FORECAST

Trade war escalation poses significant risk for Finnish economy

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Developments in international trade policy will strongly shape the economic environment in Finland in the forecast years 2025–2027. Given the twists and turns in the United States' trade policy, there is great uncertainty about the trade tariff situation in the forecast period. The alternative scenario examines two alternative paths in trade policy and how they will affect Finland. These two scenarios indicate that a cessation of the trade war would cause Finland's exports and economic growth to pick up. They also indicate that a significant escalation in the trade war would considerably weaken Finland's exports and economic growth.

In this alternative scenario to the Bank of Finland's June 2025 forecast, two different scenario paths are used to examine the impact of trade policy and trade policy uncertainty on developments in the Finnish economy in the forecast years 2025–2027.[1] The *mild scenario* describes a situation in which the trade war ends and the United States reaches agreement with its key trading partners in the second half of 2025. Average tariffs between the US and its trading partners are reduced permanently from current levels and trade policy uncertainty fades more quickly than under the baseline forecast. The *severe scenario*, on the other hand, describes a situation in which the trade war between the US and its trading partners escalates in the second half of 2025, tariffs are raised substantially and permanently from current levels, and trade policy uncertainty remains very high throughout the forecast period.

Finland’s gross domestic product (GDP) will grow more quickly under the mild scenario than in the baseline throughout the forecast period, because exports, private investment and consumption will pick up. Under the severe scenario, on the other hand, the escalation of the trade war will substantially reduce economic growth in Finland in the years of the forecast, and GDP growth will not properly pick up until 2027. The scenarios indicate that the current tariffs and uncertainty are already slowing economic growth in Finland. The possibility of an escalation in the trade war and the unpredictability of US trade policy create a clear downside risk for economic growth during the forecast period.

The two scenarios were prepared using the Bank of Finland’s Aino 2.0 model. They incorporate updated assumptions but were otherwise prepared in the same way as in the Bank of Finland’s December 2024 alternative scenario, which also describes in more detail the channels through which the trade war impacts would be transmitted. The scenario assumptions on trade policy, the level of tariffs and Finland’s external economic environment are consistent with the European Central Bank’s scenarios on the global economy. They take account of trade policy related changes in Finland’s external demand, in competitor countries’ export prices, and in oil prices over the immediate years ahead.

The scenarios also take account of the direct impact of US-imposed import tariffs on the US prices of Finland’s export products, and the impact of EU-imposed tariffs on the prices of imported US goods in Finland. The impact of trade policy on Euribor rates and exchange rates has not been included, however. The trade war caused large movements in the dollar exchange rate, in particular, during the spring, but it is difficult to predict the development of exchange rates in the different scenarios over the entire three-year forecast period.

Tariffs are significant for Finland’s economy, but so too will be the direction in which trade policy uncertainty develops. The scenarios recognise that uncertainty will affect Finland’s external demand and consequently Finnish exports, but will also have a direct impact on domestic private investment and private consumption. Growing uncertainty will cause Finnish consumers and companies to become more cautious, reducing private consumption and investment. Corporate financing costs will rise when corporate finance risk premia are increased because of the uncertain outlook. A rapid reduction in uncertainty will have the opposite effect.

Scenario assumptions: trade policy will determine the development of Finland’s external operating environment

In April 2025, the United States announced that it would impose high import tariffs on all its trading partners. Later, however, the US announced that it would postpone the entry into force of these tariffs by 90 days. The Bank of Finland’s June forecast assumes that the lower additional tariffs in place under this postponement decision will remain in place permanently during the forecast period. This means that goods imported to the United States during the forecast period are assumed to be subject to a 10% general additional tariff, which will also apply to the EU and Finland. The forecast also assumes that a 30% additional tariff will be levied on goods imported from China to the United States, and an additional 10% retaliatory tariff on China’s imports of US goods. These are added to the tariffs that were in force before Donald Trump’s second term in office.

The mild scenario assumes that the trade negotiations will lead to an outcome in which the trade tariffs between the US and its trading partners will largely be removed as of the third quarter of 2025. The US and the EU will reach a permanent agreement on trade, and all tariffs will be removed from trade in goods between them. The trade tensions between the United States and China will also ease significantly, and US tariffs on imports from China will decline to 10%. China will also cancel its retaliatory tariffs towards the United States. The mild scenario assumes, furthermore, that the uncertainty over trade policy will fade rapidly this year and during the first half of 2026.

Finland’s external demand will grow more under the mild scenario than under the baseline forecast in both 2025 and 2026, as conditions in the global economy will strengthen due to the easing of trade policy tensions. In 2027, external demand will grow in line with the baseline forecast. Lower tariffs will cause competitors’ export prices to rise more slowly than in the baseline. The price of oil will rise slightly more quickly than in the baseline, as faster global economic growth will increase the demand for oil (Table 1).

In the severe scenario, it is assumed that agreements will not be reached in the trade talks and that trade tariffs will rise substantially compared with the assumptions of the baseline forecast. The trade war between the US and China will re-escalate after the easing in the spring, and the substantial bilateral tariffs of more than 100% announced in April will enter into force. It is also assumed that trade policy uncertainty will remain high throughout the forecast period, which will further reduce international and domestic demand.

In 2025 and 2026, Finland's external demand will grow significantly more slowly under the severe scenario than under the baseline forecast, as the escalating trade war will weaken global economic growth substantially. In 2027, the global economy will gradually start to recover, and Finland's export markets will grow at almost the same rate as in the baseline forecast. Because of the higher tariffs, export prices of Finland's competitor countries will at first rise more quickly than in the baseline. Later, weaker international demand than in the baseline will slow the price growth. Similarly, the price of oil will decline significantly in relation to the baseline because of weak international demand (Table 1).

External assumptions made in the scenarios

Difference in annual rate of change in relation to baseline forecast (percentage points)	**2025**	**2026**	**2027**
Mild scenario			
External demand	0.3	0.3	0.0
Competitor countries' export price	-0.2	-0.1	0.2
Price of oil	0.8	1.1	0.1
Severe scenario			
External demand	-1.5	-1.6	-0.1
Competitor countries' export price	0.3	-0.4	-0.7
Price of oil	-3.0	-5.0	-0.2

Sources: Bank of Finland and European Central Bank.

Scenario results: trade war threatens to push Finland into a prolonged downturn

Compared with the baseline, tariffs will be lower and trade policy uncertainty will fade in the mild scenario, from the third quarter of 2025 onwards. With growth no longer hampered by international trade barriers and trade policy uncertainty, Finland's GDP growth in 2025 will be 0.2 percentage points higher than under the baseline forecast. GDP growth will, correspondingly, be

0.5 percentage points higher in 2026 and 0.1 percentage points higher in 2027 than in the baseline (Table 2). With GDP growth higher throughout the forecast period, the volume of GDP will be higher in 2027 than under the baseline forecast (Chart 1).

Since the direction of trade policy will strongly shape the development of Finland's external operating environment, exports in the mild scenario will develop more favourably during the forecast period than in the baseline (Chart 2). Furthermore, lower tariffs will also reduce Finland's export prices compared with the baseline, leading to an increase in demand for Finnish export products.

Private investment and consumption in the mild scenario will also grow more quickly than in the baseline, as uncertainty over future trade policy diminishes and tensions in the global economy ease (Table 2). The business outlook for companies will become clearer, and the investment appetite will be stronger than in the baseline. Consumer confidence will pick up and the willingness to spend will increase, further supporting economic growth.

Under the mild scenario, consumer price inflation will evolve broadly in line with the baseline forecast. On the one hand, strengthening demand and higher oil prices will add to upward price pressures, but on the other hand, a decline in import prices will slow inflation (Table 2).

Chart 1.

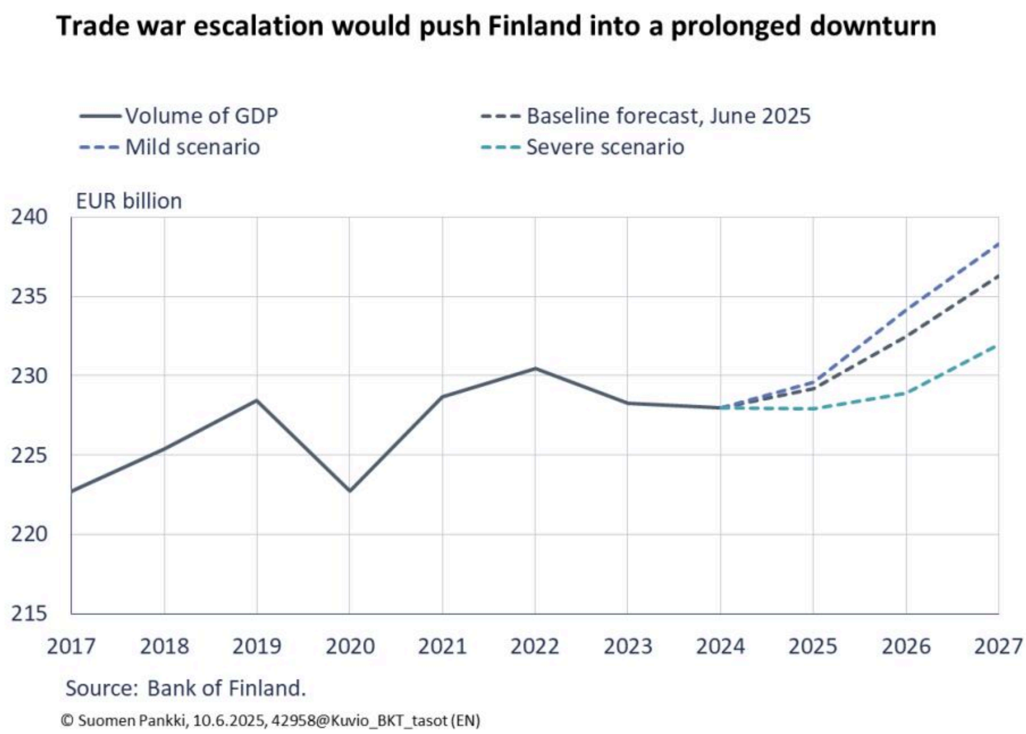
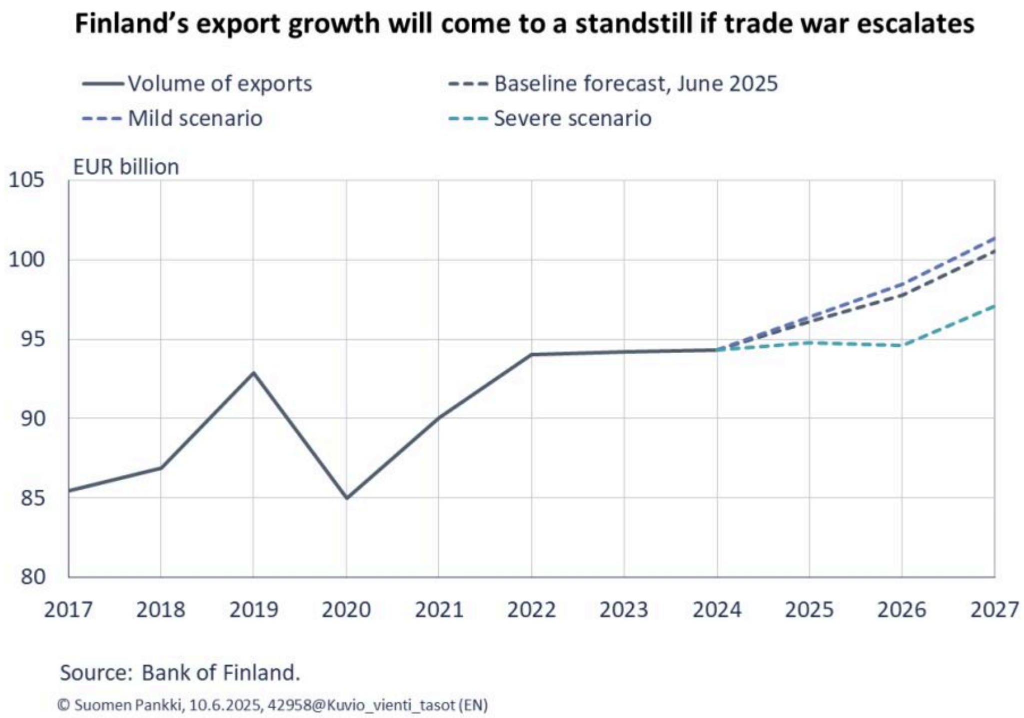


Chart 2.



In the severe scenario, tariffs will rise and the trade war will escalate, especially between the United States and China, but also between the United States and the EU. Uncertainty over trade policy will be high.

Consequently, economic growth will be substantially weaker than under the baseline throughout the forecast period. Finland will be driven into a prolonged downturn. Annual GDP growth will be 0.5 percentage points lower in 2025, and 1 percentage point lower in 2026, than under the baseline forecast. Thus, GDP will not grow at all in 2025, and growth will remain low in 2026 (Table 3). Although economic growth will recover in 2027, GDP will be significantly lower than under the baseline forecast (Chart 1).

The escalation of the trade war in the severe scenario will have a substantial impact on Finland's exports. Export growth will come to a standstill in 2025, and in 2026 exports will contract when export demand diminishes substantially. Growth in exports will pick up in 2027, but the export volume will be clearly lower than under the baseline forecast (Chart 2).

In the severe scenario, private investment and consumption will suffer from an increase in uncertainty. Companies' willingness to invest and households' willingness to spend will decrease substantially. Consumer price inflation will be slightly lower in 2026 and 2027 than in the baseline.

Although import prices will rise because of tariffs, weak consumption demand and decreasing oil prices will slow inflation (Table 3).

Results of mild scenario			
Annual rate of change (%)	**2025**	**2026**	**2027**
Gross domestic product			
Baseline forecast*	0.5	1.5	1.6
Scenario	0.7	2.0	1.8
Deviation from baseline forecast (percentage points)	0.2	0.5	0.1
Exports			
Baseline forecast*	1.9	1.7	2.8
Scenario	2.2	2.2	2.9
Deviation from baseline forecast (percentage points)	0.3	0.5	0.1
Private investment			
Baseline forecast*	-2.5	4.2	3.8
Scenario	-2.2	5.0	3.9
Deviation from baseline forecast (percentage points)	0.2	0.8	0.2
Private consumption			
Baseline forecast*	0.3	1.7	1.8
Scenario	0.7	2.7	2.1
Deviation from baseline forecast (percentage points)	0.3	1.0	0.3
Harmonised index of consumer prices			
Baseline forecast*	1.7	1.4	1.8

Source: Bank of Finland.

Results of mild scenario			
Scenario	1.7	1.4	1.9
Deviation from baseline forecast (percentage points)	-0.0	-0.0	0.1
* Bank of Finland June 2025 forecast.			

Source: Bank of Finland.

Results of severe scenario			
Annual rate of change (%)	**2025**	**2026**	**2027**
Gross domestic product			
Baseline forecast*	0.5	1.5	1.6
Scenario	-0.0	0.4	1.3
Deviation from baseline forecast (percentage points)	-0.5	-1.0	-0.3
Exports			
Baseline forecast*	1.9	1.7	2.8
Scenario	0.5	-0.2	2.6
Deviation from baseline forecast (percentage points)	-1.4	-1.9	-0.2
Private investment			
Baseline forecast*	-2.5	4.2	3.8
Scenario	-2.8	3.2	3.6
Deviation from baseline forecast (percentage points)	-0.3	-1.0	-0.2
Private consumption			
Baseline forecast*	0.3	1.7	1.8
Scenario	0.0	0.5	0.6

Source: Bank of Finland.

Results of severe scenario			
Deviation from baseline forecast (percentage points)	-0.3	-1.2	-1.2
Harmonised index of consumer prices			
Baseline forecast*	1.7	1.4	1.8
Alternative scenario	1.7	1.2	1.5
Deviation from baseline forecast (percentage points)	0.0	-0.2	-0.3
* Bank of Finland June 2025 forecast.			

Source: Bank of Finland.

Trade war poses significant risk for Finnish economy

The two scenarios indicate that the current tariffs and trade policy uncertainty are already slowing economic growth in Finland, and that the removal of these adverse effects would lead to a significant pick-up in growth this year and in 2026. By contrast, the considerably higher tariffs than at present and the growing uncertainty contained in the severe scenario would keep Finland in a protracted downturn, and Finland's economy would not grow at all this year and only slightly next year. It should be noted that the favourable growth impact of the mild scenario is not as large as the adverse growth impact of a trade war escalation under the severe scenario. Thus, the risks to the global economy and to Finland's economy caused by trade policy are clearly on the downside.

The impacts of the two scenarios on inflation are minor. The scenarios do not assume changes in exchange rates. However, an easing of the trade war could lead to a strengthening of the dollar and a larger rise in the price of oil than is assumed in the mild scenario. Because of these factors, an easing of the trade war could accelerate inflation by more than is estimated here.

Inflation will be lower under the severe scenario than under the baseline forecast in both 2026 and 2027. Although higher import tariffs will have an upward impact on inflation in the severe scenario, the weaker demand and falling oil prices will cause inflation to fall. If the import tariffs imposed by the United States on China lead to China increasing its exports to Europe, this would further slow inflation. However, it is also possible that the tariffs between the US and China could cause significant disruptions to international supply chains. This could lead to weaker availability of certain products and to price increases. These kinds of export redirection impacts and supply chain disruptions have not been taken into account in the scenario.

The assumptions of the Bank of Finland's December 2024 alternative scenario and of the mild scenario described here are broadly similar but in opposing directions.[2] The most significant difference is in the timing of the scenarios, because in the December scenario the impacts on Finland's economy were calculated from the first quarter of 2025, while in the mild scenario, the impacts are calculated from the third quarter. This affects the annual figures for 2025 and 2026 to the extent that in the mild scenario the greater impact is on economic growth for 2026. The mild scenario also assumes a more substantial change in trade policy uncertainty than was assumed in the December scenario, increasing the impact on GDP growth compared with the December scenario. The severe scenario presented here describes a substantially stronger escalation in the trade war than was anticipated in the December alternative scenario.

Notes

1. The scenarios presented here do not necessarily represent the views of the European Central Bank or the Eurosystem. ↑
2. In the alternative scenario made in December 2024, 60% bilateral tariffs were assumed between China and the United States, and 10% bilateral tariffs between other countries and the United States. In addition, the impact of trade policy uncertainty was taken into account. The assumptions made in the December scenario have since materialised for the most part, and their impacts are taken into account in the forecast made in June. The mild scenario presented here is close to the baseline scenario of the December forecast because the scenario describes the removal of tariffs and a fading of uncertainty. ↑

Key words

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