



FINLAND

March 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with Finland, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on January 23, 2024, with the officials of Finland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 20, 2024.
- An **Informational Annex** prepared by the IMF staff.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.



IMF Executive Board Concludes 2024 Article IV Consultation with Finland

FOR IMMEDIATE RELEASE

Washington, DC – Monday, March 11, 2024: On March 7, 2024 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Finland and endorsed the staff appraisal without a meeting.

Finland's economy recovered swiftly from the pandemic, but growth slowed after Russia's war in Ukraine. Weak household income growth, falling house prices, higher interest rates, and low growth in Europe has caused activity to stall in Finland, with a contraction of 0.5 percent estimated in 2023. However, inflation has fallen to more normal levels and financial conditions appear to be easing. Structurally, adverse demographics and weak productivity, have resulted in low trend growth, weighing on public finances.

A shallow recovery in economic activity is expected in 2024, as inflation pressure continues to ease and a modest recovery in real earnings support consumption. Growth is projected to improve to around 1½ percent in the medium term, partly due to an expected increase in investment and employment from the authorities' recent reforms. A combination of negative base effects and a growing output gap will keep average inflation below 2 percent in 2024. But uncertainty remains high. Downside risks to the outlook include: a resurgence of the energy crisis; an escalation of the war in Ukraine; further tightening of global financial conditions; or possibility of a deeper "balance sheet recession."

Executive Board Assessment²

In concluding the 2024 Article IV consultation with Finland, Executive Directors endorsed staff's appraisal, as follows:

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here:

<http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Finland's growth has stalled, with a modest recovery expected this year. Elevated interest rates, sluggish trading partner growth, and a declining housing market are all weighing on activity. And despite a broadly resilient labor market, unemployment is expected to increase slightly, particularly as the construction industry cuts back on employment. However, inflationary pressures are diminishing and an improvement in household purchasing power and loosening financial conditions will contribute to a modest recovery in the second half of the year. Economic growth is expected to be around ½ percent in 2024 and rebound to around 1½ percent in the medium term, driven by increase in investment and employment resulting from the labor market reforms. The external position in 2023 is assessed to be moderately weaker than implied by fundamentals and desirable policy settings.

The fiscal outlook has worsened due to higher discretionary spending and weaker growth. Increased expenditure in energy-related compensation, defense, high index-linked increases in social benefits, and support for Wellbeing Service Counties is expected to have increased the deficit to 2.5 percent of GDP in 2023. Meanwhile, debt ratio has climbed to 76 percent surpassing those of other Nordic countries. The worsened fiscal outlook is expected to persist which puts public debt on a risky path over the medium term.

Existing measures fall short of achieving the ambitious fiscal deficit target. The new government plans to adjust medium-term fiscal deficit by 2 percent of GDP through spending cuts and employment-driven fiscal gains, targeting overall fiscal deficit of 1 percent of GDP by 2027. However, consolidation will likely be diluted by new spending pressures and expected revenue shortfalls. Further measures are necessary to close the gap, as current policies would fail to curb the deficit and bring down the debt ratio.

Through a gradual but sustained adjustment, fiscal policy should be calibrated to reverse the public debt. A structural adjustment of around ¼ percent of GDP should begin in 2024, growing to ½ percent per year over the medium term, with the aim of balancing the budget by 2028. This would help place public financing on a more sustainable footing and make room for the expected increase in age-related spending. In addition to the recent reforms to social benefits, further spending cuts are required, including through efficiency gains from the Wellbeing Service Counties. These efforts should be supplemented with revenues measures such as excise tax indexation, expansion of carbon taxation, VAT rate standardization, and revising dividend taxation for non-listed companies.

Enhancing employment and productivity are essential for economic growth. The mission supports the government's efforts to boost employment through social benefit reforms, greater flexibility in the labor market, and lowering the labor tax wedge. The government should establish robust systems to closely monitor the impact of these reforms on employment. Additionally, policy should aim to improve higher education, lower skill mismatches, and more effectively attract and integrate international talent. While the

government's commitment to invest in research and development is commendable, the plan should focus on catalyzing private sector funding.

Further measures are needed to achieve Finland's ambitious and commendable climate goals. Good progress is being made on expanding the production of low-emission energy, but more is needed to achieve the 2035 carbon neutral target. Policy should consider strengthening carbon pricing and increasing the role of carbon-sinks in the land use sector.

The financial system remains resilient, but rising systemic risks warrant vigilant monitoring. Banks have sufficient capital to withstand adverse macroeconomic shocks, including geoeconomic fragmentation and weakening of profits and capital ratios. Nevertheless, their high dependence on short-term wholesale funding makes them susceptible to liquidity shocks. Hence, liquidity regulation should be tightened. In addition, banks are exposed to systemic events in the Nordic region, CRE market volatility, falling house prices, and still high household indebtedness. These call for continuous and close monitoring.

Further tightening of macroprudential policy would help target pockets of vulnerability and increase financial system resilience. Staff welcomes the recent tightening of macroprudential policy including reinstatement of systemic risk buffer to the pre-pandemic level. However, a positive neutral rate on the CCyB should be legislated and the systemic risk monitoring framework should be enhanced. Additionally, debt-to-income and debt-service-to-income limits should be added to the macroprudential policy toolkit in order to prevent excessive household indebtedness and improve borrower's repayment capacity. These measures could be activated when concerns regarding adverse effects on demand and house prices subside.

Finland: Select Economic Indicators. 2021–29

	2021	2022	2023	2024	2025	2026	2027	2028	2029
							Proj.		
	<i>(Percentage change, unless otherwise indicated)</i>								
Output and Demand (Volumes)									
GDP	2.8	1.6	-0.5	0.4	1.9	1.9	1.7	1.6	1.5
Domestic demand	2.8	3.0	-3.0	1.1	1.9	1.9	1.7	1.6	1.6
Private consumption	3.2	1.5	-0.8	0.5	1.3	1.3	1.2	1.2	1.2
Public consumption	3.9	0.5	3.0	0.3	0.5	0.9	0.9	0.9	0.8
Gross fixed capital formation	1.0	3.1	-5.7	2.0	4.4	3.4	3.9	2.4	2.4
Net exports (contribution to growth in percent of GDP)	0.0	-2.0	2.6	-0.7	0.0	0.0	0.0	0.0	-0.1
Prices, Costs, and Income									
Consumer price inflation (harmonized, average)	2.1	7.2	4.3	1.2	1.9	2.0	2.0	2.0	2.0
Consumer price inflation (harmonized, end-year)	3.2	8.8	1.3	1.9	2.0	2.0	2.0	2.0	2.0
Labor Market									
Participation Rate (15-74 years)	67.0	68.0	68.8	69.3	69.8	70.2	70.7	71.2	71.7
Employment	2.4	2.6	0.5	0.1	0.5	0.4	0.5	0.6	0.6
Unemployment rate (in percent)	7.6	6.8	7.2	7.6	7.4	7.3	7.3	7.2	7.1
Potential Output									
Output gap (in percent of potential output) ¹	-1.0	-0.4	-1.9	-2.4	-1.7	-0.9	-0.5	-0.2	0.0
Growth in potential output	0.9	1.0	1.1	0.9	1.1	1.1	1.3	1.3	1.3
	<i>(Percent of GDP)</i>								
General Government Finances²									
Overall balance	-2.8	-0.8	-2.5	-3.5	-3.4	-3.0	-2.7	-2.2	-2.3
Primary balance ³	-2.9	-0.8	-2.6	-3.2	-3.1	-2.7	-2.4	-2.0	-2.0
Structural balance (in percent of potential GDP) ⁴	-2.2	-1.0	-1.6	-2.0	-2.4	-2.4	-2.3	-2.0	-2.1
Structural primary balance (in percent of potential GDP) ⁵	-2.3	-1.0	-1.5	-1.7	-2.1	-2.1	-2.0	-1.7	-1.8
Gross debt	72.6	73.3	76.3	79.6	82.2	84.0	85.1	85.6	86.2
Net debt ⁶	-72.9	-59.3	-54.5	-49.6	-44.3	-39.6	-35.5	-32.0	-28.6
Balance of Payments									
Current account balance	0.4	-2.6	-0.5	-0.4	-0.2	-0.1	0.0	0.0	0.0
Goods and services balance	0.0	-2.4	0.3	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1
Net international investment position	1.0	-2.2	-2.6	-2.9	-2.9	-2.8	-2.6	-2.4	-2.2
Gross external debt	208.6	215.4	216.1	218.0	216.5	215.3	213.9	212.6	211.4

Sources: Bank of Finland, BIS, International Financial Statistics, IMF Institute, Ministry of Finance, Statistics Finland, and IMF staff calculations.

¹ A negative value indicates a level of actual GDP that is below potential output.

² Fiscal projections include measures as specified in the General Government Fiscal Plan.

³ Adjusted for interest expenditures and receipts.

⁴ Not adjusted for COVID-related one-off measures.

⁵ Adjusted for interest expenditures and receipts. Not adjusted for COVID-related one-off measures.

⁶ Defined as the negative of net financial worth (i.e., debt minus assets).



FINLAND

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

February 20, 2024

KEY ISSUES

Recent developments and outlook. Weak household income growth, falling house prices, higher interest rates, and stagnation in Europe has caused activity to stall in Finland, with a contraction of 0.5 percent estimated in 2023. Labor markets have shown resilience, but unemployment is expected to increase somewhat in coming months, especially from the construction sector. However, inflation has fallen to more normal levels and financial conditions appear to be easing, paving the way for a modest recovery this year, strengthening further in 2025.

Fiscal policy. Higher spending and negative growth caused a large increase in the fiscal deficit in 2023. While measures have been introduced to reduce the deficit, these are not enough to stabilize debt or to meet the government's own targets. A modest fiscal consolidation should begin this year, growing in ambition, with the aim of achieving a balanced budget by 2028. This should put debt on a firm downward trajectory and build buffers for future shocks and growing demographic pressures. Reforms to social benefits and efficiency savings in health and social services are welcome; but revenue measures are also likely to be needed to close this adjustment gap.

Structural reforms. The authorities ambitious social benefit reforms have the potential to boost employment in coming years, as well as reduce public spending. These should be complemented by reforms to reduce skills mismatches, strengthen tertiary educations, and better attract and integrate talent from abroad. Meeting Finland's ambitious and commendable climate goals require further measures.

Financial sector. Capital and liquidity buffers are well above regulatory minimum levels, but risks are elevated, including from large cross-border exposures, emerging signs of corporate distress, higher household debt service costs, and a reliance on wholesale funding. Macroprudential measures have tightened, but strengthening the regulatory toolkit further—including through the introduction of a positive neutral counter-cyclical capital buffer, tighter liquidity regulation, and the introduction of additional borrower-based macroprudential measures—would further enhance resilience.

Approved By
Oya Celasun (EUR)
and Martin Sommer
(SPR)

Mission took place virtually (January 8–9, 2024) and in Helsinki, Finland (January 11–23, 2024). The team comprised Alex Pienkowski (head), Takuji Komatsuzaki, Mauricio Vargas, and Seyed Reza Yousefi (all EUR). Robert Beyer, Salvatore Dell’Erba, Raju Huidrom, Fuda Jiang, Hannah Jung, and Rohan Srinivas (all EUR) assisted from headquarters. Ms. Karhapää (OED) joined the discussions. The mission met with Ms. Purra, Minister of Finance; Ms. Nykänen, Acting Governor of the Bank of Finland; Mr. Majanen, Permanent Secretary of the Ministry of Finance; Mr. Kurenmaa, head of the FIN-FSA; other senior officials; the ECB; representatives from the private sector, banks, labor unions, and other stakeholders.

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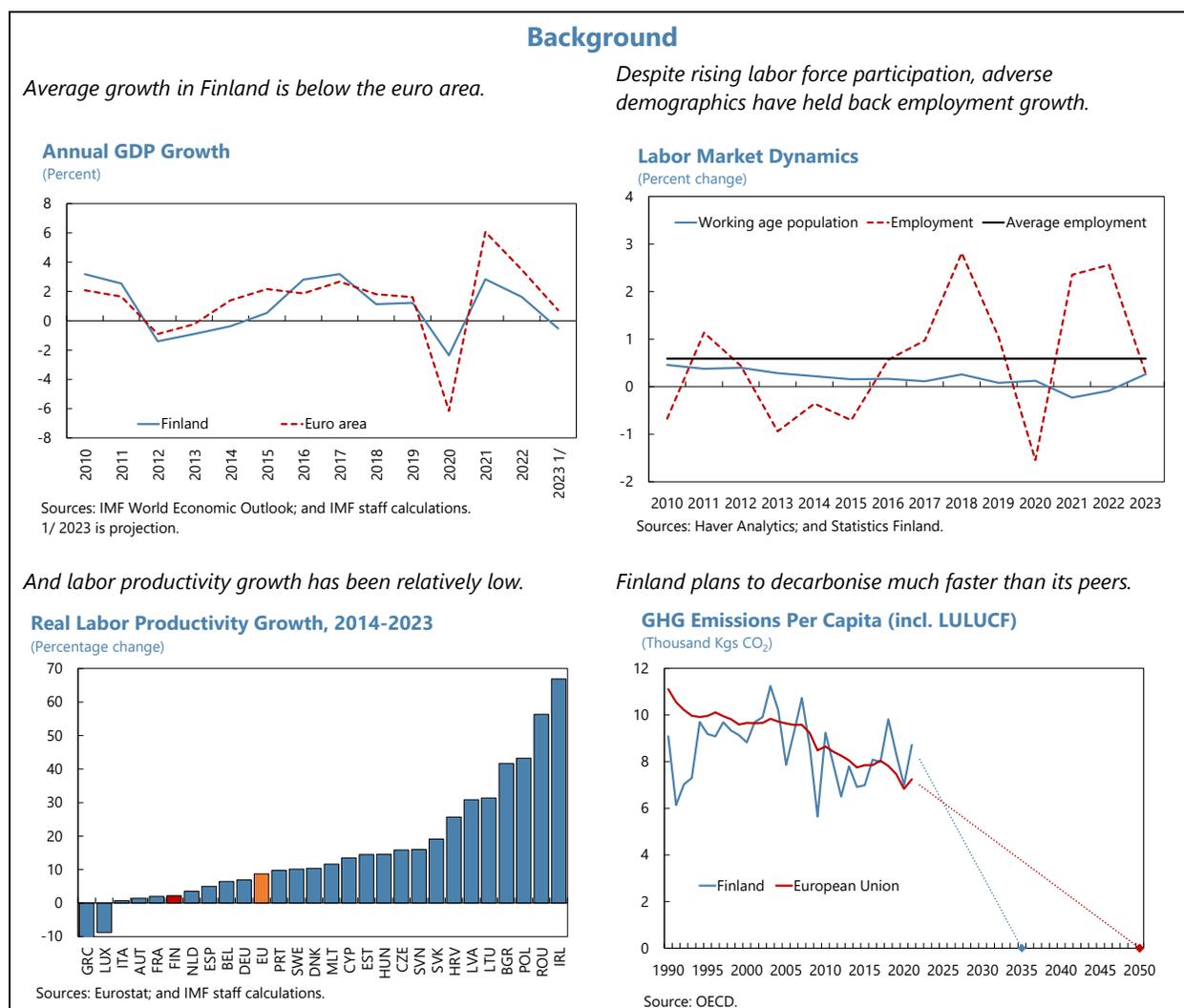
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CONTEXT

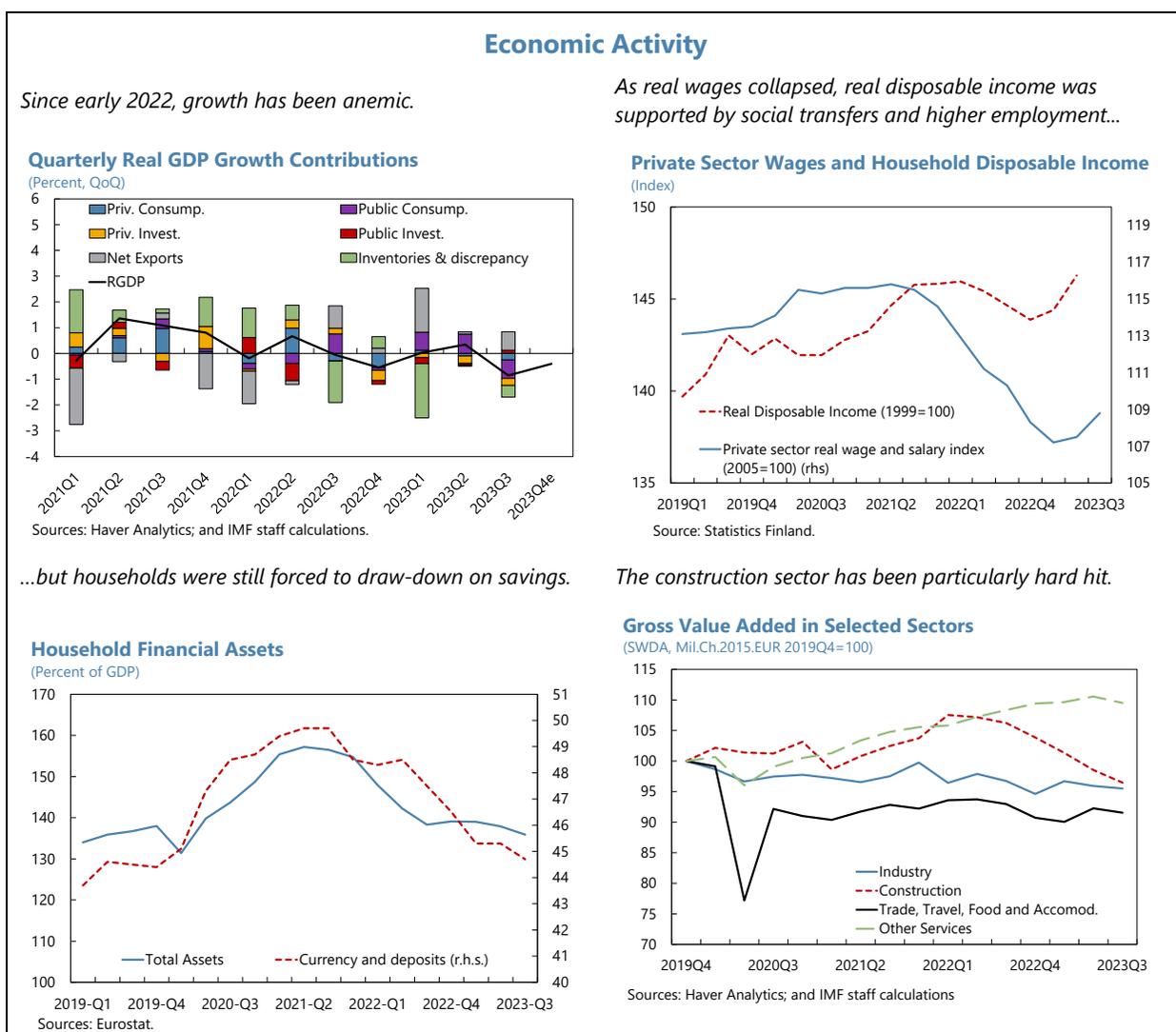
1. Long-standing structural challenges constrain growth. Finland’s economy had recovered swiftly from the pandemic thanks to strong policy support. But growth slowed after Russia’s invasion of Ukraine, with only a shallow recovery expected in 2024. Structurally, adverse demographics and weak productivity, have resulted in low trend growth, weighing on public finances. From the late 2000s, the economy quickly lost market share in the highly-productive ICT sector (Selected Issues, 2015). Since then, it has struggled to find alternative high-productivity growth industries. Going forward, however, Finland’s ambition to become carbon-neutral by 2035 (15 years before the EU), could support new growth opportunities.

2. A new government has unveiled plans to address these challenges. Formed in June 2023, the government aims to deliver a growth-friendly fiscal adjustment that incentivizes employment; and a green strategy that seeks to better foster economic growth.



RECENT ECONOMIC DEVELOPMENTS

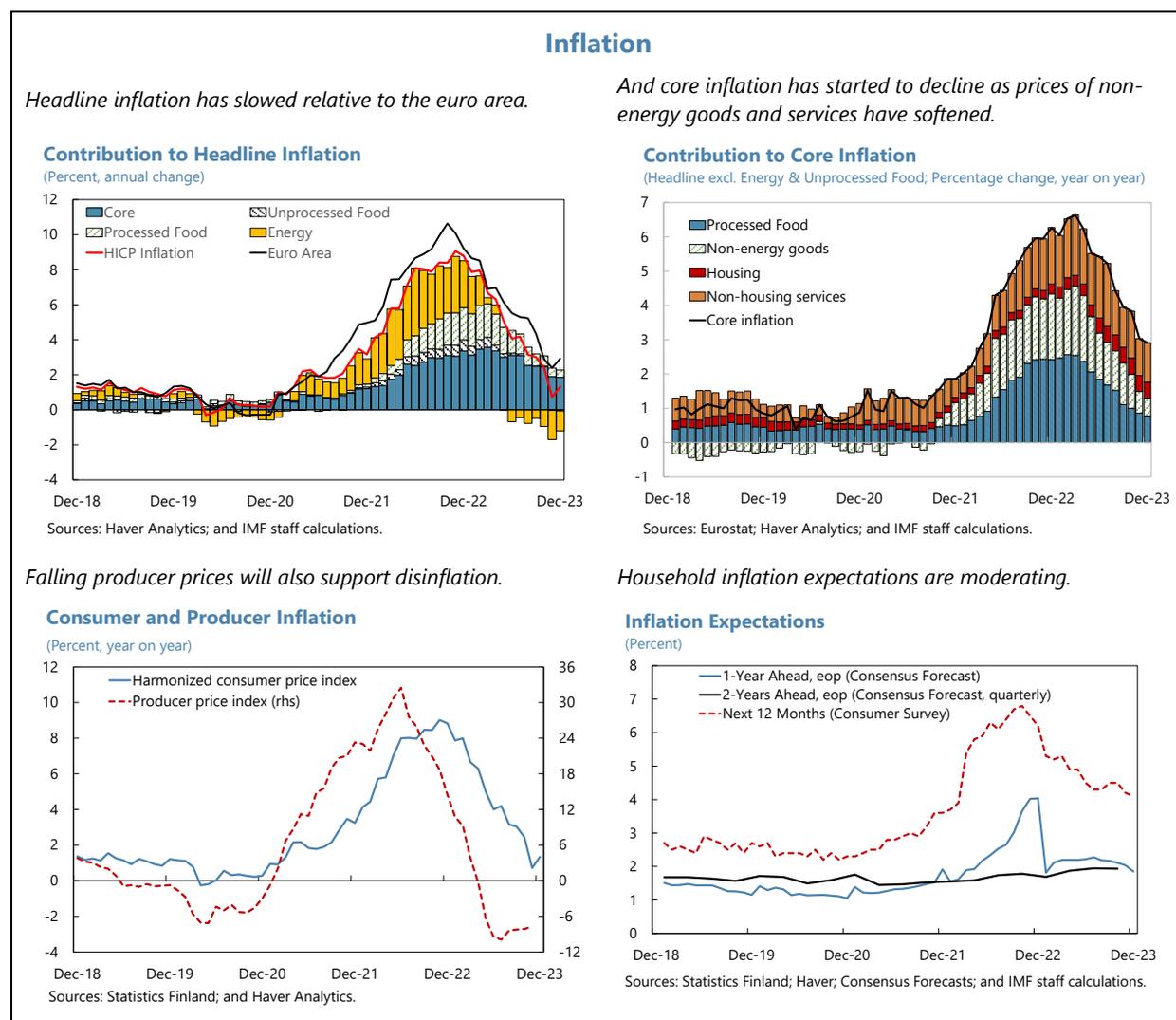
3. Economic growth has stalled (Figure 1). Given its limited direct trade and financial links to Russia, and its large energy production sector, Finland was relatively shielded from the *direct* economic impact of Russia’s invasion. However, weak trading partner growth, tight financial conditions, and a downturn in the housing market have led growth to stagnate since 2022, with a steep decline in 2023Q3 (-0.9 percent, qoq) and an estimated smaller decline in 2023Q4 (-0.4 percent, qoq). Weak real wage growth and a decline in “excess saving” buffers continues to constrain consumption. Furthermore, higher interest rates are weighing on investment; along with falling house prices, the construction sector is particularly hard hit. There is also evidence that the monetary policy transmission mechanism may be stronger in Finland than the euro area average (Annex I).



4. Inflation pressures are receding. Supported by falling energy prices, headline inflation (HCPI) has fallen from its peak in November 2022 (9.1 percent) to 1.3 percent in December. The decline in energy prices also reflects a correction in the electricity price index by Statistics Finland.¹ Core inflation remains more elevated at 2.9 percent, but momentum indicators show signs of slowing, especially for processed foods and non-energy goods (Annex II).

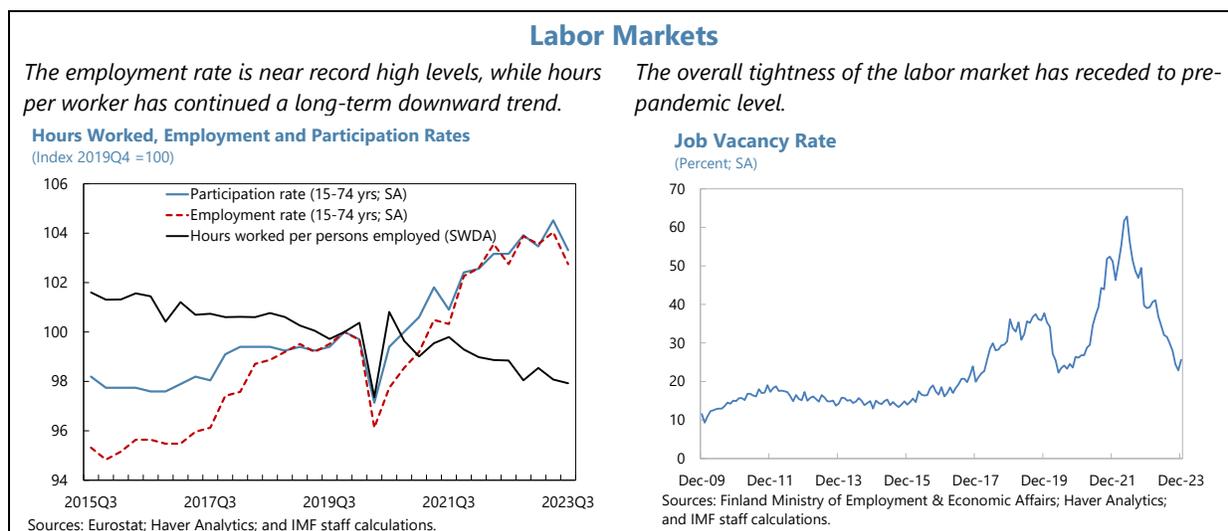
Key Inflation Indicators					
(Percent)					
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Headline, yoy (SA)	8.8	6.7	4.0	3.0	1.3
Headline, 3mma*	6.6	4.5	-0.7	1.9	-0.2
Core, yoy (SA)	6.3	6.7	5.4	3.9	2.9
Core, 3mma*	5.6	7.2	2.5	0.6	1.5

*Average of the previous 3 months' m.o.m inflation rate; annualized and seasonally adjusted

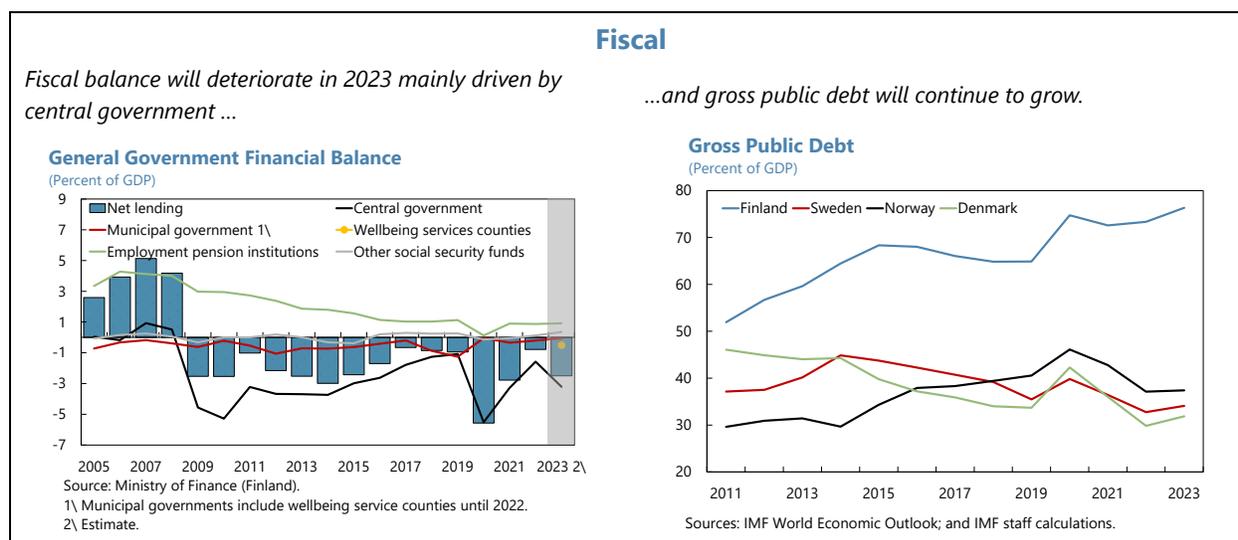


¹ Statistics Finland adjusted the electricity price index for August 2023, which corrected a double-counting error in the price increase of electricity. The impact on the yoy change rate of the HCPI is 0.70 percentage points. The correction will affect the annual change of the CPI and the HCPI until July 2024.

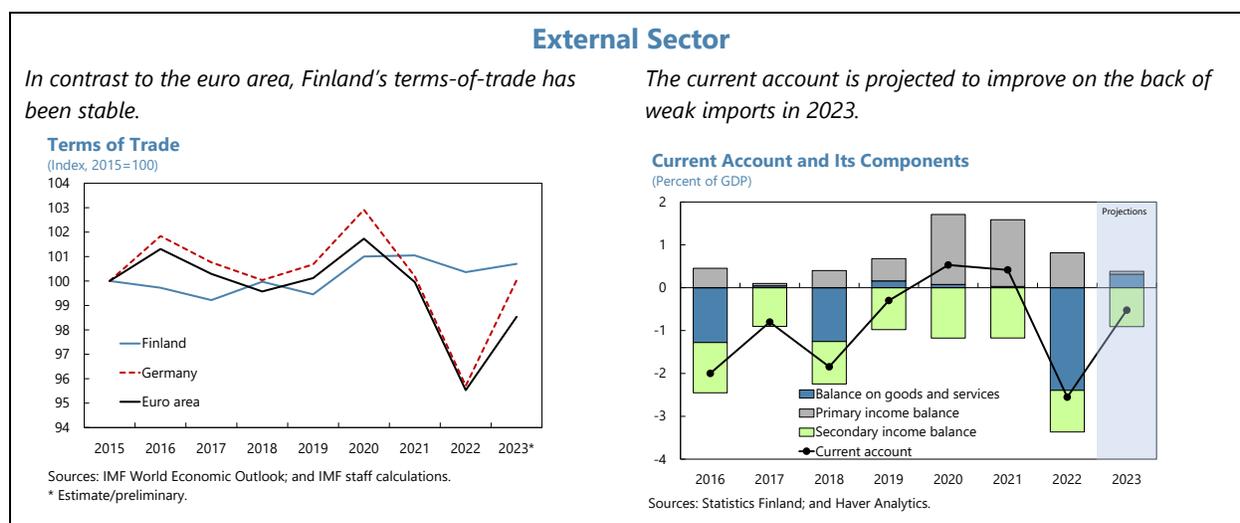
5. The labor market remains relatively strong despite slowing activity (Figure 2). In the first half of 2023, labor participation and employment rates peaked, followed by a moderate decline. The unemployment rate has edged up to 7.6 percent in December, following persistently low levels since 2022. The vacancy-to-unemployment ratio has declined back to pre-pandemic level, suggesting that the post-pandemic shift in the Beveridge Curve was mostly cyclical (Annex III). A moderate wage settlement in 2023 (average increase of 3.8 percent) implied a contraction in real wages (-1 percent in 2023Q3), reducing pressure on inflation.



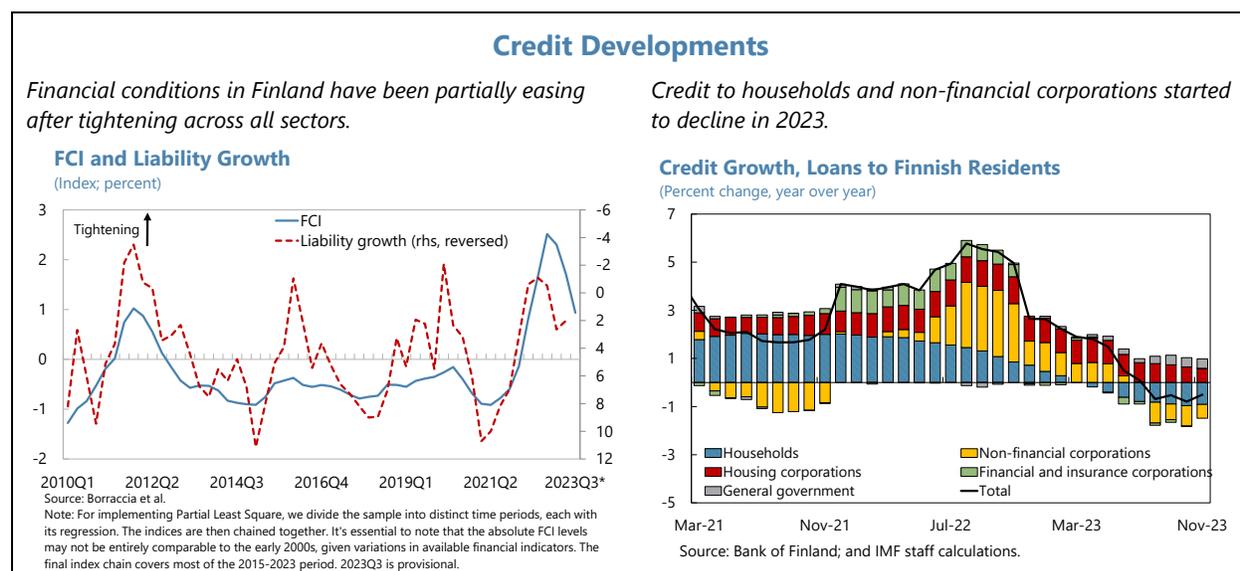
6. The fiscal deficit in 2023 is estimated to have widened by around 1 ¾ percentage points of GDP. The bulk of the deterioration is due to higher spending—mostly reflecting energy-related compensation, defense, high index-linked increases in social benefits, and support for health and social services through the local “Wellbeing Service Counties.” Following strong tax revenue buoyancy in 2022, the revenue ratio is estimated to have fallen in 2023, as the economy contracted. The fiscal deficit in 2023 is expected to deteriorate to 2.5 percent of GDP, and gross public debt—already higher than in Nordic peers—will increase to around 76 percent.



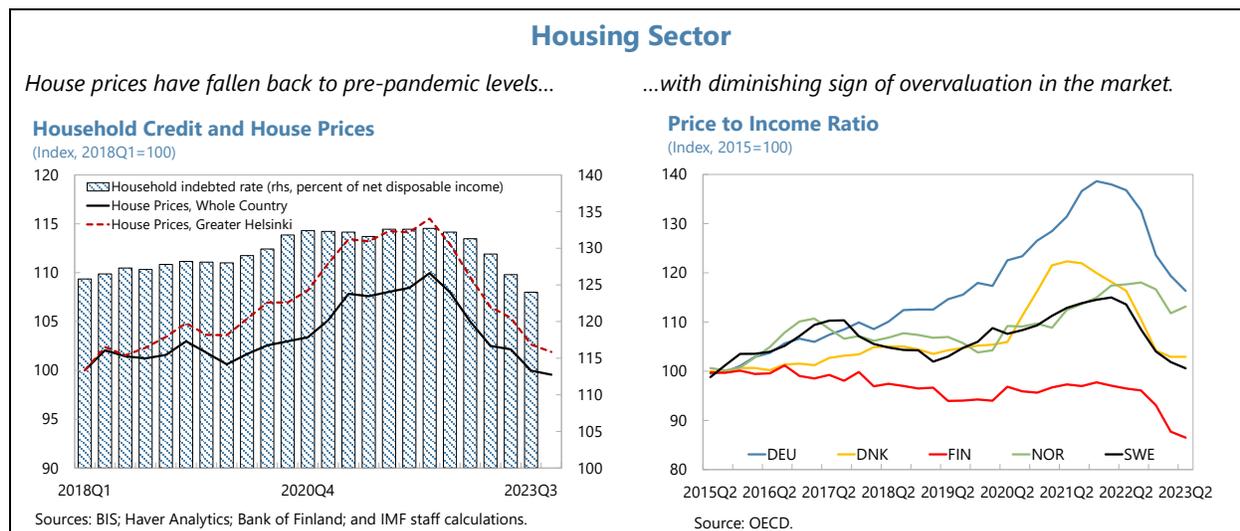
7. The external position has improved on the back of demand compression. In 2022—unlike much of Europe and despite large increases in both export and import prices—Finland’s terms-of-trade remained relatively stable, supported by its large electricity production sector. Nevertheless, a deterioration in the net services (mainly in tourism) and primary income balances (primarily a rebound bank dividends) pushed the current account deficit to 2.6 percent of GDP. In 2023, weak domestic demand led to a substantial improvement in net trade. As such, the current account deficit is anticipated to have narrowed to an estimated 0.5 percent of GDP in 2023: moderately weaker than the level implied by fundamentals and desirable policies (Annex IV). Fiscal consolidation remains the primary lever to strengthen the external balance.



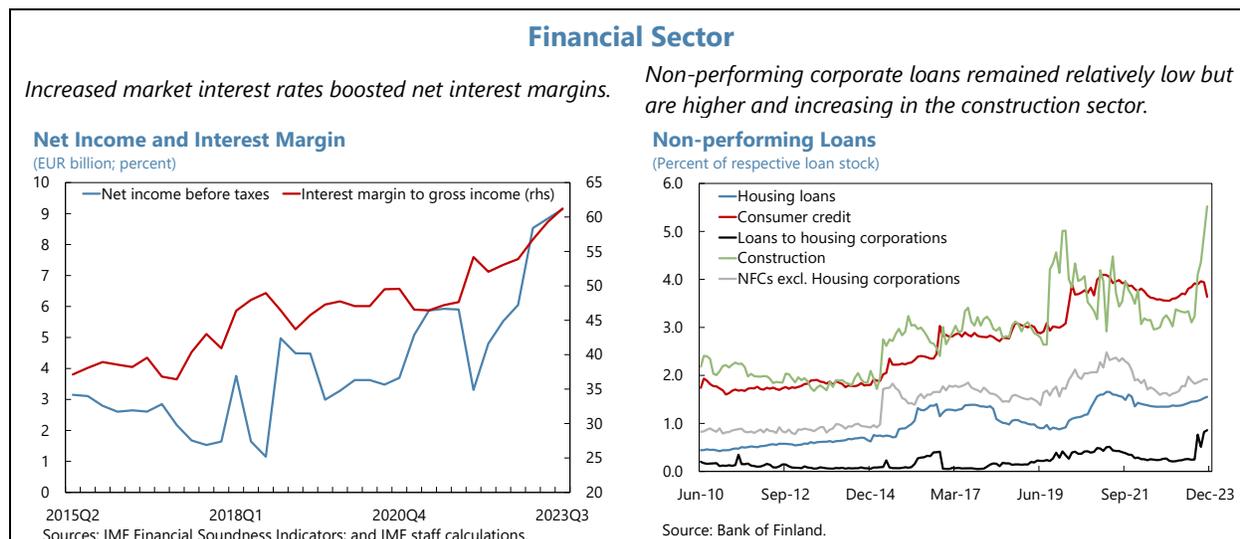
8. Financial conditions have tightened across all sectors (Figure 3). Financial conditions reached their tightest level since the global financial crisis. But conditions point to a partial easing from 2023Q1, driven mainly by moderation in the price of risk, a forward-looking component. Accordingly, credit growth contracted by 0.5 percent yoy in November 2023.



9. House prices have fallen back to pre-pandemic levels (Figure 4). During the pandemic, residential property prices increased on the back of low interest rates and a jump in household financial assets. However, as interest rates rose and economic activity slowed, house prices fell by nearly 10 percent since their peak, back to around pre-pandemic (nominal) levels. And residential construction and transaction indicators have seen steep falls. Although declining, household indebtedness remains high at 124 percent of net disposable income.

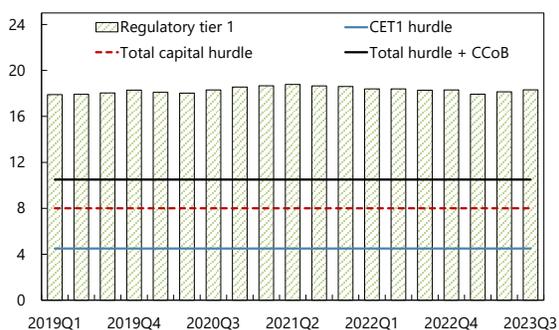


10. The financial system has been resilient to rising interest rates (Figure 5). Driven by higher net interest margins, bank earnings have increased, and liquidity positions remain strong. The spillovers from the banking sector turmoil in early 2023 in the US and Switzerland were muted, as evidenced by major banks' stable and low CDS spreads. More than 90 percent of Finnish banks' bond holdings are booked at fair value, limiting the risk from unrealized losses. Non-performing corporate loans (excluding housing companies) have increased from 1.6 percent in January 2023 to 1.9 percent in November 2023, still low as a proportion of the entire loan stock.



Banks' core tier 1 capital is well above regulatory requirements...

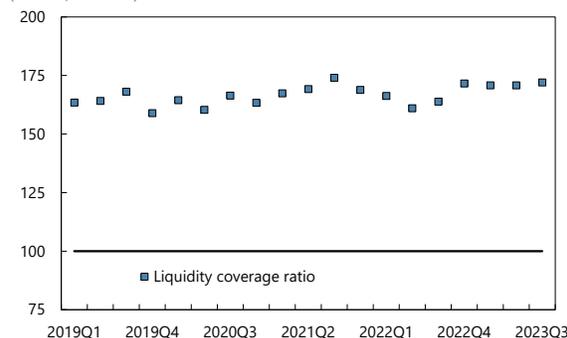
Regulatory Capital
(Percent of RWA; all banks)



Sources: Bank of Finland; and IMF, Financial Soundness Indicators.

...and liquidity remains high.

Liquidity Coverage Ratio
(Percent; all banks)



Sources: Bank of Finland; and IMF, Financial Soundness Indicators.

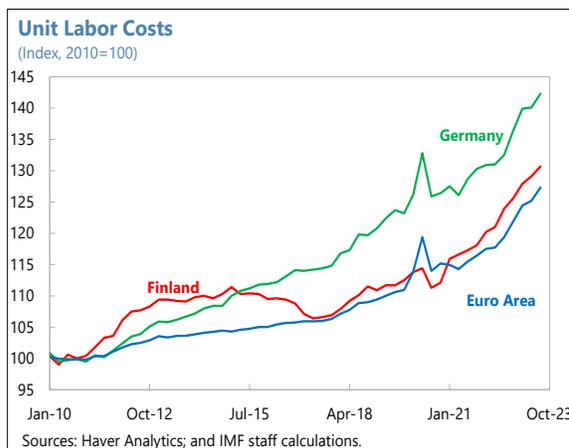
OUTLOOK AND RISKS

11. A shallow recovery in economic activity is expected in 2024.

The preliminary estimate of 2023Q4 growth shows further weakness, driven by falling house prices, weak consumer sentiment, and low investment. This, along with a large negative “carry-over” from the previous year, suggest growth of -0.5 in 2023. In 2024, still tight financial conditions will continue to weigh on economic activity, especially in the real estate sector. Unemployment is also expected to increase

somewhat, as the construction sector continues to shed jobs. But as inflation pressure continues to ease, a modest recovery in real earnings will support consumption. As such, a shallow recovery is projected in 2024 (0.4 percent). In the medium term, growth is projected to improve to around 1½ percent, partly due to an expected increase in investment and employment from the authorities’ recent reforms (Annex IV). Cost competitiveness is projected to remain broadly unchanged, while the current account deficit is projected to slowly return to balance.

Unemployment is also expected to increase somewhat, as the construction sector continues to shed jobs. But as inflation pressure continues to ease, a modest recovery in real earnings will support consumption. As such, a shallow recovery is projected in 2024 (0.4 percent). In the medium term, growth is projected to improve to around 1½ percent, partly due to an expected increase in investment and employment from the authorities’ recent reforms (Annex IV). Cost competitiveness is projected to remain broadly unchanged, while the current account deficit is projected to slowly return to balance.



Sources: Haver Analytics; and IMF staff calculations.

12. Inflation is expected to stay below 2 percent this year.

A combination of negative base effects and a growing output gap will keep average inflation below 2 percent in 2024. Relatively moderate wage increases negotiated for 2024—which average around 2.8 percent—reduce the risk of entrenched inflation.

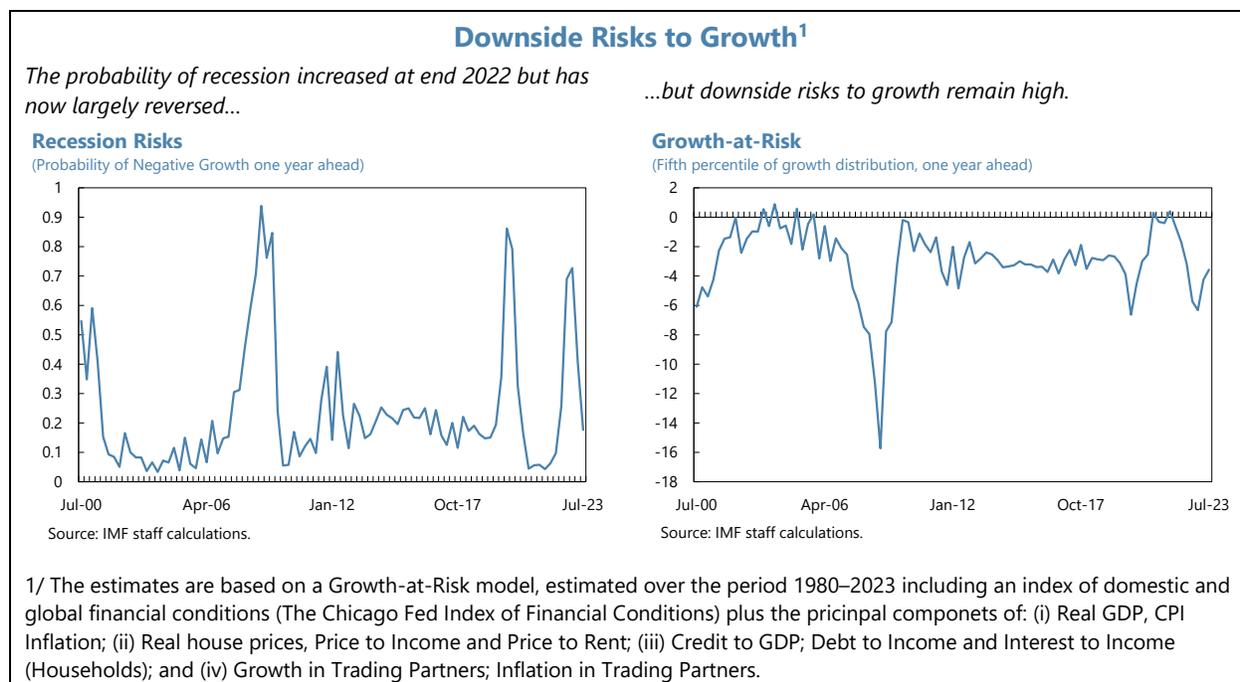
Key Macroeconomic Indicators

(In percent)

	2022	2023	2024	2025
GDP Growth	1.6	-0.5	0.4	1.9
Unemployment Rate	6.8	7.2	7.6	7.4
Inflation (avg)	7.2	4.3	1.2	1.9
Current Account (% of GDP)	-2.6	-0.5	-0.4	-0.2

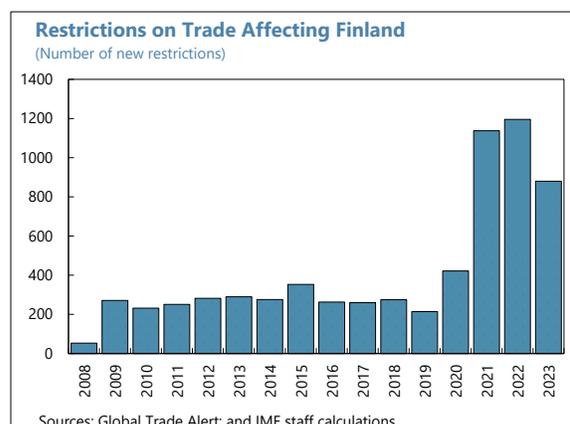
Sources: IMF WEO; and IMF staff calculations

13. But uncertainty remains high (Annex V). Downside risks to the outlook include: a resurgence of the energy crisis; an escalation of the war in Ukraine; adverse shock in other Nordic countries; or further tightening of global financial conditions. There is also a risk that the combination of high household debt, falling house prices, higher unemployment, and rising interest rates tip the economy into a much deeper “balance sheet recession.” In such a downside scenario, fiscal consolidation should pause, and automatic stabilizers be allowed to work, with targeted measures focused on the most vulnerable. The authorities could also consider delaying any increase in capital risk buffers.



14. Deepening geoeconomic fragmentation is exposing Finland to trade disruptions.

Increasing trade barriers and high exposure of major Finnish multinational enterprises to China pose a risk to the Finnish economy. While common measures of trade with China suggest a moderate increase, total foreign production exposure to China is substantial and has grown significantly over the past decade, outpacing most other trade partners (Annex VI).



Authorities' Views

15. The Finnish authorities agree that the economy faces a challenging year, with particularly high uncertainty surrounding the pace of the recovery. While monetary tightening has impacted the construction sector, its broader economic impact, including on macro-financial

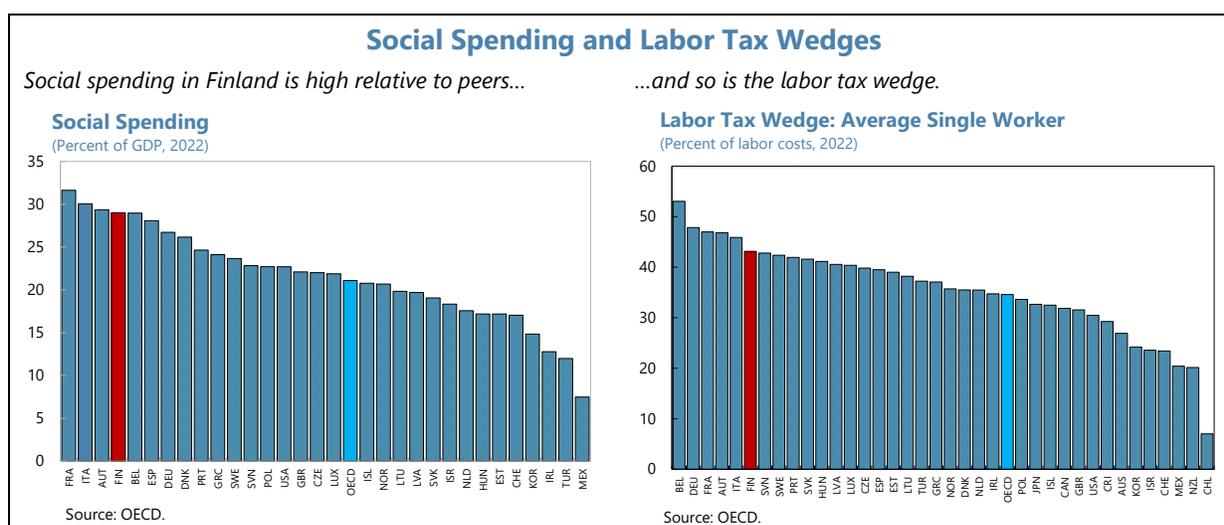
stability, is considered contained. The authorities anticipate that growth will be weak or even negative in 2024, with a pickup expected over the medium term. This recovery is anticipated to be fueled by declining interest rates, moderating inflation, wage growth, and positive impacts from labor reforms. Risks include a deeper downturn in housing construction and global economic uncertainties, such as rising geoeconomic fragmentation. However, the authorities also see upside risks, including from technological innovation, substantial planned investments in energy, and improving household finances potentially boosting economic activity above current forecasts.

POLICY PRIORITIES

A. Securing Fiscal Sustainability Amid New Priorities

16. Past policies weakened the fiscal outlook. Discretionary measures introduced in 2019 entailed higher spending over the medium term. Covid measures (which expired in 2022), defense spending, and higher public sector wages added to these pressures. And revenues are expected to fall due to reduction in indirect taxes, especially in excise taxes. With no-policy change after 2023, deficits would grow in coming years, putting debt on an increasing trajectory, reaching over 85 percent of GDP by 2028.

17. The new government program (June 2023) targets a medium-term fiscal consolidation plan over its 4-year parliamentary term (Annex VII). The planned fiscal adjustment amounts to about €6 billion (2 percent of GDP), and includes spending cuts constituting about €4 billion, with the remainder achieved through fiscal gains from additional employment. This package includes several revenue measures (some designed to boost employment), which aim to be budget neutral on net. And increased public investment will be fully financed by asset sales. The consolidation plan objectives—size, timeline, and composition—are broadly in line with previous staffs' recommendations.



18. The consolidation plan will likely, however, be diluted by new spending pressures and expected revenue shortfalls. The 2024 budget and the medium-term fiscal plan introduces a reduction in unemployment insurance contribution—due to sufficient buffers in the Employment Fund—that will decrease revenues by around ¼ percent of GDP annually. In addition, war-related discretionary defense spending, averaging around ½ percent of GDP annually, will further undermine savings.

Main Discretionary Fiscal Measures								
	EUR billion				Percent of GDP			
	2024	2025	2026	2027	2024	2025	2026	2027
Additional discretionary measures, net (June 2023) ¹	0.9	2.2	2.3	2.9	0.3	0.7	0.8	0.9
Reduction in unemployment insurance contributions, net (October 2023)	-0.7	-0.7	-0.7	-0.7	-0.2	-0.2	-0.2	-0.2
Defence discretionary spending (October 2023)	-2.1	-1.8	-1.3	-1.1	-0.7	-0.6	-0.4	-0.3
Total Impact, net	-1.9	-0.3	0.4	1.1	-0.7	-0.1	0.1	0.4

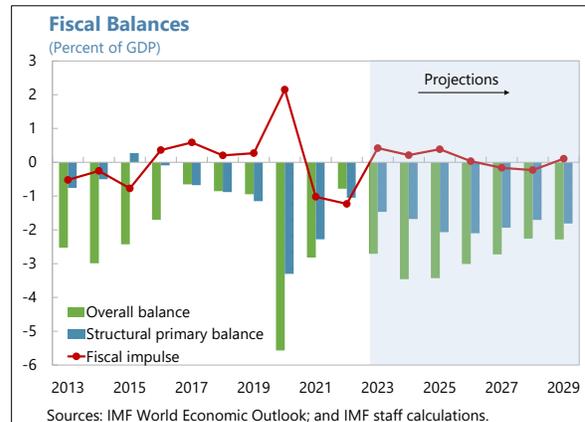
Source: MOF Economic Survey (Oct 2023); and IMF staff calculations.

Note: This table summarizes the main discretionary fiscal policy measures included in the June 2023 government program and October 2023 medium-term fiscal plan.

1/ Cost savings in well-being counties are excluded.

19. Taken together, fiscal policy will be expansionary in 2024. The structural primary balance will deteriorate by about ½ percentage points of GDP, suggesting an expansionary fiscal impulse into 2024. The overall fiscal deficit will widen by 1 percentage points, to 3.5 percent, with lower-than-expected revenues due to the deteriorating macroeconomic outlook also contributing.

20. Debt is projected to rise over the medium term. While the government targets an overall fiscal deficit of 1 percent of GDP by 2027, the staff baseline projects a 2.7 percent deficit. The planned reduction of social expenditure is welcome and will bring Finland closer to peers (IMF 2020). However, the envisaged fiscal gains from higher employment will be hindered by the weak economic outlook and persistent labor market mismatches. Moreover, efficiency savings in the Wellbeing Service Counties envisaged in the government program lack sufficient specificity and will be challenging to achieve in the near-term. Public debt will continue to rise over the medium term, although at a slower pace relative to the no-policy change scenario. Aside the persistent deficits, the debt trajectory reflects stock-flow adjustments, averaging 1½ percent annually over the medium term.²



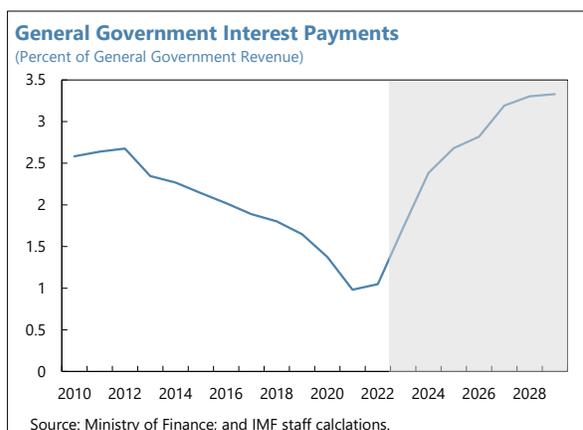
21. Public debt sustainability is subject to potential risks and long-standing demographic challenges. Overall debt sustainability risks are assessed to be low given the moderate projected debt level and manageable gross financing needs, however the medium-term risk of debt not

² This includes pre-financing (until 2024) of the planned fighter jets purchase, social housing loans, and collateral on derivative contracts used for debt management.

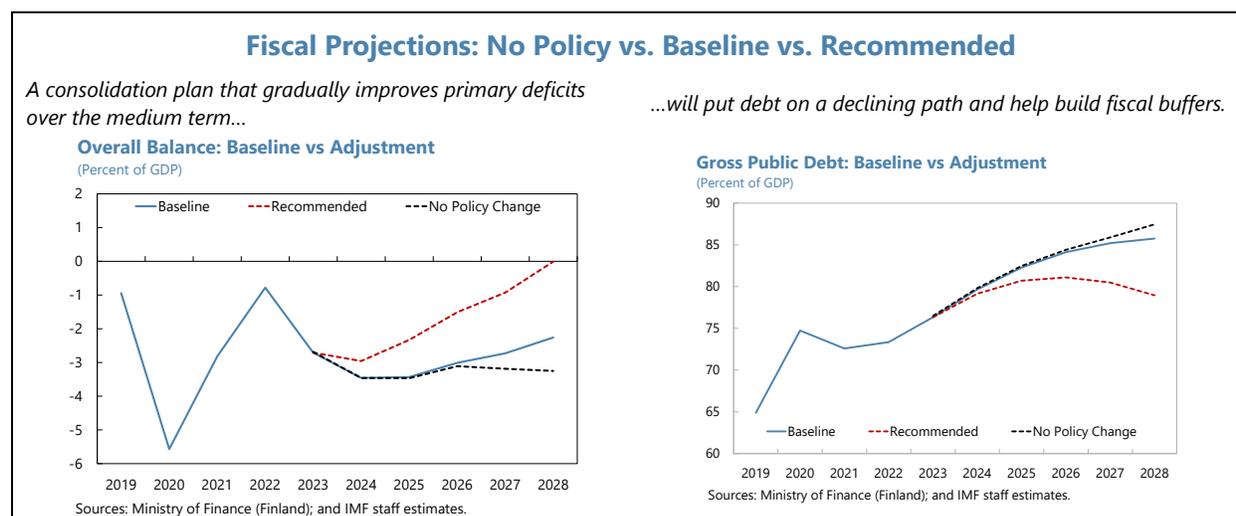
stabilizing remains high (Annex VIII). Over the long term, health and long-term care spending is projected to increase by around 2 percentage points of GDP by 2045, stressing public finances (European Commission 2021). While the pension system is broadly on a financially stable footing, maintaining a margin of safety is essential. Given the increasing share of equity and other riskier investments in pension insurance companies’ portfolios and uncertainty of future asset returns, it is crucial that a conservative approach be taken in adjusting pension contribution rates. Furthermore, there is ample room for efficiency gains in the delivery of health care service.

22. A gradual and moderate fiscal tightening would put debt on a declining path.

The unfavorable fiscal outlook points to the need for proceeding with gradual fiscal consolidation. However, given the weak growth outlook and below-target inflation, this consolidation should begin with a modest structural adjustment of ¼ percentage points of GDP in 2024, increasing to ½ percentage points of GDP over the medium term, with the aim of balancing the budget by 2028. This adjustment—which is consistent with the government’s 2027 objective—would support credibility, build buffers against future negative shocks, and mitigate the rising opportunity cost of borrowing at higher interest rates. Such a stance would put public debt on a declining path by 2027 and would create space to support the expected increase in age-related spending.



23. Additional consolidation measures are needed to achieve this objective. The recent reforms to social benefits are welcome, but further expenditure reduction is required, including through efficiency gains from the Wellbeing Services Counties. Higher revenues—including through indexation of excise taxes, the expansion of carbon taxation, greater standardization of VAT rates, and reforming the taxation of dividends from non-listed firms—should also be considered.

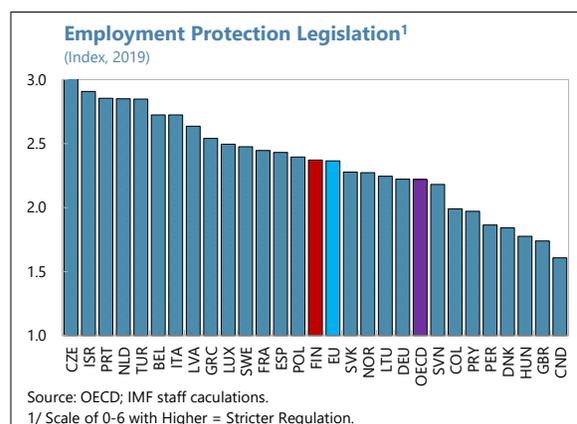


Authorities' Views

24. The authorities agreed with staff that under current policies, the substantial fiscal deficit would continue and that the debt to GDP ratio will further increase. They also concurred that sufficient measures have yet to be identified to meet the government's objective of a 1 percent of GDP fiscal deficit by 2027 and to curb the debt to GDP ratio in two parliamentary terms. However, they remain committed to this goal and were open to adding revenue measures to the fiscal adjustment efforts. But certain measures—such as increases in personal income tax, corporate income tax, carbon taxation and changes in dividend taxation of non-listed firms—were considered unlikely. They expressed concerns about the prospects of containing health care expenditure in the near-term but showed confidence in the sustainability of the pension system, indicating the ongoing review by the newly formed working groups.

B. Achieving Sustainable and Resilient Growth

25. The government has announced the implementation of an ambitious labor market reform plan to boost employment. These reforms are designed to enhance incentives to work. The measures include unemployment benefit reforms, social security and tax adjustments, and enhancements to employment services. The objective is to create 100,000 new jobs while strengthening public finances. According to the government's estimates, specific measures have been identified to create approximately three-quarters of the target (Annex VIII).



26. Reducing skill mismatches, strengthening tertiary education, and attracting and better integrating talent from abroad remain priorities for boosting productivity (Annex III, Box 1). The authorities plan to increase the proportion of young adults attaining higher education degrees to approximately 50 percent by 2030 are welcome. Concerning work and education-based immigration, recent policy adjustments have adopted a more selective framework, despite demographic trends reducing the labor force. Concurrently, negotiations on reforming the wage bargaining system are in progress, but the impact on wage flexibility and employment remain unclear. Consistent with prior IMF recommendations, the government enacted policies to phase out early retirement avenues. Last year, the “unemployment tunnel”—a mechanism facilitating early retirement for individuals over 55—was eliminated. This measure complements a comprehensive strategy to motivate continued workforce participation among older employees, supplemented by enhanced re-employment support and training incentives.

27. The government's plan to boost R&D spending can help boost productivity. The authorities have committed to increase R&D spending to 4 percent of GDP, with 1.2 percentage points of which coming from the public sector. Toward that end, the 2024 budget increases

allocation to R&D spending by €260 million (0.1 percent of GDP). It will fund both basic and applied research, and procedures have been established to allocate the funding competitively. However, the mechanisms by which public funding will catalyze private finance are yet to be established. Going forward, it is important to continue to track the effectiveness of the spending to maximize impact.

28. Countering fragmentation is key for resilience. While the authorities balance national security concerns and trade efficiency issues, they should seek to promote supply chain resilience, including by encouraging diversification. This should be complemented by efforts to pursue an open and rules-based trading system, strengthen the EU's single market, and broaden trade and development partnerships. Furthermore, fragmentation risks call for improved monitoring and preparedness for supply chain disruptions, and maintaining strategic reserves of critical goods.

29. Carbon emissions are set to fall. The authorities plan to expand the production of cheap green energy and facilitate investments in net-zero technology manufacturing projects. This is part of a broader European Union strategy to modernize and strengthen its industrial sector while simultaneously advancing towards carbon neutrality. The strategy is underpinned by the recent opening of a new nuclear power plant, an expansion in wind turbine capacity, and additional investments by the private sector. The authorities also plan to increase the share of (costlier) biofuels in vehicle and heating fuels but have offset the burden on consumers with lower fuel excises.

30. But more is needed to meet Finland's ambitious and commendable climate goals. Current policies will help to further reduce emissions but would not be sufficient to achieve the 2035 carbon neutral target. In particular, the role that forests play as carbon sinks is weakening due to increased lumbering and are currently insufficient to meet targets set at the EU level. Further actions are needed to increase the role of carbon sinks in the Land-Use, Land-Use Change, and Forestry (LULUCF) sector, particularly in forestry; and strengthening carbon pricing, together with the preparation for the introduction of ETSII ([IMF 2021](#)). Economic abatement costs in the LULUCF sector are considered to be relatively low, while strengthening carbon pricing will support fiscal consolidation efforts in addition to carbon emission reduction (¶23).

Authorities' Views

31. The authorities expressed confidence that the recent labor market reforms would enhance work incentives, increase labor participation, and improve fiscal balance, while acknowledging the complexity in quantifying the precise impact. The authorities agreed that reducing skill mismatches, strengthening education, and attracting international talent remain key challenges for long-term growth. They expressed their commitment to elevating Finland back to the top of global school rankings and increasing the share of population with tertiary education. They acknowledged the importance of strategic immigration policies to address demographic challenges. The authorities reiterated their commitment to R&D spending and concurred with the importance of catalyzing private sector funding. Regarding climate change policies, they expressed concern over the declining role of forests as a carbon sink, which could breach EU targets without corrective action. In contrast, they expressed confidence in the advancement of clean technology, and expressed hope for the improving momentum for green investment once the business environment is improved.

Box 1. Demography, Skill Gaps and Migration

Finland faces significant demographic challenges with an aging population and a low birth rate. Its old-age dependency ratio was 41% in 2022, higher than the OECD average of 33%, and is [projected](#) to reach 50% by 2050. Moreover, the population is expected to shrink by 2060.

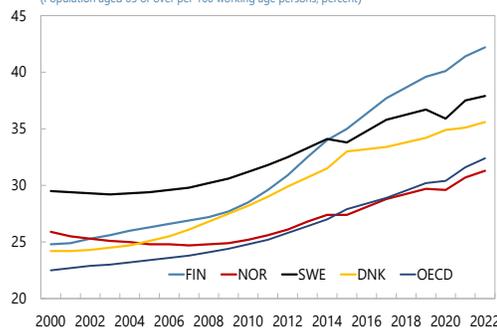
Finland experiences a skills shortage, particularly in technology sectors, [projected to need](#) 130,000 high-skilled workers in the next decade. Most companies consider hiring abroad, indicating a domestic skills gap. This shortage is exacerbated as the experienced workforce nears retirement.

Finland's younger population (25–34 years) shows stagnating tertiary education levels, now below the OECD average, in contrast to the older generation (55–64 years) who previously exceeded it. This decline in relative educational attainment contributes to the skills gap and raises concerns about future Finland's global competitiveness.

Finland also faces significant exposure to AI disruption, especially in sectors like professional services which presents both risks and opportunities. Women may be disproportionately affected, potentially increasing inequality.¹ However, a well-trained, dynamic workforce could harness AI for productivity gains.

Old Age Dependency Ratio

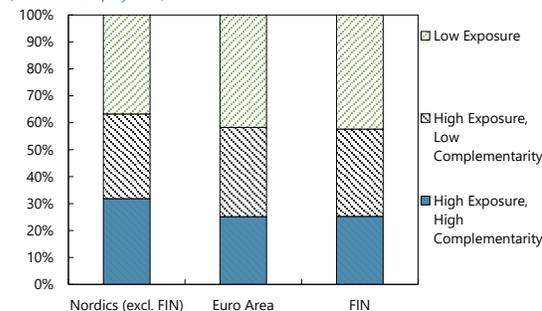
(Population aged 65 or over per 100 working age persons, percent)



Source: OECD.

Exposure to Artificial Intelligence

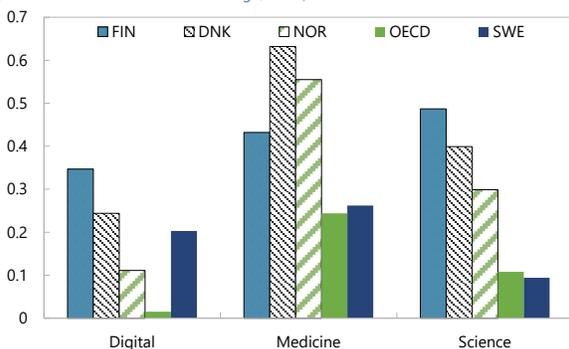
(Percent of Employment)



Sources: Cazzaniga and others (forthcoming)

Skill Needs

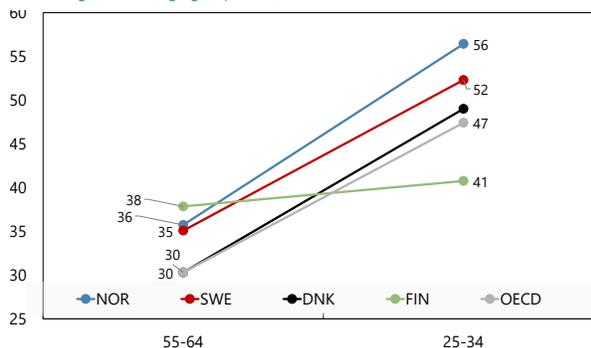
(Positive values indicate skill shortage, 2019)



Sources: OECD: Skills for Jobs.

Population with Tertiary Education

(Percentage of same age group, 2022)



Source: OECD: Education at a Glance.

Recognizing the impending challenges posed by skill shortages, Finland plans to strengthen strategic initiatives to bridge this gap. Finland's [Talent Boost](#) initiative aims to attract international talent and address integration challenges. However, addressing other problems to integration, related to linguistic and cultural barriers, and persistent bureaucratic hurdles, remain key to retain international migrants.

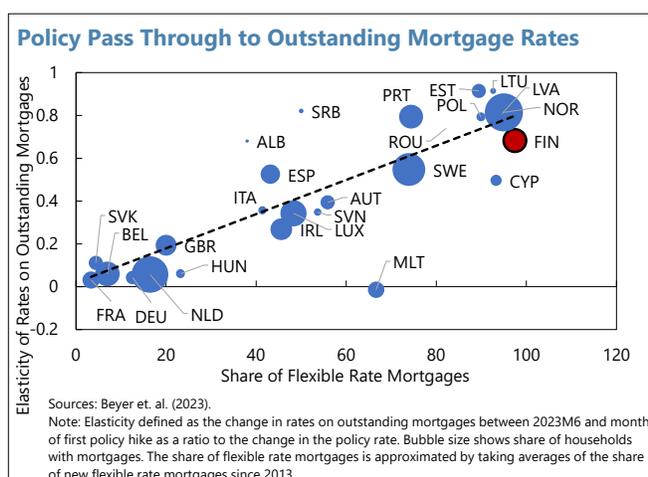
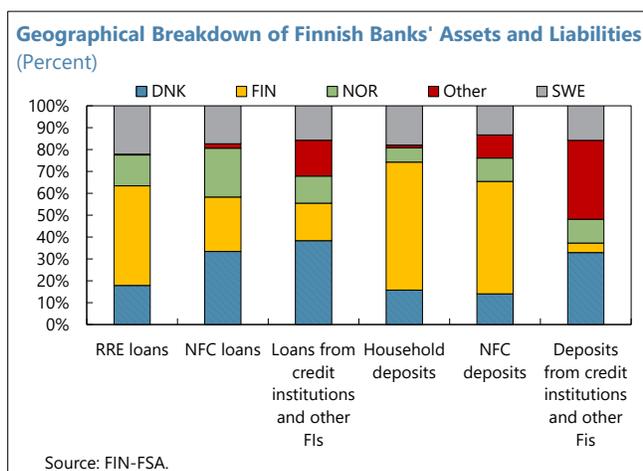
¹ Cazzaniga, Maruo, Florence Jaumotte, Longji Li, Giovanni Melina, Augustus J. Panton, Carlo Pizzinelli, Emma, Rockall, and Marina M. Tavares. (Forthcoming). *Artificial Intelligence: Implications for The Future of Work*. Staff Discussion Note.

C. Strengthening the Financial Sector

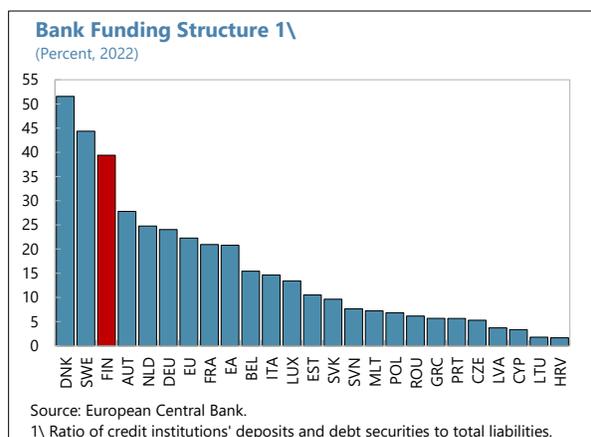
32. The financial system has sufficient capital buffers to withstand a severe macroeconomic downturn but is vulnerable to large-scale liquidity shocks and cross-border exposures. Banks are highly capitalized and well positioned for the current economic slowdown according to stress tests by the EBA/ECB and the FIN-FSA. And while banks have sufficient buffers to endure an unlikely but plausible severe scenario—with deglobalization of the world economy and significant weakening of banks’ profits and capital ratios—this would significantly erode buffers.

33. Financial sector systemic risks have risen over the last year given stalled growth, constrained real incomes, and tight financial conditions.

- *Cross-border risks.* Direct exposures to the Nordic countries pose risks to the Finnish financial system mainly through the largest banks’ lending to the commercial real estate and construction sectors, which have been undergoing a steep downturn. So far, credit losses have been limited.
- *Corporate sector risks.* Despite broadly robust debt servicing capacity of the Finnish non-financial corporates, bankruptcies and bond spreads in certain sectors, in particular construction, have been rising, implying elevated risks. Loans to ‘housing companies’ (typically multiple households within an apartment block that pool risk) have historically had high repayments rates, but NPLs have increased modestly in recent months.
- *Household sector risks.* The high pass-through of ECB policy rates to mortgage rates poses a risk to credit quality. While NPLs and stage 2 loans from households have remained relatively low so far, household indebtedness remains high, and further declines in house price, higher interest rates, or an uptick in unemployment could all undermine credit quality.



- **Liquidity risks.** The banking sector remains vulnerable to severe but plausible liquidity shocks due to its reliance on (particularly short term) wholesale funding, hence, creating risk of a procyclical contraction in credit in case of large outflows.
- **Cyberthreats.** The financial sector faces significant and persistent cyber threats from cybercriminals, especially given the current situation with the war in Ukraine.



34. To safeguard financial stability, liquidity regulation should be enhanced, and financial sector vulnerabilities should be closely monitored. It is crucial to maintain vigilant risk monitoring around households' creditworthiness, and cross-border macro-financial exposures including falling real estate markets in the Nordic region. In line with the latest Financial Sector Assessment Program (FSAP) recommendations, liquidity regulations should be tightened to enhance banks' liquidity buffers to cover a predetermined threshold of wholesale funding.

35. The authorities have tightened macroprudential policy to safeguard financial stability, but more could be done. The authorities have reinstated the 1 percent systemic risk buffer (SyRB) on credit institutions to be in effect in April 2024. The reduction in this buffer during the pandemic highlighted the merit of a *positive* neutral rate on the countercyclical capital buffer (CCyB), allowing the authorities to release capital in periods of extreme stress. While this measure should be legislated as soon as possible, the pace of this increase involves a trade-off between quickly building resilience and avoiding a pro-cyclical tightening. However, the current high banking-sector profits may make this an opportune time to raise buffers.

Macroprudential Policy Measures Implemented in 2023	
Measure	Tightening(+) / Loosening(-)
Effective January 2023	
Increased O-SII buffer requirements of two major banks, Nordea and OP Group	+
FIN-FSA non-binding recommendation on stressed debt-service-to-income ratio of a borrower should not be more than 60 percent of their net income	+
Effective July 2023	
Limiting maximum maturity to 30 years for housing and housing company loans	+
Applying loan-to-value (LTV) cap of 60 percent to housing company loans	+
Requiring amortization for housing company loans during the first five years	+
Applying loan-to-collateral (LTC) limits to both banks and non-bank credit providers	+
Non-bank credit providers to be supervised by the FIN-FSA	+
Effective December 2023	
Restored loan cap (LTC) for residential mortgage loans to its statutory baseline level of 90%	-

36. When circumstances allow, a complete set of borrower-based measures (BBMs) should be introduced into the policy toolkit. These measures, however, could be activated only when concerns about adverse impacts on house prices and demand abate. Implementation of the BBMs would help prevent excessive household indebtedness and strengthen households' repayment capacity over the medium-term. In June 2022, the FIN-FSA Board recommendation to limit stressed

debt-service-to-income (DSTI) ratio to 60 percent, but this has not been adopted by the government although has been unilaterally followed by many financial institutions.

37. The authorities have made progress on the recent FSAP recommendations, but more effort is needed. The mission welcomes recent improvements to the supervision of the financial system and systemic risk monitoring (Annex IX). Resources of FIN-FSA and Financial Stability Authority (FFSA) have been increased, and the implementation of positive credit register in 2024 would help address the existing data gaps and strengthen the analysis of granular data, in particular, those used for macroprudential analysis and policymaking. However, more needs to be done to ensure the effective operationalization of crisis management; enhance the legal and operational framework of financial oversight agencies; conduct Nordic-wide stress tests; and address procyclicality in the pension insurance sector.

38. The authorities have made progress in strengthening the anti-money laundering and combating for terrorism framework (AML/CFT). These include enhancing AML/CFT supervision and risk assessment with focus on risks from cross-border and non-resident transactions, drawing upon the recently published Nordic-Baltic regional AML TA report.

Authorities' Views

39. The authorities evaluated the financial system as resilient but recognized increasing macroeconomic risks, which require continued vigilant monitoring. They pointed to the recent tightening of macroprudential measures, including the reinstatement of the systemic risk buffer and the enhancement of the systemic risk monitoring framework. However, they mentioned the lack of political consensus to legislate limits on DTI and DSTI. They agreed that the introduction of a positive neutral CCyB might strengthen the policy toolkit, but any decision should be taken with a holistic view of bank capital needs and the complexity of macroprudential measures. This would also require legislative changes. The authorities also agreed with staff's evaluation of risks stemming from the banking sector's high reliance on short-term wholesale funding. On the AML/CFT framework, the authorities highlighted the ongoing efforts in introducing amendments to regulation and guidelines in light of the recent IMF technical assistance report.

STAFF APPRAISAL

40. Finland's growth has stalled, with a modest recovery expected this year. Elevated interest rates, sluggish trading partner growth, and a declining housing market are all weighing on activity. And despite a broadly resilient labor market, unemployment is expected to increase slightly, particularly as the construction industry cuts back on employment. However, inflationary pressures are diminishing and an improvement in household purchasing power and loosening financial conditions will contribute to a modest recovery in the second half of the year. Economic growth is expected to be around ½ percent in 2024 and rebound to around 1½ percent in the medium term, driven by increase in investment and employment resulting from the labor market reforms. The

external position in 2023 is assessed to be moderately weaker than implied by fundamentals and desirable policy settings.

41. The fiscal outlook has worsened due to higher discretionary spending and weaker growth. Increased expenditure in energy-related compensation, defense, high index-linked increases in social benefits, and support for Wellbeing Service Counties is expected to have increased the deficit to 2.5 percent of GDP in 2023. Meanwhile, debt ratio has climbed to 76 percent surpassing those of other Nordic countries. The worsened fiscal outlook is expected to persist which puts public debt on a risky path over the medium term.

42. Existing measures fall short of achieving the ambitious fiscal deficit target. The new government plans to adjust medium-term fiscal deficit by 2 percent of GDP through spending cuts and employment-driven fiscal gains, targeting overall fiscal deficit of 1 percent of GDP by 2027. However, consolidation will likely be diluted by new spending pressures and expected revenue shortfalls. Further measures are necessary to close the gap, as current policies would fail to curb the deficit and bring down the debt ratio.

43. Through a gradual but sustained adjustment, fiscal policy should be calibrated to reverse the public debt. A structural adjustment of around $\frac{1}{4}$ percent of GDP should begin in 2024, growing to $\frac{1}{2}$ percent per year over the medium term, with the aim of balancing the budget by 2028. This would help place public financing on a more sustainable footing and make room for the expected increase in age-related spending. In addition to the recent reforms to social benefits, further spending cuts are required, including through efficiency gains from the Wellbeing Service Counties. These efforts should be supplemented with revenues measures such as excise tax indexation, expansion of carbon taxation, VAT rate standardization, and revising dividend taxation for non-listed companies.

44. Enhancing employment and productivity are essential for economic growth. The mission supports the government's efforts to boost employment through social benefit reforms, greater flexibility in the labor market, and lowering the labor tax wedge. The government should establish robust systems to closely monitor the impact of these reforms on employment. Additionally, policy should aim to improve higher education, lower skill mismatches, and more effectively attract and integrate international talent. While the government's commitment to invest in research and development is commendable, the plan should focus on catalyzing private sector funding.

45. Further measures are needed to achieve Finland's ambitious and commendable climate goals. Good progress is being made on expanding the production of low-emission energy, but more is needed to achieve the 2035 carbon neutral target. Policy should consider strengthening carbon pricing and increasing the role of carbon-sinks in the land use sector.

46. The financial system remains resilient, but rising systemic risks warrant vigilant monitoring. Banks have sufficient capital to withstand adverse macroeconomic shocks, including geoeconomic fragmentation and weakening of profits and capital ratios. Nevertheless, their high

dependence on short-term wholesale funding makes them susceptible to liquidity shocks. Hence, liquidity regulation should be tightened. In addition, banks are exposed to systemic events in the Nordic region, CRE market volatility, falling house prices, and still high household indebtedness. These call for continuous and close monitoring.

47. Further tightening of macroprudential policy would help target pockets of vulnerability and increase financial system resilience. Staff welcomes the recent tightening of macroprudential policy including reinstatement of systemic risk buffers to the pre-pandemic level. However, a positive neutral rate on the CCyB should be legislated and the systemic risk monitoring framework should be enhanced. Additionally, debt-to-income and debt-service-to-income limits should be added to the macroprudential policy toolkit in order to prevent excessive household indebtedness and improve borrower's repayment capacity. These measures could be activated when concerns regarding adverse effects on demand and house prices subside.

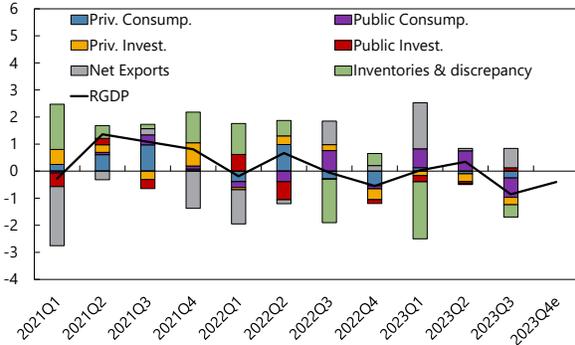
48. It is proposed that the next Article IV consultation with Finland take place on the standard 12-month cycle.

Figure 1. Finland: Real Sector

GDP declined in 2022 and 2023 as inventories unwound and private consumption was compressed...

Quarterly Real GDP Growth Contributions

(Percent, QoQ)

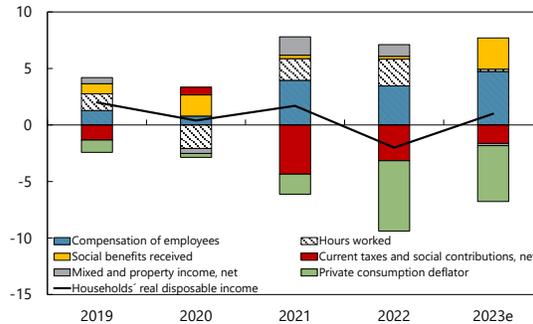


Sources: Haver Analytics; and IMF staff calculations.

...as real incomes were eroded by high inflation.

Households' Real Disposable Income: Contribution to growth

(Percent)

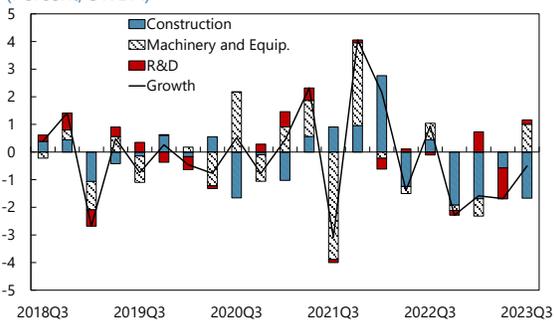


Sources: Statistics Finland; Ministry of Finance; and IMF staff calculations.

Investment has declined, particularly in construction.

Investments - Contribution to Growth

(Percent, SWDA)

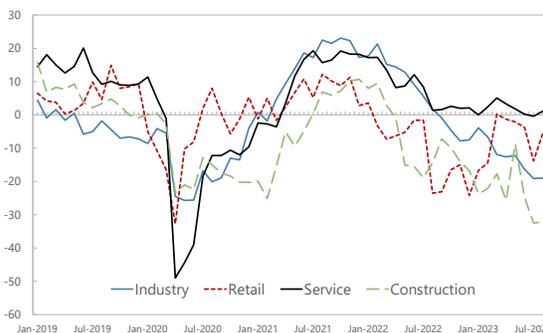


Sources: Statistics Finland; Haver Analytics; and IMF staff calculations.

High frequency indicators suggest continued weakness.

Confidence Indicator

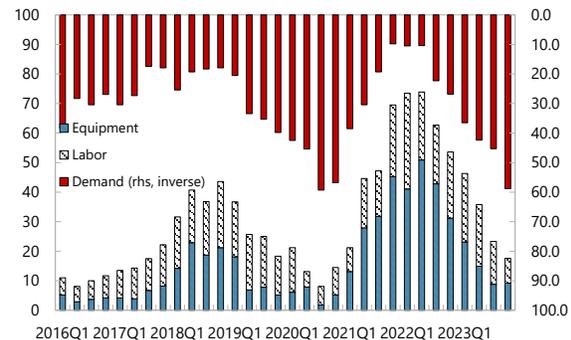
(Percent balance, SA)



Insufficient demand is increasingly limiting output in manufacturing...

Factors Limiting Production: Manufacturing

(Percent, SA)

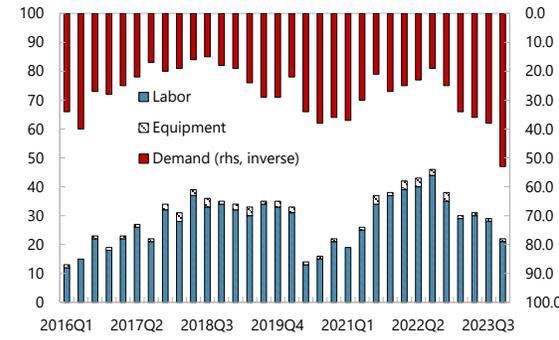


Sources: Haver Analytics; and European Commission.

...and in services.

Factors Limiting Production: Services

(Percent, SA)



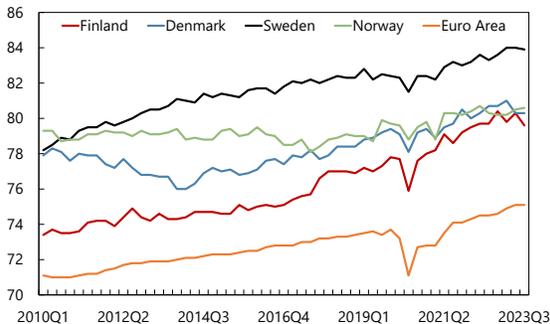
Sources: Haver Analytics; and European Commission.

Figure 2. Finland: Labor Market Developments

Labor market participation improved in recent years and remains high in 2023...

Participation Rates in Nordic Countries

(Percent of the total working-age population, age 15-64)

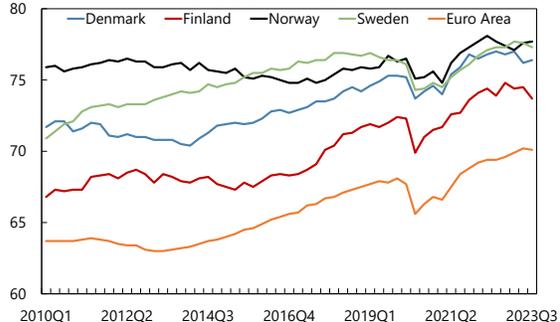


Source: Statistics Office of the European Communities; and Haver Analytics.

...and so is the employment rate.

Employment Rate

(Percent of the total working-age population, age 15-64)

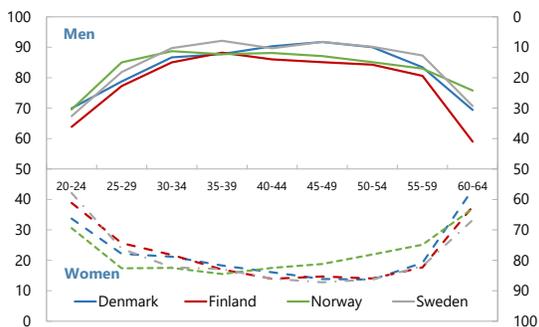


Source: Statistics Office of the European Communities; and Haver Analytics.

Employment rates of the elderly and women with care responsibilities in Finland remain behind peers.

Employment Rate by Age Cohort: 2022

(LHS: Percent, Men; RHS: Percent, Women)

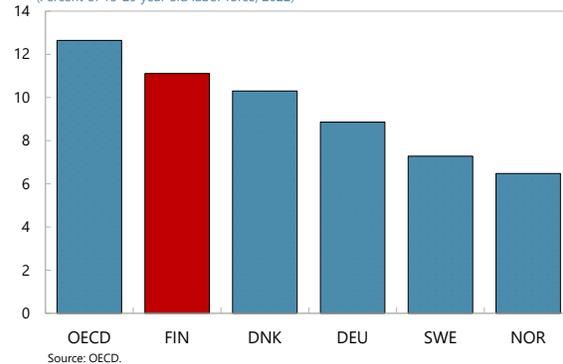


Source: OECD.

The share of youth not in employment, education, and training is larger than Nordic peers...

Youth Not in Employment, Education or Training

(Percent of 15-29 year old labor force, 2022)

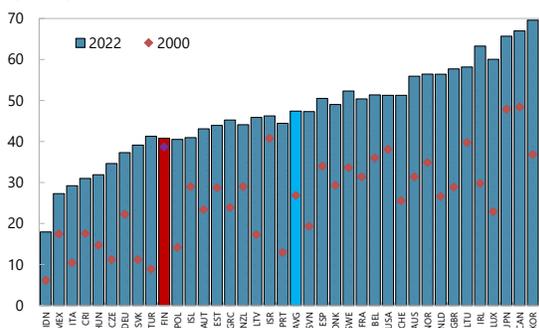


Source: OECD.

...and tertiary educational attainment among young adults is relatively low and has seen little improvement.

Share of Tertiary-Educated 25-34 Year-Olds

(Percent)

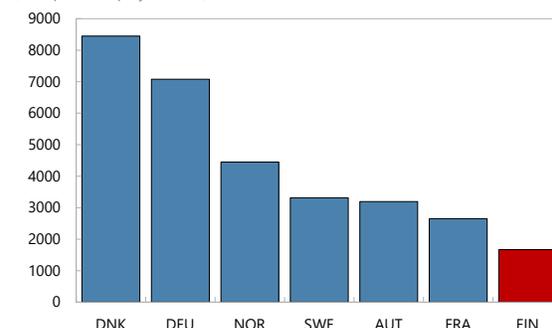


Source: OECD.

Increased spending on PES would help narrow the gap with peers.

Expenditure on Employment Services Per Unemployed

(Euro per unemployed, 2021)



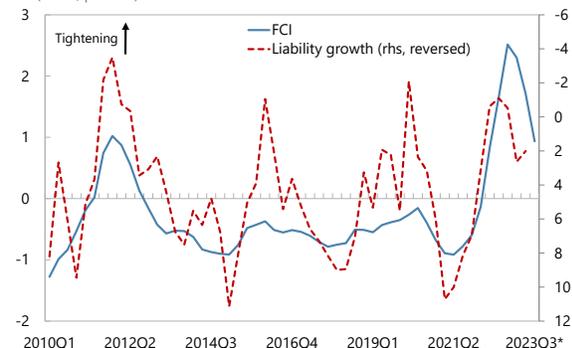
Sources: OECD; and IMF staff calculations.

Figure 3. Finland: Financial Conditions Index (FCI)

Financial conditions in Finland tightened significantly in 2022 before partial easing in 2023...

FCI and Liability Growth

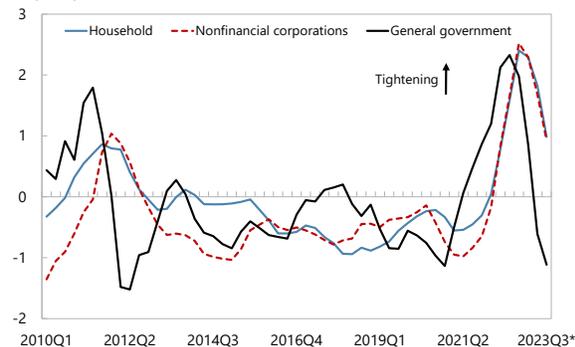
(Index; percent)



This tightening was experienced across all sectors.

FCI by Sectors

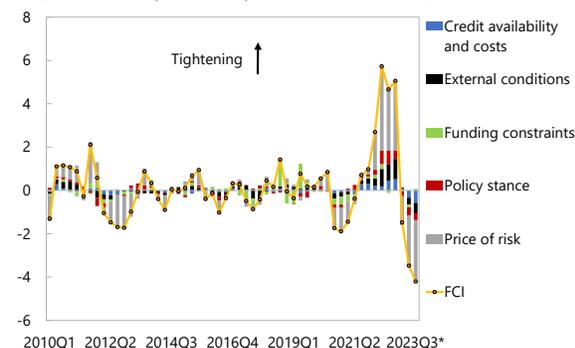
(Index)



External conditions, in addition to the price of risk, had driven NFC tightness...

FCI Changes - Nonfinancial Corporations

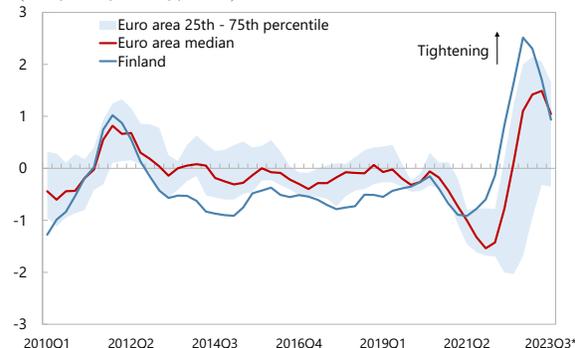
(Contribution to quarter-over-quarter first difference of FCI)



...they had tightened by much more than the euro area average.

Financial Condition Compared to Euro Area

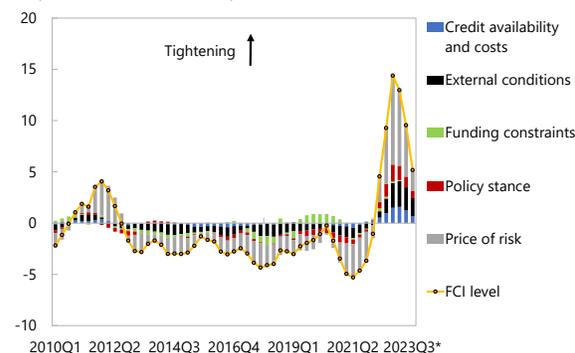
(Index, 2010Q1-2023Q3; Private)



With the price of risk, the most important factor driving this.

FCI level

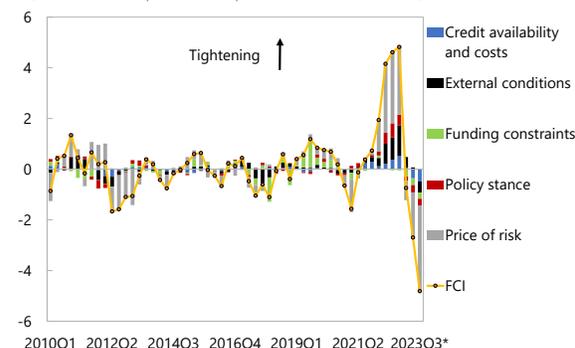
(Contribution to unscaled FCI)



...as well as for households.

FCI Changes - Households

(Contribution to quarter-over-quarter first difference of FCI)



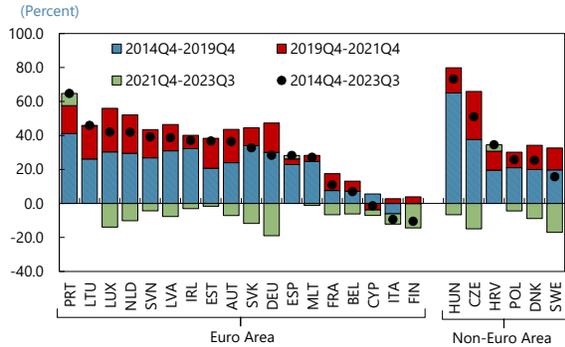
Source: Borraccia, G., Espinoza, R.A., Guzzo, V., Jiang, F., Lafarguette, R., Nguyen, H.V., Segoviano Basurto, M. and Wingender, P. 2023. "Financial Conditions in Europe: Dynamics, Drivers, and Macroeconomic Implications." IMF Working paper 23/209, Washington DC.

Note: For implementing Partial Least Square, we divide the sample into distinct time periods, each with its regression. The indices are then chained together. It's essential to note that the absolute FCI levels may not be entirely comparable to the early 2000s, given variations in available financial indicators. The final index chain covers most of the 2015–2023 period. 2023Q3 data are provisional.

Figure 4. Finland: Real Estate Market Developments

House prices in Finland, as in other European countries, have fallen in real term since 2022.

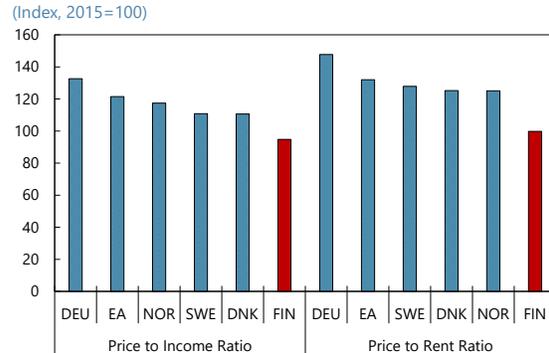
Change in Real House Price Index



Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Valuation measures were relatively benign in 2022 compared with the region.

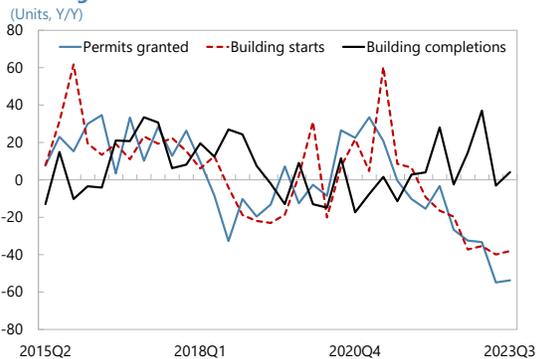
Price-to-Rent and Price-to-Income, 2022



Source: OECD.

New constructions slowed markedly in 2022 and 2023.

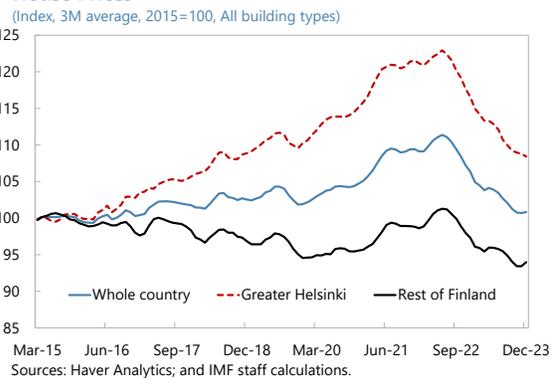
Housing Construction



Sources: Haver Analytics; and IMF staff calculations.

House prices are cooling down by more in the greater Helsinki area.

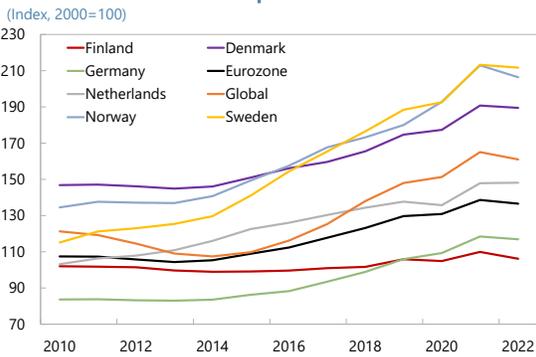
House Prices



Sources: Haver Analytics; and IMF staff calculations.

Value growth in the CRE market has been relatively benign...

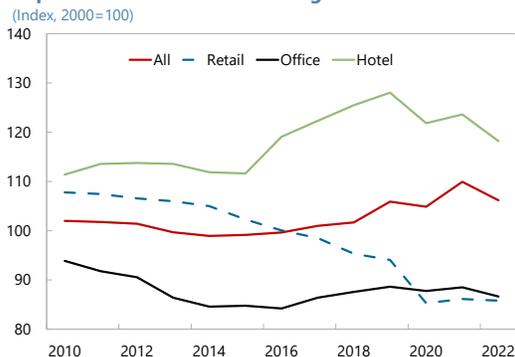
Commercial Real Estate Capital Growth Index



Sources: MSCI; and IMF staff calculations.

...although the retail segment faced strong headwinds

Capital Growth Rates Across Segments in Finland

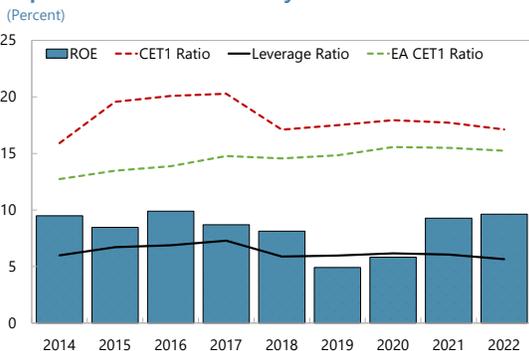


Sources: MSCI; and IMF staff calculations.

Figure 5. Finland: Banking Sector

The Finnish banking system is well capitalized.

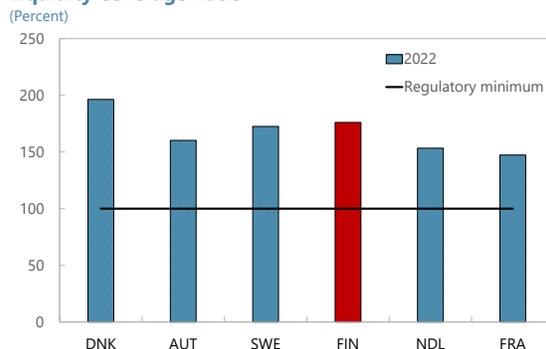
Capitalization and Profitability



Source: European Central Bank.

Banks are highly liquid, as in peer countries.

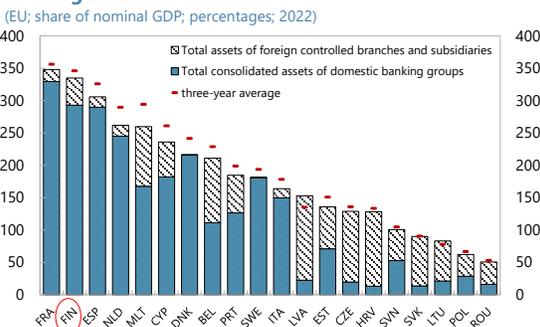
Liquidity Coverage Ratio



Source: European Central Bank.

But the banking system is relatively large...

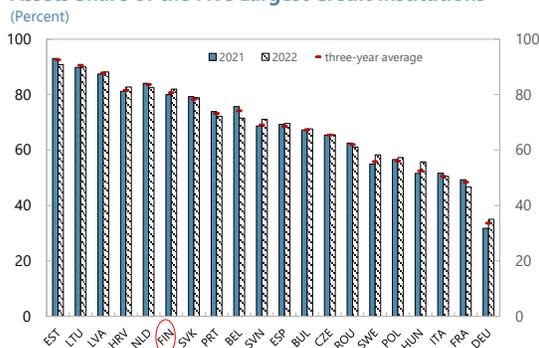
Banking Sector Size



Sources: European Central Bank; and Eurostat. Notes: Based on Consolidated Banking Data.

...and concentrated...

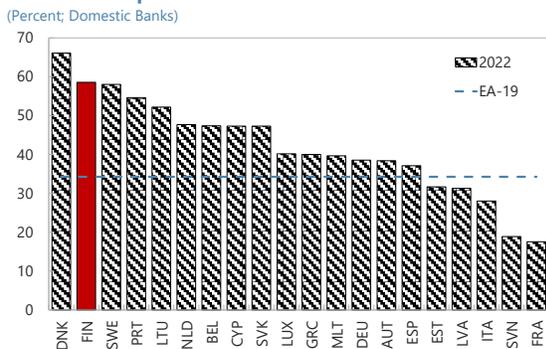
Assets Share of the Five Largest Credit Institutions



Sources: European Central Bank; and Haver Analytics.

...with large real estate exposures...

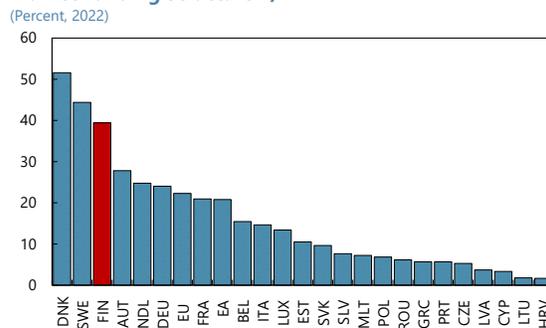
Real Estate Exposure Share



Source: European Central Bank.

...and a heavy reliance on wholesale funding.

Market Funding Structure 1/



Source: European Central Bank.

1/ Ratio of credit institutions' deposits and debt securities to total liabilities.

Table 1. Finland: Selected Economic Indicators, 2021–29

	2021	2022	2023	2024	2025	2026	2027	2028	2029	
			Proj.							
	<i>(Percentage change, unless otherwise indicated)</i>									
Output and Demand (Volumes)										
GDP	2.8	1.6	-0.5	0.4	1.9	1.9	1.7	1.6	1.5	
Domestic demand	2.8	3.0	-3.0	1.1	1.9	1.9	1.7	1.6	1.6	
Private consumption	3.2	1.5	-0.8	0.5	1.3	1.3	1.2	1.2	1.2	
Public consumption	3.9	0.5	3.0	0.3	0.5	0.9	0.9	0.9	0.8	
Gross fixed capital formation	1.0	3.1	-5.7	2.0	4.4	3.4	3.9	2.4	2.4	
Net exports (contribution to growth in percent of GDP)	0.0	-2.0	2.6	-0.7	0.0	0.0	0.0	0.0	-0.1	
Prices, Costs, and Income										
Consumer price inflation (harmonized, average)	2.1	7.2	4.3	1.2	1.9	2.0	2.0	2.0	2.0	
Consumer price inflation (harmonized, end-year)	3.2	8.8	1.3	1.9	2.0	2.0	2.0	2.0	2.0	
Labor Market										
Participation Rate (15-74 years)	67.0	68.0	68.8	69.3	69.8	70.2	70.7	71.2	71.7	
Employment	2.4	2.6	0.5	0.1	0.5	0.4	0.5	0.6	0.6	
Unemployment rate (in percent)	7.6	6.8	7.2	7.6	7.4	7.3	7.3	7.2	7.1	
Potential Output										
Output gap (in percent of potential output) ¹	-1.0	-0.4	-1.9	-2.4	-1.7	-0.9	-0.5	-0.2	0.0	
Growth in potential output	0.9	1.0	1.1	0.9	1.1	1.1	1.3	1.3	1.3	
	<i>(Percent of GDP)</i>									
General Government Finances²										
Overall balance	-2.8	-0.8	-2.5	-3.5	-3.4	-3.0	-2.7	-2.2	-2.3	
Primary balance ³	-2.9	-0.8	-2.6	-3.2	-3.1	-2.7	-2.4	-2.0	-2.0	
Structural balance (in percent of potential GDP) ⁴	-2.2	-1.0	-1.6	-2.0	-2.4	-2.4	-2.3	-2.0	-2.1	
Structural primary balance (in percent of potential GDP) ⁵	-2.3	-1.0	-1.5	-1.7	-2.1	-2.1	-2.0	-1.7	-1.8	
Gross debt	72.6	73.3	76.3	79.6	82.2	84.0	85.1	85.6	86.2	
Net debt ⁶	-72.9	-59.3	-54.5	-49.6	-44.3	-39.6	-35.5	-32.0	-28.6	
Balance of Payments										
Current account balance	0.4	-2.6	-0.5	-0.4	-0.2	-0.1	0.0	0.0	0.0	
Goods and services balance	0.0	-2.4	0.3	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	
Net international investment position	1.0	-2.2	-2.6	-2.9	-2.9	-2.8	-2.6	-2.4	-2.2	
Gross external debt	208.6	215.4	216.1	218.0	216.5	215.3	213.9	212.6	211.4	

Sources: Bank of Finland, BIS, International Financial Statistics, IMF Institute, Ministry of Finance, Statistics Finland, and IMF staff calculations.

¹ A negative value indicates a level of actual GDP that is below potential output.

² Fiscal projections include measures as specified in the General Government Fiscal Plan.

³ Adjusted for interest expenditures and receipts.

⁴ Not adjusted for COVID-related one-off measures.

⁵ Adjusted for interest expenditures and receipts. Not adjusted for COVID-related one-off measures.

⁶ Defined as the negative of net financial worth (i.e., debt minus assets).

Table 3. Finland: International Investment Position, 2014–23

(Percent of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Assets	344.9	336.8	323.8	276.9	334.5	342.3	342.8	338.5	331.8	328.3
Direct investment	61.5	63.0	67.1	69.6	70.4	73.5	68.4	71.3	70.6	71.1
Portfolio investment	138.1	145.6	145.7	139.4	141.9	145.0	149.9	166.3	144.8	143.9
Equity & investment fund shares	67.6	73.7	76.8	81.9	80.8	89.9	96.1	113.0	98.1	96.6
Debt securities	70.5	71.9	68.9	57.5	61.1	55.0	53.9	53.3	46.7	47.3
Fin. deriv. (other than reserves)	60.3	45.7	41.1	9.0	24.9	25.5	28.2	15.5	22.0	20.7
Other investment	80.7	78.1	65.3	54.9	93.4	94.1	92.1	79.6	88.9	87.2
Reserve assets	4.2	4.4	4.6	3.9	4.0	4.2	4.1	5.9	5.6	5.5
Liabilities	348.0	332.3	318.4	275.6	340.3	338.3	347.3	337.6	334.0	330.9
Direct investment	52.0	57.3	54.5	56.8	48.3	51.0	49.9	51.8	51.0	52.0
Portfolio investment	141.0	146.1	141.4	135.2	170.0	174.8	181.6	188.5	166.1	164.7
Equity & investment fund shares	44.1	48.7	52.1	54.5	62.2	62.3	69.8	87.1	67.9	64.9
Debt securities	97.0	97.5	89.3	80.8	107.8	112.5	111.8	101.4	98.2	99.8
Fin. deriv. (other than reserves)	56.9	44.3	39.6	8.7	26.2	25.7	28.6	16.2	26.0	25.0
Other investment	98.0	84.5	82.9	74.9	95.9	86.8	87.2	81.0	90.9	89.2
Net International Investment Position	-3.1	4.5	5.4	1.2	-5.8	4.0	-4.5	1.0	-2.2	-2.6
Direct Investment	9.4	5.6	12.7	12.9	22.0	22.5	18.5	19.4	19.6	19.0
Portfolio Investment	-3.0	-0.5	4.3	4.2	-28.1	-29.8	-31.7	-22.2	-21.3	-20.8
Fin. deriv. (other than reserves)	3.4	1.4	1.5	0.3	-1.3	-0.2	-0.4	-0.7	-4.1	-4.3
Other Investment	-17.3	-6.4	-17.7	-20.0	-2.5	7.3	4.9	-1.5	-2.0	-2.0

Sources: Statistics Finland and IMF staff calculations.

Note: Changes to the NIIP since the 2014 Article IV are mainly due to the switch to the BPM6 statistical standard.

Table 4. Finland: General Government Statement of Operations, 2021–29

(Percent of GDP, unless otherwise indicated)

	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Proj.			
Revenue	53.0	52.6	52.4	51.6	51.5	51.3	51.2	51.1	51.0
Tax Revenues	31.0	30.9	30.2	30.0	30.0	29.8	29.8	29.5	29.5
Taxes on production and imports	13.8	13.6	13.3	13.1	13.0	12.8	12.6	12.3	12.3
Current taxes on income, wealth, etc.	16.8	17.0	16.6	16.6	16.6	16.7	16.8	16.9	16.9
Capital taxes	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social Contributions	12.1	12.0	12.0	11.4	11.4	11.4	11.4	11.4	11.4
Grants	0.3	0.3	0.4	0.4	0.3	0.2	0.2	0.2	0.2
Other Revenue									
Expenditure	55.8	53.4	55.1	55.0	54.8	54.3	53.9	53.3	53.3
Expense	55.3	52.9	54.7	54.5	53.9	53.5	53.1	52.8	52.8
Compensation of employees	12.8	12.4	12.5	12.4	12.5	12.4	12.4	12.3	12.3
Use of goods and services	11.5	11.5	12.5	12.3	12.1	11.9	11.8	11.6	11.6
Consumption of fixed capital (CFC)	3.6	3.6	3.6	3.7	3.7	3.7	3.7	3.7	3.7
Interest	0.5	0.6	0.9	1.2	1.4	1.4	1.6	1.7	1.7
Subsidies	1.6	1.1	0.9	0.9	0.9	0.9	0.8	0.8	0.8
Grants	1.1	1.0	1.0	1.0	0.9	0.9	0.9	0.8	0.8
Social benefits	21.9	20.7	21.3	21.5	20.9	20.8	20.4	20.4	20.3
Other expense	2.3	2.1	2.0	1.6	1.6	1.6	1.6	1.6	1.6
Net Acquisition of Nonfinancial Assets	0.5	0.4	0.3	0.5	0.9	0.8	0.8	0.5	0.5
Net Operating Balance	-2.3	-0.3	-2.4	-3.0	-2.5	-2.2	-1.9	-1.7	-1.8
Net Lending/Borrowing	-2.8	-0.8	-2.7	-3.5	-3.4	-3.0	-2.7	-2.2	-2.3
Net Acquisition of Financial Assets	0.0	6.8	...	...	...	...	...	...	...
Currency and deposits	-2.1	0.0	...	...	...	...	...	...	...
Securities other than shares	0.5	0.1	...	...	...	...	...	...	...
Loans	1.1	3.0	...	...	...	...	...	...	...
Shares and other equity	-0.3	0.6	...	...	...	...	...	...	...
Financial derivatives	0.6	1.3	...	...	...	...	...	...	...
Other accounts receivable	0.1	1.7	...	...	...	...	...	...	...
Net Incurrence of Liabilities	2.5	7.1	...	...	...	...	...	...	...
Special Drawing Rights (SDRs)	0.0	0.0	...	...	...	...	...	...	...
Currency and deposits	0.0	0.0	...	...	...	...	...	...	...
Securities other than shares	1.9	4.0	...	...	...	...	...	...	...
Loans	0.2	0.9	...	...	...	...	...	...	...
Shares and other equity	0.0	0.0	...	...	...	...	...	...	...
Financial derivatives	0.0	0.0	...	...	...	...	...	...	...
Other accounts payable	0.3	2.1	...	...	...	...	...	...	...
<i>Memorandum Items:</i>									
Primary Balance ¹	-2.9	-0.8	-2.6	-3.2	-3.1	-2.7	-2.4	-2.0	-2.0
Structural Balance (in percent of potential GDP) ²	-2.2	-1.0	-1.6	-2.0	-2.4	-2.4	-2.3	-2.0	-2.1
Structural primary balance (in Percent of Potential GDP) ³	-2.3	-1.0	-1.5	-1.7	-2.1	-2.1	-2.0	-1.7	-1.8
Central Government Net Lending/Borrowing	-3.3	-1.6	-3.2	-4.1	-4.5	-4.1	-3.8	-3.3	-3.4
General Government Gross Debt	72.6	73.3	76.3	79.6	82.2	84.0	85.1	85.6	86.2
General Government Net Debt ⁴	-72.9	-59.3	-54.5	-49.6	-44.3	-39.6	-35.5	-32.0	-28.6
Central Government Gross Debt	58.1	59.2	62.1	65.1	68.1	70.3	71.8	72.8	73.8
Output Gap (Percent of Potential GDP)	-1.0	-0.4	-1.9	-2.4	-1.6	-0.8	-0.5	-0.2	-0.2
Nominal GDP (Billions of Euros)	250.7	268.4	279.3	286.6	297.7	309.4	321.0	333.4	345.6

Sources: Eurostat, Government Finance Statistics, International Financial Statistics, Ministry of Finance, and IMF staff calculations.

¹ Adjusted for interest expenditures and receipts.² Not adjusted for COVID-related one-off measures.³ Adjusted for interest expenditures and receipts. Not adjusted for COVID-related one-off measures.⁴ Defined as the negative of net financial worth (i.e., debt minus assets; excludes all pension liabilities).

Table 5. Finland: Public Sector Balance Sheet, 2014–22

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Assets	267.9	286.9	288.3	292.3	280.4	289.5	317.5	315.5	298.3
Nonfinancial	86.7	84.1	84.2	82.3	81.3	82.1	90.3	87.2	87.5
General Government	76.2	75.2	74.6	72.7	71.7	72.3	79.5	76.6	76.8
Public Corporations and Central Bank	10.5	8.9	9.6	9.6	9.6	9.8	10.8	10.5	10.7
Financial	181.2	202.9	204.1	210.0	199.1	207.4	227.3	228.3	210.8
General Government	135.7	138.4	139.3	141.7	134.1	143.0	157.1	160.9	143.5
Currency and Deposits	6.4	9.0	8.2	9.1	7.8	6.7	12.0	9.3	8.7
Debt Securities	22.5	21.6	19.9	18.4	17.0	15.7	13.2	13.0	10.8
Loans	20.3	20.4	19.5	17.8	16.2	16.3	17.1	17.4	19.3
Equity and Investment Fund Shares	80.3	81.2	86.1	88.8	85.0	96.3	105.1	112.9	92.8
Insurance, Pension and Standardized Guarantees	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial Derivatives and Stock Options	1.1	1.0	0.9	1.1	3.3	3.5	3.8	2.4	4.6
Other Accounts Receivable	5.1	5.0	4.6	6.4	4.7	4.6	5.8	5.8	7.2
Public Corporations and Central Bank	45.5	64.5	64.8	68.3	65.0	64.4	70.2	67.4	67.4
Liabilities	127.3	145.9	147.8	148.7	143.7	142.5	159.7	151.3	146.5
General Government	79.3	82.1	82.9	81.1	80.2	80.4	92.9	88.0	84.2
Currency and Deposits	0.4	0.4	0.4	0.4	0.3	0.4	0.3	0.4	0.4
Debt Securities	53.5	54.2	54.2	51.5	49.4	49.5	59.1	55.9	47.3
Loans	18.5	20.2	20.0	18.9	19.2	19.8	21.4	20.5	20.1
Equity and Investment Fund Shares	1.4	1.3	1.3	1.2	1.2	1.1	1.1	1.1	1.0
Insurance Pension and Standardized Guarantee Schemes	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial Derivatives	-0.5	-0.9	-0.3	0.3	2.7	2.9	3.4	2.7	6.4
Other Accounts Payable	6.0	6.8	7.3	8.7	7.4	6.6	7.5	7.4	8.9
Public Corporations and Central Bank	48.1	63.8	64.9	67.6	63.5	62.0	66.8	63.3	62.3
Existing Pension Liabilities 2/	302.5	300.6	298.5	295.2	296.1	298.4	324.2	312.4	312.7
To Public Sector Employees	104.4	103.2	102.5	101.3	99.7	102.4	111.3	107.2	107.3
To Private Employees	198.1	197.4	196.1	193.9	196.4	196.0	212.9	205.2	205.4
Public Sector Net Financial Worth									
Excluding Pension Liabilities	53.9	56.9	56.4	61.3	55.4	65.0	67.6	77.0	64.3
Including Existing Pension Liabilities to Public Employees	-50.5	-46.2	-46.1	-40.0	-44.3	-37.5	-43.7	-30.2	-43.0
Including Existing Pension Liabilities to All Employees	-248.6	-243.6	-242.2	-233.9	-240.7	-233.5	-256.6	-235.4	-248.4
Public Sector Net Worth									
Excluding Pension Liabilities	140.6	141.0	140.6	143.6	136.7	147.0	157.8	164.2	151.8
Including Existing Pension Liabilities to Public Employees	36.2	37.9	38.1	42.2	37.0	44.6	46.6	57.0	44.5
Including Existing Pension Liabilities to All Employees	-161.9	-159.6	-158.0	-151.6	-159.4	-151.4	-166.3	-148.2	-160.9

Sources: Finnish Centre for Pensions; Statistics Finland; Eurostat; Brede and Henn (2018); and IMF staff calculations.

Note: Public sector corporations include the largest 9 enterprises controlled by the Central Government. These account for over 90 percent of assets of Central Government controlled corporations. However, local government controlled corporations are not covered due to data limitations.

1/ Public sector balance sheet presents all of the accumulated assets and liabilities under the control of government, including central and local governments, public corporations and pension liabilities. The intertemporal net worth presented in the text adds the net present value of future expenditures and revenues.

2/ This is the net present value of already-accrued liabilities for work performed in the past, based on data (and discount rates) of the Finnish Centre for Pensions (ETK), except for 2016, which are Fund Staff estimates. These pension liabilities represent a contractual obligation to public sector employees. For private sector employees, rules governing the pension system could potentially be altered to change the present value of payouts.

Table 6. Finland: Financial Soundness Indicators, 2016–22

(Ratios, unless otherwise indicated)

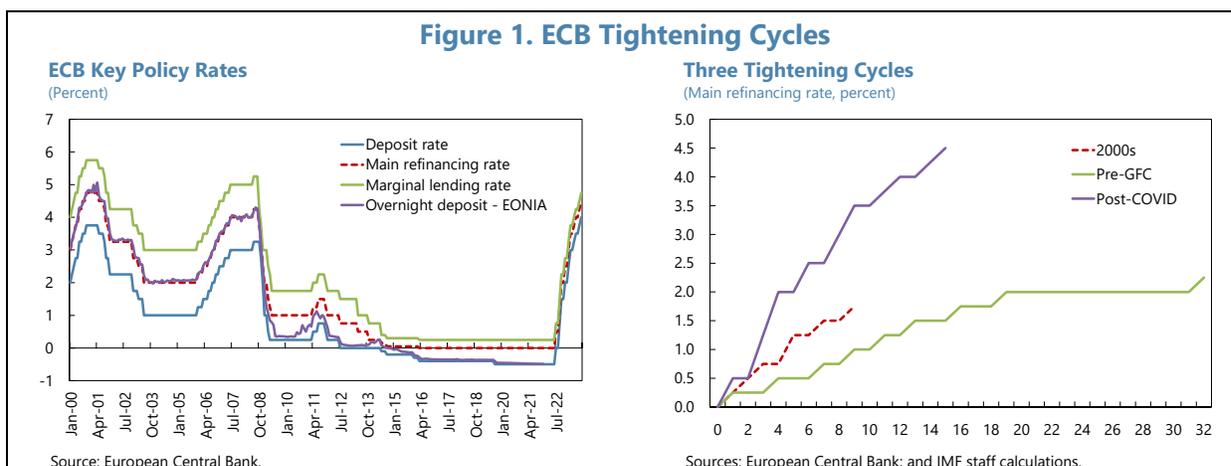
	2016	2017	2018	2019	2020	2021	2022
Capital Adequacy							
Regulatory Capital to Risk-Weighted Assets	23.3	21.4	21.5	20.5	20.6	20.6	20.3
Regulatory Tier 1 Capital to Risk-Weighted Assets	21.9	19.6	19.6	18.3	18.6	18.6	18.3
Regulatory Tier 1 capital to Total assets	6.6	5.5	7.8	5.9	6.1	6.1	5.7
Asset Quality and Exposure							
Non-performing Loans to Total Gross Loans	1.0	0.7	1.0	1.5	1.5	1.5	1.4
Non-performing Loans Net of Provisions to Capital	6.7	5.7	8.8	10.7	9.7	9.2	8.0
Earnings and Profitability							
Return on Assets	0.7	0.6	1.8	0.5	0.5	0.8	0.8
Return on Equity	8.9	7.6	26.2	6.5	6.2	9.3	9.5
Non-interest Expenses to Gross Income, percent	58.4	61.3	58.7	63.7	61.7	57.1	57.4
Personnel Expenses as Percent of Noninterest Expenses	37.6	38.2	45.8	43.9	44.4	45.4	44.4
Liquidity							
Liquid Assets to Total Assets (Liquid Asset Ratio)	21.3	14.2	8.9	17.7	17.3	18.2	20.9
Liquid Assets to Short Term Liabilities	25.1	20.9	19.1	22.1	21.7	22.2	23.8
Customer Deposits as Percent of Total (non-interbank) Loans	72.4	76.6	109.9	57.1	60.0	63.3	62.2

Sources: Bank of Finland, ECB, FIN-FSA, Financial Soundness Indicators, and OECD.

Annex I. Monetary Policy Transmission in Finland¹

The ECB is undertaking its largest and fastest tightening cycle since the start of the euro area. Finland has several structural characteristics that suggest that monetary transmission to inflation and output may be stronger than the euro area average, including: a high share of variable rate mortgages, elevated private indebtedness, and lower “excess saving” stocks. An important intermediate transmission indicator is policy rate pass-through to “real economy” interest rates. It shows that the extent of pass-through of policy rate changes has been significantly weaker than during the 2005–08 tightening cycle. But for mortgage rates in particular, the pass-through in Finland is much higher than the euro area average.

1. The euro area is experiencing its fastest monetary policy tightening cycle since inception. The ECB deposit rate increased from -0.5 percent in mid-2022 to 4 percent in September, close to where markets expect to be the ‘terminal rate’. This tightening cycle is both larger and faster than the episodes in the early 2000s and prior to the GFC.



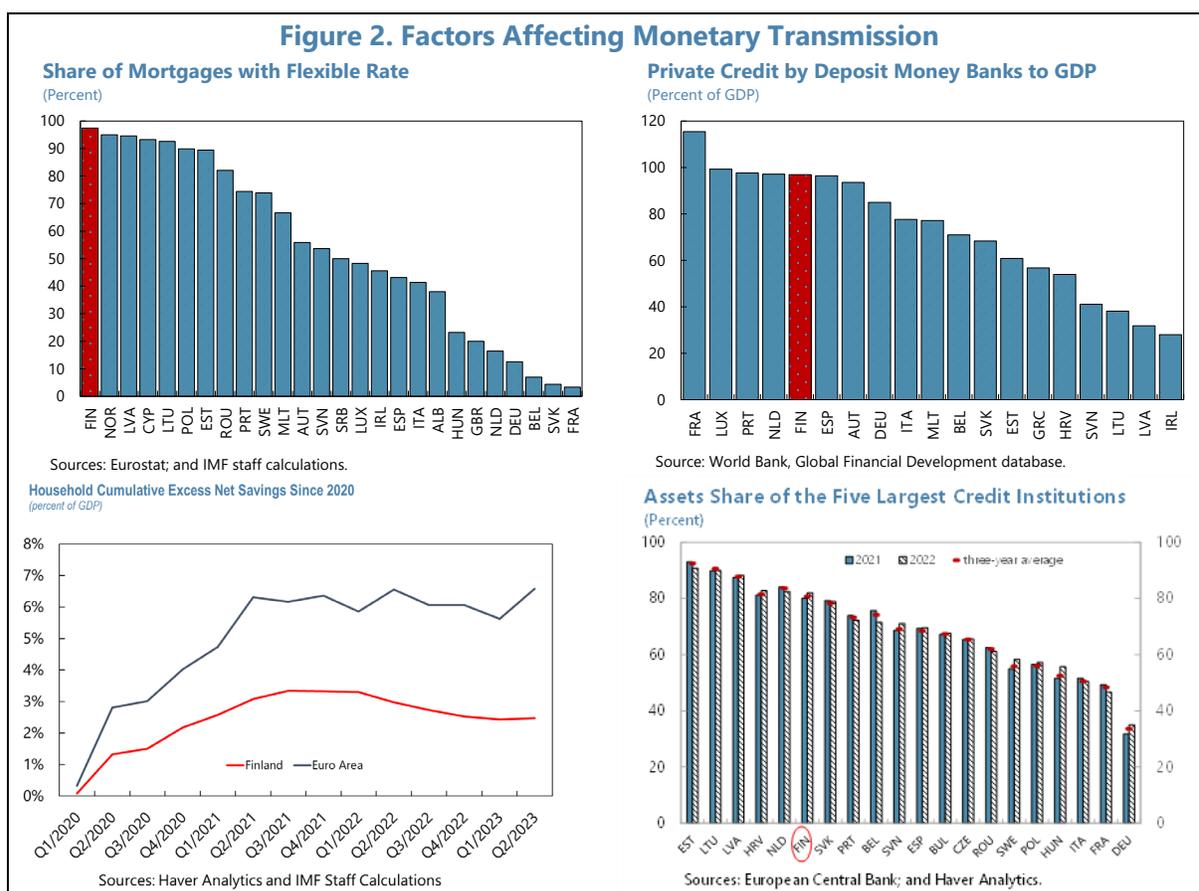
2. Several structural factors of the Finnish economy suggest that monetary transmission may be higher than in the rest of the euro area. These include:

- *A high share of variable rate mortgages.* Virtually all household mortgage loans in Finland have variable interest rates, compared to a euro area median of 52 percent.² This means that higher interest rates are quickly passed through to households, reducing disposable income. The impact of this on new borrowing, house prices, and real estate investment is more ambiguous, and will depend on the extent to which near-term debt servicing constraints are binding for households.

¹ This analysis draws heavily from: Beyer, R., Chen, R., Li, C. Y., Misch, F., Ozturk, E. O., and Ratnovski, L. (2024). Monetary Policy Pass-through to Interest Rates: Stylized Facts from 30 European Countries. IMF Working Paper 24/9.

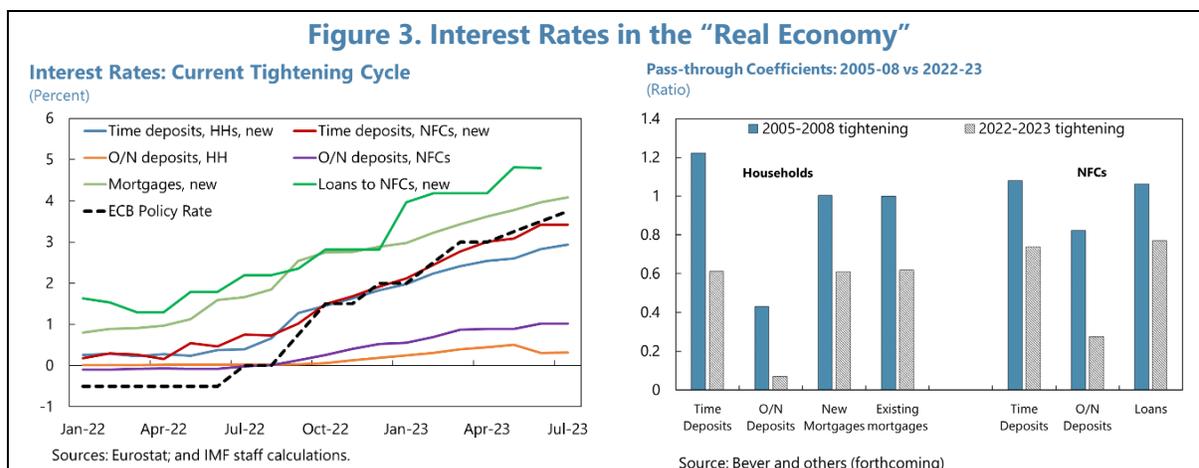
² Around 30 percent of the variable rate mortgages in Finland are protected with interest rate collars, which reduces full pass-through of policy rates to mortgage rates.

- *High private indebtedness.* Private credit is around 100 percent of GDP in Finland, well above the Euro Area average of 81 percent. As such, any increase in interest rates will have a proportionally larger impact on household disposable income and firms' costs, reducing consumption and investment.
- *'Excess saving.'* Compared with euro area, Finland has lower net household savings built up since the pandemic. Savings cushion household consumption against higher rates, thus mitigating the impact of monetary policy tightening.
- *Bank concentration.* Finland has a relatively concentrated banking sector, but the impact on transmission is theoretically ambiguous. High banking sector concentration could inhibit pass-through to deposit rates relative to lending rates. On one hand, the resulting higher net interest margins would further constrain household disposable income and firm profits. However, lower deposit rates would also disincentivize saving, supporting consumption and investment.

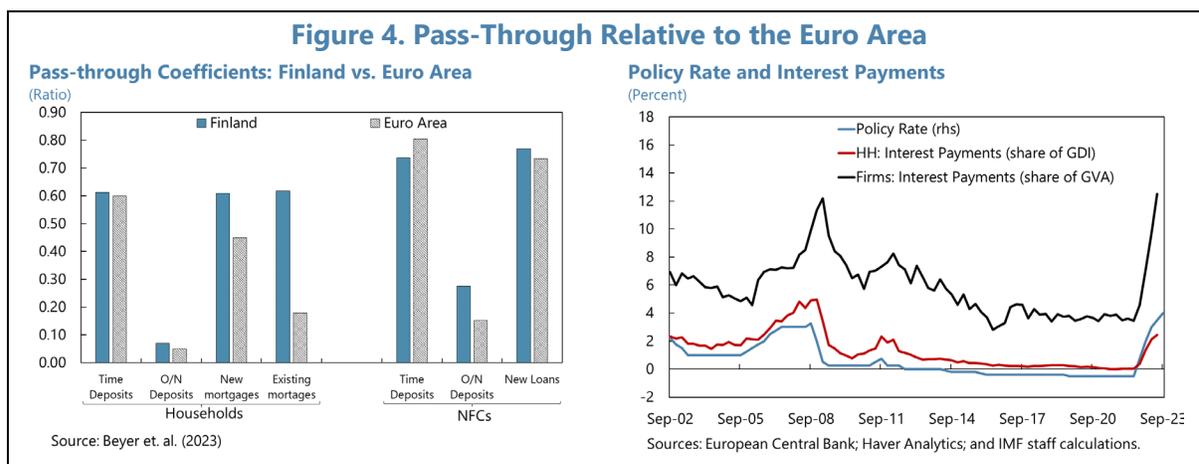


3. Interest rates in the real economy have increased, but the pass-through has been weaker than the 2005–08 tightening cycle. Ultimately, assessing the strength of the monetary transmission mechanism involves an appraisal of the impact on inflation and output. However, an important intermediate measure is the responsiveness of interest rates in the “real economy” to policy rate changes. Interest rates in Finland have increased significantly over the last year: for

example, average mortgage rates have increased fourfold, from below 1 to over 4 percent. However, the size of this pass-through—assessed using “pass-through coefficients”—appears to be smaller than in previous tightening cycles.³ The pass-through to household and NFC deposits have been particularly low, especially for overnight rates. This could be driven by a combination of structural changes in the economy and financial system, and/or external factors. In regard to mortgages, most interest rates are linked to the 12-month EURIBOR, which started to increase before the first ECB rate rise, reflecting market expectations, reducing estimated pass-through in this analysis.



4. Pass-through to existing mortgages is three times the euro area average. Not surprisingly given the high share of variable rate loans, rates on *existing* mortgages have increased by three times the euro area average. And for new mortgages, the pass-through has been around one-third higher. In addition to the impact on house prices and construction investment, this will compress household disposable income and consumption. Pass-through to corporate loans is nearly 0.8, around the euro area average, also contributing to a steep hike in firms’ costs, putting pressure on investment. The pass-through to deposit rates is broadly similar to the euro area, despite Finland’s relatively high banking sector concentration.



³ The “pass-through coefficient” is the ratio of the *cumulative* change in the “real economy” interest rate over the change in the ECB policy rate over the period June 2022 to August 2023.

Annex II. Drivers of Inflation in Finland

This annex explores inflation dynamics in Finland using three complementary approaches: (i) a dynamic factor model that decomposes inflation into common and domestic factors; (ii) an accounting identity methodology to explore the roles of wages and profits; and (iii) a look at the role of pent-up demand and supply chain disruptions in driving core inflation. It finds that much of Finland's inflation—headline as well as core—share commonalities with the euro area in recent periods; wages account for a similar share of inflation as profits; and pent-up demand has been a key driver.

A. Common vs. Domestic

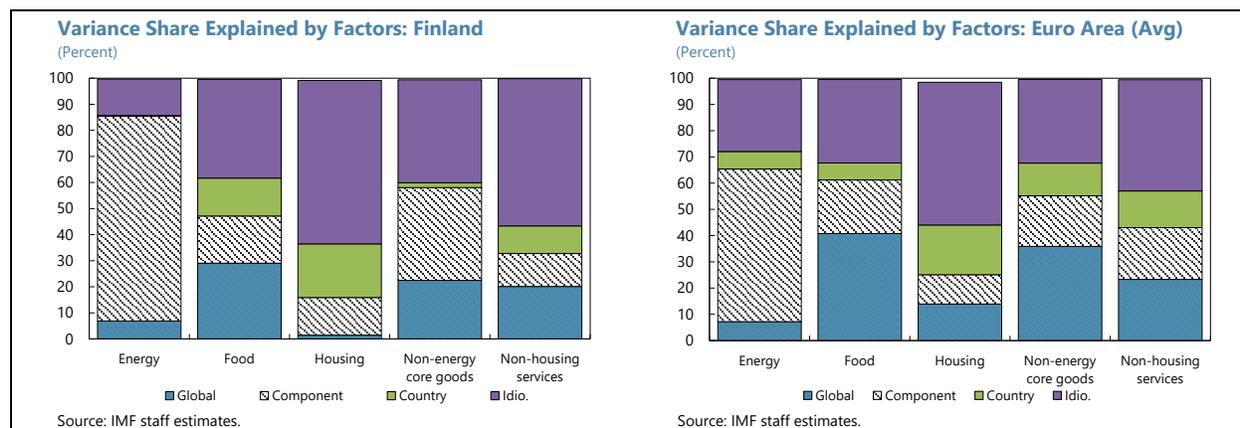
1. A multi-country dynamic factor model is used to decompose inflation components into common and domestic factors. The model follows Karadimitropoulou and León-Ledesma (2013) and decomposes 5 components of headline inflation (energy, food, housing, non-energy core goods, non-housing services) for the 20 euro area countries into the following:

- (i) A '*global factor*', common to all components and all countries;
- (ii) A *component-specific* factor, common all countries, but specific to that component (e.g., energy, core goods);
- (iii) A *country-specific* factor, common to all components but specific to a single country; and
- (iv) An *idiosyncratic* term, a residual specific to both the component and the single country.

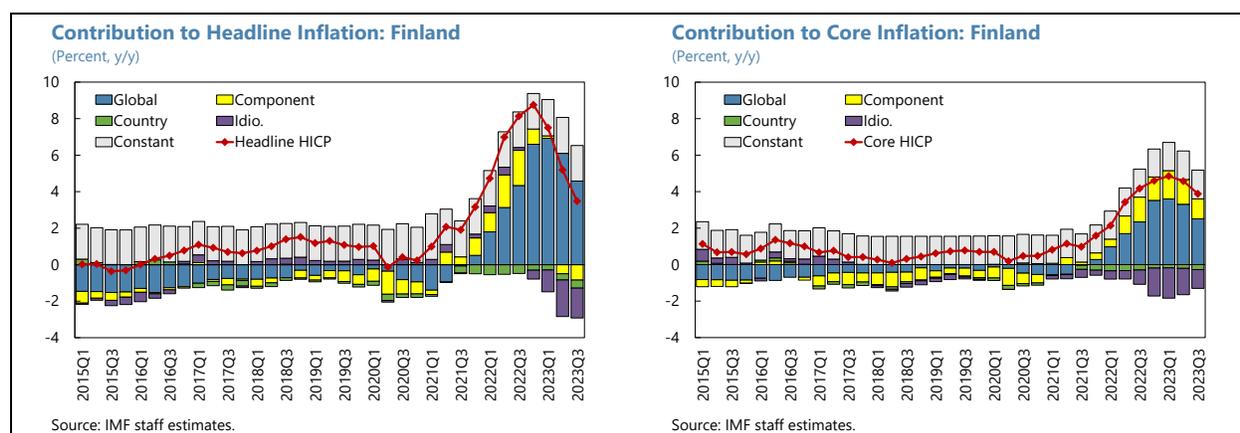
While estimating global factor models is standard in the inflation co-movement literature (see for instance, Ciccarelli and Mojon 2010), adding the component-specific dimension is novel. This, for example, helps to examine the impact of global supply chains on 'core good' inflation; the role that energy prices across countries (Ha et al. 2023); and commonalities in wage dynamics (IMF 2018) that underpin co-movement in services inflation. The model is estimated as a panel for all euro area countries, using quarterly data over 2001Q1–2023Q3.

2. Common factors explain a sizable portion of Finland's inflation dynamics, with component-specific commonality, in general, playing a key role. Not surprisingly, the *component-specific* factor is the largest driver of energy prices in Finland, explaining as much as 80 percent of its variance share during the sample period. In other words, energy inflation in Finland exhibits strong co-movement with energy inflation in other euro area countries. The role of the *component-specific* factor is also sizable for non-energy goods—consistent with the fact that these are tradables and, during recent years, have been subject to supply chain disruptions. While food inflation exhibits some component-specific commonality, the role of the *global factor* is more important—suggesting the importance of global supply/demand conditions. In general, common factors are less important in 'housing' and 'non-housing services', with domestic factors (*country-specific* and *idiosyncratic*) being dominant drivers. The relative role of the four factors in Finland is similar to the euro area average. An important contribution to the literature on inflation co-

movement is that cross-country commonalities in (aggregate) inflation are largely driven by commonalities in specific components of inflation.



3. A historical decomposition for Finland suggests that much of the recent bout of inflation was fueled by the common drivers. For headline inflation, the *global* factor explained bulk of the surge, with some contribution also coming from the *component-specific* factor. Core inflation exhibited a similar picture, except that the contributions from these two components are more persistent.¹ While this analysis cannot pin-point a specific cause, possible explanations for this include: a euro area demand shock from loose Covid-era demand management policies; terms of trade shocks that effect all countries; supply chain issues in specific sectors (non-energy core goods); or commonalities in wage dynamics. However, it is also interesting to note that the *idiosyncratic* component played a negative role in Finland, driving down inflation. Again, it is only possible to speculate on these underlying drivers, but it is possible that the steep fall in Finnish house prices may have played an important deflationary role. All in all, these results suggest that inflation in Finland tends to exhibit strong commonalities with that of the euro area. Thus, while inflation in Finland is now somewhat lower than that of the euro area, they cast doubt on whether Finnish inflation dynamics can decouple from that of the euro area.

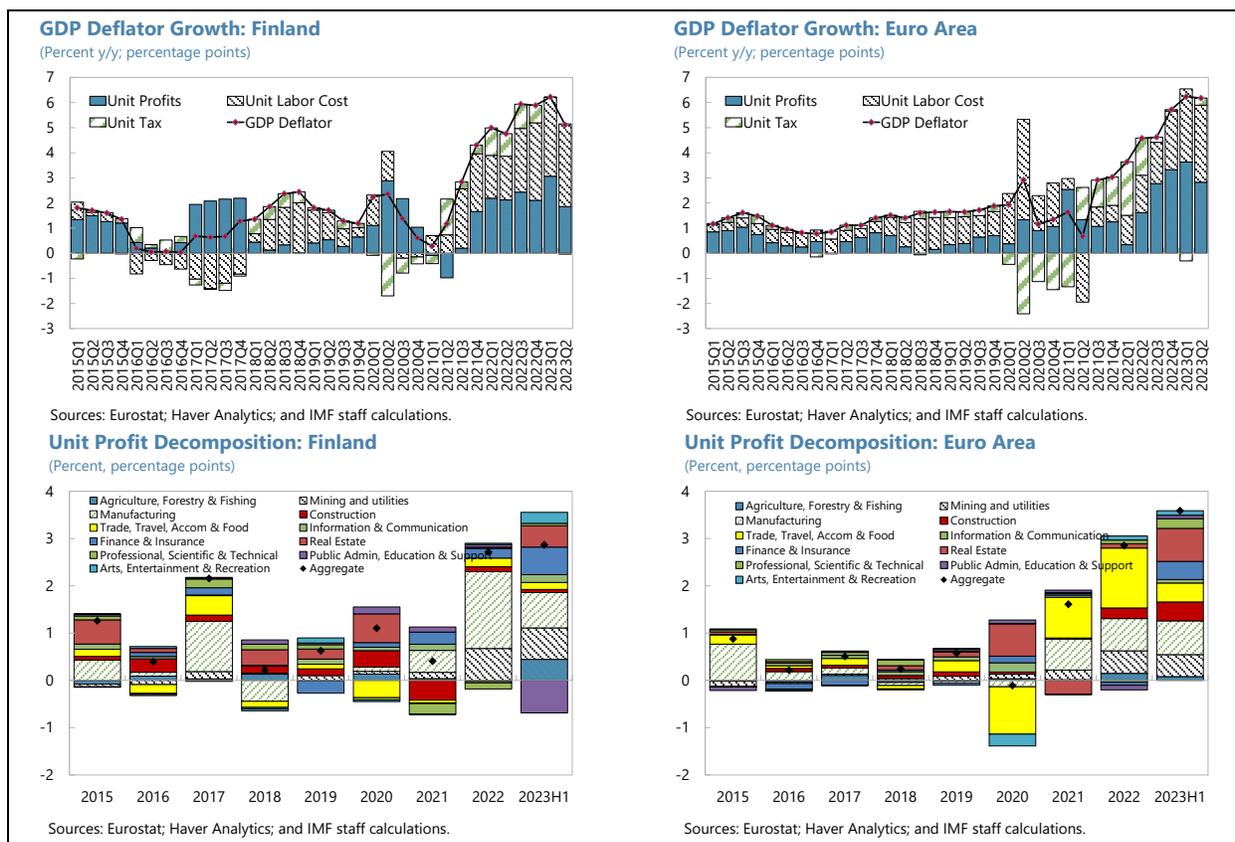


¹ These results are mostly underpinned by the dynamics of the estimated global and energy-specific factors (see Section A in Technical Details) with Finland 'positively' exposed to them.

B. Profit vs. Labor

4. Growth in the GDP deflator (as one measure of inflation) can be decomposed into three components—profits, labor costs, and taxes. Using accounting identities (Hansen, Toscani, and Zhou 2023), it is possible to split the GDP deflator (which captures the price increase of all components of GDP) into: i) unit profits (gross operating surplus and mixed income per unit of real GDP); ii) unit labor costs (labor compensation per unit of real GDP), and: iii) taxes (taxes less subsidies per unit of GDP). While this approach is only an accounting-based decomposition, it shows the relative contribution of these components to changes in the GDP deflator.

5. Profits and labor costs make up roughly equal share of inflation in Finland. The contribution of unit labor cost was relatively small in early 2022, but gradually increased thereafter, reflecting some adjustment of wages to the energy shock. In the first half of 2023, unit labor costs—on average—contribute about half of the inflation dynamics, with the remainder mostly attributed to profits. While labor costs and profits were dominant factors in 2022, higher taxes played a non-trivial role, possibly driven by the high ‘revenue buoyancy’ experienced last year. Compared to the euro area, unit labor cost has played a somewhat larger role during the first half of 2023 in Finland, due to lower productivity growth. Unit profits in Finland were mostly driven by manufacturing in 2022, but now is more broad-based (like in the euro area).²



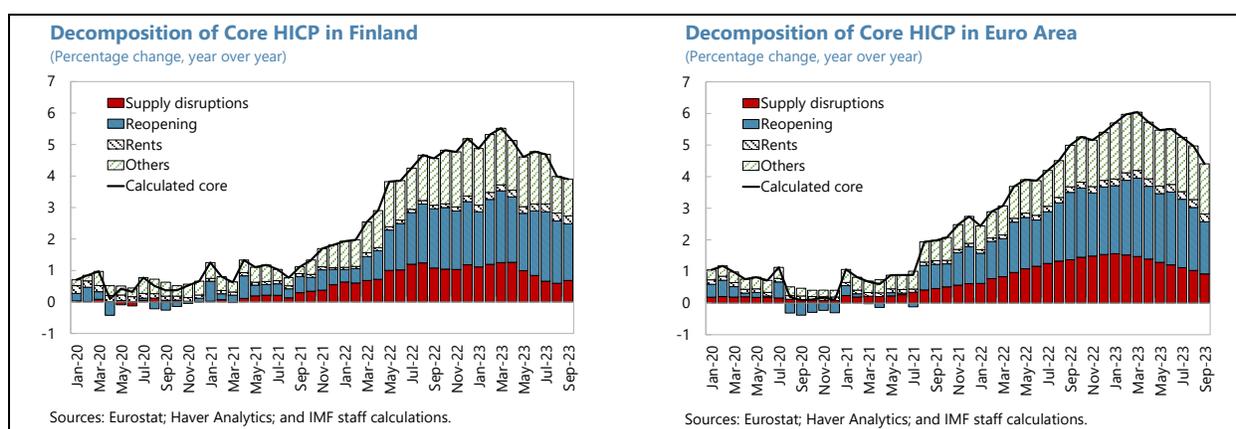
² Based on Eurostat data, sectoral profits are derived as sectoral GVA minus employee compensation.

6. Historical evidence suggests that wage dynamics will be key for the near-term inflation outlook. The experience of the euro area during the first and second oil price shocks suggests that unit labor cost, while relatively muted initially when hit by energy price shocks, tend to increase subsequently (Hansen, Toscani, and Zhou 2023). This is consistent with the view that workers tend to recoup the loss in real incomes sustained during energy shocks. Indeed, empirical analysis for Finland suggests that wage formation is partly backward looking (IMF 2023). Hence, high (headline) inflation realized thus far—even if it has moderated in recent-most periods—should imply some wage pressures going forward. Yet, negotiated wages in Finland are relatively benign—around 2.8 percent during 2024—reducing the risk of entrenched inflation in the near term.

C. Pent-Up Demand vs. Supply Chain Disruptions

7. The components of core inflation are categorized into those deemed sensitive to post-pandemic reopening (pent-up demand) and those that are sensitive to supply chain disruptions. Following Gonçalves and Koeste (2022), this is ‘bottom-up approach’ categorizes the disaggregated components of core inflation by their sensitivity to reopening—reflecting ‘pent-up demand’—and supply chain disruptions.³ The approach is based on an ad-hoc and binary classification (kept invariant during the sample period) and does not directly account for second-round effects from energy prices. That said, it is still useful as an indicative exercise.

8. There is some evidence that pent-up demand contributed to core inflation. The analysis suggests that supply chain disruptions contributed to core inflation in Finland, particularly in 2022 where it contributed to around one-fourth of the increase. Pent-up demand, however, had a more sizable contribution to core inflation. The relative split between the two components in Finland is similar to that in the euro area. While the precise contribution of these two components should be viewed as indicative, the analysis, nonetheless, suggests that pent-up demand has been a key driver. And, more broadly, as aggregate demand softens, this will help ease inflationary pressures.



³ See B in Technical Details for details. Rent for housing and the remaining others make up the rest of core inflation.

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Annex II. Appendix I. Technical Details and Additional Results

A. Dynamic Factor Model

1. **Dynamic Factor Model.** The model is represented by:

$$\pi_{i,j,t} = \beta_{i,j}^g F_t^g + \beta_{i,j}^s F_t^s + \beta_{i,j}^c F_t^c + \varepsilon_{i,j,t},$$

where $\pi_{i,j,t}$ represents inflation for each country i and component j in a given period t . Inflation is decomposed into: F_t^g (the global factor), F_t^s (the component-specific factor), and F_t^c (the country-specific factor). The idiosyncratic term is represented by $\varepsilon_{i,j,t}$. The coefficients before the factors are the factor loadings that pin down the sensitivities of inflation to the estimated factors. The factors are identified via zero restrictions on the factor loadings: for instance, only energy inflation loads on to the energy-specific factor while other inflation components are assumed to have zero loadings on that factor. Even though the model is estimated as a panel, the fact that the factor loadings are component-country specific allows model results to be derived at the component-country level. The factors and the idiosyncratic term—which are unobserved—follow AR processes. The model is estimated using Bayesian techniques (see Karadimitropoulou and León-Ledesma (2013) for details).

2. **Database.** Inflation data are based on the Harmonized Index of Consumer Prices (HICP) and are sourced from Eurostat via Haver Analytics. This ensures cross-country consistent definition of the components of inflation. The data are compiled at the quarterly frequency, which are then seasonally adjusted. For estimation, inflation enters the model as q/q growth rates of the respective HICP levels (and then demeaned). For exposition, inflation and the estimated factors are presented in terms of y/y growth rates.

3. **Estimated factors.** Thick line represents the median estimate and the dotted represent the 33–66 percentile bands.

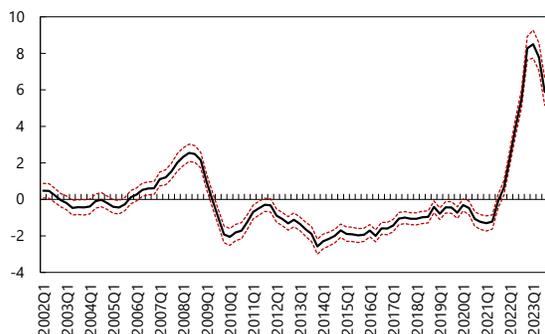
B. Decomposition of Core Inflation

4. **Following Gonçalves and Koeste (2022), the components of HICP core inflation at the 2-digit level are categorized into four groups:** (i) sensitive to supply chain disruptions; (ii) sensitive to re-opening, reflecting pent-up demand; (iii) rent; and (iv) the remaining. The components in each category are then aggregated using the corresponding HICP weights.

Figure 1. Finland: Inflation Dynamics

Global

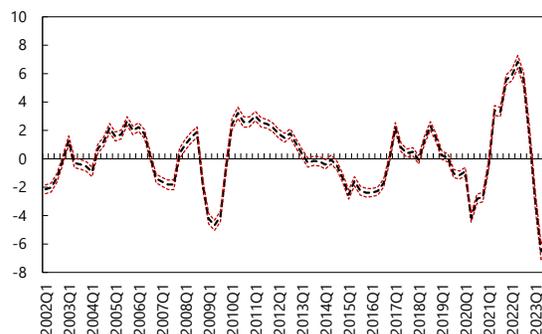
(Percent, y/y, demeaned)



Source: IMF staff estimates.

Energy

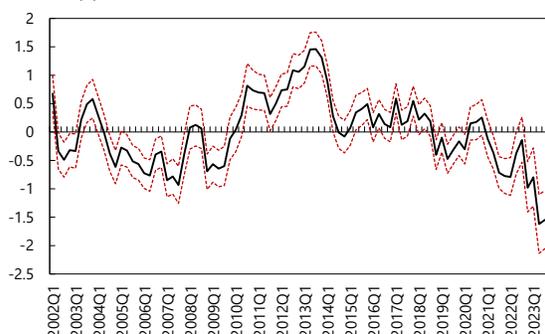
(Percent, y/y, demeaned)



Source: IMF staff estimates.

Food

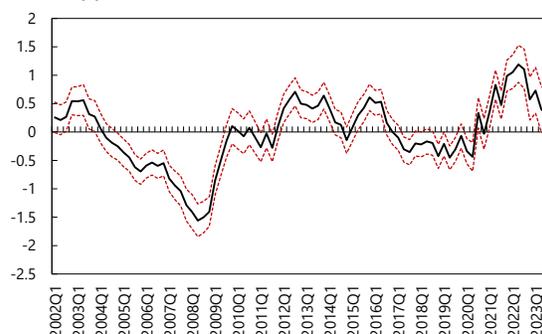
(Percent, y/y, demeaned)



Source: IMF staff estimates.

Non-Energy Core Goods

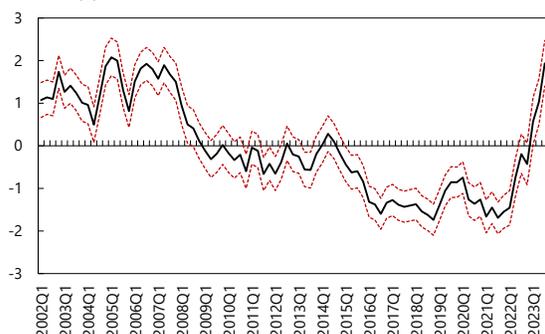
(Percent, y/y, demeaned)



Source: IMF staff estimates.

Housing

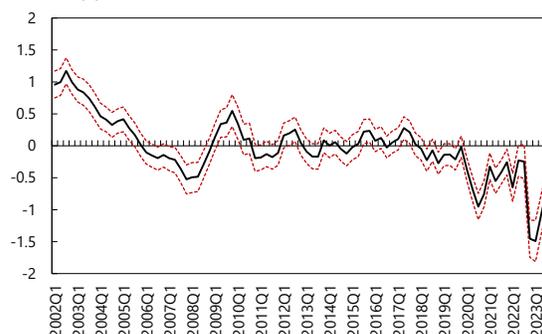
(Percent, y/y, demeaned)



Source: IMF staff estimates.

Non-Housing Services

(Percent, y/y, demeaned)



Source: IMF staff estimates.

Categorization of Core Inflation Components

Category	HICP Details	Category	HICP Details
Reopening	Clothing Footwear Transport services Recreational & cultural services Package holidays Catering services Accommodation services	Others	Maintenance & repair of the dwelling Water supply & miscellaneous services relating to the dwelling Medical products, appliances & equipment Out-patient services Hospital services Other services in respect of personal transport equipment Postal services Telephone & telefax equip. & telephone & telefax services Audio-visual, photographic & information processing equip. Other major durables for recreation & culture Other recreational items & equipment, gardens & pets Newspapers, books & stationery Education Personal care Personal effects n.e.c. Social protection Insurance Financial services n.e.c. Other services n.e.c.
Supply Chain Disruptions	Furniture & furnishings, carpets & other floor coverings Household textiles Household appliances Glassware, tableware & household utensils Tools & equipment for house & garden Goods & services for routine household maintenance Purchase of vehicles Spare parts & accessories for personal transport equipment Maintenance & repair of personal transport equipment		
Rent	Rent for housing		

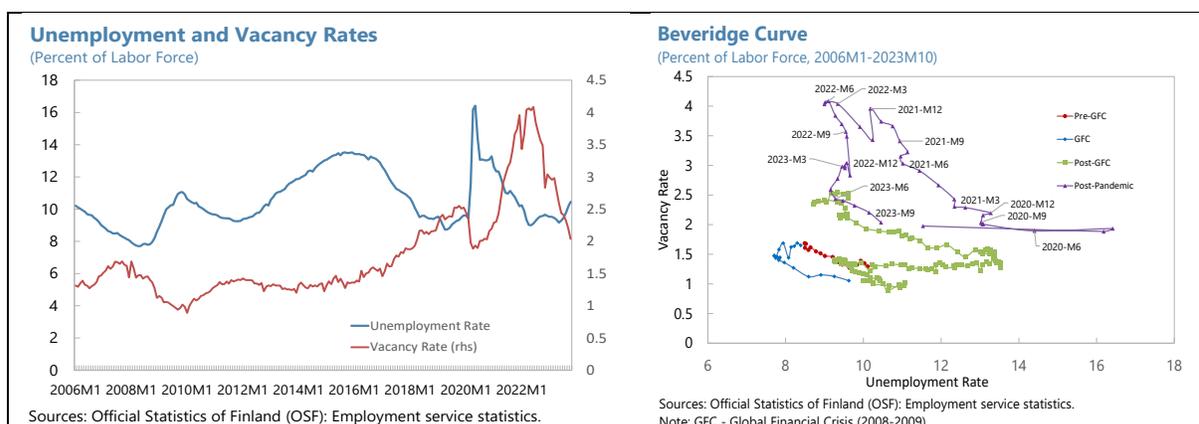
Source: Gonçalves and Koeste (2022); and IMF staff.

Annex III. Beveridge Curve Shifts in Finland

A decomposition of the shifts of the Beveridge Curve in Finland highlights reduced matching efficiency as one of the main drivers. Policies aimed at improving matching efficiency can help achieve the government's employment objective.

1. As with other advanced countries, Finland experienced a sharp rebound in economic activity after the onset of the Covid-19 pandemic. This led to a rapid decline in unemployment and a sharp rise in vacancies, indicating widespread difficulty in recruiting workers (IMF, 2022). But while labor market tightness is slowly returning to pre-pandemic level, the vacancy rate has increased steadily over the past decade. The objective of this annex is to look at these issues through the lenses of the Beveridge Curve.

2. The Beveridge Curve (BC) is a graphical representation of the inverse empirical relationship between the unemployment and the job vacancy rate. Structural factors can shift or change the slope of the curve. In Finland, the BC was relatively flat before the Global Financial Crisis. However, it started to shift outward in the aftermath of the GFC and has further steepened after the Covid-19 pandemic.



3. To better understand these dynamics, we decompose the shift of the BC using the method of Ahn and Crane (2020). The method entails two steps. In a first step, we estimate the parameters of a matching function, which represents the way new hires are formed, based on the following formula:

$$H_t = \sigma_t U_t^{1-\alpha} V_t^\alpha \quad (0.1)$$

where H_t is the flow of new hires, U_t and V_t are the unemployment and vacancy rates (normalized by the labor force), α is the elasticity of the matching function and σ_t is the time varying matching efficiency. From (1.1) we obtain the job-finding probability given by:

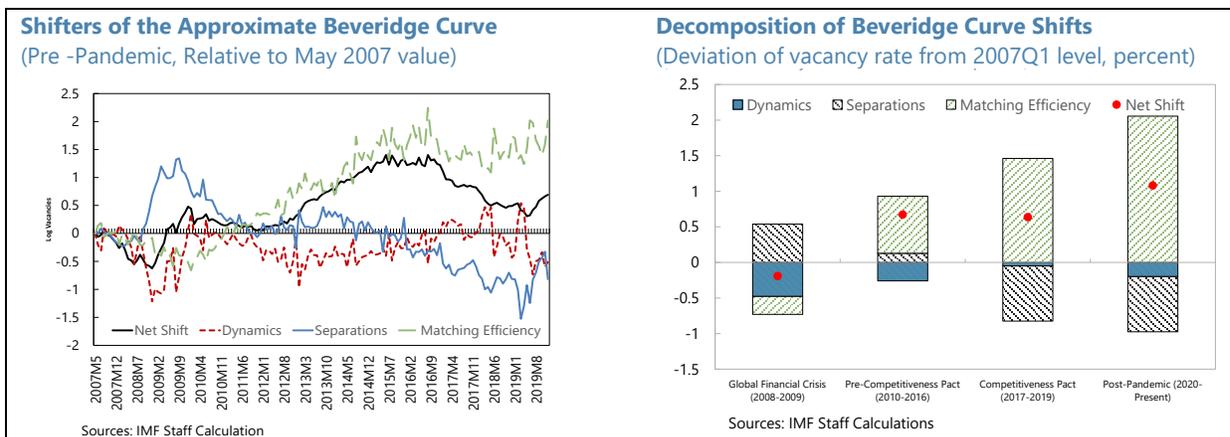
$$f_t = \sigma_t \left(\frac{V_t}{U_t} \right)^\alpha \quad (0.2)$$

which we then use to obtain the two parameters of the matching function.¹ In the second step, these parameters are used to decompose a linearized version of the BC around its steady state into three components that act as “shifters” of the intercept of the curve:

- Matching efficiency: conditional on a given unemployment path, lower matching efficiency requires more vacancies to offset lower hirings, thus shifts the curve up.
- Job-separation probability: although less intuitive, a higher job separation will also shift the curve up, as higher inflows into unemployment, conditional on a given unemployment path, require more vacancies to absorb extra workers.
- Out-of-steady unemployment dynamics: when unemployment rises, the curve will shift down as less vacancies are needed due to low job finding rate.

4. We calculate the contribution of each of these components to the shift of the BC in Finland from its pre-GFC level. For ease of exposition, we distinguish across five main periods: i) the GFC (2008–09); ii) the Pre-Competitiveness Pact (2010–16); iii) the Competitiveness Pact (2017–19); 4) the post Covid-19 pandemic (2020–present).

5. The results show that, during the GFC the unemployment dynamics (i.e., the increase in unemployment) contributed to a net downward shift of the curve. The 2010–16, is characterized by a more pronounced upward shift of the curve, due to the rise in job separations and reduced matching efficiency. After the Competitiveness Pact was signed in 2017, the decline in both job separations and unemployment driven by the Pact-induced lower wages, has contributed to a temporary downward shift of the curve, but not enough to match the persistent decline in matching efficiency. The latter has further increased during the pandemic, with no offsetting impact from the reduced job separations and lower unemployment.



¹ We measure the job-finding probability as in Shimer (2012): $f_t = 1 - \frac{U_{t+1} - U_t^s}{U_t}$ where U_{t+1}^s is the number of unemployed for less than five weeks at time $t + 1$.

6. Overall, the results show that reduced matching efficiency can explain to a large extent the persistent outward shift of the BC in Finland. This reduction in matching efficiency has not been offset by dynamics in out-of-steady state unemployment and job separations. Quantitatively, if matching efficiency in Finland recovers toward its pre-GFC level (an increase by approximately 20 percent), the implied reduction in the unemployment rate at the pre-pandemic level of vacancies would be around 2 percentage points, equivalent to an increase in headcounts of about 55 thousand. Economically speaking, these gains are a sizable portion of the government's plan to raise employment by 100k but still leaves some scope beyond matching.

7. The determinants of the deterioration in labor market matching efficiency can be due to several factors. As highlighted by the [Finnish Economic Policy Council \(2022\)](#), the nature of the job offers, including terms of the contract and wage rate, together with the undersupply of skilled labor in sectors like healthcare and IT, represent persistent structural challenges. Improving migration flows can address part the problem related to undersupply of skilled labor in specific sectors. A more decentralized wage bargain system could also improve the matching process. A thorough evaluation of Active Labor Market Policies (ALMP) as recommended by the [OECD \(2023\)](#), will ensure that public money is spent to the maximum benefit of society. In fact, while Finland's spending on ALMP is high in percent of GDP compared to other countries (0.8 percent of GDP), only about half of the jobseekers contact the Public Employment Service (PES) to search for work while there is a significant share of workers with low labor attachment.

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Annex IV. External Sector Assessment

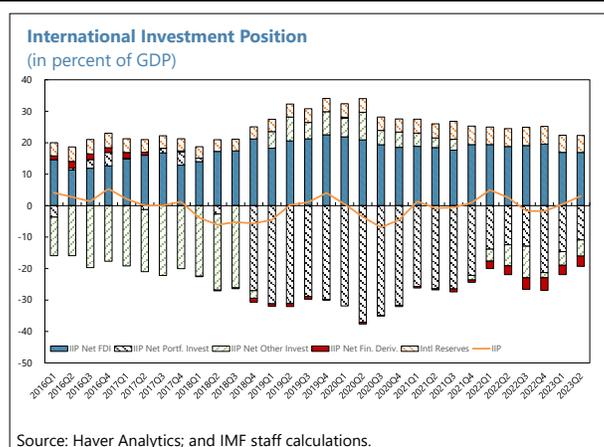
Overall Assessment: Based on projections of the current account, the external position of Finland in 2023 is estimated to be moderately weaker than the level implied by fundamentals and desirable policies.

Potential Policy Responses: Fiscal consolidation remains the primary lever to strengthen the external balance. Finland's cost competitiveness has improved over the past decade, partly due to the measured growth in labor costs. Given Finland's weak productivity growth—which could be bolstered by labor market reforms—moderation in wage bargaining settlements remains important.

Foreign Assets and Liabilities: Position and Trajectory

Background. The Net International Investment Position (NIIP) weakened in 2022 to -2.2 percent of GDP. As of 2023Q3, the NIIP has shown signs of recovery but staff projects that it might end up around -2.6 percent driven by a decrease in the stock of net direct investment. After experiencing improvement in 2021 (at 208 percent of GDP), gross external debt has steadily increased and is projected to reach 216 percent in 2023.

Assessment. Over the near term, the NIIP is projected to deteriorate slightly due small and recurrent CA deficits, but the NIIP will then stabilize over the medium term. Vulnerabilities for Finland stem from the large cross-border exposures of the financial sector, including liquidity risk related to foreign-financed wholesale funding.



2023 (est., percent GDP):	NIIP: -2.6	Gross Assets: 328	Debt Assets: 47	Gross Liab.: 331	Debt Liab.: 100
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Current Account

Background. Finland's current account deficit in 2022 reached around 2.6 percent of GDP, driven by a significant deterioration in the services and primary income balances. In the first three quarters of 2023, the current account balance improved, indicating that the deficit this year would shrink compared to the previous year. The estimated current account deficit (0.5 percent) comprises of a surplus in the goods balance driven by shrinking goods imports that more than offsets a deficit in the services balance. While the current account is projected to be negative in the near-term, due a less favorable external environment, it is expected be balanced over the medium term, supported by a higher external growth and measures aimed at preserving cost competitiveness, despite adverse demographic and labor productivity trends.

Assessment. Preliminary results from the EBA estimate a cyclically-adjusted CA of -0.8 percent of GDP and a CA norm of 0.3 percent of GDP. Staff estimates the gap for 2023 to be -1.2 percent (with a range -0.7 and -1.7), of which 1.2 percentage points is attributed to a "policy gap" and -2.4 percentage points as an unidentified residual, reflecting structural factors not accounted for in the model. According to this result, the external position in 2023 is moderately weaker than the level implied by medium-term fundamentals and desirable policies. The results are subject, however, to uncertainties and data revisions.

Finland: Model Estimates for 2023

(In percent of GDP)

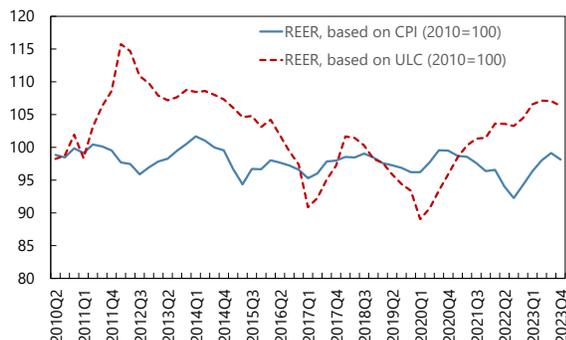
	CA model	REER model
CA-Estimate	-0.5	
Cyclical contributions (from model) (-)	0.3	
Adjusted CA	-0.8	
CA Norm (from model) 1/	0.3	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	0.3	
CA Gap	-1.2	-2.1
o/w Relative policy gap	1.2	
Elasticity	-0.34	
REER Gap (in percent)	3.4	6.1

1/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

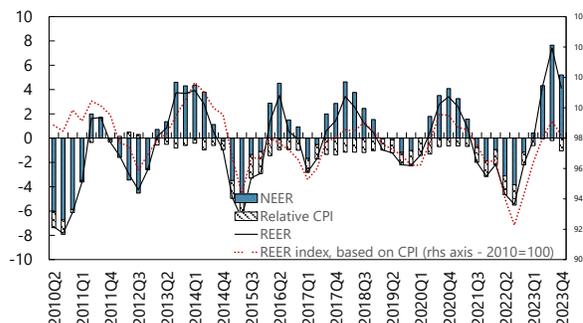
Background. Following its descent to a 10-year historical low at the onset of the pandemic, the ULC-based REER embarked on a continuous appreciation. By the end of 2023, it had appreciated by 19 percent relative to 2020H1 and 2 percent compared to 2022, indicative of a sustained recuperation in labor costs. A stable level for the ULC-based REER is expected, contingent upon moderate wage pressures. Concurrently, the CPI-based real exchange rate registered a depreciation of approximately 7 percent from 2020 to 2022Q3. However, a subsequent appreciation of about 6 percent was observed through 2023Q4, mirroring the fluctuations of the NEER.

Real Effective Exchange Rate



REER Appreciation

(In percent, year-on-year contribution to growth)



Assessment. The staff CA gap implies a REER gap of 3.4 percent (after applying an estimated elasticity of 0.34) and a range of 2.0–4.9. According to the estimated REER-gap index model, the REER gap is 6.1 percent while estimates of the EBA level REER model suggest an overvaluation of about 9 percent in 2023.

Capital and Financial Accounts: Flows and Policy Measures

Background. The financial account deteriorated slightly to -3.3 percent of GDP in 2022 on the back of higher portfolio investment liabilities outpacing improvements in the net FDI and net other investment balances. In contrast, the financial account showed a modest recovery during the first three quarters of 2023 compared to 2022. This recovery can be attributed to a stronger net other investment position, which compensated for weaker FDI and Portfolio Investment positions. The level of gross external debt rose to 215 percent of GDP in 2022, reflecting the reliance of the relatively large financial sector on foreign wholesale funding.

Assessment. Finland has a fully open capital account. It remains exposed to financial market risks against the background of interconnected regional financial markets.

FX Intervention and Reserves Level

Background. The euro has the status of global reserve currency.

Assessment. The currency is freely floating.

Annex V. Risk Assessment Matrix¹

Source of Risks and Relative Likelihood (High, medium, or low)	Impact if Risk is Realized (High, medium, or low)	Policy Response
Global		
<p style="text-align: center;">High</p> <p>Intensification of regional conflicts. Escalation or spread of the conflict in Gaza and Israel, Russia’s war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.</p>	<p style="text-align: center;">High</p> <p>The intensification of the conflict provokes a further decline in economic activity, weakening investment and growth and worsening financial conditions. The fiscal stance deteriorates due to the working of automatic stabilizers. Banks’ asset quality deteriorates, leading to capital shortfalls, and funding costs rise for corporate borrowers, reducing credit availability.</p>	<p>Provide targeted fiscal support to cushion the impact on households.</p> <p>Support firms to preserve the jobs that will be viable and prevent liquidity problems from triggering defaults and bankruptcies.</p>
<p style="text-align: center;">Medium</p> <p>Monetary policy miscalibration. Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks.</p>	<p style="text-align: center;">Medium</p> <p>A vicious wage-price spiral could result from higher and persistent inflation. A need for aggressive tightening may have adverse spillovers to corporate and household sectors through higher debt service, liquidity shortfalls, and reduced demand.</p>	<p>Stand ready to tighten fiscal policy while protecting the vulnerable.</p> <p>Deploy prudential tools to mitigate financial stability risks.</p> <p>Enhance wage bargaining coordination and flexibility to prevent risks of a wage-price spiral.</p>
<p style="text-align: center;">Medium</p> <p>Abrupt global slowdown. Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation triggering sudden stops in emerging market and developing economies.</p> <p>Europe: Intensifying fallout from Russia’s war in Ukraine, supply disruptions, tight financial conditions, and real estate market corrections exacerbate economic downturn.</p>	<p style="text-align: center;">High</p> <p>The aggressive response by central banks triggers a tightening of financial conditions, leading to higher borrowing costs, which ultimately lead to lower demand, a slowdown in domestic activity.</p>	<p>Allow automatic stabilizers to operate. The fiscal policy space should be used to support the most vulnerable but offset by other measures to avoid stimulating the economy if wage and inflation pressures persist.</p> <p>Employ macro-prudential tools to mitigate financial stability risks.</p>

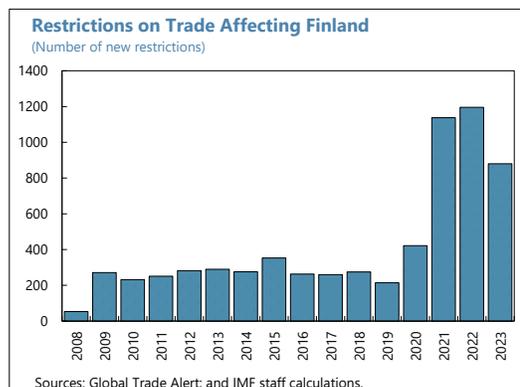
¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff’s subjective assessment of the risks surrounding the baseline (“low” is meant to indicate a probability below 10 percent “medium” a probability between 10 and 30 percent, and “high” a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Source of Risks and Relative Likelihood (High, medium, or low)	Impact if Risk is Realized (High, medium, or low)	Policy Response
<p style="text-align: center;">High</p> <p>Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.</p>	<p style="text-align: center;">High</p> <p>Higher input costs, supply disruptions and changed trade patterns generate transition costs and ultimately may result in lower real incomes and lower firm profitability.</p>	<p>In collaboration with partners, continue to support global cooperation and multilateralism.</p> <p>Promote supply chain resilience including by encouraging diversification.</p> <p>Step up the envisaged structural reforms to enhance flexibility and help sectors cope with shocks in a targeted manner.</p>
<p style="text-align: center;">Medium</p> <p>Cyberthreats. Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets) or misuse of AI technologies trigger financial and economic instability.</p>	<p style="text-align: center;">Medium</p> <p>Economic activity is disrupted, leading to weaker confidence, and capital outflows.</p>	<p>Continue to promote awareness and preparedness campaigns to inform the public.</p> <p>Continue to invest in cyber defense.</p>
Regional and Domestic		
<p style="text-align: center;">Medium</p> <p>Adverse shock in a neighboring Nordic country, leading to a correction in the housing market and/or CRE markets, and distress in the financial sector.</p>	<p style="text-align: center;">High</p> <p>Lower demand from trading partners reduces domestic output and employment. Financial sector sees declining asset quality and funding difficulties.</p>	<p>Conduct regular Nordic-wide financial stress tests.</p> <p>Reintroduce SyRB once macroeconomic uncertainties abate.</p>
<p style="text-align: center;">Medium</p> <p>Systemic financial instability. Systemic risks rise further given lower growth, elevated inflation, and tightening financial conditions. Correction in the housing and CRE markets and/or adverse shock in a neighboring Nordic country could distress the financial sector given close interlinkages across the Nordic financial system.</p>	<p style="text-align: center;">High</p> <p>A marked reversal of real estate prices in Finland or the Nordics would adversely affect financial conditions, given high household debt and variable rate mortgages, and close linkages of the banking system. Financial sector sees declining asset quality, and lending will be curtailed if doubts about the quality of covered bonds rise elevating bank funding costs.</p>	<p>Continue to closely monitor risks, including those around households' creditworthiness, cross-border macro-financial exposures, and liquidity.</p> <p>Tighten liquidity regulation and enhance banks' liquidity buffers to address systemic liquidity risks.</p>
<p style="text-align: center;">Low</p> <p>Social discontent. High inflation, real income loss, spillovers from conflicts (including migration), and worsening inequality, cause social unrest and detrimental populist policies. This exacerbates imbalances, slows growth, and leads to policy uncertainty and market repricing.</p>	<p style="text-align: center;">Medium</p> <p>The economy has shown resilience to the recent macroeconomic challenges, while social discontent due to price increases and shortages linked to the War in Ukraine are expected to be limited given broad consensus on support for Ukraine.</p>	<p>Provide targeted support to mitigate the impact of higher living costs on the most vulnerable.</p> <p>Continue constructive dialogues among the stakeholders.</p>

Annex VI. Goeconomic Fragmentation and Trade in Finland

The world is undergoing deepening goeconomic fragmentation (GEF) after decades of economic integration. In this landscape, Finland is facing increased trade and investment barriers; with its major multinational enterprises at particular risk. Its reliance on China as a significant trade partner has increased over the past decades, including in the manufacturing and technology-intensive sectors. Notably, Finland's total "foreign production exposure," including direct and indirect inputs from China has not only increased substantially but also outpaced all other trade partners.

1. Goeconomic fragmentation (GEF) is the deliberate policy-driven move towards deglobalization that entails the disconnection of trade and investment between nations. This trend, primarily motivated by national security considerations, has gained momentum since 2020 with increasing trade and investment restrictions across the globe. GEF carries significant potential for welfare costs and repercussions on international trade. These ramifications encompass elevated import prices, fragmented markets, restricted technology access, labor inefficiencies, diminished productivity, and increased financial instability.



2. As a small open economy, reliant on international trade, Finland is particularly susceptible to GEF. Globalization has gone through ebbs and flows for Finland. Trade in goods peaked in 2007 for Finland before declining in the aftermath of the "Nokia Crisis" and then entered an era known as "slowbalization:" a prolonged slowdown in global trade growth. GEF risks exacerbating this process. Enterprises may opt to relocate their operations either domestically or to neighboring and "friendly"

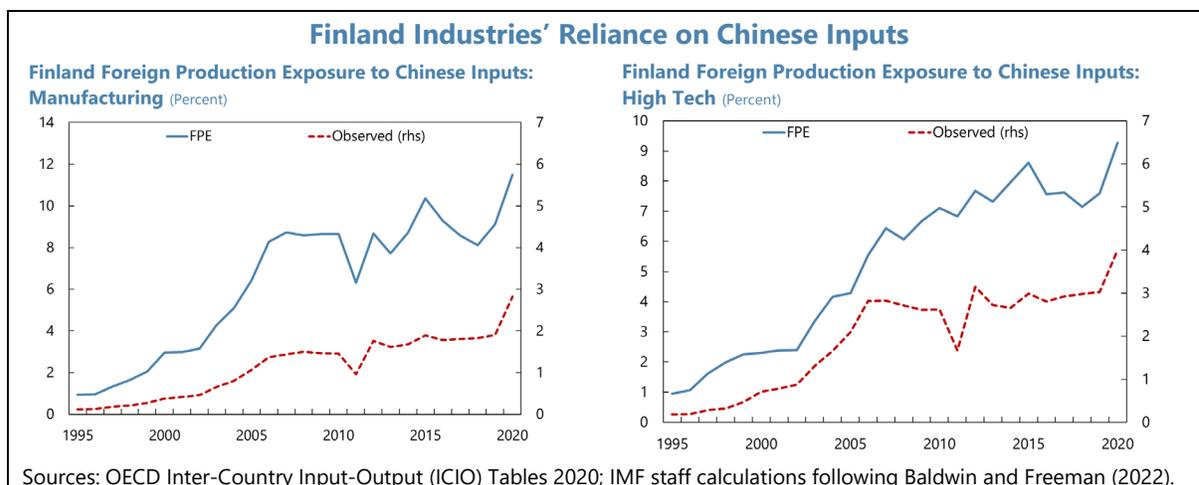


nations, aiming to mitigate supply chain vulnerabilities and bolster resilience. IMF studies find that the welfare impact of a moderate global fragmentation scenario would range between -0.75 and -0.9 percent of GDP on the Finnish economy.

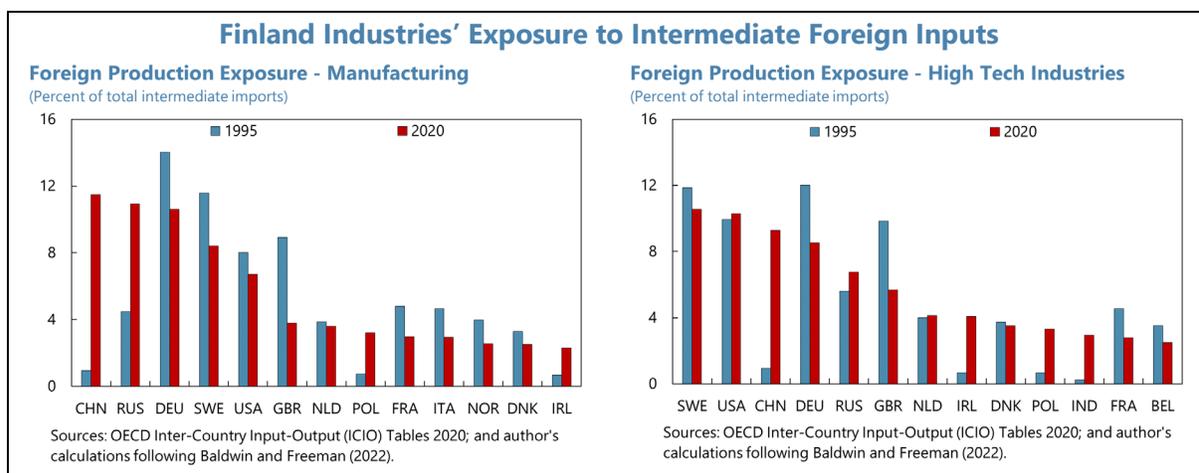
3. As noted by a recent BoF study, direct measures of trade suggest little evidence of fragmentation. Since 2017, gross trade (sum of imports and exports in final goods) has remained broadly stable with Finland's trading partners and hovered around 53 percent of GDP during the slowbalization era (except for 2022). Using this measure, trade patterns provide little evidence of GEF at least so far.

4. Nevertheless, fragmentation risks are high and China's role as a trade partner is underestimated by common measures of trade. A new metric, Total Foreign Production

Exposure (FPE), tracks all sequences of inputs to inputs, offering a more comprehensive perspective of trade reliance with other countries.¹ Finland's FPE to Chinese inputs has seen a significant surge over the past two decades across most industries, consistent with significant integration of the Chinese inputs into the global supply chain. Finnish manufacturing and high-tech sectors' "Observed" trade with China—intermediate imports as percent of gross production—have increased by less than 3 percentage points of total intermediate inputs since 1995, while their FPE have respectively increased by more than 10 and 8 percentage points since 1995, surpassing Germany as the largest provider.



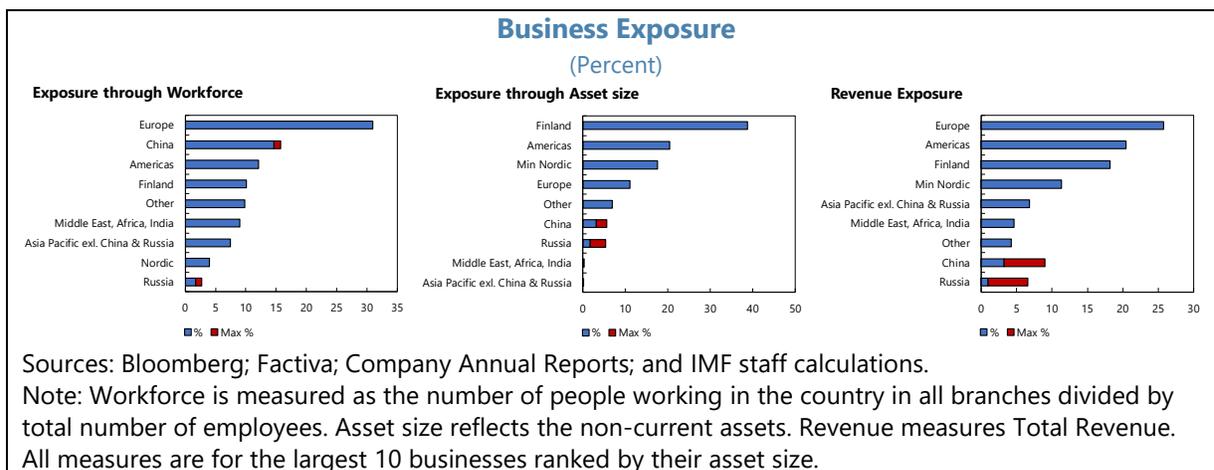
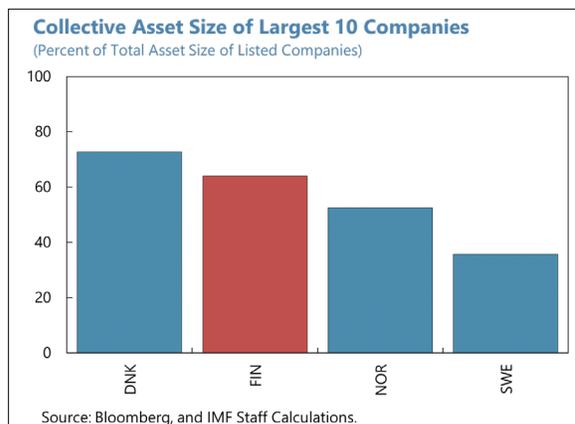
5. Although Finland's trade exposure to the US and EU is substantial, it has declined over the past decades. While reliance on intra-Nordic intermediate inputs has decreased in the past decades, reliance on only few countries (e.g., India, Poland, and Ireland) has increased besides China and Russia. The Finnish high-tech sector has also experienced similar trends in reliance on the Chinese inputs, though it has not yet surpassed all other countries.



¹ Total foreign production exposure is based on the Leontief gross trade matrix calculated from the OECD country input-output table. The matrix represents the required amount of total gross output from any source-country to produce an additional \$1 in any sector of the destination-country. The methodology was developed by Baldwin et al. (2022).

6. The business landscape in the largest multinational enterprises in Finland has considerable exposure to China and Russia.

Finland is home to few large companies (in particular, Nokia), where the top ten companies (ranked by their asset sizes) comprise 64 percent of total asset size of all listed Finnish companies. As of 2022, these largest companies collectively had substantial exposure to China and Russia in terms of their workforce, as well as their asset size and revenues.



7. Against these backdrops, Finland should consider policy measures to enhance supply chain resilience. These include diversifying suppliers and mitigating supply chain risks complemented with efforts to pursue an open and rules-based trading system, broaden trade and development partnership, and strengthen the EU’s single market. Structural reforms that focus on high-value-added sectors, addressing skilled labor shortages, and investing in technology and innovation can enhance Finland’s competitiveness. While a targeted de-risking strategy would be preferred to “outright decoupling”, continuous supply chain monitoring, including risk assessment and digitalization, and maintaining strategic reserves of critical goods is crucial to enhance preparedness and mitigate negative impacts against supply chain disruptions.

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Annex VII. Fiscal Consolidation

This annex presents key elements of the fiscal consolidation plan—spending, tax, employment, and public investment measures—in the Government Program (June 2023) and new measures—mostly loosening—in the 2024 budget and the medium-term fiscal plan (October 2023). Taken together, staff assess fiscal policy to be expansionary in 2024. In the medium term, as fiscal savings from additional employment begin to be realized—and helped by the public investment plan—the net growth impact would be positive. The plan will partially reverse the upward sloping debt trajectory but will fall short of stabilizing it.

A. Key Elements of the June 2023 Government Program

1. The medium-term fiscal consolidation plan in the new government’s program (June 2023) seeks to reverse the debt trajectory. The 4-year program—beginning 2024—envisages a fiscal adjustment of €6 billion (2 percent of GDP). The bulk of the adjustment is planned through spending cuts amounting to €4 billion (direct consolidation) and the remainder via fiscal gains from additional employment (indirect consolidation). The plan also includes tax measures and public investment (fully financed by asset sales)—these are neutral on budget in the aggregate.

2. Spending cuts seek to incentivize work and envision efficiency gains in health and social services. Cuts to social security and benefits include cuts and staggering of unemployment benefits, with an aim to incentivize work. Indexation of benefits would be frozen—mainly affecting housing allowance and student benefits—albeit with exemptions for the vulnerable (pensioners and the disabled). Most of the spending cuts to health and social services are not ex-ante or direct cuts, but rather assumed efficiency gains (about €900 million by 2027) that will be reallocated ex-post only after those gains are realized.¹

Table 1. Finland: Spending Reduction Measures¹
(EUR millions)

	2024	2025	2026	2027
Education, training & skills	36	74	111	144
Health and social services	135	413	826	1,303
Cost savings in wellbeing counties	0	236	581	874
Social security and benefits	777	1,069	1,116	1,201
Index-linked expenditure	169	307	411	519
Agriculture, forestry, environment	26	54	78	78
Business and industry, transport and housing	257	335	427	476
National defence, public security, migration & development cooperation	23	37	127	198
Administration	10	103	154	276
Total	1,433	2,392	3,251	4,195

Sources: Programme of Prime Minister Petteri Orpo’s Government June 2023.

^{1/}Spending reduction is relative to the Spring 2023 Technical Budget. The reduction in social security and benefits is net of corresponding reduction in tax income.

3. Tax measures, overall, are neutral on budget. Labor taxes will be reduced for low- and medium-income earners to increase employment resulting in a direct revenue loss of about €0.4 billion annually. Fuel excise will be lowered to offset the impact of re-increasing a distribution obligation to use certain percentage of (costlier) biofuels in transportation. The revenue impact from these measures will be fully offset by moving more items to higher VAT rates, raising real estate taxation, and increasing some other excises.

4. Employment measures are mostly tied to the spending and tax measures. For now, the government program has identified concrete measures to generate additional employment by 78,000 (out of the 100,000 envisaged). The employment impact will come from the spending and tax measures that seek to incentivize work. According to estimates in the government program, this would generate fiscal savings around €1.8 billion (0.7 percent of 2023 GDP) by 2027.

Table 2. Finland: Employment Measures

	Employment Impact		Fiscal Impact	
	Headcount	Percent change relative to 2023	Million euros	Percent of 2023 GDP
<i>Incentive trap elimination item</i>				
Increasing the employment condition for unemployment benefit to 12 months (in a 28-month period)	5,700	0.23	-	-
Grading of earnings-related benefit: 0 weeks 100%, 8 weeks 80%, 34+ weeks 75%	15,800	0.63	-	-
Monetary valuation of the employment condition	1,500	0.06	-	-
Restoring the periodisation of holiday compensation	2,200	0.09	-	-
Restoring the benefit waiting period to seven instead of five days	1,000	0.04	-	-
Ending accrual of the employment condition in pay-subsidised work	1,300	0.05	-	-
Abolishing child increases	10,000	0.40	-	-
Abandoning age-related dispensations in unemployment benefit	3,900	0.15	-	-
Subtotal	41,400	1.64	1,100	0.39
<i>Other Social Security and Taxation</i>				
Indexation measures for CPI/NPI-linked benefits	17,000	0.67	417	0.15
Reform of housing subsidies	1,900	0.08	50	0.02
Language requirement for labour market support	1,300	0.05	32	0.01
Reduction in taxation of labour	8,700	0.34	200	0.07
Abolition of adult education benefit	8,000	0.32	44	0.02
Abolition of job alternation leave	Minimal	-	-	-
Subtotal	36,900	1.46	743	0.26
Grand Total	78,300	3.10	1,843	0.66

Source: Programme of Prime Minister Petteri Orpo's Government, June 2023.

Note: Impact of employment and fiscal balances are by 2027.

5. Public investment seeks to offset the growth impact of fiscal consolidation. The plan entails public investment worth €4 billion to be fully financed by asset sales, so that it is neutral on the budget.

B. New Measures in the 2024 Budget and Medium-Term Fiscal Plan

6. Following the government program, the 2024 Budget and the medium-term fiscal plan (October 2023) envisage new measures, mostly loosening. War-related discretionary spending averages around ½ percent of GDP annually during 2024–27. Of the €4 billion investment plan, €600 million is already budgeted for the period 2024–26—this will be fully financed by funds from the Housing Fund of Finland. A reduction in unemployment insurance contribution will decrease revenues by around 0.2 percent annually. Revenue shortfalls are also due to non-discretionary items due to a deteriorating macroeconomic outlook (since the government program) and inflation-induced index adjustment of income tax brackets. On the other hand, spending reduction measures envisaged in the June government program will be partially implemented with the net effect of reducing the 2024 central government spending by €800 million.

C. Assessing the Growth Impact

7. Staff assess the growth impact by separately analyzing the impact of direct and indirect consolidation in the government program (June 2023).

- *Direct consolidation.* Using a fiscal multiplier of 0.8 (for calibration, see [IMF 2023](#)), the spending cuts in the government program—*ceteris paribus*—would result in growth downgrades of around 0.2 percentage points during 2024–27.
- *Indirect consolidation.* Staff assess employment gains to be backloaded given the weakness in economic activity and persistent labor market mismatches. We assume gains to start realizing only in 2025 (as the rebound in activity gains more momentum) rising to about 30,000 by 2027—well short of the 78,000 additional employment assumed in the government program. The impact of these additional employment on growth is assessed using an estimated Okun’s relationship for Finland. Along with the public investment budgeted so far, the additional employment would result in growth upgrade in the range of 0.1–0.3 percentage points during 2026–27.

8. Staff assess the fiscal plan to have an expansionary impact on growth, both in the near term and the medium term. The adverse growth impact of direction consolidation will be more than offset by the impact from the new loosening measures, resulting in a net growth impact that is mildly expansionary in the near term. Over the medium term, the offset will also come from the employment impact, which—along with the public investment—will result in a net growth upgrade of about 0.3 percentage points relative to the no policy change scenario.

D. Assessing the Fiscal Impact

9. Staff assess the fiscal gains from additional employment measures to be modest, around ¼ percent of GDP in 2027. The revenue gains would come mostly from additional

income tax with indirect tax (from implied larger consumption) making up the rest. These gains are smaller than envisaged in the government program (0.7 percent of GDP)—this mainly reflects the smaller employment gains assumed in the staff's assessment.

10. Taken together, the consolidation plan will partially reverse the upward-sloping debt trajectory but will fall short of reversing it. Staff do not incorporate the envisaged efficiency gains in health and social services as spending cuts in this area are not yet tangible. In addition to the smaller fiscal gains from additional employment, staff consider the impact of new spending and revenue shortfalls (after the government program was put in place). Debt will continue to rise over the medium term, but at a slower pace relative to the no-policy change scenario.

References

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Annex VIII. Debt Sustainability Analysis

Figure 1. Finland: Risk of Sovereign Stress

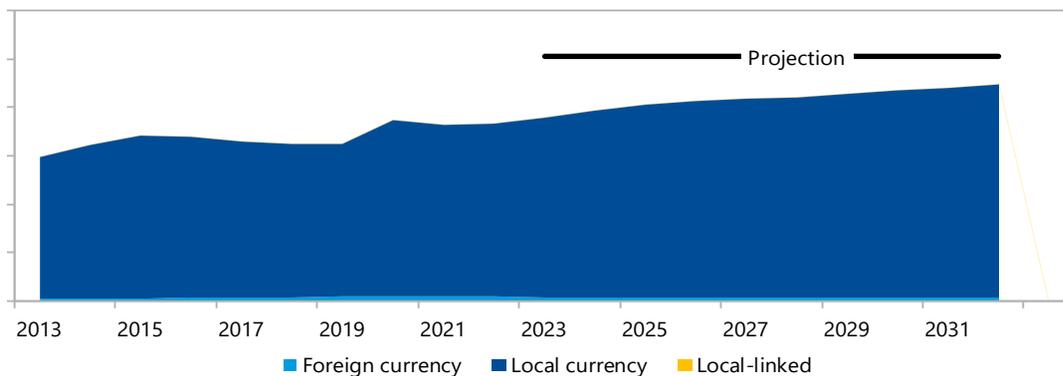
Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	Staff's assessment on the overall risk of sovereign stress is low, due to low risk of refinancing, relatively low debt, and diversified investors' base.
Near term 1/			
Medium term	Low	Low	Staff assesses the medium-term risk of sovereign stress as low, aligning with a low risk of refinancing. However, the mechanical medium-term signal from the fan chart suggests a moderate risk, predominantly due to a high probability of debt non-stabilization.
Fanchart	Moderate	...	
GFN	Low	...	
Stress test	Bank. Crisis Cont. Liabty.	...	
Long term	...	Moderate	Long-term risks are moderate as aging-related expenditures on health and social security feed into debt dynamics.
Debt stabilization in the baseline			No
DSA Summary Assessment			
<p>Commentary: Finland is at a low overall risk of sovereign stress and debt is sustainable. However, debt is expected to rise steadily for several years. The medium-term risk of debt non-stabilizing has stayed at high levels due to spending pressures. The liquidity risks as analyzed by the GFN Financeability Module are however low due to highly diversified investors' base. Over the longer run, Finland is affected by population aging which require a wide-ranging set of fiscal and structural reforms.</p>			
<p>Source: IMF staff calculations.</p> <p>Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.</p> <p>1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.</p>			

Figure 2. Finland: Debt Coverage and Disclosures

1. Debt coverage in the DSA: 1/						Comments							
		CG	GG	NFPS	CPS	Other							
1a. If central government, are non-central government entities insignificant?						n.a.							
2. Subsectors included in the chosen coverage in (1) above:													
Subsectors captured in the baseline						Inclusion							
CPS	NFPS	GG: expected	CG	1	Budgetary central government	Yes	Not applicable						
				2	Extra budgetary funds (EBFs)	No							
				3	Social security funds (SSFs)	Yes							
				4	State governments	Yes							
				5	Local governments	Yes							
				6	Public nonfinancial corporations	Yes							
				7	Central bank	Yes							
				8	Other public financial corporations	Yes							
3. Instrument coverage:						Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/			
4. Accounting principles:						Basis of recording		Valuation of debt stock					
						Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/			
5. Debt consolidation across sectors:						Consolidated		Non-consolidated					
code: ■ chosen coverage ■ Missing from recommended coverage ■ Not applicable													
Reporting on intra-government debt holdings													
		Holder		Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total	
CPS	NFPS	GG: expected	CG	1	Budget. central govt							0	
				2	Extra-budget. funds								0
				3	Social security funds								0
				4	State govt.								0
				5	Local govt.								0
				6	Nonfin pub. corp.								0
				7	Central bank								0
				8	Oth. pub. fin. corp								0
Total				0	0	0	0	0	0	0	0	0	
1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.													
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.													
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.													
4/ Includes accrual recording, commitment basis, due for payment, etc.													
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).													
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.													
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.													

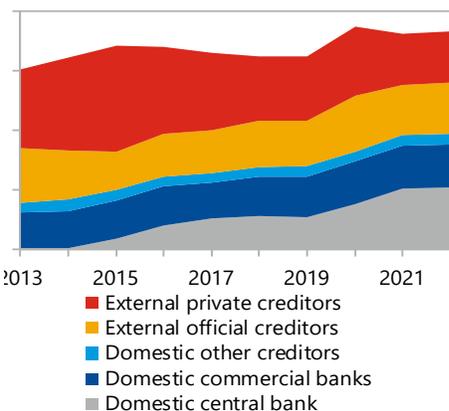
Figure 3. Finland: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



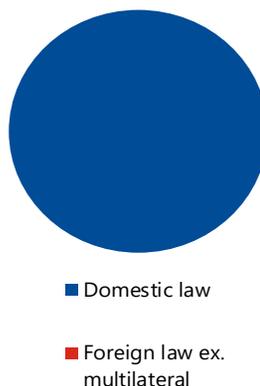
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



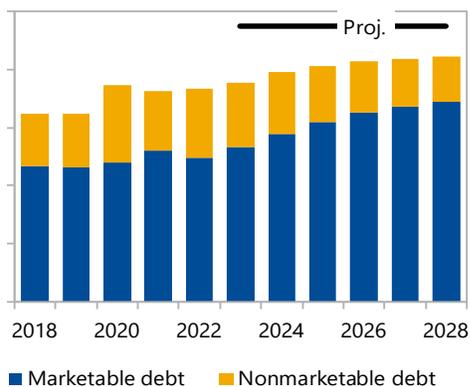
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2022 (Percent)



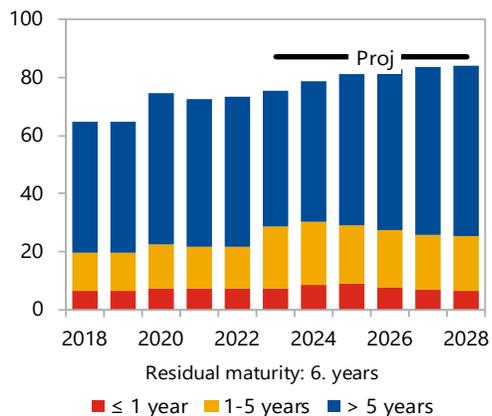
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)

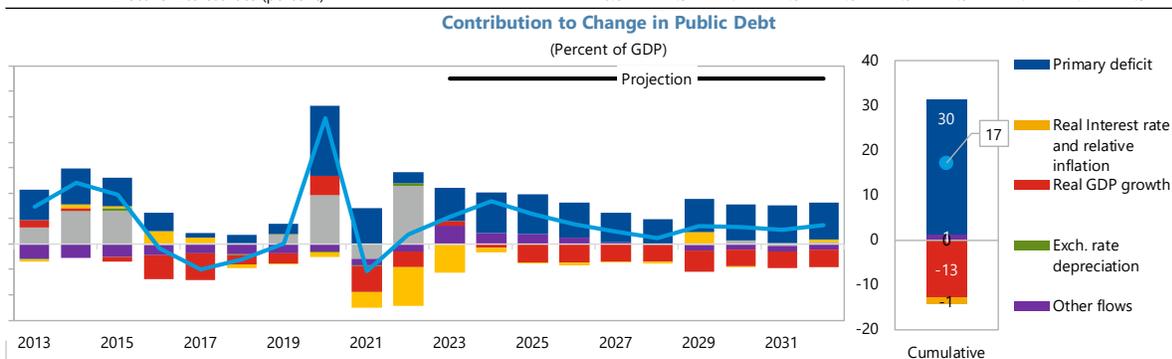


Note: The perimeter shown is general government.

Figure 4. Finland: Baseline Scenario

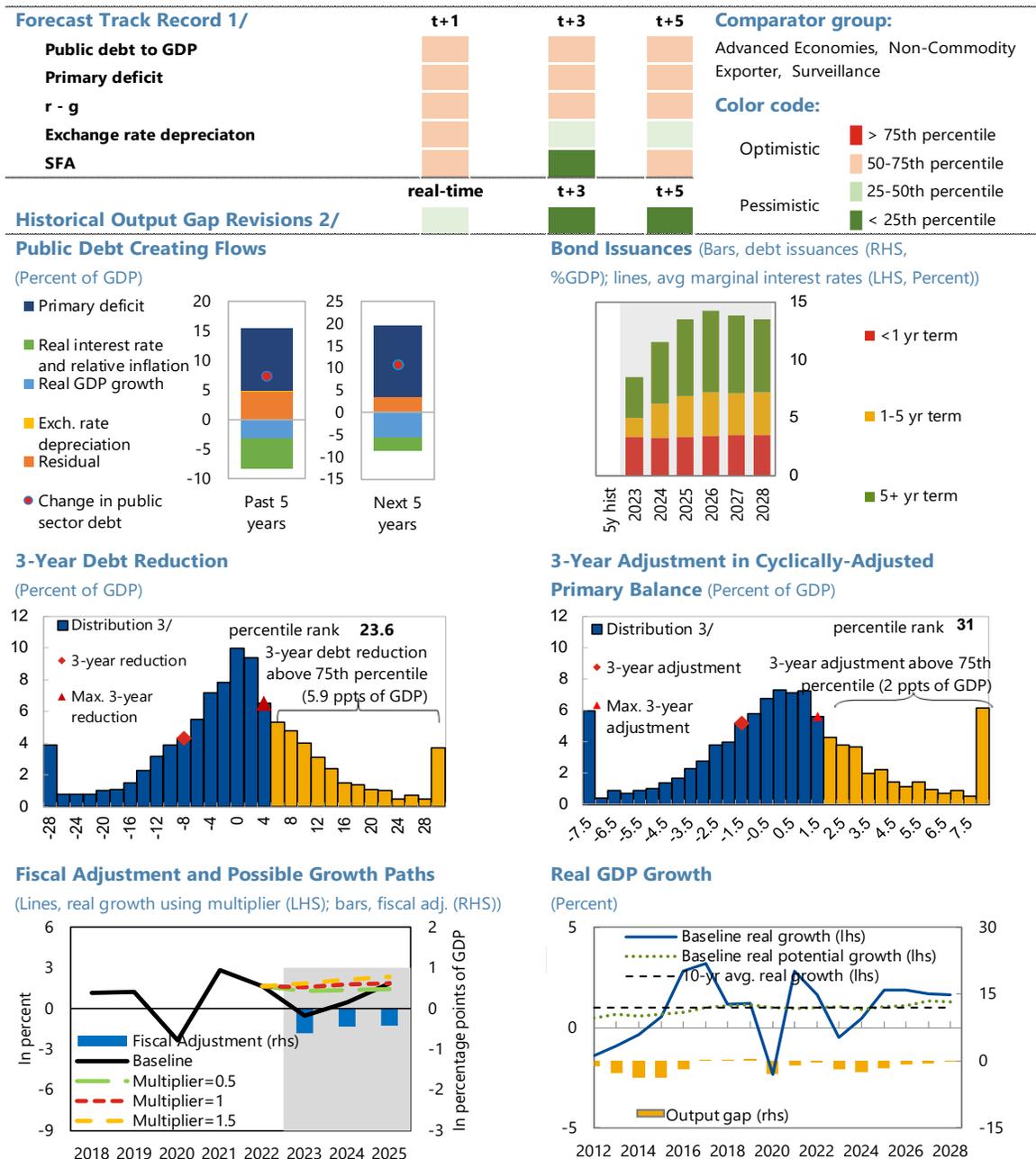
(Percent of GDP unless indicated otherwise)

	Actual		Medium-term projection					Extended projection				
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	
Public debt	73.3	75.5	78.9	81.2	82.8	83.7	84.2	85.6	86.9	88.0	89.5	
Change in public debt	0.8	2.1	3.4	2.3	1.6	1.0	0.4	1.4	1.3	1.2	1.5	
Contribution of identified flows	-3.8	2.2	3.4	2.3	1.6	1.0	0.4	1.5	1.0	1.3	1.3	
Primary deficit	0.8	2.6	3.2	3.1	2.7	2.4	2.0	2.6	2.8	3.0	2.9	
Noninterest revenues	52.0	51.6	50.6	50.4	50.1	49.9	49.7	49.4	49.4	49.5	49.6	
Noninterest expenditures	52.8	54.1	53.8	53.5	52.8	52.2	51.6	52.0	52.2	52.4	52.5	
Automatic debt dynamics	-4.0	-1.8	-0.7	-1.6	-1.7	-1.5	-1.5	-0.7	-1.3	-1.2	-1.1	
Real interest rate and relative inflation	-3.1	-2.2	-0.4	-0.1	-0.2	-0.1	-0.1	1.0	0.0	0.1	0.2	
Real interest rate	-3.1	-2.2	-0.4	-0.1	-0.2	-0.1	-0.1	1.0	0.0	0.1	0.2	
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Real growth rate	-1.2	0.4	-0.3	-1.4	-1.5	-1.4	-1.3	-1.6	-1.3	-1.3	-1.3	
Real exchange rate	0.2	...	...	...	...	...	...	...	...	...	...
Other identified flows	-0.6	1.4	0.9	0.8	0.5	0.1	-0.1	-0.4	-0.4	-0.5	-0.5	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
(minus) Interest Revenues	-0.6	-0.8	-1.0	-1.1	-1.2	-1.3	-1.4	-1.7	-1.7	-1.6	-1.6	
Other transactions	0.0	2.2	1.8	1.9	1.7	1.4	1.3	1.3	1.2	1.2	1.1	
Contribution of residual	4.6	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	0.3	-0.1	0.1	
Gross financing needs	12.1	7.4	10.8	12.8	13.7	13.6	13.4	13.7	14.3	14.9	15.4	
of which: debt service	11.9	5.6	8.6	10.8	12.2	12.5	12.8	12.9	13.2	13.5	14.1	
Local currency	n.a.	5.6	8.6	10.8	12.2	12.5	12.8	12.9	13.2	13.5	14.1	
Foreign currency	n.a.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Memo:												
Real GDP growth (percent)	1.6	-0.5	0.4	1.9	1.9	1.7	1.6	2.0	1.6	1.5	1.5	
Inflation (GDP deflator; percent)	5.4	4.6	2.2	2.0	2.0	2.1	2.1	0.9	2.2	2.2	2.1	
Nominal GDP growth (percent)	7.1	4.1	2.7	3.9	3.9	3.8	3.7	3.2	3.5	3.9	3.5	
Effective interest rate (percent)	0.8	1.5	1.7	1.8	1.8	1.9	1.9	2.1	2.2	2.3	2.4	



Commentary: Public debt is expected to continue growing in the medium and long term. This growth is mainly driven by recurrent primary deficits, which more than offsets the impact of stable positive growth.

Figure 5. Finland: Realism of Baseline Scenario



Commentary: Realism analysis does not point to major concerns as the projected fiscal adjustment and debt reduction are well within norms.

Source : IMF staff calculations.

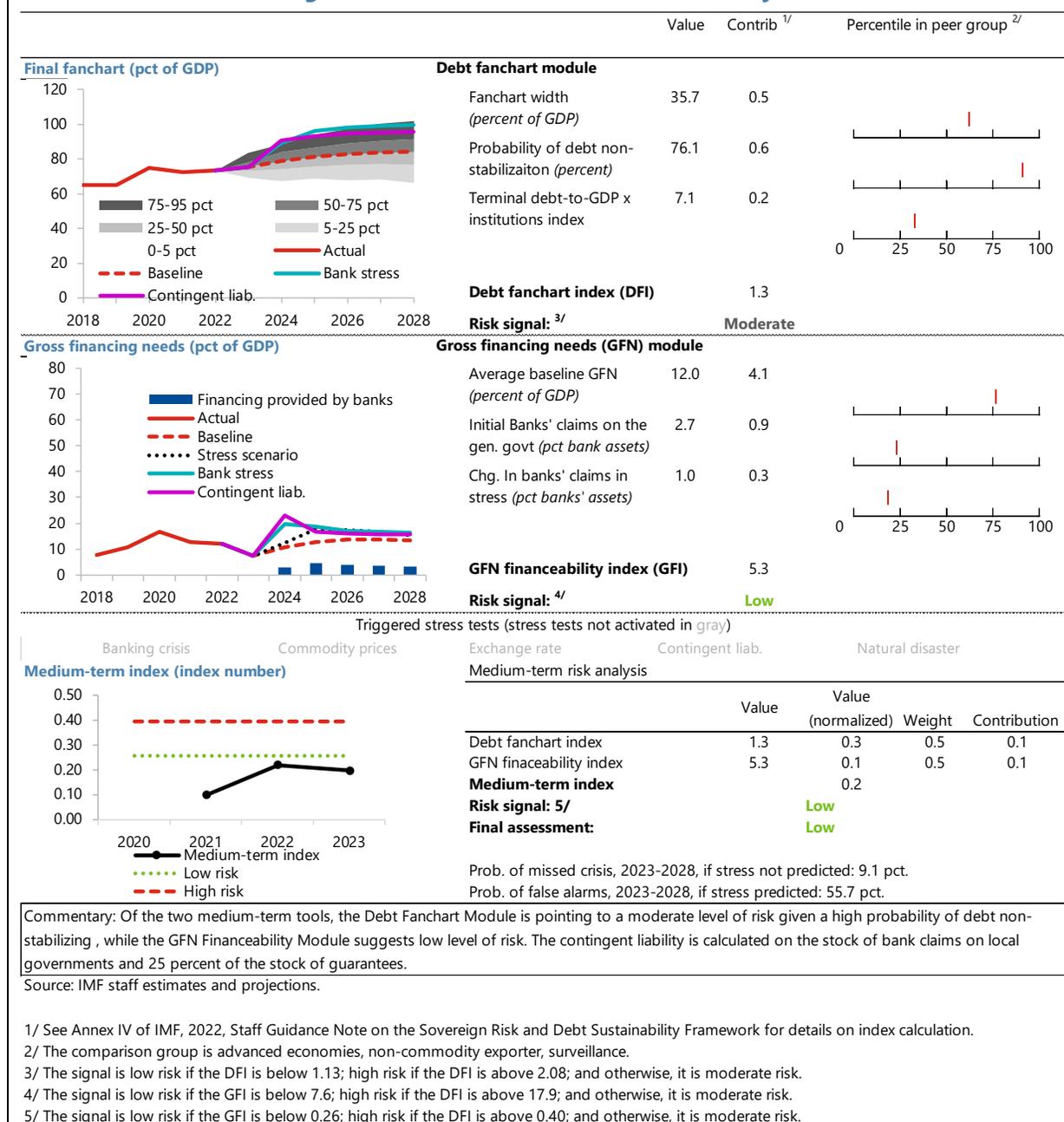
1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Figure 6. Finland: Medium-Term Risk Analysis



1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
 2/ The comparison group is advanced economies, non-commodity exporter, surveillance.
 3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
 4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
 5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Annex IX. FSAP Key Recommendations

Financial Sector Assessment Programs (FSAPs) are intended to help countries identify key sources of systemic risk in the financial sector and implement policies to enhance its resilience to shocks and contagion. An assessment under the FSAP was conducted in 2022. Its key recommendations were as follows.

Finland: FSAP Key Recommendations			
Recommendation		Authorities' Actions	Timing*
Oversight—Cross Cutting			
1	Strengthen the legal and operational framework for legal protection of officials, staff, and agents of all financial oversight agencies.	Not Implemented No plans to implement this measure.	NT
2	Secure FIN-FSA's independence by ensuring that: (i) future Board members have diverse background and experience in FIN-FSA's purview; (ii) they are not officials of Ministries; and (iii) a statement of the reasons for the dismissal of Director General and eligibility criteria for Director General is clearly in the law and publicly disclosed if a dismissal should ever take place.	Not Implemented Review of the national provisions regarding the FIN FSA's independence may take place once the CRD VI is transposed into national law.	NT
3	Increase the resources available to the FIN-FSA and other financial oversight agencies so that they are commensurate with their responsibilities and allow them to cover both traditional and emerging risks like ICT, cyber, and climate.	Partially Implemented The FFSA headcount and budget has grown, and the government has submitted a proposal to parliament regarding amendments to the Supervision Fees Act, increasing the supervision fees for FIN-FSA.	NT
Macroprudential Policy			
4	Consider providing the FIN-FSA Board with hard powers to issue regulations on macroprudential policy, including the adoption of new instruments; and/or semi-hard powers to issue recommendations on a comply or explain basis.	Not Implemented No plans to implement this measure.	MT
5	Add DTI and DSTI limits to the macroprudential policy toolkit; and introduce a positive rate of CCyB in the neutral stance.	Not Implemented There is no political consensus to legislate these measures.	MT
6	Enhance the systemic risk monitoring by strengthening the disaggregated data analysis, corporate sector vulnerability analysis and addressing existing data gaps.	Partially Implemented Implementing the positive credit register is expected to be fully operational in 2024. Micro-level data analyses are being produced more regularly for corporates and households.	MT

Recommendation		Authorities' Actions	Timing*
Systemic Risk Assessment			
7	Enhance liquidity buffers to cover a predetermined threshold of wholesale funding outflows over a five-day horizon.	Not Implemented The authorities agreed with staff's evaluation of risks stemming from the banking sector's high reliance on short-term wholesale funding.	NT
8	Lead an effort to conduct a Nordic-wide stress test coordinated exercise, considering interlinkages and spillovers, as well as liquidity-solvency interactions, and expanding the coverage to both banks and non-banking financial institutions.	Not Implemented The authorities promote this exercise and are assessing the pre-requisites and identifying the data gaps. They plan to present initial framework, including data sharing aspects, at a Nordic-Baltic Macroprudential Forum.	MT
Banking Regulation and Supervision			
9	Conduct further analysis on banks' IFRS-9 implementation, more specifically regarding staging of exposures and functioning of ECL models.	Partially Implemented Thematic analysis on IFRS9 staging and expected credit loss (ECL) was carried out in H1 2023. Credit risk analysis will remain a priority in 2024.	NT
10	Include rules on the appointment of a sufficient number of independent directors (supervisory board members) and independency criteria in the legislation.	Not Implemented FIN-FSA has submitted a proposal for legislative amendments to MoF. A discussion paper on the assessment and improvement of the existing legislation is expected by MoF in 2024.	NT
Nonbank Financial Institutions			
11	Amend PIC solvency regulations to remove remaining procyclical impacts and the short-term focus despite 2017 reforms and ensure that long-run performance to the benefit of all social partners drives the detailed regulations.	Not Implemented No changes to the regulation since FSAP assessment. However, the new government has set up a working group including parties in the labor market to consider the reform of regulation.	NT
12	Enhance the public disclosure of analysis and assessment of macroprudential risks in the NBFIs sector.	Not Implemented The authorities promote risk analysis related to NBFIs and internal analyses are planned for publication.	NT
Crisis Management			
13	Publish a policy on bail-in and transfer mechanics that addresses policy choices on valuation, issuance of new instruments and change in control requirements.	Partially Implemented FFSA has published a high-level document of the bail-in mechanic end-December 2023.	NT
14	Ensure that emergency liquidity assistance processes, procedures and operational capabilities are sufficient to support a rapid provision of temporary collateralized	Not Implemented	NT, C

Recommendation		Authorities' Actions	Timing*
	liquidity for FIs in resolution, tested internally and with external counterparties annually.	The authorities promote the implementation of this recommendation at the EU-level.	
15	Centralize cross-authority crisis coordination in the new Crisis Management Coordination Group and ensure its responsibilities include both preparation for, as well as management of, future crises.	Partially Implemented Common crisis management tasks, responsibilities and planning were centralized in 2023.	I, C
Financial Integrity			
16	Enhance AML/CFT supervision by improving the risk-based approach and tools for AML/CFT sectoral and institutional risk assessments, with a focus on risks from cross-border and non-resident transactions.	Partially Implemented Authorities have made progress in strengthening the AML/CFT. framework to mitigate risks posed by cross-border and non-resident activity, but more needs to be done in light of the recent regional Nordic-Baltic technical assistance project.	I
* Timing: C = Continuous; I = Immediate (within one year); NT = Near Term (within 1–3 years); MT = Medium Term (within 3–5 years).			

Annex X. Past Fund Staff Recommendations and Implementation

Past Staff Recommendations	Policy Actions
Fiscal Policy	
For 2023, fiscal policy should be supportive of monetary policy while prioritizing support to the vulnerable and security spending. A slightly tighter fiscal stance would strike a balance between containing aggregate demand and inflation pressures.	Not implemented. Fiscal policy in 2023 is expected to be expansionary, mainly driven by discretionary spending.
Over the medium term, fiscal consolidation needs to put the debt ratio on a declining path and make room for aging-related spending. Revisiting fiscal policy objectives and identifying specific measures would be critical for the medium-term consolidation plan.	Partially implemented. The medium-term fiscal consolidation plan in the new government program will slow the upward debt trajectory relative to no policy change. But it will fall short of reversing the debt trajectory as the consolidation plan is diluted by new spending and expected revenue shortfalls. The plan has specified consolidation measures which are broadly in line with previous staff's recommendation.
Continuing to close routes to early retirement for older workers and better targeting of in-work and out-work benefits would also help with fiscal savings. A margin of safety should also be maintained in the pension system, calling for a conservative approach to adjusting pension contribution rates.	Partially implemented. The government program seeks to cut out-of-work (unemployment) benefits. Routes to early retirement are being closed and targeting of in-work benefits is a future agenda. A government working group is studying the sustainability of the pension system, with a plan to conclude by early 2025.
Labor Market and Structural Policies	
To support employment and productivity, staff recommend more flexibility within the coordinated wage bargaining framework.	Not implemented. Wage agreements in the municipal and health sectors broke the tradition of following the private sector, having negotiated a premium over private sector wages. This weakened the wage coordination mechanism.
More should be done to increase employment by reducing work disincentives for women with care responsibilities, addressing skill shortages, improving access to tertiary education and attracting skilled foreign labor.	Partially implemented. No specific measures on home care benefits for women. In the new government program, there is the intention to address skill shortages. The authorities are planning further develop the Talent Boost initiative aimed at amplifying Finland's appeal to international talent and bolstering its workforce with specialized expertise.
The authorities should direct R&D tax incentives toward startups and SMEs where the impact of incentives will be the strongest.	Partially implemented. The new government has committed to increase R&D spending to 4 percent of GDP. There are no firm-size thresholds for R&D tax incentives.
Further measures are needed to achieve the ambitious and commendable carbon emissions objectives. Policies could include higher and better harmonized carbon prices (when energy prices subside from the current high levels) while addressing competitiveness and distributional concerns, and increased taxation of carbon-intensive peat production.	Partially implemented. The authorities plan to expand the production of cheap green energy, with the goal to help "re-industrialize" Finland. The authorities also plan to reduce fuel excises to offset the impact of re-introducing the distribution obligation. The authorities do not have a plan to expand carbon taxation in the near future. No progress on peat taxation.

Past Staff Recommendations	Policy Actions
Financial Sector and Macroprudential Policies	
The authorities should expand the macroprudential toolkit and legislate caps on debt-to-income (DTI) and debt-service-to-income (DSTI) ratios to help address borrower-side vulnerabilities from high household indebtedness.	Not implemented. The government package of macroprudential enhancements were implemented in 2023. The FIN-FSA Board recommendation to limit stressed debt-service-to-income (DSTI) ratio to 60 percent. However, no caps on DTI or DSTI ratios have been legislated by the government.
The authorities should strengthen capital requirements and reinstate systemic capital buffer requirements as circumstances allow.	Implemented. In addition to implementation of the already-planned increase in capital requirements, the authorities have reinstated a 1 percent systemic risk buffer (SyRB) on credit institutions to be in effect in April 2024.
In due time, legislate a positive neutral rate for the CCyB to increase resilience in the banking system.	Not implemented. FIN-FSA monitors the set of indicators to adjust the CCyB in response to a buildup of potential risks. However, regulatory changes are needed to impose a positive neutral CCyB.
Regulatory changes should encourage financial institutions to enhance liquidity buffers to cover a predetermined level in a wholesale funding outflow scenario and improve high-quality-liquid-assets.	Not implemented. There are no plans to implement these measures.
In line with the FSAP recommendations, the authorities should enhance the systemic risk monitoring framework and supervision of the financial system.	Partially implemented. Implementing the positive credit register is expected to be fully operational in 2024 which would help address the existing data gaps and strengthen the analysis of granular data for macroprudential analysis and policymaking. The government has submitted a proposal to Parliament regarding amendments to the Supervision Fees Act, increasing the supervision fees for FIN-FSA.
Advance the reform implementation, including by addressing ML/TF risks from non-resident and cross-border financial activity.	Partially Implemented. The Financial Supervisory Authority (FIN-FSA) has made amendments to regulations and guidelines and has announced to the EBA that it will comply with the new ML/TF guidelines.



FINLAND

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

February 20, 2024

Prepared By

European Department
(In Consultation with Other Departments)

CONTENTS

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FUND RELATIONS

As of December 31, 2023

Membership Status: Joined: January 14, 1948; Article VIII.

General Resources Account:	SDR Million	Percent Quota
Quota	2,410.60	100.00
Fund holdings of currency (Exchange Rate)	1,773.37	73.57
Reserve Tranche Position	637.23	26.43
Lending to the Fund		
New Arrangements to Borrow	5.71	
SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	3,499.96	100.00
Holdings	3,581.90	102.00

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to Fund¹

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2024	2025	2026	2027	2028
Principal	...	...	...	...	...
Charges/Interest	0.05	0.05	0.05	0.05	0.05
Total	0.05	0.05	0.05	0.05	0.05

¹ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Arrangements: The currency of Finland is the euro. The exchange rate arrangement of the euro area is free floating. Finland participates in a currency union (EMU) with 19 other members of the EU and has no separate legal tender. The euro, the common currency floats freely and independently against other currencies.

Finland has accepted the obligations under Article VIII, Sections 2(a), 3, and 4, and maintains an exchange system free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, except for those measures imposed for security reasons in accordance with Regulations of the Council of the European Union, as notified to the Fund in accordance with Decision No. 144-(52/51).

Article IV Consultation: The last Article IV consultation was concluded by the Executive Board on January 18, 2023. The staff report (IMF Country Report No. 23/38) was published with Press Release No. 23/09 (January 23, 2023).

Outreach: The team met with representatives of the private sector, academics, labor, and financial institutions.

Press conference: The mission held a press conference on January 23, 2024.

Publication: The staff report will be published.

Technical Assistance: None.

Resident Representative: None.

STATISTICAL ISSUES

(As of February 2024)

I. Assessment of Data Adequacy for Surveillance

General: Data Provision is adequate for surveillance.

National Accounts: Finland publishes the national accounts according to the European System of Accounts (ESA) 2010 since September 2014.

Price Statistics: Finland is fully compliant with best practices regarding price statistics.

Government Finance Statistics: Government finance statistics have been published based on ESA 2010 methodology since September 2014.

Monetary and Financial Statistics: Monetary data reported for *International Financial Statistics* are based on the European Central Bank's (ECB) framework for collecting, compiling, and reporting monetary data. Central bank and depository corporations surveys are reported using the standard report forms with monthly frequency. Bank of Finland reports data on some key series of the Financial Access Survey (FAS), including mobile and internet banking, and the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

Financial Sector Surveillance: Finland provides the Fund with quarterly financial soundness indicators (FSIs) which are published on the IMF website. The authorities include six more FSIs for deposit takers in their regular reporting to the Fund, in addition to the 14 core FSIs.

External Sector Statistics: Finland publishes external sector statistics based on the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* since December 2014.

II. Data Standards and Quality

Finland adhered to the Fund's Special Data Dissemination Standard Plus (SDDS Plus) on June 2018 and has met all SDDS Plus requirements since then. Finland publishes data on its [National Summary Data Page \(NSDP\)](#). Metadata are posted on the [Dissemination Standards Bulletin Board](#).

Finland received a mission to produce a Data module of the Reports on Observance of Standards and Codes (data ROSC) in October 2005. In this report the IMF assesses in detail the quality of the statistical systems of its member countries. The ROSC report for Finland can be accessed [here](#).

Finland: Common Indicators Required for Surveillance

(As of January 31, 2024)

	Date of latest observation	Date received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of publication ⁷
Exchange Rates	01/31/2024	01/31/2024	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	12/2023	01/2024	M	M	M
Reserve/Base Money	12/2023	01/2024	M	M	M
Broad Money	12/2023	01/2024	M	M	M
Central Bank Balance Sheet	01/2024	01/2024	M	M	M
Consolidated Balance Sheet of the Banking System	12/2023	01/24	M	M	M
Interest Rates ²	01/30/2024	01/31/2024	D	D	D
Consumer Price Index	12/2023	01/2024	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – –General Government ⁴	2022	09/2023	A	A	A
Revenue, Expenditure, Balance, and Composition of Financing ³ – –Central Government	2022	09/2023	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	12/2023	1/2024	M	M	M
External Current Account Balance	11/2023	01/2024	M	M	M
Exports and Imports of Goods and Services	11/2023	01/2024	M	M	M
GDP/GNP	2023:Q3	01/2024	Q	Q	Q
Gross External Debt	2023:Q3	01/2024	Q	Q	Q
International Investment Position ⁶	2023:Q3	01/2024	Q	Q	Q

1/ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

2/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

3/ Foreign, domestic bank, and domestic nonbank financing.

4/ The general government consists of the central government, including National Insurance Scheme, and local governments.

5/ Including currency and maturity composition.

6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

7/ Daily (D), weekly (W), monthly (M), quarterly (Q), annual (A), irregular (I); and not available (NA).