BUSINESSEUROPE SPRING ECONOMIC OUTLOOK

EU'S MODEST GROWTH INSUFFICIENT TO MEET GLOBAL CHALLENGES

WWW.BUSINESSEUROPE.EU

JUNE 2025

EXECUTIVE SUMMARY

ECONOMIC SITUATION

- The EU economy grew by a modest 0.9% in 2024. **Growth is expected to increase slightly to 1% in 2025, reflecting a downward revision of 0.3 percentage points (p.p.) compared to our autumn economic outlook**. A further increase to 1.4% is forecasted for 2026. The uncertainty surrounding the implementation of new US tariffs since early 2025 has contributed to **downward** revisions in GDP growth estimates reported by our member federations.
- **Investment is projected to cautiously rebound in 2025, despite elevated policy uncertainty.** BusinessEurope's member federations expect gross capital formation in the EU to expand by 1.4% in 2025, a minor downward revision of 0.1 p.p. compared to our autumn economic outlook, followed by a more robust increase to 2.4% in 2026.
- **Both inflation and unemployment are projected to continue their decline, remaining close to recent levels**. According to national member federations, headline inflation is expected to average 2.1% in the eurozone in both 2025 and 2026, bringing it near the ECB's 2% target. At the same time, unemployment is forecast to decrease from 5.5% in the EU in 2025 to 5.4% in 2026.

POLICY RECOMMENDATIONS

To reverse the trend of decreasing competitiveness against global rivals like the U.S. and China, address stagnating productivity, and boost low growth while increasing resilience, the EU should undertake several crucial measures:

- **Deepen simplification efforts** by cutting regulation following evidence-based evaluations and reducing administrative burden for firms. Reduce Single Market barriers to boost intra-EU trade and competition, which in turn would favour the emergence and growth of the most productive and innovative companies. Simplify and harmonize taxation rules to help firms unlock the benefits of the Single Market. Invest in education and training to address labour shortages.
- **Foster a savings and investment union, with deeper capital markets and improved funding** for companies, including innovative start-ups. Strengthen public in R&D investments, while incentivising private ones. Respond to global trade volatility by diversifying source and destination markets through new trade agreements while trying to find a negotiated solution with the US that is mutually beneficial.
- **Strengthen efforts to lower energy costs and increase EU's energy resilience** by investing in energy infrastructure and production capacity, diversifying sources.
- **The development of a European security and defence industry is key for the competitiveness and reindustrialisation of the EU.** For BusinessEurope, this strategy should encourage effective public-private cooperation to safeguard the functioning of critical infrastructure, industries, and services in times of crisis and address fragmentation in the single market for defence to foster increased production capacity in the European defence industries.

ECONOMIC IMPACT OF U.S. TARIFFS

- **With external trade accounting for over 22.4% of the EU's GDP in 2023 and the U.S. representing the EU's largest individual trading partner, the tariff shock represents a major external headwind.** The new U.S. "reciprocal tariff" framework has already raised average duties on EU goods exports to the U.S. from around 2% to 10%, with some sectors facing additional 25% tariffs. This policy shift affects €400-€500 billion in EU exports, particularly in high-value-added sectors such as automotive, machinery, and chemicals.
- **Potentially even more damaging is the unpredictable nature of tariffs announcements, threats, and delays**, well exemplified by the recent proposal of imposing a 50% tariff on all EU goods. This policy uncertainty creates a challenging business environment where companies are responding with costly hedging strategies, delayed investments, and shortened planning horizons.
- **Prolonged trade tensions risk amplifying inflation and supply-side disruptions.** The retaliatory tariffs would introduce upward pressure on import prices and may complicate the ECB's disinflation path and monetary easing. The European Commission is pursuing retaliatory tariffs, limited to specific sectors, and leveraging the threat of the potential imposition of higher barriers, while looking for diversification through new trade agreements, and discussing possible changes of stance in industrial policy. However, deep economic ties, particularly in high-tech manufacturing and pharmaceuticals, limit near-term substitution.

EU DEFENCE INDUSTRY

- **Global defence spending reached €2.5 trillion in 2024.** The EU accounted for 17% of this, resulting in a 17% growth over 2023. However, the EU's reliance on non-EU suppliers for procurement amounted to 78% (2022-2023). EU defence spending also suffers from a duplication of military platforms and lack of coordination, leading to inefficiency. When adjusted for a military-specific measure of purchasing power, the EU's military expenditure significantly trails China's while it exceeds Russia's by just 22%, albeit all of those are far behind the U.S.'s which is almost 2 times the budget of the EU.
- **Facing escalating global instability and Russia's aggressive stance, the EU is urgently working to bridge its spending, coordination, planning, capacity, and skills gaps.** Beyond the €8 billion from the European Defence Fund (EDF) in the current EU budget, several initiatives have been launched. The European Defence Industrial Strategy (EDIS) sets ambitious albeit non-binding targets, including 50% of procurement from EU contractors by 2030. In March 2025, the Commission announced its "ReArm Europe/Readiness 2030" initiative, providing €150 billion in EU-backed loans and creating fiscal flexibility for members' spending programs (up to 1.5% of GDP annually for defence).
- **The EU defence sector's employment rose to 581,000 in 2023.** However, it suffers from low R&D investment (4.5% vs. US's 16%), hindering innovation, and lacks long-term planning in public procurement. In 2023, EU-based companies accounted for just €75 billion of the €584 billion revenues from the top 100 global defence firms.

ABOUT THE ECONOMIC OUTLOOK

BusinessEurope publishes a biannual Economic Outlook that provides business insight into recent and projected economic developments in Europe.

In producing our economic projections and assessing current challenges and developments in the international and regional economy, BusinessEurope works closely with its member federations and draws on their specialist expertise and detailed knowledge of their national economies and ongoing interactions with business.

In particular, our EU27 and Euro area forecasts are a reflection of the GDP-size weighted economic forecasts from each member state from the economic research departments of our national member federations. Our economic projections are therefore informed by leading country experts with in-depth knowledge and day-to-day monitoring of the economic situation in every EU member state.

FOR FURTHER INFORMATION[1]

BusinessEurope Economics Department:

Lúcio Vinhas de Souza, Chief Economist and Director of the Economics Department, BusinessEurope
l.vinhasdesouza@businesseurope.eu

Fabrizio Franco, Economic Adviser, Economics Department, BusinessEurope
f.franco@businesseurope.eu

Bo Sangers, Junior Economic advisor, Economics Department, BusinessEurope
b.sangers@businesseurope.eu

BUSINESSEUROPE
Av. de Cortenbergh 168 – 1000 Brussels

[1] This publication also benefited from work by Koen Kramer, now at the Netherlands Bureau for Economic Policy Analysis (CPB). We thank his valuable contributions.

CONTENTS

OVERALL FORECAST

The first quarter of 2025 was marked by heightened policy uncertainty, contributing to a weaker business climate across Europe. GDP growth in the EU slowed slightly to 0.3%, down from 0.4% in the previous quarter, while growth in the euro area increased modestly to 0.4%, compared to 0.2% at the end of 2024.

TABLE 1: BUSINESSEUROPE ECONOMIC FORECAST

Main Variables	EU27		Euro area	
	2025	2026	2025	2026
Real GDP (annual % growth)	1	1.4	0.9	1.3
Inflation (%)	2.2	2.1	2.1	2.1
Unemployment (%)	5.5	5.4	5.9	5.8
Government net lending (% of GDP)	-2.2	-2.4	-2.1	-2.3

Source: BusinessEurope staff calculations based on Member Federations

Based on input from national business federations, we expect:

- The EU economy to grow by 1% in 2025, with EU growth rising to 1.4% in 2026. Our forecast for 2025 has been revised slightly downwards from our autumn economic outlook, due to increased economic policy uncertainty and the impact of US tariffs at the global level.
- Both industrial and services investment to pick up in the next six months despite the increased policy uncertainty in recent months, possibly due to the transmission of continued monetary easing by the ECB, and larger defence investment. Additionally, our forecast suggests that gross capital formation in the EU will return to growth, expanding by 1.4% in 2025 and 2.4% in 2026, following a contraction of 1.9% in 2024.
- Headline inflation to continue its steady decline, despite the volatility observed in the previous months, averaging 2.2% in the EU and 2.1% in the euro area in 2025, bringing it close to the ECB's 2% target. In 2026, headline inflation is expected to further decrease to 2.1% in the EU, while remaining stable in the euro area.
- Unemployment in 2025 to further decline in the EU and euro area to 5.5% and 5.9% respectively. In 2026 unemployment in the EU is expected to decline to 5.4%. Similarly, in the euro area, it is expected to fall to 5.8%.
- Uncertainty around the implementation of new US tariffs since early 2025 to create significant disruption for European exporters. This resulted in downward adjustments in the GDP growth estimates provided by our member federations.

COUNTRY DIFFERENCES

Growth rates are expected to vary significantly across Europe. The economies of Malta (3.9%), Poland (3.9%), and Denmark (3.3%) are forecast to grow robustly this year, while two countries, specifically Germany (-0.3%) and Austria (-0.3%) are to see GDP contractions this year.

TABLE 2: GDP, INFLATION, AND UNEMPLOYMENT RATES

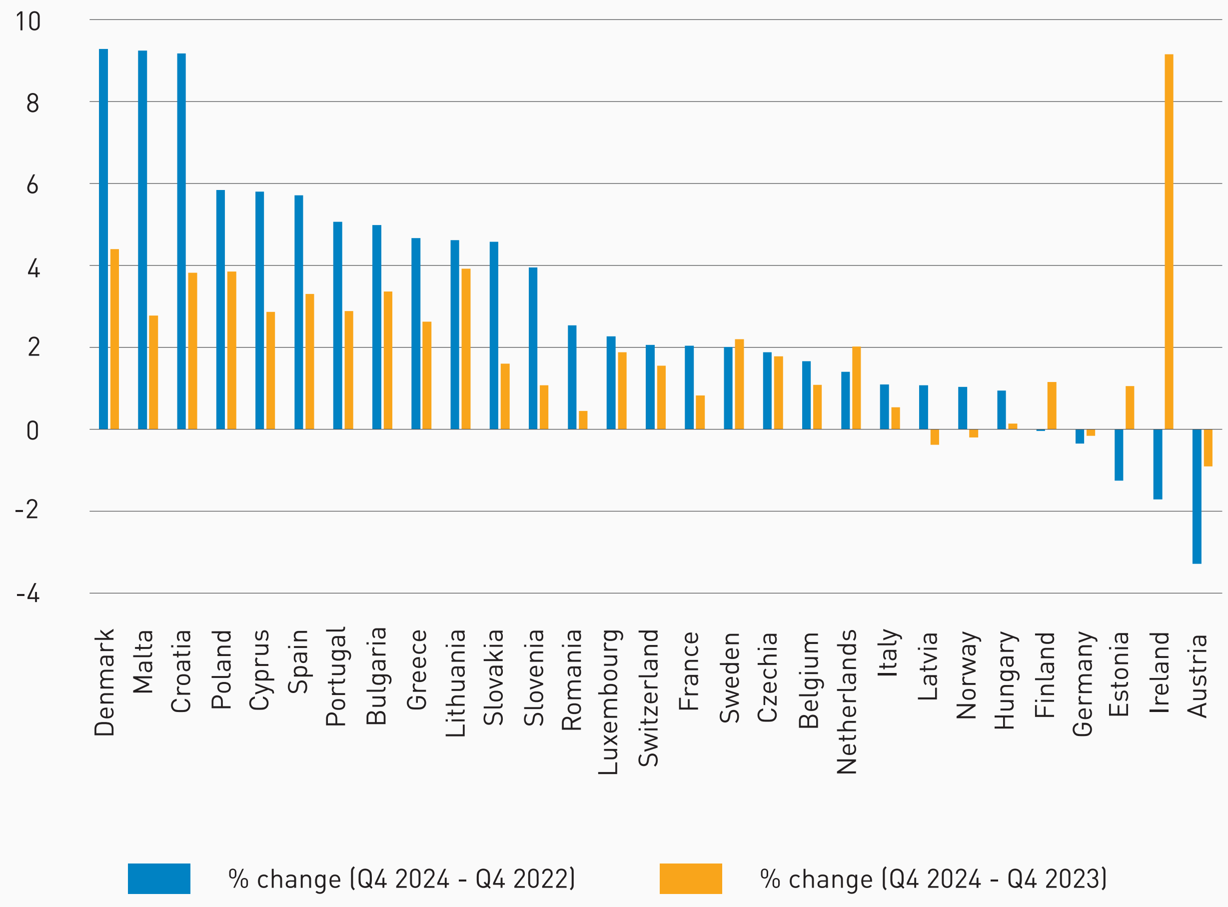
	GDP		Inflation		Unemployment	
	2025	2026	2025	2026	2025	2026
AT	-0.3	1.2	2.7	2.1	5.3	5.2
BE	0.9	1	2.1	1.3	6.1	6.1
BG	2.8	2.2	3.5	2.5	4	3.8
CY	NA	NA	NA	NA	NA	NA
CZ	1.75	2.5	2.2	2.3	2.7	3.8
DE	-0.3	1	2.2	2.4	3.3	3.3
DK	3.3	1.4	1.7	1.8	6.3	6.3
EE	1.7	2.5	5.2	3.3	7.1	6.6
EL	2.1	1.9	3	2.5	9.4	9
ES	2.5	2	2.4	1.9	10.5	10
FI	1.3	1.6	0.9	1.6	8.8	8.3
FR	0.6	1	1.3	1.6	7.8	8
HR	2.5	2.5	3.8	2.5	5.4	5.2
HU	1.5	2.5	5	5	4	4
IE	2.8	2.9	2.2	2.1	4.6	4.7
IT	0.6	1	1.8	2	6.3	5.8
LT	2.9	3	3.3	2.6	6.8	6.8
LU	2.4	2.3	2.5	1.8	5.9	5.7
LV	1.2	2.1	2.5	2.2	6.7	6.3
MT	3.9	3.6	2.2	2	3.2	3.1
NL	1.9	1.5	3	2.4	3.8	4
PL	3.9	3.3	4.2	3.3	3	3
PT	2.2	2	2.3	2.1	6.5	6.4
RO	1.5	3	4.4	3.3	3.1	2.9
SI	2.1	2.4	2.3	2.3	3.7	3.7
SK	1.9	1.9	3.9	3.7	5.3	5.2
SE	1.8	2.8	2.0	1.8	8.7	8.1
NO	1.6	1.9	2.5	2.5	3.9	3.9
CH	0.5	1.5	0.5	1	4.5	4.2

CONSUMPTION AND INVESTMENT DRIVE MARGINAL OPTIMISM AMIDST LOW GROWTH, BUT GLOBAL UNCERTAINTY LOOMS.

01

The EU economy grew by 0.3% in the first quarter of 2025, remaining stable compared to the 0.4% recorded in the final quarter of 2024.[2] This modest growth reflects a gradual rebound in consumer spending as real disposable incomes recover following the disinflation process, though momentum remains fragile, also because of the increased uncertainty which is affecting consumer confidence.

CHART 1: GDP GROWTH RATE HETEROGENEITY HIGHLIGHTS THE STRUGGLES OF GERMAN, AUSTRIAN, AND ITALIAN ECONOMIES



Source: BusinessEurope staff calculations based on Eurostat [namq_10_gdp; Chain linked volumes (2015), million euro; seasonally and calendar adjusted values]

From Q4 2022 to Q4 2024, the EU economy expanded, with significant divergence across Member States persisting (Chart 1). Preliminary data for the first quarter of 2025 confirm the trends observed throughout 2024, when Southern European economies such as Spain, Portugal, and Greece, continued to outperform the EU average, bolstered by strong tourism revenues and ongoing implementation of NextGenEU-funded projects.

[2] European Commission, European Economic Forecast, Institutional Paper n. 318, 2025.

Meanwhile, more traditionally manufacturing-dependent economies such as Germany and Austria, continue to face challenges related to industrial competitiveness, high energy costs relative to global competitors, and reduced external demand, particularly from China. Italy occupies an intermediate position among these groups, while its manufacturing sector remains under pressure due to elevated energy costs and weak demand, primarily from within the EU, it also benefits from strong tourism inflows and continued support from the National Recovery and Resilience Plan (NRRP), contributing to its positive growth performance in Q1 2025. At the same time, a rising manufacturing economy such as Poland and smaller northern EU economies like Denmark performed above the EU average.

The significant divergence between these groups of economies continues to widen, reflecting their different economic structures and varying degrees of exposure to global trade headwinds and geopolitical tensions. While tourism-dependent economies benefit from strong travel demand, Germany-linked manufacturing powerhouses face persistent challenges, stemming also from still-elevated energy costs, even as prices have eased somewhat due to weak global demand.

Looking at the main growth drivers, the composition changed compared with the previous Outlook. Private consumption is expected to be driven by improving real wages, and inflation continues to moderate. However, consumer spending remains constrained by lingering caution among European households and the gradual nature of the transmission of monetary policy easing to retail borrowing costs. Furthermore, increased uncertainty, caused also by global trade volatility, is hindering consumer confidence, potentially affecting their future spending choices.

TABLE 3: MAIN VARIABLES OF GROWTH

Main Variables	EU		Euro area		EU27 + EFTA	
	2025	2026	2025	2026	2025	2026
Private consumption (%)	1.5	1.5	1.3	1.4	1.5	1.5
Public consumption (%)	1.5	1.3	1.3	1.2	1.5	1.3
Investment (%)	1.4	2.4	1.1	2.4	1.2	2.3
Exports (%)	0.6	1.8	0.5	1.8	0.5	1.7
Imports (%)	2.0	2.3	1.8	2.3	1.9	2.2

Source: BusinessEurope staff calculations based on member federations

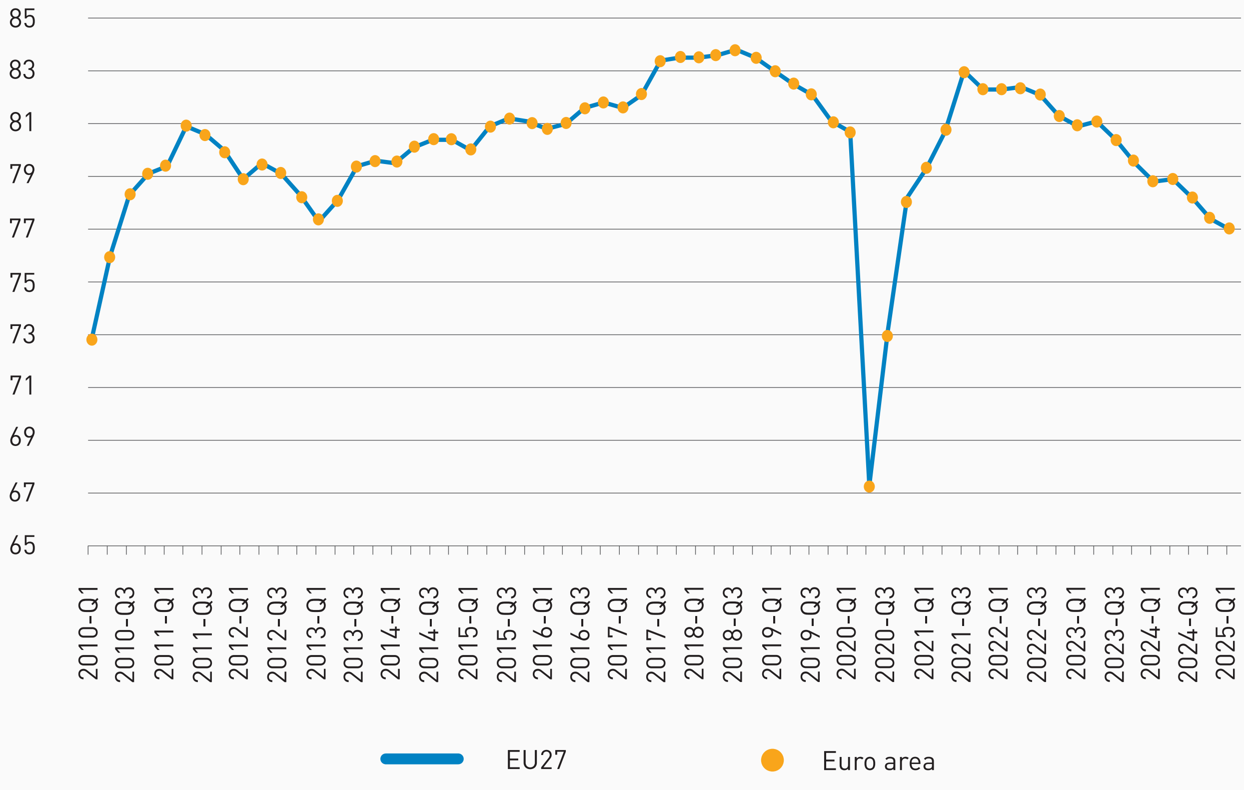
Public consumption, which provided significant support to the economy in 2024, is projected to contribute less to growth in the coming quarters as governments adjust to the new EU fiscal framework. Several Member States are now facing Excessive Deficit Procedures, limiting their capacity for fiscal stimulus despite the still-fragile recovery. However, the European Commission, with the "ReArm Europe Plan/Readiness 2030" package presented in March 2025, has proposed Member States to activate the national escape clause to allow additional defence investment to be excluded from EU deficit limits, up until 1.5% of GDP per year. Meanwhile, Germany has already legislated its defence exemption, freeing up additional room for military spending, and creating a €500 billion fund to finance infrastructure projects and climate action over the next 12 years.

Investment activity shows encouraging signs of recovery after the contraction seen in 2024. The progressive easing of monetary policy by the ECB since mid-2024 is gradually improving financing conditions, though the transmission to smaller businesses remains sluggish. Investment growth is expected to accelerate in 2026 as business confidence strengthens, and firms look to address postponed investment needs (Table 3).

The external sector presents a mixed picture. According to DG ECFIN analysis, which assumes that taxes imposed by the U.S. towards nearly all countries (including the EU) will stay at 10%, except for higher tariffs on steel, aluminium, and cars (25%), and exemptions on some products like pharmaceuticals and microprocessors, exports are forecasted to grow by a modest 0.7% in 2025 and slightly increase to 2.1% in 2026.[3] However, structural competitiveness issues continue to hinder EU producers, particularly in manufacturing, while uncertainty deriving from global trade instability threatens to worsen the picture. This is supported by the negative impact of tariffs estimated by the IMF,[4] and reflected in ECB's March 2025 estimates of decreasing euro area external demand for the following years, and its downward revisions compared with December 2024 estimates: -0.8 p.p. for exports and -0.4 p.p. for imports, down to an annual growth rate of respectively 0.8% and 1.9% in 2025.[5] Import growth is projected to outpace exports as domestic demand recovers and given the higher euro exchange rate, resulting in a slightly negative contribution from net exports to overall growth in the coming quarters.

Most worryingly, industrial capacity utilisation remains at subdued levels in early 2025, showing only marginal improvement from the concerning low points seen in late 2024. These levels, while above those observed during the COVID-19 recession, resemble those last observed during the Euro area Sovereign Crisis of the early 2010s, indicating persistent slack in manufacturing sectors (Chart 2).

CHART 2: INDUSTRIAL CAPACITY UTILISATION REMAINS AT SUBDUED LEVELS



Source: BusinessEurope staff calculation based on Eurostat [teibs 070]

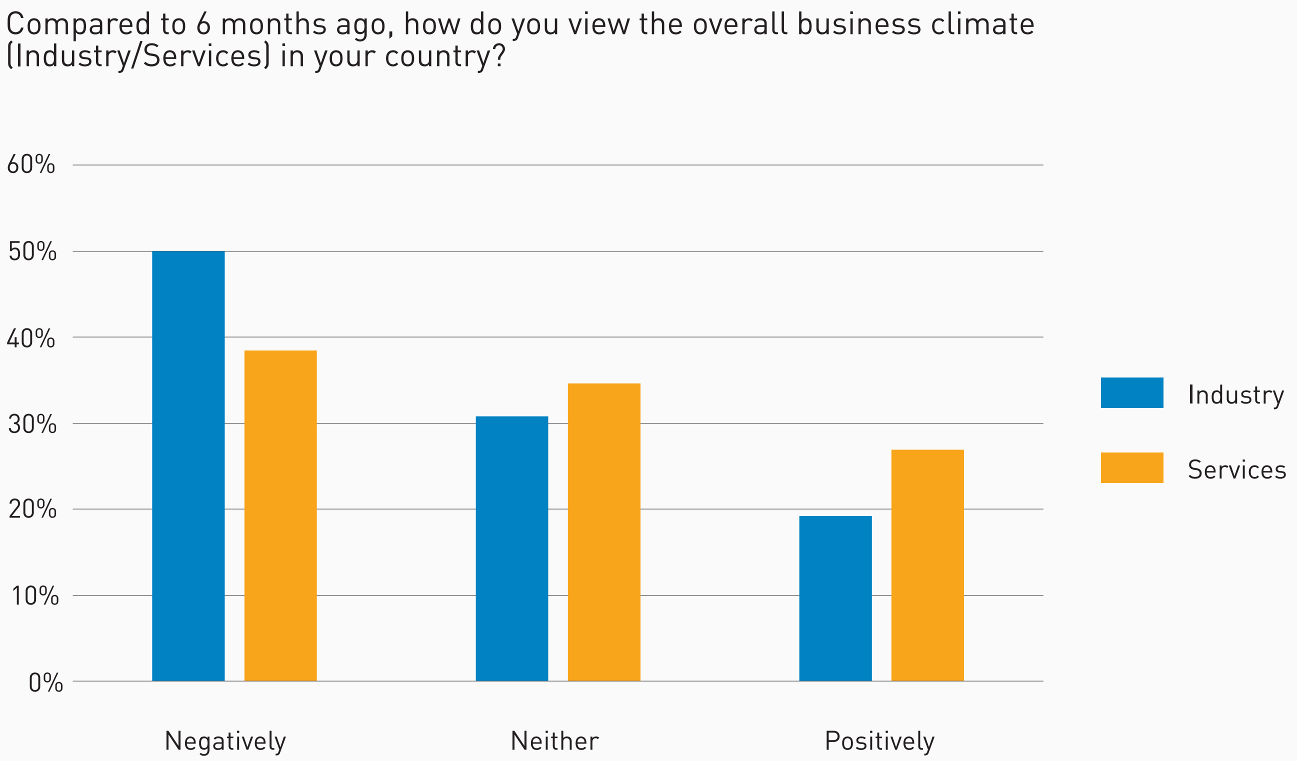
The global geopolitical situation continues to create uncertainty, with ongoing conflicts in the Middle East and the continuing war in Ukraine affecting business confidence. Chinese growth, a key source of external demand for some large EU economies, remains significantly below its pre-pandemic trend, signaling a long-term structural shift that particularly affects export-oriented EU manufacturing sectors.

3 European Commission, European Economic Forecast, Institutional Paper n. 318, 2025.
4 IMF, World Economic Outlook, April 2025.
5 ECB staff macroeconomic projections for the euro area, March 2025.

Consumer confidence has initially shown modest improvement in the first months of 2025, although remaining below its long-term average, but this positive trend reversed in March, and even more sharply in April, hitting an 18-month low. This suggests households are also feeling the effects of current trade tensions and policy uncertainty.[6] Similarly, while industrial confidence has stabilised from its negative trajectory, it has yet to show convincing signs of a strong rebound, particularly in manufacturing sectors facing structural competitiveness challenges.

As warned in our previous Outlook, the EU economy risks a "slow agony" of persistent low growth if structural challenges to competitiveness are not urgently addressed. Early 2025 data suggest this risk remains acute, with the modest recovery insufficient to close the widening gap with more dynamic economies globally. Chart 3 shows that half of BusinessEurope member federations believe that the business climate for industrial producers has worsened compared to 6 months ago: 50% view the overall business climate for industry negatively, compared to 38% in the Autumn of 2024. Additionally, 75% of member federations believe that the business climate for services – an important growth motor in recent years, compared to manufacturing – has either worsened or shown no improvement. This share was 65% in the 2024 Autumn Outlook.

CHART 3: BUSINESSEUROPE MEMBER FEDERATIONS ARE MOSTLY PESSIMISTIC ABOUT THE EUROPEAN BUSINESS CLIMATE, BOTH IN THE INDUSTRY AND SERVICES SECTORS



Source: BusinessEurope member federations

6 European Commission, European Economic Forecast, Institutional Paper n. 318, 2025.

02

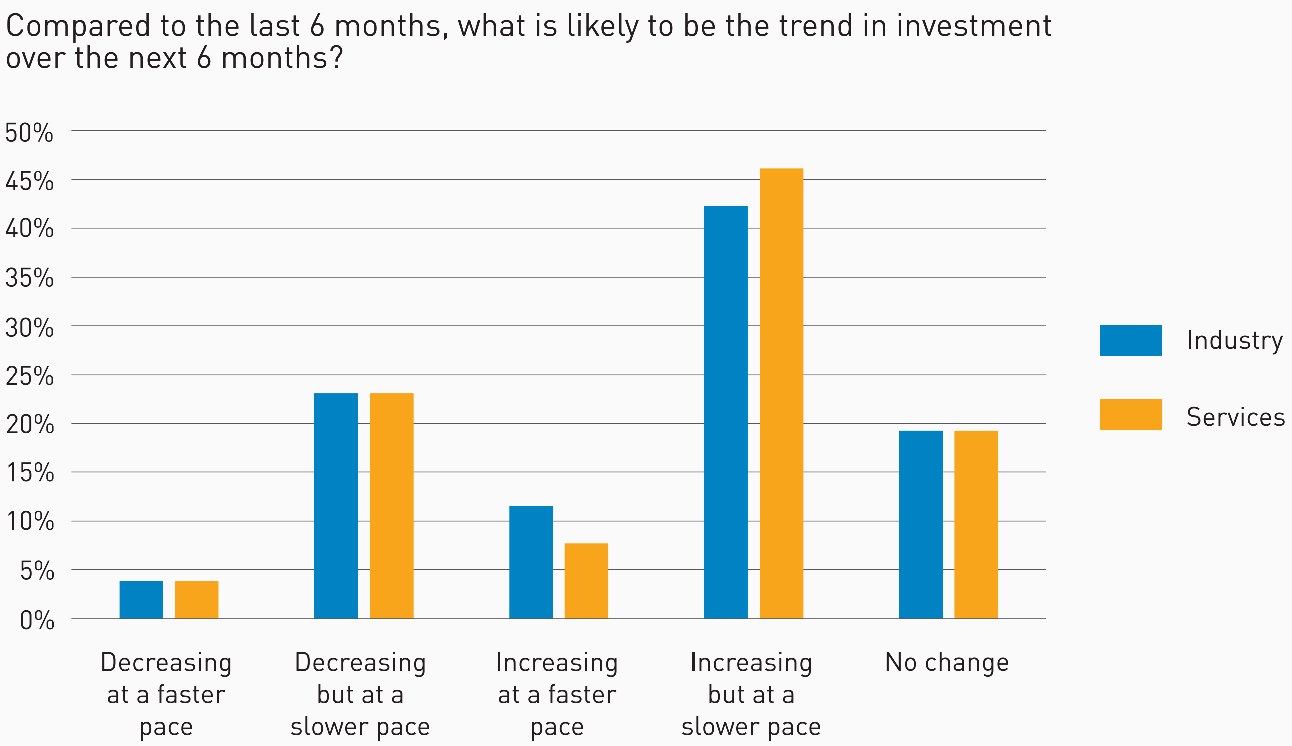
INVESTMENT: NAVIGATING UNCERTAINTY TOWARDS A CAUTIOUS REBOUND

Due to high policy uncertainty, European businesses face an unfavourable investment climate, while also confronting significant investment needs, as well as the challenge of remaining competitive in global markets. According to Eurostat data, gross fixed capital formation in the EU contracted by 1.9% in 2024.[7] However, the member federations expect gross capital formation in the EU to expand by 1.4% in 2025 and 2.4% in 2026.

Despite the ECB's continued easing of its monetary policy stance, net loan demand by firms in the euro area, as seen by surveyed banks, decreased by 3% in the first quarter of 2025. However, euro area banks expect loan demand from firms to pick up slightly, with a net increase of 4% of surveyed banks expecting an increase, according to the latest euro area bank lending survey.[8]

Credit standards for loans or credit lines to enterprises tightened less than expected in the first quarter of 2025. Drivers of the tightening are the higher perceived risks related to general economic and firm-specific outlooks. In the next quarter, a moderate tightening of credit standards is again expected, likely due to the same reasons. However, the tightening for loans to SMEs is expected to be smaller compared to loans to large firms. Additionally, euro area banks reported a substantial easing of the overall terms and conditions on new loans and credit lines to enterprises in the first quarter of 2025.[9]

CHART 4: THE MAJORITY OF BUSINESSEUROPE MEMBER FEDERATIONS STILL EXPECT INVESTMENT TO INCREASE IN THE NEXT SIX MONTHS



Source: BusinessEurope member federations

7 European Commission, European Economic Forecast, Institutional Paper n. 318, 2025.
8 ECB, The euro area bank lending survey, First quarter of 2025, April 2025.
9 ECB, The euro area bank lending survey, First quarter of 2025, April 2025.

Chart 4 shows that 57% of our member federations now expect industrial investment to pick up, a drop from 62% in the previous survey, while those anticipating a decline rose from 21% to 25%. The picture is almost identical in terms of services: 57% foresee growth, and roughly 25% expect investment to fall. Members also seem to anticipate a general slowing down in investment volatility over the next six months, as the large majority expecting either an improvement or a worsening of investments believe these trends will moderate.

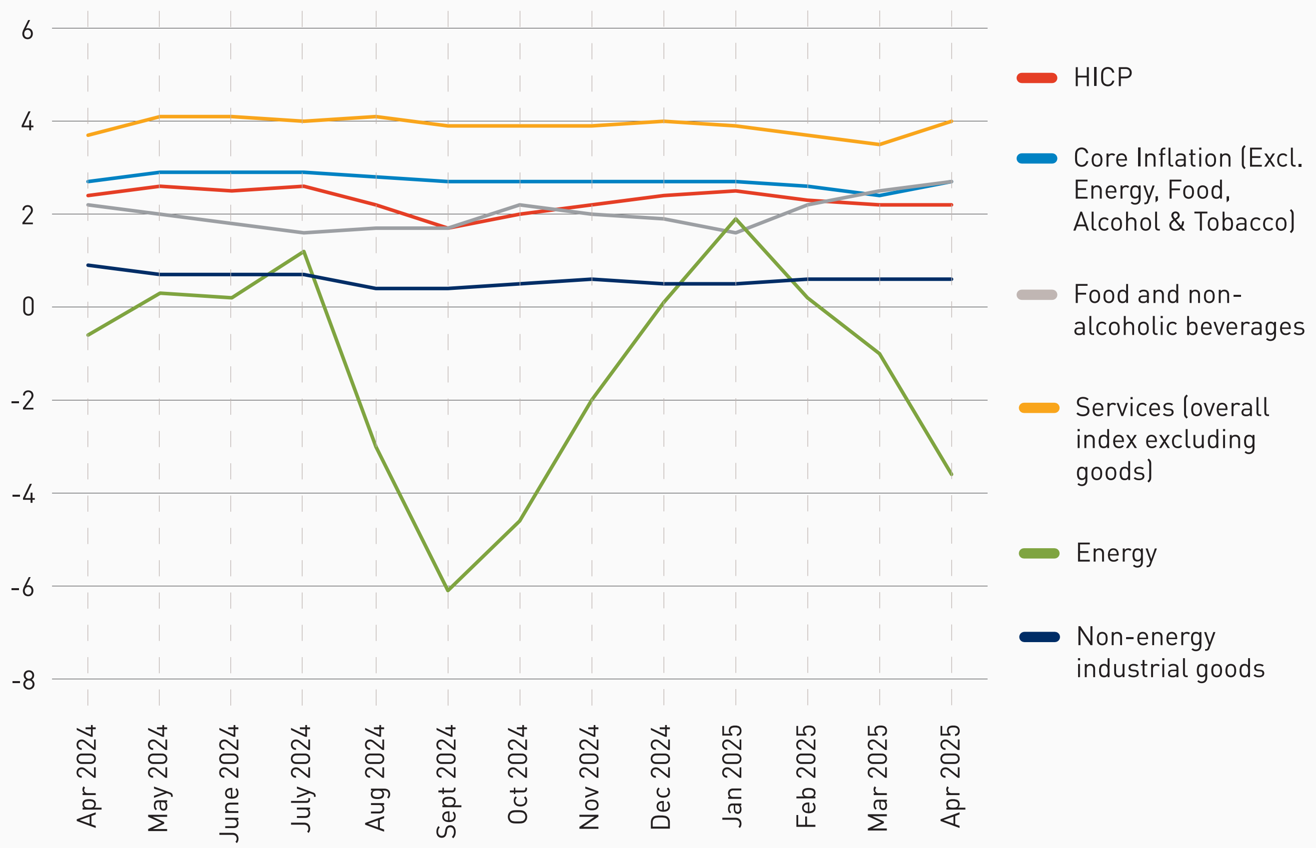
EURO AREA INFLATION & FISCAL POLICY: EVOLVING TRENDS AND BUSINESS PERCEPTIONS

03

MONETARY POLICY

Headline inflation in the euro area has increased since our Autumn Economic Outlook, with Eurostat estimating an increase of 2.2% in April 2025 (in line with the value forecasted by BusinessEurope for the whole of 2025), up from 1.7% in September 2024. However, most recent figures show a decrease to 1.9% in May 2025, falling below the 2% target of the ECB for the first time since September 2024.[10] In contrast, core inflation (excluding energy, food, alcohol, and tobacco) remains stable at 2.7%. In the meantime, the ECB continued to cut its policy rates in December, February, March, April, and June, while most measures of longer-term inflation expectations continue to stand at around 2%, supporting a sustainable return of inflation to the Governing Council's target.[11] The ECB's stance is considered appropriate for the euro area by 65.4% of BusinessEurope's survey respondents, while 17.9% consider it too tight.

CHART 5: SERVICES DRIVE CORE INFLATION BACK TO JANUARY LEVELS



Source: Eurostat

As shown in Chart 5, the annual rate of services inflation, accounting for around 45.7% of headline HICP, rose to 4% in April 2025, back to the levels of January, after going down to 3.5% in March, contributing to the dynamic of core inflation. At the same time, in the last quarter of 2024 annual growth in compensation per employee stood at 4.1%, down from 4.5% in the previous quarter. The ECB's wage tracker points to a further decline in

[10] Euro-Zone Inflation Slows Below 2%, Backing More ECB Cuts.
[11] ECB, Economic Bulletin Issue 3, 2025.

wage growth in 2025, as also indicated in the March 2025 ECB staff macroeconomic projections for the euro area. For negotiated wages, according to ECB data annual growth stands at 2.4% in Q1 2025, down from 5.4% in Q3 2024,[12] remaining above average annual inflation levels for that period. This dynamic, accompanied by the increase in prices of services, could suggest a possible lagged adjustment of prices set by service companies to the recent increase in salaries.[13]

Food (and non-alcoholic beverages) inflation is up to 2.7% in April, from 1.7% in September 2024. The annual rate of energy inflation is down to -3.6%, from 1.9% in January, while it was -6.1% in September 2024. The registered annual rate of change for industrial goods was 0.6% in April, relatively stable through the recent months, but up from 0.4% in September 2024. Inflation displays a slightly higher average level in the EU than in the euro area, with an annual rate of change of 2.4% in April 2025.

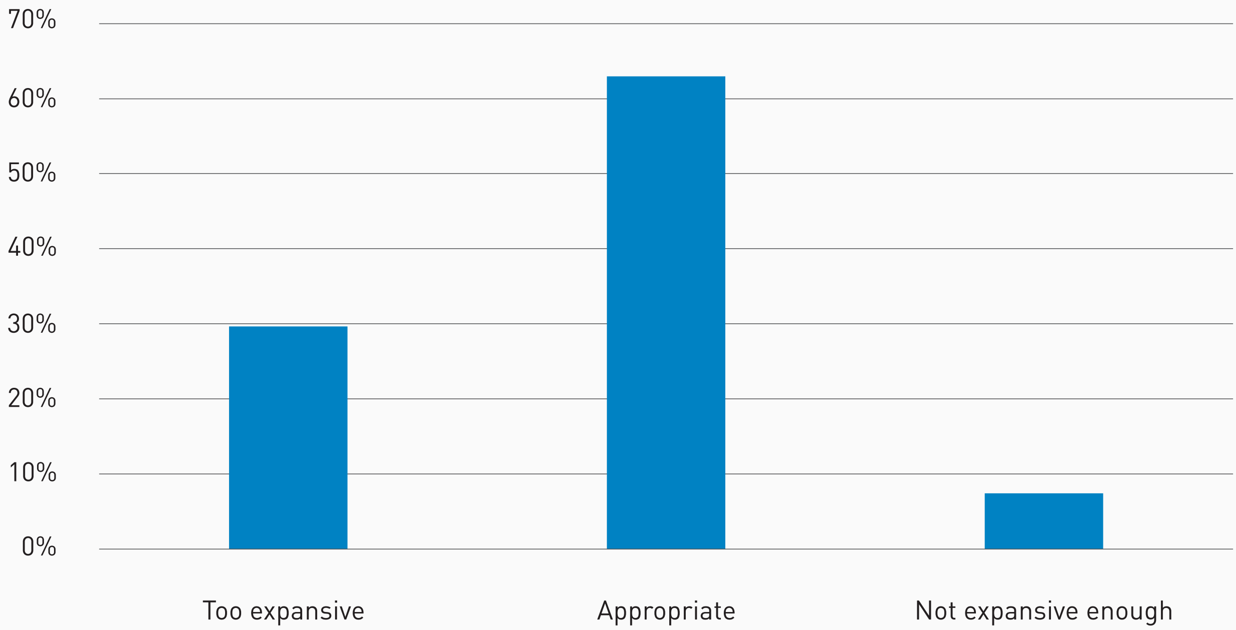
For BusinessEurope's members, inflation remains a concern, albeit a moderate one: 19.2% of survey respondents are very concerned, while approximately 61.6% are only slightly concerned, and the remaining 19.2% are not concerned at all.

FISCAL POLICY AND EURO AREA

The current outlook projects EU governments' net borrowing at -2.2% of GDP in 2025 and -2.4% in 2026, consistent with the 2025 Autumn Outlook. These figures are somewhat lower than the EC's Spring Forecast, which expects the budget deficit to be 3.3% and 3.4% in respectively 2025 and 2026. This relative optimism aligns partially with survey respondents' positive assessment of the appropriateness of fiscal policy in their own countries and in the euro area.[14]

CHART 6: MOST MEMBER FEDERATIONS THINK THE NATIONAL FISCAL POLICY IS APPROPRIATE

In light of the economic situation, how do you assess fiscal policy for your country?



Source: BusinessEurope member federations

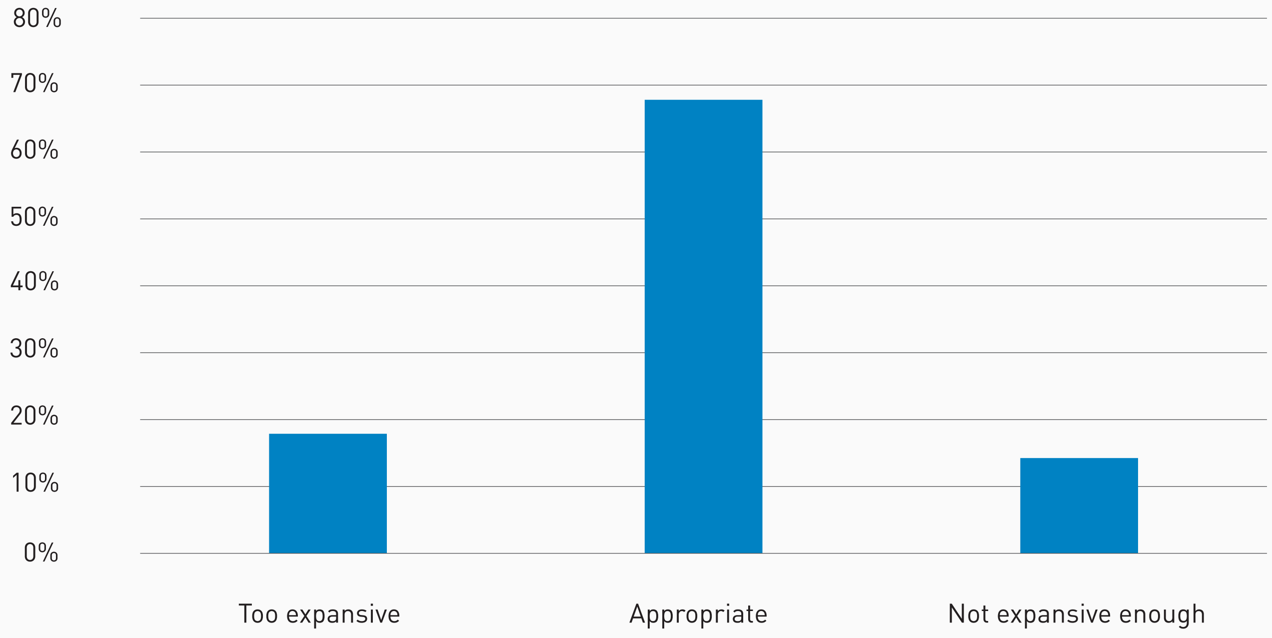
12 Negotiated wages, Euro area 20 (fixed composition), Quarterly.
13 ECB, Economic Bulletin Issue 3, 2025.
14 European Commission, European Economic Forecast, Institutional Paper n. 318, 2025.

BusinessEurope's latest survey also reveals a significant shift in members' views on national fiscal policy. When asked about the appropriateness of the fiscal stance in their respective countries, 63% of respondents now deem it appropriate while 29.6% consider the fiscal stance too expansive. This is a stark change from our Autumn Outlook, where only 42% considered it appropriate and half viewed it as too expansive. A similar share (7.4% in this iteration and 8% in the previous one) believes more stimulus is needed (Chart 6).

The same trend observed among BusinessEurope's members regarding national fiscal policy is even more pronounced when assessing the policy adopted by the euro area. A large majority (67.9%) now consider the euro area's fiscal stance to be appropriate, compared to 17.9% who deem it too expansionary and around 14.3% who believe that more stimulus is needed (Chart 7). This represents a reinforcement of the tendency seen in the Autumn Outlook, when almost 60% of respondents considered the euro area's stance appropriate, slightly more than 20% found it too expansionary, and slightly less than 20% called for more stimulus.

CHART 7: A LARGE MAJORITY OF FEDERATIONS THINK EURO AREA'S FISCAL POLICY IS APPROPRIATE

In light of the economic situation, how do you assess fiscal policy for the Euro Area as a whole?



Source: BusinessEurope member federations

The small differences between the responses provided by BusinessEurope's members to the two versions of the question -the national and the euro area ones- might derive from a more fiscally lax policy stance in those countries that are BusinessEurope's EU members and not euro area members. These differences would also be consistent with our forecasts expecting a slightly smaller deficit in the euro area compared with the EU (-2.1% vs -2.2% in 2025).

LABOUR MARKET: LOW UNEMPLOYMENT CONTINUES

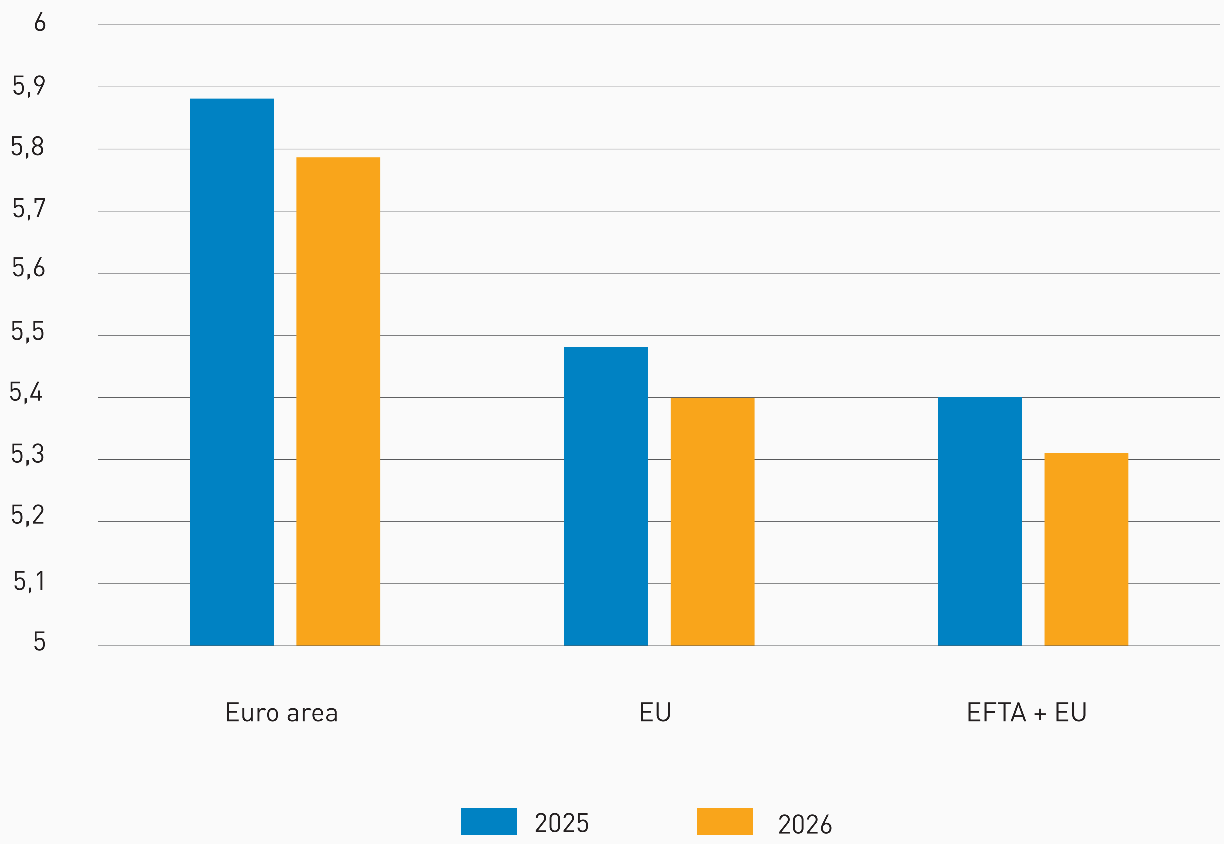
04

The EU's labour market remains robust, with unemployment remaining low at similar levels as in the previous Outlook. According to Eurostat data, unemployment in the EU and euro area fell to 5.8% and 6.2% respectively in March 2025.[15] Additionally, the share of the employed population on the total population of the EU remains at record levels (since the start of the time series in 2009), at almost 76% in the last quarter of 2024.[16]

BusinessEurope forecasts unemployment to further decline from 5.5% in the EU in 2025 to 5.4% in 2026, as shown in Chart 10. In the euro area, we expect the unemployment rate to decrease from 5.9% in 2025 to 5.8% in 2026.

According to Eurostat data, the job vacancy rate in the EU was 2.3% in the last quarter of 2024 and is estimated to remain at this level in the first quarter of 2025. In the euro area, the job vacancy rate was at 2.5% in the last quarter of 2024 and further decreased to 2.4% in the first quarter of 2025.[17] This seems to be caused by a reduction in the demand for labour, possibly linked to the slowdown in the manufacturing industry, rather than to an increase in the supply of labour and of those skills that are in-demand by companies.

CHART 8: MEMBER FEDERATIONS' FORECAST FOR UNEMPLOYMENT RATE



Source: BusinessEurope member federations

[15] Eurostat, 'Euro area unemployment at 6.2%'.
[16] Eurostat, EU labour market - quarterly statistics.
[17] Eurostat, Job vacancy statistics.

GLOBAL TRADE UNDER UNSTABLE POLICIES

05

In April 2025, the IMF estimated global trade volumes to increase by 1.7% in 2025 and 2.5% in 2026, with growth shifting downwards from the 3.8% recorded in 2024. This forecast is based on the situation as of April 4, 2025, this includes the 'reciprocal' tariff strategy of the US announced on April 2 and assumes no further retaliatory escalation. However, new announcements of the US administration and (potential) retaliatory measures from its trading partners, create significant headwinds in the global economy and could potentially head towards a significantly lower result than in the estimates.[18] The World Trade Organization (WTO) estimates that the implementation of the U.S. reciprocal tariff strategy announced on April 2, combined with the spread of broader trade policy uncertainty, could lead to a 1.5% decline in global merchandise trade in 2025.[19]

According to BusinessEurope's survey, EU exports are forecast to grow by 0.6% in 2025 and 1.8% in 2026, while imports are projected to increase by 2% and 2.3% respectively. This represents an improvement from 2023 figures but reflects a significant decline in Europe's trade balance from the 2024 figures, mirroring structural shifts in global trade patterns and ongoing competitiveness challenges for European exporters, along with the expected consumption growth in the EU. However, a stronger euro and lower energy prices could improve EU terms of trade, partially counterbalancing the dynamics in trade volumes.

The uncertainty around the implementation of new U.S. tariffs since early 2025 has created significant disruption for European exporters, particularly in automotive, machinery, and chemicals sectors. While a full assessment of the impact is still emerging, early indications suggest that EU exports to the U.S. spiked in Q1 2025 compared to the same period in 2024.[20] Exporters will likely utilise the 90-day pause on the additional reciprocal tariffs announced on 9 April to unload their inventories, to cushion expected losses in the remainder of 2025 and 2026.[21]

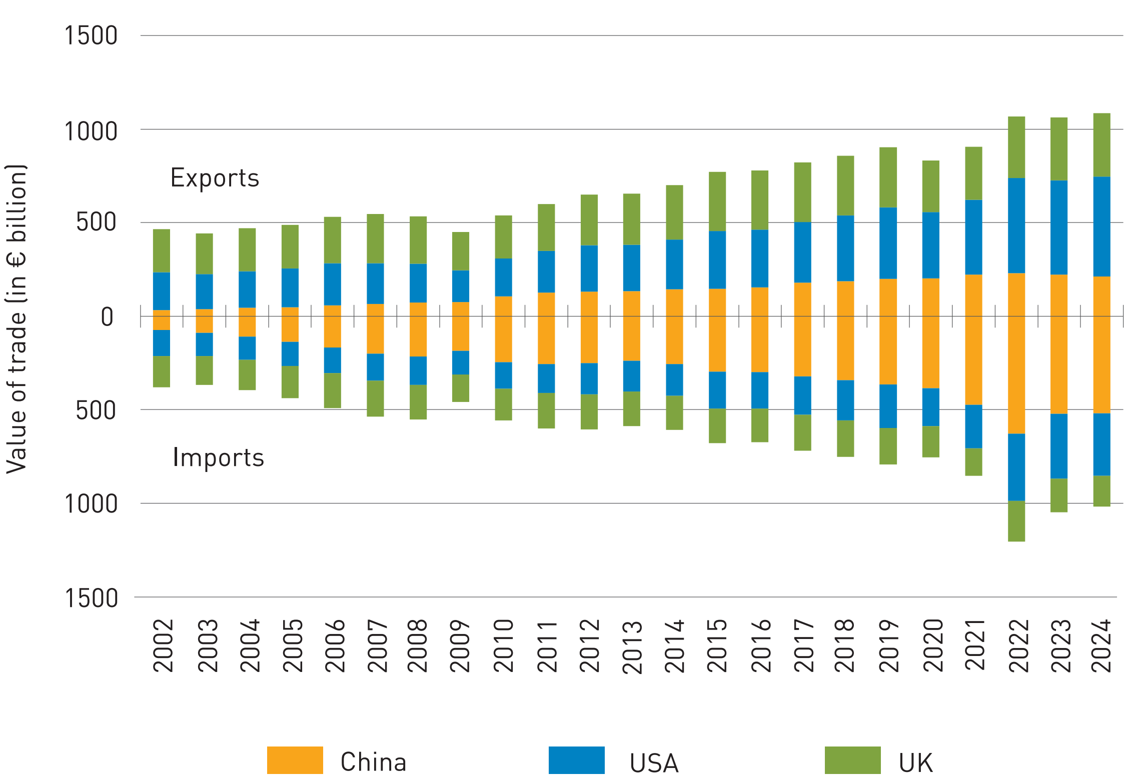
Trade diversification has become a strategic priority, with the EU continuing negotiations on new trade agreements, while seeking to protect strategic value chains through targeted industrial policy measures. However, the effectiveness of these approaches remains constrained by fiscal limitations and concerns about market fragmentation within the Single Market itself. According to IMF estimates, internal trade barriers might be as high as a tariff equivalent of about 44% on average for goods trade and 110% for services.[22]

18 IMF, World Economic Outlook, April 2025.
19 WTO, Global Trade Outlook and Statistics, April 2025.
20 Eurostat, 'EU27 (from 2020) trade by SITC product group'.
21 10% additional duties are in place as well as 50% on steel and aluminium and 25% additional duties on cars and car parts
22 IMF, Europe's Choice: Policies for Growth and Resilience, December 16, 2024.

CASE STUDY: THE ECONOMIC IMPACT OF U.S. TARIFFS ON THE EU

The EU's trade openness and export competitiveness have long been pillars of its economic model. With external trade accounting for 22.4% of the EU's GDP in 2023,[23] the bloc is particularly sensitive to disruptions in global trade flows. The U.S. remains the EU's largest individual trading partner, accounting for 20.6% of EU goods exports and around 13.7% of imports in 2024.[24] Germany, Ireland, the Netherlands, and France are among the most exposed Member States to transatlantic trade. Key export sectors include machinery and transport equipment, chemicals, pharmaceuticals, and high-end consumer goods. The EU also maintains deep trade ties with China, the UK, and Switzerland, but the transatlantic trade axis provides the main export market for the EU's high-tech industrial base, while China is the first source of imports for the region.

CHART 9: EU TRADE WITH MAJOR PARTNERS



Source: BusinessEurope Staff calculations based on Eurostat [ext_st_eu27_2020sitc]

The imposition of broad-based additional tariffs by the new U.S. administration presents a significant external shock to the European economy at a time of fragile recovery and persistent geopolitical uncertainty. The announced tariff package, anchored in a proposed "reciprocal tariff"

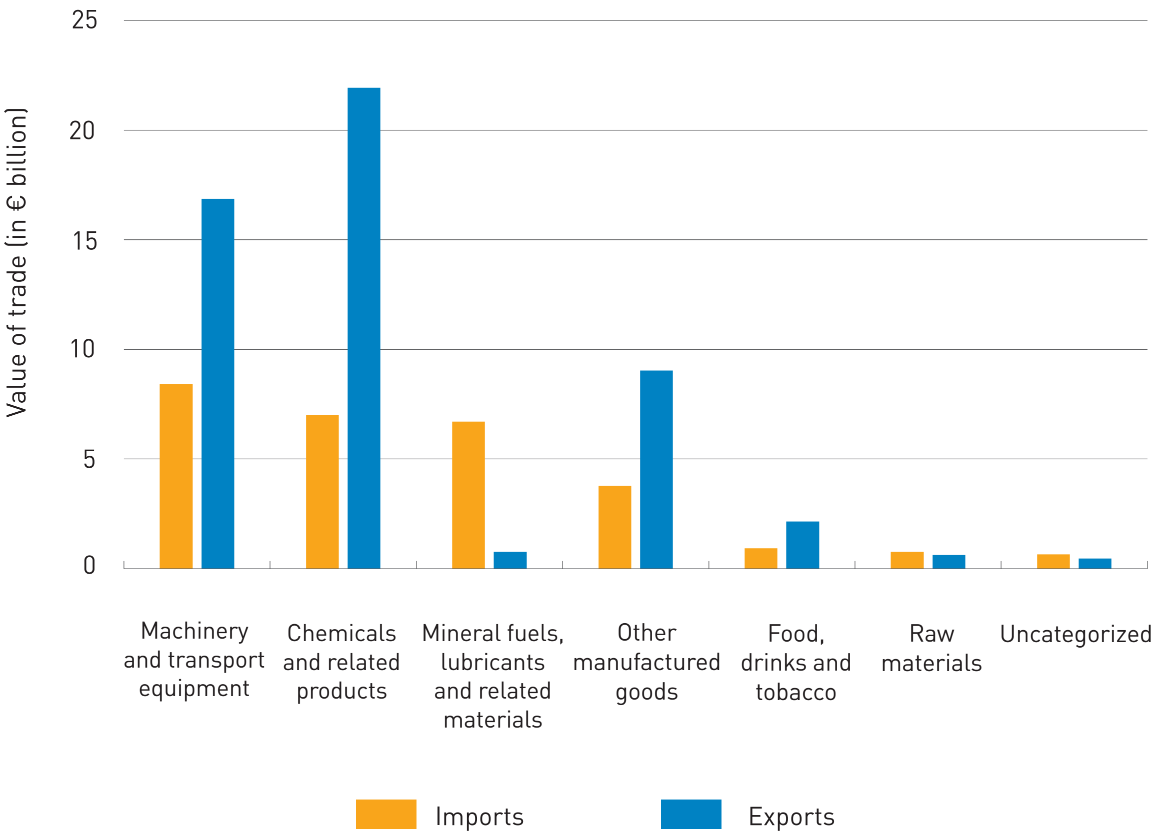
[23] Eurostat, '[World trade in goods and services - an overview](#)' (calculated as average between the percentage of extra-EU imports and exports on GDP)

[24] European Council, '[The US is the main EU trade partner](#)'.

framework, has already increased average duties on EU exports to the U.S. from around 2% to a blanket global additional 10% tariff for goods imported into the U.S., and specific additional tariffs of respectively 50% and 25% in certain industrial sectors.[25] This policy shift affects €400–€500 billion in EU exports and risks triggering retaliatory measures, further destabilising transatlantic trade.[26] Moreover, most recently, the U.S. administration doubled the tariffs on steel and aluminium import, up to 50%, which came into effect on 4 June.[27]

The tariffs target a wide range of goods, with a disproportionate impact on industrial and high-value-added exports. Automotive parts and vehicles, machinery, and chemicals are among the most exposed sectors. According to preliminary modelling estimates by the Commission, large European economies such as Germany, France, and Italy, and small US-oriented trade economies like the Netherlands and Ireland could see the sharpest output losses due to their export intensity and sectoral composition.

CHART 10: EU-US TRADE COMPOSITION



Source: BusinessEurope Staff calculations based on Eurostat [ext_st_eu27_2020sitc]

The imposition of tariffs by the new U.S. administration is projected to impact the GDP of several EU industries in 2025 and 2026. The estimated direct impacts in percentage points on GDP, as reported by BusinessEurope's members federations, are shown in Table 4:

[25] For the moment steel, aluminium and derivatives, car and car parts.
[26] Deloitte: April 2025 Economics Insider.
[27] The Guardian: Trump's 50% tariffs on foreign steel and aluminum come into effect

TABLE 4: ADJUSTMENTS OF EUROPEAN GDP GROWTH ESTIMATES (IN PERCENTAGE POINTS)

Country	2025	2026
BE	-0.2	-0.2
CZ	-0.3	-0.3
DE	-0.3	-1
DK	-0.1	-0.6
IT	-0.2	-0.3
NL	-1	-1
PT	-0.9	-0.4
SK	-0.3	-0.4
SE	-0.1	-0.1

Broader euro area output losses are estimated in the 0.2–0.3%,[28] while IMF estimates long-run effects of tariffs ranging from no effect to -0.6% on GDP, depending on the scenario used.[29] Additionally, the OECD revised its projected GDP growth in June compared to March 2025 from 3.1% to 2.9% for 2025 and from 3.0% to 2.9% for 2026 based on the assumption that tariff rates in force as of mid-May are maintained.[30]

Importantly, the cost shock is not limited to trade volumes. A deterioration in business confidence, particularly among globally integrated manufacturers, is already being observed. Survey data from early 2025 point to falling export orders, as well as renewed caution in investment intentions. This comes at a delicate moment for the EU, where demand-side drivers remain subdued.[31]

A potential secondary effect of heightened U.S.-based trade tensions is extensive trade diversion, where products previously destined for the U.S. market are rerouted to other destinations, while U.S. consumers shift to alternative suppliers. Analysis from the Rhodium Group demonstrates how U.S.-China tensions created a pattern where products previously exchanged between those countries were rerouted to third markets, a dynamic now emerging in transatlantic trade.[32] This creates a complex triangular relationship where China benefits from certain EU-U.S. frictions while also presenting alternative market opportunities for EU exporters facing U.S. tariffs. For the EU, this could lead to intensified efforts to penetrate alternative markets in Southeast Asia, Latin America, and Africa. However, these diverted exports typically command lower margins and often require costly adaptation to different regulatory requirements, only partially offsetting losses in the U.S. market. The resultant global supply chain reshuffling will introduce additional inefficiencies that further dampen EU productivity growth at a critical juncture. In the meantime,

[28] European Commission, European Economic Forecast, Institutional Paper n. 318, 2025; Bruegel, The economic impact of Trump's tariffs on Europe: an initial assessment; Conference Board, 'US Reciprocal Tariffs: First Look at What They Mean for the EU and Member States'.

[29] IMF, World Economic Outlook, April 2025.

[30] OECD Economic Outlook, Volume 2024 Issue 1

[31] BDI, 'Protectionism as a brake on the economy', European Growth Outlook, May 2025.

[32] Rhodium Group, 'Trade Diversion: Blessing or Curse?', May 2025.

Chinese intermediary goods production has proven to be more flexible in shifting production processes to account for demand in different markets, and therefore Chinese producers are expected to realign their focus on intermediary goods destined for non-disrupted trade routes.[33] Additionally, China's decision to suspend exports of rare earths exports globally as part of the trade war between the U.S. and China has raised concerns in the European automotive sector.[34]

The unpredictable nature of tariff implementation has introduced a damaging uncertainty premium into EU-U.S. business relations. The current U.S. administration has repeatedly announced, extended, reduced, and rolled back various tariff measures with limited advance notice, creating a challenging business environment where planning horizons have contracted dramatically. This policy unpredictability has forced many EU exporters to adopt costly hedging strategies, delay capital investments, and maintain redundant supply chains. Industry associations report that even in sectors where actual tariffs remain moderate, the persistent threat of sudden escalation has depressed cross-border investment flows and encouraged defensive corporate strategies focused on near-term resilience over long-term efficiency and innovation.

In parallel, a number of legal cases erupted in the U.S., challenging the administration's decision. For instance, in V.O.S. Selections, Inc. v. United States (2025), a group of small importers and twelve U.S. states challenged the new tariffs in the U.S. Court of International Trade. They argued the tariffs were illegal, claiming a misuse of the International Emergency Economic Powers Act of 1977 (IEEPA) to impose them. On May 28, 2025, a three-judge panel ruled that the administration lacked such authority under the IEEPA and blocked the tariffs. However, the ruling is temporarily on hold pending the administration's appeal to the Federal Circuit. This uncertainty may even ultimately prove more damaging to EU competitiveness than the direct cost of the tariffs themselves.[35]

Short-term tariff shocks could lead to lower inflation due to weaker growth and a stronger euro, but medium-term effects are likely inflationary. Counter-tariffs, along with increased fiscal spending on infrastructure and defence, would drive up prices. Higher import costs and supply chain disruptions also pose inflation risks. While the ECB's March 2025 projections show inflation falling to 2.1% by 2026, prolonged trade tensions could slow this, complicating the ECB's plans for further rate cuts and monetary normalisation.[36] However, according to the OECD, given the expected low inflation growth and the modest GDP growth rates, policy rate reductions are expected to continue during 2025 and 2026.[37]

Moreover, tariff-induced price distortions could disproportionately hit SMEs and consumer-facing sectors reliant on imported intermediate goods. In a worst-case escalation scenario, with retaliatory EU measures and extended tariff coverage to digital services and agricultural goods, the inflationary and growth impact would be more severe and persistent.

The European Commission has signalled a willingness to retaliate under WTO-compatible mechanisms, while also accelerating trade diversification efforts. Current discussions include ratification of pending trade agreements (e.g. with Mercosur and Mexico), a renewed focus on strategic autonomy in key value chains, and targeted support for affected sectors.[38] Nonetheless, the EU remains vulnerable to external protectionist shocks. While diversification away from the U.S. is possible in some industries, deep economic ties, particularly in high-tech manufacturing and pharmaceuticals, limit near-term substitution. Recent efforts from both the EU and the U.S. to temper trade tensions are the avenue that will lead to the least adversarial economic effects for both sides of the Atlantic provided it leads to a mutually beneficial outcome.

---

33 Rhodium Group, 'Was Made in China 2025 Successful?', May 2025.
34 Reuters: China's rare earth export curbs hit the auto industry worldwide
35 CSIS, 'The Uncertainty Tax: How Policy Volatility Will Harm the Economy', 1 April 2025.
36 ECB staff macroeconomic projections for the euro area, March 2025.; PIIE, 'The International Economic Implications of a Second Trump Presidency', September 2024.
37 OECD Economic Outlook, Volume 2024 Issue 1
38 ING, 'Tariffs: Europe's worst economic nightmare just came true', April 2025; CEPR, 'The impact of Trump's economic policy on the EU economy', 16 May 2025.

THE DEFENCE SECTOR IN EUROPE: STATE OF PLAY 06

The EU's defence sector has gained significant attention amidst the current global context, which is characterised by rising instability, conflicts, and fragmentation. From a European point of view, the main turning points have been Russia's 2022 large-scale invasion of Ukraine and the destabilisation of transatlantic relations, with the new U.S. administration hinting a lower commitment towards Europe's security, in favour of other regions (e.g., Pacific) while initially sidelining European leaders in the discussions around a possible ceasefire agreement between Ukraine and Russia. In the meantime, Russia's aggressive stance accompanied by its rising defence budget, the ongoing partial mobilisation, and the enlargement of its military-industrial apparatus, have caused discussions about EU's military preparedness and its deficiencies in its capability to react to potential threats. This renewed emphasis is evident from the increased focus of EU policymakers, with new initiatives such as "Readiness 2030," aiming to facilitate Member States' defence spending, and in-depth analyses like the Niinistö, Draghi, and Letta reports, highlighting the gaps in investment and organisation that should be addressed to maintain global competitiveness and secure the EU's position in a complex international landscape. The following section will begin with a brief recap of EU initiatives in the area, followed by a comparison of EU public defence spending and competitiveness of defence industries in an international context. While these areas are critical to the EU's strategic autonomy, the concept of security today encompasses a wide array of interdependent domains, including supply chain and technological resilience, financial stability, food and energy security, cybersecurity, and the protection of critical infrastructure (such as telecommunications networks, undersea cables, and space assets). It also covers societal preparedness in its broadest sense, encompassing resilience against threat to democracy, such as disinformation campaigns, public health, and climate-related risks.

EU INITIATIVES

The EU has launched several initiatives over the last few years in response to the escalating security challenges and the need to strengthen its defence industrial base. The European Defence Fund (EDF) has a budget of €8 billion for the 2021–2027 period, with €5.3 billion allocated to collaborative capability development and €2.7 billion to collaborative defence research.[39] In addition, the European Defence Industrial Strategy (EDIS), announced in the 2023 State of the Union speech by the Commission's President outlines several key targets for the future: according to this non-binding Commission's proposal, by 2030 the value of intra-EU defence trade should represent at least 35% of the EU defence market, and at least 50% of Member States' defence procurement budgets should be devoted to procurement from the EU's Defence Technological and Industrial Base (EDTIB), rising to 60% by 2035. Additionally, the EDIS proposes that by 2030, Member States should collaboratively procure at least 40% of their defence equipment.[40]

To try to address some of the most critical existing gaps, the EU adopted in October 2023 a programme -the European Defence Industry Reinforcement through Common Procurement Act (EDIRPA),- to support the joint procurement of defence needs that are critical and urgent among Member States in ammunition, air and missile defence platforms and the replacement of legacy systems'[41] with five cross-border procurement projects that have received €300 million funding.[42] Moreover, the Act in Support of Ammunition Production (ASAP), which was launched in 2023 with a budget of €500 million, aims to address the ammunition shortages highlighted by the war in Ukraine,[43] to ramp up 155mm Artillery Shells production to 2 million units annually by the end of 2025. This is viewed as an urgent necessity, given that Russia demonstrated a significant shell production capacity of 3 million units annually as of March 2024, powered by important shell transfers from North Korea, (as many as 5.8 million since August 2023[44]), which is expected to have increased in the meantime. For comparison, the U.S. aims to achieve an annual production rate of 1.2 million units by the end of 2025.[45]

---

39 European Defence Fund | EU Funding Overview
40 European Commission, 'EDIPA: Dedicated Programme for Defence'.
41 European Commission, EDIRPA: Addressing Capability Gaps.
42 https://ec.europa.eu/commission/presscorner/detail/en/ip_24_58.
43 European Commission, Act in Support of Ammunition Production (ASAP).
44 Rusi, 'Brothers in Arms: Assessing North Korea's Contribution to Russia's War in Ukraine', May 2025.
45 CNN, 'Russia producing three times more artillery shells than US and Europe for Ukraine', 11 March 2024.

However, the EU's current industrial capacity, limitations in skilled labour (particularly in STEM fields), raw material procurement needs, and vulnerabilities in supply chains might hinder a fast scale-up. The European Defence Industrial Programme (EDIP) is a proposal for an EU regulation published in March 2024 aiming to "bridge the gap between the ending of the short-term emergency measures such as ASAP and EDIRPA." Among the other objectives, EDIP would allocate a further €1.5 billion for the years 2025 to 2027 to start implementing part of the concrete measures identified by the EDIS. Furthermore, to address underinvestment and readiness gaps, the Commission introduced the ReArm Europe Plan and the "White Paper for European Defence – Readiness 2030," a proposal to enhance capabilities, bolster the European defence industry, integrate Ukraine's defence sector into the EU, and accelerate technological adoption. These would be supported through measures like relaxed deficit rules and facilitated private investment.

On 27 May, the first pillar of the "ReArm Europe Plan/Readiness 2030," the Security Action for Europe (SAFE) instrument was approved by the Council. This initiative will provide up to €150 billion -in the form of low-interest and long-term loans- that will be disbursed to interested Member States upon demand, and based on national plans, favouring joint procurement coming from at least two Member States, which should submit a Defence Investment Plan to qualify. Orders must benefit EU, EEA/EFTA, or Ukraine-based companies. The instrument draws its legal authority from Article 122 TFEU, which permits the Council to adopt economic policy measures and grant financial assistance via qualified majority voting on a Commission proposal. The European Parliament is not directly involved in the legislative process and raised concerns over the appropriateness of the procedure (e.g., by the JURI committee of the Parliament).

Through this initiative, the Commission also proposed a coordinated activation of the national escape clause (NEC) in its fiscal surveillance framework, allowing the Member States to gradually increase their spending on defence of up to 1.5% of GDP concerning the 2021 levels (with exceptions for those countries that increased significantly their military spending in the meantime e.g., Poland) for the years from 2025 to 2028. By the April 30, 2025, deadline, 16 Member States either requested or plan to request activation of the NEC. Among the EU's major economies, only Germany and Poland are potential future beneficiaries. Notably, Spain, France, and Italy did not submit requests, indicating they don't intend to utilise this option. For this reason, the projected additional defence expenditure is now estimated at €293-337 billion, a significant reduction from the original €650 billion estimate (which assumed full fiscal flexibility).[46] On top of that, the initiative also proposes repurposing existing cohesion policy funds (2021-2027 MFF) and expanding the Strategic Technologies for Europe Platform (STEP) to include defence, while also increasing the European Investment Bank (EIB)'s role and mobilising private capital through the completion of the Capital Markets Union (CMU).

However, limited fiscal space, particularly in high-debt EU countries like France, Poland, and Italy (major defence spenders), may curb defence spending ambitions despite escape clauses or EU loans. Sustaining higher military expenditure long-term could force these nations into difficult policy trade-offs, potentially necessitating higher taxes if non-military spending isn't curbed. A key challenge in monitoring is preventing the reclassification of non-military spending as defence expenditure to circumvent fiscal rules.[47]

In the same context, on 17 June 2025 it was issued an "EU defence omnibus simplification proposal," a legislative package aiming, in the Commission's intentions, to: introduce a fast-track permitting regime with a single point of contact; streamline the application process and participation to the EDF, facilitating also Ukrainians entities' participation; encouraging joint purchases and faster cross-border product transfers; clarifying EU rules (competition, environmental, chemicals) for defence needs; and improving access to finance via streamlined InvestEU criteria and clearer guidance on sustainable defence investments.[48]

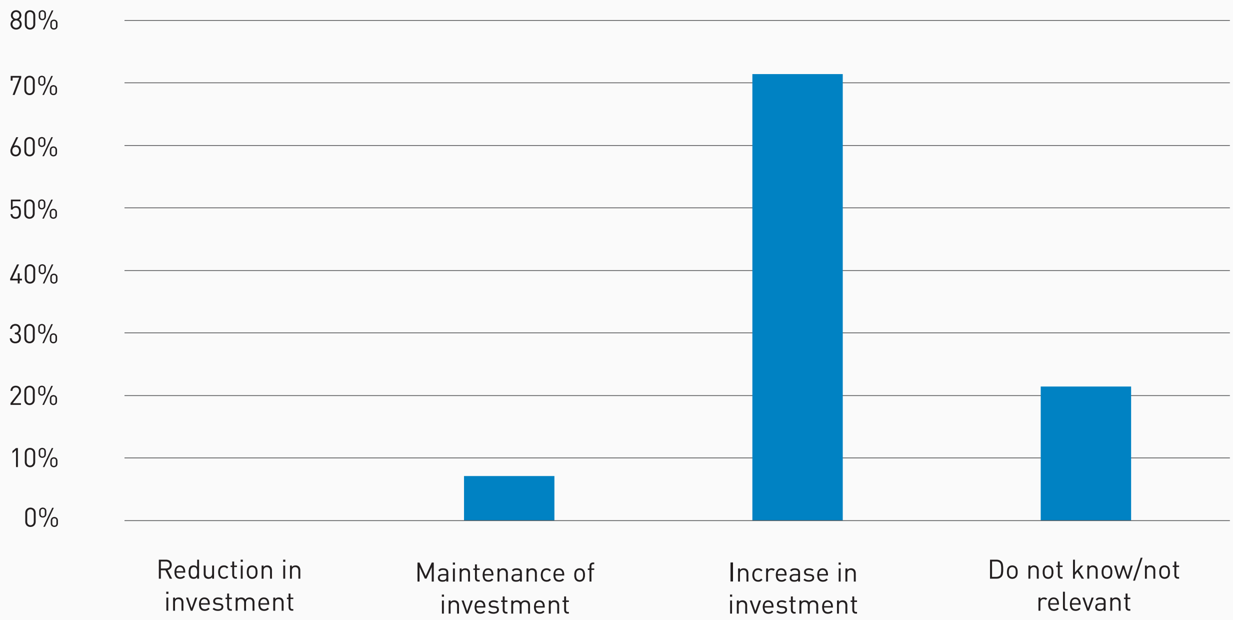
By the end of 2025, the Commission is also expected to issue a Joint Communication on Military Mobility including further legislative proposals.[49] At this regard, the EU Commissioner for Transport announced that his intention to endorse a proposal to upgrade critical parts of the dual-use[50] transport network, with estimated needs up to €75 billion, which in his words could require a "significant EU contribution" and might receive funds from the Connecting Europe Facility (CEF).[51]

[46] Defence financing and spending under the Economic Governance Framework, European Parliament
[47] OECD Economic Outlook, Volume 2025 Issue 1: Tackling Uncertainty, Reviving Growth
[48] Defence Readiness Omnibus. European Commission.
[49] European Commission, 'Introducing the White Paper for European Defence and the ReArm Europe Plan- Readiness 2030'.
[50] Definition of dual-use items from Article 2 of the REGULATION (EU) 2021/821 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 May 2021: "dual-use items' means items, including software and technology, which can be used for both civil and military purposes, and includes items which can be used for the design, development, production or use of nuclear, chemical or biological weapons or their means of delivery, including all items which can be used for both non-explosive uses and assisting in any way in the manufacture of nuclear weapons or other nuclear explosive devices"
[51] EU launches major Black Sea plan with eye on defense as Putin hovers | Politico.

DEFENCE SPENDING

Global defence spending surged to €2.5 trillion in 2024, from €2.2 trillion in 2023, representing a 7.4% real-terms increase.[52] The Stockholm International Peace Research Institute (SIPRI) estimates that, in 2024, total defence spending in the EU amounted to €329.9 billion,[53] representing a 17% increase over the previous year. Increased investments in defence are also reported by the vast majority (70%) of BusinessEurope's members federations (Chart 11). Out of this amount, investments in defence in the EU are estimated to be around 30% of total spending (around €102 billion).[54] This represents a critical increase with respect to the levels of spending preceding the large-scale invasion of Ukraine, with a 30% expenditure growth. In 2024, an overwhelming majority of EU Member States (26 out of 27) increased their defence expenditure, with 16 of these raising it by over 10% when comparing it with 2023, with Germany and Poland showing the most notable increases,[55] and 13 surpassing the 2% of GDP threshold that was agreed by NATO Heads of State and Government in 2014[56][57] according to SIPRI (see Chart 12 for a comparison between EU members states that are also NATO members, UK, U.S., Russia, and China). However, estimates of defence spending vary significantly depending on the methodology used (e.g., NATO, the UN's Classification of the Functions of Government -COFOG- division 2, and SIPRI estimates all differ). For this study, SIPRI's methodology was chosen due to its international comparability and its ability to estimate Chinese and Russian expenditures beyond officially released government data. For instance, differently from SIPRI, the European Parliament Think Tank estimates that 16 out of 27 Member States surpassed the 2% threshold in 2024.[58] This investment growth focused largely on new equipment procurement, which saw a significant 19% rise compared to 2022. However, between June 2022 and June 2023, 78% of procurement spending went still to non-EU suppliers, with 63% directed to the US.

CHART 11: THE MAJORITY OF MEMBER FEDERATIONS ALSO INDICATING AN INCREASE IN INVESTMENT OF THEIR MEMBER COMPANIES IN THE DEFENCE INDUSTRY

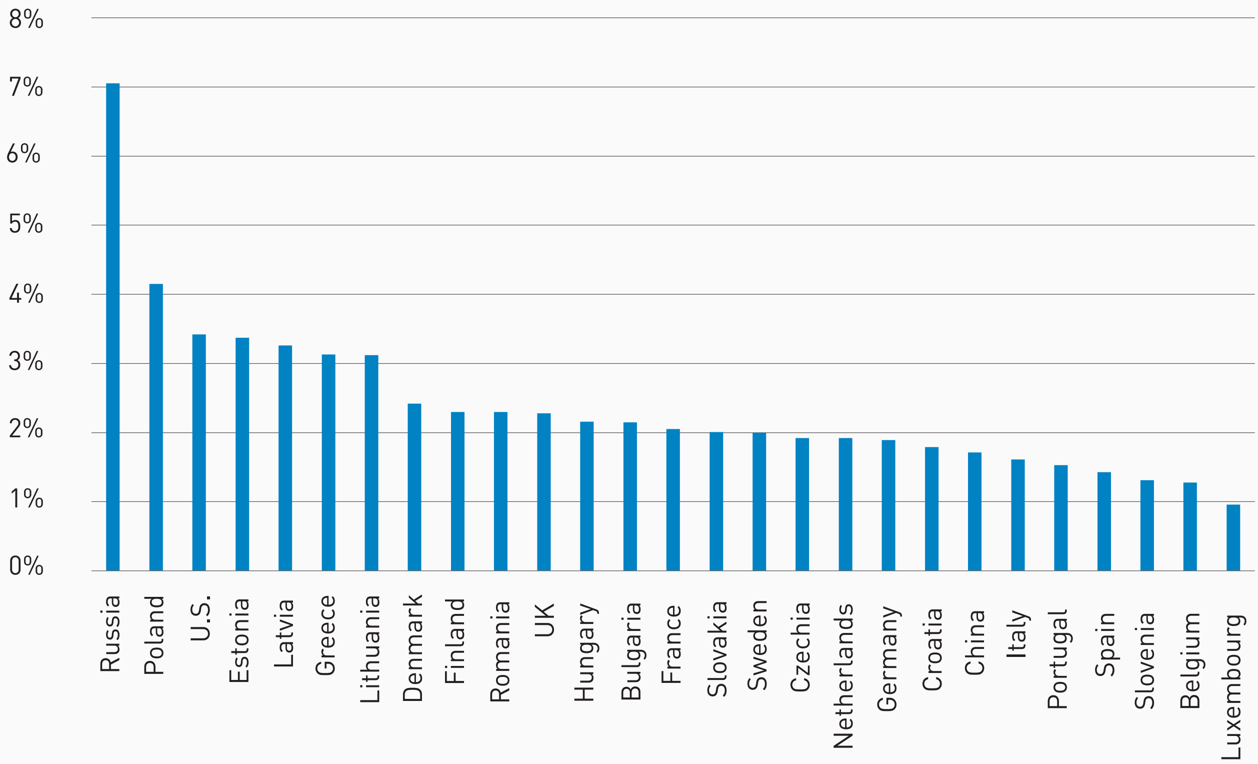


Source: BusinessEurope member federations

52 IISS, '[Global defence spending soars to new high](#)', 12 February 2025 (BusinessEurope's staff applied an approximate 2024 average exchange rate of €1 = $1.088).
53 According to a €0.9217 per $1 used for 2024.
54 European Union Council, EU defence in numbers.
55 EDA, Annual Report 2024.
56 SIPRI, Military Expenditure Database.
57 Austria, Ireland, Cyprus, Malta are EU Member States but not NATO members. Finland joined NATO in 2023, Sweden in 2024.
58 EU Member State defence expenditure, EPRS, European Parliament.

According to the Council of the EU, the EU is expected to further increase its defence spending by €100 billion by 2027,[59] with the EU allowing the activation of the national escape clause under the Stability and Growth Pact for 2025-2028 for favouring more investments at the national level (Chart 12), as indicated above.[60] Defence needs are also highly dependent on the evolution of transatlantic security relationship. A report from the International Institute for Strategic Studies (IISS), issued in May 2025, estimates that replacing the U.S. military capabilities currently or potentially deployable in Europe would cost between €201.1 billion and €306.2 billion, should the U.S. decide to withdraw gradually from the European security framework.[61]

CHART 12: DEFENCE SPENDING AS SHARE OF GDP IN 2024 (EU NATO MS, UK, US, CHINA, RUSSIA)



Source: SIPRI Military Expenditure database

Unsurprisingly, the U.S. remained the main global defence spender in 2024. According to the SIPRI military expenditure database, the U.S. allocated €862.9 billion to defence, marking a 5.4% increase from 2023 and constituting 3.4% of its GDP. Simultaneously, China's military expenditure continued its rapid ascent, reaching €282.9 billion in 2024, a 6.5% rise compared to the previous year and representing 1.7% of its GDP, according to SIPRI's estimations. Russia, in 2024, recorded a post-Soviet high in defence spending, allocating 7.1% of its GDP, amounting to €138.7 billion, a substantial 38% surge from 2023 and a remarkable 120% increase since 2021.[62]

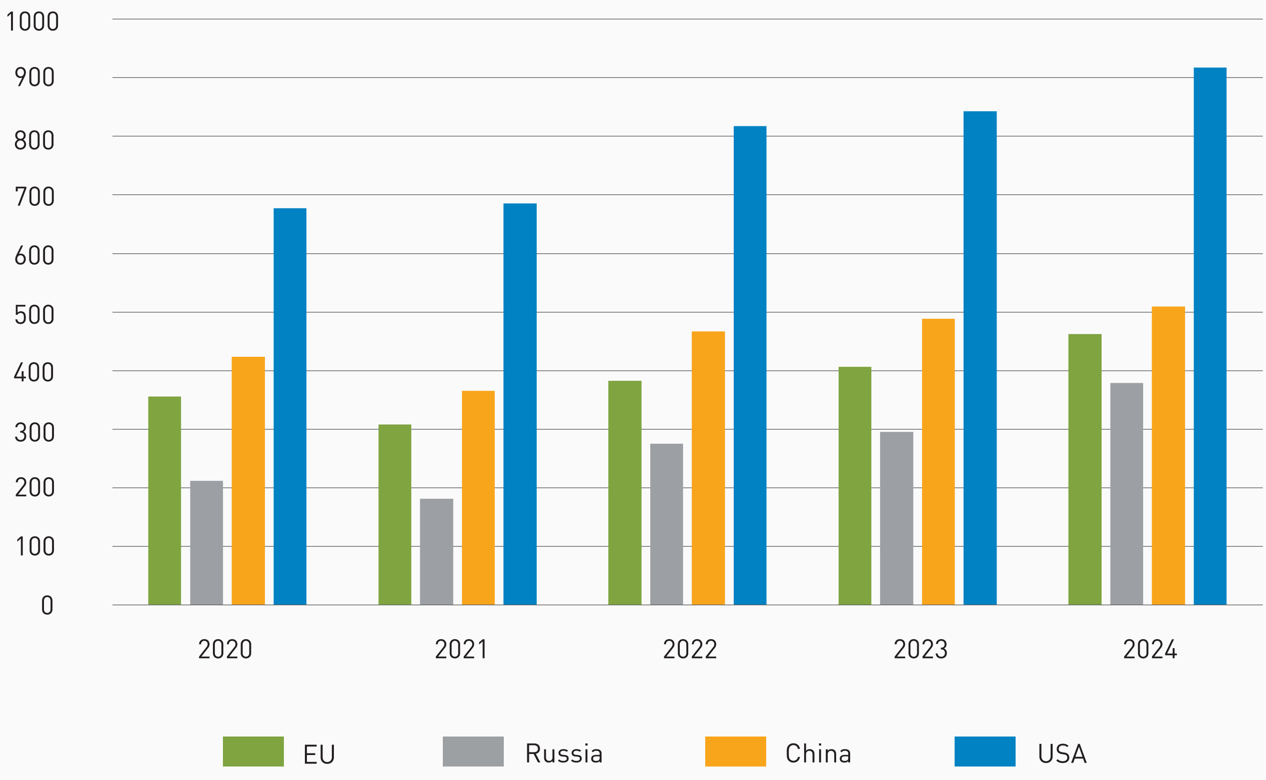
However, market exchange rates can skew the true scale of military expenditure. This is because numerous inputs for military operations, such as salaries and domestically produced equipment, are not subject to international trade. Not considering this aspect leads to an underestimation of certain countries' capabilities, such as those of Russia and China, which are characterised by lower costs compared to the U.S. and the EU.

59 European Union Council, EU defence in numbers.
60 European Commission, ReArm Europe Plan / Readiness 2030.
61 IISS, 'Defending Europe Without the United States: Costs and Consequences', May 2025 (values transformed in EUR according to the current 1 USD = 0.89 EUR exchange rate).
62 SIPRI, Military Expenditure Database.

Furthermore, while GDP based on Purchasing Power Parity (PPP) offers an alternative perspective, it is not an exhaustive method. Designed to gauge local price levels, PPP calculations can potentially overstate military spending, since procurement doesn't necessarily depend on local labour costs.[63]

The graph below (Chart 13) offers a comparison between the military spending of the EU, U.S., China, and Russia according to data and methodology used to calculate military PPP-adjusted expenditures (Roberston, 2021).[64] As the adjusted figures illustrate, the EU's military expenditure are no longer the 2nd largest among those, now trailing China's by around 9% and exceeding Russia's by just 22% in 2024 (a considerable shift from the 150% difference observed without the adjustment). The U.S. still holds a spending lead, though the adjustment partially mitigates this. Its expenditure is now only slightly (3%) above the combined military budgets of China and Russia, a substantial reduction from the more than twofold advantage observed with unadjusted figures.

CHART 13: ANNUAL MILITARY SPENDING IN MILITARY PURCHASING POWER PARITY (IN BILLION €)[65]



Source: *Military PPP Data*.

Although important, these expenditure considerations should not be taken as an exhaustive assessment of a nation's military capacity, as military output is also shaped by its defence strategy, alliances, force multipliers, and other non-budgetary elements.

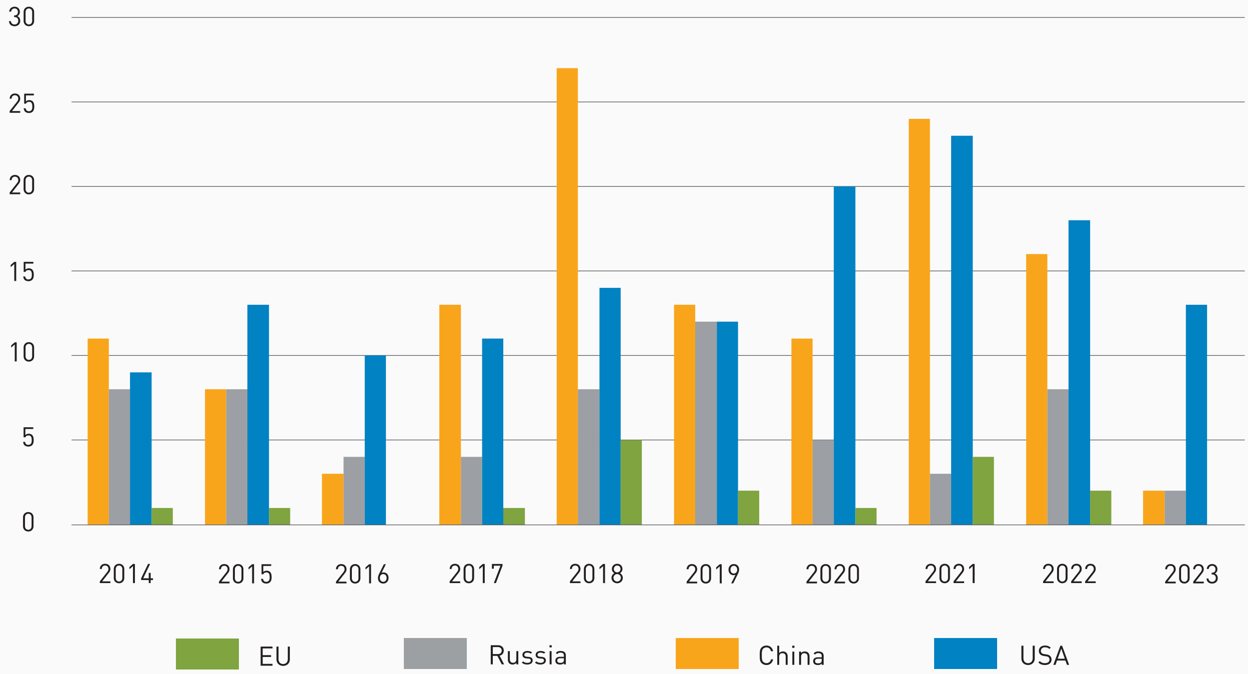
A more concerning trend emerges when comparing the European Union's capabilities in the space domain against other major defence spenders. Open-source data from the Union of Concerned Scientists (UCS) on

[63] Robertson, P., Debating defence budgets: Why military purchasing power parity matters, CEPR, 9 October 2021.
[64] Robertson, P., (2022), "The Real Military Balance: International Comparisons of Defense Spending", The Review of Income and Wealth, 68 (3):797-818.
[65] EU military expenses are slightly underestimated, as they include the sum of miliary expenses by 26 Member States apart from Luxembourg and do not take into account common EU expense. Values are originally measured in 2024 $, and have been then adjusted from $ to € by BusinessEurope's staff according to an approximation of the average annual exchange rate.

military and dual-use satellite launches (including joint military-governmental, military-civil, and military-commercial) between 2014 and 2023 highlights this gap. During this period, the U.S. led with 143 launches, followed by China (128) and Russia (62), whereas EU Member States collectively launched only 17 satellites (Chart 14).[66]

The investments needed to fill EU security gaps represents also an opportunity, particularly if investment goes to local firms for the development of new equipment. Historically, increased military spending has shown potential for positive economic spillovers, driving expansion through heightened innovation, production, procurement, and employment, although multipliers are typically lower than for other public investments like infrastructure or education and lower than 1.[67] A Kiel Institute for the World Economy (known as "IfW," from its German acronym) literature review indicates that, in the short term, such spending typically stimulates economic growth, though the magnitude depends on economic conditions, financing, and monetary policy. The IfW conservatively estimates a 0.9% to 1.5% Europe-wide GDP increase if defence spending rises from 2% to 3.5% of GDP. [68] Goldman Sachs Research suggests a fiscal multiplier of 0.5 over two years for additional EU defence spending, assuming a gradual shift towards domestic military procurement and an initial focus on equipment and infrastructure. [69] Recent estimates by the EC project a further increase in defence spending amounting to 1.5% of GDP by 2028, and assuming it is fully financed by debt. Under an "optimistic scenario," characterized by a 20% share of capital spending in total defence expenditure and yielding higher benefits to private sector productivity, this would lead to a 0.6% increase in GDP by 2028. The same estimate also predicts a limited and temporary increase in public debt and inflation as a result. Furthermore, estimating the possible multiplier is hindered by the lack of precise information on where the additional spending would be used.

CHART 14: ANNUAL LAUNCHES OF SATELLITES FOR MILITARY OR DUAL-USE PURPOSES



Source: UCS data

According to Allianz, maintaining 3% of GDP in defence spending between 1993 and 2023 would have required EU Member States to allocate an extra €365 billion (in 2020 PPP terms) annually. While short-term fixes, such as tapping NGEU funds or the European Stability Mechanism, are available, countries must be wary of falling into a debt trap and prioritise securing long-term financing for defence. BusinessEurope recommends that Europe establishes a stronger and properly financed European Defence Fund over the long run.[70]

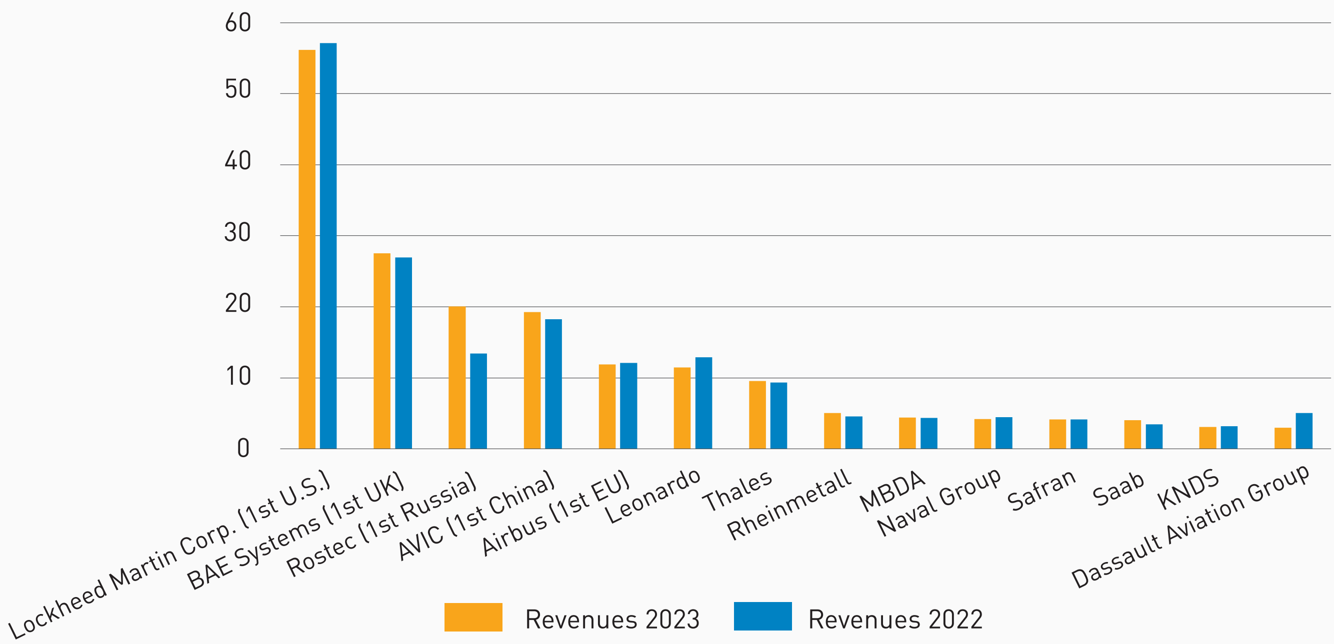
[66] Satellite Database | Union of Concerned Scientists
[67] Defence financing and spending under the Economic Governance Framework, European Parliament.
[68] Ilzetzki E., 'Guns and Growth: The Economic Consequences of Defense Buildups', Kiel Report, 2, February 2025.
[69] Goldman Sachs, 'How much will rising defense spending boost Europe's economy?', March 2025.
[70] BusinessEurope, Squaring the (budgetary) circle – Proposals on the 7th MFF (2028-2034).

Additionally, the EU should be mindful of avoiding national fund hoarding, one-off spending bursts, and investment in legacy platforms.[71]

THE EU DEFENCE INDUSTRY

In 2023, the EU defence sector employed approximately 581,000 workers, reflecting an 8.9% increase compared to the previous year. Small and medium-sized enterprises (SMEs) play a central role, with over 2500 SMEs involved in the European defence industry.[72] As also highlighted in the Draghi report, while the EU defence sector has an annual turnover of €135 billion in 2022 and competitive exports, the aggregate defence spending is about one-third of the US. Moreover, the European defence industry faces challenges beyond lower overall spending, including a lack of focus on technological development, with only 4% of total public EU defence spending allocated to R&D in 2024, amounting to €13 billion, compared to the US allocating around 16%, or €130 billion in 2023. Private R&D investments in defence by companies based in the EU is estimated at around €9.2 billion in 2023[73], while an aggregate estimation of this number for U.S. companies is not easily available, but according to our (approximative and conservative) calculations might fall in between €14.7 to €19.3 billion in 2023[74]. EU defence spending is also hampered by significant fragmentation, which leads to a lack of scale and hinders standardisation and interoperability, exemplified by the provision of ten different types of EU 155 mm howitzers to Ukraine. Furthermore, European collaborative procurement accounted for only 18% of defence equipment procurement expenditure in 2022, falling short of the 40% benchmark set by the EDIS for 2030.[75] In 2024, the EU dedicated over half of its military spending to personnel compensation, a proportion that slightly reduced to 42% in 2023. In contrast, the U.S. allocated approximately 38.5% of its defence budget to personnel costs in 2024.[76][77]

CHART 15: REVENUES FROM ARMS SALE IN 2023 AND 2022



Source: BusinessEurope staff's calculations based on SIPRI data
Note: 2023 prices in billions €, using the average 2023 exchange rate of 1 $ = 0.924 €

[71] Allianz, Captain Europe: Five ways to forge the region's defense shield, June 2025.
[72] European Union Council, EU defence in numbers.
[73] BusinessEurope's analysis, based on ASD's figures, which reports that defence R&D investments account for €14.2 billion of total R&D investments by ASD members and, at the same time, EU total (civil and defence) R&D investments represent 65% of their members' total R&D investment. See at https://umbraco.asd-europe.org/media/amoenldy/asd_facts-figures-2024_1119.pdf?rmode=pad&v=1db3a84f57bffc0
[74] This estimate includes internal R&D by major defense contractors (based on public filings), VC-backed defense-tech firms (e.g., Anduril, Palantir), and private space companies (e.g., SpaceX), drawing on data from annual reports, industry analyses, and venture databases.
[75] European Commission, The future of European Competitiveness, September 2024.
[76] European Economic Forecast. Spring 2025.
[77] Government expenditure on defence, Eurostat.

Over the decade spanning 2014 to 2023, the revenues generated by EU-based firms listed among the 100 global defence companies, account for in between 11.5% and 13.5% of the total in that list. While EU companies' revenues dipped to a low of €57.7 billion in 2016 (compared to the top 100's global sales of €481.2 billion), it rebounded to €75 billion in 2023, against a global figure of €584 billion. This includes revenues from joint ventures like MBDA, which involves the non-EU company UK BAE Systems.[78] A comparison of 2023 and 2022 arms sales revenues further highlights a significant disparity between the 10 largest EU-based arms companies and leading manufacturers from the U.S. (e.g., Lockheed Martin), the UK, China, and Russia (Chart 15).

EU DEFENCE PROCUREMENT CONTRACTS

In examining the landscape of defence procurement within the EU, a key question arises: to what extent do EU Member States prioritise EU defence companies when acquiring military equipment compared to sourcing from external, non-EU companies? Data, from the IISS offers an overview of contracts awarded by EU Member States that are also members of NATO, comparing the orders placed with contractors based within the EU against those located outside the EU. It's important to note that the figures included reflect only publicly disclosed information and are therefore probably underestimated. Nonetheless, the data can help in understanding the extent of the divergence between EU and non-EU contractors as a source of different categories of military platforms.[79] This data, as shown in Table 5, displays how non-EU sourcing is more important than EU sourcing. This divergence is even more marked if we consider that submarines, frigates, and aircraft carriers are just sourced by EU-based contractors, meaning the non-EU contractors dominate the majority of all the remaining categories. Notably, the primary non-EU provider is the U.S. Other important contractors are based in South Korea, Israel, Norway, the UK, and Türkiye.

These figures, while representing only a portion of recent defence procurement by EU members due to limited transparency on exact quantities and values, can be contextualized by comparing them to publicly disclosed military aid to Ukraine (as compiled by IfW[80]) from the broader international coalition, including also non-EU actors like the U.S., the UK, Norway, and Canada. In doing it, it's crucial to remember that a significant portion of the aid to Ukraine consisted of older, less expensive Soviet-era equipment (e.g. the hundreds of modified or overhauled T72 tanks), as also registered by the IfW.[81] This type of comparison, although being far from rigorous, can offer an insight into the amount and value of military platforms necessary for sustained, high-intensity modern warfare such that ongoing in Ukraine. In interpreting the data, it is also important to acknowledge the unique characteristics of each conflict and the fact that the already existing military assets of Ukraine and EU countries are not included in this analysis.

Between February 2022 and today, EU Member States procured at least 1,451 Armoured Fighting Vehicles (AFVs) valued at €19.2 billion, with many deliveries extending beyond 2030. In contrast, Ukraine received at least 2,100 tanks and infantry fighting vehicles (IFVs) (which constitute just two -although key- subcategories of the broader groups of AFVs) worth an estimated €4.5 billion during the same period. The comparison is even more telling with artillery. EU members have ordered 1,077 artillery units since the full-scale invasion, valued at €13.6 billion with deliveries stretching to 2031. In comparison, Ukraine received 824 artillery systems (considering only the two, main, subcategories of howitzers and Multiple Launch Rocket System) valued at €5.6 billion. In air defence, EU countries have ordered at least 339 units since February 2022, with a potential combined value reaching €131.4 billion, with contracts lasting up until 2035. Meanwhile, Ukraine received 78 systems from Western allies, valued at €8.8 billion.

---

[78] SIPRI, Arms Industry Database.

[79] The 2023 average exchange rate of 1 EUR = 1.0807 USD has been used for conversions (Table 5). For the purpose of this analysis, joint ventures with companies from the EU countries are registered as EU contractors (such as MBDA).

[80] IfW, Ukraine Support Tracker.

[81] IfW, Ukraine Support Tracker.

TABLE 5: EU VS NON-EU SOURCING IN MILITARY PLATFORMS

Military Platform	EU Sourcing	Non-EU Sourcing
Armoured Fighting Vehicles (AFVs) (Since Feb 2022)	905 units · €10.4 billion	546 units · €8.8 billion
Artillery Systems (Since Feb 2022)	296 units · €3 billion	781 units · €10.5 billion
Air-Defence Systems (Since Feb 2022)	≥262 units · up to €36.8 billion	≥77 units · up to €94.5 billion
Multirole Fighter Aircraft (Since 2015)	136 aircraft · €18.2 billion	314 aircraft · €53.3 billion
Combat ISR UAVs (Since 2015)	45 UAVs · €6.9 billion (plus unknowns)	76 UAVs · up to €1.5 billion (plus unknowns)
Principal Surface Combatants (Since 2015)	39 frigates + 1 aircraft carrier (LLI) · €36.4 billion	
Submarine Programmes (Since 2004)	28 submarines (plus R&D/ LLI) · €33.5 billion	
ASW & Maritime Patrol Aircraft (Since 2015)	55 aircraft · €5.3 billion	35 aircraft · €3.8 billion
Total	≥1,766 units · up to €150.4 billion	≥1,829 units · up to €172.3 billion

Source: BusinessEurope's elaboration of IISS data

POLICY RECOMMENDATIONS

A common defence and preparedness strategy is needed, while respecting the repartition of competences in the Treaties. The development of the European security and defence capabilities is key for increasing EU's competitiveness, societal preparedness and resilience. For BusinessEurope, this strategy should encourage effective public-private cooperation to safeguard the functioning of critical infrastructure, industries and services in times of crisis and address fragmentation in the single market, to foster increased production capacity in the European security and defence sectors.

European industry leaders stress that in the next Multiannual Financial Framework (MFF), the EU budget should prioritise the development of a robust pan-European security base as highlighted by BusinessEurope's position papers on MFF[82] and cohesion policy.[83] This can be achieved by fostering deeper partnerships among EU Member States and drawing inspiration from existing successful collaborative models. Key to this effort is the establishment of a fully functioning Single Market and Savings and Investment Union, which would reduce internal barriers to trade and investment and facilitate greater flows of private equity and venture capital into early-stage companies and start-ups critical for technological innovation. Reforms should also include a reduction in regulatory burdens, notably through a more pragmatic application of ESG requirements. Such measures are vital to unlock private investment and support the scaling-up of production and innovation for the whole economy, including the security and defence sectors.

[82] BusinessEurope, Squaring the (budgetary) circle – Proposals on the 7th MFF (2028-2034), May 2025.
[83] BusinessEurope, EU Cohesion Policy post-2027: An impactful policy for regional competitiveness, May 2025.

BusinessEurope is the leading advocate for growth and competitiveness at the European level, standing up for companies across the continent and campaigning on the issues that most influence their performance. A recognised social partner, we speak for enterprises of all sizes in 36 European countries whose national business federations are our direct members.

Austria	Belgium	Bulgaria	Croatia	Cyprus	Czech Republic
Denmark	Denmark	Estonia	Finland	France	Germany
Germany	Greece	Hungary	Iceland	Iceland	Ireland
Italy	Latvia	Lithuania	Luxembourg	Malta	Montenegro
Norway	Poland	Portugal	Rep. of San Marino	Romania	Serbia
Slovak Republic	Slovenia	Spain	Sweden	Switzerland	Switzerland
The Netherlands	Türkiye	Türkiye	Ukraine	Ukraine	United Kingdom

Avenue de Cortenbergh 168
B - 1000 Brussels, Belgium
Tel: +32(0)22376511 / Fax: +32(0)22311445
E-mail: main@businesseurope.eu

WWW.BUSINESSEUROPE.EU

EU Transparency Register 3978240953-79