

IMF: Finland—2014 Article IV Consultation Concluding Statement—Summary

Finland's strong economic record has stalled with the economy in recession for three of the last five years, largely because of a challenging external environment and structural weaknesses. This has led to high unemployment, and put public finances under pressure. A more comprehensive structural reform agenda will be necessary to strengthen medium-term growth, while the pace and structure of fiscal consolidation should be designed to protect the fragile recovery. Completing and deploying the full macroprudential toolkit will guard against domestic and regional financial stability risks.

The recovery will likely be slow and fragile. With the improving outlook in the euro area, the IMF now expects GDP growth to pick up gradually to 0.3 percent in 2014 and 1.1 percent in 2015 (down from 0.7 and 1.3 percent, respectively). However, weaker external demand could easily derail the recovery. Domestically, high and still rising levels of household debt could make consumers more cautious to spend if interest rates normalize faster than expected. The growth outcome could also change with the timing and composition of fiscal adjustment.

Recognizing the need for action, the authorities are pursuing reforms along a number of dimensions. The government has set ambitious goals for structural reforms and is finalizing fiscal plans for 2015 and the medium term. Moreover, important decisions have been made regarding the implementation of the macroprudential framework ahead of the advancing European financial stability agenda.

Bold and rapidly implemented structural reforms will make a difference. Pension reform to lift the effective retirement age is crucial for increasing labor market participation as well as encouraging younger workers to enter the labor market sooner. Plans to improve the comparatively low productivity of public sector healthcare should be specified and implemented quickly. Boosting retail competition would improve overall productivity in the private sector. R&D investment can be better focused to support innovation, especially by young firms. In addition, it is important that wage bargaining supports adjustment by steering real wages in line with overall productivity growth, while ensuring sufficient flexibility to accommodate variation at the firm and sectoral levels. Measures to increase the quantity of affordable housing would facilitate labor mobility and matching.

Fiscal policy can balance sustainability and growth. Cyclical and structural factors have weakened the public finances. Credible fiscal adjustment over the medium-term will ensure sustainability and help protect the fragile recovery. The broadly neutral fiscal stance in 2014 is appropriate. Staff simulations suggest that adjustment beginning in 2015, gradually increasing in size to match the expected strengthening of the recovery, would minimize the risks to the recovery. The credibility of a phased-in adjustment path depends critically on broad-based and continued support in parliament. Structural reforms will help improve the public finances by raising growth over the medium-term.

A robust macroprudential framework is crucial to containing financial stability risks. The planned legislation should maintain the full scope and flexibility of the European framework (CRD IV/CRR). This would ensure that the independent Board of the FSA has the capacity to respond to financial stability risks and to work toward full harmonization of macroprudential tools within the Nordic region. The Bank of Finland is well placed to support the new macroprudential policy-making process through surveillance and analysis.