Economic Survey

Summer 2015


MINISTRY OF FINANCE

Economic Survey

Summer 2015

Ministry of Finance publications – 24c/2015

Economic Prospects

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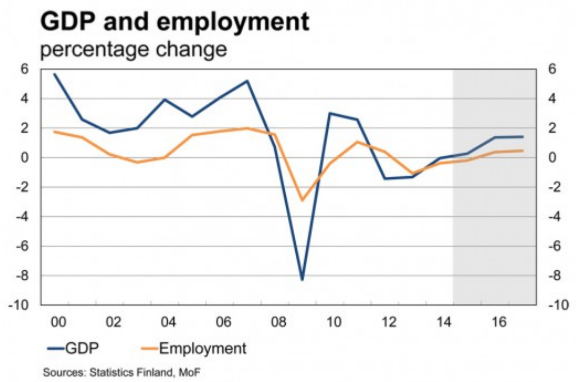
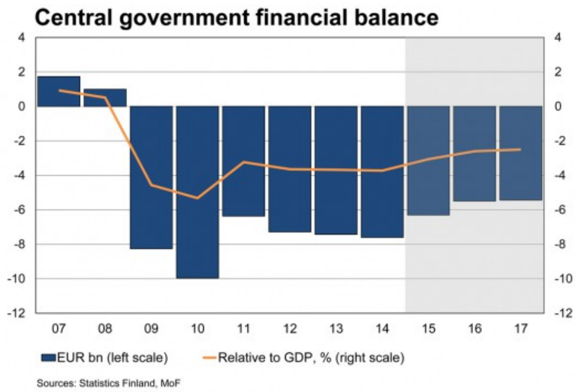
Summary

- Finland's GDP growth forecast for 2015 is 0.3%. In 2016 and 2017, GDP growth will pick up to 1.4%.
- Employment trends in early 2015 have been weaker than anticipated. Sluggish economic growth will do nothing to improve this year's employment prospects. Unemployment has continued to rise even more sharply than predicted. The projected unemployment rate for 2015 is 9.3%.
- Exports of goods and services showed very modest gains early in the year, and it is predicted that exports will increase by no more than 0.3% this year. In 2016 and 2017 export growth will accelerate to over 3% as economic growth gathers pace in the euro area.
- Positive private consumption trends are supported by increasing household real disposable income and improving consumer expectations, which will drive private consumption to growth of 1.2% this year.
- Output has shown practically no growth in Finland for the past three years. Economic growth is rebounding unevenly, as economic activity in 2015 will be maintained by only a few private service branches and primary production. Industry and construction are contracting the economy.
- In 2014 the Finnish general government deficit breached the 3% of GDP reference value. Finland will remain in breach of this limit in 2015, but the deficit will shrink in response to adjustment measures and rebounding economic growth and remain under the 3% threshold in 2016. The general government debt to GDP ratio, on the other hand, will continue to rise, albeit at slower pace.
- Domestically, the 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 our competitor countries. An improvement in public finances is only possible under conditions of favourable real economic development.





Key forecast figures

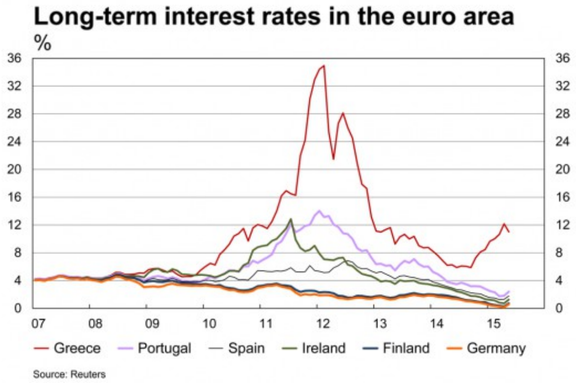
	2014* EUR bn	2012	2013*	2014*	2015**	2016**	2017**
		change in volume, %					
GDP at market prices	204	-1.4	-1.3	0.0	0.3	1.4	1.4
Imports	77	1.6	-1.6	-1.4	1.1	3.4	3.8
Total supply	**281**	**-0.6**	**-1.4**	**-0.4**	**0.5**	**1.9**	**2.0**
Exports	76	1.2	-0.7	-0.7	0.3	3.3	3.7
Consumption	164	0.4	-0.2	0.0	0.9	0.7	0.7
private	113	0.3	-0.6	-0.1	1.2	0.8	0.8
public	51	0.5	0.6	0.2	0.2	0.3	0.4
Investment	41	-2.2	-5.3	-5.1	-1.0	4.6	4.2
private	32	-3.2	-7.3	-6.5	-2.0	5.7	5.4
public	8	2.6	4.0	0.6	3.2	0.3	-0.2
Total demand	**281**	**-0.6**	**-1.1**	**-0.7**	**0.4**	**1.9**	**2.0**
domestic demand	205	-1.2	-1.3	-0.7	0.4	1.4	1.4

Other key forecast figures

	2012	2013*	2014*	2015**	2016**	2017**
GDP, EUR bn	200	202	204	206	212	218
Services, change in volume, %	0.6	-1.6	0.9	0.8	1.5	1.5
Industry, change in volume, %	-8.5	-1.5	-1.6	-1.3	2.2	2.9
Labour productivity, change, %	-2.1	0.4	0.4	0.5	1.2	1.5
Employed labour force, change, %	0.4	-1.1	-0.4	-0.2	0.4	0.4
Employment rate, %	69.0	68.5	68.3	68.5	68.8	69.1
Unemployment rate, %	7.7	8.2	8.7	9.3	9.0	8.7
Consumer price index, change, %	2.8	1.5	1.0	0.1	1.2	1.4
Index of wage and salary earnings, change, %	3.2	2.1	1.4	1.1	1.1	1.2
Current account, EUR bn	-3.9	-2.9	-2.3	-1.3	-1.1	-1.1
Current account, relative to GDP, %	-1.9	-1.4	-1.1	-0.6	-0.5	-0.5
Short-term interest rates (3-month Euribor), %	0.6	0.2	0.2	0.0	0.1	0.2
Long-term interest rates (10-year govt. bonds), %	1.9	1.9	1.4	0.6	0.8	1.2
General government expenditure, relative to GDP, %	56.1	57.8	58.6	59.1	58.4	57.9
Tax ratio, relative to GDP, %	42.7	43.9	44.2	44.7	44.5	44.0
General government net lending, relative to GDP, %	-2.1	-2.5	-3.2	-3.2	-2.5	-2.4
Central government net lending, relative to GDP, %	-3.6	-3.7	-3.7	-3.1	-2.6	-2.5
General government gross debt, relative to GDP, %	52.9	55.8	59.3	62.3	63.8	64.8
Central government debt, relative to GDP, %	42.0	44.4	46.6	48.7	49.8	50.8

Introduction

Economic growth in Finland will be slower than in our competitor countries over the next couple of years. Export growth has been muted early in the year, and market shares in international trade will continue to fall in the short term. It is forecast that in 2017, industrial output will be around one-quarter lower than 10 years ago. Without private sector investment in production, the economy's growth potential will not significantly increase.

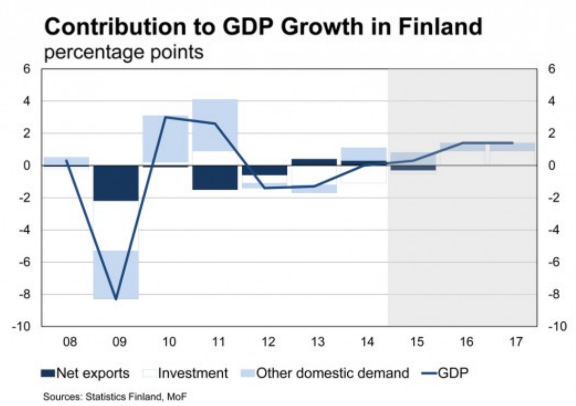


Recent trends in the global economy present a dual picture. Although early 2015 figures from the United States were depressed by exceptional circumstances, the US economy is set to post growth of 2½% this year and around 3% in the next two years. Growth prospects are also good in the UK, and it is projected that overall euro area growth will outpace Finnish growth throughout the outlook period. Among Finland's major competitors, Sweden is expected to post annual growth of around 2½% in the next years ahead, and the growth forecast for Germany is over 1½% a year.

Growth in China will slow over the outlook period. The forecast for 2017 predicts a growth rate of around 6½%. It is forecast that the Russian economy will continue to contract, by 5% in 2015 and by 2% in 2016. The situation in Russia is dire: the country's production machinery is outdated and production structure one-sided.

The forecast's background assumptions are supportive of growth. The monetary policy stance will contribute to support economic activity over the outlook horizon. Short-term interest rates will remain very low, and the three-month Euribor interest rate in 2017 is expected to average 0.2%. The ten-year interest rate will accordingly remain low, standing at 1.2% in the last year of the forecast horizon. The euro to dollar exchange rate is anticipated to drop further, reaching 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 will also benefit Finland's growth prospects. It is expected that the index of wage and salary earnings will rise moderately by just over one per cent over the next couple of years.

Finland's GDP growth forecast for the current year is 0.3%. According to Statistics Finland the growth figure for the first quarter of 2015 was –0.1%. The projection therefore is that growth will rebound in the second quarter. Exports of goods and services showed very modest gains early in the year, and it is predicted that exports will increase by no more than 0.3% this year. Imports, on the other hand, will rise by 1.1%, mainly on the back of increasing private consumption. In other words the contribution of net imports will remain negative in 2015.

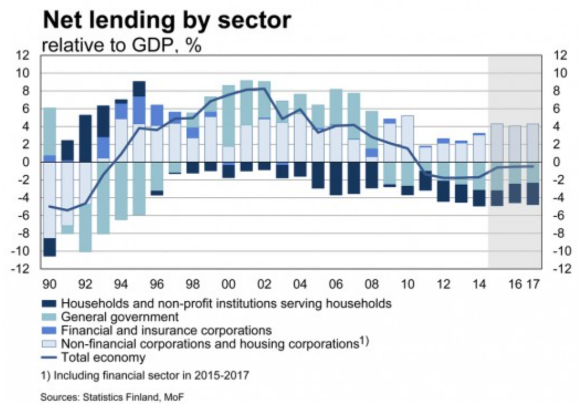


Private consumption will be bolstered by rising real household income and improving consumer expectations. As a result, private consumption will increase by 1.2% this year. Private investment will fall by 1%, mainly because of sluggish investment in building construction and R&D. Investment in machinery and equipment, on the other hand, is slightly picking up. Infrastructure investment will drive public investment to growth of 3.2%. It is forecast that the slide in industrial production will continue for the fifth year in succession, with output falling by –1.3% this year. Service production, on the other hand, is expected to increase by 0.8%.

The labour market situation will remain weak. Unemployment has continued to rise early in the year, and the projected unemployment rate for 2015 is 9.3%. It is also expected that the number of employed persons will fall somewhat. The development of labour productivity will remain subdued. Inflation will be no more than 0.1%, and without tax interventions the figures this year would show deflation.

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. Export growth will continue to remain slower than world trade growth. Exports are projected to increase by 3.3% from the year before, but imports are expected to grow at the same rate and therefore the contribution of net exports will be zero. Overall, it is thought that private investment will develop positively, and investment in building construction will also be up. Investment is mainly being driven by a few major industrial investment projects. Private consumption is expected to increase by 0.8%. On the supply side, it is expected that the five-year slide in industrial production will bottom out and that output will turn to growth of 2.2%. 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. Even so it is expected that the unemployment rate will remain at around 9%. Inflation will pick up slightly, but still come in at no more than around one per cent.

The projected GDP growth rate for 2017 is 1.4%. Growth will be driven by domestic demand, with net exports having only a negligible effect. The forecast is that cumulative growth in 2015–2017 will reach no more than 3.1%, and GDP will remain some 3% lower than at the previous cyclical peak in late 2007.



The protracted downturn and long-term structural problems mean that general government finances will remain in deficit. Previous adjustment measures have curbed, but not stopped the growth of the deficit. The 3% deficit threshold was breached last year. It will also be breached in 2015, but the deficit will contract in response to adjustment measures and rebounding economic growth and remain below the threshold in 2016. Public debt to GDP will continue to rise and exceed the 60% limit.

As far as the global economy is concerned, the risks to the forecast remain skewed to the downside. Even though it is expected that growth will rebound in the euro area and growth prospects are strong for both the UK and the United States, the global 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. Russia's economic performance will be weak over the next few years.

Domestically, the 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 our competitor countries. An improvement in public finances is only possible under conditions of favourable real economic development. It is necessary to stress that the projected economic scenario will not alone be enough to significantly improve the health of public finances in Finland.

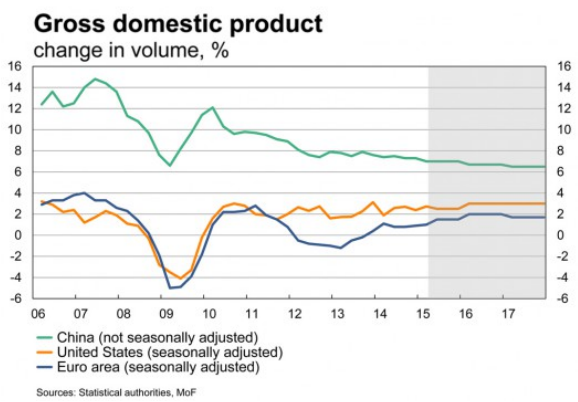
The most crucial factors with respect to the cost competitiveness of the open sector are the prices of production inputs and ease of access to those inputs. Among the factors that can be influenced by means of economic policy decision-making are the incentive effects of the tax system and the efficiency of the labour market. Factors impacting the cost structure have crucial significance in the international competition for market shares. In the absence of restructuring, mismatch problems in the labour market will soon become an obstacle to growth. A predictable economic policy and a determined strategy that addresses the challenges facing public finances will help to create a sense of faith in the future at times of difficulty.

Global economy

Global economy returning to slowly accelerating growth

In the United States, economic growth is resuming its acceleration after the temporary slowdown in the first quarter. Economic activity was sluggish on the back of a difficult winter and industrial action in US ports, which had the temporary effect of reducing demand and slowing the flow of goods. Because of the weight of US private consumption and global value networks, the effects of these temporary factors were felt in many other economies as well.

Growth prospects remain overshadowed by geopolitical tensions in Russia, the Middle East and elsewhere. Confidence has not, however, weakened to the same extent as in some earlier political and currency crises.



Private investment remains at a significantly lower level than before the crisis, especially in industrial countries, and in the euro area private investment has continued to fall. Investment growth will remain subdued. It is held back by low current and especially projected demand, high uncertainty and balance sheet adjustments necessitated by high levels of debt. In crisis-hit countries, investment is furthermore hampered by the high costs and limited availability of financing. Sluggish investment is also contributing to the exceptionally slow growth of world trade.

On the other hand, the reduced price of oil has created a significant demand surge in oil-importing countries starting from the latter half of 2014. In the euro area, for instance, the value of net imports of oil products in 2015 will be more than one percentage point of GDP lower than in 2013, releasing this sum for other consumption or investment purposes.

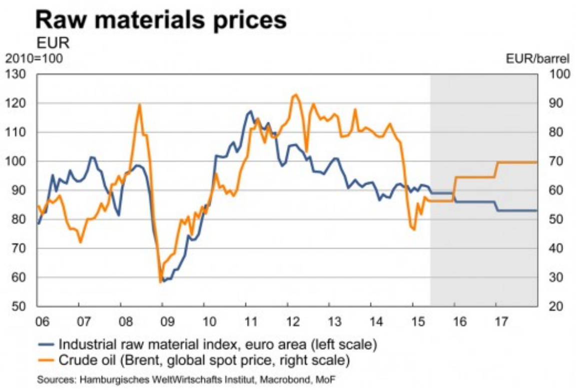
In Europe, the most promising economy at the moment is the UK, which has returned to robust growth despite substantial public sector adjustment. Spain and the Netherlands have, among others, also returned to growth, partly by virtue of earlier restructuring efforts. The fragility of growth in the euro 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.

Persistently high unemployment rates are preventing an acceleration of consumption growth, but consumption growth is also slow in Germany where employment is at record high levels. The German current account surplus will remain high and even increase, which is indicative of low domestic demand. In Europe, high levels of public debt will for some time limit the options available to governments when responding to possible future shocks.

The Chinese economy is beginning to slow after an exceptionally long period of strong growth. If the country is successful in its policy, the slowdown will be well controlled. Brazil and many other developing economies will also see slower growth over the outlook period than has been customary in recent years. Russia will remain in recession.

No threat of a deflationary cycle

The price of crude oil fell sharply in the latter half of 2014, above all due to the deteriorating outlook in developing economies, increasing US production and continued high OPEC supply. It is expected that prices will rebound only very moderately. As energy is used as an intermediate input in virtually all products and services, the effects of the oil price shock will be felt throughout the economy. Given the slowdown of demand from developing economies and high levels of supply, prices for industrial raw materials will continue to fall slowly.



Import and producer prices are falling in several industrial countries. Inflation expectations are extremely low, allowing central banks to persist with an unusual monetary policy stance. Greece is struggling to avoid deflation, but otherwise the weakening of the euro is reducing the risk of prices falling, and there is no real threat of a deflationary cycle in sight.

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 begin to move back to normal during the current year, but in the euro area interest rates will rise only very slowly.

Risks remain on the downside

Households in the euro area 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.

The investment outlook includes a risk for a negative spiral. As investment is being held back by low expected demand, demand for investment will remain subdued as well.

The economic situation in Russia remains dire. If the crisis in Ukraine persists, that would add to the climate of uncertainty and possibly increase the outflow of capital from Russia, reduce investment, and further deepen the recession in Russia. The geopolitical risks may adversely affect confidence and slow growth in the EU.

Extremely 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. Many developing economies in particular have taken out dollar-denominated loans, which may give rise to strong movements of capital.

Supply and demand

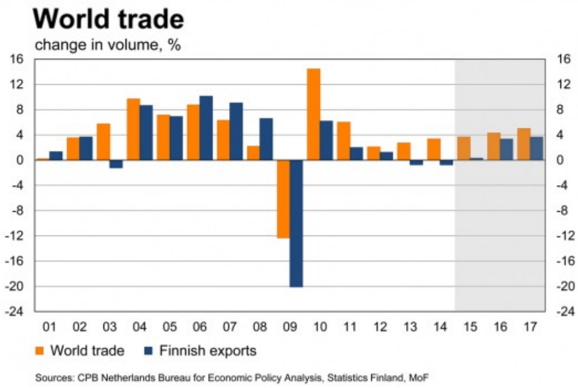
Exports bolstered by economic growth in euro area

According to Statistics Finland's quarterly accounts in June 2015, exports contracted by 0.7% in 2014. In Q1 2015, exports continued to contract by 0.9% quarter-on-quarter. Over the outlook period exports will rebound as economic growth gathers pace in the euro area. The declining euro to dollar exchange rate has the effect of supporting export growth as most foreign trade is settled in dollars or euros.

In 2015 exports will grow by no more than 0.3%. One of the reasons for the disappointing export performance lies in Russia's weak economic situation: exports to Russia have plummeted by 40% since 2010. Even though exports to Russia are not expected to recover quickly, trade with Russia is no longer falling as sharply as before.

In 2016 and 2017 export growth will accelerate to 3.3% and 3.7%. Finland will continue to lose market shares in world trade over the outlook period, but less so than in recent years as a result of accelerating economic growth in the euro area.

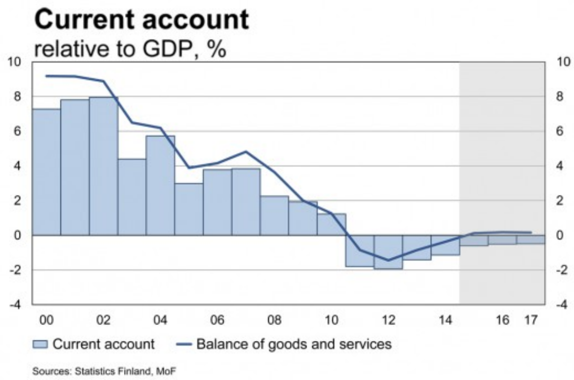
The June quarterly accounts indicate that imports fell by 1.4% in 2014. Nonetheless figures for Q1 2015 show that imports increased by 2.2% quarter-on-quarter. Rebounding investment and consumption will drive imports to accelerating growth as early as the current year, and net imports will contribute to reducing GDP in 2015. Even though export growth will pick up over the outlook period, net exports will not be sufficient to bolster GDP growth.



Current account has turned positive

Import prices are continuing to fall, but this trend has now slowed, and it is expected that prices will begin to rise towards the end of the year on the back of recovering world trade and the weakening exchange rate. A major factor behind the sharp fall in import prices in 2015 is the declining price of oil. Export prices have fallen more slowly than import prices, and the current account has turned positive. The decline in world market prices will bottom out during 2015, and both import and export prices will return to moderate growth. The current account will improve slightly over the outlook period.

The current account deficit has continued to deteriorate in 2015 despite the improving trade balance, because the balance of services has moved deeper into negative territory. In Q1 2015, the current account deficit stood at EUR 2.6 billion, or 1.3% of GDP. Positive net exports mean that the trade balance will strengthen by around one billion euros over the outlook period. The current account will remain in deficit over the outlook period despite the increasing trade balance surplus, as the factor incomes and current transfers balance is regularly showing a deficit of around EUR 1.5 billion. In 2017 the current account will continue to show a deficit of one billion euros, or 0.5% of GDP.

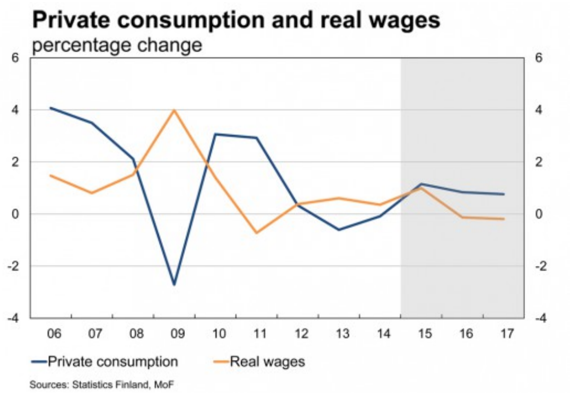


Private consumption to rebound to growth

Private consumption has declined for the past two years with falling disposable real income. Household purchasing power will improve in 2015, and private consumption consequently will return to growth. Real income is being boosted by exceptionally moderate inflation. Improving consumer confidence is also contributing to the growth of consumer demand. Household expectations have improved appreciably in the past six months. Consumers' confidence in their own finances is currently at the long-term average level. Likewise, consumers' expectations concerning the economy in general have become more positive than average.

In Q1 2015, private consumption increased by more than one per cent compared with the year before. Growth was strongest for the demand for consumer durables and services. The number of new car registrations in January–May, on the other hand, was clearly lower than last year. In the short term demand for cars is being dampened by consumer caution as customers are waiting to see how the new car tax rules turn out. In January–April retail sales were down by 0.5% from last year. However retail trade expectations have moved up from their record low levels.

During the spring banks have offered their housing loan holders the option to apply for a 6–12 month loan repayment holiday. In February–April the total value of mortgage rearrangements was over EUR 7 billion higher than in the corresponding period last year. It is estimated that the popularity of loan repayment holidays will drive consumption growth by 0.2–0.4 percentage points this year. On the reverse side of the coin, the use of repayment holidays means that household debt levels will continue to edge up. Private consumption trends are supported by increasing household real disposable income and improving consumer expectations, which will drive private consumption to growth of 1.2% this year.

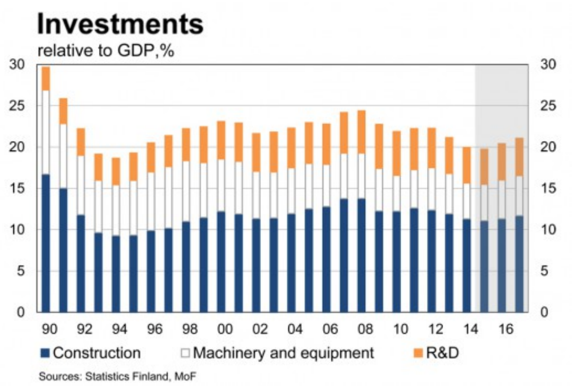


Various steps are needed to adjust public expenditure with a view to strengthening the general government budgetary position and to halting the growth of public debt. Under the new Government Programme public expenditure cuts of EUR 4 billion will be implemented during the parliamentary term. These cuts will reduce the amount of current transfers received by households by a total of EUR 0.8 billion. However, the impacts of these expenditure adjustments on household disposable income will be alleviated by income tax cuts. It is assumed that taxes on earned income will be eased next year so that the tax burden does not increase with higher earnings levels and tax progression. Furthermore, during the outlook period wage earner taxes will be eased via the earned income deduction by a total of EUR 450 million. In 2016 real income growth will be slower than this year, and private consumption growth will also slow to 0.8%.

In 2017 household real income will be unchanged from the year before. Private consumption will increase by close to one per cent, but this requires that consumer expectations remain positive, which is supported by the improving employment situation. In this scenario the household savings rate will continue to fall.

Private investment finally on the up

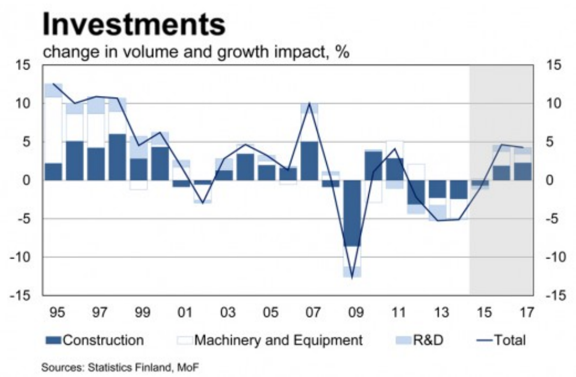
In 2014 investment fell by more than 5%, for the third consecutive year. In Q1 2015, however, private investment turned to modest growth from the previous quarter. This growth was driven by investment in machinery and equipment. It is expected that private investment will continue to grow throughout the outlook period on the back of the strengthening global economy, increasing Finnish exports and an exceptionally large forest industry investment. In annualised terms investment will be down by one per cent on last year, but from 2016 onwards investment will contribute significantly to growth, with annual investment projected to increase by 4–5%.



Investment in new housing development will slowly return to growth, and it is anticipated that renovation investment will continue to show strong, albeit slightly decelerating growth throughout the outlook period.

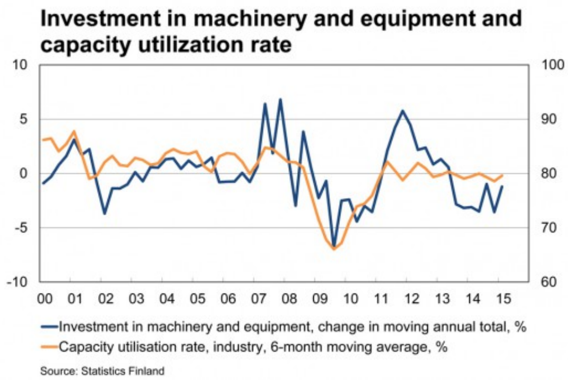
New housing investment is mainly concentrated in urban areas where housing prices and rents have developed more favourably than in other parts of the country. In 2016 and 2017 housing investment will continue to benefit from low interest rates and the gradual reduction of unemployment.

Figures for planning permissions granted suggest that investment in commercial facilities and production-related buildings will continue to fall early in the year. In 2016 and 2017 the construction of retail centres will gather pace, but a growing number of production-related facilities will also be started.



Civil engineering investment has been slightly stronger than predicted both in late 2014 and especially in early 2015. It is expected that growth will remain quite modest over the remaining years of the outlook period. The forecast does not reflect the government's pledges to step up infrastructure investment.

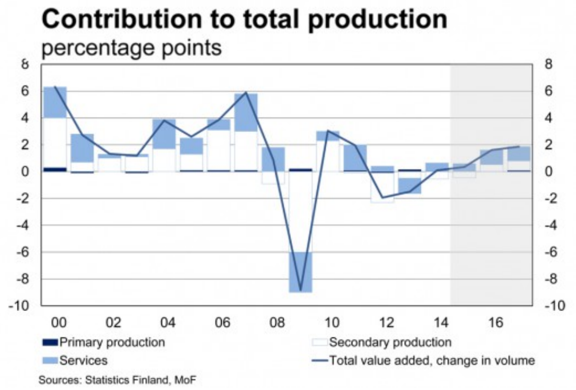
It is predicted that investment in machinery, equipment and transport equipment as well as investment in weapons systems will pick up to show good growth in the next few years. The single biggest factor is the new bioproduct mill in Äänekoski, an investment worth EUR 1.2 billion. The value of the new pulp mill's machinery and equipment alone is EUR 750 million, which represents almost 10% of the annual total investment in machinery, equipment and transport equipment as well as weapons systems. It is anticipated that most of the installation work will take place in 2016–2017.



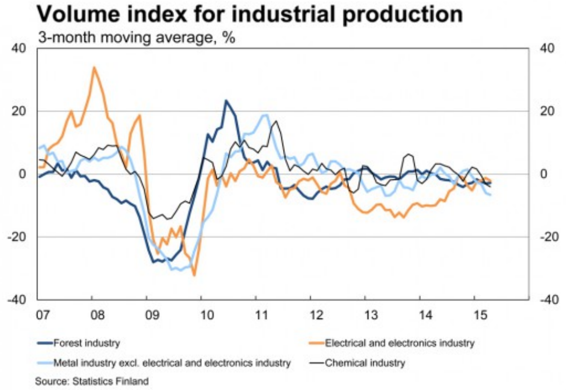
R&D investment as well as software investment declined clearly in the first quarter. The forecast for the current year has already been revised downwards, and the current projection is that R&D investment will be down by some 2% this year. In the next years ahead it will return to moderate growth.

Output growth upheld by private services, secondary production also set to rebound

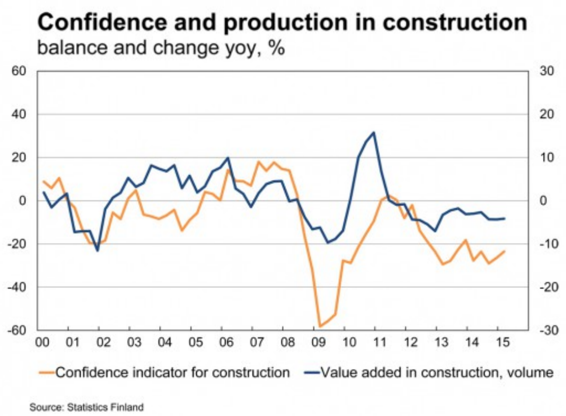
Output has shown practically no growth in Finland for the past three years. Technically, however, GDP is not in recession because over the past year the changes in output have hovered either side of zero. In Q1 2015 national value added was up 0.1% quarter-on-quarter, mainly on the strength of growth recorded in primary production and a couple of private service branches. In other words economic activity is dependent on a few domestic market sectors, while secondary production continued to contract in January–March. As economic growth has mainly come from lower-productivity services, overall productivity per hours worked has declined.



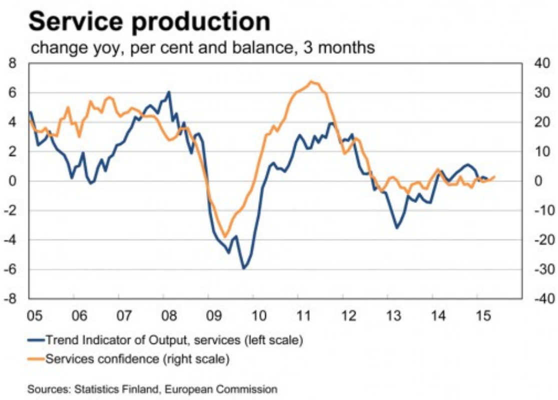
Economic growth is gradually rebounding, but unevenly so. In 2015 economic activity will be maintained by a few private service branches and primary production. The secondary sector, industry and construction, on the other hand, is contracting the economy. Accelerating global trade and growing demand for investment goods will drive output to growth in 2016 and 2017. Restructuring especially in the electronics and forest industry will act to slow growth, despite the improvement in export demand.



The cyclical outlook in industry showed a seasonal improvement early in the year. Nonetheless output expectations were falling in the spring as order books have not improved and stocks have grown. The outlook is brightest in the wood and textile industries. By contrast it is expected that in the next months ahead, output will decline in the paper, construction materials and technology industries. Rebounding export demand and the weakening external value of the euro will boost industry output. In 2015 industry value added will fall by over one per cent, but in 2016 and 2017 it is set to rise by 2% and 3%, respectively.



The outlook for construction is brighter than in late 2014, even though it is not expected that production will increase. Businesses and households are continuing to cut back on their investment, and therefore construction companies' order books are continuing to fall. However, renovation is boosting construction value added, and new building construction will rebound as the rest of the economy gathers steam in 2016 and 2017. In 2015 construction value added will decline for the fourth year in succession, this time by 2½%. In 2016 and 2017 building construction will increase by 2% and 3% on the back of rebounding new housing production.



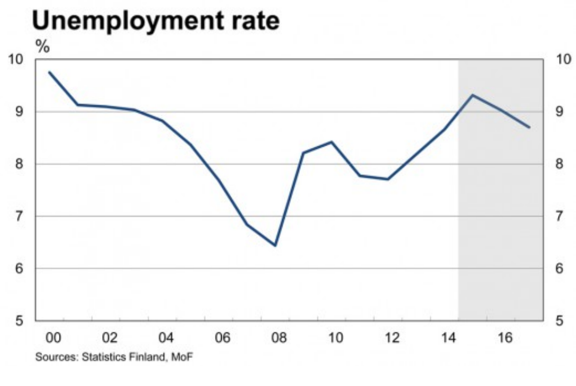
In service industries the cyclical outlook and sales expectations have shown an improvement from the first months of the year. Demand for services has recovered in some individual service branches. Growth prospects this year are strongest in traditional service sectors serving companies as well as in new technology sectors serving consumers. Financial intermediation and insurance sectors as well as real estate services in particular have seen much stronger demand in the spring and are expecting to see an improvement in their sales results. Transport and public services, on the other hand, will continue to decline. The sluggish development of household purchasing power lends no support to wholesale and retail trade. In 2015 service production will increase by almost one per cent. In 2016 and 2017 output will increase by 1½%.

Employment, prices and wages

Unemployment rate to rise clearly this year

Employment trends in early 2015 have been weaker than anticipated. In January–April the number of persons employed was 0.3% lower than during the corresponding period last year. The sluggish economy will do nothing to improve this year's employment prospects, and therefore it is projected that the number of employed persons will remain 0.2% lower than last year, even though employment will turn to moderate growth towards the end of the year.

Unemployment has continued to rise even more sharply than predicted, according to both the sample-based Labour Force Survey (Statistics Finland) and employment service statistics (Ministry of Employment and the Economy). In April the trend of the unemployment rate was 9.6%. The projected unemployment rate for 2015 is 9.3%.



Employment will return to moderate growth and unemployment will begin to slowly edge down with GDP growth in 2016 and 2017. Nevertheless the employment trend will remain weak throughout the outlook period. In 2016 and 2017 it is predicted that employment will improve by 0.4% a year. The unemployment rate is expected to fall back to 9% in 2016 and to 8.7% in 2017.

The continuing growth of long-term and structural unemployment is a particular cause for concern. In April the number of people who had been out of work for more than a year reached 104,200, up more than 15% from one year earlier. According to employment service statistics the number of structurally unemployed people in April was 204,828, more than one-tenth higher than the corresponding figure last year. Even under improving cyclical conditions the high level of structural unemployment will slow the decline in the unemployment rate.

Indeed, one of the major challenges for the new government is to resolve structural unemployment. It is crucial 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. However, the termination of an unemployment spell by labour policy measures cannot be considered a successful intervention if upon completion of these measures the individual returns to unemployment or recurring periods of labour policy measures.

Apart from the lingering weakness of the economy in general, another obstacle to an improvement in the employment situation is presented by regional and occupational mismatch problems between unemployed job seekers and job vacancies. Restructuring has resulted in large numbers of job losses in traditional industries. In recent months, however, the growth of unemployment has been more evenly distributed across all regions and occupational groups, and accordingly among different educational levels. In fact in recent months unemployment has increased more rapidly in higher educated groups.

Figures for both the employment rate and the labour participation rate convey the worrying message that employment has recently fallen most particularly in the age group 25–54 years. The growth of long-term unemployment has also been fastest in this age group. In the oldest age groups both the employment and labour participation 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 should focus on preventing retirement on disability pension and enhancing well-being in the workplace. In the youngest age groups it might also be useful to shorten study times.

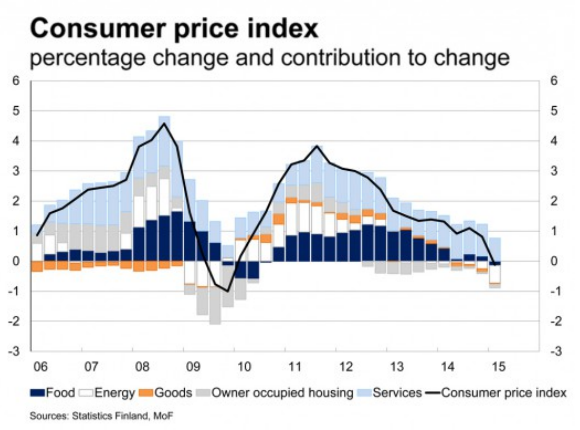
Figures for unemployed job seekers registered with employment offices and Statistics Finland's sample-based Labour Force Survey give a slightly different picture of the level and development of unemployment. Figures for employed job seekers compiled by the Ministry of Employment and the Economy are somewhat higher than those given by Statistics Finland. 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 been growing for several years. In part the discrepancy is explained by the fact that some unemployed people have given up their active search for work because of the weak economic situation. The Statistics Finland concept of unemployment is based on the criterion of active search for work. The difference in the number of people out of work has grown primarily in the age group over 25. The differences between the two sets of figures are also explained by changes in statistical methods and legislation.

No inflationary pressures in sight

There is less inflationary pressure than usual over the outlook period because there is an abundance of idle resources in the economy, the output gap is still clearly negative and future inflation expectations are moderate. The forecast is based on assumptions of slight increases in the price of oil, slowly rising import prices, moderate wage increases and low but gradually rising interest rates.

Inflation began to slow towards the end of last year following the sharp drop in world market prices of oil. In early 2015 the world market price of oil has been clearly lower than last year, and for this reason consumer prices decreased by –0.1% in January–April 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 projected inflation rate, measured by the national consumer index, is 0.1%. There are several reasons for the slower than usual increase in consumer prices, but the single biggest reason is the low price of oil. The forecast assumes that the average price of oil in 2015 will be 56 euros a barrel, which will appreciably reduce consumer prices of domestic energy.



The low price of energy is not the only factor curbing inflation. Early in the year prices of selected foodstuffs have been reduced in response to stiffening competition in daily consumer goods retail. As a result, prices of processed foodstuffs have stopped rising. Service prices will also rise more slowly than before because of moderate wage growth. In recent years service prices have been rising at a rate of almost 3%, much more rapidly than in the euro area on average (1½%).

In 2015 tax hikes will drive up prices. As in 2014, several indirect taxes (including the tobacco tax, electricity tax and annual vehicle tax) 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 around 0.3 percentage points. Without the effects of tax hikes, consumer prices would fall this year.

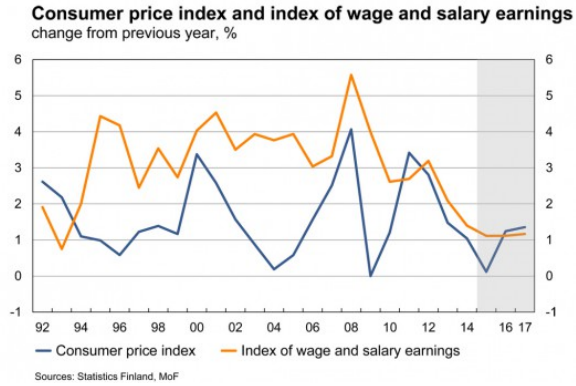
In 2016 and 2017 it is expected that inflation will pick up slightly as the price of oil rises gradually. Nonetheless inflation will edge up to no more than just over 1%, and in 2017 the national consumer price index will rise by 1.4%. The harmonised consumer price index will rise somewhat more slowly towards the end of the outlook period as the slight increase in the interest rate is not directly reflected in the index. Core inflation, which excludes the effect of energy and fresh food prices, will remain slow in 2016 and rise by less than 1%.

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 euro area inflation will be 0.3% in 2015, 1.5% in 2016 and 1.8% in 2017. On this basis the price gap between Finland and the euro area would no longer grow.

Earnings to rise moderately

Nominal earnings, as measured by the index of wage and salary earnings, increased by 1.4% last year. Contractual wages increased by 0.7% and other factors pushed up the index of wage and salary earnings by 0.7%.

In 2015 earnings will develop in line with the framework agreement negotiated by the social partners in the autumn of 2013. The Pact for Employment and Growth will push up contractual wages by an average of 0.5%. If the pact is extended under the same terms as in 2014–2015, contractual wages will increase on average by 0.4% in 2016.



The forecast for the development of earnings is based on the assumption that the contribution of factors other than contractual wage increases will drive up earnings by over half a per cent in both years. Therefore it is predicted that nominal earnings will rise by 1.1% in 2015 and 2016 as measured by the index of wage and salary earnings. This is clearly below the average of the 2000s, and well in line with the sluggish economy and slow employment trends. It is assumed that moderate earnings growth will continue in 2017, rising at a rate of 1.2%.

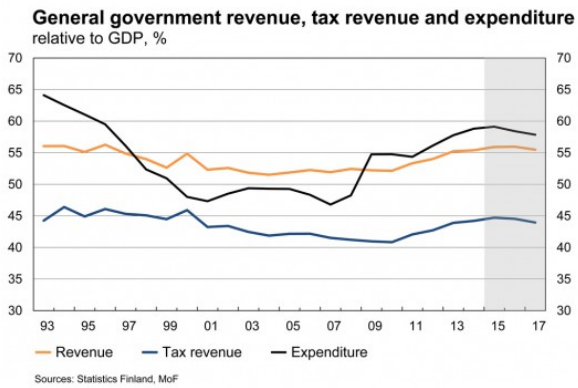
Public finances

The forecast for public finances takes account of the revised macroeconomic forecast as well as those measures announced in the new Government Programme that by June 11 have concretized to a point that it is possible to estimate their impact and that are expected to be included in the new government's first general government fiscal plan in September 2015. Measures planned for implementation after 2016 will be elaborated upon in subsequent stages of preparatory work and taken into account in later forecasting rounds.

For example, the EUR 1.6 billion earmarked for investment in key measures and projects and in the reduction of repair debt are not considered in the forecast. The same goes for the social contract and the additional savings of EUR 1.5 billion put forward as an alternative to the contract. Due to the lowered inflation forecast the impact of indexation freezes is lesser than indicated in the Government Programme.

Public finances have remained firmly in deficit for six consecutive years. This is due to the persistent weakness of the economy as well as longer term structural problems. Earlier adjustment measures have helped to curb, but not stop the growth of the deficit. Public debt has also grown at a rapid pace. Economic growth will remain sluggish over the outlook period, and therefore it will not alone be enough to correct the imbalance in public finances or to turn the debt-to-GDP ratio onto a downward path.

In 2014 the Finnish general government deficit breached the 3% of GDP reference value. In the light of current knowledge Finland will remain in breach of this limit in 2015 as well, but the deficit will shrink in response to adjustment measures as well as rebounding economic growth and remain below the threshold in 2016. The general government debt to GDP ratio, on the other hand, will continue to rise, albeit at slower pace than previously.



Central government finances have been in deficit for several years. It is predicted that the deficit will shrink moderately over the outlook period. The adjustment measures adopted earlier coupled with those introduced by the new government will help to curb the growth of expenditure and therefore prevent the deficit from swelling further. Under the current conditions of sluggish economic growth, tax revenue will increase only slightly over the outlook period. In addition it is expected that central government debt will continue to increase, albeit at a lower rate than previously.

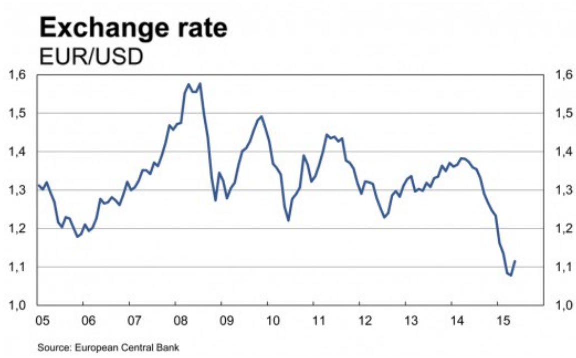
Local government finances will show a deficit of 0.8% to GDP this year. Among the factors weighing on local government finances are the growing need for services, the overall weakness of the economy, as well as measures introduced in earlier years under central government adjustment efforts, such as the cuts to central government transfers to the local government sector. Local government finances are bolstered by local authorities' own adjustment efforts. The average municipal tax rate increased by 0.1 percentage point at the start of the year. Furthermore many local governments increased their real estate tax rates.

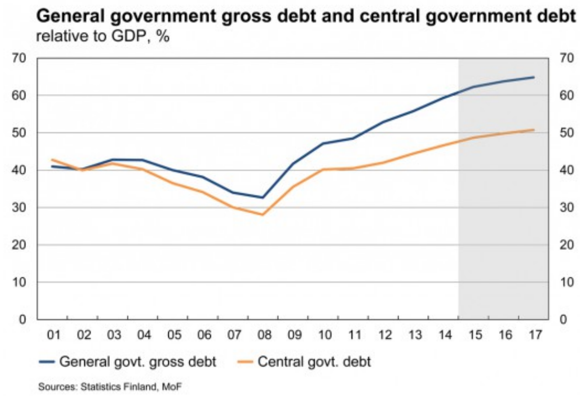
Local government finances will strengthen somewhat in the next years ahead, but still remain firmly in deficit. The local government debt ratio will climb to nearly 10% in 2017. The measures announced in the Government Programme will strengthen the net budgetary position of local government in 2016–2017. Some of these measures, such as the restructuring of upper secondary education and the incentive system designed to reduce specialised health care costs, will be taken into account once the details have become clear in subsequent preparatory work.

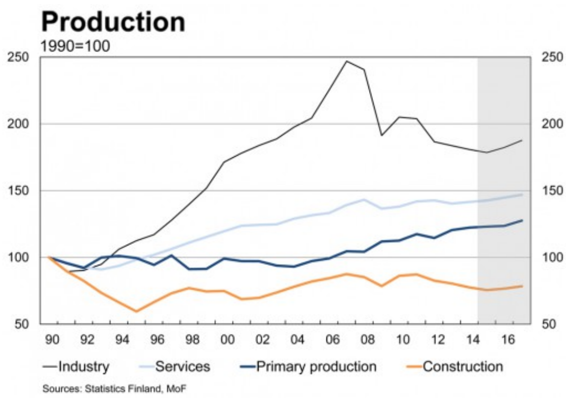
The surplus of earnings-related pension funds will fall from 1.7% of GDP last year to just over one per cent in 2015–2017. The increasing number of pensioners and the higher average level of pensions will drive up pension expenditure over the forecast horizon. The previous government's decision to cap pension indexations at 0.4% will curb the growth of pension expenditure in 2015. At the same time, the additional transfer of EUR 500 million from the State Pension Fund to central government will bring a one-off increase to the fund's expenditure. Rising pension contributions will keep revenue from contributions on an upward trend in 2015, despite slow wage bill growth. In connection with the 2017 pension reform talks it was agreed that the 0.4 percentage point increase in the earnings-related pension contribution planned for 2016 will be postponed to 2017. Although the value of pension assets has recently risen sharply, pension funds' property income will continue to decline in 2015 because of falling interest rates. However it is expected that interest revenue will turn to moderate growth towards the end of the outlook period.

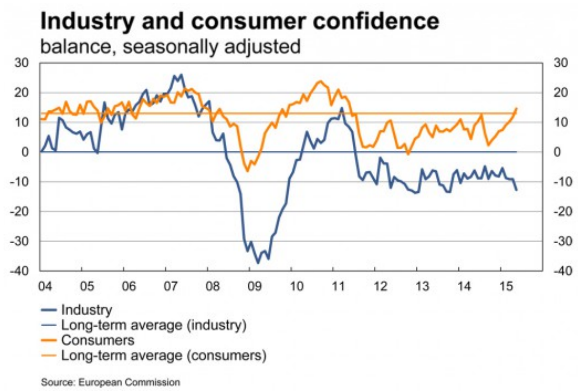
Other social security funds will also remain in deficit in 2015 with the continuing growth of unemployment expenditure. The Unemployment Insurance Fund will continue to accrue debt in 2015, and there is a risk that the ceiling specified for the counter cyclical buffer may be breached towards the end of the outlook period. The forecast therefore assumes that in 2016, the unemployment insurance contribution will have to be increased by an estimated 0.5 percentage points. Due to the contribution hike and the turnaround in the growth of unemployment, it is expected that the deficit of other social security funds will shrink towards the end of the forecast horizon. The savings decisions taken by the previous government coupled with those announced in the new Government Programme will curb the expenditure of other social security funds throughout the outlook period.

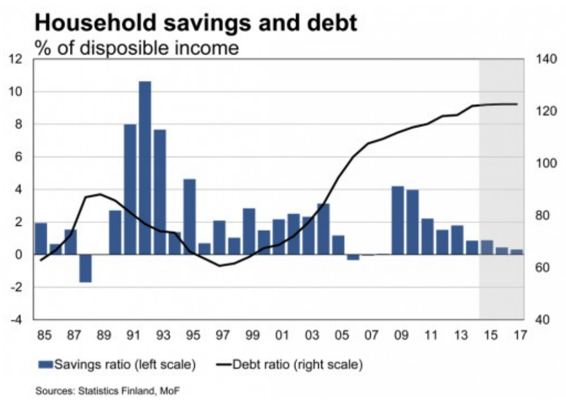
Additional graphs











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