

STUDY

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# Risk and opportunities in relation to evolving financial and economic relations with the US

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Economic Governance and EMU Scrutiny Unit (EGOV)  
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## **Abstract**

This study assesses the evolving structural divergence between the US and EU economies, driven by widening productivity gaps and asymmetric financial integration. It identifies a “Competitiveness Trilemma” constraining EU policy responses to US industrial activism. The paper analyses new transmission channels of economic shocks and proposes a strategic playbook for the European Parliament to enhance industrial sovereignty and rebalance the transatlantic partnership.

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## CONTENTS

<b>LIST OF ABBREVIATIONS</b>	<b>7</b>
<b>LIST OF BOXES</b>	<b>9</b>
<b>LIST OF FIGURES</b>	<b>9</b>
<b>LIST OF TABLES</b>	<b>10</b>
<b>EXECUTIVE SUMMARY</b>	<b>11</b>
<b>1. MACROECONOMIC ASSESSMENT</b>	<b>13</b>
<b>1.1. The long-term view: structural shifts in US-EU macroeconomic relations</b>	<b>13</b>
1.1.1. US-EU trade integration: deep links, growing imbalances	13
1.1.2. Sectoral specialisation and GVC rewiring: risks to comparative advantages	15
1.1.3. Foreign Direct Investment: resilient stocks, shifting geography	17
1.1.4. Financial integration: high interdependence, asymmetric exposure	19
<b>1.2. The medium-term view: business cycle and financial cycle realignment</b>	<b>24</b>
1.2.1. Historical business cycles: tight synchronisation, unequal recoveries	24
1.2.2. Policy drivers of cyclical divergence: the widening fiscal gap	26
1.2.3. Productivity and growth models: accelerating structural divide	29
1.2.4. Financial cycle & monetary policy: imported volatility, limits to autonomy	33
<b>2. POLICY IMPLICATIONS &amp; RECOMMENDATIONS</b>	<b>37</b>
<b>2.1. Strategic macroeconomic risks: Competitiveness Trilemma and pillars of EU response</b>	<b>37</b>
2.1.1. <b>Pillar I:</b> closing the investment gap – from regulation to capacity	38
2.1.2. <b>Pillar II:</b> managing the stabilisation deficit – macro-financial autonomy	38
2.1.3. <b>Pillar III:</b> countering weaponised interdependence – a strategic playbook	39
<b>Scenario 1: Escalation</b> – industrial and financial containment	39
<b>Scenario 2: Diversion</b> – re-orientation and industrial sovereignty	40
<b>Scenario 3: Monetary variant</b> – financial leverage and currency autonomy	41
<b>2.2. European Parliament Oversight and Institutional Capacity</b>	<b>43</b>
2.2.1. Establishing a “Transatlantic Macro & Markets Dashboard”	43
2.2.2. Institutionalising strategic foresight and legislative scrutiny	43
2.2.3. Monitoring the implementation of sovereignty instruments	44
<b>3. CONCLUSION</b>	<b>45</b>
<b>REFERENCES</b>	<b>46</b>

<b>ANNEX</b>	<b>49</b>
<b>A. 1 Cyclical analysis</b>	<b>49</b>
<b>A. 2 Revealed Comparative Advantage (RCA) analysis</b>	<b>56</b>
<b>A. 3 Monetary policy synchronisation analysis</b>	<b>59</b>
<b>A. 4 Additional figures</b>	<b>61</b>

## LIST OF ABBREVIATIONS

<b>AI</b>	Artificial Intelligence
<b>AMECO</b>	Annual Macro-Economic Database (European Commission)
<b>BLS</b>	Bureau of Labor Statistics (US)
<b>BUDG</b>	Directorate-General on Budgets (European Parliament)
<b>CAPEX</b>	Capital Expenditure
<b>CBO</b>	Congressional Budget Office (US)
<b>CHIPS</b>	CHIPS (Creating Helpful Incentives to Produce Semiconductors) and Science Act (US)
<b>CMU</b>	Capital Markets Union
<b>CPI</b>	Consumer Price Index
<b>DMA</b>	Digital Markets Act (EU)
<b>ECB</b>	European Central Bank
<b>ECON</b>	Committee on Economic and Monetary Affairs (European Parliament)
<b>EGOV</b>	Economic Governance and EMU Scrutiny Unit (European Parliament)
<b>EIB</b>	European Investment Bank
<b>EMU</b>	Economic and Monetary Union
<b>ESBies</b>	European Safe Bonds
<b>ESM</b>	European Stability Mechanism
<b>ESMA</b>	European Securities and Markets Authority
<b>ESRB</b>	European Systemic Risk Board
<b>EV</b>	Electric Vehicle

<b>FDI</b>	Foreign Direct Investment
<b>GDP</b>	Gross Domestic Product
<b>GDPR</b>	General Data Protection Regulation (EU)
<b>GVA</b>	Gross Value Added
<b>GVC</b>	Global Value Chains
<b>ICT</b>	Information and Communication Technology
<b>IMF</b>	International Monetary Fund
<b>IRA</b>	Inflation Reduction Act (US)
<b>MFF</b>	Multiannual Financial Framework (EU)
<b>MiCA</b>	Markets in Crypto-Assets Regulation (EU)
<b>MIP</b>	Macroeconomic Imbalance Procedure (EU)
<b>NBFI</b>	Non-Bank Financial Intermediaries
<b>NGEU</b>	NextGenerationEU
<b>OBBBA</b>	One Big Beautiful Bill Act (US)
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>RCA</b>	Revealed Comparative Advantage
<b>SBBS</b>	Sovereign Bond-Backed Securities
<b>SIU</b>	Savings and Investment Union
<b>STEP</b>	Strategic Technologies for Europe Platform (EU)
<b>SURE</b>	Support to mitigate Unemployment Risks in an Emergency (EU)
<b>TTC</b>	Trade and Technology Council
<b>WTO</b>	World Trade Organization

## LIST OF BOXES

Box 1: Stablecoins and the durability of the dollar dominance amid fragmentation	22
Box 2: The digital productivity divide: how AI asymmetry reshapes transatlantic economic relations	33
Box 3: A euro-area "safe asset": macro-financial, strategic and institutional considerations	36

## LIST OF FIGURES

Figure 1: US-EU trade balance: gross flows and net balances (2005–2023)	14
Figure 2: Regional composition of US and EU trade (2000–2024)	15
Figure 3: Sectoral decomposition of US-EU trade balance: goods and services (2023)	16
Figure 4: Financial integration across the Atlantic: FDI stocks as share of GDP (2009–2023)	17
Figure 5: Regional composition of US and EU FDI (2009–2023)	18
Figure 6: US-EU gross and net financial portfolio positions (2009–2023)	20
Figure 7: Regional composition of US and EU international financial portfolios (2001–2023)	20
Figure 8: Typology and composition of transatlantic portfolio holders (2024)	21
Figure 9: Holdings & risk preference: debt vs equity holdings by sector (2024)	23
Figure 10: Breakdown of US and EA public debt holders, by nationality	23
Figure 11: Supply-side and demand-side growth decomposition analysis (2021–2025)	24
Figure 12: Diverging Growth Trajectories: Revisions in output gaps and real GDP (2018–2028)	25
Figure 13: Manufacturing and energy price dynamics in the US and EU (2018–2025)	26
Figure 14: Diverging Fiscal Trajectories: Revisions in public debt and structural balances (2018–2028)	27
Figure 15: The growing US-EU productivity divide (2014–2024)	29
Figure 16: US-EU contrasted demographics and labour market dynamics (2008–2025)	30
Figure 17: Fed-ECB policy rates and divergence analysis (1999–2025)	34
Figure 18: The EU Competitiveness Trilemma as an Impossible Triangle	37
Figure A. 1: Cyclical Analysis: real economic variables (2000–2025)	51
Figure A. 2: Cyclical analysis: structural variables & prices (2000–2025)	52
Figure A. 3: Cyclical analysis: interest rates & exchange rates variables (2000–2025)	53
Figure A. 4: Cyclical analysis: financial variables (2000–2025)	54
Figure A. 5: Cyclical Analysis: risk & uncertainty (2000–2025)	55
Figure A. 6: US-EU comparative advantage by sector: changes from 2012 to 2023	57

Figure A. 7: Asymmetry analysis in Fed-ECB monetary policy synchronicity and spillovers 59

Figure A. 8: US-EU trade balance in goods and services as % of GDP 61

Figure A. 9: Fiscal indicators across EU countries (2011-2027) 61

Figure A. 10: EA countries 10Y sovereign spreads heterogeneity (2007-2025) 62

**LIST OF TABLES**

Table 1: US-EU structural divergence in sectoral composition, by GVA and employment (2019-2023) 32

Table 2: Decomposition of GVA Growth by factor contribution: US vs EU (2019-2023) 32

Table 3: Overview of strategic responses: a potential EU playbook 42

## EXECUTIVE SUMMARY

**Aim and scope.** The aim of this study is to provide the ECON Committee with a **comprehensive macroeconomic assessment** of the evolving US-EU financial and economic relations and its implications for European strategic autonomy. It identifies the shifting drivers of transatlantic integration – productivity, industrial policy, and financial structure –, evaluates the implications for European growth and stability, and conceptualises the **“Competitiveness Trilemma”** currently constraining EU policy. Finally, it outlines a **Strategic Playbook** of institutional reforms and oversight tools to enhance the European Parliament’s capacity to monitor risks and strengthen the Union’s industrial and financial sovereignty.

### Key Findings

- **Structural trade & investment reconfiguration:** While the EU retains a goods surplus, the US has cemented dominance in high-value services, generating a USD 76.1 billion surplus in 2023 driven by IP and digital sectors. Concurrently, the US has become an “investment magnet”: **EU FDI in the US reached 13.8% of EU GDP in 2023, surpassing US investment in the EU (10.1%)**, signalling that European savings are increasingly **financing US re-industrialisation**.
- **Asymmetric financial exposure and risk-return imbalance:** European investors **skew toward safety** (US Treasuries), effectively subsidising US deficits, while US investors maintain an **80% equity share** in their European portfolios, prioritising growth. Consequently, the EU is structurally long on US interest rate risk, while the **US holds a claim on European corporate performance**.
- **Business and financial cycles decoupling – the “Vulnerability Paradox”:** Since 2021, the US economy has grown **1.3x faster** than the EU. Despite this real economy divergence, financial cycles remain highly synchronised. Europe has ceased to import US growth (spillovers near zero) but continues to **import US financial volatility and monetary shocks due to deep asset exposure**.
- **Widening productivity & tech gap:** US labour productivity has grown twice as fast as the EU’s (2014–2024). This is anchored in a **massive disparity in capital deepening**, specifically in AI, where US private investment dwarfs the combined EU total, locking in a future competitive advantage.

**Main recommendations for oversight and action.** To resolve these imbalances, the paper recommends shifting from defensive regulation to **capacity building**:

- **Elevate the CMU/SIU to an industrial imperative:** The Capital Markets Union must be reframed as a tool to stem the investment drain and retain European savings for domestic “scale-ups” in critical tech sectors.

- **Establish a Euro-denominated safe asset:** To break the “financial subsidy loop” where EU savings fund US fiscal expansion, the EU requires a permanent safe asset to anchor liquidity and fund cross-border common goods (e.g., energy grids, compute capacity).
- **Implement a “Transatlantic Macro & Markets Dashboard”:** The European Parliament should mandate a monitoring tool within the European Semester to track sectoral financial exposures, invoicing currency dependencies, and productivity spreads, enabling early detection of vulnerabilities to US policy shocks.
- **Institutionalise “Competitiveness Stress Tests”:** New legislation must undergo mandatory stress tests to quantify impacts on the transatlantic CAPEX and adoption gap, ensuring regulatory objectives do not inadvertently accelerate industrial erosion.

# 1. MACROECONOMIC ASSESSMENT

## 1.1. The long-term view: structural shifts in US-EU macroeconomic relations

### 1.1.1. US-EU trade integration: deep links, growing imbalances

**Transatlantic trade remains the backbone of the global economy, but its aggregate scale conceals a growing structural asymmetry between physical goods and intangible services.** In 2023, total two-way trade reached approximately **USD 1.6 trillion**, confirming the corridor as the world's largest bilateral economic relationship (**Figure 1**). However, this volume masks a persistent United States deficit of roughly **USD 144 billion**, driven by a widening **USD 220 billion goods deficit** that is only partially offset by a **USD 76 billion services surplus**. Since 2005, the goods gap has nearly doubled, while the services surplus – despite a marked increase boosting the US trade balance – remains too small to offset the manufacturing imbalance. The result is a trade balance structurally skewed towards **European manufacturing dominance**, with the United States compensating only partially through its growing surplus in services.

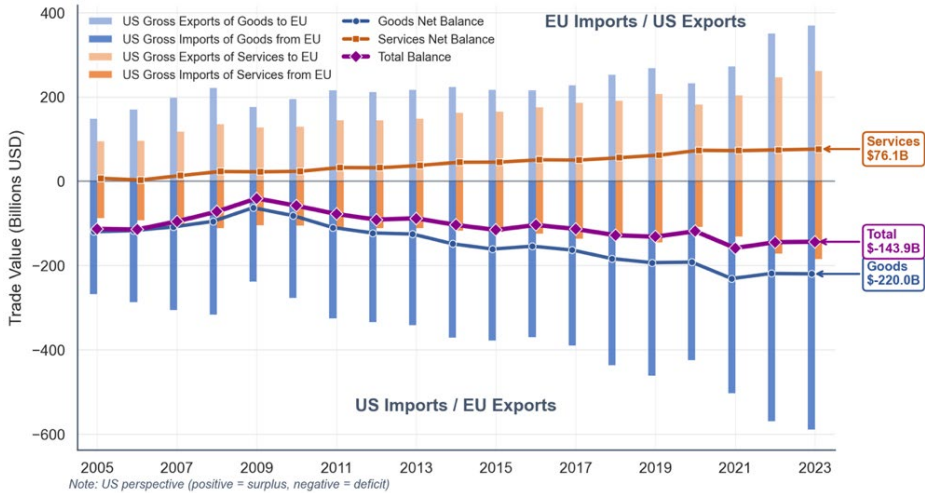
**Despite the absolute growth in imbalances, the bilateral deficit is less alarming and macroeconomically stable when normalised against GDP (Figure A. 8).** Over the past two decades, the US bilateral deficit has fluctuated narrowly between **0.5% and 0.8% of US GDP** (and 0.7% to 1.2% of EU GDP).<sup>1</sup> This indicates a **stable but uneven equilibrium** where trade tensions are likely to be driven by frictions in specific sectors rather than by a looming balance-of-payments crisis from an unsustainable trade deficit. The persistence of this deficit across business cycles points to **structural comparative advantages** rather than temporary cyclical factors. This stability implies that standard **macroeconomic adjustments are unlikely to resolve the imbalance** without fundamental shifts in underlying industrial composition.

**The United States has entrenched a dominant advantage in high-value, scalable services, generating a structural intangible<sup>2</sup> surplus vis-à-vis Europe.** Since 2005, the US services surplus has expanded systematically, fuelled by dominance in knowledge-intensive sectors such as **intellectual property, digital services, and finance**. Services now account for approximately **41% of US exports** to the EU, compared to only **24% of EU exports** to the US. This asymmetry highlights a qualitative divergence in value creation: US exports are increasingly embedded in software, algorithms, and financial intermediation (intangibles), while Europe retains its stronghold in physical value chains and location-dependent services. This trend has accelerated post-pandemic, with digital and IP-related services gaining permanent share against transport and travel.

<sup>1</sup> With the exception of the year 2021 that followed the COVID-19 outbreak, the deficit as a share of US GDP seems to have peaked in 2015, the year prior to the failure of the Transatlantic Trade and Investment Partnership (TTIP).

<sup>2</sup> See Cigna, Gunnella, and Quaglietti (2022) highlights the transformation of global value chains (GVCs), emphasising the growing role of high-value services in global trade and their increasing contribution to value-added exports, particularly in advanced economies like the United States, which leverage knowledge-intensive and intangible assets to maintain competitive advantages.

**Figure 1: US-EU trade balance: gross flows and net balances (2005–2023)**



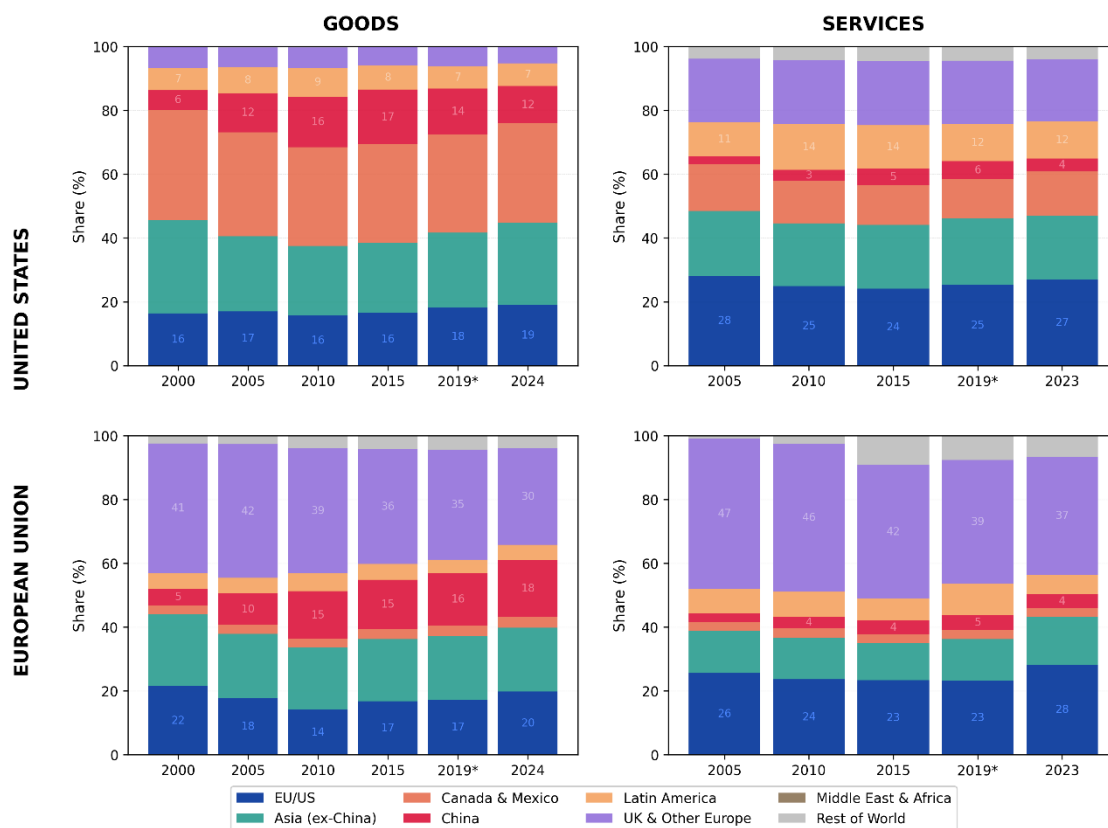
Source: UN Comtrade and author’s calculations.

**While the EU and US remain each other’s primary commercial partners, their broader trade geographies are diverging, with the US pivoting toward hemispheric integration and faster decoupling from China.** Roughly **43% of US exports** now flow to the Americas, whereas the EU maintains a more globally distributed exposure with significant reliance on neighbouring non-EU states (**Figure 2**). Crucially, post-2020 data reveal a sharp divergence in **de-risking trajectories: US imports from China fell** from a peak of 19% to **13.8% in 2024**,<sup>3</sup> while the EU’s import dependence on China has stabilised around **21.6%**. This leaves the EU more dependent on Chinese inputs in machinery and green technologies, creating a structural tension in transatlantic economic security: Washington is rewiring supply chains more quickly than Brussels, which complicates efforts to align strategies on resilience, industrial policy, and security-driven trade restrictions.<sup>4</sup>

<sup>3</sup> Goldman Sachs (2023) argues that US-China economic relations have experienced significant decoupling, particularly in investment and technology sectors, while trade remains resilient but below potential due to geopolitical tensions and policy shifts.

<sup>4</sup> The divergence in China exposure is further discussed in Poitiers, Barata da Rocha, and Boivin (2025) who argue that the structural weakening of demand from the US and China, coupled with their inward trade policies, necessitates a reorientation of EU trade policy towards deeper integration with other global partners to mitigate risks and reduce dependency on these major economies.

**Figure 2:** Regional composition of US and EU trade (2000–2024)



\* Pre-COVID baseline year. Based on total trade volumes (Exports + Imports)

Source: UN Comtrade, OECD TIS, and author's calculations.

### 1.1.2. Sectoral specialisation and GVC rewiring: risks to comparative advantages

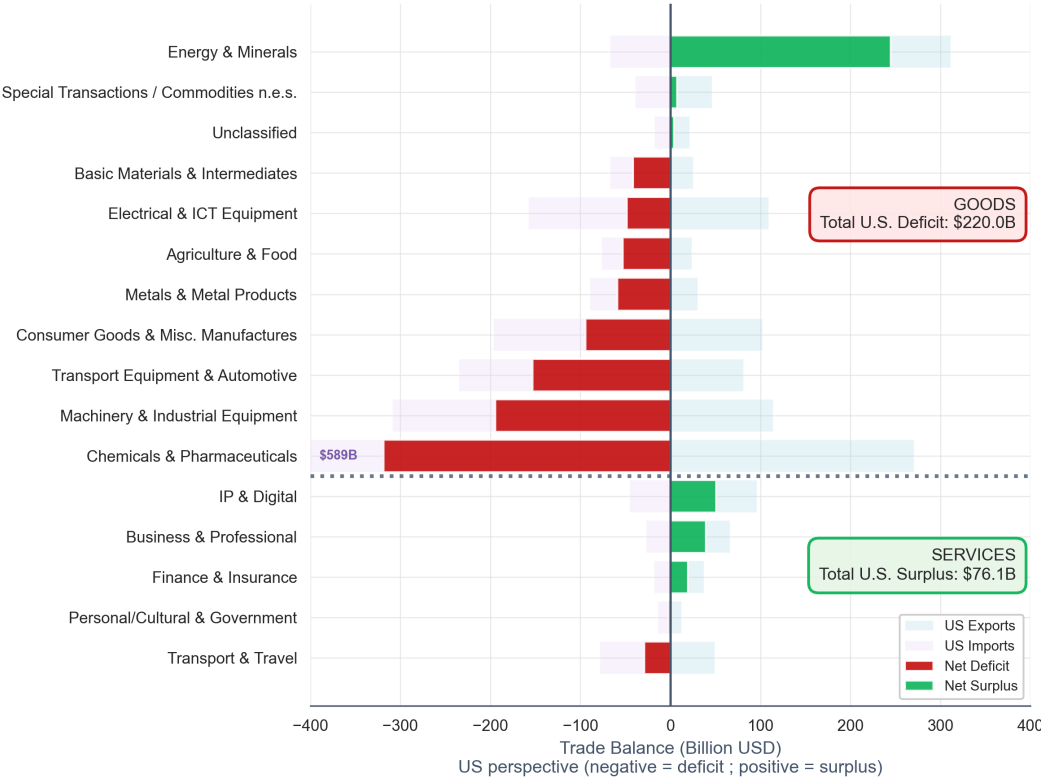
Europe's aggregate goods surplus vis-à-vis the United States is increasingly the product of a very narrow set of complex manufacturing activities, turning a core strength into a concentrated source of potential trade tension. Decomposition of the 2023 US bilateral goods deficit (Figure 3) shows that just three sectors – **Chemicals & Pharmaceuticals (USD 319 billion), Machinery & Industrial Equipment (USD 194 billion), and Automotive (USD 153 billion)** – together generate an imbalance that exceeds the overall US goods deficit with the EU. Within this, a marked "Pharma surge" stands out: the share of pharmaceuticals in US imports from the EU has more than doubled since 2010 to reach around 32%, underpinned by highly concentrated production hubs in Ireland, Germany, and Switzerland. The pattern points to a deficit rooted in **deep industrial specialisation** and global value-chain organisation, making these sectors central to Europe's external competitiveness but also particularly **exposed to any future tightening of US trade or industrial policy**.

The post-shale energy flip has reshaped the sectoral foundations of the transatlantic relationship by establishing the United States as a strategic energy supplier that partly offsets its manufacturing deficit with Europe. In the wake of the shale revolution and the 2022 energy-price and supply shocks, the US shifted from near balance to a **USD 245 billion surplus in Energy & Minerals with the EU in 2023**, effectively reversing earlier dependence patterns. Revealed Comparative Advantage (RCA) indicators capture this structural break: the US RCA in Energy & Minerals rose from

+0.74 in 2012 to +3.29 in 2023 (Figure A. 1). This reconfiguration implies a new hierarchical complementarity where the **US supplies critical upstream inputs** (energy) and intangibles, while Europe doubles down on **downstream advanced manufacturing**. Despite varying exposure across Member States, the EU has moved to replace its pre-war reliance on Russian hydrocarbons through a mix of diversification of its portfolio of global energy suppliers and renewable deployment. In the diversification effort, the United States has captured a dominant share of the reorientation, effectively **intertwining energy security and industrial competitiveness more tightly across the Atlantic**.

**Sectoral decomposition of services reveals a structural bifurcation: the United States dominates scalable digital and professional services, while Europe retains its edge in location-dependent activities.** The robust US services surplus is driven almost entirely by **IP & Digital services** (+USD 50.7 billion) and **Business & Professional services** (+USD 39.5 billion), which together account for the vast majority of the net positive balance.<sup>5</sup> By contrast, the EU maintains a comparative advantage in **Transport & Travel**, generating a **USD 29.1 billion surplus** against the US. This reflects a deepening specialisation where US exports monetise intellectual property, cloud platforms, and consulting services, whereas EU service exports remain more tightly linked to tourism and transports. This leaves the **EU's services balance more vulnerable to physical disruptions** (like pandemics) compared to the scalable, digital nature of US service exports.

Figure 3: Sectoral decomposition of US–EU trade balance: goods and services (2023)



Source: UN Comtrade, OECD TIS, and author's calculations.

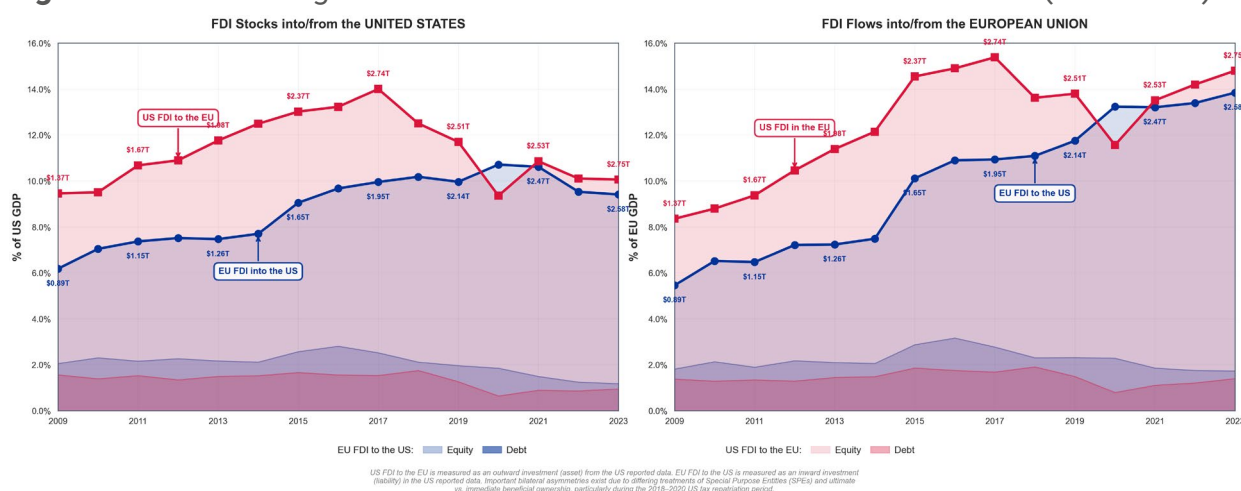
<sup>5</sup> See Hamilton and Quinlan (2024) in the Annual Survey of Jobs, Trade and Investment between the United States and Europe for *The Transatlantic Economy*, who emphasize the significant role of digital services, intellectual property, and business and professional services in driving the robust U.S. services trade surplus with Europe, with digitally-deliverable services alone contributing a USD 103 billion surplus in 2022.

**Dense, intra-firm global value chains (GVCs) blur the conventional distinction between goods and services, embedding US digital inputs ever more deeply within European industrial exports.** A substantial share of transatlantic trade consists of intermediates and intra-firm flows, evidenced by the high correlation between trade volumes and the **USD 5 trillion** two-way investment stock. Through the **“servitisation”<sup>6</sup> of manufacturing**, EU industrial exports – such as connected vehicles or precision machinery – increasingly rely on US-origin cloud services, software licenses, and digital components to maintain competitiveness. Consequently, **US policy shocks** affecting digital regulation, data localisation, or corporate taxation are likely to **propagate rapidly through European manufacturing** value chains, generating macro-relevant spillovers that are not visible in headline trade balances but are **critical for assessing strategic vulnerabilities in the transatlantic economic relationship**.

### 1.1.3. Foreign Direct Investment: resilient stocks, shifting geography

**The transatlantic Foreign Direct Investment (FDI) relationship exhibits a massive stock, broadly stable in scale and resilient to aggregate shocks, but recent flows reveal a decoupling with US capital quietly retrenching from Europe.** The gross stock of mutual FDI positions between the EU and the US is approximately **USD 5 trillion** and is solidified by **deeply integrated corporate ownership**

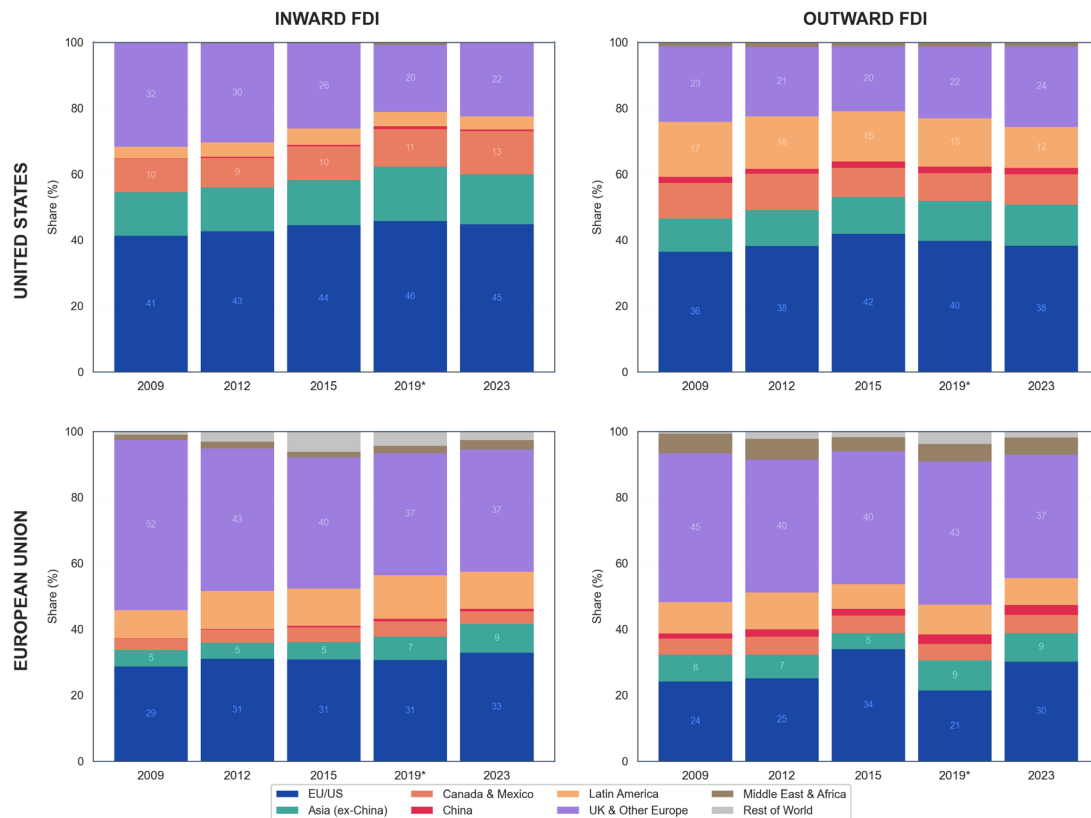
**Figure 4:** Financial integration across the Atlantic: FDI stocks as share of GDP (2009–2023)



Source: IMF DIP & ANEA, and authors' calculations.

<sup>6</sup> See for instance the concept of “Mode 5” Approach to Services Trade popularised by Lucian Cernat and Zornitsa Kutlina-Dimitrova (both at the European Commission, DG Trade). Cernat (2024) offers a recent discussion of this phenomenon.

**Figure 5:** Regional composition of US and EU FDI (2009–2023)



\* Pre-COVID baseline year. Based on FDI positions (stock). EU data excludes intra-EU.

Source: IMF DIP, and author’s calculations.

**structures.** However, recent data reveals that while the US investment position in the EU remains large, it is down 29% from its 2017 peak, reflecting a peak-and-decline dynamic driven by US tax repatriation and post-pandemic adjustments (**Figure 4**). Since 2021 alone, the EU has experienced a historic **net divestment by US firms**, amounting to nearly USD 535 billion across 2022–2023. This trend signals warns that **headline stock figures should not be interpreted as a proxy for ever-deeper integration**, as the direction of travel has fundamentally shifted, and US corporate appetite for expanding their European footprint is **undergoing a pause**.

**Post-COVID investment divergence is policy-driven rather than cyclical, with US industrial policy and cheaper energy turning America into an “investment magnet” for European firms.** Between 2009 and 2023, European outward FDI to the US increased by 188% in absolute terms, compared with 101% growth of US FDI in the EU over the same period. As a result, the US has consolidated its position as the single most important destination for European outward FDI, **capturing around 30% of extra-EU investment (Figure 5)**. In GDP-normalised terms, US FDI stock in the EU stabilised around 10.1% of EU GDP in 2023, down from a peak of 14% in 2017, while EU FDI in the US reached 13.8% of EU GDP (**Figure 4**). This reflects a **structural reallocation** where **European firms are increasingly financing the re-industrialisation of the American economy, treating the US as a growing anchor for value creation**.

**A qualitative asymmetry has emerged in the nature of FDI stocks: EU investment in the US is tangible and manufacturing-heavy, while a large part of US investment in the EU is financial and**

**tax-driven.** EU firms prioritise the “build where you sell” strategy, investing heavily in manufacturing sectors such as autos and energy to hedge against currency and tariff risks. By contrast, US investment in Europe focuses on technology, software sales, and pharmaceutical R&D hubs, and is often routed through holding companies in conduit jurisdictions – namely, the Netherlands, Luxembourg, and Ireland – qualifying as **phantom FDI**<sup>7</sup> rather than brick-and-mortar industrial investment. This composition effect means standard **FDI statistics substantially overstate the US contribution to Europe’s industrial base** while understating the extent to which European savings are underwriting US re-industrialisation.

**If current trends persist, Europe risks entering a “depleted capital stock” scenario in which the core assets of the green and digital transition are located abroad, eroding industrial sovereignty.** The relocation of anchor investments – battery gigafactories, semiconductor fabs, and AI data centres – to the US progressively **locks in future value chains and productivity gains on American soil.** Under this trajectory, European industries would **increasingly depend on US-based facilities for critical inputs, data and intellectual property.** This **geography of FDI** shapes the EU’s long-run fiscal capacity and strategic autonomy, as the tax base, high-quality jobs and technological control associated with these activities would increasingly reside outside the Union.

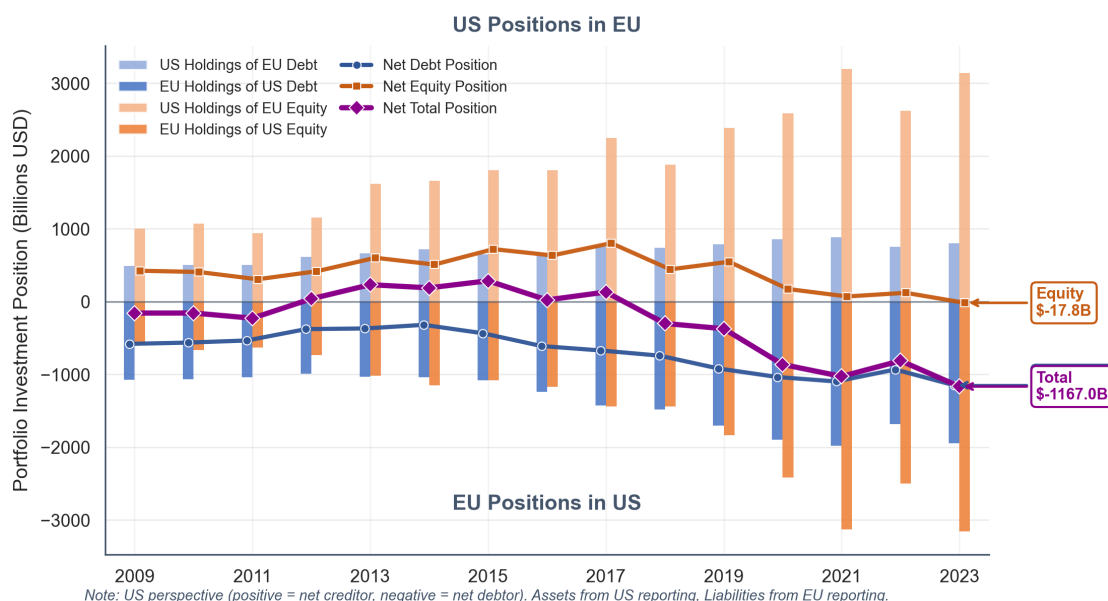
#### 1.1.4. Financial integration: high interdependence, asymmetric exposure

**Europe’s financial exposure to the United States is deep and structurally asymmetric, leaving the EU long US risk to a much greater extent than the US is exposed to Europe.** While transatlantic financial integration has tripled in absolute terms over the last decade, **EU investors now allocate approximately 53.5% of their extra-EU portfolio to US assets**, effectively treating the US as their primary external core market. In stark contrast, US investors place only about 27.2% of their foreign portfolio in the EU, diversifying more broadly across Asia and offshore centres (**Figure 7**). Consequently, US macro and financial shocks – whether monetary tightening or equity repricing – transmit powerfully into European balance sheets, whereas **EU-specific shocks are dampened by the more diversified nature of US global holdings.**

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<sup>7</sup> Damgaard, Elkjaer, and Johannesen (2019) show how empty corporate shells in tax havens undermine tax collection and distort FDI statistics. This phenomenon is also coined as the “Luxembourg Effect”. See Ahmad et al. (2025) for recent analysis of Phantom FDI.

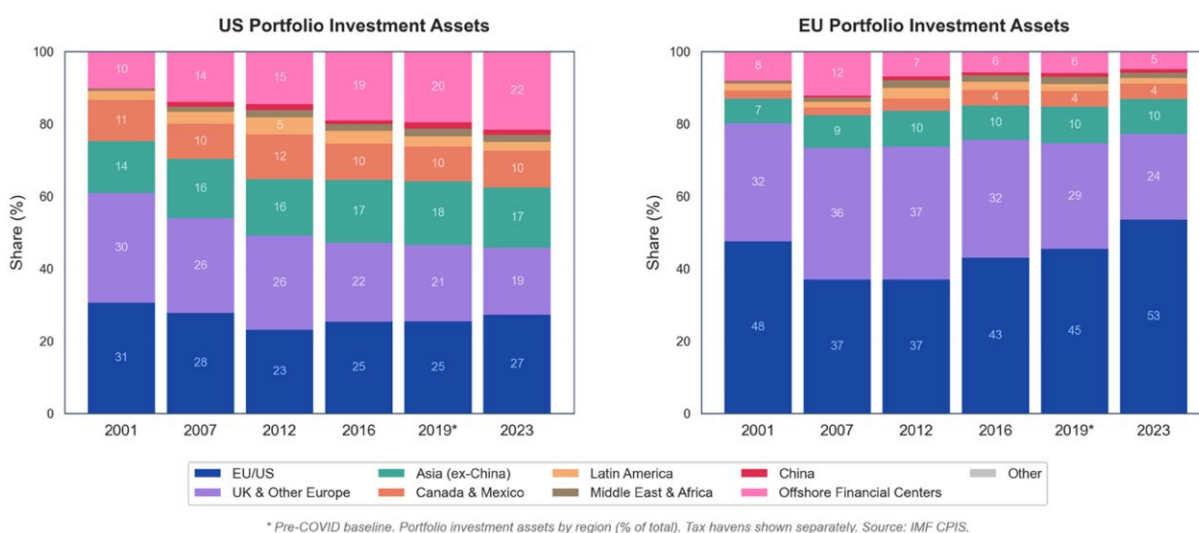
**Figure 6: US-EU gross and net financial portfolio positions (2009–2023)**



Source: IMF PIP, Eurostat, and authors' calculations.

The transatlantic financial relationship has undergone a fundamental reversal, with the United States shifting from a balanced position to becoming a massive net debtor vis-à-vis the European Union. Between 2009 and 2023, as gross cross-border holdings increased to nearly USD 9 trillion, the US position deteriorated by approximately USD 1.45 trillion, resulting in a net debtor status of roughly USD 1.2 trillion by 2023 (Figure 6). Consequently, the European financial system has become a structural creditor to the US economy, playing a critical role in funding US external imbalances and anchoring the liquidity of dollar capital markets.

**Figure 7: Regional composition of US and EU international financial portfolios (2001–2023)**

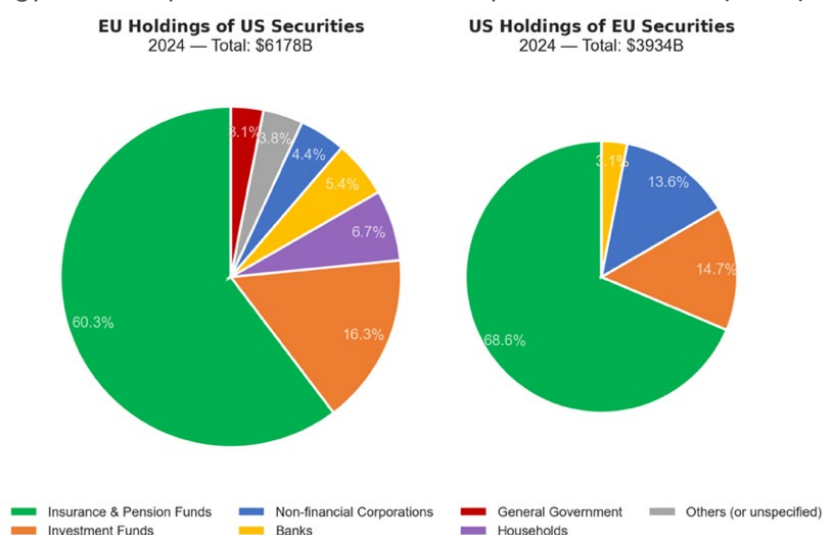


Source: IMF PIP & ANEA, and authors' calculations.

**The asymmetry in financial exposure is compounded by a major bias of European investors toward US debt while US portfolios prioritise higher-yielding European equity.** A sectoral breakdown reveals that EU holdings are skewed toward liquid US Treasuries and investment-grade corporate bonds – held largely by insurers and pension funds – while US investors maintain an average 80%–equity / 20%–debt ratio in their European portfolios (Figure 8 and Figure 9). This preference creates a risk–return imbalance: **European portfolios are tied to US fixed-income performance and the dollar**, while US investors utilize European markets primarily for corporate ownership and growth exposure.

**This financial integration reinforces the US “exorbitant privilege”, creating a de facto “financial subsidy” loop where European savings help finance US fiscal expansions.** By serving as reliable buyers of US Treasuries (Figure 10), European investors **lower the marginal cost of deficit financing**<sup>8</sup> even as the US pursues aggressive industrial policies like the IRA. This demand is further entrenched by the rise of dollar-pegged stablecoins (Box 1). Although both regions have seen a “great re-domestication” of sovereign debt issuance since the pandemic, investors located in EU financial hubs still hold around USD 1.6 trillion in US Treasuries. This in turn reinforces European exposure to US rates or term premia in an era where elevated “uncertainty is the new normal”<sup>9</sup> and US fiscal sustainability is put under question, thereby sustaining **US dollar’s status as the ultimate safe asset**<sup>10</sup>.

**Figure 8:** Typology and composition of transatlantic portfolio holders (2024)



Source: IMF PIP, and authors’ calculations.

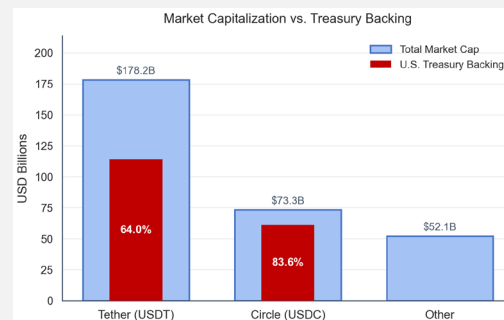
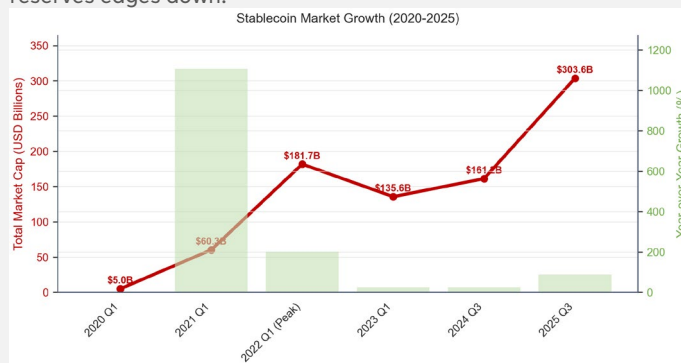
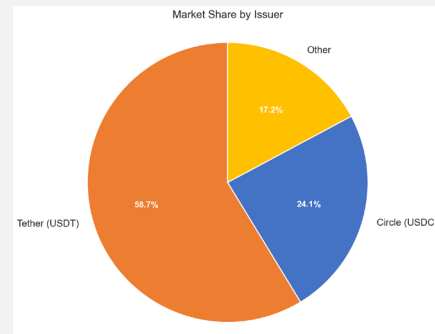
<sup>8</sup> Krishnamurthy and Vissing-Jorgensen (2012) finds that the liquidity and safety attributes of U.S. Treasuries significantly has reduced their yields by an average of 73 basis points from 1926 to 2008.

<sup>9</sup> Georgieva (2025) characterises “elevated uncertainty” as the global economy’s, driven by geopolitical fragmentation, climate shocks, and rapid technological shifts. Crucially, she underscores the precariousness of US fiscal sustainability and urges the US to “address the federal debt” and warns that US equity valuations have reached dangerous “dot-com” bubble levels.

<sup>10</sup> See Choi et al. (2024).

**Box 1: Stablecoins and the durability of the dollar dominance amid fragmentation**

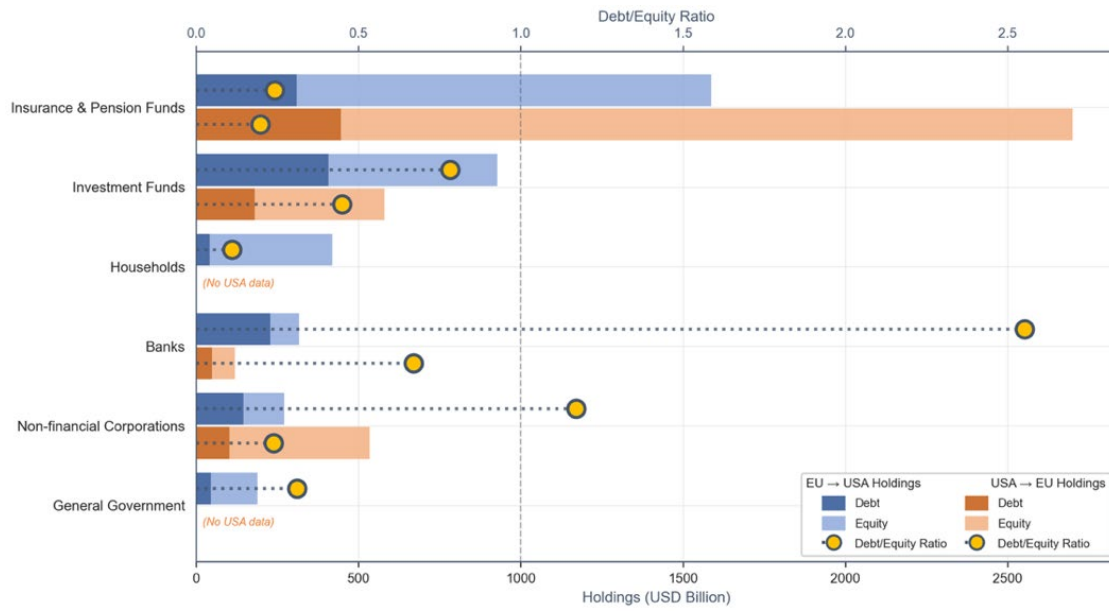
**Dollar-pegged stablecoins** such as **Tether (USDT)** and **USD Coin (USDC)** effectively operate as a digital Eurodollar system, creating a new, retail-level pipeline from European savings into short-dated US public debt. Leading USD stablecoins are backed predominantly by US Treasury bills and other high-quality dollar assets, so every new token minted is matched by an incremental claim on US public liabilities. When European households, firms or platforms exchange euros for USD stablecoins – typically to access global crypto markets or dollar-based payment rails – those **euros are converted into dollars and invested in US money markets**. This “tokenised T-bill” model scales with private demand for fast, cheap digital payments rather than with official reserve management, **reinforcing the dollar’s operational dominance in invoicing, settlement and liquidity** even if its share in central-bank reserves edges down.



For the euro area, **widespread stablecoin use risks a frictionless leakage of savings into US assets** and introduces a non-bank conduit through which **US financial conditions are imported** while remaining **largely invisible in standard statistics**. When users shift from euro bank deposits into USD stablecoins, the underlying reserves predominantly flow into US T-bills and repo, **deepening Europe’s indirect exposure to the US rate cycle while bypassing domestic intermediation captured in balance-of-payments and international portfolios data**. At scale, this could marginally hollow out the euro deposit base, **complicate ECB transmission in stress episodes**, and create new run dynamics: a loss of confidence in a major stablecoin could trigger a rapid shift from tokens into cash or directly into money-market instruments, with knock-on effects for EU on-/off-ramps and payment providers. From a policy perspective, dollar stablecoins shall be treated not just as a niche “crypto” topic but as part of the **transatlantic financial architecture**. There is a strong argument in favour of accelerating work on robust euro-denominated alternatives, clear licensing and reserve rules, and **prudential oversight of EU-based intermediaries** that rely on these instruments.

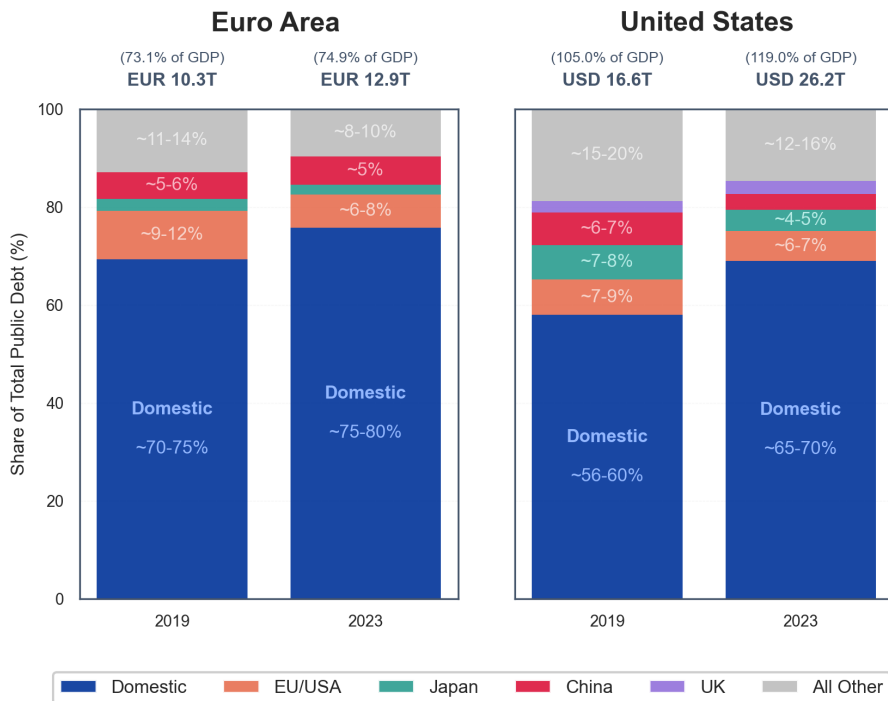
Source: CoinGecko, J.P. Morgan, US Treasury, and authors’ calculations.

**Figure 9:** Holdings & risk preference: debt vs equity holdings by sector (2024)



Source: IMF PIP, and authors' calculations.

**Figure 10:** Breakdown of US and EA public debt holders, by nationality



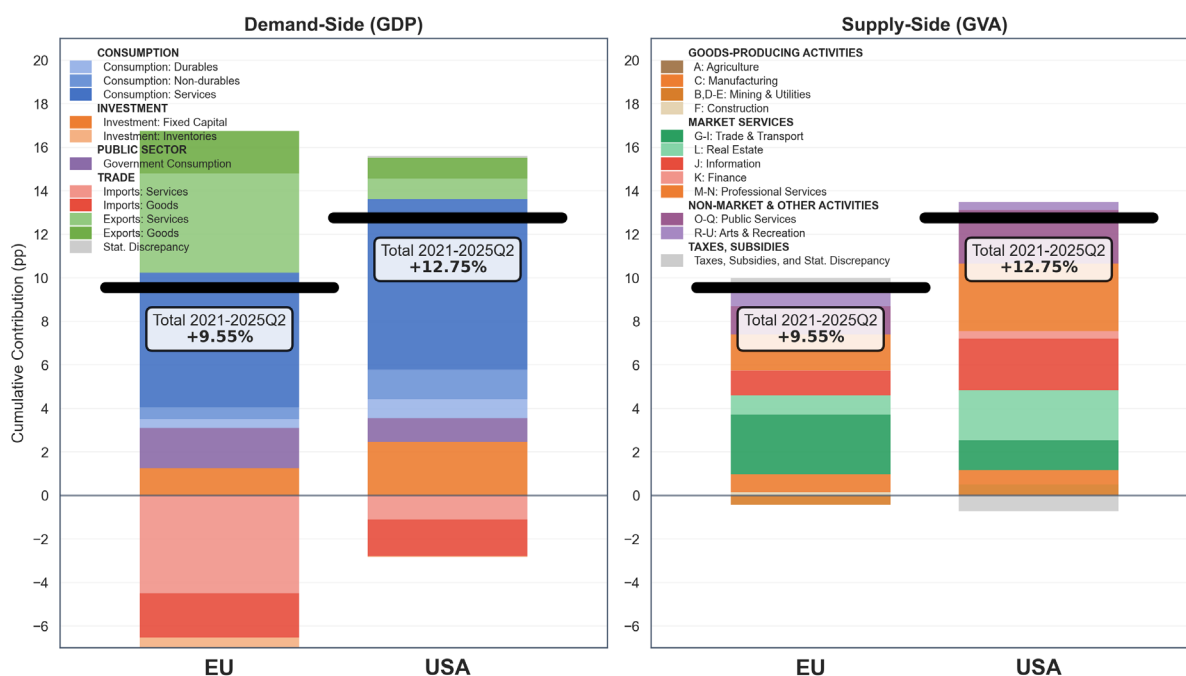
Source: US Treasury TIC, ECB; Beck et al. (2025), and authors' calculations.

## 1.2. The medium-term view: business cycle and financial cycle realignment

### 1.2.1. Historical business cycles: tight synchronisation, unequal recoveries

**Transatlantic business cycles remain tightly synchronised in timing, but the post-COVID period has opened an unusually persistent gap in levels.** Historical analysis confirms that GDP, consumption and employment still co-move very highly across the Atlantic, with rolling correlations around 0.8–0.9 for output and 0.8–0.85 for consumption, confirming the existence of a shared cycle with a slight lead of the US regarding real variables<sup>11</sup> (see [Annex](#)). However, headline synchronisation is no longer a guarantee of similar cyclical positions as amplitudes of **rebounds from the COVID-19 shock have diverged**. Since 2021 the United States has operated clearly above its estimated potential – growing 1.3 times faster than the EU during the recovery phase – while the euro area has struggled to close the output gap (**Figure A. 2** and **Figure 14**). In practice, this means the two regions are still **hit by the same shocks and share turning points, but the US recovery has been stronger and more durable**, while Europe’s upswing has been shorter and flatter.

**Figure 11:** Supply-side and demand-side growth decomposition (2021–2025)



Note: Bars show cumulative percentage point (pp) contributions to real GDP/GVA growth from 2021Q1 to 2025Q2. Each component's contribution is calculated as the change in its level divided by the starting GDP, expressed in percentage points. Contributions sum to total growth shown at the top of each bar. Demand-side:  $GDP = C + I + G + X - M$  (imports shown as negative). Supply-side: GVA by sector (taxes/subsidies adjust GVA to GDP).

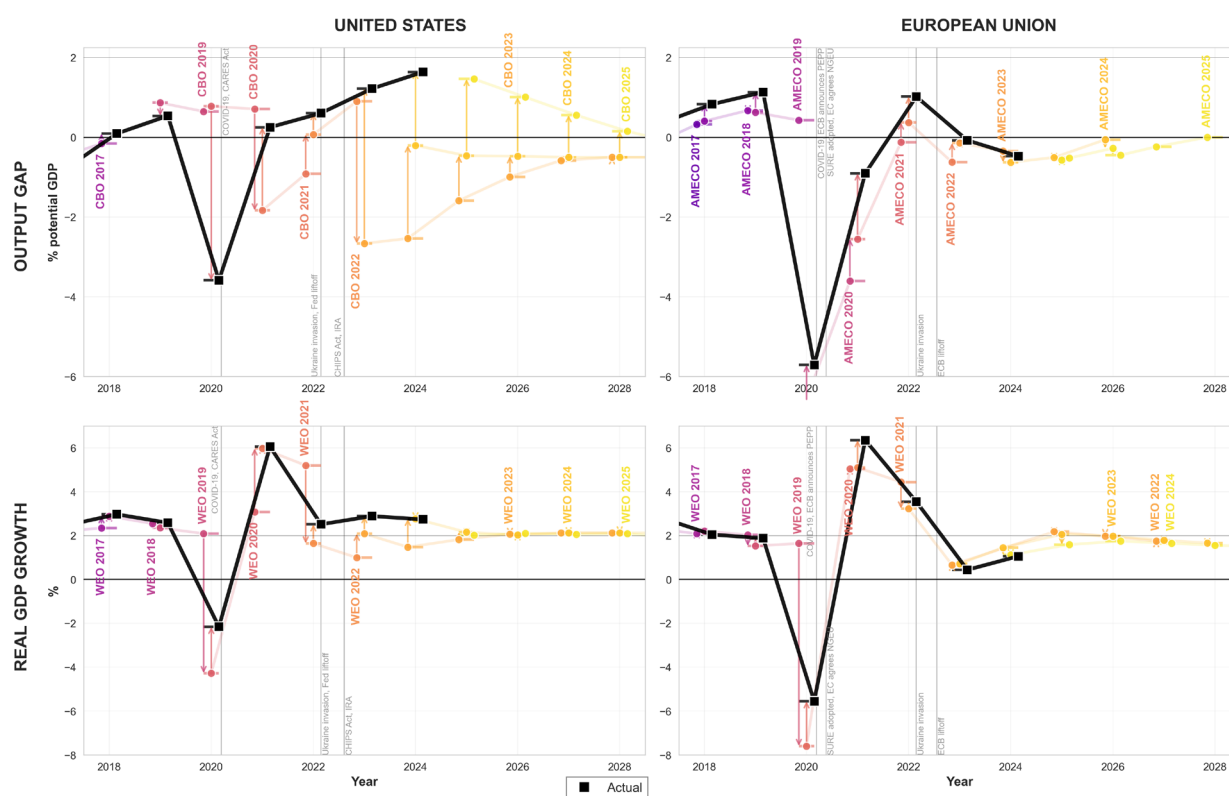
Source: CBO, Eurostat, and authors' calculations.

**The divergence in growth is driven by a fundamental decoupling of demand components: US out-performance is powered by services consumption and investment, while the EU relies on net exports and inventory cycles.** Demand-side decomposition analysis for 2021–2025 reveals that the US recovery was anchored by private consumption (+7.83pp contribution), fuelled by rapid labour market

<sup>11</sup> Lead-lag analysis indicates that US cyclical turning points on average precede European ones by one to three quarters, reinforcing a dynamic where the US acts as the locomotive of the real cycle while Europe absorbs shocks with greater inertia.

tightening and wealth effects (**Figure 11**). By contrast, the EU recovery has been heavily dependent on external demand and public spending, with private consumption constrained by real-income losses. The **divergence is particularly stark for business investment**: impulse-response analysis indicates that contrary to the pre-2020 showing two-way investment spillovers between the EU and the US, the response of the EU to US investment shocks has turned negative. This suggests a **“magnet effect” rather than positive spillovers**: the surge in US capital formation appears to be attracting global resources, with **Europe under-investing domestically and potentially reallocating capital to the US**.<sup>12</sup>

**Figure 12: Diverging Growth Trajectories: Revisions in output gaps and real GDP (2018–2028)**



Note: Forecast revisions show evolution of projections over time. Each colored point represents a forecast from a specific vintage year. Arrows show revisions between consecutive vintages. Black squares indicate actual realized values. Vertical lines mark major economic events.

Source: CBO, IMF, EC AMECO, and authors' calculations.

**Spillover patterns post-2020 point to yet another regime with markedly weakened transatlantic propagation and asymmetric shock exposure.** In the 2000s<sup>13</sup>, positive US demand shocks were typically followed by a supportive response in European activity, consistent with a strong trade and confidence channel from the US to the euro area. Post Global Financial Crisis, negative US impulses coincided with very adverse outcomes in Europe, as the sovereign-debt episode amplified common shocks and turned the US cycle into a source of asymmetric stress for the euro area. **Post-COVID, spillovers from the US to the EU have effectively fallen to zero.** This means **Europe is no longer**

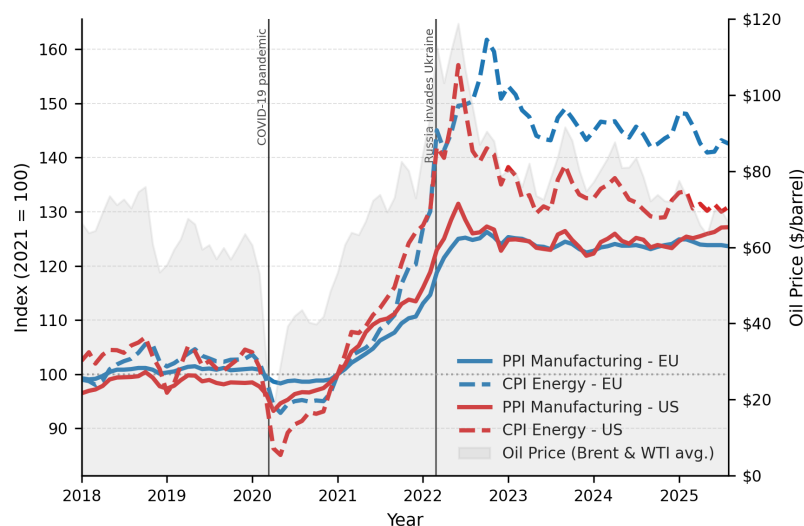
<sup>12</sup> This finding is consistent with the re-orienting of FDI flows documented previously in 1.1.3

<sup>13</sup> See Kose, Otrok, and Prasad (2012) for evidence of cyclical interdependence in industrial economies.

“importing” the US recovery and is driven instead by domestic factors, such as the energy shock and internal policy choices.

**The widening output-gap wedge will have to close over the medium run, and how it closes will determine whether the current divergence is mostly cyclical or partly structural.** Successive forecast vintages since 2020 show a systematic upward revision of US potential output and growth projections – the **US economy is now projected to run 1.5-2 percentage points above potential through 2028** – while the **euro area should remain modestly below potential (Figure 12)**. One interpretation is purely demand-side: repeated US fiscal expansions and structurally higher deficits keep activity above sustainable speed, implying that some combination of tighter monetary policy, weaker dollar and slower growth will eventually close the gap. An alternative reading<sup>14</sup> is that strong investment, resilient labour supply and productivity gains will actually **raise US potential output**, so that what looks like overheating is partly a genuine capacity expansion. This entrenchment of divergent trajectories implies that **without structural correction, the default medium-term outlook is one of a widening transatlantic prosperity gap.**

**Figure 13:** Manufacturing and energy price dynamics in the US and EU (2018–2025)



Source: BLS, US EIA, Eurostat, and authors' calculations.

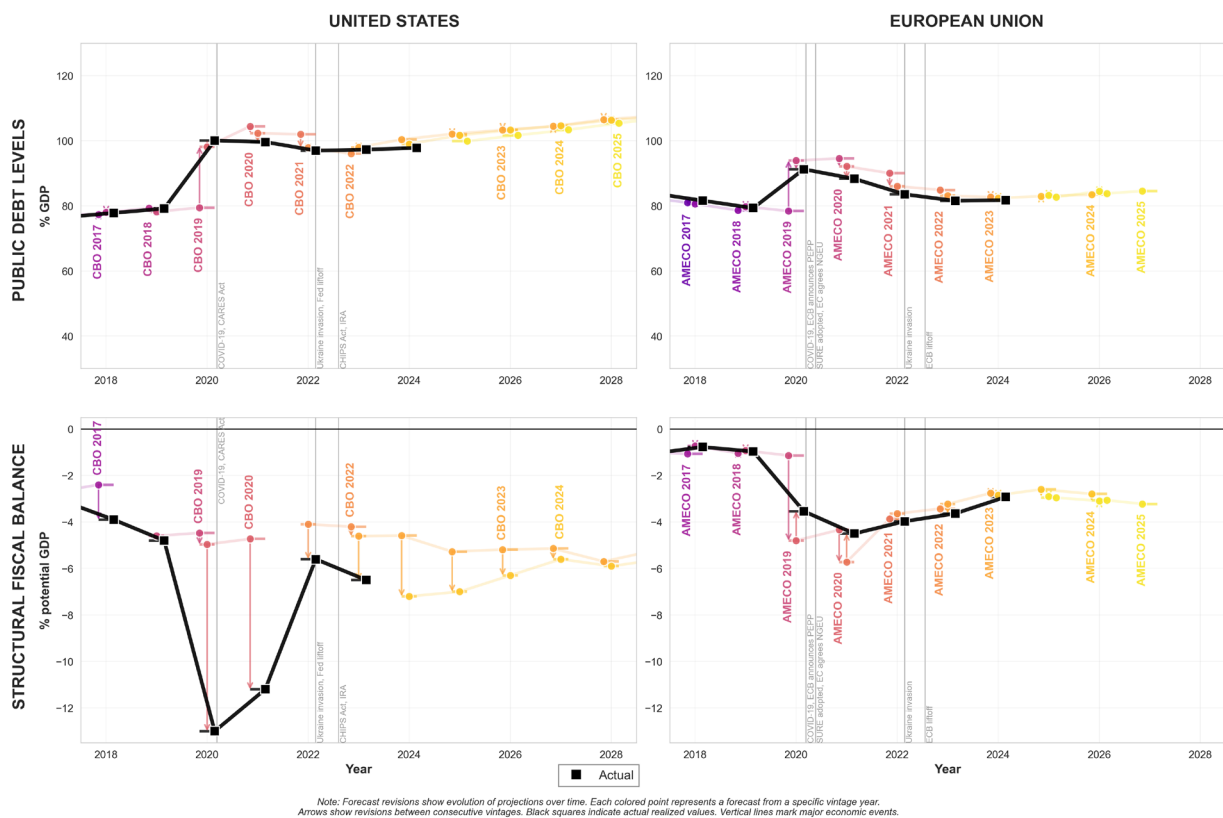
### 1.2.2. Policy drivers of cyclical divergence: the widening fiscal gap

**Fiscal stance has emerged as the primary engine of cyclical divergence post-COVID, with a large US expansion unmatched in scale by European countries, and now fiscal engines pulling in opposite directions.** Between 2020 and 2022, the United States deployed unusually large, front-loaded discretionary stimulus characterised by direct household transfers and broad support to sub-national

<sup>14</sup> The IMF sees the US-EU decoupling as increasingly structural rather than purely cyclical, driven by superior US productivity and investment growth relative to a euro area hampered by structurally higher energy costs and weak manufacturing momentum, in its *World Economic Outlook Update*, January 2025. See also Gourinchas (2025)

governments.<sup>15</sup> While Europe also loosened policy dramatically – including at the EU level via NextGenerationEU –, support was more targeted and reliant on guarantees. Divergent national responses to US packages, uneven state-aid capacity and reopening financing-condition gaps within the euro area further reinforce this policy-driven decoupling. This shift is visible in the data: **government spending moved from strongly positive correlation pre-COVID ( $\approx 0.85$ ) to sharply negative correlation thereafter (around  $-0.4$  to  $-0.5$ ), implying that fiscal policy now systematically leans against synchronisation (Figure A. 1).**

**Figure 14:** Diverging Fiscal Trajectories: Revisions in public debt and structural balances (2018–2028)



Source: CBO, EC AMECO, and authors' calculations.

**Differences in labour market institutions and the asymmetric energy shock have amplified the impact of these fiscal choices on the speed and composition of the recovery.** Broadly speaking,<sup>16</sup> the US adopted a **"go big, adjust fast"** model – large, front-loaded cash transfers and expanded unemployment benefits in a flexible labour market – while the euro area followed a **"preserve and**

<sup>15</sup> We assess fiscal magnitudes from IMF Fiscal Monitor, the COVID-19 Fiscal Policies Database as well as previous work (Mignet and Valla, 2022). For comparability, these figures focus on above-the-line measures (direct budgetary stimulus) and exclude loans and guarantees, which are closer to insurance. Over 2020–22, US discretionary above-the-line support is estimated at roughly 15% of GDP ( $\approx$  USD 3.2 trillion), versus an EU aggregate of about 14% of GDP ( $\approx$  EUR 2.3 trillion) once national packages and EU-level instruments (SURE, RRF/NextGenerationEU grants) are combined, with sizeable cross-country dispersion among large euro-area economies (roughly 10–16% of GDP). Note in addition that while NGEU disbursements started in the summer 2021 and around 70% of its grant envelope was legally committed by end-2022, all payments to finance projects and still ongoing will continue through 2026.

<sup>16</sup> See Mignet and Valla (2022) for more discussions of the composition of fiscal stimuli of US vs. EU countries in response to the COVID-19 crisis.

**protect**” model, leaning on job-retention schemes, guarantees and balance-sheet protection. The former facilitated rapid destruction and creation of jobs and faster reallocation into expanding sectors; the latter successfully limited unemployment but slowed structural adjustment and dampened private-sector dynamics.<sup>17</sup> At the same time, Russia’s invasion of Ukraine imposed a **severe terms-of-trade shock on Europe from the energy price shock**, with gas prices rising to multiples of US levels and remaining structurally higher – energy CPI rose nearly 12 percentage points more than in the US since 2021 (**Figure 13**). European governments spent heavily on temporary and fragmented energy measures just to **maintain real incomes**, whereas the US, cushioned by domestic energy production, could let fiscal support translate more directly into consumption and investment.

**As the acute phase of the crisis has passed, US fiscal support has remained expansionary while the euro area has moved back toward consolidation, creating a persistent “fiscal multiplier gap”.** Repeated US packages – COVID relief, infrastructure investment, the IRA, CHIPS and Science Act, and OBBBA – have generated a **step-change in structural deficits**, which now persist in the high single digits of GDP, significantly above pre-pandemic norms (**Figure 14**). In Europe, by contrast, the fiscal impulse from emergency support and NGEU has already peaked, and medium-term plans envisage gradual deficit reduction and rules-based consolidation under revamped fiscal rules, with cuts often falling disproportionately on public investment. This signals a **profound policy conflict**: the **US is pursuing a pro-cyclical fiscal expansion** to finance industrial and social objectives, while the **EU prioritises debt sustainability**. This divergence raises **questions about the sustainability of the US path**, as demand-side pressure may eventually require correction through tighter monetary policy or a sudden retrenchment.<sup>18</sup>

**A definitive paradigm shift in US industrial policy is rewiring the global investment map, contrasting the “New Washington Consensus” of simple, uncapped subsidies against Europe’s fragmented, rules-based constraints.** While the United States utilises open-ended tax credits to effectively **“buy” structural capacity** and drive geopolitical reshoring<sup>19</sup> – a “leap of faith” on a supply-side expansion –, the EU response remains trapped in a **“regulatory maze”** of complex state-aid considerations and national co-financing that slows disbursement. Initiatives like the Recovery and Resilience Facility must operate within a **neutral-to-contractionary fiscal framework, limiting their aggregate demand impact**. This asymmetry creates a clear business case for firms to **shift flagship projects to American soil**, capitalising on immediate federal support and deep local capital markets. Consequently, Europe finds itself **caught in the strategic crossfire between the US and China**: pressed to align with US de-risking yet unable to match the fiscal firepower of the US due to

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<sup>17</sup> See Kiss et al. (2022) for an analysis of how EU job retention schemes mitigated unemployment while temporarily obscuring labour slack; and Scopelliti (2022) for quantitative evidence comparing the US “employment adjustment” mechanism against the euro area’s “hours adjustment” model.

<sup>18</sup> The fiscal impulse from the “One Big Beautiful Bill Act” is estimated to sustain 6–7% fiscal deficits for the next 5 years in the US. Latest indicators (as of December 1<sup>st</sup>, 2025) do not show alarming signs of an unsustainable trajectory, but inflation remaining “sticky” at 3.0% even as the labour market shows signs of cooling (4.4% unemployment rate and negative private job growth following the recent government shutdown).

<sup>19</sup> BlackRock Investment Institute (2025) highlights how the prioritisation of geopolitical derisking and reshoring is fundamentally altering the macro environment by crowding in strategic investment at the cost of higher structural inflation.

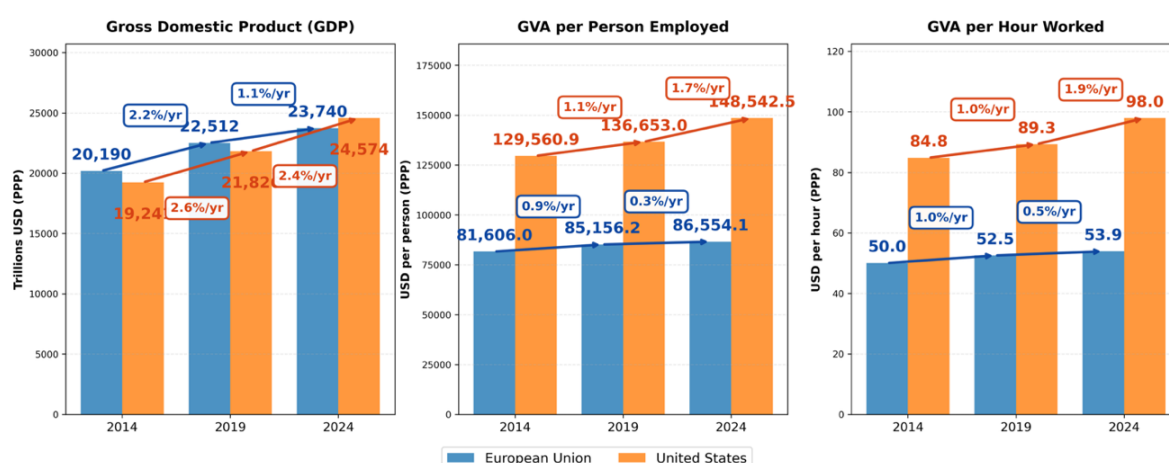
institutional constraints and the lack a unified and symmetrical fiscal instrument. The risk for the Union is a **structural erosion of industrial capacity** as global capital anchors new value chains in the US.

### 1.2.3. Productivity and growth models: accelerating structural divide

The widening US–EU cyclical gap increasingly reflects a **structural productivity divide rather than a temporary post-COVID cyclical deviation**. The striking pattern of upwards revisions in US potential output year after year (Figure 12) is increasingly treated by forecasters as a **building of genuine productive capacity across the Atlantic** rather than merely overheating.

Harmonised indicators from OECD productivity data show that **labour productivity<sup>20</sup> has grown roughly twice as fast in the US as in the EU over 2014–2024**, with the gap widening further since 2019 (Figure 15). On a per-hour basis – the cleanest measure of efficiency – the US now produces roughly 40–50% more than the EU. The US post-pandemic rebound is therefore part of a longer-running pattern in which shocks are translated into higher potential output, whereas in Europe, similar **shocks are cushioned through labour hoarding, leaving the economy on a flatter productivity path**. This **disadvantage is locked in by demographic headwinds**: while the US benefits from robust labour force growth driven by natural increase and the integration of foreign-born workers, **Europe faces acute demographic decline masked only by migration** (Figure 16). Critically, while foreign-born workers are essential to offsetting Europe's native population decline, their **integration into high-productivity sectors remains lower than in the US**, creating a self-reinforcing loop where weaker productivity constrains the fiscal space needed for forward-looking investment.

Figure 15: The growing US–EU productivity divide (2014–2024)



Source: OECD PDB, Eurostat, and authors' calculations.

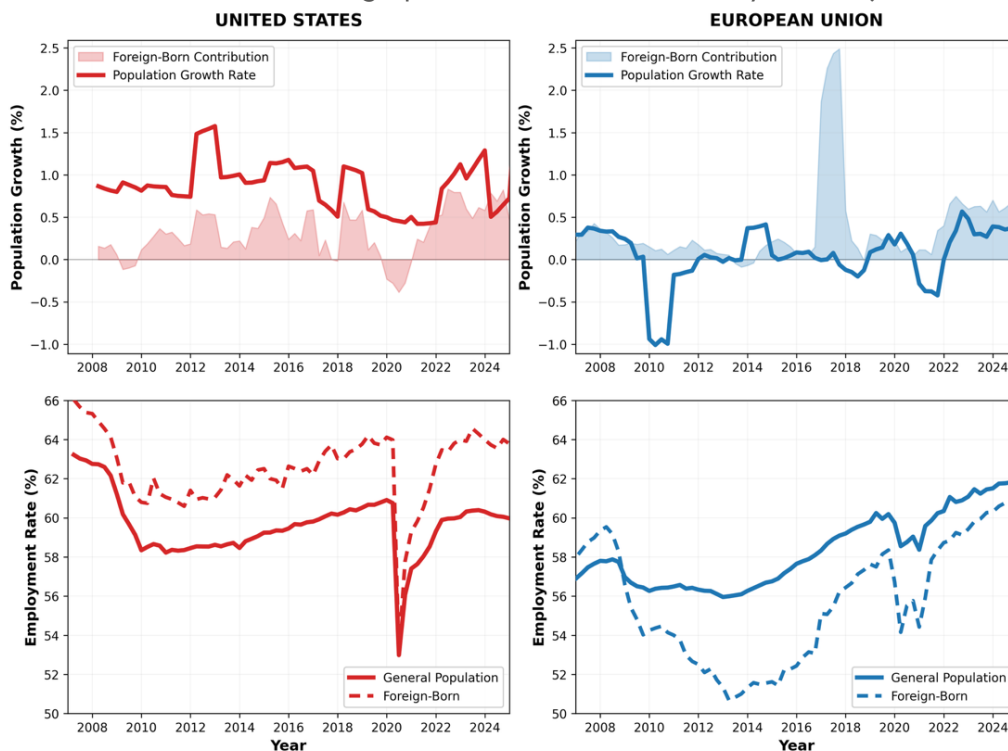
**A productivity divide driven by US superiority in capital deepening and intangible investment underpins this divergence.** Growth-accounting decompositions reveal that capital services per hour worked grew by more than 2% per year in the US after 2019, compared with only about 0.6% in the EU – a massive 3.3x advantage in capital intensity. In other words, the **US has combined stronger total-**

<sup>20</sup> See also Andersson et al. (2024).

**factor productivity with much faster investment in productive capital**, whereas **Europe has relied more on employment gains** and has struggled to maintain pre-2019 productivity growth. This implies the US is not just investing more but is **deploying capital into sectors where technological change is strongest**. Without a shift in the composition of investment, European attempts to catch up via aggregate spending alone **risk delivering diminishing returns compared to the US innovation-led model**.

**Sectoral composition reinforces the growth gap, as the US economy shifts aggressively toward the technological frontier**. Decomposition of Gross Value Added (GVA) confirms that the **US has gained share in high-productivity sectors** such as Information & Communication and Professional Services, effectively specialising in capital-intensive services where returns to scale are highest. In these frontier sectors, **Total Factor Productivity (TFP) and capital deepening jointly explain the bulk of US growth**. By contrast, **Europe's economy remains anchored in advanced manufacturing** and legacy industries but faces weaker dynamics in high-value market services and carries a larger share of low-productivity activities.<sup>21</sup> This divergence is critically amplified by the asymmetry in digital capacity with the US consolidating dominance in generative AI and cloud infrastructure (Box 2). Without a shift in the composition of investment toward these intangible assets, a **"middle-technology trap"** may exert a persistent drag on European productivity potential.

**Figure 16: US-EU contrasted demographics and labour market dynamics (2008–2025)**



Source: BLS, Eurostat, and authors' calculations.

<sup>21</sup> Hanzl-Weiss and Stehrer (2024) at the EIB provide further decomposition of the investment divergence; they document that while headline investment rates are similar, the EU faces a persistent gap in "productive investment" (excluding construction) relative to the US, driven specifically by lower capital accumulation in ICT equipment and intangible assets like R&D and software.

**Finally, firm-level evidence points to structural bottlenecks in business dynamism and innovation that prevent European firms from closing this gap.** Recent firm-level analysis<sup>22</sup> identifies critical performance gaps: European leading firms innovate and grow less than their US counterparts, particularly in the tech sector, while young high-growth firms are less disruptive and have a smaller economic footprint. A key bottleneck is the fragmented European market, which limits the economies of scale and network effects that allow US firms to scale rapidly. Furthermore, **European firms face a financing gap,<sup>23</sup> relying less on equity and venture capital**, which leads to lower and more volatile R&D investments – especially in intangible assets where US firms significantly outspend them. These structural deficiencies in labour, product, and financial markets slow resource reallocation and **penalise firms in the digital sectors**, ultimately dampening the diffusion of new technologies and the scaling up of frontier firms relative to the US ecosystem.

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<sup>22</sup> See Adilbish et al. (2025) for an in-depth treatment of firm-level causes of Europe's productivity slowdown.

<sup>23</sup> Fratto et al. (2024) provide longitudinal evidence that European scale-ups raise, on average, 50% less capital than their Silicon Valley peers after ten years of operation, a deficit attributed to a fragmented EU venture capital market that is roughly one-sixth the size of the US market, often forcing high-growth EU firms to relocate or list on US stock exchanges to access sufficient liquidity.

**Table 1: US-EU structural divergence in sectoral composition, by GVA and employment (2019–2023)**

	Sectoral size (% GVA)					Sectoral size (% Employment)				
	USA		EU		Structural Gap	USA		EU		Structural Gap
ALL ACTIVITIES	100	Δ pp 5yr	100	Δ pp 5yr		100	Δ pp 5yr	100	Δ pp 5yr	
<b>GOODS-PRODUCING INDUSTRIES</b>										
A Agriculture, Forestry & Fishing	-	-	1.6	▼ -0.08	-	-	-	4.1	▼ -0.36	-
B-E Industry (excl. Construction)	9.7	▼ -0.49	16.0	▲ 0.02	-6.3	9.6	▼ -0.32	13.9	▼ -0.69	-4.3
C Manufacturing	9.8	▼ -0.49	16.6	▲ 0.02	-6.8	9.6	▼ -0.32	13.9	▼ -0.69	-4.3
B,D,E Mining, Energy & Utilities	3.0	▲ 0.01	2.0	▼ -0.67	1.0	1.6	▼ -0.03	1.5	▼ -0.03	0.1
F Construction	3.8	▼ -0.67	5.2	▼ -0.22	-1.3	7.3	▲ 0.17	6.7	▲ 0.28	0.6
<b>MARKET SERVICES</b>	<b>42.3</b>	<b>▲ 1.09</b>	<b>39.1</b>	<b>▲ 0.95</b>	<b>3.1</b>	<b>44.0</b>	<b>▲ 0.41</b>	<b>42.7</b>	<b>▲ 0.34</b>	<b>1.4</b>
G-I Trade, Transport & Hospitality	16.9	▼ -0.31	17.3	▼ -0.63	-0.5	24.9	▼ -0.16	24.1	▼ -0.45	0.8
G Wholesale & Retail Trade	12.2	▲ -0.02	11.0	▼ -0.31	1.1	13.1	▼ -0.16	13.8	▼ -0.36	-0.7
H Transport & Storage	3.1	▼ -0.06	4.8	▼ -0.24	-1.7	5.2	▲ 0.41	5.2	▲ 0.02	0.0
I Accommodation & Food Services	3.0	▼ -0.23	2.8	▼ -0.12	0.2	6.6	▼ -0.42	5.0	▼ -0.12	1.6
J-N Business & Information Services	40.8	▲ 2.33	47.0	▲ 6.42	-6.2	20.9	▲ 0.52	19.7	▲ 0.82	1.3
J Information & Communication	8.0	▲ 1.02	5.9	▲ 0.94	2.1	4.3	▲ 0.29	3.4	▲ 0.43	0.9
K Finance & Insurance	7.3	▼ -0.42	4.4	▼ -0.02	2.9	4.7	▲ 0.08	2.3	▼ -0.04	2.5
L Real Estate	12.8	▲ 0.75	24.6	▲ 4.76	-11.8	1.8	▼ -0.06	1.1	▲ 0.03	0.7
M Professional Services	6.9	▲ 1.09	7.5	▲ 0.73	-0.5	6.0	▲ 0.13	6.5	▲ 0.44	-0.6
N Admin & Support	5.8	▼ -0.10	4.7	▲ 0.01	1.1	4.1	▲ 0.08	6.4	▼ -0.05	-2.3
<b>NON-MARKET &amp; OTHER SERVICES</b>										
O-Q Public Services	18.7	▼ -0.52	16.9	▼ -0.03	1.7	28.5	▲ 0.11	24.1	▲ 0.60	4.3
R-U Arts & Other Services	2.6	▼ -0.34	3.0	▼ -0.07	-0.4	5.8	▼ -0.17	6.0	▼ -0.11	-0.1

Note: Data shows annualised real GVA growth (2019–2023) decomposed into contributions from Labor (hours), Capital Deepening, and Productivity Gains (TFP residual). Sector codes follow NACE Rev. 2 / NAICS. Green/Red shading indicates positive/negative contribution.

**Table 2: Decomposition of GVA Growth by factor contribution: US vs EU (2019–2023)**

	USA				EU			
	GVA growth (annualized, 2019-2023)				GVA growth (annualized, 2019-2023)			
	Total	Labor Contrib.	Capital Deepening	Productivity gains	Total	Labor Contrib.	Capital Deepening	Productivity gains
<b>ALL ACTIVITIES</b>	<b>2.38</b>	<b>= 0.31</b>	<b>+ 1.06</b>	<b>+ 1.01</b>	<b>1.19</b>	<b>= 0.41</b>	<b>+ 0.54</b>	<b>+ 0.24</b>
<b>GOODS-PRODUCING INDUSTRIES</b>								
A Agriculture, Forestry & Fishing	-	-	-	-	-	-	-	-
B-E Industry (excl. Construction)	1.03	= -0.15	+ 0.86	+ 0.32	1.28	= -0.30	+ 0.40	+ 1.19
C Manufacturing	1.03	= -0.17	+ 0.91	+ 0.29	1.28	= -0.37	+ 0.40	+ 1.25
B,D,E Mining, Energy & Utilities	2.35	= -0.33	+ 0.99	+ 1.70	-5.73	= -0.03	+ -0.41	+ -5.29
F Construction	-1.78	= 0.64	+ 0.71	+ -3.14	0.22	= 1.18	+ 0.63	+ -1.59
<b>MARKET SERVICES</b>	<b>2.95</b>	<b>= 0.36</b>	<b>+ 2.00</b>	<b>+ 0.59</b>	<b>1.88</b>	<b>= 0.49</b>	<b>+ 0.80</b>	<b>+ 0.58</b>
G-I Trade, Transport & Hospitality	1.81	= 0.17	+ 1.03	+ 0.61	0.34	= 0.13	+ 0.58	+ -0.37
G Wholesale & Retail Trade	2.24	= -0.13	+ 1.58	+ 0.79	0.54	= -0.08	+ 0.76	+ -0.13
H Transport & Storage	1.77	= 2.05	+ 0.42	+ -0.69	0.01	= 0.41	+ 0.43	+ -0.84
I Accommodation & Food Services	0.35	= -0.43	+ 0.37	+ 0.41	0.15	= -0.05	+ 0.93	+ -0.74
J-N Business & Information Services	3.95	= 0.61	+ 1.65	+ 1.69	2.66	= 1.00	+ 1.00	+ 0.67
J Information & Communication	5.85	= 0.40	+ 3.79	+ 1.66	5.77	= 2.58	+ 1.86	+ 1.33
K Finance & Insurance	0.84	= 0.25	+ 0.74	+ -0.14	1.13	= 0.09	+ 1.32	+ -0.28
L Real Estate	4.46	= 0.11	+ 1.55	+ 2.80	1.24	= 0.08	+ 1.66	+ -0.50
M Professional Services	6.74	= 1.06	+ 2.19	+ 3.48	3.88	= 1.35	+ 1.36	+ 1.17
N Admin & Support	1.84	= 0.21	+ 0.12	+ 1.50	1.30	= 0.45	+ 0.09	+ 0.76
<b>NON-MARKET &amp; OTHER SERVICES</b>								
O-Q Public Services	1.58	= 0.93	+ 0.34	+ 0.31	1.21	= 1.05	+ 0.20	+ -0.04
R-U Arts & Other Services	-0.78	= -0.60	+ 0.71	+ -0.88	0.66	= 0.31	+ 0.47	+ -0.12

Note: 'Sectoral Size' is the % share of total GVA and Employment. 'Structural Gap' is the US share minus the EU share. Δ pp 5yr' is the change from 2019–2023. Sector L (Real Estate) includes imputed rents, inflating the 'Business Services' aggregate.

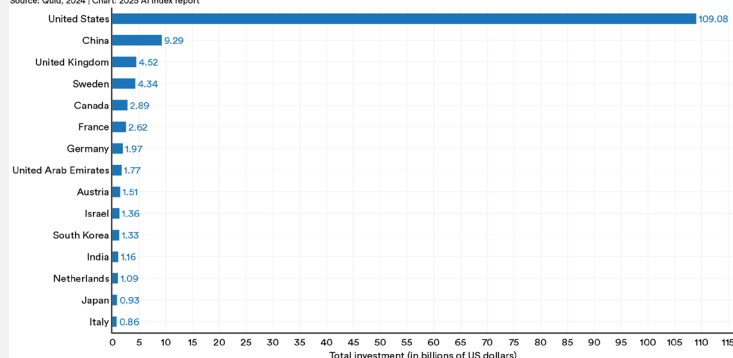
Source: OECD PDB, and authors' calculations

**Box 2: The digital productivity divide: how AI asymmetry reshapes transatlantic economic relations**

The widening productivity gap between the United States and the EU is increasingly driven by a divergence in capital deepening, specifically regarding artificial intelligence (AI) and digital technologies. Data from the **2025 AI Index** reveals the mechanism behind this divergence: a massive disparity in private capital allocation. In 2024, **US private AI investment reached USD 109.1 billion**, nearly 12 times that of China and dwarfs the combined EU total, fuelling a "high-pressure" economy capable of rapid technological diffusion. In contrast, **Europe remains caught in a "middle-technology trap"**, where its industrial base adopts AI tools but fails to produce the foundational models (US: 40 notable models in 2024; EU: negligible) or platforms that capture the highest value-added. This investment asymmetry is creating a **structural productivity decoupling**, where **US firms leverage superior digital infrastructure to compound efficiency gains**, while **EU firms face higher integration costs and fragmented capital markets**.

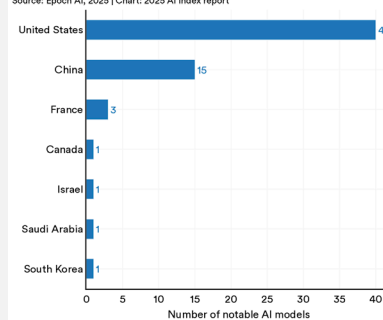
Global private investment in AI by geographic area, 2024

Source: Quid, 2024 | Chart: 2025 AI Index report



Number of notable AI models by select geographic areas, 2024

Source: Epoch AI, 2025 | Chart: 2025 AI Index report



This **technological divergence is cementing a new form of comparative advantage that risks locking the EU into a permanent intangible deficit vis-à-vis the United States**. As the US consolidates dominance in scalable, high-margin digital services – driven by generative AI and cloud infrastructure – Europe’s trade profile remains anchored in physical goods and legacy manufacturing, sectors currently squeezed by high energy costs. In addition, McKinsey warns that the real economic threat is the **adoption gap**. European firms lag their US counterparts by **45–70% in AI adoption rates**, a delay that could cost the EU up to 3% in annual productivity growth. This asymmetry is deepened by a stark **regulatory mismatch**. As noted by **Brookings**, the US employs a distributed, agency-led approach that favours flexibility and speed, whereas the EU has pursued a comprehensive, horizontal legislative framework (the AI Act). While the EU prioritises safety and fundamental rights, this "compliance-first" environment risks acting as a friction brake on the very corporate adoption required to close the productivity gap.

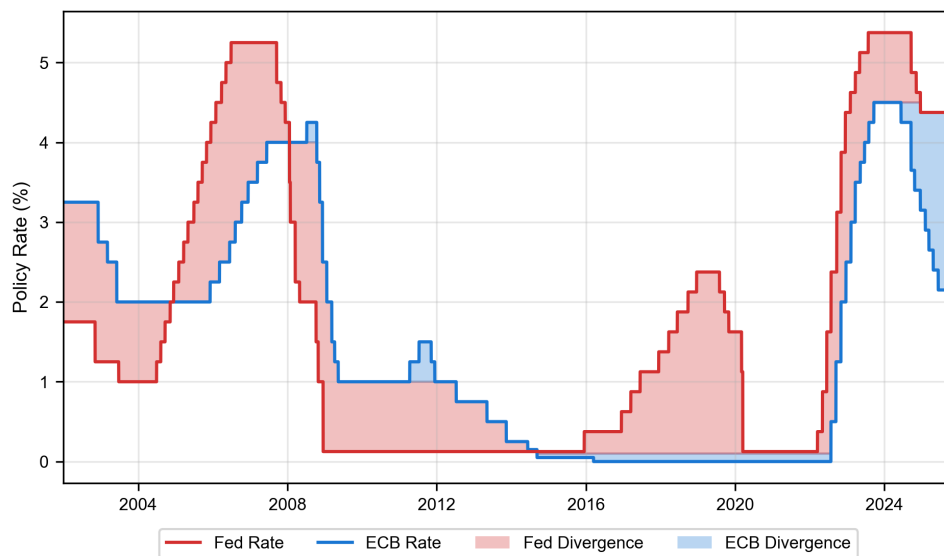
To avoid becoming **merely a regulator** and consumer of US technology, **EU competitiveness strategies must shift from defensive regulation toward scaling cross-border digital infrastructure and computing capacity**. Without a coordinated EU-level shock to investment in digital public goods, the **"twin transition" risks becoming a mechanism for transferring value from European manufacturers to US digital platforms**, permanently widening the transatlantic growth gap.

Source: Stanford 2025 AI Index Report, McKinsey (2024), Brookings (2023).

1.2.4. Financial cycle & monetary policy: imported volatility, limits to autonomy

**Despite widening divergences in real activity and potential growth, US-EU financial cycles<sup>24</sup> remain highly synchronised, leaving Europe exposed to imported financial shocks.** Cyclical analysis of equity indices, credit spreads, term premia and volatility measures shows that financial variables on both sides of the Atlantic continue to move with correlations close to one even in the post-COVID

<sup>24</sup> See Rey (2013) for the seminal framework on the global financial cycle; Boyarchenko and Elias (2024) at the NY Fed recently argue that while global business cycles have fragmented, the global *credit* cycle remains robustly synchronized.

**Figure 17:** Fed-ECB policy rates and divergence analysis (1999–2025)

Notes: see Appendix A.3 Monetary policy synchronisation analysis for details on the methodology.

Source: FRED, ECB, and authors' calculations.

period (Figure A.4 and Figure A.5). This reflects deep financial integration and common global investors. From a European perspective, however, this **financial synchronisation now interacts with asymmetric real conditions**: the euro area can face US-driven financial tightening or risk-off episodes at moments when domestic demand is weak, and output gaps are negative. In other words, Europe increasingly **imports the US financial cycle** without sharing the same underlying growth momentum, complicating monetary-policy calibration and financial-stability management.

**Exchange-rate dynamics add a further layer of complexity, with recent co-movement in US and euro-area effective exchange rates blurring traditional adjustment channels.** Given the dominance of EUR/USD in both regions' trade baskets, **theory would normally predict negative co-movement of their real effective exchange rates**: a stronger dollar should typically imply a weaker euro in effective terms, and vice versa. This pattern broadly held pre-COVID, apart from the euro-area sovereign-debt crisis, but since 2024 rolling correlations point to an **increasingly positive co-movement** (Figure A.3). One partial explanation is the symmetric surge in inflation and policy rates after 2021, but this sits uneasily with the stronger US growth performance. Unusual episodes of dollar weakness amid robust US data and concerns about fiscal sustainability suggest that investors are simultaneously **reassessing US risk** while still viewing the dollar as a global safe asset. For Europe, this implies that **exchange-rate movements no longer systematically offset cyclical divergences**, reducing the cushioning role of currency adjustment.

**US monetary shocks transmit to Europe through non-linear exchange-rate and financial channels, complicating the ECB's inflation-stabilisation task.** Event-level analysis of policy decisions (1999–2025) reveals a tight co-movement of Fed-ECB policy rate but with a clear lead of the Fed on ECB rate adjustments (Figure 17 and Figure A.7). Recent ECB research<sup>25</sup> highlights a two-stage transmission

<sup>25</sup> See Gebauer et al. (2025)

mechanism whereby a surprise Fed tightening typically appreciates the dollar and depreciates the euro, creating a short-run inflationary impulse via higher import prices for dollar-denominated energy and commodities. However, over the medium term, the transmission shifts: tighter US policy spills over into global yields and widens risk premia, dampening external demand and tightening financing conditions for European firms. This creates a **difficult balancing act for the ECB** where a mechanical response to the initial inflationary exchange-rate shock risks over-tightening policy just as the contractionary financial effects take hold. This dynamic underscores that reacting to the **Global Financial Cycle** driven by the US requires anticipating two-stage impacts on the euro area economy.

**The absence of a unified euro-area safe asset creates a structural vulnerability that amplifies transatlantic financial contagion, making Europe highly sensitive to US risk cycles.**<sup>26</sup> As explored in Box 3, the lack of a liquid, common risk-free benchmark of comparable depth to Treasuries – compounded by an incomplete Banking and Capital Markets Union – leaves Europe without a domestic anchor to rebalance financial flows on symmetric terms. Because European portfolios are structurally long on US risk to satisfy their demand for safe assets, the region **mechanically imports US financial conditions even when real business cycles diverge**. In stable periods, this allows the recycling of European savings into liquid dollar instruments; however, in downturns, **abrupt Fed tightening or US-centric risk-off episodes generate outsized wealth losses and funding stress in the EU**. This deficiency forces the euro area to absorb external financial shocks through the real economy, exacerbating the cyclical divergence arising from real business cycles decoupling.

**Decoupling risks are increasingly compounded by the threat of regulatory fragmentation and a potential “race to the bottom.”**<sup>27</sup> As the US administration signals a pivot toward deregulation – prioritising domestic growth and “America First” objectives over international standards like Basel III – the prospect of transatlantic regulatory alignment is fading. European officials have sternly warned that the pursuit of competitiveness must not become a pretext for “watering down regulation,” yet the pressure to reciprocate US flexibility threatens to compromise systemic resilience. Furthermore, rising geopolitical tensions risk spilling over into the supervision of foreign banks, creating a patchwork of **conflicting requirements that incentivizes regulatory arbitrage**. This fracturing of the global rulebook **threatens financial stability** precisely when transatlantic market correlations remain historically high.

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<sup>26</sup> Jung (2023) show transatlantic financial contagion largely occurs as European banks are significantly sensitive to US monetary policy shocks, with stronger spillovers to their stock prices and bond yields compared to non-financial corporations, driven by policy uncertainty and information effects.

<sup>27</sup> For a discussion on the mechanisms of financial fragmentation, see IMF GFSR (April 2023 issue), which highlights how geopolitical tensions and financial restrictions reduce cross-border risk diversification and increase bank funding costs, thereby amplifying macro-financial volatility. On the regulatory front, Ekberg (2025) documents a widening transatlantic divergence, noting the US administration's pivot toward prioritising domestic economic growth over international standards – exemplified by scepticism toward the Basel III Endgame – while the EU and UK maintain a focus on stability and international cooperation. Complementing this, Avril *et al.* (2025) provide empirical evidence for the euro area, showing that trade policy uncertainty directly impacts bank stability by raising CDS spreads, increasing provisioning costs, and depressing lending, particularly for banks with significant exposure to US trade sectors.

**Box 3: A euro-area “safe asset”: macro-financial, strategic and institutional considerations**

A “safe asset” is a **debt instrument** that remains **information-insensitive and liquid even in severe stress**. The euro area currently lacks a single, unified instrument of that kind. In macro-financial terms, safety is not just about low default risk but about “no-questions-asked” liquidity: investors can hold and trade the asset without repeatedly reassessing its credit quality, so it anchors pricing, collateral and **flight-to-safety dynamics in crises**. US Treasuries play this role because they are issued by a federal government with unified taxing power, and they serve as the **reference risk-free rate** for domestic and global markets. The euro area instead relies on national sovereign bonds with different risk premia, plus a limited volume of supranational issuance (EU, EIB, ESM). This fragmentation creates a thinner pool of truly safe euro assets, reinforces “home bias” in banks’ sovereign holdings and makes **euro-area financial conditions more sensitive to country-specific shocks**. It also means the ECB must use its balance sheet more actively to prevent financial fragmentation and stabilise sovereign bond markets, especially under stress (as exemplified by the recent Transmission Protection Instrument).

**Several design options could in principle deliver a euro-area safe asset within existing treaty constraints, but each involves trade-offs between risk-sharing, market discipline and legal feasibility.** At one end of the spectrum, the **“Blue Bonds and Red Bonds”** proposal argues for a mutualisation a senior layer of member-state debt up to a ceiling into a “blue bonds”, leaving any borrowing above that as purely national “red bonds”; this would create a sizable common safe tranche but requires strong common guarantees, credible fiscal rules, and close coordination between national and EU-level debt management. At the other end, **securitisation schemes** such as **ESBies/SBBS** pool and tranche national bonds to manufacture a safe senior claim without explicit joint liability, which is easier under current treaties but raises questions about the robustness of the junior tranches and whether markets would truly treat the senior tranche as risk-free in a systemic euro crisis. **Temporary programmes such as SURE and NGEU** have shown that large **EU-level issuance** is legally and politically possible in emergencies, but they are explicitly time-limited and rely on specific legal bases, so turning them into a permanent safe-asset framework would require clearer own resources and stronger EU-level fiscal governance.

Strategically, a euro-area safe asset would not be about replacing the dollar, but about **giving the euro a more robust international role and reducing Europe’s reliance on the US “exorbitant privilege”**. Today, the **dominance of US Treasuries as the global safe asset underpins structural foreign demand for dollars, allowing the US to finance itself more cheaply, run larger external deficits and use its fiscal and financial system as a central stabilisation tool for the global economy**. A deep, liquid euro safe asset could modestly rebalance this configuration by expanding the supply of euro-denominated collateral and reserves, **strengthening the euro’s use in invoicing, financing and official reserves**. For the EU, this could support more autonomous financing of common priorities (defence, green and digital transitions) and provide an **additional macro-stabilisation tool** alongside national fiscal policies and ECB monetary policy. For the transatlantic relationship, it would make the euro area a more symmetric partner: less dependent on dollar funding and US financial conditions, yet still integrated in a system where US Treasuries remain central but no longer uniquely dominant.

Source: Brunnemeier et al. (2016), Blanchard and Ubide (2025).

## 2. POLICY IMPLICATIONS & RECOMMENDATIONS

### 2.1. Strategic macroeconomic risks: Competitiveness Trilemma and pillars of EU response

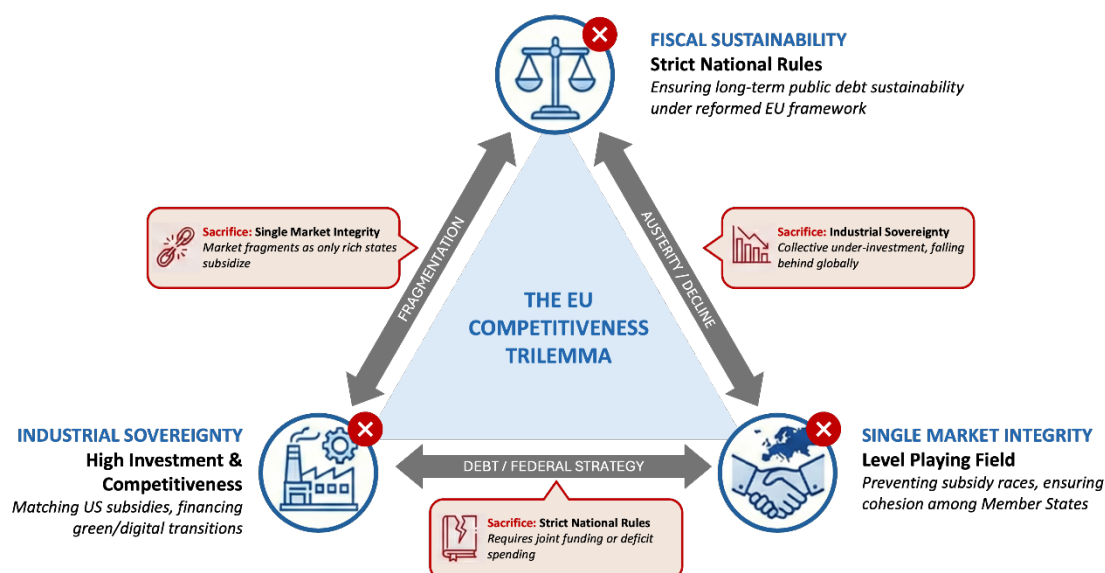
The macroeconomic assessment in Section 1 reveals a fundamental shift in the nature of transatlantic integration. While the US and EU business cycles show sign of decoupling – with the US trajectory driven by strong domestic demand and supply-side expansion, and the EU lagging – financial and technological integration has deepened. This creates a **“Vulnerability Paradox”**: Europe has ceased to “import” growth from the US (as trade spillovers have diminished), but it increasingly “imports” financial volatility and policy shocks due to the financial amplifier effect of deep asset exposure.

Consequently, EU policymakers face a **Competitiveness Trilemma**. Under the current institutional framework, it is becoming impossible to simultaneously achieve:

- **Fiscal Sustainability** (adhering to strict national debt rules);
- **Industrial Sovereignty** (matching US capital-intensive subsidies like the IRA); and
- **Single Market Integrity** (preventing subsidy races between Member States).

Resolving this trilemma requires moving beyond a reactive stance to a strategy of Strategic Autonomy and Capacity Building, structured around three pillars.<sup>28</sup>

**Figure 18:** The EU Competitiveness Trilemma as an Impossible Triangle



<sup>28</sup> Recent data confirms that the “Competitiveness Trilemma” is still very much active: while ECB backstops have compressed acute sovereign spreads (Figure A. 10) structural fiscal divergence in key economies like France and Italy (Figure A. 9) prevents the fiscal consolidation required to restore genuine policy space without risking market fragmentation.

### 2.1.1. **Pillar I: closing the investment gap – from regulation to capacity**

The structural productivity divide and the US investment magnet effect threaten to permanently erode Europe's industrial base. The US strategy of uncapped tax credits and deep private capital markets is effectively sucking liquidity and high-value capacity across the Atlantic.

**Recommendation 1: Elevate the Capital Markets Union (CMU) and Savings and Investment Union (SIU) projects to an industrial and financial Imperative.** The CMU/SIU projects must be elevated from a financial stability project to a core industrial security imperative. Currently, a significant portion of the EU's EUR 33 trillion in private savings flows into US equity markets, effectively subsidising the capitalisation of US tech rivals.

**Policy Action:** Accelerate the integration of EU equity markets and reduce the bias toward debt financing. In parallel, provide fiscal incentives to investments in sectors deemed strategic. The goal is to retain European savings to fund European "scale-ups,"<sup>29</sup> particularly in the AI and clean-tech sectors where the capital intensity gap is widest.

**Recommendation 2: Establish a European safe asset dedicated to fund strategic common goods.** To counter US fiscal firepower without fragmenting the Single Market through relaxed State Aid, the European Parliament should promote the creation of a genuine European Safe Asset dedicated to funding strategic common goods. By pooling issuance at the EU level and anchoring it in transparent governance and strong fiscal backing, this instrument would provide markets with a highly liquid, low-risk benchmark comparable to US Treasuries, while freeing national budgets from the constraints of fragmented financing. A European Safe Asset would reduce borrowing costs for priority investments, enhance the international attractiveness of the euro, and offer citizens a tangible symbol of shared responsibility for Europe's collective future.

**Policy Action:** As analysed in Box 3, a permanent **Euro-denominated Safe Asset** is essential. It would serve a dual purpose: (1) Provide the fiscal space to fund cross-border public goods (energy grids, compute capacity) that national budgets cannot afford; and (2) Offer a liquidity anchor for EU capital markets, reducing the structural reliance of European investors on US Treasuries and breaking the "home bias" in sovereign debt holding.

### 2.1.2. **Pillar II: managing the stabilisation deficit – macro-financial autonomy**

The decoupling of business cycles implies that the ECB and Fed require structurally different policy rates, yet financial synchronisation penalizes divergence. If the ECB cuts rates to support the weak euro area economy while the Fed holds rates high, the resulting spread widening risks capital flight and imported inflation.

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<sup>29</sup> Recent IMF data (see Balakrishnan and Pradhan, 2025) underscores the urgency: while the EU household saving rate is triple that of the US, Americans invest USD 4.60 in equity assets for every USD 1 invested by Europeans. Consequently, while US tech productivity has surged nearly 40% since 2005, European tech productivity has stagnated. Reframing the CMU as a 'Savings and Investment Union' is essential to close this gap.

**Recommendation 3: Implement supply-side fiscal stabilisation.** A contemporary version of the optimal monetary-fiscal policy mix would take into account the impact of the ECB rate-setting policy on transatlantic financial flows. Fiscal policy must take into account the constraint of the Fed's gravitational pull on the ECB and amplify its stabilising stance for the EU domestic cycle when needs be.

**Policy Action:** European fiscal rules must differentiate between consumption spending (which risks fuelling inflation) and investment spending (which expands supply capacity). A "golden rule" for investment in digital and green transition is necessary to prevent the "Fiscal Multiplier Gap," where EU stimulus leaks into imports of US advanced services.

**Recommendation 4: Buffer the "financial amplifier" in non-bank intermediaries.** European Non-Bank Financial Intermediaries (NBFIs) (insurers and pension funds) are heavily exposed to US corporate credit and duration risk.

**Policy Action:** Macroprudential authorities (ESRB) should implement specific buffers or stress tests for NBFIs regarding their exposure to US financial cycle turnarounds. This aims to insulate the EU real economy from repricing shocks originating in US markets.

### 2.1.3. **Pillar III: countering weaponised interdependence – a strategic playbook**

**Recommendation 5: Embed EU strategic responses in its structural macro assessment.** To ensure resilience, the EU cannot rely solely on defensive measures. It requires a **playbook of credible responses**, derived from a clear self-awareness of transatlantic strengths and vulnerabilities. To build its strategic leverage, this playbook should map actionable responses to potential future scenarios for US-EU relations.

#### **Disclaimer**

It is important to emphasise that the 3 scenarios and 'playbook' responses presented here are neither exhaustive nor necessarily the most likely outcomes. They should not be interpreted as forecasts but are rather intended as a heuristic framework to guide strategic foresight and stress-test the Union's institutional toolkit in the face of evolving threats and recomposing transatlantic relations.<sup>30</sup>

#### **Example Playbook**

##### **Scenario 1: Escalation – industrial and financial containment**

**Context:** A deterioration of relations characterised by aggressive US protectionism, universal tariffs, more stringent localisation requirements, and competitive subsidies.

Under an "Escalation" scenario of aggressive US tariffs and protectionism, the EU must prioritise Single Market cohesion over bilateral retaliation. If the US imposes universal tariffs, the primary risk to the EU

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<sup>30</sup> For a complementary analysis of global geopolitical end-states, see Sapir, Kirkegaard, and Zettelmeyer (2025). Their framework focuses on the degree of global polarity and cooperation and, in a similar fashion as us, they propose three structural scenarios for the 2030–2035 world order: (1) a collapse of international cooperation, (2) a 'world of blocs' (US, China, Non-Aligned), and (3) reinvented multilateralism.

is internal fragmentation as member states scramble for national exemptions. The strategic response should focus on defensive autonomy: activating common procurement, deploying the anti-coercion instrument collectively, and accelerating intra-EU trade deepening to offset the loss of the US export valve.<sup>31</sup>

### Response 1: Regulatory retaliation – the “tech & finance” lever

**Mechanism:** Deploying the EU’s “Brussels Effect” to tighten regulations specifically targeting US dominance in digital technology and finance. While the EU cannot build sovereignty solely through regulation, it can use market access as a penalizing lever in an eye-for-an-eye strategy.

**Strategic Goal:** To raise the cost of non-cooperation for US firms, serving as a credible deterrent against hostile US trade actions.

### Response 2: Reciprocal tariffs – the “tit-for-tat” lever

**Mechanism:** A classic, direct countermeasure involving mirror tariffs on US goods.

**Assessment:** While necessary to signal resolve, this is a narrow path – economically costly, diplomatically risky, and likely to have only short-lived impacts. It serves as a tactical backstop rather than a strategic solution.

### Scenario 2: Diversion – re-orientation and industrial sovereignty

**Context:** US capital and trade flows continue to drain from Europe (“investment magnet”).

A “Diversion” scenario requires an aggressive industrial sovereignty response centred on the Capital Markets Union (CMU). To counter the investment drain to the US, the EU cannot rely on subsidies alone. The response must be structural: completing the CMU to unlock the trillions in European private savings that currently sits idle or flows to the US. This scenario treats the completion of the CMU not as financial regulation, but as a primary tool of industrial survival.

### Response 3: Human capital embargo – the “talent” lever

**Mechanism:** Aggressive incentives to repatriate European nationals currently contributing to US value-added in high-skill sectors.

**Strategic Goal:** To deprive the US of valuable expertise and address the US-EU labour productivity differential. While difficult to implement, it addresses a core long-term threat: the brain drain of EU innovation capacity.

### Response 4: Industrial sovereignty – the “capacity” lever

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<sup>31</sup> To build resilience, the EU must first remove its own internal brakes. It is estimated that current non-tariff barriers within the Single Market are equivalent to a 44% tariff on manufacturing and a 110% tariff on services. Removing these barriers is a prerequisite for any credible 'Industrial Sovereignty' strategy. See Kammer (2025).

**Mechanism:** Fast-tracking the Draghi Report agenda and the Net-Zero Industry Act. This involves large-scale subsidies, private funding mobilisation, and the issuance of European debt to finance economic transformation.<sup>32</sup>

**Strategic Goal:** To leverage the US retreat from the green transition as an opportunity to build long-term EU comparative advantages in clean tech and EVs. This requires EU-level backstops (sovereignty envelopes, joint procurement) to prevent fragmentation.

### Scenario 3: Monetary variant – financial leverage and currency autonomy

**Context:** US fiscal instability, debt-ceiling tensions or debt-sustainability concerns create market volatility from re-pricing of US assets. Weaponisation of the USD by the US, for instance via restrictions on clearing infrastructure (SWIFT/Fedwire), exit fees, or aggressive foreign deployment of US stablecoins.

In a “Monetary Variant”, the EU has a strategic opportunity for financial realignment and to position the Euro as a stabilizer. If doubts about US debt sustainability rise, the EU can leverage this by issuing a genuine Euro-denominated Safe Asset. This would not only stabilise European collateral markets but also offer global investors a diversification alternative to the dollar, effectively turning US fiscal weakness into a catalyst for European monetary sovereignty.

### Response 5: Monetary leverage – the “financial subsidy” lever

**Mechanism:** Severing the “financial subsidy loop” whereby European savings fund US debt. This involves accelerating alternative payment systems (including crypto/stablecoin regulation) and reducing the structural bid for US Treasuries.

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<sup>32</sup> However, this push must avoid the trap of protecting mature industries (“mid-tech”) at the expense of innovation. Industrial policy must be coordinated at the EU level to avoid diverting trade away from established comparative advantages.

**Strategic Goal:** To test the “exorbitant privilege” of the dollar. By stopping the financing of US deficits, the EU can raise US borrowing costs and counterbalance dollar dominance. This response turns US fiscal profligacy into a catalyst for European monetary sovereignty.

**Table 3:** Overview of strategic responses: a potential EU playbook

Scenario	Strategic Response	Actionable Levers	Likelihood	Strategic Potential & Strength
<b>1. ESCALATION</b>  <i>Industrial &amp; Financial Containment</i>	<b>Response 1:</b> Regulatory Retaliation	<ul style="list-style-type: none"> <li>Digital Markets Act (DMA) enforcement</li> <li>GDPR penalties</li> <li>Antitrust investigations targeting US tech monopolies</li> </ul>	<b>High</b> Aligns with existing EU capabilities	<b>Moderate/High</b> Uses market access as a weapon. Effective deterrent, but risks counter-retaliation without building domestic capacity
	<b>Response 2:</b> Reciprocal Tariffs	<ul style="list-style-type: none"> <li>Common Commercial Policy (WTO-compliant countermeasures)</li> <li>Anti-Coercion Instrument (ACI) activation</li> </ul>	<b>Low/Medium</b> Seen as a “narrow path” or last resort due to economic cost	<b>High Impact/High Risk</b> Direct economic pain for US exporters, but risks inflationary blowback and trade war spiral
<b>2. DIVERSION</b>  <i>Trade Reorientation &amp; Industrial Sovereignty</i>	<b>Response 3:</b> Human Capital Embargo	<ul style="list-style-type: none"> <li>“Returnee” Tax Breaks</li> <li>Research Grants (Horizon Europe)</li> <li>Talent Partnerships</li> </ul>	<b>Low</b> Difficult to enforce; relies on soft incentives vs higher US wages	<b>High (Long-term)</b> Addresses the root cause of the productivity gap (innovation capacity) rather than just symptoms
	<b>Response 4:</b> Industrial Sovereignty	<ul style="list-style-type: none"> <li>Sovereignty Fund / STEP</li> <li>EIB Guarantees for clean tech</li> <li>IPCEI (Important Projects of Common European Interest) expansion</li> </ul>	<b>Medium</b> High consensus on need, low consensus on joint funding	<b>Very High</b> The only structural fix. Builds permanent comparative advantage in green/tech sectors, reducing reliance on US supply chains
<b>3. MONETARY VARIANT</b>  <i>Financial leverage &amp; Currency autonomy</i>	<b>Response 5:</b> Monetary Leverage	<ul style="list-style-type: none"> <li>Digital Euro acceleration</li> <li>Stablecoin/Crypto Regulation (MiCA) to track/limit USD flows</li> <li>Euro-denominated Safe Asset issuance</li> </ul>	<b>Low/Medium</b> Requires high ECB/Commission coordination	<b>High (Asymmetric)</b> Attacks the US “exorbitant privilege” by reducing the automatic financing of US deficits by EU savings

Notes: This table maps the five strategic responses identified in the playbook against the three stress scenarios. It evaluates each response based on the actionable institutional levers available, the political likelihood of deployment, and its strategic strength (impact).

## 2.2. European Parliament Oversight and Institutional Capacity

The European Parliament, and specifically the ECON Committee, plays a critical role in ensuring that the EU's economic governance remains robust in the face of the structural shifts identified in this study. However, current oversight mechanisms are often fragmented and reactive, lacking the real-time granularity to track US-originating shocks. To shift from ex-post observation to active strategic management, we recommend the following institutional innovations.

### 2.2.1. Establishing a "Transatlantic Macro & Markets Dashboard"

To address the monitoring blind spots regarding financial and real-economy transmission channels, the Parliament should mandate the creation of a **Transatlantic Macro & Markets Dashboard**. Rather than functioning as a standalone exercise, this dashboard should be integrated as a specialised auxiliary module to the **European Semester**.

Specifically, it would complement the **Macroeconomic Imbalance Procedure (MIP)** by zooming in on the US component of external imbalances. This allows the ECON committee to strip away aggregate global data and assess whether a Member State's external position is structurally vulnerable to specific US policy shocks, such as a tariff hike or a Treasury yield spike. The dashboard should track three specific clusters of variables:

- **Financial Transmission Cluster:** To monitor the financial amplifier effect, this cluster must track sectoral portfolio exposure to US assets. Aggregated national data often hides risks; therefore, the dashboard should break down International Portfolio Investment (IPI) assets by domestic holding sector (e.g. pension funds versus banks) specifically vis-à-vis US issuers;
- **Trade & Exchange Rate Cluster:** To measure the true pass-through of currency fluctuations, the dashboard requires data on invoicing currency by sector (e.g., knowing if machinery exports are invoiced in dollars vs. euros). It should also track value-added trade exposure to identify hidden dependencies on US intellectual property or software embedded in European exports.
- **Real Economy & Competitiveness Cluster:** To monitor the diversion risk, this cluster should track the transatlantic productivity spread (quarterly labour productivity gaps in strategic sectors like AI and Biotech) and the capital intensity gap (venture capital volumes relative to the US).

Implementing this dashboard will require the **ESRB** and **Eurostat** to close significant data gaps, particularly regarding bilateral invoicing data and the systematic reporting of NBFIs exposure to US private credit markets.

### 2.2.2. Institutionalising strategic foresight and legislative scrutiny

Oversight cannot rely solely on EU institutions self-reporting. The Parliament should leverage independent expertise to scrutinise whether EU policies are robust against stress-test scenarios such as those of Escalation, Diversion, and Monetary Variant described above.

### The Annual Transatlantic Stability Report

The Parliament could mandate an independent **panel of experts**, convened by its EP services, to produce an annual “State of Transatlantic Risks” report. This report would serve as the factual basis for a dedicated scrutiny hearing with the ECB President and the Trade Commissioner, moving the dialogue from domestic compliance to strategic resilience.

### Instituting “Competitiveness Stress Tests” for legislation

EU regulation often prioritises safety without fully quantifying the impact on the transatlantic productivity gap. The Parliament should introduce a procedural requirement that the impact assessments for all major economic legislation (e.g. the AI Act, Data Act) include a specific **“Competitiveness Stress Test.”** This test must explicitly answer whether the regulation risks widening the capital expenditure (CAPEX) or adoption gap with US competitors, ensuring that compliance costs are weighed against the risk of structural industrial erosion.

### Scrutinising new transmission channels

As highlighted in Box 1, USD-denominated stablecoins and crypto-assets increasingly act as frictionless conduits for importing US monetary policy, yet they often fall outside traditional banking oversight. The ECON Committee should request regular, dedicated data from the ECB and ESMA on **“EUR-to-USD-crypto” net flows**. Oversight must treat these not as niche assets, but as systemic components of the transatlantic financial architecture that affect monetary transmission.

#### 2.2.3. Monitoring the implementation of sovereignty instruments

As the EU deploys new funding instruments such as the **Strategic Technologies for Europe Platform (STEP)** and the proposed **European Competitiveness Fund** within the new Multiannual Financial Framework (MFF), the oversight of the Parliament must shift from compliance to performance.

The ECON and BUDG committees should establish a joint working group to monitor the **net strategic impacts** of these funds. Crucially, success should not be measured merely by absorption rates or expenditure compliance, but by the tangible **reduction of the transatlantic investment gap** in critical technologies. If instruments like the Competitiveness Fund spend billions but the US-EU venture capital gap continues to widen, the policy mechanism must be flagged for immediate review.

### 3. CONCLUSION

The empirical evidence presented in this study confirms that the **transatlantic economic relationship has entered a phase of structural divergence**, with the United States pulling ahead in growth, productivity, and technological leadership. However, this trajectory of relative European decline is not preordained. The widening gap forces EU policymakers to confront a **"Competitiveness Trilemma"**: under the current institutional framework, it is becoming impossible to simultaneously maintain strict fiscal sustainability rules, achieve industrial sovereignty, and preserve the integrity of the Single Market. **As the United States leverages its unified market and aggressive macro-stabilisation tools to build capacity, Europe's fragmented response risks locking the continent into a "middle-technology trap."** To resolve this trilemma, the Union must heed the warning of IMF Managing Director Kristalina Georgieva and move beyond "lofty rhetoric on how to lift competitiveness" and "get it done" by prioritising decisive action to **deepen the internal market** rather than engaging in a subsidy race it cannot win.

A central pillar of this structural reform must be the **reclamation of monetary and financial autonomy by Europe**. The current financial architecture creates a "financial subsidy loop" where European savings, lacking a domestic safe asset, flow into US Treasuries, effectively granting the dollar an **"exorbitant privilege" that finances American industrial policy**. Addressing the asymmetries in investment capabilities requires completing the Capital Markets Union and establishing a euro-denominated safe asset to anchor liquidity and retain capital within the EU. Without correcting these financial plumbing issues, Europe will continue to import US financial conditions and volatility while exporting the capital needed for its own innovation ecosystem.

Despite these economic frictions, **the United States remains Europe's partner of choice, bound by shared democratic values and deeply integrated economies**. The imperative for policymakers is to **reinvigorate transatlantic cooperation**, ensuring that the **drive for strategic autonomy** strengthens rather than weakens the alliance. Mechanisms such as the Trade and Technology Council (TTC) and joint climate task forces are essential forums to pre-empt conflict, align subsidy efforts, and set global standards. If **Brussels and Washington** can converge on frameworks for AI risk management and data sharing, they **can present a united front that safeguards their economic security**; if they drift apart, they risk opening opportunities for systemic rivals to exploit their division.

Ultimately, the future of US-EU relations will be defined by whether the two blocs choose a path of managed divergence or renewed cooperation. A **balanced partnership requires a stronger Europe** – one that has addressed its internal stabilization deficit and productivity bottlenecks. By resolving its domestic contradictions and leveraging its unique strengths in the single market, the **EU can transform from a reactive regulator into an equal peer**. The path forward lies not in decoupling, but in rebalancing the relationship to ensure that both the US and the EU can lead the global economy toward a sustainable and secure future.

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## ANNEX

### A. 1 Cyclical analysis

#### Methodology

##### Overview

We analyse business cycle synchronisation between the United States and the European Union using quarterly macroeconomic data spanning 2000–2024. Our approach employs a two-stage process: (1) data transformation to isolate cyclical components, and (2) multi-method synchronization analysis to capture different dimensions of economic co-movement.

##### Data Transformation

For each macroeconomic variable, we apply the Hodrick-Prescott (HP) filter ( $\lambda=1600$  for quarterly data) to decompose the series into trend and cyclical components. The cyclical component captures deviations from the long-run trend, representing the business cycle fluctuations we analyse.

- **Real economy variables** – GDP, consumption, investment, government spending, industrial production (HP-filtered log levels)
- **Labor market variables** – unemployment rate, labour force participation (HP-filtered levels)
- **Price variables** – core CPI, industrial prices (HP-filtered cycles for most analyses; year-over-year growth rates for predictive methods requiring stationarity)
- **Financial and interest rate variables** (HP-filtered levels or growth rates depending on stationarity requirements)

All series are seasonally adjusted at the quarterly frequency and standardized to ensure comparability.

##### Synchronisation Analysis Methods

We employ complementary methods to provide a comprehensive assessment of US-EU cyclical relationships:

1. **Rolling Correlation (5-Year Window)** – Measures the time-varying linear association between US and EU cycles. High positive correlations indicate synchronised expansions and contractions. The rolling window captures evolving synchronization patterns over time.
2. **Cross-Correlation with Leads and Lags** – Identifies lead-lag relationships by computing correlations at different time shifts ( $\pm 8$  quarters). Determines whether one economy systematically leads or follows the other's cyclical movements.
3. **Concordance Index** – Calculates the proportion of time both economies are in the same cyclical phase (both above or both below trend). Values near 1 indicate strong phase synchronization; values near 0 indicate countercyclical behaviour.
4. **Rolling VAR Impulse Response Functions (20-Quarter Window)** – Estimates time-varying spillover effects using bivariate Vector Autoregressions (VARs). Traces the dynamic response of one economy to a one-standard-deviation shock in the other over a 4-quarter horizon. Provides directional spillover measures: US→EU and EU→US.

5. **Reaction Probabilities** – Event-based analysis measuring the conditional probability that one economy enters a specific cyclical phase (expansion/contraction) given the other's current phase. Captures asymmetric synchronization patterns across cycle stages.

*Interpretation*

Rolling correlation and concordance measure the degree of co-movement. VAR-IRFs quantify spillover magnitudes and persistence.

**Figure A. 1:** Cyclicity Analysis: real economic variables (2000–2025)



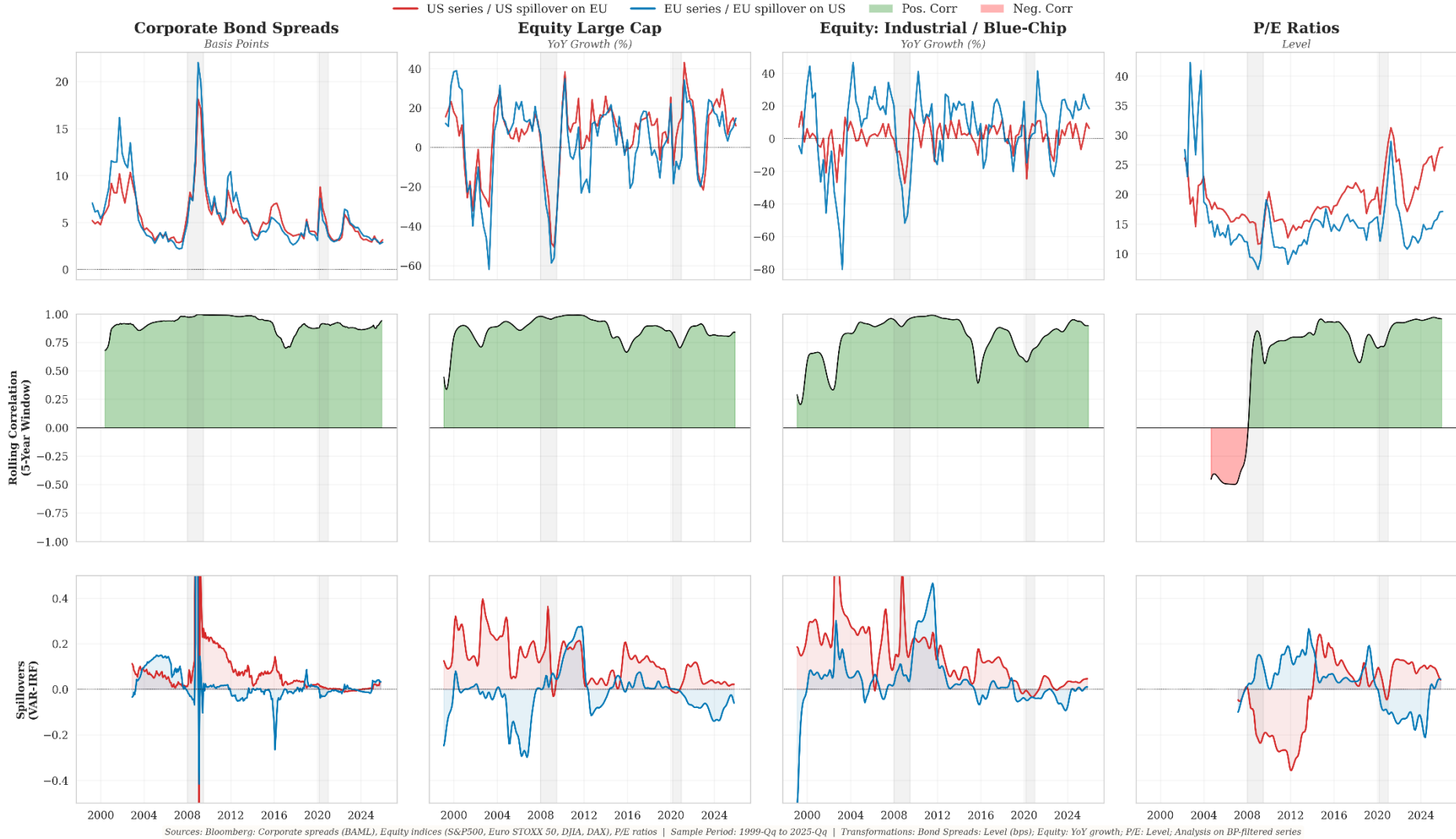
**Figure A. 2: Cyclicity analysis: structural variables & prices (2000-2025)**



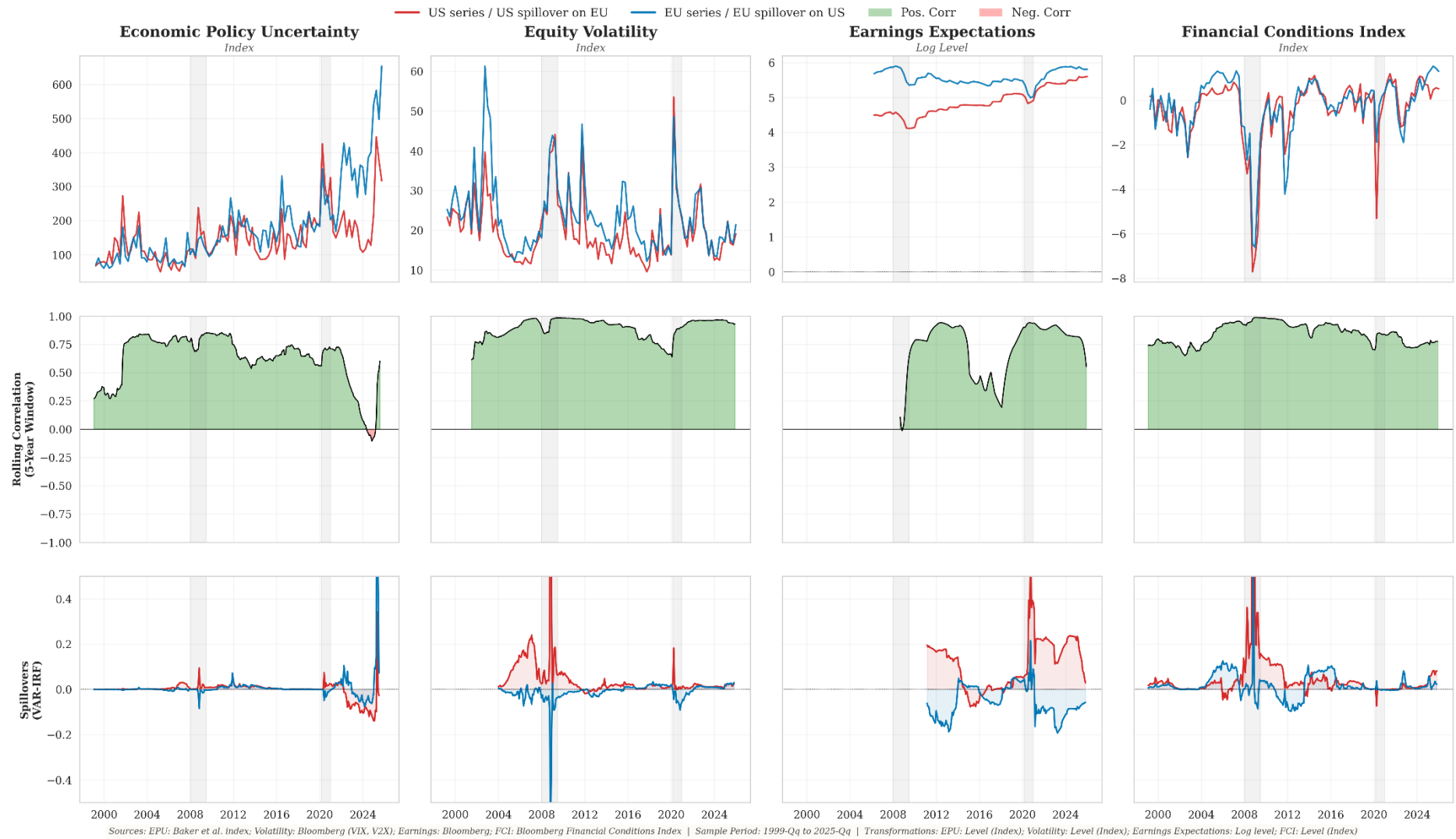
**Figure A. 3:** Cyclicity analysis: interest rates & exchange rates variables (2000–2025)



**Figure A. 4:** Cyclicity analysis: financial variables (2000–2025)



**Figure A. 5: Cyclicity Analysis: risk & uncertainty (2000–2025)**



## A. 2 Revealed Comparative Advantage (RCA) analysis

### Methodology

#### Overview

The Revealed Comparative Advantage (RCA), or Balassa Index, measures a country's export specialisation by comparing its sector-specific export share to the world average. The index is calculated as:

$$RCA_{i,c} = \frac{X_{i,c}/X_c}{X_{i,world}/X_{world}}$$

where  $X_{i,c}$  represents country  $c$ 's exports in sector  $i$ ,  $X_c$  is the country's total exports, and the denominator captures the same ratio at the world level.

#### Interpretation

- **RCA > 1:** The country is more specialised in that sector than the global average (comparative advantage)
- **RCA < 1:** The country is less specialised (comparative disadvantage)
- **RCA ≈ 1:** No clear specialisation pattern

The index is scale-free, making it directly comparable across sectors, countries, and time periods.

### Results

#### Energy sector transformation

The most dramatic shift occurred in **Energy & Minerals**, where the US RCA advantage surged from +0.74 in 2012 to +3.29 in 2023 (change: +2.55). The US shale revolution enabled the country to move from moderate to overwhelming export specialization, with its RCA rising from 2.97 to 4.95, while the EU's fell from 2.24 to 1.66.

#### Technology leadership sustained

The US maintained and slightly strengthened its advantage in **Electrical & ICT Equipment** (+1.02 → +1.23). Both regions exhibit high RCA values (>2.0), confirming strong global competitiveness, but the US edge persists with its RCA increasing from 3.17 to 3.50.

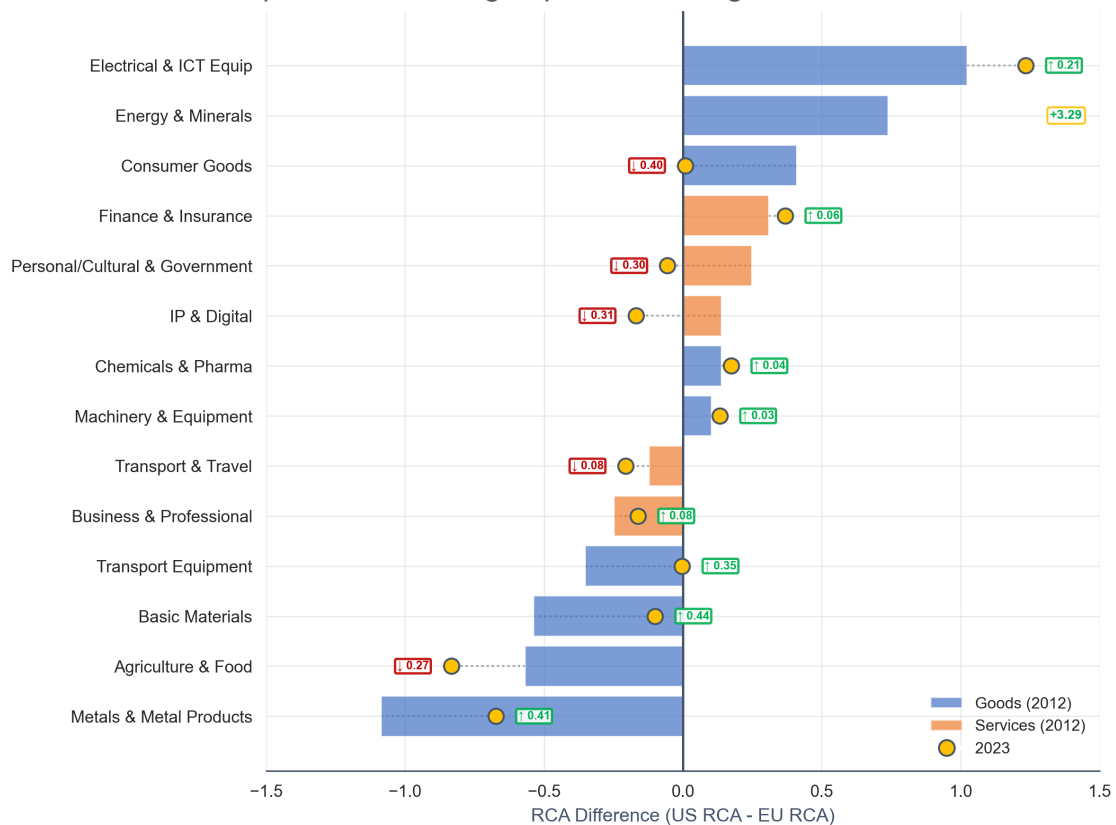
#### Services reversal

A significant structural shift emerged in services trade. In 2012, the US held comparative advantages in three of five services sectors; by 2023, this shrank to just one:

- **Finance & Insurance** remains the sole US services stronghold (advantage grew from +0.31 to +0.37)
- **IP & Digital** flipped from US advantage (+0.14) to EU advantage (-0.17), a swing of -0.31
- **Personal/Cultural & Government** similarly reversed from +0.25 (US) to -0.06 (EU)

The average services RCA difference shifted from +0.07 (US favour) to -0.04 (EU Favor), marking a clear erosion of traditional US services dominance.

**Figure A. 6:** US–EU comparative advantage by sector: changes from 2012 to 2023



Positive = US advantage ; Negative = EU advantage  
 Labels show change 2012→2023: ↑ green = US gained advantage, ↓ red = EU gained advantage

Source: UN Comtrade, OECD TIS, and authors' calculations.

### Manufacturing Convergence

Across most goods sectors, the US narrowed historical EU leads:

- **Basic Materials:** EU advantage compressed from -0.54 to -0.10 (US gain: +0.44)
- **Metals & Metal Products:** from -1.09 to -0.67 (US gain: +0.41)
- **Transport Equipment:** nearly converged from -0.35 to -0.00 (US gain: +0.35)
- **Consumer Goods:** US advantage evaporated (+0.41 → +0.01), reflecting EU catch-up (EU gain: -0.40)

Overall, the average goods RCA difference moved from near parity (-0.01) to a US advantage (+0.36).

### Persistent structural specialisations

Despite convergence trends, certain sectors show enduring dominance:

- **EU strengths:** Agriculture & Food (advantage deepened: -0.57 → -0.83), Metals & Metal Products (though narrowing)
- **US strengths:** Energy & Minerals (massively reinforced), Electrical & ICT Equipment, Finance & Insurance

## Strategic Implications

The 2012-2023 period witnessed a **fundamental restructuring of US-EU trade specialisation**. The US transitioned from balanced goods trade and services dominance to a clear goods advantage driven by the energy boom, while the EU strengthened its position in services – inverting the traditional pattern. Energy independence has become a cornerstone of US competitiveness, while the EU's gains in digital, professional, and cultural services challenge longstanding US leadership in the tertiary sector. Manufacturing sectors exhibit broad convergence, with the notable exception of energy-related goods. This reconfiguration reflects divergent resource endowments (shale revolution), policy choices, and evolving global value chains, underscoring the dynamic nature of transatlantic comparative advantages.

### A. 3 Monetary policy synchronisation analysis

#### Main text analysis: divergence attribution

In **Figure 17**, we attribute the absolute policy rate gap  $|Fed - ECB|$  to each central bank using cumulative counters ( $FED\_divergence, ECB\_divergence$ ) that always sum to the total gap.

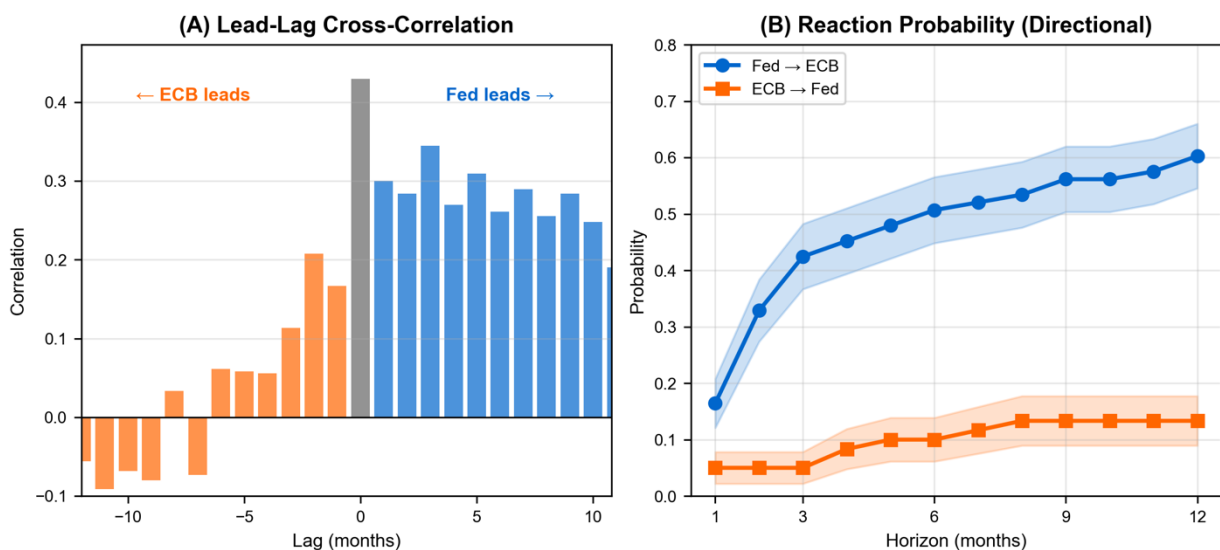
Attribution rules:

- **Widening the gap:** Add the full change to the **mover's** divergence counter
- **Resolving the gap:**
  - First reduce the **mover's own** divergence counter (up to available amount)
  - Second, Reduce the **other bank's** counter with any remaining gap reduction

This “first-own, then-other's” principle ensures counters remain non-negative and sum to  $|Fed - ECB|$  at all times, providing a complete attribution of divergence responsibility.

#### Panel A: Lead-lag cross-correlation

**Figure A. 7:** Asymmetry analysis in Fed-ECB monetary policy synchronicity and spillovers



Source: ECB, Fed, and authors' calculations.

This analysis computes the cross-correlation between Fed and ECB policy rate changes at different time lags ( $\pm 12$  months). We use

- Take first-differenced monthly policy rates ( $\Delta Fed\_Rate, \Delta ECB\_Rate$ )
- Compute the correlations where negative lags indicate ECB leads Fed, and positive lags indicate Fed leads ECB)
- Identify the peak correlation identifies the dominant lead-lag relationship

#### Panel B: Reaction probability

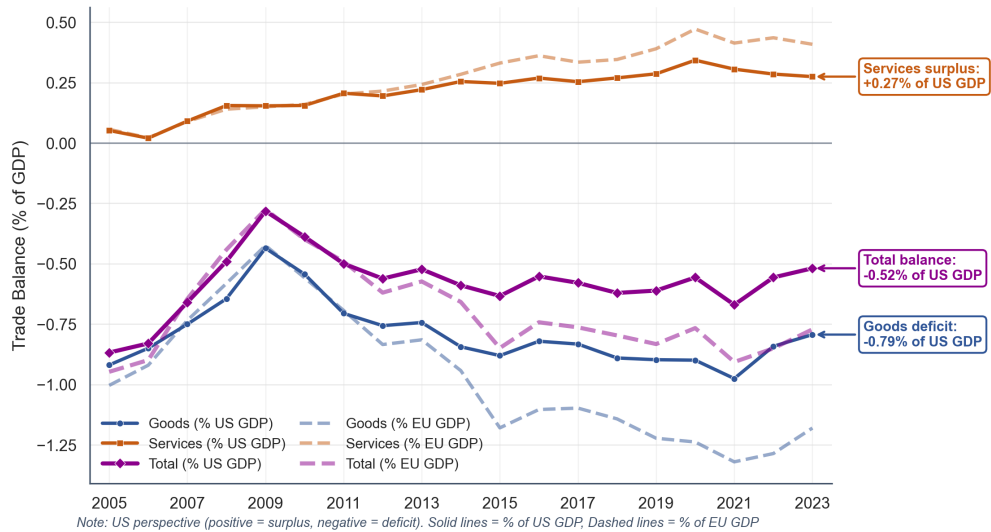
This analysis measures the probability that one central bank responds to the other's policy move within a given horizon (1-12 months). The encoding criteria:

- Reaction = 1 (TRUE follow) if both criteria are satisfied:
  - Action Filter: Follower bank moves in the same direction (hike/cut) as leader within horizon H
  - Level-Based Filter: Follower's rate move is converging
    - For hikes: Follower's rate **before** the move < Leader's **new** rate
    - For cuts: Follower's rate **before** the move > Leader's **new** rate
- Reaction = 0 (FALSE, No reaction) if:
  - No same direction move occurs within horizon, OR
  - Move fails the level-based filter (diverging move)

Standard errors are computed as  $SE = \sqrt{[p(1 - p)/n]}$  for each horizon.

## A. 4 Additional figures

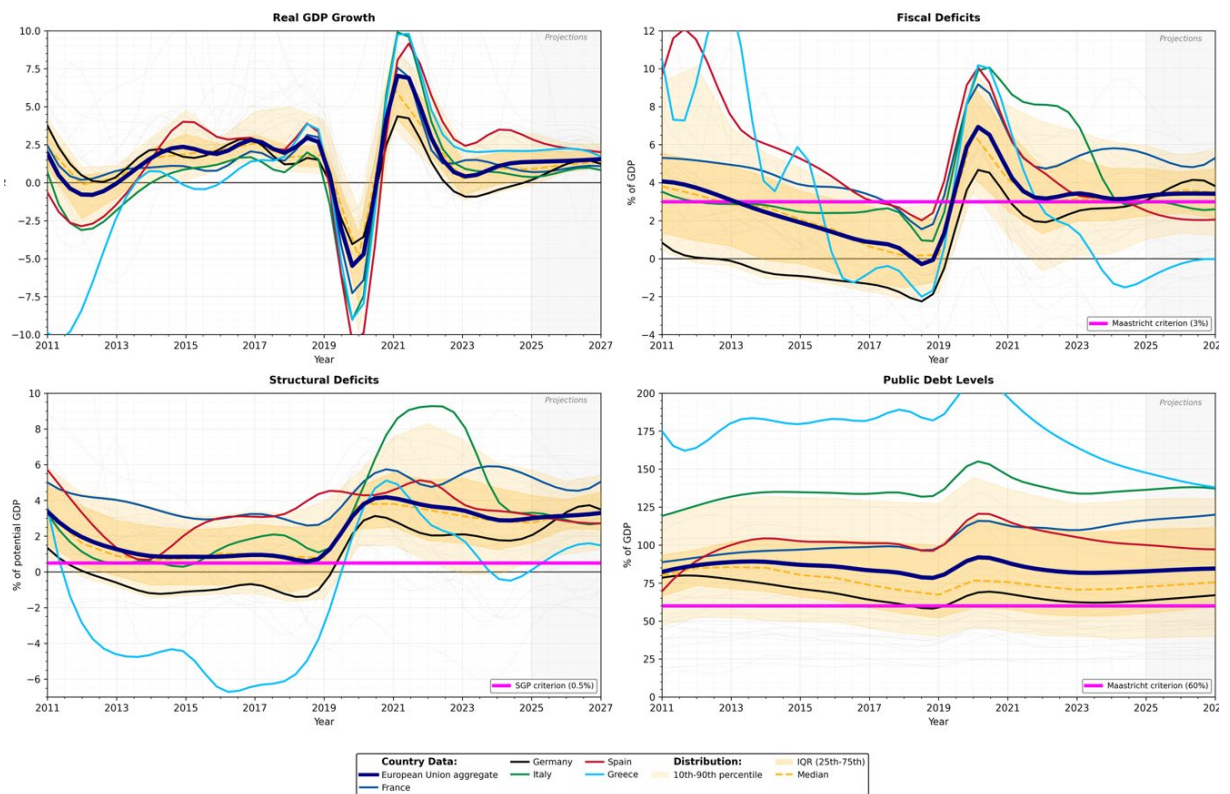
**Figure A. 8:** US-EU trade balance in goods and services as % of GDP



Source: UN Comtrade and author's calculations.

**Persistent Fiscal Fragmentation and Structural Divergence:** Analysis of fiscal indicators (Figure A. 9) reveals a persistent two-tier Europe where aggregate stability masks deep structural divergences. While the median debt-to-GDP ratio has stabilized near 64%, the GDP-weighted mean

**Figure A. 9:** Fiscal indicators across EU countries (2011-2027)

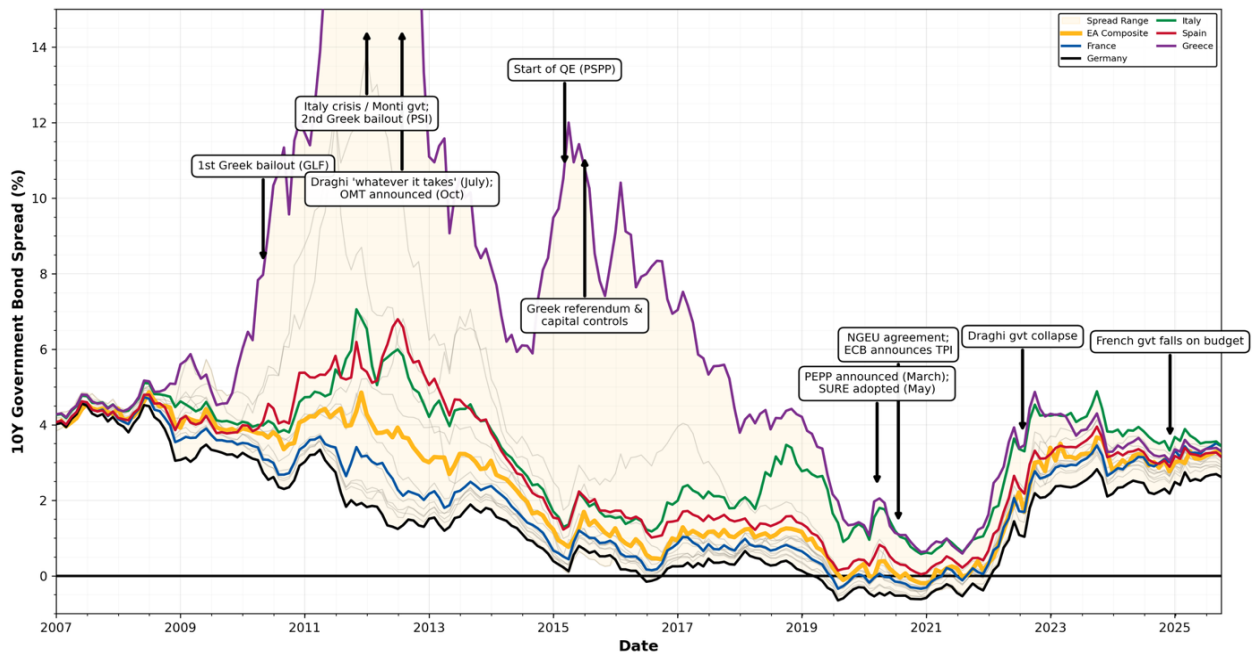


Source: EC AMECO (November 2025).

remains significantly higher (approx. 90%), driven by large economies – notably France, Italy, and Spain – that consistently exceed debt and deficit thresholds. Projections for 2025–2027 indicate that 78% of Member States will violate structural deficit rules, a deterioration compared to the 2013–2019 recovery period.

**The “Quiet Fragmentation” of Sovereign Spreads:** Sovereign spread dynamics (Figure A. 10) highlight a new regime of quiet fragmentation. While bilateral spreads remain historically compressed compared to the 2011–2012 crisis – likely due to the ECB’s Transmission Protection Instrument (TPI) and implicit backstops – underlying heterogeneity is rising. A key paradox has emerged where Italian spreads have compressed relative to Germany, while French spreads have widened to multi-year highs (approx. 0.82 pp), reflecting market discrimination based on fiscal credibility rather than just a core-periphery divide. The widening interquartile range of spreads suggests that while acute crisis is absent, financial disintegration is slowly creeping back into the Eurozone, complicating the single monetary policy.

**Figure A. 10:** EA countries 10Y sovereign spreads heterogeneity (2007–2025)



Source: Fred, ECB.

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This study assesses the evolving structural divergence between the US and EU economies, driven by widening productivity gaps and asymmetric financial integration. It identifies a “Competitiveness Trilemma” constraining EU policy responses to US industrial activism. The paper analyses new transmission channels of economic shocks and proposes a strategic playbook for the European Parliament to enhance industrial sovereignty and rebalance the transatlantic partnership.

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