

Finland

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Macroeconomic overview

In 2009, the global economy suffered its most severe downturn since the Second World War. The year was exceptionally bad for the Finnish economy. Real GDP plunged by 7.8%. The last comparable recession in GDP was more than 90 years ago. During the previous recession, in 1991, real GDP fell by 6.0% on the previous year. The Finnish economy grew strongly from 2004 to 2007, recording a 3.9% annual average growth rate, which was above the euro area. However, real GDP growth in 2008 dropped to 1.2%. The economy was heavily impacted by higher inflation, the credit crunch, and the decreased demand for Finnish exports, which accounted for around 45% of GDP. Export volumes contracted by 25.5% year-on-year in Q1 2009. The average annual unemployment rate in 2009 was 8.2% and is expected to rise up to 10% by the end of 2010. The GDP performance was mainly affected by the decrease in exports and investment. The volume of exports fell by 25% and investment decreased by more than 13%. Private consumption dropped by more than 2%.

Consumer prices stayed constant in 2009 as measured by the national consumer price index. However, the harmonised consumer price index, which excludes the effect of interest rates and house prices, went up by 1.6%, which is well above the average for the whole euro area. Inflation is expected to reach 1.5% this year because of rising prices in energy and other raw materials. Falls in house prices and interest rates will however slow down.

Earnings increased very rapidly in 2009, once put in the context of the cyclical downturn in economic environment. Wage rates rose by 3.7% and earnings by 3.9%. The number of unemployed people started to rise during 2009. However, unemployment did not increase as much as the fall in real GDP would explain, but it will continue to rise in 2010 despite the trend of output growth, and the unemployment rate is expected to climb up to 10.2%.

Housing and mortgage markets

There was a 5.2% fall in the average price of existing dwellings, up to Q1 2009. Adjusted for inflation, existing dwelling prices fell by 6.8% year-on-year to end-Q1 2009, according to Statistics Finland. Prices of new dwellings fell by only 1% year-on-year, to EUR 2,738 per square meter, or by 2.6% inflation-adjusted. Helsinki was more affected by the decline than the rest of Finland. Existing dwelling prices fell by 7.5% in the Helsinki Metropolitan Area, to EUR 2,708 per square meter (by 9% in real terms). Prices of new dwellings fell by 4.6% (6.2% in real terms).

The trend in the housing market has then totally changed since spring 2009. The remarkable fall in the interest rate boosted demand and turned the prices up again. There was an upswing in house prices from Q4 2008 to Q4 2009. In the Finnish housing market, developments in housing loans are typically linked to short-term interests. Households came back quickly to the housing market although the economic forecasts assumed market downturns due to rising unemployment.

Finland's housing market is still influenced by a decade of housing shortage as a result of weak activity in residential construction. 30,000 dwellings on a yearly basis were completed annually from 1994 to 1999, which is far less than the estimated housing needs. The main reasons for the need of increased residential construction activity are ongoing internal migration and changes in the economic structure of the country. Finland's private rental market is still relatively subdued, with about half of rental dwellings (roughly 800,000 units) receiving some form of government subsidy or support. Even after the complete deregulation of the private rental market in 1995, it still suffers from a distortion deriving from the large social housing sub-sector. Rents in the rental housing sub-sector, which benefit from Government-subsidised loans, are 25% lower than private rents in Helsinki, and 15% cheaper than the rest of the country. Following the initial rapid rent increases due to the rent liberalisation, recent rental growth has slowed down. From 2001 to 2007, house prices in Finland rose by around 50%, while private rents recorded a 17% growth rate. In Helsinki, house prices rose by 55%, while private rents rose by only 12% over the same period. From Q4 2008 to Q4 2009, government-subsidised rents rose by 5.3%.

Traditionally, Finland has had a very cyclical economy, which is highly exposed to global markets and sensitive to global shocks. This is the major cause of the volatility of the country's housing market. From 1980 to present, the country experienced four distinct house-price cycles. However, in 2009 the house price behaviour was totally different compared with earlier depressions. The relative volatility of house prices in Finland is also due to:

- The housing market's high interest rate sensitivity; and
- An insufficiently responsive supply side.

The boom in Finnish house prices lasted from 2001 to Q2 2008 and was mainly based on:

- Sustained growth in the economy and in wages;
- Changes in the mortgage market, combined with low interest rates, which made housing more affordable for all income classes;
- Changes in the tax system: owner-occupation is still encouraged by the current tax system, despite the reforms which were undertaken during the 1980s, since it allows a flat 29% tax deduction on mortgage interests, while there is no tax on rental income and capital gains on permanent homes.

In 2009, house prices were rising in Finland primarily as a result of the decrease in the level of interest rates. In fact, since the 1990s the Finnish housing market has become more and more interest-rate sensitive. In 1994, about 70% of new mortgages were variable rate.

Since 2001, more than 90% of new mortgages issued every year have been at variable rates. The rise in interest rates on new loans in October 2008 up to 5.53%, following a spike in inflation due to rising food import prices, represented a severe shock to the housing market. Combined with the global recession, these hikes in rates soon set off a severe economic downturn which became evident in the Finnish economy in Autumn 2008. When in May 2009 the ECB lowered its base rate down to 1.00%, Finland's average new housing loan mortgage rates fell to 2.55%.

	EU27, 2009	Finland, 2009	Finland, 2008
GDP growth (%)	-4.2	-7.8	1.2
Unemployment rate (%)	8.9	8.2	6.4
Inflation (%)	1.0	1.6	3.9
% owner occupied	68.2	59.0	59.0
Residential Mortgage Loans as % GDP	51.9	58.0	47.5
Residential Mortgage Loans per capita, EUR thousand	12.37	18.61	16.67
Total value of residential loans, EUR million	6,125,727	99,118	88,367
Annual % house price growth	-6.8	-0.3	0.5
Typical mortgage rate (euro area), %	2.71	2.45	5.07
Outstanding Covered Bonds as % outstanding residential lending	23.2	7.7	6.5

Sources: EMF, EUROSTAT, ECB, Statistics Finland

Notes:

- Typical mortgage rate in the euro area refers to the APRC (Source: ECB)
- EU owner occupation rate average derived from EMF calculations based on latest available data.

Finland= 2008