



FINLAND

January 2019

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR FINLAND

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 2018 Article IV consultation with Finland, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 11, 2019 consideration of the staff report that concluded the Article IV consultation with Finland.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 11, 2019, following discussions that ended on November 06, 2018, 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 December 17, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Finland.

The documents listed below have been or will be separately released.

Selected Issues

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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IMF Executive Board Concludes 2018 Article IV Consultation with Finland

On January 11, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Finland.¹

Finland is enjoying its third consecutive year of economic recovery. The employment rate has picked up sharply and the unemployment rate has declined to its lowest level since 2011. Wages have started to recover, but inflation remains low. Export market shares have improved slightly leading to a pickup in exports, while stronger tax revenues and lower spending, including on unemployment benefits, have improved fiscal balances. Growth in 2018 is expected to be 2.4 percent, then 1.9 percent in 2019 as global demand slows and financial conditions tighten. There are downside risks to this outlook, particularly from the global environment: an increase in protectionism could weaken demand for Finnish exports and damage confidence, and higher bank funding costs could mean tighter credit.

Recent reforms have boosted trade and employment. The 2016 Competitiveness Pact helped make Finnish exports more cost competitive. Changes to social benefits enhanced incentives to look for jobs, and new rules for temporary hires have the potential to boost employment and labor flexibility. Nevertheless, problems remain with productivity and the labor market. Firms are facing difficulties matching workers to job opportunities. Unemployment rates remain persistently high in some regions despite ample vacancies in others. Job mobility is low and has not picked up. Meanwhile, productivity growth is still below pre-crisis rates, despite the strength of the recovery.

The 2019 budget implies a moderate tightening of fiscal policy. The planned health and social services reform targets substantial savings from efficiency gains which, if realized, would make a substantial contribution toward closing the fiscal sustainability gap and restoring fiscal buffers.

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. 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 summing up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

That said, savings from the proposed reform are uncertain and will depend crucially on implementation.

The banking sector is sound but has distinctive features that pose challenges for supervision. Immediate financial stability risks appear limited, but the system is highly concentrated, interconnected with financial sectors of other Nordic countries, and reliant on wholesale funding. In addition, the size of the banking sector has increased substantially with the recent redomicile of Nordea to Finland. This has increased demands on supervision and heightens the importance of continued close regional cooperation and preparedness for crises.

Household financial vulnerabilities remain a concern. Household debt has been increasing as the economy has recovered, and some borrowers appear vulnerable to interest rate increases. The growth in consumer credit raises the question of whether some borrowers are sufficiently informed about the conditions of their loans.

Executive Board Assessment²

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the continued good economic performance but noted that growth is likely to slow next year as global demand moderates and financial conditions tighten. Given relatively modest potential growth, Directors stressed the need for structural reform, particularly in the labor market, and cautious fiscal policy. While sound overall, the financial sector's increased size and regional interconnectedness have increased the demands on supervision.

Directors welcomed recent reforms that have made Finnish exports more cost competitive and helped boost employment. They noted, however, that productivity growth remains below what was seen before the crisis. Therefore, Directors stressed the need for ongoing structural reforms and targeted infrastructure investment to bolster long-term productivity growth.

Directors agreed that the focus of structural reforms should be on increasing labor market dynamism while maintaining a strong safety net. This would call for increased wage flexibility at the firm level and further changes to unemployment benefits to foster increased job search. Directors also noted that efforts to increase regional labor mobility could help reduce regional disparities in unemployment rates.

² At the conclusion of the discussion, the Managing Director, as a 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>.

Given looming age-related spending pressures and contingent liabilities, Directors underscored the need to continue to rebuild fiscal buffers. Thus, they supported the moderate tightening implied by the 2019 budget and noted that fiscal policy should concentrate on raising the effectiveness of public spending, such as those proposed in the social services and health care reform.

Directors noted that the size of the banking sector has increased substantially with the recent redomicile of the largest financial group in the Nordic countries to Finland, increasing the demands on supervision and regional cooperation as well as crisis preparedness. While housing price increases have been relatively moderate, risks from the real estate sector should be monitored closely due to the high level of household indebtedness.

Directors also noted that growing reliance on consumer credit calls for additional consumer protection measures, such as better information disclosure requirements and interest rate caps. Macroprudential policies could be improved by the use of debt-based tools and access to better data, such as from a comprehensive positive credit registry.