

- *In spite of a weak first quarter this year, the Finnish economy will start growing this year, fuelled especially by domestic demand and exports. GDP growth for 2010 is forecast at 1.5% and at 2.5% for the following two years.*
- *The world economy has recovered swiftly from the collapse caused by the financial crisis, and growth in world trade is expected to be fast in the next two years. Growth in the euro area will be sluggish though.*
- *Employment was better than anticipated in the early months of this year, but will continue to decline. The unemployment rate is estimated to climb to 9.5% this year and the employment rate to drop below 68%.*
- *Private investment will continue to decrease this year, but is forecast to increase in 2011 and 2012. Growth in household income will accelerate this year, as wage and property income will start increasing this year. Once employment starts improving, growth in earned income will further accelerate in 2011 and 2012. Private consumption is predicted to return to a growth path between 2% and 3%.*
- *Domestic price pressure will be moderate over the projection period. Owing to a rise in import and producer prices, inflation will accelerate to 2½% next year.*
- *Accelerated economic growth notwithstanding, the deficit in public finances will slide down to 3.2% of GDP. The deficit in central government finances will increase to 5.7% this year, and central government will remain in deficit in 2011 and 2012 too. The need to borrow in central government will be in the range of EUR 8 billion both in 2011 and 2012.*

Small open economies such as Finland do not have means of protecting themselves against global demand shocks. Before the economic crisis, Finland's economy was in good shape by international standards. The demand-driven downturn impacted the Finnish economy fast and very strongly. GDP plummeted by 8% in 2009, plunging general government finances from surplus into a deficit. Downturns created by a lack in demand are generally fairly short-lived, and it would appear to be the case



this time too. In spite of the drop in the first quarter this year, the **Finnish economy** will turn to a path of growth, with GDP growth forecast at 1½% this year. The assumption in the estimate is that growth will be fast in the latter half of the year. Economic expansion for 2011 is projected at 2½%, with domestic demand being the main engine of growth.

The prevailing uncertainty in the financial markets is a distinct risk in the forecast, especially since the uncertainty mainly involves Finland's key export markets in Europe. In uncertain circumstances, the planning horizons of economic actors tend to shrink and growth potential fails to be utilised. The role of well-coordinated and credible economic policy that dispels uncertainty is crucial in the current circumstances. The assumption in this forecast is that the financial markets will gradually stabilise and that light monetary policy will be in place to boost growth.

WORLD ECONOMY CONTINUES TO RECOVER

The **global economy** is still recovering fast. Our estimate is that world ppp-adjusted GDP growth will expand by over 4% this year and next. Robust support packages and recovery measures have played their part in fuelling growth, with governments using these measures to boost demand, which had dropped during the recession, but also private demand is expected to be strong particularly in developing economies. The main emphasis will be on developing economies such as China, where economic growth is forecast at over 9% this year and around 9% next year.

Growth in world trade is growing strongly. Capacity utilisation rates around the world are beginning to reach pre-recession levels, which is partly hampering growth in trade. World trade is expected to grow by 11% this year and by 8% next year. Imports in developing economies have already exceeded their pre-recession levels. Finland had already lost part of its market share in world trade already before the financial crisis, and has lost more footing during the recent rapid recovery period.

The **United States** economy has also recovered fast. The depth of the US financial markets has dampened the effects of the banking crisis on the real economy. Economic growth is estimated at over 3% for this year and at around 3% for next year. Growth in the US is expected to slow down partly because unemployment is deteriorating and owing to significant adjustment needed in public finances.

EURO AREA GROWTH STILL SLOW

Growth in the **euro area** is still sluggish and is expected to accelerate only slowly. This year's economic growth is forecast at a little over 1% and next year at just below 2%. Imports to the euro area will also be weak. On the one hand, growth is being hampered by stabilisation measures for public sector deficits, but on the other hand, the depreciation in the euro is perking growth. As a rough estimate, these two offset one another. In the medium term, the stabilisation measures in general government finances will boost the outlook in the euro area, as more room is created for private investment and once households can be encouraged to consume.

Economic growth in Russia is expected to accelerate to a good 5% this year and to decelerate slightly in the medium term. The high price level of oil and low capacity utilisation rate are sustaining growth in Russia, although rigidities in the economy, government steering and protectionist measures are hampering growth in the medium range. The Swedish economy is also recovering fast, with growth exceeding 2% this year and expected to reach around 3% next year.

The forecast for the international economy contains risks in both directions. It is still not clear at what level risk premia will settle in the wake of the financial crisis. Low risk premia could accelerate investment and benefit our exports. In the short term, large public sector stabilisation packages could reduce demand and increase unemployment, but in the medium term they might improve consumer and business confidence and pave the way for growth in private demand. Negative risks in the global economy are related to the fragility of economic growth, public sector debt ratios, slow improvement in unemployment rates and uncertainties in developments in the financial markets.

FINNISH EXPORT DEMAND EXPECTED TO STRENGTHEN

Foreign trade was very weak in the first quarter of this year. In April, as the global economy grew and the euro depreciated, and also because deliveries had been postponed owing to the strike by stevedores, export demand accelerated, which started showing up in exports. Especially exports in the forest industry and metal industry boosted exports in April. Export order books in companies have increased, although they are still short of normal levels. Imports remained low into April, although price rises raised the value of imports. Household consumer demand and the use of intermediate consumption in industrial output will raise import demand, but imports in investment goods will remain sluggish.

The rise in world market prices will increase both export and import prices this year. Import prices will rise more sharply than export prices, partly because energy is largely imported. The sustained deterioration in the terms of trade will reduce the trade and current accounts throughout the forecast period. Exports will increase by 5½% and imports by 3½% this year. Both exports and imports will grow quite steadily in the following two years, slackening to some extent by 2012 as international demand starts to weaken.

The surpluses in both the **trade account** and the **current account** have been contracting continuously since 2008, and the near future is not likely to show any deviation from the trend, as Finland's position in the export markets has become weaker and the terms of trade is continuing to deteriorate. However, both the trade and current account will still stay in surplus, though the trade account surplus-to-GDP ratio will slide to 1% over the projection period and that for the current account to ½%.

RECOVERY IN PRODUCTION FUELLED BY EXPORTS...

Output in the **manufacturing industry** rose slightly in the first quarter of this year relative to last year, and growth further improved in April. In the metal industry, growth builds mainly on the processing of metals, but the forest and chemical industries have also clearly grown more. Demand for metal products will improve in 2011 and 2012, as both domestic and foreign investment will accelerate, whereas peak growth in the forest and chemical industries has been surpassed. Output in the manufacturing industry will grow by 4½% this year, accelerating to 6% next year, after which it will start decelerating again. The volume of production recorded in 2008 will not be reached in the next few years.

Output in the service sector in the first quarter of this year stayed at the same level as late last year. Although the volume of production did not grow, turnover in service sector businesses has started growing, by just below 1% on the previous quarter, and job prospects in the service sector have improved. The outlook for the future has become more positive than before, and confidence in service enterprises and employment prospects has improved considerably in the past few months. Likewise, confidence in retail trade and sales expectations suggests that domestic trade will strengthen. Particularly the most recent observations on the trend in new registrations indicate that growth in trade is accelerating. Service production is anticipated to grow by ½% this year, and to further strengthen both in 2011 and 2012. Better household purchasing power and growth in employment are boosting recovery in consumer services. With industrial output and construction picking up, business and transport services are also expected to recover.

...BUT INVESTMENT WILL IMPROVE ONLY AFTER CAPACITY UTILISATION HAS INCREASED

Private investment is forecast to decrease by 2% this year but to increase by 5% next year and by 4% in 2012. The volume of public investment will be the same in 2010 as in 2009, but it will drop in 2011.

The decline in investment slowed down early this year largely thanks to accelerated housing construction. The factors of uncertainty in housing construction and the house markets would appear to have diminished, interest rates have remained low and house prices have returned to the pre-recession level and development path. House starts are expected to increase markedly this year, and the overall volume is anticipated to remain stable or maybe even rise slightly in later years of the projection period. House renovations, too, will be brisk this year but are unlikely to increase much in the next few years. This year, other building construction will decrease from last year, but will pick up again in 2011 and 2012 thanks to brisker economic activity. Civil engineering construction is expected to start expanding in 2011 and 2012, fuelled by other forms of investment. This year, investment in machinery and equipment is estimated to decline, as capacity in the economy is not in full use yet. The capacity utilisation rate in industry is likely to rise towards the end of 2010, following the recovery in demand, and generating more investment in machinery and equipment in 2011 and 2012.

EMPLOYMENT OUTLOOK BETTER THAN ANTICIPATED

Developments in **employment** proved to be better than expected in the early months of this year. The rate of growth in unemployment is decelerating and some minor signs of recovery in labour input demand are on the horizon. Employment prospects are nonetheless still deteriorating. In May this year, there were still 13,000 less employed people than a year ago. Also the number of unemployed persons has decreased. Taking all this into account there is a remarkable increase (43,000 persons) in people outside labour force. The number of people registered in active labour market schemes had risen to 91,000, which accounts for 3½% of the labour force. On the other hand, group and individual redundancies have been decreasing. The unemployment and employment figures for the next few months are crucial when estimating the trend for the whole year; without a relatively ample supply of summer and trainee jobs, 2010 will not turn out to be particularly good in terms of job prospects. There is a risk that the situation will further deteriorate if only a small number of those in active labour market training schemes eventually manage to find a job or new studies and the majority end up unemployed.

A recovery in economic growth impacts employment with a lag, as companies tend to first re-employ staff they might have laid off before, and new recruitment follows only after that. Labour input as measured in terms of hours worked will grow this year already, but the number of employed people will continue to decrease. The unemployment rate is expected to rise to 9.5% and the employment rate to drop to just below 68%.

In 2011, the gradual improvement in the economy and financial policy will have an effect on the labour market. Jobs in industry and services alike will increase. The unemployment rate will edge down to 8.9% and the employment rate will climb to 68.8%. The size of the working age population (15-64-year-olds) is now starting to shrink, and from 2011 the decrease will be around 10,000 to 20,000 people per annum, depending on migration. This shift in the population trend could result in a shortage in labour in some industrial sectors and geographical regions in Finland. At the same time, many people risk prolonged unemployment, meaning that the number of long-term unemployed will grow.

FASTER GROWTH IN PRIVATE CONSUMPTION

Following nearly a year of growth, **private consumption** dipped in the January to March quarter. Household final consumption expenditure was down ½% early in the year from the end of last year, as acquisitions in consumer durables and services were sluggish. Consumers still have confidence in their own prospects, although confidence in the Finnish economy eroded in May. Growth in household income will accelerate this year, as wage earnings and income from assets will increase while income taxes will not be tightened on average. In 2011 and 2012, growth in wage earnings will be faster because employment will rise, so the outlook for growth in consumption is good. Indeed, consumption was back on its growth path in the spring, as especially consumption of consumer durables has increased and consumption in daily consumer goods is brisk. With house purchases having picked up since last year, consumption in semi-durables will also grow. Although the first part of this year was sluggish, private consumption is forecast to increase to around 2%, as acquisitions will grow after the dip in the winter. Household saving will take a downward turn next year and growth in consumption will accelerate to nearly 3% in 2012.

PRICE PRESSURE TO REMAIN MODERATE

The cost impact of last autumn's collective pay bargaining round will be moderate this year, less than 1%. Approximately half of the rise in the **level of wages and salaries** is accounted for by earlier collective agreements and the carryover effect of pay increases at the end of last year. Collective agreements contracted so far this summer are mostly for one year at a time. Some pay settlements are still pending, which makes it very difficult to predict wage developments. Wage earners' earnings are estimated to increase by about 2.6% this year. With next year's collective agreements still open, it is difficult to estimate to what extent economic growth and better job prospects will affect the capacity of companies to handle pay increases and to what extent pressure will mount for pay rises. The Ministry of Finance forecasts the rise in wages and salaries to accelerate to 2.8% in 2011 and to 3% in 2010.

The record fast rise in **unit labour costs** in 2008 and 2009 will level off this year, as growth in productivity will gradually pick up. The rise in labour costs will also ease off. Unit labour costs are not expected to increase this year, but will rise at a rate of around 2% both in 2011 and 2012.

The national price index shows that **consumer prices** in Finland did not rise at all last year. This year prices are estimated to rise 1½%. There is virtually no domestic price pressure, but with world market prices having hiked and the euro depreciated, import and producer prices took a sharp turn upwards early this year. Following higher import and producer prices, consumer prices will increase by an average of 2½% in 2011. Indirect taxation will also raise domestic prices both this year and next. In 2012 consumer prices are expected to be up by a rate of about 2%.

BUDGETARY POSITION IN PUBLIC FINANCES REMAINS WEAK

In the wake of the economic crisis the **budgetary position in public finances** deteriorated exceptionally fast, as total output contracted and unemployment started rising. Despite the gradual mend in economic growth, the general government deficit-to-GDP ratio will continue to slide, down to 3.2% this year. Higher unemployment and stimulatory measures will weaken the budgetary position. However, the budgetary position will strengthen considerably in 2011, once economic growth accelerates, taxation becomes tighter and social security contributions increase. The public debt-to-GDP ratio will continue to grow so that it will exceed 51%, however, owing to central and local government borrowing.

The deterioration in economic activity has been particularly apparent in central government, which comprises tax items that are most sensitive to cyclical fluctuations. With economic growth improving, tax revenue will grow this year. Tougher VAT is boosting tax revenue. Regardless, the deficit in central government finances will continue to deepen this year to 5.7% of GDP. Accelerated economic

growth, slower growth in expenditure and tighter energy taxes next year will ease the deficit in central government to 4.2% of GDP. Central government finances will remain in a deficit in 2012 too. Thus central government will need to borrow at a volume of around EUR 8 billion both in 2011 and 2012.

It would appear to be that the damages caused by the economic crisis to **local government finances** are less detrimental than anticipated. Local government finances will remain tight this year, as receipts from local taxes will drop owing to poor employment prospects. Statistics for the first months of this year indicate that the deficit will not grow, though, as local government spending has been moderate with the exception of purchases of services, and corporate income tax revenue in local government has grown substantially, for instance. Government action, such as higher corporate income tax apportionments to local government and abolishing national pension contributions, helped boost local government finances considerably during the acute financial crisis.

The outlook in growth in local government tax revenue for the next few years seems to be better than expected. Expenditure pressure in local government is substantial, however, and especially investment is anticipated to remain at a high level. If the balance in local government finances is to be improved and the required investments are to be secured without a mounting debt burden, it is essential to ensure that consumption expenditure is kept well in moderation.

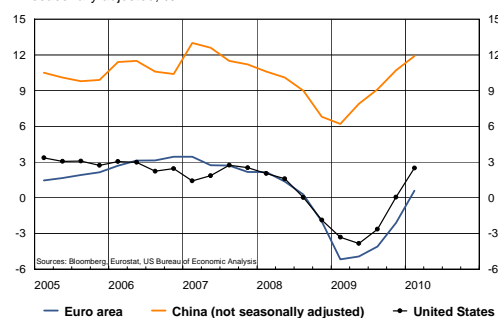
The surplus in the **social security funds** will shrink to 2.9% of GDP this year, mainly due to fast-growing expenditure related to unemployment security benefits. The improvement in the business cycle will increase the wage bill, though, which together with higher social security contributions will increase receipts in the social security funds. Growth in earnings-related pension expenditure will accelerate from next year onwards, mainly due to index adjustments. The surplus in the social security funds is expected to amount to 3.1% of GDP in 2011 and to further improve in 2012.

International economy

The world economy is still recovering faster than anticipated, especially in developing economies such as China. The US economy is also recovering fast from the recession. Growth in the euro area is sluggish, however, and it is anticipated to accelerate very slowly. World trade has recovered and imports in developing countries have already exceeded the pre-recession level. Finland has lost some its market share in world trade.

GDP

change in volume relative to the equivalent quarter of the previous year seasonally adjusted, %

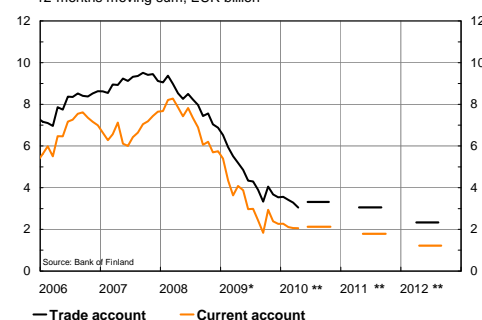


Economic developments in Finland

The surpluses in both the trade account and the current account have been contracting continuously since the peak year of 2008, and the near future is not likely to show any deviation from the trend, as Finland's position in the export markets has become weaker and the terms of trade is continuing to deteriorate. However, both the trade and current account will still stay in surplus, though the trade account surplus-to-GDP ratio will slide to 1% over the projection period and that for the current account to ½%.

External balance

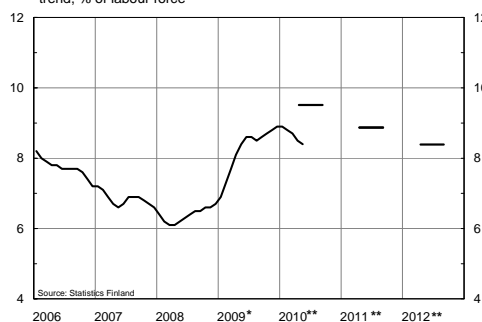
12-months moving sum, EUR billion



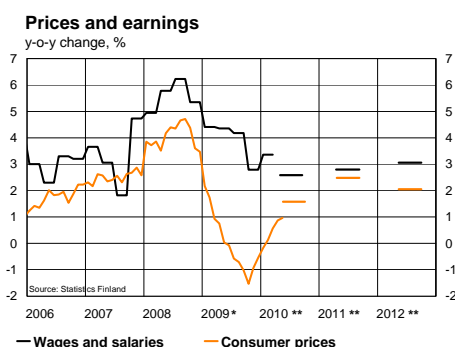
The unemployment rate will continue to rise this year, reaching its peak level in the course of the year. Measured in terms of an annual average, the unemployment rate is forecast at 9.5% for this year. Towards the end of the forecast period, as the economy recovers, the number of employed will grow and unemployment will decrease.

Unemployment rate

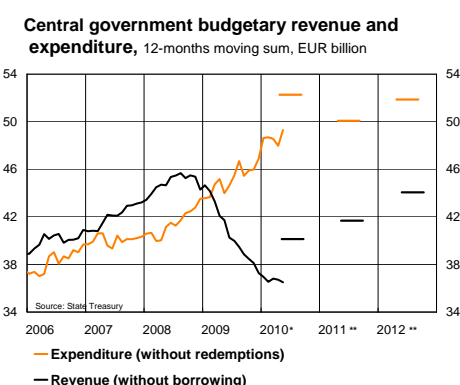
trend, % of labour force



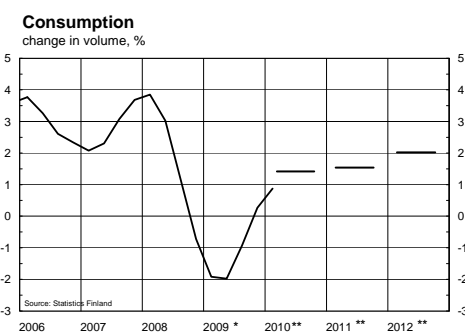
The wages and salaries of wage earners are estimated to increase by 2.6% this year. With inflation accelerating at the same time to about 1½%, real earnings will grow by just over 1%. The increase in earnings is anticipated to accelerate slightly in 2011 and 2012, to the tune of about 3%. Real earnings will increase only marginally in 2011 and by about 1% in 2012.



Central government revenue was down by 5½% between January and May relative to the same period a year earlier. Central government revenue from tax receipts was 13% lower early this year than last year. The accrual in tax revenue in central government is smaller partly because the corporate income tax apportionment for central government was reduced in the spring of last year to help strengthen local government finances. The accrual in VAT early this year was 1½% smaller, partly accounted for by the reduction in VAT on foodstuff introduced late last year. Central government expenditure was up by 14½% between January and May. Early this year, on-budget expenditure increased as a result of factors of timing related to income transfers to local government, and due to the legislative reform governing universities.



Following the dip early last winter in private final consumption expenditure, fuelled by consumer durables, growth will recover and accelerate on the one hand thanks to growth in income and on the other because saving will decrease both in 2011 and 2012. Public final consumption (mainly education, social welfare and health care services) will increase, as local government finances will improve to some extent both in 2011 and 2012.



For further information, please contact:

Mr. Mika Kuismanen, Head of the Forecasting Unit, tel. +358 040 502 5107,
+358-9-160 34865

Mr. Harri Kähkönen, Financial Counsellor, tel. +358-9-160 33194

Information on Public Finances:

Mr. Sami Yläoutinen, Head of the Stability Unit, tel. +358 040 735 1778,
+ 358 9 160 34706

<http://www.vm.fi/english>

Key forecast figures

| | 2009* | 2008* | 2009* | 2010** | 2011** | 2012** |
|----------------------|--------|-------|---------------------|--------|--------|--------|
| | EUR bn | | change in volume, % | | | |
| GDP at market prices | 169 | 1.2 | -8.0 | 1.5 | 2.5 | 2.6 |
| Imports | 58 | 6.6 | -21.5 | 3.7 | 4.2 | 3.5 |
| Total supply | 227 | 2.8 | -12.8 | 2.0 | 3.0 | 2.8 |
| Exports | 62 | 6.5 | -24.0 | 5.5 | 5.3 | 4.1 |
| Consumption | 137 | 2.0 | -1.3 | 1.3 | 1.5 | 2.0 |
| private | 94 | 1.7 | -2.1 | 2.0 | 2.0 | 2.7 |
| public | 43 | 2.7 | 0.7 | -0.1 | 0.2 | 0.5 |
| Investment | 34 | -0.2 | -13.9 | -1.9 | 3.7 | 3.2 |
| private | 29 | -0.2 | -16.3 | -2.2 | 4.7 | 3.7 |
| public | 5 | -0.7 | 4.0 | -0.1 | -2.2 | 0.0 |
| Total demand | 227 | 2.8 | -12.8 | 2.0 | 3.0 | 2.8 |
| domestic demand | 166 | 1.0 | -7.3 | 0.9 | 2.1 | 2.3 |

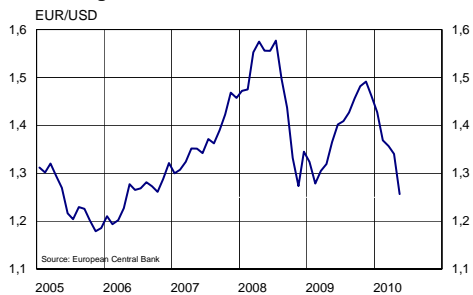
| | 2008* | 2009* | 2010** | 2011** | 2012** |
|---|-------|-------|--------|--------|--------|
| Services, change in volume, % | 1.5 | -4.1 | 0.5 | 1.9 | 1.9 |
| Industry, change in volume, % | 0.1 | -19.9 | 5.1 | 5.4 | 4.3 |
| Labour productivity, change, % | -0.3 | -3.1 | 1.0 | 1.0 | 0.5 |
| Employed labour force, change, % | 1.6 | -2.9 | -1.1 | 1.3 | 1.5 |
| Employment rate, % | 70.6 | 68.3 | 67.7 | 68.8 | 70.0 |
| Unemployment rate, % | 6.4 | 8.2 | 9.5 | 8.9 | 8.3 |
| Consumer price index, change, % | 4.1 | 0.0 | 1.5 | 2.5 | 2.0 |
| Index of wage and salary earnings, change, % | 5.5 | 3.9 | 2.6 | 2.8 | 3.0 |
| Current account, EUR bn | 6.4 | 2.1 | 2.0 | 1.8 | 1.2 |
| Current account, % of GDP | 3.5 | 1.2 | 1.1 | 0.9 | 0.6 |
| Short-term interest rates (3-month Euribor), % | 4.8 | 1.2 | 0.8 | 2.0 | 3.8 |
| Long-term interest rates (10-year Govt. bonds), % | 4.3 | 3.7 | 3.3 | 4.0 | 4.5 |
| General government expenditure, % of GDP | 49.5 | 55.6 | 56.2 | 55.4 | 55.2 |
| Tax ratio, % of GDP | 43.1 | 42.9 | 42.9 | 43.9 | 44.1 |
| General government net lending, % of GDP | 4.1 | -2.4 | -3.2 | -1.3 | -0.9 |
| Central government net lending, % of GDP | 0.5 | -5.1 | -5.7 | -4.2 | -4.0 |
| General government gross debt (EMU), % of GDP | 34.2 | 44.0 | 49.7 | 51.0 | 52.6 |
| Central government debt, % of GDP | 29.5 | 37.6 | 43.4 | 45.8 | 47.7 |

Sources:

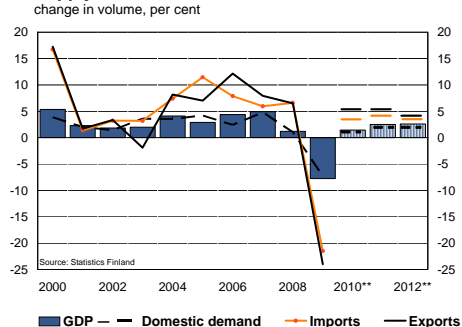
Statistics Finland, Bank of Finland, EU, OECD

Forecast: Ministry of Finance, Economics Department

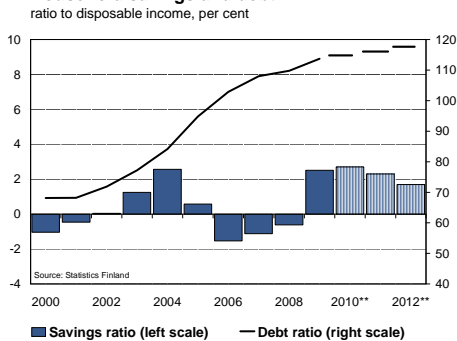
Exchange rate



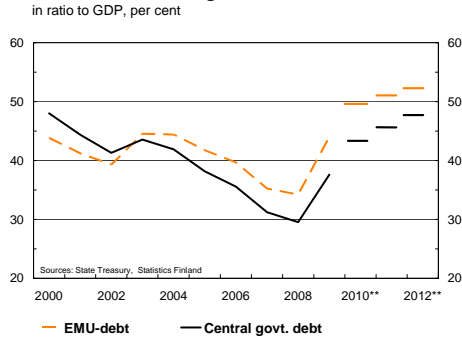
Supply and demand



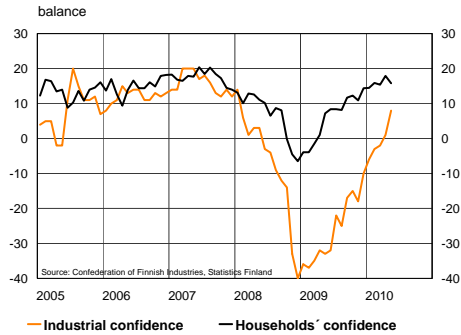
Household savings and debt



General and central government debt



Industrial and households' confidence



Short interest rates and real housing prices

