the status of unemployed job seeker was automatically revoked if the individual had not re-registered by a specified date. This meant that the unemployed job seeker would be removed from the Ministry of Employment and the Economy statistics. On the other hand, those who had forgotten to renew their status and then re-registered, would also start a new unemployment spell. As the automatic revoke procedure is no longer applied, the new practice may be reflected in statistics on the level of unemployment and in the duration of unemployment spells. However as yet no assessment has been made of the size of this effect.

Figures for unemployed job seekers registered with employment offices and Statistics Finland's sample-based Labour Force Survey give a slightly different picture of the level and development of unemployment. Figures for unemployed job seekers compiled by the Ministry of Employment and the Economy are usually somewhat higher than the unemployment rate reported by Statistics Finland, which is based on the criterion of active search for work. On the other hand, Statistics Finland figures for youth unemployment tend to be higher than the Ministry's figures: people under 25 more often look for work without registering with the employment office. In older age groups, by contrast, Ministry figures are almost always higher. The gap between the two sets of unemployment statistics has increased in recent years. Apart from changes in statistical methods and legislation, another factor explaining the growing discrepancy between the two sets of figures is that some unemployed people have given up their active search for work because of the weak economic situation.

Structural and long-term unemployment

Structural unemployment can be measured in different ways. It can be defined from the vantage point of the unemployed. Who are structurally unemployed? On the other hand, from an economics perspective we can ask what is the level of unemployment when the economy is in balance?

In economics, structural unemployment refers to the level of unemployment that would prevail when the economy is in balance. In the short term there is a negative correlation between unemployment and the rate of inflation, but in the longer term unemployment is at its equilibrium level and is independent of inflation. The level of equilibrium unemployment is affected above all by labour market institutions and wage formation (level of unemployment security, tax wedge, unionization rate, labour policy). Equilibrium unemployment is assessed using statistical time series methods and it is often described as the non-accelerating inflation rate of unemployment (NAIRU)[1].

[1] This concept is used among others by the OECD. The European Commission, however, uses the related concept of NAWRU (non-accelerating wage inflation rate of unemployment).

The employment service statistics compiled by the Ministry of Employment and the Economy define the following as structurally unemployed [2]:

- Long-term unemployed
  - People who have been registered as unemployed job seekers for at least 12 consecutive months
- Repeatedly unemployed
  - People who have been registered as unemployed job seekers for at least 12 months in the last 16 months
- Those made unemployed after a labour market measure
  - People who are made unemployed after a labour market policy measure include those who within the past 12 months have taken part in a labour market policy measure, labour market support traineeship or coaching for working life, labour market training, training trials, job alternation as a substitute, self-motivated education, or rehabilitative work; whose placement has terminated three months before the day of count; and who are unemployed job seekers on the day of count that month.
- Those repeatedly circulating between labour market measures
  - People who repeatedly circulate between labour market policy measures include those who take part in labour market policy measures, labour market support train eeship or coaching for working life, labour market training, training trials, job alter nation as a substitute, self-motivated education, or rehabilitative work on the day of the count; who within the last 16 months have taken part in any of the above-mentioned measures that have nonetheless terminated three months before the commencement of the measure on the day of count; and who have been regis tered as unemployed job seekers for at least a total of 12 months or taken part in the above-mentioned measures within the last 16 months.

Based on these definitions, the number of structurally unemployed persons in January 2015 stood at 201,055, up by around 27,220 persons (15.7%) from the year before. In 2014 the average monthly number of structurally unemployed persons was 186,000.

Development of long-term unemployment by age group

In the early 2000s the number of long-term unemployed (according to the Ministry definition, i.e. people who had been out of work for more than 12 consecutive months) was long on a downward trend. In the past few years the duration of unemployment spells and the numbers of long-term unemployed have started clearly to rise again in the weak cyclical environment. At the same time it has become increasingly difficult for a large part of the unemployed to find work in the open labour market.

The Economic Policy Council has pointed out that the unemployment figures compiled by the Ministry of Employment and the Economy are not comparable over time. These figures should additionally include unemployment pension recipients. On this basis, according to the Economic Policy Council, long-term unemployment as a proportion of total unemployment has in fact decreased during the recession.

Unemployment pension recipients are perhaps best compared to older long-term unemployed people who have been out of work for more than one year. If unemployment pension recipients are included among the unemployed, the number of older long-term unemployed persons was clearly higher, especially in the early 2000s. The unemployment pension was dis-

[2] These definitions are based on the National Institute for Health and Welfare welfare compass, see: http://hyvinvointikompassi.thl.fi/web/hyvinvointikompassi/indikaattori/-/indicator/r/658/c/658/g/total/i/3071

continued in connection with the 2005 pension reform, and the number of unemployment pension recipients has fallen sharply since 2010. The very last unemployment pensions were awarded in 2011 to people born in 1949. The unemployment pension was replaced by additional days of unemployment security. People eligible for additional days of unemployment security are in turn defined as unemployed job seekers, in contrast to people formerly receiving an unemployment pension. When making such comparisons, however, it is important to bear in mind that according to both statistical legislation and the Ministry of Employment and the Economy, unemployment pension recipients should not be compared to the unemployed.

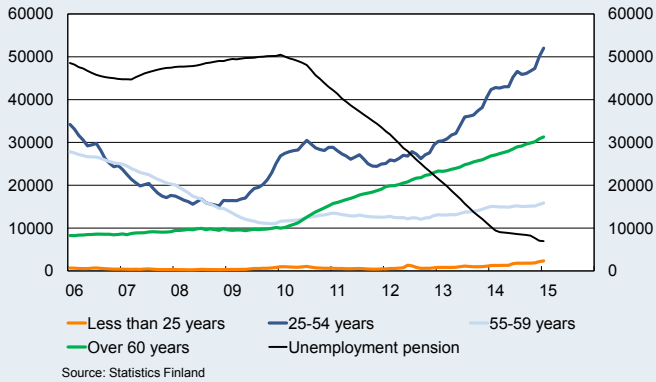
The Figure below shows the numbers of long-term unemployed job seekers and unemployment pension recipients for 2006–2014 in different age groups. After the financial crisis since 2009, the number of long-term unemployed has started rising in all age groups. Indeed the discontinuation of the unemployment pension is reflected in the growing number of long-term unemployed people in the age group over 60. Long-term unemployment in the age group 55–59, by contrast, has increased only marginally since the financial crisis. On the other hand long-term unemployment has increased sharply among people in their prime working age and among younger people.

Number of long-term unemployed over 60 years had increased to over 30,000 at the end of 2014, while it has been less than 10,000 at the lowest. The number of long-term unemployed in the primary working age of25-54 years was about 15,000 at the lowest. In the end of 2014 the number of 25-54 years old has increased to over 50,000. Young long-term unemployed under25 years of age counted only couple of hundreds at the lowest, but at the end of 2014 they were more 2,000 of them. In relative terms, the most substantial increase in the long-term unemployment has been among the young people.

The sum of long-term unemployed and unemployment pension recipients was higher (108,000) in January 2015 than in the turn of 2008-2009, when they accounted to 90,000 at the lowest. On the other hand in the early 2000s the sum of all long-term unemployed and unemployment pension recipients was clearly higher. In 2006 the sum of long-term unemployed and unemployment pension recipients was more than 120,000, when the sum was only 102,000 in the beginning of 2015. Unemployment pension recipients did not have a significant contribution to the development of long-term unemployment of the elderly.

Whether the increase of long-term unemployment is cyclical or structural problem is difficult to answer. Both factors have their contribution. Even though unemployment would be cyclical to begin with, there is a risk that it will become structural. On the other hand when business cycle improves the duration of unemployment spells tends to become shorter. One must also pay attention that changes in the population age structure complicates the comparison between the end of 1990's and the beginning of 2000. Also this setup does not take into account discouraged workers.

Long-term unemployed (unemployed for over a year) by age groups and persons on unemployment pension



Source: Statistics Finland

1.6 Incomes, costs and prices

1.6.1 National income

Nominal net national income growth increased by 0.7% last year, compared with 0.8% in 2013. In the past three years the favourable trends in nominal net national income have been driven by increasing employee compensations. Property income and entrepreneurial income, on the other hand, declined in 2012 and 2013, but rebounded to growth in 2014.

Among the components of national income, employee compensations increased by 0.4% from the previous year. Wage bill growth was 0.6%, and social security contributions paid for the benefit of employees remained unchanged from 2013. Wage bill growth was clearly slowed by the deteriorating employment situation. Nonetheless in the last quarter of 2014 wage bill growth in the economy reached an average of 1.3% compared with the year before. In the private sector the wage bill increased in the last quarter by 1.7% and in the public sector by 0.5%.

Employee compensations as a proportion of national income remained unchanged since 2013 at 62%. The proportion of employee compensations has increased clearly from the figure of around 56–57% in the early 2000s. The last time this figure was as high as this was during the 1990s recession, when it peaked at 74% in 1991. The reason why this percentage increased in 2012 and remained at the same level in 2013 lies in the relatively sharp rise in employee compensations and on the other hand in the lowered level of property and entrepreneurial income.

In 2014 operating surplus figures, which describe levels of business profitability, started rising as companies looked to improve their profitability by cutting expenses. When property income to and from other countries is taken into account, property and entrepreneurial income increased in total by 1.4% in 2014. The amount of property income paid from foreign countries into Finland hardly increased at all last year, whereas property income paid out of Finland increased by some 5%. In net terms, property income payments into and out of Finland were still rather close to balance. Taxes on production and imports net of subsidies increased by 0.4%, reflecting last year's increase in indirect taxes.

Table 11. Disposable income

	2014 share, %	2012	2013	2014	2015**	2016**	2017**	On average 2014/2004
		change, %						
Compensation of employees	61.5	3.6	0.6	0.4	1.7	1.8	1.9	3.2
Wages and salaries	49.9	3.5	0.5	0.6	1.5	1.6	1.9	3.3
Employers' contributions to social security schemes	11.6	4.1	1.0	0.0	2.3	2.4	2.0	2.6
Property and entrepreneurial income, net	22.4	-7.6	-1.2	1.4	1.3	4.8	5.7	-1.2
Taxes on production and imports minus subsidies	16.1	3.8	4.5	0.4	1.6	2.0	1.7	3.5
National income	100.0	0.9	0.8	0.7	1.6	2.5	2.7	2.1
Disposable income		1.0	0.3	0.6	3.3	2.5	2.7	2.1
Gross national income, EUR bn		200.8	202.6	204.0	206.6	212.6	219.2	

Table 12. Index of wage and salary earnings and labour costs per unit of output

	2012	2013	2014	2015**	2016**	2017**	On average 2014/2004
	change, %						
Index of negotiated wage rates	2.9	1.4	0.8	0.6	0.6	0.8	2.3
Wage drift, etc.	0.3	0.7	0.6	0.6	0.7	0.8	0.8
Index of wage and salary earnings	**3.2**	**2.1**	**1.4**	**1.2**	**1.3**	**1.5**	**3.1**
Real earnings[1)]	0.4	0.6	0.4	0.9	-0.1	-0.2	1.3
Average earnings[2)]	3.3	2.0	1.3	1.2	1.2	1.5	3.1
Labour costs per unit of output[3)]							
whole economy	5.6	2.1	0.4	1.1	0.1	0.0	2.7

[1)] The index of wage and salary earnings divided by the consumer price index.

[2)] Computed by dividing the national wage bill by the number of hours worked by wage and salary earners. The figures are affected by structural changes in the economy.

[3)] Compensation of employees divided by gross value added in volume at basic prices.

It is forecast that the operating surplus of businesses based in Finland will increase both in the current year and in 2016 and 2017, which will accelerate national income growth. The acceleration of operating surplus growth is supported by the pick-up of economic activity, which will push businesses to try and improve their profitability and increase their profits. On the other hand taxes on production and imports net of subsidies will continue to rise over the outlook period with increasing indirect taxes.

During the current year it is predicted that wage bill growth will pick up slightly from the previous year, despite a slowdown in earnings growth, because employment is not weakening at the same rate as in 2014. It is thought that social security contributions will rise more sharply than the wage bill because employer contributions were increased at the beginning of 2015 and agreed increases to earnings-related pension contributions will also tighten tax bases in 2016 and 2017.

Wage bill growth will accelerate slightly in 2016 and 2017 with the improving economy and strengthening employment, but still remain clearly slower than the average rate for the 2000s. It is predicted that the share of employee compensations will fall only marginally towards the end of the outlook period, so there will be no major changes in the functional distribution of income over the next few years.

1.6.2 Wages and salaries

Nominal earnings, as measured by the index of wage and salary earnings, increased by 1.4% last year. Contractual wages were up by 0.8%, other factors pushed up the wage index by 0.6%. The contribution of other factors was more or less unchanged, as in 2011–2013 they accounted for an average 0.6%. In 2015 earnings will develop in line with the new wage settlement negotiated in 2013 by the social partners. Under the Pact for Employment and Growth, collective wages will rise by 0.4% in 2015; this rise will take effect at different

times of the year in different branches. For this reason collective wages will rise this year by an average of around 0.6%. The forecast for the development of earnings works from the assumption that the contribution of factors other than collective wage increases will drive up earnings by around 0.6%. Therefore it is predicted that nominal earnings will rise by 1.2% in 2015 as measured by the index of wage and salary earnings.

The labour market confederations will meet by 15 June 2015 to negotiate on the third and last wage increase under the Pact for Employment and Growth and on its timing in 2016. If no agreement is reached on the second phase increases, individual branches can opt to cancel their agreements after the first phase.

The forecast's background assumptions regarding collective wage increases in 2016 and 2017 are that wages will rise on average by 0.6% in 2016 and by 0.8% in 2017. In these two years it is assumed that the contribution of factors other than collective wage increases will drive up earnings by over half a per cent. Therefore it is predicted that nominal earnings will rise by 1.3% in 2016 and by 1.5% in 2017 as measured by the index of wage and salary earnings. This is well below the average rate for the 2000s. This reflects the broader assessment of slow economic growth, low inflation, the resources available in the economy, and sluggish employment trends during the outlook period.

1.6.3 Consumer prices

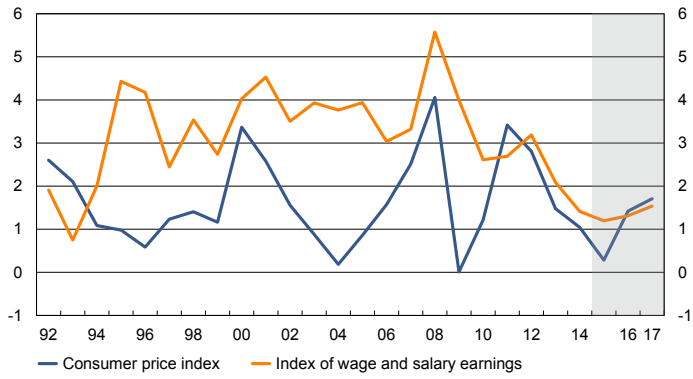
In 2014 consumer prices increased on average by 1%. Prices increased more slowly than in earlier years. As in previous years, inflation was mostly driven by rising service prices, which were up by almost 3%. In 2014 several indirect taxes were raised, which increased the overall price level by almost half a percentage point. On the other hand prices of energy, goods and fresh foods declined. The harmonised consumer price index, which in contrast to the national index does not include owner-occupied housing or interests, increased by 1.2%.

Inflation began to slow towards the end of last year following the sharp drop in world market prices of oil. Oil prices have continued to fall in early 2015, and therefore consumer prices decreased by 0.2% in January from the year before. This is the first time that consumer prices have fallen in Finland since January 2010, in the wake of the international financial crisis.

In 2015 it is expected that consumer prices will remain more or less unchanged from last year. The inflation rate is expected to average 0.3%. There are several reasons for the slower than usual increase in consumer prices, but the single biggest reason is the low price of oil. Even though the euro has at the same time weakened against the dollar, the euro-denominated crude oil barrel price has dropped to below 40 euros in early 2015. The forecast assumes that the average price of oil in 2015 will be 54 euros a barrel, which will significantly reduce consumer prices of domestic energy.

Lower energy prices are not the only factor curbing inflation. Early in the year prices of selected foodstuffs have been reduced in response to stiffening competition in the retail trade of daily consumer goods. For the time being it is unclear to what extent these price reductions will be reflected in the consumer price index. However the assumption is that

Consumer price index and index of wage and salary earnings
change from previous year, %



Sources: Statistics Finland, MoF

there will be less upward pressure than usual on food prices. Furthermore, it is predicted that because of moderate wage growth, service prices will rise more slowly than earlier. In recent years service prices have been rising at around 3%, much more rapidly than in the euro area on average (1½%).

In 2015 tax hikes will cause the price level to increase. As in 2014, several indirect taxes (including the tobacco tax, electricity tax and annual vehicle tax[1]) were raised at the beginning of the year. In 2015 it is predicted that indirect tax hikes will increase the national consumer price index by 0.3–0.4 percentage points. Without the effects of tax hikes, consumer prices would fall this year. In 2016 it is expected that inflation will pick up to over 1%, and in the last year of the outlook period in 2017, the national consumer price index will rise by 1.7%. The harmonised consumer price index will rise somewhat more slowly towards the end of the outlook period as the slight increase in interest rates is not directly reflected in the index. Core inflation will rise at most by 1%. There is less inflationary pressure than usual because there are idle resources in the economy and the output gap is still clearly negative. Future inflation expectations are also moderate. The forecast is based on assumptions of slight increases in oil prices, moderate wage increases and low, albeit slowly rising interest rates.

Since the onset of the international financial crisis prices in Finland have risen much more sharply than in the euro area. Measured by the harmonised consumer price index, prices in Finland have risen by 14% since year-end 2008, compared with an increase of 9% in the euro area. The ECB forecast is that the euro area inflation in 2015 will be 0%, in 2016 1.5% and in 2017 1.8%. Therefore the price gap between Finland and the euro area would no longer grow.

1 The annual vehicle tax increases from the beginning of 2016, but for tax technical reasons, the effect will be equally divided between 2015 and 2016.

Table 13. Price indices

	2012	2013	2014	2015**	2016**	2017**	On average 2014/2004
	change, %						
Export prices[1)]	1.1	-0.8	-1.7	-0.3	1.2	1.4	0.4
Import prices[1)]	2.1	-1.3	-1.8	-1.2	1.1	1.3	1.7
Consumer price index	2.8	1.5	1.0	0.3	1.4	1.7	1.7
Harmonized index of consumer prices	3.2	2.2	1.2	0.3	1.3	1.4	1.9
Basic price index for domestic supply	3.1	0.2	-1.3	-2.6	2.1	2.0	2.5
Building cost index	2.4	1.0	1.0	0.8	1.5	1.9	2.5

[1)] As calculated in the National Accounts.

2 Economic policy and public finances

2.1 General government finances

Public finances remain in deficit because of the persistent cyclical weakness, although adjustment measures to increase revenue and reduce expenditure have helped to curb the growth of the deficit. Economic growth will be sluggish over the next few years, and will not be enough to correct the imbalance in public finances. Even when the downturn subsides, the general government budgetary position will be burdened by population ageing, which will continue to drive up public expenditure, affecting local government finances and the pension system in particular.

In 2014 the general government budgetary balance was –3.2% of GDP. The balance will improve very slowly over the outlook period, and general government debt to GDP will rise to its highest level in decades.

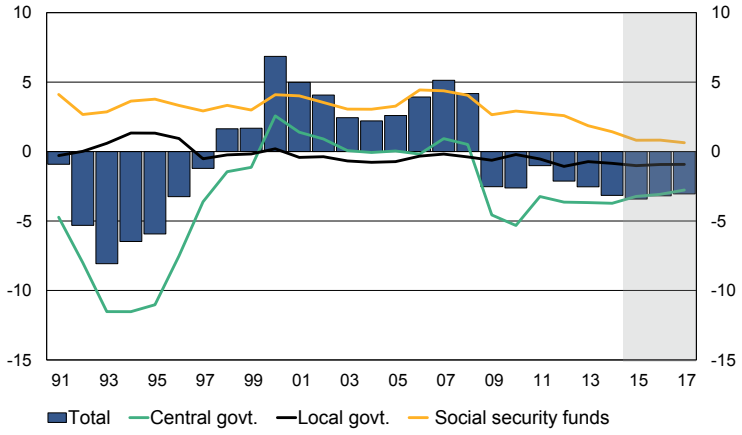
General government in Finland consists of central government, local government, and social security funds. The latter are further divided between earnings-related pension funds that manage statutory earnings-related pension insurance and other social security funds.

Central government and local government are firmly in deficit, and other social security funds also show a slight deficit. The earnings-related pension sector is in surplus. The budgetary position of all subsectors of the economy deteriorated in 2014. The combined deficit of central and local government amounted over EUR 9 billion. The sector that is most vulnerable to cyclical fluctuations is central government, mainly because of the high cyclical sensitivity of tax revenue. Subdued tax revenue growth had the effect of depressing local government finances as well. The central government deficit will slowly improve during the outlook period, whereas the deficit in the local government sector will remain more or less unchanged. Reduced property income and pension expenditure are acting to narrow the surplus shown by authorised pension providers. Unemployment-related expenditure is also weighing down on the position of other social security funds.

Public expenditure is continuing to rise despite adjustment. The expenditure rate or public expenditure to GDP has climbed to a very high level above all because of slow GDP growth, but the expenditure rate is also driven by unemployment-related expenditure and population ageing. Tax revenue, on the other hand, has followed the changes in total output and dropped to a lower level. The tax rate, i.e. the ratio of taxes to output, has been driven up by tax hikes. It is expected that the tax rate will remain fairly stable over the outlook period.

Under the EU Treaty it is required that the budgetary deficit must not exceed 3% of GDP and the general government debt to GDP ratio must not be higher than 60%. In 2014 Finland's deficit exceeded the 3% threshold and will remain over 3% in 2015. Furthermore, Finland shall be above the 60% government debt to GDP threshold from the current year onwards. In 2015 this excess over the reference value can still be explained by the country's contribu-

The financial balance of general government subsectors
% of GDP

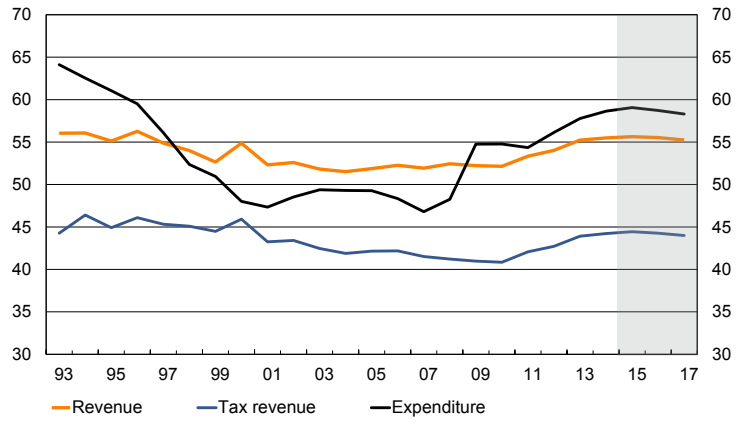


Sources: Statistics Finland, MoF

tions to solidarity operations and the cyclical situation. The Commission makes its assessment of whether the criteria have been fulfilled and assesses the need to open an Excessive Deficit Procedure (EDP) based not only on outcome figures, but also on forecasts. It is possible that an EDP will be opened this year on the basis of the deficit and/or the debt criterion.

The 2013 Stability Programme set a Medium-Term Objective (MTO) for public finances in Finland. The MTO was set at a structural budgetary position of –0.5% of GDP. There is a significant deviation in the structural balance position of the general government jeopardising the achievement of the MTO. Significant deviations from the MTO or the adjustment path to the MTO are however only examined, when Member States are in the preventive arm of the Stability and Growth Pact, i.e. if the deficit and debt criteria are breached and an EDP is opened, a significant deviation cannot trigger a procedure.

General government revenue, tax revenue and expenditure
% of GDP



Sources: Statistics Finland, MoF

EU Stability and Growth Pact procedures

The EU Stability and Growth Pact consists of a corrective and preventive arm. The corrective arm is based on Article 126 of the EU Treaty, which says that Member States shall avoid excessive general government deficits. Breaching the deficit (3% of GDP) or debt (60% of GDP) limits will trigger the Excessive Deficit Procedure (EDP).

The preventive arm of the Pact is part of the multilateral surveillance mechanism specified under Article 121 of the EU Treaty. Its purpose is to prevent the occurrence of excessive deficits and to ensure that public finances in Member States are on a sound and sustainable basis. A procedure leading to sanctions was added to the preventive arm in connection with the post-crisis reforms. This was subsequently labelled by the Commission as the Significant Deviation Procedure (SDP).

Excessive Deficit Procedure (EDP)

In the corrective arm of the Stability and Growth Part, the European Commission assesses the existence of an excessive deficit on the following criteria:

- whether the general government deficit ratio exceeds the 3% reference value, unless
  - the deficit has declined substantially and continuously and reached a level that comes close to the reference value; or
  - the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;
- whether the debt ratio exceeds the reference value, unless the debt ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.[1]

If the Commission is of the opinion that the criteria have been breached on the basis of actual, planned or projected figures, it will prepare an excessive deficit report that analyses compliance with the criteria and the need to open an excessive deficit procedure. This report will take into account all other relevant factors. [2]

If the Commission considers that the criterion or criteria have been breached, it will address an opinion to the Member State concerned and recommend to the Council that a decision is made on the existence of an excessive deficit. At the same time the Council shall address recommendations to the Member State on how to correct the excessive deficit. These recommendations will specify a path to a nominal deficit position, the required annual improvement in the structural balance (usually 0.5% of GDP) and a deadline for the correction of the excessive deficit. The first review of the corrective steps taken by the Member State (so-called effective action) usually takes place after five (and in some cases three) months. If it is the Council's assessment that the Member State has taken effective action but the economy is still not recovering as expected, the Member State may be granted an extension to correct the excessive deficit. If the Council's opinion is that the Member State has not taken effective action, the procedure can be extended to include sanctions, which in the case of EDP may be in the form of a fine. Sanctions have never been imposed.

[1] The Commission assesses the need for an excessive deficit report on a breach of the debt criterion on three conditions: backward-looking debt reduction benchmark, forward-looking debt reduction benchmark, and debt level corrected for business cycle effects. The Commission will decide to prepare an excessive deficit report only in the event that all three criteria are breached. Furthermore, the debt reduction rule provides for a three-year transition period for countries that at the time of introducing the six pack regulations had a current excessive deficit decision in place. During the transition period governments are required to follow the principles of minimum linear structural adjustment (MLSA) to ensure that the country is in compliance with the debt rule by the end of the transition period. If the country fails to follow this rule during the transition period, the Commission will prepare an excessive deficit report.

[2] No detailed list is presented of other relevant factors, but Member States may themselves draw attention to factors that they consider significant. In cases where the deficit criterion is breached, other relevant factors will be taken into account if the debt ratio is under 60%, and when the debt ratio exceeds 60% provided that the breach of the deficit criterion is marginal and temporary. Other relevant factors are always taken into account when assessing compliance with the debt criterion.

Significant Deviation Procedure

The preventive arm of the EU Stability and Growth Pact has gained increasing significance in recent years as more and more Member States have managed to get below the 3% deficit threshold and moved out of the excessive deficit procedure and into the preventive arm. In the preventive arm surveillance focuses on possible deviations from the medium-term objective (MTO) or adjustment paths to MTO. This is assessed by monitoring the general government structural balance and expenditure growth.

A binding requirement to set a medium-term budgetary objective is also included in the Fiscal Compact signed among the governments of the Member States, and consequently incorporated in national legislation. Under the Fiscal Compact, the lower limit of the country-specific MTO for euro countries was set at a structural deficit of 0.5% of GDP. Exempted from this requirement are countries where the public debt to GDP ratio is less than 60% and where there are no long-term sustainability risks (in these cases the lower limit is –1% of GDP).

A country that fails to achieve its medium-term budgetary objective will be expected to converge towards the MTO at an annual pace of at least 0.5% of GDP. Stronger consolidation efforts are required in good times, whereas the efforts may be more limited in economic bad times. In its communication of 13 January 2015 on flexibility within the existing rules of the Stability and Growth Pact, the Commission has specified the exact meaning of "good times" and "bad times". [3] A Member State is considered to have achieved its MTO if the structural balance deviates from the objective by less than 0.25% of GDP. Once the MTO is achieved, the Member State is expected to remain at the MTO.

Adherence to the MTO is also considered on the basis of the expenditure benchmark. The purpose of the expenditure benchamark is to ensure that Member States meet their MTO or remain on the adjustment path towards the MTO. The expenditure benchmark dictates that expenditure growth in countries that have achieved their MTO must not exceed their medium-term potential GDP growth. In countries that have not achieved their MTO, expenditure growth shall be slower than this unless it is offset by discretionary measures on the revenue side.

Compliance with the requirements of the preventive arm of the Stability and Growth Pact is assessed ex post, in-year and ex ante. A Significant Deviation Procedure is launched if there is evidence of a significant - at least 0.5% of GDP - ex post deviation from the adjustment path to the medium-term objective. This assessment will be based on both the structural budgetary position and the expenditure benchmark. If a Member State deviates significantly from only one of these two criteria, the Commission will make a comprehensive assessment of compliance with the requirements of the preventive arm. The first step of the procedure involves the Commission addressing a warning to the Member State, followed by the Council's approval of recommended corrective actions. Regulations have been enacted to develop the procedure further so that it can eventually lead to sanctions. The sanction would take the form of an obligation to lodge an interest-bearing deposit, although that would be converted into a non-interest-bearing deposit if the decision is reached that an excessive deficit exists in the Member State. As yet no significant deviation procedures have been opened.

In addition to cyclical conditions, the Commission's communication on flexibility within the existing rules of the Stability and Growth Pact specified two further flexibility elements that under the preventive arm justify a temporary deviation from the MTO or from the adjustment path towards the MTO. Under the "investment clause" and "structural reform clause", Member States are allowed to deviate from their MTO in order to accommodate public investment or major structural reforms that have long-term budgetary effects, for instance by raising potential sustainable growth, and that therefore have a verifiable impact on the long-term sustainability of public finances.

[3] http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/2015-01-13_communication_sgp_flexibility_guidelines_en.pdf

Table 14. General government finances [1)]

	2012	2013*	2014*	2015**	2016**	2017**
	EUR billion					
Current taxes	31.2	32.9	33.8	34.3	35.5	36.6
Taxes on production and imports	28.1	29.2	29.6	29.8	30.3	30.7
Social security contributions	25.5	25.9	26.3	27.1	27.7	28.5
Taxes and contributions, total [2)]	85.4	88.7	90.2	91.8	94.1	96.4
Other revenue [3)]	23.1	23.6	23.5	23.7	24.6	25.3
of which interest receipts	2.5	2.5	2.2	1.9	1.8	2.0
Total revenue	**107.9**	**111.6**	**113.2**	**114.9**	**118.0**	**121.1**
Consumption expenditure	48.7	50.2	50.9	51.8	52.9	54.1
Subsidies	2.7	2.7	2.8	2.7	2.6	2.6
Social security benefits and allowances	36.1	38.4	40.2	41.6	42.8	44.3
Other current transfers	5.6	6.0	6.0	5.8	6.1	5.9
Subsidies and current transfers, total	44.4	47.1	49.0	50.1	51.5	52.8
Capital expenditure [4)]	8.6	8.9	9.1	9.4	9.6	9.8
Other expenditure	10.6	10.5	10.6	10.7	10.8	11.1
of which interest expenses	2.8	2.6	2.6	2.5	2.4	2.4
Total expenditure	**112.2**	**116.7**	**119.6**	**122.0**	**124.8**	**127.7**
Net lending (+) / net borrowing (-)	**-4.2**	**-5.1**	**-6.4**	**-7.1**	**-6.8**	**-6.7**
Central government	-7.3	-7.4	-7.6	-6.7	-6.5	-6.1
Local government	-2.1	-1.5	-1.7	-2.1	-2.0	-2.0
Employment pension schemes	4.8	3.7	3.5	2.5	2.7	2.3
Other social security funds	0.4	0.0	-0.6	-0.8	-1.0	-1.0
Primary balance [5)]	-3.8	-4.9	-6.0	-6.3	-6.1	-6.2

[1)] As calculated in the national accounts, ESA95.

[2)] Incl. capital taxes.

[3)] Incl. capital transfers and consumption of fixed capital.

[4)] Gross fixed capital formation and capital transfers.

[5)] Net lending before net interest expenses.

Table 15. Main economic indicators in general government

	2012	2013*	2014*	2015**	2016**	2017**
	% of GDP					
Taxes and social security contributions	42.7	43.9	44.2	44.4	44.3	44.0
General government expenditure [1]	56.1	57.8	58.6	59.1	58.7	58.3
Net lending	**-2.1**	**-2.5**	**-3.2**	**-3.4**	**-3.2**	**-3.1**
Central government	-3.6	-3.7	-3.7	-3.2	-3.1	-2.8
Local government	-1.1	-0.7	-0.9	-1.0	-0.9	-0.9
Employment pension institutions	2.4	1.8	1.7	1.2	1.3	1.1
Other social security funds	0.2	0.0	-0.3	-0.4	-0.5	-0.4
Primary balance [2]	-1.9	-2.4	-2.9	-3.0	-2.9	-2.8
General government debt [3]	**52.9**	**55.8**	**59.3**	**62.5**	**64.4**	**66.0**
Central government debt	42.0	44.4	46.6	48.7	50.2	51.6
General government employment. 1000 person	630	633	629	627	625	622
Central government	139	142	140	138	136	135
Local government	480	480	479	478	478	477
Social security funds	11	11	11	11	11	11

[1] EU-harmonized definition.

[2] Net lending before net interest expenses.

[3] Public debt is estimate by the Ministry of Finance also for years 2011, 2012 and 2013 due to the statistics revision. See box on page 70.

Table 16. Fiscal balance and debt ratios in some EU economies

	2014*	2015**	2016**	2014*	2015**	2016**
	Fiscal balance			Debt		
	% of GDP					
Finland	-3.2	-3.4	-3.2	59.3	62.5	64.4
United Kingdom	-5.4	-4.6	-3.6	88.7	90.1	91.0
Sweden	-2.2	-1.6	-1.0	41.4	41.3	40.6
Denmark	1.8	-2.8	-2.7	45.0	42.7	43.6
Ireland	-4.0	-2.9	-3.1	110.8	110.3	107.9
Spain	-5.6	-4.5	-3.7	98.3	101.5	102.5
Netherlands	-2.8	-2.2	-1.8	69.5	70.5	70.5
Luxembourg	0.5	-0.4	0.1	22.7	24.4	25.1
Portugal	-4.6	-3.2	-2.8	128.9	124.5	123.5
Austria	-2.9	-2.0	-1.4	86.8	86.4	84.5
Germany	0.4	0.2	0.2	74.2	71.9	68.9
France	-4.3	-4.1	-4.1	95.3	97.1	98.2
Belgium	-3.2	-2.6	-2.4	106.4	106.8	106.6
Italy	-3.0	-2.6	-2.0	131.9	133.0	131.9
Greece	-2.5	1.1	1.6	176.3	170.2	159.2

Source: EU Commission forecast winter 2015; Finland: Ministry of Finance

2.1.1 Estimates of fiscal policy impact

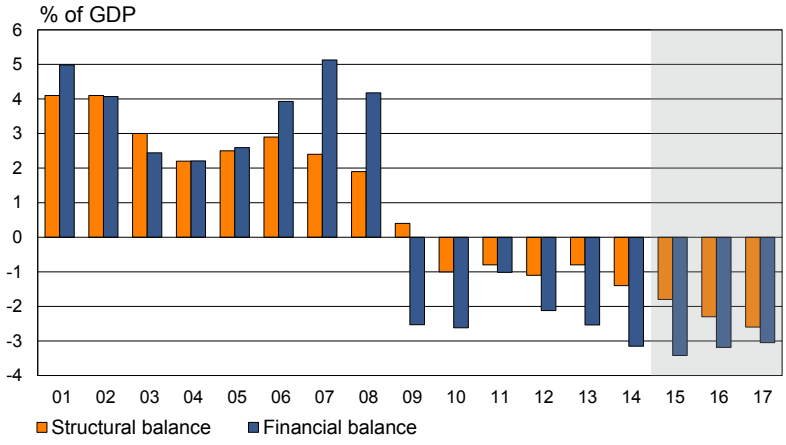
In 2015 the fiscal policy stance at general government level will be restrictive. The adjustment measures adopted by the Government will tighten central government fiscal policy by some EUR 3 billion. Changes to tax bases will slightly increase the tax rate. Furthermore, pension contributions will increase by 0.4 percentage points and the municipal tax rate will increase.

In 2015 it is projected that the tax rate will rise marginally from 2014, i.e. to 44,4% of GDP. If no new decisions are made to change existing tax bases, the tax rate will fall moderately over the outlook period as the most important tax bases such as the wage bill and private consumption will increase more slowly than output in 2016–2019. The expenditure rate will start slowly to fall in 2016 in response to savings measures and reduced cyclical expenditure.

The current fiscal policy stance can also be examined based on changes in the structural balance as assessed using the EU harmonized method. Structural balance is assessed by removing the cyclical effect from the public sector balance. The remainder describes the effect of the policy pursued and other than cyclical factors on the balance. Changes in the structural balance thus describe changes in the overall fiscal policy stance. Strengthening structural balance suggests fiscal consolidation while weakening structural balance suggests fiscal expansion.

An examination of the fiscal policy stance via changes in the structural balance does not give the exact same picture as an examination derived from individual revenue and expenditure measures. It is forecast that the structural balance will deteriorate slightly in 2015. In contrast to the conclusion suggested by an examination of individual measures, the structural balance will not improve at all in 2016–2019.

General government financial balance and cyclically adjusted balance [1)]



1) Based on the European Commission's production function approach.

Sources: Statistics Finland, MoF

The difference between the fiscal policy stance as measured on the basis of changes in the structural balance and the combined effect of individual fiscal policy measures is explained by several factors that are mainly related to the measurement of the structural balance.

Estimates of the structural primary balance are subject to uncertainties because of inaccuracies in the measurement of the output gap. Revenue and expenditure elasticities estimated for the output gap also exhibit annual variation. A third significant factor is age-related expenditure, which is increasing even without separate decisions. The growth of age-related social and health care expenditure will adversely affect the structural balance even if fiscal policy otherwise were neutral. In other words, fiscal policy only becomes contractionary when adjustment measures exceed the deterioration resulting from population ageing.

Calculation of adjustment needs

The state of public finances has deteriorated rapidly: both the public sector deficit and debt have increased. Halting the growth of debt and stabilising public finances will require adjustment. The scale of adjustment required can be estimated in different ways. One way to consider the needs for medium-term adjustment, say over the budget planning period, is to use a dynamic equation of public deficit/debt. The example used here is a calculation of adjustment needs in central government finances. Calculations for general government as a whole can be performed on the same principle, provided that it is borne in mind that the surplus of earnings-related pension funds cannot be used to cover debts.

The central government budget balance is the difference between central government revenue and expenditure. If central government expenditure exceeds revenue, the difference is covered by debt. The central government primary balance refers to the budget balance excluding interest payments. The determination of central government debt can be described as follows:

$$DEBT(t)=DEBT(t-1)+ i(t)*DEBT(t-1)-PB(t),$$

where t describes time, DEBT the level of debt, i interest payable on debt, and PB the primary balance. Central government debt in year t is determined by the previous year's debt, interest payments on debt servicing, and the central government primary balance. A deficit primary balance increases the amount of debt, a surplus balance decreases the amount of debt.

Interest payments on central government debt are determined under market conditions. Indirectly, interest expenses may also be influenced the country's credit rating. In recent years interest costs on Finnish state debt have been exceptionally low despite a high debt burden. The state has been able to borrow at an exceptionally low interest rate.

Primary balance is defined as referring to the difference between revenue and primary expenditure.

$$PB(t)=TR(t)-PE(t).$$

Policymakers can influence the primary balance through the decisions they make. The primary balance can be improved by increasing revenue (TR) or by reducing primary expenditure (PE). In long-term debt calculations primary balance is negatively affected by the growth of age-related expenditure as a result of population ageing. Part of age-related expenditure is based on existing agreements that are difficult to change. In other words, only part of age-related expenditure can be adjusted.

Calculations of primary balance and debt dynamics can be used to assess the scale of adjustment measures required to achieve different budget balance and debt targets. As a rule, central government debt and budget balance are examined in relation to GDP. Therefore the level of GDP also has a major bearing on ratios – even in the absence of adjustments, rapid GDP growth reduces ratios. Of course, adjustment will also influence GDP. The relationship between adjustment and GDP can be examined by means of a fiscal policy multiplier.

The multiplier effect of fiscal policy refers to the effects of public finances adjustment on GDP. Empirical research and model simulations have shown that adjustment slows the growth of the economy in the short term. The size of the fiscal policy multiplier is subject to considerable uncertainty: it varies from country to country and depending on current conditions. The higher the multiplier, the greater the slowing impact of adjustment on economic growth.

Adjustment increases revenue or reduces expenditure by the amount of adjustment agreed and impacts the level of nominal GDP via the fiscal policy multiplier. An alternative scenario trajectory is thus created to the baseline scenario that takes into account all the effects of adjustment. The baseline scenario for adjustment calculations is the most recent Ministry of Finance public finances forecast, which works from a no-adjustment assumption.

At the aggregate level, the simplest way to examine adjustment is to use the fiscal policy multiplier in the manner described above. In practice the approach taken to adjustment can have a significant impact on growth, i.e. different measures have different impacts on economic growth.

2.1.2 General government debt

Preliminary figures indicate that general government debt increased by EUR 8.4 billion last year to EUR 121 billion. In the space of six years, Finland's euro-denominated debt has increased by almost EUR 58 billion and the debt to GDP ratio has increased by 27 percentage points to almost 60%. The debt ratio will continue to rise over the following years and breach the 60% limit in 2015. Nonetheless Finland's debt ratio is still some 35 percentage points lower than in the euro countries on average.

The general government debt forecast is based on central government's net borrowing needs and on the central government debt forecast derived from those figures. In addition, the forecast takes account of the debt accrued by off-budget entities that in the national accounts are included in central government. These entities include Senate Properties, universities' property companies, Solidium and the Finnish Broadcasting Company YLE.

The general government debt figure is impacted by local government deficits and the need for borrowing derived from those deficits. So far social security funds effectively have no debt at all, but last year the unemployment insurance contribution and central government transfers received by the Unemployment Insurance Fund were not enough to cover the increased outlays on unemployment benefits and the fund was forced to borrow. Borrowing will continue in 2015, which will increase public debt.

General government debt also includes some other items, such as loans granted by the European Financial Stability Facility (EFSF) to recipient countries, security deposits related to government derivative contracts, debts related to public–private partnership projects, the capital assets of the State Nuclear Waste Management Fund and coins in circulation.

Debt statistics furthermore reflect internal general government debt, which is consolidated out of the measure of public debt in order to eliminate double counting in the statistics. The biggest single internal general government debt item are investments by earnings-related pension funds in government debt securities. All in all internal general government debt last year stood at EUR 4 billion.

Table 17. Change in general government debt ratio and related factors

	2013*	2014**	2015**	2016**	2017**	2018**	2019**
Debt ratio. % of GDP[1)]	55.8	59.3	62.5	64.4	66.0	67.0	67.8
Change in debt ratio	2.9	3.5	3.2	1.9	1.6	1.0	0.8
Factors impacting change in debt ratio							
Primary budgetary position	1.3	1.9	2.2	2.0	2.0	1.7	1.4
Interest expenditure	1.3	1.3	1.2	1.1	1.1	1.1	1.1
Change in GDP volume	0.7	0.1	-0.3	-0.9	-1.0	-0.9	-0.8
Change in GDP price	-1.4	-0.7	-0.4	-0.9	-1.1	-1.3	-1.3
Acquisition of financial assets (net)	1.8	1.7	1.2	1.3	1.1	0.9	0.8
Other factors 1[1)]	-0.9	-0.7	-0.7	-0.7	-0.5	-0.5	-0.3

[1)] Includes privatization proceeds. lending and factors related to the valuation and timing of revenue and expenditure.

Plus indicates increasing effect on debt ratio. minus a lowering effect on debt ratio.

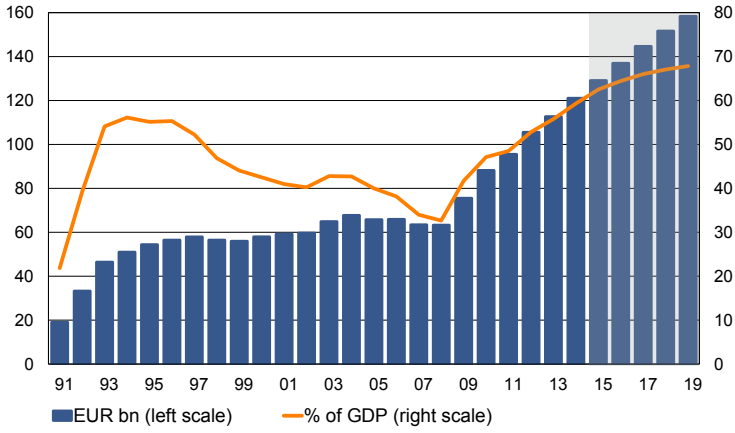
Table 17 describes factors impacting the general government debt ratio. A plus sign indicates that the factor has the effect of increasing the debt ratio, a minus sign that it decreases the debt ratio.

In 2014 the debt ratio increased by 3.5 percentage points. Most of this increase, 1.9 percentage points is explained by the deep deficit position in the primary balance of general government. Increasing interest payments accounted for 1.3 percentage points of the increase in the debt ratio. When the debt is compared to GDP, GDP growth has the effect of lowering the debt ratio. In 2014 the declining GDP volume increased the debt ratio, but rising prices lowered it by 0.7 percentage points.

Earnings-related pension funds are included in general government. Part of the earnings-related pension contributions collected from employees and employers are prefunded, and therefore earnings-related pension funds show a surplus. Fund surpluses are not used to pay off general government debt. For this reason the surplus of earnings-related pension funds must be excluded from the range of factors impacting the change of debt ratio. In 2014 the surplus was 1.7% of GDP.

In addition to these factors, central government lending and factors related to the valuation and timing of revenue and expenditure were among the factors decreasing the general government debt ratio by 0.7 percentage points in 2014.

General government debt



Sources: Statistics Finland, MoF

2.2 Central government

Finnish GDP has shown no growth in three years. As a consequence, central government finances have plunged into substantial deficit. In 2014 the national accounts deficit grew by EUR 0.2 billion to EUR 7.6 billion, or –3.7% of GDP. The sluggish economic growth was reflected most particularly in VAT revenue. The tax base changes announced by the Government also contributed to slightly reduce tax revenue in 2014. The single most significant tax base change was the reduction of the corporate income tax rate. On the other hand, interest payments on state debt were down from the previous year, but transfers paid to other sectors increased in 2014.

In 2015 the economy will continue on a very slow growth path, which inevitably will be reflected in central government finances. It is estimated that national accounts central government expenditure will fall by –0.3%. Revenue will be up by 1.5%. Tax base changes in indirect taxation will boost tax revenue growth despite the sluggish economy. Many adjustment measures on the expenditure side will in turn curb the growth of expenditure, and the deficit in central government finances will shrink considerably. A one-off transfer of EUR 0.5 billion will be made from the State Pension Fund to the central government budget.

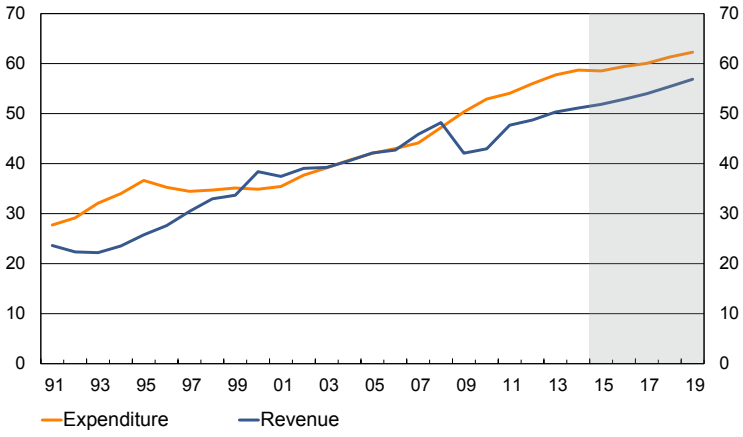
Economic growth will pick up in 2016, boosting tax revenue growth. At the same time expenditure growth will remain moderate, and the deficit will shrink somewhat. The state of central government finances in 2016 will depend not only on the rebound of economic growth, but also on the first budget of the new government and any measures included in that budget to reduce the central government deficit.

According to the medium-term baseline scenario, annual economic growth in 2017–2019 will average 1.3% – a very slow rate historically. For this reason the central government budget balance will hardly improve at all without adjustment. However, the baseline scenario includes no new measures, and this scenario predicts an average increase in central government expenditure of 1.6% and an increase in revenue of 2.5% in 2017–2019. In 2019 it is estimated that the central government budget balance will show a deficit of 2.3% of GDP.

At year-end 2014 state debt stood at EUR 95 billion. As budgets will continue to run deficits over the next few years, central government debt will also continue to rise. In 2015 central government debt will exceed EUR 100 billion. In the medium term the accumulation of debt will slow, but even so it is expected that central government debt will reach EUR 124 billion by 2019, which is 53% of GDP.

State guarantees include all guarantees issued by central government, state enterprises, state-owned joint stock companies and special credit institutions ultimately backed by central government. These guarantees are not an expenditure item and do not show up in the State Budget, unless the guarantees are called. The amount of government-issued guarantees has increased in recent years. At year-end 2014 the stock of state loan guarantees was up 16% from the year before, standing at almost EUR 39 billion, or more than 70% of total State Budget expenditure.

Central government revenue and expenditure
EUR bn



Sources: Statistics Finland, MoF

Table 18. Central government [1)]

	2012	2013*	2014*	2015**	2016**	2017**
	EUR billion					
Current taxes	11.8	12.2	12.6	12.7	13.4	14.0
Taxes on production and imports	28.1	29.2	29.6	29.8	30.3	30.7
Taxes and contributions, total [2)]	40.5	42.1	42.7	43.1	44.3	45.4
Other revenue [3)]	8.5	8.7	8.8	9.3	9.1	9.3
of which interest receipts	0.5	0.4	0.4	0.4	0.4	0.4
Total revenue	**49.0**	**50.7**	**51.6**	**52.4**	**53.4**	**54.6**
Consumption expenditure	12.9	13.6	13.7	13.9	14.0	14.2
Subsidies and current transfers, total	36.1	37.5	38.2	37.9	38.6	39.0
to general government	24.5	25.4	25.9	25.8	26.3	26.8
Interest expenses	2.7	2.5	2.5	2.4	2.3	2.3
Capital expenditure [4)]	4.6	4.6	4.8	4.9	5.0	5.2
Total expenditure	**56.3**	**58.2**	**59.2**	**59.1**	**60.0**	**60.7**
Net lending (+) / net net borrowing (-)	**-7.3**	**-7.4**	**-7.6**	**-6.7**	**-6.5**	**-6.1**
Primary balance[5)]	-5.1	-5.4	-5.5	-4.6	-4.6	-4.2

1) As calculated in the national accounts.
2) Incl. capital taxes.
3) Incl. capital transfers (excl. capital taxes) and consumption of fixed capital.
4) Gross fixed capital formation and capital transfers.
5) Net lending before net interest expenses.

2.2.1 Central government expenditure

Central government's national accounts expenditure increased nearly 2% last year, or by some EUR 0.8 billion, even though adjustment measures on the expenditure side reduced on-budget expenditure by around half a billion euros. Transfers to other social security funds, non-profits, and international development cooperation increased in particular. Investment expenditure increased nominally by 1% and consumption expenditure by less than 1%. The ratio of central government expenditure to GDP increased to 29%.

Adjustment measures on the expenditure side of the budget in 2015 will exceed last year's corresponding measures. National accounts nominal expenditure will be lower than last year, and the expenditure to GDP ratio will also be down. Current transfers account for over one-half of total central government expenditure: these transfers go predominantly to the local government sector and social security funds, but they also include transfers to domestic non-profits, fees paid to the EU, and development aid. Almost one-quarter of total expenditure goes to consumption, i.e. labour costs and acquisitions of production inputs.

In the medium term central government expenditure growth will be relatively slow and the expenditure to GDP ratio will fall, but still remain higher than before the financial crisis. Expenditure growth will be constrained among other things by adjustment measures and reduced price changes to on-budget spending limits expenditure. In line with the technical spending limits it is projected that investment expenditure will increase as a result of new transport infrastructure projects, and the share of investments in total central government expenditure will increase.

Interest expenses have remained rather moderate because of low interest rates and the country's strong credit rating, even though central government debt has risen appreciably for six years in a row. In 2014 national accounts interest expenses amounted to 4.2% of total expenditure, compared to the peak figure of over 16% in 1997. In the medium term central government debt will continue to rise year on year, but because of the low interest rate environment interest outlays will remain relatively moderate.

Central government on-budget accounts and expenditure in 2016–2019

The spring 2015 general government fiscal plan for 2016–2019 covers the next parliamentary term. The fiscal plan is prepared from the premise of not including new policy orientations. It reflects the effects of decisions taken by the current Government on expenditure and revenue estimated over the coming years. The plan is intended to provide a sound technical foundation on which the new Government formed after the elections can reliably base its policies. Public finances policies and the spending limits, i.e. the binding expenditure ceiling for the 2016–2019 parliamentary term will be decided by the new Government that emerges from the April elections.

In 2015–2019, central government on-budget expenditure will increase on average by some 1½% per annum. During this same period real expenditure growth is projected to average around ½% per annum.

In 2016–2018 the average level of central government on-budget expenditure will be around EUR 1.5 billion higher than in last spring's fiscal plan. This increase is explained among other things by the revised distribution of costs between central and local government, the rise in cyclical expenditure, the transfer of responsibility for the calculation and payment of basic income support to the Social Insurance Institution Kela, and transport projects decided upon by Prime Minister Stubb's Government (e.g. the Western Metro Extension, the Ring Rail Line, business and industry transport investments in Äänekoski, Pyhäjoki and Sokli). On the other hand, interest outlays on central government debt will decrease considerably from the spring 2014 fiscal plan due to the low interest rate forecast.

Central government budget balance: estimate 2015–2019, current prices, EUR billion

	2015 budgeted	2016	2017	2018	2019
Total estimated expenditure (current prices1)	54.3	54.4	55.5	56.2	57.3
Total estimated revenue	49.1	48.4	49.3	50.6	52.0
Estimated on-budget balance	**-5.2**	**-6.0**	**-6.2**	**-5.6**	**-5.3**

[1] Expenditure converted into current prices using the MoF price index forecast for central government expenditure. The index provides a rough estimation of price trends over the budget planning period.

It is estimated that on-budget revenue (excluding net borrowing) will increase by some 1½% a year over the budget planning period. Tax revenue growth is predicted to average 2½% per annum. Economic growth is expected to be subdued over the planning period, and therefore tax bases will show only slow growth. In 2019 on-budget revenue is predicted to reach EUR 52.0 billion.

On-budget revenue estimates are significantly lower than in last spring's fiscal plan. The current economic outlook is considerably weaker than one year ago. The weaker macroeconomic outlook means that the tax revenue forecast for 2016–2018 is down by some EUR 1.5–2.5 billion. Furthermore, the Government has called off several planned tax base changes (e.g. increasing the excise duty on sweets, introducing a power plant tax, withdrawing the right to deduct corporate entertainment expenses) and decided on several other measures reducing tax revenue (e.g. raising the VAT threshold, introducing a deduction for families with children, lowering the tax on peat), which taken together lower the net revenue forecast by around EUR 0.5 billion per annum from the year before.

Factors impacting change in central government budget balance compared with spring 2014 general government fiscal plan, EUR billion

	2016	2017	2018
Estimated balance, general government fiscal plan 3 April 2014	**-3.3**	**-2.6**	**-2.5**
New transport projects (Western Metro Extension, Ring Rail Line, Helsinki railway yard, road projects to support business and industry in Pyhäjoki, Äänekoski and Sokli, review of overall level of infrastructure projects)	-0.1	-0.4	-0.5
Revised costs to central government from the transfer of basic income support to Kela in 2017		-0.1	-0.1
Revised distribution of costs between central and local government in 2016 and preparation for annual revisions	-0.4	-0.5	-0.5
Increase in cyclical expenditure	-0.5	-0.5	-0.3
Decrease in projected interest payments on central government debt	0.5	0.9	1.3
Other change (net), including downward revision of expenditures	-0.3	-0.5	-0.2
New changes to tax bases (net)	-0.5	-0.5	-0.4
Impact of lowered maroeconomic forecast on tax revenue	-1.4	-2.0	-2.4
Other change on revenue side (net), e.g. timing changes in incomes from the EU	-0.1	-0.2	0.1
CHANGE TOTAL	**-2.7**	**-3.6**	**-3.1**
Estimated balance, general government fiscal plan 2 April 2015	**-6.0**	**-6.2**	**-5.6**

2.2.2 Central government revenues

Taxes are the largest source of central government revenue. The major tax revenue items are taxes on earned and capital income, value added tax and corporate income tax. The development of tax revenue depends crucially on the general performance of the economy and the structure of economic growth. Overall tax accrual and the structure of taxation is also affected by Government decision-making.

Central government tax revenue, in national accounts terms, increased by no more than just over 1% last year. Sluggish tax revenue growth was due to the weak performance of the economy and to the tax base changes introduced in 2014, which had the effect of reducing tax receipts. The single most significant tax base change was the lowering of the corporate income tax rate, which reduced corporate income tax revenue. On the other hand income taxes paid by households increased exceptionally strongly, among other things due to increased capital income and the decision not to make adjustments for real earnings growth and inflation.

GDP growth in 2015 will remain slow, which will be reflected in sluggish growth of tax bases. The most significant tax base changes were made to excise duties at the start of the year. Next year the revival of economic growth will accelerate the growth of tax bases, which will translate into faster tax revenue growth. Central government corporate income tax revenue will increase with the expiry of the temporary increase in the share of corporate income tax revenue paid to local governments and the transfer of parishes' share of corporate tax revenue to central government.

Table 19. Forecasts for certain revenue and demand items impacting taxable income and the tax base in 2013-2019. annual change

	2013	2014	2015	2016	2019/2015**
	change. % per year				
Taxable earned income and capital income	3.1	2.2	2.4	2.0	2 1/2
Wage and salary earnings and other income	0.8	0.6	1.6	1.8	2
Pensions and other social security benefits	6.6	5.0	3.5	1.9	3 1/2
Capital income	12.6	2.2	5.1	3.1	3
Index of wage and salary earnings	2.2	1.4	1.2	1.3	1 1/2
Operating surplus	0.0	3.2	1.0	4.6	5
Value of household consumption expenditure	3.3	1.4	0.8	2.1	2 1/2
VAT base	1.3	0.1	0.5	2.0	2 1/2
Petrol consumption	-2	-2.5	-2.0	-2.0	-2
Diesel consumption	-0.8	-1.2	1.0	1	1
Electricity consumption	2.6	-1 1/4	3½	3 1/2	2
Duty-paid alcohol consumption	-4.3	0	-1 1/2	-1	-1
New passenger cars	-7.2	0.8	2.9	1.9	2
Consumer price index	1.5	1.0	0.3	1.4	1 1/2

In the medium term tax revenue will increase on average by 2.4% a year. The revenue forecasts for the outlook period take account of the tax base changes decided by the Governments of Prime Ministers Katainen and Stubb, including measures that will take effect during the 2016–2019 budget planning period.

As for other sources of central government revenue, significant items include property income and transfers from the State Pension Fund. In connection with the spring 2014 spending limits discussions the Government of Prime Minister Katainen announced significant sales of government property and other transfers. In 2015 EUR 500 million will be transferred from the State Pension Fund to central government. This transfer will have the effect of narrowing the surplus of earnings-related pension funds. In 2014 central government property income increased by almost 6%. One contributing factor was the sales of government property, which will continue in the current year.

Taxes on earned and capital income

Revenue from earned and capital income taxes consists of receipts from progressive income tax, capital income tax and withholding tax paid by people with limited tax liability. The most significant source of revenue is the progressive income tax. Almost 70% of the earned income tax base consists of wage and salary earnings, over 25% of taxable social benefits and less than 5% of other revenue.

Earned and capital income tax revenue will grow very slowly in 2015. This is due to sluggish economic activity and last year's underlying, exceptionally strong growth of tax revenue. Several changes were made to tax bases, some of which contributed to increase tax revenue and others to reduce it. All in all it is estimated that the tax base changes introduced from the beginning of 2015 will slightly decrease central government revenue from earned income and capital income taxes. The most significant changes that have the effect of reducing cen-

Table 20. Impact of change in selected tax base items on tax revenue

Tax category	Tax base / Demand item	Change	Change in tax revenue, EUR million
Taxes on earned income	Wage and salary earnings	1-pp	378 of which central govt. 128 and local govt. 169
	Pension incomes	1-pp	118, of which central govt. 31 and local govt. 76
Capital income tax	Investment income	1-pp	31
Corporate tax	Operating surplus	1-pp	40, of which central govt. 24 and local govt. 15
VAT	Value of private consumption	1-pp	119
Car tax	Sales of new cars	thousands	7
Energy tax	Electricity consumption	1%	10
	Petrol consumption	1%	13
	Diesel consumption	1%	14
Duty on alcoholic beverages	Alcohol consumption	1%	14
Duty on cigarettes	Cigarette consumption	1%	7

tral government tax revenue are the inflation adjustments made to the three lowest income brackets in the progressive income tax scale, the increase to the earned income deduction and the introduction of the child deduction. Capital income tax revenue will increase as a result of a higher tax rate at the higher end of capital income and the lowering of the progression threshold to EUR 30,000.

Over the budget planning period, it is projected that earned and capital income tax revenue will increase on an average by 4.4% per annum. Unemployment will slowly decrease and the wage bill will increase on average by 2.0% per annum. Tax revenue from pensions will increase with the growing number of pension recipients. The earned and capital income projection for 2017–2019 assumes that tax bases will be adjusted for inflation each year in order to ensure that taxes on labour do not increase as a result of rising earnings levels.

Corporate income tax

Revenue from corporate income tax paid by businesses on their profits is shared between central government, local government and, until 2015, parishes. From 2016 onwards, the revenue will be shared between central and local government, while parishes will receive instead an indexed appropriation. The forecast for corporate income tax revenue assumes that the tax base loosely follows the development of the national accounts operating surplus, and the forecast for the current year also takes account of tax revenue data for the early part of the year. Furthermore, the forecast reflects the tax base changes made that impact revenues for the forecast years.

Corporate income tax has represented a declining proportion of total tax revenue in recent years. This trend is mainly explained by the discretionary measures announced by the Governments of Prime Ministers Katainen and Stubb, particularly the lowering of the corporate income tax rate. That rate is currently 6 percentage points lower than when Prime Minister Katainen's Government took office in summer 2011. It is thought that the lower tax rate contributes to boosting economic growth. However the growth-inducing effects will only become apparent in the longer term as the economy gathers steam.

In 2015 economic activity will remain sluggish and revenue from corporate income tax will show no growth. It is projected that the operating surplus will increase by less than 1%. Corporate income tax revenue will be depressed by the extension of the increased deductions on production-related investments in 2015–2016 and the reinstatement of deductions for corporate entertainment expenses.

Central government revenue from corporate income tax may differ from overall corporate income tax revenue for several reasons. Firstly, corporate income tax revenue for the calendar year may accumulate more slowly or more rapidly than the corporate income tax for the tax year. Taxes for a given tax year accumulate over many years, and the level of supplementary prepayments made in the year following the tax year, for instance, varies widely.

It is estimated that central government corporate income tax revenue will increase on average by 9% a year over the budget planning period. The growth forecast for total payments of corporate income tax over the budget planning period is 5% per annum, which roughly corresponds with the average growth of the national accounts operating surplus during

this period. Central government revenue from corporate income tax will rise more rapidly than payments, above all because of the expiry of the temporary increase in the share of corporate tax revenue paid to local governments and parishes, and the transfer of parishes' share of corporate tax revenue to central government. It is estimated that these changes will increase central government corporate income tax revenue by over EUR 300 million in 2016.

In order to balance the finances of local governments and parishes, the share of corporate income tax revenue allocated to local governments was increased by 10 percentage points and that allocated to parishes by 0.8 percentage points in 2009–2011. The share received by central government was lowered accordingly. In 2012–2015, the revised allocation rules were adjusted such that the share going to local governments was temporarily increased by 5 percentage points and that going to parishes by 0.4 percentage points.

Indirect taxes

The single most important source of indirect tax revenue is VAT. It is estimated that, given the sluggish growth of private consumption, national accounts VAT revenue will increase by no more than 0.5% this year. The moderate growth of wages and salaries and the slow improvement in the employment situation will constrain household consumption throughout the outlook period. During this period national account VAT revenue is estimated to increase on average by 2.5% a year, a relatively low rate compared with the growth figures seen in the early 2000s.

Revenue from the motor car tax fluctuates sharply. It is estimated that in the coming years, demand for cars will remain lower than over the past few years. Two tax base changes were made to the motor car tax from the beginning of 2015: the tax subsidy for taxis was halved and the tax subsidy for motor vehicles imported into Finland as removal goods was discontinued. The forecast is that revenue from the motor car tax will decline on average by 0.5% a year in 2016–2019. This is explained by the subdued consumption outlook for households and by the reduced levels of CO2 emissions in new cars, which means that the tax payable on these cars is lower than on older cars. The vehicle tax is a time-based tax that is levied in 12-month periods on passenger cars, vans and heavy goods vehicles. Overall, revenue from the vehicle tax is relatively stable. The vehicle tax will be increased from the beginning of 2016.

Some 60% of energy tax revenue consists of excise duties on petrol and diesel, 20% comes from electricity and the rest from other energy products. Energy taxes have been significantly increased in recent years. Taxes on transport fuels have been raised in successive stages. The most recent increase was at the beginning of the current year. In its spring 2014 spending limits discussions the Government decided to raise the electricity tax from the beginning of 2015. Other tax base changes introduced from the beginning of the year include the increase to the CO2 tax on fossil heating, power plant and machinery fuels, the removal of the mining industry from the lower electricity tax band, and the cancellation of the tax subsidy for natural gas. Furthermore, the peat tax was lowered. Energy taxes are set to rise appreciably in 2015 as a result of these tax band changes. Given the shrinking tax base, it is projected that revenue from energy taxes will be marginally negative to the end of the budget planning period.

Revenue from other excise duties is usually highly stable, unless tax base changes are made. The tobacco tax was raised once again from the beginning of the year; the previous tax hike was at the start of 2014. One tax base change was made in alcohol taxation, where the tax relief for small breweries was increased by raising the threshold for both the highest and the lowest production volumes.

Table 21. Central government on-budget revenue: estimates for 2012-2018. EUR billion

	2014 provisional financial accounts	2015 budget incl. supplementary budget proposal	2016	2017	2018	2019	2019/2016 annual change. %
Total tax revenue estimates	39.3	39.9	40.9	41.8	43.0	44.3	2 1/2
Income and wealth taxes[1]	12.3	12.0	13.1	13.7	14.3	15.1	4
Taxes based on turnover	17.5	17.8	17.9	18.3	18.8	19.3	2
Excise duties	6.6	7.1	7.0	7.0	6.9	6.9	1
Other taxes	2.9	3.0	2.9	2.9	3.0	3.0	1/2
Miscellaneous revenue	5.2	6.0	5.1	5.1	5.3	5.4	1
Interest income and profit entered as income	2.6	2.8	1.9	1.9	1.9	1.9	-5 1/2
Total revenue estimates	**47.7**	**49.1**	**48.4**	**49.3**	**50.6**	**52.0**	**2**

[1] Incl. YLEtax from 2013 onwards (on average 500 EUR million per year).

Table 22. Impact of discretionary tax measures on general government tax revenue

	2014	2015	2016	2017	2018	2019
	EUR million					
Earned income taxes	-47	-184	28	35	100	-38
Average increase in municipal tax rate	350	101	0	0	0	0
Investment income tax	57	100	46	6	0	0
Corporate tax	-935	27	10	65	0	0
YLEtax	42	0	0	0	0	0
Other direct taxes	141	-104	13	-15	43	18
Value-added tax	155	27	-29	-7	0	0
Energy taxes	151	279	18	-1	0	0
Other indirect taxes	132	156	115	0	0	0
Social security contributions	620	378	196	271	0	0

2.2.3 On-budget accounts and national accounts

In 2014 central government net funding requirement was EUR 6.4 billion, while preliminary figures put total national accounts net lending at EUR 7.6 billion. The two major factors explaining the difference between the budget and national accounts figures for the 2014 budgetary position are interest outlays and property income. National accounts interest outlays were EUR 0.8 billion higher than the on-budget interest outlays, which is especially due to the fact that national accounts interest payments do not include the effect of derivative instruments (swaps and futures), in contrast to the on-budget figures.

The difference between the two sets of property income figures is explained by the fact that budget entries by the state investment company Solidium, which is classified as part of central government sector, do not show up as central government revenue in the national accounts because they are internal transfers within central government. By contrast, dividends received by Solidium are entered as central government revenue. This caused a difference of EUR 0.7 billion in the national accounts and on-budget accounts for central government.

There are also other classification differences that cause divergence between on-budget and national accounts figures. On-budget accounts comprise a total of some 70 separate accounting units. In the national accounts, central government includes on-budget entities and Solidium as well as about 10 extra-budgetary funds. Among state enterprises, Senate Properties falls under the national accounts definition of central government, Metsähallitus (National Board of Forestry) does not. Universities, universities' property companies, VTT Technical Research Centre of Finland and the Finnish Broadcasting Company YLE are also extra-budgetary units that come under the central government sector.

The concepts and classifications applied in on-budget accounts and in the national accounts differ in many respects. For instance, the content of consumption expenditure items in on-budget accounts differs quite considerably from national accounts consumption expenditure, and on-budget investment expenditure covers only a small part of expenditure classified as investment in the national accounts. One significant difference comes from the use of deferrable appropriations. These are two or three-year grants that are entered in the Budget for one year only. In the national accounts, deferrable appropriations are entered on the basis of their use. The net effect of deferrable appropriations can vary widely from year to year.

Perhaps the single most significant difference between the on-budget net financing requirement and national accounts net lending comes from financial investments. Financial investments such as central government loans, capitalisations and share purchases are entered in the State Budget as expenditures. Loan repayments, revenue from share sales, etc., are accordingly entered on the revenue side. In the national accounts, these items are entered as financial transactions, which do not affect central government's fiscal balance as measured by net borrowing. Table 23 provides a rough description of the differences between the on-budget net financing requirement and national accounts net lending.

Table 23. On-budget balance and central government net lending[1)]

	2013	2014*	2015**	2016**	2017**
	EUR billion				
On-budget surplus (+)/deficitT (-) [2)]	**-8.4**	**-6.4**	**-5.2**	**-6.0**	**-6.2**
Privatization proceeds (net proceeds from equity sales)	0.1	-0.1	-1.2	-0.4	-0.4
Financial investment, net	0.3	-0.7	-0.3	-0.9	-0.8
Rvenue surplus in off-budget units	-0.6	-1.1	-0.2	-0.2	-0.2
Cash/accrual basis adjustment	0.1	0.4	0.0	0.0	0.0
Other adjustment items [3)]	1.1	0.2	0.2	1.0	1.5
Central government net lending (+) /-borrowing (-)	**-7.4**	**-7.6**	**-6.7**	**-6.5**	**-6.1**

[1)] In national accounts terms.

[2)] Incl. government debt servicing.

[3)] Incl. debt cancellations, profit on reinvested foreign direct investments, super dividends

2.3 Local government

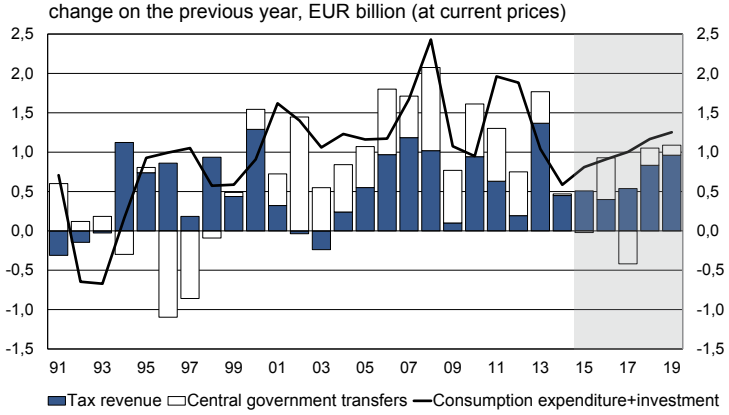
According to preliminary national accounts figures, local government finances showed a deficit of 0.9% of GDP. Local government tax revenue growth was slowed by weak tax base growth as well as one-off factors. Central government transfers to local government were unchanged from 2013. Local governments responded to the tightening economic situation by adjusting their expenditure and increasing their tax rates. Consumption expenditure showed particularly slow growth: the value of consumption expenditure increased at the slowest rate recorded in the 2000s. Expenditure growth was slowed by both adjustment measures and the slow increase in costs. The average municipal tax rate increased by 0.36 percentage points, and several municipalities put up their real estate tax rates. Despite the adjustment efforts, the deficit increased from the year before.

The local government deficit will increase to 1.0% of GDP in 2015. Revenue from taxes and central government transfers will increase only slightly faster than last year. Tax revenue growth is held back by the sluggish economy. As part of the central government adjustment measures, central government transfers to local government will be cut by EUR 190 million.

Municipalities will continue their adjustment efforts by measures on both the expenditure and revenue sides. One-third of all municipalities raised their municipal tax rate at the start of the year, and the average municipal tax rate increased by one decimal point to 19.84%. Furthermore, several municipalities put up their real estate tax rate from the beginning of 2015. However many of these tax hikes were the result of increases to the statutory lower and upper limits of real estate tax from the beginning of the year. These increases do not contribute to improve the state of local government finances because they are deducted from the transfers received from central government.

Cost levels will continue to rise moderately, curbing expenditure growth in the local government sector. Municipalities and joint municipal authorities will also continue to seek out greater efficiencies. Personnel expenses account for more than one-half of municipalities' and joint municipal authorities' operating expenses. Staff redundancies are therefore one inevitable route to achieve savings. Most of these staff reductions can be absorbed through natural attrition, but terminations and layoffs will also continue. General economic tightness will also slow the growth of local government investment. Nonetheless expenditure growth will continue to outpace revenue growth.

Local government taxes, central government transfers, consumption expenditure and investment
change on the previous year, EUR billion (at current prices)



Sources: Statistics Finland, MoF

Securing the stability of local government requires substantial measures to strengthen local government finances

There is a real risk of local government debt increasing sharply in the years ahead. The local government outlook for 2016–2019 is assessed here in terms of a pressure projection that only considers such measures with a bearing on local government finances that have already been agreed. The assessment does not take account of municipalities' and joint municipal authorities' planned adjustment measures for 2016–2019. The municipal tax rate and the real estate tax rate are held constant at 2015 level. It is assumed that taxes on earned income will be revised in 2017–2019 to reflect changes in earnings levels.

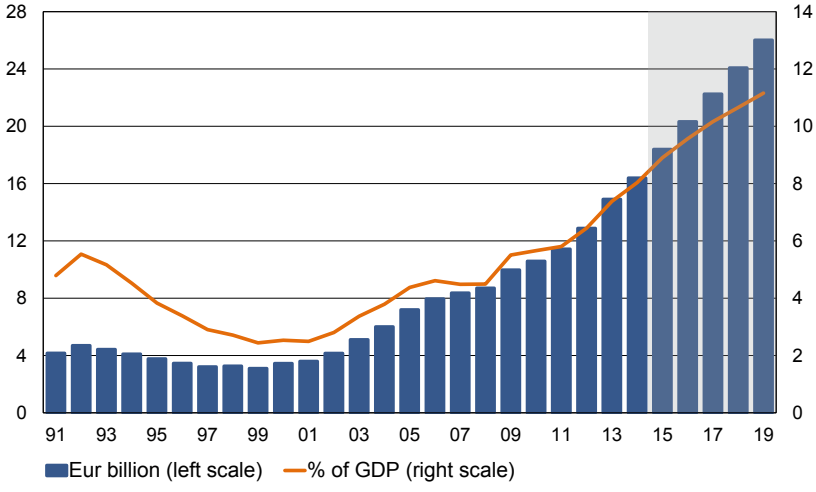
Local government finances will remain highly strained over the next few years. Increases in expenditure will be driven by population ageing and the associated growth of age-related expenditure. Local government investment will fall only slightly despite the tight economic environment. This is by virtue of major investment projects in growth centres, repair debt, and major hospital investments. At the same time, tax revenue growth will be much slower than usual, despite the improving economic situation.

Local government finances will be boosted in 2016 by the statutory revision of the distribution of costs between central and local government, in which basic prices and finances are adjusted to reflect true costs. As a result, central government transfers to local government will increase by EUR 340 million. In 2016 and 2017, central government adjustment measures will include cuts of EUR 90 million in transfers to the local government sector. The expiry of the temporary increase in the share of corporate income tax revenue will reduce local government tax revenue by some EUR 210 million in 2016.

Local government expenditure and revenue growth will slow in 2017 as the Social Insurance Institution Kela takes over responsibility for the calculation and payment of basic income support. Social benefits paid out by municipalities will consequently decrease by some EUR 700 million. At the same time central government transfers will decrease as the government grant previously allocated for the funding of basic income support is discontinued and the share of the costs of basic income support financed by municipalities is deducted from central government transfers. It is projected that this reform will reduce local government administrative costs. However basic income support expenditure is expected to increase as it is thought that the reform will reduce underuse of the benefit. The change will have only limited impact on local government net lending.

The current imbalance between local government revenue and expenditure is rapidly increasing the debt burden in the local government sector. It is projected that local government debt will rise to some EUR 26.5 billion in 2019. High expenditure pressures and the growing debt burden constitute a major risk to the stability of local government finances. In the medium term low interest rates will keep in check the growth of interest expenditures. Unless active steps are taken to curb the growth of debt, rising interest expenses will also begin to accelerate the growth of debt as interest rates begin to pick up in the future. In other words, securing the stability of local government finances will require substantial efforts both to strengthen local government finances and to curb the growth of debt.

Local government debt



Sources: Statistics Finland, MoF

Table 24. Local government [1)]

	2012	2013*	2014*	2015**	2016**	2017**
	EUR billion					
Taxes and social security contributions	19.4	20.7	21.2	21.7	22.1	22.6
of which municipal tax	16.9	17.9	18.2	18.6	19.1	19.6
corporate tax	1.2	1.5	1.4	1.4	1.3	1.3
real estate tax	1.3	1.4	1.5	1.6	1.7	1.7
Other revenue [2)]	17.9	18.4	18.4	18.4	19.0	18.8
of which interest receipts	0.3	0.2	0.3	0.3	0.3	0.3
of which transfers from central government	13.5	13.9	13.9	13.9	14.4	14.0
Total revenue	**37.2**	**39.1**	**39.6**	**40.1**	**41.1**	**41.4**
Consumption expenditure	32.2	33.0	33.6	34.2	35.0	36.0
of which compensation of employees	21.4	21.7	21.7	21.8	22.1	22.3
Income transfers	3.0	3.1	3.1	3.4	3.4	2.7
of which social security benefits and allowances	1.2	1.3	1.3	1.4	1.4	0.7
subsidies and oher transfers	1.5	1.6	1.6	1.8	1.8	1.8
interest expenses	0.2	0.2	0.2	0.2	0.2	0.2
Capital expenditure [3)]	4.1	4.4	4.6	4.6	4.7	4.7
Total expenditure	**39.4**	**40.6**	**41.3**	**42.2**	**43.1**	**43.4**
Net lending (+) / net borrowing (-)	**-2.1**	**-1.5**	**-1.7**	**-2.1**	**-2.0**	**-2.0**
Primary balance [4)]	-2.2	-1.5	-1.8	-2.2	-2.1	-2.1

[1)] As calculated in the national accounts.

[2)] Incl. capital transfers and consumption of fixed capital.

[3)] Gross capital formation and capital transfers.

[4)] Net lending before net interest expenses.

2.4 Social security funds

2.4.1 Earnings-related pension funds

In 2014 the surplus of earnings-related pension funds fell to 1.7% of GDP. Since 2008, this surplus has contracted by well over two percentage points. Earnings-related pension expenditure has risen sharply in recent years with the growing number of pensioners and with the higher average level of pensions, as new pensions are higher than the old ones in payment. The weaker employment situation and slower rise in earnings have in turn dampened the growth of incomes from contributions, even though pension contribution rates have increased sharply in recent years. Low interest rates have in turn reduced property income earned on pension assets. However rising property and stock prices in particular have increased the total value of pension assets to EUR 172.5 billion at year-end 2014.

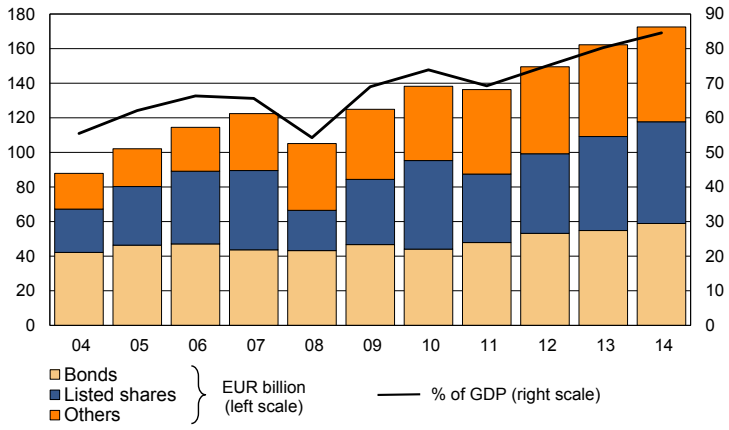
The growing number of pensioners and the rise in the average level of pensions will continue to drive earnings-related pension expenditure growth throughout the outlook period. Pension expenditure growth will be slowed by the decision taken in the spring 2014 spending limits discussions to freeze the earnings-related pension index increment to 0.4% in 2015. Slower inflation and expected moderate rises in earnings mean that annual indexations of pensions will remain at less than 2% in 2016– 2019. Earnings-related pension expenditure will increase at an annual average rate of just over 5% during the forecast period. Pension expenditure to GDP will climb to almost 15% at the end of the outlook period, compared with the figure of just 10% in 2008.

Earnings-related pension contributions were once again increased at the beginning of 2015, by 0.4 percentage points. As is current practice, the burden of the increase is equally shared by employees and employers. In connection with the 2017 pension reform agreement the central labour market organisations also agreed on the level of earnings-related pension contributions. The 0.4 percentage point increase that was supposed to have taken effect in 2016 was postponed until 2017, and the decision was made to freeze the contribution to the level of 24.4% in 2017–2019. Long-term projections by the Finnish Centre for Pensions suggest that when the pension reform is put in place, this contribution level will be sufficient to finance pensions even beyond 2019. In the medium term, however, the freezing of pension contributions at the 2017 level will eat into the surplus of pension funds, as the downward effects of the pension reform on pension expenditure will only begin to be seen from the 2020s onwards.

Moderate wage increases and slow employment growth mean that wage bill growth will remain sluggish, which will be directly reflected in revenue from pension contributions. It is projected that pension funds' interest and dividend revenue will turn to moderate growth from 2016 as interest rates begin to pick up.

In 2015 the surplus in earnings-related pension funds will fall to 1.2% of GDP. Part of the reason for this drop is the additional transfer of EUR 500 million from the State Pension Fund to central government. In 2016–2019 the surplus in earnings-related pension funds will continue to weaken, dropping to 0.8% of GDP in 2019. The growth of revenue from pension contributions and the increase in interest revenue that will follow with the rebounding of the economy will not be enough to halt the narrowing of the surplus, as pension expenditure will continue to grow rapidly over the medium term.

Investment portfolio of pension funds by type of investment (all members)



Source: The Finnish Pension Alliance TELA

Table 25. Finances of social security funds[1)]

	2012	2013*	2014*	2015**	2016**	2017**
	EUR billion					
Investment income	3.8	3.7	3.5	3.5	3.8	3.9
Social security contributions	25.5	25.9	26.3	27.1	27.7	28.4
of which contibutions paid by employers	17.7	17.9	17.9	18.3	18.7	19.1
contributions paid by insured	7.8	8.0	8.4	8.7	8.9	9.4
Transfer from general government	12.3	12.9	13.5	13.6	13.6	14.6
Other revenue	0.5	0.5	0.6	0.6	0.6	0.6
Revenue	**42.0**	**43.0**	**43.9**	**44.7**	**45.6**	**47.6**
Consumption expenditure	3.6	3.5	3.6	3.7	3.8	3.9
Social security benefits and allowances	30.6	32.8	34.4	35.6	36.8	38.9
Other outlays	2.7	2.9	3.0	3.7	3.3	3.4
Expenditure	**36.9**	**39.2**	**41.0**	**43.0**	**43.9**	**46.2**
Net lending (+) / net borrowing (-)	**5.2**	**3.8**	**2.9**	**1.7**	**1.8**	**1.4**
Earnings-related pension schemes	4.8	3.7	3.5	2.5	2.7	2.3
Other social security funds	0.4	0.0	-0.6	-0.8	-1.0	-1.0
Primary balance [2)]	3.5	2.0	1.3	0.5	0.6	0.1

[1)] As calculated in the National Accounts.

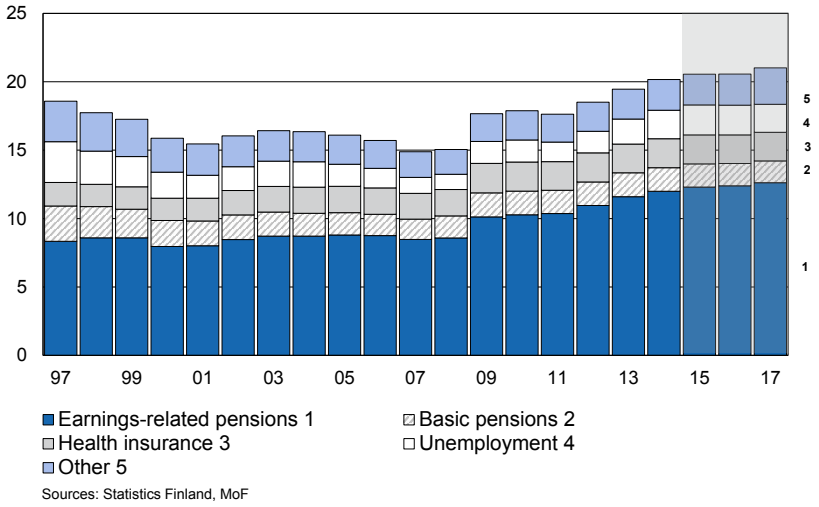
[2)] Net lending before net interest expenses.

2.4.2 Other social security funds

Other social security funds include the Social Insurance Institution (Kela) and the Unemployment Insurance Fund, which are responsible for the provision of basic security and for earnings-related unemployment security, respectively. The expenditure of other social security funds increased by 5.5% in 2014. The sharp rise in expenditure that has continued for more than a year is attributable to an increase of some 15% in earnings-related unemployment security expenses and in basic unemployment security. Sickness insurance expenditure increased by 2% last year, somewhat more slowly than the average for the past few years. Because of the growth of unemployment expenditure other social security funds fell into a deficit of 0.3% of GDP last year, even though transfers from central and local government to other social security funds increased by EUR 460 million from the previous year.

It is forecast that unemployment-related expenditure will still rise in 2015, but then begin to fall with lower levels of unemployment towards the end of the outlook period. Unemployment expenditure will be reduced by the decision to cut earnings-related unemployment expenditure by EUR 50 million from 2015. Furthermore sickness insurance expenditure will be reduced by EUR 51 million from this year. Despite these savings sickness insurance expenditure is projected to increase on average by over 2% a year over the outlook period. There will also be expenditure savings as a result of the 0.4% increase in the national pension index in 2015, which is 0.7 percentage points less than the normal adjustment for inflation.

Benefits, allowances and medical care reimbursements
% of GDP



Sources: Statistics Finland, MoF

In 2015–2019 it is estimated that other social security funds' expenditure will increase on average by 2% a year. Employees' and employers' sickness insurance contribution decreased by 0.06 percentage points from the beginning of 2015. Employees' unemployment insurance contribution increased by 0.15% and the average employer contribution increased by 0.13 percentage points. Despite the increases in the unemployment security contributions, the growth of unemployment expenditure will drive the unemployment security fund, and by the same token other social security funds into a deficit of 0.4% of GDP this year. In the medium term other social security funds will be close to balance. The relative contributions of the local government sector and central government to Kela financing will be revised in 2015 as local governments assume responsibility for the financing of labour market subsidies for the long-term unemployed. From the beginning of 2017 Kela will take over from local governments the task of calculating and making payments of basic income support.

Table 26. Social security contributions rates and pension indices

	2012	2013	2014	2015	2016*	2017**
SOCIAL INSURANCE CONTRIBUTIONS [1]						
Employers						
Sickness insurance	2.12	2.04	2.14	2.08	2.12	2.12
Unemployment insurance	2.32	2.32	2.20	2.33	2.33	2.33
Earnings-related pension insurance	17.35	17.35	17.75	18.00	18.05	18.15
Local government pension insurance	23.60	24.00	23.79	23.65	23.80	23.50
Employees						
Sickness insurance	2.04	2.04	2.16	2.10	2.16	2.18
Unemployment insurance	0.60	0.60	0.50	0.65	0.65	0.65
Earnings-related pension insurance	5.45	5.45	5.85	6.00	5.95	6.25
Pensioners						
Sickness insurance	1.39	1.47	1.49	1.49	1.51	1.53
Pension indices						
Earnings-related index (over 65)	2407	2475	2509	2519	2528	2564
National pension index	1565	1609	1630	1637	1640	1663

[1] Annual averages. The contributions of employers and the unemployment and employment pension contributions of beneficiaries as percentages of wages and salaries. The figures are weighted averages.

2.5 Long-term sustainability of public finances

Despite the adjustment efforts, it is anticipated that balance will not be restored in public finances over the medium term, and that the public debt to GDP ratio will continue to rise. The challenge of balancing public finances is further compounded by population ageing, which is driving up pension expenditure as well as health care and long-term care costs. The slowdown of productivity growth and stalling labour input growth are in turn curbing economic growth and therefore slowing the growth of tax revenue.

The long-term balance of general government is measured by the sustainability gap, which is the current value of future public finance deficits. The sustainability gap indicates the extent of medium-term adjustment necessary in public finances in order to prevent public debt from spiralling out of control, in the long term, as a result of rising age-related expenditure.

The MoF Economics Department's assessment of the long-term sustainability of public finances is based on EU harmonized methods and calculation rules. The assessment of age-related expenditure is based on a model developed by the Ministry of Social Affairs and Health for social expenditure analysis. The background assumptions (employment, productivity, interest rate and inflation) are based on those published last year for the report by the EU Economic Policy Committee's Ageing Working Group, which will come out in 2015.[1]

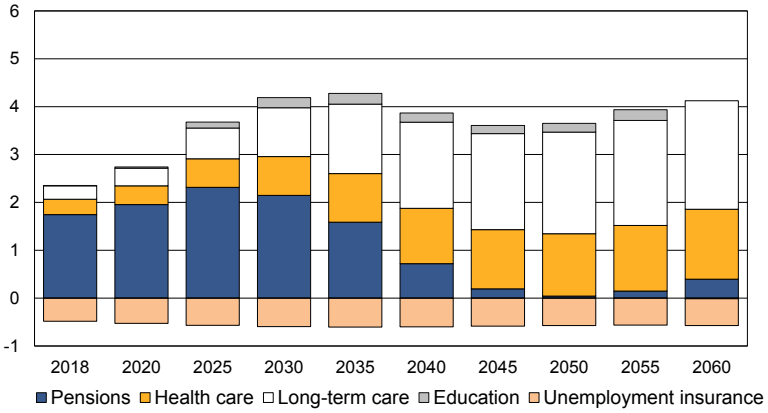
According to these assumptions productivity will increase on average by 1.4% in 2019–2060. The Ageing Working Group's assumptions are not followed in projections of demographic trends, which are based instead on Statistics Finland's 2012 population projection; or in the 2015–2019 projections of economic development, which are based on the MoF Economic Department's economic forecast presented in this outlook.

Taking account of the pension reform that is scheduled for implementation from the beginning of 2017 reduces the sustainability gap in public finances by around one percentage point. It is projected that the reform will both increase the employment rate and reduce pension expenditure. However the assessment of the medium-term structural position of public finances has deteriorated significantly from last autumn, which has increased the sustainability gap estimate by some two percentage points. The sustainability gap is estimated at around 5% of GDP at an annual level in 2019.

The sustainability projection is in essence a pressure projection that reflects future trends under the existing set of rules based on long-term population projections, the weight of spending in different age groups, and economic development. The further one reaches ahead of time with the projection, the greater the uncertainty, which is why the projection is highly sensitive to the assumptions on which it is based. Sustainability gap calculations are nonetheless useful tools in providing a consistent way of analysing the future challenges and opportunities that lie ahead for public finances.

[1] The 2015 Ageing Report: Underlying Assumptions and Projection Methodologies, European Economy 8/2014.

Change in age-related expenditure
from year 2012, % of GDP



The figure is compiled using the model developed by the Ministry of Social Affairs and Health for social expenditure analysis.

Source: MoF

Table 27. General government finances 2013–2060, % of GDP

	2013	2019	2030	2040	2060	2060-2013
	% of GDP					change, %
Total expenditure	57.8	57.8	63.4	65.3	72.5	14.7
of which age-related and unemployment expenditure	29.3	30.7	32.3	32.0	32.2	2.9
Pensions	13.4	14.5	14.8	13.4	13.1	-0.3
Old-age pensions	12.1	13.3	13.6	12.3	12.3	0.2
Other pensions	1.3	1.2	1.2	1.1	0.8	-0.5
Health care	6.1	6.3	6.8	7.1	7.5	1.3
Long-term care	2.2	2.4	3.1	3.9	4.4	2.2
Education	6.1	6.1	6.3	6.3	6.1	0.0
Unemployment	1.5	1.3	1.2	1.2	1.3	-0.2
Interest expenditure	1.3	1.1	5.1	7.3	14.3	13.0
Total revenue	55.2	55.4	56.7	55.9	55.4	0.1
of which: property income	3.3	3.5	4.8	4.0	3.5	0.2
Net lending *)	-2.5	-2.4	-6.6	-9.4	-17.1	-14.6
of which: transfer to pension funds	1.8	0.8	0.8	1.3	1.2	-0.6
General government debt	55.8	67.8	106.0	152.2	293.5	237.8
General government assets, consolidated	119.5	124.4	110.6	94.9	88.0	-31.6
Pension funds`financial assets, consolidated	77.5	82.4	75.6	66.0	66.8	-10.7

*) Cyclically-adjusted net lending as of 2019.

Table 28. Underlying assumptions

	Assumptions, %			
	2019	2030	2040	2060
Labour productivity growth	0.8	1.4	1.5	1.5
Real GDP growth	1.2	1.5	1.8	1.6
Participation rate				
males (15-64)	77.3	77.5	77.3	77.7
females (15-64)	74.2	74.9	75.3	76.2
total (15-64)	75.8	76.2	76.3	77.0
Unemployment rate	7.6	6.9	6.8	7.2
Old-age dependency ratio*	36.3	43.8	44.8	49.8
Inflation	1.8	2.0	2.0	2.0
Real interest rate	0.1	3.0	3.0	3.0
Real return of asset	0.7	3.5	3.5	3.5

*** the ratio of people aged over 64 to those aged 15–64**

Souce: Ministry of Social Affairs, Statistics Finland, Ministry of Finance.

Appendix 1

Changes from the previous forecast

Table 1. Evolution of forecasts over time1

	2014*				2015**				2016**				2017**
	eb1	es2	es3	es1	eb1	es2	es3	es1	eb1	es2	es3	es1	es1
GDP at market prices, change in volume, %	0.2	0.0	0.1	-0.1	1.4	1.2	0.9	0.5	1.6	1.4	1.3	1.4	1.5
Consumption, change in volume, %	0.3	0.1	0.1	-0.1	0.3	0.3	0.3	0.4	1.0	0.9	0.7	0.7	0.8
Exports, change in volume, %	-0.5	0.4	1.7	-0.4	4.6	4.0	3.3	1.5	4.8	4.6	4.2	3.0	3.5
Unemployment rate, %	8.5	8.6	8.6	8.7	8.4	8.5	8.8	8.8	8.1	8.2	8.6	8.6	8.3
Consumer price index, change, %	1.3	1.1	1.1	1.0	1.7	1.5	0.8	0.3	1.9	1.8	1.7	1.4	1.7
Central government net lending, % of GDP	-3.7	-3.4	-3.2	-3.7	-2.4	-2.6	-2.5	-3.2	-2.2	-2.3	-2.3	-3.1	-2.8
General government net lending, % of GDP	-2.6	-2.7	-2.7	-3.2	-1.7	-2.4	-2.6	-3.4	-1.4	-1.7	-2.1	-3.2	-3.1
Central government debt, % of GDP	49.3	47.6	46.6	46.6	49.8	48.5	48.0	48.7	50.0	49.0	48.7	50.2	51.6

[1] Release date: Economic Bulletin 18.6.2014 (eb1), Economic Survey 15.9.2014 (es2), Economic Survey 17.12.2014 (es3) and Economic Survey 2.4.2015 (es1).

Sources: Statistics Finland, MoF

Table 2. Outturn data and forecasts used in budget process for 2010-2014

	Years 2010-2014		Average forecast errors	
	Forecast averages, % ch.	Outcome averages, % ch.	Forecast under-/over-estimation[1], pp.	Magnitude of forecast error[2], pp.
GDP (volume)	1,4	0,8	0,5	2,3
GDP (value)	3,5	2,8	0,6	2,5
Private consumption (value)	3,3	3,4	-0,2	2,1
Current account, % of GDP	0,5	-0,8	1,4	1,6
Inflation	2,3	2,0	0,3	0,7
Wage bill	2,9	2,2	0,7	1,3
Unemployment rate	8,5	8,2	0,3	0,7
Central government debt, % of GDP	45,6	43,7	1,9	1,9
Central government net lending, % of GDP	-3,9	-4,0	0,1	0,7
General government net lending, % of GDP	-2,0	-2,3	0,3	1,2

Forecasts are compared with March preliminary national accounts data.
Averages for the past five years are calculated on the basis of spring and autumn forecasts concerning the budget year.

[1] Over- or understimation is indicated by average forecast error. [2] The average of absolute error values indicates the average magnitude of forecast errors, regardless of the direction of error.

Appendix 2

Recent policy measures

7 August 2014

The Government approved the general budget of the European Union for 2015 as adopted by the European Commission on 25 June 2014. The Government submitted to Parliament a communication on the Commission's proposal containing the new draft general budget of the European Union for the financial year 2015.

27–28 August 2014

The Government agreed on the 2015 budget proposal. The proposal is essentially based on decisions made in the general government fiscal plan last spring and in the government programme in June. In its budget discussions the Government also agreed on a supplementary budget proposal for 2014 and on measures to step up implementation of the structural policy programme.

Proposed appropriations for 2015 come to EUR 53.7 billion, around one billion less than budgeted for 2014, including supplementary budget proposals. The reduced level of appropriations is due to earlier expenditure savings decisions, which will have a much greater impact next year than this year. The Government's earlier adjustment decisions will reduce net central government spending in 2015 by some EUR 2 billion compared with savings achieved in 2014. It is estimated that the net effect of the tax changes put in place during 2015 will increase central government tax revenue by some EUR 0.3 billion. All in all, the savings and revenue enhancement measures decided upon by the Government during its term in office will contribute to strengthen central government finances by 2.5% of GDP at an annual level in 2015. It is estimated that on-budget revenue in 2015 will come to around EUR 49.2 billion, with tax revenue accounting for some EUR 40.0 billion. Central government tax revenue is expected to increase by some 2% in 2015. This growth will be driven by the expansion of tax bases and new tax base changes.

The 2015 budget proposal predicts that the deficit will shrink by almost EUR 3 billion to EUR 4.5 billion At year-end 2015, government debt is projected to stand at around EUR 102 billion, or 48.5% of GDP.

In 2015, central government transfers to local government will be around EUR 9.9 billion, with imputed central government transfers accounting for around EUR 9.0 billion. Government aid will decrease by some 5% compared with 2014. Savings in central govern-

ment transfers to local government will reach EUR 188 million. The universities of applied science funding reform will also contribute to lower the amount of central government transfers, although overall the reform will be cost neutral between central and local government. It is projected that in national accounts terms, local government finances will remain firmly in deficit in 2015.

The second supplementary budget proposal for 2014 foresees a reduction of EUR 233 million in on-budget revenue and an increase of EUR 95 million in appropriations. These adjustments will increase the central government net borrowing requirement by EUR 327 million, bringing the total to EUR 7.4 billion in 2014. In line with Prime Minister Stubb's government programme, the second supplementary budget proposal for 2014 allocates additional resources to boost growth and employment. In particular, supplemental appropriations are provided for transport and infrastructure projects. Net tax revenue estimates are revised downwards by EUR 360 million. Revenues from several indirect taxes are expected to fall given the weaker economic outlook and reduced tax receipts. Projected value added tax revenue, for instance, is down by EUR 247 million.

4 September 2014

The Government submitted to Parliament its second supplementary budget proposal for 2014. Net revenue is projected to decrease by EUR 233 million, and net appropriations to increase by EUR 95 million. The second supplementary budget proposal for 2014 thus shows a deficit of EUR 327 million. Central government net borrowing in 2014 is estimated at EUR 7.4 billion.

The ECB Governing Council decided to lower the interest rate for the Eurosystem's main refinancing operations to 0.05%, with effect from the operation to be settled on 10 September 2014.

15 September 2014

The Government submitted to Parliament its proposal for the 2015 budget.

2 October 2014

The Government decided to adopt the 2015 draft budgetary plan. Draft budgetary plans are part of the coordinated surveillance exercise that takes place annually in the autumn. The draft budgetary plan should allow the identification of any departures from the budgetary strategy outlined in the most recent Stability Programme. It shall include information on macroeconomic forecasts and assumptions, budgetary targets, public expenditure and revenue forecasts under a no-policy-change scenario, expenditure and revenue targets, discretionary measures included in the draft budget, the targets set by the Union's Strategy for Growth and Jobs and country-specific recommendations, comparisons between the most recent Stability Programme and draft budgetary plan, as well as a methodological annex. The 2015 draft budgetary plan is based on the 2015 budget pro-

posal submitted by the Government to Parliament on 15 September 2014, which in turn is largely based on the spring 2014 spending limits decision, the 2014 supplementary budgets and the 2015 basic public services budget.

10 October 2014

Parliament adopted the second supplementary budget for 2014. Parliament decided that the second supplementary budget for 2014 will be put into effect as of 15 October 2014.

21 October 2014

The Government decided on the third supplementary budget proposal for 2014. The net revenue estimate is increased by EUR 601 million. Projected tax revenue is up by EUR 317 million, and appropriations are increased by a net of EUR 77 million. The supplementary budget proposal includes several revisions of appropriations with opposite effects. The third supplementary budget proposal for 2014 lowers the central government net borrowing requirement by EUR 523 million, reducing central government net borrowing in 2014 to EUR 6.9 billion. Based on the budgeted figures, central government debt at year-end 2014 is estimated to stand at EUR 96.6 billion. The 2014 unallocated reserve will come in at EUR 123.8 million.

23 October 2014

The Government submitted to Parliament the third supplementary budget proposal for 2014.

13 November 2014

The Government submitted to Parliament its proposal for an amendment to the third supplementary budget proposal for 2014. The proposal increases the need for central government borrowing by EUR 90 million. Proposed central government net borrowing for 2014 is EUR 7.0 billion.

17 November 2014

The Government agreed on amendments to the 2015 budget proposal. The proposed amendments foresee additional appropriations of EUR 107 million and a reduction of EUR 97 million in estimated revenues. The supplementary budget proposal increases the central government net borrowing requirement by some EUR 203 million. Central government net borrowing in 2015 would thus amount to EUR 4.7 billion.

20 November 2014

The Government submitted to Parliament its proposal for an amendment to the 2015 budget proposal.

25 November 2014

Parliament adopted the third supplementary budget for 2014 and the amendment to the third supplementary budget for 2014. Parliament decided that the third supplementary budget for 2014 will be put into effect as of 1 December 2014.

4 December 2014

The Government submitted to Parliament its proposal to amend the Act on the implementation of regulations under the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (EMU) and the application of the Treaty as well as requirements concerning multiannual frameworks for public finances. It is proposed that the act be amended to include provisions concerning the independence of economic forecasting activities as required by the EU regulation for monitoring and assessing draft budgetary plans. According to the proposal the head of the Ministry of Finance department responsible for economic forecasting shall independently resolve matters concerning macroeconomic forecasts that inform budgetary and fiscal planning.

5 December 2014

The Ministry of Finance set the base rate at 0.25% as of 1 January 2015 through to the end of June 2015. The base rate has been 0.5% since 1 July 2014.

19 December 2014

Parliament adopted the 2015 budget and the amendment to the 2015 budget. Parliament decided that the 2015 budget will be put into effect as of 1 January 2015.

6 February 2015

The President of the Republic ratified the amendment to the Act on the implementation of regulations under the Treaty on Stability, Coordination and Governance in the Economic and Monetary union (EMU) and the application of the Treaty as well as requirements concerning multiannual frameworks for public finances. The act is amended to include provisions concerning the independence of economic forecasting activities as required by the EU regulation for monitoring and assessing draft budgetary plans. The Act enters into force on 9 February 2015.

9 February 2015

The Government discussed the 2015 supplementary budget proposal. Given the foreseen EUR 36 million reduction in revenues and the EUR 312 million increase in appropriations, the 2015 supplementary budget proposal increases the central government borrowing requirement by EUR 348 million, pushing up net borrowing in 2015 to EUR 5.1 billion. Central government debt at year-end 2015 is estimated to stand at around EUR 100 billion, or some 48% of GDP.

12 February 2015

The Government submitted to Parliament its 2015 supplementary budget proposal. The proposal foresees a reduction of EUR 36 million in net revenue and an increase of EUR 312 million in net appropriations. The supplementary budget proposal for 2015 increases the net borrowing requirement by EUR 348 million. Central government net borrowing in 2015 is estimated at EUR 5.1 billion.

24 February 2015

The Government submitted to Parliament its proposal for an amendment to the 2015 supplementary budget proposal.

Sources: Parliament documents search, Valtioneuvoston viikko publication, Ministry press releases, ECB bulletins

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