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EUROJÄRJESTELMÄ



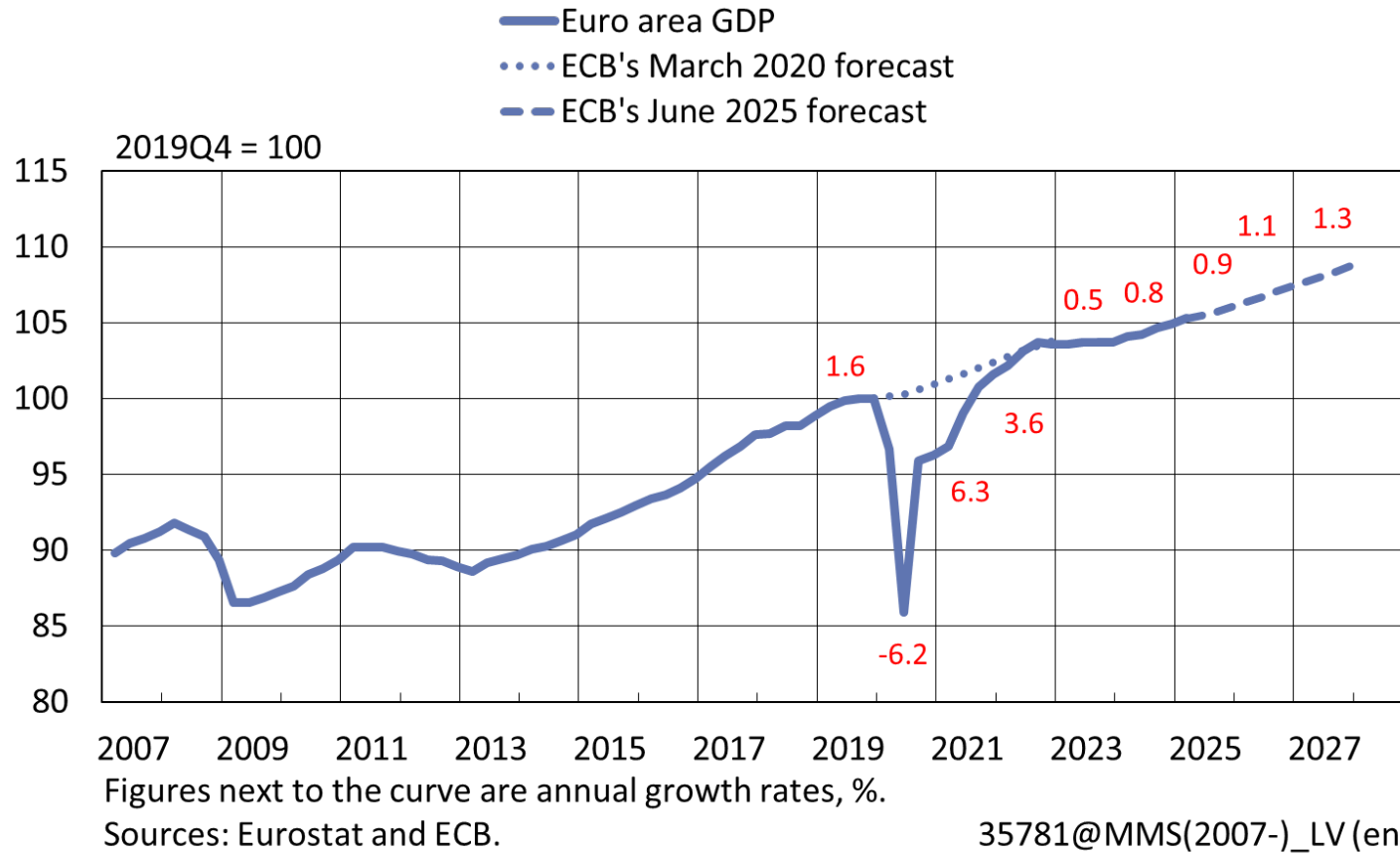
FINLANDS BANK
EUROSYSTEMET

Sluggish growth in the shadow of the trade war

Bank of Finland Bulletin press briefing
10 June 2025

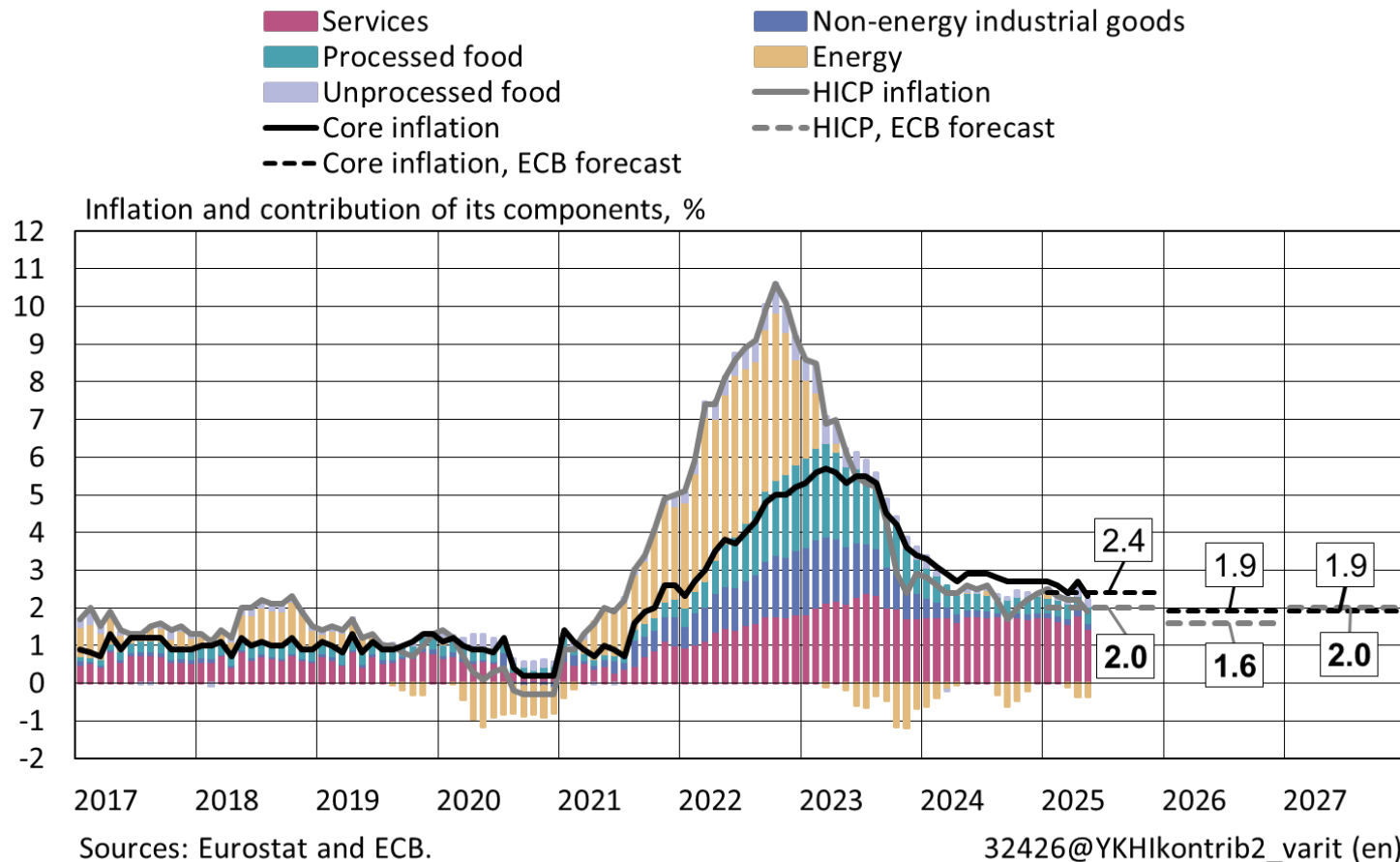
Governor Olli Rehn
Bank of Finland

Trade war and uncertainty are clouding growth in the euro area's economy



- According to the ECB's June forecast, the euro area economy will strengthen gradually as purchasing power is bolstered by rising household real incomes.
- Interest rate cuts are supporting the gradual strengthening of growth.
- Risks to economic growth remain tilted to the downside.

Euro area inflation is at around the ECB's 2% medium-term target

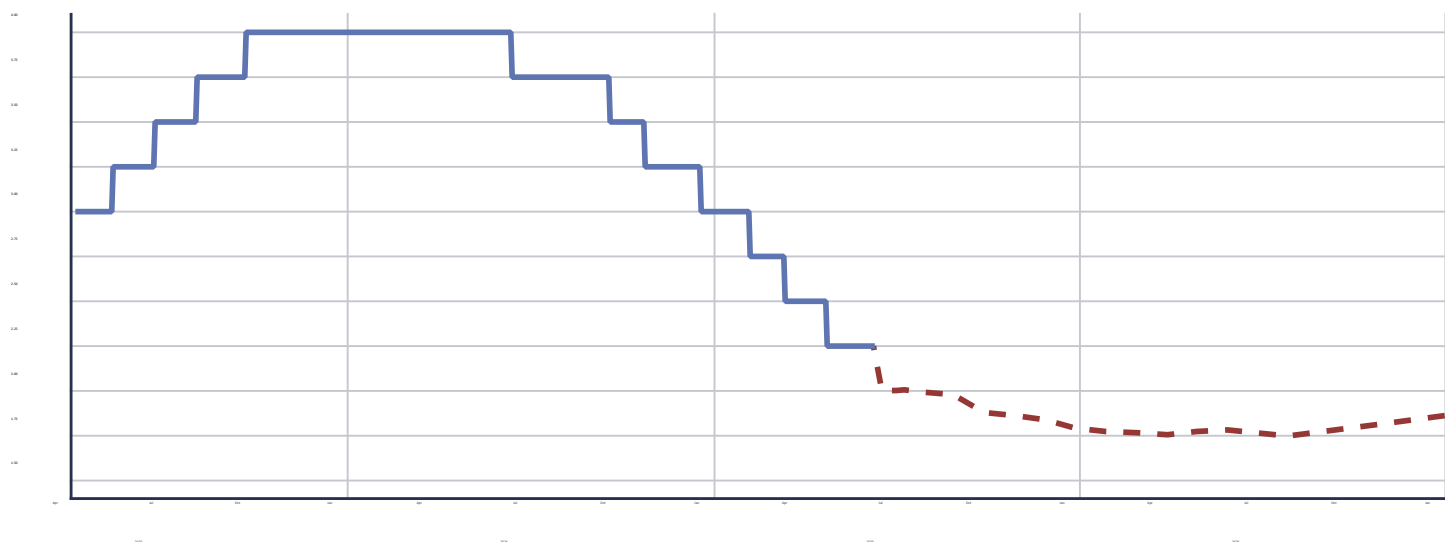


- Since 2021, the ECB has had a **symmetric inflation target of 2% over the medium term.**
- Inflation is projected to fall below the ECB's 2% target in the short term, due mainly to a decline in energy prices.
- Higher tariffs will bring price pressures. The trade war's harm to economic growth is also weighing on the inflation outlook.

ECB Governing Council continued to lower interest rates at its June meeting

Market expectation for ECB's deposit facility rate*

— Market expectation 10/06/2025



Source: ECB, Bloomberg and Bank of Finland's calculations.

Based on €STR OIS rates and an assumption of constant 8 bps spread between ECB's deposit rate and €S

- The ECB reduced its main policy rate
2.25% ➡ 2.00%
- The ECB Governing Council will ensure that inflation stabilises at its 2% medium-term target.
- Decisions will continue to be taken meeting by meeting, on the basis of incoming data and analysis and an overall assessment.

Competitiveness – an urgent European task

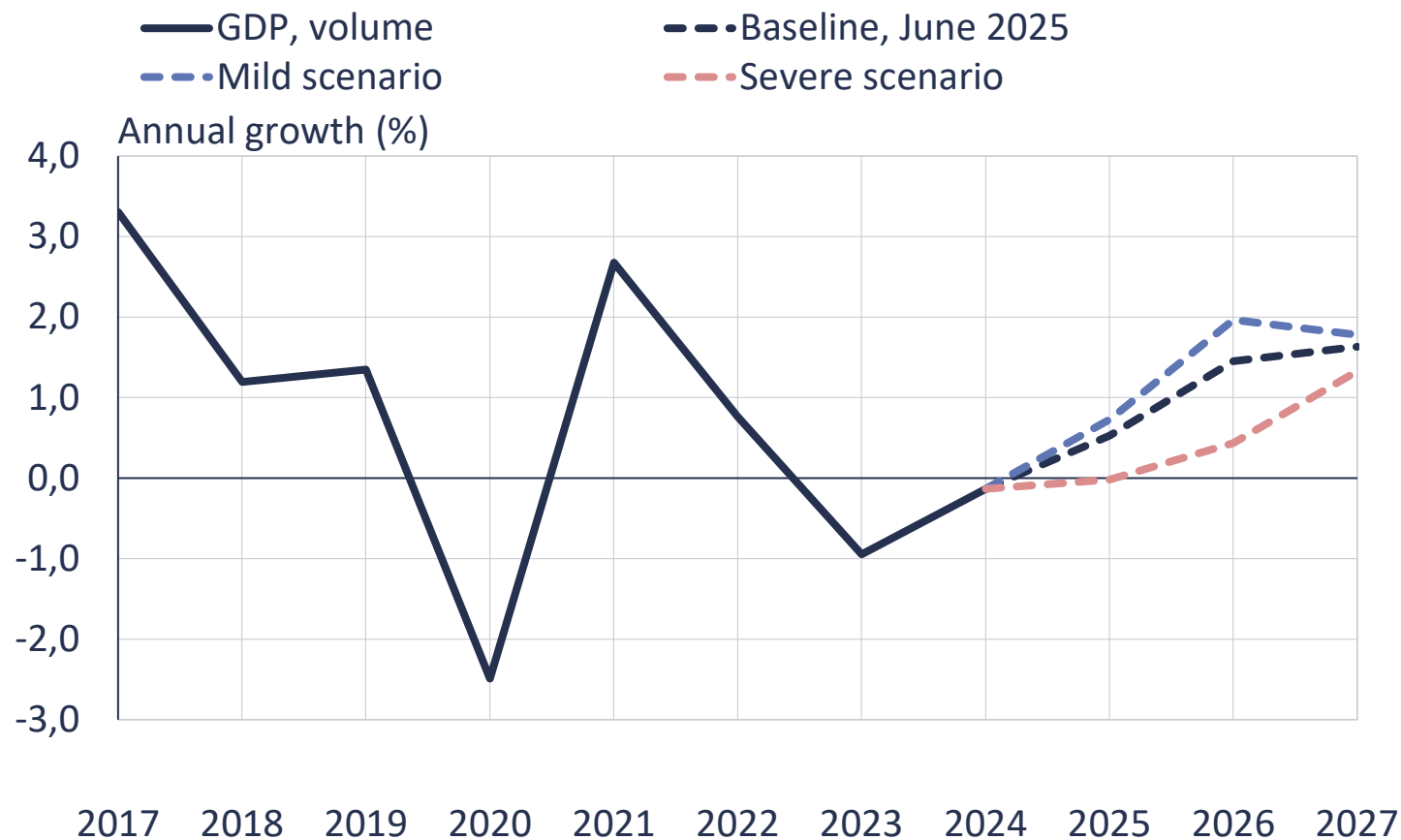
- The geopolitical situation calls for rapid action to improve competitiveness and resilience. Primary responsibility is with the governments of the EU Member States and the European Parliament – the European Commission has the right of initiative.
- The ECB supports this by ensuring price and financial stability in the euro area.
- The Commission's Competitiveness Compass proposals must be taken forward quickly – particularly those that simplify regulation.
- The Savings and Investments Union must be completed in a swift and determined manner – just like the single market, where the target for completion was 1992.
- Legal basis of a digital euro must be defined – it is also part of a resilient Europe.
- Fiscal sustainability must be ensured, with a focus on reforms and investments that support sustainable growth.

Trade policy developments will shape Finland's economic environment in 2025–2027

- **Bank of Finland's June forecast baseline scenario:**
 - The postponement by 90 days of the entry into force of the higher import tariffs announced in early April remains in force permanently.
- **Severe scenario:**
 - The trade war between the United States and its trading partners escalates in the second half of 2025, tariff levels increase significantly and permanently.
 - Trade policy uncertainty remains elevated.
- **Mild scenario:**
 - The trade war will be over in the second half of 2025. Average tariffs between the United States and its trading partners are reduced permanently.
 - Trade policy uncertainty dissipates.

See article: Trade war escalation poses a significant risk to the Finnish economy
Petteri Juvonen and Aino Silvo

An escalation of the trade war would slow the recovery in Finland's economy



Source: Bank of Finland.

Severe scenario compared to the baseline:

- Zero GDP growth in 2025 and slow growth in 2026.
- Export growth grinds to a halt in 2025 and exports contract in 2026.
- Inflation is lower than in the baseline.

Mild scenario:

- Higher GDP growth in 2025-2026.
- Stronger growth in exports, private investment and consumption.
- Inflation develops closely in line with the baseline.

Strengthening of defence is necessary – national and European financing solutions are needed

- Russia's war in Ukraine and geopolitical uncertainty underline the need to strengthen Europe's common defence capability.
- Finland has announced that it will increase defence spending to 3% of GDP in 2029.
- The escape clause in the EU's new fiscal rules provides flexibility.
 - This would allow an increase in defence spending by 1.5% of GDP compared with defence spending in 2021, provided that debt sustainability is secured.
- In addition, common European financing solutions must be found for European joint projects.

Simulation outcomes: the economic impact of the increase in defence spending depends on the domestic content of procurement

- In the simulations, Finland's defence spending is increased towards the 3% level and euro area defence spending is raised by 1 percentage point relative to GDP in 2026–2029.
- The increase in defence spending raises the level of output and prices compared to the baseline.
- If the procurements are made in Finland and the euro area, Finland's GDP in 2029 will be around 0.7% higher due to the increase in demand.
 - The rise in prices and the financing of the additional spending partly with tax increases will curb private demand and weaken the impact on economic growth.
- If only half of the increase in defence spending is allocated to procurement from outside the euro area, the level of GDP in 2029 will be 0.3% higher.

See article: How would higher defence spending affect growth in Finland's economy?
Mikko Sariola, Harri Pönkä, Pirkka Jalasjoki,
Jarkko Kivistö

Europe's triple challenge

✓ Defence: Europe must take more responsibility for its own defence.

→ Joint procurements and coordinated investments provide economies of scale and efficiency.

✓ Decarbonisation: the green transition is not only a cost – it is a long-term strategy for ensuring energy availability and competitiveness.

→ Green transition is both a climate target and a geopolitical necessity.

✓ Dynamism: the productivity gap between Europe and the United States must be closed.

→ Investments in human capital, deepening of the capital markets, strengthening of innovation.

Main messages

- Euro area inflation is close to the ECB's 2% medium-term target.
- According to the ECB's June forecast, economic growth in the euro area is sluggish but will strengthen slightly in 2026 and 2027. Growth in Finland's economy will also pick up gradually.
- Escalation of the trade war would, however, weaken the growth outlook significantly.
- Europe must now respond to a difficult triple challenge – strong defence, the green transition and growth that is sustainable. Europe's security and economic future rests on these.



” **Vakauden puolesta,
tutkitun tiedon pohjalta.**

*Securing stability,
in science we trust.*

