

## Finnish economy continues to cool down

- Finnish GDP growth is expected to slow down to 2.6 per cent in 2008 and 2.1 per cent in 2009.
- Growth is mainly driven by domestic demand, because exports are clearly facing headwinds from weaker global economy.
- Inflation continues to surprise on the upside. Consumer prices are now expected to rise 3.8 per cent in 2008 and 2.5 per cent in 2009, assuming no major energy price spikes in near future.
- Both external balances and public finances are expected to maintain a surplus through the forecast period 2008-2009.

### GDP growth will be roughly halved

GDP grew 4.4 per cent last year. Agriculture and forestry production expanded surprisingly strongly by 17 per cent. Manufacturing rose by 6 per cent, while subsector metal engineering expanded 10 per cent and forest industries stalled. Construction rose 7.5 per cent and trade 6 per cent. GDP growth decelerated to about 3 per cent during first quarter. Full year growth is forecast to amount to 2.6 per cent and 2.1 per cent in 2008 and 2009 respectively. Slowdown is expected to be broad based.

### Growth of export is winding down

Exports of goods and services grew 5.5 per cent in 2007, which was already less than during the previous three years. Volumes of goods and services rose at the same speed. Export prices rose on average by more than one per cent.

Value of processed wood product exports rose about 21 per cent in 2007, but paper and pulp industry exports increased only 3 per cent. Metal engineering exports increased by one fifth in value. Electronics rose about 10 per cent in value. Germany, Sweden and Russia were the most important export markets, each absorbing 10-11 per cent of Finnish exports. Importance of Russia has risen, although the figure includes roughly one third goods from third countries only passing through Finland.

Many companies especially in technology industries (metals, electronics, IT) have large order books, implying that exports should grow also this year. Exports of goods and services rose by about 5 per cent y-on-y in volume during first quarter. Weaker global outlook weighs on the future outlook of Finnish exports and strong euro exchange rate causes challenges especially in forest industries, which are sensitive to price competition. Exports are expected to rise modestly by 2-3 per cent both in 2008 and 2009, but downside risks exist if the main export markets decline further.

### Fixed investments have risen markedly

Investment volume grew nearly 8 per cent in 2007. Housing investment growth stalled, but other building construction rose 20 per cent. Machinery CAPEX rose by 6 per cent and infrastructure construction roughly by 5 per cent. Due to the strong expansion, investments per GDP ratio has risen over 20 per cent first time since 1992. Investments continued fast growth at 8 per cent during the first quarter, although housing construction shrank by 4.5 per cent.

Growth of investments are expected to clearly slow down from 2007. Housing construction declines, but other construction probably continues to grow both in 2008 and 2009. Worried by economic slowdown and rising financing costs, manufacturing industries will invest only marginally more than in 2007.

### Private consumption cools from high figures

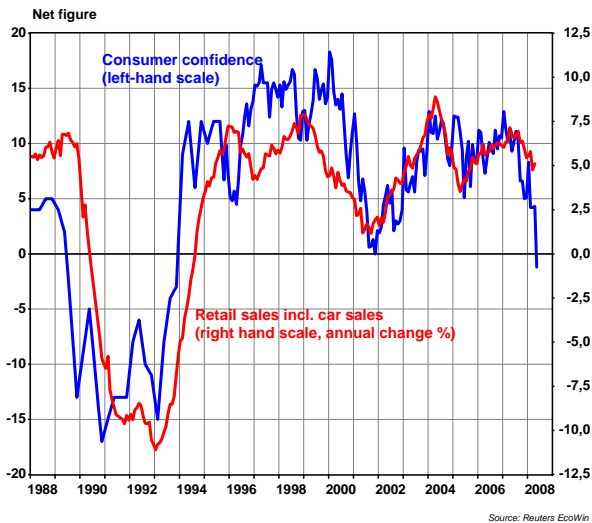
Volume of private consumption has risen roughly 4 per cent annually during the past two years. Consumption of non-durables and durables rose 4 per cent and consumption of services rose 3 per cent in 2007. Fastest growth was recorded in semi-durable goods, which rose 7 per cent. Households became more indebted, because purchasing power increased only by little more than 2 per cent. Consequently, debt per disposable income ratio broke old records exceeding 100 per cent. Comparing to other developed countries, however, Finnish households are not highly indebted yet. Higher interest rates coupled with a notable decline in consumer confidence to whole economy and recently also to own household economy points to increasing caution.

Private consumption continued to increase by 4 per cent during the first quarter, but the full year figure is expected to be less than three per cent. Slowdown will continue into 2009, when private consumption is forecast to expand slightly more than 2 per cent. Thanks to tax changes, car sales will grow significantly this year. Electron-

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ics purchases level off, which is natural after the massive sales of digital TV equipment in 2007. Average base salaries will rise at least 5 per cent this year and almost as much next year. Number of employed persons is also growing at least this year, implying fairly strong growth in total income. Non-labour incomes like pensions are not rising as fast.

### Consumer confidence and retail sales growth



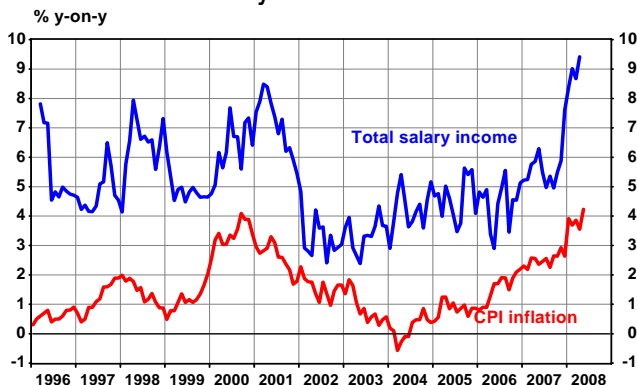
### Unemployment rate flattening out

Employment rose 2 per cent last year, which in other terms means net 50 000 new employees. Especially construction and several service industries have added work force. Employment in manufacturing industry has been fairly stable, despite of high profile factory closedowns. Unemployment rate decreased by 0.8 percentage points to 6.9 per cent last year. Employment continued to rise by 2 per cent during the first four months of this year. Despite of slowdown in housing building and fears of skilled labour shortage, construction has added one tenth to the workforce. Also private services employed roughly 4 per cent more than a year earlier. Unemployment rate has continued to fall faster than our previous forecast assumed, but the economic slowdown is expected to ease demand for labour during the second half of this year and next year. Unemployment rate is forecast to be 6.3 per cent in 2008 and 6.2 per cent in 2009.

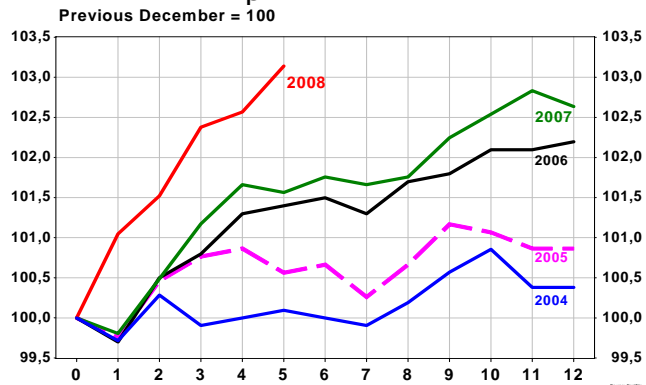
### Inflation has accelerated to 4 per cent, but is likely to decelerate in 2009

Consumer price inflation rose by 0.9 percentage point to 2.5 per cent in 2007. Some prices were further raised at the beginning of 2008, because the government lifted taxation on energy and alcohol. Food prices have continued to climb on the back of fast appreciation of raw materials. In January-May 2008, inflation run at 3.9 per cent. Food was 7 per cent more expensive and also housing costs had risen 6 per cent. Inflation is unlikely to abate fast and full year inflation is expected to be 3.8 per cent. Assuming that oil and other raw material prices will not continue to surge, inflation should fall below 3 per cent in 2009. Reduction of food VAT will cause one-off decline during the latter half of the year and interest rates are expected to be slightly lower. Nominal housing prices are likely to remain fairly unchanged over the forecast period, which causes the real prices to decline. Risk of nominal price decline in housing will increase, if benchmark interest rates stay higher than expected. Base salaries are likely to increase at least 5 per cent in 2008 and almost as fast in 2009. Given higher employment, total salary incomes will continue to rise fairly fast.

#### Total salary income and inflation



#### Consumer price index 2004-2008



### Current account and state finances remain unproblematic

Current account has been in the positive territory since 1994. Thanks to stable terms of trade and positive trade balance, current account surplus was EUR 7.3 billion last year. Current account surplus should remain large in 2008 and 2009, although terms of trade may cause it to shrink marginally in 2008.

Central government tax income rose by 6 per cent in 2007 and total income had a similar increase. Expenditure rose only by 2 per cent, even if transfers to local government, state pensions and debt interest expenses grew 4 - 7 per cent. Expenditure was constrained by decrease in transfers to businesses and households, especially thanks to decreasing unemployment. Budget surplus increased by EUR 1.8 billion to EUR 4 billion in 2007. Income has continued to rise at the same speed in January-April 2008 and expenditure has risen slightly faster, translating to a cumulative surplus of EUR 1.4 billion.

Central government gross debt amounted to EUR 55.6 billion at the end of May. The debt to GDP ratio stood at 32 per cent being one of the lowest in EU-15. The debt is expected to further decrease towards the end of the year. Despite some challenges in local government, public finances are in good shape for expansionary fiscal policy if the economic cycle continues to worsen.

#### FINLAND

National accounts	2006	2007	2008	2009
Volume change, %				
GDP	4,9	4,4	2,6	2,1
Imports	7,8	4,8	1,5	2,0
Exports	11,8	5,5	2,0	2,5
Consumption	3,1	2,8	2,1	2,0
- private	4,1	3,7	2,7	2,3
- public	0,6	0,8	0,5	1,0
Investments	4,7	7,6	3,5	2,0
- private	6,5	8,1	3,5	2,0
- public	-6,4	3,5	2,0	2,0
KPI	2006	2007	2008	2009
Unemployment rate, %	7,7	6,9	6,3	6,2
Salaries, %	3,0	3,3	5,2	4,8
Inflation, %	1,6	2,5	3,8	2,5
Current account, bn.euro	7,6	7,3	7,2	7,5
CA / GDP, %	4,5	4,1	3,8	3,8

Sampo Bank / Economists