Allianz

Half-Time Outlook 2026-27:
AI holds the score, growth slows to +2.5%

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Allianz Research

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Executive Summary

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- **Yellow card only: As the Middle East conflict de-escalates – despite temporary flare-ups – we expect only a mild slowdown in global growth in 2026 to +2.5%, followed by a rebound to +2.9% in 2027, broadly in line with our previous baseline outlook. AI is strongly propping up the global economy, offsetting the drag from the energy shock and the trade war.** The energy shock is still working through balance sheets, with consumer purchasing power recovering only in Q4 2026 and firms' profitability still exposed. The US is set to grow at +2.1% in 2026 supported by energy exports, a savings rate at its lowest since 2008, AI investment (a third of growth) and fiscal support (7.3% deficit). The Eurozone (ex-Ireland) will grow by just +0.9% in 2026 but rebound to +1.2% in 2027, held back by higher energy dependence, minimal AI offset and subdued growth in Germany as bold reforms are needed on top of the fiscal stimulus. China will stay resilient at +4.7%, led by exports and high-tech manufacturing, but faces headwinds from weak domestic demand and US tariffs. Global trade of goods will avoid a recession, growing by +2.9% in volume terms in 2026 and +2.4% in 2027 as the US trade war reloads with Section 301 following the expiry of Section 122 from 24 July, raising the US effective tariff rate from 8% to 13%.

- **Has inflation been knocked out? The peak should already be behind us.** With oil flows normalizing and crude prices even falling back below pre-war levels, the energy shock should prove short-lived, limiting second-round effects on broader inflation and avoiding a repeat of the 2022 inflation surge. We still expect some volatility during US-Iran negotiations triggering temporary oil price spikes but overall we see them dropping to USD75/bbl and USD67/bbl by the end of 2026 and 2027. Gas prices are still higher compared to pre-war levels, but with EUR41/MWh expected at the end of 2026 and EUR32/MWh in 2027 they remain in the trading range of the past three years. This suggests a far more muted inflationary impact than in 2022, when prices surged by over 500% to above EUR300/MWh. Headline inflation should therefore reach central bank targets in 2027 in major economies. We expect the ECB to stay on hold at 2.25% (around neutral) after having already delivered one insurance hike in June, while the Fed will raise policy rates at least once this year to 4.0% amid persistent inflation, driven by strong AI-related investment demand, before a normalization back to 3.5% in H2 2027.

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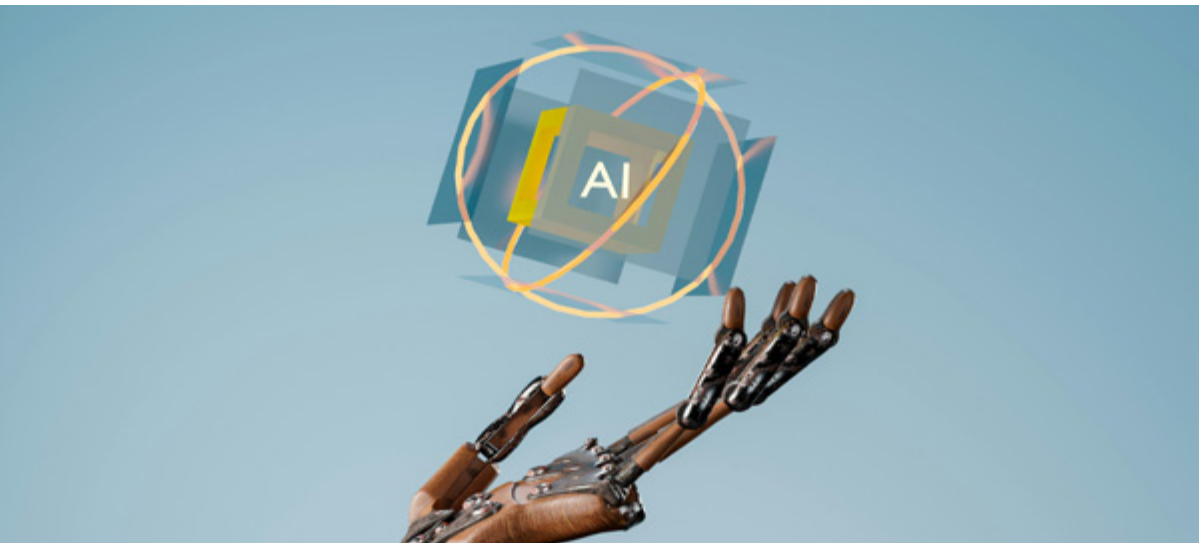
- **The goalposts are shifting for corporates: Earnings held up in Q1 2026 but the delayed impact will hurt down the line.** Most European sectors posted positive EPS growth in Q1, while US earnings were buoyed by AI-driven tech. But a profitability squeeze might be building: Turnover growth was revised down for 12 out of 16 sectors, led by pharma (-2.0pps to 0%), utilities (–1.6pps), and motor vehicles (–1.3pps). Only electronics (+1.7pps to 11%), information & communication services (+0.7pps) and food & beverages (+0.4pp) bucked the trend. The auto sector remains most exposed via elevated net leverage meeting higher rates. Against this backdrop, we expect global insolvencies to increase by +4% in 2026 before plateauing in 2027.

- **Capital markets are playing the advantage, largely looking through near-term risks.** US rates should gradually decline to 4.35% by the end of 2026 and 4.1% in 2027 as inflation pressures and monetary tightening fade next year. German Bunds will hover around 3% amid ongoing supply pressures from quantitative tightening and a high fiscal deficit around 4% of GDP – above Italy and Spain. Equities remain supported by nominal growth and AI upside, although valuations leave little room for disappointment and relative value becomes more relevant. After strong year-to-date gains, further upside in 2026 looks limited with our full-year forecast of 13% total return for the S&P500 and 14% for the Eurostoxx, but in 2027 we see ongoing solid performance of 11% on both sides of the Atlantic. EM stocks are leading the charts (29% total return expected for 2026) driven by the strong weight of top South Korean and Taiwanese semiconductor companies in the index. Credit markets should continue to deliver attractive carry, even as ultra-tight spreads leave valuations stretched and skew risk to the downside. Rising issuance and falling interest coverage ratios are likely to drive a mild widening in spreads over the next two years – but elevated carry should still be enough to offset those valuation losses. Private markets remain a story of rising dispersion, with AI-related infrastructure and high-quality private credit outperforming more challenged segments.

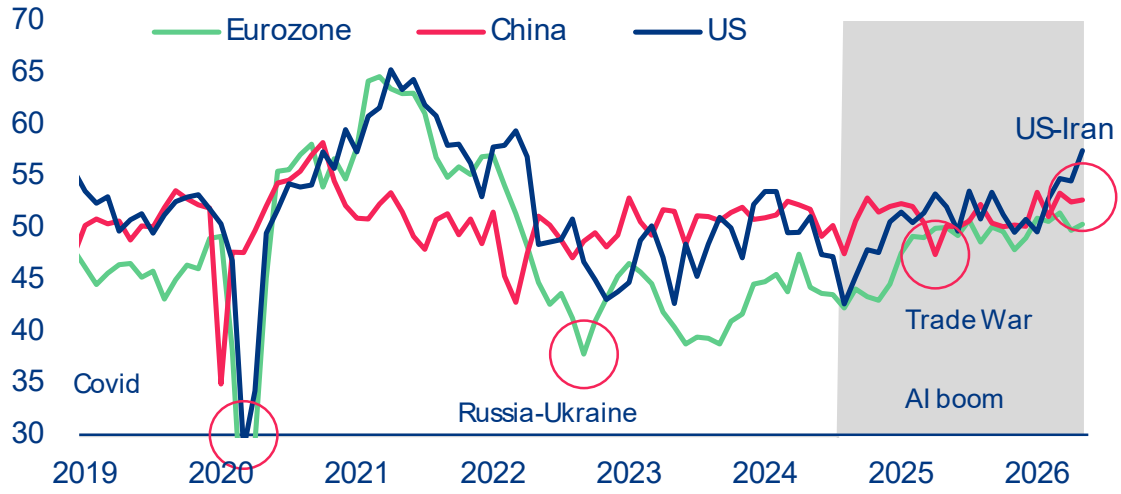
- **More shocks ahead? The number of risks ahead has certainly not decreased.** AI is doing the heavy lifting that geopolitics and fiscal policy cannot. But it is also concentrated, unevenly distributed and itself a source of downside risk if delivery disappoints as it would hit trade, investment and consumption. In addition, global policy uncertainty remains well above trend, with many risks ahead including a reloaded escalation of the trade war, US midterm elections, a subdued German fiscal push and polarization ahead of upcoming elections in key European countries. Climate risks remain omnipresent – the latest heatwave in Europe has passed, but risks of a severe El Nino year are still looming. Labor markets are still tight, but the medium-term outlook is more fragile. In several European economies, AI-driven layoffs could outweigh productivity gains, ultimately weighing on growth.



AI is propping up the world economy

With the de-escalation of the Middle East conflict, we expect only a temporary slowdown in global growth in 2026 before a rebound to +2.9% in 2027, broadly in line with our previous baseline outlook. The reopening of the Strait of Hormuz is unlikely to fully materialize before year-end, while the energy shock is still working its way through balance sheets, with consumer purchasing power only recovering in Q1 2027 as real wage growth returns to positive territory and firms' profitability remaining exposed to downside pressures. Energy prices are expected to gradually return to pre-war levels by end-2027, with Brent crude averaging USD83/bbl in 2026 before easing to USD70 in 2027, while European natural gas (Dutch TTF) averages EUR43/MWh in 2026 before falling to EUR34/MWh in 2027. However, past increases will continue to feed through supply chains, utility bills and rents over the coming quarters. Against this backdrop, global GDP growth is expected to slow to +2.5% in 2026, the weakest pace since the Covid-19 crisis, before rebounding to +2.9% in 2027, broadly in line with the 2023-2025 average. The slowdown (-0.5pp compared with 2025) remains managed despite the US-Iran war and the energy crisis, and is almost evenly split between advanced economies (-0.2pp) and emerging markets (-0.3pp). The AI boom, explaining around one-third of US growth and driving close to two-thirds of Asian export growth, provides a genuine cushion to the global economy, but also increases concentration risks going forward. Overall, the US economy is expected to grow by +2.0-2.1% in 2026, broadly in line with potential growth. The Eurozone (excluding Ireland) is expected to grow by just +0.9% in 2026 before rebounding to +1.2% in 2027. China remains resilient, with GDP growth expected at +4.7%, driven by exports and high-tech manufacturing.

Figure 1: PMI new orders manufacturing index



Sources: LSEG Datastream, Allianz Research

Table 1: Real GDP growth forecasts, %

Growth (yearly %)	2023	2024	2025	2026f	2027f
Global	**2.8**	**2.9**	**3.0**	**2.5**	**2.9**
USA	**2.9**	**2.8**	**2.1**	**2.1**	**2.0**
Latin America	**2.0**	**1.8**	**2.4**	**2.3**	**2.7**
Brazil	3.3	3.0	2.6	2.0	2.1
UK	**0.3**	**1.0**	**1.3**	**1.0**	**1.4**
Eurozone	**0.6**	**0.9**	**1.5**	**0.3**	**1.2**
Eurozone excl. Ireland	**0.7**	**0.9**	**1.1**	**0.9**	**1.2**
Germany	-0.7	-0.5	0.4	0.7	1.2
France	1.9	1.4	0.9	0.5	1.1
Italy	1.0	0.6	0.7	0.6	0.7
Spain	2.5	3.5	2.8	2.2	1.7
Central and Eastern Europe	**1.4**	**2.3**	**2.3**	**2.1**	**2.4**
Poland	0.2	3.1	3.6	3.2	2.9
Russia	3.9	4.9	1.1	0.7	1.8
Türkiye	5.0	3.5	3.6	3.4	3.8
Asia-Pacific	**4.3**	**3.9**	**4.4**	**4.3**	**4.0**
China	5.4	5.0	5.0	4.7	4.4
Japan	0.7	-0.2	1.1	0.9	1.0
India	7.1	7.2	7.5	6.5	6.4
Middle East	**2.1**	**2.4**	**3.2**	**-2.1**	**5.0**
Saudi Arabia	0.5	2.6	4.5	2.7	5.3
Africa	**2.7**	**3.5**	**4.2**	**4.0**	**4.0**
South Africa	0.8	0.5	1.1	1.3	1.4

Sources: National, Allianz Research

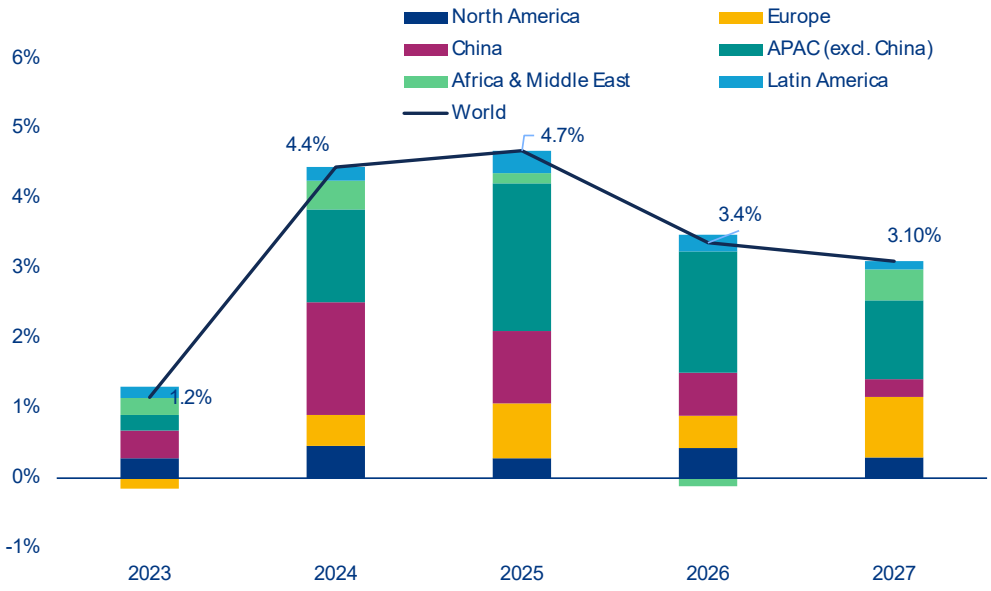
In 2026, 80% of global trade volume growth in goods and services is driven by Asia and the US (60% in 2027). Trade of goods in volume is projected to grow by +2.9% in 2026 and +2.4% in 2027. The closure of Strait of Hormuz from early March to mid-June 2026 contributed to a sharp contraction of global trade in Q2 2026 by blocking 4% of global trade. In parallel, the trade war initiated by the US in 2025 continues to cause losses to exporters. Starting 24 July, a new set-up built around Section 301 of the Department of Commerce will be established, bringing the US effective tariff rate back to 13%, what is was before the SCOTUS decision on the IEEPA tariffs (commonly known as "Liberation Day" tariffs). The pivot to Section 301 is expected to negatively affect Asian countries in particular, but exporters are adapting via rerouting or identifying new markets, reducing the impact.

A structural tailwind partly offsets these geopolitical headwinds: AI-linked supply chains. Surging demand for semiconductors, servers and data-center hardware is keeping both goods and services trade elevated through 2026, broadening the recovery beyond traditional manufacturing. This AI-driven investment cycle supports trade especially in North America and Asia, and cushions the cyclical losses from trade frictions. In 2027, this cycle of the AI capex investment is projected to slow after peaking in 2026 but it will continue to be the main driver of trade.

On the fiscal front, the energy shock hit at a moment when most countries were doing little to consolidate, given already weak growth and rising spending pressures – defence chief among them. Fiscal stances were broadly neutral at best, with governments balancing post-pandemic spending legacies against moderating growth outlooks and no major consolidation effort on the horizon. Learning from the 2022 energy crisis, most support measures implemented by both advanced and emerging economies were once again largely untargeted but remained contained, helped also by the more moderate scale of the energy-price spike relative to that earlier shock. As a result, we do not expect a significant impact on government budgets this year.

Shocks to be continued? The number of risks ahead has all but decreased. AI is doing the heavy lifting that geopolitics and fiscal policy cannot. But it is also concentrated, unevenly distributed and itself a source of downside risk if delivery disappoints as it would hit trade, investment and consumption. In addition, global policy uncertainty remains well above trend, with a reloaded trade war, US midterm elections, a subdued German fiscal push and polarization ahead of upcoming elections in key European countries all risks to watch. Climate risks remain omnipresent – the latest heat wave in Europe has passed but risks of a severe El Nino year are still looming.

Figure 2: Global trade of goods and services, volume and annual growth

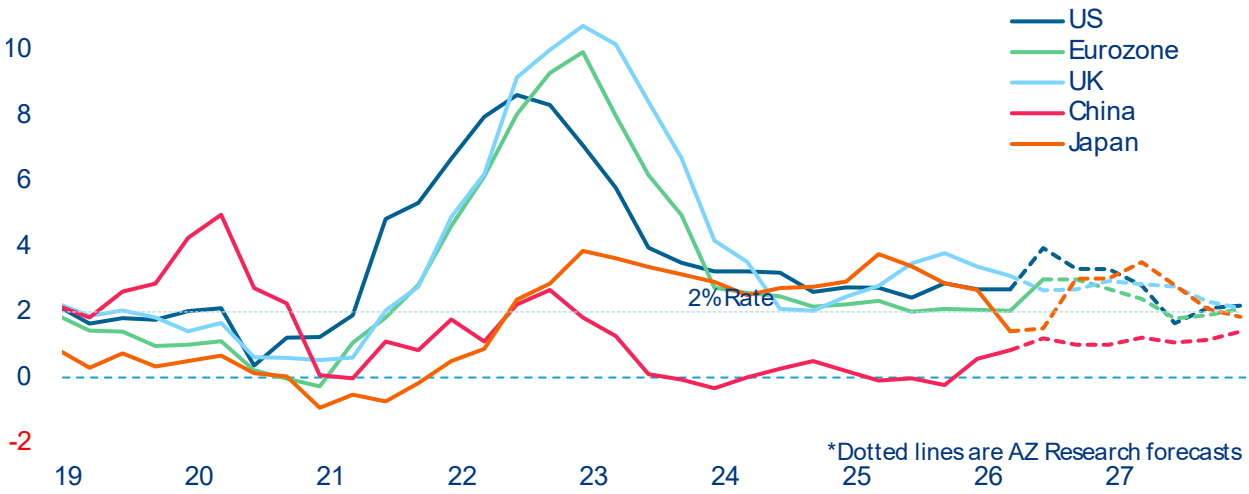


Sources: Oxford Economics, Allianz Research

Peak inflation should be behind us

Inflation rates are past their peaks and should normalize towards central banks' targets by spring 2027, but core prices are expected to remain sticky in the US and the UK. The sharp decline in oil prices will pull down headline inflation rates across most markets, stretching well into 2027. In the US, after peaking at +4.0% y/y in Q2-26, we expect CPI inflation to decline and trough at +1.7% in Q2 2027, thanks to strong negative base effects of energy prices one year after the Iran shock. In the Eurozone, we expect inflation to trough at +1.8% in Q2-2027, from a peak of +3.1% reached in Q2 2026. UK inflation should be a bit more steady as Ofgem utility price hikes in July and September should delay somewhat the pullback of energy inflation. We expect UK inflation to land at +1.9% by Q4 2027. Japanese inflation should reach +2% by Q3-2027. Against this backdrop, while lower energy inflation will pull down headline inflation rates decisively over the coming

Figure 3: Quarterly inflation, y/y, %



Sources: LSEG Datastream, Allianz Research

Table 2: Inflation forecasts, yearly, %

Inflation (yearly %)	2023	2024	2025	2026f	2027f
Global	**6.1**	**4.7**	**3.8**	**5.1**	**3.3**
USA	**4.1**	**3.0**	**2.7**	**3.3**	**2.2**
Latin America	**14.8**	**16.6**	**7.6**	**4.0**	**3.3**
Brazil	4.6	4.4	5.0	4.7	3.7
UK	**7.4**	**2.5**	**3.4**	**2.9**	**2.5**
Eurozone	**5.5**	**2.4**	**2.1**	**2.7**	**2.1**
Germany	6.0	2.3	2.2	2.6	2.2
France	4.9	2.0	0.9	1.7	1.3
Italy	5.7	1.0	1.5	2.7	2.1
Spain	3.6	2.8	2.7	3.1	2.1
Central and Eastern Europe	**11.2**	**3.9**	**5.0**	**4.4**	**3.3**
Poland	11.6	3.8	3.8	3.0	2.6
Russia	5.9	8.4	8.7	7.0	7.0
Türkiye	53.4	60.0	35.2	31.2	22.2
Asia-Pacific	**3.1**	**2.2**	**1.3**	**2.3**	**2.1**
China	0.2	0.2	0.1	1.0	1.2
Japan	3.3	2.7	3.2	2.4	2.2
India	5.7	5.0	2.2	4.5	4.0
Middle East	**16.5**	**10.6**	**13.8**	**17.8**	**10.2**
Saudi Arabia	2.5	1.5	2.0	2.5	2.4
Africa	**17.0**	**15.1**	**8.7**	**10.2**	**11.4**
South Africa	5.9	4.5	3.2	4.3	3.9

Sources: National, Allianz Research

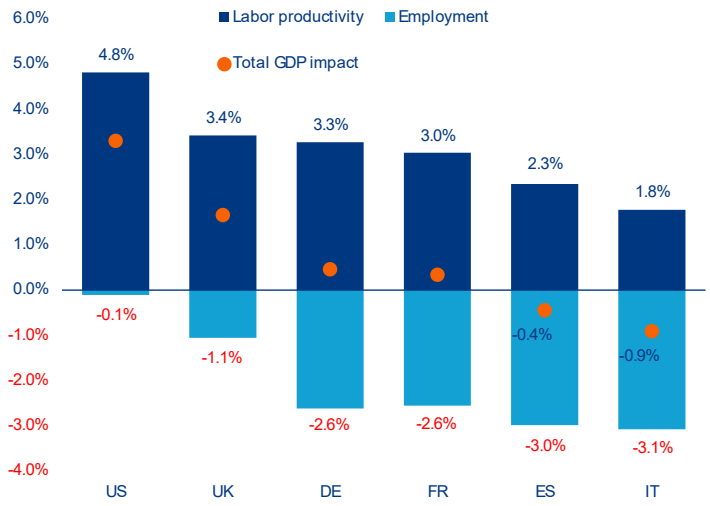
quarters, core prices will accelerate as supply-chain disruptions from the conflict in the Middle East have pushed up the cost of key industrial inputs. Moreover, despite energy prices retreating, corporates have already passed on part of the rise in oil and gas prices onto their selling prices. Consumer prices typically exhibit downward rigidity so we would not expect lower energy prices, and a rapid easing of supply-chain disruptions, to weigh much on core prices. However, with GDP growth generally soft and below potential, and central banks cautious, we are not forecasting any meaningful "price-wage" loop second-round effects to materialize. After accelerating or remaining sticky through early 2027, core inflation should start to subside

US and Eurozone labor markets remain resilient at the headline level, but adjustment is increasingly visible beneath the surface. In the US, job creations have picked back up since the beginning of the year but hiring intentions are soft, pointing to a shaky outlook. In the Eurozone, unemployment remains close to historical lows but labor demand has clearly normalized, with declining vacancies, softer hiring intentions and moderating wage growth. Crucially, this is not a repeat of 2022: Labor shortages have largely eased and firms are no longer hiring aggressively, reducing incentives for labor hoarding as growth weakens. Instead, adjustment is occurring primarily through slower hiring rather than layoffs, delaying but not eliminating the risk of rising unemployment. Risks are also becoming more sectoral. Persistent weakness in Eurozone manufacturing – driven by weak demand, elevated uncertainty and still-high energy costs – contrasts with more resilient services, pointing to growing labor-market divergence. Structurally weak productivity growth, despite accelerating AI adoption, adds further pressure on margins and hiring decisions. While a sharp deterioration remains unlikely, labor markets on both sides of the Atlantic are entering a phase of thinner buffers, with Europe's exposure now industrial rather than energy-driven.

AI is set to transform labor markets over the next decade, with the adjustment likely to come mainly through workforce reallocation rather than mass layoffs. In the near term (one to three years), AI is expected to reshape up to one-quarter of jobs across major advanced economies through task reorganization, automation and augmentation. Exposure is greatest in the US (27.5% of jobs), followed by Germany (18.5%) and France (16.9%), while Italy remains the least exposed (10.0%). Most of those AI-exposed jobs will be reorganized around a human in the loop, while AI automates some roles and augments others. Early signals of the transformation are already emerging before headline employment weakens: slower hiring of junior talent, weaker wage growth and growing polarization between routine cognitive workers and those in AI-complementary roles. In the medium term, disruption is likely as jobs disappear faster than workers can be reskilled, meaning long-term productivity gains will come at the price of medium-term labor-market pain. Over the next decade, we expect a moderately negative employment effect across all major economies, ranging from -0.1% in the US (-170k jobs) to -3.1% in Italy (-740k jobs). The US as the hub of AI production should benefit more from new AI-related job creation and a stronger competitive position, while Europe remains more exposed because of its sectoral employment mix and slower adoption. However, shrinking working-age populations should cushion the blow across much of Europe as AI helps ease demographic labor shortages: By 2036, the workforce is set to decline by 5.6mn workers in Germany, 4.2mn in Italy and 2.3mn in Spain. At the same time, AI should lift labor productivity across all major developed markets, with cumulative gains ranging from +1.8% in Italy to +4.8% in the US by 2036, further widening the transatlantic productivity and growth gap. Overall, AI should substantially lift potential growth, with inflationary effects in the short term but disinflationary effects over the longer term.

We expect the Fed to deliver a 25bps interest rate hike in September to re-affirm its anti-inflation credentials amid sticky core inflation. Although declining energy prices are now pulling down US inflation, the Fed is not out of the woods yet. To limit the pass-through of higher input costs onto consumer prices and wages, as well as to firmly anchor inflation expectations, we expect the Fed to hike interest rates by 25bps at the September meeting. The fact that the Fed has not hit its 2% target since 2021, as well as signs that spare capacity in the economy has decreased recently, will add further impetus to convince a majority of the FOMC voting members to act after increasingly delivering hawkish comments. Chairman K. Warsh stressed that the Fed has a lot of work to do on the inflation front during the June press conference, while other FOMC members have been increasingly vocal on inflation risks. After hiking in September, we expect the Fed to keep interest rates in the 3.75-4.00% bound for an extended period – through

Figure 4: Cumulative 10-year impact of AI on labor markets and growth



Sources: LSEG Datastream, Bloomberg, Allianz Research

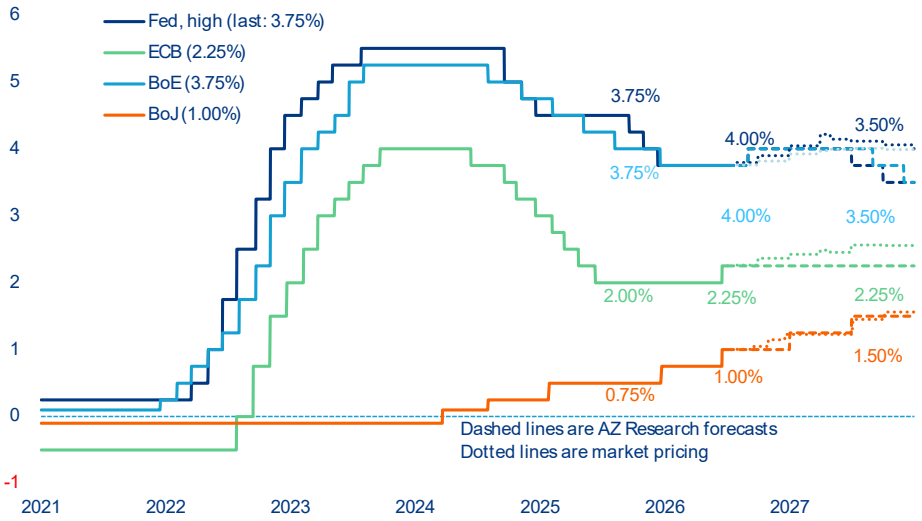
mid-2027 – to keep a sufficiently restrictive stance and oversee a reduction of core price pressures. We expect two rate cuts in H2 2027, pushing the Fed interest rate towards their neutral level of 3.25-3.5%.

The ECB is done for now after one insurance hike and inflation undershooting expectations. The ECB raised its policy rate to 2.25% on 11 June, reacting to inflation surpassing 3% and fears of a prolonged energy-price shock. With the notable de-escalation in the Middle East and oil prices having dropped to pre-war levels thereafter, inflation risks have largely dissipated. At the same time, the economy is still weak and operating below potential. Taken together, we do not see any reason for the ECB to hike further from here; it is instead likely to keep rates at current levels going forward. The current level could be seen as sitting at the upper range of the self-proclaimed neutral rate range of 1.75% to 2.25%, which is a good spot to be both now and going forward. Inflation is expected to hit the target in 2027 but at the same time growth should rebound mildly, justifying this policy stance. At the same time, quantitative tightening is continuing at full run-off speed – keeping pressure on long-term rates and capital markets but not on the real economy.

The Bank of England (BoE) is expected to deliver a 25bps hike in September. Despite continuing sticky wage growth and core inflation predating the Iran crisis, the BoE has so far refrained from increasing interest rates. Admittedly, positive real rates (on both the short and long end) even after the spike in energy prices have meant that the stance of UK monetary policy has been more restrictive than the Fed or the ECB. However, inflation expectations have started to drift up while wage growth has proved more sticky than expected recently. Business surveys point to UK corporates planning to increase selling prices sharply in the next couple of months. Meanwhile, GDP growth has proved resilient to the Iran shock. Against this backdrop, we expect the BoE to sound increasingly hawkish through the summer, and to deliver a 25bps rate hike in the September meeting, pushing the bank rate to 4%. Amid persistent core price pressures, we see the BoE on hold throughout September 2027, before cutting the bank rate to 3.5% by end-2027.

The Bank of Japan (BoJ) delivered a 25bps hike to 1% in June, as expected, supported by resilient activity despite disruptions from the Middle East conflict. However, inflation has remained subdued so far thanks to government subsidies and cap on energy prices even as underlying price pressures build. We expect inflation to pick up over the second half of the year as the pass-through from rising producer prices feeds into the broader economy, pushing 2026 inflation to +2.4%. Looking forward, we expect the BoJ to maintain its current pace, deliver the next hike in Q1 2027 and reach a final policy rate of 1.5% by end-2027.

Figure 5: Monetary policy key rates, %



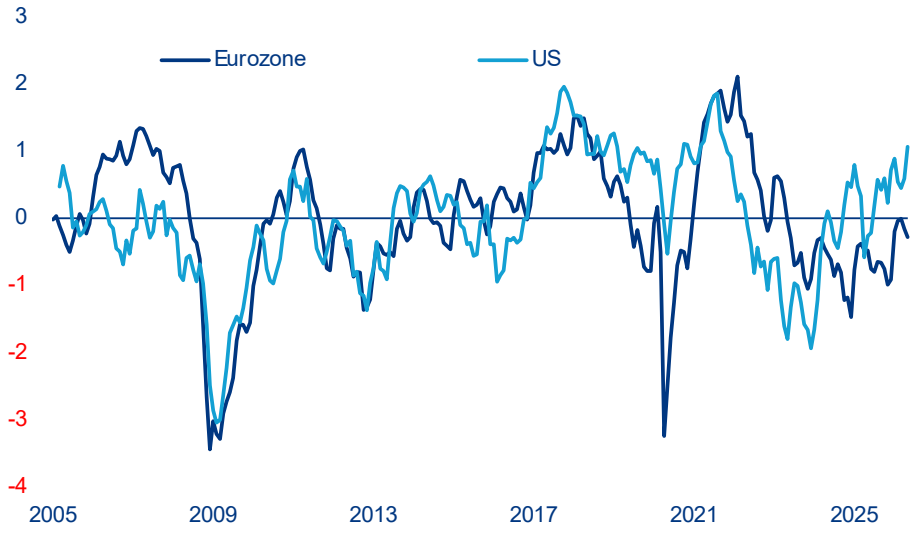
Sources: LSEG Datastream, Bloomberg, Allianz Research

Developed markets: Energy shock manageable

US growth is expected to be soft, at +2.1% in 2026 and +2.0% in 2027, with AI capex spending and consumer spending shaping the outlook. The spike in inflation in Q2 2026 has pushed US households' real income growth into negative territory. Yet, they have mostly "looked through" the temporary dip in purchasing power and continued to spend on non-energy items by reducing their savings, although expenditures have weakened noticeably since year. The savings rate fell to historical lows in April-May. Elevated equity prices have contributed to resilient consumption spending and a lower savings rate. While a sharper pullback of consumer spending represents one of the most significant near-term risks, surveys point to continued softness but no significant slowdown in the next months. Lower inflation should support spending heading into 2027, but we expect households to rebuild savings buffers, which should keep the consumption pick-up moderate. US GDP growth in 2026 should continue to be powered by strong AI-related investment spending, but we expect this momentum to fade in 2027 as hyperscalers consolidate their balance sheets and supply-chain strains constrain capex expansion. Meanwhile, fiscal policy is expansionary in 2026 but will turn slightly restrictive in 2027, with the federal fiscal impulse turning from +0.7% GDP to -0.1%. Tax cuts have helped support consumer spending this year, while tariff refunds have benefitted corporates. On trade, the fading momentum of the AI capex cycle should lead to a slowdown in imports growth in 2027.

Eurozone growth is set to slow in 2026 before recovering toward potential the following year. Ireland's outsized volatility – despite accounting for only ~4% of Eurozone GDP – is distorting the aggregate picture: its Q1 2026 contraction, reflecting the reversal of 2025's pharma-export boom, pulled headline Eurozone GDP into negative territory, even as the bloc ex-Ireland still expanded. We expect Eurozone growth ex-Ireland at a decent +0.9% in 2026 (+0.3% including Ireland), picking up to +1.2% next year. The bloc has also borne the brunt of the Hormuz shock, facing weaker growth and higher inflation as a net energy importer. The shock hit industry hard during the second quarter via input costs and margin pressure, while services activity – more exposed to confidence effects from the Iran conflict – also suffered. Providing some offset, Germany's defense and infrastructure stimulus is delivering near-term tailwinds, while Southern Europe continues to benefit from NGEU inflows.

Figure 6: Capex intentions, net balance, z-score



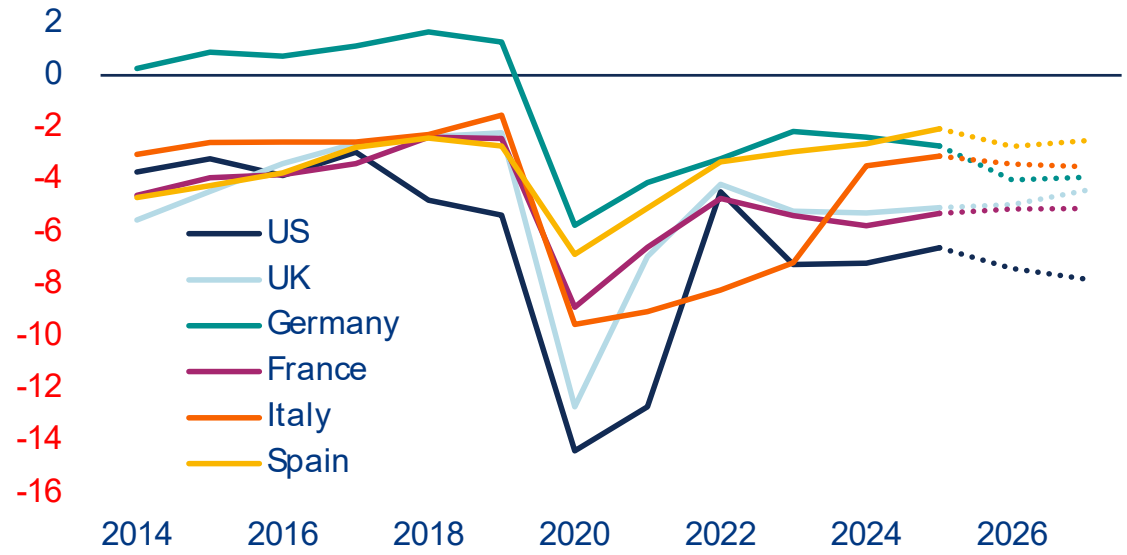
Sources: Philadelphia Fed, European Commission, Allianz Research

Germany's economic outlook remains fragile. GDP growth is forecast at +0.7% in 2026 amid geopolitical uncertainty, tariffs and elevated energy and input costs despite the fiscal bazooka, before improving to +1.2% in 2027 as trade tensions ease and fiscal support continues. Inflation is set to rise to +2.6% in 2026 due to increased energy and input prices, but moderate to +2.2% in 2027 as energy prices fall, though fiscal spending and wage growth will keep it above target. Fiscal policy is expansionary, with higher defense spending, a EUR500bn infrastructure fund and tax incentives supporting demand, while structural reforms and pension changes aim to address ageing-related pressures. The fiscal deficit will widen to around 4% and thereby surpass that of Italy and Spain in the next two years while and debt will rise to about 66% of GDP.

In France, GDP growth should be muted this year (+0.5%) amid tight fiscal policy and low consumer confidence. French economic momentum has taken a significant hit from the Iran crisis, with GDP growth expected to dip to a meagre +0.5% this year (after +0.9% in 2025). Despite elevated savings buffers, French households have slowed down their spending in the face of declining purchasing power. Furthermore, elevated input costs and a rise in mortgage rates are weighing on the housing market. Fiscal policy is tight, with the government firmly committed to reining in the deficit, which limits the degree of support to households and corporates' balance sheets and aggregate demand. The industrial sector and exports have been a bright spot, benefiting from strong demand for capital goods and transportation equipment. We expect a pick-up of exports in 2027.

The energy shock has likely weighed on Italy's activity, given its structurally high dependence on imported energy. Still, Italy kicked off 2026 with a degree of quiet momentum, surprising again on growth in Q1 (+0.3% q/q), helped by a positive contribution from the Winter Olympics. Remaining NGEU inflows are helping buffer both structural and cyclical weaknesses, while broader growth remains constrained by geopolitical tensions and global trade shifts. Overall, we expect GDP to grow by +0.6% in 2026 and +0.7% next year. Inflation has already eased to +3.0% y/y in June from May's +3.2%, with the fuel price cap helping cushion the pass-through of higher energy prices. Fiscal metrics will only be mildly affected by these temporary, untargeted measures, but 2027 looks tougher: NGEU grants – which partly count as revenue – wind down just as election-year spending pressures build.

Figure 7: Government fiscal balance, % of GDP



Sources : LSEG Datastream, Allianz Research

Spain continues to post above-Eurozone-average growth despite multiple challenges. GDP expanded by a still-solid +0.6% q/q in Q1, providing a strong carry-over into 2026; we expect economic growth to remain robust but to moderate from +2.8% in 2025 to +2.2% in 2026 and +1.7% in 2027. Crucially, Spain remains better insulated from the energy shock than most Eurozone peers: A structural shift toward renewables has meaningfully reduced exposure to volatile fossil fuel prices. In addition, the government has intervened with one of Europe's most ambitious crisis packages (a EUR5bn fiscal package), which has helped keep inflation anchored at +3.2% for three consecutive months. With that package set to expire just as a new round of measures is being negotiated, the durability of this inflation buffer is itself becoming a near-term risk to watch. Also, political fragility remains a key theme, with approaching elections compounding the challenge of sustaining reform and policy support without a stable parliamentary majority to pass it.

The UK economy has held up, thanks to supportive public policy, with GDP expected at +1.0% this year. While a concern for the BoE, elevated wage growth is supporting households' real income and consumption in the near term. Strong wage growth has been driven by the public sector, with hefty pay hikes decided by the government. As a result, we expect households' spending to grow at about the same rate as last year (+1.0%). Meanwhile, the strong government push for infrastructure spending is providing some impetus for the sector, though private activity remains weak. The residential sector is expected to dip sharply this year, hit by the double whammy of elevated input costs and higher mortgage rates. British exports should continue to be soft, constrained by trade frictions with the EU, though key products should outperform (pharmaceuticals, transportation equipment).

The Japanese economy remained resilient despite headwinds from geopolitical tensions and we expect GDP growth at +0.9% this year. Growth remains supported by exports linked to global AI demand and robust consumer demand, on the back of strong wage gains secured over the spring and government subsidies cushioning household energy costs. Fiscal policy continues to be a tailwind, with the Takaichi administration maintaining its expansionary stance and supporting near-term demand.

Emerging markets: The Middle East takes a hit

Exposure to energy imports continues to determine the impact of the US-Iran war on emerging markets, while stronger fundamentals have supported resilient performance. The latest shock has served as a live test of increased EM central bank credibility, restarting a hiking cycle or pausing cuts. Southeast Asian countries, together with South Africa, the Czech Republic and Türkiye were first movers, hiking between 25 to 100bps amidst the energy price pressures, while only a handful of EMs continued with their easing cycles (Argentina, Brazil, Mexico and Hungary). Moving forward, the most exposed countries, mainly in Asia, are forecasted to continue hiking through H2 2026, before returning to easing in 2027, while LATAM and CEE countries will begin and continue their easing cycles through the second half of 2026.

The Chinese economy faced headwinds from the disruptions related to the Middle East conflict, but we maintain our +4.7% forecast for 2026. The disruptions ranged from higher oil prices to lower external demand, but strong Q1 results with growth at +5%, driven by strong exports and robust AI demand, provided enough cushion to offset them. The key risk to the economy remains weak domestic demand, rooted in structurally high household savings and low consumer confidence.

Following the normalization in the Middle East, we expect inflationary pressures to peak in Q3 before easing in Q4, though price pressure should remain relatively contained, with consumer inflation at +1% in 2026, well below the +2% upper target. In the short term, Chinese firms are likely to pass most of the rising PPI burden through to export prices rather than absorb it, modestly eroding their competitiveness.

While the Asia-Pacific region was among the most exposed to the Iran conflict, the growth outlook holds firm at +4.3% in 2026, powered by the AI boost. However, gains are far from evenly shared, with a group of winners emerging, including countries such as Taiwan, Singapore and South Korea, while countries such as the Philippines and Indonesia lag as domestic turmoil compounds exposure to the conflict. Despite recent developments towards normalization in the Gulf, we expect inflation to remain elevated in the near term as second-round effects from elevated fuel, energy and fertilizer prices keep weighing on the region. This leaves central banks at different stages of their tightening cycles: We now expect the Philippines and Indonesia, which started earliest, to conclude, while India and South Korea still have hikes ahead.

The Middle East remains the most negatively impacted region, with GDP expected at -2.1% in 2026 as the direct war impact and closure of the Strait weights negatively on the economies. Growth is expected at +5.0% in 2027. In the Gulf, the drop in oil exports and collapse of tourism and trade will be the main contributors to negative growth, especially in small economies locked by the Strait, such as Bahrain, Kuwait and Qatar. Saudi Arabia, the UAE and Oman are expected to perform better, given that they could bypass the Strait.

In Africa, growth is expected to remain above +4% in 2026 and 2027, even though the war weighed negatively, with increased inflation pressures. The AI investment cycle is also contributing to a surge in exports of minerals and metals in several African economies, especially in the South and Central areas.

After a promising start to the year, Central and Eastern Europe has slowed as the Iran shock and weak German demand weighed on activity, triggering downward growth revisions across the region. We expect regional growth of +2.2% in 2026 before a modest pickup to +2.4% in 2027 as the Middle East disruption fades. Dispersion is wide: Poland remains the growth engine on sizeable EU-funds inflows, with the NBP looking through near-term price pressures, on hold at 3.75% and tightening only from end-2026. Romania is the outlier and the only economy set to contract as front-loaded fiscal consolidation bites and inflation accelerates toward +11% before favorable energy base effects pull it sharply lower from mid-year. Hungary and Slovenia, by contrast, have proved more resilient. The common channel is the consumer: Higher commodity prices and inflation fears have dented household confidence, threatening private consumption. Regional inflation should average +3.8% in 2026, normalizing toward +2.7% in 2027. The energy shock has left most central banks in wait-and-see mode. Czechia is the hawkish exception, having hiked to 3.75% on core pass-through, while Hungary has resumed its easing cycle on a firm forint and contained inflation. We forecast GDP growth of +3.4% in 2026 for Türkiye, reflecting resilient domestic demand despite restrictive financial conditions and elevated external uncertainty. Inflation is expected to remain stubbornly high at around 28-30% throughout 2026, delaying a more meaningful easing cycle, while the Turkish lira continues to appreciate in real terms, weakening business competitiveness and household consumption.

Latin America is expected to benefit from the normalization of inflation, allowing central banks to continue or resume monetary easing through H2 2026 despite heightened domestic uncertainty. The region is relatively insulated from the direct impact of higher energy prices, with several major economies benefiting from commodity exports and diversified export bases, although weaker global demand and tighter financial conditions will continue to weigh on activity. Growth should therefore remain moderate rather than accelerate, with external demand subject to continued pressure due to potential trade agreement reviews and Asian demand. Weather-related risks associated with a potential return of El Niño could create localized disruptions to agricultural and electricity production as well as food prices, while political uncertainty has generally receded following the completion of the region's main electoral cycle, with Brazil standing out as the principal exception as fiscal concerns and the election outlook continue to weigh on investor sentiment. Despite the expected monetary easing, corporate insolvencies are forecast to increase rather than decelerate, particularly in Brazil and Colombia, as the cumulative effects of higher-for-longer interest rates, slowing economic growth and still-tight financing conditions continue to weigh on corporate balance sheets.

Corporates: Resilience on borrowed time

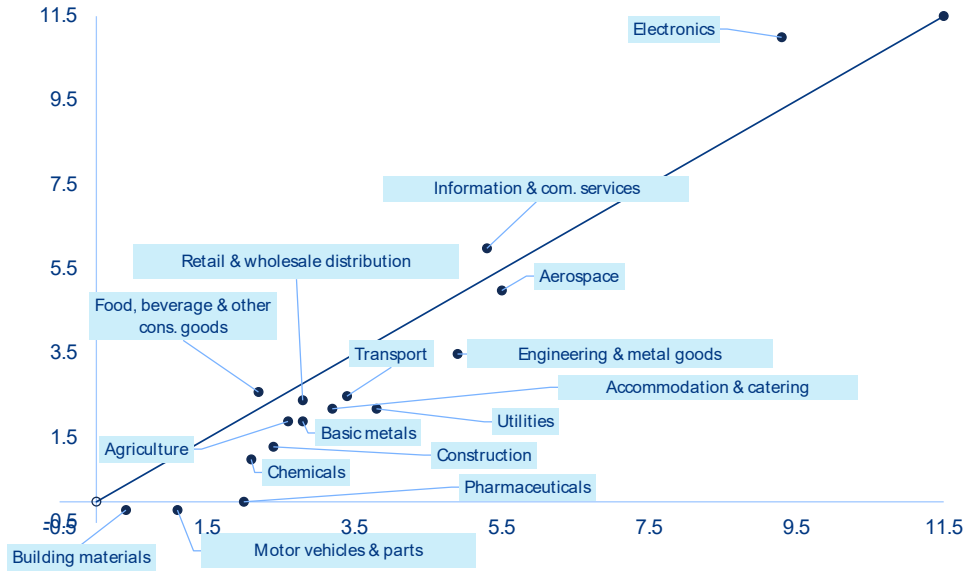
Corporate earnings across Europe and the US showed remarkable resilience through the first quarter of 2026. Most sectors held their ground and defied expectations of an immediate derailment. In Europe, the overwhelming majority of sectors reported positive EPS growth in Q1, with no broad-based collapse in profitability that might have been feared given the scale of the geopolitical shock. This is partly because the full economic pass-through of the disruption takes time to materialize and partly because commodity prices, while elevated, did not spike to catastrophic levels. In the US, the story was shaped above all by the technology sector, which continued to provide the primary driver of earnings momentum: AI-related capex remained robust, sustaining corporate profitability across the US market even as other headwinds intensified. The macro backdrop hitting Europe and the Middle East disproportionately harder than other regions had not yet fully percolated through to corporate income statements by the end of Q1. This timing gap between the geopolitical event and corporate earnings impact is a recurring feature of major supply shocks: the transmission channels through energy prices, shipping costs and consumer sentiment tend to work with a lag, meaning that Q1 2026 results largely reflected business conditions shaped before the worst of the disruption took hold. The headline story for Q1 2026 is therefore one of contained damage: companies entered the crisis with resilient balance sheets and, for at least one quarter, managed to absorb or defer the costs of the conflict.

Yet the resilience of Q1 should not be mistaken for immunity: a profitability squeeze might be on the horizon. Several sectors face delayed but very real consequences from the Hormuz disruption that are likely to materialize as early as Q2 2026. Firms across Europe are already signaling rising cost pressures through elevated selling-price expectations, while the broader outlook for corporate profitability is on the downside everywhere, a warning clearly visible in forward-looking business surveys. These signals suggest that the cost shock is working its way through supply chains and input prices even as top-line revenues have, so far, held up. The automotive sector stands out as a particular vulnerability, especially in Europe: Already under structural pressure from Chinese competition, auto manufacturers and parts suppliers carry elevated net leverage and are therefore acutely exposed to the higher short-term interest rates that have accompanied the inflationary consequences of the war. With central banks holding rates above pre-war levels to contain the inflationary shock, the debt servicing burden for highly leveraged sectors is set to intensify in coming quarters. There are, however, some pockets of relief. Jet fuel prices have eased ahead of the summer season, providing a tailwind for transport and aviation sectors during the peak travel period. The net picture for the remainder of 2026 is one of a two-speed corporate world: sectors with high pricing power and limited cyclical exposure could weather the storm, those with the opposite profile face a reckoning that Q1 figures only deferred.

2026 turnover growth forecasts have been revised down for 12 out of 16 sectors. The deepest revisions have fallen on sectors most directly exposed to energy cost pass-through and demand weakness (see Figure 8). Pharmaceuticals suffered the steepest cut, with 2026 turnover growth revised down by 2.0pps to 0% (from +2.0% in March) as the sector contends with both higher input costs and softening consumer purchasing power. Utilities saw their growth estimate reduced by 1.6pps to +2.2%, reflecting the overhang of elevated energy prices on industrial and household demand. Motor vehicles and parts fell 1.3pps to -0.2%, tipping into negative territory and confirming the sector's particular vulnerability. Other notable downward revisions include construction (-1.1pp to +1.3%), chemicals (-1.1pp to +1.0%). Against this broadly downbeat picture, three sectors bucked the trend and received upward revisions. Electronics stands out most sharply, upgraded by 1.7pps to +11.0%, powered by the continued acceleration in AI hardware investment and data center build-out that has proved resilient to the macro environment. Information and communication services also moved higher, up 0.7pp to +6.0%, while food, beverages and other consumer goods received a modest upward revision of 0.4pp to +2.6%, supported by the normalization of agricultural commodity prices following the initial war-driven spike. Looking into 2027, the revisions picture is more balanced, with growth broadening across a wider range of sectors as the Hormuz disruption fades and supply chains normalize.

Business insolvencies are projected to increase by +4% globally in 2026 (-2pps vs. April forecasts). Notably, the war in Iran and its various spillovers have not triggered a wave of additional insolvencies. Q1 marked a 15th consecutive quarter of year-on-year increases, slightly above +5% globally, following a strong +10% in Q4 2025. All regions contributed positively – North America (+19%), Asia (+3%, +11% excluding China) and Western Europe (+6%, now in its 20th consecutive quarter of y/y growth). The exception is Central and Eastern Europe, which posted its first decline (-10% y/y) after 14 quarters of increases. Over the last four quarters, the global trend stands at approximately +7%. Early Q2 data does not point to any exceptional rebound or surge relative to pre-war expectations. Most countries posted y/y declines in April and May, though fewer working days may partly explain this outcome. Year-to-date, a slim majority of countries are on the downside – most often from already elevated levels. Yet our headline indicator still points to +5% y/y globally, as the largest markets (US, Brazil, Japan, Germany, India, South Korea, France) see insolvencies stable at high levels or on a prolonged uptrend. China remains the major exception, with fewer cases than anticipated. We continue to expect a delayed profitability squeeze in the coming months, bringing greater differentiation across countries and sectors depending on their exposure to war-related spillovers – and conversely, their ability to benefit from global tailwinds (AI, defense). Overall, the global rise in insolvencies is expected to continue in 2026 (+4%) before stabilizing in 2027, marking five consecutive years of increases. North America would be the largest contributor, with US insolvencies projected to extend their rebound (+9% in 2026). Asia will see contrasting trends, with most countries prolonging their rise except Australia, Singapore and Hong Kong. Western Europe is expected to post a modest increase (+2%) in 2026, followed by a slight decline (-3%) in 2027, with most countries (nine out of 17) within the -4%/+4% range, indicating quasi-stable insolvency levels, often high by historical standards.

Figure 8: Turnover growth forecast change (%, June forecast vs March forecast)



Sources: Oxford Economics, Allianz Research

Capital markets: Cautiously optimistic

Capital markets navigated a volatile second quarter, dominated by the Iran conflict and its aftershocks. Oil prices, which had surged past USD120 a barrel on the closure of the Strait of Hormuz, tumbled back to pre-war levels following the mid-June MoU between Iran and US, while equities staged a sharp recovery: All major indices more than erased their war-related losses with the MSCI world even surpassing double digit performance year-to-date. Yet the relief has come with caveats. The Federal Reserve, under new chair Kevin Warsh, struck a more hawkish tone at its June meeting, flagging the risk of renewed hikes and dampening investor hopes for easy monetary policy. Markets have also chosen to look through the plethora of risks ahead, buoyed by resilient growth and the ongoing AI boom. We expect this constructive backdrop to persist but narrow. Rates should gradually decline as inflation pressures fade, equities remain underpinned by strong earnings and AI-driven demand despite stretched valuations. Credit should keep delivering solid carry even as issuance nudges spreads wider from historically tight levels. Within private markets, dispersion remains the defining theme, with AI-linked infrastructure and high-quality credit set to outperform.

The Fed and the ECB are trading different macro tapes, yet the rates market could end up in a surprisingly similar place. Both central banks are seen in a hawkish stance in the short-run to contain a common energy-price shock but their macro environment diverges. In the US, the monetary-policy outlook tightened against a backdrop of resilient activity and a starting disinflation trend. In the Eurozone, the ECB is expected to further tighten into an economy operating below potential and where inflation recedes more slowly. This divergence is paradoxically equally supportive for duration, notably in the belly of the curve. We see markets shifting to a bull flattening in the US and a bull steepening in the Eurozone. The US curve will gradually move back toward a late-cycle profile. The front end might remain volatile due to fragile monetary policy expectations and residual inflation risk, the improving price dynamics and decreasing positive output gap argue for a lower long end of the curve with a 10y yield at 4.35% at year-end and 4.1% in 2027. At current yield levels, intermediate and long maturities offer an attractive mix of positive real returns and convexity. In the Eurozone, we expect the stagflation narrative to fade as price presses eases and concerns over real activity become the main concern. We expect a bull steepening of Euro curve as markets will reassess the ECB's hawkish leeway on the short end of the curve while the long end remains anchored by a stable term premium keeping the 10y Bund yield around 3%. The belly is therefore the sweet spot to benefit from this curve move in a three to 12 months horizon.

Table 3: Capital market forecasts

EMU	Last*	Unit	2023	2024	2025	2026f	2027f
Government Debt							
ECB deposit rate	2.25	%	4.00	3.00	2.00	2.25	2.25
10y yield (Bunds)	2.94	%	2.03	2.36	2.85	2.90	3.00
10y EUR swap rate	3.00	%	2.48	2.39	2.93	2.90	3.00
20y EUR swap rate	3.23	%	2.51	2.39	3.23	3.00	3.10
Italy 10y sovereign spread	79	bps	168	117	65	80	80
France 10y sovereign spread	79	bps	53	83	71	90	60
Spain 10y sovereign spread	48	bps	97	70	44	40	40
Corporate Debt							
Investment grade credit spreads	76	bps	135	101	78	80	90
High-yield credit spreads	262	bps	395	311	270	280	315
High-yield credit spreads ex-CCC	216	bps	333	239	219	230	250
Equity							
Eurostoxx (total return p.a.)	14 ytd	%	19	10	25	14	11

US	Last*	Unit	2023	2024	2025	2026f	2027f
Government Debt							
Fed Funds rate (high)	3.75	%	5.50	4.50	3.75	4.00	3.50
10y yield (Treasuries)	4.47	%	3.87	4.57	4.16	4.35	4.10
Corporate Debt							
Investment grade credit spreads	75	bps	104	82	79	80	90
High-yield credit spreads	272	bps	334	292	281	290	325
Equity							
S&P 500 (total return p.a.)	11 ytd	%	26	25	18	13	11

UK	Last*	Unit	2023	2024	2025	2026f	2027f
Government Debt							
BoE rate	3.75	%	5.25	4.75	3.75	4.00	3.50
10y yield sovereign (Gilt)	4.80	%	3.54	4.57	4.47	4.80	4.60
Corporate Debt							
Investment grade credit spreads	80	bps	134	91	80	90	100
High-yield credit spreads	388	bps	515	364	420	430	450
Equity							
FTSE 100 (total return p.a.)	9 ytd	%	8	10	26	9	8

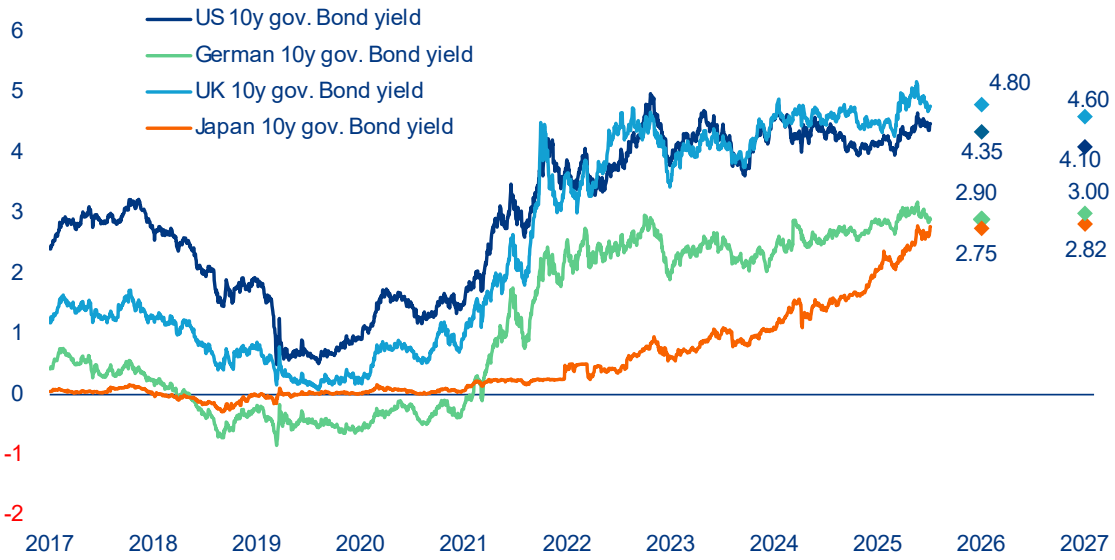
Emerging Markets	Last*	Unit	2023	2024	2025	2026f	2027f
Government Debt							
Hard currency spread (vs USD)	238	bps	384	325	253	245	270
Hard currency spread ex-CCC (vs USD)	165	bps	215	202	163	170	185
Local currency yield	6.09	%	6.19	6.39	5.87	6.20	6.10
Equity							
MSCI EM (total return p.a. in USD)	24 ytd	%	10	8	34	29	12

FX & Commodities	Last*		2023	2024	2025	2026f	2027f
EUR USD	1.14	$ per €	1.10	1.04	1.17	1.15	1.15
Oil (Brent)	72	$ per bl	78	75	61	75	67
Natural gas (Dutch TTF)	44	€ per MWh	32	49	28	41	32

Sources: LSEG Datastream, Bloomberg, Allianz Investment Management
Notes: Year end figures
* As of 6.Jul 2026

Source: LSEG Datastream, Allianz Research

Figure 9: 10y government bond yields including forecasts, %



Sources: LSEG Datastream, Allianz Research

Among Eurozone sovereign bonds, valuations are broadly fair. The special support for Italian BTPs from NGEU flows is fading, while French OATs are likely to trade temporarily wide to Italy as political risk premia are repriced ahead of the presidential election. Our central scenario remains a centrist victory; if that holds, OAT spreads should re-compress and may again move below Italy once the political risk premium normalizes. German Bunds will maintain their safety premium versus the EUR swap curve. This should keep front-to-belly swap spreads positive. The long end stays capped by term premium and a weak duration demand. Overall, German swap spreads should stay tight and broadly range-bound.

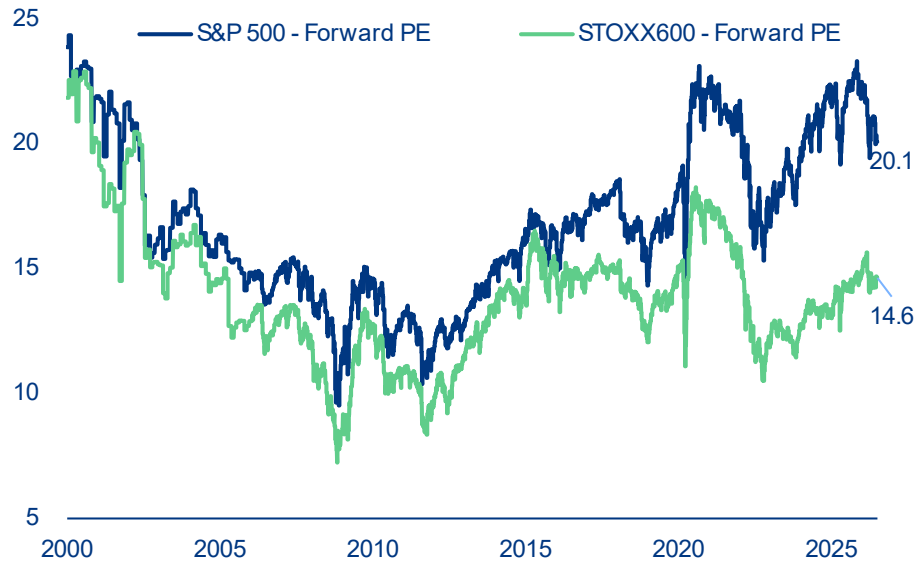
The EUR/USD exchange rate traded within a range of 1.14–1.18 during the last quarter, broadly the same range that has prevailed over the past year. Movements within this range continue to be driven by a combination of opposing factors. On the positive side for the euro, persistent policy uncertainty in the US has provided support. On the negative side, geopolitical risks such as the conflict with Iran, although currently fading, have weighed on the currency. In addition, the AI investment theme remains heavily US-centric and continues to support the US dollar. More recently, lower-than-expected inflation figures in the Eurozone have provided additional support for the euro, bringing EUR/USD back towards the lower end of its trading range around 1.14. Overall, we view the current exchange rate as being close to fair value and therefore expect broadly flat performance going forward.

Global equity markets are entering Q3 2026 on solid footing. The S&P 500 has risen by +11% year-to-date, and the Eurostoxx has risen by +14% (total return). Markets have also shown welcome resilience to the conflict in Iran. The Eurostoxx has now recovered its war-related losses and is trading at a level that is 1.5% higher than before the conflict began, even though the situation remains prone to flare-ups following the memorandum to end the war that was signed in mid-June. This resilience supports a positive medium-term outlook for equities, although the distribution of near-term outcomes still carries a downside bias related to the durability of the ceasefire. A confirmed, lasting stand-down would further bolster European equities, given the region's sensitivity to energy prices and geopolitical risk premia. However, renewed strikes or ceasefire violations, as witnessed in the aftermath of the signing, would curtail this potential upside before it translates into earnings. Valuations remain split. The S&P 500 trades at 20.4x forward earnings, compared to 14.7x for the STOXX 600. This difference is largely justified by expected earnings growth: 29.8% for the S&P 500 and 13.5% for

the STOXX 600. This leaves further upside for US equities capped at the level of actual earnings, while Europe's relative discount continues to offer a cushion rather than a catalyst. There is room for either mean reversion higher should the ceasefire hold or compression of the price-to-earnings ratio should it not. Beyond absorbing equity market liquidity, IPOs can create additional selling pressure as venture capital investors receive listed shares that no longer fit their mandates and may reduce positions after the lock-up period. This could weigh on AI stocks and challenge market sentiment, particularly as current valuations appear to rely more on confidence in future growth than on present-day financial metrics. Looking ahead, we forecast total returns of 13% for the S&P 500 in 2026 (easing to 11% in 2027) and 14% for the Euro Stoxx (easing to 11%), with a selective approach favoring quality earnings over growth optionality being advisable until the geopolitical landscape stabilizes further.

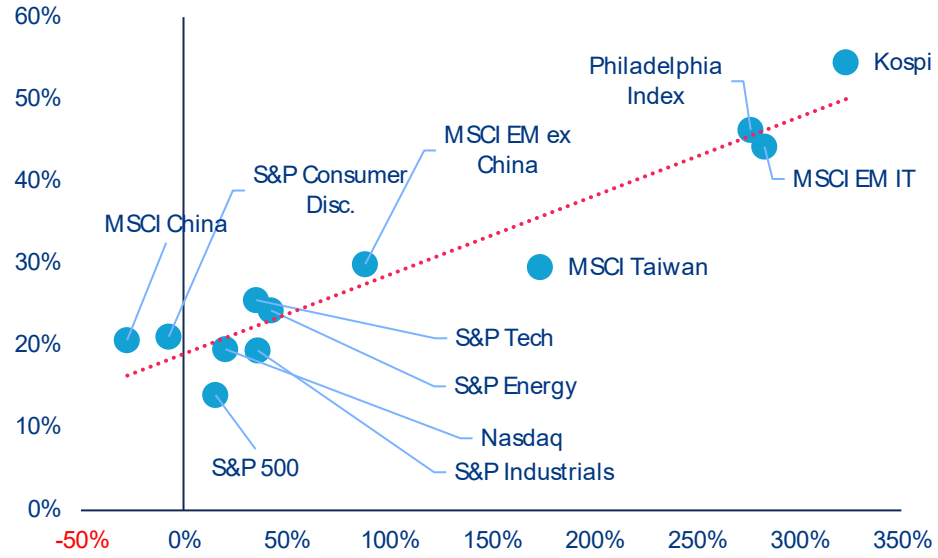
Semiconductors remain the dominant driver of both returns and volatility across global equity markets, and the cycle is not yet exhausted. The Kospi and the Philadelphia Semiconductor Index sit at the top of the return-risk frontier with annualized returns above 250% – substantially outpacing broader indices like the S&P 500 and Nasdaq, which cluster in the 10-30% return range. Our cyclical analysis of South Korean semiconductor export prices – one of the most reliable leading indicators of the global semi cycle – shows the cyclical component had not yet peaked as of late June 2026, with the reading spiking sharply to its highest level since the early 2000s. Historical episodes show the cycle typically overshoots before reversing, and on that basis the trade still has meaningful room to run. This matters for index-level positioning: Given how heavily semi-exposed markets like South Korea and Taiwan have contributed to recent return dispersion, the durability of this cycle is a first-order input into both regional allocation and sector-level conviction. The risk, as ever, is that a confidence shock in AI-linked capex spending – the primary demand driver behind the current upcycle – could turn the cycle faster than the price signal alone would suggest.

Figure 10: Forward price-earnings ratio for US and European equities



Sources: LSEG Datastream, Allianz Research

Figure 11: Risk-return analysis of selected equity indices, 2026 ytd



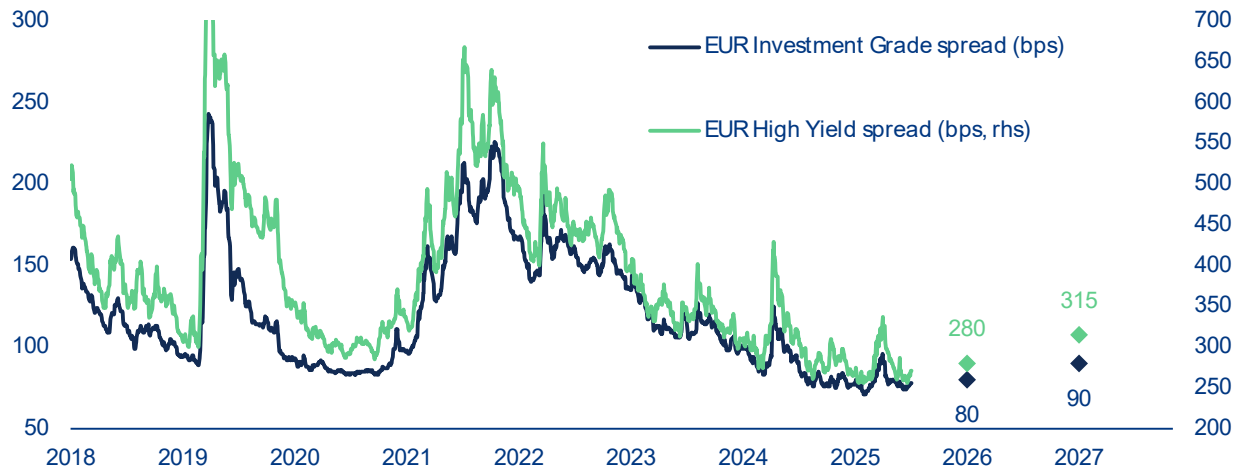
Sources: LSEG Datastream, Allianz Research
Notes: Annualized returns (x-axis) vs annualized volatitility (y-axis)

Corporate credit markets proved resilient through the first half of 2026 despite private debt concerns, the software selloff and the Iran shock. Investment-grade spreads settled around 76–77bps in both Europe and the US, slightly tighter than at the start of the year. Spreads are tight but elevated all-in yields still offer a cushion to total return. With steady rates and growth, faded tail risk and supportive technicals, carry – the income earned from holding credit – was and will continue to be the main source of return. That said, today's tightness is largely demand-driven and therefore less durable: yield-seeking buyers are price-sensitive and could pull back quickly if the rates outlook shifts.

Looking forward, in Europe, spreads should hold around current tight levels – near 80bps for investment grade and 280bps for high yield – through 2026, supported by a mild macro backdrop and steady demand for yield against limited net supply. In 2027 we expect a moderate widening to 90bps for IG and 315bps for HY, anchored by fundamentals rather than a sharp correction: credit metrics are slipping slightly below average and the net upgrade trend is losing momentum. US investment-grade follows a similar path, while high-yield spreads are expected to drift toward 290bps, wider than Euro high yield due to lower rating quality. The ratings drift is slightly weaker in the US credit market with downgrades prevailing, but the downgrade trend has started to ease. Fundamentals – especially leverage ratios, lifted by the growing share of AI-related financing – warrant a closer look.

EM debt benefits from strong fundamental background and constructive sentiment. However, valuations are stretched for hard currency, while local currency tends to underperform under Fed tightening cycles. The structural growth advantage of emerging markets remains intact, with EM growth continuing to outpace that of advanced economies by a meaningful margin. This growth differential is expected to widen further, supporting sovereign creditworthiness and reducing default risk, thereby providing a solid fundamental anchor. Demand dynamics have been exceptionally strong, driven by sustained inflows into the asset class and increasing participation from crossover investors. As a result, EM sovereign spreads remain at multi-year tight levels, reflecting both robust fundamentals and supportive technicals. Also, spreads offer no premium relative to US corporates. At the same time, spread volatility remains low and does not fully capture prevailing geopolitical uncertainties. From the current levels, spreads are expected to widen modestly to around 270bps by 2027. With hard currency spreads offering no additional pick-up, EM local currency assets provide relatively better

Figure 12: European corporate credit spreads, bp



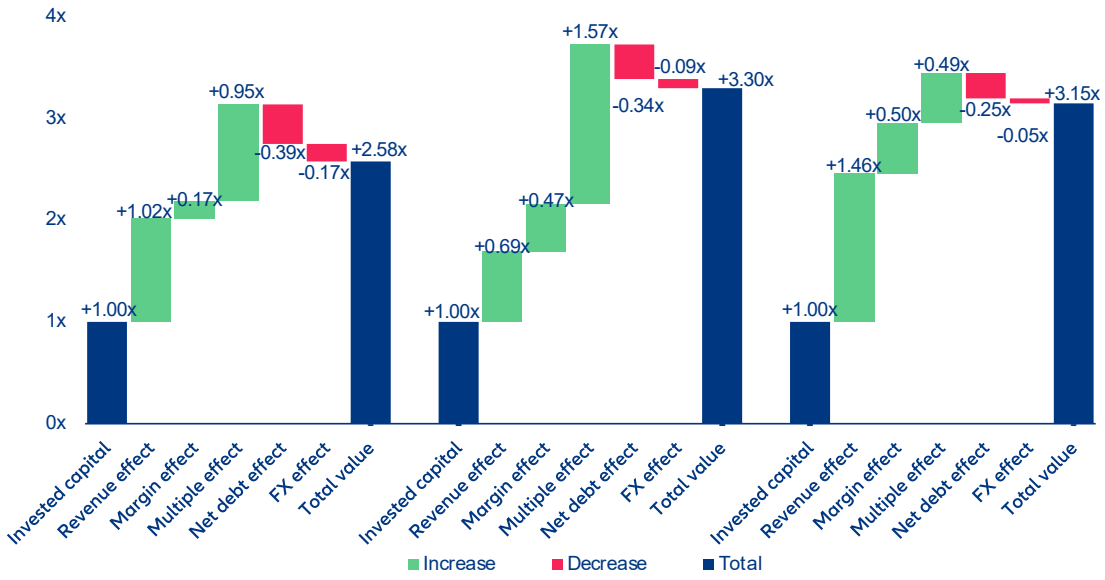
Sources: LSEG Datastream, Allianz Research

value at current yield levels. Considering their correlation with US Treasury yields and ongoing EM central bank cycles, LC yields are expected to move broadly sideways. Even though the valuation looks better for EM LC, it has historically underperformed during Fed tightening cycles, which warrants a neutral view in the current environment.

Across private markets, a pair of forces is doing most of the sorting: interest rates that stay relatively high and AI defining the line between winners and losers. The same dichotomy bears on each asset class differently. Private equity is stuck at the exit, with a record backlog of unsold companies and fundraising starved to match. Private debt still earns its elevated coupon but stress is gathering in the weakest, AI-exposed borrowers. Infrastructure is the clear standout, carried by the data-center build out at the heart of the AI supercycle. Real estate is recovering, if unevenly, as cheaper financing slowly filters through, but AI keeps a lid on the office recovery. The common thread is dispersion, capital is rewarding contracted, well-covered, AI-aligned assets and shunning the rest, and the gap between the two is the widest in years. But that dispersion is as much an opportunity as a warning. Thematically aligned pockets are still expected to perform through the cycle (i.e. defense, AI etc.), but generalist strategies might see their returns compress.

Private equity is at a turning point. Its basic model – buy a company, improve it, then sell it on at a profit – has slowed sharply at the exit, leaving a striking backlog of unsold companies. US buyout funds now hold more than 13,300 of them, about a decade's worth of sales at the current pace. Most were bought in 2020-21, when money was cheap, valuations rich and software allocation was high so they are now hard to sell at those prices. With little cash flowing back, investors stay reluctant to commit fresh capital and most of what is raised pools into the largest funds. Even so, the conditions for a thaw are quietly building as rates stabilize which should lead to a timid gradual recovery rather than a sudden snapback of exits. The more important shift is in where returns come from. The cheap re-rating that drove the 2020-21 peak is over; from here, value has to be earned operationally, through revenue growth and wider margins rather than rising multiples or cheap leverage. That rewards managers who can genuinely improve the businesses they own and leaves the rest behind. Taking all this together, and with the "Softwarepocalypse" still mostly ahead, we expect private equity to return around 7-9% this year, with a stronger pickup towards 11-12% in 2027 as private equity markets normalize (Figure 13).

Figure 13: US private equity value bridge

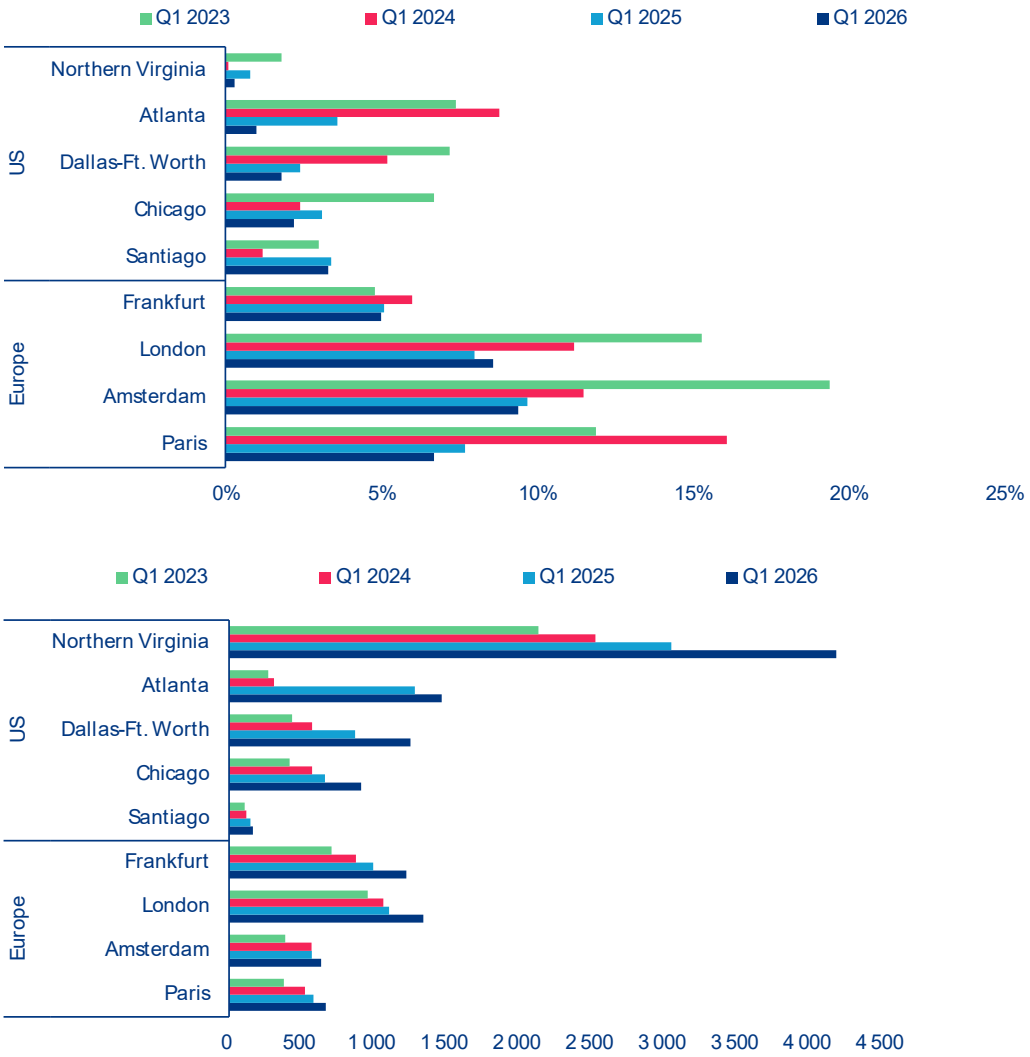


Data as of Q2 2025. Pooled value bridge across a subset of exited buyout holdings, weighted by invested capital.
Sources: MSCI Private Capital Universe, MSCI Private Asset and Deal Metrics data

Private debt entered the year as one of the better positioned private market sub-asset classes, and the shock it was bracing for has now partly arrived. Much of the alarm bundles four distinct worries (retail-vehicle redemptions, loan quality, software concentration and wrapper design) into one, overstating the systemic threat. If anything, the macro supports the income case, with the Fed holding near 3.75–4.00% into mid-2027, relief comes only after the 2027–29 maturity wall. As a result, floating rate coupons stay high, a tailwind for income but a headwind for the weakest borrowers, whose coverage is squeezed and where payment-in-kind is spreading, now around 8% of BDC investment income. Also on valuations, marks flatter the divergence. Private NAVs continue to hold while listed vehicles trade near 17% discounts. Positioning turns on two points. The asset class straddles the AI story, a legacy software book exposed to disruption versus a fast growing book financing the datacenter build out. Along these lines, capital is rotating accordingly, toward asset-based finance, infrastructure, opportunistic strategies, Europe and closed-end structures. In this junction, direct lending still offers income and seniority, but the prudent posture is selective, not directional, by favoring the senior, well covered and well disclosed books, and treating transparency and capital structure, not headline yield, as the binding constraint. We expect spreads to remain compressed around the 500-550bps range as the pipeline has a quality bias due to software having fallen out of favor and demand remaining high.

Infrastructure is expected to sustain strong performance, underpinned by AI buildout as a growth lever. Data centers continue to dominate the deal market this year. Despite strong new-build across major regions, demand keeps outstripping supply, holding vacancy at record lows (Figure 14) while rents keep growing strongly. With power, permitting, and land constraints sustaining the scarcity, the economics stay attractive for ready-to-use data centers contracted long-term to investment-grade counterparties. Two tailwinds are strengthening the case. First, the token economics are getting more compelling: usage keeps surging despite significant efficiency gains as workloads shift from chatbots to agentic, reasoning-heavy models and the paradigm grows more compute-intensive. Token prices are stabilizing at the frontier even as serving costs keep falling, supporting provider margins. Hyperscaler AI revenue is now beginning to cover the capex depreciation, pointing to a more sustainable cycle. Second, rising data sovereignty demands across regions add a further durable tailwind. We continue to see infrastructure as a strong play in the AI supercycle – the foundation on which the whole AI stack is built – with tangible, contracted earnings rather than speculative upside.

Figure 14: Despite strong new-build (up), data center demand keeps outstripping supply, driving record-low vacancy rates (down)



Sources: CBRE, Allianz Research

Real estate continues to recover in 2026, though along another bumpy and uneven path. The recent energy-led inflation spike and a hawkish near-term policy stance have weighed on pricing and decision-making, but the macro environment ahead is expected to turn more supportive. With the Iran conflict de-escalating and energy pressures easing, we expect the Fed to deliver a final hike before pivoting to cuts, and the 10-year yield to drift lower. This combined with shrinking new supply and resilient occupier demand should underpin a progressive, income-led recovery. Capital is returning selectively, with the widest dispersion in years between prime and secondary assets and between structural winners (data centers, industrial) and laggards (trophy office), driven by the structural tailwinds and disruptive risks of AI.

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