BANK OF FINLAND BULLETIN

BANK OF FINLAND ARTICLES ON THE ECONOMY

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ACCESSIBLE SUMMARY

Ukraine war is slowing growth in Finland’s economy and fuelling rise in prices

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Russia’s war in Ukraine is curbing economic growth worldwide. At the same time, the general level of prices has been climbing at a significantly increased rate. The war is further accelerating the rise in the prices of energy, raw materials and food, and their availability has also deteriorated. In addition, the COVID-19 pandemic is still not completely behind us. The uncertain situation in the economy and the rise in prices are reducing the total consumption of products and services by Finnish households. The level of investment by businesses in Finland is also suffering.

Finnish companies’ exports to Russia are collapsing due to the war in Ukraine and the international sanctions taken against Russia. Finland’s imports from Russia are also falling steeply. Growth in the economy of the 19-country euro area is slowing as a consequence of the war, and this will curb growth in Finnish exports to the euro area. Prior to the war, Finland’s export growth was already hit by the reduced availability of raw materials and components as a result of the COVID-19 pandemic. The war has exacerbated these availability problems. Forecasts suggest that the availability of materials will gradually improve next year, which will brighten the picture for Finnish exports. This projection is surrounded by uncertainty, however, because it is difficult to foresee the path of the war or the pandemic.

Total consumption of products and services by households will decline due to the heightened uncertainty and the general rate of increase in prices (inflation). The purchasing power of household income will weaken, meaning that as prices rise, the amount of products and services that this income can buy will fall. Alongside this, the demand for many services is rising as the pandemic subsides. Households feeling pressure on their income will try to balance this by using any savings they accumulated during the pandemic.

Chart 1.

A major share of the steep rise in prices is currently explained by the price rises for fuel and electricity. However, prices are now rising across a broader range of products. Companies whose costs go up as a result of elevated energy and materials prices are having to raise the prices of products they make and sell. A significant rise is expected in food prices, in particular. Product prices will also rise as a result of companies experiencing difficulty obtaining key components, spare parts or other items. Prices for services will rise due to a growth in demand for them. The rate at which prices are rising is expected to slow when the increase in energy prices levels off in 2023 and the availability of materials improves.

The deficit in Finland's public finances, reflecting an imbalance between revenues and expenditure, has grown during the pandemic. The public finances will remain in deficit during the 2022–2024 forecasting period, though the deficit will shrink a little. Government borrowing will increase as spending continues to exceed income.

The growth in Finland's economy may turn out to be lower than forecast, and even a recession cannot be ruled out. The war in Ukraine could also lead to unanticipated and powerful movements in energy prices. The war could impede the growth in Finland's export markets in Europe by more than expected. The pandemic, too, is still not completely behind us. The rapid rise in prices could persist for longer than anticipated, especially if inflation and pay increases begin to feed each other. It could also lead to market rates rising by more than expected. A sharp rise in interest rates would weaken growth in consumption and investment, in particular.

On the other hand, the economy could grow by more than has been forecast. Once the shock of the war in Ukraine has subsided, households might display greater confidence in the outlook for the economy. Exports and investment, too, could pick up by more than anticipated if companies are able to adjust quickly to the supply chain bottlenecks and find new markets to replace those lost.

Tags

Ukraine, forecast, economic growth, Russia, war, inflation