Autumn Economic Outlook 2024-26: The great balancing act

Allianz Research

End of Q3 2024 updated economic and capital markets outlook

30 September 2024

Economic outlook 2024-26: The great balancing act

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1	**Steady (not stellar) global growth ahead at +2.8% until 2026, in line with the long-term average.** The US economy is slowing but will remain the main support to the global economy in 2024. Momentum is gradually building in Europe but will be weak in China, given the absence of major stimulus.
2	**Recession risks in the US are rising but the economy is still within the range of a soft landing** helped by strong household finances, a rising trend in manufacturing investment and its technology sector. However, US consumption is expected to slow further next year, in line with the slowdown of earnings growth. In Europe, leading indicators still show recession risks but are improving from low levels.
3	**It's austerity time (again).** The fiscal consolidation ahead will be the big elephant in the room as it will represent a drag on GDP growth of around -0.3pp on average until 2027 in both US and Europe. Tax hikes, mainly on corporates, are more likely than spending cuts. In addition, quantitative tightening (QT) will transfer more than 3pps of debt/GDP per year to investors in Europe.
4	**Inflation should reach the 2% target in H1 2025, allowing for a strong(er) easing cycle ahead**. Inflation surprised on the downside during the summer, and we expect sticky services inflation to soften slowly, driven by decelerating wages, while energy and goods will continue to drag inflation down. Oil prices should remain below 80 USD/bbl in 2025-26 in the absence of a stronger recovery in demand and no supply shock. Gradual central bank easing should continue until terminal rates are reached next year, with the Fed cutting down to 3.5%, the ECB to 2.25% and the BoE to 3.0%. Emerging market central banks will cautiously proceed with their easing cycles as portfolio inflows should pick up again on more favorable interest rate differentials.
5	**Real wage growth revives consumers' purchasing power, but excess savings continue to build up in Eurozone countries amid subpar confidence**. Consumer spending has favored services over goods, but amid high inflation, services sales in volume have started to slow. Some durable goods are likely to be replaced in the next quarters, especially in Europe, in line with the replacement cycle. Nominal wage growth is set to normalize by 2025 in line with the cooling down of labor markets once some corporates (mainly in food, auto, materials, and machinery & equipment) reduce labor hoarding.
6	**Restocking has started and is likely to be a tailwind for the global trade recovery.** H1 confirmed the exit from 1.5 years of trade recession, and we expect the recovery to be more sustained going forward, along with the rebound in consumption. Overall, we expect global trade to increase by around +3% in 2025-26 in volume terms, but to remain below the long-term average.
7	**Corporates are recovering by digging into inventories.** Revenues and earnings growth in Q2 were fueled by corporate destocking. The Europe-US divide persists; despite a slight improvement in corporates' financials in Q2, Eurozone fixed capital investment fell to 7% below pre-pandemic levels and far behind peers such as the US and the UK. Major insolvencies continued to accelerate, mainly in retail, construction and services. Overall, we expect business insolvencies to rise by +10% in 2024 and by +1% in 2025.
8	**Capital markets remain under the spell of central banks.** Markets are now pricing a strong policy rate cutting cycle for most Western central banks, dragging long-term government bond yields lower while providing some tailwinds to riskier investments, with government bond spreads in Southern Europe narrowing further. As we see less easing by the Fed and the ECB compared to market pricing, we do not see long-term yields falling below current levels in the near term.
9	**Risky assets at the mercy of political uncertainty**. After a relatively weak Q2 earnings season, which has partially deflated some market imbalances (e.g. AI boom), market participants have quickly lowered expectations for corporates' growth capabilities. Nevertheless, decent single-digit earnings and revenue growth paired with declining financing rates should help maintain a decent single-digit return profile over the next three years. However, still elevated (geo)political uncertainty will keep investors awake as periods of heightened volatility are to be expected.
10	**Geopolitical tensions pose downside risks to our scenario** with a potential surge in US protectionism if Donald Trump wins the US elections, along with high political uncertainty in major European countries (France, Germany, Belgium, Netherlands…) as well as the ongoing conflicts in Russia-Ukraine and the Middle East and tensions in the South-China-Sea and with Taiwan. Overall, our downside scenario translates to -1.5pp lower global growth and +1pp higher inflation, which would keep interest rates higher for longer.

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Global macro 2024-2026

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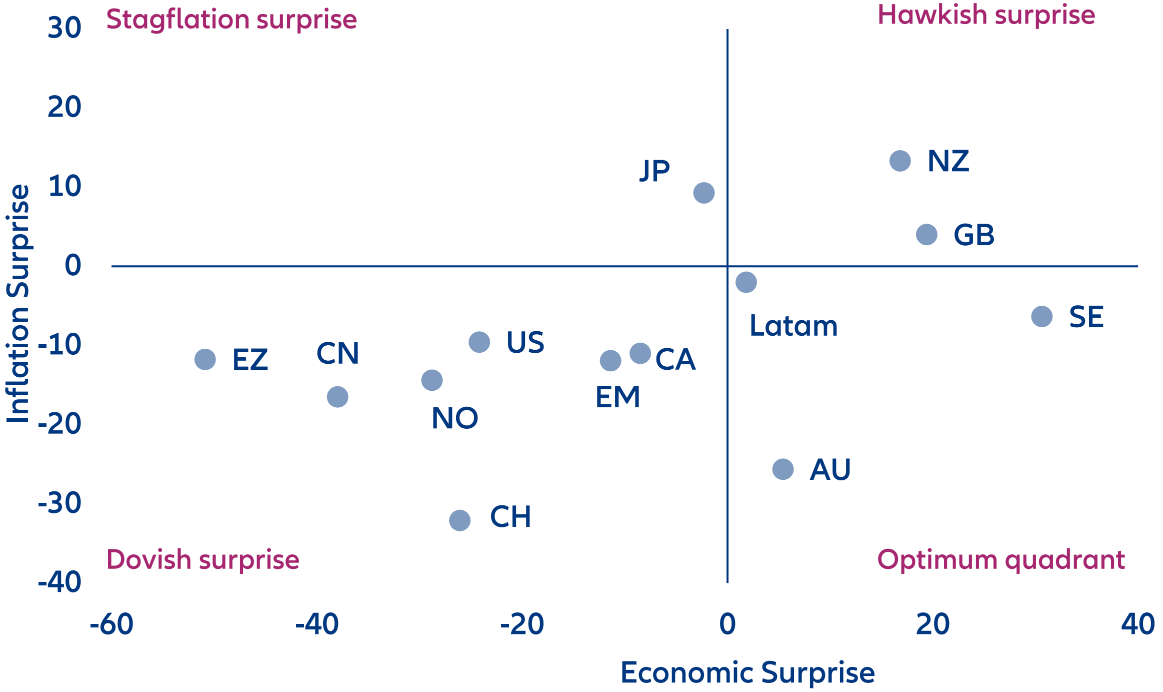
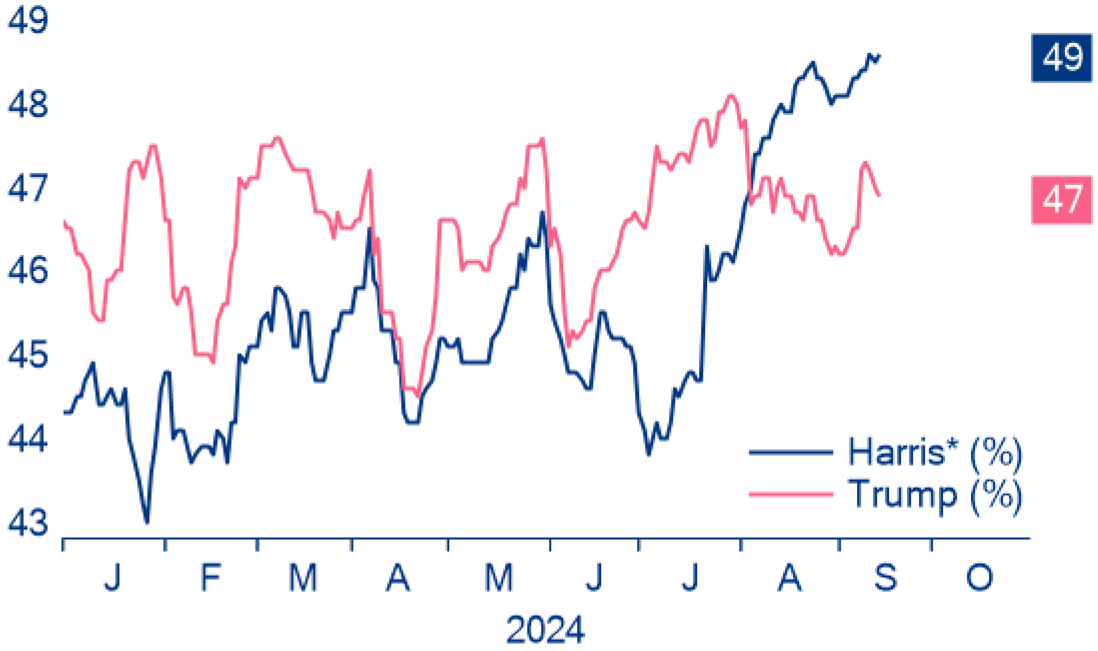
What have we learned during summer? 1/2

Inflation and economic activity surprised on the downside, initiating a faster monetary easing cycle



Sources: Citi, LSEG Datastream, Allianz Research
Notes: Citi Economic Surprise index on the x-axis and August inflation versus economists' expectations on the y-axis.

Democrats overtook Republicans in the polls



Sources: RealClearPolitics, LSEG Datastream, Allianz Research
* Chart also shows Joe Biden polls until he dropped out in July and gave way to Kamala Harris.

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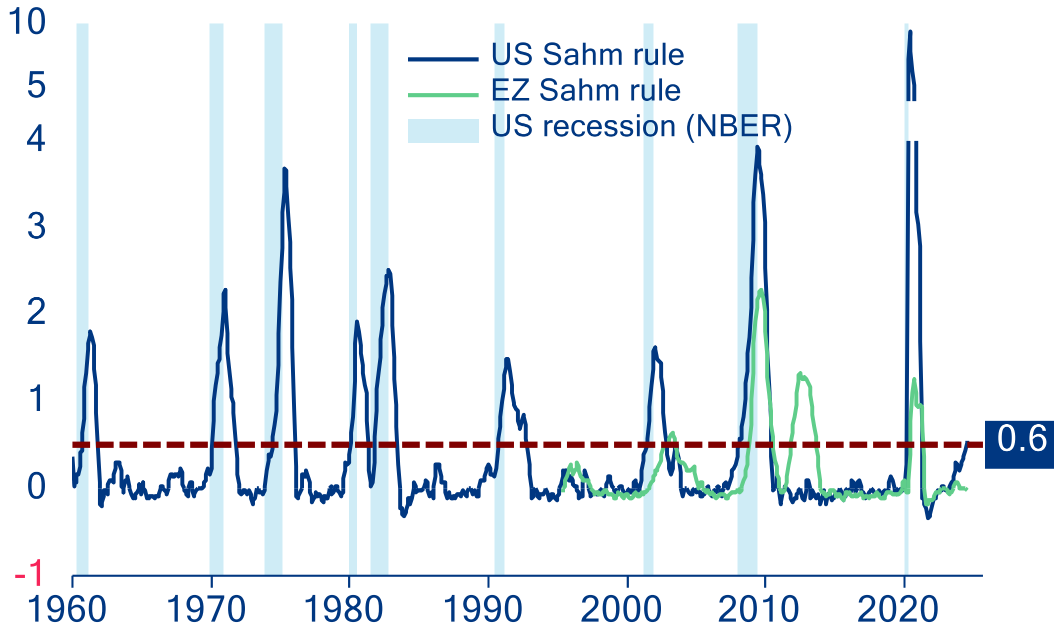
What have we learned during summer? 2/2

US labor market points to increasing risks as the unemployment rate slowly edges up

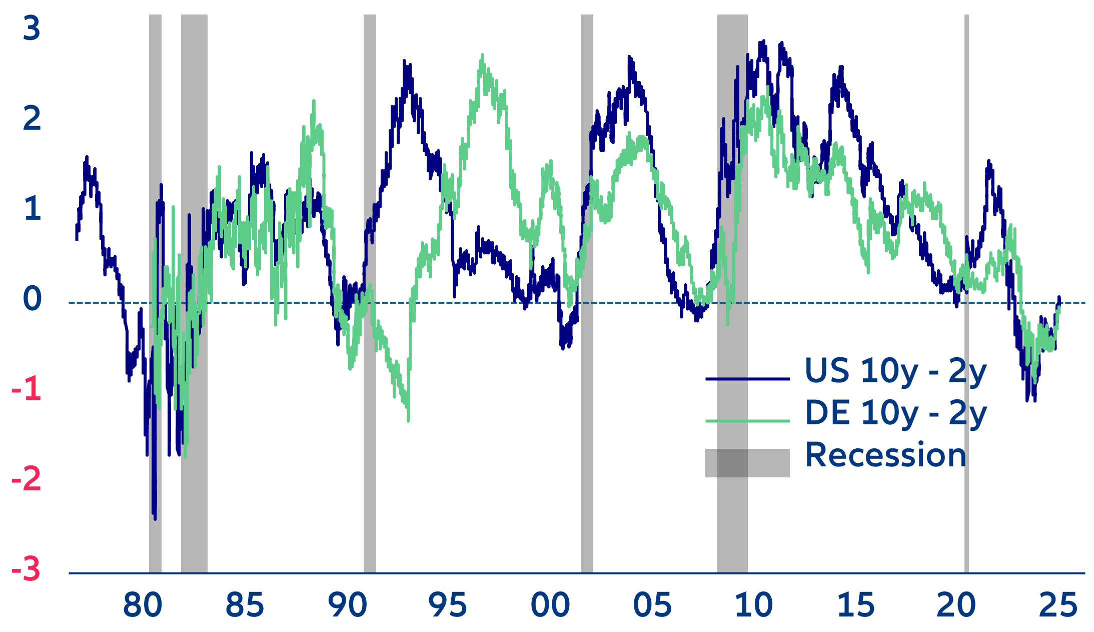
%



Sources: LSGE Datastream, Allianz Research
Sham rule = three-month average of the unemployment rate – 12-month low. When it rises above 0.5 p.p. the rule predicts the early stage of a recession.

Recessions usually started when the yield curve normalizes, but this time should be different

pp



Sources: LSGE Datastream, Allianz Research

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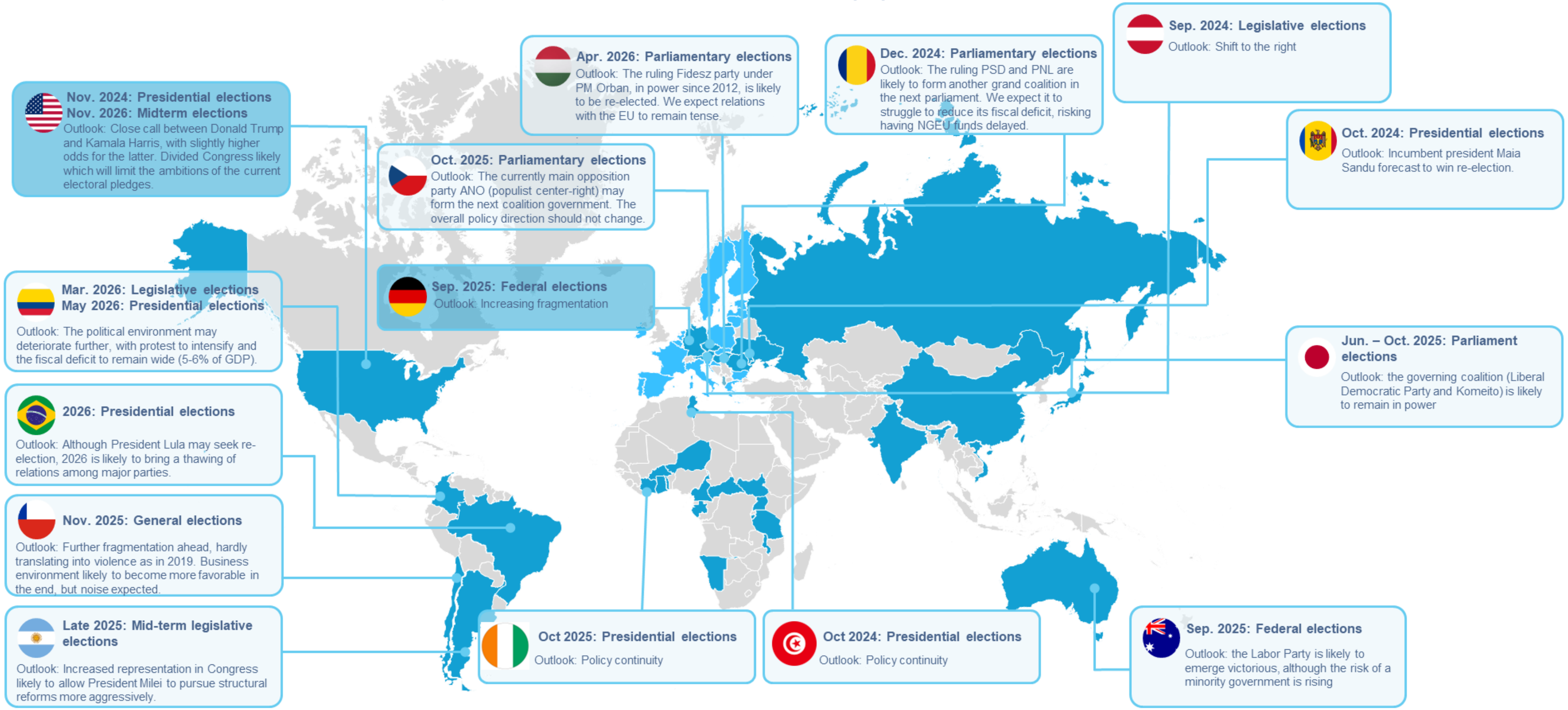
Geopolitical risk will continue to weigh on the economic outlook

Political uncertainty world map with upcoming general elections in 2024-26



Ongoing geopolitical conflicts in Russia-Ukraine, Middle east and tensions in the South-China-Sea and Taiwan.

Our Baseline: No further significant escalation.

France and UK still on the watch list

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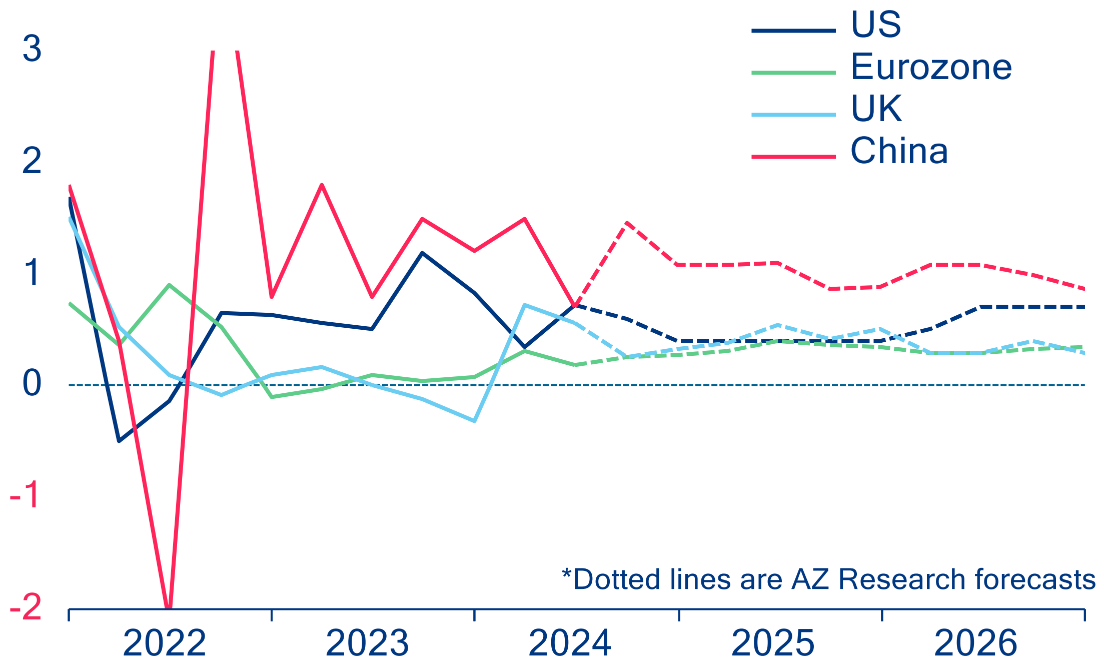
Steady (not stellar) global growth ahead

Global real GDP growth (%)

Growth (yearly %)	2022	2023	2024f	2025f	2026f
Global	**3.1**	**2.7**	**2.8**	**2.8**	**2.8**
USA	**1.9**	**2.5**	**2.6**	**1.7**	**2.2**
Latin America	**3.9**	**1.9**	**2.0**	**2.7**	**2.6**
Brazil	3.1	2.9	2.1	2.4	2.0
UK	**4.4**	**0.1**	**1.2**	**1.8**	**1.3**
Eurozone	**3.5**	**0.5**	**0.8**	**1.4**	**1.4**
Germany	1.7	-0.1	-0.1	0.7	1.1
France	2.6	1.1	1.1	1.4	1.2
Italy	4.2	1.0	0.8	1.2	0.9
Spain	5.8	2.5	2.7	2.0	2.0
Central and Eastern Europe	**1.1**	**1.1**	**2.4**	**3.3**	**3.3**
Poland	5.9	0.1	3.0	3.8	3.6
Russia	-1.3	3.7	3.9	2.2	1.6
Türkiye	5.5	4.5	4.0	4.1	4.0
Asia-Pacific	**3.2**	**4.3**	**4.2**	**4.0**	**3.8**
China	3.0	5.3	5.0	4.3	4.0
Japan	1.2	1.8	-0.0	1.2	1.0
India	6.5	7.8	7.0	6.4	6.4
Middle East	**6.1**	**1.3**	**1.9**	**3.4**	**3.5**
Saudi Arabia	7.5	-0.8	1.4	4.3	4.1
Africa	**3.9**	**3.0**	**3.2**	**3.6**	**3.6**
South Africa	1.9	0.7	1.2	1.7	2.0

European growth catches up with the US sequentially

GDP growth, q/q in %



Sources: LSEG Datastream, Allianz Research

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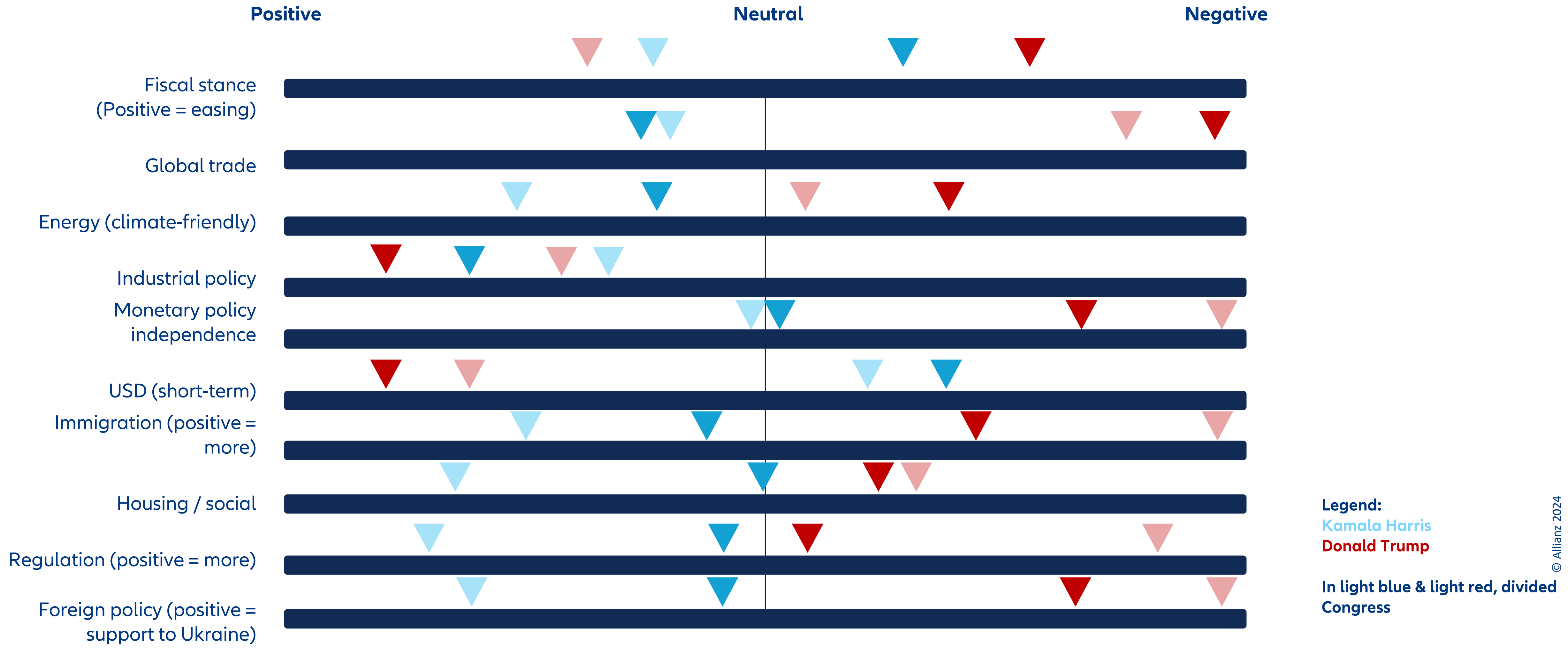
US elections: Trumponomics vs Harrinomics



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What a Trump government would mean for the economy and capital markets in the US

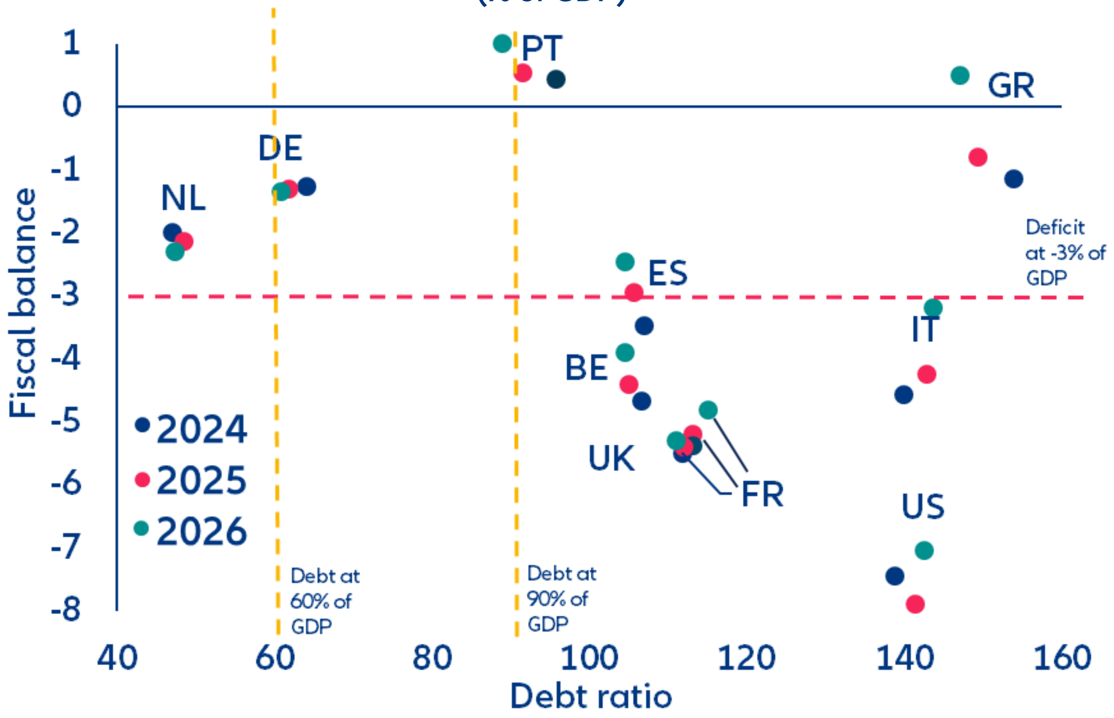
			Policy continuity (50%)			Trump – contained trade war (25%)		Trump – disruptive trade policy (20%)	
			Moderate fiscal tightening ; tariff hikes concentrated on China.			*Contained trade war (US effective tariff rate to 4.5%) ; stepped-up boarder controls on imports ; moderate fiscal expansion funded by customs receipts*		*Full-blown trade war (US effective tariff rate to 12%) ; stepped-up border controls on imports fiscal expansion funded by customs receipts, but weaker economy increase deficits*	
Economic indicators	Unit	2023	2024	2025	2026	2025	2026	2025	2026
Real GDP growth	%	2.5	2.6	1.7	2.2	1.2	1.9	0.3	1.6
Inflation	%	4.1	2.9	2.2	2.2	3.8	2.9	4.4	2.6
Fiscal deficit	% of GDP	6.2	5.8	6.2	5.4	6.5	5.9	7.2	6.6
Fed policy rate	% (eop)	5.50	4.50	3.50	3.50	4.50	4.00	4.75	2.75
Market indicators	Unit	2023	2024	2025	2026	2025	2026	2025	2026
10y Treasury rate	%	3.87	3.90	3.70	3.70	4.30	4.00	4.40	3.40
IG – Corp. spread	bps	104	100	90	85	110	90	200	160
HY – Corp. spread	bps	334	330	320	310	360	330	600	450
S&P 500	ytd%	26	13	8	9	7	12	-15	10

Sources: LSEG Datastream, Allianz Research

It's austerity time (again)!

Excessive Deficit Procedure has been launched for FR, IT, BE due to breaches to the new EU fiscal rules...

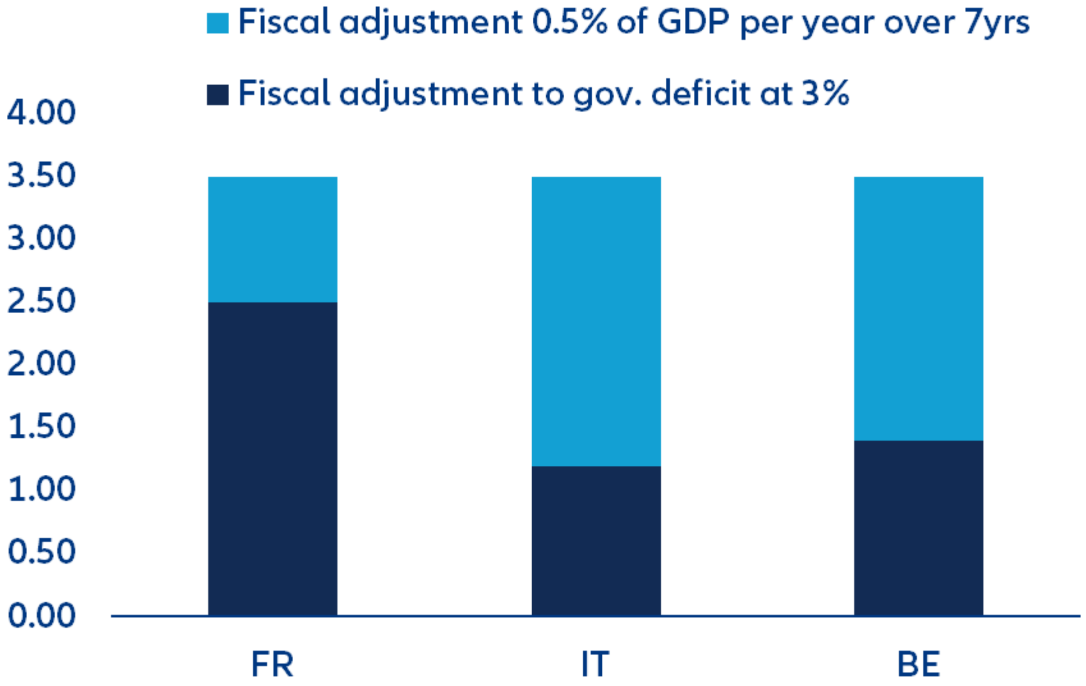
(% of GDP)



Sources: LSEG Datastream, IMF, EC AMECO, Allianz Research.

...with fiscal adjustment required weighing on countries' growth to around -0.3pps per year

% of GDP

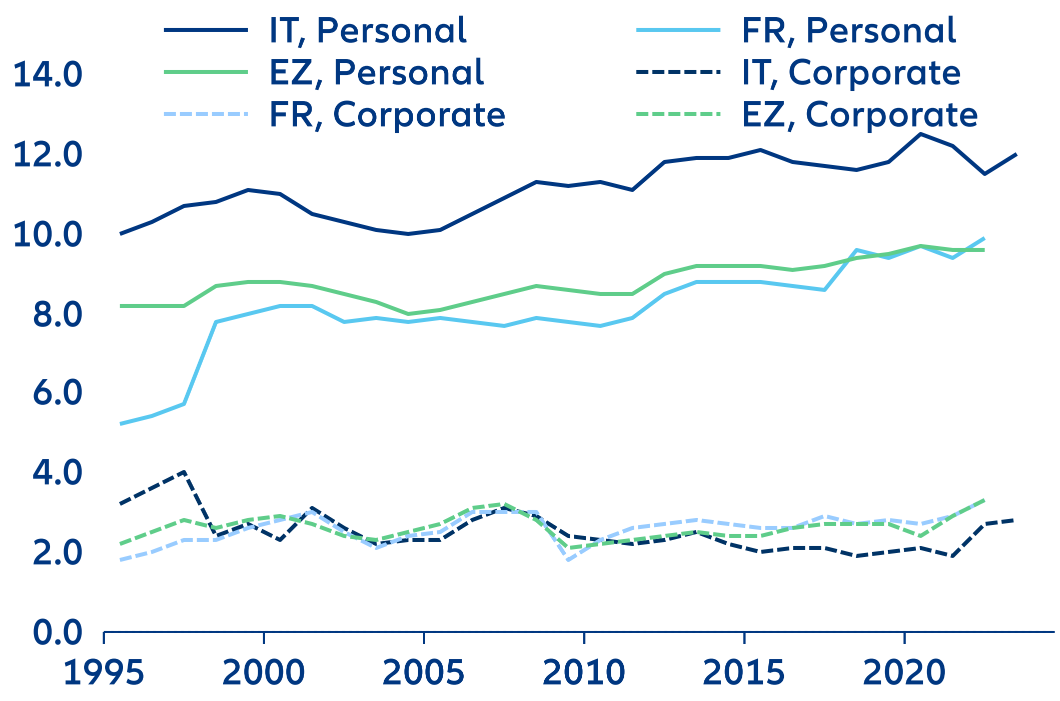


Sources: LSEG Datastream, Allianz Research.

Austerity likely to be achieved through higher taxes

Corporate tax hikes are more likely…

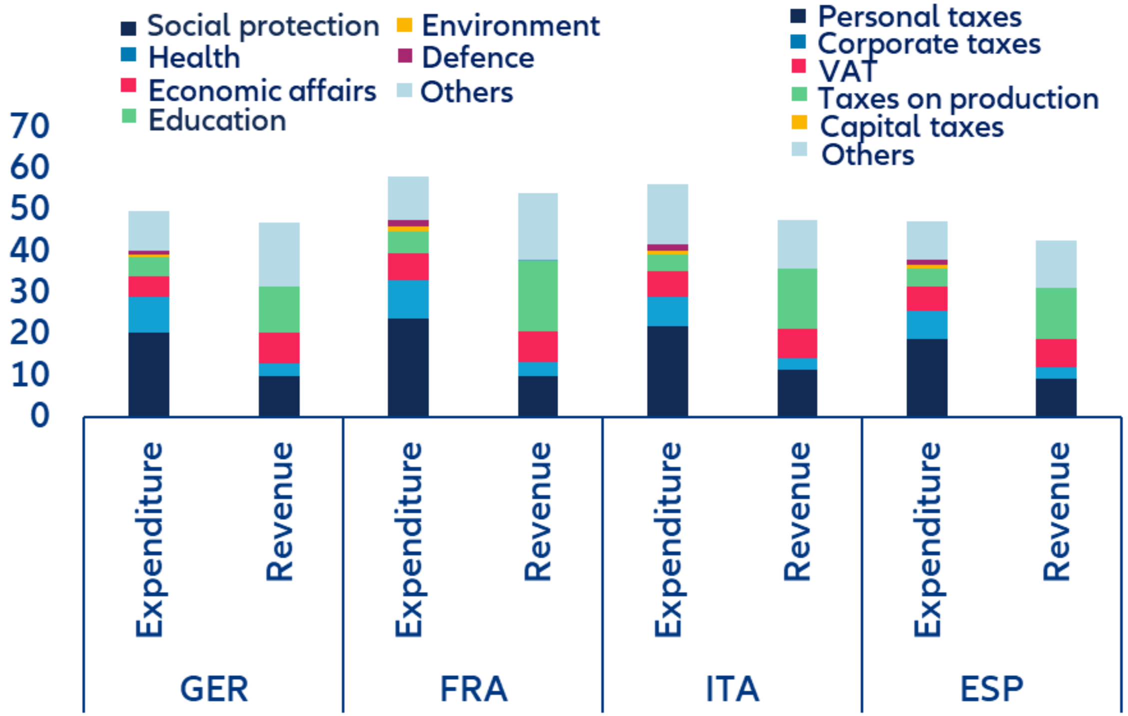
Personal and corporate income tax, % of GDP



Sources: LSEG Datastream, Allianz Research.

…than spending cuts

Government expenditures and revenues, % of GDP



Sources: LSEG Datastream, Allianz Research.
Note: 2022 is the latest available data

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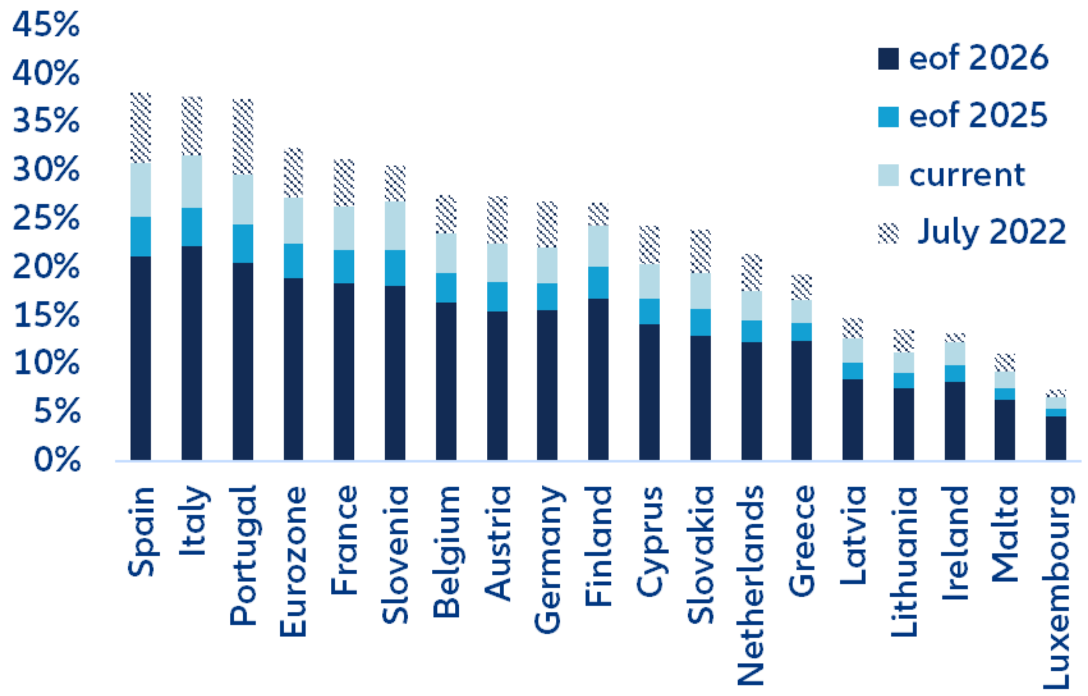
Despite fiscal tightening, investors must buy significant amounts of sovereign debt from the ECB

Quantitative tightening flushes more than 3pp of debt/GDP per year to investors

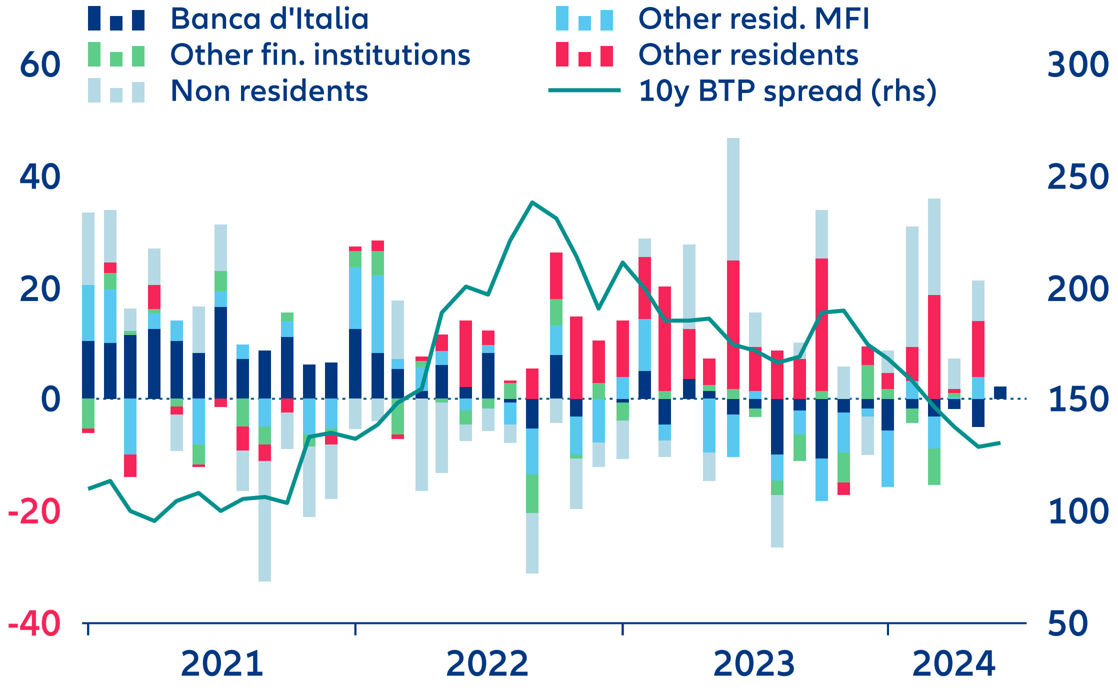
ECB holdings of sovereign debt in % of GDP



Sources: ECB, LSEG Datastream, Allianz Research

Domestic investors, attracted by high yields continue to fill the gap

Italian government bond flows, EUR bn

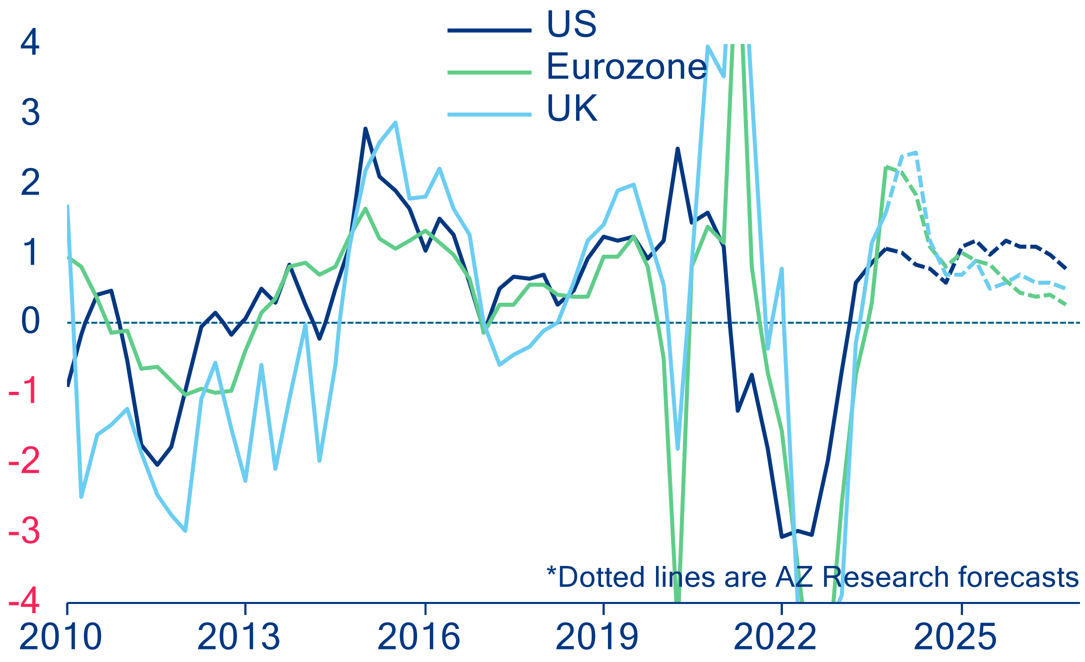


Sources: LSEG Datastream, Allianz Research

Consumers: Reckoning time soon?

Real wage growth revive consumers' purchasing power

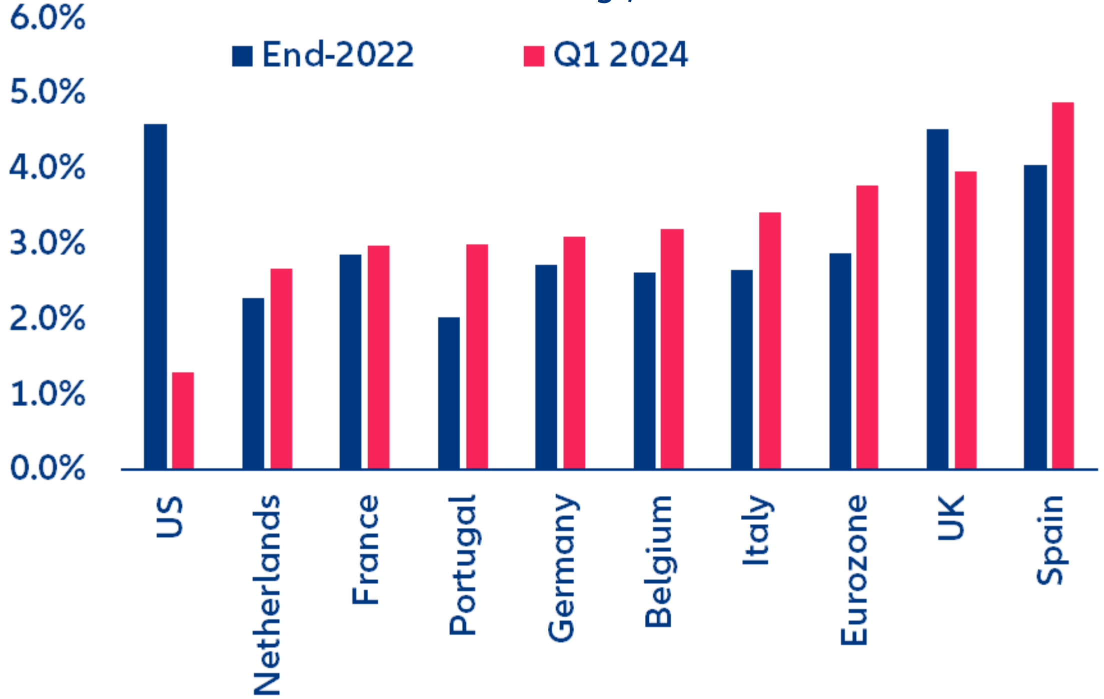
Real wage growth, y/y in %



Sources: LSEG Datastream, Allianz Research

But excess savings continue to build up in Eurozone countries amid subpar confidence

Excess savings, % of GDP



Sources: LSEG Datastream, Allianz Research

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Consumer: Rebalancing between goods & services spending to come ?

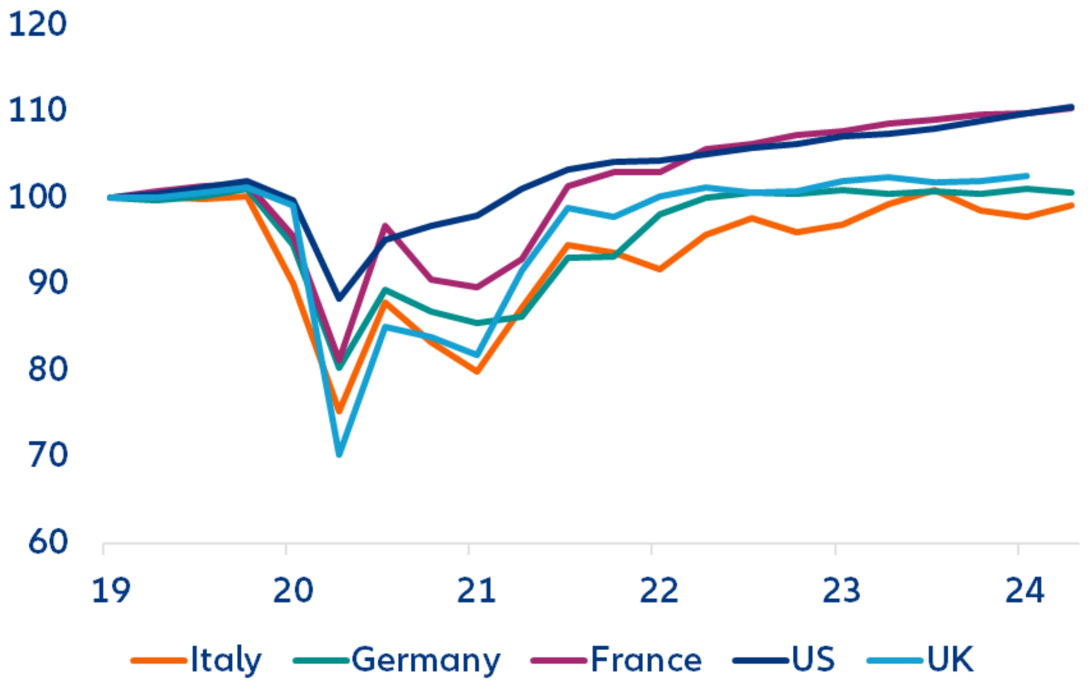
Consumer spending has favored services over goods

Aggregate US, UK, France, Germany - y/y in %

Sources: LSEG Datastream, Allianz Research

Amid high inflation, services sales in volume start to stall

Index, Q1 2019=100

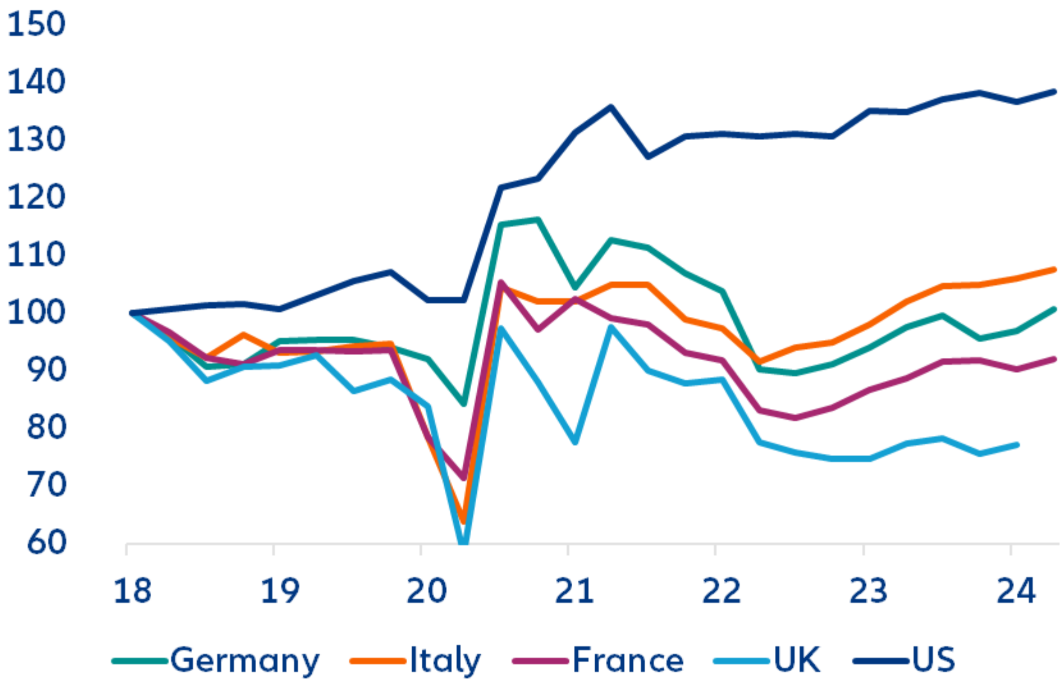


Sources: LSEG Datastream, Allianz Research

Some durable goods are likely to be replaced in the next quarters especially in Europe

Large volumes of durables bought in 2020-2021…

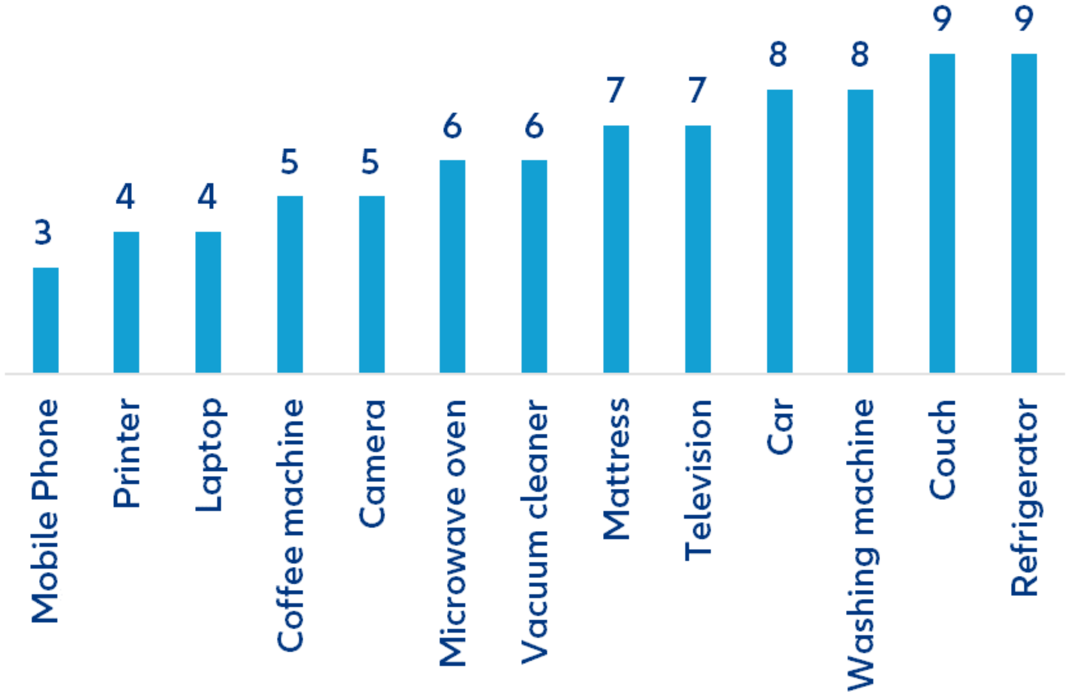
Index, 100 = Q1 2018



Sources: LSEG Datastream, Allianz Research

…could be up for replacement

Life of span in years

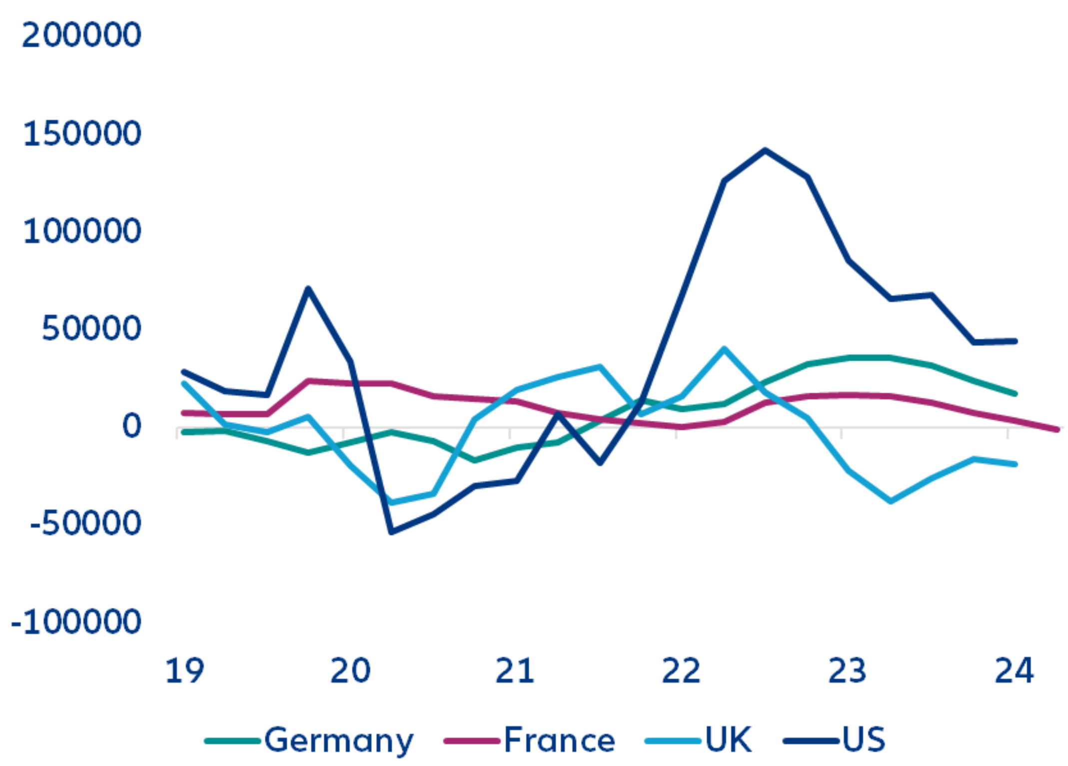


Sources: various sources, Allianz Research

Corporates are recovering by digging in inventories

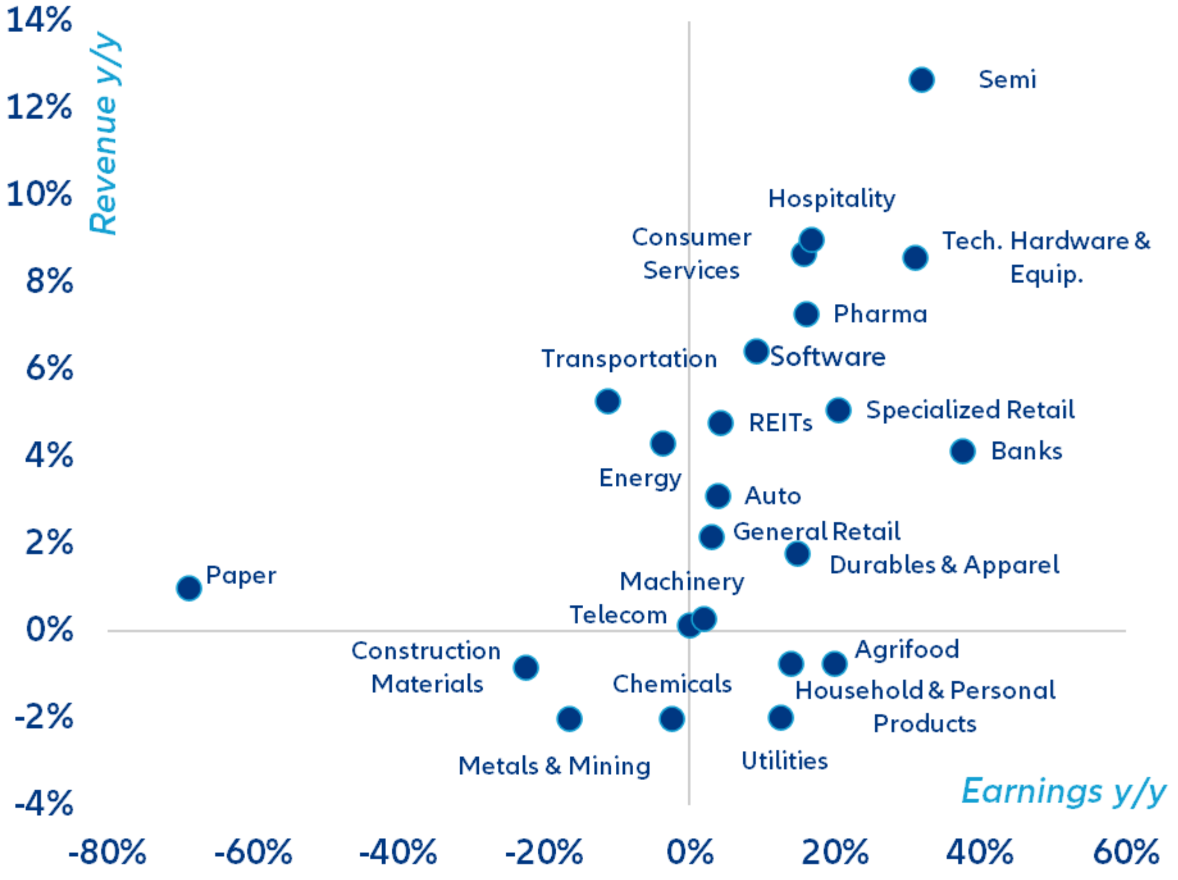
Inventories have decelerated quite substantially

Change in inventories, USD millions 4Q cumulative



Sources: LSEG Datastream, Allianz Research

Which allowed most sectors to grow in Q2



Sources: LSEG Refinitiv, Allianz Research
Note: the scope is global

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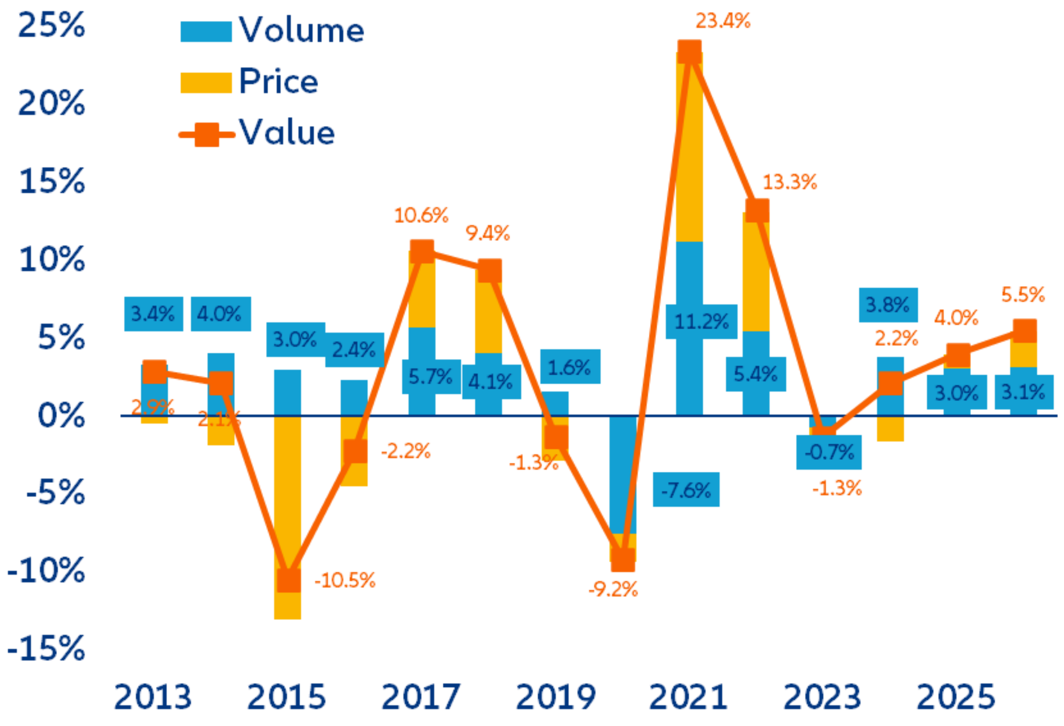
Restocking a tailwind for global trade recovery

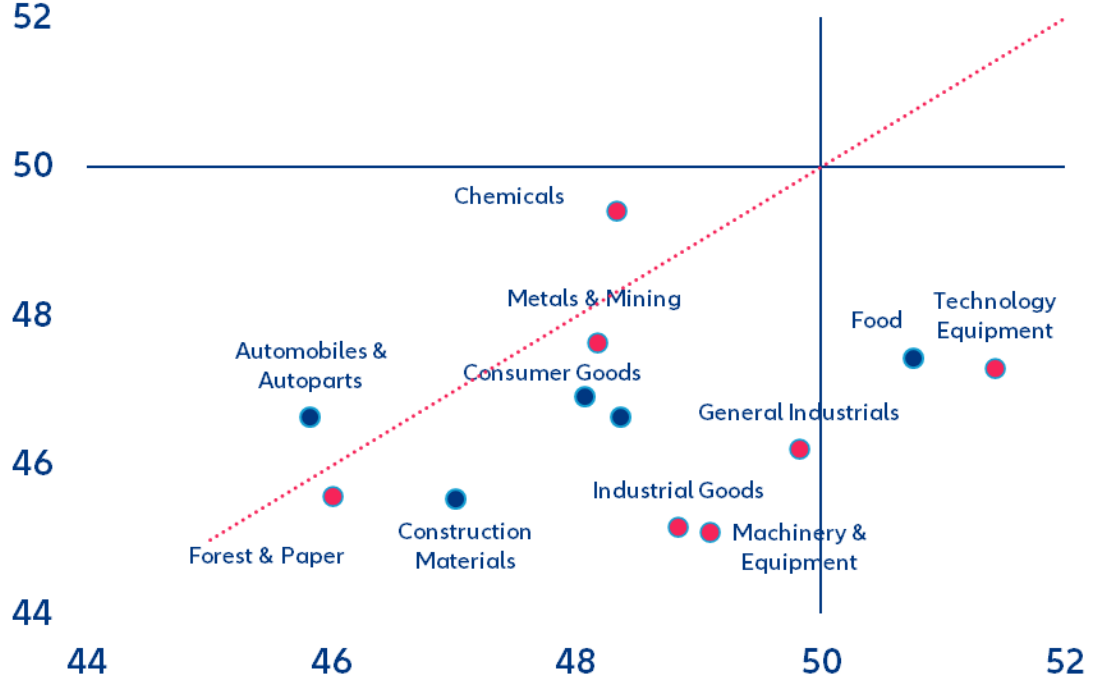
Global trade growth recovering but to remain below long-term average



Sources: LSEG Datastream, Allianz Research

Export orders improve for most sectors, especially those with low inventories

PMI New export orders Aug. 23 (y-axis) vs Aug.24 (x-axis)



Sectors with markers in red have low inventories (PMI Stock of finished goods < 50)
Sources: S&P Global, Bloomberg, Allianz Research

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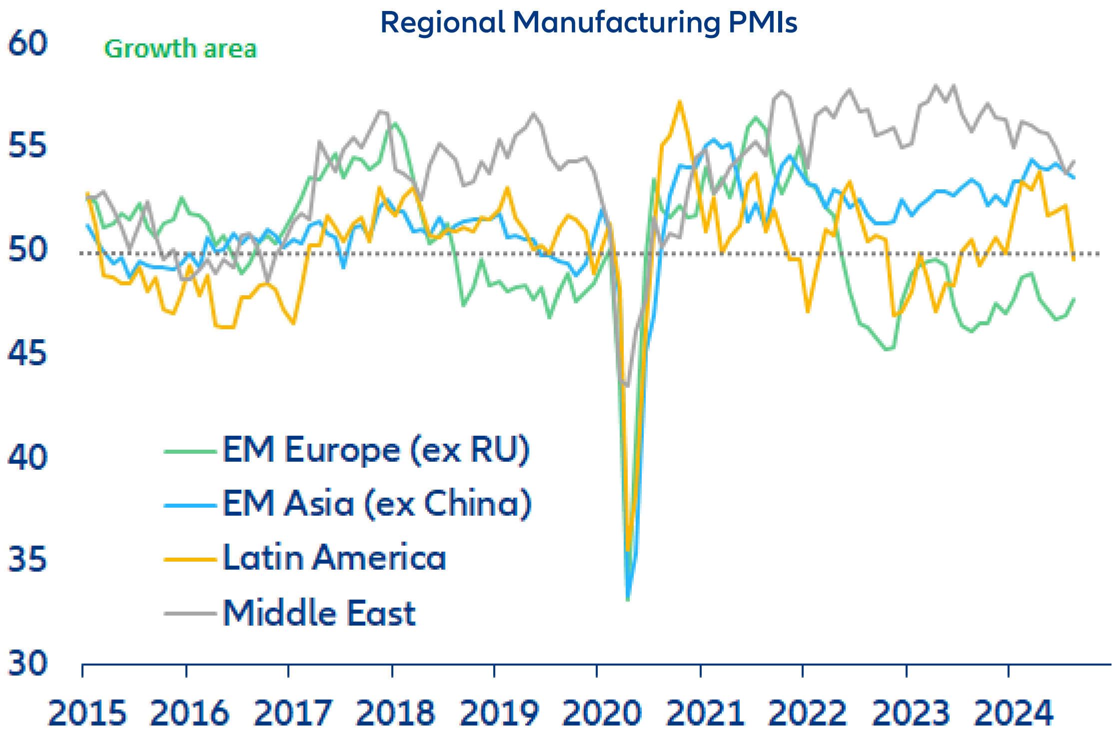
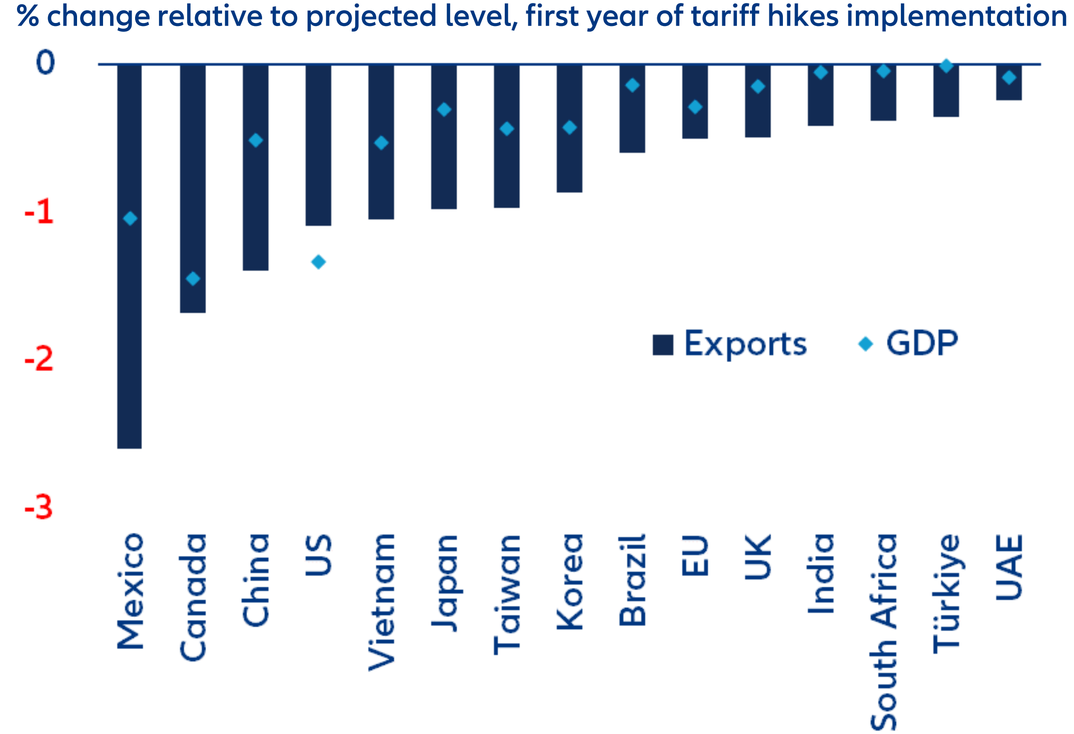
Exports are recovering, especially in EM Asia and the Middle East

The global trade recovery supports the manufacturing sector, particularly in Asia and the Middle East



Sources: LSEG Datastream, S&P Global, Allianz Research

Trade outlook remains very uncertain, depending on the US trade policy from 2025



Note: this scenario assumes tariffs on China are increased to 60% and tariffs on many other countries are increased to 10%, on all goods that are not critical dependencies. Most countries also retaliate with tariff hikes on imports from the US.
Sources: Oxford Economics model, Allianz Research

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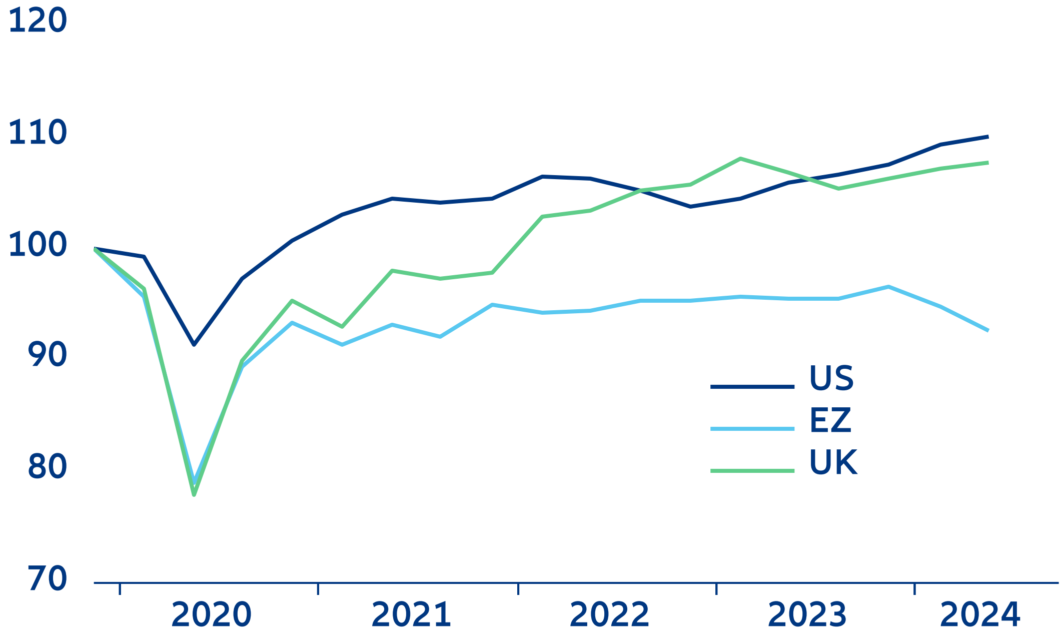
The Eurozone needs to revive investment

Eurozone fixed capital investment fell to 7% below pre-pandemic levels and far behind peers

Gross fixed capital formation index 100 = Q4 2019



Sources: LSEG Datastream, Allianz Research

Draghi’s report: Reduce regulation to boost investment

Boost investments in decarbonization, digital innovation, and infrastructure to 5% of GDP to maintain global competitiveness

Bridge the innovation gap with higher investments in R&D and pivot on a tech strategy to bring technology to the market

Decarbonization with affordable green tech and consistent energy strategy - invest in grids and decouple fossil from clean energy prices

Reduce economic and security dependencies by redesigning value chains, improving joint procurement, and allowing select mergers

Less with more focus: streamline regulations, unify industrial policy, address fragmented capital markets and financial systems, focus on emerging sectors that drive future innovation and competitiveness

Sources: various, Allianz Research

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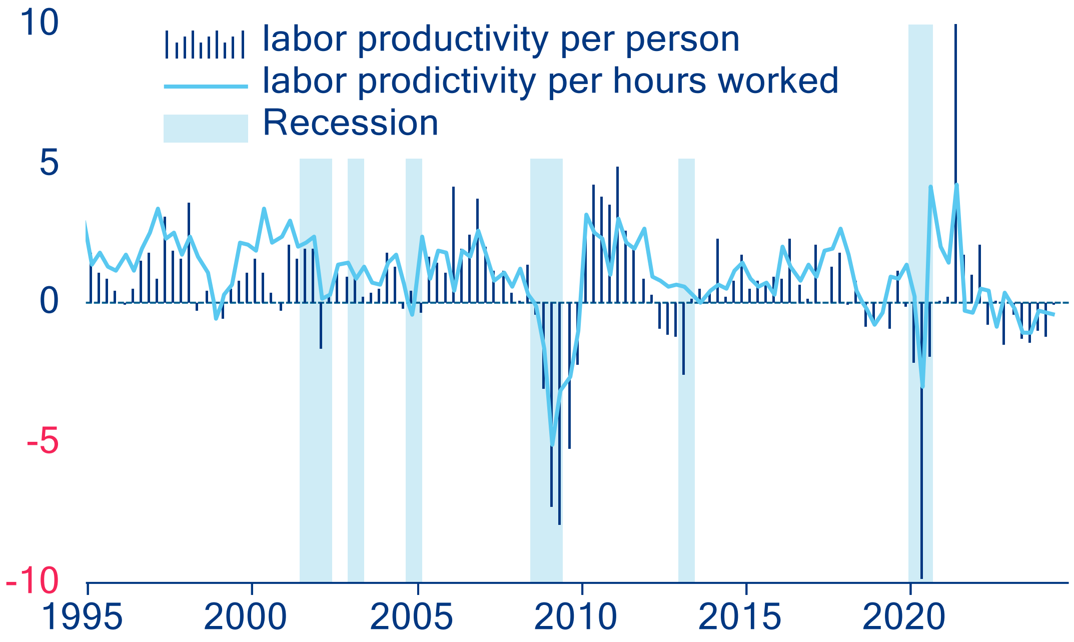
Berlin, we have a problem: structural factors leading to prolonged recession risks in Germany

German labor productivity has never been that low for such a long time

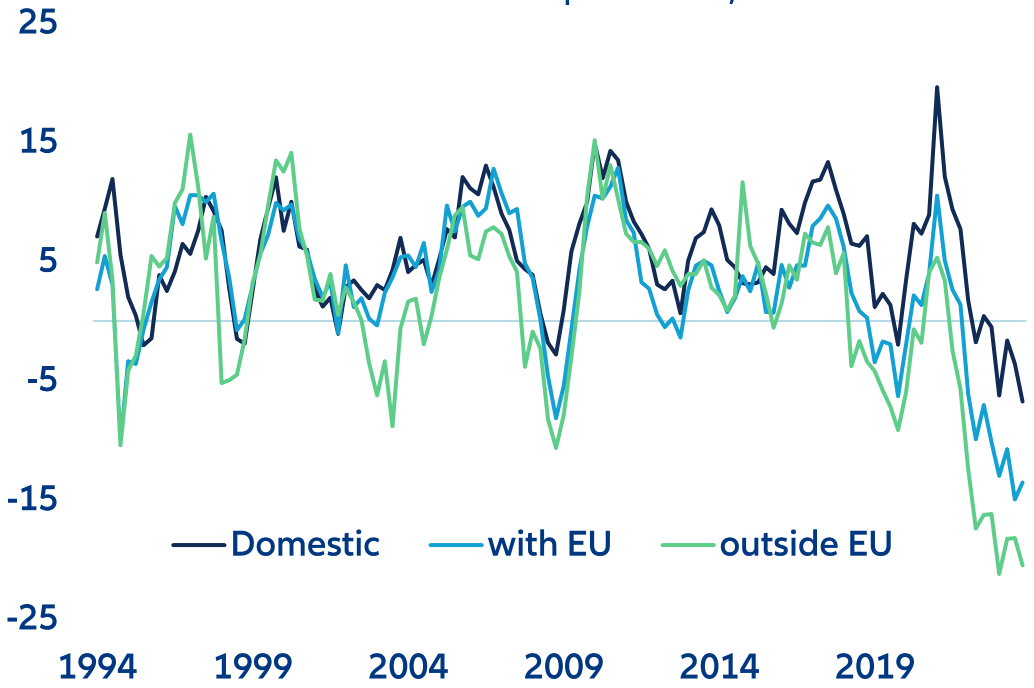
y/y %



Sources: LSEG Workspace, Allianz Research

German companies lost competitiveness abroad and at home

Firm's assessment of own competitiveness, net balance



Souces: ifo institute economy survey, Allianz Research

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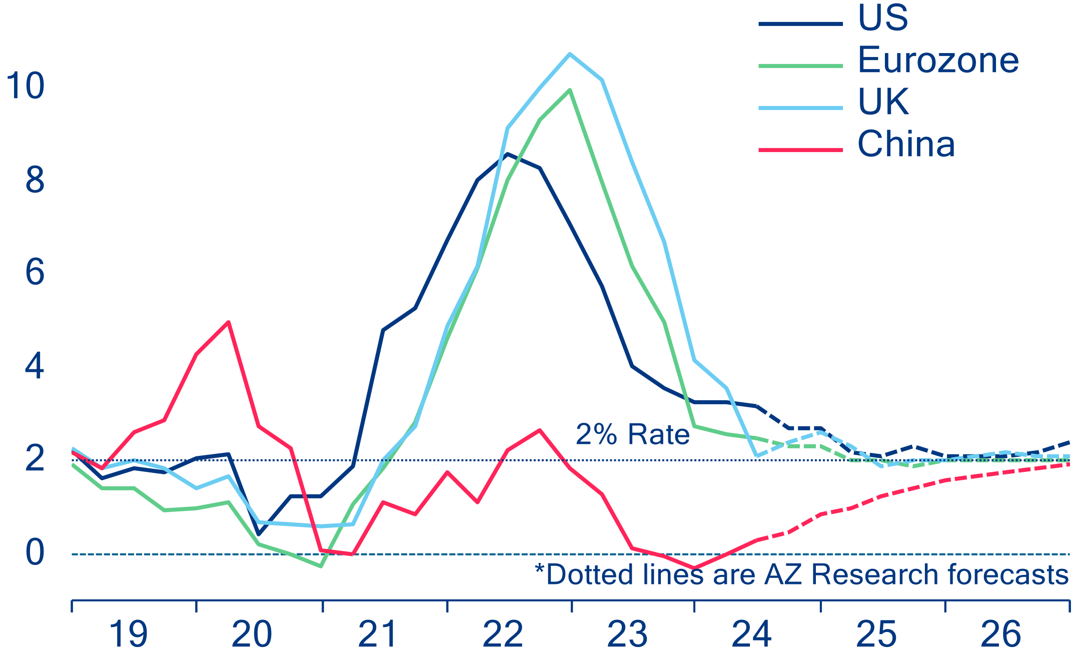
Disinflation continues with targets to be reached in 2025

Inflation forecasts, %

Inflation (yearly %)	2022	2023	2024f	2025f	2026f
Global	**8.2**	**6.2**	**5.4**	**3.7**	**3.2**
USA	**8.0**	**4.1**	**2.9**	**2.2**	**2.2**
Latin America	**14.0**	**14.4**	**16.7**	**9.8**	**6.1**
Brazil	9.3	4.6	4.1	3.0	3.5
UK	**9.1**	**7.3**	**2.6**	**2.2**	**2.1**
Eurozone	**8.4**	**5.4**	**2.4**	**2.0**	**2.0**
Germany	6.9	5.9	2.4	2.1	1.9
France	5.2	4.9	2.2	1.7	1.8
Italy	8.2	5.6	1.2	2.0	2.0
Spain	8.4	3.5	3.0	2.2	1.9
Central and Eastern Europe	**9.1**	**11.0**	**3.9**	**3.8**	**3.4**
Poland	14.4	11.4	3.6	3.8	3.6
Russia	13.8	5.9	6.9	4.8	4.0
Türkiye	72.3	53.9	58.0	24.2	17.3
Asia-Pacific	**3.9**	**3.0**	**2.0**	**2.2**	**2.3**
China	2.0	0.2	0.4	1.3	1.8
Japan	2.5	3.3	2.6	1.8	1.6
India	6.7	5.7	4.5	4.6	4.5
Middle East	**13.9**	**10.7**	**12.5**	**5.1**	**4.8**
Saudi Arabia	2.5	2.3	2.5	2.0	2.0
Africa	**14.2**	**18.2**	**18.3**	**11.1**	**5.7**
South Africa	6.9	5.9	4.2	3.8	3.2

Approaching central bank targets in 2025

Quarterly inflation rates, y/y %



Sources: LSEG Datastream, Allianz Research

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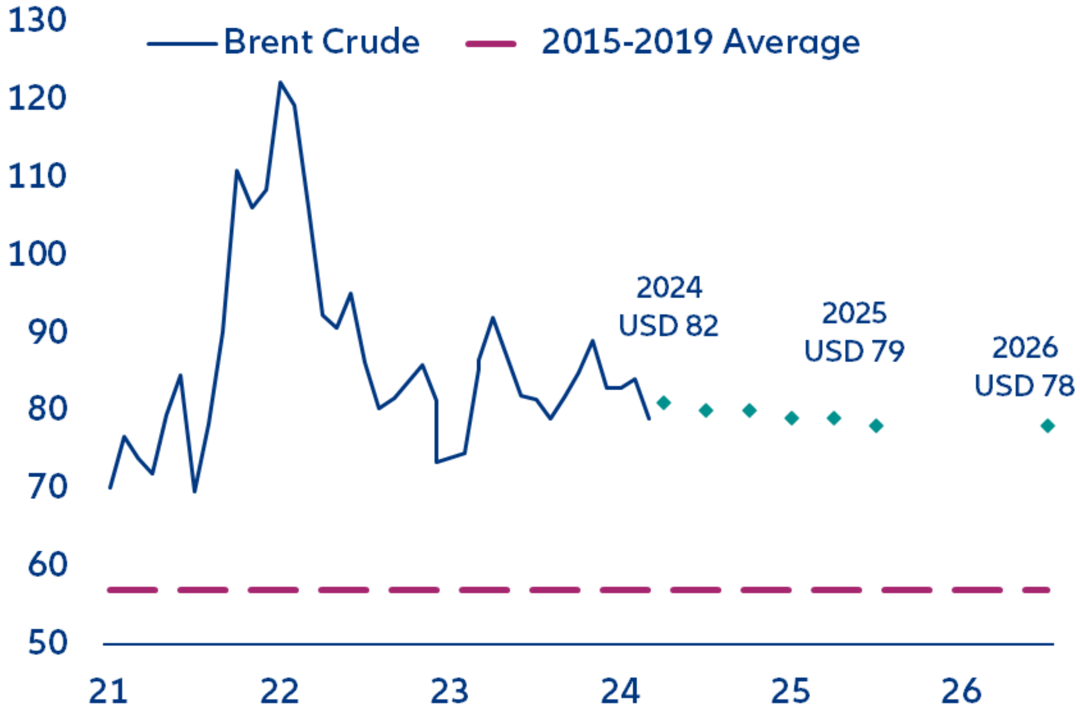
Downside risk on oil prices, gas prices stable

Oil prices to remain expensive despite lower demand

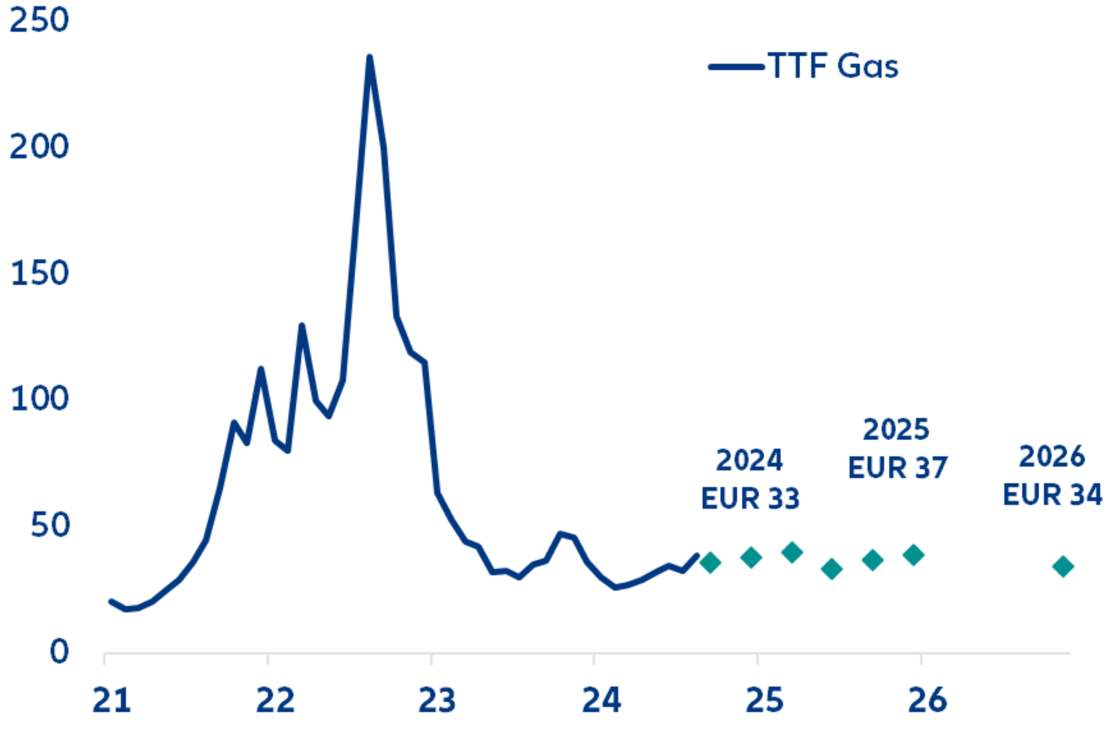
average price in USD/bbl



Sources: LSEG Datastream, Allianz Research

Gas prices in Europe lower but energy crisis not over

average price in EUR/MWh



Sources: LSEG Datastreram, Allianz Research

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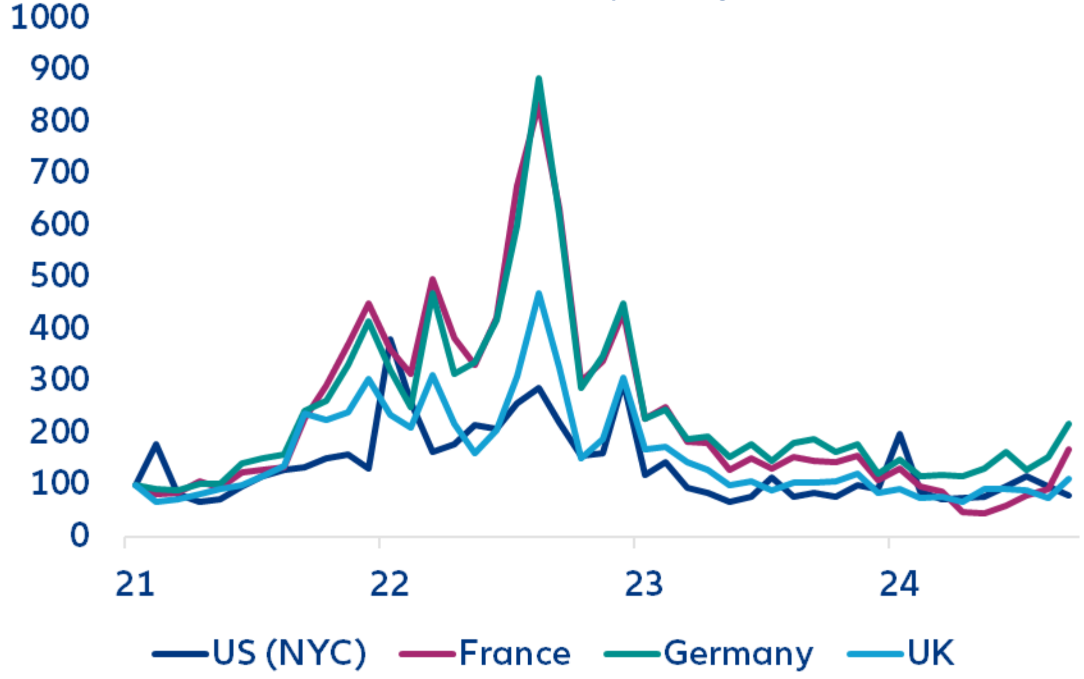
Power prices an issue in Europe, impact on consumer depends on governments

Wholesale power prices are rising in Europe on the back of weather and geopolitics related worries

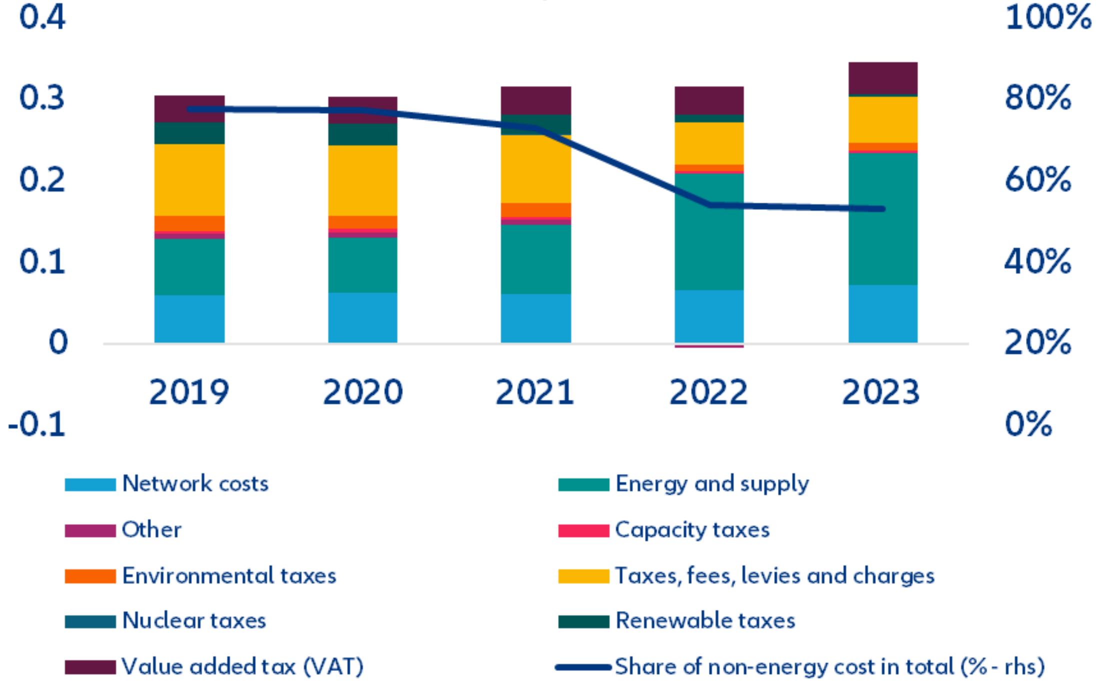
Jan 21=100, monthly averages



Sources: LSEG Datastream, Allianz Research

This rise can partly translate into consumer prices as governments start fiscal consolidation

EUR/kwh



Sources: Bruegel, Eurostat, Allianz Research

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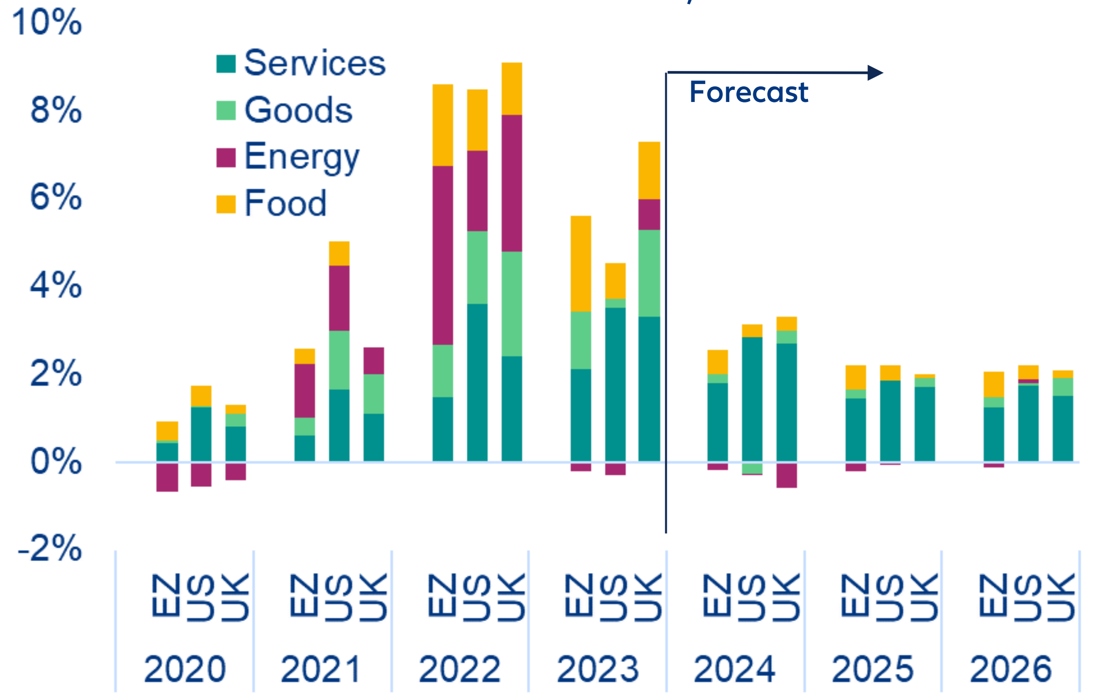
Sticky services inflation to soften slowly while energy and goods drag inflation down

Slower wage growth to eventually push down service inflation, while falling oil prices ease energy prices

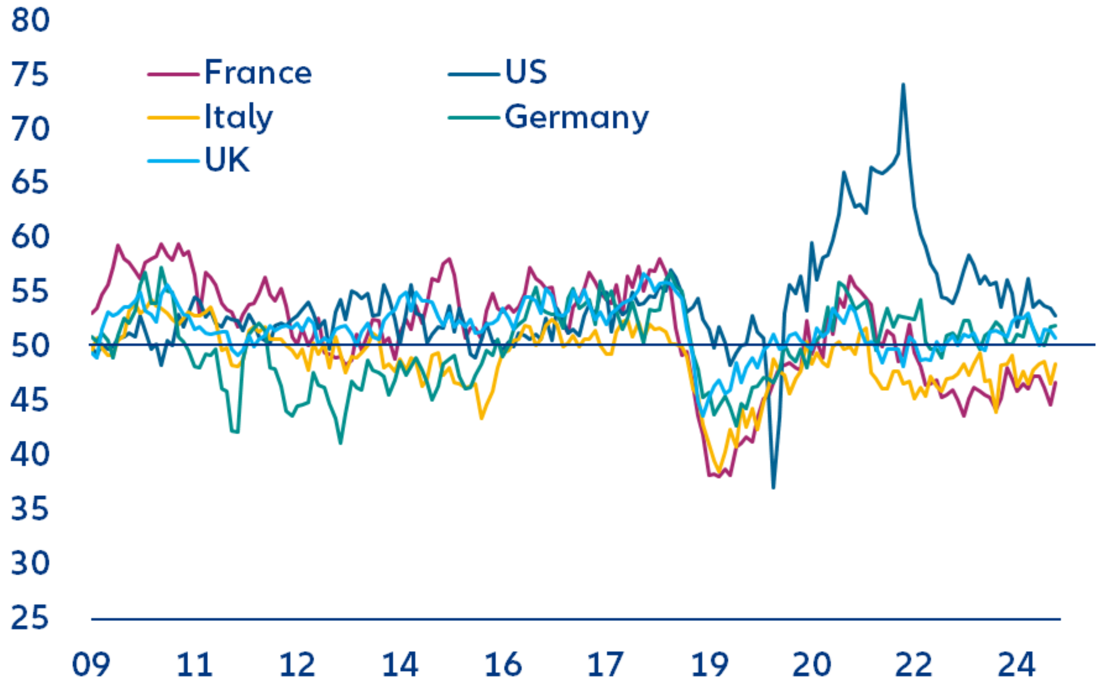
Inflation contributions, %



Sources: LSEG Datastream, Allianz Research

Output prices in the services sector suggest further inflation deceleration ahead

PMI services output prices, index



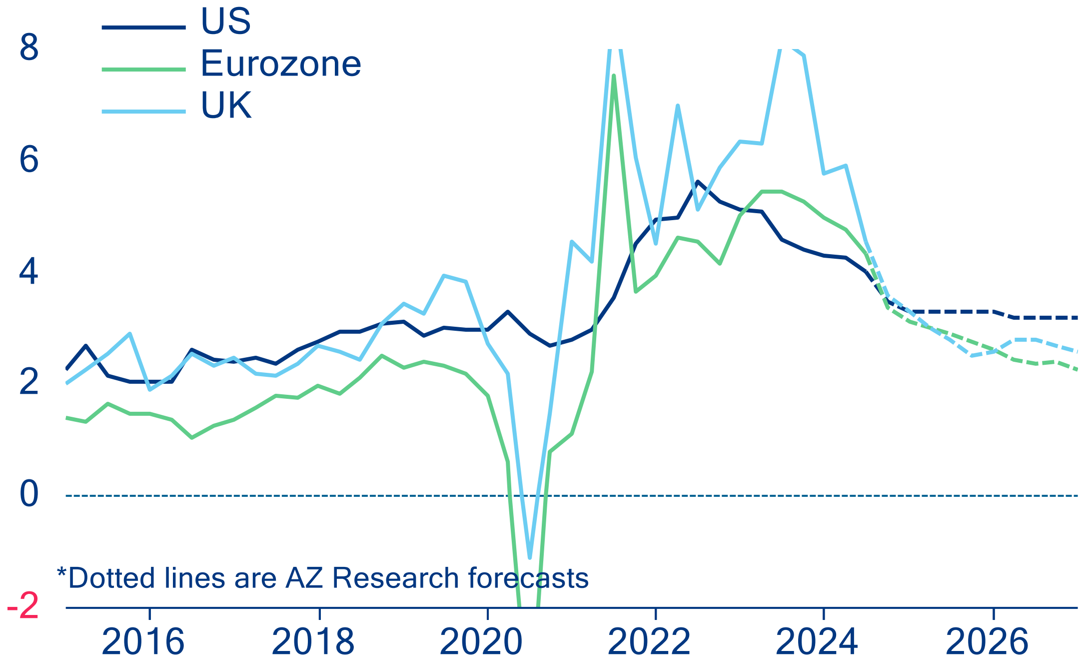
Sources: S&P Global (PMI survey), Allianz Research
Note: when the PMI indicator is below 50 it suggests a fall of the indicator in the months ahead

Allianz

Wage growth should slow down further along cooling labor markets

Nominal wage growth to normalize by 2025

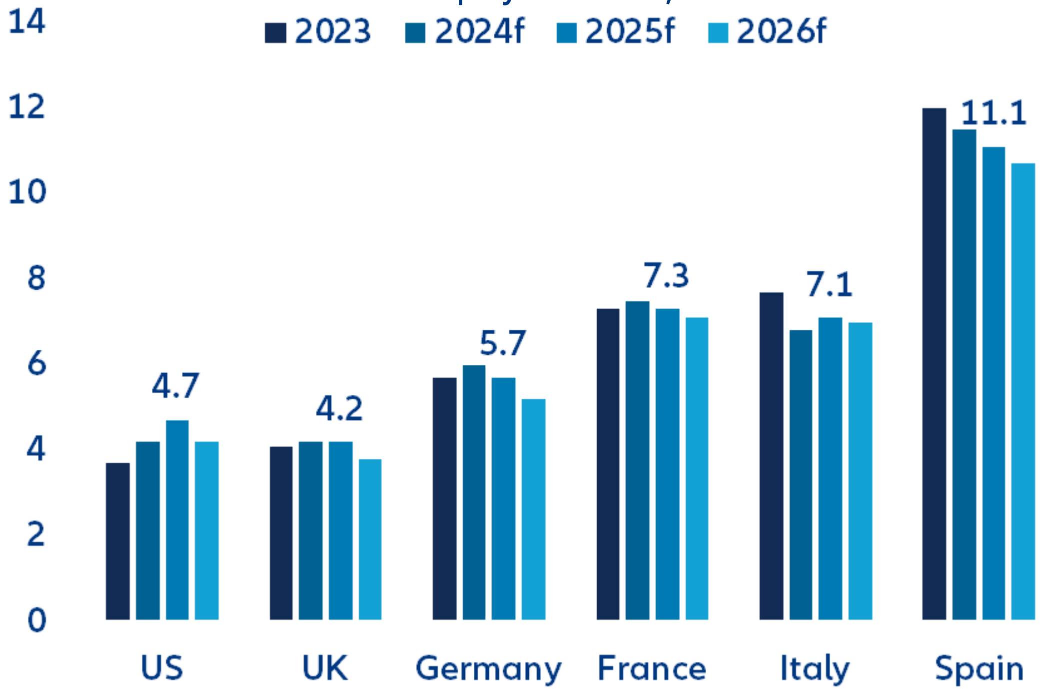
quarterly y/y in %



Sources: LSEG Datastream, Allianz Research

Unemployment rates edge up in the US but remain stable in Europe

Unemployment rates, %



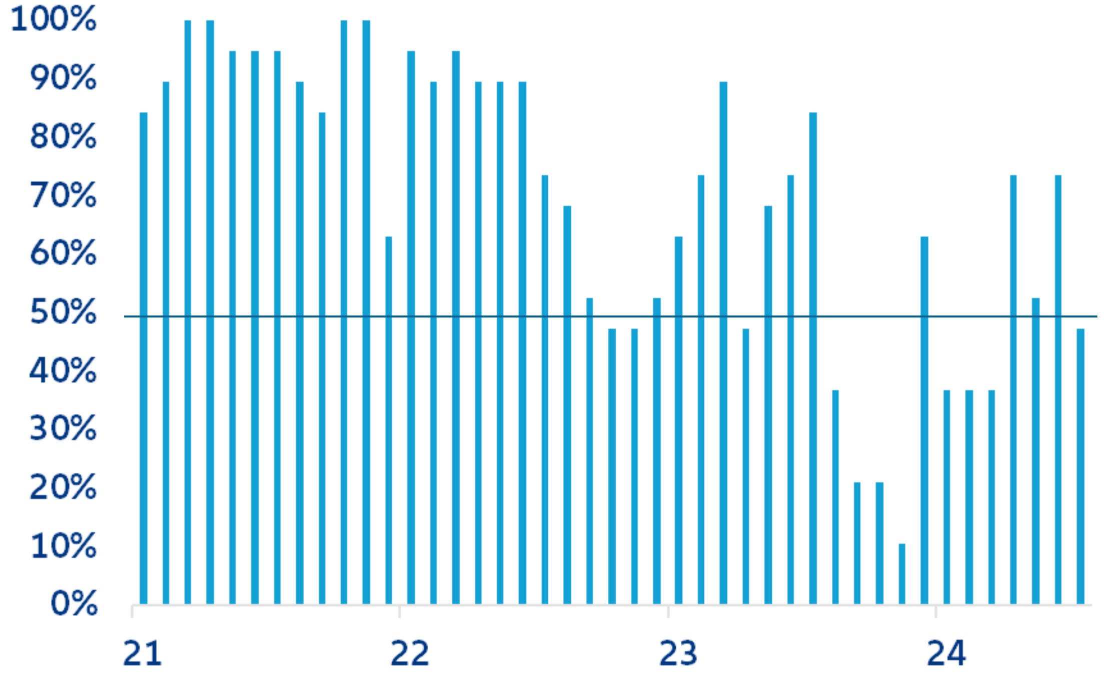
Sources: LSEG Datastream, Allianz Research
Note: Data indicated is the forecast for 2025

Allianz

Employment remains resilient with some sectors hoarding labor

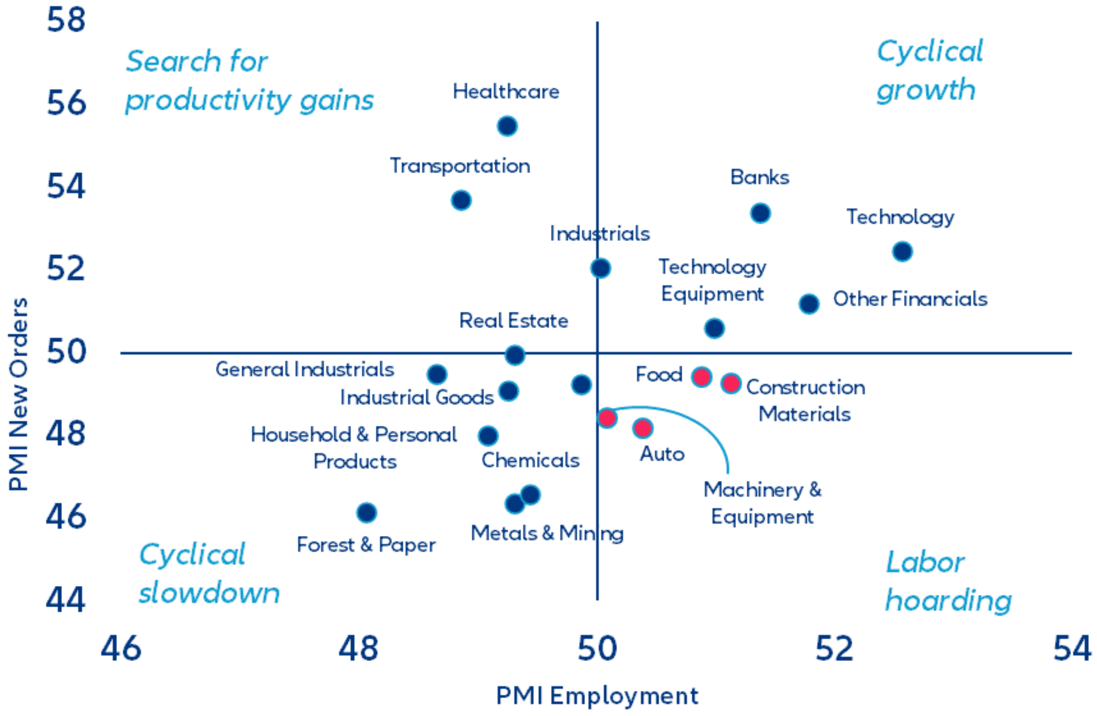
About 50% of sectors are positive regarding employment prospects

% of global sectors with Employment PMI above 50



Sources: S&P, Allianz Research

Food, Auto, Materials & Machinery and equipment seem to be hoarding labour



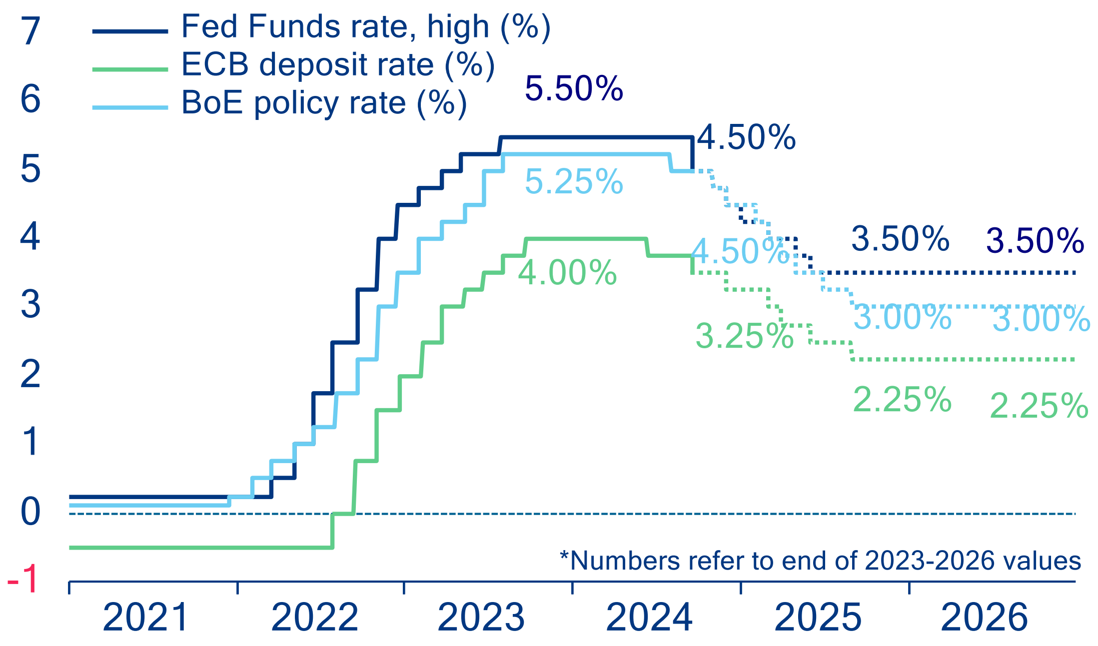
Sources: S&P, Allianz Research as of 15th Sep.

Allianz

Strong easing cycle ahead while QT remains on autopilot contributing to steepening yield curves

The Fed caught up in the easing cycle race with an initial 50bp cut, to be followed by gradual 25bp cuts

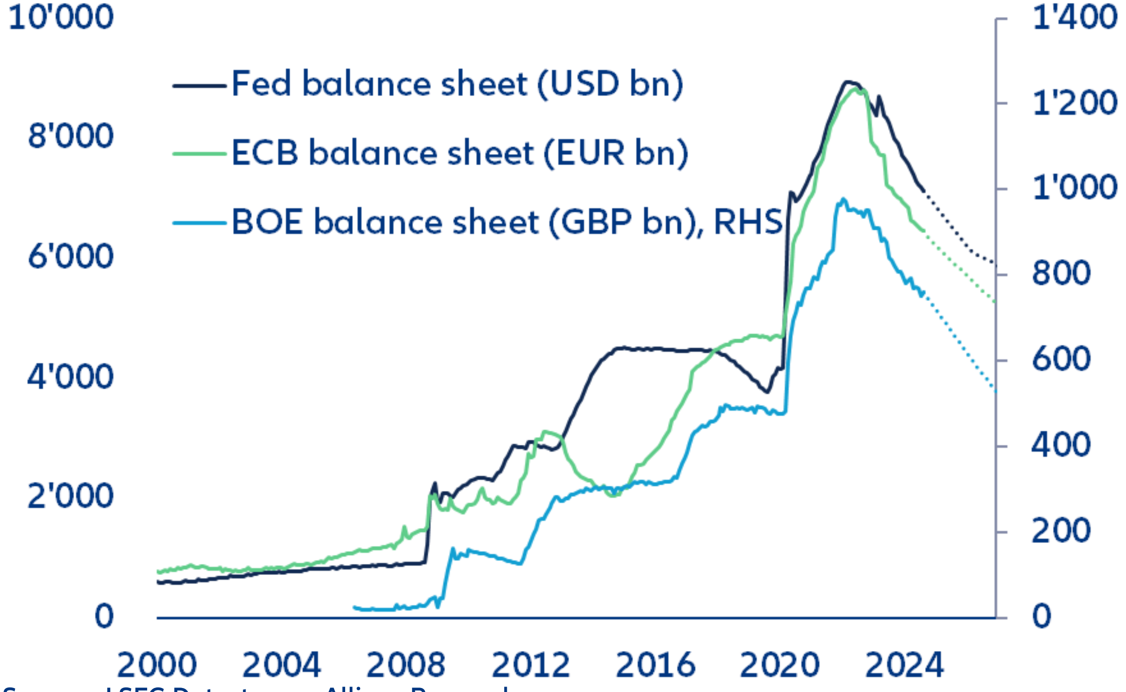
%



Sources: LSEG Datastream, Bloomberg, Allianz Research

ECB accelerated QT in July while the Fed decelerated

bn USD, EUR, GBP (RHS)



Sources: LSEG Datastream, Allianz Research

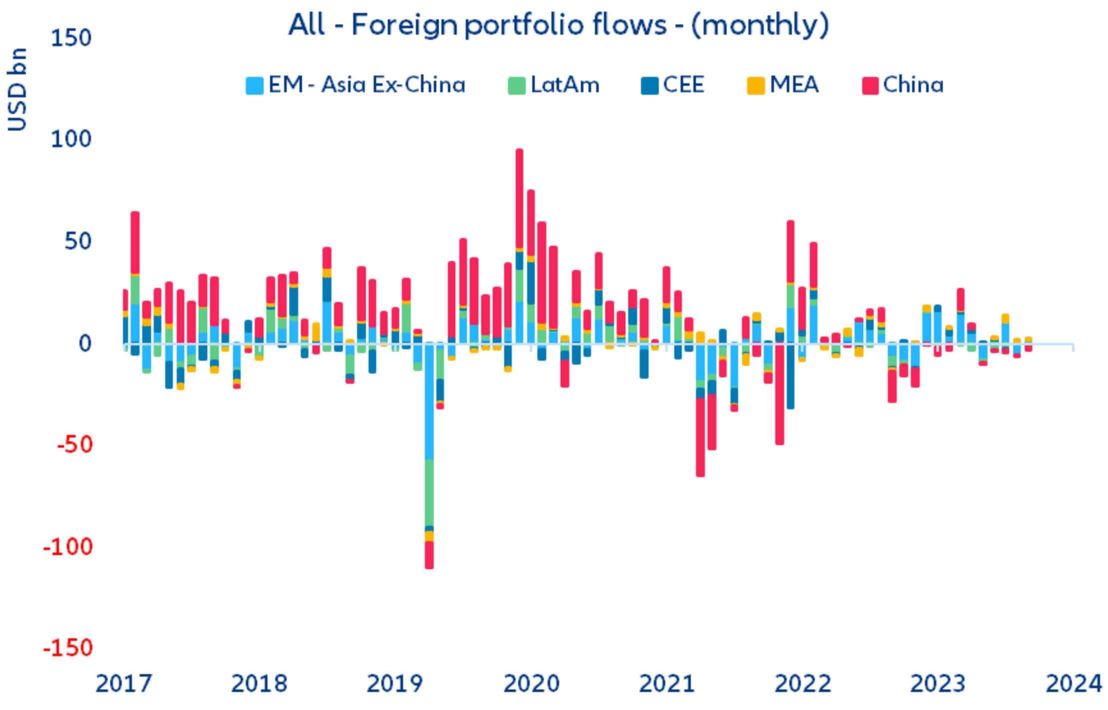
Notes: The ECB announced to stop full reinvestment of its PEPP program from July 2024 onwards effectively increasing QT from around EUR28bn per month to EUR35bn and to EUR40bn from 2025. The Fed announced to limit its monthly runoff from currently USD95bn to USD60bn per month from June 2024 onwards with the cap on Treasuries lowered from 60 to 25bn. The BOE confirmed in September a continuous run-off of around GBP8bn per month.

Allianz

EM central banks cautiously starting easing cycles

Portfolio inflows to pick-up again with Western central banks cutting policy rates faster than…

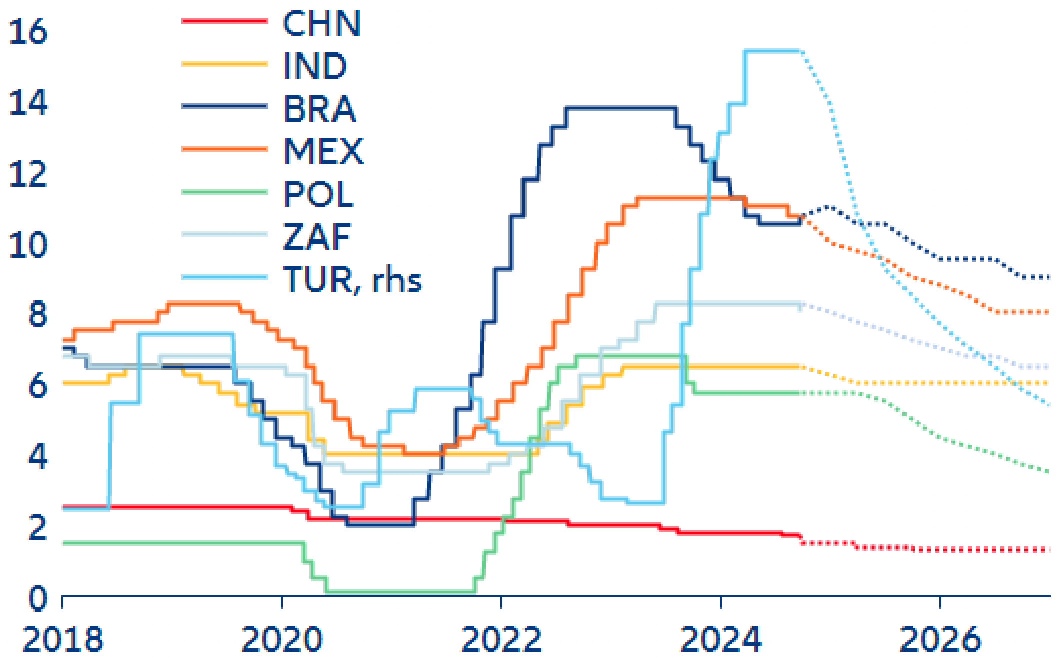
Monthly foreign portfolio flows by region, USD bn



Sources: IIF, LSEG Datastream, National sources, Allianz Research. Currency composition of the debt varies widely across selected countries. Loans and other debt instruments not included.

…most major EM central banks, which are slowly lowering their policy rates (Brazil being an exception)

%, dotted lines refer to AZR forecasts

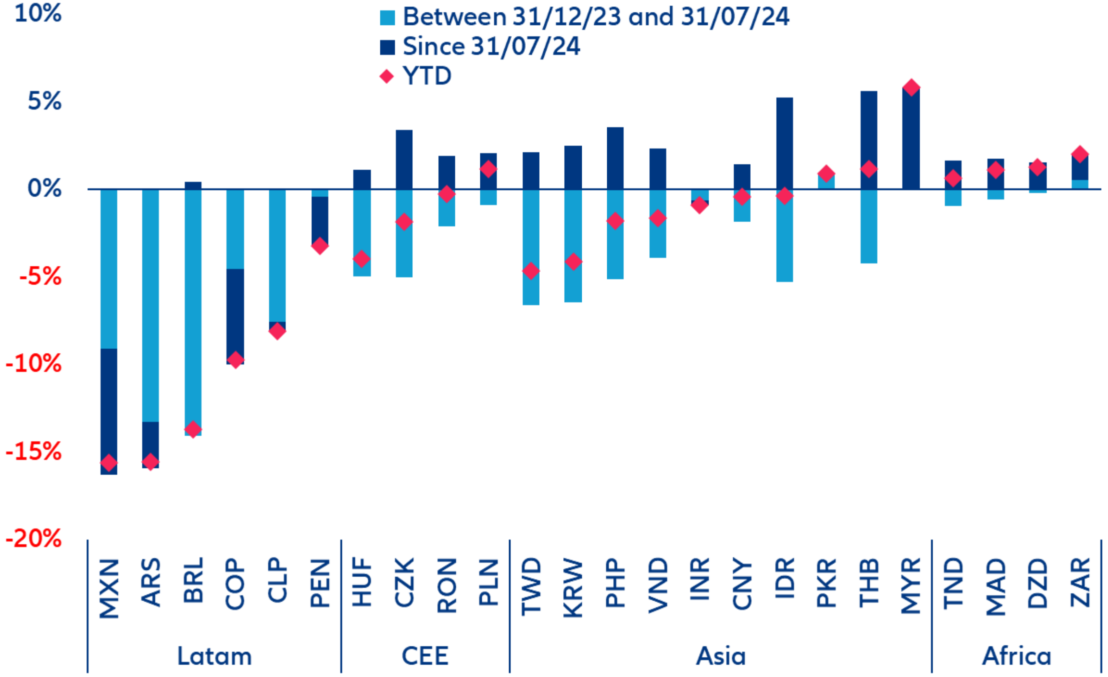


Sources: LSEG Datastream, Allianz Research. As of September 2024.

EM FX: CEE, Asia and Africa benefit from weaker USD while Latam suffers from carry trade unwind

Carry erosion and USD weakening favors Asian and CEE FX; LatAm underperforms

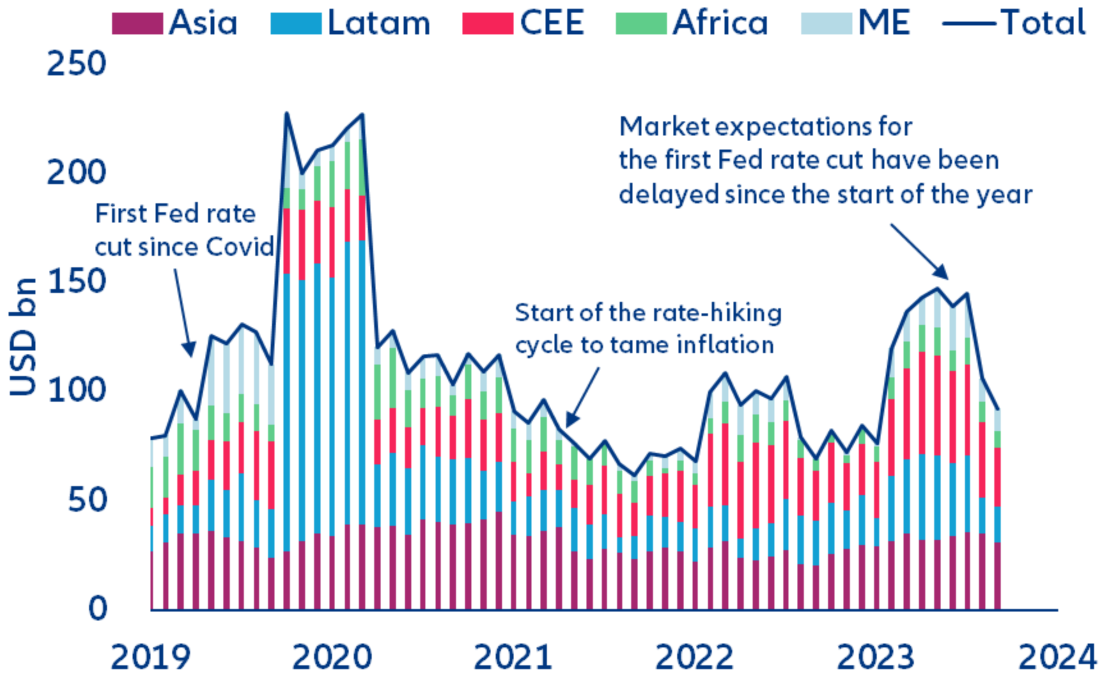
YTD performance in FX of selected EM currencies, %



Sources: LSEG Datastream, Allianz Research. Data as of 11/09/2024
Note: BOJ raised policy rate from 0-0.1% to 0.25% on 31/07/24

Hard currency sovereign debt issuances slowed down but 2024 already better than 2022 and 2023

rolling 6-month sum



Sources: Bloomberg, LSEG Datastream, Allianz Research.

Allianz

Insolvencies to rise by +11% in 2024 and by +2% in 2025, before stabilizing at high levels in 2026

2025 business insolvencies forecasts,

changes and levels

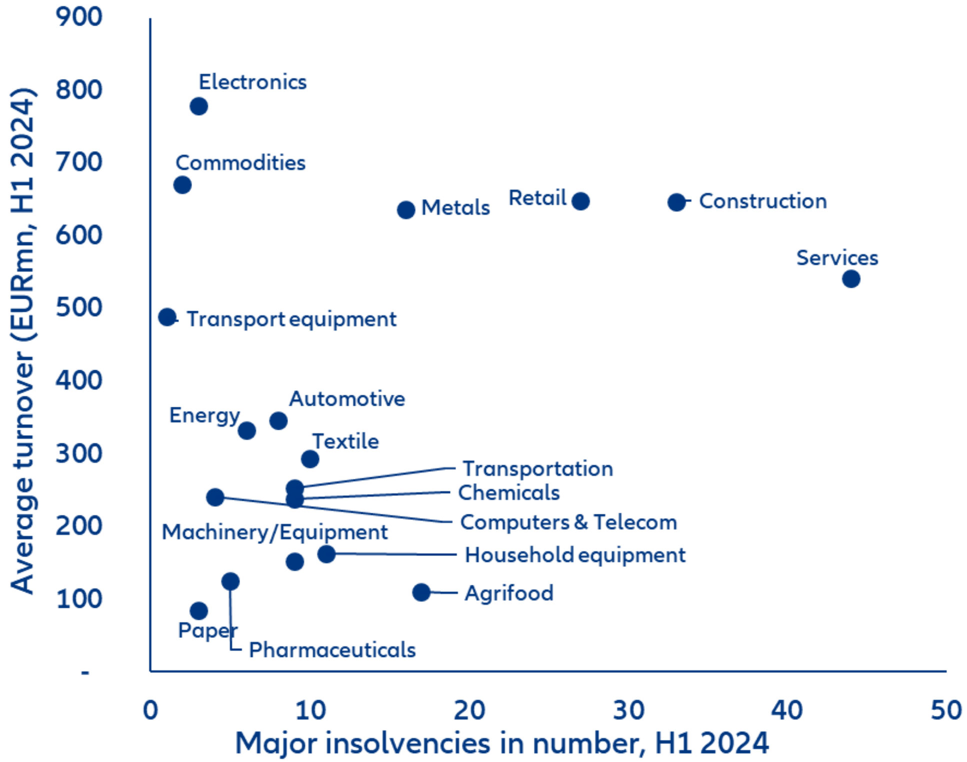
2025 expected change (y/y)	Very low level (more than -15%)	Low level (-15% to 0%)	High level (0% to +15%)	Very high level (+15% and more)
Noticeably increasing (+5% and more)	Taïwan Türkiye	Portugal Russia		Morocco US
Increasing (0% to +5%)		China Italy Romania	India	Germany Spain
Decreasing (-10% to 0%)	Czechia Latvia South Africa	Ireland Luxembourg Norway	Belgium Brazil Bulgaria Denmark Estonia France Japan Netherlands	Australia Austria Canada Finland 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 statistics, Allianz Research

Major insolvencies by sector, H1 2024

number of cases (x axis) and average turnover (y axis, EURmn)

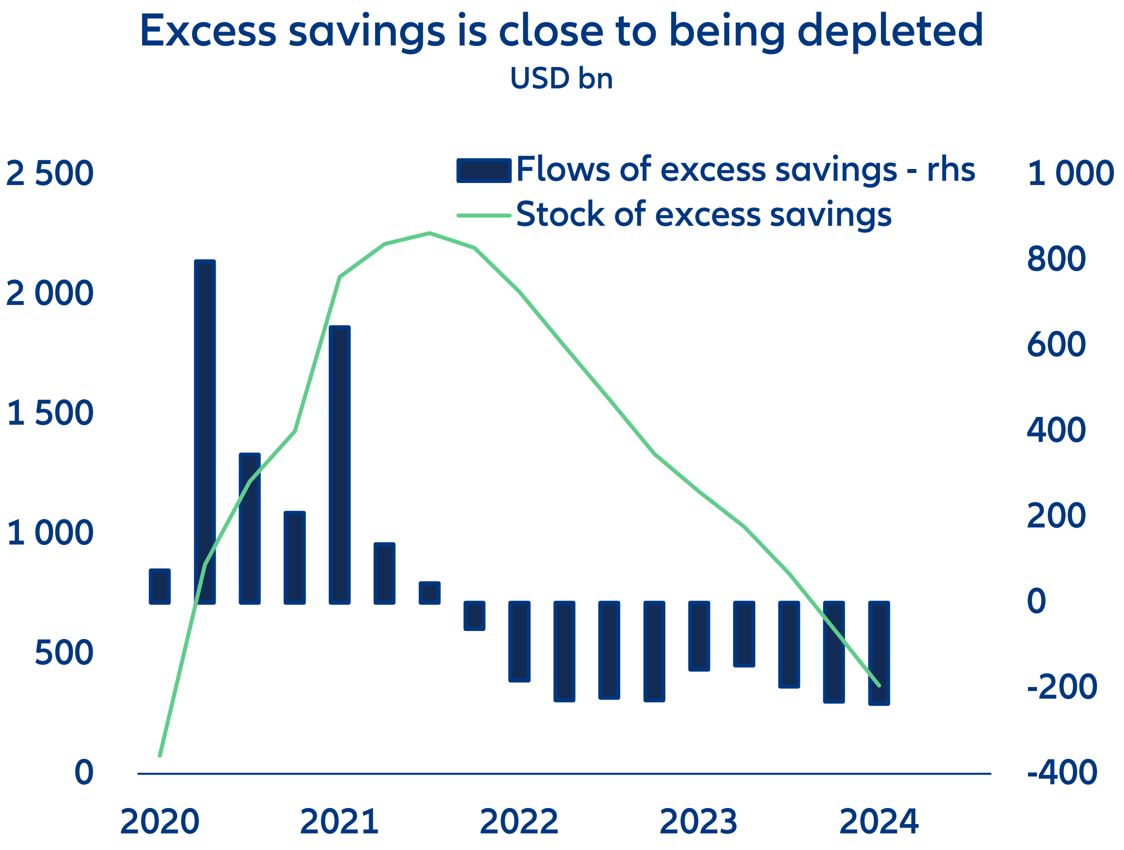


(*) Firms with an annual turnover exceeding EUR50mn
Sources: Allianz Trade business units

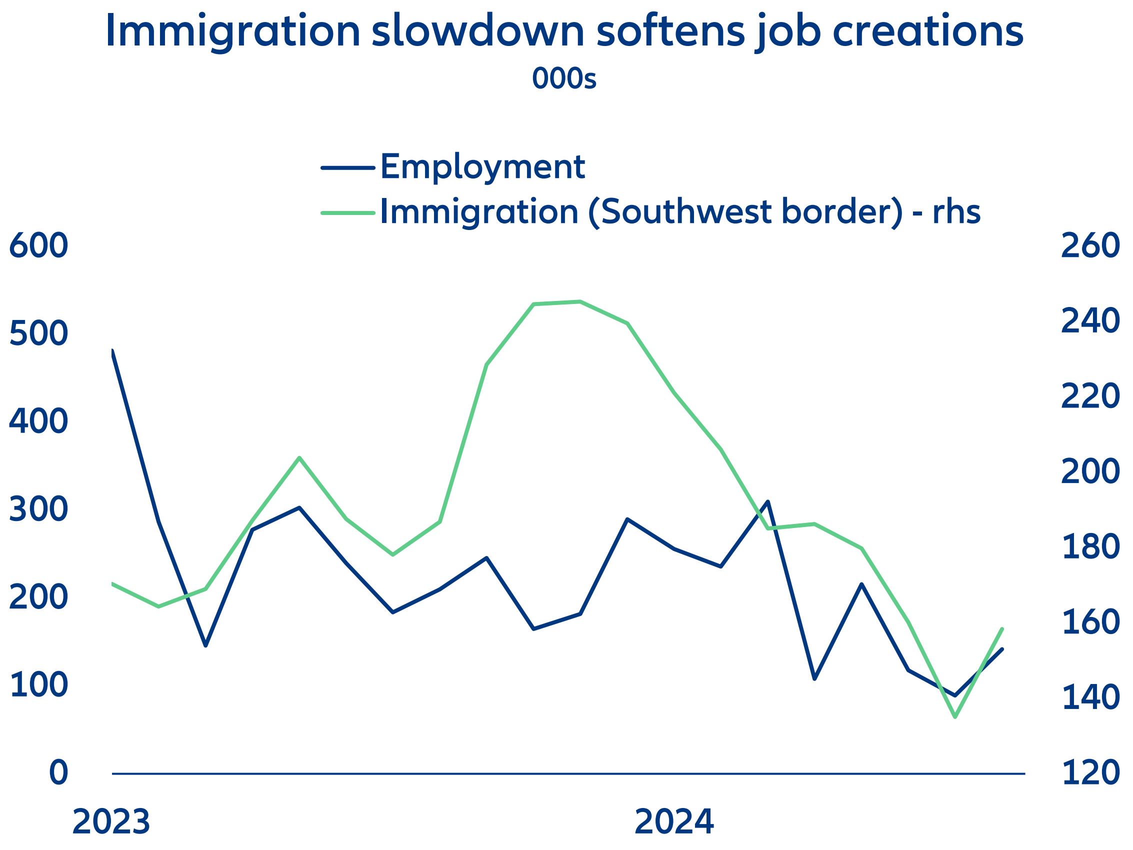
Regional outlooks 2024-2026

Allianz

GDP growth to slow down substantially in 2025 as current tailwinds fade



Source: LSEG Workspace, Allianz Research



Source: US CBP, LSEG Workspace, Allianz Research

Allianz

US elections: Trumponomics vs Harrinomics

	Fiscal policy	Trade policies	Industrial policy / Energy	Regulation	Foreign policy
Kamala Harris	• **Tax cuts for middle- class**, elimination of taxes on tips, extension of the child credit limit to $6K • Partial extension of the Trump 2017's **personal tax cuts** • **Raise corporate tax** from 21% to 28% • **Raise the corporate alternative minimum tax** (Inflation Reduction Act) from 15% to 21% • **Raise stock buyback tax** (Inflation Reduction Act) from 1% to 4%. • Levy **new 25% minimum tax on wealthiest** (on income & unrealized gains). • **Raise** the **personal tax** rate from 37% to 39.6% on income above $400,000 for single filers and $450,000 for joint filers. • **Raise capital gains tax** rates from 0-20% to 44.6% and create an unrealized capital gains tax at 25%. • **Tax long-term capital gains** and qualified dividends at 28 percent (as opposed to 39.6 percent as in the Biden budget) for taxable income above $1 million and tax unrealized capital gains at death above a $5 million exemption ($10 million for joint filers)	Harris stated that she is "not a protectionist Democrat". She has also been a vocal supporter of the **current trade policy**.	• Strengthening anti-pollution **regulation** & **phase out fossil fuel** subsidies. • Promote economy-wide **net-zero emissions by 2050**. • Continue **Inflation Reduction Act** and **Chips Act**	• **Ban** "hidden" and "surprise" **fees by banks** and other companies • **Cap "unfair" rent** increases • Expand **cap on prescription drugs** costs. • Strengthen **antitrust drive**: pass a federal "price gouging" ban on food and groceries. • **Cut red tape on energy projects** – particularly obstacles to building green infrastructure (transmission lines, etc).	Harris strongly expressed **support for both Ukraine and Israel**
Donald Trump	• Extend all the Trump's 2017 **personal tax cut** • **Cut the corporate tax** rate from 21% to 15% for companies that produce in the US. • **Non-green industrial subsidies** • **Defence & security** • **Repeal** or reduction of some **green subsidies and social spending** from IRA/BBB • **Discretionary budget cuts** (following federal government spending audit)	• 10% across-the-board **tariffs on US imports.** • 50-60% on imports from **China**. • 100-200% tariff rate on **Mexican auto imports** if they are built in Chinese-owned factories. • Linking **tariffs** to **currency** valuation. • Countries trying to drop use of the **USD** to face **severe tariff hikes** (up to 100%).	• **Exit Paris climate accord**. • Promote oil/gas/coal exploration and extraction (restart **oil drilling**). • Pump **gas price target** of $1.87 per gallon. • Substantial **new non-green industrial subsides** through the channeling of customs receipts into a National Sovereign Wealth Fund (NSWF) which would invest in manufacturing hubs.	• Unwind **Basel III rules** for regional banks. • **Eliminate 10 regulations** for every new regulation.	Promises to resolve the Russia-Ukraine war swiftly; **cut financial aid to Ukraine**

Note: We highlight the most important measures. Please note that the colors refer to the economic impact on the US economy.

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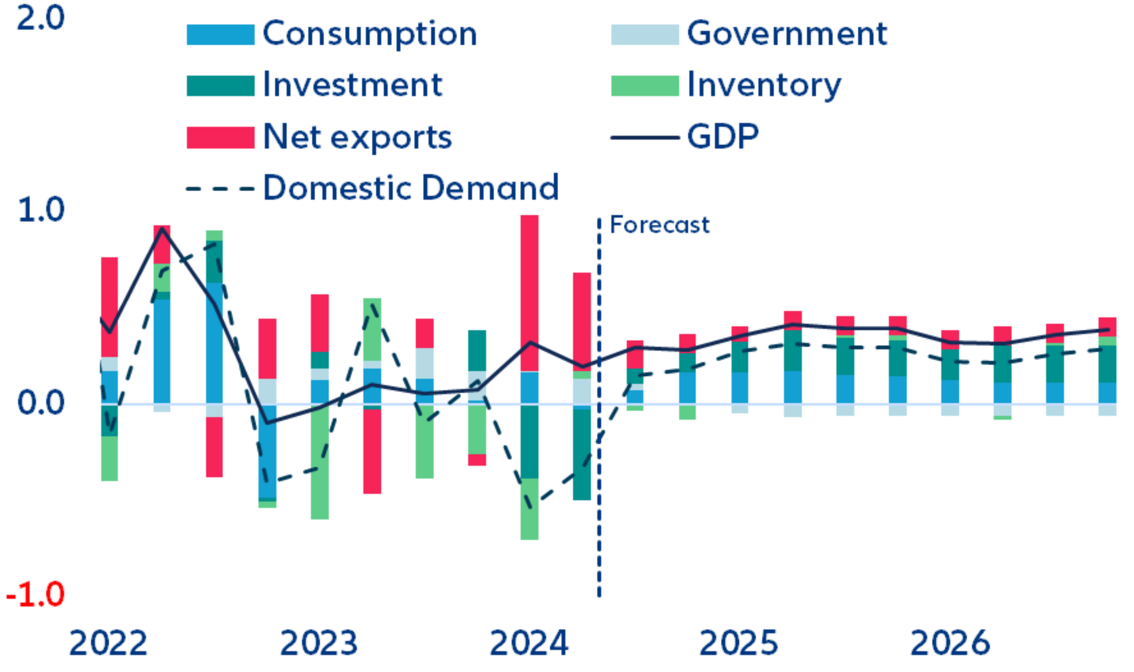
Eurozone growth to be supported by trade and consumption, while downside risks fade

Fiscal consolidation, rebound in trade, higher real wages and pent-up investment to drive growth

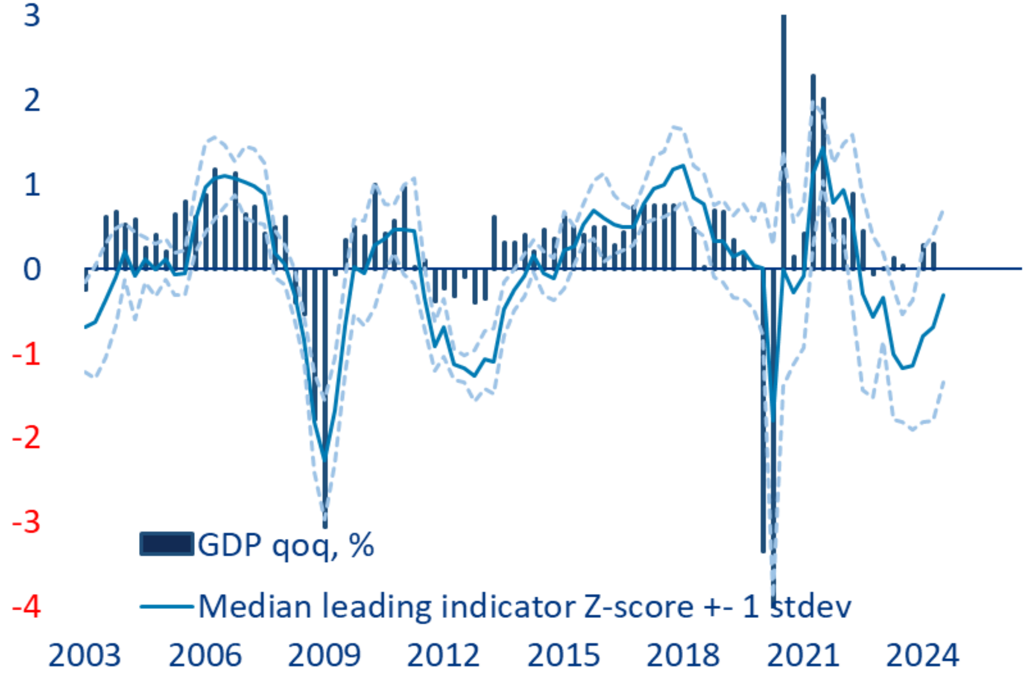
Quarterly GDP components growth contributions, in %



Source: LSEG Datastream, Allianz Research
Notes: Domestic Demand is defined as GDP-Net exports contribution.

Leading indicators reflect ongoing weakness in domestic demand but are improving from low levels

GDP growth, in % and index



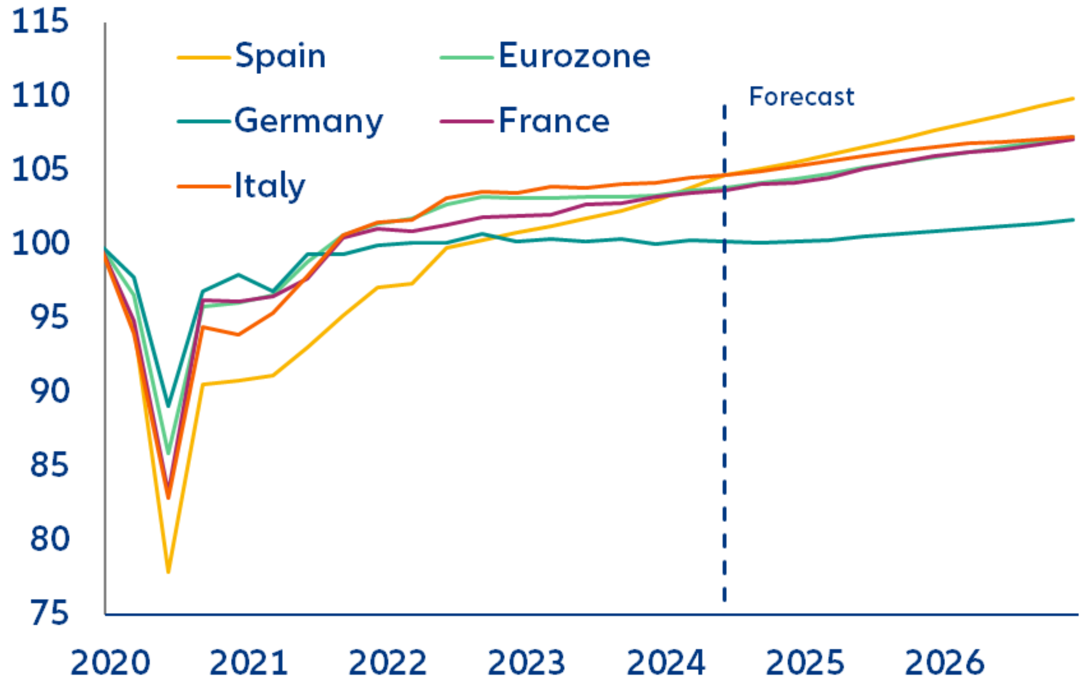
Source: LSEG Datastream, Allianz Research
Notes: Median leading indicator is the median of several normalized leading indicators (Z-scores) such as PMIs, change in credit demand, economic sentiment, consumer confidence

Allianz

The Eurozone suffers from weak productivity and weak Germany

Germany's multi-year stagnation drags down the entire Eurozone

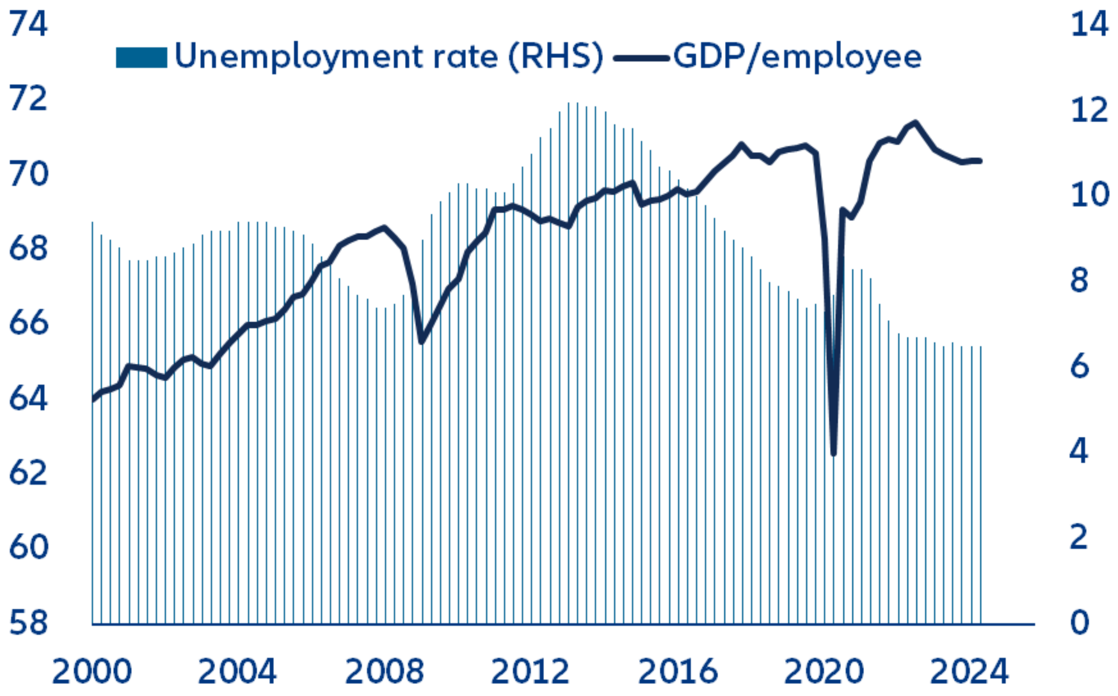
GDP index, 100=2019 Q1



Sources: LSEG Datastream, Allianz Research

The Eurozone still enjoys record low unemployment, but productivity fell back to 2017 levels

Unemployment rate in % and productivity in thousand EUR



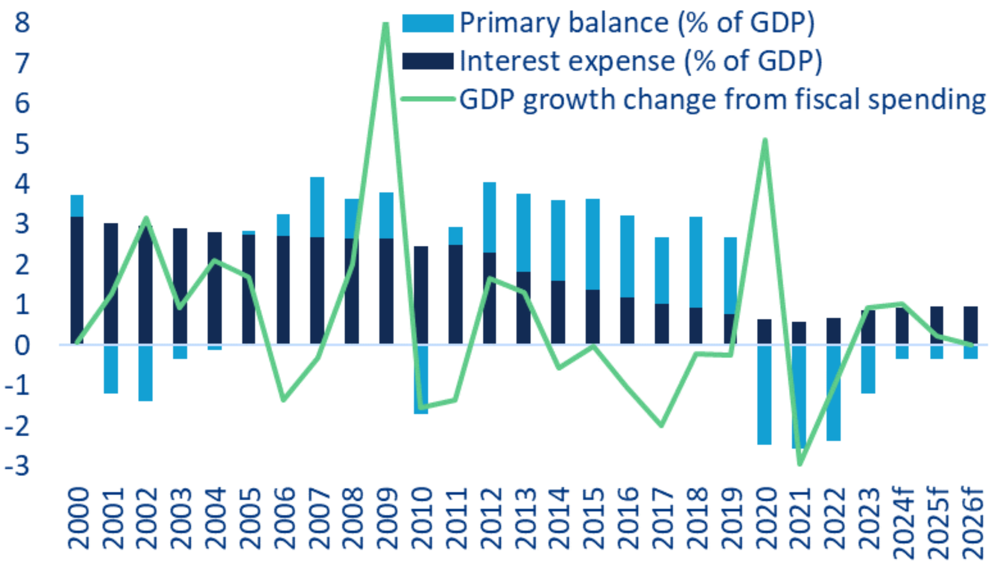
Sources: LSEG Datastream, Allianz Research

Allianz

Navigating troubled waters: Budget discussions prolong recession risks into 2025

Austerity could prolong recession risks

% of GDP and pp

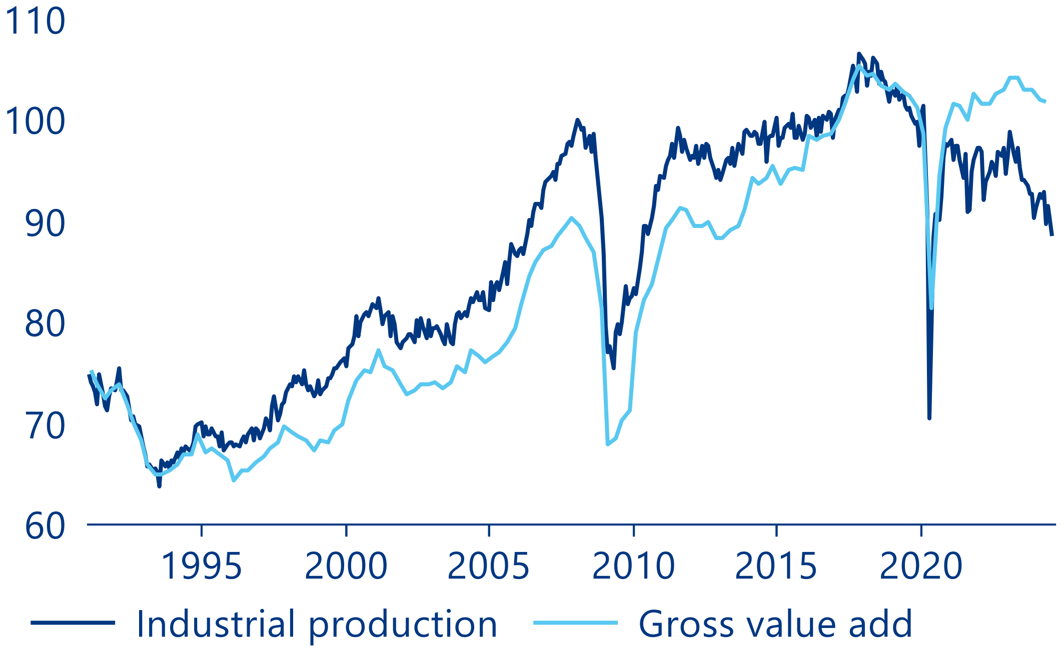


Sources: LSEG Workspace, Allianz Research

Note: Fiscal stance (r-g) is calculated as the difference between the interest rate ratio and the potential growth rate, which translates into the change in GDP growth in pp from fiscal spending by using a fiscal multiplier of 1.

Activity still declining even though GVA shows greater signs of life in manufacturing than IP

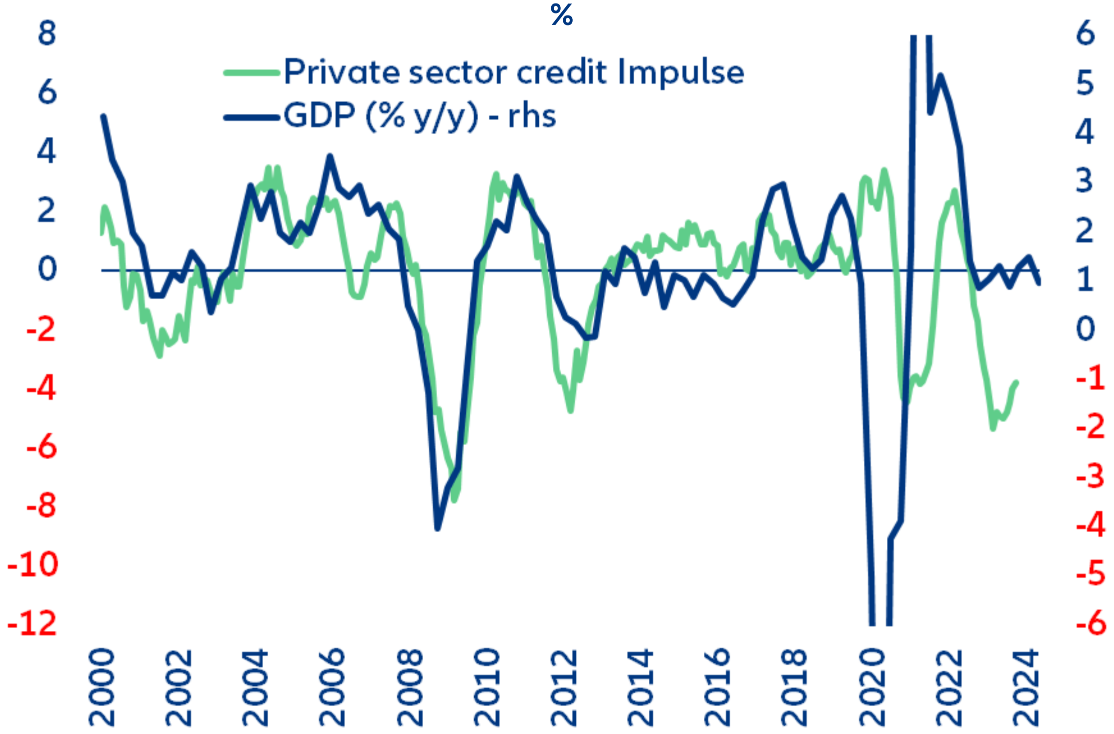
Index 100=2017



Souces: LSEG Workspace, Allianz Research

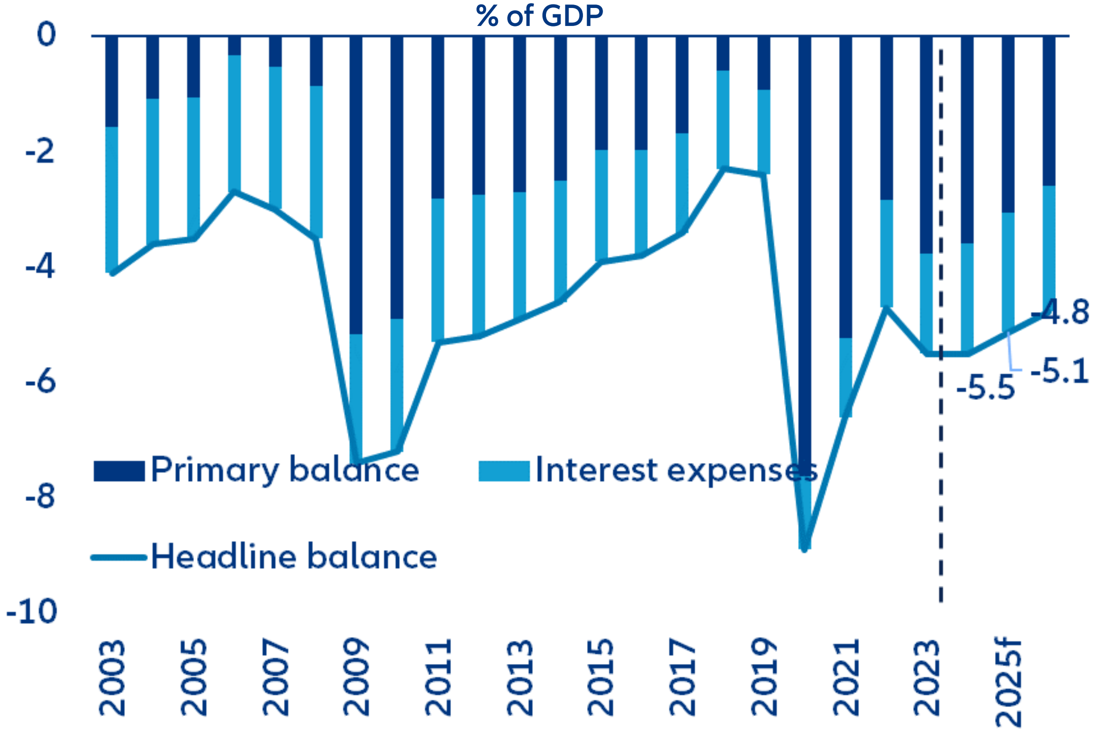
Growth braced to accelerate a touch in 2025 ; political crisis means underwhelming austerity

The credit impulse is improving and should turn positive at the turn of the year



Source: LSEG Workspace, Allianz Research

We expect 0.4% GDP of fiscal consolidation per year in 2025-26



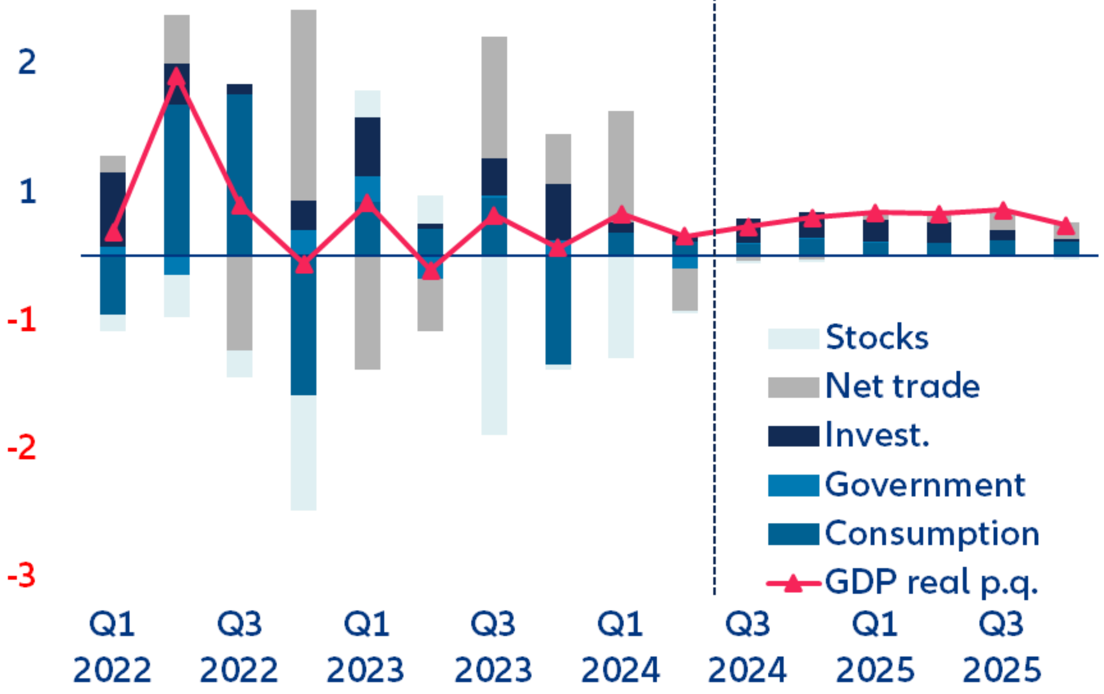
Source: LSEG Workspace, Allianz Research

Allianz

The calm before the (fiscal) storm?

Investment activity to resume; NGEU catch-up will try to make up for 2021-2023 *Superbonus* boost

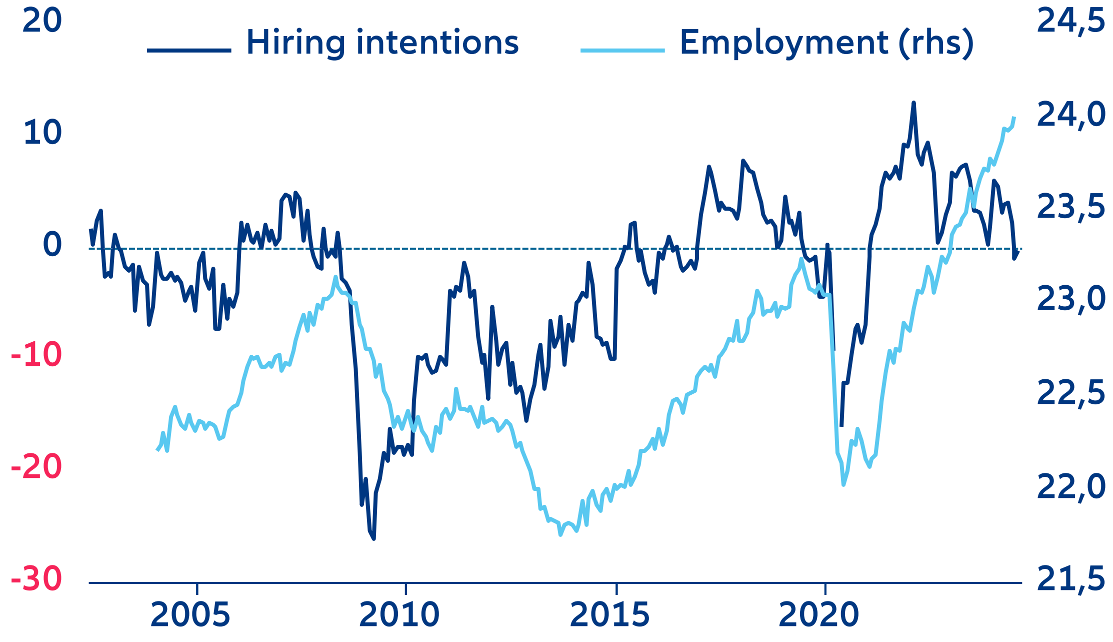
Contribution to GDP growth, % and pps



Sources: LSEG Workspace, Allianz Research

Employment at its record high, but surveys signal a cooling labour market

index and million



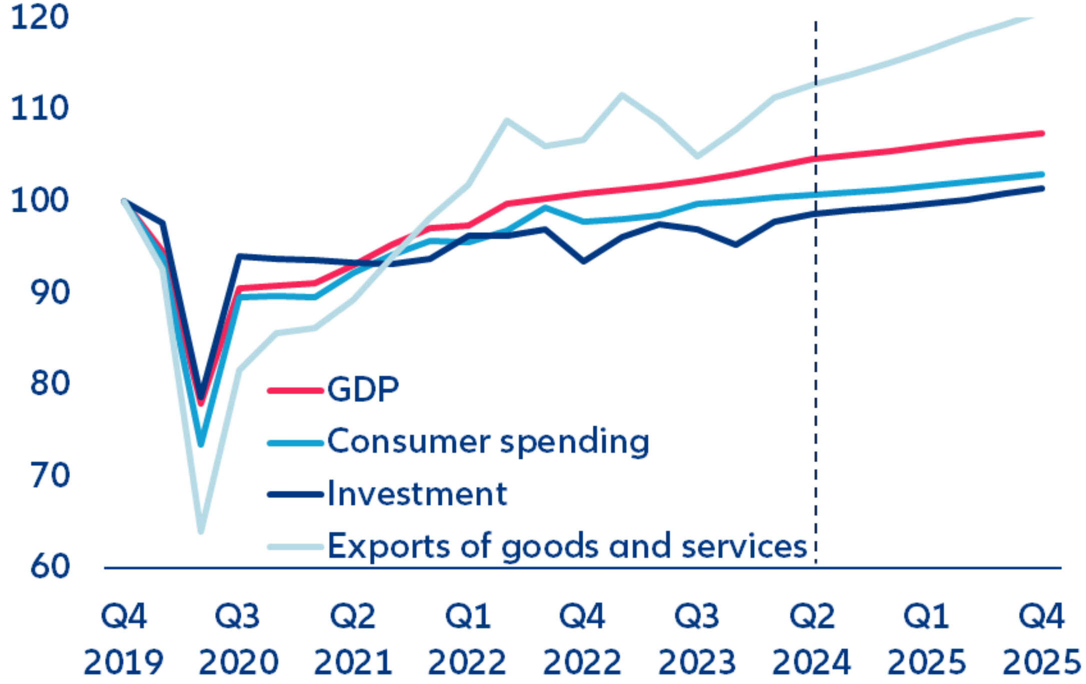
Sources: LSEG Workspace, Allianz Research

Allianz

Strong pace of growth to normalise after strong rebound

Private consumption and investment have just recovered to pre-pandemic levels

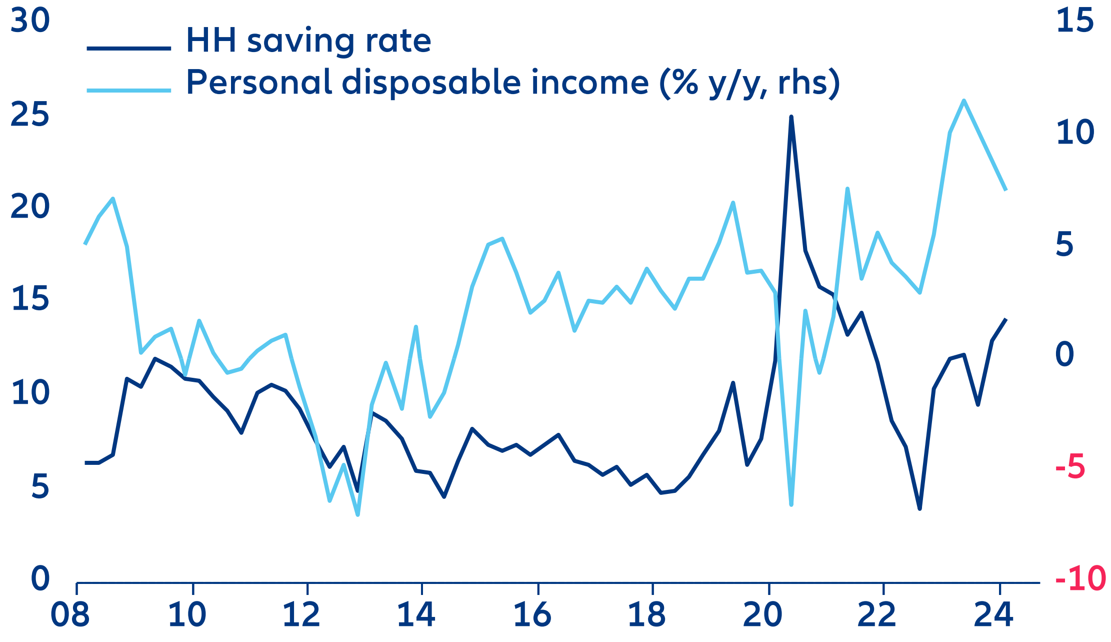
Index 100=2019



Sources: LSEG Workspace, Allianz Research

Disposable income growth decelerated while savings increased; spending growth will be limited

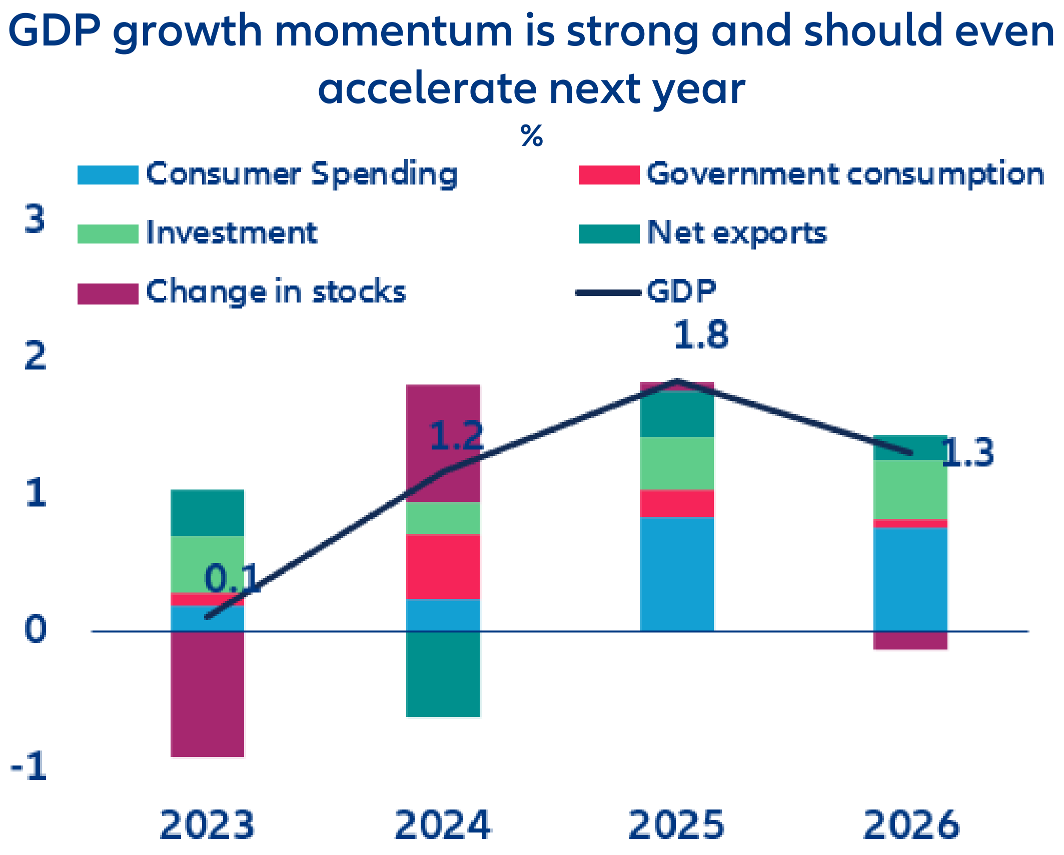
%



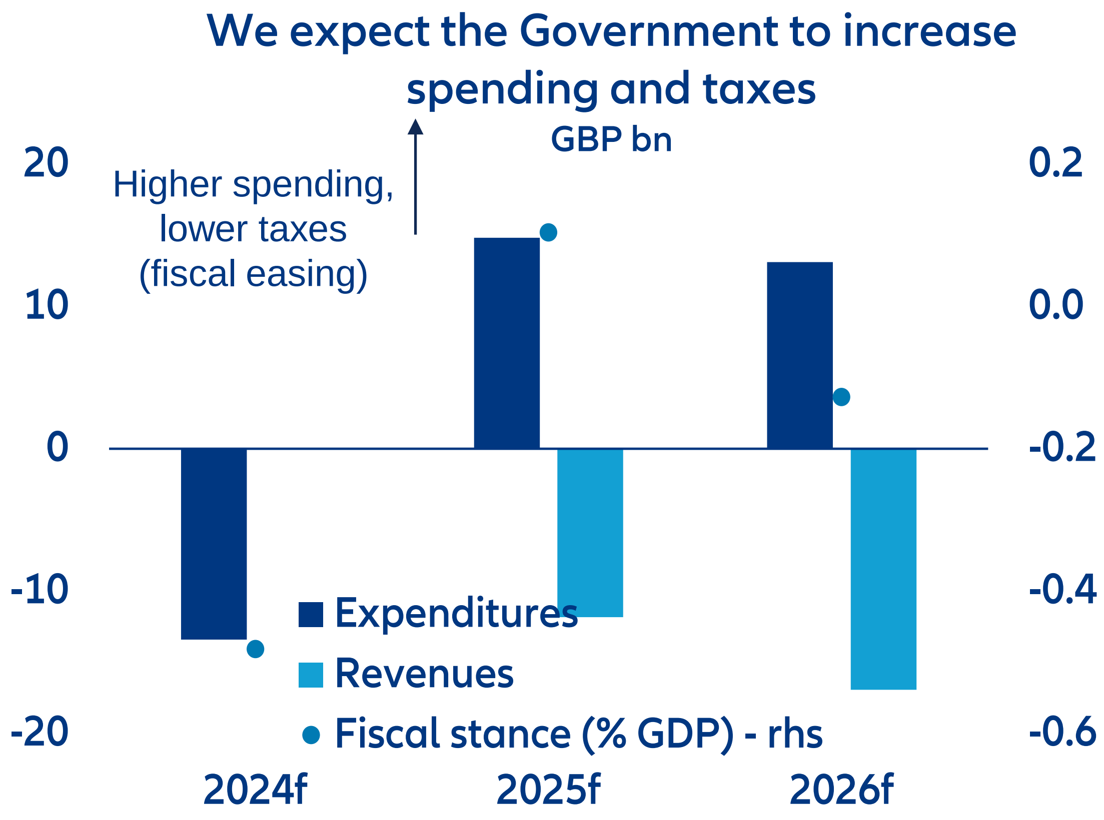
Sources: LSEG Workspace, Allianz Research

Allianz

Economy in a catch-up phase ; Fiscal policy set to be titled towards more spending, more taxes



Source: LSEG Workspace, Allianz Research



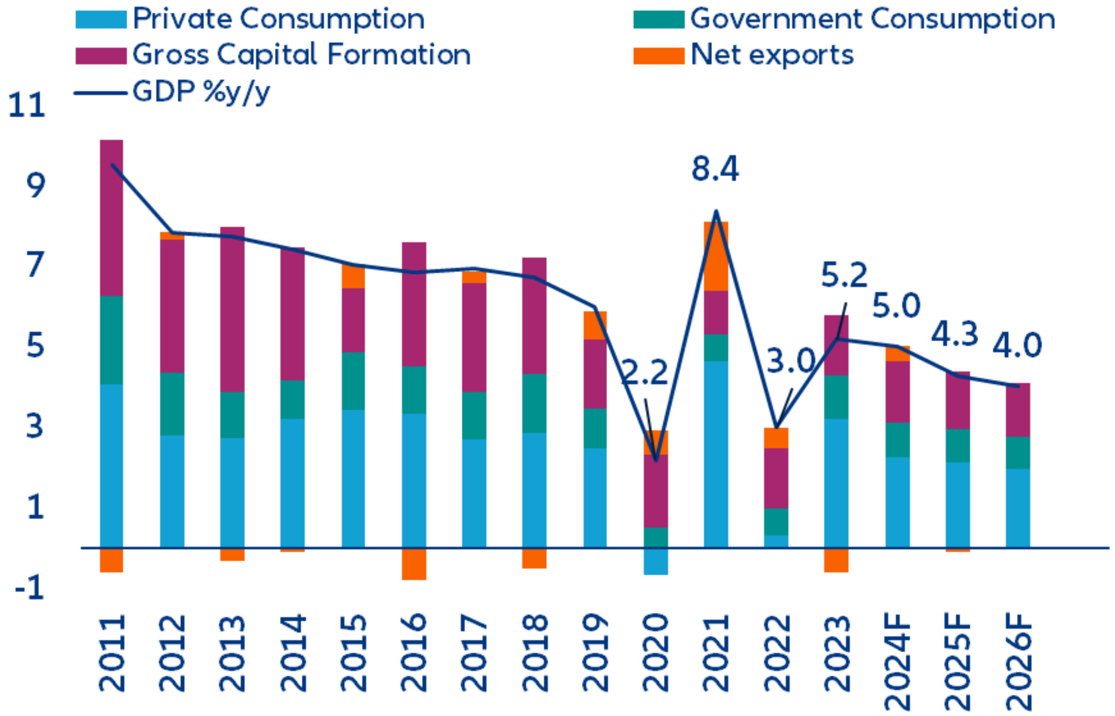
Source: LSEG Workspace, Allianz Research

Allianz

Managed slowdown: still weak private sector and real estate crisis partly cushioned by policy support

Growing by "around 5%" in 2024: risks are on the downside

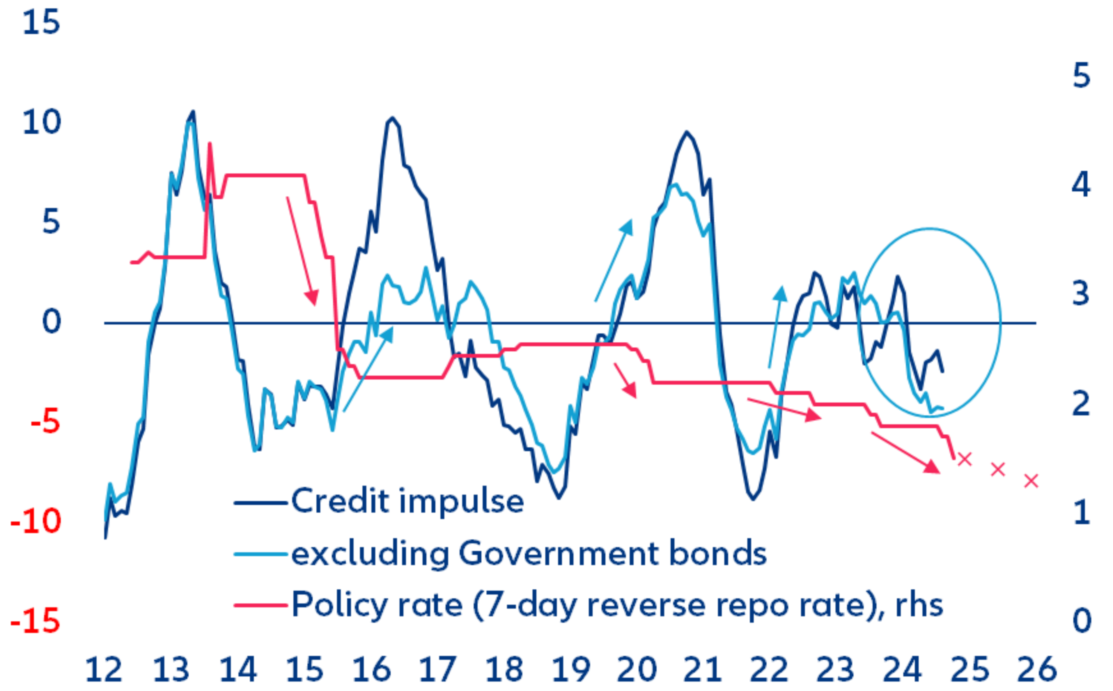
Real GDP growth %y/y and contributions



Sources: national sources, LSEG Datastream, Allianz Research

Policy easing will further accelerate, but efficiency on the private sector has been limited

Credit impulse (overall and excl. Government bonds, policy rate and forecasts)

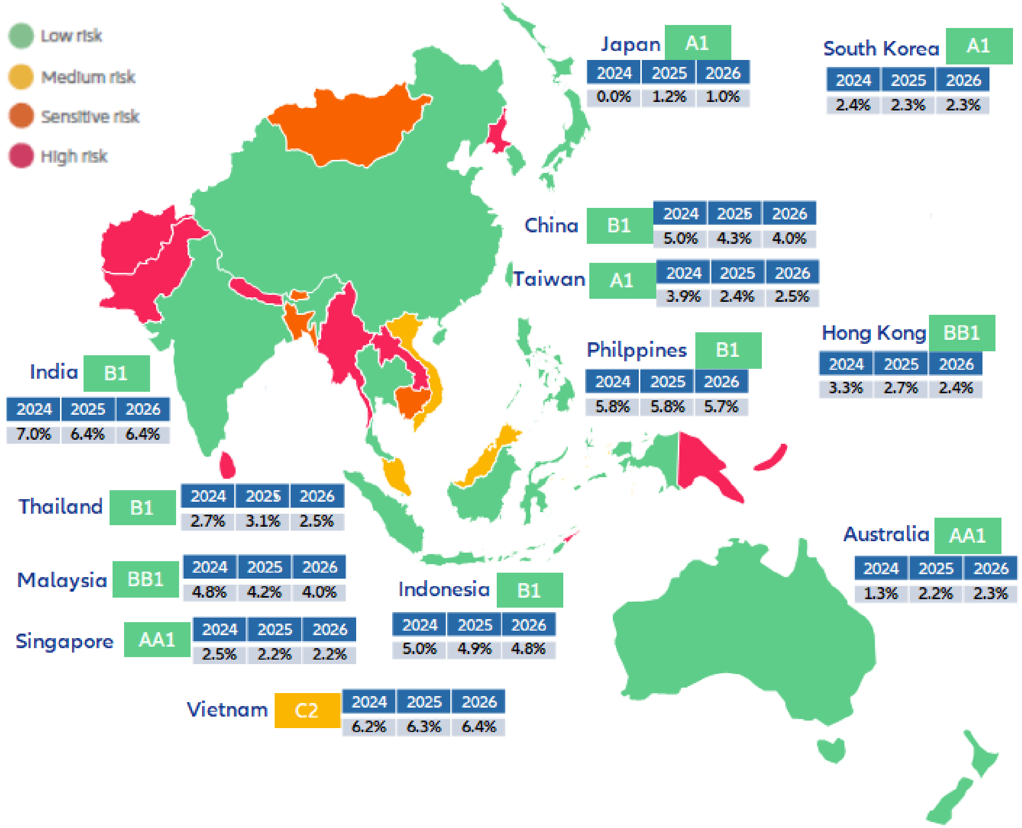


Sources: national sources, LSEG Datastream, Allianz Research

Allianz

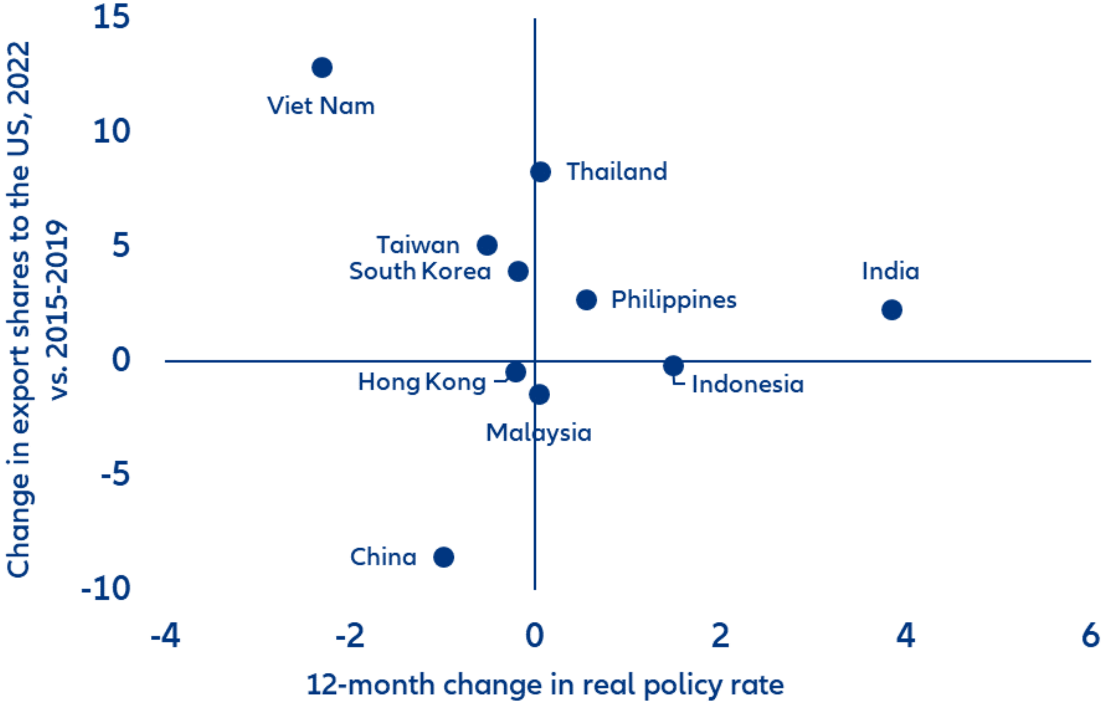
Emerging Asia well positioned in changing globalization, while domestic easing is underway

GDP growth forecasts and short-term country risk, as of Q3 2024



Source: Allianz Research

Tailwinds from changing globalization and easing domestic conditions

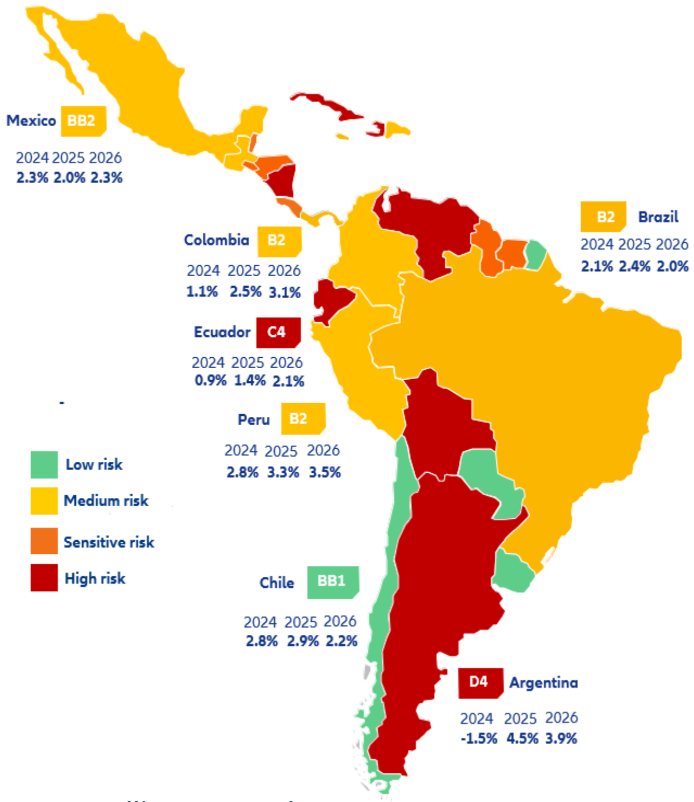


Sources: national sources, ITC, Allianz Research

Allianz

Short-term challenges rebalance, but FX and fiscal are still on top of the list

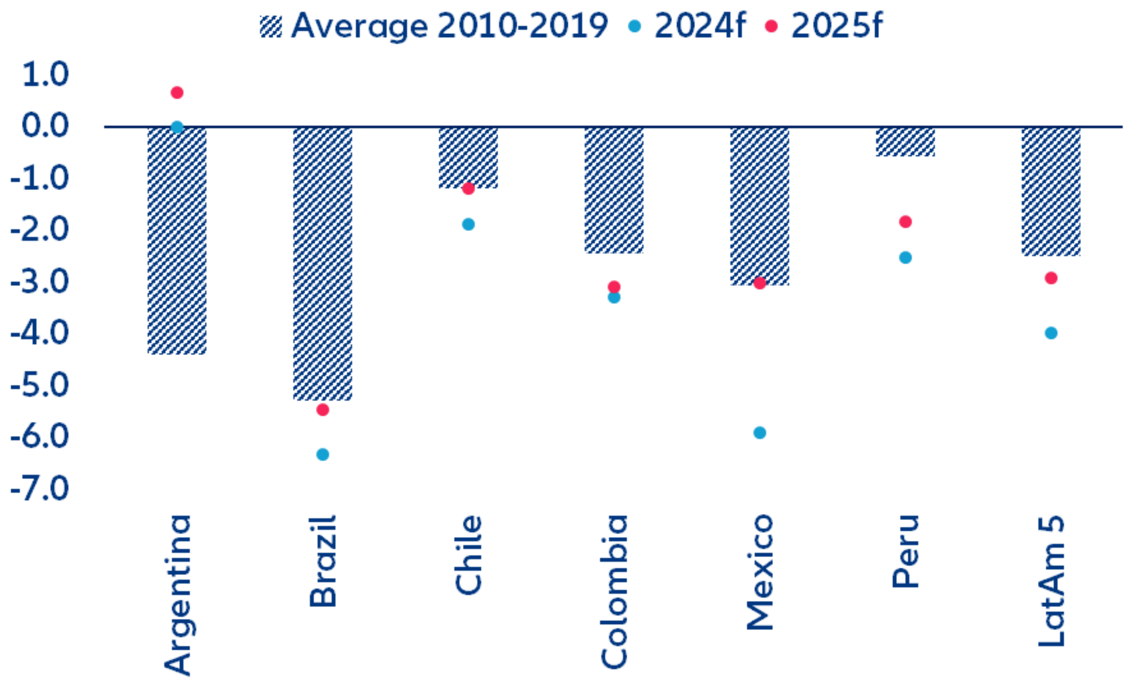
Regional growth stable at 2% this year, with an acceleration in 2025...



Sources: LSEG Datastream, Allianz Research

...while fiscal deficits remain large along with financing costs

% of GDP

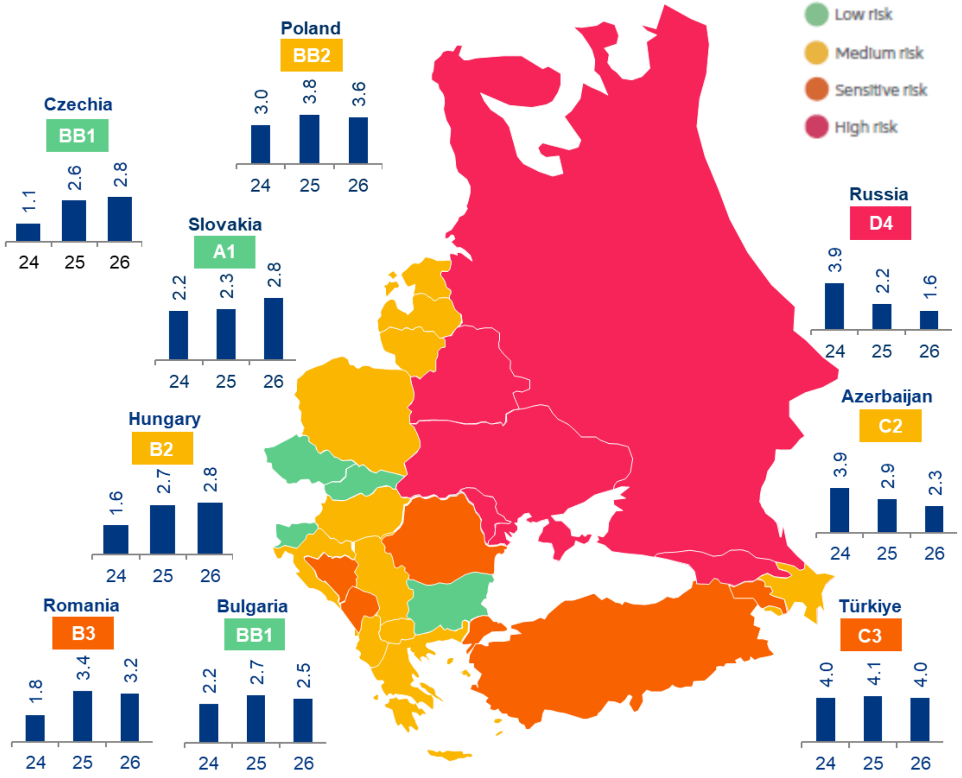


Note: LatAm 5 includes Brazil, Chile, Colombia, Mexico and Peru.
Sources: IMF, Allianz Research

Allianz

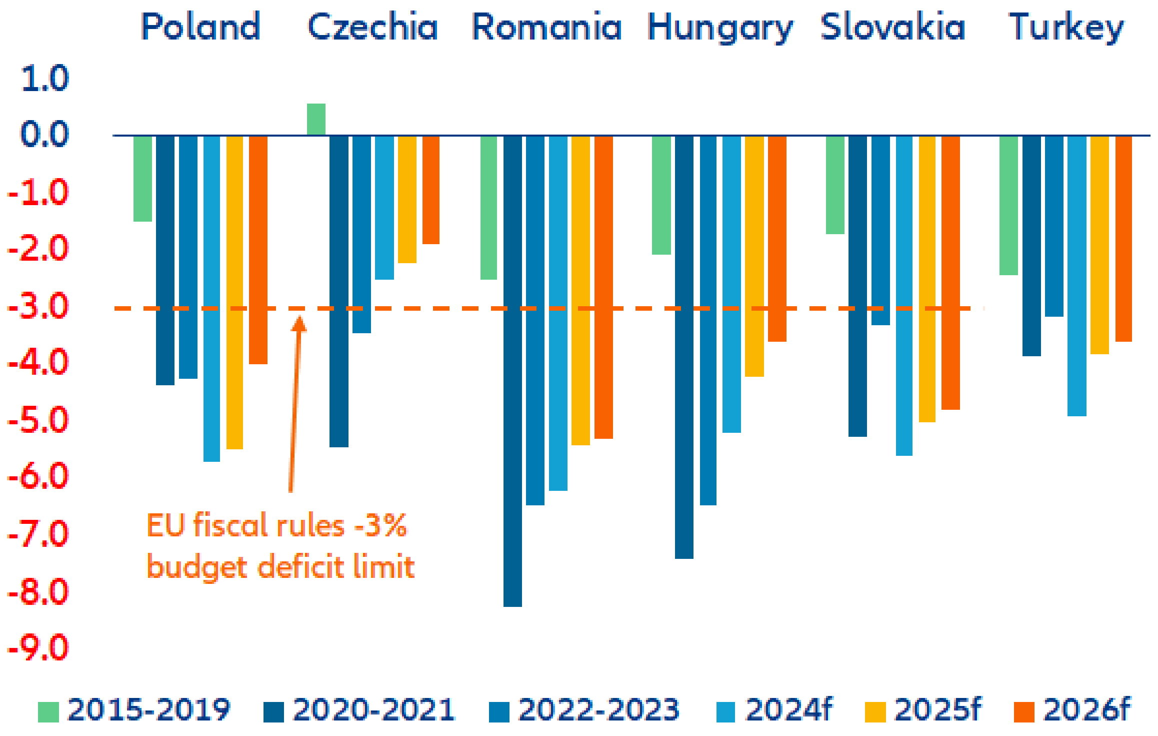
Strong fiscal stimulus supports continued gradual recovery but puts public finances at risk

GDP growth and short-term country risk as of Q3 2024



Sources: LSEG Datastream, Allianz Research

Budget deficit in % of GDP: EDP opened against PL, HU and SK (RO already in it since 2020)



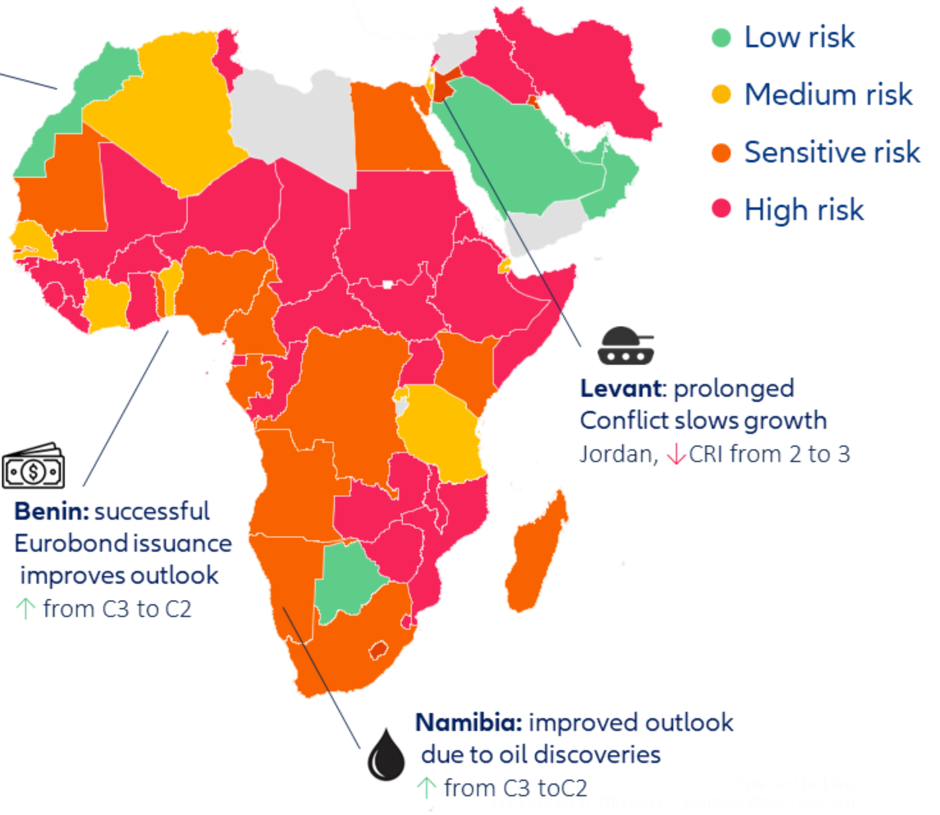
Sources: LSEG Datastream, Allianz Research

Allianz

Rebalancing: decelerating oil price and inflation, propel growth in diversified economies

Growth accelerate across the board with diversified and reform-driven economies leading the charge

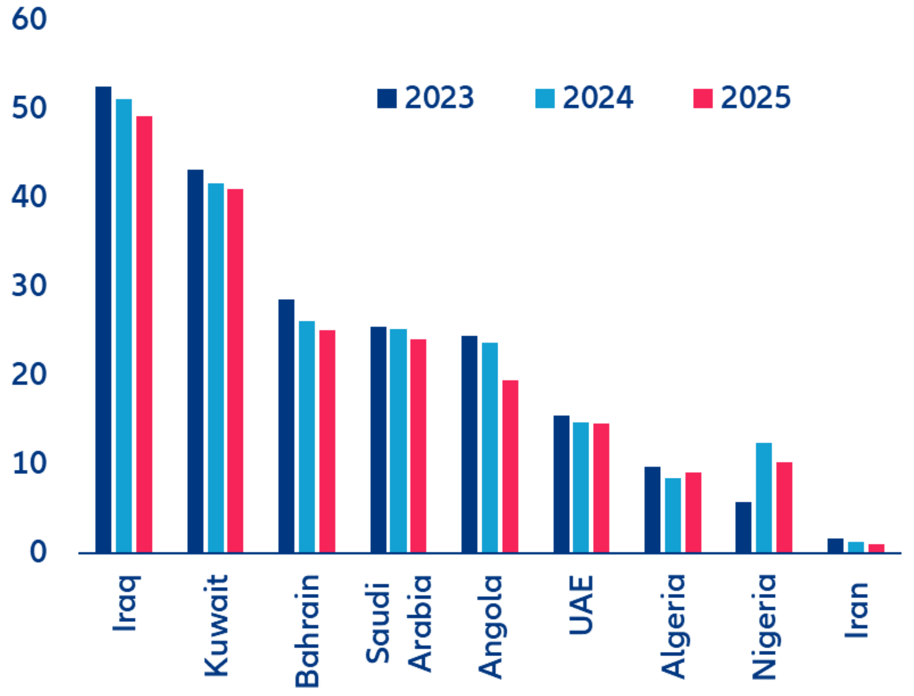
Country risk ratings as of Q3 2024



Real GDP growth, %		2023	2024	2025
North Africa:				
Algeria	C2	3.0	3.1	2.5
Egypt	D3	4.0	3.8	3.1
Morocco	B1	3.1	3.5	3.8
Tunisia	D4	1.0	1.8	2.0
West Africa:				
Cote d'Ivoire	C2	7.0	6.5	6
Nigeria	D3	3.0	3.1	3.0
Senegal	C2	7.0	7.2	7.0
Southern Africa:				
Angola	D3	2.0	2.8	3.3
South Africa	D3	1.2	1.7	2.0
East Africa:				
Kenya	C3	5.0	5.5	5.5
Tanzania	C2	5.0	5.5	5.5
Middle East:				
Israel	B2	-1.0	4.1	4.0
Saudi Arabia	B1	1.4	4.3	4.1
UAE	BB1	3.8	4.8	5.1

While falling oil prices expose vulnerabilities in non-diversified oil economies

Oil revenue, % of GDP



Sources: OPEC, IMF, Allianz Research

Capital Markets outlook

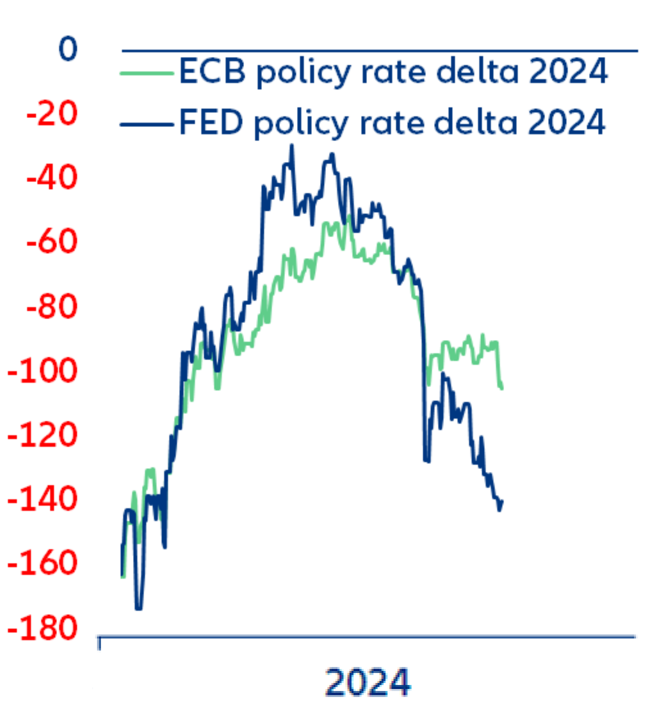
2024-2026

Allianz

Volatility to fade slowly but markets remain on alert amid policy rate uncertainty, elections and AI

Fluctuating central bank expectations amid inflation swings lead to volatility

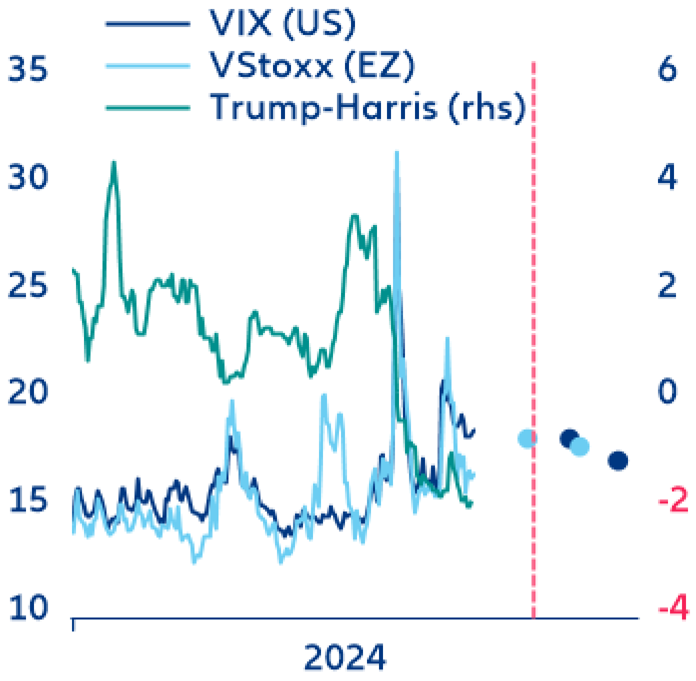
Market based central bank expectations, bps



Sources: Bloomberg, Allianz Research

Macro and (Geo)Political uncertainty will keep markets vibrant

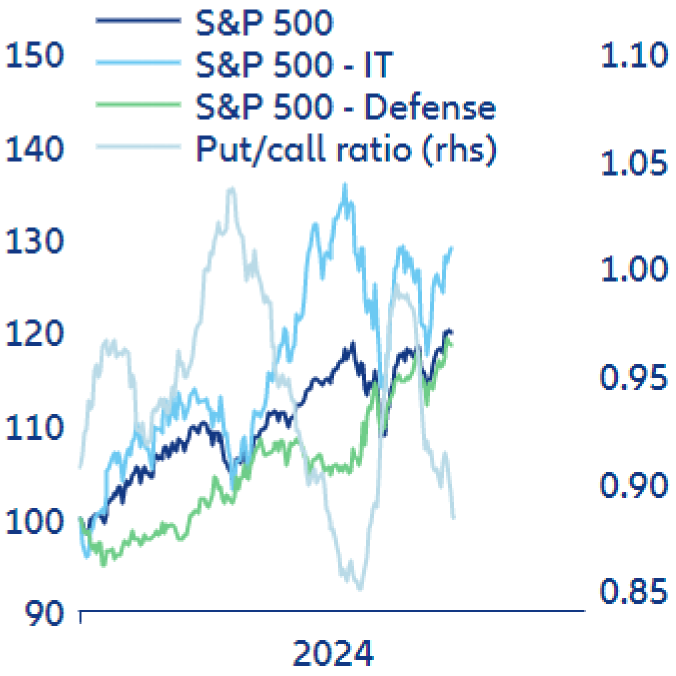
Equity volatility indices



Sources: LSEG Datastream, Allianz Research
Note: Red vertical line represents US election day.

Leading investment themes (eg AI) struggle; investors ready to hedge

Index, 100 = Dec 2023

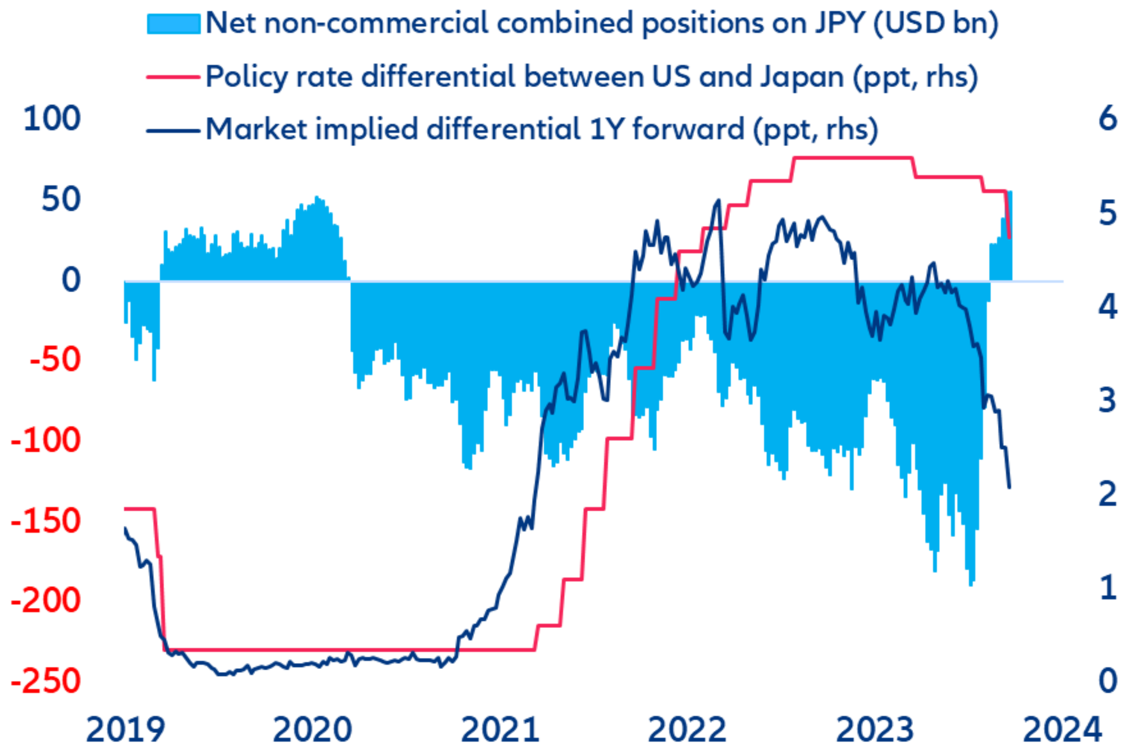


Sources: LSEG Datastream, Allianz Research

Allianz

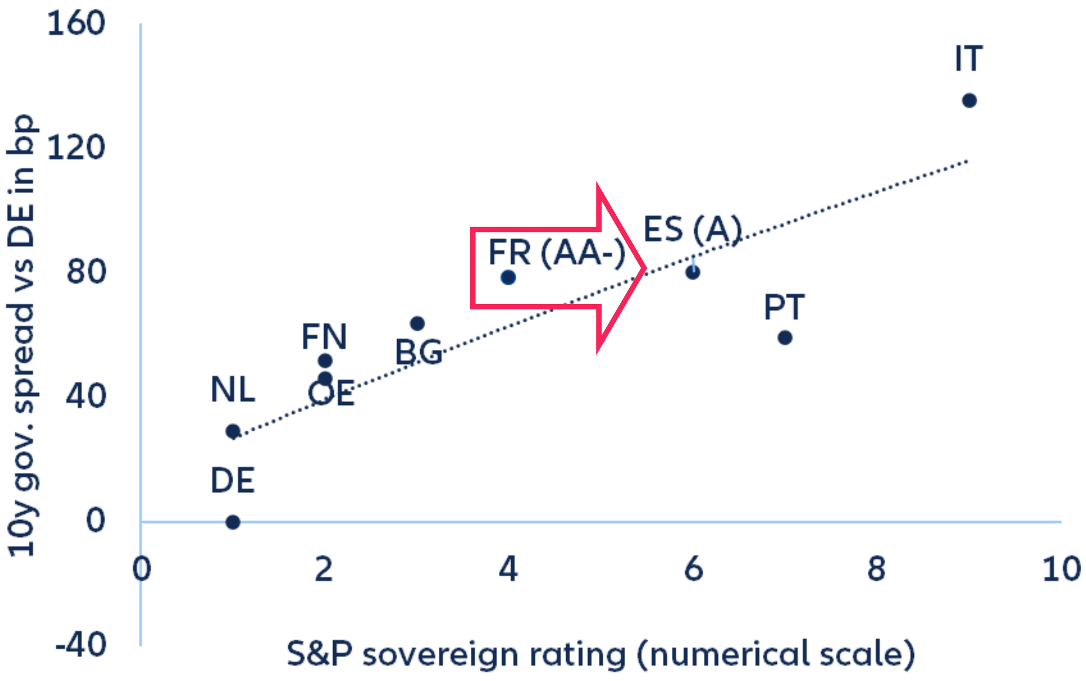
Financial risks: Further BOJ hikes amid global easing and France losing AA rating among others

Carry trade unwind blamed for August turmoil



Sources: Bloomberg, Allianz Research.
Note: The upper bound of the policy rate is taken for the calculation

A rating downgrade of France with a negative outlook to add volatility in Eurozone spreads



Sources: LSEG Datastream, Allianz Research.

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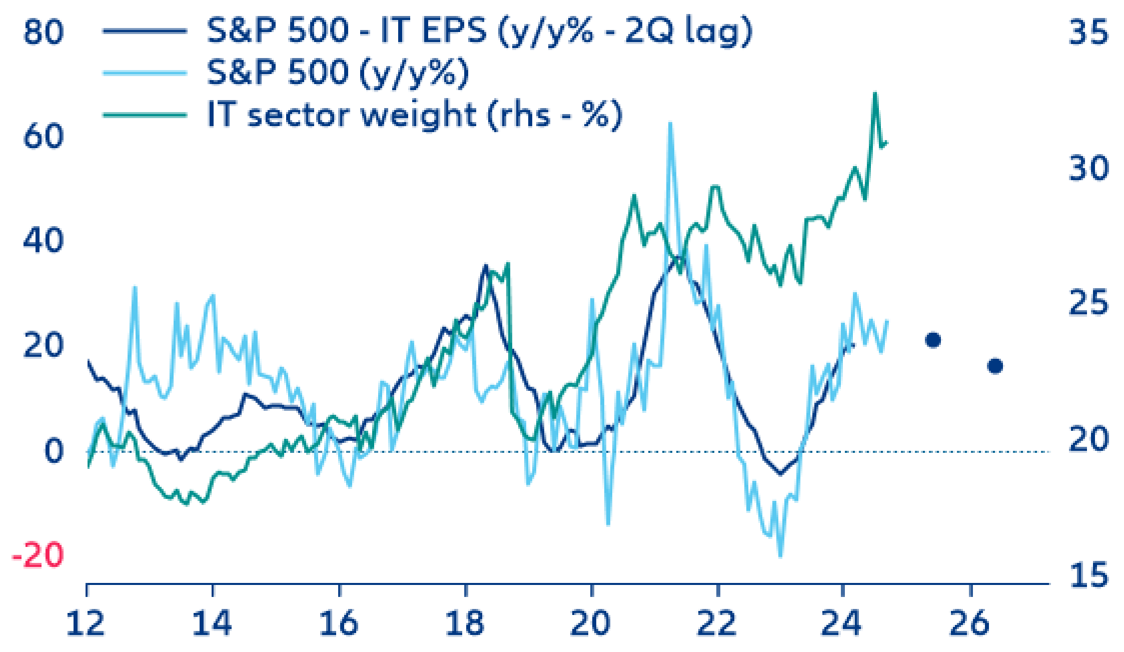
Concentration risks and historic patterns point to downside risks for US equities

Decelerating Tech earnings and high index concentration are the perfect combination for volatility

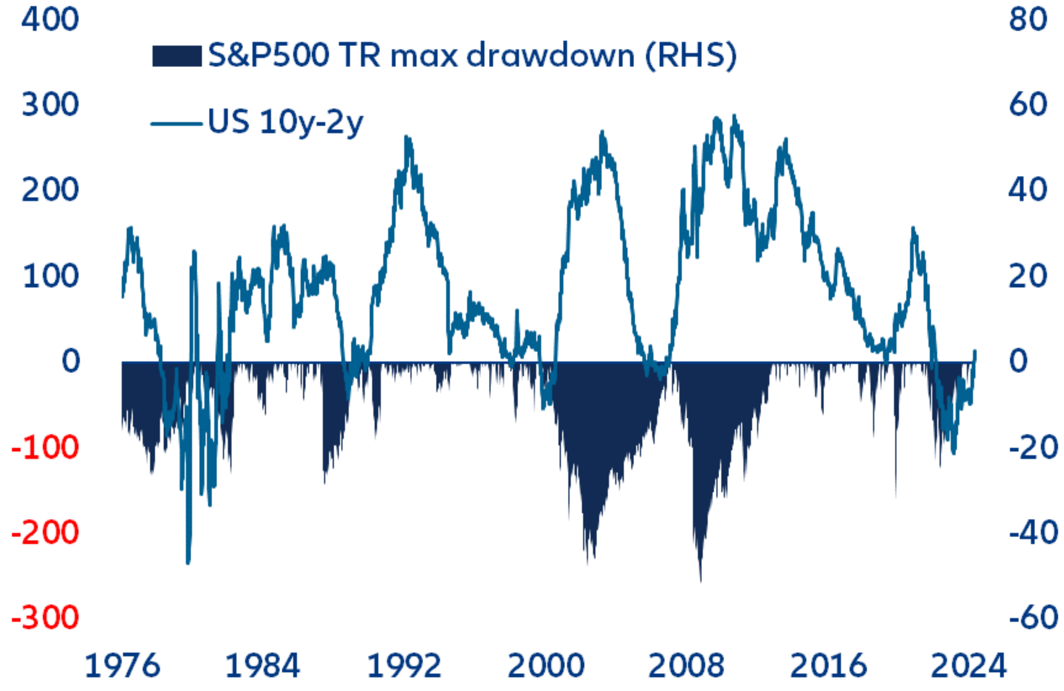
%



Sources: LSEG Datastream, Allianz Research.
Note: Dots represent consensus for EPS growth in 2025 and 2026

Historically, once the yield curve normalizes, equities do not do well in the US

bps, pp



Sources: LSEG Datastream, Allianz Research.

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Markets to navigate the policy-heavy environment

Capital Markets: Eurozone and US

year-end figures

EMU	Last*	Unit	2023	2024f	2025f	2026f
Government Debt						
ECB deposit rate	3.50	%	4.00	3.25	2.25	2.25
10y yield (Bunds)	2.17	%	2.03	2.30	2.20	2.20
10y EUR swap rate	2.40	%	2.48	2.60	2.50	2.50
20y EUR swap rate	2.48	%	2.51	2.70	2.70	2.70
Italy 10y sovereign spread	131	bps	168	130	120	100
France 10y sovereign spread	80	bps	53	70	50	40
Spain 10y sovereign spread	79	bps	97	70	60	50
Corporate Debt						
Investment grade credit spreads	114	bps	135	120	110	100
High-yield credit spreads	347	bps	395	360	350	340
Equity						
Eurostoxx (total return p.a.)	13 ytd	%	19	10	8	7

US	Last*	Unit	2023	2024f	2025f	2026f
Government Debt						
Fed Funds rate (high)	5.00	%	5.50	4.50	3.50	3.50
10y yield (Treasuries)	3.79	%	3.87	3.90	3.70	3.70
Corporate Debt						
Investment grade credit spreads	92	bps	104	100	90	85
High-yield credit spreads	314	bps	334	330	320	310
Equity						
S&P 500 (total return p.a.)	22 ytd	%	26	13	8	9

Capital Markets: UK, Emerging Markets, FX

year-end figures

UK	Last*	Unit	2023	2024f	2025f	2026f
Government Debt						
BoE rate	5.00	%	5.25	4.50	3.00	3.00
10y yield sovereign (Gilt)	4.01	%	3.54	3.80	3.60	3.50
Corporate Debt						
Investment grade credit spreads	114	bps	134	120	120	110
High-yield credit spreads	416	bps	515	440	410	410
Equity						
FTSE 100 (total return p.a.)	10 ytd	%	8	7	8	7

Emerging Markets	Last*	Unit	2023	2024f	2025f	2026f
Government Debt						
Hard currency spread (vs USD)	198	bps	215	220	220	210
Local currency yield	6.10	%	6.19	6.3	5.9	5.8
Equity						
MSCI EM (total return p.a. in USD)	16 ytd	%	10	7	7	8

Others	Last*		2023	2024f	2025f	2026f
EUR USD	1.12	$ per €	1.10	1.10	1.10	1.11

Sources: LSEG Datastream, Bloomberg, Allianz Research
Notes: Year end figures
* As of 26.Sep 2024

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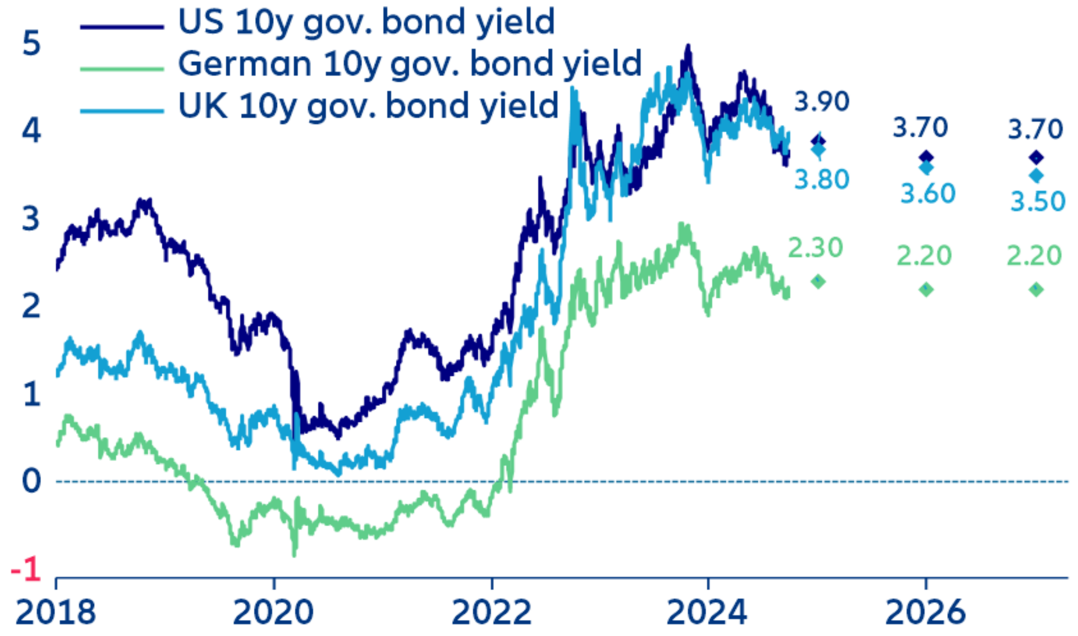
Long-term yields are caught between falling policy rates and government spending on top of QT

Sovereign bond yields to ease slightly on lower policy rates and further normalizing inflation expectations

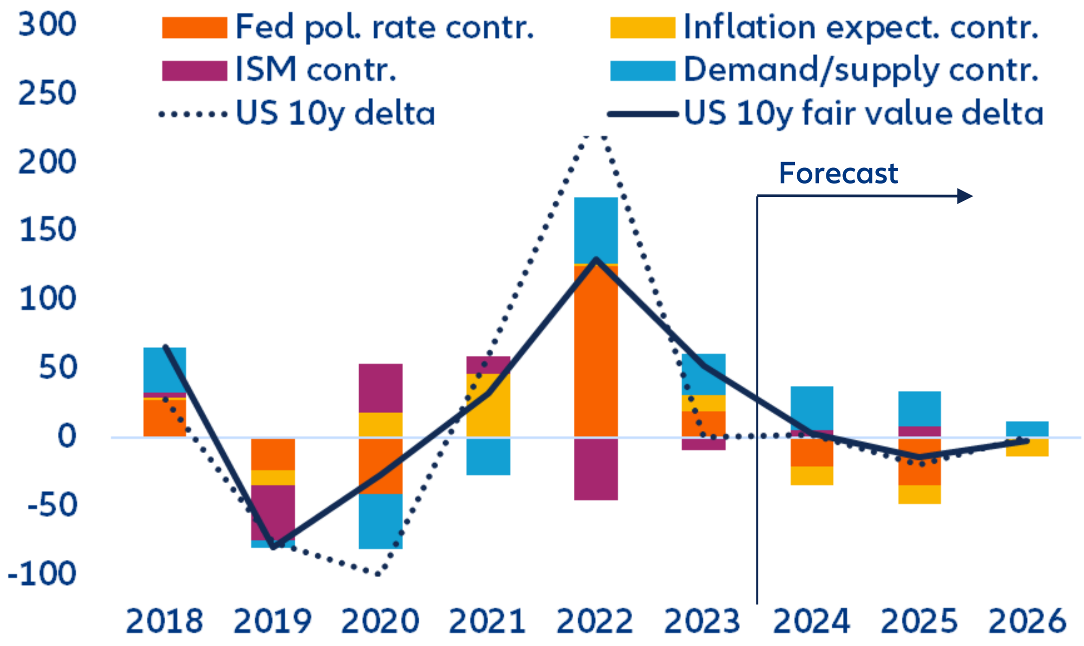
Yields in %



Sources: LSEG Datastream, Allianz Research

Net debt issuance and ongoing quantitative tightening to slow down the fall in yields

Fair value US 10y government bond yield, annual delta in bps



Sources: Bloomberg, Allianz Research

Notes: The fair value model uses 3m OIS rates, University of Michigan long-term inflation expectations, the ISM purchasing manager index and the share of US debt to be bought by private domestic investors (i.e. excluding the Fed and overseas investors)

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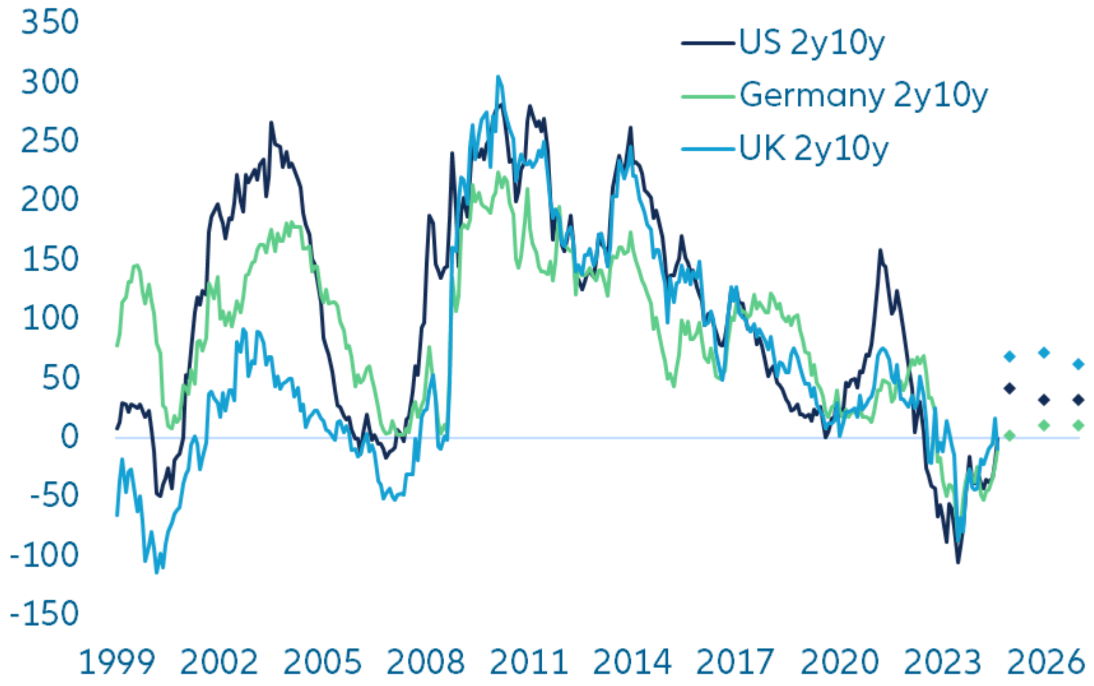
German yield inversion sticky while French government bond spreads to narrow only next year

Yield curve inversion to cease unevenly, Germany lags on high ECB terminal rate and little Bund supply

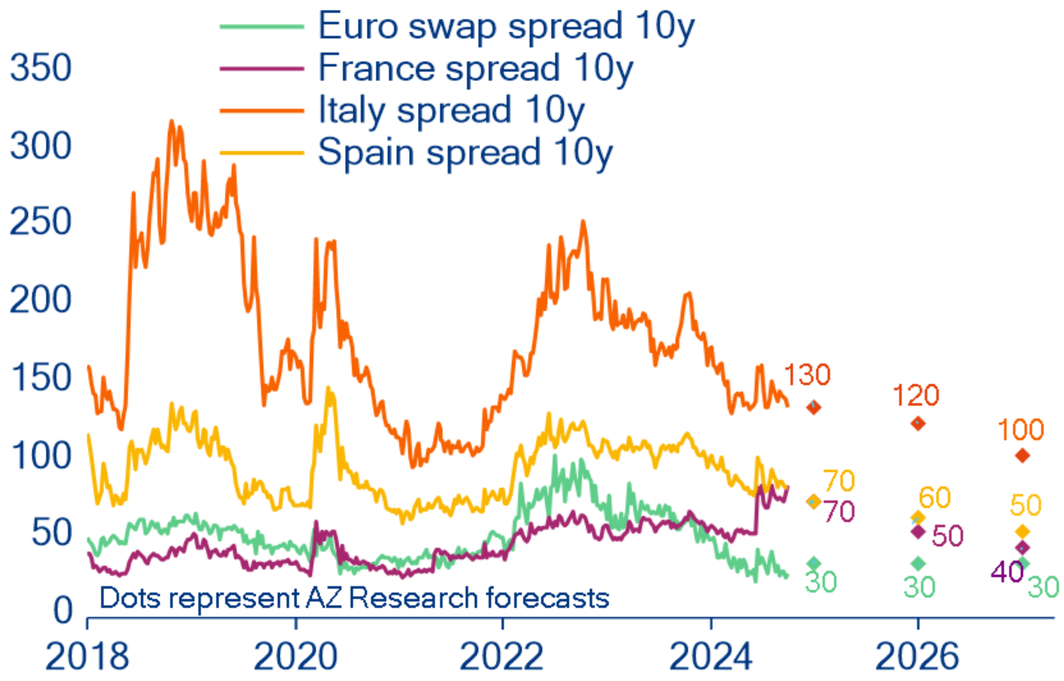
10y – 2y government bond yields in bps



Sources: LSEG Datastream, Allianz Research

Spread normalization continues anticipating ECB pivot, economic rebound and European integration

Yield spreads vs. 10y German bund yields in bps

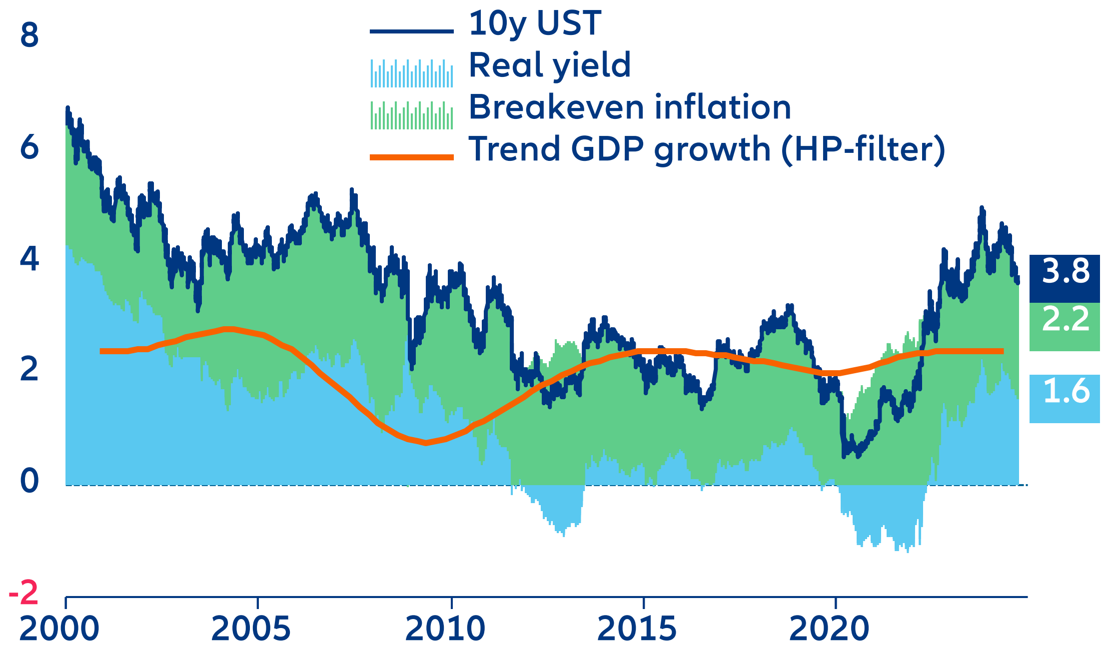


Sources: LSEG Datastream, Allianz Research

Real bond yields to stay above 2010s levels in line with economic growth again

US real government bond yield to stay at pre-GFC levels after a decade of ultra-loose monetary policy

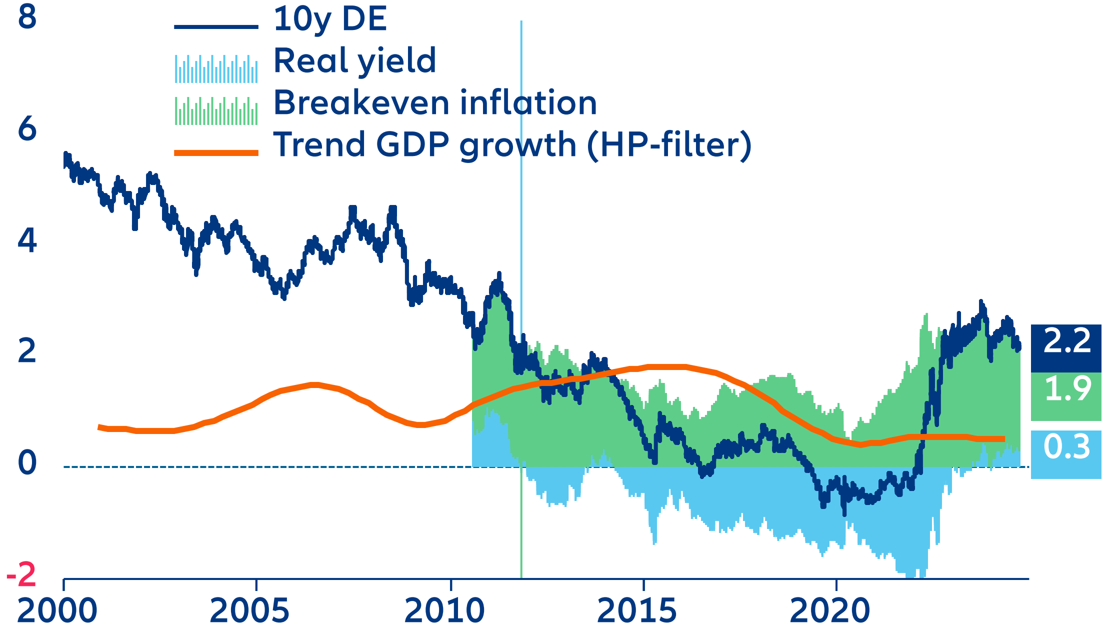
Nominal and real 10y government bond yields, %



Source: Bloomberg, LSEG Datastream, Allianz Research
Notes: Real yields based on inflation linked bonds.

Similarly, German real yields are back to pre-Euro-crisis levels and set to remain at these levels

Nominal and real 10y government bond yields, %

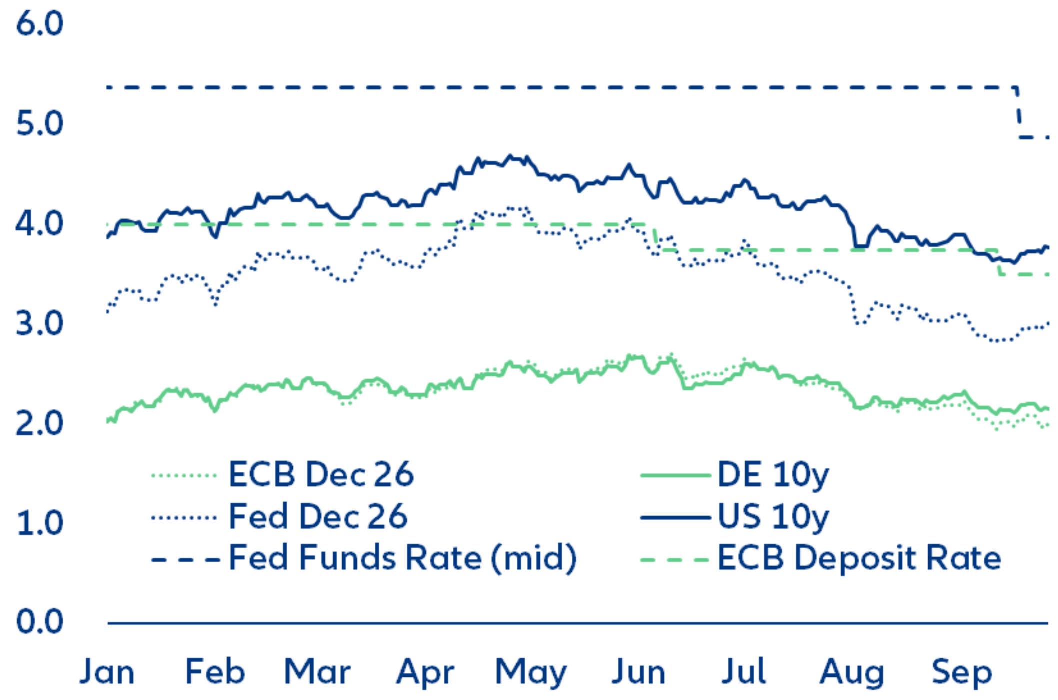


Source: Bloomberg, LSEG Datastream, Allianz Research
Notes: Real yields based on inflation linked bonds which were only introduced in 2006 in Germany and continuous time series are only available from 2012.

Bond yields react to terminal rate pricing while short term expectations impact FX markets

Expected terminal rates fell in line with 10y yields during summer and are now below our expectations

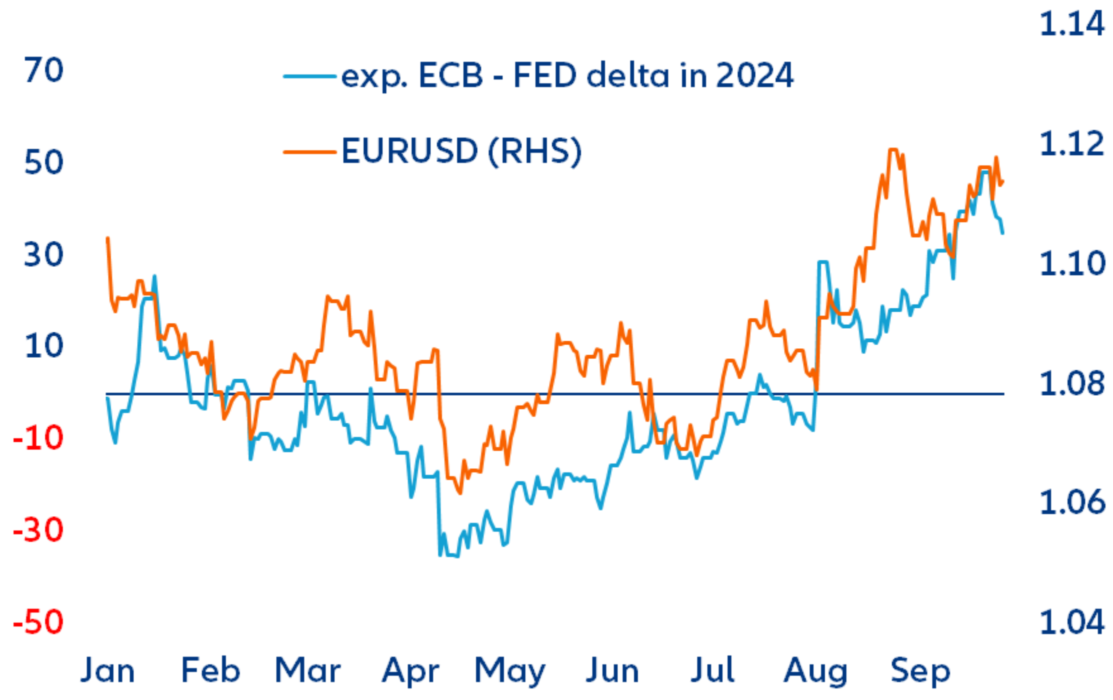
%



Sources: Bloomberg, Allianz Research
Notes: Dotted lines show future based expectations of policy rates at the end of 2026

Markets have priced in more cuts for the Fed than the ECB in 2024 which has given the Euro some tailwind

Policy rate delta in bps and EURUSD

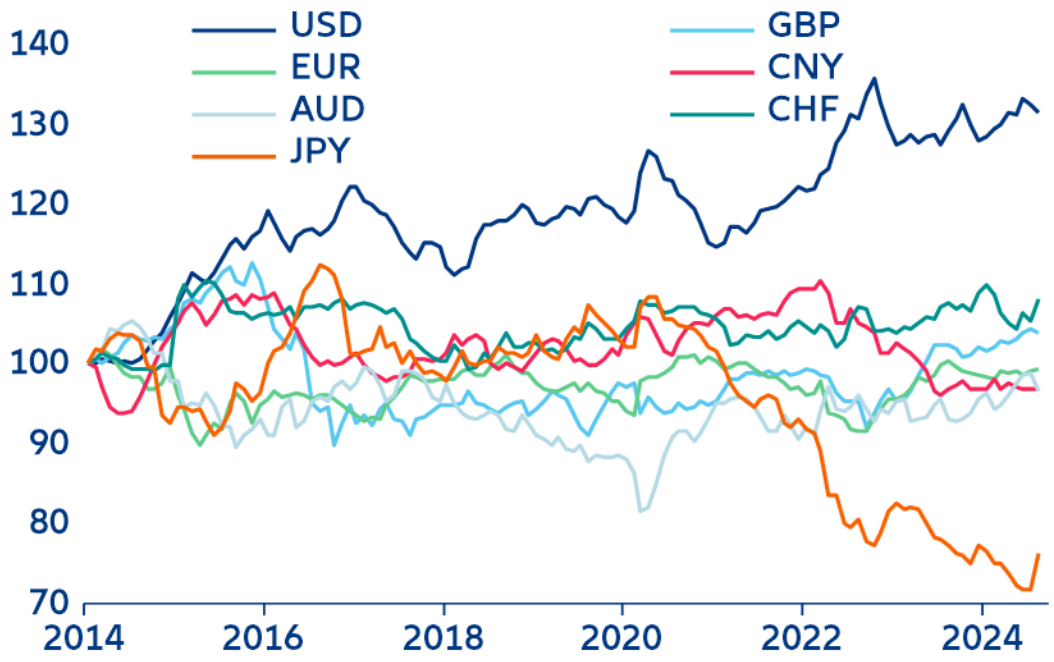


Sources: Bloomberg, Allianz Research

Modest depreciation ahead for the USD amid gradual economic and geopolitical normalization

The USD remains overvalued against JPY and CNY but less so against the EUR

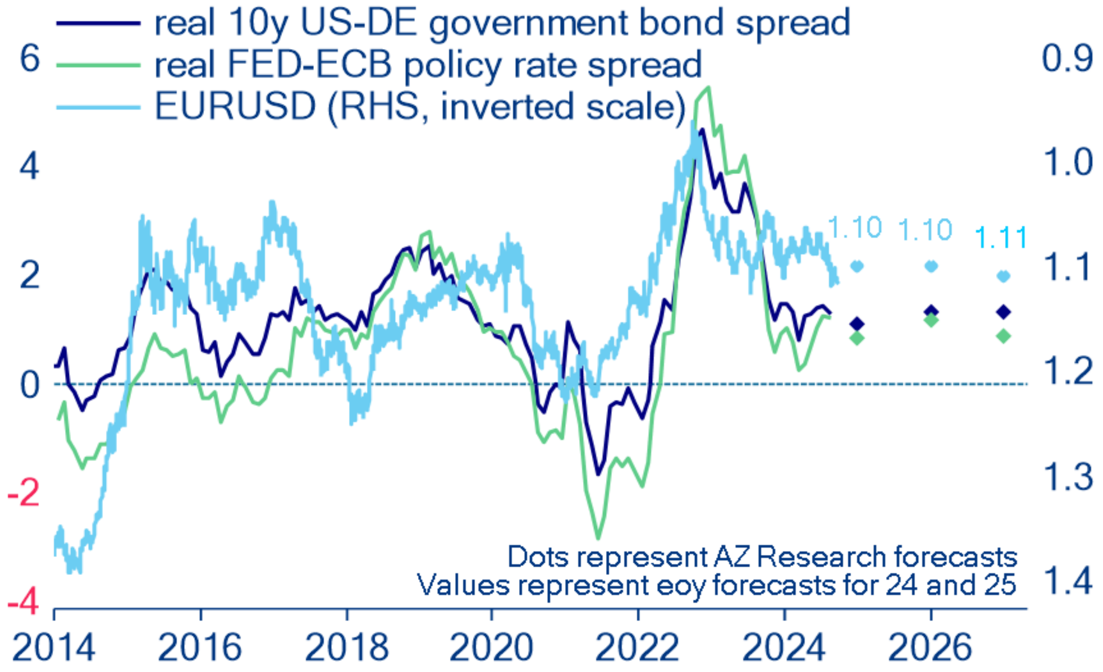
Real effective exchange rate indices (2014=100)



Sources: LSEG Datastream, Allianz Research

Comparatively stronger easing by the Fed compared to ECB provides some tailwind to the EUR

Yield differentials in pp and EURUSD exchange rate



Sources: LSEG Datastream, Allianz Research

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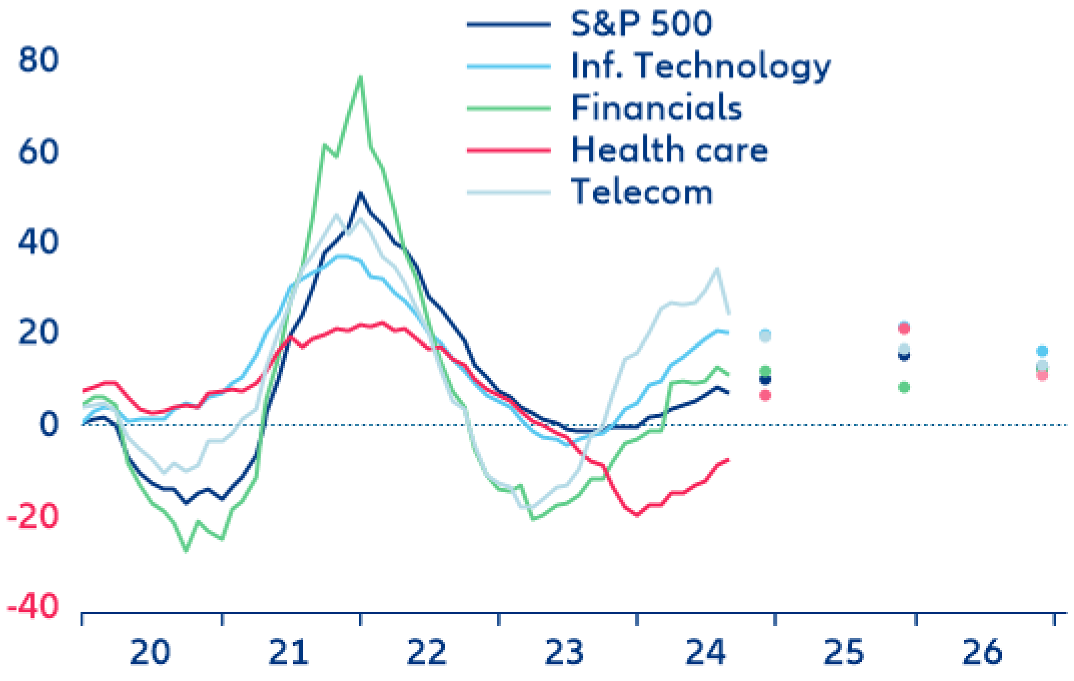
The earnings momentum is cooling signaling lower market returns moving forward

The earnings boom, especially for Tech, is cooling leaving the door open for market consolidation

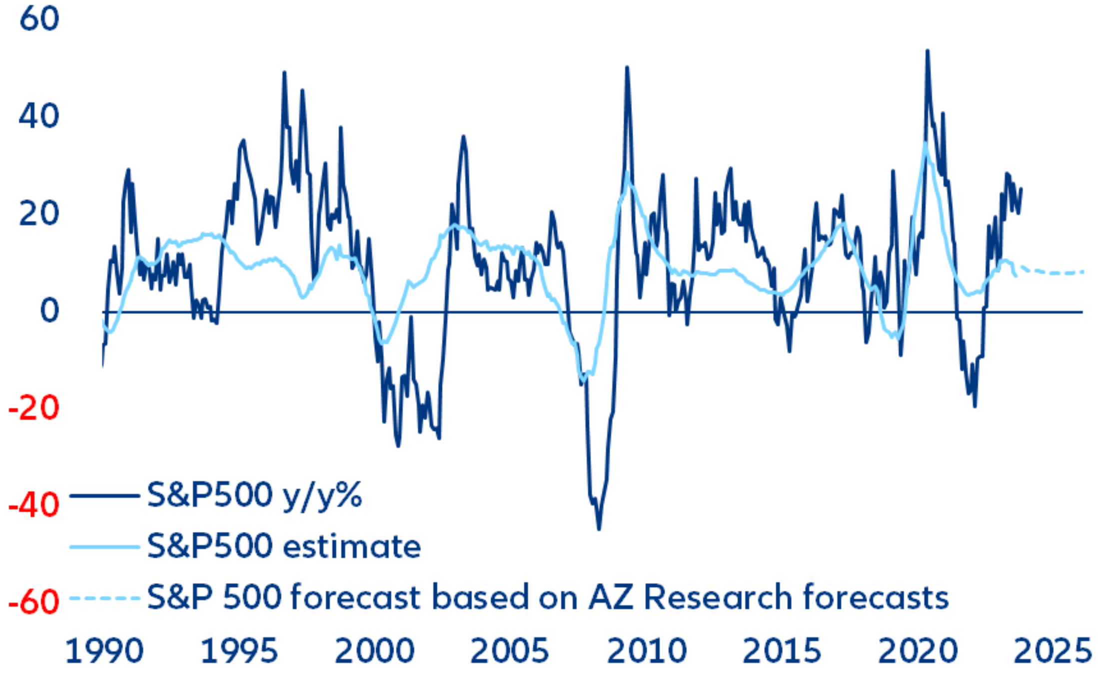
yoy, %



Sources: LSEG Datastream, Allianz Research
Note: Dots represent 2024 and 2025 consensus

Our EPS-based modelling hints towards a 7 to 9% total return for the S&P 500 moving forward

yoy, %



Sources: LSEG Datastream, Allianz Research

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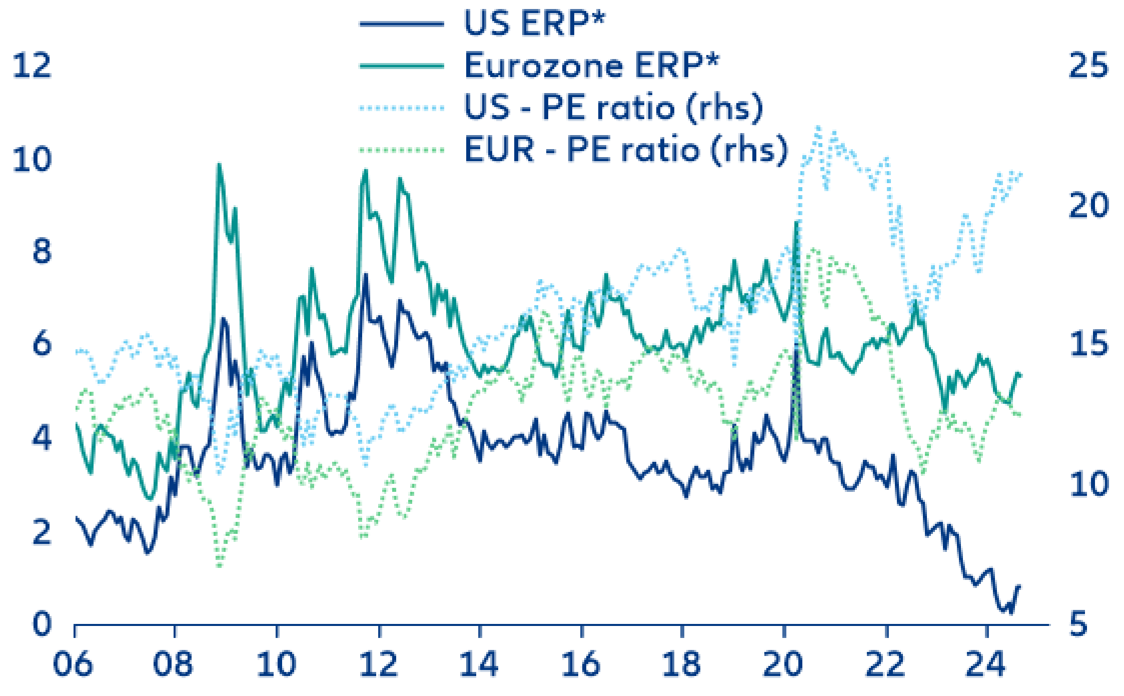
US EQ remains pricy, but we continue to expect high-single/low-double digit returns through 2026

The latest EQ market correction has timidly reduced the priciness of US equities, but valuations remain stretched

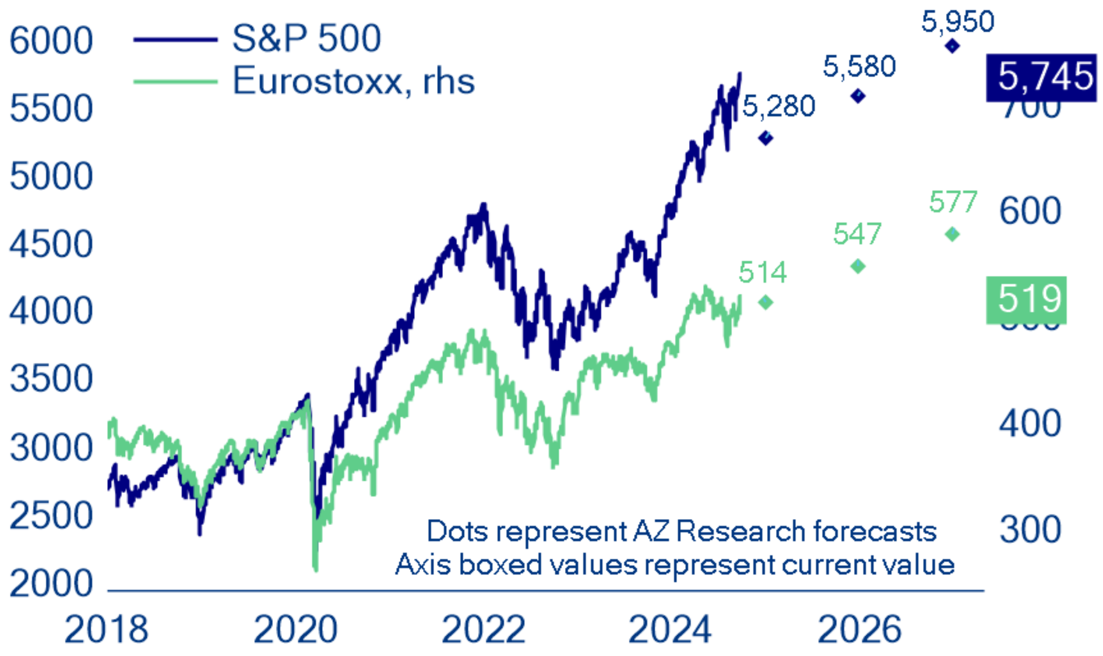
pp, ratio



Sources: LSEG Datastream, Allianz Research
*ERP: Equity Risk Premium

Resilient earnings and favorable risk appetite set stage for equities to finish 2024 at ~10-15% total return

index



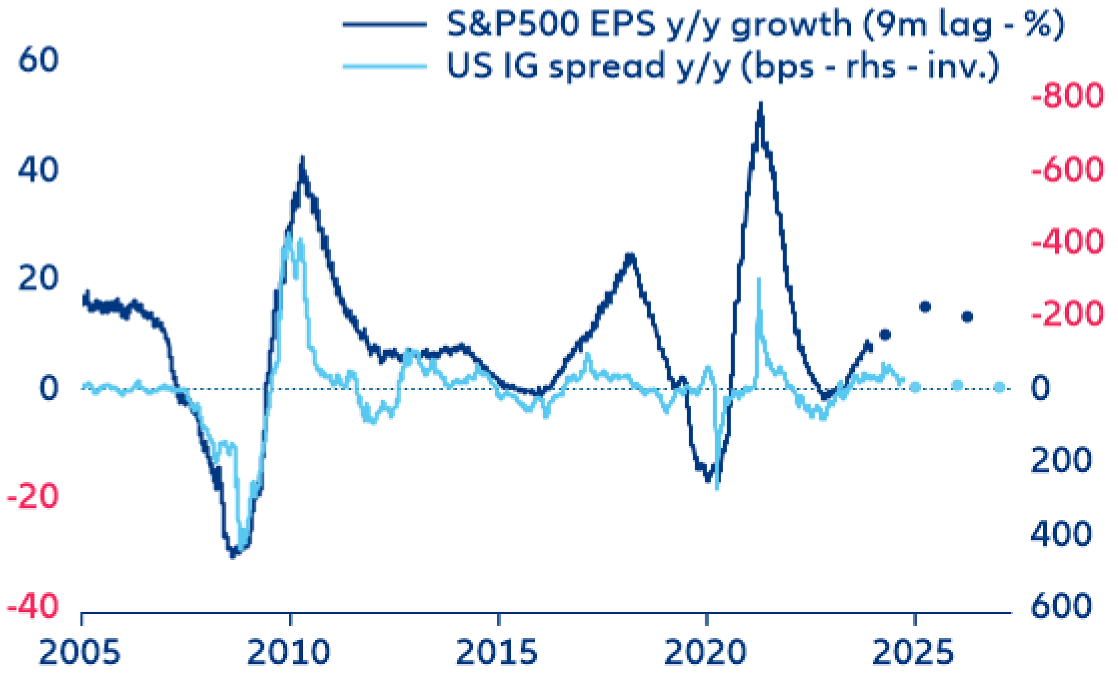
Sources: LSEG Datastream, Allianz Research

Allianz

Credit spreads remain tight, but no structural widening expected

Fundamentals suggest there might be room for further spread compression but already tight spreads

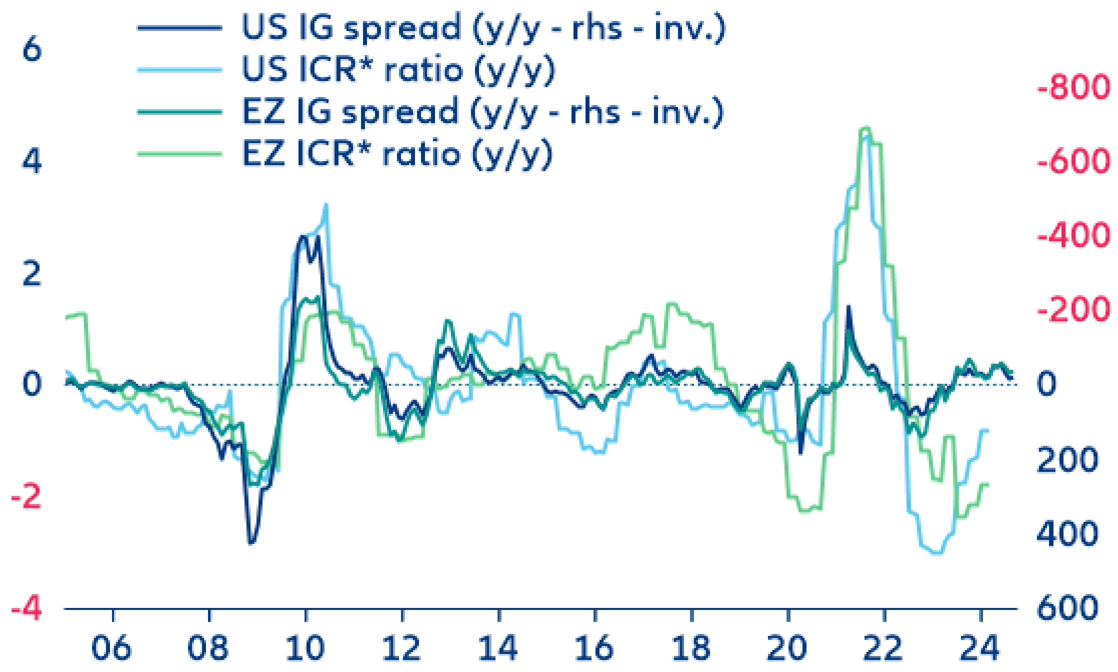
%, bps



Sources: LSEG Datastream, Allianz Research

... deteriorating debt servicing and a need to refinance at higher rates hints towards sideways trading

%, bps



Sources: LSEG Datastream, Allianz Research
Note: ICR – Interest Coverage Ratio

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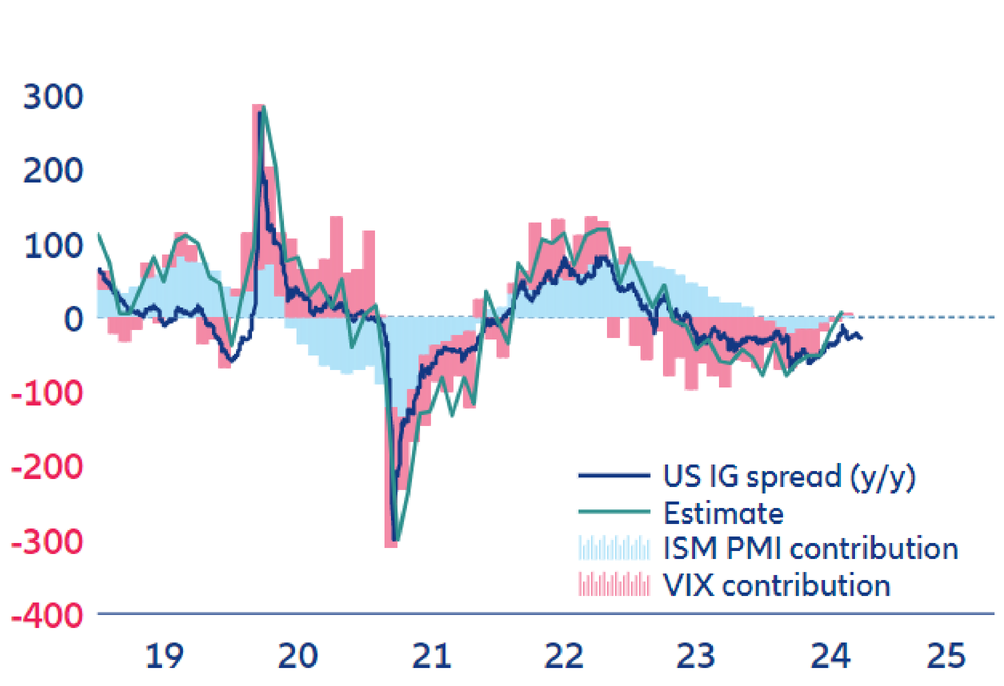
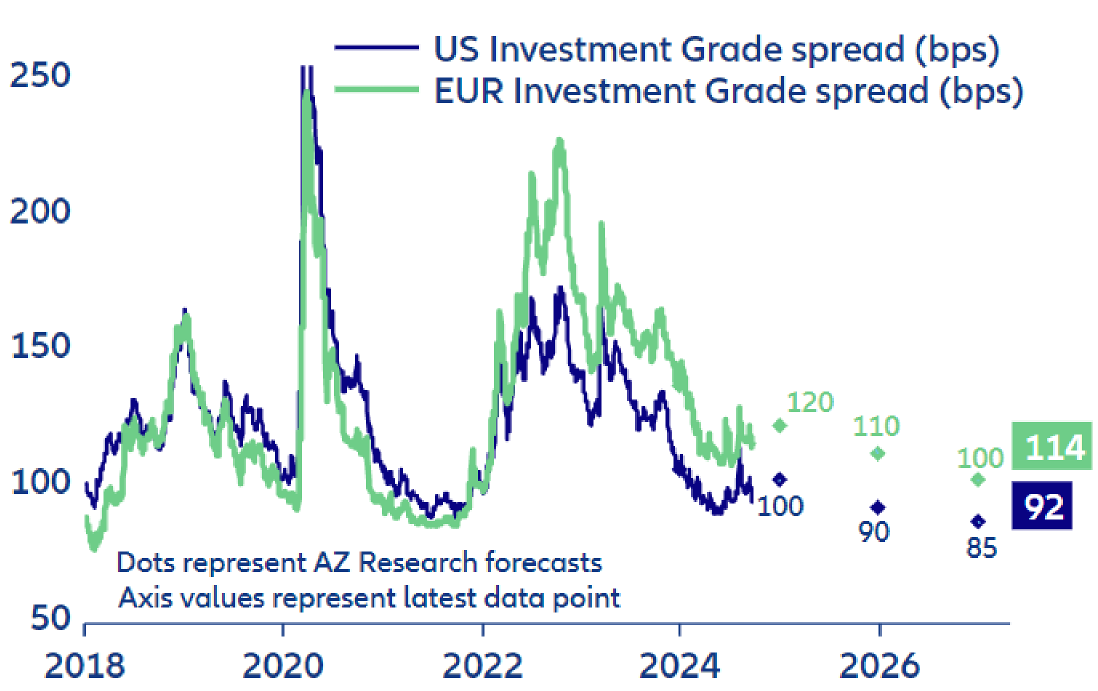
High demand and increasing credit quality should keep spreads stable through 2026

Despite stable fundamentals, spreads will remain extremely vulnerable to equity volatility



Sources: LSEG Datastream, Allianz Research

Corporate spreads look tight given the uncertainty thus we do not expect a significant compression



Sources: LSEG Datastream, Allianz Research

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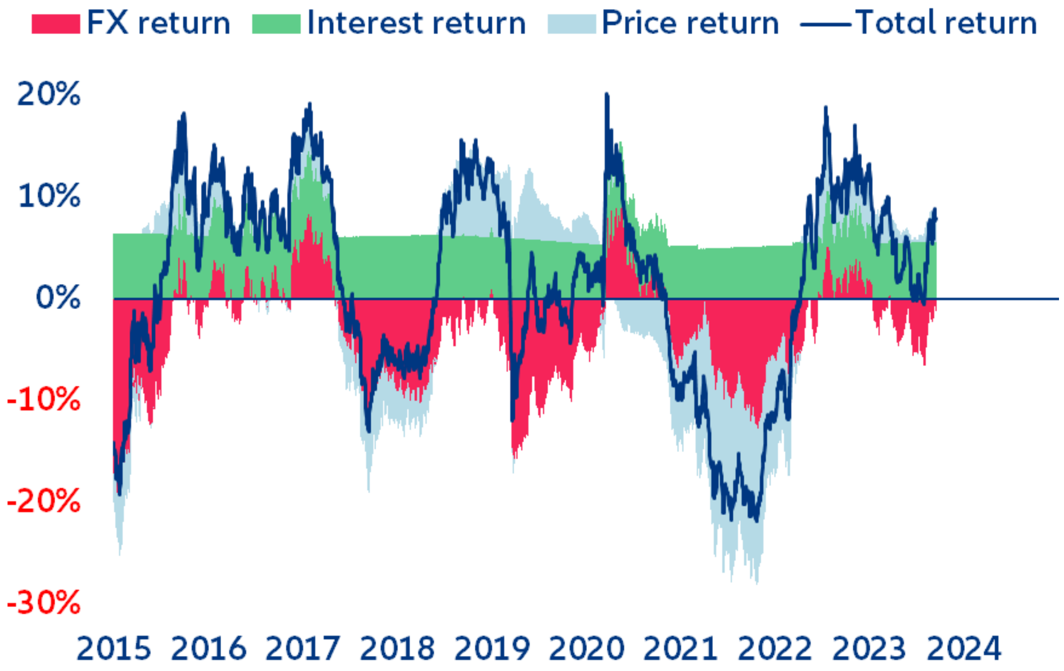
EM LC returns gain from falling yield, HC spreads to remain tight

Local currency return trending upwards amid weak USD and falling yields

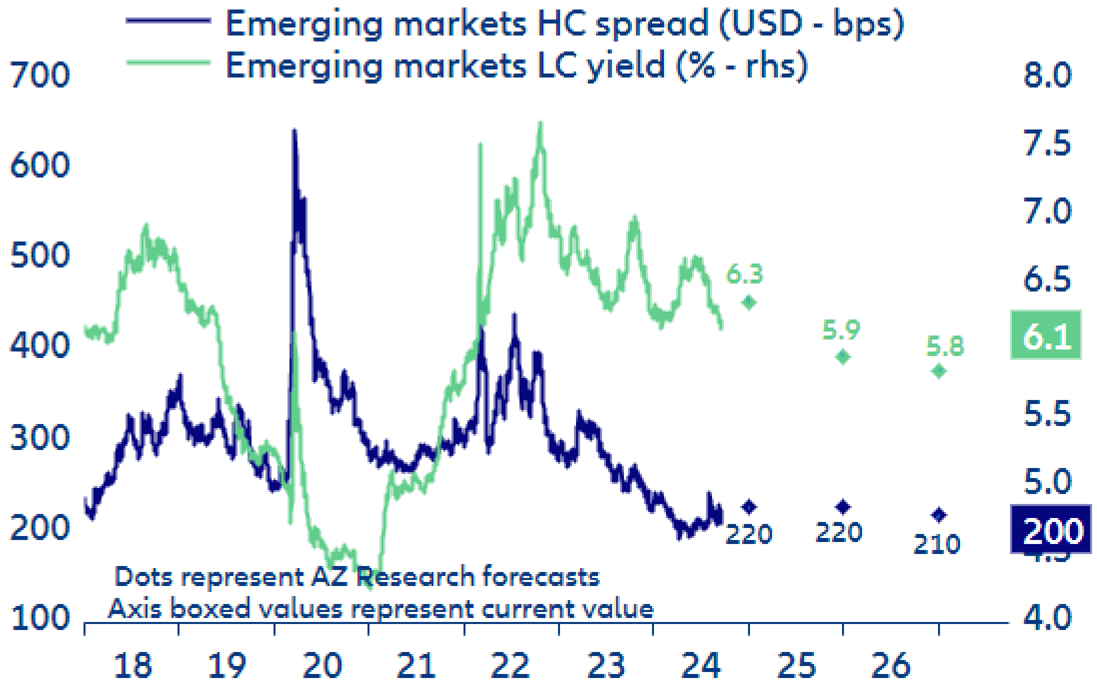
Performance breakdown, y/y %



Sources: Bloomberg, Allianz Research. The performance of emerging market local currency sovereign debt is proxied by the JPM GBI-EM Global Diversified Index

EM spreads hold tight; yields to trend lower structurally but possible upward movements in the short term

%, bps



Sources: Bloomberg, LSEG Datastream, Allianz Research. HC = Hard Currency. LC = Local Currency. Sov = Sovereign.

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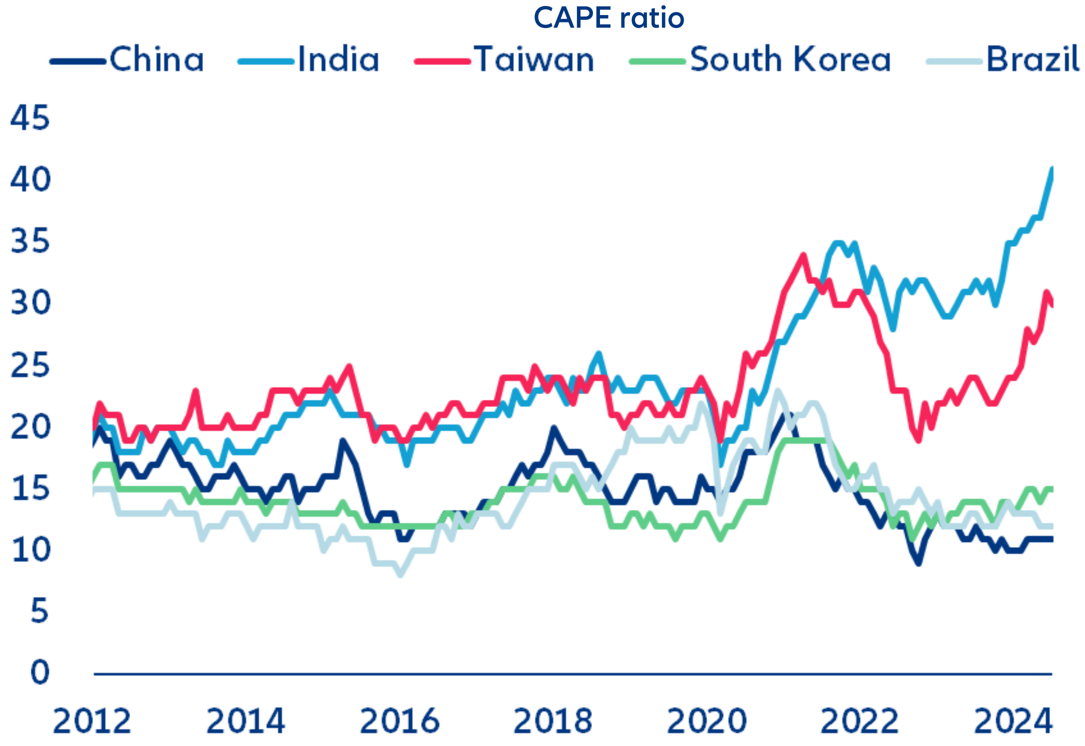
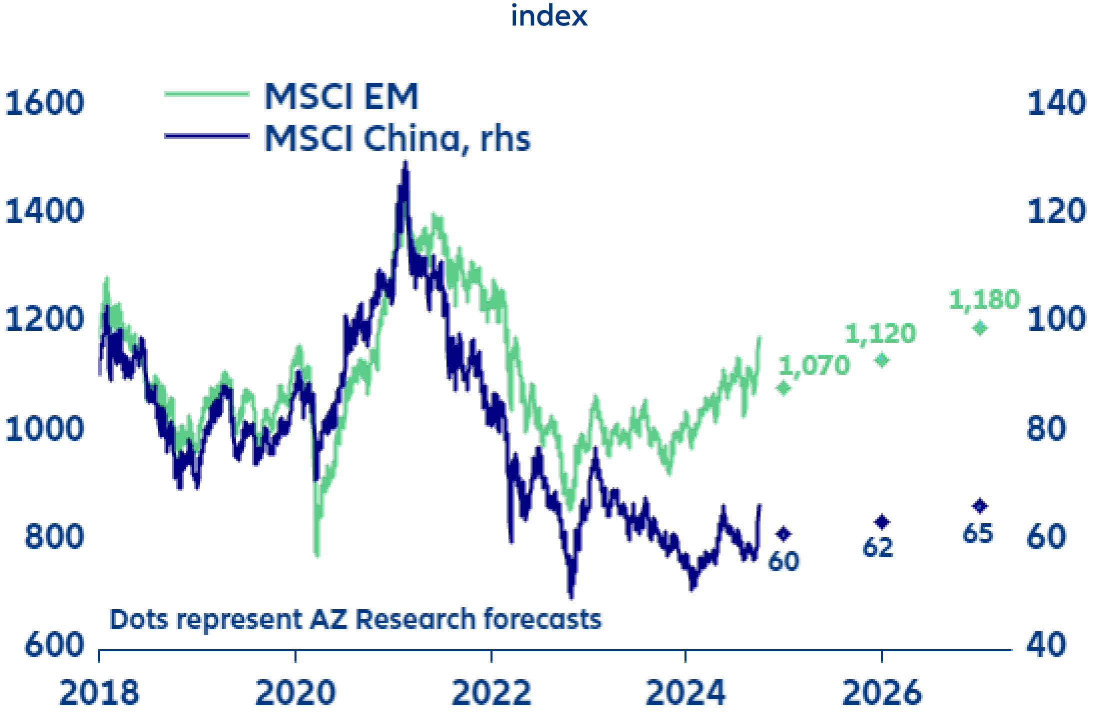
EM equities to underperform, we remain cautious amid regional headwinds

CAPE ratios for Taiwan and India almost at decade high, while China's earnings deteriorate despite low valuation



Sources: Barclays, Allianz Research.
Note: Equity markets of the selected regions are proxied by region-specific indices published by MSCI; China (24.4%), India (19.9%), Taiwan (18.8%), South Korea (11.7%) and Brazil (4.5%) are the top five weighted economies in the MSCI EM Index as of Aug 30

Increased volatility on China's latest stimulus and macro & political uncertainty



Sources: LSEG Datastream, Allianz Research.