# European macroeconomic outlook in light of US policy changes

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# Main US policy changes and how they may affect Europe

1. Increased US **tariffs** a) make European exports less competitive, b) weakens US economic growth; and c) enhance import competition in European markets (e.g. diversion of Chinese sales from the US into Europe)

2. Intensified **geopolitical and policy uncertainty** affects the business climate and weights on enterprise investment

3. **US financial markets** may be affected by perceived incoherence between fiscal expansion and measures that hinder supply (tariffs, reduced foreign labour and foreign students, attacks on rule of law)

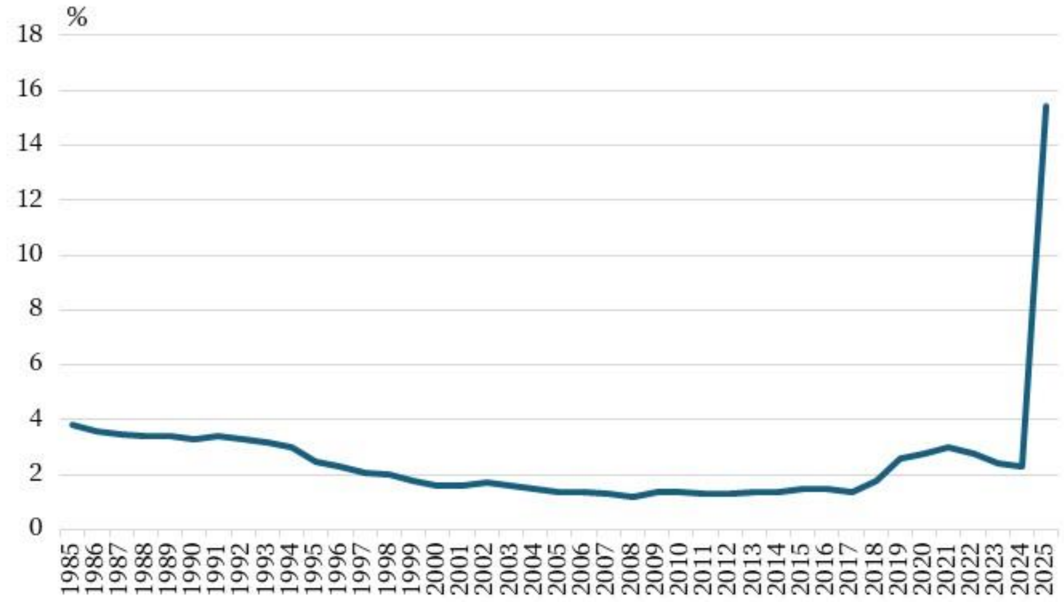
# The tariff escalation initiated by the US Administration, without precedent since WWII, has shaped the European economic debate

**Liberation day & proposed tariffs on US imports from the EU (under negotiation until 9-July)**

| | |
|---|---|
| Universal | 10% |
| Additional "reciprocal" | 10%-40% |
| Product-specific (Section 232 tariffs) | Steel: 50%.<br>Aluminum: 50%.<br>Auto: 25%.<br>Auto parts: 25%. |
| Potential future tariffs | Copper, trucks, commercial aircraft, jet engines, among others. |

Source: Bertoldi and Buti (2025). Note: These figures are cumulative and add up to those in vigor in end-2024. The universal tariff must be added to the reciprocal tariff.

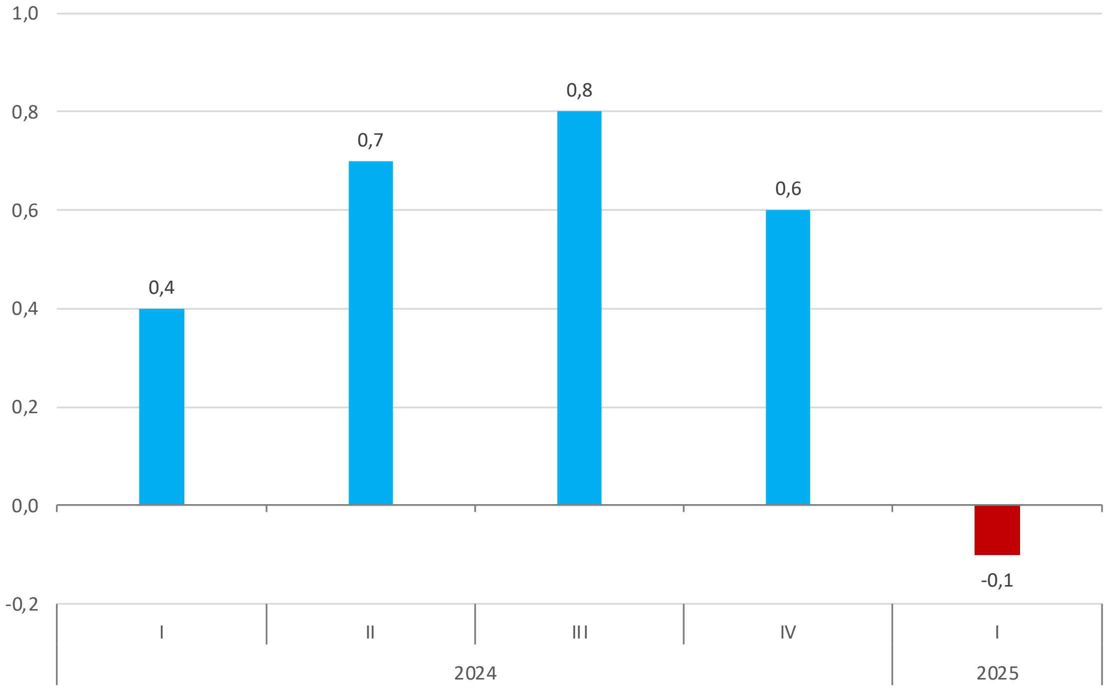
**US effective tariff rates**




Source: OECD.

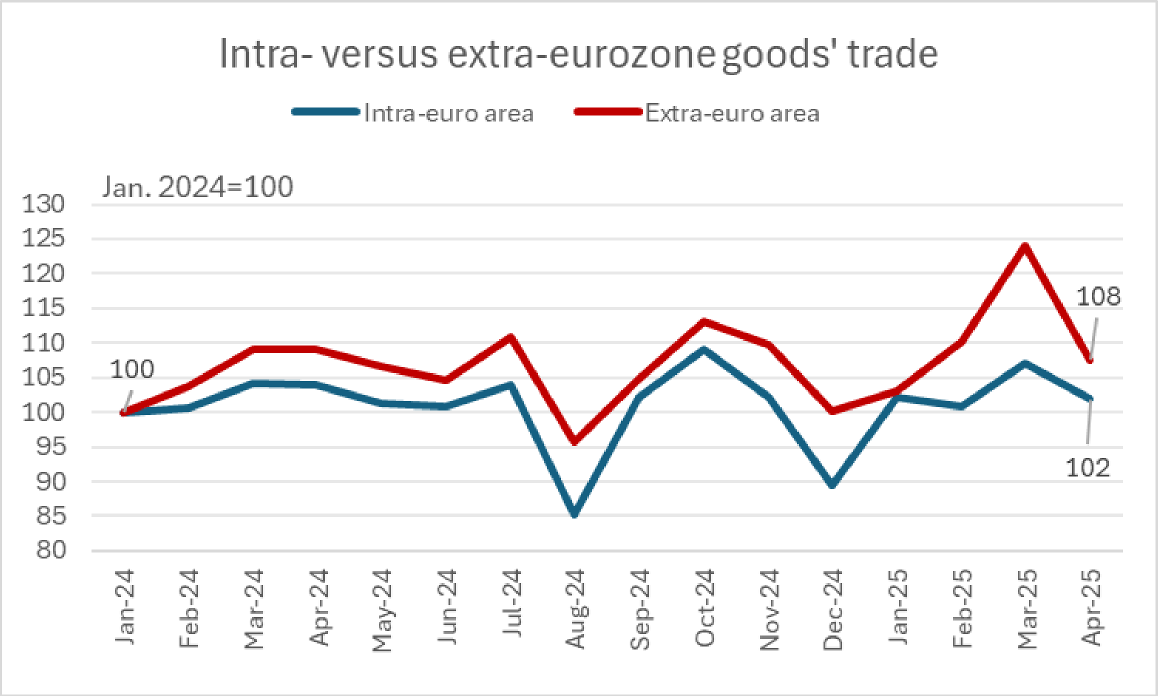
# Following a sharp rise in “advanced” deliveries to the US in March, Eurozone exports have registered a significant drop


US quarterly GDP growth




Source: Eurostat and BEA.

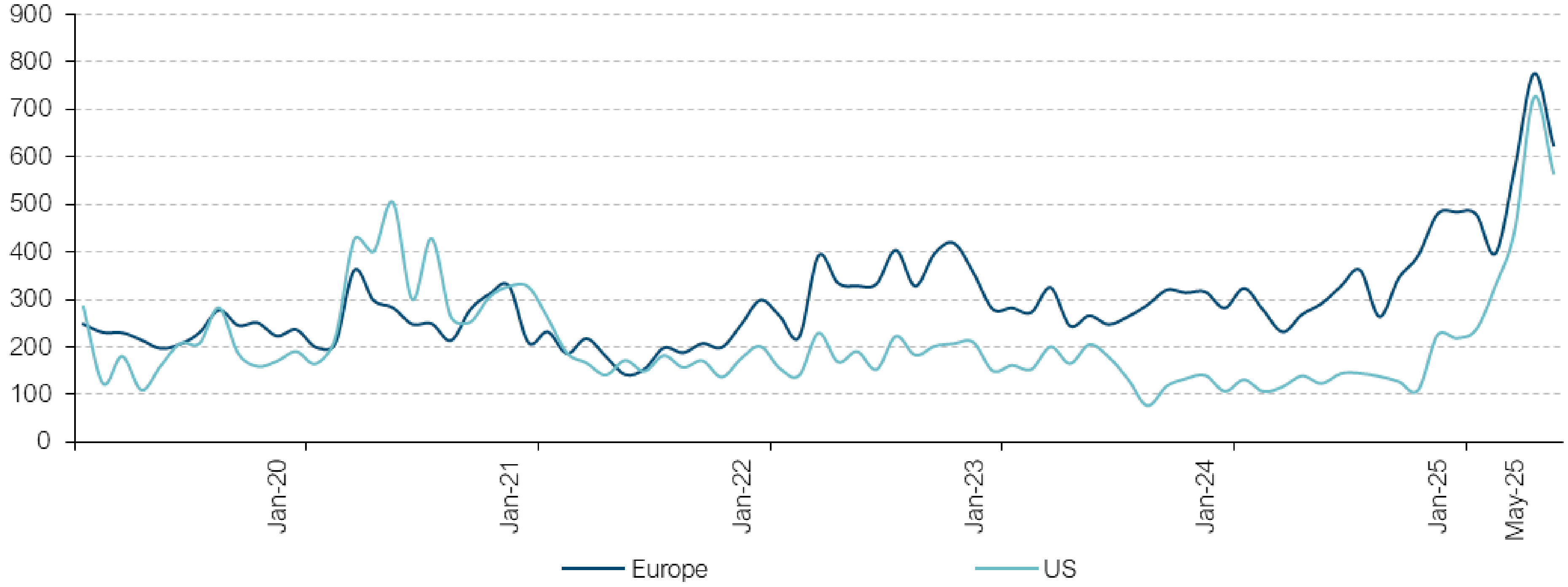
# Two trends amplify the impact of US tariffs:
# a) Eurozone imports from China are trending upward & exports to China tend to decline
# b) The internal EU market is weak, so cannot compensate for global trade tensions


Source: Eurostat.

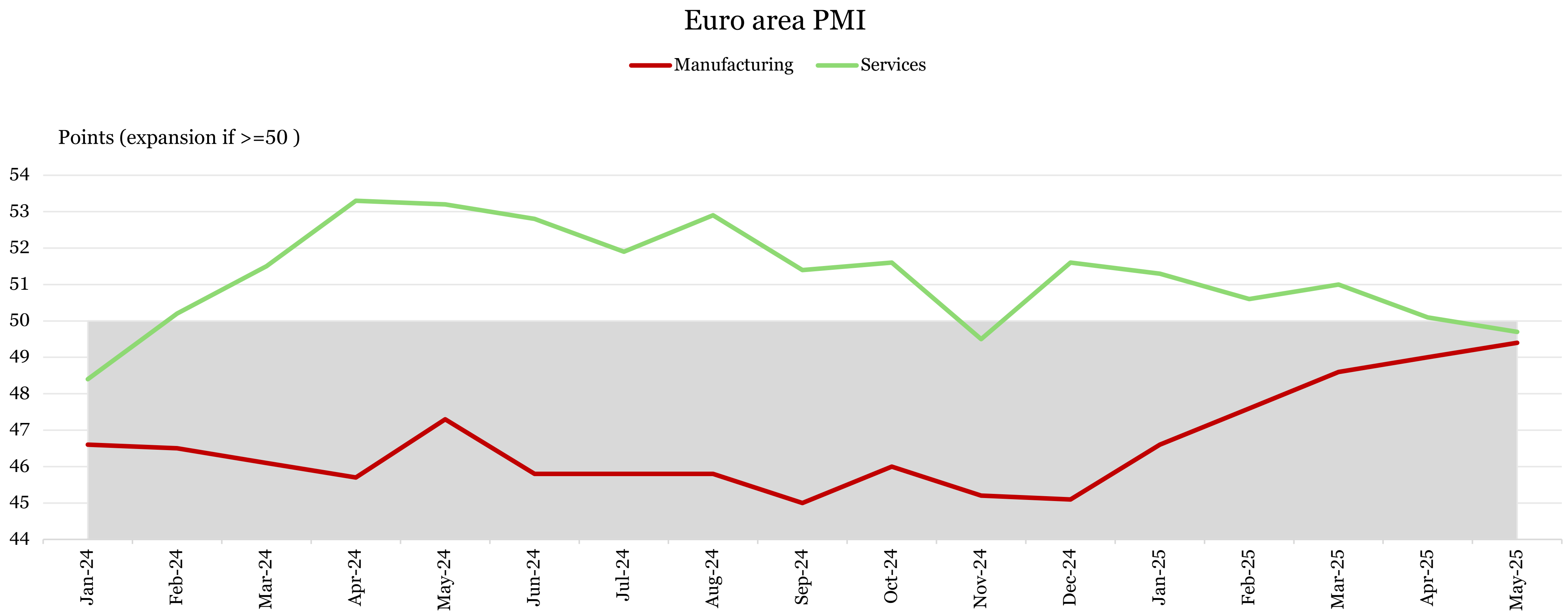
# Policy uncertainty has increased significantly

Economic Policy Uncertainty Index




**Source:** www.PolicyUncertainty.com.

# Business surveys point to both services and manufacturing in contractionary territory (though with a less negative picture in manufacturing sentiment, driven by Germany)




Source: S&P Global. Note: Purchasing Managers' Index (PMI) where values above 50 indicate expansion. Grey area represents contraction territory.

## So far, the Eurozone economy is resilient. However, growth remains weak and is mainly sustained by consumption (investment is subdued)

## Net exports “explained” only 8% of GDP growth during the first quarter of 2025, down from 59% during 2023-2024

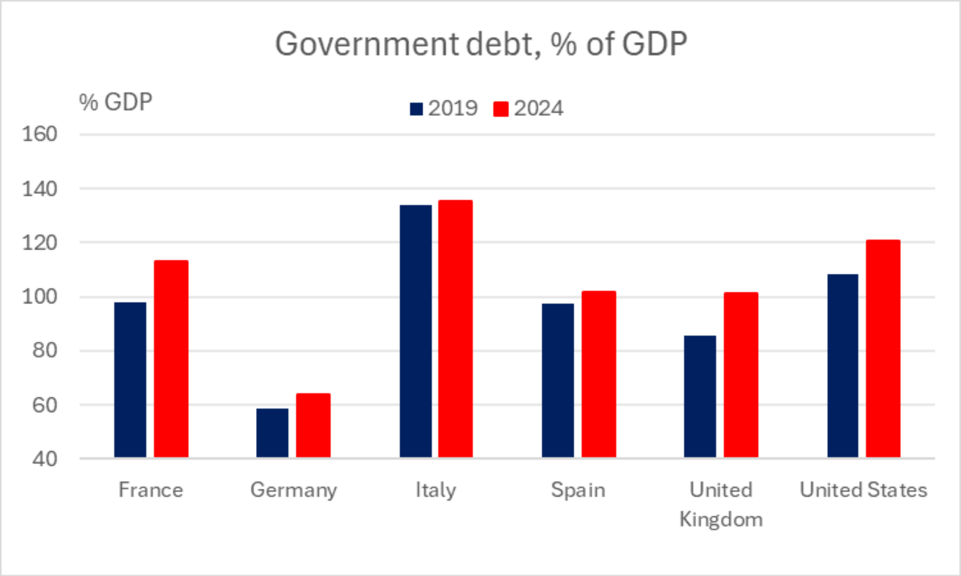
| **Contributions to average annual GDP growth in 2023-24** | | |
|---|---|---|
| | | |
| | *in p.p.* | *% of total* |
| Consumption | 0,8 | 41% |
| Investment | -0,5 | |
| Net exports | 0,4 | 59% |
| | | |
| **GDP** | **0,7** | **100%** |

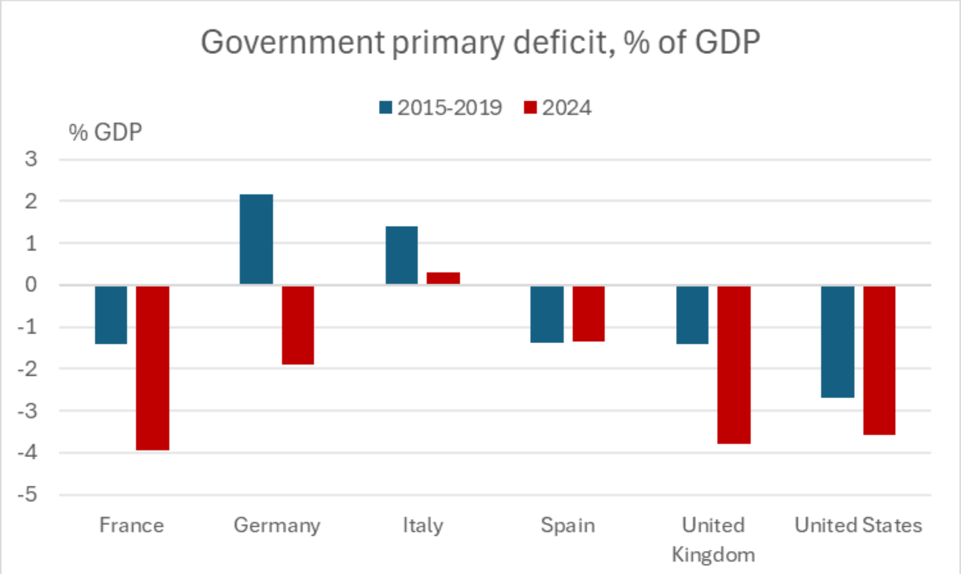
| **1st quarter of 2025** | | |
|---|---|---|
| | | |
| | *in p.p.* | *% of total* |
| Consumption | 0,13 | 92% |
| Investment | -0,01 | |
| Net exports | 0,02 | 8% |
| | | |
| **GDP** | **0,25** | **100%** |

Source: Funcas based on Eurostat (1st quarter is without Ireland).

# A major fiscal boost is in the making in the US and, to a lesser extent, in those European countries that have fiscal space

- United States: "One Big Beautiful Bill" (still in Senate)
  - Tax cuts & other tax provisions: 12.9% 2024 GDP ($ 3.8 trillion)
  - Deficit funding: 10.2% 2024 GDP ($2.9 trillion)
- Germany Merz plan
  - Infrastructure fund: 11.6% 2024 GDP (€500 bn).
  - Defence spending over 1% of GDP, exempt from 'debt brake'.
  - Länder can issue new net borrowing up to 0.35% GDP annually
- European Union
  - NATO proposed increase in defence spending up to 5% of GDP
  - **Escape clause (France, Spain, Italy, and the Netherlands have not requested its activation)**
    - Only on defence spending.
    - Up to 1.5% GDP annually.
    - For a period of four years.

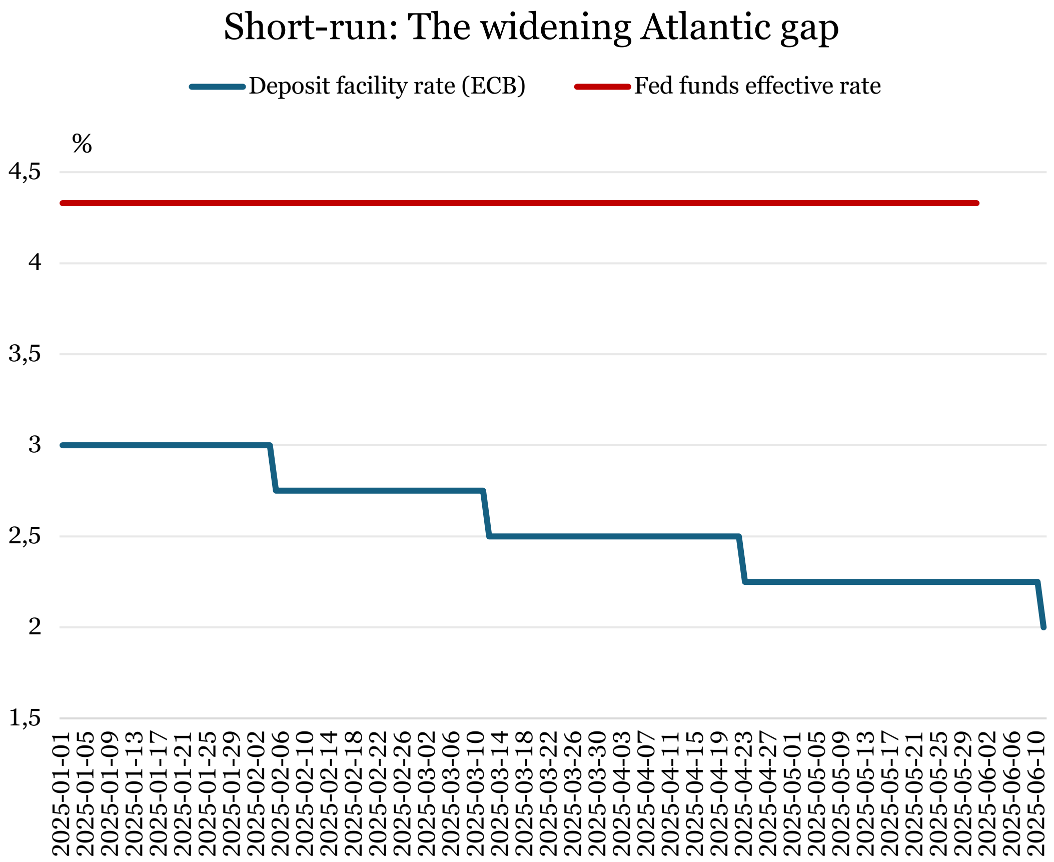


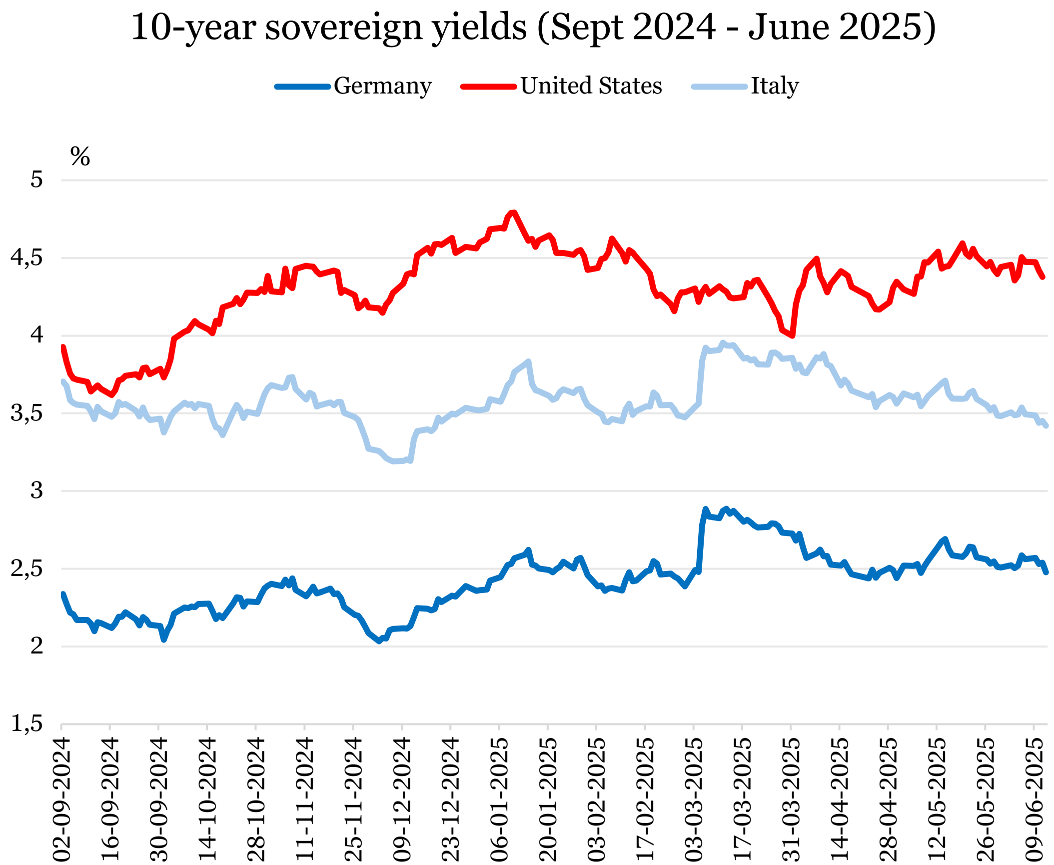

Source: IMF

# Inflation in the Eurozone reached 1,9% in May (2,3 core), compared to 2,4% in the US (2,8% core)

# The Fed is pausing while the ECB has cut rates




Source: European Central Bank and Fred St. Louis.



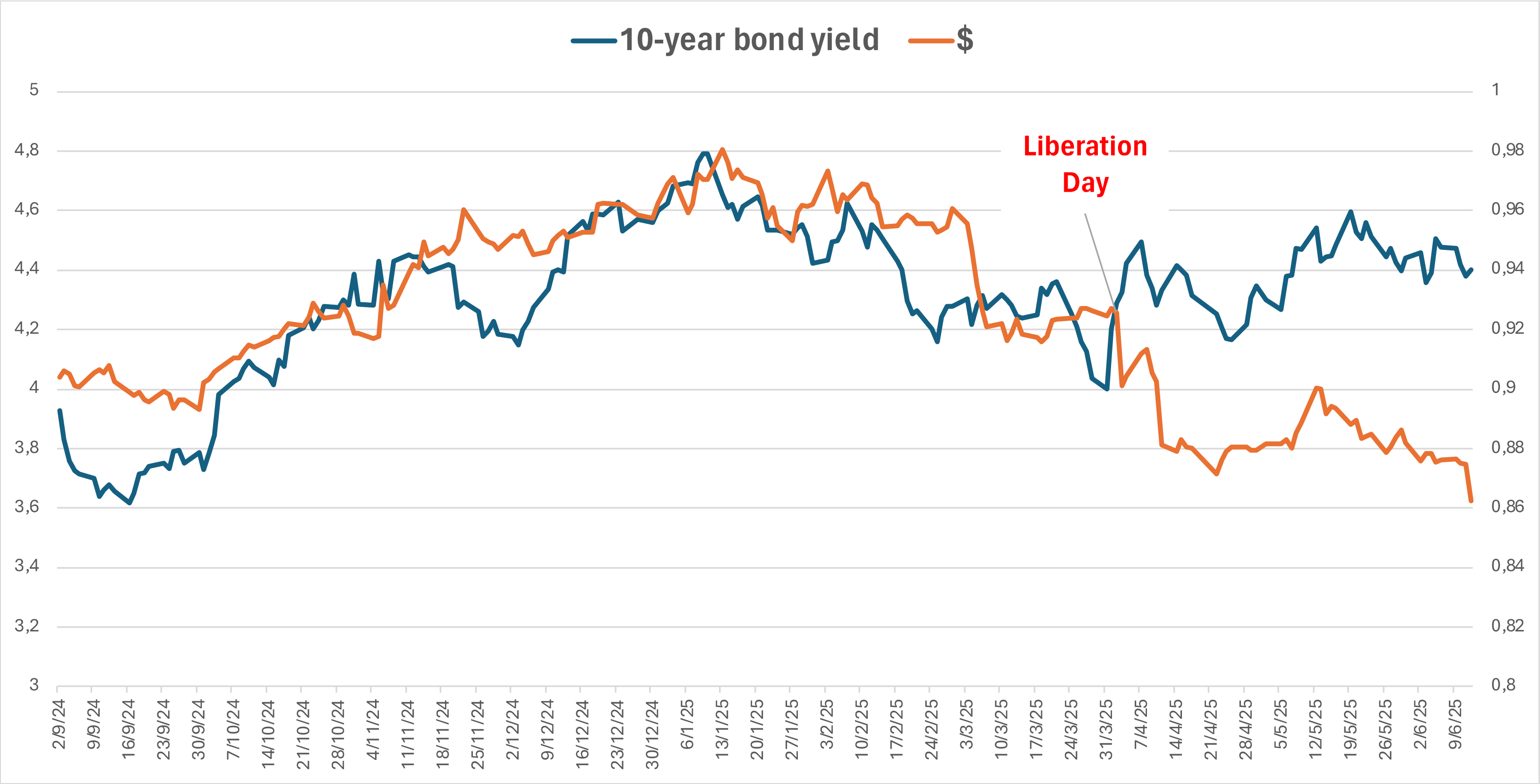

Source: Investing.com. Last observation: 12th June 2025.

# Financial conditions seem more favorable in the Eurozone than in the US

| COMPARISON OF AVERAGE INTEREST RATES | | |
|---|---|---|
| Category | Euro Area | United States |
| Mortgage Rate (30-Year Fixed) | - | 6.81% |
| Mortgage Rate (15-Year Fixed) | - | 5.92% |
| Mortgage Rate (Composite New Loans) | 3.32% | - |
| Mortgage Rate (Floating Fixation) | 3.92% | - |
| Mortgage Rate (>10Y Fixation) | 3.10% | - |
| Credit Rate to Non-Financial Firms (Composite) | 3.93% | ~7 to 9% |
| Credit Rate to Households (Consumer Loans) | 7.52% | - |
| Credit Rate to Households (Personal Loans, 700 FICO) | - | 12.26% |

Source: Vitor Constancio.

# Since Liberation Day, the euro has appreciated vis-à-vis the dollar, even though the US yield increased, suggesting a change in portfolio investment flows




Source: ECB.

## Outlook under a mild scenario (Robert Armstrong “TACO” case)

The latest ECB projections are for Eurozone GDP growth of 0,9% this year and 1,1% in 2026, compared to around 1,2% and 1,4% in a no trade war baseline

Inflation would be contained at 2% this year and 1,6% in 2026, slightly less than in a no trade war baseline

This is possible only if a) reciprocal tariffs are not applied, and b) and financial markets contain to some extent US policy uncertainties (both trade and fiscal)

Though negative in the short term, this scenario would include a gradual rebalancing of capital flows in favour of Europe: an opportunity which, to be seized, would requires reforms

## Outlook under a prolonged uncertainty scenario (No TACO)

ECB estimates that growth would be 0,5% in 2025 and 0,7% in 2026, while demand depression would ease inflation further

This is based on the assumption that a) reciprocal tariffs are applied, and b) and financial markets do not really act as a buffer against US policy uncertainties

Though the ECB does not dig into the full implications of the adverse scenario, the question arises as to whether US financial stability would be maintained and the implications for Europe

# Concluding remarks

- US policy changes represent a twin demand and uncertainty shock to the European economy
- This affects the short-term outlook particularly for business investment (though less than in the US, which also faces supply-cum-credibility shock)
- Markets perceive greater policy credibility, offering room for manoeuvre to both the ECB and fiscal policy, particularly in low-debt countries
- The deepening of the single market and removing barriers to financial fragmentation and investment would boost the medium-term outlook

Thank you for your attention

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