

The contents of this document are preliminary and subject to change.

GRAY/23/3485

January 13, 2023

**Statement by Mr. Parkyn and Ms. Choi on Finland  
(Preliminary)  
Executive Board Meeting  
January 18, 2023**

We thank staff for the informative reports and Mr. Pösö and Mr. Kraavik for the insightful Buff statement. We are encouraged that Finland's economy recovered from the pandemic owing to policy support and supply-side reforms. However, we note that trend growth has remained slow and the working-age population is shrinking. The post-Covid recovery is faltering after Russia's invasion of Ukraine and risks remain tilted to the downside. While we broadly agree with the thrust of the staff's appraisal, we encourage the authorities to continue prudent policies, reforms to ensure longer-term sustainability and lift potential growth.

**We welcome the focus on achieving fiscal sustainability taking account of aging-related fiscal pressures and downside risks.** While war-related spending and energy subsidy needs are increasing, the fiscal outlook puts public debt on a riskier path. And rising expenditure pressures related to demographic transition need to be deliberately managed within the context of the medium-term fiscal framework. A gradual fiscal policy tightening with more prioritized spending and identification of specific consolidation measures on the revenue and expenditure sides are needed. We welcome that the authorities' revised fiscal framework is anchored on the objective of debt sustainability and is supported by analysis of the full sovereign balance sheet and intertemporal net worth. However, we are cautious about staff's suggestions for legislating expenditure ceilings as they can be inflexible and lead to over-determination of fiscal rules. *Have staff considered whether the independent fiscal institution that sits within the National Audit Office could play a stronger role in supporting the fiscal framework?*

**We note staff's assessment that the Finnish banking system is broadly sound and agree with the recommendations to address structural vulnerabilities to strengthen the resilience of the financial sector.** We note that the banking system is relatively large and concentrated with elevated real estate exposures and a heavy reliance on wholesale funding. The evaluation that the recent shocks amplified vulnerabilities of borrower-side with the increase in household indebtedness and corporate debt is also worrisome. Staff also pointed out that the Finnish banking sector is interconnected with other financial systems in the Nordic region, which can be systemic risks to

monitor. *Could staff elaborate on the mechanism and the recent trend of this interconnectivity?* The authorities should encourage financial institutions to reduce the dependence on wholesale funding and build up liquidity and capital buffers to enhance the resilience to shocks if needed.

**The housing market warrants particular attention given its broad macro-financial, structural and social implications.** We concur with the Financial Sector Assessment Program's recommendations to strengthen the macroprudential framework, including adding tools to address borrower-side vulnerabilities and the enhancements to systemic risk monitoring. At the same time, we note that legislating for caps on Debt-to-Income and Debt Service-to-Income ratios has been challenging due to distributional concerns, especially regarding housing affordability for younger generations. *While we welcome staff analysis of the distributional incidence of these measures, we wonder if they are fully addressing policymakers' concerns and objectives regarding housing affordability? Staff comments are welcome.* We emphasize the need for staff advice that addresses housing market issues in a holistic manner considering the need for coordination of macro-financial policy with structural policy measures (e.g., reforms to improve housing supply responsiveness) and appropriate institutional arrangements that ensures operationally independent regulators have clear mandates and social license.

**Boosting employment and productivity is paramount to address long-standing structural challenges.** We positively note that labor market participation continued to improve and the employment rate has increased. However, the employment rate remains lower than that of Nordic peers, and the share of youth not in employment, education, and training is larger than some of the peers. We share staff's views that policy measures should be taken that would improve incentives for greater labor participation by older age groups, which could have significant benefits for employment and fiscal sustainability. We note staff's view on the role that attracting foreign labor could play in addressing skills gaps in the labor market. It would be important that migration policy is well coordinated with broader structural reforms given its potential implications for public investment, infrastructure and the housing market.

**Further policy measures are needed to meet emission reduction goals.** The energy crisis underscores the macro-criticality of managing the climate transition. *In addition to the policy measures proposed by staff, we wonder if subjecting the forestry sector to carbon pricing could make a highly efficient contribution to achieving emission reductions.*