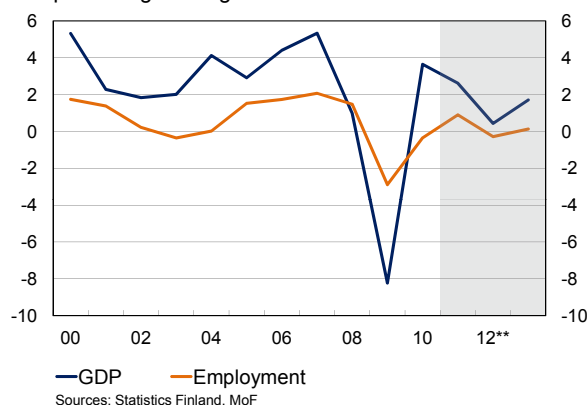


Economic Bulletin

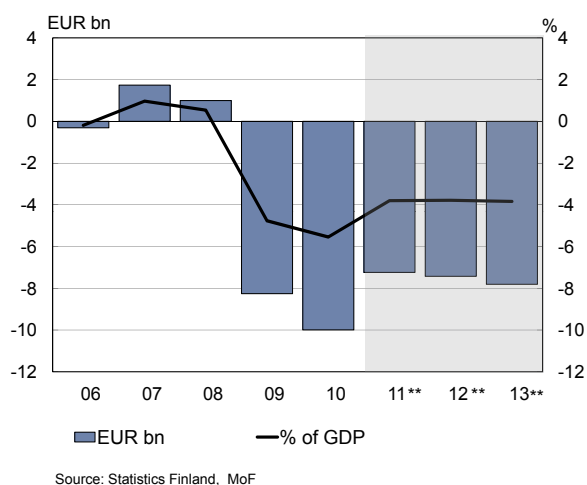
20.12.2011

Ministry of Finance Economics Department, Finland

GDP and employment percentage change



Central government financial balance



- The GDP growth forecast for the current year is 2.6%. Next year, growth will slow to 0.4%, suggesting the possibility of recession. In 2013 GDP growth will reach 1.7%. Economic recovery in Finland will depend largely on domestic demand.
- The slowdown of growth will add to imbalances in the Finnish economy. In this situation it is essential that measures are put in place to foster market-driven growth.
- Dwindling international and domestic demand is also reflected in investment demand. Private investment is projected to contract by 1½% in 2012. The investment to GDP ratio will start falling again in 2012.
- Unemployment will begin to edge up in 2012. With the demand for labour on the decline, the unemployment rate will rise to 8.1%. Despite the decrease in the number of employed persons, demographic changes mean that the employment rate will not fall in 2012.
- The volume of private consumption will increase by ½% next year. It is expected that household uncertainty will be reflected in the structure of consumption. Demand for consumer durables will start falling in 2012.
- The annual change in consumer prices is expected to come in at 2.7% in 2012, as the more subdued economic outlook means there is less upward pressure on consumer prices. Nonetheless inflation is running higher in Finland than in many of its competitors. On the other hand the increases agreed under the comprehensive wage settlement last November were slightly higher than expected, which certainly does nothing to ease producer cost pressures.
- The public finances deficit will deepen to -1.4% of GDP in 2012. The debt to GDP ratio will increase by just over one percentage point solely for the reason that the value of GDP is more than EUR 4 billion lower than previously forecast.



MINISTRY OF FINANCE

Economic growth slows sharply – Finnish economy set to face significant challenges in the years ahead

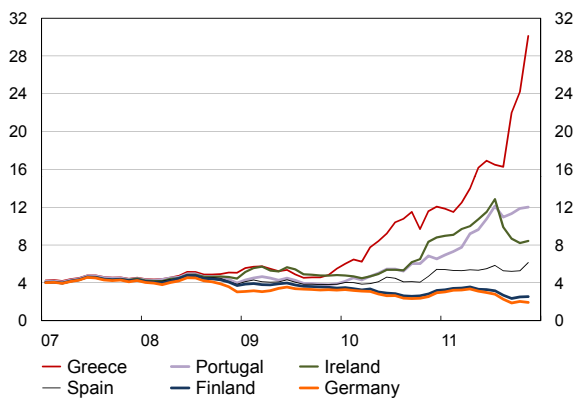
The economy maintained solid momentum in the first half of 2011, and in the summer it was still expected that annual figures would show favourable growth. However the sense of uncertainty that began to take hold late in the summer, especially in the eurozone, is once again quickly feeding through into the real economy. Since the early autumn, economic statistics have indicated a broadly based slowdown in activity both in Finland and across Europe. Outside of Europe, growth is also slowing in countries like China, although Chinese growth rates are still high in comparison to advanced economies. In the field of monetary policy, the ECB and several other central banks have reduced their base rates with a view to supporting growth over the next few months. However the difficulty is that in many countries interest rates have been relatively low for some time now, and this move may well prove inadequate unless it is coupled with other significant economic policy measures. Fiscal policy, then, has moved in a contractionary direction in several major economic regions.

The Finnish economy is projected to post growth of 2½% in 2011, falling short of earlier forecasts. Second quarter growth rates were significantly revised downwards in connection with the release of Statistics Finland's third quarter figures. As long as the economy continues to swing sharply, these kinds of statistical revisions are unavoidable. In 2012 economic growth will slow to around ½%, with the main growth contribution coming towards the end of the year. The forecast includes the possibility that the economy will dip into recession in late 2011 and early 2012.

Growth in 2012 will depend almost entirely on domestic demand, since exports will remain subdued in 2012. Without better than average economic performance in Russia, Sweden and Germany, Finland's major trade partners, export prospects for next year would be poor indeed. The unemployment rate will start rising slightly in 2012 and reach over 8%. The effective mechanisms that are in place to reduce working hours through layoffs, for instance, will help to curb any sharp rise in the unemployment rate. Finnish inflation will remain clearly higher than the euro area average at 2¾%. Real earnings will remain negative in 2011, but next year it is predicted that earnings will overtake inflation. For reasons of competitiveness it is important that special consideration is given to domestic cost factors. In 2013 the economy will resume moderate growth at a predicted rate of 1¾%.

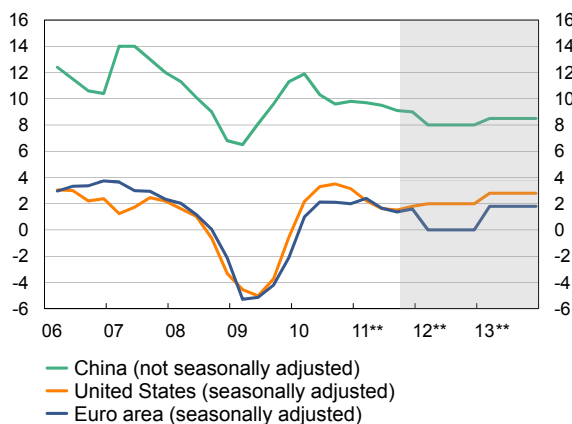
Finland's public finances deteriorated rapidly in the wake of the previous global economic crisis. With growth remaining sluggish and the economy possibly heading for recession, the state of public finances will again present a serious challenge. One of the most important lessons that can be drawn from the current situation is that there exists no single threshold level of public debt beyond which countries run into difficulties. The only concern for financiers is how governments can meet their current and future obligations in view of the economic outlook. Access to finance in Finland and the country's economic success are dependent on the international market. For purposes of future growth it is important to conduct a credible fiscal policy and to adopt a structural policy that creates a sound

Long interest rates in the euro area per cent



Source: Reuters

Gross domestic product change in volume, per cent



Sources: Statistical authorities, MoF

platform for that growth. There is only limited scope for stimulus in the next few years ahead.

The situation in the financial markets remains fragile. Stock and currency market volatility and risk premiums in the US corporate loans market, for instance, were already falling back to pre-crisis levels, but have now been edging up again. Meanwhile in the banking system, risk premiums have risen sharply, and it remains unclear at what level they will settle in the next few years. In the euro area in particular, the way that the banking and stability problems are addressed will be reflected in activities in the real economy. During the financial crisis the recession was exacerbated by lack of confidence. As the banking and financial crisis unfolded, earlier optimistic risk assessments gave way to fears of default, and access to finance quickly deteriorated. The banking system is now faced with a new crisis of confidence, especially in the UK and in the euro area. This may signal renewed difficulties with access to finance, which would adversely impact economic activity.

The forecast involves risks in both directions, although the downside risks are certainly dominant. The downside risks in the global economy have to do primarily with public sector indebtedness and financial imbalances, but also with the fragility of private demand and prolonged high unemployment. It is also possible that the crisis in peripheral euro countries may persist longer and through the financing channel have a greater impact on economic activity throughout the euro area than expected in the forecast's background assumptions.

Global economy slowing

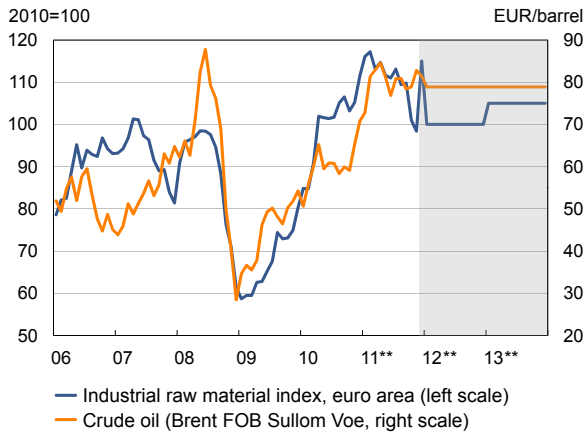
The global economy is temporarily slowing down. World GDP adjusted for purchasing power will increase at around 3.5% in 2012, but recover to a growth pace of over 4% in 2013. This growth is mainly driven by developing countries. In traditional industrial countries, growth will slow or turn into recession. This slowdown is fundamentally due to a lack of confidence in the ability of certain states to meet their obligations, the withdrawal of governmental support and stimulus measures, the consolidation of public finances and the fragility of private demand in many industrial countries.

In many industrial countries the need for financial consolidation concerns not just public finances, but also private households and financial institutions. This will dampen demand and cause growth to slow both this year and next. Later on the massive reconstruction efforts in Japan will stimulate growth and especially demand for investment goods.

The US economy recovered quite robustly from the recession, not least as a result of intensive stimulus and because the depth of the financial markets dampened the effects of the banking crisis on the real economy. However economic growth in the US has now lost some momentum and will remain below 3% over the outlook period. Growth will be constrained by reduced household wealth, continued low investment, high unemployment, external imbalances and the needs for substantial fiscal adjustment. Economic activity will furthermore be deterred by uncertainty over how the political system plans to tackle the challenge of public sector adjustment.

Growth has stalled in the EU and in the euro area. Activity in 2012 will remain unchanged from 2011. In the EU, uncertainty caused by the debt crisis and the steps taken to consolidate public finances will slow growth especially in 2011 and 2012. However trends vary widely within the EU: in 2012 Sweden and Germany, for instance, will achieve growth of around 2% and close to 1%, respectively, whereas the countries hardest hit by the economic and financial crisis will see negative growth.

Raw materials prices EUR



Sources: Hamburgisches WeltWirtschafts Institut, Reuters, MoF

Sluggish demand in industrial countries is holding back growth in developing countries, too, and in most cases growth rates will fall short of the recent trend. The Chinese economy, for instance, will slow to 8% in 2012. Russia is in the position to achieve growth of around 4.5% on the back of strong oil prices.

The burst of growth that followed the previous recession also stoked inflation. The rise in producer and import prices has now come to a halt, however. Part of the increase in raw materials prices is due to a more permanent scarcity of supply and the extent of international demand, which means that high price levels are a permanent feature. In 2012 inflation will average just under 2% in the euro area and in the United States. Given the lowered inflation expectations, central banks have been in the position to persist with an unusual monetary policy stance.

Foreign trade stagnant but set to recover towards the end of 2012

In early 2011 foreign trade was characterized by buoyant expectations and rising world market prices. Export volumes in the first quarter of 2011 were substantially higher than the lows recorded one year ago, but since then the market has been subdued. Export prices began to fall in the summer as price increases in the most cyclically sensitive product categories – metals, pulp and sawn goods – turned negative.

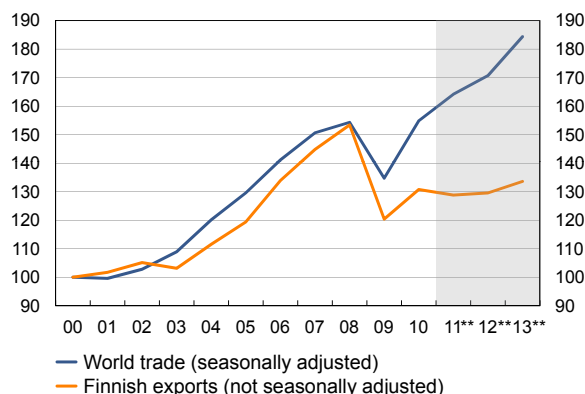
Export orders began to fall during the autumn in the wake of the deteriorating global situation and the euro market debt crisis. In the forest industry export orders have dropped to half of normal levels. New orders for post-cyclical machinery and metal products, by contrast, have increased appreciably, and export order books are stronger than one year ago. Goods exports in January-September were up by 7½% on the year before, and exports overall were up by just over 1%. The value of goods exports plummeted in October. As a result of weak performance towards the end of the year, exports will contract by 1½% this year. Export demand will remain weak through to the end of 2011 and into early 2012.

One of the strengths of the Finnish position is that the outlook continues to remain satisfactory in our key export markets, i.e. Sweden, Germany and Russia. This will help to curb the slide in export demand. However export growth cannot resume until there is some resolution to the debt crisis in euro countries. It is possible that exports will be back on a growth track by the latter half of 2012, leaving enough time to post annual export growth of half a per cent. In 2013 exports will increase by 3%.

In January-September imports were up by ½% and goods imports by 8%. Imports, too, have slowed during the course of the year. In October the value of goods imports was unchanged from a year earlier. Demand for imports will continue to remain subdued with the slowdown of both consumption and domestic output. In 2011 imports will fall by half a per cent. Next year they will increase by the same amount and accelerate further to 2½% in 2013.

Service exports and imports have declined sharply during 2011, which will contribute to depress growth figures for exports and imports as a whole. Fluctuations in service exports and imports are often quite large but nonetheless difficult to predict: this is due to the large proportion of internal service events in major international corporations, for which data are only available with some delay.

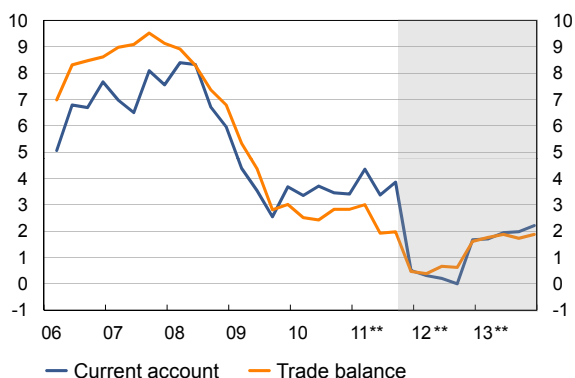
World trade 2000=100



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

External balance

EUR billion, moving annual sum, seasonally adjusted



Sources: Statistics Finland, MoF

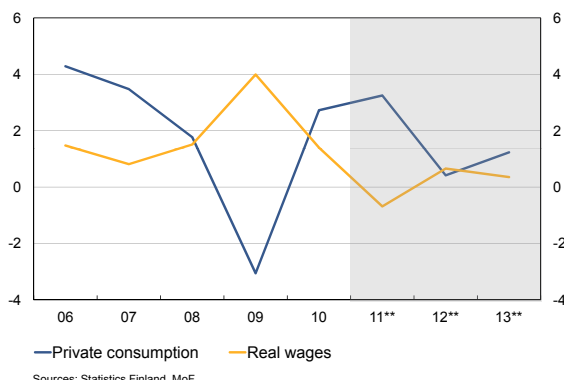
The current account for January-September showed a surplus of half a billion euros. It is expected that this year the surplus will remain unchanged from the level already reached and then begin slowly to improve over the following years.

Private consumption growth slowed by uncertainty and weak real incomes

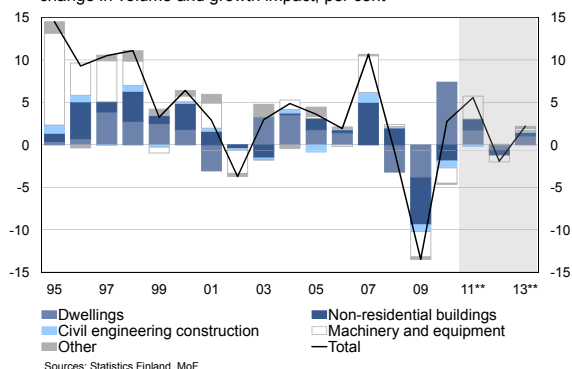
Private consumption growth will be relatively strong in 2011. The volume of private consumption will be up by almost 3½%. This trend is supported by a buoyant employment situation and low interest rates. Since the late spring, household expectations about the general economic situation and their own finances have dropped with exceptional speed. Consumer uncertainty has increased at almost the same rate as it did in connection with the 2009 recession. There are also mounting fears over the threat of unemployment. However for the time being at least the gloomier household expectations have not spilled over to affect consumption propensity. In 2011 the household savings rate will drop markedly from the exceptionally high level to which it climbed during the previous recession.

In 2012 conditions for continued private consumption growth will deteriorate markedly. If there is no improvement in household expectations, the savings rate will no longer continue to fall in the same way as this year. The growth of private consumption in 2012 will therefore largely depend on the development of household real income. The single most important source impacting consumers' disposable income is their wage income. With businesses adjusting their operations in response to deteriorating growth prospects, the employment situation will tighten. The rise in prices will slow in 2012 but nonetheless remain high. As a result household purchasing power will increase only marginally. In volume terms private consumption will increase by around ½% next year. It is expected that household uncertainty will be reflected in the structure of consumption, too. Demand for durable goods will begin to fall next year. On the other hand the consumption of services and non-durable goods will continue to rise, albeit more slowly than before.

Private consumption and real wages
percentage change



Investments
change in volume and growth impact, per cent



Investment to contract in 2012

Investment developed in line with positive expectations in 2011. Investment figures for the year would have been excellent had it not been for the sovereign debt problems and the uncertainties following the euro crisis. However given the strong demand that prevailed in many industries in the spring and especially in 2010, it is expected that investment in machinery, equipment and transport equipment will show annual growth. Investment in building construction, on the other hand, started to fall by the early part of the year. Housing investment peaked in 2010, while the short term peak in non-residential building construction will be reached this year. Housing renovation is expected to develop steadily throughout the outlook period. It is thought that non-residential renovation activities will more closely follow cyclical trends and therefore come more closely in line with the forecast profile. Civil engineering construction will continue to contract in 2011.

Dwindling international and domestic demand is also reflected in the level of investment demand, and it is predicted that private investment will fall by around 1½% in 2012. The number of new building starts is anticipated to be much lower than in 2011; the difference could be up to

several thousand. In residential and especially in non-residential housing construction the completion of ongoing investments will maintain a stable volume into early 2012, but the outlook needs to improve by the autumn if new projects are to get off the ground. However the general economic situation is not expected to improve until towards the end of 2012. It is thought that at this point, investment will resume more quickly than after the 2008 financial crisis. This is due, among other reasons, to continuing demand pressure in the housing market in growth regions and to needs to upgrade production capacity.

With all the uncertainty surrounding the economy and the very real threat of recession, there is a tendency now to postpone investment in machinery, equipment and transport equipment because of slack demand and pressure to cut costs. However the contraction in investment will only be moderate because of the relatively low level of current investment. The volume of civil engineering investment has dropped fairly low and therefore is no longer expected to fall in 2012. The investment to GDP ratio will start coming down again in 2012 and return to a growth path in 2013, falling slightly short of the average for the 2000s, reaching around 19%.

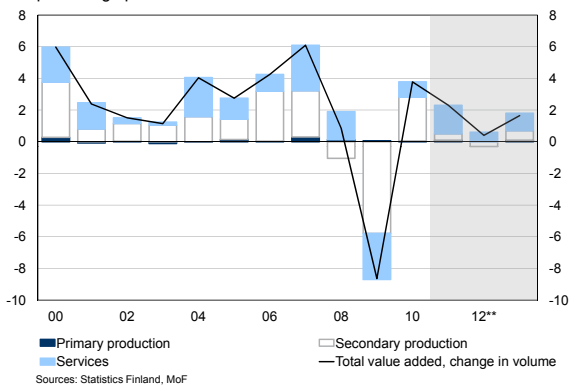
Industrial output and service growth dampened by slackening demand

Total output showed strong and broadly based growth right through to the autumn. In January-September the total volume of value added in different sectors was up almost 3% on the year before; in July-September it increased by 0.8% on the previous quarter. Output increased most notably in private services, especially in trade and the transport sector, building construction and in the major industry branches, i.e. the chemical and metal industries. In July-September value added continued to fall sharply in the electrical and electronics industry and to a lesser extent in energy supply, financial intermediation and insurance, and in public services. Given the strength of performance in the early part of the year, average annual output growth is still projected to come in at almost 2½%.

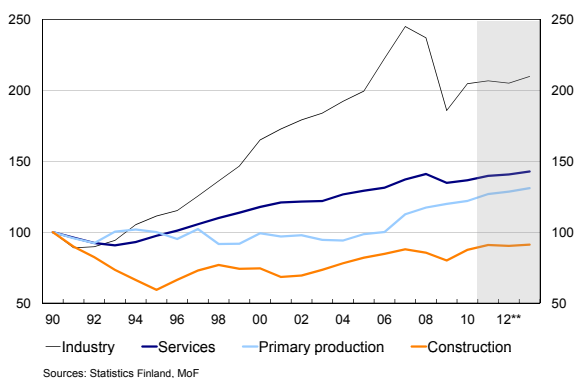
Production conditions have deteriorated rapidly. Business tendency surveys indicate that following the summer escalation of the European financial crisis and the autumn slump in world trade, the single biggest obstacle to output growth in many branches is no longer the lack of skilled labour, but the scarcity of demand. In addition, capacity underuse has clearly increased since the early part of the year. Among the main sectors of the economy, the cyclical outlook is gloomiest in building construction, but the outlook has also deteriorated rapidly in industry and services. The value of new industrial orders has now fallen for four consecutive months, but order books are still healthy and should see the technology industry at least remain on a growth path into the new year. Orders have dwindled in all main sectors of the economy, but most notably in the electrical and electronics industry and the forest industry. As demand has slowed down, businesses have begun to reduce their inventories of finished products. Nonetheless the ratio of new orders to inventories has begun to fall, and therefore no rapid upturn is in sight. Production in the construction sector is mainly driven by ongoing warehouse and industrial new builds, housing construction and various renovation projects.

It is projected that the economic situation will continue to deteriorate well into 2012, and therefore annual growth in 2012 will slow to around ½%. Industry and construction are expected to decline, whereas output in

Contribution to production
percentage points



Production
1990=100



private services will continue to rise. If an escalation of the financial crisis can be avoided, economic activity will slowly begin to pick up towards the end of next year, and by 2013 secondary industries might be able to push output growth to close to 2%.

The risks to the general economic outlook are mainly on the downside, although the recent bottoming out of confidence in certain branches may be indicative of an approaching upturn. In addition the existing stock of planning permissions granted means that if necessary, the construction of residential, business and office premises can be started up very quickly. Sensitivity to cyclical economic trends is most pronounced in the transport sector, which may rebound quickly if industry starts to pick up again.

Demand for labour input set to fall next year

Following this year's positive employment trends, the number of persons employed will decrease in 2012. With the economy continuing to slow down, the demand for labour input will start to fall next spring. The slow-down of demand is largely reflected in the declining number of hours worked as a result of layoffs and other mechanisms to reduce working hours, but the number of persons employed will also decline somewhat. In 2011 the number of persons in employment will increase by around one per cent, but next year the figure will drop by around 0.3%. The number of hours worked will decrease by just under one per cent next year. In 2013 the demand for labour input will start rising again as the economy gathers steam, and the number of persons employed will slowly rise.

The decline in the unemployment rate that began in 2010 came to a halt in the autumn. Unemployment will begin to edge up slightly next spring with the slowing demand for labour. However the rise in unemployment will remain moderate as businesses will adjust their labour input primarily through the number of hours worked. On the other hand the supply of labour will also decrease with the continuing ageing of the population. The 2012 unemployment rate is forecast at 8.1%. In 2013 unemployment will begin slowly to come down with the recovery of labour demand. The projected unemployment rate for 2013 is 8.0%.

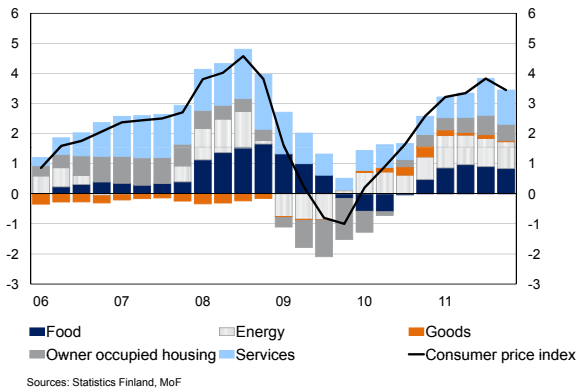
The declining number of people of working age (15–64 yrs) will significantly impact the operation of the labour market over the next few years. The number of people of working age will decrease by 10,000 in 2011 and by 17,000 in 2012. The changing demographic structure is most clearly reflected in the fact that despite the declining number of persons employed, the employment rate will not fall in 2012. The employment rate will remain at 68.5% next year. In 2013 the population of working age will continue to shrink (–19,000) and the employment rate will edge up to almost 69%, even though employment growth will remain weak. By 2013 the number of working-age people will drop by a total of 46,000. As this trend continues it is important that continued steps are taken to increase the supply of labour in the long run.

Gloomy economic outlook reduces upward pressure on consumer prices

Consumer prices have developed in line with expectations in the latter part of 2011, but the weakening economic outlook will affect the 2012 inflation forecast. The average inflation rate for 2011 is expected to come in at around 3.5% as measured by the national inflation index. Prices of energy commodities in particular increased considerably during the cur-



Consumer price index
percentage change and contribution to change



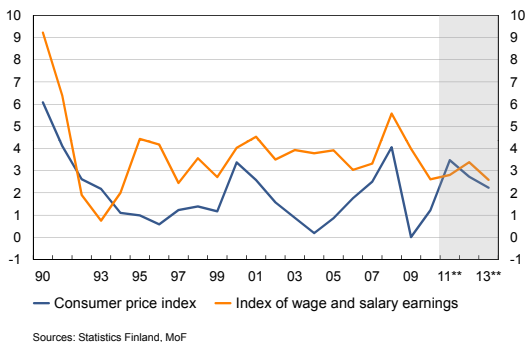
rent year. In addition, rises in certain excise duties and energy taxes have contributed to push up consumer prices in 2011. During the past year the euro area harmonized index of consumer prices has risen more slowly than the national index. This is because costs of owner occupied housing and especially interest rates on housing loans have increased from last year.

Consumer prices are predicted to rise by 2.7% in 2012, with the declining economic outlook reducing the upward pressure on consumer prices. On the other hand the increases agreed under the comprehensive wage settlement last November were slightly higher than expected, which certainly does nothing to ease producer cost pressures. Because of the higher labour costs involved, consumer prices for services are affected more by the wage settlement than the prices of other commodities. The forecast anticipates no sharp fall in oil or other import prices because the euro is expected to weaken against the major currencies. In 2012 the sudden change in monetary policy will be reflected in lower reference rates and in lower consumer interest expenses than recorded in the current year, even though fixed interest housing loans have gained increasing popularity during the course of the autumn.

Many indirect taxes will be increased from the beginning of 2012. These tax hikes will put upward pressure on consumer prices for transport fuels, certain foods, alcohol and tobacco products, certain services as well as newspaper and magazine subscriptions. An increase has also been approved to the car tax, which is reflected in the price of new cars, and the annual vehicle tax will also rise during the course of the year. All in all it is predicted that the upward pressure on consumer prices from these tax hikes will amount to around one per cent in 2012. The tax changes will also cause inflation to accelerate around the turn of the year, although during 2012 it will slow again.

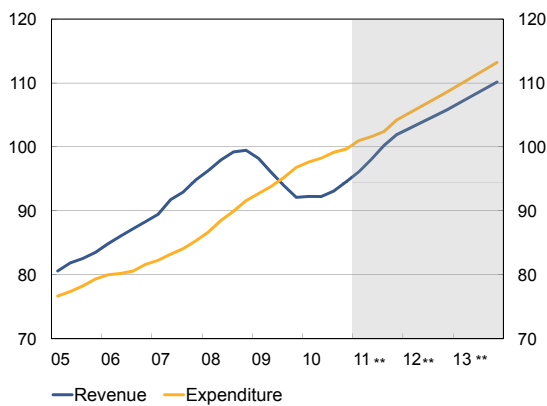
Nominal earnings to accelerate in 2012

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



In late November the labour market confederations and the Government expressed the shared view that the labour market framework agreement adopted was sufficiently inclusive and comprehensive. The wage increases implemented in different branches in line with the agreement will increase nominal earnings by close to 3% from the current year. This estimate includes the effects of the pay rises already introduced during the current year, the pay rises due next year plus a one-off increase of 150 euros payable to employees in 2012. Including the effect of additional factors beyond the negotiated wage increases and the one-off item, the index of wage and salary earnings will rise by 3.4% in nominal terms and by 0.7% in real terms in 2012. The wage and salary earnings index will slow in 2013 since the second pay rise under the framework agreement is lower than the first one and there is no agreement on a second one-off increment.

General government revenue and expenditure moving annual sum, EUR bn



Source: Statistics Finland, MoF

Public finances deficit set to deepen

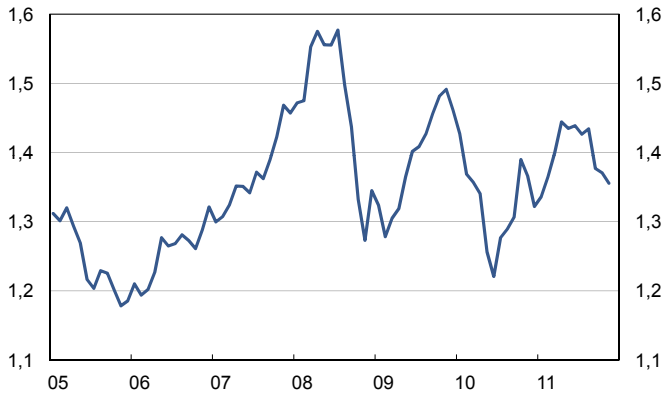
The recent weakening of the growth outlook is directly reflected in the general government budgetary position. The public finances deficit will deepen to -1.4% of GDP in 2012; in the September the deficit was still estimated at just over half a percentage point. The expenditure rate and the debt ratio will rise by just over one percentage point in 2012 solely for the reason that the value of GDP in 2012 is more than EUR 4 billion lower than previously forecast. Finland's public debt will also be increased by the loans granted under the European Financial Stability Facility (EFSF). However Finland's public debt to GDP ratio will remain below the 60% threshold specified in the EU Treaty.

Among the sub-sectors of general government, the outlook since the early autumn has weakened most notably for central government finances. Tax revenue estimates have been revised downwards because it is expected that key tax bases such as private consumption, earned income and investment income as well as business operating surpluses will grow more slowly than previously forecast. Furthermore the costs of the labour market framework agreement to central government will be over EUR 400 million in 2012 and around EUR 550 million in 2013. It is estimated that the national accounts deficit in central government finances will be around EUR 7.4 billion, which is 3.8% of GDP.

Local government finances are slightly in deficit this year. Tax revenue growth in local government has slowed at the same time as wage and salary expenditure has accelerated towards the end of the year. One of the reasons for the slowdown of tax revenue growth in the municipal sector is that the revenue apportionments were adjusted following the completion of the 2010 tax assessment in favour of central government. In 2012 local government tax revenue and central government transfers to local government will increase much more slowly than during the current year, even though the average municipal tax rate will rise by 0.09 percentage points. Although local government expenditure will slow appreciably and new investments will be postponed, the local government deficit will deepen in 2012. The local government loan stock also looks set to continue to grow. In 2013 it is expected that the rise in costs will slow as a result of moderate wage settlements, but municipal finances will continue to remain in deficit.

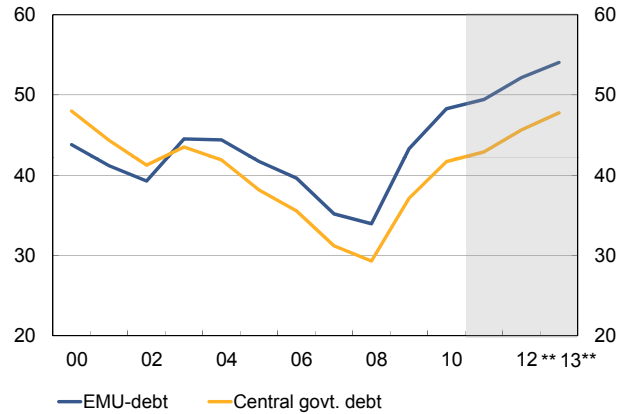
The slowdown of wage bill growth will erode the revenue of social security funds in 2012. At the same time, with the loss of economic momentum, unemployment-related expenditure is set to increase. Earnings-related pension expenditure will increase as a result of a much higher indexation than last year. It is expected that the uncertainty surrounding the economic outlook will reduce pension funds' property income during the forecast period. The surplus in earnings-related pensions funds will narrow to just under 3% of GDP. Other social security funds will be close to balance.

Exchange rate EUR/USD



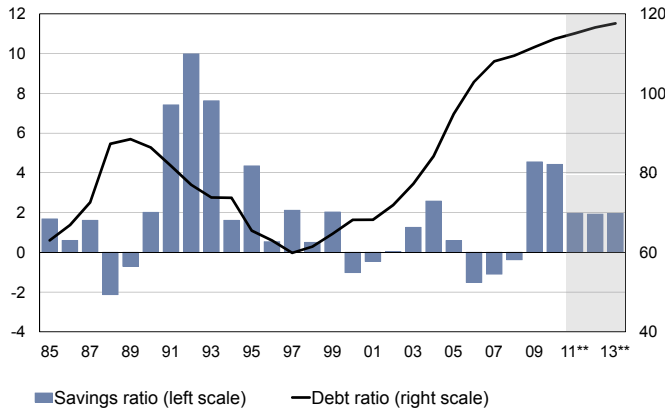
Source: European Central Bank

General and central government debt in ratio to GDP, per cent



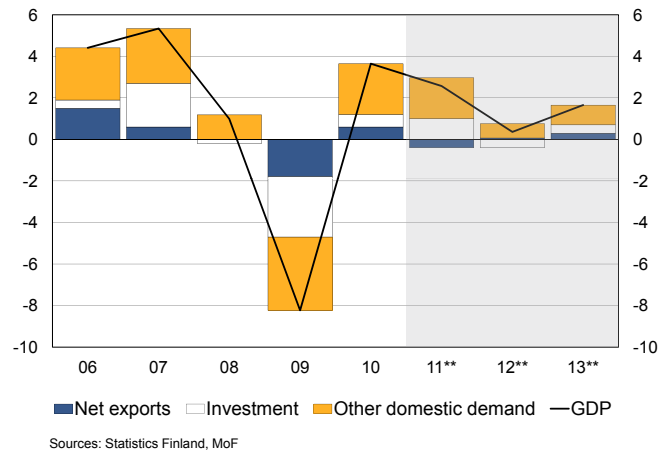
Source: Statskontoret, Statistics Finland, MoF

Household savings and debt ratio to disposable income, per cent



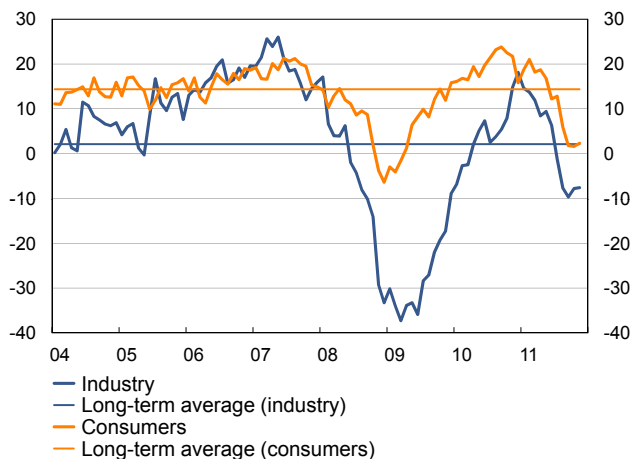
Sources: Statistics Finland, MoF

Contribution to GDP Growth in Finland percentage points



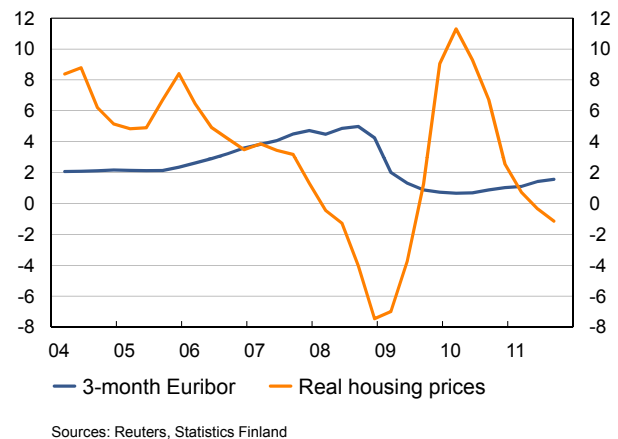
Sources: Statistics Finland, MoF

Industry and consumer confidence balance, seasonally adjusted



Source: European Commission

Short interest rates and real housing prices per cent and change relative to the equivalent quarter of the previous year



Sources: Reuters, Statistics Finland



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