INTERNATIONAL MONETARY FUND

IMF Country Report No. 25/10

FINLAND

January 2025

2025 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 2025 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 15, 2025 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 15, 2025, following discussions that ended on November 8, 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 December 12, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Finland.

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.

PRESS RELEASE

PR25/005

IMF Executive Board Concludes 2025 Article IV Consultation with Finland

FOR IMMEDIATE RELEASE

Washington, DC – **January 21, 2025:** On January 15, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Finland.

The Finnish economy is recovering from the 2023 recession, supported by easing inflation and real wage growth. However, the rebound is hindered by stagnant construction investment and weak external demand. Employment remains robust, driven by lower real wages, increased immigration, higher public employment, and increased participation rates. Inflation has temporarily fallen below 2 percent, reflecting declining energy prices and subdued domestic demand.

The economy is projected to have contracted by 0.3 percent in 2024 before rebounding to around 1½ percent in 2025, as private investment and consumption recover alongside easing interest rates and stabilizing house prices. External demand will pick up somewhat but will be offset by stronger imports. Risks remain tilted to the downside, with intensification of regional conflicts and geopolitical fragmentation. Structural challenges, such as adverse demographics and low productivity growth, weigh on the medium-term outlook. Supported by the recent VAT hike and recovering domestic demand, inflation is expected to stabilize around 2 percent in 2025.

Executive Board Assessment[2]

Directors welcomed Finland's strengthening growth momentum following the 2023 recession and the decline in inflation. However, the outlook is clouded by longstanding structural challenges, including from low productivity growth and aging population, and risks are tilted to the downside, particularly on the external front. To strengthen the economy's resilience, Directors highlighted the need to ensure fiscal sustainability and financial stability, while implementing structural reforms focused on boosting potential growth.

[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.

Directors commended the authorities' ongoing fiscal efforts, while emphasizing the need for additional consolidation to reverse public debt dynamics amid pressures from defense and aging-related spending. They concurred that the adjustment should involve both spending and revenue measures, while protecting productivity-enhancing spending, including public investments, education, and R&D.

Directors were encouraged by the resilience of the banking system but noted remaining pockets of vulnerability, including from high reliance on wholesale funding, household indebtedness, and cross-border risks. They welcomed the reinstatement of the systemic risk buffer and recommended further strengthening of the macroprudential toolkit. Directors commended Finland's initiative in conducting joint Nordic and Baltic-wide banking sector stress tests, and urged continued monitoring of financial stability risks related to non-bank financial institutions. They also encouraged further strengthening the AML/CFT framework.

Directors agreed that structural reforms are essential for enhancing Finland's potential growth. They welcomed the recent labor market reforms, and encouraged further efforts to increase labor force participation rates, reduce skill mismatches, and address the steep decline in average hours worked since the pandemic. Exploring further measures to improve productivity, including by easing access to risk capital, reviewing barriers to entry into the services sector, and promoting the deepening of the European Single Market, will also be key. Directors considered that strengthening the role of carbon sinks through additional policy measures, including taxes, will be important to help meet Finland's ambitious national climate mitigation targets.

Finland: Selected Economic Indicators, 2021–30										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
							Proj.			
Output and Demand (Volumes)				*(Percentage change, unless otherwise indicated)*						
GDP	2.7	1.5	-1.2	-0.3	1.5	1.5	1.4	1.3	1.2	1.2
Domestic demand	3.0	3.0	-4.2	-0.8	1.9	1.8	1.6	1.4	1.2	1.2
Private consumption	3.2	1.3	0.3	-0.4	1.0	1.1	1.1	1.1	1.1	1.1
Public consumption	3.9	-1.0	3.4	1.0	0.5	0.6	0.9	0.9	0.9	0.9
Gross fixed capital formation	1.7	2.6	-9.0	-6.6	4.2	3.8	3.5	2.7	1.8	1.8
Net exports (contribution to growth in percent of GDP)	-0.1	-1.7	3.1	1.2	-0.4	-0.2	-0.2	-0.1	0.0	0.0
Prices, Costs, and Income										
Consumer price inflation (harmonized, average)	2.1	7.2	4.3	1.0	2.0	2.0	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	2.0
Labor Market										
Participation Rate (15-74 years)	67.0	68.0	68.6	68.9	69.3	69.6	70.1	70.5	70.9	71.4
Employment	2.4	2.6	0.3	-1.1	0.5	0.4	0.5	0.6	0.6	0.6
Unemployment rate (in percent)	7.6	6.8	7.2	8.3	8.1	7.9	7.8	7.6	7.4	7.3
Potential Output										
Output gap (in percent of potential output)[1]	0.6	1.1	-0.9	-2.2	-1.5	-0.8	-0.5	-0.3	-0.2	0.0
Growth in potential output	0.9	0.9	0.9	0.9	0.8	0.8	1.0	1.1	1.1	1.0
General Government Finances[2]					*(Percent of GDP)*					
Overall balance	-2.8	-0.4	-3.0	-3.7	-3.2	-2.6	-2.3	-2.1	-2.1	-2.1
Primary balance[3]	-2.9	-0.4	-3.0	-3.9	-2.8	-2.0	-1.4	-1.0	-1.0	-1.0
Structural balance (in percent of potential GDP)[4]	-3.2	-1.5	-2.4	-2.2	-2.30	-2.1	-2.4	-2.5	-2.5	-2.5
Structural primary balance (in percent of potential GDP)[5]	-3.3	-1.5	-2.5	-2.3	-2.0	-1.5	-1.5	-1.4	-1.4	-1.4
Gross debt	73.1	73.9	77.0	81.6	84.2	85.3	85.9	86.6	87.4	88.2
Money and interest rates										
Domestic nonfinancial private sector credit growth (e.o.p.)	5.3	6.1	3.9	...	...	...	...	...	...	...
National saving and investment										
Gross national saving	25.1	25.3	22.4	21.3	21.9	22.5	22.9	23.3	23.5	23.7
Gross domestic investment	24.8	27.5	22.8	21.5	22.3	22.9	23.3	23.6	23.8	23.9
Balance of Payments										
Current account balance	0.3	-2.2	-0.4	-0.3	-0.4	-0.4	-0.4	-0.3	-0.2	-0.1
Goods and services balance	0.1	-1.9	0.3	0.8	0.5	0.4	0.3	0.2	0.3	0.3
Net international investment position	2.3	0.2	12.6	12.0	11.2	10.4	9.5	8.8	8.3	7.8
Gross external debt	209.6	215.7	215.3	214.8	211.7	209.2	206.6	204.5	202.4	200.3

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.

INTERNATIONAL MONETARY FUND

FINLAND

STAFF REPORT FOR THE 2025 ARTICLE IV CONSULTATION

December 12, 2024

KEY ISSUES

Recent developments and outlook. The economy has begun to recover from the 2023 recession, but the strength of the rebound is hindered by still weak construction investment and tepid growth among trading partners. Falling energy prices and weak domestic demand have temporarily reduced inflation below 2 percent. The economic recovery is expected to gain momentum in 2025, but downside risks, especially from abroad, remain elevated.

Fiscal policy. The economic downturn and increases in expenditure are expected to drive the fiscal deficit to 3.7 percent in 2024, further increasing public debt. The anticipated economic recovery, along with new consolidation measures, will reduce the deficit in 2025, but further effort is required to put debt on a downward trajectory. Staff suggest that the overall balance be gradually closed to around zero by 2029. Especially when the economy remains weak, fiscal adjustment should be carefully designed to limit the growth implications and supported by structural reforms to lift output over the medium-term.

Financial sector. Banks are well capitalized and have sufficient liquidity to withstand all but the most severe shocks. Despite weak growth and elevated interest rates, NPLs have remained low. Nevertheless, systemic risks remain, including from a reliance on wholesale funding markets, large cross-border exposures, and high household debt. The introduction of a positive neutral counter-cyclical capital buffer and a full set of borrower-based macroprudential measures would strengthen resilience further.

Structural reforms. Ambitious labor market reforms initiated in 2023 will continue to support employment as the economy recovers. However, there is potential to increase participation rates further, strengthen educational outcomes, and attract more high-skilled talent from abroad. While Finland performs well on many business and innovation metrics, deeper structural reforms are needed to raise productivity growth. Attention should be given to increasing the availability of risk capital, reducing barriers to entry into the services sector, and continuing to pursue the deepening of the EU's single market.

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

Mission took place virtually (October 24–25, 2024) and in Helsinki, Finland (October 29–November 8, 2024). The team comprised Alex Pienkowski (head), Takuji Komatsuzaki, Theodore Renault, Mauricio Vargas, and Seyed Reza Yousefi (all EUR). Rohan Srinivas and Rachelle Vega (all EUR) assisted from headquarters. Ms. Karhapää (OED) joined the discussions. The mission met with Mr. Rehn, 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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ANNEXES

CONTEXT

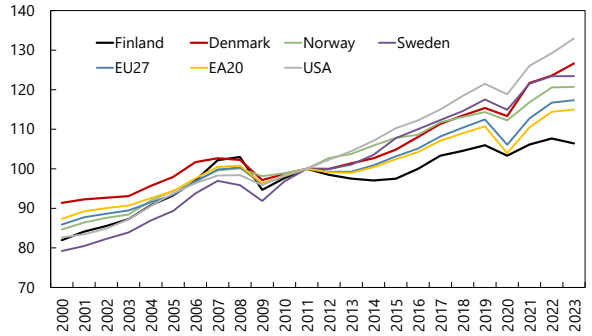
1. Growth in Finland has lagged its peers over the last decade. Following strong growth in the 2000s, the Global Financial Crisis (GFC) triggered a steep fall in economic activity. After a partial recovery, cumulative growth—at only 7 percent since 2011—has been well below its peers. Part of this was driven by stagnation in total hours worked, but most is attributed to weaker labor productivity growth (Annex I).

2. Public and private debt also increased significantly over this period. Over the last fifteen years, public debt increased by over 40 percent of GDP, as spending outpaced economic growth. Despite a recent decline, household indebtedness has also increased considerably, driven by consumer credit and housing-related[1] loans.

Background

Since the GFC, growth in Finland has lagged its peers …

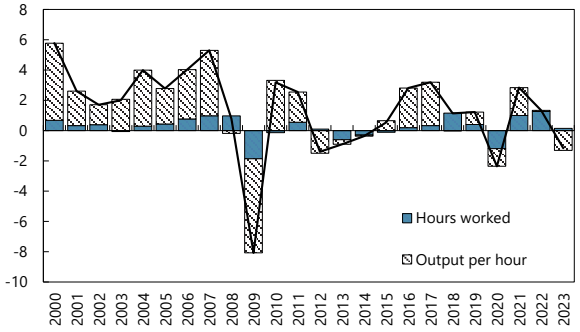
Real GDP
(Index, 2011=100)



Sources: Haver Analytics; and IMF staff calculations.

… driven by a steep slow-down in labor productivity.

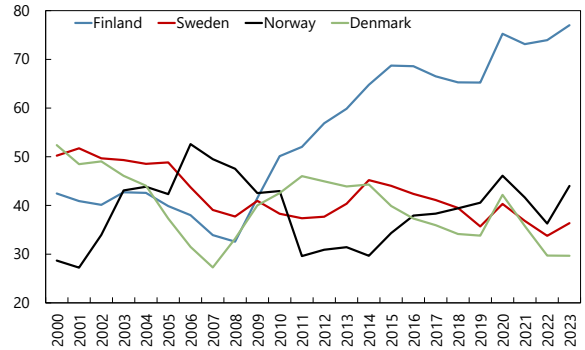
GDP Growth
(Percent change)



Sources: Eurostat; and IMF staff calculations.

Over this period, there has been a steep increase in public debt …

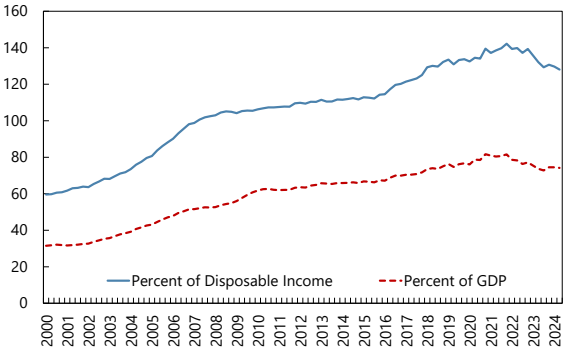
Gross Public Debt
(Percent of GDP)



Sources: IMF World Economic Outlook; and IMF staff calculations.

… and household liabilities.

Household Liabilities
(Percent)



Sources: Eurostat; and IMF staff calculations.

[1] These loans encompass housing company and mortgage loans.

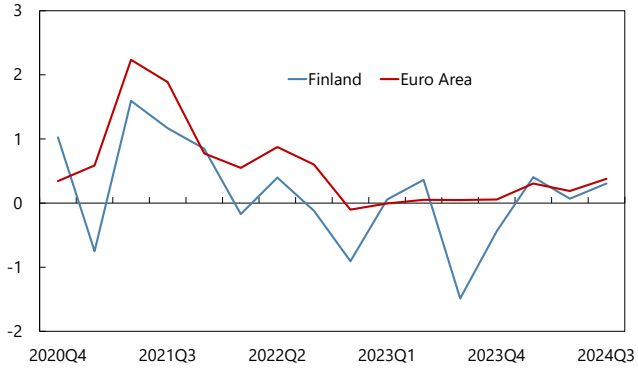
RECENT ECONOMIC DEVELOPMENTS

3. Finland experienced a hard landing in 2023 and only a shallow recovery since. Output fell by 1.2 percent in 2023 followed by a weak rebound in 2024Q1–Q3, with growth averaging only 0.3 percent, q.o.q. Weak trading partner growth, a collapse in house prices, the unwinding of elevated inventories, and tight monetary conditions all contributed to this weak economic situation. Indeed, there is some evidence that monetary transmission may be stronger in Finland than the euro area average given Finland's high share of variable rate mortgages (Annex I, 2024 Article IV). Investment—especially in construction—has been particularly hard hit, while consumption has shown more resilience. More recently, activity was support by a pick-up in exports and higher public consumption, but high-frequency indicators remain subdued (Figure 1).

The Post-Pandemic Recovery

Following a post-pandemic bounce-back, growth has fallen in several quarters, and is well below the euro area average.

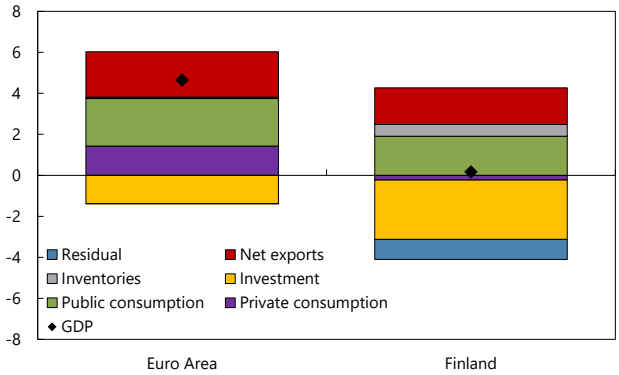
Quarterly Real GDP Growth
(Percent, QoQ)



Sources: Haver Analytics; and IMF staff calculations.

This weak performance was driven by a steep decline in investment and tepid private consumption growth.

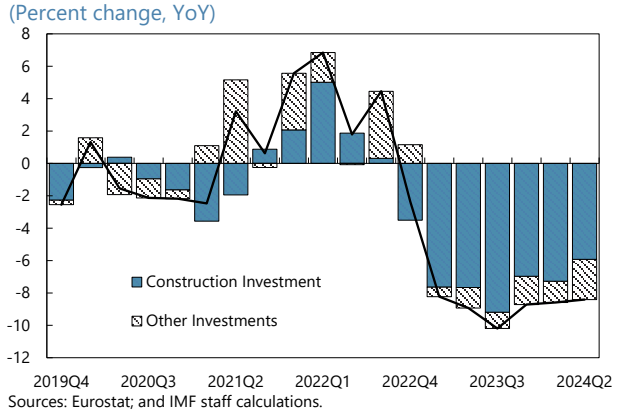
Real GDP Growth
(Percent change, 2019Q4-2024Q3)



Sources: Haver Analytics; and IMF staff calculations.

Construction investment collapsed under pressure from higher interest rates and weak economic activity.

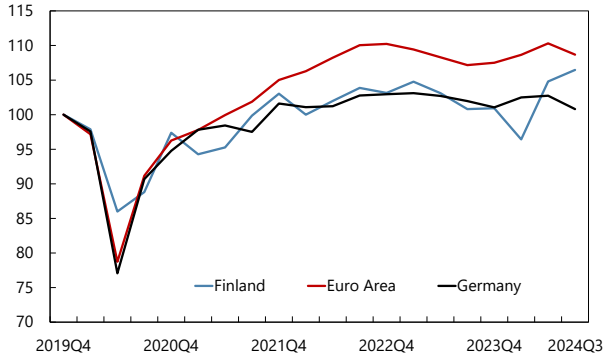
Investment
(Percent change, YoY)



Sources: Eurostat; and IMF staff calculations.

Export volumes have stagnated on the back of weak trading partner growth and a long-term decline in market share.

Export Volumes
(Index, 2019Q4=100)



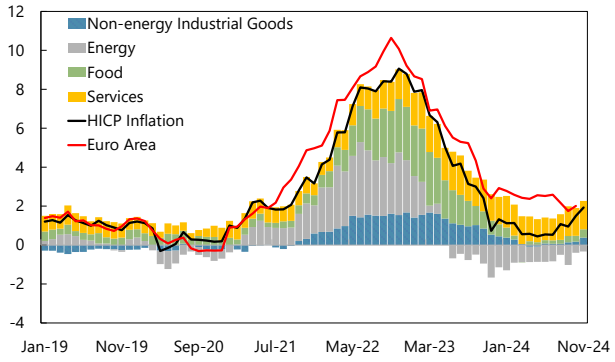
Sources: Haver Analytics; and IMF staff calculations.

4. Falling energy prices and weak domestic demand pushed inflation below 2 percent. 12-month headline inflation reached 1.5 percent in October 2024, driven by falling energy prices and moderating core inflation (2.3 percent) from weak domestic demand. The correction of a double-counting error in the price of electricity, which temporarily reduced HICP inflation by 0.7 percentage points, dropped out of the annual measure in August 2024. As of 2024Q3, real wages grew by 1.5 percent over the previous 12-months, but a decline in corporate profits prevented further inflationary pressure.

Inflation

Inflation fell sharply in 2023 as energy prices declined and goods prices stabilized.

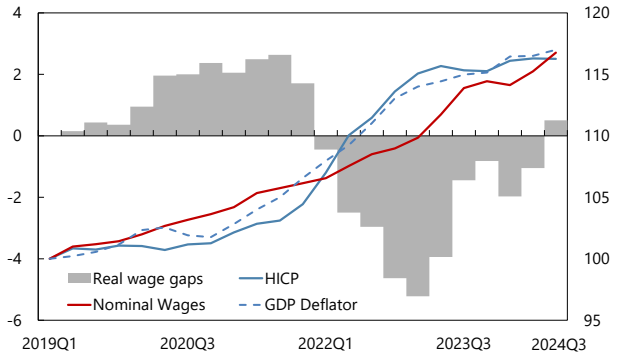
Contribution to Headline Inflation
(Percent, annual change)



Sources: Haver Analytics; and IMF staff calculations.

As in the rest of the Euro Area, nominal wage growth accelerated in 2023, supporting a recovery in real wages.

Nominal Wages and Prices (HICP)
(Index, 2019Q1=100)



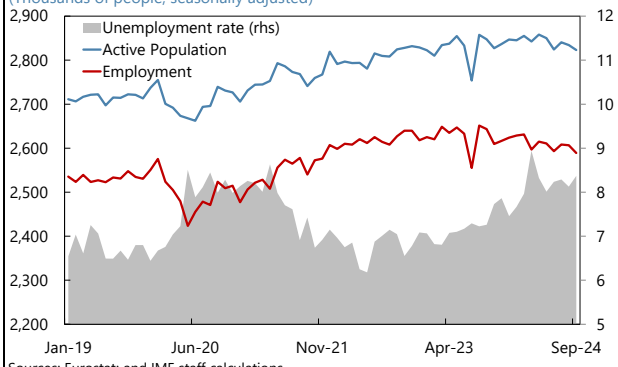
Sources: Statistics Finland; Haver Analytics; and IMF staff calculations.

5. Despite a recent dip, employment growth has been strong since the pandemic. Employment has increased by around 3 percent since 2019, supported by higher immigration, greater public employment, and increased participation rates (Figure 2). The recent decline in employment is concentrated in the construction sector. Despite higher employment, total hours worked increased by less than 1 percent, as a result of a large drop in *average* hours worked, particularly among full-time workers, with the largest impact from high-skilled women (Annex II).

Labor Markets

The unemployment rate increased in recent months, but employment remain relatively high.

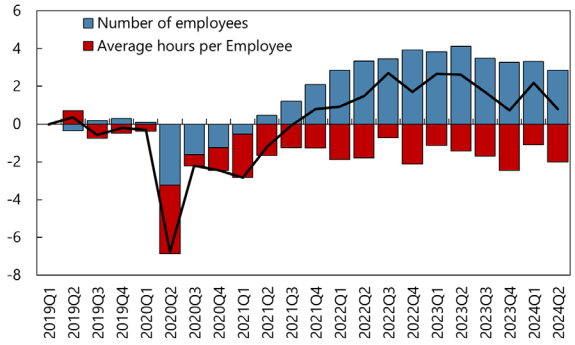
Labor Market Indicators
(Thousands of people, seasonally adjusted)



Sources: Eurostat; and IMF staff calculations.
Note: Data for workers between 15-74 years old.

However, the growth in the number of workers has been partly offset by the decline in average hours worked.

Total Hours Worked
(Percent change since 2019Q1)



Sources: Eurostat; and IMF staff calculations.

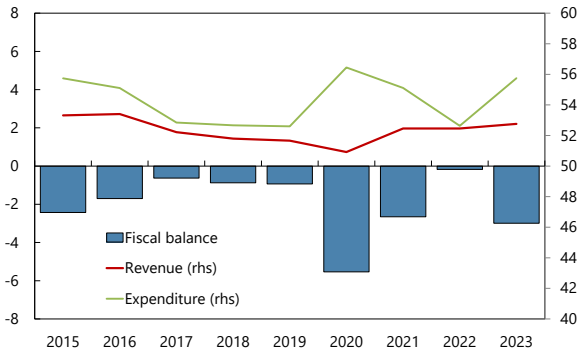
6. The fiscal deficit deteriorated to 3 percent in 2023. In addition to cyclical factors, this fiscal deterioration was driven by an increase in expenditures associated with defense and immigration-related spending, higher goods and services prices, rising interest payments, and pressure from local government health and social services, through the newly formed "Wellbeing Service Counties". As a result, public debt, which is already higher than Nordic peers, increased to 77 percent of GDP (Annex III).

Fiscal

Higher expenditure increased the fiscal deficit …

Revenue, Expenditure, Overall Balance

(Percent of GDP)

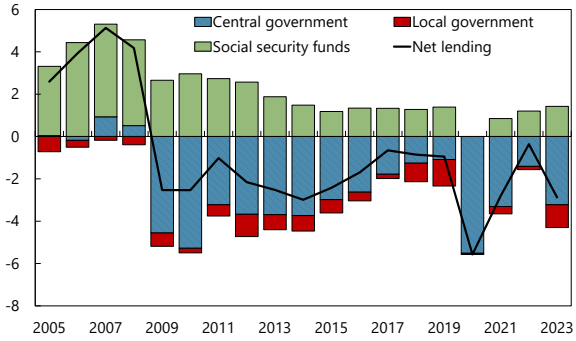


Sources: Haver Analytics; and IMF staff calculations.

… in both central and local government.

General Government Financial Balance

(Percent of GDP)



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

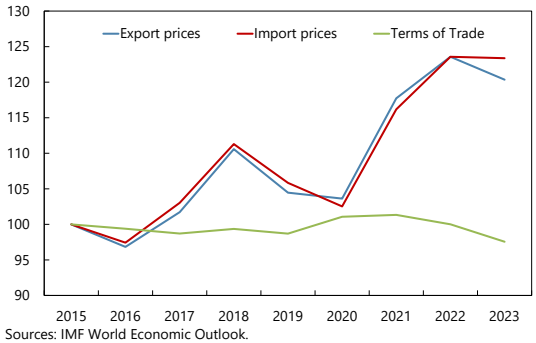
7. A positive shift in the goods and services balance led to an improvement in the 2023 current account. Despite export volumes staying flat in 2023, weak domestic demand caused import volumes to fall by 7 percent. Despite a modest deterioration in the terms-of-trade, the overall trade balance improved significantly. The primary income balance continued to weaken as investment income *outflows* increased from a sharp drop after the pandemic. Taken together, the current account balance experienced substantial improvement to -0.4 percent of GDP in 2023. Data up to 2024Q3 suggest the current account will remain at a similar level. The external position for 2024 remains moderately weaker than the level implied by fundamentals and desirable policies (Annex IV).

External Sector

In 2023, export prices decreased more quickly than import prices, resulting in a small weakening of the terms of trade.

Trade Prices

(Index, 2015=100)

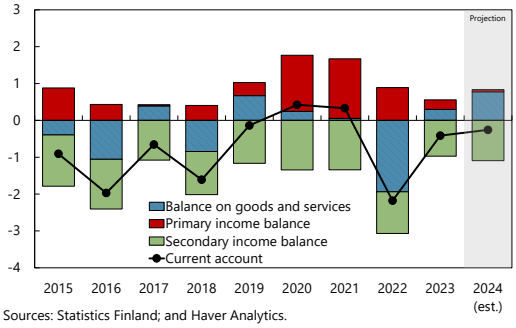


Sources: IMF World Economic Outlook.

But weak domestic demand led to a significant reduction in import volumes, supporting the current account.

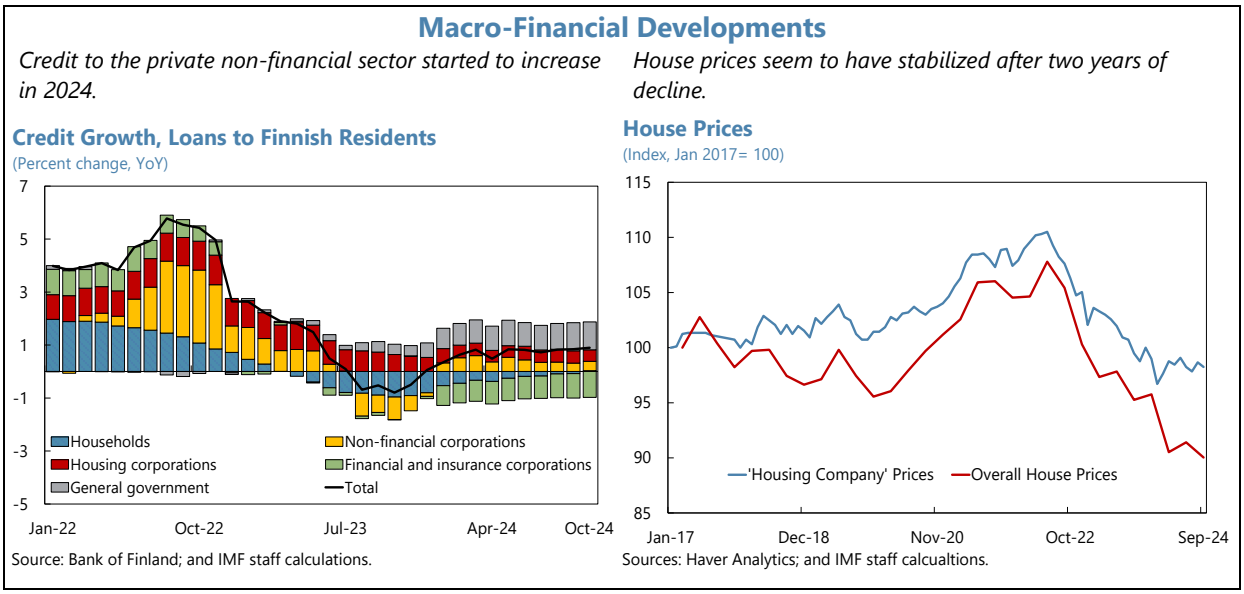
Current Account and its Components

(Percent of GDP)



Sources: Statistics Finland; and Haver Analytics.

8. Credit has started to grow and house prices appear to have stabilized. Domestic credit growth ticked up from -0.8 in October 2023 to 0.9 percent in October 2024, yoy, amid easing financial conditions but still weak economic activity (Figure 3). Concurrently, lending rates on new bank loans have begun to decline. There are tentative sign house prices have stabilized, supported by a modest recovery in mortgage lending and increased residential real estate activity (Figure 4). Credit indicators, including credit-to-GDP gaps, continue to be below trend, indicating no signs of growing upside cyclical risks.



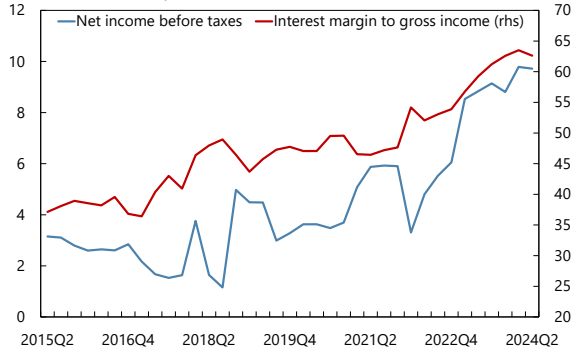
9. The financial sector has shown resilience during the economic downturn. The quality of bank credit portfolios deteriorated modestly, as higher debt servicing costs and weaker growth led to an uptick in bankruptcies. Non-financial corporate (excluding housing companies) NPLs also increased, especially in the construction sector, but remain low in aggregate at 2 percent of total loans. Meanwhile, net interest margins and net income remain high, supporting profitability. Banking sector tier 1 capital ratio surpassed 19 percent and the leverage ratio was above 6 percent in 2024Q2, both above EU averages (Figure 5). The liquidity coverage ratio of banks stood at around 170 percent, on average, exceeding the regulatory requirements.

Financial Sector

Bank profitability has been boosted by still-high net interest margins

Net Income and Interest Margin

(LHS: EUR billion; RHS: percent)

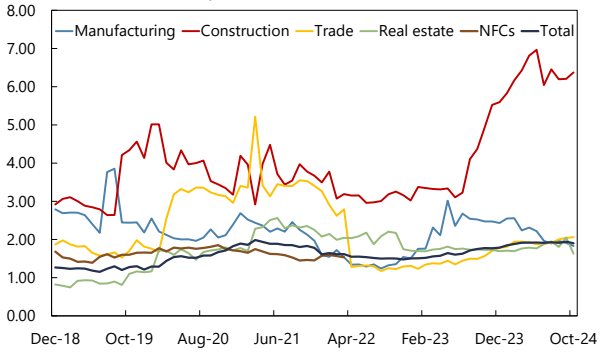


Sources: IMF Financial Soundness Indicators; and IMF staff calculations.

Non-performing corporate loans in the construction sector have started to decline from their peak.

Non-Performing Loans

(Percent of net domestic corporate loans in selected industries)

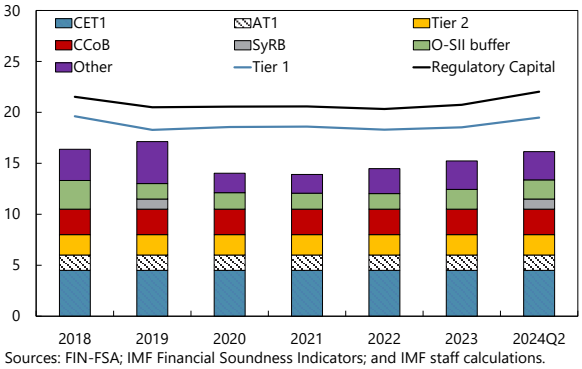


Source: Bank of Finland.

Banks' regulatory capital is well above the requirements…

Regulatory Capital

(Percent of RWA, all banks)

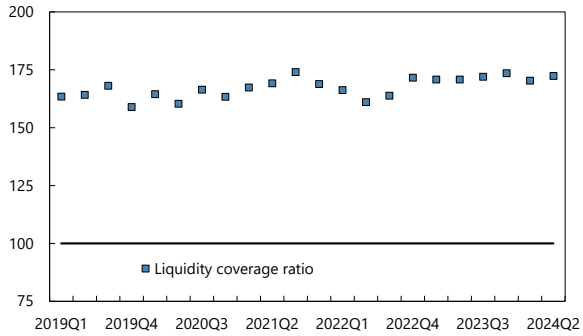


Sources: FIN-FSA; IMF Financial Soundness Indicators; and IMF staff calculations.

…and liquidity remains high.

Liquidity Coverage Ratio

(Percent; all banks)



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

OUTLOOK AND RISKS

10. A stronger recovery in 2025. Growth in the final quarter of 2024 is expected to have been positive, but a large negative carry-over from the previous year implies a slightly negative GDP outturn in 2024. Construction investment will recover slowly (Box 1), but an increase in infrastructure and defense spending will support relatively strong investment growth from a low base. Private consumption will grow modestly as house prices stabilize and monetary policy eases, with lower interest rates expected to raise credit growth. While a limited pick-up in

Key Macroeconomic Indicators

(Percent)

	2022	2023	2024	2025	2026
GDP Growth	1.5	-1.2	-0.3	1.5	1.5
Output Gap (% of Potential GDP)	1.1	-0.9	-2.2	-1.5	-0.8
Unemployment Rate	6.8	7.2	8.3	8.1	7.9
Inflation (avg)	7.2	4.3	1.0	2.0	2.0
Current Account (% of GDP)	-2.2	-0.4	-0.3	-0.4	-0.4

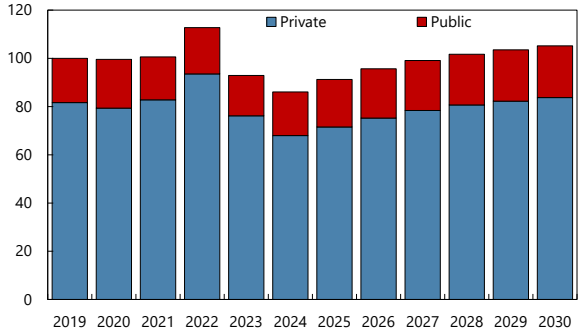
Source: IMF World Economic Outlook; and IMF staff calculations.

external demand is expected, the impact on net trade will be offset by stronger imports. As the energy prices stabilize, HICP inflation is expected to return to around 2 percent in 2025.

11. Risks are tilted to the downside. External downside risks dominate the outlook, and include: an escalation of Russia's war in Ukraine; adverse shock in other Nordic countries, including in the real estate market; greater geoeconomic fragmentation (see Annex VI of the 2024 Article IV Consultation), commodity price volatility or further tightening of global financial conditions (Annex V). However, domestic risks are more positive and include a faster recovery in output, potentially from higher investment and innovation from the green transition, a further expansion of the vibrant ICT sector, or stronger employment growth associated with the government's recent reforms.

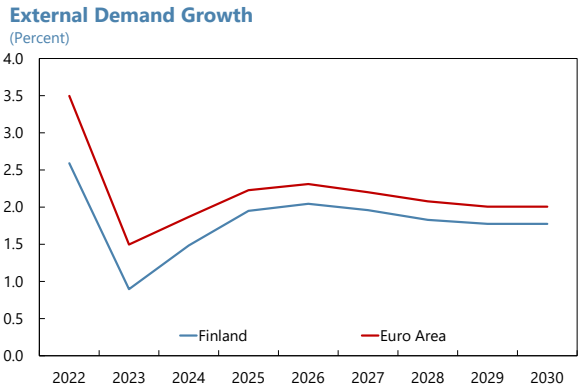
Growth Narrative

While investment is expected to recover, it will not return to pre-pandemic levels until 2027.



Sources: IMF World Economic Outlook; and IMF staff calculations.

External demand will recover but will remain below the euro area average.



Sources: IMF Global Economic Environment Database.

Authorities' Views

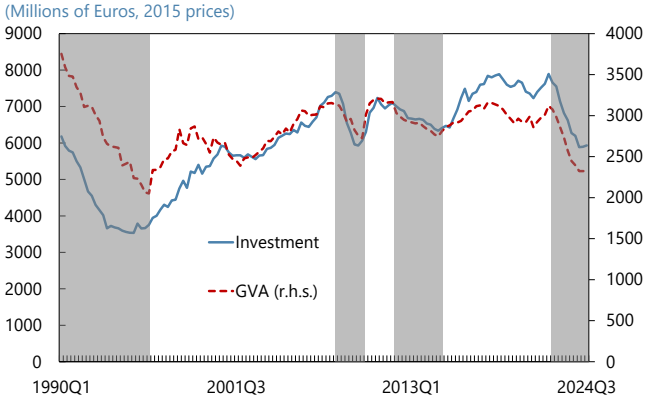
12. The authorities acknowledge the ongoing challenges faced by the Finnish economy, including the anticipated slow recovery of the construction sector. They view the slight contraction projected for 2024 as a turning point and with a nascent recovery ahead. The impact of recent labor market reforms are expected to become more apparent during the upward phase of the economic cycle. The authorities noted that lower inflation reflects a stabilization in prices that could help restore consumer confidence. They expressed cautious optimism over the economic outlook, anticipating a gradual recovery in 2025 supported by private consumption and investment. Nevertheless, they consider risks to be tilted to the downside in the near term, and in particularly will remain vigilant regarding external risks, such as geopolitical tensions and potential economic slowdowns in trading partner countries. In the medium term, they consider risks to be broadly balanced.

Box 1. The Downturn in Construction Investment

Historical cross-country experience suggests that the recovery in construction investment is likely to be long and slow.

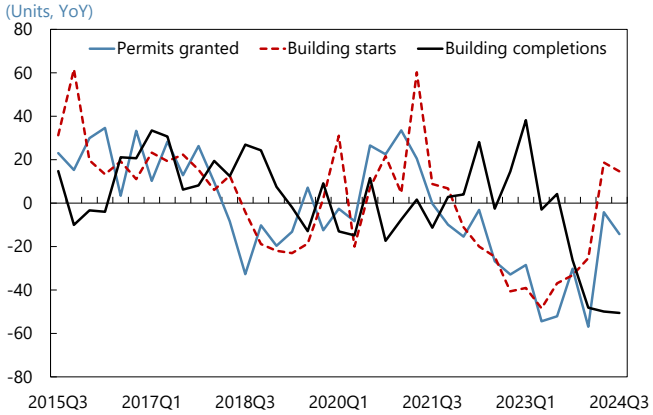
The collapse in construction investment is the most severe since the early 1990s. Since early 2022, higher interest rates (with a high pass-through to mortgage rates) and weak economic conditions triggered a steep fall in real estate prices. This precipitated a collapse in real construction investment of around 20 percent, exceeding the decline in the GFC. High frequency indicators suggest that the construction cycle may have turned, but the strength of the recovery is highly uncertain.

Construction
(Millions of Euros, 2015 prices)



Sources: Haver Analytics.
Note: Shaded areas represent downturns.

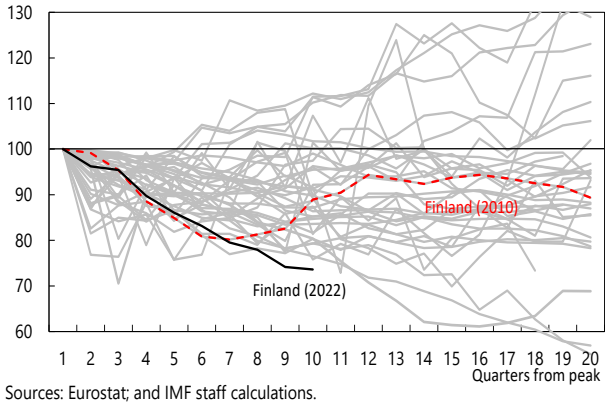
Housing Construction
(Units, YoY)



Sources: Haver Analytics; and IMF staff calculations.

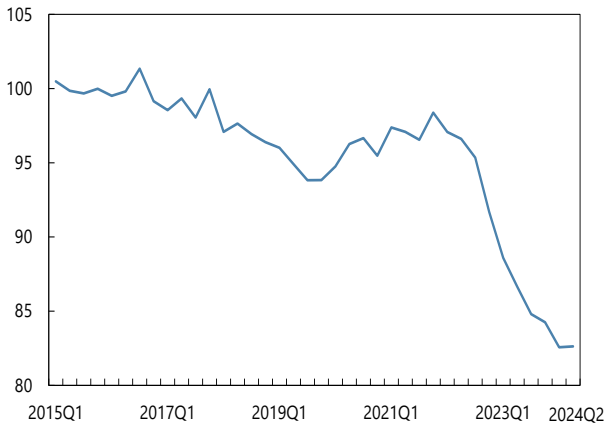
Historical cross-country experience suggests that the recovery will be long and slow. In Finland, the last major decline in construction investment started in 2010. Then, the initial recovery begun after 1½ years, but it took around 6 years to reach its previous peak. Looking at a wider sample of European countries, with similarly-sized downturns, most did not experience a recovery to previous peaks for at least 5 years, suggesting that the recovery in Finland could be long and slow. Nevertheless, there are reasons for some optimism: the absence of a financial crisis and little indication that house prices were substantially overvalued prior to the downturn point to some upside potential in construction investment.

Historcial Downturns in Construction Investment
(Index, Peak=100)



Sources: Eurostat; and IMF staff calculations.
Note: Sample of advanced economy European countries from 1996Q1 to 2024Q1, where construction investment fell between 10 and 30 percent.

Price to Income Ratio
(Index, 2015=100)

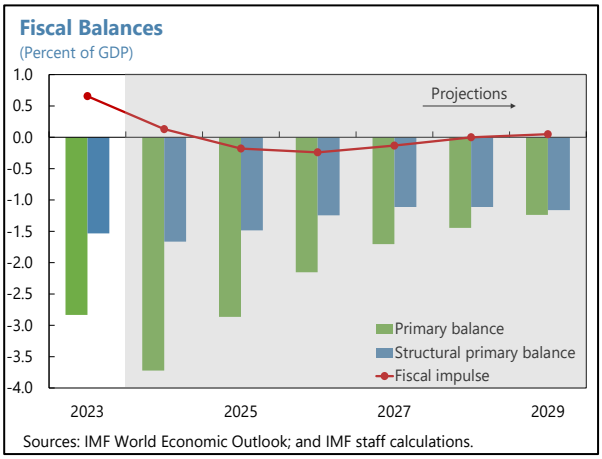


Source: OECD.

POLICY PRIORITIES

A. Achieving Sustained Fiscal Consolidation

13. Despite new fiscal measures, the deficit is set to continue to increase in 2024. In June and October 2023, the government set out an ambitious fiscal adjustment plan, with the aim of stabilizing debt by 2027.[2] However, weaker-than-expected revenues and increased pressures from health and social services, a reduction in unemployment insurance contributions, and an increase in defense spending led to a projected worsening of fiscal balance in 2024. This prompted additional consolidation measures announced in April 2024, amounting to €3 billion (1 percent of GDP), equally divided into revenue and expenditure. Some of the measures were implemented in 2024, such as an increase in VAT rates from 24 to 25.5 percent in September and an increase in tobacco tax in November. Nevertheless—and contrary to previous staff advice (Annex VI)—the overall fiscal balance is projected to worsen by about ¾ percent of GDP in 2024 to 3.7 percent of GDP.



Sources: IMF World Economic Outlook; and IMF staff calculations.

Main Fiscal Consolidation Measures Announced in April 2024

	EUR billion	Percent of GDP
Total	**3**	**1.0**
Revenue	**1.5**	**0.5**
VAT rate increases from 24 to 25.5 percent	1.09	
Excise tax increases	0.08	
Reduction of the household tax credit	0.1	
Increasing pension income taxation	0.15	
Expenditure	**1.6**	**0.5**
Improving the efficiency of central government activities	0.28	
Scaling back of the obligations of wellbeing services counties	0.6	
Reduction in the duties and obligations municipalities	0.1	
Adjustment of housing allowance for pensioners and students	0.1	
Reduction of funding for vocational education	0.1	
Bringing forward the implementation of some measures specified in the 2023 Government Programme	0.1	

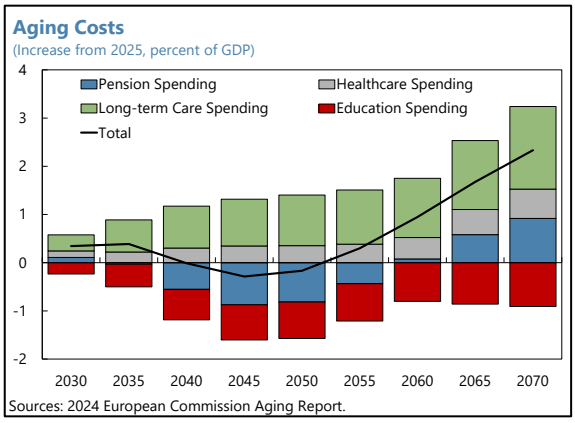
Source: April 16, 2024 government announcement, General Government Fiscal Plan for 2025-2028, Economic Survey Summer 2024, August 8, 2024 Minister of Finance's Press Release on the 2025 draft budget and inputs from the authorities
Note: Effects will mostly materialize in 2025 and beyond. VAT increases from 24 to 25.5 percent (September 2024) and tobacco tax increases (November 2024) take place in 2024
Note: Sum of the measures do not add up to total, as smaller measures are omitted.

14. The fiscal deficit is projected to tighten in 2025. The overall fiscal balance is projected to improve by ½ percent of GDP in 2025, on the back of the anticipated economic recovery and as the

[2] See Annex VII of the 2024 Article IV Consultation Staff Report.

bulk of April 2024 consolidation measures are realized. However, these measures are partially offset by increases in age-related expenditures and military spending, including the start of the delivery of "big-ticket items," such as the F-35 fighter jets.

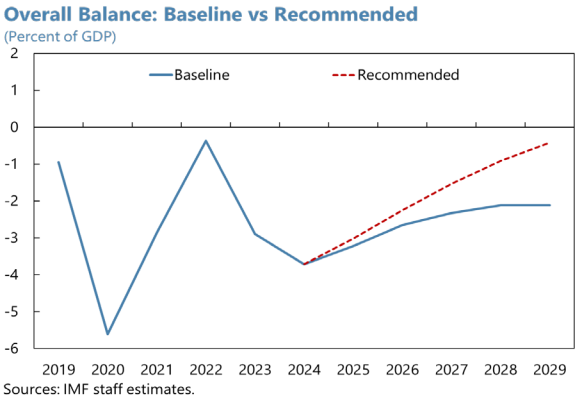
15. But an additional fiscal adjustment is needed to reduce debt. Under staff's baseline projection, fiscal consolidation slows down from 2026, leading debt to gradually continue increasing to nearly 90 percent of GDP by 2030. While contained over the medium term, age-related fiscal costs will put further pressure on public finances. Consistent with previous staff advice to put debt on a declining path by 2027, the authorities should aim to effectively close the overall deficit by 2029. This implies that fiscal consolidation should continue at a measured pace, amounting to around ½ percent of GDP per year from 2025 to 2029.



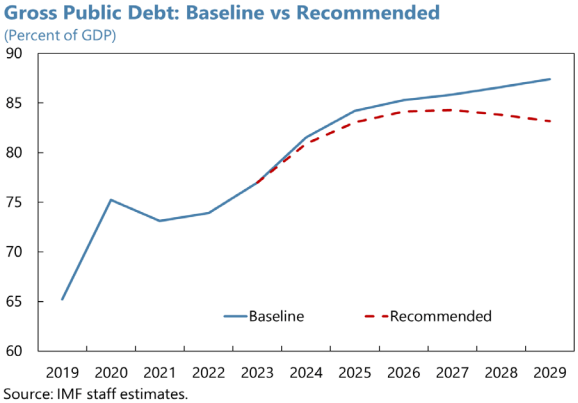
16. Consolidation efforts should be complemented with growth-supporting measures. Despite the estimated negative output gap, a modestly tight fiscal stance is warranted by the need to credibly reduce the fiscal deficit and build buffers for potential adverse shocks over the medium-term. Recent consolidation efforts—which increased consumption taxes and rationalized social benefits but lowered the labor tax wedge and protected investment—have a relatively low fiscal multiplier and should be a model for future efforts. This should be complemented by structural reforms that have the potential to accelerate the pace of the recovery. Such a strategy would also protect against the risk that the recent downturn is more permanent than anticipated. Moreover, the ongoing monetary loosening in the euro area will support aggregate demand.

Fiscal Projections: Baseline vs. Recommended

½ percent of GDP annual structural adjustment amounts to a cumulative 2½ percent of GDP consolidation …



… leading to a clear turnaround in the debt dynamics.

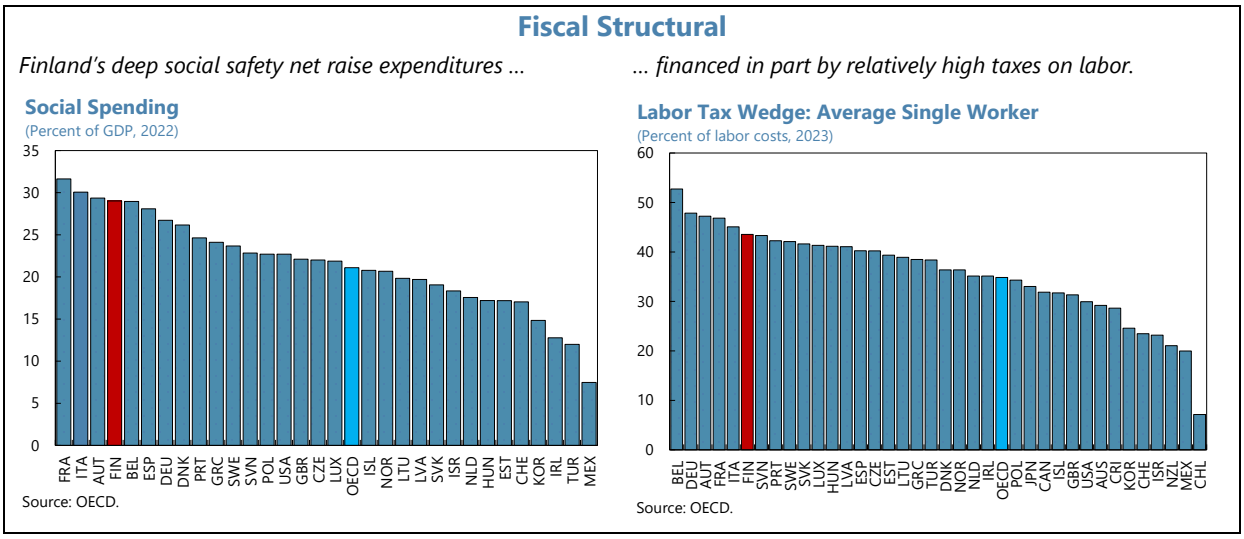


Note: The "recommended" path implies that the structural primary balance (net of interest expenses and receipts) improves by around ½pts of GDP per year between 2025–29. The "baseline" projection is based on specific announced measures by the authorities, and staff's projections of nominal GDP and associated revenues and expenditure elasticities.

17. Both expenditure and revenue measures should be targeted. Rationalization of health and social care provision by the Wellbeing Service Counties is critical. Recent changes to service delivery obligations are an important first step, but further effort on reviewing procurement contracts to reduce personnel costs and goods spending, and consolidating service delivery centers is also key. Similarly, local government spending needs to be examined to investigate increases in the wage bill. Staff supports the authorities' intention to protect spending on investment, R&D support, and education, as these are essential to raise productivity. Increasing revenues—including through further simplification of VAT regime, indexation of excise duties, the expansion of carbon taxation, and reforming the taxation of dividends from non-listed firms—should also be considered.

Authorities' Views

18. The authorities agreed with staff on the fiscal outlook and were open to reviewing potential additional consolidation measures. They concurred with staff on the expected moderate size of structural fiscal improvement in 2025 despite the substantial consolidation measures, due to offsetting spending increases. On the medium-term outlook, the authorities expected that the full implementation of the consolidation measures announced in 2023 and 2024 would be sufficient to comply with the new EU economic governance framework, in which Finland must comply with the "debt sustainability safeguard". However, they acknowledged sizable implementation risks, especially regarding Wellbeing Services Counties spending. The authorities were open to looking into further fiscal consolidation to ensure the stabilization of the debt-to-GDP ratio but see little scope for further revenue measures. They emphasized the challenge of having to pursue both fiscal adjustment and support growth, and the importance of protecting growth-enhancing spending.



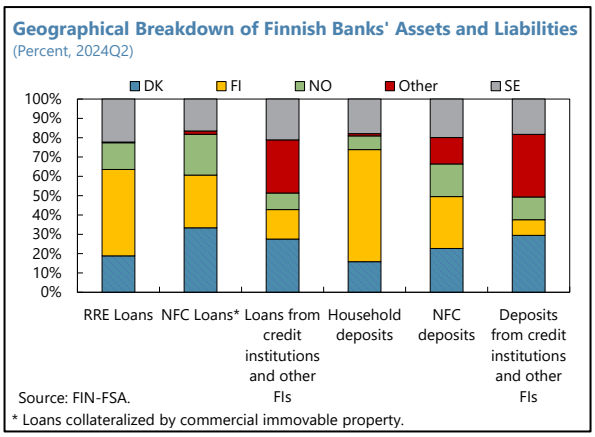
B. Financial Sector Resilience

19. The banking system has proved resilient to recent economic shocks but is vulnerable to severe liquidity outflows. Despite elevated interest rates and a recession, capital and liquidity buffers remained strong. And stress tests conducted by the EBA/ECB and the authorities indicate that

banks are well-prepared to withstand a severe recession scenario. However, the 2022 Financial Sector Assessment Program (FSAP) found that a heavy reliance on short-term wholesale funding poses risks to financial stability and could result in liquidity shortfalls and a procyclical contraction in credit. Nevertheless, absent severe liquidity shocks, with strong capital and profitability, the financial sector is well positioned to support the economic recovery.

20. While financial sector systemic risks are contained, vulnerabilities remain:

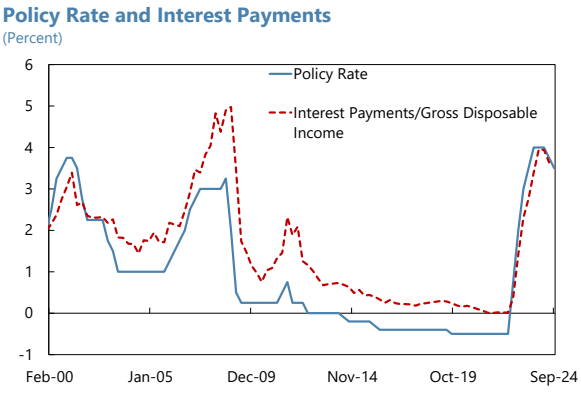
- *Cross-border risks*. The Nordic financial sector is large and highly interconnected. Finland's largest banks have significant direct lending to other Nordic countries' real estate and construction sectors, which have recently experienced volatility in prices and bankruptcy rates.



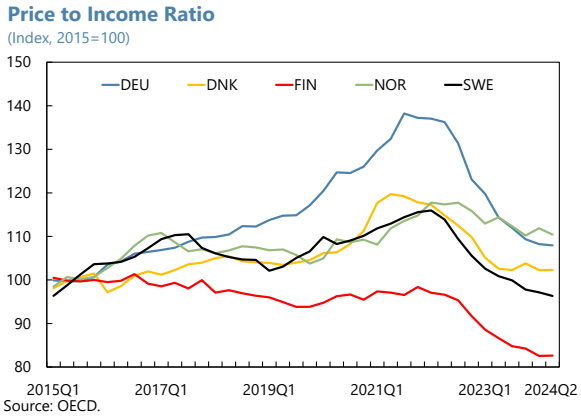
- *Household sector risks*. Household indebtedness has started to decline in recent years but remains high (Figure 6). Supported by strong employment, households have been resilient to higher debt servicing costs so far, despite a high share of variable rate mortgages (Annex I, 2024 Article IV). NPLs and Stage 2 loans from households are relatively low, and there are few signs of house price overvaluation. However, a steep rise in unemployment or further declines in house prices could deteriorate credit quality.

Household Sector Risks

Households have experienced steep hikes in debt servicing costs.



While house prices have fallen, there are few signs that they were significantly overvalued.



- *Corporate sector and commercial real estate (CRE) risks*. The debt service burden of non-financial corporates is elevated, and the number of bankruptcies increased significantly in 2023, mainly driven by the construction sector. However, bankruptcies have started to fall recently and aggregate NPLs remain modest. Despite a significant downturn and still-low transaction volumes,

the CRE market appears broadly resilient. Banks' credit losses from the CRE market have remained low, as they represent only a small share of their total portfolio. Real estate investors have been able to renew maturing funding without a significant increase in forced sales.

- *Non-bank Financial Institutions (NBFIs)*. Insurance and pension funds—the largest players in the NBFI sector—hold sizable capital and liquidity buffers. While insurance and pension companies have been resilient, high interest rates and the downturn in the CRE market led to higher redemption rates for real estate funds. This forced some liquidity management measures, but net flows have shown signs of stabilization.

- *Cyberthreats*. Financial institutions have faced a steep increase in the intensity of cyber-attacks. However, banks' active countermeasures and progress in the implementation of a backup payment system have helped contain adverse impacts.

21. Surveillance of cross-border risks should be enhanced. Cross-border macro-financial risks, especially those arising from the Nordic real estate sector, need to be better monitored. Staff welcome Finland's initiative to lead discussions with its neighbors to undertake a joint Nordic-Baltic banking sector stress test, a key FSAP recommendation. Moreover, staff welcome the formation of a cybersecurity cooperation group for incident management in the financial markets and call for continued focus on cybersecurity risks, which increasingly target financial institutions.[3]

22. The reinstatement of the systemic risk buffer (SyRB) will enhance resilience, but further measures are needed to target pockets of vulnerability. As planned, the SyRB on credit institutions was increased to 1 percent in 2024, following its suspension during the pandemic. That said, to further strengthen resilience during periods of significant stress, a *positive* neutral rate for the Counter-Cyclical Capital Buffer (CCyB) should be introduced in addition to the SyRB (see 2022 FSAP). And in line with past IMF advice, a full set of borrower-based measures, including debt-to-income and debt-service-to-income limits, should also be added to the policy toolkit to contain potential excessive risk-taking in the future. The introduction of such policies is designed to build resilience rather than limit credit growth. As such, their introduction to the toolkit should be prompt, but they could be phased in gradually. And with strong profits and capital above regulatory minimums, any impact on lending is expected to be small. Bank liquidity buffers should be enhanced to cover wholesale funding outflows over a five-day horizon and they should hold a higher stock of high-quality liquid assets. Finally, the systemic risks arising from the NBFI sector warrant closer monitoring, particularly through enhanced supervisory focus on liquidity risks and open-ended real estate funds.

23. While authorities have advanced well in implementing the 2022 FSAP recommendations, further efforts are advisable, including in the areas of crisis management and NBFIs (Annex VII). Implementation of the first phase of the positive credit register was completed in April 2024, rendering data on consumer credit and loans. This will enhance the quality

[3] An MoU on cybersecurity cooperation was signed between the Ministry of Finance and US Department of the Treasury in March 2024.

of financial sector supervision and macro- and micro-prudential analyses. While these efforts should continue, authorities should ensure emergency liquidity assistance processes are adequate, amend regulations to address remaining procyclicality issues in the pension insurance companies, and enhance independency criteria of financial oversight agencies.

24. Progress has been made in strengthening the Anti-Money Laundering/ Countering the Financing of Terrorism (AML/CFT) framework. Authorities have made notable advancements in implementing recommendations from the 2023 Nordic-Baltic regional technical assistance report, including enhancing the collection of data and information for the assessment of ML/TF cross-border and non-resident risks and strengthening the powers of AML/CFT supervisors. The 2023 National Risk Assessment included the assessment of cross-border financial flows and highlighted the risk of evasion of sanctions. Building on these, the authorities should develop a minimum AML/CFT supervisory engagement model, including for virtual asset service providers, and implement measures to combat sanctions evasion.

Authorities' Views

25. The authorities assessed the financial sector to be sound, supported by strong capital buffers. Despite challenges from elevated credit risks in the construction sector and volatility in real estate markets, NPLs have increased only modestly, and bank profits and capital buffers remain high. The authorities noted Finnish banks' strong liquidity position but concurred with staff's assessment on their vulnerability to liquidity risks due to heavy reliance on short-term wholesale funding. They also agreed that systemic vulnerabilities—particularly from high household debt and cross-border exposures—remain elevated. They were supportive of plans to conduct a joint Nordic-Baltic banking stress test and emphasized the importance of well-calibrated macroprudential measures. These include the introduction of a positive neutral counter-cyclical capital buffer (PN-CCyB) and a comprehensive set of borrower-based measures. However, taking a holistic view of bank capital needs, the FIN-FSA favors adjusting the structural buffer requirements to offset, in whole or in part, the impact of a PN-CCyB on capital requirements if risks remain unchanged. Additionally, implementing these measures requires legislative changes, and the authorities would consider it beneficial to include these measures into the EU legislation. The Ministry of Finance perceived no need for legislative changes regarding the FSAP recommendations on strengthening the legal and operational framework of financial oversight agencies as they deem staff legal protection is already ensured by statutory law. As to granting additional hard powers to issue macroprudential policy regulation, Ministry of Finance noted their preference to first see whether the non-binding guidelines currently in use prove to be effective in addressing the identified weaknesses.

C. Reviving Productivity and Growth

26. Significant labor market reforms continue. In 2023, consistent with past staff advice, reforms took place aimed at boosting employment including changes to unemployment benefits, social security and tax adjustments, and enhancements to employment services. In 2024, the government introduced measures to limit legal rights to take strike action and changes to govern

pay increases in the collective bargaining process. However, the impact of the more recent labor-relations measures on competitiveness, wage flexibility, and employment are unclear.

27. But further efforts to increase participation rates and reduce skills mismatches are needed. To support an aging population, the authorities aim to increase participation rates to levels closer to those of its Nordic peers, particularly in light of the low participation rates observed among older individuals and younger people (Figure 2). Potential policy responses include advancing recent measures to reduce avenues for early retirement, continuing to enhance existing measures that provide *targeted* subsidies to incentivize employment, and promoting the hiring of workers with reduced work capacity and older workers. Additionally, the Comprehensive Reform of Integration Act expected to enter into force in 2025, will strengthen policies to accelerate the integration and employment of immigrants. There is also a need to reduce skills mismatches and strengthen tertiary education (see Box 1, 2024 Article IV). The authorities plan to increase the proportion of young adults attaining higher education degrees to approximately 50 percent by 2030 are welcome. While the 'Talent Boost' program aims to fill existing skills gaps with foreign workers, better supporting integration by reducing linguistic and cultural barriers, and lowering bureaucratic hurdles, remain key.

28. Attention also needs to be given to the recent steeper-than-trend fall in average hour worked. While part of this decline is likely cyclical or associated with the changing preferences of a relatively rich and aging society, there may also be market and policy issues that require attention. Indeed, the significant declines among certain groups—younger people, low-skilled workers, and older, high-skilled female employees—deserves special attention (Annex II). Potential policy measures could focus on enhancing youth employment opportunities, fostering active aging initiatives, and promoting upskilling for low-skilled workers.

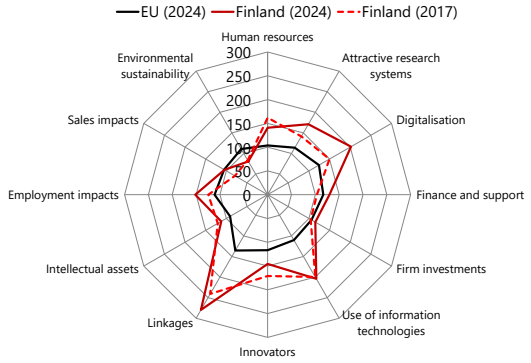
29. Impressive levels of digitalization, R&D spending, and venture capital finance provide a strong foundation business. Finland performs strongly across many innovation performance measures, especially in digitalization. And despite a multi-year decline, R&D expenditure is high by EU standards, and the authorities have ambitious plans to raise it further with the support of public funding. Finland also has a relatively large venture capital sector, supported by public-sector investment funds and a large domestic pension industry.

30. But weak productivity growth requires further focus on structural reforms. While business entry and exit rates are similar to the EU average, there is evidence that the formation of *high-growth* firms, so called "Gazelles" has slowed in recent years (Annex VIII). And that slower productivity growth at the *frontier* has been an important driver of the slowdown in *aggregate* productivity, particularly in the services sector (Annex IX). While there are likely no 'silver-bullet' policy recommendations, attention should be given to the tax treatment of venture capital funding and rebates associated with investment spending by firms. Attention should also be paid on barriers to entry, that are more stringent in Finland compared with international best practices.

Innovation

Finland scores well on many innovation indicators …

Innovation Performance Indicators 2024

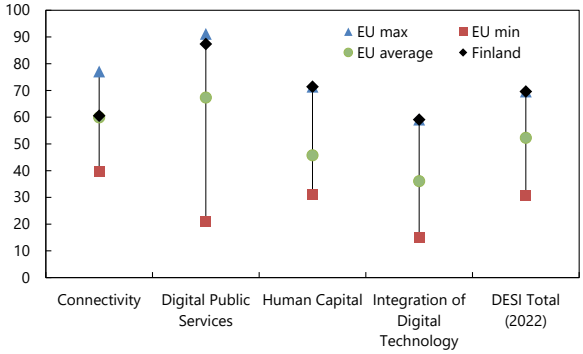


Source: European Innovation Scoreboard 2024.

… especially on digitalization.

Digital Economy and Society Index by Main Dimensions

(Weighted score, 0 to 100)

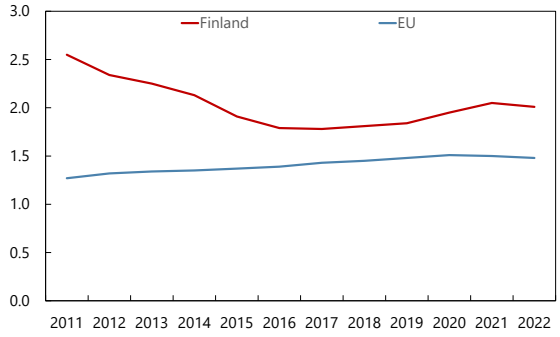


Sources: European Commission; and IMF staff calculations.

R&D is well above the EU average, despite a decline.

Business Enterprise Expenditure on R&D

(Percent of GDP)

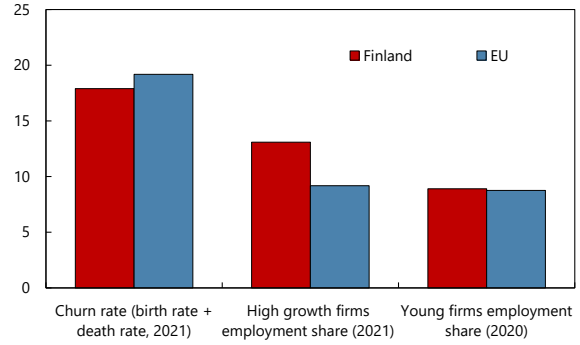


Source: Eurostat.

Business dynamism indicators are similar to EU averages.

Selected Business Dynamism Indicators

(Percent)



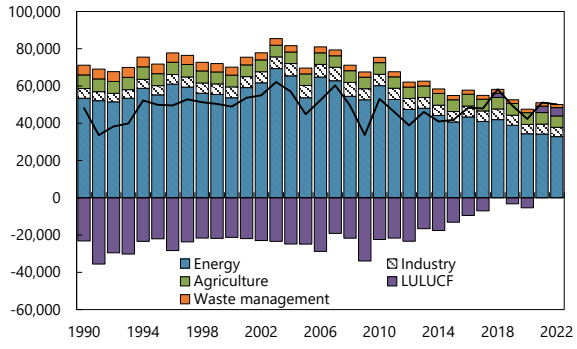
Sources: Eurostat; Haver Analytics; and IMF staff calculations.

31. Strengthening the role of carbon sinks is key to the continued reduction of net carbon emissions. Increased tree lumbering in recent years has diminished the carbon sink in the Land Use, Land-use Change, and Forestry (LULUCF) sector and threatens compliance with the national objective of becoming carbon neutral by 2035 and country-specific EU targets. To meet these objectives, additional policy measures are needed to restore the role of carbon sinks over the medium term. The use of taxes—on lumbering, land-use change, and the burning of biomass—should be considered. While the marginal abatement costs are likely to be low in the LULUCF sector, emission reduction could also be targeted in other non-Emissions Trading System (ETS) sectors. Heavy investment in renewable energy is currently planned, but additional emission reduction could also be achieved through greater equalization of carbon taxes across sectors.

Climate

The reduction in the role of 'carbon sinks' risks have undermined Finland's emission reduction targets.

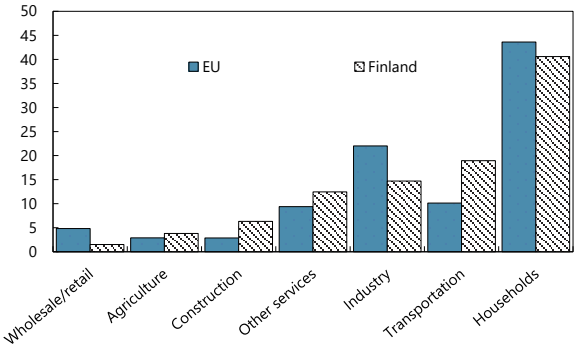
GHG Emissions by Sector
(Thousands of tonnes of CO2 equivalent)



Source: Eurostat.

While energy taxes remain comparable with the EU average, there remains large differences across sectors.

Energy Taxes
(Percent)



Sources: Eurostat.

Authorities' Views

32. The authorities emphasized the importance of labor market reforms initiated in 2023 to boost employment through changes to unemployment benefits, social security, and tax policies. To support an aging population, they aim to raise participation rates among older individuals while addressing skills mismatches and enhancing tertiary education to achieve a 50% higher education attainment goal by 2030. Additionally, they expressed concern about the decline in average hours worked and will continue to explore policies that promote youth employment and upskilling for low-skilled workers. Despite strengths in digitalization, R&D, and venture capital, weak productivity growth remains a challenge, particularly supporting the scale-up of promising startups. While the authorities emphasized the good progress in emission reductions outside the LULUCF sector and the importance of restoring carbon sinks, they acknowledged that meeting the LULUCF sector emission reduction targets within the specified timeframe presents significant challenges. The upcoming Energy and Climate Strategy in early 2025 provides an opportunity to revisit potential policy options.

STAFF APPRAISAL

33. The economic recovery has started and will gain momentum in 2025. While economic activity turned slightly positive in the first three quarters of 2024, on the back of declining interest rates and higher real incomes, output growth is projected to be slightly negative in 2024 due to a substantial negative "carry-over" from the previous year. Despite a recent decline, employment has remained broadly resilient, supported by higher immigration, greater public employment, and increased participation rates. Looking ahead, activity is expected to rebound in 2025 bringing growth to around 1½ percent, supported by higher private consumption and a gradual recovery in investment. Inflation, which has fallen steeply on the back of declining energy prices and weak domestic demand, is expected to increase to around 2 percent in 2025. Finland's external position is

assessed to be moderately weaker than the level implied by medium-term fundamentals and desirable policies.

34. The fiscal position has deteriorated but consolidation efforts have begun. The fiscal deficit reached 3 percent in 2023, driven by the deep economic downturn and new expenditure commitments, including from defense spending. As a result, public debt, which is already higher than in Nordic peers, reached 77 percent of GDP in 2023. New consolidation measures announced in Spring 2024, which included an increase in VAT rates, are welcomed. But the full impact will not be realized until 2025, and the fiscal deficit is expected to deteriorate further to 3.7 percent of GDP in 2024.

35. While the fiscal deficit is projected to improve in 2025, further adjustment is necessary to put debt on a downward trajectory. The cyclical recovery, along with recent fiscal measures, is anticipated to help reduce the fiscal deficit by ½ percent in 2025. But public debt is still expected to increase to nearly 90 percent of GDP by 2030. To address this, fiscal consolidation of ½ percent of GDP per year from 2025 to 2029 is needed, which will effectively close the fiscal balance and put debt on a declining path. This requires additional concrete measures on both expenditure and revenue. Productivity-enhancing spending—such as public investment, R&D support, and education—should be protected.

36. The financial sector has remained resilient, but some vulnerabilities warrant attention. Banks have high capital and liquidity buffers, positioning them well to support the economic recovery. While stress tests suggest that banks could withstand a severe recession scenario, a heavy reliance on short-term wholesale funding makes them vulnerable to severe liquidity shocks. Hence, bank liquidity buffers should be enhanced, and the stock of high-quality liquid assets should be increased. Additional systemic vulnerabilities also persist, including high household debt and significant interconnectedness with other Nordic countries. In this regard, staff welcomes Finland's initiative to lead discussions with its neighbors to undertake a joint Nordic-Baltic banking sector stress test. Finally, persistent cyber-attacks targeted at financial institutions have been contained thanks to the strong preparation and active countermeasures adopted by the banks and relevant authorities.

37. Further measures are needed to target pockets of vulnerability. Staff welcomes the reinstatement of the SyRB to its pre-pandemic level. However, a *positive* neutral rate on the CCyB should also be legislated, which could be released in periods of extreme stress. Additionally, borrower-based measures such as debt-to-income and debt-service-to-income limits should be incorporated into the macroprudential policy toolkit. Finally, the authorities should continue to monitor financial stability risks associated with non-bank financial institutions, particularly real estate funds which have recently faced liquidity challenges.

38. Labor market reforms should continue, with focus on increasing labor participation rates and reducing skill mismatches. Although significant labor market reforms were conducted in 2023, further efforts are needed to increase participation rates, which are presently lower than in Nordic peers. This should be complemented with policies to reduce skills mismatches and strengthen

tertiary education. In this context, the authorities' plan to increase the proportion of young adults attaining higher education degrees to approximately 50 percent by 2030 is welcome. The recent steeper-than-trend decline in average hours worked also warrants attention. While part of the decline is likely cyclical or associated with the changing preferences of a relatively rich and aging society, there may also be market and policy failures that require attention.

39. Structural reforms are needed to strengthen business innovation and revive productivity growth. Finland's innovation and business environment metrics are ranked high by EU standards, and despite a multi-year decline, R&D expenditures relative to GDP remains elevated. Finland also has a notable venture capital sector, supported by public-sector investment funds and a large domestic pension industry. Nevertheless, productivity growth has remained weak over the past two decades. It is crucial to focus on the formation of "Gazelles", which has not been growing in recent years, as well as on the productivity growth of frontier firms. While there is no 'silver-bullet' solution, revisiting the tax treatment of venture capital funding and rebates associated with investment spending by firms could be beneficial. Moreover, deepening the European Single Market could further ease growth constraints. In the service sector, which has experienced stagnant productivity in recent years, focus should be given to potential barriers to entry and excessive regulation.

40. Finland is unlikely to become carbon neutral by 2035. The recent increase in tree lumbering has diminished the carbon sink. As a result, the objective of becoming carbon neutral by 2035 is unlikely to be met. Strengthening the role of carbon sinks through additional policy measures, including taxes, will be key to continuing the reduction in net carbon emissions.

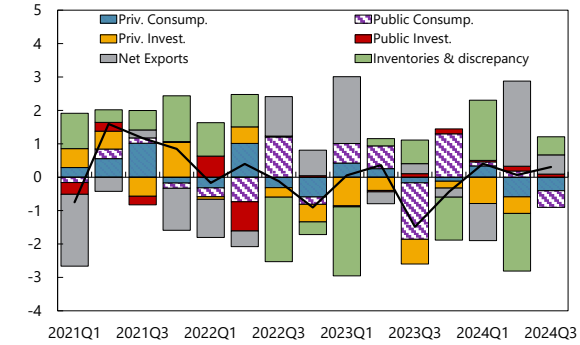
41. It is proposed that the next Article IV consultation with Finland take place on the standard 12-month cycle.

Figure 1. Finland: Real Sector

GDP fell in 2023 due to shrinking inventories and an ongoing contraction in investment.

Quarterly Real GDP Growth Contributions

(Percent, QoQ)

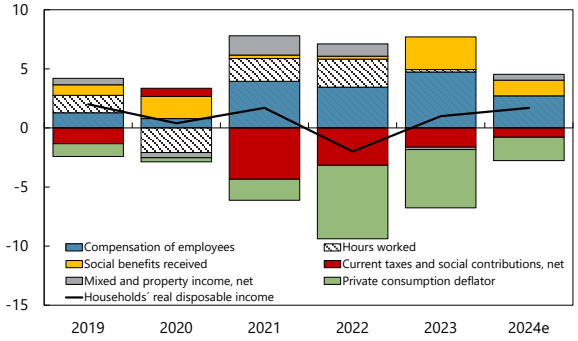


Sources: Haver Analytics; and IMF staff calculations.

Nonetheless, positive real disposable income growth helped keep private consumption growth positive.

Households' Real Disposable Income: Contribution to Growth

(Percent)

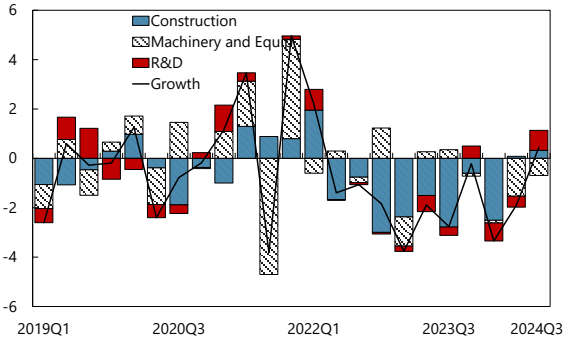


Sources: Statistics Finland; Ministry of Finance; and IMF staff calculations.

Construction investment plummeted in 2023, with the decline persisting into 2024.

Investments - Contribution to Growth

(Percent, SWDA)

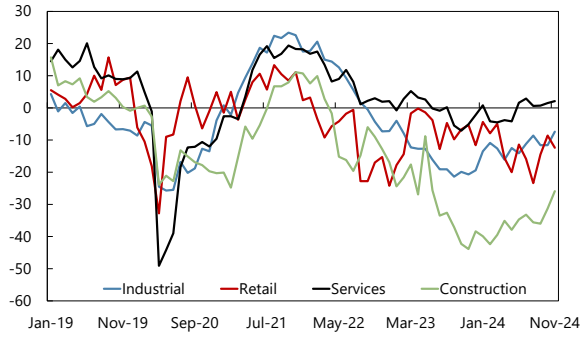


Sources: Statistics Finland; Haver Analytics; and IMF staff calculations.

High-frequency indicators signal a slowdown across all sectors, with the construction sector experiencing a more pronounced deceleration.

Confidence Indicator

(Percent balance, SA)

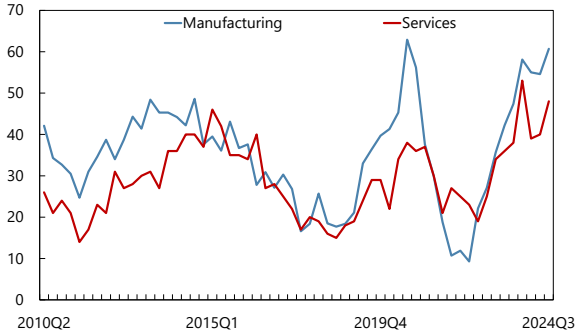


Sources: European Commission; and Haver Analytics.

Weak demand appears to be holding back manufacturing and services output …

Factors Limiting Production: Demand

(Percent, SA)

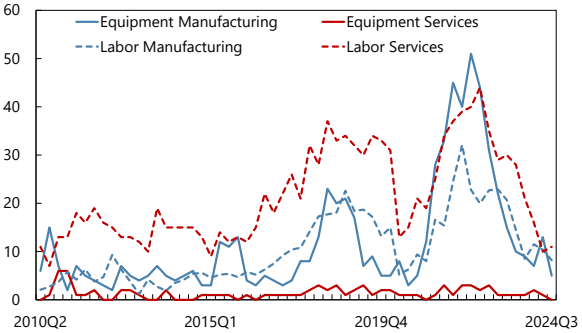


Sources: European Commission; and Haver Analytics.

…while supply constraints have eased significantly.

Factors Limiting Production: Manufacturing and Services

(Percent, SA)

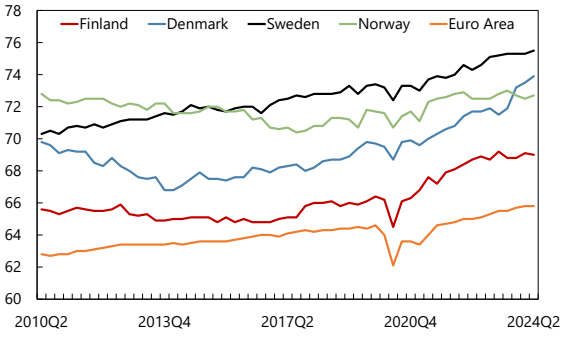


Sources: European Commission; and Haver Analytics.

Figure 2. Finland: Labor Market Developments

Labor force participation rates outpace the euro area average but lag behind those in the Nordic region.

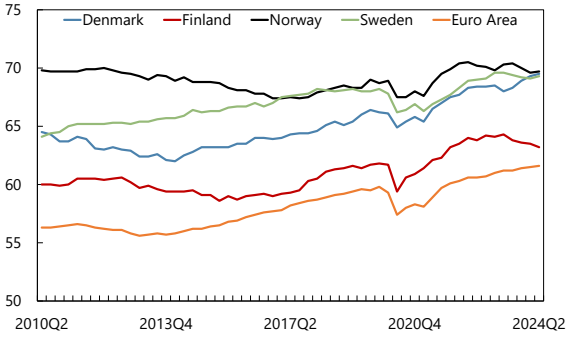
Participation Rates in Nordic Countries
(Percent of the total working-age population, age 15-74)



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

Following a consistent rise after the pandemic, the employment rate experienced a modest decline.

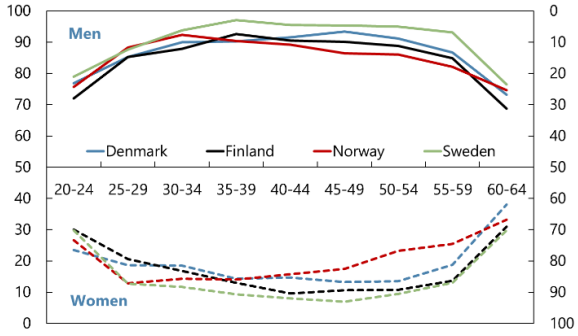
Employment Rate
(Percent of the total working-age population, age 15-74)



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

Participation rates of young people and older men are particularly low.

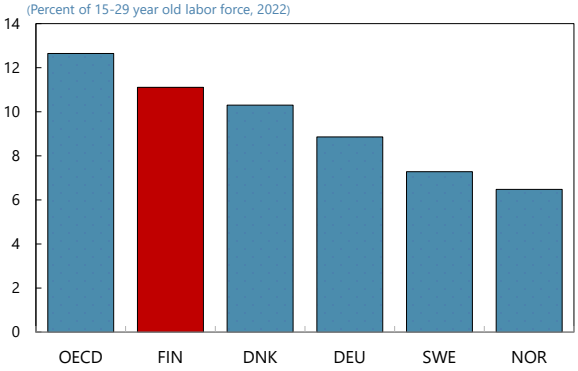
Participation Rate by Age Cohort, 2023
(LHS: Percent, Men; RHS: Percent, Women)



Source: OECD.

Indeed, the share of youth not in employment, education, or training is larger than Nordic peers...

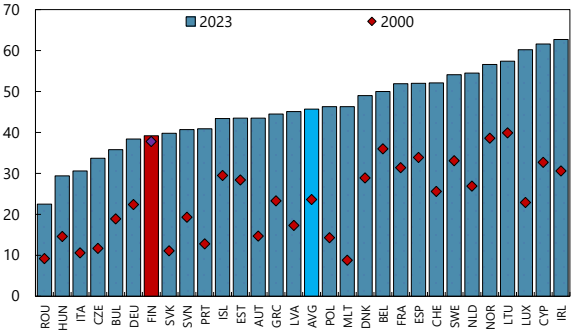
Youth Not in Employment, Education or Training
(Percent of 15-29 year old labor force, 2022)



Source: OECD.

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

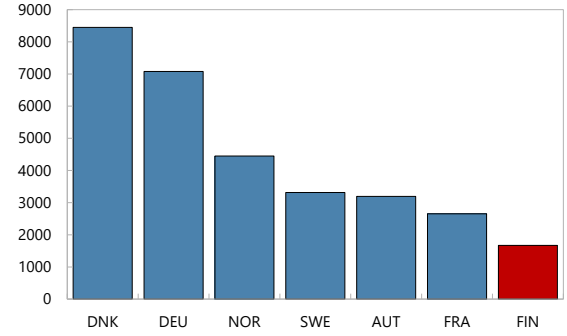
Share of Tertiary-Educated 25-34 Year-Olds
(Percent)



Source: OECD.

Increased spending on public employment services (PES) would help narrow the gap with peers.

Expenditure on Employment Services Per Unemployed
(Euro per unemployed, 2021)



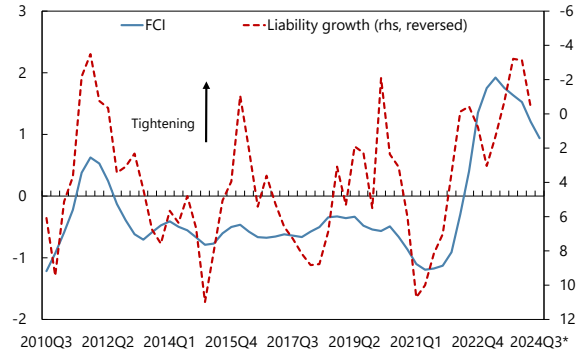
Sources: OECD; and IMF staff calculations.

Figure 3. Financial Conditions Index (FCI)[1]

While still elevated, financial conditions in Finland eased in 2023 and 2024…

FCI and Liability Growth

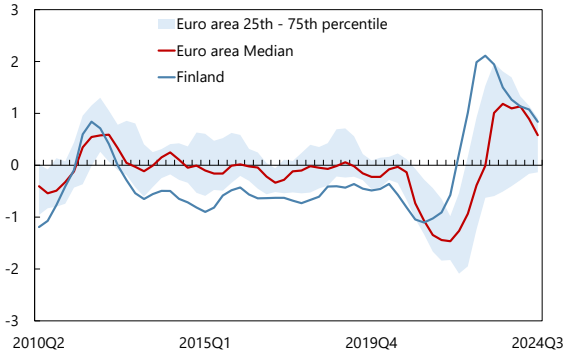
(Index; percent)



…and by relatively more than the euro area average.

Financial Condition Compared to Euro Area

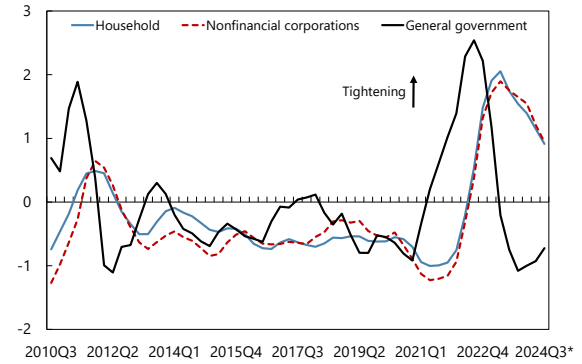
(Index, 2010Q1-2024Q3)



This easing was experienced across all sectors.

FCI by Sectors

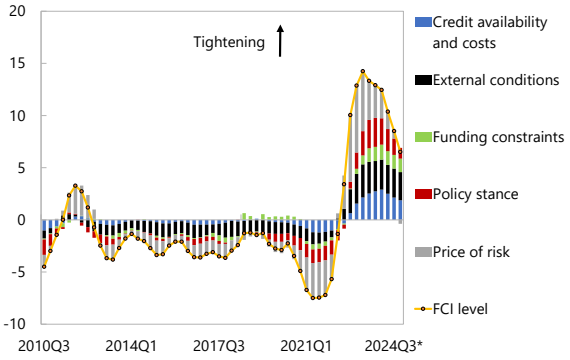
(Index)



With the price of risk and policy stance the most important factor driving this.

FCI level

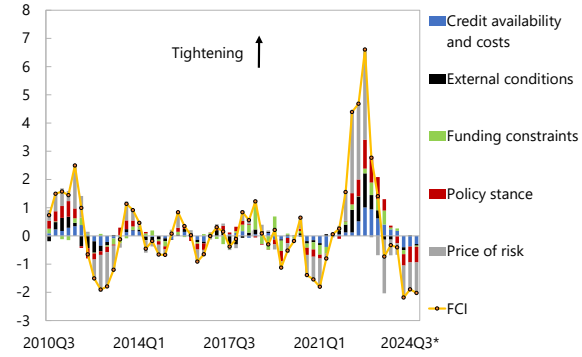
(Contribution to unscaled FCI)



These factors seem to be driving FCI easing in NFCs …

FCI Changes - Nonfinancial Corporations

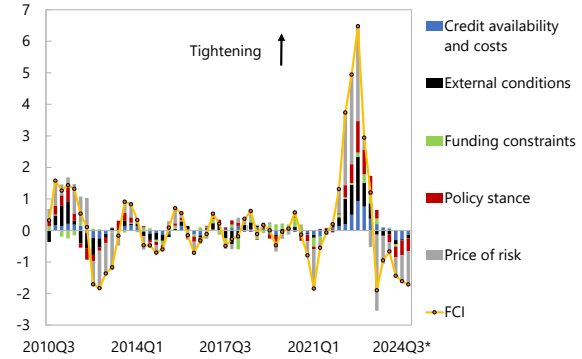
(Contribution to quarter-over-quarter first difference of FCI)



…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.

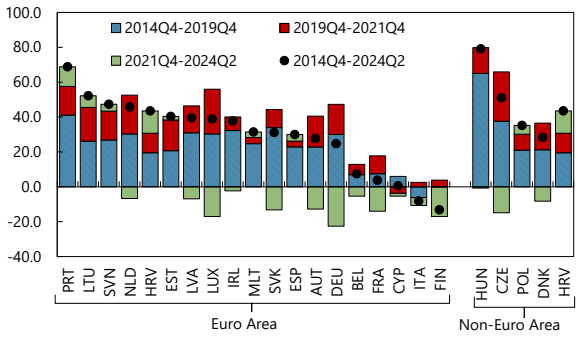
1\ For implementing Partial Least Square, we divide the sample into distinct time periods, each with its regression. The indices are then chained together. It's essential to note that the absolute FCI levels may not be entirely comparable to the early 2000s, given variations in available financial indicators. The final index chain covers most of the 2015–2024 period. 2024Q3 data are provisional.

Figure 4. Real Estate Market Developments

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

Change in Real House Price Index

(Percent)

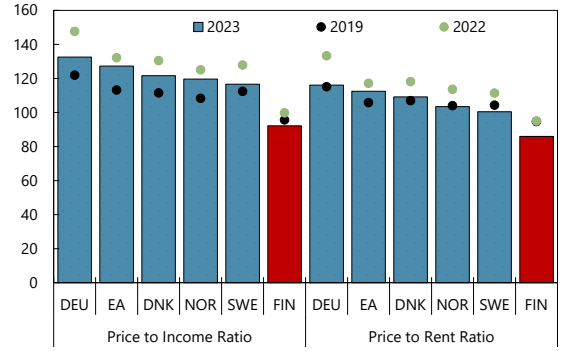


Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Finnish valuation measures were relatively benign compared with the region.

Price-to-Income Ratio and Price-to-Rent Ratio

(Index, 2015=100)

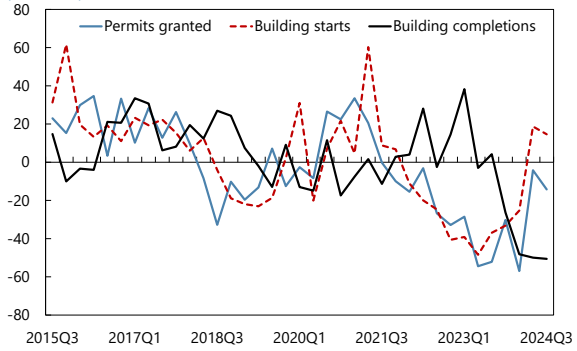


Source: OECD.

Construction sector was hit hard in 2023 with some early signs of recovery in 2024.

Housing Construction

(Units, YoY)

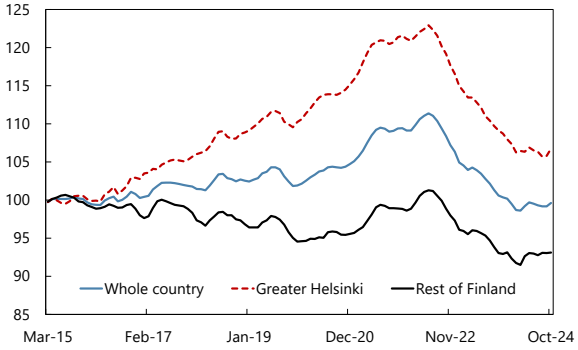


Sources: Haver Analytics; and IMF staff calculations.

And house prices appear to have stabilized.

House Prices

(Index, 3m average, 2015=100, all building types)

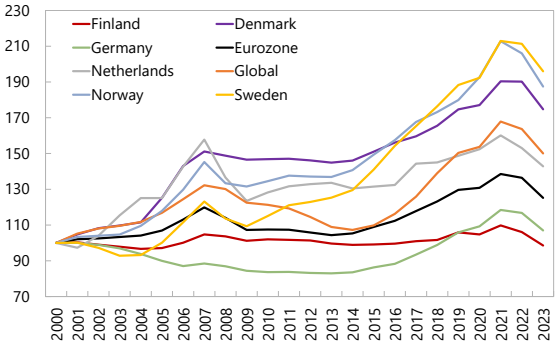


Sources: Haver Analytics; and IMF staff calculations.

The CRE market has undergone a price correction…

Commercial Real Estate Capital Growth Index

(Index, 2000=100)

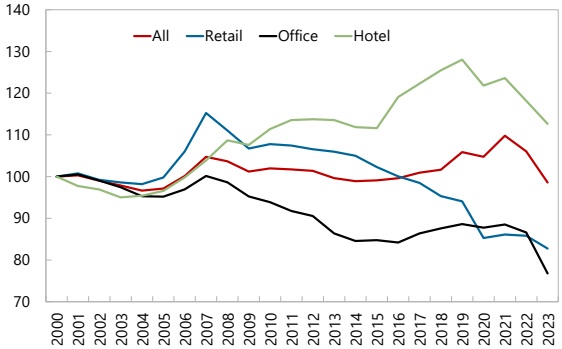


Sources: MSCI; and IMF staff calculations.

…with the retail and office segments facing strong headwinds.

Capital Growth Rates Across Segments in Finland

(Index, 2000=100)



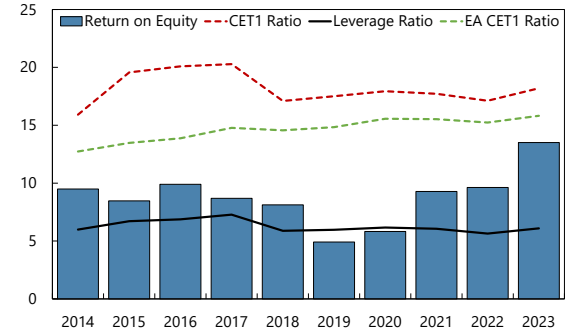
Sources: MSCI; and IMF staff calculations.

Figure 5. Banking Sector

The Finnish banking system is well capitalized.

Capitalization and Profitability

(Percent)

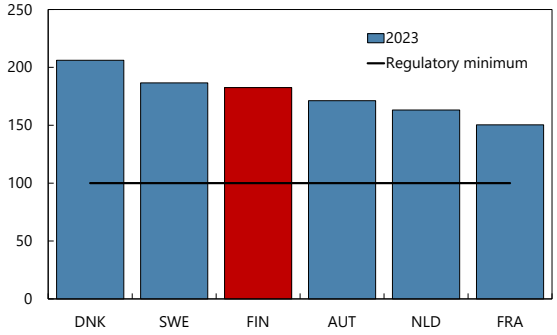


Source: European Central Bank.

Banks are highly liquid, as in peer countries.

Liquidity Coverage Ratio

(Percent)

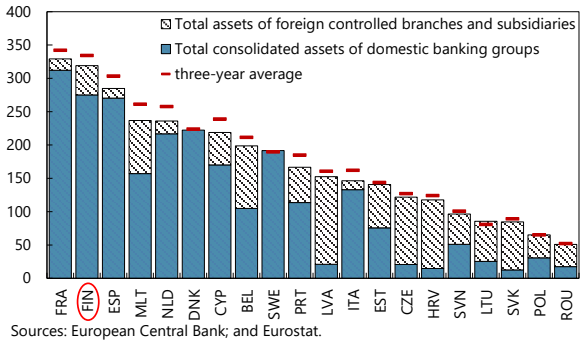


Source: European Central Bank.

But the banking system is relatively large…

Banking Sector Size

(EU; share of nominal GDP; percentages; 2023)

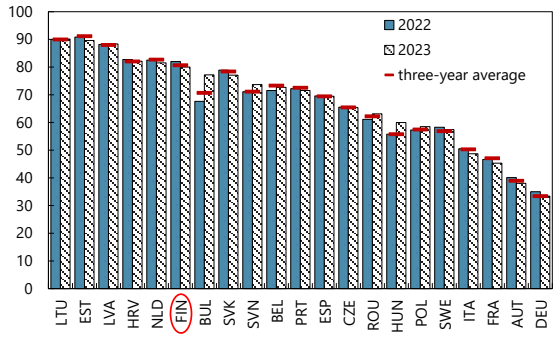


Sources: European Central Bank; and Eurostat.
Notes: Based on Consolidated Banking Data.

…and concentrated…

Assets Share of the Five Largest Credit Institutions

(Percent)

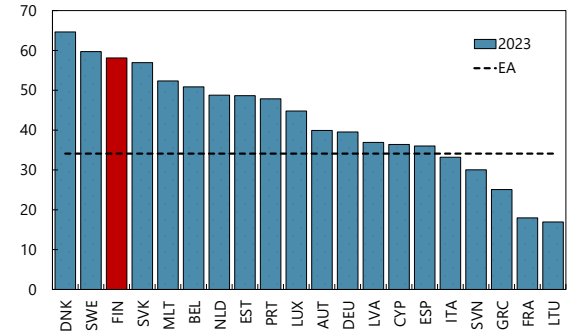


Sources: European Central Bank; and Haver Analytics.

…with large real estate exposures…

Real Estate Exposure Share

(Percent; domestic banks)

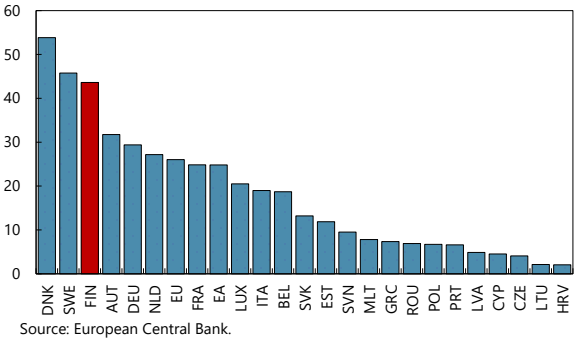


Source: European Central Bank.

…and a heavy reliance on wholesale funding.

Market Funding Structure 1/

(Percent, 2023)

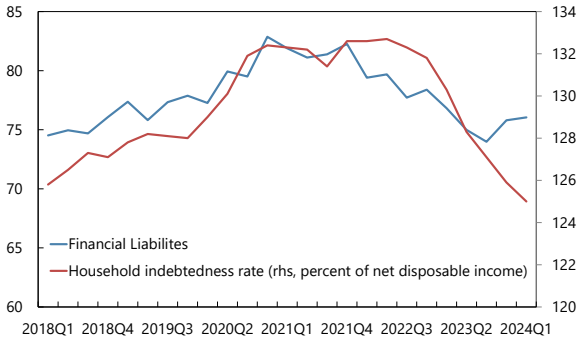


Source: European Central Bank.
1/ Ratio of credit institutions' deposits and debt securities to total liabilities.

Figure 6. Household Balance Sheets

Household indebtedness has declined in recent years…

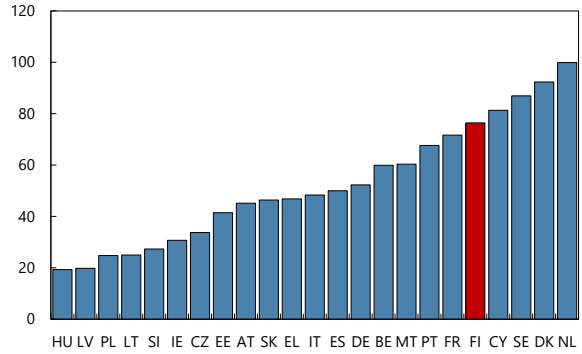
Financial Liabilities
(Percent of GDP)



Sources: Eurostat; and IMF staff calculations.

… but remains high by European standards.

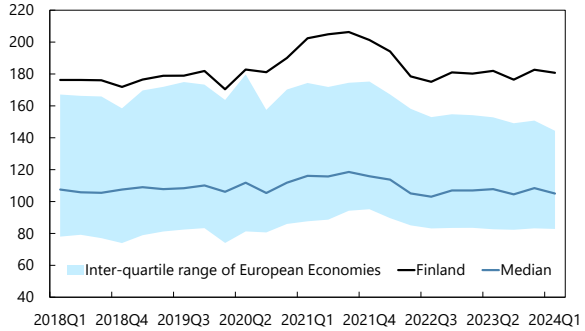
Financial Liabilities
(Percent of GDP)



Sources: Eurostat; and IMF staff calculations.

However, a high stock of financial assets means that net worth is high relative to European peers …

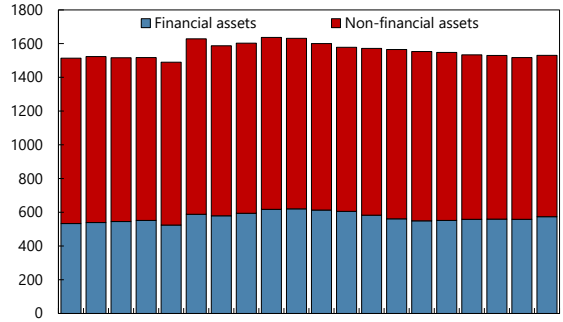
Net Financial Assets
(Percent of GDP)



Sources: Eurostat; and IMF staff calculations.
*Net Worth = Financial assets - Financial liabilities.

… which is further bolstered by significant non-financial—mainly housing— wealth.

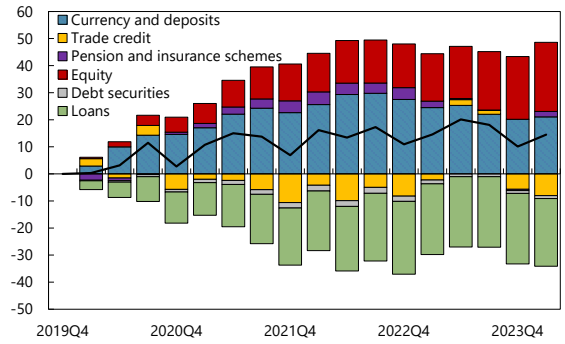
Household Assets
(Percent of GDP)



Sources: Eurostat; and IMF staff calculations.

The recent increase in net wealth has been supported by an accumulation of cash and equity holdings …

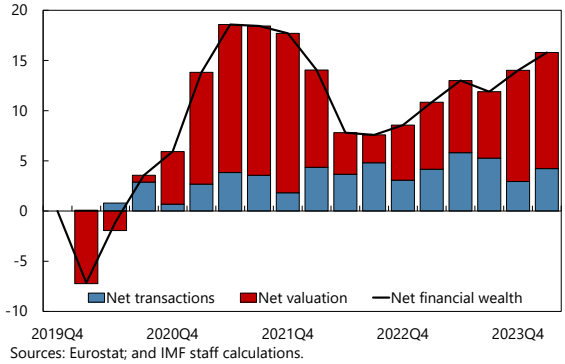
Cumulative Net Financial Transactions
(Percent of 2019 GDP)



Sources: Eurostat; and IMF staff calculations.

.. and strong valuation gains.

Cumulative Change in Net Financial Wealth
(Percent of 2019 GDP)



Sources: Eurostat; and IMF staff calculations.

Table 1. Finland: Selected Economic Indicators, 2021–30

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
						Proj.				
				(Percentage change, unless otherwise indicated)						
Output and Demand (Volumes)										
GDP	2.7	1.5	-1.2	-0.3	1.5	1.5	1.4	1.3	1.2	1.2
Domestic demand	3.0	3.0	-4.2	-0.8	1.9	1.8	1.6	1.4	1.2	1.2
Private consumption	3.2	1.3	0.3	-0.4	1.0	1.1	1.1	1.1	1.1	1.1
Public consumption	3.9	-1.0	3.4	1.0	0.5	0.6	0.9	0.9	0.9	0.9
Gross fixed capital formation	1.7	2.6	-9.0	-6.6	4.2	3.8	3.5	2.7	1.8	1.8
Net exports (contribution to growth in percent of GDP)	-0.1	-1.7	3.1	1.2	-0.4	-0.2	-0.2	-0.1	0.0	0.0
Prices, Costs, and Income										
Consumer price inflation (harmonized, average)	2.1	7.2	4.3	1.0	2.0	2.0	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	2.0
Labor Market										
Participation Rate (15-74 years)	67.0	68.0	68.6	68.9	69.3	69.6	70.1	70.5	70.9	71.4
Employment	2.4	2.6	0.3	-1.1	0.5	0.4	0.5	0.6	0.6	0.6
Unemployment rate (in percent)	7.6	6.8	7.2	8.3	8.1	7.9	7.8	7.6	7.4	7.3
Potential Output										
Output gap (in percent of potential output)[1]	0.6	1.1	-0.9	-2.2	-1.5	-0.8	-0.5	-0.3	-0.2	0.0
Growth in potential output	0.9	0.9	0.9	0.9	0.8	0.8	1.0	1.1	1.1	1.0
				(Percent of GDP)						
General Government Finances[2]										
Overall balance	-2.8	-0.4	-3.0	-3.7	-3.2	-2.6	-2.3	-2.1	-2.1	-2.1
Primary balance[3]	-2.9	-0.4	-3.0	-3.8	-2.9	-2.0	-1.4	-1.0	-1.0	-1.0
Structural balance (in percent of potential GDP)[4]	-3.2	-1.5	-2.4	-2.2	-2.3	-2.3	-2.5	-2.5	-2.5	-2.6
Structural primary balance (in percent of potential GDP)[5]	-3.3	-1.5	-2.5	-2.3	-2.0	-1.7	-1.6	-1.4	-1.4	-1.4
Gross debt	73.1	73.9	77.0	81.6	84.2	85.3	85.9	86.6	87.4	88.2
Money and interest rates										
Domestic nonfinancial private sector credit growth (e.o.p.)	5.3	6.1	3.9	...	...	...	...	...	...	...
National saving and investment										
Gross national saving	25.1	25.3	22.4	21.3	21.9	22.5	22.9	23.3	23.5	23.7
Gross domestic investment	24.8	27.5	22.8	21.5	22.3	22.9	23.3	23.6	23.8	23.9
Balance of Payments										
Current account balance	0.3	-2.2	-0.4	-0.3	-0.4	-0.4	-0.4	-0.3	-0.2	-0.1
Goods and services balance	0.1	-1.9	0.3	0.8	0.5	0.4	0.3	0.2	0.3	0.3
Net international investment position	2.3	0.2	12.6	12.0	11.2	10.4	9.5	8.8	8.3	7.8
Gross external debt	209.6	215.7	215.3	214.8	211.7	209.2	206.6	204.5	202.4	200.3

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.

Table 2. Finland: Balance of Payments, 2021–30

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
						Proj.				
				Billions of euros						
Current Account	0.8	-5.8	-1.1	-0.7	-1.0	-1.2	-1.4	-1.1	-0.8	-0.5
Goods and services	0.1	-5.2	0.8	2.2	1.5	1.3	0.8	0.8	1.0	1.1
Exports of goods and services	99.3	122.7	117.0	116.7	120.0	123.4	127.1	131.1	135.2	139.4
Goods	70.2	88.4	83.8	80.7	82.9	85.3	87.8	90.6	93.5	96.3
Services	29.1	34.3	33.2	36.1	37.1	38.1	39.3	40.5	41.8	43.1
Imports of goods and services	99.2	127.8	116.2	114.5	118.5	122.1	126.3	130.4	134.3	138.3
Goods	68.0	88.4	74.4	72.3	74.9	77.5	80.5	83.3	85.9	88.5
Services	31.1	39.4	41.8	42.2	43.6	44.6	45.8	47.1	48.4	49.8
Income	0.7	-0.6	-1.9	-2.9	-2.6	-2.5	-2.2	-1.8	-1.7	-1.6
Compensation of employees										
o/w Investment income	0.7	-0.6	-1.9	-2.9	-2.6	-2.5	-2.2	-1.8	-1.7	-1.6
Capital and Financial Account	0.2	-3.4	-6.6	-0.8	-1.3	-1.6	-1.6	-1.3	-1.0	-0.7
Capital account	0.1	-0.1	-0.3	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1
Financial account	0.0	-3.3	-6.3	-0.8	-1.2	-1.4	-1.5	-1.2	-0.9	-0.6
Direct investment	-2.7	8.6	-1.0	1.1	1.3	1.6	2.1	2.1	2.3	1.7
In Finland	19.9	12.7	-0.2	7.9	7.1	7.3	6.5	8.2	7.5	8.5
Abroad	17.2	21.3	-1.2	9.1	8.4	9.0	8.6	10.3	9.7	10.3
Portfolio investment	20.1	-9.1	1.6	-2.2	-1.3	-1.3	-1.6	-1.4	-1.4	-1.4
Financial derivatives	1.9	-5.2	-2.4	-1.5	-1.5	0.0	0.0	0.0	0.0	0.0
Other investment	-22.2	1.9	-4.6	1.8	0.3	-1.7	-2.0	-1.9	-1.7	-0.9
Assets	-27.9	40.0	-3.6	-8.6	-8.6	-8.6	-8.6	-8.6	-8.6	-8.6
Liabilities	-5.8	38.1	1.0	-10.4	-8.9	-6.8	-6.6	-6.7	-6.8	-7.7
Reserve assets	2.9	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-0.9	2.5	-4.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
				Percent of GDP						
Current Account	0.3	-2.2	-0.4	-0.3	-0.4	-0.4	-0.4	-0.3	-0.2	-0.1
Goods and services	0.1	-1.9	0.3	0.8	0.5	0.4	0.3	0.2	0.3	0.3
Exports of goods and services	39.9	46.1	42.8	41.8	41.5	41.1	41.0	40.9	40.8	40.7
Goods	28.2	33.2	30.7	28.9	28.7	28.4	28.3	28.2	28.2	28.1
Services	11.7	12.9	12.1	12.9	12.8	12.7	12.7	12.6	12.6	12.6
Imports of goods and services	39.9	48.0	42.5	41.0	40.9	40.7	40.7	40.6	40.5	40.4
Goods	27.4	33.2	27.2	25.9	25.9	25.8	25.9	26.0	25.9	25.9
Services	12.5	14.8	15.3	15.1	15.1	14.9	14.8	14.7	14.6	14.5
Income	0.3	-0.2	-0.7	-1.0	-0.9	-0.8	-0.7	-0.6	-0.5	-0.5
Capital and Financial Account	0.1	-1.3	-2.4	-0.3	-0.5	-0.5	-0.5	-0.4	-0.3	-0.2
Capital account	0.1	0.0	-0.1	0.0	0.0	-0.1	0.0	0.0	0.0	0.0
Financial account	0.0	-1.2	-2.3	-0.3	-0.4	-0.5	-0.5	-0.4	-0.3	-0.2
Direct investment	-1.1	3.2	-0.4	0.4	0.5	0.5	0.7	0.6	0.7	0.5
Portfolio investment	8.1	-3.4	0.6	-0.8	-0.4	-0.4	-0.5	-0.4	-0.4	-0.4
Financial derivatives	0.8	-1.9	-0.9	-0.5	-0.5	0.0	0.0	0.0	0.0	0.0
Other investment	-8.9	0.7	-1.7	0.6	0.1	-0.6	-0.6	-0.6	-0.5	-0.3
Reserve assets	1.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-0.4	1.0	-1.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP at current prices (bln euros)	248.8	266.1	273.3	279.5	289.4	299.8	310.3	320.9	331.5	342.3

Sources: Bank of Finland, Statistics Finland; and IMF staff calculations.

Table 3. Finland: General Government Statement of Operations, 2021–30

(Percent of GDP, unless otherwise indicated)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
				Proj.						
Revenue	53.4	53.4	53.8	53.9	54.3	54.3	54.1	53.9	53.9	53.9
Tax Revenues	31.2	31.2	30.2	30.2	30.5	30.7	30.7	30.7	30.7	30.7
Taxes on production and imports	13.9	13.7	13.0	13.0	13.3	13.2	13.2	13.2	13.2	13.2
Current taxes on income, wealth, etc.	16.9	17.2	16.8	16.7	16.7	17.0	17.0	17.0	17.0	17.0
Capital taxes	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Social Contributions	12.2	12.1	12.4	11.6	11.9	11.9	11.9	11.9	11.9	11.9
Grants	0.3	0.3	0.4	0.5	0.4	0.4	0.2	0.2	0.2	0.2
Other Revenue	9.7	9.7	10.8	11.7	11.4	11.4	11.3	11.1	11.1	11.1
Expenditure	56.3	53.7	56.7	57.6	57.5	57.0	56.4	56.0	56.0	56.0
Expense	55.8	53.2	56.3	57.2	56.5	56.2	55.6	55.4	55.4	55.4
Compensation of employees	12.9	12.5	13.1	13.1	13.1	13.1	13.1	13.0	13.0	13.0
Use of goods and services	11.6	11.5	12.5	12.7	12.6	12.3	12.1	12.0	12.0	12.0
Consumption of fixed capital (CFC)	3.6	3.6	3.7	3.7	3.8	3.8	3.8	3.8	3.8	3.9
Interest	0.5	0.6	1.2	1.3	1.5	1.8	2.1	2.2	2.2	2.3
Subsidies	1.6	1.1	1.0	1.0	1.0	1.0	0.9	0.9	0.9	0.9
Grants	1.1	1.0	1.0	1.0	0.9	0.9	0.9	0.9	0.8	0.8
Social benefits	22.1	20.9	21.5	22.4	21.9	21.5	21.0	20.9	20.9	20.9
Other expense	2.3	1.9	2.2	1.8	1.6	1.8	1.7	1.7	1.7	1.8
Net Acquisition of Nonfinancial Assets	0.5	0.5	0.4	0.5	1.0	0.8	0.8	0.6	0.6	0.6
Net Operating Balance	-2.4	0.1	-2.5	-3.2	-2.2	-1.9	-1.5	-1.5	-1.5	-1.5
Net Lending/Borrowing	-2.9	-0.4	-2.9	-3.7	-3.2	-2.6	-2.3	-2.1	-2.1	-2.1
Net Acquisition of Financial Assets	0.4	6.6	2.4	...	...	...	...	...	...	...
Currency and deposits	-2.1	0.0	0.5	...	...	...	...	...	...	...
Securities other than shares	0.6	0.1	0.3	...	...	...	...	...	...	...
Loans	1.1	3.3	-0.1	...	...	...	...	...	...	...
Shares and other equity	-0.3	0.7	1.1	...	...	...	...	...	...	...
Financial derivatives	0.6	1.2	0.4	...	...	...	...	...	...	...
Other accounts receivable	0.5	1.3	0.1	...	...	...	...	...	...	...
Net Incurrence of Liabilities	2.4	6.8	4.9	...	...	...	...	...	...	...
Special Drawing Rights (SDRs)	0.0	0.0	0.0	...	...	...	...	...	...	...
Currency and deposits	0.0	0.0	0.0	...	...	...	...	...	...	...
Securities other than shares	1.9	4.0	4.2	...	...	...	...	...	...	...
Loans	0.2	0.9	0.8	...	...	...	...	...	...	...
Shares and other equity	0.0	0.0	-0.5	...	...	...	...	...	...	...
Financial derivatives	0.0	0.0	0.0	...	...	...	...	...	...	...
Other accounts payable	0.3	1.8	0.4	...	...	...	...	...	...	...
Memorandum Items:										
Primary Balance[1]	-2.9	-0.4	-3.0	-3.8	-2.9	-2.0	-1.4	-1.0	-1.0	-1.0
Structural Balance (in percent of potential GDP)[2]	-3.2	-1.5	-2.4	-2.2	-2.3	-2.3	-2.5	-2.5	-2.5	-2.6
Structural primary balance (in Percent of Potential GDP)[3]	-3.3	-1.5	-2.5	-2.3	-2.0	-1.7	-1.6	-1.4	-1.4	-1.4
Central Government Net Lending/Borrowing	-3.3	-1.4	-3.2	-3.9	-3.9	-3.4	-3.0	-2.9	-2.9	-2.8
General Government Gross Debt	73.1	73.9	77.0	81.6	84.2	85.3	85.9	86.6	87.4	88.2
General Government Net Debt[4]	-73.7	-60.3	-55.8	-50.8	-45.9	-41.6	-37.9	-34.5	-31.3	-28.2
Central Government Gross Debt	58.7	60.1	62.4	66.1	68.8	69.9	70.5	71.3	72.2	73.1
Output Gap (Percent of Potential GDP)	0.6	1.1	-0.9	-2.2	-1.5	-0.8	-0.5	-0.3	-0.2	0.0
Nominal GDP (Billions of Euros)	248.8	266.1	273.3	279.5	289.4	299.8	310.3	320.9	331.5	342.3

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 4. Finland: Financial Soundness Indicators, 2016–2024Q2

(Ratios, unless otherwise indicated)

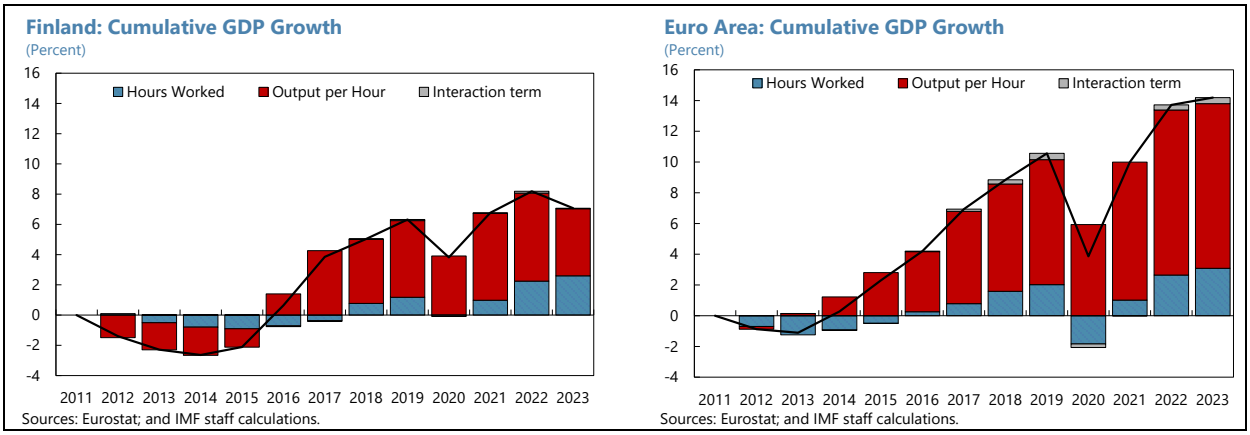
	2016	2017	2018	2019	2020	2021	2022	2023	2024Q2
Capital Adequacy									
Regulatory Capital to Risk-Weighted Assets	23.3	21.4	21.5	20.5	20.6	20.6	20.3	20.7	22.0
Regulatory Tier 1 Capital to Risk-Weighted Assets	21.9	19.6	19.6	18.3	18.6	18.6	18.3	18.5	19.5
Regulatory Tier 1 capital to Total assets	6.6	5.5	7.8	5.9	6.1	6.1	5.7	5.8	6.1
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	1.3	1.4
Non-performing Loans Net of Provisions to Capital	6.7	5.7	8.8	10.7	9.7	9.2	8.0	7.7	8.2
Earnings and Profitability									
Return on Assets	0.7	0.6	1.8	0.5	0.5	0.8	0.8	1.2	1.3
Return on Equity	8.9	7.6	26.2	6.5	6.2	9.3	9.5	14.5	16.0
Non-interest Expenses to Gross Income, percent	58.4	61.3	58.7	63.7	61.7	57.1	57.4	48.3	47.2
Personnel Expenses as Percent of Noninterest Expenses	37.6	38.2	45.8	43.9	44.4	45.4	44.4	45.1	46.6
Liquidity									
Liquid Assets to Total Assets (Liquid Asset Ratio)	21.3	14.2	8.9	17.7	17.3	18.2	20.9	21.0	20.5
Liquid Assets to Short Term Liabilities	25.1	20.9	19.1	22.1	21.7	22.2	23.8	23.8	23.0
Customer Deposits as Percent of Total (non-interbank) Loans	72.4	76.6	109.9	57.1	60.0	63.3	62.2	62.3	62.4

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

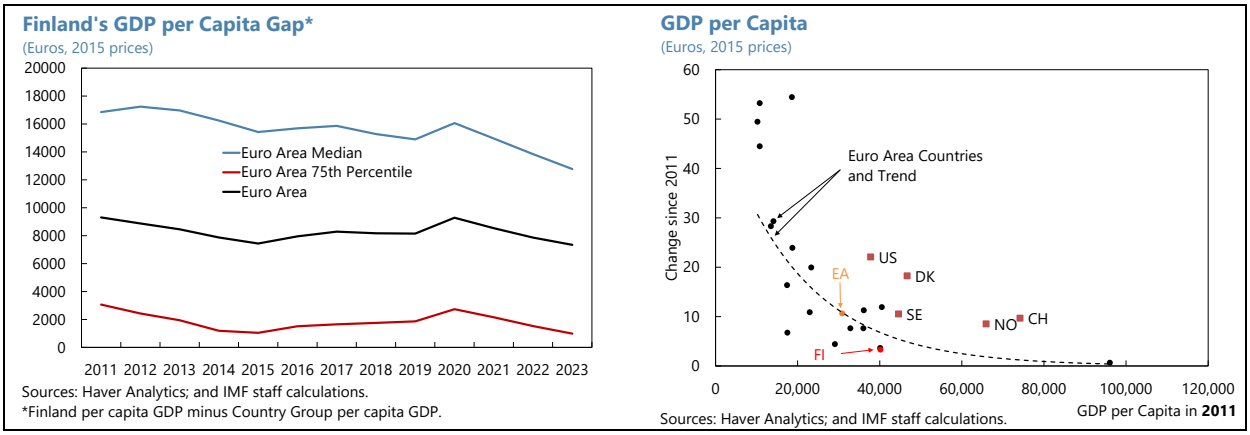
Annex I. 10 Salient Facts on Finnish Growth

This annex establishes the salient facts surrounding Finland's growth performance since 2011: a time when the acute phase of Global Financial Crisis had ended but many countries were struggling to grow. The organizing framework closely follows the work of Lopez-Garcia and other (2021).

1. Fact 1: Over the last decade, hours worked contributed little to GDP growth, while weak labor productivity growth drove the wedge with the euro area. Real GDP growth has increased by only 7 percent since 2011, half that of the euro area. Labor's contribution to growth was low in both regions, with the divergence driven by productivity developments.

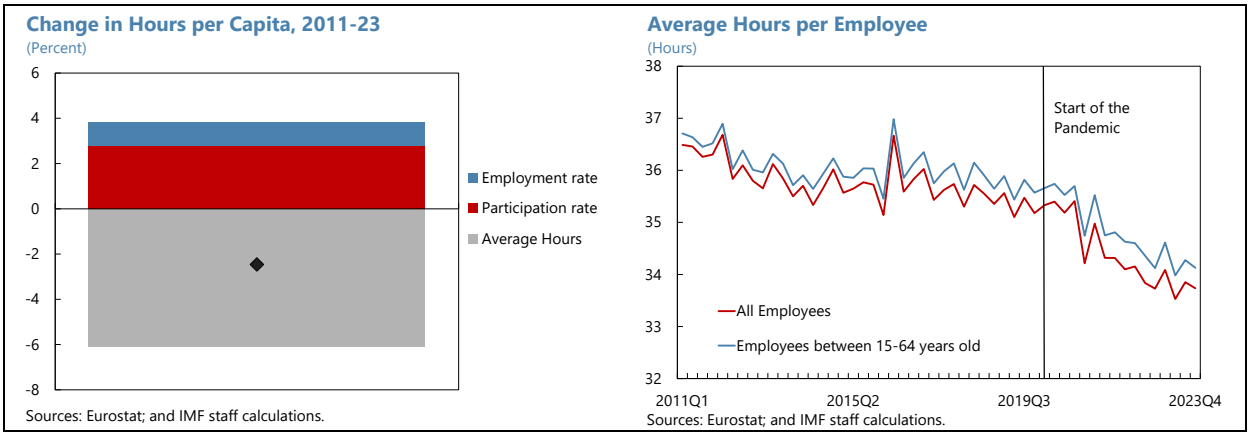


2. Fact 2: Finland remains a relatively rich country: its growth performance is similar to other well-off euro area countries, but below peers outside the currency union. Finland has remained within the top quartile of richest countries in the euro area, despite the gaps with both the mean and median closing as poorer countries "catch up." However, relative to peers outside the currency union—the USA, Denmark, Sweden, Norway, Switzerland—growth has underperformed.

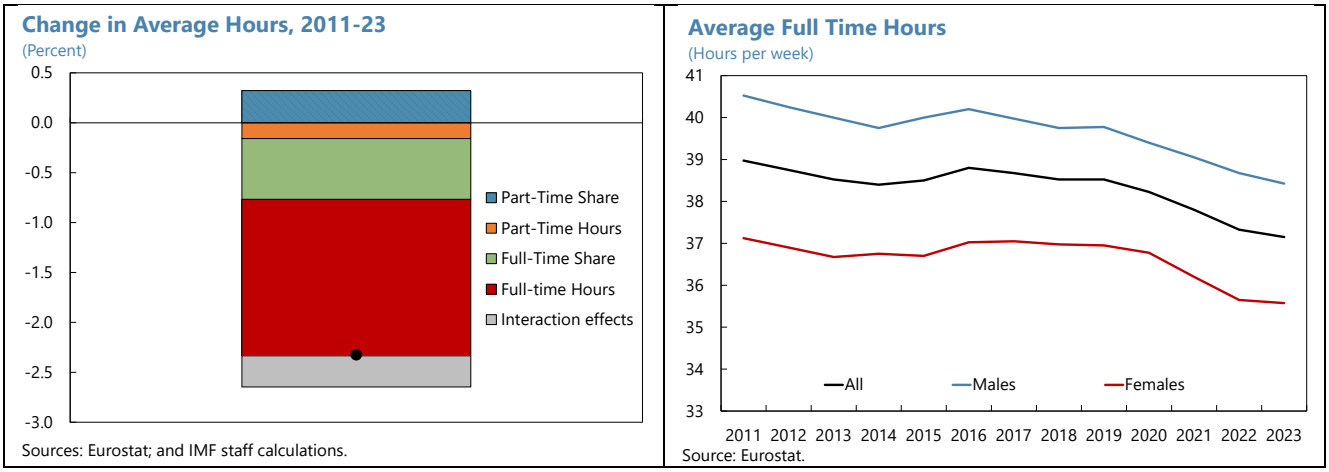


3. Fact 3: While total hours worked has remained broadly stable, this masks a steep decline in average hours per employee. Despite an impressive increase in total employment—through greater participation and lower unemployment—this was almost fully offset by significant

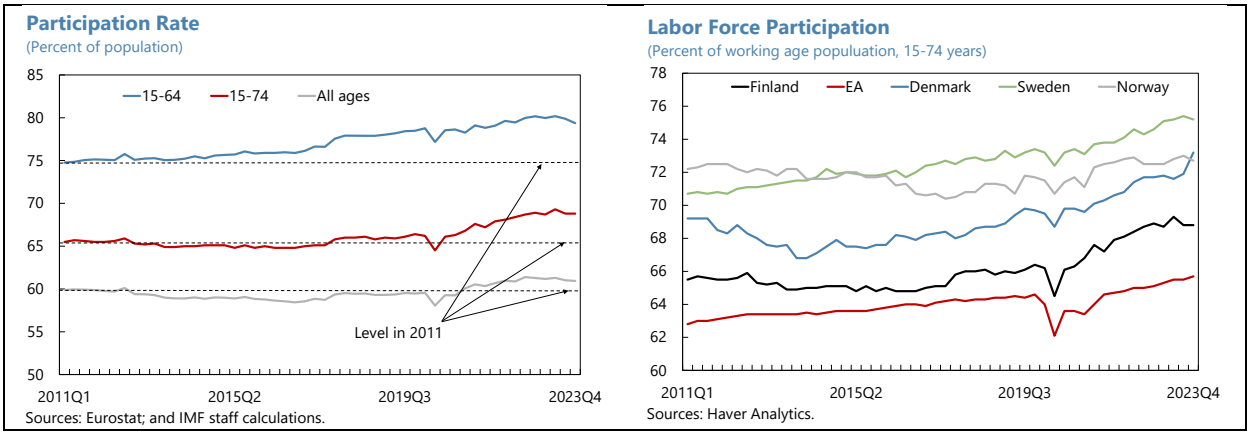
decline in average hours, which accelerated after the pandemic. Had average hours remained at the 2011 levels, potential output would have been around 3 percent higher, assuming constant employment and labor productivity.



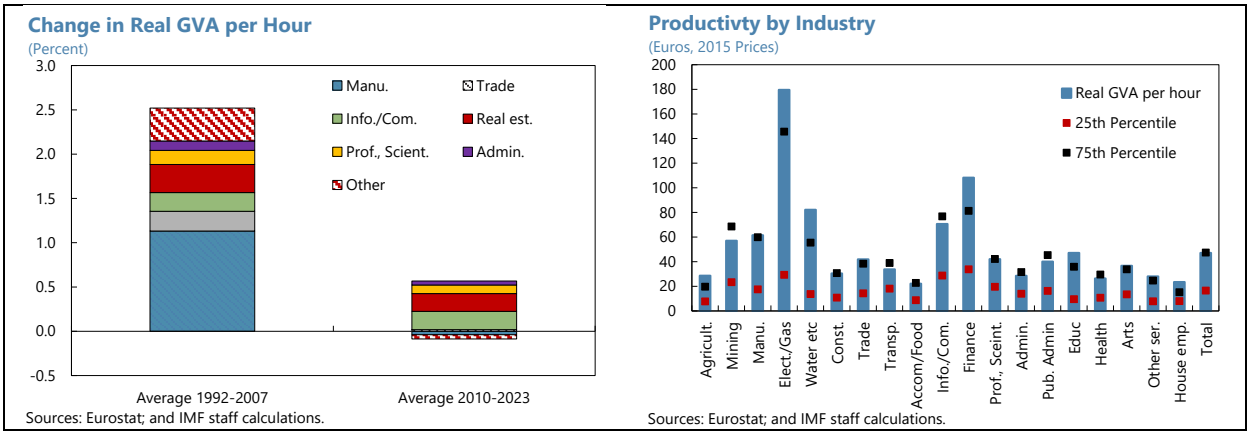
4. Fact 4: The fall in average hours was mainly driven by a decline in full-time hours. While there was a shift to greater (mainly female) part-time employment, most of the decline was driven a falling full-time hours. Such a decline could be associated with greater sick, holiday, and parental leave, as well as a decline in contracted full-time hours. This decline is slightly higher for men (5.2 percent) than females (4.2 percent), perhaps reflecting a shift towards a more equal distribution of parental leave, consistent with the work of Astinova and other (2024).



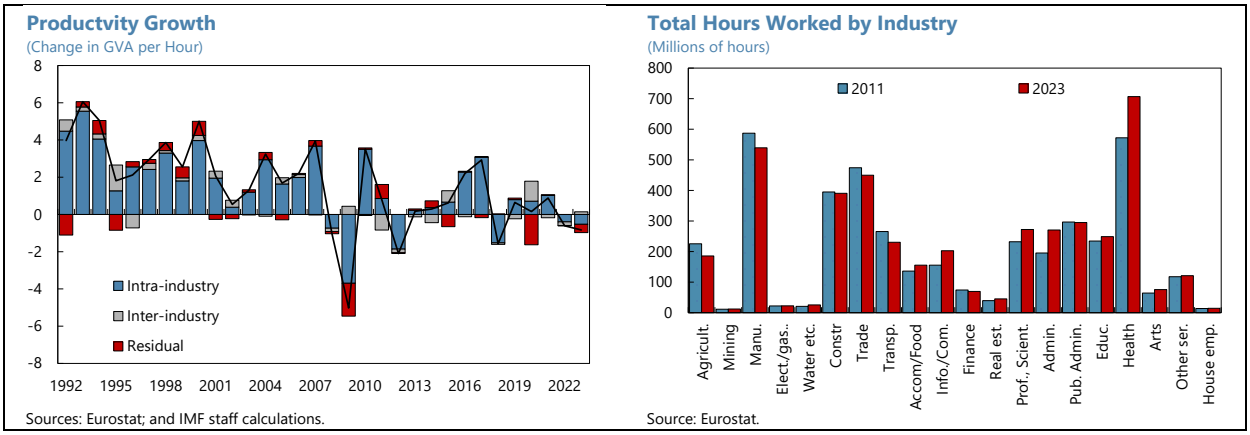
5. Fact 5: While labor force participation (and employment) has increased, there is significant potential for further progress to reach Nordic peers. Over the last decade, through a combination of later retirement and higher participation within the age groups, the participation rate of 16–74 year-olds has increased by over 3 percentage points. This has allowed the share of employed people in the total population to remain broadly stable, despite Finland's aging population. However, participation rates remain below Nordic peers, suggesting that further progress can be made.



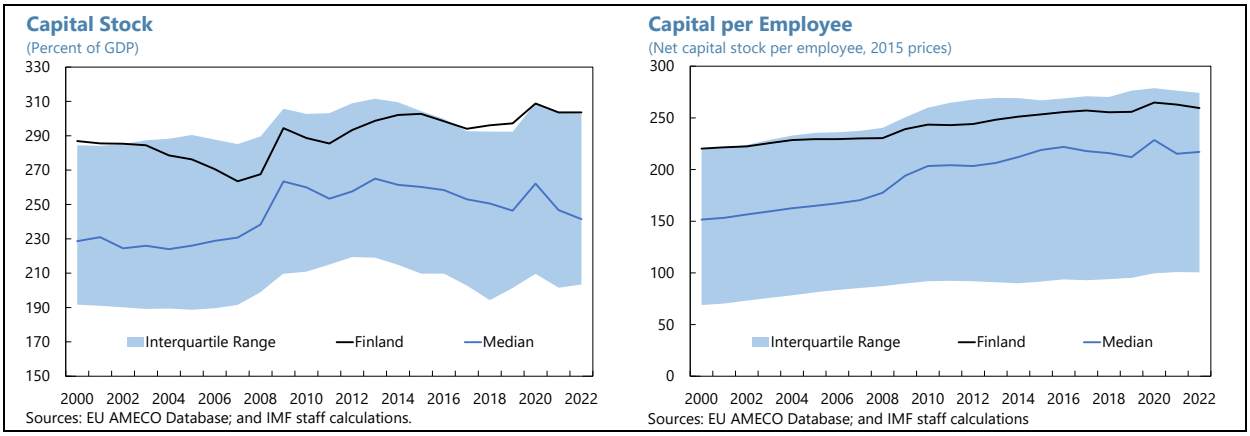
6. Fact 6: The decline in productivity was broad based across all industries, but Finland remains relatively competitive in finance and the utility sectors. The well-documented decline in mobile phone manufacturing sector (Selected Issues, 2015) was clearly an important driver of the decline in productivity growth in the last decade. But in most other industries, productivity growth also stalled. Nevertheless, industries in Finland remain relatively productive compared to country peers, with the finance and utility sectors particularly strong.



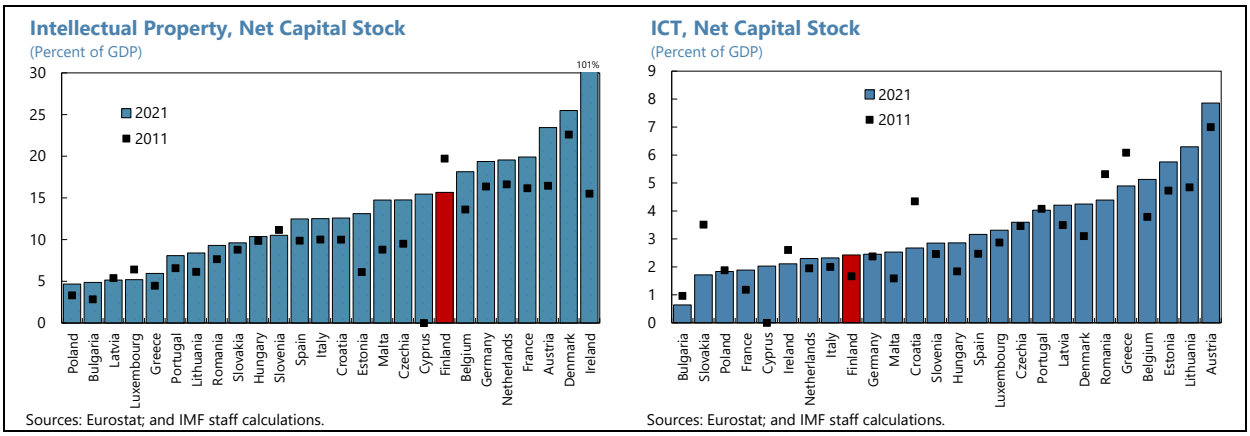
7. Fact 7: As with most advanced economies, productivity growth is primarily generated *within* industries, rather than labor moving *between* industries. Most increases in productivity occur within industries (NACE21 disaggregation), rather than labor shifting between industries with different productivity levels. In other words, most of the change is driven by the *intensive* rather than the *extensive* margin. Indeed, the change in total hours worked in each industry over the last decade is very small. These results are not unusual when compared to the euro area as a whole.



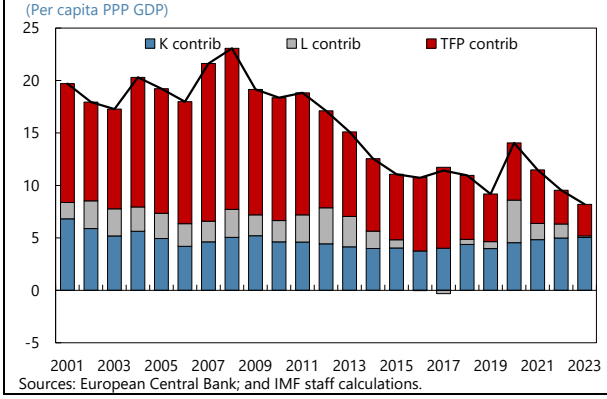
8. Fact 8: Finland has relatively high capital-to-GDP and capital-to-employee ratios. Finland's estimated capital stock has remained broadly stable as a share of GDP over the last two decades, at around the top quartile within the EU. Similarly, Finland's capital per employee ratio, while trending up, has also remained around the top quartile.



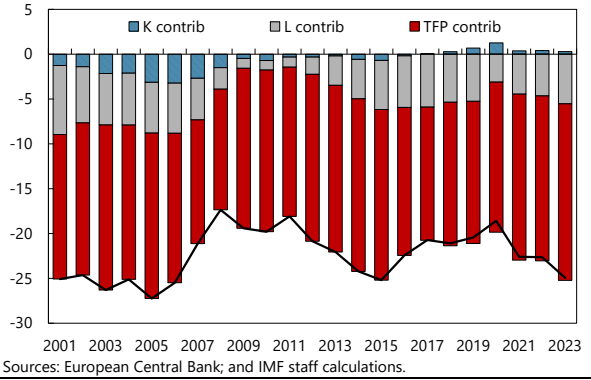
9. Fact 9: Intellectual property is relatively high, but declining; ICT capital is relatively low, but increasing. Intellectual property, which is dominated by accumulated R&D, is relatively high by European standards, despite declining from 20 to 16 percent of GDP over the last decade. In contrast, ICT capital stock, which is low by European standards has increased.



10. Fact 10: Weak total factor productivity (TFP) growth accounts for Finland's poor growth performance. The catch-up by poorer European economies has been driven entirely by higher relative TFP growth, with Finland's positive 'capital gap' remaining largely unchanged. And the large GDP gap with the USA, which has not closed, is accounted almost entirely by TFP differences.



Sources: European Central Bank; and IMF staff calculations.



Sources: European Central Bank; and IMF staff calculations.

Annex II. Declining Average Hours Worked

Intensifying an ongoing downward trend, Finland experienced one of the sharpest declines in average actual hours worked (AAHW) in euro area after the pandemic. Low-skilled labor and younger employees tend to have lower AAHW. But after the pandemic, there was also a sharp decline in hours worked by high-skilled workers, especially women, and full-time employees. This annex builds upon the analysis presented in Astinova and others (2024).

Introduction

1. While labor force participation and employment rates have significantly improved since 2011, these gains have been partly offset by the decline in average hours worked. The total number of employees increased significantly since 2017 through a combination of lower unemployment, increases to the retirement age, and increased migration. As such, since 2011, the number of employees grew by an impressive 8 percent. At the same time, however, average hours worked per employee fell by around 3 percent.[1] Consequently, *total* hours worked in 2023 were only 5 percent higher than in 2011. The dynamics of AAHW has important implications for assessing the contribution of workforce to total economic output and for informing potential policy responses.

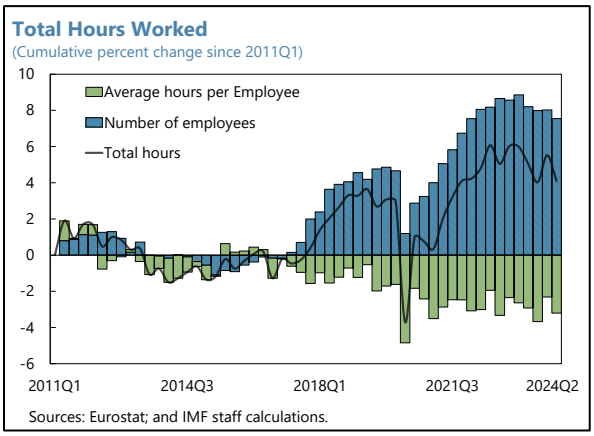
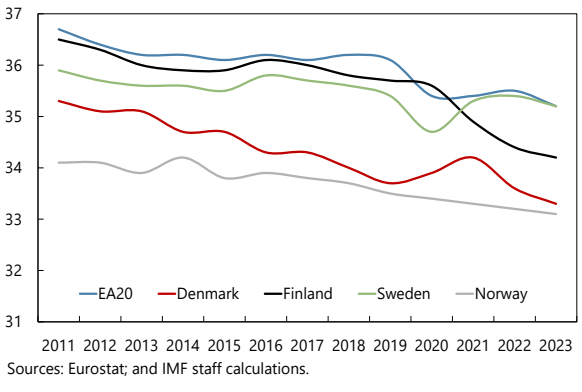
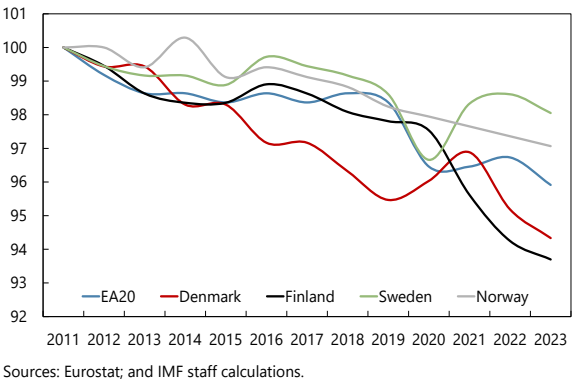


Figure 1. Finland: AAHW, Long-Term Trends





[1] This AAHW measure considers hours worked in all jobs (i.e., main job and additional jobs). It differs slightly from the definition used in the rest of the analysis, which comprises hours worked in the main job only.

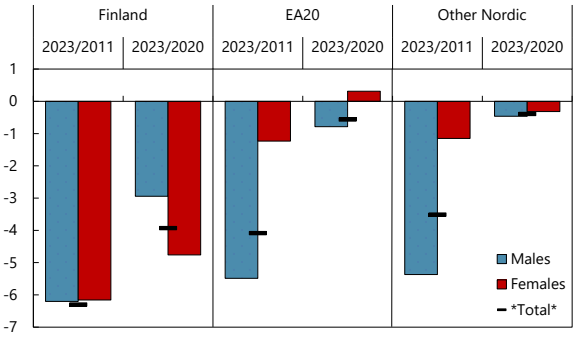
2. Finland's reduction in AAHW is part of a long-term downward trend across advanced economies, which intensified in Finland after the pandemic. The long-term trend in European countries was analyzed by Astinova and others (2024). They find that, after the pandemic, AAHW in Europe continued to fall, with men and younger workers driving this trend. And the drop in AAHW closely matches the fall in desired hours, suggesting the fall is primarily due to structural rather than cyclical factors. Prior to the pandemic, Finland's AAHW was broadly similar to the euro area average and Sweden. But since 2019, it has fallen by a much faster rate than peer countries. Nevertheless, AAHW remains somewhat higher than Denmark and Norway.

Stylized Facts

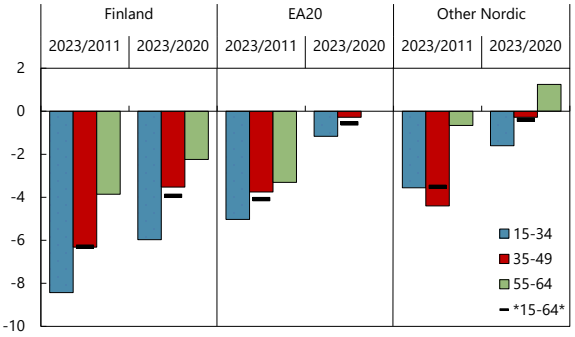
Finland and the Region

3. Finland's AAHW in the main job declined by over 6 percent between 2011 and 2023, with 4 percentage points of this reduction occurring after the pandemic. While the decline in AAWH is a common feature across countries, the drivers in Finland have some unique characteristics (Figure 2):

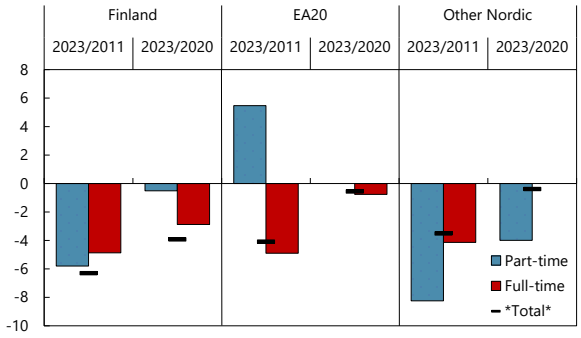
Figure 2. Finland: Regional Comparisons of the Change in AAHW



Sources: Eurostat; and IMF staff calculations.



Sources: Eurostat; and IMF staff calculations.



Sources: Eurostat; and IMF staff calculations.

Sources: Eurostat; and IMF staff calculations.

- Both men and women experienced a drop in working hours, although the decline for women has been more pronounced in Finland compared to other countries and happened mostly after 2020.

- All age groups reduced AAHW, however younger workers (15–34) in Finland typically work less hours, and faced the steepest decline, particularly after 2020. Interestingly, unlike in Finland, the AAHW of older workers (55–64) remained resilient in both the euro area and Nordic region after the pandemic.

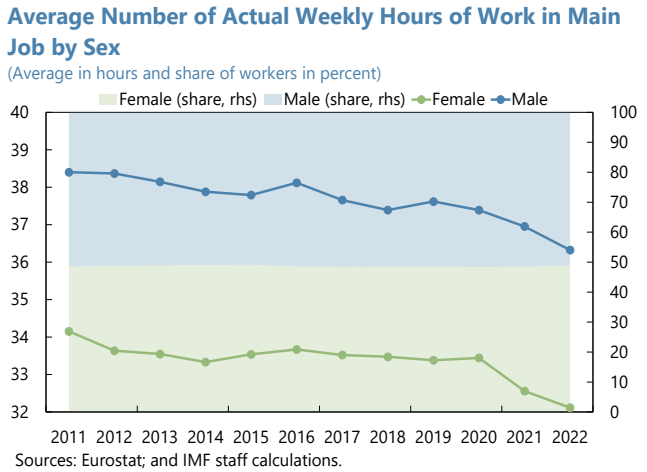
- Part-time workers saw significant declines in AAHW across Nordic countries until the pandemic. The trend shifted to a sharp drop in full-time workers' hours in Finland after the pandemic. In the euro area, part-time AAHW increased, partially offsetting the decline in full-time workers.

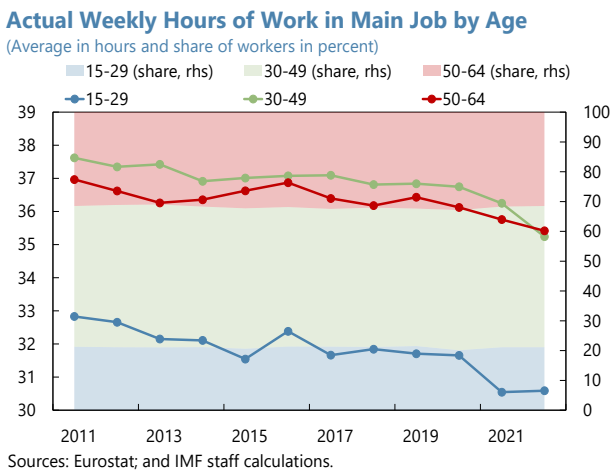
- Self-employed workers saw larger AAHW declines than employees, similar to other Nordic countries. Post-pandemic, Finland's employee decline worsened, unlike trends in the euro area and in the Nordics.

Finland's Main Demographic and Social Condition Changes

4. Micro-data analysis can provide deeper insights into these trends. Results from the Household Survey data for Finland between 2011 and 2022[2] confirm the previous findings and provides additional elements of analysis, such as changes in the distribution between groups and their long-term trends.

Figure 3. Finland's AAHW by Demographic Conditions

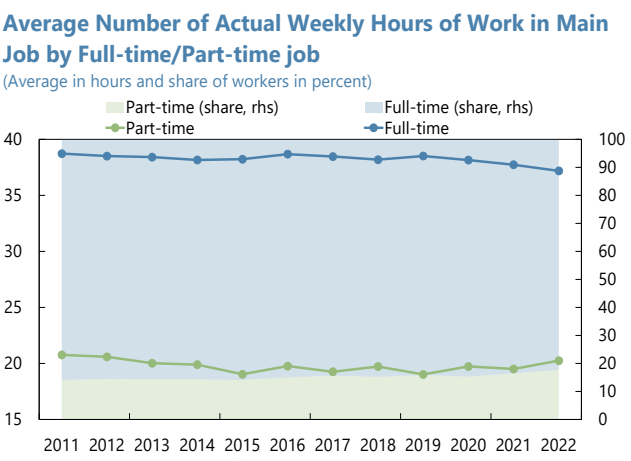




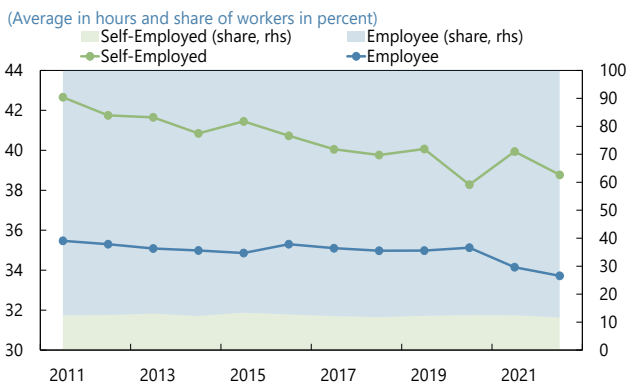
[2] The results are for workers between 15–64 years, receiving compensation, and working more than zero hours in the week of the survey. Thus, it excludes workers in family business who don't receive compensation or those who were employed but reported zero worked hours.

- **By gender and age**. Men typically worked more hours than women, with a balanced distribution in the labor market. Men's AAHW has steadily declined since the 2010s, while women's AAHW remained more stable before the pandemic but experienced a sharper decline after. Younger workers (15–29) consistently worked fewer hours than older groups.

Figure 4. Finland's AAHW by Employment Conditions



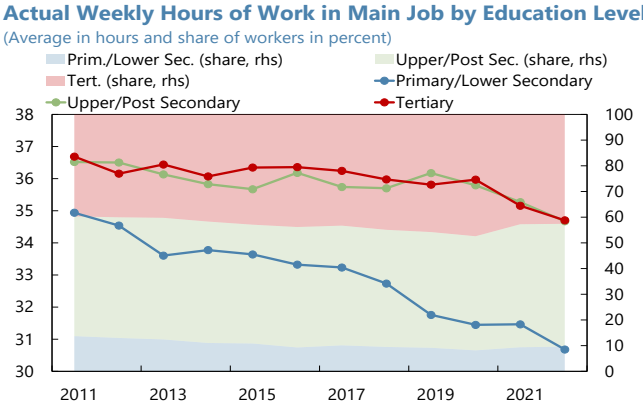
Sources: Eurostat; and IMF staff calculations.



Sources: Eurostat; and IMF staff calculations.

- **By type of employment**. By definition, full-time workers maintained higher AAHW than part-time workers, but after 2020, part-time hours increased while full-time AAHW dropped. Self-employed workers worked more hours than employees but saw a clear decline from 2011 to 2020, with employee AAHW remaining stable before a sharp post-pandemic fall.

Figure 5. Finland's AAHW by Education Level



Sources: Eurostat; and IMF staff calculations.

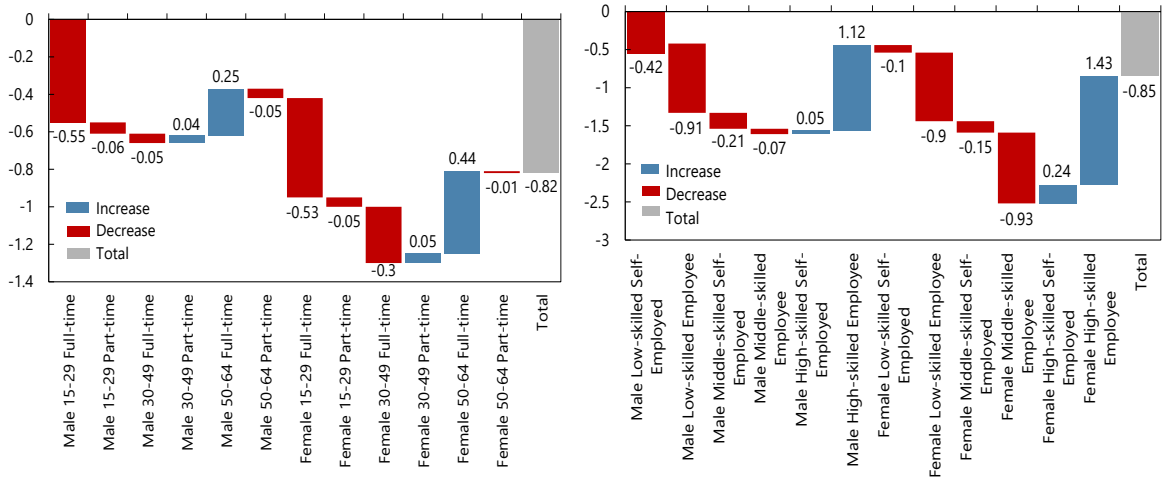
- **By education level**. Education level significantly influenced hours worked, with workers possessing upper secondary and tertiary education consistently working more hours than those with lower educational attainment. However, post-2020, workers with higher education levels saw a notable reduction in hours, whereas those with primary or lower secondary education continued on the same long-term decline.

The Relative Importance of these Factors

5. The relative contribution of each factor in driving down AAHW is important. Shapley decompositions can identify the main contributors to the annual changes in AAHW.[3] Given the distinct trends observed, the results are divided into two time periods, using the pandemic as the cutoff, as well as the cumulative change over the entire period from 2011 to 2022. Annual change decompositions for the whole period are also shown in the Appendix (Figures 1 and 2).

6. Drivers before the pandemic. In general, high-skilled employees, and full-time workers aged 50–64 increased their AAHW between 2011 and 2020. Most other demographic groups experienced a steady decline in AAHW. The youngest and low-skilled workers were generally the groups with highest cumulative decline during this period, regardless of their gender (Figure 6). Females in the 30–49 age group also contributed significantly to the reduction. The decomposition by full- and part-time jobs and employment status shows that full-time self-employed workers accounted for most of the drop in AAHW (Appendix, Figure 2). Notably, the trends for employees were stark, with high-skilled employees' AAHW increasing, while low-skilled employees' AAHW decreased.

Figure 6. Selected Decompositions of the Decline in AAHW – Pre Pandemic



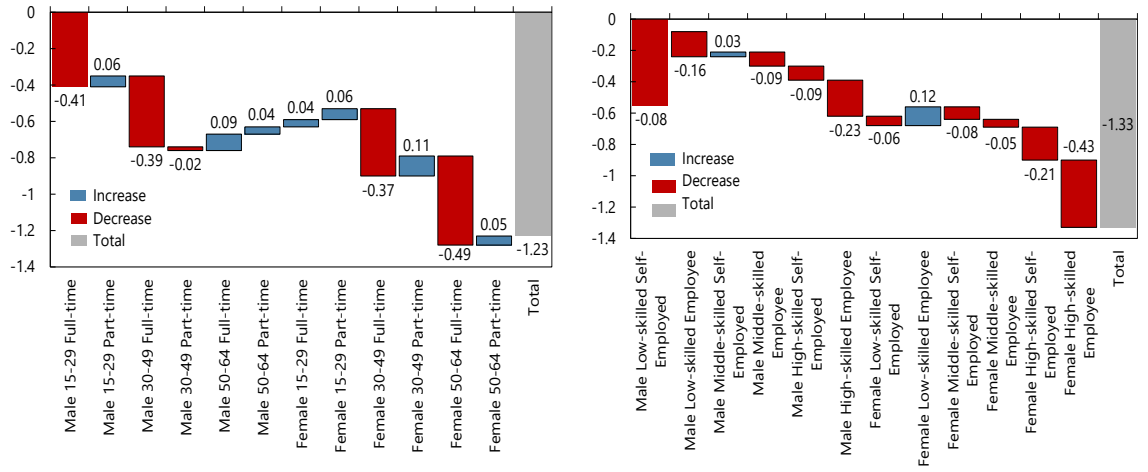
Sources: Eurostat Labor Force Surveys; and IMF staff calculations.

7. Drivers after the pandemic. In the gender and age decomposition, female workers, 30 and older, drove much of the decline, along with the youngest and prime-working-age males (15–49 years old). The trends for female full-time workers in the 15–29 and 50–64 age groups have reversed compared to the pre-pandemic period. For the 15–29 group, AAHW was declining before the pandemic but has shown a slight increase since. In contrast, the 50–64 group saw strong increases in AAHW pre-pandemic, but now faces a sharp decline. Notably, high-skilled

[3] The Shapley decomposition implemented in our analysis follows the methodology described in Azevedo et al. 2013.

females and males reversed their previous positive trends as well, with sharp reductions in working hours post pandemic. The decomposition by full-time/part-time employment reveals a sharp decline in full-time employee hours, while part-time employee workers saw increases in AAHW. Part-time self-employed workers demonstrated some resilience during this period.

Figure 7. Selected Decompositions of the Decline in AAHW – Post Pandemic



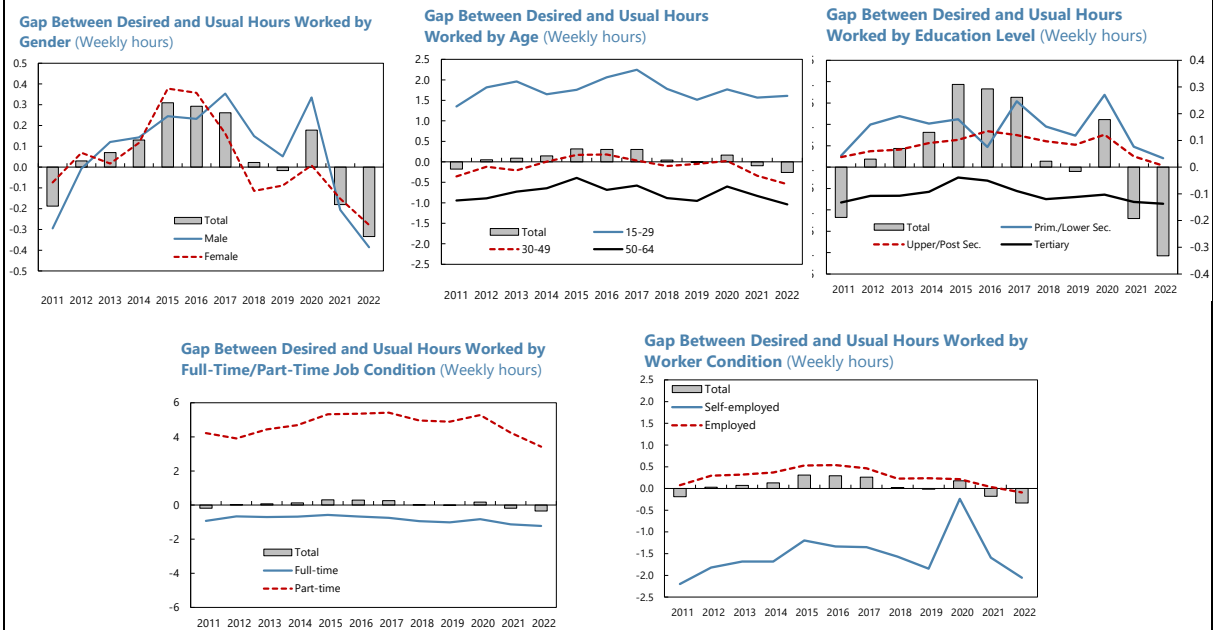
Sources: Eurostat Labor Force Surveys; and IMF staff calculations.

8. The differences between these two periods highlight both the exacerbation of pre-existing trends and the introduction of new dynamics driven by the pandemic. Before the pandemic, the decline in AAHW was primarily driven by younger, low-skilled workers, whereas high-skilled, full-time employees aged 50–64 actually increased their hours worked. In contrast, the 2020–2022 period reflects the broader impact of the pandemic, with older workers, particularly females in the 50–64 age group, experiencing sharp reductions in AAHW. Full-time employees faced a marked decline in hours, while part-time workers showed more resilience. Notably, high-skilled male and female workers with tertiary education saw a reversal in their previous trend, with a significant drop in hours worked post-pandemic.

Working Hours Preferences

9. The analysis of work hour preferences in Finland reveals distinct patterns across demographic and employment categories. The gap between desired working hours and usual working hours are minimal across genders but notable disparities emerge in age, skill level, and employment type. Younger workers generally prefer to increase their hours, contrasting with older workers who often wish to work less. Part-time workers predominantly seek more hours, indicating an unmet demand for full-time opportunities, whereas self-employed individuals frequently express a preference for fewer hours. Skill levels also shape preferences: low- and mid-skilled workers typically desire additional hours, whereas high-skilled workers, particularly in full-time positions, often lean towards reducing their working hours.

Figure 8. Gap Between Desired and Usual Hours Worked



Sources: Eurostat's Labor Force Surveys; and IMF staff calculations.

Policy Implications

10. Targeted policy interventions should focus on both structural labor market issues and the more acute disruptions caused by the pandemic. The following potential recommendations are designed to enhance workforce resilience, promote greater equity across demographic groups, and encourage higher working hours where needed:

- **Boost youth employment opportunities**: The significant decline in hours worked among younger workers highlights the need for targeted policies to engage this group. Expanding vocational training, apprenticeships, and job-placement programs can bridge skills gaps and provide younger workers with more stable, full-time employment opportunities.

- **Support for full-time workers**: As full-time employees have experienced the steepest declines in AAHW, particularly post-pandemic, potential policies should focus on making full-time employment more attractive. Flexible scheduling options and productivity-based incentives tied to performance rather than hours could help retain and motivate full-time workers. Conducting an analysis of productivity differentials between part-time and full-time workers would help inform more targeted measures.

- **Female workforce re-engagement**: Given the post-pandemic sharp reduction in hours worked among older women (50–64), policies that facilitate the re-engagement of women in the workforce are crucial. Recognizing that this reduction may reflect personal preferences or other factors, initiatives like flexible work arrangements, affordable reskilling programs, and

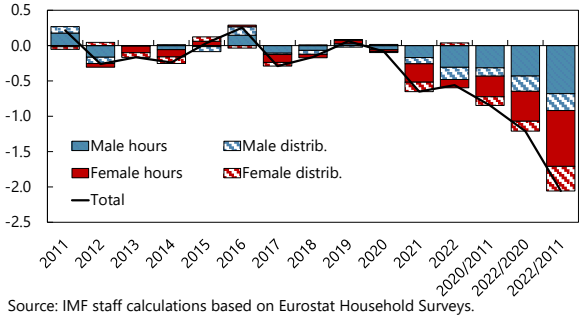
return-to-work schemes can offer tailored options to those looking to expand their hours or take on new roles.

- **Targeted support for low-skilled workers**: The persistent decline in AAHW among low-skilled workers across all periods calls for targeted interventions. Upskilling and lifelong learning programs should be expanded to provide low-skilled workers with pathways to higher-paying, more stable jobs.
- **Promote resilience for the self-employed**: While self-employed workers showed resilience post-pandemic, they also faced long-term declines in AAHW. Policies that boost job stability for self-employed individuals could be beneficial, alongside financial support programs to enhance their productivity and working hours.
- **Encourage active aging in the workforce**: Older, high-skilled workers showed positive trends pre-pandemic but this reversed post-2020. It could be important to implement active aging policies. These could include incentives for continued work, phased retirement schemes, or flexible working options for older workers to encourage their continued participation in the labor market.

Appendix. Demographic Decomposition of Change in Hours Worked

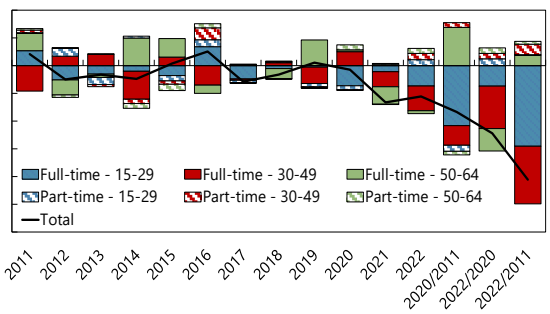
Figure 1. Finland: Decomposition of Change in Actual Hours Worked

Decomposition of Change in Actual Hours Worked by Gender (In hours)



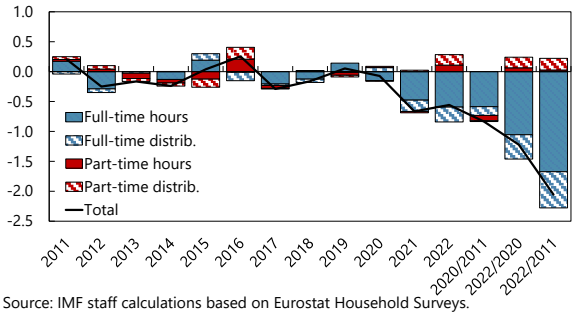
Source: IMF staff calculations based on Eurostat Household Surveys.
The chart shows the decomposition of the annual change compared to the previous year from 2010 to 2022, along with the accumulated changes for the following periods: 2011-2020, 2020-2022, and 2011-2022.

Decomposition of Change in Actual Hours Worked by Full-time/Part-time Condition and age (In hours)



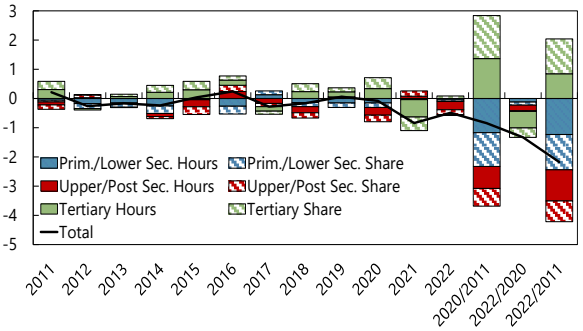
Source: IMF staff calculations based on Eurostat Household Surveys.
The chart shows the decomposition of the annual change compared to the previous year from 2010 to 2022, along with the accumulated changes for the following periods: 2011-2020, 2020-2022, and 2011-2022.

Decomposition of Change in Actual Hours Worked by Full-Time/Part-time Job (In hours)



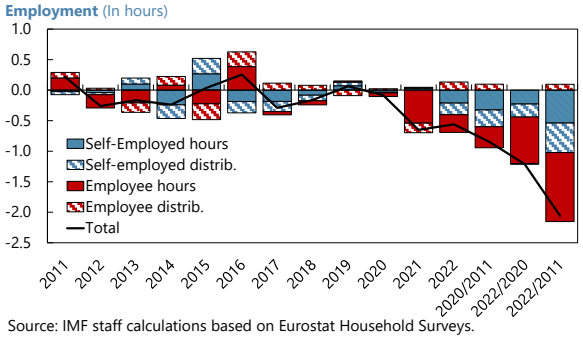
Source: IMF staff calculations based on Eurostat Household Surveys.
The chart shows the decomposition of the annual change compared to the previous year from 2010 to 2022, along with the accumulated changes for the following periods: 2011-2020, 2020-2022, and 2011-2022.

Decomposition of Change in Actual Hours Worked by Education Level (In hours)



Source: IMF staff calculations based on Eurostat Household Surveys.
The chart shows the decomposition of the annual change compared to the previous year from 2010 to 2022, along with the accumulated changes for the following periods: 2011-2020, 2020-2022, and 2011-2022.

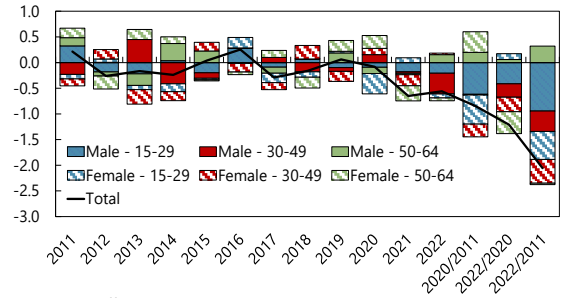
Decomposition of Change in Actual Hours Worked by Condition of Employment (In hours)



Source: IMF staff calculations based on Eurostat Household Surveys.
The chart shows the decomposition of the annual change compared to the previous year from 2010 to 2022, along with the accumulated changes for the following periods: 2011-2020, 2020-2022, and 2011-2022.

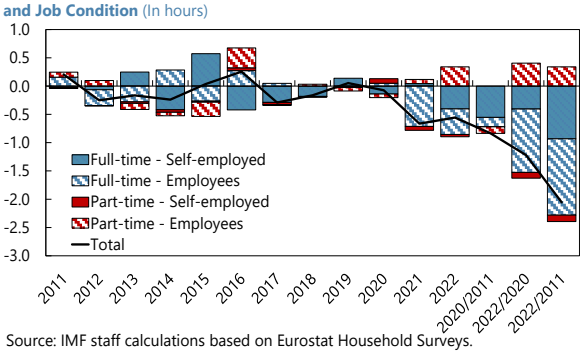
Figure 2. Finland: Shapley Decompositions of the Change in AAHW

Decomposition of Change in Actual Hours Worked by Gender and Age Group (In hours)



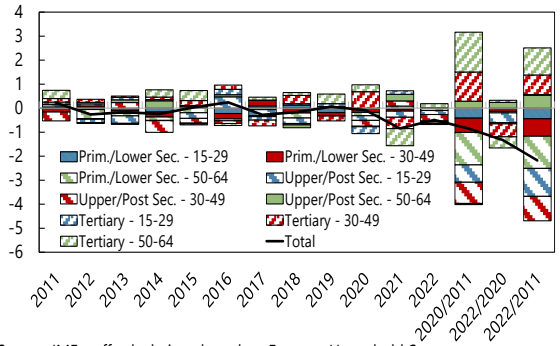
Source: IMF staff calculations based on Eurostat Household Surveys.
The chart shows the decomposition of the annual change compared to the previous year from 2010 to 2022, along with the accumulated changes for the following periods: 2011-2020, 2020-2022, and 2011-2022.

Decomposition of Change in Actual Hours Worked by Full-time/Part-time Job and Job Condition (In hours)



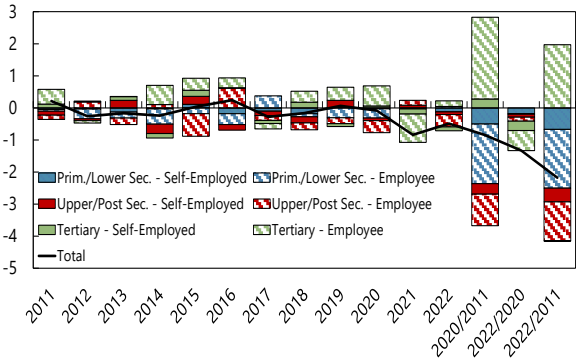
Source: IMF staff calculations based on Eurostat Household Surveys.
The chart shows the decomposition of the annual change compared to the previous year from 2010 to 2022, along with the accumulated changes for the following periods: 2011-2020, 2020-2022, and 2011-2022.

Decomposition of Change in Actual Hours Worked by Education Level and Age Group (In hours)



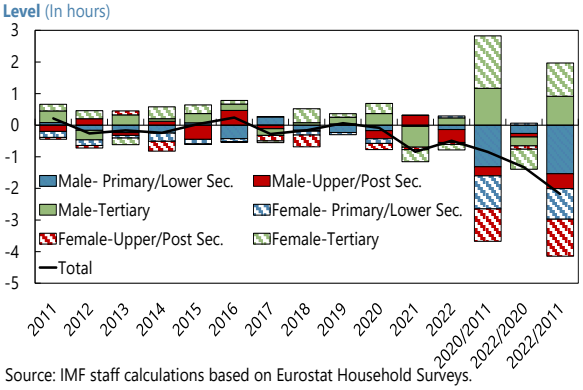
Source: IMF staff calculations based on Eurostat Household Surveys.
The chart shows the decomposition of the annual change compared to the previous year from 2010 to 2022, along with the accumulated changes for the following periods: 2011-2020, 2020-2022, and 2011-2022.

Decomposition of Change in Actual Hours Worked by Education Level and Job Condition (In hours)



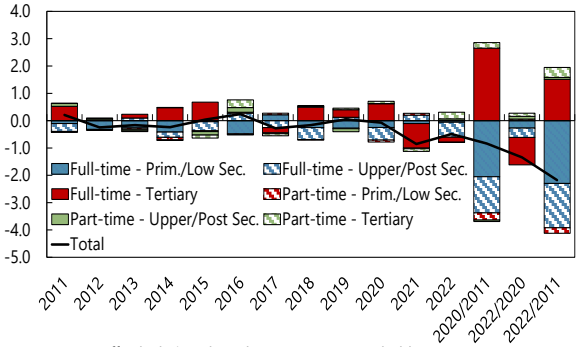
Source: IMF staff calculations based on Eurostat Household Surveys.
The chart shows the decomposition of the annual change compared to the previous year from 2010 to 2022, along with the accumulated changes for the following periods: 2011-2020, 2020-2022, and 2011-2022.

Decomposition of Change in Actual Hours Worked by Gender and Education Level (In hours)



Source: IMF staff calculations based on Eurostat Household Surveys.
The chart shows the decomposition of the annual change compared to the previous year from 2010 to 2022, along with the accumulated changes for the following periods: 2011-2020, 2020-2022, and 2011-2022.

Decomposition of Change in Actual Hours Worked by Full-time/Part-time Job and Education Level (In hours)



Source: IMF staff calculations based on Eurostat Household Surveys.
The chart shows the decomposition of the annual change compared to the previous year from 2010 to 2022, along with the accumulated changes for the following periods: 2011-2020, 2020-2022, and 2011-2022.

References

Wagner de Azevedo, João Pedro and Inchauste Comboni, Maria Gabriela and Sanfelice, Viviane, Decomposing the Recent Inequality Decline in Latin America (December 1, 2013). World Bank Policy Research Working Paper No. 6715.

Diva Astinova, Romain A. Duval, Niels-Jakob H Hansen, Ben Park, Ippei Shibata and Frederik G. Toscani, 2024. "Dissecting the Decline in Average Hours Worked in Europe," IMF Working Papers 2024/002, International Monetary Fund.

Annex III. 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 and diversified investor 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.
Fanchart	Low	...	
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.
Sustainability assessment 2/	Not required for surveillance countries		
Debt stabilization in the baseline			No

DSA Summary Assessment

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 liquidity risks as analyzed by the GFN Financeability Module are however low due to highly diversified investor base. Over the longer run, Finland is affected by population aging which require a wide-ranging set of fiscal and structural reforms.

Source: IMF staff calculations.

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.

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.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure 2. Finland: Debt Coverage and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/						
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	
	2	Extra budgetary funds (EBFs)	No	Not applicable
	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	

	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/
3. Instrument coverage:					

	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/
4. Accounting principles:					

		Consolidated	Non-consolidated
5. Debt consolidation across sectors:			

Color code: chosen coverage; Missing from recommended coverage; Not applicable

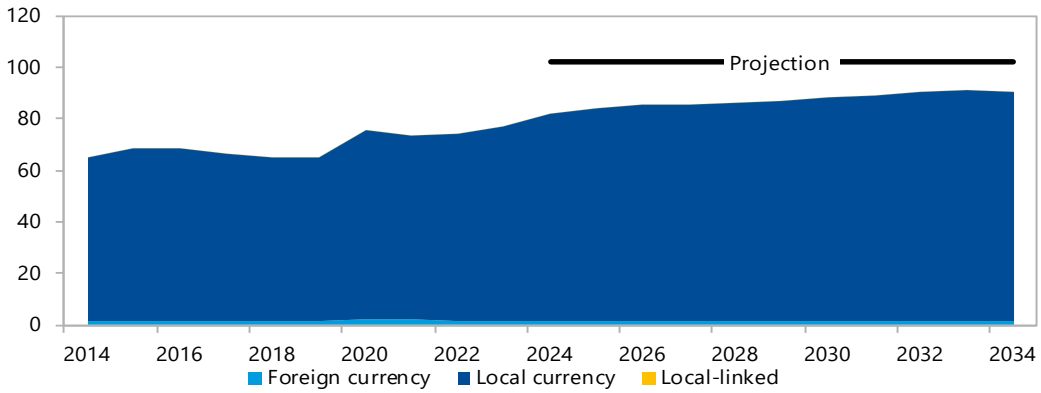
Reporting on Intra-Government Debt Holdings

		Issuer \ Holder	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	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.

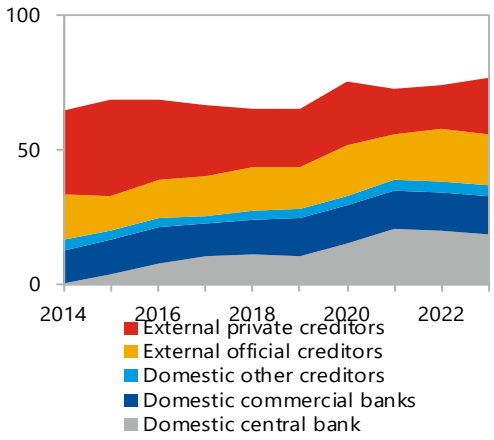
Figure 3. Finland: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



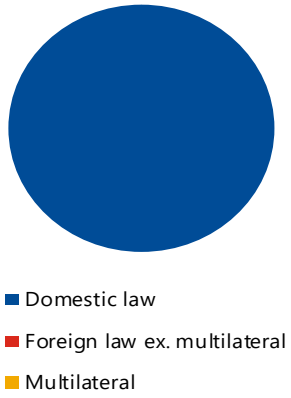
Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)



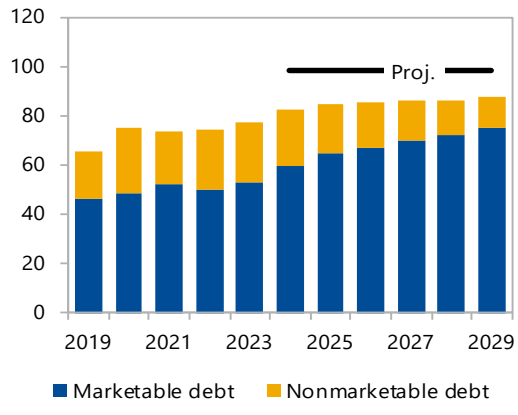
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (percent)



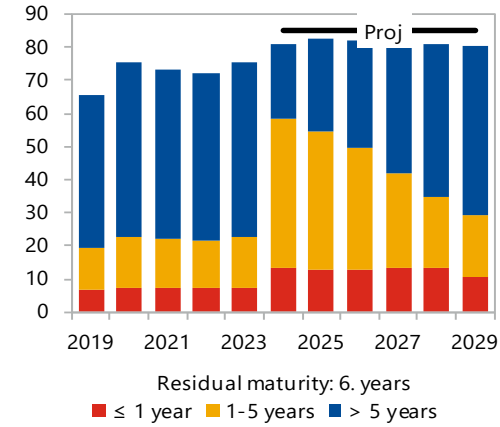
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



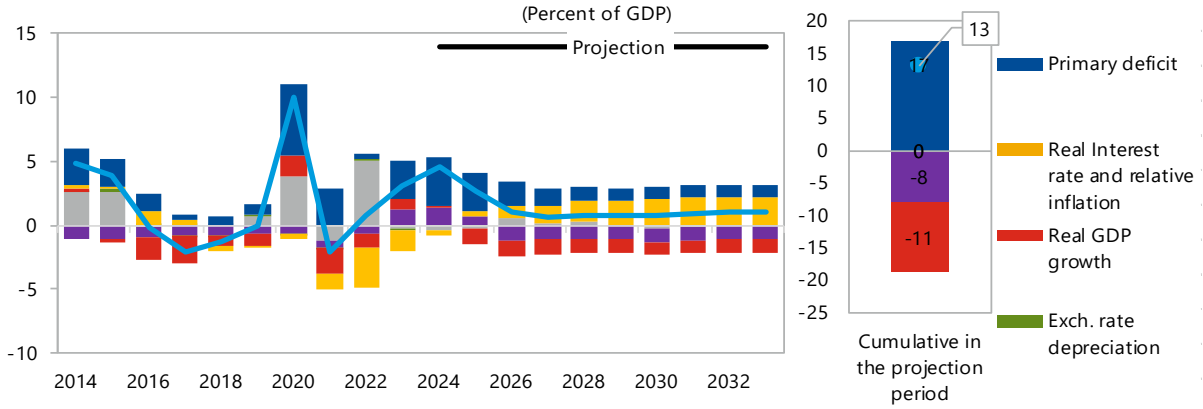
Note: The perimeter shown is general government.

Figure 4. Finland: Baseline Scenario

(Percent of GDP unless indicated otherwise)

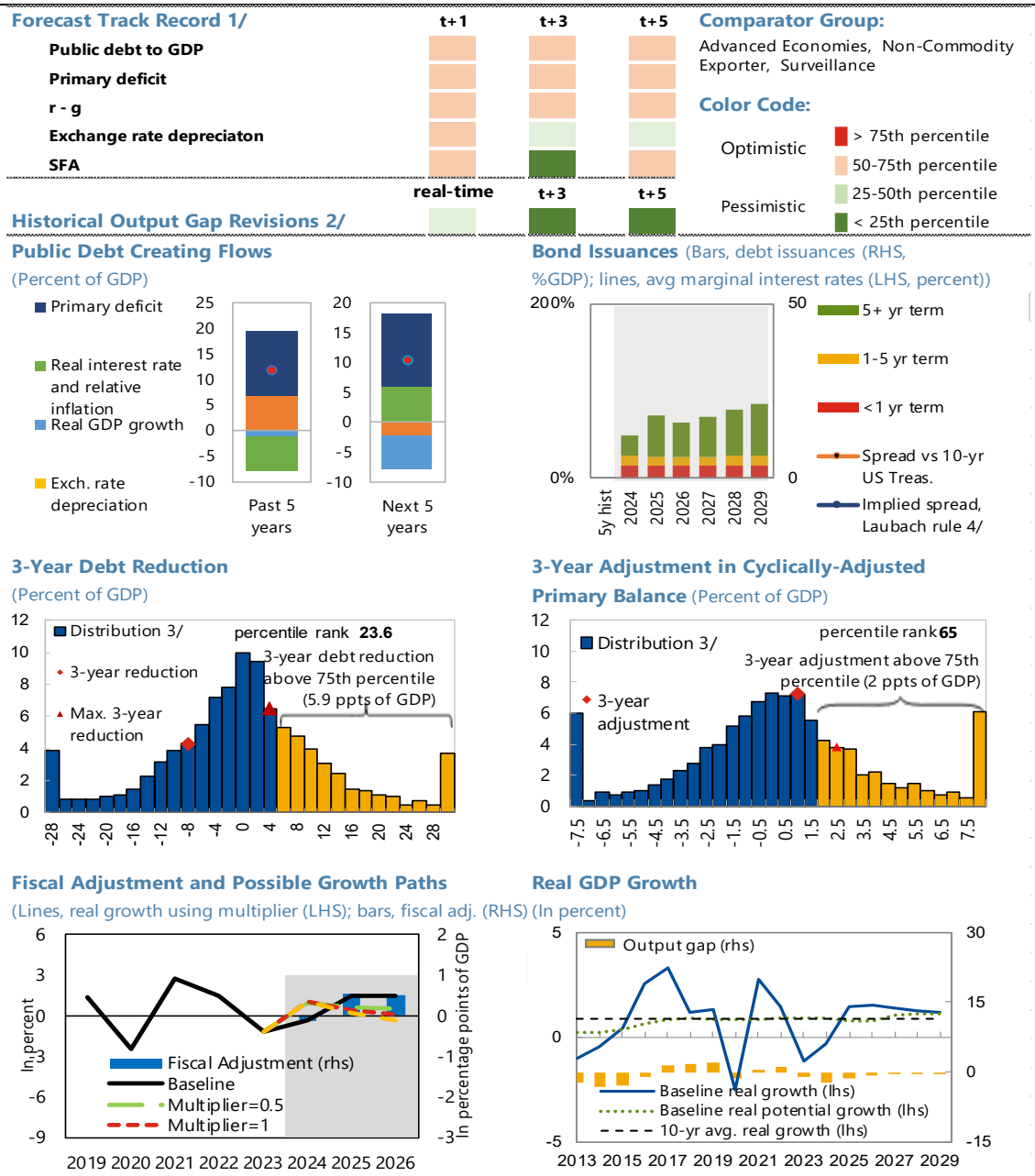
	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	77.0	81.6	84.2	85.3	85.9	86.6	87.4	88.2	89.1	90.1	91.1
Change in public debt	3.1	4.6	2.6	1.0	0.6	0.8	0.8	0.7	0.9	1.0	1.0
Contribution of identified flows	3.4	5.0	2.9	0.5	0.5	0.5	0.8	0.9	1.0	1.0	1.0
Primary deficit	3.0	3.8	2.9	2.0	1.4	1.0	1.0	1.0	1.0	1.0	1.0
Noninterest revenues	52.6	52.5	53.0	53.2	53.0	52.8	52.8	52.8	52.8	52.8	52.8
Noninterest expenditures	55.6	56.3	56.0	55.2	54.3	53.8	53.8	53.8	53.8	53.8	53.8
Automatic debt dynamics	-0.8	-0.1	-0.7	-0.4	0.2	0.6	0.9	1.0	1.1	1.1	1.1
Real interest rate and relative inflat	-1.6	-0.4	0.5	0.9	1.4	1.7	2.0	2.1	2.2	2.2	2.2
Real interest rate	-1.7	-0.4	0.5	0.9	1.3	1.7	2.0	2.1	2.2	2.2	2.2
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	0.9	0.3	-1.2	-1.3	-1.2	-1.1	-1.0	-1.0	-1.1	-1.1	-1.1
Real exchange rate	0.0	...	...	...	...	...	...	...	...	...	...
Other identified flows	1.2	1.3	0.7	-1.2	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
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	-1.3	-1.5	-1.2	-1.2	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Other transactions	2.5	2.8	1.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of residual	-0.3	-0.4	-0.3	0.5	0.1	0.3	0.0	-0.2	-0.1	0.0	0.0
Gross financing needs	15.0	10.6	17.2	17.2	18.9	21.0	22.5	21.4	16.7	17.4	17.5
of which: debt service	13.3	8.2	15.6	16.4	18.6	21.0	22.6	21.5	16.8	17.5	17.6
Local currency	13.3	8.2	15.6	16.4	18.6	21.0	22.6	21.5	16.8	17.5	17.6
Foreign currency	0.0	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)	-1.2	-0.3	1.5	1.5	1.4	1.3	1.2	1.2	1.2	1.2	1.2
Inflation (GDP deflator; percent)	3.9	2.6	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Nominal GDP growth (percent)	2.7	2.3	3.5	3.6	3.5	3.4	3.3	3.3	3.3	3.3	3.3
Effective interest rate (percent)	1.6	2.1	2.7	3.2	3.7	4.1	4.4	4.5	4.6	4.6	4.5

Contribution to Change in Public Debt



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 Assumptions



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.

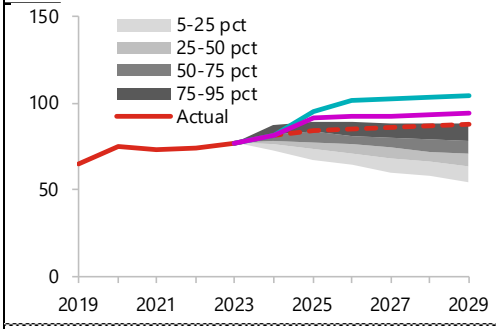
2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

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

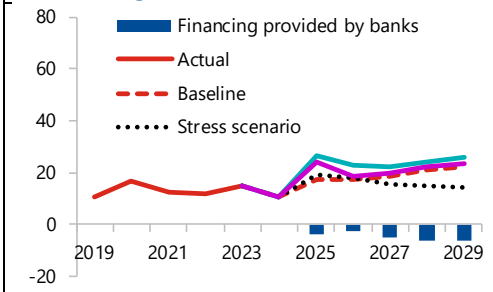
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Figure 6. Finland: Medium-Term Risk Assessment

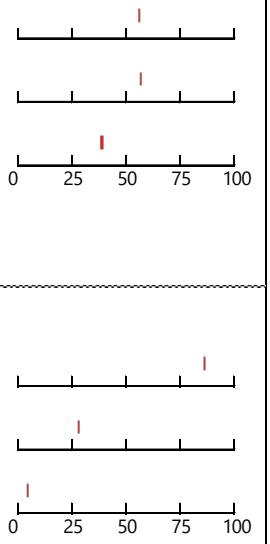
Final Fanchart (Percent of GDP)



Gross Financing Needs (Percent of GDP)



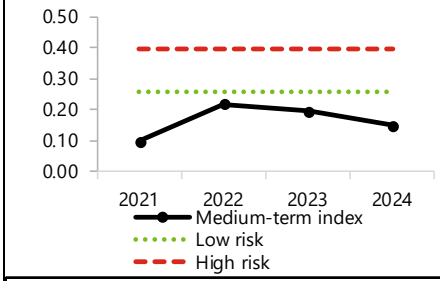
	Value	Contrib 1/	Percentile in peer group 2/
Debt fanchart module			
Fanchart width *(percent of GDP)*	33.4	0.5	
Probability of debt non-stabilizaiton *(percent)*	6.1	0.1	
Terminal debt-to-GDP x institutions index	9.0	0.2	
Debt fanchart index (DFI)		0.7	
Risk signal: 3/		Low	
Gross financing needs (GFN) module			
Average baseline GFN *(percent of GDP)*	17.9	6.1	
Initial Banks' claims on the gen. govt *(pct bank assets)*	3.1	1.0	
Chg. In banks' claims in stress *(pct banks' assets)*	0.0	0.0	
GFN financeability index (GFI)		7.1	
Risk signal: 4/		Low	



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index (Index Number)



Medium-term risk analysis

	Value	Value (normalized)	Weight	Contribution
Debt fanchart index	0.7	0.2	0.5	0.1
GFN finaceability index	7.1	0.1	0.5	0.1
Medium-term index		0.1		
Risk signal: 5/		Low		
Final assessment:		Low		

Prob. of missed crisis, 2024-2029, if stress not predicted: 0.0 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 70.5 pct.

Commentary: Medium-term analysis points to a low risk in both modules.

Source: IMF staff estimates and projections.

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.

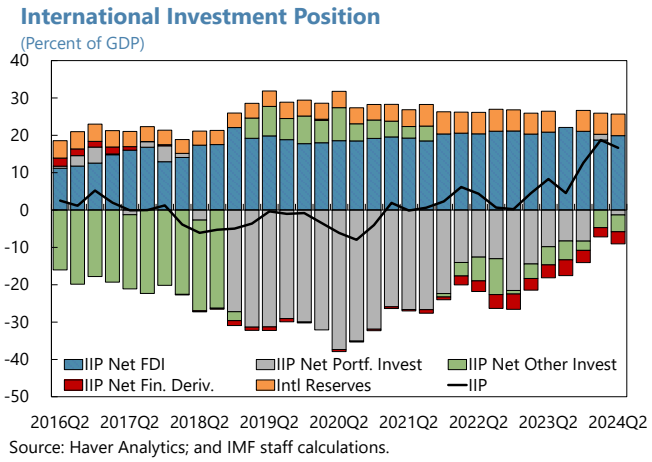
Annex IV. External Sector Assessment

Overall Assessment: The external position of Finland in 2024 is estimated to be moderately weaker than the level implied by fundamentals and desirable policies.

Fiscal consolidation remains the key tool for improving the external position. Finland's cost competitiveness strengthened during the 2010s, however, it has experienced a decline since 2020. With Finland's ongoing challenge of sluggish productivity, which could benefit from labor market reforms, it remains crucial that wage increases align closely with productivity gains.

Foreign Assets and Liabilities: Position and Trajectory

Background. The Net International Investment Position (NIIP) strengthened in 2023 to 12.6 percent of GDP driven by valuation gains of portfolio investment assets. As of 2024Q2, the NIIP has risen further, but it is projected to be around 12 percent of GDP by end-2024. The stock of portfolio investment bottomed out in 2020 and has been gradually recovering since. After experiencing improvement in 2021 (at 210 percent of GDP), gross external debt has steadily increased and is projected to reach 215 percent in 2024.



Source: Haver Analytics; and IMF staff calculations.

Assessment. Over the near term, the NIIP is projected to reduce slightly due small projected CA deficits. Vulnerabilities for Finland stem from the large cross-border exposures of the financial sector, including liquidity risk related to foreign-financed wholesale funding.

2024 (est., percent GDP):	NIIP: 12.0	Gross Assets: 332	Debt Assets: 51	Gross Liab.: 320	Debt Liab.: 109

Current Account

Background. Finland's current account deficit contracted significantly in 2023, declining to around 0.4 percent of GDP. This improvement was primarily driven by a significant reduction in imports that outpaced a decrease in exports. In addition, following a couple of years of large positive contributions, the primary income balance moderated to about 0.3 percent of GDP.[1] In the first three quarters of 2024, the accumulated current account balance was close to zero, despite registering deficits in the first two quarters. A surplus in goods trade offset deficits in the services account, as well as in the primary and secondary income accounts. Those developments suggests that the 2024 current account deficit would be similar in magnitude to 2023. The projected 2024 current account deficit is estimated at 0.3 percent, comprising a surplus in the goods balance that more than offsets a deficit in the services balance. The current account is projected to remain in deficit in the near-term, due a less favorable external environment, with a slight improvement over the medium term, supported by fiscal consolidation, stronger external growth, and measures aimed at preserving cost competitiveness, despite adverse demographic and labor productivity trends.

[1] Following the start of the COVID-19 pandemic, and due to economic uncertainty and global market fluctuations, investment income inflows and outflows fell. However, investment income expenditures declined more rapidly than investment income inflows, contributing to a temporary boost in the primary income balance. However, since 2022, this trend has reversed, with expenditures on investment income growing faster than inflows, bringing both to similar levels in 2023.

Assessment. Preliminary results from the EBA methodology estimate a cyclically-adjusted CA of -1.0 percent of GDP and a CA norm of 0.6 percent of GDP. Staff estimates the gap for 2024 to be -1.6 percent (with a range -1.0 and -2.2), of which 0.7 percentage points is attributed to a "policy gap" and -2.3 percentage points as an unidentified residual, reflecting structural factors not accounted for in the model. According to this result, the external position in 2024 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 2024

(In percent of GDP)

	CA model	REER model
CA-Estimate	**-0.3**	
Cyclical contributions (from model) (-)	0.7	
Adjusted CA	**-1.0**	
CA Norm (from model) 1/	**0.6**	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	**0.6**	
CA Gap	**-1.6**	**-2.5**
o/w Relative policy gap	0.7	
Elasticity	-0.33	
REER Gap (in percent)	**4.8**	**7.7**

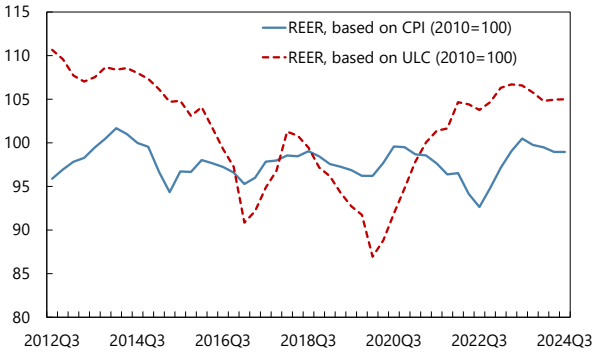
1/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. Following a drop to a 10-year low at the start of the pandemic, the ULC-based REER saw consistent appreciation until 2023 and stabilized. By 2024Q3, it had increased by 20 percent compared to early 2020, though it was still 2 percent below its 2023 peak, partly reflecting rising labor costs. Since the 2010s, there has been no systematic increase in the gap between real wages and productivity. A stable ULC-based REER is expected, provided wage pressures remain moderate. Meanwhile, the CPI-based REER experienced a 7 percent depreciation between 2020 and 2022Q3, followed by an equivalent appreciation by 2024Q3, driven largely by nominal exchange rate movements (NEER). Both, the ULC and CPI-based REER measures, indicate a real appreciation, compared to the previous decade average levels.

Assessment. The staff CA gap implies a REER gap of 4.8 percent (after applying an estimated elasticity of 0.33) and a range of 3.0–6.7. According to the estimated EBA REER-gap index and level models, the REER gap suggests an overvaluation of about 7.7 and 4.1 percent, respectively.

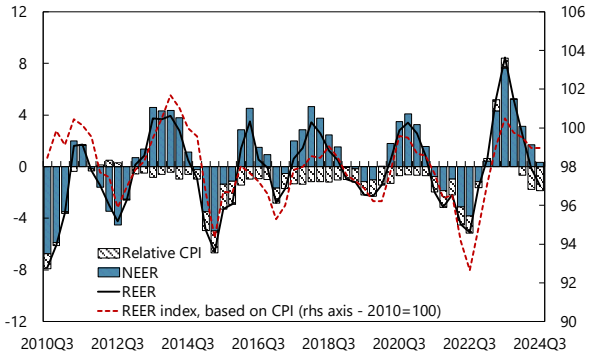
Real Effective Exchange Rate



Sources: IMF staff calculations.

REER Appreciation

(Percent, year-on-year contribution to growth)



Sources: IMF staff calculations.

Capital and Financial Accounts: Flows and Policy Measures

Background. The financial account deteriorated slightly to -2.3 percent of GDP in 2023 on the back of lower other investment assets and net FDI outpacing improvements in the net portfolio investment and net financial derivatives. Similarly, the financial account showed a deficit during the first three quarters of 2024. This continued downturn can be attributed to weaker FDI and portfolio investment positions. The level of gross external debt remained around 215 percent of GDP in 2023, reflecting the reliance of the relatively large financial sector on foreign wholesale funding. Significant fluctuations in capital flows are common in countries with large financial sectors, such as Finland, where the banking sector exceeds three times the country's GDP. These large fluctuations likely contributed to considerable net errors and omissions in the Balance of Payments (BOP) statistics—for example, by hindering a more accurate and comprehensive compilation of source data— thereby introducing uncertainty into staff estimates and projections.

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 Matrix[1]

Source of Risks and Relative Likelihood (High, medium, or low)	**Impact if Risk is Realized** (High, medium, or low)	**Policy Response**
Global		
High **Intensification of regional conflicts**. Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and 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.	**High** 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.	Provide targeted fiscal support to cushion the impact on households. Support firms to preserve the jobs that will be viable and prevent liquidity problems from triggering defaults and bankruptcies.
Medium **Monetary policy calibration**. Amid high uncertainty and data surprises, major central banks' stances turn out to be too loose, hindering disinflation, or too tight for longer than warranted, which stifles growth.	**Medium** A resurgence of inflation could lead to a wage-price spiral and erode central bank credibility. Conversely, a too tight policy may delay the recovery in the construction sector and intensify spillovers to households and firms through higher debt service, liquidity shortfalls, and reduced demand.	Stand ready to adjust fiscal policy to support growth while avoiding inflationary pressures. Safeguard financial stability.
High **Commodity price volatility**. Supply and demand fluctuations (e.g., due to conflicts, export restrictions, OPEC+ decisions, and green transition) cause recurrent commodity price volatility, external and fiscal pressures and food insecurity in EMDEs, cross-border spillovers, and social and economic instability.	**High** Rising energy prices and a resurgence in inflation would place pressure on the economy, eroding households' disposable income under the weight of increased costs.	Implement targeted fiscal policies to support households, preserving domestic demand while minimizing inflationary pressures.
Medium **Global growth slowdown**, including due to supply disruptions, tight monetary policy, rising corporate bankruptcies, or a deeper-than-envisaged real estate sector contraction, with adverse spillovers through trade and financial channels.	**Medium** The response by central banks to rein in inflation leads to higher borrowing costs, which ultimately cause lower demand and a slowdown in domestic activity.	Allow automatic stabilizers to operate. The fiscal policy should be used to support the most vulnerable. Employ macro-prudential tools to mitigate financial stability risks.

[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**
High **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.	**High** Higher input costs, supply disruptions and changed trade patterns generate transition costs and ultimately may result in lower real incomes and lower firm profitability.	In collaboration with international partners, continue to strengthen global cooperation and multilateralism. Enhance supply chain resilience by promoting diversification. Accelerate structural reforms to increase economic flexibility and help sectors better absorb and adapt to shocks.
High **Cyberthreats**. Cyberattacks on physical or digital infrastructure and service providers or misuse of AI technologies trigger financial and economic instability.	**Medium** Economic activity is disrupted, leading to weaker confidence, capital outflows, and financial sector volatility.	Continue to raise public awareness through targeted preparedness campaigns. Strengthen investments in cyber defense to enhance resilience against evolving threats. Utilize the banking backup payment system.
Regional and Domestic		
Medium **Adverse shock in a neighboring Nordic country**, leading to a downturn in the real estate markets, and distress in the financial sector.	**High** Lower demand from trading partners reduces domestic output and employment. Financial sector sees declining asset quality and funding difficulties.	Conduct regular Nordic-wide financial stress tests.
Medium **Systemic financial instability**. Systemic risks rise further given lower growth and a protracted recovery. The current 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.	**High** A higher marked downturn in real estate prices in Finland or the Nordics 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.	Continue to closely monitor risks, including those related to households' creditworthiness, cross-border macro-financial exposures, and liquidity conditions. Strengthen liquidity regulations and enhance banks' liquidity buffers to mitigate systemic liquidity risks.
Low **Social discontent**. Slower than expected real income recovery, 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.	**Medium** The economy has shown resilience to recent challenges, with limited social discontent from the war in Ukraine due to broad support. Recent labor market reforms have faced some implementation resistance, which could add to social discontent.	Provide targeted support to mitigate the impact of higher living costs on the most vulnerable. Continue constructive dialogues among the stakeholders.

Annex VI. Past Fund Staff Recommendations and Implementation

Past Staff Recommendations	Policy Actions
Fiscal Policy	
The unfavorable fiscal outlook points to the need for proceeding with gradual fiscal consolidation. Structural adjustment of around ¼ percent of GDP should begin in 2024.	**Not implemented**. The deficit in 2024 is expected to deteriorate considerably. While part of this can be explained by weaker-than-expected nominal growth, there was also expenditure slippage.
Over the medium term, the structural adjustment should grow to ½ percent per year, 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.	**Partially implemented**. New fiscal consolidation measures were announced in April 2024, amounting to €3 billion (1 percent of GDP), equally divided into revenue and expenditure. But additional fiscal adjustment is needed to reduce debt.
Further spending cuts are required, including through efficiency gains from the Wellbeing Services Counties. These 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.	**Partially implemented**. The April 2024 consolidation announcement includes spending cuts such as relaxation of the service delivery obligations of the Wellbeing Services Counties and efficiency gains in the Central Government, and revenue measures such as VAT and excise tax increases. The authorities aim to achieve further efficiency gains from the Wellbeing Services Counties but see little scope for further revenue measures.
Labor Market and Structural Policies	
To support employment and productivity, staff supports the government's efforts to boost employment through social benefit reforms, greater flexibility in the labor market, and lowering the labor tax wedge. Additionally, policy should aim to improve higher education, lower skill mismatches, and more effectively attract and integrate international talent.	**Partially implemented**. Reforms initiated in 2023 included changes to unemployment benefits, social security and tax adjustments, and enhancements to employment services. Some other reforms, such as the comprehensive reform of the Integration Act for integration and employment of immigrants, will enter into force in 2025.
Further measures are needed to achieve Finland's ambitious and commendable climate goals. Policy should consider strengthening carbon pricing and increasing the role of carbon-sinks in the land use sector.	**Not implemented**. The increased tree lumbering in recent years undermines national and EU carbon emission targets in this sector and creates potential fiscal risks.
Financial Sector and Macroprudential Policies	
Introduce a complete set of borrower-based measures into the policy toolkit.	**Not implemented**. No caps on DTI or DSTI ratios have been legislated by the government.
Liquidity regulations should be tightened to enhance banks' liquidity buffers to cover a predetermined threshold of wholesale funding.	**Not implemented**. There are no plans to implement this measure.
Legislate a positive neutral rate for the CCyB to increase resilience in the banking system.	**Not implemented**. No changes are expected before European Commission's legislative proposal on macroprudential policy.
Lead an effort to conduct a Nordic-wide stress test coordinated exercise, considering interlinkages and spillovers, as well as liquidity-solvency interactions.	**Not implemented** (Initiated). Finland is leading discussions with its neighbors to undertake a joint Nordic-Baltic-wide banking stress test.

Annex VII. 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.

	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*** The Ministry of Finance does not foresee or deem any legislative changes necessary pertaining to 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, but Initiated*** A review of the national provisions regarding the FIN FSA's independence is ongoing as part of the CRD VI implementation. Possible legislative changes are expected January 2026.	NT
3	Increase the resources available to the FIN-FSA, FFSA 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.	***Implemented*** In contrast to the consolidation measures envisaged for the ministries, the budget and administrative fees of Financial Stability Authority (FFSA) have grown. The amended Supervision Fees Act came into force in January 2024, increasing supervision fees for the 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*** The Ministry of Finance does not foresee or deem any legislative changes necessary pertaining to 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*** No changes are expected before European Commission's legislative proposal on macroprudential policy.	MT
6	Enhance the systemic risk monitoring by strengthening the disaggregated data analysis, corporate sector vulnerability analysis and addressing existing data gaps.	***Partially Implemented*** The first stage of the positive credit registry is functional, and data quality checks are being performed by the authorities. 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, but Initiated*** Finland is leading discussions with its neighbors to undertake a joint Nordic-Baltic-wide banking stress test. The authorities are identifying the pre-requisites, methodology and data gaps in consultation with the Fund and neighboring countries.	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.	***Implemented*** Thematic analysis on IFRS9 staging and expected credit loss (ECL) was carried out and published in October 2024.	NT
10	Include rules on the appointment of a sufficient number of independent directors (supervisory board members) and independency criteria in the legislation.	***Partially Implemented*** A discussion paper on the assessment and improvement of the existing legislation was published by MoF in Spring 2024. Possible legislative changes are expected with the implementation of the CRD VI in 2026–2027.	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 NBFI sector.	***Partially Implemented*** The authorities promote risk analysis related to NBFIs and some of the internal analyses are being published.	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*** The authorities promote the implementation of this recommendation at the EU-level, which has not progressed so far.	NT, C

	Recommendation	Authorities' Actions	Timing*
	Liquidity for FIs in resolution, tested internally and with external counterparties annually.		
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.	***Implemented*** To the extent permitted by law, 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

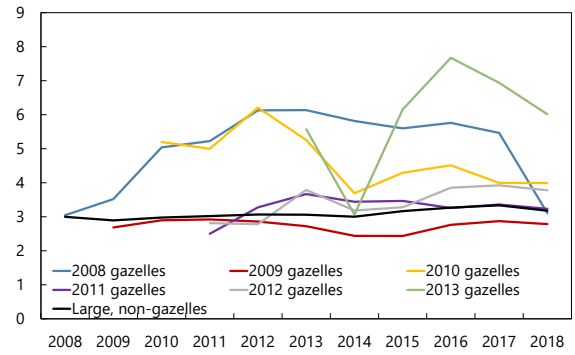
* Timing: C = Continuous; I = Immediate (within one year); NT = Near Term (within 1–3 years); MT = Medium Term (within 3–5 years).

Annex VIII. Where Are the Gazelles? Access to Finance for Fast-Growing Young Firms

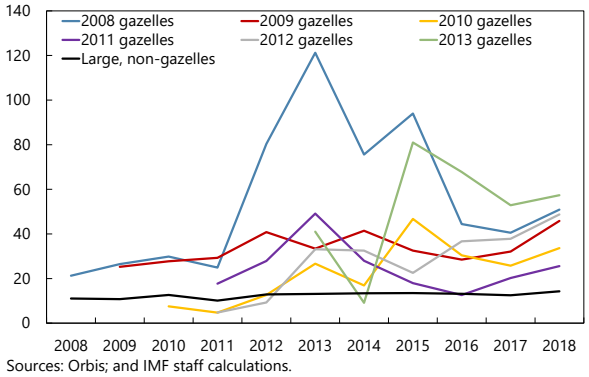
This annex discusses access to finance for high-growth young firms, often referred to as "gazelles." The analysis finds that gazelle births in Finland have underperformed compared with the EU and supports the view that they are relatively under-leveraged, potentially limiting their ability to scale up. Moreover, while Finland fares better than most European countries in terms of venture capital (VC) financing, there is room to further enhance access to risk capital, including by revisiting the tax policy. These include removing disincentives that complicate international and domestic investment in VC.

1. The productivity of gazelles is notably higher than larger incumbent firms.[1] Following Adilbish and others (2024), gazelles are defined as firms with an annualized sales growth exceeding 20 percent over a three-year period, and ultimately grow to employ at least 100 individuals before the age of 11. These firms play a critical role in driving aggregate productivity growth. This is evidenced by their persistently higher Total Factor Productivity of Revenue (TFPR) compared to larger non-gazelle firms. These firms are not only an important direct driver of productivity, they also incentivize incumbent firms to innovate and remain competitive. Gazelles also exhibit a comparatively higher average level of revenue product of capital (ARPK).

Number of Gazelles by Birth Cohort, and in Select Sectors



Sources: Orbis; and IMF staff calculations.

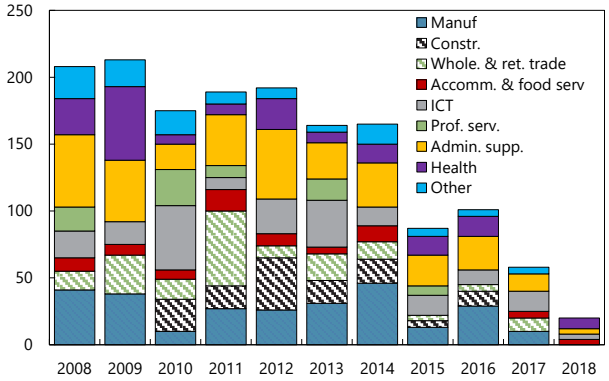


Sources: Orbis; and IMF staff calculations.

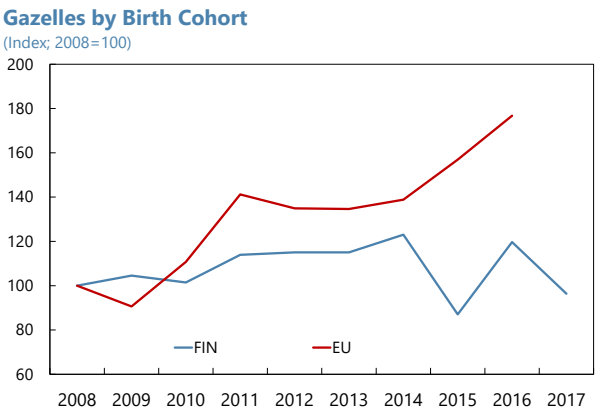
2. Relative to the EU, gazelle births have remained modest in Finland. The creation of such firms remained broadly unchanged from 2008 to 2018, underperforming the notable growth in the EU. This trend has been observed across all sectors including high-tech industries and in information and communication technology (ICT).

[1] Our analysis uses firm-level data from Moody's Orbis database, covering 2008 to 2018.

Number of Gazelles by Birth Cohort, and in Select Sectors



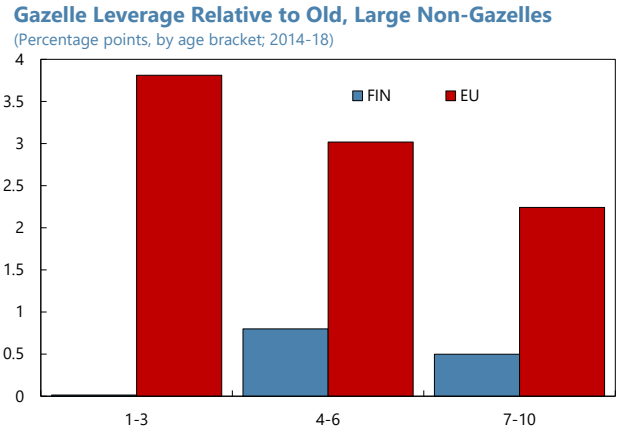
Sources: Adilbish et al.(2024); Orbis; and IMF staff calculations.

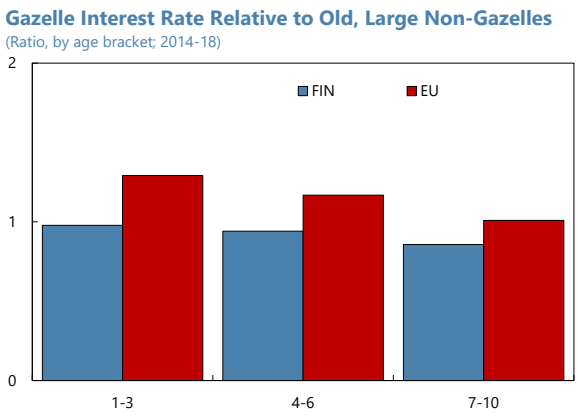


Sources: Adilbish et al.(2024); Orbis; and IMF staff calculations.

Note: The series in the left chart are indexed to 2008 (equal to 100) and adjusted for right censoring. The number of gazelles post-2011 is adjusted based on when they are observed, following the distribution of the 2008–2011 cohorts.

3. Finnish gazelles are relatively under-leveraged.[2] In the United States and many other European countries, gazelles are significantly more leveraged than larger firms (Adilbish and others, 2024). This supports their investment in new technologies and helps them to scale-up quickly. However, data suggests otherwise for the Finnish gazelles: these young firms are not benefiting from higher leverage. This suggests that they could face challenges in accessing capital to scale, which could hurt their potential growth.



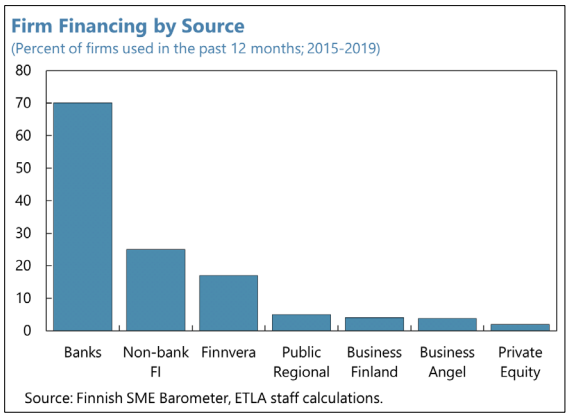


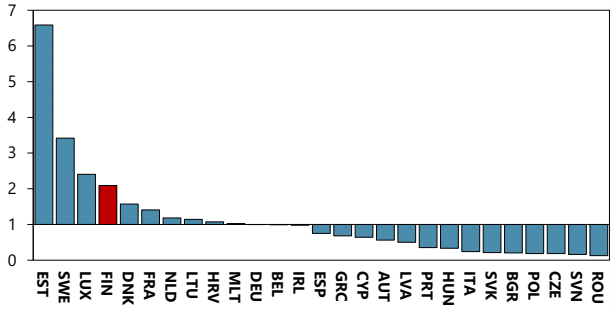
Source: Orbis; and IMF staff calculations.
Note: Europe includes AT, BE, CH, CZ, DE, DK, ES, FR, GB, GR, HU, IE, IS, IT, NL, PL, PT, RO, SE, SI & SK. The estimates are based on linear fixed effects regression controlling for country, industry and year fixed effects.

[2] Leverage is defined as the sum of loans and long-term debt as percent of total assets. Outliers including the largest 5 percent observations and those with negative values are excluded.

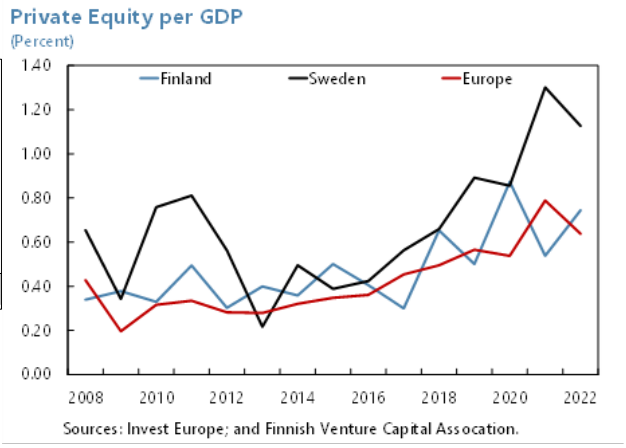
4. Nevertheless, Finnish gazelles, do not typically face higher interest rates. Empirical analysis indicates that while in other European countries gazelles typically encountered higher cost of financing, Finnish gazelles typically face costs comparable to large non-gazelle firms. A recent survey by Research Institute of the Finnish Economy (ETLA) also finds that the cost of financing is not typically a major obstacle for corporates in Finland. Firms expressed other factors, including availability of staff, energy costs, and economic uncertainty, as the top concerns. This contrasts with many other European firms, particularly those with higher intangible investments (Adilbish and others, 2024), who face higher borrowing costs.

5. Finland also compares well to European countries in terms of VC financing. Adilbish and others (2024) show that European VC-backed gazelles tend to outperform those without such support, and—relative to the size of the economy—the EU remains significantly less developed compared to that of the United States and Sweden. However, Finland fares relatively well in access to VC financing, and public institutions, such as Finnvera and Tesi, are major providers of funding. Despite this, Finland does not lead in total private equity (PE) investment, driven by fewer and smaller buyouts, which restricts broader access to funding. Total PE in Finland was around 0.75 percent of GDP, close to the EU average but behind Sweden at 1.1 percent of GDP. As such, VC funding rather than buyouts, remains a major source of funding.





Sources: PitchBook; IMF WEO October 2023; and IMF staff calculations.
Note: Ratio of a country's share of total EU VC investments to its share of the EU's total GDP, averaged over 2019-2023. Countries above 1 contribute to EU27 VC investments disproportionately compared to their share of EU27 GDP.



6. Tax policy changes could potentially further improve access to risk capital and support the growth of young, innovative firms. Foreign investors in Finnish VC are set up as limited partnerships. Current tax treatment requires that they pay taxes in advance and then are only partially rebated for investment spending after two to three years. Moreover, domestic VCs face a disadvantage, as returns for limited partnership domestic VCs are taxable, whereas returns

for domestic non-profit investors in foreign VCs are tax-exempt. These potential differences should be reviewed to better support VC financing and investment.

7. Across Europe, a further deepening of the Single Market would help alleviate growth constraints. Expanding the scale and scope of VC funds across European would support the availability of equity financing and promote entry and innovation for startups and young firms that lack tangible collateral. To support investment in larger funds, harmonization of VC regulations is critical. In addition, an enhanced role for the European Investment Fund (Euro Area Policies Article IV, 2024) in catalyzing investment and providing due diligence would be beneficial. As part of broader capital market union reforms, improving the portability of pensions would help create a larger pool of cross-border, and long-term capital. Moreover, it is crucial to offset demographic headwinds to human capital and improve availability of young high-skilled workers to foster gazelle formation.

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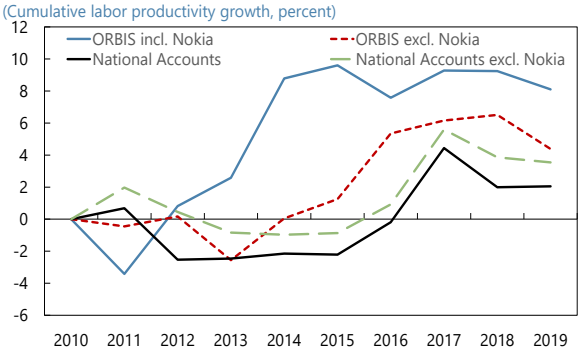
Annex IX. Productivity Trends at the Firm Level in Finland

This annex examines the firm-level dynamics underlying the weak labor productivity growth in Finland since 2010. Compared with its Nordic peers, firm-level productivity growth in Finland has been much weaker, in particular for the most productive "frontier" firms. Looking across sectors, labor productivity has continued to grow in the manufacturing and "tech" sectors but has been particularly sluggish in non-tech services. While there is no 'silver bullet' solution, there might be scope to lower barriers of entry by easing regulations, especially in the services sector.

1. Finland's labor productivity has been stagnant since the Global Financial Crisis (GFC). After a robust growth in the 2000s, Finland's private sector labor productivity dipped after the GFC and has been stagnant since then. Its performance has also been weaker compared with the neighboring countries.

2. This annex exploits granular data to analyze firm-level productivity developments underlying this weak performance since 2010. Orbis is an international database of firm-level balance sheet and income statements. The database has been widely used for academic and policy studies, including by the International Monetary Fund (2015, 2016).[1] This study uses Orbis to address the following questions: (i) how has productivity developed in firms at the productivity frontier, and how quickly have "laggard" firms caught up to this frontier?; (ii) how does Finland's labor productivity growth compare to its country peers?; and (iii) does labor productivity growth differ across sectors?

Finland's Labor Productivity Has Been Stagnant Since 2010
(Cumulative labor productivity growth, percent)

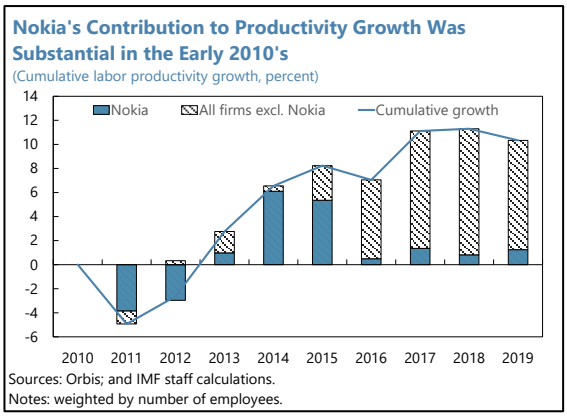


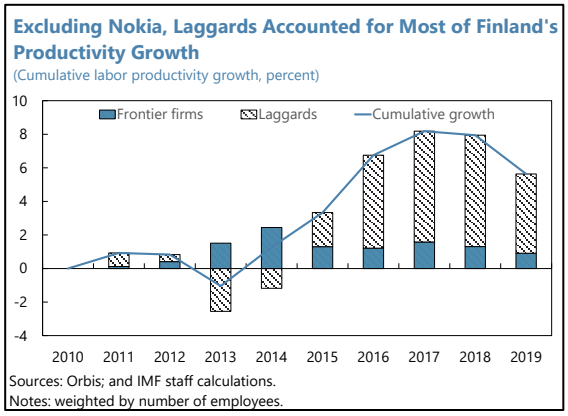
Sources: Eurostat; Orbis; and IMF staff calculations.
Notes: Labor productivity for the private business sector. The dashed line for National Accounts excludes the manufacture of computer, electronic and optical products.

3. Over the last decade, Finland's modest productivity growth appears to be driven by the dynamics of the laggard firms. Given its prominence in the Finnish economy, Nokia accounted for almost all the cumulative labor productivity decline in 2011–12, and for a substantial part of the subsequent growth until 2015. However, its impact waned towards the end of the decade. Outside Nokia, the sample is divided into the frontier firms, which are defined as the top 10 percent most productive firms in each sector-year, and the laggards that correspond to the bottom 90 percent (Zheng, Duy and Pacheco, 2021).[2] Of the modest aggregate labor productivity gain—only 6 percent between 2010 and 2019—the laggards accounted for the bulk of this, mainly since 2016.

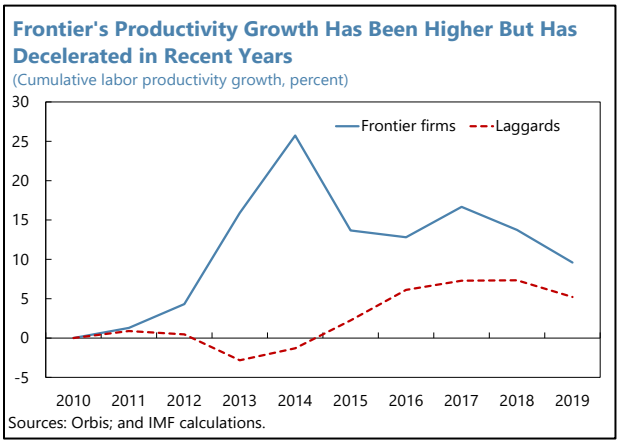
[1] While Orbis is subject to certain limitations, such as changing coverage over time or the presence of outliers, data cleaning was performed to ensure its comparability with national accounts data.

[2] Sectors are at 2-digit level following the Eurostat's NACE Rev.2 classification.

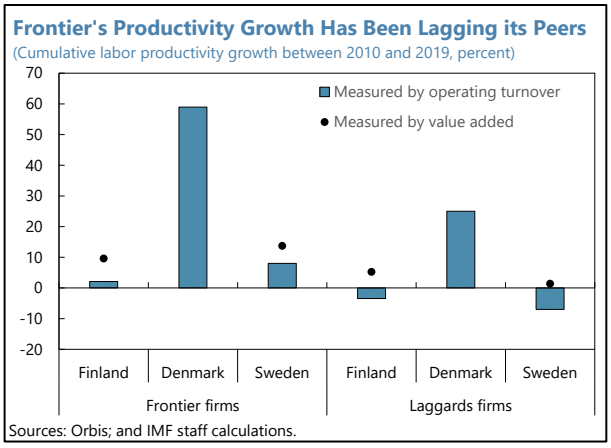




4. Despite some productivity gains, frontier firms were too small to lift the aggregate economy-wide productivity. Frontier firms enjoyed twice the labor productivity gains of the laggards over the last decade. However, this has only resulted in a 10 percent cumulative productivity growth over nearly a decade. In addition, frontier firms account for less than 10 percent of employment and, therefore, are too small to raise aggregate productivity. In contrast, labor productivity of the laggards, which account for the bulk of employment, has been sluggish over the same period, growing only 5 percent cumulatively.



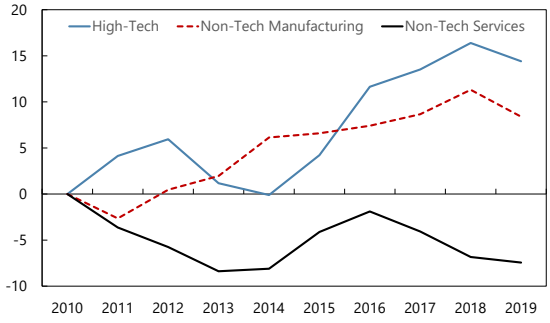
5. Compared with its Nordic peers, productivity growth in Finland has been weaker, more so for the frontier firms. In all countries, frontier firms' productivity grew faster than that for the laggards. However, frontier firms' productivity grew significantly slower in Finland than in Denmark and Sweden, whether measured by value added or by operating turnover per employee.[3] Comparing the productivity growth of the laggards, their labor productivity stagnated in Sweden as in Finland, but the productivity of the laggards in Denmark continued to expand rapidly.



[3] Labor productivity is measured by both value added and operating turnover per employed persons due to unavailability of value added data for Denmark in Orbis.

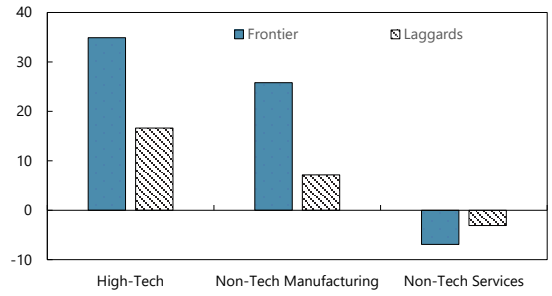
6. Looking across sectors, Finland's labor productivity growth has been particularly disappointing in non-tech services. Productivity in both the tech and non-tech manufacturing sectors expanded between 2010 and 2019, reaching 14 percent cumulative productivity gains for the former and 8 percent for the latter.[4] Productivity growth in these sectors has been even higher for the leading firms, surging by 35 percent and 26 percent, respectively. In contrast, both for frontier and laggards firms in the non-tech services sector experienced negligible productivity growth over the same period. This weak performance has hence weighed on aggregate labor productivity developments in Finland.

Productivity Has Been Slugglish in Non-Tech Services
(Cumulative labor productivity, percent)



Sources: Orbis; and IMF staff calculations.

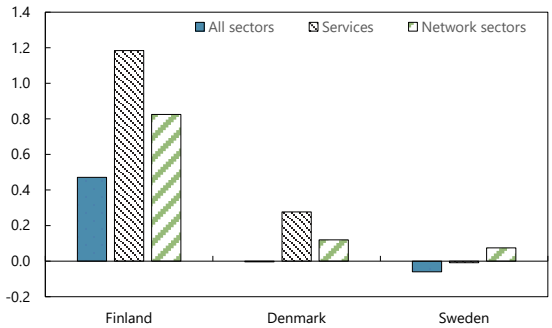
Frontier's Productivity Growth Has Been Robust in the High-Tech and Non-Tech Manufacturing Sectors
(Cumulative labor productivity growth between 2010 and 2019, percent)



Sources: Orbis; and IMF staff calculations.

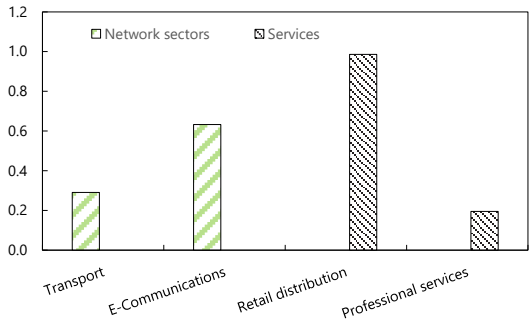
7. There could be scope to promote innovation and competition by easing administrative barriers to entry, especially in the services sector. The sluggishness of labor productivity growth in the non-tech services sector could be partly driven by over stringent barriers of entry (International Monetary Fund, 2024). The regulatory barriers are high relative to Denmark and Sweden, and regulation has been stringent in services, particularly in retail distribution and in some network sectors, such as transport or e-communications. Easing these barriers could facilitate the exit of less productive firms and the entry of more productive firms and ultimately benefit labor productivity growth.

Barriers to Entry are Relatively Stringent in Finland...
(Relative to average of top five OECD countries)



Sources: OECD; and IMF staff calculations.

... Particularly in Some Sectors
(Relative to average of top five OECD countries, selected sectors)



Sources: OECD; and IMF staff calculations.

[4] The high-tech sector includes the manufacturing of computer, electronic, optical products, and electrical equipment as well as services sectors related to programming and broadcasting activities, telecommunications, computer programming, information service activities and scientific research and development.

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Annex X. Data Issues

Table 1. Finland: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/
A

Questionnaire Results 2/

Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	A	A	A	A	A	A

Detailed Questionnaire Results

Data Quality Characteristics						
Coverage	A	A	A	A	A	
Granularity 3/	A		A	A	A	
			A		A	
Consistency			A	B		A
Frequency and Timeliness	A	A	A	A	A	

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund are adequate for surveillance.
B	The data provided to the Fund have some shortcomings but are broadly adequate for surveillance.
C	The data provided to the Fund have some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund have serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Data provided by Statistics Finland, Bank of Finland and the Ministry of Finance, and other national sources are adequate for surveillance. Relatively large sizes of stock-flow adjustments in Finland mainly reflect surpluses in its pension fund, and do not imply statistical shortcomings. The consistency of External Sector statistics is currently assessed as "B," taking into account the significant errors and omissions in BOP estimates, which average around 2 percent of GDP over the previous decade.

Changes since the last Article IV consultation. No new data weaknesses have been identified since the last Article IV consultation.

Corrective actions and capacity development priorities. Not applicable.

Use of data and/or estimates in Article IV consultations in lieu of official statistics available to staff. Staff does not use any data and/or estimates in the staff report in lieu of official statistics.

Other data gaps. Not applicable.

Table 2. Finland: Data Standards Initiatives

Finland adheres to the Special Data Dissemination Standard (SDDS) Plus since June 2018 and publishes the data on its National Summary Data Page. The latest SDDS Plus Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Table 3. Finland: Table of Common Indicators Required for Surveillance

As of November 27, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Finland[8]	Expected Timeliness[6,7]	Finland[8]
Exchange Rates	Nov-24	21-Nov-24	D	D	D	...	...	...
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Oct-24	15-Nov-24	M	M	M	30	1W	30
Reserve/Base Money	Oct-24	15-Nov-24	M	M	M	30	2W	2
Broad Money	Sep-24	25-Oct-24	M	M	M	30	1M	30
Central Bank Balance Sheet	Aug-24	3-Sep-24	M	M	M	30	2W	2
Consolidated Balance Sheet of the Banking System	30-Oct-24	30-Oct-24	M	M	M	30	1M	30
Interest Rates[2]	20/11/2024	21-Nov-24	D	D	D	...	...	...
Consumer Price Index	Oct-24	16-Nov-24	M	M	M	30	1M	14
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	2024:Q1	19-Jun-24	Q	Q	A/Q	90	2Q/12M	90
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Jul-24	28-Aug-24	M	M	M	30	1M	20
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2024:Q2	30-Sep-24	Q	Q	Q	30	1Q	12
External Current Account Balance	2024:Q3	11-Nov-24	Q	Q	Q	30	1Q	42
Exports and Imports of Goods and Services	2024:Q3	11-Nov-24	M	M	M	30	8W	38
GDP/GNP	2024:Q3	29-Nov-24	Q	Q	Q	90	1Q	65
Gross External Debt	2024:Q2	18-Sep-24	Q	Q	Q	90	1Q	60
International Investment Position	2024:Q3	11-Nov-24	Q	Q	Q	90	1Q	60

[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 (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

INTERNATIONAL MONETARY FUND

FINLAND

STAFF REPORT FOR THE 2025 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 12, 2024

Prepared By

European Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

As of October 31, 2024

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)	1,802.73	74.78
Reserve Tranche Position	607.87	25.22
Lending to the Fund		

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	3,499.96	100.00
Holdings	3,596.84	102.77

Outstanding Purchases and Loans: None.

Latest Financial Arrangements: None.

Projected Payments to Fund[1]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2024	2025	2026	2027	2028
Principal	...	...	...	...	...
Charges/Interest		0.03	0.03	0.03	0.03
Total		0.03	0.03	0.03	0.03

[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 Rate 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 of the IMF's Articles of Agreement, and maintains an exchange system free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, other than restrictions maintained solely for security reasons, which have been notified to the Fund pursuant to the Executive Board Decision No. 144-(52/51).

Article IV Consultation: The last Article IV consultation was concluded by the Executive Board on March 7, 2024. The staff report (IMF Country Report No. 24/72) was published with Press Release No. 24/75 (March 11, 2024).

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

Press conference: The mission held a press conference on November 8, 2024.

Publication: The staff report will be published.

Technical Assistance: None.

Resident Representative: None.

Statement by Mr. Vitas Vasiliauskas, Executive Director for Finland
and Ms. Henna Karhapaa, Senior Advisor to the Executive Director
January 15, 2025

On behalf of the Finnish authorities, we thank the mission team led by Alex Pienkowski for the constructive discussions and the well-balanced AIV Report. The authorities highly appreciate staff's views on economic context, outlook, risks, and policy priorities, which contribute to the policy debate in Finland. The authorities broadly agree with staff's assessment and recommendations and agree that further efforts are required to combat fiscal challenges and boost Finland's growth potential.

Recent Economic Developments, Outlook, and Risks

The Finnish economy is slowly recovering from a recession with positive quarterly growth throughout 2024. However, on annual basis the economy is expected to slightly contract in 2024 given a negative carry-over. Investments continued to decline driven by contracting construction activity and private consumption decreased despite strengthening of household purchasing power reflecting weak consumer confidence and concerns about unemployment. Exports have remained relatively muted, while showing some signs of growth. The weak cyclical situation has put pressure on the labor market. Inflation has slowed and is expected to remain moderate.

The economic recovery is expected to strengthen from 2025 onwards. The Ministry of Finance projects the economy to grow by 1.6 percent in 2025 and 1.5 percent in 2026 and 2027, while the Central Bank forecasts growth of 0.8 percent in 2025, 1.8 percent in 2026, and 1.3 percent in 2027. The recovery is supported by subsided inflation and falling interest rates. The strengthening of growth is expected to gradually increase employment and improve confidence in the future among households and businesses. Companies' cost competitiveness in global markets is good, and exports are expected to gradually pick up as conditions improve in Finland's export markets. The housing market is slowly picking up as the downturn in construction has ended and improved confidence and population growth boost housing demand.

Risks to the outlook are towards the downside with both global and domestic factors contributing to forecast uncertainty. US trade policies and potential trade wars pose risks to global and euro area growth, which would negatively impact Finland's economy. Uncertainty in the global economy is elevated by the Russia's war of aggression against Ukraine and the situation in the Middle East continuing. Domestically, increased household saving has delayed consumption growth. If consumer caution persists, growth may fall short of expectations. Additionally, fiscal policy tightening could, in the short term, weaken private consumption by more than has been forecast. There are also positive risks, including numerous investment plans and increased immigration, which boost labor potential and economic growth. As demand recovers, Finland's economy has significant growth potential and could exceed expectations.

Fiscal Policy

The year 2024 has been challenging for public finances. The Ministry of Finance estimates that the deficit deteriorates to 4.2 percent of GDP, while the debt ratio exceeds 82 percent of GDP. The weak economic cycle is reflected in public finances in many ways, including weaker employment and subdued private consumption, and additionally the rapid inflation of recent years creates lingering effects to expenditures. In 2025, the Ministry of Finance expects the fiscal balance to improve to 3.5 percent of GDP supported by recovering growth and the government's fiscal consolidation measures, although only gradually due to significant defense procurement projects, increasing demand for public services, and rising interest expenditure. The pace of debt accumulation will begin to slow from 2025 onwards.

The government is committed to pursue fiscal consolidation efforts to stabilize public debt to GDP. In the coming years, fiscal deficits will continue to gradually improve towards 2 percent of GDP by 2029. The gradual reduction of the deficit reflects a strengthening of economic activity and the implementation of saving measures and tax increases agreed upon by the government. Of the government's fiscal consolidation package, including the wellbeing services counties and municipal administrations' own adjustment plans, about EUR 8 billion, or more than 2.5 percent of GDP in total, is included in the MoF forecast at the 2027 level. If implemented as planned and economic growth develops as expected, public debt to GDP ratio will stabilize by 2027 to about 87 percent of GDP. The government is also pursuing various reforms and measures to promote private investments aimed at supporting employment and economic growth in the longer term.

The Ministry of Finance estimates the structural sustainability gap to be around 1.5 percent of GDP, equivalent to approximately EUR 5 billion at 2029 levels, reflecting the ageing population and other longer-term spending pressures. Compared to the previous forecast, the sustainability gap estimate has decreased by approximately 0.5 percentage points. The revision is in large part due to updates to demographic scenarios as net immigration has increased strongly since the pandemic, deviating significantly from developments in recent decades. However, the continuation of strong net immigration levels is subject to high uncertainty.

Structural reforms

The government is pursuing an agenda that aims to build a dynamic and stable society by supporting economic vitality and sustainable public finances. Vitality refers to factors like employment, education, innovation, and competitiveness, while sustainability involves efficient public sector service pledges. In Finland, although many factors contributing to economic vitality are in good shape, they are not strong enough. Slow productivity and income growth, coupled with rising public expenditure, risk long-term financial sustainability. Effective policies and leveraging global opportunities, such as climate change and technological advancements, are essential to sustain the Nordic welfare society.

A great deal of structural reforms have been taken or are being implemented, including many measures recommended by the IMF. The government has pursued several measures concerning

incentives for work and other measures affecting employment, for example a large number of social security changes, including to housing allowance and earnings-related unemployment security. The Ministry of Finance estimate (as of December 2024) is that the structural employment measures strengthen employment by approximately 89 000 employed persons. The government is also taking forward many reforms to labor market legislation, such as strike rights and on the field of collective bargaining to allow more flexibility at firm level. Efforts to increase Finland's R&D expenditure to 4 percent of GDP by 2030 have continued. Furthermore, the government aims to increase seats in higher education (doctoral programs), streamline permit procedures, reduce bureaucracy, promote fair competition, safeguard the availability to clean and affordable energy, and improve accessibility throughout Finland with investments rail and the road network.

Finland has the most ambitious climate target in the EU, aiming to achieve carbon neutrality by 2035. However, with current scenarios, this goal is unlikely to be achieved without additional measures, particularly related to the carbon sinks of LULUCF sector, though other sectors also require further action. With current measures, the EU LULUCF 2021-2025 target will not be met, and the authorities are exploring possible options. Additional policy measures are also needed to restore the role of carbon sinks over the medium term to meet EU targets and the national 2035 target. The government emphasizes a technology-neutral, cost-effective clean transition to pave the way for sustainable growth, including by leveraging the bioeconomy. Efforts are underway to advance a tax subsidy for large industrial investments that promote the clean transition, such as projects on renewable energy production, energy storage, and decarbonization of industrial processes.

Financial Sector Issues

The operating environment for the Finnish financial sector has been challenging during the past few years. The real estate market has experienced a rather severe downturn, with declining prices and muted trading volumes. This has had implications especially to the construction sector, for which the credit risks are still elevated. Cyber and hybrid attacks have also become more prominent, which highlights the need for a comprehensive approach to maintaining resilience and preparedness to ensure trust in financial stability. Despite the difficult operating environment, the financial system has been resilient and stable, supported by various policy measures.

Banks have strong capital positions and robust profitability, supporting resilience of the financial sector. NPLs have increased only modestly. Several stress tests conducted by the domestic and European authorities indicate that the Finnish financial sector could withstand severe macro-financial shocks. However, the authorities agree that there are certain vulnerabilities related to banks' funding structure. The structural systemic risks and vulnerabilities in regard to Finland's financial stability emanate from a large and concentrated banking sector, household indebtedness, and interconnections in the Nordic-Baltic region. Cross-border macro-financial risks and interlinkages, especially in the Nordic-Baltic region, call for further monitoring and surveillance. In this regard, the authorities appreciate the IMF's support provided to undertake a Nordic-Baltic stress test, in cooperation with other Nordic-Baltic authorities.

The experience with the current institutional framework for macroprudential policy – as well as cooperation and knowledge sharing between authorities – have been positive. Nevertheless, the authorities see merit in further enhancing the macroprudential toolkit. The IMF's recommendation to add a full set of borrower-based measures is welcome and the authorities agree that a positive neutral rate for the countercyclical capital buffer (PN-CCyB) should be considered, while acknowledging that it would require regulatory changes. The authorities prefer to include the new measure into the EU legislation first to ensure that the measure is defined and used in a consistent manner across Europe, while allowing consideration of country-specific factors in the decision-making. With respect to PN-CCyB and other macroprudential buffer requirements, the authorities highlight the need for calibrating the requirements through a holistic assessment of capital needs based on systemic risks and vulnerabilities.