FORECAST FOR THE FINNISH ECONOMY – JUNE 2025

New obstacles to Finland's economic recovery

30 Jun 2025 – Forecast – Finnish economy

Finland's economy is facing new obstacles to its recovery. Trade policy tightening and uncertainty over the development of the global economy will slow the pace of economic growth, and a clearer improvement in economic conditions will not be seen until next year. The Finnish economy will grow this year by 0.5%, and by 1.5% in 2026 and 1.6% in 2027. Inflation will stay below 2% in the immediate years ahead. Unemployment will fall slowly. Finland's public finances will continue to be deeply in deficit, and the accumulation of public debt will continue.

Overview

The Bank of Finland's forecast incorporates the assumption that growth in the global economy will lose pace in the immediate years ahead, as growth in the United States' economy especially, but also in other key economies, becomes adversely affected by the trade war. The trade war and the uncertainty over the path of the global economy will weaken the already subdued conditions in the euro area. Finland's export markets will grow at a slowly over the coming years. The forecast assumes that uncertainty over the direction of trade policy will nevertheless diminish gradually, provided that the United States reaches agreement with its key trading partners. Uncertainty will not disappear completely, however, during the years of the forecast. The increasing expenditure on defence and the investment in infrastructure in many countries of the euro area, especially Germany, will underpin growth in the euro area economy from 2026 onwards.

Financing conditions have eased as interest rates have fallen. The financial markets expect the 3-month Euribor rate to remain near 2% in the immediate years ahead. The looser financing conditions than in recent years will support the recovery in economic growth, both in Finland and the euro area.

Finland's economy has recently faced new external shocks in a situation where the domestic economy has not properly had time to strengthen after previous crises. The Finnish economy will grow by 0.5% in 2025. In 2026, growth will strengthen to 1.5%, and in 2027 to 1.6%.

Private consumption will barely grow in 2025, as consumers are still very cautious and the labour market is weak. In 2026–2027, private consumption growth will pick up as consumer confidence rises. Household purchasing power will strengthen, because the negotiated collective agreements will raise employees' earnings, inflation will remain moderate and household interest payments will be less than in previous years. An increase in employment will also underpin purchasing power and consumption.

Private investment will see a further slight decline in 2025. Uncertainty over trade policy will erode business confidence. This will also slow business investment. Although the lowest point in housing construction has now been reached, residential investment in 2025 will still be down year on year. However, the slowdown in investment will start to ease when uncertainty abates and the lower level of interest rates than in previous years improves the attractiveness of investments. Private investment will begin to grow gradually in 2026 and 2027.

Finnish exports will recover slightly in 2025 after a weak 2024. However, exports in 2025 and 2026 will grow only slowly. The tariffs on goods will remain high, and uncertainty over the path of the global economy will remain greater than in earlier years. However, interest rates are now lower than in previous years, which will increase the profitability of investments in the euro area and therefore strengthen Finland's exports. Exports will increase in 2027, driven by growth in the export markets.

Inflation will continue to be low. Increases in product taxation will push up consumer prices in 2025, but in other respects the rise in prices will be subdued this year. Energy prices will fall further. Despite the gradual recovery in the economic cycle, inflation will remain below 2% annually throughout the 2025–2027 forecast period. Nominal earnings will increase in accordance with the outcome of the spring 2025 negotiations on collective agreements, and real earnings will also rise.

The weak cyclical conditions have continued for some time and are still weighing on the labour market. Growth in the economy will be slow at the start of the forecast period, which will limit growth in the demand for labour. Employment will start to rise gradually when cyclical conditions improve. However, the fall in unemployment will be slow, and in 2027 the unemployment rate will still be 8.5%, which is above the structural unemployment rate.

Fiscal policy is being tightened in 2025 through the Government's fiscal adjustment measures, and the general government deficit will decrease. The improvement in Finland's public finances will slow after this, and the deficit will still be 3.6% of gross domestic product (GDP) in 2027. Tax cuts and higher defence spending are among the factors that will weaken the fiscal balance. The public debt-to-GDP ratio will rise to 88% by 2027.

The risks surrounding the forecast are tilted towards weaker growth and lower inflation than projected. Slower growth and lower inflation would arise if there were a considerable tightening of trade policy from the present position and a prolonging of the uncertainty. Geopolitical tensions in Ukraine and the Middle East could further elevate the uncertainty. In Finland, there is uncertainty over when the recovery in housing construction will take place, and how strong this will be. In the immediate years ahead, the Finnish economy also has the potential to grow more quickly than anticipated if, for instance, agreement is reached in trade negotiations and the trade policy uncertainty dissipates. Investments in the green transition in Finland may also occur more rapidly than expected.

Table 1. Key forecast outcomes (1/2)

Percentage change on the previous year	2024	2025[f]	2026[f]	2027[f]
GDP	-0.1	0.5	1.5	1.6
Private consumption	-0.1	0.3	1.7	1.8
Public consumption	0.7	-0.2	-0.1	-0.0
Fixed investment	-7.1	0.4	4.6	2.9
Private fixed investment	-10.2	-2.5	4.2	3.8
Public fixed investment	7.4	11.5	5.7	0.2
Exports	0.1	1.9	1.7	2.8
Imports	-2.4	0.8	2.7	2.6
Effect of demand components on growth				
Domestic demand	-1.5	0.2	1.8	1.6
Net exports	1.1	0.5	-0.4	0.1
Changes in inventories and statistical error	0.3	-0.2	0.0	-0.1
Savings rate, households, %	2.8	3.1	2.9	2.2
Current account, % of GDP	0.3	-0.4	-0.1	-0.1

Key forecast outcomes (2/2)

	2024	2025f	2026f	2027f
Labour market				
Number of hours worked	0.2	-0.1	0.3	0.6
Employment rate (20–64-year-olds), %	76.7	76.1	76.2	76.4
Unemployment rate, %	8.4	9.2	9.0	8.5
Unit labour costs	-0.5	2.1	1.9	2.2
Labour compensation per employee	0.5	3.1	2.7	3.0
Productivity per employee	1.0	0.9	0.8	0.8
GDP, price index	1.4	2.0	1.7	2.3
Private consumption, price index	2.1	1.7	1.5	1.9
Harmonised index of consumer prices	1.0	1.7	1.4	1.8
Excl. energy	1.9	2.4	1.7	1.8
Energy	-8.0	-5.1	-1.7	1.7
General government, % of GDP				
General government balance	-4.4	-3.9	-3.8	-3.6
General government gross debt (EDP)	82.1	84.9	86.7	87.9

f = forecast.

Sources: Bank of Finland and Statistics Finland.

Operating environment: assumptions and financing conditions

The global economy is suffering as a result of the unpredictable trade policy of the United States. Uncertainty about the path of the global economy will remain elevated in the immediate years ahead. Weakening conditions in the global economy and uncertainty about the outlook are curbing growth in Finland's export markets. The financial markets expect interest rates to remain close to 2% in the years ahead. The Bank of Finland forecast is based on data available on 21 May 2025.

Global economy suffering from trade policy tightening

Concerns about the slackening performance of the global economy grew stronger in the course of spring 2025 in the face of the tightened and highly unpredictable trade policy of the US administration. At the beginning of April, the United States announced high import tariffs on nearly all its trading partners, including the European Union. These tariffs were to be imposed on top of any existing import tariffs. At the same time, the United States and China got into an open trade war.

The United States has since introduced various exemptions and postponements to the entry into force of the tariffs. On 9 April 2025, the US administration announced a 90-day postponement of the high country-specific import tariffs. During this transition period, a 10% tariff would be applied to all US imports of goods, except for imports from Canada, Mexico and China, and certain product categories.[1] An escalation of the trade war between the United States and China had then already taken place, with the two countries reciprocally imposing import tariffs well in excess of 100%, until the US administration on 12 May 2025 eased its tariff policy and announced a 90-day postponement also of tariffs on Chinese imports. During the postponement, a 30% tariff will be applied to US imports of Chinese goods. In late May, the United States announced it would impose a 50% tariff on goods imports from the EU effective from 1 June 2025, only to declare, a few days later, a suspension of the tariffs until July.

The Bank of Finland's forecast takes into account all announcements of US import tariffs and trading partners' retaliatory tariffs up to 21 May 2025. The forecast assumes that the US general 10% import tariff will remain in force permanently throughout the forecast period 2025–2027, after the 90-day transition period announced in April. A further assumption is that the EU will refrain from imposing retaliatory tariffs on the United States. Similarly, the general import tariff imposed by the United States on China is assumed to remain at 30% throughout the forecast period, and a re-escalation of the US-China trade war is not anticipated. China is assumed to retaliate by imposing a 10% tariff on imports from the United States.

Uncertainty about the way in which trade policy – and US foreign and security policy more broadly – will develop will gradually ease but nevertheless remain exceptionally elevated over the next few years. The alternative scenario of the June forecast (see: Trade war escalation poses significant risk for Finnish economy) explores the impacts of different assumptions of near-term trade policy on the global and Finnish economies. Geopolitical tensions and international conflicts increase uncertainty for businesses and consumers regarding the economic outlook.

Growth in world trade was sluggish in late 2024. However, the international goods trade started to pick up at the turn of the year (Chart 1). This was only temporary, as exporters and importers were anticipating the introduction high US import tariffs in spring 2025. The higher import tariffs in the international goods trade, together with elevated trade policy uncertainty, are weighing on global demand. The forecast assumes that growth in world trade will slow markedly in 2025 and 2026 and rebound in 2027 in step with a

1. According to the US announcement, these tariffs would be applied on top of the import tariffs that were in force on 2 April 2025.

gradual de-escalation of the trade war and dissipation of the uncertainty that followed in its wake (Table 2).

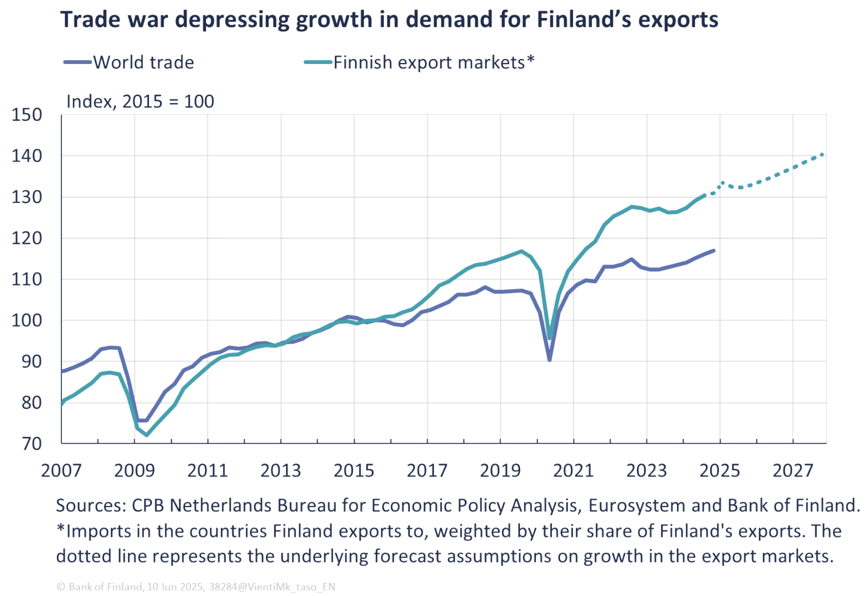
The trade war will cause a marked downturn in economic growth in the United States in particular, but will also have an adverse impact on the Chinese economy and the emerging economies in Asia. Consequently, global economic growth is expected to slow in 2025 and 2026. Towards the end of the forecast period in 2027, the global economic growth will recover as trade policy tensions ease and global demand rebounds (Table 2).

Euro area growth has been subdued during the past few years, and industrial production, in particular, has performed weakly for a long time. The trade war and uncertainty about the path of the global economy are weakening economic conditions, and the euro area economy is projected to grow fairly slowly in 2025. Growth in the economy will pick up slowly in 2026 and 2027 as uncertainty gradually fades (Table 2). In the immediate years ahead, euro area growth will mainly rest on domestic private consumption in an environment of sustained moderate inflation and strengthening household purchasing power. Financial markets also expect interest rates to stay lower than in previous years, thus supporting investment and consumption. The increase in defence spending and investment in infrastructure (see: How would higher defence spending affect Finland's economic growth?) in many euro area countries, notably Germany, will boost economic growth from 2026 onwards.[2]

Finland's export markets will therefore grow sluggishly in the years ahead (Chart 1). Demand for Finnish export products will strengthen slightly in the other euro area countries, as the trade policy tensions prompt a shift of trading to the EU single market. During the past few years, the United States has been one of Finland's most important trading partners, but US import demand has fallen due to the increase in tariffs. The trade war will erode Finland's external demand from countries outside the euro area, especially in 2025 and 2026. Towards the end of the forecast period, in 2027, growth in Finland's export markets will recover when global cyclical conditions improve.

2. More detailed information on the euro area macroprudential projections is available on the ECB website.

Chart 1.



The trade war is also reflected in commodities prices and exchange rates. Oil prices fell significantly in spring 2025, in response to weakening global demand for oil due to the trade war and heightened uncertainty. The forecast assumes that the price of oil will decline, in line with market expectations, to below USD 63 per barrel in 2026 in response to weakening economic conditions, reaching around USD 64 per barrel in 2027. Weak international demand will also weigh on other commodity prices. By contrast, the euro has strengthened against the US dollar in the first half of 2025, as the dollar has depreciated amid the twists and turns of US trade and economic policy. This has also brought about an increase in Finland's nominal effective exchange rate (Table 2).

Interest rates will remain low in the immediate years ahead

At its June meeting, the European Central Bank (ECB) decided to lower all three policy rates by 0.25 percentage points.[3] Effective from 11 June 2025, the deposit facility rate will be 2.00%, the interest rate on the main refinancing operations 2.15% and the interest rate on the marginal lending facility 2.40%. According to the ECB Governing Council, inflation in the euro area is currently at around the 2% medium-term target. The Governing Council will follow a meeting-by-meeting and data-dependent approach to determining the appropriate monetary policy stance especially in the current conditions of exceptional uncertainty. The interest rate decisions of the Governing Council will be based on an assessment of the inflation outlook in the light of the incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission.

Financing conditions eased further during the first half of 2025. In the spring, the 3-month Euribor declined to close to 2%. At the same time, the average interest rate on new housing and corporate loans has continued to decline (Chart 2). The average interest

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3. More detailed information on the ECB's monetary policy decisions is available on the ECB website.

rate on the stocks of household and corporate loans will continue to fall for some time yet, as lending rates are being adjusted to reflect the lower reference rates. The financial markets expect the 3-month Euribor to remain close to 2% in 2025 and 2026 and to rise to 2.2% in 2027 (Table 2).

According to the ECB's Bank Lending Survey, credit terms for corporate loans were eased in the first quarter of 2025, whereas credit terms for housing loans remained unchanged in the same period. There were no significant changes in Finnish banks' credit standards. Banks expect demand for housing loans to grow and demand for corporate loans to remain unchanged in the second quarter of 2025. According to the Business Tendency Survey released by the Confederation of Finnish Industries in April 2025, difficulties in accessing finance did not significantly restrict businesses' scope for expanding production capacity. However, financial problems were still relatively common in the construction sector.

Chart 2.

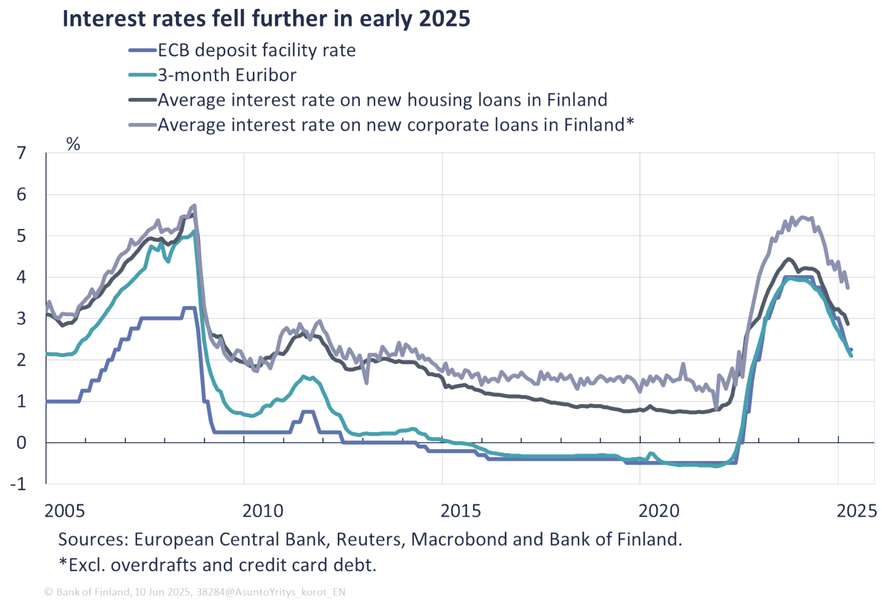


Table 2. Forecast assumptions

Volume change year on year, %	2024	2025f	2026f	2027f
Euro area GDP	0.8	0.9	1.1	1.3
World GDP (excl. euro area)	3.6	3.1	2.9	3.2
World trade (excl. euro area)[1]	4.2	3.1	1.7	3.1
	2024	2025f	2026f	2027f
Finland's export markets, % change[2]	2.2	2.6	1.7	2.9
Oil price, USD/barrel[3]	82.0	66.7	62.8	64.2
Raw material prices (excl. energy), USD, % change[4]	9.2	6.8	-0.4	0.6
Export prices of Finland's competitors, EUR, % change	0.3	0.9	1.8	2.3
3-month Euribor, %[3]	3.6	2.1	1.9	2.2
Finland's nominal effective exchange rate[5,6]	103.0	103.8	104.2	104.2
USD value of one euro[6]	1.08	1.11	1.13	1.13

[1]Calculated as the weighted average of imports.

[2] The growth in Finland's export markets is the import growth in the countries Finland exports to, weighted by their average share of Finland's exports.

[3]Technical assumption derived from market expectations.

[4]Technical assumption derived from market expectations. In the longer term, raw material prices are assumed in part to follow movements in global economic activity.

[5] Broad nominal effective exchange rate, 2020=100. The index rises as the exchange rate appreciates.

[6]Assuming no changes in the exchange rate.

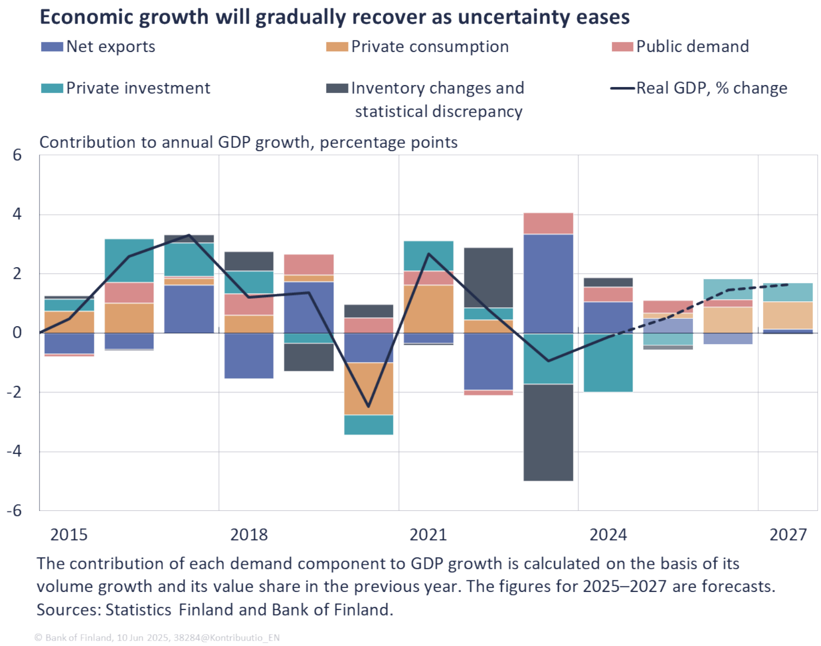
f = forecast.

Sources: European Central Bank and Bank of Finland.

Demand and the public finances

Growth in the Finnish economy will be slow in 2025, as the uncertain outlook for the global economy is dampening growth in exports and private investment, in particular. Consumers also remain cautious. Uncertainty over the direction of trade policy will remain high in the immediate years ahead. Growth in the economy will nevertheless gather pace little by little as uncertainty gradually eases, business and consumer confidence improves and demand in Finland's export markets strengthens. Inflation will be moderate and household purchasing power will rise. Despite the gradual strengthening of cyclical conditions, the general government finances will remain deeply in deficit.

Chart 3.



The contribution of each demand component to GDP growth is calculated on the basis of its volume growth and its value share in the previous year. The figures for 2025–2027 are forecasts.
Sources: Statistics Finland and Bank of Finland.

Private consumption will recover from uncertain times

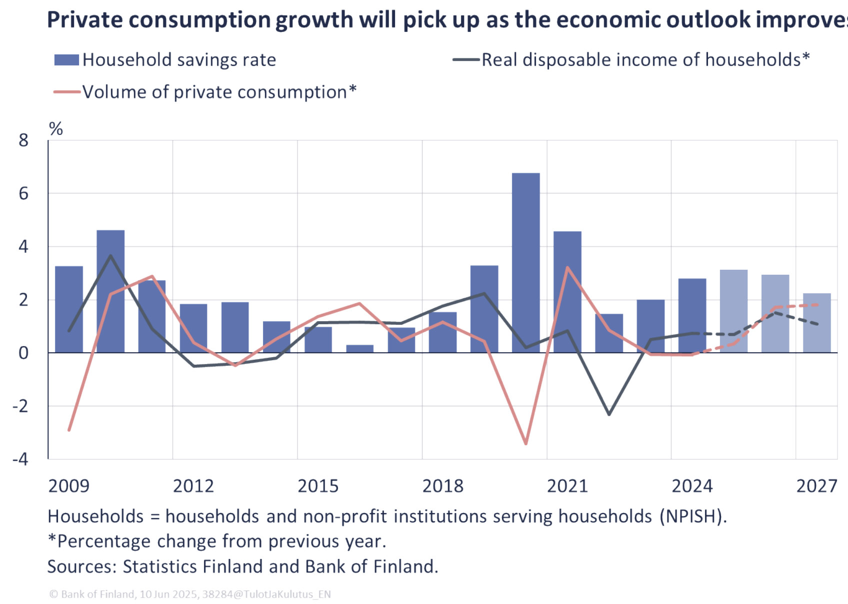
The purchasing power of households strengthened in 2024, as household disposable income increased and inflation was significantly lower than in the preceding years. Growth in households' interest payments also slowed markedly during 2024 as a result of declining market rates. This reduced the interest burden of indebted households. Private consumption was nevertheless very subdued, because consumer confidence has long been very weak.

According to the forecast, household purchasing power will strengthen in 2025, albeit at a slow pace (Chart 4). Employees' earnings will rise on account of the collective agreements negotiated during the spring, and inflation will be low. Households' interest payments will decrease, strengthening the purchasing power of indebted households, in particular. However, the increase in benefit income will slow due to the cuts made to social security and lower index-linked increases. Moreover, labour market conditions will still be weak in 2025, and the unemployment rate will remain high.

Despite stronger purchasing power, private consumption will barely grow in 2025 as consumers are still very cautious (Chart 4). There remains an elevated threat of unemployment, and uncertainty about the economic outlook is high. Consequently, the household savings rate will be high in 2025. Low inflation, wage increases negotiated during the collective bargaining round and declining interest payments will all enable the accumulation of savings.

Private consumption growth will gather pace in 2026 and 2027. Economic uncertainty will gradually dissipate and consumer confidence will improve. The negotiated collective agreements will raise employees' earnings, and inflation will remain moderate in the immediate years ahead. The unemployment rate will decline and labour market conditions will gradually improve, which will also bolster the rise in household income and the strengthening of purchasing power. Despite the growth in disposable income, households in the immediate years ahead will continue to save a relatively large share of their income. The real interest rate will remain positive throughout the forecast period, and this will encourage households to save. The savings rate will stay above 2% for the entire forecast period (Chart 4).

Chart 4.

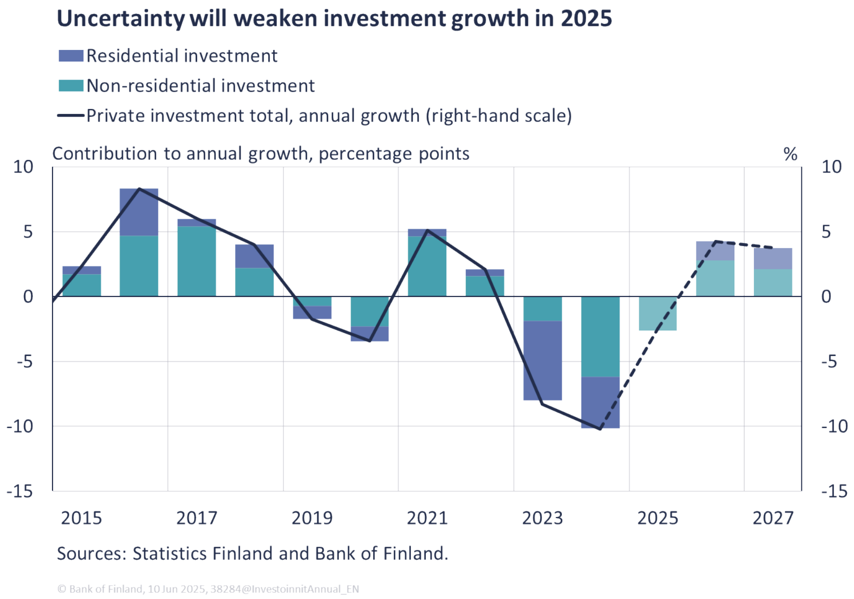


Slowdown in investment will gradually ease

Private investment fell sharply in 2024 in response to a contraction in both housing construction and non-residential investment. Residential investment has seen a historically large drop in recent years, falling more or less to the same levels as at the start of the millennium. Investment in the green transition has not advanced in recent years either.

Private investment will see a further slight decline in 2025 (Chart 5). The tariffs on foreign trade and the uncertainty over international trade policy will erode business confidence and weaken the economic outlook. This will also dampen the growth in non-residential investment. Residential investment will also be down year on year in 2025, although the lowest point has now been reached. Underpinning an upturn in housing construction will be the brisk construction of publicly supported rental housing, although this is expected to decline significantly in the immediate years ahead.

Chart 5.



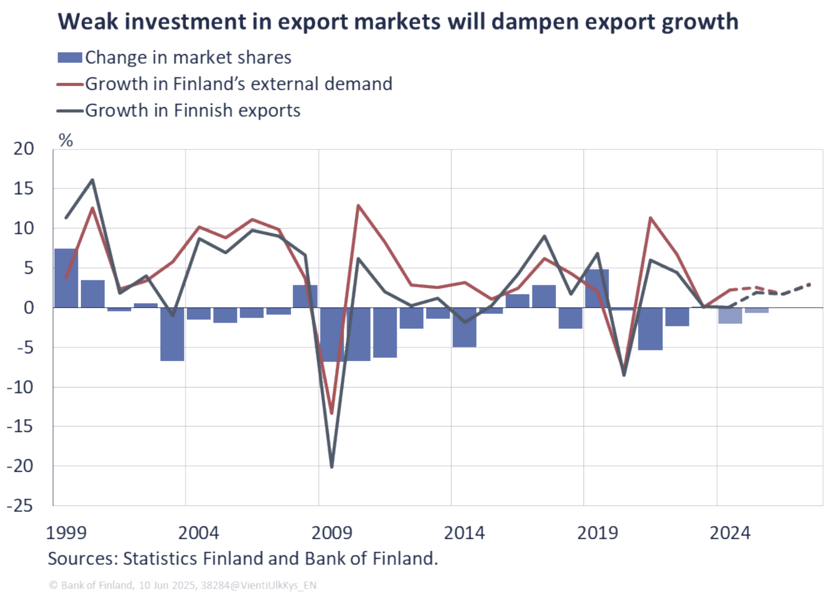
The slowdown in private investment will start to ease, however, when uncertainty gradually abates and business and consumer confidence strengthens. Housing construction will pick up gradually, and residential investment will grow in 2026 and 2027 (Chart 5). Although sales of new homes are still slow and there are plenty of unsold dwellings, the growth in household income and the gradual strengthening of consumer confidence will start to show in housing sales. In addition, with the fall in mortgage interest payments and in housing prices, households and residential property investors will become more interested in new home sales. There has already been a slight pick-up in sales of existing dwellings, but for new-build housing construction to recover, new home sales must pick up. The economic conditions for housing construction will only improve slowly, however, and despite all the positive developments, housing construction will remain far behind its peaks of 2021 and 2022.

Non-residential investment will also start to pick up in 2026, when growth in demand strengthens both domestically and in Finland's key export markets (Chart 5). Uncertainty related to trade policy tensions is expected to dissipate to some extent, and this will also slowly start to support the growth in non-residential investment. The lower level of interest rates than in recent years will also improve the attractiveness of investments. Non-residential investment will continue to grow in 2027. The growing need for energy will boost investment in the green transition. In addition, the defence equipment industry will increase its investments in the immediate years ahead.

Trade war will erode export growth

In 2024, exports were roughly unchanged from the previous year. Goods exports declined substantially and demand in Finland's export markets was weak. Service exports, in turn, increased, supporting total exports. Export industries lost market shares, however, as Finland's export markets grew faster than exports. Economic uncertainty depressed the growth in non-residential investment in Finland's main export markets, such as Germany. This hampered the growth in Finland's exports, which are heavily weighted towards capital goods and intermediate goods.

Chart 6.



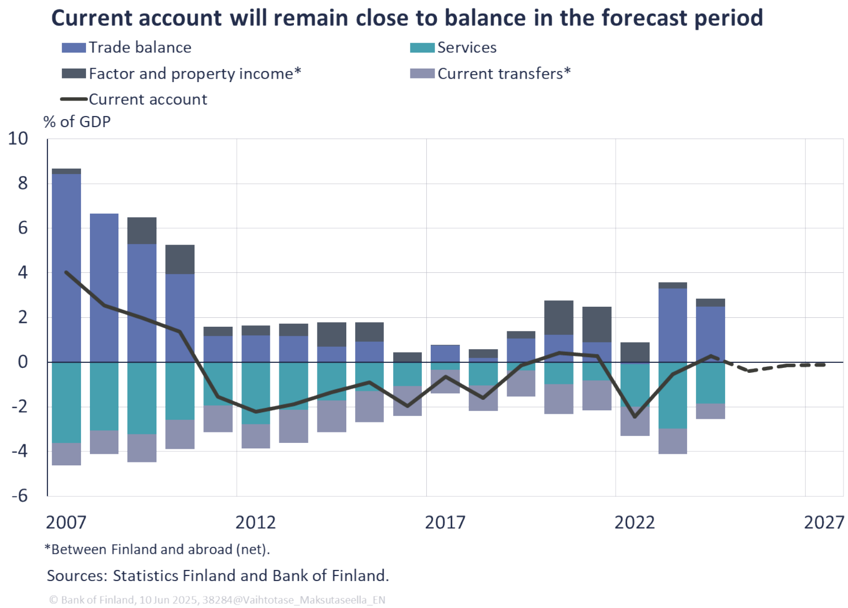
Finnish exports will recover slightly in 2025 after a weak 2024 (Chart 6). At the same time, lower interest rates will boost the profitability of investments in the euro area, and therefore strengthen Finland's exports centred on capital and intermediate goods. Trade policy tensions will remain elevated but will gradually ease towards the end of the year.

Nevertheless, exports will grow only slowly in 2026, because the changes in trade policy will reduce the demand for exports for some time. As the global economic outlook gradually strengthens, the demand for investment in the euro area and around the world will also pick up. This will bolster the growth in Finnish exports. Consequently, exports will strengthen in 2027, driven by growth in the export markets. Nevertheless, in the immediate years ahead, the tariffs on goods will remain above previous years' levels and uncertainty over the path of the global economy will remain high, even though trade policy tensions will ease slightly.

Imports contracted for two consecutive years in 2023 and 2024 and were weaker than exports. This was attributable to weak domestic demand and, in particular, a decrease in goods exports (as the production of export products involves a substantial amount of imported inputs). Imports will begin to grow in 2025, however, as domestic demand gradually picks up. The growth in imports will strengthen in 2026 and 2027. The recovery in private consumption and investment will boost imports of consumer goods, capital goods and services. The growth in exports, too, will push up imports, as the demand for imported inputs used in the production of exports increases. Defence-related procurement will also contribute to increased imports in the immediate years ahead.

The current account showed a slight surplus in 2024. The trade balance was substantially in surplus, but at the same time the services account was clearly in deficit. With the increase in imports, the current account will show a slight deficit again in 2025. In 2026 and 2027, the current account will remain almost in balance (Chart 7).

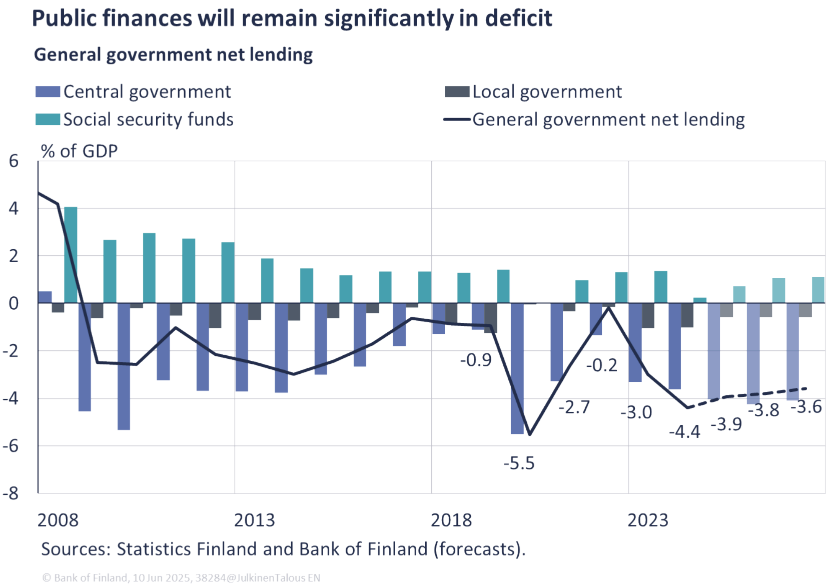
Chart 7.



Public finances are still deeply in deficit

The general government deficit deepened to 4.4% of GDP in 2024. Fiscal policy is being tightened in 2025 through the Government's fiscal adjustment measures, and the deficit will decrease by half a percentage point of GDP in 2025. After this, however, the improvement in the general government budgetary position will slow (Chart 8). During the forecast period, the general government deficit will not fall below the 3% of GDP reference value specified in the EU rules. In its mid-term policy review, the Government decided on tax reductions, the direct impact of which will ease the fiscal stance and weaken the general government balance in 2026 and 2027.

Chart 8.



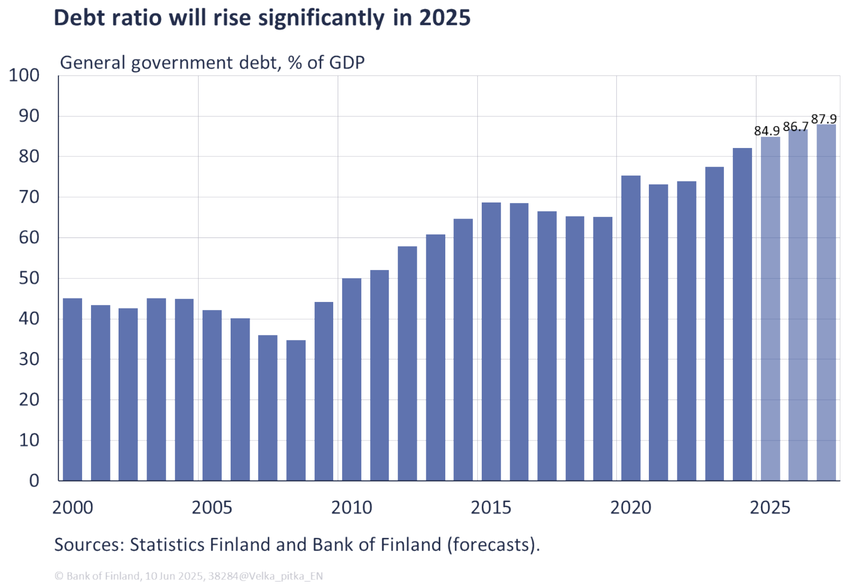
Central government finances will be under strain from the financing of health and social services and R&D expenditures, growth in spending on defence and preparedness measures, and the rising interest payments on central government debt. The procurement of fighter jets and corvettes by the Defence Forces is significantly pushing up public investment. These factors will keep the central government deficit at around 4% of GDP, despite the fiscal austerity measures targeting central government final consumption expenditure.

Final consumption expenditure of local government will grow on account of the fairly large wage increases agreed during the spring negotiations on collective agreements. At the same time, however, cost-saving measures are being implemented in municipalities and wellbeing services counties, and these will mean reductions in the number of employees and in the use of purchased services and temporary agency work. In 2025, the wellbeing services counties' finances will strengthen as a result of the first ex-post control of the funding for the sector, carried out to adjust central government funding for wellbeing services counties in accordance with their actual costs.

The expenditure growth of the earnings-related pension providers will slow due to index-linked increases being based on more moderate inflation. Transfers from earnings-related pension providers to central government will increase temporarily in 2027, when the State Pension Fund will make a one-off transfer of EUR 1 billion to central government finances. The expenditure of other social security funds will be driven up by higher unemployment expenditure. However, the cuts to social security already decided will significantly slow the growth in monetary social benefits paid.

The general government debt-to-GDP ratio will rise to 85% in 2025 and will climb further to 88% by the end of the forecast period (Chart 9). The amount of debt will be swelled by the large imbalance between revenues and primary expenditure and by the rising level of interest payments. The debt ratio will rise particularly strongly in 2025, which will also be attributable to the slow growth in nominal GDP. In addition, the level of recorded EDP debt[4] will rise due, for example, to the growth in the stock of ARA interest subsidy loans (for rental and right-of-occupancy housing).

Chart 9.



Supply and cyclical conditions

Finland's economy has faced new external shocks in circumstances where the domestic economy has not had time to strengthen properly. In the current year, 2025, resources are underutilised and the output gap remains negative. A clearer strengthening of the economy is not expected until next year, and growth in potential output is slow. The unemployment rate is high and will exceed the level of structural unemployment throughout the forecast period, 2025–2027. A strengthening of the economy will also improve employment after a time lag.

Labour market recovering slowly

The weak cyclical conditions have continued for some time and are still weighing on the labour market. The employment rate has declined from the record highs of 2022, and unemployment has increased. Cyclical conditions are slowly strengthening. The number of people employed has not decreased further in the first half of 2025 compared with the previous year. In the early part of the year, the number of new temporary lay-offs has also decreased and the reduction in hours worked has come to a halt. The unemployment rate, nevertheless, remains high.

The weak cyclical conditions have reduced the demand for labour, which has not yet started to recover. This is reflected in the very low number of job vacancies. The labour force participation rate has nevertheless remained high (see: Labour market flows run

4. EDP (excessive deficit procedure) debt refers to debt as reported under the EU's Stability and Growth Pact.

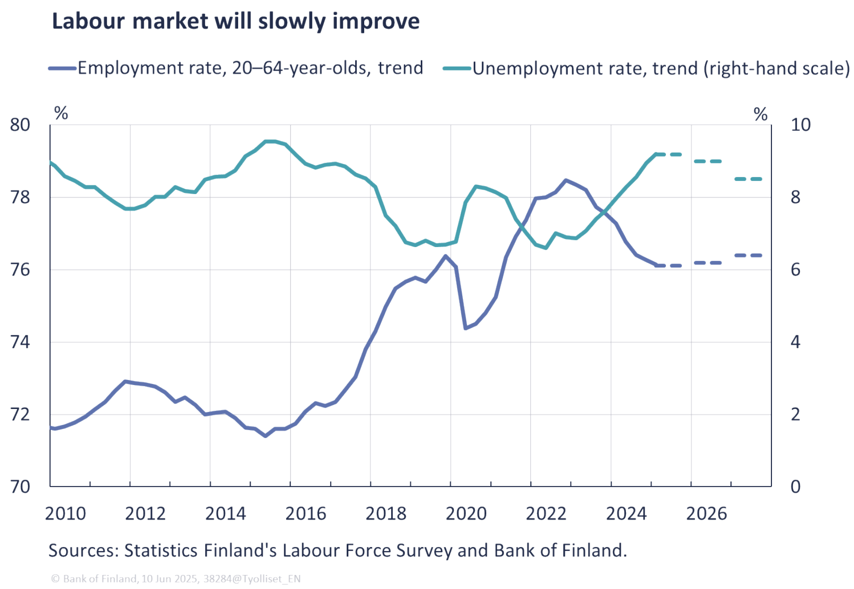
deeper – Participation has raised both employment and unemployment). The unemployment rate remains high, as there are an increasing number of people flowing into unemployment especially from outside the labour force, and also fewer unemployed people have been able to find work. Long-term unemployment has also increased. The current unemployment rate is estimated to be clearly above the level of structural unemployment.

At the beginning of the forecast period, the Finnish economy has faced new external shocks, and uncertainty surrounding the international operating environment is limiting the growth in labour demand. Labour demand in the construction sector is especially weak. Employment is starting to improve, but it will not reach its previous peak during the current forecast period. The gradual improvement in the economy will also slowly reduce unemployment. However, the improvement in unemployment will be slow and the unemployment rate is expected to stay above the level of structural unemployment throughout the forecast period, 2025–2027.

In 2025, the employment rate will decline slightly to 76.1% (Chart 10) and the unemployment rate will be 9.2%. The demand for labour will increase as cyclical conditions improve, and the employment rate will rise to 76.4% in 2027. Nevertheless, the employment rate at the end of the forecast period will not see a return to its 2022 high of 78%, since employment at that time was boosted by good cyclical conditions.

The unemployment rate will start to decline slowly as cyclical conditions improve, and in 2026 it will be at 9.0%. In 2027, the unemployment rate will still be 8.5%, which is above the level of structural unemployment. The public sector has seen strong employment growth in recent years, but this trend has now halted.

Chart 10.

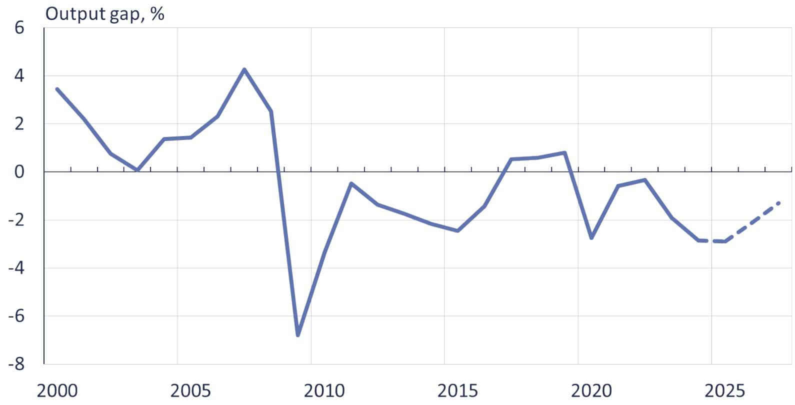


Economy will not enter more favourable cyclical phase until next year

The recovery in Finland's economy will be slow. The economy has faced new external shocks in circumstances where the domestic economy has not had time to strengthen properly. In 2025, the output gap will remain significantly negative, which means that economic resources will continue to be underutilised.[5] Next year, the economy will strengthen but remain weaker than previously estimated and the output gap will remain open. The economy will continue to recover in 2027. Economic growth will be stronger than usual, bringing the output gap closer to neutral (Chart 11).

Chart 11.

Cyclical conditions will improve slightly in 2026, but economic resources will continue to be underutilised



Output gap assessed using the Unobserved Components Model (UCM).
Source: calculations by the Bank of Finland.

The growth in Finland's potential output in the years 2025–2027 will be low, rising at an average annual rate of less than 1% (Chart 12). The growth in all production factors (capital, labour, total factor productivity) will be subdued.

Growth in investment, and therefore also in the capital stock, will be slow, especially in the early part of the forecast period, which will curb growth in potential output. A further increase in economic uncertainty will reduce the attractiveness of non-residential investment. With interest rates being lower than in previous year, this would normally encourage investment, but unfortunately high uncertainty in the global environment is curbing the investment appetite. Therefore, growth in the capital stock will strengthen only slowly towards the end of the forecast period. The crises of recent years have weakened growth in total factor productivity due to the cessation of trade with Russia, the reorganisation of supply chains and the use of more expensive inputs.[6] Higher

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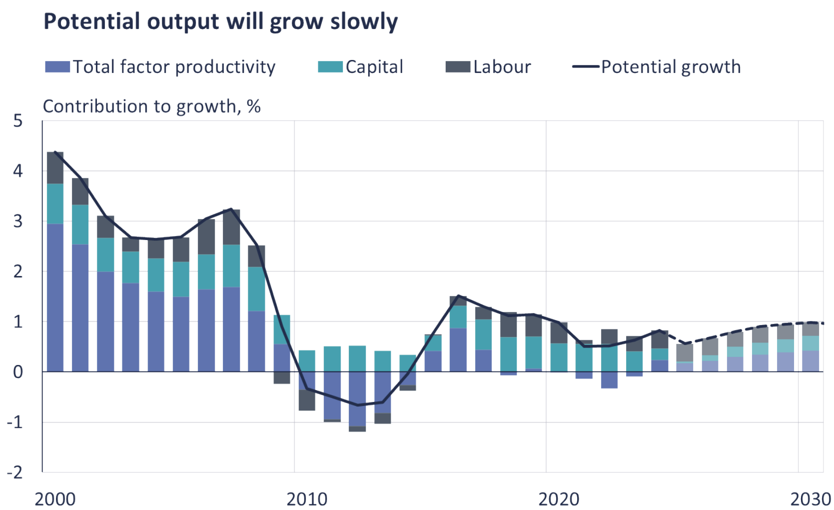
5. Potential output is the volume of GDP when all the inputs in the economy are in normal use. The output gap is the difference between the economy's actual and potential GDP. When actual and potential GDP are at the same level and are growing at the same rate, the output gap will be zero and the economic cycle is said to be neutral.
6. Higher and more volatile prices of energy may weaken potential output through various channels. See e.g. Deutsche Bundesbank (2022b) Impact of permanently higher energy costs on German potential output, Monthly

tariffs are exacerbating the situation by causing production losses due to inefficient reallocation of resources across different sectors and countries.[7] Weak productivity growth is also attributable to the fact that a majority of employment growth in recent years has not been in the private sector but in public services, where productivity growth is below average.

The labour supply is growing. After a long decline, the number of working-age people has started to grow in 2023 and 2024 due to increased immigration. According to Statistics Finland's population projection the working-age population will continue to grow in the future as a result of net immigration. This would support growth in potential output (Chart 12). However, the supply of labour will be weakened by employees working considerably fewer hours on average than before the COVID-19 crisis. Population ageing is increasing part-time employment, which weakens the prospects for growth in the average number of hours worked but also improves the participation rate. Additionally, the slight increase in structural unemployment, which is due to the prolonged weak economic cycle and subsequent unemployment, will reduce the importance of labour as a source of potential output.[8]

Chart 12.



The chart presents estimates of the growth in potential output (produced using the Bank of Finland's Unobserved Components Model) and the contributions of the different components.
Source: calculations by the Bank of Finland.

Crises hamper estimation of potential output

The economy has been hit by various different crises in recent years. This has led to uncertainty about the growth potential of the economy. The growth potential could alter if there are permanent changes in, for example, international trade tariffs, globalisation, production methods, energy prices, household behaviour or immigration.[9] Climate

Report, December 2022, p. 29 and the ECB's projections (ECB Bulletin 5/2022, Box 4).

7. See e.g. IMF (2020) Modelling Trade Tensions: Different Mechanism in General Equilibrium.

8. In estimating the potential output in the forecast period, a technical assumption is made in which the participation rate is set at the average level of the previous business cycle.

change is also causing uncertainty over the long-term prospects for growth.[10]

Russia's invasion of Ukraine and geopolitical tensions could weaken the growth potential of the economy in the long term if they reduce international trade permanently and lead to a less effective global division of labour. This would weaken productivity growth. Allocating resources to defence instead of more productive activities and education could also impede productivity growth in the long term. On the other hand, technological advances, such as the use of artificial intelligence, could boost productivity.

The future development of the capital stock will be affected by a number of factors which are pulling in opposing directions. The reorganisation of production and the possibility of extensive investments in the green transition could strengthen the capital stock. On the other hand, investments may be cancelled or postponed due to geopolitical uncertainties and uncertainty over trade policy, which would weaken the growth of capital stock in the short term.[11]

Part of the capital stock may also become obsolete should there be significant disruptions in the availability of energy. Furthermore, the removal of polluting capital stock will reduce the capital stock overall and require new investment to replace it with less polluting capital.

There is much uncertainty about the growth in labour input concerning, for example, how immigration to Finland will take shape and how immigrants will be integrated into the labour market. The increase in working remotely since the crises of recent years may have boosted the labour supply if this greater flexibility means that more economically inactive people are attracted to the labour market than before. The increase in the supply of labour would then strengthen potential output.

Prices and costs

Changes in taxation will push up consumer prices in 2025, but otherwise the rise in prices will be low. Despite a gradual recovery in the economy, inflation will remain below 2% annually throughout the 2025–2027 forecast period. Nominal earnings will increase in accordance with the outcome of the spring 2025 collective agreement negotiations, and real earnings will rise, too. Finland's cost competitiveness relative to the euro area will remain virtually unchanged.

Inflation subdued in the immediate years ahead

Inflation, as measured by the Harmonised Index of Consumer Prices (HICP), has in recent months been around 2%. The inflationary impact of the increases in consumer taxes has been approximately 1 percentage point, and so the overall impact on prices has been low in other respects. However, services prices have continued to rise at an annual rate of over 3%, due to higher prices for healthcare and passenger transport services. In

9. European Commission's Spring 2023 Economic Forecast, special issues.

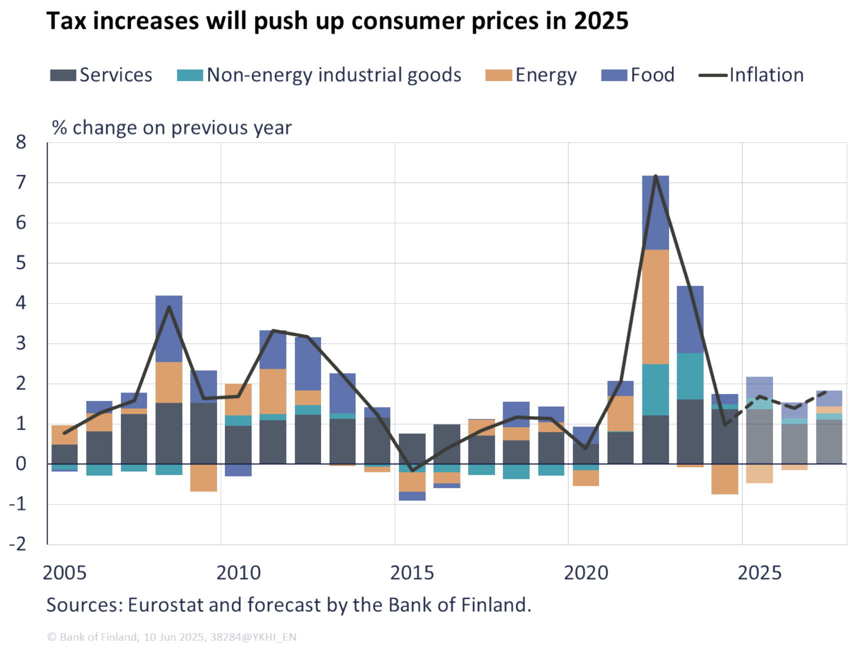
10. See the ECB's article on the impacts of climate change on potential output (How climate change affects potential output), ECB Economic Bulletin, Issue 6/2023.

11. Greater uncertainty and the high cost of energy will dampen the investment appetite.

contrast, the decline in energy prices that started in 2023 is still continuing. The lowering of interest rates on housing loans and consumer credit has slowed inflation, as measured by the national Consumer Price Index (CPI), which in recent months has been at about 0.5%.

According to the forecast, HICP inflation will remain low, averaging 1.7% for 2025 (Chart 13). Consumer confidence is still weak, which will dampen consumption demand and therefore also future price pressures. In the baseline scenario, the direct inflationary impact of the US tariffs is expected to remain small in Finland. Nevertheless, the announcements on tariff policy have increased uncertainty, which has spilled over to the world market prices of energy and commodities, and the decline in these prices has been amplified by the depreciation of the US dollar. The decrease in energy commodity prices has a direct impact on the consumer price of energy and also an indirect impact on the consumer prices of other commodities.

Chart 13.

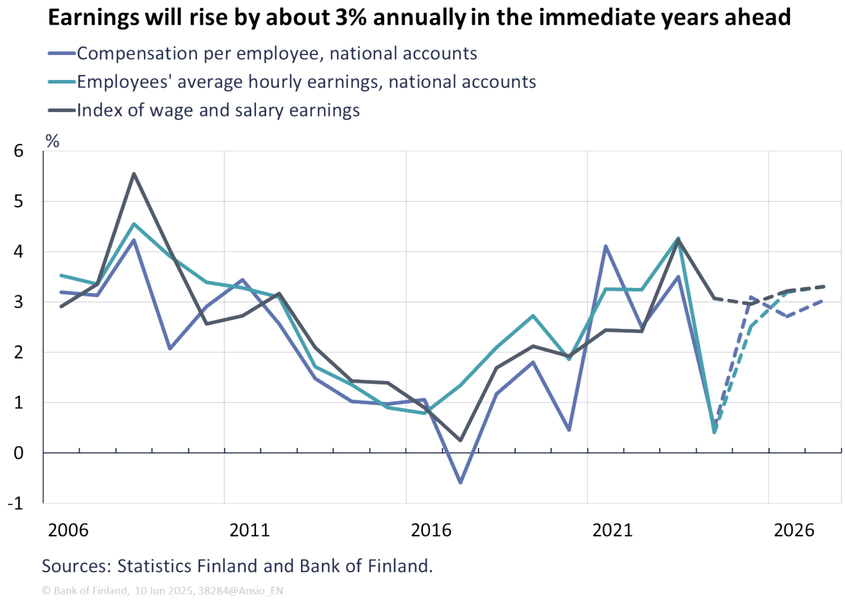


In 2026, the upward impact on prices resulting from the changes in taxation will largely fade, and inflation in Finland will slow to 1.4%. Wage increases will support household purchasing power and thus consumption demand, and they will also push up costs for companies. Both these developments will have an upward impact on inflation. The decline in the consumer prices of energy will come to a halt, and in 2027 they will start to rise based on the market assumptions for the price of oil. In 2027, the economy will continue to improve and the output gap will move closer to neutral. As a result, inflation will rise slightly, to 1.8%.

Collective bargaining agreements bring robust growth in earnings

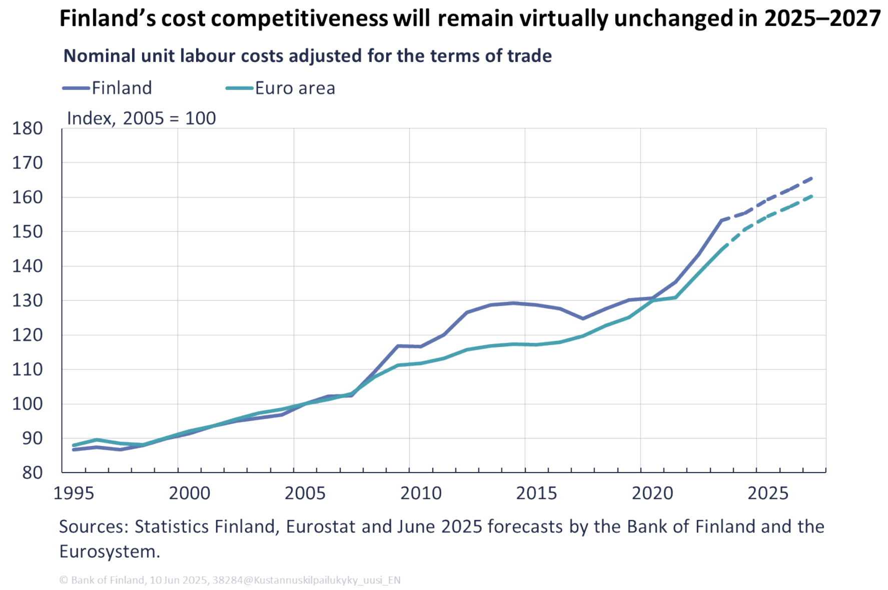
The collective bargaining agreements concluded in spring 2025 will largely determine growth in nominal earnings for the next three years. The agreements are mainly in line with the generally adopted level of pay rises, i.e. wages will rise by a total of about 8% in 2025–2027. Taking into account wage drift, the level of nominal earnings, as measured by the index of wage and salary earnings, is expected to rise by a total of about 9.5% (Chart 14). Average hourly earnings and compensation per employee, will both rise by approximately 3% per year in the next three years.

Chart 14.



Finland's cost competitiveness, measured using relative unit labour costs adjusted for the terms of trade, will remain virtually unchanged during the forecast years 2025–2027 compared with the euro area average (Chart 15). Both the cost of labour and labour productivity per employee will develop at virtually the same pace as the euro area average.

Chart 15.



Risk assessment

Finland's economic growth outlook is overshadowed by uncertainty, and the risks related to the growth forecast are predominantly on the downside. The risks regarding inflation concern the possibility that it will be lower than forecast.

The trade negotiations between the EU and the United States are continuing. While the outcome of these is still unknown, tariffs could remain clearly above the levels we have been used to. A worldwide tightening of trade policies would further slow the growth of global trade and growth in Finland's export markets. A more detailed assessment of the impacts of alternative trade policy developments on Finland's economy is available in the alternative scenario (see: Trade war escalation poses significant risk for Finnish economy).

The protracted uncertainty fuelled by the unpredictability of US trade policy poses an even greater risk to growth in Finland's export markets than tariffs. The unpredictable policy of the United States could also cause considerable fluctuations in the dollar exchange rate. A further weakening of the US dollar would alsohinder Finnish export growth. Uncertainty is further increased by geopolitical tensions in Ukraine and the Middle East. An escalation of the Middle East situation, in particular, could disrupt energy markets and companies' supply chains. If the easing of uncertainty takes longer than expected, the recovery in private consumption and investment will be delayed.

The aggressive power politics of the superpowers has also fuelled uncertainty in the financial markets. An escalation would increase the likelihood of a liquidity crisis or operational disruption, for example (see: Global upheaval – Financial stability at risk from power politics). The risks of disruptions in the financial markets increase further if the economic outlook remains subdued for a long time.

In housing construction, the lowest point in the cycle seems to have passed. However, there will be no substantial upturn in housing construction until households' greatest uncertainties recede, and it may take longer than expected for confidence to return. Household sentiment is especially affected by the deterioration in the labour market. Furthermore, construction companies still have plenty of unsold dwellings, which is slowing new starts. Forthcoming cuts to state-financed housing construction may also slow the recovery in housing production. A protracted downturn in the credit and real estate markets would also increase the risks of banks and investors.

The longer housing production remains low, the greater the cumulative need for new housing will be in the future. In the short term, this excess demand could then be reflected more in the prices of dwellings than in construction.

Reducing the general government deficit and turning the debt ratio around appear to be taking longer than expected. The Government aims to boost economic growth this year with a package of measures that includes substantial tax cuts. The effectiveness of these measures aimed at reducing the debt ratio is difficult to assess in advance. The continued accumulation of public debt could further weaken household and business confidence. The risk of higher government borrowing costs will also grow if investor confidence in the resilience of Finland's public finances weakens.

It is also possible that the Finnish economy will grow more quickly than forecast in the immediate years ahead. The pace of economic recovery at turning points in the business cycle has often been faster than initially expected. The recovery would be assisted if trade negotiations are concluded more smoothly than expected, which would reduce uncertainty and strengthen international demand.

Investment, in particular, may still provide a positive surprise. Investment plans for the green transition in Finland amount to hundreds of billions of euros, and the proportion of these that come to fruition may eventually be greater than expected. European investments in infrastructure and defence equipment may also provide more export opportunities for Finland than anticipated.

The risks surrounding the forecast for inflation are also predominantly on the downside. Trade policy and the eventual level of the new tariffs are also causing uncertainty regarding inflation. Tariffs will lead to increases in international prices, but if the uncertainty caused by trade policy continues, this will add to downward pressure on energy and raw material prices. This would also be transmitted to other consumer prices. Continued uncertainty would also slow economic growth, which would be another factor pushing down inflation.

Geopolitical tensions are increasing the risk of higher than expected inflation. When crises escalate, they can lead to spikes in energy prices.

Tags

forecast, GDP, employment, inflation, economic forecast, Finland