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January 17, 2023

**Statement by Mr. Zhang and Ms. Yang on Finland
(Preliminary)
Executive Board Meeting 23/4
January 18, 2023**

We thank staff for the well-written set of reports and Mr. Pösö and Mr. Kraavik for the helpful Buff statement. Finland's authorities have successfully steered their economy through the adverse impact of the pandemic by effective policy support and reforms. However, global headwinds and structural challenges, including unfavorable demographics and low productivity growth, are undermining economic outlook. The banking supervisory framework is sound and financial sector is broadly resilient, vulnerabilities to liquidity shocks and cross-border exposures may require further policy responses. We broadly agree with staff's appraisal and would like to focus our comments on the following points.

Fiscal policy should better support t vulnerable households without adding inflationary pressures, while preserving long-term fiscal and debt sustainability. In light of high inflation and deteriorating real wages, fiscal measures should be supportive of monetary efforts to bring down inflation. It is concerning that most 2023 compensate measures for higher energy price are less-targeted and/or distortionary, and we agree with staff that energy related measures should be better targeted to support the vulnerable and to incentivize energy conservation. *We note that the authorities pointed out practical difficulties in designing better targeting measures in a short time, and we are interested in the best practices of peer countries whose experiences may be shared to the Finnish authorities, staff elaboration is welcome.* Longer-term fiscal imbalance is further aggravated by population ageing and general government finances that are not on a sustainable footing. In this regard, we welcome the authorities' ongoing work on spending and tax reviews and the proposal of a new fiscal framework to anchor on debt sustainability. *We take note of the recent re-classification of guaranteed loans to social housing developers as public debt has produced a level shift in*

public debt and appreciate staff comments on the parameters of debt coverage, and how they are applied across the membership.

Structural policy needs to focus on boosting employment and productivity. We take positive note of the upward trend in the employment rate as increasing employment is an important part of the growth strategy. We welcome the authorities' proposal to increase R&D spending to 4 percent of GDP, which could help boost productivity. Addressing skill shortages would enhance the effectiveness of the R&D spending. As the authorities pointed out, there is potential on improving work-based immigration, especially skilled foreign labor. *We are interested in the measures to attract skilled foreign labor in the targeting sectors, and welcome staff comments in this area.* The recent wage agreements in the municipal and health sectors have weakened the wage coordination mechanism. We encourage the authorities to strengthen the coordination mechanism and improve flexibility in the system.

We support staff's recommendation in addressing financial vulnerabilities. It is encouraging that the FSAP stress tests indicate that the financial sector remains solvent in a severe adverse scenario. However, risks to financial stability emanate from a concentrated banking sector, household indebtedness, and interconnections in the Nordic-Baltic region, and the banking system remains vulnerable to liquidity shocks. Therefore, we see merits in enhancing liquidity buffers, reactivating systemic buffers, allowing for a positive neutral rate for the counter-cyclical buffers, and legislating caps to debt-to-income or debt-service-to-income ratios. Furthermore, the systemic risk monitoring framework should be enhanced, and we welcome the authorities' commitment in this area.

With these remarks, we wish the authorities every success in their policy endeavors.