

Diverging allies face stormy waters

Europe's dilemma one year after Trump's re-election

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Von der Leyen and Trump in Turnberry, Scotland: The Art of the Deal?

One year after Trump's second election victory, Europe is facing a harsher version of **"America First"**. This time, transatlantic relations are defined as much by **aggressive action** as by confrontational rhetoric. The US doubles down on economic **protectionism**, industrial **nationalism**, and the **weaponisation** of trade and regulation. Brussels reacts with caution and pragmatism trying to strike the right balance between **appeasement** and **confrontation**. The result: a strategic polarization between allies who still share values but increasingly **diverge on interests** in times of growing geo-economic tensions.

According to Trump, **'tariffs'** is not only "the most beautiful word in the dictionary" but are also his most important tool when dealing with trading partners. One of his main concerns is the EU's **"unfair" trade surplus** in goods, while conveniently ignoring Washington's corresponding surplus in services, which partially offsets the overall imbalance. Furthermore, even the EU's goods surplus disappears when trade in pharmaceuticals, which is fundamentally shaped by US tax incentives for offshoring, is ignored. In response to Trump's erratic threats, the EU refrained from retaliatory actions and instead advocated for a **negotiated compromise**. The EU managed to prevent a full-scale tariff war by concluding the so-called **Turnberry Deal** on 21 August 2025. The legally non-binding agreement grants the US **free market access** for industrial goods while most European products face a **15% tariff**, including cars. Furthermore, the EU commits to purchasing US energy products worth \$750 billion by 2028 and makes indirect concessions regarding the application of the CSDDD, CSRD, and CBAM regulations. The mutual tariff dispute on **steel and aluminium** remains unresolved for the time being. The deal is **asymmetric** and represents a significant setback relative to previous conditions. Nonetheless, as of now it succeeded in **preventing a more damaging outcome** and secured a **comparatively advantageous arrangement** relative to other countries.

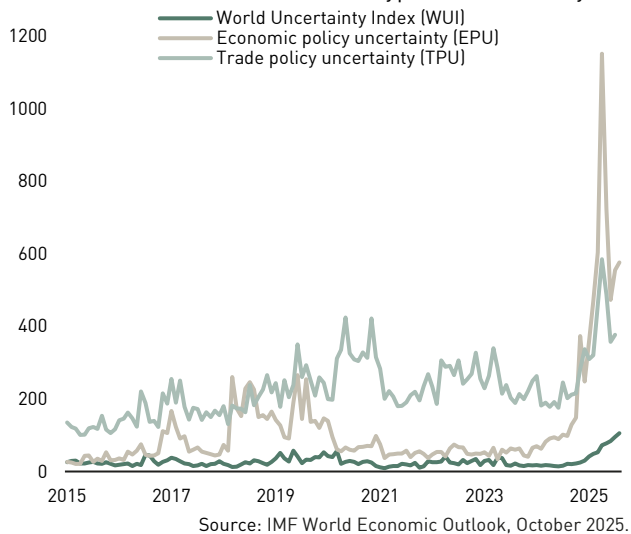
Trump's **industrial strategy** focuses on **reshoring**, **deregulation**, and **technological leadership**. The EU, however, struggles to agree on **common industrial priorities** and faces difficulties mobilising substantial levels of **public and private investment**. Fragmented **capital markets**, burdensome **red tape**, high **energy costs**, and complex governance impede European **productivity and growth**. This applies especially to critical sectors such as **artificial intelligence**, semiconductors, quantum computing and cybersecurity. Meanwhile, Beijing's relentless rise on the global stage further complicates the picture. Both the US and the EU regard **China as a systemic rival**, yet their approaches diverge. Washington combines high tariffs and strict export controls with aggressive foreign investment screening, whereas Brussels oscillates between active engagement and targeted trade defence measures. The **EU's industrial policy**, shaped by its **internal market logic and decentralised fiscal policy**, aims to achieve **sovereignty through coordination and regulation**. However, this approach leaves Europe **vulnerable** to the more unilateral, financially strong, and coercive measures by the US and China.

Europe's push for **digital sovereignty** - exemplified by legislative frameworks such as the Digital Services Act - reflects a desire to set its own rules and standards in **data governance**, privacy, and platform regulation. While the White House views some of these initiatives as regulatory overreach and unfair to US companies, the Berlaymont argues that such frameworks are necessary to preserve **democratic values** and hold digital multinationals accountable. At the same time, **security cooperation** remains vital. The war in Ukraine underscores Europe's dependence on the US and Trump's transactional approach to alliances fuels uncertainty in Brussels. The **intersection of technology and security** - from 5G networks to dual-use exports - highlights the growing complexity of maintaining a united front. Yet it is precisely this united front that is essential for upholding political confidence and economic competitiveness within the stormy international waters. Otherwise, Europe is **caught in a strategic dilemma between accommodating US demands and fighting unfair Chinese practices**.

Indicators to watch

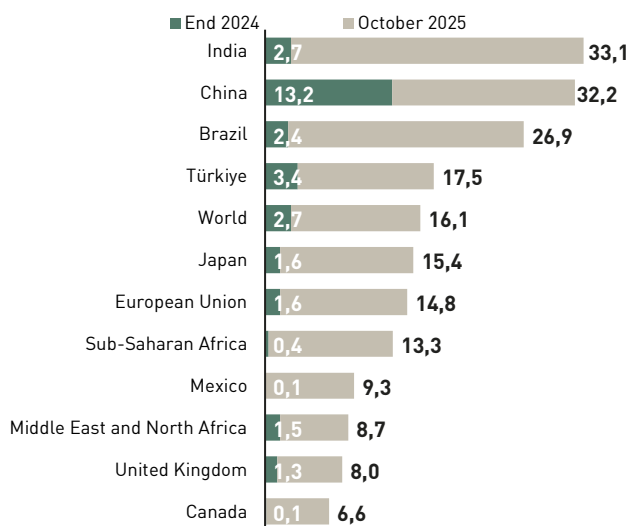
Measures of uncertainty

Indices based on media attention to types of uncertainty



US Effective Tariff Rates by Country or Region

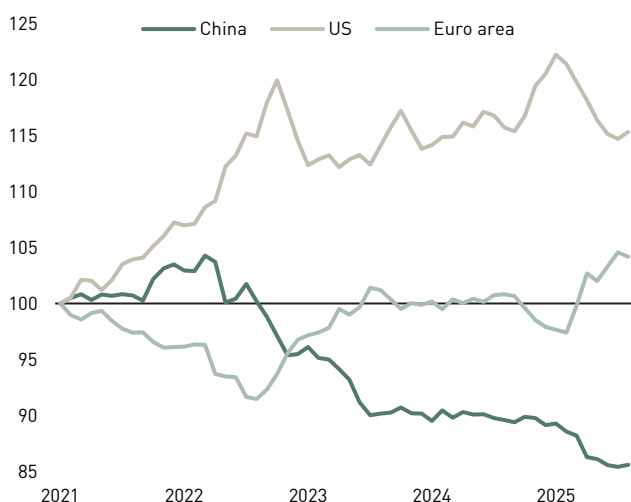
In %



Source: IMF World Economic Outlook, October 2025.

Real effective exchange rates (REER)

Index: Jan. 2024 = 100, CPI-based deflator



Source: IMF Data Portal, REER = trade-weighted real value of a currency.

Uncertainty measures have receded from their peaks

Rising uncertainty has emerged as a defining feature of the 2020s, following the pandemic, Russia's invasion of Ukraine and, most recently, Donald Trump's re-election as US President. The latter's erratic trade policies caused a sharp spike in uncertainty measures in 2025, reaching record highs around the time of the "reciprocal" tariffs announcement in early April. Although these measures have since eased, they remain above pre-2024 levels and therefore many companies will continue to take a "wait-and-see" approach. Despite the elevated policy and trade uncertainty, the world economy has proven more resilient than anticipated. As of October 2025, the IMF is forecasting GDP growth of around 3.2% in 2025 and 3.1% in 2026. While this represents a cumulative downgrade of 0.2 pp since the forecast a year prior, the world economy does not (yet) drift into recession territory.

Tariffs have ended up lower than feared on April 2nd

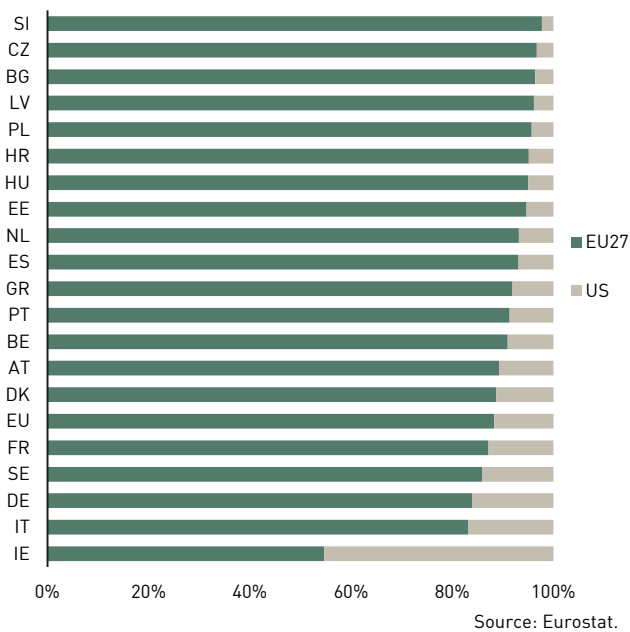
Although the tariffs announced on April 2nd ('Freedom Day') turned out lower than expected, they remain significantly higher than at the start of the year, when an effective tariff rate of 10% was considered the worst-case scenario – compared with the actual policy rate of 16.1% in October 2025. An additional 6 pp may not sound like much, but marks the difference between a 270% and a 500% increase. Surprisingly, the tariffs also appear to contradict geopolitical objectives: India – a key US ally in the Indo-Pacific – faced the largest tariff hike, while tariffs on China remained essentially unchanged from pre-April 2nd levels and are even set to decline by 10 pp following a meeting between Trump and Xi. Although enthusiasm for the deal has been muted, following what some have termed Europe's "Summer of Surrender", the EU has secured relatively favourable tariff rates, with an effective rate around 1.3 pp below the global average.

The US-dollar has merely returned to its 2024 level

Tariff hikes usually go hand in hand with a stronger domestic currency, so this year's USD weakness has been surprising. When a country makes imports more expensive, trade flows typically adjust, and the exchange rate tends to rise. With a floating exchange rate, steady monetary policy, and – apart from China – little tit-for-tat on trade, the dollar's decline most likely reflects investors reallocating capital away from the US amid doubts about its future growth prospects. But to put this into perspective: even after the recent drop, the dollar is only back to its 2024 level. By contrast, the far bigger real depreciation story is China. The yuan's real effective exchange rate has fallen by almost 15% since early 2021, making Chinese goods cheaper abroad. This is a key reason why China's trade surplus became so large – and why it poses a threat to Europe's industrial base at a time when US demand for EU goods seems set to decline.

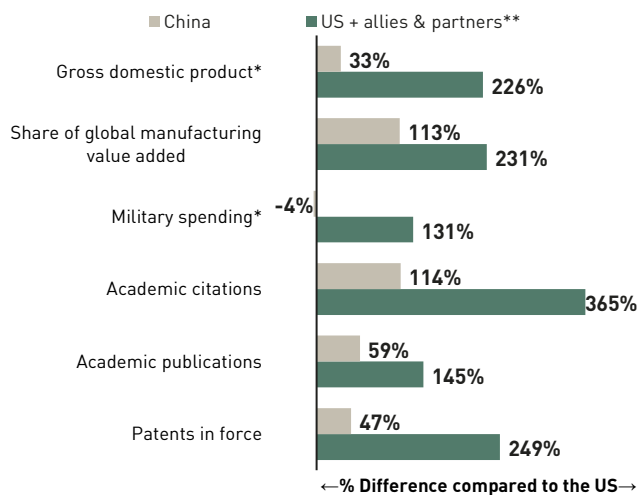
Share of exports to other EU member states vs. the US

In %, 2025



China vs the US and allies across key economic metrics

In % of the US level



Source: NYT, *adjusted for differences in purchasing power. **Canada, India, Japan, South Korea, Mexico, New Zealand, EU, UK & Taiwan.

Intra-EU trade is far larger than external trade with the US

Although the EU secured a lower effective tariff rate than many other countries, exports to the US have still been affected, falling by 22% in August compared to the same month a year earlier. While this is a blow to Europe's struggling export sector, it has ways to make up for it. On average, EU members trade 10x more with each other than they export to the US. A 20 % drop in exports to the US would therefore require only a little over a 2% increase in intra-EU trade to offset the shortfall. Therefore, the most straightforward response is to strengthen the European single market and reduce the EU's reliance on US demand. Furthermore, as Bruegel shows, EU export growth is largely driven by demand from markets beyond the US and China. While the US and China together absorb 30% of globally traded EU value added, the remaining 70% goes to other partners that have contributed most to the growth in EU exports over time. Deepening these ties (and concluding Mercosur/India) would help offset US/China headwinds.

The US alone cannot match China in key metrics

China now rivals or surpasses the US in several economically significant areas. It leads the US in global manufacturing value added, academic publications and citations, and active patents. However, the picture changes once traditional allies and partners are included. Taken together, this broader coalition has an economic and innovation base at least twice the size of China's across virtually every measure. With only a quarter of China's population, the US simply cannot compete with China alone. Nevertheless, the current US administration has so far been cautious in deepening cooperation with allies. Certain policy decisions – such as stricter immigration measures affecting highly skilled workers, enhanced controls on foreign staff in high-tech manufacturing, and rhetoric that has caused friction with the European Union – risk undermining broader strategic coordination.

TAKE: In recent years, trade with the US has been a rare bright spot for European companies who have been struggling with **high energy costs** and **mounting competition from heavily subsidised Chinese companies**. Consequently, when Donald Trump returned to the White House and began implementing his strict tariff policy agenda, Europe had little appetite for a prolonged trade confrontation with the US. Yet even if the resulting arrangement is asymmetrical, it left **EU exporters in a relatively solid – if fragile – position**, enjoying lower effective tariff rates than most other major exporting countries. However, the longer-term challenge may lie elsewhere. The **Sino-US trade war** and China's subsequent weaponisation of its dominance in **rare earths** production and refining could ultimately prove more damaging to Europe. These dynamics risk undermining Europe's efforts to rebuild its defence capabilities, sustain support for Ukraine, and expand **manufacturing capacity in key strategic technologies**. A more confrontational stance from the US is only one aspect of a global environment that is becoming less predictable and less favourable to Europe's ability to translate economic strength into geopolitical influence. To regain genuine strategic autonomy, the EU will require a **Draghi-style industrial policy drive** – one that actively manages critical dependencies and builds supply chains resilient to the whims of external powers.



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