



# FINLAND

January 2022

## 2021 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 2021 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 26, 2022 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 26, 2022, following discussions that ended on November 19, 2021, 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 January 7, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Finland.

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## IMF Executive Board Concludes 2021 Article IV Consultation with Finland

FOR IMMEDIATE RELEASE

**Washington, DC – January 31, 2022:** On January 26, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation<sup>1</sup> with Finland.

Finland experienced one of the smallest contractions in economic activity in 2020 among European countries, thanks to a successful containment strategy of the pandemic and a comprehensive policy response. The economic recovery in 2021 was strong, and output and employment are now above their pre-pandemic levels. Consumer prices increased markedly in 2021, reflecting the global rise in raw materials' prices and pandemic-related production bottlenecks. The current account has hovered around balance.

The recovery is expected to continue into 2022. Output is projected to grow at 2¾ percent in 2022, buoyed by private consumption and investment. Growth could be stronger with a faster unwinding of household savings, but pandemic-related risks to global growth remain high and could negatively impact Finland. Medium-term growth prospects are constrained by adverse demographics and low productivity—trends that precede the pandemic.

Fiscal policy during the pandemic provided timely and needed support. Pre-pandemic, the government embarked on an ambitious program to build a socially, economically and ecologically sustainable society, with additional spending financed largely through backloaded measures to boost employment. Public debt has increased to close to 70 percent of GDP and is projected to remain on an increasing trajectory in the medium term, as the current and planned employment measures will unlikely produce sufficient fiscal gains to bring the fiscal deficit back to its pre-pandemic level.

The financial system has weathered the pandemic well. Banks are well-capitalized, liquid, and profitable, and the lowering of structural capital buffer requirements at the onset of the pandemic provided additional lending and loss-absorbing capacity. But the banking sector is large and highly concentrated, and banks are highly exposed to residential and commercial real estate, the latter facing headwinds from the pandemic. The increase and changing composition of household debt has added to borrower-side vulnerabilities.

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<sup>1</sup> 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.

## Executive Board Assessment<sup>2</sup>

Executive Directors welcomed the authorities' swift and comprehensive policy response to the pandemic, which helped limit its health and economic impact. They noted that while an economic recovery is underway, supported by a high vaccination rate and a strong rebound in domestic demand, risks remain elevated amid high pandemic-related uncertainty. In this context, Directors agreed that macroeconomic policies should remain flexible, while structural reforms should continue to address longstanding challenges, including low productivity and an ageing population.

Directors recommended that fiscal policy should remain flexible in the near term, supporting the economic recovery as needed. Noting that public debt will remain on a rising trajectory and the need to prepare for aging-related pressures, they recommended a moderately faster and well-calibrated fiscal consolidation over the medium term, focused on expenditure reduction and guided by a spending review. Directors also underscored the importance of enhancing policy credibility by returning to the original spending limit in the context of medium-term fiscal adjustment.

Directors supported structural policies to boost employment and productivity. They encouraged prioritizing efforts to reduce labor market rigidities and improve the employment prospects of women with care responsibilities, improve tertiary education, and address skill shortages. They also highlighted the need for a more flexible wage bargaining system that supports employment and productivity. Directors commended the authorities for setting an ambitious target of net-zero greenhouse gas emissions by 2035, and called for a more comprehensive strategy to meet this goal. In this context, many Directors encouraged the authorities to consider the merits of implementable measures that strengthen carbon pricing, complemented with fiscal incentives, and informed by a deeper staff analysis on their social and sectoral impacts.

Directors welcomed the resilience of the financial system. They noted however that rising vulnerabilities in household finances and banks' high exposure to real estate warrant continued close monitoring. Directors also recommended additional measures to enhance macrofinancial resilience, including restoring structural capital buffers in the banking system to pre-pandemic levels. Further efforts are also needed to enhance the macroprudential toolkit, including through introducing targeted borrower-based measures and a positive neutral countercyclical buffer requirement in the medium term.

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<sup>2</sup> 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: Selected Economic and Social Indicators, 2019–2026

	2019	2020	2021	2022	2023	Projections			
						2024	2025	2026	2027
<b>Output and demand (volumes)</b>	(Percentage change, unless otherwise indicated)								
GDP	1.3	-2.9	3.4	2.8	1.5	1.3	1.3	1.3	1.3
Domestic demand	-0.4	-2.7	3.1	2.8	1.5	1.2	1.3	1.3	1.2
Private consumption	0.7	-4.7	3.8	3.7	1.4	1.3	1.3	1.2	1.2
Public consumption	2.0	0.5	3.3	-0.5	0.5	0.5	0.5	0.5	0.5
Gross fixed capital formation	-1.6	-0.7	1.0	4.1	2.6	1.6	1.8	1.8	1.8
Change in stocks (contribution to growth in percent of GDP)	-0.9	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	6.8	-6.8	4.6	5.0	3.4	3.3	3.2	3.2	3.2
Imports of goods and services	2.3	-6.5	3.6	4.9	3.3	3.3	3.2	3.2	3.2
Net exports (contribution to growth in percent of GDP)	1.7	-0.1	0.3	0.1	0.1	0.0	0.0	0.0	0.0
<b>Prices, costs, and income</b>									
Consumer price inflation (harmonized, average)	1.1	0.4	2.1	2.7	1.7	1.8	1.8	1.8	1.9
Consumer price inflation (harmonized, end-year)	1.1	0.2	3.8	1.7	1.7	1.8	1.8	1.8	1.9
GDP deflator	1.5	1.3	2.3	1.9	1.7	1.7	1.7	1.7	1.7
<b>Labor market</b>									
Labor force	0.3	-0.4	1.6	0.1	0.0	0.0	0.1	-0.1	-0.1
Employment	1.1	-1.5	1.6	1.2	0.0	0.1	0.1	0.1	0.0
Unemployment rate (in percent)	6.7	7.8	7.8	6.8	6.7	6.7	6.7	6.6	6.5
<b>Potential output and NAIRU</b>									
Output gap (in percent of potential output) <sup>1</sup>	0.2	-3.7	-1.4	0.0	0.1	0.0	0.0	0.0	0.0
Growth in potential output	1.3	1.0	1.0	1.4	1.4	1.3	1.3	1.3	1.3
<b>General government finances<sup>2</sup></b>	(Percent of GDP)								
Overall balance	-0.9	-5.4	-3.4	-2.1	-1.6	-1.6	-1.5	-1.5	-1.5
Primary balance <sup>3</sup>	-0.8	-5.3	-3.4	-2.2	-1.8	-1.7	-1.7	-1.6	-1.6
Structural balance (in percent of potential GDP) <sup>4</sup>	-1.0	-2.7	-2.5	-2.0	-1.7	-1.5	-1.5	-1.5	-1.5
Structural primary balance (in percent of potential GDP) <sup>5</sup>	-0.9	-2.6	-2.5	-2.2	-1.9	-1.7	-1.6	-1.6	-1.6
Gross debt	59.5	69.5	69.9	69.3	70.1	71.4	72.5	73.6	74.5
Net debt <sup>6</sup>	-62.6	-64.5	-57.6	-52.8	-49.6	-46.6	-43.7	-40.9	-38.2
<b>Money and interest rates</b>	(Percent)								
M3 (Finnish contribution to euro area, growth rate, e.o.p.)	10.2	...	...	...	...	...	...	...	...
Finnish MFI euro area loans (growth rate, e.o.p.)	5.3	...	...	...	...	...	...	...	...
3-month Euribor rate (percent)	-0.4	...	...	...	...	...	...	...	...
10-year government bonds yield	0.1	...	...	...	...	...	...	...	...
<b>National saving and investment</b>	(Percent of GDP)								
Gross national saving	23.8	25.2	24.7	24.7	24.9	24.8	24.9	24.9	24.9
Gross domestic investment	24.1	24.4	23.8	24.2	24.4	24.5	24.6	24.7	24.8
<b>Balance of payments</b>									
Current account balance	-0.3	0.8	0.8	0.6	0.4	0.4	0.3	0.2	0.1
Goods and services balance	0.2	0.3	0.5	0.3	0.3	0.3	0.3	0.4	0.4
Net international investment position	4.0	-5.8	-4.5	-3.7	-3.0	-2.5	-2.0	-1.7	-1.4
Gross external debt	224.2	225.1	225.4	222.3	222.9	222.1	221.6	221.0	220.4
<b>Exchange rates (period average)</b>									
Euro per US\$	0.89	...	...	...	...	...	...	...	...
Nominal effective rate (appreciation in percent)	-0.6	...	...	...	...	...	...	...	...
Real effective rate (appreciation in percent) <sup>7</sup>	-1.6	...	...	...	...	...	...	...	...

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

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

<sup>2</sup> Fiscal projections include measures as specified in the General Government Fiscal Plan.

<sup>3</sup> Adjusted for interest expenditures and receipts.

<sup>4</sup> Not adjusted for COVID-related one-off measures.

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

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

<sup>7</sup> CPI-based real effective exchange rates.



# FINLAND

## STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

January 7, 2022

### KEY ISSUES

**Context:** With strong policy support, Finland suffered a relatively mild economic contraction in 2020 followed by a swift recovery in 2021. Medium-term growth prospects are less strong, due to adverse demographics and low productivity growth—trends that precede the pandemic. Public debt has increased due to pandemic-related support and will remain on a rising trajectory in the medium term, largely reflecting permanent spending increases.

**Fiscal policy:** In the near term, fiscal policy should remain flexible, providing support as needed. But policy should gradually refocus on placing public finances on a stronger footing. A moderately faster than currently envisaged consolidation over the medium term would bring debt on a declining path. The adjustment effort should focus on reducing expenditure; additional measures to boost employment and growth—continuing to close routes to early retirement for older workers and better targeting of benefits—would also help. Returning to spending limits would enhance fiscal credibility.

**Structural policies:** Structural policies to boost employment and productivity remain key for bolstering potential growth, even though these may not result in immediate fiscal savings. These include improving employment among women with care responsibilities, improving tertiary education, and addressing skill shortages. The wage bargaining system should support employment and productivity.

**Climate policies:** A more comprehensive strategy is required to meet Finland's ambitious climate goal of net-zero emissions by 2035. This includes strengthening carbon pricing through higher and more harmonized pricing across sectors, reinforced by fiscal incentives across different sectors, including the use of feebates.

**Macroprudential and financial policies:** Targeted policies are required to address rising vulnerabilities in household finances. These include income-based measures for riskier borrowers and addressing features of the tax code that create investor preference for housing company loans. Capital requirements aimed at structural risks should be raised to pre-pandemic levels. A positive neutral countercyclical capital buffer requirement in the medium term would provide some macroprudential policy space.

Approved By  
**M. Pradhan (EUR) and**  
**M. Sommer (SPR)**

The hybrid mission took place virtually (November 8–10, 2021) and in Helsinki (November 11–19, 2021). The team comprised Salvatore Dell’Erba, Olamide Harrison, Raju Huidrom, and Wojciech Maliszewski (head, all EUR). Hannah Jung and Tan Wang (both EUR) assisted from headquarters. Mr. Pösö (OED) joined the discussions. The mission met with Ms. Saarikko, Minister of Finance; Mr. Rehn, Governor of the Bank of Finland; Mr. Majanen, Permanent Secretary of the Ministry of Finance; Ms. Tuominen, head of the FIN-FSA; other senior officials; the ECB; social partners; and representatives of the financial sector and academic communities.

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