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Can Europe Rise to the Challenge Posed by Donald Trump's America?

Published on: 27 June, 2025 | Author: Investment Team

We are all familiar with the law of unintended consequences or as Helmut von Moltke put it in a sadly topical context, "no plan survives contact with the enemy."

Donald Trump has breezed through so many norms, protocols, laws and precedents in the course of his still brief (barely 6 months?) second tenure of the White House that it difficult to make sense of the intended consequences of his Presidency let alone the unintended. Nevertheless, consequences there are and they are legion.

Virtually all academic opinion is highly critical of Trump's economic policies. There is almost no disagreement that the imposition of tariffs will lower growth and raise inflation.

What is thought to be almost as bad is the on/off nature of his policymaking. CEOs are repeatedly reporting that it is impossible to plan or invest when they have no visibility on pricing and margins from one week to the next. Like all economic variables the real impact of Trump's policies will take effect with a lag; we won't have any idea of the true consequences until later this year at the earliest.

Nonetheless the "Budget Lab" at Yale University, analogous in some ways to the Institute for Fiscal Studies over here, estimates up to a 2% hit to US growth in the near term and 0.5% per year after the initial shock is absorbed.

Trump has raised the cost of importing goods into the US, but he is also threatening to weaponise the US dollar itself. Many international goods are traded in US dollars, almost all countries seek to hold reserves in USD and the US has, until recently, been a magnet for inward foreign investment, which actually benefits US consumers. Trump wants to monetise these flows; he wants to charge fees on dollar swap lines and impose taxes, or renegotiate the terms of the US instruments that foreign investors hold, typically US Treasury bonds. He is tinkering with the plumbing of the world's financial architecture in a way that brings to mind children with matches or bulls in China shops.

There are two very real consequences flowing from these actions: firstly, by deterring investment Trump is chipping away at the competitive edge of the US economy and secondly, by weaponising the currency, he is also chipping away at the attractiveness of the US dollar as a reliable asset for overseas investors, including governments and their financial reserves.

The third major consequence involves the twin threats to Europe: Putin from the East and, de facto, US withdrawal from NATO in the West.

If you are a fan of the Harry Potter series, you may be familiar with school motto which runs "Draco dormiens nunquam titillandus" which is translated as "never tickle a sleeping dragon."

The sleeping dragon in question is Germany, the largest economy in Europe by some margin.

For very obvious reasons recent German political history has been moulded by the events of the 1930s and 1940s but though the horrors of the second world war cast a long shadow, the existential threat to Europe from the East (and West) is enough to cast that shadow aside. Donald Trump has indeed tickled a sleeping dragon, and Germany is in the throes of casting off decades of economic and foreign policy dogma including the fabled "debt-brake" and the self-imposed limits on military spending.

The German cabinet this week approved the 2025 budget which contains provisions for EUR850 billion of new investment: EUR500 bn for infrastructure and EUR400bn for defence. This is the largest fiscal expansion since the reunification of East and West in the 1990s.

The key to the consequences of these decisions is in the Keynesian multipliers that transmit higher spending through the economy, and in this case, through the global economy as a whole. Interestingly it is the companies that we already own in Europe and Asia which have performed best this year and we would expect this trend to continue for the time being.