# Republic of Finland
## Rating Report

SCOPE AA+ STABLE OUTLOOK

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

## Rating rationale:

**Wealthy and modern economy:** Finland's ratings are supported by the country's wealthy, resilient and modern economy, which benefits from elevated human capital, effective policies and a strong infrastructure in future economic areas such as digitalisation and the environmental transition.

**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, as well as the ECB's supportive monetary policies.

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

**Rating challenges include:** i) the country's moderate growth potential, constrained by weak productivity dynamics, 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; 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 scorecard | | Reserve currency adjustment (notches) | Qualitative scorecard | Final rating |
|---|---|---|---|---|---|---|
| | | Weight | Indicative rating | | Notches | |
| Domestic Economic Risk | | 35% | aaa | | -1/3 | AA+ |
| Public Finance Risk | | 25% | aa | | 0 | |
| External Economic Risk | | 10% | bbb | | -2/3 | |
| Financial Stability Risk | | 10% | aaa | | 0 | |
| ESG Risk | Environmental Risk | 5% | aaa | | +1/3 | |
| | Social Risk | 5% | bbb+ | | 0 | |
| | Governance Risk | 10% | aaa | | 0 | |
| **Overall outcome** | | | **aaa** | | **-1** | |

Note: The sum of the qualitative adjustments, capped at 1 notch per rating pillar, is weighted equally and rounded to the nearest integer. The reserve currency adjustment (+1 for euro area countries) applies to currencies in the IMF's SDR basket.
For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings GmbH

## Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced over the next 12 to 18 months.

**Positive rating-change drivers**

- Material improvement in growth outlook
- Improved fiscal outlook, resulting in sustained public debt reduction

**Negative rating-change drivers**

- 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 and local currency**

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


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Bloomberg: RESP SCOP

## Domestic Economic Risks

- **Growth outlook:** Finland's economy has proved resilient to the Covid-19 shock. A robust economic recovery of 3.5% last year, after a 2.3% contraction in 2020, drove real GDP back to pre-pandemic levels as early as the first half of 2021. Due to Russia's invasion of Ukraine, we have revised our growth forecasts for this year down by about 1pp to 1.7%, followed by 1.5% in 2023. We expect the conflict to impact the economy via several channels, including trade links, consumer and business confidence and energy price shocks, in addition to uncertain secondary effects via lower economic activity in the euro area. Over the medium term, we expect economic growth to converge towards a modest growth potential of about 1.2%, constrained by a declining working-age population, moderate productivity gains and labour rigidities preventing further significant gains in employment.

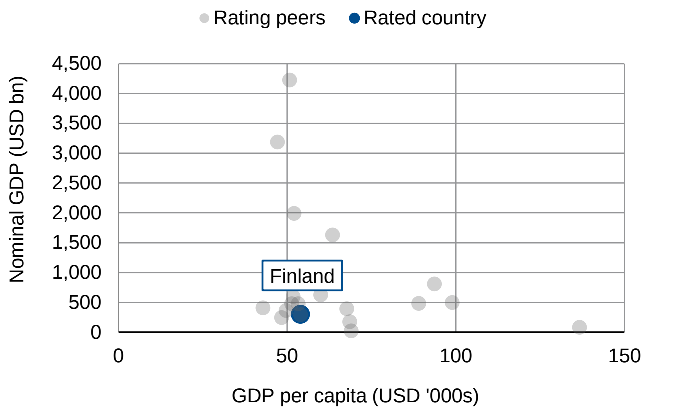
- **Inflation and monetary policy:** Inflation has been rising rapidly from mid-2021 and has accelerated further in recent months. The harmonized inflation rate stood at 5.8% YoY in March, below the 7.5% rate recorded for the euro area. We expect price pressures to remain elevated in the coming months, especially given the ramifications of the Russia-Ukraine war for food and energy prices. This results in an overall average inflation rate for the year at around 4%-5%, albeit below the euro-area average, given the more marginal role of natural gas in Finland's energy mix. While the ECB's monetary policy stance remains accommodative, we expect gradual steps toward policy normalization, including the end of net asset purchases and an eventual increase in interest rates in H2 2022. This reflects the challenging combination of a slowdown in economic growth and inflation mostly driven by supply-side factors.

- **Labour market:** The labour market has recovered from the pandemic shock. In February there were 90,000 more employed than two years previously, and the employment rate stood at 72.7%, against 70% pre-shock, gradually closing the gap to the government target of 75%. Finnish workers are highly qualified: almost 50% have a university degree, well above the euro-area average, while low-skilled employees are about half the euro-area average. The unemployment rate is also close to pre-crisis levels, at 6.7%. We expect the unemployment rate to remain at around 6.7% in 2022-23, given that further unemployment reductions are limited by labour market rigidities, resulting in a structural unemployment rate above that of peers.

**Overview of our qualitative assessments for Finland's *Domestic Economic Risks***

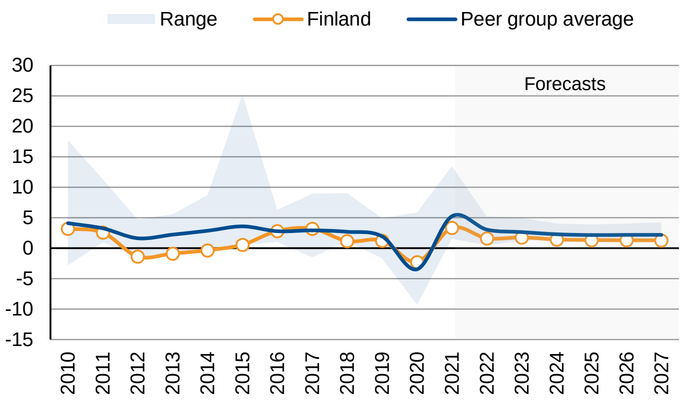
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| aaa | Growth potential of the economy | Weak | -1/3 | Resilient economy, relatively modest growth potential |
| | Monetary policy framework | Neutral | 0 | ECB is a credible and effective central bank; effective policy framework and transmission over the cycle |
| | Macro-economic 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 '000s




Source: IMF WEO, Scope Ratings GmbH

**Real GDP growth,** %




Source: IMF WEO, Scope Ratings GmbH

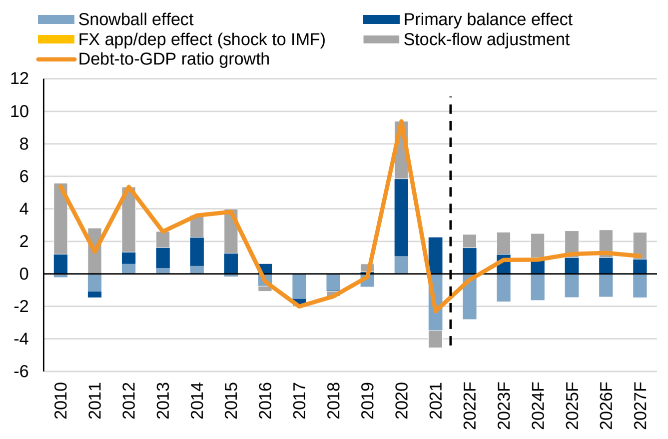
## Public Finance Risks

- **Fiscal outlook:** Finland's public finances have recovered rapidly from the Covid-19 pandemic, with the fiscal deficit for last year expected to have narrowed to about 2.6% of GDP, from 5.5% in 2020. The better-than-expected results create some fiscal room to address increased fiscal costs related to the Russia-Ukraine war, which is likely to increase Finland's defence spending and support measures for dealing with energy price shocks. Still, for this year, we expect a gradual recovery in the fiscal deficit to about 2.1% of GDP, as Covid-19 measures are phased out. Looking ahead, we expect a further gradual convergence towards a structural deficit of 1.5% of GDP by 2027. This is based on persistent fiscal imbalances driven by Finland's ageing population, besides the costs related to the government reform programme.
- **Debt trajectory:** Last year's strong recovery, together with the unwinding of accumulated cash holdings, resulted in a lower-than-expected debt ratio of 65.8% of GDP in 2021, after the 10pp increase caused by the pandemic shock in 2020. We expect the debt-to-GDP ratio to increase slightly in the next five years to above 70%, given persistent fiscal deficits and a moderate growth outlook. High inflation is likely to support the debt trajectory this year, while financing costs are expected to gradually rise over the forecasting horizon, although remaining low from a historical perspective. Contingent liabilities pose risks to the debt trajectory, given sizeable government guarantees of about 25% of GDP, while long-term sustainability is challenged by rising ageing-related costs, with the net present value of the increase in healthcare and pension spending until 2050 estimated by the IMF at 40% of GDP.
- **Debt profile and market access:** The Finnish government is by far the wealthiest in the euro area, with a net financial asset position of EUR 181bn by end-2021, or 72% of GDP, stemming from its public pension scheme. The State Treasury's gross borrowing declined last year to 11% of GDP, from 16.5% in 2020. We expect funding needs to average 10% of GDP over 2022-27. The debt profile is robust, with an average debt maturity of 6.4 years and about 97% of debt in euros, the remainder consisting of (hedged) USD programmes to broaden the investor base. The Eurosystem held 28% of total government debt as of Q3 2021. Market conditions remain favourable, although financing costs have increased, with the yield on the 10-year government bond above 1.2% at the time of writing, from about 0% at the beginning of the year.

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

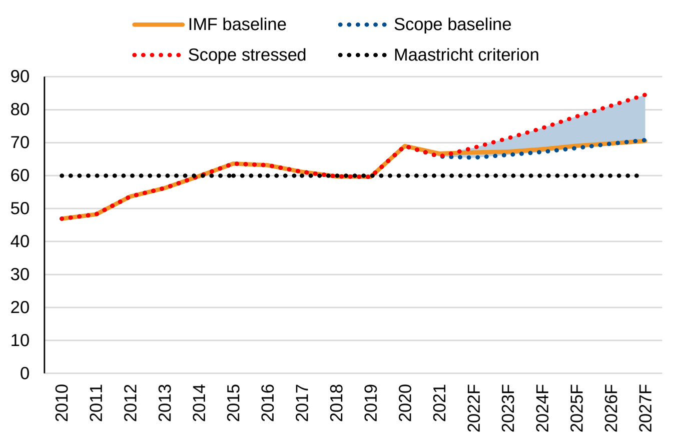
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| aa | Fiscal policy framework | Neutral | 0 | Gradual recovery in the fiscal position; structural fiscal imbalances |
| | Debt sustainability | Neutral | 0 | Debt set to remain on upward trajectory in the medium term |
| | Debt profile and market access | Neutral | 0 | Excellent government market access, favourable debt profile, in line with peers |

**Contributions to changes in debt levels**, pps of GDP




Source: IMF WEO, Scope Ratings GmbH

**Debt-to-GDP forecasts**, % of GDP




Source: IMF WEO, Scope Ratings GmbH

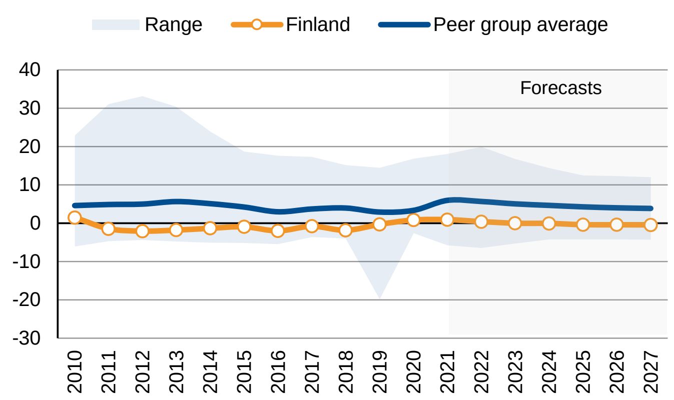
## External Economic Risks

- **Current account:** Finland has traditionally run small current account deficits, averaging -1.2% of GDP over 2015-2019, with surpluses in the goods and primary income balance insufficient to offset deficits in the services and secondary income accounts. In 2020 and 2021 the current account balance turned positive, at 0.7% of GDP, driven by larger surpluses in the goods balance, but especially in primary income, as financial institutions halted dividend distributions. We expect the current account balance to weaken towards a balanced position in the coming years, as dividend distributions normalise, while weaker trade relations with Russia (the fifth largest export market for Finland last year) will affect the goods export outlook. Overall, Finland's export markets are well diversified by geography. Key export sectors reflect the country's core industries, with larger shares in the forest, machinery and metal manufacturing, and chemical industries.
- **External position:** Finland's external debt is high relative to the size of the economy, reflecting the large size of its banking sector. It stood at 204% of GDP as of Q4 2021, which is high compared to the other Nordic countries and euro-area peers, although about 20pp below 2018-20 levels. Financial institutions account for about half of total external debt, while the general government and central bank sectors together account for about a quarter. The level of short-term external debt is elevated, just below 80% of GDP by end-2021, which signals vulnerability to external shocks. However, the net debtor position of the Finnish economy is moderate, with the net international investment position at -4.7% of GDP by end-2021, thanks to the ample net assets of Finland's social security funds.
- **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. In 2020, 23% of outstanding international debt securities, 26% of international loans and 25% of international deposits were denominated in euros, making the euro the second most used currency globally after the US dollar.

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

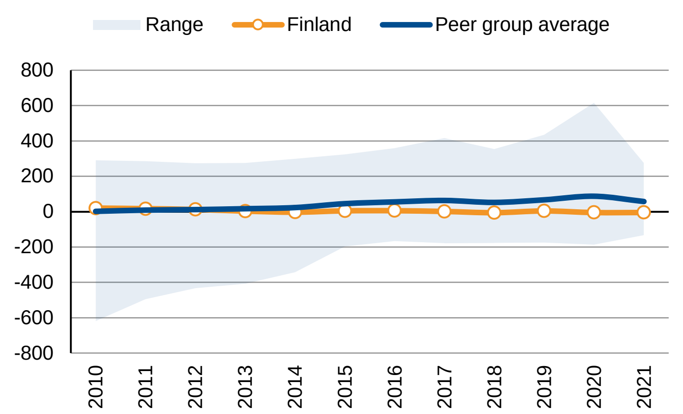
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| bbb | Current account resilience | Weak | -1/3 | Moderate export sectoral diversification and external competitiveness compared to peers |
| | External debt structure | Weak | -1/3 | Elevated external debt, reflecting liabilities of Finnish financial institutions; a large share is short-term external debt |
| | Resilience to short-term shocks | Neutral | 0 | Small and open economy, benefitting from euro-area membership |

**Current account balance**, % of GDP




Source: IMF WEO, Scope Ratings GmbH

**Net international investment position**, % of GDP




Source: IMF WEO, Scope Ratings GmbH

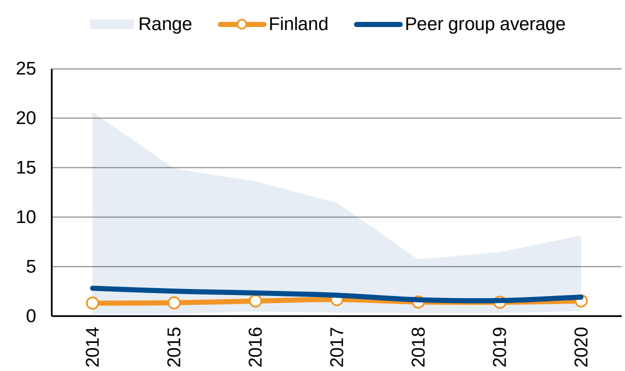
## Financial Stability Risks

- **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 was resilient during Covid-19, as reflected in capitalisation, profitability and asset quality metrics. The CET1 ratio stood at 17.9% as of Q4 2021, above the EU average of 15.7%, and the return on equity was 9.4%, above the European average of 7.3%. The sector's asset quality outperforms the euro-area average, as reflected in a lower non-performing loan ratio of 1.3% by end-2021, unaffected by the pandemic. Banks' liquidity position is strong as well, with the liquidity coverage ratio at 179.2%. A loan-to-deposit ratio significantly above the EU average (169.5% vs 108.6% as of Q4 2021) indicates Finnish banks' greater reliance on wholesale funding.
- **Private debt:** Finland's private-sector debt stood at 187.2% of GDP in Q3 2021, broadly in line with 2015 levels. This is above the euro-area average of 172.1%, but significantly below levels in Denmark, Norway and Sweden. Non-financial corporations' debt was 118.7% of GDP as of Q3 2021, while households' debt stood at 68.4% of GDP. Debt service ratios in both segments compare favourably vis-à-vis the other Nordic economies. Households' indebtedness relative to disposable income, mostly related to housing loans, has been on an increasing trend in recent decades and reached 135.9% by the end of last year.
- **Financial imbalances:** Housing price dynamics have remained fairly stable in Finland compared to the other Nordic countries. However, there was a marked acceleration last year following the pandemic shock, especially in the Greater Helsinki area, where the annual growth rate of housing prices peaked above 6.5% in mid-2021, before slowing to 4.3% by year-end. In response, the Financial Supervisory Authority has decided to maintain the maximum loan-to-collateral ratio for new residential mortgage loans other than first-home loans at 85%, after a 5pp tightening decided in June 2021. The Financial Supervisory Authority is also closely monitoring the effects of the Russia-Ukraine conflict on the stability of the Finnish financial system and remains ready to intervene with further macroprudential instruments if necessary. Overall, the direct exposure of the Finnish financial sector to Russia is limited, representing only around 0.1% of banks' total assets, 0.3% of insurance entities' investments and 0.4% of management companies' investments. Nevertheless, heightened risks could materialise via indirect exposures, cyberattacks and the repricing of risk in financial asset valuations.

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

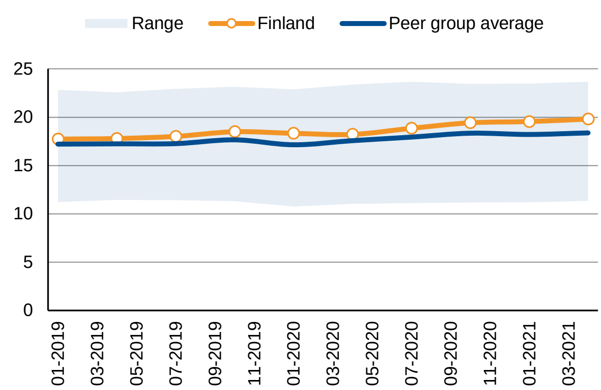
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| aaa | Banking sector performance | Neutral | 0 | Solid capitalisation and profitability, in line with peers |
| | Banking sector oversight | Neutral | 0 | Oversight by the Bank of Finland and the ECB as part of Banking Union |
| | Financial imbalances | Neutral | 0 | High private-sector debt levels, large size of the banking sector vis-à-vis the real economy |

**Non-performing loans**, % of total loans




Source: World Bank, EBA, Scope Ratings GmbH

**Tier 1 ratio**, % of risk-weighted assets




Source: IMF WEO, Scope Ratings GmbH

## ESG Risks

- **Environment:** Finland has one of the most ambitious emission reduction targets globally, namely, to become carbon neutral by 2035. The new Climate Change Act, submitted to the Parliament in March 2022, sets emission reduction targets for 2030, 2040 and 2050, at 60%, 80% and at least 90% respectively compared to 1990 levels. This transition will require significant policy efforts and economic transformations. According to the latest Annual Climate Report, new measures are needed to cut emissions by 11 million tonnes of $CO_2$-equivalents (Mt $CO_2$-eq) of a total gap of 27 Mt $CO_2$-eq to attain carbon neutrality. At the same time, Finland benefits from several factors facilitating these efforts. These include ample natural resources, such as land sector use for emissions sinks and renewable energies, which already account for more than 40% of the county's total energy consumption, one of the highest shares in the EU. Finland has low vulnerability to natural disaster risks as captured by the World Risk Index.

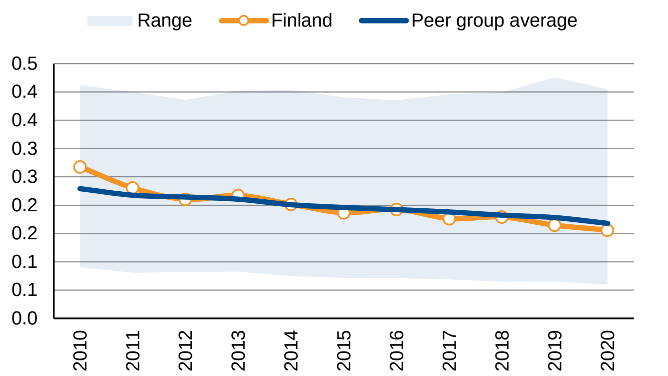
- **Social:** Finland benefits from an advanced social safety net and a high-quality education system. This fosters inclusion and has led to the lowest levels of income and gender inequality among European countries. Social risks relate to the country's adverse demographic trends, with a rapidly ageing population. Finland has the second highest old-age dependency ratio in the euro area, at 36.8% in 2021, up from 22.9% in 2000. According to the 2021 Ageing Report, the ratio will increase to about 47% by 2030, with serious implications in terms of higher social spending and lower growth potential.

- **Governance:** Finland benefits from the outstanding quality of its institutions, ranking above the 99th percentile in five out of six World Bank Governance Indicators. The ruling five-party coalition led by Social Democrat Prime Minister Sanna Marin has retained a good record on reform implementation. A landmark healthcare system reform was adopted last year, and policy efforts have been made to increase employment and public investment, while effectively navigating the pandemic crisis. The executive has faced stability challenges related to the decision to raise government spending ceilings. Elections will be held next year, with opinion polls showing stable support for the Prime Minister's party at about 20%. At the same time, the liberal-conservative NCP polls at around 25% in recent weeks, also given their long-standing support for NATO membership, which is gaining significant public opinion support. Finland's 1,300km long border with Russia has placed geopolitical risks at the centre of the policy agenda, given Russia's aggressive military stance since the escalation of the war.

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

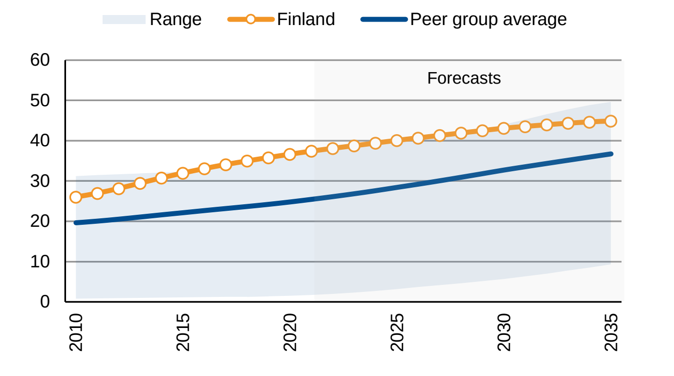
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| aaa | Environmental risks | Strong | +1/3 | Good record in environmental sustainability and governance; ambitious policy efforts to achieve carbon neutrality by 2035 |
| | Social risks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

**$CO_2$ emissions per GDP,** Mt $CO_2$-e



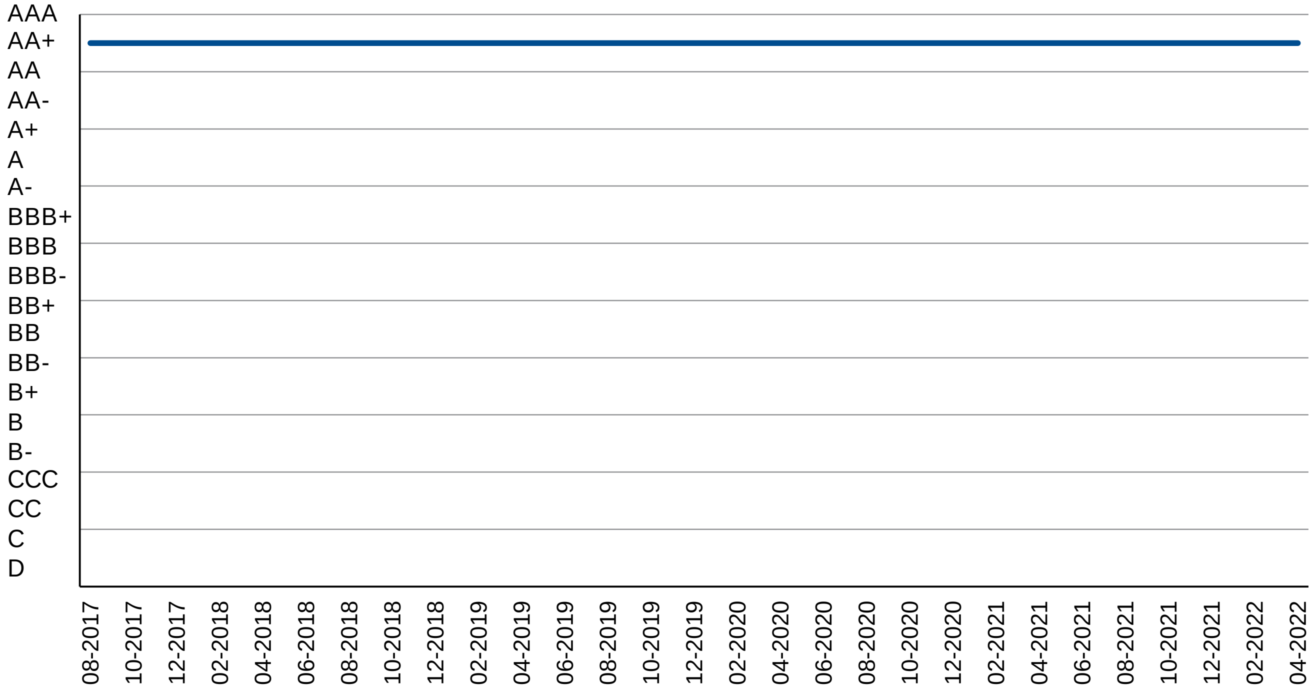

Source: European Commission, Scope Ratings GmbH

**Old age dependency ratio**, %




Source: United Nations, Scope Ratings GmbH

## Appendix I. Rating history




## 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 our Core Variable Scorecard.

| Peer group* |
|---|
| Austria |
| Belgium |
| Denmark |
| Finland |
| 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 29) used in our quantitative model, the Core Variable Scorecard.

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021E | 2022F | 2023F |
|---|---|---|---|---|---|---|---|---|
| **Domestic Economic Risk** | | | | | | | | |
| **GDP per capita, USD ‘000s** | 43.9 | 46.4 | 50.0 | 48.7 | 49.2 | 54.0 | 53.7 | 56.8 |
| **Nominal GDP, USD bn** | 240.7 | 255.6 | 275.8 | 268.5 | 271.6 | 298.9 | 297.6 | 314.5 |
| **Real growth, %[1]** | 2.8 | 3.2 | 1.1 | 1.2 | -2.3 | 3.5 | 1.7 | 1.5 |
| **CPI inflation, %** | 0.4 | 0.8 | 1.2 | 1.1 | 0.4 | 2.1 | 3.8 | 2.7 |
| **Unemployment rate, %[1]** | 9.0 | 8.8 | 7.4 | 6.7 | 7.8 | 7.6 | 6.7 | 6.6 |
| **Public Finance Risk** | | | | | | | | |
| **Public debt, % of GDP[1]** | 63.2 | 61.2 | 59.8 | 59.6 | 69.0 | 65.8 | 65.4 | 66.3 |
| **Interest payment, % of government revenue** | 2.0 | 1.9 | 1.7 | 1.6 | 1.3 | 1.0 | 0.7 | 0.6 |
| **Primary balance, % of GDP[1]** | -0.6 | 0.3 | 0.0 | -0.1 | -4.8 | -2.2 | -1.6 | -1.2 |
| **External Economic Risk** | | | | | | | | |
| **Current account balance, % of GDP** | -2.0 | -0.8 | -1.8 | -0.3 | 0.8 | 0.9 | 0.4 | 0.0 |
| **Total reserves, months of imports** | 1.2 | 1.1 | 1.0 | 1.1 | 1.4 | - | - | - |
| **NIIP, % of GDP** | 5.3 | 1.3 | -5.5 | 4.1 | -4.8 | -4.5 | - | - |
| **Financial Stability Risk** | | | | | | | | |
| **NPL ratio, % of total loans** | 1.5 | 1.7 | 1.4 | 1.4 | 1.5 | - | - | - |
| **Tier 1 ratio, % of risk weighted assets** | 21.9 | 19.6 | 19.7 | 18.5 | 18.1 | - | - | - |
| **Credit to private sector, % of GDP** | 94.0 | 93.4 | 94.2 | 95.4 | 101.0 | - | - | - |
| **ESG Risk** | | | | | | | | |
| **$CO_2$ per EUR 1,000 of GDP, Mt $CO_2$-e** | 192.4 | 176.2 | 178.9 | 164.4 | 155.7 | - | - | - |
| **Income quintile share ratio (S80/S20), x** | 3.9 | 3.9 | 4.0 | 4.0 | - | - | - | - |
| **Labour force participation rate, %** | 75.8 | 76.6 | 77.8 | 78.2 | - | - | - | - |
| **Old age dependency ratio, %** | 33.1 | 34.1 | 35.0 | 35.8 | 36.6 | 37.4 | 38.1 | 38.7 |
| **Composite governance indicator[2]** | 1.8 | 1.8 | 1.8 | 1.7 | 1.8 | - | - | - |

[1] Forecasted values are produced by Scope and may differ from those presented in the charts of the previous sections
[2] Average of the six World Bank Governance Indicators
Source: European Commission, IMF WEO, World Bank, Scope Ratings GmbH

## Appendix IV. Economic development and default indicators

| | |
|---|---|
| IMF Development Classification | Advanced economy |
| 5y USD CDS spread (bps) as of 27 April 2022 | 15.5 |

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