Republic of Finland
Rating Report

AA+ STABLE OUTLOOK

Credit strengths	Credit challenges
• Wealthy and modern economy • High government debt affordability • Outstanding institutional quality	• Moderate growth potential • Rising fiscal pressures • Financial stability vulnerabilities

Rating rationale:

Wealthy and modern economy: Finland's ratings are supported by its wealthy and modern economy, which benefits from high human capital and a strong infrastructure in economic areas such as digitalisation and the environmental transition. The economy proved resilient to the external shocks related to the Covid-19 pandemic and the Russia-Ukraine war.

High government debt affordability: Finland's fiscal resilience is anchored to the government's ample net financial asset position, a favourable debt structure and prudent liquidity management, underpinning debt affordability in the context of rising financing costs.

Outstanding institutional quality: Finland ranks among the top countries globally in terms of governance indicators and has a strong record of implementing structural reforms to enhance external competitiveness, strengthening the sustainability of the welfare system and addressing labour market rigidities.

Rating challenges: i) the country's moderate growth potential, constrained by weak productivity growth, labour market rigidities and a declining working-age population; ii) rising fiscal pressures from Finland's ageing population, which weigh on the medium-term trajectory of public finances; and iii) financial stability risks, including those arising from the size of the Finnish banking sector relative to that of the domestic economy.

Finland's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	aa	EUR [+1]	-1/3	AA+
Public Finance Risk		20%	aa		0	
External Economic Risk		10%	bb+		-1/3	
Financial Stability Risk		10%	aaa		0	
ESG Risk	Environmental Factors	5%	aa		+1/3	
	Social Factors	7.5%	b+		0	
	Governance Factors	12.5%	aaa		0	
Indicative outcome			**aa+**		**0**	
Additional considerations					**0**	

*Qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's Sovereign Rating Methodology. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook reflects the balanced risks to the ratings.

Positive rating-change drivers	Negative rating-change drivers
• Material improvement in growth outlook • Improved fiscal outlook, resulting in sustained debt reduction	• Significant deterioration in growth outlook over the medium term • Weaker fiscal outlook, resulting in a material increase in public debt • Crystallisation of financial stresses on the government balance sheet • Escalation of geopolitical risks threatening macroeconomic stability

Ratings and Outlook

Foreign currency

Long-term issuer rating	AA+/Stable
Senior unsecured debt	AA+/Stable
Short-term issuer rating	S-1+/Stable

Local currency

Long-term issuer rating	AA+/Stable
Senior unsecured debt	AA+/Stable
Short-term issuer rating	S-1+/Stable

Lead Analyst

Giulia Branz, CFA
+49 69 6677389-43
g.branz@scoperatings.com

Team Leader

Dr Giacomo Barisone
+49 69 6677389-22
g.barisone@scoperatings.com

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Phone +49 69 6677389-0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891-0
Fax +49 30 27891-100

info@scoperatings.com
www.scoperatings.com

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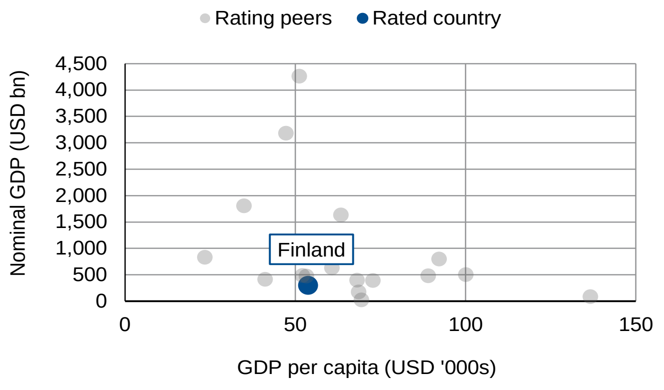
Domestic Economic Risks

- **Growth outlook:** the Finnish economy has strongly rebounded from Covid-19, with a real GDP growth of 2.1% in 2022 and 3.0% in 2021, despite the adverse economic impact of the Russia-Ukraine war on trade, confidence and inflation. A slowdown in economic activity was however visible in H2 2022, with negative growth in Q3 (-0.1%) and Q4 (-0.4%), as consumption and investment suffered from the erosion in purchasing power and higher financing costs. We expect these pressures to continue this year, resulting in a mild economic contraction of 0.3% across 2023. Recovery should gain pace in H2 2023 and continue in 2024, though growth will likely remain moderate next year at 1.3%. Over the medium term, we expect growth to converge towards a modest potential of 1.2%, constrained by a declining working age population and mild productivity gains.
- **Inflation and monetary policy:** inflationary pressures are still high and likely to persist for longer than initially anticipated. The harmonised inflation rate stood at 7.9% YoY in February 2023, halting the declining trend observed since December 2022, while core (harmonised) inflation has continued to increase, reaching 5.0% YoY. We expect a high but declining average inflation rate of about 5% for 2023, down from 7.2% in 2022, as energy prices soften and the effects of monetary policy tightening become visible. Inflation should then converge towards the European Central Bank's (ECB) target of 2% by 2025. The rapid increase in interest rates, with the euro area policy rate at 3% as of March 2023 up from -0.5% in H1 2022, is affecting financing conditions for Finnish households and businesses, for whom average interest rates on loans have soared higher than 2011 levels and will contribute to an economic slowdown.
- **Labour market:** the Finnish labour market remains resilient though signs of economic weakening have been visible in recent months. Employment is at a record high, with the employment rate (trend adjusted) stable at over 74% in recent months. The unemployment rate (trend adjusted) is also stable at below 7%. We expect some deterioration in the coming months, with the unemployment rate averaging 7.2% in 2023-24. The slowdown in economic activity should alleviate pressures from labour shortages signalled in high vacancies over the past months and also contain wage pressures. Finnish workers are highly qualified: more than 43% have a university degree, outperforming the euro-area average, and low-skilled employees are about half the euro-area average.

Overview of Scope's qualitative assessments of Finland's *Domestic Economic Risks*

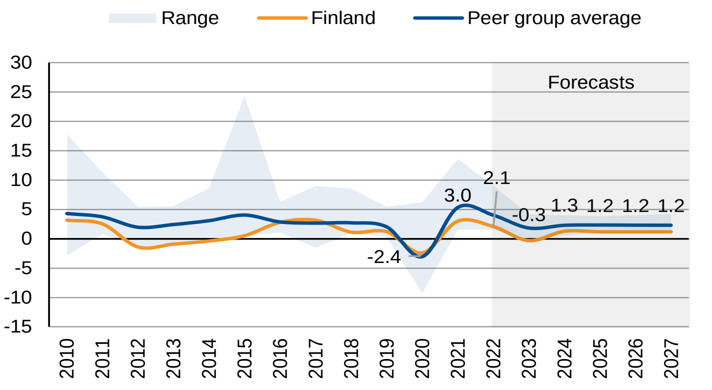
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Weak	-1/3	Resilient economy, relatively modest growth potential
	Monetary policy framework	Neutral	0	ECB is a credible and effective central bank; effective policy framework and transmission over the cycle
	Macroeconomic stability and sustainability	Neutral	0	Competitive economy, favourable business environment and highly skilled labour force; limited economic diversification

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

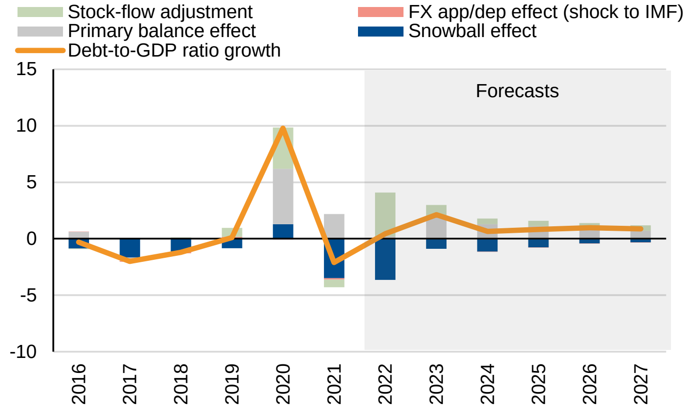
Public Finance Risks

- **Fiscal outlook:** Finland's public finances have recovered rapidly from Covid-19. In 2022, the fiscal deficit narrowed to just 0.8% of GDP, from 5.6% in 2020 and 2.7% in 2021, thanks to strong nominal GDP, employment growth and the phasing out of pandemic-related spending. Also, the fiscal costs of the energy crisis have been moderate compared to European peers. A fiscal deterioration is expected for this year, however, with the deficit widening to close to 3% of GDP, driven by the economic slowdown and the lagged impact of inflation on public wages and social benefits, on top of high defence costs and the roll-out of the reorganisation of health and social services. Also, interest costs are increasing rapidly, requiring additional EUR 1bn of new borrowing in the first supplementary budget of the year. We expect the deficit to narrow to 2.0-2.5% of GDP in 2025-27, though this will also depend on the policies implemented by the new government after the April 2023 general elections.
- **Debt trajectory:** the debt-to-GDP ratio increased slightly to 73.0% in 2022, from 72.6% in 2021 (74.7% in 2020), despite the narrow deficit and strong nominal GDP growth, owing to advance funding to the newly created counties responsible for healthcare and other out-of-budget debt changes. We expect debt to increase to about 75% of GDP in 2023 and then to remain on a slightly upward trajectory at around 78% of GDP by 2027, due to modest growth, persistent deficits and a rising interest burden. The impact of the ageing population will also become more visible on public finances, challenging the debt trajectory. According to the Finnish Ministry of Finance, a fiscal adjustment of EUR 9bn will be required to ensure fiscal sustainability in the long run. Contingent liabilities also pose risks, given sizeable government guarantees of 25% of GDP.
- **Debt profile and market access:** the Finnish government is the wealthiest in the euro area, with a net financial asset position of EUR 160bn in Q3 2022, or 61% of GDP, stemming from its public pension scheme. We expect annual funding needs to stabilise at a still moderate 12-15% of GDP over 2023-27, which is however twice as high as before Covid-19. The debt profile is robust, with an average maturity of 7.6 years and 98% of debt in euros, the remainder consisting of (hedged) USD programmes to broaden the investor base. Market conditions remain favourable, although financing costs have markedly increased, given the record-high supply of euro area sovereign bonds and the ECB's tightening policies. The yield on Finland's 10-year government bond is currently at about 2.8%, up from 1% one year ago.

Overview of Scope's qualitative assessments for Finland's *Public Finance Risks*

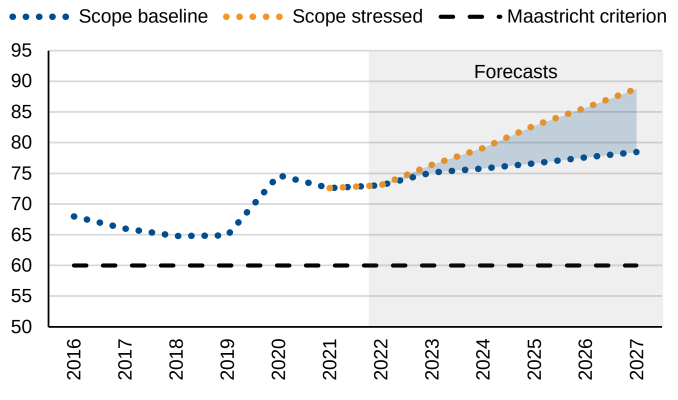
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa	Fiscal policy framework	Neutral	0	Robust fiscal recovery after the Covid-19 pandemic; rising spending pressures over the medium term
	Debt sustainability	Neutral	0	Debt set to remain on a slight upward trajectory in the medium term
	Debt profile and market access	Neutral	0	Excellent government market access, favourable debt profile

Contributions to changes in debt levels, pp of GDP



Source: Statistics Finland, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: Statistics Finland, Scope Ratings forecasts

We do not show IMF WEO forecasts for comparison, as they do not yet incorporate last year's Methodological change in Finland's statistics on government debt

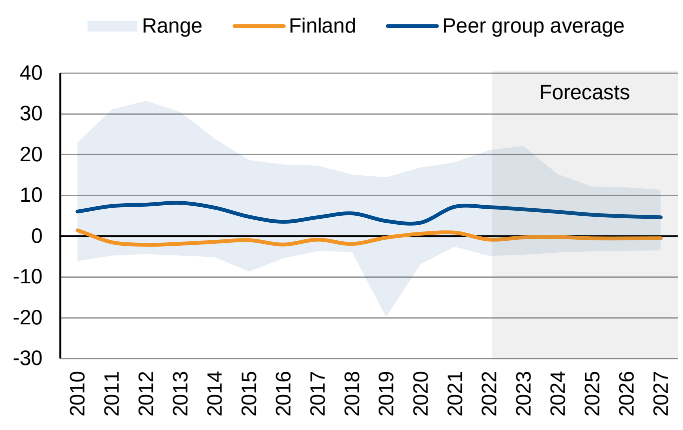
External Economic Risks

- **Current account:** After posting small current account deficits averaging 1.2% of GDP over 2015-2019, Finland's current account turned into a small surplus (0.5% of GDP) in 2020-2021. In 2022, the ramifications of the Russia-Ukraine war had a material impact, resulting in a sizeable current account deficit of 3.9% of GDP on the back of a significant deficit in the goods and service balances, driven by an increase in energy and commodity prices, a slowdown in external demand and a recovery of tourism abroad. The current account was, however, close to balance in Q4 2022, thanks to a strong recovery in goods exports. We expect the current account balance to post declining deficits in the coming years, as external demand gradually improves and energy prices normalise. Overall, Finland's export markets are well diversified by geography. Exports to Russia were more than halved last year, to 2.6% of the total. Key export sectors reflect the country's core industries, with larger shares in the forest, chemical and metal manufacturing industries.
- **External position:** Finland's external debt is high relative to the size of its economy, reflecting its large banking sector. It stood at 213.5% of GDP by end-2022, which is slightly below the average over the past three years but remains high compared to other Nordic countries and euro area peers. Financial institutions account for more than half of total external debt, while the general government and central bank sectors together account for about a fifth. Short-term external debt is high, at 95.2% of GDP as of Q4 2022, signalling vulnerability to external shocks. Finland's net international investment position has however remained broadly close to balance over the years and stood at -2.7% of GDP at end-2022. Most of the net external liabilities are in the form of portfolio investments in debt instruments.
- **Resilience to shocks:** together with other euro-area member states, Finland benefits from the euro's status as an international reserve currency, significantly mitigating risk from currency sell-off and sudden stops of capital flows.

Overview of Scope's qualitative assessments for Finland's *External Economic Risks*

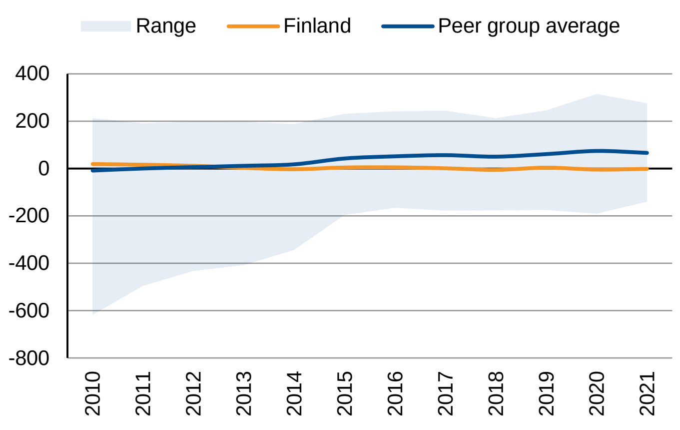
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Current account resilience	Neutral	0	Moderate export sectoral diversification and competitiveness
	External debt structure	Weak	-1/3	High external debt, reflecting liabilities of Finnish financial institutions; a large share of it being short-term external debt
	Resilience to short-term shocks	Neutral	0	Euro-area membership mitigates exposure to international markets

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position, % of GDP



Source: IMF, Scope Ratings

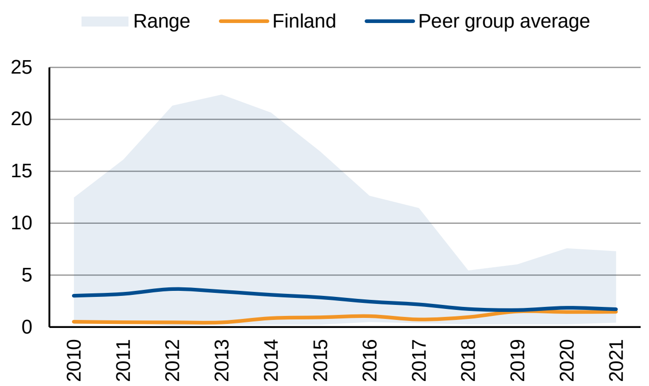
Financial Stability Risks

- **Banking sector:** the Finnish banking sector is large and highly concentrated, with total assets over three times the size of the domestic economy. The sector is solid and resilient to shocks, as reflected in capitalisation, profitability and asset quality metrics outperforming EU averages. The Common Equity Tier 1 ratio stood at 17.2% as of Q4 2022, above the EU average of 15.0% in Q3 2022. Profitability is strong, with a return on equity of 8.7% in Q3 2022, albeit below 2021 levels, as the growth in net interest income was not sufficient to compensate for lower income in other items and due to a non-recurring charge in Q1 2022. The sector's asset quality also outperforms the euro-area average, as reflected in a lower non-performing loan ratio of 1.0% in Q3 2022. Finnish banks benefit from a liquidity position, with a liquidity coverage ratio of 163.7%. However, a loan-to-deposit ratio significantly above the EU average indicates that Finnish banks rely greatly on wholesale funding, making them vulnerable to market disruptions and rising funding costs.
- **Private debt:** Finland's private sector debt stood at 179.3% of GDP in Q3 2022, back down to 2014 levels. This is above the euro-area average of 167.0%, but significantly below Denmark, Norway and Sweden. The debt of non-financial corporations was 113.1% of GDP as of Q3 2022, while household debt stood at 66.2% of GDP. Debt service ratios in both segments compare favourably to other Nordic economies, especially regarding households. This is an important mitigating factor in the context of rising interest rates, especially as housing loans typically have variable rates in Finland. Household indebtedness relative to disposable income, mostly related to housing loans, has been increasing in recent decades and was just over 133% in Q3 2022.
- **Financial imbalances:** following the rapid rise in interest rates, housing prices have cooled down significantly with a 3% YoY correction in Q4 2022, although the decline is currently not as steep as in the other Nordics. Transactions have also significantly declined at the end of 2022. The Financial Supervisory Authority has maintained the maximum loan-to-collateral ratio for new residential mortgage loans other than first-home loans at 85% and recommended a stressed debt-service-to-income limit of 60% for the granting of future housing loans as of January of this year. Heightened risks for the Finnish financial sector amid higher financial market uncertainty could stem from a strong interconnection particularly with Nordic and Baltic financial systems, cyberattacks and the repricing of risk in financial asset valuations.

Overview of Scope's qualitative assessments for Finland's *Financial Stability Risks*

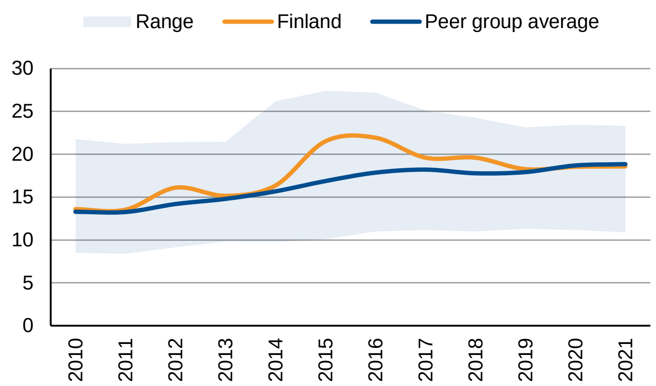
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Profitable and adequately capitalised banking sector
	Banking sector oversight	Neutral	0	Effective oversight by the Bank of Finland and the ECB as part of the European banking union
	Financial imbalances	Neutral	0	High private sector debt, large banking sector relative to the real economy, highly concentrated and interconnected

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

ESG Risks

- **Environment:** Finland aims to become carbon neutral by 2035, one of the most ambitious emissions reduction targets globally. The Climate Change Act enforced in July 2022 has set targets to reduce emissions by 60%, 80% and at least 90% compared to 1990 levels for 2030, 2040 and 2050 respectively, which will require significant policy efforts and economic transformations. The government 2022 Annual Climate Report highlighted the need for additional measures to cut emissions by 4.2 tonnes of CO2-equivalents, on top of reductions achievable with measures already implemented or targeted by national strategies. Finland benefits from large renewable energy resources, which already account for more than 40% of the county's total energy consumption, the second highest share in the EU. Finland plans to double its wind power capacity, and a new nuclear reactor will become fully operational in 2023, further enhancing the diversification, security and sustainability of its energy mix. Finland also benefits from low vulnerability to natural disasters, as captured by the World Risk Index.

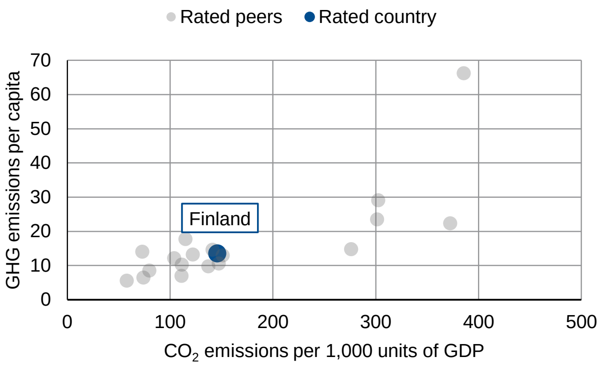
- **Social:** Finland benefits from an advanced social safety net and a high-quality education system, reflected in the lowest levels of income among European countries, as well as a share of people at risk of poverty and social exclusion well below the EU average (14% versus 22%). Social risks relate to the country's adverse demographic trends. Finland has the second highest old-age dependency ratio in the euro area, at 37.4% in 2022, up from 22.2% in 2000. According to the European Commission's 2021 Ageing Report, the ratio will increase to about 47% by 2030, with negative implications in terms of social spending and lower growth potential.

- **Governance:** Finland benefits from outstanding institutional quality. The ruling five-party coalition led by Social Democrat Prime Minister Sanna Marin has retained a good record on implementing reforms, including the landmark healthcare system reform, and navigating the major external crises related to the Covid-19 pandemic and the Russia-Ukraine war. Elections will be held in April 2023. Polls suggests multiple government formations to be possible, as the centre-right National Coalition Party, the Social Democratic Party and the right-wing populist Finns Party are leading polls with about 20% voter share each. Finland has been exposed to geopolitical risks since the escalation of the Russia-Ukraine war, given its 1,300km long border with Russia. In our view, however, Finland's significant international ties to European and other Western allies strongly limit security risks. This is especially true since the country has applied to join NATO and its application is likely to go through to full membership this year.

Overview of Scope's qualitative assessments for Finland's *ESG Risks*

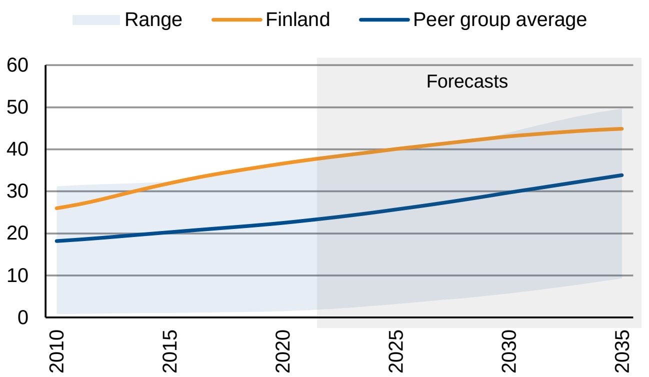
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa	Environmental factors	Strong	+1/3	Good record in environmental sustainability and governance; ambitious policy efforts to achieve carbon neutrality by 2035
	Social factors	Neutral	0	Unfavourable demographics, but strong income equality, high-quality education system
	Governance factors	Neutral	0	Very high quality of institutions and stable policy environment, geopolitical risk exposure

CO_2 emissions per GDP and greenhouse-gas emissions per capita, $mtCO_2e$



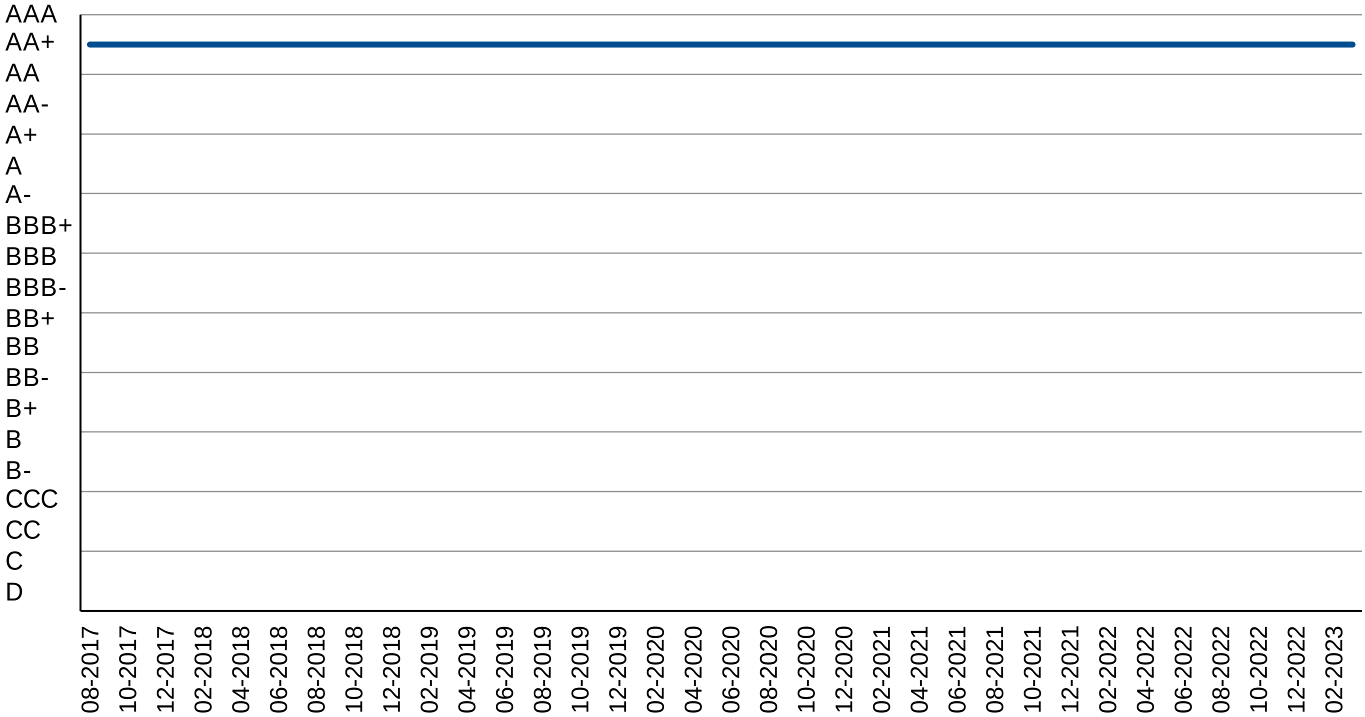
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories as per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Austria
Denmark
Germany
Ireland
Luxembourg
Netherlands
Norway
Sweden
Switzerland
United Kingdom

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2017	2018	2019	2020	2021	2022
Domestic Economic	GDP per capita, USD '000s	IMF	46,437	50,032	48,668	49,158	53,774	50,818
	Nominal GDP, USD bn	IMF	255.6	275.8	268.5	271.6	297.6	281.4
	Real growth, %	IMF	3.2	1.1	1.2	-2.2	3.0	2.1
	CPI inflation, %	IMF	0.8	1.2	1.1	0.4	2.1	6.5
	Unemployment rate, %	WB	8.6	7.4	6.7	7.8	7.5	-
Public Finance	Public debt, % of GDP	IMF	61.2	59.8	59.6	69.0	66.2	66.7
	Interest payment, % of revenue	IMF	0.5	0.3	0.3	0.2	0.0	0.1
	Primary balance, % of GDP	IMF	-0.4	-0.7	-0.8	-5.4	-2.6	-2.0
External Economic	Current account balance, % of GDP	IMF	-0.8	-1.8	-0.3	0.6	0.9	-0.8
	Total reserves, months of imports	IMF	1.1	1.0	1.1	1.4	1.5	-
	NIIP, % of GDP	IMF	1.3	-5.5	4.1	-4.3	-1.3	-
Financial Stability	NPL ratio, % of total loans	IMF	0.7	1.0	1.5	1.5	1.5	-
	Tier 1 ratio, % of risk-weighted assets	IMF	19.6	19.6	18.3	18.6	18.6	18.4
	Credit to private sector, % of GDP	WB	93.4	94.2	95.4	100.2	-	-
ESG	CO_2 per EUR 1,000 of GDP, $mtCO_2e$	EC	175.5	180.2	163.3	145.9	143.8	-
	Income share of bottom 50%, %	WID	21.6	21.7	21.7	21.5	21.5	-
	Labour-force participation rate, %	WB	76.6	77.8	78.2	-	-	-
	Old-age dependency ratio, %	UN	33.7	34.7	35.5	36.4	37.1	37.8
	Composite governance indicators*	WB	1.8	1.8	1.7	1.8	1.8	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps)	25

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
F-75008 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30 31 58 14

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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