18 August 2017

Public Finance

# Republic of Finland
# Rating Report

AA+ STABLE OUTLOOK

## Credit strengths

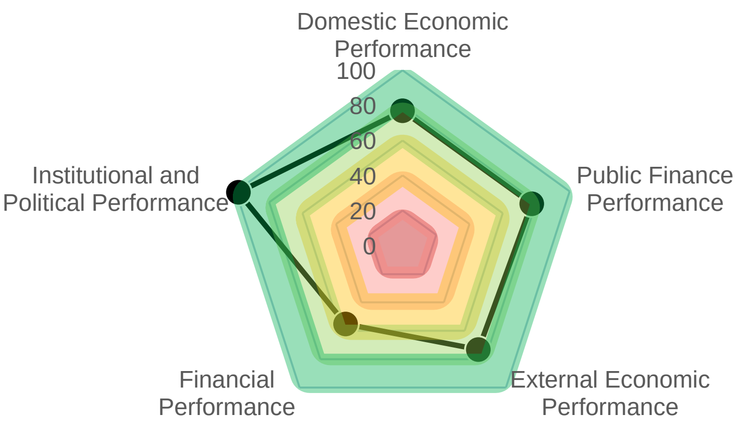
- Wealthy and diversified economy
- High institutional strength
- Commitment to structural reforms
- High public debt affordability
- Large public sector assets

## Credit weaknesses

- Low growth potential
- Reform implementation risks
- Ageing population

**Rating rationale and Outlook:** The AA+ rating reflects Finland's wealthy and diversified economy, high institutional strength and commitment to ongoing structural reforms aimed at improvements in the country's competitiveness and efficiency of public finances. The country also benefits from a strong fiscal framework and high debt affordability. However, these supporting factors are balanced by challenges such as lower growth potential following a deep restructuring of the economy and rapid increase in Finland's public debt ratio. The Stable Outlook reflects Scope's assessment that risks for Finland remain fairly balanced.

**Figure 1: Sovereign rating categories summary**




## Positive rating-change drivers

- Significant improvement in growth potential
- Quicker than expected return to primary budget surpluses

## Negative rating-change drivers

- Derailed implementation of reforms
- Deterioration of growth prospects

## 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 |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## Domestic economic risk

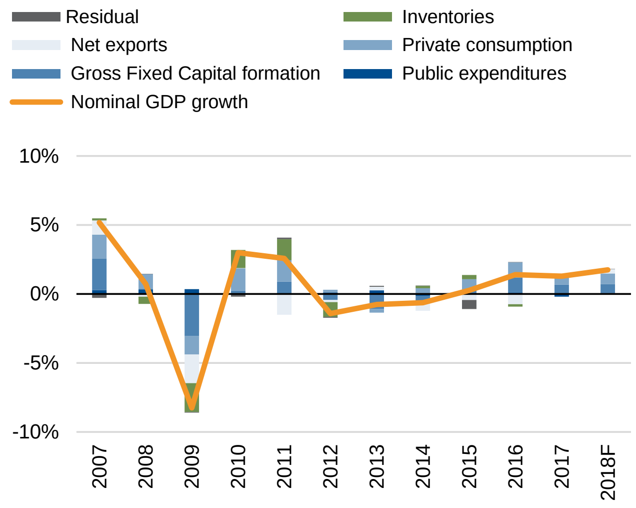
**Recovery is underway and strengthening**

Following three years of prolonged contraction (from 2012 to 2014), Finland's economic performance started to recover and grew at 0.3% and 1.4% in 2015 and 2016, respectively. Growth was supported by private consumption as well as investment in both residential and non-residential construction. Both drivers will continue to make a positive contribution to economic growth in 2017 and 2018, albeit at a slower pace than before; however, this is likely to be counterbalanced by a positive contribution from net exports.

Leading confidence indicators, especially the consumer confidence indicator, which is at its highest level since 2010, clearly point to continued economic recovery. Moreover, GDP results for the first quarter of 2017, which rose by 1.6% QoQ compared to 0.4% in Q1 2016, indicate the economic expansion is strengthening.

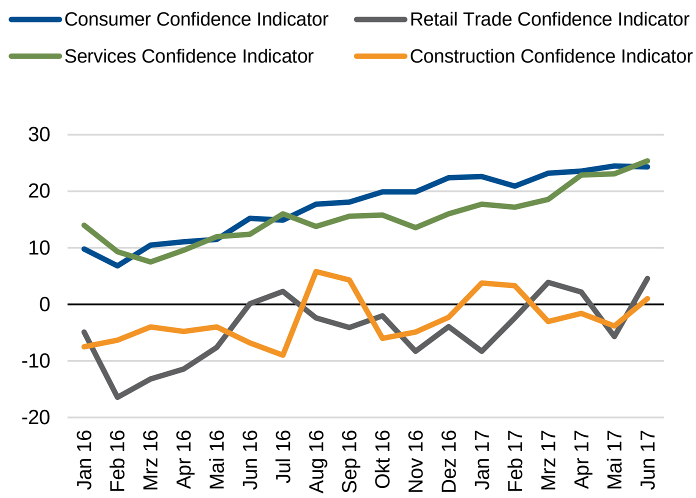
Over a longer horizon until 2020, the IMF forecasts the country's real GDP will grow at around 1.4-1.5%. This is an improvement compared to the recent contraction but is still lower than the pre-crisis rate of growth.

**Figure 2: Contributions to real GDP growth, %**




Source: EC, Calculations Scope Ratings AG

**Figure 3: Confidence indicators, percent balance, SA %**




Source: ECB

The anticipated slowdown in private consumption is expected to be driven by the implementation of the Competiveness Pact reforms, which aim at curbing labour costs in the private and public sector. Construction, on the other hand, has been enjoying stronger demand due to improved confidence among businesses and households, and it seems to have achieved a peak in new orders. Net exports have been a drag on growth in the past but are expected to pick up in 2017, supported by rising car exports, economic recovery among Finland's main trading partners (and thus higher import demand), and gains in cost-competitiveness resulting from implementation of the Competitiveness Pact.

The Finnish economy suffered a significant disruptive change in the nation's economic structure over the last 10 years, which has had a negative impact on growth potential. This structural change involved deep restructuring within ITC and in the wood and paper industries. The negative impact was amplified by rapid wage increases outpacing labour productivity in post-crisis years, which impaired the country's cost-competitiveness and contributed to a decrease in Finland's share in global and intra-EU exports. As a result, medium-term potential GDP growth is expected to be lower than in pre-crisis years and

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stay at around 1% according to IMF estimates (compared with the country's average real growth rate of 3.5% from 2000 to 2007).

**Finland's economic potential was impaired**

Other structural features like a decline in the working age population coupled with an increasing number of retirees, a relatively low level of investment that still has not returned to the level seen pre-crisis[1], and a high private-sector debt ratio do not make the task of moving the country out of a low-growth trap easier and will make restructuring of the Finnish economy slow and politically taxing.

Though growth potential was negatively affected, the economic structure became more diversified and less dependent on particular industries, making the economy more resilient to future downturns. Overall, the decline in electronics and restructuring in forest-related industries seem to have bottomed out, as evidenced by a slower pace of losses in export shares and cost-competitiveness. Scope attributes these signs of recovery partly to extensive policy measures via the Competitiveness Pact being undertaken by authorities to boost productivity growth.

**Competitiveness Pact is important, but implementation risks remain**

The Competitiveness Pact is aimed at boosting competitiveness through three types of measures, each yielding a unit labour cost reduction of 5% by 2019: i) a one-off cut in labour costs; ii) wage moderation over the coming years; and iii) productivity gains at the corporate level generated by enhanced flexibility, notably in wage negotiations. The one-off cut in labour costs includes a reduction in public-sector employees' annual holiday bonuses for two years (2017-2019), a 24-hour increase in annual working time without matching compensation starting from 2017, and a 12-month freeze on wage increases to be undertaken largely in 2017. Long-term measures include new wage-setting practices known as the Finnish model, to commence in 2018. These practices are supposed to take into account competitiveness and productivity developments in particular industries and use wages in the tradeable sector to serve as an anchor for the rest of the economy.

The country's largest trade unions, business representatives and the government signed the pact in the summer of 2016. It went into effect in 2017, and over 90% of employees are covered by the pact[2]. At the same time, it's Scope's view that the implementation risk associated with the Competitiveness Pact remains high, as most important and difficult aspects of the reform relate to wage negotiations and an alignment with productivity is yet to start (expected in autumn 2017, when most sectoral collective agreements expire).

**Tax reforms have long-term benefits but short-term disadvantages**

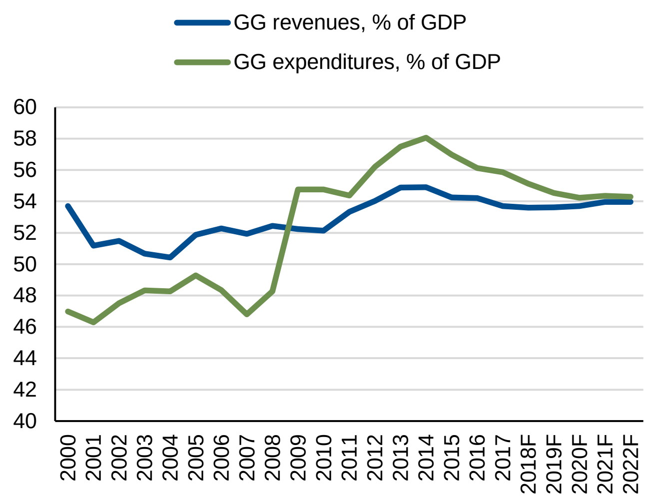
In addition to the freeze in salaries, a larger share of social security contributions was shifted permanently to employees. To alleviate the impact of these measures on households, as of 2017, the government announced personal-income tax cuts through increased deductibility of earnings from taxable income for low- and medium-income groups and reformed social security contributions to reduce inactivity traps[3]. These tax-related measures are favourable for businesses and are expected to contribute to economic expansion in the medium to long term, but in the short term weaken general government revenues.

## Public finance risk

Finland benefits from i) a robust fiscal framework that allows it to contain public expenditure growth, ii) a solid debt profile and iii) a high level of public sector assets, mostly in the form of statutory earnings-related pension funds. However, stabilisation of debt dynamics could prove fragile due to slower growth and less-than-forecasted results of structural reforms aimed at containing expenditure growth.

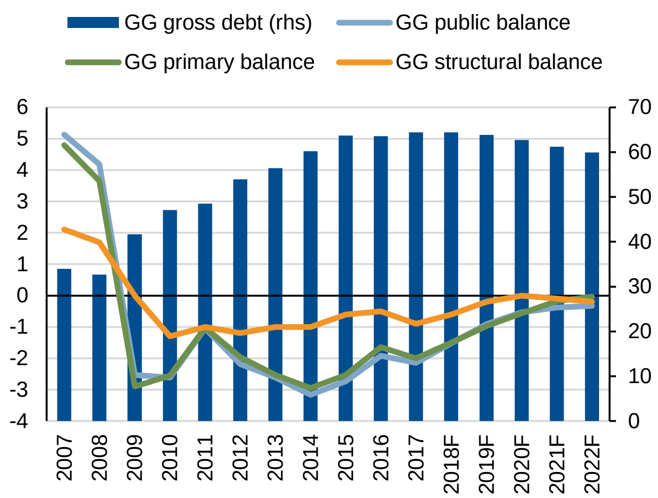
[1] Country report Finland 2017, European Commission, February 2017, p. 35
[2] Country report Finland 2017, European Commission, February 2017, p. 6
[3] The inactivity trap reflects the interplay of tax and benefits systems, which discourages a move from unemployment to a paid job

**Figure 4: Budget revenue and expenditures, % of GDP**




Source: IMF

**Figure 5: Budgetary balances and public debt, % of GDP**




Source: IMF

**Economic recovery and fiscal consolidation measures will reduce budget deficits**

2016 budgetary performance was better than expected – the budget deficit stood at 1.9% of GDP compared to 2.6% projected in the 2016 Stability Programme – driven by economic recovery, higher contributions to unemployment insurance and lower government wage costs. It is expected that the budget deficit will widen in 2017 before starting to improve again in 2018. The main reason behind this temporary deterioration in budget performance is implementation of the Competitiveness Pact. According to the government, deficit-reducing measures related to the wage freeze, the permanent increase in working hours, and the temporary reduction in holiday bonuses for public-sector servants will not outpace tax cuts that result in a slower pace of revenue growth.

It's expected that beyond 2018, the country will run minor budget deficits benefitting from structural reforms and economic recovery, with 2018-2020 budget consolidation measures to be accompanied by increasing economic activity in the private sector, boosting budget revenues. There is risk that both factors might provide less positive contributions than expected, however.

Budgetary reforms also include an overhaul of social and healthcare services and the establishment of regional administrations, which will take over social and healthcare responsibilities from municipalities. If implemented, the reforms could reduce annual healthcare expenditure growth to 0.9% in real terms compared to the current 2.4%[4]. The reforms are expected to take effect in January 2019 but have been postponed by a year to allow more time to address inconsistencies in the draft legislation[5], which will delay an expected positive impact on expenditure growth. In addition, effective in 2017, a reform to unemployment insurance benefits aimed at strengthening incentives to accept job offers will cut the period of entitlement to earnings-related unemployment from 500 to 400 days with a positive impact on the social security fund balance and therefore on budget finances.

Finland continues to face long term pressures from its ageing population. Finland's sustainability gap is substantial at just over 3.0% of GDP in 2016 and over the longer term, the projected reduction in the working-age population will continue to restrain Finland's growth potential, posing additional risks to public finances. Scope recognizes

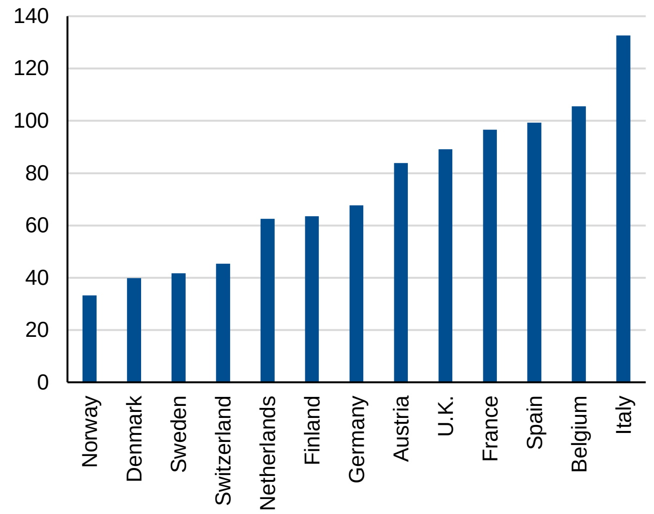
[4] Country report Finland 2017, European Commission, February 2017, p. 16
[5] http://www.helsinkitimes.fi/finland/finland-news/politics/14872-finnish-government-pushes-back-social-and-health-care-reform.html

that the government has already started to address long-term financing of the pension system in 2017.

**Medium- to longer-term challenges from an ageing population**

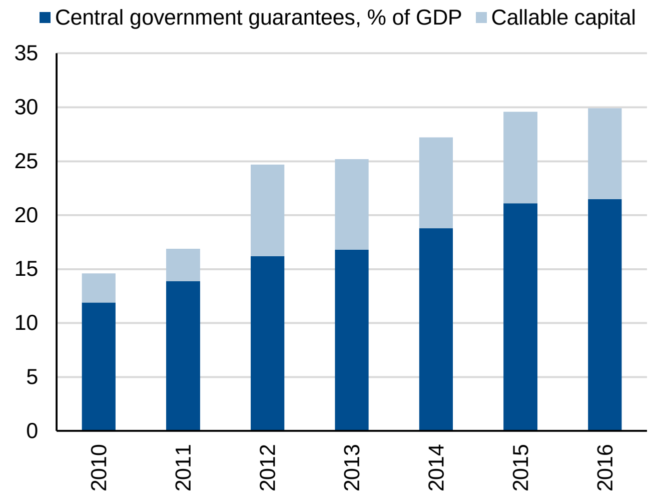
The reforms to healthcare and social services will help reduce medium-term debt sustainability risk. Similarly, a 2017 pension reform (which will gradually increase the minimum retirement age (from 63 to 65 by 2027) and eventually link it to life expectancy) will support long run fiscal dynamics. These measures are a continuation of the earnings-related pension system reforms that began in 2005 and are aimed at strengthening the incentive to work longer. All this suggests that longer-term challenges to public finances are well recognised by national authorities and are being addressed.

**Figure 6: Finland's public sector debt compared with that of other EU countries in 2016, % of GDP**




Source: IMF

**Figure 7: Guarantees and callable capital, % of GDP**




Source: General government fiscal plan 2018-2021

**Fiscal framework helps contain government expenditures**

The sustainability of public finances in Finland is aided by a sound fiscal framework, which sets limits on central government spending for the duration of the parliamentary term. The spending ceilings are set in real terms and go through price- and cost-related adjustments on an annual basis. The effectiveness of the framework is determined by the fact that it covers almost 80% of central government expenditures, excluding those prone to cyclical changes, such as unemployment benefits. Central government expenditures make up about 60%[6] of general government expenditures. Although the central government spending limits have helped curb budget expenditure growth to within a 3% threshold during the post-crisis period (with the exception of 2014), they were unable to prevent a rapid accumulation of public debt starting from 2009, indicating deficiencies in the expenditure adjustment mechanism during periods of sharp revenue decline.

**Public debt has seen rapid increase**

At the end of 2016, Finland's public debt ratio stood at 63.8% of GDP. Though it remains one of the lowest among euro area countries at the end of 2016, its deterioration has been rapid, given the ratio stood at only 32.7% of GDP as of the end of 2007 (Figure 6). It is expected that the public debt ratio will peak at 64.4% of GDP in 2018 before declining to 62.7% of GDP by YE 2020, continuing its fall to under the 60% threshold by YE 2022.

[6] Including social security expenditures

**Finnish central government debt profile is solid**

The Finnish government's interest-to-revenue ratio stood at a low 2% in 2016 and has been on a declining trend, pointing to high debt affordability. Average maturity of debt is stable and at around six years for the last six years, whereas gross financing needs stood at a moderate 7.8% of GDP at the beginning of 2017 according to IMF calculations. However, the share of general government debt held by non-residents, although reduced from 79.3% in 2013 to 69.8% in 2016, was still one of the highest among euro area peers. This points to a less stable investor base, as domestic investors tend to be less prone to risk reversals in times of crisis.

**Net debt is negative thanks to high stock of prefunded pensions**

Finland's net public debt ratio is negative and stood at -51.4% at the end of 2016 – due to the government's large stock of pension assets in statutory earnings-related pension funds. The country is one of the few among developed countries (the others being Norway and Sweden[7]), where gross public debt is smaller than the stock of public assets. Going forward, net debt is expected to deteriorate somewhat more than gross debt as net inflows to pension funds slow due to a diminishing number of contributors (from the falling working age population). Large assets in pension funds is a partial positive factor, as while the pension system is partially pre-funded and in surplus, these assets cannot be liquidated in large quantities to fulfil government financing needs.

Finland's contingent liabilities in the form of guarantees and callable capital in euro area and international institutions have almost doubled in the last six years (Figure 7), driven by the expansion of guarantees provided to Finnvera, the export credit and SME financing agency, and contributions to the European Stability Mechanism (ESM) and European Financial Stability Facility (EFSF). Another important beneficiary of state guarantees is the National Housing Fund, an off-budget fund that subsidises interest payments for housing projects that are mostly socially oriented.

## External economic risk

Finland's external risk is moderate. Although the country's current account balance deteriorated and moved into negative territory post-2008, these deficits have been stable and have not exceeded 2% of GDP so far.

**Finland is a creditor country with a slightly negative current account**

Finland used to possess relatively large current account surpluses before 2011. These were driven by the country's strong export industries, particularly electronics and pulp and paper. However, Nokia's decline (its mobile phones were unable to compete with smartphones) combined with much weaker demand for paper and pulp industry products (a result of digitalisation) significantly weakened the country's merchandise trade position, which turned negative in 2011 and dragged down the overall current account balance. In 2013, the merchandise trade balance recovered and returned to positive territory, after the decline in electronics bottomed out and the paper industry invested in new products and technology.

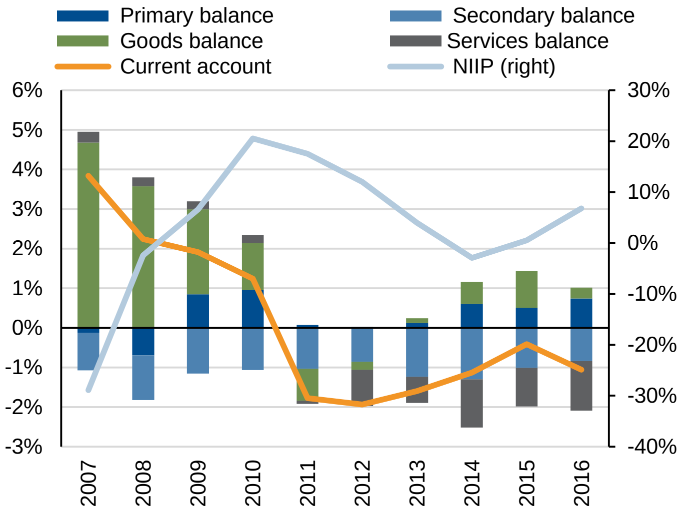
Going forward, Scope expects that visible improvements in the country's cost-competitiveness relative to main EU export markets (Figure 9) alongside expected further improvements with the implementation of the Competitiveness Pact will help Finnish exporters compete internationally and support the country's external position.

However, an improved outlook for Finnish export industries still has some caveats related to the current structure of exports and the economic performance of major trading partners. Finland's exports are dominated by intermediate products and investment goods, which account for about two-thirds of goods exports and are destined for countries like China, Germany and Sweden[8], making Finnish exporters dependent on performance

[7] The IMF fiscal monitor, 2016
[8] Country report Finland 2017, European Commission, February 2017, p. 32

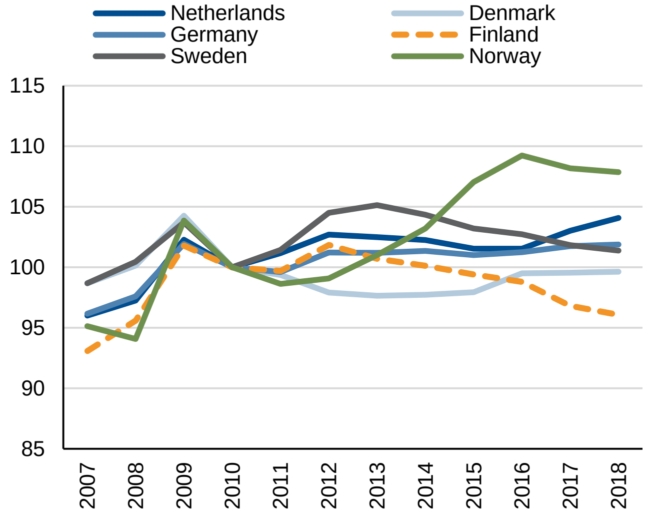
in these markets and economic swings when investments decline. That aside, Finland is still susceptible to the pace of economic recovery in Russia; although the share of the Russian market has decreased markedly, it still made up 5.7% of Finnish exports in 2016.

**Figure 8: Finland's current account and international external position, % of GDP**




Source: IMF

**Figure 9: Unit labour costs (2010=100)**




Source: European Commission

Although recent negative current accounts have contributed to a decline in Finland's net international investment position (NIIP), Finland has remained a modest net creditor country with a NIIP of 6.8% of GDP at the end of 2016.

**High gross external debt is likely to decline**

Finland's gross external debt stood at a high 196.2% of GDP as of the end of 2016, indicating reliance on external funding largely on the part of banks and corporates. Net external debt is much lower – at 46.3% of GDP at YE 2016 – with considerable external assets held across multiple sectors. Going forward, the external debt ratio is likely to decline following the conversion of Nordea's Finnish subsidiaries into branches, with an associated move of a large share of the bank's assets and liabilities onto the Swedish balance sheet.

## Financial stability risk

Scope considers the Finnish banking sector sound and to pose a low risk to financial stability. Finland's banking sector is one of the most highly capitalised in the EU, and its asset quality is among the highest. The aggregate Tier 1 capital ratio was 23.1% in 2016, with non-performing loans to gross loans at just 1.3%. Although the low interest rate environment impacted banking sector profitability, Finnish banks managed to control costs more efficiently than their euro area peers.

**The Finnish banking system is a low risk to financial stability apart from select concerns**

The Finnish banking sector is large and concentrated. In 2016, total assets were equal to 277.3% of GDP[9], and the three largest banks – OP Group, Nordea Bank Finland and Danske Bank Nordea – control the market. The latter two are headquartered in Nordic neighbours (Sweden and Denmark respectively), making the extent of regional interconnectedness very high. This exposes Finland's economy to tighter financial conditions in the event of a downturn in neighbouring countries. This interconnectedness, however, will diminish with the conversion of Nordea's Finnish subsidiaries into branches.

[9] Country report Finland 2017, European Commission, February 2017, p. 47

This will reduce the size of the banking sector in Finland and the amount of potential contingent liabilities for the sovereign.

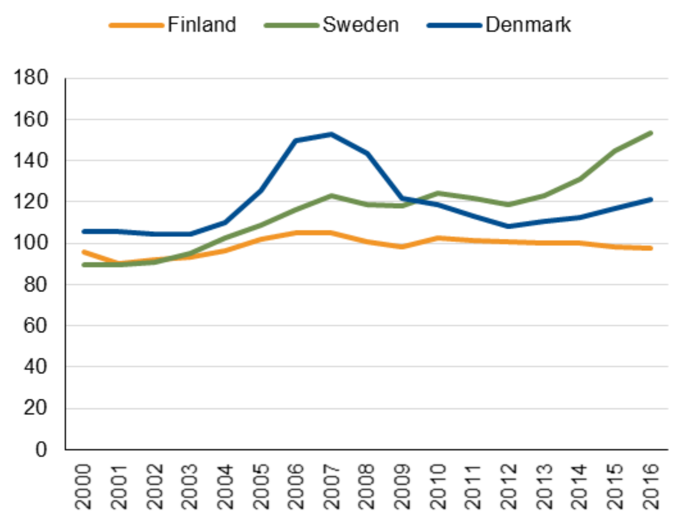
Another concern is the banks' dependence on predominately foreign-financed, short-term wholesale funding, which exposes banks to shifts in foreign investor sentiment and to shocks in global financial markets.

Finland shows a high level of non-financial private sector debt, which stood at 148.5% of GDP at YE 2016 (on a consolidated basis). Less than 60% of non-financial private sector debt is carried by corporations, with the rest held by households. Unlike company debt, household debt, which is predominately made up of mortgages, has been following a rising trend relative to both GDP and household disposable income. Household indebtedness is likely to continue growing given the wage freeze under the Competitiveness Pact, whereas non-financial corporations may see their debt reduced due to increased profitability.

**Despite the high level of household indebtedness, risks to financial stability are low**

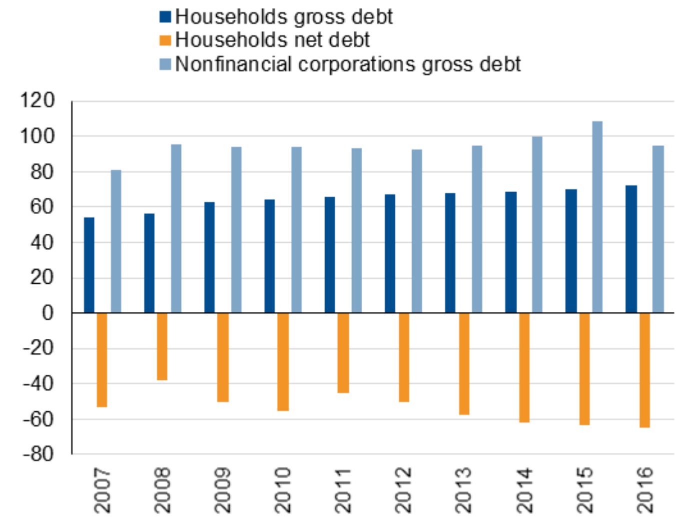
Though household debt is likely to rise, households' net asset position will continue to be positive, supported by household assets including equity holdings via pension plans and real estate assets. Moreover, though most household mortgages have variable interest rates – they have fixed monthly payments, which helps buffer households from interest rate shocks[10]. Going forward, a maximum 90% loan-to-value ratio for housing loans (and 95% for first time buyers) introduced in July 2016, combined with a gradual reduction in the tax deductibility of interest payments, will help curb the extension of new mortgages[11]. Finally, rising household debt has not caused an increase in home prices relative to income, with this ratio largely stable and hovering around its long-term average during the post-crisis period, unlike in other Nordic countries (Figure 10).

**Figure 10: Price-to-income ratio (standardised)**




Source: OECD

**Figure 11: Household and non-financial corporate debt, % of GDP**




Source: Government of Finland, European Commission

10 Finland, 2016 Article IV consultation, IMF country report, November 2016, p. 7
11 Country report Finland 2017, European Commission, February 2017, p. 23

## Institutional and political risk

**Government coalition has been stable despite turmoil within the Finns Party**

Following general elections in 2015, the government coalition comprised three parties – the Centre Party (KSEK), which leads the coalition, the right-wing Finns Party (PS) and the centre-right National Coalition Party (KOK). In the spring of 2017, the coalition narrowly avoided collapse when Timo Soini, the leader of PS, stepped down and paved the way for Jussi Halla-aho, a eurosceptic with strong anti-immigrant views, to assume the party leadership. A group of moderate PS members then broke away to form the New Alternative Party (SDP), which now is also part of the governing coalition. The change in PS leadership appeared to be a reaction to the sharp drop in popular support following compromises the PS made as a member the ruling coalition. The sustainability of the coalition until the next parliamentary elections scheduled for 2019 remains a concern, as the successful implementation of reforms is crucial for the long-term economic prospects of the country and sustainability of public finances.

## Methodology

The methodology applicable for this rating and/or rating outlook “Public Finance Sovereign Ratings” is available on www.scoperatings.com.

Historical default rates of Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/governance-and-policies/regulatory/esma-registration.
Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

A comprehensive clarification of Scope’s definition of default, definitions of rating notations can be found in Scope’s public credit rating methodologies at www.scoperatings.com.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

# I. Appendix: CVS and QS results

## Sovereign rating scorecards

Scope's Core Variable Scorecard (CVS), which is based on relative rankings of key sovereign credit fundamentals, signals an indicative "AA" ("aa") rating range for the Republic of Finland. This indicative rating range can be adjusted by up to three notches on the Qualitative Scorecard (QS) depending on the size of relative credit strengths or weaknesses versus peers based on analysts' qualitative analysis.

For the Republic of Finland, the following relative credit strengths have been identified: 1) economic policy framework, 2) macroeconomic stability and imbalances, and 3) market access and funding sources. Relative credit weaknesses are signalled for 1) growth potential of the economy. Combined relative credit strengths and weaknesses generate a one notch adjustment and signal a sovereign rating of AA+ for Finland. A rating committee discussed and confirmed these results.

| Rating overview | |
|---|---|
| CVS category rating range | aa |
| QS adjustment | AA+ |
| Final rating | AA+ |

To calculate the rating score within the CVS, Scope uses a minimum-maximum algorithm to determine a rating score for each of the 22 indicators. Scope calculates the minimum and maximum of each rating indicator and places each sovereign within this range. Sovereigns with the strongest results for each rating indicator receive the highest rating score; sovereigns with the weakest results receive the lowest rating score. The score result translates to an indicative rating range that is always presented in lower-case.

Within the QS assessment, analysts conduct a comprehensive review of the qualitative factors. This includes but is not limited to economic scenario analysis, review of debt sustainability, fiscal and financial performance and policy implementation assessments.

There are three assessments per category for a total of 15. For each assessment, the analyst examines the relative position of a given sovereign within its peer group. For this purpose, additional comparative analysis beyond the variables included in the CVS is conducted. These assessments are then aggregated using the same weighting system as in the CVS.

The result is the implied QS notch adjustment, which is the basis for the analysts' recommendation to the rating committee.

## Foreign- versus local-currency ratings

Finland's debt is predominantly issued in euros, or it is hedged. Because of its history of openness to trade and capital flows and the euro's reserve currency status, Scope sees no evidence that Finland would differentiate among any of its contractual debt obligations based on currency denomination.

## II. Appendix: CVS and QS Results

**CVS**

| Rating indicator | Category weight |
|---|---|
| **Domestic economic risk** | **35%** |
| Economic growth | |
| Real GDP growth | |
| Real GDP volatility | |
| GDP per capita | |
| Inflation rate | |
| Labour & population | |
| Unemployment rate | |
| Population growth | |
| **Public finance risk** | **30%** |
| Fiscal balance | |
| GG public balance | |
| GG primary balance | |
| GG gross financing needs | |
| Public debt | |
| GG net debt | |
| Interest payments | |
| **External economic risk** | **15%** |
| International position | |
| International investment position | |
| Importance of currency | |
| Current-account financing | |
| Current-account balance | |
| T-W effective exchange rate | |
| Total external debt | |
| **Institutional and political risk** | **10%** |
| Control of corruption | |
| Voice & accountability | |
| Rule of law | |
| **Financial risk** | **10%** |
| Non-performing loans | |
| Liquid assets | |
| Credit-to-GDP gap | |
| **Indicative rating range** | **aa** |
| **QS adjustment** | **AA+** |
| **Final rating** | **AA+** |

**QS**

*Maximum adjustment = 3 notches*

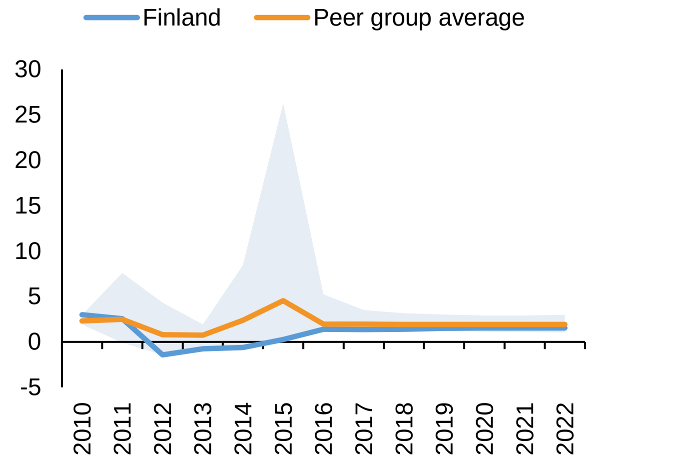
| | +2 notch | +1 notch | 0 notch | -1 notch | -2 notch |
|---|---|---|---|---|---|
| Growth potential of the economy | ○ Excellent outlook, strong growth potential | ○ Strong outlook, good growth potential | ○ Neutral | ◉ Weak outlook, growth potential under trend | ○ Very weak outlook, growth potential wel under trend or negative |
| Economic policy framework | ○ Excellent | ◉ Good | ○ Neutral | ○ Poor | ○ Inadequate |
| Macroeconomic stability and imbalances | ○ Excellent | ◉ Good | ○ Neutral | ○ Poor | ○ Inadequate |
| Fiscal performance | ○ Exceptionally strong performance | ○ Strong performance | ◉ Neutral | ○ Weak performance | ○ Problematic performance |
| Debt sustainability | ○ Exceptionally strong sustainability | ○ Strong sustainability | ◉ Neutral | ○ Weak sustainability | ○ Not sustainable |
| Market access and funding sources | ○ Excellent access | ◉ Very good access | ○ Neutral | ○ Poor access | ○ Very weak access |
| Current-account vulnerabilities | ○ Excellent | ○ Good | ◉ Neutral | ○ Poor | ○ Inadequate |
| External debt sustainability | ○ Excellent | ○ Good | ◉ Neutral | ○ Poor | ○ Inadequate |
| Vulnerability to short-term shocks | ○ Excellent resilience | ○ Good resilience | ◉ Neutral | ○ Vulnerable to shock | ○ Strongly vulnerable to shocks |
| Perceived willingness to pay | ○ Excellent | ○ Good | ◉ Neutral | ○ Poor | ○ Inadequate |
| Recent events and policy decisions | ○ Excellent | ○ Good | ◉ Neutral | ○ Poor | ○ Inadequate |
| Geo-political risk | ○ Excellent | ○ Good | ◉ Neutral | ○ Poor | ○ Inadequate |
| Financial sector performance | ○ Excellent | ○ Good | ◉ Neutral | ○ Poor | ○ Inadequate |
| Financial sector oversight and governance | ○ Excellent | ○ Good | ◉ Neutral | ○ Poor | ○ Inadequate |
| Macro-financial vulnerabilities and fragility | ○ Excellent | ○ Good | ◉ Neutral | ○ Poor | ○ Inadequate |

*** Implied QS notch adjustment = (QS notch adjustment for domestic economic risk)*0.35 + (QS notch adjustment for public finance risk)*0.30 + (QS notch adjustment for external economic risk)*0.15 + (QS notch adjustment for institutional and political risk)*0.10 + (QS notch adjustment for financial stability risk)*0.10**

Source: Scope Ratings AG

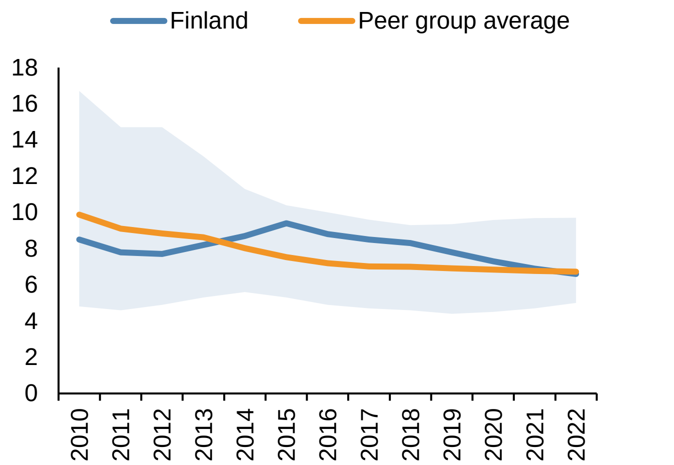
## III. Appendix: Peer comparison

**Figure 12: Real GDP growth**



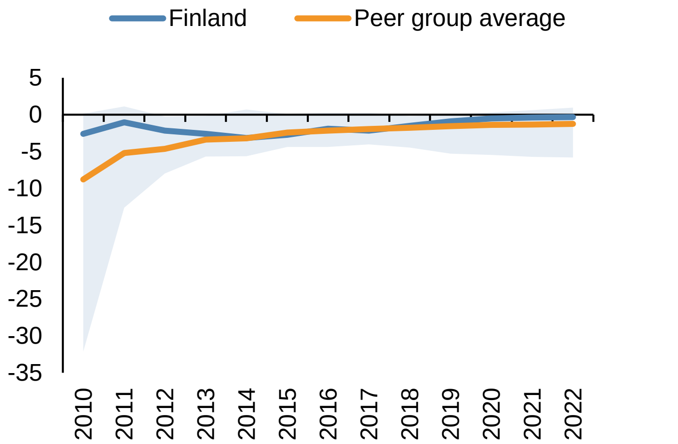

Source: IMF, Calculations Scope Ratings AG

**Figure 13: Unemployment rate, % total labour force**



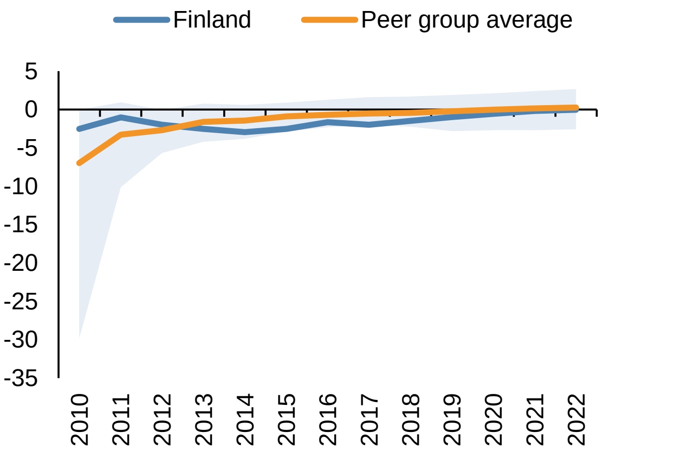

Source: IMF, Calculations Scope Ratings AG

**Figure 14: General government balance, % of GDP**



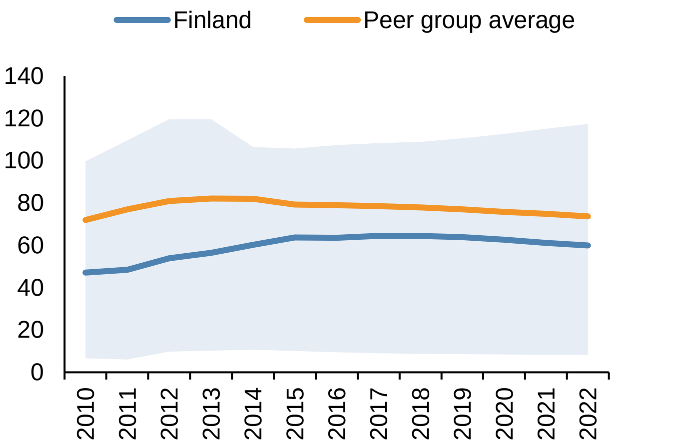

Source: IMF, Calculations Scope Ratings AG

**Figure 15: General government primary balance, % of GDP**



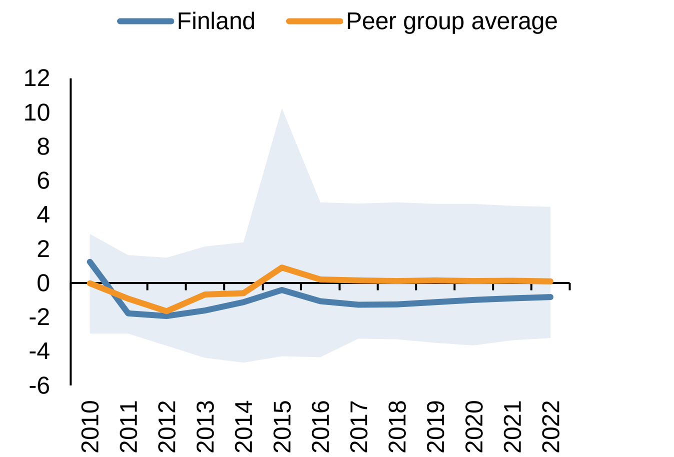

Source: IMF, Calculations Scope Ratings AG

**Figure 16: General government gross debt, % of GDP**




Source: IMF, Calculations Scope Ratings AG

**Figure 17: Current account balance, % of GDP**




Source: IMF, Calculations Scope Ratings AG

## IV. Appendix: Statistical tables

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017E | 2018F |
|---|---|---|---|---|---|---|---|
| **Economic performance** | | | | | | | |
| Nominal GDP (EUR bn) | 199.8 | 203.3 | 205.5 | 209.5 | 214.1 | 217.9 | 224.5 |
| Population (thous) | 5,413.0 | 5,436.6 | 5,459.7 | 5,482.0 | 5,503.1 | 5,523.2 | 5,542.5 |
| GDP-per-capita PPP (USD) | 40,620.2 | 41,293.5 | 41,511.8 | 42,275.2 | 43,052.7 | - | - |
| GDP per capita (EUR) | 36,903.0 | 37,385.2 | 37,615.4 | 38,228.5 | 38,958.6 | 39,507.1 | 40,544.3 |
| Real GDP growth | -1.4% | -0.8% | -0.6% | 0.3% | 1.4% | 1.3% | 1.7% |
| GDP growth volatility (10-year rolling SD) | 3.9 | 3.9 | 3.8 | 3.8 | 3.6 | 3.2 | 3.2 |
| CPI, % change | 3.2% | 2.2% | 1.2% | -0.2% | 0.4% | 1.0% | 1.2% |
| Unemployment rate (%) | 7.7 | 8.2 | 8.7 | 9.4 | 8.8 | 8.6 | 8.2 |
| Investment (% of GDP) | 22.5 | 21.4 | 20.9 | 21.1 | 21.9 | 22.3 | 22.8 |
| Gross national savings (% of GDP) | 20.6 | 19.8 | 19.8 | 20.7 | 20.9 | 21.0 | 21.5 |
| **Public finances** | | | | | | | |
| Net lending/borrowing (% of GDP) | -2.2 | -2.6 | -3.2 | -2.7 | -1.9 | -2.2 | -1.8 |
| Primary net lending/borrowing (% of GDP) | -0.8 | -1.4 | -1.9 | -1.6 | -0.9 | -1.1 | -0.8 |
| Revenue (% of GDP) | 54.0 | 54.9 | 54.9 | 54.2 | 54.2 | 53.3 | 52.9 |
| Expenditure (% of GDP) | 56.2 | 57.5 | 58.1 | 57.0 | 56.1 | 55.5 | 54.6 |
| Net interest payments (% of GDP) | 1.4 | 1.3 | 1.2 | 1.2 | 1.1 | 1.0 | 1.0 |
| Net interest payments (% of revenue) | 2.6 | 2.3 | 2.2 | 2.1 | 2.0 | 1.9 | 1.8 |
| Gross debt (% of GDP) | 53.9 | 56.5 | 60.2 | 63.7 | 63.6 | 65.5 | 66.2 |
| Net debt (% of GDP) | -50.2 | -53.7 | -54.3 | -54.4 | -51.4 | -47.6 | -44.7 |
| Gross debt (% of revenue) | 99.8 | 102.9 | 109.7 | 117.4 | 117.3 | 122.8 | 125.3 |
| **External vulnerability** | | | | | | | |
| Gross external debt (% of GDP) | 227.5 | 207.7 | 218.7 | 210.6 | 196.2 | - | - |
| Net external debt (% of GDP) | 39.7 | 40.3 | 47.8 | 43.8 | 46.3 | - | - |
| Current account balance (% of GDP) | -1.9 | -1.6 | -1.3 | -0.6 | -1.1 | -1.5 | -1.4 |
| Trade balance [FOB] (% of GDP) | - | 0.1 | 0.7 | 1.1 | 0.3 | -0.1 | 0.2 |
| Net direct investment (% of GDP) | 1.3 | -0.8 | -6.3 | -7.6 | 9.5 | - | - |
| Official forex reserves (EOP, Bil. USD) | 5.7 | 6.7 | 6.4 | 6.2 | 6.5 | - | - |
| REER, % change | -2.7% | 2.8% | 2.5% | -2.9% | 1.3% | - | - |
| Nominal exchange rate (EOP, USD/EUR) | 1.32 | 1.38 | 1.21 | 1.09 | 1.05 | - | - |
| **Financial stability** | | | | | | | |
| Non-performing loans (% of total loans) | 0.8 | 0.7 | 1.5 | 1.3 | 1.3 | - | - |
| Tier 1 ratio (%) | 16.3 | 15.5 | 16.6 | 22.4 | 23.1 | - | - |
| Consolidated private debt (% of GDP) | 148.6 | 147.7 | 149.6 | 152.9 | 148.5 | - | - |
| Domestic credit-to-GDP gap (%) | 5.3 | 5.5 | 3.5 | 0.4 | -5.7 | - | - |

Source: IMF, European Commission, European Central Bank, World Bank, United Nations, Scope Ratings AG

## V. Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings AG.

Rating prepared by Ilona Dmitrieva, Lead Analyst

Person responsible for approval of the rating: Dr Stefan Bund, Chief Analytical Officer

The ratings/outlook were first assigned by Scope as a subscription rating in January 2003. The subscription ratings/outlooks were last updated on 05.05.2017.

The senior unsecured debt ratings as well as the short term issuer ratings were assigned by Scope for the first time.

As a "sovereign rating" (as defined in EU CRA Regulation 1060/2009 "EU CRA Regulation"), the ratings on Republic of Finland are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Sovereign Ratings Calendar of 2017" published on 21.07.2017 on www.scoperatings.com). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In this case, the deviation was due to the recent revision of Scope's Sovereign Rating Methodology and the subsequent placement of ratings under review, in order to conclude the review and disclose ratings in a timely manner, as required by Article 10(1) of the CRA Regulation.

Rating Committee: the main points discussed were (1) Finland's economic recovery and outlook, (2) public deficit and debt sustainability analysis, (3) ongoing structural reforms and impact on potential growth, (4) external economic position, (5) financial and banking sector performance, (6) peers consideration.

### Solicitation, key sources and quality of information

The rating was initiated by Scope and was not requested by the rated entity or its agents. The rated entity and/or its agents did not participate in the ratings process. Scope had no access to accounts, management and/or other relevant internal documents for the rated entity or related third party.

The following material sources of information were used to prepare the credit rating: public domain and third parties. Key sources of information for the rating include: the Ministry of Finance of Finland, the Central Bank of Finland, European Commission, European Central Bank (ECB), Statistical Office of the European Communities (Eurostat), IMF, OECD, and Haver Analytics.

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