FIVE REASONS TRUMPONOMICS NEED NOT WEAKEN EUROPE, EVEN THE OPPOSITE

The consensus view currently holds that the great divergence between the US and EU economies observed since the pandemic is bound to continue. As a snapshot of current conditions, it is certainly true that the US economy has a strong growth momentum and bullish animal spirits, while Europe has neither. But extrapolating from a snapshot, as instinct tempts us to do, is often wrong. In fact, there are solid reasons to expect the gap between US and Europe growth to shrink in 2025—as envisioned in BNP Paribas' central scenario, with the US economy slowing down and the Eurozone's accelerating (albeit modestly so). Beyond the year-ahead outlook, there are at least five reasons to challenge the view that Donald Trump's economic policies will make Europe even weaker. Let's consider them in turn.

1. Europe was built through crises, as founding father Jean Monnet famously said. The return of Trump to the White House is undoubtedly perceived by European policymakers as a crisis. Conveniently arriving on the heels of two landmark reports by former Italian Prime Ministers[1] that provide a roadmap for the EU to make itself fit for preserving its place in the world for decades to come, this crisis has already started accelerating much needed change. Instead of being shoved into drawers around EU government palaces, these reports have provided the bulk of the ingredients for the EU's 5-year work plan, renamed "competitiveness compass".

"Europe is ready for change" summed up EC President Ursula von der Leyen in Davos a few weeks ago. Just five months ago, the consensus in Brussels was that member states broadly agreed on the diagnostics, but were so far apart on the remedies that little would happen. Now, there is good reason to believe we will see changes of the same order of magnitude as those brought about by the Covid pandemic: with deeper and better integrated internal markets for goods and services; with far more firms operating at scale; with more pragmatic regulations; and with higher investment—both collective among member states and by the private sector—including in areas critical to economic sovereignty, green transition, and defense. This won't happen overnight, but the EU has as good a chance as ever to come out of this latest crisis stronger.

2. Europe has greater macro stability and macro-policy space, both monetary and fiscal. Unlike many previous crises, Europe faces this one in a position of relative strength. Its inflation has fallen within near-term reach of the ECB's 2% target and the ECB's policy stance is heading to neutral fast The Federal Reserve, by contrast, is finding itself having to pause its easing cycle with rates at an elevated 4.5%, and the Bank of England is projecting resurgent inflation which will constrain its ability to cut rates fast or deep below the current 4.5%. Eurozone growth is below potential, but substantially positive, and a host of sentiment indicators are beginning to perk up. Should an adverse shock hit—for example in the form of US tariffs—, there is substantial scope for both monetary and fiscal policy to help. Fiscal room, admittedly, is not evenly distributed across member countries. But, by and large, those that have the most to lose from trade frictions with the US also have the most fiscal space (*Chart 1*). Italy, which does not, can expect a boost from over 3% of GDP worth of untapped Resilience and Recovery Facility funds. By contrast, the US and UK have no room for fiscal expansion.

PUBLIC DEBT AND EXPORTS TO THE US AS A SHARE OF GDP OF THE EU COUNTRIES

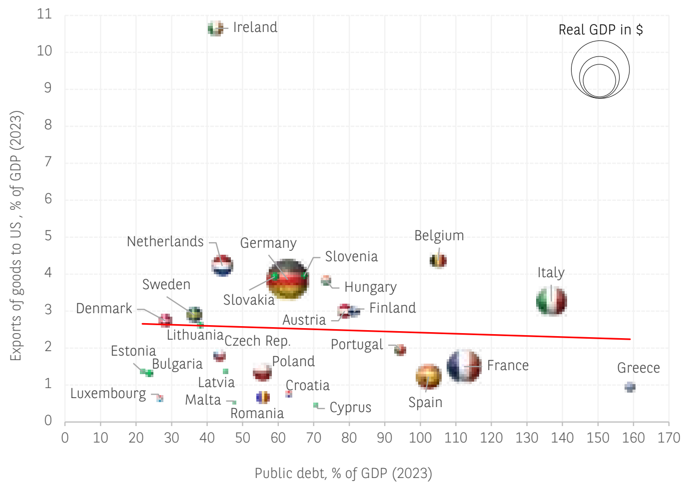

CHART 1

SOURCE: COMTRADE, IMF, BNP PARIBAS. CHART: TARIK RHARRAB

3. Europe's vulnerability to US tariffs is overstated. It is true that the US is the EU's top trading partner, and that it exports more goods to the US than it imports. As Chart 1 shows, for several countries, exports to the US account for a sizable share of GDP. Still, the share of the US in total exports of EU countries is under 8%. As such, it would take relatively small increases in EU exports to other countries to compensate for the loss of exports to the US (*Chart 2*). In particular, because the EU trades predominantly with itself, the agenda of deepening the single market identified by Enrico Letta, extensively picked up in the EC's Competitiveness Compass, has the potential to unlock meaningful additional intra-EU trade. To offset a 1% decline in exports to the US, it only takes a 0.12% increase in intra-EU trade. Small increases in exports to close neighbours in non-EU Europe would also suffice. And only slightly higher ones for exports to fast-growing Asia ex-China[2]. As such, it is encouraging that the EU has signalled a strong intent to remain open for trade deals with any willing partners; recent reports suggest it might even

1 Cf. '*Much More Than A Market*', Enrico Letta, April 2024 and '*The Future of European Competitiveness*', Mario Draghi, September 2024.
2 Some have argued that if the entire world tries to make up for the loss of the US market, competition will be intense and exports hard to grow. But the US market will only really disappear if its trade deficit does, and that will only happen if and when the Federal government runs fiscal surpluses, or households and businesses surpluses large enough to offset the gaping ones of the Government. Absent a dramatic collapse in investment, this seems highly unlikely in the foreseeable future.

reduce some existing "most favoured nation" tariffs in response to Trump's threat of "reciprocal" ones. This would lower its average external tariff rate and boost trade.

4. Europe can step into the void left by US on energy transition. The US government putting on pause, or even in reverse, its efforts to limit global warming is unquestionably bad news. But, at least in one respect, it might benefit Europe's economy: by removing the powerful incentive of the subsidies enacted under President Biden under the misnamed Inflation Reduction Act to boost green investment in the US. Now, with the EU doubling down on its own efforts to decarbonize its economy and support R&D and investments to that effect, its attractiveness to green-minded capital (from both within and outside the EU) will be magnified.

5. Europe provides policy predictability and stability. In democracies, political uncertainty waxes and wanes often based on electoral cycles. It was high in both Europe and the US in 2024, owing both to planned elections (in the US and EU Parliament), and unplanned ones (in France in Germany). Now the fog has largely cleared in Europe, and the policy outlook at both EU and national levels is now fairly predictable over a multi-year horizon; whereas in the US, the unique policy-making style of President Trump means uncertainty remains, and is likely to remain, extremely high. Whether on tariffs, fiscal policy, immigration, and hence inflation and interest rates (both short and long), nobody can be sure whether to expect average, very good, or very bad outcomes. This is not an attractive backdrop for investment or hiring decisions.

Clearly, none of this guarantees that Europe will outperform expectations, let alone outperform the US on any time horizon. But it does have strong cards to play. And a crisis-level sense of urgency that it needs to play them.

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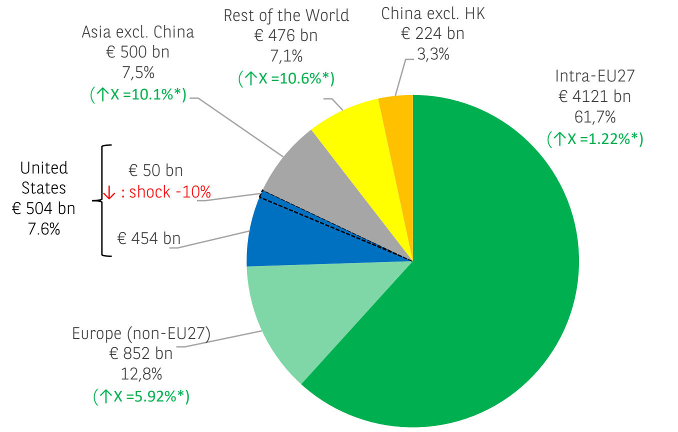
EXPORTS OF THE EU COUNTRIES BY DESTINATION



* All things being equal, a 10% (i.e., €50 billion) decrease in exports to the United States would require the European Union 27 to increase its exports by X% to the regional area in question in order to compensate for the shortfall. For example, exports to the rest of Europe (non-EU27) would need to increase by 5.92%, assuming that exports to other regional areas remain constant.

CHART 2

SOURCE: EUROSTAT, BNP PARIBAS
CHART: TARIK RHARRAB