

## **Challenges for Europe Facing Severe Economic and Geopolitical Environments**

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Under the influence of Trump 2.0, which has been shaking the world dramatically, the traditional international order is creaking and upsetting in various fields and perspectives. Tensions have emerged and are growing in traditional relations between allies and between close countries due to changes in tariff policy and views about the value and significance of alliances. On the other hand, China has attracted global attention as a strategic competitor for the United States. Trump 2.0 has imposed additional tariffs on China, signaling an escalating bilateral trade war. While demonstrating a tough stance against China, U.S. President Donald Trump has indicated an attitude of giving priority to dialogue with Chinese President Xi Jinping. It will be important to see how the U.S.-China relationship will develop.

Regarding Russia, which continues its invasion of Ukraine, Trump has demonstrated his approach to his Russian counterpart Vladimir Putin, indicating that Trump 2.0 has given priority to resolving key international problems in the world through talks between the leaders of great powers. In this regard, media have begun to use the word “Yalta 2.0,” referring to the 1945 Yalta talks between U.S., British, and Soviet leaders who decided on the international order after World War II.

Under these circumstances, all countries in the world are under the influence of the creaks and disturbance of the international order. In my view, however, the domestic and external environment surrounding Europe has become particularly severe, increasing the sense of uncertainty significantly.

First, economic growth in Europe has been markedly sluggish so far. According to the International Monetary Fund's “World Economic Outlook” released in January 2025, economic growth in the eurozone is estimated at 0.4% for 2023 and 0.8% for 2024, slipping below 1.0% for two consecutive years. The United Kingdom's economic growth is also sluggish, estimated at 0.3% for 2023 and 0.9% for 2024. Compared to the U.S. economic growth, close to 3% for both years, Europe's growth is far more sluggish.

The most emblematic of the European stagnation is a slump in Germany, Europe's largest economy, which has been the driving force of the European economy. Germany's economic growth is estimated at minus 0.3% for 2023 and minus 0.2% for 2024, remaining negative for two consecutive years. This is the first consecutive two-year negative growth since the 2002-2003 slump, during which Germany was called the “sick man of Europe.” The consecutive two-year negative growth is the second since the reunification of East and West Germany.

Various problems have been pointed out as to why the European economy as a whole, and Germany in particular, once Europe's most powerful economy, is struggling. Particular attention is paid to the view that the existence of the gas supply from Russia at competitive prices had been an important factor that had supported the German economy. Since the start of the war in Ukraine, the

pipeline gas supply from Russia has plummeted, pushing gas prices in Europe up to extraordinarily high levels for a time. Although gas prices have been stabilized to a certain extent, energy cost hikes have reportedly hurt the European economy including Germany, despite the introduction of alternative energy sources to avoid physical shortages following the loss of competitive energy supply. In addition, overall cost increases and inflation triggered by soaring energy prices and other factors are also hurting the European and German economies. The high interest rate policy that has been implemented to combat inflation is also weighing on the economy.

Furthermore, the influx of cheap Chinese-made electric vehicles (and other goods) and a decline in exports amid China's economic slowdown have served a body blow to manufacturing industries and exports, which have supported the German economy so far. It is reported that the automobile industry, which is the center of the German economy, has come under strong downside pressure and plunged into a difficult situation.

Under these circumstances, the abovementioned IMF outlook forecast that eurozone economic growth would pick up to 1.0% in 2025, with Germany restoring a positive growth rate of 0.3%. However, no optimism can be warranted about the future. If tariffs are raised under Trump 2.0 to affect world trade, it could have a great impact on Europe and Germany. In addition, there is a possibility that various economic burdens will inevitably increase on Europe over the Russia- Ukraine issue. The situation will continue to be severe and uncertain for the European economy.

That is why the ruling center-left Social Democratic Party (SPD) in Germany suffered a major defeat in February's general election, allowing the center-right Christian Democratic and Social Union (CDU/CSU), the largest opposition group, to become Germany's top political party. The far-right Alternative for Germany (AfD) became the second largest party. The election results have been attributed to voters' strong dissatisfaction with the aforementioned severe economic situation and an accommodative immigration policy. Currently, a grand coalition between the CDU/CSU and SPD is being explored. However, there is still a high level of uncertainty about the future of German politics, the management of the government, and economic policies.

In addition to the economic downturn, security and geopolitical issues are weighing on Europe. Under the abovementioned "Yalta 2.0" order under Trump 2.0, Europe will have to address its own security with a stronger sense of urgency than ever before. While Trump has taken leadership in Ukraine peace efforts, the United States' relationship with Ukraine and Europe over the Ukraine war has changed drastically from that under the previous Biden administration, as symbolized by the heated exchange of words between President Trump (and Vice President JD Vance) and Ukrainian President Volodymyr Zelensky on February 28 that was reported along with shocking images around the world.

The outcome of negotiations between the United States and Russia on the Ukraine war is uncertain. But one thing seems to be clear, whatever the outcome will be—in addition to strengthening its support for Ukraine, Europe will need to inject policy resources and money at a level that was previously unthinkable in order to enhance its own security. In that regard, the message of Trump 2.0 is quite clear. Europe will become strongly aware of Russia's presence for its own security and have no choice but to strengthen its strategic response measures by significantly increasing military spending and security costs.

On March 4, in fact, European Commission President Ursula von der Leyen announced a European rearmament plan to invest up to 800 billion euros (about 125 trillion yen) to strengthen

defense capabilities. The plan will be discussed at a special European Union summit on March 6.

What implications do the growing economic hardship, uncertainty and massive security costs have for Europe? Regarding energy-related issues, which I am interested in, the first point is that it will be even more important for Europe to secure energy at stable and competitive prices. Any unbridled rise in energy costs may no longer be tolerable for Europe. Cost containment and minimization are very important on the European agenda. On the other hand, the enormous security costs that are inevitable will require various adjustments and balancing in the implementation of other policy agendas. Under such circumstances, it will be important to pay attention to how the Europe-led decarbonization policy for the world would be affected. The future initiatives of Europe in dire straits will attract much attention.

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