Allianz

Riders on the storm

Managing uncertainty: Updated Outlook

10 April 2024

Allianz Research

Content

Page 3-4
Executive Summary

Page 5-10
An unprecedented tariff salvo kicks off a (temporary?) full-fledged trade war

Page 11-14
Reflation risks make central banks cautious

Page 15-17
Growth in developed markets should slow down to +1% in 2025, the lowest level since the pandemic

Page 18-19
Emerging markets' growth should moderate at +3.9% in 2025, below 10-year average

Page 20-22
When the levy breaks: How firms cope with tariff and policy uncertainty

Page 23-29
Capital markets outlook: Trump's second term got mispriced

Executive Summary

Ludovic Subran
Chief Investment Officer &
Chief Economist
ludovic.subran@allianz.com

Jordi Basco Carrera
Lead Investment Strategist
jordi.basco_carrera@allianz.com

Ana Boata
Head of Economic Research
ana.boata@allianz-trade.com

Maxime Darmet
Senior Economist for UK, US & France
maxime.darmet@allianz-trade.com

Lluis Dalmau
Economist for Africa &
Middle East
lluis.dalmau@allianz-trade.com

Guillaume Dejean
Senior Sector Advisor
guillaume.dejean@allianz-trade.com

Björn Griesbach
Senior Investment Strategist & Eurozone
Economist
bjoern.griesbach@allianz.com

Jasmin Gröschl
Senior Economist for Europe
jasmin.groeschl@allianz.com

Françoise Huang
Senior Economist for Asia Pacific
francoise.huang@allianz-trade.com

Ano Kuhanathan
Head of Corporate Research
ano.kuhanathan@allianz-trade.com

Maria Latorre
Sector Advisor B2B
maria.latorre@allianz-trade.com

Maxime Lemerle
Lead Advisor Insolvency Research
maxime.lemerle@allianz.com

Yao Lu
Investment Strategist
yao.lu@allianz-trade.com

Maddalena Martini
Senior Economist for Italy, Spain, Greece
& Benelux
maddalen.martini@allianz.com

Luca Moneta
Senior Economist for Emerging Markets
luca.moneta@allianz-trade.com

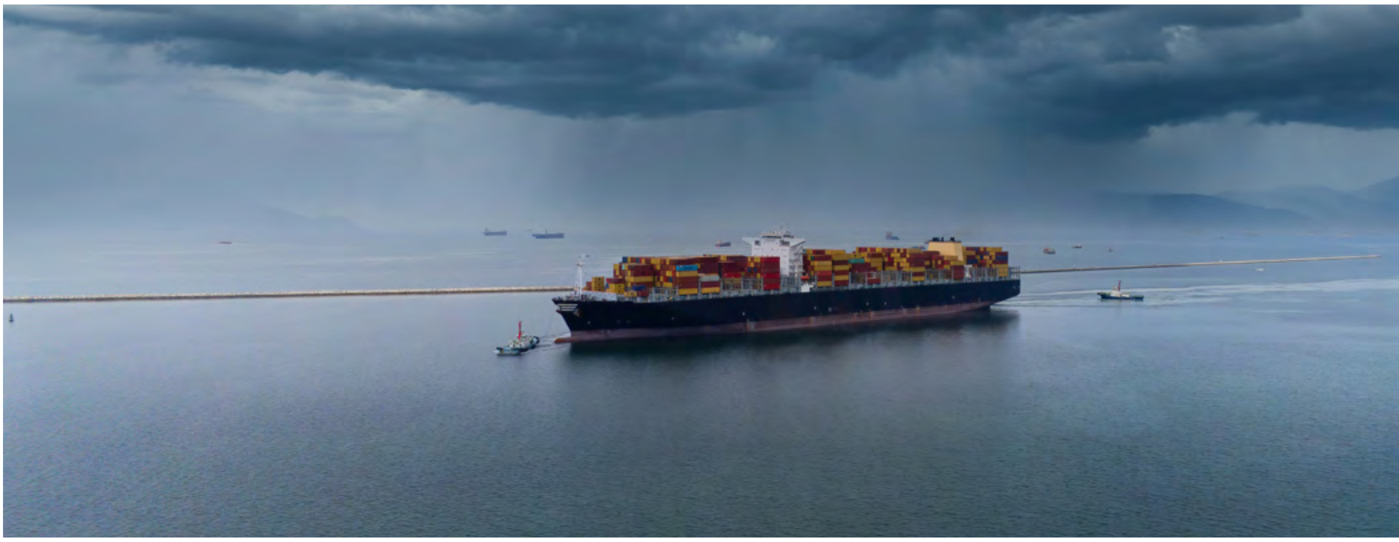
Sivagaminathan Sivasubramanian
Data Analyst
Sivagaminathan.Sivasubramanian@
allianz-trade.com

- **The US has kicked off a full-fledged trade war: On 2 April, US president Donald Trump announced "reciprocal" tariffs that exceeded expectations, with products imported from China set to be taxed at a staggering 130% from 10 April.** The Liberation Day announcements included a universal minimum tariff of 10%, taking effect on 5 April at 12:01 a.m. EDT.1 President Trump also originally decided to impose individualized reciprocal higher tariffs on over 50 countries with which the US has the largest trade deficits, but ultimately announced a 90-day pause for all these countries except China. They are thus subject to only +10pps tariff hikes, while China is facing +125pps. Accounting for sectoral exclusions that were listed in the Executive Order (e.g. semiconductors, pharmaceuticals, copper, minerals), the US effective tariff rate on China now stands at 130%, while the EU faces 9%. All the tariff hikes bring the US global import tariff rate to 25.5%, the highest level since the 1890s. We assume bilateral deals could lower the US import tariff rate to 10.2% by Q4 2025.
- **In 2025, global GDP growth will slump to a mere +2.3%, the lowest level since the pandemic.** Global economic growth is set to decelerate by -0.6pp from +2.9% in 2024 due to the US trade war. The current level of global uncertainty is as high as it was during the Covid-19 pandemic. The US will enter a mild recession (cumulative decline of -0.5% Q1-Q3), with a weak +0.8% in 2025, due to ongoing policy disruptions, import tariff hikes and retaliation tariffs from China. Europe will not escape lower growth due to higher trade restrictions and a weaker US economy, despite the German fiscal stimulus and higher defense spending. We have cut forecasts to +0.8% in 2025 and +1.5% in 2026. Increasingly worried households are likely to increase precautionary savings, dampening consumer demand.
- **Reflation risks make central banks cautious.** Inflationary pressures, particularly in the US, are resurfacing, with headline inflation expected to peak at 4.3% by summer, driven by tariffs. Consequently, the Federal Reserve is expected to adopt a cautious approach, holding rates in place until October and then cutting them to 4% by end-2025 and 2.75% by mid-2026. Persistent stagflationary risks will reinforce the Fed's focus on combating inflation above promoting growth. Europe's continued disinflation contrasts sharply, suggesting divergent monetary policy responses between the two regions. The ECB is likely to bring rates down to 1.5%, -50bps more than expected.
- **Emerging markets are dealing with the (tariff) stick and gaining from the (diversification) carrot.** Emerging markets are responding strategically by adjusting tariffs on American goods and diversifying imports. Israel, Vietnam, India and Thailand, to name a few, have opted for (resp.) cutting tariffs, seeking a trade agreement or increasing imports. Overall, countries which have the highest export dependency on the US and that are subject to the

highest tariff hikes are likely to negotiate first, by committing to buy more US products, lowering import tariffs to close to 0 and increasing investments in the US when possible. Many nations in Asia (e.g. Cambodia, Vietnam, Taiwan, , Thailand and South Korea) and a few in Latin America (e.g. Mexico, Colombia) are likely to do so. Like a fog of war, it is unclear what the final tariff landscape will look like, but the cost of uncertainty is high as tariff arbitrage is now off the table for most companies – until the dust settles. China has taken a harsher tone, announcing retaliation of +84pps tariffs on all US imports, effective on 10 April, and potentially more to come. China demonstrated signs of economic recovery in Q1 and is proactively promoting consumption-focused reforms. Fiscal stimulus and monetary easing are expected to support GDP growth to reach +4.5% in 2025 and +4.2% in 2026, despite lingering downside risks.

- **Companies are adopting short-term strategies such as frontloading imports, diversifying supply chains and adjusting prices to mitigate tariff impacts, while policy uncertainty hampers investments, especially outside the US.** US companies are expected to manage over the next few months with solid balance sheets and stockpiling covering six months of demand (especially for retailers and consumer electronics). However, two-thirds may pass tariff costs to consumers, varying by sector. Meanwhile, production is also shifting from China to Southeast Asia, Mexico and even the US to avoid tariffs. Companies have announced nearly USD1trn in investments in the US despite higher labor costs, which could affect profitability. Strong brands like luxury and tech can absorb costs without losing market share, while low-margin sectors like retail have fewer options. Overall, global uncertainty will suppress capital expenditures, particularly in Europe. Negotiating price cuts and selectively lowering selling prices are additional tactics. Global insolvencies are projected to rise by +7% in 2025 due to the slump in global demand and geopolitical issues, with the US seeing an +16% increase and Western Europe a +5% rise.

- **Capital markets have miscalculated Trump's second term.** Capital markets had already suffered from a more aggressive US policy stance before Liberation Day, reflected in lower US yields, falling equity prices, and a weaker dollar. Liberation day then reenforced those dynamics with markets sharply shifting into risk-off mode and only partially reversing after the subsequent announcement of a partial 90-day tariff pause. With a US recession now our baseline and lower central bank terminal rates than current market pricing, bond yields are expected to fall further from current levels. Equity markets continue to face heightened concentration risks. Nonetheless, our macroeconomic outlook suggests a bottoming out in risk-off moves. We expect both US and Eurozone equities to recover from current levels towards year-end, although downside risks remain and volatility will remain high amid a mixture of forthcoming trade deals and counter-tariffs.



An unprecedented tariff salvo kicks off a (temporary?) full-fledged trade war

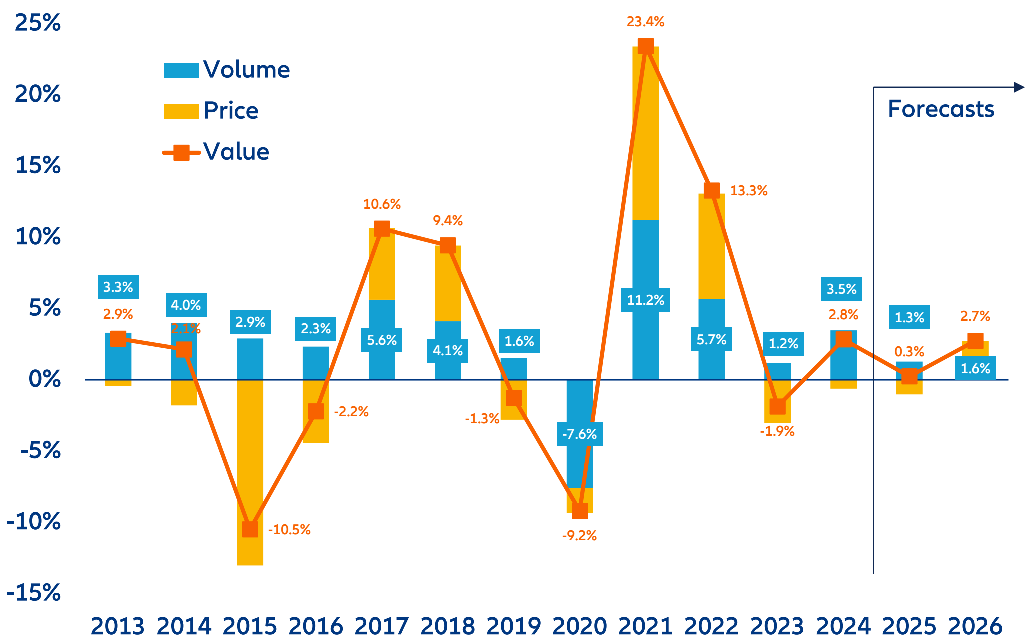
On 2 April, US president Donald Trump announced "reciprocal" tariffs that exceeded expectations, with products imported from China set to be taxed at a staggering staggering 130% from 10 April. The Liberation Day announcements included a universal minimum tariff of 10%, taking effect on 5 April at 12:01 a.m. EDT.[1] President Trump also originally decided to impose individualized reciprocal higher tariffs on over 50 countries with which the US has the largest trade deficits[2], but ultimately announced a 90-day pause for all these countries except China. They are thus subject to only +10pps tariff hikes, while China is facing +125pps. Accounting for sectoral exclusions that were listed in the Executive Order (e.g. semiconductors, pharmaceuticals, copper, minerals), the US effective tariff rate on China now stands at 130%, while the EU faces 9%. The top five highest tariff levels after China are Bangladesh (25%), Pakistan (20%), Cambodia (15%), Indonesia and Japan (both at 14%). Saudi Arabia (4%), Singapore (5%), Norway (6%), Ecuador (6%), Switzerland and the UAE (both at 7%) are now among the nations enjoying the lowest US tariff levels. All the tariff hikes bring the US global import tariff rate to 25.5%, the highest level since the 1890s. In our baseline scenario, we assume that it could decline to 10.2% by Q4 2025, taking into account import diversification, bilateral deals that would partially reverse the tariff hikes from Liberation Day, while certain countries' sectors would be targeted with tariff hikes that had been excluded on Liberation Day (e.g. pharmaceuticals in China and India etc.).

These moves will take the effective import-weighted tariff rate to 25.5%, a level last seen in the 1890s (vs 2.5% before the start of Trump's second term) and could push global trade into a recession. In our baseline scenario, global export losses could reach up to USD480bn in 2025 and USD354bn in 2026. A recession in global trade of goods is expected in volume terms (-0.5% in 2025) while total trade in goods and services should rise by just +1.3% in 2025 (-1.5pp) and +1.3% in 2026 (-0.7pp), in volume terms, down from close to +3% expected in Q4 2024. As the predominant supplier to the US, China faces export losses of up to USD293bn or 1.4% of total GDP. The highest losses are expected in the machinery & equipment

(USD54bn), followed by household equipment/home appliances (USD48bn) and computers & telecom sector (USD26bn). Other significant sectors at risk include textiles, apparel footwear (USD16bn), electronics (USD11bn) and chemicals, plastics & rubber (USD10bn). The EU is next in line, with USD33bn in expected export losses, and within the regional bloc Germany is most exposed, with potential export losses amounting to USD9bn. Unsurprisingly, the export losses would be concentrated in machinery & equipment (USD1.9bn) and automotive manufacturers (USD1.6bn). Vietnam emerges as one of the most exposed countries after China. In Vietnam, the sectors that will face the biggest losses are textiles, apparel & footwear (USD1.3bn), followed closely by computers & telecom (USD1.2bn) and machinery & equipment (USD0.8bn). South Korea and Japan are also quite exposed, each with potential maximum export losses of USD14bn, while Taiwan could experience up to USD7bn of export losses. For Taiwan, the computers & telecom sector accounts for USD1.8bn of potential losses, while electronics (excluding semis) accounts for USD0.8bn and machinery & equipment adds USD0.6bn. South Korea's main export losses are primarily in automotive manufacturers (USD3.5bn), machinery & equipment (USD1.7bn) and electronics (USD0.9bn). Japan's export losses will mostly be felt in automotive manufacturers (USD4.4bn), machinery & equipment (USD3.2bn) and automotive suppliers (USD0.7bn). Overall, we expect rerouting is likely to continue, benefitting next-generation trade hubs in Southeast Asia (such as Vietnam and Malaysia), the Middle East (mainly the UAE) and Latin America (e.g. Chile, Colombia or Mexico).

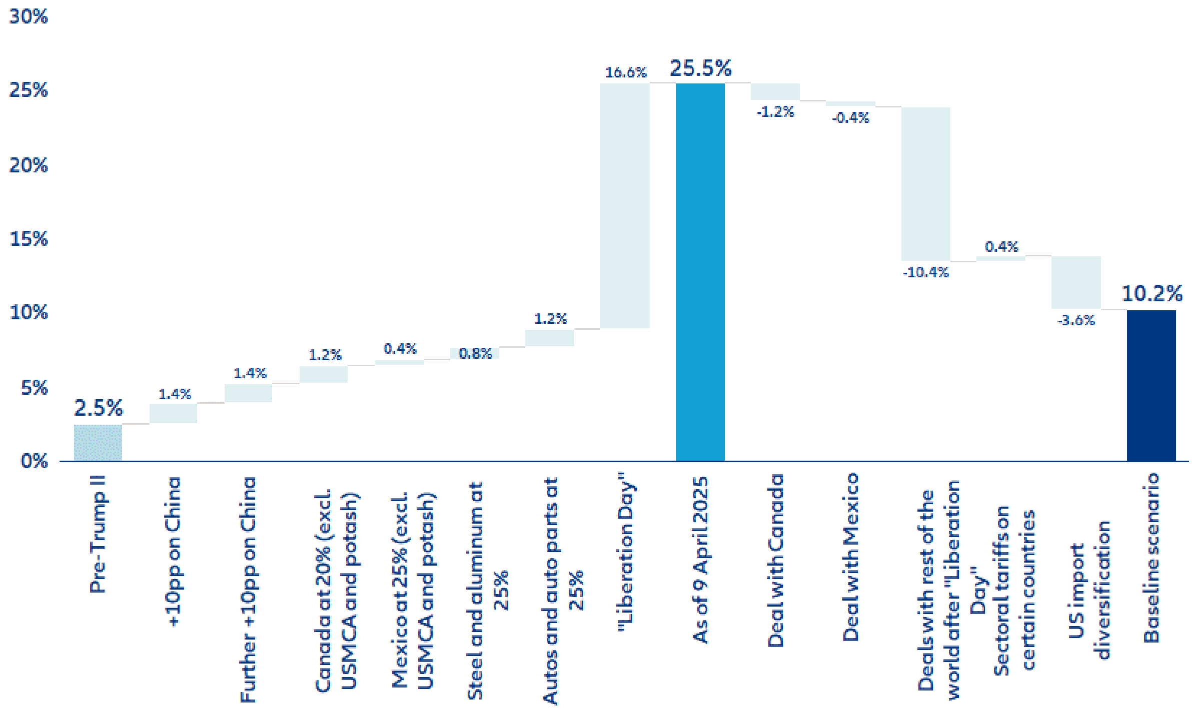
Global economic growth is projected to strongly decelerate to its lowest level since 2008, with forecasts adjusted downward by -0.6pp to +2.3% in 2025. This slowdown will be largely driven by recession in the US (cumulative fall in GDP of -0.5% in Q1-Q3), which is expected to record very low growth of +0.8% in 2025 due to persistent and sizable policy disruptions. These include immigration crackdowns, tariff hikes, spending cuts and layoffs. As households grow increasingly concerned, precautionary savings are likely to rise, further dampening consumer demand. The current levels of global uncertainty are as high as they were during the Covid-19 pandemic.

Figure 1: Global trade of goods and services, annual growth



Source: LSEG Datastream, Allianz Research

Figure 2: US global effective import tariff rate, weighted average in %



Source: Allianz Research

China has announced +84pps in additional tariffs on all US imports, effective on 10 April. These levies would cause annual export losses amounting to USD64bn for the US. The impact is expected to be most substantial for the US agriculture sector, specifically for soybean, wheat and corn exporters, as well as for the US pharmaceutical and energy industries. We estimate that the agrifood sector could face about USD22.3bn export losses and the oil & gas industry up to USD19.3bn, while pharma and machinery & equipment could lose respectively USD15.6bn and USD14.1bn. On top of the tariff hike, China's Ministry of Commerce also announced retaliation in the form of non-tariff measures, including an export ban on seven rare earth minerals used in high-tech products. The retaliation also includes the addition of 11 US firms to the "unreliable entities" list, including several drone manufacturers, barring them from doing business in China. Finally, the Ministry also announced new investigations into US regarding medical imagining equipment.

Most Southeast and East Asian countries have avoided retaliation so far, instead announcing a willingness to negotiate, either with lower tariffs or higher imports from the US. Others had already lowered tariffs on US imports beforehand. Israel falls in the second category, having lowered tariffs on all US imports to zero just a few days prior. Together with Israel, India has been the most active in offering a deal to the White House. Earlier in March, India had already lowered tariffs on some US imports such as high-end motorcycles and bourbon, and dropped a tax on digital services. India has hinted at lowering tariffs on USD23bn of other imports, with the goal of reaching a trade agreement with the US by autumn 2025. The Ministry of Commerce in Thailand has indicated plans to increase imports of US products, including agricultural goods like corn and soybeans, as well as energy products such as crude oil and natural gas. Additionally, discussions are underway to reduce tariffs on specific US goods to help balance the trade relationship. Vietnam had proactively reduced import duties on several US products on 26 March to mitigate potential trade tensions, including liquefied natural gas (LNG) and automobiles. Additionally, Vietnam moved to approve Starlink services, aiming to strengthen economic ties with the US.

1. https://ec.europa.eu/commission/presscorner/detail/en/ip_25_740

In the downside scenario, should the US maintain its average import tariff at 26.3% until the end of 2026, the US recession would be prolonged until early 2026. In this scenario, US GDP growth is projected to slow significantly to +0.4% in 2025 and +1.4% in 2026, compared to baseline expectations of +0.6% and +2.3%, respectively. This deceleration would be driven by persistently high tariffs weighing on trade volumes and economic expansion. Inflation in the US is anticipated to rise even more in the downside scenario, reaching +4.1% in 2025 and +2.2% in 2026 (annual averages), suggesting ongoing price pressures despite weaker growth. China's GDP growth would be reduced to +4.3% in 2025 and +3.5% in 2026, down from baseline projections of +4.5% and +4.2%, respectively, as policy stimulus would struggle to compensate for the prolonged high level of tariffs. Inflation would remain low at 0.5% in 2025 and 0.8% in 2026 amid cautious consumer demand and external pressures. Meanwhile, the Eurozone would see a modest growth deceleration, with GDP growth forecasted at +0.7% in 2025 and +1.1% in 2026, slightly below baseline expectations of +0.8% and +1.5%, respectively. Inflation would remain relatively stable, with a minor decrease to 1.9% in 2025 and 1.7% in 2026, indicating limited pressures despite economic uncertainties.

Further downside risks can arise from fiscal and geopolitical factors. First is a potential US withdrawal from NATO, which would push European NATO members to increase spending to 4% of GDP to fill the gap, which in turn could push budget-stressed economies close to a sovereign crisis, with the ECB stepping in through a reload of the Quantitative Easing Program (QE). Second, a Fed mismanagement of its fiscal stimulus, with a much higher (unfunded) program of tax cuts which would spark market's loss of confidence. Third, in Europe, high energy prices and extensive defense spending after the US withdraws from NATO could fuel inflation, keeping monetary policy tight. The stagflationary shock would be followed by a deflationary recession in 2026, leading to strong rate cuts and QE. Further, and rather as a tail risk, would be the Fed caving and setting interest rates lower than warranted by economic conditions. This would raise questions about its independence and could drive up inflation. The situation could deteriorate further with a "Mar-a-Lago accord" that proposes to depreciate the dollar through potentially unorthodox channels to discourage demand for dollar assets. For instance, the imposition of "user fees", on interest payments to foreign holders of US Treasuries, along with the swapping of Treasury holdings with "century bonds" to mitigate the side effect of higher interest rates. Another option would be to actively devaluate the US currency through the Fed printing dollars in order to buy foreign currencies just like the Swiss National Bank has done to weaken the Swiss Franc since 2015. The establishment of a US sovereign wealth fund (SWF) could serve the purpose to depreciate the dollar by purchasing foreign assets by early 2026, financed through a combination of tax revenues, tariffs, market borrowing or by leveraging existing government assets – estimated at USD5.7trn (including ~800bn USD in gold at current market prices), aimed at boosting returns on federal assets and supporting strategic goals.

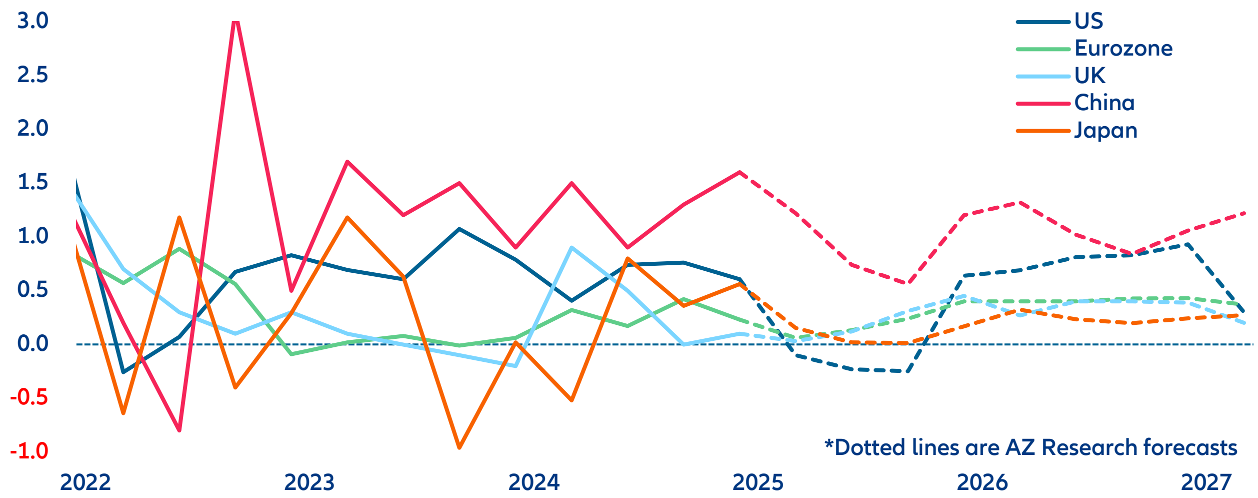
Forget austerity; defense spending will likely reshape fiscal policy in Europe. France and Italy, among others, have been adjusting their fiscal paths to comply with reintroduced fiscal rules, especially on the expenditure side. However, recent developments are forcing European nations to boost fiscal spending related to defense to build a common European capacity. The two major Eurozone countries under the European Commission's Excessive Deficit Procedure reported improved fiscal deficits for 2024 compared to initial estimates: France's deficit stands at -5.8% of GDP and Italy's at -3.4% (down from -6.1% and -3.8% projected, respectively). Despite these improvements, new spending challenges have emerged following the Trump administration's initiative to increase defense spending to at least 2% of the countries' GDP within a limited timeframe. Germany has already taken

Table 1: Global real GDP growth and Allianz Research forecasts, %

Growth (yearly %)	2022	2023	2024	2025f	2026f
Global	**3.3**	**2.9**	**2.9**	**2.3**	**2.8**
USA	**2.5**	**2.9**	**2.8**	**0.8**	**2.2**
Latin America	**3.9**	**2.1**	**2.2**	**2.3**	**3.0**
Brazil	3.1	3.2	3.3	2.3	2.2
UK	**4.8**	**0.4**	**0.9**	**0.6**	**1.4**
Eurozone	**3.6**	**0.5**	**0.8**	**0.8**	**1.5**
Germany	1.5	-0.1	-0.2	0.1	1.6
France	2.6	1.1	1.1	0.4	1.2
Italy	5.0	0.8	0.7	0.4	0.8
Spain	6.2	2.7	3.3	2.0	1.8
Central and Eastern Europe	**1.0**	**1.3**	**2.1**	**2.4**	**3.0**
Poland	5.5	0.0	2.8	2.7	2.9
Russia	-1.3	3.7	3.9	3.0	2.5
Türkiye	5.5	5.1	3.2	2.5	3.0
Asia-Pacific	**3.4**	**4.5**	**4.2**	**3.9**	**3.8**
China	3.1	5.4	5.0	4.5	4.2
Japan	0.9	1.5	0.1	1.0	0.8
India	7.0	8.8	6.7	6.0	6.2
Middle East	**6.2**	**1.2**	**1.6**	**2.4**	**3.6**
Saudi Arabia	7.7	-0.8	1.4	3.1	4.1
Africa	**3.8**	**2.8**	**3.2**	**3.5**	**3.7**
South Africa	1.9	0.7	0.6	1.5	1.8

Sources: National, Allianz Research

Figure 3: Quarterly real GDP growth rates, q/q, %

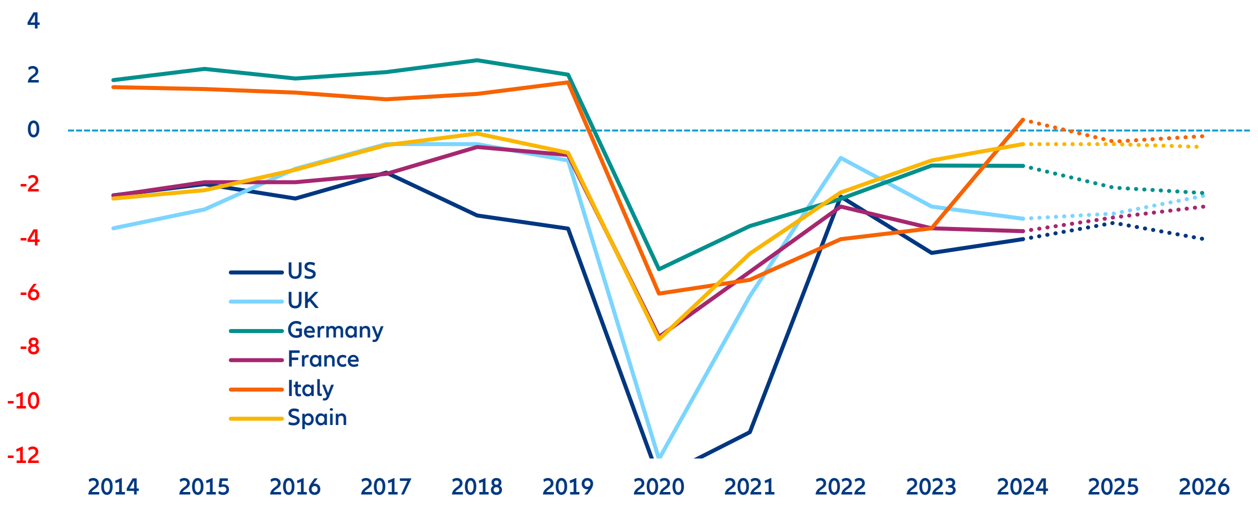


Sources: National, Allianz Research

steps by exempting defense spending from its normal budget constraints, allowing new debt beyond 1% of GDP. Europe is expected to strike a balance between accommodating new debt and maintaining economic and fiscal stability while meeting defense objectives. Lower growth amid trade disruption will further challenge the fiscal outlook.

US deficits: caught between new sources of revenues versus weak economy, tax cuts and rising interest expenses. In the US, we expect the federal deficit to remain stable at -7% of GDP in 2025 (calendar year). On the one hand, sharp tariff increases will boost revenues for the US Treasury. We estimate that around USD310bn of additional customs receipts will be collected this year (factoring in a partial reversing of tariffs in Q4)[2] . Besides, DOGE-induced cutbacks to some federal agency funding should bring additional, albeit limited savings (less than USD40bn). On the other hand, we expect the government to use around one third of the new customs receipts to fund new fiscal spending (including industrial subsidies and support to households' income). Besides, with market interest rates still elevated, interest expenses will continue to grow rapidly. Finally, a weak economy will limit growth of non-customs revenues. In all, while the primary balance should narrow to -3.4% GDP in 2025 (after -3.9%), interest expenses should rise to 3.6% GDP (after 3.1%), meaning that the headline federal deficit should stabilize at -7% GDP. In 2026, we expect the federal deficit to widen to -7.8% of GDP. The enactment of new tax cuts (we expect around USD250bn) will only be partially funded by spending cuts (around USD150bn). It is important to note, however, that the exact timing of the tax cuts is uncertain and could happen before Q4 2025. In 2026, customs receipts should decrease relative to 2025 (-USD86bn) on the back of lower tariffs following trade deals with foreign partners. This would also contribute to push up the federal deficit once again. The increasing precarious state of US public finances present a risk for borrowing costs and could therefore limit appetite for further tax cuts, or even force policymakers to tighten fiscal policy in 2026 (deeper spending cuts and/or limited or no tax cuts at all). GDP growth would be negatively impacted relative to our baseline forecast.

Figure 4: Primary fiscal balance, % of GDP



Sources: LSEG Datastream, Allianz Research

2. We assume an elasticity of imports to tariffs of -1 and an 85% compliance rate

Reflation risks make central banks cautious

Inflation dynamics will further diverge between the US and the UK versus the Eurozone. In the US and the UK, inflation has proven stickier than in the Eurozone and is expected to pick up further in both countries for most of 2025. In the US, strong economic growth has prevented an easing of inflation towards the Fed's target. For 2025, steep tariff hikes will push the economy into a recession but push up prices as we expect that most of the import duties will be passed on to consumers. CPI inflation should peak at around +4.3% in Q3 2025, from +3.0% in Q1, before easing as prolonged weak activity starts to bear down on price pressures. In the UK, steep rises in regulated prices as well as strong wage growth will push inflation further away from the BoE's target in coming months. However, we expect UK inflation to ease gently from the end of Q3 as a cooling labor market and a weak economy start to bite on underlying price pressures. Normalization of inflation at around 2% is expected in Q2 2026 in both economies. In contrast, Eurozone inflationary pressures have largely receded – despite divergence between countries – and we expect the ECB's 2% inflation target to be undershot in 2025, given lower energy prices and imported deflation from global overcapacities amid the trade war. Retaliatory tariffs should have a relatively limited impact on prices and will be largely offset by stronger headwinds to growth, a stronger euro (for Eurozone countries) and lower prices in China amid increasing over-capacity. However, any supply-chain disruptions arising from the trade war could pose an upside risk to inflation.

Keep an eye on labor markets. In both the US and the Eurozone, labor markets have shown signs of recovery, accompanied by resilient wage growth that has enhanced households' purchasing power. However, emerging trends suggest potential reversals. In the US, the unemployment rate is expected to rise close to 5% by early 2026, driven by recession due to higher tariffs and inflation. Despite these challenges, significant labor shortages, exacerbated by tight immigration policies, should prevent a more pronounced increase in unemployment. In the Eurozone, the unemployment rate has held steady at 6.2% for four consecutive months as of January but this stability conceals underlying weaknesses. Employment intentions softened in February, job vacancies are decreasing and companies are shifting away from the labor-hoarding practices observed in recent years. Consequently, the unemployment rate may begin to rise, although any increase is expected to be modest. Moreover, new US tariffs are likely to exert pressure on labor in sectors most affected by these sanctions. As both regions navigate these labor market dynamics, it remains essential to monitor developments closely as they will significantly influence economic trajectories and policy responses.

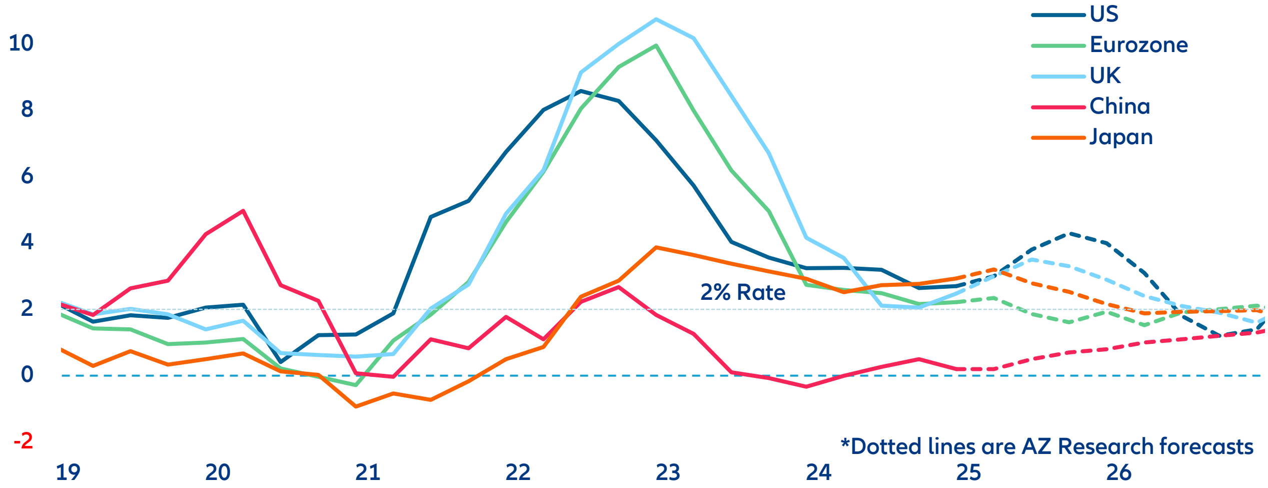
To preserve its credibility, we think the Fed will prioritize its fight against inflation over support to economic activity, with a first cautious 25bps cut penciled in for October. Prolonged elevated inflation has thus far not eroded inflation credibility credentials, as indicated by relatively well anchored medium-term inflation expectations and cooling wage growth. However, there are signs that the private sector, notably, households, is starting to question the capacity to bring inflation back to target, especially as tariffs are set to increase (goods and food) prices further. Short-term (12 months) inflation expectations have shot up across all surveys, which is uncommon given that in the meantime oil prices have dropped. Medium-term (five-year) household inflation expectations also rose. In this context, we think the Fed will

Table 2: Inflation forecasts, yearly, %

Inflation (yearly %)	2022	2023	2024	2025f	2026f
Global	**8.2**	**6.1**	**5.4**	**4.2**	**3.1**
USA	**8.0**	**4.1**	**3.0**	**3.7**	**2.0**
Latin America	**14.2**	**14.8**	**16.8**	**8.7**	**5.7**
Brazil	9.3	4.6	4.4	4.9	3.5
UK	**9.1**	**7.3**	**2.5**	**3.2**	**2.0**
Eurozone	**8.4**	**5.4**	**2.2**	**1.9**	**1.9**
Germany	6.9	5.9	2.3	1.9	1.9
France	5.2	4.9	2.0	0.9	1.5
Italy	8.2	5.6	1.0	1.8	1.9
Spain	8.4	3.5	2.8	2.4	1.9
Central and Eastern Europe	**9.1**	**11.0**	**3.9**	**4.8**	**3.7**
Poland	14.4	11.4	3.8	4.5	3.8
Russia	13.8	5.9	8.4	9.5	6.0
Türkiye	72.3	53.9	58.5	32.3	18.7
Asia-Pacific	**4.0**	**3.0**	**1.8**	**1.7**	**2.0**
China	2.0	0.2	0.2	0.6	1.2
Japan	2.5	3.3	2.7	2.7	1.8
India	6.7	5.7	5.0	4.1	4.3
Middle East	**17.2**	**16.4**	**14.9**	**16.5**	**12.7**
Saudi Arabia	2.5	2.3	1.7	1.9	2.0
Africa	**14.6**	**17.0**	**18.9**	**12.3**	**8.8**
South Africa	6.9	5.9	4.4	3.5	4.7

Sources: National, Allianz Research

Figure 5: Quarterly inflation rates, y/y, %



Sources: national, Allianz Research

remain on the sidelines for most of 2025, meaning that it is ready to accept a period of weak activity to bring inflation back under control. We expect the Fed to deliver a 25bps rate cut in October, followed up in December, cautiously shifting its focus away from inflation towards support to the economy. We would expect the size of Fed rate cuts to increase in early 2026, with two 50bps rate cuts penciled in for the first two meetings of the year.

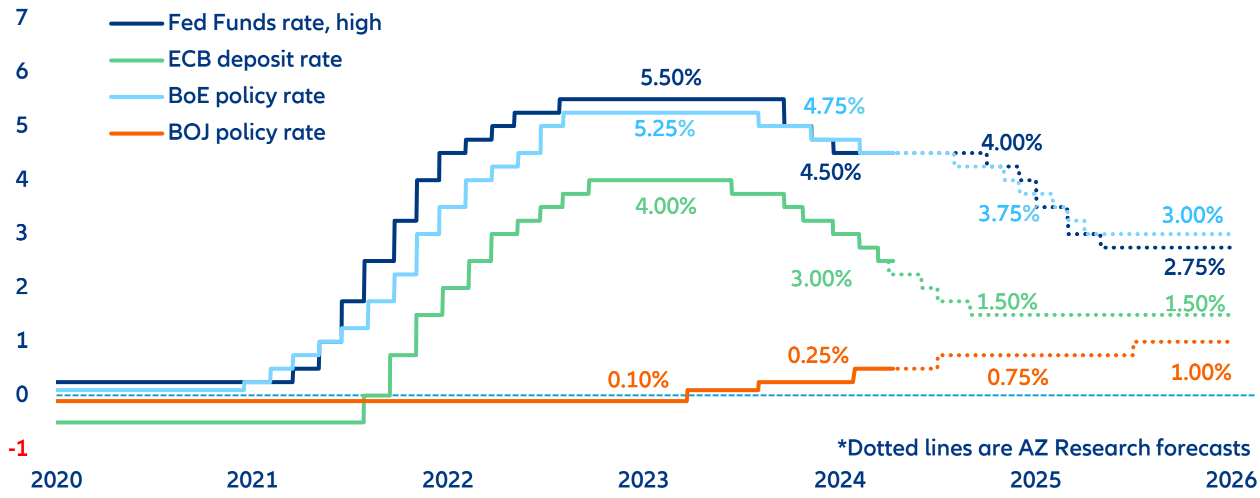
The ECB will cut below its self-proclaimed neutral rate of 2.0% this year while keeping quantitative tightening at full-roll-down mode. As inflation is expected to fall below the ECB's target by mid-2025, and the economy will continue to show a negative output gap amid headwinds from the global trade war, the ECB is very likely to move monetary policy from still slightly restrictive territory to accommodative. ECB staff have estimated the neutral nominal rate at 1.75%-2.25%. Given the additional economic headwinds, we expect the ECB to continue cutting the policy rate down to 1.5% by September 2025. Meanwhile, quantitative tightening is set to continue with the ECB not reinvesting any maturing bonds in its APP and PEPP program, leading to a reduction of bond holdings by roughly EUR40bn per month. Risks are high and asymmetric to the downside. The German-induced fiscal boost will not be able to outweigh the headwinds from intensifying trade frictions coming from the US. But the ECB retains considerable leeway to contain widening Eurozone spreads in the event of financial stress. The most likely first response would be a halt to quantitative tightening, which would lower the net-net issuance of Eurozone government bonds by around EUR480bn annually – far exceeding the currently debated increase in defense spending (EUR140bn annually, which would raise EU-wide defense spending from 2.2% to 3% of GDP).

The Bank of England is expected to remain on hold until August amid rising inflationary pressures but will act forcefully later. The UK economy is stuck in a mild stagflationary trap, with both lower growth and higher inflation. In this environment, the BoE has become more concerned about the risk of de-anchoring of inflation expectations and a wage-price spiral loop. We expect the BoE to remain on hold for the next two meetings (May and June), before delivering a cautious 25bps cut in August amid early signs that core inflation will be receding. After another skip in September, we think that increasing evidence that inflation and wage growth are firmly cooling will prompt the BoE to shift its focus to the support of growth. We expect back-to-back 25bps rate cuts in

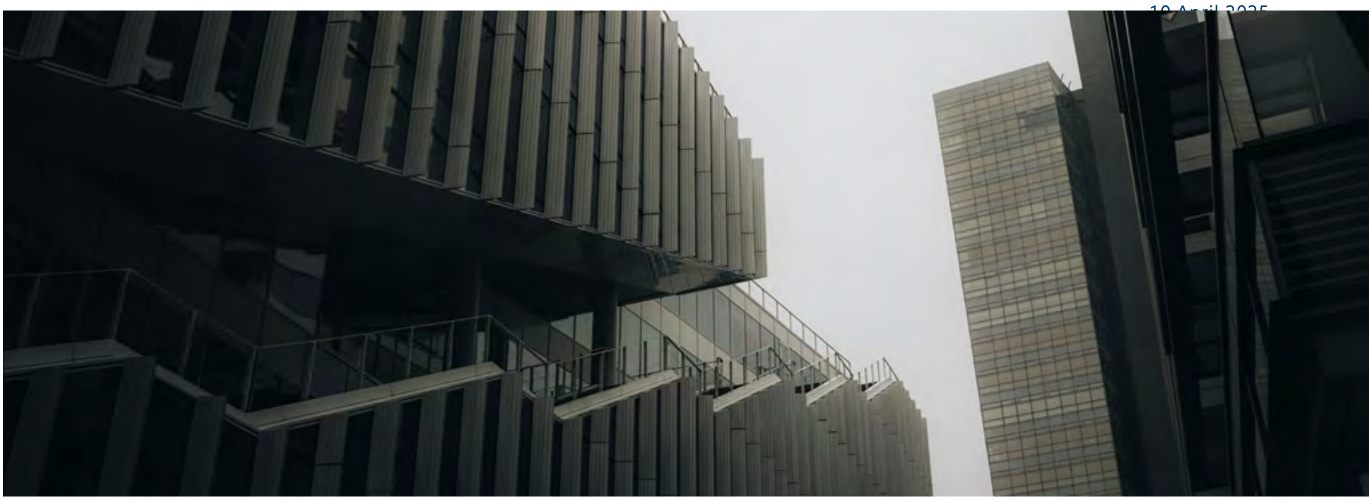
November and December, which will bring the Bank Rate to 3.75% at the end of 2025. Additional rate cuts are likely in early 2026, bringing the Bank Rate to 3.0% by mid-2026.

The Bank of Japan (BoJ) will continue going against the trend but retain a cautious approach to normalizing its monetary policy. After ending negative interest rates in March 2024 and delivering two more hikes in August 2024 and January 2025, the BoJ will likely continue to gradually lift its policy rate. We expect the next rate hike to happen in late July (25bps to 0.75%) and another one in 2026 to 1%. Ultimately, the pace and precise timing of upcoming rate hikes will be data-dependent as the BoJ aims to find a balance between its inflation mandate and the need to support economic growth and ensure financial stability. The BoJ will be particularly wary of US trade policy and domestic wage dynamics, with the latest annual spring wage negotiations (shunto) somewhat stronger than expected. At the same time, a larger-than-expected negative from the trade war would increase the likelihood that the BoJ keep policy rates on hold this year. In parallel of policy rate changes, the BoJ will also steadily scale back its asset purchase programs. Overall, policy normalization will be gradual, with the BoJ probably favoring an accommodative stance, and Japanese interest rates remaining lower than in other major economies in the coming years.

Figure 6: Monetary policy key rates, %



Sources: LSEG Datastream, Allianz Research



Growth in developed markets should slow down to +1% in 2025, the lowest level since the pandemic

We expect a contained recession in the US through Q3 2025, followed by a moderate rebound in 2026. After stellar growth for the past three years, the tide has turned quickly for the US economy amid abrupt tariff hikes and soaring policy uncertainty. Forward-looking indicators linked to household confidence have deteriorated sharply amid concerns over job prospects and rising inflation expectations. We now expect weak GDP growth of +0.8% this year. GDP is expected to have contracted (mildly) as early as Q1 2025, but this is explained by a negative contribution from net trade rather than weakening domestic demand. However, we forecast Q2 and Q3 GDP to register negative growth on the back of declining consumer and investment spending. From Q1 to Q3, we expect GDP to decline by a cumulative -0.5% – a significant hit to the economy. Ramped-up industrial subsidies and fiscal spending – funded by new customs receipts – should prevent a deeper recession. However, negative wealth effects, market crash spilling over to weakening financial institutions' balance sheets, prolonged high uncertainty and high inflation and high interest-rate fatigue are factors of risk that could amplify the downturn. The timing of when new industrial subsidies will be effectively disbursed is uncertain. They will probably come in the second half of 2025, meaning they will support activity in the latter part of the year and in 2026. Activity in 2026 will be further supported by tax cuts, the Fed loosening monetary policy and our assumption that some tariffs on foreign partners will be unwound (''trade deals'') by end-2025. We are penciling in +2.2% growth in 2026. The weaker supply-side potential of the US economy, induced by tight immigration policy and less efficient supply-chains, will limit the scope of the recovery in 2026.

The Eurozone is expected to remain below its economic potential in 2025, with trade war risks outweighing Germany's fiscal stimulus. Economic growth slowed to +0.2% q/q in Q4 2024, down from +0.4% q/q in Q3. On the positive side, domestic demand continues to drive growth, with both consumption and investment rising, while net exports remained flat after a strong first half of 2024. Encouragingly, this has marked the fourth consecutive quarter of expansion following a prolonged stagnation in 2022 and 2023. Looking through quarterly volatility, we expect weaker growth to persist with the negative output gap remaining throughout 2025. Two opposing forces are largely at play: the more aggressive-than-expected trade war stance from the US on the downside and the strong fiscal stimulus from Germany on the upside. Thanks to additional fiscal spending, growth should be supported by domestic consumption, investment and government spending. However, net exports will face headwinds. In 2024, the Eurozone exported goods worth EUR531bn to the US, equivalent to 3.5% of Eurozone GDP, making it by far the most important trading partner. As these goods now become significantly more expensive in the US due to tariffs, demand will certainly drop, negatively impacting GDP growth in the Eurozone. But lower energy prices and a stable currency outlook should provide additional tailwinds. All in all, we expect growth at +0.8% in 2025 and +1.5% in 2026, slightly up from the sluggish +0.5% and +0.8% recorded in the previous two years.

Germany is unleashing billions to boost growth through defense and infrastructure spending but the hit from tariffs could offset a significant part of it. A two-thirds majority in the Bundestag in March exempted defense spending from the normal budget, allowing new debt above 1% of GDP, and created a special EUR500bn infrastructure fund to address decades of underinvestment (capital stock -10pps over the last decade). Debt-financed fiscal spending is expected to add to GDP but increased tariffs will pinch, resulting in net growth of only +0.1% to GDP in 2025, followed by +1.6% in 2026, although structural reforms need to be implemented to actually realize potential growth. Risks such as inflation and capacity constraints remain and the debt-to-GDP ratio is projected to exceed 75% by 2037, up from 63% currently. Capital markets had already priced in this fiscal stance after the announcement and are now pricing in around 30bps higher interest rates for Germany. Given the upside to growth and inflation, the resulting additional debt-servicing costs should be manageable (0.1-0.2% of GDP, ceteris paribus). The newly presented future coalition's government program includes strong incentives to help German businesses – like a 30% super depreciation until 2027, lower corporate taxes from 2028, abolishing the Supply Chain Act and easing electricity costs. However, it lacks key structural reforms, especially in pensions, with costly concessions. All in all, the plan overpromises on relief without sufficient budget backing, making a true economic reset and restored competitiveness unlikely unless priorities shift.

The French economy should continue to flatline in the first half of 2025. Economic momentum has deteriorated sharply since the end of 2024, owing to a combination of weaker external demand (particularly the manufacturing sector in Europe) and domestic political uncertainty. Meanwhile, tariff-driven external headwinds have risen. Against this backdrop, inflation has dropped substantially, helping to support households' purchasing power. The labor market has deteriorated but we do not expect large layoffs amid still elevated labor and skills shortages). We expect GDP to grow by a weak +0.4% in 2025, with tariff-induced export losses amounting to around USD 7bn. Nevertheless, the resilience of the consumer will be key to prevent the economy from potentially slipping into recession territory. Another supportive factor is the easing of monetary and financial conditions, with credit becoming easier to get and interest rates coming down a bit (particularly for corporates The expected fading of the trade war at the end of 2025 and the continuing pick-up in credit will support the economy. In 2026, a substantial pick-up in German growth will provide additional tailwinds. We expect GDP to accelerate to +1.2%.

10% of Italian exports are directed to the US, making the country vulnerable to the trade war. Although economic activity managed to avoid stagnation as initially anticipated at the end of 2024, the 2025 outlook remains cloudy. The modest growth has been primarily driven by a rebound in investment activity and partially by household consumption, which are both expected to continue throughout the year. But at the beginning of 2025, the trade balance showed a slight deficit, which the protectionist policies announced by the new US administration could widen in the coming months. We expect GDP to grow by a timid +0.4% and potential export losses can go up to USD9bn. Small and medium-sized enterprises and firms in strategic sectors exporting to the US market remain particularly exposed to trade disruptions. The labor market is beginning to show signs of strain; despite the low unemployment rate, there has been a decline in labor force participation. Furthermore, while overall employment numbers continue to rise, the average number of hours worked per employee is decreasing, and the reliance on wage supplementation remains high, especially within the manufacturing sector.

Spain begins the year on solid footing with a more balanced growth mix. 2024 GDP growth of +3.2% was more than four times the Eurozone average and we anticipate that private consumption and NGEU investments will continue to be key drivers of growth this year, with overall activity expected to remain solid compared to Eurozone peers, expanding by around +2%. Additionally, economic activity has become less dependent on the booming tourism sector, which nonetheless achieved record revenues exceeding EUR120bn. The lower dependency on US exports makes Spain more exposed to a weaker Eurozone bloc than to tariff wars.

The UK economy is stuck in a low growth, high inflation environment. Economic momentum has deteriorated since the end of 2024, owing to a combination of weaker external demand and Budget-induced lower confidence and prolonged tight financial conditions (particularly for mortgage holders). Inflation has remained sticky, contributing to keeping the BoE hawkish and financial conditions tight. Despite UK exports to the US being subject to lower tariffs than most large economies (at 10%), the economy will feel the pinch of weaker growth in Europe and the US. Tariff-induced exports losses to the US could amount to USD 5.8bn. We expect GDP to expand by a weak +0.6% in 2025. Lingering weak demand should eventually allow inflationary pressures to ease back, and the BoE to switch to dovish mode to support aggregate demand from August. This would set the stage for an economic recovery in 2026, including on the housing market. Further tailwinds will come from Germany's upcoming large fiscal easing, which should support UK exports. Increased government spending on public services and infrastructure will limit the downside on short-term growth and support medium-term growth. However, overall fiscal policy will be very tight, with further austerity measures likely. GDP is expected to grow by +1.4% in 2026.

A recovery is likely ahead for Japan but will be capped by external headwinds. We have revised our GDP growth forecasts for Japan downwards to +1% in 2025 (-0.2pp compared to our December 2024 forecast) and +0.8% in 2026 (-0.3pp). This still reflects a path of economic recovery after barely any growth in 2024 (+0.1%). The high cost of living has been weighing on private consumption, but household spending is expected to improve going forward, thanks to rising real wage growth and a supportive fiscal policy. Additionally, investment will be supported by the government's industrial policies to drive digitalization and clean-energy technology. Indeed, fiscal-consolidation efforts will likely be undermined after the government coalition lost its parliamentary majority in the October 2024 snap lower-house election. Domestic political uncertainty (with the tenure of the prime minister potentially at risk following the July 2025 upper-house election) and external headwinds resulting from the ongoing trade war will keep a lid on business sentiment. Indeed, we estimate that the Liberation Day announcements will raise the US import tariff on shipments from Japan to nearly 21%, and that a deal by the end of the year could bring it back towards 14%. Still, this compares with 1.5% at the end of 2024 and is likely to weigh on Japanese exports and investment.

Emerging markets' growth should moderate at +3.9% in 2025, below 10-year average

China will further step up policy support (at least 2pp of additional fiscal stimulus to 3.8% of GDP) to make up for the higher-than-expected tariff hikes. We have slightly revised down our GDP growth forecast for China to +4.5% in 2025 (-0.1pp) and keep 2026 unchanged at +4.2% based on: better-than-expected economic activity data in Q1, expectations of further policy easing and the possibility to partially mitigate higher tariffs with trade diversion and a moderately weaker CNY. Prior to Liberation Day, risks to our GDP growth forecast in 2025 were probably on the upside: despite still fragile fundamentals, activity data had surprised positively at the turn of the year and the credit impulse had been recovering, thanks to policy easing and signs of private sector confidence bottoming out. A large fiscal package (RMB2.4tn) had already been announced in early-March to underpin the official GDP growth target maintained at "around 5%", but we believe that the door was left open to step up policy support further, should economic headwinds call for it. We estimate that around RMB2.7tn of additional fiscal stimulus is likely needed to help mitigate the drag on GDP growth from higher tariff rates from the US (currently at 109% and potentially at 87% after a deal is struck, vs. 25% in our original contained trade war scenario). Finally, another possible mitigation tool for Chinese policymakers is to allow for the CNY to depreciate. Although there are very early signs suggesting that the PBOC is considering this (the onshore mid-rate was fixed 0.14% weaker vs. the USD on 3 April, the largest daily adjustment since December), we continue to believe that a significant weakening of the CNY is not Chinese policymakers' preferred option as it may also dent domestic confidence. Ultimately, China's outlook will depend a lot on the scale of the fiscal stimulus and its efficiency to effectively lift domestic confidence.

Uncertainties and risks abound for emerging market economies, but pockets of resilience and opportunities can still be found. Growth in emerging markets (EM) excluding China is forecast to reach +3.5% in 2025 and +3.9% in 2026 (after +3.5% in 2024). The economic outlook is expected to slightly improve in 2025 in most regions, and somewhat deteriorate in Emerging Asia. Exports should moderate in the context of the US trade war, but domestic demand is expected to improve, thanks to moderating inflation in Asia, Latin America and Africa; easing monetary conditions in Asia, Latin America (except Brazil), part of Africa and the Middle East and fiscal support in emerging Europe and parts of Latin America. Downside risks to the economic outlook particularly relate to global trade (e.g. a long-lasting full-fledged trade war and further escalation for Mexico and the rest of Latin America) and (geo-)political tensions, although a significant upside risk for emerging Europe resides in a potential deal between Ukraine and Russia. In the longer run, the trade war could create opportunities for EMs with critical resource endowments and supply-chain competitiveness.

Table 3: Key drivers and challenges for emerging market economies

Emerging Asia, excluding China	• We expect the Asia-Pacific region overall to grow by +3.9% in 2025 (after +4.2% in 2024), followed by +3.8% in 2026. Growth in Emerging Asia excluding China will take a small step down in 2025 (+3.5% vs. +3.7% in 2024) before edging up in 2026 (+3.6%). South and Southeast Asia will continue to outperform, with India growing by +6% in 2025 and +6.2% in 2026 and ASEAN by +4.3% in 2025 and +4.4% in 2026. Nevertheless, even in these countries, the pace of growth will be below the pre-pandemic long-term average despite potential rerouting of exports from China increasing in the next months. • Tailwinds include cautiously easing monetary policies and moderating inflation that support domestic demand while fiscal policy is consolidating in most economies. • Inflation fell below central bank targets in most of the region and is likely to remain moderate. We forecast inflation for Emerging Asia (excluding China) overall at 2.6% in 2025 (after 3.2% in 2024), and 2.8% in 2026. • Domestic conditions provide grounds for monetary easing and the US trade war being more aggressive than previously anticipated also supports the case for policy rate cuts across Emerging Asia. The rate-cutting cycle has already started in most economies of the region and should continue in 2025-2026. • The main geopolitical risks in the region remain around the Taiwan Strait and the South China Sea. Economies also need to affirm themselves amidst the US-China rivalry. In terms of domestic politics, the situation needs to be monitored mainly in South Korea, Indonesia and the Philippines.
Emerging Europe	• The region's growth is projected to reach +2.3% in 2025 and +2.8% in 2026. Economic activity in CEE is steadily recovering, primarily driven by domestic demand and fiscal stimulus. However, US reciprocal and sector-specific tariffs – particularly in the automotive sector – pose a significant challenge to this recovery. While CEE economies see demand from the US accounting for less than 1.5% of GDP across the region, the impact is still felt through integrated supply chains, particularly with Germany. On the positive side, the region could see benefits if a peace agreement is reached between Ukraine and Russia. • Inflation is forecast to remain above central bank targets in most economies until the end of 2025, driven by fiscal stimulus and strong wage growth. This will keep the regional average at around +4.1% in 2025 and +3.3% in 2026. • This combination of tight labor markets, rising wages and accelerating inflation limits the central bank's scope for monetary easing. The interaction of these factors poses significant risks to economic stability and growth prospects. Policy rates are therefore expected to remain above pre-pandemic levels. Fiscal policy is expected to remain loose, putting public finances at risk in the medium term. • Growth in Russia remains at around +2.5% on average in the forecast period, with a substantial shift from war related to non-war-related sectors as we move into 2026 and 2027 with great unknowns and a potentially net positive impact on the energy sector. In Türkiye, inflation will remain well into double digits until 2026 despite the efforts of the central bank. Growth will continue to be subdued (+2.5%) and accelerate in 2026 to +3.0%.
Latin America	• The outlook for Latin America remains positive with a regional GDP growth forecast of +2.3% for 2025 and +3% in 2026, despite external headwinds. The resilience of consumer demand, coping mechanisms on trade and inertial or shifting foreign investment due to business uncertainty, particularly in Mexico, characterize the current cycle with another wave of elections pending across the Southern cone. • For the moment, the baseline growth forecast for Mexico in 2025 remains above consensus (+1.2%), with risks clearly on the downside, even if we do not expect a contraction at the end of the year. Argentina is set for a rebound (+3.8% in 2025) driven by more stable macroeconomic conditions and rising investment. Additional investment in Andean economies and a one-off remittance increase benefiting Central America are propping up short-term growth. Brazil's economy may eventually slow down to +2.3% after three consecutive years of upward revisions of GDP forecasts, due to spending cuts, lower commodity prices, higher financing conditions affecting primary sectors and an increasing cost of living. • Some growth will fall on the shoulders of governments, which are struggling to reduce public spending or increase revenues. Moreover, the impact of increased trade tensions will be felt mostly in countries with strong manufacturing exports, while it should be relatively muted for extractive industries, which already serve a variety of markets.
Africa and the Middle East	• In 2025, growth has been revised down due to the tariff shock and the oil price decline: +3.5% in Africa, +2.4% in the Middle East, followed by +3.7% and +3.6% in 2026, respectively. The recently announced US tariffs are expected to have relatively low direct impact on African exports due to the region's low export exposure to the US market. However, certain economies such as South Africa will experience more due to higher exposure. Secondary effects will have greater impact on Africa, oil exporters have faced notable downward revisions in trade forecasts due to the oil price decrease since the announcement. Currency moves in the region have been felt only in selected markets mainly South Africa and some oil exporters. Debt concerns will persist across the region, especially in Mozambique and Kenya, even though the USD performance has so far not increased pressure on the downside. • Inflation is expected to fall to 12.2% in 2025, from 18.9% in 2024, even though price pressures will continue in some sizable economies such as Ethiopia and Nigeria. In the Middle East, inflation has also been revised down due to forecasted lower oil revenues but remains higher than previous year at 16.5% in 2025, and to fall in 2026 to 12.7%, with diverging developments. Gulf countries are expected to experience a slight increase, while a decline is likely in some non-GCC countries such as Israel, Jordan or Lebanon. • Central banks in African and non-GCC economies are holding rates in the uncertain global economic context. Egypt and Nigeria are expected to join the easing cycle during the second half of 2025. Gulf economies continue to follow the Fed's lead. • The conflict in the Levant has begun normalizing, even if risks remain localized in Gaza, Syria, Lebanon and Israel. Meanwhile conflicts in the horn, central Africa and Yemen remain and could eventually escalate.

Source: Allianz Research

When the levy breaks: How firms cope with tariff and policy uncertainty

Auto, textiles, non-food retail, renewables and agriculture are the most vulnerable in the current context. Escalating tariffs and tighter immigration controls in the US expose several sectors to substantial risk (see Table 4). Among the most vulnerable are automotive, textiles, non-food retail and agriculture. Automotive manufacturers face increased costs from tariffs imposed on imported vehicles and parts, disrupting intricate supply chains, and in turn potentially pushing up consumer prices and curbing demand in the US. In Europe, the industry is vulnerable to lower demand from the US but also to supply-chain risks. Similarly, the textile sector will be grappling with elevated input prices due to tariffs on fabrics and apparel imports, reducing profit margins and competitiveness. Non-food retail firms, particularly smaller firms reliant on imported consumer electronics, furniture and apparel, must absorb higher procurement costs or pass them onto consumers, risking weaker sales performance. For European peers, this means higher competition as products intended for the US will be diverted towards the region. Agriculture is doubly vulnerable in the US: retaliatory tariffs from trading partners may undermine export markets for key US commodities like soybeans, pork and dairy, while domestic immigration crackdowns raise labor costs and increases inflationary risks. Renewable energy and power generation are also challenged, with tariffs on imported solar equipment significantly raising project costs, potentially leading to project cancellations or delays. In Europe, the chemicals sector will also face significant headwinds through lower exports towards the US and increased competition from non-European producers that will try to offload their products in Europe as the US market will become less accessible.

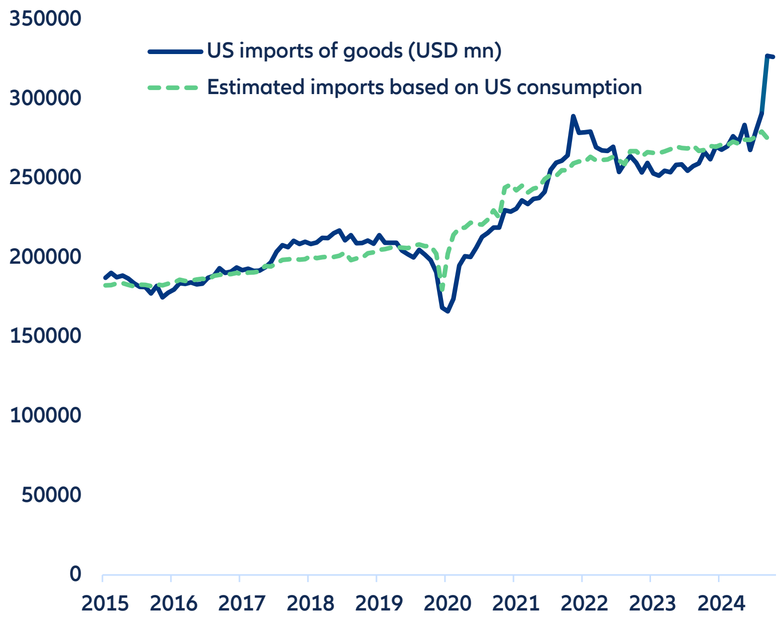
Table 4: Sector assessment

Sector	Overall growth outlook 25-27	Impact of US tariffs on European industries	Impact of Trump policies on US industries (immigration, fiscal, tariffs, deregulation etc.)
Automotive	Negative	Significant	Negative
Textiles	Negative	Significant	Negative
Retail - Non-Food	Negative	Low	Negative
Agriculture	Negative	Medium	Negative
Renewables / Power	Neutral	Significant	Negative
Home Appliances	Neutral	Medium	Negative
Food & Beverages	Neutral	Medium	Negative
Furniture	Neutral	Medium	Negative
Shipping	Neutral	Low	Negative
Retail - Food	Neutral	Low	Negative
Air Transport	Neutral	Low	Negative
Construction	Positive	Low	Negative
Metals & Mining	Positive	Significant	Positive
Chemicals	Positive	Significant	Positive
Computers & Telecom	Positive	Medium	Neutral
Machinery & Equipment	Neutral	Medium	Positive
Software & IT Services	Positive	Low (Services excluded)	Positive
Electronics	Positive	Medium	Positive
Pharmaceuticals	Positive	Significant	Positive
Oil & Gas	Negative	Medium	Positive
Transport - Road	Neutral	Low	Positive

Sources: Oxford Economics, Allianz Research
*refers to the turnover expectations for each industry at the global level over 25-27

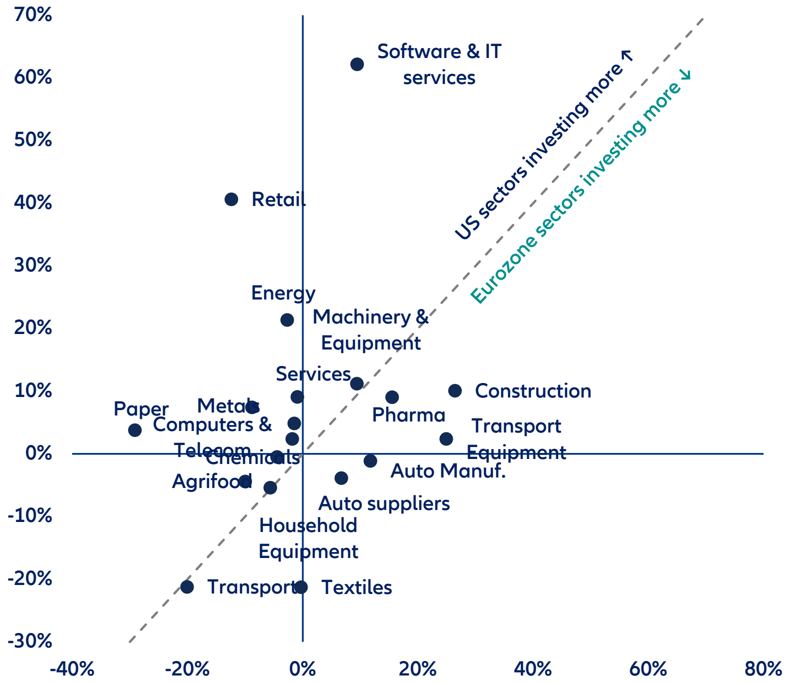
In the short term, firms will cope by frontloading, bypassing tariffs and adjusting (selling/purchasing) prices. US firms are swiftly implementing short-term strategies to mitigate the short-term financial impacts. One prevalent strategy has been frontloading, i.e. accelerating the importation of goods before tariffs take effect (see Figure 7). Especially in sectors such as retail and computer and consumer electronics, corporates have significantly increased their inventories to hedge against impending cost increases. For example, major retail companies such as Costco reported a +10% y/y rise in inventory, while Williams-Sonoma's inventory grew by +6.9%. These firms have mentioned that their purchases were intended as frontloading ahead of tariffs. Our estimates suggests that the high levels of imports from US firms between December 2024 and February 2025 could cover up to six months of US consumer demand. However, this strategy carries the risk of overstocking if consumer demand does not align with heightened inventory levels. Simultaneously, companies are diversifying their supply chains to reduce reliance on regions affected by tariffs. Many firms are relocating manufacturing from China to Southeast Asia, Mexico and the US to circumvent the additional costs associated with Chinese imports as China remains the main target for the Trump administration. This strategic shift not only mitigates tariff exposure but also enhances supply-chain resilience against geopolitical uncertainties. However, it raises some question marks on future profitability. Firms have also been negotiating price reductions with existing suppliers. While this strategy can alleviate some cost pressures, its success depends on suppliers' willingness and ability to absorb reduced margins. A last coping mechanism is reducing their own selling prices for those that have the leeway to do so (i.e. sufficiently ample profitability).

Figure 7: US imports of goods actual vs estimated



Sources:Bloomberg, Allianz Research

Figure 8: Short-term debt to assets (Q3 2024 vs 5Y average)



Sources:LSEG Datastream, Allianz Research

Tariffs are boosting investments in the US but overall uncertainty weighs on capex everywhere else. As companies are contemplating adjustments to their manufacturing footprints, many are considering or have announced expanding their production capabilities in the US to mitigate potential tariffs. By increasing manufacturing presence in the US, firms affirm their confidence in the long-term strength of the US real economy. Nevertheless, despite these proactive measures, the pervasive uncertainty surrounding trade policies is exerting a significant drag on corporate investment, particularly in Europe. The unpredictability of tariff implementation complicates strategic planning, leading many firms to adopt a cautious stance. While certain sectors face headwinds due to increased import costs, others find incentives to boost capex – especially in the US. Some sectors also need to navigate complex environments: for example, the US oil & gas industry is grappling with the dual challenge of tariffs on imported steel, which raises production costs, and the administration's push for increased drilling activities. Overall, companies are delaying expansion plans and new hiring as the volatile tariff environment complicates the forecasting of earnings, supply-chain costs and market demand. This reticence is particularly evident in sectors heavily reliant on international trade, where the risk associated with capital investment has markedly increased. Despite the various short-term coping mechanisms, the overarching uncertainty is dampening long-term investment, especially in Europe.

Against this backdrop, we expect global corporate insolvencies to increase by about +7% in 2025. This upward trend is likely to continue into 2026, though at a slower pace (5%, compared to the 3% expected before Liberation Day). In the US, the situation will be more severe. Insolvencies are projected to jump by 16% in 2025 (from 11% expected previously) and 6% in 2026. Western Europe faces a more modest increase, with insolvencies expected to rise by 5% in 2025 (compared to 3% expected previously). Projections for 2026 show a decrease in insolvencies (-2% compared to -3% expected previously). We continue to expect insolvencies in China to rise by 7.5% in 2025. However, the 2026 outlook shows a significant rise of 10%. Asia excluding China presents a mixed picture, with insolvencies rising by 1% (compared to 0.5% expected previously). The 2026 projections indicate a decrease of -3% (compared to -4% expected before the Liberation Day announcements).

Capital markets outlook: Trump's second term got mispriced

Capital markets have misread the implications of Trump's second term. While the initial market reaction immediately after the US presidential elections was a classic risk-on rally – equities surged, credit spreads tightened, yields rose and the dollar strengthened – the market narrative has reversed, particularly since the inauguration of President Trump. With a significantly more aggressive stance towards tariffs – especially after "Liberation Day" – tough foreign policy, restrictive immigration policy as well as government cost-cutting, investors are now grappling with a risk-off market environment – even after the latest announcement of a partial 90-day pause in additional tariffs. The dollar has lost value, several US equity indices went into correction or even bear market territory – in particular small and medium caps as well as the tech-heavy Nasdaq 100 – while interest rates have fallen amidst high volatility in line with a more sluggish growth outlook and more central bank cuts. The path ahead looks anything but straightforward with mounting geopolitical risks and a US administration that asserted that markets might have to go through a "detox" period – a stark contrast to the initial expectation of a more market-friendly policy stance under a Trump presidency. Overall, we are cautious on our outlook on risk markets and expect somewhat lower rates in Europe. However, we emphasize a high probability for an even more pronounced risk-off scenario should sentiment deteriorate further.

Government bond yields will experience divergent trends across key markets in 2025, with the US remaining at current levels while Germany and the UK will drop. In the US, current yield levels reflect opposing forces as rising inflation expectations and economic growth headwinds from more aggressive policy measures (tariffs, migration) largely neutralize each other in 2025. Additionally, anticipated fiscal slippage due to tax cuts in 2026 is offset by expected central bank easing starting late 2025, anchoring the 10-year yield at a spread of approximately 80bps above the Fed's expected terminal rate. We see the long-term terminal rate at around 3.5% but the Fed cutting below that level in 2026 will add temporary downward pressure on US rates. Overall, we see US rates approaching 4.0% in 2025 and 3.9% in 2026, marginally lower than current levels. In Europe, we have a solid conviction for lower Bund yields. Headwinds from trade restrictions particularly for Germany most will likely push yields down towards 2.1% and 2.20% in 2025 and 2026. This dynamic should be supported by more ECB cuts than currently priced by the market and increased global investor demand for bunds amid escalating uncertainty from US political developments. The UK outlook also strongly favors lower yields as a weak economic environment coupled with gradually subsiding inflation pressures supports a downward trajectory in rates despite intermittent inflationary spikes. Increased pressure for defense and broader public spending creates additional fiscal challenges, making further tax increases increasingly probable providing additional headwinds for growth. Consequently, we anticipate the re-emergence of a positive US-UK 10-year yield spread, reflecting the UK's lower potential growth at similar long-term inflation levels. We expect UK 10y yields to approach 4.1% in 2025 and 3.7% in 2026. In any case, volatility will remain elevated across rates markets amid persistent geopolitical uncertainties, with risks skewed toward lower yields

Table 5: Capital market forecasts

EMU	Last*	Unit	2022	2023	2024	2025f	2026f
Government Debt							
ECB deposit rate	2.50	%	2.00	4.00	3.00	1.50	1.50
10y yield (Bunds)	2.63	%	2.56	2.03	2.36	2.10	2.20
10y EUR swap rate	2.57	%	3.14	2.48	2.39	2.00	2.10
20y EUR swap rate	2.67	%	2.87	2.51	2.39	2.10	2.20
Italy 10y sovereign spread	123	bps	213	168	117	110	100
France 10y sovereign spread	76	bps	55	53	83	80	70
Spain 10y sovereign spread	72	bps	109	97	70	60	50
Corporate Debt							
Investment grade credit spreads	114	bps	166	135	101	100	90
High-yield credit spreads	403	bps	494	395	311	340	310
Equity							
Eurostoxx (total return p.a.)	-1 ytd	%	-12	19	10	9	7

US	Last*	Unit	2022	2023	2024	2025f	2026f
Government Debt							
Fed Funds rate (high)	4.50	%	4.50	5.50	4.50	4.00	2.75
10y yield (Treasuries)	4.27	%	3.83	3.87	4.57	4.00	3.90
Corporate Debt							
Investment grade credit spreads	118	bps	138	104	82	105	90
High-yield credit spreads	457	bps	479	334	292	370	320
Equity							
S&P 500 (total return p.a.)	-15 ytd	%	-18	26	25	1	7

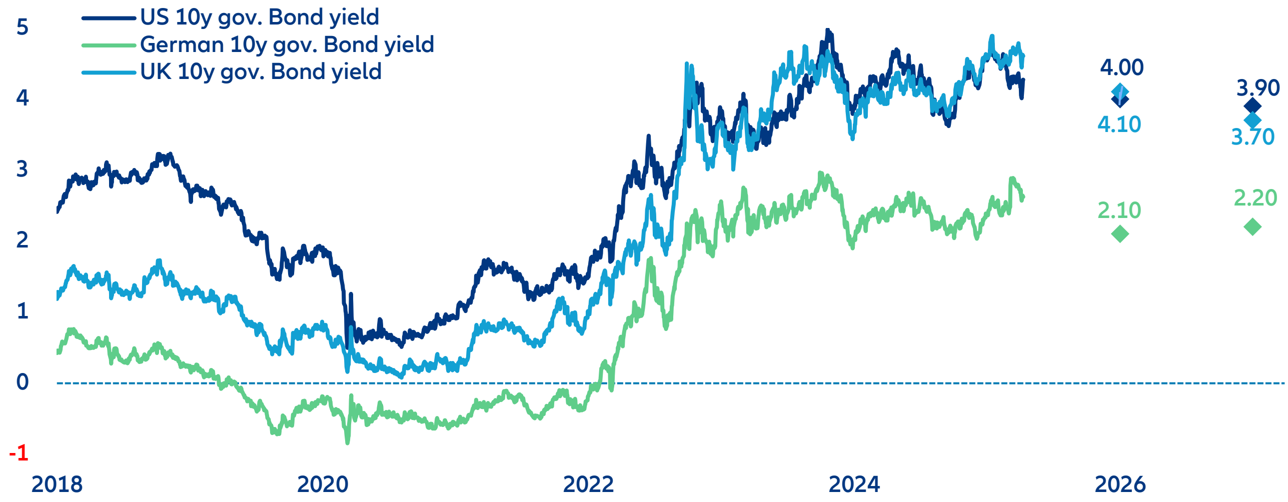
UK	Last*	Unit	2022	2023	2024	2025f	2026f
Government Debt							
BoE rate	4.50	%	3.50	5.25	4.75	3.75	3.00
10y yield sovereign (Gilt)	4.61	%	3.67	3.54	4.57	4.10	3.70
Corporate Debt							
Investment grade credit spreads	127	bps	192	134	91	105	100
High-yield credit spreads	477	bps	663	515	364	410	380
Equity							
FTSE 100 (total return p.a.)	-2 ytd	%	5	8	10	7	7

Emerging Markets	Last*	Unit	2022	2023	2024	2025f	2026f
Government Debt							
Hard currency spread (vs USD)	254	bps	273	215	202	240	220
Local currency yield	6.34	%	6.86	6.19	6.4	6.1	5.9
Equity							
MSCI EM (total return p.a. in USD)	-6 ytd	%	-20	10	8	3	6

Others	Last*		2022	2023	2024	2025f	2026f
EUR USD	1.09	$ per €	1.07	1.10	1.04	1.12	1.10
Oil (Brent)	65	$ per bl	83	78	75	66	69
Natural gas (Dutch TTF)	36	€ per MWh	76	32	49	38	34

Sources: LSEG Datastream, Allianz Research
Notes: Year-end figures,
*As of 8. Apr 2025

Figure 9: 10y government bond yield forecasts, %



Sources:LSEG Workspace, Allianz Research

Yield curves will steepen, reflecting stronger monetary policy easing amid economic headwinds. In the US, the yield curve (2y10y) is expected to steepen in line with forward curves as short-term yields fall with lower policy rates while longer-term yields stay put amid inflation concerns. Germany will experience a flatter curve as short-term yields are already close to longer-term equilibrium, while 10y rates are expected to drop from current levels. The UK yield curve will gradually steepen further as the drop in short-term rates alongside monetary easing will outpace the drop in 10y yields.

For Eurozone spreads we hold a neutral stance, with minor widening risks amid high financial market volatility. Gradual economic convergence, driven by common policy objectives around defense, climate initiatives and geopolitical pressures, should help ease spread dynamics in the long run. However, significant exceptions remain, particularly France, where political uncertainties and persistent fiscal deficits will likely sustain elevated spreads relative to peers. Conversely, continued economic resilience in southern European economies, such as Spain, will support tighter spreads against German bunds, which face relative upward pressures. Italian spreads could widen marginally amid financial turbulences and fiscal slippage in case of additional defense spending or support for the economy.

For EURUSD, our conviction remains modest, with short-term upside pressures on the dollar arising from a slightly quicker pace of monetary easing expected from the ECB relative to the Fed compared to market pricing. In the near term we expect the USD to strengthen amid a more hawkish Fed stance and vivid cuts by the ECB. Towards the end of the year, however, when strong rate cuts will be priced in for the Fed, the euro should strengthen again, reaching 1.12. The US administration's preference for a weaker dollar stance supports this move, although direct currency interventions remain unlikely given potential market disruptions. From a longer-term perspective, the USD is anticipated to modestly strengthen again against the euro by 2026 as declining US inflation lifts the real interest rate differential, favoring the dollar, leading to a slight depreciation of the Euro to 1.10.

Equity markets will continue to suffer until trade and geopolitical uncertainty abates. Since the beginning of 2025 and up until the tariff wave, US and European equity markets had moved in opposite directions in terms of performance, earnings and overall investor sentiment. In the US, equities faced headwinds, with the S&P 500 declining by approximately 5% (until 31 March) due to escalating trade tensions and tariff implementations

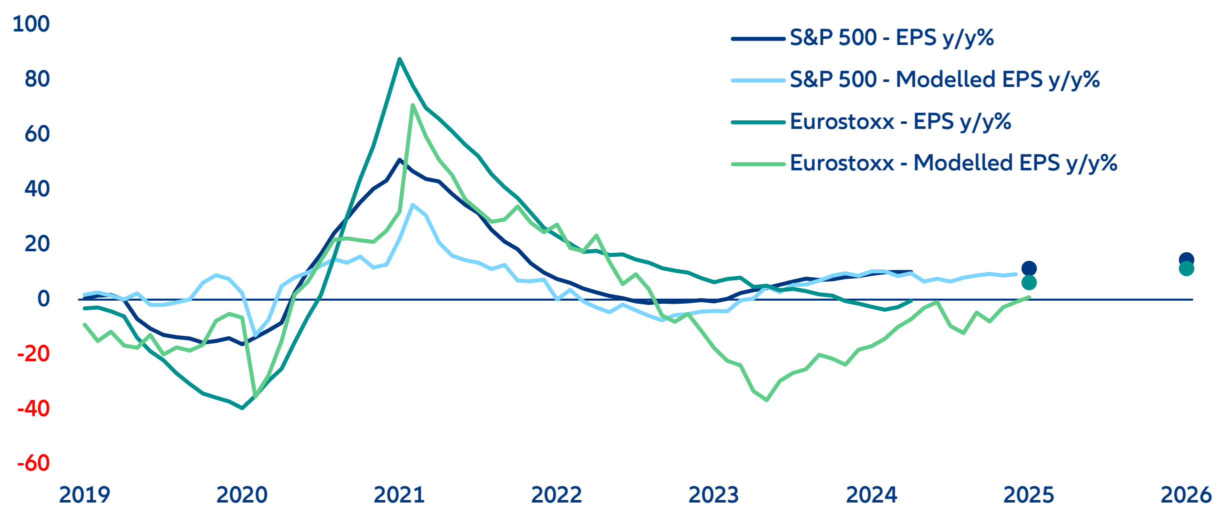
– such as the 25% tariff on autos – which impacted investor sentiment and led to downward revisions in earnings forecasts. Across the Atlantic, European equities outperformed their US counterparts, with the STOXX 600 rising by 7% (until 31 March), reflecting improved sentiment supported by increased infrastructure and defense spending, particularly in Germany. However, the broad new tariffs announced in early April derailed the market as equity investors shifted toward safe-haven assets, causing transatlantic divergences to converge with downside correlations increasing at an alarming speed and with US markets bottoming, for the time being, at -17% ytd.

Looking ahead, European corporate earnings prospects remain relatively optimistic, with positive recovery momentum expected to be only timidly derailed in Q1 and to continue throughout the year, fueling a fundamentals-based recovery. The Eurostoxx is projected to deliver resilient total returns of 9% in 2025, driven by attractive valuations, improved sentiment and supportive fiscal policies, before moderating slightly to 7% in 2026 as markets normalize. Meanwhile, the US equity market is anticipated to break even in 2025 with total returns of around 1%, driven by stabilizing monetary policy expectations, trade and geopolitical conditions and better-than-expected earnings. Growth in the US is expected to modestly improve to 7% in 2026, benefiting from declining Fed Funds rates, easing inflationary pressures, and strengthening investor confidence. Nonetheless, investors should remain cautious of short-term volatility from retaliatory trade frictions, geopolitical tensions and disruptions in global supply chains that could periodically trigger market turbulence (Figure 10 and 11).

Corporate credit markets have become more sensitive after a long period of lethargy. Since early 2025, both US and European corporate credit markets have shown resilience, supported by strong investor demand despite high macroeconomic uncertainty. In Europe, investment-grade (IG) credit spreads narrowed to about 90bps, while high-yield (HY) spreads increased slightly to 320bps, reflecting similar trends than that in European equity markets. In contrast, US markets saw IG spreads widen modestly to 90bps and HY spreads rise more noticeably to 330bps, driven by rising default rates, concerns about an economic slowdown and heightened trade and geopolitical uncertainty. However, the trade war has reactivated the sensitivity of corporate credit to equity market movements. This has triggered a structural widening of spreads, especially in the high-yield segment. In the US, HY spreads have surged to 450bps, while IG spreads have moved to around 115bps on both sides of the Atlantic. This widening reflects the increased caution among investors as they navigate the uncertainty brought by ongoing market disruptions.

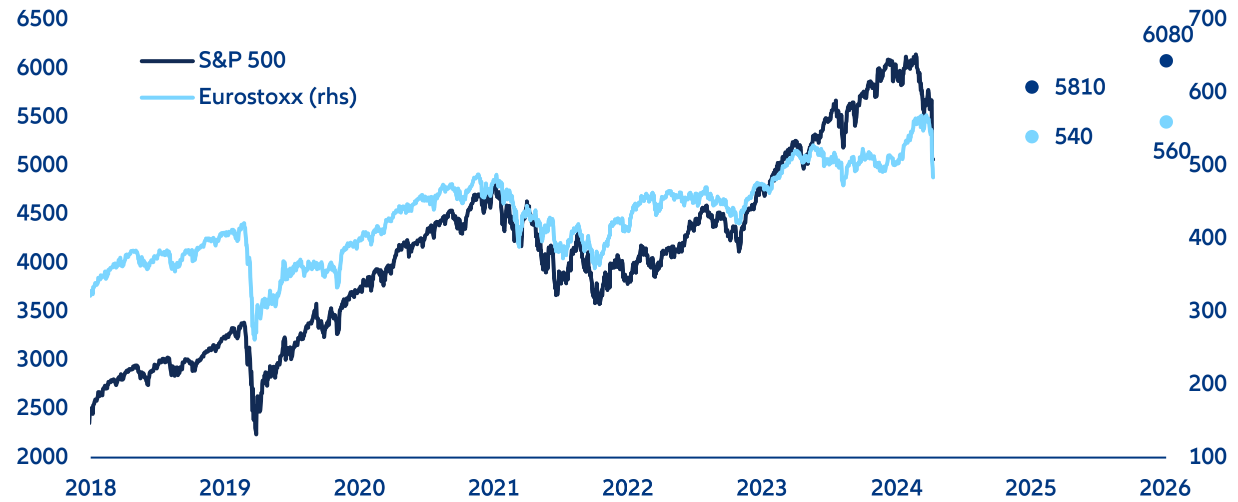
Looking ahead, European credit markets are expected to return to tighter levels, benefiting from continued robust investor appetite, historically low new issue premiums, controlled corporate debt levels and increased fiscal

Figure 10: S&P 500 and Eurostoxx EPS growth, %



Sources: LSEG Datastream, Allianz Research

Figure 11: S&P 500 and Eurostoxx Forecasts, index



Sources: LSEG Datastream, Allianz Research

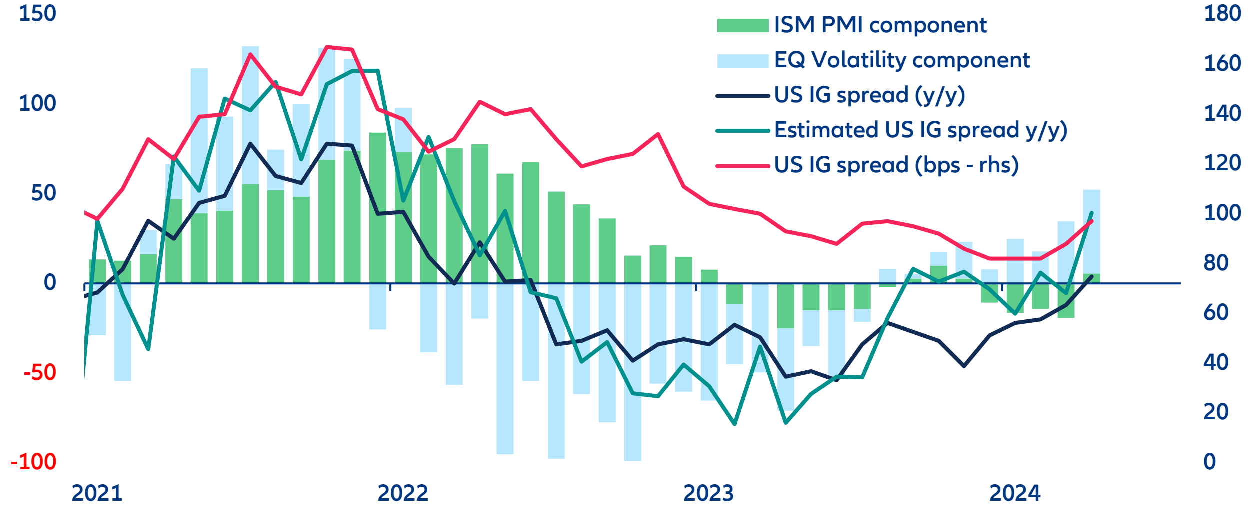
spending in certain key geographies. However, increasing geopolitical tensions, potential tariff retaliations and limited break-even cushions present notable risks that could continue to trigger continuous short-term widening volatility. In the US, accelerating default risks due to rising costs and negative rating trends present challenges, especially within high-yield segments. Nevertheless, attractive yields and improving macroeconomic fundamentals forecasted for late 2025 and into 2026 can offer opportunities, particularly for investors selectively targeting sectors resilient to economic fluctuations.

In this context, corporate credit markets in the US and Eurozone are expected to follow similar divergent over the next two years. Eurozone IG spreads are anticipated to remain relatively stable at around 100bps in 2025 once the tariff intensity recedes, with a slight tightening to 90bps in 2026, underpinned by resilient corporate fundamentals and sustained investor demand. EUR high-yield spreads are projected to tighten from current levels to 340bps in 2025 before stabilizing at 310bps in 2026 as investor sentiment gradually recovers. In the US, investment-grade spreads are forecasted to compress to approximately 105bps in 2025 followed by a tightening back to 90bps in 2026 as confidence returns. Similarly, US high-yield spreads are expected to compress to 370bps in 2025, reflecting cautious but improving market sentiment as corporate fundamentals maintain the asset class resilient and afloat. This is likely to lead to 300bps by 2026, supported by improving economic conditions and decreasing economic uncertainty. Despite our rather positive outlook, investors should carefully monitor short-term volatility related to geopolitical developments and ongoing trade tensions, positioning strategically to capitalize on market opportunities as conditions evolve (Figure 12 and 13).

We hold a constructive view on EM sovereign debt, supported by strengthened balance sheets despite external headwinds from US tariffs. EM sovereign debt has shown resilient performance, with hard currency and local currency bonds delivering total returns of 1.1% and 4.4% respectively, even amid the broad global asset sell-off triggered by tariff tensions. Hard currency spreads have widened by 51bps from a historically tight level to 252bps (as of 7 April). However, the decline in US Treasury yields has largely offset the impact of this spread widening. Meanwhile, local currency yields have declined further to 6.2%, and FX effects have turned into a positive contributor due to dollar weakness. Debt sustainability has broadly improved across EMs, underscored by strong net upgrades in credit ratings. Looking ahead, we expect EM sovereign debt to stay resilient, with hard currency spreads narrowing slightly to around 240bps albeit with some risk of further widening in the short term, and local currency yields falling further to 6.0% by year-end.

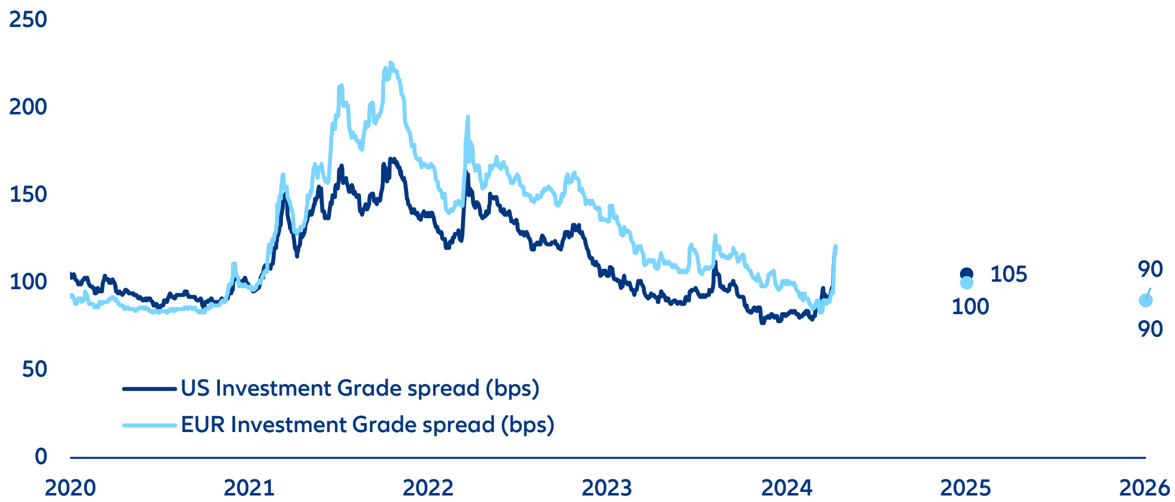
With index heavyweights heavily exposed to tariff risks and the potential escalation of geopolitical tensions, we remain cautious on EM equities. EM stocks delivered solid performance earlier in the beginning of the year,

Figure 12: US Investment Grade corporate spread decomposition, bps



Sources: LSEG Datastream, Allianz Research

Figure 13: Investment Grade corporate spread forecasts, bps



Sources: LSEG Datastream, Allianz Research

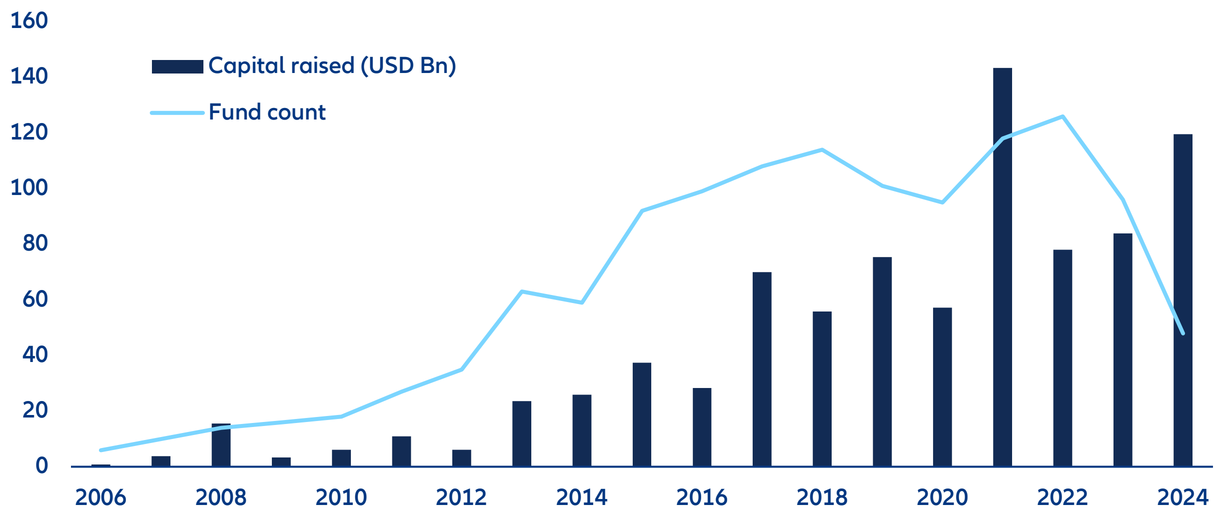
driven largely by the tech rally in China. However, the scope and scale of the tariffs have exceeded both our and market expectations, triggering a broad sell-off in global risky assets and more than erasing EM equity gains since the start of the year. While negotiations may lead to a rollback of some tariffs for some EM countries, escalating tensions between the US and China continue to weigh on the index's largest component. This is occurring against a backdrop of already weak domestic demand in China and poses risks to the broader APAC region, which remains closely tied to China through trade channels. Rising recession risks could further weigh on both US and EM growth. We expect a partial rebound in EM equities once there is more clarity on the tariff situation. Attractive valuations relative to developed markets should also provide some cushion. We expect EM equities to deliver a total return of 3% by year-end.

Private assets will continue to provide some return buffer, albeit also falling victim to the short-term uncertainty. Private equity, notably buyouts and in the US, have continued to experience elevated valuations in

2024, but for the middle market segment where multiples stayed relatively favorable compared to highly valued public markets. Exit activity has, however, remained rather subdued, and even come to a halt after Liberation Day, despite economic conditions hinting towards a reacceleration of deal-making. Nevertheless, the secondaries market remains vibrant, partially filling the exit gap. Conversely, private debt has continued to face intense competition in 2024, characterized by tightening credit spreads and abundant capital chasing limited opportunities. In this regard, narrowing risk premiums have continued to reduce the relative attractiveness of private debt, compounded by expectations of lower yields due to anticipated interest rate cuts. Looking forward, private equity will continue to offer a decent alternative to public equities however distributions are likely to lag behind the cycle as exit activity remains subdued, especially in H1. Meanwhile, private debt is expected to remain competitive as its total return proposition and low-default environment is likely to continue prompting investors to increasingly explore private lending and other alternative credit strategies. These areas may offer enhanced yields and diversification, positioning private debt as a valuable component of investment portfolios despite the challenging landscape anticipated for 2025 (Figure 14).

We expect the real estate sector in the US and Europe to continue its recovery, with further improvements in liquidity and stabilization of capital value following more than two years of downturn. Net operating income growth is expected to be moderate as economic expansion faces headwinds from tariff policies and geopolitical tensions. Favorable supply and demand dynamics support multi-family and US retail, given tight supply and low availability, while industrial demand remains strong, though supply is catching up. Office sector growth remains challenged by secular shifts in work patterns, yet demand for high-quality assets in prime locations remains resilient. Valuations appear attractive, with upside potential as cap rates moderately compress amid drifting long-term bond yields. Property values have likely bottomed and are expected to stabilize with declining long-term rates. Liquidity conditions continue to improve, with a recovery in investment volumes and deal activity supported by easing credit conditions and strengthening demand on both sides of the Atlantic. The easing cycle and a narrowing gap in buyer-seller expectations should further support the market rebound.

Figure 14: Direct Lending volumes and fund count



Sources: LSEG Datastream, OECD, Allianz Research

Our team

Chief Investment Officer & Chief Economist Allianz SE

Ludovic Subran
ludovic.subran@allianz.com

Head of Economic Research Allianz Trade

Ana Boata
ana.boata@allianz-trade.com

Head of Insurance, Wealth & ESG Research Allianz SE

Arne Holzhausen
arne.holzhausen@allianz.com

Macroeconomic Research

Lluis Dalmau
Economist for Africa & Middle East
lluis.dalmau@allianz-trade.com

Maxime Darmet Cucchiarini
Senior Economist for UK, US & France
maxime.darmet@allianz-trade.com

Jasmin Gröschl
Senior Economist for Europe
jasmin.groeschl@allianz.com

Françoise Huang
Senior Economist for Asia Pacific
francoise.huang@allianz-trade.com

Maddalena Martini
Senior Economist for Italy, Greec, Spain & Benelux
maddalena.martini@allianz.com

Luca Moneta
Senior Economist for Emerging Markets
luca.moneta@allianz-trade.com

Corporate Research

Ano Kuhanathan
Head of Corporate Research
ano.kuhanathan@allianz-trade.com

Guillaume Dejean
Senior Sector Advisor
guillaume.dejean@allianz-trade.com

Maria Latorre
Sector Advisor, B2B
maria.latorre@allianz-trade.com

Maxime Lemerle
Lead Advisor, Insolvency Research
maxime.lemerle@allianz-trade.com

Sivagaminathan Sivasubramanian
ESG and Data Analyst
sivagaminathan.sivasubramanian@allianz-trade.com

Pierre Lebard
Public affairs manager
pierre.lebard@allianz-trade.com

Capital Markets Research

Jordi Basco Carrera
Lead Investment Strategist
jordi.basco_carrera@allianz.com

Bjoern Griesbach
Senior Investment Strategist & Eurozone Economist
bjoern.griesbach@allianz.com

Yao Lu
Investment Strategist
yao.lu@allianz.com

Insurance, Wealth and ESG Research

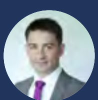
Michaela Grimm
Senior Economist, Demography & Social Protection
michaela.grimm@allianz.com

Patrick Hoffmann
Economist, ESG & AI
patrick.hoffmann@allianz.com

Hazem Krichene
Senior Economist, Climate
hazem.krichene@allianz.com

Patricia Pelayo-Romero
Senior Economist, Insurance & ESG
patricia.pelayo-romero@allianz.com

Kathrin Stoffel
Economist, Insurance & Wealth
kathrin.stoffel@allianz.com



Markus Zimmer
Senior Economist, ESG
markus.zimmer@allianz.com

Recent Publications

04/04/2025 | What to watch
28/03/2025 | What to watch
26/03/2025 | Invest in your future: How to save your way out of employment vulnerability
20/03/2025 | What to watch
18/03/2025 | Global insolvenvy Report The corporate battlefield: Global insolvencies in times of war economics
14/03/2025 | What to watch
11/03/2025 | Plug, baby, plug: Unlocking Europe's electricity market
07/03/2025 | What to watch
06/03/2025 | The New Jedi Order: global chip war and the semiconductor industry
27/02/2025 | What to watch
25/02/2025 | Climate risk and corporate valuations
20/02/2025 | What to watch
18/02/2025 | From hard-to-abate to decarbonized: Strategies for transforming Europe's industrial sector
14/02/2025 | What to watch
13/02/2025 | How Europe can take back the wheel in the global auto sector
06/02/2025 | What to watch
03/02/2025 | Allianz Country Risk Atlas 2025: Repeat and rewind?
31/01/2025 | What to watch
30/01/2025 | Allianz Global Pension Report 2025 : Time to walk
23/01/2025 | What to watch
21/01/2025 | Insuring the future: The virtuous cycle of insurance and sustainability
16/01/2025 | What to watch
15/01/2025 | Allianz Risk Barometer: Identifying the major business risks for 2025
10/01/2025 | What to watch
09/01/2025 | Germany – quo vadis?
19/12/2024 | Economic outlook 2025-26: Defying gravity?
12/12/2024 | What to watch
09/12/2024 | Divided we fall – The risks of competitive fragmentation on Europe's road to net zero
06/12/2024 | What to watch
04/12/2024 | The weight is over: How GLP-1 treatments are reshaping pharma and beyond
28/11/2024 | What to watch
27/11/2024 | How the retail sector is navigating year-round challenges
21/11/2024 | What to watch
18/11/2024 | Little fires everywhere: How polarization is shaping the economy (and what to do about it)
15/11/2024 | What to watch
14/11/2024 | The geoeconomic playbook of global trade
07/11/2024 | What to watch
14/11/2024 | The geoeconomic playbook of global trade
07/11/2024 | What to watch

Discover all our publications on our websites: Allianz Research and Allianz Trade Economic Research

Director of Publications
Ludovic Subran, Chief Economist
Allianz Research
Phone +49 89 3800 7859

Allianz Group Economic Research
https://www.allianz.com/en/economic_research
http://www.allianz-trade.com/economic-research
Königinstraße 28 | 80802 Munich | Germany
allianz.research@allianz.com

@allianz

allianz

Allianz Trade Economic Research
http://www.allianz-trade.com/economic-research
1 Place des Saisons | 92048 Paris-La-Défense Cedex | France
research@allianz-trade.com

@allianz-trade

allianz-trade

About Allianz Research
Allianz Research encompasses Allianz Group Economic Research and the Economic Research department of Allianz Trade.