SUOMEN PANKKI EUROJÄRJESTELMÄ FINLANDS BANK EUROSYSTEMET

Europe and Finland – Resilience under the shadow of power politics

The Bank of Finland's biannual lunch for EU Heads of Mission
28 November 2025

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Bank of Finland

Power politics is overshadowing the world economy now with exceptional force

Europe
- Russia's illegal war in Ukraine
- Inflation stabilising to the 2% target
- Productivity and industrial competitiveness?

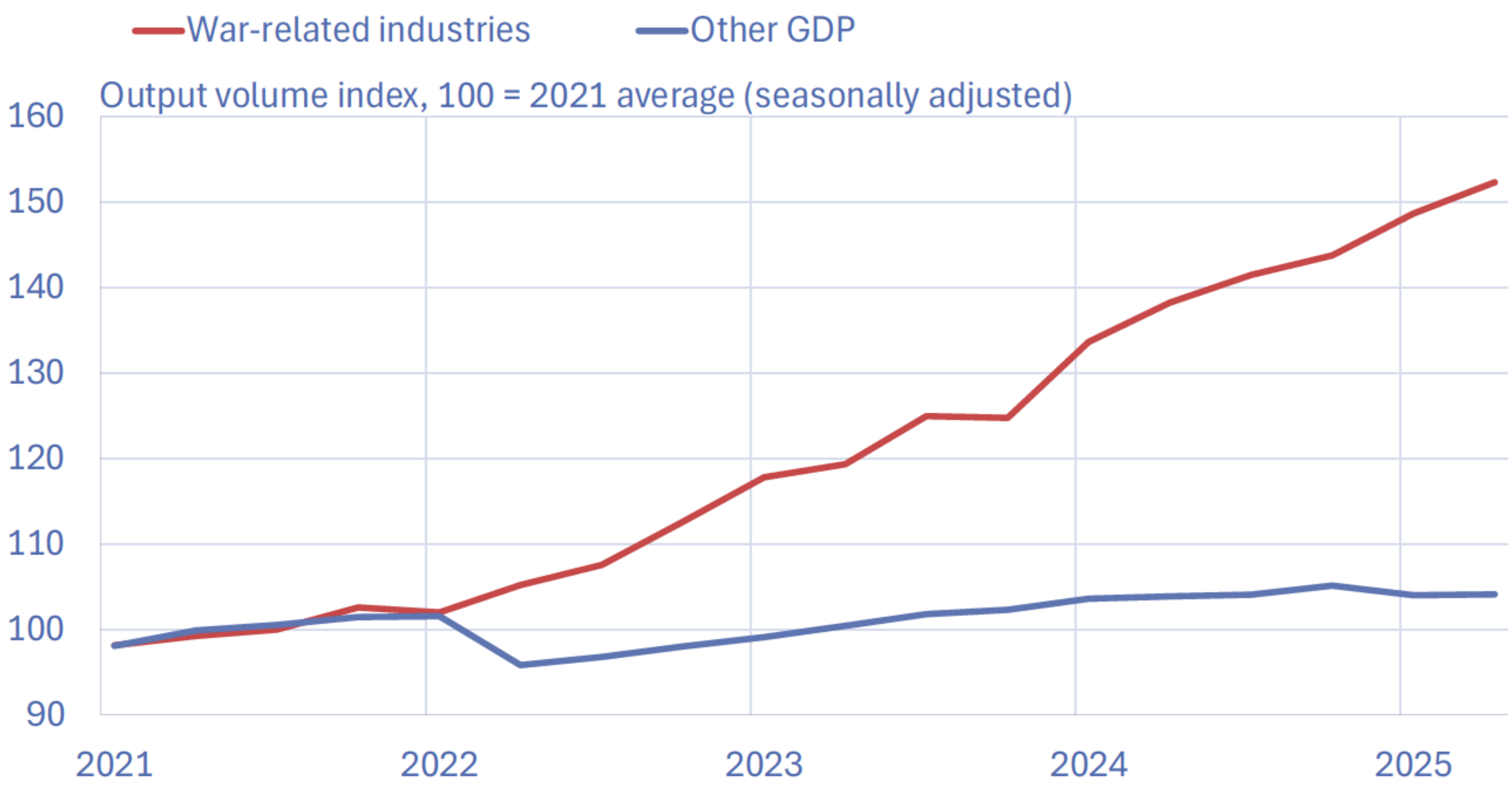
Russia
- Sanctions limit financing and technological possibilities
- Economic growth dependent on war-related industries
- Slow growth continues, no major economic crisis in sight

United States
- Trade and fiscal policies?
- Approach to Ukraine, Russia?
- Strategic competition with China: trade, tech, Taiwan?

Asia
- China has leaped to superpower status, but has its own economic and political challenges
- Asia's century under way – threatened by conflict in the South China Sea?

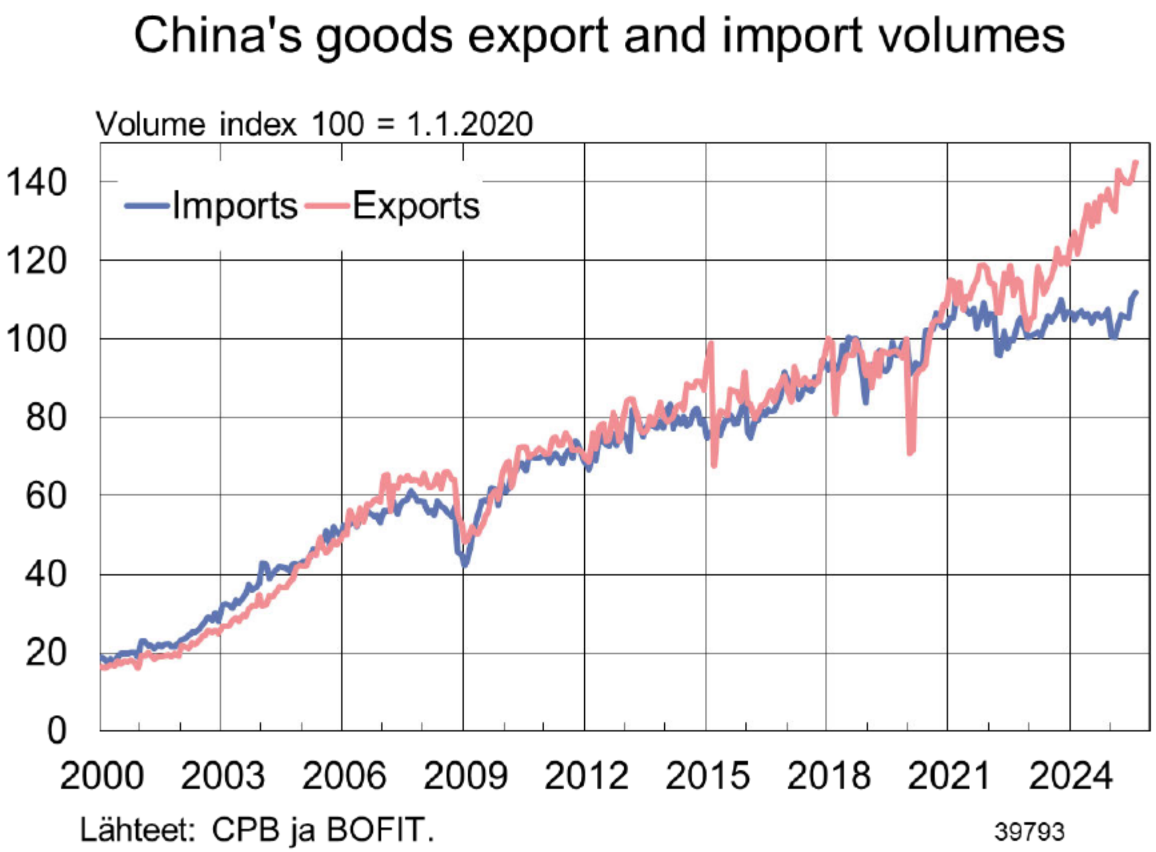
Global troubles
- Erosion of rules-based system
- The Middle East conflict and power shifts
- Climate goals slipping: on track to +2.5ºC to +3.0ºC?

Russian economy experiencing stagnation, except for war-related industries



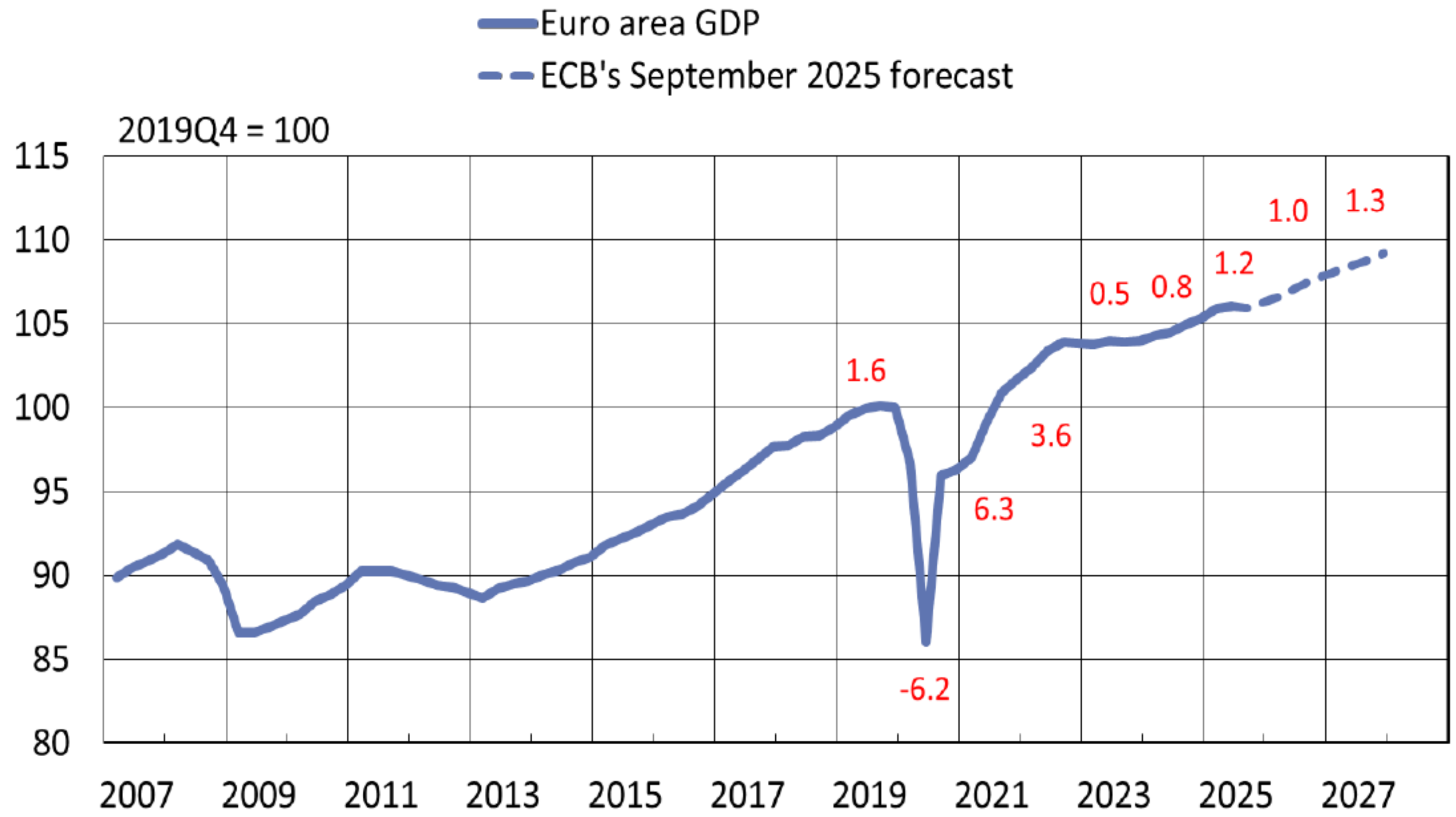
Note. The proxy for war-related industries includes manufacturing of metal products, computers & electronics, other transport equipment and public administration & national defence.
Sources: Rosstat, BOFIT.

Despite increased export barriers, China’s goods exports have grown exceptionally well and boosted GDP growth



- The drop in exports to the US has been compensated mostly by higher exports to ASEAN countries, from where many of the goods will eventually be exported to US markets.
- A weak yuan and falling domestic prices have maintained the strong price competitiveness of Chinese goods.
- About a third of China’s GDP growth comes from net exports this year.
- Current account surplus at a record high.

European economy has demonstrated resilience despite higher US tariffs



Figures next to the curve are annual growth rates, %.
Sources: Eurostat and ECB.
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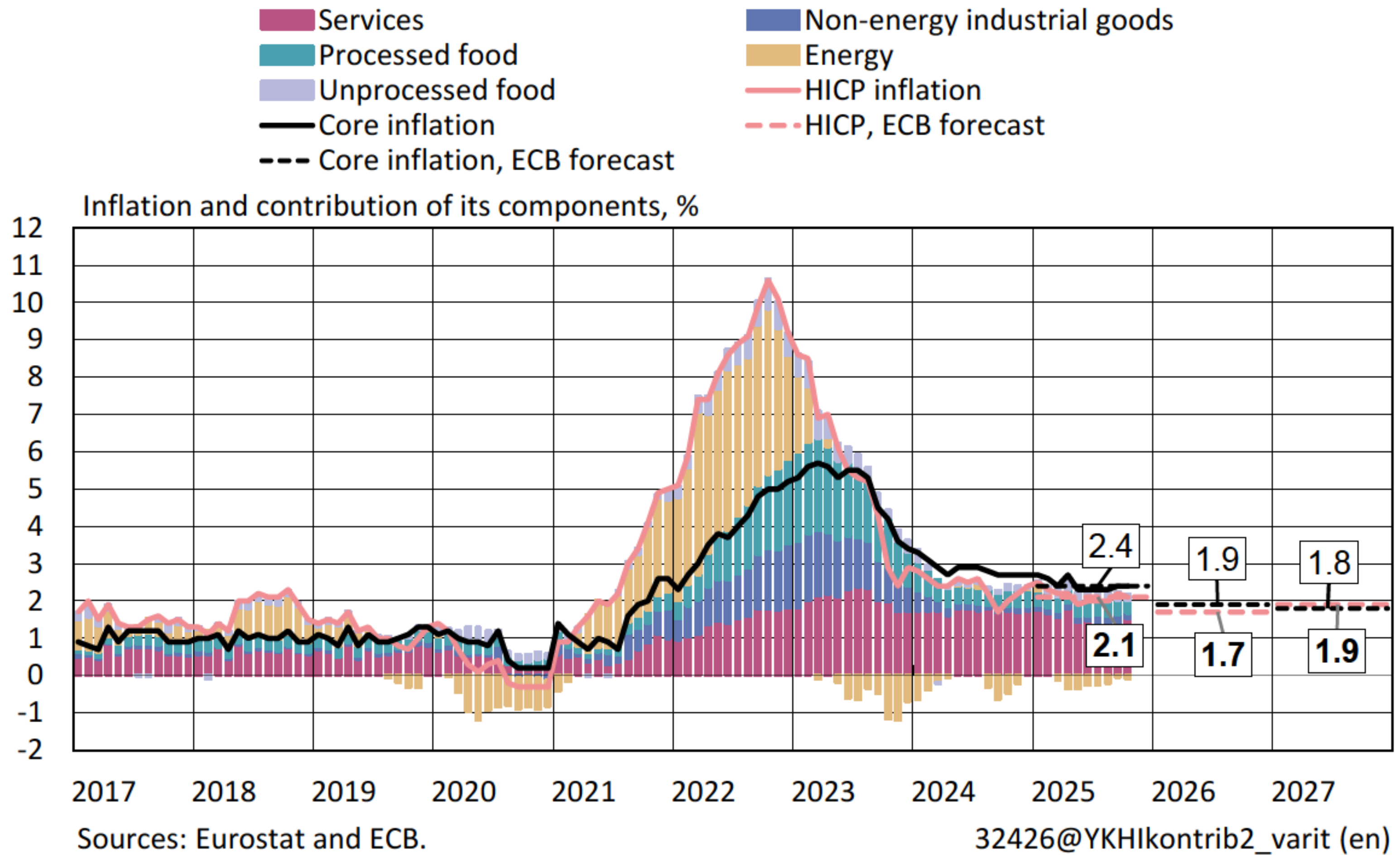
- The euro area economy is projected to grow in 2025–2027 at a steady but rather slow pace.
- Drags on growth:
  - Higher US tariffs
  - Pervasive uncertainty
- Drivers of growth:
  - Improved purchasing power
  - Employment holding up
  - Increased defence spending

Euro area inflation is currently at around the ECB's 2% target



- Inflation has stabilised around the ECB's symmetric 2% target over the medium term.
- Annual inflation (HICP) at 2.1% in October.
- Risks to inflation two-sided.
- Inflation expectations are for now well anchored.

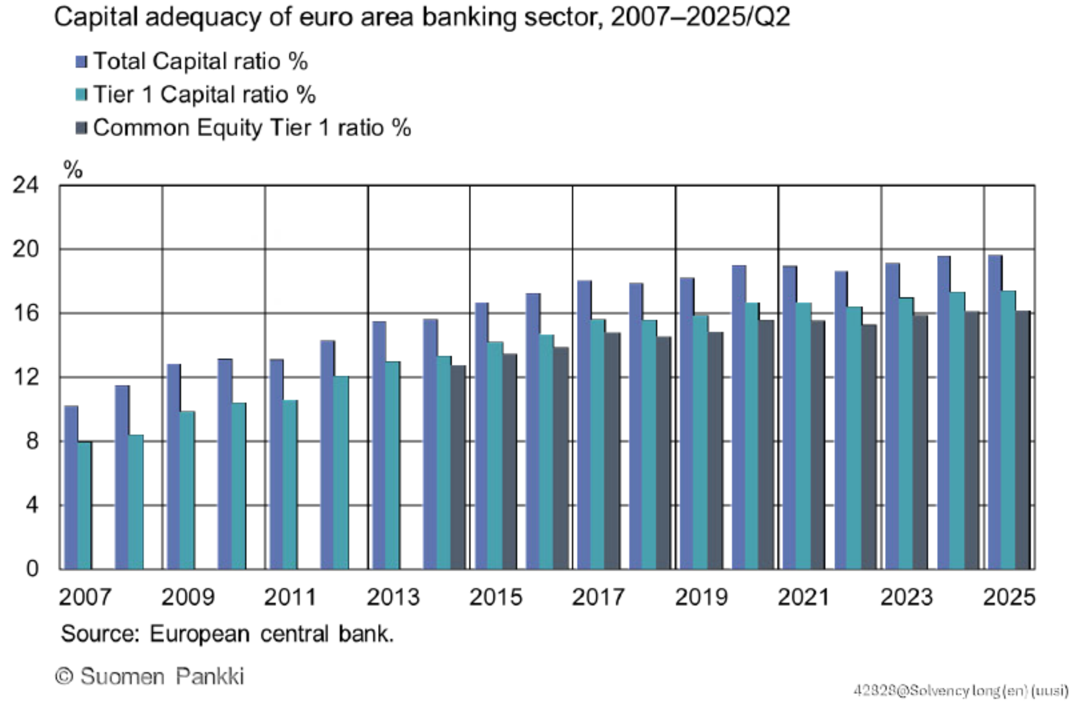
AI boom is fuelling market valuations

- Stock markets are experiencing a strong boom related to artificial intelligence.
- AI firms face very high growth expectations that extend far into the future.
- If return expectations are not met, a potential market correction could also lead to higher credit risks.
- Investments in AI hyperscalers further increase European exposures to the US dollar and US financial markets.

Global stock indices

Source: Macrobond

Capital buffers are critical for financial system resilience

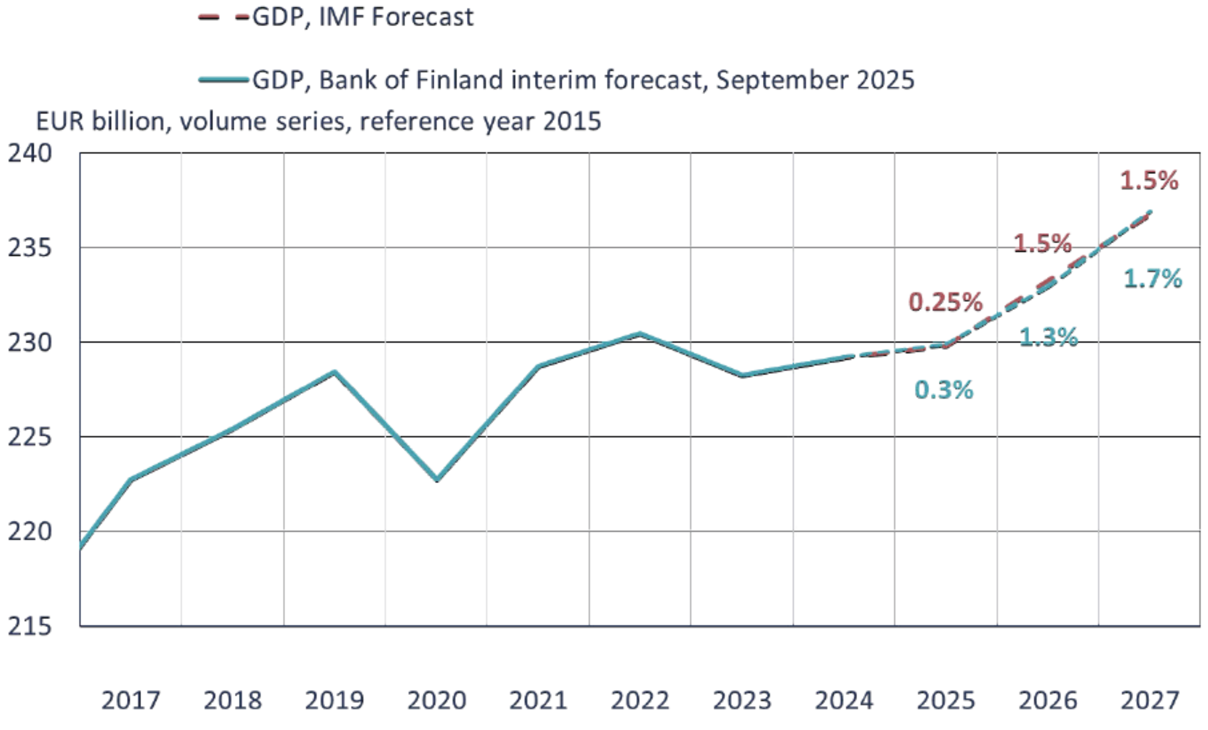


- Adequate capital buffers for banks are critical in today's uncertain world.
- The results of stress tests have confirmed the risk-bearing capacity of European banks.
- Better functioning European capital markets would boost Europe's competitiveness.
- Regulation must focus more on the stability of the non-bank universe.

ECB preparing proposals to simplify financial regulation – High-Level Task Force on Simplification

- ECB Governing Council has established a High-Level Task Force to make proposals – by the end of this year, 2025 – to simplify financial regulation.
- Mandate to propose simplification with a focus on three areas:
  - Capital requirements
  - Banking supervision
  - Reporting obligations
- It is important to reduce fragmentation and overlaps in European regulation, while maintaining banks' resilience and strong capital buffers.
- Essential to combine competitiveness with resilience. Simplification is needed, but we must not throw the baby (= capital buffers) out with the bathwater.

IMF: The recovery of the Finnish economy has been slow but is expected to accelerate next year



Souces: Bank of Finland, IMF, Statistics Finland.

- In 2025, activity remains subdued – the IMF projects annual growth of 0.25%.
- Looking ahead, the IMF projects growth of 1.5% in 2026 and 2027, supported by gradual recovery in domestic demand.
- Positive signals in exports and investment, from icebreakers to data centres and digital technologies.
- IMF forecast in line with BoF September interim forecast. Next BoF forecast will be published on December 19.

A parliamentary pact on fiscal rules was reached

- The new EU fiscal framework requires reforming domestic fiscal rules in 2025.
- In Finland, a broad parliamentary consensus on national fiscal rules and procedures for setting fiscal targets was reached in October.
- Parliamentary agreement on a reduction of the debt-to-GDP ratio over 7 to 8 years = two parliamentary cycles. Applying the Swedish model.
- The parliamentary pact for fiscal policy is an important signal of cross-party commitment to sustainable public finances.

Europe’s triple test

✅ **Defence**
Europe must take greater responsibility for its own defence.
→ Common procurement and coordinated investment are essential for scale and efficiency.

✅ **Decarbonisation**
The green transition is a long-term strategy for energy security, competitiveness and innovation.
→ Decarbonisation is both a climate goal and a geopolitical imperative.

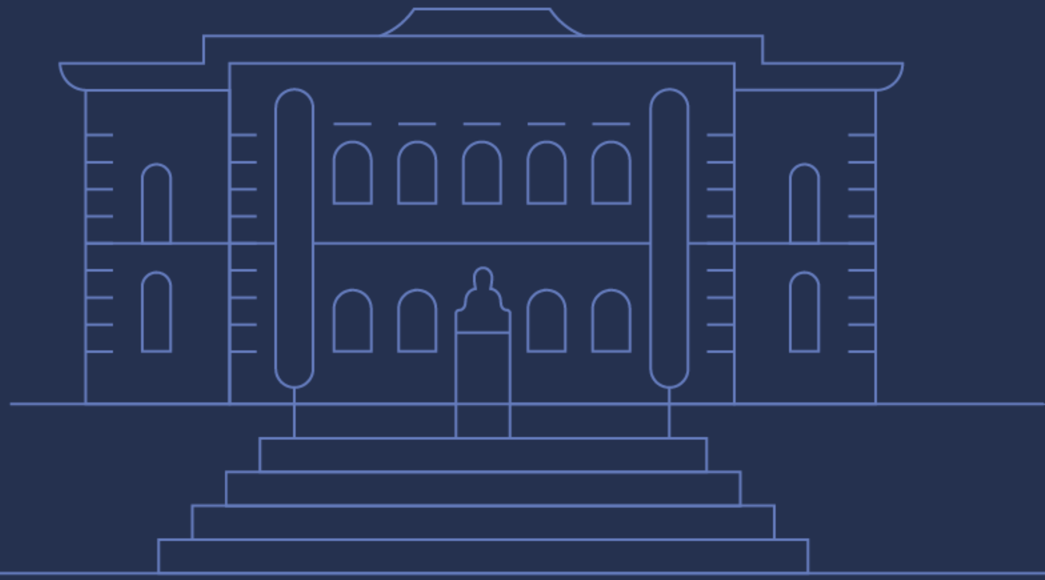
✅ **Dynamism**
Europe must close the productivity gap with the US.
→ Invest in human capital, attract global talent, deepen capital markets and foster innovation ecosystems.

- 🔑 **Strategic action across these three fronts will shape Europe’s economic future and strategic autonomy.**

Europe under pressure, Europe united

- Russia's war of aggression in Ukraine has reminded us, painfully, that **security and economics are inseparable**.
- Progress has always come from concrete action and shared solutions, from coal and steel to the single market, the euro – and now defence and the green transition.
- By boosting defence, the green transition and industrial competitiveness, we reinforce the very fabric of Europe.

We must stand with Ukraine until a just and lasting peace is achieved.



Securing stability,
in science we trust.