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REPUBLIC OF FINLAND	Assigned Ratings/Outlook: AA+ /stable	Type: Monitoring, unsolicited
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	28-10-2016 24-07-2020 "Sovereign Ratings" "Rating Criteria and Definitions"

Rating Action

Neuss, 24 July 2020

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of "AA+" for the Republic of Finland. Creditreform Rating has also affirmed Finland's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "AA+". The outlook is stable.

Key Rating Drivers

1. Wealthy, competitive, and welcoming economy featuring a high per-capita income; however, weakening productivity growth, not least linked to need to enhance productive investment, poses challenges to medium-term growth prospects, in particular against a backdrop of unfavorable demographic developments; macro-financial risks related to high and rising household debt
2. Significant contraction of economic output owing to Covid-19 in 2020, with recovery from the second half of the year to lay the ground for real GDP to rebound in 2021, although not yet to pre-corona levels; shape of recovery highly dependent on further evolution of the virus and the ability to minimize the fallout
3. Exceptionally strong institutional conditions that set standards and are augmented by the advantages entailed by EU/EA membership; continued sound policy-making and strong dedication to structural reforms notwithstanding some delays in implementing parts thereof and a somewhat more challenging political backdrop in light of a five-party government coalition
4. Covid-19-related surge in government deficit and plunging economic growth will send public debt ratio upwards; further out, debt trend contingent on reform success in reining in aging costs, while medium-to-longer-term outlook also clouded by risks associated with high contingent liabilities; fiscal risks contained by substantial government assets, high debt affordability and track record of fiscal prudence
5. NIIP close to balance lately; risks as regards external exposure appear limited and mainly relate to large external liabilities by the financial sector

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Reasons for the Rating Decision

The Republic of Finland's very high creditworthiness is underpinned by the exceptionally high quality of its institutional conditions, the strong underlying macroeconomic performance profile, solid public finances, as well as broadly contained external risks.

Macroeconomic Performance

A relatively wealthy economy featuring high per-capita income, a very favorable business environment, and high non-cost competitiveness represent key elements of Finland's strong macroeconomic performance that should help to overcome the corona crisis. Further out, weakening productivity growth could weigh somewhat on competitiveness and on the medium-to-longer term outlook, given comparatively low levels of productive investment that could restrict potential growth; the same applies to Finland's aging workforce. Our baseline scenario is for Covid-19 to have a very negative but temporary impact on real GDP and the labor market, although we acknowledge that uncertainty remains very high and further waves of infections could delay a recovery.

Finnish GDP growth continued to soften after peaking at 3.3% in 2017, dropping to 1.1% in 2019 (2018: 1.5%) with Q4-19 seeing a decline in GDP versus the previous quarter (-0.3%). Domestic demand weakened markedly on the back of lower private consumption growth, which halved to 0.9% in 2019, and a decline in gross fixed capital formation, which contracted by 1.0% (2018: 3.9%), the first decline since 2014. The slower increase in private consumption, which in Q4-19 even shrank from the preceding quarter, can be partly attributed to decelerating job creation. The fall in investment was largely down to construction investment, which accounts for some 60% of gross fixed capital formation and which contracted by 0.2%, driven by falling investment in dwellings.

Against the backdrop of slowing domestic demand, import growth decreased to 2.4% (2018: 5.5%), whereas exports expanded strongly by 7.5% (2018: 1.7%), boosted in particular by vividly rising services exports - mainly ICT related services - but also by the delivery of two large cruise ships. With that, net exports provided a large positive contribution to GDP growth last year, adding 1.9 percentage points. On the flipside, owing to the delivery of the ships, the change in the inventory component dragged on growth in 2019 (-1.3 p.p.).

Economic developments in the current year are largely determined by the outbreak of the coronavirus and the decisive response by governments around the world, which led to a severe contraction of economic activity, partly already visible in the national account data for Q1-20. With the q-o-q decline of 1.9%, Finland was thus in a technical recession already at the turn of the year. Having said that, compared to many other European countries (EA: -3.6%), the slump in Q1 appears rather moderate, which can be explained by Finland's somewhat less strict containment measures, as also suggested by the Blavatnik School of Governance stringency index. While private consumption saw a rather small decline compared to other European countries (-0.5% q-o-q, vs. -4.7% in the euro area), as did gross fixed capital formation, the drop in exports was considerably sharper (-8.6% q-o-q vs. EA -4.2%). Since most of the measures were imposed at the end of the first quarter, the nega-

tive effects of the containment measures will be particularly evident in Q2-20, and we therefore expect the economic slump to be considerably more severe in the second quarter of this year.

In reaction to the outbreak of the viral disease, the Finnish government issued numerous decrees to temporarily shut down public and economic life and thus contain the spread of the virus and save human lives. To this end, a state of emergency was declared on 16 March, entailing the closure of most public institutions, restrictions on freedom of movement and the right of assembly, and was not lifted until 16 June. In order to mitigate the adverse economic effect of the restrictions, several packages including measures to support the health sector, help the vulnerable, safeguard jobs, ensure continued liquidity for companies of all sizes, and provide aid to the particularly hard-hit sectors were adopted between March and June. With the latest follow-up package from June, the government increasingly aims to revitalize the economy after the most acute crisis phase, for instance via investment in infrastructure projects under consideration of declared environmental/sustainability goals, but also aiming at increasing social inclusion by strengthening social services and educational offers to the young, as well as fostering digitization skills.

The government's response to the crisis has been flanked by monetary policy, with the ECB also supplementing its initial measures, leading the Pandemic Emergency Purchase Program (PEPP) to currently amount to EUR 1,350bn and to run at least until the end of June 2021. Reinvestments of maturing principal payments from securities purchased under PEPP until at least the end of 2022 will further add to the accommodative stance. An additional envelope of EUR 120bn to the Asset Purchase Program until the end of the year remains in place, as do a number of measures to ensure liquidity to the banking sector, a comprehensive set of collateral measures to mitigate the tightening of financial conditions across the euro area, and measures to temporarily mitigate the effect of rating downgrades on counterparties' collateral availability. As for macroprudential measures, the FIN-FSA board, amongst other things, decided that it would refrain from setting a countercyclical capital buffer (CCyB) requirement for banks and other credit institutions, and relaxed the residential mortgage loan cap.

Under the given circumstances, a forecast on the further economic development of Finland is subject to unusually high uncertainty. The main negative impact on the Finnish economy should have been felt in Q2-20, as mentioned above, and assuming that there will be no second wave of infections, the Finnish economy should recover in the second half of the year. According to Statistics Finland, workday-adjusted output fell by 5.5% in May-20 vs. May-19, following an upwardly-revised outcome in April, when workday-adjusted output declined by 5.3% y-o-y (previously -7.9%). In light of re-opened shops and restaurants, private consumption should pick up again, also bolstered by the aid packages. The EU Commission's consumer confidence indicator, which in May returned to the level seen in February after a sharp decline in April, would back this expectation. Notwithstanding, 2020 overall should see a sharp drop in private consumption due to the likely very weak first half. While we would tentatively expect private consumption to remain a supportive pillar to GDP growth next year, we are wary of possible obstacles, as it remains unclear how

many companies may become insolvent and how many jobs will thus be lost in the end, despite best efforts to avoid it.

We note that consumer confidence had been trending down prior to the Covid-19 pandemic, and that the labor market had displayed signs of cooling, although it had still been in a relatively strong position when the crisis struck. Following growth of 2.5% in 2018, employment creation shifted down a gear to 1.6% in 2019, thereby still exceeding euro area employment growth (2019: 1.2%). After unemployment peaked in 2015 (9.4%), it has been steadily declining, dropping from 7.4% in 2018 to 6.7% last year and standing below the euro area average of 7.5%. Finland's participation rate is among the highest in EU-27 and increased further from 77.9% in 2018 to 78.3% in 2019, well above AA-rated peers and in line with AAA sovereigns Denmark (79.1%) and Germany (79.2%). In addition, Finland counts among the best performers as regards the EU's Social Scoreboard among our AA-rated countries, especially well-performing with a view to equal opportunities and access to the labor market. Given these observations, the Finnish economy should be able to show some resilience to the Covid-19 shock. What is more, an already high mobile work capacity by European comparison could help to cushion the blow. Having said that, labor market metrics have deteriorated substantially, and we will continue to monitor developments carefully. According to latest labor force survey data (Statistics Finland), the number of unemployed persons rose sharply by 14.1% y-o-y in the second quarter of 2020, whereas the number of persons in disguised unemployment jolted by 60.6% to 179,000. At the same time, the average number of employed persons fell by 3.1% to 2.514m over the same period.

As far as investment activity is concerned, we would expect a steep decline this year and a more or less lagging recovery going forward, as many investment projects have been postponed or cancelled altogether. While the ongoing uncertainties with regard to Covid-19 weigh heavily and complicate any planning, the prior pronounced slowdown in international trade and the generally less cooperative global trading environment had already put a strain on gross fixed capital formation, as reflected in declines in investment in machinery and equipment in 2018 and 2019. Industrial confidence (European Commission data) has not yet shown any signs of improvement in June after a plunge in April, and export expectations for the months ahead (European Commission) have drastically fallen in Q2. To be sure, public investment will lend some support, as authorities have implemented a raft of investment projects.

Following its significant contribution to GDP growth last year, the near-term outlook for foreign trade thus appears rather gloomy, also given that new orders remain at a very subdued level following the drop in Q1. Overall, we expect Finnish exports and imports to shrink significantly in 2020, with the fall in exports presumably stronger, pointing to net trade posing a significant drag to the GDP outcome this year. This being said, strongly rebounding Chinese GDP growth in Q2 provides for some silver lining, bearing in mind that China has gained importance as a Finnish export destination, now claiming a share of 5.4% of goods exports in 2019 (Tulli). Moreover, with Germany and the Netherlands Finland counts two countries among its top five export markets that might manage to overcome this crisis comparatively well, as suggested by our [Pandemic Vulnerability Index](#), although

they, too, will see sharp contractions in economic output this year. And lastly, the high significance of telecom, computer and information services in total services exports (36.4% in 2019, Statistics Finland data) might act as a stabilizing factor, given that digitization and work from home, requiring respective infrastructure, have been boosted by the corona crisis. Taken together, we estimate that real GDP will nose-dive by about 5.8% in 2020, while a rebound in 2021 to the tune of 2.9% will not make up for lost output yet. Needless to say, these assumptions remain subject to a high degree of uncertainty.

Turning to the more fundamental picture underlying our credit assessment, Finland continues to boast a high degree of prosperity, judging by a per capita income of USD 47,975 (PPP terms) in 2019, one of the highest in Europe, albeit remaining below AA-rated peers such as Belgium (USD 49,523) and Austria (USD 53,558). Moreover, Finland being ranked 12th out of 189 countries considered in the United Nations Human Development Index (HDI), up three ranks from the previous year, would back the impression of a very high standard of living in the country, among other things based on an above-average level of school education and a thus highly qualified workforce in addition to a high life expectancy.

Further elements we take into account consist in the country's welcoming business environment as well as its highly competitive economy. According to the World Bank's Doing Business Report 2020, business-related procedures in the country are comparatively smooth, mirrored in a good 20th place out of 190 economies, although we note that the country has slipped three ranks compared to the preceding year. Major strengths include resolving insolvency (rank 1) and paying taxes (rank 10), whereas there is still scope to improve as regards protecting minority investors (rank 61). Finland's high level of non-cost competitiveness is also reflected in the very good ranking of its economy in the World Economic Forum's assessment of global competitiveness, in which Finland comes in 11th out of 144 economies. This puts the country in a better position than its other AA-rated peers, but AAA-rated countries such as the Netherlands and Germany, which are among Finland's main trading partners, still score better. The fact that Finland tops the EU's Digital Economy and Society Index (DESI) ranking deserves particular attention in the current circumstances, paying testament to the country's strong position as regards digital competencies.

Looking at cost-related components of competitiveness, Finland displays a more advantageous stance versus its main trading partners: Owing to declining real compensation per employee, in particular when considering the abovementioned longer time horizons, real unit labor costs have ultimately developed more favorably in Finland, albeit to a lesser extent more recently (2019 vs. 2018), as real compensation was broadly stable. Tying in with the country's generally favorable competitive stance, we observe that the global export market share rose slightly from 0.40% to 0.44% in 2016-19, to a stronger extent driven by a rising share of services exports over that period (0.51 to 0.59%), only edging up a little further thanks to services exports in 2018-19.

That being said, we note ongoing deficiencies in terms of productivity growth. Real labor productivity per person shrank by 0.5% in 2019, generally comparing unfavorably with the euro area as whole and some of its key trading partners. The latter conclusion also holds when taking a longer time horizon into account (2019 vs. 2016 and vs. 2010), which reveals that real labor productivity per person has increased less than in most of its fellow EU-27

members. In this context we observe that areas often conducive to higher productivity, such as business services and to some extent also financial and insurance activities, have generally accounted for a lower share of total gross value added compared to the euro area, which should deliver part of the explanation and would echo calls for more targeted investment in this regard. On the other hand, we note that R&D investment persistently ranks among the highest in Europe, posting at 2.75% of GDP in 2018 (all sectors).

We will continue to monitor productivity developments with a view to the need to enhance the growth potential. Given that the country has to tackle a rather serious demographic challenge in light of a projected further decline of already one of the lowest working-age populations by European comparison (2019: 61.8%, EA: 63.8%), fostering the growth potential through a stronger focus on upskilling and increasing investment in areas conducive to productivity seems of the essence. To this end, we would recall the government's ambitious and multi-pronged reform agenda that initiates steps in this direction, aiming at enhancing skills, education, social inclusion, R&D and infrastructure. Depending on the further evolution of the pandemic, implementation may prove challenging and palpable progress may take some time to materialize.

Apart from these considerations, we note that private debt, especially household debt, is moving at an elevated level by a European perspective, and that declining risk-bearing capacities may restrain medium term growth and economic flexibility going forward. At the end of 2019, total private debt amounted to 145.6% of GDP (Eurostat), up from 144.5%, with the increase driven by rising household debt which accounted for 66.2 p.p. thereof. Expressed as percent of disposable income, household liabilities came to 115.6% last year (2018: 114.0%), comparing relatively high among EU countries. We continue to monitor these developments vigilantly.

Institutional Structure

The sovereign's extraordinarily strong and sound institutional framework, in particular by global comparison, remains a key driver of our credit rating. Adding to this are the significant advantages that both EU and euro area membership entail, not least with a view to the ECB's credible and accountable monetary policy, as well as bank supervision tasks. Tying in with this, MFI interest rates and the HICP inflation have been broadly synchronized with euro area developments as a whole. Access to broad and deep capital markets and, in a wider sense, a large common market with respective standards ensures ample opportunities for a small, open economy while offering more clout as regards trading with third parties.

Our assessment of Finland's institutional quality is also confirmed in an impressive way by the World Bank's Worldwide Governance Indicators (WGIs), our preferred gauge in this context, where the sovereign achieves excellent rankings in all categories, significantly exceeding the average rankings of the AA-peers in our rating universe and even those of our AAA-rated sovereigns. As to the categories rule of law and control of corruption, Finland is placed at the top of the set of 209 economies, having improved from 3rd in the latter category. In addition, the sovereign is attested to be very effective in formulating and implementing policies, coming in 3rd as far as government effectiveness is concerned, up from

rank 5 in the preceding year. When it comes to voice and accountability, which includes freedom of expression and free media, Finland climbed from rank 6 to 4.

As regards the current political environment, policymaking may have become more challenging in light of a government coalition comprising five parties with differing priorities. The resignation of former social democratic prime minister Rinne last December following a dispute over the future strategy of the state postal service, which lost him the confidence of the Centre Party within the coalition, may be a case in point, although we acknowledge that multi-member coalitions are not new to Finland. We think that the relatively swift and smooth process of agreeing on Rinne's successor, fellow party member and former Minister of Transport and Communications Sanna Marin, the ongoing commitment to formerly communicated coalition policy priorities, and the cohesion in tackling the corona crisis would back expectations of continuity in traditionally consensus-oriented Finnish politics.

In our view, a whole set of announced reforms highlights the government's aspiration to decisively increase momentum in this respect while also raising the bar against which performance will ultimately be measured. Reforms envisaged include a national roadmap for research, development and innovation to support sustainable growth, adopted in April this year, as do plans to improve and develop the National Transport System, where the aim is to have a first draft by this fall, with implementation envisaged to take place between 2021 and 2032. Furthermore, in a strategy and action plan adopted in June 2020 and meant to be put in practice by 2023, the Finnish government seeks to take more targeted action against the grey economy and economic crime, focusing on prevention, more effective access to information, and better exchange of information between the various state authorities. Smaller reforms already about to be implemented include the introduction of a Job Marketplace, which started in 2019 and is to be fully available by 2021, and the new act on adult education, which comes into force in August 2020. Further envisaged social reforms would, among other things, concern family leave, which is scheduled to come into force in fall 2021, and, further out, a wider social security reform.

While all these points seem to be steps in a welcome direction, we would point to the need to monitor to what extent and how timely implementation can/will follow, all the more so as the ongoing pandemic may last for longer – or similar cases of pandemics may occur – and require more attention as well as fiscal means otherwise earmarked for the above-mentioned structural goals.

Picking up on some questions we have raised over the government's effectiveness as regards implementing reforms on earlier occasions, we note that June saw a draft bill on the long-awaited and delayed reform of the regional government, health and social services (SOTE). Disagreement over this reform had ultimately brought down the prior government in 2019. The reform should have a major impact on Finnish municipalities in an economic and operational sense. It foresees, among other things, the establishment of 21 new self-governing health and social services counties, which would take over the tasks in these areas from the municipalities from 2023 - two years later than originally intended. We understand that the draft is still being debated, and that comments and amendments can be received until September 2020. According to the envisaged timeline, the draft bill is to be submitted to parliament in December 2020 and the first district elections in the health and

social districts are to be held in early 2022. Given the slow progress of the SOTE reform so far, a further delay cannot be completely ruled out. Especially in view of the ageing population and associated fiscal challenges in the medium to long term, a timely reform of social and health care would be crucial to ensure fiscal sustainability (see below) and foster the economy's growth potential.

Fiscal Sustainability

Prior to the Covid-19 pandemic, fiscal risks appeared to have moderated in the face of a downward trending debt-to-GDP ratio that had fallen below the Maastricht threshold in 2018, as well as in light of moderate headline deficits and ongoing credible commitment to fiscal consolidation efforts. We expect the heavy burden on public finances through Covid-19 and the related strong economic downturn to be temporary, although uncertainty concerning our baseline scenario remains high. Further out, we view the debt trend contingent on the government's reform success to rein in aging costs, while the medium-to-longer-term outlook is also clouded by risks associated with high contingent liabilities. Meanwhile, we think that fiscal risks are contained by substantial government assets, high debt affordability, and a track record of fiscal prudence.

The moderation of the Finnish general government deficit over recent years mirrors efforts to overcome the detrimental budgetary impact of the global financial crisis and the structural shift during which key industries such as electronics and wood underwent a restructuring. In 2019, the headline deficit came to 1.1% of GDP, slightly up from a deficit of 0.9% in the preceding year. Total expenditure increased by 2.6% (2018: 2.7%, Eurostat data), among other things driven by the public wage bill and public investment, which increased by 2.4% and 2.0% respectively. Meanwhile, general government revenue rose more slowly than expenditure (2.0%), with taxes on production and imports only increasing by 1.5% (2018: 4.5%), mirroring easing economic activity. The latter was also reflected in a smaller increase in VAT revenue (2.4%, 2018: 4.7%), as well as in moderating net social contributions (1.3%, 2018: 2.3%).

Due to the Covid-19 pandemic, perspectives for Finland's public finances have worsened significantly. Before the crisis struck, Finnish authorities were already set to embark on a more expansionary fiscal path in order to finance the ambitious structural reforms aimed at reaching carbon neutrality by 2035, as well as enhancing social inclusion and wellbeing. A balanced budget was envisaged to be reached by 2023 under "normal" global economic circumstances. To this end, we are aware that in November 2019 the National Audit Office of Finland announced that Finland might violate the EU Stability and Growth Pact in 2020, as public spending would grow much faster than permitted by EU regulations. While at the time of presenting, the DBP20 the government had operated under the assumption of net borrowing to the tune of 1.4% of GDP, we think that the containment and support efforts associated with the corona crisis along with operation of automatic stabilizers will have the headline deficit surge to approx. 8.0% of GDP this year. The Covid-19 pandemic has so far led to four supplementary budgets adopted by the government between March and June. A significant number of measures to mitigate the economic fallout both for individuals and the corporate sector, and increasingly to assist and sustain an economic rebound, has been

implemented, totaling approx. EUR 22bn or about 9.7% of GDP, of which roughly EUR 6bn or 2.6% of GDP would directly affect the budget in 2020.

The sharply rising general government deficit, coupled with the slump in real GDP growth, will at least temporarily reverse the downward trend of the public debt ratio. General government debt was reduced from an intermediate peak at 63.6% of GDP in 2015 to 59.4% of GDP in 2019 (2018: 59.6%), thanks to vivid nominal GDP growth, falling interest expenses, and some spending restraint. Given that Finland's public debt was markedly lower than compared to the median of our AA-peers last year (68.3% of GDP), and considerably lower than the public debt level in the euro area as a whole (84.1%), the country thus should be in a better position to weather this storm. For 2020, we expect the public debt ratio to leap to approx. 70% of GDP and to stabilize next year, mainly on the back of the assumed recovery in GDP growth.

While we have limited visibility on the development further afield, we see risks related to the more medium-to-longer-term fiscal outlook. Thus, we would have to mention the current and expected further demographic developments. As illustrated by latest Eurostat data, Finland's old-age dependency ratio has evolved briskly over the recent years, having increased by 4.9 p.p. to 35.1% in 2014-19, one of the highest readings in Europe. We note that the country already faces elevated age-related fiscal pressure by European comparison which is likely to mount unless addressed adequately.

Moreover, contingent liabilities related to public guarantees may significantly hamper fiscal consolidation. As mentioned further above, the Finnish government has issued a substantial amount of guarantees in response to the current crisis, which adds further to an already high level of guarantees mainly related to the important shipping industry and Finnvera. According to Statistics Finland, central government guarantees amounted to around 24.6% of GDP in Q4-19 and thus increased further in the course of the year (Q1-19: 23.1% of GDP), whereas general government guarantees, drawing on Eurostat data only available until 2018, stood at 32.6% of GDP (2017: 31.8% of GDP), by far the highest ratio among EU countries. Based on data from the Ministry of Finance, Covid-19 related guarantees and loan authorizations to the tune of EUR 12.2bn, or 5.4% of GDP, including increased authorization by EUR10bn as regards Finnvera, would add to that.

Looking at the Finnish banking sector, we recall that following the relocation of Nordea's headquarters to Finland in 2018, assets-to-GDP expanded materially, making the Finnish banking sector the second-largest in the EU on this count, implying large contingent liability risks. In Q4-19, this ratio climbed to 340% of GDP, with the bulk of assets (roughly 300% of GDP) being held by domestic banks. The loan-to-deposit ratio remained stubbornly high, pointing to persistent liquidity risks pertaining to the prevalence of wholesale funding. In the first quarter of 2020, the ratio stood at 158.8% of GDP, the third-highest reading in the EU. Having said that, we note that according to FIN-FSA the banking sector was considered solid at the end of 2019, and we would conclude that, overall, the sector seemed in a good position to face the shock caused by the outbreak of the novel coronavirus. This impression is backed, among other things, by the relatively generous capital buffers, mirrored in a CET1 ratio of 17.6% in Q4-19 compared to 15.0% in the EU (EBA data). In the same vein, a low NPL ratio, at 1.4% in Q4-19, well below the EU-28 average of 2.7%, continues to point to a

relatively high asset quality. Against the backdrop of the lower-for-longer interest rate environment, profitability might come under more pressure, though, and a likely rising number of insolvencies and job losses could see NPLs rise going forward.

In view of the relatively high household debt by European comparison, as mentioned further above, we would flag the need to monitor developments regarding the banking sector and, more generally, risks to macro-financial stability. As also pointed out by Bank of Finland in its recent financial stability assessment, we note that housing loans and housing company loans borne by households account for roughly three quarters of household's total loan stock, and not least due to the rise of housing company loans, the composition of household debt has become riskier over time. Lending to the private sector was certainly not excessive pre-corona, although comparatively vivid lending associated with housing companies had led to the recommendation of macro-prudential measures last fall, which have been echoed by the Finnish central bank this spring. While lending to NFC including the housing companies had seen some acceleration compared to a year earlier, expanding by 7.7% in Feb-20, housing company-related loans moderated to 8.7% from 12.4% a year earlier. Lending to households had also accelerated somewhat before the health crisis broke out, driven by stronger growth in housing loans, although consumption-related loans were still expanding at a higher rate (Feb-20: 3.9% vs. 2.7%).

However, we do not think that the housing market and associated price developments cause any major reason for concern at this stage. OECD data on house prices point to very moderate development, with the 3-year growth rate at just 0.9% in Q4-19. Affordability indicators do not point to any overvaluation.

With the pandemic marking a turning point, we observe that lending to private households has so far eased somewhat (May-20: 2.8%, Feb-20: 3.0%), whereas NFCs seem to increasingly make use of government-backed lending (May-20: 11.1%). While the current aim of national authorities is to ensure ongoing credit flow to the private sector, not least reflected in FIN-FSA's decision in June to bring the maximum loan-to-collateral ratio for residential mortgage loans other than first-home loans back to the 90% standard level, we will observe closely how this situation is evolving.

Notwithstanding the high uncertainty surrounding the corona crisis and its ultimate impact on public finances, we would deem fiscal risks as limited at this stage, bearing in mind the favorable starting point as well as the ongoing low interest rate environment that contributes decisively to debt affordability. Interest outlays in 2019 only amounted to 0.9% of GDP or 1.6% of total revenue, having continuously fallen over recent years. Finnish 10-year bond yields entered negative territory at the end of June 2019, and have generally stayed there since. At the beginning of July 2020, Finland's 10-year bond yields posted at -0.236%. The financing conditions on which the Finnish sovereign can borrow should remain very favorable as, supported by the continued accommodative stance of ECB policy, refinancing costs should remain at a low level for the foreseeable future.

In addition, we reiterate that fiscal risks seem to be mitigated to some extent by the substantial amount of government assets, of which a larger part arguably might be made available relatively swiftly. In Q4-19, Finland's total financial assets amounted to 135.7% of GDP,

having increased against the preceding year (Q4-18: 127.4% of GDP), of which assets to the tune of 95.3% of GDP were held in the form of equity and investment fund shares, whereas currency and deposits totaled 6.6% of GDP.

Perhaps even more importantly, we would emphasize the favorable track record of fiscal prudence demonstrated by the sovereign, embedded in a very favorable institutional setting, characterized by forward-looking, responsive, and proactive policy-making.

Foreign Exposure

Finland's external position improved markedly last year, partly due to a one-off effect related to ship deliveries. Despite some remaining weaknesses relating to a comparatively high share of external liabilities of the financial sector, the overall conclusion remains that external risks seem broadly contained at this stage.

The country's current account balance, which has averaged -1.2% over the last five years, came in notably less negative in 2019, shrinking to -0.5% of GDP (2018: -1.7% of GDP), for one part as exports were buoyed by the delivery of cruise ships which helped to lift the surplus in goods trade by 1.0 p.p. to 1.1%, the highest level since 2013. At the same time, higher exports of services had the deficit in the respective balance narrow by 0.7 p.p. to -0.5%. This year's first quarter saw the current account balance revert back to a somewhat more negative position (-1.2% of GDP), mainly on the back of a lower goods surplus. This should, by and large, set the tone for the current year as a whole, for which we expect a slightly higher deficit compared to 2019, aligned with our set of assumptions underlying our baseline scenario for net external trade.

Following fluctuations also associated with the relocation of Nordea's headquarters to Finland in the prior year, the country's net international investment position (NIIP) improved in 2019, going back to a positive 1.5% of GDP (2018: -6.6%). Latest available data relating to Q1-20 show a balanced position in the NIIP. We note that vulnerabilities related to underlying sectoral positions as regard the NIIP have decreased compared with a year earlier, as reflected in a less negative - albeit still pronounced - NIIP of MFI's (-50.9% of GDP in Q1-20), as well as of NFC (-29.4%). Overall, high and positive NIIPs as regards social security funds (57.9% of GDP), the Bank of Finland (31.7% of GDP), and collective investment schemes (21.8% of GDP) continue to compensate for the former.

Rating Outlook and Sensitivity

Our rating outlook on Finland's sovereign ratings is stable, as we consider the risks caused to the economic and fiscal prospects by the Covid-19 pandemic as by and large balanced by the abovementioned factors – above all, the extraordinary institutional set-up – thus mitigating fiscal risks in the short to medium term, and as we expect the unprecedented recession to be temporary. Given the current considerable economic and financial market uncertainty and the very dynamic development of this pandemic, the assessment and interpretation of economic developments is significantly more difficult than under normal circumstances for the near future, as is the case for other indicators.

A negative rating action could be prompted if the corona crisis proves to be longer lasting and more detrimental to economic activity and the labor market, possibly exacerbated by renewed nation-wide infection waves and required counter-action. This could also cause significant negative reverberations via the large relative size of the banking sector. In this context, a sustained further deterioration of public finances would have an adverse effect on the credit rating, which could be triggered, among other things, by a materialization of relatively high contingent liabilities and/or if the banking sector starts to show distress, as well as in the case of failure to convincingly tackle the cost challenges related to demographics. In addition, a pronounced and persistent worsening of price- and non-price-competitiveness, the latter possibly via failure to increase productivity, might also lead us to consider a downgrade.

Although we consider a positive rating action as highly unlikely under the current circumstances, this could be triggered if public finances are able to revert more quickly than expected to a sustainable and firmly downward-sloping trajectory, provided that reforms to tackle the age-related cost challenges are implemented in a timely fashion. Upward pressure could also result from a swift and frictionless implementation of the ambitious reform agenda targeted towards enhancing labor productivity and the economy's competitiveness.

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Ratings*

Long-term sovereign rating	AA+ /stable
Foreign currency senior unsecured long-term debt	AA+ /stable
Local currency senior unsecured long-term debt	AA+ /stable

*) Unsolicited

Economic Data

[in %, otherwise noted]	2014	2015	2016	2017	2018	2019	2020e
Real GDP growth	-0.4	0.5	2.8	3.3	1.5	1.1	-5.8
GDP per capita (PPP, USD)	40,880	41,358	42,822	44,826	46,596	47,975	n.a.
HICP inflation rate, y-o-y change	1.2	-0.2	0.4	0.8	1.2	1.1	0.2
Default history (years since default)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Life expectancy at birth (years)	81.3	81.6	81.5	81.7	81.8	n.a.	n.a.
Fiscal balance/GDP	-3.0	-2.4	-1.7	-0.7	-0.9	-1.1	-8.0
Current account balance/GDP	-1.3	-0.9	-2.0	-0.9	-1.7	-0.5	n.a.
External debt/GDP	217.2	210.6	194.5	181.0	216.4	219.7	n.a.

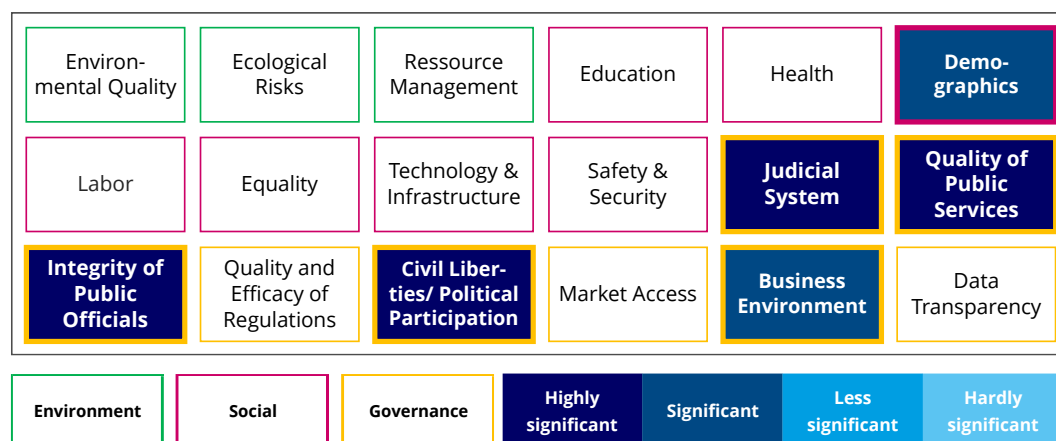
Source: International Monetary Fund, Eurostat, own estimates

ESG Factors

While there is no universal and commonly agreed typology or definition of environment, social, and governance (ESG) criteria, Creditreform Rating views ESG factors as an essential yardstick for assessing the sustainability of a state. Creditreform Rating thus takes account of ESG factors in its decision-making process before arriving at a sovereign credit rating. In what follows, we explain how and to which degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor and outline why these ESG factors were material to the credit rating or rating outlook.

For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down [key principles of the impact of ESG factors on credit ratings](#).

ESG Factor Box



The governance dimension plays a pivotal role in forming our opinion on the creditworthiness of the sovereign. As the World Bank's Worldwide Governance Indicators Rule of Law, Government Effectiveness, Voice and Accountability, and Control of corruption have a material impact on Creditreform Rating's assessment of the sovereign's institutional set-up, which we regard as

a key rating driver, we consider the ESG factors 'Judicial System and Property Rights', 'Quality of Public Services and Policies', 'Civil Liberties and Political Participation', and 'Integrity of Public Officials' as highly significant to the credit rating.

The social dimension plays an important role in forming our opinion on the creditworthiness of the sovereign. Indicators or projections providing insight into likely demographic developments and related cost represent a social component affecting our rating or adjustments thereof. We regard the ESG factor 'Demographics' as significant since it has a bearing on the economy's potential growth as well as medium-term fiscal prospects.

Since indicators relating to the competitive stance of the sovereign such as the World Bank's Ease of Doing Business index and the World Economic Forum's Global Competitiveness Indicator add further input to our rating or adjustments thereof, we judge the ESG factor 'Business Environment' as significant.

While Covid-19 may have significant adverse effects on several components in our ESG factor framework in the medium to long term, it has not been visible in the relevant metrics we consider in the context of ESG factors – though it has a significant bearing concerning economic prospects and public finances. To be sure, we will follow ESG dynamics closely in this regard.

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	28.10.2016	AA+ /stable
Monitoring	01.09.2017	AA+ /stable
Monitoring	27.07.2018	AA+ /stable
Monitoring	26.07.2019	AA+ /stable
Monitoring	24.07.2020	AA+ /stable

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. Neither the rated sovereign nor a related third party participated in the credit rating process. Creditreform Rating AG had no access to the accounts, representatives or other relevant internal documents for the rated entity or a related third party. Between the disclosure of the credit rating to the rated entity and the public disclosure no amendments were made to the credit rating.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	NO
With Access to Internal Documents	NO
With Access to Management	NO

The rating was conducted on the basis of CRAG's ["Sovereign Ratings" methodology](#) (v1.2, July 2016) in conjunction with its basic document ["Rating Criteria and Definitions"](#) (v1.3, January 2018). CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG's rating methodologies and basic document "Rating Criteria and Definitions" is published on our [website](#).

To prepare this credit rating, CRAG has used following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, Bank of Finland, Statistics Finland, Republic of Finland – Ministry of Finance, Tulli, FIN-FSA.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG's "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information

about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: <https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>.

An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

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