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February 3, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Finland - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Finland. A draft decision appears on page 16.

This subject has been tentatively scheduled for discussion on Friday, March 2, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Hedfors (ext. (5)8830) or Mr. Hemphill (ext. (5)8822).

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INTERNATIONAL MONETARY FUND

FINLAND

Staff Report for the 1983 Article IV Consultation

Prepared by Staff Representatives for the
1983 Consultation with Finland

Approved by L.A. Whittome and S. Kanesa-Thasan

February 2, 1984

I. Introduction

Article IV consultation discussions were held with the Finnish authorities in Helsinki during the period November 16 to 30, 1983. The staff team consisted of Messrs. H. Ungerer, P. Hedfors, R. Hicks, W. Hemphill, and M. Rodlauer, with Ms. H. Walters as secretary (all EUR). The mission had meetings with officials from the Bank of Finland, the Ministries of Finance, Trade and Industry, and Foreign Affairs, and with representatives of a private research institute and a large commercial bank. In addition, the head of the mission met with the Governor of the Bank of Finland. Mr. A. Lindå, Alternate Executive Director, attended the discussions as an observer. Finland has accepted the obligations of Article VIII, Sections 2, 3, and 4.

II. Background

The Finnish economic performance in the late 1970s and early 1980s was favorable by international standards. Over 1978-82, economic growth--while weakening perceptibly towards the end of the period--was significantly higher on average in Finland (4 percent) than in its main trading partners (less than 2 percent) (Chart 1). The rate of inflation corresponded broadly to international developments and, indeed, was running below the average of partner countries until mid-1980 (Chart 3). The external current account--albeit in deficit for most of the time--posed no immediate constraint. However, the unemployment rate, at an average of almost 6 percent for the period, compared with rates of less than 2 percent in the early 1970s (Chart 2).

While several factors contributed to these relatively favorable developments, it is notable that they date back to the adoption in 1977 of a medium-term economic program for the period 1978-82. In 1977 the Finnish economy was in a recession that had followed upon a serious overheating in 1974-75. As the severe imbalances caused by the overheating were receding under the influence of restrictive policies, the emphasis of policy shifted toward economic recovery and the restoration of full employment. Under the 1978-82 program, economic policies were given a medium-term supply-side orientation although they also incorporated traditional demand management measures.

The principal aim of the program was to achieve export-led recovery based on the expansion of the enterprise sector, while the growth of the public sector was to be restrained. To this end, policies aimed at strengthening competitiveness and profitability of enterprises; they began with a substantial devaluation of the markka in 1977-78 and included reductions in employers' social security charges, the introduction of investment incentives for the manufacturing sector, and the use of tax concessions to encourage moderate wage settlements. At the same time limits were set for the share of taxes in GDP.

Exports were targeted to grow at an average rate of 7 percent in volume terms in 1978-82. This objective came close to being met, as exports rose on average by 6 percent. Similarly, economic growth in 1978-82--although declining in the course of the period--was close to the targeted rate, which had been set at an annual average of 4 1/4 percent. Nevertheless, policies failed to bring about the desired reduction in unemployment. However, this resulted mainly from an unexpectedly strong increase in the participation rates of both men and women. Inflation had been targeted to run slightly below the expected international rate as a means of maintaining competitiveness; in this respect, performance under the program deteriorated somewhat in the second half of the period, following the second large oil-price increase.

In sustaining a relatively high rate of growth without major external imbalances, Finland was helped by its trading relations with the U.S.S.R. Under the bilateral trade and payments agreement in place, changes in exports to the U.S.S.R. have broadly offset fluctuations in Finland's trade with market economies (Chart 7). Moreover, the Finnish economy weathered the second round of oil price increases without major current account difficulties as the initially large bilateral imbalance arising from Finnish purchases of Soviet oil was corrected through increased Soviet purchases of Finnish products.

In early 1982, the Finnish authorities, given the continuing international recession, viewed economic prospects as very weak. Official forecasts made in early 1982 suggested an increase in real GDP of only 1.5 percent. Unemployment had been rising since 1980, had reached more than 5 1/2 percent by early 1982, and was forecast to increase further. The inflation rate--while on a downward trend--remained high at about 11 percent in January 1982 as against 9 1/2 percent in the major trading partners.

III. The Finnish Econony in 1982 and 1983

1. Policies and Developments in 1982

Confronted with the unfavorable prospects for 1982, the Finnish authorities decided to adopt a more expansionary monetary and fiscal policy stance. Despite the continuing high rate of inflation, a measured shift towards reflation was considered feasible, given some notable strengths in the Finnish economy in other respects (the projected surplus on the current account, the decline in the ratio of foreign debt to GDP since the late 1970s, and the satisfactory financial position of the Central Government). With monetary policy eased already in 1981, the overall expansionary stance was reinforced by a decision in early 1982 to add a package of supplementary measures to the original 1982 budget. These measures included tax relief for households and a reduction in employers' social security contributions.

The average increase in wage and salary earnings in 1982 amounted to 10.7 percent (1.3 percent in real terms). Besides the wage increases, income developments in 1982 were marked by a scheduled substantial increase in social security benefits, a strong rise in entrepreneurial incomes from agriculture, and inflation adjustments in income taxation that exceeded the nominal rise in the earnings level. As a result, households' disposable incomes grew by 14.4 percent (4.6 percent in real terms).

The stance of policy, in combination with the buoyant income developments, strongly boosted domestic demand. With this development accompanied by a significant weakening in price competitiveness (see Chart 8) and sluggish foreign demand, the current account of the balance of payments deteriorated in the course of 1982. In addition, the widespread expectation of an exchange rate adjustment of the Swedish krona following the Swedish elections scheduled for early September added to pressures on the markka. Substantial intervention in the foreign exchange markets by the Bank of Finland in support of the currency occurred during the period from mid-September to early October.

On October 6, the Finnish authorities devalued the markka by 4 percent, and on October 11, following the 16 percent devaluation of the Swedish krona, by an additional 6 percent. Given Sweden's importance for Finland as a competitor in third-country markets, especially as regards the forest-based industries, the implications of the Swedish devaluation were sizable not only for Finnish competitiveness but also for exchange rate expectations. The devaluations of the markka restored price competitiveness to its long-term average level. Currency unrest, however, was not immediately arrested. Toward the end of 1982, it appears that reflows of short-term capital indeed occurred but at a lower rate than had been expected.

After the devaluations, monetary policy was gradually tightened, chiefly by raising the average cost of commercial bank borrowing from the Bank of Finland. This shift in monetary policy from its previous easy stance was designed to help sustain the relative price effects of the devaluations, but also to dampen expectations about a resurgence of inflation. Despite this shift, the growth of the monetary aggregates continued at a high rate, and indeed accelerated, as the year came to a close; growth of bank credit to the private sector reached 20 percent during 1982 (Table 1). The failure of the monetary aggregates to respond to the tightening of monetary policy--a problem which has characterized the whole of the recent period--reflects a combination of elements. In part it can be traced to the limitations of the policy mechanisms in Finland which focus on influencing banks' profitability but which are not designed to have a direct impact on the demand for credit. Furthermore, the evolution of an unregulated ("gray") money market has also had a number of implications for recent monetary developments and policies. This market covers a variety of financial activities which are outside the traditional banking transactions influenced by the Bank of Finland. 1/

In October 1982, the authorities also decided on a number of other measures. A price freeze was introduced until December 15, 1982, followed by intensified price monitoring until the end of March 1983. Fiscal policy measures were aimed at improving the cost position of enterprises and encouraging moderation in the income negotiating process; a further reduction in the social security contributions paid by private sector employers was an important component of this package. To help finance these measures, the general sales tax was increased, but only with effect from mid-1983. Altogether, the fiscal impact in 1982 was quite expansionary and the authorities have estimated that general government operations (including financial operations of municipalities and the social security funds) had a positive impact of about 2 percentage points on GDP in that year, with substantial lagged effects continuing well into the next year. The Central Government's budgetary deficit, after declining in 1981, nearly doubled in 1982 and was back to the equivalent of some 2 percent of GDP (Table 2). To finance this deficit, increased reliance was placed on foreign borrowing.

It was not apparent until the summer of 1983 that the buoyancy of the Finnish economy in 1982 had been underestimated. The Finnish representatives acknowledged that with hindsight financial policies in 1982 had been too expansionary. Among other things, it had not been possible to foresee the extent of anticipatory consumer purchases following the devaluations and the imposition of the price freeze. Similarly, the expiration in late 1981 and early 1982 of the investment tax on "nonessential" construction work had exerted an unexpectedly strong influence on building activity. As a result, real GDP in 1982 grew by 2 1/2 percent, compared to earlier forecasts of only 1 1/2 percent. Total domestic demand grew by 4 1/2 percent, boosted mainly by private and public consumption while investment grew only moderately, in particular in the private sector. In contrast to the brisk expansion of domestic demand, exports of goods and services fell by nearly 4 percent in real terms, resulting in a markedly negative impact of the foreign balance on overall growth. Consumer prices (on average) rose by 9.3 percent. In spite of the buoyant economic activity, the unemployment rate rose by about 1 percentage point for the year on average to 5.9 percent.

1/ Some implications of these developments are discussed in Section IV. 2. See also the Appendix in the recent economic developments paper.

The trade account of the balance of payments in 1982 deteriorated somewhat as exports to market economies (about three quarters of total exports) continued to fall in real terms, while exports to state-trading countries shifted abruptly from strong real growth to slight decline. The latter development reflected the large creditor position of Finland that had developed on the bilateral account with the Soviet Union. Imports of consumer products rose sharply under the influence of anticipatory purchases. Nevertheless, total imports rose by only 1 percent in volume terms. There was a substantial deterioration on the services account in 1982. A major component of this decline was the fall in net investment income, linked especially to the continuing increase in the average rate of interest on foreign debt. Overall, the deficit on the current account increased from the equivalent of 1/2 percent of GDP in 1981 to 2 percent in 1982 (Table 3). With respect to market economies, the change is estimated to have been somewhat larger. The short-term capital account including net errors and omissions was in moderate surplus for the year as a whole. This development reflects foreign borrowing by banks for on-lending in the domestic market as well as the reflows of speculative funds that had occurred at year-end. However, a larger portion of the current account balance was financed by net long-term capital inflows, almost exclusively representing foreign borrowing by the Central Government. In large part because of valuation changes, gross convertible reserve assets of the Bank of Finland increased by one sixth to SDR 1.5 billion, the equivalent of ten weeks' imports from market economies.

2. Policies and developments in 1983

The original intention for fiscal policy in 1983, as proposed in the budget of the Central Government submitted to Parliament in the early fall of 1982, was that it should take a broadly neutral stance. However, as indicated above, the background situation subsequently changed because of the devaluations of October 1982 and the measures taken around that time, while continuation of the international recession was causing concern. In this new situation, the authorities formulated a fiscal policy that implied a continuation of the reflationary stance until mid-1983, to be followed by a gradually more restrictive emphasis. In mid-1983, additional expenditures were authorized in a supplementary budget, but at this time the sales tax increase (announced in October 1982) took effect and the temporary cut in withholding taxes, granted to employees in early 1982, was reversed. As the year went on, fiscal policy became significantly less stimulatory.

In the event, the budget is estimated to have been in deficit (on a cash basis) by Fmk 7.7 billion (equivalent to 2.9 percent of GDP) in 1983, compared with Fmk 5.2 billion (2.2 percent of GDP) in 1982 (Table 2, Chart 6). As in other recent years, external borrowing played an important role in financing this deficit, but in a departure from normal practice, the Central Government borrowed Fmk 1 billion from the Bank of Finland during the year. The financial position of the municipalities, after weakening significantly in 1982, showed a modest improvement in 1983 due, in part, to the agreement reached with the Central Government that growth in the volume of their spending would be reduced. The expansionary fiscal impact of general government operations in 1983 was estimated by the authorities at around 1/2 a percentage point of GDP.

The authorities also made renewed attempts to tighten monetary policy. The Bank of Finland's call money rate 1/ was raised in several steps from 11 percent at the beginning of 1983 to 15 percent by May 1983, raising further the cost of commercial bank borrowing from the Bank of Finland. In July, the Bank of Finland's base (discount) rate was raised by 1 percentage point to 9 1/2 percent and there was a corresponding adjustment to the average lending rate of the banks. The cash reserve deposits which commercial banks are required to maintain with the Bank of Finland had already been raised in April. Despite this gradual tightening of monetary policy, monetary aggregates in the first three quarters continued to grow quite strongly (Chart 5 and Table 1); in particular, net domestic credit to the private sector rose by 21 percent during the one-year period ending August 1983. Around September 1983, there was renewed restlessness in foreign exchange markets, resulting in a significant outflow of capital. On September 15, 1983 the Bank of Finland responded by raising the call money rate from 15 to 18 percent. The move arrested capital outflows and signalled to the markets the authorities' view that there was no need for a further devaluation and that external and domestic monetary stability would be accorded high priority. In late September and in October, the call money rate was lowered in steps to 16.7 percent in view of restored confidence in currency markets.

With the fiscal package adopted in the context of the devaluations of October 1982, the Government had hoped to moderate wage demands for the 1983 round of negotiations. However, with a 10 percent rise in average wage and salary earnings the results outstripped by far the gains in labor productivity, and unit labor costs for the whole economy increased by 7.0 percent. The Finnish representatives said that one reason for the disappointing outcome of wage negotiations in 1983 was that it proved impossible to arrive at a comprehensive, centralized wage agreement of the kind concluded in 1981. Under the decentralized bargaining procedure, contractual increases that were negotiated relatively late in the wage round tended to be successively higher than those agreed earlier.

The growth of domestic demand is estimated to have slowed down in 1983. This reflected mainly a weakening of private consumption demand in reaction to the anticipatory purchases in 1982 and a somewhat slower growth in disposable incomes in 1983. In contrast, private fixed investment may have risen slightly faster than in 1982. With the foreign

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1/ The call money market is a facility through which the Bank of Finland either provides financing to, or accepts deposits from, the commercial banks. These deposits are not counted against obligatory cash reserve deposits.

balance exerting little net influence, overall economic growth is officially estimated to have continued at the same rate as in 1982, i.e., 2 1/2 percent. The most recent information suggests that growth may have been somewhat stronger. In contrast to the development in Finland's main trading partners, the slowdown in inflation came to an end in 1983 and consumer prices rose on average at almost the same rate as in 1982, or by close to 9 percent. Unemployment rose slightly in 1983 to an average rate of 6.2 percent.

According to the last detailed forecasts for the balance of payments for 1983, prepared by the Bank of Finland in September of that year, merchandise imports grew faster than the year before, and the volume of exports, which had fallen in 1982, rose by about 3 1/2 percent, roughly the same rate as for imports. Exports to market economies were estimated to have grown faster (by about 5 percent) while exports to state trading countries were expected to have remained unchanged in volume terms. With the terms of trade approximately constant, the trade balance was thus not expected to have changed significantly, while a further increase in, especially, net payments of investment income probably offset improvements in other service items. On this basis, the current account deficit would have amounted to 1 3/4 percent of GDP, little changed from 2 percent the year before (Table 3). Regarding the long-term capital account, a modest decrease in the substantial inflow to the government sector would have been partly offset by a net outflow from the enterprise sector. The short-term account is thought to have continued to show a sizable inflow, mainly related to changing patterns of trade financing. The balance on the current and capital accounts taken together would be in deficit by some SDR 0.2 billion.

Subsequently, at the time of the staff visit, the Finnish authorities--on the basis of data for the first ten months of 1983--provided a revised estimate for the current account; in terms of GDP, the deficit would amount to 2 1/4 percent instead of 1 3/4 percent. As of December 31, 1983, gross convertible reserve assets of the Bank of Finland stood at SDR 1.3 billion (after allowance for valuation changes), equivalent to about eight weeks of imports from market economies.

IV. Future Policies and Prospects

1. Policy objectives and prospects

Against the background of the deterioration of Finland's relative price performance in recent years, the Finnish authorities have set as main objectives of economic policy a higher degree of domestic price stability and the maintenance of international competitiveness.

In adopting these objectives, the authorities were guided by an analysis of economic prospects in the medium term under alternative assumptions regarding the stance of economic policy. With a "passive" economic policy--defined as one that would accommodate current trends in the economy--inflation in Finland would be higher than in other countries and international competitiveness would deteriorate with adverse consequences for export performance and economic growth; unemployment would continue to rise over the medium term. In contrast, an "active" economic policy, including demand management and supply-side elements and designed gradually to reduce inflation to a rate lower than that in main competitor countries, would permit a stronger growth of exports, investment and overall output, and unemployment would be significantly lower than under the "passive" alternative.

For 1984, the authorities have adopted a target to reduce the increase in the consumer price index during the year to 6 percent (equivalent to an average increase of 8 percent). The maximum increase in negotiated wages and salaries compatible with this target is no more than 3 percent as of March 1, 1984. Including carryover and estimated wage drift, this would yield a total increase in wage rates of 8 percent, implying no increase in real terms. However, allowing for an increase in hours worked and taking into account projected developments in nonwage earnings, total disposable income is forecast to grow by 9 percent, or 1 percent in real terms.

On the basis of these assumptions, real GDP is officially projected to rise by 3 percent. The underlying export forecast implies a growth in the volume of merchandise exports to market economies of 9 percent, and is partly based on past cyclical patterns of export performance. Exports of forest industry products usually respond quickly to a recovery in the market economies, since inventories of construction materials are often replenished in the early stage of an upturn of economic activity. In addition, the devaluations of October 1982 are expected to have a major impact on export performance in 1984.

Traditionally, the Finnish economy has shown a proneness to inflation which is the result of a variety of factors. The forestry-based industries are highly exposed to competition in third markets. Even a small increase in the bilateral exchange rate with a major competitor, such as Sweden, affects strongly the viability of the many small enterprises in this sector and often becomes a strong source of pressure for devaluations. The prevalence of governmental regulations, licensing, and price controls, tends to reduce the flexibility of markets. Moreover, indexing arrangements--although formally abolished by law for wage and salary contracts in 1968--and other forms of linkages and earnings guarantees--providing, e.g., for rough parity between increases in farmers' incomes and the incomes of industrial workers--have tended to perpetuate the inflationary momentum. Eventually this has led to pressures for new exchange rate changes. As a result, the Finnish economy has, throughout the post-war period, experienced a sequence of inflation-devaluation cycles.

2. Main policy issues

In the light of all this, it is obvious that the outcome of the upcoming round of wage negotiations will be of crucial importance for developments in 1984 and beyond. The stance of economic policy in 1984 and the question as to how economic policy should respond if wage increases were to exceed the limit consistent with the authorities' inflation target formed an important part of the consultation discussions. In Finland, the Government has only very limited possibilities to take a direct role in the wage formation process, and wages in the public sector follow, rather than set, the general trend. The Finnish representatives stated, however, that the Government was determined to follow in 1984 a tight fiscal policy and that a further tightening of monetary policy was being actively considered. The mission urged the adoption of a firm if gradual approach to adjustment, including early measures aimed at giving clear signals to the economy before the wage negotiations began in early 1984.

The approved budget for 1984 provides for a moderately restrictive stance of fiscal policy, aimed at countering inflation and strenthening the Government's financial position. Altogether, the Central Government's deficit is forecast at Fmk 5.8 billion for 1984, or about 2 percent of GDP compared with almost 3 percent for the estimated outcome for 1983 (Table 2). Budgetary revenues are forecast to be about 10 percent higher than the estimated outcome for 1983. Budgetary expenditures are forecast to rise by only 6 1/2 percent, with the efforts to restrain spending focusing especially on a tighter control of transfers to municipalities. In the past, the growth of expenditure turned out to be markedly higher than envisaged because of the practice of introducing supplementary budgets in the course of the year. However, the Finnish representatives were quite firm in their view that the proposed budget deficit should not be exceeded. The Government was prepared to take steps to achieve this aim; and taxes would be increased if required. Expenditure cuts were difficult to implement during the year but certain categories of expenditure could be temporarily delayed and transferred from one year to the next. An important part of the budgetary deficit is again expected to be financed by foreign borrowing.

In the field of monetary policy, the authorities have been concerned about the strong expansion of monetary aggregates during 1983 despite several restrictive measures. They have publicly stressed the need to safeguard the competitiveness of the Finnish economy and to avoid excessive wage agreements. They indicated to the mission their willingness to take action at an early stage. Consistent with this view, the Bank of Finland announced, on December 16, 1983, several measures which took effect on January 1, 1984. In particular, the cost of central bank refinancing was increased and the banks were allowed to charge higher lending rates to their customers. As regards the former, the credit quotas under which banks could obtain funds from the Bank at the lower base rate (at present 9.5 percent) were abolished, and all refinancing from the Bank of Finland will now be transacted at the call money rate which was raised from 16.7 to 17.5 percent. This arrangement strengthens the role of this rate--set by the Bank of Finland--as a significant influence on interest rates in financial markets. The higher call money rate provides also an encouragement for banks to deposit funds with the Bank of Finland, resulting in a reduction of bank liquidity. At the same time, the formula governing bank lending rates in the regulated market was modified so as to allow banks to pass on in their lending rates a higher proportion of the cost of borrowing in the unregulated money market where generally higher interest rates prevail. Together, these measures will tend to increase costs for most credit to the private sector (except for private housing where the authorities consider relatively inexpensive finance as socially desirable) and to gradually reduce the interest rate differential between the regulated and unregulated markets. 1/

While these measures have been taken in view of present and prospective developments of the economy, they also need to be seen as important steps in making the financial system less complex and in improving the control of the authorities over monetary developments.

The evolution of an unregulated ("gray") short-term money market--in which corporations and various financial institutions (including the banks) are the chief participants--has had an important bearing on the channels and tools of monetary policy. It has expanded rapidly in recent years and is estimated to have reached by mid-1983 a size equivalent to about 15 percent of the regulated sector. Of particular importance, interest rates in the unregulated market, determined by the forces of supply and demand, are significantly higher than in the regulated sector. The development of the unregulated market--partly attributable to these interest rate differentials--has given a somewhat greater role to the price mechanism than has typically been the case in the Finnish financial system, where the demand for credit is far greater than the supply of funds. This has left the banks with the responsibility to allocate and ration credit. Traditionally, monetary policy in Finland has focused on influencing the banks' profitability through the cost of central bank refinancing rather than controlling directly their liquidity and the level of their lending. However, as noted above, some adaptation of monetary instruments has recently been made in light of the changing conditions in financial markets. In particular, restrictions on bank lending rates were recently liberalized allowing banks to pass on a part of the costs of their borrowing in the unregulated market. Furthermore, the complex system of marginal interest rates on commercial banks' borrowing from the central bank has been simplified so that the cost of all such borrowing is now at a single call money rate.

V. External Policies

1. Exchange rate policy

The principal aim of Finnish exchange rate policy is to keep the nominal effective rate constant under normal circumstances. For this

1/ For a detailed discussion see the Appendix in the recent economic developments paper.

purpose, the external value of the markka is defined in terms of an index reflecting a weighted average of the exchange rates most important for Finland's foreign trade. The level of the index is kept fixed, and accordingly the Bank of Finland stands prepared to buy or sell the intervention currency (the U.S. dollar).

There is a formal "band of fluctuation" around the index with a width of 4 1/2 percent (until October 1982, 6 percent, Chart 9). In practice, it is not utilized to absorb short-term variations in the supply and demand for foreign exchange, since the thinness of the exchange market could result in excessive exchange rate fluctuations. Instead, the band constitutes a range within which the Bank of Finland is empowered to make discretionary changes in the exchange rate. Movements outside the band require the consent of the Government.

The operation of the index was changed in several respects with effect from January 1, 1984. Most significantly, the Soviet ruble was dropped from the index calculations. Its share, formerly about 25 percent, was redistributed among the 12 remaining currencies; at the same time the weights for these currencies were revised by replacing the former base year (1974) by a moving reference year (at present, 1981). These modifications implied no change in the effective exchange rate at the time of transition but, of course, may subsequently lead to developments different from what would otherwise occur.

The Finnish authorities observed that the Soviet ruble had followed the U.S. dollar rather closely during the preceding couple of years, which in effect tended to increase the weight of the U.S. dollar and at times had amplified exchange rate fluctuations. Henceforth, only the convertible currencies most important for Finland's foreign trade will be taken into account when calculating the currency value of the markka. The Bank of Finland will continue quoting the Finnish markka rate for the ruble as at present, based on the ruble/U.S. dollar exchange rate as quoted by the Soviet State Bank.

2. Foreign debt

During 1982, total foreign indebtedness of the Finnish economy increased by the equivalent of 2 1/2 percentage points of GDP (including valuation effects from the exchange rate changes), to 17 1/2 percent, a ratio below the peak of 21 percent in 1977. Beyond 1982, illustrative staff projections (see Appendix I) suggest a further increase amounting to 1-2 percentage points of GDP during the mid-1980s, depending on the specific assumptions adopted regarding the 1984 current account. After the middle of the decade the debt ratio is projected to decrease gradually. The Finnish authorities would expect this ratio to decline in the longer run as well, reflecting amortization of loans obtained in the late 1970s to finance a major increase in investment in infrastructure and in productive capacity in key industries. They regard a ratio as high as 20 percent over the medium term as manageable.

3. Trade policy, official development assistance

The Finnish authorities hold firmly to the view that a liberal trade policy serves best the interests of a small open economy like Finland whose performance is highly dependent on exports. Therefore, the worsening climate in international trade is observed with increased concern. A cornerstone of Finnish trade policy in the years to come will therefore be to take a stance against worldwide protectionist tendencies.

The Finnish trading system has remained highly open except for trade in agricultural products and, to a minor extent, textiles and clothing. Finland participates in the European free trade system through its association with EFTA, its free trade agreement with the EC, and a similar agreement with Spain. Trade arrangements corresponding to those embodied in the free trade agreements with European market economies have been concluded with the Soviet Union and five other European state-trading countries.

In 1980, the Government announced its intention to reach a level of official development assistance corresponding to 0.7 percent of GDP by the latter part of the decade. The Finnish authorities reaffirmed this objective and noted that the level had been constantly raised since 1979, from 0.20 percent of GDP to 0.36 percent in 1983. The 1984 budget proposal embodies a further increase of ODA appropriations to Fmk 1.1 billion, which represents 0.39 percent of forecast GDP.

4. Bilateral payments agreements

Finland maintains bilateral payments agreements with Bulgaria, the German Democratic Republic, Hungary, and the Soviet Union. In January 1982 and January 1983, respectively, the bilateral payments agreements with Romania and China were terminated. Since then, Finland has not imposed any restrictions on the making of payments and transfers for current transactions with these two countries.

Finland's bilateral payments agreements with Hungary, concluded in 1948, became subject to Article VIII after Hungary became a Fund member in 1982. The agreement provides a clearing account system for the purpose of settling all bilateral current transactions; it involves a restriction subject to approval by the Executive Board. In September 1983, both parties agreed to terminate the agreement as early as practicable but not before the end of 1984. During the discussions, the Finnish authorities indicated to the mission that they strongly favor early termination and that the matter will be discussed again in the next meeting of the Finnish-Hungarian trade commission in the fall of 1984.

VI. Staff Appraisal

Finland's economic performance over the last five to six years was, on average, noticeably better than in many other industrialized countries. Since late 1980, however, unemployment was rising and inflation, at an average annual rate of around 10 percent, gradually eroded the country's competitive position. Nevertheless, confronted with a less promising outlook, the authorities decided on an expansionary stance of demand management policies for 1982, while retaining the emphasis on the supply side that had been a guiding principle in Finnish economic policy since 1978.

With hindsight, it is now clear that the economy was more buoyant than expected and that the overall policy line became too expansionary. The current account deficit increased from 1/2 a percent of GDP in 1981 to 2 percent in 1982. As the external situation deteriorated and speculative capital outflows increased, the Finnish authorities devalued the markka in October 1982 in two steps by a total of 10 percent. The second move was prompted by the large devaluation by Sweden, Finland's main competitor for forestry-based products.

Price competitiveness was restored but the unrest in the foreign exchange markets was not arrested immediately. Around that time, monetary measures were taken, primarily with the aim of curbing the rise in domestic prices. However, with economic activity expected to remain sluggish, the expansionary stance of fiscal policy was continued and special measures to contain cost increases in industry and to encourage moderation in the forthcoming wage negotiations were decided upon.

Despite the fiscal concessions, wage settlements in early 1983 were disconcertingly high. The monetary measures taken throughout 1983 with the intention of tightening the stance of policy failed to constrain the growth of monetary aggregates; in particular, the expansion of bank credit to the private sector was excessively high. The impact of fiscal policy was again expansionary in 1983, although less so than in 1982. While GDP grew by about 3 percent, possibly even more, unemployment--already high by historical Finnish standards--nevertheless continued to increase slightly. The rate of inflation remained high and somewhat above the average for Finland's main trading partners, resulting in a renewed deterioration of competitiveness. For 1983, the current account deficit is estimated to have been somewhat higher than in 1982.

Concern about the possibility of another devaluation of the Finnish currency in the autumn of 1983 led to renewed and apparently rather substantial capital outflows. The Finnish authorities responded with a sharp rise in the call money rate, the key interest rate for bank borrowing from the central bank, to demonstrate their conviction that the development of fundamentals did not warrant another devaluation. Subsequently, capital outflows ceased, and toward the end of the year, a significant reflow appears to have occurred.

For 1984, economic prospects in general are quite favorable and real GDP is expected to grow by 3 percent, perhaps even more. However, inflation remains a problem in Finland. The staff, therefore, agrees with the authorities that it is essential to bring down the rate of price increase to safeguard international competitiveness. The Government has set a target for limiting inflation to 6 percent which requires that negotiated wage increases (apart from carryover and wage drift) be not more than 3 percent. These targets appear somewhat ambitious, in particular if seen against past developments, and there are doubts whether they can be realized. There is the danger that Finland's inflation rate will remain higher than that of its trading partners, and that price competitiveness will deteriorate. The results of the forthcoming wage round, therefore, will greatly influence economic developments in 1984. They will also have an important bearing on the medium-term strategy of the Government to break with the post-war pattern of devaluation cycles.

The staff therefore welcomes the monetary measures which came into effect at the beginning of January. They might serve as a signal of the authorities' intentions, particularly to the social partners. The authorities should not hesitate to take further steps as required, thus avoiding the possible need to take stronger measures at a later stage. The staff sees a particular need to raise interest rates on commercial bank lending to curb the strong growth of credit to the private sector. For 1984, fiscal policy is already intended to be somewhat restrictive and envisages a reduction in the deficit of the Central Government's budget. Any slippage on the expenditure side should be avoided, and additional tightening measures may have to be taken if the economic situation, and in particular the position as regards inflation, does not develop as expected.

In view of the gap between monetary policy intentions and actual developments, the staff feels that the set of instruments available to the Bank of Finland has been inadequate. The staff welcomes, therefore, the various measures of the authorities aimed at deregulating and simplifying the financial system as well as improving the transmission channels of monetary policy, and encourages the authorities to continue their efforts in this direction. The authorities should consider ways and means to influence more directly the liquidity of the banking system and the public at large.

The staff commends the Finnish authorities for their support of a liberal system of international trade. The staff welcomes the increase in ODA in recent years and encourages the Finnish authorities to persevere further in raising its level which at present does not compare well with that of many other industrialized countries.

The staff welcomes the elimination of the exchange restrictions involved in the bilateral payments agreements with Romania and the People's Republic of China. In view of the fact that the bilateral payments agreement with Hungary became subject to Fund jurisdiction after completion of the last Article IV consultation in January 1982 and since the Finnish authorities have stated that they favor an early termination of this agreement, the staff recommends that the Executive Board approve the restrictions under the current agreement with Hungary until the end of January 1985.

It is recommended that the next Article IV consultation with Finland be held on an 18-month cycle.

VII. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to Finland's exchange measures subject to Article VIII, Section 2 (a), in light of the 1983 Article IV consultation with Finland conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund welcomes the termination of the bilateral payments arrangements with two Fund members and the intention of the authorities to terminate a bilateral payments arrangement with a third Fund member. The Fund grants approval until January 31, 1985 of the restriction on the making of transfers of balances for current international transactions arising from the remaining arrangement.

Table 1. Finland: Monetary Survey, 1980-83

(In billions of Finnish markkaa, end of period)

	1980	1981	1982	August 1982	August 1983
1. Total net domestic credit	89.2	102.6	123.4	112.1	138.8
(Percentage change) 1/	(20.6)	(15.0)	(20.3)	(14.0)	(23.8)
Private sector	92.7	107.3	128.3	116.3	140.3
Government	-3.6	-4.7	-4.9	-4.2	-1.5
2. Net foreign assets	-0.4	1.3	-1.7	3.4	-2.4
3. Other items (net)	7.1	9.2	14.1	13.4	20.8
4. Money and quasi-money (M3) 2/ (1 + 2 - 3)	81.6	94.6	107.5	102.0	115.6
(Percentage change) 1/	(14.7)	(15.9)	(13.7)	(13.7)	(13.3)
5. Quasi-money 2/	66.6	77.4	87.6	83.4	94.6
6. Money (M1)	15.0	17.2	19.9	18.6	21.0
Demand deposits	10.7	12.4	14.7	13.9	15.9
Currency held by the public	4.3	4.8	5.2	4.7	5.1
Memorandum item					
Reserve money	8.3	8.1	9.2	8.7	11.0

Source: IMF, International Financial Statistics.

1/ From same period of previous year.
2/ Including import deposits.

Table 2. Finland: Central Government Finances, 1980-84

(In billions of Finnish markkaa)

	1980	1981	1982	1983 Official estimates	1983 Approved budget 1/	1984 Approved budget 1/
Revenue	45.3	53.6	60.4	66.9	64.0	73.5
(Percentage change)	(15.8)	(18.4)	(12.5)	(10.8)	(9.8)	(14.8)
Taxes	39.4	46.9	52.2	57.1	56.3	64.5
Nontaxes	5.9	6.8	8.2	9.7	7.7	9.1
Expenditures	49.5	56.2	65.5	74.5	70.8	79.3
(Percentage change)	(12.9)	(13.6)	(16.6)	(13.8)	(13.3)	(12.0)
Consumption	13.7	15.6	18.2	20.9	20.1	21.7
Transfers	26.3	30.4	35.4	39.9	39.6	45.3
Fixed investment	4.1	4.6	5.0	5.4	4.8	4.8
Other	5.4	5.6	6.9	8.3	6.3	7.5
Central government deficit	4.1	2.5	5.2	7.7	6.8	5.8
(In percent of GDP)	(2.2)	(1.2)	(2.2)	(2.9)	(2.5)	(2.0)
Financed by net borrowings from:						
Abroad	1.5	2.3	2.8	2.4	...	...
Bank of Finland	-0.4	0.3	0.2	-0.2	...	...
Deposit money banks	1.1	-1.0	0.1	0.4	...	...
Domestic nonbank sector	2.0	1.0	2.1	5.0	...	...

Source: Data provided by the Finnish authorities.

1/ Figures for the approved budgets for 1983 and 1984 are appropriations and cannot therefore be compared directly with the other data provided in this table which are on a cash basis.

Table 3. Finland: Balance of Payments, 1980-84

(In millions of Finnish markkaa)

	1980	1981	1982	1983 1/	1984 1/
A. Current account balance	-5,155	-1,211	-4,698	-4,692	-6,532
Trade balance 2/	-5,455	-1,437	-2,225	-2,114	-4,401
Service and transfer balance 2/	300	226	-2,473	-2,578	-2,131
Of which: investment income	(-3,308)	(-4,359)	(-5,446)	(-5,850)	(-6,000)
B. Long-term capital, net 3/	182	2,398	3,052	1,584	3,300
Of which: Central Government	(1,509)	(1,951)	(2,974)	(2,600)	(2,400)
C. Short-term capital and errors and omissions, net 3/	5,835	558	1,508	1,900	2,000
D. Balance on current and capital accounts 3/	862	1,745	-138	-1,208	-1,232
F. Change in reserves 4/	-1,278	-2,399	-832	1,208	1,232
Memorandum items:					
Current account balance (in SDR billions)	-1.1	-0.2	-0.9	-0.8	...
Current account balance (in percent of GDP)					
All partners	-2.8	-0.6	-2.0	-1 3/4	-2 1/4
Market economies 5/	-1.0	-0.4	-2.1	...	...

Sources: Bank of Finland, Monthly Bulletin and estimates and forecasts; and IMF staff estimates.

1/ Bank of Finland estimates and forecasts from September 1983.
2/ Merchandise exports, f.o.b.; imports, c.i.f.
3/ IMF oil facility drawings and repurchases and changes in other foreign term assets and liabilities held by the Bank of Finland are included in reserves.
4/ Figures are for changes in the stock, including tied currencies and reserve-related liablities, as valued in markkaa at end-period. The difference between the balance on current and capital accounts (line D) and the change in reserves (line E) with sign reversed is attributable to counterpart items, including valuation changes in reserves related to exchange rate changes (Fmk 283 million in 1980, Fmk 523 million in 1981, and Fmk 970 million in 1982).
5/ Staff estimates based on the sum of the trade balance with market economies and the service balance with all partners.

Finland: Medium-Term Debt Projections

The illustrative projections given in the tabulation below are based on a number of assumptions. Domestic developments in 1983-84 follow the official forecasts given in the 1984 Budget Proposal 1/ (prepared mid-1983) while foreign developments are envisaged in "World Economic Outlook - General Survey," (ID/83/5, 8/19/83). For 1985-88, output of other industrial countries is assumed to increase by 3 percent, and their GDP deflators on average by 5 1/2 percent per year; for Finland, for these years, it is assumed that the level of the GDP deflator relative to partner countries remains unchanged and that demand management policies result in the same growth rate as achieved abroad. Conservation of energy is estimated to result in a medium-term reduction in the income elasticity of overall demand for imports relative to its average historical level; an offsetting reduction in the export elasticity occurs because of the bilateral payments arrangements between Finland and its major oil supplier, the Soviet Union. Interest rates are assumed to decline gradually from their current levels, and to be positive in real terms after 1984 by 2 percentage points on short-term foreign debt and 4 percentage points on long-term foreign debt.

In the staff's calculations, net external debt is defined to exclude equity capital. The debt service ratio refers to net interest payments plus amortization on medium- and long-term debt, minus amortization received on medium- and long-term assets, this difference expressed in percent of exports of goods and nonfactor services.

	1982	1983	1984	1985	1986	1987	1988
Current account in percent of GDP 1/	-2.0	-2.1	-1.6	-1.2	-1.0	-0.7	-0.5
Net external debt of the economy, in percent of GDP	17.7	18.4	18.6	18.6	18.5	18.2	17.7
Debt service ratio	11.8	13.5	11.5	9.4	11.3	10.5	9.2

1/ The less favorable current account developments for 1984 projected in September 1983, shown in Table 3, would imply somewhat higher debt figures starting in 1984 (about 3/4 percentage point for net external debt in relation to GDP, and 1/2 percentage point for the debt service ratio).

Finland - Fund Relations

(As of December 31, 1983)

Date of membership	January 14, 1948
Status	Article VIII
Quota	SDR 574.9 million
Fund holdings of Finnish markkaa	SDR 451.94 million or 78.61 percent of quota
Finland's holdings of SDRs	SDR 36.96 million or 25.91 percent of net cumulative allocation of SDR 142.69 million
Gold distribution	162,608 fine troy ounces
Exchange system	Effective November 1977, the external value of the markka has been expressed formally in terms of a trade-weighted basket of currencies of Finland's most important trading partners. On November 30, 1983 US$1 = Fmk 5.7790
Last consultation	The Staff Report for the 1981 Article IV Consultation (SM/82/1) was considered by the Board on January 25, 1982 (EBM/82/10:1) when the following decision was taken: 1. The Fund takes this decision relating to Finland's exchange measures subject to Article VIII, Sections 2 and 3, in light of the 1981 Article IV consultation with Finland conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies). 2. Finland maintains a bilateral payments arrangement with a Fund member. The Fund welcomes the intention of the authorities to terminate this bilateral payments arrangement and grants approval until January 31, 1983 of the restriction on the making of transfers of balances for current international transactions arising from the arrangement.

Finland: Basic Data

Area and population	1982
Total area	337,000 square kilometers
Total population	4,827,000
GDP	Fmk 236.7 billion; per capita US$10,174; per capita SDR 9,243

	1982 (In billions of markkaa)	1982 (In percent)	1980	1981	1982 1/	1983 2/	1984 2/
			(Volume changes in percent)				
Demand and Supply							
Private consumption	131.3	55.5	2.9	1.6	3.9	2	3 1/2
Public consumption	47.4	20.0	4.4	3.5	5.3	3 1/2	3 1/2
Gross fixed investment	56.9	24.0	10.5	1.3	3.0	2 1/2	2 1/2
Public	7.9	3.3	9.1	0.8	5.6	-1/2	-3
Private	49.0	20.7	10.8	1.3	2.5	3 1/2	3
Stockbuilding 3/	--	--	1.6	-2.8	0.5	--	1/2
Total domestic demand	235.6	99.5	6.7	-1.1	4.5	2 1/2	3
Exports of goods and services	75.5	31.9	9.0	4.3	-3.8	1 1/2	4
Imports of goods and services	74.3	31.4	11.8	-3.9	1.3	1 1/2	3
Foreign balance 3/	1.1	0.5	-0.4	2.6	-1.7	--	1/2
Gross domestic product	236.7	100.0	6.0	1.5	2.5	2 1/2	3
National savings ratio 4/	...	...	26.8	26.2	24.5	24.5	24.9
Labor market 5/ (annual averages; in thousands)							
Labor force			2,442	2,481	2,526	2,544	2,550
Employment			2,328	2,353	2,377	2,387	2,405
Unemployment rate (in percent of labor force)			(4.7)	(5.1)	(5.9)	(6.2)	(5.7)
Participation rate (in percent of population aged 15-74)			(67.5)	(68.2)	(69.0)	(69.1)	(68.9)

1/ Preliminary.
2/ Official estimates and forecasts as of September 1983.
3/ Changes as a percentage of previous year's GDP.
4/ National savings (defined as GDP minus consumption) as a percentage of GDP.
5/ Figures adjusted to correspond to the new data collection method introduced in 1983.

Basic Data (cont'd.)	1980	1981	1982	1983 1/	1984 1/
Prices and incomes (annual percentage changes)					
Consumer prices	11.6	12.0	9.3	8.6	8
GDP deflator	8.8	11.7	8.9	8 1/2	7 1/2
Unit labor costs					
Whole economy	10.5	13.7	7.7	7.0	6 1/2
Manufacturing	9.9	9.6	4.9	5.0	...
Total labor compensation 2/	17.1	15.7	10.2	9.5	9.7
Real household disposable income 3/	4.0	0.3	4.7	2	2.6
Savings Ratio 4/	8.0	6.9	7.7	8	7 1/2
Public finance (in percent of GDP) 5/					
General government					
Revenue	37.8	39.6	40.0	39.7	...
Expenditure	38.2	39.0	41.5	42.0	...
Balance	-0.4	0.6	-1.5	-2.3	...
Central government					
Revenue	24.2	25.3	25.5	25.5	25.3
Expenditure	26.5	26.5	27.7	28.4	27.3
Balance	-2.3	-1.2	-2.2	-2.9	-2.0
Monetary data (end of period; changes in percent) 6/					
Narrow money (M1)	6.3	14.7	15.9	12.9	...
Broad money (M3)	14.7	15.9	13.7	13.3	...
Domestic credit to the private sector	18.7	15.7	19.6	20.6	...
Interest rates (annual average in percent)					
Base (discount) rate	9.2	9.3	8.8	9.0	...
Call money market rate	12.4	11.5	11.6	14.7	...
Average cost of bank borrowing from central bank	12.4	11.6	12.0	14.6	...
Average bank lending rate	9.8	9.8	9.3	9.5 7/	...

1/ Offical estimates and forecasts.
2/ Wages, salaries, and social security contributions.
3/ Including social insurance contributions paid by, on behalf of, or to households; corrected by the deflator for private consumption.
4/ Households' savings as a percent of personal disposable income.
5/ General government data are on a national accounts basis; expenditures cover current outlays and gross investment. Central government data are on a cash flow basis. Figures for 1983 are official projections. Central government figures for 1984 (approved budget) are not directly comparable with those for previous years (cash outturns).
6/ Data for 1983 give growth rates for August 1983 over August 1982.
7/ Average January-November 1983.

Basic Data (cont'd.)

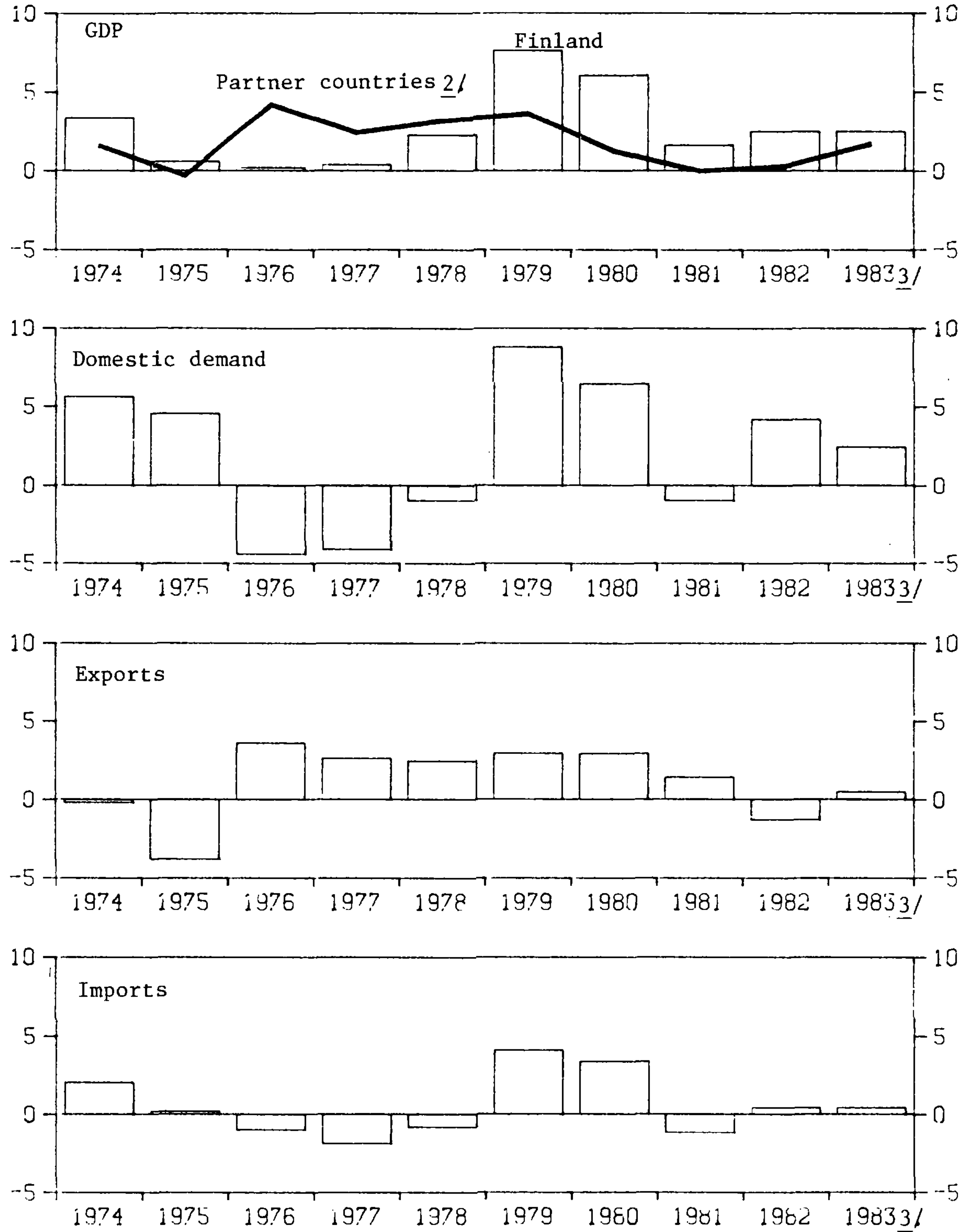
	1980	1981	1982	1983	1984
Balance of payments (in millions of SDRs) 1/					
Trade balance 2/	-1,124	-283	-419	-355	-720
Services balance	137	117	-364	-325	-226
Current account balance	-1,062	-238	-884	-789	-1,069
(In percent of GDP)	(-2.8)	(-0.6)	(-2.0)	(-1.8)	(-2.2)
Long-term capital, net	37	472	574	266	540
Short-term capital, and errors and omissions	1,202	110	274	319	327
Balance on current and capital accounts	177	344	-27	-204	-202
International reserves (end of period, in millions of SDRs)					
Gross official convertible reserve assets 3/	1,592	1,471	1,545	1,353	...
Total reserves 4/	1,438	1,847	1,808	1,443	...
Exchange rates and international competitiveness (period averages)					
Markkaa per SDR	4.8	5.1	5.3	6.0	...
Markkaa per US$	3.7	4.3	4.8	5.6	...
Exchange rate indicators (change in percent over previous period, foreign currency per markka)					
Bank of Finland currency index 5/	3.2	0.5	-2.4	-7.4	...
IMF MERM	4.5	-4.0	-1.4	-9.3 6/	...
Relative unit labor costs in manufacturing	2.8	3.7	0.9	-4.3 7/	...
Relative consumer prices	2.9	3.7	2.8	-4.0 7/	...

1/ Data for 1983 give Bank of Finland estimates, converted by the average SDR rate for 1983; 1984 data are Bank of Finland forecasts converted by the average SDR rate for December 1983.
2/ Merchandise exports, f.o.b.; imports, c.i.f.
3/ Gold, at national valuation, SDRs, reserve postion in the Fund, foreign bonds, and liquid assets in convertible currencies.
4/ Gross convertible reserve assets plus balances on bilateral nonconvertible accounts.
5/ A negative figure indicates an effective depreciation of the markka.
6/ January-November 1983, change over January-November 1982.
7/ First three quarters of 1983, change over first three quarters of 1982.

CHART 1

FINLAND

Growth of GDP and Contribution to Growth 1/



Sources: Central Statistical Office of Finland, National Accounts; Ministry of Finance, Economic Survey; IMF, World Economic Outlook.

1/ Change as percentage of preceding year's GDP.

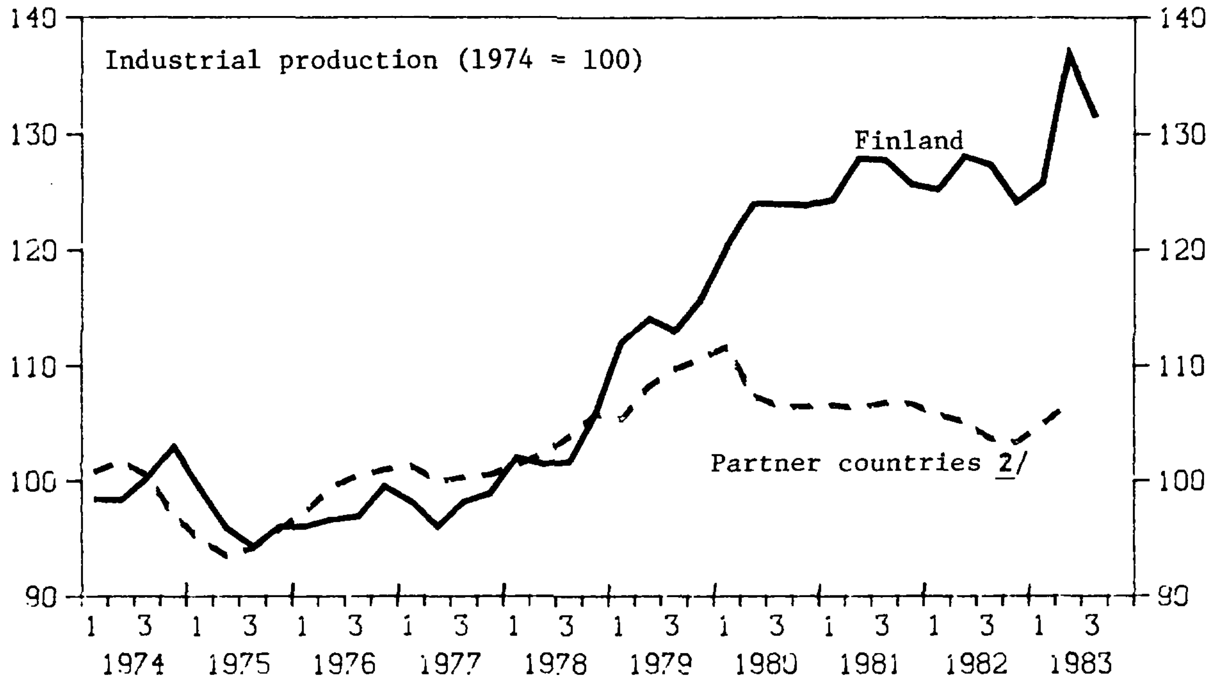
2/ Average of 12 market economy trading partners, currency index weights.

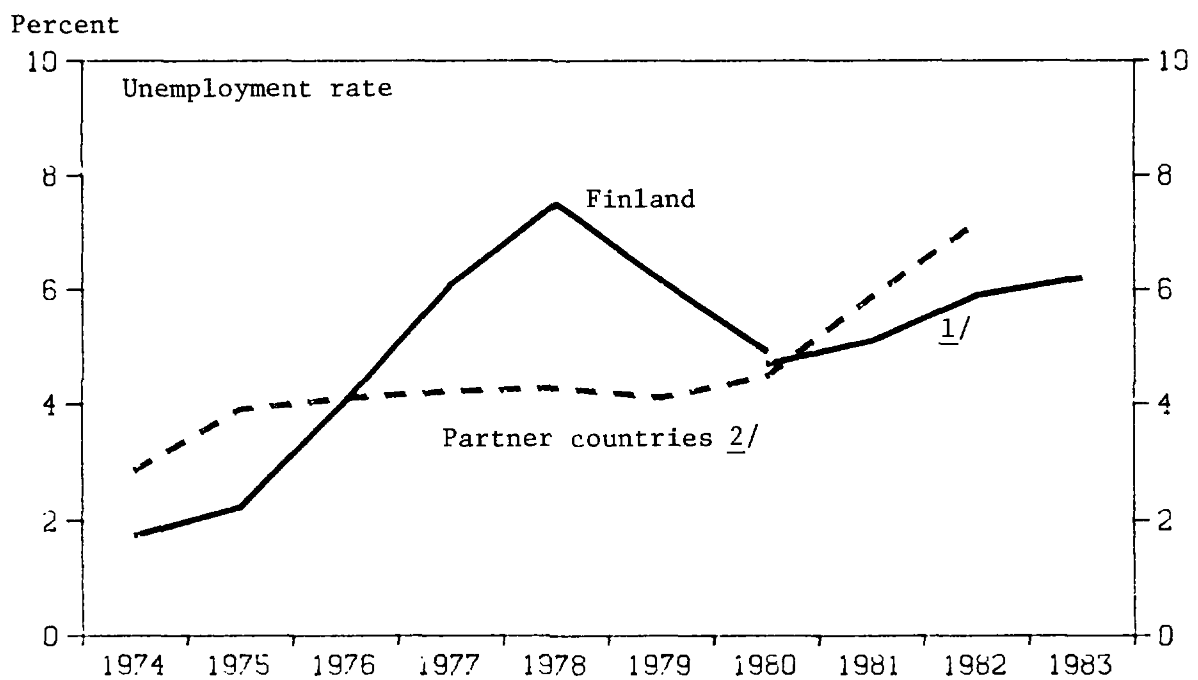
3/ Official estimates as of September 1983.

CHART 2

FINLAND

Unemployment and Industrial Production





Sources: IMF, International Financial Statistics, and World Economic Outlook.

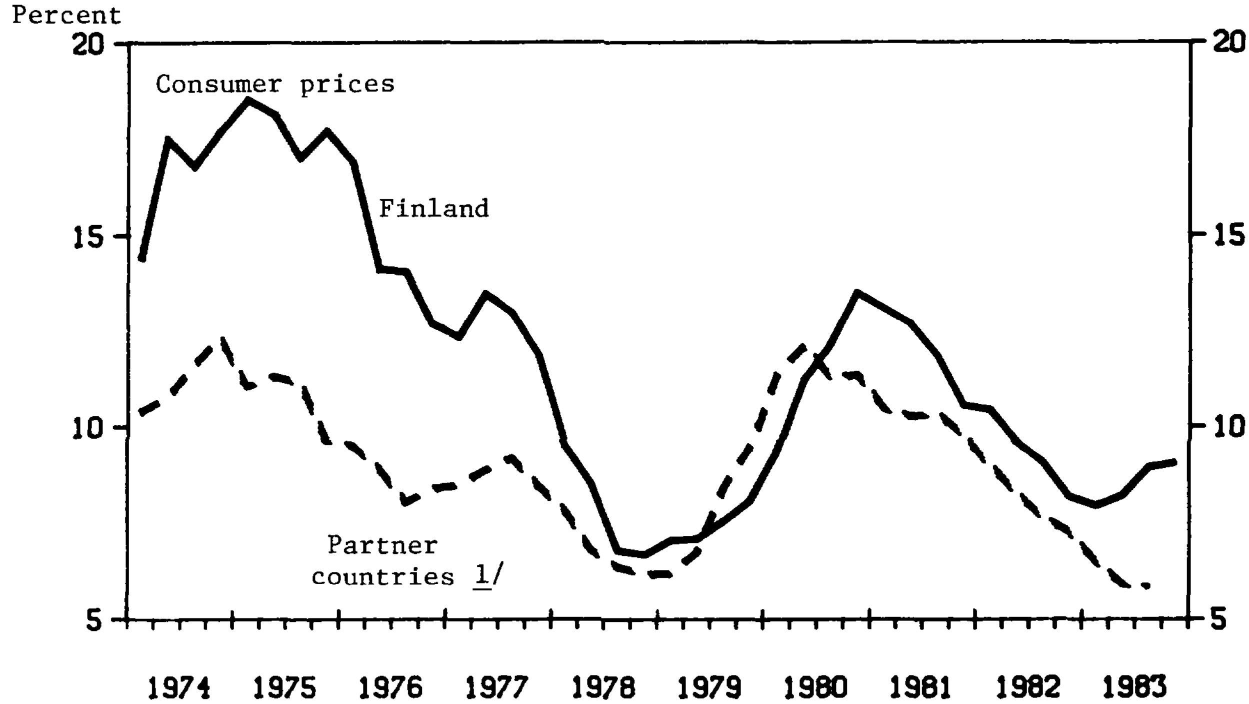
1/ The data for 1980 to 1983 are based on a new data collection method introduced in 1983, which accounts for the slight break in the line.

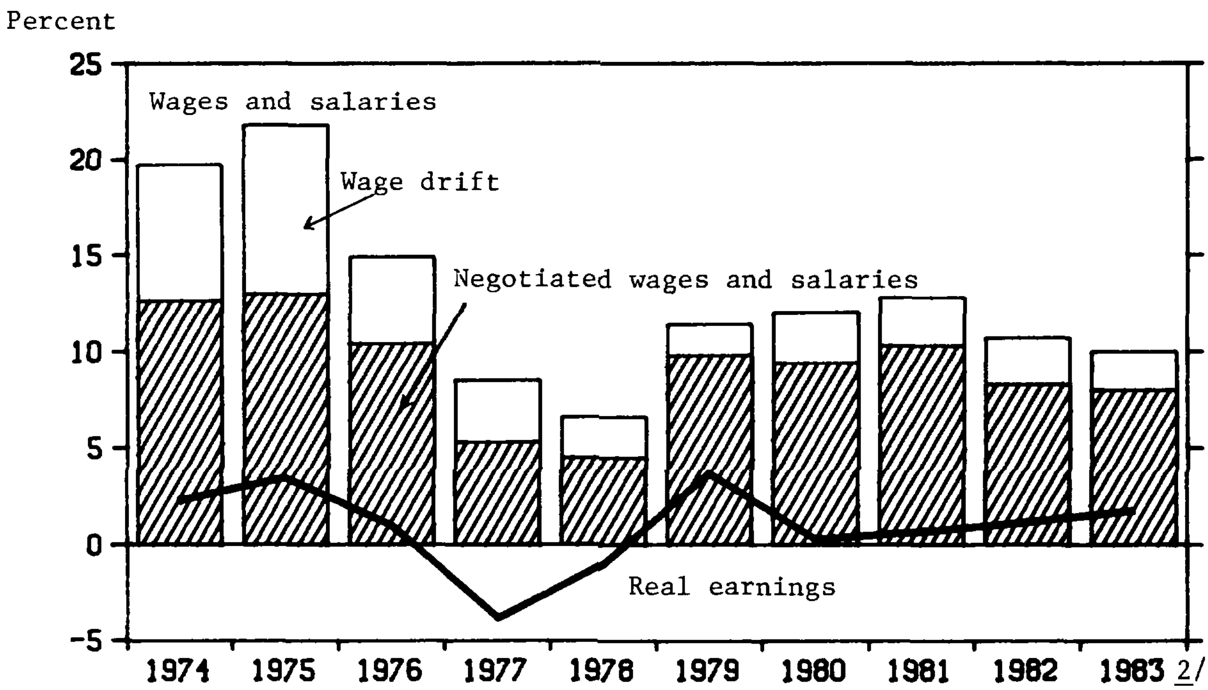
CHART 3

FINLAND

Inflation and Wage Developments

(Rates of change over preceding years)





Sources: IMF, International Financial Statistics; and Ministry of Finance, Economic Survey.

1/ Average of 12 market economy trading partners, currency index weights.

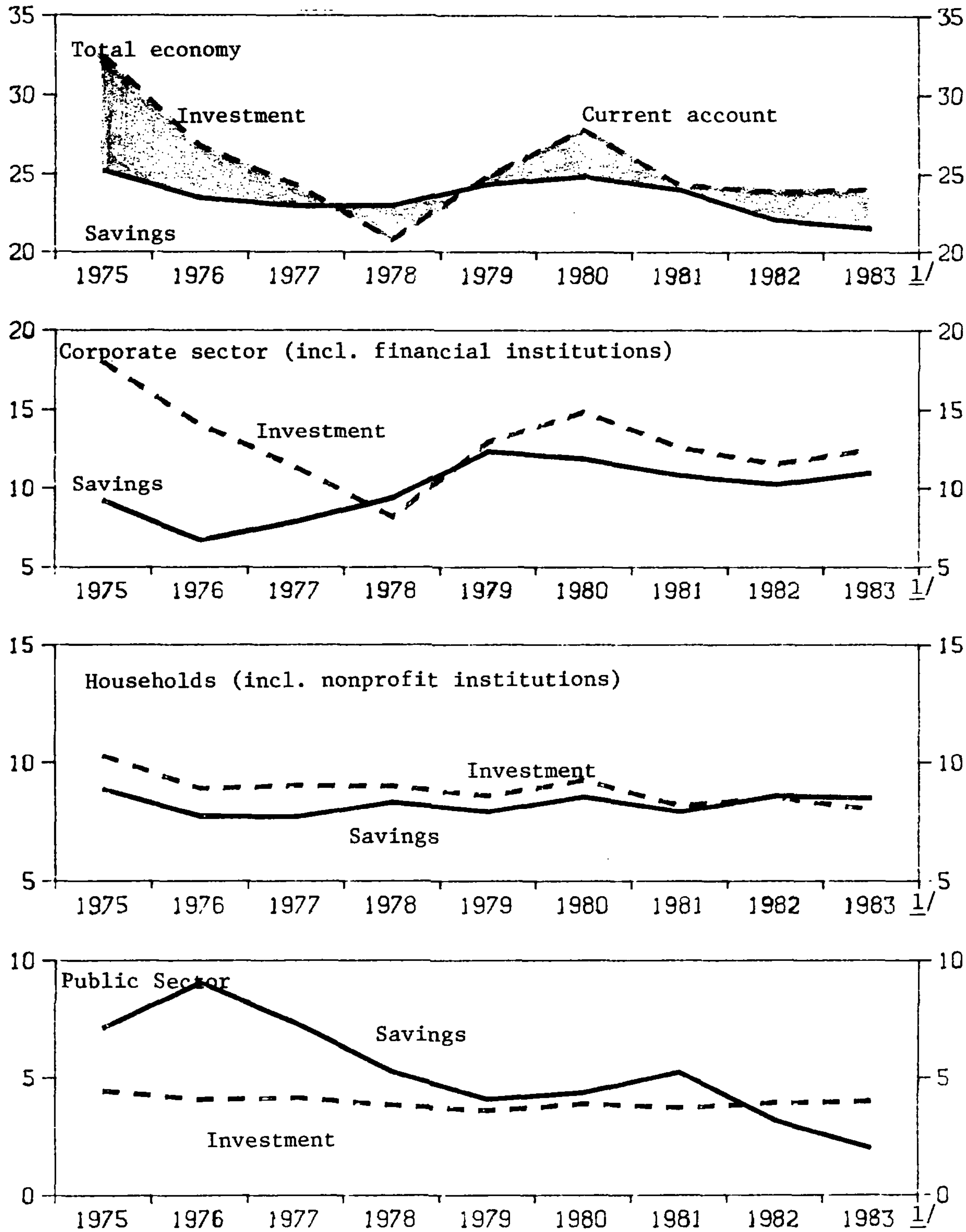
2/ Official estimates as of September 1983.

CHART 4

FINLAND

Savings, Investment, and Current Account

(In percent of GDP; national accounts basis)



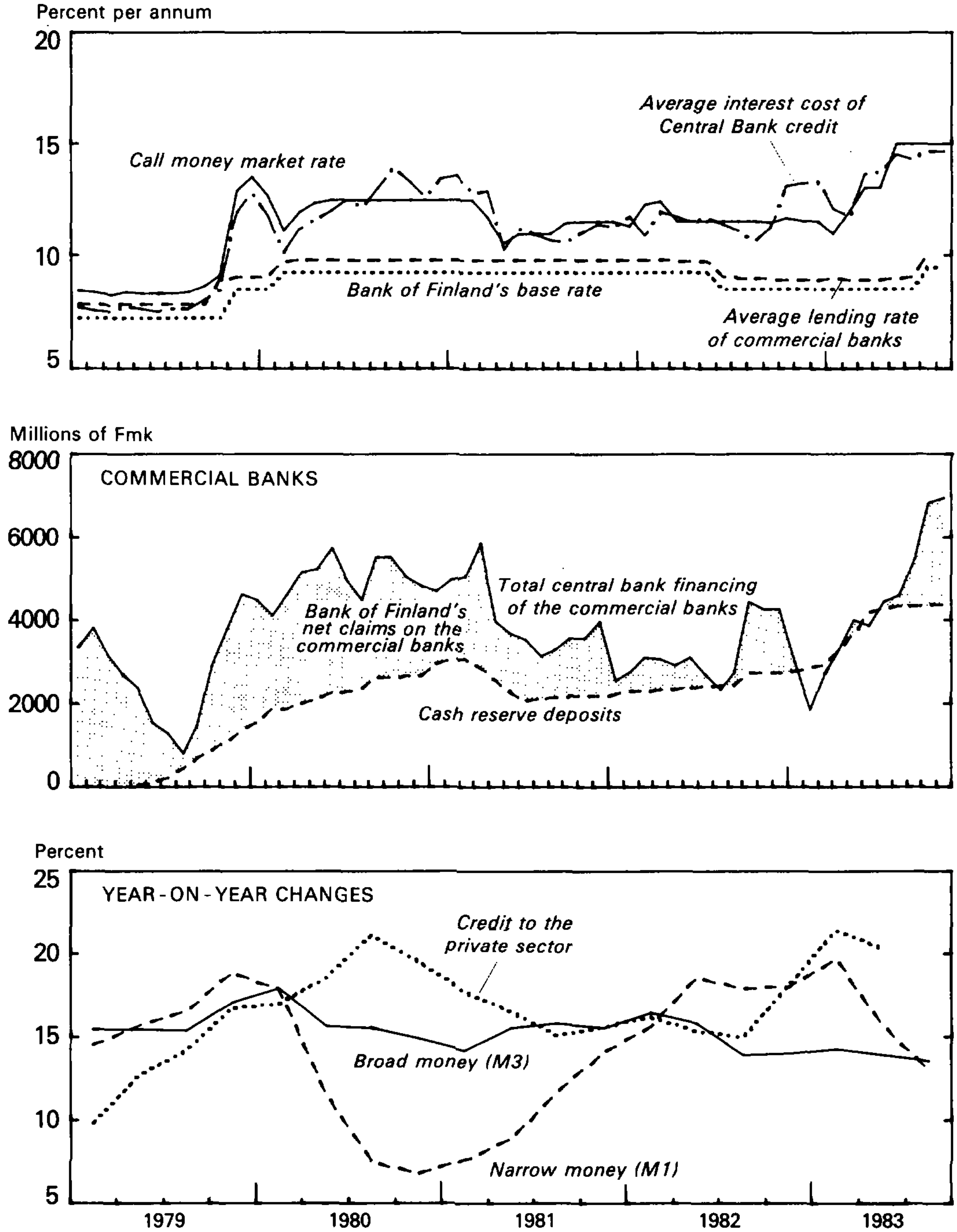
Source: Central Statistical Office of Finland, National Accounts.

1/ Official estimates as of September 1983.

CHART 5

FINLAND

SELECTED MONETARY INDICATORS

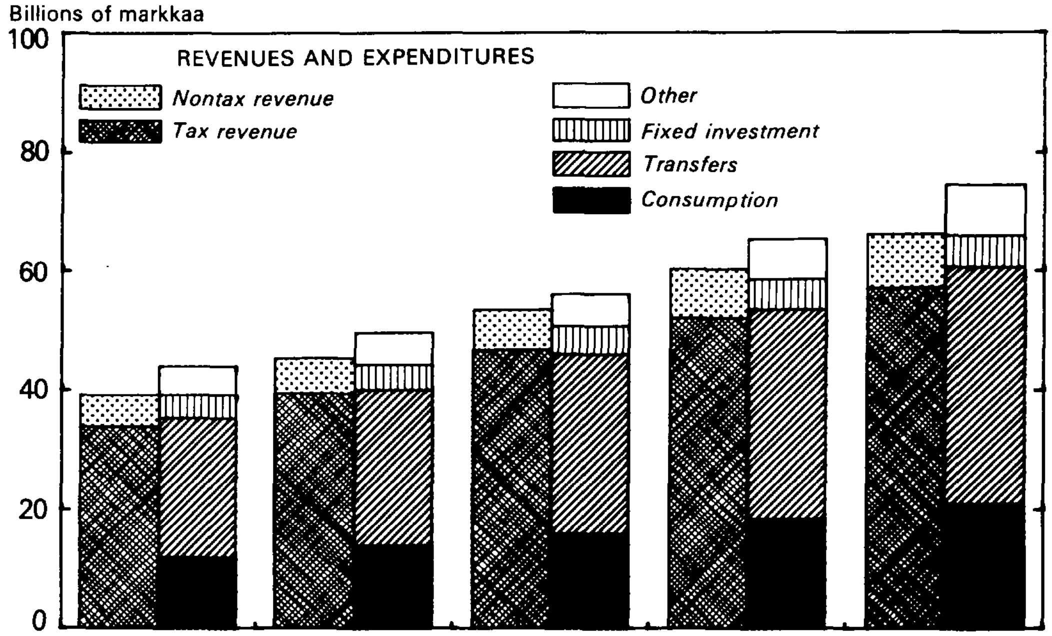


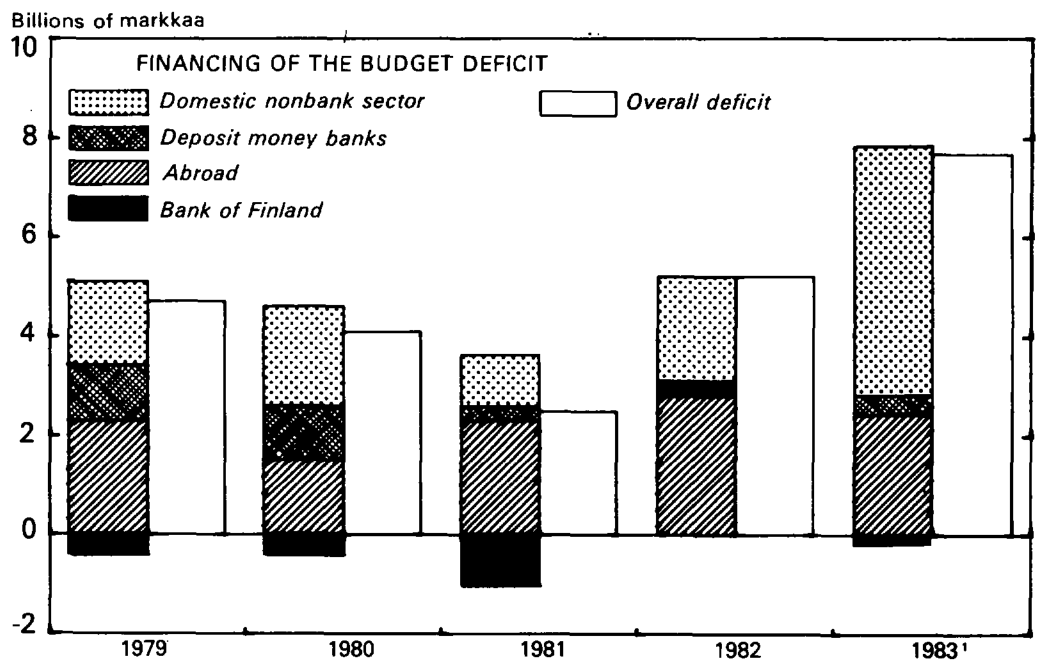
Source: Bank of Finland.

CHART 6

FINLAND

CENTRAL GOVERNMENT FINANCES



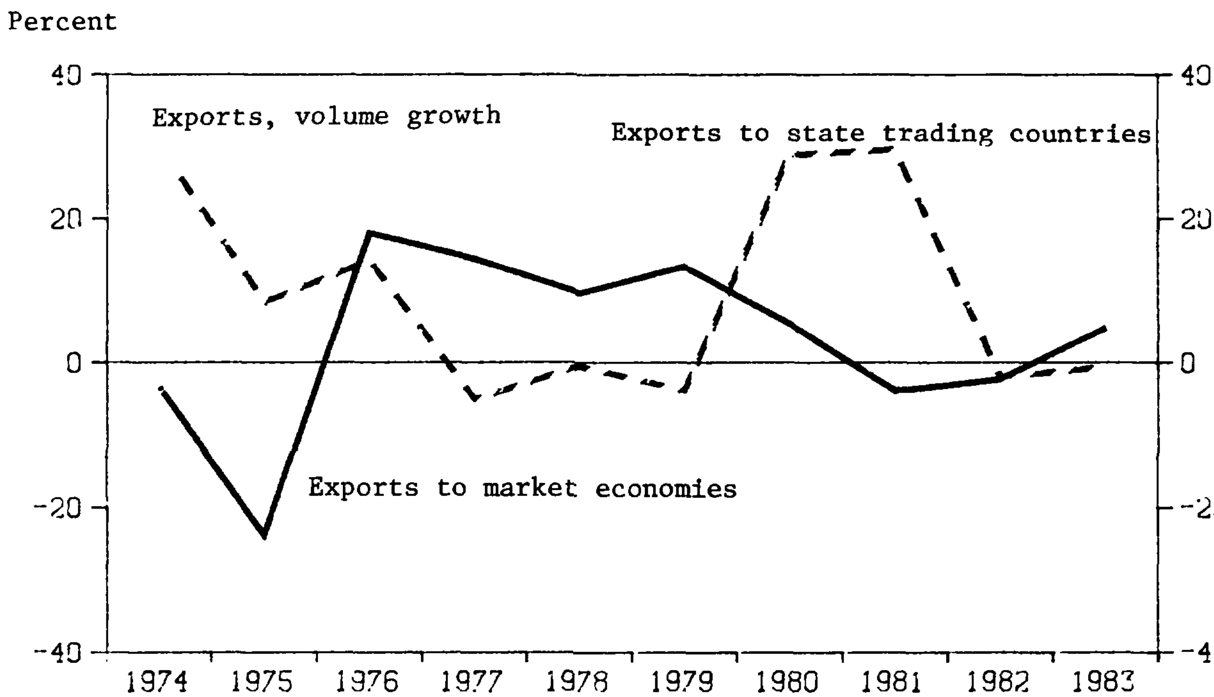


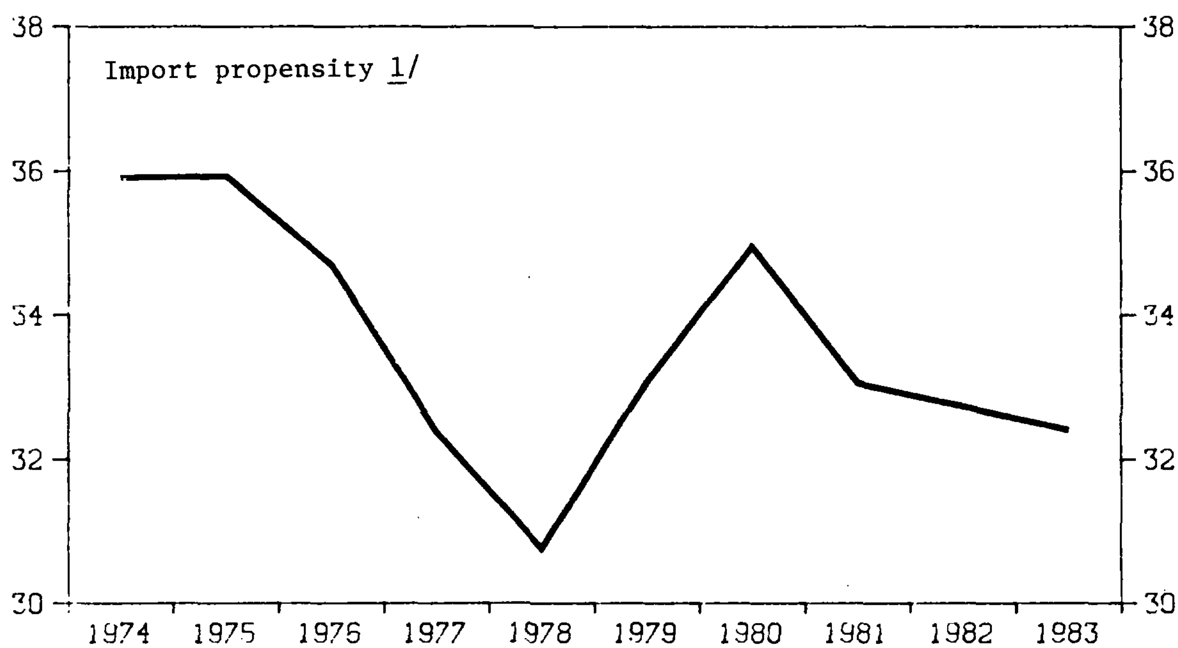
Source: Data provided by the Finnish authorities.
[1]Official estimate.

CHART 7

FINLAND

Foreign Trade





Sources: Central Statistical Office of Finland, National Accounts; and data provided by the Bank of Finland.

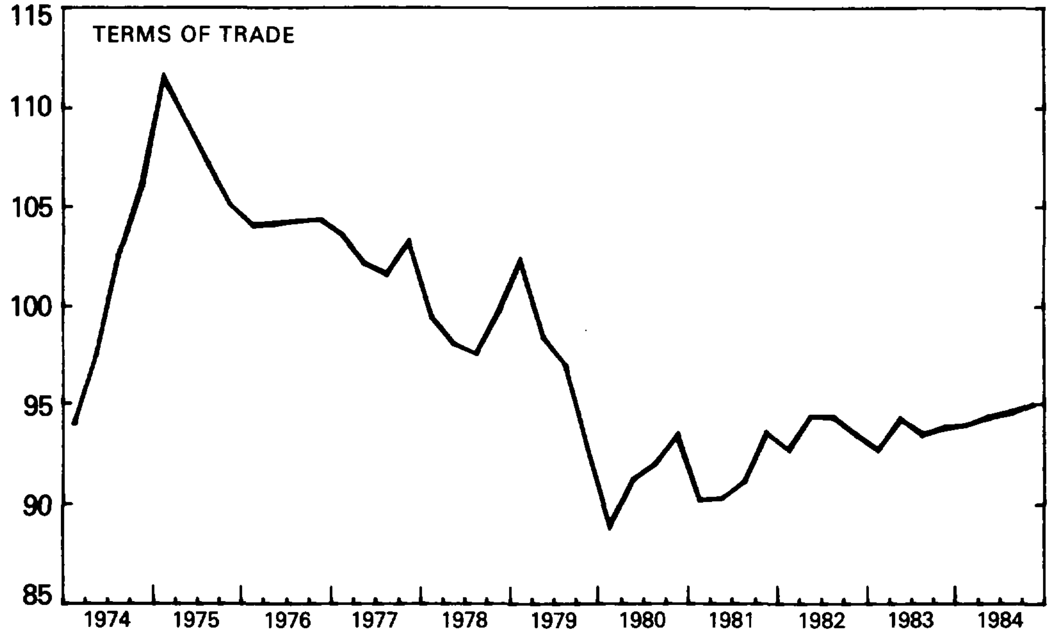
1/ Imports of goods and nonfactor services at 1980 prices as percent of GDP at 1980 prices.

CHART 8

FINLAND

INDICATORS OF RELATIVE PRICES AND COSTS[1]

(Indices; 1974=100)



Sources: Central Statistical Office, *Tilastotiedotus*, "Kansantalouden Tilinpito"; information provided by the Finnish authorities; IMF, *International Financial Statistics;* and staff calculations.

[1] Developments in 1983-84 reflect Bank of Finland estimates and forecasts from September 1983.

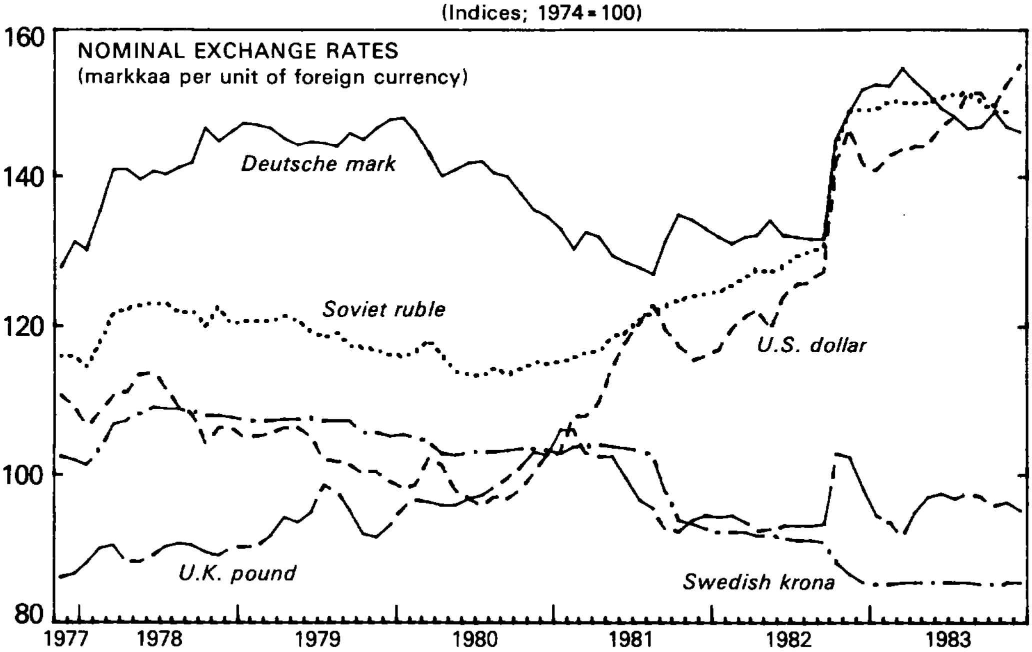
[2] In markkaa. Developments in Finland are shown relative to a weighted average of 12 market-economy trading partners, utilizing official currency index weights as of January 1, 1984.

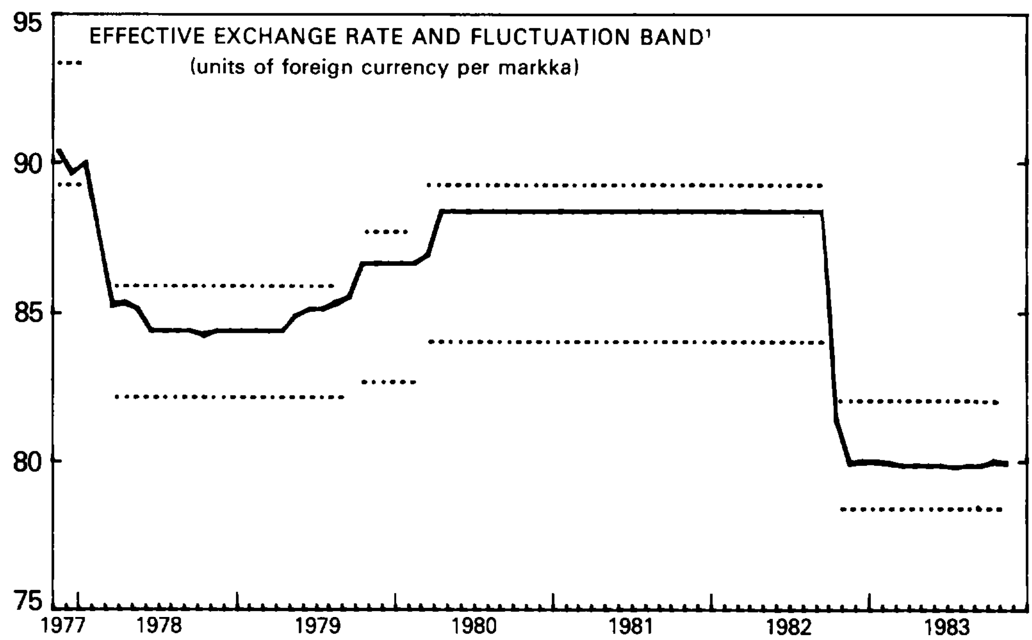
CHART 9

FINLAND

SELECTED EXCHANGE RATES

(Indices; 1974=100)





Sources: Bank of Finland: *Monthly Bulletin;* and IMF, *International Financial Statistics,* and staff calculations.
[1]The solid line indicates movements in the official currency index, inverted so that an increase corresponds to a markka appreciation. The dotted lines indicate the so-called fluctuation band.