Finland — 2025 Article IV Mission

Summary of the Concluding Statement

The economy has started to recover, but near-term growth will remain sluggish. After GDP fell by 1.2 percent in 2023, quarterly growth turned slightly positive in the first half of 2024. But activity this year is expected to be weak, with annual growth projected at -0.3 percent, as private investment continues to contract. Looking ahead, output is projected to grow by 1.6 percent in 2025 as private investment spending partially recovers and private consumption increases further, with interest rates falling and house prices stabilizing. Headline inflation is expected to stabilize around 2 percent by the end of 2025.

The fiscal deficit continued to widen. The fiscal deficit increased to 3.0 percent of GDP in 2023. As a result, public debt, which is already higher than in Nordic peers, increased to 77 percent of GDP in 2023. The deficit is set to continue to increase in 2024 despite new fiscal consolidation measures announced in April 2024.

Greater medium-term fiscal adjustment is needed to reduce debt. On top of efforts in 2023, the Finnish government announced new fiscal consolidation measures in April 2024, which are an important first step in reducing the fiscal deficit. Despite remaining weaknesses in the economy, this fiscal consolidation is warranted by the need to credibly start reducing the fiscal deficit. Building on this positive initial fiscal adjustment, additional measures especially in 2026 and beyond are needed to put debt on a firm downward trajectory. To achieve this, the authorities should aim to balance the fiscal budget by 2029.

Further efforts to increase labor participation rates and reduce skill mismatches are needed. In recent years, welcome reforms aimed at boosting employment were deployed, including changes to unemployment benefits, social security and tax adjustments, and enhancements to employment services. These should support Finland's aspiration to increase participation rates closer to Nordic peers, and be complemented with policies to reduce skills mismatches and strengthen tertiary education.

Building on strong foundations, further structural reforms are needed to strengthen business innovation and growth. Finland excels across many innovation metrics and has a notable venture capital sector. However, weak productivity growth necessitates further structural reforms. Attention should be given to the tax treatment of venture capital funding and rebates associated with investment spending by firms. Focus should also be on potential barriers to entry and excessive regulation in the service sector, which has experienced stagnant productivity in recent years.

While the banking system is resilient and systemic risks are contained, vulnerabilities remain. Nevertheless, vulnerabilities remain, including: large and highly interconnected banks; liquidity risks due to a high reliance on short-term wholesale funding; and high household indebtedness. In this context, staff welcome Finland's initiative to lead discussions with its neighbors to undertake a joint Nordic-Baltic banking sector stress test. Despite a steep increase in the intensity of cyber-attacks targeted at financial institutions, strong preparation and active counter-measures by the banks and relevant authorities have meant that the impact on financial stability has been contained.

Further measures are needed to target pockets of vulnerability. The introduction of a *positive* neutral rate for the Counter-Cyclical Capital Buffer and a full set of borrower-based measures to the policy toolkit would allow the authorities to release capital in periods of extreme stress. Bank liquidity buffers should be enhanced to cover a predetermined threshold of wholesale funding outflows over a five-day horizon and they should hold a higher stock of high-quality liquid assets. Finally, the authorities should continue to make further progress in implementing the 2022 Financial Sector Assessment Program recommendations including in the areas of crisis management and non-bank financial institutions.