SUOMEN PANKKI EUROJÄRJESTELMÄ FINLANDS BANK EUROSYSTEMET

Economic outlook for the euro area and Finland under the strain of power politics

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Geopolitics is dominating economic developments

Europe

- **Russia, Ukraine, Europe's security**
- Productivity and industrial competitiveness

Global troubles

- **Rules-based international trade under threat**
- Middle East conflict and shifting power relations
- Climate goals slipping: on track for +2.5°C to +3.0°C?

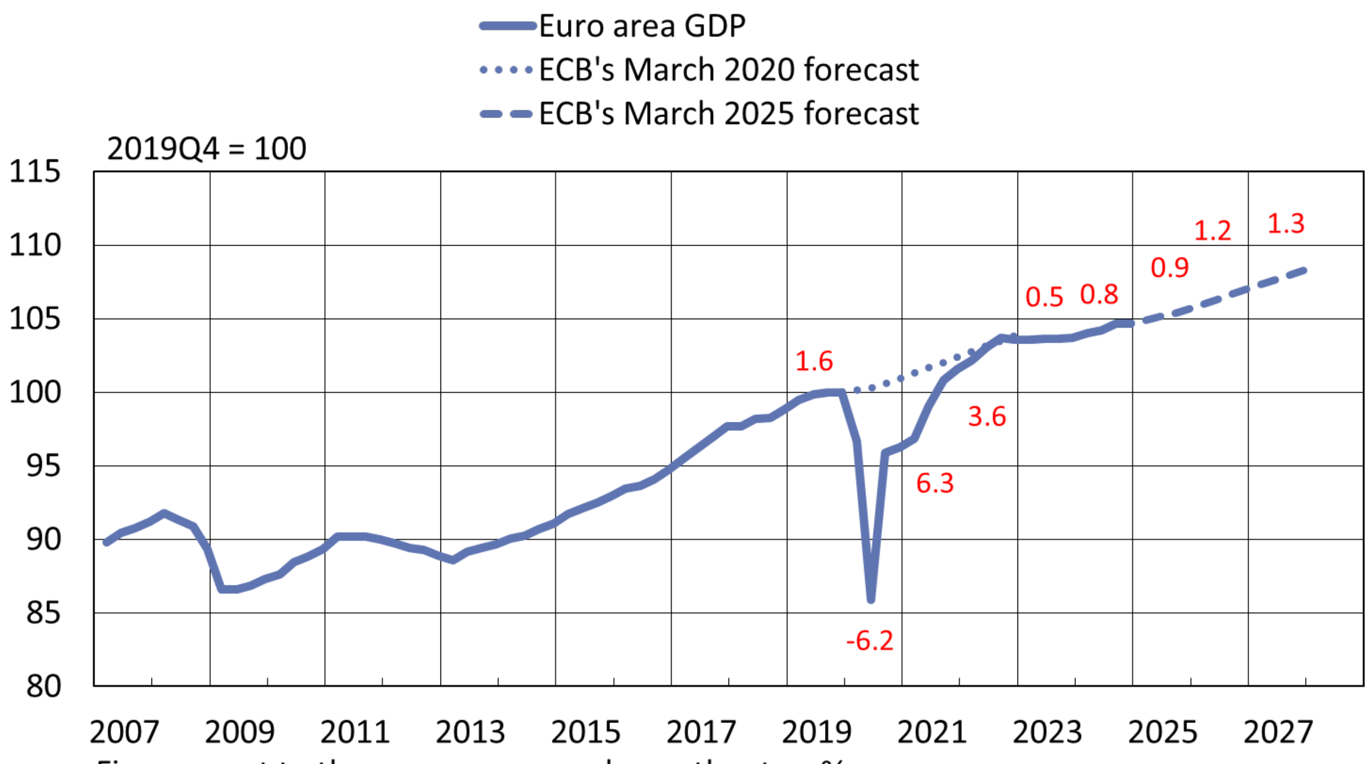
United States

- Relations with Europe?
- Way forward for democracy and the rule of law?
- What is the West?

Asia

- China's economic woes
- India now world's most populous and fastest growing G20 country
- Asia's century under way – or will it collapse with conflict in the South China Sea?

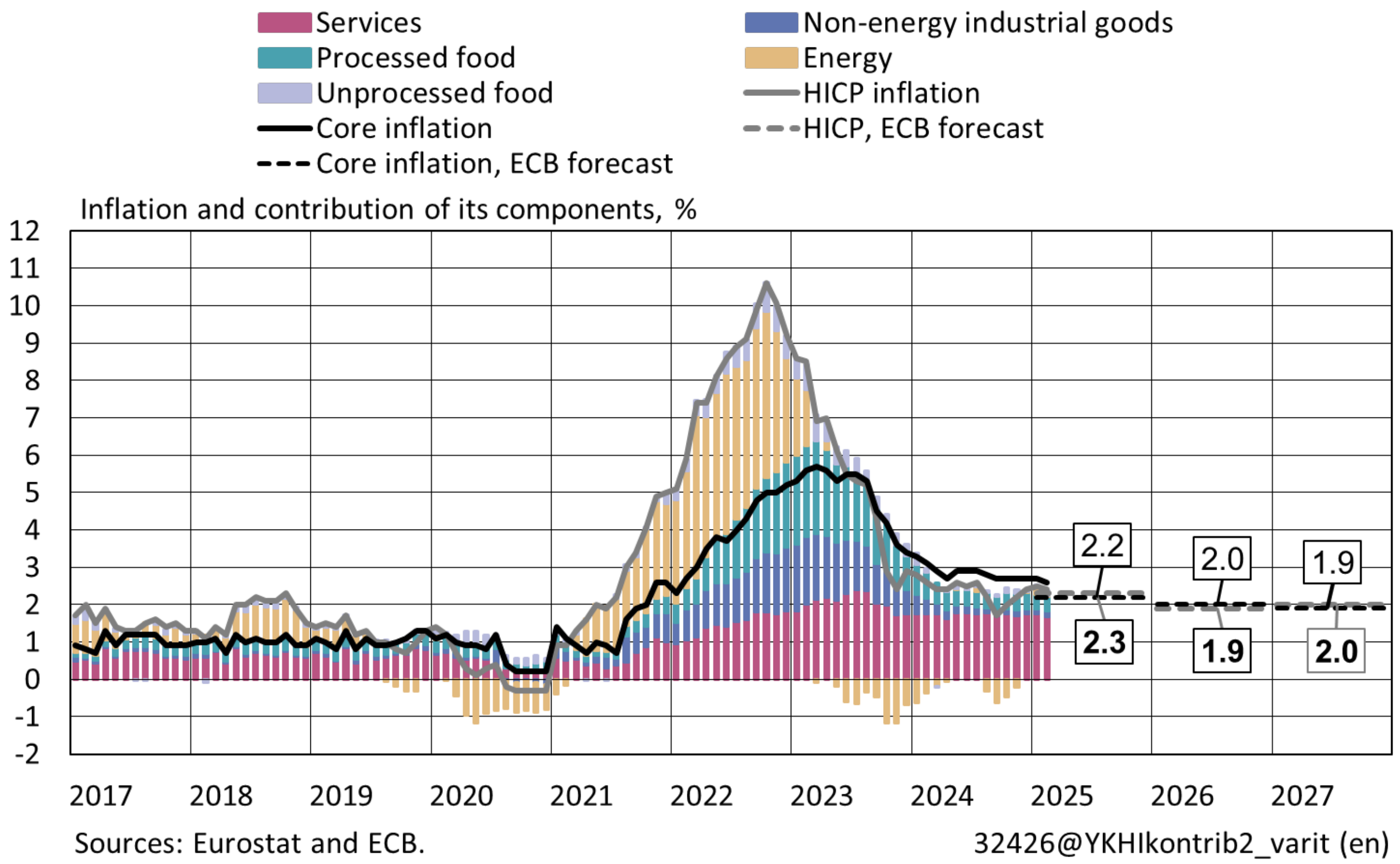
Growth in euro area economy picking up slowly – Exceptional uncertainty is slowing the recovery



Figures next to the curve are annual growth rates, %.
Sources: Eurostat and ECB. 35781@MMS(2007-)_LV (en)

- According to the ECB's March forecast, the economy will gradually strengthen as purchasing power is bolstered by growth in household real income.
- Growth is weaker than before and the outlook is clouded by exceptional uncertainty.
- Interest rate cuts will strengthen consumption and investment in the euro area over time.

Euro area inflation stabilising at the 2% target

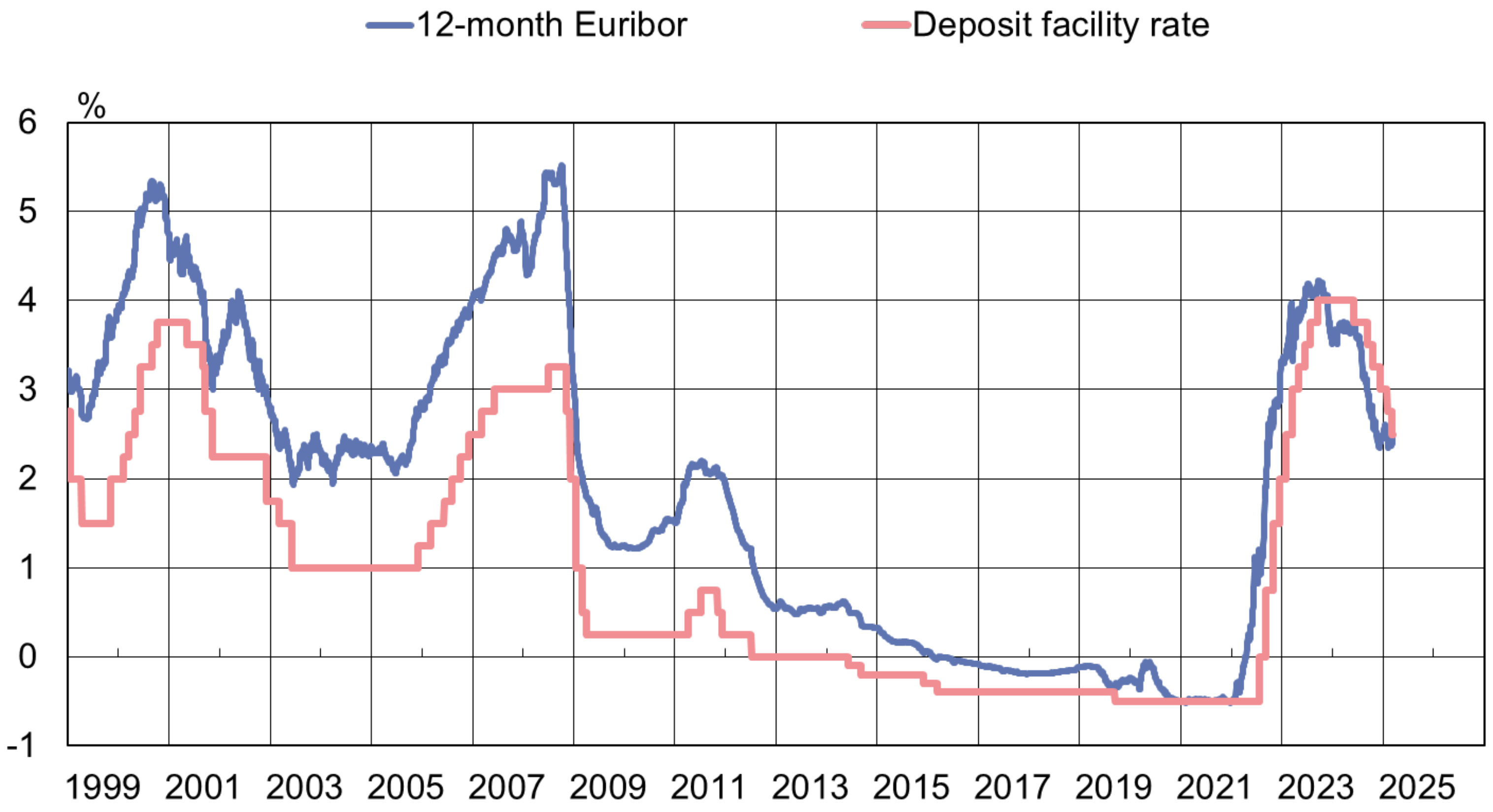


- Euro area wage inflation is projected to slow.
- Most measures of underlying inflation also suggest that inflation will settle sustainably at around the ECB's 2% target over the medium term.
- Inflation risks are two-sided.

ECB's decision to ease monetary policy spurred by inflation stabilising and growth weakening

- At its March meeting, the Governing Council of the ECB reduced the deposit facility rate to 2.50%.
- Since June last year, this principal policy rate has been lowered six times in a row, by a total of 1.5 percentage points (4% → 2.5%).
- Monetary policy is becoming meaningfully less restrictive.
- The ECB is not committed to a particular rate path but preserves full optionality as uncertainty is high. The Governing Council's decisions will be made on a meeting-by-meeting basis and in the light of incoming data and an overall assessment.

Interest rate cuts are helping support economic growth in Finland and across the euro area



Sources: ECB and EMMI.

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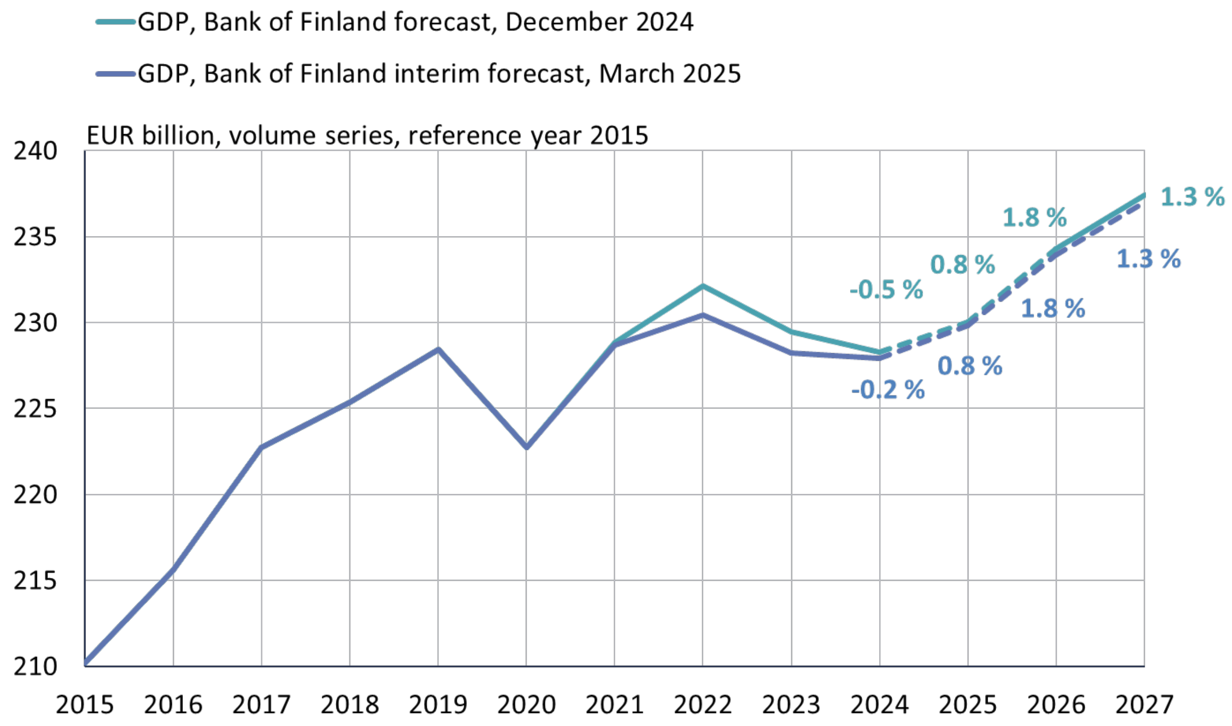
- The 12-month Euribor, the most important loan reference rate in Finland, is now at 2.5% (10 March 2025).
- The Euribor has fallen from its autumn 2023 peak by some 1.8 percentage points.
- For comparison: in 1999-2008, the 12-month Euribor averaged 3.4%.

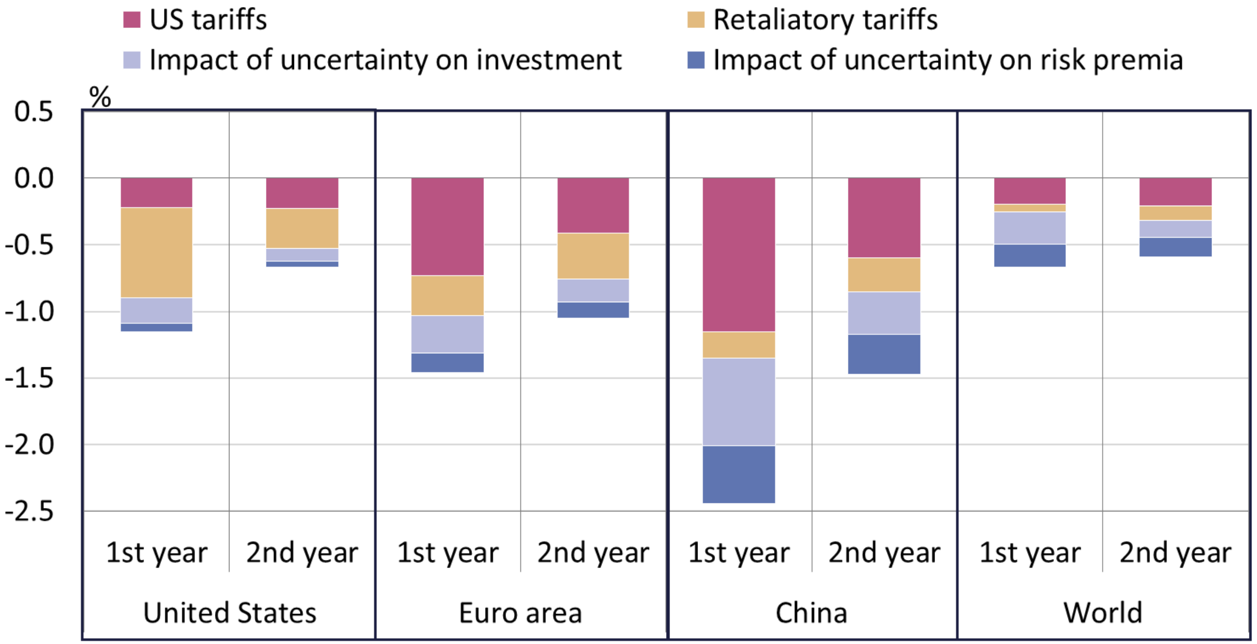
Finland's economy will slowly grow – Growth under the shadow of uncertainty



Sources: Statistics Finland and Bank of Finland.

- Finland's economy is recovering from a recession
  - Economic growth will pick up gradually
  - As the economy recovers, employment, too, will start to improve
  - Inflation will remain moderate
- Elevated risks and uncertainty
  - Will additional tariffs be imposed on Finland's and Europe's exports?
  - A weakening security situation will increase uncertainty
  - Consumers and businesses are cautious

Bank of Finland’s scenario calculation: A trade war would weaken growth worldwide



Source: Calculations by the Bank of Finland.

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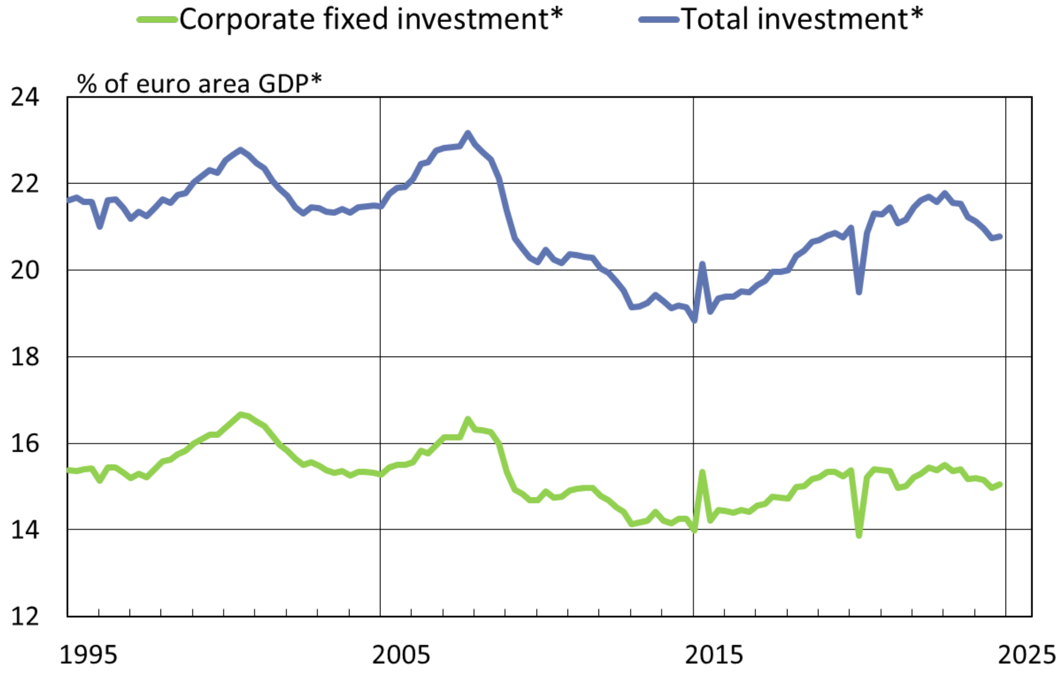
- Scenario calculation’s assumptions: 25% US tariff on imports from the euro area; 20% US tariff on imports from China; symmetric retaliatory tariffs. The increase in uncertainty is taken into account.
- There are no winners in a trade war
  - World GDP approx. -0.5% per year
  - Significantly stronger impacts on the euro area and especially on China
  - Retaliatory tariffs would weaken the market position of US companies in particular
- In addition to the direct barriers to trade, uncertainty related to trade disputes will hit investment and raise risk premia
- Impact on inflation moderate

Euro area investment growth has been weak – Increase in defence investment in sight

Investment ratios



Sources: Eurostat and calculations by the Bank of Finland.
*Excl. Ireland's investment in intellectual property products.
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- Euro area investment recovered very slowly from the global financial crisis
  - The investment ratio decreased, due particularly to a contraction in construction investment
- The situation improved in 2015–2019, and investment also recovered rapidly from the pandemic slump
- Since 2022, growth in corporate fixed investment has been negative
  - Investment in machinery and equipment has contracted
- Post-financial crisis investment growth has been the result of investment in intellectual property products
- Defence investment in Europe is expected to grow

In conclusion: Europe is under challenge from the world of geopolitics – Investment is needed now in security and productivity

- The world is in transition, as it was 30 years ago – but is now going into reverse.
- All of Europe must invest substantially in defence.
- Necessary investment in defence is having to be made in an environment where public finances are under pressure. Common European solutions are also needed.
- At the same time, Europe must find ways to increase productivity. The single market must be finalised and investment made in human capital and research.

→ Requires that Europe has the capacity for renewal and remains united. Recent weeks have shown that a common response is more critical than before. No time to waste.

> Securing stability –
> in science we trust.