Forecast

Import tariffs and trade policy uncertainty will dampen economic growth

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The incoming administration in the United States is planning widespread tariffs on imported goods. Such tariffs would hamper Finland's goods exports, as the United States is an important trading partner for Finland. However, the impact of the import tariffs themselves would remain limited. Finland's external demand could be weakened more broadly by a general increase in trade policy uncertainty and by an expansion of barriers to international trade. This would reduce exports and corporate investment and would markedly hinder growth in Finland's economy.



Tariffs on trade in goods would slow economic growth through a variety of channels

The return of protectionism in world trade would weaken economic growth in Finland and elsewhere in the world. The imposition of general import tariffs on all trade in goods that is planned by the incoming US administration would hamper Finland's goods exports and reduce the competitiveness of Finnish companies on the US market relative to companies operating in the United States. In recent years, the US has become one of Finland's most important trading partners in both goods and services.

How would the import tariffs planned by US President-elect Donald Trump affect Finland's economic growth, exports and inflation? This alternative scenario to the Bank of Finland's December 2024 forecast investigates the economic consequences of the United States imposing general tariffs on all goods imports as set out in Trump's campaign promises. The scenario also includes an increase in international trade policy uncertainty and the imposition of retaliatory symmetric tariffs by the rest of the world on all imports of goods from the United States. The main aim of the scenario is to look at the different channels through which changes in international trade policy would be transmitted to the Finnish economy. The scenario was prepared using the Bank of Finland's Aino 2.0 model.

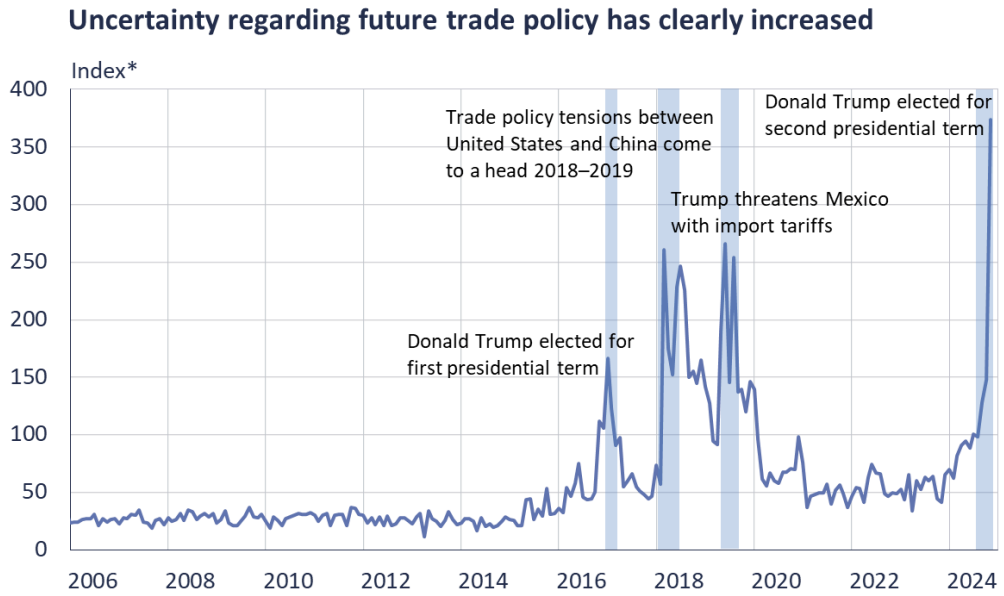
If implemented, the general import tariffs planned by the United States would weaken Finnish exports and slow economic growth in Finland. The impacts of a tighter trade policy would be transmitted to the Finnish economy through a variety of channels. The tariffs would directly weaken Finland's goods exports bound for the United States. Since many goods include a substantial service export component, exports of services would also suffer. Tariffs would also cause indirect harm to Finland through other countries, which would also affect exports of both goods and services. For example, if Germany's exports to the United States are hampered, this will also affect Finland's exports of goods and services to Germany. Companies' production and supply chains are often global, making them susceptible to disruptions in international trade. This was made apparent during the COVID-19 pandemic.

At the time of writing this scenario, the details of the incoming Trump administration's trade policy measures – their implementation, allocation, timing and scale – are unknown. This has already substantially increased uncertainty regarding the development of international trade policy, as was also the case in 2018–2019 during Trump's first presidential term (Chart 1).

Trading partners of the United States are probably planning countermeasures against the US, which further increases trade policy uncertainty. In addition, retaliatory tariffs placed on US imports by the European Union and the rest of the world would be harmful to the international

economy. Increased uncertainty and trade policy countermeasures could weaken GDP growth indirectly in Finland and the rest of the euro area by more than the impact of the US tariffs.

Chart 1.



*Trade policy uncertainty index. Formed on the basis of prevalence of news stories related to trade policy uncertainty in the US press.

Source: Caldara et al. (2020), The Economic Effects of Trade Policy Uncertainty, Journal of Monetary Economics 109.

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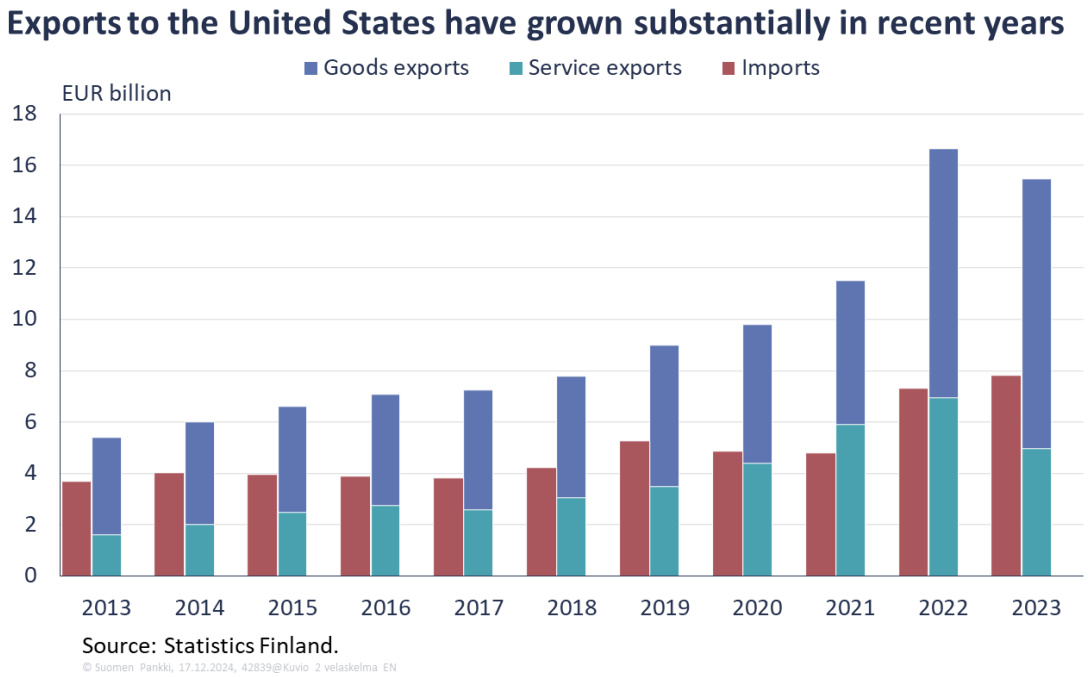
Companies around the world will readily delay investments if uncertainty over the global operating environment increases. Since Finland's exports are focused mainly on investment goods and intermediate products, the growing uncertainty within the international economy could easily lead to reduced demand for Finland's export products. Finnish companies could also reduce or postpone their own investments. Uncertainty can also push up the risk premia required by lenders and raise financing costs for Finnish companies, further slowing investment growth.

United States has become Finland's most important export destination country

Nearly two thirds of Finland's total exports are to Europe, and the euro area alone accounts for over a third of Finland's total export value. Among countries outside Europe, the most important export market is definitely the United States, which takes more than 13% of Finland's exports by value. In 2023, Finland's exports to the US amounted to just over EUR 15 billion, or 5.5% of Finland's GDP (Chart 2). In both goods and services, Finland's trade with the US shows a surplus, i.e. Finland exports more goods and services to the US than it imports from there. Around 70% of

Finland's exports to the United States are goods and around 30% are services.

Chart 2.



Finland's goods exports to the United States have grown strongly in recent years. In 2020–2023, their value grew by a total of almost 95%, nearly doubling. The United States has surpassed Sweden and Germany as Finland's largest export destination country (Chart 3).

The main drivers of the growth in goods exports to the US have been the shipbuilding industry and industrial machinery and equipment (Chart 4). Other important categories among the exports to the US include chemical products, such as refined petroleum products, and miscellaneous manufactured articles, such as health technology instruments and scientific instruments.

Chart 3.

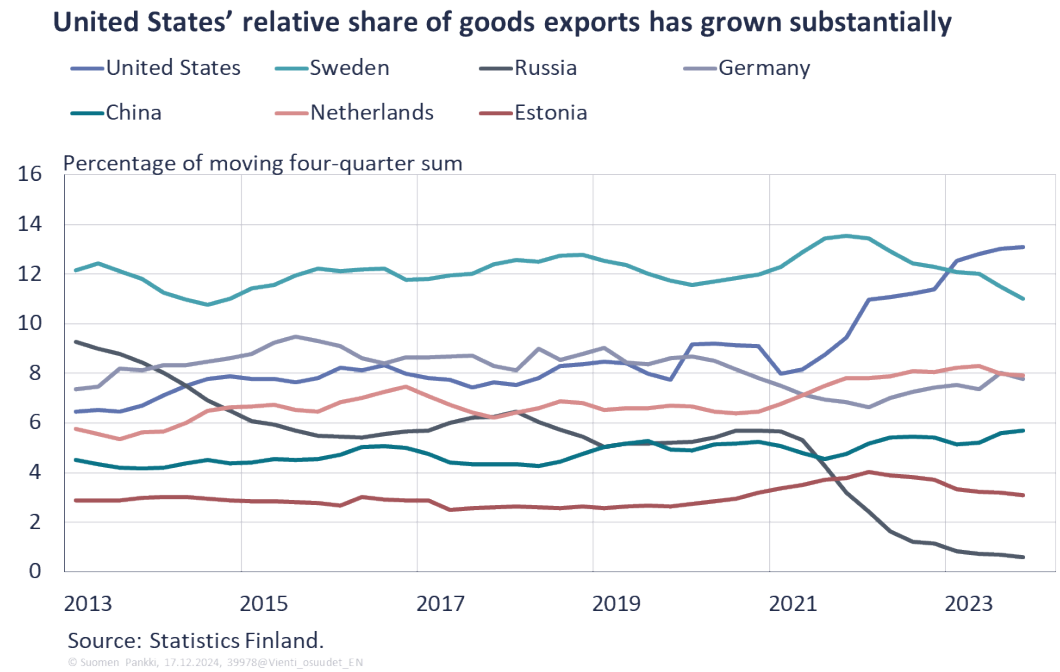
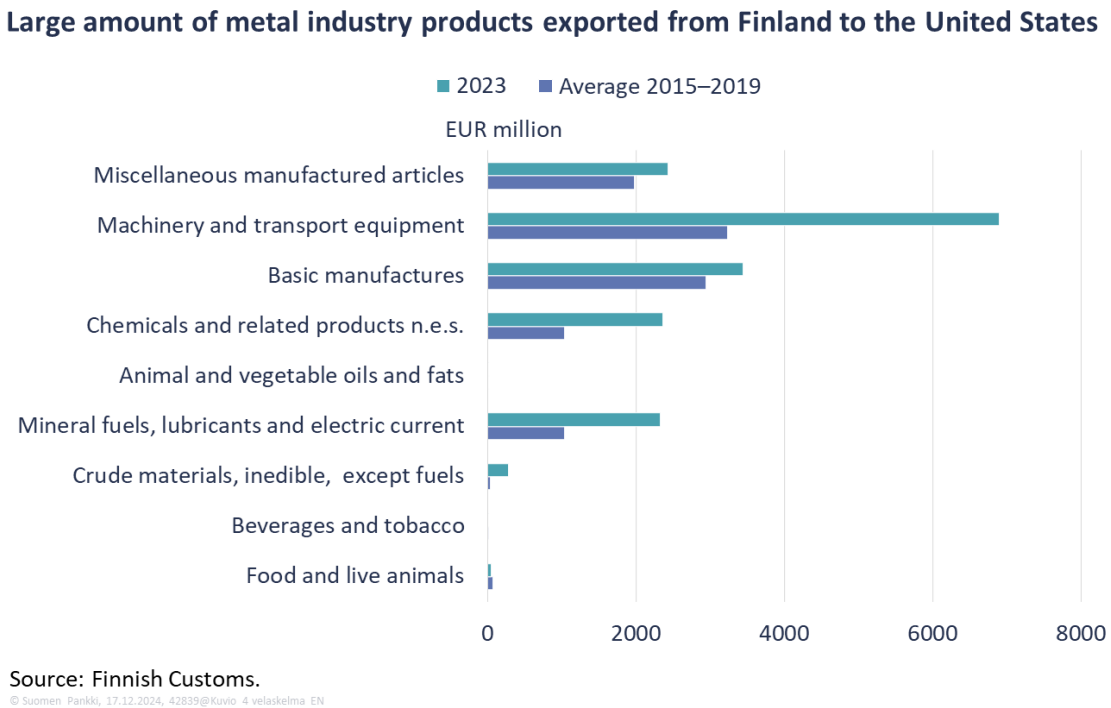


Chart 4.



Scenario assumptions: tariffs will reduce Finland's external demand

The assumption made in this alternative scenario is that during the first half of 2025, at the very beginning of Donald Trump's presidential term, the United States will impose a general 60% tariff on all goods imported from China and a 10% tariff on goods imports from everywhere else, including Finland. These barriers to trade are assumed to be permanent. The scenario takes account of the effects of the US import tariffs on external demand and the effects that are transmitted from the international economy to Finland because of trade policy countermeasures, uncertainty, changes in exchange rates and changes in competitor countries' export prices.

The scenario includes assumptions that are based on model calculations and on expert judgement regarding the impact of the import tariffs on Finland's external demand, the export prices of competitor countries and the euro exchange rate. The assumptions are based on academic research into the impacts of the tariffs imposed during Donald Trump's first presidency and on recent studies and assessments regarding the international impacts of the new tariffs referred to in Trump's campaign promises.[1] According to the research literature, economic growth could be substantially weakened by an increase in trade policy uncertainty concerning particularly the growing threat of trade wars, which is also accounted for in this scenario.[2]

The scenario assumes that the tariffs imposed by the United States and the related second-round effects will, as a whole, have the strongest adverse impact on the international economy in 2025 (Table 1). Trade policy uncertainty, in particular, is assumed to be substantial at the beginning of Trump's presidential term, but to start to dissipate afterwards.

External assumptions made in the alternative scenario

Difference in annual rate of change in relation to baseline forecast (percentage points)	**2025**	**2026**	**2027**
Finland's external demand			
1a. US import tariffs	-0.5	-0.3	-0.2
1b. Retaliatory tariffs	0.1	-0.1	-0.4
1c. Trade policy uncertainty	-0.5	0.3	0.1

** The external value of the euro will weaken as the trade-weighted exchange rate appreciates.*
Source: Bank of Finland.

External assumptions made in the alternative scenario			
Total	***-0.9***	***-0.1***	***-0.5***
Competitor countries' export prices			
2a. US import tariffs	0.0	0.0	0.0
2b. Retaliatory tariffs	0.0	0.0	0.0
2c. Trade policy uncertainty	-0.5	0.3	0.2
Total	***-0.5***	***0.3***	***0.2***
Broad trade-weighted exchange rate*			
3a. US import tariffs	0.3	0.2	0.3
3b. Retaliatory tariffs	-0.3	-0.2	-0.3
3c. Trade policy uncertainty	-0.1	0.0	0.0
Total	***-0.1***	***0.0***	***0.0***

** The external value of the euro will weaken as the trade-weighted exchange rate appreciates.*
Source: Bank of Finland.

First, we examine only the impact of US import tariffs on Finland's external operating environment (Table 1, rows 1a, 2a and 3a). Due to the tariffs, growth in Finland's external demand will slow down slightly compared with the baseline of the December forecast.

The tariffs will cause the US dollar to strengthen against the euro. Imports to the United States will decrease, reducing demand for foreign currency and strengthening the dollar. The increase in import prices will raise consumer prices in the US. As a consequence, the interest rate level in the US could rise relative to the euro area, which would also strengthen the US dollar's exchange rate. The weakening of the euro against the dollar will strengthen the price competitiveness of Finnish companies' exports and partly offset the effects of the import tariffs. However, the change in the exchange rate weighted by the US share in Finland's foreign trade will remain relatively minor.

The scenario makes a simplifying assumption that the import tariffs imposed by the US will not affect the export prices of Finland's competitor countries in relation to the baseline forecast. The overall impact of the US tariffs on competitor countries' export prices remains unclear. On the one hand, import tariffs will push up the prices of imported inputs in the US, and thus also the export prices of US companies. On the other hand, import restrictions may cause export companies based

in other countries, especially China, to seek new export markets aggressively in Europe, for example, which will push down competitor countries' export prices.

Second, the scenario assumes that trading partners of the US will impose symmetric retaliatory tariffs on imports of US goods (Table 1, rows 1b, 2b and 3b). The retaliatory tariffs will weaken the value of the dollar against the euro. Finland's external demand will initially increase slightly, as some demand will shift from US products to goods produced elsewhere. In the longer term, the global increase in barriers to trade will slow GDP growth in the world economy and hinder growth in Finland's export demand compared with the baseline forecast. Moreover, the appreciation of the euro will further weaken the demand for Finland's exports.

Third, the scenario takes account of the increase in trade policy uncertainty (Table 1, rows 1c, 2c and 3c). According to the scenario assumptions, this will cause companies around the world to defer investments, reducing international demand. As a result, growth in Finland's external demand will slow down, and competitors' export prices will decrease in relation to the baseline forecast in 2025. When uncertainty dissipates from 2026 onwards, Finland's external demand will start to strengthen again, and competitor countries' export prices will start to rise. The scenario also assumes that increased uncertainty will directly weaken Finnish private investment in 2025.[3]

Scenario results: changes in trade policy will weaken economic growth in Finland

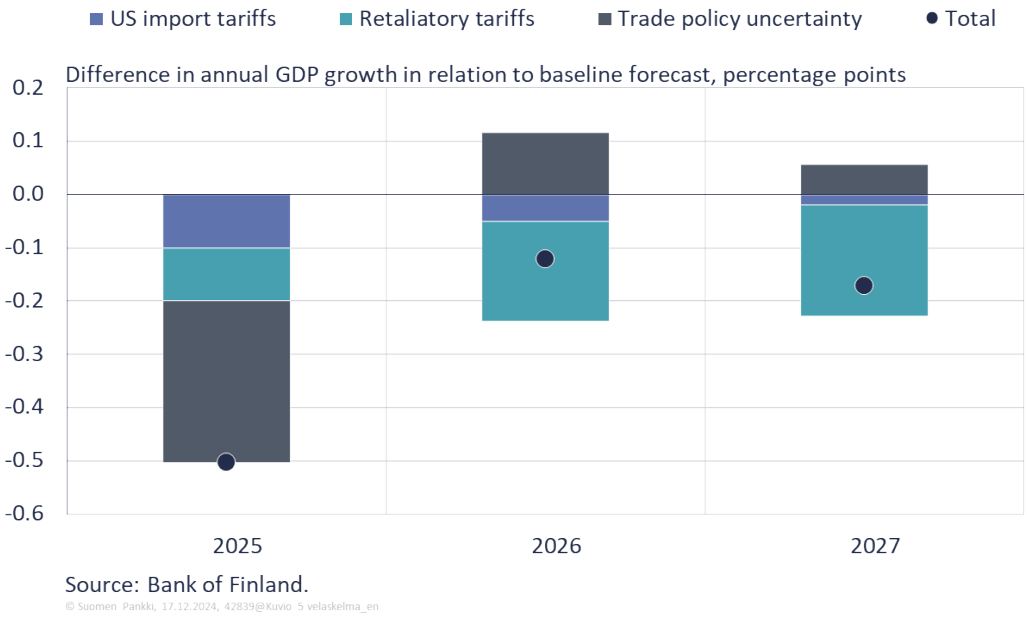
Next, the impacts of trade policy changes on the Finnish economy will be presented, itemised by different factors. First, we present the effects of the US import tariffs on the Finnish economy. The overall impacts are then examined. This also takes account of the effects of retaliatory tariffs imposed by the rest of the world and the effects of trade policy uncertainty (Table 2).

Tariffs imposed by the United States have only a minor impact on the Finnish economy

The setting of import tariffs by the United States will dampen growth in the Finnish economy, with GDP growing in the 2025 calculation by 0.1 percentage points less than in the Bank of Finland's December 2024 baseline forecast. In 2026 and 2027, the US tariffs will have an even smaller adverse impact on GDP growth (Chart 5). Due to the tariffs, the level of GDP at the end of 2027 will be below that of the baseline forecast.

Chart 5.

Import tariffs planned by the United States would dampen economic growth in Finland



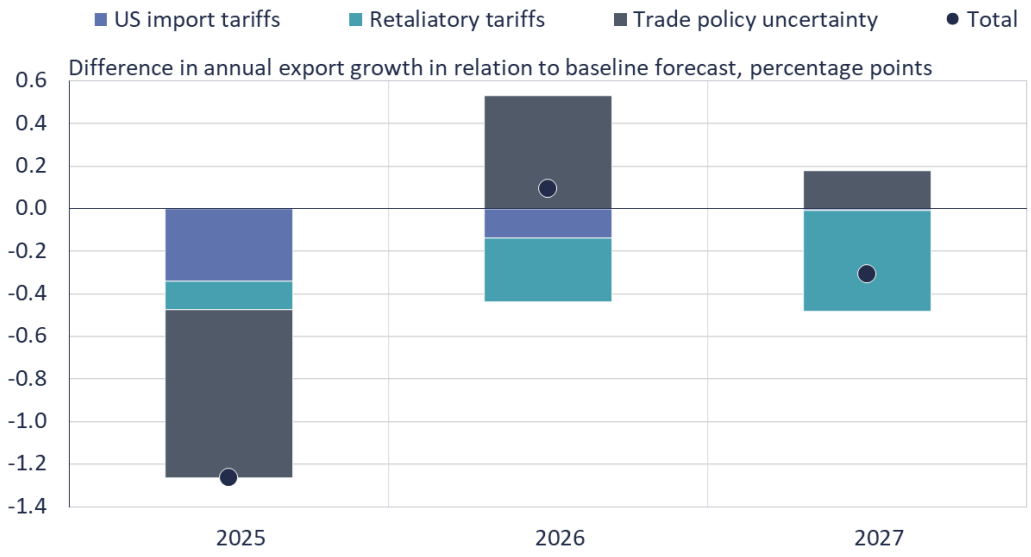
Source: Bank of Finland.

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In 2025, the import tariffs imposed by the United States will reduce annual growth in Finland's exports by 0.3 percentage points compared with the baseline of the December forecast (Chart 6). In 2026 and 2027, the tariffs will have a very minor impact on Finnish export growth. The tariffs will raise the prices of Finnish export products in the United States and reduce the demand for them there. However, the impact of the tariffs on Finland's export demand will be mitigated by the fact that the tariffs also affect Finnish companies' competitors. In the scenario, the dollar is assumed to strengthen against the euro because of the import tariffs, which will contribute to improving the price competitiveness of Finnish exports, reducing the impact of the tariffs. The impact of the US import tariffs on Finland's consumer price inflation will also be minor, at 0.1 percentage points per year in 2026 and 2027 (Chart 7).

Chart 6.

Finland's GDP growth would be dampened by US tariffs primarily as a result of reduced growth in exports

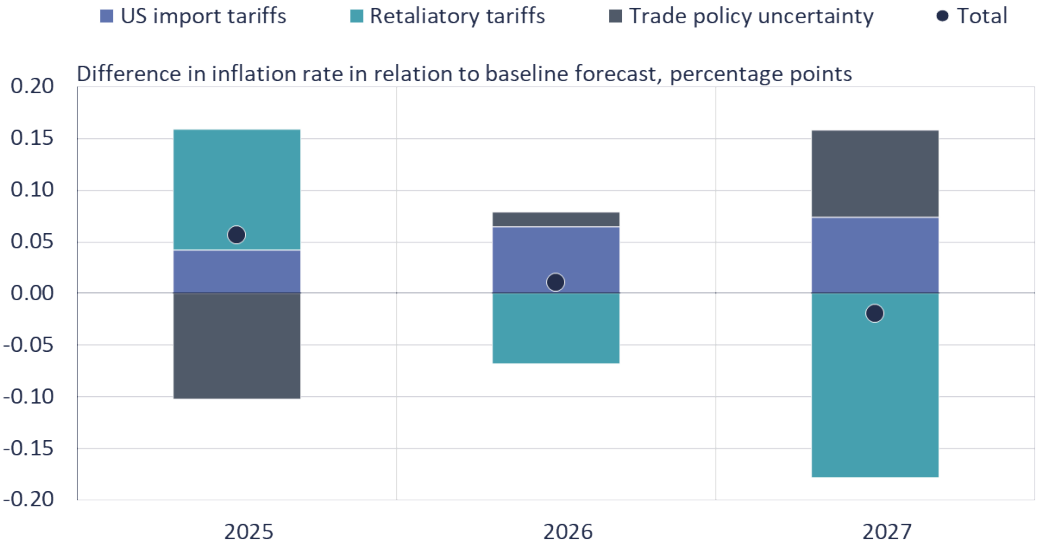


Source: Bank of Finland

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Chart 7.

US tariffs would cause only a slight rise in inflation in Finland*



*According to Harmonised Index of Consumer Prices (HICP).
Source: Bank of Finland.

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Retaliatory tariffs and uncertainty will deepen the impacts on the Finnish economy

The estimated overall impact of the US import tariffs on Finland's economic growth increases dramatically when also taking into account the impacts of retaliatory tariffs by the rest of the world and the increase in trade policy uncertainty. Overall, GDP growth will slow down by a total of 0.5 percentage points in 2025 compared with the baseline forecast (Chart 5). The increase in uncertainty will reduce corporate investment in Finland. When uncertainty gradually starts to fade, its harmful impact on the economy will also decrease. In 2027, economic growth will be 0.2 percentage points lower than in the baseline forecast. In 2026 and 2027, the impacts on Finnish economic growth will remain quite minor overall. A total of EUR 4.5 billion in GDP volume will disappear over three years.

According to the scenario results, US import tariffs and their second-round effects in the international economy, together with retaliatory tariffs and an increase in uncertainty, will slow the growth of Finland's exports by 1.3 percentage points as a whole in 2025 compared with the baseline scenario (Chart 6). When trade policy uncertainty dissipates in 2026, export growth will rise slightly more than in the baseline forecast. In 2027, export growth will again weaken against the baseline forecast, as growth in international trade will slow because of increased barriers to trade.

The slowing of economic growth will also weaken the labour market in Finland. Employment will decline and the unemployment rate will rise compared with the baseline forecast, especially in 2025. Employment will not have returned to the baseline level by 2027. Trade policy countermeasures will also dampen the growth of private consumption throughout the 2025–2027 review period, as prices of products imported to Finland will rise and household income growth will slow down. Based on the scenario results, an increase in trade policy uncertainty will not have a substantial impact on households' consumption decisions.

The effects on consumer price inflation are very minor as a whole, as there are several factors in the scenario that have opposing effect on inflation (Chart 7). The euro's exchange rate will weaken as a result of the tariffs imposed by the United States, which will push inflation up slightly in Finland. Increased uncertainty will reduce aggregate demand and ease inflation pressures in 2025. However, retaliatory tariffs will raise prices of imports to Finland on a one-off basis, accelerating inflation temporarily in 2025. Retaliatory tariffs will nevertheless also strengthen the euro's exchange rate, which will reduce their impact on inflation in 2026 and 2027.

The results of the alternative scenario are of similar magnitude as those presented in, for example, the International Monetary Fund's (IMF) assessment of the euro area impacts of US import tariffs

under similar assumptions, published in the IMF's World Economic Outlook in October 2024. The impacts of the changes in trade policy on GDP growth in the euro area are nevertheless slightly higher than the impacts estimated here for Finland. This is mainly because the impact of trade policy uncertainty on investment and economic growth is assessed as being stronger. According to the IMF World Economic Outlook, the overall impacts on consumer price inflation in the euro area are minor, however. In December, the Deutsche Bundesbank, Germany's central bank, also published a similar scenario of the impacts of US tariffs on Germany's economy. Tariffs and their second-round effects would significantly curb economic growth in Germany which, like Finland, is an export-driven economy.

Results of the alternative scenario			
Annual rate of change (%)	**2025**	**2026**	**2027**
Gross domestic product			
Baseline forecast	0.8	1.8	1.3
Alternative scenario	0.3	1.7	1.2
Deviation from baseline forecast (percentage points)	*-0.5*	*-0.1*	*-0.2*
Exports			
Baseline forecast	2.7	2.7	2.9
Alternative scenario	1.4	2.8	2.6
Deviation from baseline forecast (percentage points)	*-1.3*	*0.1*	*-0.3*
Private investment			
Baseline forecast	0.9	6.7	4.6
Alternative scenario	-0.2	5.5	4.2
Deviation from baseline forecast (percentage points)	-1.2	-1.2	-0.4
Harmonised index of consumer prices			
Baseline forecast	1.9	1.5	1.7

Source: Bank of Finland.

Results of the alternative scenario			
Alternative scenario	1.9	1.5	1.6
Deviation from baseline forecast (percentage points)	*0.1*	*0.0*	*0.0*
Number of employed persons			
Baseline forecast	-0.2	0.8	0.7
Alternative scenario	-0.4	0.7	0.6
Deviation from baseline forecast (percentage points)	*-0.3*	*-0.2*	*-0.1*

Source: Bank of Finland.

Finland benefits from rules-based free trade

Import tariffs imposed by the United States would weaken US demand for Finnish export products, thus slowing the growth of GDP and exports in Finland. Although the United States is a major trading partner for Finland, the 10% general import tariffs planned by Donald Trump would have a limited impact on Finland's GDP. Despite its significance, the United States accounts for just a little more than one tenth (13%) of Finland's goods exports. Moreover, a growing share of Finland's exports to the United States consists of services, which are not directly affected by the tariffs.

An increase in general trade policy uncertainty in the international economy will likely be a much stronger constraint on economic growth and exports. For a small, export-driven, open economy such as Finland's, rules-based free trade is especially important. Trump's tough-talking trade policy initiatives are leading to increased speculation about other countries' possible countermeasures, and more generally about the strengthening of protectionist attitudes and increasing barriers to trade.

The surge in trade policy uncertainty in the international economy will likely also hinder corporate investment globally. The composition of Finland's export trade is heavily focused on investment goods and intermediate products whose exports are hit particularly easily in these kinds of situations. On the other hand, the reduction in import demand from the United States will force export companies all over the world to seek new markets outside the US or to move production to the US, which will tighten the competitive field. Many Finnish companies already have a considerable amount of production in the United States. Thus, Finland's export performance also

depends on the ability of Finnish export companies to adapt to changing trade policy.

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Notes

1. See e.g. Amiti et al. (2019), Gunnella and Quaglietti (2019), Caldara et al. (2020), Fajgelbaum et al. (2020), Fajgelbaum and Khandelwal (2022), Furceri et al. (2022), Boer and Rieth (2024) and International Monetary Fund (2024). ↑
2. Caldara et al. (2020). ↑
3. The direct impact of uncertainty on private investment is assumed to be such that investment will decrease by 1% in 2025 compared with the baseline forecast. This is in line with results reported by Lindblad et al. (2019). The authors assessed the impact of general international uncertainty on investment in Finland. ↑

Keywords

alternative scenario, forecast, import tariffs, international trade, trade policy