Executive summary

This week, we looked into three important topics:

• First, **the wind sector bust is a learning moment for climate policy**. The sector is grappling with rising operating and financing costs, quality-control problems and supply-chain issues. Inflation and global energy-price fluctuations have led to increased costs for wind power projects, casting doubt over the feasibility of many ventures. Overall, the eight largest renewable energy firms reported a -USD3bn combined decrease of assets in the first half of the year. Without government guarantees to act as a financial backstop for large industrial projects, climate targets could be at risk.

• Second, **it’s the immigration, stupid!** Around a third of US growth since 2021 (1.3pp) can be explained by the return of migrants or foreign-born employment – while it only accounted for a fifth of Eurozone growth. Foreign-born job creation has accounted for 40% of the gains in total employment in the US despite making up around 17% of total employment in 2021. Assuming that the Eurozone had had similar immigration patterns as the US since 2021, the Eurozone could have added 1.3pp to its GDP growth (or increased it to +5.3%). Smart immigration policies are needed on both sides of the pond.

• Last, **US corporate spreads – too low to be true?** The rapid increase in sovereign yields has pushed up those of corporate bonds, which are now offering some of the highest yields in the last 20 years. However, spreads in relative terms are at their lowest point since 2007. Amid growing concerns over the economy, the compensation for the additional risk taken on corporate bonds seems low. But going forward, we expect this situation to unfold mainly through lower bond yields instead of wider credit spreads.
The wind sector bust is a learning moment for climate policy

The eight largest renewable energy firms reported a -USD3bn decrease of assets in the first half of the year, with wind-power projects in particular facing turbulent conditions. The renewables sector is in the midst of a difficult year, battling everything from rising costs to higher interest rates. The case of Siemens Energy, a major player in the wind power sector, exemplifies the ongoing challenges: The company is seeking approximately EUR 15bn in guarantees from the German government to stabilize its financial position after the discovery of defects in its newest onshore turbine models that will lead to losses and increased repair costs. The whole sector is grappling with rising construction and financing costs, quality-control problems and supply-chain issues. Inflation and global energy-price fluctuations have also led to increased costs for wind-power projects, casting doubt over the feasibility of many ventures. Some projects in the US but also in the UK are at risk of being abandoned if governments do not offer support. As these projects were initiated before the energy crisis, with guaranteed feed-in-tariffs that were low, they are now becoming more and more unprofitable. Although balance sheets remain solid, firms have been writing down assets (Figure 1) and providing lower guidance on earnings. In total, between Q1 2023 and Q2 2023, the eight largest renewable energy firms reported a combined decrease of assets of USD3bn. Unsurprisingly, and as an indicator of further turbulence ahead, the Q3 earnings season started with another large impairment in wind assets of USD4bn by Orsted, one of the leaders in renewable energy.

Figure 1: Total assets of the eight largest renewable energy companies (USD bn)

Sources: Refinitiv, Allianz Research

Without government guarantees to act as a financial backstop for large industrial projects, climate targets could be at risk. Recent challenges underscore the need for a comprehensive reassessment of policies and support mechanisms for the renewables sector. The UK has set a target of reaching offshore wind capacity of 50GW by 2030 (five times current capacities). However, these ambitions received a reality check when the last round of capacity auctions did not receive any bids as the current auction system does not provide sufficient returns on investment. Ahead of the sixth round of auctions for Contracts for Difference (CFDs), industry representatives have suggested to raise the bidding limits for new offshore wind farms by 25-70% to offset rising supply-chain costs (the actual increase is reported to lie between 20%-50%). In addition, renewable energy developers are lobbying the UK Treasury to eliminate the windfall tax on offshore wind farms and to enhance subsidies and tax incentives, for instance in the form of more generous capital allowances, which would offer tax relief to ease initial project costs. Similarly, in Germany, wind-capacity expansion reached 1.3GW in 2023, just about a quarter of the highest additions seen in the last decade. The most recent onshore wind auction reflected this trend, with only 1.4GW of capacity being put forward by companies for development. This figure represents a decline from the 1.6GW offered in the preceding auction. In response to the diminished interest and to sustain competition, Germany’s regulatory body, Bundesnetzagentur, reduced the amount of capacity tendered from 3.2GW to approximately 1.7GW, a controversial move given the renewable targets. Furthermore, the maximum rates for tenders increased from 5.88
cents to 7.35 euro cents per kilowatt-hour for onshore wind auctions and bidders asked for around 7.32 cents per kilowatt-hour.

So far, the responses from the UK and US (wind target: 630GW by 2035) governments have been comparatively less proactive than that of the EU (wind target: 420GW by the end of the decade). The European Commission unveiled a “wind power package” of measures to assist developers, including measures such as a specific auction design (including that Member States index their auction prices and tariffs), financing support (develop de-risking tools and counter-guarantees with the EIB by the end of 2023 and increase clean-tech subsidies), level-playing-field (monitor possible unfair trade practices and activate the relevant policy instruments if necessary), addressing administration staff shortages (using digitization to increasing the numbers of permits that can be processed by current staff), and streamlining long approval procedures (offshore wind projects often waiting as long as five years for a green light). As the demand for clean energy continues to grow and the expansion of wind power projects will remain essential to achieve global climate goals, addressing issues related to financing, quality control, supply-chain stability and government support will be crucial.

It’s the immigration, stupid!

Around a third of US growth since 2021 has been fueled by foreign-born employment, compared to only a fifth for the Eurozone. On a purely accounting basis, GDP growth can be broken down into four main components: hours worked per job, labor productivity and employment (foreign and domestic). Since 2021, US GDP has grown by +3.5% on average, largely fueled by job creation. Total employment has grown +3.2% annualized on average since Q1 2021, which largely reflects a catch-up effect from the pandemic-induced job losses. Of this, foreign-born job creation has accounted for 1.3pp, i.e. 40% of the gains in total employment, despite making up around 17% of total employment in 2021 (18.6% in Q2 2023) (Figure 2). In fact, foreign-born employment is +9.8% above its pre-pandemic level compared to +0.6% for US-born employment. Because the former has contributed 1.3pp, it explains 37% of GDP growth. However, in the Eurozone, employment growth accounted only for 1.8pp of the +4.0% GDP growth seen since 2021 (annualized). Of this, foreign-born employment contributed 0.8pp, accounting for approximately 21% of overall GDP growth. In the Eurozone, the main contributor to GDP growth was hours worked (2.3pps). Assuming that the Eurozone had similar immigration patterns as the US since 2021, the Eurozone could have added 1.3pp to its GDP growth (or increased it to +5.3%), with job growth accounting for 3.1pp of total GDP growth. In this counterfactual analysis, foreign-born employment would add 1.2pp or 23% to GDP growth.

![Figure 2: Breakdown of quarterly employment growth (% non-annualized)](image)

*Sources: BLS, Allianz Research*

But the foreign-labor tailwind is set to fade in the US amid a tightening of immigration policy. The foreign-born workforce has surged in the US due to a swift recovery in immigration over the last two years. In 2022, nearly a million temporary work visas were issued, aligning with pre-pandemic patterns, and permanent immigration also bounced back, with 460,000 new arrivals. However, the scope for continued rapid growth in labor supply seems limited. Although there might be a short phase of catch-up immigration, caps on H1-B and H2-B visas and stringent...
limits on employment-based permanent immigration will likely curb this trend. The recent data indicate a decline in temporary immigration and most permanent immigrants are still accepted based on family ties, with only 50,000 employment-based green cards issued last year. The participation rate in the foreign-born labor force has rebounded quickly, but with it now surpassing pre-pandemic levels and an aging population, further significant increases seem unlikely. The data show that the prime-age participation rate is at a 20-year high, supporting the growth in the US-born labor force. In summary, while an improved labor supply has aided in stabilizing the job market, future adjustments will likely depend more on moderating labor demand.

Figure 3: Breakdown of annualized GDP growth since 2021 (%)

Sources: BLS, Eurostat, Allianz Research

US corporate spreads – too low to be true?

In the US, the additional yield from corporate bonds compared to sovereign bonds has reached record low levels not seen since 2007. The rapid increase in sovereign yields has pushed up those of corporate bonds, which are now offering some of the highest yields seen in the last 20 years. In fact, excluding the year 2008, yields of investment grade (IG) bonds are the highest since 2003 (Figure 4). In this environment, credit spreads are somewhat higher than pre-Covid levels, but hovering around post-GFC averages. However, if we look at spreads in relative terms – that is, how much additional yield an investor gets from corporate bonds relative to government bonds – we find that they are at their lowest point since 2007 (Figure 5) across the Eurozone and US, investment grade and high yield. But, isn’t this a contradiction? Focusing on the US, where markets play a greater role in debt financing and where this phenomenon is more acute, it appears that the compensation for the additional risk taken on corporate bonds is low and at risk of correction, given growing concerns about the economy. As rising insolvency numbers show, corporates find themselves in a difficult position as the economy cools and interest rates on debt increase. Moreover, the upcoming shift towards more restrictive fiscal policy in 2024, coupled with a gradual easing of monetary policy to come only in the second half of 2024, present further headwinds for corporate bonds.

Risks for corporates are tilted to the downside, but there are three elements that could help to explain the current mispricing of relatively low credit spreads. Corporates took good advantage of ultra-low interest rates after the Covid-19 pandemic and extended debt maturities under favorable conditions, which has allowed them to stretch the “monetary policy lag” and consequently muddle through the initial period of higher interest rates. However, this is only temporary, as the interest coverage ratio is shrinking and the “corporate debt wall” approaching, as shown in Figure 6. In a high-for-longer scenario, this silver lining could wane as corporates fully integrate higher interest rates. Another related argument would be the limited supply of corporate bonds especially in comparison to sovereign bonds (Figure 7). Since the pandemic, this was driven by subdued corporate issuance as companies avoided tapping the market as much as possible amid increased risk, government support and rising yields. At the same time the market was flooded with US treasuries among large stimulus programs to support the economy – a trend that set in not only since the pandemic but already since the GFC. Last but not least, the large fiscal deficit, Fitch’s recent sovereign downgrade and heightened political risk could have led to the perception of increased relative risk of US treasuries compared to corporates.
Figure 4: Recent evolution of US IG credit spreads and US yields (10Y)

Figure 5: Lowest spreads relative to government bond yields since 2007 in the US. Left: IG, right: HY

Figure 6: Non-financial corporate debt maturing by year and quality (USD bn)

We expect the relative spread mispricing to unfold mainly through lower bond yields instead of wider credit spreads, which would make the extra compensation of corporate risk more attractive again. Whereas our year-end expectations for US yields are around 50bps below current levels (4.7% vs. 4.2%), current pricing of credit spreads is much closer to our year-end forecast (133 current vs. 130 expected) and 50bps in HY (450 current vs. 400 expected). Should this not be the case, with sovereign yields staying elevated and macroeconomic expectations not
improving, a return to long-term average\(^1\) of relative spreads would imply a widening of around 50bps and 120bps, respectively, in IG and HY.

**Figure 7: Ratio of non-financial corporate debt with respect to sovereign debt in the US.**

Sources: LSEG Datastream, Allianz Research. Note: \(^1\) The sample to calculate the interest coverage ratio in the RHS is major 1000 US listed companies; weights of each sector in equity or debt indexes differ greatly. Note: \(^2\) The data for bonds matured year-to-date has been calculated a posteriori and is indicative.

\(^1\) From this average, periods of extreme market conditions have not been taken into account.
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