Economic Outlook 2025-26: Defying gravity?

Allianz Research

End of Q4 2024 updated economic and capital markets outlook

19 December 2024

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Economic Outlook 2025-26: Defying gravity?

1 **Global economic growth: Not quite "dancing through life".** Global real GDP growth is expected to remain moderate but steady at +2.8% in 2025-26. We expect developed economies to experience a slight slowdown, with growth tapering from +1.8% in 2025 to +1.7% in 2026. In contrast, emerging economies are likely to sustain robust growth at +4.1% across both years. The US economy is forecasted to grow at +2.3% in 2025, slowing to +1.8% in 2026. The Eurozone is projected to grow by +1.2% in 2025 and +1.5% in 2026, with countries like Spain and Ireland leading with higher growth rates. Germany, however, is set to record modest growth after two years of recession. China's growth is projected to moderate from +4.6% in 2025 to +4.2% in 2026 as the country continues to transition towards a more consumption-driven economy while managing external trade pressures.

2 **Is "Something bad" on the way? After the super electoral year, "the Wizards (and not us)" of policy design will be very influential for both the economy and capital markets.** Political changes, such as the US elections, could reshape economic landscapes and introduce uncertainties. Geopolitical risks, including tensions between major powers, continue to be a significant concern for global stability. A potential trade war by Q2 2025, with US tariffs rising to 60% for China and 10% for others, could increase US inflation and weaken global growth. Significant US immigration cuts might strain labor markets in key sectors and add to inflationary pressures. Challenges to the Federal Reserve's independence, including possible currency interventions, could dramatically increase financial risks. Fiscal policy changes, such as major spending cuts or extensive tax cuts, could impact market confidence. In the Middle East, a tougher US stance on Iran could slow growth and raise oil prices. Similarly, reduced US support for Taiwan might lead to tariffs and negatively impact semiconductor equities. The climate and energy transition faces challenges, with the potential repeal of the Inflation Reduction Act, which could maintain neutral growth and reduce inflation while boosting fossil equities.

3 **"No one mourns the wicked": Inflation should finally retreat to 2% in 2025, allowing for monetary policy easing to continue until end-2025. "Thank goodness" central bank policy will shift from taming inflation to supporting growth (but do not hold your breath).** However, upside risks remain from potential tariff implementation in the US and unfolding retaliation measures. Further supply-chain constraints, from the rise in protectionist measures and ongoing conflicts triggering higher transportation costs, could temporarily increase inflation. The Fed, the BoE and the ECB are expected to lower rates to 3.5%, 3.25% and 2% by end-2026, respectively. Emerging markets are also likely to see cautious monetary easing, except for countries like Brazil, which may face rate hikes due to economic overheating.

4 **"No good deed" goes unpunished: Government bond yields are expected to remain broadly stable over the next two years, with markets already pricing in significant central bank easing.** The effects of large US fiscal deficits and accelerated quantitative tightening in Europe will offset the downward pressure from falling policy rates. French bond spreads are likely to remain wider than those of Spain, reflecting comparatively weaker fundamentals for France, while swap spreads in Europe should remain close to zero.

5 **But the outlook is not entirely "wonderful" for risky assets.** Recovering earnings and strong fundamentals should support risky assets, with equities projected to deliver an average total return of 8-10% and credit spreads likely to remain steady through 2025 and 2026. However, high valuations, economic uncertainty and concentration risks could cap gains and leave risky assets exposed to unexpected political or economic shocks.

6 **"What is this feeling?": Uncertainty continues for companies.** While policy shifts and geopolitical risks present challenges, sectors like AI and technology are expected to see growth. Investment in infrastructure and sustainable sectors is also projected to increase. Business insolvencies are expected to increase by +2% in 2025 and to stabilize at high levels in 2026.

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Global macro 2025-2026

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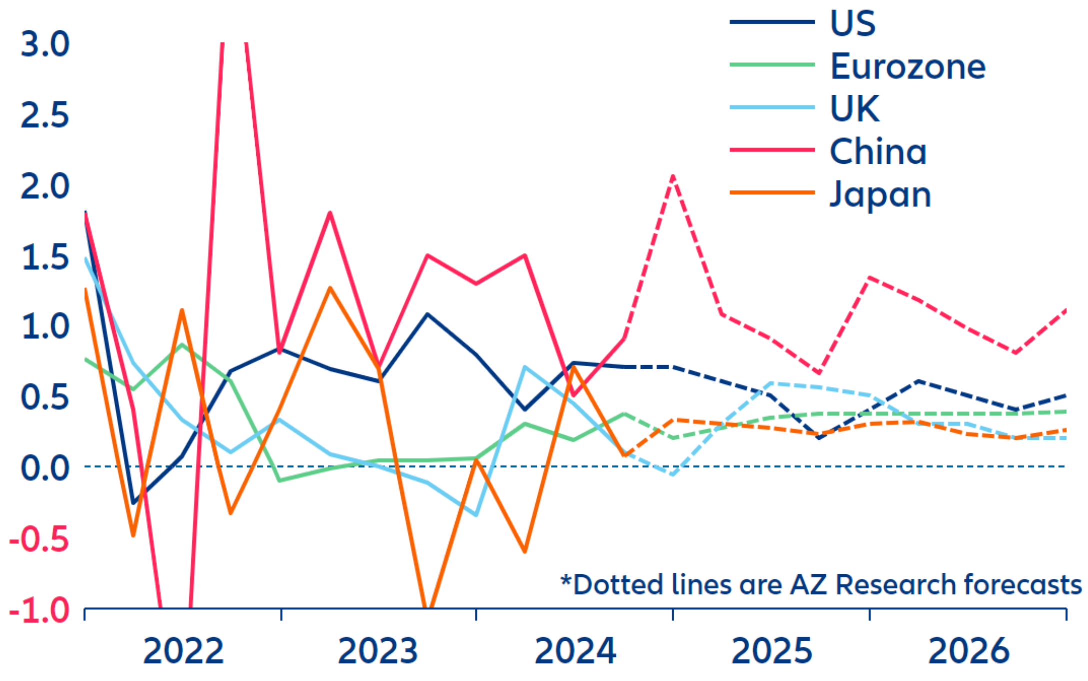
Global growth: Four years in a row below 3%

Global real GDP growth

Growth (yearly %)	2022	2023	2024f	2025f	2026f
Global	**3.3**	**2.8**	**2.8**	**2.8**	**2.8**
USA	**2.5**	**2.9**	**2.8**	**2.3**	**1.8**
Latin America	**3.9**	**1.9**	**2.0**	**2.6**	**3.2**
Brazil	3.1	2.9	3.1	2.5	2.3
UK	**4.8**	**0.3**	**0.8**	**1.3**	**1.5**
Eurozone	**3.6**	**0.5**	**0.8**	**1.2**	**1.5**
Germany	1.5	-0.1	-0.1	0.4	0.9
France	2.6	1.1	1.1	0.7	1.2
Italy	4.8	0.8	0.5	0.8	1.0
Spain	6.2	2.7	3.0	1.8	2.0
Central and Eastern Europe	**1.1**	**1.2**	**2.1**	**3.0**	**3.2**
Poland	5.9	0.1	2.6	3.4	3.4
Russia	-1.3	3.7	2.8	1.8	2.0
Türkiye	5.5	5.1	2.7	2.5	3.5
Asia-Pacific	**3.2**	**4.3**	**4.2**	**4.1**	**3.9**
China	3.0	5.3	4.9	4.6	4.2
Japan	1.1	1.7	-0.3	1.2	1.1
India	6.5	7.8	6.6	6.4	6.5
Middle East	**6.1**	**1.3**	**2.1**	**3.0**	**3.2**
Saudi Arabia	7.7	-0.8	1.4	4.3	4.1
Africa	**3.9**	**3.1**	**2.8**	**3.4**	**4.0**
South Africa	1.9	0.7	1.1	1.7	1.6

US growth to slow-down below potential

GDP growth, q/q % (not annualized)



Sources: LSEG Datastream, Allianz Research

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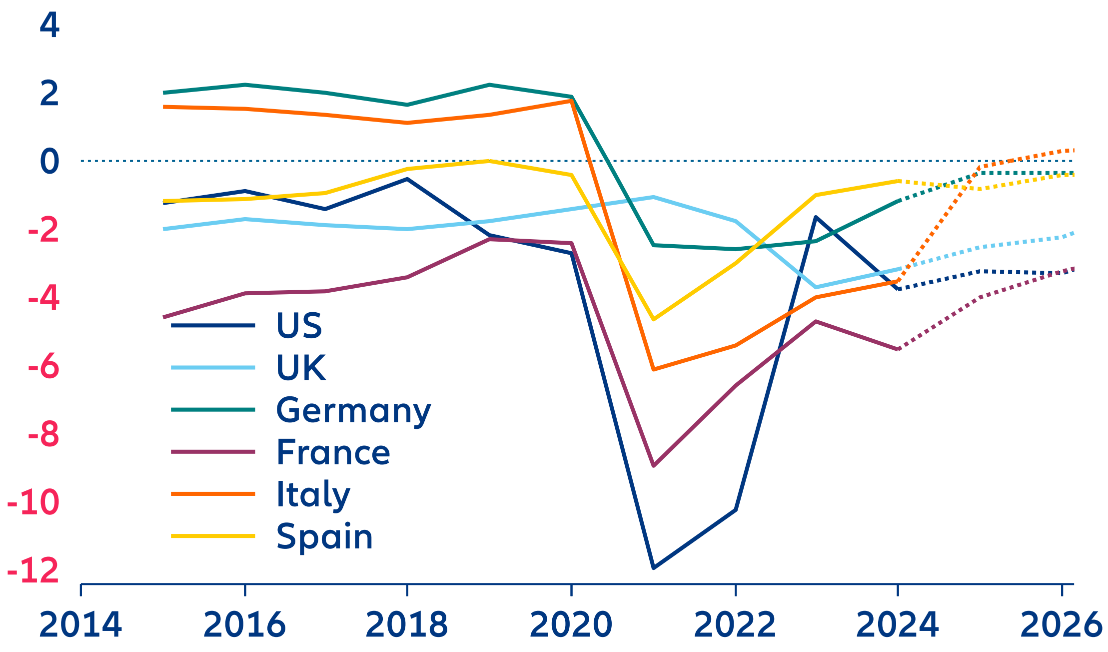
From Ballots to Realpolitik: The year after the super election-year

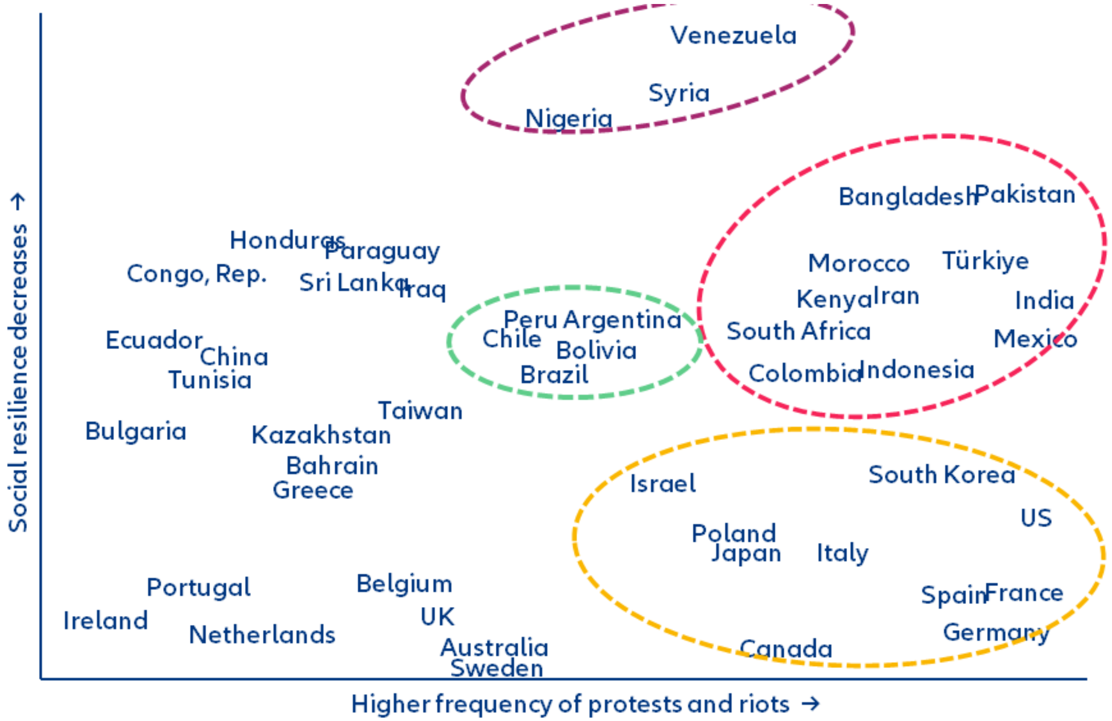
Newly elected politicians face the ugly task of tightening fiscal deficits...

Primary balance, % of GDP



Sources: LSEG Datastream, Allianz Research

...which weighs on growth and social resilience fueling risks of public backlash



Source: ACLED, Allianz Research

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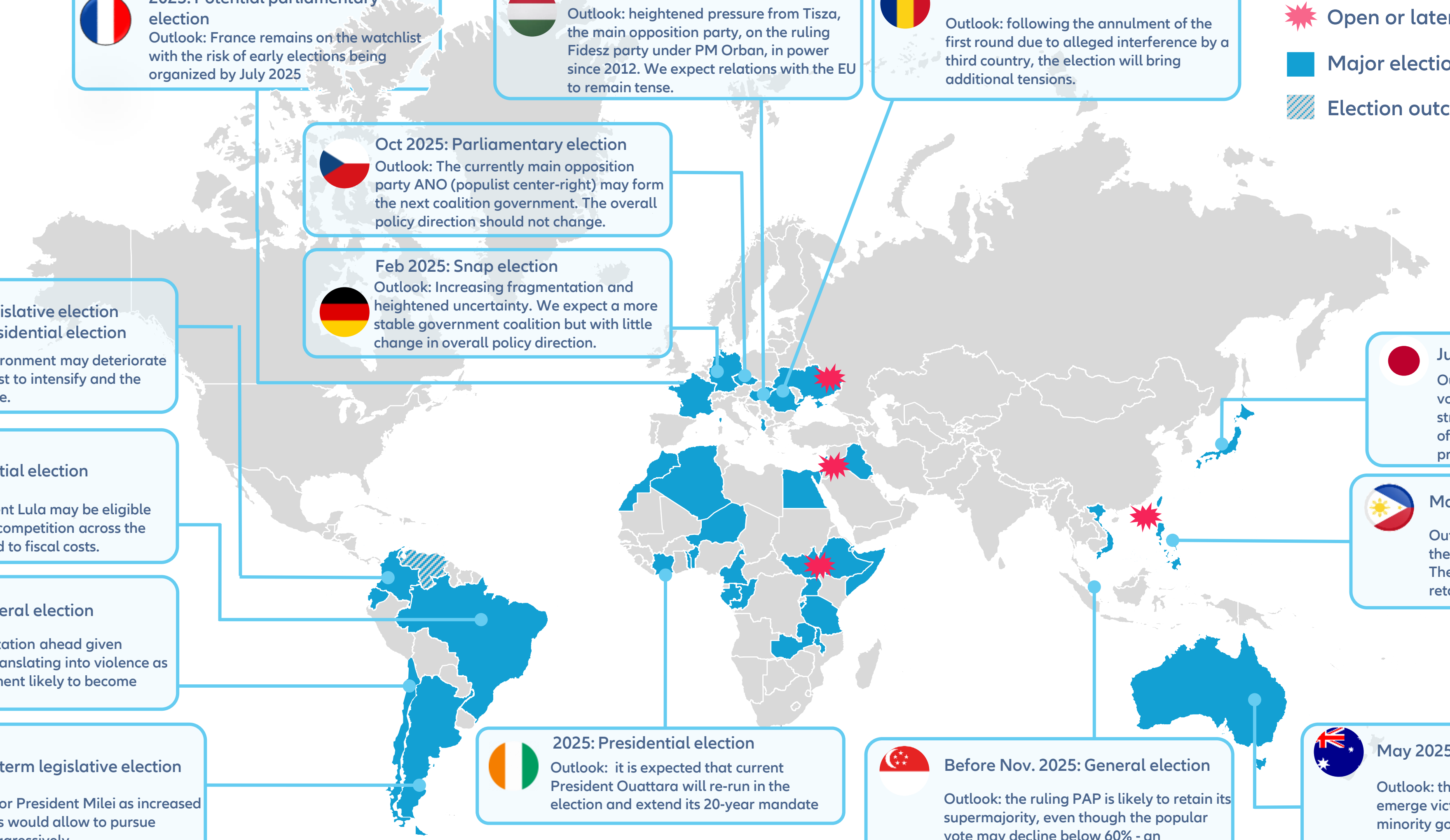
GLOBAL ECONOMIC OUTLOOK 2025-2026

Geopolitical risk: Further elections ahead while military conflicts continue



2025: Potential parliamentary election
Outlook: France remains on the watchlist with the risk of early elections being organized by July 2025

Apr 2026: Parliamentary election
Outlook: heightened pressure from Tisza, the main opposition party, on the ruling Fidesz party under PM Orban, in power since 2012. We expect relations with the EU to remain tense.

Q1 2025: Presidential election
Outlook: following the annulment of the first round due to alleged interference by a third country, the election will bring additional tensions.

Open or latent risk of military confrontation

Major election in sight

Election outcome not widely recognized

Oct 2025: Parliamentary election
Outlook: The currently main opposition party ANO (populist center-right) may form the next coalition government. The overall policy direction should not change.

Feb 2025: Snap election
Outlook: Increasing fragmentation and heightened uncertainty. We expect a more stable government coalition but with little change in overall policy direction.

Mar. 2026: Legislative election
May 2026: Presidential election
Outlook: The political environment may deteriorate further in 2025, with protest to intensify and the fiscal deficit to remain wide.

2026: Presidential election
Outlook: Although President Lula may be eligible for re-election, increasing competition across the political spectrum may add to fiscal costs.

Nov 2025: General election
Outlook: Further fragmentation ahead given ongoing reforms, hardly translating into violence as in 2019. Business environment likely to become more benign in the end.

Oct 2025: Mid-term legislative election
Outlook: Crucial junction for President Milei as increased representation in Congress would allow to pursue structural reforms more aggressively.

2025: Presidential election
Outlook: it is expected that current President Ouattara will re-run in the election and extend its 20-year mandate

Before Nov. 2025: General election
Outlook: the ruling PAP is likely to retain its supermajority, even though the popular vote may decline below 60% - an unprecedented low.

July 2025: Upper house election
Outlook: half of the seats will be up for vote and the LDP-Komeito coalition may struggle to retain their majority. The risk of Japan returning to frequent changes of prime minister has risen.

May 2025: General election
Outlook: the lower house in full and half of the upper house seats will be up for vote. The president's administration is likely to retain power.

May 2025: Federal election
Outlook: the Labor Party is likely to emerge victorious, although the risk of a minority government is rising

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Risks to our scenario: More downsides than upsides

Factor	Market Theme	Description	Probability	Macro impact	Market impact
Trade	Full blown trade war	Rising tariffs will raise inflation in the US and depress global economic confidence and growth	45%	Growth - - Inflation + +	DM interest rates: - DM equities: -
Immigration	US cuts immigration drastically	Strong drop in net immigration or even massive deportation (above 1mn people per year)	20%	Growth - - Inflation neutral	US interest rates: - US equities: -
Monetary policy	Fed independence seriously challenged	Fed's mandate tweaked to allow for lower interest rates and its independence reduced	35%	Growth - Inflation + +	US interest rates: + US equities: -
	USD currency intervention	Fed intervenes on the FX market to weaken the USD	20%	Growth - Inflation +	EZ interest rates: -
US Fiscal policy	Fiscal spending cuts	DOGE drastically cuts spending (more than USD300bn per year), including federal agencies and social spending	30%	Growth - Inflation -	US interest rates: - US equities: -
	Tax cuts	All tax cuts promised are delivered (>2.5% of GDP in total)	45%	Growth + Inflation +	US interest rates: + US equities: +
Geopolitics	Ukraine-Russia end of war	Ukraine-Russia ceasefire, peace talks, US lifts sanctions on Russia, but Europe keeps them	45%	Growth + Inflation neutral	EZ industrials: +
	Europe under pressure on NATO	US threatens to defund NATO, pressuring Europe to increase defense spending to above 2% of GDP per year	40%	Growth + Inflation +	EZ defense stocks: +
	Middle East: Tougher stance and sanctions on Iran	US escalates pressure on Iran, including threats of US military intervention	30%	Growth – Inflation +	Oil price: +
	China-Taiwan: US reduces support to Taiwan	US threatens to impose tariffs on Taiwanese imports and to withdraw support against China if Taiwan does not increase military spending	30%	Growth – Inflation +	Semiconductor equities: -
Climate transition	Climate & energy transition	Repealing of the IRA, defunding of environmental agencies	55%	Growth neutral Inflation –	Fossil equities: + Oil price: -
EZ Fiscal policy	Germany lifts the debt brake completely	A two-third majority in the newly elected German parliament changes the constitution to remove the debt brake	20%	Growth + Inflation +	DE interest rates: + EZ equities: +

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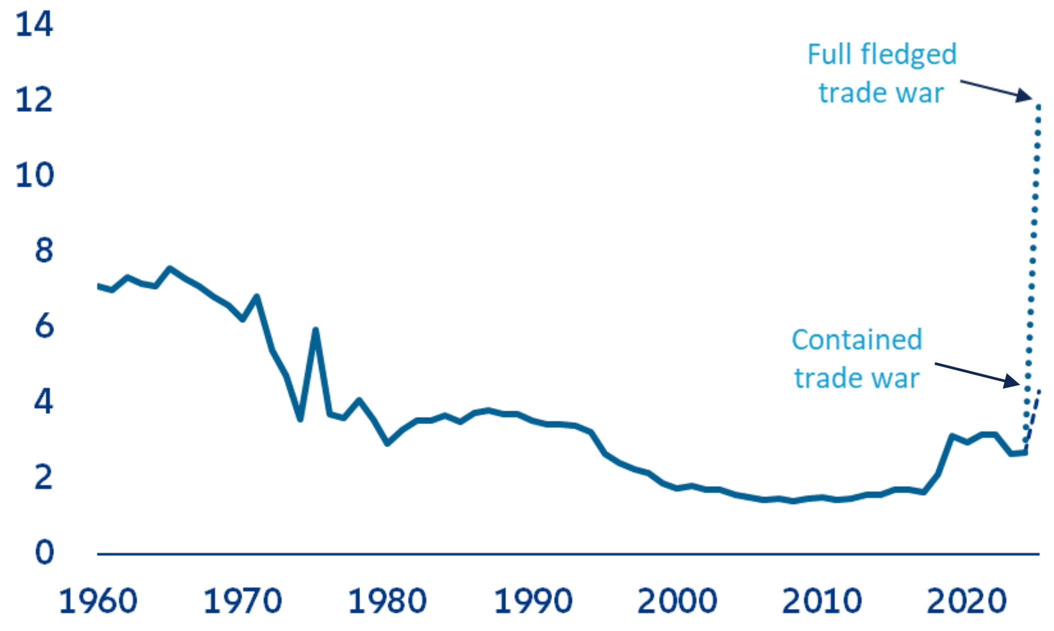
Global Economy can endure a contained trade war, with tariffs largely used as a bargaining tool

US effective tariff rate under two scenarios

%



Sources: FRED, Allianz Research

Top 15 most impacted countries

Trade losses, USDbn

	Contained trade war (USDbn)	Full-fledged trade war (USDbn)
	2025-26	2025-26
China	-34.2	-125.3
Mexico	0.0	-52.1
Canada	0.0	-39.2
Germany	-8.0	-24.5
Japan	-6.8	-24.3
South Korea	-6.1	-20.3
Netherlands	-5.0	-15.8
Viet Nam	-1.0	-14.8
India	-4.1	-14.2
France	-4.2	-13.4
Ireland	-3.5	-13.3
Thailand	-5.7	-12.5
UK	-2.8	-10.7
Italy	-3.3	-10.5
Malaysia	-4.7	-10.2

Sources: UNCTAD, Allianz Research

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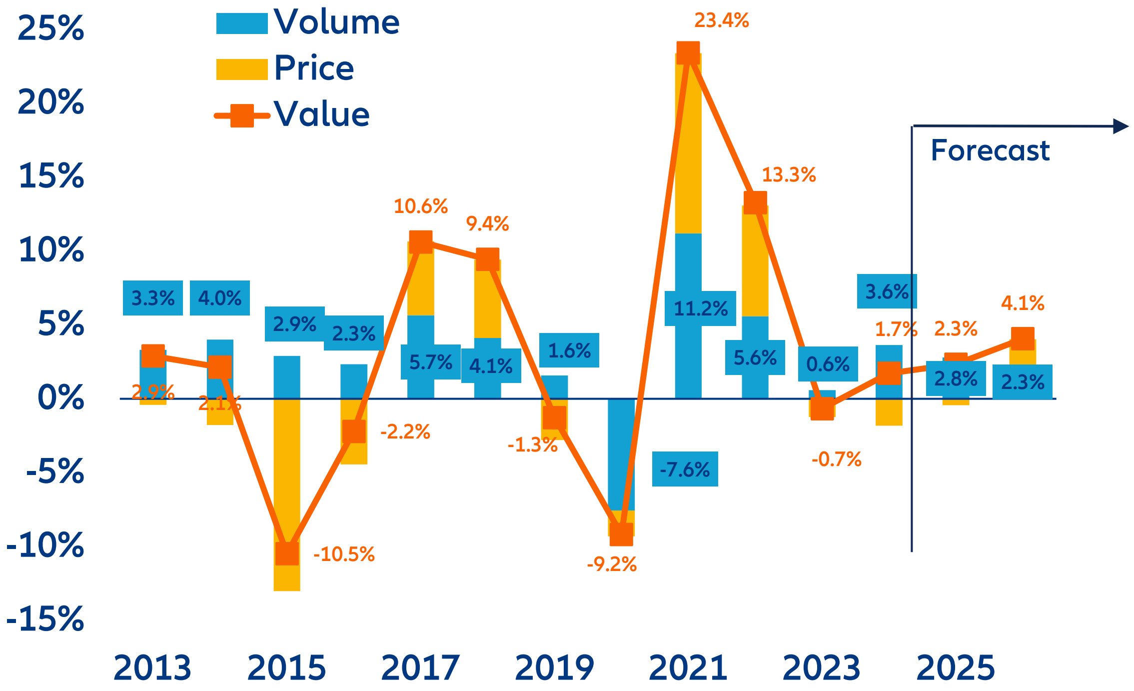
Global trade recovery to stumble from rising tariffs amid fragility of complex supply chains

Downside revisions in the context of the trade war, particularly in prices in 2025 and in volume in 2026

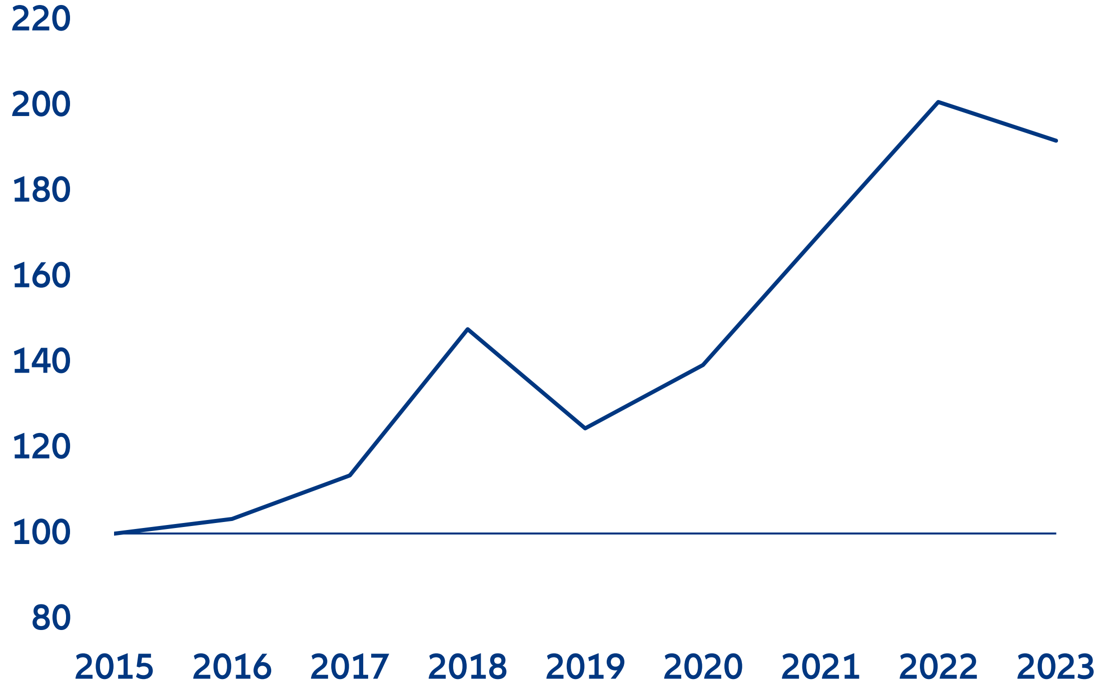
Global trade in goods and services, growth in %



Sources: LSEG Datastream, Allianz Research

The complexity of global supply chains doubled compared to 2017

Proprietary supply-chain complexity index, base 100 = 2015



Note: our proprietary supply-chain complexity index considers shifts in trade flows, geographic distance, geopolitical alignment, our country risk rating, infrastructure connectivity and quality
Sources: national sources, LSEG Datastream, Allianz Research

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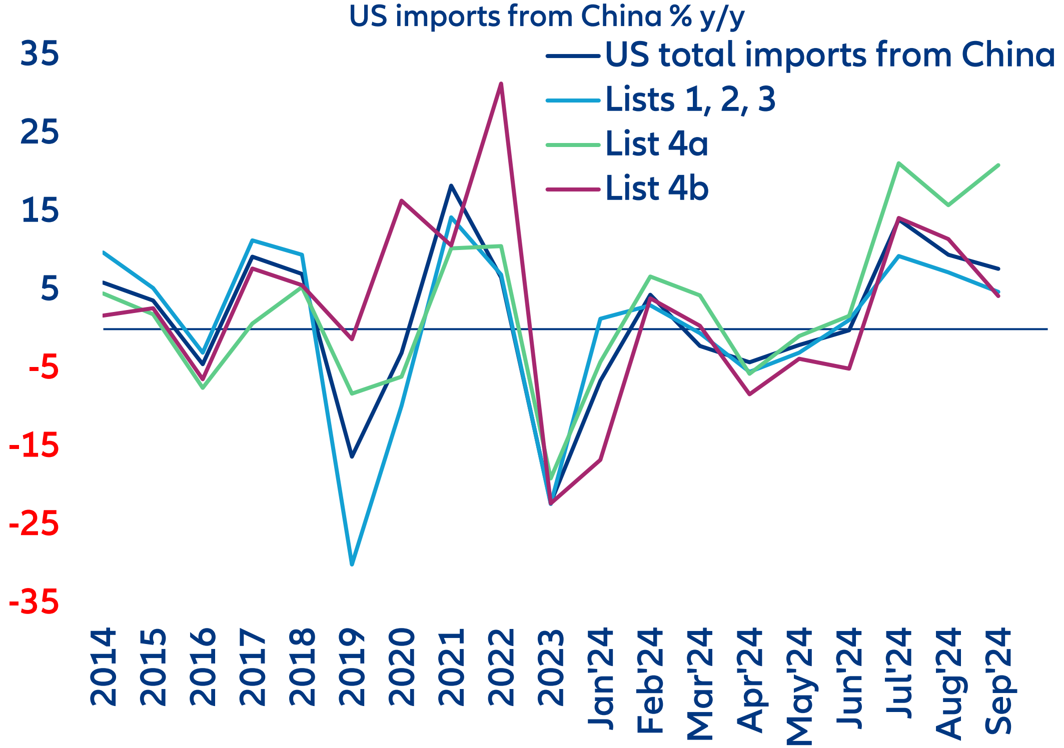
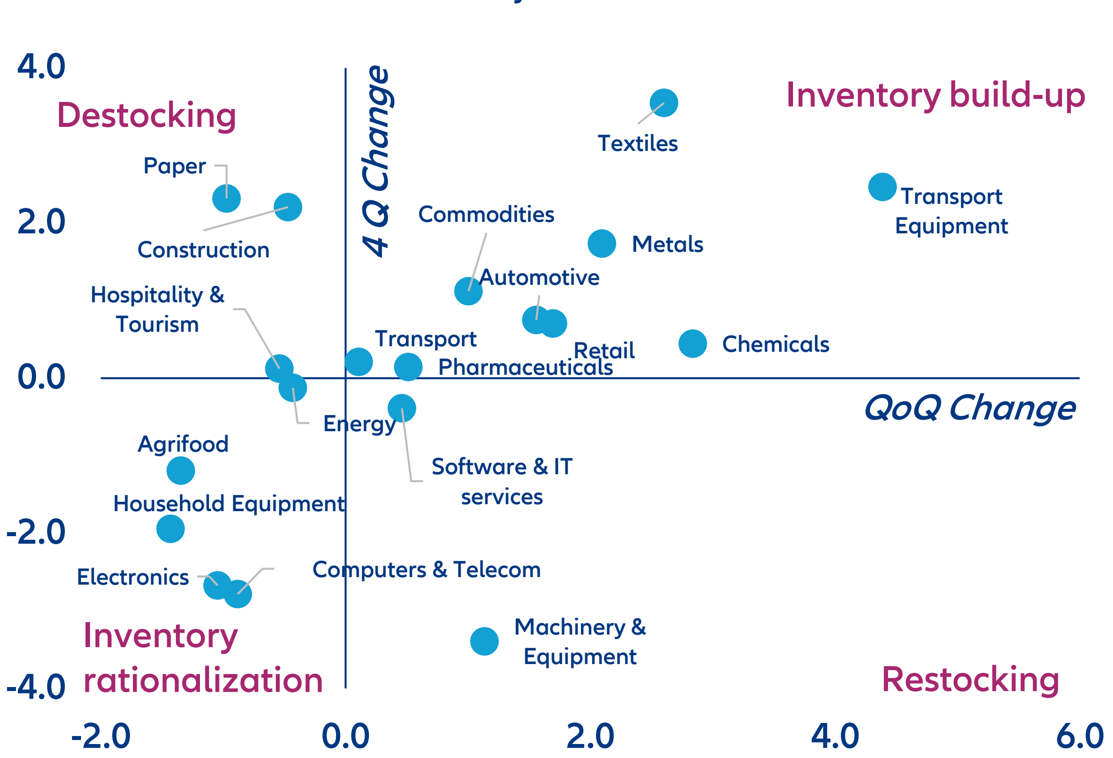
Corporates build up precautionary stocks in anticipation of the looming trade war

Frontloading US imports from China, particularly in consumer goods that could see higher tariffs in 2025



Lists of imports from China that were targeted during the first Trump administration: List 1 (machinery, electronics, industrial goods) with current tariff rate at 25%, List 2 (chemicals, plastics, semiconductors) at 25%, List 3 (consumer goods, furniture, textile) at 25%, List 4a (footwear, clothing, kitchenware) at 7.5% and List 4b (smartphones, laptops, toys) at 0%.
Sources: ITC, USTR, Allianz Research

Inventory rebalancing to continue



Sources: LSEG Datastream, Allianz Research

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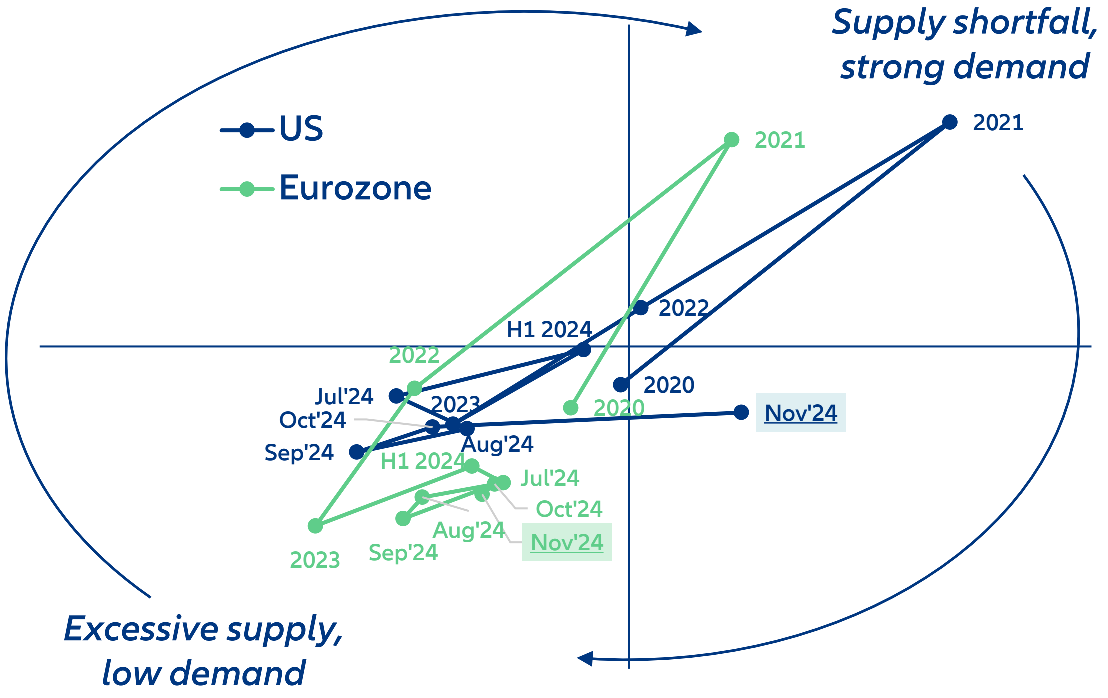
Cyclical Gaps: Europe must revive investment to avoid a shrinking growth potential

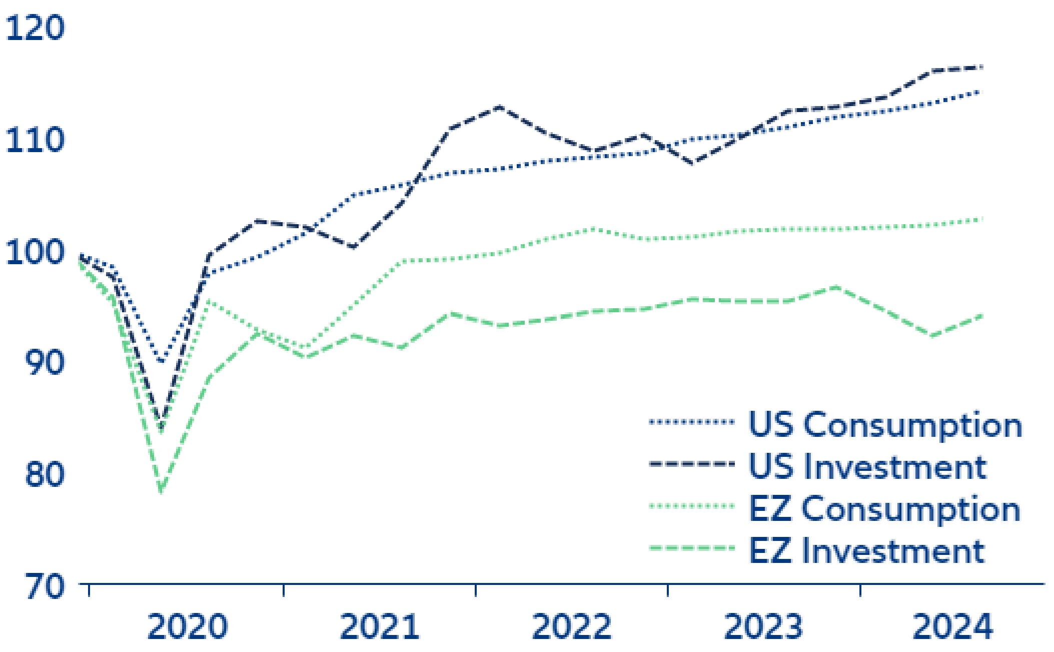
Limited room for further growth acceleration in the US



Note: horizontal axis represents an index for Production shortfall (New orders – Output), vertical axis represents an index for Demand (New orders + Backlogs of work)
Sources: S&P Global, Allianz Research

The Eurozone suffers from structurally weak domestic demand with particularly low investment

index 2019=100



Sources: LSEG Datasream, Allianz Research

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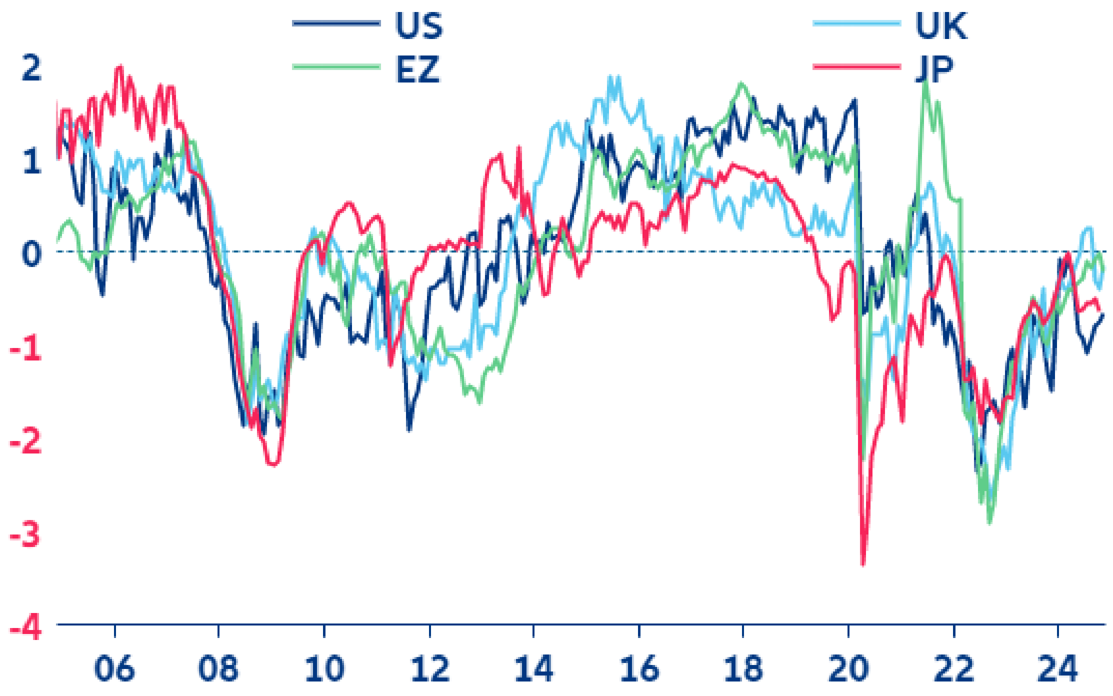
Consumption: Confidence is key to improve demand

Consumer sentiment is still undermined by high political and economic uncertainty

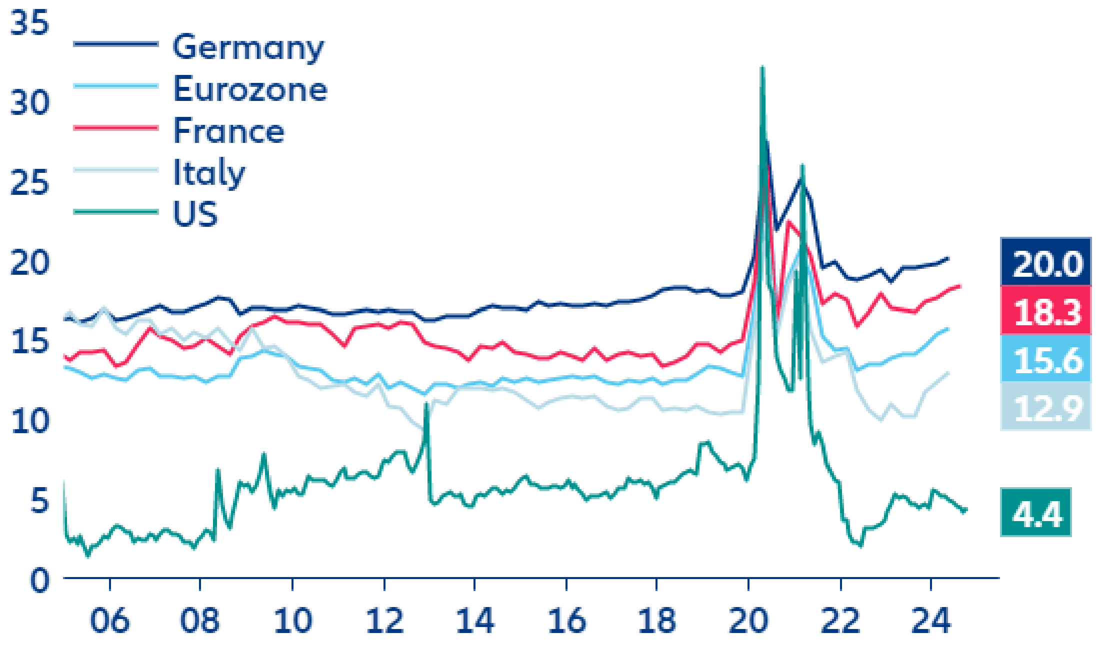
Consumer confidence, Z scores



Sources: LSEG Workspace, Allianz Research

Savings rates remain far above their pre-pandemic levels in Europe, while in the US, they have fallen below

Household saving rates, %



Sources: LSEG Datastream, Allianz Research

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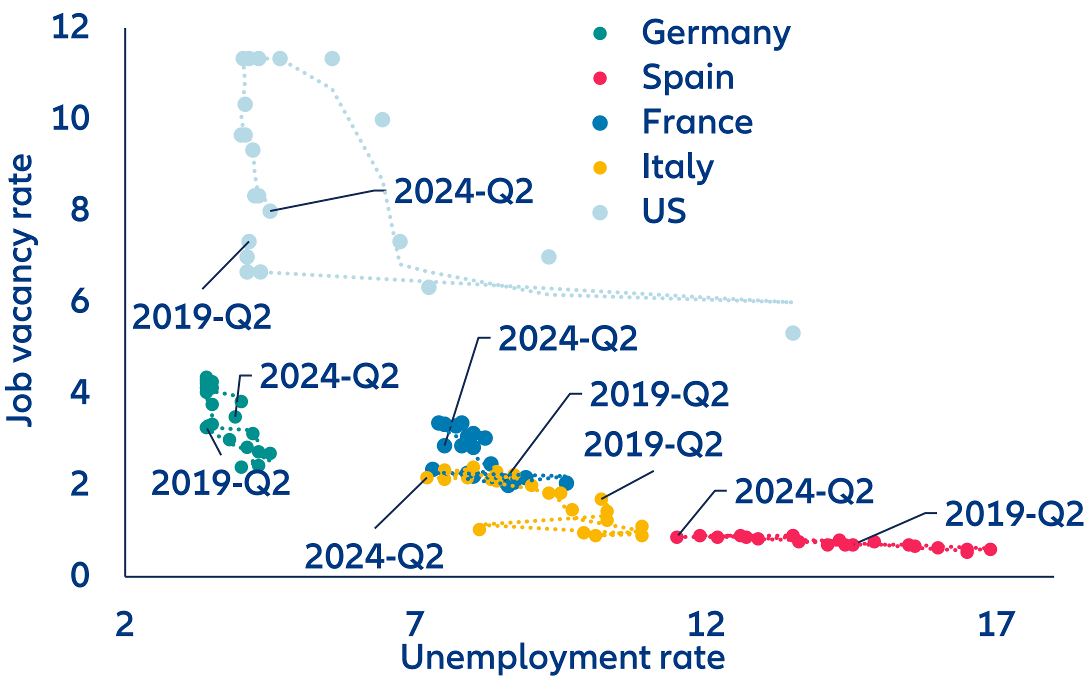
Labor market tightness is easing, supporting wage growth normalization

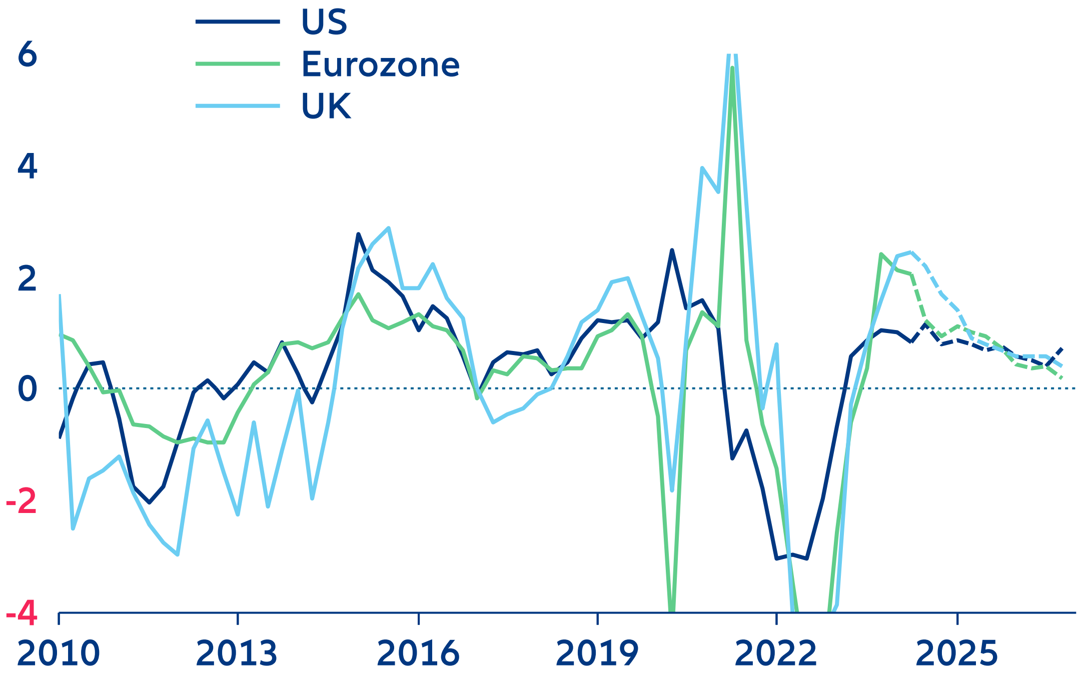
Vacancy rates have started to decline from record highs during the post-pandemic recovery



Sources: LSEG Datastream, Allianz Research

Wage growth is set to normalize globally

quarterly real wage growth, % y/y



Sources: LSEG Datastream, Allianz Research. Note: dotted lines are AZR forecasts

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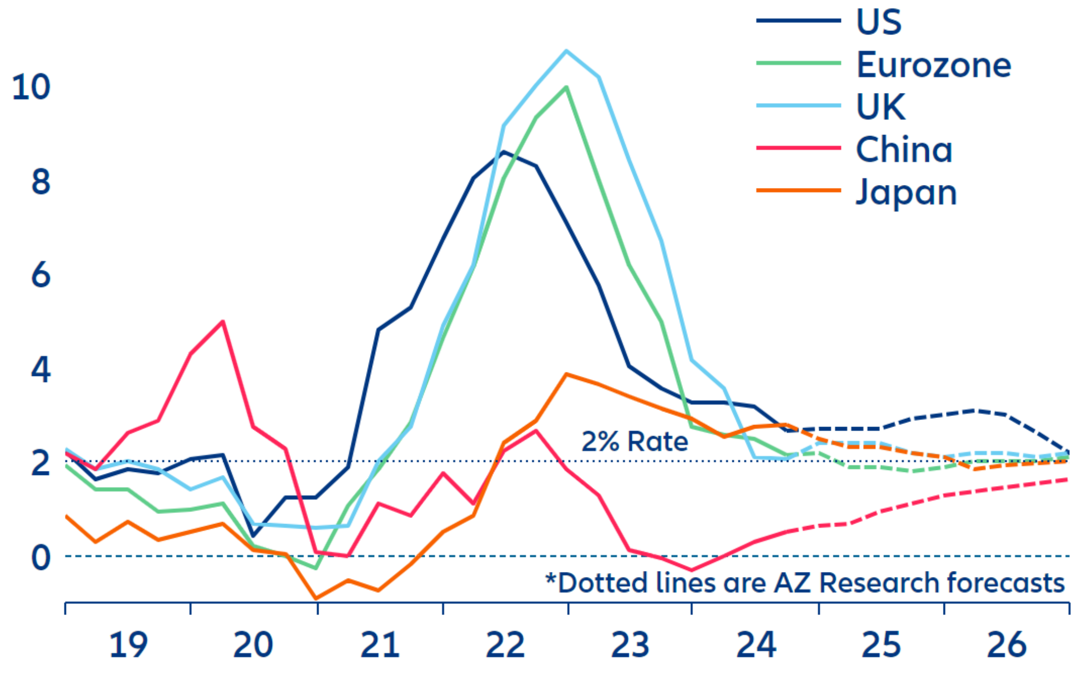
Most large economies to reach inflation target in 2025 but disinflation process to stumble in US

Inflation forecasts

Inflation (yearly %)	2022	2023	2024f	2025f	2026f
Global	**8.2**	**6.1**	**5.6**	**3.9**	**3.2**
USA	**8.0**	**4.1**	**2.9**	**2.8**	**2.7**
Latin America	**14.0**	**14.4**	**16.7**	**10.7**	**6.5**
Brazil	9.3	4.6	4.3	4.0	3.5
UK	**9.1**	**7.3**	**2.5**	**2.3**	**2.2**
Eurozone	**8.4**	**5.4**	**2.4**	**1.9**	**2.0**
Germany	6.9	5.9	2.2	2.1	2.0
France	5.2	4.9	2.0	1.6	1.8
Italy	8.2	5.6	1.0	1.7	2.0
Spain	8.4	3.5	2.7	2.1	1.9
Central and Eastern Europe	**9.1**	**11.0**	**3.9**	**4.4**	**3.4**
Poland	14.4	11.4	3.8	4.4	3.6
Russia	13.8	5.9	10.0	12.0	8.0
Türkiye	72.3	53.9	59.3	34.5	18.5
Asia-Pacific	**4.0**	**3.0**	**1.9**	**2.0**	**2.2**
China	2.0	0.2	0.4	1.0	1.5
Japan	2.5	3.3	2.5	2.2	1.9
India	6.7	5.7	4.9	4.3	4.4
Middle East	**13.9**	**10.7**	**12.5**	**11.4**	**7.2**
Saudi Arabia	2.5	2.3	1.7	2.3	2.1
Africa	**14.2**	**18.2**	**18.1**	**12.1**	**8.9**
South Africa	6.9	5.9	4.6	4.4	4.9

Approaching central bank targets in 2025

Quarterly inflation rates, y/y %



Sources: LSEG Datastream, Allianz Research

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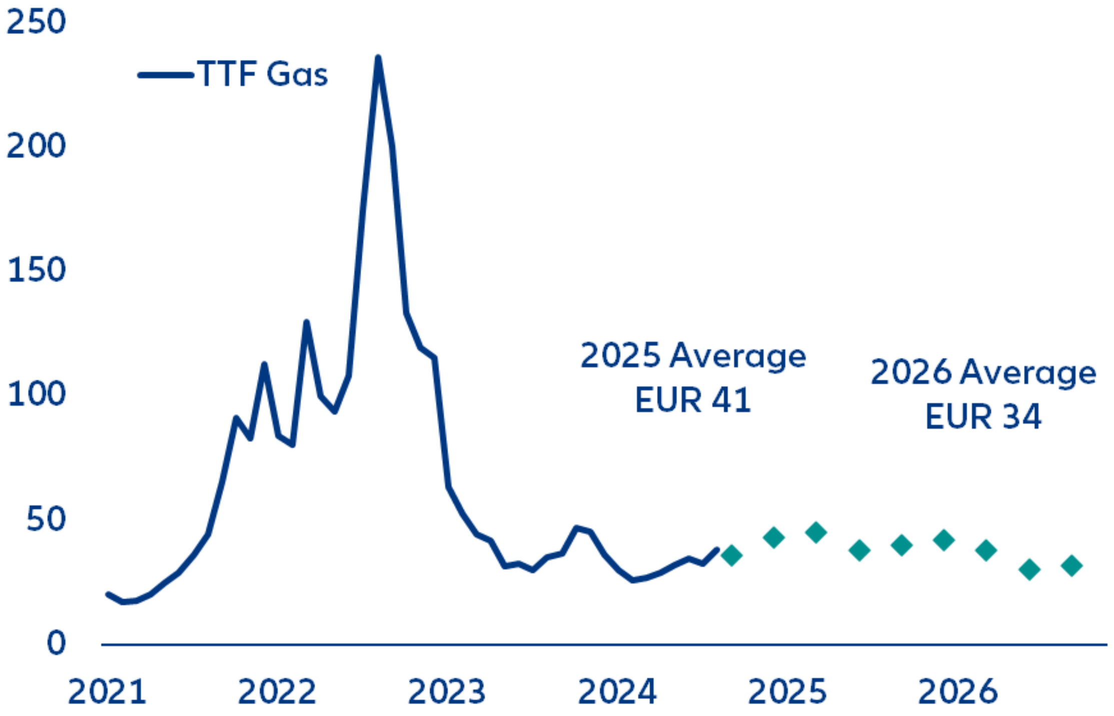
US policy to have significant impact on oil & gas prices in 2025

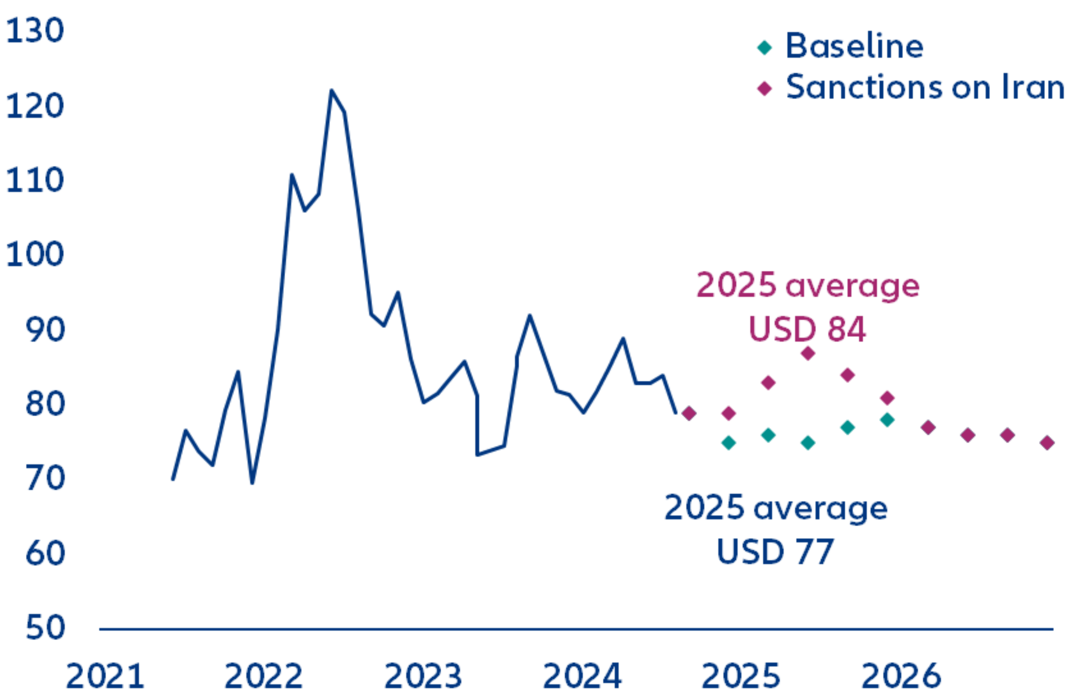
Natural gas prices to remain under pressure in 2025

in EUR/MWh



Sources: LSEG, Allianz Research

Under tougher sanctions, we expect oil to trade +10% higher on average in 2025



Sources: LSEG, Allianz Research

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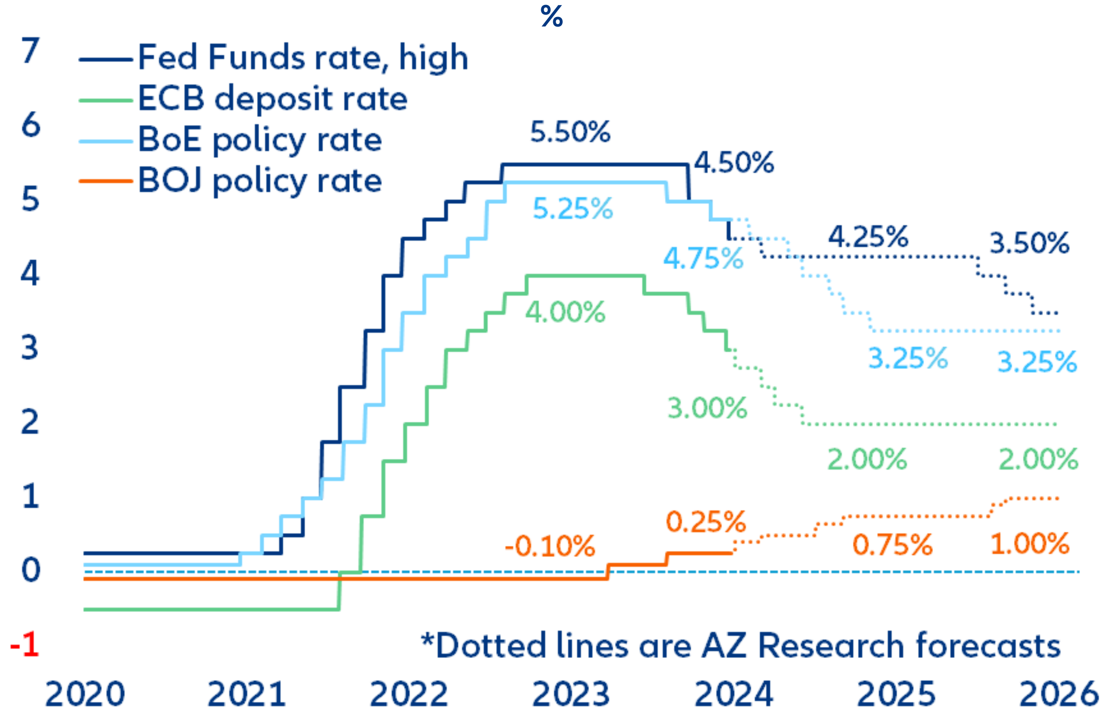
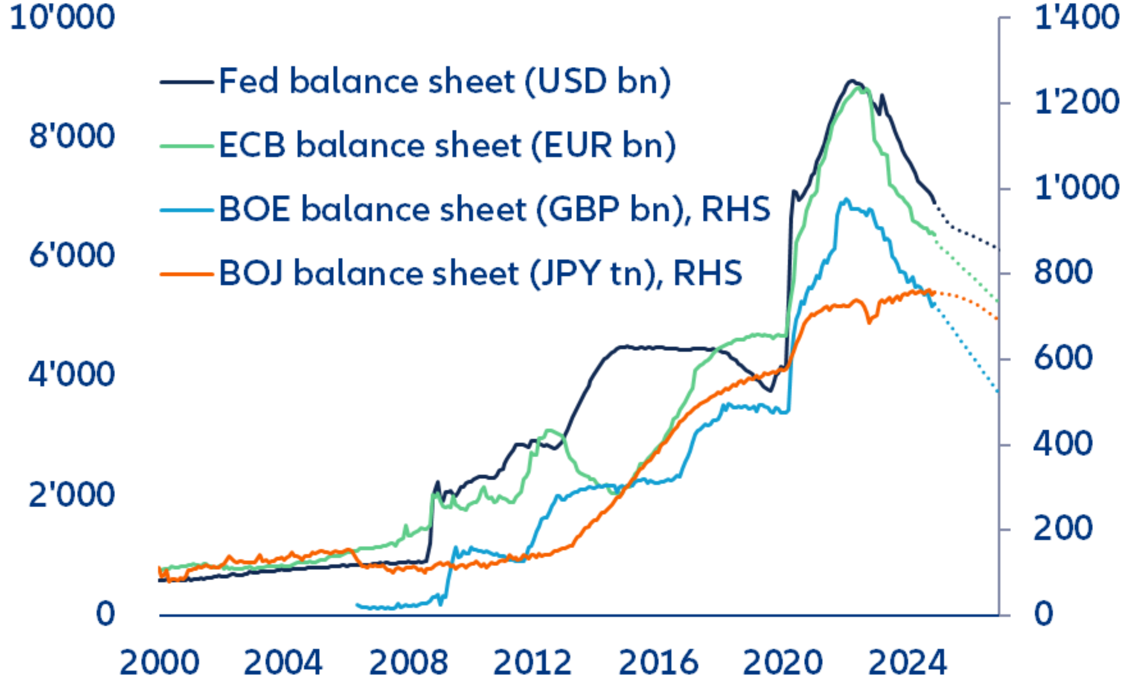
Central bank easing cycles to come to a halt in 2025 with Bank of Japan being the outlier

Central bank cutting cycle under way except for BoJ which has only started its tightening cycle



Sources: LSEG Datastream, Bloomberg, Allianz Research

Global quantitative tightening in 2025 with the BoJ finally joining



Sources: LSEG Datastream, Allianz Research
Notes: The ECB announced to halt reinvestment of bonds in its PEPP program completely from 2025 onwards effectively increasing QT to an average of EUR40bn per month, while the Fed announced to limit its monthly runoff from currently USD95bn to USD60bn per month (25bn treasuries + 35bn MBS) from June 2024 onwards.

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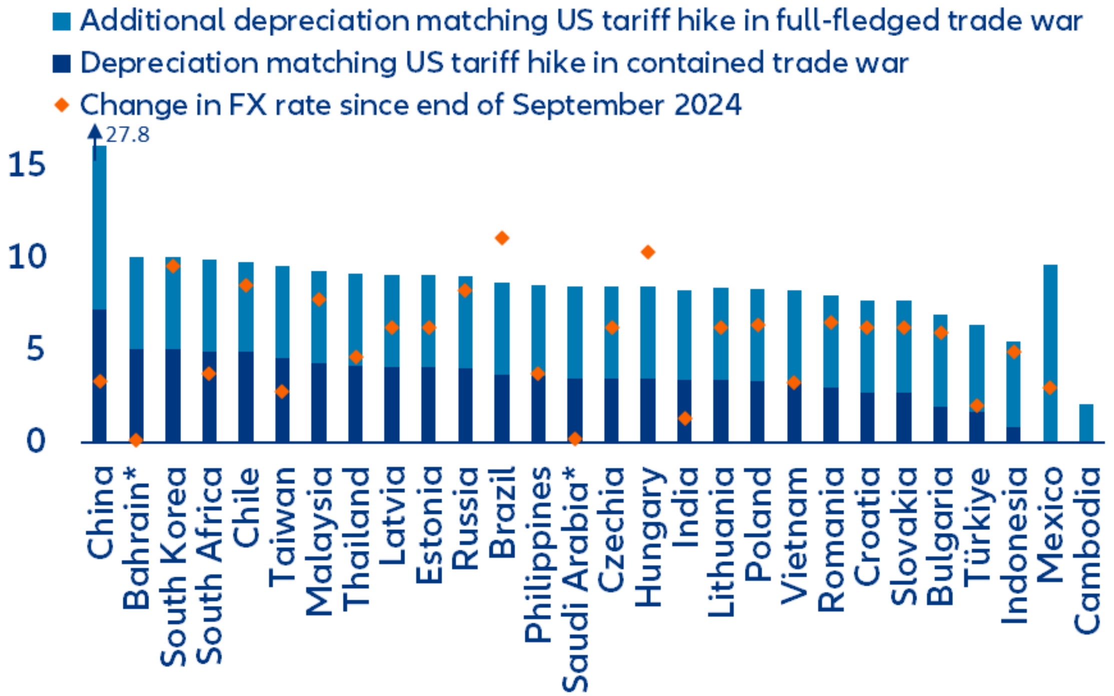
Central banks in emerging markets to err on the side of hawkishness or cautious easing

The rise in US tariffs could be partly mitigated by FX...

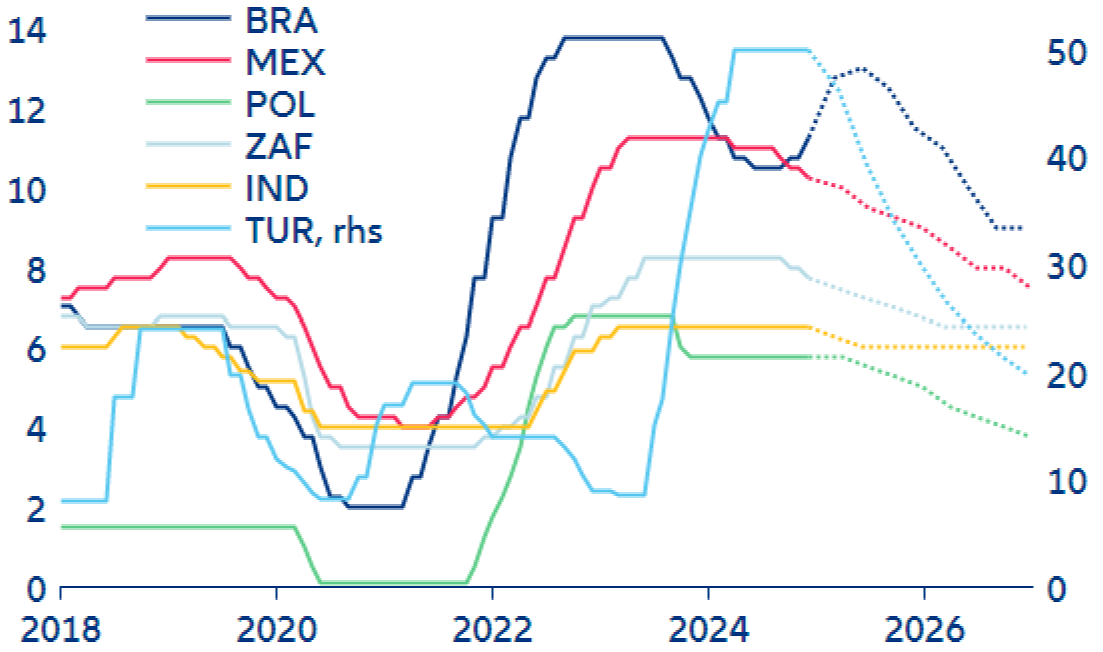
USDLCU FX rate change and change to match tariff hike, in %



Change in FX rate since end of September 2024, as of 5 December 2024.
* Currencies pegged to the USD
Sources: LSEG Datastream, World Bank, ITC, Allianz Research

...but will delay easing cycles across EM regions

ppts



Sources: LSEG Datastream, Allianz Research.

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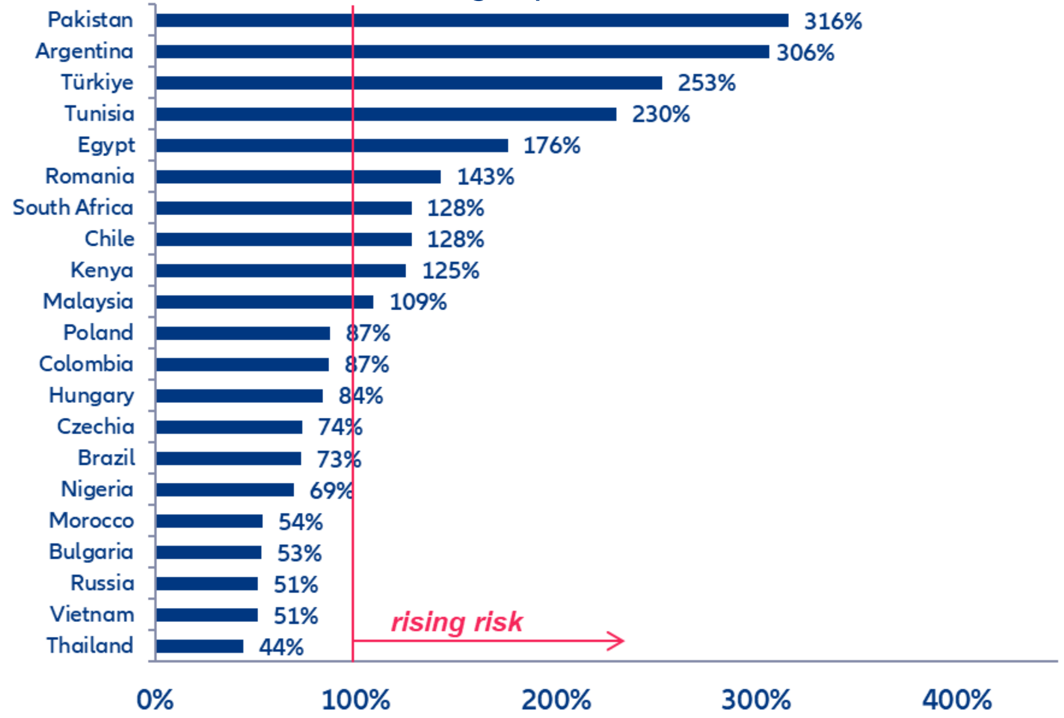
EMs with higher savings will be better shielded from FX and balance of payment risks

A handful of EMs in each region face large external financing requirement in the next 12 months...

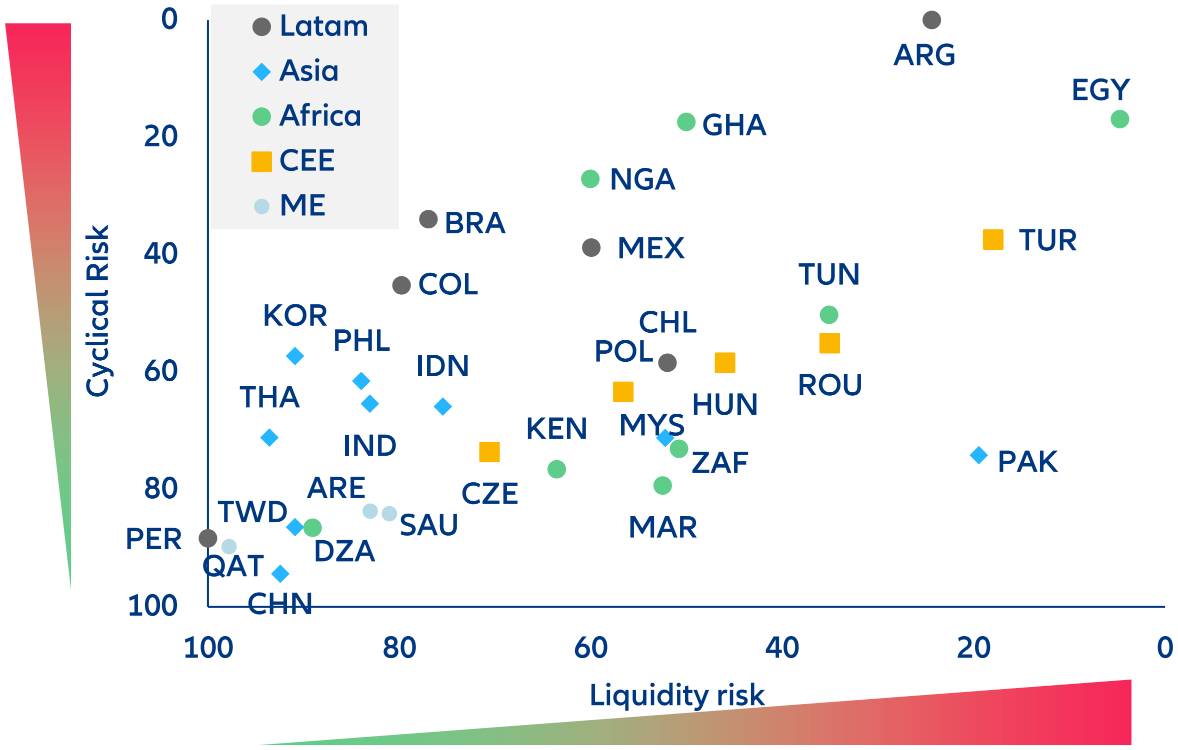
Gross external financing requirements as % of FX reserves



Sources: LSEG Datastream, national statistics, Allianz Research
Note: Gross external financing requirement = current account balance + maturing external debt repayments in the next 12 months.

...while their exposure to BoP risks and market volatility is also high

Vulnerabilities to external shocks



Sources: LSEG Datastream, Allianz Research. To calculate the score for each risk, we aggregate the individual scores (from 0 (bad) to 100 (good)) of a set of variables. Liquidity risk comprises a set of variables (e.g. BoP) that points to vulnerabilities in the medium term, while cyclical risk points to short-term problems (e.g. market volatility).

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China's fiscal and monetary package to achieve 2024 GDP growth target and add +0.4pp to 2025

Easing measures since the end of September have been focused on reducing the structural risk of a fiscal/financial crisis, rather than stimulating short-term growth

Main measures announced since September 2024

Monetary policy	
Policy rates	-20bps to the 7-day reverse repo rate -30bps to the medium-term lending facility rates About -20-25bps in loan prime rates and deposit rates *Looking forward: in 2025, two policy rate cuts of -10bps each*
Liquidity	-50bps to the reserve requirement ratio for banks, unleashing RMB1tn of long-term liquidity *Looking forward: another -25-50bps cut in 2024; two cuts of -25bps each in 2025*
Housing policy	
Interest rates	-50bps reduction for existing mortgages on average, lowering interest payments by RMB150bn for 150mn people (estimated to amount to 0.3% of projected 2024 household consumption expenditure, or 0.1% of projected GDP)
Down payment	Minimum down payment requirement cut to 15% for all types of purchases
Housing inventories	Commercial banks can use 100% of the RMB300bn relending loan facility to finance loans to state-owned enterprises that acquire unsold apartments *Looking forward: funding from local government special bonds will likely be used to buy unused lands and housing inventories*
Fiscal policy	
Local government funding	Commitment to spend RMB2.3tn worth of unused funds from local government special bonds, by the end of the year Debt swap program to bring implicit debt on-balance amounts to RMB10tn over five years (2024-2028). It is expected to reduce local government debt servicing costs over this period by RMB600bn (i.e. 0.5% of 2024E nominal GDP).
Central government funding	No announcement for now *Looking forward: we expect in 2025 a larger fiscal deficit target and an enlarged quota for ultra-long-term central government special bonds (adding RMB1-2tn)*

Source: Allianz Research

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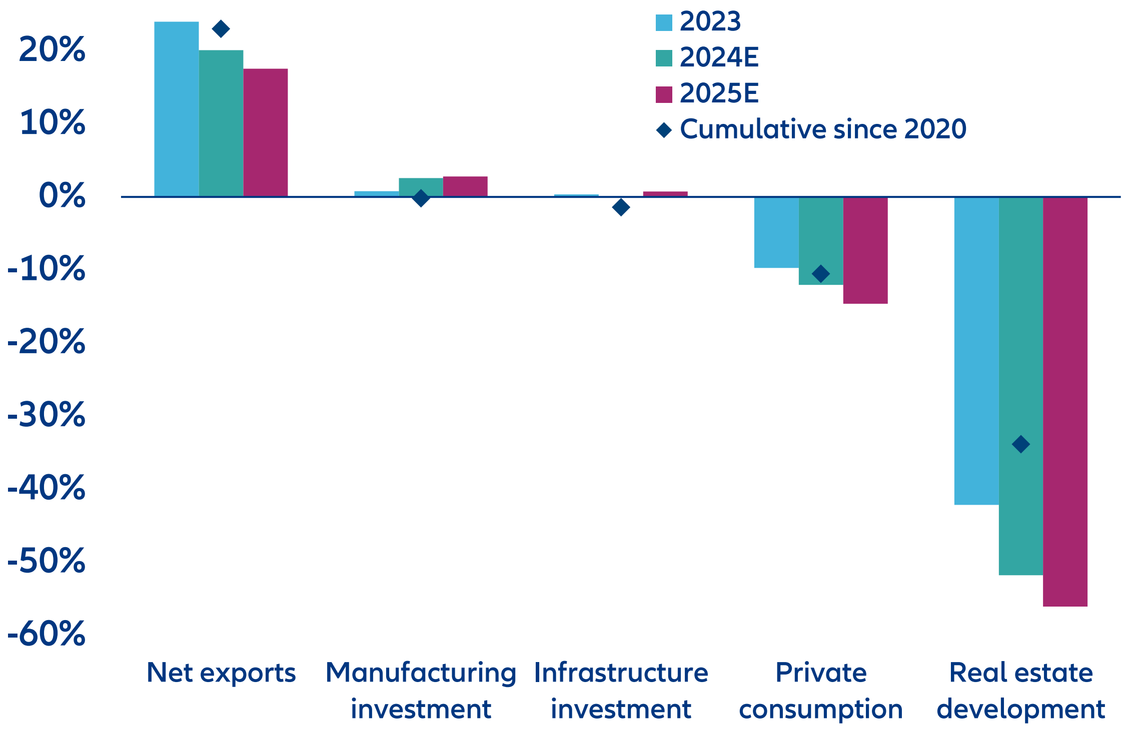
Limited China impulse to emerging markets

Underperforming China's private consumption remains a major drag for global growth

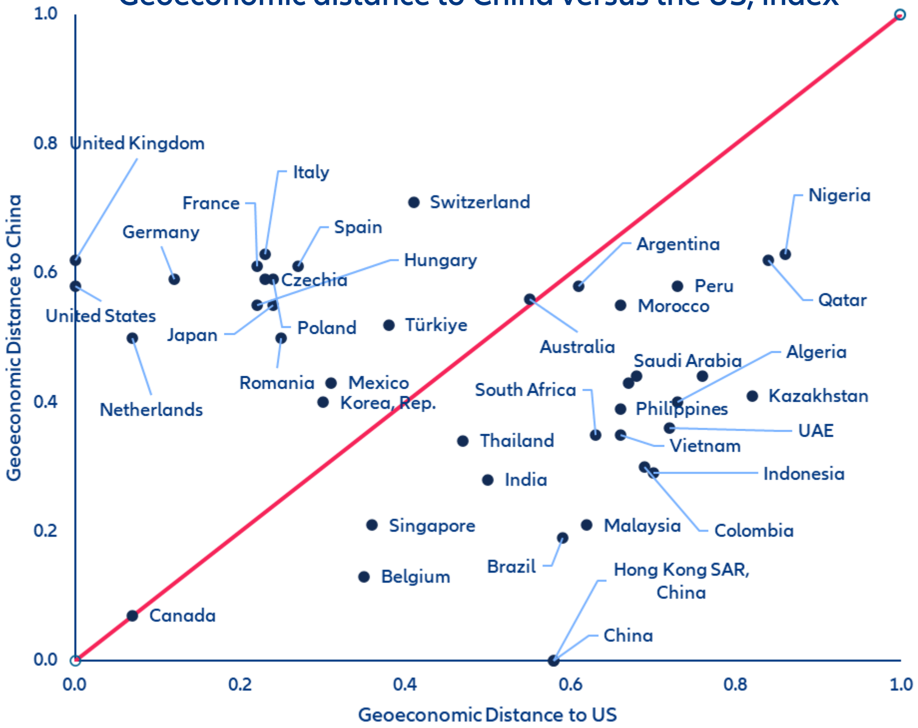
Distance to pre-pandemic trend



Sources: national sources, LSEG Datastream, Allianz Research

Next-generation trade hubs are usually in China's sphere of influence,

Geoeconomic distance to China versus the US, index



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Notes: Distance to the US and China based on geopolitical distance, trade complementarity and foreign direct investment sorted by distance to China. Only countries with at least 1% weight in global trade as well as those that are emerging trade hubs are shown in this table. Emerging trade hubs are highlighted in bold.
Source: Allianz Research

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Business insolvencies to plateau at a high level in 2025

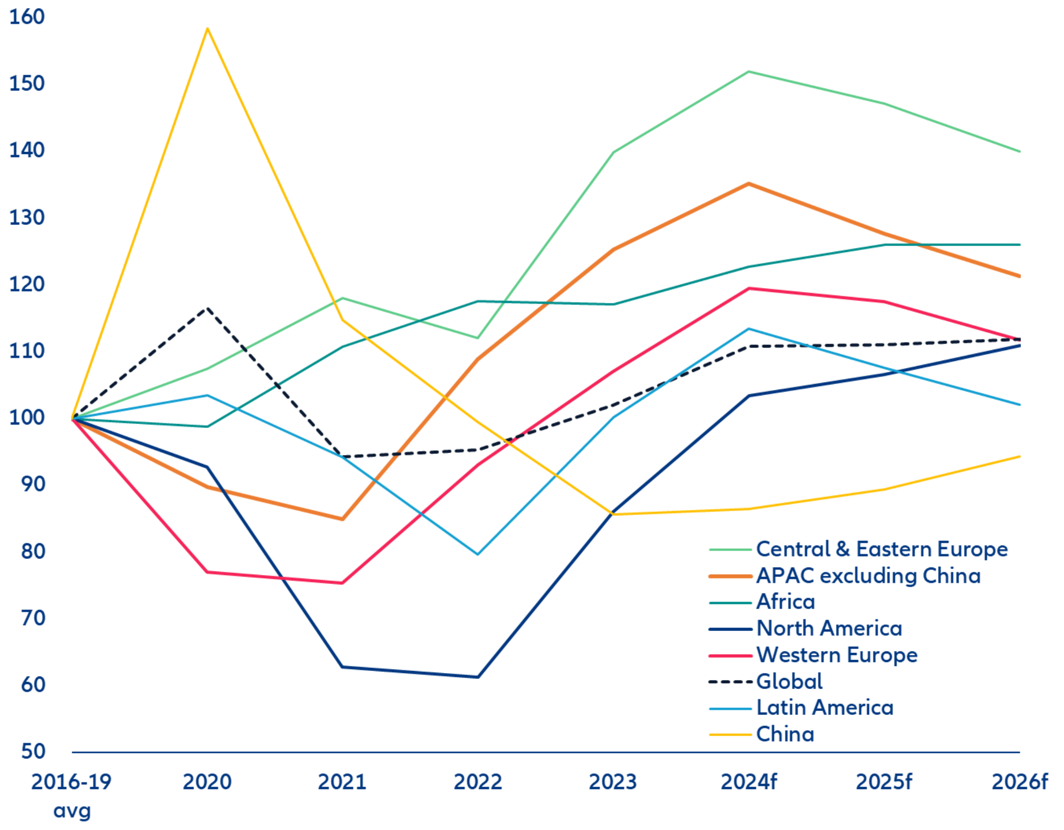
Insolvency heat map 2025

2025 expected change (y/y)	Very low level (more than -15%)	Low level (-15% to 0%)	High level (0% to +15%)	Very high level (+15% and more)
Noticeably increasing (+5% and more)	Taïwan, Türkiye	Italy, Portugal, Russia		Morocco
Increasing (0% to +5%)		China, Romania	India, US	Germany, Spain
Decreasing (-10% to 0%)	Czechia, Latvia, South Africa	Bulgaria, Denmark, Luxembourg, Norway	Belgium, Estonia, Ireland, Japan, Netherlands	Australia, Austria, Brazil, Canada, Finland, France, Hong-Kong, Singapore, Slovakia, Switzerland, UK
Noticeably decreasing (more than -10%)	Chile, Lithuania		New-Zealand	Colombia, Hungary, Poland, South Korea, Sweden

2025 expected level compared to 2016-19

Sources: national sources, Allianz Research

Regional and global insolvency indices, annual level, basis 100: 2016-2019 avg



Sources: National sources, Allianz Research

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Regional outlooks 2025-2026

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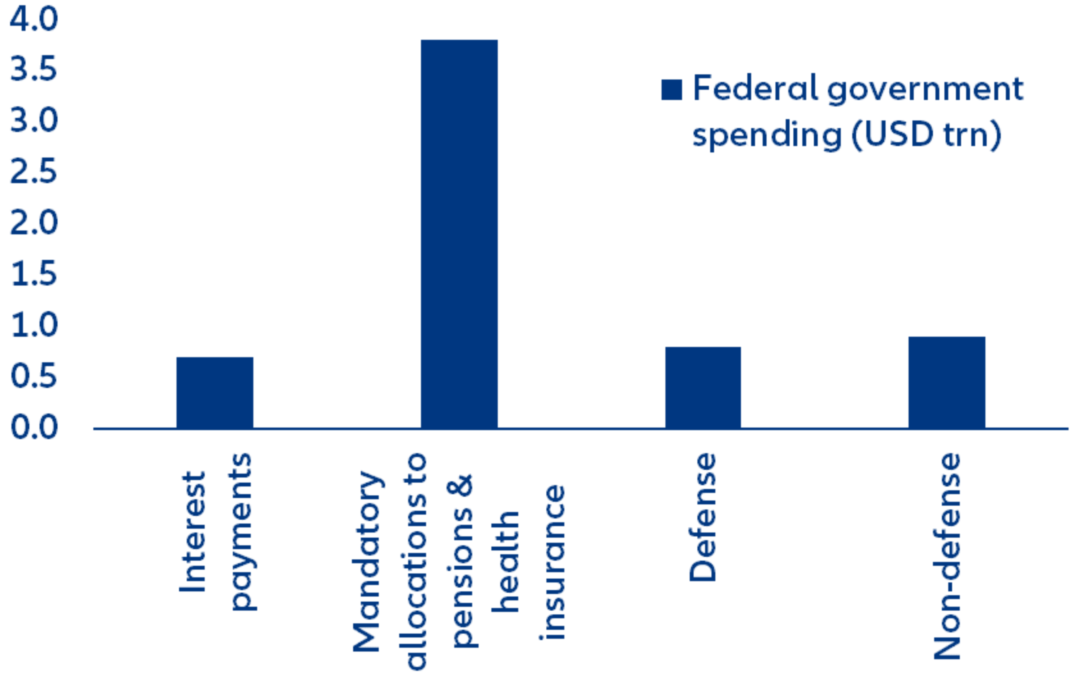
Reduction of the US deficit would require drastic spending cuts if taxes are not raised

Entitlement programs make up the bulk of federal spending

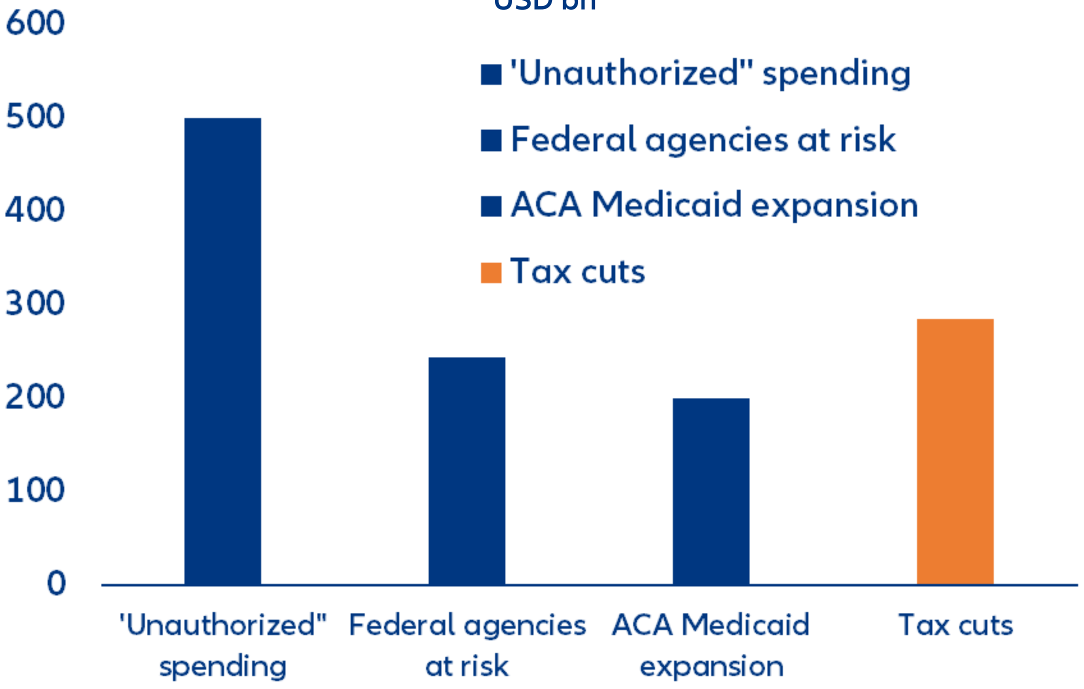
USD trn



Sources: LSGE Workspace, Allianz Research

Large savings could target ACA, federal agencies, "unauthorized" spending by Congress

USD bn



Sources: various, Allianz Research

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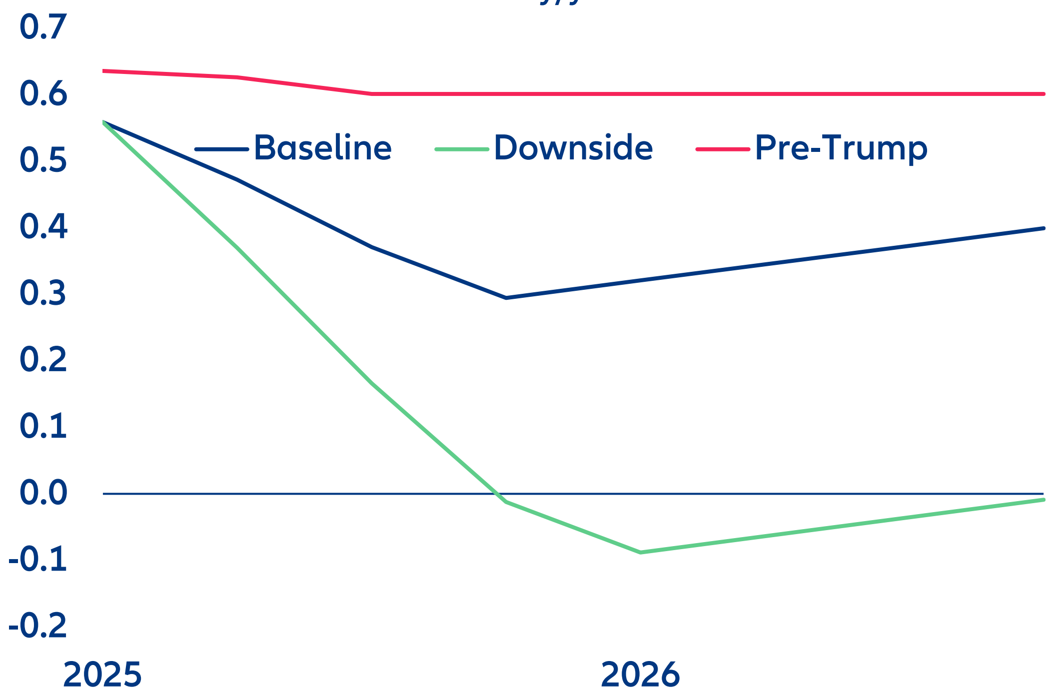
Full implementation of deportation pledge could reduce US potential growth by -0.6pp

Slowing immigration inflows and deportations would weigh drastically on population growth

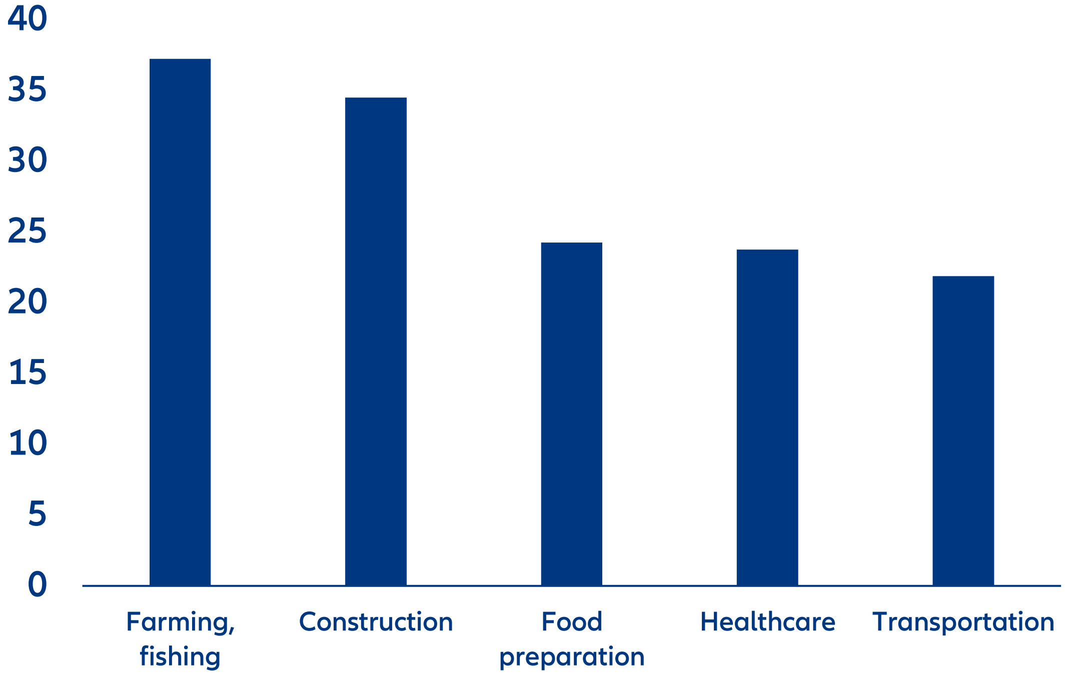
% y/y



Source: Allianz Research
Baseline = net immigration inflows reduced to 0.75 Mn/per year ; Downside = net immigration inflows reduced to 0.75 Mn/year + 1 Mn undocumented people living and/or working in the country deported per year.

Sectors reliant on foreign labor would suffer the most

% of workforce foreign-born



Sources: LSGE Workspace, Allianz Research

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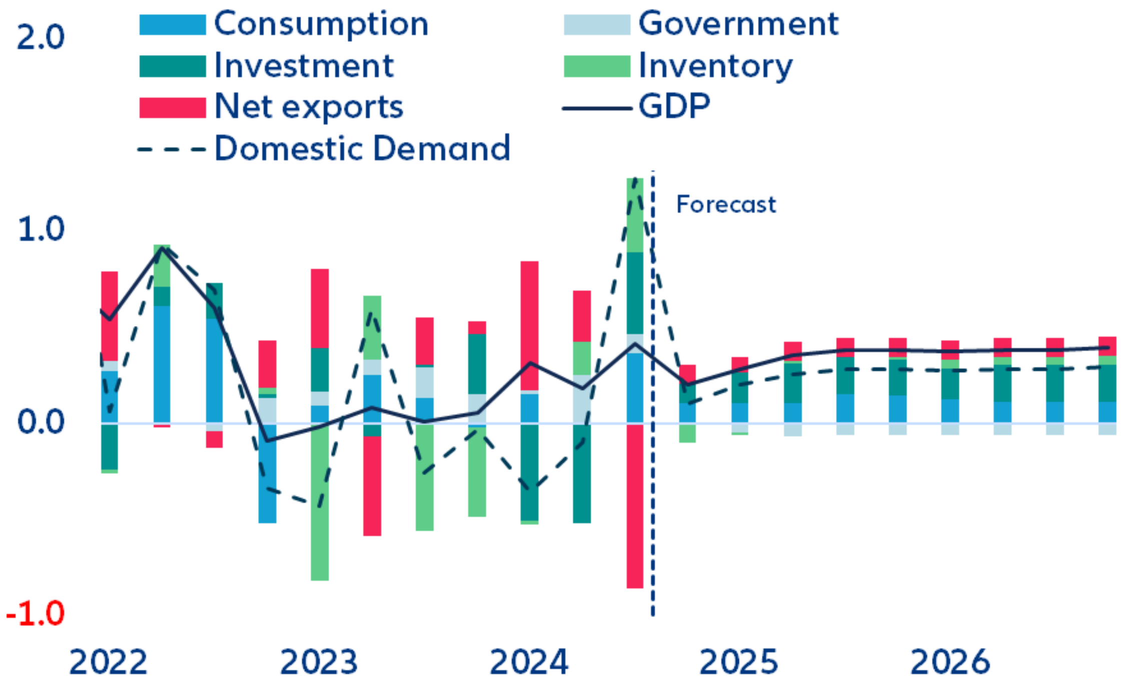
Eurozone's domestic demand awakens, but productivity needs attention

Economic momentum will be fueled by a rebound in consumption and investment

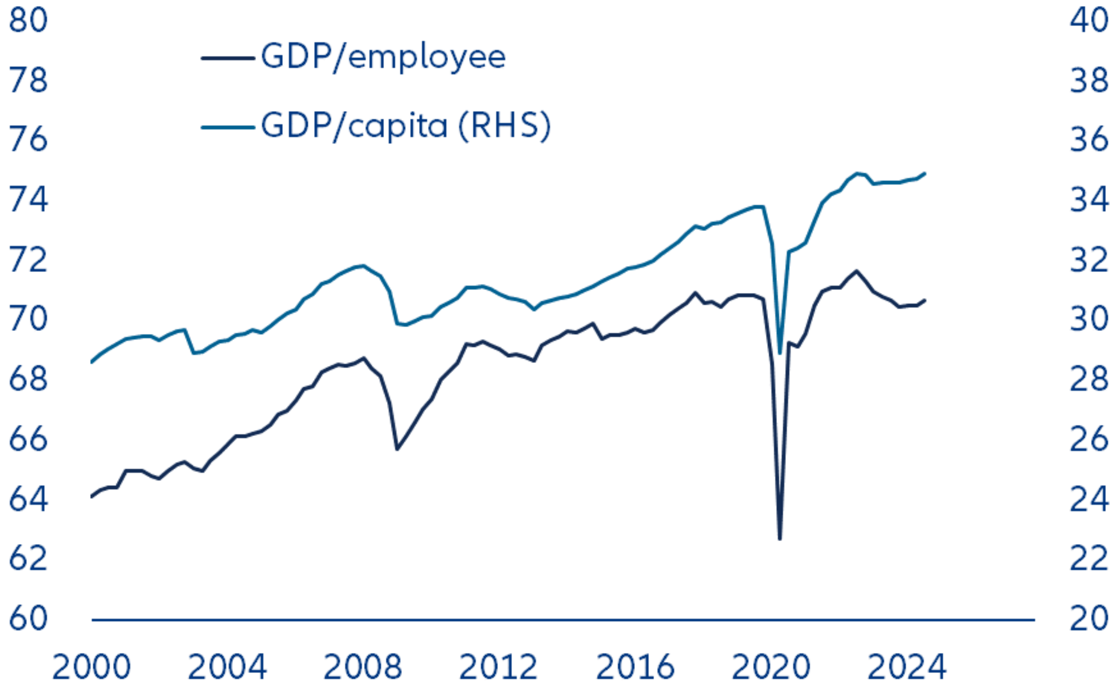
%



Sources: LSEG Datastream, Allianz Research

Eurozone real GDP per employee is at the same level as in 2018 suggesting low productivity growth

thousand euro in 2015 prices



Sources: LSEG Datastream, Allianz Research

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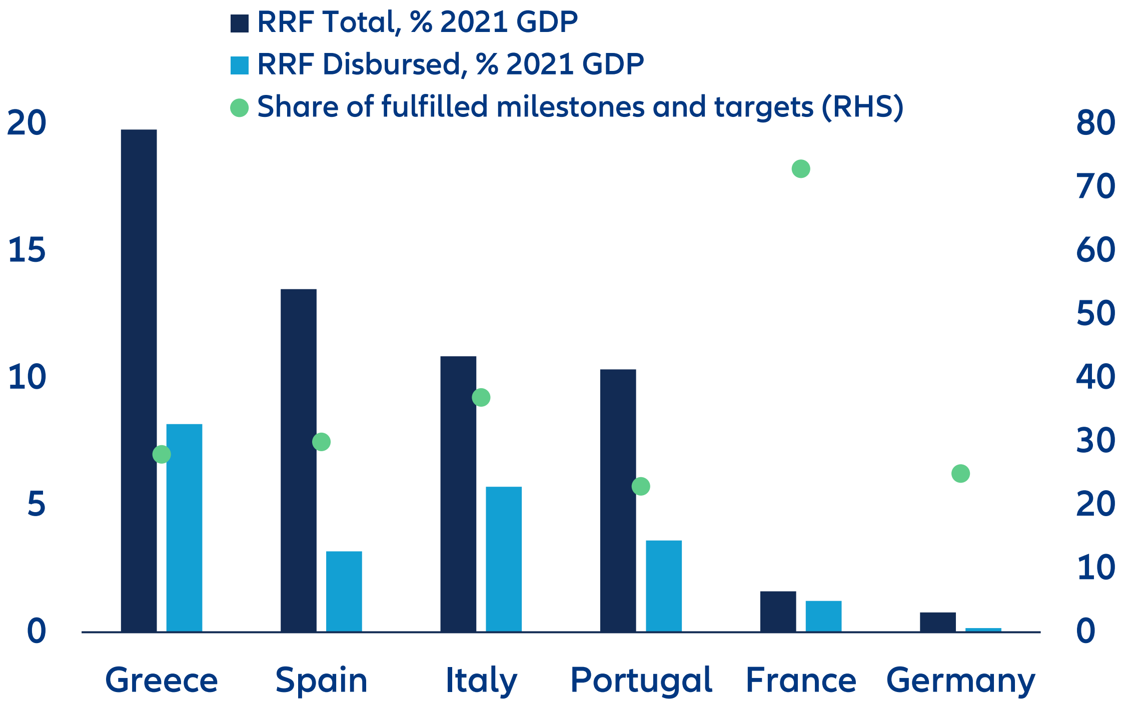
Next Generation EU: two years to go, still 60% of total resources to be disbursed

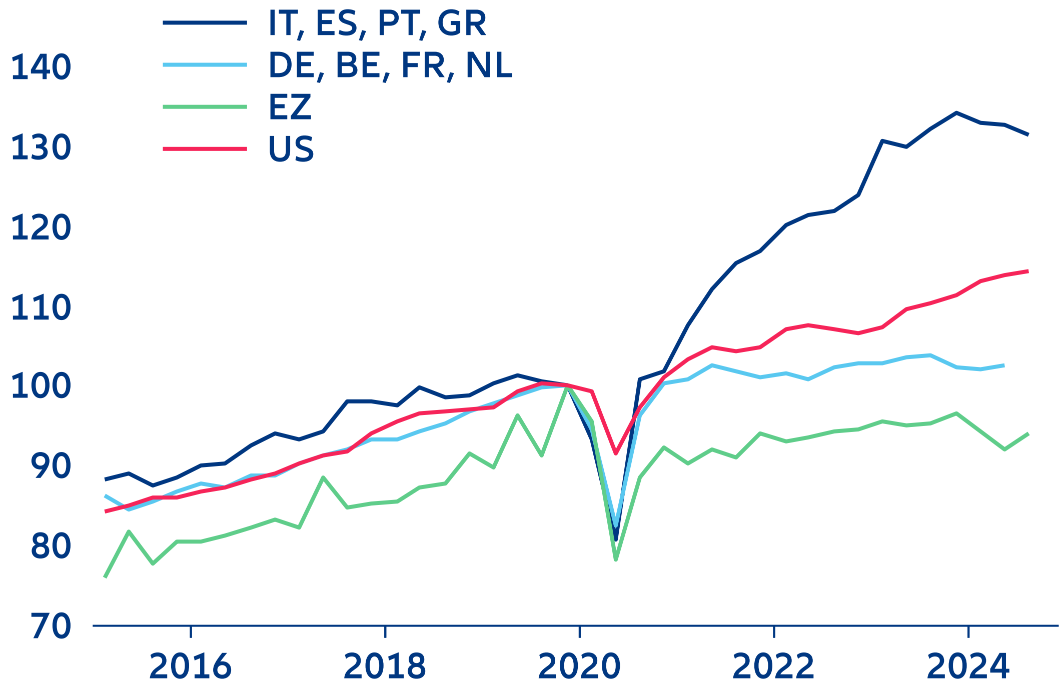
Heterogenous disbursement paths across countries, and risk of further delays remain



Sources: European Commission, Allianz Research. Note: the RRF is a performance-based instrument; funds are disbursed when Member States have satisfactorily fulfilled key steps in the implementation of the reforms and investments which are referred to as milestones (qualitative) and targets (quantitative).

The funds have helped boost the pace of investment growth in Southern Europe

Gross fixed capital formation, 2019=100



Sources: LSEG Datastream, Allianz Research

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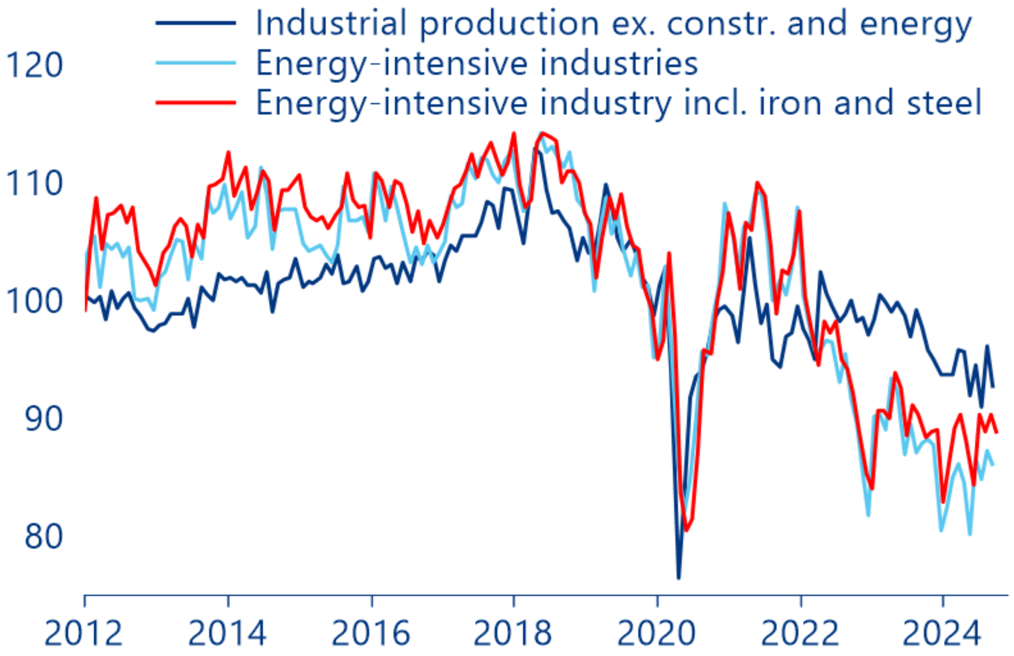
Germany struggles with high energy costs, lack of competitiveness, and reform delays

Energy-intensive industries have taken a hit from high energy costs

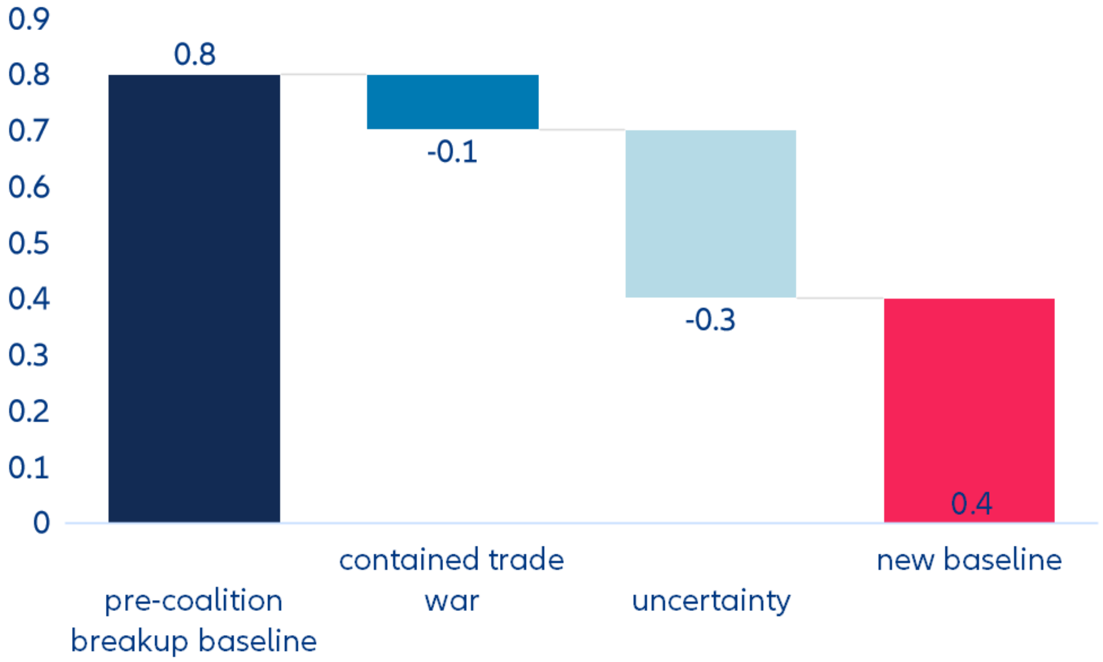
Index, Feb 2022 = 100



Sources: LSEG Datastream, Allianz Research

German GDP growth outlook 2025 revised to the downside amid trade war and uncertainty

y/y in %



Sources: LSEG Datastream, Allianz Research

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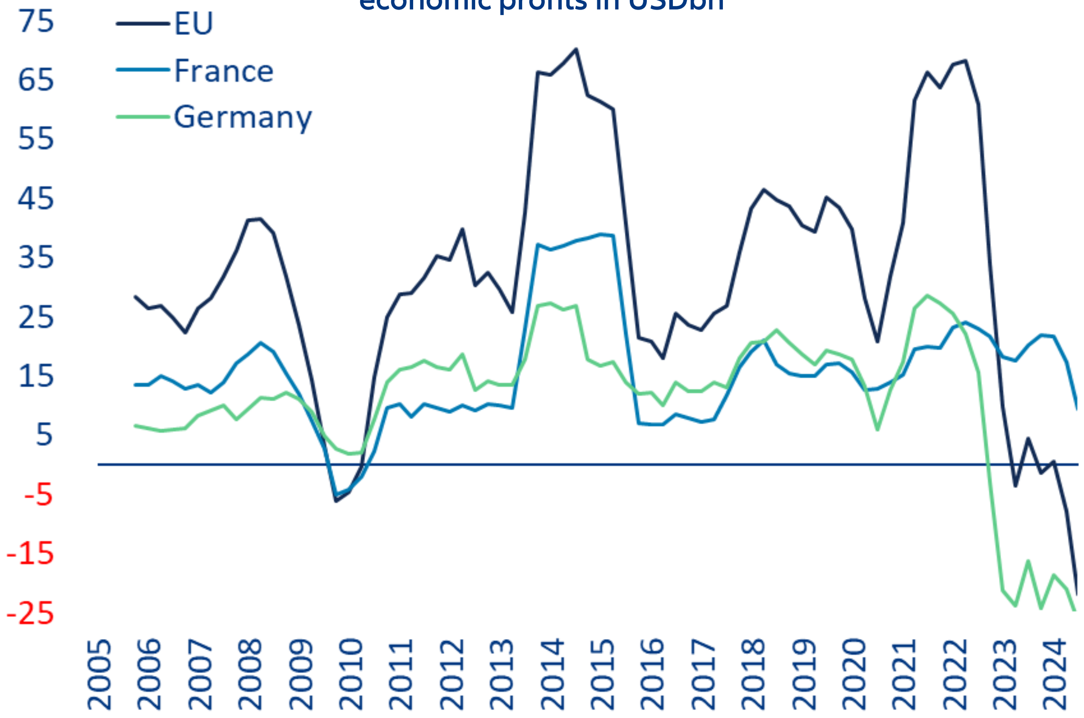
Germany needs a new direction and a close alliance between politics and business

Total value creation dropped post-pandemic to historically low levels

economic profits in USDbn



Sources: Crux of Capitalism, Allianz Research

Less regulation, more investment

Increase investment in infrastructure, decarbonization and digital innovation to 5% of GDP, maintain competitiveness

Double innovation investment to 6% of GDP (currently 3.1%), especially in future technologies

Decarbonization through green technology and consistent energy strategy (grid expansion and price decoupling of fossil and clean energy); EUR838bn by 2035

Globalization is over: Reduce dependencies by redesigning value chains, rethink German model – focus on 2-4 future tech sectors

Prosperity must come from within Europe: Streamlining of regulation, standardization of industrial policy, consolidation of capital markets and financial systems

Sources: Allianz Research

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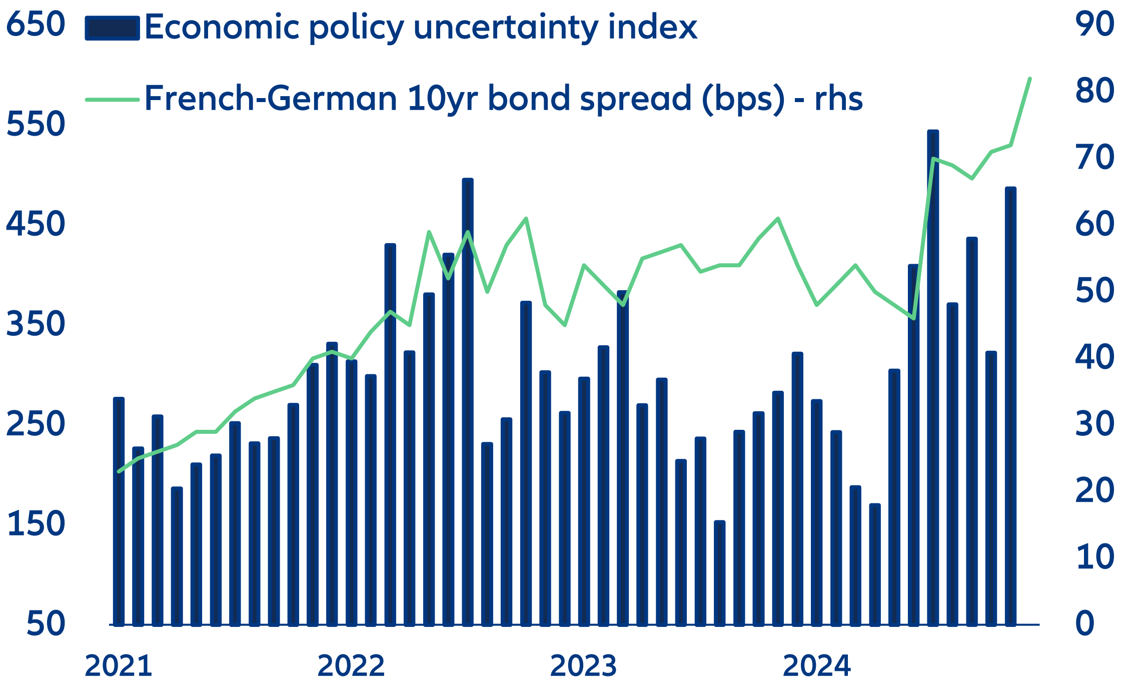
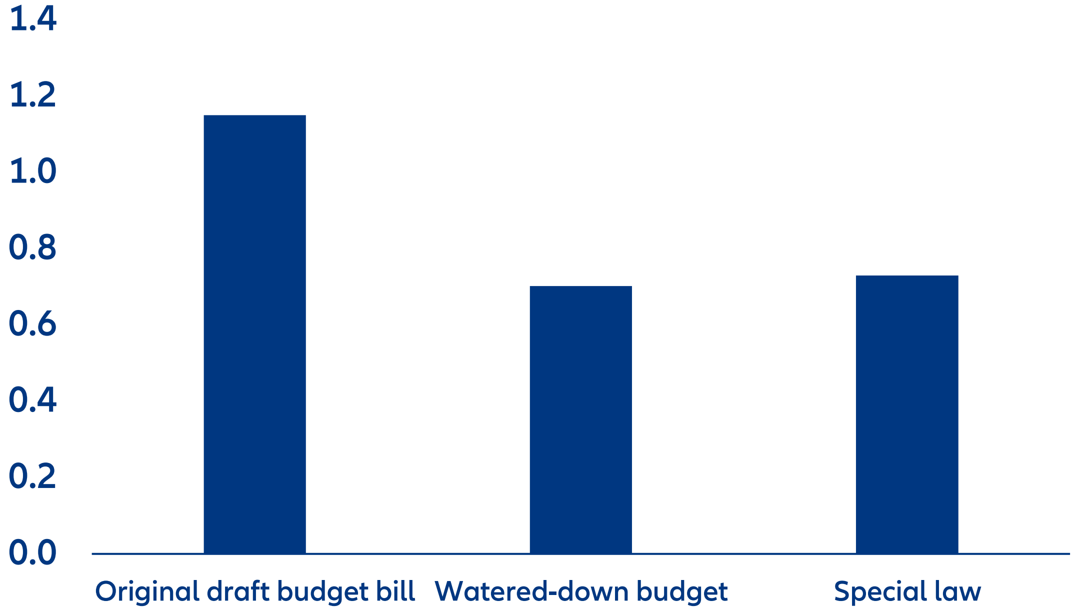
Political uncertainty will weigh on growth while deficits will remain high

Large increase in uncertainty and widening of bond spread



Sources: LSGE Workspace, Allianz Research

The size of the fiscal adjustment in 2025 will be lower than initially planned (change in structural balance, % GDP)



Sources: Allianz Research

* Special law = rolling over of the 2024 budget, with frozen central government spending and increase in income tax ("bracket creep").

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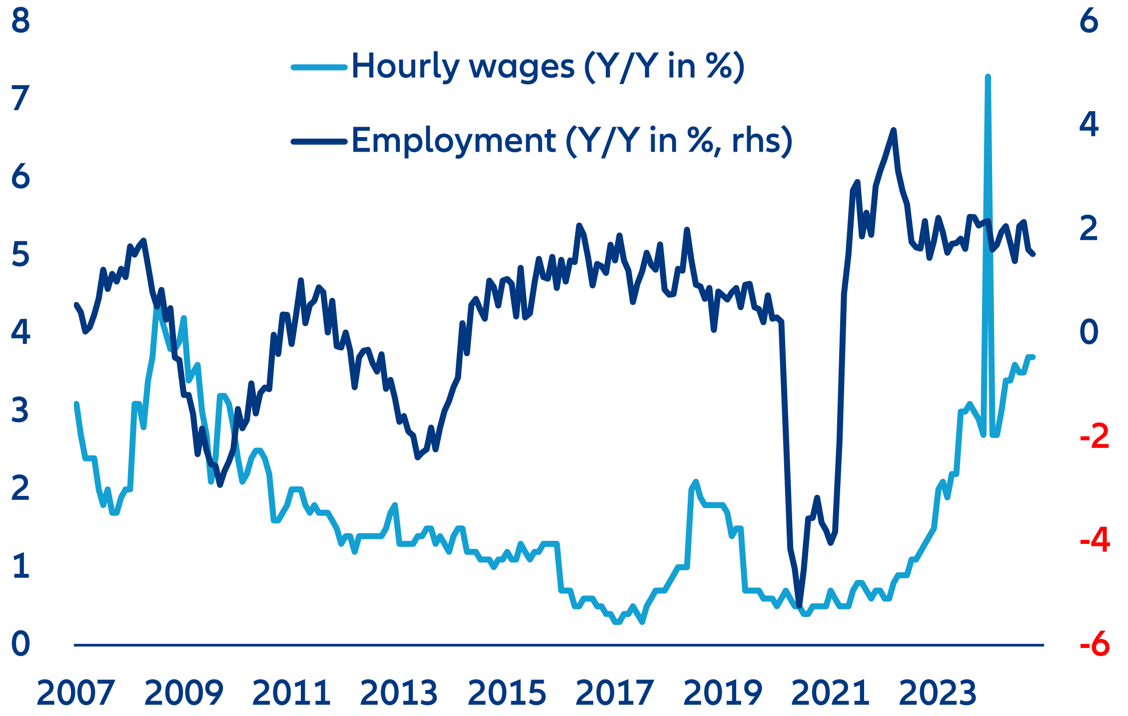
Subtle signs of economic softening while embarking on fiscal efforts

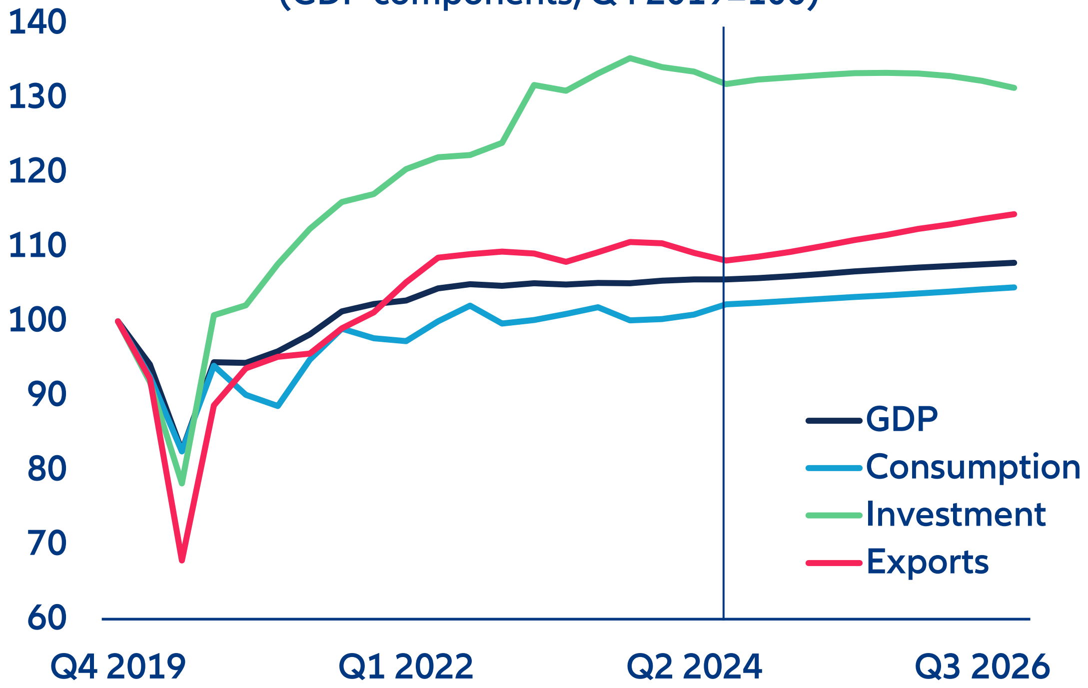
A resilient labor market and wages recovery will support consumption..



Sources: LSGE Workspace, Allianz Research

..while NGEU catch up will not make up for the 2020-2023 Superbonus boost

(GDP components, Q4 2019=100)



Sources: LSGE Workspace, Allianz Research

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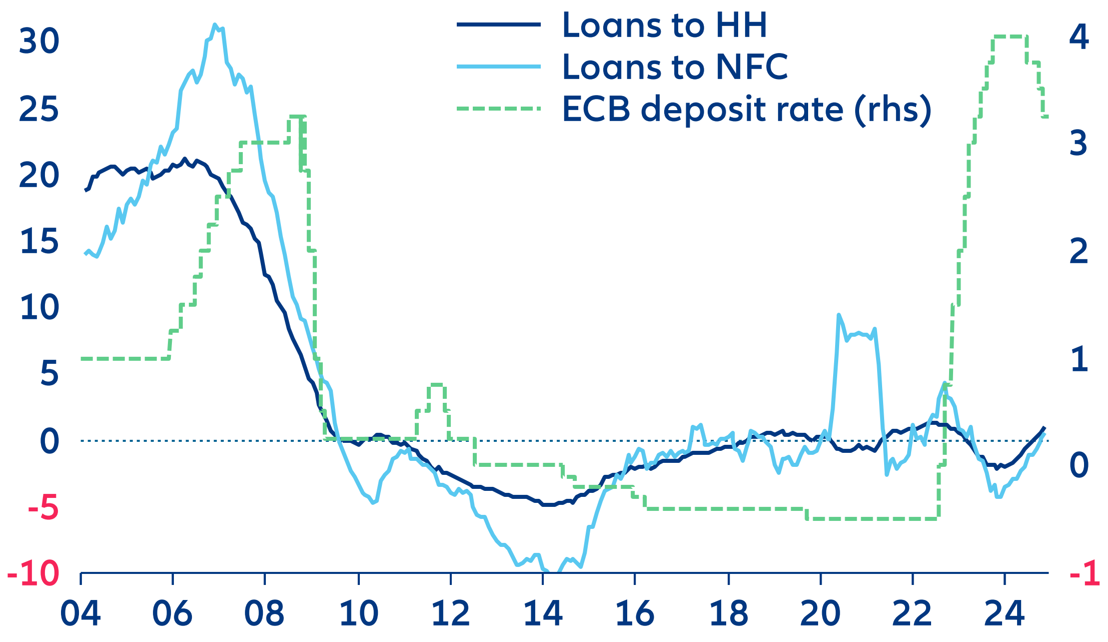
Investment and consumption will try to catch up with exports

Monetary policy easing should support private consumption and corporate investment in 2025..

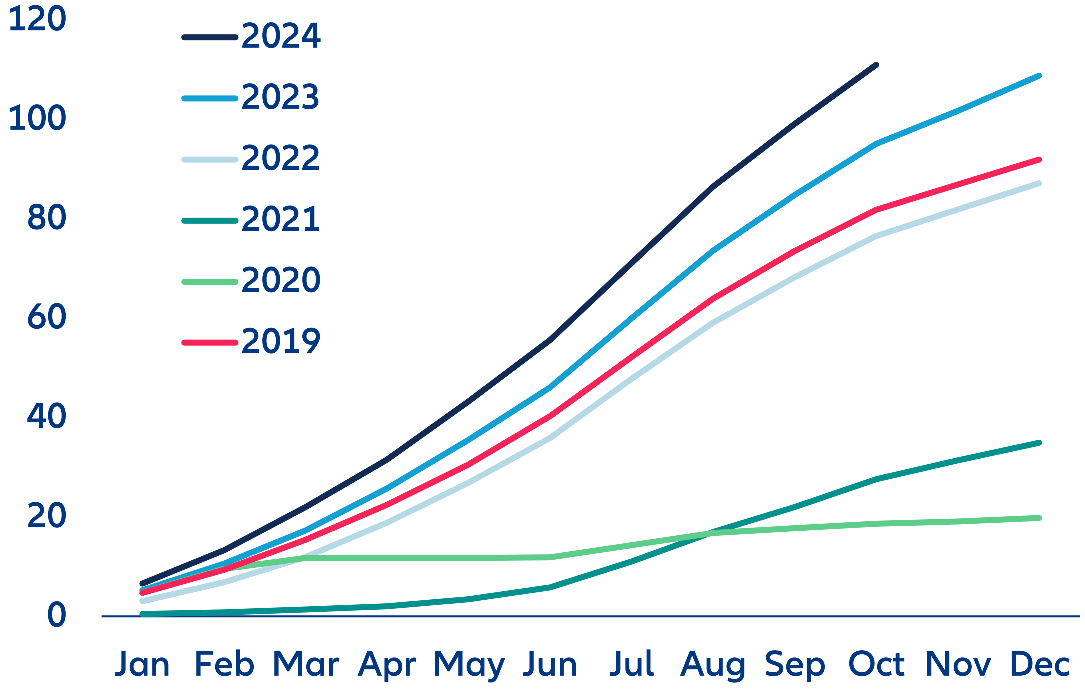
loan growth, % y/y



Sources: INE, Allianz Research

..while tourist expenditure will surpass EUR 120 bn this year

cumulative monthly expenditure, EUR bn



Sources: INE, Allianz Research

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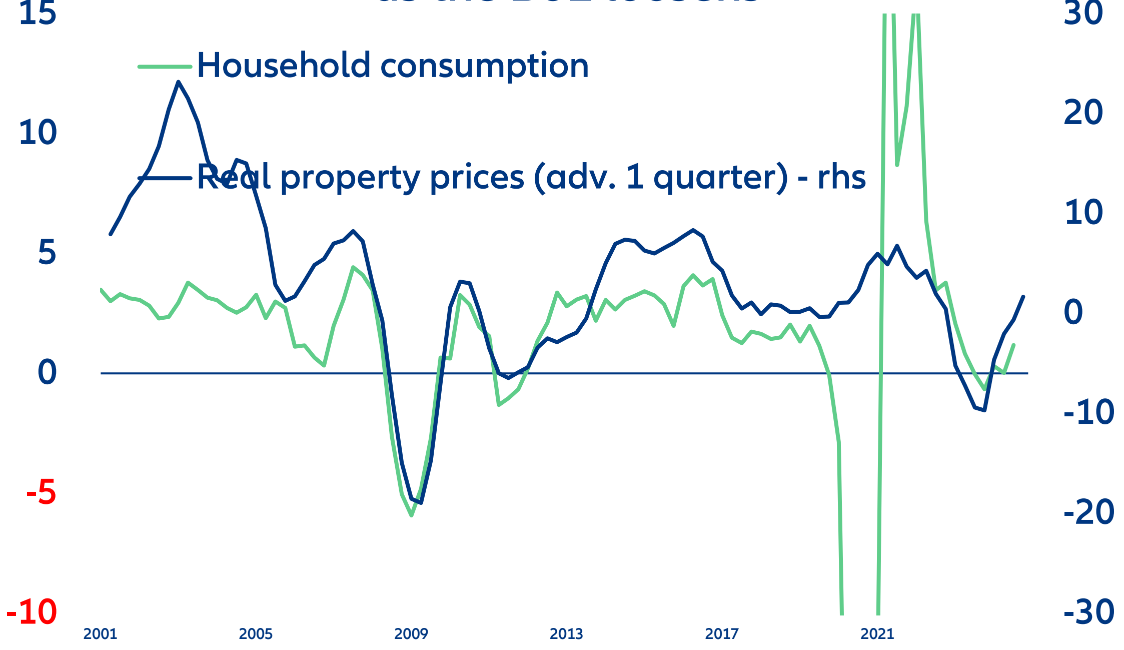
Growth momentum to improve amid looser financial conditions but tax hikes a downside risk

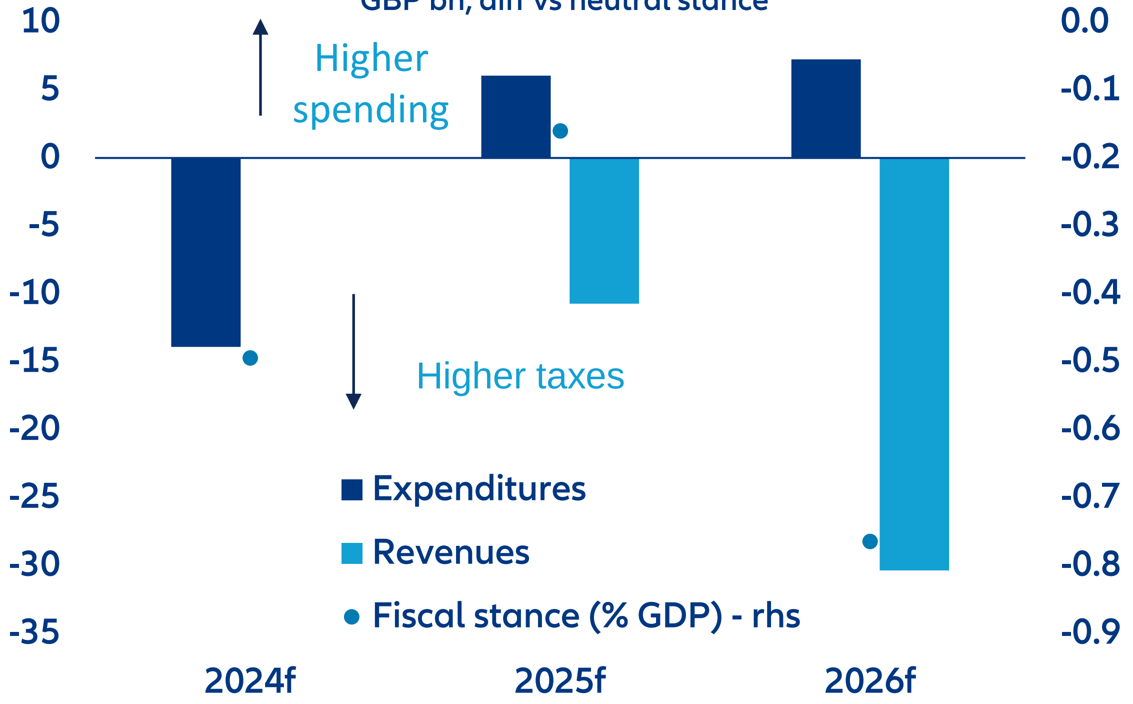
Positive wealth effects should support household consumption as the BoE loosens



Sources: LSGE Workspace, Allianz Research

Tax set to increase from 2025, notably the National Insurance

GBP bn, diff vs neutral stance



Sources: LSGE Workspace, Allianz Research

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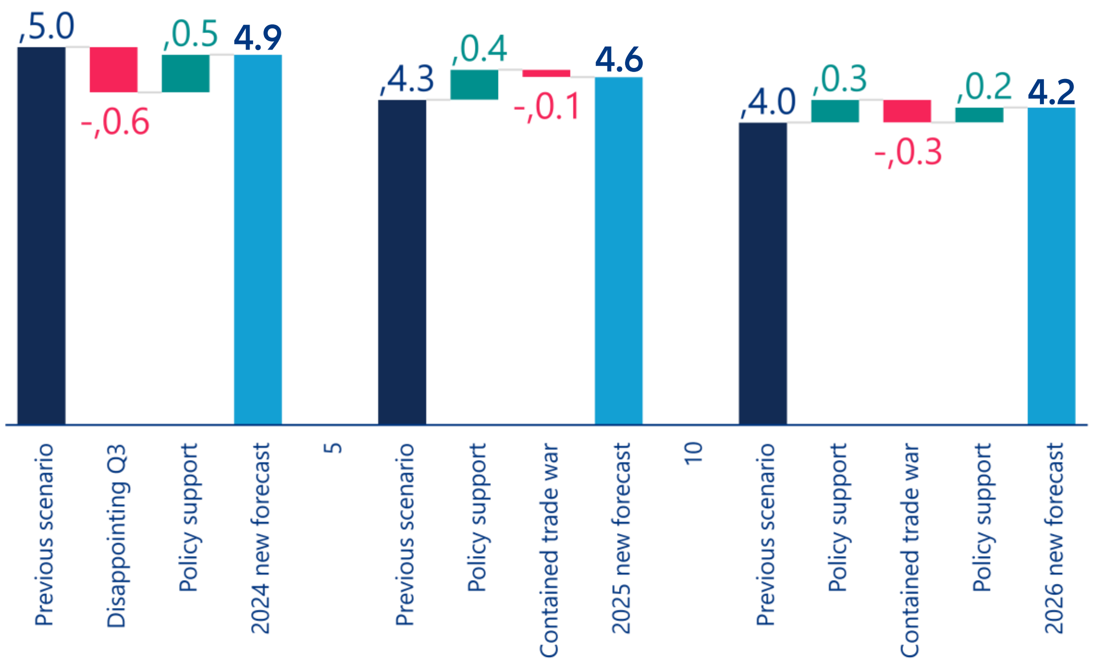
Policy support to cushion but not prevent an economic slowdown in coming years

The contained trade war and still soft domestic demand weigh on the economic outlook

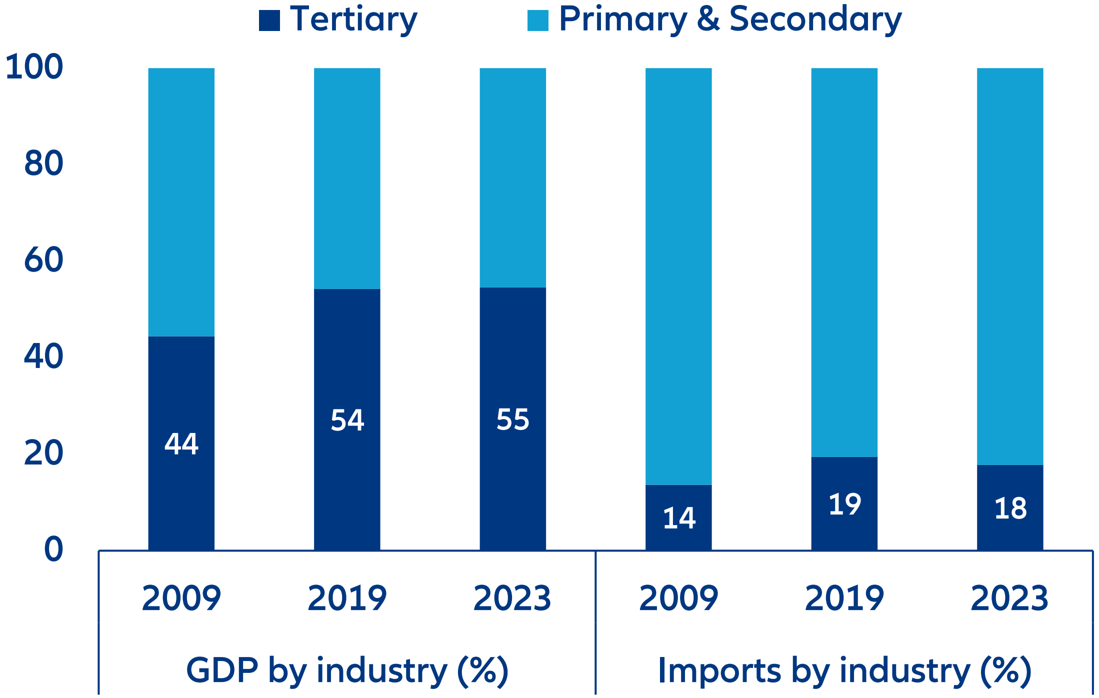
2024, 2025 and 2026 GDP growth forecasts revisions



Sources: national sources, Allianz Research

Chinese growth is benefitting less the rest of the world, in part due to the continued rise of services

Breakdown of GDP and imports by industry (%)



Sources: national sources, Allianz Research

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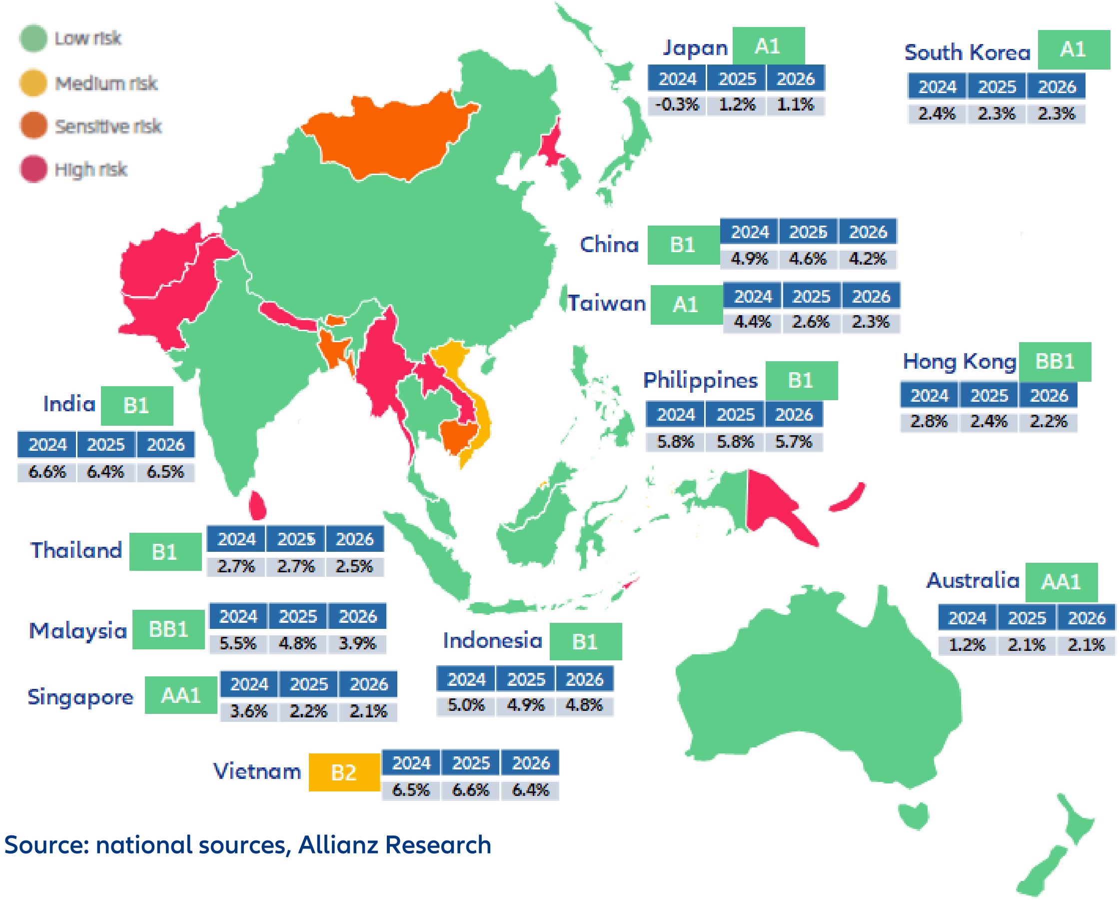
EM Asia resilience thanks to monetary easing and promising long-term trade potential

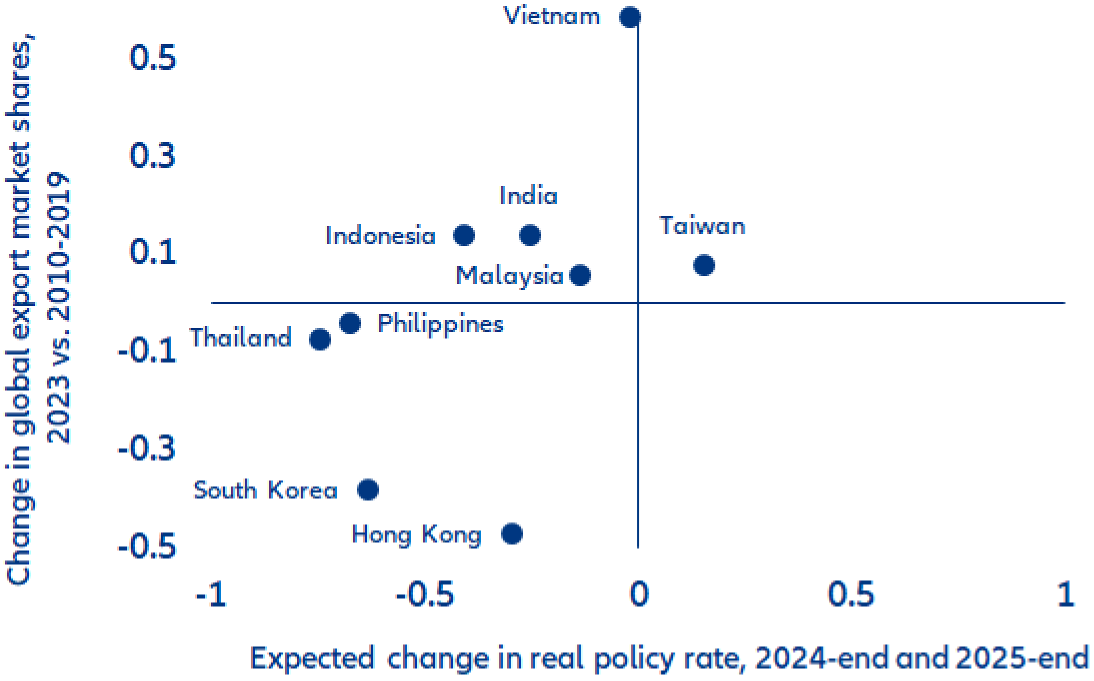
Growth to moderate in 2025-26 but remain robust

GDP growth forecasts and short-term country risk, as of Q4 2024



Source: national sources, Allianz Research

Resilience stems from expected monetary easing and still strong export potential in most of EM Asia



Sources: national sources, ITC, Allianz Research

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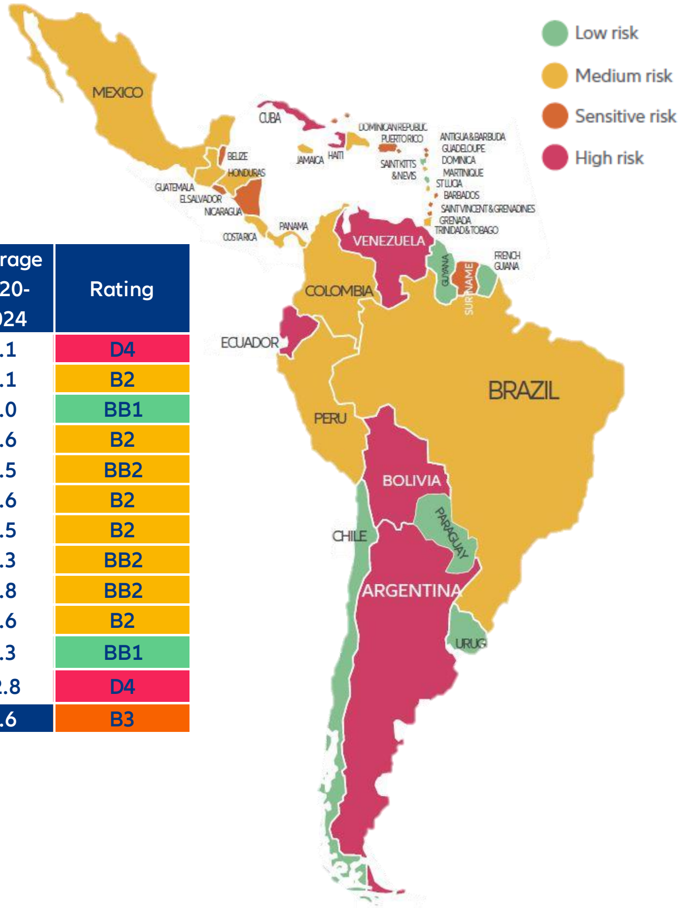
Will economic growth or inflation last longer?

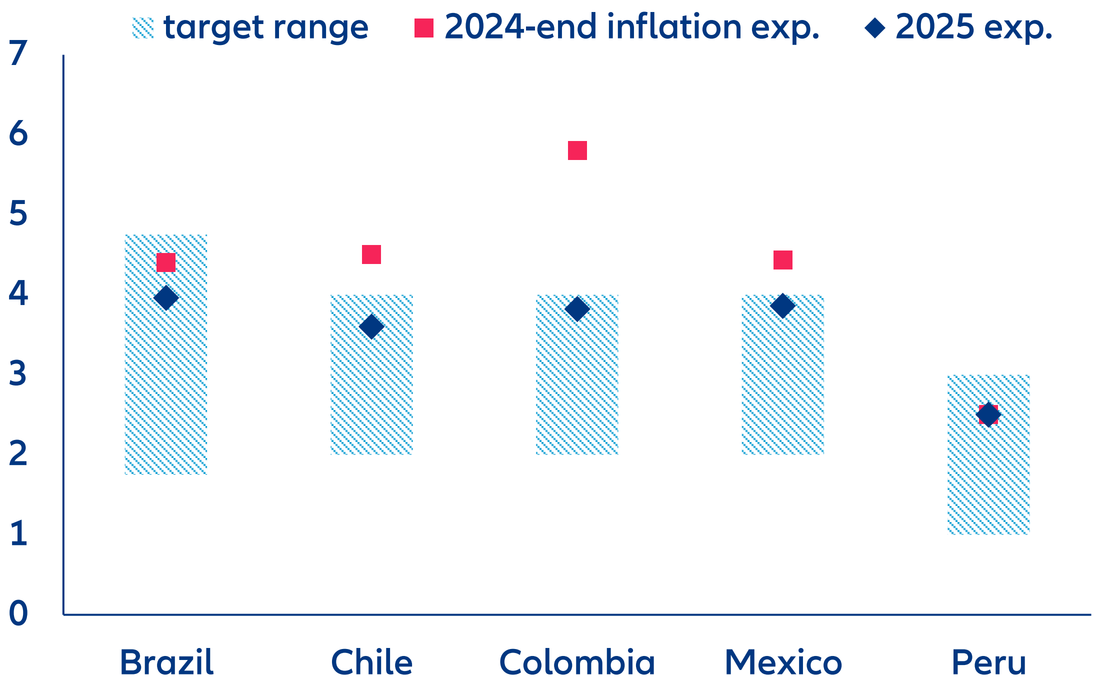
Our short-term country risk indicators point towards an overall improvement, but fragilities remain



GDP (real growth, %)	2024	2025	2026	Average 2020-2024	Rating
Argentina	-3.5	4.0	4.7	0.1	D4
Brazil	3.0	2.5	2.3	2.1	B2
Chile	2.4	2.3	3.0	2.0	BB1
Colombia	1.6	2.5	3.5	2.6	B2
Costa Rica	4.0	3.5	3.5	3.5	BB2
Dominican Republic	5.0	4.5	4.0	3.6	B2
Guatemala	3.5	3.6	3.7	3.5	B2
Mexico	1.7	1.5	3.5	1.3	BB2
Panama	2.5	3.0	4.0	3.8	BB2
Peru	3.1	3.5	3.0	1.6	B2
Uruguay	3.2	3.0	2.6	1.3	BB1
Venezuela	3.0	4.5	3.5	-2.8	D4
LatAm	2.0	2.6	3.1	1.6	B3

Source: Allianz Research

Inflation at year-end still above or in the upper-end of the target band (pps)



Sources: LSEG Datastream, Allianz Research

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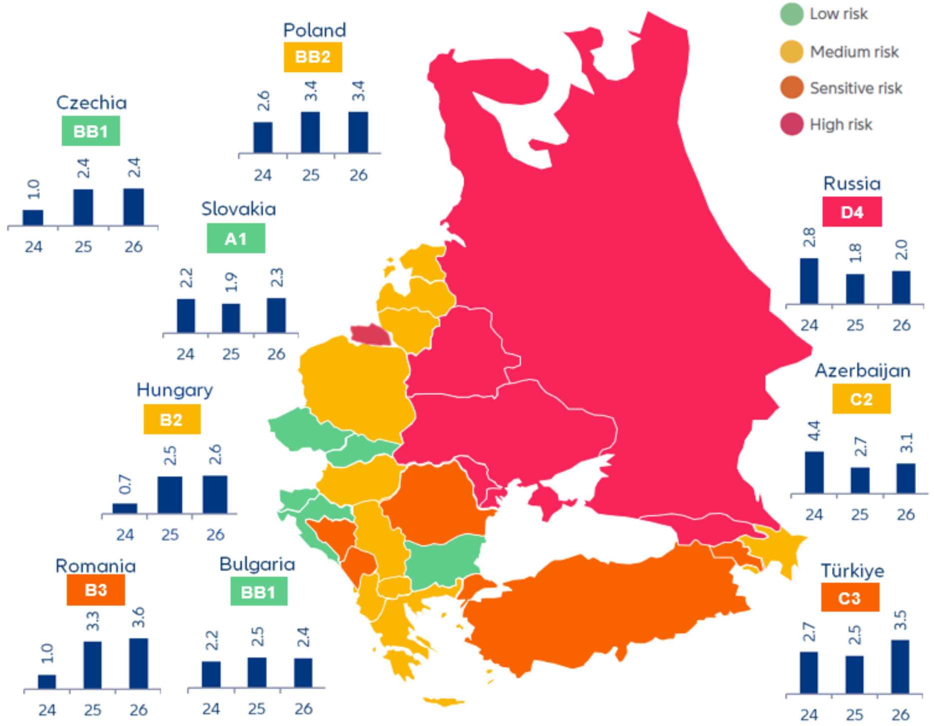
Growth in CEE gains momentum supported by double-digit wage increases

Improved growth prospects in Central and Eastern Europe in 2025

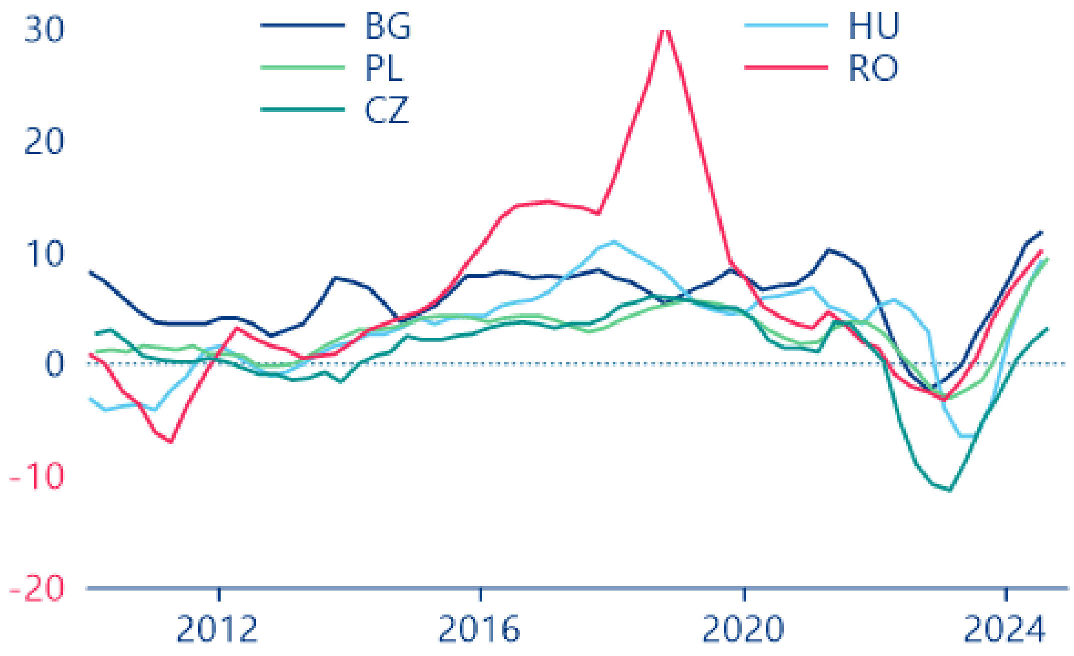
y/y in %



Sources: Allianz Research

Real wage growth has surged in the region

y/y in %



Sources: LSEG Datastream, Allianz Research

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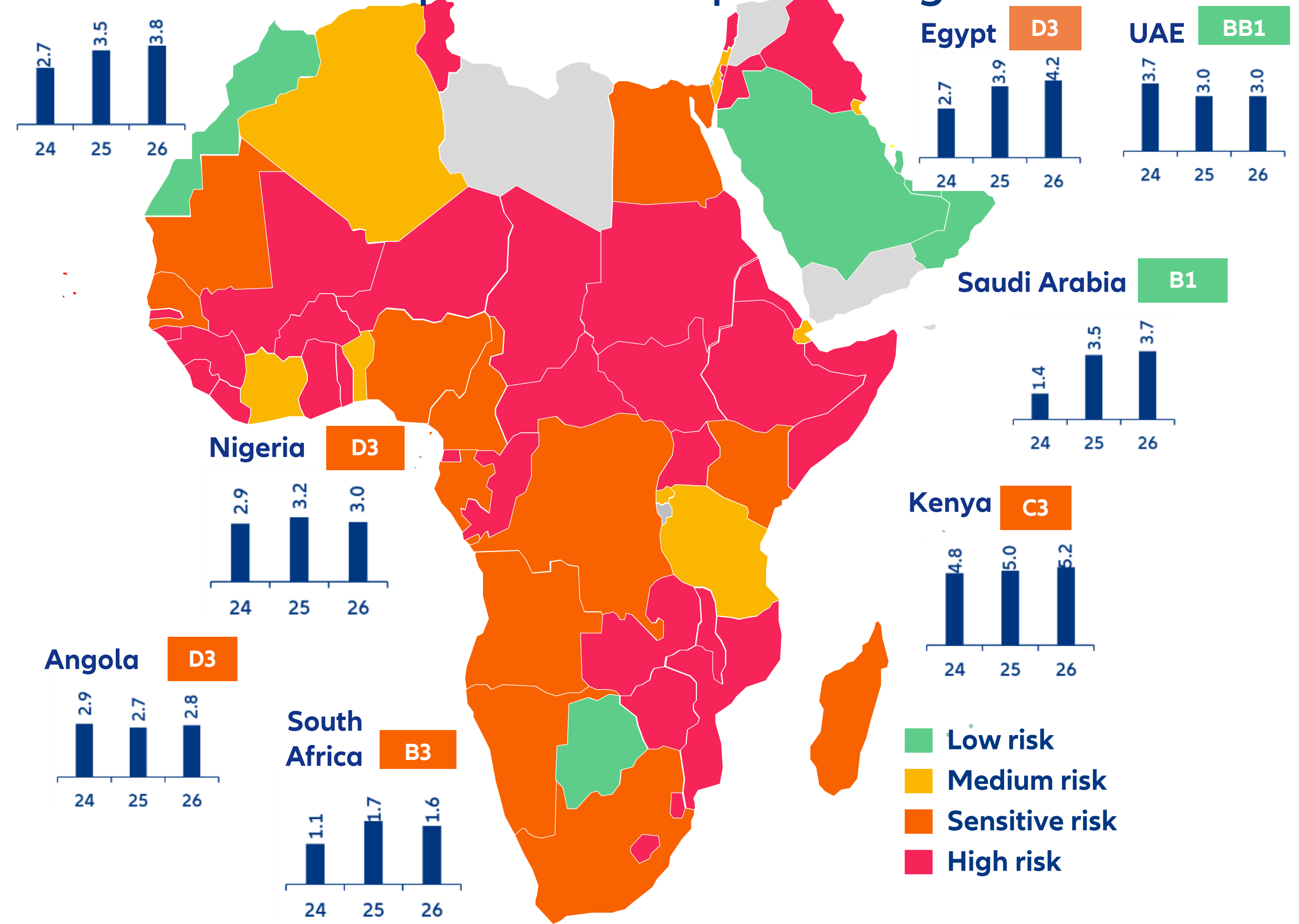
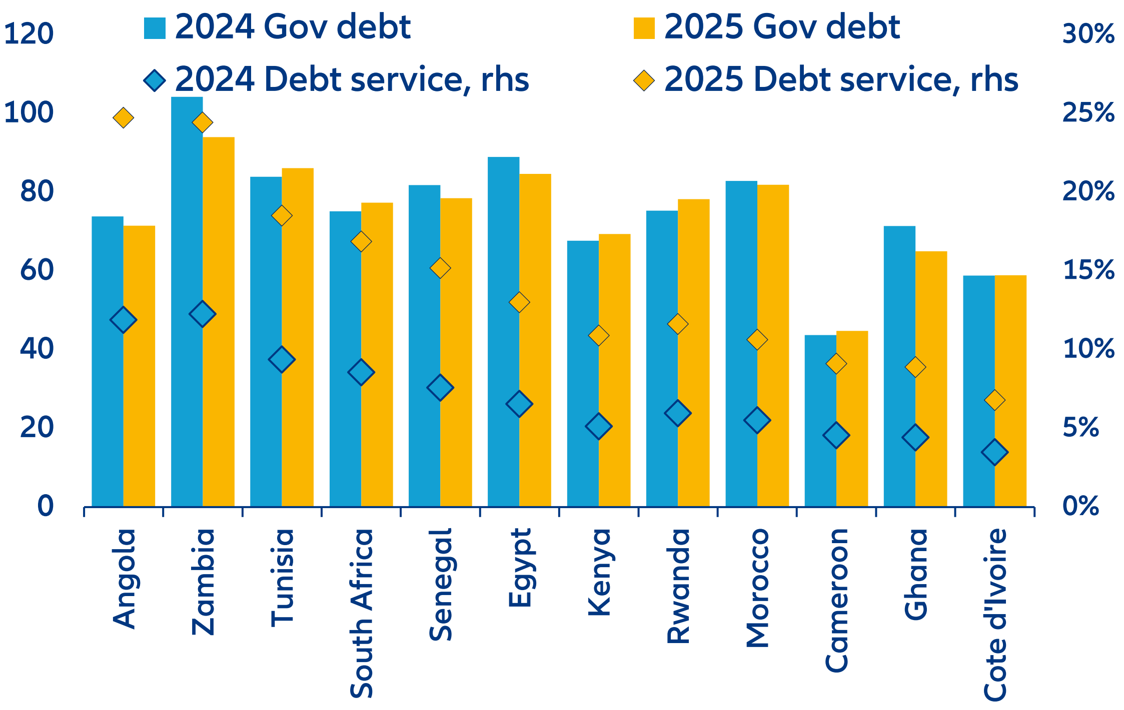
Debt, liquidity and oil continue to dictate the region's outlook

GDP growth to pick up slightly in 2025, with oil exporters underperforming



Debt service to increase throughout the continent, while government debt starts to stabilize (% of GDP)



Sources: Oxford Economics, AZT Research

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Capital Markets outlook

2025-2026

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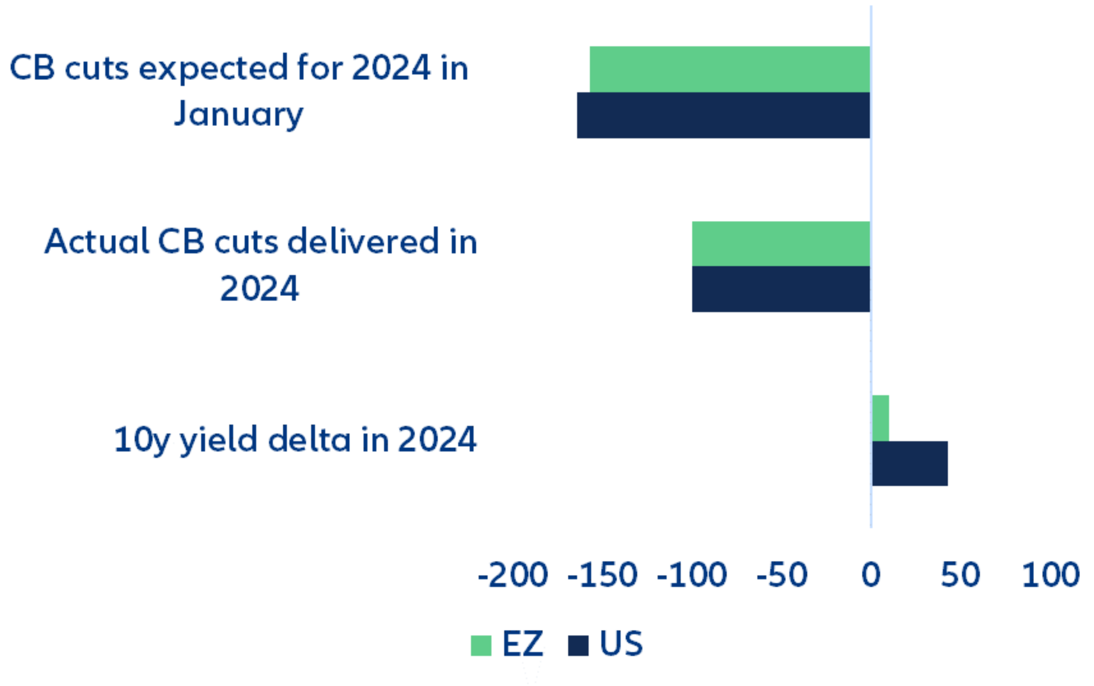
Hard landing risks have not materialized in 2024 keeping rates and equity markets up

Instead of the initial 160bps of rate cuts expected by markets, only a 100bps have been delivered in 2024

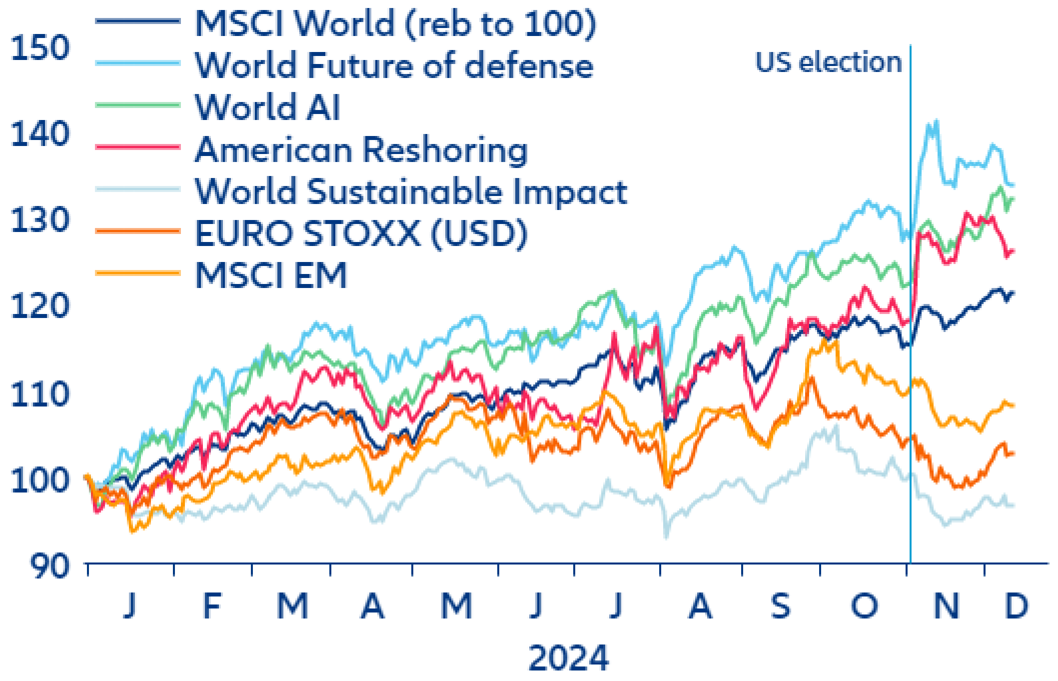
bps



Sources: Bloomberg, Allianz Research

Nevertheless, equity markets soared on defense, AI and American reshoring while Europe struggled

Index Jan 2024=100



Sources: LSEG Datastream, Allianz Research

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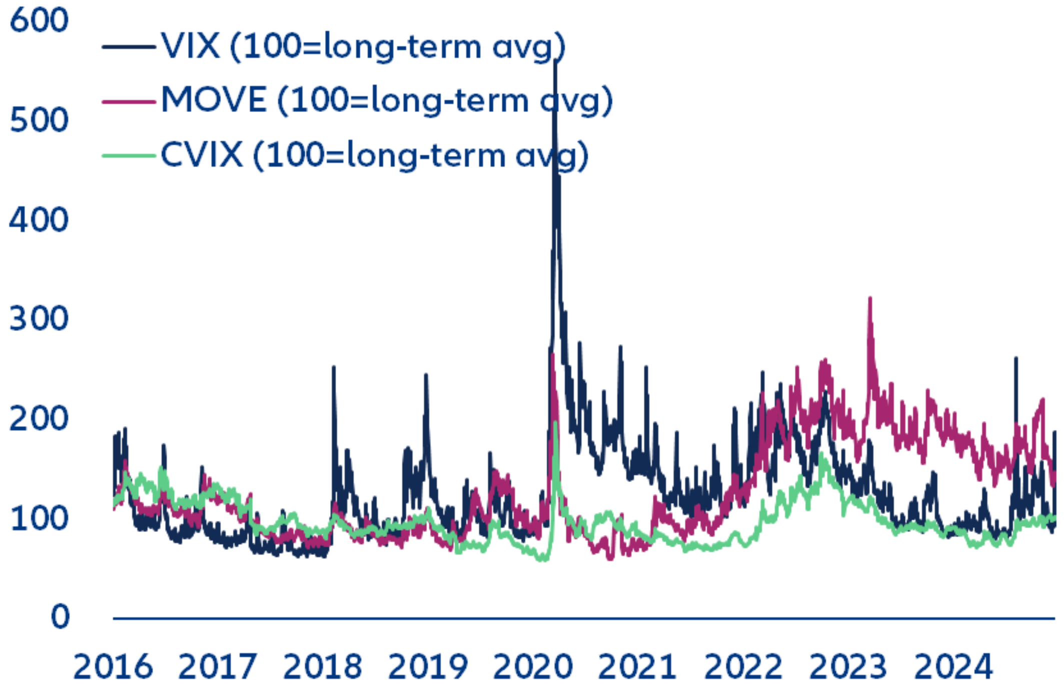
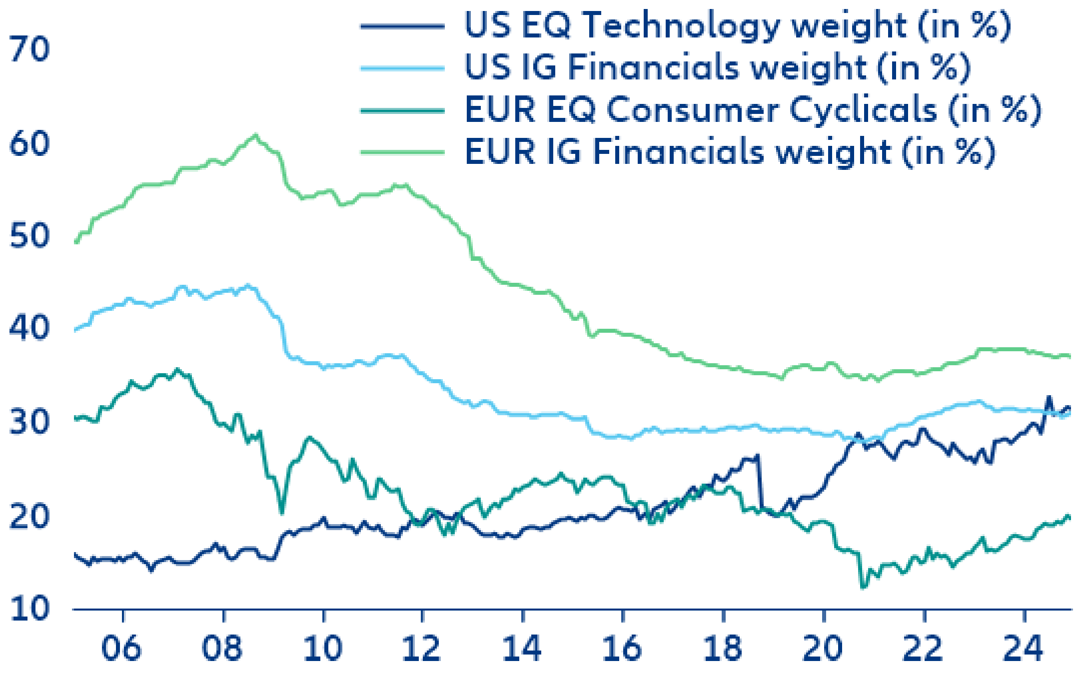
Uncertainty has fallen after the super-election year and the start of the global monetary easing cycle

Investors anticipate less volatility in equities, rates and currencies as election uncertainty fades…



Sources: Bloomberg, Allianz Research
Notes: VIX is an option-based measure of expected volatility in equity markets, MOVE for US treasury markets and CVIX for FX markets.

… but concentration risk across risky assets remains one of the biggest threats to market stability



Sources: LSEG Datastream, Allianz Research

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The dollar and bonds echo 2016 post-Trump election while equities diverge

2024

	18/12/2024		Trump wins (first day market reaction)	Trump wins (overall reaction until 18.12.2024)	Trump wins fst 100d in office (reaction until 30.4.2025)
S&P500	5872	%	2.5%	1.5%	?
RUSSEL 2000	2232	%	5.8%	-1.3%	
STOXX600	514	%	-0.5%	1.0%	
Oil Brent	73	%	-0.8%	-2.8%	
EURUSD	1.04	%	-1.8%	-5.3%	
US 10Y	4.51	bps	16	24	
DE 10Y	2.24	bps	-2	-18	
US 2Y (central bank expectations)	4.35	bps	9	18	
DE 2Y (central bank expectations)	2.02	bps	-12	-27	
US 2y inflation swap (infl. exp.)	2.55	bps	20	13	
DE 2y inflation swap (infl. exp.)	2.07	bps	0	-10	

2016

	18/12/2016		Trump wins (first day market reaction)	Trump wins (overall reaction until 18.12.2016)	Trump wins fst 100d in office (reaction until 30.4.2017)
S&P500	2258	%	1.1%	5.5%	11.4%
RUSSEL 2000	1364	%	3.1%	14.1%	17.2%
STOXX600	360	%	1.5%	7.5%	15.6%
Oil Brent	55	%	0.7%	19.9%	12.4%
EURUSD	1.05	%	-1.1%	-5.2%	-1.2%
US 10Y	2.59	bps	20	74	43
DE 10Y	0.31	bps	2	13	13
US 2Y (central bank expectations)	1.25	bps	4	40	41
DE 2Y (central bank expectations)	-0.81	bps	0	-17	-10
US 2y inflation swap (infl. exp.)	2.06	bps	4	13	-6
DE 2y inflation swap (infl. exp.)	1.29	bps	-2	28	59

This time is different:

- Fed was in a hiking cycle in 2016 (now cutting)
- Stocks were "cheap" in 2016, now "expensive" (PE ratio, ERP)
- Trade war in first Trump presidency started only in 2018, now it is expected to start after inauguration

Sources: Bloomberg, Allianz Research

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Markets to navigate the aftermath of the super-election year

Capital Markets: Eurozone and US

year-end figures

EMU	Last*	Unit	2022	2023	2024f	2025f	2026f
Government Debt							
ECB deposit rate	3.00	%	2.00	4.00	3.00	2.00	2.00
10y yield (Bunds)	2.24	%	2.56	2.03	2.20	2.00	2.00
10y EUR swap rate	2.23	%	3.14	2.48	2.20	2.10	2.10
20y EUR swap rate	2.23	%	2.87	2.51	2.20	2.20	2.20
Italy 10y sovereign spread	116	bps	213	168	120	100	90
France 10y sovereign spread	81	bps	55	53	80	80	70
Spain 10y sovereign spread	70	bps	109	97	70	60	50
Corporate Debt							
Investment grade credit spreads	98	bps	166	135	105	105	100
High-yield credit spreads	303	bps	494	395	310	330	330
Equity							
Eurostoxx (total return p.a.)	11 ytd	%	-12	19	11	8	8

US	Last*	Unit	2022	2023	2024f	2025f	2026f
Government Debt							
Fed Funds rate (high)	4.50	%	4.50	5.50	4.50	4.25	3.50
10y yield (Treasuries)	4.50	%	3.83	3.87	4.40	4.10	4.00
Corporate Debt							
Investment grade credit spreads	79	bps	138	104	85	80	80
High-yield credit spreads	273	bps	479	334	280	300	300
Equity							
S&P 500 (total return p.a.)	25 ytd	%	-18	26	26	13	10

Capital Markets: UK, Emerging Markets, FX

year-end figures

UK	Last*	Unit	2022	2023	2024f	2025f	2026f
Government Debt							
BoE rate	4.75	%	3.50	5.25	4.75	3.25	3.25
10y yield sovereign (Gilt)	4.56	%	3.67	3.54	4.50	3.90	3.60
Corporate Debt							
Investment grade credit spreads	91	bps	192	134	95	95	90
High-yield credit spreads	337	bps	663	515	350	370	370
Equity							
FTSE 100 (total return p.a.)	10 ytd	%	5	8	10	8	7

Emerging Markets	Last*	Unit	2022	2023	2024f	2025f	2026f
Government Debt							
Hard currency spread (vs USD)	198	bps	273	215	210	220	205
Local currency yield	6.10	%	6.86	6.19	6.3	6.0	5.8
Equity							
MSCI EM (total return p.a. in USD)	10 ytd	%	-20	10	10	7	8

Others	Last*		2022	2023	2024f	2025f	2026f
EUR USD	1.05	$ per €	1.07	1.10	1.05	1.05	1.08
Oil (Brent)	75	$ per bl	83	78	75	78	75
Natural gas (Dutch TTF)	41	€ per MWh	76	32	38	37	34

Sources: LSEG Datastream, Bloomberg, Allianz Research
Notes: Year end figures
* As of 18.Dec 2024

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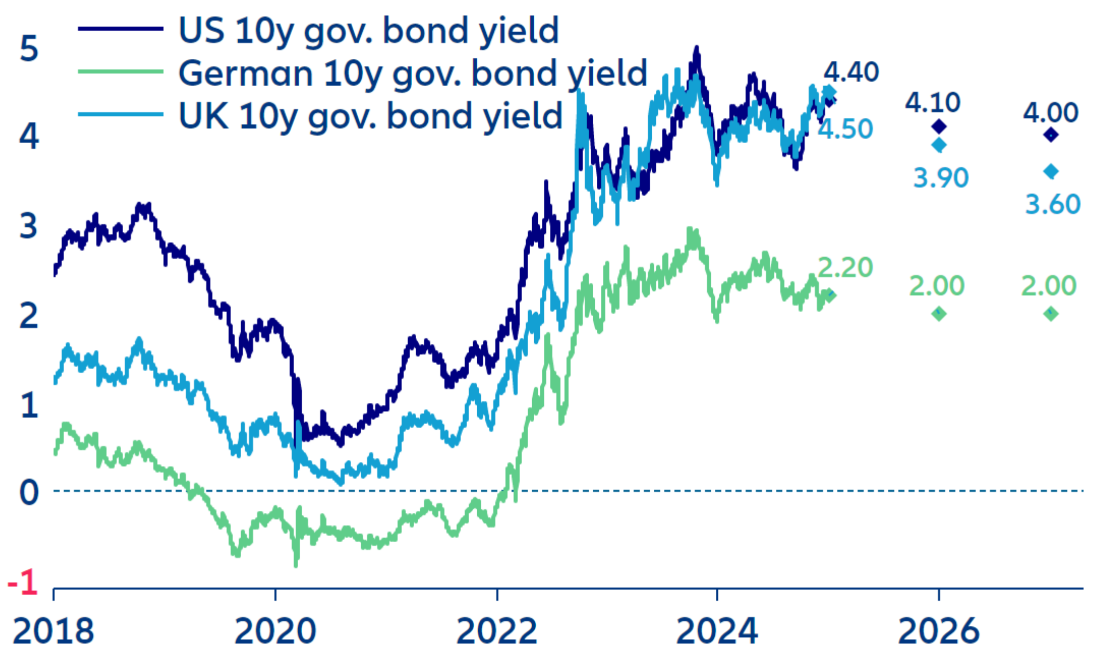
Long-term yields have priced in central bank easing but will increasingly depend on bond vigilantes

Sovereign bond yields to move sideways with lower policy rates largely priced in

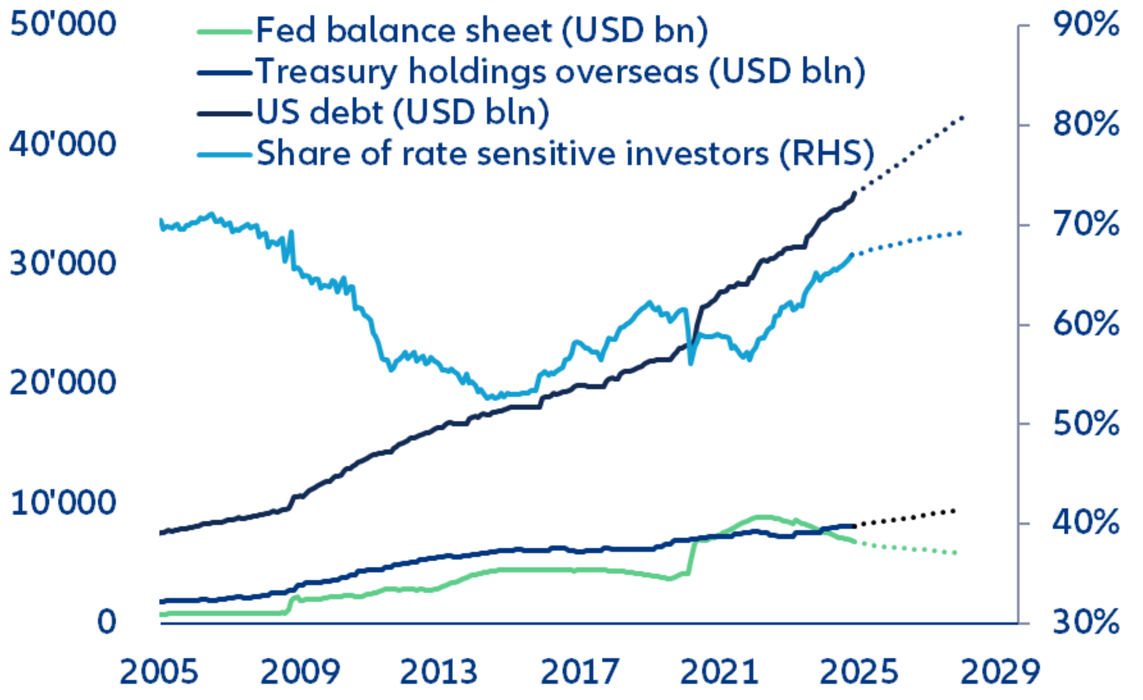
10y government bond yields in %



Sources: LSEG Datastream, Allianz Research

With the Fed and overseas investors reducing their ownership share, rate sensitive investors take over

USD bn (LHS), % (RHS)



Sources: LSEG Datastream, Allianz Research

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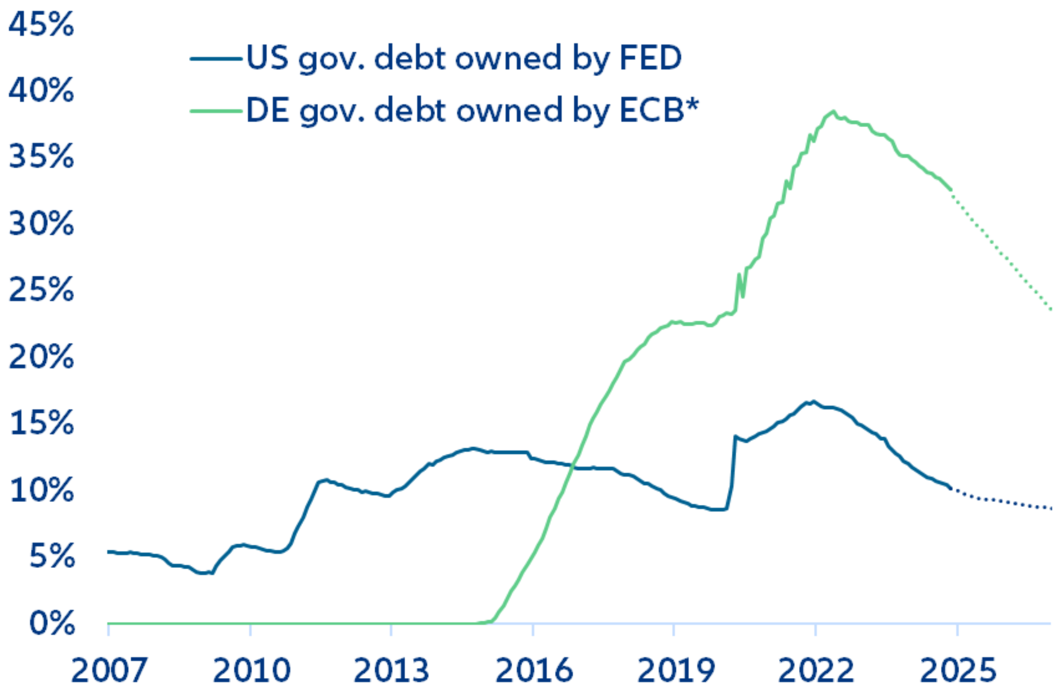
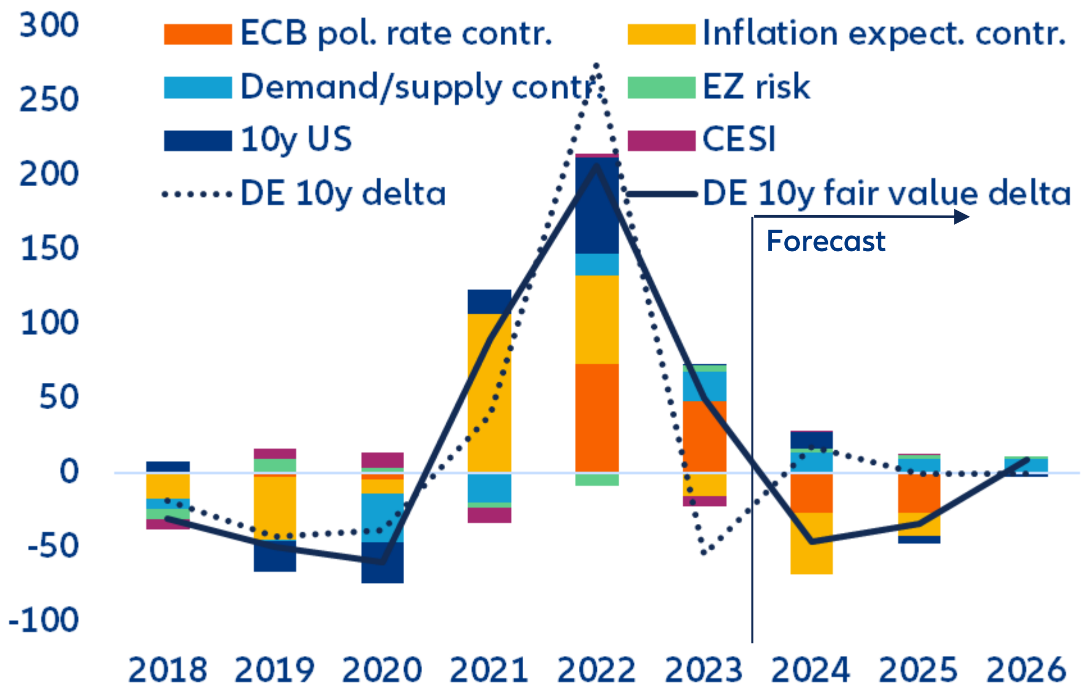
The ECB's accelerated QT offsets policy rate cuts and Germany's fiscal austerity

Germany’s high capital key & low debt led to ECB buying comparatively more bunds – now it’s selling



Sources: Bloomberg, Allianz Research

Nevertheless, policy rate cuts and falling inflation expectations outweigh demand & supply imbalance



Sources: Bloomberg, Allianz Research

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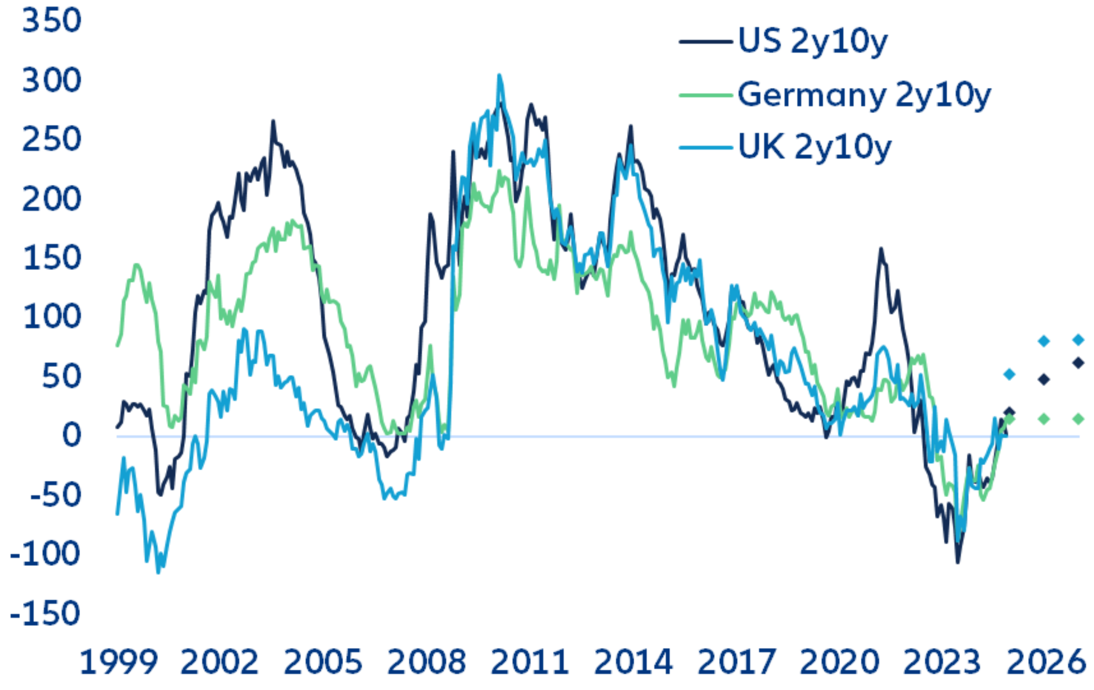
Monetary policy normalization will bull-steepen curves but it is not enough to save French spreads

Yield curve inversion to cease unevenly, Germany lags with comparatively high ECB terminal rate

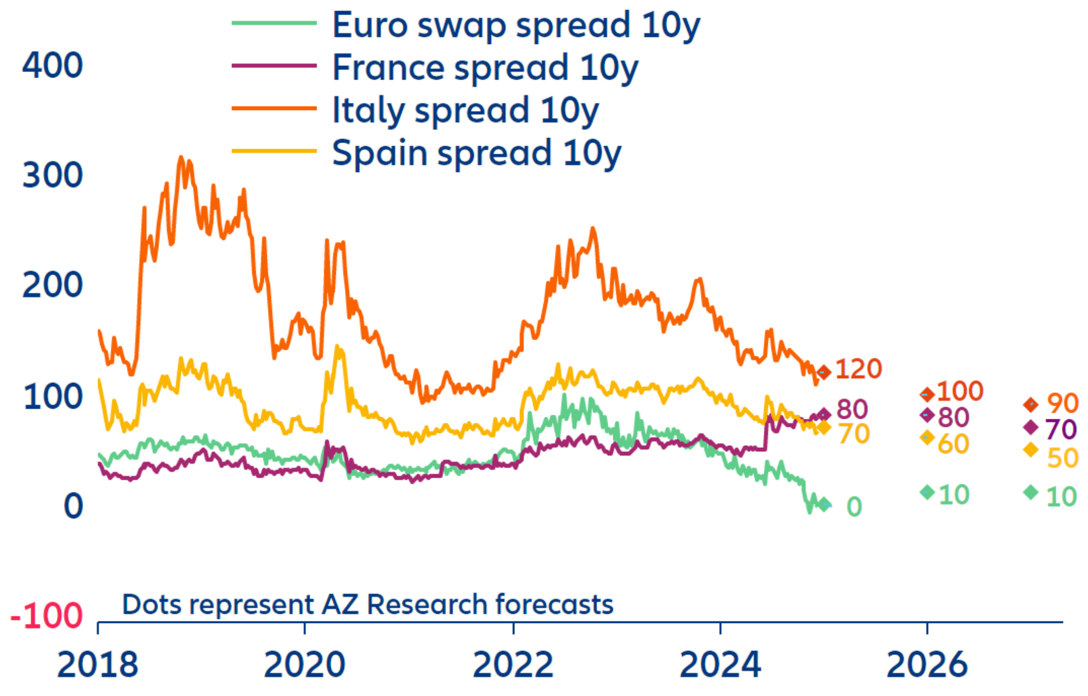
10y – 2y government bond yields in bps



Sources: LSEG Datastream, Allianz Research

Spread normalization continues except for France characterized by political turmoil and fiscal slippage

Yield spreads vs. 10y German bund yields in bps



Sources: LSEG Datastream, Allianz Research

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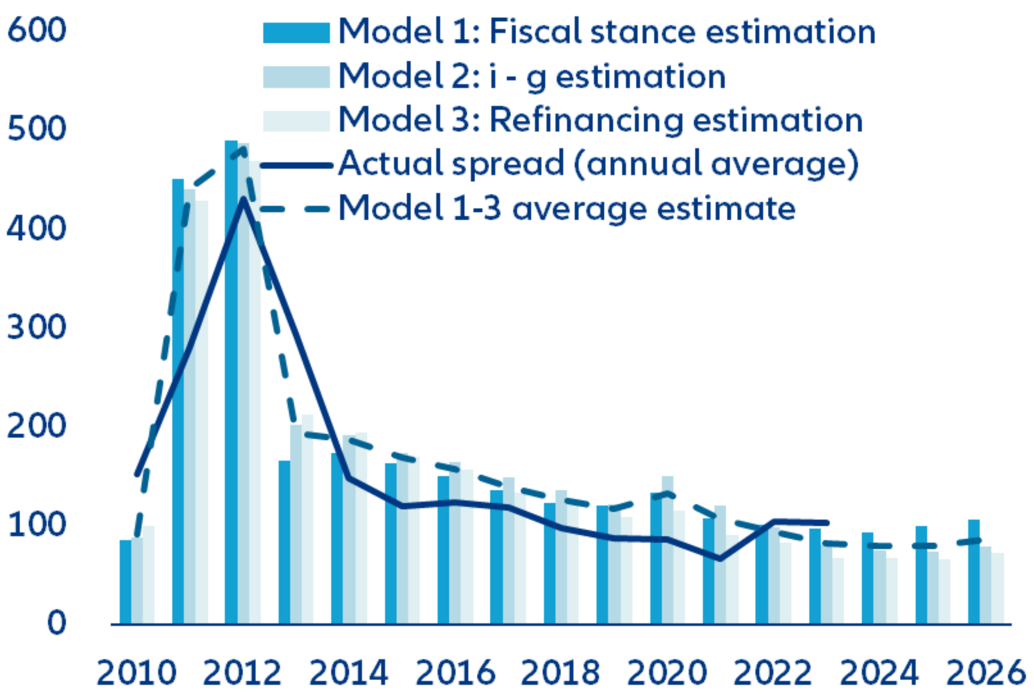
French government bond spreads prone to rise based on fundamentals while Spain outperforms

Fair value models showing lower spreads in Spain…

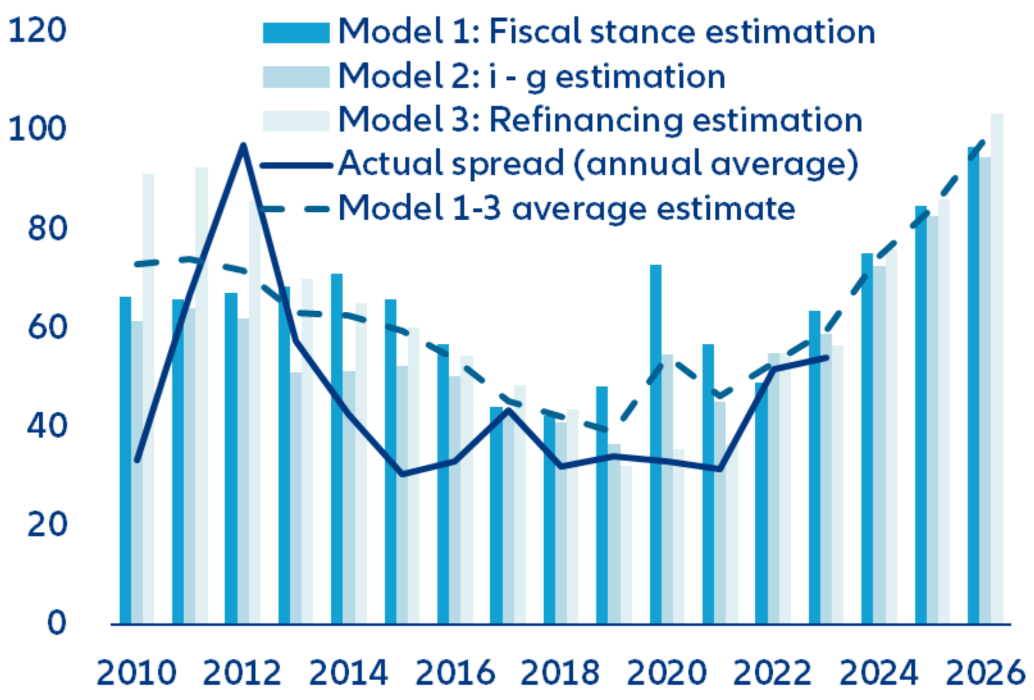
bps



Sources: LSEG Datastream, Allianz Research

… while indicating upward pressure in France

bps



Sources: LSEG Datastream, Allianz Research

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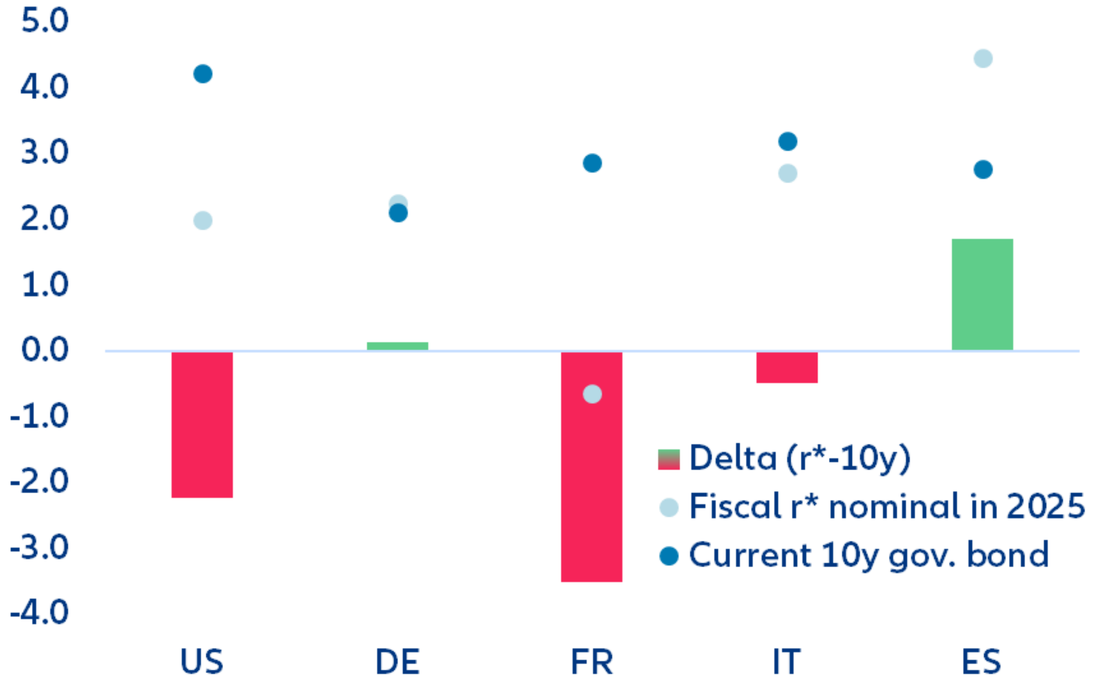
France's fiscal r* gap widens, while the US faces budget strain on serving its large debt stock

France faces a large fiscal r* gap, while Spain excels thanks to high nominal GDP growth

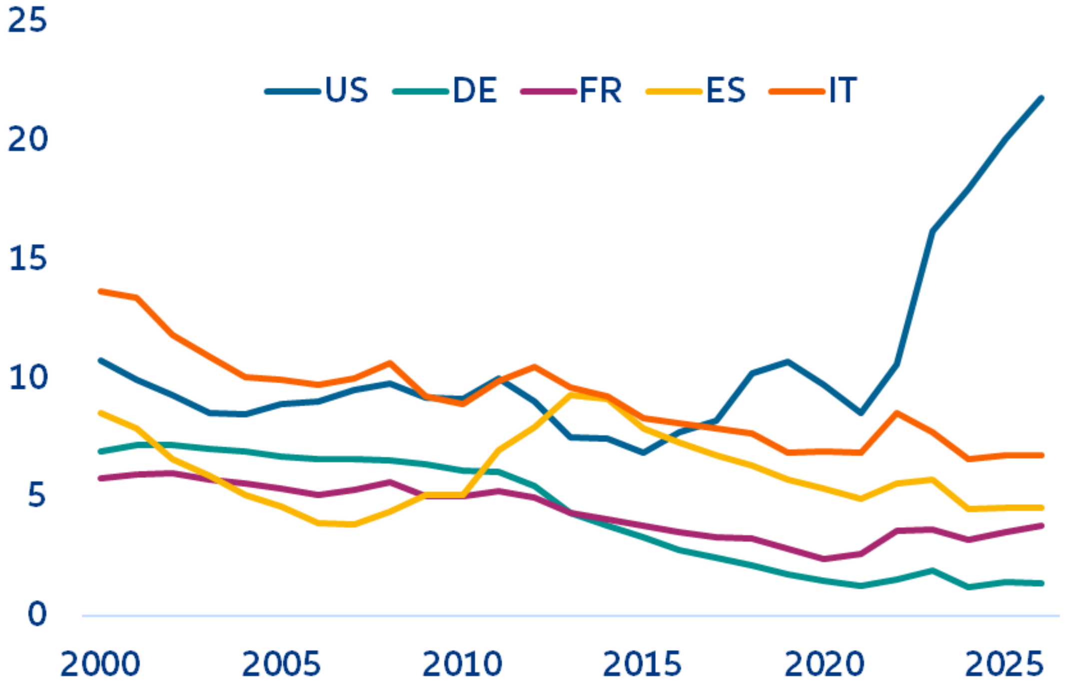
yields in %



Sources: LSEG Datastream, Allianz Research
Notes: Nominal fiscal r* is defined as the interest rate, that keeps debt/GDP levels stable given nominal GDP growth and primary deficit

But the US stands out with high interest payments eating up a slimmer government budget

Debt servicing in % of government receipts



Sources: LSEG Datastream, Allianz Research

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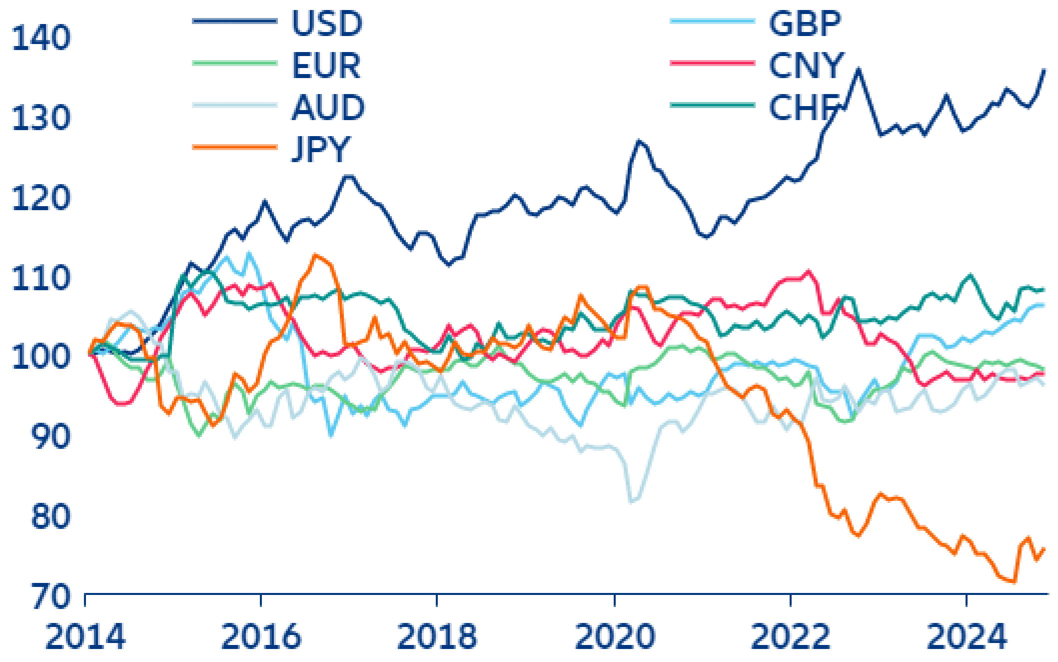
Strong Dollar reflects central bank divergence as Fed stays a high for a bit longer

The USD looks increasingly overvalued against JPY and CNY but not the EUR

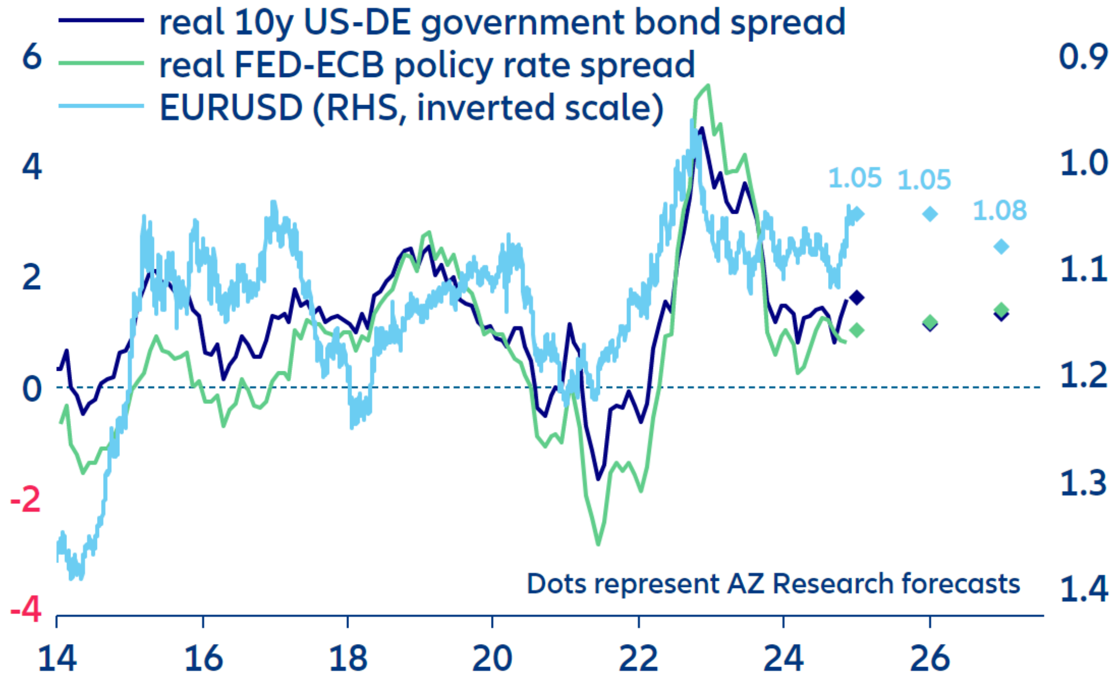
Real effective exchange rate indices (2014=100)



Sources: LSEG Datastream, Allianz Research

Interest rate differential points to ongoing weakness of EURUSD but lower geopolitical risk should support

Yield differentials in pp and EURUSD exchange rate



Sources: LSEG Datastream, Allianz Research

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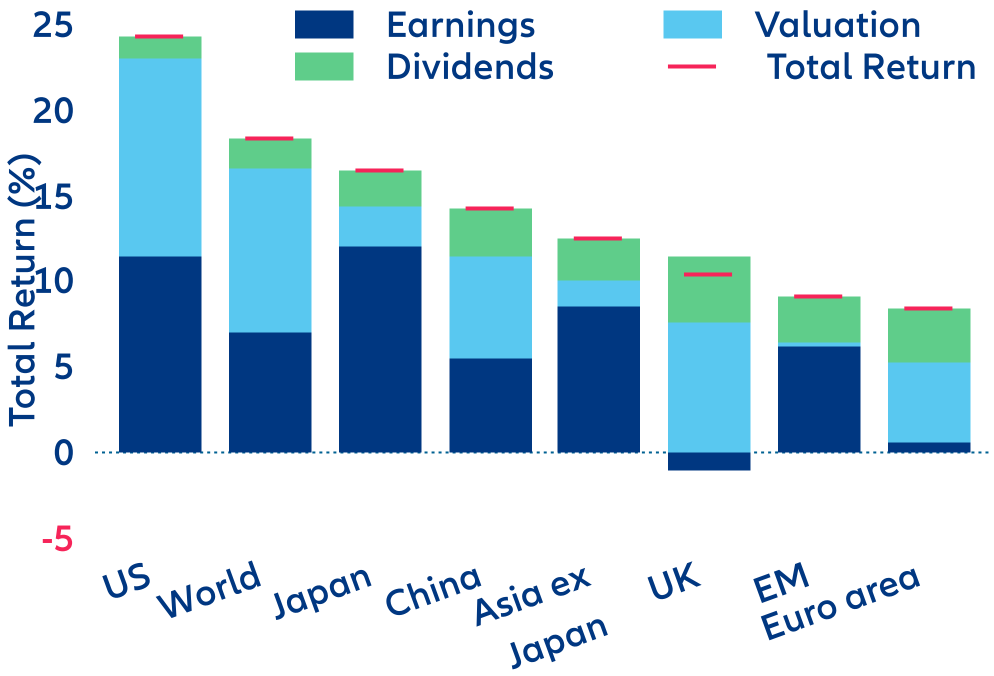
Optimism unleashed, markets soar as investors bet on earnings growth

Valuations represent more than half of the 24, performance depicting economic optimism…

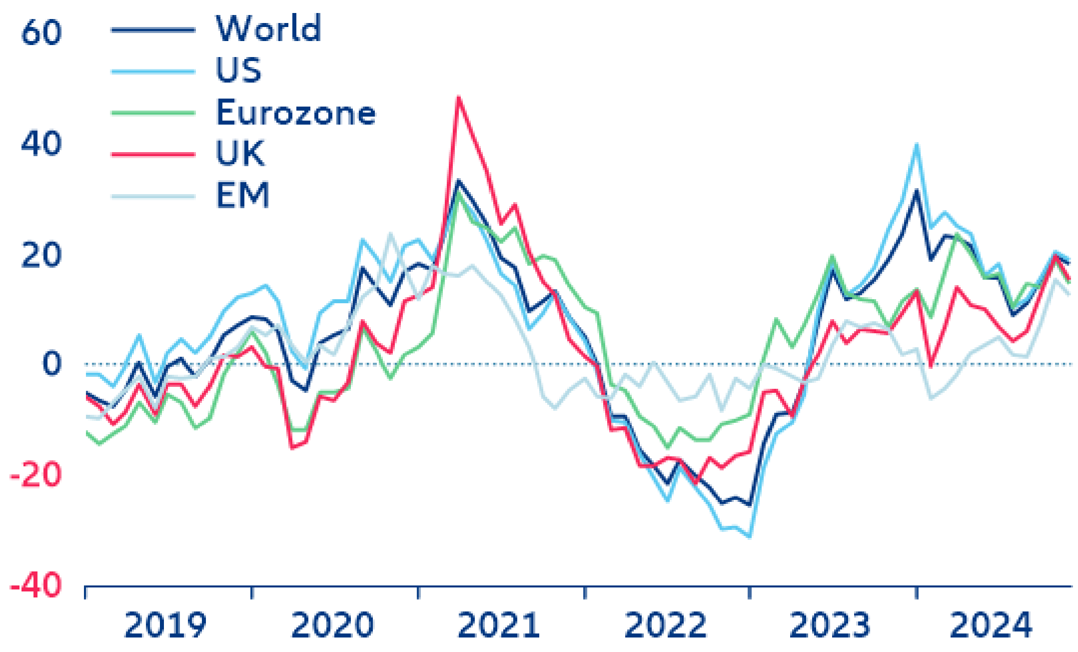
%



Sources: LSEG Datastream, Allianz Research

… and even at a sector level the outperformance of cyclicals vs defensives shows a bet on growth

Cyclicals vs defensives, y/y %



Sources: LSEG Datastream, Allianz Research

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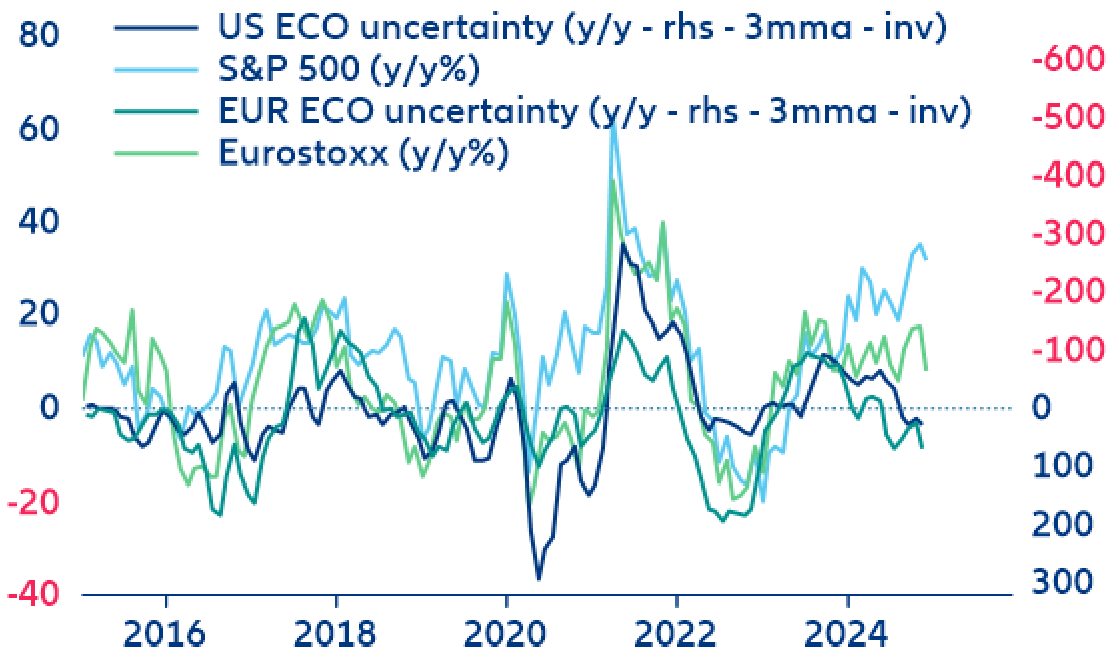
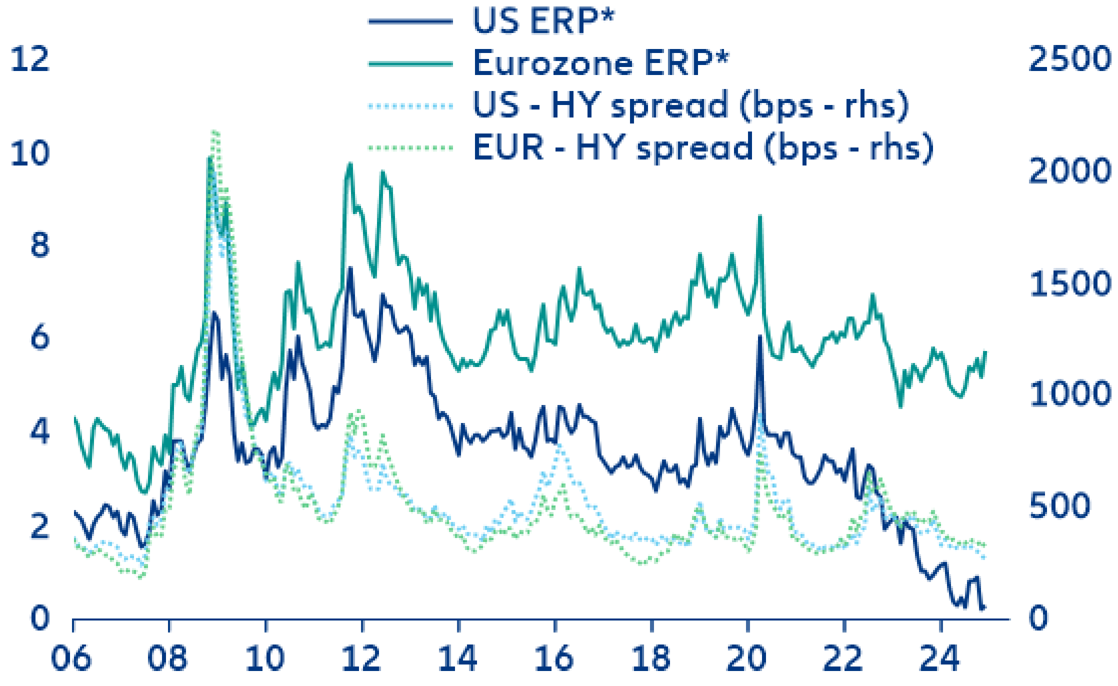
Significant economic uncertainty is expected to cap the upside potential for most asset classes

This market exuberance is unfolding amid an increasingly uncertain and challenging environment



Sources: LSEG Datastream, Allianz Research

Tight valuations and high economic uncertainty will limit upside potential across assets moving forward



Sources: LSEG Datastream, Allianz Research

*ERP: Equity Risk Premium - Extra return investors expect to earn from stocks compared to safer investments like government bonds.

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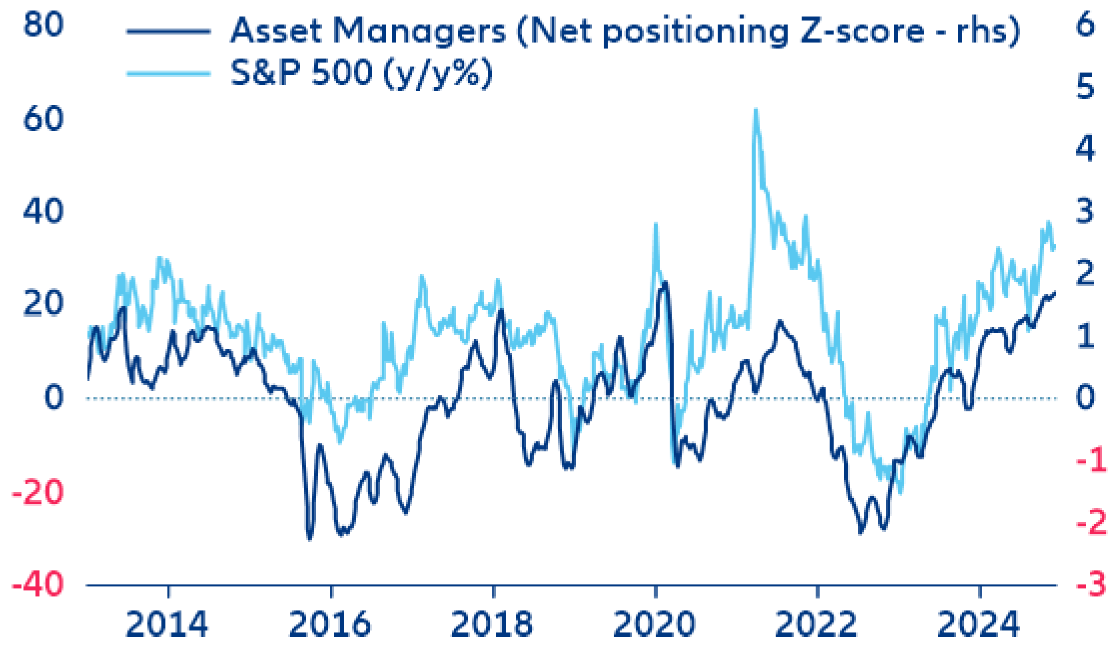
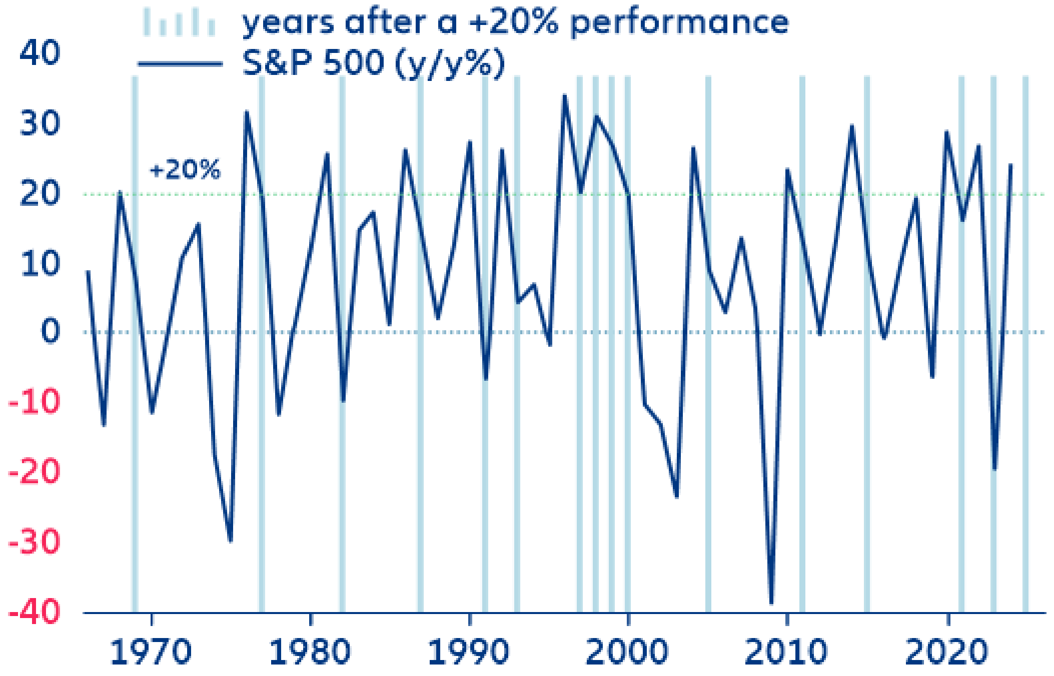
US economic and market optimism persists, but returns are likely to decelerate

Investors remain highly optimistic about US equities, though a deceleration in momentum appears likely



Sources: LSEG Datastream, Allianz Research

Two consecutive years of +20% returns is rare but three in a row tends to be a bubble-like black swan



Sources: LSEG Datastream, Allianz Research

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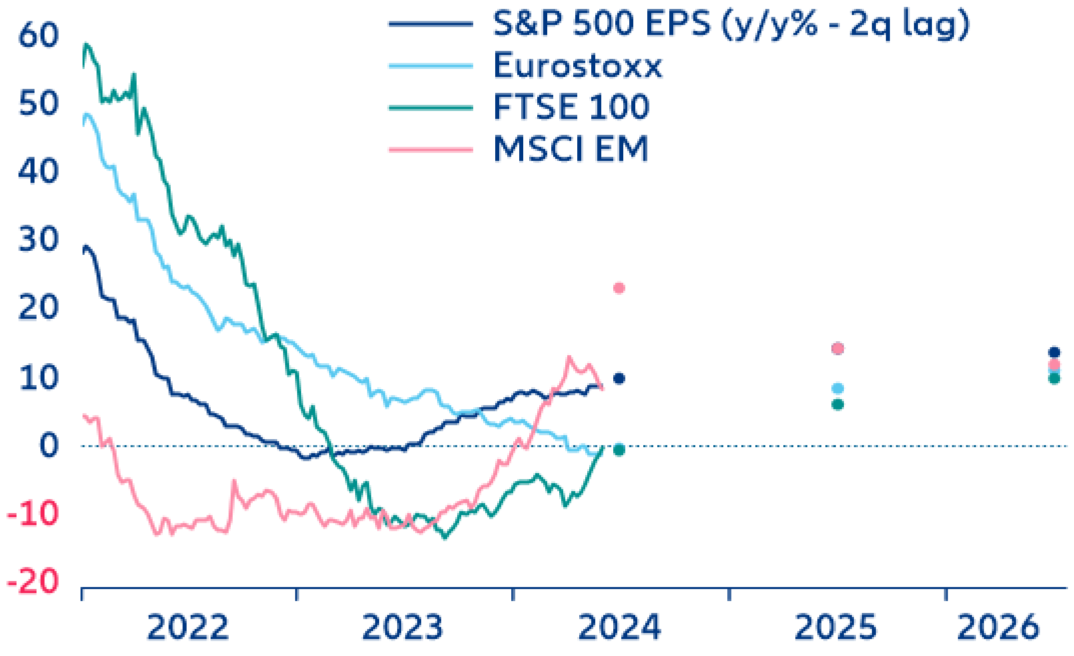
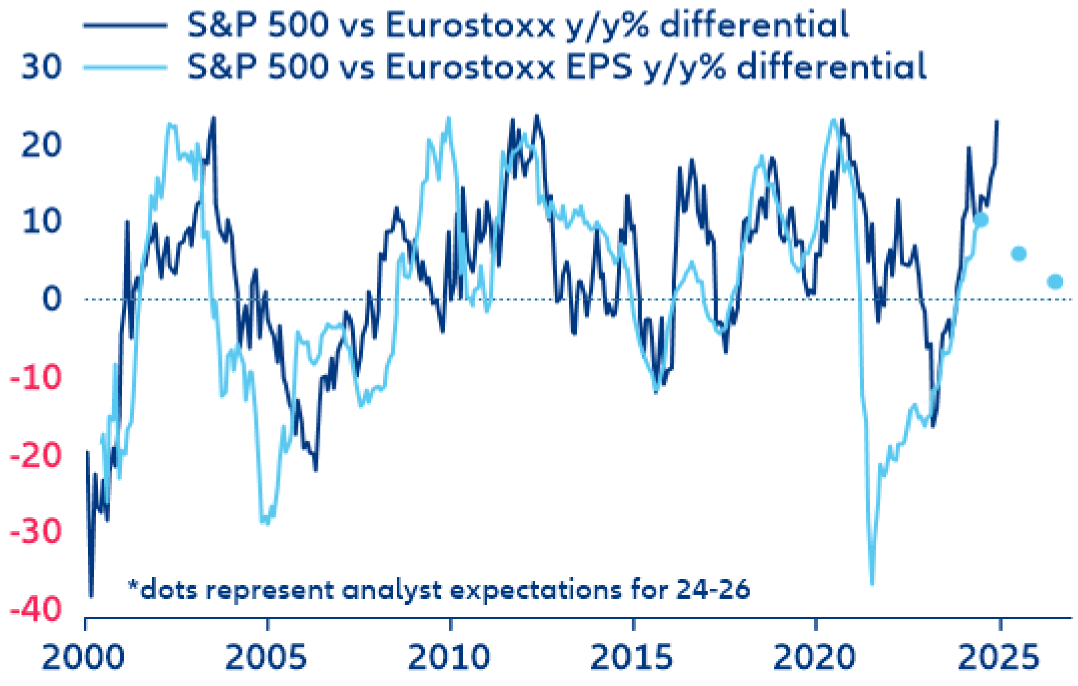
Earnings rebound anticipation meets the need to deliver

An earnings rebound and acceleration are anticipated, esp. in the Eurozone, but this will need to be confirmed



Sources: LSEG Datastream, Allianz Research

Earnings projections suggest that the performance gap between US and EUR equities will narrow



Sources: LSEG Datastream, Allianz Research

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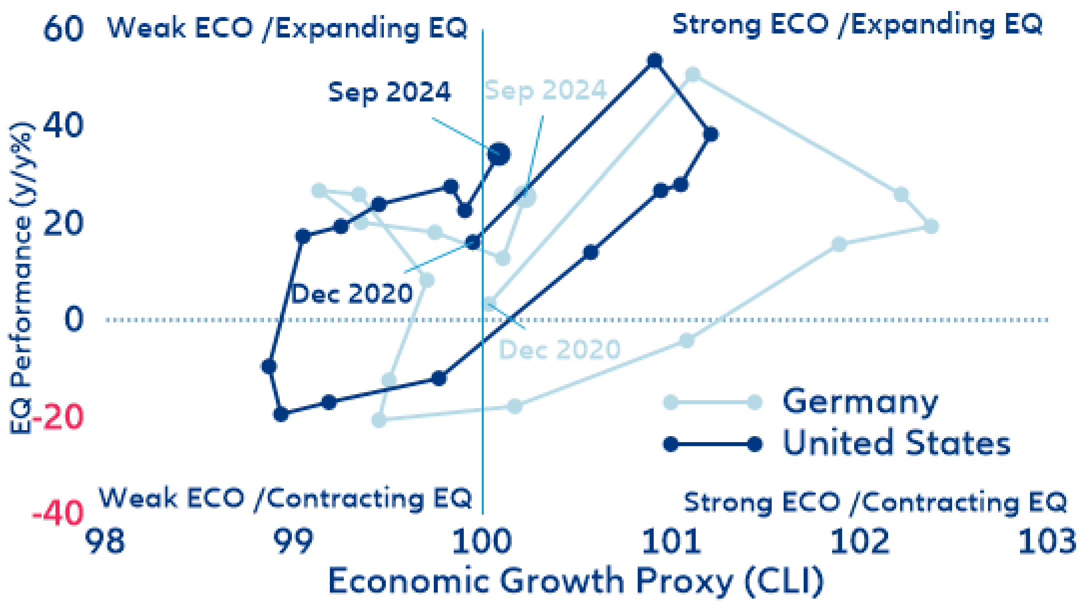
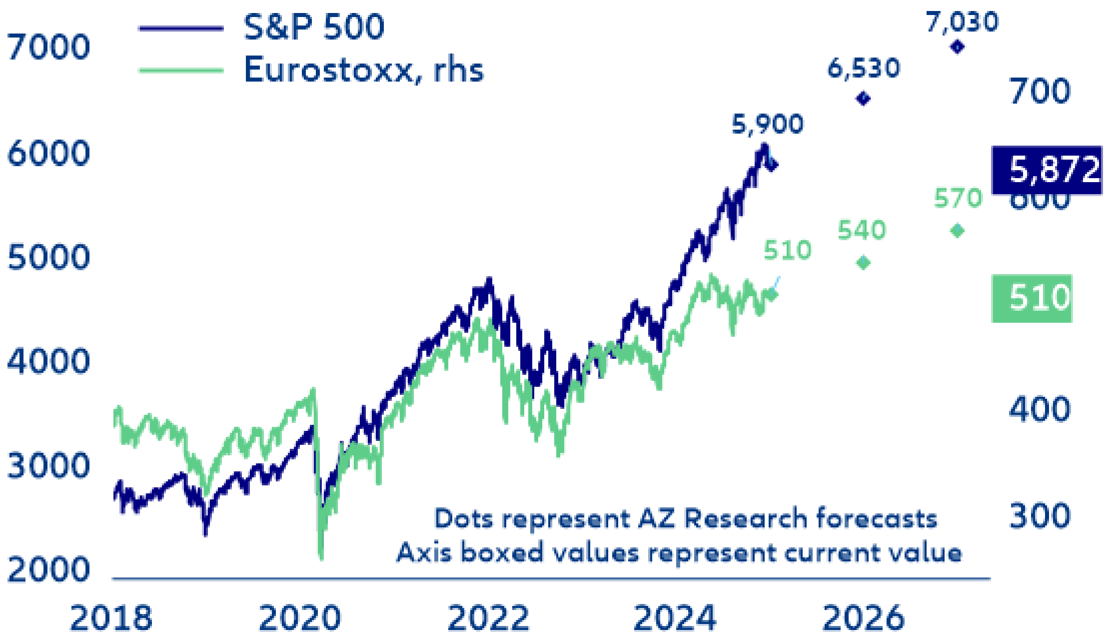
Balancing fundamentals and valuations in a mid-to late-cycle phase

Despite the expected earnings recovery market and economic dynamics suggest a mid-late cycle phase



Sources: OECD, LSEG Datastream, Allianz Research
Note: CLI – Composite Leading indicators

The fundamentals-valuations-uncertainty trifecta leads us to envisage ~9% total returns for 2025 -2026



Sources: LSEG Datastream, Allianz Research

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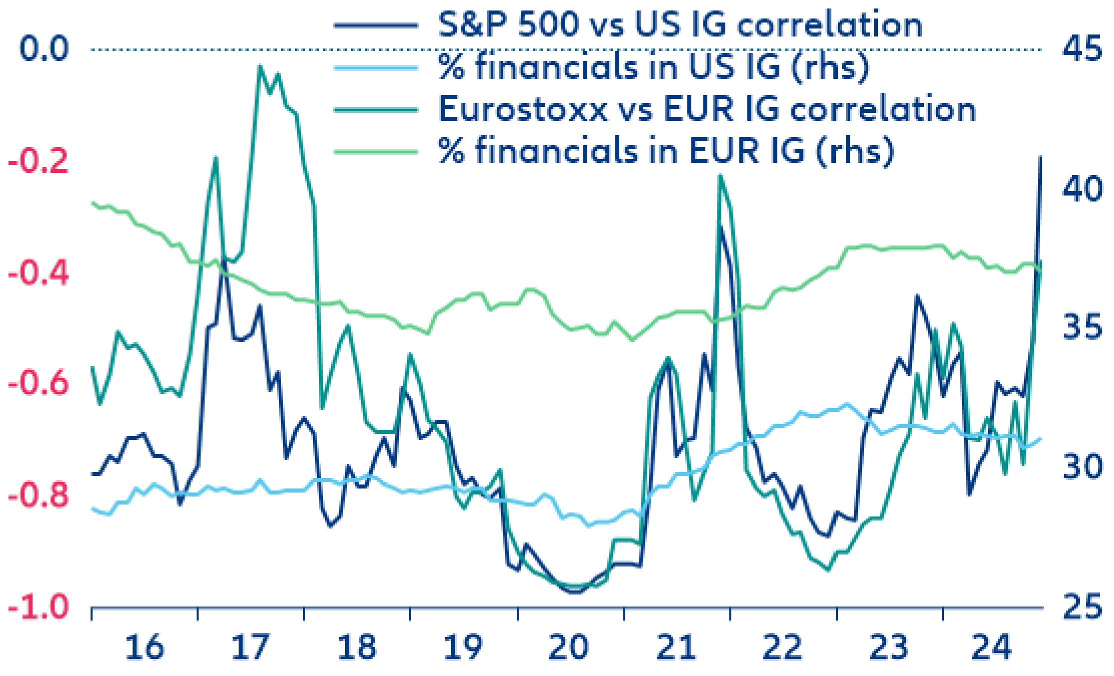
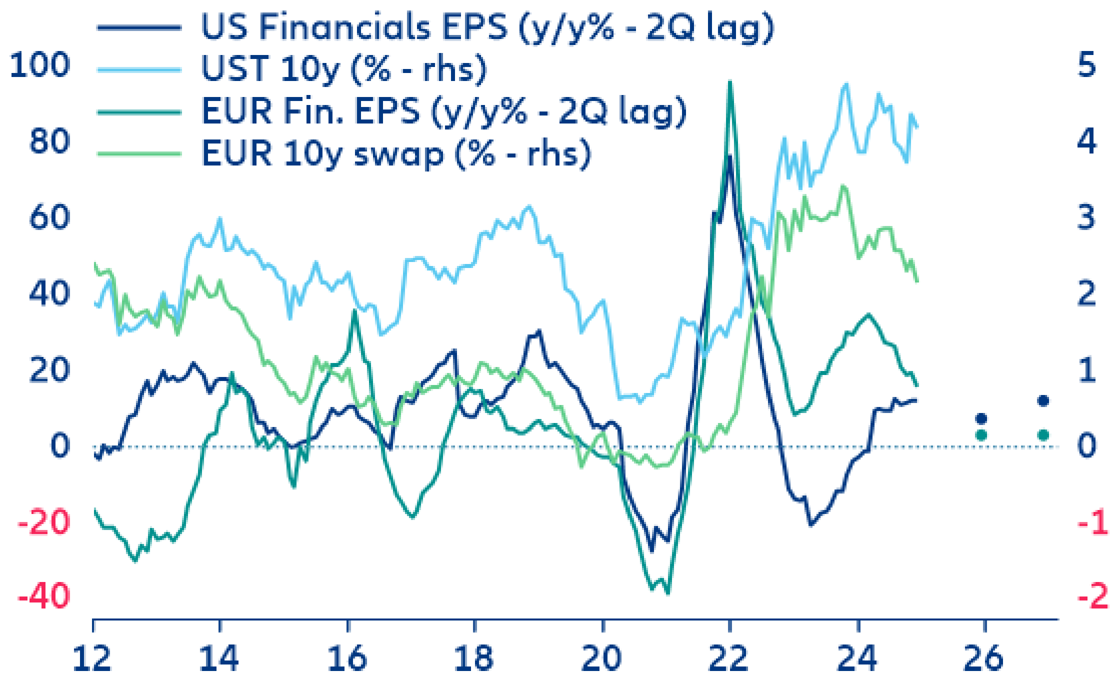
Tight and holding, corporate credit's resilience amid high valuations

Robust demand and a resilient sector mix have decoupled corporate credit from equity performance



Sources: LSEG Datastream, Allianz Research
Note: 12m rolling correlation of monthly returns

Credit spreads can sustain current levels as long as the dominant sectors continue to deliver



Sources: LSEG Datastream, Allianz Research
Note: Analyst EPS growth expectations in dots

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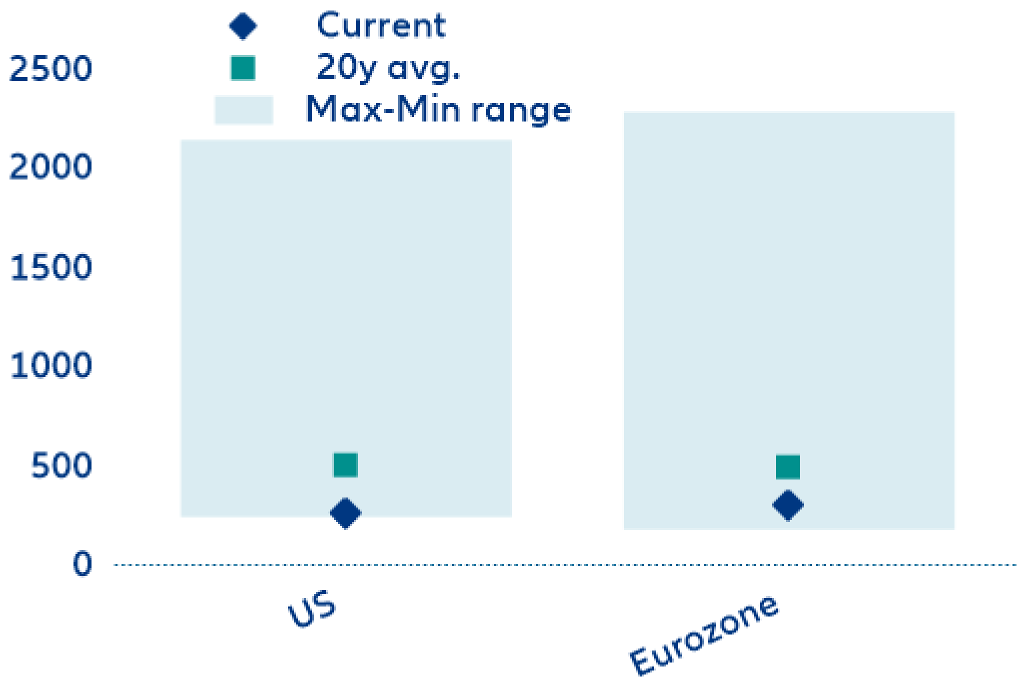
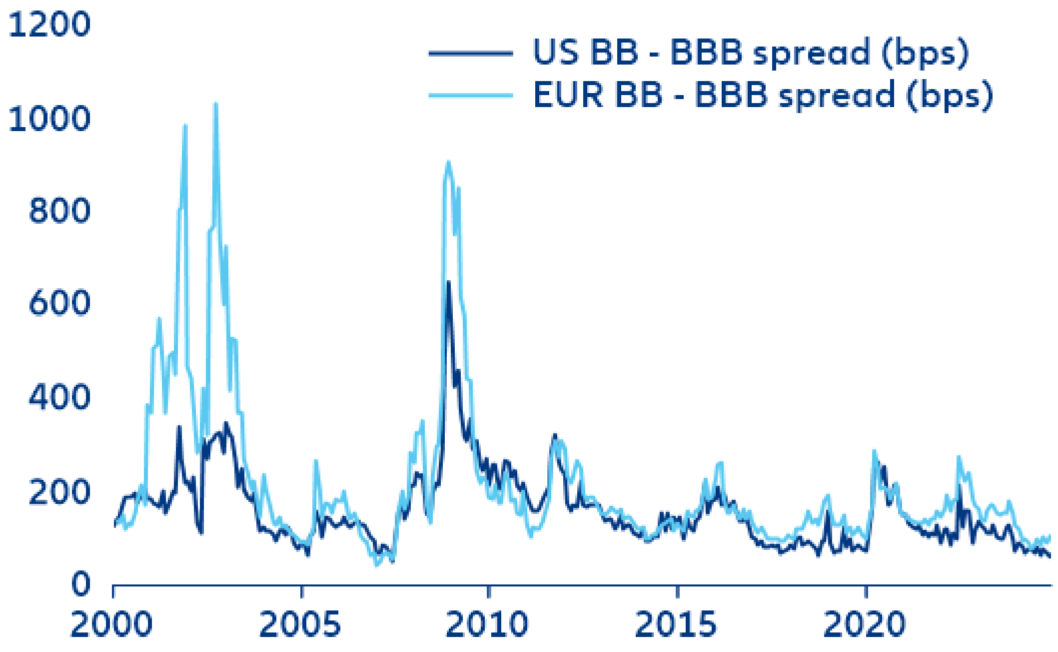
Corporate spreads are nearing their tightness limit with minimal space for further compression

Both investment grade and high yield spreads are closing in on their lowest levels in 20 years



Sources: LSEG Datastream, Allianz Research
Note: High Yield corporate credit spreads

Across the rating spectrum, the high yield-investment grade spread continues to tighten



Sources: LSEG Datastream, Allianz Research

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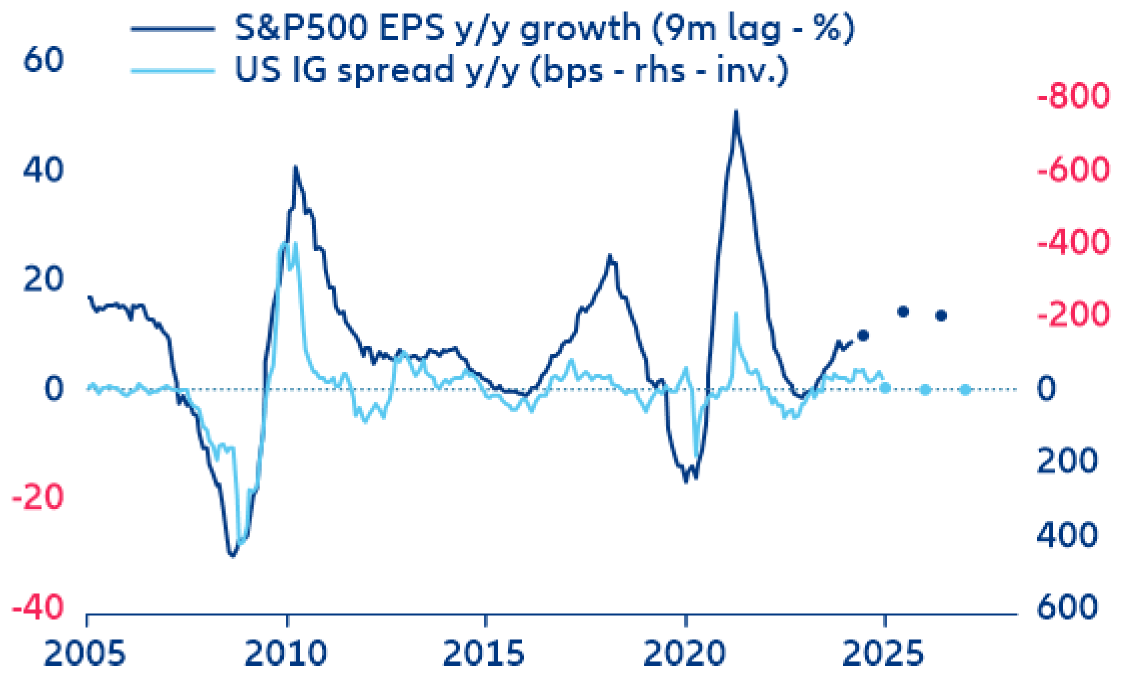
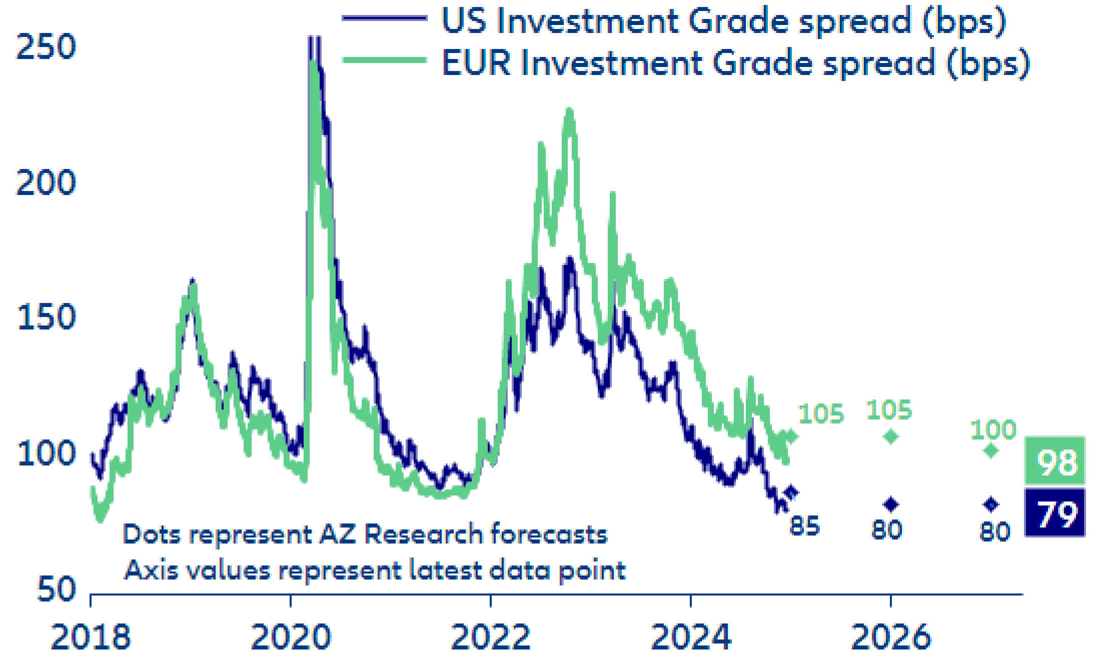
Corporate spreads to hold within range, facing constrained compression and volatility threats

Equities and corporates likely to stay detached in 25-26, with spreads resisting further compression



Sources: LSEG Datastream, Allianz Research

Earnings should drive slight compression, but spreads are set to hover near current levels with heightened vulnerability to market and economic uncertainty



Sources: LSEG Datastream, Allianz Research

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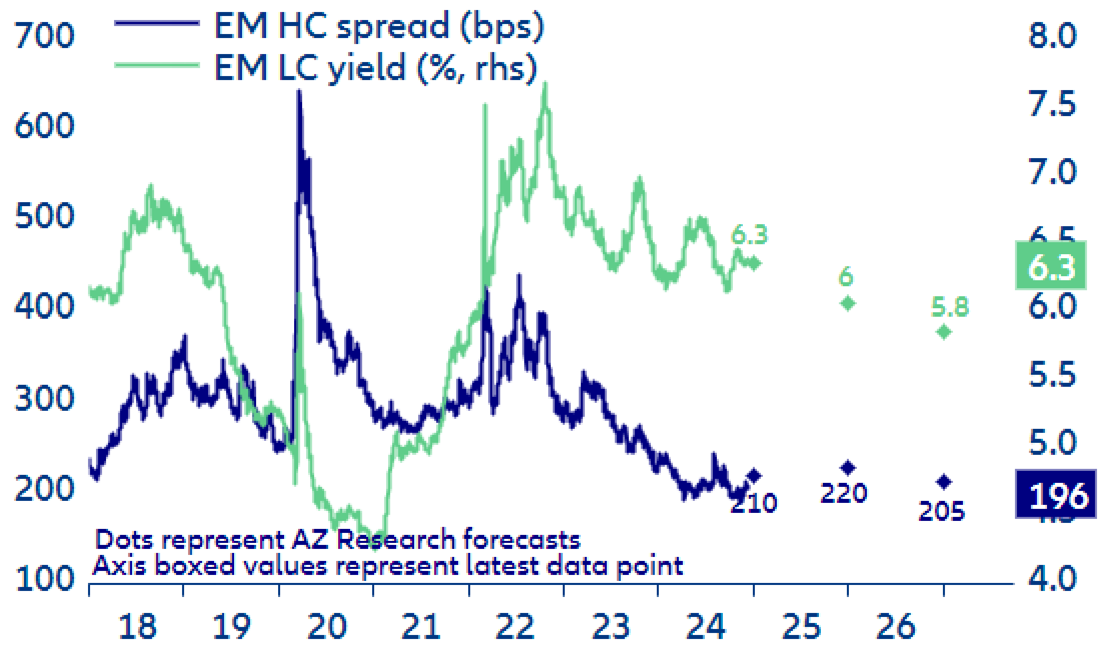
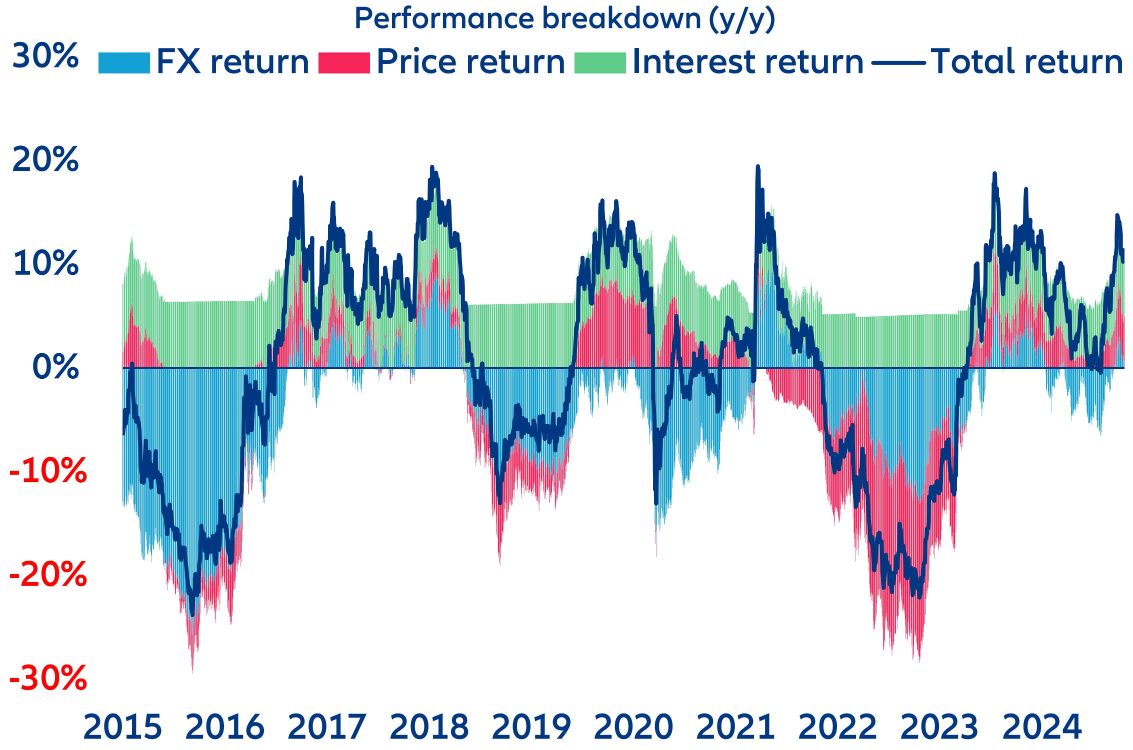
EM HC spreads under upward pressure, LC yields to continue falling

HC spread ticked up post-election but remains stretched; LC yield trending downwards



Sources: Bloomberg, Allianz Research

Local currency returns to continue benefiting from falling yields, but likely to face FX pressure



Sources: Bloomberg, Allianz Research

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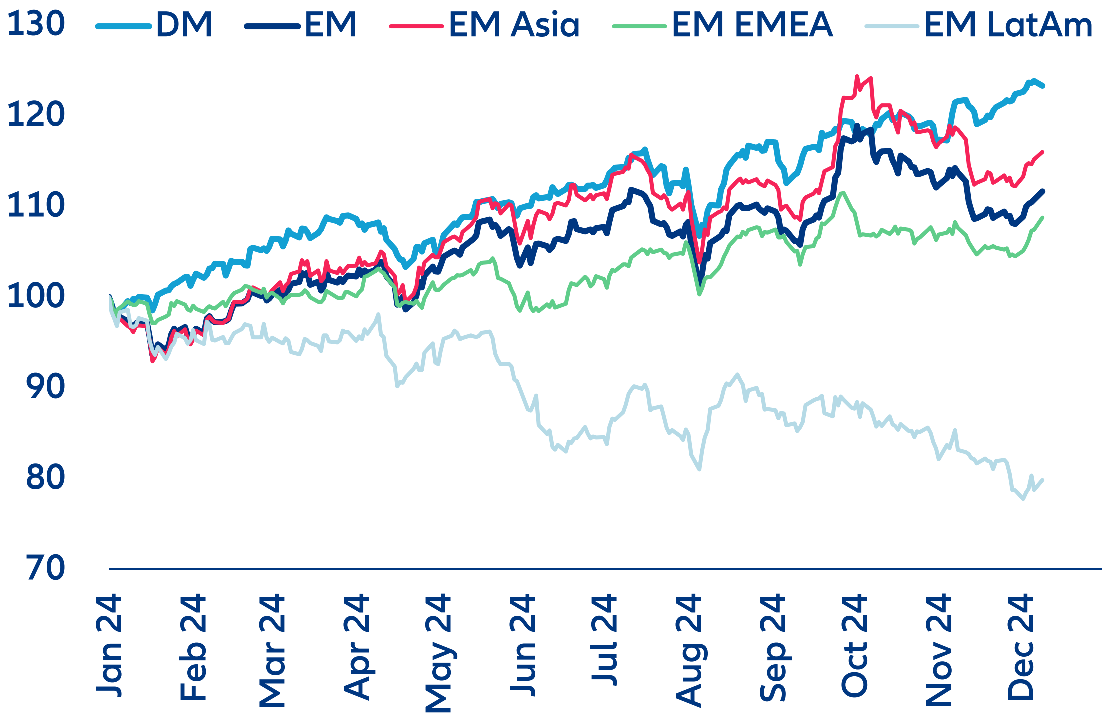
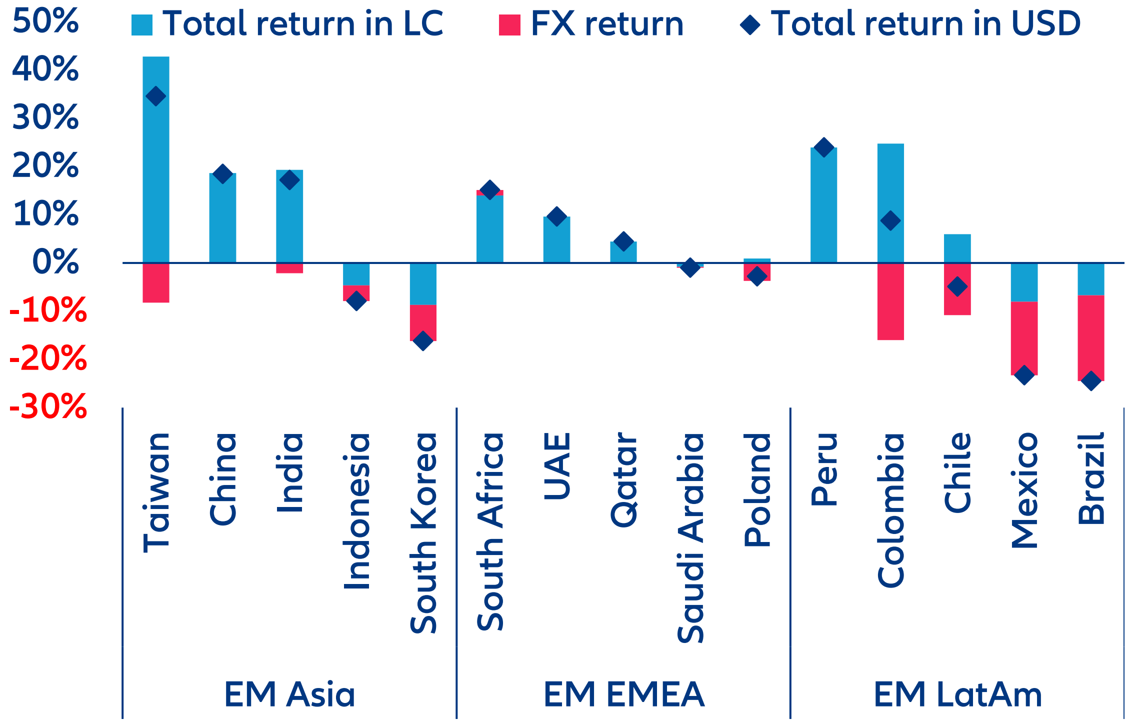
Currency weakness weighs on the total returns of EM equities, especially for LatAm

EM continues to underperform DM, with LatAm experiencing an especially significant drop



Sources: LSEG Datastream, Allianz Research

FX continues to drag on total returns as USD strengthens



Sources: LSEG Datastream, Allianz research
Note: Regional equity performance proxied by MSCI indices

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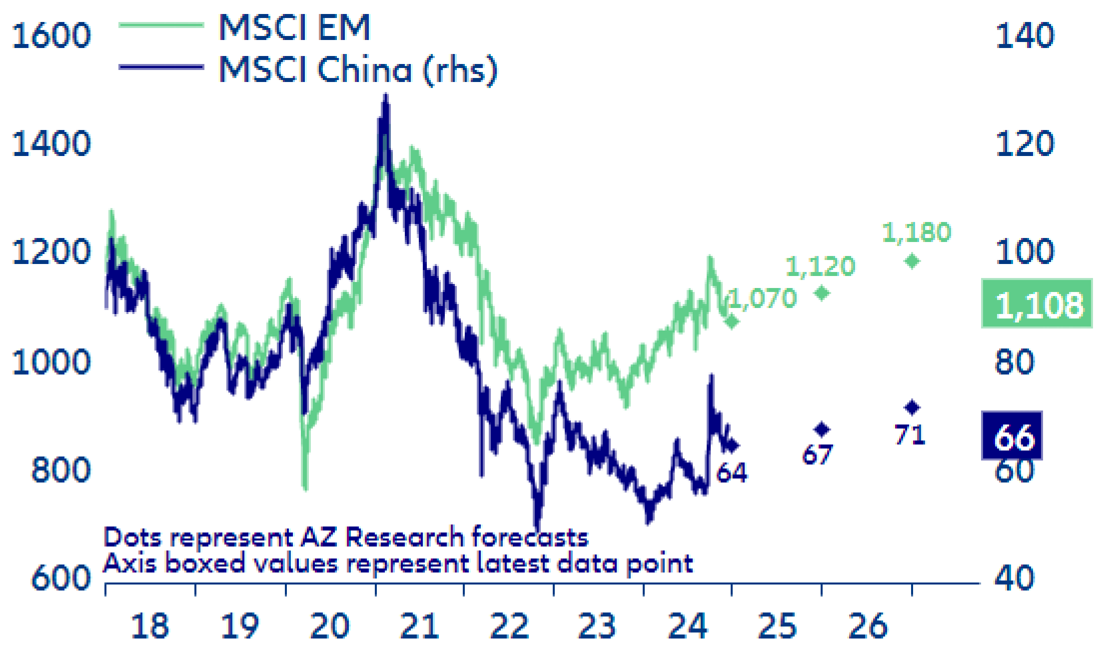
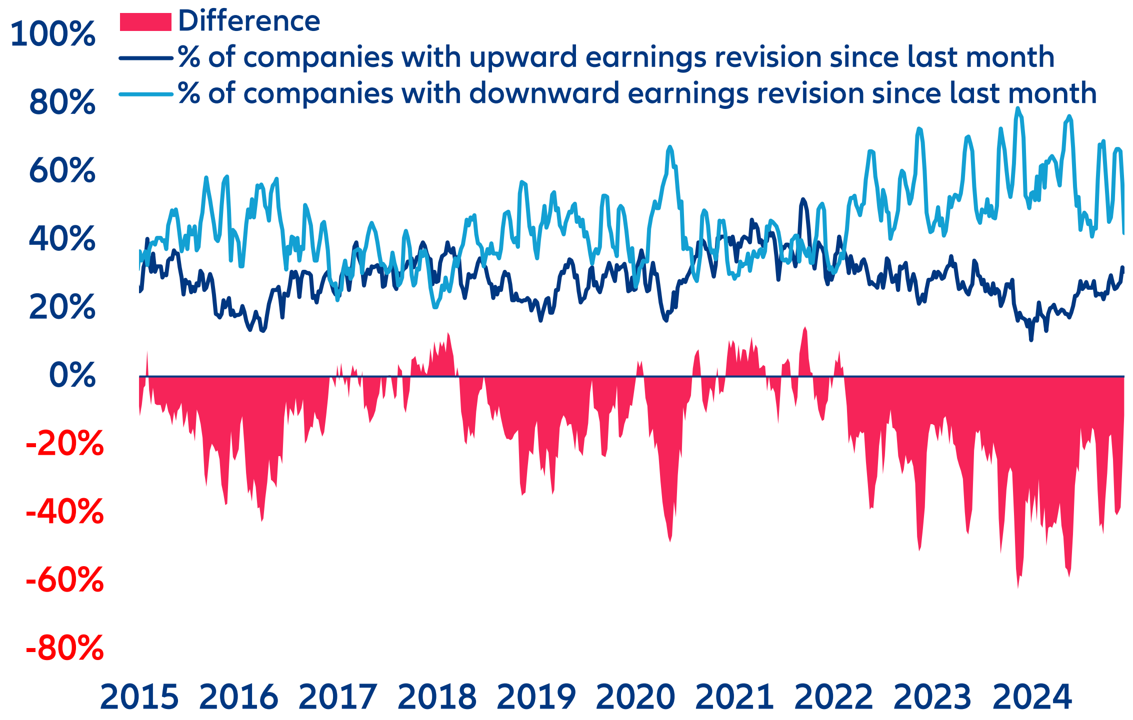
China's policy deliveries and earnings recovery on top of the list for EM equity performance in 2025

Chinese stimulus hopes may lift EM equities again, but weak fundamentals and headwinds limit upside



Sources: LSEG Datastream, Allianz Research

Downward earnings revision of Chinese equities have consistently outweighed upward revision since 2021



Sources: LSEG Datastream, Allianz research

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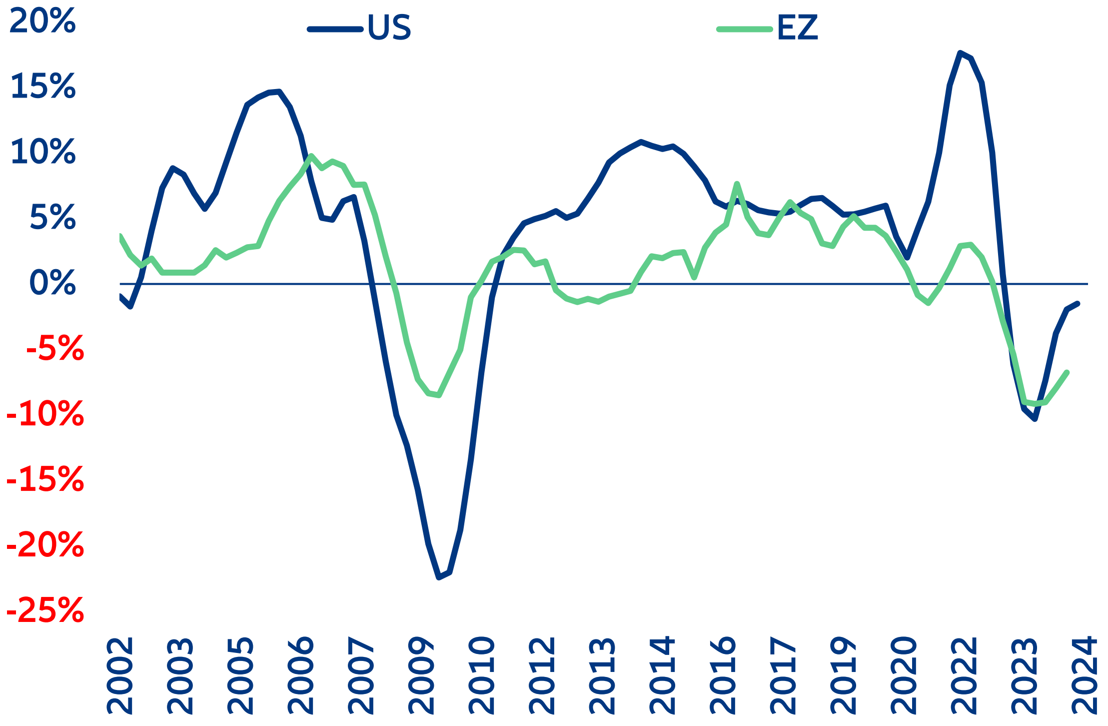
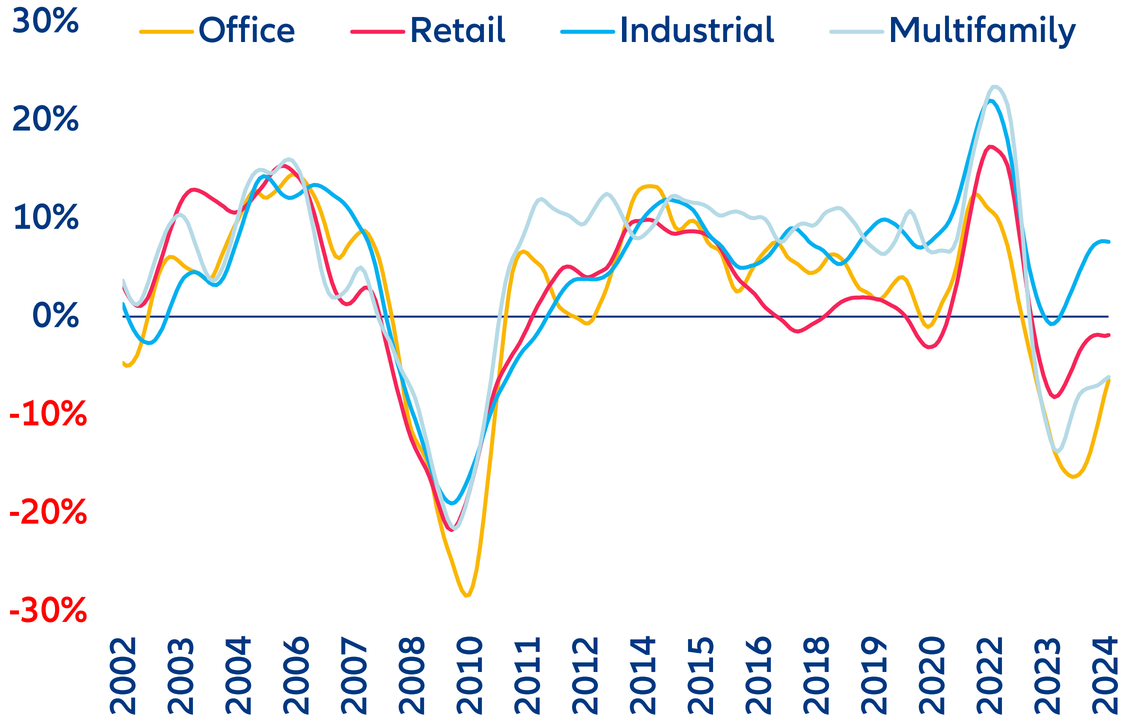
Commercial real estate stabilizing in the US but structural changes weigh on office space

Change in CRE prices in the US and EZ
(y/y)



Sources: LSEG Datastream, Allianz Research
Note: CRE prices proxied by RCA Commercial Property Price Indexes

Change in CRE prices by property type in the US
(y/y)



Sources: LSEG Datastream, Allianz Research
Note: CRE prices proxied by RCA Commercial Property Price Indexes

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